TRENDMACRO LIVE!

On Q4 GDP

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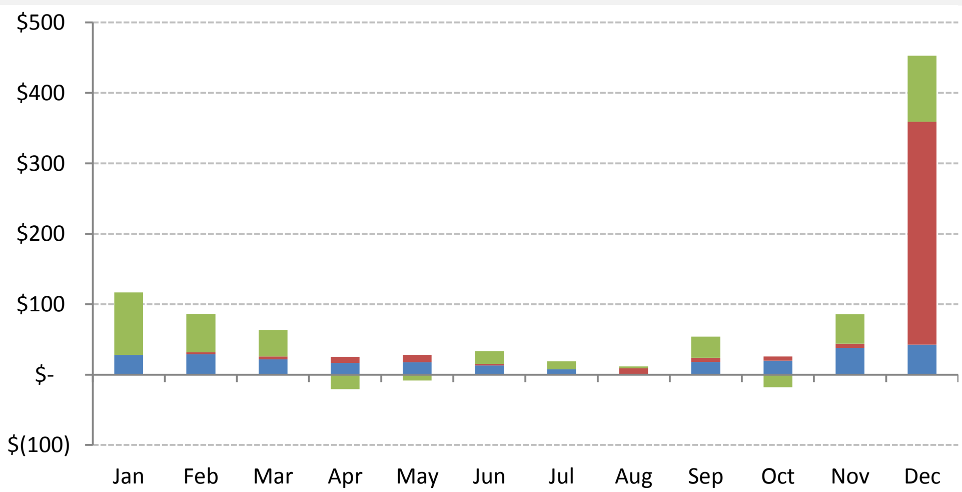
A tax-driven surge in personal income could drive mutual fund flows and mask 2013 weakness.

This morning's advance estimate of Q4-12 gross domestic product managed to disappoint already very low expectations -- with an outright negative print of 0.1%. The stock market scarcely reacted, probably seeing little immediate threat to earnings in the two big drivers of this morning's disappointment -- big drops in defense spending and in change in inventories (please see "Data Insights: GDP" January 30, 2013, to be posted shortly). Gold reacted differently, jumping $10 at the announcement, and drifting higher as of this writing -- as though it expects this morning's disappointing numbers to nudge today's FOMC meeting more toward the dovish.

The most fascinating element in Q4 GDP was the surge in personal income, which we can infer with great precision took place entirely in December (please see the chart below).

Personal income **Wage/salary** **Dividends** **Other**

Monthly change, SAAR, USD billions, nominal



Source: BEA, TrendMacro calculations

- The jump was concentrated in wages and salaries, and in dividends. As the BEA explained, it was due to "accelerated compensation in the form of bonus payments" and "accelerated and special dividends that were paid by many companies in the

Update to strategic view

US MACRO: There was little market reaction to a seemingly big disappointment in Q4 GDP, as it was driven by defense and inventories -- factors seen as transitory. Of more interest is the massive surge in personal income, driven by accelerated bonus and dividend payments concentrated in December, to get ahead of hikes in personal income tax rates. This is precisely the pattern we saw in December 1992 and December 1993 ahead of the Clinton-era tax hikes. This may explain the jump in equity mutual fund flows, and drive a brief jump in consumption in early 2013 -- masking the blow from the cessation of the Social Security tax "holiday."

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fourth quarter in anticipation of changes in individual income tax rates."

- This is precisely the pattern we saw in December 1992 and again in December 1993 in anticipation of the Clinton-era tax hikes that went into effect in two phases.
- We think it's possible that this tax-driven surge in personal income could be part of the explanation for why retail equity mutual fund flows have suddenly improved. It may also create a brief jump in consumption early in 2013 that could temporarily mask the blow to consumption from the end of the Social Security tax "holiday" (see "Tax Hikes Have Consequences" January 2, 2013).

Bottom line

There was little market reaction to a seemingly big disappointment in Q4 GDP, as it was driven by defense and inventories -- factors seen as transitory. Of more interest is the massive surge in personal income, driven by accelerated bonus and dividend payments concentrated in December, to get ahead of hikes in personal income tax rates. This is precisely the pattern we saw in December 1992 and December 1993 ahead of the Clinton-era tax hikes. This may explain the jump in equity mutual fund flows, and drive a brief jump in consumption in early 2013 -- masking the blow from the cessation of the Social Security tax "holiday."

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Recommended Reading

The Federal Reserve's Balance Sheet and Earnings: A primer and projections
Seth Carpenter, Jane Ihrig, Elizabeth Klee, Daniel Quinn, and Alexander Boote
Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board
January 2013

Yes, Mr. President, We Are a Nation of Takers
Nicholas Eberstadt
Wall Street Journal
January 28, 2013

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