Economic Research Department

US

BBVA

GDP Observatory

April 30th 2008

GDP Growth in 1Q08

- **Spending on goods fell, but services continued solid**
- **Non-residential investment deteriorated significantly, signaling a future broad based deterioration**
- **We maintain our forecast of 1% GDP growth in 2008**

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1Q08 GDP Growth
Preliminary: May 29
Final: June 26

2Q08 GDP Growth
Advance: July 31

GDP growth remained at a sluggish 0.6% in 1Q08. This was 0.4 pp less than our estimate. On a year-over-year basis, real GDP growth was 2.5%, similar to that of 4Q07. Private consumer expenditures (PCE), government spending, net exports and private inventories added to growth. This was partially offset by a negative contribution from both residential and, surprisingly, non-residential investment.

Non-residential investment (NRI) decreased 2.5%, following a 6.0% gain in 4Q07 and an average of 12.9% during the past two years. First quarter decline was broad based, mainly driven by a slump in structures in commercial and health care, power and communication, and mining. These declines may well reflect spill over effects from the credit turmoil and adds to ongoing weakness in industrial and transportation equipment. The only sector that keeps growing is IT, which benefits from external demand. However, risks remain tilted to the downside and no sector is immune.

Residential investment came in line with expectations. It fell 26.7% after declining 25.2% during 4Q07. We expect this trend to continue for at least two more quarters. Private inventories climbed $1.8 billion, adding 0.8 pp to overall GDP growth. This is the main source of difference between BEA figures and our forecast. In our view, this number is likely to be revised up in the next release in order to be consistent with monthly indicators of business inventories. In 2Q08 we expect inventories to fall as firms scale back production to deal with weaker demand.

PCE was higher than our forecast. The reason lies on the resiliency of services spending which contributed with 1.4 pp to overall GDP growth –higher than the average contribution of 1.1% during the past five years. Once again, services offset the disappointing figures of both durables and non-durables goods, which declined 6.1 and 1.3% respectively, subtracting 0.8 pp to total GDP growth. Going forward, we expect spending on services to deteriorate significantly as they have historically lagged the trend on goods. PCE will decline in 2Q08 and remain weak in following quarters due to credit tightening, decelerating labor markets, and higher energy and food prices. Exports came in line with our expectations, reflecting still solid demand from abroad.

Despite still positive growth, downside risks persist. Non-residential weakness in 1Q08 seemed to reflect second round effects from credit and housing market distress. In that sense, 1Q08 GDP non-residential investment readings could well be a warning sign of a broad based deterioration of economic activity. We expect a contraction in GDP growth during 2Q08 but maintain our forecast of 1% for the whole year.

1Q08 GDP (Q/Q % real change, AR)

	Actual	Forecast	Diff*
GDP	0.6	1.0	-0.4
Personal consumption	1.0	0.4	0.6
Nonresidential investment	-2.5	4.7	-7.2
Residential investment	-26.7	-23.8	-2.9
Inventories ($bn)	1.8	15.0	-13.2
Public spending	2.0	0.0	2.0
Exports	5.5	5.6	-0.1
Imports	2.5	2.8	-0.3
Price indexes (YoY % change)			
GDP	2.6	3.3	-0.7

* Actual - forecast

Real Nonresidential Investment
(QoQ annualized % change)