

Growth Continued in Q4

We still believe the odds of a recession are higher than most investors think. Monetary policy tightening started back in 2022 and inflation remains above the Federal Reserve’s 2.0% target, which means the Fed will be reluctant to get loose anytime soon.

Meanwhile, the federal budget deficits in the past two years have averaged roughly 6.5% of GDP, which is enormous considering the US was not at war and the unemployment rate averaged about 4.0% during the same timeframe. We think those deficits have temporarily masked or hidden some of the pain the economy will eventually feel from the tightening of monetary policy compared to a few years ago. Now, in the short run, reducing government spending, like on “green energy” and Medicaid may temporarily reduce economic growth.

However, in the meantime, the economy continued to grow in the fourth quarter. Innovators and entrepreneurs in high-tech industries and elsewhere have been overcoming government obstacles to push the economy forward. And if the new Administration in Washington moves swiftly to deregulate, there is a chance this will continue.

For the fourth quarter itself, we estimate that Real GDP expanded at a 2.8% annual rate, mostly accounted for by growth in consumer spending. (This 2.8% estimate is not yet set in stone; reports on Tuesday about durable goods and Wednesday about international trade and inventories might lead to an adjustment.)

Consumption: Auto sales soared at a 26.4% annual rate in Q4, the fastest pace for the year, while “real” (inflation-adjusted) retail sales excluding autos climbed at a tepid 1.2% rate. Real service spending appears up a moderate 2.3% pace, bringing our estimate of real consumer spending on goods and services, combined, to a 3.1% rate, adding 2.1 points to the real GDP

growth rate (3.1 times the consumption share of GDP, which is 68%, equals 2.1).

Business Investment: We estimate a 2.9% growth rate for business investment, with gains in intellectual property leading the way and business investment in equipment as well as commercial construction both up slightly. A 2.9% growth rate would add 0.4 points to real GDP growth. (2.9 times the 14% business investment share of GDP equals 0.4).

Home Building: Residential construction rose at a moderate pace in the fourth quarter, buffeted between a lack of housing supply (which should boost growth) and higher mortgage rates (which should dampen construction). Home building looks like it grew 2.5% rate, which would add 0.1 points to real GDP growth. (2.5 times the 4% residential construction share of GDP equals 0.1).

Government: Only direct government purchases of goods and services (not transfer payments) count when calculating GDP. We estimate these purchases were up at a 2.3% rate in Q4, which would add 0.4 points to the GDP growth rate (2.3 times the 17% government purchase share of GDP equals 0.4).

Trade: The trade deficit looks like it was stable in the fourth quarter, with neither imports nor exports changing much on net versus the third quarter, in spite of monthly volatility due to the threat of and actual port strikes. We’re projecting net exports will have zero net influence on Q4 real GDP growth.

Inventories: Inventory accumulation looks like it was slightly slower in Q4 than Q3, translating into what we estimate will be a 0.2 point subtraction from the growth rate of real GDP.

Add it all up, and we get a 2.8% annual real GDP growth rate for the fourth quarter. As we’ve been saying, not a recession yet, but that doesn’t mean that the US economy is out of the woods.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-27 / 9:00 am	New Home Sales – Dec	0.675 Mil	0.671 Mil		0.664 Mil
1-28 / 7:30 am	Durable Goods – Dec	+0.5%	-3.3%		-1.2%
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.4%	+0.4%		-0.2%
1-30 / 7:30 am	Initial Claims – Jan 25	225K	218K		223K
7:30 am	Q4 GDP Advance Report	+2.7%	+2.8%		+3.1%
7:30 am	Q4 GDP Chain Price Index	+2.5%	+2.7%		+1.9%
1-31 / 7:30 am	Personal Income – Dec	+0.4%	+0.4%		+0.3%
7:30 am	Personal Spending – Dec	+0.5%	+0.5%		+0.4%
8:45 am	Chicago PMI – Jan	40.0	39.4		36.9