

## GDP Below Forecast But Consumers Cheer Up

Gross Domestic Product for the fourth quarter of 2003 rose 4.0% compared to an 8.2% increase in the third quarter. Subcategories such as exports and consumer spending will be discussed below.

The Chicago Purchasing Managers' Index (a measure of manufacturing activity in the Chicago area) expanded to 65.9 in December from 61.2 in November.

The University of Michigan Consumer Confidence Index for January rose to 103.8 compared to 92.6 in December. This survey is based on only 500 households.

### GDP Growth Disappoints

This was not a particularly good GDP report; it should have been better considering all the fiscal stimulus of the third quarter. At 4%, it came in below economists' expectations, which had centered around 5%. We can see several things at work here. First, personal spending fell considerably relative to the previous quarter; mostly this reflects lower sales of autos and auto parts. Consumer spending in the previous quarter was spurred by distribution of the child tax credit and lower withholding rates on wages. Without this fiscal stimulus, consumer spending slowed to a more normal rate.

The next biggest factor in the fourth quarter slowdown was lower investment spending on economic infrastructure, especially business equipment and software. Imports and exports both increased in the quarter, but the rate of growth on the import side was far greater than on the export. (Imports are subtracted from GDP estimates because, while the consumption occurs here in the U.S., another country actually makes the goods and services and so are not part of our gross 'domestic' product.) Lastly, inventory growth was a substantial contributor to GDP in the fourth quarter.

Slowing economic activity was inevitable in the fourth quarter after the blowout in the third. But can we still find signs of what's coming. For one thing, it looks like consumer

spending tapered off a little more than expected. This probably reflects the decrease in inflation-adjusted disposable personal income which fell 0.5% after having increased 6.3% in the previous quarter. Here we have the real, key issues for continued economic expansion: Can consumer spending continue at past rates if consumer income begins to stagnate?

### Manufacturing Activity Still Upbeat

The Chicago Purchasing Manager Index reports on manufacturing activity just in the Chicago area, but tends to reflect the national trend. The index shows the U.S. manufacturing sector continuing to recover from its worst recession in decades. The biggest changes since last month's report are in the prices paid and production components of the Index, consistent with higher commodity input prices and increased factory output.

### Consumer Sentiment Perks Up

The University of Michigan Consumer Confidence Index is a somewhat overrated index. It surveys only 500 households, which is a rather too small statistical sample for the U.S. population. Such surveys also tend to measure current sentiment about economic conditions even when asking about future expectations. In fact, consumer sentiment measures of future expectations are lowest when economic conditions are at their worst and, as you might expect, are highest when economic conditions are good.