ECONOMIC UPDATE

REGIONS

November 24, 2021

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Data Wrap: Q3 Real GDP; Durable Goods Orders; Advance Trade In Goods

- The BEA's second estimate shows real GDP rose at an annualized rate of 2.1 percent in Q3, up from the advance estimate of 2.0 percent
- Durable goods orders fell by 0.5 percent in October, with core capital goods orders up by 0.6 percent
- The U.S. deficit in trade in goods narrowed to -$82.9 billion in October

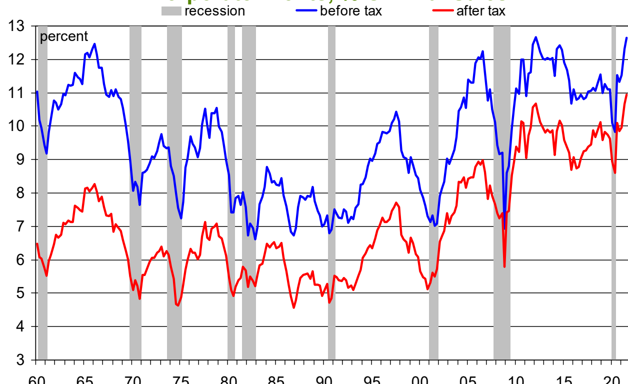
Real GDP: Revised and more complete source data put annualized Q3 real GDP growth at 2.1 percent, up from the initial estimate of 2.0 percent but short of what we and the consensus forecast expected. We anticipated upward revisions to consumer spending and the change in nonfarm business inventories, which proved to be the case, but in each instance the upward revision was less than our forecast anticipated. At the same time, fixed investment – business and residential – is now reported to have been a bigger drag on top-line growth than was the case in the initial estimate. That said, the revisions to the initial estimate do not alter the main theme of the Q3 GDP data, which is that lingering supply chain and logistics issues provoked a dramatic decline in spending on consumer durable goods, while the late-summer spike in COVID cases took some of the steam out of growth in consumer spending on services. With Q4 growth in consumer spending off to a fast start and what apparently will be a much smaller trade deficit, Q4 real GDP growth will be much closer to the better than 6.0 percent pace seen over the first half of 2021 than to the 2.1 percent growth logged in Q3.

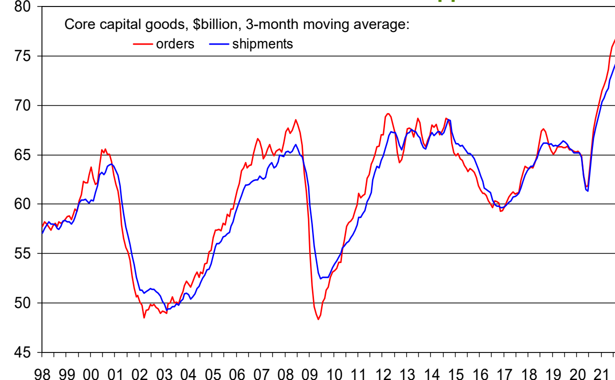
Today's release offers the first look at corporate profits as measured in the GDP data. Before-tax profits rose by 4.3 percent in Q3, with after-tax profits up 4.2 percent, which translate into over-the-year increases of 20.7 percent and 19.1 percent, respectively. That profit growth slowed in Q3 comes as no surprise given significantly more intense cost pressures. Indeed, what may be surprising is the extent to which corporations were able to pass higher costs along in the form of higher prices. As a side note, the GDP Price index rose at an annualized rate of 5.9 percent in Q3, up from the initial estimate of 5.7 percent growth. While there is some question as to how much more pricing power firms will be able to exercise, for now further growth in profits led to wider margins in Q3, and with another sizable increase in retained earnings in Q3, corporations continue to sit on substantial cash balances.

The manner of GDP accounting means that a much smaller drawdown in business inventories in Q3 than that seen in Q2 added 2.13 percentage points to top-line GDP growth. That doesn't change the fact that business inventories have been significantly depleted over the past several months while backlogs of unfilled manufacturing orders have grown sharply. Backfilling orders and restocking inventories will be powerful tailwinds for GDP growth in 2022, assuming recent signs that supply-side bottlenecks have begun to ease were not just false alarms.

Durable Goods Orders: Durable goods orders fell by 0.5 percent in October, matching our below-consensus forecast. As we anticipated, sharp declines in defense and nondefense aircraft orders overwhelmed higher motor vehicle orders, meaning transportation was on net a drag on top-line orders. Of more significance, however, is that core capital goods orders, a leading indicator of business investment in equipment and machinery as measured in the GDP data, rose by 0.6 percent, also matching our forecast. October marks the eighth consecutive monthly increase in core capital goods orders. At the same time, shipments of core capital goods (which feed into the GDP data) rose by 0.3 percent in October, the eighth consecutive monthly increase. That both orders and shipments of core capital goods have been on such strong rolls makes the decline in business investment in equipment and machinery reported in the Q3 GDP data quite puzzling – on a nominal basis, shipments of core capital goods rose at an annualized rate of 10.4 percent in Q3. Be that as it may, continued growth in core capital goods orders suggests business investment will be a support for GDP growth over coming quarters.

Advance Trade In Goods: Under the heading of "did not see that one coming," the advance October data on international trade show the deficit in the goods account narrowed to -$82.9 billion, a much smaller gap than anyone expected and much smaller than the average Q3 deficit of -$90.6 billion. To be sure, global trade flows have been significantly distorted since the onset of the pandemic, and the 10.7 percent jump in U.S. exports of goods reflects an abrupt easing of capacity constraints for outbound cargo. While narrowing of the trade deficit is a bit overstated, it does at least set the stage for net exports to add to current quarter GDP growth.





