# ECONOMIC UPDATE

REGIONS

October 28, 2016




## Q3 2016 GDP: Consumers Get Some Help In Q3, But It's Temporary Help

- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.9 percent in Q3.
- Consumer spending, net exports, and inventories were the main drivers of Q3 growth but business investment remains weak.

According to the BEA's initial estimate, the U.S. economy expanded at an annual rate of 2.9 percent in Q3. We'll throw in the usual caution that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to large revision. Still, many will no doubt be cheered by what is, at least for now, the fastest quarterly growth rate since Q3 2014. Even taking the initial estimate at face value, however, the details of today's report are far less encouraging then implied by the headline number. In other words, how far down into the details one goes should really be governed by how happy they want to feel about today's report.

In contrast to Q2, when growth in real consumer spending more than entirely accounted for the increase in real GDP, growth in Q3 was broad based. The problem, however, is many of the drivers of Q3 growth will not be replicated in Q4, which could, once again, leave consumers as the main driver of current quarter growth. For instance, the trade deficit fell sharply in Q3, to -\$522.9 billion from -\$558.5 billion in Q2 (annualized rates). This was a function of 14.5 percent annualized growth in real U.S. exports, which was primarily driven by a surge in soybean exports, as crop failures amongst other major producers and solid growth in global demand fueled U.S. exports. This, however, is a one-off spike (indeed, soybean exports fell in September) and while exports of U.S. goods added 1.1 percentage points to top-line real GDP growth in Q3, this will be reversed in the Q4 GDP data.

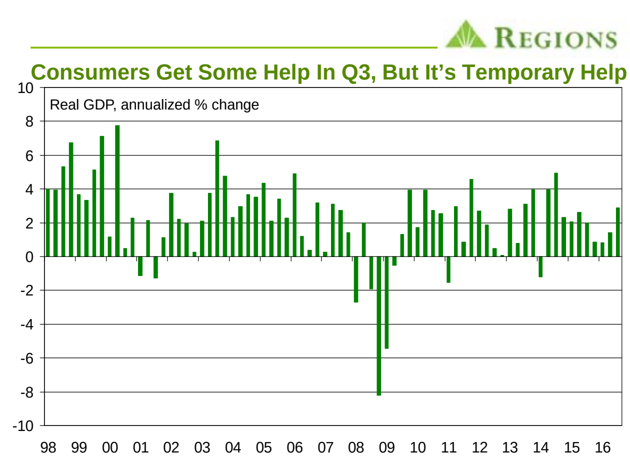
Inventory accumulation in the nonfarm business sector added 0.6 percentage points to top-line real GDP growth in Q3. While this marks the end of the long-running inventory correction that has been a persistent drag on top-line growth, we don't expect inventories to be nearly as supportive of growth going forward. Inventory-to-sales ratios remain elevated and business will likely remain cautious in managing inventories barring signs of faster and sustainable growth in demand.

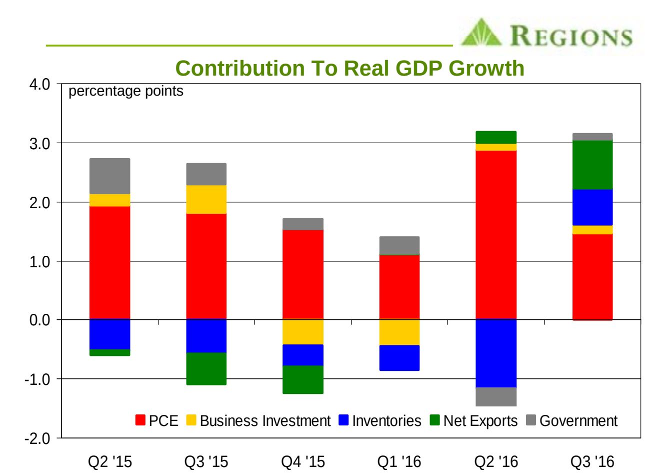
Businesses are also likely to remain reticent to increase capital outlays over coming quarters. Real business investment in equipment and machinery posted a fourth consecutive decline in Q3, which is highly unusual to see during an expansion. Business spending on structures did bounce back in Q3, and investment in intellectual property products logged another increase. Still, spending on equipment and machinery is far and away the main component of business fixed investment, and while orders for core capital goods have shown some signs of life in recent months, it is highly unlikely that we will see a material and sustained increase in business outlays in equipment and machinery unless and until the outlook for growth, domestic and foreign, improves.

While overall government spending rose at an annualized rate of 0.5 percent in Q3, state and local government spending remains notably weak. The 0.7 percent (annualized) decline in Q3 marks the third such decline in the last four quarters. Both defense and nondefense spending by the federal government logged advances in Q3 but the outlook for both, particularly defense spending, remains uncertain until we have a sense of how the post-election political landscape will look.

With annualized growth of 2.1 percent in Q3, real consumer spending added 1.47 percentage points to top-line real GDP growth. Spending on consumer durable goods rose at an annual rate of 9.5 percent, with broad based gains in spending on motor vehicles, home furnishings & appliances, and recreational vehicles and goods. Real spending on nondurable goods fell at an annual rate of 1.4 percent, with dining out the one strong spot, while spending on household services advanced at an annual rate of 2.1 percent. Bolstered by solid growth in wage and salary earnings, real disposable personal income excluding transfer payments rose at an annual rate of 2.6 percent in Q3. Ongoing labor market improvements will fuel further growth in personal income and, in turn, consumer spending over coming quarters.

Not to totally dismiss the headline Q3 growth number, but it is built on several transitory factors that simply will not be replicated in Q4. This means that, once again, consumers will be responsible for doing the heavy lifting for the U.S. economy.





**Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203**

Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com