ECONOMIC UPDATE

REGIONS

November 28, 2018

Q3 GDP: Same Headline, Different Details . . .

- The BEA's second estimate shows real GDP grew at an annualized rate of 3.5 percent in Q3 2018, matching the initial estimate
- Pre-tax corporate profits are up 10.3 percent year-on-year as of Q3, with after-tax profits up 19.4 percent.

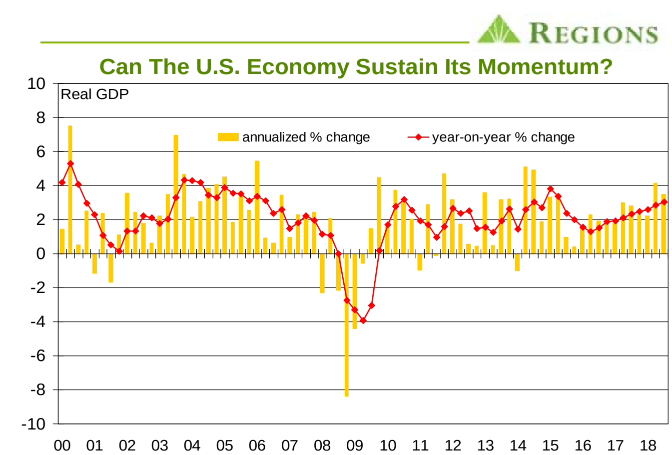
If something works, you stick with it, right? In this case, that something is the BEA's estimate of Q3 2018 real GDP growth, with the BEA's second estimate of 3.5 percent matching their initial estimate. While it is quite unusual for the second estimate of real GDP growth in any quarter to match the initial estimate, that this is the case with the Q3 data doesn't mean there weren't revisions to the data. There were, including one that particularly caught our eye, but on net those revisions were a wash, which resulted in no change to the top-line growth number, But, as our regular readers well know, we routinely state that the details in any given data release are far more important than the top-line number. The bottom line here is that the U.S. economy carried a good deal of momentum into the home stretch of 2018 and 2019 should be another year of solid growth, even if growth falls a bit shy of this year's pace.

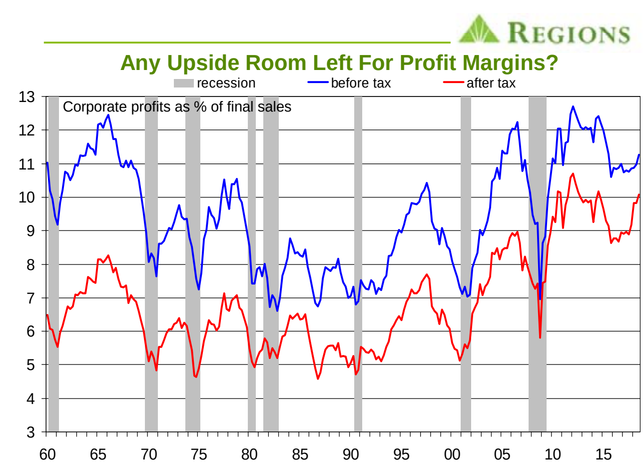
As noted above, while the top-line growth number was unchanged, there were plenty of revisions to the details of the Q3 GDP data. For instance, real consumer spending was originally reported to have grown at an annualized rate of 4.0 percent which, as we noted at the time, surprised us to the upside. The BEA's second estimate puts annualized growth in real consumer spending at 3.6 percent, with growth in spending on consumer durable goods having been revised lower. The biggest factor here is that real spending on motor vehicles is now reported to have declined in Q3 rather than having grown at an annualized rate of 3.8 percent as initially reported, and the revisions are in line with the modest decline in unit motor vehicle sales seen in Q3. The BEA's second estimates of growth in spending on nondurable consumer goods and on household services are not materially different than the initial estimates.

As with consumer spending, the BEA's second estimate of Q3 growth in business spending on equipment and machinery is more closely aligned with the higher frequency data than was the case with the initial estimate. Real business spending on equipment and machinery is now shown to have grown at an annualized rate of 3.4 percent in Q3, which may not seem all that impressive, but keep in mind the initial estimate showed growth of just 0.4 percent. As you may recall, there were some who jumped on that initial estimate as "proof" that the 2017 tax bill was "a flop," on the grounds that the tax bill had failed to deliver the highly touted boom in business investment – an argument just as nonsensical now as it was then. Our reaction to the initial estimate was that it was at odds with the high frequency data and it would be wise to wait for the revised data before drawing conclusions about the state of business investment. Though those quick to pounce on that initial estimate seem to have overlooked this, the slower growth in Q3 came on the heels of what had been average annualized growth of 8.6 percent over the prior six quarters. In other words, there had been a notable pick-up in business investment spending long before there was a 2017 tax bill. Sure, it is unlikely that growth will pick back up to that 8.6 percent pace over coming quarters, but we remain firm in our view that there is plenty of room to the upside for business investment spending. This is a critical point because continued growth in spending on equipment and machinery and on research & development is the key to there being the sustained improvement in labor productivity needed to lift the economy's "speed limit." In contrast to those who already seem to have arrived at the final page, our view is that this story hasn't been written yet.

Elsewhere in the data, inventory accumulation in the nonfarm business sector is now reported to be larger, growth in government spending slower, and the trade deficit larger relative to the initial estimates. As was the case in Q2, the Q3 data on trade are skewed by firms, domestic and foreign, playing the game of "time the tariffs" and there are early signs that this is also the case with the Q4 data.

Today's release brings the initial estimate of Q3 corporate profits. While profit growth slowed on a sequential basis, before-tax corporate profits are up 10.3 percent year-on-year, with after-tax profits up 19.4 percent. Going forward, margins figure to come under more pressure given increases in input costs, both labor and non-labor, and shipping costs. Wide margins give firms some room to absorb higher costs, but what remains to be seen is whether, or to what degree, firms at some point become more aggressive in testing their pricing power.





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