

Special Commentary — April 27, 2022

# Heads Up: Negative Print for Q1 GDP Growth?

## Summary

- We are not formally changing our projection of a 0.6% annualized GDP growth rate in the first quarter, but the risks to that estimate appear to be skewed to the downside when the BEA reports data tomorrow.
- The U.S. international trade deficit in goods widened more than expected in March amid a surge in imports. The data suggest that net exports will exert a larger drag on Q1 GDP growth than the already sizable 2.0 percentage points we have penciled in for the quarter.
- Some of the surge in imports—we estimate real goods imports jumped about 9% in March—may have ended up in inventories, which would partially offset the drag from net exports.
- Regardless, we wouldn't be surprised if the advance estimate of Q1 GDP growth is slightly negative. That said, the headline growth rate will be misleading as it will likely mask reasonably solid consumer and business demand.
- A negative growth rate in the first quarter also does not indicate recession. Instead, the official arbiter of recessions—the Business Cycle Dating Committee at the NBER—looks at a number of monthly indicators in determining business cycle peaks, such as nonfarm payrolls, which have continued to grow at a solid pace.
- Although the economy does not appear on the cusp of another downturn, the probability of a recession next year is not insignificant.

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Table 1

	Wells Fargo U.S. Economic Forecast															
	Actual				Forecast								Actual		Forecast	
	2021				2022				2023				2020	2021	2022	2023
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product <sup>1</sup>	6.3	6.7	2.3	6.9	0.6	1.2	2.3	2.2	2.4	2.3	1.8	1.5	-3.4	5.7	2.8	2.1
Personal Consumption	11.4	12.0	2.0	2.5	3.0	0.1	1.9	1.7	1.8	1.8	1.7	1.5	-3.8	7.9	2.5	1.6
Business Fixed Investment	12.9	9.2	1.7	2.9	7.8	5.0	4.7	4.5	4.4	3.9	3.5	3.2	-5.3	7.4	5.1	4.2
Equipment	14.1	12.1	-2.3	2.8	6.0	4.5	4.0	4.0	4.0	3.1	2.2	1.7	-8.3	13.1	4.0	3.5
Intellectual Property Products	15.6	12.5	9.1	8.9	12.0	5.6	5.0	4.9	4.9	4.8	4.8	4.8	2.8	10.0	8.5	4.9
Structures	5.4	-3.0	-4.1	-8.3	2.5	4.8	5.9	5.1	4.6	4.1	3.8	3.4	-12.5	-8.0	0.2	4.6
Residential Investment	13.3	-11.7	-7.7	2.2	2.0	4.0	4.5	4.5	3.0	2.8	2.3	2.0	6.8	9.2	0.7	3.3
Government Purchases	-4.2	-2.0	0.9	-2.6	0.0	2.6	2.4	2.1	2.0	1.7	1.6	1.3	2.5	0.5	0.4	2.0
Net Exports <sup>2</sup>	-1.6	-0.2	-1.3	-0.2	-2.0	0.0	-0.3	-0.5	-0.2	-0.1	0.0	0.0	-0.2	-1.9	-0.9	-0.2
Inventories <sup>2</sup>	-2.6	-1.3	2.2	5.3	-0.6	-0.2	0.0	0.3	0.2	0.1	-0.2	-0.3	-0.6	0.1	1.0	0.1

Forecast as of: April 07, 2022

<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter <sup>2</sup> Percentage Point Contribution to GDP

Source: U.S. Department of Commerce and Wells Fargo Economics

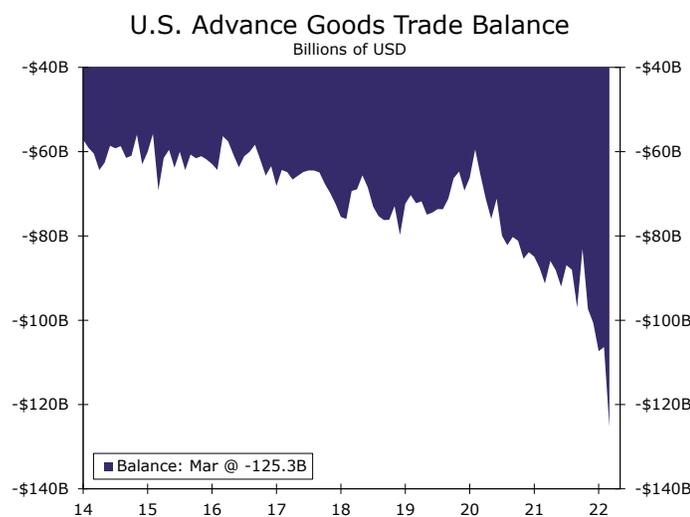
## Net Exports Appear To Have Exerted a Significant Drag on Q1 GDP Growth

Preliminary data from this morning showed that the United States incurred a \$125.3 billion deficit in international trade in goods in March, which represents a significant widening from the \$106.3 billion worth of red ink that was incurred in February (Figure 1). We had already anticipated that net exports would exert a drag of 2.0 percentage points on headline GDP growth in the first quarter. But the significant widening in the trade deficit in March means that real net exports likely sliced off more than 2.0 percentage points from top-line GDP growth. Some of the surge in imports in March—we estimate that real imports of goods jumped about 9% in March relative to February—may have ended up in inventories. If so, then inventories may not exert the 0.6 percentage point drag on real GDP growth we currently expect (Figure 2).

