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1st Quarter GDP (Preliminary)

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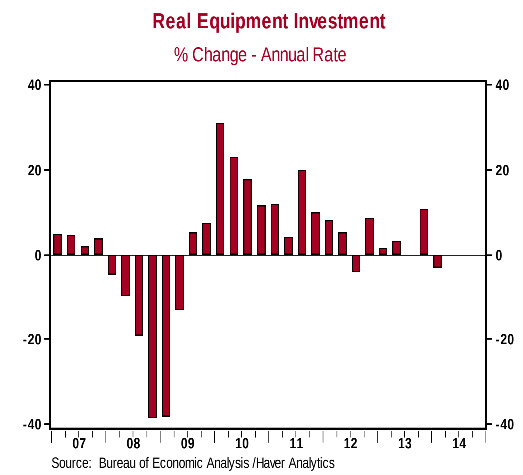
- Real GDP was revised to a -1.0% annual rate in Q1 from a prior estimate of +0.1%. The consensus expected -0.5%.
- The largest downward revision, by far, was for inventories. Commercial construction and net exports were also revised down while business investment in equipment and intellectual property were revised up.
- The largest positive contribution to the real GDP growth rate in Q1 was personal consumption. The weakest components were inventories and net exports.
- The GDP price index was unrevised at a 1.3% annual rate. Nominal GDP growth – real GDP plus inflation – was revised down to a 0.3% annual rate from a prior estimate of 1.4%.



Implications: Forget about GDP for a moment. The most important economic news this morning was in the labor market, where initial claims fell 27,000 last week to 300,000 and continuing claims declined 17,000 to 2.63 million. Both the four-week average for initial claims and continuing claims are the lowest since 2007. Plugging these figures into our payroll models suggests a gain of 200,000 in May. (The forecast will change as we get more data in the next week on claims, the ADP index, and consumer spending.) Now back to Q1 GDP: look out for the Pouting Pundits of Pessimism. As we said in our most recent Monday Morning Outlook, it's important to remember the report is for Q1, the last days of which ended two months ago, so it's a "rearview mirror" picture of the economy. Real GDP was revised down to -1% at an annual rate from an original estimate of +0.1%. But as we have always argued, the weather was the chief culprit behind Q1 weakness and the downward revision was almost completely due to lower inventories, which leaves more room for growth in future quarters. Nothing in today's news changes our forecast that real GDP will grow at about a 3% rate in the year ahead. Despite today's downward revisions, nominal GDP (real growth plus inflation) is up 3.4% from a year ago; nominal GDP excluding government purchases is up 4.3% from a year ago. These figures continue to suggest a federal funds rate of essentially zero makes monetary policy too loose. Today's report also provided the first glimpse at overall corporate profits, and boy was the headline ugly. Corporate profits fell 9.8% in Q1, but there are two good reasons. First, as with overall GDP, weather had a negative effect. Second and more important, the big drop in corporate profits was due to a large "capital consumption adjustment" which reflects the expiration of 50% bonus depreciation provision and higher limits for expensing under the American Taxpayer relief Act of 2012. In other words, this is a one-off event and we expect corporate profits to rebound sharply in the coming quarters. In other news today, pending home sales (contracts on existing homes) increased 0.4% in April after a 3.4% gain in March. These reports suggest existing home sales, which are counted at closing, will increase about 2% in May.

4th Quarter GDP Seasonally Adjusted Annual Rates	Q1-14	Q4-13	Q3-13	Q2-13	4-Quarter Change
Real GDP	-1.0%	2.6%	4.1%	2.5%	2.0%
GDP Price Index	1.3%	1.6%	2.0%	0.6%	1.4%
Nominal GDP	0.3%	4.2%	6.2%	3.1%	3.4%
PCE	3.1%	3.3%	2.0%	1.8%	2.5%
Business Investment	-1.6%	5.7%	4.8%	4.7%	3.4%
Structures	-7.5%	-1.8%	13.4%	17.6%	4.9%
Equipment	-3.1%	10.9%	0.2%	3.2%	2.7%
Intellectual Property	5.1%	4.0%	5.7%	-1.5%	3.3%
Contributions to GDP Growth (p.pts.)	**Q1-14**	**Q4-13**	**Q3-13**	**Q2-13**	**4Q Avg.**
PCE	2.1	2.2	1.4	1.2	1.7
Business Investment	-0.2	0.7	0.6	0.6	0.4
Residential Investment	-0.2	-0.3	0.3	0.4	0.1
Inventories	-1.6	0.0	1.7	0.4	0.1
Government	-0.2	-1.0	0.1	-0.1	-0.3
Net Exports	-1.0	1.0	0.1	-0.1	0.0