ECONOMIC UPDATE

REGIONS

November 7, 2013

Q3 2013 Real GDP: Firmer Headline, Softer Details

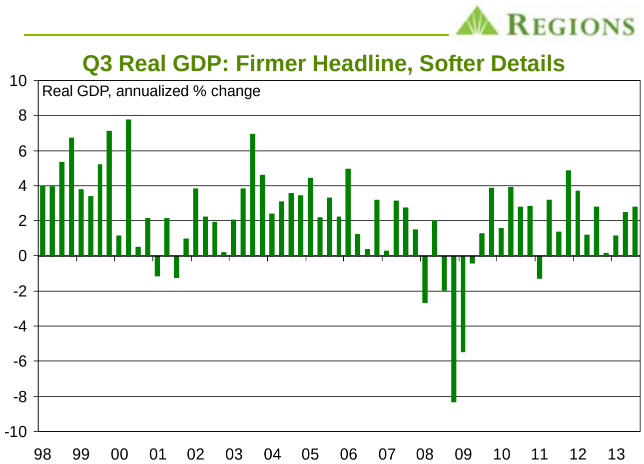
- Real GDP grew at an annualized rate of 2.8 percent in Q3 according to the BEA's first estimate.
- The GDP Price Index rose at an annualized rate of 1.9 percent in Q3.
- Inventory accumulation and a sharp slowdown in the growth of imports made the largest contributions to real GDP growth in Q3.

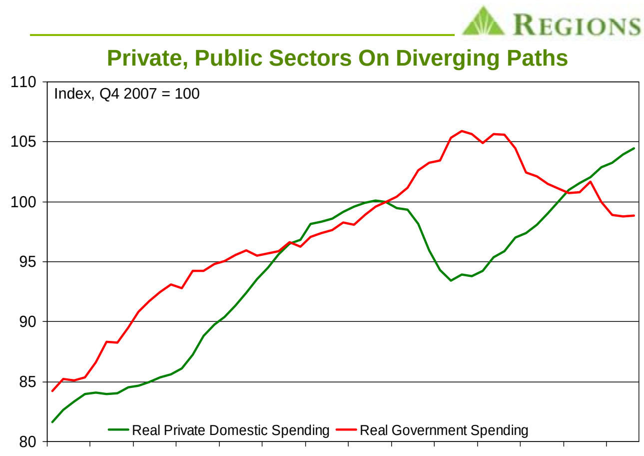
The U.S. economy grew at an annualized rate of 2.8 percent during 2013's third quarter according to the BEA's initial estimate. This is well ahead of the consensus expectation of 2.0 percent growth. Looking under the hood, however, the underlying details are not as encouraging as the headline growth number, as the main drivers of Q3 growth were a jump in the rate at which nonfarm businesses accumulated inventories during the quarter and a sharp deceleration in the rate of growth of imports. We will also add our usual caveat about the BEA's first estimate of GDP in any given quarter – the first estimate is based on source data that are far from complete or that are subject to revision by the issuing agencies and, as such, subsequent estimates of GDP may differ materially from the initial estimate. Though the BEA makes no mention of this, we question whether the collection of source data was impacted by the partial shutdown of the federal government in October which, if this is the case, could add to the uncertainty around the first estimate of Q3 real GDP. It will also remain to be seen whether, and to what extent, the shutdown will have an impact on Q4's GDP data.

In terms of the first pass at Q3, growth in real consumer spending slowed to an annualized rate of 1.5 percent from the 1.8 percent growth posted during Q3. The slowdown in consumer spending was entirely due to consumer spending on services, which rose at an annualized rate of just 0.1 percent in Q3 compared to 1.2 percent growth in Q2. Unusually mild weather during Q3 held down household spending on utilities and, in turn, held down overall spending on services. It is worth noting that over the course of the current recovery/expansion, growth in spending on household services has been well below longer-term norms and is the primary factor behind what has been a slower pace of growth in overall consumer spending – spending on household services accounts for roughly two-thirds of total consumer spending. Growth in spending on consumer durable goods and on nondurable consumer goods picked up in Q3, with spending on motor vehicles and household furnishings driving overall growth in spending on consumer durables.

Business investment was a mixed bag during Q3 according to the first estimate. Spending on structures rose at an annualized rate of 12.3 percent, marking the second consecutive quarter with double-digit growth but spending on equipment fell at an annualized rate of 3.7 percent. The GDP data on business investment in equipment and machinery are based on the monthly shipments of these goods, but trends in new orders are a precursor of trends in shipments. As such, weakness in orders for core capital goods orders in September, and for Q3 as a whole, calls into question whether we can expect much of a bounce back in business investment in Q4. It was the sizeable increase in business inventory accumulation that was the main driver of growth in overall business investment in Q3. The gain in inventory accumulation was well ahead of our expectations and, more significantly, if it does withstand revisions, could act as somewhat of a drag on production during Q4. Growth in residential fixed investment also picked up in Q3, growing at an annualized rate of 14.6 percent, a pace we would expect to slow during Q4, perhaps significantly, as the housing market digests the impact of higher mortgage interest rates.

Growth in imports of goods and services slowed sharply in Q3, with growth in total imports slowing to an annualized rate of 1.9 percent, down from Q2 growth of 6.9 percent. Thus, imports deducted "only" 0.3 percent from top-line growth compared to a 1.1 percent drag in Q2. Leaving aside inventories and trade, growth in private domestic demand was considerably below top-line growth in Q3. Still, as the chart below shows, the private and public sectors remain on divergent paths. State and local government spending rose at an annualized rate of 1.5 percent in Q3 but federal government spending contracted at an annualized rate of 1.7 percent. A key question as we look ahead to 2014 is the extent to which the drag on overall growth from the federal government will fade. There is a good deal of uncertainty as to how the Q4 data will be impacted by the federal government sector, and that will carry over into 2014 as well with ongoing fiscal policy uncertainty hanging over us.





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