ECONOMIC UPDATE
REGIONS
July 25, 2024

Q2 2024 GDP – 1st Estimate: Economy Settling Back Toward Longer-Term Trend?

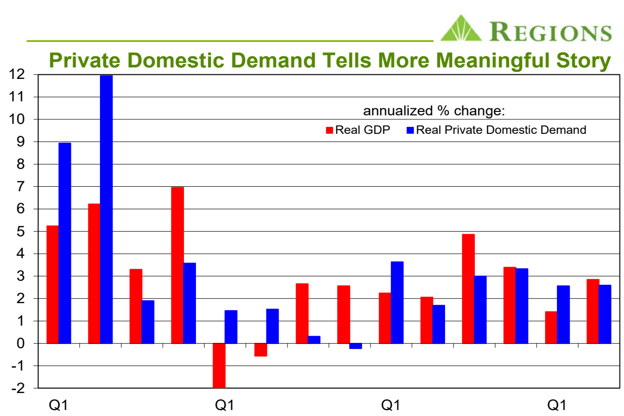
- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.8 percent in Q2 2024, following growth of 1.4 percent in Q1
- Consumer spending, business fixed investment, inventory accumulation, and government spending were the drivers of Q2 growth

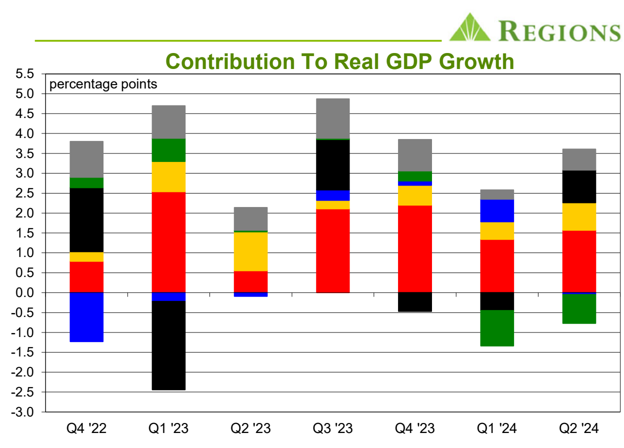
The BEA's initial estimate puts Q2 real GDP growth at an annual rate of 2.8 percent, topping our above-consensus forecast of 2.1 percent and doubling the pace of growth logged in Q1. Consumer spending, business investment in equipment and intellectual property products, inventory accumulation, and government spending were the drivers of Q2 growth, while a wider trade deficit and a dip in residential fixed investment were drags on growth. Real private domestic demand, or, combined business investment and household spending, grew at an annual rate of 2.6 percent for a second straight quarter. As we routinely note, we see real private domestic demand as the most meaningful indicator of the underlying health of the economy. As is our custom, we'll note here that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision as the gaps in the data are filled in. That said, GDP outperformed expectations in Q2, which lends some support to our premise that the slowdown in the pace of economic activity suggested in the recent high frequency data is more likely a reflection of economic growth settling back toward the steady but not spectacular trend rate of around two percent seen in the decade prior to the pandemic as opposed to the start of a more pronounced slowdown or the start of a recession. To be sure, the jury is still out on that call, but we've seen nothing that would lead us to a different conclusion.

Real consumer spending grew at an annual rate of 2.3 percent in Q2, adding 1.57 percentage points to top-line real GDP growth, with goods spending up at a 2.5 percent rate and services spending up at a 2.2 percent rate. Despite a sharp decline in sales in June triggered by a cyberattack on dealer network software, spending on motor vehicles increased in Q2 and added one-tenth of a point to overall real GDP growth. As we discussed in this week's *Economic Preview*, we are heavily discounting the reported growth in spending on nondurable consumer goods in Q2, as the 0.9 percent increase in control retail sales, a direct input into the GDP data, in June was no more than a gift from seasonal adjustment, with the unadjusted data showing a weaker than normal June for control retail sales. Though discretionary services spending did bounce back from the decline posted in Q1, it is clear that discretionary services spending has softened considerably over recent months. All in all, our take is that growth in consumer spending is slowing, with a stark divide between lower and upper income households. On the whole, this leaves growth in consumer spending realigning with growth in disposable income after the pandemic and the policy response to it threw what historically been a fairly stable relationship off track.

Business fixed investment grew at an annual rate of 5.2 percent in Q2, adding 0.69 percentage points to top-line growth. Business outlays on equipment and machinery grew at an annual rate of 11.6 percent, much faster than any of the high frequency data suggested, while spending on intellectual property products grew at a 4.5 percent rate. In contrast, business spending on structures weakened markedly, reflecting nearly across the board weakness in nonresidential construction, with ongoing growth in manufacturing construction a notable outlier. Real residential fixed investment declined, with both single family and multi-family construction down, ending a run of three straight quarters of residential fixed investment adding to top-line real GDP growth. That mortgage interest rates stubbornly held at seven percent throughout Q2 took an increasing toll on single family sales, which is reflected in the GDP data.

A faster pace of business inventory accumulation added 0.82 percentage points to top-line real GDP growth in Q2. We will, however, note that a considerable portion of the inventory build in Q2 was due to a jump in motor vehicle inventories on the retail level. This is, for the most part, no more than the flip side of the decline in sales in June stemming from the cyberattack. As such, we see this as pretty much of a wash in terms of the impact on top-line real GDP growth; absent the cyber attack, growth in consumer spending would have been stronger and there would have been less inventory accumulation. The wider trade deficit knocked 0.72 percentage points off top-line real GDP growth in Q2; though U.S. exports grew in Q2, imports into the U.S. grew at a faster rate. We will note that many retailers are pulling import orders ahead over concerns of shipping delays impacting the holiday sales season. As such, trade may be a bigger drag on, and inventory growth may be a bigger support for, Q3 real GDP growth. While the net effect may be a wash for reported real GDP growth, this does go to our point about real private domestic demand being the more meaningful metric.





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