ECONOMIC UPDATE
REGIONS
February 26, 2016

Q4 2015 GDP Revisions: A "Better" Headline On Top Of Worse Details

- The BEA's second estimate shows annualized real GDP growth of 1.0 percent in Q4 2015, up from the initial estimate of 0.7 percent.
- Upward revisions to inventory accumulation and net exports offset downward revisions to domestic demand and pushed top-line growth up.

The BEA's second estimate of Q4 2015 shows real GDP grew at an annualized rate of 1.0 percent, up from the initial estimate of 0.7 percent growth and confounding expectations of a downward revision. So, if the top-line GDP growth number is better – abstracting away from the fact that "better" is a low hurdle to clear when the initial estimate is 0.7 percent – then why does the revision make us feel worse? The obvious answer would be "there's just no pleasing some people" but, even if Mrs. Chief Economist would roll her eyes and nod in agreement, that's not it. Instead, going through the details of the revisions paints a less constructive picture of the economy, particularly for Q1 2016 growth.

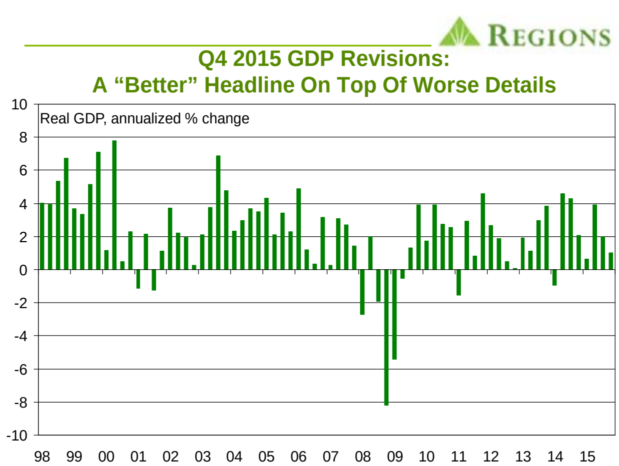
Relative to the BEA's initial estimates, growth in private domestic demand is now reported to be a bit slower and inventory accumulation in the nonfarm business sector is now reported to be stronger. Growth in real consumer spending was revised down from 2.2 percent to 2.0 percent (annualized rates) due to slower growth in spending on goods while services spending was revised higher. We will caution that in the BEA's third estimate of Q4 GDP, due on March 25, there could be a potentially large revision to growth in consumer spending, as this will be the first estimate incorporating the Quarterly Services Survey on which the BEA's estimates of household spending on services is based. Note the QSS helps the BEA refine their estimate of spending on health care, and in the past this has sometimes resulted in large revisions to estimates of growth in consumer spending. Still, the January data show growth in real consumer spending got off to a solid start in Q1 and will be more of a support for real GDP growth than in Q4.

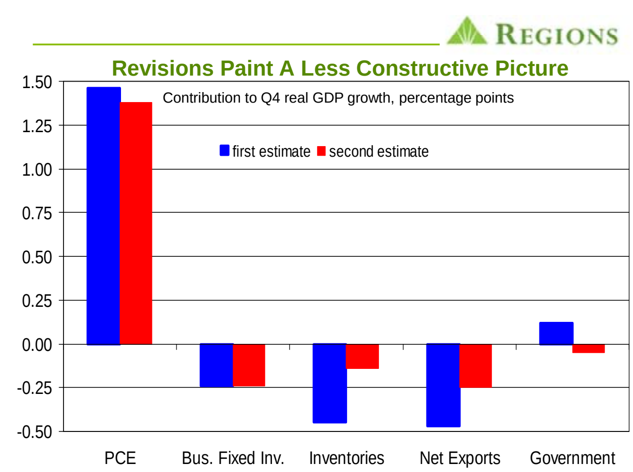
Business fixed investment spending was revised lower in the BEA's second estimate of Q4 GDP. Real business spending on equipment and machinery fell at an annualized rate of 1.8 percent, not as severe as the initial estimate of a 2.5 percent decline. But, real business spending on structures is now reported to have declined by 6.6 percent compared to the initial estimate of 5.3 percent (annualized rates) while growth in real business spending on intellectual property products grew less rapidly than initially estimated. While January's increase in core capital goods orders offers some encouragement for business investment spending in Q1, we're holding judgment for now as this increase merely clawed back the sharp decline seen in December 2015 and we'll want to see follow through in the February and March data before making material revisions to our forecast for growth in business investment spending.

The BEA's initial estimates of growth in government spending on the state/local and federal levels were revised lower so instead of a 0.7 percent increase in total government spending in Q4 the BEA now reports a 0.1 percent decline (annualized rates). The easing of the budget caps on federal government spending did not impact Q4 growth but will be reflected in the Q1 data; on the whole, government spending will be a modest support for top-line real GDP growth in 2016.

These downward revisions were more than offset by upward revisions to net exports and the rate of inventory accumulation. The trade deficit is now reported to be smaller than the BEA had initially estimated, but even here the details are concerning. Real exports of U.S. goods and services declined at a slightly faster rate than initially estimated, and the narrower trade gap is solely due to the BEA now reporting total imports fell modestly in Q4 rather than advancing modestly as first estimated. The advance estimate for January, released this morning, shows a sharp decline in U.S. exports of goods, and we expect trade to be a larger drag on growth in Q1 2016 than was the case in Q4 2015. The same is true of inventories – we have pointed out before that one of the headwinds facing U.S. manufacturers is a significant inventory overhang. That firms made less progress in working down this overhang in Q4 than had previously been reported means the task ahead of them in Q1 is more difficult and, January's bounce in durable goods orders notwithstanding, inventories will be a larger drag on Q1 growth than we had until this point built into our forecast.

We'll take a lousy headline and better details over a better headline and lousy details any day. So, despite the upward revision to Q4 growth, the details of the revision pose a downside risk to our Q1 growth forecast.





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