ECONOMIC UPDATE

REGIONS

April 30, 2014

Q1 2014 Real GDP: More Noise Than Signal In BEA's First Pass At Q1 GDP

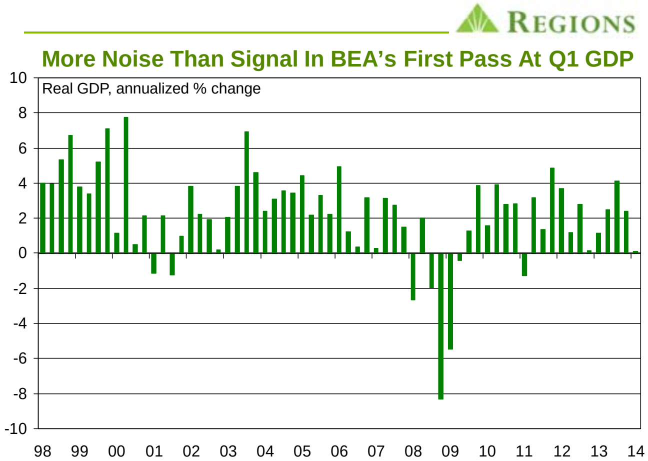
- According to the BEA's first estimate, the U.S. economy grew at an annualized rate of 0.1 percent in Q1, down from 2.6 percent in Q4 2013.
- The GDP Price Index rose at an annualized rate of 1.3 percent in Q1, compared to 1.6 percent in Q4 2013.
- Real consumer spending advanced at an annualized rate of 3.0 percent; inventories, trade, and investment acted as drags on top-line growth.

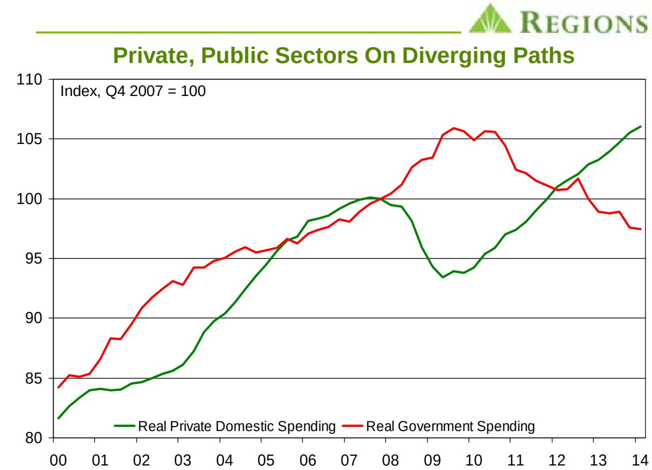
In our weekly *Economic Preview* we wrote that "nothing would surprise us" when it came to the BEA's first estimate of Q1 real GDP growth. But, as we see the headline print showing annualized growth of just 0.1 percent, we have to admit to being at least a bit surprised but at the same time are about as unconcerned as one can be over such a weak headline. Our point was two-fold – first, there would be some effects from the unusually harsh winter weather, and those effects would be reversed during Q2 and, second, as is the case in any given quarter, the BEA's first pass at GDP is based on incomplete source data and incorporates estimates for trade, inventories, construction spending, and certain components of government spending. As such, subsequent estimates of GDP incorporate more complete source data and there are often substantial changes between the first and third estimates. So, while today's report is certainly eye catching, we do not find it to be representative of the underlying health of the U.S. economy – and, to be sure, this will also be our reaction when the Q2 report is issued with what presumably will be a more robust headline growth number.

Real consumer spending grew at an annualized rate of 3.0 percent in Q1, though there was a sharp divergence between growth in spending on goods and growth in spending on services. Real spending on goods grew by just 0.4 percent, annualized, while spending on services grew at an annualized rate of 4.4 percent, the fastest growth since 2000. This is one area in which the harsh winter weather impacted both the level and the composition of spending. Purchases of consumer durables, such as motor vehicles and household appliances, were to some extent delayed during Q1 though, as is apparent in the retail sales data, bounced back in March and will show further growth in April. Other types of consumer spending, however, were foregone as higher utilities outlays took a larger share of household budgets – spending on utilities rose at an annualized rate of 6.0 percent, adding seven-tenths of a point to top-line real GDP growth. The other main driver of growth in spending on household services was the 9.9 percent annualized growth in outlays on health care, which reflects the implementation of the Affordable Care Act. Note that as reported in the GDP data all outlays on health care either by or on behalf of consumers (i.e., regardless of who actually foots the bill) are booked as consumer spending. This is one source of the myth consumer spending accounts for 70 percent of GDP, but that is another story for another day. Still, as the ACA expands further it will support reported growth in consumer spending on services.

Private investment fell at an annualized rate of 6.1 percent, with business fixed investment and residential investment falling while a slower pace of inventory accumulation on the part of nonfarm businesses also acted as a drag on overall investment. There are some weather effects at play here with residential and commercial construction spending, while the slowdown in business spending on equipment partly reflects payback from such spending being pulled forward into 2013 to take advantage of tax incentives. Another sizeable drag on top-line growth was a wider trade gap, as exports of goods are reported to have fallen at an annualized rate of 12.0 percent after growth of 11.8 percent in Q4 2013, and the decline in total U.S. exports swamped the decline in total imports. All in all, net exports knocked 0.83 points off of top-line growth. In the government sector, federal government spending rose modestly – the first such advance since Q3 2012 – but spending on the combined state and local levels declined by 1.3 percent (annualized). Note that most of the data referenced in this paragraph rely, to varying degrees, on estimates and will be revised as more complete source data become available.

Our point is not that today's weak headline number will be revised to show the economy grew at a dizzying pace in Q1. Instead, maybe anyone tempted to panic over a backward looking number based on incomplete data should just take a breath. Or, one could simply look at the flow of high frequency data over the past few weeks and ask which view of the economy is more reflective of reality.





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