Consumer Metrics Institute News

December 22, 2011: Third Quarter GDP Revised Downward Yet Again

In their third estimate of the third quarter 2011 GDP, the Bureau of Economic Analysis (BEA) revised the headline growth number downward once again to an annualized growth rate of 1.81%. This revision represents a drop in the reported growth rate of well over a half percent (-0.65%) from the BEA's original reading of the third quarter, now moving the latest growth rate closer to the second quarter's anemic 1.34% growth rate than the misleadingly optimistic numbers provided to us just two months ago.

The bulk of the downward changes over the past two months have come from two factors: a much lower estimate for the consumption of consumer services and a greatly increased "draw down" of inventories. Exports were stronger than originally thought, and imports were shown to be weaker -- although in both cases the changes came at least partially from a fuller recognition of the stronger currency and weakening commodity prices (particularly oil). Meanwhile, the public's per-capita disposable income was still reported to be shrinking (at an annualized -1.9% rate), which does not bode well for the real economy moving forward.

This revision to the prior month's report does not reflect actual changes in the economy, but rather another month's improvement in the BEA's understanding of what was happening in the prior quarter. But such revisions continue to tell us much about the timeliness of the BEA's data collection processes, and the quality of the data that we can expect from their earliest reports.

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

-- Aggregate consumer expenditures for goods was revised slightly to a +0.33% annualized growth (previously reported to be +0.30%).

-- The annualized growth rate for consumer services was revised sharply downward by -0.43%, and is now estimated to be at 0.90%. This is likely a sign of both dropping demand and eroding prices within the consumer services sector.

-- The growth rate of private fixed investments was increased by 0.07%, with the new number coming in at 1.52%.

-- The draw-down of inventories is now reported to be pulling -1.35% from the headline annualized growth rate. If that number is correct it implies that manufacturers were being extremely cautious during the third quarter -- tightening inventories in anticipation of a weakening economy and engineering better bottom lines as a consequence of the reduced production costs. It remains likely, however, that the inventory "draw down" is at least partially an phantom artifact of dropping commodity prices -- with the inventory valuations moving downward in concert with weakening prices even as physical inventory levels remained largely unchanged.

-- Total expenditures by governments at all levels is reported to be very slightly contracting, continuing a string of four quarters of contraction. This number masks a duality between Federal and state and local spending levels, where Federal increases (primarily defense spending, which added 0.27% to the headline number) were more than offset by contracting state and local spending. Furthermore, for state and local governments "consumptive expenditures" (i.e., operating budgets) continue to drop sharply but are at least 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 +0.64%.

-- Imports are now removing -0.21% from the growth rate of the overall economy, nearly unchanged from the -0.24% rate reported for the second quarter -- which was supposedly a one-quarter suppression of imports as a consequence of the Sendai tsunami.

-- The annualized growth rate of "real final sales of domestic product" was revised slightly to +3.16%, with the number that high largely as a consequence of the (possibly phantom) reduction in inventories.

-- Working backwards from the data tables, the effective "deflater" used by the BEA to offset the impact of inflation was 2.57%, slightly higher than 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 volatility 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 to be growing at a 2.32% annualized growth rate, more than a half percent higher than the official headline rate.

-- Perhaps the most negative item in the report concerns per-capita disposable income, which is now reported to have been shrinking at an annualized -1.9% rate during the third quarter.

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%	+	12.6%	+	20.1%	+	-3.7%
Contribution to GDP Growth %	1.81%	=	1.23%	+	0.17%	+	-0.02%	+	0.43%

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	1.81%	1.34%	0.36%	2.36%	2.50%	3.79%	3.94%	3.81%	1.69%	-0.69%	-6.66%
Consumer Goods	0.33%	-0.38%	1.10%	1.87%	1.09%	0.87%	1.45%	0.12%	1.70%	-0.52%	0.05%
Consumer Services	0.90%	0.87%	0.36%	0.61%	0.75%	1.18%	0.47%	0.21%	-0.04%	-0.76%	-1.07%
Fixed Investment	1.52%	1.07%	0.15%	0.88%	0.28%	2.12%	0.15%	-0.42%	0.13%	-2.26%	-5.09%
Inventories	-1.35%	-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	0.64%	0.48%	1.01%	0.98%	1.21%	1.19%	0.86%	2.51%	1.49%	-0.02%	-3.82%
Imports	-0.21%	-0.24%	-1.35%	0.39%	-1.89%	-3.13%	-1.83%	-2.36%	-2.08%	2.24%	6.26%
Real Final Sales	3.16%	1.62%	0.04%	4.15%	1.64%	3.00%	0.84%	-0.12%	1.48%	-0.11%	-4.00%

Summary

This report continues a tendency of the BEA to revise their previously published data downwards, and it brings their "final" reading for the economy's annualized growth rate for the third quarter of 2011 (now reportedly 1.81%) far closer to the anemic data for the first two quarters of 2011 (0.36% and 1.34% respectively) than to the highly optimistic 2.46% headline that they generated just two months ago. This report, even if taken at face value, is sobering for a number of reasons:

-- A headline number of 1.81% is disappointing given that we are now six quarters into a "recovery," when numbers closer to 4% should be expected.

-- Federal fiscal spending continued to sustain the headline number, with defense spending contributing more than a quarter of a percent. Any successful efforts to restrain the deficit will have direct and immediate impact on these numbers.

-- The contracting per-capita disposable income explains the public's mood, even if consumers are seemingly "self-medicating" their psyches through increased (and perhaps ill-considered) holiday spending.

-- When compared to earlier data for the same quarter, this set of revisions again tells us that the BEA has been chronically misreading the economy with an optimistic bias (best exemplified by the massive downward revisions to the numbers for the "Great Recession" this past July). If the Federal Reserve continues to believe that it can and should "engineer" the economy for happier outcomes, we hope that their tinkering is informed by better and more timely data than that provided by the BEA.

Given the recent tendencies of the BEA to eventually revise weak data even lower -- and especially in such cases as the first two quarters of 2011, when they have used badly lagging deflaters -- we see no reason to believe that the actual U.S. economy during 2011 experienced any meaningful growth. Coupled with shrinking per-capita "real" disposable income and the likelihood of curtailed defense spending, we find the prospects for a happy new year to be far less than we might have wished.