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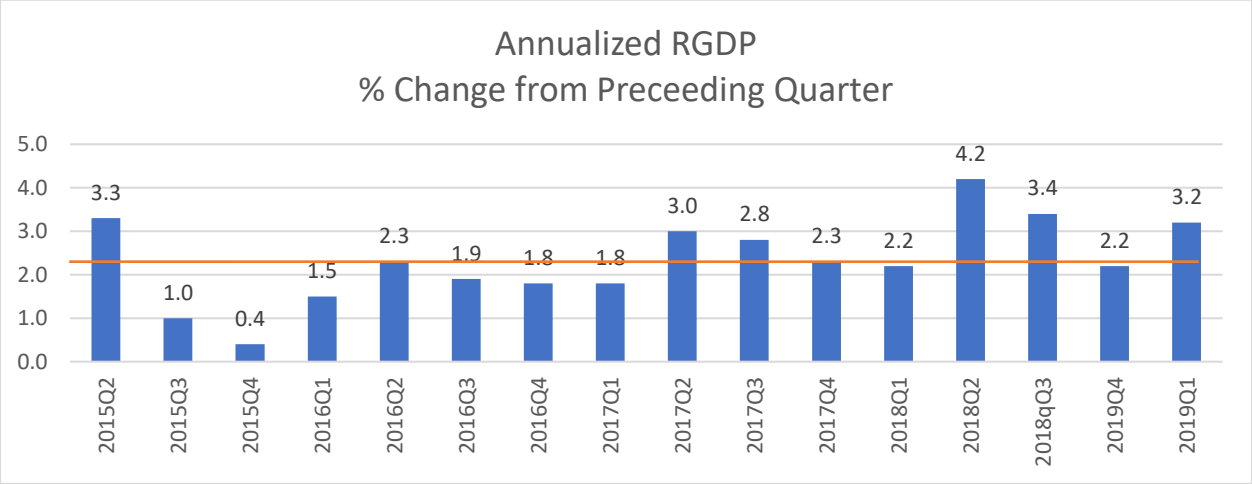
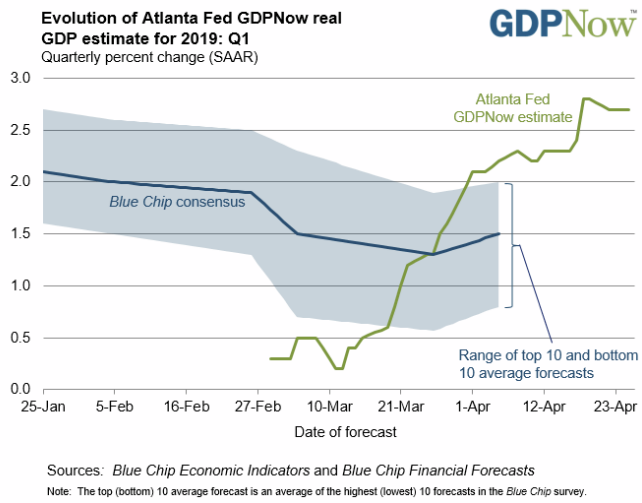
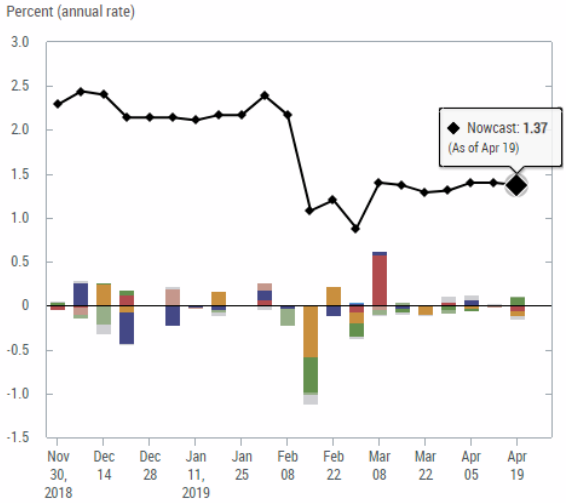
Behind the Headline: Above Trend 2019Q1 GDP (advance)

Philip Chao, April 30, 2019



The advance estimate for first quarter real GDP came in at 3.2% and surprised on the upside. This is above the consensus estimate by market participants. The two federal reserve bank nowcast models also projected lower economic growth for the quarter. As a reference, the average GDP has been at 2.3% since 2015Q2.





