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TD Economics

Data Release: Once again, Q1 growth upgraded in second estimate

- The second estimate of U.S. real GDP growth for the first quarter of 2017 was revised up to 1.2%(annualized), from 0.7% in the advance estimate. This reflected upward revisions to business investment, consumer spending, and state and local government spending that were partly offset by downward revision to private inventories.

- Consumer spending growth was upgraded, but was still weak at only 0.6% (prev. 0.3%), a marked deceleration from the 3.5% pace recorded in Q4. Both spending on services was slightly stronger, and the decline in durable goods was smaller.

- Business investment was already a bright spot in Q1, and was revised up to 11.4%, reflecting even stronger spending on structures (+28.4%) and intellectual property (+6.7%). Residential investment was largely unchanged.

- Offsetting all this good news, weaker inventory investment subtracted 1.1 percentage points from growth, slightly more than in the advance estimate (-0.9 p.p.).

Key Implications

- Today's growth upgrade continues the pattern of upward revisions to GDP estimates between the first and third release. While this provides some encouragement that the weakness in Q1 was not as bad as previously thought, it doesn't really change the story of another soft start to the year, followed by a rebound in Q2. Many of the factors depressing growth in Q1 were temporary, and a reversal in Q2 is expected to drive a rebound of greater than 3% growth.

- Looking through the noisy quarter-to-quarter swings in GDP (as discussed in our recent report), we judge underlying growth in the U.S. economy to be running slightly better than 2%. With an aging population, this is a decent pace of growth relative to the economy's potential (see our recent report) and strong enough to generate a modest pickup in inflation.

- The Fed has already indicated it is looking through the Q1 GDP disappointment, and will take its cue more from what the revisions mean for growth in the second quarter and beyond. Moreover, it will likely be more focused on whether job market strength continues in next week's payrolls report and how that squares with the cooler core inflation readings we have seen in March and April. We expect that the Fed will stick to its gradual pace of rate hikes and hike in June, if the data cooperates.

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