



Economic Flash!

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Bringing Johnny home hits Q4 US GDP

Commerce Department's BEA's sa GDP data on a chain-weighted basis.
annualized % chg from prior quarters, in 2005 chain dollars:

	Q4-A	Q3-F	Q2	2011
GDP	2.8	1.8	1.3	1.7
Final Sales of				
Dom. Product	0.8	3.2	1.6	1.9
Final Sales to				
Dom. Buyers	0.9	2.7	1.3	1.8
PCE price index	0.7	2.3	3.3	2.4
Core PCE price index	1.1	2.1	2.3	1.4
Mkt-based PCE price				
index	0.7	2.6	3.5	2.5
Core Mkt-based index	1.2	2.3	2.4	1.4
GDP price index	0.4	2.6	2.5	2.1
Implicit Deflator	0.4	2.6	2.6	2.1
Consumer Spending	2.0	1.7	0.7	2.2
Durable Goods	14.8	5.7	-5.3	8.1
NonDurable Goods	1.7	-0.5	0.2	1.7
Services	0.2	1.9	1.9	1.4
Business Investment	1.7	15.7	10.3	8.6
Structures	-7.2	14.4	22.6	4.1
Equipment/software	5.2	16.2	6.2	10.3
Housing Investment	10.9	1.3	4.2	-1.4
Exports	4.7	4.7	3.6	6.8
Imports	4.4	1.2	1.4	5.0
Government Purchases	-4.6	-0.1	-0.9	-2.1
Federal	-7.3	2.1	1.9	-2.0
State and Local	-2.6	-1.6	-2.8	-2.3

- US GDP came in slightly light of consensus forecasts in Q4 2011, despite significant support from inventory accumulation, as a big unwind in defense spending cut demand growth. The 2.8% annualized growth rate was two ticks below the street's expectation, although this was still a notable improvement from 1.8% in the prior quarter. But real final sales, which exclude inventory accumulation, disappointed by increasing at a meager 0.8% pace following a strong Q3 reading, with consumption and business investment spending both leaner than anticipated.
- Consumer spending rose at a moderate 2.0% pace, barely exceeding that of the previous quarter. The weaker-than-expected figure suggests that consumer spending ended Q4 on an even softer note than the 0.1% rise in December retail sales would suggest.
- Businesses were also cautious. Fixed investment rose at a 3.3% rate, a clear downshift compared with double-digit growth in the previous quarter. Meanwhile government consumption fell by 4.6%, with a particularly large decline in expenditure at the federal level. This entirely reflected a 12.5% reduction in national defense spending, presumably linked to the bringing home of troops from Iraq. While fiscal restraint

will still be in play, government spending is unlikely to be as much of a drag in following quarters. Non-defense federal spending was actually slightly higher compared with the previous quarter.

- With exports and imports both rising at an around 4.5% pace, net trade made little contribution to growth, shaving off only 0.1%-pts.
- On the positive side, residential construction rose at a near-11% annualized pace. This is a clear improvement compared with the preceding three quarters of 2011, and ties in with recent more encouraging news regarding multi-family housing starts.
- Inventories easily provided the greatest support to Q4 GDP, adding 1.9%-pts. The advance follows a running down of inventories in the prior quarter, though, and the rate of accumulation over the second half of 2011 as a whole was not indicative of excess stockpiling.
- The GDP price deflator was also much softer than expected in Q4 2011, with the 0.4% rate well below readings of 2.5% in the previous three quarters of the year. The deflator on personal consumption rose only 0.7%, although excluding food and energy posted a slightly firmer 1.1% reading.

Implications & Actions

Re: Economic Forecast — Despite coming in slightly light of the consensus, the headline figure was still reflective of reasonably strong growth in US GDP towards end-2011. However, some of the details were disappointing, given indications that consumer spending and business investment growth may have softened towards year end. Although the large inventory contribution doesn't necessarily signal a sharp reversal at the start of 2012, it does limit the potential for stronger accumulation to support growth. Therefore, we continue to expect growth to downshift towards a 2% pace.

Re: Markets — Equity futures had fallen immediately prior to the release, and continued to slide given the disappointing GDP number. The figures proved positive for fixed income.

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