Economic Indicator — March 28, 2024

# A Hollywood Ending for Fourth Quarter GDP


## Summary

The latest revisions put Q4 GDP at 3.4%, the second fastest quarterly growth rate in two years. Much of the upside was attributable to stronger consumer spending, yet fresh profits data affirmed it was a good quarter for the bottom line as well with profits up by the most since the Q2-2022.



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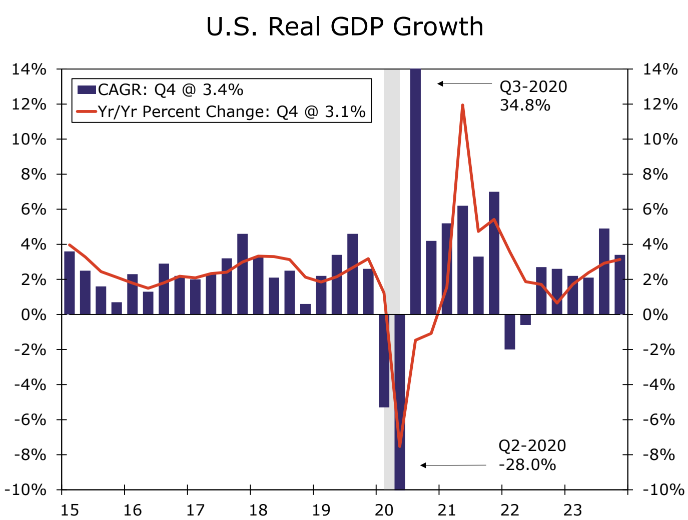
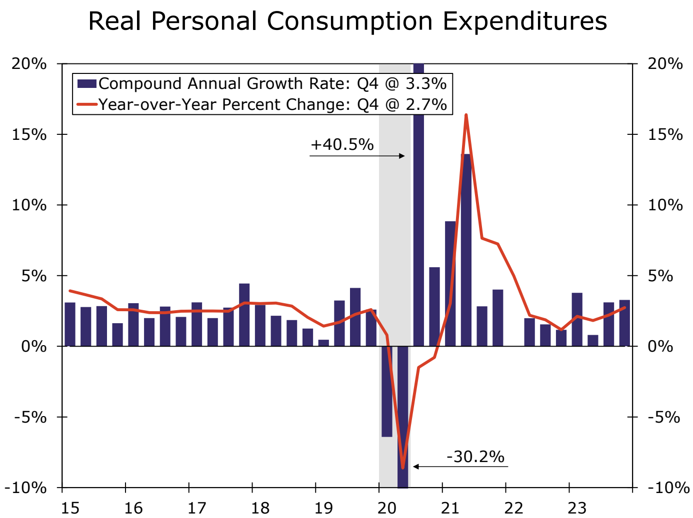



Source: U.S. Department of Commerce and Wells Fargo Economics

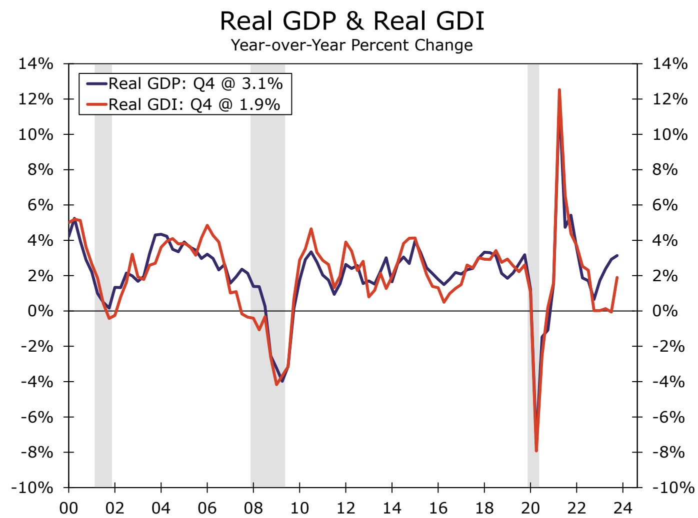
## Hindsight 2024

In its latest revision to fourth quarter GDP, the Commerce Department flagged growth during the period at 3.4%, which is a faster clip than previous estimates (chart). With the benefit of even more hindsight, consumer spending is now pegged at an annualized growth rate of 3.3% up from just 3.0% previously (chart). What drove the adjustment higher was a better finish than expected for services outlays. While it may be encouraging to see sustained consumer spending growth in this sector, the staying power could be problematic for the Fed should the sustained demand there prevent a cooling in service prices. Tomorrow will bring monthly data for February on PCE inflation; we already know from the January report that the trend decline in services inflation has been interrupted.

Structures spending jumped to 3.7% from 2.4% in the prior estimate on upward revisions to private nonresidential construction spending. One theme we've highlighted is how a boom in manufacturing construction has scope to lift future output capacity. In the meantime it can be supportive to topline growth through stronger structures investment. Residential fixed investment growth was revised lower by a tenth of a percent.




