Don’t Blame Households for First Quarter GDP

The first quarter GDP numbers were ugly. Real GDP grew by an anemic 0.2%. In this article I’ll explain why. The bad news is far worse than the single glimmer of hope. As always, my methods are transparent. **Click here to download the Excel workbook containing all the data I used here (and a bit more).**

One technical note: throughout this article you will see phrases like “a decrease of -0.2%.” I know this is the arithmetic equivalent of a double negative. Please just treat negative numbers as negative numbers and try not to worry about the issue.

Executive Summary

The worst news from this report is the collapse of gross private domestic investment. While the **overall growth rate was +2.0%,** that figure hides some very distressing data. **Business fixed investment (nonresidential construction and equipment) fell by –2.5%. Structures (nonresidential construction) fell by –23.1%. Even worse, spending on computers and peripheral equipment fell by –29.2%.**

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For those who have forgotten basic macroeconomics, **business fixed investment is the engine of future economic growth. And it’s very difficult to blame these numbers on weather. This is business spending, not consumer spending. The last time we saw numbers like this, bad things followed.**

Despite a 4% increase in disposable personal income, consumer spending grew by only 1.9%. Consumption was buoyed by **increased spending on services (2.8% growth contributed percentage points to the 1.9% total growth)**. T**he disparity between income growth and spending growth was caused by a whopping increase in the saving rate from 4.6% in 2014:IV to 5.5% in 2015:I.**

And there was **more bad news from the foreign sector. Exports fell by -7.2%, with exports of goods falling by –13.3%.**

A Quick Digression

The graph below shows the **growth rate of real GDP quarter-by-quarter since 2000.**[1]

GDP Growth 2000-2015

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According to the NBER Business Cycles Committee, there have been **two recessions since January 1, 2000**. The first (the dot-com crash) began in March, 2001 and ended in November of that year. For convenience I'll assume it lasted for the last three quarters of that year. The second began in December, 2007 and ended in June, 2009. Again, to make my life easier, I will assume the recession began in January, 2008. Luckily, June is the end of the second quarter, saving me one assumption. **The average growth rate for the period between the end of the 2001 recession and the beginning of the 2008 recession was 2.8% per year. Since June, 2009 the growth rate has been 2.2%.**

The U.S. economy is still sick. It will not be cured until (if and when) the current regulatory onslaught emanating from Washington, D.C. is not just slowed, but rolled back. The U.S. needs business climate change.

The Good[2]

Despite a **4% increase in disposable personal income. consumer spending grew by only 1.9%.**[3] The contribution to total growth was percentage points. But the news is not all good. **Of those percentage points, came from growth in spending on services.**[4]

The disparity between income growth and spending growth was caused by **a whopping increase in the saving rate from 4.6% in 2014:IV to 5.5% in 2015:I. To see what this means, consider the following table (based on BEA Table 2.1**[5]):

Personal Income and Its Disposition (click the image for a larger version)

Personal income grew by $145.6 billion. Disposable personal income rose by $132.2 billion. But most of that – $124.4 billion – went into consumer saving (much of which was probably debt liquidation). Only $7.8 billion was spent. With that number, it's surprising that consumption spending grew at all.

The Bureau of Economic Analysis publishes "expanded detail" GDP accounts. One disturbing fact: **spending on "Motor Vehicles and Parts" fell by a whopping 3.0%.** Fortunately, **that category is a small part of overall consumer spending, only dragging**

down the total growth by percentage points. Spending on groceries, clothing, and footwear fell by –2.5% and –2.9% respectively, combining for a drag of percentage points on consumer nondurables spending.

The growth in services spending was 2.8%. Households contributed percentage points to that total. **The drag was from final consumption expenditures of non-profit institutions, amounting to – percentage points**. That category's growth rate was a phenomenal –10.8%.

