ECONOMIC UPDATE

REGIONS

October 30, 2014

Q3 2014 Real GDP: First Glance Looks Good, But Wait For Revisions

- The BEA's initial estimate shows real GDP rose at an annualized rate of 3.5 percent in Q3 after annualized growth of 4.6 percent in Q2.
- The GDP Price Index rose at an annualized rate of 1.3 percent in Q3.

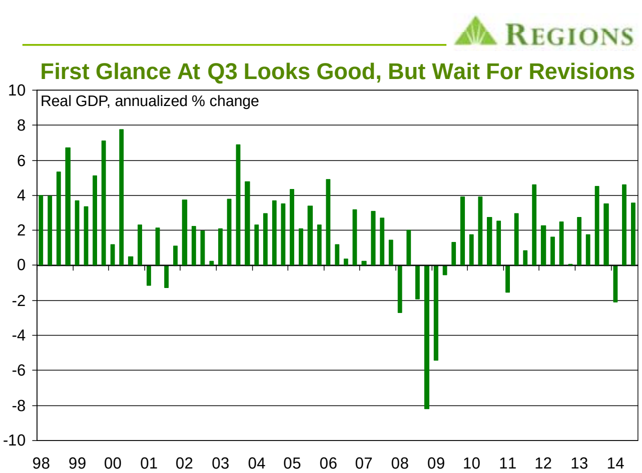
According to the BEA's initial estimate, real GDP expanded at an annualized rate of 3.5 percent in Q3, slightly ahead of our forecast of 3.2 percent growth. As we do each quarter, we will note the BEA's first pass at real GDP in any given quarter is based on highly incomplete source data and hence subject to large revisions – the typical change in headline real GDP growth (without regard for sign) between the first and third estimates is 0.6 percent. With that bit of bookkeeping out of the way, while the headline growth rate was not meaningfully out of alignment with expectations the composition of growth was.

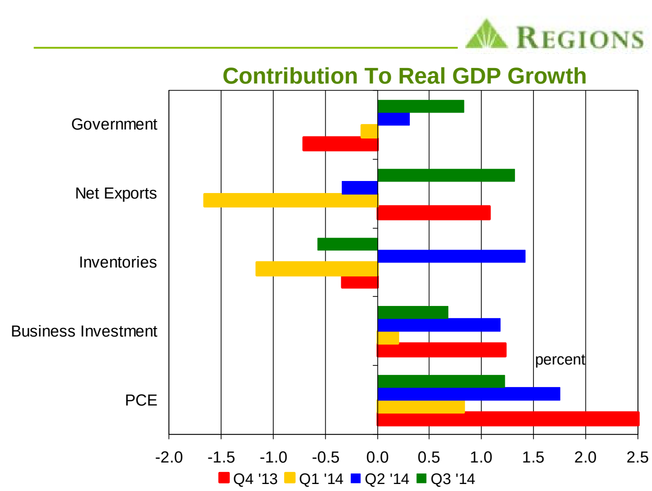
Real consumer spending grew at an annualized rate of just 1.8 percent in Q3, adding 1.22 points to top-line growth. Spending on motor vehicles and parts rose at an annualized rate of 9.9 percent as unit motor vehicle sales came in at an annual rate of 16.81 million units for the quarter. This, however, was largely a function of August's sales rate soaring to 17.5 million units, while the underlying trend is closer to 16.4 million units, so right off the bat motor vehicles figure to be a drag on Q4 growth. Spending on household furnishings and equipment rose at an annualized rate of 3.6 percent, down from a double-digit gain in Q2 – this is one area where a still sluggish recovery in the housing market is making itself felt in the GDP data. One drag on growth in consumer spending remains services, which account for roughly two-thirds of all consumer spending. Real spending on household services rose at an annualized rate of just 1.1 percent in Q3 and growth in spending on services continues to lag well behind the pace seen in prior cycles. In Q3, at least, lower outlays on energy and utilities held down spending on services, and the one wild card in the data is spending on health care, the path of which is still uncertain in the wake of the ACA taking hold.

Business investment in equipment rose at an annualized rate of 7.2 percent, smaller than our anticipated double-digit growth and short of what the underlying data on core capital goods shipments suggests. This is a key component to track, both in terms of pending revisions to the BEA's initial estimate but also in terms of such spending in Q4 and subsequent quarters. The September report on durable goods orders suggests a slower pace of business investment in Q4 – it is shipments that are incorporated into the GDP data but a drop in orders today implies a corresponding drop in shipments down the road. What we do not know at this juncture is whether September's decline in orders was a reaction to turbulence in financial markets and worries over global growth or the start of a sustained downturn, though we think it to be the former. The pace of inventory accumulation in the nonfarm business sector slowed sharply in Q3, shaving 0.72 points off top-line GDP growth, but this sets up a more favorable growth profile for Q4.

Two key supports for growth in Q3 were a smaller trade gap, which was expected, and a jump in government spending, which was not expected. As for trade, while the recent headlines pertaining to global growth have not exactly been inspiring of late, we'll make two points. First, it takes time for slower prints on global growth to work their way into the trade data, so the U.S. is by no means immune to slower global growth. That said, for all the talk about the moribund Euro Zone economy, Canada and Mexico combined account for over one-third of all U.S. exports compared to less than 13 percent for the Euro Zone, and North America continues to enjoy growth that, while not stellar, is nonetheless better than other parts of the world Defense spending rose at an annualized rate of 16.6 percent in Q3, adding 0.66 points to top-line growth. The reported increase in defense spending may or may not survive revision but if it does this boost to Q3 growth figures to be a drag on Q4 growth. Speaking of drags on growth, real single family residential investment fell at an annual rate of 6.2 percent in Q3 and while this drag will fade in Q4, it will be some time before single family construction makes a meaningful contribution to top-line GDP growth.

Pending revision, the first round of Q3 GDP data shows an economy that, while clearly not firing on all cylinders nonetheless continues to post steady improvement. We expect growth to remain near 3.0 percent over coming quarters.





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