We are not formally changing our projection of 0.6% annualized GDP growth rate in Q1-2022 (Table 1), but the risks to that estimate appear to be skewed to the downside. In short, we would not be surprised if the advance estimate of Q1 GDP growth, which the Bureau of Economic Analysis (BEA) is scheduled to release on Thursday morning April 28, turns out to be slightly negative.

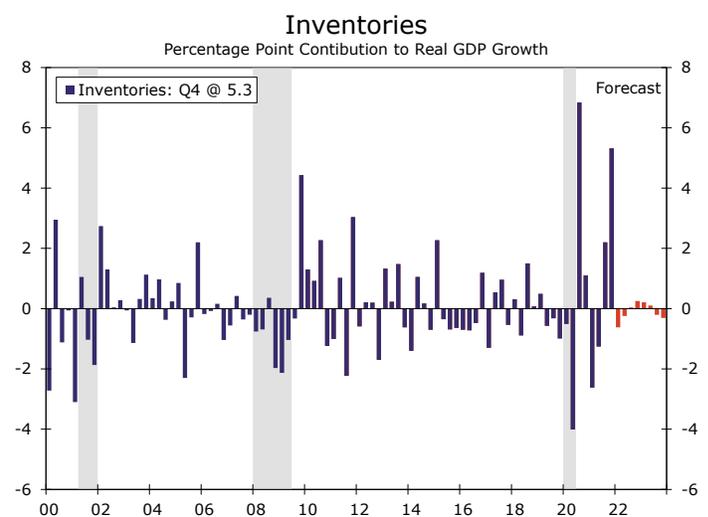
**Don't be surprised if real GDP growth in Q1 turns out to be negative.**

Figure 1



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 2



Source: U.S. Department of Commerce and Wells Fargo Economics

## Is the Economy in Recession?

If the BEA reports tomorrow that GDP growth was indeed negative in the first quarter, does this mean that the U.S. economy has slipped into recession? No. For starters, recessions are not defined as two consecutive negative quarters of real GDP growth as many often assume. Rather, the Business Cycle Dating Committee at the National Bureau of Economic Research (NBER) is the official arbiter of U.S. recessions. The committee looks at a number of monthly indicators when it makes its determination of business cycle peaks and troughs, and one of these indicators is nonfarm payrolls. In that regard, payrolls grew at an average pace of 562K per month in the first quarter. Industrial production, which is another important monthly indicator that the committee considers, grew at a robust annualized rate of 8.1% in Q1 on a sequential basis. In our view, the probability that the NBER's Business Cycle Dating Committee eventually declares that a recession started in Q1-2022 is very low.

Furthermore, a negative print in GDP growth in the first quarter, should it actually happen, would likely be due to two volatile components in the national income and product accounts: net exports and inventories. The underlying growth momentum in the economy appears to have remained reasonably solid in the first quarter. We estimate that real personal consumption expenditures (PCE), which account for roughly two-thirds of total spending in the economy, grew at an annualized pace of about 3% in Q1. We project that business fixed investment spending (BFI) rose nearly 8% in the first quarter.

**Even if GDP growth is negative, the underlying growth momentum in the economy appears to have remained reasonably solid in Q1.**

Although the U.S. economy does not appear to be on the cusp of another downturn, the probability of recession next year is not insignificant, in our view. As we discussed in more detail in a recent report, we would estimate that the probability of recession by the end of 2023 is roughly 30% or so. To put that probability into context, consider that the U.S. economy has been in recession about 13% of the time

since 1960. The recent surge in inflation is the underlying cause of our elevated estimate of recession probability. The jump in consumer prices has eroded real disposable income (*i.e.*, “purchasing power”) in recent months. Indeed, real disposable income has declined for seven consecutive months. Consumers have been able to maintain positive rates of real spending by reducing their savings rates. But if inflation continues to erode purchasing power, then consumers may eventually decide to retrench.

Furthermore, the jump in inflation has caused the Federal Reserve to turn hawkish. As we wrote in a recent [report](#), we look for the Federal Open Market Committee (FOMC) to raise its target range for the fed funds rate by 50 bps at its meeting on May 4. We also expect that the FOMC will hike by another 50 bps at its meeting in June and by an additional 100 bps by the end of the year. We also expect the Fed to start shrinking its balance sheet, which will act as a form of additional monetary tightening. The combination of declining real disposable income and monetary tightening could potentially cause the economy to lose enough momentum that it slips into recession in 2023. Stay tuned.

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