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Q2 2014 Real GDP: What's Next After Q2's Big Bounce?

- > Real GDP rose at an annualized rate of 4.0 percent in Q2 following a 2.1 percent (annualized) contraction in Q1.
- > The GDP Price Index rose at an annualized rate of 2.0 percent in Q2.
- > The annual benchmark revisions resulted in a slight downgrade to prior estimates of real GDP growth for the 2011-13 period.

Though not threatening to displace Bubba Newman as *The Comeback Kid*, the U.S. economy nonetheless staged quite a comeback of its own in Q2, with real GDP expanding at an annual rate of 4.0 percent. This follows a 2.1 percent contraction in Q1 that is smaller than the previous estimate of 2.9 percent (annual rate). The revised Q1 figure is a product of the BEA's annual benchmark revisions to the GDP data, with today's report incorporating revisions to all GDP data starting in 2010 with some series revised back to 1999. On the whole, those revisions resulted in slightly slower growth over the 2011-13 period, with real GDP now reported to have advanced 1.6 percent in 2011, 2.3 percent in 2012, and 2.2 percent in 2013, compared to the prior estimates of 1.8 percent, 2.8 percent, and 1.9 percent, respectively. Still, it is interesting to note that growth over the second half of 2013 is now reported to be faster than initially estimated, which puts it more in line with the improvement seen in the higher frequency data that suggested the economy carried a good deal of positive momentum into 2014. Sure, by now we all know what happened to that momentum during Q1, but the point is Q1 is the outlier here and the economy clearly regained its footing in Q2.

Real consumer spending rose at an annualized rate of 2.5 percent in Q2, which added 1.69 points to top-line real GDP growth. What was the fastest quarterly pace of motor vehicle sales since Q1 2006 led to a surge in spending on consumer durable goods, which grew at an annual rate of 14.0 percent (inflation adjusted) in Q2. Real spending on household services rose at an annual rate of just 0.7 percent. Spending on services accounts for roughly two-thirds of all consumer spending, and recall it was this component, in particular consumer spending on health care, which led to the wild swings in the BEA's prior estimates of Q1 real GDP growth. Anyone hoping the benchmark revisions and new data for Q2 would bring some clarity will be disappointed. Real outlays on health care are reported to have risen by 0.7 percent in Q2 following a 1.4 percent decline (annual rates) in Q1, and the impact of the Affordable Care Act has yet to be clearly established in the data on

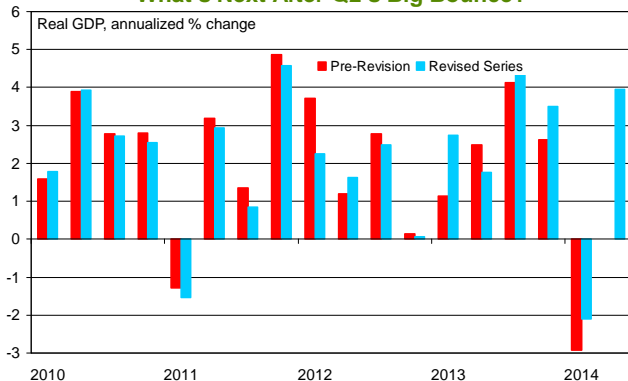
consumer spending. Note the Q2 figure is an estimate based on highly incomplete data and it will not be until the September 11 release of the Quarterly Services Survey that there is hard data for the BEA to work with. As such, today's estimate of health care spending in Q2 can be expected to undergo material revision in the months ahead.

Real business fixed investment rose at an annual rate of 5.9 percent in Q2, a significant snapback from the paltry 0.2 percent gain logged in Q1, with spending on both structures and equipment rebounding smartly. There was also a significant rebound in the pace at which private sector businesses added to inventories in Q2 following a sharp slowdown in Q1. After deducting 1.16 points from top-line real GDP growth in Q1, inventory accumulation added 1.66 points to top-line growth in Q2. Another series in which there have been sharp swings in recent quarters has been exports of U.S. goods, which have now logged three consecutive quarters of double-digit changes. After rising 13.6 percent in Q4 2013, exports of U.S. goods fell 11.9 percent in Q1 2014 and are now reported to have risen 12.9 percent in Q2 (all annual rates). Still, despite the bounce back in exports in Q2, net trade acted as a drag on top-line real GDP growth in Q2 thanks to annualized growth of 13.3 percent in imports of goods into the U.S. Total government spending is reported to have risen at an annual rate of 1.6 percent in Q2 as a jump in spending on the combined state and local government level (up 3.1 percent) more than offset another contraction in spending on the federal government level (down 0.8 percent) despite rising defense outlays.

While the comeback in real GDP in Q2 is encouraging, the question now becomes "what's next?" One thing today's report does is to narrow what had been a large gap between the GDP data and the higher frequency data. While the growth rate seen in Q2 cannot be sustained, our baseline forecast still calls for growth to remain above 3.0 percent over the second half of 2014. Maybe not on par with Bubba Newman, but we'll take it nonetheless.



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Contribution To Real GDP Growth

