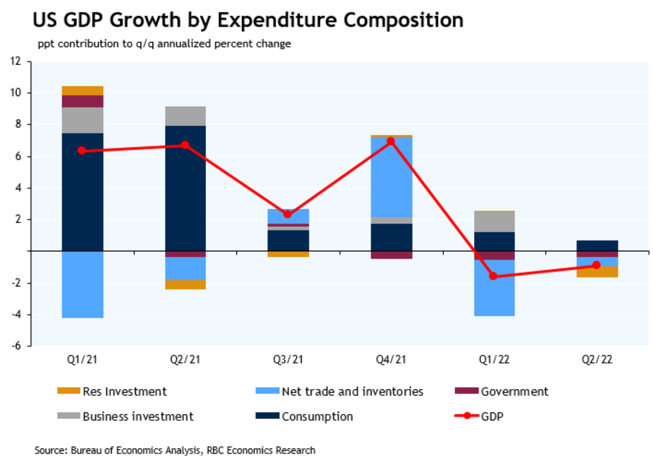
July 28, 2022

U.S. economy contracted again in Q2

- U.S. GDP decreased by an annualized 0.9% in Q2, adding to the 1.6% Q1 drop
- Weakness relatively broadly-based with offset from stronger services consumption and a larger net trade add
- Still resilient economic backdrop and elevated inflation to keep Fed on a more aggressive hiking path, slowing consumer demand further down the road



The 0.9% annualized decline in U.S. GDP in Q2 was relatively broadly-based – led by slower residential investment (-14%), a tick lower in business investment (-0.9%), alongside a smaller inventory build. Residential investment fell sharply due to rapidly cooling resale activities, following interest rate hikes from the Federal Reserve. A smaller build of inventories, particularly at general merchandise stores also contributed negatively to growth this quarter. Offsetting those weaknesses were stronger services consumption (+4.1%) and exports (+18%), the latter aided by easing supply chain constraints that have likely helped alleviate some of the capacity pressures that capped output growth in Q1.

The second consecutive decline in GDP in Q2 does not qualify as a 'recession' on its own. Other indicators on balance have looked much better. Industrial output rose by an annualized 6.2% in Q2 and the economy added another 1.1 million over the same quarter, including a 372k increase in June. Both retail and wholesale sales are still at levels well above pre-pandemic. Indeed, there's hardly evidence for the NBER's three criteria for a recession – depth, diffusion and duration – all being met at this point.

US Quarterly GDP Summary

	Q3-21	Q4-21	Q1-22	Q2-22	Q2-22
	q/q annualized %				y/y %
GDP	**2.3**	**6.9**	**-1.6**	**-0.9**	**1.6**
Consumer spending	2.0	2.5	1.8	1.0	1.8
Business investment	1.6	2.9	10.0	-0.1	3.5
Structures	-4.1	-8.3	-0.9	-11.8	-6.4
Machinery/equipment	-2.4	2.8	14.1	-2.7	2.7
Intellectual property	9.1	8.9	11.2	9.2	9.6
Residential investment	-7.7	2.1	0.5	-14.0	-5.0
Exports	-5.3	22.4	-4.8	18.0	6.8
Imports	4.7	17.9	18.9	3.1	10.9
Net exports (q/q annl contribution)	-1.3	-0.2	-3.2	1.4	
Inventories (q/q annl contribution)	2.2	5.3	-0.4	-2.0	
Household disposable income (q/q %)	0.2	0.4	-0.3	1.6	1.9
Saving rate (%)	9.5	7.9	5.6	5.2	

Source: Bureau of Economic Analysis, RBC Economics

Still, higher inflation and interest rates are adding to a slower global growth backdrop as building economic headwinds. There is still an excess amount of job openings relative to available unemployed workers, but initial jobless claims have been edging higher in recent weeks. We retain the view that the Fed will remain on a more aggressive hiking path to push back against inflation. That will work to slow consumer spending (that's currently buoyed by pent-up demand for travel and hospitality services) more significantly into 2023. We also expect labour market conditions to subsequently weaken and the unemployment rate to rise to 4.9% by the end of next year.

Claire Fan | Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-3639
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