Weak spending by businesses hinders 2nd-quarter growth

By Nelson D. Schwartz
July 29, 2016 – *The New York Times*

The American economy barely rebounded last quarter from its winter doldrums, weighed down by anemic business spending, overstocked shelves at factories and warehouses, and a surprisingly weak housing sector.

Consumer spending remained healthy but it was swamped by the poor showing in other sectors of the economy.

Besides the drop in corporate investment, weaker government spending also held back growth, reinforcing a trend that has hobbled the recovery in recent years. The number was well below the 2 percent pace of expansion that economists had been looking for, highlighting the economy's continued ability to disappoint experts who have been confident that better times are around the corner.

Over all, the economy expanded at an annualized rate of 1.2 percent in the second quarter, the Commerce Department reported Friday morning, just slightly better than the 0.8 percent pace recorded in the first quarter. The major drags were plunging business spending and excess inventories.

The low number came despite resilient consumer behavior in the spring, as household spending rose at an annualized rate of 4.2 percent.

"The consumer is doing all the heavy lifting," said Nariman Behravesh, chief economist at IHS Markit. "Aside from technology and software, business spending was bad and housing was also surprisingly weak, which is payback for gains in recent quarters."

One potential bright spot is that the big overhang from inventories — groaning shelves at warehouses that need to be worked off — will dissipate in coming quarters, Mr. Behravesh said.

In addition, Mr. Behravesh said, wages are finally beginning to inch higher for many workers after years of stagnation. Gas prices also remain low, despite a recent uptick.

However, he said, "the other 30 percent of the economy like trade, capital spending and inventories are struggling, especially in the manufacturing sector."

While grappling with weak demand from overseas customers in Asia and Europe, many factories and mills have also been hit by the plunge in energy prices.

Blast furnaces and steel plants in the rust belt of the Midwest might be thousands of miles from oil fields in Texas and North Dakota, but they have been idled as demand for items like pipes and drill bits has collapsed. That has caused pain in many blue-collar communities in states like Illinois, Indiana, Pennsylvania and Ohio.

It has also contributed to vastly differing perceptions of the economy, with workers in the West finding themselves priced out of neighborhoods in booming San Francisco and Seattle, while families in less prosperous parts of the country say they feel like the recession never really ended.

On the other hand, low gas prices have delivered a windfall for shoppers everywhere, whether they are returning to the mall or spending online.

Domestically focused service industries like software, health care and financial services are also doing well, lifting incomes among white-collar workers.

A strong real estate market in many parts of the country and the run-up on Wall Street are providing additional encouragement to more affluent consumers to open their wallets.

This week, the Federal Reserve acknowledged improving economic conditions in the United States after a two-day meeting of policy makers, although the central bank held off any increase in interest rates.

Despite resilient consumers, the Fed is much more focused on hiring and wages, said Michael Gapen, chief United States economist at Barclays.

If employers continue to add workers at a healthy pace in July and August, he said, the Fed could move to raise rates as soon as September. “It’s all about the labor market,” he said.

For the remainder of 2016, Mr. Behravesh of IHS Markit is looking for an annualized growth rate of 2.5 percent. While the strong household spending evident in the second quarter should moderate a bit, he expects the drag from tepid businesses spending and the overhang from ample inventories to also ease.