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US Economics Analyst

One Step Back, Two Steps Forward: Q1 Growth and Omicron (Walker)

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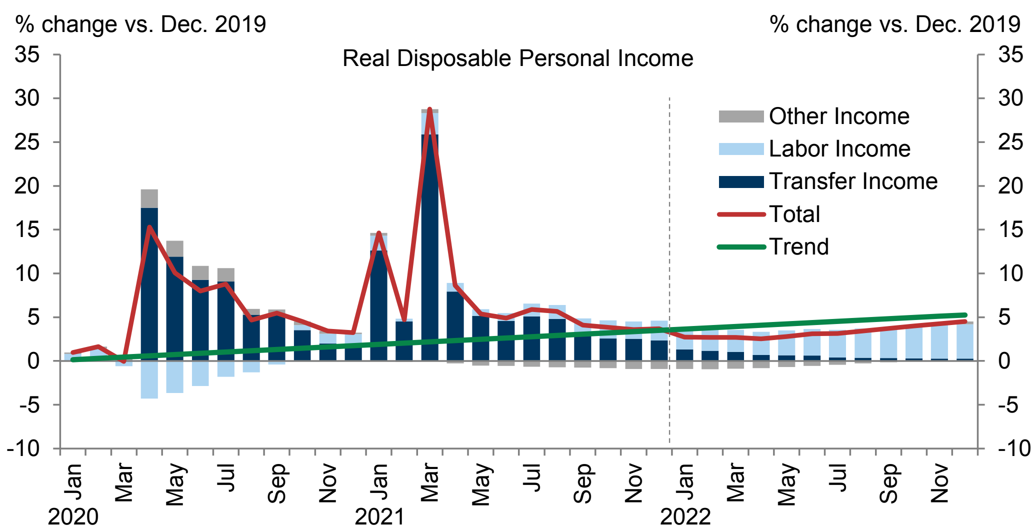
- Last week's GDP report showed blistering growth of nearly 7% in Q4, capping off a year in which GDP grew at the fastest rate since the 1980s. However, growth is likely to slow abruptly in 2022, as fiscal support fades and, in the near term, virus spread weighs on services spending and prolongs supply chain disruptions.
- We have long highlighted that the fiscal impulse will fade sharply from 2021 into 2022. Fiscal support boosted real disposable income to 5% above the pre-pandemic trend on average in 2021, but following the lapse of the expanded child tax credit this month, disposable income has likely dipped below trend and, we estimate, will remain an average of 1% below the pre-pandemic trend in 2022—even after penciling in strong gains in labor income.
- Q1 growth is likely to be particularly soft because the fiscal drag will be accompanied by a hit from Omicron. High frequency data indicate that spending on virus-sensitive services has declined sharply since early December, and we estimate that overall real services spending declined by 0.6% in January. But the rebound from Omicron is likely to be swift, and we estimate that consumption will grow at a modest 1.5% annualized pace in Q1.
- Virus spread has also hit the supply side of the economy. Worker absenteeism appears to have peaked at 3.5% of the adult population in early January, and renewed foreign virus restrictions will likely prolong supply chain disruptions and interrupt domestic production. This is likely to weigh on inventory accumulation and exports in Q1.
- Based on our new analysis, we now expect annualized real GDP growth of +0.5% in Q1 (previously +2.0%), +3.5% in Q2 (previously +3.0%), +3.0% in Q3, +2.0% in Q4, and +2.2% in 2022 Q4/Q4 (previously +2.4%). On an annual average basis, our GDP growth forecast is now +3.2% (vs. +3.8% consensus) in 2022.

One Step Back, Two Steps Forward: Q1 Growth and Omicron

Last week's GDP report showed blistering growth of nearly 7% in Q4 (qoq ar), capping off a year in which GDP grew at 5.7%, the fastest rate since the 1980s. However, growth is likely to slow abruptly in 2022, as fiscal support fades further and, in the near term, virus spread weighs on services spending and prolongs supply chain disruptions.

We have long highlighted that the fiscal impulse will fade sharply from 2021 into 2022. Fiscal support boosted real disposable income to 5% above the pre-pandemic trend on average in 2021, but disposable income had faded to trend by the end of the year. Following the lapse of the expanded child tax credit this month, we estimate that disposable income has now dipped below trend and will remain an average of 1% below the pre-pandemic trend in 2022—even after penciling in strong gains in labor income (Exhibit 1). This decline should weigh on consumer spending—and is a large part of why we expect growth to slow to only slightly above potential by the end of the year—but the impact should be cushioned by spending of excess savings built up during the pandemic that still total nearly $2½tn.

