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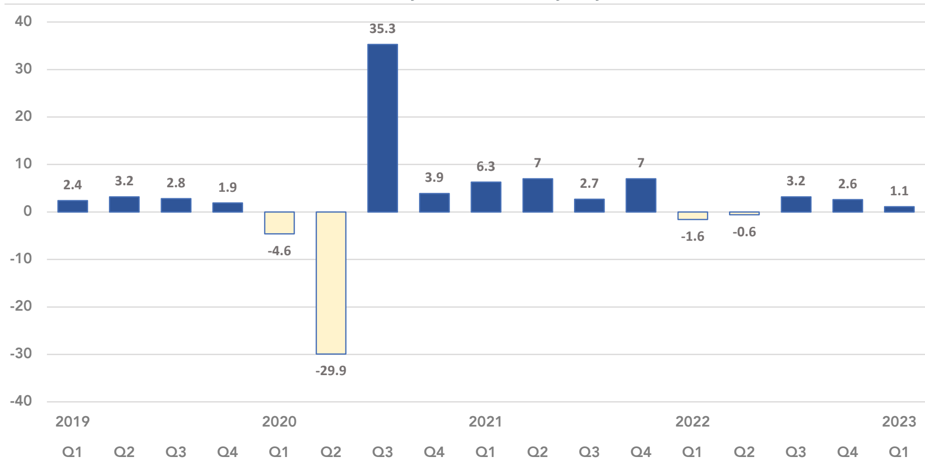
GDP GROWTH: TRENDING IN Q1 2023

The nation's gross domestic product slowed dramatically in the first quarter, reflecting reduced production of goods and services that rose at a seasonally adjusted 1.1% annual rate in the first three months of the year. Nevertheless, the Q1 data released by the Commerce Department shows that consumers still are spending despite higher prices driven by high inflation, which the Federal Reserve is trying to stifle by raising interest rates. Spending on travel, restaurants and other services continues to rebound. Purchases of goods also rose after four straight quarters of declines.

The first-quarter gain was down from 2.6% in the last three months of 2022 but it was the third straight quarter of growth after output declined in the first half of last year. Compared to the fourth quarter, the deceleration in real GDP in the first quarter primarily reflected a downturn in private inventory investment and a slowdown in nonresidential fixed investment.

In addition to increases in consumer spending, there were gains in exports, local, state and federal government spending and nonresidential fixed investment. These gains were partly offset by declines in private inventory investment and residential fixed investment. Imports, which are a subtraction in the calculation of GDP, increased.



There was robust Q1 consumer spending, which rose at an annual rate of 3.7 percent.

First-quarter consumer spending rose at an annual rate of 3.7%, the fastest growth since mid-2021, when the Covid-19 vaccine rollout lifted the economy. Consumers have been buoyed by a strong job market and rising wages, which have helped them weather the combination of rising prices and higher borrowing costs. Within exports, the increase in consumer goods was partly offset by a drop in services. Within federal government spending, the increase was led by nondefense costs. The increase in state and local government spending primarily reflected an increase in compensation of state and local government employees. Within nonresidential fixed investment, increases in structures and intellectual property products were partly offset by a decrease in equipment.

The decrease in private inventory investment was led by wholesale trade and manufacturing. Within residential fixed investment, the leading contributor to the decrease was new single-family construction. Current dollar GDP increased 5.1%, or $327.9 billion, in the first quarter, to $26.47 trillion. In the fourth quarter, GDP increased 6.6%, or $414.1 billion. Personal income increased $278.9 billion in Q1, compared with an increase of $398.8 billion in the fourth quarter. The increase in the first quarter primarily reflected increases in compensation and government social benefits.

Disposable personal income increased $571.2 billion, or 12.5%, in the first quarter, compared with an increase of $403.0 billion, or 8.9%, in the fourth quarter. The increase in the first quarter reflected an increase in personal income and a decrease in personal current taxes. Real disposable personal income increased 8% in the first quarter, compared with an increase of 5% in the fourth. Personal savings were $946.2 billion in the first quarter, compared with $758.8 billion in the fourth quarter. The personal saving rate – personal saving as a percentage of disposable personal income – was 4.8% in the first quarter, compared with 4% in the fourth.

