Analyzing Shifts in GDP under the Trump Administration

Gallagher Financial Planning's Investment Strategy Team

Since President Trump's inauguration in January, his administration has moved swiftly to reshape the Federal Government and the broader economy of the United States. Given that this is President Trump's second term, his Administration understands the importance of decisive action to ensure the President can leave behind the legacy he envisions. Two of his main points of focus thus far have been improving the balance of trade and increasing efficiency within the Federal government with regard to spending and its workforce. These topics have circulated through financial news for months, but people are now starting to consider the effects of these changes as the projection for the upcoming first quarter's Gross Domestic Product or "GDP" have turned negative[1]. For many, this can be disconcerting as after nearly three years (eleven quarters) of uniterupted growth, it appears that the first quarter of 2025 might break this streak. Although this is a normal reaction to a weaking economy, as the saying goes, "the devil is in the details."

GDP Overview

GDP is released quarterly and only includes finished goods and services produced within the country

GDP is the monetary value of all the finished goods and services produced within a country. Which means that products that are in process/unfinished or sold as used are both excluded from the calculation. This indicator of economic performance is released on a quarterly basis and is typically analyzed on a quarterly or annual basis. Quarterly GDP can be used to evaluate the short-term effects of specific market events such as the implementation of tariffs as well as changes in monetary and fiscal policy. As opposed to annual GDP, which is often used by analysts to compare national economies of similar sizes.

The four components of GDP are Personal Consumption Expenditures, Private Investment, Government Spending, and Net Exports

Taking it a step further, there are two main types of GDP. First, Nominal GDP, which measures the total value of all goods and services produced at current market prices. For this calculation, there are no adjustments for inflation, which can create complications when comparing two economies with drastically different inflation rates. In contrast, Real GDP measures the total value of goods and services but adjusts for any inflation or deflation. To put more simplistically, Real GDP measures actual growth as it adjusts for the rise in values associate with inflation. Whereas Nominal GDP is the full rise in values (growth + inflation). For this reason, Real GDP is the preferred measure for economic activity as using "constant prices" rather than "current prices" allows for a more accurate measure of economic change over time without the added impact of inflation.

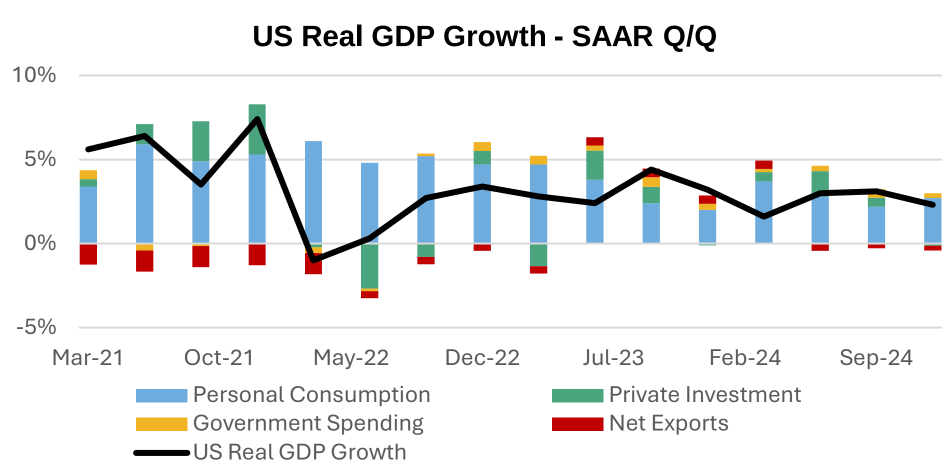
Components of GDP

[1] Projection based on the Atlanta Fed's GDPNow Forecast of GDP for the first quarter of 2025.

While GDP is reported as a single figure, it represents the sum of four distinct areas of economic activity. These components include Personal Consumption Expenditures, Private Investment, Government Spending, and Net Exports. Each of these components are calculated independently, with no overlap in spending or products, to ensure that GDP is an accurate representation of economic activity. The detailed breakdown of each component's contribution to total GDP can be used to identify trends in which areas of the economy are growing or shrinking. This information is essential to investors as it can be used to better understand economic trends and mitigate potential risks.

Source: Bloomberg

Personal Consumption Expenditures represents the largest portion of GDP among the four components



Personal Consumption Expenditures is the total amount of spending by consumers on goods and services during a given period. Over the past 50

While change in private inventories is often discussed, the true driver of the Private Investment component is fixed investment

years, personal consumption has always represented the majority of GDP. It accounted for about 60% of GDP at the end of 1974 but has since trended higher reaching a peak of 69% in mid-2021 and settling at 68% by the end of 2024. This shows that the U.S. economy is driven in large part by consumer spending as it had made up more than 59% of total GDP since 1975. Taking this a step further, its rising contribution shows the U.S. economy's growing reliance on persistent consumer spending.

