

## Growth Surge in Q3 Masks Weak Trend

We still think a recession is coming, but it definitely didn't start in the third quarter. Instead, as we set out below, it looks like real GDP expanded at a 4.7% annual rate. If we are right about that number, that would be the fastest pace of growth for any quarter since 2014, with the exception of the re-openings from COVID in 2020-21.

Keep in mind, though that even with growth that fast, the growth rate since the end of 2019 – the pre-COVID peak – would be only 1.9% per year, reflecting an underlying trend that is still slow.

Why do we still think a recession is coming? Because after the surge in money creation in 2020-21, monetary policy started getting tight in 2022. In the past year the M2 measure of the money supply is down 3.7%. Meanwhile the yield curve (we like to compare the 10-year Treasury yield to the target federal funds rate) has been inverted since late 2022 and is likely to stay that way for at least the next several months.

Higher short-term interest rates mean businesses have the ability to lock in healthy nominal returns on cash with minimal risk. In turn, this should lead to a reduction in risk-taking and business investment.

Meanwhile, jobs are still expanding rapidly. Payrolls are up 2.1% in the past year. During the economic expansion that happened before COVID (mid-2009 through early 2020), a pace that fast (2.1% or more) only happened when the unemployment rate was about 5.5%, which meant plenty of workers still available for hire. Now it's happening when the unemployment rate is less than 4.0%. This suggests employers are out over their skis and vulnerable to any softness in demand.

The bottom line is that the economy grew rapidly in Q3 but Q4 and beyond are likely to be much slower.

**Consumption:** "Real" (inflation-adjusted) retail sales outside the auto sector rose at a 3.7% annual rate in Q3 while it looks like real services, which makes up most of consumer

spending, should be up at about a 4.0% pace. The one weak spot was autos and light trucks, which declined at a 2.5% rate. Putting it all together, we estimate that real consumer spending on goods and services, combined, increased at a strong 4.1% rate, adding 2.8 points to the real GDP growth rate (4.1 times the consumption share of GDP, which is 68%, equals 2.8).

**Business Investment:** We estimate a 4.5% growth rate for business investment, with gains in intellectual property and equipment leading the way while commercial construction was roughly unchanged. A 4.5% growth rate would add 0.6 points to real GDP growth. (4.5 times the 14% business investment share of GDP equals 0.6).

**Home Building:** Residential construction is showing some resilience in spite of some lingering pain from higher mortgage rates. Home building looks like it grew at a 7.5% rate, which would add 0.3 points from real GDP growth. (7.5 times the 4% residential construction share of GDP equals 0.3).

**Government:** Only direct government purchases of goods and services (not transfer payments) count when calculating GDP. We estimate these purchases – which represent a 17% share of GDP – were up at a 1.8% rate in Q3, which would add 0.3 points to the GDP growth rate (1.8 times the 17% government purchase share of GDP equals 0.3).

**Trade:** Looks like the trade deficit shrank in Q3, as exports expanded rapidly in spite of foreign economic weakness. We're projecting net exports will add 0.5 points to real GDP growth.

**Inventories:** Inventories look like they grew a little bit faster in Q3 than in Q2, suggesting they'll add about 0.2 points to the growth rate of real GDP. When a recession hits, we expect inventory declines to play a significant role in the drop in GDP.

Add it all up, and we get a 4.7% annual real GDP growth rate for the third quarter. Look for much slower growth in the fourth quarter.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-25 / 9:00 am	New Home Sales – Sep	0.681 Mil	<b>0.684 Mil</b>		0.675 Mil
10-26 / 7:30 am	Initial Claims – Oct 21	208K	<b>205K</b>		198K
7:30 am	Q3 GDP Advance Report	+4.5%	<b>+4.7%</b>		+2.1%
7:30 am	Q3 GDP Chain Price Index	+2.7%	<b>+3.2%</b>		+1.7%
7:30 am	Durable Goods – Sep	+1.8%	<b>+3.4%</b>		+0.1%
7:30 am	Durable Goods (Ex-Trans) – Sep	+0.2%	<b>+0.2%</b>		+0.4%
10-27 / 7:30 am	Personal Income – Sep	+0.4%	<b>+0.4%</b>		+0.4%
7:30 am	Personal Spending – Sep	+0.5%	<b>+0.4%</b>		+0.4%
9:00 am	U. Mich Consumer Sentiment- Oct	63.0	<b>62.0</b>		63.0