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US Economics | North America

4Q GDP: Growth slows with a drag from the shutdown

Real GDP rose 1.4% q/q a.r. in 4Q, vs. our 1.3% estimate and consensus 2.8%. The slowdown was exaggerated by a 1pt drag from federal shutdown, as expected. More fundamentally, private final domestic purchases rose 2.4%, slowing from 2.9% in 3Q and 2.5% y/y, with slower consumption & faster capex.

Key Takeaways

- Core PCE prices +2.7% in 4Q, a tenth above our expectations, and headline PCE +2.9%. Core PCE rose 0.355% m/m in Dec, slightly below our expectation.
- The 4Q cons slowdown reflected slower real goods cons, services remained solid. We expect a tariff drag in 1Q despite an expected uptick in Jan retail sales.
- Real DPI rose just 0.07% in 4Q, the second quarter in a row of nearly flat growth. The saving rate fell further from 4.2% in 3Q to 3.6% in 4Q.
- AI accounted for about ½ of the rise in capex, though AI-imports lowered its overall contribution to GDP to near zero. Other capex picked up on faster R&D.
- With 4Q GDP largely as we expected, our 1Q estimate remains at 2.2%.

MORGAN STANLEY & CO. LLC

Michael T Gapen

Chief US Economist

Michael.Gapen@morganstanley.com

+1 212 761-0571

Sam D Coffin

Economist

Sam.Coffin@morganstanley.com

+1 212 761-4630

Diego Anzoategui

Economist

Diego.Anzoategui@morganstanley.com

+1 212 761-8573

Arunima Sinha

Global Economist

Arunima.Sinha@morganstanley.com

+1 212 761-4125

Heather Berger

Economist

Heather.Berger@morganstanley.com

+1 212 761-2296

Lingdi Xu

Economist

Lingdi.Xu@morganstanley.com

+1 212 761-2957

4Q GDP

The GDP report mostly fit our expectations for slowing after a strong 4Q. The slowdown to an 1.3% pace was exaggerated by the government shutdown, but private final domestic purchases too slowed to 2.4% vs 2.9% in 3Q and 2.5%/y. The slowdown was led by consumption, and tariffs will likely be a bigger drag on consumption in 1Q. Capex remained narrow outside of AI, but there were some signs of improvement in R&D spending. Residential investment fell -1.5% after a 7.1% decline in 3Q.

For the year, the 4Q GDP report underlines the gradual slowing in domestic demand. At times last year, that slowdown was obscured in the GDP data by large swings in inventories and imports. But real consumer spending decelerated to 2.2%/y in 4Q from 3.4% a year earlier. Business capex picked up slightly including non-AI spending (Exhibit 8). Real residential investment was down 3.7% y/y in 4Q after a 1.3% rise a year earlier.

Trade and inventory investment together added 0.3 pct pt to growth, in line with our estimate. We do not expect further drops in imports as they [have likely retraced frontloading effects](#). The surge in imports last spring had appeared to be frontloading ahead of tariffs. There was some of that, but more of the surge appears to have been AI-related purchases of tech. With hyperscalers' capex plans accelerating, there is no reason to expect reversal. Other imports, non-AI, generally did not show the same surge in demand; there was little excess to reverse; they likely soften gradually as tariffs continue to take a toll.

No change to our forecasts for 2026. Our 1Q real GDP growth remains at 2.2%, and our full year at 2.4%.

