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Economics Group

WELLS FARGO SECURITIES

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GDP: Slower in Q4—Floating on Thin Ice

Real GDP growth rose at just a 0.7 percent annualized pace in the fourth quarter. Final domestic spending was positive, but trade and inventories were drags. Inflation remains below the Fed's 2 percent target.

Domestic Spending Drives GDP Gains

Real GDP rose at a 0.7 percent annual pace in the fourth quarter following a 2.0 percent rate in the third quarter. It is worth noting that since the 1980s, real GDP has trended lower—a signal of a changing framework for the economy (top graph).

There is some positive news in the report. Real final sales to domestic purchasers, which excludes inventories and trade, rose at a 1.6 percent pace following a 2.9 percent increase in the second quarter (middle graph).

Consumer spending remains a positive force with the support of improving labor market conditions and stronger purchasing power due to the decline in retail gasoline prices. Consumer spending rose at a 2.2 percent rate in the fourth quarter with durable goods spending advancing at a 4.3 percent pace. Nondurable goods spending rose 1.5 percent. Despite some uncertainty, consumers are in a much better position at this stage of the business cycle. Household balance sheets are healthy and credit availability has improved. Residential investment continues to boost overall economic activity—up 8.1 percent in the fourth quarter. The pickup in household formations since the beginning of the year and continued low mortgage rates will continue to support the housing market recovery.

Drags From Net Exports and Inventories

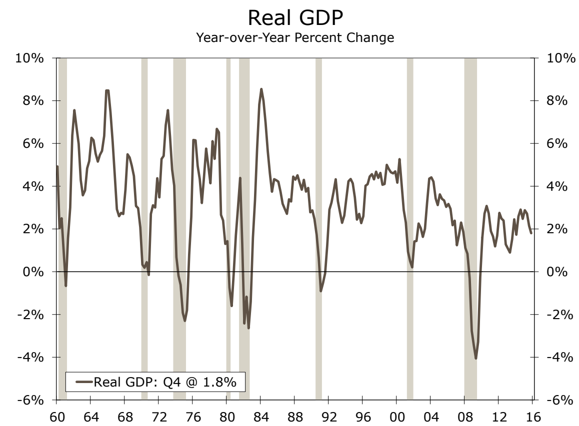
Much of the slower pace in real GDP growth was due to the volatile inventory component. Inventories slashed 0.45 percentage points from headline GDP—a second consecutive quarterly drag. The swing in inventories is not all that surprising given the sharp accumulation that occurred in the first half of the year. Net exports and structures investment were also weak during the quarter, with net exports subtracting 0.5 percentage points from growth in the fourth quarter. Structures investment reduced overall growth for the second consecutive quarter. Recall these estimates are preliminary and based on monthly data for only part of the quarter.

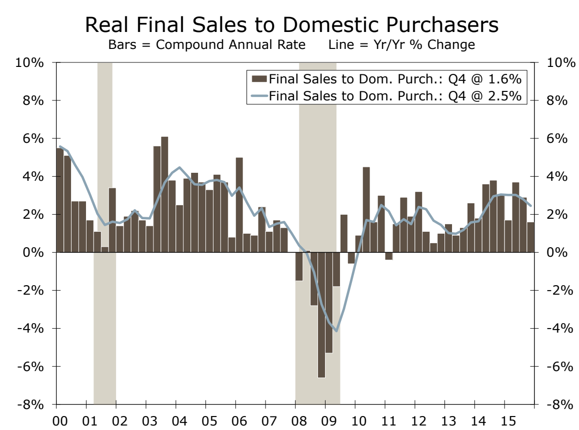
Inflation: Remains Below 2 Percent Target

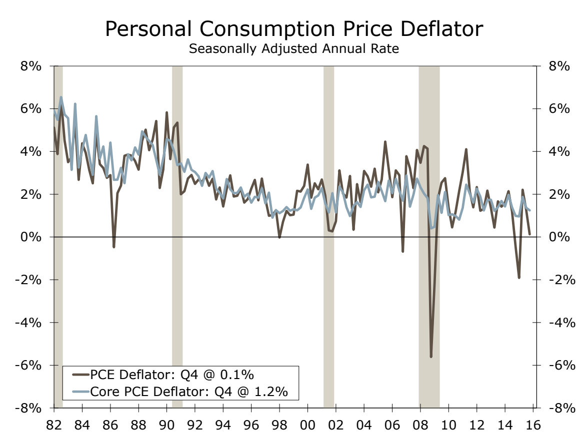
On the inflation front, there was not any big change to the underlying story. Since the 1990s, overall inflation has remained modest (bottom graph) despite the significant expansion of the Fed's balance sheet and decades of financial turmoil.

In the fourth quarter, overall inflation came in at 0.8 percent with sharp declines in export and import prices. The Fed's benchmark PCE deflator came in at just 0.1 percent with both durable and nondurable prices registering a decline, but services up at a 2.0 percent pace.

Given the modest real GDP gain and continued low inflation, we see no case for a Fed rate hike in March. For the year we still have overall PCE inflation remaining below 2 percent.







Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

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