ECONOMIC UPDATE

REGIONS

July 27, 2018

Q2 2018 GDP: Robust Growth, But Is It Built To Last?

- The BEA's initial estimate shows real GDP grew at an annualized rate of 4.1 percent in Q2 after growth of 2.2 percent in Q1
- Consumer spending and net exports were the main drivers of Q2 growth, inventories were a material drag on growth

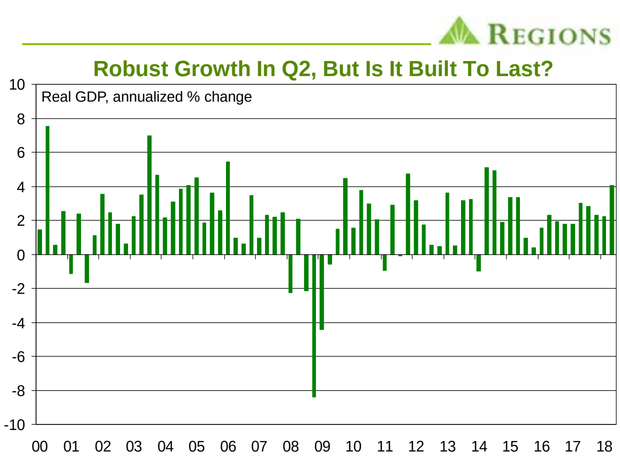
The BEA's initial estimate shows real GDP grew at an annualized rate of 4.1 percent in Q2. The initial estimate of Q2 GDP incorporates the BEA's comprehensive revisions to the historical data as well as methodological changes which, on the whole, do not materially alter the narrative of the U.S. economy, particularly in the post-recession years. To that we'll add our usual caveat that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizeable revision. As the data now stand, the 4.1 percent annualized growth in Q2 is the fifth fastest quarterly growth rate of the current expansion, now in its tenth year. While no one thinks the rate of growth seen in Q2 is sustainable going forward, the more relevant question is whether, or to what extent, the economy can sustain a rate of growth faster than the middling average of 2.2 percent seen over the life of the expansion prior to Q2. Let's just say the jury is still out.

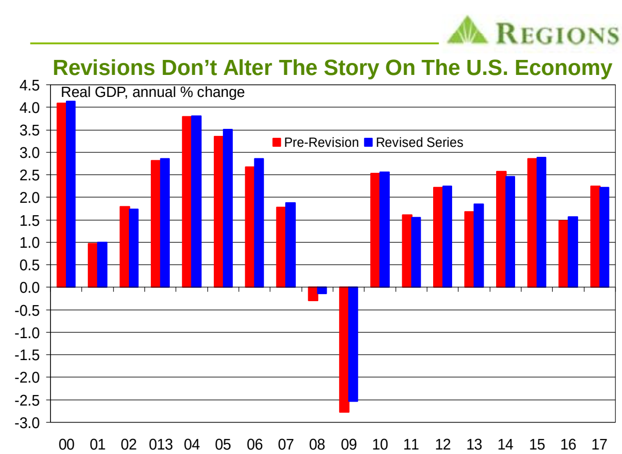
Real consumer spending grew at an annualized rate of 4.0 percent in Q2, up from 0.5 percent growth in Q1, adding 2.69 points to top-line real GDP growth. Real spending on goods rose at an annualized rate of 5.9 percent in Q2, while spending on household services grew at an annualized rate of 3.1 percent, a pace considerably faster than that implied by the monthly data on personal consumption expenditures prior to the comprehensive revisions. It is worth noting that the comprehensive revisions, which include revisions to personal income as well as consumer spending, show a much higher personal saving rate than had been previously reported. One can see the impact of the 2017 tax bill in the data on disposable personal income and saving. Real disposable personal income grew at an annualized rate of 4.4 percent in Q1, reflecting lower personal income tax rates, which helped boost the saving rate to 7.6 percent; in Q2, growth in real disposable personal income slowed to 2.6 percent and the saving rate dipped to 6.8 percent.

The real trade deficit narrowed significantly in Q2, which added 1.06 points to top-line real GDP growth. Real net exports grew at a 9.3 percent rate, with exports of goods growing at a 13.3 percent rate, while growth in imports slowed sharply. It should be noted that the BEA's first estimate of Q2 growth comes prior to the release of the June data on international trade, and reports from several main ports show a surge in imports in June while export shipments faded, so it remains to be seen how the initial estimate of the Q2 trade gap will look after revision. The Q2 trade data are clouded by firms, domestic and foreign, playing "time the tariffs," as foreign firms stepped up orders of U.S. goods in order to beat the imposition of retaliatory tariffs on U.S.-made goods, while in June U.S. firms stepped up imports of consumer goods from China ahead of the possible implementation of tariffs on such goods. These distortions will wash from the data which, along with the effects of a stronger U.S. dollar, means the boost to top-line real GDP growth from trade seen in Q2 will not be repeated.

Business fixed investment grew at an annualized rate of 7.3 percent in Q2, down from growth of 11.5 percent in Q1. Real spending on equipment and machinery grew at an annualized rate of 3.9 percent in Q2, but this should be put in the context of significantly faster growth over the prior several quarters – from Q1 2017 through Q1 2018 growth in real spending on equipment and machinery averaged 9.4 percent. While we don't look for growth to return to this pace over coming quarters we do think it will be faster than Q2's pace. Residential fixed investment contracted for the fourth time in the past five quarters, which mainly reflects slow but steady growth in single family construction and a contraction in multi-family construction (in inflation adjusted dollars). Bolstered by faster defense spending, total federal government spending grew at an annualized rate of 3.5 percent, while combined state and local government spending grew at a 1.4 percent rate.

It will take time to process a revision as comprehensive as that to the GDP data. The main point for now, however, is that while the robust growth seen in Q2 is not sustainable, we do expect solid growth over the back half of 2018 and the first half of 2019. Beyond that, however, as the kick from fiscal stimulus begins to fade, the key to doing better than the middling post-recession average growth rate of 2.2 percent will be sustained growth in business investment.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com