ECONOMIC UPDATE

REGIONS

March 28, 2019

Q4 GDP: Downward Revision Doesn't Alter The View Of The U.S. Economy

- The BEA's revised estimate shows real GDP grew at an annualized rate of 2.2 percent in Q4 2018, down from the initial estimate of 2.6 percent
- Before-tax corporate profits rose by 7.8 percent for 2018 as a whole, with after-tax corporate profits up by 16.2 percent

The headline on our analysis of the BEA's initial estimate showing real GDP grew at an annualized rate of 2,6 percent in Q4 2016 was "Better Than Expected, But Some Questions In The Details," and our expectation was that revised data would show growth was not quite that strong. Making use of revised and more complete source data, BEA now puts Q4 real GDP growth at an annualized rate of 2.2 percent, slightly better than our forecast of 2.1 percent growth. The revised data show slower growth in consumer spending and business fixed investment and a decline in total government spending, while trade was not as big of a drag on top-line growth as was first estimated. Still, with the revisions basically in line with what we had expected, today's release does not alter our view of where the U.S. economy is or how it will perform over the course of 2019.

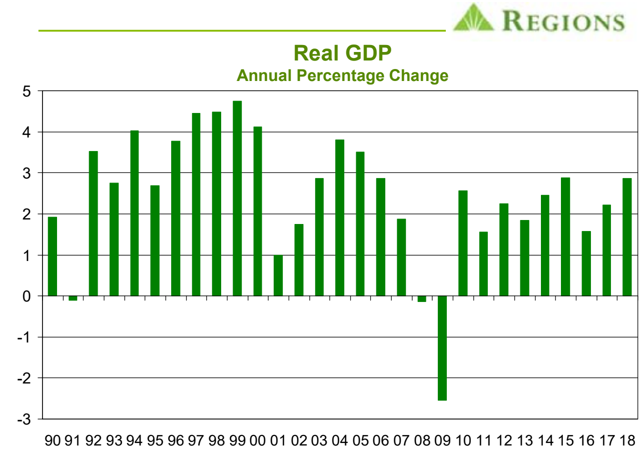
The revised data leave full-year 2018 real GDP growth at 2.9 percent, which ties 2015 as the fastest annual growth of the current expansion, but in the data equivalent of a photo finish, the 2.857 percent growth in 2018 comes up a bit shy of the 2.881 percent growth in 2015. You know, for those who insist on there always being a winner. Real private domestic demand grew by 3.1 percent in 2018 after 3.0 percent growth in 2017.

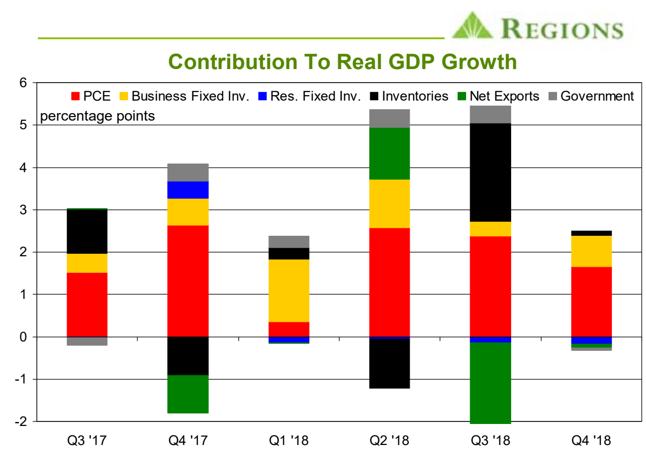
Real consumer spending grew at an annualized rate of 2.5 percent in Q4, a downward revision to the initial estimate of 2.8 percent growth. Growth in spending on consumer goods, both durable goods and nondurables, was marked down while spending on household services was revised slightly higher. For 2018 as a whole, real consumer spending grew by 2.6 percent, slightly ahead of 2.5 percent growth in 2017.

The revised data show business fixed investment grew at an annualized rate of 3.1 percent in Q4 2018, down from the initial estimate of 3.9 percent growth. Outlays on business structures contracted at a faster pace than had been initially estimated, while growth in spending on equipment & machinery and on intellectual property products was not quite as robust as initially estimated. Still, real spending on equipment & machinery grew at an annualized rate of 6.6 percent while spending on intellectual property products grew at an annualized rate of 10.7 percent, solid gains despite the slight downward revisions. We have spent a good amount of time discussing investment in intellectual property products, as this is an important, even if largely overlooked, component of business investment spending. The vast majority of intellectual property investment consists of outlays on software and research and development, and solid growth in spending in these areas is a hopeful sign that labor productivity growth will continue to strengthen after having been anemic over much of the current expansion. For 2018 as a whole, real business investment in equipment & machinery grew by 7.4 percent and real outlays on intellectual property products grew by 7.5 percent, matching 2016 as the strongest growth in this category since 2000 (okay, 2018 wins the tie breaker, with growth of 7.520 percent besting growth of 7.495 percent).

The build in business inventories was revised slightly lower, now put at \$96.8 billion rather than \$97.1 billion (annualized). While such a large build in one quarter would typically result in a much smaller build, if not an outright decline, in inventories in the following quarter, as the data are now tracking the inventory build in Q1 2019 will be even larger. While this will be supportive of current quarter growth, there will be payback in the Q2 GDP data, but the more fundamental question is whether these sizeable inventory builds reflect continued uncertainty over the course of current trade spats or whether they reflect weakening final demand. We think it is some of both, but it is too soon to be more precise.

The data on corporate profits support the view of softening final demand. Not the full-year figures – pre-tax profits up by 7.8 percent and after-tax profits up by 16.2 percent – but the Q4 figures, showing modest declines in profits compared to Q3. Most of the decline is due to a sharp decline in profits in the financial sector, but profits in the nonfinancial corporate sector were down slightly with only trivial growth in foreign profits. We look for some further erosion in the current quarter data, in line with our premise of decelerating growth in the U.S. and markedly slower global growth. Still, though Q1 2019 is shaping up to be a quarter to forget, at least in terms of real GDP growth, we are more constructive on the rest of the year and still look for full-year growth between 2.0 and 2.5 percent.





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