

US GDP: So Much For A 'Patient' Soft Patch!

2019Q1 GDP growth, q/q % change SAAR:

Actual: 3.2

Scotia: 2.0

Consensus: 2.3

Prior: 2.2

- **The US economy ripped higher into 2019** with a growth print that beat all estimates within consensus. While there are dints and dings to the composition, the overall headline and underlying details still stand up solidly. There will be revision risk into subsequent readings as there always is, so treat the readings as a tentative first round of estimates.
- **Whether or not one controls for quality details, the US economy hasn't really been in much of a soft patch;** growth was 3.2% in Q1 and 2.2% in Q4. **The Fed's 'patience' toward risks and inflation may well be tested over the course of the year.** The US economy continues to grow at an above-potential pace that continues to push the output gap further into excess demand territory. **This movement into excess demand over the past year has not been giving enough time to influence core PCE with a multi-quarter lag.** Further, smoothing through week by week wiggles shows the broad USD to be largely moving sideways this year after last year's sharp appreciation, and with that could come a **maturization of the disinflationary effects of prior dollar strength** over the duration of 2019 through likely over the second half.
- On the details and how they hand-off to Q2, this report is a classic example of how one should be very careful toward any tendency to cherry-pick the arguments. It's important to treat them holistically. **Strong and perhaps unsustainable contributions to growth from inventories and imports were a factor, but the offsets are that the softness in housing and consumption could well have been an undershoot** that should itself be controlled against because we're already getting indications that both housing and consumption will revert higher into Q2. Details on these arguments follow.
- Chart 1 shows a breakdown of the weighted contributions to GDP growth in Q1 on the bars and the black line is actual GDP growth.
- **One surprise was that the federal government shutdown had very little discernible effect.** Federal government spending ex-defense dragged 0.16% off GDP but this was offset by higher defense spending by the Federal government to leave the Fed's flat on net. It was also offset by state and local governments where spending added 0.4% to GDP growth.
- **Net trade added one full percentage point to GDP growth.** Exports added 0.45% to GDP growth. Imports added 0.58% because they fell (less leakage from GDP in an accounting sense).
- **One could argue that the import decline and its positive contribution to GDP growth should be removed from the top line growth reading, but this is often a dicey practice. This is one of those times.** To remove the addition to growth from imports in Q1 you'd also likely have to remove the subtractions to Q3 and Q4 GDP growth from a surge of imports. You might

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Chart 1

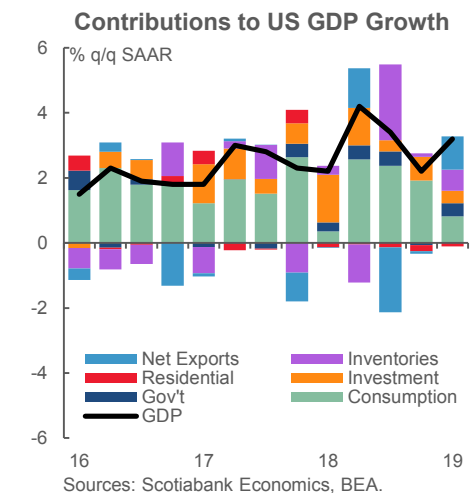
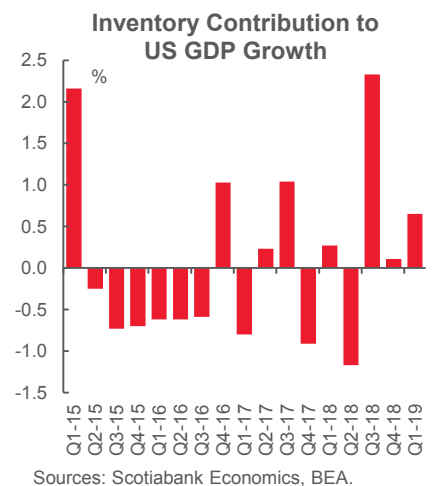


Chart 2



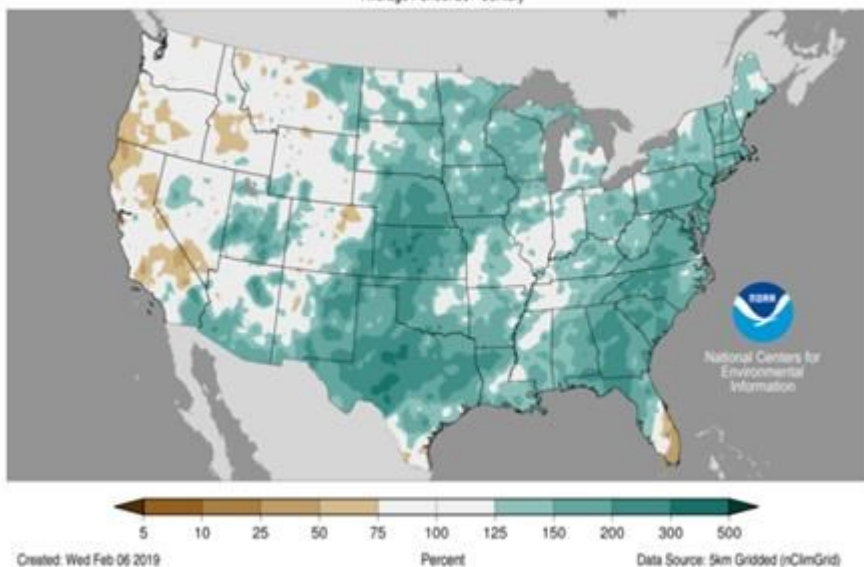
even go further back in time including earlier last year's contributions from imports. Blame Trump. Businesses have been trying to front-run his tariff threats through advance ordering. **To remove imports as an addition to Q1 GDP growth, you'd have to remove a substantial part of prior import drag effects on growth.**

