ECONOMIC UPDATE
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Q1 Real GDP: Maybe Curb Your Enthusiasm Just A Tad. Or Not – Up To You

- The BEA's third estimate shows real GDP grew at an annualized rate of 2.0 percent in Q1, up from the second estimate of 1.3 percent growth
- Relative to the second estimate, consumer spending and net exports were revised higher, business investment was revised lower

Our practice has always been to offer a detailed take on the first and second estimates of real GDP for any given quarter, but to let the third estimate go without comment. That simply reflects the typical patterns in the estimates – the first estimate in any given quarter is based on highly incomplete source data and hence prone to sizable revision, and we've always felt both merited breaking down. The third estimate, however, does not tend to change much from the second estimate and given that the third estimate of real GDP in any quarter comes out three months after the quarter has ended, it usually feels like old news. As such, while we of course analyze the data, we just don't feel what are typically modest revisions merit further comment. Welcome to the exception to that general rule. The BEA's third estimate shows real GDP grew at an annualized rate of 2.0 percent in Q1, up from the second estimate showing 1.3 percent growth. Granted, 2.0 percent growth isn't great but it is, as we understand these things, better than 1.3 percent growth, particularly at a time when many are on recession watch. Moreover, the upward revision has been accompanied by the usual outpouring of "what does this mean for the FOMC?" takes, in part because one source of the upward revision to top-line real GDP was an upward revision to consumer spending, as in "those pesky consumers won't stop spending, so the FOMC will have to push rates up even further to teach them a lesson." Okay, we're paraphrasing, but only a little.

Our take is that there is much less to this upward revision than meets the eye, and whatever it may or may not mean for the FOMC, our take is that it shouldn't make the slightest difference. First, the upward revision to real consumer spending, now shown to have grown at an annual rate of 4.2 percent, the fastest quarterly growth rate since Q2 2021, owes entirely to an upward revision to services spending, as goods spending was revised down as we expected. Within services, however, it was an upward revision to spending on health care that accounted for the bulk of the upward revision, and it helps to recall that in the BEA's accounting, health care outlays are booked as consumer spending regardless of how those outlays are paid for or who pays them. In contrast, our proxy for discretionary services spending was little changed between the second and third estimates of Q1 GDP. So, those thinking the upward revision to consumer spending has, or should have, implications for the FOMC may want to rethink that.

Additionally, a sharp downward revision to imports into the U.S. led to a much smaller trade deficit than reported in the BEA's second estimate of Q1 GDP. Under GDP accounting conventions, imports are treated as a deduction, so the downward revision to imports effectively added to real GDP growth. But, as we've often noted, imports of capital goods and inputs to production used by U.S. firms account for a sizable share of total imports, and it was a downward revision to imports of capital goods that accounted for the biggest chunk of the downward revision to imports in Q1. While that may be good for the GDP math, we'd say it's at the same time terrible for the productive capacity of the U.S. economy, particularly when coupled with a downward revision to business fixed investment. In that sense, i.e., less growth in supply, it would make sense to think the revised Q1 GDP data would be worrisome for the FOMC, but those talking about potential implications for the FOMC seem solely focused on faster growth in demand that isn't really there given that it mainly reflects increased outlays on health care.

Perhaps the most telling, at least to us, sign that there is less to the revised data than meets the eye is in the not seasonally adjusted data. While most pay no mind to the unadjusted GDP data, the GDP data are like any other data series to us in that we always look at the trends in the unadjusted data as the most meaningful gauge of what is actually going on in the economy. The not seasonally adjusted data barely budged between the BEA's second and third estimates – the level of real GDP was indeed revised up, but by all of 0.02 percent, hardly setting a new and bolder path for either the economy or monetary policy. Indeed, the quarter/quarter and year/year percentage changes in both nominal and real GDP in the not seasonally adjusted data in the BEA's third estimate are identical to those in the BEA's second estimate. To us, this simply raises questions about what really changed in the seasonally adjusted annualized data, i.e., the data or the seasonal adjustment factors used to produce the headline growth number.

Sure, anyone is free to have whatever reaction they want to any given data release, but, our take is that the actual changes in the economy, and in turn the implications for the FOMC, are far, far, smaller, almost to the point of being trivial, than would be implied by the headline growth number being revised up from 1.3 percent to 2.0 percent. We just thought this might be useful context.

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