ECONOMIC UPDATE
REGIONS
May 30, 2019

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Q1 GDP: Can The U.S. Economy Maintain Its Momentum?

- The BEA's second estimate shows real GDP grew at an annualized rate of 3.1 percent in Q1, down from the first estimate of 3.2 percent growth
- After-tax corporate profits were down 3.50 percent from Q4 2018 but rose 1.94 percent year-on-year

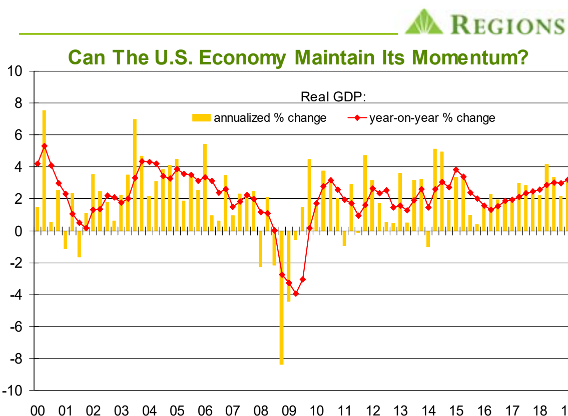
The BEA's second estimate shows real GDP grew at an annualized rate of 3.1 percent in Q1 2019, a modest downward revision to the initial estimate of 3.2 percent growth. As with the initial estimate, inventories and trade were the main drivers of Q1 growth, while growth in consumer spending was notably weak and real residential fixed investment declined for a fifth consecutive quarter. Today's release included the BEA's initial take on Q1 corporate profits; profits, both before and after tax, fell on a quarter-to-quarter basis, while before-tax profits were up 3.1 percent year-on-year and after-tax profits were up 1.9 percent. As we noted upon the release of the initial estimate of Q1 GDP, the boosts from inventories and trade seen in Q1 will not be repeated in Q2 but growth in real consumer spending will be better than was the case in Q1, with the net result a slower pace of real GDP growth. One thing that has changed, however, is that we see greater downside risk to business investment, which largely reflects uncertainty over the course of trade policy.

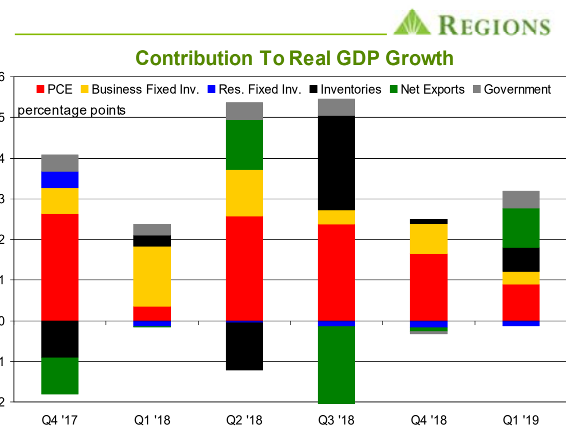
Real consumer spending is now reported to have grown at an annualized rate of 1.3 percent in Q1, a modest upward revision from the initial estimate of 1.2 percent growth. Spending on goods fell less sharply than had first been reported, while spending on household services, which accounts for roughly two-thirds of consumer spending as measured in the GDP data, was modestly stronger than first reported. Growth in consumer spending added .90 percentage points to top-line real GDP growth in Q1.

Real business fixed investment grew at an annualized rate of 2.3 percent in Q1, down from the initial estimate of 2.7 percent. While there was an upward revision to business outlays on structures, spending on equipment and machinery was revised sharply lower, with what was initially reported to be an increase of 0.2 percent now shown to be a contraction of 1.0 percent (annualized rates). Additionally, the initial estimate of 8.6 percent annualized growth in real investment in intellectual property products was revised down to 7.2 percent, which is still a solid increase and keeps intact a string of healthy growth. This is important given that increased outlays on intellectual property products, which consist mainly of R&D and software, are a precursor to faster labor productivity growth, and the trend rate of productivity growth has picked up over the past several quarters. As noted above, we do see greater downside risk to business investment spending, but this would be concentrated in spending on structures and equipment and machinery while we continue to expect further growth in spending on intellectual property products.

The initial estimate of the rate of inventory accumulation was revised modestly lower, but inventory accumulation nonetheless added 0.60 percentage points to top-line growth in Q1. The broader point, however, is that Q1 marked a third consecutive quarter of rapidly rising business inventories, and we've noted that we think the next several months will see this inventory overhang being worked off, which will act as a drag on activity in the manufacturing sector and will weigh on top-line real GDP growth as well. While the U.S. trade deficit is now reported to be larger than the initial estimate, growth in real U.S. exports was revised higher, with annualized growth of 4.8 percent compared to the initial estimate of 3.7 percent. Growth in exports of both goods and services was revised higher. The larger trade deficit, however, stems from the decline in imports of goods now shown to be less severe than initially reported. Though larger than was first estimated, the Q1 trade deficit is still smaller than was the Q4 2018 deficit. As such, trade added 0.96 percentage points to top-line real GDP growth in Q1.

Profits in the nonfinancial corporate sector were up 7.0 percent year-on-year in Q1, but were down 4.4 percent from Q4 2018, and while profits in the financial sector rose relative to Q4 2018, they were down year-on-year. Foreign profits fell both sequentially and on an over-the-year basis, and will likely remain under pressure. The 3.13 year-on-year increase in total corporate profits is the smallest such gain since Q3 2017, and both before and after tax profit margins narrowed in Q1. Rising labor costs will further pressure margins, while at the same time top-line revenue growth is likely to lose some of the upward momentum seen over the past several quarters. Though we do not yet see the expansion threatened by the uncertainty over trade policy, souring business sentiment could lead to growth decelerating faster than we had anticipated would be the case.





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