Exhibit 1: We Estimate Household Income Dipped Below the Pre-Pandemic Trend After the Expanded Child Tax Credit Expired in January

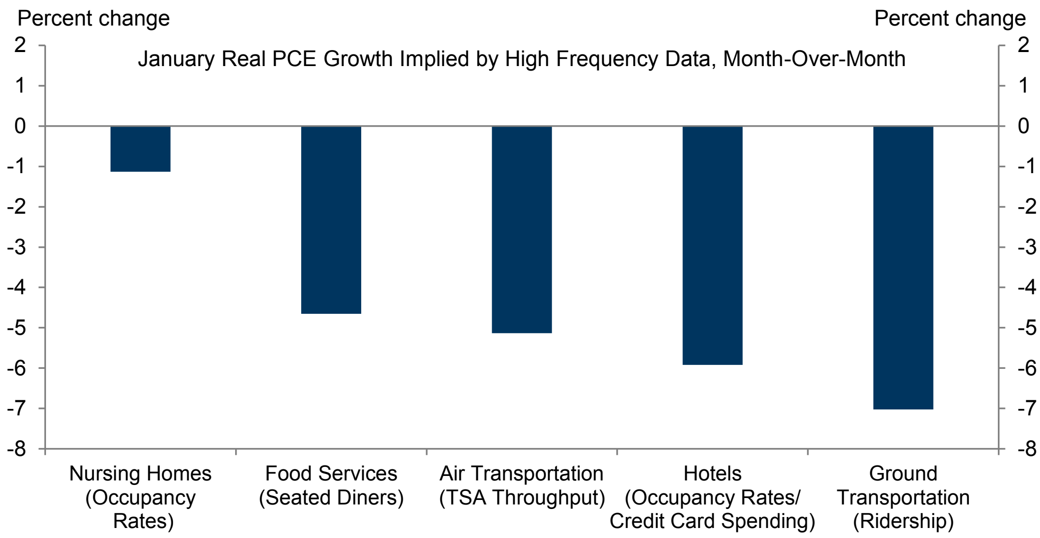


Source: Department of Commerce, Goldman Sachs Global Investment Research

Another Bump in the Road to Service Sector Recovery

While the fiscal headwind will impact 2022 as a whole, Q1 may look especially soft, in part because the rapid spread of the Omicron variant has weighed on services spending and may prolong supply chain disruptions. High frequency data already indicate that spending on virus-sensitive services, like air transportation and food services, has declined sharply (Exhibit 2), a message that has been corroborated by business activity surveys that have softened on net in January.

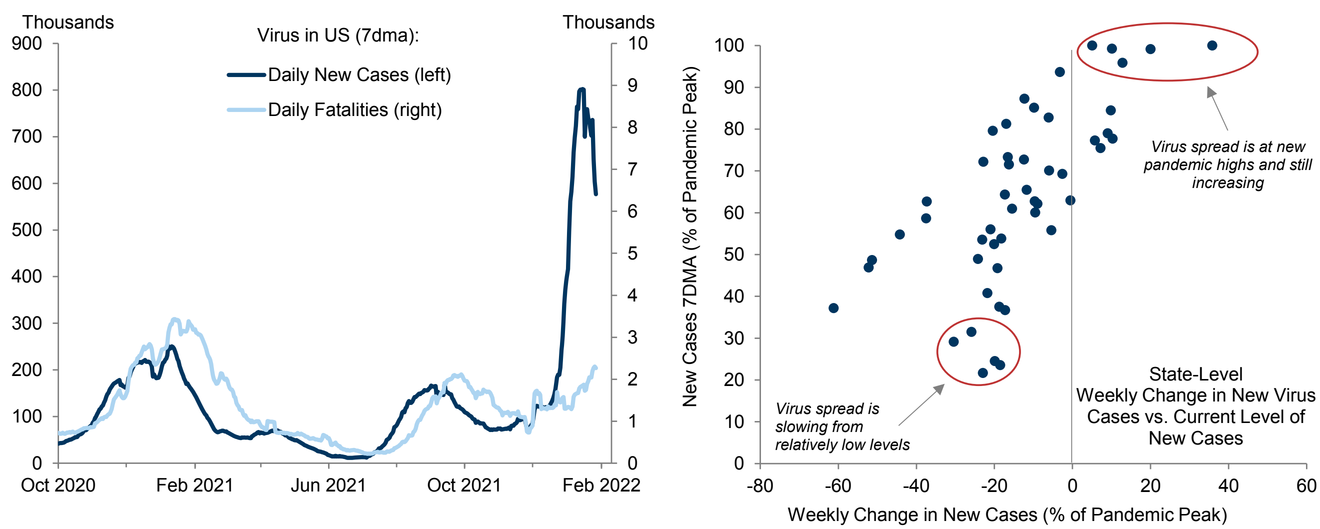
Exhibit 2: High Frequency Data Point to Substantial Sequential Declines in Several Services Categories



Source: Goldman Sachs Global Investment Research

While the hit to virus-sensitive services categories appears deep, the rapid improvement in the domestic virus situation suggests that the weakness may be brief (Exhibit 3, left), though the nationwide rate of improvement might not be as quick as in, for example, South Africa or London, because some states are still on an upward virus trajectory (Exhibit 3, right).

