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Economics Group

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Inventory Swing Pulls Real GDP Lower in Q3

Real GDP growth rose at a 1.5 percent annual pace in the third quarter. The slower pace of economic activity was due to a large detraction in inventories. Real final sales, which excludes inventories, rose 3.0 percent.

The Details of the GDP Report Are More Promising

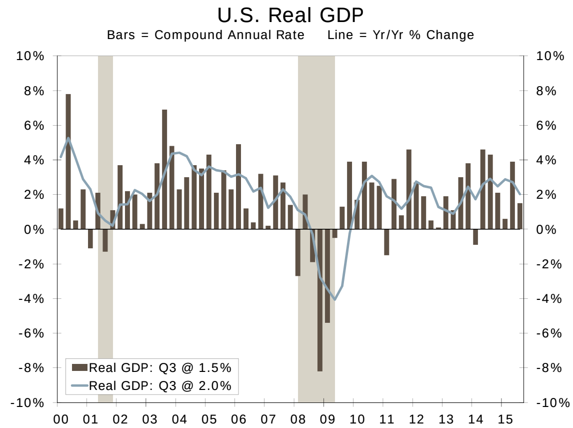
Real GDP rose at a 1.5 percent annual pace in the third quarter following a 3.9 percent rate in the second quarter. At first blush, the slower pace is disconcerting especially given the Federal Reserve will carefully weigh every data point until the December FOMC meeting. That said, the lackluster pace of economic activity in the third quarter is not the final read on the U.S. economy. The Fed will have two additional nonfarm payroll reports to gauge overall labor market activity, which we expect will continue to show improvement. On the inflation front, there was not any big change to the underlying story. The core PCE deflator, which is closely watched by the Federal Reserve, rose to 1.3 percent during the quarter.

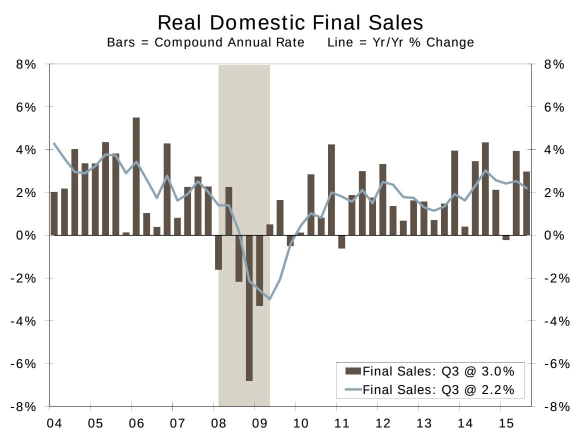
Much of the slower pace in real GDP growth was due to the volatile inventory component. Inventories shaved an eye-popping 1.44 percentage points from the headline, which is the largest detraction since late 2012. The swing in inventories is not all that surprising given the sharp accumulation that occurred in the first half of the year. Net exports and structure investment were also weak during the quarter, while government purchases added to real GDP growth.

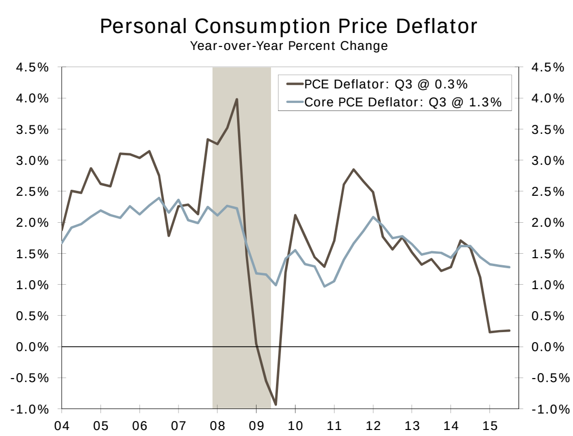
There is some positive news in the report. Real private final sales to domestic purchasers, which excludes inventories and trade, rose to a 3.2 percent pace following a 3.9 percent increase in the second quarter. On the back of improving labor market conditions and stronger purchasing power due to the decline in retail gasoline prices, consumer spending has been a bright spot. Consumer spending rose to a 3.2 percent rate in the third quarter with durable goods spending firming at a 6.7 percent pace. Nondurable goods spending was also solid, increasing 3.5 percent. Despite some uncertainty that was evident in the latest consumer confidence report, consumers are in a much better position at this stage of the business cycle. Household balance sheets are healthy and revolving credit is picking up.

Residential investment continues to boost overall economic activity. The pickup in household formations since the beginning of the year will continue to support the housing market recovery. Although new home sales were weak during the month, housing starts, existing home sales and builder sentiment are likely painting the more accurate picture.

Structure investment, on the other hand, fell 4.0 percent following a 6.2 percent increase in the second quarter. Along with inventories, structures are extremely volatile and typically give an inaccurate reading of nonresidential construction in the advance release. The figures in this component are not credible until the third release. Equipment spending rose 5.3 percent during the quarter, which shows that companies are getting a little more comfortable putting money to work.







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