WELLS FARGO

Economic Indicator — November 29, 2023

# Revised GDP Data: Profit Growth Remained Robust in Q3-2023


## Summary

- The sequential rate of real GDP growth in Q3-2023, which was originally reported as 4.9%, was revised up to 5.2%. Although growth in real PCE was tamped down a bit, growth in real fixed investment was not as weak as originally reported.
- Today's release provided the first look at the income side of the National Income and Product Accounts. In that regard, real gross domestic income rose only 1.5% in the third quarter, marking the fourth consecutive quarter in which growth in real GDI has not kept pace with growth in real GDP. Wages and salaries continue to rise at a strong pace, at least in nominal terms, but elevated inflation is eroding the real value of those wage increases.
- Despite weak growth in GDI, corporate profits rebounded in Q3. Pre-tax profits rose by the most in five quarters, leaving the level of profits only a stones-throw away from the recent cycle peak.
- Economy-wide profit margins also improved during the quarter amid a sturdy level of end-demand offsetting a still-high cost environment.
- Rebounding profits can be supportive of economic growth, but to the extent we see renewed pressure on margins in coming quarters, headcounts and thus broader growth may be at risk of slowing. Recession risks are elevated, but a downturn is far from a certain outcome particularly in an environment of rebounding profits growth.



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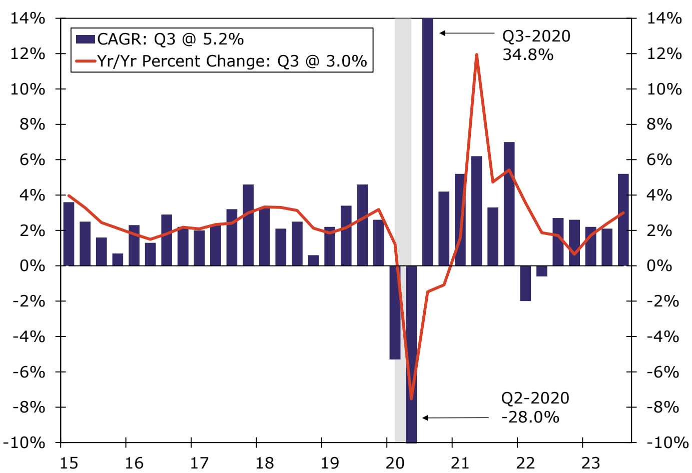
## Real GDP Growth Revised Higher, But Real Income Growth Continues to Lag

Revised data that were released this morning showed that real GDP grew at an annualized rate of 5.2% in Q3-2023 relative to the previous quarter (chart), which was stronger than the initial estimate of 4.9% that was reported a month ago. Although the Bureau of Economic Analysis (BEA) revised the growth rate in real personal consumption expenditures (PCE) down to 3.6% from 4.0%, growth in real fixed investment spending was not as weak as initially reported. Furthermore, the revised data showed that real government spending grew 5.5% in Q3, up from the 4.6% growth rate that was initially reported.

The second release of the National Income and Product Accounts (NIPA) for any quarter is important because it is the first time that analysts get to view income creation data in that quarter. In theory, the income side of the NIPA accounts should be equivalent to the spending side. That is, the act of spending creates an equivalent amount of income for somebody in the economy. In reality, however, the two sides rarely are identically equivalent due to data errors and omissions. In that regard, real gross domestic income (GDI) grew only 1.5% in the third quarter on a sequential basis. Indeed, growth in real GDI has lagged growth in real GDP for four consecutive quarters. On a year-over-year basis, real GDP is up 3.0% while real GDI is down 0.2% (chart). Growth in real consumer spending, which was up 2.3% on a year-ago basis in the third quarter, could eventually be at risk if growth in real income remains weak. Although nominal wages and salaries rose 5.6% (year-over-year) in Q3, high inflation is eroding growth in real purchasing power.

