January 26, 2018

Fourth Quarter 2017 GDP Review

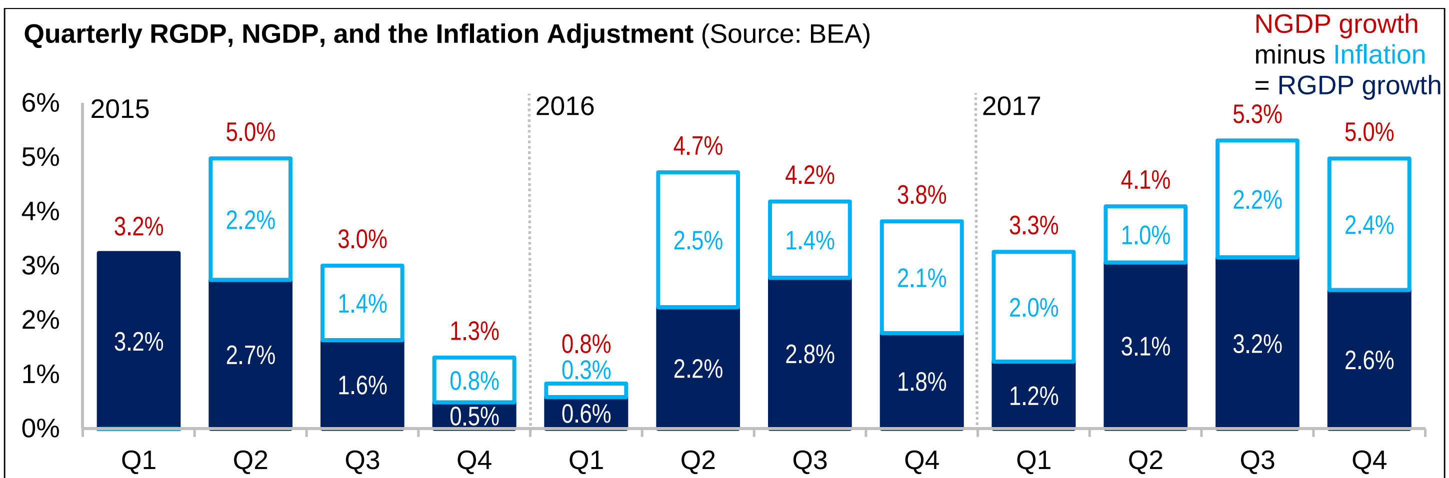
GDP Review Snapshot

- Real GDP grew at an annualized rate of 2.6% in the fourth quarter of 2017.
- Full-year real GDP growth was 2.3% compared to 1.5% in 2016.
- Business nonresidential fixed investment, which declined in 2016, rebounded sharply in 2017, perhaps driven by expectations of better tax treatment of these purchases.

Details

The Bureau of Economic Analysis (BEA) reported that real gross domestic product (RGDP) grew at a 2.6% annual rate[1] in Q4-2017. Nominal GDP (NGDP), which measures total spending in the economy without adjusting for inflation, increased by 5.0%. After adjusting for 2.4% inflation—as measured by the GDP deflator—RGDP growth was 2.6%.

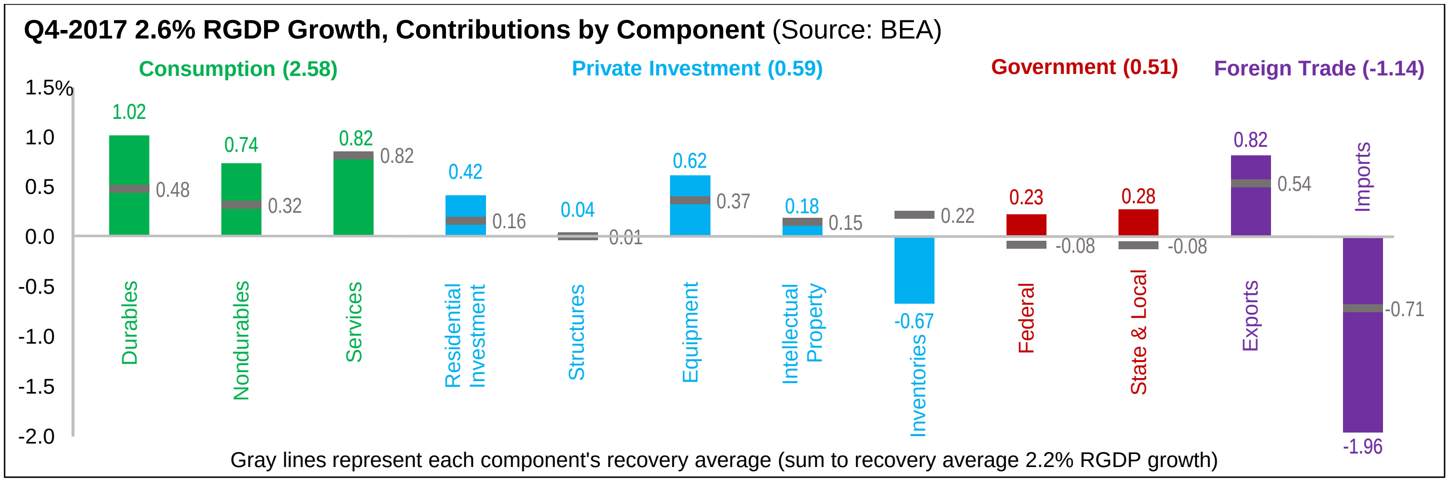
Quarterly RGDP, NGDP, and the Inflation Adjustment (Source: BEA)



