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1st Quarter GDP (Preliminary)

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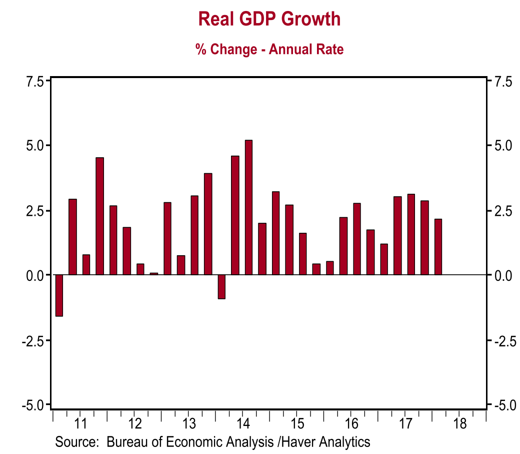
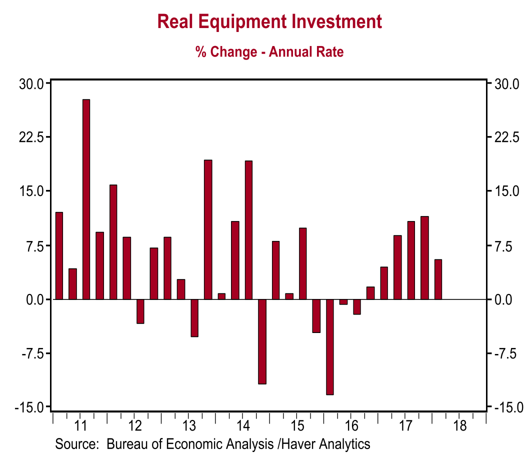
- Real GDP was revised slightly lower to a 2.2% annual rate in Q1 from a prior estimate of 2.3%. The consensus expected 2.3%.
- The largest downward revision was for inventories. The largest upward revision was for business investment in intellectual property.
- The largest positive contribution to the real GDP growth rate in Q1 came from business fixed investment. The weakest component was residential investment.
- The GDP price index was revised slightly lower to a 1.9% annual rate from a prior estimate of 2.0%. Nominal GDP growth – real GDP plus inflation – was revised down to a 4.2% annual rate from a prior estimate of 4.3%.





Implications: Real GDP growth was revised modestly lower for the first quarter, but the "mix" of growth is now more favorable for a pickup in future quarters. The second reading for Q1 real GDP growth was revised ever so slightly to a 2.2% annual rate from a prior estimate of 2.3%. But the key reason for the downward revision was slower growth in inventories, which leaves more room for production in the near future. Meanwhile, business fixed investment – equipment, structures, and intellectual property – was revised to a 9.2% annualized growth rate from a prior estimate of 6.1%. Compared to a year ago, real GDP is up 2.8% and we are increasingly confident we will see growth of around 4% for the second quarter. The tax cuts enacted in late December – paired with deregulation coming from Washington, DC - are spurring increased activity and higher levels of business investment, both of which should push productivity higher going forward. The most disappointing news in today's report was that economy-wide corporate profits slipped 0.6% in Q1. However, they're still up 4.3% in the past year. Meanwhile, after-tax profits hit an all-time record high and are up 14% from a year ago. Expect continued gains in after-tax profits as the tax cut feeds through to the bottom line in the coming quarters. Today's report is also a reminder that the Federal Reserve is behind the curve. Nominal GDP growth (real growth plus inflation), was revised slightly lower to a 4.2% annual growth rate in Q1 versus a prior estimate of 4.3%. Still, nominal GDP is up 4.7% from a year ago and is up at a 4.4% annual rate in the past two years. This pace of economic growth warrants a much higher Fed rate than the current 1.625% or the 1.875% the Fed is almost certain to move to in June. At present, the federal funds futures market has about 25% odds of four or more rate hikes this year. We put the odds of four Fed hikes, 25 basis points each time, at closer to 80%, and expect a rebound in long-term yields as well. In other news this morning, the ADP index reported private payrolls rose 178,000 in May. Plugging this data into our models suggests Friday's official Labor Department report will show a healthy nonfarm payroll gain of 183,000. On the housing front, the national Case-Shiller index reported home prices were up 0.4% in March and are up 6.5% versus a year ago, an acceleration from the 5.7% gain in the twelve months ending March 2017. In the last year, price gains were led by Seattle and Las Vegas.

1st Quarter GDP Seasonally Adjusted Annual Rates	Q1-18	Q4-17	Q3-17	Q2-17	4-Quarter Change
Real GDP	**2.2%**	2.9%	3.2%	3.1%	2.8%
GDP Price Index	**1.9%**	2.3%	2.1%	1.0%	1.8%
Nominal GDP	**4.2%**	5.3%	5.3%	4.1%	4.7%
PCE	**1.0%**	4.0%	2.2%	3.3%	2.6%
Business Investment	**9.2%**	6.8%	4.7%	6.7%	6.8%
Structures	**14.3%**	6.3%	-7.0%	7.0%	4.9%
Equipment	**5.5%**	11.5%	10.8%	8.8%	9.1%
Intellectual Property	**10.9%**	0.9%	5.2%	3.7%	5.1%
Contributions to GDP Growth (p.pts.)	**Q1-18**	**Q4-17**	**Q3-17**	**Q2-17**	**4Q Avg.**
PCE	**0.7**	2.8	1.5	2.2	1.8
Business Investment	**1.1**	0.8	0.6	0.8	0.8
Residential Investment	**-0.1**	0.5	-0.2	-0.3	0.0
Inventories	**0.1**	-0.5	0.8	0.1	0.1
Government	**0.2**	0.5	0.1	0.0	0.2
Net Exports	**0.1**	-1.2	0.4	0.2	-0.1