DALLASFED Economic Update

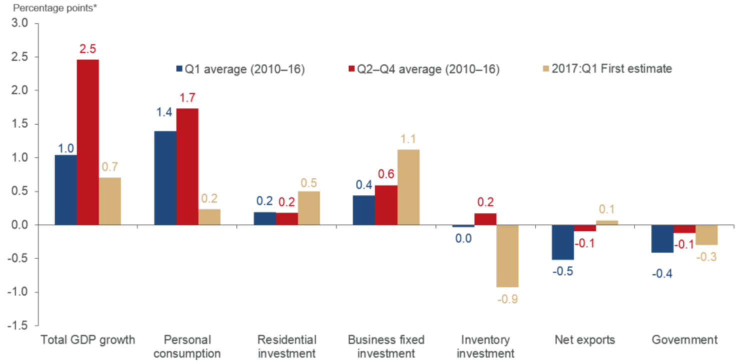
U.S.

Soft First-Quarter GDP Data Inconsistent with Other Strong Indicators

May 11, 2017

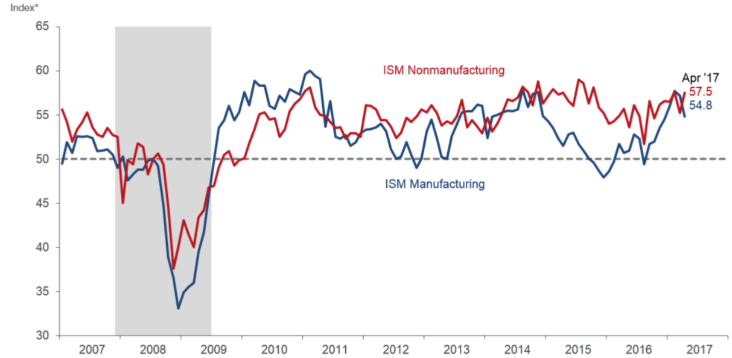
The advance estimate of U.S. gross domestic product (GDP) growth in the first quarter was rather disappointing. Personal consumption expenditures (PCE), business fixed investment, residential fixed investment and net exports contributed to output growth; however, these gains were nearly offset by a decline in private inventory investment and government spending. The latest data on inflation measures also showed prices rising at a slower rate than earlier in the year and lagging wage growth. In contrast, employment growth was particularly strong in April and Institute for Supply Management (ISM) indexes for the manufacturing and service sectors remained positive.

Chart 1
First-Quarter Growth Estimates on Average Subpar in Recent Years



*Contribution to total real gross domestic product growth, quarter over quarter; seasonally adjusted annualized rate.
SOURCE: Bureau of Economic Analysis.

Chart 2
ISM Indexes Point to Continued Expansion



*Values above 50 indicate expansion.
NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Institute for Supply Management (ISM); NBER.

Slow First Quarter Largely Due to Weak Personal Consumption Expenditures

The advance estimate of real GDP for first quarter 2017 showed the economy growing at a lackluster seasonally adjusted annual rate of 0.7 percent *(Chart 1)*, considerably below consensus forecast. PCE contributed a meager 0.2 percentage points to output growth, a sizeable drop from the 2.4 percentage-point contribution in fourth quarter 2016. The slowdown in consumption growth was partially a result of a cutback in purchases of high-priced items such as automobiles and in part due to a decrease in consumption of utilities—particularly for heating—likely due to a milder winter season.

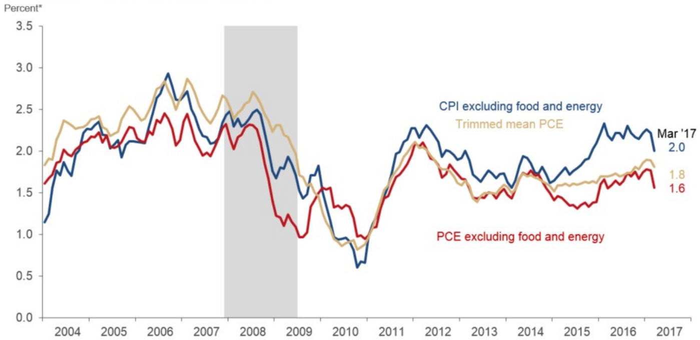
Nevertheless, the past quarter marked a pickup in fixed investment spending (both residential and nonresidential), which cumulatively added 1.6 percentage points to GDP growth. The historically volatile component of GDP, investment in private inventories, subtracted 0.9 percentage points from output growth, nearly offsetting gains from fixed investment. Net exports contributed 0.1 percentage points to GDP growth, following a negative 1.8 percentage-point contribution in fourth quarter 2016. Tepid GDP growth should not be a cause for concern, mainly because a slow first quarter followed by a rebound in subsequent quarters, appears to be the norm during the past few years.

ISM Indexes Suggest Expanding Service and Production Activity

Enthusiasm among producers, which had soared in the first few months of 2017, seems to have slightly tapered off. The ISM manufacturing survey's composite index reading of 54.8 in April indicated a slowdown in growth in U.S. production activity *(Chart 2)*. The new orders index, a notable predictor of future investment, dropped to 57.7—7 percentage points below its March value of 64.7. Nevertheless, the composite and new orders indexes are still well in the expansionary zone.

