Weekly Commentary by Professor Jeremy J. Siegel

Disappointing GDP but Details Much Better; No Surprises at Fed

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There is no question that GDP overall disappointed, with the first quarter growth rate coming out at 2.2%, weaker than the official estimate of 2.5% and considerably weaker than the "whisper" numbers which approached 3%. Yet, the details of the report are much better than the headline number. First, the decline in government purchases shaved 0.6 percentage points (ppts) off the growth rate, indicating that private GDP increased at a 2.8% rate. (The decline in government purchases was surprising since the loss of jobs in the government sector had moderated in the first quarter.) Furthermore, inventory accumulation was less than expected and added 0.6 ppts to the overall growth rate in contrast to 1.8 percentage points added by inventory accumulation in the previous quarter. Therefore final sales were up 1.6 percentage points, better than the 1.3% in the fourth quarter. Finally, consumption was strong, up 2.9%. The "structure" category of investment subtracted 0.35 percentage points from growth while housing investment was strong, adding 0.4 percentage points, which I believe is the largest since the housing slowdown began in 2006. Also, the GDP price deflator rose at a 1.5% annualized pace, six tenths below estimates, a favorable development. Stock futures fell on the headline number, but recovered after studying the details.

As noted in Wednesday's FOMC Commentary, the Fed meeting and projections came out pretty much as expected. Bernanke certainly skirted the critical question of reporters that 2 FOMC members pushed forward the date of tightening and what would happen if more members joined that opinion. Bernanke indicated that those projections come out before the meeting and participants view them as "tentative." After a discussion of the outlook, Bernanke hinted that some may have changed their mind. In any case, of the voting members of the FOMC, Bernanke seemed to have little trouble gathering a strong majority for the end of 2014 date. Richmond President Jeffrey Lacker was the only dissenter, as he was at the last two meetings.

Earnings, after coming in far above expectations through Wednesday, have softened a bit in recent releases, but first quarter numbers, when they are all in, are still going to be well above expectations. This is a strong positive for the market, and would normally propel stocks much higher if it were not for the uncertainty generated by the "fiscal cliff" on January 1 and the European situation. Nevertheless, if European anxieties ease, stocks should resume their upward trend and if Congress extends most of the tax cuts, this could propel stocks to new highs.
