U.S. economy grew at 1.6 percent annual rate in first quarter 2024, a sharp slowdown.

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U.S. economic growth slowed in the first three months of the year, after more than a year and a half of rapid expansion - a welcome cool-off that nonetheless raises questions about how the rest of the year might shake out.

The U.S. economy grew by an annualized rate of 1.6 percent in the first three months of the year, a sharp slowdown from the previous quarter's growth rate of 3.4 percent, according to the Bureau of Economic Analysis's measurement of gross domestic product, the sum of all of the goods and services produced in the country.

The deceleration reflects swings in business inventory and trade, as well as weakening household and government spending. In the most recent quarter, Americans bought more foreign-made goods while selling fewer U.S.-made items overseas, both of which dragged down economic growth.

"Clearly this is a notable slowdown - growth has stepped down quite a bit, but that's coming after some really strong numbers," said Claudia Sahm, chief economist at New Century Advisors. "You have to pick your head up and look at the context: We have an economy that's still really working for consumers and businesses despite the fact that inflation is elevated and interest rates are higher than before the pandemic."

Markets, though, were decidedly downbeat on the potential of lower economic growth and higher inflation, commonly referred to as "stagflation." All three major stock indexes tumbled by more than 1 percent Thursday morning, with the Nasdaq and Dow Jones Industrial Average both down about 1.6 percent at lunchtime.

"What the market is worried about, even at the margin, is any suggestion that stagflation is taking hold," said Quincy Krosby, chief global strategist at LPL Research. "Certainly the economy is still solid - perhaps not stellar like it was - but the question is whether it will stay that way."

After the pandemic recession, the U.S. economy bounced back far stronger than anticipated. Unemployment, at 3.8 percent, is in the longest stretch of near-record low jobless rates since 1970. Wages are going up. And crucially, families, businesses and governments are continuing to spend, keeping money sloshing through the economy.

Even though Americans are making more money than they were last year, they're spending more and saving less. Disposable incomes rose by 1.1 percent after accounting for inflation in the first quarter. Still, people saved an average 3.6 percent of their income in early 2024, down from 4 percent the quarter before, the GDP report shows.

That exuberant spending - especially on travel, restaurants, concerts and other services - has recently lifted inflation, reigniting fears that the Federal Reserve may have to be even more aggressive in its efforts to slow the economy.

The central bank has raised interest rates 11 times in the past two years, making it more expensive for families and businesses to borrow money. That's put a chill on some parts of the economy, including home sales. Now there are signs that those higher costs are weighing down other purchases and investments as well: Manufacturing spending took a hit and Americans spent less on goods, including cars, at the beginning of the year, according to the GDP report. A downturn in government spending, which has been juicing the economy in recent months, also contributed to cooling growth.

Those signs of deceleration, combined with a recent uptick in price growth, is muddying the economic picture.

Inflation - still considerably higher than the Fed's 2 percent goal - has ticked up for two months, while economic growth appears to be uneven. Many are closely watching what happens next, starting with a fresh round of inflation and consumer spending data on Friday, as well as upcoming earnings reports from tech giants Apple and Nvidia.

"The soft landing is coming into view, although not in the way either the Fed or the Biden administration might like," said Eswar Prasad, an economics professor at Cornell University. "Business investment is already weakening, and if you have consumer demand also weakening, that's going to make for a very complicated scenario in the summer and fall."

Still, he said, the chances of a recession this year remain slim. Americans are continuing to spend, especially on experiences they missed out on during the pandemic.

Ralph Rapa opened a brewery in Coconut Creek, Fla., two months ago, and says there's been a steady stream of young families and other locals stopping in for $7 pints. Nights with special events have been particularly popular - he hosts karaoke on Wednesdays, live music Thursdays through Sundays, and paint-and-sip events once a month.

"People might be anxious about inflation, but everybody seems to have money to drink and eat," he said. "They want to get out - they want live music and family-friendly, dog-friendly places to hang out."

Rapa, a railroad health and safety manager, came up with the idea for Rule G Brewing three years ago when the pandemic was still in full swing. He has poured more than $1 million into the business from a mix of personal and retirement funds, crowdfunding, investments and a grant from the Small Business Administration. He expects it will take a few years to become profitable. In the meantime, Rapa says, he's hopeful his business - and the economy - will hold up.

Still, there is mounting evidence that Americans are pulling back. Many families have used up their pandemic savings and are taking on extra debt to keep up with costs. Credit card debt has risen 22 percent since the pandemic. Delinquencies on credit cards and car loans are also rising, especially among younger and lower-income Americans, as inflation and higher interest rates take a toll on household budgets.

"We're a bit concerned about the U.S. consumer," said Erik Lundh, principal economist at the Conference Board. "There's been quite a surge in debt, and just making interest payments on that stuff is eating into people's pocketbooks and their ability to spend and save."

As a result, Lundh said, consumer spending is poised to tumble in the coming months, potentially denting economic growth. He expects GDP growth to slow to 0.5 percent in the middle of the year, before rebounding in the fall.

"We don't think things are going to fall apart this year, but consumers are going to have to pause and do some hard thinking on how they're spending their money," he said.

In Bend, Ore., Kristi Coughlin and her family have started to rethink their spending, especially on food. Instead of going out to dinner three times a week like they used to, they're eating more "hodgepodge meals" at home - enchiladas with tater tots, say, or leftover rotisserie chicken with chili.

"We're buying less fresh stuff than we used to," the 40-year-old registered dietitian said. "I don't get a cart at the grocery store anymore. My new rule is: If I can't carry it, I don't buy it."

Her household of three is also relying more on frozen fruits and vegetables, canned beans and leftover meats. Coughlin, who has 17 chickens in her yard, has started trading eggs for a morning brew at her local coffee shop. In all, her family spends about $1,800 a month on groceries, considerably more than they did before the pandemic.

Other costs, such as medical bills and their older daughter's college fees, have also gone up. Coughlin and her husband, an electrician, are both self-employed, making them particularly susceptible to the whims of the economy. They're not struggling financially, at least not yet. "But we're cutting back proactively," she said, "just in case."

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Graphic:

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