Moving onto the next component, Private Investment is the total amount of spending companies made to produce their goods and services. This component is made up of two sub-components, fixed investment and change in private inventories. While financial news often emphasizes the impact of a change in private inventories, the sub-component only accounted for about 0.29% of total Private Investment, and 0.052% of total GDP in 2024. It's clear that the true driver of private investment is actually fixed investment which represented 99.71% of Private Investment and 17.75% of GDP at the end of 2024. This falls right near the middle of its 50-year range from 13-21%.

Impact of Reduced Government Spending

Government Spending is the third component that makes up GDP. This value encompasses Federal, State, and Local government spending and has historically ranged from 17-23% of total GDP. While the range is fairly tight, the impact of government spending has been declining as its highest contribution of 23% occurred in 1975. To contrast, its lowest contribution of 17% was seen in the most recent quarter and has strictly occurred in years after 2015.

Breakdown of U.S. GDP in Q4 2024

Components of GDP	Nominal Contribution	Percent Contribution
Personal Consumption Expenditures	**$20,262.70**	**68.2%**
Goods	$6,352.50	21.4%
Services	$13,910.20	46.8%
Private Investment	**$5,289.90**	**17.8%**
Fixed Investment	$5,274.40	17.7%
Change in Private Inventories	$15.50	0.1%
Net Exports	**-$931.10**	**-3.1%**
Exports	$3,218.60	10.8%
Imports	-$4,149.70	-14.0%
Government Spending	**$5,098.10**	**17.2%**
Federal	$1,924.70	6.5%
National Defense	$1,110.60	3.7%
Nondefense	$814.20	2.7%
State and Local	$3,173.30	10.7%

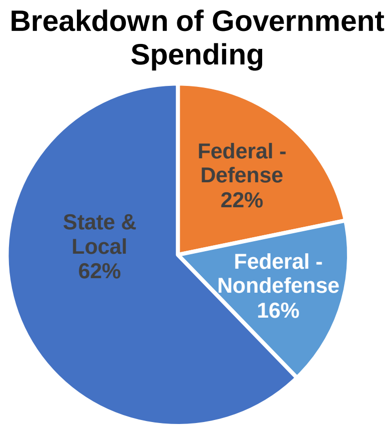
Source: Bloomberg. Data in billions.

Net exports contribute the lowest nominal amount to GDP of the four total components

The reported $16.5 billion cut in federal spending will have a negative impact of less than 1/10th of a percent on GDP

government only accounted for 38% of the total government spending in the United States in the final quarter of 2024

Given the Trump Administration's emphasis on reducing the size of the federal government, we decided to further analyze the data to understand the magnitude these changes could have on GDP. At the end of 2024, Federal spending accounted for 38% of total government spending, which means that 62% of government spending was done by State and Local governments. Federal spending can be further split into two sub-components, national defense (22%) and nondefense (16%).



Source: Bureau of Economic Analysis.

Going further down the rabbit hole of GDP contributions, when breaking down the contributions from the federal government, we note a few key observations. First, the majority of the contribution comes from defense spending at roughly 58% of the federal government's contribution as of the end of 2024. Second, and equally important is that nondefense spending represented 42% of the federal government's contribution in the last quarter of 2024. This equates to a contribution of less than 3% or about $814 billion to GDP. Compared to defense-focused spending, this subcomponent covers funding for Medicare and Medicaid, Social Security, and the salaries of federal government employees. With the current proposed workforce cuts and agency budget reductions, this sub-component looks to be impacted the most. Thus far, the newly established Department of Government Efficiency (DOGE) claims to have cut $55 billion from federal government spending, but based on published receipts this amount is closer to $16.5 billion. This would result in a miniscule -0.056% impact on total GDP.

Impact of a Rise in Net Exports

The final component of GDP is Net Exports. This is calculated by subtracting total imports or the goods we purchase from outside the U.S. from total exports or the goods we produce in the U.S. and sell abroad. Historically, net exports are the only component that has consistently produced a negative figure over the past 50 years. While its impact on total GDP has ranged from -6% to +1%, the difference in nominal terms from 1975 to 2024 is astounding. Net exports at the end of 1975 represented a trade surplus with a (+) $13.8 billion impact on total GDP, compared to the current quarter where the U.S. had a (-) $931 billion trade deficit.

Impact of Net Exports on GDP

Decade	Net Exports	GDP	Impact
1980's	-$78.68	$4,173.16	-1.89%
1990's	-$100.92	$7,577.18	-1.33%
2000's	-$577.61	$12,601.26	-4.58%

2010's	-$539.22	$18,030.00	-2.99%
2020's	-$880.54	$26,648.15	-3.30%

Source: Bloomberg. Data in billions.

