

# Tea Leaf

...weekly since 1976

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## Sluggish

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

U.S. economic growth recorded its slowest growth pace in four years during 2007's first quarter. Friday, April 27 saw the U.S. Commerce Department's first official estimate of economic growth (GDP), which came in at a 1.3% real (inflation adjusted) annual rate. By comparison, the financial community had expected growth closer to a 1.7% pace.

Note: updated construction data released on Monday, April 30 suggests the 1.3% growth pace could be revised closer to 1.5%-1.6%. The U.S. Commerce Department will revise the current estimate in both late May and late June.

It was no surprise that weakness in the nation's housing sector contributed to the soft economic growth pace. New home construction fell at a 17.0% annual rate during the quarter. Such performance was actually better than the 19.8% housing contraction pace in the prior quarter. Spending on home construction has now declined for six consecutive quarters, the first such occurrence since the early 1980s.

It's also no surprise that those economists forecasting recession this year are trumpeting the weakness in housing as their primary reason. These forecasters would suggest that housing has not yet bottomed. They suggest that weakness in new home construction and softness in existing home prices on both coasts, in the Southwest, and in the upper Midwest (Big 3 auto country) will soon impact overall consumer spending, tipping the economy into recession.

This is not our view... never has been. We continue to expect the nation's housing market to move toward stabilization over the balance of the year, with modest improvement in 2008.

Strength during the first quarter was primarily found in the consumer spending area. Consumer spending, which

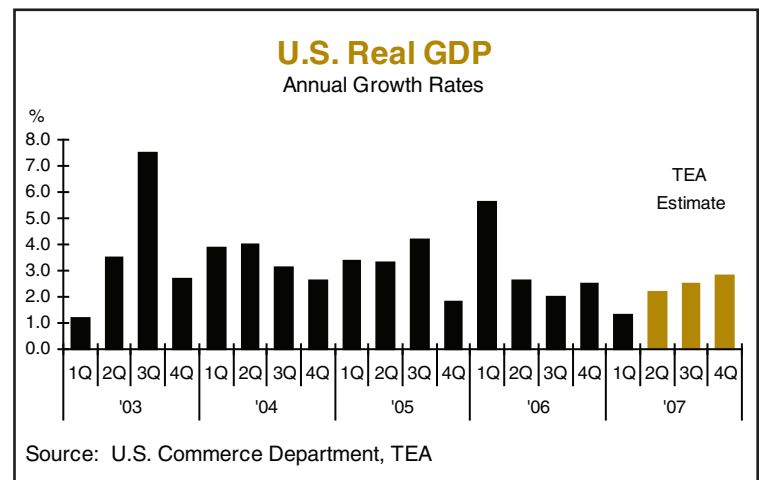
accounts for roughly 70% of overall U.S. economic performance, rose at a 3.8% annual rate during the January to March period. The 3.8% growth pace compared to a 4.2% pace during the prior quarter.

Business fixed investment (corporate spending on construction, software, equipment, etc.) rose at a 2.0% annual rate, after declining at a 3.1% pace during the October to December 2006 quarter. Fear that businesses will continue to spend cautiously also supports the recession-is-imminent view.

Another positive aspect of the first quarter report was the fact that business inventories grew at a lesser rate during the first quarter than in the fourth quarter. Since GDP is a measure of what is *produced*, not what is *sold*, the leaner level of production in the first quarter suggests rising production in the current quarter.

The American economy continues to easily rank as the world's largest, with total output of goods and services this year to be near \$13.7 trillion. Most estimates continue to rank Japan second, with annual output one-third that of the U.S. Some analysts rank China second, although a fourth place ranking behind Germany is more commonplace.

We continue to expect the U.S. economy to gain strength as 2007 matures, with stronger economic growth in each subsequent quarter. We also expect to see a return to stronger economic growth in 2008.