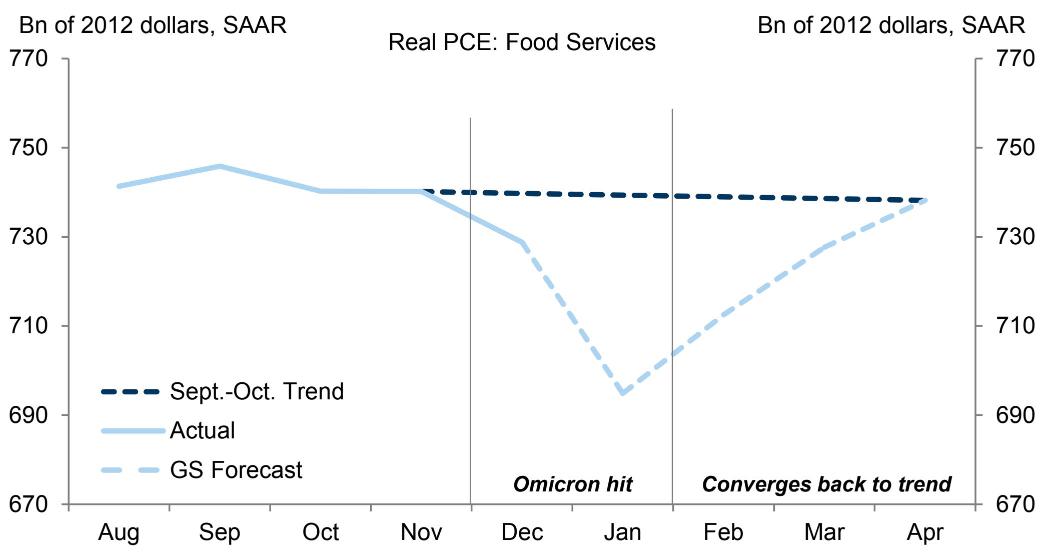
Exhibit 3: While Virus Spread Is Slowing Rapidly on Net, Daily New Cases Are Almost Triple the Delta Peak and Still Increasing in Some States



Source: JHU CSSE, Goldman Sachs Global Investment Research

Following our earlier approach, we estimate the near-term path of consumer services spending using high frequency data to gauge the depth of the Omicron hit at the category level, and then assume that virus-sensitive categories rebound to their pre-Omicron trend by spring (illustrated in Exhibit 4) and that virus-insensitive categories—such as housing—continue to grow at their recent trend.

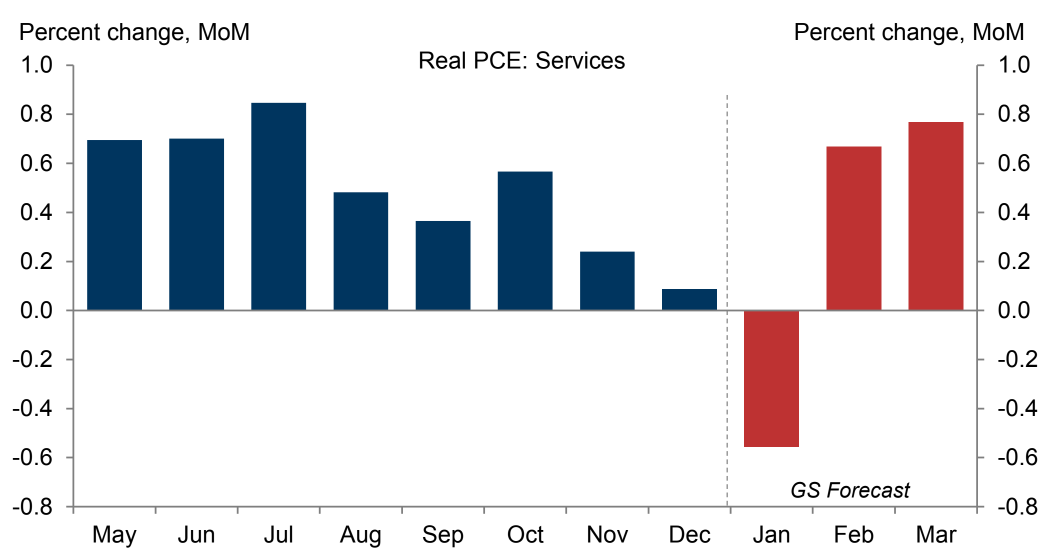
Exhibit 4: We Use High Frequency Data to Gauge the January Trough for Spending on Virus-Sensitive Services, Then Assume That Spending Will Rebound to the Pre-Omicron Trend by Spring



Source: Department of Commerce, Goldman Sachs Global Investment Research

Our modeling suggests that real services spending declined by 0.6% in January (Exhibit 5), but also calls for above trend growth in February and March as the Omicron hit reverses. This implies services spending growth of roughly +1% in Q1 (qoq ar), well below the nearly +5% growth rate of Q4.