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Q1 2023 ECONOMIC REPORTS

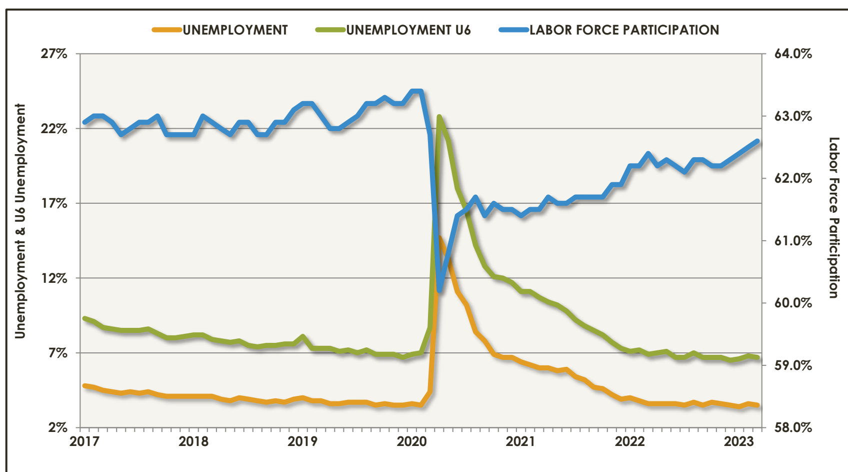
EMPLOYMENT: TRENDING IN Q1 2023

Although nonfarm U.S. employment gains totaled 236,000 in March and the 3.5% unemployment rate was little changed, job openings fell to their lowest level in nearly two years, a sign to some economists of an easing labor market.

A loosening of employment conditions would be welcomed by the Federal Reserve. The central bank has raised interest rates nine times in the past year to slow the economy and hiring in order to reduce the rate of inflation. The Federal Funds Rate has increased from near zero to a range of 4.75% to 5%. Inflation has fallen to 5% after peaking in June at 9.1%. There were 9.9 million job openings in March, a decline of 632,000 jobs from the month before, according to the Labor Department. Nevertheless, the job market remains tight with 1.7 positions for every unemployed person, down from 1.9 openings.

The largest decreases in openings were in professional and business services, down 278,000 jobs; health care and social assistance, down 150,000 jobs; and warehousing and utilities, down 145,000 jobs. Construction jobs were up 129,000 and there were 38,000 added positions in the arts, entertainment and recreation. Nevertheless, overall employment conditions remain stronger and more resilient than any time in the last 50 years. The number of unemployed persons, 5.8 million, changed little in March. Broadly, the employment metrics have shown little net movement since early 2022.

United States Unemployment



Nevertheless, employment conditions remain stronger and more resilient than any time in the last 50 years.

The most added jobs in March were in service-led industries. Employment continued to trend up in leisure and hospitality, government, professional and business services, and health care, according to the U.S. Bureau of Labor Statistics. Leisure and hospitality added 72,000 jobs in March, lower than the average monthly gain of 95,000 over the prior six months. Most of the job growth occurred in food services and drinking places, where employment rose by 50,000. Employment in leisure and hospitality is below its pre-pandemic February 2020 level by 368,000, or 2.2%.

Government employment increased by 47,000 in March, the same as the average monthly gain over the prior six months. Overall, employment in government is below its February 2020 level by 314,000, or 1.4%. Employment in professional and business services continued to trend up in March with 39,000 jobs, slightly more than the average monthly gain in the prior six months. Within the industry, employment in professional, scientific, and technical services continued its upward trend in March with 26,000 jobs.

Over the month, health care added 34,000 jobs, less than the average monthly gain of 54,000 over the prior six months. There were 15,000 jobs added in home health care services in March and 11,000 in hospitals. Employment continued trending up in nursing and residential care facilities by 8,000. Social assistance jobs were up 17,000 positions.

Among the major worker groups, the unemployment rate for Hispanics decreased to 4.6% in March, essentially offsetting an increase in the prior month. The unemployment rates for adult men were 3.4%; women 3.1%; teenagers, 9.8%; Whites, 3.2%; Blacks, 5%; Asians, 2.8%. All showed little or no change from the previous month.

