Written by **Bob Adelmann** on May 29, 2015

U.S. Economy Goes Negative in the First Quarter

The Commerce Department reported on Friday that the U.S. economy shrank at an annual rate of 0.7 percent, a sharp downward revision from its previous tepid estimate that it would grow by 0.2 percent.

It caught most mainstream economists off guard once again, with many predicting positive growth right up until Friday, and more remaining doggedly optimistic that growth will return. Economists polled by the *Wall Street Journal* just 10 days ago were holding to a 3-percent growth rate in the economy for 2015, while analysts polled by the AP just prior to the release on Friday were still predicting growth of between 2 and 2.5 percent for the year.

Paul Ashworth, chief U.S. economist at Capital Economics, is waiting for evidence that growth will return in the second quarter: "While the evidence of a second-quarter rebound hasn't been overwhelming, we still think that the outlook for the economy is very encouraging," he asserted.

After all, the cold winter weather is history, as is the West Coast port dispute. Gas prices are still lower than a year ago, and those savings will have to show up sooner or later in increased consumer spending. And it's almost summer, when families are beginning to plan their vacations, which will boost the economy. Inventory builds, which were weak in the first quarter, will increase in the second and third quarters as those consumers come into the market. And, of course, there's the housing market, continuing its seemingly inevitable ascent.

Reality reveals a vastly different picture — one that Ashworth and his peers are missing. Just because the economy rebounded in 2014 from a negative first quarter doesn't mean there's some eternal law that says it must happen again this year. Consumers aren't spending for at least two reasons: There aren't as many of them, and they're paying down debt instead of increasing it. Manufacturers aren't building inventory because they can see further than can the economists: Sales demand is slack for the foreseeable future. The housing market is being goosed by low- and no-down payment loans. And capital expenditures in the energy business have leveled off as developers are waiting to see where the prices of oil and natural gas will settle.

There's the GDPNow report from the Atlanta Fed, which just came out on Tuesday, estimating growth in the second quarter to be barely positive, at 0.8 percent. There's the plunge in U.S. containerized ocean export activity that has dropped 28 percent from a year ago and to half of what it was in 2012.

There's the Baltic Dry Index, which indirectly measures economic activity through shipping rates charged for carrying dry goods by sea: such essential economic basics as coal, iron ore, and grain. It is down 25 percent year-to-date, and down almost 40 percent year-over-year.

To blame the stronger dollar misses the point. These indexes have been falling, especially containerized activity, ever since the end of the financial crisis in March 2011.

If the economy ran on predictions by economists, everything should be just swell by the end of the year. The AP opined that business restocking should “be a positive for the second quarter growth, since it means businesses will not have as big a backlog of unsold goods.” Consequently, “economists see little cause for concern with the first quarter drop. They are forecasting solid GDP growth [for] the rest of the year, with steady job gains propelling the economy. The harsh winter is gone. So is a labor dispute that slowed trade at West Coast ports. Home sales and construction are rebounding. Business is picking up.”

The reality is that unemployment is dropping not so much due to new job creation but from discouraged unemployed workers leaving the job market. And those much-touted wage raises, either voluntary (i.e., Walmart) or mandatory (i.e., minimum wage laws), aren’t keeping up with inflation, which is coming in, according to the Cleveland Fed, at a persistent 2.2 percent a year.

But not to worry. Naroff Economic Advisors chief economist Joe Naroff, who was quoted by the AP, remains doggedly optimistic: “Eventually consumers will start spending those [gas] savings” and improved employment, according to the AP, “will continue to put money in more people’s hands and fuel spending gains.”

Informed observers will instead focus on GDPNow, the “nowcasting” tool offered by the Atlanta Fed, the Baltic Dry Index (BDI), and the containerized freight index. If it’s being built, it will need to be shipped. If it’s not being built, it won’t be. Eventually mainstream economists will catch up with that reality.

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