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




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

## Gap Is Closing

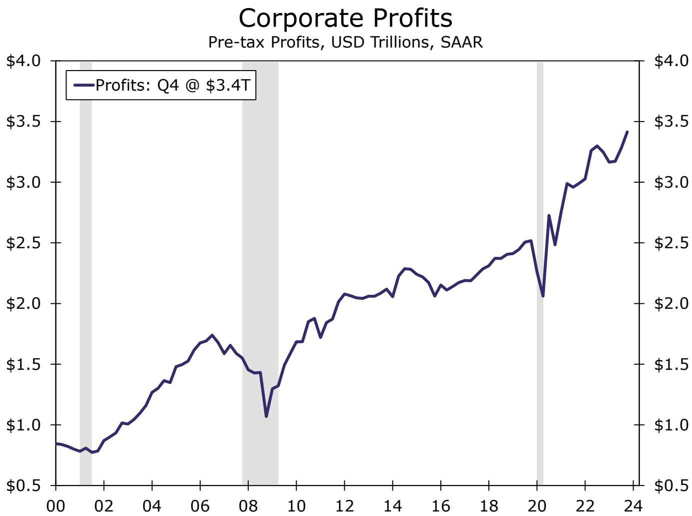
The new data in this release come on the income side of the National Income & Product Accounts (NIPA) and show a slightly brighter picture of the economy at the end of last year than implied by the GDP estimates. The output and income side of GDP accounting should in theory be equivalent as the creation of output generates an equal amount of income, but in reality the two differ due to statistical discrepancies and data omissions. Real gross domestic income (GDI) rose at an annualized rate of 4.8% in Q4, indicating a stronger pace of growth to end the year. As seen in the nearby chart, this outturn has led the recent unusually wide gap between the annual growth rates of GDP and GDI to narrow. We expect the two measures to converge further in subsequent data releases.

The largest component of GDI is employee compensation, which was revised a touch lower in this updated release. It was still up at a 4.5% annualized rate during the quarter, consistent with solid income growth that has helped sustain consumer spending.

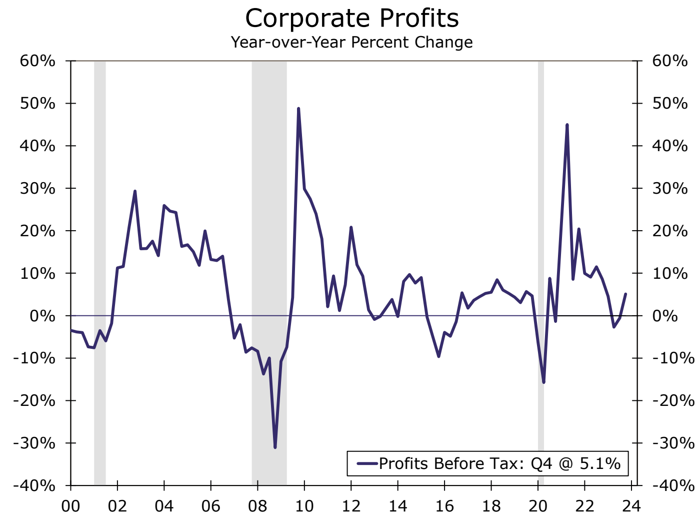
## Spotlight on Profits

The new piece of income data in this release is economy-wide corporate profits. Pre-tax profits were stronger than we had anticipated, rising 4.1% (not annualized) during the quarter, or by $105 billion (chart). This marks the largest quarterly gain since the second quarter of 2022 and leaves profits about 5% above where they stood at the end of last year (chart).

Most of the year-end profit strength was concentrated in domestic industries specifically, where profits rose $142 billion in Q4. Foreign profits, or remittances from foreign subsidiaries less remittances of American subsidiaries to foreign parents, fell by $8.9 billion. The industry composition was fairly mixed during the quarter and for the year as a whole, but at a broad level overall domestic profit growth remained solid at the end of the year. The largest gainers on a year-ago basis aren't too surprising based on solid economic conditions last year. Retail saw the largest gain in annual profits followed by food & beverage manufacturers, transportation & warehousing and computers & electrical products manufacturers.




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




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

Sturdy profits have helped propel economic growth and afforded firms with the means to continue to expand and hire. While firms have generally pulled back on making large capital expenditures, decent year-end profitability suggests businesses entered 2024 in adequate financial shape. Broad measures of profit margins remain elevated suggesting businesses have been able to offset higher input costs of material and labor by increased sales. Undistributed corporate profits also ripped higher in Q4, up 9.5% both compared to a quarter earlier as well as the end of last year.

Although firms have enjoyed solid profitability in recent years, slower consumer spending at the start of this year suggests we may be due for weakening demand. We ultimately anticipate a slower pace of economic growth this year as the labor market moderates and dents purchasing power as households have become increasingly dependent on income. But elevated margins, a still-decent cash position for many firms and the likelihood of falling borrowing costs in the second half of the year will likely support capital expenditures and firms profitability generally. To the extent continued profitability enables hiring, spending could be sustained. In other words, corporate profits will likely continue to rise this year, but at a slower pace.

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