MONETARY POLICY: TRENDING IN Q1 2023

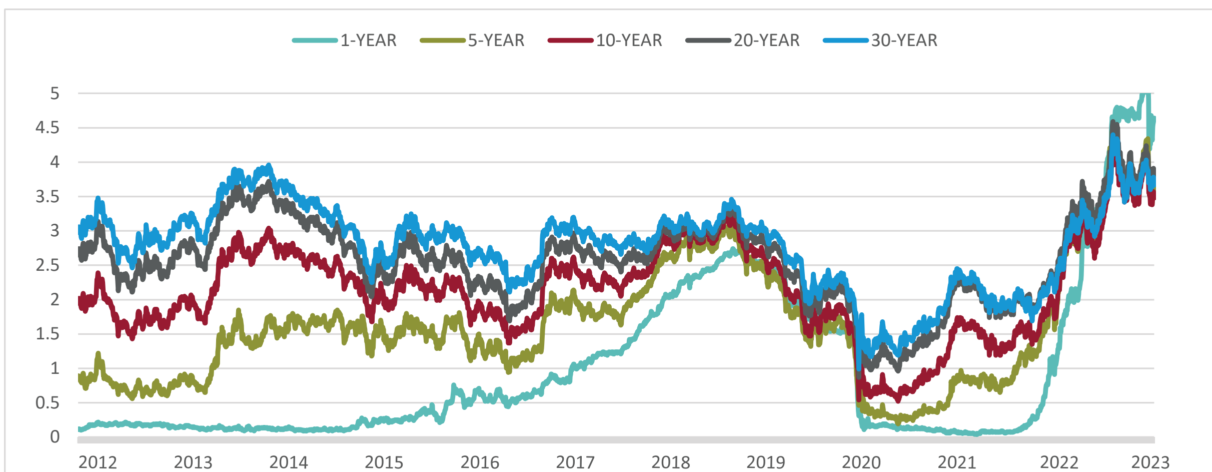
The Federal Reserve increased interest rates twice in the first quarter, bringing the benchmark borrowing rate to a new 4.75%-5% target range – the highest since the mid-2000s – as Fed Chairman Jerome Powell signaled that the need for more tightening was increasing.

To combat inflation, the Fed has been trying to slow investment, spending and hiring. The U.S. inflation rate is 4.98% compared to 6.04% in February and 8.54% a year ago.

In a meeting in March with reporters after the second rate hike this year, Powell remarked on the emergence of "serious difficulties at a small number of U.S. banks," without naming Silicon Valley Bank, Signature Bank and Silvergate Bank. History has shown that isolated banking problems, if left unaddressed, can undermine confidence in healthy banks and threaten the banking system, Powell said.

In response to these events, Powell said, the Federal Reserve, working with the Treasury Department and the FDIC, created the Bank Term Funding Program to ensure that banks that hold safe and liquid assets can borrow reserves against those assets at par. He said the new program along with the longstanding discount window is "effectively meeting the unusual funding needs that some banks have faced and makes clear that ample liquidity in the system is available."

Daily Treasury Yield Curve Rates (Decade Trend)



Turning to the broader economy and monetary policy, Powell said inflation remains too high, a view widely shared among the 12 members of the Federal Open Market Committee, which votes on monetary policy and interest rates. He said the Fed remains committed to bringing inflation back down to its 2% goal.

The Fed raised interest rates seven times in 2022 to their highest level in 15 years. Although it signaled late last year an expectation that inflation will ease in 2023 enough to begin slowing rate hikes, Fed insiders say recent banking sector stress has many voting members calling for tighter credit. Economists expect another quarter percent increase in May.

In subsequent remarks to financial industry professionals in Manhattan, New York Fed President John Williams, pointed to signs that both demand for labor and inflation were cooling and that he expected inflation to fall to around 3.5% this year. "Inflation is still too high, and we will use our monetary policy tools to restore price stability," said Williams, vice chair of the FOMC and Powell ally.

"The thing that makes this very difficult," he said, is that "we're in an economy that's very strong. So, the tightening that might happen in credit conditions – that's in the context of what is otherwise a very strong economy." Williams said stresses in the banking system would lead to tighter lending standards for households and businesses, which would in turn reduce consumer spending.

