February 3, 2025

Morning Briefing

Anatomy Of
Gross National Product

Check out the accompanying chart collection.

Executive Summary: Why is the US economy so strong? Look in the mirror: The consumer is the engine of growth. Yes, technological advancements will continue to buoy GDP, as will Trump 2.0 deregulation and lower taxes. But consumer spending accounts for nearly 70% of real GDP. We reject the notion that consumer spending will slow in the face of depleted saving and other drags; it's too resilient, which is why the economy is so resilient. Likewise, we don't expect capital spending to slow notwithstanding a weak Q4; companies still have much to gain from investments in AI and other technological innovations. That's the linchpin of our productivity-led Roaring 2020s outlook (55% odds) and higher S&P 500 price targets for the rest of the decade. ... Also: Dr Ed reviews "Woman of the Hour" (+).

YRI Weekly Webcast. Join our live webcast with Q&A on Mondays at 11 a.m., EST, with Ed and Eric. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

US Economy I: The Year of the Consumer. The American economy put up impressive numbers in 2024. Much of the financial media chatter has focused on the advent of artificial intelligence (AI) and Trump 2.0. But lost in hullabaloo is the fact that the US consumer is powering the economy to new heights. We expect that the consumer will continue to do so in 2025.

We are big believers that improvements in automation, robotics, and data processing (i.e., AI and quantum computing) will continue to boost worker productivity, alleviate high-skilled labor shortages, and stimulate capital spending. We are also Trump 2.0 bulls, expecting deregulation and lower taxes to fuel more domestic investment, hiring, and consumption.

However, the strength of the consumer is the engine of economic growth. Indeed, personal consumption expenditures on goods (21.4%) and services (46.8%) make up 68.2% of US nominal GDP (*Fig. 1*).

Many hard-landers who had been calling for a recession over the past three years have thrown in the towel. But even more people now seem to be expecting an economic slowdown this year. The pervasive pessimism hinges on the consumer, specifically the prospect that consumer spending will slow as the result of weakening hiring, rising consumer credit delinquencies, depleted saving, and perhaps deportations.

Even if the consumer doesn't buckle, Trump 2.0 trade wars might cause a recession after all. US export industries might suffer as America's trading partners retaliate. American consumers and businesses will have to pay more for imported goods, parts, and materials. Tariffs are taxes, which could depress economic growth. But considering that the economy withstood the most rapid Federal Reserve tightening cycle in four decades without a slowdown, we are optimistic about its resilience to shocks.

Our base-case outlook remains our technology-driven, productivity-led Roaring 2020s scenario, with a 55% subjective probability. As a result, it's more than likely that the current bull market in stocks is not nearing its final inning, nor even the seventh inning stretch. Our S&P 500 price targets of 7000 by year-end 2025, 8000 by the end of 2026, and 10,000 by the end of the decade remain intact.

Here's more on the sources of last year's GDP growth and what we expect this year:

(1) *New records*. Last year, real GDP rose 2.8% to yet another record high of $23.5 trillion (saar), increasing 2.3% q/q (saar) in Q4 (*Fig. 2*). The quarterly slowdown in headline GDP growth from Q3's 3.1% was largely due to volatile inventory investment. Importantly, real personal consumption expenditures (PCE) rose to a new record high, reaching $16.3 trillion after growing 4.2% (saar) in Q4 and 2.8% for the whole of 2024. That was the highest quarterly growth since Q1-2023 and up from 1.9% in Q1-2024. Real consumer spending on both goods and services rose to record highs last quarter (*Fig. 3*).

(2) *Goods boom*. Real consumer spending on goods jumped 6.6% q/q (saar) during Q4, led by a 12.1% leap in durable goods purchases. Perhaps some of the increase stemmed from consumers' front-running potential tariffs. More likely, it was driven by year-end incentives that boosted auto sales. However, we note that durable goods consumption had been accelerating throughout the year. After falling 1.8% in Q1, real durable goods PCE increased 5.5%, 7.6%, and 6.6% in Q2, Q3, and Q4, respectively, to a new record high (*Fig. 4*).

Demand for goods, especially durables like autos and appliances, surged during the pandemic. So consumer demand that goods producers normally would have seen in 2022 and 2023 was pulled forward into 2020 and 2021. But consumers were back buying briskly during 2024 despite higher interest rates. This is one sign that higher-for-longer (or, in our view, normal-for-longer) interest rates won't slow consumers' purchasing of big-ticket items.

