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Q3 2022 GDP: Domestic Demand A Bit Firmer, Trade Still The Biggest Driver Of Q3 Growth

- The BEA's second estimate shows real GDP grew at an annualized rate of 2.9 percent in Q3
- Corporate profits declined by 1.1 percent in Q3, leaving them up 4.4 percent year-on-year

Revised and more complete source data show real GDP grew at an annual rate of 2.9 percent in Q3, ahead of the BEA's initial estimate of 2.6 percent but falling a bit short of our above-consensus forecast of 3.1 percent. Consumer spending, business fixed investment, and net exports were all revised higher from the initial estimates, as we expected, but our forecast was done in by a downward revision to the rate of inventory accumulation in the nonfarm business sector. As in the initial estimate, a smaller trade deficit was by far the main driver of Q3 growth while a sharp contraction in residential fixed investment largely negated moderate growth in consumer spending and business fixed investment, leaving but modest growth in real private domestic demand. As we noted upon the releases of the GDP data for the first two quarters of 2022, which showed contractions in real GDP, private domestic demand is a more meaningful gauge of the underlying health of the U.S. economy given the extent to which swings in inventories and net exports can, and often do, sway top-line real GDP growth from one quarter to the next. To be sure, the contraction in residential fixed investment was a punishing weight on private domestic demand in Q3, but as the declines in residential fixed investment moderate over coming quarters we expect slowing growth in consumer spending and business fixed investment, with the net effect being little to no growth in real private domestic demand.

The upward revision to real consumer spending is basically a case of addition by less subtraction; real spending on consumer goods is still shown to have contracted in Q3 (the third straight quarterly contraction) but by less than initially estimated, while there was a slight downward revision to the initial estimate of growth in services spending. The net result is that real consumer spending grew at an annual rate of 1.7 percent in Q3 rather than the 1.4 percent rate first reported. That inflation adjusted spending on goods has fallen in three consecutive quarters is a useful point to keep in mind while processing reports of "blowout" consumer spending over the Thanksgiving weekend, given that in many if not most cases it took aggressive discounting to entice consumers, meaning that the start to the holiday shopping season felt much better for consumers than it did for retailers. To us, the bigger question surrounding consumer spending is how long services spending will remain as strong as it has

been over the past several months. Services spending accounts for roughly two-thirds of all consumer spending, and while thus far services spending has held up better than we've anticipated, it remains to be seen how much longer that will be the case.

The upward revision to growth in business fixed investment is also a case of addition by less subtraction. While growth in business spending on equipment, machinery, and intellectual property products was marked down, the contraction in business spending on structures is now shown to be much smaller than initially estimated. As such, real business fixed investment is now reported to have grown at an annual rate of 5.1 percent in Q3 rather than the 3.7 percent rate first reported. At the same time, the contraction in real residential fixed investment is now shown to be a bit more severe than had initially been estimated; real investment in single family structures is now shown to have contracted at an annual rate of 37.4 percent in Q3 rather than the 36.3 percent decline first reported. While we expect further contractions real residential fixed investment over coming quarters, they will not be as severe as that seen in Q3. Faster growth in exports and a larger contraction in imports relative to the initial estimates led to the trade deficit narrowing more than had first been reported. As such, net exports added 2.93 percentage points to top-line real GDP growth in Q3. At the same time, a slower pace of inventory accumulation than had first been reported means that inventories knocked 0.97 percentage points off of top-line real GDP growth.

Included in the BEA's second estimate of Q3 GDP is their first estimate of Q3 corporate profits. On a sequential basis, corporate profits were down by 1.1 percent in Q3, with profits from domestic operations down by 1.1 percent and profits from foreign operations down 1.0 percent. Profits in the financial sector were down 7.1 percent in Q3 while nonfinancial corporate profits were up a modest 0.3 percent. On an over-the-year basis, corporate profits were up by 4.4 percent in Q3 with both domestic and foreign profits higher. Though down from post-pandemic peaks, profit margins are nonetheless still elevated by historical standards, but it remains to be seen how margins will hold up in the face of a slowing economy in which it looks like firms are seeing their pricing power fade.

