ECONOMIC UPDATE

REGIONS

July 26, 2019

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Q2 GDP: Consumers Carry The Load In Q2

- The BEA's first estimate shows real GDP grew at an annualized rate of 2.1 percent in Q2 after growth of 3.1 percent in Q1
- Consumer spending was the main support for Q2 real GDP growth, while trade and inventories were significant drags on growth

The BEA's initial estimate shows real GDP grew at an annualized rate of 2.1 percent in Q2 2019, ahead of the 1.8 percent growth we and the consensus expected. The initial estimate of Q2 GDP incorporates the BEA's annual benchmark revisions, with revisions going back to Q1 2014. Though there were some changes to quarter-to-quarter growth, the broader picture of the U.S. economy was left unchanged. Over the Q3 2009 through Q1 2019 period, average annualized real GDP growth is now reported to be 2.3 percent, as was the case prior to the benchmark revisions. Consumers carried the load for the U.S. economy in Q2, with growth in real consumer spending roaring back from an uninspired Q1. Conversely, after having been prime supports for 3.1 percent real GDP growth in Q1, net exports and inventories were significant drags on Q2 growth. Real fixed investment was also a drag on Q2 growth, having logged its first decline since Q4 2015. All in all, the report on Q2 GDP changes nothing, but rather reinforces what has all along been apparent in the high frequency data, i.e., U.S. consumers remain on solid ground, with both the willingness and the wherewithal to spend, while businesses remain somewhat hamstrung by ongoing uncertainty over trade policy and an inventory correction that has further to run.

Real consumer spending grew at an annualized rate of 4.3 percent in Q2, quite a rebound from 1.1 percent growth in Q1. Growth in real consumer spending added 2.85 percentage points to top-line real GDP growth in Q2, or, in other words, more than accounted for Q2 growth. Inflation adjusted spending on consumer durable goods advanced at an annualized rate of 12.9 percent in Q2, with motor vehicles and home furnishings both growing at a more rapid pace than in Q1. Spending on nondurable consumer goods grew at an annualized rate of 6.0 percent in Q2, as tipped by the monthly data on control retail sales over the course of Q2. After growing at an annualized rate of 1.0 percent in Q1, real spending on household services, which accounts for roughly two-thirds of consumer spending as measured in the GDP data, grew at a 2.5 percent rate in Q2.

Not unexpectedly, fixed investment was weak in Q2, with real business fixed investment contracting at an annualized rate of 0.6 percent and real residential fixed investment contracting at a 1.5 percent pace. Real spending on business structures contracted at an annualized rate of 10.6 percent in Q2, more than offsetting a modest rebound in spending on equipment and machinery (annualized growth of 0.7 percent) and 4.7 percent annualized growth in spending on intellectual property products.

Real business inventories grew at an annualized rate of $71.7 billion in Q2, but as this was smaller than the $116.0 billion (annualized) build in Q1, inventories were a drag on growth, deducting 0.86 percentage points off of top-line real GDP growth. Inventory accumulation added 0.53 percentage points to top-line growth in Q1. The trade deficit widened in Q2 with real exports declining at a 5.1 percent rate while real imports grew at a 0.1 percent rate. The wider trade deficit knocked 0.65 percentage points off of top-line real GDP growth in Q2 after having added 0.73 percentage points in Q1. The swings in inventories and net exports seen over the past two quarters are not atypical, which is one reason the headline real GDP growth number is not always the best indicator of the underlying health of the U.S. economy. Our preferred metric is real private domestic demand, or, combined household and business spending, which grew at a 3.2 percent pace in Q2. Total government spending grew at an annualized rate of 5.0 percent in Q2, adding 0.85 percent to top-line real GDP growth. Federal government spending grew at an annualized rate of 7.9 percent, with nondefense outlays rising at a 15.9 percent. Combined state and local government spending rose at an annualized rate of 3.2 percent in Q2.

As noted above, the report on Q2 changes nothing in terms of how we and most analysts see the economy. Global business sentiment has sagged under the weight of ongoing uncertainty over trade policy, and while this has taken a toll on business investment, there is little evidence of any spillover into the broader economy. Nor does the report on Q2 GDP change anything for the FOMC. A cut in the Fed funds rate at next week's meeting has been, and remains, a given, though we continue to question what exactly a lower funds rate will do to firm up the soft spots in the Q2 GDP data.

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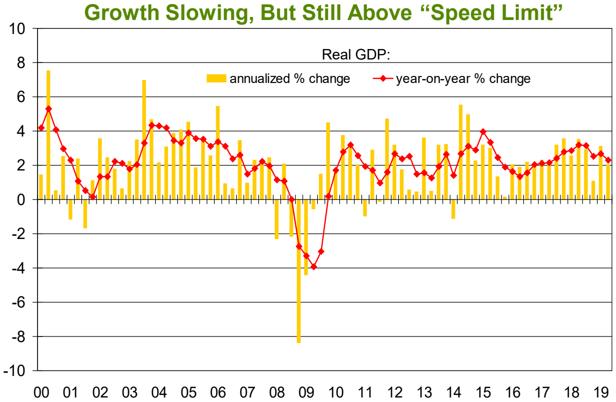
Growth Slowing, But Still Above "Speed Limit"



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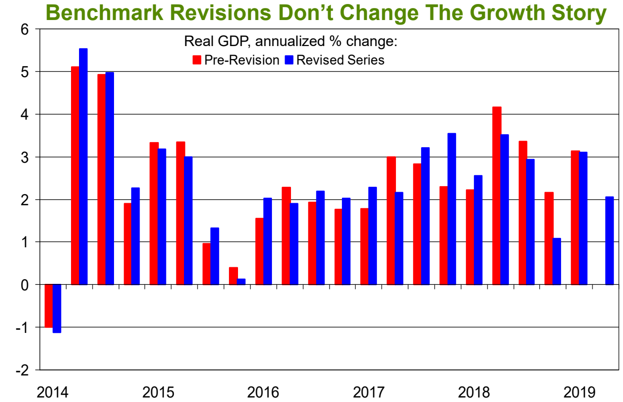
Benchmark Revisions Don't Change The Growth Story



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