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Fourth Quarter GDP (Advance)

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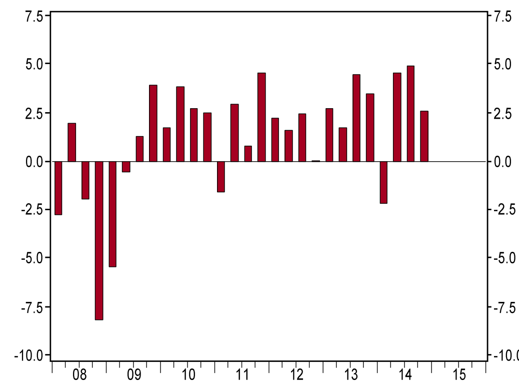
- The first estimate for Q4 real GDP growth is 2.6% at an annual rate, a little short of the 3.0% the consensus expected. Real GDP is up 2.5% from a year ago.
- The largest positive contributions to the Q4 real GDP growth rate were consumer spending and inventories. The largest drags were net exports and government purchases.
- Combined, personal consumption, business investment, and home building were up at a 3.9% annual rate in Q4 and 3.2% in the past year.
- The GDP price index was unchanged in Q4. Nominal GDP – real GDP plus inflation – rose at a 2.5% rate in Q4, is up 3.7% from a year ago, and up at a 4.1% annual rate from two years ago.

Implications: Today's report on GDP confirms that six years into the recovery the economy remains a Plow Horse. Ultimately, we believe the key reason is the expansion of government transfers in the past decade or so, which has lowered the growth potential of the US economy toward (but not fully to) a more European pace. After a weather-related plunge in the first quarter of last year, real GDP growth roared back at a 4.8% annual rate in the middle two quarters of 2014. But with real growth at a 2.6% annual rate in Q4, we're right back near the trend, which includes a 2.5% growth rate in 2014 and a 2.3% rate since the recovery started in mid-2009. The best news in the report was "core" GDP (real GDP excluding inventories, trade, and government, none of which can be relied on for long-term growth). It grew at a robust 3.9% annual rate in Q4 and was up 3.2% in 2014, exactly matching the pace in 2013. The worst news was that inventories added 0.8 percentage points to the real GDP growth rate in Q4. This pace will be very tough to sustain. However, the government estimated that net exports were a drag of a full percentage point. We believe as actual data comes in that this drag will be smaller. On net, we still expect growth in the 2.5 – 3% range for 2015. In terms of monetary policy, today's report should keep the Federal Reserve on track to raise rates in June. Nominal GDP (real GDP plus inflation) rose at a tepid 2.5% annual rate in Q4, but was up 3.7% in 2014 and at an annual rate of 4.1% in the past two years, not much below the average of 4.4% in the past twenty years. Nominal GDP is growing too fast for a short-term interest rate near zero. The Fed is also watching the Employment Cost Index, which grew 2.3% in 2014, the fastest pace since 2008. In other recent news, new claims for jobless benefits fell 43,000 last week to 265,000. That's in part related to MLK Day, but it's still the lowest level since 2000 and there's an MLK Day every year. Continuing jobless claims fell 71,000 to 2.39 million. As a result, our models now suggest a January nonfarm payroll gain of 245,000, another solid month. Meanwhile, the Chicago PMI, a measure of manufacturing sentiment in that region, increased to 59.4 in January from 58.8 in December. On the housing front, pending home sales, which are contracts on existing homes, slipped 3.7% in December, suggesting existing home sales, which are counted at closing, will be down in January.

Real GDP Growth

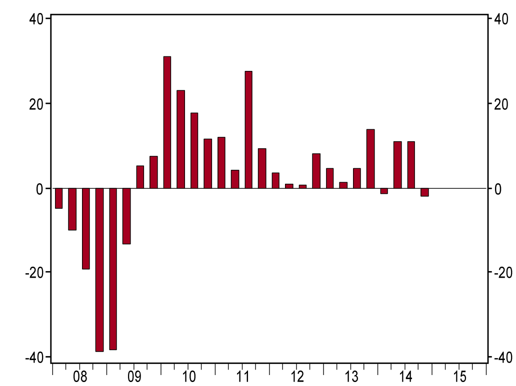
% Change - Annual Rate



Source: Bureau of Economic Analysis /Haver Analytics

Real Equipment Investment

% Change - Annual Rate



Source: Bureau of Economic Analysis /Haver Analytics

4th Quarter GDP Seasonally Adjusted Annual Rates	Q4-14	Q3-14	Q2-14	Q1-14	4-Quarter Change
Real GDP	**2.6%**	5.0%	4.6%	-2.1%	2.5%
GDP Price Index	**0.0%**	1.4%	2.1%	1.3%	1.2%
Nominal GDP	**2.5%**	6.4%	6.8%	-0.8%	3.7%
PCE	**4.3%**	3.2%	2.5%	1.2%	2.8%
Business Investment	**1.9%**	8.9%	9.7%	1.6%	5.5%
Structures	**2.6%**	4.8%	12.6%	2.9%	5.7%
Equipment	**-1.9%**	11.0%	11.2%	-1.0%	4.7%
Intellectual Property	**7.2%**	8.8%	5.5%	4.7%	6.5%
Contributions to GDP Growth (p.pts.)	**Q4-14**	**Q3-14**	**Q2-14**	**Q1-14**	**4Q Avg.**
PCE	**2.9**	2.2	1.8	0.8	1.9
Business Investment	**0.2**	1.1	1.2	0.2	0.7
Residential Investment	**0.1**	0.1	0.3	-0.2	0.1
Inventories	**0.8**	0.0	1.4	-1.2	0.3
Government	**-0.4**	0.8	0.3	-0.2	0.1
Net Exports	**-1.0**	0.8	-0.3	-1.7	-0.6