The Daily Dish

Deciphering the 4th Quarter GDP Data

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Yesterday the Department of Commerce released the 1st estimates of gross domestic product (GDP) in the 4th quarter of 2022. The release is a timely reminder of the difficulty in gauging the strength of and outlook for the economy.

First, the data are, literally, already economic history that does not directly inform anyone of the conditions on January 27, 2023. A constant challenge for policymakers is the fact that most of the statistically valid data arrives with a lag; only anecdotes and non-representative data are typically available in real time.

Second, the data often do not tell a single, cohesive story. For example, the top-line growth rate for GDP was 2.9 percent (at an annual rate). That sounds good (especially compared to a consensus forecast of 2.6 percent) and led some outlets to characterize growth as "strong." Unfortunately, fully one-half (1.46 percentage points) of that growth rate is due to a rise in inventories. Inventory fluctuations are often transitory and quickly reversed. Is growth strong if it is about to fall off a cliff?

Also, one piece of good news is that personal consumption expenditures (PCE) grew across the board: 0.5 percent for durable goods, 1.5 percent for non-durable goods, and 2.6 percent for services. This is in contrast to a mixed picture in the 3rd quarter. So, the much-awaited demise in household spending does not appear in these data.

But that might not be good news because equipment investment turned negative for the second time in three quarters, falling at an annual rate of 3.7 percent. In every postwar recession except the pandemic, a decline in business spending led the downturn and was followed a quarter or two later by falling PCE.

Finally, the strongest piece of data in the report was the fact that the price index for market-based PCE only rose at an annual rate of 3.8 percent, down from 5.0 percent in the 3rd quarter. This is the Fed's preferred measure of inflation. Does the slower inflation change the trajectory of future Fed policy and thus the economy?

In short, the data are signaling either strength, or weakness, or a change in future policy. Clear as mud!

The third reason that putting together a cohesive story on the outlook is difficult is that different data paint a different picture. Yesterday the Census Bureau released data on new orders for capital goods in December. Orders for non-defense capital goods, excluding aircraft, fell 0.2 percent in December (an annual rate of -2.4 percent). This is a leading indicator of future business investment and mirrors the weak investment data in the GDP report. But the Department of Labor released weekly data on new claims for unemployment insurance benefits, which fell. This strength in the labor market cuts in the direction of strength in the economy.

Yesterday the Department of Commerce released the 4th quarter GDP data. It did not settle any major debate on the economic outlook.