First Quarter GDP Report

April 28, 2017

Summary

Economic growth during the first quarter has slowed to an annual rate of 0.7 percent from 2.1 percent from the previous period. Excluding inventories, final sales grew at an annual rate of 1.8 percent. Consumption led by weak auto sales rose only 0.3 percent. On the other hand, business fixed investment rose 10.4 percent. The inflation rate accelerated to 2.3 percent from 2.1 percent.

Analysis

Economic growth during the quarter was anticipated but still a disappointment. There have been special factors which dragged down economic momentum during the quarter. Unseasonably warm weather cut utility bills. The delay in tax refunds postponed consumer purchases. Auto sales have peaked during the final quarter of 2016 and are moving sideways. After a surge during the previous quarter, inventory accumulation slowed significantly. The labor department acknowledged a possible seasonal adjustment problem and is working to correct it.

Even though some of the factors that depressed economic growth during the first quarter are temporary, others are not. Most important is auto sales which supported consumer spending in
this recovery. Consumption, the backbone of economic growth for much of 2016, has begun to soften in part because of the headwind coming from car sales. Interest rates on car loans have been rising. Potential buyers have been accustomed to special deals and promotions. After a period of buying spree, the average age of the cars on the road has decreased.

Hopefully consumer spending will play a bigger role in the future than it did during the first quarter. Employment gains have been healthy. Wage gains have accelerated lending support to consumer spending. The wealth effect from higher stock and home prices should help consumer spending.

On the positive side, business investments including housing, commercial construction, equipment and intellectual property have powered up. After a long period of soft spending on investments, the turnaround beginning the fourth quarter of 2016 could be a new trend heralding healthier investment spending and productivity in the future. Clearly, business sentiment has improved helping investments. The improved sentiment can be attributed in part to the Trump Administration, but whether the trend will continue remains to be seen. The latest proposal on tax cuts, if implemented, could boost investments.

Net export was a positive during the quarter. Going forward, external factors could represent tailwinds for the economy. China’s economic growth, which had been the locomotive for the global economy, is showing new signs of life. With the ongoing Quantitative Easing by the ECB, the Euro-zone economy is showing more strength. Japan is doing better thanks to exports and improved consumer spending. Emerging market economies are coming out of the doldrums as commodity prices revive.

Housing continues to support the economy. Rents now exceed the monthly payments on median-priced homes boosting demand for houses. With strong demand, inventories are at a very low level. The housing affordability, though trending down, is still supportive of home sales.

Commercial construction has picked up some steam. All indications are that the sector should be in a rising trajectory in coming quarters. Commercial lease rates are rising. In some cases, like industrial and apartments, healthy demand leads to more activities.

The FOMC is probably concerned about the latest weakness in economic growth and won’t pull the trigger again at the May meeting. However, if the economy shows more zip in coming quarters, a possible hike in September is likely. Employment gains will be supportive of economic growth. The inflation gauge rose 2.3 percent is above the central bank’s target of 2 percent. The stimulus from the Trump Administration could be another catalyst for hawkish attitudes in future FOMC meetings.