ECONOMIC UPDATE
REGIONS
November 29, 2017

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Q3 2017 GDP: Better The Second Time Around

- The BEA's second estimate shows real GDP grew at an annualized rate of 3.3 percent in Q3 2017, up from the first estimate of 3.0 percent
- Fixed investment, inventories, government spending, and net exports were all revised higher relative to the initial estimate
- Adjusted after-tax corporate profits rose by 5.8 percent in Q3 and were up 7.7 percent year-on-year

Revised and more complete source data show real GDP grew at an annualized rate of 3.3 percent in Q3, faster than the BEA's initial estimate of 3.0 percent and matching our above-consensus forecast. Save for consumer spending, which was revised slightly lower, growth in spending in the other broad categories is now shown to have been faster than the BEA had initially estimated. The key question, of course, is the extent to which this faster growth can be sustained. The two main reasons for encouragement are the pick-up in business investment and what for the first time in over a decade is synchronized global growth; the main cause for concern is whether or not we have the ability to stay out of our own way, particularly where trade policy is concerned.

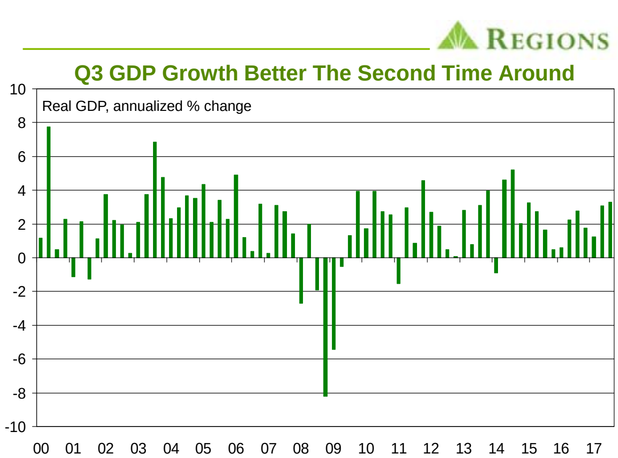
As we pointed out with the release of the BEA's initial estimate of Q3 GDP, don't let the headline growth number trick you into thinking that Hurricanes Harvey and Irma had no impact on overall growth in Q3. The effects of the storms are easily visible in the details on fixed investment in structures and consumer spending, amongst other areas.

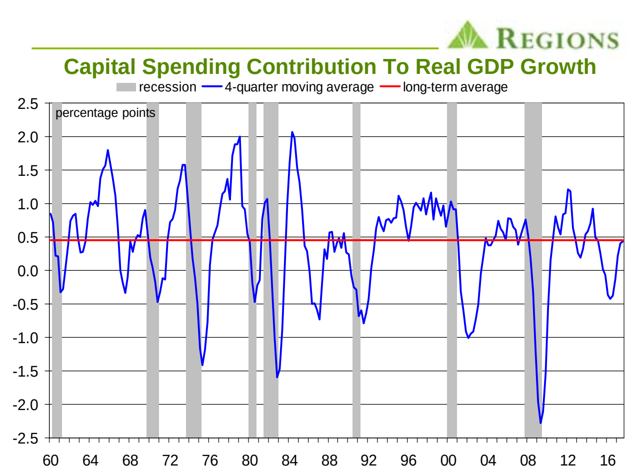
Growth in inflation adjusted spending on both durable and nondurable consumer goods is now shown to have been slightly slower in Q3 than was initially reported. Annualized growth in spending on motor vehicles is now pegged at 12.6 percent compared to the initial estimate of 14.7 percent, which is the primary factor behind the downward revision in growth of spending on consumer durables. Real household spending on services grew at an annnualized rate of 1.9 percent in Q3, up from the initial estaimte of 1.5 percent. This mainly reflects what was a sharp upward revision to health care outlays and a smaller upward revision to spending on recreation services. In contrast, spending on lodging, dining out, and utilities was revised lower. To our earlier point, the details on consumer spending show the mixed effects of the hurricanes, with spending on motor vehicles driven by post-hurricane replacement demand and while the storms sharply curtailed utilities outlays.

Real business fixed investment grew at an annualized rate of 4.7 percent in Q3, with spending on equipment and machinery and spending on intellectual property products stronger than initially estimated. The 10.4 percent growth (annualized) in spending on equipment and machinery is the fastest since Q2 2014, and is in keeping with the high frequency data on core capital goods orders. While we have for some time been pointing to firmer business investment spending as the single most encouraging element of the economic data, it is worth putting this into perspective. For much of the current expansion, business investment has been a notable laggard, and the recent run of solid growth only takes the contribution of capital spending to top-line real GDP growth back to its long-term average. The question now is whether tax legislation will prompt a sustained period of robust business investment spending that would contribute not only to faster growth today but also, in the form of enhanced growth in labor productivity, faster growth tomorrow. What stands out from the chart below is that the 1990s are a decided outlier in terms of growth in capital spending. While we don't expect the legislation now being debated to produce a repeat, there is nonetheless some hope of a prolonged period of above-average growth.

Elsewhere in the revised Q3 data, state and local government spending fell less sharply than initially estimated while federal government outlays were slightly higher than first reported. Inventory accumulation in the nonfarm business sector was faster than initially estimated, which added 0.72 points to top-line real GDP growth but also raises the risk that inventories will be a drag on current quarter growth. Exports of U.S. goods were slightly stronger than first estimated, reflecting a more favorable valuation of the U.S. dollar along with firming global growth.

The U.S. economy entered into 2H 2017 with considerable momentum. The keys to this being sustained will be the recent growth in business investment continuing and policy makers not hurling obstacles, in the form of restrictive trade policies and totally whiffing on corporate tax reform, in the economy's path. We'll see how this all plays out in the weeks and months ahead.





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