Economic Research Department

BBVA

U.S.

GDP Observatory

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# GDP will rise in 1Q10

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- Consumption, inventories and non-residential investment will drive growth in the first quarter
- Stronger than expected 1Q10 data and 4Q09 GDP prompted a revision to our baseline scenario
- Economic growth will slow in the second half of 2010

| **1Q10 GDP Releases** | |
|---|---|
| **Advance:** | **April 30** |
| Preliminary: | May 27 |
| Final: | June 25 |

## Consumer spending and inventories will drive economic growth

Friday's GDP results are expected to present sustained economic growth for the third consecutive quarter. We are forecasting a quarterly annualized growth rate of 3.5% in 1Q10. While the economy will expand at a slower rate than 4Q09's 5.6%, the results are expected to illustrate firming of private demand.

As in the fourth quarter, GDP growth will be driven by personal consumption and inventories. Consumption is expected to expand at an accelerating pace of 3.1% in 1Q10 and contribute two-thirds of overall economic growth. Preliminary BEA data indicate that non-durable goods and services will be the primary drivers, while durable goods may be a drag on the recovery due to the slow in auto sales experienced in January and February.

Inventories will also provide a significant boost to GDP growth as they are expected to increase for the first time since 1Q08. After significantly whittling down inventories to accommodate the steep decline in demand, businesses are now beginning to rebuild stock to meet demand growth.

Non-residential investment will also contribute to GDP growth by rising for the second consecutive month. The 6.0% increase in industrial production of high tech goods indicates that businesses continued to invest in equipment and software in 1Q10. Nevertheless, investment in structures declined as indicated by the average 3.5% drop in non-residential construction spending in the first two months of 2010.

Residential investment in 4Q09 benefitted from a boom in November before declining in the following months. As a result, even though construction spending grew in January and February, average residential investment for the quarter will fall below that of the previous quarter and subtract from GDP growth. Nevertheless, residential investment is expected to recover slowly throughout the year.

Lastly, while export growth has helped to boost economic growth by stimulating industrial production, net exports will subtract from GDP growth due to stronger growth in imports.

### Economic growth will reach 3.0% in 2010

First quarter GDP growth will be stronger than previously expected, primarily due to consumer demand, which is picking-up faster than anticipated. Our growth estimates for 1Q10, coupled with better than expected GDP growth in 4Q09, have led us to revise up our GDP forecast for 2010 to 3.0% from 1.9%. The main driver of the revision is softer household deleverage which supports higher consumer spending. Looking forward, even though the job market is improving, the unemployment rate will remain high, averaging 9.3%, in 2010. Therefore, personal consumption will expand at a stable pace. However, the impact of inventories will ease in 2H10 as businesses bring stocks closer in line with sales, while the pace of business investment will decelerate somewhat. As a result, growth will be stronger in the first half of the year than in the second half. Our outlook still assumes a high level of excess capacity and thus limited inflationary pressures, both of which will justify low interest rates for a prolonged period.

**Leading Indicators**
12-month % change

| | Mar | Feb | Jan | 4Q09 |
|---|---|---|---|---|
| PCE (real) | | 1.6 | 1.3 | 1.0 |
| Retail sales | 5.4 | 4.4 | 4.5 | 2.0 |
| Retail sales ex. autos & gasoline | 5.2 | 4.5 | 4.4 | 1.5 |
| Capital goods new orders* | | 8.4 | 8.7 | -6.4 |
| New orders, nonmanuf. ISM (index) | 52.1 | 55.0 | 54.7 | 53.3 |
| Housing starts | 0.2 | 7.3 | 24.8 | -13.3 |
| Residential construction | | -18.6 | -21.5 | -28.7 |
| Business inventories ($ bn) | | 6.1 | 2.3 | 1.7 |
| Manufacturing inventories ($ bn) | | 25.2 | 13.4 | 6.3 |
| Federal public spending | 7.3 | 16.8 | -14.4 | -0.4 |
| Goods exports (real) | | 12.1 | 14.2 | -1.5 |
| Goods imports (real) | | 10.7 | 2.4 | -6.7 |

