4th floor
Ropemaker Place
25 Ropemaker Street
London
EC2Y 9LY
United Kingdom

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Markit Economic Research

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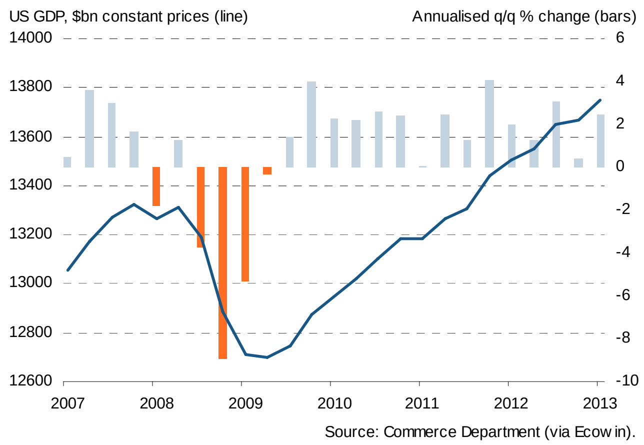
United States

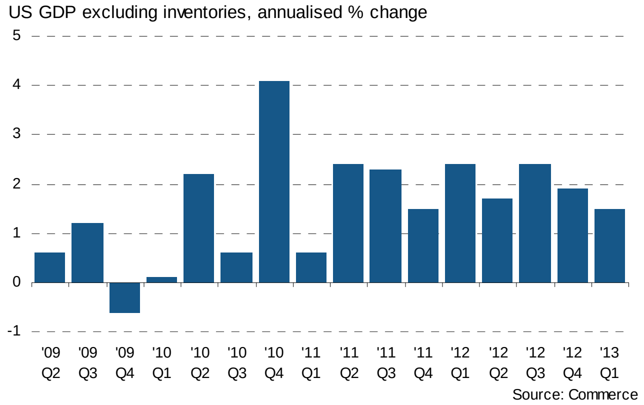
No end to Fed stimulus in sight as economic growth fails to impress in Q1

- **GDP growth accelerates to 2.5% but growth of final sales weakens to 1.5%**
- **Consumer spending rises sharply, though fuelled by a fall in the savings rate**
- **GDP disappointment follows signs that growth could weaken again in Q2**

US GDP



Final sales



The US economy expanded at a slower-than-expected rate in the first quarter. Gross domestic product (GDP) rose at an annualised rate of 2.5%, up sharply from the end of last year, but economists were hoping to see growth of at least 3.0%. Moreover, even this weaker-than-hoped growth rate exaggerates the true underlying momentum in the economy, as growth of final demand slowed compared with the fourth quarter.

The disappointment will push back expectations of when the Fed will start to withdraw its stimulus, especially as recent data suggest that the rate of growth could weaken again in the second quarter.

The increase was driven by personal spending, inventories, exports and both residential and non-residential fixed investment. A fall in government spending acted as a drag on the economy, according to the Commerce Department.

The upturn represents a substantial improvement on the near-stagnation seen in the fourth quarter, when an inventory drag and a steep fall in defence spending caused annualised growth to weaken to just 0.4%, its lowest for almost two years (equivalent to a 0.1% quarter-on-quarter increase). But, just as the weakness of the headline number in the fourth quarter understated the true health of the economy, the upturn in the first quarter exaggerates the pace of recovery. Excluding inventories, growth was just 1.5% compared with 1.9% in the fourth quarter.

Spring swoon

The concern is that growth could weaken again in the second quarter as the economy once again sees a 'spring swoon'. Markit's flash Manufacturing PMI fell sharply in April, signalling the weakest pace of expansion since last October. The disappointing PMI suggests that the boost to the economy received in the first quarter from the 1.3% increase in manufacturing output may not be repeated in the second quarter. Official data have already pointed to a weakening of the manufacturing sector in March.

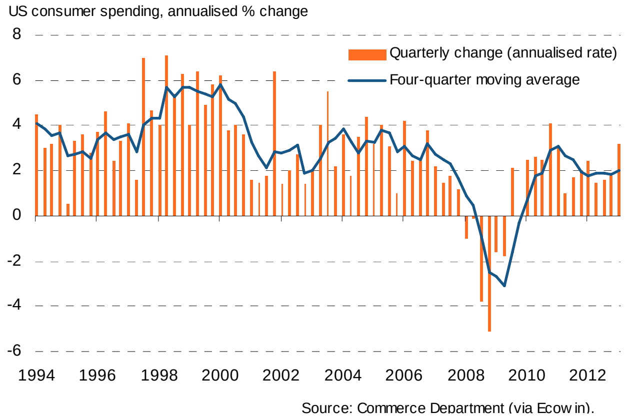
The main problem facing the manufacturing sector in the second quarter is slower export sales, after flash PMI surveys indicated a general darkening of the global economic climate in April. This points to a waning of the growth impetus received from foreign demand: exports increased at a rate of 2.9% in the first three months of the year, reversing a 2.8% fall in the fourth quarter.

Consumer sector boost set to wane?

At the same time as foreign demand is creating a renewed headwind for the economy, the domestic consumer sector is showing signs of struggling in the face of higher taxes and government spending cuts. Retail sales fell 0.4% in March, and a further decline could be on the cards for April after consumer confidence was reported to have fallen to its lowest since last July on policy and job market worries. Non-farm payrolls rose by a sluggish 88,000 in March, its smallest monthly rise since June of last year.

While consumer spending growth accelerated from 1.8% in the fourth quarter to 3.2% in the first quarter – its strongest rise since the end of 2010 – there is therefore a strong likelihood that this pace will soften again in the second quarter. The fact that households had to dip into their savings to the greatest extent since late-2007 adds to the perception that spending growth will not be sustained at the rate seen in the first quarter.

Consumer spending growth



Chris Williamson

Chief Economist

Markit

Tel: +44 207 260 2329

Email: chris.williamson@markit.com

For further information, please visit www.markit.com