Comerica Bank

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Blowout GDP Growth In The Third Quarter, But A Slowdown Is Likely Ahead

- **Real GDP surged 4.9% annualized in the third quarter, the fastest growth since late 2021.**
- **Consumer and government spending were big tailwinds. Business spending on inventories was strong, too, while fixed investment growth was slower.**
- **Continued jobless claims rose sharply in the month through mid-October, a sign that the economy could be slowing at the beginning of the fourth quarter.**
- **The Fed will see the third quarter's strong growth as reinforcing the case for restrictive monetary policy near-term.**

Real GDP accelerated to 4.9% at a seasonally-adjusted annualized rate in the third quarter of 2023, up from 2.1% in the second quarter to the fastest since the fourth quarter of 2021. This was above the 4.5% consensus forecast. In year-over-year terms, real GDP accelerated to 2.9% from 2.4% in the prior quarter and was the fastest since the first quarter of 2022. The third quarter's robust growth reflects strong spending by consumers and the government and cooler spending by businesses. Of the 4.9% annualized increase, personal consumption expenditures contributed 2.69 percentage points and government spending contributed 0.79 percentage points.

Business spending on inventories was strong after companies managed inventories cautiously between early 2022 and mid-2023; private investment in inventories contributed 1.32 percentage points to annualized growth. But business spending on nonresidential fixed investment was flat in the third quarter, in part reflecting headwinds from high interest rates and margin pressures. Spending on structures added 0.05 percentage points to annualized growth, spending on equipment subtracted 0.19 percentage points, and spending on intellectual property added 0.14 percentage points. Private residential fixed investment added 0.15 percentage points to the quarter's annualized growth rate. Net exports subtracted 0.08 percentage points from growth, with a 0.68 percentage point contribution from exports offset by a 0.75 percentage point headwind from more imports. The strong dollar was a headwind to exporters in the third quarter.

Gross final sales to private domestic purchasers, which strips out the effects of volatile components like inventories, the trade deficit, and government spending, rose 3.3% annualized in the third quarter, which was also the fastest increase since the fourth quarter of 2021. This can be thought of as a measure of core GDP, reinforcing that the third quarter's strong growth isn't a fluke. The GDP price deflator, the price of all goods and services produced, picked up to 3.5% at a seasonally-adjusted annualized rate from 1.7% in the second quarter, largely reflecting higher energy prices.

In a separate release, initial jobless claims rose to a still-low 210,000 in the week ended October 21 from 200,000 in the prior week, which was revised from 198,000 in the prior release. But continued jobless claims jumped to 1,790,000 in the week ended October 14 from 1,727,000 in the week earlier, and are up 132,000 (8.0%) from their recent trough in early September.

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In short, the third quarter's economic growth was excellent, but it doesn't seem to be holding up in October. Continuing jobless claims are up to the highest since May, after a large increase since Labor Day. Their rise reflected increases in the Midwest, where the UAW strike is a big issue, as well as in larger coastal states like California, New York, and New Jersey, where other factors are likely at play.

Consumer spending growth is likely to cool in the fourth quarter, due to knock-on effects of the UAW strike, the restart of student loan payments, and other cost of living pressures. A Fitch Ratings report was quoted in the press in late October as showing subprime auto loan delinquencies are up to the highest since 1994, and the Census Bureau's bi-weekly Pulse Survey shows that the share of households struggling to cover day-to-day living expenses was higher in early October than any time in 2021 or 2022.

While the UAW strike now looks like it is nearing resolution, it will still weigh on industrial production in the fourth quarter, and a potential government shutdown would be a further incremental negative for growth. In addition, multifamily housing starts fell sharply in the third quarter, and homebuilder sentiment edged lower, both pointing to a slowdown in residential investment ahead. Comerica forecasts for real GDP growth to slow to 0.7% annualized in the fourth quarter, and to just 0.5% annualized in the first quarter of 2024—a meaningful slow patch after the third quarter's surge.

The Fed will see the third quarter's blockbuster GDP report as evidence that restrictive interest rates continue to be appropriate near-term. The Fed will likely hold rates steady at their next decision November 1, but still may raise rates another quarter percent in December or January before ending the rate hike cycle. And cuts are quite a ways off, even if inflation slows near-term—the next CPI report will probably run cool since gas prices at the pump are down $0.30 a gallon over the last month. More broadly, the economy has been much stronger than forecast in 2023. Annual real GDP will likely grow about 2.4% this year, well above the 0.5% forecast of the Fed's December 2022 dot plot. That will reinforce the Fed's impression that forecasting tools developed in the pre-pandemic economy are less accurate in the current environment, causing the Fed to put more emphasis on backward-looking data in hand when calibrating policy, and less emphasis on their view of the outlook.