ECONOMIC UPDATE

REGIONS

April 28, 2017

Q1 2017 GDP: A Quarter To Forget . . . And We Intend To Do Just That

- The BEA's first estimate shows real GDP grew at an annualized rate of 0.7 percent in Q1 2017 after 2.1 percent growth in Q4 2016.
- Residential and business fixed investment were the main supports for Q1 growth, inventories and government spending were the main drags.

The U.S economy expanded, but only barely, in Q1 2017, with the BEA's initial estimate putting real GDP growth at 0.7 percent. This is largely in line with expectations. While it is hard to take away too many positives from such a middling top-line growth number, the stronger than anticipated rebound in business fixed investment is encouraging. There are a number of factors behind the weak headline print on the Q1 GDP report, some more worthy of concern than others. The reality, however, is the U.S. economy is neither as weak as implied by today's report nor as robust as we expect the Q2 GDP report to imply.

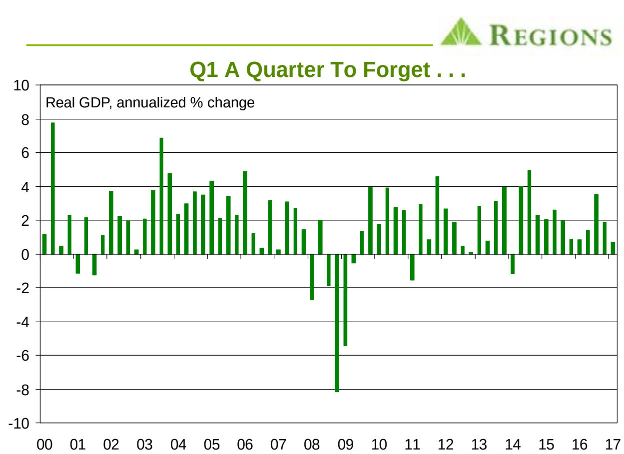
We'll repeat our standard caveat that in any given quarter the BEA's initial estimate of GDP is based on highly incomplete source data and, as such, prone to sizeable revision. Trade, inventories, consumer spending on services, and government spending are the components for which the revisions can be sizeable. Moreover, it is our understanding that the first estimate of Q1 2017 GDP does not incorporate this week's revisions to the data on retail sales. This is significant given that control retail sales, a direct input into the GDP data, were revised significantly lower for both Q4 2016 and Q1 2017. As such, revisions will show even weaker growth in real consumer spending in Q1 than is incorporated into the BEA's first pass at Q1 GDP.

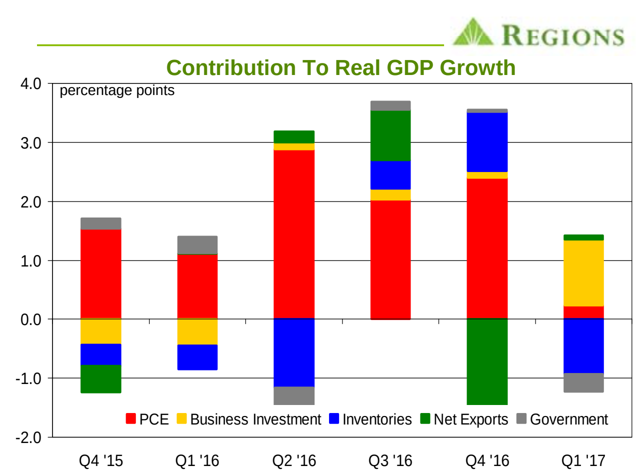
For now, real consumer spending is reported to have grown at an annualized rate of just 0.3 percent in Q1. Spending on consumer durable goods declined at an annualized rate of 2.5 percent. This is mainly a reflection of a slowdown in motor vehicle sales. Q1 saw unit motor vehicle sales of 17.3 million units, annualized, a solid number but one that is well short of the annual sales rate of 18.1 million units seen in Q4 2016, which was clearly an unsustainably high pace. This alone took 0.45 points off of top-line real GDP growth in Q1. Also, spending on household services was notably weak in Q1, rising at an annualized rate of just 0.4 percent. One culprit is lower outlays on household utilities, one result of an atypically mild winter. We've estimated lower utilities outlays took two-tenths of a percent off of growth in consumer spending in both January and February, which is supported by the Q1 GDP data.

Inventory accumulation slowed to an annual rate of $10.3 billion in Q1 from Q4's rate of $49.6 billion – in calculating GDP growth it is the rate of change in inventory accumulation that matters, so the slower pace of inventory growth in Q1 was a sizeable drag on top-line growth, taking off 0.93 percentage points. Real government spending contracted at an annual rate of 1.7 percent in Q1, which shaved 0.30 percentage points off of top-line growth.

After having been a sizeable drag on Q4 growth, trade was neutral in Q1 as a slightly smaller trade deficit added 0.07 points to top-line growth. Real U.S. exports grew at an annualized rate of 5.8 percent, outpacing the 4.1 percent growth in imports. As noted above, one encouraging detail from today's report is the growth in business fixed investment. Business spending on structures grew at an annualized rate of 22.1 percent, which in part reflects increased spending on energy platforms. Of particular note is the 9.1 percent annualized growth in business spending on equipment and machinery. This is an area that has significantly underperformed over the course of the present expansion which, in our view, is the primary factor behind what is an anemic trend rate of productivity growth. Note that orders for core capital goods bottomed in September 2016 but orders do not turn up in the GDP data until the goods are shipped, hence the growth recorded in Q1. What is important is whether that growth is sustained over coming quarters, and the data on core capital goods orders suggests this will be the case.

As has been widely discussed, the GDP data have long been plagued by the issue of residual seasonality, which has resulted in Q1 growth in any given year being, on average, significantly slower than growth in subsequent quarters. That explains some, but not all, of the middling growth reported for Q1 2017. That said, we're about as unconcerned as we can be with a headline print of 0.7 percent growth. The underlying drivers of consumer spending remain intact, business investment is gradually rebounding, global growth is firming, and consumer and business confidence remains elevated. These factors add up to an economy much healthier than the headline print on the Q1 GDP report.





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