

Second Quarter GDP: Strong Headline, Soft Undercurrent

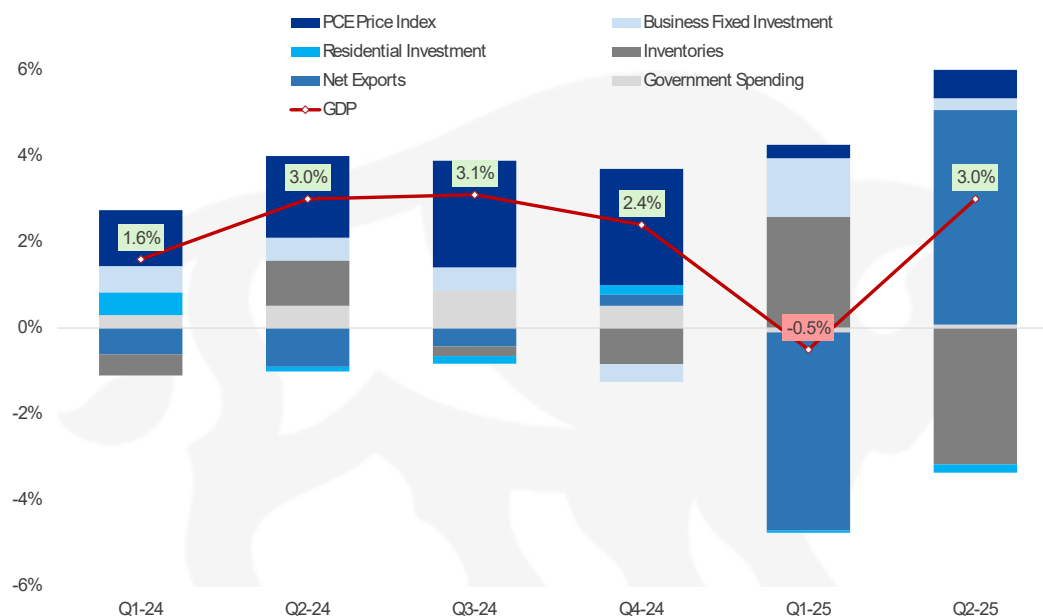
At first glance, today's second-quarter GDP report paints a picture of a resilient economy, seemingly unshaken by the turbulence of tariffs. The headline +3.0% quarter-over-quarter annualized growth rate marks a sharp rebound from Q1's -0.5% contraction and easily beat expectations for a +2.6% gain. 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.

Consumer spending, which makes up about two-thirds of GDP, rose +1.4% in Q2 after a sluggish +0.5% gain in Q1. That marks the softest back-to-back quarters for consumption since the pandemic. For the first half of the year, consumer spending grew at just a +1.0% annualized pace, down sharply from +3.1% in 2024, highlighting a key vulnerability for the economy.

Gross Domestic Product (Quarter-over-Quarter Annualized Percent Change)



Source: Bureau of Economic Analysis

Please see disclosure starting on page 2.

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Housing remains a persistent drag. Residential fixed investment fell at a -4.6% annualized rate in Q2, following a -1.3% decline in Q1, marking the weakest stretch since 2022 as high prices and high mortgage rates continue to weigh on activity.

Real final sales to domestic purchasers, a cleaner measure of underlying demand that strips out trade and inventory effects, rose just +1.1% in Q2, down from +1.5% in Q1 and the weakest reading since late 2022. Business fixed investment rose +1.9%, reversing some of Q1's +10.3% tariff-driven spike.

On the inflation front, the GDP price index rose +2.0% in Q2, while the core PCE price index increased +2.5%, slightly above expectations but still the lowest reading in three quarters.

Beneath the strong headline, the Q2 GDP report reveals a more fragile economic picture. With the FOMC meeting underway, the data adds weight to the case for rate cuts, though a move today remains unlikely. Still, the Fed may begin laying the groundwork for a potential cut in September. For now, slower growth is still growth and today's headlines have been enough to send yields modestly higher- but the underlying softness is hard to ignore.

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Market Indications as of 10:19 A.M. Central Time

DOW	Down -53 to 44,580 (HIGH: 45,014)
NASDAQ	Up 51 to 21,150 (HIGH: 21,179)
S&P 500	Up 8 to 6,379 (HIGH: 6,390)
1-Yr T-bill	current yield 4.08%; opening yield 4.06%
2-Yr T-note	current yield 3.90%; opening yield 3.87%
3-Yr T-note	current yield 3.85%; opening yield 3.82%
5-Yr T-note	current yield 3.94%; opening yield 3.90%
10-Yr T-note	current yield 4.37%; opening yield 4.32%
30-Yr T-bond	current yield 4.90%; opening yield 4.86%

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