Economic Indicator — January 27, 2022

6.9% GDP Is Not Screaming Growth, It's Screeching Brakes

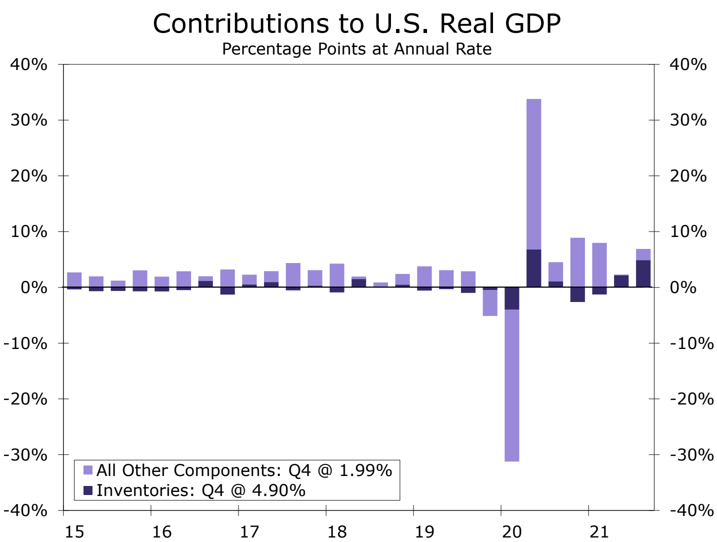
Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

Shannon Seery
Economist | Wells Fargo Economics
Shannon.Seery@wellsfargo.com | 704-410-1681

Summary

The economy grew at a 6.9% annualized rate in the fourth quarter. Savor the flavor because it will not last; the details behind the better-than-expected headline point to a slowing in spending and a back-up in inventories. Without the boost from inventories, GDP would have been just 2.0% in Q4.



Source: U.S. Department of Commerce and Wells Fargo Economics

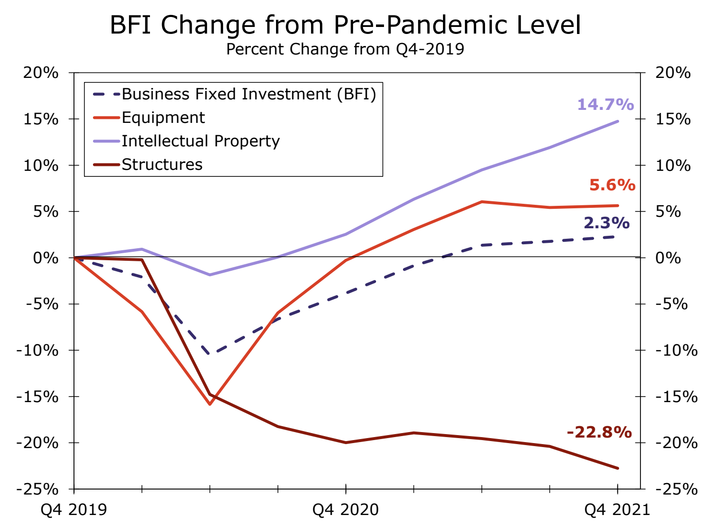
A Very Upbeat Signal of a Slowdown

It is tempting to celebrate a better-than-expected outturn with 6.9% GDP growth in the fourth quarter (chart), but due to a confluence of factors we will not likely see that sort of growth again for some time. While to some extent the year-end surge was a function of steady consumer and business spending, both petered out at the end of the year as Omicron cases climbed and hospitalizations followed.

Not knowing what was coming in terms of the pandemic, many retailers stocked up in anticipation of strong holiday sales and businesses continued to pull out all the stops to source much needed inventories. But after a strong October and decent November, retail sales ended the year with a flop in December. Meanwhile, the challenge businesses have already faced finding workers was exacerbated by increased absenteeism due to illness related to the new variant. Against that backdrop, inventories started stacking up. The result of this stockpiling was a 4.9 percentage point boost to headline growth from inventories (chart). We had anticipated a build, but this was even larger than we had penciled in. That makes it difficult for inventories to provide a lift in the first quarter. In the absence of that boost, our already modest expectation for 2.8% GDP growth in Q1 may get revised even lower.

Advance trade figures for December released yesterday showed a significant widening in the country's trade deficit. On that basis, we had been poised for a drag from net exports for the fourth quarter; and trade was perfectly neutral in terms of its contribution to headline growth (even taken out to two decimal points; it was 0.00). We look for trade to be a consistent drag on headline GDP growth throughout 2022, but here too, we worry the surprisingly neutral influence in Q4 will either be revised lower or come at the expense of an even larger drag on first quarter growth. The trade deficit doesn't widen without weighing on growth at some point.

