Economics

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US Q3 GDP: 3% is the new 2%

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Annualized Qtrly Chg.	24 Q3	24 Q2	24 Q1	23 Q4	23 Q3	23 Q2
Real GDP	2.8%	3.0%	1.6%	3.2%	4.4%	2.5%
Personal consumption	3.7%	2.8%	1.9%	3.5%	2.6%	1.0%
• Goods	6.0%	3.0%	-1.2%	3.4%	3.5%	-0.3%
• Durable goods	8.1%	5.4%	-1.7%	2.8%	4.2%	-0.3%
• Nondurable goods	4.9%	1.7%	-0.8%	3.6%	3.1%	-0.4%
• Services	2.6%	2.7%	3.4%	3.5%	2.1%	1.6%
Gross private investment	0.3%	8.3%	3.6%	0.7%	10.1%	8.0%
• Fixed investment	1.4%	2.3%	6.5%	3.5%	2.5%	8.6%
• Nonresidential	3.3%	3.9%	4.5%	3.8%	1.1%	9.9%
• Structures	-4.1%	0.2%	6.2%	6.5%	1.8%	16.4%
• Equipment	11.1%	9.9%	0.3%	0.7%	-1.0%	12.5%
• Intellectual Property	0.6%	0.7%	7.5%	5.2%	2.8%	3.9%
• Residential	-5.2%	-2.8%	13.7%	2.6%	7.7%	4.5%
Exports	8.9%	1.0%	1.9%	6.2%	4.9%	-4.8%
• Goods	12.2%	0.9%	-0.3%	5.3%	7.5%	-10.9%
• Services	3.0%	1.3%	6.2%	8.0%	0.0%	8.7%
Imports	11.2%	7.6%	6.1%	4.2%	4.7%	-3.1%
• Goods	11.6%	8.4%	6.5%	1.8%	5.1%	-5.0%
• Services	9.5%	4.3%	4.8%	14.8%	2.6%	5.0%
Government	5.0%	3.0%	1.8%	3.6%	5.7%	2.9%
• Federal	9.7%	4.3%	-0.4%	-0.4%	5.3%	-1.1%
• National defense	14.8%	6.5%	-2.5%	-1.3%	6.7%	0.8%
• Nondefense	3.2%	1.6%	2.6%	0.9%	3.4%	-3.6%
• State and local	2.3%	2.3%	3.1%	6.1%	5.9%	5.4%

Source: Haver Analytics.

- The US economy continued growing at strong pace in Q3, with GDP growth coming in at 2.8% q/q annualized, very close to consensus expectations of 2.9% and a couple of ticks below last quarter's 3.0% increase. The pickup in growth was driven by consumption again, which came in at scorching 3.7% (+2.5pp contribution) compared to expectations of 3.3% and the government component at 5.0% (+0.9pp). Business investment growth slowed a bit at 3.3% (+0.5pp) compared to the 4% average over the past three quarters because of softness in structures and IPP investment, but equipment investment was very strong growing at over 11% in the quarter. These forces were partly offset by a drag from net trade (-0.6pp), as import growth exceeded export growth, a contraction in residential investment (-0.2pp) and inventories (-0.2pp). Stripping out inventories and net trade, final sales to domestic purchasers growth came in at a strong 3.5%, up from 2.8% in Q2. The core PCE price deflator came in at 2.2% q/q annualized, one tick above expectations, and below the 2.8% last quarter.

- Is the economy overheating? Well, not exactly. 3% is the new 2%! Growth has averaged nearly 3% over the past two years, while inflation and job market have cooled over the same period. The only way to square that circle is if the non-inflationary speed limit of the economy, potential output, has improved materially, which is also consistent with a higher r*. So as odd as it seems, a 3% reading should no longer be eye-popping at this point. The Fed's focus will be on the job market and inflation, with Friday's payroll data being more consequential for the next FOMC meeting than today's close-to-consensus GDP print.
- The pickup in consumption was driven by a broad-based surge in durable goods, which grew at 8.1%, its fastest pace since 23Q1. Services consumption grew at about the same pace as last quarter, coming in at 2.6%, a tick lower than in Q2. The labor market cooled modestly in the quarter, with the unemployment rate rising two ticks on a quarterly average basis and payroll employment growth cooling. Average hourly earnings growth was steady at 4%. But it is not just the labor market that is feeding into consumption, there was yet again very strong wealth gains with equity prices rising over 20% in the quarter and house prices jumping 13% q/q annualized. Asset income is about 16% of income and Millennials, who according to research from Fed staff are the main drivers of retail sales gains (Chylak et al, 2024), have seen the largest increase in net worth over the post-pandemic period. Their wealth has more than doubled since 19Q4, towering over the nearly 50% increase amongst baby boomers, who saw the second fastest growth amongst demographic groups.
- So even with the labor market continuing to cool, consumption growth may not necessarily tail off dramatically. The role of asset income and spend-happy Millennials are a structural tailwind to consumer spending. An important headwind for consumption, however, is the crackdown on immigration currently underway. Border patrol activity suggests apprehension and detentions have slowed, likely implying that border guards are doing a better job in preventing illegal crossings. Regardless of who wins the election, that trend is unlikely to change. Putting these two forces together along with lower rates, we think household consumption will gradually slow as potential growth eases with less population growth, but we're not anticipating the consumer to fall off a cliff.
- Equipment investment was broad-based across its sub-components, likely reflecting the influence of lower long-rates. The slowdown in IPP investment continued with R&D investment remaining subdued. Government spending soared on the back of defense spending. Residential investment contracted slightly is averaging close to flat growth over the past two quarters.
- We can't know for sure what happened in the core PCE index until tomorrow's release of the monthly data, but it seems very possible it has more to do with slight upward revisions prior months. Assuming August is revised up to around 0.2% and a 0.3% assumption for September gets one to the 2.2% q/q annualized reading for Q3. Inflation in Q3 as a whole, looked very good and the Fed will place more weight on that quarterly reading than the m/m pace or the base-year effects plaguing the year-over-year effects which should drop out next year.
- The bottom line here is that GDP growth is very healthy and economy is operating not far from its newly expanded capacity. The Fed's attention will still be on the labor market and we expect some gap between GDP and the jobs market to continue opening up. The strong improvement in productivity mean firms don't need to expand their workforces as much, and output can grow at a healthy pace with the help of past investments in technologies that continue to pay-off. That dynamic will continue to boost consumption indirectly through the optimism in the equity market. It's a complicated and messy, but overall very nice problem to have for the Fed. While the diagnosis of the economy has changed with upward surprises and revisions, the recipe for the Fed is the about the same. Gradual rate reductions are expected to keep the music going while trying to figure out where the neutral rate really is.

Implications & actions

Re: Economic forecast — GDP roughly came as expect and our Fed call remains unchanged. We expect two 25bps cuts in November and December.

Re: Markets — Bond yields rose while the dollar has dropped after initially rising.