Exhibit 5: The Pullback in Virus-Sensitive Services Likely Caused an Outright Decline in Overall Services Spending in January

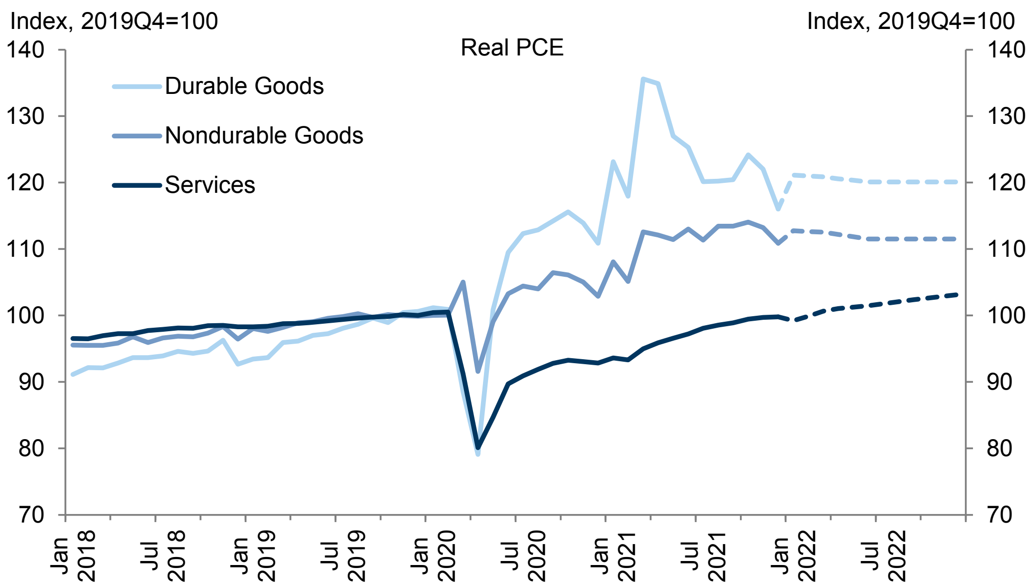


Source: Department of Commerce, Goldman Sachs Global Investment Research

Fortunately, our expectation for a swift rebound in services spending, as well as the reversal of residual seasonality that we believe accounted for most of the sharp decline in durable (-4.9%) and nondurable (-2.1%) goods spending in December, should keep Q1 PCE growth only moderately below trend at +1.5% (qoq ar)—though noticeably below the +3.3% pace in Q4.

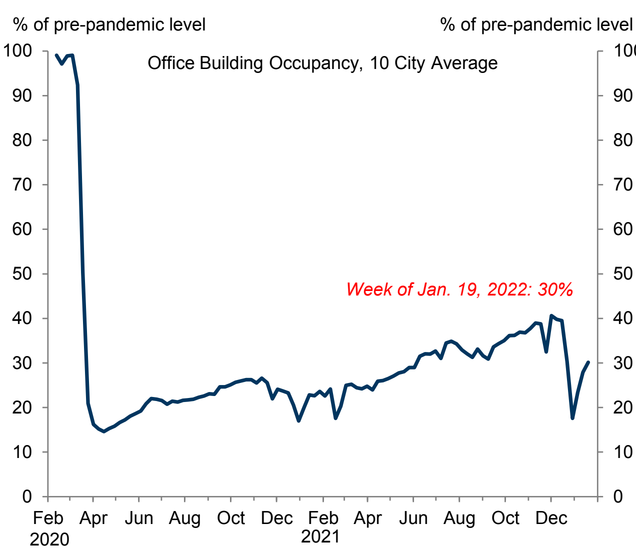
While we expect services spending to quickly return to the pre-Omicron trend, we still think that consumer spending will remain skewed toward goods spending (Exhibit 6)—relative to the pre-pandemic norm—for at least the medium term, in part because a more persistent work from home trend, which has only been reinforced during Omicron as companies have delayed return-to-office plans, will likely contribute to the continued shortfall in spending on office-adjacent services (Exhibit 7).

Exhibit 6: Consumer Spending Remains Skewed Towards Goods—and Is Likely to Remain So Through Year-End



Source: Department of Commerce, Goldman Sachs Global Investment Research

Exhibit 7: Office Attendance in Major Cities Has Not Yet Rebounded from the Holiday Lows, as Elevated Virus Spread Has Delayed Plans to Return to Offices



