Datanote: U.S. GDP, Q2

In one line: Better than Q1, but likely unsustainable

- Q2 GDP rose at a 2.8% annualized rate, above the consensus, 2.0%.
- The core PCE deflator rose at a 2.9% rate, above the consensus, 2.7%.
- The GDP deflator rose at a 2.3% rate, below the consensus, 2.6%.

The GDP consensus always looked

a bit low, but the outturn is above our 2.2% forecast too, thanks mostly to a substantial overshoot in government spending, up 3.6%. This easily overshot our 0.7% forecast, with both defense and state and local government spending outperforming. That said, the 2.8% increase in S&L spending was the smallest in two years, and a further slowing is inevitable in the wake of the rollover in S&L revenue growth.

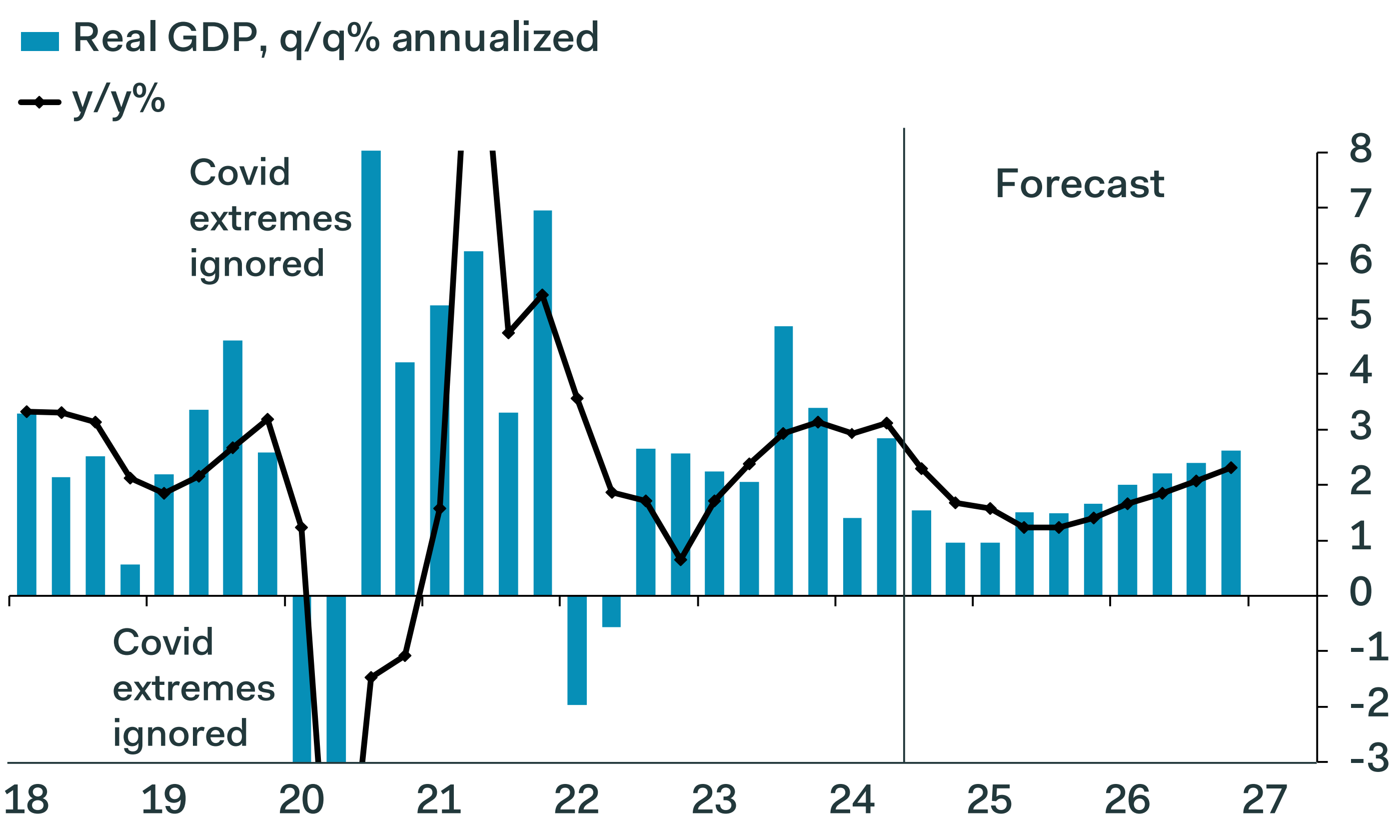
The biggest contribution to GDP growth was the 2.3% increase in consumption, up from the 1.5% Q1 estimate but probably not an indication of a rebound in the trend, and a 3.6% gain in private fixed investment. Both were only slightly stronger than we expected. The standout in the capex numbers was an unexpected 11.6% leap in spending on equipment, beating the pace implied by monthly data by some four percentage points. The weakness of capex intentions surveys, however, suggests this is unsustainable. Investment in IP and software rose 4.5%, in line with the recent trend, while while investment in nonresidential structures fell by 3.3%, as the push from the CHIPS Act faded. In Q2 last year, nonres investment spending rose at a 16.1% pace, so the turnaround has been abrupt.

