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July 30, 2026 • 630.517.7756 • www.ftportfolios.com

2nd Quarter GDP (Initial)

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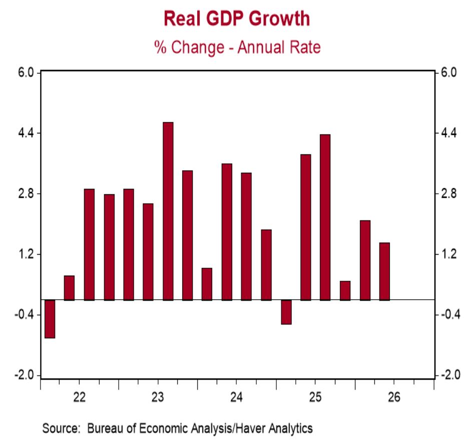
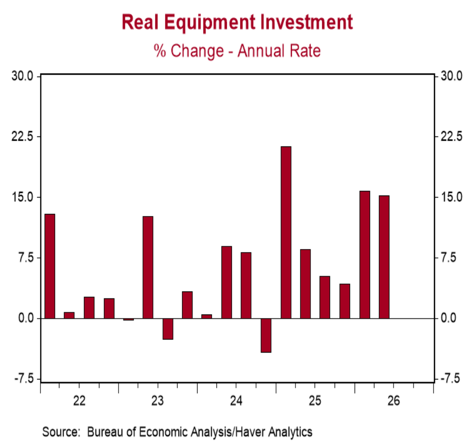
- Real GDP increased at a 1.5% annual rate in Q2, lagging the consensus expected 2.0%.
- The largest positive contributions to real GDP growth in Q2 came from personal consumption, business investment in equipment, and intellectual property. Home building also eked out a slight gain. The largest drags on growth were net exports and inventories, with small declines for commercial construction and government purchases.
- Personal consumption, business fixed investment, and home building, combined, rose at a 3.9% annual rate in Q2. We refer to this as "core" GDP.
- The GDP price index increased at a 6.2% annual rate in Q2 and is up 4.3% from a year ago. Nominal GDP (real GDP plus inflation) rose at a 7.9% annual rate in Q2 and is up 6.5% from a year ago.





Implications: Economic growth was mediocre in the second quarter, with inflation running hot due to the Iran War. Real GDP grew at a 1.5% annual rate in Q2, lagging the consensus expected 2.0% as well as the 2.1% growth rate in Q1. Personal spending, which grew at a 3.2% rate, was the key driver for economic growth in the second quarter. However, the AI/data center build-out also remains a very important factor. Data center construction grew at a 15.2% rate, business investment in information processing equipment grew at an 8.3% pace, investment in software grew at an 11.4% rate, and R&D was up at a 7.5% pace. Without this build-out, real GDP would have grown at less than a 1% pace. By contrast, the best news in today's report was that Core Real GDP – which includes consumer spending, business fixed investment, and home building, and excludes more volatile categories like government purchases, inventories, and international trade – grew at a 3.9% rate in the second quarter, the fastest pace in more than three years, and is now up 2.6% from a year ago. In the meantime, inflation was a problem, largely due to higher oil prices, with GDP prices up at a 6.2% rate in Q2 and up 4.3% from a year ago. As a result, nominal GDP rose at a 7.9% pace in Q2 and is up 5.6% annualized in the past two years. We expect this to drop in the quarters ahead, but if it does not the Federal Reserve will likely get more pressure for a rate hike. One reason we think nominal GDP will drop is that the M2 measure of the money supply has grown just 4.8% annualized over the past two years, which is less than nominal GDP and less than the 6.0% pre-COVID pace when inflation averaged below 2.0%. In other news this morning, new claims for unemployment insurance rose 9,000 last week to a still very low 197,000. Continuing claims declined 7,000 to 1.782 million. These figures suggest moderate payroll growth in July.

2nd Quarter GDP *Seasonally Adjusted Annual Rates*	Q2-26	Q1-26	Q4-25	Q3-25	4-Quarter Change
Real GDP	**1.5%**	2.1%	0.5%	4.4%	2.1%
GDP Price Index	**6.2%**	3.6%	3.7%	3.8%	4.3%
Nominal GDP	**7.9%**	5.8%	4.2%	8.3%	6.5%
PCE	**3.2%**	0.5%	1.9%	3.5%	2.3%
Business Investment	**8.4%**	10.6%	2.4%	3.2%	6.1%
Structures	**-5.0%**	-4.7%	-6.6%	-5.0%	-5.3%
Equipment	**15.2%**	15.8%	4.3%	5.2%	10.0%
Intellectual Property	**8.8%**	13.8%	5.4%	5.6%	8.3%
Contributions to GDP Growth (p.pts.)	**Q2-26**	**Q1-26**	**Q4-25**	**Q3-25**	**4Q Avg.**
PCE	**2.1**	0.4	1.3	2.3	1.5
Business Investment	**1.2**	1.4	0.3	0.4	0.8
Residential Investment	**0.1**	-0.3	-0.1	-0.3	-0.2
Inventories	**-0.7**	0.2	0.1	-0.1	-0.1
Government	**-0.1**	0.7	-1.0	0.4	0.0
Net Exports	**-1.0**	-0.4	-0.2	1.6	0.0

Source: Bureau of Economic Analysis