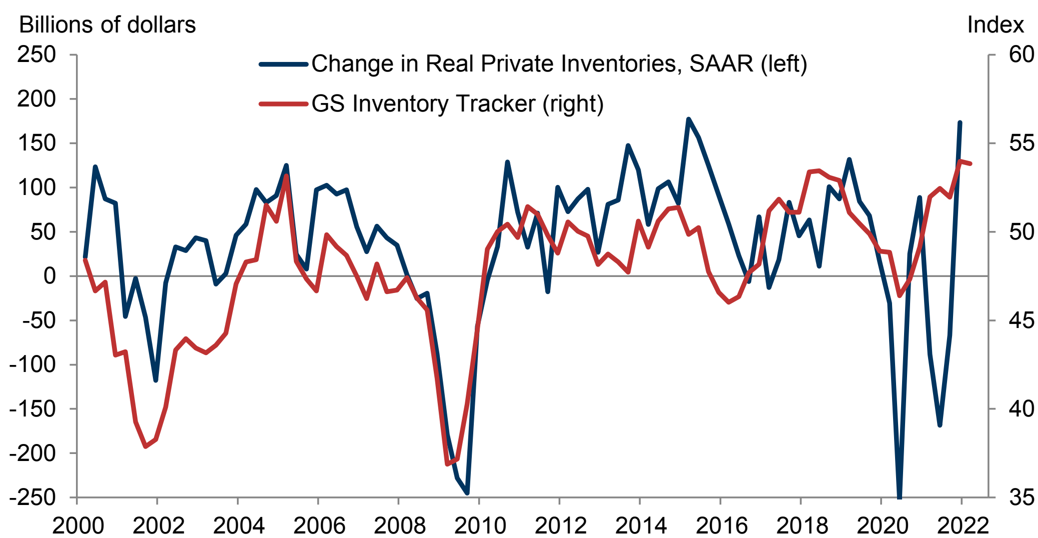
Company	Sector	Planned Return to Office Date
Airbnb	Lodging	September 2022
Apple	Technology	Delayed indefinitely
Chevron	Energy	February 2022
Citigroup	Financial services	February 2022 (for NYC workers)
CNN	Media	Delayed indefinitely
Facebook	Technology	March 2022
Ford	Autos	March 2022
Google	Technology	Delayed indefinitely
JPMorgan Chase	Financial services	February 2022
Lyft	Technology	Earliest in 2023
Microsoft	Technology	Delayed indefinitely

Source: Kastle Systems, Data compiled by Goldman Sachs Global Investment Research

Virus Spillovers to Inventories and Trade

For the purposes of GDP accounting, the *change* in the change in inventories is what impacts GDP growth. Thus, even a repeat of Q4's six-year high for inventory growth—which boosted Q4 GDP growth by 4.9pp—would contribute zero to Q1 GDP growth. Our inventory tracker, which replicates our survey tracker methodology and tracks or leads the inventory investment component of GDP—points to continued inventory build in Q1, but certainly not the acceleration needed to overcome the hurdle set by Q4's rapid accumulation (Exhibit 8).

Exhibit 8: Our Inventory Tracker Points to Continued Inventory Build In Q1, but Not the Acceleration Needed to Offset the GDP Drag from Q4's Rapid Accumulation

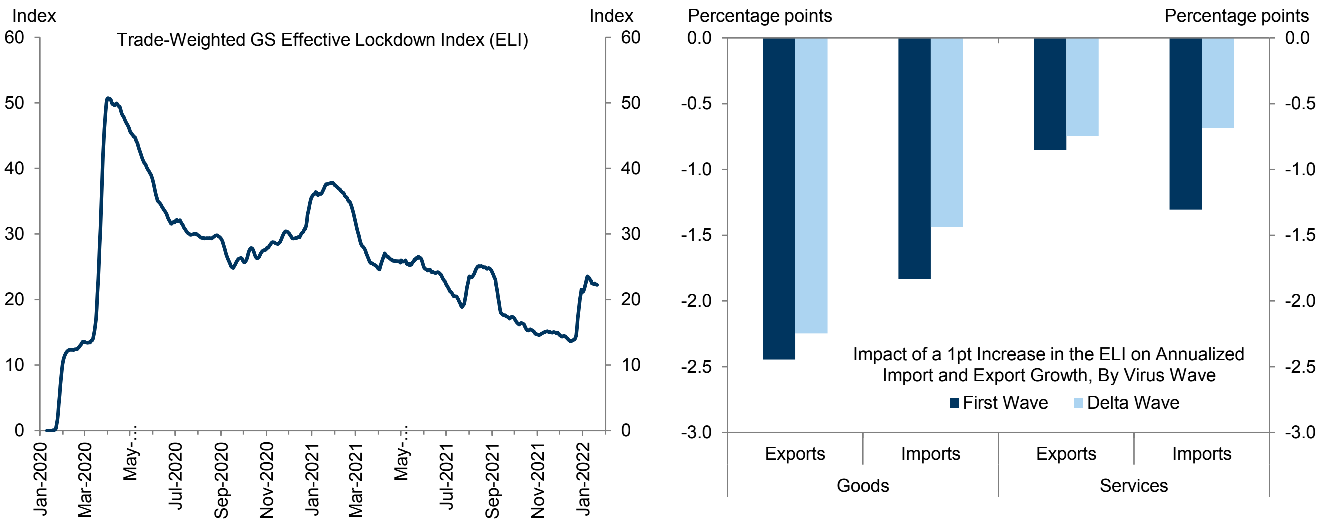


Source: Department of Commerce, Goldman Sachs Global Investment Research

We are currently penciling in +$65bn (annualized) in inventory growth in Q1 (vs. +$173bn in Q4), which would contribute -2pp to Q1 GDP growth. This reflects an expected drawdown in auto inventories based on production schedules and recent company commentary. We are also assuming moderately slower growth in broader manufacturing and trade inventories, in part because Omicron has already caused a disruptive wave of worker absenteeism in the US and threatens to be more disruptive abroad, especially in China.

