First Trust
Monday Morning OUTLOOK

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# Slower Growth in Q3

Keynesianism can temporarily giveth, but ultimately always taketh away…and then some.

When the US fell into the COVID crisis, the federal government went on a massive spending binge. Pre-COVID, in the twelve months through March 2020, federal outlays were $4.6 trillion, or 21.4% of GDP. In the next twelve months outlays soared to $7.6 trillion, or 36.2% of GDP. Outside of wartime, we know of no other time when the government has ramped up spending that much or that fast. As a result, as well as very easy money, the economy partially bounced back faster than it would have in the absence of the extra spending.

But the extra spending was like an opioid given to a car crash victim, temporarily masking the economic pain caused by government-imposed shutdowns. Ultimately, there is no free lunch when it comes to spending, and the economic bill is already starting to come due.

As recently as early August, the consensus among economists was that real GDP would grow at about a 7% annual rate in the third quarter, even faster than it grew in the first half of the year when the government was passing out checks like it was going out of style. Now, as we set out below, we're estimating that the economy grew at only about a 2% rate.

**Consumption:** Car and light truck sales fell at a 61.6% annual rate in Q3, largely due to supply-chain issues, while "real" (inflation-adjusted) retail sales outside the auto sector were roughly unchanged. The good news is that although we only have reports on spending on services through August, it looks like real services spending should be up at a solid rate. Putting it all together, we estimate real consumer spending on goods and services, combined, increased at a tepid 0.9% annual rate, adding only 0.6 points to the real GDP growth rate (0.9 times the consumption share of GDP, which is 69%, equals 0.6).

**Business Investment:** The third quarter should continue growth led by investment in business equipment. Investment in intellectual property should also gain, as usual, but commercial construction should be down for the quarter. Combined, business investment looks like it grew at an 3.8% annual rate, which would add 0.5 points to real GDP growth. (3.8 times the 13% business investment share of GDP equals 0.5).

**Home Building:** Residential construction looks like it slowed slightly in the third quarter. That's not due to less demand – sales are trending higher and inventories remain very low – but instead reflects supply-chain issues and lingering problems getting people to work, given unusually high jobless benefits that only ran out nationally late in the third quarter. We estimate a contraction at a 2.1% annual rate in Q3, which would subtract 0.1 point from real GDP growth. (-2.1 times the 5% residential construction share of GDP equals -0.1).

**Government:** It's hard to translate government spending into GDP; only direct government purchases of goods and services (and not transfer payments like extra unemployment insurance benefits) count when calculating GDP. We estimate federal purchases grew at a 0.6% annual rate in Q3, which would add 0.1 point to real GDP growth. (0.6 times the 18% government purchase share of GDP equals 0.1).

**Trade:** A faster economic recovery in the US earlier this year as well as the labor shortage have spurred a rapid recovery in imports, which are at an all-time high. At present, we're projecting that the surge in imports relative to exports will subtract 1.3 points from real GDP growth in Q3.

**Inventories:** Inventories look like they fell again in Q3 as businesses with supply-chain issues keep having to dip into inventories to meet demand. However, inventories didn't fall as rapidly as they did in Q2, and in the arcane world of GDP accounting, that means inventories will make a <u>*positive*</u> contribution to growth, which we are estimating at 2.2 points.

Add it all up, and we get 2.0% annualized real GDP growth for the third quarter, nowhere close to the "sugar high" 6.5% annual rate of growth in the first half of the year.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 10-26 / 9:00 am | New Home Sales – Sep | 0.757 Mil | **0.756 Mil** | | 0.740 Mil |
| 10-27 / 7:30 am | Durable Goods – Sep | -1.0% | **-2.2%** | | +1.8% |
| 7:30 am | Durable Goods (Ex-Trans) – Sep | +0.4% | **+0.1%** | | +0.3% |
| 10-28 / 7:30 am | Initial Claims – Oct 24 | 289K | **295K** | | 290K |
| 7:30 am | Q3 GDP Advance Report | 2.8% | **2.0%** | | 6.7% |
| 7:30 am | Q3 GDP Chain Price Index | 5.3% | **4.6%** | | 6.1% |
| 10-29 / 7:30 am | Personal Income – Sep | -0.2% | **+0.4%** | | +0.2% |
| 7:30 am | Personal Spending – Sep | +0.6% | **+0.4%** | | +0.8% |
| 8:45 am | Chicago PMI | 63.5 | **65.5** | | 64.7 |
| 9:00 am | U. Mich Consumer Sentiment- Oct | 71.4 | **71.4** | | 71.4 |