

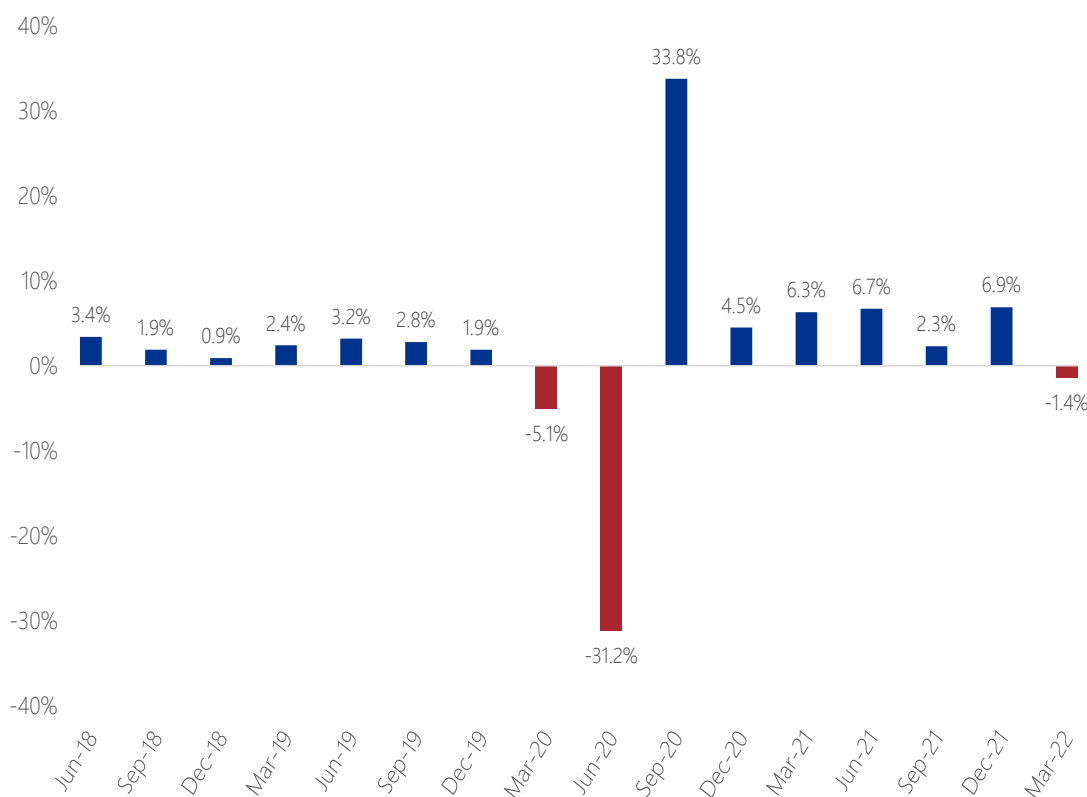
Markets Looks Past Negative GDP Headline

This morning's initial estimate of first quarter gross domestic product (GDP) showed the U.S. economy contracted by -1.4%, a sharp decline from the prior quarter's +6.9% advance. A headline like that might normally set off recession alarm bells and talk of rate cuts. However, today's negative GDP headline doesn't tell the full story. Wednesday morning's release of preliminary trade data for March showed the U.S. trade deficit widening significantly from \$106.3 billion in February to \$125.3 billion in March. In the weird world of GDP math, the trade deficit subtracts from GDP, so a larger deficit means a larger *reduction* in GDP. Yesterday's trade data gave investors ample warning that the GDP headline could be negative. In fact, today's release revealed that trade subtracted 3.2 percentage points from the headline. Combine that with softer growth in inventories, which subtracted a little more than 0.8 percentage points, and you have a couple of statistical oddities stripping 4 points away. Government spending was also negative, subtracting almost -0.5%.

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U.S. GDP - Quarterly Annualized Percent Change



The real story is in real final sales to domestic purchasers, a measure of underlying demand that ignores the impact of trade and inventories, which increased at an annualized +2.6% pace in Q1.

Source: US Census Bureau

The real story is in real final sales to domestic purchasers, a measure of underlying demand that ignores the impact of trade and inventories, which increased at an annualized +2.6% pace in Q1, an improvement from +1.7% in Q4. Consumers certainly did their part as personal consumption grew 2.7% during Q1, a bit more than Q4's +2.5%. This is the largest component of GDP and shows consumers have

thus far weathered the inflationary storm and continue to spend at a solid pace. However, much of that growth came early in the quarter and there are signs that spending is starting to soften as higher prices take their bite out of consumer wallets. Business investment also made a positive contribution, jumping +9.2% with a notable +15.3% increase in equipment and software purchases. This is likely a reaction to the lack of available labor as businesses try to fill the labor gap with more equipment.

The bottom line is that the positive underlying details of today's GDP report far outweigh the negative headline. Seasonal adjustments, supply chain issues, stimulus dollars, and Covid-19 have all contributed to volatile patterns in economic data over the last two years. GDP data is no exception and the true underlying pace of economic growth probably lies about halfway between Q4's overstated +6.9% and Q1's understated -1.4%, something closer to +2.75%.

Nothing here changes the outlook for the Fed, either. We continue to expect the Fed will announce a 50-basis point hike at the conclusion of next Wednesday's FOMC meeting. An announcement on balance sheet reduction is very likely as well. In addition to the Fed's FOMC meeting, next week brings a full slate of important economic data, including the ISM surveys, JOLTS, durable goods orders, auto sales, and the April employment report. Investors will have plenty to keep them busy.

Bond markets have had a wild week. After a deep selloff last Friday, bonds rallied early in the week as news out of China raised fears that the weeklong lockdown of Shanghai might be expanding to Beijing as covid cases surged. Those fears seem to have abated over the last two days and bonds have largely resumed their trend toward higher yields.

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Market Indications as of 9:24 A.M. Central Time

DOW	Up 124 to 33,426 (HIGH: 36,800)
NASDAQ	Up 95 to 12,584 (HIGH: 16,057)
S&P 500	Up 25 to 4,209 (HIGH: 4,797)
1-Yr T-bill	current yield 1.99%; opening yield 1.93%
2-Yr T-note	current yield 2.63%; opening yield 2.58%
3-Yr T-note	current yield 2.79%; opening yield 2.74%
5-Yr T-note	current yield 2.87%; opening yield 2.82%
10-Yr T-note	current yield 2.86%; opening yield 2.83%
30-Yr T-bond	current yield 2.94%; opening yield 2.92%

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