THREE ON THURSDAY

First Trust

FIRST TRUST ECONOMICS

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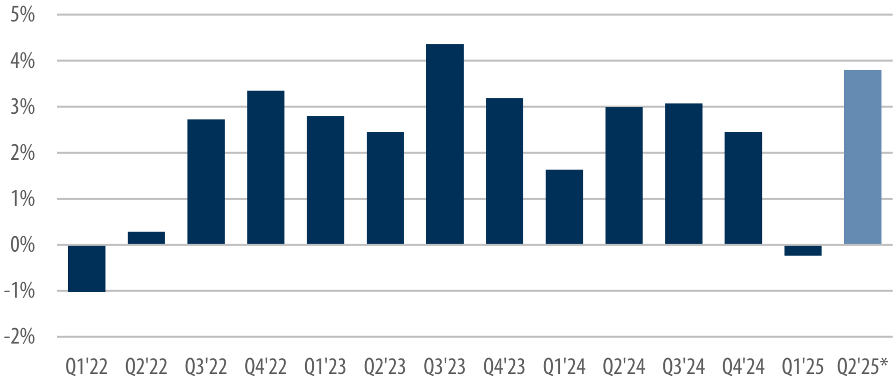
Real GDP in Q1 and Q2: Ignore the Whiplash

Real (inflation-adjusted) GDP shrank in the first quarter of 2025—marking the first contraction since 2022—and instantly igniting partisan crossfire. The Left points to the downturn as evidence that President Trump's return to office has already derailed the economy, declaring a recession imminent. Meanwhile, the Right argues the contraction reflects the economic fragility President Biden left behind, insisting President Trump's pro-growth policies need more time to take effect. In this week's Three on Thursday, we cut through the political noise and dissect the real drivers behind the Q1 slump and assess whether the weakness is likely to persist or reverse in Q2. See the three charts below for a closer look at what's really going on beneath the headline number.

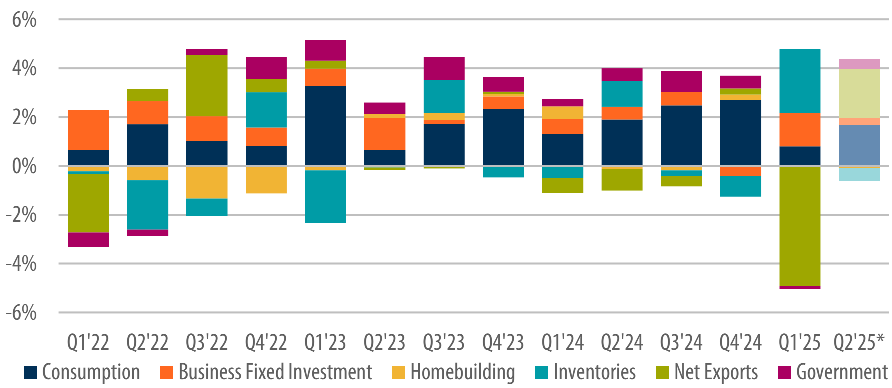
Annualized Change in U.S. Real GDP



Sources: Bureau of Economic Analysis, First Trust Advisors. Quarterly data Q1 2022 – Q1 2025. *Atlanta Fed estimate for Q2 2025 as of 6/9/25.

Real GDP (Gross Domestic Product) measures the total value of all goods and services produced in a country, adjusted for inflation. By stripping out the impact of rising prices, it offers a clearer view of actual economic growth than nominal GDP, which can be distorted by inflation. In essence, real GDP answers a critical question: Is the economy truly producing more, or are things just getting more expensive? In Q1 2025, real GDP in the United States contracted at a 0.2% annualized rate—its first decline since Q1 2022, when it fell by 1.0% annualized. But the Atlanta Federal Reserve's (Fed) GDPNow model is expecting a strong rebound in Q2 with Real GDP growing 3.8% at an annualized rate.

Contributions to U.S. Real GDP



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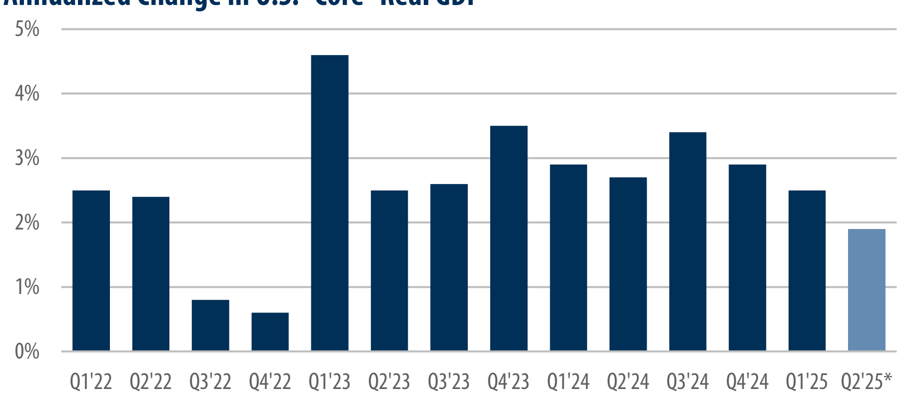
Real GDP is calculated as Consumption + Investment + Government Spending + Exports – Imports. Exports add to GDP because they're produced here, while imports subtract since they're consumed but not produced domestically. In Q1 2025, the biggest drag, by far, came from net exports (exports minus imports), as businesses rushed to front-run tariffs by importing a record amount of goods. This alone slashed Real GDP growth by 4.9 percentage points—the largest trade drag since at least 1947. With that surge in imports peaking in March, imports are now slowing, meaning trade should now be a substantial boost to Q2 growth. The Atlanta Fed's GDPNow model currently forecasts net exports adding 2.0 percentage points to Q2 GDP, with overall growth at 3.8%.

Annualized Change in U.S. "Core" Real GDP



Sources: Bureau of Economic Analysis, First Trust Advisors. Quarterly data Q1 2022 – Q1 2025. *Atlanta Fed estimate for Q2 2025 as of 6/9/25.

Just as the contraction in real GDP during Q1 2025 wasn't cause for alarm, the anticipated strength in Q2 shouldn't spark too much enthusiasm either, as both are largely driven by fluctuations in trade. For a clearer picture of underlying growth, we focus on "core" GDP—consumption, business fixed investment, and residential investment (homebuilding)—excluding more volatile components like inventories, government outlays, and trade. These are the areas that, over time, really drive sustainable growth in the economy. Core GDP came in at a 2.5% annual rate in Q1 2025, the slowest pace in nearly two years, but not even close to recessionary. Right now core GDP for Q2 looks to be growing at a 1.9% annualized pace. Weaker than previous quarters, but still not recessionary.