First Trust

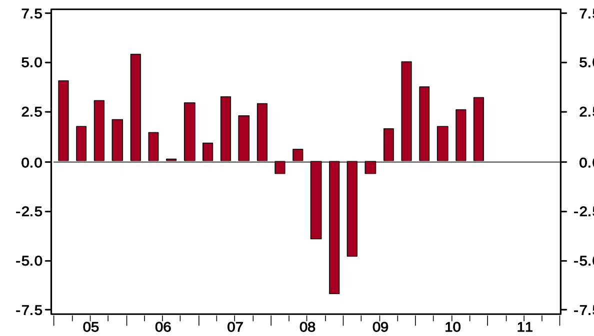
Data Watch

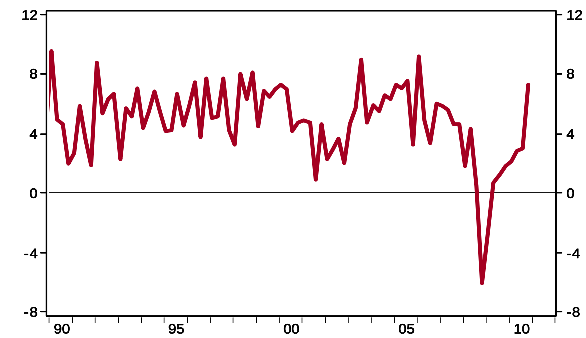
January 28, 2011 • 630.322.7756 • http://www.ftportfolios.com

4TH QUARTER GDP (ADVANCE)

Chief Economist – Brian S. Wesbury
Senior Economist – Robert Stein, CFA

- The first estimate for Q4 real GDP growth is 3.2% at an annual rate, slightly lower than the consensus expected.
- The largest positive contributions to the real GDP growth rate were net exports, which added 3.4 points to the real GDP growth rate, and personal consumption, which increased at a 4.4% annual rate.
- The weakest component of real GDP, by far, was inventories, which alone reduced the real GDP growth rate by 3.7 points.
- The GDP price index increased at a 0.3% annual rate in Q4. Nominal GDP – real GDP plus inflation – rose at a 3.4% rate in Q4 and is now up 4.2% versus a year ago.





Implications: Real GDP grew at a 3.2% annual rate in Q4. This was slightly lower than the consensus (3.5%), but significantly lower than our much publicized forecast of 5.4%, which was the highest forecast in the consensus survey. But don't throw us out as being those crazy optimists just yet. Our forecast was largely based on a key insight about how the government (mis)measures oil prices, so we predicted net exports would add 3.3 points to the GDP growth rate, much higher than anyone else. And guess what? Net exports added 3.4 points to the GDP growth rate! And because we were so bullish on trade, we predicted real final sales (real GDP excluding inventories) would grow at a 7.1% annual rate, the fastest pace since 1984. And, guess what? Real final sales came in at *exactly* that 7.1% growth rate! Where we were off, was with government spending (much weaker than we had expected), personal consumption and home building (stronger than we expected) and inventories (substantially below both our forecast and the consensus). Inventories alone subtracted 3.7 points from real GDP growth. In other words, manufacturers and retailers underestimated consumer demand and ran down inventories dramatically in the fourth quarter. Anecdotal reports suggest that low inventory levels are having a cost in the form of lost sales. Moreover, prices are not likely to be slashed to reduce excess inventories after the holidays. What this means is that there is more room for production increases in 2011 and inflation will continue to move higher. Our original forecast of 4% real GDP growth this year is probably too low. Real consumer spending grew at a 4.4% annual rate in Q4, the fastest in almost five years, while business investment continued to advance and home building increased without any assistance from homebuyer tax-credits.

4th Quarter GDP *Seasonally Adjusted Annual Rates*	Q4-10	Q3-10	Q2-10	Q1-10	4-Quarter Change
Real GDP	**3.2%**	2.6%	1.7%	3.7%	2.8%
GDP Price Index	**0.3%**	2.1%	1.9%	1.0%	1.3%
Nominal GDP	**3.4%**	4.6%	3.7%	4.8%	4.2%
PCE	**4.4%**	2.4%	2.2%	1.9%	2.7%
Business Investment	**4.4%**	10.0%	17.2%	7.8%	9.8%
Structures	**0.9%**	-3.6%	-0.5%	-17.8%	-5.5%
Equipment and Software	**5.8%**	15.4%	24.8%	20.5%	16.4%
Contributions to GDP Growth (p.pts.)	**Q4-10**	**Q3-10**	**Q2-10**	**Q1-10**	**4Q Avg.**
PCE	**3.0**	1.7	1.5	1.3	1.9
Business Investment	**0.4**	0.9	1.5	0.7	0.9
Residential Investment	**0.1**	-0.8	0.6	-0.3	-0.1
Inventories	**-3.7**	1.6	0.8	2.6	0.3
Government	**-0.1**	0.8	0.8	-0.3	0.3
Net Exports	**3.4**	-1.7	-3.5	-0.3	-0.5

Source: Commerce Department