While the sensitivity of trade—and broader economic activity—to virus spread and restrictions has declined over the pandemic (Exhibit 9, right), renewed foreign virus restrictions are still likely to disrupt the international flow of goods. We estimate that the tightening in the Effective Lockdown Indexes (ELIs) of the US's trade partners would weigh on Q1 exports by 9pp and on imports by 6.5pp (both annualized) if sustained for the rest of the quarter.

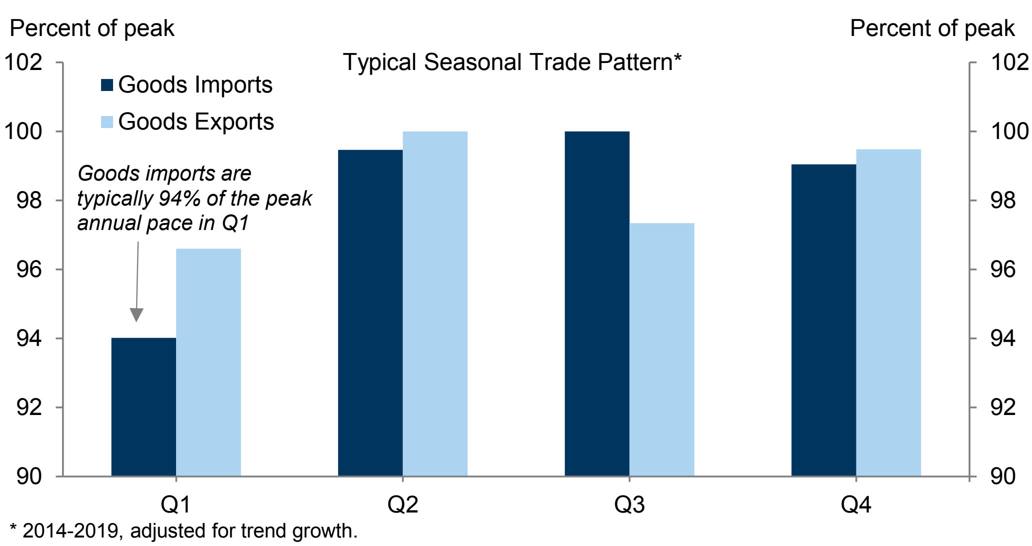
Exhibit 9: Foreign Policy Tightening in Response to Omicron Will Likely Weigh on Trade, Even if the Sensitivity to Changes in Restrictions Is More Moderate Than in Prior Virus Waves



Source: Goldman Sachs Global Investment Research

However, even with the tightening in the ELIs, the outlook for trade in Q1 appears strong, because—in addition to the very strong underlying trend (exports grew +24.5% qoq ar in Q4, imports grew +17.7%)—seasonality will be supportive of goods imports and exports. Goods trade typically declines sharply in Q1 on a not-seasonally adjusted basis because of the Lunar New Year and a post-holiday seasonal lull in demand for goods (Exhibit 10). But with demand so high today and trade instead appearing to be limited by supply constraints, imports and exports could look quite strong on a seasonally-adjusted basis if the not seasonally-adjusted flow of goods remains firm.

Exhibit 10: On a Seasonally-Adjusted Basis, Congested Goods Trade Should Benefit from the Typical Seasonal Lull in Q1



Source: Goldman Sachs Global Investment Research

Our Updated GDP Forecasts

We have lowered our Q1 GDP forecast by 1.5pp to +0.5% (qoq)—mainly reflecting our expectation for a large negative contribution from the inventories component of GDP—and we have nudged up our Q2 forecast by ½pp to +3.5%, which will benefit from the post-Omicron rebound. We have raised Q3 slightly to +3% (from +2.75%) and left Q4 unchanged (at +2.0%), which lowers our 2022 annual average GDP forecast by 0.2pp to +3.2% (vs. +3.8% consensus). However, the annual average masks the sharp deceleration in growth from 2021 into 2022, which is better captured by the 2022 Q4/Q4 rate, which we now expect will be +2.2% (previously +2.4%).

Ronnie Walker

We thank Manuel Abecasis for his extensive contributions to this report.

