Growth in the US economy hovered around its non-inflationary potential rate in Q3 at 1.9%, with the composition closely mirroring the prior quarter’s. Consumer spending drove the bulk of the advance, but decelerated moderately, with the slowdown partly offset by a bump in residential investment which captured the first effects of lower bond yields. The continued weakness in capital spending and exports, however, signals that the US economy is feeling the weight of trade policy uncertainty and slower global growth.

The slowdown in business investment was broad-based, with structures investment particularly weak, shaving 2.8%-pts off of overall capital spending. Mining and energy accounted for just under half of that softness, reflecting the global slowdown in growth which has put pressure on world oil demand growth. Declines were seen in the remaining structures categories including manufacturing which mirrors the softness seen in that sector since the start of the year. Equipment spending was
the other soft spot, shaving 1.3%-pts off of total capital spending. However, there was a surprise gain in industrial equipment investment which came in contrast to monthly shipments data that indicated a contraction on the quarter. Still, that came following two soft quarters and likely will not be sustained given the deterioration in industrial activity readings and sentiment. Intellectual property products was the only major positive in business investment given that it is less sensitive to cyclical forces.

- The slowdown in household spending was foreshadowed by recent softness in retail sales, however, consumer fundamentals should put a floor under a deceleration ahead even as job gains slow. Indeed, consumption is running below the pace of real disposable income gains in both q/q and y/y terms, and the savings rate edged up to 8.1% in Q3. Lower interest rates, while apparent in the bump in residential investment— which posted its first positive reading since 2017— haven’t translated through to other areas of spending. Furniture and durable household equipment spending decelerated and could be one area of strength ahead given its ties to housing market activity.

- Core PCE prices accelerated to a 2.2% pace in q/q annualized terms, and while ticking up to 1.7% in y/y terms, they remain below the Fed’s target. Given that growth is on a slower trajectory, there could be limited upside for inflation ahead, with the Fed more concerned about where growth is headed and risk mitigation.

Implications & Actions

Re: Economic Forecast  — The negative impacts of trade uncertainty and a slowing global picture materialized more meaningfully in the business investment figures, consistent with the Fed lowering rates once more, later today, to mitigate a further deterioration. However, the strong consumer is one reason why the Fed will likely take an extended pause thereafter, rather than entering a deeper easing cycle.

Re: Markets  — Market reaction was limited in the immediate aftermath, with the data close to consensus, but yields declined later in the morning.