ECONOMIC UPDATE

REGIONS

October 28, 2021

Q3 2021 GDP: Slowdown In Growth Likely To Be, Well, Transitory

- The BEA's first estimate shows real GDP grew at an annualized rate of 2.0 percent in Q3 2021
- Consumer spending and nonfarm inventories were the main drivers of Q3 growth, fixed investment and trade were drags on growth

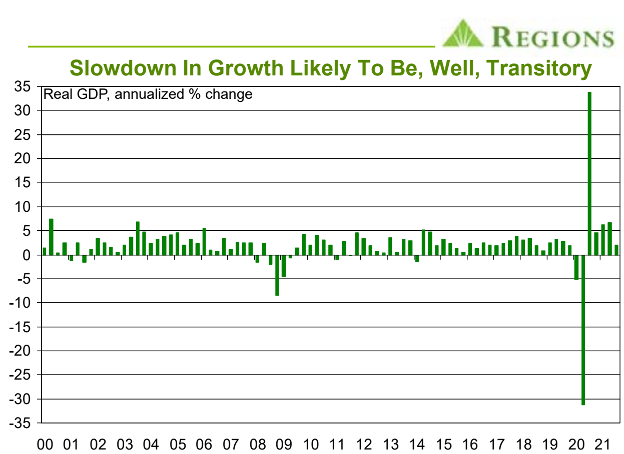
Real GDP expanded at an annualized rate of 2.0 percent in Q3, just above our forecast of 1.9 percent but below the consensus forecast of 2.6 percent growth. To be sure, forecasts of Q3 growth were all over the map, but one thing most forecasts, ours included, had in common is that they were much lower by the end of Q3 than they were at the beginning of Q3, when growth was expected to come in slightly above 7.0 percent. The late-summer spike in COVID cases and worsening global supply chain and logistics bottlenecks weighed heavily on Q3 growth as the quarter wore on. The GDP Price Index increased at an annualized rate of 5.7 percent, following up on the annualized increase of 6.1 percent in Q2. As we do each quarter, we'll note that the initial estimate of GDP in any given quarter is based on incomplete source data, and much of the source data available at the time of the initial estimate is subject to revision, making the initial estimate of GDP prone to sizable revision. But, regardless of whether, or to what extent, the initial estimate of Q3 growth is revised, the main story line will remain the same, which is that the supply side of the economy has simply been unable to keep pace with demand, thus serving to keep inflation elevated. It will likely not be until well into 2022 that the supply side of the economy is functioning more normally.

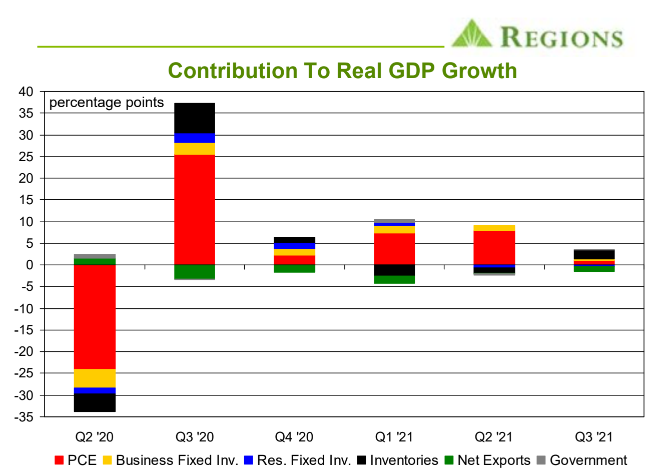
In the interest of everyone just moving along with their lives, we'll get this out of the way first: despite declining further, nonfarm business inventories nonetheless added 2.07 percentage points to top-line real GDP growth in Q3. In the fun-filled and fast-paced world of GDP accounting, the change in inventories from one quarter to the next factors into the calculation of the level of GDP, but it is the change in the change in inventories that factors into the calculation of GDP growth. So, while real nonfarm business inventories fell at an annual rate of $77.7 billion in Q3, that is smaller than the annualized contraction of $168.5 billion in Q2. With inventories having been so depleted over the past few quarters, any decline in Q4 will be smaller than that seen in Q3, so from a purely mathematical standpoint, inventories will make a positive contribution to current quarter real GDP growth. On a more practical basis, at some point when global supply chain and logistics bottlenecks have cleared, inventories will have to be replenished, which will be a powerful tailwind for GDP growth over the course of a few quarters. When that will be, however, is anyone's guess at this point.

On an inflation adjusted basis, consumer spending grew at an annualized rate of 1.6 percent in Q3, adding 1.09 percentage points to top-line real GDP growth. The increase in consumer spending was more than accounted for by spending on services, which grew at a 7.9 percent rate while spending on goods contracted at a 9.2 rate (services spending accounts for roughly two-thirds of all consumer spending). Real spending on consumer durable goods contracted at a 26.2 percent rate, less harsh than the 29.2 percent contraction our forecast anticipated, in a reflection of the extent to which lean inventories of big-ticket items such as motor vehicles, appliances, and home furnishings are limiting spending.

Real business fixed investment grew at an annual rate of 1.8 percent in Q3, the slowest growth rate of the recovery from the 2020 recession. Somewhat surprisingly, real business spending on equipment fell at a 3.2 percent rate, which seems at odds with double-digit growth in shipments of core capital goods during the quarter. That business investment in structures tumbled at a 7.3 percent rate comes as no surprise, and the Q4 data likely won't be much better. Conversely, business investment in intellectual property (IP) products, which includes R&D outlays and spending on software, grew at a 12.2 percent rate, the fourth straight quarter of double-digit growth. Growth IP investment tends to front-run changes in labor productivity growth, and to some extent the run of rapid growth in IP products is firms responding to persistent labor supply issues and markedly faster wage growth. With the slowdown in the pace of construction in Q3, real residential investment contracted at a 7.7 percent rate. A wider trade deficit also acted as a drag on Q3 real GDP growth.

At the risk of using an already overused term, the slowdown in real GDP growth in Q3 is likely to be, well, transitory. One drag on Q3 growth, the late-summer spike in COVID cases, has subsided, which will support growth in services spending. The bigger drag in the form of supply side constraints, including labor supply, will persist into 2022, but as those constraints ultimately ease, growth is likely to snap back vigorously.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com