

US GDP growth disappoints as corporate America comes under pressure

The US economy expanded at a 1.1% annualised rate in the first quarter – lower than the 1.9% consensus – as business investment and a run down in inventories partially offset weather-boosted consumer spending and robust government expenditure. The headwinds from higher borrowing costs and reduced credit availability will weigh more heavily in 2H 2023



A busy US data calendar this week features third-quarter GDP figures and Friday's release of the Federal Reserve's preferred measure of inflation, the core PCE deflator

1.1%

US annualised GDP growth in Q1 2023

Lower than expected

GDP disappoints as investment and inventories weigh heavily

US first quarter GDP rose at a 1.1% annualised rate, below the 1.9% consensus figure and our own 1.5% forecast. The details show decent strength in consumer spending (+3.7% annualised). This was largely generated by the huge spike in spending in January, as unseasonably warm weather prompted a surge in activity after cold and wintry conditions held back activity in December. Government spending was also strong, rising 4.7%, while net exports added 0.11pp to headline growth.

It was the business sector that held back growth overall, with the investment story looking much weaker than expected. Non-residential fixed investment grew just 0.7% annualised while residential investment fell 4.2%, its eighth consecutive quarterly decline. Inventories then subtracted a huge 2.26pp from headline growth. Inventories have been very volatile over the past couple of years, but that is something we just have to live with until legacy supply chain issues and China disruptions abate.

Stagflation fears are overstated, but recession looks increasingly likely

In terms of the inflation story, the core PCE deflator for the first quarter rose 4.9% annualised versus 4.4% in the fourth quarter of 2022 and above the 4.7% consensus. This will no doubt bring headlines of stagflation given low GDP growth, and also suggests there is a risk that the deflator's month-on-month print (due out 8:30ET on Friday) comes in at 0.4% MoM rather than 0.3%. Of course, it could alternatively mean there were slight upward revisions to either January or February. Hopefully, it will indeed be an upward revision to January and instead, March comes in at 0.3% or lower and those stagflation concerns recede to some extent.

Looking to second quarter GDP growth, we have to expect a reversal in consumer spending given recent retail sales trends, while the softening in non-defence capital goods orders ex aircraft suggests business investment will remain subdued. Moreover, with CEO confidence in recession territory and the NFIB's small business optimism below the lowest levels experienced during the pandemic, corporate and small businesses in America are adopting a defensive posture, which means much less hiring and capital expenditure.

Our current expectation is for second quarter GDP to record growth of 0-0.5%, with the clear threat of negative GDP prints in the third and fourth quarters as the most rapid and aggressive series of Federal Reserve interest rate increases in 40 years are more fully felt and the tightening of lending standards intensifies in the wake of recent bank stresses.

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