TD Economics

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Data Release: U.S. economy grew by 2.4% in Q1 on strong private demand but falling government spending

- The second estimate of first quarter real GDP was revised down to 2.4% (annualized) from an initial estimate of 2.5%. The consensus was for an unchanged print.

- While the headline number was slightly weaker, consumer spending was revised up to 3.4% (from 3.2% initially). Business fixed investment was unchanged at 4.1% as higher spending on equipment and software was offset by softer spending on structures.

- The main source of downward revision was to inventory investment which went from adding 1.03 percentage points to adding 0.63 percentage points. All of the gain in inventories was in the farm sector. Non-farm inventories subtracted 0.21 from growth (from an initial estimate of +0.25 pp). Government was also revised down, mainly at the state and local level and subtracted 0.97 percentage points from real GDP growth (from an initial estimate of -0.8).

- Both exports and imports were revised down. Export growth was revised to 0.8% (from 2.9% initially) and imports to 1.9% (from 5.4%) initially. On balance, the drag from net exports was revised lower to -0.21 percentage points (from -0.5 pp initially).

- Corporate profits before tax declined 2.2% (non-annualized) in the first quarter. Profits declined across sectors, but was led by profits from the rest of the world, which fell 7.3%. Domestic financial profits were down 0.44% and domestic non financial down 0.8%.

Key Implications

- The revisions to economic growth was relatively small and does not change the underlying story. Given ongoing signs of improvement in consumer demand, slower inventory accumulation in the first quarter is likely to be met with faster growth in the second.

- The rise in home prices and improvement in consumer confidence is encouraging and should support continued gains in consumer spending. However, it has not changed our expectation for real GDP growth to decelerate to below 2.0% in the second quarter. Indeed, the outturn is likely to be similar to the first, with relatively robust private domestic demand offset by cuts in government consumption and investment.

- Financial markets are likely to look past the slowdown in growth in the second quarter, particularly if it is met with ongoing private sector resilience. As signs of growth increase, attention has turned to the exit from monetary accommodation. This is necessary, but may also increase volatility as markets attempt to gauge whether the improvement qualifies as substantial in the eyes of the Fed.

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