As of April 25th, the top left graph shows the Atlanta Federal Reserve's GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the first quarter of 2019 is 2.7. Based on data through April 19th, the top right graph shows the New York Federal Reserve Bank's Nowcast estimate at 1.7%.

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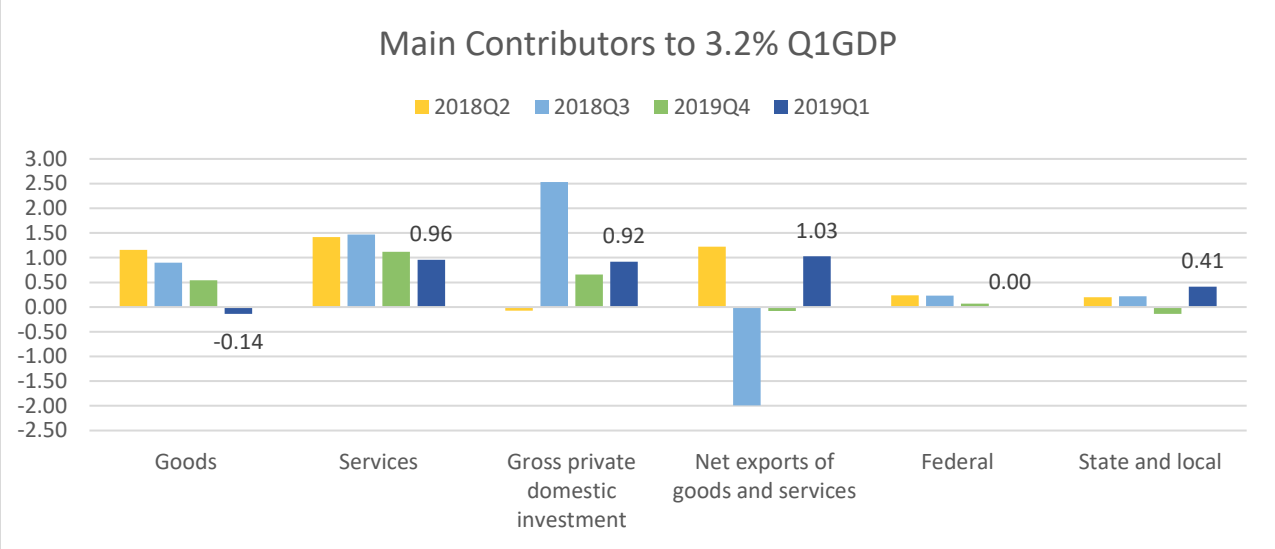
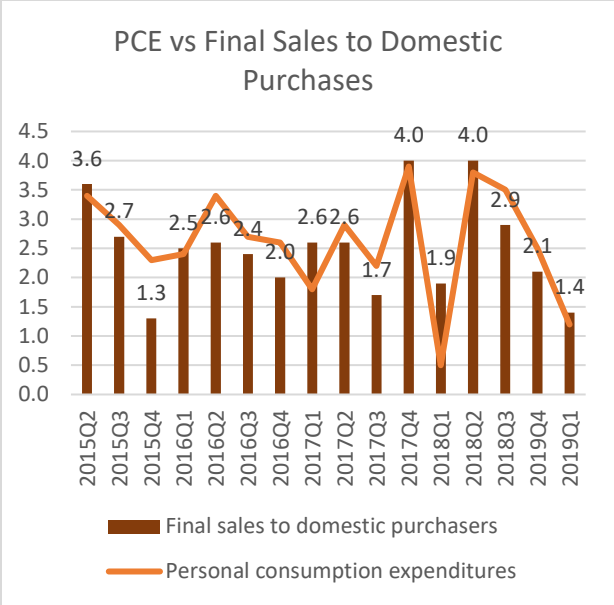


