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Worse than they thought

July 1—The initial measurement of the Gross Domestic Product (GDP) for the first quarter of 2014 by the Commerce Department was a disappointing 0.1%, well below expectations that were in the 2% growth range. Even 2% growth would have left the economy struggling to create enough jobs for those entering the labor market, but at least the economy grew slightly.

The first revision was a substantial downgrade. Commerce reported that GDP actually contracted by 1% in the first quarter. The economic sluggishness was attributed to the severe cold weather experienced in much of the U.S., and an uptick was expected with the spring thaw.

In June the Commerce Department reported that more complete data revealed a GDP loss of 2.9% in the first quarter, the worst showing in five years. This was the largest quarterly decline since World War II that was not part of a recession—assuming, of course, that a recession is not under way already.

What happened? Exports fell by 10%, as growth in emerging markets cooled and Europe remained sluggish. Businesses drew down inventories, which were at unsustainable levels. To the surprise of many, health spending fell by 6.4%. Reportedly, this was the element that the Bureau of Economic Analysis failed to capture in its first two growth estimates. Perhaps the confusion associated with the rollout of the Affordable Care Act was a contributing factor.

The financial markets shrugged off the bad news. The Dow Jones Industrial Average was up 0.3% the day that the bad news was announced, and the S&P 500 rose 0.5%. Still, this poor showing will make it difficult to meet the growth targets for 2014. It also suggests that the Fed will be raising interest rates later rather than sooner.

Housing

The housing market is facing some troubling crosscurrents. According to a recent study by the Joint Center for Housing Studies of Harvard University, the availability of apartments hasn't kept up with the demand, especially at the cheaper end of the spectrum. The result is that more people are paying a larger share of their income for housing. In 1960 about one-quarter of households had to pay more than 30% of their income for housing, and now about half do. Soaring home prices put a purchase out of reach for many households, so demand for rentals spiked.

Another troubling factor is the slowness of the millennial generation in forming households. Millennials are those born from 1985 to 2004, and they number nearly 86 million. Because they are burdened by unprecedented education debt, the phenomenon of moving back in with one's parents has become routine. Some 16% of households age 25-34 have more than $50,000 in education debt, up from just 5% with that much debt in 2001. Some 39% have some education debt, and that may have interfered with making a first-time home purchase.

Still, the Harvard study suggests that the millennials will be forming households and buying houses in greater numbers soon, as the leading edge of the cohort reaches age 30. Traditionally, first-time buyers make up about 35% of the market, and their purchases allow existing homeowners to "trade up" to more expensive homes.

Employment

In May the economy added 217,000 jobs. The significance of that is that the total number of jobs added during the recovery finally equaled the number lost during the recession, about 9 million. However, that good news needs to be tempered by the observation that the population continued to grow, so job growth has not been sufficient to provide a job for all the new entrants to the labor market.

During the period from 2004 through 2008, the labor force participation rate was a fairly steady 66%, according to the Bureau of Labor Statistics. The participation rate dropped as the recession began and continued to fall during the recovery. As of May, the Bureau reported that the participation rate was 62.8%, the lowest rate since the Reagan administration. Thus, the lower unemployment rate is partly attributable to the larger than expected number of people who have simply dropped out of the labor market. Fewer workers means lower national income, lower tax collections, and slower economic growth.

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