Advance Release of the 4Q2016 GDP

Hello everyone, I'm Jamie Sumner, chief analyst at Seifried & Brew [Slide 1]. For this week, we want to review the fourth quarter GDP release that came out last Friday. As you know this is the "Advance Release", and the GDP came out at 1.9% for the fourth quarter 2016 [Slide 2]. This number was a little below where we saw the estimates coming in, which came in at around 2.2%. So the GDP number is showing a little bit of softening compared to what most U.S. economists in general have anticipated for the fourth quarter. Let's look at the individual components of the GDP to see where the softness had occurred [Slide 3]. First, we want to look at the overall GDP. We can see where we are in the fourth quarter, here at this 1.9%, compared to the third quarter of 2016, at 3.5%.

Now let's look at the different contributing components within the numbers; Consumer Spending, Investments, Government and Net Exports [Slide 4]. Here we can see 170 basis points stemming from the Consumer Spending segment. This is below what we saw in third quarter of 2016 when it was 203 basis points. So, we witnessed a little softening inside the Consumer Spending segment.

Strength in Investments offset a lot of the weakness in Consumer Spending, as Investments of 167 basis points were built into the 1.9% GDP. That's significantly higher than what we saw in the third quarter of 2016, at just 50 basis points and also compares well to the prior quarters before that when it was also negative in the Investment component. Bottom line: we are seeing a big upswing in Investments. Investments include inventories which contributed about 100 basis points, so inventories are one of the pivotal factors in the big Investment increase. The question for us moving forward into the first quarter of 2017 is, have businesses built up their inventories already and are we going to see a pull off in those inventory purchases throughout 2017? My assumption is we are going to see that as we move along throughout the year. My assumption stems from the softness in the Consumer Spending segment as we might see that roll off into the first quarter of 2017 thereby showing a lower GDP in the first quarter. A highlight, though, inside Investments is the fact that residential fixed investments picked up, where it was negative the past two quarters. In my view, that's a significant positive in Investments.

In the fourth quarter of 2016, the Government component contributed 21 basis points, which is a little higher than what we saw in the third quarter when it was 14 basis points. Net exports, defined as exports minus imports, experienced a big negative change, as imports that flow into the United States took away 170 basis points because of a lot of imports that flowed into the U.S. This compares to the third quarter of 2016 when it was 85 basis points but at a positive; therefore the net change is pretty significant, at over 200 basis points.

In conclusion, we are seeing softness in the Consumer Spending segment, which has been moving along here little by little. Investments are propped up by those inventory numbers, Government spending has stayed relatively the same, and Exports, that is net exports, have taken away 170 basis points because of the imports that we saw flow into the U.S. economy last quarter. As we hone in on Inventories and Net Exports, which are fairly volatile in nature historically, we back these components out to get to a final sales number to domestic purchases [Slide 5] thereby giving us a more domestic outlook on how the true GDP is faring. As one can see here [Slide 5], back in the first quarter 2016 it was fairly low at 1.2%. The second quarter picked up a little to 2.4%, third quarter at 2.1%, and the

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fourth quarter at 2.5%. Bottom line is we are witnessing continued strength when dissecting the data and numbers and that's a positive when we look at these numbers backing out inventories and net exports. So domestically it seems like the U.S. is still pretty strong from an economic perspective in moving our way through this expansion here.

Finally, in terms of inflation numbers, core personal consumption expenditures (PCE) have been slowly coming down since the first quarter of 2016 when it was up at 2.1% [Slide 6]. Every quarter since then, the PCE has been slowly coming down, as the PCE was 1.8% in the second quarter of 2016, 1.7% in the third quarter of 2016, and at 1.3% in the fourth quarter of 2016. So, we are seeing this continual downward momentum as we move along. The Federal Reserve has set this target at around 2%. So, the question one must ask oneself then is, will this need to get back up to the 2% level before the Federal Reserve starts to really tighten the Fed Funds short-term borrowing rate at a faster pace? This slowdown is suggesting to us that right now perhaps the Federal Reserve is not going to tighten over the next quarter.

Stay tuned….we will talk more about that later this month. But for now, this is where we are. Look forward to next week when we are going to look at the new Federal Reserve Bank of Philadelphia maps, both the coincident index and the leading index. Have a great week everyone!

Materials set forth above are based on transcripts/slides presented from the Seifried & Brew Briefing transmitted on the above date. For further reference please click on *http://seifriedbrew.com/briefings.html*

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