

FOURTH QUARTER REAL GDP: TRUE OR FALSE? WEB BUZZ 2011.02.07

Very few analyze the details of the GDP numbers. The headline number sets the traders off to buying or selling based on what their expectations were going into the number announcement. However, sometimes it pays to look at the details to ascertain if something is rotten in Denmark. Sure enough there was!

Let us give you John Mauldin's explanation as to why the inventory calculation made the real GDP number much higher than it actually was.

Moody's correctly noted that "private inventories were an enormous drag on growth" and concluded that this was a good thing, in that they assumed that meant inventories went down and thus inventory rebuilding in future quarters will add to GDP growth. And that is where you have to look at the numbers, and there we find an anomaly. There really wasn't that big a drop in inventories. It was in large part in the statistics, not in the warehouse.

Oil in the 4th quarter rose from roughly \$81 to \$89, or about 10%. On an annualized basis, this is 40%. Inventory investment is equal to the change in book value of the inventories, minus what is known as IVA, or inventory valuation adjustment, which is used to correct for prices going up or down. Because the value of oil rose and thus cost more to acquire, the accounting requires that you reduce the value of the current inventories. Thus "real" imports fell at 13% annual rate. Why? Because the deflator rose by 19%, largely because of the rise in the price of oil.

I know, I know, I just wrote that because the price of oil went up, the “real” value of imports went down, as well as inventories. Some of you are getting economic whiplash right about now.

When taking into account this aberration, it would appear that the real GDP number for the 4th quarter was more like 2.4% as opposed to 3.2%. The four quarters of 2010 based upon the above were:

1Q10: 3.7%

2Q10: 1.7%

3Q10: 2.6%

4Q10: 2.4%

What does this all mean? Nothing other than the fact that this recovery is extremely weak and those who are treating it as a normal V-shaped recovery are in for a huge disappointment.