Economics

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US GDP: Solid, if a bit disappointing

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Annualized Qtrly Chg.	21 Q2	21 Q1	20 Q4	20 Q3	20 Q2	20 Q1
Real GDP	6.5%	6.3%	4.5%	33.8%	-31.2%	-5.1%
Personal consumption	11.8%	11.4%	3.4%	41.4%	-33.4%	-6.9%
• Goods	11.6%	27.4%	-0.3%	49.5%	-10.0%	0.3%
• Durable goods	9.9%	50.0%	1.1%	89.0%	-1.5%	-12.0%
• Nondurable goods	12.6%	15.9%	-1.1%	31.8%	-13.9%	7.0%
• Services	12.0%	3.9%	5.3%	37.5%	-42.4%	-10.0%
Gross private investment	-3.5%	-2.3%	24.6%	82.1%	-48.8%	-5.3%
• Fixed investment	3.0%	13.0%	17.7%	27.5%	-30.4%	-2.3%
• Nonresidential	8.0%	12.9%	12.5%	18.7%	-30.3%	-8.1%
• Structures	-6.9%	5.4%	-8.2%	-15.3%	-46.8%	-0.8%
• Equipment	13.0%	14.1%	26.5%	55.9%	-36.2%	-21.4%
• Intellectual Property	10.7%	15.6%	10.2%	8.0%	-10.6%	3.8%
• Residential	-9.8%	13.3%	34.4%	60.0%	-30.8%	20.3%
Exports	6.0%	-2.9%	22.5%	54.5%	-59.9%	-16.3%
• Goods	5.8%	-1.4%	25.6%	99.0%	-65.0%	-4.8%
• Services	6.6%	-6.0%	16.0%	-4.9%	-48.6%	-34.8%
Imports	7.8%	9.3%	31.3%	89.2%	-53.1%	-13.1%
• Goods	5.8%	10.7%	30.1%	103.7%	-49.2%	-7.5%
• Services	19.3%	2.2%	37.6%	29.7%	-67.6%	-33.4%
Government consumption	-1.5%	4.2%	-0.5%	-2.1%	3.9%	3.7%
• Federal	-5.0%	11.3%	-3.2%	-5.4%	20.6%	2.4%
• National defense	-0.8%	-5.8%	5.3%	1.7%	3.2%	-0.8%
• Nondefense	-10.4%	40.8%	-14.0%	-14.4%	50.1%	7.3%
• State and local	0.8%	-0.1%	1.2%	0.1%	-5.5%	4.5%

Source: Haver Analytics.

- Economic activity in the US in the second quarter underwhelmed, but it still advanced by enough to exceed its pre-pandemic level. The 6.5% annualized GDP gain was well below the consensus expectation of 8.4%, with the downside miss reflecting a more significant drop in residential investment than anticipated, compounded by declines in government spending and inventories. Despite that, consumers still showed solid gains in spending, not only on services that reopened, but also on goods. With the savings rate still elevated at close to 11%, there remains ample room for consumers to drive strong growth ahead, while some of the disappointments in other components do not look to have staying power.

- While the drop in residential investment was expected given the cooling in housing starts and home sales seen over the quarter, the deterioration was more severe than thought. The pulling forward of demand at the start of the pandemic dulled the usual spring seasonal upswing in homebuilding, but elevated prices might also have been a new headwind for demand. While job openings in the construction industry trended up through April, there was a sharp drop in May, suggesting that the cause of the slowdown in the housing market isn't likely reflective of a labor shortage as of late. With mortgage rates set to rise into 2022, residential investment isn't likely to be a major growth contributor ahead.
- The drop in government spending was accounted for by the federal level, in which payments related to the processing of PPP loans dropped off. Still, federal government assistance to state and local governments increased, mitigating some of drop. With state and local governments expected to spend those funds ahead, particularly when the school year begins, government spending will likely swing back to a growth contributor. The proposed infrastructure bill could, over time, add to that momentum.
- A drop in retail inventories explained the decline in private inventory investment, as spending on goods remained strong despite the run up in prices. Autos appear to have been the main source of weakness here, with inventory investment held back by the global chip shortage. With those pressures beginning to fade, it's likely that inventory accumulation will resume ahead. The other weak spot in retail inventories is clothing, an area that was hit by behaviour changes during the height of the pandemic. While we expect some restocking ahead, some of that will be met by imports rather than domestic output.
- While the strong consumption gain was better than expected, the ramping up of services spending has been limited by the labor shortage in reopening industries. With Americans still sitting on excess savings resulting from both previous generous government support and higher wages, consumption is expected to remain strong ahead, particularly for services. There isn't yet evidence of higher prices holding back consumption, although the core PCE deflator posted a lofty 6.1% annualized quarter-over-quarter gain (+3.4% y/y).
- Business investment in equipment continued to rise, in line with the durable goods figures, but the structures component remains a weak spot, and declined again in Q2. Commercial structures (restaurants, offices, hotels, malls) remained under pressure, while manufacturing and power/communication structures also saw investment drop off. Post-Covid, the rise of e-commerce, and the retention of some work-from-home practices could weigh on the need for retail and office space, while supporting warehouse demand. Spending on mining structures continued to rebound as oil prices received a lift.

Implications & actions

Re: Economic forecast — The overhang of savings suggests that growth over the balance of the year should be strong, assuming that the labor shortage fades ahead as government benefits dry up. However, this downside miss suggests a bit weaker annual growth in 2021 than previously expected, with reopening bottlenecks and labor shortages pushing more activity into 2022. Still, we see the US economy on track towards full employment by this time next year, and with core inflation pressures likely to remain a bit above target, that will still be sufficient to have the Fed paring bond purchases early in 2022, and hiking in the latter half of that year.

Re: Markets — Despite the headline miss, market reaction was muted, likely reflecting the strong showing from consumers, as well as the fact that the bond market has built in a fair bit of caution on the outlook during its recent rally.

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