4th Quarter GDP (Advance)

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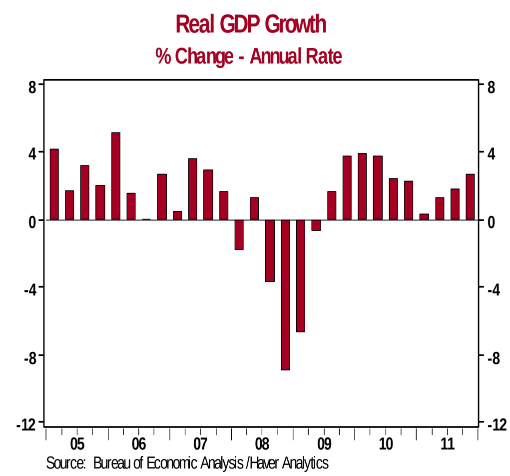
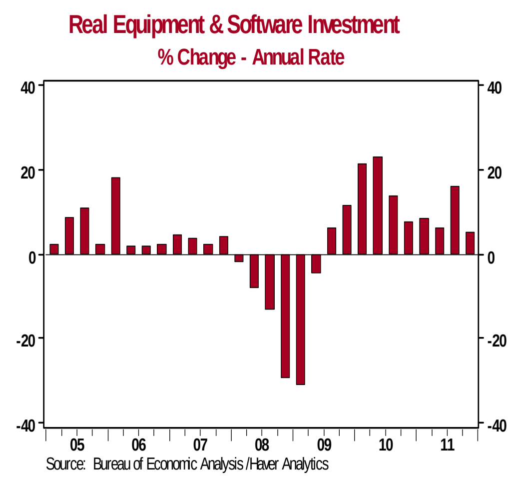
- The first estimate for Q4 real GDP growth is 2.8% at an annual rate, slightly less than the consensus expected 3.0% rate.
- The largest positive contributions to the real GDP growth rate were inventories and personal consumption.
- The weakest component of real GDP, by far, was government purchases, which reduced the real GDP growth rate by 0.9 points.
- The GDP price index increased at a 0.4% annual rate in Q4. Nominal GDP – real GDP plus inflation – rose at a 3.2% rate in Q4 and was up 3.7% in 2011.

Implications: Real GDP grew at a 2.8% annual rate in the fourth quarter, up from 1.7% in Q3 and its strongest growth since Q2 2010. The Q4 increase came in just slightly below the consensus estimate of 3%. Nonetheless, the market seems to be disappointed in the data. The reason? Because consumption and business investment were weaker than expected, while inventories jumped. We do not agree with this disappointment. The weakest part of today's report – by far – was government purchases, driven by a wind-down of operations in Iraq and continued state and local spending cuts. Excluding government, real GDP grew at a robust 4.5% annual rate in Q4 and was up 2.6% for 2011 as a whole. Home building was up at a 10.9% annual rate in Q4. Excluding a couple of quarters in 2009-10, which were artificially and temporarily inflated by the homebuyer tax credit, this is the fastest growth in residential construction since 2004. Real GDP has now accelerated for three quarters in a row, durable goods orders have jumped for the past two months and suggest that business investment will accelerate in 2012. With housing and investment improving, the Federal Reserve will have a difficult time justifying QE3. However, nominal GDP grew at a 3.2% annual rate in Q4, which is a slowdown from recent quarters. We think this was a false signal. Nominal GDP grew 3.7% in 2011 and is up at a 4.2% annual rate in the past two years. These are not that far from the Federal Reserve's long-run outlook of a 4.5% growth rate for nominal GDP. As a result, we think essentially zero percent interest rates are too low and that trying to boost the economy further with easier money would be a mistake. A third round of quantitative easing is not needed and we expect the Fed to raise rates well before its current forecast of late 2014 or beyond.





4th Quarter GDP *Seasonally Adjusted Annual Rates*	Q4-11	Q3-11	Q2-11	Q1-11	4-Quarter Change
Real GDP	**2.8%**	1.8%	1.3%	0.4%	1.6%
GDP Price Index	**0.4%**	2.6%	2.5%	2.5%	2.0%
Nominal GDP	**3.2%**	4.4%	4.0%	3.1%	3.7%
PCE	**2.0%**	1.7%	0.7%	2.1%	1.6%
Business Investment	**1.7%**	15.7%	10.3%	2.1%	7.3%
Structures	**-7.2%**	14.4%	22.6%	-14.4%	2.7%
Equipment and Software	**5.2%**	16.2%	6.3%	8.7%	9.0%
Contributions to GDP Growth (p.pts.)	**Q4-11**	**Q3-11**	**Q2-11**	**Q1-11**	**4Q Avg.**
PCE	**1.5**	1.2	0.5	1.5	1.2
Business Investment	**0.2**	1.5	1.0	0.2	0.7
Residential Investment	**0.2**	0.0	0.1	-0.1	0.1
Inventories	**1.9**	-1.4	-0.3	0.3	0.2
Government	**-0.9**	0.0	-0.2	-1.2	-0.6
Net Exports	**-0.1**	0.4	0.2	-0.3	0.1

Source: Commerce Department