ECONOMIC UPDATE
REGIONS
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## Q2 2026 GDP – 1st Estimate: Details Paint A Much More Constructive Picture

- The BEA's initial estimate shows real GDP grew at an annualized rate of 1.5 percent in Q2 after growth of 2.1 percent in Q1
- Consumer spending and business fixed investment were the main drivers of Q2growth while net exports and inventories were drags

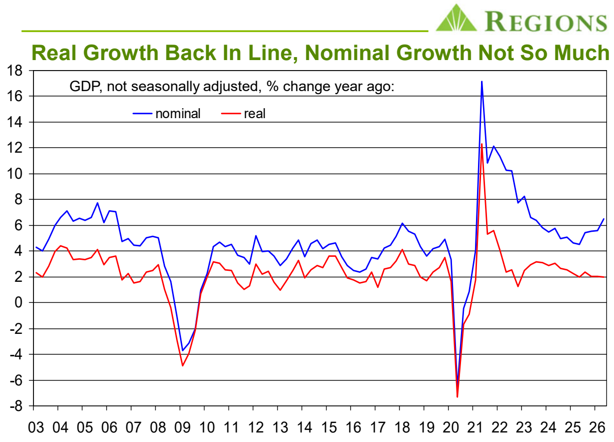
The BEA's initial estimate shows real GDP grew at an annual rate of 1.5 percent in the second quarter of 2026, falling short of what we (2.4 percent) and the consensus (2.0 percent) anticipated. Right off the bat, there are a few points for us to make. First, the GDP Price Index rose at an annual rate of 6.2 percent in Q2, easily faster than our forecast, one implication being that while nominal GDP grew at an annual rate of 7.9 percent in Q2, the spike in the GDP Price Index means that translated into less real growth than we anticipated. Second, our forecast anticipated growth in real private domestic demand – combined household and business spending adjusted for price changes – of over three percent in Q2 but, at an annual rate of 3.9 percent, actual growth came in even faster than we expected. We routinely note that we consider real private domestic demand to be a more reliable guide to the underlying health of the U.S. economy than is top-line real GDP growth. Third, we pointed to net exports as a source of uncertainty around our forecast, and a wider trade deficit than we anticipated knocked a full percentage point off top-line real GDP growth. That GDP accounting treats imports as a drag on growth is one of the more maddening quirks of GDP accounting given that over one-half of all imports that come into the U.S. are raw inputs or intermediate goods ultimately used in production of final goods, and that share has risen significantly over recent months. So, all things considered, despite top-line growth falling short of our forecast, the details of the Q2 data paint a more constructive picture of the state of the U.S. economy. This seems as good a spot as any for us to toss out our usual caveat that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision as more complete and revised source data become available.

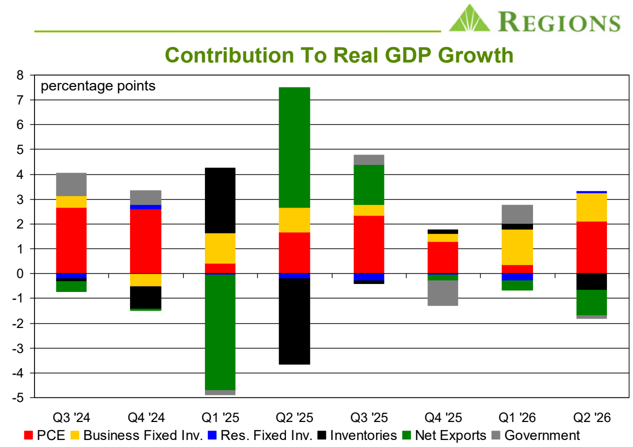
The first chart below goes to our point about the impact of rising prices in the Q2 data. Using the not seasonally adjusted data – the only basis on which year-on-year comparisons of GDP have any meaning – we show the gap between nominal growth and real growth. Two things stand out to us. First, and most obviously, is the acceleration in nominal GDP growth over the past few quarters. Second, despite this faster nominal growth, real GDP growth has more or less flatlined right at 2.0 percent, which may seem vaguely familiar as far as the economy's growth rate goes. In other words, it is taking increasingly rapid nominal growth to yield the same rate of real growth, which is a sign of an accelerating pace of price increases. The same macro point applies to households, helping account for why measures of consumer sentiment remain so depressed.

Real consumer spending grew at an annual rate of 3.2 percent in Q2 after the tepid 0.5 percent pace logged in Q1. This, however, is where our caveat about the initial estimate is worth minding, as the initial estimate of Q1 growth came in at a 1.6 percent rate. The biggest hole in the BEA's initial estimate of consumer spending in any given quarter is services spending, and that applies here as well. For now, the data show a marked pickup in the pace of growth of services spending, with a much stronger print on our proxy of discretionary services spending. We won't, however, get too attached to this initial estimate. As the data now stand, growth in consumer spending added 2.12 percentage points to top-line real GDP growth in Q2.

Real business fixed investment grew at an 8.4 rate in Q2, adding 1.15 percentage points to top-line real GDP growth. Real outlays on business equipment and machinery grew at an annual rate of 15.2 percent, a nice follow-up to Q1 growth of 15.8 percent, while real outlays on intellectual property products (of which computer software and R&D are the primary components) grew at an 8.8 percent rate. Much, but by no means all, of the growth in these components of business investment is tied to AI but, either way, these are important determinants of labor productivity growth and we've consistently argued we are in the early phases of what we expect will be a sustained period of accelerating productivity growth. On the flip side, a tenth consecutive quarterly contraction in real spending on business structures acted as a drag on business fixed investment.

Joining net exports in thwarting our forecast of top-line real GDP growth was a much larger drawdown in business inventories than we anticipated, which took 0.67 percentage points off top-line growth. One point to consider here is that while now running for several quarters, the drawdown in manufacturing inventories was particularly large in Q2. This ongoing drawdown in inventories is consistent with indicators of improving conditions in the factory sector.

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