

October 31, 2022

More treats than tricks in third quarter GDP

Economic growth in the third quarter was much stronger than the first half of the year, but underlying details suggest slowing momentum heading into the fourth quarter. Additionally, new home sales fell sharply in September and are likely to continue to decline going forward as mortgage rates recently climbed to their highest level in over 20 years.

Real GDP growth returns to the right side of zero

After two negative quarters, economic growth climbed solidly in the third quarter as real GDP grew by 2.6 percent (annualized). The gain, which was larger than consensus expectations, reversed the modest declines seen in the first half and eases imminent recession fears.

Just as growth in the first half wasn't as poor as the figures showed, this reading somewhat overstates the strength of the economy going into the fourth quarter. Net exports accounted for all the headline growth, while consumers pulled back on discretionary goods spending due to high inflation and rising interest rates. Businesses spent solidly on equipment and software products, but that was more than offset by a steep decline in residential home construction. Final sales to private domestic purchasers — referred to as core GDP — grew by a meager 0.1 percent, its slowest growth since the Covid shutdown; excluding the pandemic period, this was the weakest pace of growth since the Great Recession.

Real GDP growth in the fourth quarter should be slower with little momentum on the consumer side and trade unlikely to experience another surge. Still, the onset of a recession appears to be a few quarters away, especially with positive labor market trends likely to support growth.

Consumers continue to spend despite inflation; new home sales decline

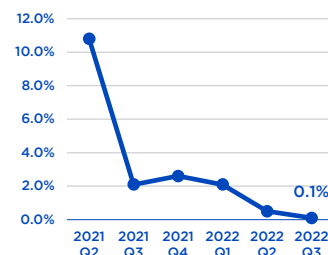
Personal income climbed by a solid 0.4 percent in September due to a 0.6 percent increase in nominal wages. The purchasing power of that additional income, however, was mostly offset by higher prices. Core PCE inflation, which strips out the volatile food and energy components, climbed by 0.5 percent, and the 12-month change rose to 5.1 percent, a six-month high.

Despite the fast pace of inflation, consumer spending remained resilient, growing by 0.6 percent for September and 0.3 percent in inflation-adjusted terms. Consumption on services led the way once again; services expenditures were stronger than goods spending for the fifth time in the last six months. Personal saving as a percent of disposable income fell to 3.1 percent — less than half the 30-year median — as households increasingly dip into savings to pay for current expenses.

Elsewhere, new home sales fell by 10.9 percent in September to a seasonally adjusted rate of 603,000 units as soaring borrowing costs scare off many buyers. While up from July's low, sales have dropped by more than 28 percent from December 2021. The median sales price for a new home climbed significantly in September and was only modestly below July's record high. With year-over-year growth at 13.9 percent, the cost for a new home remains elevated with prices for labor and materials up sharply. Sales are expected to fall further in coming months as mortgage rates continue to spike; the 30-year fixed mortgage rate climbed above 7.0 percent for the first time in more than 20 years in October.

Downward trend in core growth

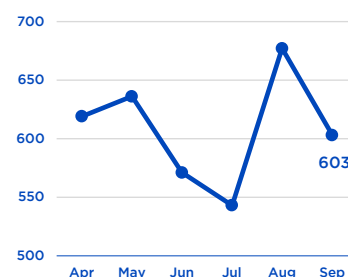
Final sales to private domestic purchasers, annualized



Final sales to private domestic purchasers, also known as core GDP, continued its downward trend and was virtually flat in the third quarter.

New home sales fall as mortgage rates rise

New home sales, seasonally adjusted annual rate, thousands



New home sales fell sharply in September as builders shift away from single-family homes with mortgage rates at 20-year highs.

