Manulife Asset Management

Investment Note

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US Q1 GDP Disappoints, but is expected to accelerate in Q2

Economic growth in the first quarter appears to have ground to a halt, coming in below expectations. Our Chief Economist Megan Greene takes a closer look, and explains why last Friday's data reinforces her belief that the United States fundamentally remains to be a 2% economy.

GDP for the first quarter of 2017 came in even softer than expected, at 0.7% on a seasonally adjusted annual rate basis[1] (SAAR). Q1 GDP pretty much always looks weak in the US because of seasonality, but there may be more than that at play here. We expect a rebound in Q2 GDP growth, however it may be more muted than some analysts are expecting given some recent indicators for domestic demand.

The worst news: Consumption data

In my opinion, the worst news in this GDP print was the consumption data. Private consumption, which accounts for roughly 70% of US GDP, grew by only 0.3% quarter-on-quarter SAAR in Q1[1]. This tells a very different story than that which you would glean from the confidence and some of the employment data. While consumer confidence is at post-crisis highs[2] and job growth has continued (on a three-month moving average basis), real wage growth is stagnating[3]. A few transitory factors may have also contributed to lower private consumption:

- Warm weather in Q1 resulted in lower utilities usage.
- Tax refunds were delayed this year.
- Auto sales fell out of bed in March[3], and it is too early to know if this is part of a broader trend or just a one-off data point. There is some evidence it might be the latter as dealer incentives shifted car sales into the end of 2016. But either way, this dragged on private consumption.

The best news: Investment data

The best news came from the investment data. Private investment decelerated from 9.4% to 4.3%, but non-residential investment grew by 9.4%[1], the best since 2013 and absolutely

[1]US Department of Commerce: News Release, 28 April 2017.
[2]University of Michigan: Index of Consumer Sentiment, as of 28 April 2017.
[3]Bloomberg, as of 28 April 2017.

crucial if we are to generate any productivity growth. While this is positive for GDP growth, we do not expect strong non-residential investment to carry through into Q2 because of the disappointing core capital goods orders we have seen over the past three months3. New orders are a forward-looking indicator, and their growth has been decelerating since January. This suggests capital expenditure may slow in Q2.

Expect GDP growth to accelerate in Q2

GDP growth was expected to be weak in Q1, but its composition has been somewhat of a surprise, with weak consumption and relatively strong investment. There continues to be a schism between the soft (confidence and survey) data and the hard data feeding into GDP growth.

In our view, this reflects optimism about potential policies coming through but an unwillingness to spend or invest until they actually materialize. We expect GDP growth to accelerate in Q2 and to reflect slightly stronger consumption and weaker investment. This GDP print has done nothing to change our view that the US is fundamentally a 2% growth economy. There may be temporary, policy-driven 'sugar hits' or drags on the economy in the next few years, but they are unlikely to move the dial on potential US GDP growth.