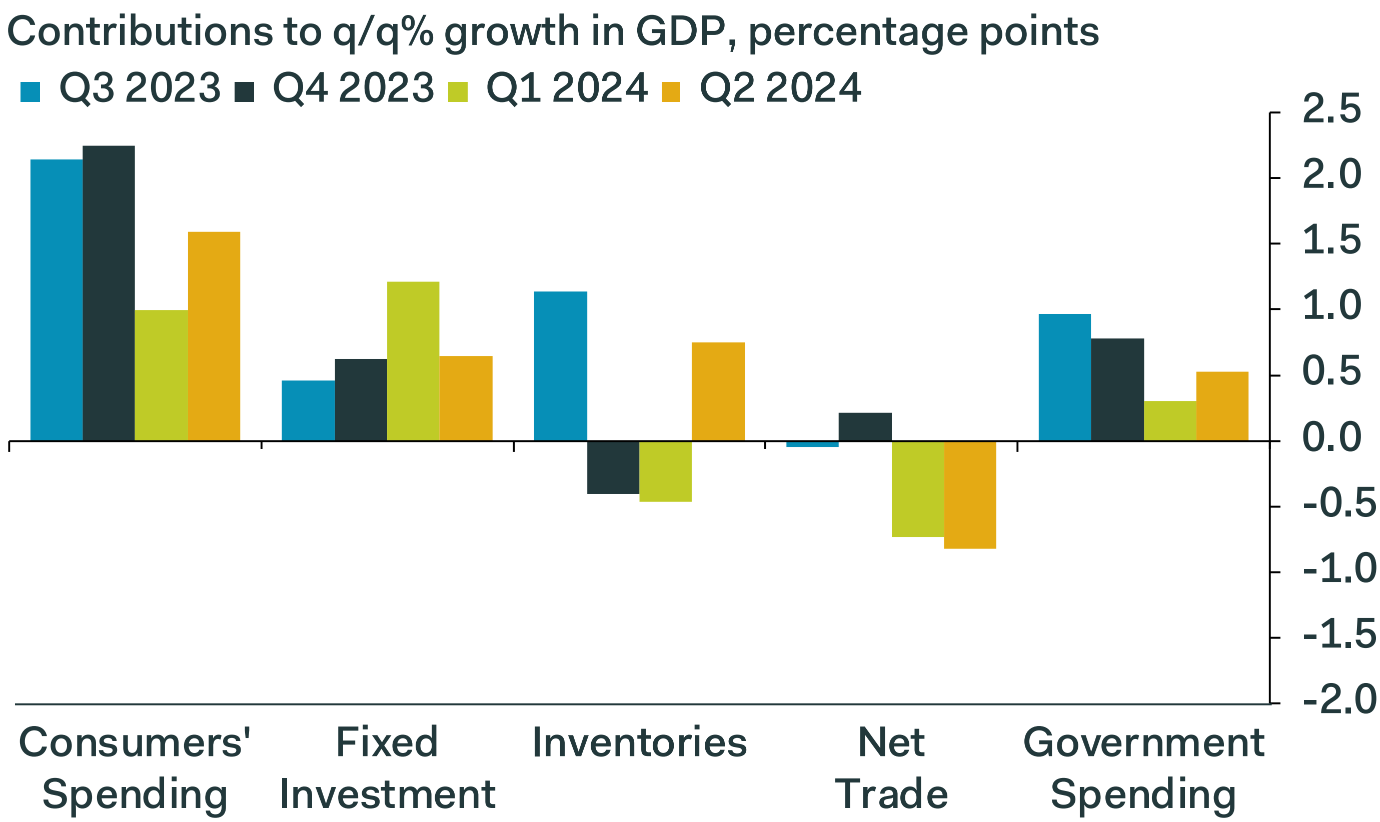
Elsewhere, a hefty drag from net foreign trade, which subtracted 0.7 percentage points from GDP growth, was offset by a 0.8pp contribution from rising inventories. We expect much smaller swings in both trade and inventories in the second half, though both are volatile.

