ECONOMIC UPDATE

REGIONS

July 29, 2021

Q2 2021 GDP: A Perfect Snapshot Of The Predicament Facing The U.S. Economy

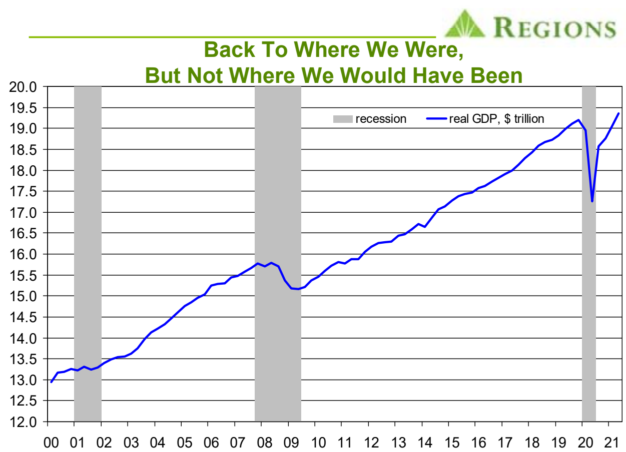
- The BEA's first estimate shows real GDP grew at an annualized rate of 6.5 percent in Q2 2021
- Consumer spending and business fixed investment were the main drivers of Q2 growth, inventories, trade, and government were drags

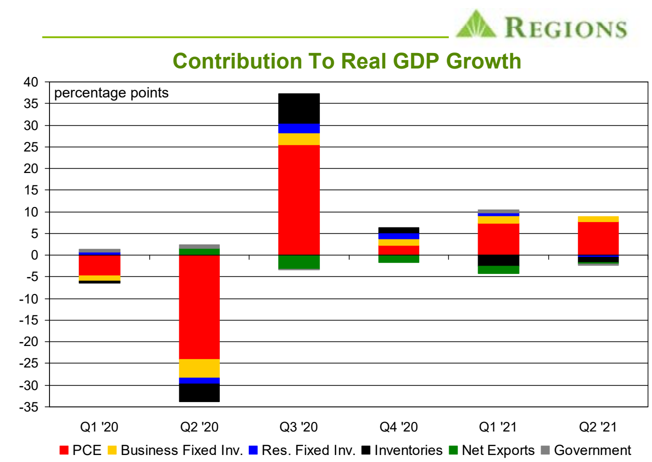
Real GDP expanded at an annualized rate of 6.5 percent in Q2 2021, a bit below our forecast of 6.9 percent and well below the 8.4 percent growth anticipated by the consensus forecast. That our forecast diverged so widely from the consensus mainly reflected different views on nonfarm inventories, residential fixed investment, and government spending, each of which we expected to be meaningful drags on top-line growth, putting us at odds with most forecasts. The GDP Price Index increased at an annualized rate of 6.0 percent, topping our forecast of 5.4 percent growth and the largest such increase since Q4 1981. As we do each quarter, we'll note that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, is prone to sizable revision. As the data now stand, however, the Q2 GDP data embody the predicament facing the U.S. economy, which is that the supply side of the economy has simply been unable to keep pace with demand, thus begetting significantly faster inflation. We have from the start argued that, given they are global in nature, many of the supply chain and logistics bottlenecks could be more persistent than many have been assuming, and we anticipate them weighing on current quarter growth in consumer spending.

Real private domestic demand, or, combined business and household spending, grew at an annualized rate of 9.9 percent in Q2. Consumers led the way, with real consumer spending growing at an annualized rate of 11.8 percent, following growth of 11.4 percent in Q1. Real spending on goods advanced at an annualized rate of 11.6 percent while real spending on services, the largest component of consumer spending, grew at an annualized rate of 12.0 percent. Growth in consumer spending on services largely reflects the further reopening of the economy as falling COVID-19 case counts and consumers getting back out and about, sparking spending on things such as travel, tourism, dining out, recreation, and entertainment. Recall that in prior quarters consumer spending on goods grew at notably rapid rates while spending on services was rather listless by comparison, and we had expected Q2 to mark the start of a transition in the mix of consumer spending (recall that in Q1 real consumer spending on goods grew at an annualized rate of 27.4 percent). That spending on both goods and services was so robust in Q2 in part reflects consumers paring down what was a sizable pool of excess saving, as the personal saving rate fell from 20.8 percent in Q1 to 10.9 percent in Q2. We anticipate a marked slowdown in consumer spending on goods in Q3, in part reflecting the ongoing shift in the mix of consumer spending but also reflecting supply constraints which we expect to act as a meaningful drag on spending on consumer durable goods such as motor vehicles, appliances, and home furnishings.

Real business fixed investment grew at an annual rate of 8.0 percent in Q2, with double-digit growth in spending on machinery/equipment and intellectual property products with a sharp decline in business spending on structures acting as a drag on overall business investment. Nonfarm business inventories fell sharply in Q2, which deducted 1.1 percentage points from top-line real GDP growth. That inventories were widely expected to be a meaningful support for Q2 real GDP growth is curious given that supply-side constraints have been acting as a drag on growth in business output in a time of robust growth in demand, which has led to sinking inventory/sales ratios on the manufacturing, wholesale, and retail levels, while price effects whittled away at whatever growth there was in nominal inventories. While our forecast has anticipated inventories contributing to Q3 growth, we are revisiting that assumption in light of ongoing supply chain and logistics bottlenecks. Real residential fixed investment fell at an annualized rate of 9.8 percent in Q2, lopping five-tenths of a percent off of top-line real GDP growth, reflecting the slowdown in housing construction thanks in part to materials shortages. A decline in federal government spending dragged overall government spending lower in Q3, which took 0.3 percentage points off of top-line real GDP growth, while a wider trade deficit than our forecast anticipated trimmed 0.4 percentage points off of top-line growth.

The Q2 GDP data embody what has been a growing imbalance between supply and demand and the corresponding increase in inflation. It isn't a matter of when this imbalance will reverse, it's a matter of when. We've seen nothing to change our view that it will be later rather than sooner.





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