ECONOMIC UPDATE

REGIONS

February 28, 2019

Q4 GDP: Better Than Expected Top-Line Growth, But Some Questions In The Details

- The BEA's "initial" estimate shows real GDP grew at an annualized rate of 2.6 percent in Q4 2018, after growth of 3.4 percent in Q3
- Full-year 2018 real GDP growth was 2.9 percent, compared to growth of 2.2 percent in 2017

The BEA's "initial" estimate shows real GDP grew at an annualized rate of 2.6 percent in Q4 2018, easily topping expectations, which puts full-year 2019 growth at 2.9 percent. If this number sticks, 2018 would be the best year for real GDP growth during the current expansion, now in its tenth year. That is a big "if," however, as some of the details beneath the headline growth number look, at least to us, a bit curious. Today's release marks the first look at the Q4 GDP data, as the release of what would have been the first estimate was canceled due to the partial government shutdown. Normally, we caution that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizeable revision. While today's release effectively combines what would have been the BEA's first two estimates of Q4 GDP, we'll caution that the backlog of data releases delayed by the shutdown has yet to be fully cleared, so we'd caution against getting too attached to that 2.6 percent growth print. That said, pending revisions are not likely to call into question our premise that while the rate of U.S. economic growth has slowed, the economy nonetheless remains on solid ground.

Real consumer spending grew at an annualized rate of 2.8 percent in Q4. While considerably below the average 3.7 percent pace seen over the middle two quarters of 2018, 2.8 percent growth is considerably above the pace implied by the Census Bureau's initial estimate of December retail sales, an estimate we and most others heavily discounted as it was starkly at odds with other indicators of consumer spending. Real spending on goods grew at an annualized rate of 3.9 percent in Q4, with real spending on household services growing at an annualized rate of 2.4 percent. Motor vehicle sales were a prime support for Q4 growth in consumer spending, but are shaping up as a drag on Q1 2019 growth.

While we have no quibbles with the BEA's initial estimate of growth in consumer spending, the details on business investment and inventories look a bit suspect. Real business fixed investment is reported to have grown at an annual rate of 6.2 percent in Q4; while real spending on structures declined at a 4.2 percent rate, real spending on equipment and machinery rose at an annual rate of 6.7 percent and real spending on intellectual property products rose at an annual rate of 13.1 percent. The estimate of spending on equipment and machinery seems too strong, based on the monthly data on orders and shipments of core capital goods. Those data have been relatively uninspiring over recent months, leading some to declare the 2017 tax bill was "a flop" on the grounds that it had failed to deliver the highly touted boom in business investment. Our view remains that it is too soon to make any such judgment and, as we have pointed out before, one huge problem with the "flop" argument is that it fails to account for business spending on intellectual property products, the vast majority of which consists of outlays on software and research and development. As the numbers now stand, real spending on equipment and machinery grew by 7.5 percent in 2018 with real spending on intellectual property products up 7.7 percent. If that's a "flop," then, thank you, and may we please have another in 2019. 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, the reported $97.1 billion (annualized) add to business inventories strikes us as too high given the monthly data, and we'll note the December data have yet to be released. Real residential fixed investment fell at an annualized rate of 3.5 percent in Q4, in line with other data pointing to a dismal quarter for housing market activity. A wider trade deficit deducted from Q4 growth, but, again, the December data are not yet available, with the BEA's estimate acting as a substitute.

While there is some play in the initial estimate of Q4 GDP, the bottom line is that the U.S. economy remains on solid ground, with real GDP up 3.1 percent year-on-year in Q4 2018. Our view is that largely disappointing December data was an outlier as opposed to an ominous sign of what's ahead in 2019. It helps to recall that there is a distinction between slowing growth and the end of growth, and we're seeing the former, not the latter.

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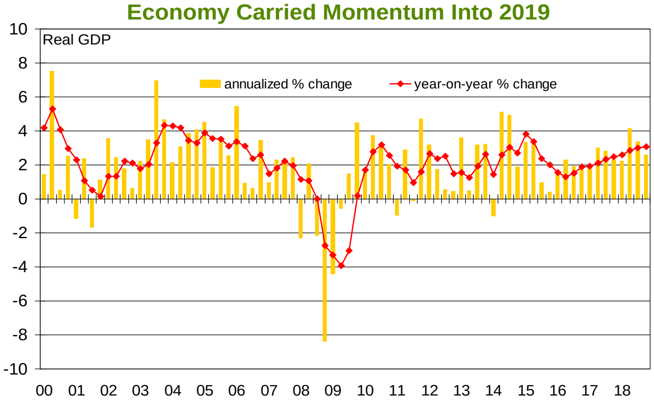
Economy Carried Momentum Into 2019



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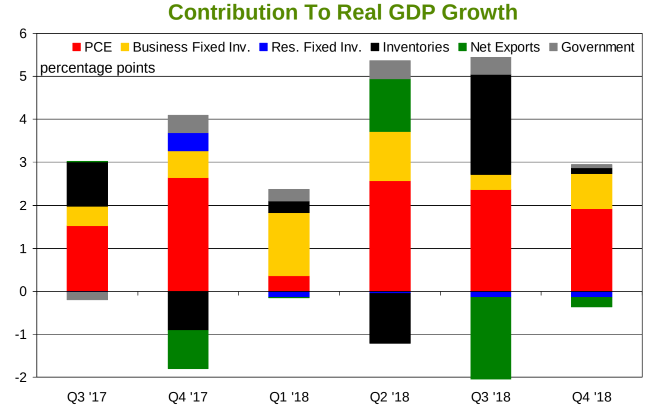
Contribution To Real GDP Growth



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