Second Quarter GDP (Advance)

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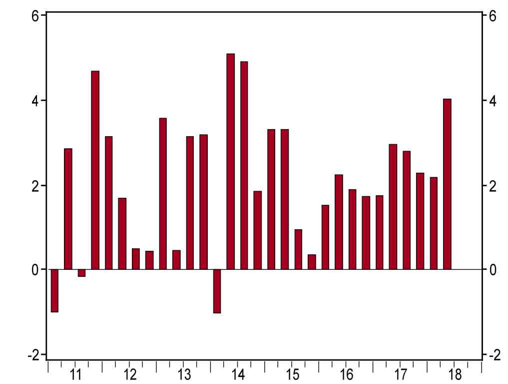
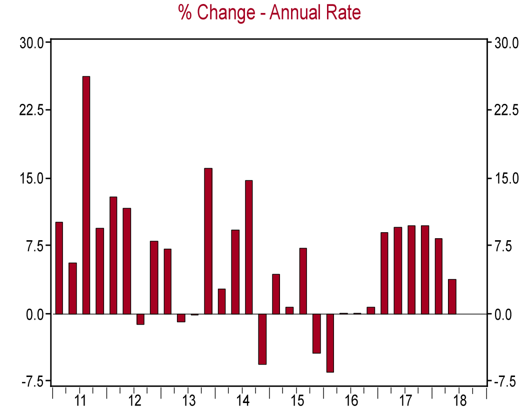
- The first estimate for Q2 real GDP growth is 4.1% at an annual rate, almost exactly the consensus expected 4.2%. Real GDP is up 2.8% from a year ago.
- The largest positive contributions to real GDP growth in Q2 were consumer spending and net exports. The largest drag was inventories.
- Personal consumption, business investment, and home building, combined, grew at a 4.3% annual rate in Q2 and are up 3.2% in the past year.
- The GDP price index increased at a 3.0% annual rate in Q2. Nominal GDP (real GDP plus inflation) rose at a 7.4% annual rate in Q2, is up 5.4% from a year ago, and up at a 4.6% annual rate from two years ago.

Implications: The US economy is the strongest it's been in a decade. Real GDP grew at a 4.1% annual rate in the second quarter, very close to consensus expectations, and is poised for continued robust growth in Q3. Some analysts are focusing on net exports, which boosted growth by 1.1 percentage points in Q2. The theory is that some exporters, particularly in the farm sector, rushed shipments abroad in Q2 to get ahead of foreign tariffs. So, the theory goes, net exports will be much weaker in Q3, which means real GDP growth will be much weaker, as well. What this theory misses is that inventories were a substantial and unusual drag on growth in Q2, as businesses reduced their inventories at the fastest pace since late 2009, back when some companies were taken by surprise by higher demand when the recession was over. And with companies now having more room on shelves and showrooms that means faster growth in Q3. As a result, our initial forecast for real GDP growth in Q3 is 4.5%, even faster than was just reported for Q2. We like to follow "core" real GDP, which excludes inventories, international trade, and government purchases, none of which can be counted on for long-term economic growth. Core real GDP grew at 4.3% annual pace in Q2 and is up 3.2% in the past year. In terms of the monetary policy, today's report shows that the Fed has its work cut out for it. Nominal GDP – real GDP growth plus inflation – grew at a 7.4% annual rate in Q2 and in the past year is up 5.4%, the fastest pace since 2006. As a result, we are confident that the Fed will not only raise rates twice more this year (25 basis points each time) but will also raise rates four times next year. By contrast, the futures market in federal funds only suggests a 6% chance of raising rates that much by the end of 2019. In turn, long-term interest rates should move up as well to reflect faster growth and more inflation. Deregulation and lower tax rates are boosting economic growth. The Plow Horse Economy – the plodding roughly 2% growth rate of mid-2009 through 2016 is dead and gone and more good news is on the way.





2nd Quarter GDP Seasonally Adjusted Annual Rates	Q2-18	Q1-18	Q4-17	Q3-17	4-Quarter Change
Real GDP	4.1%	2.2%	2.3%	2.8%	2.8%
GDP Price Index	3.0%	2.0%	2.5%	2.2%	2.4%
Nominal GDP	7.4%	4.3%	5.1%	4.8%	5.4%
PCE	4.0%	0.5%	3.9%	2.2%	2.7%
Business Investment	7.4%	11.5%	4.9%	3.4%	6.7%
Structures	13.2%	13.9%	1.3%	-5.8%	5.3%
Equipment	3.8%	8.5%	9.9%	9.8%	8.0%
Intellectual Property	8.2%	14.1%	0.7%	1.7%	6.0%
Contributions to GDP Growth (p.pts.)	**Q2-18**	**Q1-18**	**Q4-17**	**Q3-17**	**4Q Avg.**
PCE	2.7	0.4	2.6	1.5	1.8
Business Investment	1.0	1.5	0.6	0.5	0.9
Residential Investment	0.0	-0.1	0.4	0.0	0.1
Inventories	-1.0	0.3	-0.9	1.0	-0.2
Government	0.4	0.3	0.4	-0.2	0.2
Net Exports	1.1	0.0	-0.9	0.0	0.0

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