ECONOMIC UPDATE
REGIONS
January 30, 2020

Q4 Real GDP: No Surprises, But Business Investment Remains A Concern

- The BEA's initial estimate puts annualized Q4 real GDP growth at 2.1 percent, following growth of 2.1 percent in Q3
- Net exports, consumer spending, and government spending were the main drivers of Q4 growth

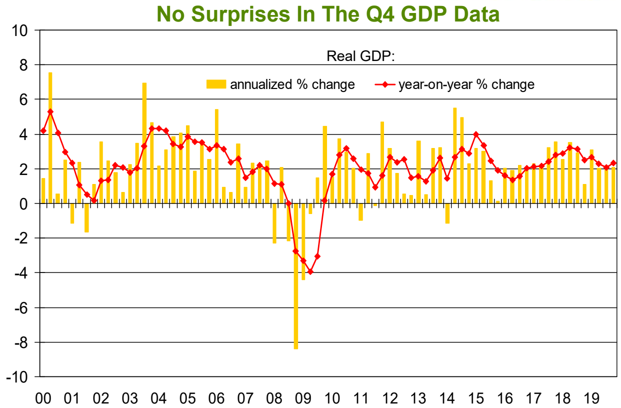
The BEA's initial estimate puts Q4 real GDP growth at an annualized rate of 2.1 percent, matching our above-consensus forecast and unchanged from Q3's growth rate. Based on the initial estimate for Q4, real GDP grew by 2.3 percent for 2019 as a whole, following growth of 2.9 percent in 2018. Net exports – in the form of a much smaller trade deficit – consumer spending, and government spending were the main drivers of growth in Q4, although growth in real consumer spending is reported to have slowed markedly during the quarter. Inventories and business fixed investment were drags on Q4 growth. As we point out each quarter, the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision, and there is no reason to think the initial estimate for Q4 will be any different. That said, there nothing in the initial estimate of Q4 growth changes how we expect the economy to evolve over the course of 2020. Q1 growth will be significantly challenged by Boeing shutting down production of the 737 Max, and the fallout from the Corona virus could be an additional headwind. As 2020 progresses, we expect real GDP growth to meander back towards trend, which at present we peg at less than 2.0 percent.

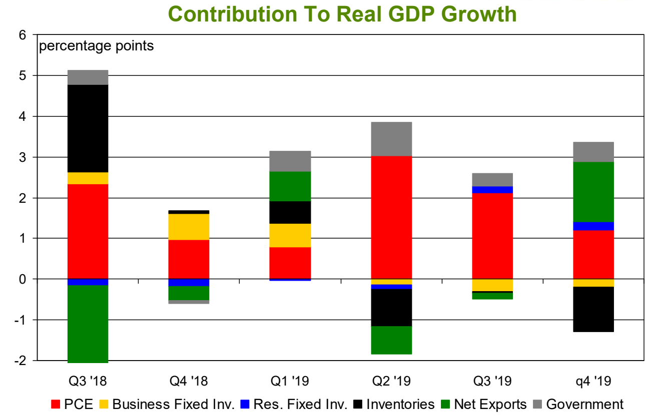
Real consumer spending grew at an annualized rate of 1.8 percent in Q4, quite the slowdown after growth of 3.2 percent in Q3 and 4.6 percent in Q2. Growth in spending on goods slowed sharply in Q4, with growth in spending on services little changed from Q3's pace. The slowdown in spending on goods in the Q4 GDP data is in line with the monthly data on control retail sales. Recall that nominal control sales fell sharply in September and, as such, ended Q3 below the quarterly average, hence setting a weak base for Q4 growth. To the point that nominal control retail sales contracted in Q4. We've noted all along that we do not find the retail sales data to be reliable – according to the retail sales data, online sales contracted in Q4, which simply does not seem plausible and is dramatically at odds with reports from retailers and data providers on the strength of online sales around the holiday season.. Why all of this matters here is that control retail sales are a direct input into the GDP data on consumer spending. Despite the tepid growth reported in the Q4 GDP data, we have few concerns over the state of U.S. consumers.

While real exports of goods contracted at an annualized rate of 1.1 percent in Q4, real exports of services grew at a 6.4 percent rate, pushing total exports higher, while at the same time real imports declined at an 8.7 percent rate. The net result was a sharply narrower U.S. trade deficit, which added 1.48 percentage points to top-line real GDP growth. Keep in mind, however, that trade flows were badly distorted over the course of 2019 due to ongoing trade disputes. With at least some semblance of trade peace between the U.S. and China, trade flows should at least take some steps back toward normal in 2020, though other sources of trade frictions remain in place. The bottom line is that the smaller trade gap seen in Q4 is likely nothing more than a one-off occurrence, as opposed to the start of a sustained decline in the trade deficit.

Real residential fixed investment grew at an annual rate of 5.8 percent in Q4, adding 0.21 percentage points to top-line real GDP growth. This marks the first time residential fixed investment has added to top-line growth in back-to-back quarters since Q4 2016/Q1 2017. Residential fixed investment did contract mildly for 2019 as a whole, but we expect the growth seen over the back half of 2019 to be, well, built upon in 2020, with residential fixed investment making a positive contribution to full-year 2020 real GDP growth.

Business fixed investment contracted at an annualized rate of 1.5 percent in Q4, marking a third consecutive quarterly decline, something rarely seen outside of recessionary periods. There is little in the high frequency data on business investment to suggest the Q1 2020 GDP data will show any meaningful improvement. But, we think it is worth once again noting that the weakness in business investment has been confined to "old school" business investment, i.e., structures and equipment, while "new age" business investment, i.e., intellectual property products, has been on a nice roll since mid-2015 and grew at an annual rate of 5.9 percent in Q4. This has, at least in our view, laid the ground for the improvement in productivity growth seen over the past several quarters. Still, the weakness in "old school" business investment is concerning, as it reflects underlying concerns over factors such as trade and global growth.





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