Q1 2022 GDP: Trade, Inventories Sink Q1 GDP

- The BEA's first estimate shows real GDP contracted at an annualized rate of 1.4 percent in Q1 2022 after 6.9 percent growth in Q4 2022
- Inventories and trade combined to knock 4.0 percentage points off the change in top-line real GDP

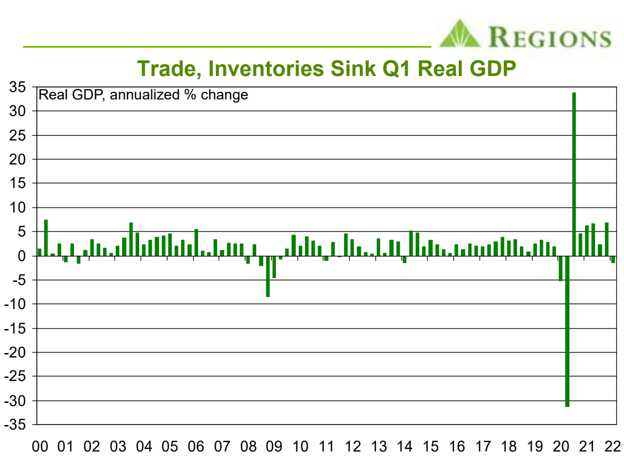
Real GDP contracted at an annualized rate of 1.4 percent in Q1 2022 according to the initial estimate from the Bureau of Economic Analysis (BEA). The headline print was weaker than expected but at the same time is not a huge surprise. For instance, our forecast had real GDP expanding at an annualized rate of 1.1 percent in Q1, but subsequent to that forecast being published, the Census Bureau released the annual benchmark revisions to the retail sales data and the initial estimate of the March trade deficit. The revised retail sales data showed slower Q1 growth in consumer spending on goods than had previously been reported, while the trade data showed the deficit in the goods account ballooned to an all-time high. With this information in hand, a contraction in Q1 GDP became a distinct possibility, particularly with inventories expected to be a meaningful drag on Q1 growth. To that point, the combination of a smaller build in business inventories and a wider trade deficit took 4.0 percentage points off the change in real GDP, more than negating growth in real private domestic demand. Neither a smaller inventory build nor a wider trade deficit is symptomatic of broader economic ills. That said, to those already anxious about the state of the U.S. economy the details of the Q1 GDP report won't matter but, no, the contraction in real GDP in Q1 does not mark the start of the recession that some see as inevitable.

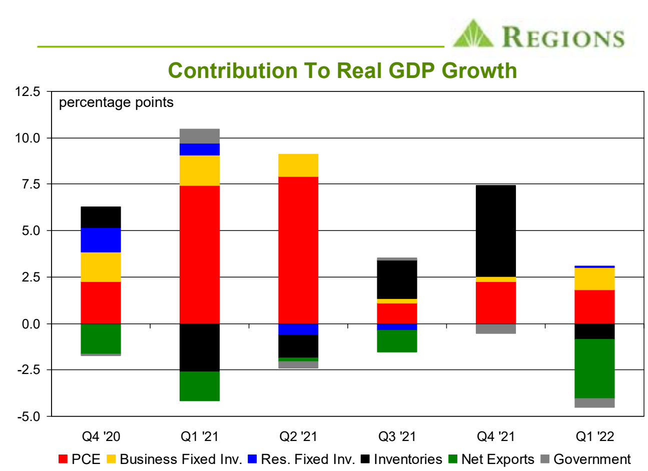
Real consumer spending grew at an annualized rate of 2.7 percent in Q1, contributing 1.8 percentage points to the change in top-line real GDP. After adjusting for inflation, spending on goods fell at a 0.1 percent rate, with spending on nondurable consumer goods falling at a 2.5 percent rate. In contrast, real spending on consumer durable goods advanced at a 4.1 percent rate while real spending on services rose at a 4.3 percent rate. As noted above, the revised retail sales data presaged the drop in spending on nondurable goods, and spending on consumer durable goods will be softer in Q2 than was the case in Q1. We attribute this to three factors; higher prices for necessities like food, energy, and shelter are weighing on discretionary spending, higher interest rates raise the effective costs of consumer durable goods, and shifting patterns in consumer spending are favoring services at the expense of goods. By all accounts, growth in services spending, is shaping up to be stronger in Q2 than was the case in Q1, which will support growth in overall consumer spending as services account for almost two-thirds of all consumer spending.

Real business fixed investment grew at an annual rate of 9.2 percent in Q1, with outlays on equipment/machinery growing at a rate of 15.3 percent and outlays on intellectual property products expanding at an 8.1 percent rate. That spending on business structures contracted further in Q1 comes as no surprise, but the 0.9 percent annualized downturn is milder than those seen over the prior few quarters. That orders for core capital goods continue to grow suggests business investment will remain a support for GDP growth – orders precede shipments, and it is shipments that feed into the GDP data – despite lingering supply chain issues and heightened uncertainty around the economic outlook. Business outlays on intellectual property products, the vast majority of which consist of research and development, have been growing at a torrid pace over the past several quarters, and growth in such expenditures tends to lead growth in labor productivity. This is one way firms are countering labor supply constraints and helping offset higher labor costs.

Real business inventories grew at an annual rate of $158.7 billion in Q1, but as this was smaller than the $193.2 billion increase in Q4 2021, inventories acted as a drag on Q1 GDP, taking 0.84 percentage points off the change in top-line real GDP. Whether, or to what extent, inventories will add to Q2 growth remains very much up in the air given the renewed threat posed to global supply chains by the current round of shutdowns in key manufacturing and shipping centers across China. The U.S. trade deficit widened sharply in Q1; U.S. exports fell at an annual rate of 5.9 percent while imports into the U.S. rose at a 17.7 percent rate. The wider trade deficit took 3.20 percentage points from the change in real GDP.

Some are arguing the weak headline print will make the FOMC more cautious in raising the Fed funds rate, but that argument won't survive the annualized 8.0 percent increase in the GDP Price Index. Still, while not dismissing it out of hand, with consumer spending on services and business investment still on solid ground, the weak headline print on Q1 real GDP is not reflective of the health of the U.S. economy.





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