

US Economic Comment

Reasons to doubt some of the Q1 GDP weakness

Economics

Americas

Q1 GDP tracking at 1 ¼% but Q1 GDP prints have a history of downward bias

The downward bias to Q1 GDP prints is well documented. Since 1980, real GDP growth rates have been, on average, 0.8 pct pt lower in Q1 than in Q2-Q4. That bias has become more pronounced recently, with a -1.3 pt deviation since 2000. Fed research, based on a second seasonal adjustment of real GDP growth comes to a similar conclusion. Correcting for the residual seasonality "pushes up published first-quarter real GDP growth ... by about 1½ percentage points in the past several years." ¹ Adjusting our 1% forecast for Q1 GDP for this bias would put growth at about a 2¼-to-2½% pace.

Employment and ISMs suggest stronger growth

Aggregate hours worked rose at a 1.8% annual rate so far in Q1—close to the 1.7% annual rate in Q4 and the 2.0% y/y in Q4. Yet our GDP tracking puts Q1, at 1 ¼%, slightly slower than Q4's 1.4% annual rate and well below the 2.0%/y pace in Q415. Some of the relative shortfall in Q1 GDP in a different circumstance might be attributed to inventory- or trade-contributions to growth (less reflective of growth in labor input); however, the weakness that we're seeing in Q1 activity reflects stalled capex and weak consumption more than inventory- or trade- drags.

ISMs similarly suggest faster growth. They ought to be running above GDP growth currently: Idiosyncratic weakness in particular sectors (as in the energy sector now) tends not to be fully reflected in diffusion indexes like the ISMs. Still, even with recent weakness in the manufacturing ISM and declines in the nonmanufacturing ISM index, our all-economy ISM index appears consistent with a >2% trend in real GDP growth.

Even if Q1 weakness is exaggerated, Q2 may also be weak

We've been surprised at the pattern in Q1 data—stalled capex, soft consumption, but no apparent inventory drawdown. Our longstanding 1.0% forecast for Q1 real GDP growth has included a significant drag from inventories ([LINK](#)), a drag that does not appear to be occurring based on data through Jan/Feb. Inventories may still turn out to be negative for Q1 after February and March stocks are tallied. But for now, the elevated I/S ratio does not appear to be coming down, and it threatens a larger drag from inventories later in the year. Even if Q1 growth is understated, we continue to forecast 1.5% real GDP growth in 2016 with a weaker H1 than H2.

Figure 1: Q1 growth rates relative to trend

Average growth in Q1 minus average growth in Q2-Q4	Real GDP	Consumption	Nonresidential structures	Equipment	Intellectual property	Residential investment	Government spending	Net exports contrib.	Inventories contribution	Real GDI
since 80	-0.8	-0.3	-3.4	-1.5	0.5	-0.6	-1.3	-0.1	0.0	0.2
since 90	-1.2	-0.2	-3.8	-0.2	0.5	-1.4	-1.5	-0.3	-0.3	0.1
since 00	-1.3	-0.1	-4.7	0.3	0.5	-1.2	-1.5	-0.3	-0.5	0.5
Contribution to growth (since 00)	-1.3	-0.1	-0.1	0.0	0.0	0.0	-0.3	-0.3	-0.5	

Source: Bureau of Economics and UBS

¹ "The Puzzle of Weak First-Quarter GDP Growth", FRBSF Economic Letter. Glenn D. Rudebusch, Daniel Wilson, and Tim Mahedy, May 18, 2015. [LINK](#)

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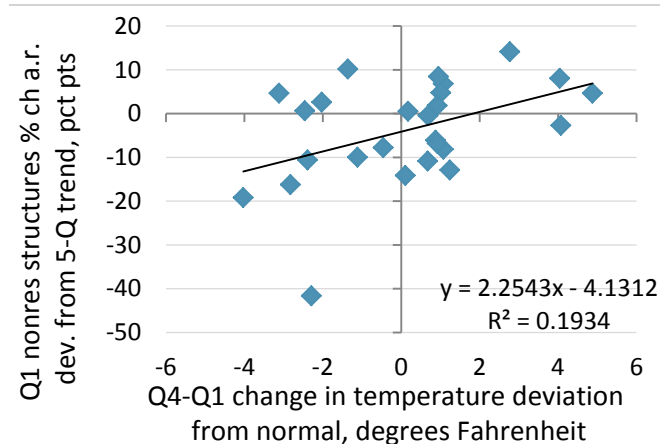
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Another look at Q1 GDP bias

As noted, the shortfall in Q1 growth relative to other quarters suggests that it is biased downward by as much as 1.3 pct pt since 2000 (see tables). The distortion appears most evident in nonresidential construction (4.7 pt below trend, on average in Q1) but is in fact more widespread. Looking at contributions to GDP growth and their Q1 pattern, consumption, Federal government spending, inventories, and exports all appear to routinely subtract as much or more from Q1 growth as nonresidential structures spending does.

