ECONOMIC UPDATE

REGIONS

April 26, 2019

Q1 GDP: Built For Speed, But Is It Built To Last?

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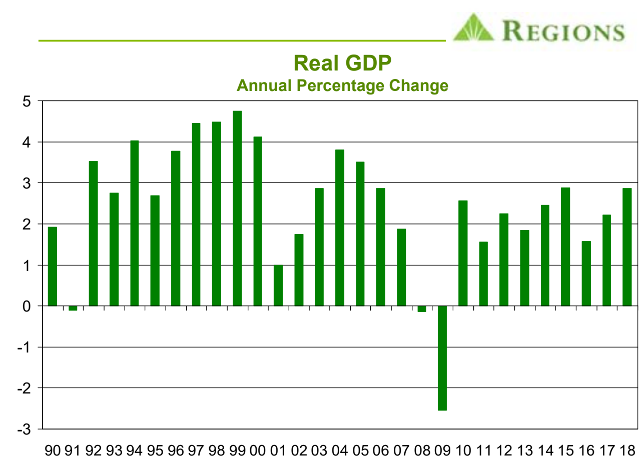
- Inventories, and trade were prime supports for Q1 growth, offsetting weak business and residential fixed investment

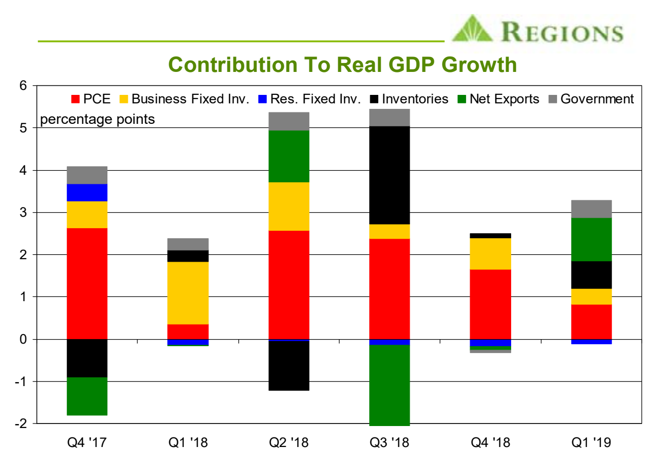
The BEA's initial estimate shows real GDP grew at an annualized rate of 3.2 percent in Q1 2019, better than we (2.8 percent) and the consensus (2.2 percent) expected. Inventories and trade were prime supports for growth in Q1, offsetting weak fixed investment on both the business and residential fronts. That Q1 growth topped 3.0 percent is surprising in its own right, but is even more surprising given the many obstacles thrown in the path of the U.S. economy over the past several months. For instance, BEA estimates that the partial government shutdown shaved three-tenths of a point off of top-line real GDP growth in Q1. Perhaps most strikingly, recall that 2019 got off to a sour start in terms of market sentiment and much of the key economic data, to the point that it was hard to find a headline that did not include the word "recession" and futures markets were pricing in Fed funds rate cuts – plural, not singular. We've stated before that through all of this, our outlook for the U.S. economy did not change, and while there are some soft details beneath the lofty Q1 headline growth number and Q1's growth pace won't likely be sustained, the U.S. economy nonetheless remains on firm footing.

As we do in every quarter, we'll note that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision. Pending revisions to the initial Q1 estimates notwithstanding, perhaps the more relevant question is the degree to which Q1's growth pace will be sustained going forward. Given the extent to which inventories and trade added to growth in Q1 2019, this suggests that maybe we shouldn't get too attached to that 3-handle on top-line real GDP growth. For instance, a sizable increase in business inventories added 0.65 percentage points to top-line real GDP growth in Q1, marking a third consecutive quarter of significant growth in business inventories. At some point, there will be payback, with inventories acting as a material drag on top-line growth, and we think that will come in the Q2 data. The U.S. trade deficit narrowed sharply in Q1, with exports of U.S. goods growing at an annualized rate of 4.7 percent while imports of goods into the U.S. contracted at an annualized rate of 4.4 percent. This added 1.05 points to top-line real GDP growth, but this figures to also reverse in the Q2 data.

Inventories and trade are inherently volatile from one quarter to the next, which is why we often point to private domestic demand as a better marker of underlying growth. Talk about curbing your enthusiasm, real private domestic demand grew at an annualized rate of just 1.3 percent in Q1. Real consumer spending grew at an annualized rate of 1.2 percent in Q1, as real spending on consumer goods contracted at an annualized rate of 0.7 percent, the weakest quarterly performance since Q2 2011, while the decline in spending on consumer durables (down at an annualized rate of 5.3 percent) is the largest since Q4 2009. Spending on nondurable consumer goods grew at an annualized rate of 1.7 percent while real spending on household services grew at a 2.0 percent rate. As we've noted, the weakness in Q1 consumer spending reflects the extent to which consumer spending fell off the table in December 2018 (which, for the record, we still don't buy, but it's what the numbers say so we have to go with it), which set a very low base for Q1 growth in consumer spending. Keep in mind, however, that consumer spending on goods jumped in March, with the level of spending well above the Q1 average, which sets the stage for much more rapid growth in consumer spending in the Q2 GDP data. If this does prove to be the case, it will offset much, though not all, of the payback we expect from trade and inventories, thus mitigating the slowdown in top-line real GDP growth.

Business fixed investment grew at an annualized rate of 2.7 percent in Q1, as solid growth in investment in intellectual property products offset weakness in spending on structures and equipment/machinery, and residential fixed investment contracted at a 2.8 percent rate. We look for more support from both of these components over coming quarters. All in all, to borrow a phrase from Fed Chair Powell, the U.S. economy is in a good place of solid growth with few signs that inflation is an imminent threat. Maybe not quite as good as implied by the headline growth number on the Q1 real GDP report, but still, to borrow a phrase from Larry David, pretty, pretty good. While we do not think the headline print on the Q1 GDP report reflects a sustainable pace of growth, we continue to expect real GDP growth of around 2.4 percent for 2019 as a whole. Not as good as 2018, but much better than many feared as this year began.





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