Comerica Economic Alert

Robert A. Dye, Ph.D. ■ Daniel Sanabria ■ @Comerica_Econ

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2017Q2 GDP, June Employment Cost Index

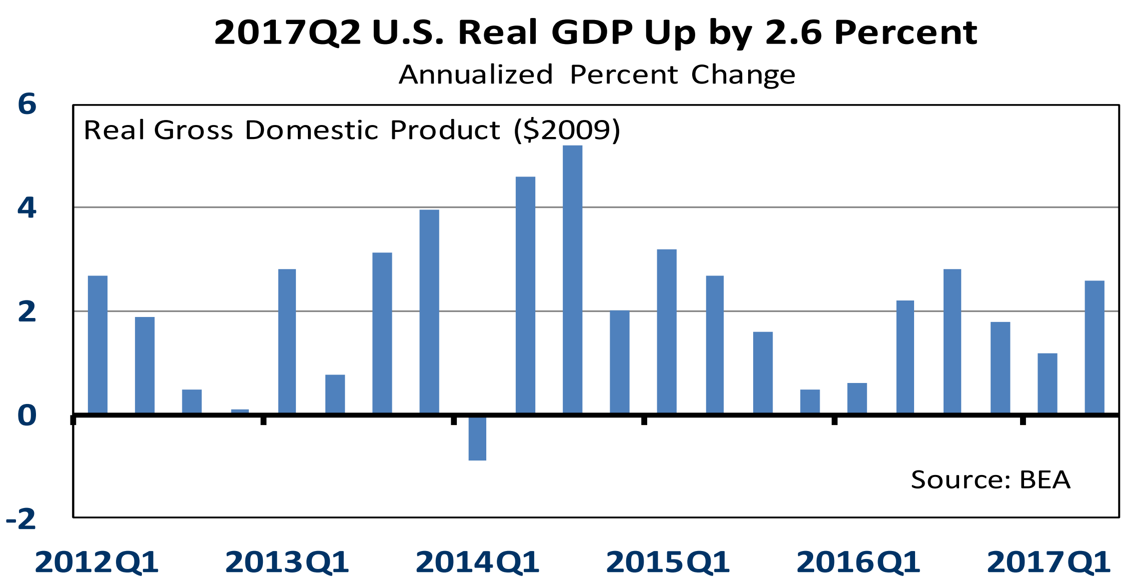
GDP Resumes Moderate Growth, as Expected. Employment Costs Edging Up

- Real Gross Domestic Product for 2017Q2 increased at a moderate 2.6 percent annualized rate.
- Worker Compensation increased by 2.4 percent for the 12 months ending in June.

Real gross domestic product growth increased to a moderate 2.6 percent annualized rate in the second quarter, after a revised 1.2 percent growth rate for the first quarter of 2017. As expected some of the quirky factors that held back GDP in Q1 reversed in Q2. Still, it would be an exaggeration to say that GDP growth rebounded. It did not. Rather it resumed a moderate growth track that looks like it will continue through the current third quarter. Real consumer spending increased at a solid 2.8 percent annualized rate in Q2 after a weather-beaten Q1. Even as unit auto sales slowed, other consumer spending on durables and nondurables was strong. Real business fixed investment growth was reasonable at a 5.2 percent, held in check by subdued gains in intellectual property. Inventories were neutral for the quarter. Net exports were a small positive, adding 0.18 percentage points to Q2 growth after dragging on headline growth in Q1. Government spending added to GDP in Q2, growing at a 0.7 percent annual rate after shrinking in Q1. If we have a similar 2.5 percent (plus or minus a couple of tenths) growth rate in Q3, that will be enough to keep job growth engaged, putting more downward pressure on the unemployment rate. Today's GDP report will keep the Federal Reserve on track as they prepare for balance sheet reduction this fall. Looking farther down the road, moderate GDP growth, leading to a lower unemployment rate, is expected to put upward pressure on labor costs. This is the Philips Curve relationship that has received a good deal of attention recently. Fed policy makers will be watching to see if the Phillips Curve holds up in this business cycle and inflation starts to accelerate in 2018.

The Employment Cost Index for June increased by 0.5 percent over the previous three-month period. For the 12 months ending in June, compensation costs are up by 2.4 percent. This was a tame report, but it does show that the rate of increase in both wages/salaries and benefits is climbing off the lows of 2009-2013. The rate of increase remains less than previously expected, but it is now showing the kind of steady increase that we saw in the 1990s that caused the Federal Reserve to increase the fed funds rate to 6.5 percent by mid-2000. This increase in interest rates in turn contributed to the Recession of 2001.

Market Reaction: U.S. equity markets open with losses. The 10-year Treasury bond yield is down to 2.30 percent. NYMEX crude oil is up to $49.52/barrel. Natural gas futures are up to $2.97/mmbtu.



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