Q3 2015 Real GDP: Inventories Do A Number On The Headline

- Real GDP grew at an annualized rate of 1.5 percent in Q3 2015 according to the BEA's initial estimate.
- The GDP Price Index rose at an annualized rate of 1.3 percent.
- Consumer spending, business spending on equipment, and government were the main supports; inventories and trade were drags.

In the wake of the data showing 3.9 percent annualized growth in real GDP in Q2 we stressed the importance of looking beneath the headline number and cautioned the details of the Q2 data set up a weak Q3 growth profile. As such, we stated that we would neither get too high over the Q2 headline nor too low over what we expected would be a weak Q3 headline. So, while the BEA's initial estimate shows real GDP grew at an annualized rate of just 1.5 percent in Q3, looking beneath the headline shows the U.S. economy on firmer footing than implied by the headline Q3 growth number.

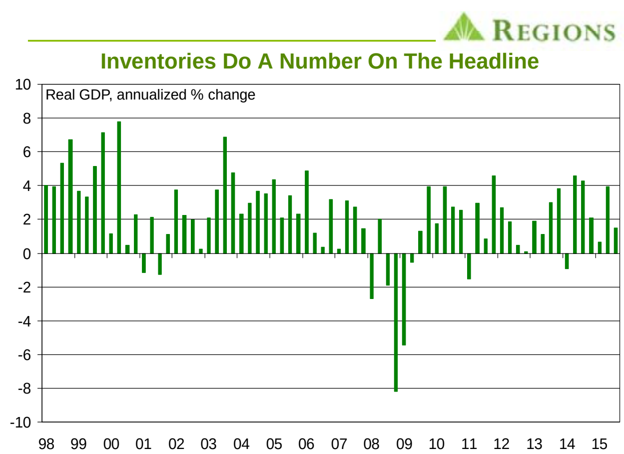
We'll start with our usual caveat that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, is prone to large revision. For instance, lacking complete Q3 data for inventories and trade – the two most inherently volatile components of GDP growth – the BEA must make estimates to round out its first read on GDP. To that point, BEA estimates inventories deducted 1.44 percentage points off of top-line real GDP growth in Q3. As we noted last quarter, the first half of 2015 saw the largest back-to-back inventory build on record in the quarterly GDP data which go back to 1947, setting the stage for a sizeable inventory correction in Q3, which is indeed what we got. Still, we were actually looking for a bigger drag from inventories in Q3 that was reported today, but that will become clearer over coming weeks as further source data come in. Be that as it may, the good news here is the inventory drawdown in Q3 will likely have been large enough that inventories will be a positive for current quarter GDP growth rather than the significant drag they were in Q3.

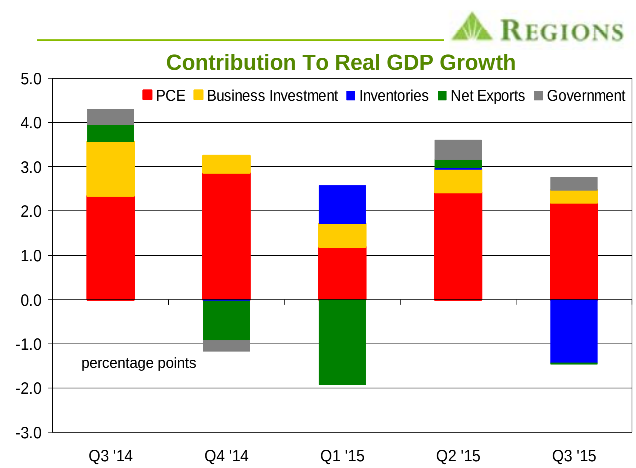
As to the rest of today's report, real private domestic demand grew at an annual rate of 3.2 percent, with consumer spending providing the main support. In Q3, real consumer spending grew at an annualized rate of 3.2 percent, thus adding 2.19 percentage points to top-line real GDP growth. Still, we think the first estimate of growth in consumer spending looks a bit light, particularly growth in spending on consumer durables, so this could be a source of upward revision down the line.

That said, the data on inflation adjusted consumer spending helps illustrate a point we have been making in recent months as to the retail sales data. Nominal retail sales have looked squishy over the past few months, which some have interpreted as a sign of fundamental weakness in consumer spending. Our point has been price effects have been holding down nominal consumer spending but the data on real, i.e., inflation adjusted, spending show a much firmer consumer spending profile. Over the past six quarters average annualized growth in real consumer spending has been 3.4 percent – which includes the 1.7 percent growth in a frozen Q1 2015 – which is a meaningfully faster trend rate than had been the case earlier in the current expansion.

Business fixed investment was a mixed bag in Q3 – spending on structures fell and spending on intellectual property products grew at a much slower pace than has been the case over the past several quarters, while growth in spending on equipment and machinery accelerated sharply. Real exports of U.S. goods grew at an annualized rate of 0.7 percent, reflecting the one-two punch from weaker global demand and a stronger U.S. dollar. At the same time, however, growth in imports of goods slowed as well, so trade was only a modest drag on top-line real GDP growth. We look for that drag to intensify in Q4, however, as import growth should accelerate while exports will continue to face a challenging environment, with both global demand and the U.S. dollar remaining hurdles. Additionally, business investment in equipment and machinery will likely slow in Q4 reflecting the ongoing softness across of the manufacturing sector, with the auto industry a notable outlier.

All in all, Q3 real GDP looks about as we had expected it to with the meaningful story the details rather than the headline growth number. For what it's worth, the 1.5 percent annualized growth in Q3 leaves the economy's average rate of growth since the end of the 2007-09 recession at 2.2 percent. Sure, that's more familiar than it is comforting but, despite what will likely remain some sharp swings in the quarterly growth rates, we don't look for it to change much over coming quarters.





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