One tailwind for goods consumption has been deflation. PCED durable goods prices fell 1.1% y/y in December and have been falling since June 2023 (*Fig. 5*). However, nondurables prices are starting to increase, and durable goods prices are likely to follow. That's even before the Trump administration's tariffs take effect. Goods inflation will weigh on inflation-adjusted real consumption. The question is how much rising prices impact demand. As of now, we aren't expecting overall demand to decrease meaningfully. Still, a negative hit to growth from trade wars is in our "what could go wrong" bucket, to which we currently assign a 20% subjective probability.

(3) *Incomes rising on all cylinders*. Driving consumer spending has been real income growth. In December, disposable personal income (DPI) rose 5.0% y/y to a new record high of $22.1 trillion (saar) (*Fig. 6*). In real terms, DPI rose 2.4% y/y in December and has been increasing at roughly its pre-pandemic pace, if not a bit faster.

The historically tight labor market and rising productivity have fueled real wage gains, particularly for lower-wage workers, who represent roughly four-fifths of US employment. Their nominal wage gains have been outpacing inflation for nearly two years after stagnating for much of the early-to-mid 2010s (*Fig. 7*).

While the overall labor market has been red hot, the white-collar job market was much cooler over the past few years. Inflation eroded the wages and salaries of higher-wage workers for much of the post-pandemic period. Now, their real income growth is accelerating rapidly.

While higher-wage workers' real wages fell during the pandemic, rising nonlabor income and a huge wealth effect from rapidly rising stock and home prices more than offset that. Interest, dividend, rental, and proprietors' incomes all have risen to record highs, totaling $7.1 trillion (saar) in December (*Fig. 8*).

Nonlabor income has been a boon, particularly to the retiring Baby Boomers and high-income households, as have rising asset prices. A reduced need to save leaves even more after-tax income to be spent. That's one reason that the savings rate is down to 3.8% as of December (*Fig. 9*). We expect it to turn negative over the remainder of this decade as retirees continue to spend without the benefit of any labor income.

Slowing immigration is likely to weigh on the growth rates of the labor force and technology-led productivity enhancers may and aggregate weekly hours. So it's likely that real average hourly earnings growth and the wealth effect will be the main drivers of consumer spending over the next few years (*Fig. 10*, *Fig. 11*, and *Fig. 12*).

US Economy II: Investment Slowdown? While last year was a bright one for business capital spending, it finished with a whimper rather than a bang. For much of 2023 and 2024, government incentives and real business needs sparked a boom in nonresidential fixed investment, particularly in high-tech sectors and construction of manufacturing facilities. The weakness in Q4 was an anomaly in this respect, but we don't expect it to be the start of a trend.

Technological innovation, of course, is a linchpin of our Roaring 2020s scenario, and we expect areas like software and research and development (R&D) to continue growing into a bigger part of the overall economy. The pro-tech, pro-business stance of Trump 2.0 and real demand for AI will continue to drive the high-tech investment boom that now accounts for more than half of US capital spending (*Fig. 13*).

While the Mangificent-7 tech companies will continue to shell out cash for new AI- and energy-related projects, the rate of growth for that spending may slow this year and next. However, we believe that slowing capex growth by the Mag-7 will be offset by hastening of the S&P 493's collective investments in technology to augment the productivity of their workforces. Eventually, even small- and medium-sized businesses will be investing in AI-enabled products to increase productivity and efficiency. No doubt, venture capital and private equity firms will implement these technologies across their portfolio companies to boost profit margins.

Here's more on the capital investment front:

(1) *Temporary weakness in Q4*. Overall economic growth was strong during Q4. Real final sales, which excludes business inventory investment, rose 3.2% q/q (saar) in Q4. Real private domestic demand—the Fed's preferred measure of core real GDP, which excludes federal spending, business inventory investment, and trade—also rose 3.2%. However, these were mostly consumer driven. Real business investment rose just 1.5% q/q (saar) in Q4 and 1.7% for the whole year. Though it did reach a record high of $3.5 trillion (saar), annual growth was down from 3.2% in 2023 and 7.8% in 2022 (*Fig. 14*).

Intellectual property (IP)—which includes software, research and development (R&D), and entertainment, literary, and artistic originals—rose 2.6% q/q (saar) to a new high of $1.5 trillion (*Fig. 15*). However, annual growth was down from 5.8% in 2023 to 4.1% in 2024.

Capital equipment investment fell 7.8% q/q (saar), its worst quarter since the pandemic. On a y/y basis, it slowed marginally from 3.5% to 3.4%. However, we expect equipment investment to rebound this quarter as information processing equipment reaches a new record high alongside R&D and software investment (*Fig. 16*).

