ECONOMIC UPDATE

REGIONS

April 27, 2018

Q1 2018 GDP: Better Than Expected Headline Covers Some Curious Details

- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.3 percent in Q1 2018 after growth of 2.9 percent in Q4 2017
- Consumer spending, business fixed investment, and inventory accumulation were the main drivers of Q1 growth

The BEA's initial estimate pegs Q1 real GDP growth at 2.3 percent, bettering our above-consensus forecast of 2.1 percent. Ahead of today's release the main question was the extent to which the long-standing issue of residual seasonality, i.e., the lingering presence of seasonal patterns in data that have been seasonally adjusted, would weigh on reported Q1 growth. Over the past two decades the pattern has been for Q1 growth to be significantly weaker than growth in the remaining three quarters of any given year due to residual seasonality. Our model yielded Q1 growth of 2.7 percent in the absence of residual seasonality, but perhaps the better option is to simply eliminate the issue by focusing not on the annualized quarterly growth (i.e., headline) number and instead focus on the year-on-year change in real GDP. On this basis, real GDP advanced 2.9 percent in Q1, which is the fastest year-on-year growth since Q2 2015. In short, the soft headline print on the Q1 GDP report notwithstanding, nothing has altered our view that the U.S. economy headed into 2018 with a good deal of positive momentum.

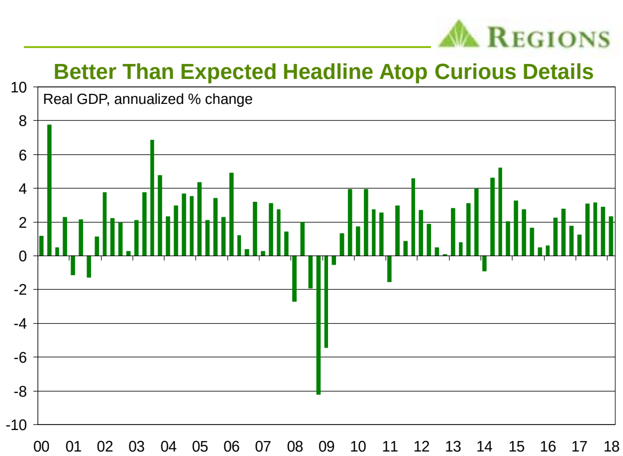
Aside from the issue of residual seasonality, there is a more significant reason to not get too attached to the BEA's first estimate of Q1 GDP. As is the case in any given quarter of any given year, the BEA's first estimate of GDP is based on highly incomplete source data and makes use of a number of estimates and, as such, is prone to sizeable revision. We expect no less of the first estaimte for Q1 2018. Specifically, the estimates of trade and inventories look somewhat curious, particularly in light of data released just yesterday that is likely not incorporated into today's estimate of GDP. For some perspective, the average revision, on an absolute value basis, between the first and third estimates of real GDP growth over the 1993-2016 period was 0.6 percentage points.

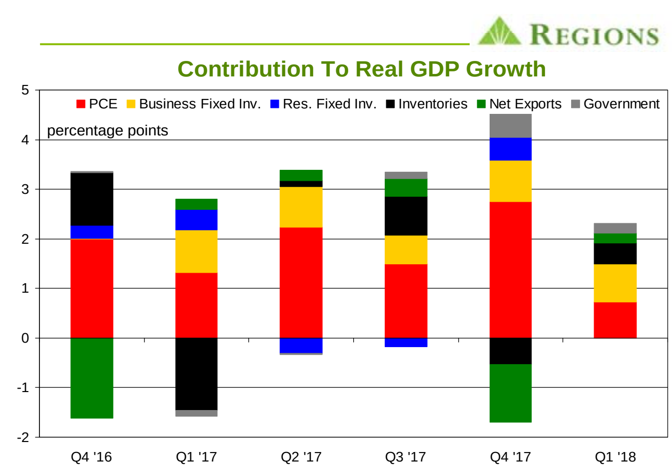
With these caveats in mind, under the heading of "for whatever it's worth" we'll sort through some of the details in today's report. Real consumer spending is reported to have grown at an annual rate of 1.1 percent in Q1, which should come as no surprise given the robust growth seen in Q4 2017 that to a large degree reflected replacement spending in the wake of the two hurricanes. This is seen in the patterns in spending on motor vehicles – after annualized growth of 19.1 percent in Q4 spending on motor vehicles fell at an annualized rate of 15.1 percent in Q1 even though unit sales came in at a healthy annualized rate of 17.2 million units in Q1. Spending on home furnishings and other consumer durables exhibited similar patterns, as did spending on nondurable consumer goods, particularly clothing.

After growing at a double-digit pace over the back half of 2017, real business spending on equipment and machinery grew at an annualized rate of 4.7 in Q1, which seems likely to be revised lower given the March data released yesterday. Either way, given the strength of spending over 2H 2017 and that Q1 was too soon to have seen any material impacts from the 2017 tax bill, that growth in business fixed investment slowed in Q1 is no surprise. Our forecast for 2018, however, anticipates stronger spending over the remainder of the year, so the March data at least give us pause. Residential fixed investment was basically flat in Q1 as moderate growth in single family structures was negated by lower (real) outlays for multi-family and other structures.

One of the more curious elements of the BEA's first estimate of Q1 GDP is the reported narrowing of the trade deficit, to the point that trade added 20 basis points to top-line real GDP growth. This despite real trade deficits in January and February that were significantly wider than the Q4 average. Even allowing for a much narrower gap in March, as the advance data suggest, the trade numbers in the GDP report look somewhat suspect. Government spending is typically a prime source of residual seasonality, but today's report shows real government outlays rising at a stronger than expected annualized rate of 1.2 percent in Q1. Finally, the build in business inventories was larger than that seen in Q4, but by significantly less than implied in the monthly data.

Perhaps the best thing that can be said about today's GDP report is that it wasn't as bad as many had feared. Granted there is a good deal of noise in the Q1 data and we'll likely see sizeable revisions, but our bottom line is that our expectations for growth for 2018 remain intact.





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