

# The Latest U.S. GDP Reading Deserves a Closer Look



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## Key Takeaways

- To the surprise of investors and economists alike, the U.S. economy, as measured by the GDP, grew by 3.2% in the first quarter of 2019, blowing past consensus estimates of 2.3% growth.
- While the growth number of 3.2% is undoubtedly strong, the underlying data paints a mixed picture of the economy. The greater than expected growth came from historically more volatile components of GDP and slowed from the core components of longer-term stable and sustainable growth.
- Overall, investors should find comfort in the first quarter growth. These results confirm that growth is not stalling, but rather slowing, a natural side effect given the late stages of this economic cycle, even if the top line GDP numbers are extremely strong.

## Economic Growth Accelerates in the First Quarter

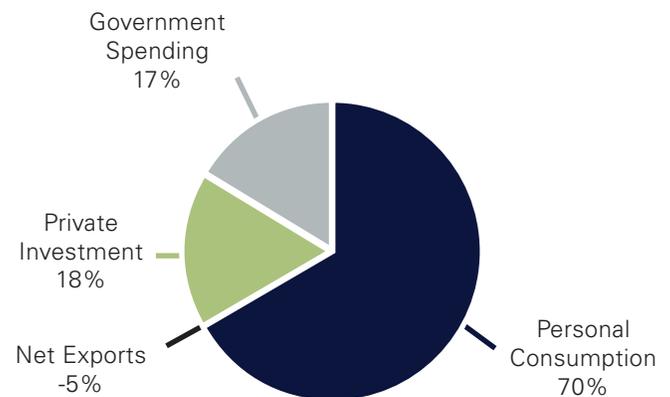
U.S. economy, as measured by the gross domestic product (GDP), grew 3.2% in the first quarter of 2019, accelerating its pace from 2.2% at the end of 2018. The reading came as a surprise to many given it significantly surpassed consensus estimates of 2.3%. The U.S. economy grew at a faster pace, despite the government shutdown earlier in the year and overcoming the fading effects of the tax cuts. The 3.2% GDP reading is strong by any measure; however, the details of the report were a mixed bag.

## Breaking Down the Numbers: A Look Under the Hood

To understand this further, a look under the hood will provide some additional insight. To get us started, consider the following breakdown of GDP. The chart highlights the four components of GDP in 2018: Consumer Spending (blue), Government Spending (gray), Investment Spending

(aka business spending, green) and Net Exports (no color). Consumer spending represents the bulk (nearly 70%) of the US economy. Government spending and private businesses account for the remainder of the balance. Finally, net exports (trade) contributed a net negative effect. In short, the U.S. economy requires consumers to continue spending in order to keep this economic engine running.

## 2018 GDP Composition



In the latest GDP reading, while the GDP number was over 3%, personal consumption added only 0.82% to GDP growth, a significantly weaker contribution relative to historical numbers. Private investment accounted for 0.92%. A further look at private investment shows, the contribution to growth was not businesses spending but rather increased inventories. Higher inventories, especially in the manufacturing industry, indicate that businesses are stockpiling goods rather than selling them. Higher inventories today typically signal slower growth in the future because it indicates that companies are cutting back on production. These changes are a strong indication that businesses have likely increased inventories in reaction to imposed and pending tariffs. Finally net exports, trade historically has been a negative contributor to growth. Over

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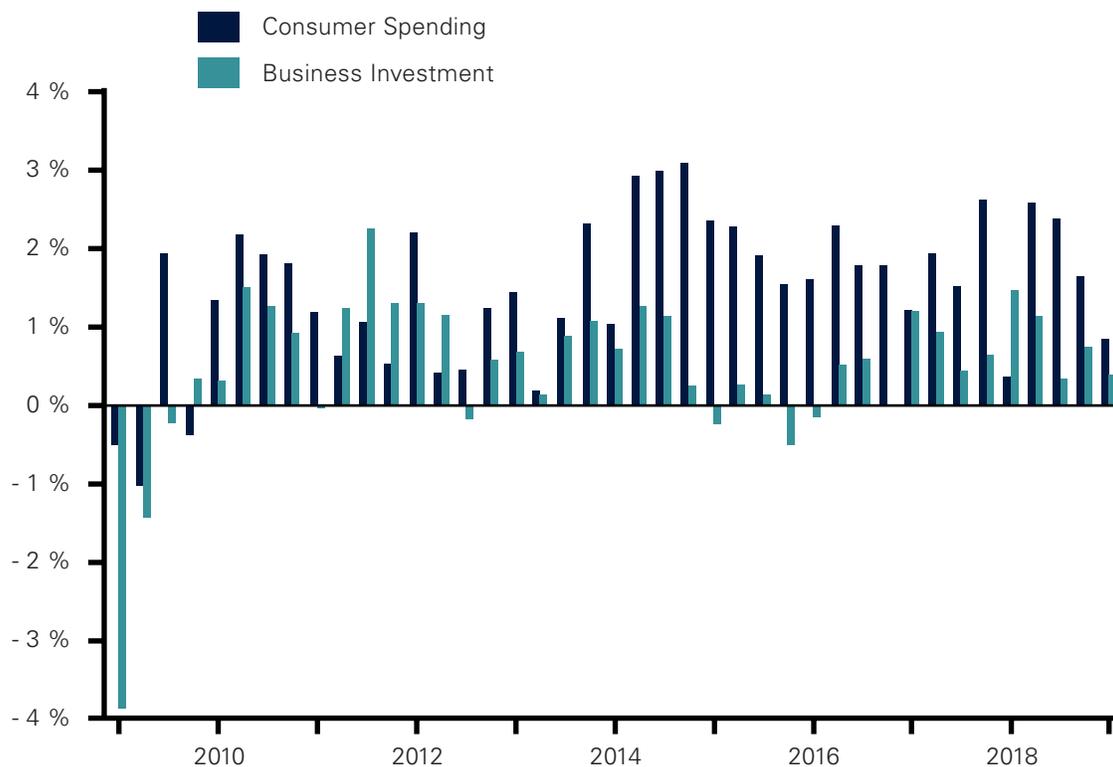
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the past five years, trade has had a negative impact on GDP. However, the impact of trade was in sharp contrast this quarter. Net exports, which looks at the net of goods exported relative to those imported, provided a solid 1.03% contribution to growth. Higher imports, generally mean we consumed things we did not produce domestically and thus lowers GDP. In the first three months of 2019, imports fell, likely driven by trade and tariff discussions which added to the GDP. Finally, government spending contributed 0.41%, with state and local governments driving much of that contribution.

Overall, the latest report reaffirms the story of continued growth in the U.S. economy. Any time you see 3% growth in GDP that is a good thing. However, there are a couple of

reasons for concern. First, personal and business spending have now been declining for the last three quarters. In addition, drivers of growth this quarter from net exports and inventories within business spending are historically two volatile components of GDP. Growth exceeded expectations due to a buildup in inventories and the surge in net exports, which are likely to be reversed in future quarters. While no single quarter can provide definitive conclusions, investors will need to pay closer attention to the details and not just the headline numbers. In the end, these results indicate that investors should welcome the confirmation that growth is not stalling, there is no imminent recession threat, but rather the economy is slowing, a natural reaction to late cycle investing.

## US: Contributions to real GDP growth



Source: Oxford Economics/Haver Analytics

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