ECONOMIC UPDATE

REGIONS

January 28, 2021

Q4 2020 GDP: Setting The Stage For An Uneven Start To 2021

- The BEA's initial estimate shows real GDP grew at an annualized rate of 4.0 percent in Q4 2020
- Consumer spending, business fixed investment, and residential fixed investment were the main drivers of Q4 growth

Real GDP expanded at an annualized rate of 4.0 percent in Q4 2020, less than the consensus forecast of 4.2 percent growth and our forecast of 5.2 percent growth. Real private domestic demand grew at an annualized rate of 5.6 percent, which was countered by further contraction in government spending and a wider trade deficit. While business fixed investment grew faster than our forecast anticipated, growth in consumer spending and the build in nonfarm business inventories both came in shy of our forecast. For full-year 2020, real GDP contracted by 3.5 percent. As of Q4 2020, the level of real GDP stood 2.5 percent below that of Q4 2019, a gap we anticipate will be closed in Q3 2021. As we do each quarter, we'll note that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, is prone to sizable revision.

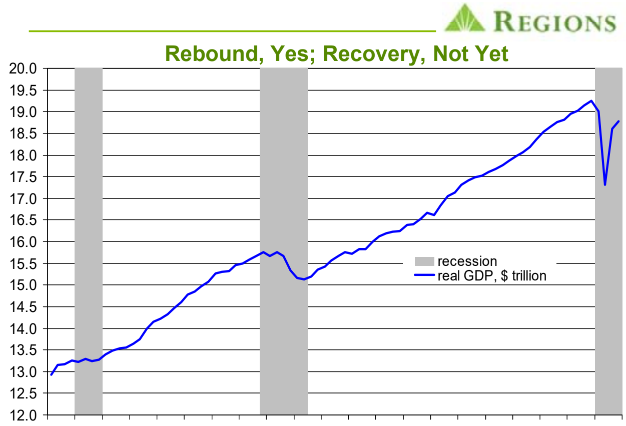
Real consumer spending grew at an annualized rate of 2.5 percent in Q4, which added 1.70 percentage points to top-line real GDP growth. Growth in total consumer spending in Q4 was more than accounted for by growth in spending on services, as spending on goods contracted. Spending on consumer durable goods was flat in Q4, with higher spending on motor vehicles negated by lower spending on household furnishings and appliances and lower spending on recreational goods/vehicles. Spending on nondurable consumer goods contracted at an annualized rate of 0.7 percent in Q4. Recall that consumer spending ended Q3 2020 on a strong note and posted a further advance in October before deteriorating over the final two months of Q4. While the December data on consumer spending were incorporated into today's GDP release, the monthly data will not come out until tomorrow. If real consumer spending declined in December, as we anticipate, that will leave the level of spending in December below the Q4 average, meaning that consumer spending carried little momentum into 2021. This is one reason behind our expectations of weak Q1 real GDP growth, and the December data on consumer spending will help refine our forecast Q1 growth.

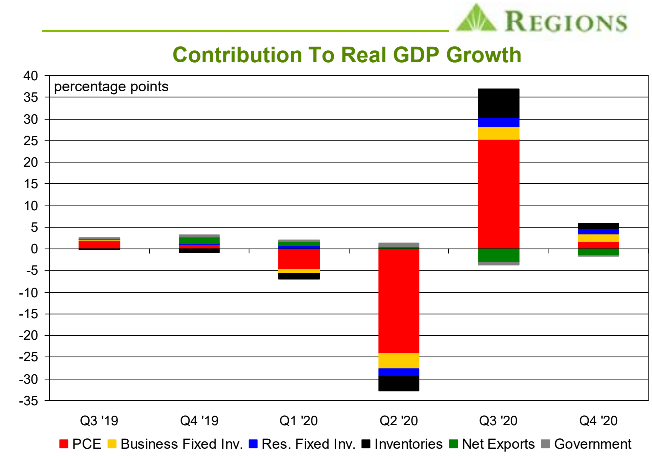
Real business fixed investment grew at an annual rate of 13.8 percent in Q4, adding 1.73 percentage points to top-line real GDP growth. Spending on equipment and machinery rose at an annualized rate of 24.9 percent, spending on intellectual property products rose at an annualized rate of 7.5 percent, and spending on structures rose at an annualized rate of 3.0 percent. Growth in each category was faster than our forecast anticipated, but it is the growth in spending on structures that is the most surprising.

Residential fixed investment grew at an annualized rate of 33.5 percent in Q4, adding 1.29 percentage points to top-line real GDP growth. Continued rapid growth in single family construction and continued strength in spending on home improvement projects were the main drivers of growth in residential fixed investment in Q4, with a smaller contribution from growth in multi-family construction.

To the downside, the trade deficit widened considerably in Q4; while real exports of both goods and services grew further in Q4, growth in imports was even faster on both fronts, hence the wider trade deficit. The wider trade deficit trimmed 1.52 percentage points from top-line real GDP growth. Real government spending contracted at an annualized rate of 1.2 percent in Q4, deducting 0.22 percentage points from top-line real GDP growth. On the federal level, while real defense outlays grew at an annual rate of 5.0 percent, real non-defense outlays dropped at a rate of 8.4 percent. Still, even with back-to-back quarterly declines, the level of total federal government spending is still easily above the pre-pandemic level. State and local government spending fell at a 1.7 percent rate in Q4, the third consecutive quarterly decline. This raises an important, yet often overlooked point, which is that even should the federal government provide financial support to state and local governments, it will go more toward filling in a hole than toward being additive to overall growth.

The economy got off to an uneven start in 2021, with strength in manufacturing and single family residential construction and sales set against flagging consumer spending. While it is reasonable to expect the economy to be performing more strongly at the end of 2021 than at the beginning, when a transition to faster growth will occur remains highly uncertain and depends much more on progress on the vaccine front than however much more fiscal policy support there will be.





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