The projected decline in GDP for Q1 2025 is driven by an influx of imports as companies stocked up prior to the implementation of additional tariffs

As illustrated, the impact of the trade balance over the past 50 years has significantly fluctuated in terms of percent of GDP. While a trade deficit has become increasingly more normal, it has been widening in recent years. Throughout the 1980's and 1990's, the trade deficit averaged less than 2.0% of GDP. This significantly changed in the 2000's, when it jumped to 4.6%. The average drags on GDP later settled in the 2010's around 3.0% before beginning to rise again in the current decade where they have averaged 3.3%. For these reasons, it is understandable that the Trump Administration is focused on reducing the deficit and balancing trade.

While specific tariffs have already been implemented, in preparation for the frequently discussed broader implementation of reciprocal tariffs, many companies have "front loaded" their imports through bulk purchases prior to the implementation of these new tariffs. This was generally done to avoid the additional costs associated with tariffs in the future and to conceivably provide some flexibility in the near term as companies adjust to potentially higher costs. Consequently, this unusual increase in imports has resulted in a largely negative projection for net exports in the first quarter of 2025. While this figure has had a minimal impact on GDP in the past, net exports are projected to push GDP growth into negative territory for the first time since 2022.

The last time the United States had a trade surplus was in the third quarter of 1980

The expectation for negative growth in GDP has led to renewed recession fears for some market participants. The reason for this is because two consecutive quarters of negative GDP growth was previously considered an indicator of a recession. However, situations such as these show the importance of truly understanding the data. If you were to strip net exports out or replace it with last quarter's value, the upcoming change in GDP is expected to be positive as all other components look to be growing as of this publication. This shows that the projected decline in GDP was driven by the significant inflow of imports that were "front loaded" to avoid the upcoming tariffs and may only be temporary. The other takeaway is that the rest of the economy appears to be healthy as the other components of GDP have remained stable, which should help to put some investors at ease.

Conclusion

Putting it all together, measuring the growth of any economy, especially the largest one on the planet, is overly complex and challenging. Investors are astutely aware that any changes to how such a complex system operates has the potential to have a widespread impact. While the pace and magnitude of the changes coming from the Trump Administration have not been seen in over a generation, it is important to also put them in perspective of the overall economy and the true drivers of growth: consumers and businesses.

Jason Orlosky
Head of Investment Strategy & Platform
Area Vice President
Gallagher Financial Planning Team
Jason_Orlosky@ajg.com
(609) 532-3909

Jim McCarriston*

Client Investment Analyst
Gallagher Financial Planning Team
Jim_McCarriston@ajg.com
(781) 246-1433

Ryan Gallagher*

Client Investment Analyst
Gallagher Financial Planning Team
Ryan_Gallagher1@ajg.com
(781) 404-5202

*Jim McCarriston and Ryan Gallagher are not acting in the capacity of an investment advisor representative

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Index definitions

S&P 500 Index: is a capitalization weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 500 of the leading large cap U.S. companies.

Dow Jones Industrial Average Index: is a price weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 30 blue-chip stocks that are generally regarded as the leaders in their industry.

NASDAQ Composite Index: is a capitalization weighted index that is generally considered representative of the U.S. Technology market. It consists of all three tiers of the NASDAQ: Global Select, Global Market, and Capital Market.

Russell 2000 Index: is a capitalization weighted index that is generally considered representative of the U.S. Small Cap market. It consists of 2,000 of the leading small cap U.S. companies.

MSCI EAFE Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of developed international markets. The EAFE region includes developed market countries in Europe, Australasia, the Far East, and Israel.

MSCI Europe Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of European developed markets.

MSCI Japan Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Japanese market.

MSCI Emerging Markets Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

MSCI China Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Chinese market.

Bloomberg U.S. Aggregate Bond Index: is a broad-based flagship benchmark that measures the investment grade U.S. dollar denominated, fixed-rate, taxable bond market. The index includes Treasuries, government-related and corporate securities, Mortgage-Backed Securities or "MBS" (agency fixed-rate pass-throughs), Asset-Backed Securities or "ABS", and Commercial Mortgage-Backed Securities or "CMBS" (agency and non-agency).

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Bloomberg U.S. Corporate High Yield Bond Index: measures the U.S. dollar denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating from the ratings agencies (Moody's, Fitch, and S&P) are Ba1/BB+/BB+ or below. Bonds issued from an emerging market country are excluded from the index.

Crude Oil: is represented by the generic front month futures contract for West Texas Intermediate (WTI) crude oil.

Gold Spot Price: is represented by the current spot price of one Troy Ounce of gold in U.S. dollars.

Inflation: is measured by the year-over-year change for the Consumer Price Index or "CPI". This index represents the changes in the prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer) and sales and excise taxes paid by consumers are also included.

Fed Funds Rate: is the target interest rate set by the U.S. Federal Reserve (Fed) or "Central Bank". This index reflects the Fed's efforts to influence short-term interest rates as part of its monetary policy strategy. The index value is calculated by using the midpoint of the Fed's rate policy when they target a rate range (i.e., 0.25% - 0.50%).

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