US GDP (Q3 2024 – first estimate)

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McDreamy economy … but is it a costume?

- Real GDP advanced a robust 2.8% annualized in Q3 2024, following a strong 3.0% gain in Q2. Real final sales rose 3.0% while inventories subtracted a modest 0.2 percentage points (ppt) from growth. Consumer spending drove the gain with an impressive 3.7% increase while business investment, led by equipment, rose a moderate 3.3% and residential investment fell 5.2%. Net trade represented a 0.6ppt drag on growth with imports outpacing exports while government spending, driven by federal defense outlays, rose 5.0%.
- What are the main takeaways? First, domestic demand retained solid momentum through September with final sales to private domestic purchasers rising 3.5%. Second, inflation continues to converge toward the Fed's target without much economic pain – a soft-landing scenario only the most optimistic had dreamt of. Third, a gently softening labor market, a bifurcated consumer outlook and ongoing disinflation should favor a gradual recalibration of Fed policy with a 25 basis points (bps) rate cut post-election following an outsized 50bps "catch-up" rate cut in September.
- Looking ahead, we foresee consumers and businesses still spending but doing so more prudently amid still-elevated costs and rates. We continue to expect that lower-income households with larger debt burdens will exercise more spending restraint while families at the higher end of the income spectrum will spend more freely and drive a disproportionately larger share of consumer outlays. We anticipate GDP growth in Q4 will average a more moderate 1.5%–2.0%.
- Upward revisions to income growth and historically robust productivity growth remain the key pillars to the US economic outperformance while selective consumer prudence in the face of high prices and reduced pricing power continue to drive disinflation. We foresee real GDP growth averaging 2.7% in 2024 and easing to 1.9% in 2025, but note the unusually elevated level of uncertainty dependent on the upcoming election outcome.

In the details:

Growth in real final sales to domestic purchasers (which excludes the net international trade components) picked up to 3.5% from 2.8% in the prior quarter — its strongest performance in four quarters — while real final sales to private domestic purchasers (also excluding government spending) grew 3.2%. On a year-over-year (y/y) basis, real GDP growth cooled 0.3ppt to 2.7% y/y while growth in real final sales to private domestic purchasers accelerated 0.1ppt to 3.1% y/y.

On the inflation front, price pressures continued to ease in Q3 with headline inflation flat at 2.3% y/y — the lowest since Q1 2021 — and core personal consumption expenditures (PCE) inflation steady at 2.7% y/y — also the lowest since Q1 2021. Both are now within striking distance of the Fed's 2% target. We foresee headline and core PCE inflation ending the year around 2.3% and 2.6% y/y in Q4, respectively, and cooling to 2.1% y/y in Q4 2025.

Consumer spending grew an impressive 3.7% in Q3 — its strongest gain since Q1 2023 — following a solid 2.8% gain in Q2. Spending on durable goods led the gains, up 8.1% (the strongest since Q1 2021) with homogenously strong spending on autos, furniture and furnishings, and recreational goods and vehicles. Outlays on nondurables grew a strong 4.9% on robust spending on clothing, groceries and gas.

Spending on services posted a respectable 2.6% advance as households spent relatively freely on transportation services, leisure and accommodation as well as recreation services this summer.

Household finances remain healthy even if increased polarization is evident. Lower-income and younger families are gradually more constrained by elevated debt financing costs and rising delinquencies while older generations and higher-income households have more fixed-rate debt and are therefore less burdened by elevated debt servicing costs. We foresee gradually cooling consumer spending growth from 2.6% in 2024 to 2.0% in 2025 as slower employment growth weighs on income trends and prices and rates remain generally elevated.

Residential investment fell 5.1% following a 2.8% contraction in Q2. Still, investment remains down 15% from its 2021 Q1 peak. While the worst of the housing sector correction is behind us, historically low affordability, made worse by the recent rebound in mortgage rates and slower income growth, will cap residential investment growth in the coming quarters. Construction activity is, however, still likely to benefit from an undersupplied housing market.

Business investment growth eased slightly to 3.3% in Q3 following a 3.9% advance in Q2. Equipment investment surged 11.1%, after a sturdy 9.8% bounce in Q2, driven by notable strength in information processing equipment and transportation equipment investment. Intellectual property investment only grew 0.6% despite strong growth in software investment – likely indicating some initial growth tailwinds from investment in generative AI (GenAI).

Government spending growth picked up to 5.0% as federal outlays rose 9.7%, driven by a 14.9% advance in federal defense outlays. Spending growth at the state and local level steadied with a 2.3% increase. The reacceleration in gross investment growth likely points to outlays support from the CHIPS and Science Act and the Inflation Reduction Act (IRA).

Net international trade subtracted 0.6ppt to GDP growth, as the very strong 11.2% increase in imports (driven by goods and services) outpaced the 8.9% advance in exports (driven by goods over services). Looking ahead, we anticipate cooler imports as domestic activity slows and moderate exports momentum as global activity remains subdued.

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