The US Economic and Financial Outlook

THE US ECONOMIC AND FINANCIAL OUTLOOK
(% change on previous period, annualized, except where noted)

	2019	2020	2021	2022	2023	2024	2025	2021				2022			
			(f)	(f)	(f)	(f)	(f)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
OUTPUT AND SPENDING															
Real GDP	**2.3**	**-3.4**	**5.7**	*3.2*	*2.2*	*2.2*	*2.3*	**6.3**	**6.7**	**2.3**	**6.9**	*0.5*	*3.5*	*3.0*	*2.0*
Real GDP (annual=Q4/Q4, quarterly=yoy)	**2.6**	**-2.3**	**5.5**	*2.2*	*2.0*	*2.2*	*2.2*	**0.5**	**12.2**	**4.9**	**5.5**	*4.1*	*3.3*	*3.4*	*2.2*
Consumer Expenditures	**2.2**	**-3.8**	**7.9**	*2.8*	*2.0*	*2.2*	*2.2*	**11.4**	**12.0**	**2.0**	**3.3**	*1.5*	*2.5*	*2.0*	*2.0*
Residential Fixed Investment	**-0.9**	**6.8**	**9.0**	*0.3*	*2.6*	*2.0*	*2.0*	**13.3**	**-11.7**	**-7.7**	**-0.8**	*4.0*	*4.0*	*3.0*	*3.0*
Business Fixed Investment	**4.3**	**-5.3**	**7.3**	*3.8*	*3.4*	*3.7*	*3.9*	**12.9**	**9.2**	**1.6**	**2.0**	*5.6*	*3.8*	*3.2*	*3.2*
Structures	**2.1**	**-12.5**	**-8.2**	*-2.3*	*1.6*	*2.6*	*3.0*	**5.4**	**-3.0**	**-4.1**	**-11.4**	*1.0*	*1.0*	*1.0*	*1.0*
Equipment	**3.3**	**-8.3**	**12.9**	*2.7*	*2.6*	*2.8*	*3.0*	**14.1**	**12.2**	**-2.4**	**0.8**	*3.5*	*4.0*	*2.5*	*2.5*
Intellectual Property Products	**7.2**	**2.8**	**10.2**	*8.2*	*5.0*	*5.2*	*5.2*	**15.6**	**12.5**	**9.1**	**10.6**	*10.0*	*5.0*	*5.0*	*5.0*
Federal Government	**3.8**	**5.0**	**0.6**	*-2.4*	*-0.8*	*-0.1*	*0.0*	**11.3**	**-5.3**	**-5.1**	**-4.0**	*-1.2*	*-1.0*	*-1.0*	*-1.0*
State & Local Government	**1.3**	**0.9**	**0.3**	*1.7*	*1.6*	*1.0*	*1.0*	**-0.1**	**0.2**	**4.9**	**-2.2**	*2.3*	*2.5*	*2.5*	*2.5*
Net Exports ($bn, '12)	**-905**	**-943**	**-1,281**	*-1,343*	*-1,310*	*-1,274*	*-1,261*	**-1226**	**-1245**	**-1317**	**-1338**	*-1314*	*-1342*	*-1356*	*-1360*
Inventory Investment ($bn, '12)	**75**	**-42**	**-38**	*138*	*109*	*60*	*60*	**-88**	**-169**	**-67**	**174**	*65*	*130*	*180*	*175*
Industrial Production, Mfg.	**-2.0**	**-6.6**	**6.2**	*3.4*	*2.2*	*1.8*	*2.1*	**2.8**	**5.0**	**3.9**	**4.9**	*1.7*	*3.7*	*3.6*	*2.4*
HOUSING MARKET															
Housing Starts (units, thous)	**1,292**	**1,397**	**1,598**	*1,679*	*1,726*	--	--	**1,599**	**1,588**	**1,562**	**1,644**	*1,687*	*1,661*	*1,640*	*1,728*
New Home Sales (units, thous)	**683**	**828**	**765**	*895*	*934*	*928*	*919*	**896**	**737**	**699**	**728**	*890*	*881*	*864*	*946*
Existing Home Sales (units, thous)	**5,327**	**5,658**	**6,132**	*6,154*	*6,242*	*6,318*	*6,393*	**6,303**	**5,833**	**6,057**	**6,333**	*6,111*	*6,141*	*6,169*	*6,194*
Case-Shiller Home Prices (%yoy)*	**3.4**	**9.5**	*15.1*	*9.0*	*2.7*	*3.5*	*3.8*	**12.3**	**16.9**	**19.7**	*15.1*	*12.5*	*11.3*	*10.1*	*9.0*
INFLATION (% ch, yr/yr)															
Consumer Price Index (CPI)**	**2.3**	**1.3**	**7.1**	*4.0*	*2.9*	*2.5*	*2.4*	**1.9**	**4.8**	**5.3**	**6.7**	*7.4*	*6.8*	*5.9*	*4.4*
Core CPI **	**2.2**	**1.6**	**5.5**	*3.9*	*2.8*	*2.6*	*2.5*	**1.4**	**3.7**	**4.1**	**5.0**	*6.2*	*5.5*	*5.0*	*4.3*
Core PCE** †	**1.6**	**1.5**	**4.9**	*2.9*	*2.2*	*2.3*	*2.2*	**1.7**	**3.4**	**3.6**	**4.6**	*5.1*	*4.4*	*3.9*	*3.2*
LABOR MARKET															
Unemployment Rate (%)^	**3.6**	**6.7**	**3.9**	*3.4*	*3.2*	*3.1*	*3.0*	**6.0**	**5.9**	**4.7**	**3.9**	*3.8*	*3.6*	*3.4*	*3.4*
U6 Underemployment Rate (%)^	**6.8**	**11.7**	**7.3**	*6.6*	*6.3*	*6.1*	*5.9*	**10.7**	**9.7**	**8.5**	**7.3**	*7.1*	*6.9*	*6.7*	*6.6*
Payrolls (thous, monthly rate)	**168**	**-785**	**537**	*173*	*115*	*99*	*90*	**518**	**615**	**651**	**365**	*133*	*217*	*187*	*157*
Employment-Population Ratio (%)^	**61.0**	**57.4**	**59.5**	*60.1*	*60.1*	*60.1*	*60.0*	**57.8**	**58.1**	**58.9**	**59.8**	*59.6*	*59.8*	*60.0*	*60.1*
Labor Force Participation Rate (%)^	**63.3**	**61.5**	**61.9**	*62.2*	*62.1*	*62.0*	*61.9*	**61.5**	**61.6**	**61.7**	**61.9**	*62.0*	*62.1*	*62.2*	*62.2*
Average Hourly Earnings	**3.3**	**4.8**	**4.0**	*4.8*	*4.1*	*4.2*	*4.0*	**4.9**	**2.0**	**4.2**	**4.9**	*4.1*	*4.1*	*3.9*	*4.0*
GOVERNMENT FINANCE															
Federal Budget (FY, $bn)	**-984**	**-3,129**	**-2,772**	*-1,100*	*-1,050*	*-1,150*	*-1,300*	--	--	--	--	--	--	--	--
FINANCIAL INDICATORS															
FF Target Range (Bottom-Top, %)^	**1.5-1.75**	**0-0.25**	**0-0.25**	*1.25-1.5*	*2-2.25*	*2.5-2.75*	*2.5-2.75*	**0-0.25**	**0-0.25**	**0-0.25**	**0-0.25**	*0.25-0.5*	*0.5-0.75*	*1-1.25*	*1.25-1.5*
10-Year Treasury Note^	**1.92**	**0.93**	**1.52**	*2.00*	*2.30*	*2.50*	*2.60*	**1.74**	**1.45**	**1.52**	**1.52**	*1.75*	*1.90*	*1.95*	*2.00*
Euro (€/$)^	**1.12**	**1.22**	**1.13**	*1.15*	*1.20*	*1.25*	*1.25*	**1.17**	**1.18**	**1.16**	**1.13**	*1.12*	*1.14*	*1.14*	*1.15*
Yen ($/¥)^	**109**	**103**	**115**	*115*	*110*	*105*	*105*	**111**	**111**	**112**	**115**	*116*	*117*	*116*	*115*

