A Slowing Economy; Another View

April 29, 2024

Last week, the Bureau of Economic Analysis announced that the Gross Domestic Product (GDP) for the first quarter of 2024 came in at a 1.6% annualized growth rate, surprising many economists who expected a higher number. One measure of inflation, the personal consumption expenditure (PCE) came in slightly above expectations at 3.6% suggesting that a slowing economy and rising inflation could produce stagflation, an environment where the economy goes nowhere and inflation stays high. The inflation number alone was enough to expect that the Federal Reserve would postpone interest rate cuts until later in 2024, if at all.

In drilling down on the individual components of the GDP report, a couple of data points stand out. First, the two strongest components were consumer spending on services up 1.5%, and consumer spending on goods, up 0.7% with a large contribution from online sales. The major detractor from growth was net exports, down 0.9%. If it were not for that negative plot, GDP would have been up 2.6% for the first quarter, well above expectations.

One might question the arbitrary decision to subtract net imports from the economic data since rising imports suggest stronger, not weaker, economic growth. If consumers are wise and choose to purchase lower-priced imports then the absence of that availability implies that inflation would be a lot higher than reported or consumers would not be spending as much. When our trade balance is in deficit, we import more goods and services than we export. In other words, we get to use these imports while the countries running a balance of trade surplus end up holding cash that is expected to be used at some future time, ultimately resulting in a trade balance. If the U.S. economy continues to grow at a higher rate than its trading partners then it is likely that the trade deficit will continue until our partners grow faster than we are growing.

When we look at economic growth as measured by the expanding consumer it is obvious why imports are rising. If the consumer overspends or runs up his credit card balances and is forced to slow down, the economy will slow down. In such an environment, imports are likely to fall leading to a smaller trade deficit that will contribute to stronger economic data. The faster the trade deficit falls, the faster the economy will grow statistically even though it is likely that the consumer is weaker.

After the weak GDP report last week, the stock market temporarily declined but by the end of the week, stocks were back in rally mode with the leaders remaining in the tech camp. Investors saw through the misleading traditional measure of GDP growth and realized that the economy continued in a respectable uptrend. From our perspective, a rising trade deficit in the U.S. is a better indicator of a strong economy than the sum of the parts in the quarterly GDP report.

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