Consumer Metrics Institute News

March 29, 2012: BEA Leaves 4Q-2011 Annualized GDP Growth Essentially Unchanged at 2.97%

In their "final" revision of their estimate of the fourth quarter 2011 GDP, the Bureau of Economic Analysis (BEA) found that the annualized rate of U.S. domestic economic growth was 2.97%, down a mere 0.01 percent from their last estimate for the fourth quarter and still more than a percent higher than their "final" estimate of 1.81% for the third quarter of 2011. This revision to the prior month's report does not reflect actual monthly changes in the economy, but rather another month's improvement in the BEA's understanding of what was happening during the prior quarter.

Even if there was no meaningful alteration in the headline number, there were a few notable changes within the "mix" of the components. The contribution that the consumption of consumer goods made to the headline number strengthened, but it was offset by a nearly equal weakening of demand for consumer services. Similarly, the contribution of fixed investments to the headline number increased (relative to the prior report) by a quarter of a percent, only to be offset by a nearly equal drop in exports.

Although this is the last time that a monthly revision will be issued covering the fourth quarter of 2011, the BEA annually makes substantial revisions to historic data in July of each year -- and the scope of those modifications are often substantial in both size and the historic reach. Unfortunately, for the past several years those July revisions have resulted in quiet (and media neglected) acknowledgments that the "Great Recession" was far more severe than was previously reported -- long after the potential for market or electoral consequences of those admissions had passed.

And once again the most interesting component in this report was the effective overall "deflater" that the BEA used to correct the "nominal" data into "real" numbers: **annualized** inflation during 4Q-2011 is now reported by the BEA to have been a mere 0.84%. As a reminder, lower "deflaters" cause the reported "real" growth rates to increase -- and once again very low seasonally adjusted BEA inflation "deflaters" have been the headline number's best friend.

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

-- The contribution to the annualized growth rate for consumer expenditures for goods was revised upward to 1.29%, which is up nearly one percent from the 0.33% rate reported for the third quarter of 2011. At first reading this improvement in the reported numbers is certainly a positive sign for the economy, putting the consumer goods growth rates on par historically with numbers recorded in the fourth quarter of 2006.

-- On the other hand, the contribution made by consumer services was revised downward to an anemic 0.19% -- more than offsetting the gains observed in the goods sector. In the same historical context, the fourth quarter of 2006 saw services contribute 1.32% to the headline number, more than a percent higher than now reported for 4Q-2011.

-- The growth rate contribution from private fixed investments was revised up to 0.78% (from 0.53% previously), but this remains 0.74% weaker than the 1.52% annualized rate reported for the third quarter.

-- The contribution from inventories (1.81% annualized) dropped somewhat from the 1.88% reported previously, but it still represents in its own right a +3.16% improvement in the headline number compared to the third quarter. As mentioned last month the substantial swing could be the result of either real changes in inventory levels or phantom data artifacts as changing "deflaters" puffed up the calculated "real" inventory valuations.

-- The reported drag on GDP growth from contracting expenditures by governments at all levels was not meaningfully changed at -0.84% (slightly less than the -0.89% drag previously reported), remaining -0.82% worse than during the third quarter of 2011.

-- The annualized contribution to the growth rate from exports was revised sharply down to 0.37% (from 0.59% in the prior report).

-- Imports are reported to be removing -0.63% from the growth rate of the overall economy, essentially unchanged from the -0.65% previously reported and still a significant deterioration from the -0.21% rate reported for the third quarter.

-- The annualized growth rate of "real final sales of domestic product" was revised upward slightly to 1.16%, but it is still a full two percent below the +3.16% reported for the third quarter of 2011. If this number is accepted at face value (and not as a consequence of "deflaters" playing havoc with inventory valuations) it still indicates a much weaker economy than is conveyed in the headline number.

-- Real per-capita disposable income is now reported to have grown at a 0.96% annualized rate during 4Q-2011.

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 - 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)	$15.3	=	$10.9	+	$2.0	+	$3.0	+	$-0.6
% of GDP	100.0%	=	71.0%	+	13.1%	+	19.7%	+	-3.8%

