Daiwa Capital Markets

U.S. Data Review

- Q2 GDP: strong support from consumers, governments; other areas soft

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U.S. GDP in Q2

The U.S. economy grew at an annual rate of 2.1 percent in the second quarter, a touch firmer than the expected increase of 1.8 percent. This pace might seem underwhelming when viewed in isolation, but it is a respectable performance for this stage of the business cycle. The pace is slightly stronger than the economy's potential rate of growth, which is the relevant benchmark when the economy is fully employed.

GDP and Related Items*

		18-Q4	19-Q1	19-Q2
1.	Gross Domestic Product	1.1	3.1	2.1
2.	Personal Consumption Expenditures	1.4	1.1	4.3
3.	Nonresidential Fixed Investment	4.8	4.4	-0.6
3a.	Nonresidential Structures	-9.0	4.0	-10.6
3b.	Nonresidential Equipment	7.4	-0.1	0.7
3c.	Intellectual Property Products	11.7	10.8	4.7
4.	Change in Business Inventories (Contribution to GDP Growth)	0.1	0.5	-0.9
5.	Residential Construction	-4.7	-1.0	-1.5
6.	Total Government Purchases	-0.4	2.9	5.0
6a.	Federal Government Purchases	1.1	2.2	7.9
6b.	State and Local Govt. Purchases	-1.2	3.3	3.2
7.	Net Exports (Contribution to GDP Growth)	-0.4	0.7	-0.7
7a.	Exports	1.5	4.1	-5.2
7b.	Imports	3.5	-1.5	0.1
	Additional Items			
8.	Final Sales	1.0	2.6	3.0
9.	Final Sales to Domestic Purchasers	1.3	1.8	3.5
10.	Gross Domestic Income	0.8	3.2	--
11.	Average of GDP & GDI	0.9	3.1	--
12.	GDP Chained Price Index	1.6	1.1	2.4
13.	Core PCE Price Index	1.7	1.1	1.8

** Percent change SAAR, except as noted*
Source: Bureau of Economic Analysis via Haver Analytics

Most components of GDP were in line with our expectations. We would highlight government spending as the area that led to slightly faster-than-expected growth. Total government spending rose 5.0 percent, led by a jump of 7.9 percent at the federal level and supported by an increase of 3.2 percent at the state and local level. The growth of federal spending was easily the strongest of the current expansion. One has to go back to the recession, when the government was striving to stimulate the economy, to find firmer results. Much of the growth occurred in nondefense expenditures and could be viewed as an offset to declines in the prior two quarters, but still, overall spending seemed firmer than the previous underlying trend. The increase at the state and local level represented the second consecutive brisk advance (3.3 percent in Q1), reflecting robust efforts on highways and other infrastructure projects.

Consumer spending also stood out on the strong side with growth of 4.3 percent. This advance, however, was not surprising, as previous reports on consumer activity suggested brisk results.

Business fixed investment was perhaps the most important area of this report, as it is vulnerable to downside risks because of uncertainty associated with the trade war and slow global economic growth. Results were indeed soft, with activity declining 0.6 percent. The weakness was concentrated in outlays for structures (i.e. construction), where activity fell 10.6 percent. Both mining (oil wells) and non-mining structures contributed to the weakness. Outlays for equipment rose, but only marginally (0.7 percent). Investment in intellectual property grew 4.7 percent, slower than the recent norm (average growth of 6.7 percent over the eight quarters of 2017-18).

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Two areas were decidedly slow: inventory investment and net exports subtracted 0.86 and 0.65 percentage point, respectively, from GDP growth. However, the softness in both areas could be viewed as reflecting a dose of random volatility. Inventory investment had contributed noticeably in the prior three quarters (average contribution of 0.9 percentage point) and was due for a cooling. Trade figures have been buffeted by responses to the trade war, and the softening in Q2 followed a contribution of 0.73 percentage point in the previous quarter (although the outlook for net exports is not favorable in a fundamental sense given a firm dollar and slow growth in key foreign economies).

The report included benchmark revisions to the previous five years. The new data showed that growth in 2018 when measured on a Q4-to-Q4 basis was lighter than previously believed (2.5 percent versus 3.0 percent), but activity in the prior four years was firmer than previously believed. All told, the level of GDP at the end of the revision period was little changed from the previous estimate.