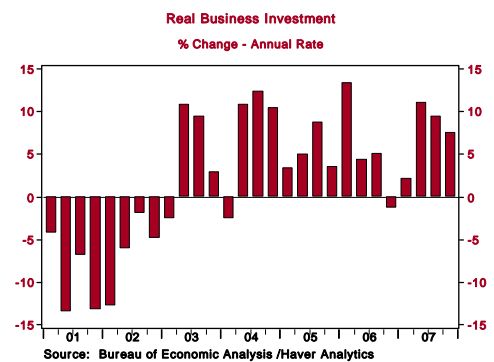


## 4<sup>TH</sup> QUARTER GDP (ADVANCE)

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

- The first estimate for Q4 real GDP growth is 0.6% at an annual rate versus a consensus expected 1.2%. Real GDP increased 2.5% in 2007.
- The strongest component of real GDP was business investment, with spending on structures up at a 15.8% annual rate. Real consumption was up at a 2.0% annual rate, adding 1.4 points to the GDP growth rate. State and local government spending added an unusually high 0.5 points to the growth rate.
- The two largest drags on real GDP growth were inventories and home building, which combined to lop off 2.4 percentage points. Excluding housing, real GDP grew at a 1.8% rate in Q4 and is up 3.5% versus last year.
- The GDP price index rose at a 2.6% annual rate in Q4 as well as versus last year. Nominal GDP – real GDP plus inflation – grew at a 3.2% rate in Q4 and is up 5.1% versus a year ago.

**Implications:** Real GDP grew less than expected but the weakest parts – inventories and home building – suggest we have faster growth ahead. Inventory ratios are razor thin, so inventories will likely support GDP in 2008. Home building will be less of a drag in 2008 as the sector is a shrinking share of the economy and new home inventories have been falling. Today's report is consistent with our forecast of a rebound to a 3% real GDP growth rate in Q1. Meanwhile, the inflation news remains bad. In Q4, prices were up at a 2.6% rate for GDP (what we produce) but up at a 3.8% rate for Gross Domestic Purchases (what we buy). In other news today, the ADP employment measure had private sector payrolls up 130,000 in January, showing that the labor market remains healthy. The Federal Reserve makes another decision on interest rates later today. Although we are concerned about inflation, the Fed left the goal of price stability out of last week's emergency statement. A desire to "get ahead of the curve" and a nominal GDP growth rate of only 3.2% in Q4 is probably low enough for the Fed to self-justify a 50 basis point rate cut.



4th Quarter GDP <i>Seasonally Adjusted Annual Rates</i>	Q4-07	Q3-07	Q2-07	Q1-07	4-Quarter Change
<b>Real GDP</b>	<b>0.6%</b>	4.9%	3.8%	0.6%	2.5%
<b>GDP Price Index</b>	<b>2.6%</b>	1.0%	2.6%	4.2%	2.6%
<b>Nominal GDP</b>	<b>3.2%</b>	6.0%	6.6%	4.9%	5.1%
<b>PCE</b>	<b>2.0%</b>	2.8%	1.4%	3.7%	2.5%
<b>Business Investment</b>	<b>7.5%</b>	9.4%	11.0%	2.1%	7.4%
<b>Structures</b>	<b>15.8%</b>	16.4%	26.2%	6.3%	16.0%
<b>Equipment and Software</b>	<b>3.7%</b>	6.2%	4.7%	0.3%	3.7%
<b>Contributions to GDP Growth (p.pts.)</b>	<b>Q4-07</b>	<b>Q3-07</b>	<b>Q2-07</b>	<b>Q1-07</b>	<b>4Q Avg.</b>
<b>PCE</b>	<b>1.4</b>	2.0	1.0	2.6	1.7
<b>Business Investment</b>	<b>0.8</b>	1.0	1.1	0.2	0.8
<b>Residential Investment</b>	<b>-1.2</b>	-1.1	-0.6	-0.9	-1.0
<b>Inventories</b>	<b>-1.3</b>	0.9	0.2	-0.7	-0.2
<b>Government</b>	<b>0.5</b>	0.7	0.8	-0.1	0.5
<b>Net Exports</b>	<b>0.4</b>	1.4	1.3	-0.5	0.7

Source: Commerce Department