* Nondefense excluding aircraft

**Gross Domestic Product**
Quarterly annualized rate, sa — forecasts in bold

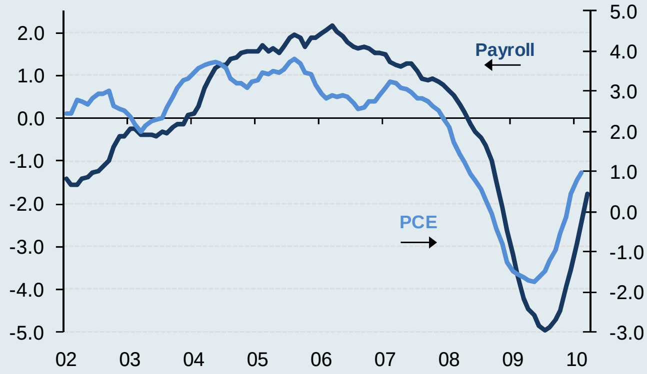
| | 1Q10 | 4Q09 | 3Q09 | 2Q09 | 1Q09 |
|---|---|---|---|---|---|
| GDP | **3.5** | 5.6 | 2.2 | -0.7 | -6.4 |
| Personal spending | **3.1** | 1.6 | 2.8 | -0.9 | 0.6 |
| Nonresidential investmen | **4.7** | 5.3 | -5.9 | -9.6 | -39.2 |
| Residential investment | **-3.1** | 3.7 | 18.9 | -23.2 | -38.2 |
| Inventories ($ bn) | **41.7** | -19.7 | -139 | -160.2 | -113.9 |
| Public spending | **-3.5** | -1.3 | 2.7 | 6.7 | -2.6 |
| Exports | **4.9** | 22.8 | 17.8 | -4.1 | -29.9 |
| Imports | **7.0** | 15.8 | 21.3 | -14.7 | -36.4 |

Source: BBVA ERD & BEA

# Trends

**Nonfarm Payroll & PCE**

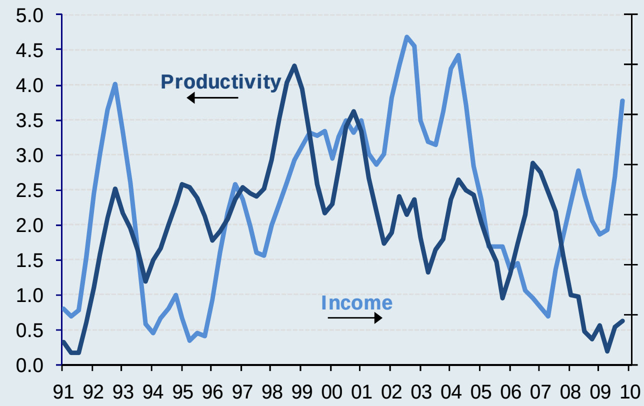
(Annual % Change & Real Annual % Change, 6MMA)




Source: BEA & BLS

**Nonfarm Productivity & Real Disposable Income**

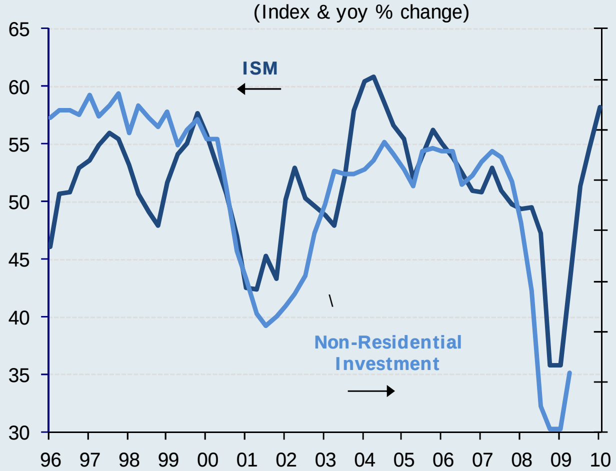
(Annual % Change, 4QMA)




