Economic Indicator — May 25, 2023

# Revised GDP Data Show Contractions in Income and Profits in Q1-2023


## Summary

- The second estimate of real GDP growth showed the U.S. economy expanded at an annualized rate of 1.3% in the first quarter, up about two-tenths of a percentage point from the preliminary estimate.
- The modest upward revision to Q1 GDP growth does not really change the overall narrative of the economy at present. Incoming data beyond Q1 show the economy continuing to grow, albeit at a sub-trend level.
- Today's release also included the first look at the income side of the National Income and Product Accounts (NIPA). To that end, real gross domestic income (GDI) contracted at a 2.3% annualized rate in Q1, demonstrating notably weaker growth.
- Corporate profits slipped 5.1% (not annualized) in the first quarter. Profit growth has slowed in recent quarters. Profits have now slipped for three straight quarters and slipped on a year-ago basis for the first time in two years.
- Profits tend to peak ahead of a broader economic recession. We look for further weakness in profit growth over the course of the year. Dwindling profits and heightened uncertainty leave firms with less means and desire to invest.
- Although we believe that the U.S. economy is not in recession at present, we continue to believe that it is tracking toward a downturn later this year.



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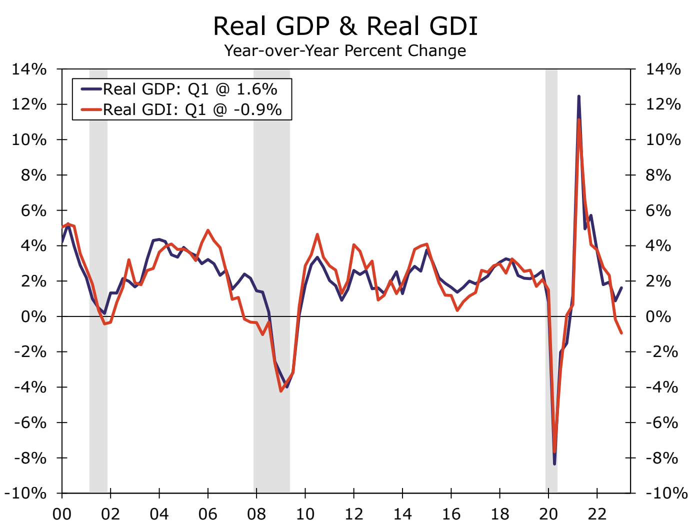
## Not Much Upside From Upward Revision

Revised data that were released this morning showed that real GDP expanded at a 1.3% annualized rate in Q1-2023, which was higher than the first estimate of 1.1% that was released a month ago. Stronger growth in the headline rate of GDP growth reflects an upward tweak to real consumer spending (3.8% annualized growth in Q1 versus the initial print of 3.7%) as well as less weakness in fixed investment spending (-0.2% versus -0.4% initially). In general, however, the modest upward revision to Q1 GDP growth does not really change the overall narrative of the economy at present. That is, incoming data continue to show that the U.S. economy continues to expand, albeit at a sub-trend rate of growth.

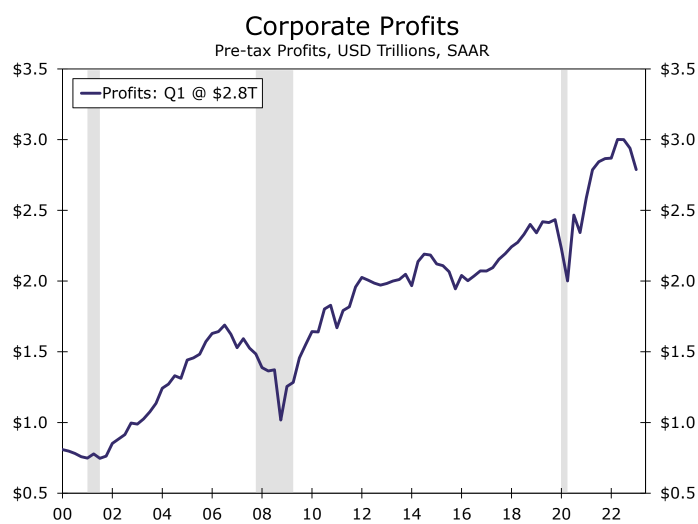
Consistent with this narrative of sub-trend growth were the data on gross domestic income (GDI), which were released for the first time for the first quarter. In theory, real GDP and real GDI should be equivalent, but they usually differ somewhat in practice due to data omissions. In that regard, real GDI *contracted* at an annualized rate of 2.3% in Q1, which follows the drop of 3.3% that was registered in the last quarter of 2022. On a year-over-year basis, real GDP was up 1.6% in Q1-2023 while real GDI fell 0.9% (Figure 1), signaling the widest gap between the two measures on record. This weakness in GDI suggests that real GDP growth in recent quarters may be revised lower in subsequent data releases. Although one side of the National Income & Product Accounts (NIPA) may be contracting, we would stress that the U.S. economy is probably not in recession at present. Notably, incoming data continue to show resilience in the labor market.

Figure 1




Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 2




Source: U.S. Department of Commerce and Wells Fargo Economics

## Profits Look to Have Peaked

Corporate profits was one of the factors that weighed on income in Q1. Similar to GDI, today's data release also provided the first estimate of corporate profits in the first quarter. Pre-tax profits came in modestly weaker than we anticipated, declining 5.1% (not annualized) during the first quarter, or by $151 billion. The level of corporate profits is still nearly 15% ahead of pre-pandemic levels, but profit growth has notably slowed since peaking in the second quarter of last year (Figure 2). Profits have now slipped for three straight quarters and on a year-ago basis, profits are down 2.8%, marking the first annual decline in two years.

Weaker profits at the start of the year were fairly broad based across the economy. Nonfinancial domestic profits saw the largest decline (down $109 billion, or accounting for around 70% of the overall profit decline). But domestic financial profits and even profits from the rest of the world (or remittances from foreign subsidiaries less remittances of American subsidiaries to foreign parents) slipped in the first quarter.

Profits tend to peak ahead of a broader economic recession. Lower profits and heightened uncertainty leave firms with dwindling means and desire to make new investment. Still-elevated inflation may also crimp profitability as the year progresses if firms find it more challenging to pass costs on to the end consumer. Although we believe that the U.S. economy is not in recession at present, we continue to believe that it is tracking toward a downturn later this year. For details, see our most recent U.S. Economic Outlook.

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