US Macroeconomics

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What Should We Make of Strong GDP?

The first estimate of Q4 real GDP was much better than expected, rising 3.3% at an annualized rate following a huge 4.9% increase in the previous quarter. **Over the last year, the economy grew a solid 3.1%**. The biggest contributor was the consumers. Household spending grew 2.8% and contributed nearly 60% of Q4's bottom line.

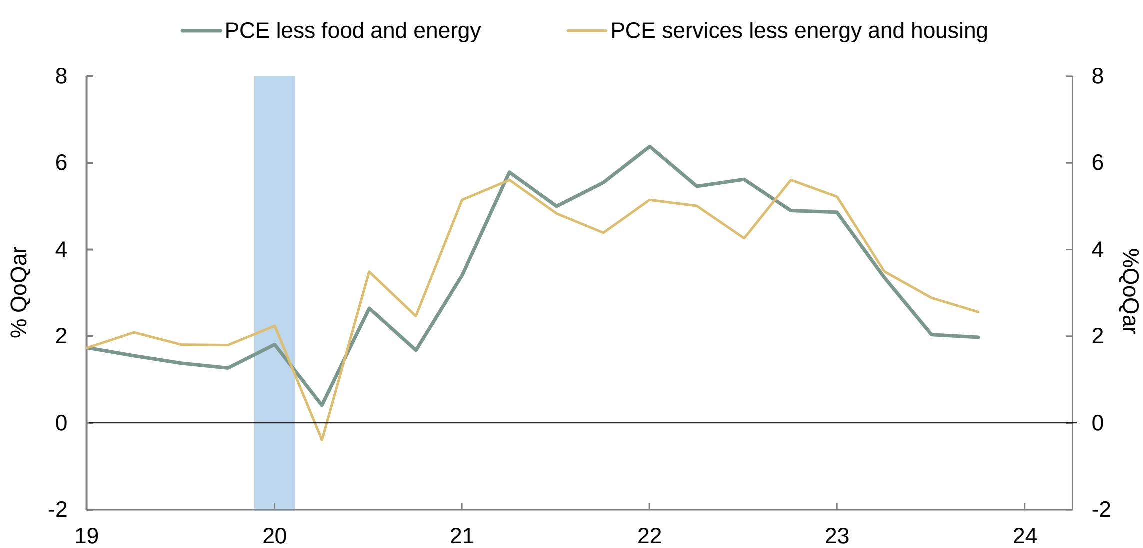
Business fixed investment increased a slight 1.7%, and residential (1.0%) was soft, too. The inventory contribution was nearly zero, and net exports added 40 basis points. Government spending continues to add to measured output, adding about 60 bps to output, its sixth consecutive quarterly increase.

Finally, real final sales to private domestic purchasers (i.e., GDP plus imports less exports, inventories, and government) rose 2.6%. While weaker than overall real GDP, the former's performance was solid, suggesting that underlying aggregate demand is holding up despite the persistence of restrictive monetary policy.

Arguably more important than the better Q4 GDP performance was the ongoing slowing in inflation, as illustrated in the chart below. The core PCE deflator increased just 2.0% at annualized rate last quarter, its second 2% reading in a row. Moreover, PCE services excluding energy and housing (i.e., the super core) was up only 2.6%, its lowest reading in three years. With employment costs tracking the collapse in the labor quits rate, itself at a near five-year low, the growth in the super core is destined to slow further.

So why is the economy performing so admirably? One, growth may not be as strong as it appears. For example, **growth in real gross domestic income (GDI) has not kept up with growth in real GDP**. Q4 GDI is released on March 28th. Through Q3 2023, the latest available data, real GDI fell 0.2% over the previous four quarters compared to a 2.9% increase for real GDP. The resulting "statistical discrepancy" is one of the largest on record. The fact that nonfarm payrolls, which capture the income-side of the economy and have been revised down in 10 out of the last 11 months, strongly suggests that GDP gains are overstating economic performance.

Two, **massive government spending is keeping demand stronger than it otherwise would be regardless of the specific economic yardstick used**. Our work has shown that there has been a record large $3.3 trillion in cumulative excess federal spending since January 2021. See our note titled "The Real Story is Excess Government Spending" on January 12, 2024. Consequently, we are leery that the latest GDP data tell the full story on the economy's health.



Source: BEA, Haver, SMBC Nikko

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