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Second Quarter GDP (Advance)

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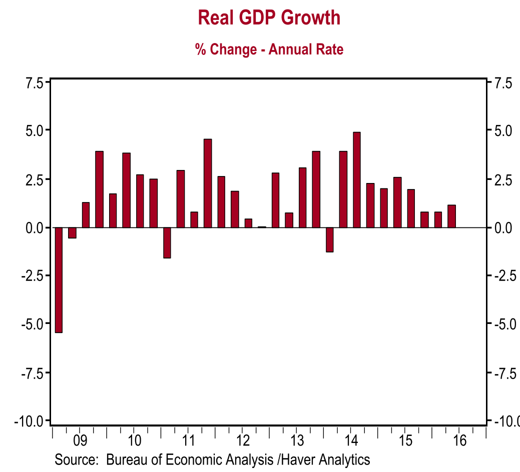
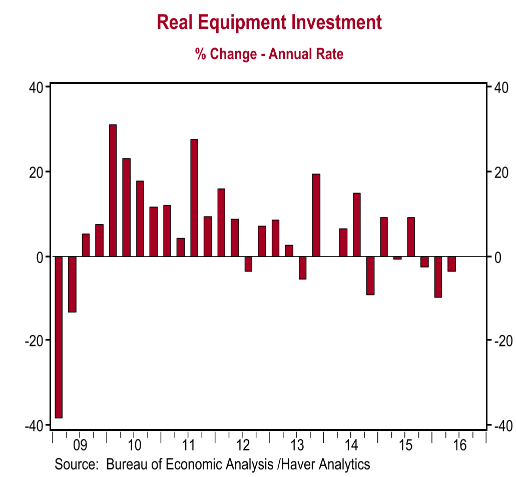
- The first estimate for Q2 real GDP growth is 1.2% at an annual rate, below the consensus expected 2.5%. Real GDP is up 1.2% from a year ago.
- The largest positive contribution to real GDP growth in Q2 was consumer spending. The largest drag was inventories.
- Personal consumption, business investment, and home building, combined, grew at a 2.7% annual rate in Q2 and are up 2.2% in the past year.
- The GDP price index increased at a 2.2% annual rate in Q2. Nominal GDP (real GDP plus inflation) rose at a 3.5% annual rate in Q2, is up 2.4% from a year ago, and up at a 3.3% annual rate from two years ago.





Implications: Today's tepid GDP report reinforces our view that the economy remains a Plow Horse. Real GDP grew at a 1.2% annual rate in the second quarter, below the consensus expected 2.5%. However, the negatives in today's report are being exaggerated by some analysts. For example, real GDP is up only 1.2% in the past year. But that follows a year in which real GDP grew by 3.0%. Average it out and we get 2.1% growth, the exact same Plow Horse average growth rate since the economy started to recover in mid-2009. Moreover, most of the unusual drag on growth in the past year has been from inventories and a drop in oil drilling and transportation, which is temporary. We like to follow "core" real GDP, which excludes inventories, international trade, and government purchases, none of which can generate long-term economic growth. Core real GDP grew at a solid 2.7% annual pace in Q2. And that includes a 6.1% annualized drop in home building that is likely to reverse in the quarters to come, given strong fundamentals in that sector. Today's report was also the one time annually when the government goes back and revises the GDP figures for the past few years and the result was a much smoother path for GDP growth over that timeframe, with fewer of the fast and slow outlying quarters that have whipsawed investors over that period. In addition, the government revised up corporate profits by about 6% as of the first quarter of this year, supporting the views of bullish equity investors. Although some see today's headline as a reason for the Fed to keep postponing rate hikes, we don't. Nominal GDP (real GDP growth plus inflation) has grown 2.4% in the past year and at a 3.3% annual rate in the past two years, both high relative to a federal funds rate that still hovers at less than 0.5%. In other recent news, initial unemployment claims rose 14,000 last week to 266,000 while continuing claims increased 7,000. Plugging these into our models suggest payrolls increased a solid 190,000 in July. In other news this morning, the Chicago PMI, a measure of manufacturing sentiment in that region, came in at 55.8 in July, a little lower than June's 56.8 but higher than consensus expectations. Look for the national ISM Manufacturing index, to be released on Monday, to show continued healthy growth in July.

2nd Quarter GDP Seasonally Adjusted Annual Rates	Q2-16	Q1-16	Q4-15	Q3-15	4-Quarter Change
Real GDP	**1.2%**	0.8%	0.9%	2.0%	1.2%
GDP Price Index	**2.2%**	0.5%	0.8%	1.3%	1.2%
Nominal GDP	**3.5%**	1.3%	1.8%	3.2%	2.4%
PCE	**4.2%**	1.6%	2.3%	2.7%	2.7%
Business Investment	**-2.3%**	-3.4%	-3.3%	3.9%	-1.3%
Structures	**-7.9%**	0.1%	-15.2%	-4.3%	-7.0%
Equipment	**-3.5%**	-9.5%	-2.6%	9.1%	-1.9%
Intellectual Property	**3.5%**	3.8%	4.5%	2.1%	3.5%
Contributions to GDP Growth (p.pts.)	**Q2-16**	**Q1-16**	**Q4-15**	**Q3-15**	**4Q Avg.**
PCE	**2.8**	1.1	1.5	1.8	1.8
Business Investment	**-0.3**	-0.4	-0.4	0.5	-0.2
Residential Investment	**-0.2**	0.3	0.4	0.4	0.2
Inventories	**-1.2**	-0.4	-0.4	-0.6	-0.6
Government	**-0.2**	0.3	0.2	0.3	0.2
Net Exports	**0.2**	0.0	-0.5	-0.5	-0.2