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Fed Worried About Continued Growth (A Good Thing)

By **Harlan Green** / Special to CASA

FOURTH QUARTER GROSS DOMESTIC PRODUCT GROWTH WAS A BUST. What does that say about 2013? Are consumers tapped out and capital expenditures (capex) shrinking, the two main drivers of economic growth? It doesn't seem so, as long as the Federal Reserve keeps interest rates this low.

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The Federal Reserve was worried about diminished growth at its January FOMC meeting, and so voted to continue its Quantitative Easing programs.

"The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction," said the FOMC press release of its meeting. "Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative."

Barron's Magazine recently predicted an increase in capex spending this year, citing Standard and Poor's estimate of 9.9 percent growth, vs 6.9 percent last year. It also cites ultra-low interest rates that provide a double nudge: punitive returns for companies that continue to hoard cash and alluring rates on equipment loans. Also, the fiscal cliff deal in early January extended a tax perk called accelerated depreciation, which sharply increases the portion of capex that companies can write off against income right away.

Consumers are spending like their recession is over. Consumer debt continues to grow, especially for autos and student loans, while they continue to pay down revolving credit card debts.

The revolving credit component (primarily credit card balances) declined $3.6 billion in December. Given the healthy retail sales figures for December, consumers are still relying on cash. This may be due to consumers continuing to mend their credit and/or due to credit card companies keeping credit tight.

The Commerce Department said consumer spending was moderately strong in December. Retail sales gained 0.5 percent after a 0.4 percent rebound the month before, with automobiles leading the way. That's six percent per year, close to normal sales' growth. Without autos and gasoline, strength in the core was also broad based. Gains were led by furniture and home furnishings, food services and drinking places, and health and personal care. A decline was seen in electronics and appliance stores.

One caveat: The Fed seems to have painted itself into a corner with its stated mandate of two to 2.5 percent inflation, as we said last week. It's a scenario eerily similar to Germany's fixation on inflation since its 1920s hyperinflation, and the reason Germany is punishing the Mediterranean countries with its austerity demands. Though U.S. inflation is running below two percent at the moment, it could rise with short term rises in gas prices and cause the Fed to terminate its QE program.

What about 2013? We think zero growth of Q4 Growth Domestic Product was an aberration and will probably be revised upward in the next estimate. It looks like the fiscal cliff negotiations and higher payroll taxes aren't stopping consumers or companies from spending more than originally anticipated.

Harlan Green has been the 11-year Editor-Publisher of PopularEconomics.com, a weekly syndicated financial wire service. He writes a Popular Economics Weekly Blog. He is an economic forecaster and teacher of real estate finance with 30-years experience as a banker and mortgage broker.