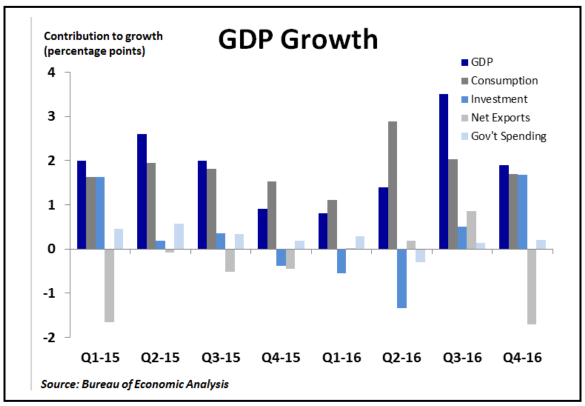
Ed's Eye on the Economy

January 27, 2017

Fourth Quarter 2016 GDP Report

Growth slows as consumer spending tapers and exports plunge

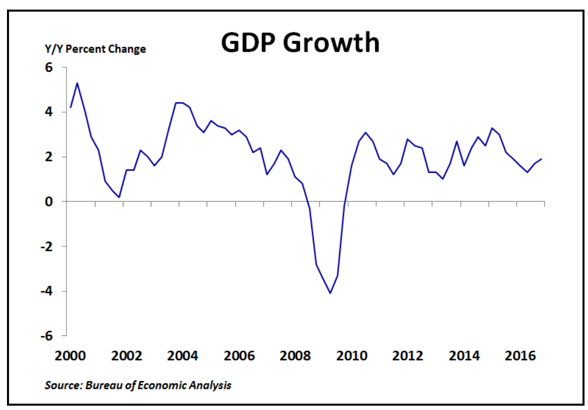
The U.S. economy softened in the fourth quarter, growing at an annualized rate of 1.9% from the previous quarter, far below the 3.5% pace in the third quarter and less than the 2.2% consensus forecast. Compared to a year ago, the economy grew 1.9%, slightly higher than the 1.7% seen in the third quarter and the best year-over-year rate in all of 2017.



Consumer spending once again drove economic growth in the fourth quarter, but quarter-over-quarter growth slowed from 3.0% to 2.5%, weighed down by the slowest growth in services consumption in over three years. Gross private domestic investment soared 10.7%, the strongest growth since the second quarter of 2014, as private inventories jumped while residential investment spiked by 10.2%. Historically low mortgage rates spurred a surge in housing starts in October, and activity remained strong throughout the quarter even as rates increased. A positive contribution from equipment investment after four quarters of declines also helped. Trade was a huge drag on growth as exports plunged 4.3% while imports jumped 8.3%. The lagged effects of the strengthening of the dollar over the last several months are now showing up in the trade numbers, as the trade deficit widened to an annualized $600 billion, the largest since the second quarter of 2008. Finally, government spending rose 1.2%, driven by non-defense federal spending and state and local spending, while national defense spending plunged.

The contributions to growth were as follows: consumer spending 1.70 percentage points (pp), gross private domestic investment 1.67 pp, driven primarily by rising inventories, government spending 0.21 pp and net exports -1.70 pp. Thus, trade completely wiped out all of the contributions from consumer spending.

Today's report makes it official: Barack Obama was the first president since Herbert Hoover to never see economic growth above 3.0% in any year of his presidency. In addition, his annual average of 1.5% was the worst in the post-war era. Even if you take out the awful -2.8% from 2009, his average would match George W. Bush's 2.1% and only surpass



Truman. Looking ahead, the stock market has soared on expectations of better trade deals, fewer regulations and a surge in infrastructure spending. On the downside, the stronger dollar could dampen exports while higher interest rates could put a dagger into the housing market. The Trump era has begun. Time will tell if his policies are the right recipe for America.

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