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Markets & Economies

U.S. Economy: GDP Bounces Back in the Second Quarter

Stronger-than-expected U.S. growth was paced by robust demand. Here are the implications for U.S. Federal Reserve policy and key asset classes.

Giulio Martini,
Partner, Director of Strategic Asset Allocation

U.S. gross domestic product (GDP) growth exceeded expectations in the second quarter of 2024, accelerating at a 2.8% seasonally adjusted annual rate (SAAR), according to an advance report released by the U.S. Bureau of Economic Analysis on July 25. That doubling of the 1.4% pace registered in the first quarter was due almost entirely to a shift in inventory accumulation. Underlying final demand rose much more uniformly across the first two quarters, with ongoing strength in its domestic components: consumer spending, fixed investment, and government spending.

Here's a closer look at key details of the report:

- Final demand rose at a 2.1% pace in the second quarter after a 1.9% increase in the first quarter, with domestic final demand up 2.8% (2.5%), and private domestic demand increasing 2.3% (2.2%). U.S. Federal Reserve (Fed) officials have highlighted domestic final demand recently to claim that the economy was much stronger in the first quarter than suggested by below-trend headline GDP growth.
- The combination of inventory change and net export impact contributed 0.1% to growth after subtracting 1.1% in the first quarter. The rise in inventories likely involves a disproportionate share of imported goods as shipping problems and supply chain fragility trigger precautionary "buy in advance" behavior. Motor vehicle inventories probably increased sharply in the second quarter, owing to a software glitch in June that delayed reported sales by at least 0.5 million units SAAR. This will unwind in the third quarter.
- Consumer spending advanced at a 2.3% pace as goods purchases bounced back after dropping in the first quarter. Current retail sales data suggest goods purchases are picking up in the third quarter at an even faster pace.
- Business fixed investment rose at a surprisingly robust 14.2% pace, boosted by aircraft deliveries and a surge in imported machinery. Investment in nonresidential structures dropped modestly after an extended pickup led by manufacturing.
- Residential construction spending dropped slightly after rising sharply over the prior three quarters, likely led by large increases in spending on renovations and refurbishment.
- Government spending continued contributing disproportionately, adding 0.5% to GDP growth, a bit less than the 0.7% it added over the prior four quarters. Government spending has been much stronger in the current economic expansion than in the previous one, and it is the most significant wildcard for determining whether the next inflection point for GDP is slightly upwards or slightly downwards.

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Policy & Investment Implications

There is no reason for the Fed to cut interest rates if GDP and final demand are growing well above trend. Thus, if Fed policymakers suggest that rate cuts are needed at the July 30–31 meeting of the Federal Open Market Committee, it will be for insurance against a potential downturn. Inasmuch as inflation remains above the 2% target, and it is still unclear at what pace it will settle and how sticky it will be, the debate over whether and when rate cuts are justified should be quite lively.

In this environment, we think investors should consider shortening the duration of their exposure and emphasizing shorter-maturity investments. They may also want to take advantage of floating-rate-related products, which can react very quickly to rising short-term interest rates. Credit may continue to perform well, as investors can still realize attractive positive carry above U.S. Treasury yields.

For equities, ongoing U.S. economic strength should continue to support corporate earnings, contributing to positive market environment. We continue to emphasize companies in the innovation space, along with stocks of quality companies—those with steady, consistent revenue growth. International equity markets are quite attractively valued relative to the United States, which, in our view, presents the opportunity for some attractive returns.

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The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

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Glossary & Index Definitions

Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

Fiscal policy is the use of government spending and taxation to influence the economy. Governments typically use fiscal policy to promote strong and sustainable growth and reduce poverty.

The **Federal Reserve (Fed)** is the central bank of the United States. The **federal funds (fed funds) rate** is the target interest rate set by the Fed at which commercial banks borrow and lend their excess reserves to each other overnight.

Gross Domestic Product (GDP): The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com

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