



Third Quarter GDP Handily Tops Estimates

Growth Reaccelerates, but the Signal is Nuanced

- ▲ **Q3 real GDP jumped 4.3%**, the fastest pace of 2025, but the headline was amplified by swings in trade, inventories, and government spending rather than a step-change in underlying demand.
- ▲ **Core private domestic demand grew a solid 3.0%**, maintaining its recent strong pace and confirming continued expansion.
- ▲ **Consumer spending perked up**, led by health care, travel, professional services, recreational goods, and prescription drugs, signaling ongoing resilience.
- ▲ **Investment remained uneven**, with further inventory drawdowns weighing on growth, particularly in manufacturing, trucking, and warehousing.
- ▲ **Inflation firmed at the margin**, with core PCE rising at a **2.9% annual rate in Q3 and also up 2.9% year-over-year**.
- ▲ *The third quarter delivered a headline surge in growth, but the signal beneath the noise points to a resilient—rather than overheating—economy, increasingly driven by business fixed investment and value-conscious consumer spending.*

A Strong Headline, Filtered Through the Noise

Real GDP accelerated sharply in the third quarter, rising at a **4.3% annualized pace**, marking the strongest quarterly growth rate of 2025. On the surface, the report suggests a decisive reacceleration in economic momentum following solid growth in the first half of the year. Beneath the headline, however, the picture is more nuanced. **Core private domestic demand advanced at a still-healthy but far less dramatic 3.0%**,

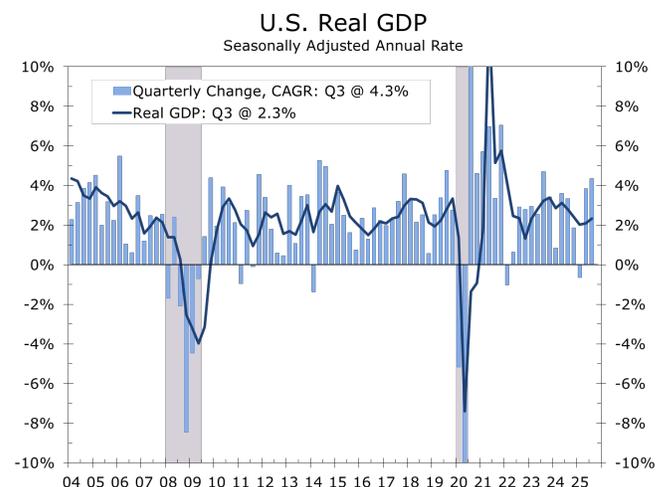
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measured through a release affected by the recent federal government shutdown.

The economy is growing—but not at the breakneck pace the headline implies. We continue to stress that **real final sales to private domestic purchasers** provide a more reliable assessment of the economy's underlying momentum.

Averaging GDP and GDI points to growth near the upper end of trend—not a breakout.

Income-side measures reinforce this interpretation. **Real gross domestic income (GDI) rose at a 2.4% pace**, notably below the headline GDP gain and more closely aligned with trend growth in labor income and profits. Because GDI is constructed from wages, salaries, profits, and other income flows, it is typically less sensitive to short-term swings in trade and inventories that can distort GDP in any single quarter. **Averaging GDP and GDI, which rose 3.4% in Q3, offers a more balanced read on underlying activity**, particularly in a quarter affected by data disruptions.



Source: Bureau of Economic Analysis (BEA)

