



STAFF ANALYSIS

Real GDP Growth Revised Up to 2.7% in 3rd Quarter

Lack of Quality Growth May Signal Trouble on the Horizon

November 29, 2012

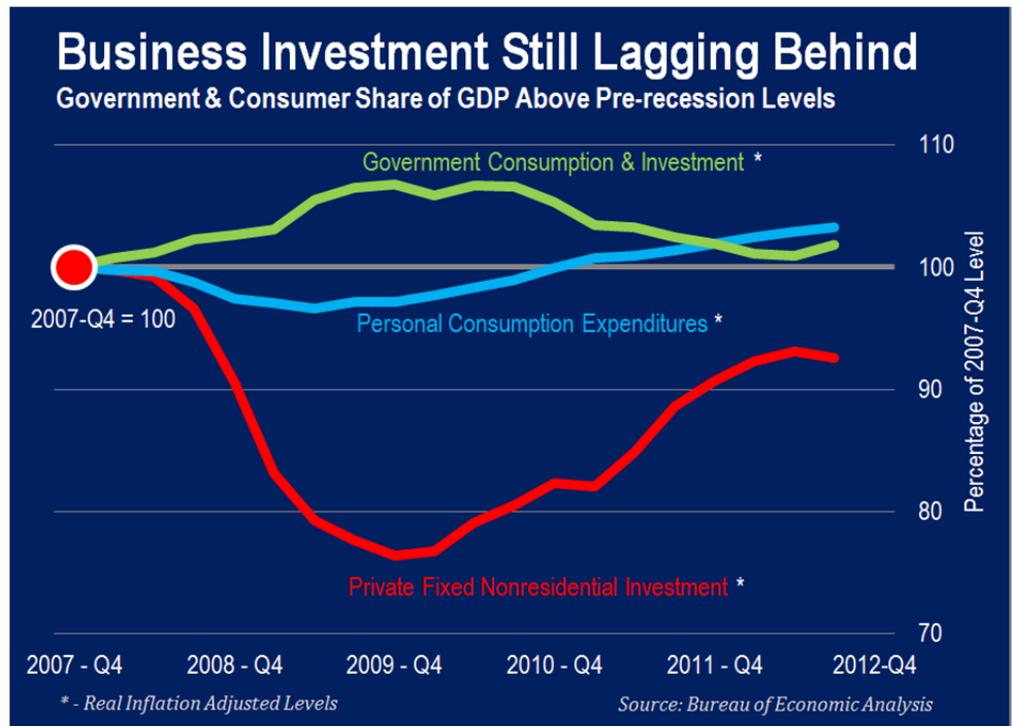
The Bureau of Economic Analysis (BEA) revised its estimate of real gross domestic product (GDP) growth upwards by 0.7 percentage point to 2.7% today. BEA had previously estimated that real GDP grew at an annual rate of 2.0% during the quarter. The 3rd-estimate of 3rd-quarter GDP will be released on December 20, 2012.

The upward revision was driven by growth in private inventories. In the BEA's prior estimate, the change in private inventories had subtracted 0.1 percentage point from real GDP growth. In the BEA's current estimate, the change in private inventories contributed 0.8 percentage point to real GDP growth suggesting another potential drag on 4th-quarter growth.

Business Investment Still Missing in Action

A large amount of attention is focused on the importance of consumer spending as a component of GDP.

Personal consumption expenditures (PCE) account for slightly more than 70% of GDP. However, in real terms, real PCE are higher than at the start of the recession in the December 2007. And despite recent declines, real government consumption and investment is higher than the 4th-quarter 2007. It is business investment that has not recovered to pre-recession levels. Real private fixed nonresidential investment remains below 4th-quarter 2007 levels.



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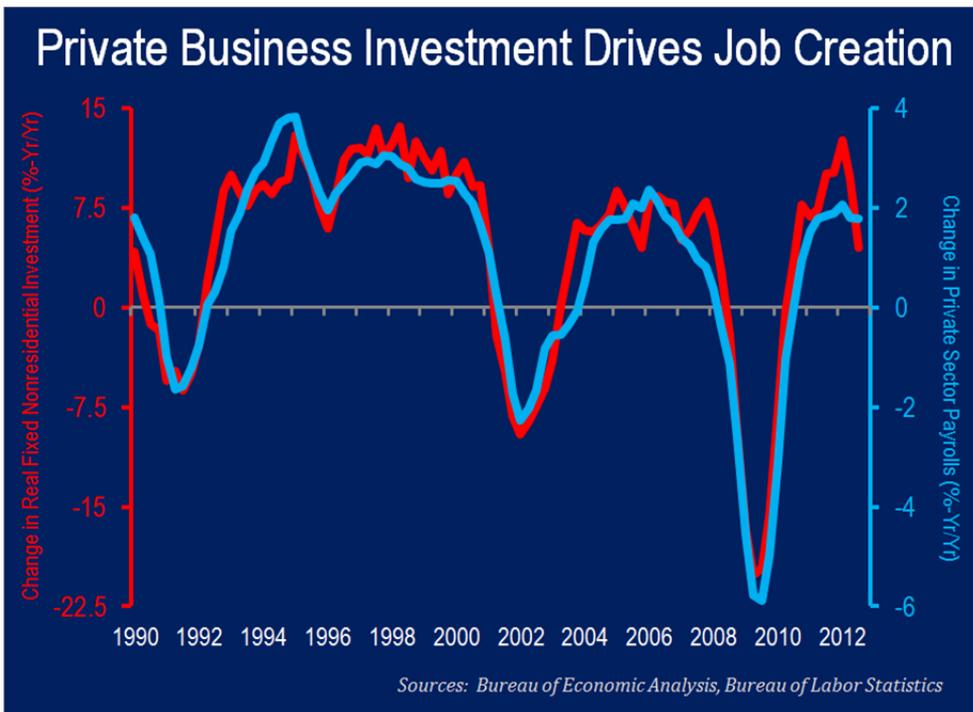
Private fixed nonresidential investment encompasses private business investment in buildings, computers and software, and other equipment.

BEA’s revised estimates represent a step backward. Fixed nonresidential investment declined at annual rates of 2.2% on a real basis and 1.5% on a nominal basis during the quarter. This represents the first decline on a real basis since the 1st-quarter 2011 and the first nominal decline since the 4th-quarter 2009. On a year-over-year basis, real private fixed nonresidential investment has only increased by a total of 4.5% in the past four quarters and remains 7.3% lower than in the 4th-quarter 2007.

Business Investment Drives Job Creation

Policymakers should be concerned by the lethargic growth in private business investment because private investment drives job creation.

Changes in private sector payrolls are highly correlated with changes in real private fixed nonresidential investment. The following chart illustrates the relationship since 1990.



It is because of this relationship that policymakers must insure that any actions taken to address the “fiscal cliff” do not adversely impact private business investment.

The substandard pace of job creation in the present recovery can be traced in large part to the failure of private business investment to regain its 4th-quarter 2007 levels. Faster growth in private business investment will lead to higher growth in private sector job creation.