ECONOMIC UPDATE
REGIONS
August 29, 2013

Q2 2013 Real GDP: Q2 Growth Better, Will H2 Be Better Still?

- Revisions put Q2 real GDP growth at 2.5 percent (annualized), compared to the initial estimate of 1.7 percent.
- The GDP Price Index <u>rose</u> at an annualized rate of 0.8 percent during Q2.
- Corporate profits <u>rose</u> by 3.9 percent quarter-over-quarter and were <u>up</u> by 5.0 percent on a year-over-year basis.

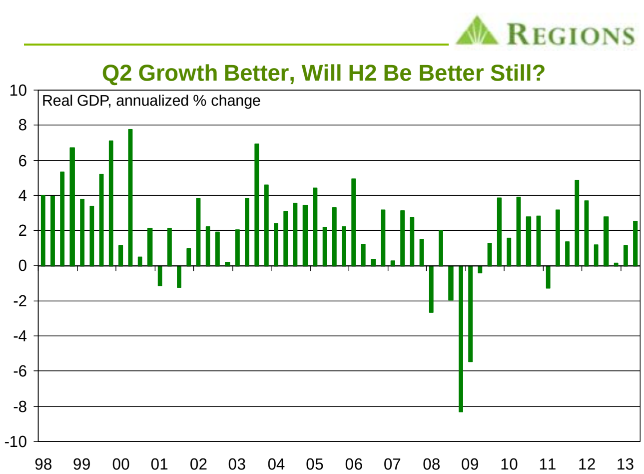
The U.S. economy grew at an annualized rate of 2.5 percent during 2013's second quarter according to the BEA's revised estimate. This is well ahead of the initial estimate of 1.7 percent annualized growth. The economy is still characterized by the dichotomy between an expanding private sector and a contracting public sector, though the drag from the public sector should progressively fade over coming quarters. Today's report also includes the first look at Q2 corporate profits, and the BEA reports profits rose by 5.0 percent on a year-over-year basis, with profits from domestic operations accounting for all of this increase as profits from foreign operations were down from Q2 2012.

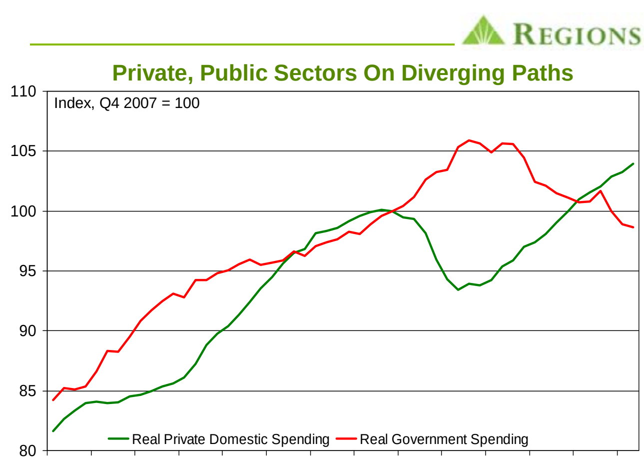
The most significant revision to the Q2 GDP data was to net exports – rather than a real trade deficit of $451.3 billion the trade gap is now reported at $422.0 billion (these are annualized figures). Instead of deducting 0.8 percent from top-line growth as reported in the initial estimate, net exports are now reported to have been a neutral factor on Q2 growth. There were revisions within the business fixed investment category – spending on structures was revised significantly higher while spending on equipment and intellectual property products was revised lower – but these were basically a wash and overall business fixed investment did not materially change. The decline in government spending is now reported to be slightly larger than in the initial estimate. This is due to spending on the combined state and local level being marked down – rather than making a small positive contribution to growth as initially reported, state and local government spending is now shown to have been a modest drag on growth. There was no change to the BEA's estimate of the decline in federal government spending, which deducted 0.12 percent from top-line growth.

Real consumer spending grew at an annualized rate of 1.8 percent in Q2, matching the BEA's initial estimate. Spending on consumer durable goods, such as motor vehicles, home furnishings, and appliances, continued to drive growth in overall consumer spending in Q2, though spending on motor vehicles (adjusted for inflation) declined slightly during the quarter. Recall that Q2 got off to a slow start with unit motor vehicle sales slipping in April. Since then, however, the pace of motor vehicle sales has risen steadily and July sales were running easily ahead of Q2's pace, so spending on consumer durables should make a larger contribution to growth in Q3. Spending on household services, however, grew at an annualized rate of just 1.1 percent in Q2 and has been persistently weak over the course of the recovery.

The narrowing of the trade gap was a function of sharply faster growth in U.S. exports, with exports of goods reported to have grown at an annualized rate of 10.1 percent during Q2, the best performance since Q4 2010. This offset faster growth in imports of goods which, at an annualized rate of 7.1 percent, posted the fastest growth since Q3 2010. The pop in export growth was mainly due to sizeable gains in U.S. exports of aircraft & parts, motor vehicles, and consumer goods. We do not expect this pace of growth to be sustained over coming quarters. While there are signs the Euro Zone may be starting to emerge from recession, that still leaves Europe on a long and winding road to recovery that is unlikely to make a meaningful impact on U.S. exports, and emerging market economies are on shakier ground in part due to the fallout from uncertainty over the course of the Fed's asset purchases.

The data on corporate profit growth are encouraging and should be supportive of second half growth, given that profit growth tends to lead investment and hiring – profit growth in the nonfinancial sector accelerated in Q2 even as pricing power remains spotty. Stepped up spending in the corporate sector is one factor behind our anticipated pickup in growth over 2013's second half. Moderately faster growth of consumer spending and inventory rebuilding in the nonfarm business sector will also play a role in this. A key factor, however, will be what we expect to be a progressive easing of the drag from fiscal policy, even as there is plenty of pointless political drama on tap for coming months.





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