Sagging Consumer Spending Restrains Q4 GDP Growth

The initial reading of fourth quarter GDP growth came in at an annualized rate of +2.1%, exactly matching both the median forecast and third quarter growth. On the surface, the Q4 number was as expected, but the underlying details paint a much weaker picture. In particular, the downward trend in consumer spending continued, with household consumption growing at just a +1.8% annualized rate during the quarter, following a +4.6% advance in Q2 and +3.2% in Q3. Business investment growth was negative for the third straight quarter. With the China trade war no longer escalating, the hope is that U.S. businesses will increase their spending in 2020, but early indications are that purchasing managers remain pessimistic.

While consumer spending slipped and business inventory accumulation slowed, the trade deficit narrowed. Net exports actually added nearly a point and a half to the overall GDP number in the fourth quarter. When the volatile inventory and trade components, as well as government purchases are factored out, real final sales rose by just +1.4%.

Today's release also provided some key inflation data. The Fed's preferred measure, the core personal consumption expenditures (PCE) price index rose at a sluggish +1.3% annualized pace during the quarter. The Fed would like to see core prices growing at +2.0% or better, so this is well off the mark.

For all of 2019 (subject to revision), GDP grew at +2.3%, down from +2.9% in 2018. The current quarter has a couple of potentially significant drags on growth, the Boeing shutdown and the coronavirus. Most economists expect GDP to sag; the January Bloomberg survey indicates a +1.6% median growth forecast in Q1, but recent developments suggest downside risk to the forecasts. The FOMC would rather not cut rates again this year, but the inflation decline (if it continues) will grant policy-makers some leeway. The bond market has already priced in a rate cut. It didn't take long. The two-year Treasury yield has dropped 20 basis points in just two weeks, while the 10-year has shed 27 basis points during the same period and 45 basis points in January alone.

Please see disclosure on page 2.
Market Indications as of 11:40 A.M. Central Time

DOW                 Down 193 to 28,541 (HIGH: 29,348)
NASDAQ           Down 75 to 9,199 (HIGH: 9,402)
S&P 500            Down 16 to 3,257 (HIGH: 3,329)
1-Yr T-bill     current yield 1.44%; opening yield 1.49%
2-Yr T-note     current yield 1.37%; opening yield 1.41%
5-Yr T-note     current yield 1.36%; opening yield 1.41%
10-Yr T-note    current yield 1.54%; opening yield 1.59%
30-Yr T-bond    current yield 2.01%; opening yield 2.04%