ECONOMIC UPDATE

REGIONS

May 30, 2013

Q1 2013 Real GDP: Modest Revisions, Broader Story Remains The Same

- Revised data put Q1 real GDP growth at an annualized rate of 2.4 percent, down from the BEA's initial estimate of 2.5 percent.
- The GDP Price Index rose at an annualized rate of 1.1 percent during Q1 compared to the initial estimate of 1.2 percent.
- Corporate profits fell by 2.2 percent between Q4 2012 and Q1 2013, and were up by 3.6 percent on a year-over-year basis.

Growth in the U.S. economy was a tad slower than initially estimated by the BEA, with real GDP growth now put at an annualized rate of 2.4 percent compared to the initial estimate of 2.5 percent. The BEA's second estimate incorporates more complete source data and revisions to previously released data. To us, however, the bigger story here is the growing momentum in the private sector, as private domestic demand grew by better than three percent (annualized) for the second consecutive quarter, and in fact private domestic demand growth is now shown to be faster than in the BEA's initial estimate. The government sector, however, continues to act as a drag on overall growth, and that drag is now shown to have been more severe in Q1 than previously estimated. The net result is another quarter of unsatisfactory top-line growth, but we expect to see growth improve over the second half of 2013 and into 2014 as fiscal drag becomes progressively less severe.

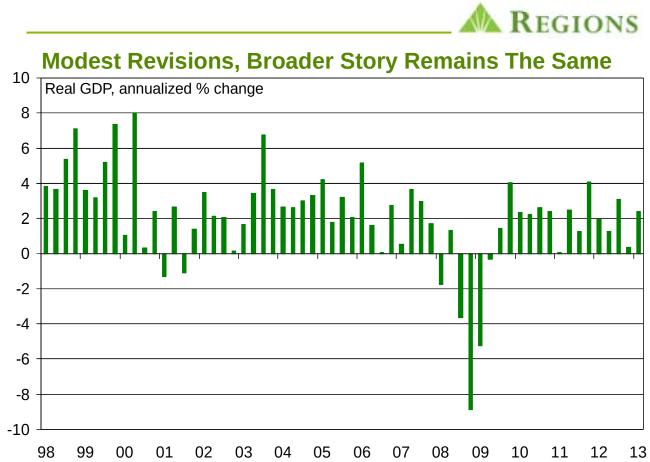
As was anticipated to be the case, real consumer spending and business spending on equipment and software were revised higher while the trade deficit was revised lower, relative to the initial estimates, while business spending on structures and the size of private sector business inventory accumulation were revised lower. What was not anticipated was the downward revision to government spending, as federal government spending was revised lower as was total spending on the state and local government levels. After the revisions, the government sector deducted 0.97 percentage points from top-line growth in Q1, and has acted as a drag on overall growth in 11 of the past 13 quarters.

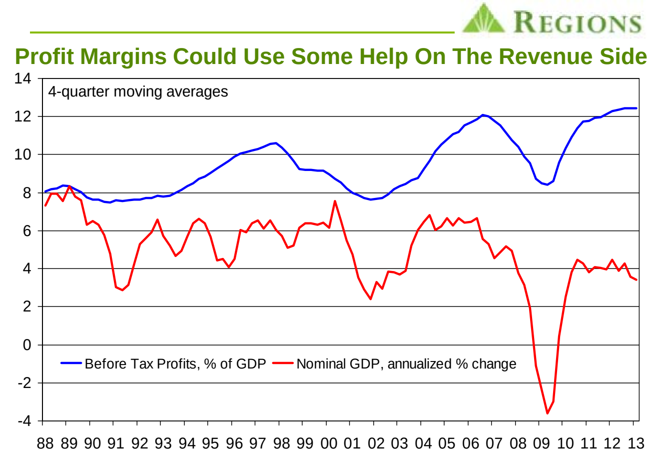
Construction spending was also a source of the downward revision to Q1 growth. Business spending on structures declined at an annualized rate of 3.5 percent, a sharper decline than incorporated into the BEA's initial Q1 estimate. In addition, revised data put annualized growth in residential investment at 12.0 percent in Q1, down from the initial estimate of 12.6 percent growth. Still, Q1 marks the third consecutive double-digit increase in residential investment and we expect similar gains over coming quarters as the housing market continues to heal.

Real personal consumption expenditures grew at an annualized rate of 3.4 percent during Q1, up from the initial estimate of 3.2 percent, with the upward revision coming from higher spending on goods, both durable and nondurable. Spending on household services grew at an annualized rate of 3.1 percent, matching the BEA's initial estimate. This growth is chiefly a reflection of higher utilities outlays during Q1, and such spending will be considerably lower in Q2. This is the main reason we expect growth of real consumer spending to slow to around 2.2 percent during the current quarter.

Also included in today's report is the first look at Q1 corporate profits. As corporate profits go, Q1 was a quarter to forget, with total before-tax profits falling by 2.2 percent relative to Q4 2012. Profits were lower across the board, from domestic and foreign operations, and in the financial and nonfinancial sectors of the economy. On an over-the-year basis, corporate profits were up by 3.6 percent from Q1 2012. While this is not to suggest the corporate sector is suffering – as a percentage of GDP corporate profits continue to hover at record highs – there is still reason for at least some concern. As seen in the second chart below, top-line revenue growth, as reflected by nominal GDP growth, has been mediocre over the course of the current recovery, and stringent expense management has been the prime driver of profit growth. That can only take you so far, however, and in the absence of an improved rate of top-line revenue growth, profit margins will come under pressure, though will remain elevated.

When looked at as a whole, the U.S. economy continues to meander along a path of slow and uneven growth but this top-line view masks a stark dichotomy between healthy growth in private domestic demand and a contracting government sector. We maintain, however, as the year progresses fiscal drag will fade and top-line growth will look better.





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