(2) *Volatile inventories.* Slower private inventories investment reduced real GDP growth by 0.93ppt in Q4 after dragging it down in Q1, largely due to inventory drawdowns by wholesalers and auto dealers (*Fig. 17*). We expect inventory investment to rebound during the first half of this year.

US Economy III: Trade Wars & DOGE. On Saturday, President Trump imposed tariffs of 25% on imports from Canada and Mexico. Chinese imports were slapped with an additional 10% tariff. These developments are bound to weigh on US economic growth unless trade negotiations between the US and these three trading partners move quickly to reverse the tariffs. Also weighing on the economy might be the Trump administrations moves to cut government spending through executive orders and the efforts of the Department of Government Efficiency (DOGE).

(1) *Trade wars could weaken global economic growth.* The US trade deficit impacted Q4's GDP growth only minimally, but naturally it will be highly topical this year. Trade is not a large portion of US nominal GDP but invariably is interconnected with intermediate prices, labor costs, and the revenues of domestic producers. Given our optimistic outlook for the US consumer—especially relative to Chinese and European consumers—we do not expect tariffs to significantly reduce the trade deficit, which stood at $1.3 trillion (saar) in Q4 (*Fig. 18*).

YRI's real global growth proxy accelerated to 3.8% y/y in Q4 (*Fig. 19*). It is simply the sum of real US exports and imports. It is currently growing about as fast as just before Trump 1.0 tariffs turned its growth rate negative in 2019. Trump 2.0 tariffs could turn it negative again.

(2) *Government spending slowdown*. Even if the Department of Government Efficiency (DOGE) manages to cut federal spending and therefore weigh on real GDP growth, we expect businesses and consumers will fill the gap. Deregulation and lower tax rates are

likely to spur more hiring and investment in an economy already at full employment. That should drive increased productivity growth and real wage gains.

Movie. "Woman of the Hour" (2023, +) is another serial killer movie based on a true story. Too bad there is no shortage of films of this genre. This one is about Rodney Alcala, who appeared in 1978 on the television show "The Dating Game." He was captured in 1979 and identified as a serial killer for murdering numerous women and girls. Anna Kendrick is the director and stars in the movie. Beware of strangers taking your picture and striking up a conversation. Evil may lurk behind that charming veneer. (See our movie reviews *archive*.)

Calendars

US: Mon: ISM M-PMI & Price Index 49.5 & 52.6; Construction Spending 0.1%; Bostic; Musalem. **Tues:** Job Openings 7.88 million; Factory Orders -0.7%; Daly; Bostic; Jefferson. (FXStreet estimates)

Global: Mon: Eurozone Headline & Core CPI 2.5%y/y & 2.6%y/y; Eurozone, Germany, Italy, & France M-PMI 46.1, 44.1, 45.3; UK M-PMI 48.2. **Tues:** Spain Unemployment Change 45.4k; China Caixan NM-PMI 52.3. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): Last week saw the US MSCI index fall 0.9% w/w and underperform the 0.5% gain of the AC World ex-US index. The US MSCI closed on Friday 1.2% below its January 23 record high (its first record high since December 6). The AC World ex-US improved to 5.9% below its June 15, 2021 record high, but it had been just 0.7% below at the end of September. EAFE was the best performing region last week, with a gain of 0.8%, followed by Europe (0.6%) and the AC World ex-US. EMU was the worst regional performer, albeit with a gain of 0.1%, followed by EM Asia (0.2), EM (0.3), and EMEA (0.4). The Brazil MSCI index performed the best among country indexes last week, with a gain of 3.9%, followed by Switzerland (2.0), Spain (2.0), Japan (1.7), and the UK (1.5). Mexico was the week's worst country performer, falling 2.7%, followed by Korea (-2.4), the US (-0.9), France (-0.8), and Canada (-0.7). On a ytd basis, the US MSCI index is up 3.0%, but lost its lead last week against the AC World ex-US (4.0). Among regional indexes, EM Latin America is ahead of the pack ytd, leading with a gain of

9.4%, followed by EMU (7.6), Europe (6.8), EAFE (5.2), EMEA (4.5), and the AC World ex-US. The worst performing regions so far in 2025: EM Asia (0.6) and EM (1.7). Looking at the major selected country markets that we follow, Brazil is the best ytd performer with a gain of 12.3%, followed by Sweden (9.8), Germany (9.4), Switzerland (8.1), and France (8.0).