- Chart 2 tracks inventory contributions to GDP growth. **Inventories added 0.65% to Q1 GDP growth after a 0.1% contribution in Q4 and a whopping 2.33% contribution in Q3 of last year.** Keep in mind a lot of considerations here. For many quarters, inventories subtracted from growth (9 of the past 17 quarters). Last year's Q3 surge in the inventory effect was partly a reversal of the prior quarter's depletion. Again, tariff front-running and the aftermath is causing a lot of volatility here. The point is to be careful toward alarmist inventory talk.
- **Regardless, stripping out the import and inventory contributions still yields growth of about 2% in Q1. Either way, it wasn't much of a soft patch!**
- **Private consumption added only 0.8 percentage points to GDP growth in Q1.** That's weak, but most of that was known in advance and **there is good cause to expect a stronger contribution in Q2.** For one thing, the first quarter appeared to end on a very solid note given what we know of March retail sales that were very strong. While Q1 total consumption grew by 1.2% in q/q annualized terms, we can't tell exactly how Q1 ended with monthly data until Monday when we get both February and March consumption figures given the shutdown lags. If retail sales are any guide, however, then the hand-off from Q1 into Q2 should be quite solid which means the quarterly math should favour a solid start to tracking consumption contributions to Q2 GDP growth. Adverse weather and confidence-dampening shutdown effects might have otherwise explained much of the Q1 consumer softness.
- Nonresidential investment added 0.4% to GDP growth overall. Structures investment was flat and equipment spending also added nothing to GDP growth following decent contributions over prior quarters.
- **Housing knocked 0.1 points off of top line GDP growth with mild drag effects extending for the past five quarters.** Much of that was the surge in mortgage rates and the effects of the Tax Cuts and Jobs Act that damaged housing by raising the after-tax cost of home ownership through lowering interest deductions and SALT deductions. **If, however, the sharp acceleration in new home sales so far this year translates into Q2 housing starts then residential investment could be poised to make a comeback as an addition to GDP growth.** Recall new home sales have surged to the second highest reading since 2007 and posted strong growth over Q1.
- Last, the two pictures below serve as a reminder to be wary toward weather and seasonality influences here. The first picture shows precipitation over 2018Q4 compared to historical norms and hence how unusually wet (snow and rain) it was over Q4 through vast parts of the US. The second picture shows how this effect was then more concentrated in the middle of the US and the west. If sizeable parts of the US were both wetter and colder than normal over Q4 and Q1 then could a burst of weather affected pent-up activity in consumption and housing lie in store? Perhaps, but data will inform this.
- As a final point, note that the plague of Q1 seasonally depressed growth wasn't a factor here. Make all the excuses you want for how the US economy performed in Q1, but the absence of a notable shut down effect, the absence of any obvious seasonal distortion, and care toward holistically controlling for what may have been both temporary downside and temporary upside influences on Q1 growth as Q2 beckons make this reading an undeniably solid start to 2019. Now bring on next week's Fed meeting and I'd be amazed if they simply donned a dark cloud above their heads and ignored it all. This is not the stuff of rate cuts priced in markets.

Precipitation Percent of Average

October–December 2018

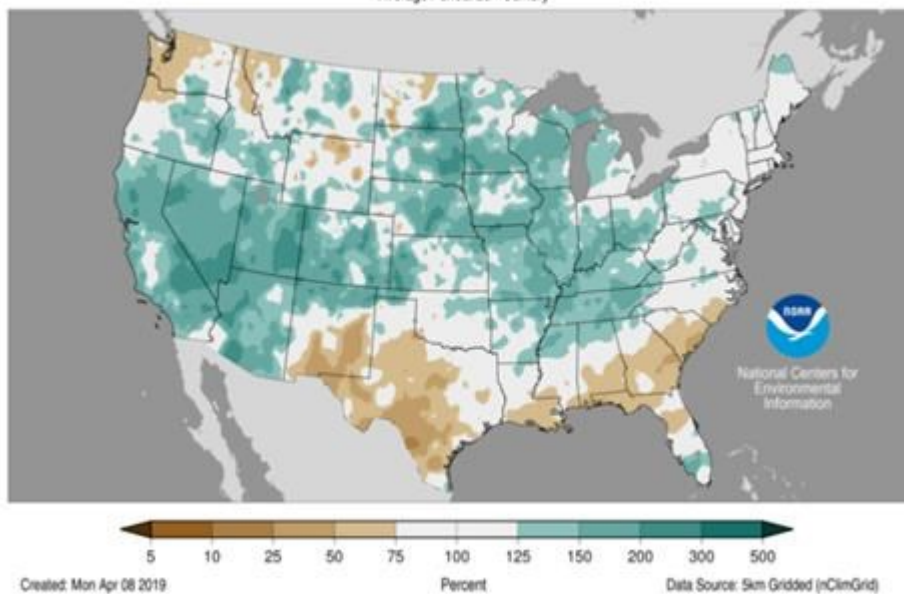
Average Period: 20th Century



Precipitation Percent of Average

January–March 2019

Average Period: 20th Century



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