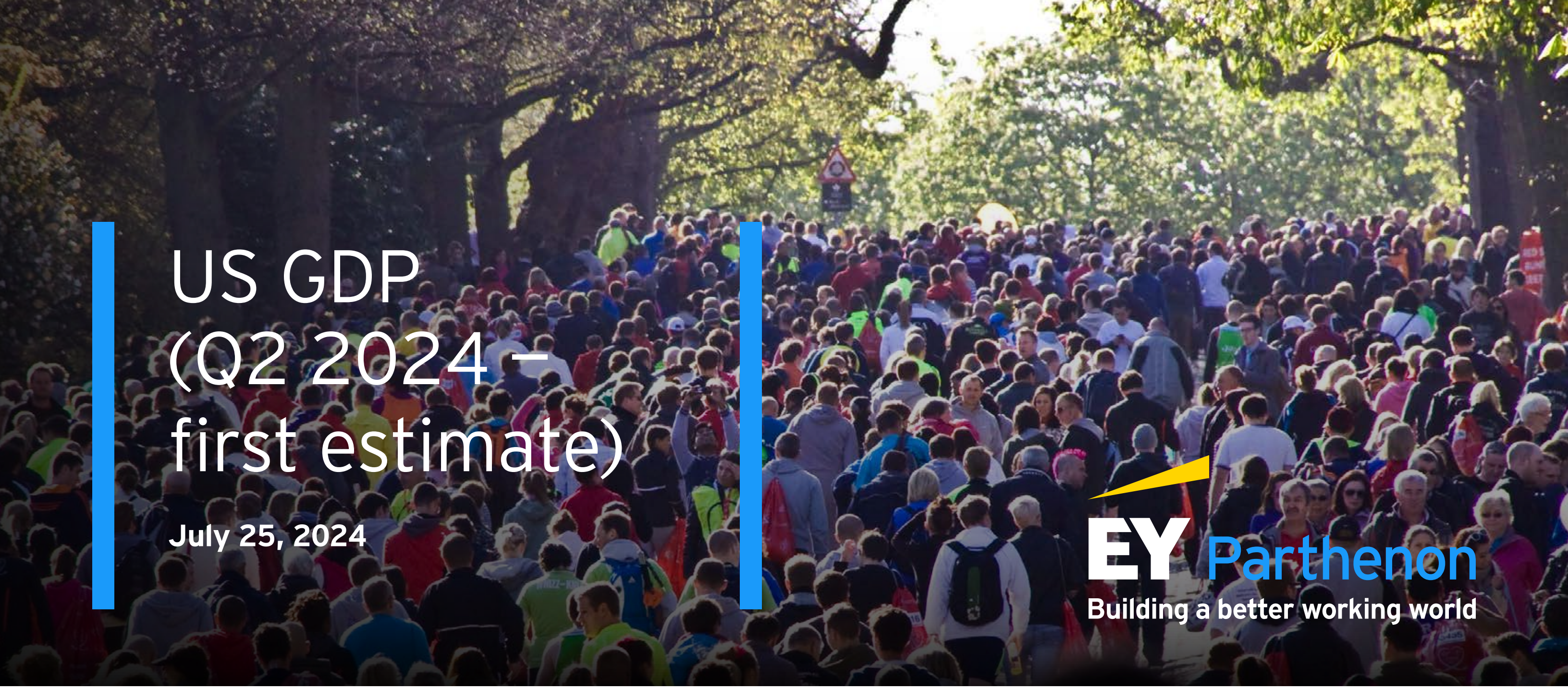

US GDP (Q2 2024 – first estimate)

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EY Parthenon
Building a better working world

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US economy cools

- Real GDP advanced a robust 2.8% annualized in Q2 2024, double the modest 1.4% gain in Q1. The main takeaway from this report is that domestic demand retained solid momentum through June with final sales to private domestic purchasers rising 2.6% in Q2, after a similar advance in Q1. Still, recent labor market and consumer spending data point to gently softening economic activity as we pass the midyear point.
- The underlying growth mix signals robust but decelerating momentum from April through June, along with easing inflationary pressures:
  - **Consumer spending** grew 2.3% with consumers stocking up on durable goods (cars, furniture, and recreational goods and vehicles) and spending freely on transportation and recreational services, but exercising more prudence with clothing, dining and stays away from home amid elevated prices and rates.
  - **Business investment** grew a robust 5.2% as surging business equipment investment led by information processing and transportation equipment offset a pullback in structures. Investment in intellectual property products also rose strongly driven by software and research and development (R&D).
  - **Residential investment** fell back 1.4%, following a 16% surge in the prior quarter, as home sales and starts cooled despite lower mortgage rates.
  - **Stronger inventory accumulation** led to a substantial 0.8 percentage point (ppt) boost to real GDP growth.
  - **Net trade** represented a substantial 0.7ppt drag on GDP growth with imports growing faster than exports. The fact that strong domestic demand pulled in more imports is a good sign.
  - **Government spending** growth picked up to 3.1% – adding 0.5ppt to GDP growth – with federal spending up 3.9% and state and local outlays growing at a healthy 2.6% pace.
- On the inflation front, price pressures eased modestly in Q2 with headline inflation flat at 2.6% year over year (y/y) – the lowest since Q1 2021 – and core personal consumption expenditures (PCE) inflation softening 0.2ppt to 2.7% y/y – also the lowest since Q1 2021. We foresee headline and core PCE inflation ending the year around 2.5% y/y in Q4, and we expect the late-July Federal Open Market Committee (FOMC) statement will signal openness to a rate cut in September. We foresee two 25 basis points (bps) rate cuts before year-end.

