Economic Analysis

Solid growth in 1Q21 underpins strongest expansion in almost 40 years

Nathaniel Karp

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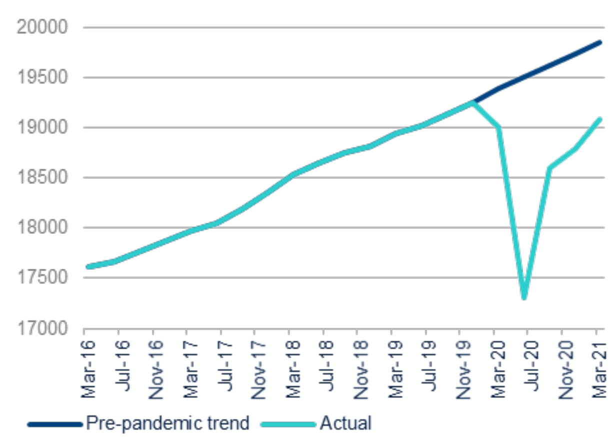
According to the BEA, real GDP increased at an annual rate of 6.4% in the first quarter 2021. This was slightly higher than our expectation of 5.8%, and stronger than 4.3% in the previous period. Although in level terms real GDP stands 0.9% lower than 4Q19 –before the start of the recession-, it will fully recover during 2Q21. However, relative to where GDP would have been in the absence of the pandemic, the difference is 3.6%, and it will take around four more quarters to eliminate this gap.

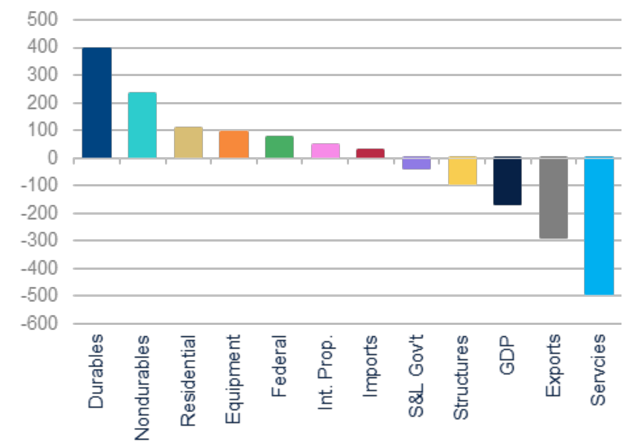
The strong economic performance in 1Q21 reflected large contributions from personal consumption expenditures (7pp), private nonresidential fixed investment (1.3pp), and government consumption expenditures and gross investment (1.1pp). The boost to consumption, which increased 10.7% QoQ SAAR, reflected solid gains in nonmotor vehicles and parts, food services and accommodations, food and beverages purchased for off-premises, and furnishings and durable household equipment. This was mainly driven by the massive fiscal support at the end of 2020 and the start of 2021, accommodative monetary policy conditions, and a successful vaccination campaign that has allowed consumers to spend again in services that were severely impacted by the pandemic. As a result, while durable goods consumption stands 22% ($394bn) above pre-pandemic levels, the gap for consumption of services remains large at 5.7% or $491bn. Under current trends, it will take at least another four quarters for services to fully recover.

Figure 1. **REAL GDP (CHAINED 2012 US$BN)**



Source: BBVA Research and BEA

Figure 2. **REAL GDP 1Q21 VS 4Q19 (CHAINED 2012 US$BN)**

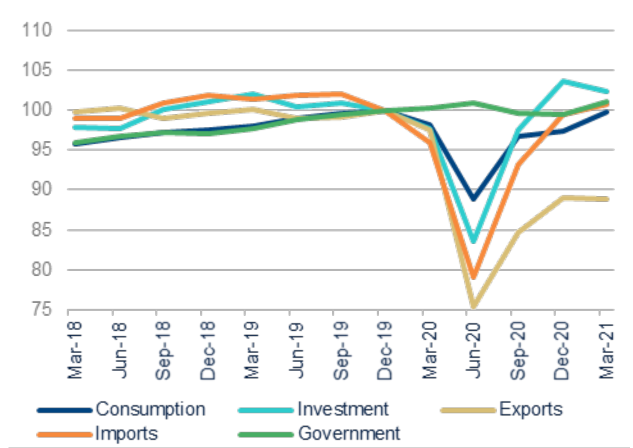


Source: BBVA Research and BEA

On the investment side, the largest contributions came from information processing equipment, software and residential. On the one hand, firms continue to invest heavily on new technologies and IT equipment to boost efficiency and be better prepared for the post-Covid environment. On the other hand, low inventories in the residential market and fast home price appreciation generate large incentives to boost supply. It is worth noting that private fixed investment has fully recovered and stands 4.6% above pre pandemic levels.

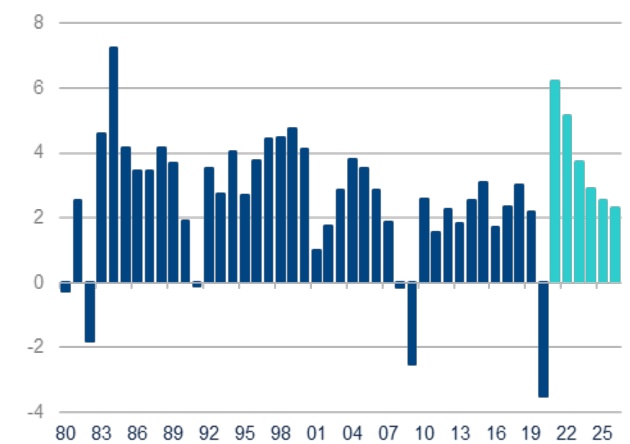
Meanwhile, the positive contribution of government consumption expenditures and gross investment reflected solid gains in federal nondefense consumption and state and local consumption. The former was boosted by purchases of vaccines and the increase in payments to banks for processing and administering PPP loan applications. The latter benefited from federal aid and the reopening of the economy.

Figure 3. **REAL GDP INDEX** (4Q19=100)



Source: BBVA Research and BEA

Figure 4. **REAL GDP GROWTH** (%)



Source: BBVA Research and BEA

In contrast, net exports, inventories and structures posted a drag of 2.6pp, 0.9pp and 0.1pp, respectively. The negative contribution from net exports reflected solid gains in imports and modest declines in exports. On the one hand, imports continue increasing at a solid pace in tandem with stronger consumption of durable goods such as imported autos and, computer and electronic equipment, as well as the recovery of services like foreign travel, telecommunications, and computing services. On the other hand, weak global conditions are limiting the recovery of exports, particularly petroleum products, automotive vehicles, other durable consumption goods and overall services.

Meanwhile, the drop in inventories reflected the impact of supply chain bottlenecks and stronger consumption expenditures, which forced businesses to reduce their stockpiles. In addition, despite strong growth in mining exploration, shafts and wells, structural pressures and negative effects from the Covid-19 crisis continue to weigh on private investment in structures, particularly, lodging, recreation, and commercial.

Going forward, we expect both consumption and investment to continue expanding at a solid pace. In fact, households have around $2tn in excess savings, which combined with low borrowing costs and the reopening of the economy, will provide solid support to pent up demand. Meanwhile, business investment will remain strong as bottlenecks fade away and supply continues catching up with demand. This will also support the rebuilding of inventories. Furthermore, the recovery in global demand will also benefit export growth. As a result, we maintain our baseline scenario of real GDP growth in 2Q21 of almost 10%, and more than 6% for 2021. This will mark the strongest economic expansion in almost 40 years.