US Q4 REAL GDP: STRONG DOMESTIC DEMAND AND MOMENTUM SUGGEST MORE TO COME

*Real GDP advanced 2.6% q/q in Q4, as robust domestic final sales grew by 4.3% annualized, but a wider trade deficit and slower inventory building subtracted 1.1 and 0.7 percentage points, respectively, from domestic production (see Chart 1). Q4/Q4 gain was lifted to 2.5% and nominal GDP rose by 5% q/q annualized for the second consecutive quarter

*Consumption rose a robust 3.8% annualized and business investment rose a strong 6.8% in Q4, capping off a strong rebound in capital spending following its outright decline in 2016. The strong momentum at year-end 2017 supports our above-consensus forecasts for 3% real GDP growth this year

*Durable goods orders advanced a strong 2.9% m/m in December due to large gains in nondefense aircrafts, while orders excluding transportation were still up by a solid 0.6% m/m and shipments in core capital goods orders rose once again. Business investment will benefit from a favorable starting point in Q1

Q4 GDP

Real final domestic demand — consumption plus fixed investment and government purchases not including inventory change and changes in exports and imports — advanced by an exceptionally strong 4.3% in Q4, the third fastest pace in this economic recovery and faster than all but three quarters in the prior expansion (see Chart 2). There was a synchronized improvement in real growth across sectors: business fixed investment (7% q/q annualized), residential fixed investment (12%), government purchases (3%) — the best gain since Q2-15, and private consumption (4%).

Consumers willingly loosened their purse strings for the holiday shopping season, matching their elevated optimism — the personal saving rate fell to a very low 2.6% in Q4, the third lowest in history (see Chart 3). Looking into 2018, increases in disposable incomes — stemming from employment gains, one-time bonuses and wage increases announced by companies, and changes in withholding schedules as part of the tax reform — will spur gains in consumer spending. We expect strong consumption to continue.

We project strong nominal and real GDP growth momentum in 2018. Nominal GDP growth over 5% and further unemployment rate declines are expected to push average hourly wage increase over 3% in 2018, an acceleration from 2.5% yr/yr currently.

Net trade and inventories subtracted significantly from Q4 GDP, as imports surged 13.9% relative to the healthy 6.9% annualized increase in exports. The strength in imports reflects the very strong U.S. domestic demand — business investment as well as consumption (see Chart 4). It is noteworthy that, while imports rose so rapidly, inventory building fell markedly from $38.5 billion to $9.2 billion, reflecting the strength in product demand. The momentum in product demand and low inventories point toward strong production needs in 2018. In 2018, exports are expected to grow at a healthy pace, but imports are projected to grow faster, widening the trade deficit, reflecting continued strength in domestic consumption and investment. We also expect inventory rebuilding to pick up in coming quarters.
Residential investment rose 11.6% annualized in Q4, adding 0.4 percentage points to the real GDP growth, but that gain only offsets the declines in Q2 and Q3. We project further gains in housing activity in 2018.

Q1-2018 headline GDP will probably be impacted by a statistical quirk. The Q1 GDP estimate from the Bureau of Economic Analysis (BEA) tends to be biased downwards because of residual seasonality—seasonal trends that remain in the data despite seasonal adjustment (see Chart 5). The BEA plans to correct for this residual seasonality in three stages that will be completed by July 2018. Nevertheless, we expect Q1 GDP growth to increase by 2.6%, but indeed the underlying trend is likely closer to 3%.

In response to the momentum in the economy and prospects for positive implications of the tax reform and fiscal stimulus, we expect the Fed to upgrade its 2018 GDP forecast again at its March meeting (and possibly its policy rate forecast as well). In its December 2017 updated forecast, the Fed forecast real GDP to grow 2.5% in 2018 Q4/Q4. In current circumstances, that seems very low.

