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GDP Growth Sputters at the Start of 2011

Rising at a slower-than-expected pace, real GDP grew 1.8 percent in the first quarter. Weather disruptions, higher food and energy prices and a sizeable decline in government outlays weighed on economic growth.

Growth Slowed in Q1

Real GDP rose at an annualized rate of 1.8 percent in the first quarter. That turned out to be a bit slower than consensus, but confirmed what many had expected—weather disruptions and sharply higher gasoline and food prices have been taking a toll on economic growth.

Coming off the strongest annualized rate of growth in nearly five years, real consumer spending pulled back to 2.7 percent in the first quarter. Retail gasoline prices have risen roughly 85 cents since the start of the year, while food prices were up an annualized 7.5 percent over the past three months. These price increases have taken a toll on consumers' purchasing power and have weighed considerably on consumer confidence and their willingness to spend. That said, consumer spending held up reasonably well despite those challenges. Spending on durable goods, which would normally fall if consumers were wary about their income and job prospects, increased at a 10.6 percent annualized pace on the quarter, following a 21.1 percent gain in Q4. However, with expectations of further price increases at the pump and grocery store in the coming months, we still expect consumer spending will remain under pressure.

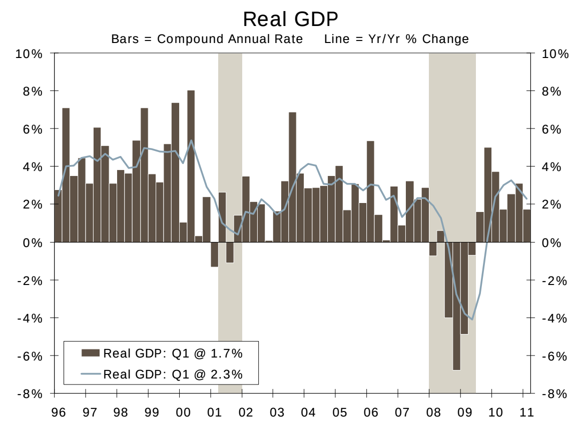
Beyond the consumer, the details were mixed. Business investment increased a modest 1.8 percent as the 11.6 percent gain in equipment & software spending was largely offset by a weather-related 21.7 percent contraction in nonresidential structures spending. The weather also impacted residential construction spending which declined 4.1 percent.

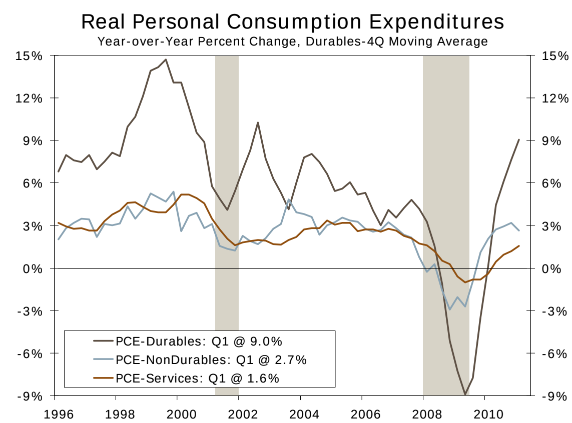
After subtracting almost 3.5 percentage points off the top line in Q4, inventory investment added close to a full percentage point to real GDP in Q1. Net exports proved to be a neutral factor last quarter as the 4.9 percent gain in exports barely offset the 4.4 percent gain in imports.

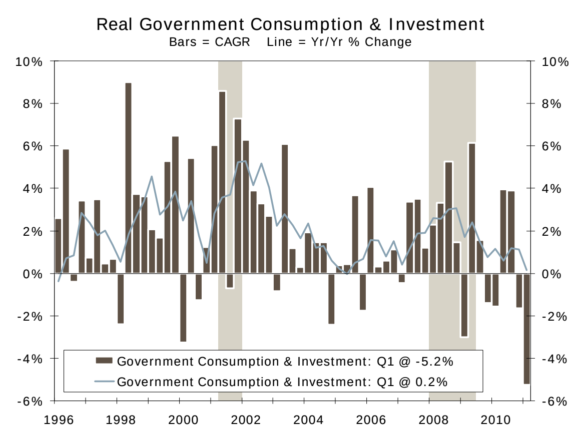
Marking the largest quarterly drop since 1983, government spending fell at a 5.2 percent annual rate in the first quarter following a 1.7 percent decline in the fourth quarter. Spending at all levels of government should remain under pressure as officials are forced to continue to make difficult decisions in terms of spending cuts and tax increases to bring deficits under control.

Economic Growth Persists but Will Likely Remain Soft

Looking ahead, economic growth should persist in the coming quarters as the pace of hiring continues to pick up. Income growth will likely help support consumer spending, though higher gasoline and food prices should continue to sap purchasing power. Supply disruptions will likely impact durable goods outlays and inventories in the second quarter, though we believe that will be short lived. Production should ramp back up as firms take advantage of expiring tax breaks on equipment purchases. The U.S. economy continues to expand, but significant challenges here and abroad should limit how just how fast the recovery proceeds.







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