ECONOMIC UPDATE

REGIONS

January 27, 2022

Q4 2021 GDP: Inventory Build Bolsters Q4 Growth

- The BEA's first estimate shows real GDP grew at an annualized rate of 6.9 percent in Q4 2021
- For full-year 2021, real GDP grew by 5.7 percent, with nominal GDP growth of 10.0 percent

Real GDP expanded at an annualized rate of 6.9 percent in Q4 2021, faster growth than we and the consensus expected. Much of Q4's growth is due to a build in nonfarm business inventories, ending a run of sizable drawdowns, with consumer spending and business fixed investment also supporting top-line growth. Decreased public sector spending, a wider trade deficit, and a contraction in residential fixed investment acted as drags on Q4 growth. The GDP Price Index also rose at an annual rate of 6.9 percent. With the release of the Q4 data, we have a first look at full-year 2021 growth, with real GDP growing by 5.7 percent in 2021. While it is being widely noted that real GDP growth in 2021 was faster than in any year since 1984, that means nothing without 2021 growth being put into the context of the 3.4 percent contraction in real GDP in 2020, which is the largest annual contraction in the life of the BEA's data which go back to 1948. As we do each quarter, we'll note that the initial estimate of GDP in any given quarter is based on highly incomplete source data and, as such, prone to sizable revision in the second and third estimates.

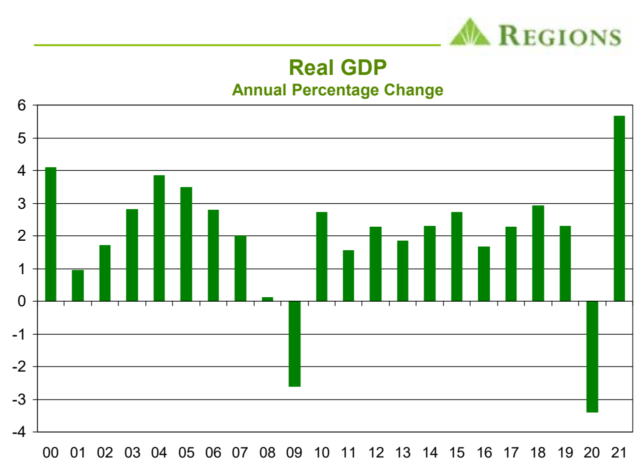
Real nonfarm inventories rose at an annualized rate of $173.5 billion in Q4, but it is the change in the change in inventories that matters for the rate of GDP growth. As such, coming off of a contraction of $66.8 billion (annualized) in Q3, the build in inventories in Q4 added 4.90 percentage points to top-line real GDP growth. While our forecast anticipated a build in nonfarm business inventories in Q4, the actual increase in stocks was much larger than we anticipated. As such, while we anticipate a further build in stocks in 2022, we'll have to revisit our view on how large that build will be given the size of the Q4 2021 increase.

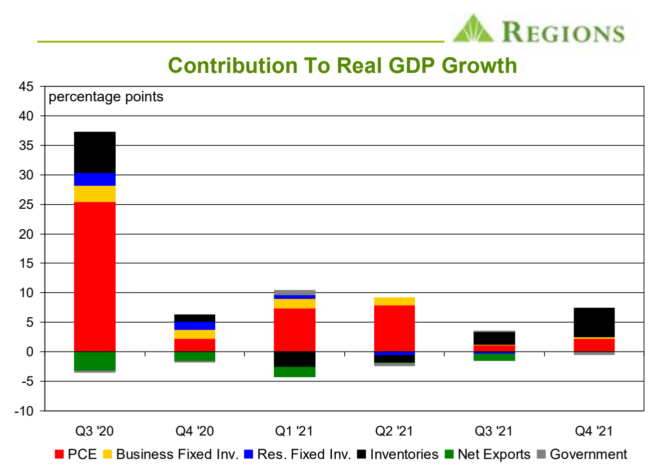
Real consumer spending grew at an annualized rate of 3.3 percent in Q4, adding 2.25 percentage points to top-line real GDP growth. Inflation adjusted spending on goods grew at an annual rate of just 0.5 percent in Q4, with lean inventories of consumer durable goods such as motor vehicles, furniture, and appliances weighing on spending, while inflation adjusted spending on nondurable consumer goods actually contracted in Q4. Real spending on services grew at an annualized rate of 4.7 percent, thus accounting for almost all of the growth in consumer spending in Q4. The rebound in consumer spending on services has been put on pause in early-2022 due to the spread of the Omicron variant, but as case counts subside services spending will almost surely pick back up.

Business fixed investment was a mixed bag in Q4. Outlays on equipment and machinery rose at an annual rate of 0.8 percent in Q4 after having contracted in Q3 but fell well short of the double-digit growth seen over the first half of 2021. Business spending on structures contracted at an annual rate of 11.4 percent in Q4, the eighth contraction in the past nine quarters. In stark contrast, business spending on intellectual property products, such as research and development and computer software, grew at an annual rate of 10.6 percent in Q4 and for all of 2021 grew by 10.2 percent. Growth in business spending on intellectual property products is a precursor of growth in labor productivity, and firms have been putting an even greater emphasis on automation and technology as a means of countering labor supply constraints, which we think has much further to run in the quarters ahead. Reflecting the swing in single family construction and sales seen over the back half of 2021, residential fixed investment in single family structures contracted at an annual rate of 10.4 percent in Q4 after having contracted at a 6.4 percent rate in Q3.

It is worth noting that real disposable personal income contracted at an annual rate of 5.8 percent in Q4. As we've noted in our write-ups of the monthly personal income data, the running off of various pandemic-related transfer payments weighed on growth in personal income in Q4, with rapidly rising prices compounding that hit. At the same time, however, brisk wage growth and further job gains are leading to notably rapid growth in labor earnings, the largest component of personal income. As such, beneath the distortions from the provision of and subsequent pullback of transfer payments, trend income growth is on a solid path, but rapidly rising prices are eroding consumers' purchasing power.

While we think there is further room for inventory restocking to add to real GDP growth in 2022, the economy will be adapting to a policy mix that is less supportive than was the case in 2021, and the longer inflation remains elevated, the bigger the threat to growth in discretionary consumer spending. Shoring up growth in business fixed investment will, as always, be critical in sustaining growth over the longer-term.





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