Exhibit 1: 4Q GDP

	4Q/4Q % change		Q/Q % change, a.r. (unless noted)				forecast	error
	2024	2025	1Q25A	2Q25A	3Q25A	4Q25E		
Real GDP	2.4	2.2	-0.6	3.8	4.4	1.4	1.3	0.1
Final Sales ¹	2.6	2.4	-3.2	7.5	4.5	1.2	0.9	0.3
Final Domestic Demand²	3.0	1.9	1.4	2.4	2.8	1.1	0.9	0.2
Final Private Domestic Demand³	2.9	2.5	1.9	2.9	2.9	2.4	2.2	0.2
Personal Consumption Expenditures	3.4	2.2	0.6	2.5	3.5	2.4	2.2	0.2
– Goods	4.2	1.3	0.2	2.2	3.0	-0.1	0.2	-0.3
– Services	3.0	2.6	0.8	2.6	3.6	3.4	3.1	0.3
Nonresidential Fixed Investment	0.9	5.9	9.5	7.3	3.2	3.7	2.6	1.1
– Structures	-4.8	-4.5	-3.1	-7.5	-5.0	-2.4	-2.0	-0.4
– Equipment	3.2	9.4	21.4	8.5	5.2	3.2	4.7	-1.5
– IPP	2.3	8.6	6.5	15.0	5.6	7.4	3.0	4.4
Residential Investment	1.3	-3.7	-1.0	-5.1	-7.1	-1.5	1.0	-2.5
Exports	3.3	1.7	0.2	-1.8	9.6	-0.9	2.0	-2.9
Imports	6.2	-2.0	38.0	-29.3	-4.4	-1.3	1.2	-2.5
Government	3.6	-1.0	-1.0	-0.1	2.2	-5.1	-6.0	0.9
Inventory contribution (pct pts, a.r.)	-0.2	-0.2	2.6	-3.4	-0.1	0.2	0.3	-0.1
Trade contribution (pct pts, a.r.)	-0.5	0.5	-4.7	4.8	1.6	0.1	0.1	0.0
Nominal GDP (Current \$)	4.9	5.6	2.9	6.0	8.3	5.1	4.0	1.1
Nominal Consumption	6.0	5.1	4.1	4.7	6.3	5.3	5.1	0.2

1) GDP less contribution from inventory investment

2) GDP less contributions from inventory investment and trade

3) GDP less contributions from inventory investment, trade, and the government sector. (Private final consumption plus investment.)Source: BEA, Morgan Stanley Research

Inflation

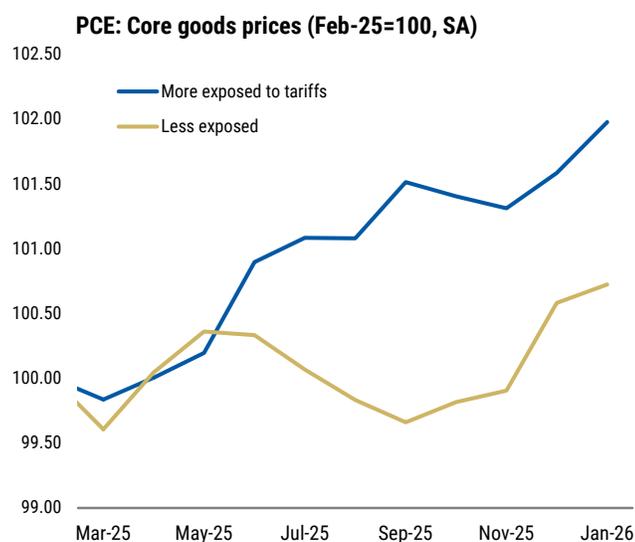
Core PCE inflation rose 0.36% m/m in December, slightly lower than our expectation

(consensus 0.3%, MSe 0.39%).

The December reading is consistent with core PCE 3-month annualized inflation at 3.07% (2.39% in November), and the 6-month annualized pace at 2.87% (2.68% in November). The 12-month comes at 3.00% in December (vs 2.83% in November).

The December data combined with our tracking for January core PCE at 0.49%/m/m implies a 12-month pace for core prices at 3.07%, above target but also higher than 2024 and 2025 q4/q4 inflation. We think the Fed is aware of typical seasonal distortions during the first quarter of the year and, as a consequence, the acceleration in prices in January doesn't change the FOMC's outlook materially. We continue to expect two cuts in 2H26 as inflation starts to decelerate in 2Q26.

Exhibit 2: The tariff push continues



Source: BLS, BEA, Morgan Stanley Research.

As expected, core goods prices reaccelerated in December after relatively soft prints in October and November.

The tariff pass-through continued in December with rising prices of goods more exposed to tariffs. Goods less exposed to tariffs also accelerated, but mainly due to payback in software prices after months of weakness. We forecast another strong core goods PCE reading in January, with a continued push from tariffs. If we are right in our forecasts, the total effect of tariffs on core PCE prices would be 50bp by January. Our models suggest a total tariff push of 70bp, which means that the remaining tariff impulse for the rest of 2026 is about 20bp.

Core services accelerated in December as we anticipated.

Consistent with CPI numbers, housing inflation came in stronger in December. But the key component explaining the strength in services was "Recreation Services". In particular, video and video games subscriptions rose sharply in December contributing more than 10bp to the overall print, and keeping services elevated despite the relatively weak print in healthcare.

