ECONOMIC UPDATE

REGIONS

October 26, 2023

Q3 2023 GDP: More A Sprinter Than A Marathon Runner

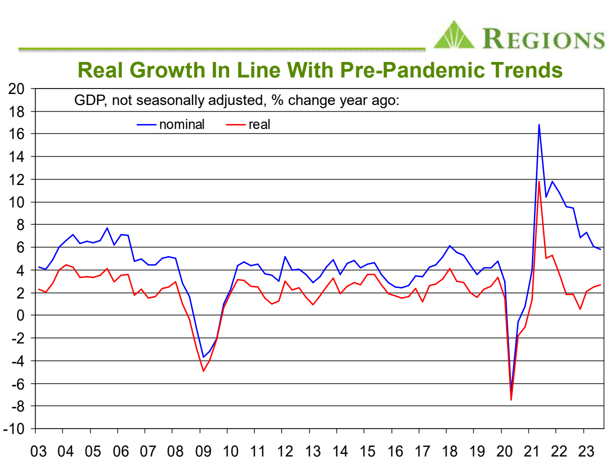
- The BEA's initial estimate shows real GDP grew at an annualized rate of 4.9 percent in Q3 2023
- Consumer spending, government spending, and inventory accumulation were the main drivers of Q3 growth

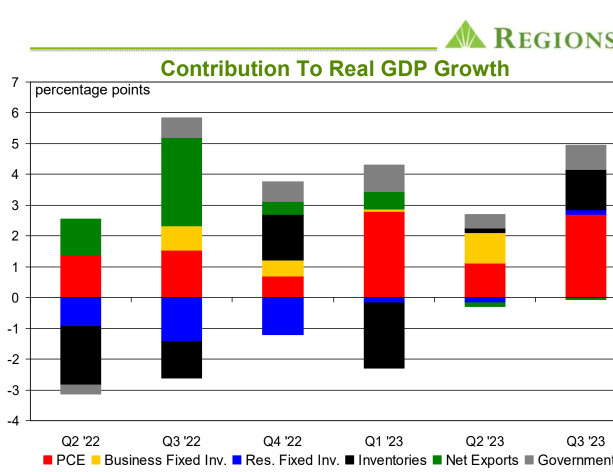
The initial estimate from the BEA puts Q3 real GDP growth at an annual rate of 4.9 percent, slightly ahead of our above-consensus forecast of 4.8 percent growth. As we anticipated, consumer spending, government spending, and a faster pace of nonfarm business inventory accumulation were the main drivers of Q3 growth, but, contrary to our expectations, the initial estimate shows a slightly larger trade deficit acting as a modest drag on growth. That is a perfect segue to our standard disclaimer that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to meaningful revision over subsequent months as source data are released and revised. That said, the initial Q3 print is in line with the firmer tone, at least on the surface, of much of the recent economic data, leaving two alternative views of how to interpret the robust Q3 growth. One interpretation is that the economy is largely immune to the effects of higher interest rates and what many for some time saw as an inevitable recession is off the table. The alternative take is that the burst of growth in Q3 is unsustainable, largely a function of one-off supports that will quickly fade, and that while perhaps less probable than had seemed to be the case, recession is still a possibility in the not-too-distant future. Our regular readers know that we lean more toward the latter than the former interpretation, and we expect real GDP growth to slow to a virtual crawl in Q4.

Real consumer spending grew at an annual rate of 4.0 percent in Q3, adding 2.69 percentage points to top-line real GDP growth. Spending on goods rose at an annual rate of 4.8 percent while services spending grew at an annual rate of 3.6 percent. While that may seem at odds with recent trends in consumer spending, in terms of goods versus services spending, what stands out to us is that our proxy for discretionary services spending grew at an annual rate of 5.2 percent in Q3. As we have for some time pointed out, however, we see Q3 as the last hurrah for discretionary services spending and expect a pronounced slowdown in Q4.

Real business fixed investment was basically flat in Q3, in line with our forecast. Spending on equipment and machinery fell at an annual rate of 3.8 percent and growth in spending on structures slowed dramatically from the heady pace of the prior two quarters, and while investment in intellectual property products remains a key support for overall business investment, it too has settled into a notably slower pace over recent quarters. After having been a drag on top-line real GDP growth for nine straight quarters, residential fixed investment grew at an annual rate of 3.9 percent in Q3, adding slightly to top-line growth. While U.S. exports grew in Q3, so too did imports into the U.S., with the net result being a slightly larger trade deficit than that seen in Q2. A faster rate of inventory accumulation in the nonfarm business sector added 1.32 percentage points to Q3 real GDP growth. Total government spending grew at an annual rate of 6.2 percent, adding 0.79 percentage points to top-line growth. State and local government spending is being bolstered by infrastructure projects, the effects of which have also been apparent in the employment data over the past few months.

To our earlier point about how to interpret the Q3 growth number, we will make the following points. Much of the recent data, particularly for the month of September, has been flattered by seasonal adjustment, thus sending misleadingly strong signals, which was especially notable in the September retail sales data. It is the seasonally adjusted source data that flow into the BEA accounts, and that carried into the initial print on Q3 real GDP growth. To that point, the not seasonally adjusted data show a slightly smaller increase in real GDP than typical for a third quarter, and the unadjusted data show real GDP growth in line with pre-pandemic trends, which to us is a more meaningful view than that offered by the headline (seasonally adjusted, annualized) Q3 growth print. Rising motor vehicle inventories, particularly on the retail level, added to Q3 growth, but that will not be repeated in the Q4 data. With the most recent run-up in mortgage interest rates, we expect residential fixed investment to revert to being a drag on growth. We've noted that we expect a sharp slowdown in discretionary services spending in Q4, and if we are correct on that point, it will weigh on top-line real GDP growth. As anyone who knows the breed can attest, greyhounds can run really, really fast, they just can't run really, really fast for very long. In that sense, we see the economy as having been more of a sprinter than a marathon runner in Q3, and the payback for that effort will come in the Q4 data.





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