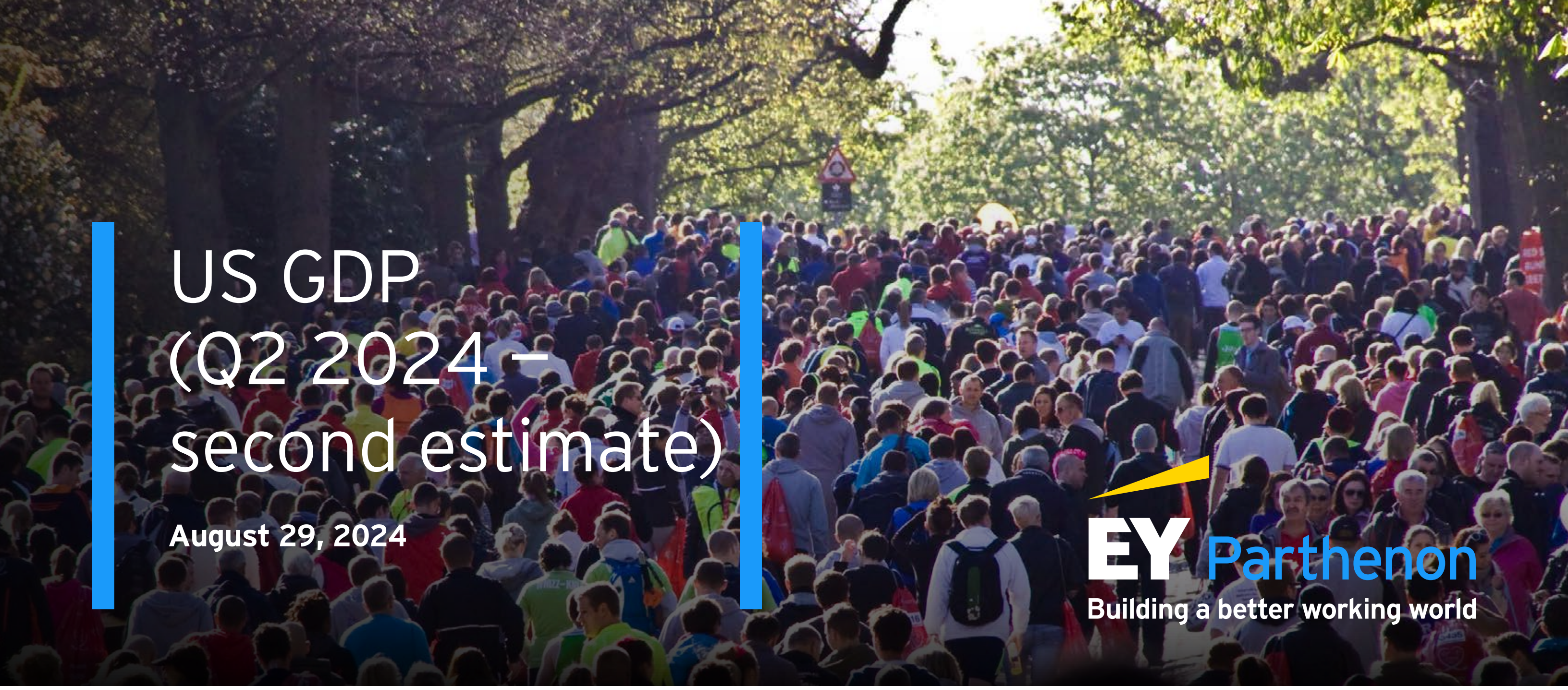

US GDP (Q2 2024 – second estimate)

August 29, 2024

EY Parthenon
Building a better working world

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The economy looked good in Q2, but …

- Real GDP growth was revised 0.2 percentage points (ppt) higher to 3.0% annualized, more than double the modest 1.4% gain in Q1. The main takeaway from this report is that domestic demand retained solid momentum through midyear, but income is under pressure. Recent labor market, consumer spending and business investment data points to gradually softening economic activity in H2.
- The underlying growth mix signals robust momentum:
  - **Consumer spending** growth was revised up an impressive 0.6ppt to 2.9% led by a significant upward revision to nondurables and services. Consumers stocked up on durable goods (cars, furniture, and recreational goods and vehicles) and spent freely on transportation and recreational services, but exercised more prudence with clothing and dining and stayed away from real estate amid elevated prices and rates.
  - **Business investment** growth was revised lower 0.6ppt to 4.6% as the surge in business equipment investment led by information processing and transportation equipment was revised down, but still offset a pullback in structures. Investment in intellectual property products rose more modestly post-revisions, driven by software and R&D.
  - **Residential investment** fell 2.1%, 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 0.8ppt boost to real GDP growth.
  - **Net trade** represented a substantial 0.8ppt 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 was revised lower to 2.7% — still adding 0.5ppt to GDP growth — with federal spending up 3.3% and state and local outlays growing at a healthy 2.3% 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 0.3ppt to 2.6% 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.

- The major blemish in this report came from gross domestic income (GDI) only rising 1.3% in Q2, following a similarly soft 1.3% increase in Q1. As a result, gross domestic output (GDO), which is the average of GDP and GDI, climbed 2.1% in Q1. Looking at the broader trend, while real GDP retained strong momentum in Q2, up 3.1% y/y, real GDI only grew 2.0% y/y. The forward-looking GDO measure is likely a more accurate gauge of underlying economic momentum in Q2 at 2.6% y/y.
- The report also provided the first glance at how companies fared during Q2. Before-tax corporate profits rose by $57.6b, following a $47.1b decrease in Q1. Stronger domestic financial and nonfinancial profits offset weaker international profits. Profit margins rose 0.1ppt to 12% of GDP — elevated by historical standards.
- Despite elevated financial market volatility and softer economic data, worries about an imminent US recession are overstated. Labor market conditions have visibly softened, but economic momentum remains positive. The US economy is still moving forward at a modest to moderate pace.
- We expect slower economic activity heading into 2025 as still-elevated prices and interest rates curb private sector activity. Households will spend more prudently as labor market conditions and income growth soften further while elevated financing costs lead businesses to hire and invest with discretion. Still, business leaders and consumers are not retrenching, and financial market volatility is more a reflection of the Federal Reserve being behind the curve in terms of easing policy than reflective of any fundamental economic weakness. This is positive as Fed policy easing in the coming months should support the economy and reduce financial market volatility. We foresee real GDP growth averaging 2.5% in 2024 and easing to 1.7% in 2025.
- Unless labor conditions deteriorate materially in the coming weeks, we continue to expect a majority of policymakers will favor a 25-basis-points (bps) cut in September. We foresee 25bps rate cuts in September, November and December (75bps total in the remainder of 2024).

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