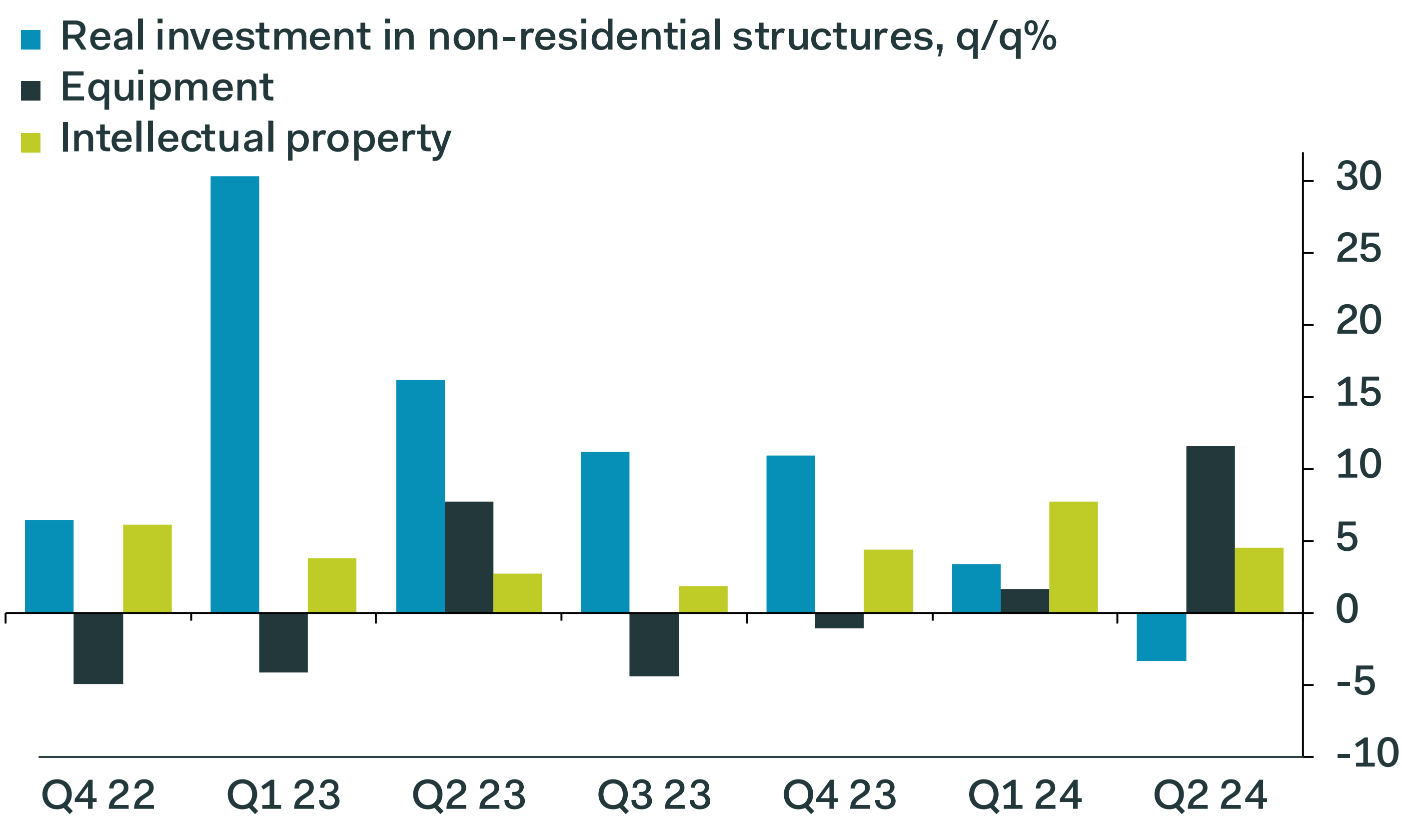
We expect consumption to struggle in the second half, under the weight of much slower growth in real after-tax incomes than last year, when the 4.2% leap was almost double the long-run average. Rising unemployment and slowing wage growth will both scare people into saving more and constrain the spending power of people who remain unworried about the job market. Business capex too is likely rise only modestly, given the severe financing constraint on small companies and the uncertainty over the economic outlook. An election campaign in which the current front-runner is threatening massive import tariffs is a disincentive to invest too.

