U.S. economy grew by 2.3% in first quarter, easing slightly

By Patricia Cohen
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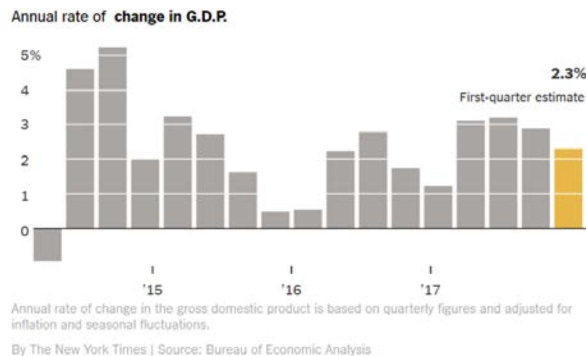
The economy grew at an annual rate of 2.3 percent in the first quarter, the government reported Friday, offering a preliminary glance at how last year's sweeping package of tax cuts is affecting consumers and businesses this year.



During the first three months of 2018, the economy was whacked around like a pinball. The stock market took investors on a giddy up-and-down ride. President Trump imposed tariffs on allies and rivals alike, stoking fears of a trade war. And the revamped tax code shifted business incentives and started to put more money in workers' paychecks.

Still, the economy ended up puttering along just a bit above the average yearly growth rate that it had registered since the recession ended nearly nine years ago.

While the pace is equal to the performance for all of last year, it is below the 2.9 percent annualized rate recorded in the fourth quarter of 2017, and short of President Trump's goal of at least 3 percent. Most forecasters, however, expect quarterly growth to float around the 3 percent mark for the rest of the year.

"This is not too bad," said Carl R. Tannenbaum, chief economist of Northern Trust in Chicago. "The 2.3 percent figure is moderately encouraging." Economists had expected economic growth to ease in the quarter.

"The rest of 2018 seems well assured given the substantial support that is going to come from government fiscal policy," Mr. Tannenbaum said, referring to the $1.5 trillion cost of the tax cuts.

He noted, however, that "longer term, the immediate benefits of tax reform will fade, and what we'll be left with is the bill."

Economists on Wall Street and in Washington have repeatedly warned that the economy's upward streak is unlikely to extend beyond the next year or two. The nation's debt has topped $21 trillion and is growing, a level many view as unsustainable. And if the Federal Reserve follows through on its plan to raise interest rates, the cost of paying off that debt will grow larger.

In the longer run, the Fed expects real annual growth in the United States to fall to 1.8 percent. The Congressional Budget Office's 10-year outlook comes to the same disappointing conclusion.

The winter's tale

Expectations about the first-quarter figure had fluctuated as pieces of the puzzle emerged. Imports fell and exports rose more than expected, narrowing the merchandise trade deficit for the first time in six months. Orders of durable goods remained sluggish, but revived somewhat as commercial aircraft orders surged in March. And although consumers continued to express a lot of confidence, they pulled back on their spending.

Holiday shopping in the final quarter of 2017 had revved up consumer spending — which accounts for more than two-thirds of the nation's economic activity — to 4 percent. Businesses responded by replenishing depleted inventories. But the shopping surge receded

when the new year started; consumer spending grew only 1.1 percent in the first quarter.

Although the tax overhaul promised to increase take-home pay, its effects may have been blunted for several reasons, including the time it took for the Internal Revenue Service to produce updated withholding tables and for payroll managers to adjust their systems. A poll of registered voters done in April and released this week by Politico/Morning Consult found that only about a fifth of those surveyed were noticing more money in their paychecks.

“I think the fact that we didn’t see a big spurt in spending after the tax cut suggests it’s either too early in the game or consumers are going to continue to be a bit cautious,” said Kathy Bostjancic, chief United States financial economist at Oxford Economics. Nonetheless, she added, “I think there is a legitimate question as to how much of the tax cuts get saved to pull down debt, and how much actually gets spent.”

As for business spending, many of the tax incentives were aimed not at immediate investment decisions, but at those in the medium term. “It does take time for that to filter through,” Ms. Bostjancic said. Some businesses may have also sped up their timetables for purchases at the end of 2017 in order to take advantage of bigger deductions before the tax changes went into effect.

For several years, first-quarter growth rates have been weaker than the longer-term trends indicated, only to rebound in later months. This year, the result could reflect a falloff in spending after an unusual surge that followed the havoc wrought by late-summer hurricanes. Severe winter weather could have also slowed consumption. But some analysts wonder if data adjustments are part of the problem.

Government economists try to account for seasonal changes, but the corrective measures may be only partially successful. “There’s a little weakness in Q1 and then the other quarters are artificially inflated because of that,” Ms. Bostjancic said.

Looking ahead

In any case, the gross domestic product estimate released Friday by the Commerce Department is not the final word on the first quarter. The estimate will be revised twice in the next couple of months. In the past, the final number has higher or lower by as much as a percentage point.

This G.D.P. report, though, is the latest that the Federal Reserve will have when its policymakers meet next week. At last month’s meeting, Fed officials raised interest rates and affirmed that they expected two more increases this year. Their concern is that a tight labor market will push up inflation as employers increase wages to compete for workers.

The number of workers applying for jobless benefits last week fell to its lowest level in nearly 50 years. Salary and benefit costs to employers also increased, according to new figures released Friday.

For most Americans, who have seen little income growth in recent decades, though, fears of steeper inflation seem overblown. That is why some economists warn against raising rates too much and too fast, arguing that the increases will choke off the recovery.

At the conclusion of the March meeting, Jerome H. Powell, the new Fed chairman, said: “We’re trying to take that middle ground.”

Michael Pearce, a senior economist at Capital Economics, said he did not expect the Fed’s outlook to change much, regardless of Friday’s report.

“The Fed already acknowledged some of the incoming data and that they think it could strengthen this year,” he said. Last month, the central bank announced that it had raised its median estimate for annual growth this year to 2.7 percent, from 2.5 percent.