U.S. GDP Flash

Consumer Spending Growth Overshadowed by Federal Austerity

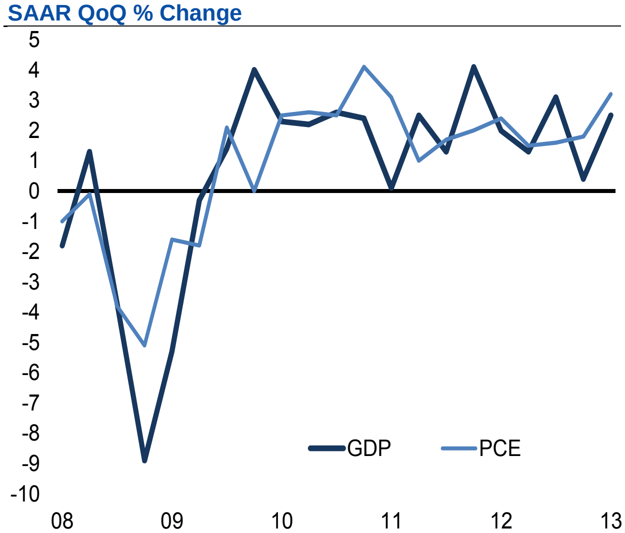
- **Real GDP grew 2.5% SAAR in 1Q13 after a sluggish end to 2012**
- **PCE was up 3.2% as consumers rallied, its highest growth rate since 4Q10**
- **Weakness in government spending and net exports dragged down quarterly growth**

The advanced report for real GDP growth in 1Q13 fell short of consensus expectations, coming in at 2.5% on a QoQ seasonally-adjusted annualized rate (SAAR) as opposed to the expected 3.1%. In line with our forecasts, the slower growth emerged from a mixture of government spending cutbacks and a sluggish global economy that resulted in reduced demand for exports. However, the bright spot in the report was clearly personal consumption, which surged 3.2% in 1Q13 after a rather weak 1.8% in 4Q12. In particular, the services sector saw a prolific rise in demand as it grew by 3.1% SAAR, its fastest pace in nearly 8 years. Adding to the quarter's growth in a strong fashion was private domestic investment, specifically residential. Given the continued growth in the housing market, the past three quarters have shown strong upward movements in residential investment and we expect this to continue as the housing recovery endures. In terms of contributions to the change in real GDP, the services sector was a massive player in the 1Q13 figure, contributing 1.5 percentage points. Residential investment added 0.31pp, down slightly from the past quarter, while the change in private inventories reversed its prior negative figure and contributed 1.0pp to real GDP.

While the underlying foundation of the economy, the consumer, has continued to recover in a remarkable fashion, prevailing headwinds have hindered the economy from realizing its potential. The government shoulders the largest drag on GDP growth due to the financial austerity imposed by the sequester and general budget reform. The 4.1% SAAR decline in government consumption for 1Q13 is less of a drag compared to the 7.0% decline in 4Q12. Still, the spending cuts will continue to put strong downward pressure on GDP growth. Defense spending cuts were the biggest culprit, down 11.5%, and the federal spending cuts will continue to put downward pressure on the economy as the sequester-related provisions unfold throughout the rest of 2013 and beyond. In addition to the drag caused by government spending, net export growth also pulled GDP growth downward as global demand remains weak. While exports did increase 2.9% following a 2.8% drop in the final quarter of 2012, external demand was not enough to offset the 5.4% increase in imports.

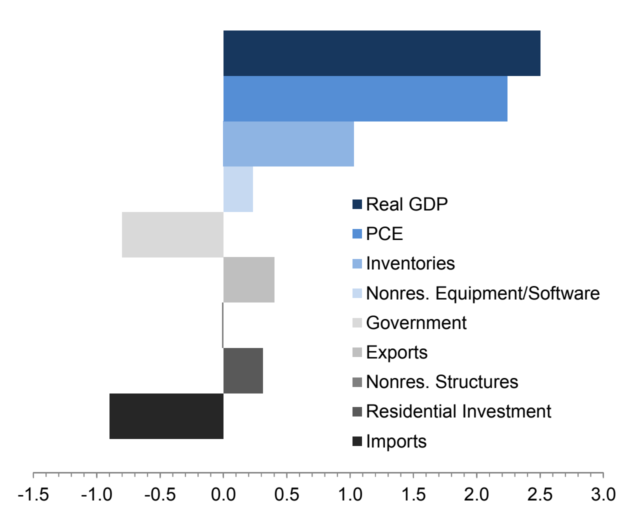
As for inflation, the GDP deflator remains mild at an annualized 1.2% rate after a softer 1.0% rate in 4Q12. Excluding food and energy, inflationary pressure grew 1.5%. Looking ahead to the second and final estimates for the quarter, we do not expect to see much upward revision to the report. Most of the data we are seeing come in to close out the first quarter have been weaker than in January and February, particularly consumer activity which could weigh on the PCE figure in the upcoming revisions. Still, we maintain our baseline scenario for slightly weaker growth in 2Q13 but then acceleration again in the second half of the year as economic activity gets back on track.

Chart 1
U.S. Real GDP and Personal Consumption Expenditures SAAR QoQ % Change



Source: Bureau of Economic Analysis & BBVA Research

Chart 2
Contributions to Real GDP Growth 1Q13 Advance, SAAR Percentage Points



Source: Bureau of Economic Analysis & BBVA Research

Kim Fraser
kim.fraser@bbvacompass.com
+1 713 831 7345

Alejandro Vargas
alejandro.vargas@bbvacompass.com
+1 713 831 7348

BBVA | RESEARCH | 2001 Kirby Drive, Suite 310, Houston, TX 77019 USA | www.bbvaresearch.com

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