ECONOMIC UPDATE

REGIONS

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Q1 2023 GDP: Not As Bad As The Headline, But Still Not Good

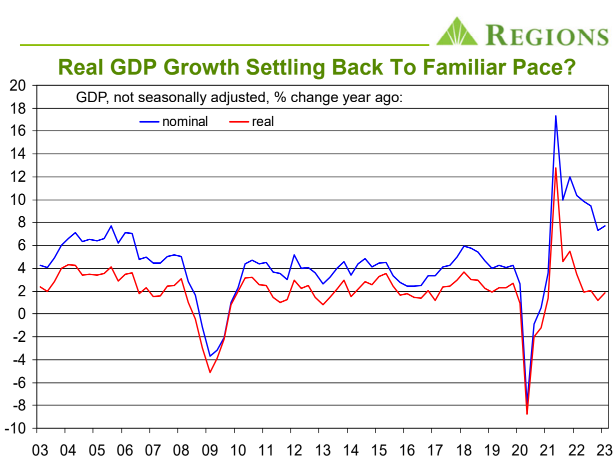
- The BEA's first estimate shows real GDP grew at an annualized rate of 1.1 percent in Q1 2023 after 2.6 percent growth in Q4 2022
- Consumer spending was the main driver of Q1 growth, a draw in nonfarm business inventories was a significant drag on Q1 growth

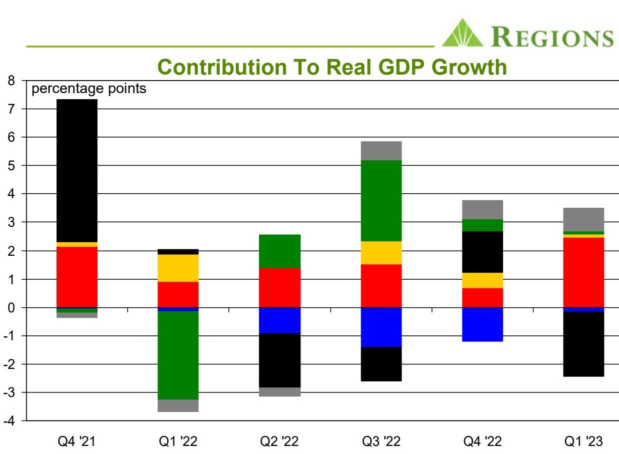
According to the initial estimate from the Bureau of Economic Analysis (BEA), real GDP grew at an annualized rate of 1.1 percent in Q1 2023, far below what we and the consensus expected. We'll insert our usual caveat here, which is that in any given quarter the BEA's initial estimate of GDP is based on highly incomplete source data and, as such, prone to sizable revision. The glaring caveat here, however, is that a modest draw in nonfarm business inventories took 2.3 percentage points from top-line real GDP growth, making the headline growth print look misleadingly weak. Real private domestic demand, or, combined business and household spending, rose at an annualized rate of 2.9 percent in Q1, the fastest quarterly growth rate since Q2 2021. That, however, does not at all mean all is well with the economy, with the "truth" lying somewhere between the prints on real GDP growth and real private domestic demand growth. Perhaps of more relevance, year-on-year growth in not seasonally adjusted real GDP, the only proper basis on which to make over-the-year comparisons, came in at 2.0 percent in Q1, in line with the trend rate of growth in the years leading up to the pandemic. The reality is that the economy lost momentum as Q1 progressed, ending the quarter on a softer note than it began the quarter on. Our expectation is that real GDP will more or less flatline over the middle two quarters of 2023.

There are two main culprits in our miss on our forecast of Q1 growth, which we expected to come in at an annualized rate of 2.3 percent. First, inventories were a much more powerful drag on Q1 growth than our forecast anticipated. As noted above, a modest draw in nonfarm business inventories took over two percentage points off top-line real GDP growth. Second, growth in consumer spending was slower than we expected thanks to revisions to the recent historical data on retail sales. Those revisions were released Monday, subsequent to our publishing our forecast on Q1 GDP growth, and show a much weaker trajectory of control retail sales, a direct input into the GDP data on consumer spending on goods, than had previously been reported. To that point, the revised data show nominal control retail sales grew at an annualized rate of 5.5 percent in Q1, considerably weaker than the 9.5 percent growth that had been reported. As such, total consumer spending grew at an annual rate of 3.7 percent in Q1, well below the rate incorporated into our forecast. Much of that growth came in the form of a jump in unit sales of new motor vehicles in Q1, which alone contributed 1.06 percentage points to top-line real GDP growth. Real spending on nondurable goods grew at an annual rate of just 0.9 percent and real spending on services grew at an annual rate of 2.3 percent, though discretionary services spending grew at a much faster pace.

Real business fixed investment grew at an annual rate of 0.7 percent in Q1, with a striking divergence amongst the individual components. Real outlays on business structures grew at a 11.2 percent rate and real outlays on intellectual property products grew at a 3.8 percent rate, but real outlays on equipment and machinery fell at a 7.3 percent rate. While this is, to us, easily the most disappointing element of the Q1 GDP data, it comes as no surprise given the weakness seen in the data on core capital goods orders over the last several months of 2022 and which has persisted into 2023, a point lost on those reflexively pointing to stress in the banking system and tighter credit conditions to explain falling business spending on equipment and machinery. If that is the most disappointing element of the Q1 GDP data, perhaps the most encouraging element is that the drag from residential fixed investment was much smaller than had been the case over prior quarters. While that for the most part reflects growth in multi-family construction, the drag from single family construction is abating and the higher frequency data on new home construction and sales suggests single family activity should be a modest support for real GDP growth over the back half of 2023, if not before.

As noted above, Q1 ended on a softer note than it began on. With consumer spending on goods fading and many businesses having right-sized stocks, inventory accumulation is likely to remain slow. We also expect discretionary services spending to soften in the months ahead while business outlays on equipment and machinery fade further. These drags will be offset by further growth in business spending on intellectual property products, rising government spending, and some improvement in residential fixed investment. The net result will likely be flattish real GDP in the quarters ahead.





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