Sources:
Bureau of Economic Analysis; Census Bureau

The Week Ahead

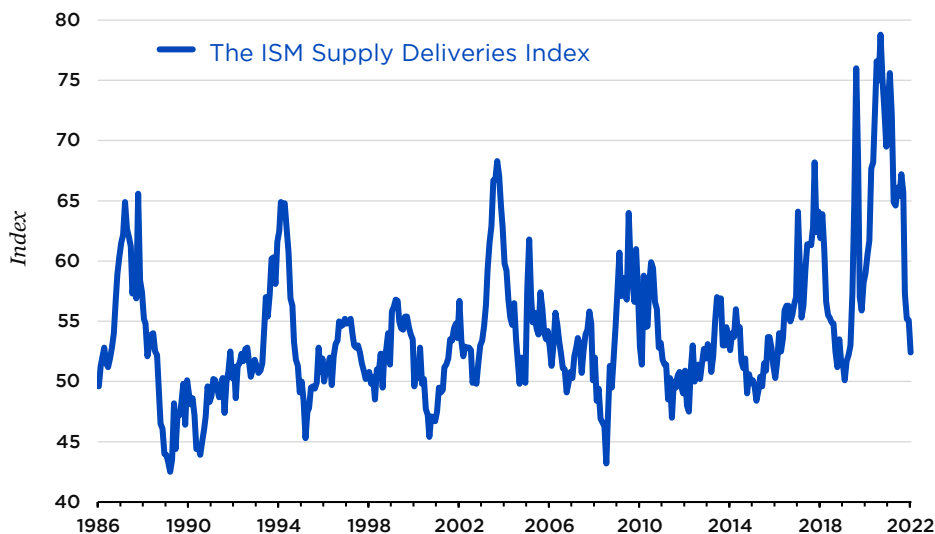
Here's what we are watching this week — in addition to the November FOMC meeting:

ISM
Manufacturing



↓ Slightly weaker manufacturing activity

The manufacturing expansion likely continued in October, albeit at a modest rate with even weaker new orders. Anxiety about a recession has made purchase managers nervous, forcing firms to use back orders to keep production steady. But the order pause has given supply chains a chance to heal. The supplier delivery index shows that shipping delays are nearly at an end, helping to ease input costs for producers.



Sources: Institute for Supply Management

Labor
Productivity



↓ Productivity expected to level off

Less drag from higher compensation and the return of positive economic growth should leave third-quarter labor productivity only modestly under the second quarter's reading, a meaningful improvement from the previous period's four percent retreat. Output per worker remains moderately above the 2019 level, giving firms some relief from wage pressures.

Nonfarm
Payrolls



↑ Solid employment gains should continue

October job gains are expected to exceed 200,000 as total employment gains for 2022 approach four million. Labor conditions should remain tight with another sub-four percent unemployment reading — with more good news for workers in the form of healthy wage gains. Still, some potential workers remain on the sidelines, keeping the labor force near its pre-pandemic levels and offering employers few candidates.

Additional Economic Indicators

Previous Week's Indicators

	Period	Actual	Previous
Chicago Fed National Activity Index	September	0.1	0.0
S&P Global US Manufacturing PMI	October	49.9	52.0
S&P CoreLogic CS 20-City YoY	August	13.1	16.0
Conf. Board Consumer Confidence	October	103	108
Richmond Fed Manufact. Index	October	-10	0
Advance Goods Trade Balance	September	-\$85.2 b	-\$87.3 b
New Home Sales	September	603 k	677 k
Durable Goods Orders	September	0.4%	0.2%
GDP Annualized QoQ	Third Quarter	2.6%	-0.6%
GDP Price Index	Third Quarter	4.1%	9.0%
Initial Jobless Claims	Week ending October 22	217,000	214,000
Continuing Claims	Week ending October 15	1,438 k	1,383 k
Kansas City Fed Manufacturing Activity	October	-7	1
Employment Cost Index	Third Quarter	1.2%	1.3%
Personal Income	September	0.4%	0.4%
Personal Spending	September	0.6%	0.6%
Real Personal Spending	September	0.3%	0.3%
PCE Core Deflator MoM	September	0.5%	0.5%
PCE Core Deflator YoY	September	5.1%	4.9%
Pending Home Sales MoM	September	-10.2%	-2.0%
U. of Mich. Sentiment	October	59.9	59.8

This Week's Indicators

	Release Date	Period	Forecast*	Previous
Dallas Manufacturing Activity	Monday	October	-12.0	-17.2
S&P Global US Manufacturing PMI	Tuesday	October	50.1	49.9
JOLTS Job Openings	Tuesday	September	9,400 k	10,053 k
Construction Spending MoM	Tuesday	September	-0.4%	-0.7%
ISM Manufacturing	Tuesday	October	50.5	50.9
ADP Employment Change	Wednesday	October	150,000	208,000
Federal funds rate (lower bound)	Wednesday	November 2	3.75%	3.00%
Initial Jobless Claims	Thursday	Week ending October 29	230,000	217,000
Continuing Claims	Thursday	Week ending October 22	1,480 k	1,438 k
Trade Balance	Thursday	September	-\$80.0b	-\$67.4b
Nonfarm Productivity	Thursday	3Q	-0.4%	-4.1%
ISM Services Index	Thursday	October	56.0	56.7
Factory Orders	Thursday	September	0.2%	0.0%
Change in Nonfarm Payrolls	Friday	September	225,000	263,000
Unemployment Rate	Friday	September	3.6%	3.5%
Average Hourly Earnings YoY	Friday	September	0.3%	0.3%



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