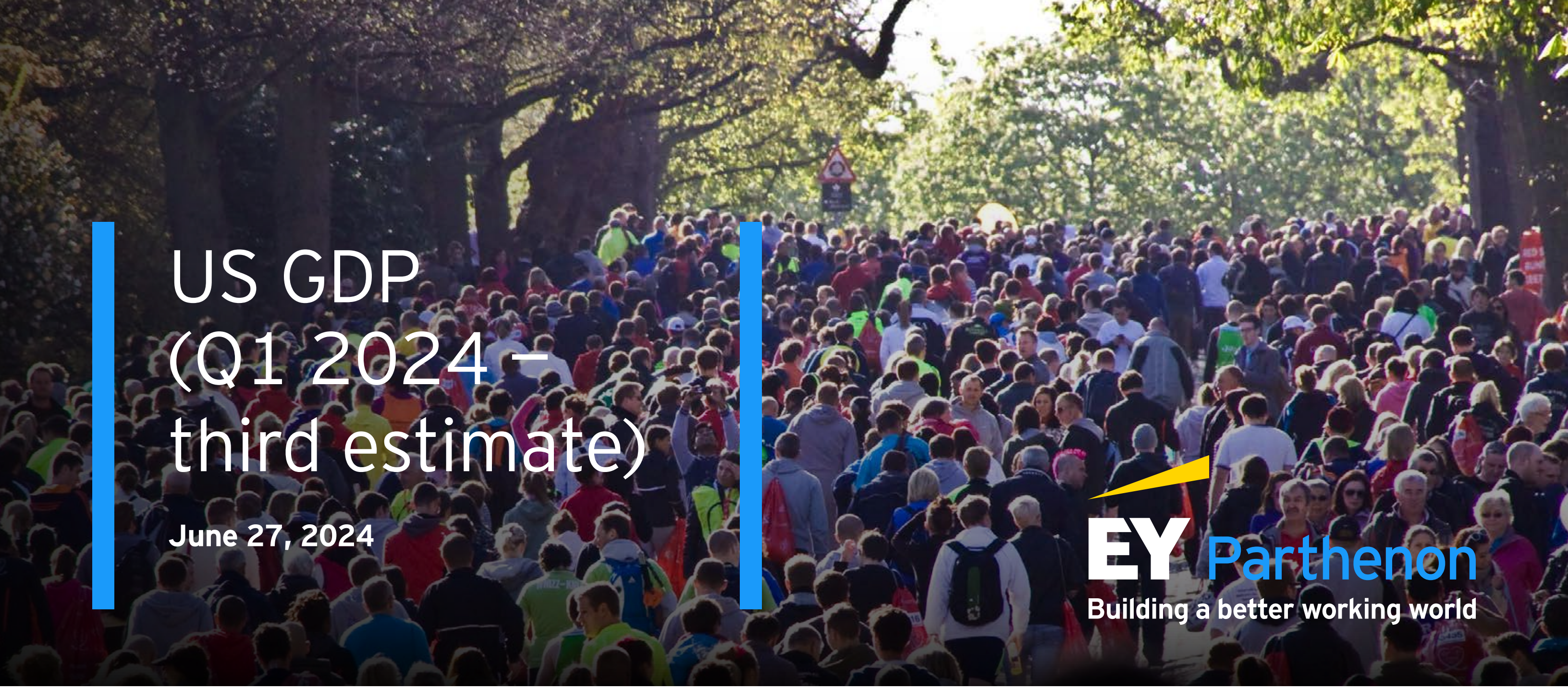

US GDP (Q1 2024 – third estimate)

June 27, 2024

EY Parthenon
Building a better working world

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Gentle economic cooling underway

- Real GDP growth was revised higher by 0.1 percentage points (ppt) to 1.4% annualized in Q1, following a strong 3.4% gain in Q4 2023 and above-2% growth in the prior six quarters. The main takeaway from this third and final GDP estimate is that the economy remained resilient in the first quarter but that private sector demand growth was cooling, led by more consumer prudence. Importantly though, the economy is not retrenching, with business investment retaining moderate momentum and real final sales to private domestic purchasers up 2.6% year over year (y/y).
  - **Consumer spending** growth was revised 0.5ppts lower to a modest 1.5% as a plunge in spending on durable and nondurable goods was offset by strong spending on services.
  - **Business investment** growth was revised up substantially to 4.4% as business equipment investment rose 1.6% and structures outlays and intellectual property investment grew a strong 3.4% and 7.7%, respectively.
  - **Residential investment** growth was revised up 0.5ppt to a remarkable 16%, supported by resilient construction activity.
  - **Government spending** growth was revised up 0.5ppt to 1.8%, roughly in line with the advance reflecting slower growth in state and local outlays and a mild contraction in federal outlays.
  - **Business inventories** are now estimated to have been a 0.4ppt drag on GDP growth in Q1.
  - **Net international trade** shaved 0.7ppt off GDP growth on strong import growth.
- Real gross domestic income (GDI) only rose 1.3% (annualized) in Q1 and gross domestic output (GDO) – the average of GDP and GDI which is considered a more accurate measure of economic growth – grew 1.4%. As such, while real GDP is up 2.9% y/y, GDI is only up 1.8% y/y and GDO is 2.4% higher than last year – a better gauge of underlying momentum in Q1.
- On the inflation front, price pressures eased modestly in Q1 with headline inflation cooling 0.2ppt to 2.6% y/y – the lowest since Q1 2021 – and core personal consumption expenditures (PCE) inflation softened 0.3ppt to 2.9% y/y – also the lowest since Q1 2021. We foresee headline and core PCE inflation ending the year around 2.6% y/y.
- Before-tax corporate profits declined by $47.1b following strong increases of $133.5b and $108.6b in the prior two quarters. Profit margins narrowed 0.3ppts to 11.9% of GDP, down from their 12.8% peak in Q2 2022 but a level that is still elevated by historical standards.

- As of late June, it seems the economy may have passed an inflection point with consumer sentiment, consumer spending, unemployment and inflation all pointing toward a slowdown in economic activity. This is not a retrenchment, but rather more prudence on the part of consumers and business leaders facing the burn of cost fatigue and higher interest rates.
- We foresee a bifurcated consumer spending outlook where modest real disposable income growth forces low- and median-income households to dial back on their outlays amid persistently elevated prices and more expensive credit. Rising election uncertainty will likely curb capex even as easing financial conditions remain supportive of high-return investment opportunities and deal volumes.
- Overall, we anticipate real GDP growth around 2% in Q2 and moderating below 2% in the second half of the year on slower private sector activity even as the drag from inventories and international trade dissipates. We foresee average GDP growth around 2.4% in 2024 and 1.7% in 2025.
- We continue to believe that a July onset of the Fed easing cycle would have been optimal given ongoing disinflation and softening labor market conditions, but a September onset is now likely given policymakers' backward-looking hawkish bias. We expect two rate cuts of 25 basis points (bps) in 2024, in September and December, and 125bps of easing in 2025.

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