Source: BEA & BLS

**ISM & Non-Residential Investment**

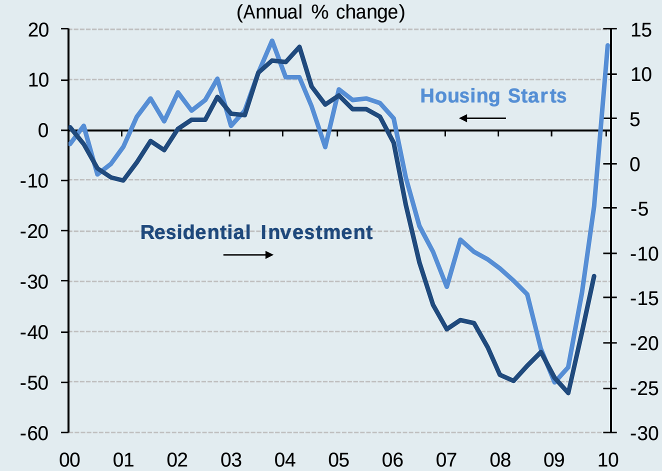
(Index & yoy % change)




Source: ISM & BEA

**Housing Starts & Residential Investment**

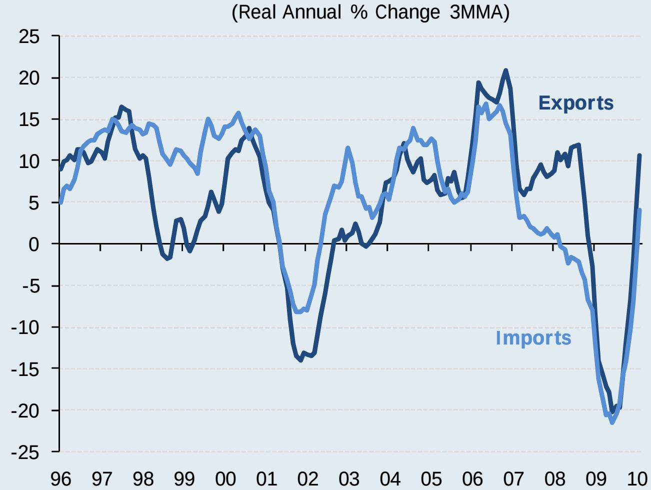
(Annual % change)




Source: BEA and US Census Bureau

**Merchandise Exports & Imports**

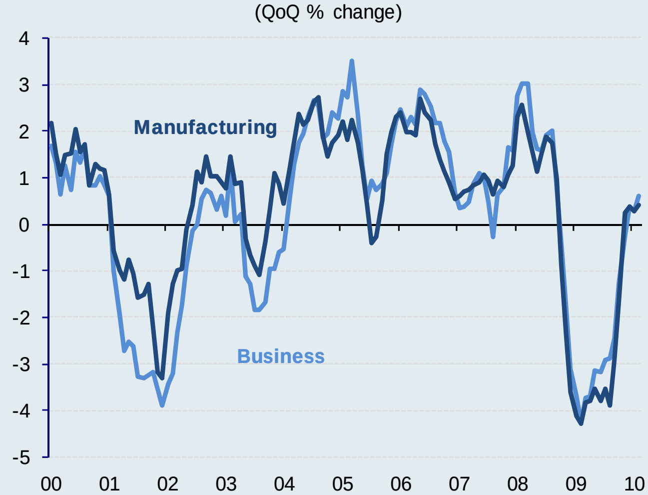
(Real Annual % Change 3MMA)




Source: U.S. Census Bureau

**Business & Manufacturing Inventories**

(QoQ % change)




Source: U.S. Census Bureau