ECONOMIC UPDATE

REGIONS

August 30, 2017

Q2 2017 GDP: Not Great, But Pretty Darn Good . . .

- The BEA's second estimate shows real GDP grew at an annualized rate of 3.0 percent in Q2 2017, up from the initial estimate of 2.6 percent.
- Consumer spending, business investment spending, and inventory accumulation were revised higher relative to the initial estimate.
- Before-tax corporate profits were up 1.3 percent from Q1 and up 6.97 percent year-on-year.

Revised and more complete source data put Q2 real GDP growth at an annualized rate of 3.0 percent, ahead of the BEA's initial estimate of 2.6 percent growth. Our above-consensus forecast was for 3.1 percent growth. Prior estimates of growth in consumer spending and business investment were revised higher, and nonfarm business inventories are now reported to have grown modestly as opposed to contracting as was initially reported. The faster pace of growth in Q2 is certainly welcome news, but keep in mind it comes on the heels of annualized growth of just 1.2 percent in Q1. As such, this puts real GDP growth for the first half of 2017 right at the 2.1 percent average rate that we've all come to know but not necessarily love over the course of the current expansion.

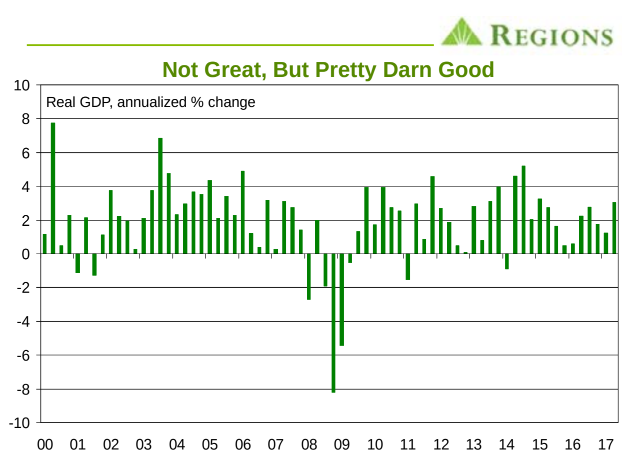
Real consumer spending grew at an annualized rate of 3.3 percent in Q2, up from the first estimate of 2.8 percent and adding 2.28 percentage points to top-line real GDP growth. Spending was revised higher across the board, i.e., spending on durable and nondurable consumer goods and on household services. Growth in spending on household furnishings and appliances, recreational goods and vehicles, utilities, apparel, and wireless communication services was notably strong in Q2. Keep in mind we are referring to inflation adjusted spending here, and the Q2 GDP data reinforce a point we have been making for some time now – there is simply no way to make any sort of meaningful assessment of consumer spending without accounting for price changes, specifically, what has been a prolonged period of goods price deflation.

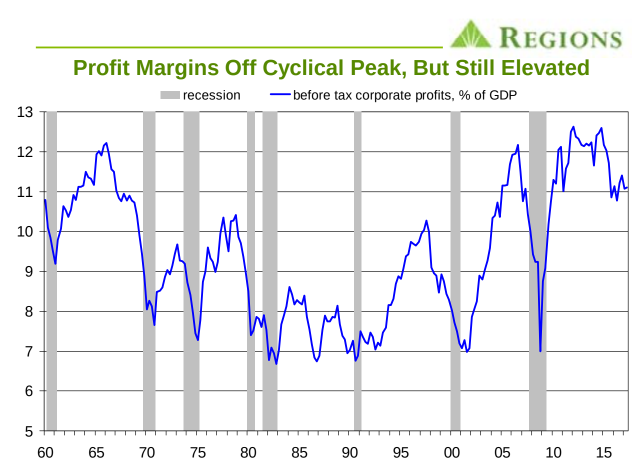
While consumer spending has all along been a primary support for GDP growth over the course of the current expansion, now in its ninth year, growth in business investment spending is a more recent, not to mention much welcomed, development. Growth in each of the three broad categories of business fixed investment – structures, equipment and machinery, and intellectual property products – was revised higher in the BEA's second estimate of Q2 GDP, and business fixed investment added 0.85 percentage points to top-line real GDP growth. Real investment in business equipment and machinery grew at an annualized rate of 8.2 percent in Q2, on the heels of 8.9 percent growth (annualized) in Q1. What is now a run of three consecutive quarters of growth follows four consecutive quarterly contractions from Q4 2015 through Q3 2016, which had never occurred during an expansion. We have for some time argued that what has been underinvestment on the part of firms over the course of the current expansion is a key factor behind what has been an anemic trend rate of labor productivity growth, which makes the recent run of growth encouraging from a longer-term growth perspective.

With steady growth in U.S. exports of goods and a slower rate of growth in imports into the U.S., the trade deficit narrowed slightly in Q2, which added 0.21 percentage points to top-line real GDP growth. Nonfarm business inventories rose modestly in Q2 and were a slight positive for top-line growth, and we look for a larger contribution in Q3. Total government spending contracted at an annualized rate of 0.3 percent in Q2. The aggregated government figure masks a sharp split between spending on the federal level, up 1.9 percent, and spending on the state and local levels, down 1.7 percent (annualized rates).

Corporate profits were up smartly in Q2, though on a quarter/quarter basis growth was driven by domestic nonfinancial corporations. On a year-on-year basis, profits were up in each of the broad segments, i.e., financial and nonfinancial corporations, and domestic and foreign profits. Still, it is worth noting that nominal GDP growth, a proxy for growth in top-line revenue, remains notably weak by historical standards, with a run rate of less than four percent, suggesting discipline on the cost side continues to be a key component of profit growth.

The U.S. economy entered into 2H 2017 with considerable momentum. We remain constructive in our outlook for consumer spending, but the key will be the extent to which the recent strength in business investment can be sustained, which is necessary for there to be a meaningful change in the economy's trend rate of growth.





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