ECONOMIC UPDATE

REGIONS

August 29, 2012

Q2 2012 Real GDP: Minor Revisions Don't Alter The Bigger Picture

- The BEA's second estimate puts Q2 real GDP growth at an annualized rate of 1.7 percent, up from the first estimate of 1.5 percent.
- The GDP Price Index rose at an annualized rate of 1.6 percent during Q2, unchanged from the first estimate.
- The first look at Q2 corporate profits shows before-tax corporate profits rose by 6.1 percent from Q2 2011.

Revisions now put real GDP growth at 1.7 percent (annualized) during Q2 2012, matching expectations and up from the BEA's initial estimate of 1.5 percent growth. Upward revisions to spending on household services, consumer durables, net exports, and state and local government spending offset downward revisions to spending on nondurable consumer goods, business investment in equipment and software, and the rate of inventory accumulation. These changes, however, amount to tinkering around the edges of an economy if not, to borrow a phrase from Chairman Bernanke, stuck in the mud then at least stuck in neutral Since Q3 2009, the start of the recovery from the Great Recession, real GDP growth has averaged 2.22 percent.

Overall consumer spending was revised slightly higher, with the first estimate of 1.5 percent annualized growth now put at 1.7 percent. The revisions, however, now show less spending on goods and more on services, with annualized growth of 2.4 percent marking the most rapid growth in spending on household services since the start of the recovery. Almost all of the upward revision here, however, is due to spending on utilities. With spending on motor vehicles and household furnishings declining in Q2, though slightly less than previously estimated, and spending on nondurable goods revised lower, the composition of overall consumer spending is somewhat less favorable than initially reported. The strong July retail sales report suggests consumer spending got off on a stronger footing in Q3, but we don't expect growth in real consumer spending to stray far from the 2.0 percent mark for the quarter as a whole.

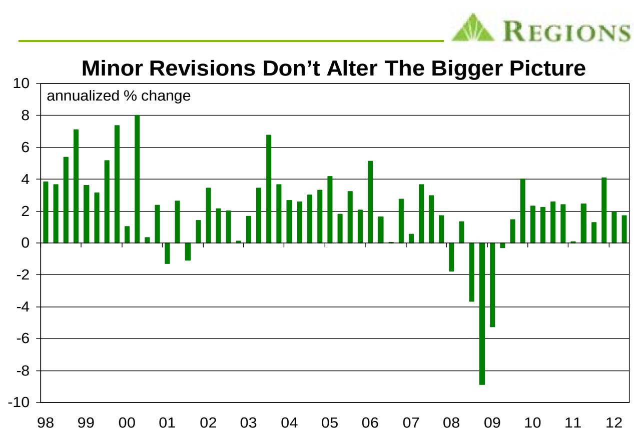
Business spending on equipment and software grew at an annualized rate of 4.7 percent during Q2, down from the initial estimate of 7.2 percent. This highlights to us what has been a troubling trend – the ongoing decline in orders for core capital goods. Declining orders during Q2 will show up in the form of lower shipments over coming months, which is the metric that feeds into the GDP data, so we expect even further deceleration in growth of business investment spending over the second half of the year.

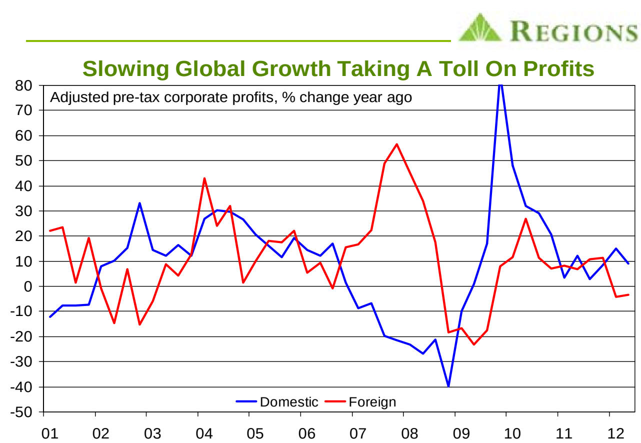
Instead of adding to top-line real GDP growth during Q2 as initially reported, inventory accumulation is now shown to have acted as a drag on growth, deducting 0.23 percent from the headline number. Business inventories rose during the quarter, but at a much slower pace than the BEA first estimated, and in the fun-filled world of GDP accounting, it is the change in the change in inventory accumulation that matters, thus the deduction from top-line growth. While there will no doubt be some analysts who will take this as a positive sign for current quarter growth, we're not so sure – in the absence of signs of a meaningful pick up in the pace of final demand, firms will keep a tighter hold on inventory accumulation, so we don't expect a big bounce back in inventory accumulation during Q3.

The big swing in business inventories was basically neutralized by a big swing – in the opposite direction – in net exports. A smaller trade gap than initially estimated now means that net exports added 0.32 percent to top-line real GDP growth. While the Euro Zone remains a mess and growth in China (our third largest export market) has slowed, U.S. exports to Canada and Mexico have held up better. Still, coming quarters will likely see growth in overall U.S. exports slow and trade will be less supportive of overall growth.

Today's report brings our first look at Q2 corporate profits. On an over-the-year basis, total corporate profits were up by 6.1 percent during Q2, with domestic profits rising by 9.1 percent and foreign profits falling by 3.3 percent.

The revisions to the Q2 GDP data don't really change the bigger picture, nor will what should be slightly better Q3 growth. The risks, both here and abroad, remain weighted to the downside as policy makers have their work cut out for them.





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