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US Q4 GDP: Slowing beneath the headlines

by **Katherine Judge** katherine.judge@cibc.com

Annualized Qtrly Chg.	22 Q4	22 Q3	22 Q2	22 Q1	21 Q4	21 Q3
Real GDP	2.9%	3.2%	-0.6%	-1.6%	7.0%	2.7%
Personal consumption	2.1%	2.3%	2.0%	1.3%	3.1%	3.0%
• Goods	1.1%	-0.4%	-2.6%	-0.1%	2.3%	-7.9%
• Durable goods	0.5%	-0.8%	-2.8%	7.7%	5.1%	-22.0%
• Nondurable goods	1.5%	-0.1%	-2.4%	-4.4%	0.7%	1.7%
• Services	2.6%	3.7%	4.6%	2.1%	3.5%	9.2%
Gross private investment	1.4%	-9.6%	-14.1%	5.4%	32.0%	10.4%
• Fixed investment	-6.7%	-3.5%	-5.0%	4.8%	0.6%	-1.1%
• Nonresidential	0.7%	6.2%	0.1%	7.9%	1.1%	0.6%
• Structures	0.4%	-3.6%	-12.7%	-4.4%	-12.7%	-6.7%
• Equipment	-3.8%	10.6%	-2.1%	11.4%	1.6%	-2.2%
• Intellectual Property	5.3%	6.8%	8.9%	10.8%	8.1%	7.4%
• Residential	-26.7%	-27.1%	-17.8%	-3.1%	-1.1%	-5.8%
Exports	-1.3%	14.6%	13.8%	-4.6%	23.5%	-1.1%
• Goods	-7.0%	17.8%	15.5%	-7.2%	23.4%	-3.7%
• Services	12.4%	7.5%	9.9%	1.6%	23.6%	4.7%
Imports	-4.6%	-7.3%	2.3%	18.4%	18.6%	6.6%
• Goods	-5.6%	-8.6%	-0.4%	20.4%	19.6%	0.2%
• Services	0.4%	-0.8%	16.6%	9.0%	14.0%	45.4%
Government consumption	3.7%	3.7%	-1.6%	-2.3%	-0.9%	-0.2%
• Federal	6.2%	3.7%	-3.4%	-5.3%	0.0%	-7.2%
• National defense	2.4%	4.7%	1.5%	-8.5%	-5.3%	-3.1%
• Nondefense	11.2%	2.5%	-9.2%	-1.1%	7.4%	-12.2%
• State and local	2.3%	3.7%	-0.6%	-0.4%	-1.6%	4.6%

Source: Haver Analytics.

- The US economy grew at an impressive 2.9% annualized pace in Q4, in line with our forecast, and a touch above the 2.6% expected by the consensus. The growth was driven by inventory restocking as supply chain issues faded, and consumption, with both services and goods gaining ground. While the headline figure represented a very modest deceleration from the 3.2% pace of growth seen in Q3, final domestic demand, which removes inventories and net trade, slowed more significantly, to 0.8% annualized, from 1.5% in Q3, as business investment cooled markedly. That's an early sign that activity is responding to higher interest rates, but with consumption growth still strong, and the GDP advance well above the Fed's December median projection (1.0% y/y actual vs. 0.5% y/y Fed), the Fed will remain on track for two 25bp hikes in Q1 to reach the terminal rate.

- The consumer contributed 1.4%-points to growth despite the squeeze from higher interest rates, with services consumption accounting for most of the advance. Health care services was a key contributor, along with housing and personal care. Discretionary services still advanced, and although spending on accommodation and food services slowed markedly, growth in recreation services remained robust. Goods consumption increased modestly relative to services, but grew for the first time in three quarters, as autos rebounded with the fading of supply chain issues. That leaves goods consumption 3.5% above its pre-pandemic trend growth line, and services 1.5% below that benchmark.
- Inventory restocking contributed 1.5%-points to growth, as the manufacturing industry restocked petroleum and coal products, as well as chemicals, adding to increases in utilities, mining, and construction. With stock levels generally elevated across industries, with the exception of autos, that component will likely become a drag on growth in early 2023.
- Business investment slowed markedly, with a drop in equipment investment partly offsetting an increase in intellectual property products. Computer equipment investment plummeted, potentially reflecting weaker demand from businesses in the tech and media sectors that are downsizing, after surging at the height of the pandemic. That more than offset increases in transportation and industrial equipment. Forward-looking indicators suggest more caution amongst businesses in CAPEX, as orders of core capital goods dropped off in December. After six consecutive quarters of decline, investment in non-residential structures inched forward, as the mining sector ramped up investment, in line with efforts for US oil production to supplant Russian supply. Investment in commercial and health structures continued to flounder, as the pandemic has dented prospects for office buildings, hotels, and convention centers.
- International demand faltered in Q4 as the economic outlook dimmed in key trading markets. Total exports fell, with cyclical components including industrial supplies and capital goods (ex. autos) declining. That masked progress in auto shipments as supply chain issues faded. Imports of goods plummeted, in line with elevated inventory levels stateside, as consumer goods imports fell by 21% annualized. Overall, imports fell by more than exports.
- The sharp drop in residential investment reflected weakness in the single-family market, in line with higher mortgages rates on average over the quarter, which thwarted new single-family construction, while lower home sales held back brokers' commissions. Although mortgage rates eased off over the quarter, they remain elevated, and residential investment is likely to remain a drag on growth in the quarters ahead, with the Fed set to hold rates higher for longer than markets are currently accounting for.
- The Fed's preferred measure of inflation facing consumers, core PCE prices, slowed to 3.9% q/q annualized, from 4.7% in the prior quarter, in line with expectations. The 4.7% y/y core PCE reading in Q4 was a tick below the Fed's December projection. The GDP deflator, which includes prices faced by producers and export markets in addition to consumers, slowed to 3.5% annualized, from 4.4%.

Implications & actions

Re: Economic forecast — The savings rate remains low by historical standards, and with businesses becoming more cautious about investing amidst elevated inventory levels and weaker demand from abroad and domestically, Q1 GDP growth is set to weaken, as the lagged impacts of past rate hikes materialize more fully. The initial jobless claim data received today pointed to a still strong labor market, however, which will leave the Fed on track for two final 25bp rate hikes in Q1, before policymakers pause to assess the expected slowdown in growth.

Re: Markets —There was little market reaction to the data as it wasn't far off of the consensus, and won't sway the Fed from a likely 25bp hike next week.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC