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That Was the Quarter That Was(n't)

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Cut through all the statistical noise, and first quarter growth looks nothing like the advertised boom.

Ordinarily, we tend not to dwell much on official government-produced statistical compilations of economic performance such as GDP. Aside from the methodological distortions inherent to such massive data aggregates, the timeliness of the unavoidably backward-looking releases is always suspect. At this point, two-thirds of the way through the second quarter, rehashing the fine points of numbers dating to the first three months of the year could rightfully be considered beside the point. And yet Friday's release of initial revisions to first quarter GDP, with its headline number showing growth at a 5.6% annual rate, was an instructive exercise. While the *Associated Press* on Friday termed the first quarter results "remarkable," perhaps the most remarkable thing about the quarter was that so much excitement could be generated over what was, in reality, an exhibition of very little fundamental economic strength.

Consider, first, that while growth was reduced by 0.2% from last month's "advance" estimate, a swing in inventories made an even larger contribution to growth than first calculated. Of the 5.6% in reported growth, fully 3.47% was accounted for by the "change in private inventories," up from an initially estimated 3.1%. Despite widespread reports to the contrary, this increase was not attributable in any way to inventory *rebuilding*, which would reflect increased production to replenish depleted stockpiles. Even the *Washington Post*'s veteran economics correspondent, the venerable **John Berry**, got this wrong, writing that the "swing in inventory investment gave an even larger impetus to production than reported earlier…." The inventory contribution was entirely explained by the bookkeeping convention under which a slower pace of inventory *liquidation* in the first quarter ($25.7 billion vs. $119.3 in last year's fourth quarter) counts as "growth." Increased production had nothing to do with it.

With more of overall first quarter growth attributable to inventories, that also meant less was due to final sales. In fact, the 2% growth of real final sales (down from 2.6% in the advance estimate) actually was considerably weaker than the 3.8% increase in the fourth quarter last year. There were other indications in the data suggesting that the first quarter was in some ways actually slower than last year's fourth quarter, which had a reported growth rate of 1.7%. Personal consumption expenditures, for example, fell from 6.1% to 3.2%. In any case, the largest component of growth in final sales -- nearly 60% -- was accounted for by increased government spending. Break it all down and despite the reported GDP growth rate of 5.6%, real private economic activity in the quarter expanded at a rate of less than 1%!

As suggested above, the first quarter data tell us nothing of any real significance about the economy's current status. Last week we noted early indications that relief from deflationary impulses appeared to be having some positive influence on the market's risk aversion. It turns out that last week was the year's most active yet for launching new IPOs, an indication that growth expectations could be turning higher. Still, it’s probably worth bearing in mind that even if expansionary forces take appreciably deeper root *this* quarter, the reported growth rate is unlikely to come close to matching that of the first quarter. TM

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