



Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 374-7034

GDP: Modest Growth Continues—Sustained Expansion Ahead

Real GDP rose 2.8 percent with gains in consumer spending, business equipment investment and housing. The negatives were the restructuring in local government and federal defense cuts. Inflation is slowing.

Growth: Continued Momentum at a Modest Pace

Sustained growth—neither boom nor bust—remains the theme for this economy and has been our outlook now for some time. Real GDP rose at a 2.8 percent pace in the fourth quarter and is up 1.6 percent from a year ago. The gains in the fourth quarter reflected modest underlying growth in real domestic final sales, up 0.8 percent (top graph), with improvement in consumer spending, business investment—equipment and residential—yet weakness in government spending.

Consumer spending rose 2.0 percent in the fourth quarter with improvement in spending on durables and nondurables, and yet weak service spending. This is in contrast to the prior two quarters when weaker spending reflected higher prices, specifically for gasoline and groceries. Yet, the case for a full-fledged expansion at the pace of post-WWII history remains elusive as employment and income gains remain limited and housing and state and local government continue to restructure.

Consumer Spending: Positive, But Not Exuberant

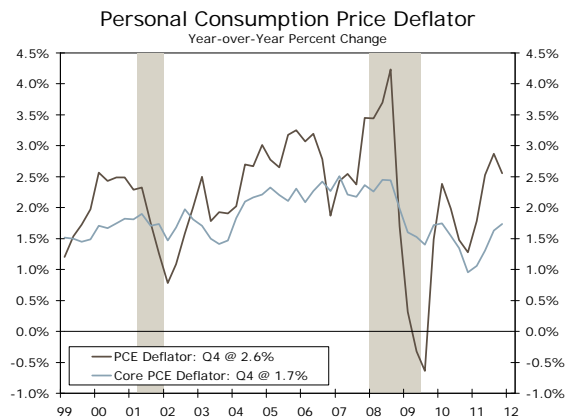
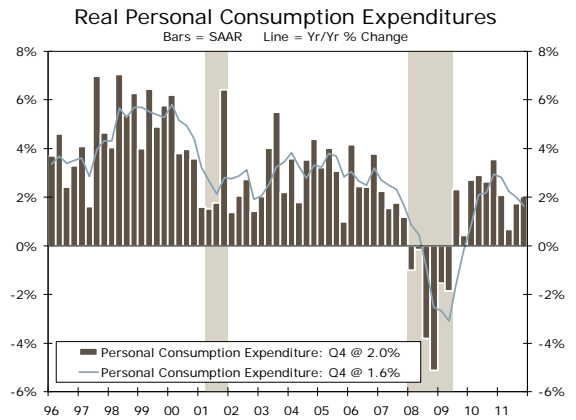
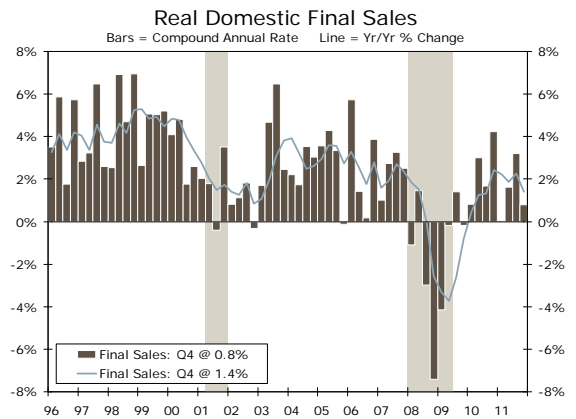
Consumer spending continues to increase at a 2 percent pace (middle graph) and yet it is obvious from the graph that this pace is much slower than that experienced in the prior two expansions.

Income, wealth, credit and consumer confidence all play a role in explaining this slower pace of consumer spending. As for income, slower job and wage gains limit the growth of earned income. Meanwhile, very low interest rates limit the gains in interest income for many investors. Gains in housing wealth remain constrained for many and nonexistent, even negative, for many others. Credit, especially home equity loans, remains limited compared to its popularity in the past and this has limited consumer purchases of nondurables. Finally, all of these factors, plus the steady drumbeat of pessimistic rhetoric, has meant very low levels of consumer confidence at this point in the economic recovery.

Inflation: Above Perceived Fed Target, Definitely Not Deflation

With Chairman Bernanke’s comments earlier this week that the overall PCE deflator, not the core, will be targeted at 2 percent over time, it is useful to examine the details of this release. The fourth-quarter gain in the PCE of 0.7 percent reflected an outright decline in the prices of durable goods and below recent trend increases in nondurables and services (bottom graph). These patterns suggest that moderate economic growth will support the view that PCE measured inflation will continue to moderate on a year-over-year basis and thereby support the Federal Reserve’s continued easy monetary policy.

It is interesting that both export and import prices, and both services and goods, came in negative. This hints that global competitiveness to fight for market share in a moderate growth global economy is alive and well.



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2012 Wells Fargo Securities, LLC.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

