Second Quarter GDP: Strong Headline, Soft Undercurrent

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At first glance, today's second-quarter GDP report paints a picture of a resilient economy, seemingly unshaken by the turbulence of tariffs. The headline +3.0% quarter-over-quarter annualized growth rate marks a sharp rebound from Q1's -0.5% contraction and easily beat expectations for a +2.6% gain. But a closer look under the hood reveals an economy that's not firing on all cylinders.

The apparent strength in Q2 is largely a mirror image of Q1's distortions. In the first quarter, businesses front-loaded imports to get ahead of anticipated tariffs, causing inventories to surge by $160.5 billion and contributing +2.6 percentage points to GDP. That inventory build reversed in Q2, with a $26.0 billion drawdown subtracting -3.2 points from growth. Similarly, Q1's import surge dragged net exports down by -4.6 points, while Q2 saw a -30.3% plunge in imports, flipping net exports to a +5.0 point contribution to GDP.

This volatility, driven largely by trade policy, has added significant noise to the data. In reality, growth didn't collapse in Q1, nor did it jump in Q2. Averaging the two quarters gives a clearer picture: the economy expanded at a modest +1.25% annualized pace in the first half of 2025, less than half the +2.8% pace seen in the second half of 2024.

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