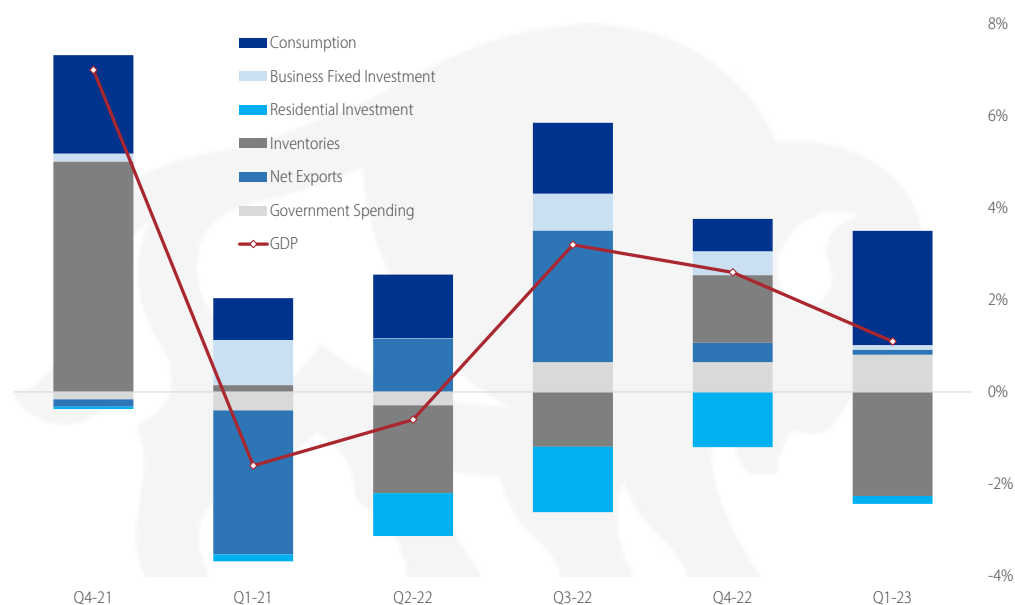


## Q1 GDP is Stronger than Headline Suggests

First quarter GDP growth *appeared* much weaker than forecasts had indicated, but the underlying details suggest continued resilience and support additional Fed tightening. The initial measure of real GDP for the first quarter rose +1.1%, well below the +1.9% median forecast and down from +2.6% growth in Q4. However, the breakdown told a different story.

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### Gross Domestic Product (Quarter-over-Quarter Annualized Percent Change)



Source: Bureau of Economic Analysis

The biggest driver of the U.S. economy, personal consumption, rose an annualized +3.7%, adding 2.5 percentage points to the overall number, *the most in nearly two years*. Although Q1 consumer spending was actually below the +4.0% forecast, it was a significant jump from the +1.0% increase in the final quarter of 2022. The Q1 spending breakdown was surprising as goods purchases grew at a +6.5% annual rate, while spending on services climbed +2.3%. Unseasonably warm January weather and solid auto sales drove the surge in goods.

The counterbalance to strong consumer spending during the quarter was a drop in inventory accumulation. Business inventories, which can be extremely volatile from quarter-to-quarter and extremely difficult to predict, shaved almost 2.3 percentage points from the headline number. This suggests that U.S. companies are bracing for softer sales in the coming months. Domestic final sales, *which exclude inventories*, grew by +3.2% in Q1 following a +0.7% advance in Q4 2022.

It's important to note that inventory weakness has a tendency to reverse itself within a quarter or two, especially when spending is solid. This points to a bump in Q2 GDP, which may keep growth positive in the spring months. In addition to the inventory

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drag, business investment in new equipment fell -7.3%, subtracting 0.4 from the headline. This also indicates fading business optimism.

Residential investment (housing) fell -4.2%, subtracting from GDP for the eighth straight quarter, but the drag on overall growth was less than two-tenths. Housing may have found a bottom.

There is a considerable amount to unpack in the initial measure of Q1 GDP. The quarterly numbers, which are inherently stale to begin with, are subject to revisions in the coming months, while the banking crisis that's now dominating headlines emerged too late in the quarter to have much of an impact. But, when the volatile inventory component is stripped away, economic growth does seem to be holding up much better than expected. . . . *It's not clear if this is good news or bad news.*

Also released this morning were two Q1 inflation reports, both of which were hotter than expected. The GDP price index, forecasted to fall, actually rose from an annual rate of +3.9% to +4.0%. At the same time, core PCE (a Fed favorite) rose from an annual pace of +4.4% to +4.9%.

The bond market has concluded in early trading that the Fed is now almost certain (90%) to hike the overnight target by another 25 bps next Wednesday. Yields are higher across the curve reflecting a reduced likelihood of rate cuts before year end.

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## Market Indications as of 9:56 A.M. Central Time

DOW	Up 167 to 33,468 (HIGH: 36,800)
NASDAQ	Up 153 to 12,007 (HIGH: 16,057)
S&P 500	Up 40 to 4,096 (HIGH: 4,797)
1-Yr T-bill	current yield 4.76%; opening yield 4.62%
2-Yr T-note	current yield 4.05%; opening yield 3.94%
3-Yr T-note	current yield 3.78%; opening yield 3.68%
5-Yr T-note	current yield 3.56%; opening yield 3.49%
10-Yr T-note	current yield 3.51%; opening yield 3.44%
30-Yr T-bond	current yield 3.76%; opening yield 3.70%

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