ECONOMIC UPDATE
REGIONS
October 29, 2020

Q3 2020 GDP: Rebound, Yes; Recovery, Not Yet

- The BEA's initial estimate shows real GDP grew at an annualized rate of 33.1 percent in Q3 2020
- Consumer spending, business fixed investment, and residential fixed investment were the drivers of Q3 growth

Real GDP expanded at an annualized rate of 33.1 percent in Q3, a touch short of our forecast of 33.6 percent, fueled by consumer spending and fixed investment – business and residential – while government spending declined and the trade deficit widened. While Q3's growth rate is easily the fastest quarterly growth rate on record, it comes after an annualized contraction of 34.1 percent in Q2, easily the largest on record. This leaves us with a level of real GDP 3.5 percent below that of Q4 2019, and the relevant question is how long it will take to fill in this gap. Our forecasts have had that happening later than anticipated by many, if not most, other analysts, and the recent upturn in COVID-19 cases is a rather unpleasant reminder that this may take even longer than any of us are anticipating. As we do each quarter, we'll note that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, is prone to sizable revision. Given how noisy much of the source data have been over the past several months, it is likely that subsequent revisions to the initial estimate of Q3 GDP will be larger than normal.

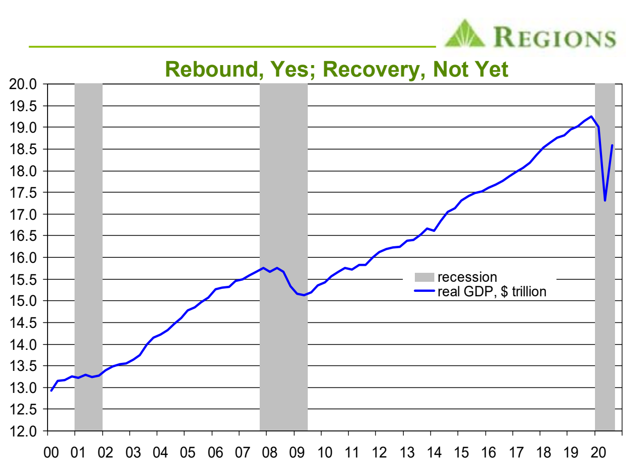
Real consumer spending grew at an annualized rate of 40.7 percent in Q3 after having contracted at a 33.2 percent rate in Q2. Real spending on goods advanced at an annualized rate of 45.4 percent in Q3, more than making up for the annualized contraction of 10.8 percent in Q2. While consumer spending on services rose at an annualized rate of 38.4 percent in Q3, this only partially fills in the gap left by the annualized contraction of 41.8 percent in Q2. Spending on activities such as travel, tourism, recreation, dining out, sporting events, and live arts performances, amongst others, remains depressed, and our view is that it will take quite some time before expenditure levels in these categories return to pre-pandemic levels. Given the relative weights – services account for over two-thirds of all consumer spending – even with the vigorous rebound in consumer spending on goods, total consumer spending remains 2.5 percent below the level as of Q4 2019. Growth in consumer spending added 25.27 percentage points to top-line real GDP growth in Q3.

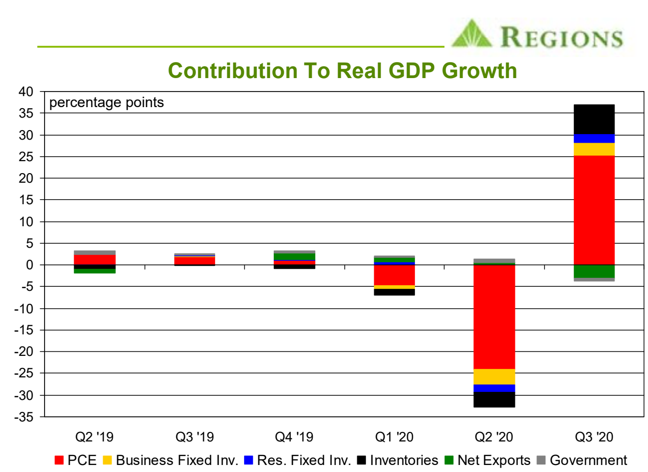
Real business fixed investment grew at an annual rate of 20.3 percent in Q3, adding 2.88 percentage points to top-line real GDP growth. Growth in outlays on equipment and machinery more than accounted for the entire increase in business fixed investment in Q3, offsetting declines in outlays on intellectual property products and on business structures. Growth in equipment spending was powered by transportation equipment and information processing equipment, the latter to some extent aided by increased spending related to the drastic increase in remote working arrangements. Though the decline in spending on intellectual property products was modest and hence had little impact on top-line growth, what is concerning is that research and development outlays declined for a third consecutive quarter. R&D spending is a precursor of patterns in labor productivity growth, which in turn is a key determinant of any economy's sustainable rate of long-term growth. This alone makes it worth keeping a close eye on R&D spending in the quarters ahead.

Residential fixed investment grew at an annualized rate of 59.3 percent in Q3, adding 2.09 percentage points to top-line real GDP growth. A significantly faster pace of single family construction and stepped up spending on home improvement projects were the main drivers of growth in residential fixed investment in Q3.

To the downside, the trade deficit widened considerably in Q3, as growth in imports was materially faster than was growth in exports. The wider trade deficit trimmed 3.09 percentage points from top-line real GDP growth. Real government spending contracted at an annualized rate of 4.5 percent in Q3, deducting 0.68 percentage points from top-line real GDP growth. On the federal level, real non-defense outlays dropped at a rate of 18.1 percent, but this only partially reverses the annualized increase of 37.6 percent in Q2, reflecting pandemic-related assistance spending. State and local government spending fell at a 3.3 rate after falling at a 5.4 percent rate in Q2, and spending on the state and local levels is likely to remain under pressure over coming quarters.

Obviously, the pace of growth seen in Q3 is not even remotely sustainable, and the question is the extent to which growth will slow in Q4 and beyond. Though forecasts vary, the one thing that seems clear is that the downside risks to any forecast remain formidable.





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