Consumer Metrics Institute News

October 27, 2011: GDP Improves Dramatically

The Bureau of Economic Analysis's (BEA) first ("Advance") estimate of third quarter 2011 U.S. Gross Domestic Product (GDP) was reported to be 2.46%, nearly twice the rate reported for the second quarter. The improvements were broadly spread across all sectors of the economy, with consumer goods and services showing the greatest strength. Even the contraction in governmental spending that had been a fixture of the prior three quarters subsided, and the increasing rate of inventory draw-downs indicates that supply chains were struggling to keep up with consumers.

Among the notable items in the report**:**

-- Aggregate consumer expenditures for goods flipped from prior quarter contraction (-0.38%) to slight growth (now reported to be +0.35%).

-- The growth of consumer expenditures for services was substantially stronger during the quarter, at an improved (yet arguably still modest) 1.38% annualized growth rate. Between them, the consumer improvements in expenditures for both goods and services were large enough to generate the entire growth in the headline number.

-- The growth rate of private fixed investments was also reported to be improving, with the annualized growth rate now reported to be 1.60%.

-- The draw-down of inventories accelerated during the quarter, indicating that production has lagged demand. This change may be a good sign for the overall health of the economy, and the lower inventory levels may signal the need for increasing factory activities in the near future.

-- Total expenditures by governments at all levels flattened out, breaking a string of three prior quarters of contraction. The changes were primarily at the state and local levels, where "consumptive expenditures" (i.e., operating budgets) continued to shrink but were offset by increasing investments on infrastructure.

-- Exports strengthened slightly relative to the second quarter, raising the contribution that they made to the overall GDP growth rate to 0.55%.

-- Imports also increased somewhat when compared to the prior period, and are now removing -0.34% from the growth rate of the overall economy. The combination of the revisions in the import and export numbers nearly offset each other and made a miniscule -0.03% downward change in the published headline number.

-- The annualized growth rate of "real final sales of domestic product" was sharply higher at 3.54% -- more than double the 1.62% annualized rate recorded for the second quarter. This was the result of the higher consumer expenditures for both goods and services, and the increased draw-down of inventories.

-- Working backwards from the data tables, the effective "deflater" used by the BEA to offset the impact of inflation was 2.52%, essentially unchanged from the second quarter. In a significant shift from prior reports this number is higher than similar data from the BEA's sister agencies -- which have more tightly tracked the impact of gasoline and grocery costs over the past year and a half. Substituting the line-item

appropriate (CPI or PPI) current inflation rate published by the Bureau of Labor Statistics (BLS) causes the "real" GDP growing at a 2.94% annualized growth rate, slightly higher than the headline rate. This reverses two prior quarters where a BLS price-deflated GDP was actually in contraction.

-- The only really negative data in the report relates to per-capita disposable income, which was reportedly shrinking at an annualized -1.7% rate during the third quarter (and a -2.32% annualized rate using the BLS CPI as a deflater). This one line item largely explains the mood of the general public, since these per-capita numbers are what impacts individual Americans and are the real source of the frustration within the populace.

The Numbers (as Revised)

As a quick reminder, the classic definition of the GDP can be summarized with the following equation:

GDP = private consumption + gross private investment + government spending + (exports â imports)

or, as it is commonly expressed in algebraic shorthand**:**

GDP = C + I + G + (X-M)

For the first quarter of 2011 the values for that equation (total dollars, percentage of the total GDP, and contribution to the final percentage growth number) are as follows**:**

GDP Components Table

	Total GDP	=	C	+	I	+	G	+	(X-M)
Annual $ (trillions)	$15.2	=	$10.8	+	$1.9	+	$3.0	+	$-0.6
% of GDP	100.0%	=	71.1%	+	12.6%	+	20.1%	+	-3.8%
Contribution to GDP Growth %	2.46%	=	1.73%	+	0.52%	+	0.00%	+	0.24%

The quarter-to-quarter changes in the contributions that various components make to the overall GDP can be best understood from the table below, which breaks out the component contributions in more detail and over time. In the table we have split the "C" component into goods and services, split the "I" component into fixed investment and inventories, separated exports from imports, added a line for the BEA's "Real

Finals Sales of Domestic Product" and listed the quarters in columns with the most current to the left**:**

Quarterly Changes in % Contributions to GDP

	3Q-2011	2Q-2011	1Q-2011	4Q-2010	3Q-2010	2Q-2010	1Q-2010	4Q-2009	3Q-2009	2Q-2009	1Q-2009
Total GDP Growth	2.46%	1.34%	0.36%	2.36%	2.50%	3.79%	3.94%	3.81%	1.69%	-0.69%	-6.66%
Consumer Goods	0.35%	-0.38%	1.10%	1.87%	1.09%	0.87%	1.45%	0.12%	1.70%	-0.52%	0.05%
Consumer Services	1.38%	0.87%	0.36%	0.61%	0.75%	1.18%	0.47%	0.21%	-0.04%	-0.76%	-1.07%
Fixed Investment	1.60%	1.07%	0.15%	0.88%	0.28%	2.12%	0.15%	-0.42%	0.13%	-2.26%	-5.09%
Inventories	-1.08%	-0.28%	0.32%	-1.79%	0.86%	0.79%	3.10%	3.93%	0.21%	-0.58%	-2.66%
Government	0.00%	-0.18%	-1.23%	-0.58%	0.20%	0.77%	-0.26%	-0.18%	0.28%	1.21%	-0.33%
Exports	0.55%	0.48%	1.01%	0.98%	1.21%	1.19%	0.86%	2.51%	1.49%	-0.02%	-3.82%
Imports	-0.34%	-0.24%	-1.35%	0.39%	-1.89%	-3.13%	-1.83%	-2.36%	-2.08%	2.24%	6.26%
Real Final Sales	3.54%	1.62%	0.04%	4.15%	1.64%	3.00%	0.84%	-0.12%	1.48%	-0.11%	-4.00%

Summary

The improved numbers in the consumer sector were much stronger than consensus expectations, although to a large extent they only mirrored our data at the Consumer Metrics Institute -- which had been showing dramatic improvements in on-line consumer demand for discretionary durable goods since our indexes bottomed in late May. The improved numbers also seem to have caught the factories off guard, and the rapid draw-down in inventories should improve corporate bottom lines later this year.

But as good as the numbers are for 3Q-2011 -- and they are broadly stronger across nearly all segments of the economy -- it is important to keep a 2.46% annualized growth rate in perspective. If the economy is now in the tenth quarter of "recovery" from the "Great Recession" we might expect something much stronger. On the other hand this headline number is probably high enough to ward off further Quantitative Easing experiments by the Federal Reserve -- since it is certainly not prima facie evidence of a need for even more desperate monetary or fiscal actions by government, even if the growth rate remains sluggish by historical "recovery" standards.

And perhaps most importantly, the restive public saw their per-capita slice of the pie shrink yet again. This report certainly makes for good headlines and provides ample material for positive political spin. But we expect that the mood of most Americans will be one of disbelief -- especially with regard to their household budgets and employment prospects. The dramatic changes in consumer spending during the third quarter are most likely directly tied to moderating gasoline and grocery prices -- not fundamental changes in household disposable income or wealth. Until those start to improve (and unemployment

numbers drop sharply) we don't expect this upward bounce to have real legs.

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