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## Q4 2012 Real GDP: GDP Underperforms Even The Most Mediocre Of Expectations

- The BEA's first estimate shows real GDP contracted at an annualized rate of 0.1 percent following annualized growth of 3.1 percent in Q3.
- The GDP Price Index rose at an annualized rate of 0.6 percent during Q4, down from annualized growth of 2.7 percent in Q3.
- For 2012 as a whole, real GDP grew by 2.2 percent, ahead of the 1.8 percent increase for 2011.

There are near misses, there are off by a mile misses, and then there are not even in the same universe misses. The BEA's first pass at Q4 2012 real GDP falls into the latter category, with the initial estimate showing the economy contracted at an annualized rate of 0.1 percent, thus managing to underperform even the most mediocre of expectations. And, while it's too late to reason with the recessionistas already filling the air waves with cries of "I told you so, the economy is in a recession," the rest of us will want to actually look at the details of the Q4 report. Sure, doing so doesn't lessen the shock value of the headline number, but it does at least show an economy being pulled in opposite directions – public and private sectors, foreign and domestic – and ending up going nowhere during 2012's fourth quarter.

Recall that during 2012's third quarter the combination of a large build in private sector inventories and higher government spending, mainly a function of a surprising spike in defense spending, accounted for roughly half of reported real GDP growth of 3.1 percent. We had anticipated these factors would be reversed in the Q4 data, and this was indeed the case, but to a larger extent than we had anticipated (see the second chart below). Together, a significantly smaller inventory build and a decline in government spending took 2.6 percent off of top-line real GDP growth. We had also expected trade to be a small drag on Q4 growth, and this was the case with trade shaving 0.25 percent off of top-line growth. Note, however, the BEA's first estimate incorporates estimates of many data points, including the December trade gap. If, as we expect, the December trade gap comes in materially smaller than November's, the drag from trade will be even smaller.

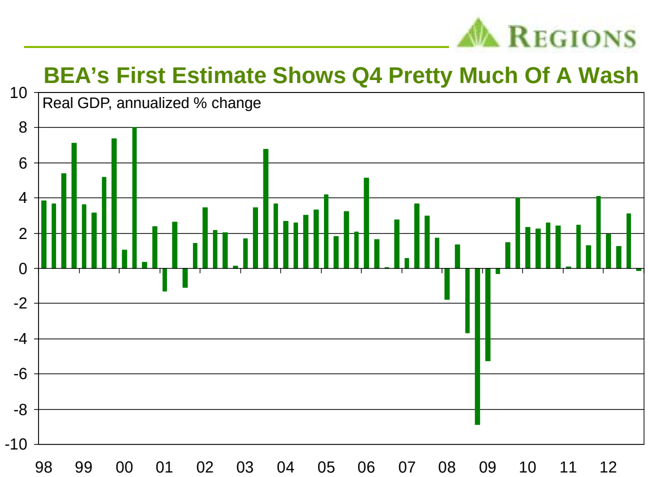
For a different take on the performance of the U.S. economy in Q4, consider real final sales to private domestic purchasers – GDP stripping out inventories, exports, and government. This metric, which is the best measure of underlying demand in the private domestic sector, rose at an annualized rate of 3.1 percent in Q4, up from annualized growth of 1.7 percent in Q3. Sure, those so inclined can, and will, dismiss this as an attempt to manipulate the data to arrive at a happy place, to which we will simply say "knock yourselves out."

Real consumer spending grew at an annualized rate of 2.2 percent during Q4, up from 1.6 percent growth during Q3. Higher motor vehicle sales fueled 13.9 percent growth in consumer spending on durable goods, with spending on household services growing at a faster pace. After having declined during Q3, business spending on equipment and software rebounded in a big way during Q4, with annualized growth of 12.4 percent coming in ahead of our expectations – the recovery in core capital good shipments over the last few months pointed to a rebound in the Q4 GPD data. Another source of growth in private domestic demand in Q4 was residential investment, which added 0.36 percent to top-line growth – note that 2012 was the first year since 2005 that residential investment added to, rather than deducted from, top-line GDP growth.

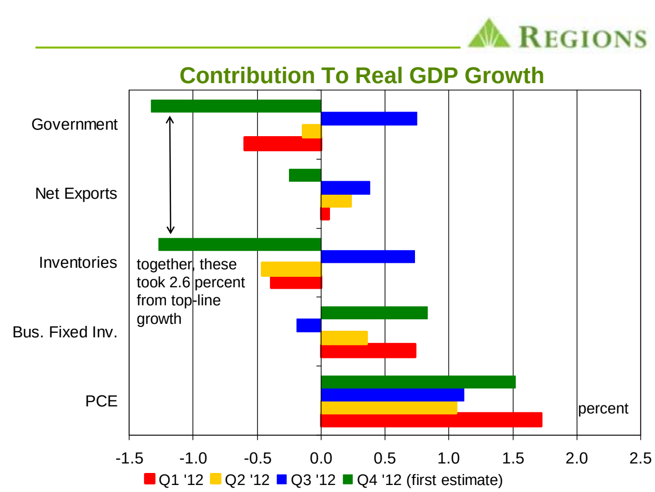
Another strong detail of the Q4 report is the 6.8 percent annualized growth in real disposable personal income (7.9 percent excluding transfer payments). This was underpinned by a surge in dividend income in anticipation of higher tax rates on investment income in 2013, which will obviously not be repeated in the current quarter. But, it is worth noting that there was a significant acceleration in growth of wage and salary earnings, which rose at an annualized rate of 3.6 percent during Q4, as presaged by the faster growth in aggregate private sector earnings in the November and December employment reports.

A wise old economist (now much older but no less wise) once told us "the number is what the number is." As such, we'll take the Q4 GDP report at face value but note the dichotomy in the underlying details. The current quarter, it will face its own challenges, particularly from our "leaders" in Washington, but there is nothing in the data that points to the economy being in recession or going there anytime soon.

**BEA's First Estimate Shows Q4 Pretty Much Of A Wash**




**Contribution To Real GDP Growth**

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