ECONOMIC UPDATE

REGIONS

January 30, 2025

Q4 2024 GDP – 1st Estimate: Soft Headline Masks Strong Private Domestic Demand

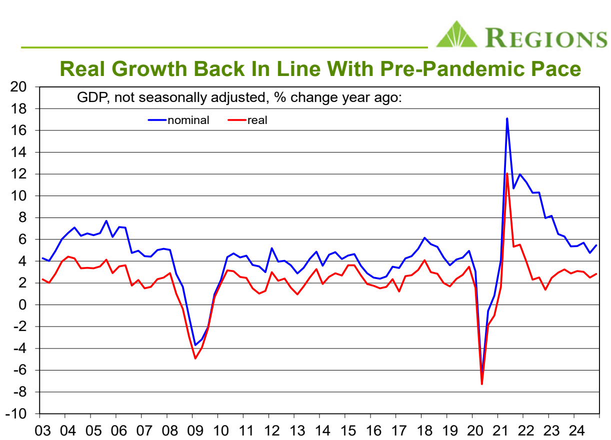
- The BEA's initial estimate shows real GDP grew at an annualized rate of 2.3 percent in Q4 2024 after growth of 3.1 percent in Q3
- Consumer spending, residential fixed investment, and government spending were the main drivers of Q4 growth

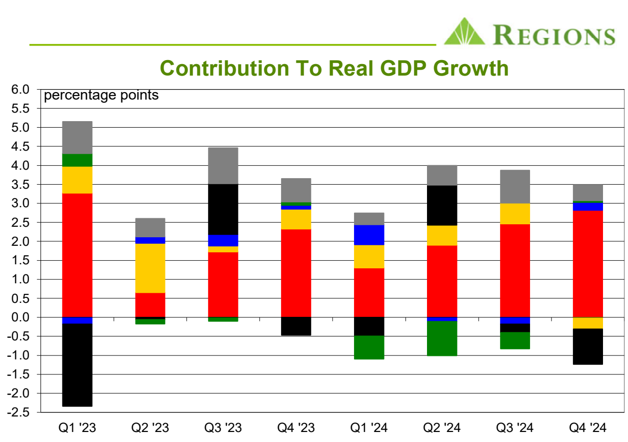
The BEA's initial estimate puts Q4 real GDP growth at an annual rate of 2.3 percent, well short of our above-consensus forecast of 2.9 percent. That comes as no surprise after Wednesday's release of the advance data on international trade in goods and wholesale/retail inventories for the month of December. The data showed a larger trade deficit and weaker inventory accumulation than we had anticipated, all but dooming our Q4 real GDP growth forecast. That said, we routinely point to inventory accumulation and trade as swing factors in the GDP data, in that these components tend to be highly volatile from quarter-to-quarter which can, and often does, skew the headline GDP growth print. As such, we routinely cite real private domestic demand, or, combined business and household spending, as the better gauge of the underlying health of the U.S. economy. To that point, real private domestic demand grew at an annual rate of 3.2 percent, only modestly slower than the 3.4 percent pace set in Q3, as solid growth in consumer spending and residential fixed investment offset a slump in business fixed investment. For full-year 2024, real GDP grew by 2.8 percent, the second straight year in which real GDP growth easily outpaced what we consider to be the economy's sustainable longer-term pace. As is our custom, we'll note here that the BEA's initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision as the gaps in the data are filled in. Either way, the stumble on trade and inventories notwithstanding, the U.S. economy ended 2024 on firm footing.

Real consumer spending grew at an annual rate of 4.2 percent in Q4, which added 2.82 percentage points to top-line real GDP growth. Real goods spending grew at a 6.6 percent rate, even faster than the 5.6 percent pace logged in Q3, with growth dominated by spending on consumer durable goods such as motor vehicles and recreational goods and vehicles. Real services spending grew at a more sedate pace of 3.1 percent in Q4, but this was nonetheless an acceleration from the pace set in Q3, with a notable pick-up in growth in our proxy for discretionary services spending. That spending was so strong in Q4 goes to our point about the supports for discretionary spending pushing aggregate spending measures higher despite many of lower-to-middle income households struggling with the effects of cumulative price increases over the past few years. This does, however, point to a downside risk for discretionary spending in 2025 should there be a meaningful correction in equity prices and/or a significant and broadly based decline in house prices.

We did not, based on the monthly data on core capital goods orders, expect much from business fixed investment in Q4, and yet we got even less. Real spending on equipment and machinery tumbled at an annual rate of 7.8 percent in Q4, knocking 0.42 percentage points off top-line real GDP growth. As we noted in our preview of the Q4 GDP data, while core capital goods orders firmed over the final months of 2024, it will take some time for this to turn up in the GDP data, which incorporate shipments, not orders, of core capital goods. Growth in spending on intellectual property products slowed to an annual rate of 2.6 percent in Q4 from the 3.1 percent pace seen in Q3. As we routinely note, spending on intellectual property products, the bulk of which consist of outlays on software and R&D, tends to front-run productivity growth, so continued investment in these areas will be key to sustaining the acceleration in labor productivity growth seen over the past several quarters. An offset to business fixed investment being weaker than we anticipated in Q4 was growth in residential fixed investment being stronger than we anticipated. We do not, however, hold out hope of this being sustained into 2025 given the extent to which elevated mortgage rates are weighing on construction of new single family homes, though a stepped-up pace of multi-family activity will likely act as at least a partial offset.

Though business inventories grew in Q4, that they grew by a substantially smaller amount than in Q3 meant they were a drag on top-line real GDP growth, as it is the change in the change in inventories that enters into the calculation of real GDP growth. The slower pace of inventory accumulation knocked 0.93 percentage points off Q4 real GDP growth. Exports out of and imports into the U.S. fell in Q4, yielding little net change in the trade deficit. Both trade flows and inventory accumulation were rocked over the back half of 2024 by concerns over a potential port strike and the likelihood of expanded tariffs in 2025. These disruptions played a part in the Q4 data, and the uncertainty over tariffs will likely continue to sway the data over the next few months.





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