The above chart compares the major components of the GDP over the trailing four quarters: PCE (consumer spending on Goods and Services), Gross Private Investment (business spending or capital expenditure) Net Exports, and Government Expenditure (federal and state spending and investments.) The Q1 GDP's rise is attributable to a rise in business spending and non-federal government spending. The right chart compares the Final Sale to Domestic Purchasers, and we witness a continuing weakness exhibited since the high reached in 2018Q2. Final Sales to Domestic Purchasers measures how American consumers are spending. Exports (i.e. foreign buyers) are removed and imports are added to the final sales numbers.



Since consumption of goods and services represents approximately 70% of the U.S. economy, the subcomponents show that consumers continue the slowing spending trend (rate of change) over the prior three quarters with goods in negative territory. Net export and state & local government spending and investments helped to push up the first quarter GDP. Advance estimates are typically unreliable and subject to revisions. As more data comes in for the second and final estimates, the first quarter may be weaker than 3.2%. Regardless, if the trend of a weakening consumer spending continues, the GDP may trend down from here to the 2% to 2.5% range. (We expect 2019 to be a 2.3% real GDP year.)

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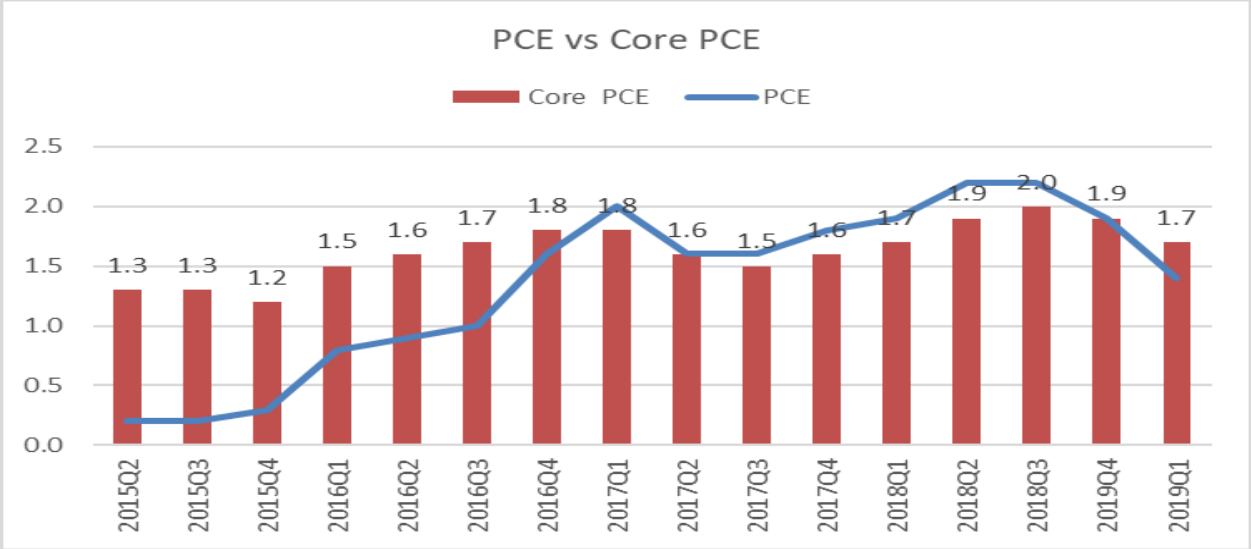

Finally, the Federal Reserve's preferred gauge for inflation, core PCE (PCE excluding energy and food prices), is showing further weakness after reaching 2.0% in 2018Q3. This continuing sign of no or weak inflation is of concern to the Federal Reserve. The weaker consumer spending supports this lower demand-pull inflation scenario. The FOMC has been and continues to be concerned about its inability to inflate the economy.

From the top line basis, the economy looks great. GDP is above trend; unemployment is at multi-decade lows; inflation is in-check, the Fed is on hold; and the stock market is buoyant…what could go wrong?

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