TrendMacrolytics

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TRENDMACRO LIVE!

On Fourth Quarter GDP

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Don't be fooled by the headlines painting this morning's reported 3.1% growth rate for fourth quarter GDP as a disappointment. Except for trade-deficit obsessives, this data captures an economy in the midst of a vigorous expansion with key indicators pointing toward long-run sustainability. Were it not for the subtraction to growth owing to the decline in "net exports," the report would have printed with an eye-popping 4.8% growth rate. To our way of thinking, moreover, one of the main drivers of the trade "imbalance" -- a 9.1% increase in imports -- is in fact an indicator of economic *strength*. The other side of the trade-deficit ledger -- a 3.9% slide in exports -- mostly reflects slower growth *outside* the **US**.

To some extent, the fourth-quarter trade numbers also reflect the short-run "J-curve" effects of a sliding dollar, with the bookkeeping value of export shipments reduced, and that of imports raised, due to the currency translation. In any case, it should be clear what the net-export data *don't* reflect: a weaker US economy.

Of course, it shouldn't be overlooked that the fourth quarter of 2004 ended nearly a month ago. Such backward-looking data has only marginal import in shaping a forward-looking economic outlook. But to the extent that the data impacts sentiment bearing on the policy outlook, it can't be completely dismissed as yesterday's news. Today's knee-jerk rally in the credit markets, for example, represents a bet that the weaker than expected headline number could incline **the Fed** to take an even more "measured" approach in the policy normalization process. We'd be surprised if that's the case, however. For one thing, it appears to overlook the fact that according to the Fed's favored price index in the GDP tables -- the core personal consumption expenditures deflator -- the fourth quarter saw the annualized inflation rate jump from 0.9% to 1.6%. While, obviously, 1.6% inflation is nothing to be terribly alarmed about in the abstract, the Fed can't afford to ignore the near-doubling of the rate in a single quarter.

For our purposes, the GDP data were most encouraging in portraying what can only be characterized as an ongoing boom in business fixed investment. Overall, nonresidential fixed investment saw its third consecutive quarter of double-digit growth, finishing the year with a 10.3% year-on-year growth rate. Reinforcing our confidence that expected returns to capital remain robust, pointing toward continued economic strength, equipment and software expenditures registered growth of nearly 15% in the quarter, and better than 13% on the year, rivaling the best years of the late-1990s investment boom. TM

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