Economic Update

November 29, 2023

Upward Revision to Q3 GDP; Profits Up Solidly

- **There was a modest upward revision to real GDP growth in the third quarter, to 5.2% from 4.9%. Inventories were a big contributor to third quarter growth, but demand was strong.**
- **Corporate profits rose more than 3% in the third quarter.**
- **Real gross domestic income increased a more modest 1.5% in the third quarter.**
- **PNC's baseline forecast is for a mild recession starting in mid-2024.**

Real GDP growth in the third quarter was revised somewhat higher to 5.2% at an annualized rate, according to the second estimate from the Bureau of Economic Analysis, from 4.9% in the advance estimate. This was the strongest quarter for GDP growth since the fourth quarter of 2021.

There were upward revisions to business fixed investment, state and local government, investment in housing, investment in inventories, and federal government spending. These were partly offset by downward revisions to consumer spending and exports.

Demand was strong in the third quarter, with consumer spending adding 2.4 percentage points to annualized growth. Inventories added 1.4 percentage points to growth in the third quarter. Residential investment increased for the first time since the first quarter of 2021.

On a year-over-year basis real GDP growth was 3.0%, the best pace since the first quarter of 2022.

Corporate profits rose 3.3% in the third quarter, not annualized and not adjusted for inflation. This was the second straight quarter of higher profits. Most of the increase in profits came from domestic nonfinancial corporations. On a year-over-year basis profits were down 0.7% in the third quarter.

Real gross domestic income, an alternative measure of the size of the economy that is based on the income to households and businesses, rose 1.5% at an annualized rate in the third quarter. This was the strongest quarterly growth in a year; real gross domestic income growth has been running behind real GDP growth. On a year-ago basis real gross domestic income was down 0.2%.

The U.S. economy is expanding in the second half of 2023. Although GDP growth in the third quarter was very strong, much of this came from inventories, which will be a drag in the near term. That being said, final demand (GDP minus inventories) was still solid in the third quarter, up 3.7% annualized. But this strong pace of demand will not persist. Households need to increase their saving as income growth slows, weighing on consumer spending. The drag from high interest rates will continue to accumulate, particularly in interest-rate sensitive segments like consumer durable goods, housing, and business investment. The weaker growth in real gross domestic income also suggests that GDP might be overstating the economy's strength.

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PNC expects a recession starting in mid-2024 as the drag from tight monetary policy continues to increase. But the recession should be short and mild, thanks to strong consumer balance sheets and a tight labor market that will discourage layoffs.

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