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Data Wrap: Personal Income/Spending; PCE Deflator; New Home Sales

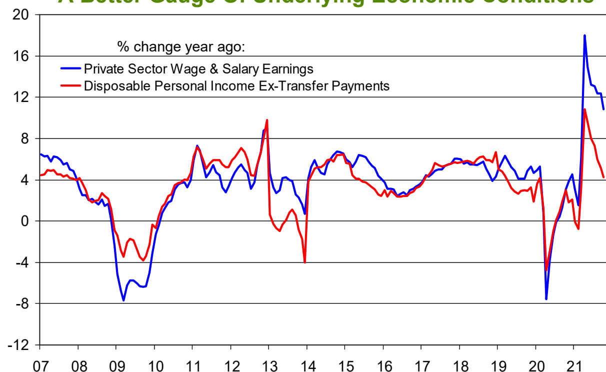
- Personal income rose by 0.5 percent in October, personal spending rose by 1.3 percent, and the saving rate fell to 7.3 percent
- The PCE Deflator rose by 0.6 percent in October, with the core PCE Deflator up by 0.4 percent
- New home sales rose to an annual rate of 745,000 units in October from September's (revised) sales rate of 742,000 units

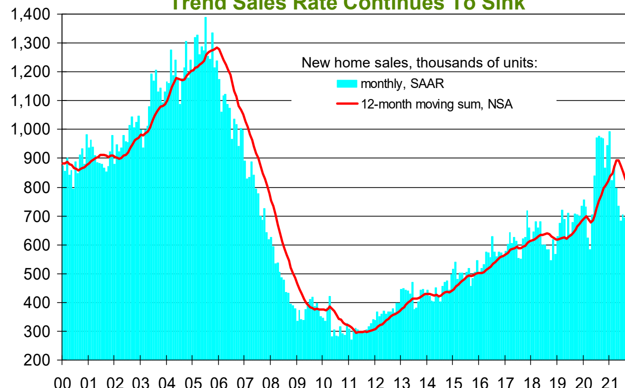
Personal Income: Total personal income rose by 0.5 percent in October, besting our above-consensus forecast of 0.3 percent. Stronger growth than we expected in private sector wage and salary earnings underpinned growth in personal income, which has been the case over the past several months and will remain the case going forward. Private sector wage and salary earnings have notched back-to-back monthly increases of 1.0 percent, with October's increase coming despite a decline in the average length of the workweek. Asset-based income rose by 0.9 percent in October, with dividend income up 1.2 percent and interest income up 0.6 percent. Transfer payments fell by 0.5 percent, matching our forecast, with the decline more than accounted for by lower unemployment insurance (UI) benefit payouts as more and more people run off benefit rolls. The three rounds of Economic Impact Payments (EIP) associated with the various pandemic relief measures are proving to be the gift that keeps on giving; despite the third – and final – round of payments coming in March, EIP funds are still making their way to recipients, which on an annualized basis added $31.3 billion to transfer payments in October, topping the amount paid out in September. Nonfarm proprietors' income, a proxy for small business profits, rose by 0.2 percent in October, but it helps to recall that accounting for the Paycheck Protection Program has acted as a drag on proprietors' income over the past four months and will continue to do so for a few more months.

We have been noting that, thanks to a series of wide swings in transfer payments, the headline personal income number is a less useful guide to household financial conditions than would otherwise be the case. With the end of supplemental unemployment insurance benefits, more and more people falling off UI benefit rolls, the temporary lift from the Child Care Tax Credit (which will reverse in January), and seemingly never-ending Economic Impact Payments, transfer payments continue to exert an outsized influence on total personal income. Our focus has been, and will remain, on ex-transfers personal income and private sector wage and salary earnings, far and away the largest single component of personal income. Continued improvement in labor market conditions, and what should be greater numbers of people returning to the labor force once we get into 2022, mean private sector labor earnings will continue to grow at a healthy clip. This will be a much more useful guide to household financial conditions than top-line income growth.

Personal Spending: Personal spending rose by 1.3 percent in October, matching our above-consensus forecast. As hinted at in the report on October retail sales, consumer spending on goods rose sharply, with the 2.2 percent increase fueled by spending on consumer durable goods rising by 3.3 percent. Consumer spending on services, not captured in the retail sales data, rose by 0.9 percent, the strongest gain since July as the late-summer spike in COVID cases held down services spending in August and September. With spending growth easily outpacing income growth, the personal saving rate fell from 8.2 percent in September to 7.3 percent in October. The saving rate is a monthly flow, and the lower saving rate should not draw attention away from what remains a substantial stock of excess saving in the household sector. Barring another spike in COVID cases, which obviously cannot be ruled out, we expect spending patterns to normalize further in the months ahead, with less emphasis on goods and more emphasis on services, but on the whole consumer spending will remain a main support for GDP growth. The PCE Deflator rose by 0.6 percent in October, with the core PCE Deflator up 0.4 percent, each one-tenth of a point lower than our forecast, with over-the-year-increases of 5.0 percent and 4.1 percent, respectively.

New Home Sales: Total new home sales "rose" to an annual rate of 745,000 units in October, well below our forecast of 848,000 units, but estimates of sales over the prior three months were revised sharply lower, as has been the norm over recent months. Not seasonally adjusted sales came in at 59,000 units, well below our forecast, with sales in the South region remaining weak. Lagging sales are, in our view, more of a supply-side story than a demand-side story, with builders continuing to limit sales while they contend with sizable order backlogs and shortages of materials and labor. This is unlikely to change any time soon.





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