ECONOMIC UPDATE

REGIONS

May 29, 2014

Q1 2014 Real GDP: Sometimes Less Is Just Less . . .

- Revised data show real GDP contracted at an annualized rate of 1.0 percent in Q1, compared to the initial estimate of 0.1 percent growth.
- Revisions show the GDP Price Index rose at an annualized rate of 1.3 percent in Q1, matching the initial estimate.
- On a year-over-year basis, corporate profits declined by 3.0 percent in Q1 on a decline in profits from domestic operations.

With all due respect to Robert Browning, or if you are so inclined, Joss Stone, sometimes less is not more, sometimes less is just less. That would be the case with the U.S. economy in Q1 2014, when real GDP contracted at an annualized rate of 1.0 percent, a sharp downward revision to the BEA's initial estimate of 0.1 percent "growth." As we always point out with the GDP data, the BEA's initial estimate is based on highly incomplete source data and there are typically large revisions from the first and second estimates, though the revisions in Q1 are a bit larger than normal. The BEA will issue a third estimate of Q1 GDP on June 25 and the numbers will be revised further still as part of the annual benchmark revisions due on July 30. This isn't to suggest the Q1 numbers will look any better, but does at least serve notice we have even more occasions on which to talk about the impact of the harsh winter weather as July comes to a close, so at least there's that.

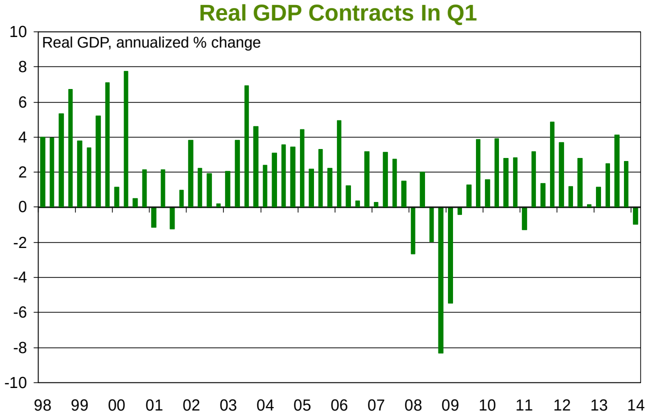
There was a slight upward revision to real consumer spending, now reported to have grown at an annualized rate of 3.1 percent instead of 3.0 percent. The upward revision came from spending on motor vehicles and nondurable goods, as spending on household furnishings and household services was revised lower. Still, spending on household services grew at an annualized rate of 4.3 percent, with higher outlays on utilities, thanks to the harsh winter weather, and health care, thanks to the implementation of the ACA, leading the way. Aside from consumer spending, however, the other upward revisions came in the form of things not being as bad as the BEA initially estimated. For instance, exports of U.S. goods fell at an annualized rate of 9.8 percent, as opposed to the first estimate of 12.0 percent. Still, with imports of goods now reported to have risen in Q1 – they initially shown to have fallen – the trade gap widened further than the BEA initially estimated

Far and away the most significant downward revision came in the data on nonfarm business inventories. Note in the calculation of GDP growth it is the rate of change, not the absolute change, that matters. So, while nonfarm inventories grew in Q1, they grew at a slower rate than the BEA initially estimated, to the point that inventories took 1.62 points from top-line real GDP growth as opposed to the initial estimate of a 0.57 percent deduction. Another significant downward revision came from business spending on structures, initially estimated to have risen at an annualized rate of 0.2 percent but now reported to have contracted at an annualized rate of 7.5 percent. Overall business fixed investment contracted at an annualized rate of 3.1 percent in Q1, a less harsh decline than the initial estimate of 5.5 percent as the decline in spending on business equipment was not as large as initially estimated.

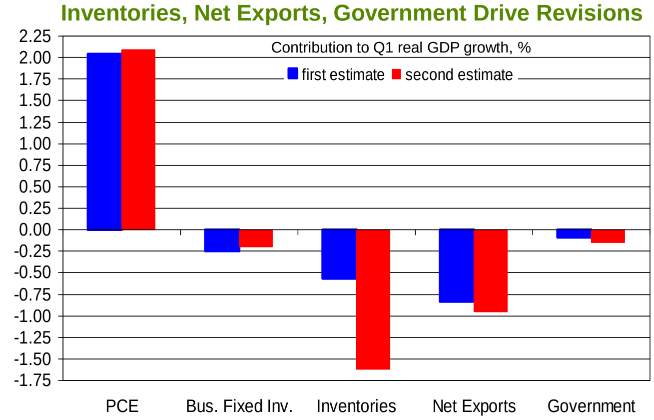
Total government spending declined at an annualized rate of 0.8 percent in Q1 compared to the initial estimate of a 0.5 percent decline. The downward revision came on the combined state and local levels, where spending fell at an annualized rate of 1.8 percent rather than 1.3 percent as initially estimated. Federal government spending rose at an annualized rate of 0.7 percent, unchanged from the initial estimate. The decline in spending on the state and local levels is a bit surprising given what have been improving revenue trends, and we would look for at least modest increases in spending over coming quarters.

While we do not mean to simply brush aside the Q1 GDP data, it is important to at least put it in context. By now we're as tired of talking about the harsh winter weather as you are of hearing about it, but there is no denying the impact on the economy. The relevant question is the extent to which it was the weather and the extent to which is was a sudden turn for the worse in the health of the economy. We have noted there is cause for concern with housing but beyond that there is nothing in the flow of high frequency data to suggest Q1 is a true portrayal of the economy's underlying health. We'll say the same with what we expect to be outsized – and unsustainable – real GDP growth in Q2. As is typically the case, the truth is somewhere in between, but closer to what we will see in the Q2 data than what we saw in the Q1 data.

Real GDP Contracts In Q1



Inventories, Net Exports, Government Drive Revisions



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