First Trust

Morning Outlook

Recession Alert?

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Is the US already in recession? Probably not. But in the first quarter, real GDP is very likely to have a minus sign in front of it. Yes, a negative reading for real growth!

Even before Friday there were some troubling signs. Retail sales fell 0.9% in January while housing starts dropped 9.8%. The personal saving rate hit a new post-COVID low in the fourth quarter, existing home sales declined 4.9% for the month and, with pending home sales (contracts on existing homes) down, February will likely be weak as well. Meanwhile, manufacturing production slipped in January as did shipments of capital goods excluding aircraft and national defense.

In addition, in what could be an early sign of layoffs in the private sector from DOGE-related government spending cuts in Washington, initial claims for unemployment insurance jumped to 242,000, up noticeably from the 213,000 in the same week the year before.

But the real reason for a drop in real GDP was reported last Friday. The advance report on international trade in January reported a massive surge in imports for the month, led by industrial supplies. This is important because the primary way the government counts GDP is to add up all the things we're buying – whether by consumers, businesses, or the government – and then to subtract out imports. Gross Domestic "Product" is a measure of how much the US is producing, so imports don't count. For example, if we buy 100 mousetraps total but we imported 20 of them, then we only made 80 mousetraps in the USA.

Plugging the surge in imports into our models suggests negative growth for Q1, which was confirmed by the Atlanta Fed's GDP Now, which is tracking -2.8% growth in Q1.

But just because we expect a negative reading in Q1 doesn't mean a recession is here. The data are volatile for many reasons. For example, unusually cold winter weather plus California fires probably held down retail sales and homebuilding.

And it seems clear that the surge in imports in January reflects many importers front-running proposed tariffs by the Trump Administration – they're bringing the goods in early to avoid higher tariffs later – which means the import surge should reverse sometime in the next few months. If so, the drop in Real GDP in the first quarter could be followed by a temporary surge in Real GDP growth in the second quarter.

But that still leaves the effects of what is likely to be a consistent effort by the Trump Administration to bring down government spending. We think those efforts are a positive for future long-term economic growth, but in the short-term could deliver some pain as some consumers and businesses who have grown addicted to living off government redistribution need to adapt to a more free-market environment.

With headwinds, tailwinds, and side winds hitting all at once, the data are not very clear. While we do expect the US to face an eventual recession, a negative Real GDP growth report for Q1 is not yet defining evidence. It is a reason to be concerned, but we will look elsewhere for confirmation.