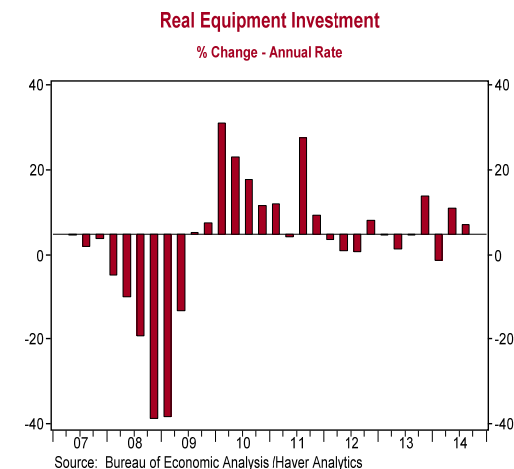
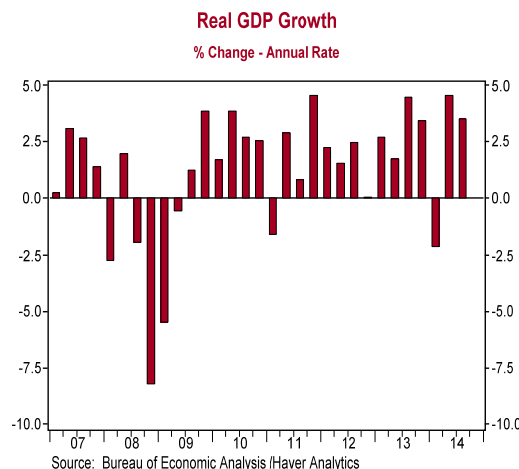


## Third Quarter GDP (Advance)

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- The first estimate for Q3 real GDP growth is 3.5% at an annual rate, beating the 3.0% the consensus expected. Real GDP is up 2.3% from a year ago.
- The largest positive contributions to the Q3 real GDP growth rate were net exports, consumer spending, and government purchases. The only drag was inventories.
- Personal consumption, business investment, and home building were all positive in Q3, growing at a combined rate of 2.3% annualized. Combined, they are up 2.8% in the past year and up at a 2.8% annual rate in the past two years.
- The GDP price index increased at a 1.3% annual rate in Q3. Nominal GDP – real GDP plus inflation – rose at a 4.9% rate in Q3 and is up 3.9% from a year ago and up at a 3.8% annual rate from two years ago.

**Implications:** Real GDP surprised to the upside in Q3, growing at a 3.5% annual rate. The best news in the report was that real business investment (excluding inventories) grew at a 5.5% annual rate in Q3 and is up 6.7% from a year ago. Some pessimistic analysts will surely point out that the trend in real GDP growth is still tepid, up 2.3% from a year ago and up at that very same 2.3% rate in the past two years. These data are accurate, of course, which is why we've been calling the economy a plow horse. But even a plow horse will sometimes pick up his pace. Arguing against this view are those who say government spending boosted growth in Q3. Yet, even without government spending, Q3 real GDP grew 3.3%, and if we exclude government, trade, and inventories, real GDP is up 2.8% annually in past 2 years. And that's roughly what we think the underlying trend is for the economy as a whole. In other words, a slight improvement from the 2.3% pace many have become used to. Monetary policy is loose and will remain that way even as the Fed eventually starts lifting short-term rates. Federal spending has declined to 20% of GDP versus 24% of GDP five years ago. Corporate profits are at a record high. All of these factors signal better economic growth ahead. Meanwhile, today's report continues to show that the Fed should start raising rates earlier than the market now expects. Nominal GDP (real GDP plus inflation) increased at a 4.9% rate in Q3 and is up at a 3.8% annual rate in the past two years. For comparison, nominal GDP is up at a 3.6% rate in the past decade. A short-term interest rate of essentially zero is too low given current economic conditions. Regardless, we expect the Fed to wait until the second quarter of next year to start lifting rates. In other news this morning, new claims for unemployment insurance increased 3,000 last week to 287,000. The four-week moving average is 281,000, the lowest since May 2000. Continuing claims for regular state benefits rose 29,000 to 2.38 million. It's still early, but plugging these data into our models suggests October payrolls will be up about 240,000, another solid month.



| <b>3rd Quarter GDP</b><br><i>Seasonally Adjusted Annual Rates</i> | <b>Q3-14</b> | <b>Q2-14</b> | <b>Q1-14</b> | <b>Q4-13</b> | <b>4-Quarter Change</b> |
|---|--------------|--------------|--------------|--------------|-------------------------|
| <b>Real GDP</b>   | <b>3.5%</b>  | 4.6%         | -2.1%        | 3.5%         | 2.3%                    |
| <b>GDP Price Index</b>  | <b>1.3%</b>  | 2.1%         | 1.3%         | 1.5%         | 1.6%                    |
| <b>Nominal GDP</b>  | <b>4.9%</b>  | 6.8%         | -0.8%        | 5.0%         | 3.9%                    |
| <b>PCE</b>  | <b>1.8%</b>  | 2.5%         | 1.2%         | 3.7%         | 2.3%                    |
| <b>Business Investment</b>  | <b>5.5%</b>  | 9.7%         | 1.6%         | 10.4%        | 6.7%                    |
| <b>Structures</b>   | <b>3.7%</b>  | 12.6%        | 2.9%         | 12.8%        | 7.9%                    |
| <b>Equipment</b>  | <b>7.2%</b>  | 11.2%        | -1.0%        | 14.1%        | 7.7%                    |
| <b>Intellectual Property</b>                                      | <b>4.2%</b>  | 5.5%         | 4.7%         | 3.6%         | 4.5%                    |
| <b>Contributions to GDP Growth (p.pts.)</b>                       | <b>Q3-14</b> | <b>Q2-14</b> | <b>Q1-14</b> | <b>Q4-13</b> | <b>4Q Avg.</b>          |
| <b>PCE</b>  | <b>1.2</b>   | 1.8          | 0.8          | 2.5          | 1.6                     |
| <b>Business Investment</b>  | <b>0.7</b>   | 1.2          | 0.2          | 1.2          | 0.8                     |
| <b>Residential Investment</b>                                     | <b>0.1</b>   | 0.3          | -0.2         | -0.3         | 0.0                     |
| <b>Inventories</b>  | <b>-0.6</b>  | 1.4          | -1.2         | -0.3         | -0.2                    |
| <b>Government</b>   | <b>0.8</b>   | 0.3          | -0.2         | -0.7         | 0.1                     |
| <b>Net Exports</b>  | <b>1.3</b>   | -0.3         | -1.7         | 1.1          | 0.1                     |