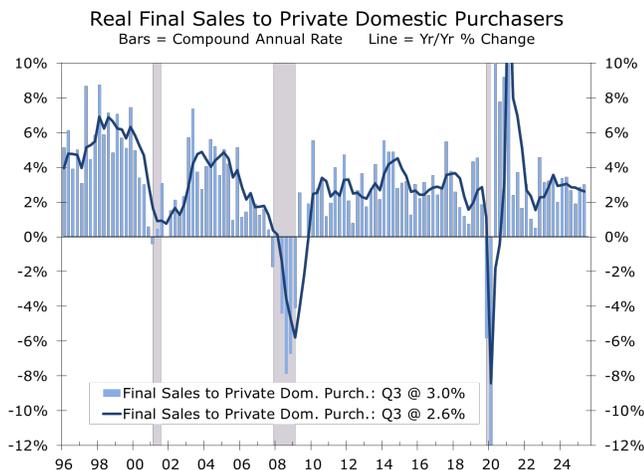


Historically, **gaps between GDP and GDI tend to emerge late in the cycle**, when investment surges, inventory swings, or policy timing inflate measured output even as income growth slows. A comparable episode occurred in **late 1999**, when headline GDP growth remained strong amid the tech boom, but **GDI and labor income growth had already begun to cool**, signaling that momentum was becoming increasingly concentrated in investment and asset-driven activity. In that period, GDP continued to look robust even as income-based measures provided an earlier warning that underlying growth was losing breadth.

Core GDP remains the most reliable signal, reflecting resilience, not re-acceleration.

The cleanest read on underlying momentum comes from **real final sales to private domestic purchasers**, or core GDP, which rose at a **3.0% pace**, modestly above Q2's 2.9%. By stripping out inventories, trade, and government spending, this measure confirms **private demand remains firmly expansionary**.

Consumer spending reaccelerated across both services and goods. Services gains were led by health care, international travel, and professional services. Goods spending was supported by recreational goods, vehicles, and prescription drugs, with information processing equipment again contributing meaningfully.



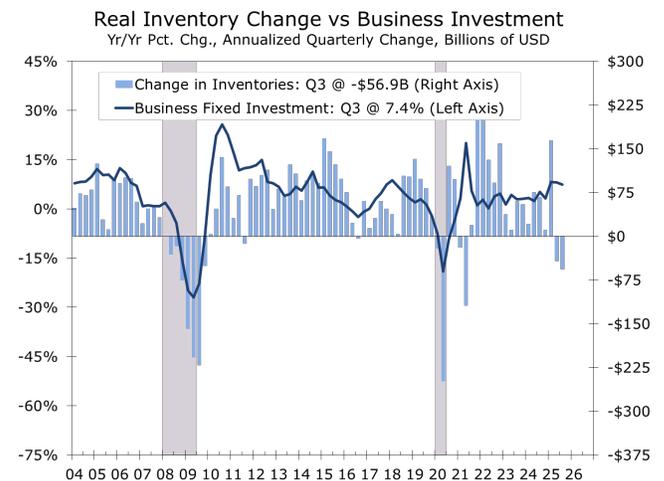
Source: Bureau of Economic Analysis (BEA)

Real disposable income growth slowed during the quarter, suggesting that recent spending strength is being supported in part by a lower saving rate and wealth effects rather than accelerating labor income. The decline in saving was **exacerbated by a spike in light vehicle sales**, as households pulled purchases forward ahead of the expiration of attractive electric vehicle tax credits. Together, these dynamics reinforce evidence of a **K-shaped consumer**, with higher-income households driving discretionary categories such as travel, recreation, and professional services.

Saving fell due to timing, not stress, as EV purchases were pulled forward.

Private investment remained a modest drag on growth, but far less so than in prior quarters. The decline was driven primarily by **inventory liquidation**, particularly in wholesale trade and manufacturing. Inventories were built up earlier in the year ahead of tariffs, and businesses have since been drawing down stocks as trade relationships are refined.

Gross private fixed investment held up better than the headline suggests, reinforcing the view that businesses remain cautious but not retreating. Growth slowed outside of data-center-related construction, with intellectual property investment cooling modestly and structures investment weakening as factory and mining construction softened following earlier front-loaded buildouts.



Source: Bureau of Economic Analysis (BEA)



Trade and Government Flatter the Headline

Exports rebounded in the third quarter, supported by gains in both goods and services. Imports declined again, boosting measured GDP but complicating interpretation of domestic momentum. These trade dynamics have become a recurring source of volatility in recent quarters and are best viewed as amplifiers rather than drivers of the business cycle.

