Economy Shrank in First Quarter as U.S. Trade Deficit Surged

by Sho Chandra
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The world’s largest economy hit a bigger ditch in the first quarter than initially estimated, held back by harsh winter weather, a strong dollar and delays at ports.

Gross domestic product in the U.S. shrank at a 0.7 percent annualized rate, revised from a previously reported 0.2 percent gain, according to Commerce Department figures issued Friday in Washington. The median forecast of 84 economists surveyed by Bloomberg called for a 0.9 percent drop. By contrast, the report also showed incomes climbed, fueling the debate on whether GDP is being underestimated.

A swelling trade gap subtracted the most from growth in 30 years as the appreciating dollar caused exports to slump while imports rose following the resolution of labor disputes at West Coast ports. Federal Reserve officials are among those who believe the setback in growth will be temporary, helping explain why they are considering raising interest rates this year.

“A lot of the weakness was really contained in the first quarter,” said Gennadiy Goldberg, a U.S. strategist at TD Securities USA LLC in New York. “This sets us up nicely for a rebound in the second quarter.”

Stock-index futures held earlier losses after the report. The contract on the Standard & Poor’s 500 Index maturing in June fell 0.2 percent to 2,117 at 8:51 a.m. in New York.
Survey Results

Economists’ forecasts ranged from a decline of 1.2 percent to an increase of 0.2 percent. The GDP estimate is the second of three for the quarter, with the third release scheduled for June, when more information becomes available. The economy grew at a 2.2 percent pace from October through December.

The revisions showed the trade gap widened more than previously estimated, inventories grew at a slower pace and consumer spending climbed less than previously estimated. That was partly offset by a gain in home building.

While poor weather and merchandise delays due to a labor dispute at West Coast ports were temporary restraints, the damage caused by the plunge in fuel prices and stronger dollar may be longer-lasting.

The income side of the economy was more upbeat last quarter, with the GDP report offering a first snapshot of the quarter’s gross domestic income. The measure, which shows the money earned by the people, businesses and government agencies whose purchases go into calculating growth, is seen by researchers including some at the Fed as a better gauge of the strength of the economy.

Income Side

GDI adjusted for inflation climbed at a 1.4 percent annualized rate in the January through March period after rising 3.7 percent in the fourth quarter. While the income and GDP should theoretically match, the different methods used in calculating the numbers cause them to sometimes diverge.

“Recently, the income side of the economy has been growing faster than the product side (GDP),” Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities Inc. in New York, wrote in a note. “This suggests that GDP growth is understated.”

The contraction last quarter may not have been as bad as it appears, in part due to the so-called residual seasonality that probably distorted the data. The tendency of the first quarter to be persistently weak in recent years has sparked a debate about the extent of the bias, with the Fed Board and regional Fed banks including the San Francisco Fed jumping into the fray.

The results of the various research indicates first-quarter growth has underperformed the rest of the year by about 1.6 percent to 1.7 percent on average. The Bureau of Economic Analysis this month said it’ll make changes to further minimize the bias, and take this into account when issuing annual benchmark revisions in July.

Consumer Spending

Among the details of the first-quarter GDP report, household consumption grew at a 1.8 percent annualized rate, revised down from an initial estimate of 1.9 percent. The median forecast in the Bloomberg survey called for a 2 percent gain, following a 4.4 percent jump in the fourth quarter.

Consumers’ purchasing power grew, with disposable income adjusted for inflation increasing 5.3 percent. The saving rate rose to 5.5 percent from 4.7 percent.
The report included revisions to fourth-quarter personal income. Wages and salaries grew by $117.2 billion, up from the $94.5 billion gain previously reported.

The figures also offered a first look at corporate profits. Before-tax earnings dropped 5.9 percent from the prior quarter and were up 3.7 percent from the same time last year.

The trade deficit subtracted 1.9 percentage points from growth, the most since 1985, compared with the previously estimated drag of 1.25 points.

Projected Rebound

The economy is poised to pick up this quarter. A Bloomberg survey of economists in May predicted growth will accelerate to a 2.7 percent pace in the April through June period, with household consumption expanding 3.2 percent.

An improving labor market is among reasons consumers may be more willing to spend. Payrolls rebounded in April, as employers added 223,000 jobs after an 85,000 gain in March. The unemployment rate fell to 5.4 percent, the lowest since May 2008. Weekly applications for jobless benefits are hovering just above 15-year lows reached at the end of April.

“The U.S. economy seems well-positioned for continued growth,” Fed Chair Janet Yellen said in a May 22 speech in Providence, Rhode Island. “Households are seeing the benefits of the improving jobs situation.”

If the economy continues to improve as she expects, “it will be appropriate at some point this year” to start raising rates, Yellen said.

Auto Sales

Automobile sales also bode well for consumer spending and factory production. Cars and light trucks sold at a 16.5 million annualized rate in April after 17 million the prior month, data from Ward’s Automotive Group showed.

Corporate investment data also indicate a pickup is under way. Bookings for non-military capital goods excluding aircraft -- a proxy for future corporate spending -- advanced 1 percent in April after rising 1.5 percent the prior month.

General Motors Co. is among automakers with plans to invest. The company said it will spend $439 million to build a new paint shop at its Corvette sports car plant in Bowling Green, Kentucky.

More hiring, easier credit availability and borrowing costs still close to historically low levels are helping to revive the housing market. The pace of new-home sales jumped 6.8 percent last month, more than projected. The index of pending home resales, considered a leading indicator because it tracks contract signings, climbed in April to the highest level in nine years, the National Association of Realtors reported this week.