4Q19 US GDP – Not Quite as Steady as it Appears
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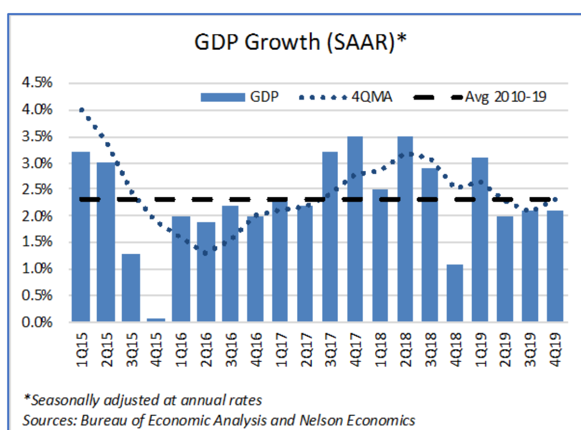
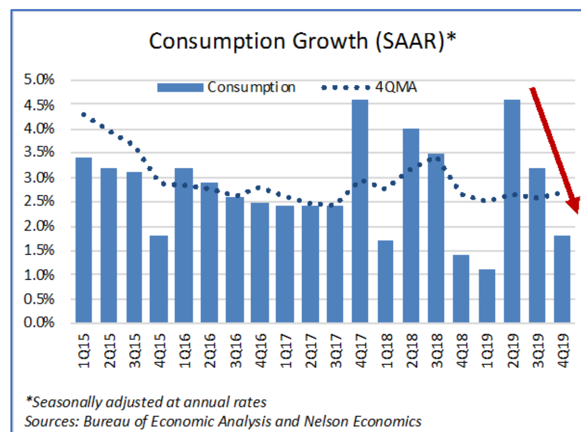
- *Despite the steady growth implied by recent quarterly GDP figures, below the surface the US economy shows signs of weakening in key sectors.*
- *Growth was led by a sharp decline in imports, reflecting weaker consumer spending as well as the bite from rising import tariffs. Consumption and business investment both decelerated again in 4Q, with investment actually declining for the third consecutive quarter.*
- *The coronavirus pandemic has emerged as perhaps the biggest downside risk for the global economy, though impacts will be focused on China while hits to the US are likely to be minimal.*
- *Expect GDP and job growth to slow further this year, though the risks of recession appear to be receding.*
- *In the property sector, market fundamentals should remain strong overall, though transactions and appreciation will likely trend down.*

Real Gross Domestic Product (GDP) grew at an annualized rate of 2.1% in the fourth quarter of 2019 according to the first official estimate, broadly in line with consensus expectations *(chart below on left)*. If that figure holds through subsequent estimates – and some adjustments are typical – GDP growth for all of 2019 would come in at just 2.3%, its slowest annual rate since 2016 and equal to the modest average for this economic cycle.

After spiking to 3.1% in the first quarter, GDP growth has since stalled at 2.1%, despite three rate cuts by the Fed last year meant to bolster economic growth. Blame fading stimulus from the Tax Cut and Jobs Act (TCJA), the growing drag from our escalating trade wars, as well as slowing global trade and growth overall, all of which limit demand for US products. The rising US dollar, slower job and wage growth, and shrinking corporate profits are also contributing to the slowdown.



*Seasonally adjusted at annual rates
Sources: Bureau of Economic Analysis and Nelson Economics



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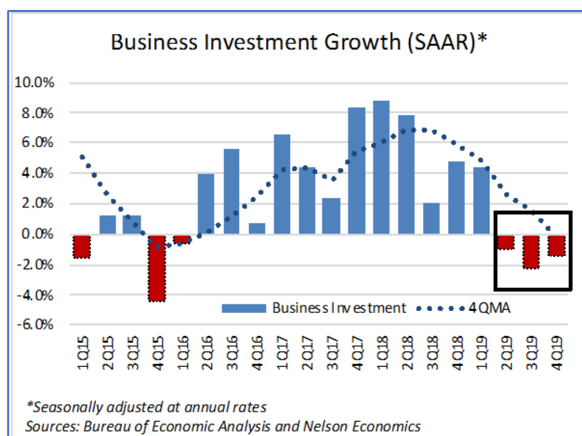
The Devil is in the Details

But that's not the bad news. More disappointing is the composition of the measured economic growth. Consumption, which accounts for some 70% of GDP, decelerated again in 4Q to an annualized rate of 1.8%, the second consecutive quarter of slower growth, and less than half the 4.6% growth rate in 2Q *(chart above on right)*. Despite buoyant consumer sentiment, which usually tracks closely with consumer spending, consumer outlays are being held back by slumping disposable income growth.