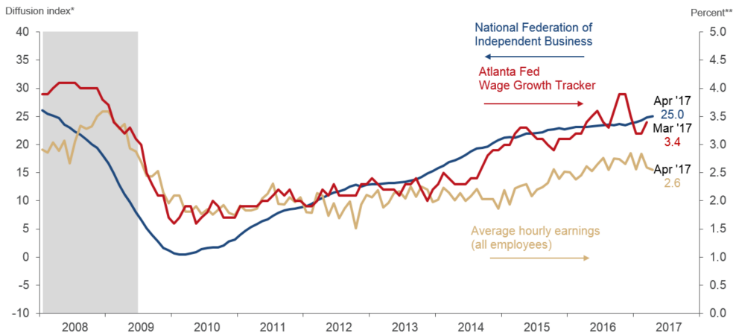
A brighter picture was presented by the ISM nonmanufacturing survey, with its composite index coming in at 57.5, higher than the 55.2 registered in March, and above the consensus forecast of 55.8. This means that the index regained almost all the ground lost in March, as it is now only a notch below its February value. Details of the report were generally upbeat. Seventeen industries reported growth in business activity, three more than in March. The employment component of the index registered a slight decline to 51.4 from the 51.6 in March. Employment was reported to have increased in nine industries and fallen in five. Interestingly, given its poor performance in the last few months, retail trade was one of the sectors where employment expanded.

Chart 3
Inflation Measures Fall Slightly in March



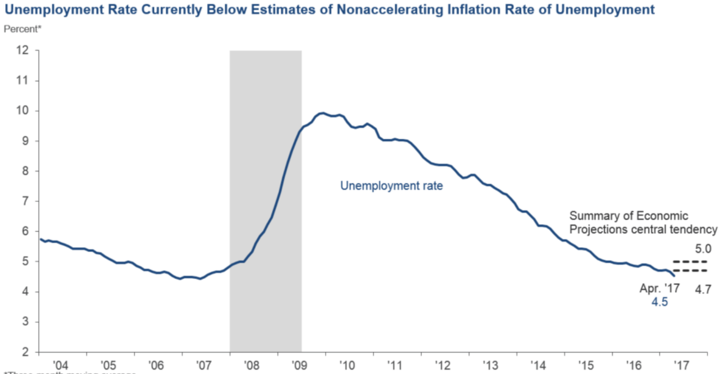
*12-month percent change.
NOTES: Shaded area indicates National Bureau of Economic Research (NBER) recession.
CPI is Consumer Price Index and PCE is personal consumption expenditures.
SOURCES: Bureau of Economic Analysis; Bureau of Labor Statistics; NBER.

Chart 4
Wage Growth Lags Behind a Tightening Labor Market



*Net percent reporting increased compensation over the last three months; four-quarter moving average.
**Year over year, seasonally adjusted.
NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; National Federation of Independent Business; NBER.

Chart 5
Unemployment Rate Currently Below Estimates of Nonaccelerating Inflation Rate of Unemployment



*Three-month moving average.
NOTE: Shaded area indicates National Bureau of Economic Research (NBER) recession.
SOURCES: Bureau of Labor Statistics; Federal Reserve Board's Summary of Economic Projections; NBER.

Inflation Measures Ebb Below the Fed's Target

Most measures of price inflation suggest that following several quarters on the rise, upward price pressures have somewhat eased. Year over year, the PCE core price index rose 1.6 percent in March but was 0.2 percentage points lower than it had been in the previous three months *(Chart 3)*. According to the Dallas Fed Trimmed Mean PCE, the year-over-year inflation rate in March was 1.8 percent, 0.1 percentage points lower than its previous reading. Similarly, when measured by the core Consumer Price Index (CPI), inflation retreated in March, dropping to a 2 percent rate on a year-over-year basis, the first time it has been this low since November 2015. Wireless-telephone services, motor vehicles and clothing were among the consumer categories that experienced the largest price declines in March.

The indicators of nominal wage growth plotted on Chart 4 do not show any signs of significant upward pressure on labor costs. The only measure showing some consistent acceleration over the last quarters is the National Federation of Independent Business diffusion index, which measures the net percent of small businesses that increased compensation over the previous three months.

Strong Employment Report Keeps Optimism Alive

In contrast to the weak estimate for real GDP growth in the first quarter, the most recent employment report was quite strong and above consensus forecast, raising hopes for a prompt pickup in economic activity in subsequent quarters. The headline unemployment rate ticked down in April to 4.4 percent—its lowest value since May 2007—bringing down the three-month moving average to a level below most estimates of the nonaccelerating inflation rate of unemployment *(Chart 5)*. Nonfarm payroll employment rose by 211,000 jobs in April. This compares with 79,000 jobs that were added in March, which was down from the initial estimate of 98,000. Job gains occurred in leisure and hospitality, health care and social assistance, financial activities and mining in April.

—Emil Mihaylov

About the Author

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