ECONOMIC UPDATE

REGIONS

October 30, 2019

Q3 Real GDP: Growth Decelerates Further In Q3

- The BEA's initial estimate shows real GDP grew at an annualized rate of 1.9 percent in Q3, after 2.0 percent growth in Q2
- Consumer spending and government spending were the main drivers of Q3 growth; business fixed investment contracted further

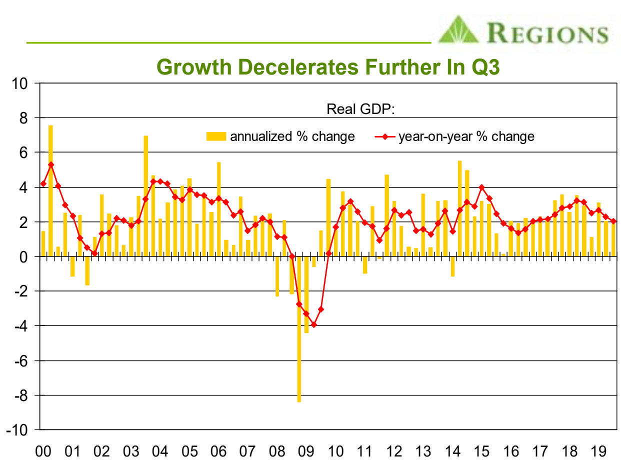
The BEA's initial estimate puts Q3 real GDP growth at an annualized rate of 1.9 percent, besting the 1.4 percent growth we expected and the 1.6 percent growth the consensus expected. Consumer spending and government spending were the main drivers of Q3 growth, and residential fixed investment contributed to top-line growth for the first time since Q4 2017. Business fixed investment contracted for a second consecutive quarter, while a slightly larger trade deficit and a smaller build in business inventories were also modest drags on growth. We'll toss out our usual caveat – the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to what can be sizable revisions as more source data become available and replace BEA estimates. Right off the bat, the BEA's estimate of Q3 inventory accumulation seems much too high to us, suggesting a downward revision to top-line real GDP growth. Also, growth in consumer spending was stronger than had been implied by the monthly data on retail sales; this doesn't necessarily mean the BEA's estimate is too high, but if not the initial estimate of September retail sales will be revised higher. Either way, that consumer spending remains the main driver of GDP growth is no surprise. To us, the more relevant, not to mention concerning, story is the ongoing weakness in business investment.

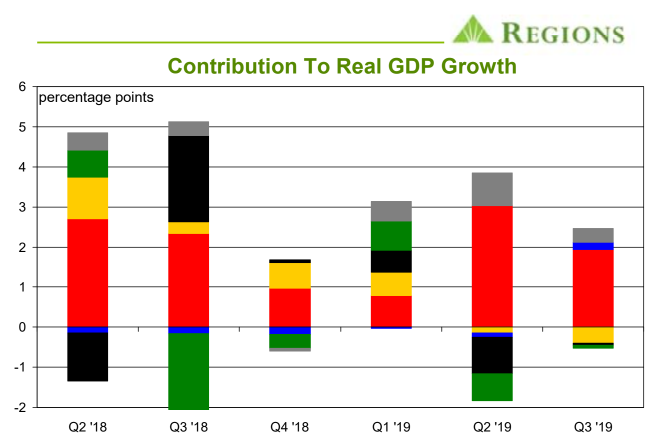
Real consumer spending grew at an annualized rate of 2.9 percent in Q3, which added 1.93 percentage points to top-line real GDP growth. Real spending on goods was up 5.5 percent and real spending on services was up 1.7 percent (annualized rates). Discretionary spending grew at a solid pace in Q3, which is a sign that consumers continue to shake off the trade concerns that have rattled global businesses.

Real business fixed investment contracted at an annualized rate of 3.0 percent in Q3, following a 1.0 percent (annualized) contraction in Q2. The contraction in Q3 shaved 0.40 percentage points off of top-line real GDP growth. Real spending on business structures contracted at a 15.3 percent rate, with real spending on business equipment & machinery contracting at a 3.8 percent rate. Real spending on intellectual property products grew at an annualized rate of 6.6 percent in Q3, better than the 3.6 percent growth rate seen in Q2 but below what had been the run rate over the prior several quarters. The high frequency data on core capital goods orders, an early indicator of business investment in equipment & machinery in the GDP data, have weakened further of late, which does not bode well for the Q4 GDP data. In the absence of meaningful progress on trade, it is hard to spot a catalyst for a rebound in business investment. Along the lines of a dim ray of light being better than no light at all, annualized growth of 5.1 percent in residential fixed investment added 0.18 percentage points to top-line real GDP growth in Q3. This is notable in that residential fixed investment has been a persistent drag on real GDP growth over the past two years, having risen only once in the prior nine quarters. We look for further growth, albeit modest, over coming quarters, largely reflecting the boost from low mortgage interest rates.

Real exports of U.S. goods grew at an annualized rate of 1.6 percent in Q3 after having contracted at a 5.9 percent rate in Q2. Real imports of goods grew at an annualized rate of 0.4 percent in Q3, which follows 0.1 percent growth in Q2. Clearly, the data on trade in goods have been distorted by trade disputes over recent quarters – recall that imports of goods were notably strong over the back half of 2018, as firms were building stockpiles in an attempt to avoid tariffs. The more recent high frequency data suggest trade flows have slowed considerably, suggesting little change in the overall trade deficit until there is some sort of resolution of ongoing trade disputes. Growth in total government spending added 0.35 percentage points to top-line real GDP growth in Q3, with federal government spending the main driver.

Aside from quibbling over some of the details of the BEA's initial estimate of Q3 GDP, we think the bigger question is how much longer consumer spending can offset sour business sentiment. The danger is that businesses begin to pull back not only on capital spending but also on payrolls, which would take much of the steam out of growth in consumer spending. Absent a meaningful resolution of ongoing trade disputes, sooner or later we'll have an answer to our question, just not an answer we or anyone else will like.





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