Meanwhile, business investment contracted 1.5% in the quarter, falling for the third straight quarter *(chart below on left)*. On a four-quarter moving average, business investment has decelerated for six consecutive quarters since peaking in mid-2018. Investments in equipment and especially structures have dropped by even more. These figures demonstrate that the TCJA has failed to provide a lasting boost to business investment, as much of the corporate tax savings have been invested in dividends and stock buybacks, rather than plants and machinery.

But perhaps the most discouraging news is that the single greatest driver of GDP growth was the nearly 9% decline in imports *(chart below on right)*. In national income accounting, exports add to GDP while imports – which send income abroad – reduce GDP, so a fall in imports augments GDP. However, falling imports reflects both weaker consumer spending as well as the bite from rising import tariffs, particularly on Chinese exports, so is hardly a sign of economic might.



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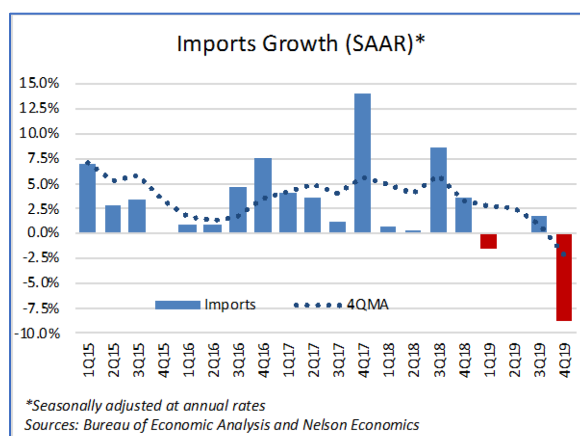

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Add it all up, and underlying economic growth appears weaker than the steady growth implied by recent quarterly GDP estimates. Indeed, "final sales to private domestic purchasers" – a wonky-sounding measure of economic output that excludes government purchases and net exports, and thus is a better measure of the core domestic private economy – grew by just 1.4% in 4Q19.

To be sure, not all the signs are negative. Manufacturing staged a modest recovery in January, after falling into a recession during the second half of last year. Residential investment (housing renovations and new construction) picked up in the second half of the year as interest rates fell. And the global economy seems to have stabilized, with growth prospects improving this year after dipping in 2019.

Most positively, risks of recession seem to be receding, as the Fed reversed course and moved to support growth through a series of rate hikes, which helped the yield curve revert to its normal upward slope -- though as I argued recently, that by itself does not actually eliminate the risks of a downturn. However, the more favorable financial conditions also will be helped by the de-escalation in trade tensions as the Trump administration reached a trade truce with China while Congress enacted the refined trade deal with North America trade deal (which still must be ratified by Canada).

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What’s Next?

Despite the steady growth implied by recent quarterly GDP figures, below the surface the US economy showed signs of weakening during the second half of 2019 in some key sectors. Expect growth to slow further this year, though likely not to actually turn down.

The Conference Board forecasts US real GDP growth of 2.1% in 2020, down slightly from the 2.3% last year, while the St. Louis Fed reports a consensus forecast of just 1.8%. However, both outlooks were prepared before the magnitude of the coronavirus pandemic became apparent. Forecasts by Oxford Economics predict short-term economic impacts will be focused on China (GDP lowered by 0.5% this year), with only limited impacts on the global economy (-0.2%). Potential hits to the US economy at this point appear to be quite minor – though downside risks will depend on how the spread of the virus progresses. It is still way too soon to know if this might precipitate longer-lasting changes to supply chains.

For property investors and owners, this outlook means more of the same: Drivers for leasing and acquiring real estate will remain moderately strong this year, so market fundamentals should remain healthy. Nonetheless, downside risks in the near-term appear to outweigh prospects for a strong turnaround. Thus, pursuits for opportunity must be balanced with overall caution, with the expectation that space absorption, sales transactions, and price and rent appreciation rates will likely trend down this year, though but still remain positive.

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