ECONOMIC UPDATE

REGIONS

July 28, 2017

Q2 2017 GDP: Different Headline, Same Old Story . . .

- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.6 percent in Q2 2017.
- Consumer spending and business fixed investment spending were the main drivers of Q2 growth.

The BEA's initial estimate puts Q2 real GDP growth at an annualized rate of 2.6 percent, slightly ahead of the consensus forecast of 2.5 percent but below our forecast of 2.8 percent. As in any given quarter, the BEA's initial estimate of real GDP is based on highly incomplete source data and prone to sizeable revision. That real GDP growth was stronger in Q2 after subpar Q1 growth, now reported at 1.2 percent, was not surprising, and over the first half of 2017 real GDP expanded by (insert drum roll, dramatic pause, or the method of your choosing to add even a hint of suspense here) 2.0 percent.

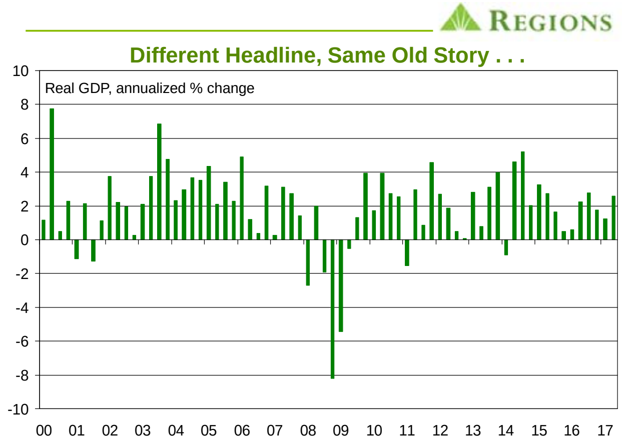
As is the case each year, the first estimate of Q2 real GDP incorporates the BEA's annual benchmark revisions, reflecting revised source data and methodological changes, to recent historical data. In this case the revisions cover the Q1 2014 through Q1 2017 period. It is often the case that, for any given data series, the benchmark revisions can bring a sudden change in what had been the prevailing narrative based on the post-revision data, which can be somewhat unsettling. The good news with this year's benchmark revisions is that the underlying narrative of the economy remains the same. The bad news with this year's benchmark revisions is that the underlying narrative of the economy remains the same. As seen in our second chart below, while the pattern of quarterly growth changed a bit, average annualized quarterly growth from Q3 2009 through Q1 2017 remains 2.12 percent. Okay, fine, if you insist on taking something positive away from the benchmark revisions, that average annualized quarterly growth rate went from 2.118 percent prior to the revisions to 2.123 percent after the revisions.

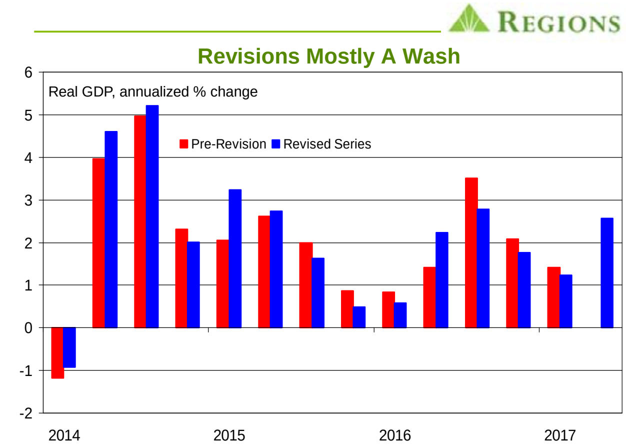
Real consumer spending grew at an annualized rate of 2.8 percent in Q2 after growth of 1.9 percent in Q1. In the prior estimate, Q1 growth had been estimated at 1.1 percent and the upward revision stems mainly from the benchmark revisions to the retail sales data that showed faster growth in control retail sales. As for Q2 growth, real spending on goods grew at an annualized rate of 4.7 percent, which is noticeably above the 1.0 percent annualized growth in nominal spending on goods. This goes to a point we have been making for some time now, i.e., falling prices for many consumer goods are distorting the view on consumer spending, as the nominal data (such as the monthly retail sales reports) give the impression that consumer spending is weaker than is actually the case. Growth in overall consumer spending added 1.93 percentage points to top-line real GDP growth in Q2.

Real business fixed investment spending grew at an annualized rate of 5.2 percent in Q2. Real spending on business structures grew at an annual rate of 4.9 percent while spending on intellectual property products, which includes the type of R&D spending needed to drive faster labor productivity growth, increased at an annualized rate of just 1.4 percent. More significantly, real business investment in equipment and machinery grew at an annualized rate of 8.2 percent in Q2. This marks the third consecutive quarter of growth following four consecutive quarters of contraction, something unprecedented during an expansion. What remains to be seen, however, is the extent to which this momentum can be carried forward, particularly given what look to be steadily diminishing prospects for meaningful corporate tax reform.

The inflation adjusted value of private sector inventories fell in Q2, with a decline in farm inventories offsetting a modest increase in nonfarm inventories, meaning inventories were a drag on top-line real GDP growth for a second consecutive quarter (this is the main reason for our miss on our forecast for top-line growth). Net exports were a small positive for Q2 growth, as a narrower trade deficit added 0.18 points to top-line growth. Real exports of U.S. goods grew at an annualized rate of 2.8 percent while real imports of goods grew at an annualized rate of 2.0 percent. This is one avenue by which overall real GDP growth could perk up coming quarters, as accelerating global economic growth and a softer U.S. dollar improve the prospects for growth in U.S. exports.

Consumers will continue to do most of the heavy lifting, but they will need some help from business investment and trade in order for there to be a meaningful change in the economy's trend rate of growth. After eight years, that 2.1 percent growth story could use some upbeat edits.





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