Economics

Economic Indicator — October 26, 2023

Economic Resilience on Display in Q3 GDP

Summary

U.S. economic growth accelerated in the third quarter to a 4.9% annualized pace, signaling the economy remains resilient in the face of higher rates and still-elevated prices. While persistent strength in demand could put the inflation descent in jeopardy, we do not anticipate this report changes much for policymakers, and we expect the FOMC to leave rates unchanged at next week's meeting.

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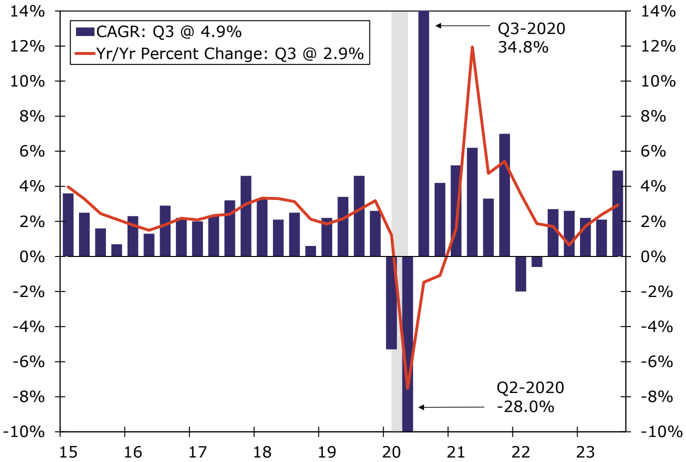
U.S. Real GDP Growth



Source: U.S. Department of Commerce and Wells Fargo Economics

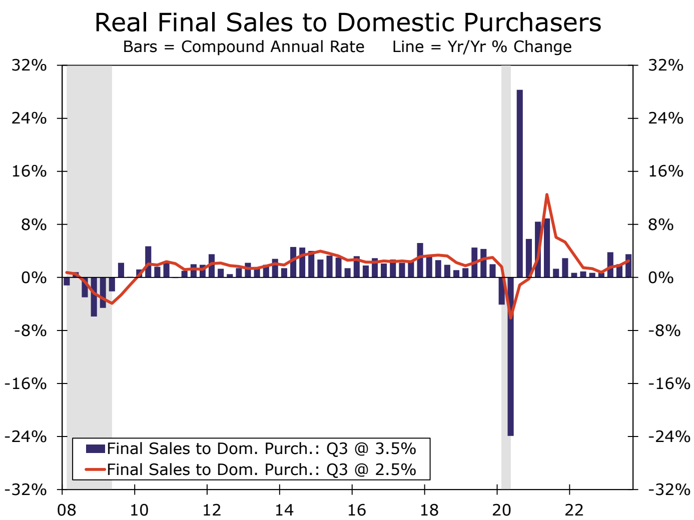
Economic Growth was Strong in the Third Quarter

U.S. economic output accelerated in the third quarter as real GDP rose at a 4.9% annualized rate (chart). At the start of 2023, a number of forecasters, including many at the Federal Reserve, thought the U.S. economy would be either slowing or perhaps even entering a recession by the second half of the year. Instead, it is accelerating. Third quarter growth is more than double the pace of the prior period's growth (+2.1%) and well-above what many observers estimate to be the potential growth rate in the U.S. economy today (~1.8%).

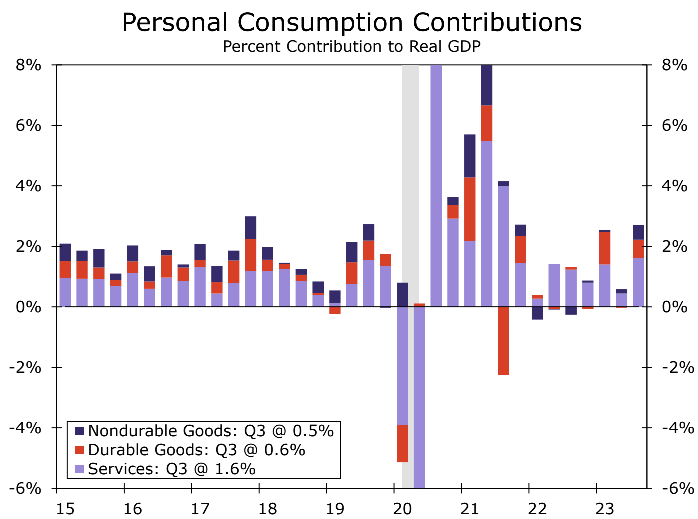
There's no denying this is a strong outturn, but an $80.6 billion build in inventories was responsible for 1.3 percentage points of headline growth. Net exports were the largest surprise to us. We had anticipated a boost from trade, but net exports *subtracted* 0.1 percentage points from growth on stronger import activity, which does not immediately square with the advance monthly data. Real imports rose at a 5.7% annualized clip in Q3, or by the most in six quarters. Still, growth is tempered a bit when we strip through some of these volatile components and look at the core parts of the economy. Real final sales to domestic purchasers were still robust but expanded at a more moderate 3.5% clip last quarter. As seen in the nearby chart, that's still a pace well ahead of the roughly 2.3% quarterly annualized growth rate averaged over the previous expansion.

Economic growth was lifted by a robust pace of consumer spending throughout the period, as evidenced by fairly strong monthly retail sales data. Real personal consumption expenditures expanded at a 4.0% annualized pace, or the fastest rate of expansion since mid-2021 when the economy was bouncing back amid reopening. Growth was fairly broad based among major spending categories as well, though services continue to account for a majority of consumption (chart). Services spending rose at the fastest pace in over two years, and goods purchases bounced after a weak second quarter. We will get the full release for September Personal Income & Spending tomorrow, which will include the monthly spending details, but we expect consumption ended the quarter quite strong, setting the fourth quarter up for a decent pace of growth as well.

Beyond consumer spending, residential investment was also pretty strong, seeing its first positive pace of growth in ten quarters (+3.9%). Nonresidential investment was weaker, but most of that weakness is attributed to slower equipment outlays during the period, which fell at an annualized rate of 3.8%. Structures investment (+1.6%) and intellectual property products (+2.6%) both expanded.



Source: U.S. Department of Commerce and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Eonomics

The pullback in equipment spending was a little larger than we had anticipated, though it is consistent with the separately released data on September Durable Goods out this morning. These data show that nondefense capital goods shipments, which feed into the BEA's calculation of equipment investment, slipped 0.2% in September. The advance in broad durable goods orders in September was largely driven by a surge in aircraft orders, which we anticipated from previously released Boeing data. Equipment spending has been volatile in recent quarters, and we anticipate it will remain under pressure as borrowing conditions grow less favorable.

Not Much Changes for the FOMC

Third quarter growth demonstrates the U.S. economy remains resilient in the face of higher rates and still-elevated prices. While we still anticipate it will take a period of below-trend growth to ultimately sniff out inflation, we do not think this report changes much for monetary policymakers, who are set to meet next week. We still anticipate the FOMC will elect to leave rates unchanged at the conclusion of its meeting.

Policymakers had anticipated the strength exhibited in today's report based on strong monthly data, with little of the underlying details coming as much of a surprise. Inflation also continued to moderate with the core PCE deflator easing to a 2.4% annualized pace in the third quarter. Separately released data on jobless claims showed a slight uptick in initial claims for unemployment as well as those continuing to make claims. While both measures remain low and consistent with a tight labor market, the more persistent rise in continuing claims adds to some signs of moderation. The recent upward move in longer-dated yields can also add to financial tightness in the economy. We thus anticipate the FOMC will remain cautious to take further action at this point. We also ultimately still anticipate the economy will show more meaningful signs of slowing later this year and early next year as tighter financial conditions more meaningfully materialize and begin to weigh on spending and investment decisions.

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