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TRENDMACRO LIVE!

On Q4 2011 GDP

Friday, January 27, 2012

Donald Luskin

Four years after the last business cycle peak, real output has grown less than 1%.

This morning's GDP report showed 2.8% annual real growth in the fourth quarter of 2011, slightly below the consensus of 3.0%.

- 2.8% real growth is about normal. The problem is that, now 10 quarters past the official trough of the Great Recession, real output has only grown 6.2% cumulatively -- that after a 5.1% drop from the prior cycle peak. So now four years after the prior cycle peak in Q4 2007, real output has advanced cumulatively by only 72 bp.
- By post-war historical standards, output should have recovered 14.6% from trough-- not just 6.2%. That difference gives us powerful intuition about how deep the "output gap" is.
- If there's any news here at all -- considering that this has been the case now for many quarters -- it is good news: with an output gap as deep as the one we have now, if the economy falls into recession it will be so mild as to be unnoticeable (see "Testing 1, 2, 3" September 7, 2011).
- That's fortunate, because we still think there's a decent chance that we'll see a recession here. S&P 500 forward earnings continue to fall from their high last August -- they are our favorite and most reliable business cycle indicator. And we are in the midst of the worst earnings season in three years (the aggregate surprise-factor statistics that you hear are massively distorted by the extraordinary performance of a single company, Apple, which has contributed 70% of the aggregate dollar value of surprise seen so far).
- What's more, of the 2.8% real growth reported, 1.9% came from change in inventories. It's not that inventory growth isn't legitimate output -- it's that, by definition, it borrows from future output. Over time, inventory changes sum to zero, so historically we see quarters with large inventory gains followed by quarters with large inventory losses.

Bottom line

Another weak quarter, with the majority of growth coming from change in inventories -- which, by definition, must be given back in the future. The output gap deepens, meaning that if we fall into recession here, it will likely be very mild.

Update to strategic view

US MACRO: Another weak quarter, with the majority of growth coming from change in inventories -- which, by definition, must be given back in the future. The output gap deepens, meaning that if we fall into recession here, it will likely be very mild.

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