Contribution to GDP Growth % 2.98% = 1.52% + 2.41% + -0.89% + -0.06%

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

	4Q-2011	3Q-2011	2Q-2011	1Q-2011	4Q-2010	3Q-2010	2Q-2010	1Q-2010	4Q-2009	3Q-2009	2Q-2009	1Q-2
Total GDP Growth	2.97%	1.81%	1.34%	0.36%	2.36%	2.50%	3.79%	3.94%	3.81%	1.69%	-0.69%	-6.6
Consumer Goods	1.29%	0.33%	-0.38%	1.10%	1.87%	1.09%	0.87%	1.45%	0.12%	1.70%	-0.52%	0.0
Consumer Services	0.19%	0.90%	0.87%	0.36%	0.61%	0.75%	1.18%	0.47%	0.21%	-0.04%	-0.76%	-1.0
Fixed Investment	0.78%	1.52%	1.07%	0.15%	0.88%	0.28%	2.12%	0.15%	-0.42%	0.13%	-2.26%	-5.0
Inventories	1.81%	-1.35%	-0.28%	0.32%	-1.79%	0.86%	0.79%	3.10%	3.93%	0.21%	-0.58%	-2.6
Government	-0.84%	-0.02%	-0.18%	-1.23%	-0.58%	0.20%	0.77%	-0.26%	-0.18%	0.28%	1.21%	-0.3
Exports	0.37%	0.64%	0.48%	1.01%	0.98%	1.21%	1.19%	0.86%	2.51%	1.49%	-0.02%	-3.8
Imports	-0.63%	-0.21%	-0.24%	-1.35%	0.39%	-1.89%	-3.13%	-1.83%	-2.36%	-2.08%	2.24%	6.2
Real Final Sales	1.16%	3.16%	1.62%	0.04%	4.15%	1.64%	3.00%	0.84%	-0.12%	1.48%	-0.11%	-4.0

Summary

The headline number of 2.97% is certainly decent, and in the same historical "ball-park" context of pre-recession 4Q-**2006** (2.75%), some five years ago. The components of the current number, however, are significantly skewed relative to the historic reference**:**

-- In 4Q-2006 both consumer goods and consumer services were growing at roughly comparable rates (which we might normally expect, should the growth be fueled by fatter wallets), and between them they contributed enough growth to nearly account for the entire headline number. That was certainly not true five years later.

-- In 4Q-2006 "real" per capita disposable income was growing at a 4.28% annualized rate. That number dropped to a miserable 0.96% rate in 4Q-2011 -- after actually going negative (i.e, contracting) in both the second and third quarters of 2011.

-- The current dichotomy between consumer goods and services is likely telling us something about relatively inelastic demand for certain consumer goods (e.g., energy and food) even in the face of rising prices. If per-capita disposable income is tightly constrained any impact of rising food and energy prices will show up as decreased demand or softer prices (or both) in consumer services. This would cause the relative growth rates for goods and services to decouple in much the manner we are now observing.

-- In 2006 both exports and imports were adding positive contributions to the headline number, with exports alone contributing the equivalent of two-thirds of the headline. By the same quarter in 2011 the combined contributions from exports and imports had dropped from a positive 1.94% contribution to a -0.26% drag on the headline number.

-- In 2006 Governments at all levels were contributing a modest 0.22% to the headline number. That number grew (under stimulus) to +1.21% in the second quarter of 2009. But by 4Q-2011 sharply contracting governments were sucking -0.84% from that headline number -- a trend that is not likely to reverse anytime soon.

-- During 4Q-2006 "real final sales" was growing at a robust 3.82%. Five years later that number was a relatively weak 1.16%.

In our previous reports we had expressed misgivings about the headline number masking general weakness within the detailed line items. Since this revision does not materially revise anything, our misgivings are still in place. This headline number continues to consist mainly of a substantial inventory growth that (if real) is unsustainable and will necessarily reverse in the coming quarters. On the other hand, a significant portion of the apparent inventory growth may be an artifact of progressively larger seasonal adjustments to inventory "deflaters" -- drawing the accuracy of the headline number itself into question.

We continue to believe that despite rosy headline numbers, the underlying dichotomies in the data indicate an economy in dynamic flux -- with consumers less involved in the recovery than is generally accepted, governments continuing to produce major headwinds, and with trade likely to become a major drag going into 2012. We further believe that the quality of these numbers (particularly the inventory data and the "deflaters" used) is such that we should eventually expect substantial revisions (most likely downward) to the published growth rates -- but probably not before the post-election quiet of July 2013.

Yet the true consequence of overly optimistic headlines at this time (which, incidentally, are much to the relief of the BEA's political masters) is that a 3% growth rate at face value simply cannot justify any further easing by the Federal Reserve -- at least as the purported rationale for such easing. In fact, one might argue that headline numbers similar to 4Q-2006 suggest that monetary policies should be tightened to avoid a 2005-2007 style bubble. If some form of QE is actually offered by Mr. Bernanke in the near future, it can only be because he simply does not believe the BEA's optimism. When the numbers from the BEA and the actions of the Fed move in opposite directions, who (or what) are we to trust?