Digging deeper into household services spending, **housing and utilities grew by 4.9%, and transportation services by 3.4%.** Contrary to what you may have read about healthcare spending being under control, the first quarter growth rate was 5.4% — and that in a quarter when income growth was anemic. **There is a bit of good news in that food services and accommodations grew by only 1.6%. That's good news because jobs in that sector typically pay pretty low wage rates.**

The Bad

Net exports dragged growth down by a whopping – percentage points. Even worse, **– percentage points of that decline were caused by a -7.2% decrease in exports. And, capping off a dreadful series of numbers, exports of goods fell by –13.3%, contributing – percentage points to the – percentage point overall contribution of exports to net exports.**

Goods exports are important because they include manufacturing, agriculture, and other areas. Growing exports of goods encourages businesses to expand capacity. They do that by investment spending. Which brings us to the really bad news.

The Ugly

Gross private domestic investment grew by 2.0%. How can that possibly be bad news?

As always, **the devil is in the details. Business fixed investment (nonresidential construction and equipment) fell by –2.5%, dragging down gross private domestic investment by percentage points. Structures (nonresidential construction) fell by — take a deep breath — –23.1%. The drag on nonresidential investment was – percentage points. Even worse, spending on computers and peripheral equipment fell by –29.2%, dragging equipment spending down by – percentage points.**

What bailed out investment? Transportation equipment spending grew by 23.7%, boosting nonresidential investment by percentage points. And "intellectual property products" contributed percentage points to that category, with of those percentage points coming from research and development. (I've written about this squishy category before. While

it’s **not as bad as including illegal drugs and prostitution in GDP, it’s still subject to a lot of, um, interpretation.**)

Finally, **the change in private inventories contributed percentage points to gross private domestic investment. Inventory change is always problematic because we don’t know how much is planned inventory change (good because it reflects business optimism) and unplanned inventory change (bad because it means domestic spending on domestically produced goods was less than domestic production). Given the terrible first quarter consumer spending numbers, it’s easy to believe that most of this increase is unplanned. Meaning businesses will cut production in future quarters to liquidate their excess inventory.**

The last time we saw business fixed investment collapse like this was in the first quarter 2010. **Over the period 2010:II through 2012:IV real GDP growth averaged 2.0%, including a decrease of –1.5% in 2011:I. Given the expected time lags in the impact of changes in investment, it’s a safe bet that the 2011:I drop was at least partly caused by the investment collapse in 2010:I.**

A Note on the Income-Expenditure Multiplier

There has been quite a bit written about the government spending multiplier ever since the ARRA was passed. It has become clear that **there is more to fiscal policy than government spending**. **What gets purchased** by the spending and **the timing** both matter. **Sorting out the impact of the actual purchases made under ARRA, the timing of the expenditures, and the effect of regulations will create jobs for hundreds of economists over the next decade.**

But there is considerably less disagreement about the existence of a tax multiplier. Tax cuts, especially personal income tax cuts, that are viewed as permanent will cause spending and production to rise. The tax multiplier is probably greater than 1.0.

And **there is no research I know of that disputes the existence of an investment multiplier. My guess is that the investment multiplier for business fixed investment is larger than the multiplier for intellectual property and inventory change.**

Conclusion

Economics is often called “the dismal science.” The subject would be a lot less dismal if policymakers would stop making foolish choices.

[1] U.S. Bureau of Economic Analysis, “Table . Percent Change From Preceding Period in Real Gross Domestic Product” #gdp (accessed May 2, 2015).

[2] Material from this point forward is from one of the sources cited in footnotes 3, 4, and 5.

[3] U.S. Bureau of Economic Analysis, “Table . Percent Change From Preceding Period in Real Gross Domestic Product, Expanded Detail” #gdp (accessed May 2, 2015).

[4] U.S. Bureau of Economic Analysis, “Table . Contributions to Percent Change in Real Gross Domestic Product, Expanded Detail” #gdp (accessed May 2, 2015).

[5] U.S. Bureau of Economic Analysis, “Table 2.1. Personal Income and Its Disposition” #personal (accessed May 2, 2015).