Exhibit 3: PCE inflation summary

PCE m/m (%)	Sep-25 m/m	Oct-25 m/m	Nov-25 m/m	Dec-25 m/m	y/y
Headline	0.26	0.20	0.21	0.36	2.90
Food at Home	0.45	-0.01	-0.01	0.41	
Energy	1.69	-0.26	1.75	0.25	
Core	0.19	0.23	0.17	0.36	3.00
Core Goods	0.18	0.00	-0.02	0.43	1.97
Core Services	0.19	0.31	0.23	0.33	3.33
Housing	0.15	0.14	0.14	0.30	
Transportation Services	0.71	0.26	0.23	-0.19	
Healthcare Services	0.11	0.45	0.26	0.02	
Recreation Services	0.26	0.03	-0.01	2.30	
Food Services and Accommodations	0.28	0.13	0.14	0.86	
Financial Services and Insurance	0.14	0.93	0.59	0.61	
Communication Services	-0.27	0.18	0.62	-1.81	
Education Services	0.12	0.21	0.21	0.09	
Professional and Other Services	-0.10	0.18	0.35	0.05	
Personal Care and Clothing Services	0.83	0.40	0.40	0.57	
Social Services and Religious Activity	0.39	0.31	0.38	0.55	
Household Maintenance	0.60	0.90	0.90	-3.16	
Foreign Travel by U.S. Residents	0.48	-0.08	-0.33	0.69	
Less: Expenditures in the U.S. by Nonresidents	0.95	-0.08	0.05	0.74	
Nonprofit Institutions Serving Households	0.29	-0.38	-0.37	0.05	
Core Services ex Housing	0.21	0.36	0.25	0.34	3.34

Source: BEA, Morgan Stanley Research.

Consumption and income

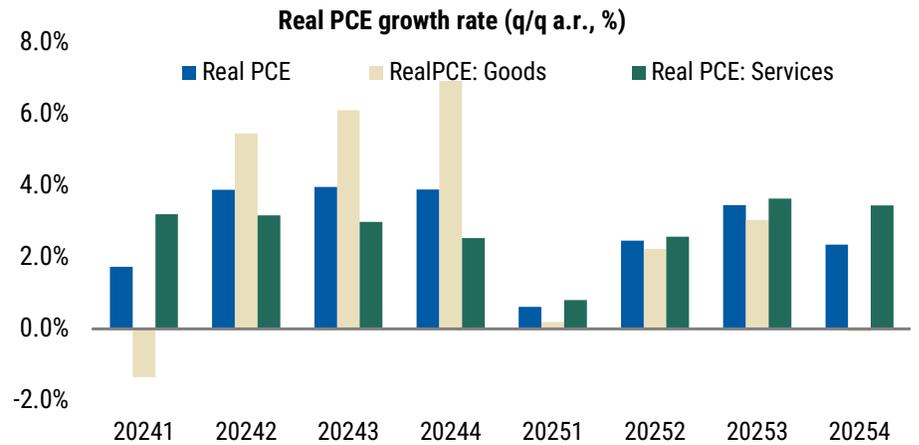
Quarterly real consumption spending was up 2.4%q/q for 4Q25, with real goods spending -0.1%, and the strength primarily in services consumption (up 3.4%). The biggest drag on goods consumption was the close to 1pct pt drop in real durable goods consumption (-0.9% q/qsar), due to the big drop in auto purchases (down 6.6%). Within services, the strength was fairly broad-based.

The December monthly spending data showed that the quarter ended on a soft note, with real personal spending up 0.1% m/m. There was also downward revisions to real spending for October and November (revisions for the two months were -0.2%). The monthly data also indicates that real goods spending was weak throughout the quarter, with December being the softest month. Real services spending for December remained in line with the moderate pace of the prior months.

Real disposable personal income rose 0.07% q/q saar in 4Q, in-line with our expectation and the second quarter in a row of nearly flat real DPI growth. Real labor compensation was stronger in 4Q, +1.4%. Income was dragged down by declines in proprietor's income and rental income. With solid consumption but slow income growth, the saving rate fell from 4.2% in 3Q to 3.6% in 4Q.

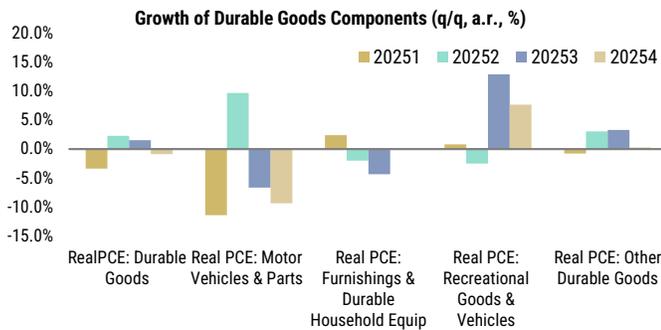
In December, nominal personal income rose 0.3% m/m and real disposable personal income was flat. Labor compensation was weaker in December as expected, with nominal labor comp up 0.2% m/m on the back of slower hours. Proprietor's income and transfer receipts were strong in Dec, while rental and asset income were weaker.