The Fed is balancing the risk of a sharper slowdown from any lending pullback with risks of stronger-than-anticipated growth because of better global economic activity, including in Europe and China, Williams said. "The uncertainty can go both ways. I've been surprised by the economic data. Inflation is still too high, and we will use our monetary policy tools to restore price stability," Williams said.

GLOBAL ECONOMY: TRENDING IN Q1 2023

It's been one year since central banks began raising interest rates in efforts to slam the brakes on inflation. Although pricing pressures have receded, risks to financial stability have increased along with pessimism that a soft landing can be achieved.

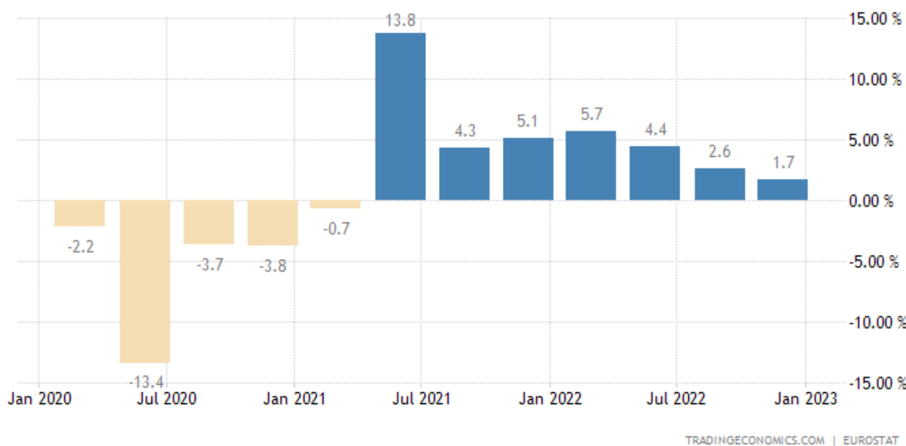
Declines in food and energy prices have been the key to the reduction in global inflation from 8.7% a year ago to 7%, estimated by the International Monetary Fund, even as labor markets remain tight in a number of economies.

High commodity prices that increased after Russia's invasion of Ukraine have moderated. The economies of China and other nations hit with widespread Covid outbreaks last year appear to be recovering, easing supply-chain disruptions.

But the recent exposure of banking sector vulnerabilities and fears of contagion even among non-bank financial institutions has emerged as a side effect of the steep rate hikes that is causing concern among central bankers.

The IMF's baseline forecast, which assumes that the recent financial sector stresses are contained, is for growth to fall from 3.4% in 2022 to 2.8% this year before rising slowly and settling at 3% in 2028.

European Union GDP Annual Growth Rate



Risks to the outlook are heavily skewed to the downside with the chances of a hard landing having risen sharply, says the IMF.

Advanced economies are expected to see an especially pronounced growth slowdown, from 2.7% in 2022 to 1.3% this year.

The weak outlook reflects the continuation of tight central banking policies widely believed necessary to bring inflation under control. Fallout from recent deterioration in financial conditions, Russia's war on Ukraine and growing geoeconomic fragmentation also weigh on the forecast.

The IMF said the epic failures of Silicon Valley Bank and Signature Bank in the United States and the loss of market confidence in Credit Suisse, a global systemically important bank in Europe, are powerful reminders of the challenges posed by interaction between tighter monetary and financial conditions and the buildup in vulnerabilities. What initially appeared to be isolated events in the U.S. banking sector was amplified globally by new technologies, the IMF said. The rapid spread of information through social media quickly spread to banks and financial markets across the world, causing a sell-off of risk assets. It also led to a significant repricing of monetary policy rate expectations, the IMF said.

Risks to the outlook are heavily skewed to the downside with the chances of a hard landing having risen sharply, says the IMF. Financial sector stress could worsen, and contagion could take hold, weakening the real economy through a sharp deterioration in financing conditions and compelling central banks to reconsider their policy paths.

Other risks include concern that pockets of sovereign debt distress could – in the context of higher borrowing costs and lower growth – spread and become more systemic. The war in Ukraine could intensify and lead to more food and energy price spikes, pushing up inflation. Core inflation could be more persistent than anticipated, requiring even more monetary tightening, the IMF said.

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