Fourth Quarter GDP (Advance)

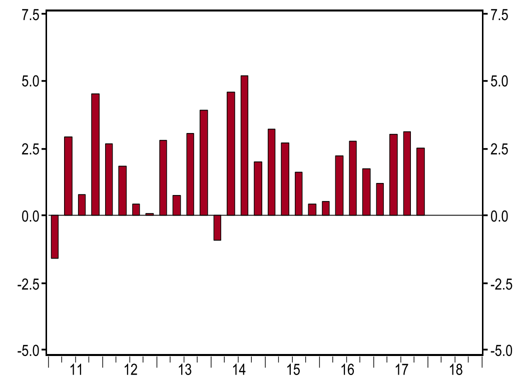
Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Economist

- The first estimate for Q4 real GDP growth is 2.6% at an annual rate, below the consensus expected 3.0%. Real GDP is up 2.5% from a year ago.
- The largest positive contribution to the Q4 real GDP growth rate was consumer spending. The largest drags were net exports and inventories.
- Combined, personal consumption, business investment, and home building were up at a 4.6% annual rate in Q4 and 3.3% in the past year.
- The GDP price index rose at a 2.4% annual rate in Q4 and is up 1.9% from a year ago. Nominal GDP – real GDP plus inflation – rose at a 5.0% rate in Q4, is up 4.4% from a year ago, and up at a 3.9% annual rate from two years ago.

Implications: The headline growth rate of 2.6% for fourth quarter real GDP and 2.5% for 2017 make the economy look like it's still a Plow Horse, but the details of the report show it's not. The parts of GDP that are the most volatile from quarter to quarter – international trade and inventories – were major drags on growth in Q4. We like to follow "core" GDP, which we define as consumer spending, business investment in equipment, structures, and intellectual property, as well as home building. Adjusted for inflation, core GDP grew at a 4.6% annual rate in Q4, the fastest pace since 2014, and rose 3.3% in 2017. Consumer spending was very strong in Q4, in part due to the surge in auto sales late in the year to replace vehicles destroyed in Hurricanes Harvey and Irma. Meanwhile, home building grew at an 11.7% annual rate, the fastest in over a year. Business investment in equipment grew at an 11.4% rate, the fastest since 2014. We expect real GDP to grow at a 3%+ rate in 2018, which would be the first year that's happened since 2005. In particular, the tax cuts enacted in late December and the deregulation coming from Washington, DC are going to help spur faster growth. Meanwhile, today's report makes it even clearer the Federal Reserve is behind the curve. Nominal GDP – real GDP growth plus inflation – grew at a 5.0% annual rate in Q4, was up 4.4% in 2017, and up at a 3.9% annual rate in the past two years. All of these are much higher than the Fed's current target for short-term rates of 1.375%. The Fed has been saying it will raise short-term rates three times in 2018. The investor consensus has recently come around to that view as well, but thinks the odds of two rate hikes is higher than the odds of four. We think the opposite, that if the Fed doesn't raise rates three times in 2018, it will be four hikes, not two.

Real GDP Growth

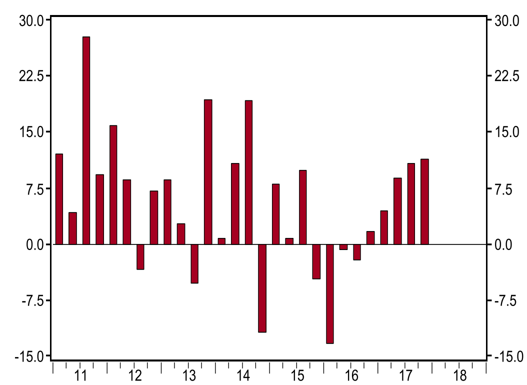
% Change - Annual Rate



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*	**Q4-17**	**Q3-17**	**Q2-17**	**Q1-17**	**4-Quarter Change**
Real GDP	**2.6%**	3.2%	3.1%	1.2%	2.5%
GDP Price Index	**2.4%**	2.1%	1.0%	2.0%	1.9%
Nominal GDP	**5.0%**	5.3%	4.1%	3.3%	4.4%
PCE	**3.8%**	2.2%	3.3%	1.9%	2.8%
Business Investment	**6.8%**	4.7%	6.7%	7.1%	6.3%
Structures	**1.4%**	-7.0%	7.0%	14.8%	3.7%
Equipment	**11.4%**	10.8%	8.8%	4.4%	8.8%
Intellectual Property	**4.5%**	5.2%	3.7%	5.8%	4.8%
Contributions to GDP Growth (p.pts.)	**Q4-17**	**Q3-17**	**Q2-17**	**Q1-17**	**4Q Avg.**
PCE	**2.6**	1.5	2.2	1.3	1.9
Business Investment	**0.8**	0.6	0.8	0.9	0.8
Residential Investment	**0.4**	-0.2	-0.3	0.4	0.1
Inventories	**-0.7**	0.8	0.1	-1.5	-0.3
Government	**0.5**	0.1	0.0	-0.1	0.1
Net Exports	**-1.1**	0.4	0.2	0.2	-0.1