Consumer Metrics Institute News

November 22, 2011: Third Quarter GDP Revised Downward

In their second estimate of the third quarter 2011 GDP, the Bureau of Economic Analysis (BEA) revised the headline growth number downward by over a half percent to an annualized growth rate of 2.01%. The real story within the data, however, was that compared to last month's "Advance" estimate the new report showed substantially weaker commercial fixed investments while the draw-down of inventory levels was more intense -- putting the new numbers for third quarter aggregate commercial GDP into net contraction. In general consumer contributions were slightly weaker, while a substantial downward revision in imports somewhat softened the bad news in the headline number. Meanwhile, the public's per-capita disposable income continued to shrink -- but at a newly revised and sharply greater rate.

As usual, this revision to the prior month's report does not reflect actual changes in the economy, but rather a month's improvement in the BEA's understanding of what was happening in the prior quarter. As such it tells us as much about the BEA's "guesstimating" processes as it does about the economy.

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

-- Aggregate consumer expenditures for goods was revised downward slightly to a +0.30% annualized growth (previously reported to be +0.35%).

-- The annualized growth rate for consumer expenditures was also revised downward by 0.05%, and is now estimated to be at 1.33%.

-- The growth rate of private fixed investments was lowered by 0.15%, with the new number coming in at 1.45%.

-- The draw-down of inventories is now nearly a half percent worse than previously reported, pulling -1.55% from the headline annualized growth rate. Conventional wisdom is that this bodes well for the economy in the future, since production will presumably have to eventually ramp-up to replace that lost inventory.

But in fact there are a number of wildly conflicting ways to spin this inventory number:

-- Production has lagged demand, with factories struggling to keep up with increasing demand (unfortunately implausible given the anemic consumer growth numbers mentioned above);

-- Factories are reducing inventories in anticipation of weakening demand (plausible);

-- Inventory levels were ridiculously high to begin with (implying that much of the "recovery" was wishful thinking; again plausible);

-- Factories have simply cut production costs by cutting production levels (thereby inflating bottom lines without the benefit of increasing commerce; highly plausible);

-- Or our favorite: the BEA's deflaters have shot them in the foot again (with deflating commodity prices "shrinking" inventories even as physical inventories remain largely unchanged; also highly plausible).

Of the five spin scenarios outlined above, the only positive one is also the least plausible.

-- Total expenditures by governments at all levels is now reported to be very slightly contracting, continuing a string of four quarters of contraction. This number masks a duality in state and local spending levels, where "consumptive expenditures" (i.e., operating budgets) continue to shrink but are partially offset by increasing investments on infrastructure.

-- Exports are now reported to be slightly higher relative to the previous estimate, raising the contribution that they made to the overall GDP growth rate to +0.58%.

-- Imports dropped substantially compared to the previous "Advance" report, and are now removing only -0.09% from the growth rate of the overall economy (previously this number was -0.34%, a full quarter of a percent worse for the headline number).

-- The annualized growth rate of "real final sales of domestic product" was revised up slightly to +3.56%. This was the result of the higher draw-down of inventories offsetting the generally weaker numbers shown elsewhere.

-- Working backwards from the data tables, the effective "deflater" used by the BEA to offset the impact of inflation was 2.49%, essentially unchanged from the previous report. Again, unlike past quarters this number is generally in the same ball-park as 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 2.46% annualized growth rate, somewhat higher than the official headline rate.

-- Perhaps the most negative item among the revisions is in per-capita disposable income, which was revised sharply downward and is now reportedly shrinking at an annualized -2.1% rate during the third quarter (revised from a -1.7% in the previous "Advance" estimate). If you are looking for one line item that largely explains the mood of the general public, this is the one to monitor.

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)

In the new report 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%	+	12.5%	+	20.1%	+	-3.7%
Contribution to GDP Growth %	2.01%	=	1.63%	+	-0.10%	+	-0.02%	+	0.50%

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	2.01%	1.34%	0.36%	2.36%	2.50%	3.79%	3.94%	3.81%	1.69%	-0.69%	-6.66%
Consumer Goods	0.30%	-0.38%	1.10%	1.87%	1.09%	0.87%	1.45%	0.12%	1.70%	-0.52%	0.05%
Consumer Services	1.33%	0.87%	0.36%	0.61%	0.75%	1.18%	0.47%	0.21%	-0.04%	-0.76%	-1.07%
Fixed Investment	1.45%	1.07%	0.15%	0.88%	0.28%	2.12%	0.15%	-0.42%	0.13%	-2.26%	-5.09%
Inventories	-1.55%	-0.28%	0.32%	-1.79%	0.86%	0.79%	3.10%	3.93%	0.21%	-0.58%	-2.66%
Government	-0.02%	-0.18%	-1.23%	-0.58%	0.20%	0.77%	-0.26%	-0.18%	0.28%	1.21%	-0.33%
Exports	0.59%	0.48%	1.01%	0.98%	1.21%	1.19%	0.86%	2.51%	1.49%	-0.02%	-3.82%
Imports	-0.09%	-0.24%	-1.35%	0.39%	-1.89%	-3.13%	-1.83%	-2.36%	-2.08%	2.24%	6.26%
Real Final Sales	3.56%	1.62%	0.04%	4.15%	1.64%	3.00%	0.84%	-0.12%	1.48%	-0.11%	-4.00%

Summary

This report does not bode well for a number of reasons:

-- The headline number, at face value, is anemic -- especially given that we are now six quarters into a "recovery," when numbers well north of 3% should be expected.

-- When compared to month-earlier data, this set of revisions again tells us that the BEA has initially been misreading the economy with an optimistic bias. This follows a trend that is best exemplified by the massive downward revisions to the numbers for the "Great Recession" announced by the BEA this past July. The problem, of course, is that it is not just the public that looks at this data -- in principle the data exists primarily to inform policy makers. We're not sure that it is in the best interests of the economy to have policy makers always looking through rose tinted glasses.

-- The numbers would be worse if not for a substantial drop in the impact of imports. Weakening consumption of imported goods may be positive for the BEA's massive GDP spreadsheet, but we're not convinced that it signals a strong economy either domestically or globally.

-- The contracting per-capita disposable income not only explains the public's mood, it is a bad omen for holiday spending and any hope that this "recovery" (such as it is) has long to live.

In short, the BEA reports that growth is poor by historical "recovery" standards and that consumer disposable income is contracting at a significant rate. And other factors in the report (including weakening demand for imported goods and factories lowering inventory levels) indicate that overall levels of commerce are not nearly as good as the headline number might indicate. This is neither a ringing endorsement of an ongoing "recovery" nor an sign that consumers will be the engine of organic growth necessary to sustain one.

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