ECONOMIC UPDATE
REGIONS
May 30, 2018

Q1 2018 GDP: Revisions Don't Change The Growth Outlook

- The BEA's second estimate shows real GDP grew at an annualized rate of 2.2 percent in Q1, down from the initial estimate of 2.3 percent
- Pre-tax corporate profits fell 0.6 percent between Q4 2017 and Q1 2018, while after-tax profits were up by 5.9 percent

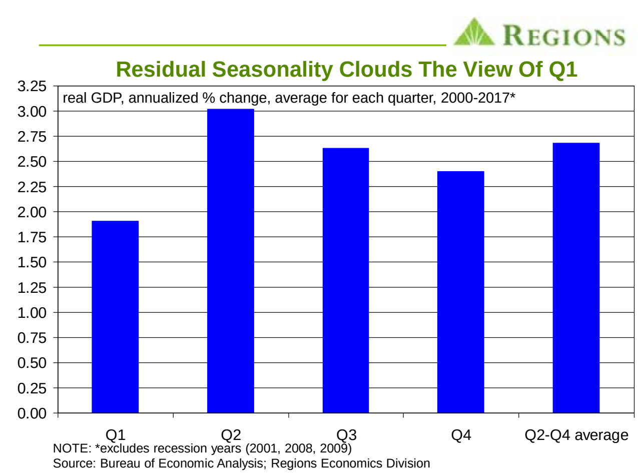
The BEA's second estimate puts Q1 real GDP growth at 2.2 percent, matching our below-consensus forecast and below the initial estimate of 2.3 percent growth. As in any given quarter, the second estimate of Q1 GDP is based on revised and more complete source data than the BEA had at their disposal at the time of their initial estimate, but what is notable is the degree to which the revisions to the various details in effect canceled each other out, leaving but a small change to the top-line growth number. At the same time, the estimate of Q1 2018 growth is prone to the same residual seasonality issues that have for many years injected a downward bias to measured Q1 growth relative to growth in the remaining three quarters. Perhaps the best way to compensate for any residual seasonality effects is to look at year-on-year, rather than annualized, growth in real GDP; doing so shows real GDP grew by 2.82 percent between Q1 2017 and Q1 2018, which is in line with what we expect for 2018 as a whole when all is said, done, and revised.

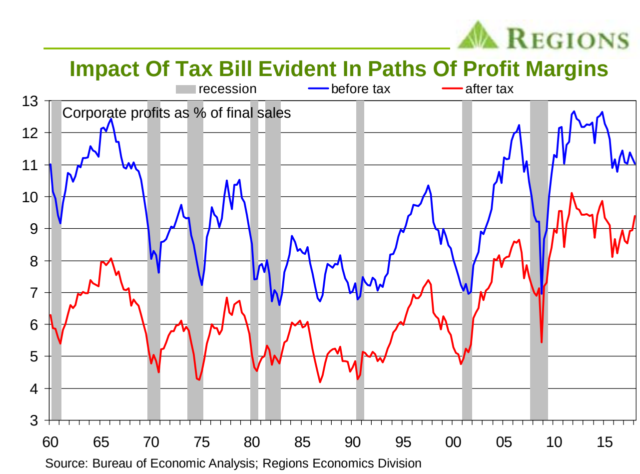
Real consumer spending grew at an annualized rate of 1.0 percent in Q1, slightly below the initial estimate of 1.1 percent growth. As we expected, growth in spending on goods was a bit better than initially estimated while growth in spending was a bit slower. Of far more signficance, however, is that any assessment of Q1 consumer spending must be put in the context of Q4 2017 consumer spending, when post-hurricane replacement demand drove spending on consumer goods ranging frm apparel to automobiles. As such, the 4.0 percent growth in real consumer spending in Q4 2017 was the fastest growth since Q4 2014 and there was always going to be payback in the Q1 2018 spending data. As we have noted, the trend rate of growth in real consumer spending is neither as strong as implied by the Q4 2017 data nore as weak as implied by the Q1 2018 data.

Private sector fixed investment is now reported to have grown at an annualized rate of 6.5 percent in Q1 compared to the initial estimate of 4.6 percent growth. The rate of inventory accumulation in the nonfarm business sector was revised sharply lower, while a downward revision to U.S. exports and an upward revision to imports into the U.S. resulted in a wider trade deficit than had initially been estimated. Business spending on structures, equipment and machinery, and intellectual property products is now shown to have been stronger than initially estimated, but residential fixed investment was revised lower. As with the data on consumer spending, the Q1 data on business spending must, or at least should, be put into proper context. Many are dismissive of the notion that the 2017 tax bill will contribute to faster growth in business investment spending and, sure, the 5.5 percent annualized growth in spending on equipment and machinery in Q1 falls somewhat short of a "boom." Which is fine, but Q1 growth must be put in the context of what was double-digit growth in each of the final two quarters of 2017, i.e., before the tax bill was even the tax bill, so a slower rate of growth in Q1 should have come as no surprise. Nor is it reasonable to expect any and all effects from the tax bill to have magically appeared in the Q1 data. In other words, it is far too soon to be able to assess the impacts of the 2017 tax bill on firms' capital spending decisions.

What we do see in the Q1 data, however, is the impact of the tax bill on corporate profits, with today's report providing the first look at profits as measured in the GDP data. Pre-tax corporate profits fell by 0.6 percent between Q4 2017 and Q1 2018, but after-tax profits rose by 5.9 percent. Year-on-year, pre-tax profits were up 4.3 percent while after-tax profits were up 14.0 percent. The cut in the statutory corporate income tax rate from 35 percent to 21 percent led to a $117.4 billion quarter/quarter decline in corporate income taxes. The dip in pre-tax profits may be more meaningful, as it shows firms contending with higher costs for non-labor inputs and faster growth in labor costs. Still, lower tax bills give firms an added buffer that could dampen any impulse towards raising output prices while still leaving firms with ample capacity for returning capital and upping capital spending.

All in all, the revisions to the Q1 GDP data don't lead to meaningful changes in the outlook for growth going forward. The data on corporate profits support our expectation that the corporate sector will be a bigger contributor to growth in 2018 than has been the case in recent years.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com