U.S. Economy Grows 3.5 Percent

Bolstered by consumer spending and a narrowing trade deficit, GDP grows further despite weakness abroad.

By Katherine Peralta
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Amidst global economic instability, the U.S. economy continued to grow in the third quarter. Its gross domestic product grew at an annual rate of 3.5 percent, beating the consensus estimate of Bloomberg-surveyed economists, who called for an expansion of 3 percent.

The released Thursday is the Commerce Department's first estimate of economic growth for the July through September period; it'll issue two more estimates that reflect updated data. This quarter's growth was buttressed by household spending, exports, government spending and what's called nonresidential fixed investment, or plant construction and equipment purchasing.

In the second quarter, the economy grew at an annual rate of 4.6 percent, a burst of growth Amherst Pierpont chief economist Stephen Stanley called "clearly not sustainable" following a weather-depressed first quarter, when the economy shrank.

Looking ahead, some worry instability abroad may threaten U.S. growth. But there may be good reason to believe that economic fundamentals at home will prevail.

"Things in Europe look tenuous [and] we've seen slowed growth in China but I think the internal drivers of the U.S. economy are strong enough to overcome that," says Gus Faucher, senior economist at PNC Financial

Services. “So I don’t expect to see anything overseas that would push the economy not only back into recession but a significant weakening in growth.”

The Strong

Helping to boost the GDP reading was a 1.8 percent rise in consumer spending, which makes up about two-thirds of the economy. That’s a slight slowdown from the 2.5 percent increase the prior period.

Looking to the fourth quarter, consumer wallets are likely to feel continued relief from lower prices at the pump. The price nationwide of a gallon of unleaded regular gas hit $3.04 this week, the lowest level in almost four years, according to AAA. Morgan Stanley economists see this as providing a big tailwind for consumers heading into the retail-important holiday shopping season this quarter.

“We can’t underestimate the impact that lower gas prices are going to have on the consumer,” Ellen Zentner, a senior economist at Morgan Stanley, said in a video sent to clients. “We’re already seeing that reflected in higher consumer confidence numbers and we think that will boost annualized growth in real consumer spending by 0.4 to 0.6 percent in the fourth quarter alone.”

Continued strong job gains would also bode well for consumer spending down the road. Job growth has averaged 227,000 per month so far in 2014, the best clip of gains since 1999. This morning the Labor Department reported that the four-week average number applications for jobless benefits remain near a 14-year low. The Labor Department will release its monthly employment report next Friday.

The Head-Scratcher

A shrinking trade deficit was one more plus for the most recent GDP growth. Exports rose 7.8 percent in the third quarter, compared with an increase of 11.1 percent in the second. Imports, which are a drag on GDP, decreased 1.7 percent, compared with a rise of 11.3 percent in the second quarter.

Bernard Baumohl, chief global economist at the Economic Outlook Group, calls the export figures “a bit of a head-scratcher.”

For one, anemic growth in Europe prompted a decision from its central bank this week to start injecting the economy with 1.7 billion euros in asset purchasing to stimulate growth through easier lending and spending. Further, China last week said its economy grew at the slowest pace in more than five years.

Responding to weak economic conditions abroad, the U.S. dollar has strengthened in value against other currencies. This makes exports relatively more expensive and could moderate future growth.

“Why, if there is so much weakness abroad, are we still seeing such strong growth in exports?” **Baumohl** says, noting the U.S. has been importing less oil from overseas. This means more domestic oil production, a boost for manufacturing.

The Risks

The biggest downside risks to further growth are uncertain, but could come from abroad, many economists including **Baumohl** say, and could be anything from the Middle East, Eastern Europe, Ebola or unrest over protesting in Hong Kong.

“Without question biggest threat to this recovery is not going to stem from misguided policy here in the United States. The biggest threat to the U.S. economy will come from overseas,” **Baumohl** says. “More likely it will be the result of some geopolitical event erupting that could jolt the global economy.”

The U.S. central bank is confident enough in the underlying strength of the U.S. economy that it decided this week to end a stimulus program intended to jolt life into the recovery.

“The committee continues to see sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in a context of price stability,” the Federal Open Market

Committee statement said. It also noted that labor market slack is “gradually diminishing.”

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