Exhibit 4: Real consumption spending has slowed in 2025



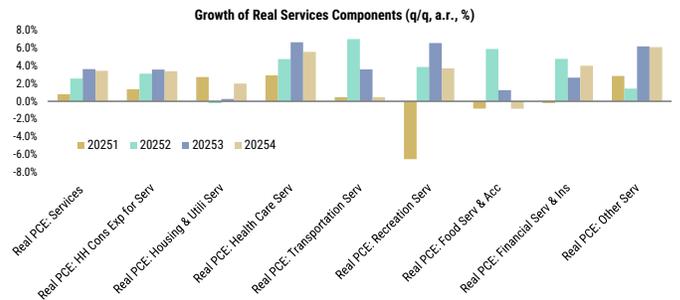
Source: BEA, Haver Analytics, Morgan Stanley Research

Exhibit 5: The drag on real goods consumption was related to autos



Source: BEA, Haver Analytics, Morgan Stanley Research

Exhibit 6: Most services categories have continued to show solid growth in 2025



Source: BEA, Haver Analytics, Morgan Stanley Research

Nonresidential investment

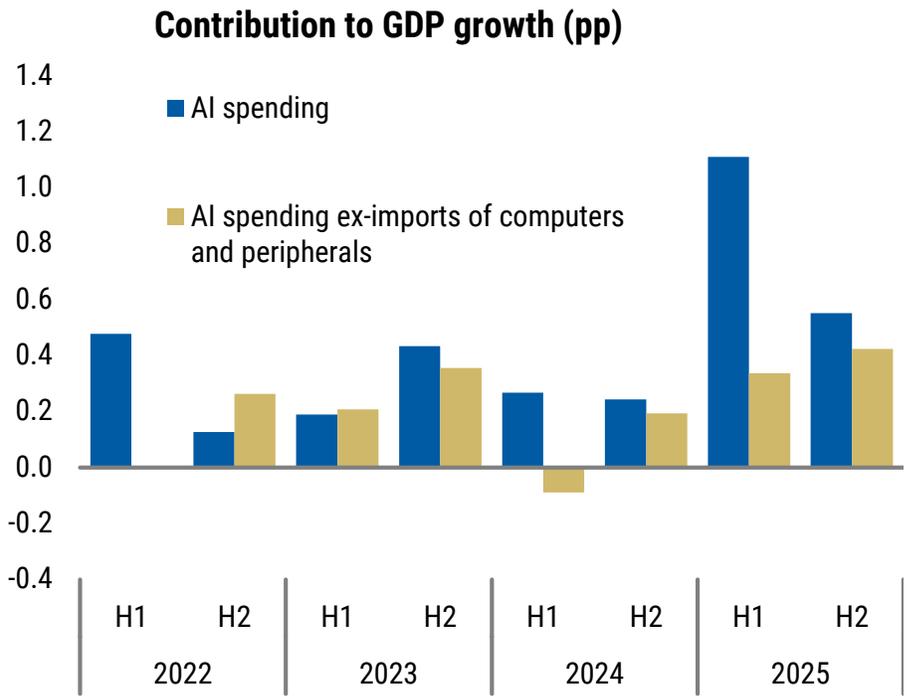
AI-related spending (data centers, power structures, IT equipment, software)

accounted for most of the rise in nonresidential capital spending. AI-related spending directly contributed 0.8 pct pt to real GDP growth; however, the positive contribution to growth from business spending was fully offset by imports of AI-related capital goods. After adjusting for the drag from imports, AI-related spending actually subtracted a tenth from real GDP growth; over the past year, it added an average of 0.13 pct pt per quarter.

Real spending on software is reported up at a 6.9% annual rate in 4Q, and would have been stronger except for a sharp upswing in prices, which rose 3.9%. Those prices are above trend now and we expect some reversal in coming quarters.