	Actual		Blue Chip Consensus Forecast			
Component/Quarter	Q3-2017	**Q4-2017**	**Q4-2017**	Q1-2018	Q2-2018	Q3-2018
Real GDP (RGDP) growth	3.2%	**2.6%**	**2.7%**	2.5%	2.8%	2.6%
Nominal GDP (NGDP) growth	5.3%	**5.0%**	**4.9%**	4.5%	4.7%	4.7%
GDP deflator (inflation rate)	2.1%	**2.4%**	**2.2%**	2.0%	1.9%	2.1%

Consumer spending contributed +2.58 (+1.62[2]) percentage points to the measured RGDP growth rate of 2.6 percent. Business non-residential fixed investment, which excludes inventories, contributed +0.84 (+0.53) percentage points. Residential investment contributed +0.42 (+0.16) percentage points while business inventories subtracted -0.67 (+0.22) percentage points. Increased federal government spending (mostly in defense) added +0.23 (-0.08) percentage points, while spending by state and local governments contributed +0.28 (-0.08) percentage points. Net exports subtracted -1.14 (-0.71) percentage points from RGDP growth.

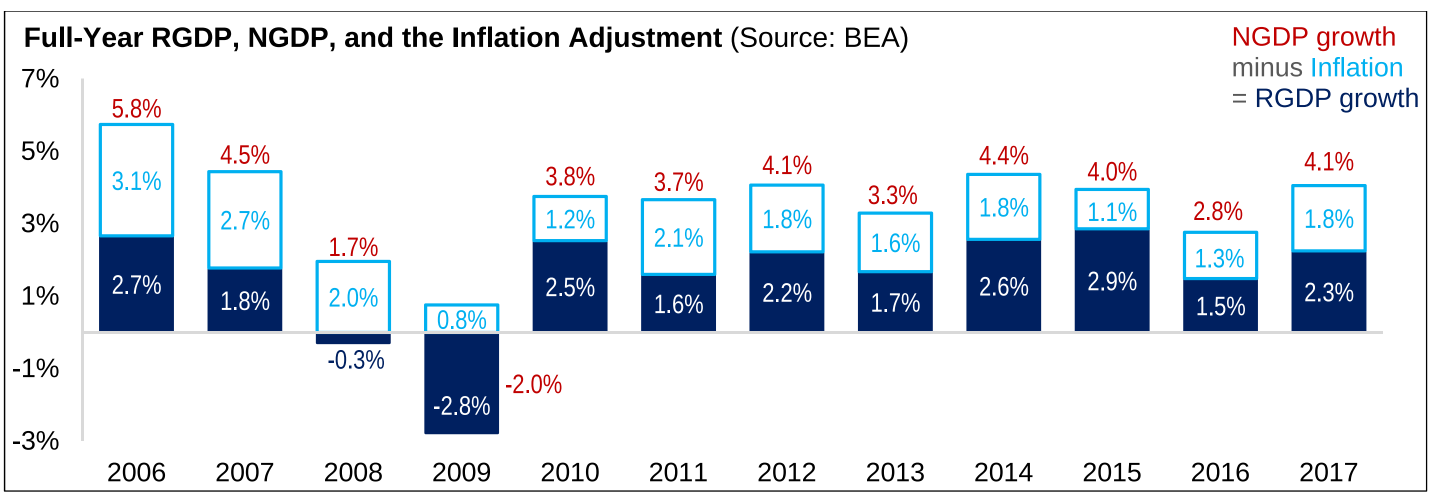
Two updates to BEA's initial GDP report are scheduled for February 28 and March 28. The Q1-2018 GDP report is scheduled for April 27, 2018, at 8:30am.