US Stock Indexes (*link*): Just four of the 48 major US stock indexes that we follow rose for the week, down from all 48 rising in the prior two weeks. The Nasdaq Industrials index was the best performer, with a gain of 0.6%, ahead of Dow Jones Industrials (0.3%), S&P 500 LargeCap Value (0.1), S&P 600 SmallCap Pure Growth (0.0), and S&P 100 Equal Weighted (0.0). The S&P 500 Transportation index, with a decline of 2.9%, was the worst performer, followed by S&P 400 MidCap Pure Growth (-2.0), S&P 500 LargeCap Growth (-2.0), S&P 400 MidCap Growth (-1.8), and Dow Jones 20 Transports (-1.8). All 48 of the indexes are still positive so far in 2025, up from just four indexes positive four weeks earlier and 46 rising in 2024. The S&P 500 LargeCap Pure Growth index is in the top spot as the best performer so far in 2025, with a gain of 5.8%, ahead of Russell MidCap Growth (5.7), Nasdaq Industrials (4.7), Dow Jones Industrials (4.7), and Russell 1000 Value (4.7). The worst performing major US stock indexes ytd: Russell 1000 Growth (1.0), S&P 600 SmallCap Pure Value (1.0), Russell 3000 Growth (1.1), S&P Industrial Composite (1.5), and Nasdaq Composite (1.5).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose last week, and seven beat the S&P 500's 1.0% decline. That compares to ten S&P 500 sectors rising a week earlier, when four were ahead of the S&P 500's 1.7% gain. The outperformers last week: Consumer Staples (2.7%), Health Care (2.1), Communication Services (1.9), Financials (1.2), Consumer Discretionary (0.7), Materials (0.5), and Real Estate (-0.1). The underperformers last week: Information Technology (-3.8%), Energy (-3.8), Utilities (-1.4), and Industrials (-1.2). The S&P 500 is up 2.7% ytd, with 10 sectors in positive territory and seven sectors ahead of the index. Communication Services now wears the crown as the best ytd performer, with a gain of 8.2%, ahead of Health Care (7.0), Financials (6.4), Materials (6.3), Industrials (5.8), Consumer Discretionary (4.3), and Utilities (3.5). These sectors are lagging the S&P 500 so far in 2025: Information Technology (-2.2), Real Estate (2.0), Energy (2.0), and Consumer Staples (2.6).

US Economic Indicators

GDP (*link*): *Real GDP* growth was solid again during Q4, though slightly below expectations, while prices accelerated. *Real GDP* expanded 2.3% (saar)—slightly below the 2.5% increase expected and slower than Q3's 3.1%. Meanwhile, the quarterly gain in the GDP deflator picked up to 2.2% (saar), faster than Q3's 1.9%, with the PCED accelerating from 1.5% during Q3 to 2.3% during Q4. Excluding food and energy, it climbed from 2.2% to 2.5% (saar). The gains in Q4 real GDP were led by consumer spending, trade, and federal government spending, while investment spending subtracted a full percentage point from Q4's GDP. *Real consumer spending* accelerated for the third straight quarter from 1.9% (saar) during Q1-2024 to 4.2% during Q4, with *goods consumption* picking up from Q1's -1.2% to 6.6% over the comparable periods. *Services consumption* increased 3.1% during Q4—close to the average quarterly gain of 3.0% during 2024. Within goods consumption, *durable goods* (to 12.1% from 7.6% during Q3) expanded at a double-digit rate, while *nondurable goods* (3.8 from 4.6) consumption slowed a bit, but was solid; both these measures were negative during Q1. The gain in *goods* consumption was led by recreational goods and vehicles as well as motor vehicles & parts—primarily new light trucks. Within *services consumption*, the main contributor was health care, notably hospital services. Both federal (3.2%, saar) and state & local (2.0) spending accounted for the increase in *government spending* last quarter. *Residential investment* posted its first gain in three quarters, climbing 5.3% (saar) during Q4 following declines of 4.3% and 2.8% the prior two quarters. Meanwhile, *nonresidential fixed investment* contracted 2.2% (saar) during Q4, on widespread declines, led by a 7.8% drop in equipment spending; intellectual property products (2.6%, saar) was the only component in the plus column. *Turning to trade*, imports, which are a subtraction in the calculation of GDP, decreased during the quarter, contributing 0.12ppts to Q4 GDP, while real exports declined for the first time in six quarters during Q4.

