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US Q3 GDP limited by supply chain woes and Covid spread

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Annualized Qtrly Chg.	21 Q3	21 Q2	21 Q1	20 Q4	20 Q3	20 Q2
Real GDP	2.0%	6.7%	6.3%	4.5%	33.8%	-31.2%
Personal consumption	1.6%	12.0%	11.4%	3.4%	41.4%	-33.4%
• Goods	-9.2%	13.0%	27.4%	-0.3%	49.5%	-10.0%
• Durable goods	-26.2%	11.6%	50.0%	1.1%	89.0%	-1.5%
• Nondurable goods	2.6%	13.9%	15.9%	-1.1%	31.8%	-13.9%
• Services	7.9%	11.5%	3.9%	5.3%	37.5%	-42.4%
Gross private investment	11.7%	-3.9%	-2.3%	24.6%	82.1%	-48.8%
• Fixed investment	-0.8%	3.3%	13.0%	17.7%	27.5%	-30.4%
• Nonresidential	1.8%	9.2%	12.9%	12.5%	18.7%	-30.3%
• Structures	-7.2%	-3.0%	5.4%	-8.2%	-15.3%	-46.8%
• Equipment	-3.2%	12.2%	14.1%	26.5%	55.9%	-36.2%
• Intellectual Property	12.2%	12.5%	15.6%	10.2%	8.0%	-10.6%
• Residential	-7.7%	-11.7%	13.3%	34.4%	60.0%	-30.8%
Exports	-2.5%	7.6%	-2.9%	22.5%	54.5%	-59.9%
• Goods	-5.1%	6.4%	-1.4%	25.6%	99.0%	-65.0%
• Services	3.8%	10.4%	-6.0%	16.0%	-4.9%	-48.6%
Imports	6.1%	7.1%	9.3%	31.3%	89.2%	-53.1%
• Goods	-0.1%	4.3%	10.7%	30.1%	103.7%	-49.2%
• Services	44.3%	23.6%	2.2%	37.6%	29.7%	-67.6%
Government consumption	0.8%	-2.0%	4.2%	-0.5%	-2.1%	3.9%
• Federal	-4.7%	-5.3%	11.3%	-3.2%	-5.4%	20.6%
• National defense	-1.4%	-1.0%	-5.8%	5.3%	1.7%	3.2%
• Nondefense	-9.2%	-10.7%	40.8%	-14.0%	-14.4%	50.1%
• State and local	4.4%	0.2%	-0.1%	1.2%	0.1%	-5.5%

Source: Haver Analytics.

- Economic activity moderated in the US in Q3, reflecting supply chain bottlenecks. The 2.0% annualized pace of growth was below the consensus expectation for a 2.6% pace and included a sizable drop in goods consumption as vehicle sales plummeted, and a deceleration in services spending. The main driver of growth was a slower drawdown in inventories, as excluding inventories, final sales declined by 0.1% annualized. With the savings rate still elevated at 8.9%, consumers have ample spending power to drive growth ahead. The final quarter should benefit from a rebound in Hurricane Ida impacted sectors, while the deceleration in Covid cases could support spending on services. Supply chain issues remain a downside risk.

- The 9% annualized drop in goods spending was mostly accounted for by vehicles, but other durable goods including furniture and recreational goods and vehicles also fell. While we expect supply chains to disentangle as trading partners gain control of Covid, that might not happen meaningfully until well into 2022. With the holiday season approaching, supply chains are likely to remain under pressure as demand remains strong. The drop in goods consumption partly offset an advance in services consumption which decelerated markedly as the Delta variant gained momentum. However, high frequency service activity indicators have started to inch forward again as Delta variant cases have decelerated.
- The drop in residential investment reflected material and labor shortages that limited renovations and new home building. As those issues ease, we expect to see homebuilding accelerate in 2022, in line with the overhang of building permits and solid trends in household formations. While yields have risen lately, we are still entering 2022 at a lower level than previously thought and home purchase intentions have risen recently, while homebuilder confidence remains elevated.
- Business investment in equipment was also limited by supply chain issues, with capital goods down over the quarter, and investment in transportation equipment plummeting. Structures investment was limited by declines in manufacturing, commercial, healthcare, and power structures, while mining structures was the only sub-component to show growth. Oil rig counts have climbed steadily higher since late 2020, but mining structures investment is still 20% below pre-pandemic levels. While the fourth quarter should show a continued recovery in that component as oil prices have risen, a full recovery may not be in the cards as futures suggest a fall in prices in the coming years on higher OPEC+ supply. A climb in software investment just offset drops in the latter components to see business investment rise.
- The drop in federal government spending reflected the end of PPP loan processing, but that was offset by higher spending from state and local governments which started to put federal funds received earlier to use. As in-person classrooms returned, the rise in state and local government spending reflected increased employee compensation in the education sector.
- Exports dropped off on broad-based declines in goods categories as trading partners dealt with Covid which stifled both demand and supply chains. Imports still showed solid growth but that didn't reflect goods being brought into the country. Instead, it was Americans travelling abroad that bolstered services imports. That's something that will continue as travel restrictions are eased, while goods imports will be supported by inventory replenishment, but that will likely take longer to recover as supply chain issues continue.

Implications & actions

Re: Economic forecast — We look for an acceleration in growth in Q4 as Hurricane Ida impacts reverse, which will feed into inventory accumulation, while services spending could be supported by the deceleration in Delta variant cases. The US economy is still on track to reach full employment by mid-2022. With the Fed expected to end QE tapering by then after a likely mid-November start, and cyclical inflationary pressures building on the reacceleration in services spending, the Fed should be able to start hiking rates in Q3 2022.

Re: Markets — While the USD is weaker following the downside miss, yields didn't show any sustainable momentum as this print won't alter the Fed's path forward materially.

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