April 28, 2017

TD Economics

Data Release: Serial disappointment in Q1 GDP growth continues

- Once again, the advance estimate of first quarter economic growth disappointed. Real GDP was reported to have grown by a paltry 0.7%(annualized), slowing from a 2.1% pace in Q4 and falling short of the median consensus estimate of 1.0%.

- The biggest culprit in Q1's growth slowdown was consumers. Real consumer spending barely grew (+0.3%), after running above 3% in the past three quarters. Spending on durable goods declined 2.5%, after rising 11.4% in Q4. Spending on services was also quite weak (+0.4%), cooling from a 2.4% pace in the fourth quarter of 2016. Unseasonably warm weather depressed utility consumption early in the quarter.

- On the bright side, non-residential business investment growth accelerated to 9.4% from 0.9% in Q4. The pickup was led by a boom in spending on structures (+22%), but spending on equipment (+9%) and intellectual property (2.0%) also posted gains.

- Residential investment also had a strong first quarter, jumping ahead 13.7% following through on a 9.6% gain in Q4.

- As expected, net-exports exerted a very slight 0.1%-point drag on growth in the first quarter. Exports rebounded 5.8% after falling 4.5% in Q4, while imports rose 4.1%, a healthy follow through on a 9.0% gain in Q4.

- Weak inventory investment was an accomplice in Q1's growth miss. Inventories subtracted 0.9%-points from growth, after adding 1.0% the previous quarter.

- Government spending fell 1.7%, subtracting 0.3%-points from real GDP growth. The decline was led by defense spending which fell 4.0% and state and local government (-1.6%).

Key Implications

- Today's report marks the fourth year in a row that the advance release of first quarter GDP has been below 1%. In the past three years, growth went on to accelerate through the remainder of the year, and we expect 2017 to follow the same pattern. Much of the hits to growth were temporary, and we expect the second quarter to rebound above 3%. This should be driven by return to normalcy for the U.S. consumer. While we don't expect purchases of interest-rate sensitive durable purchased to return to their recent double-digit pace, slightly stronger growth combined with a return to normal in utilities consumption should see personal consumption expenditure growth top 3%.

- Looking through the noisy quarter-to-quarter swings in GDP (as discussed in our recent report), we judge underlying growth in the U.S. economy to be running slightly better than 2%. With an aging population this is a decent pace of growth relative to the economy's potential (see our recent report) and strong enough to generate a pickup in inflation.

- In its decision next week, the Fed is unlikely to put too much stock in another Q1 GDP disappointment. It will likely be more concerned with the cooling in inflation seen in March. We expect that the Fed will stick to its gradual pace of rate hikes and take a pass at this meeting, and hike in June, if the data cooperates.

Leslie Preston, Senior Economist
416-983-7053

@TD_Economics