**December Durable Goods**

Core durable goods shipments (non-defense capital goods excluding aircraft) advanced 0.6% m/m in December, increasing for the eleventh consecutive month, the longest streak of monthly gains in this series, and highlights the very strong rejuvenation among U.S. businesses last year (see Chart 6). The lighter regulatory environment and the new tax legislation that for many businesses raise expected after-tax rates of return on investment are responsible for a large chunk of the enthusiasm and elevated confidence. To be sure, other factors that were headwinds for two years all turned more favorable in 2017 — global growth, U.S. dollar, energy prices.

Manufacturing sentiment measures in early January continue to show very elevated future capex plans and financial conditions remain very favorable so far. Besides the elevated capex plans, shipments continue to outpace inventory growth. Durable goods inventories rose by 0.3%/m, but the durable goods inventories-shipment ratio is near recent lows, at 1.65 (see Chart 7) and firms continue to view their customers' inventory levels as too low and will likely have to accelerate production more to meet the very robust customer demand (see Chart 8).

*Any production disruptions from the inclement weather early in the year will likely be made up in coming weeks/months.*

**Chart 1: U.S. real GDP (quarter-over-quarter, annualized %)**

![Chart 1: U.S. real GDP (quarter-over-quarter, annualized %)](chart.png)
Chart 2: Real final sales to domestic purchasers

Source: Quarterly data. Source: Bureau of Economic Analysis and Berenberg Capital Markets

Chart 3: Personal saving rate

Source: Quarterly data. Source: Bureau of Economic Analysis and Haver Analytics
Chart 4: Real imports of goods and services (quarter-over-quarter, annualized %)

Source: Quarterly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 5: Average real GDP growth by quarter, 2013-17

Source: Quarterly data. Source: Bureau of Economic Analysis and Berenberg Capital Markets
Chart 6: Manufacturing shipments of nondefense capital goods excluding aircraft

Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 7: Manufacturers inventory-shipments ratio for durable goods

Source: Monthly data. Source: Census Bureau and Haver Analytics
Chart 8: ISM manufacturing: customer inventories index

ISM Manufacturing: Customer Inventories Index
NSA, 50+ = Too High

Source: Institute for Supply Management/Haver Analytics

Source: Quarterly data. Source: Institute for Supply Management and Haver Analytics
Disclaimer

This document was compiled by the above mentioned authors of the economics department of Berenberg Capital Markets LLC (hereinafter also referred to as “BCM”). BCM has made every effort to carefully research and process all information. The information has been obtained from sources which we believe to be reliable such as, for example, Thomson Reuters, Bloomberg and the relevant specialised press. However, we do not assume liability for the correctness and completeness of all information given. The provided information has not been checked by a third party, especially an independent auditing firm. We explicitly point to the stated date of preparation. The information given can become incorrect due to passage of time and/or as a result of legal, political, economic or other changes. We do not assume responsibility to indicate such changes and/or to publish an updated document. The forecasts contained in this document or other statements on rates of return, capital gains or other accession are the personal opinion of the author and we do not assume liability for the realisation of these.

This document is only for information purposes. It does not constitute a financial analysis, investment advice or recommendation to buy financial instruments. It does not replace the recipient’s procurement of Independent legal, tax or financial advice.

This document has been classified as fair and balanced for the purposes of FINRA rules. Please contact Berenberg Capital Markets LLC (+1 617.292.8200), if you require additional information.

Remarks regarding foreign investors
The preparation of this document is subject to regulation by US law. The distribution of this document in other jurisdictions may be restricted by law, and persons, into whose possession this document comes, should inform themselves about, and observe, any such restrictions.

United Kingdom
This document is meant exclusively for institutional investors and market professionals, but not for private customers. It is not for distribution to or the use of private investors or private customers.

Copyright
BCM is a wholly owned subsidiary of Joh. Berenberg, Gossler & Co. KG (“Berenberg Bank”). BCM reserves all the rights in this document. No part of the document or its content may be rewritten, copied, photocopied or duplicated in any form by any means or redistributed without the BCM’s prior written consent. Berenberg Bank may distribute this commentary on a third party basis to its customers.

© 2018 Berenberg Capital Markets, LLC, Member FINRA and SPIC.