
Modest GDP rebound likely in Q3: Prudential

By Editor Test *Wed, Sep 5, 2012*

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The latest commentary from John Praveen of Prudential International Investments Advisors offers the following data and analysis:

- **Despite the modest upward revisions, Q2 GDP remained below the Q1 pace of 2%. Looking ahead, the U.S. economy appears on track to a modest rebound with GDP growth tracking around 2.2% in Q3.** Consumption spending is likely to recover to over 2% in Q3 from the anemic 1.7% pace in Q2. July retail sales grew stronger-than-expected at 0.8% MoM (month-over-month) and core sales were up an even stronger 0.9% suggesting a good start to Q3 spending. Business investment spending is also likely to strengthen. Industrial production was off to a strong start in Q3, rising 0.6% MoM in July driven by 3.3% jump in car production. However, business confidence is hovering around the 50 level, which suggests that lingering uncertainty will keep a lid on business investment spending. Consumer and business spending remain the main drivers of U.S. growth, supported by modest gains in income, profits, and a recovery in housing.

- **However, there are potential risks to the U.S. economy in late 2012/early 2013 with the potential massive fiscal cliff of large spending cuts and tax increases in 2013 resulting from expiring tax cuts and spending cuts set to be triggered at the end of 2012.** A total of \$576bn (3.6% of GDP) of fiscal adjustment is set to occur in January 2013 as a result of the expiration of the Bush tax cuts (\$280bn, 1.8% of GDP), expiration of the payroll tax holiday (\$125bn, 0.8% of GDP) and temporary unemployment benefits (\$40bn, 0.3% of GDP), and spending cuts or so called "sequestration" (\$98bn, 0.6% of GDP).

- **With U.S. elections due in November and the nation highly polarized, it appears unlikely that any agreement will be reached before the November 6 elections.** However, a fiscal agreement is likely to be reached between the November election and year-end on extending at least some of the tax cuts and/or preventing the spending cuts. As a result the fiscal drag is likely to be smaller, around 1% of GDP, rather than the -3.6% drag from the full fiscal cliff. However, the uncertainty about the fiscal cliff remains a risk for the U.S. economy and financial markets.

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Data mavens may be interested in the following section of Praveen's report:

- **U.S. Q2 GDP growth was revised up modestly to 1.7% QoQ (quarter-over-quarter) annualized rate from 1.5% in the advance estimate.** The major contribution to the upward revision was trade, which swung from a -0.3% drag to a 0.3% positive contribution. However, this was offset by inventories

which swung from a 0.3% contribution to a -0.2% drag. In revisions: Consumer spending was revised up (to 1.7% from 1.5%); the contraction in government spending was revised smaller (to -0.9% from -1.4%) while investment spending was revised down (3.0% from 8.5%).

- **Consumer spending was revised higher but remained soft. Consumption grew 1.7% in Q2, revised up from 1.5%**, after 2.4% in Q1, with upward revisions to both durable goods and services spending. Service spending was the largest contributor to Q2 consumer spending. **Government spending was revised to a smaller decline of -0.9%** from -1.4% initially reported, after -3% with weakness in state and local spending. **Trade added 0.3% to Q2 GDP growth** after 0.1% in Q1 with exports adding 0.8% and imports subtracting -0.5%. Exports grew 6%, while imports grew a more modest 2.9%.
- **Investment spending was revised down to 3.0% from earlier reported 8.5% growth.** Spending on equipment and software grew 4.2%, revised down from 5.4%, after 7.5% in Q1. Residential investment grew 8.9%, revised down from 9.7% after 20.6% in Q1. Residential investment has now contributed to real GDP growth for five consecutive quarters and reflects the modest ongoing recovery in the housing market.
- **U.S. Q2 GDP growth was driven by revised contributions** from consumer spending (1.1%), business investment (0.4%), net exports (0.3%) and residential investment (0.2%). Meanwhile, the largest drags came from decreased government spending (-0.2%) and shrinking inventories (-0.2%).