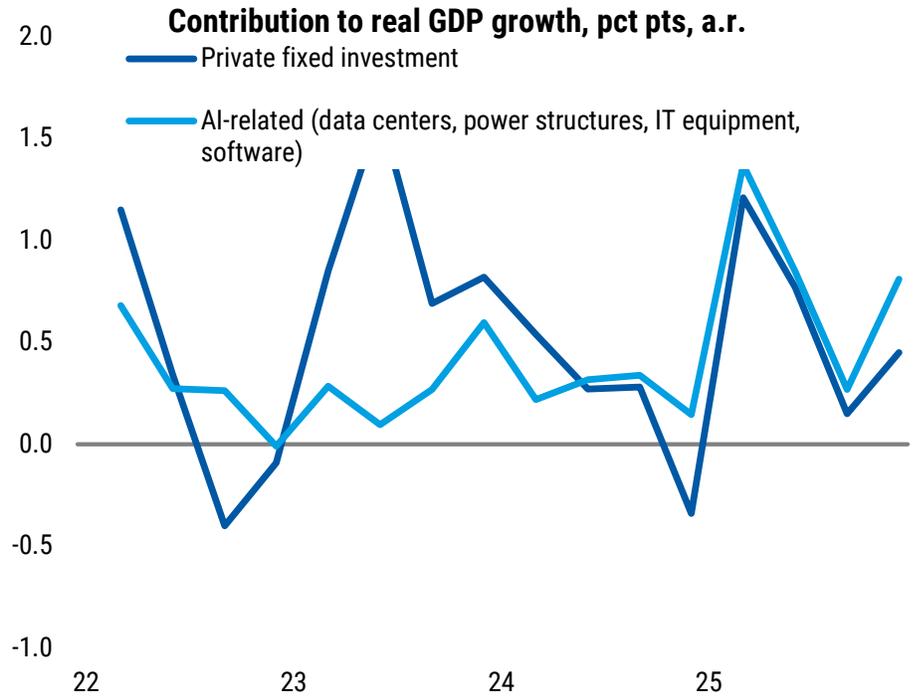
Elsewhere, capex was not quite as weak as in recent quarters. R&D spending rebounded. But industrial and transport equipment investment remained weak.

Exhibit 7: A smaller contribution from AI, exaggerated by software pricing



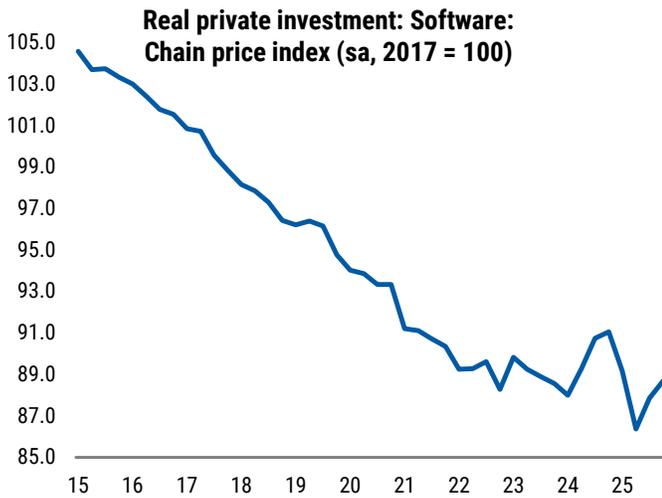
Source: BEA, Morgan Stanley Research

Exhibit 8: AI-related spending accounted for much of the growth in nonresidential fixed investment in 4Q



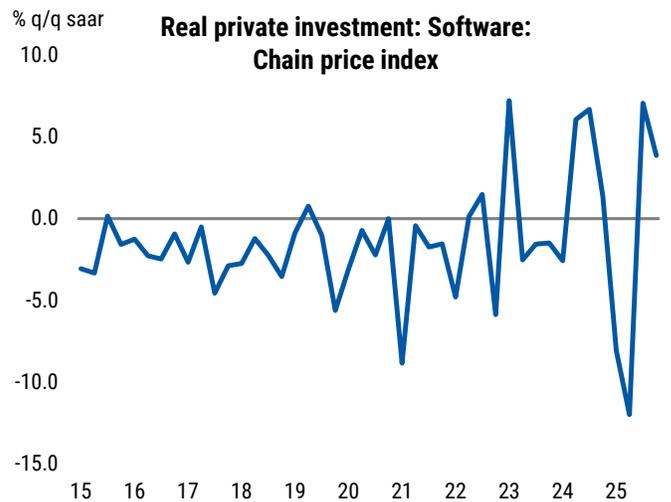
Source: BEA, Morgan Stanley Research

Exhibit 9: Software prices bounced above trend...



Source: BEA, Haver Analytics, Morgan Stanley Research

Exhibit 10: Without the rise in software prices, AI-related investment would have been stronger.



Source: BEA, Haver Analytics, Morgan Stanley Research

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