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US Macroeconomics

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Weakness Below the Surface with Downward Momentum

The advance Q4 real GDP report showed a 2.9% annualized increase, slightly more than consensus expectations. But **two-thirds of the growth was in inventories and net exports**. This matters because it's unlikely either subcomponent of GDP will contribute meaningfully to growth this quarter or next. Why? Underlying domestic demand has slowed dramatically.

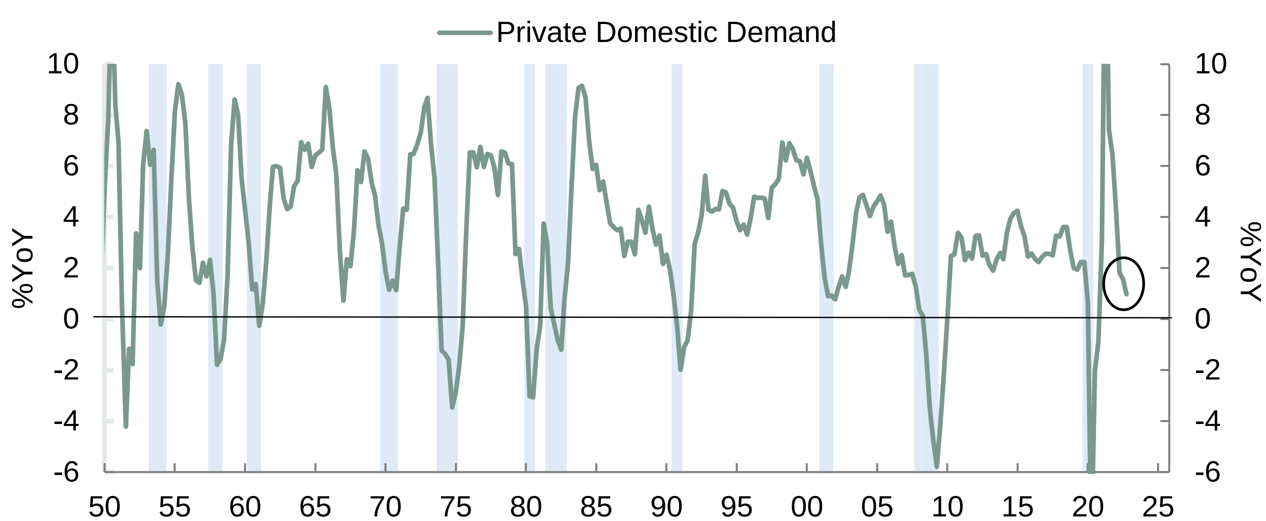
Real GDP excluding inventory building, exports, and government spending or what is officially known as final sales to private domestic purchasers rose just 0.2% at annualized rate last quarter. This is the lowest non-pandemic reading for private domestic demand since Q4 2009 when the economy was still recovering from a deep recession that began the previous year. **Over the past four quarters, private domestic demand increased just 1.0%, which is the smallest increase outside of recession since 1951** (see chart below). Our research strongly suggests the economy is unlikely to avoid recession this year.

In the GDP details, real consumption grew a decent 2.1% last quarter, while fixed investment spending fell for the third consecutive quarter, down 6.7%. Residential activity was again the weakest sector, declining at a 26.7% annualized rate after near-similar decline in Q3. There is no doubt that housing is in a deep recession.

Troublingly, business equipment is now weakening, too, down nearly 4% last quarter. Some of this was offset from spending on intellectual property products (i.e., software and R&D) which rose 5%. And commercial structures eked out a small gain (0.4%) following six consecutive quarterly declines. This small respite should be short-lived as higher borrowing costs and tighter lending standards put renewed downward pressure on the sector.

Moreover, **consumer spending should soften when households decide to replenish depleted savings**. The personal savings rate stood at just 2.9% last quarter, only marginally above its all-time low of 2.4% in Q3 2005.

No doubt, downward momentum in private domestic demand will lead to less inventory building, a bad omen for the factory sector. Sometimes a strong external sector can offset weak domestic activity but not this time, because inflation-adjusted exports of goods have fallen in three out of the last four months. For the US to experience a soft landing, the underlying trend in private domestic demand must soon reverse.



Source: BEA, NBER, Haver, SMBC Nikko

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