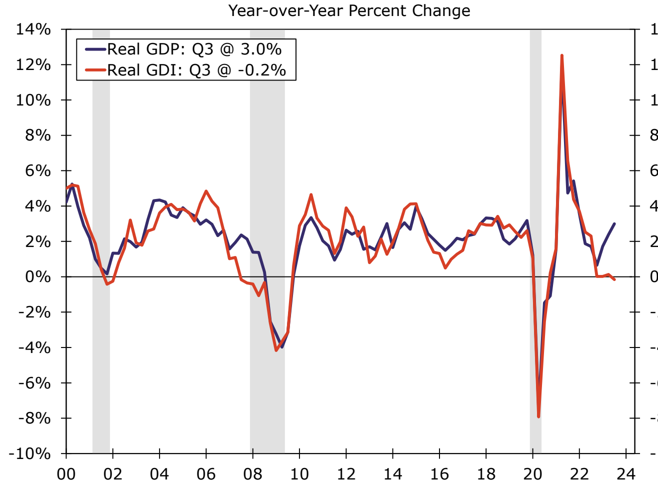
U.S. Real GDP Growth




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

Real GDP & Real GDI

Year-over-Year Percent Change



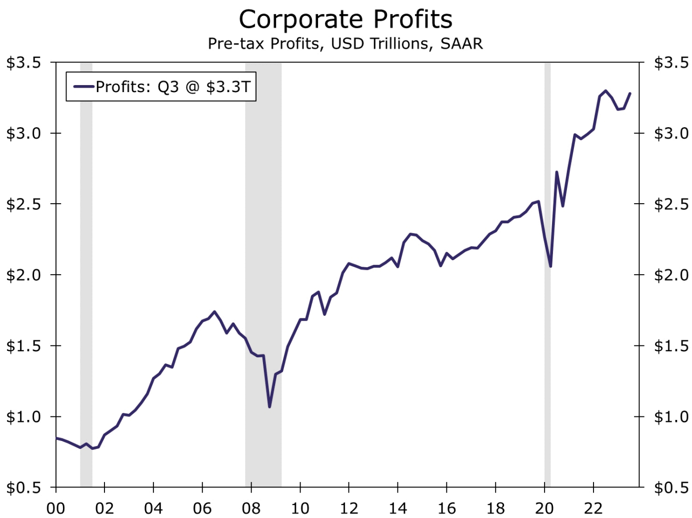

Source: U.S. Department of Commerce and Wells Fargo Economics

## Firms Profitability Rebounds in Q3

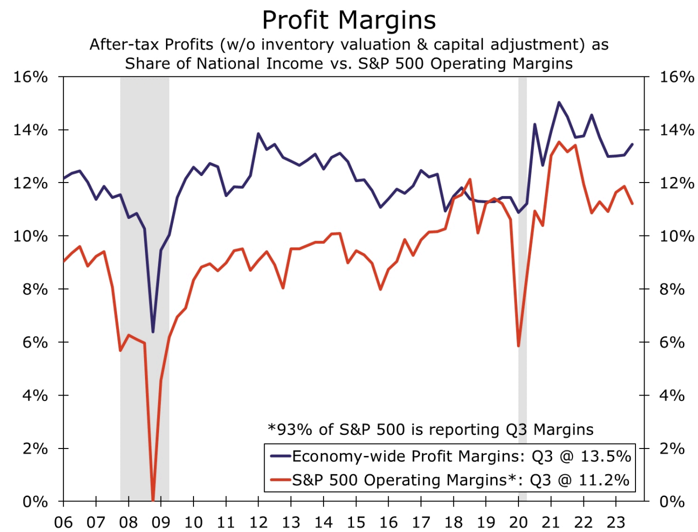
Today's data release also provided our first look at corporate profits in the third quarter. In short, profitability remained in solid shape. Corporate profits bounced 3.3% (not annualized) in Q3, or by $105.7 billion. This marked the largest quarterly gain since the second quarter of last year and signals some stabilization in firms' profitability. Pre-tax profits are still about 0.7% off their year-ago level, which also happens to be the recent cycle peak, but they are 0.9% *above* the level that prevailed at the end of last year, demonstrating a slight upswing (chart). Profit growth was also rather broad based, with no particular segment responsible for the uptick.

Margins improved in the third quarter as well. While there are a few ways to cut this data, we find after-tax profits without inventory valuation or capital adjustment tend to track most closely with more widely recognized measures such as the operating earnings of the S&P 500. This economy-wide margin measure rose to 13.5% in Q3, while the S&P operating margin is tracking to have slid modestly to 11.2%. Economy-wide margins are holding up somewhat better than those of the largest 500 public companies (chart).

While the profit data came in better than we had anticipated, it's not too surprising given the strong pace of end-demand during the quarter. As previously mentioned, real consumer spending rose at a 3.6% annualized clip. The steady level of demand has enabled firms to broadly maintain elevated margins amid a still-elevated cost environment emanating from the tight jobs market. We've seen higher financing costs and increased economic uncertainty weigh on firms' capital investment plans, but businesses have continued to hire. A potential cost offset in some industries, such as retail, may also come from better inventory management, where tighter inventories can help to offset other costs and slowing sales. The extent that we see renewed pressure on margins ahead, however, could spell trouble for headcounts and broader growth. Recession risks are elevated, but a downturn is far from a certain outcome particularly in an environment of rebounding profit growth.



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



Source: U.S. Department of Commerce, S&P Global and Wells Fargo Economics

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