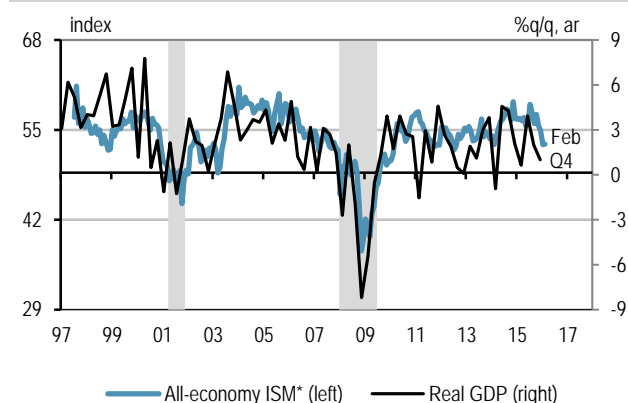
The drags from nonresidential construction also probably somewhat reflect winter weather—they're not purely bias. We compared the deviation of nonresidential structures growth from its surrounding trend with temperature measures. When the drop in temperatures from Q4 to Q1 was greater than normal, nonresidential structures tended to be further below trend, and the opposite was true for

Figure 2: Swings toward colder temperatures are associated with greater weakness in nonresidential structures spending.



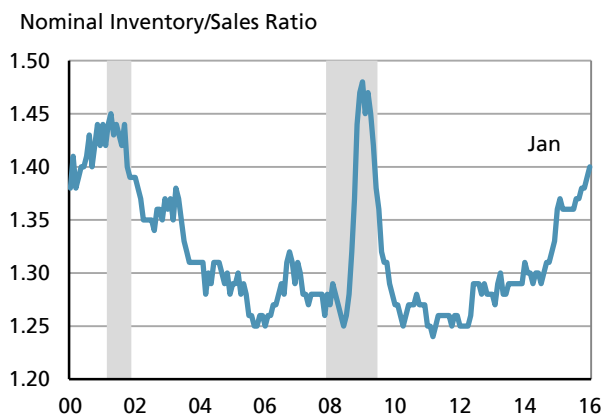
Source: National Climatic Data Center, Bureau of Economic Analysis, and UBS

Figure 4: ISM indexes have faded but look stronger than GDP.



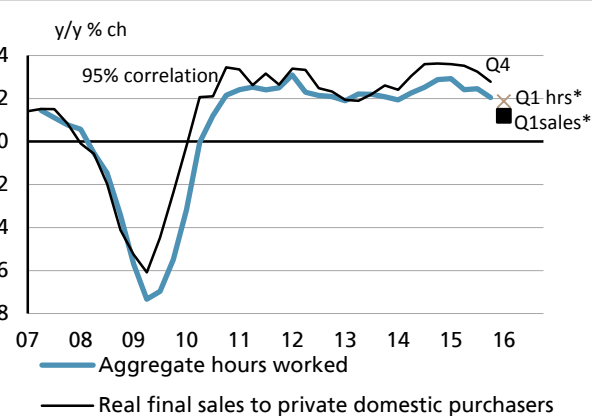
Note: Shaded areas mark recessions. * Economy-weighted average of manufacturing ISM index (12% weight) and nonmanufacturing ISM index (88%).
Source: Institute of Supply Management, Bureau of Economic Analysis and UBS

Figure 3: The high inventory/sales ratio spells an eventually larger drag from inventories.



Note: Shaded areas mark recessions. Source: Census Bureau and UBS

Figure 5: Growth in final sales to private domestic purchasers slowed much more sharply in Q1 than did aggregate hours worked.



* y/y % changes except for Q1 observations, which are the quarterly % change (a.r.) in Q1 hours and in estimated real final sales to domestic purchasers.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, and UBS

greater-than-normal increases in temperature. Still, weather effects can be severe enough to have biased the nonresidential series downward somewhat in Q1s: the most negative readings for nonresidential spending growth tended to be more extreme than the most positive ones and tended to coincide with the larger negative temperature swings. Not a surprise: worse weather seems to hurt more than better weather helps.

For Q1 this year, weather may not explain weakness. After a warm Q4, there's been no downswing in temperatures relative to normal. We're nevertheless likely to see weakness as energy structures investment continues to plummet and other structures investment remains weak.

A "second opinion" on Q1 growth

Real gross domestic income (GDI) shows Q1 growth estimates slightly above the average Q2-Q4 estimates—if anything a bias in the other direction. However, the first estimate of Q1 GDI will not be released until June 28, two months after the Q1 advance GDP estimate.

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