Fourth Quarter Economic Indicators	Oct-17	Nov-17	Dec-17
ISM Manufacturing Index (>50, expansion)	58.7	58.2	59.7
ISM Non-Manufacturing Index	60.1	57.4	55.9
U.S. Trade Balance (millions)	-48,914	-50,497	N/A
Retail Sales	0.7%	0.9%	0.4%
Business Inventory-to-Sales Ratio	1.34	1.33	N/A
Housing Starts	8.8%	3.0%	-8.2%
Durable Goods Orders	-0.4%	1.7%	2.9%
Personal Income	0.4%	0.3%	N/A
Personal Outlays	0.2%	0.7%	N/A
Nonfarm Payroll Job Growth	211,000	252,000	148,000
Private Payroll Job Growth	222,000	239,000	146,000
PCE Inflation (12-month change)	1.6%	1.8%	N/A
Core PCE Inflation (12-month change)	1.4%	1.5%	N/A
Consumer Confidence	126.2	128.6	122.1

Annual Growth

Despite slowing considerably in 2016 to 1.5%, RGDP growth rebounded in 2017 to 2.3% (these measures show the percentage change in the average level of RGDP from its average value the year before). Two notable developments were the turnaround in private investment and exports. In 2016 these *subtracted* 0.28 and 0.04 percentage points from annual RGDP growth, respectively, while in 2017, these *added* 0.53 and 0.40 percentage points to RGDP growth.



Context

RGDP grew at annualized rates of 3.1, 3.2, and 2.6% in the second, third, and fourth quarters, respectively. These easily exceeded this economic expansion's 2.2% average, and diverge from longer-run growth projections of 1.8%-1.9% as published in the Federal Reserve's December 2017 Summary of Economic Projections and the Congressional Budget Office's June 2017 10-Year Economic Projections.

2017's improved economic performance runs counter to the notion of a "new normal" of slow growth. On the contrary, these developments support the JEC Republicans' perspective that Obama-era policies artificially constrained the U.S. economy's potential, which led to the meager economic performance of the prior eight years. Consequently, the anticipation and the actual enactment of reforms to our outdated tax code and burdensome regulations continue to unleash the U.S. economy's potential.

Noteworthy

Perhaps 2017's most promising development was the acceleration of business investment in equipment. In 2016, this was a drag on RGDP growth, while for Q1 through Q4 in 2017 its contribution to RGDP growth steadily rose from 0.24 to 0.48 to 0.58, and, to 0.62 percentage points, respectively. These additions to the U.S. capital stock will increase worker productivity, which will lead to greater production and higher incomes. Tax reform, which takes effect this year, should support this trend.

In the fourth quarter, business investment in equipment was largely driven by investments in communications and transportation equipment. Perhaps not coincidentally, the tax reform framework announced by congressional and administration leaders shortly before the fourth quarter began indicated that they intended to make business purchases of equipment fully deductible from taxes as of September 27, 2017. Residential investment strength was driven by an increase in real estate brokerage commissions. The large upswing in exports was driven by increased exports of petroleum products. Imports, which are subtracted from GDP, were largely driven by increased imports of cell phones and communications equipment.

Private inventory investment registered a 0.67 percentage point reduction to RGDP growth largely because of BEA's inventory valuation adjustment (IVA). A sharp rise in petroleum prices this quarter led the measured book value of petroleum inventories to increase. As *real* GDP measures *how much is produced* in a given period, BEA deducts inventory book values changes driven by price changes. This led measured inventory investment to contribute negatively to RGDP growth. Real final sales of domestic product, which is RGDP excluding investment in private inventories, grew at an annualized rate of 3.3% in Q4.

---

[1] Quarterly numbers are reported here at annual rates unless stated otherwise. An annual rate for a quarter means BEA calculated the change from the previous quarter as if it occurred throughout a year.

[2] A component's average contribution to RGDP growth during this economic expansion, which began Q3-2009, is shown inside the parentheses.