ECONOMIC UPDATE
REGIONS
August 28, 2014

Q2 2014 Real GDP: Even More Spring In Economy's Q2 Step

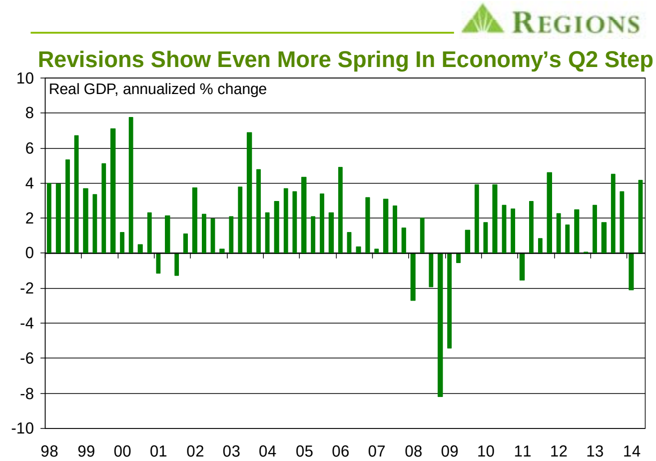
- The BEA's second estimate shows real GDP rose at an annualized rate of 4.2 percent in Q2 compared to the initial estimate of 4.0 percent.
- The GDP Price Index rose at an annualized rate of 2.1 percent in Q2, slightly ahead of the initial estimate of 2.0 percent.
- After tax corporate profits rose 8.4 percent in Q2 but were down 9.1 percent year-over-year.

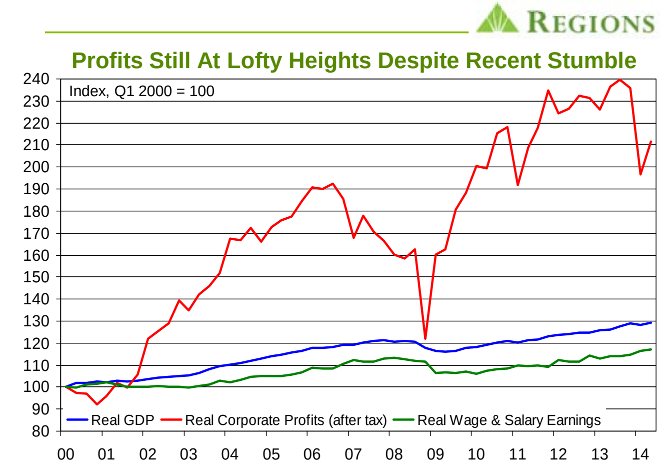
Turns out there was more spring in the economy's step in Q2 as it recovered from a Q1 to forget. The BEA's second estimate shows real GDP grew at an annualized rate of 4.2 percent during the spring quarter, up from the initial estimate of 4.0 percent growth. In addition to the slightly faster rate of growth, the composition of growth is now shown to be more favorable. There were upward revisions to business investment – across the board in structures, equipment, and intellectual property – as well as U.S. exports of goods, while the pace of inventory accumulation was revised lower as were growth in imports and government spending. By now it quite clear the contraction in real GDP seen in Q1 was an outlier, sparked by transitory factors on top of an unusually harsh winter, and the growth seen in Q2 sets the economy firmly back on the track laid out over 2H 2013. While the pace of growth seen in Q2 is not sustainable, the economy should nonetheless grow at a better than 3.0 percent rate over coming quarters.

Though growth in real consumer spending remained at 2.5 percent, as in the BEA's initial estimate, there were some changes to the underlying details. Spending on durable goods, led by motor vehicles, and on household services was revised slightly higher while spending on nondurable consumer goods was revised lower. Even with the upward revision, real spending on household services rose at a paltry 0.8 percent annual rate – recall spending on services accounts for roughly two-thirds of all consumer spending. As we have noted over the past few months, there remains a lack of clarity around household outlays on health care in the wake of the Affordable Care Act taking effect. The BEA reports that, after falling in Q1, real household outlays on health care rose just 0.4 percent (annualized) in Q2. Note even in the BEA's second estimate of GDP, the Q2 figure for health care spending 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. Given Q2 revenue growth in the health care sector, however, we expect the BEA's third estimate of Q2 GDP to show significantly faster growth in health care outlays which, given such spending accounts for over 11 percent of real GDP, means headline growth would be revised even higher.

Real business fixed investment is now reported to have risen at an annual rate of 8.4 percent, compared to the initial estimate of 5.9 percent. All components of fixed investment were revised higher, most significantly investment in equipment which is now reported to have grown at an annual rate of 10.7 percent. Residential investment was revised slightly lower but still logged a double-digit increase. The details of residential investment, however, are not at all encouraging as anyone regularly reading our write-ups of the residential construction data will be aware of. Investment in single family structures rose at just 1.7 percent (annualized), a sharp downward revision from the first estimate of 5.8 percent growth. Investment in multi-family structures was revised significantly higher, with annualized growth now put at 30.2 percent. Single family construction accounts for a much larger share of housing market and economic activity than does multi-family, from generating construction jobs to associated spending by occupants and, as such, has a larger impact on top-line GDP. That we have yet to see a meaningful pick-up in the pace of single family activity means housing will make a smaller contribution to top-line growth in the near term than we and other analysts anticipated would be the case.

Though rebounding in Q2, corporate profits failed to regain the ground lost in Q1. In Q2, domestic profits in both the financial and nonfinancial sectors posted smart gains, but foreign profits posted only a meager gain. This will bear watching over coming months with a global outlook that looks shakier than it did a few weeks back. Still, barring a global economic meltdown, the U.S. economy should continue to grow and faster growth in business capital spending is encouraging, not only for top-line growth in the near term but also for productivity growth over the longer term, which is key to faster growth in labor earnings.





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