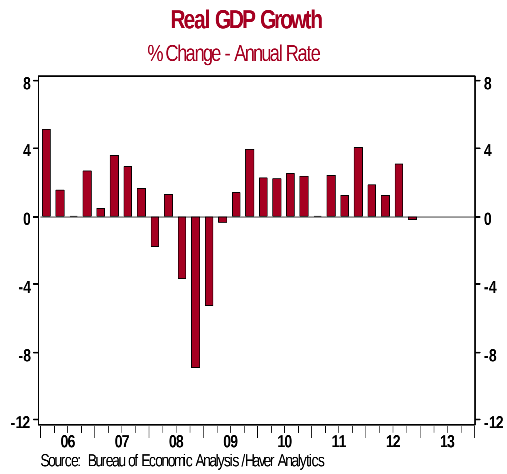
First Trust DATAWATCH

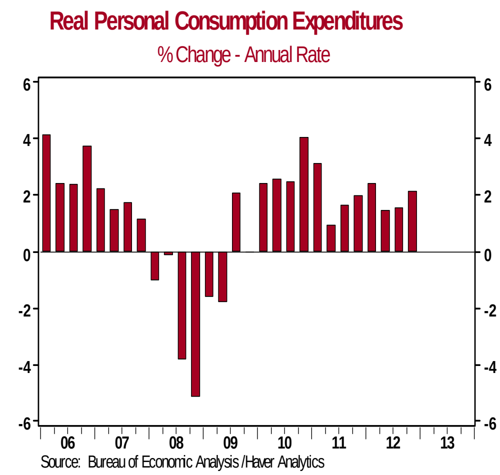
January 30, 2013 • 630.517.7756 • www.ftportfolios.com

Fourth Quarter GDP (Advance)

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Senior Economist
Strider Elass – Economic Analyst

- The first estimate for Q4 real GDP growth is -0.1% at an annual rate, much lower than the 1.1% the consensus expected. Real GDP is up 1.5% from a year ago.
- The largest negative drags on the Q4 real GDP growth rate, by far, were government and inventories, which subtracted a combined 2.6 points.
- Personal consumption, business investment, and home building were all positive in Q4, growing at a combined rate of 3.4% annualized.
- The GDP price index increased at a 0.6% annual rate in Q4. Nominal GDP – real GDP plus inflation – rose at a 0.5% rate in Q4 and is up 3.3% from a year ago.





Implications: As we said in last week's MMO: ignore the GDP headline, which was likely to be weak, but misleading. As it turns out, the headline was even weaker than we thought, coming in (slightly) negative for the first time since 2009 and lower than any forecast from the 83 groups making a prediction. We thought inventories would subtract 1.3 points from the GDP growth rate and got that exactly right; but government purchases also subtracted 1.3 points from the growth rate of real GDP, due to the largest drop in defense (relative to GDP) since the wind-down in Vietnam in 1973. The reason the real GDP contraction at a 0.1% annual rate is misleading is that the key components of GDP – personal spending, business investment, and home building – were all rising and came in at a combined 3.4% annual growth rate, exactly as we forecast. Reductions in inventories and government purchases may hurt in the short run, but looking ahead to 2013 we think these cuts are a positive: lower inventories mean more showrooms and shelves to be stocked; less government means lower deficits and the potential for lower taxes (or fewer future tax hikes). For now, we maintain our forecast that real GDP will grow in the 2.5% to 3% range in 2013, but think the risk of an upside surprise modestly outweighs risks to the downside. Despite a slight contraction in real growth and soft *nominal* GDP growth of 0.5%, these data still don't justify the current round of quantitative easing. Nominal GDP is still up 3.3% in the past year, much too fast for a short-term interest rate target near zero. In other news today, the ADP employment index showed a private payroll gain of 192,000 in January. As a result, we are raising our forecast for Friday's official employment report to a 160,000 gain in nonfarm payrolls. On the housing front, the Case-Shiller index, a measure of home prices in 20 major metro areas, showed a 0.6% gain in November and is up 5.5% in the past year. Recent price gains are led by San Diego, San Francisco, Atlanta, and Las Vegas.

4th Quarter GDP Seasonally Adjusted Annual Rates	Q4-12	Q3-12	Q2-12	Q1-12	4-Quarter Change
Real GDP	-0.1%	3.1%	1.3%	2.0%	1.5%
GDP Price Index	0.6%	2.7%	1.6%	2.0%	1.7%
Nominal GDP	0.5%	5.9%	2.8%	4.2%	3.3%
PCE	2.2%	1.6%	1.5%	2.4%	1.9%
Business Investment	8.4%	-1.8%	3.6%	7.5%	4.3%
Structures	-1.1%	0.0%	0.6%	12.8%	2.9%
Equipment and Software	12.5%	-2.6%	4.8%	5.4%	4.9%
Contributions to GDP Growth (p.pts.)	**Q4-12**	**Q3-12**	**Q2-12**	**Q1-12**	**4Q Avg.**
PCE	1.5	1.1	1.1	1.7	1.4
Business Investment	0.8	-0.2	0.4	0.7	0.4
Residential Investment	0.4	0.3	0.2	0.4	0.3
Inventories	-1.3	0.7	-0.5	-0.4	-0.3
Government	-1.3	0.8	-0.1	-0.6	-0.3
Net Exports	-0.3	0.4	0.2	0.1	0.1

Source: Commerce Department