

## Economics Group

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### GDP: Moderate Growth with Mixed Details: Profits Slow

*First quarter GDP growth of 1.9 percent represents a moderate but subtrend pace of growth. The underlying details suggest a mix of pluses and minuses that produce a mixed picture of the economy.*

#### GDP Growth: Details Provide a Mixed Picture of the Economy

What you see depends on where you sit. This is certainly true of today's GDP release. Growth was up 1.9 percent, with positive contributions from personal consumption, equipment and residential investment. Weakness was apparent for structures and in all three levels of government.

As evident in the top graph, real domestic final sales appear to have settled in at around 2 percent growth for the past six quarters. This pattern sets an underlying forward momentum to the economy, although the pace of the gain remains subpar compared to earlier economic recoveries. Over the same period, consumer spending gains have come in at a steady 2.0 percent, suggesting that the consumer has become comfortable with the current pace of job and income gains. Disposable personal income grew 2.9 percent in the first quarter after a gain of 3.7 percent for all of 2011.

#### Equipment & Software Slowdown: Negative Signal

Equipment & software spending growth has slowed (middle graph) noticeably over the last three quarters. The slowdown is consistent with the slowdown in nondefense capital goods orders, ex-aircraft, and reflects, in part, the reduction of the tax credit for investments. Meanwhile, it appears that many firms feel comfortable with the stock of capital goods relative to their expected pace of final sales, and so many firms do not see the need to add aggressively to their capital stock. The slowdown is reinforced by the slower pace of profit growth that is now apparent with today's release.

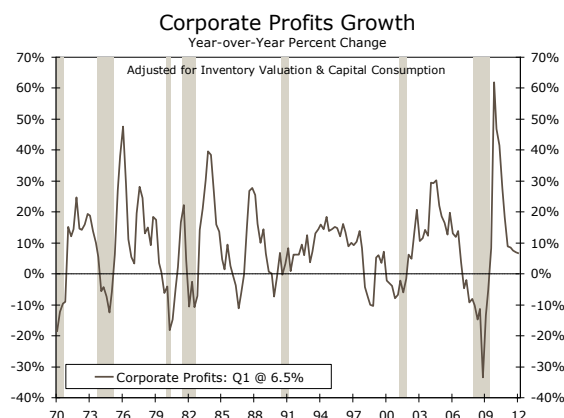
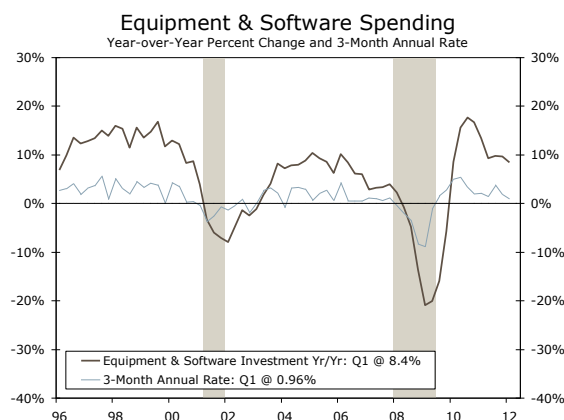
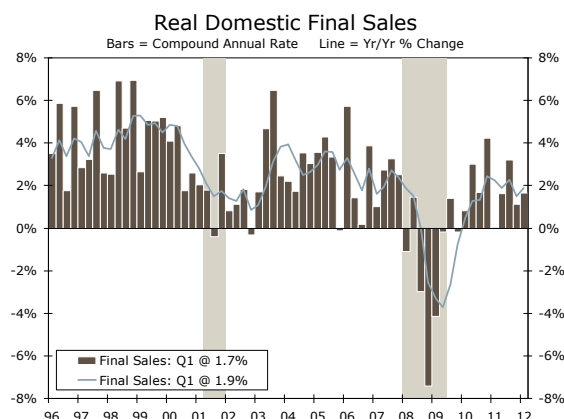
Meanwhile, spending on structures has clearly downshifted and now represents a drag on growth, compared to adding to growth in 2011. The shift appears driven by a decline in energy structures.

Government spending, especially national defense, also subtracted from economic growth. The reason for the sharp decline is not clear but could reflect preparations for impending defense department cuts in 2013.

#### Profits: Slower Gains Suggest Less Support for Capital and Jobs Going Forward

Corporate profit growth has slowed to 6.5 percent compared to a year ago (bottom graph), suggesting slow business investment and job gains going forward. Profits from current production increased \$11.4 billion in the first quarter after a gain of \$16.8 billion in the fourth quarter and \$32.5 billion in the third quarter. Domestic industry profits slowed for both financial and nonfinancial sectors.

Profits provide the incentive to produce and are a signal that business operations are being successful. The slowdown in profits provides less incentive for businesses to expand production and thereby add new equipment and workers. Slower profit growth reinforces the message of weaker orders data and suggests an economy that is doing ok, not great.



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

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