Personal Income & Consumption (*link*): Personal income for December was in line with expectations, while spending beat expectations. *Personal income* rose 0.4% in December, following gains of 0.3% and 0.7% the prior two months, with *disposable income* matching those gains. *Personal consumption expenditures* (PCE) accelerated for the second successive month, increasing 0.7%, following gains of 0.6% and 0.5% the prior two months. Goods consumption climbed 0.9%, following a 1.1% gain in November and a 0.1% downtick in October. Both *durable goods* (0.6%) and *nondurable goods* (1.0) consumption rose during the month, as did *services* consumption (0.6). Adjusted for inflation, *real PCE* climbed 0.4%, near November's 0.5% and double October's 0.2%. *Real goods consumption* posted back-to-back gains of 0.7% and 1.1% in December and November, respectively, after showing no gain in October. Adjusted for inflation, *durable goods consumption* posted solid increases of 1.1% in December and 2.6% in November, with *nondurable goods consumption* climbing 0.5% and 0.2% in the two months. These are stronger readings than in October, when the former edged up 0.1% and the latter edged down 0.1%. Meanwhile, *services consumption* posted gains of 0.2% and 0.3% over the past eight months. *Real disposable income* increases slowed to 0.1% in both November and December from 0.4% in October. *Personal saving* fell over the past two months by $109.8 billion (from $953.0 billion in October to $843.2 billion in December). December's saving rate fell from 4.3% in October to 3.8% in December—the lowest since December 2022. It was at a recent peak of 5.5% at the start of 2024.

Personal Consumption Deflator (*link*): Both the *headline and core PCEDs* were in line with expectations for December, climbing 0.3% and 0.2%, respectively. The *yearly rate for the headline* PCED climbed to 2.6% y/y, up from 2.4% in November, while the core rate held at 2.8%. The headline and core rates peaked at 7.2% and 5.6%, respectively, during June 2022 and September 2022. *Goods* prices moved out of negative territory in December, showing no change, with the yearly decline in the durable goods rate narrowing to -1.1% and the nondurable goods rates moving back above zero to 0.6%. There's deflation in *durable goods* prices: used motor vehicles (-3.4% y/y), furnishings & durable household equipment (-2.3), motor vehicles & parts (-0.9), and recreational goods & vehicles (-0.9), though the rate for motor vehicles parts & accessories (1.5) remains above zero, while other durable goods (0.0) fell to zero after a brief move above. Within *nondurable goods* prices, there has been some movement in recent months. The rate for household supplies has moved up from a recent low of -2.9% to 0.6% in December. The rate for magazines, newspapers, and stationary, has moved down from a recent peak of 5.4% to 0.0%, while personal care has dropped from a peak of 8.0% in 2023 to just above zero at the end of 2024. The rate for clothing and footwear has been volatile in a range between zero and 2.0% in recent months. Meanwhile, the rate for pharmaceuticals & other medical products is disinflating, while the rate for recreational products has dropped back below zero. Services PCED has dropped from 6.0% in January 2023 to 3.8% at the end of 2024. Within *services*, *housing* costs remain stubbornly high but are down from recent peaks: owners' equivalent rent (to 4.8% from 8.2%), tenant rent (4.3 from 8.8), and housing & utilities (4.7 from 8.3). Looking at *non-housing* services, transportation (4.2 from 15.3) and personal care (6.3 from 10.4) services showed noticeable drops in the rate of inflation, though they have moved up recently; the communication services (-1.2) rate has dropped back below zero.

Employment Cost Index (*link*): The employment cost index (ECI), which is the broadest measure of labor costs—and the Fed's preferred measure—held relatively steady on a three-month basis in December, though has slowed dramatically based on yearly comparisons. The overall *ECI for private industry workers* increased 0.9% during the three months ending December, up a tick from September's 0.8%, with *wages & salaries* (to 0.9%

from 0.8%) showing an identical pattern. Meanwhile, *benefits* held steady at 0.8%. On a yearly percent change basis, *overall labor costs* for the private sector remains on a steep downtrend, with the rate for overall compensation slowing from a peak of 5.5% in mid-2022 to 3.6% during Q4-2024 and the rates for *wages & salaries* (from 5.6% to 3.6%) and *benefits* (5.3 to 3.3) both easing over the comparable periods.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for both the EU and the Eurozone rose in January, with the EU measure climbing by 1.1 points to 95.8 and the Eurozone ESI by 1.5 points to 95.3. Among the *six largest EU economies*, France's ESI (+3.3 points to 96.2), posted the largest gain, followed by those of Italy (+1.8 to 100.2), Spain (+1.5 to 104.4), and Germany (+1.2 to 88.1), while Poland's (-2.0 to 97.1) posted a sharp drop and the Netherlands' (-0.8 to 99.6) posted a more modest decline. *By sector*, for the overall EU, construction (+1.4 to -4.9), industry (+1.1 to -11.9), and services (+0.4 to 6.7) confidence all improved, while retail confidence (-0.5 to -3.3) edged down and consumer confidence was unchanged at -13.3.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Eric Wallerstein, Chief Markets Strategist, 201-661-3575
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102