WEEKLY ANALYSIS

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THE HOUR OF TRUTH DRAWS NEAR IN THE UNITED STATES

Q2 GDP will mask weakness in consumption. Effects of tariffs postponed to H2. Continuing Fed dilemma. Rates vacillate between recession and inflation. Chaos has destabilized the dollar. Focus on defensive equities.

Key points

- GDP likely but misleading to rebound in Q2
- Economy withstands Trump-induced chaos
- Leading indicators remain indecisive
- Employment shows signs of cracking
- Dilemma remains intact for Fed
- Price indices yet to react to tariffs
- Between recession and inflation rates also waver
- Chaos has not been kind to the dollar
- Rebalancing in favor of more defensive sectors

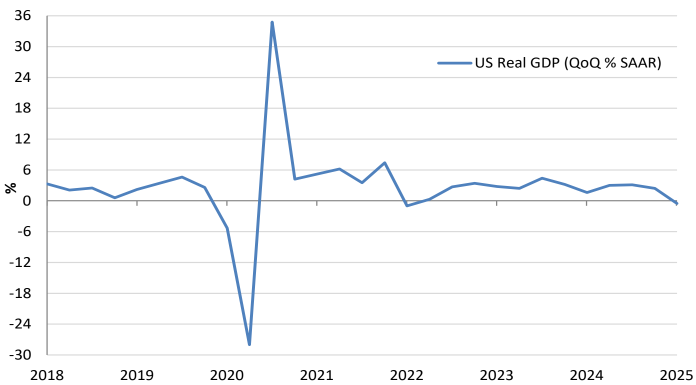
Likely but misleading GDP rebound in Q2

The US economy recorded a Q1 GDP contraction of -0.5% annualized, but subsequent revisions to published data showed a markedly less dynamic behavior of household consumption, which seems to be continuing into Q2 and is a worrying factor for the medium-term evolution of GDP. Domestic demand proved weaker after revision, with consumer spending down from +1.8% to just +0.5%. It should be remembered that the 1st quarter GDP calculation had been exceptionally affected by two main components: net exports and inventories. These two factors combined had a negative short-term impact on the GDP calculation. In anticipation of the introduction of higher customs tariffs, imports had logically risen sharply, penalizing the level of growth in the GDP calculation, while inventories, up for the same reasons, positively impacted the calculation for a negative combined result. Household consumption, historically the main component of GDP, ultimately contributed just 0.31% to GDP, its lowest contribution of the last five years, after having largely sustained economic momentum with an average contribution of +2.41% and consistently positive data. All categories of service spending were revised downwards, especially leisure spending, which ultimately turned negative. These findings put into perspective the analysis that exclusively blames the weak economic momentum and negative Q1 GDP result on a deteriorating trade balance.

However, Q2 GDP to be published on July 30 will certainly show reassuring growth in the first analysis, as it will probably be significantly positive on a real annualized basis. The likely rebound in Q2 GDP could even approach +2%. But it should be stressed, for a better understanding of this next result, that the bulk of this +1.6% increase will be due to the mechanical effect induced by the Q1 backlash in net export statistics. After massive imports in Q1 and the build-up of inventories, we expect to see a drop in imports in Q2, which will have a positive impact on the calculation of GDP.

GDP growth will therefore probably be positive, but it will mask the growing weakness of household confidence and consumption. Without necessarily fearing a collapse in this dynamic, we consider it likely to observe a contraction in household spending over the coming months, which is certainly the main threat to GDP in the 2nd half of the year.

Quarterly GDP growth - United States



Sources: Bloomberg, BBGI Group SA