ECONOMIC UPDATE
REGIONS
December 5, 2013

Q3 2013 Real GDP: Looks Better Than It Feels

- The BEA's second estimate of Q3 real GDP puts growth at an annualized rate of 3.6 percent, compared to the initial estimate of 2.8 percent.
- The GDP Price Index rose at an annualized rate of 2.0 percent in Q3, compared to the initial estimate of 1.9 percent.
- Corporate profits rose 5.6 percent on a year-over-year basis, with domestic profits up by 6.6 percent and foreign profits up 1.8 percent.

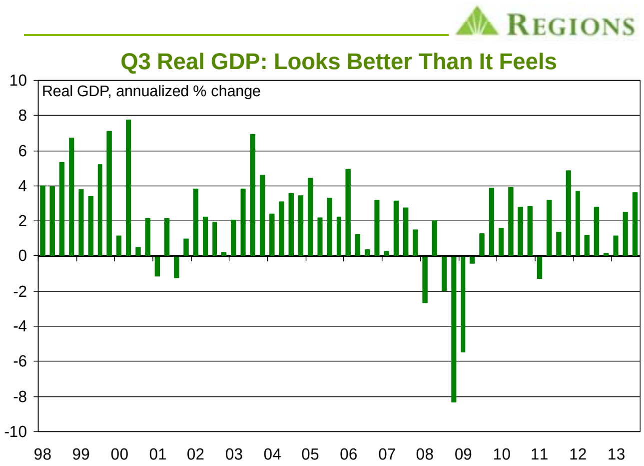
Sure, we're familiar with the whole thing about not looking a gift horse in the mouth, yet we just can't get all that worked up about the news that real GDP grew at an annualized rate of 3.6 percent during Q3. While this is considerably above the BEA's initial estimate of annualized growth of 2.8 percent, not to mention way above the average growth rate of 2.2 percent over the course of the recovery from the Great Recession, the reality is that the details of today's report are much less impressive than the headline number. The biggest factor behind the upward revision is a faster inventory build in the nonfarm business sector than the BEA had incorporated into their first estimate – inventory accumulation added 1.68 percent to top-line growth in Q3. Moreover, given the inherent volatility in the rate at which inventories change from quarter to quarter, the larger build during Q3 is likely to be followed by a much smaller build during Q4, meaning that inventories will act as a drag on current quarter growth.

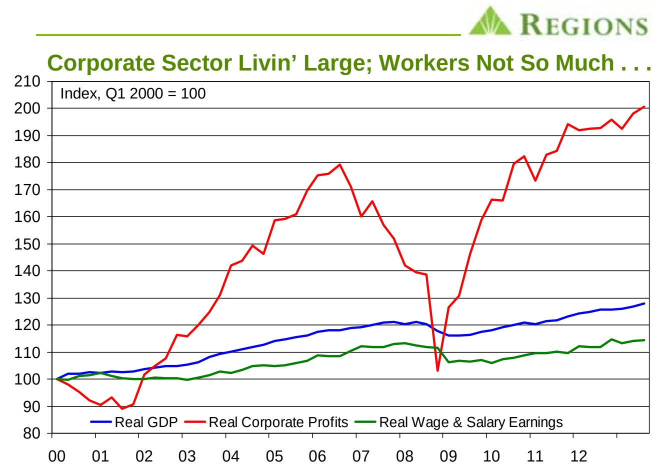
As to those pesky beneath the headline details, real consumer spending advanced at an annualized rate of 1.4 percent during Q3, down from the initial estimate and a slower rate of growth than seen in Q2. As has been the case over the course of the recovery, spending on consumer durables (such as motor vehicles, furniture, and appliances) grew at a healthy clip but spending on household services – which accounts for two-thirds of all consumer spending – was flat during Q3. Overall, growth in real consumer spending added just 0.96 percent to top-line growth, the smallest contribution since Q4 2009. Real business fixed investment grew at an annualized rate of 3.5 percent, with a second consecutive double-digit increase in spending on structures and a modest gain in spending on intellectual property products while spending on equipment was flat. Residential fixed investment grew at an annualized rate of 13.0 percent, adding 0.38 percent to top-line growth.

Growth in both exports and imports of goods slowed during Q3, but the slowdown in imports was more pronounced with the net result being a slightly narrower trade gap. Total government spending grew at an annualized rate of 0.4 percent, as spending on the state and local levels grew at a rate of 1.7 percent – the fastest growth since Q2 2009 – which offset another decline in federal government spending, as both defense and nondefense spending fell.

Today's report offers the first look at corporate profits (as measured in the NIPA data) for Q3, with total before-tax profits up by 5.6 percent on an over-the year basis. Most of the growth came from domestic profits, which grew by 6.6 percent. Profits from foreign operations rose by just 1.8 percent, but this comes on the heels of four consecutive declines in foreign profits on an over-the-year basis. Corporate dividend payments fell sharply in Q3 – down by 17.4 percent from Q2 – but this is more a reflection of what was an exceptionally sharp increase in payouts during Q2. In terms of the path of dividend payments prior to the distortions introduced by changes in tax rates in January 2013, the level of dividend payments in Q3 reflects solid growth. Still, while corporate cash balances remain extremely elevated, we may be seeing a shift away from increased dividend payments towards greater share buybacks. Either way, though, corporate cash flows remain healthy while growth in wage and salary earnings continues to lag, a reflection of what remains an elevated degree of slack in the labor markets. Wage and salary earnings grew at a slower rate in Q3 which fed through to a slowdown in the rate of growth of real disposable personal income. We do expect to see earnings growth, and in turn personal income growth, improve over coming quarters which could lead to modest erosion in corporate profit margins, though margins will nonetheless remain wide.

As noted above, we expect some payback for Q3's heady growth, with current quarter growth shy of two percent. Still, in 2014 we expect further strengthening in the private sector to more fully offset the ongoing drag from the federal government, which will leave us feeling better when we see headline growth pick up.





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