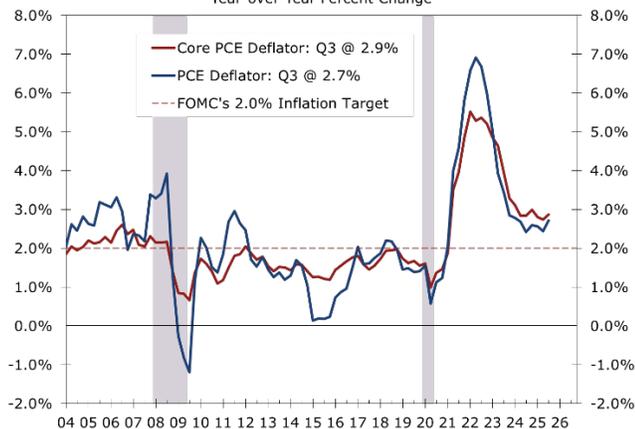
Government spending also contributed positively, with increases at both the federal and state and local levels. Defense spending led the federal gains, while state and local consumption expenditures also rose. As with trade, these contributions lift the headline but offer limited insight into the sustainability of private-sector growth.

Inflation Moves the Wrong Way at the Margin

Inflation data were less reassuring. The **gross domestic purchases price index rose at a 3.4% pace**, while **PCE inflation accelerated to a 2.8% pace** and **core PCE increased to 2.9%**. While inflation remains well below its 2022 peak, the third-quarter uptick was already apparent in earlier CPI data.

Encouragingly, core capital goods prices remain well behaved, suggesting that underlying investment-related inflation pressures are contained even as headline deflators temporarily firm. With tariff effects now largely reflected in the data, we look for the deflators to follow the CPI lower in coming quarters.

Personal Consumption Price Deflator
Year-over-Year Percent Change



Source: Bureau of Economic Analysis (BEA)

Profits Quietly Improve

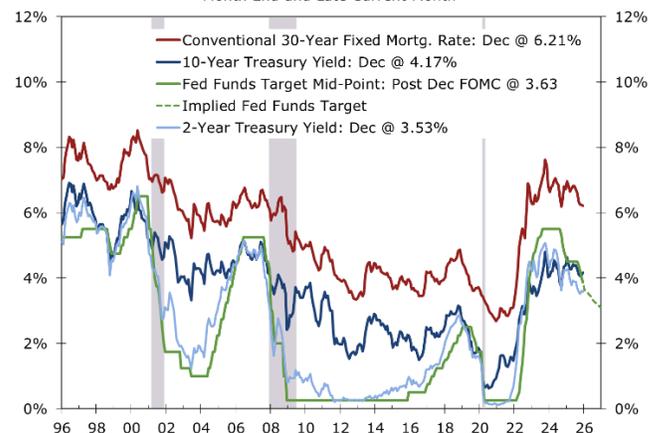
Corporate profits from current production increased **\$166 billion** in the third quarter, a sharp rebound from the prior period. Combined with steady income growth, this improvement supports margins, balance sheets, and capital spending optionality heading into 2026. This aspect of the report received less attention than the headline GDP number but remains an important underpinning for medium-term growth

Policy and the Road Ahead

From a policy perspective, the third-quarter report argues for **flexibility rather than urgency**. Growth remains above potential, inflation has firmed modestly, and labor income continues to support demand. At the same time, the absence of broadening inflation pressure and signs of cooling outside of AI-related investment argue against renewed tightening.

The most likely outcome is a for the **Fed to cut rates more slowly, by perhaps cutting at every other FOMC meeting**, which will not only allow for a clearer read of the data but also extend the easing cycle. The expansion remains intact, underlying momentum is moderating gradually. Yet the labor market is still deserving of additional Fed support but without undermining hard-won progress at reducing inflation.

10-Year Treasury, Mortgage Rate & Fed Funds
Month End and Late Current Month



Source: Bureau of Economic Analysis (BEA) and Federal Reserve

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