- The US economy is decelerating moderately as we pass the midyear point. Nothing alarming, but labor market momentum is cooling with initial claims for unemployment on a gentle uptrend, the unemployment rate creeping up past 4%, payrolls gently slowing, hours worked moderating and wage growth easing.
- With real disposable income growth having slowed to only 0.9% y/y in Q2, consumers are favoring prudence over exuberance. Lower- and median-income households with higher debt burdens and weaker savings buffers are showing more price sensitivity and discretion in their purchases while higher-income families are still spending relatively freely.
- While businesses are not pulling back, they are also being more judicious with their hiring and investment decisions while offering discounts and incentives to draw more price-discriminating customers. The housing market remains largely frozen with limited supply and depressed affordability constraining demand. Looking ahead, cost fatigue and general macroeconomic uncertainty around elections, policy and geopolitical developments have kept expectations in check. We foresee real GDP growth averaging 2.3% in 2024 and moving slightly below potential at 1.7% in 2025.

In the details:

Real GDP advanced 2.8% with real final sales up 2.0% and inventories boosting growth by 0.8ppt. Growth in real final sales to domestic purchasers (which excludes the net international trade components) picked up to 2.7% from 2.4% in the prior quarter, while real final sales to private domestic purchasers (also excluding government spending) grew 2.6% as in the prior quarter. On a year-over-year basis, real GDP growth picked up 0.2ppt to 3.1% y/y, while growth in real final sales to private domestic purchasers accelerated 0.3ppt to 2.9% y/y.

Consumer spending grew 2.3% in Q2 following a modest 1.5% gain in Q1. Spending on durable goods led the gains, up 4.7%, on rebounding car sales, furniture sales and healthy spending on recreational goods and vehicles. Spending on services only grew 2.2% as healthy advances in health care (+4.0%), recreation (+4.1%) and transportation (+3.9%) were partially offset by slower spending growth in restaurants and hotels (+1%), housing and financial services. Outlays on nondurables grew a modest 1.4% as strong spending on gasoline was offset by softer spending growth on groceries and a pullback in spending on clothing.

While there is no sign of retrenchment, consumers are growing increasingly cautious as they feel the pinch from higher prices and borrowing costs. We expect consumer prudence will continue in H2 as elevated prices and interest rates take a growing toll on households' finances. We project that real consumer spending will grow around 2.0% in 2024 and slow to 1.7% in 2025.

Residential investment fell 1.4% — following three consecutive quarterly gains and the third largest advance in a decade in Q1. Still, investment remains down 16% from its 2021 Q1 peak. While the worst of the housing sector correction is behind us, we anticipate modest residential investment growth in H2 constrained by historically low affordability (despite lower mortgage rates) and sluggish income growth. Construction activity is, however, still likely to benefit from a severely undersupplied housing market.

Business investment growth picked up to 5.2% in Q2 following a 4.4% advance in Q1. Equipment investment surged 11.6%, after a modest 1.6% gain in Q1, driven by notable strength in information processing equipment and transportation equipment investment. Intellectual property investment grew 4.5% driven by investment in software and R&D — potentially indicating some initial growth tailwinds from investment in generative artificial intelligence (GenAI).

Government spending growth picked up to 3.1% as federal outlays rose 3.9% driven by a 5.2% advance in federal defense outlays. Spending growth at the state and local levels is also cooling with a 2.6% increase in Q2 — its weakest in two years. The re-acceleration in gross investment growth likely points toward lingering policy support from the CHIPs Act and Inflation Reduction Act.

Net international trade subtracted 0.8ppt from GDP growth, as the robust 6.9% growth in imports (driven by goods more than services) outpaced the 2.0% advance in exports (driven by services over goods). Looking ahead, we anticipate cooler imports as domestic activity slows and moderate exports momentum as global activity remains subdued.

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