ECONOMIC UPDATE

REGIONS

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Q1 2024 GDP: Headline Miss Masks More Constructive Details

- The BEA's initial estimate shows real GDP grew at an annualized rate of 1.6 percent in Q1 2024
- Consumer spending and fixed investment were the main drivers of Q1 growth, while inventories and trade were meaningful drags on growth

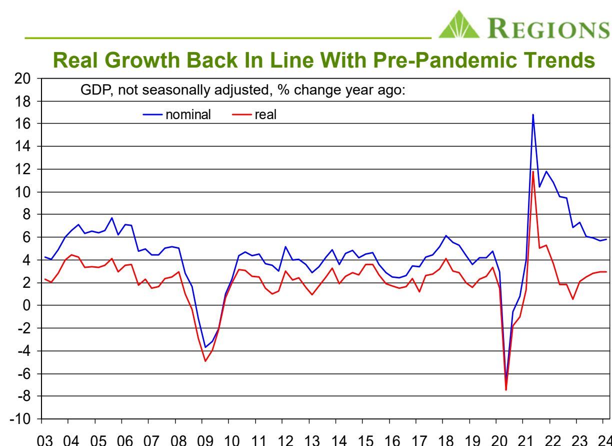
The initial estimate from the BEA puts Q1 real GDP growth at an annual rate of 1.6 percent, well short of expectations and ending a run of six straight quarters of growth above 2.0 percent. Consumer spending, business investment in equipment, machinery, and intellectual property products, and residential fixed investment were the primary supports for growth. At the same time, however, a wider trade deficit and a slower pace of inventory accumulation in the nonfarm business sector acted as meaningful drags on Q1 growth, with a drop in defense spending acting as a minor drag. As always, we'll note that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revisions. We'll also note that inventories and trade tend to be the most volatile components of GDP and often team up to act as swing factors, which to some extent is the case in the Q1 data. To that point, real private domestic demand, the sum of household and business spending, rose at an annual rate of 3.1 percent in Q1, down only slightly from the 3.3 percent pace set in Q4 2023. In that sense, we find the miss on Q1 growth to be much less concerning than had the shortfall been accounted for by a drop in fixed investment, though we'll admit to feeling more than a bit unsettled as we saw the numbers come across our screen.

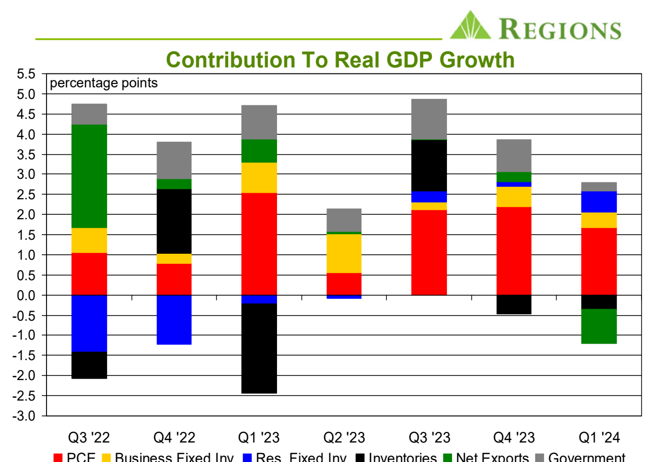
Real consumer spending grew at an annual rate of 2.5 percent in Q1, adding 1.68 percentage points to top-line real GDP growth. Adjusted for price changes, consumer spending on goods fell at a 0.4 percent rate, with a steep decline in outlays on motor vehicles accounting for most of this drag, while a sharp decline in gasoline expenditures acted as a meaningful drag on real spending on nondurable consumer goods. Services spending, which accounts for roughly two-thirds of all consumer spending, grew at an annual rate of 4.0 percent in Q1, the fastest growth since Q3 2021.

Single family residential investment logged a third straight quarter of double-digit annualized growth, higher mortgage rates notwithstanding. This more than offset a second straight decline in multi-family outlays. Real business fixed investment grew at an annual rate of 2.9 percent, which added 0.39 percentage points to top-line real GDP growth. One notable weight on business fixed investment was business spending on structures, reported to have declined at a 0.1 percent rate after accounting for price changes, a rather rude end to what had been a run of four straight quarters of double-digit growth. We don't, however, make too much of this modest decline, seeing it as a pause rather than a reversal of course. Recall that business spending on structures has largely been driven by construction of new manufacturing facilities, particularly focused on production of semiconductor chips, electric vehicles, and electric vehicle batteries. Though perhaps having peaked, that wave of investment has by no means dried up, and we expect this component to resume the role of a driver of overall business investment in coming quarters. Real outlays on equipment and machinery grew at a 2.1 percent rate in Q1 after having contracted over the prior two quarters. While it is too soon to know whether Q1 marks a turning point or merely a continuation of the up-and-down nature of spending in this category, we've noted that at some point we do expect to see a run of sustained growth in spending on equipment and machinery with an eye toward sustaining faster labor productivity growth. To that point, real outlays on intellectual property products grew at an annual rate of 5.4 percent, the fastest growth since Q4 2022.

This raises a related point, though it is a point lost on those either unable or unwilling to go beyond the simple GDP math that shows imports to be a drag on GDP, which is that imports of capital goods excluding motor vehicles accounted for much of the growth in total imports. Such imports go toward current and/or future production here in the states, and come on top of the growth in business investment in equipment and machinery booked in Q1. We'd defy anyone to concoct a plausible case for that being a negative for the U.S. economy, the implications for the GDP math notwithstanding. A slower rate of inventory accumulation – recall that for GDP growth, it is the change in the change in inventories that matters – knocked three-tenths of a point from top-line real GDP growth. That this marks a second straight quarter of deceleration is a sign that businesses have mostly right-sized inventories after scrambling to make up for pandemic-related disruptions in production and inventories.

To be sure, you'd rather hit a forecast than miss a forecast. That said, in the case of Q1 GDP the miss is made more palatable by the details of the data on business investment and capital goods imports.





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