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.
** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.
† PCE = Personal consumption expenditures. ^ Denotes end of period.
Note: Published figures in bold.

Source: Goldman Sachs Global Investment Research

Economic Releases

Date		Time (ET)	Indicator	Estimate GS	Consensus	Last Report
Mon	**Jan 31**	10:30	Dallas Fed Manufacturing Index (January)	n.a.	9.0	8.1
Tue	**Feb 01**	9:45	Markit US Manufacturing PMI (January final)	n.a.	55.0	55.0
		9:00	**Construction Spending (December)**	**+1.0%**	**+0.6%**	**+0.4%**
		10:00	**ISM Manufacturing Index (January)**	**58.2**	**57.5**	**58.7**
		10:00	JOLTS Job Openings (December)	n.a.	10,300k	10,562k
		17:00	**Lightweight Motor Vehicle Sales (January)**	**14.5M**	**12.70M**	**12.44M**
Wed	**Feb 02**	**8:15**	**ADP Employment (January)**	**flat**	**+200k**	**+807k**
Thu	**Feb 03**	**8:30**	**Initial Jobless Claims**	**245k**	**250k**	**260k**
		8:30	Continuing Claims	n.a.	1,600k	1,675k
		8:30	**Nonfarm Productivity (Q4 preliminary)**	**+3.2%**	**+3.2%**	**-5.2%**
		8:30	**Unit Labor Costs (Q4 preliminary)**	**+1.2%**	**+1.0%**	**+9.6%**
		9:45	Markit US Services PMI (January final)	n.a.	50.9	50.9
		10:00	**ISM Services Index (January)**	**60.0**	**59.0**	**62.0**
		10:00	**Factory Orders (December)**	**-1.0%**	**-0.2%**	**+1.6%**
Fri	**Feb 04**	**8:30**	**Nonfarm Payrolls (January)**	**-250k**	**+150k**	**+199k**
		8:30	**Private Payrolls (January)**	**-275k**	**+150k**	**+211k**
		8:30	**Unemployment Rate (January)**	**3.9%**	**3.9%**	**3.9%**
		8:30	**Average Hourly Earnings (January)**	**+0.6%**	**+0.5%**	**+0.6%**
		8:30	Labor Force Participation Rate (January)	n.a.	61.9%	61.9%

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Joseph Briggs and Ronnie Walker, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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