Source: U.S. Department of Commerce and Wells Fargo Economics

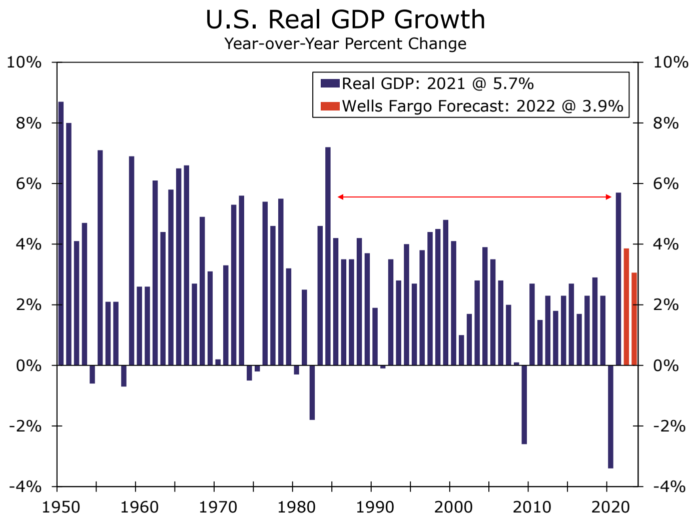


Source: U.S. Department of Commerce and Wells Fargo Economics

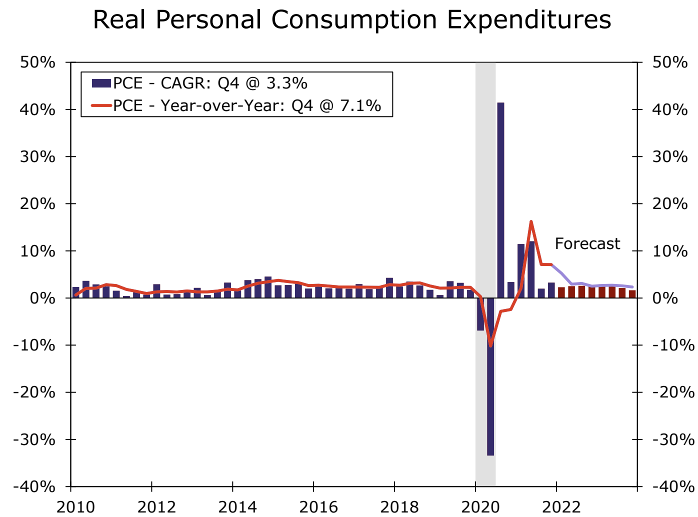
Sometimes You Can Be Right for the Wrong Reasons

Despite the Omicron variant aggravating already severe supply chain issues at the end of last year, the productive sector of the economy held up fairly well. Business fixed investment rose at a 2% annualized pace in the fourth quarter. While this was roughly in line with our expectation, the drivers of growth were a bit different from anticipated with modestly stronger equipment spending (+0.8%, annualized) and weaker structures investment (-11.4%). Intellectual property was the main story in the fourth quarter, rising at a 10.6% annualized pace, which marks the fourth double-digit pace of growth in the last five quarters bringing the level of real intellectual property spending 14.7% ahead of pre-pandemic level (chart). The strength in intellectual property products spending was broad based with sizable annualized gains in software (+12.7%), research & development (+6.7%) and entertainment (+24.2%). Sustained gains in these areas have the potential to boost productivity growth and perhaps contribute to labor-saving technology which is of particular importance in today's particularly-tight labor market that many businesses find themselves in.

Equipment spending surprised to the upside due to the surge in shipments in the final month of the year. The separately released data on durable goods orders for December revealed nondefense shipments rose 1.1% during the month. Overall orders declined 0.9%, but that weakness was tied to a 14.4% decline in aircraft orders in December, consistent with orders data from Boeing. Excluding transportation, orders rose 0.4% and point to resilient demand for equipment. While the trend in core capital goods orders has been clear, severe supply constraints of physical inputs and the labor needed to complete the job continue to hold back the overall pace of activity. As supply issues continue to gradually thaw, shipments should gain pace and equipment spending should accelerate this year.



Source: U.S. Department of Commerce and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Economics

Fiscal Stimulus Has Mostly Faded, Monetary Tightening on the Way

GDP growth in 2021 had a six-handle in three out of four quarters; full year growth came in at 5.7%, the fastest since 1984 (chart). Estimates will vary, but most economists put the potential growth rate for the U.S. economy at somewhere in the range of 2 to 3 percent. That is essentially the sustainable growth rate for our economy based on what we can reasonably expect in terms of labor force growth, cap-ex and productivity. The point being we just finished a year during which the economy grew at essentially double its expected growth rate.

In no small part, the well-above trend rate of growth can be linked to the massive stimulus that was poured into the economy. From direct stimulus checks to consumers, to supplements to jobless benefits and expansions of the Child Tax Credit, transfer payments over the past couple of years have allowed consumers to have their cake and eat it too. In the past two years, retail sales shot up as much as it did in percentage terms over the span of nine years in the prior expansion in the wake of the financial crisis. Not only that—household balance sheets now hold more that $2 trillion dollars in accumulated savings over that same two-year period.

In the absence of that stimulus, consumer spending is poised to slow. We do not have a quarterly growth rate north of 3.0% for consumer spending throughout the rest of this year or next year (chart). To the extent that there is good news in that, this will allow supply chains a chance to catch up. The inventory build we saw in Q4 was an unhealthy one, and an argument could be made that it was unintentional. But a slower, sustained build in inventories over the next couple of years will not only underpin growth it will allow for a smoother, if somewhat slower expansion in the business sector. It would do this by alleviating the demand side of the supply chain crisis. As the pandemic recedes, and with some luck, foreign production will pick up, ports around the world will normalize and with some semblance of normal returning to supply chains we would expect to see full year growth of roughly 4% this year and closer to 3% next year. The training wheels are off and the last major push from fiscal policy is behind us. The defining challenge for the economy in the next year or two will be how well we can sustain growth not just in the absence of fiscal policy, but in the face of tightening monetary policy.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

The 2022 Annual Economic Outlook: Restoring Balance in the Post-Pandemic Economy is available at wellsfargo.com/economicoutlook

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. (“WFBNA”). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation offer or solicitation with respect to the purchase or sale of any security or other financial product nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report. The views and opinions expressed in this report are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2022 Wells Fargo Bank, N.A.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority (“FCA”). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 (“the Act”), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. (“WFSE”). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE