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US Q2 GDP: Not too hot, not too cold

by **Ali Jaffery** ali.jaffery@cibc.com

Annualized Qtrly Chg.	24 Q2	24 Q1	23 Q4	23 Q3	23 Q2	23 Q1
Real GDP	2.8%	1.4%	3.4%	4.9%	2.1%	2.2%
Personal consumption	2.3%	1.5%	3.3%	3.1%	0.8%	3.8%
• Goods	2.5%	-2.3%	3.0%	4.9%	0.5%	5.1%
• Durable goods	4.7%	-4.4%	3.2%	6.7%	-0.3%	14.0%
• Nondurable goods	1.4%	-1.1%	2.9%	3.9%	0.9%	0.5%
• Services	2.2%	3.3%	3.4%	2.2%	1.0%	3.1%
Gross private investment	8.4%	4.4%	0.7%	10.0%	5.2%	-9.0%
• Fixed investment	3.6%	7.0%	3.5%	2.6%	5.2%	3.1%
• Nonresidential	5.2%	4.4%	3.8%	1.5%	7.4%	5.7%
• Structures	-3.4%	3.4%	10.9%	11.2%	16.1%	30.3%
• Equipment	11.6%	1.6%	-1.1%	-4.4%	7.7%	-4.1%
• Intellectual Property	4.5%	7.7%	4.3%	1.8%	2.7%	3.8%
• Residential	-1.4%	16.0%	2.8%	6.7%	-2.2%	-5.3%
Exports	2.0%	1.6%	5.0%	5.4%	-9.3%	6.8%
• Goods	1.6%	-0.5%	6.2%	7.7%	-16.0%	12.0%
• Services	2.6%	5.8%	2.8%	1.0%	6.3%	-3.5%
Imports	6.9%	6.1%	2.2%	4.2%	-7.6%	1.3%
• Goods	7.7%	6.5%	1.3%	5.9%	-6.5%	1.8%
• Services	3.6%	4.4%	6.2%	-2.8%	-12.3%	-1.2%
Government	3.1%	1.8%	4.6%	5.8%	3.3%	4.8%
• Federal	3.9%	-0.2%	2.4%	7.1%	1.1%	5.2%
• National defense	5.2%	-0.9%	0.5%	8.4%	2.3%	1.9%
• Nondefense	2.2%	0.6%	4.8%	5.6%	-0.4%	9.4%
• State and local	2.6%	3.0%	6.0%	5.0%	4.7%	4.6%

Source: Haver Analytics.

- The US economy strengthened in Q2, with GDP growth coming in at 2.8% q/q annualized, well above consensus expectations of 2.0% and above last quarter's 1.4% increase. The pickup in growth was driven by consumption, which came in at 2.3% (+1.6pp) compared to expectations of 2.0% and a large inventory contribution (+0.8pp) after two consecutive quarters of being a drag on growth. Business investment growth was strong at 5.2% (+0.7pp) up from 4.4%, driven by equipment investment, and government spending growth also accelerated to 3.1% (+0.5pp) from 1.8% the prior quarter. These forces were partly offset by a drag from net trade (-0.7pp), as import growth exceeded export growth. Stripping out inventories and net trade, final sales to domestic purchasers growth came in at 2.7%, up from 2.4% in Q1. The core PCE price deflator came in at 2.9% q/q annualized, two ticks above expectations, but below the 3.7% last quarter. Taking the first half of the year as a whole, the US economy has cooled to about a 2% pace compared to the sizzling 4% pace seen in the second half of last year. The GDP and labor market data are telling us that the economy is operating close to its potential level. The Fed will have a closer look at the modest consumption and inflation surprises with the monthly PCE release tomorrow, but worries about downside risks in the labor market and sufficient progress on inflation, with more shelter disinflation clearly in the pipeline, is still going to be enough to get them started with the easing cycle in September.

- The pickup in consumption was driven by a rebound in goods consumption of 2.5% growth after last quarter's contraction of 2.3%. The level of goods consumption remains fairly steady around its new post-pandemic trend, supported in this quarter by durable goods demand. Services consumption cooled to a 2% pace, which is roughly speaking about normal for that component, compared to the over 3% growth over the prior two quarters. While the labor market shifted down a few gears in Q2, wage growth and wealth gains were solid in the quarter which ultimately supported spending in the quarter.
- Other components of demand were strong, but its unlikely that strength is durable. Business investment rose largely because the volatile transportation category surged by an eye-popping 50% annualized in the quarter after three straight months of decline, likely reflecting deliveries of aircrafts. Government spending increased because federal defense spending jumped in the quarter, but non-defense spending and state and local government spending look like they are slowing down, consistent with a softer pace of government hiring and lower construction spending. Residential investment was contracted slightly after a sharp increase last quarter.
- We can't know for sure what happened in the core PCE index until tomorrow's release of the monthly data, but it seems very possible it has more to do with slight upward revisions to April and May because they have a greater weight in the quarter annualized calculation than June. A combination of 0.30% for April and 0.10% for May and June gets you to a 2.9% Q/Q SAAR as well. So, we don't think this is a freakout moment for the remaining hawks in the FOMC.
- The bottom line here is that GDP growth is still solid and the economy is likely operating close to capacity. Its not too hot, nor too cold. But the trend has come down and the Fed should be focused on where the economy is headed as opposed to where it is right now. Soon the labor market could show signs of some slack if real rates stay where they are, while lower shelter prices will add a major disinflationary force to the last mile regardless of the near-term direction of monetary policy.

Implications & actions

Re: Economic forecast — The overall trend in GDP is softer and that is broadly consistent with the Fed's view of the economy cooling gradually. Our Fed call remains unchanged and we continue to expect two cuts this year, in September and December.

Re: Markets — Bond yields and the broad dollar rose after today's above-consensus GDP and core inflation data.