ECONOMIC UPDATE

REGIONS

April 29, 2015

Q1 2015 Real GDP: Another Q1 To Forget

- The BEA's first estimate shows annualized real GDP growth of 0.2 percent in Q1 2015.
- The GDP Price Index <u>fell</u> by 0.1 percent (annualized) in Q1.

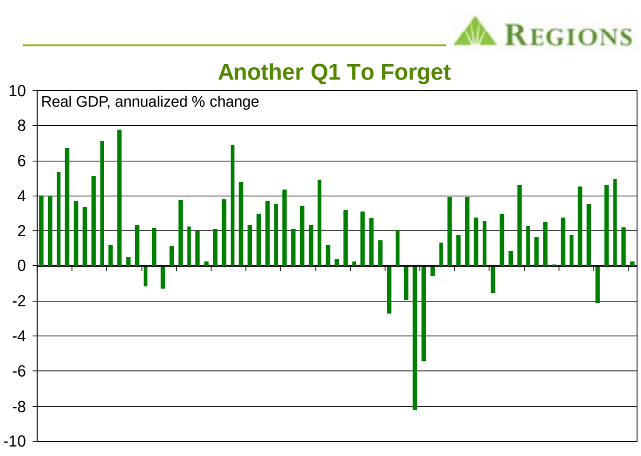
Stop us if you've heard this one before. The U.S. economy got off to a miserable start in 2015 with real GDP growth of just 0.2 percent (annualized), short of the consensus forecast of 1.0 percent growth and our call of 0.9 percent growth. As we regularly point out, the initial estimate in any given quarter is based on highly incomplete source data and, as such, relies heavily on estimates of missing data points. That said, no amount of revision is likely to make Q1 look all that much better, the only question now is whether or not this will prove to be another instance of the first quarter of a given year being weak with subsequent quarters showing better growth. This has been the case more often than not over the past several years and, for what it's worth, we expect that to be the case this year.

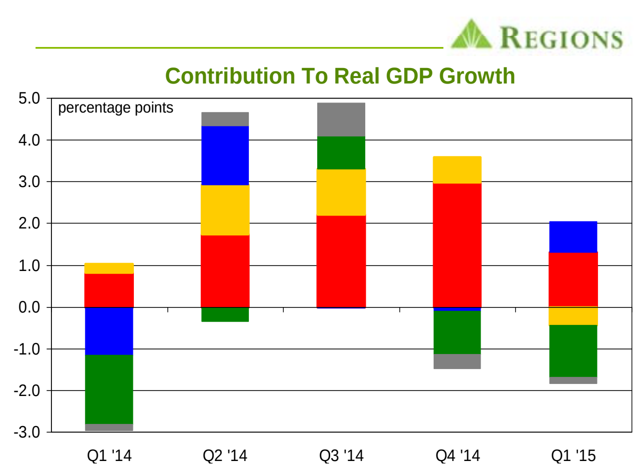
By now the litany of the U.S. economy's Q1 2015 ills is all too familiar – harsh winter weather, the widespread impact of the West Coast port strike, a sharp curtailment of investment in the energy sector, and a soft global growth environment all contributed to the listless economy in Q1. These factors are apparent in the GDP data, including a 23.1 percent annualized decline in business spending on structures, a decline primarily driven by energy companies slashing investment outlays in the face of low oil prices. The decline in business spending on structures took 0.8 percentage points off of top-line real GDP growth. The pullback in the energy sector can also be seen in business spending on equipment, which rose just 0.1 percent (annualized) in Q1. The impact of low oil prices has been apparent in the monthly data on new orders for oil and gas field equipment, which as of February (the BEA estimated March data) were down 37 percent from their summer peak.

A ballooning trade deficit deducted 1.3 percentage points from top-line real GDP growth in Q1, reflecting the combination of the port strike and a softer global growth environment. Exports of U.S. goods are reported to have fallen at an annualized rate of 13.3 percent in Q1, while imports of goods into the U.S. rose at an annualized rate of 0.9 percent, down from 10.4 percent growth in Q4. On the services side, however, trade flows were healthier, with exports of U.S. services rising at an annualized rate of 7.3 percent and imports of foreign services rising at an annualized rate of 6.3 percent. Though the port strike was settled in February the backlog left in the strike's wake was so large that its impact will continue to be felt in the trade data but, whether it is in the Q2 data or the Q3 data, at some point there will be a sharp narrowing of the trade deficit. This of course will have an outsized impact on the top-line GDP number but will tell us no more about the underlying health of the U.S. economy than does the sharply wider trade gap in Q1.

Real consumer spending grew at an annualized rate of 1.9 percent in Q1, a far cry from the 4.4 percent growth posted in Q4. Spending on goods rose just 0.2 percent with spending on nondurable goods declining at an annualized rate of 0.3 percent mostly due to a slower pace of motor vehicle sales. Weather distorted consumer spending patterns in Q1 and this is one area where we expect the Q2 data to look much better, as personal income growth remained healthy in Q1, rising at an annualized rate of 4.0 percent, with growth in disposable personal income (i.e., after-tax income) rising at an annualized rate of 4.1 percent. Reflecting the combination of firmer growth in disposable income and slower growth in spending, the saving rate rose to 5.5 percent from 4.6 percent in Q4. Another positive for the economy in Q1 was business investment in intellectual property products, specifically, software and research & development which both will ultimately turn up in improved worker productivity. Spending on intellectual property products rose at an annualized rate of 7.8 percent in Q1 after double-digit growth in Q4.

We frequently point out the value of not getting too wrapped up in the headline numbers from any given data release and instead focusing on the underlying trends. Admittedly, with a number as putrid as today's print on Q1 real GDP growth that is hard to do. Nonetheless, we do expect coming quarters to bring better GDP growth, with the "truth" being somewhere in between those and the forgettable Q1 number.





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