

US Macroeconomics

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Boom Before the Bust

The Atlanta Fed’s current tracking estimate for Q3 real GDP growth is 5.8%. If that is accurate and not revised, it will be the largest non-pandemic quarterly increase since Q3 2003 (6.8%). But that increase was the result of the Jobs and Growth Tax Relief Reconciliation Act of 2003. There is no such legislation today.

The predicted spurt in Q3 2023 real GDP is not the result of either the 2022 Inflation Reduction or the CHIPS and Science Acts. This is evident from the latest CBO scoring which projects inflation-adjusted government appropriations rising by only 1% per annum from the remainder of 2023 thru 2025.

Moreover, the expected pop in real GDP growth is due to stronger consumer spending (4.8%) and a bounce-back in residential investment (11.4%). Incidentally, the latter would break a long string of nine consecutive quarterly declines. **We estimate that Q3 output rose a lesser but still strong 3.5% last quarter,** which is also near the New York Fed’s GDP Nowcast. What is behind this projected strength?

It could be nothing more than one last surge in real GDP growth before the onset of recession. Indeed, this is a relatively common phenomenon. Investors may not want to extrapolate from the current quarter’s predicted boom.

For example, **real GDP growth boomed in Q1 1960, rising over 9%. Yet, the economy was in recession the next quarter.** In Q4 1973, real GDP expanded nearly 4%. Remarkably, this was also the quarter the economy entered recession! History repeated in 1981.

Real GDP was booming, growing almost 5% in Q3 1981. Yet this, too, was the quarter in which the economy entered recession. No wonder it is so hard for economists to predict recessions!

More recent history shows a similar pattern. **While not a boom, real GDP was performing solidly right up to the economic inflection points of 2001 and 2008.** Growth rose 2.4% and 2.5%, respectively, in Q4 2000 and Q4 2007. But these quarters marked the peak in economic output, as downturns began immediately thereafter.

What’s next? Given record fast (and large) interest rate hikes, a deeply inverted Treasury yield curve, tightening commercial bank lending standards and a collapse in the Index of Leading Economic Indicators, it is doubtful the economy will experience a soft landing. While a recession may still be a ways away, we caution investors to not read much into the possibility that the economy is expanding rapidly this quarter.

Boom Before the Bust				
Boom	Growth (%)		Bust	Drop (%)
Q1 1960	9.3	→	Q2 1960	-2.1
Q4 1973	3.9	→	Q1 1974	-3.4
Q3 1981	4.9	→	Q4 1981	-4.3
Q4 2000	2.4	→	Q1 2001	-1.3
Q4 2007	2.5	→	Q1 2008	-1.6
Q3 2023	3.5*	→	Q4 2023	?

*= SMBC Forecast

Sources: Philadelphia FRB, SMBC Nikko

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