ECONOMIC UPDATE

REGIONS

August 25, 2022

Q2 2022 GDP: First-Half Contraction Still A Thing, At Least For Now

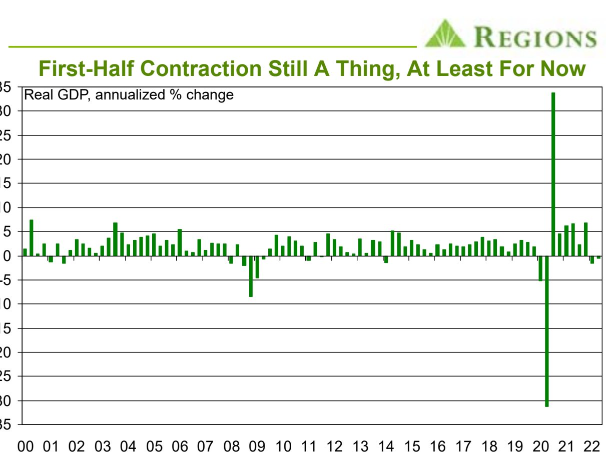
- The BEA's second estimate shows real GDP contracted at an annualized rate of 0.6 percent in Q2
- Gross Domestic Income grew at an annualized rate of 1.4 percent; after-tax corporate profits rose by 9.1 percent (quarter/quarter)

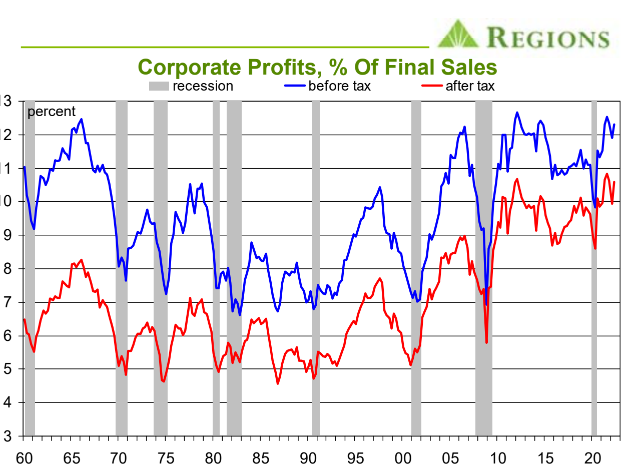
Revised and more complete source data show real GDP contracted at an annualized rate of 0.6 percent in Q2, matching our above-consensus forecast and slightly less harsh than the 0.9 percent contraction first reported. Consumer spending and net exports were the primary supports for Q2 real GDP while a slower pace of inventory accumulation and a drop in government spending were the primary drags. While the modest upward revision to the Q2 data leaves the back-to-back contraction in real GDP over 1H 2022 intact, it is interesting, not to mention a blessed relief, that talk of the U.S. economy being in recession has died down. Recall that you could hardly avoid such talk after the release of the initial estimate of Q2 GDP. We countered that with two points – first, the definition of recession employed by the National Bureau of Economic Research was not even close to being met, and, second, Gross Domestic Income (GDI) rose in Q1, and we fully expected it to do so again in Q2. That turned out to be the case, as real GDI rose at an annual rate of 1.4 percent in Q2 after having risen at a 1.8 percent rate in Q1. Not great by any stretch, but of more relevance is that history shows that when GDP and GDI diverge in the initial estimates, GDI usually proves to have been the more reliable indicator. We bring that up now as the BEA will release its annual comprehensive revisions to the GDP data, which will cover Q1 2017 through Q1 2022, on September 29 along with the release of the third estimate of Q2 GDP. While the revisions won't alter the reality of the economy over 1H 2022, they could at least alter the perceptions.

Real consumer spending grew at an annual rate of 1.5 percent in Q2, up from the initial estimate of 1.0 percent. Real spending on consumer durable goods was basically flat, contrary to the initial estimate of a 2.6 percent (annualized) decline. While spending on motor vehicles fell by more than was initially estimated, spending on home furnishings and appliances and on recreational goods/vehicles was revised higher. At the same time, real spending on nondurable goods was revised up while real spending on services was revised down, mainly reflecting a sizable downward revision to spending on health care.

While the revised data left real business fixed investment flat in Q2, there was some shifting in the composition. The contraction in spending on business structures was larger than initially estimated while growth in outlays on intellectual property products, the vast majority of which consists of spending on software and R&D, is now shown to be even stronger than first reported, with annualized growth of 10.0 percent. As we routinely note, spending on intellectual property products tends to lead changes in productivity growth. Though you'd be hard-pressed to find any evidence of that in the recent productivity data, we do think that what has for some time been robust spending on intellectual property products will pay big dividends down the road in terms of enhanced productivity. This will be a critical offset for structurally slower labor force growth. Real business inventories grew at a slightly faster pace in Q2 than was first reported but, as growth was still substantially slower than was the case in Q2, inventories still knocked 1.83 percentage points off the quarterly change in real GDP.

After inventory and capital adjustments, before-tax corporate profits rose by 6.1 percent in Q2 with after-tax profits up 9.1 percent from Q1; on an over-the-year basis, pre-tax profits were up 8.1 percent and after-tax profits were up 7.4 percent. While it's obviously better to have pricing power than to not have pricing power, workers haven't exactly been without their own pricing power. Aggregate wage and salary earnings were up 11.0 percent year-on-year in Q2, the fifth straight double-digit increase in what is far and away the largest single component of personal income. Rental income and proprietors' income also supported growth in personal income in Q2. Gross Domestic Income encompasses both personal and business income, so with corporate profits up strongly and further growth in personal income, GDI expanded further in Q2. What remains to be seen is the extent to which profit growth will hold up. Thus far, there is little evidence that growth in labor costs is ebbing, but lower costs for non-labor inputs will provide somewhat of an offset. Still, it is worth keeping in mind that profit margins, which we measure as a percent of final sales, not nominal GDP, remain notably elevated despite being down from recent peaks. While there is a limit to pricing power, a limit which is likely fast-approaching, even with some compression margins will remain high by historical standards.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com