ECONOMIC DATA

U.S. Corporate Profits Soared in Second Quarter, Boosted by Tax Cuts and Economic Growth

Commerce Department measured 16.1% year-over-year gain, the largest in six years

Retailers played a prominent role in corporate profit growth. Target Corp. had its best quarterly results in more than a decade in the second quarter. **PHOTO:** SCOTT OLSON/GETTY IMAGES

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WASHINGTON—U.S. corporate profits boomed in the second quarter, boosted by large tax cuts and stronger economic growth than initially reported.

The Commerce Department said Wednesday that its broadest measure of after-tax profits across the U.S. rose 16.1% in the quarter ended June 30 from a year earlier, the largest year-over-year gain in six years.

Because of the lower corporate tax rate signed into law last year, taxes paid by U.S. companies in the quarter were down 33% from a year earlier, according to the government data, or more than $100 billion at an annual rate.

Strong economic growth also played a role. The Commerce Department revised upward its estimate of how fast the U.S. economy grew in the second quarter, to an annual rate of 4.2% from an earlier estimate of 4.1%.

Good economic news and robust corporate earnings reports have powered the stock market in recent weeks. On Wednesday, the S&P 500 index added 0.6%, while the tech-heavy Nasdaq Composite climbed 1%. Both set new highs. The Dow Jones Industrial Average closed up 61 points, or 0.2%, at 26124.57.

The government profit report capped a string of strong earnings by individual companies. Executives across a range of industries were largely upbeat in the recently completed earnings season.

Farm and construction equipment maker Deere & Co., for example, said healthy demand for road-building equipment has extended its order book well into 2019 and that the nation's agricultural economy may prove strong even though many farmers are being hammered by retaliation abroad against recently imposed U.S. tariffs. Its sales in the second quarter rose 32% from a year earlier, to $10.3 billion.

"Overall, we are encouraged by the outlook for the rest of 2018 and the early interest for our latest technology," Deere & Co. Chief Financial Officer Rajesh Kalathur told investors on Aug. 17.

One worry is that as the impetus from tax cuts wanes, profit and economic growth could slow next year and beyond. Executives in earnings calls also expressed concerns about Trump administration trade policy and the risk of rising barriers to sales at home and abroad.

Still, analysts see little sign of a letup in earnings momentum this year, though Wall Street projections for 2019 point toward a modest slowdown.

For now, rising profits could fuel economic growth in the coming months.

"Businesses have more money to continue boosting investment in the second half of the year," said Roiana Reid, an economist at Berenberg Capital Markets. Companies "will need to increase production to meet strong domestic demand and replenish inventories," she said.

Per-share earnings for companies in the S&P 500 rose 24.8% over the second quarter of 2017, the second-fastest rate since late 2010 and trailing only this year's first quarter, according to data from Thomson Reuters that incorporates analysts' adjustments to results. That rate is projected to slow to 9.3% by next year's second quarter.

Sales by S&P 500 companies grew 9.5% in the most recent quarter, the fastest rate since the autumn of 2011, suggesting a robust business environment helped drive profits, beyond the effect of tax cuts and share buybacks that help boost per-share earnings.

"Earnings have been good no matter how you measure them," said Howard Silverblatt, senior index analyst at S&P Dow Jones Indices. "The big takeaway here is that sales are up," he said.

If there is a soft spot in the corporate landscape it might be a hint of strain from the rest of the world. Earnings abroad by U.S. companies fell from the first quarter to the second, the Commerce Department said Wednesday, though they were still up robustly from a year earlier.

But domestic earnings boomed, including surprising performances by many store-based retailers. Some have been hurt by online competition, but strong consumer demand is driving their sales.

Earnings for consumer-staple companies, such as food and household-goods makers, rose at the fastest rate since mid-2008, at 13.8%, in the second quarter from a year earlier, while those at consumer discretionary companies, such as retailers, were up 23%, Thomson Reuters estimates. Among them, Walmart Inc. and rival Target Corp. reported their fastest quarterly sales growth in more than a decade.

"The U.S. economy and drivers for home improvement spending are strong," Craig Menear, chief executive of Home Depot Inc., told investors earlier this month. "We feel very positive about the strength of the home-improvement sector and the customers' willingness to spend."

Some large public companies credited the tax overhaul for a significant share of their rising profit. United Rentals Inc., which leases construction and other heavy equipment, said lower taxes contributed about half of its 62% increase in per-share earnings. Bank of America said it expects about half of full-year 2018 earnings growth by S&P 500 companies will stem from tax changes.

The government report on profits differs from S&P 500 data because it measures profits across the whole economy, including private and publicly listed companies. That makes it the most comprehensive scorecard for corporate financial health.

The report also makes adjustments for changes in the value of company inventories and capital investments, and shifts in business depreciation schedules. That smooths out fluctuations that might result from big commodity price swings or tax changes.

But the government report included a puzzle. Though many individual companies reported increases in dividends and share buybacks, the national data showed little impact on dividends across the entire economy. They were paid out at an annual rate of $1.22 trillion in the second quarter, down 0.9% from the rate of payment a year earlier.

Mr. Silverblatt noted that dividends tend to change much more slowly than earnings. When raising dividends executives want to be sure they can sustain them. They also are reluctant to lower them, which can be taken by investors as a sign of a dimming outlook.

As for the current quarter, underlying demand appeared solid at the start of the period. Retail sales jumped in July from the prior month and business equipment orders were up.

The Conference Board said Tuesday its index of U.S. consumer confidence climbed to 133.4 in August from 127.9 in July, hitting its highest level since October 2000. The University of Michigan's index of consumer sentiment has declined in four out of the last five monthly readings but remains at historically high levels.

"The economy is strong," Federal Reserve Chairman Jerome Powell said in Jackson Hole, Wyo., last week, adding that inflation "is near our 2% objective, and most people who want a job are finding one."

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