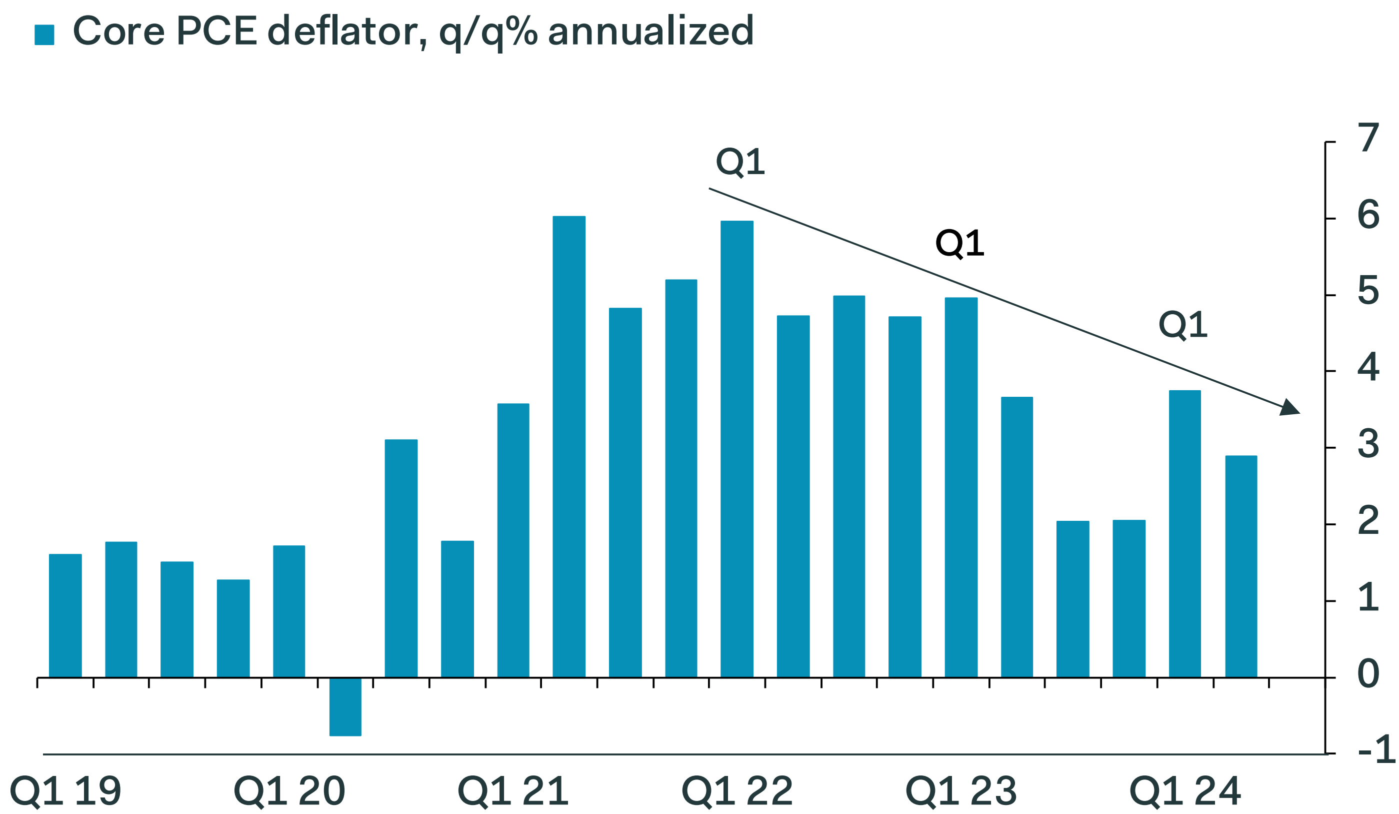
The 2.9% increase in the Q2 core PCE deflator implies a 0.28% increase in June, assuming no revisions to April and May. That's far enough away from our 0.15% forecast, based on the CPI and PPI data, to suggest that the prior data will be revised up. The updated numbers will be released alongside the June data tomorrow. Whatever the new monthly data show, the downward trend in core PCE inflation is clear.

The bottom line here is that this report likely will mildly disappoint investors who had been looking for the Fed to ease next week, or to cut by 50bp in September. But these data are first estimates and are subject to potentially large revisions; they are not definitive evidence of anything. We remain firmly of the view that the trend in growth is slowing, with a further softening likely in the second half, and we expect the Fed to ease by 25bp in September, followed by 50bp each in November and December as unemployment rises and core inflation falls faster than the Fed expects.




Contributions to q/q% growth in GDP, percentage points
Q3 2023
Q4 2023
Q1 2024
Q2 2024
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
-1.5
-2.0
Consumers' Spending
Fixed Investment
Inventories
Net Trade
Government Spending


Real investment in non-residential structures, q/q%
Equipment
Intellectual property
30
25
20
15
10
5
0
-5
-10
Q4 22
Q1 23
Q2 23
Q3 23
Q4 23
Q1 24
Q2 24


Core PCE deflator, q/q% annualized
Q1
Q1
Q1
7
6
5
4
3
2
1
0
-1
Q1 19
Q1 20
Q1 21
Q1 22
Q1 23
Q1 24