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Economics Group

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Another Soft First Quarter U.S. GDP Performance

Drags from BFI, trade and inventories tamped down the pace of Q1 GDP growth. Consumer spending is still the primary pillar of support for the current economic expansion and should remain so for the rest of 2016.

Business Investment Weighs Heavily

As widely expected, the pace of U.S. real GDP growth slowed in the first quarter, rising to just a 0.5 percent annualized rate and extending the downward slide seen since the second half of 2015. The past three first quarters have registered soft rates of growth, suggesting that the BEA is still having seasonal adjustment issues.

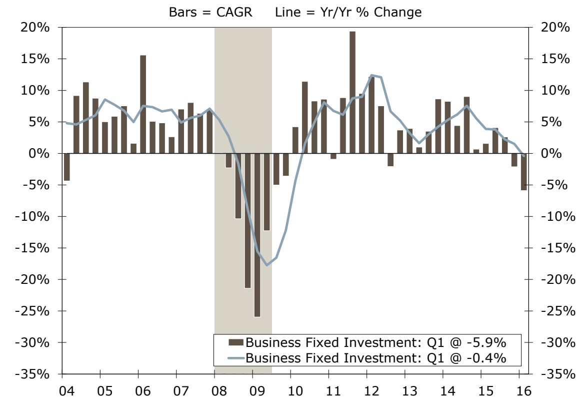
By far the biggest component weighing on overall economic activity last quarter was business fixed investment (BFI). Nonresidential business fixed investment, which constitutes spending on equipment, structures and intellectual property, dropped at a 5.9 percent annualized pace in Q1, the largest decline since the second quarter of 2009. In particular, mining plunged a record 86 percent. Business equipment investment dropped at a 8.6 percent annualized rate, structures were down 10.7 percent and intellectual property was up a modest 1.7 percent. As has been the case for a while, firms are still dealing with a challenging operating environment. Although energy prices have stabilized, sluggish demand persists and will limit the pace of recovery in business investment.

Elsewhere, component performance was mixed but largely came in as expected. Slowing from Q4, the pace of consumer spending increased at a 1.9 percent annualized rate in Q1, predominantly led by services. Consumer durable goods spending fell 1.6 percent, consistent with the pullback in motor vehicle purchases. Residential investment recorded a second consecutive double-digit gain, up 14.8 percent, reflecting the continued positive momentum of the housing recovery. Inventories and net exports each subtracted a little more than three tenths of a percentage point off top line growth. Led by state & local, government spending rose 1.2 percent.

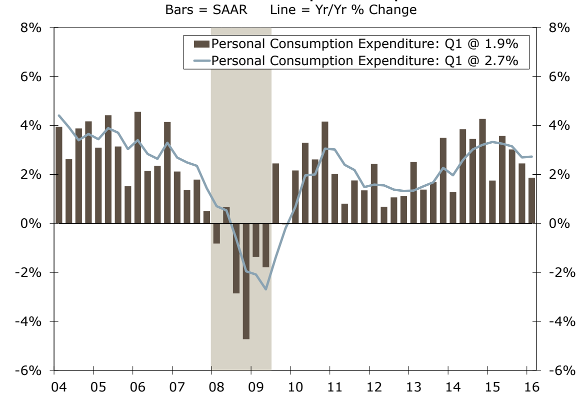
GDP Growth Rebound Still in Place

Following the soft Q1 performance, there is understandable concern over the likelihood that GDP growth will pick up in the remainder of the year. As in past periods, where Q1 activity was soft, we also expect to see a rebound unfold in Q2. For starters, employment gains remained solid as we moved through Q1, resulting in a firming rate of real income growth (3.0 percent year over year). Both suggest the backdrop for consumer spending remains favorable to the outlook for continued overall economic expansion. Drags from trade and inventories are likely to remain, but the magnitude should lessen. Business fixed investment remains the wild card. On one hand, we have seen modest improvement in the business sentiment surveys, yet we have not seen that relative optimism translate to better shipments and orders data. On balance, we still feel comfortable that U.S. GDP growth will move back towards trend in Q2 and into the second half of the year–our call is for growth of 2.3 percent and about 2.5 percent, respectively.

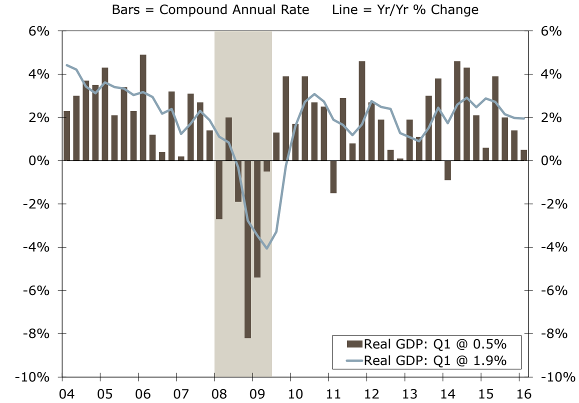
Real Business Fixed Investment



Real Personal Consumption Expenditures



U.S. Real GDP



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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