ECONOMIC UPDATE
REGIONS
October 27, 2017

Q3 2017 GDP: Growth On An Even Keel . . . For Now

- The BEA's first estimate shows real GDP grew at an annualized rate of 3.0 percent in Q3 2017 after 3.1 percent growth in Q2.
- Consumer spending, business investment spending, net exports, and inventory accumulation were the main drivers of Q3 growth.

The BEA's initial estimate puts annualized Q3 2017 real GDP growth at 3.0 percent, right in line with the 3.1 percent growth logged in Q2. Our above-consensus forecast was for growth of 3.2 percent. Consumer spending, business investment, net exports, and inventory accumulation were the main drivers of Q3 growth while public sector spending remains a notable laggard. The past two quarters have seen the fastest back-to-back growth since Q2-Q3 2014, with growth easily ahead of the average rate of growth that has prevailed since the end of the 2007-09 recession. The key question, of course, is the extent to which this faster growth can be sustained. The two main reasons for encouragement are the pick-up in business investment and what for the first time in over a decade is synchronized global growth; the main cause for concern is whether or not we have the ability to stay out of our own way.

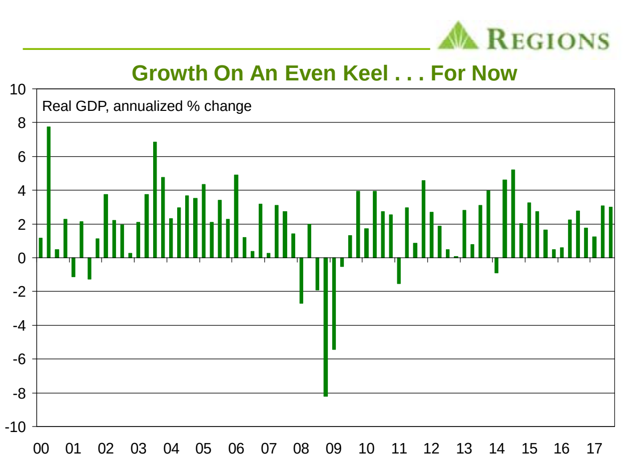
We'll toss out the usual caveat that in any given quarter, the initial estimate of GDP is based on highly incomplete source data and, as such, prone to large revision over subsequent months. And, as a side note, we've already heard one analyst express amazement that the GDP data show no effects of Hurricanes Harvey and Irma, apparently going on the headline growth number alone. Those effects are there and easily visible for anyone looking at the details of today's report.

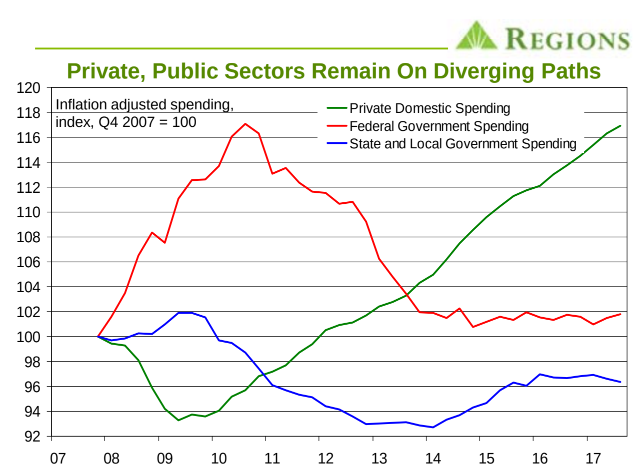
The initial estimate shows real consumer spending grew at an annualized rate of 2.4 percent in Q3, down from 3.3 percent in Q2. Spending on consumer durable goods rose at an annualized rate of 8.3 percent, faster than the 7.6 percent growth in Q2. The spike in motor vehicle sales in September (post-hurricane replacement buying) was a key contributor, with inflation adjusted spending on motor vehicles and parts rising at an annualized rate of 14.7 percent. Spending on household furnishings and appliances rose at an annualized rate of 7.4 percent and spending on the always popular "other" durable goods rose at a double-digit rate. Real spending on nondurable goods rose at an annualized rate of 2.1 percent, while spending on services (which accounts for roughly two-thirds of consumer spending as defined in the GDP accounts) rose at an annualized rate of just 1.5 percent. Utilities outlays were sharply curtailed by the hurricanes, which weighed on growth in services spending, while growth in health care expenditures has slowed sharply over the past two quarters.

Spending on structures is another area in which the hurricanes impacted measured GDP growth in Q3. Real residential investment declined at an annualized rate of 6.0 percent while real investment in business structures declined at an annualized rate of 5.2 percent. Together, these declines in spending on structures took four-tenths of a point off of top-line real GDP growth. To be sure, the decline in residential investment also reflects the slow but steady deceleration in multi-family activity, which we expect to continue over coming quarters.

We have for some time now been telling anyone who would listen that the most encouraging element in the economic data has been the pick-up in business investment spending. Real spending on equipment and machinery rose at an annualized rate of 8.6 percent in Q3 after growth of 8.8 percent in Q2. At the same time, spending on intellectual property products has posted solid gains in each of the past three quarters. These two forms of investment not only support faster top-line growth today but also lay the groundwork for faster growth down the road to the extent they foster faster productivity growth, without which the sustainable rate of real GDP growth is considerably less than the 3.0 percent pace seen over the past two quarters. A faster pace of inventory accumulation added seven-tenths of a point to top-line real GDP growth in Q3, matching our forecast, but the caveat here is that unless this pace is sustained, which we do not expect will be the case, inventories will be a drag on current quarter growth.

The U.S. economy entered into 2H 2017 with considerable momentum. One key going forward will be the extent to which the recent strength in business investment can be sustained, which is necessary for there to be a meaningful change in the economy's trend rate of growth. Another key is policy not hurling obstacles in the economy's path in the form of restrictive trade policies and totally whiffing on corporate tax reform.





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