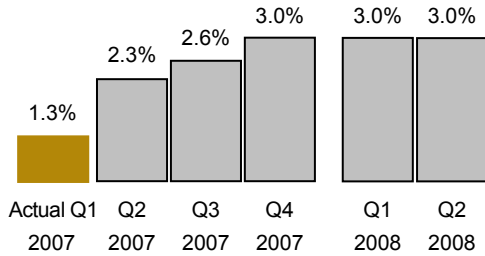
## Quarterly economic survey

The USA TODAY economic survey of 53 top economists was conducted April 20-25. Actual 1st quarter 2007 numbers and median forecasts through 2nd quarter 2008:

USA TODAY • MONDAY, APRIL 30, 2007

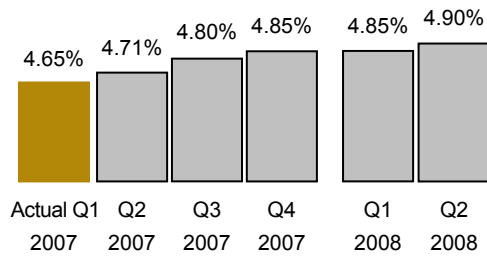
### Gross domestic product

(real annual growth rate)



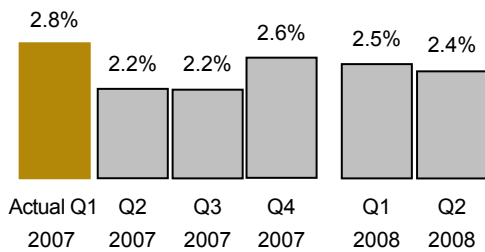
### 10-year T-note yield

(quarter end)



### Consumer price index

(12 months ended)



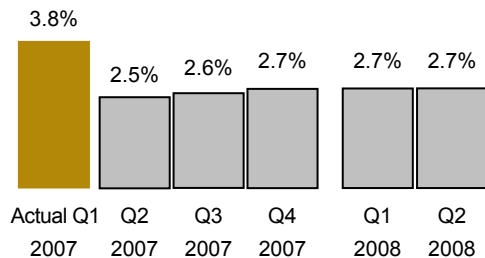
### Federal funds rate target

(quarter end)



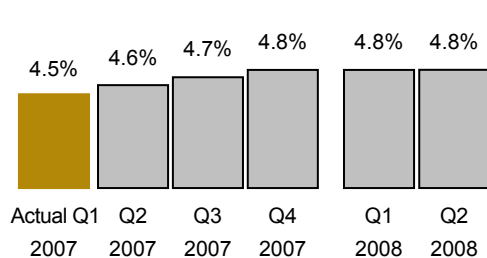
### Consumer spending

(real annual growth rate)



### Unemployment rate

(quarter end)



**Survey participants:** Scott Anderson, Wells Fargo; Nariman Behraves, Global Insight; Richard Berner, Morgan Stanley; David Berson, Fannie Mae; Kathleen Camilli, Camilli Economics; Dewey Daane, Vanderbilt University; Richard DeKaser, National City; Rajeev Dhawan, Georgia State University; William Dunkelberg, National Federation of Independent Business; Michael Englund, Action Economics; Gail Fosler, The Conference Board; Lyle Gramley, Stanford Washington Research Group; Ethan Harris, Lehman Brothers; Maury Harris, UBS; Stuart Hoffman, PNC Financial Services Group; Dave Huether, National Association of Manufacturers; William Hummer, Wayne Hummer Investments; Paul Kasriel, Northern Trust; Irwin Kellner, North Fork Bank; David Kelly, Putnam Investments; David Lereah, National Association of Realtors; Tim Martin, Bank of America; Ken Mayland, ClearView Economics; Tim McGee, US Trust; Ed McKelvey, Goldman Sachs; James Meil, Eaton; Robert Mellman, JPMorgan; Gregory Miller, SunTrust Banks; Richard Moody, Mission Residential; Joel Naroff, Naroff Economic Advisors; Frank Nothaft, Freddie Mac; Joel Prakken, Macroeconomic Advisers; Maria Ramirez, Maria Fiorini Ramirez, Inc (MFR); Donald Ratajczak, Morgan Keegan; David Resler, Nomura Securities International; Tim Rogers, Briefing.com; David Rosenberg, Merrill Lynch; Chris Rupkey, Bank of Tokyo-Mitsubishi UFJ; John Ryding, Bear Stearns; David Seiders, National Association of Home Builders; Robert Shrouds, DuPont; Allen Sinai, Decision Economics; James Smith, Parsec Financial Management; Sean Snaith, University of Central Florida; Sung Won Sohn, Hanmi Bank; Diane Swonk, Mesirow Financial; Gary Thayer, A.G. Edwards; **Jeff Thredgold, Thredgold Economic Associates**; Mark Vitner, Wachovia; Brian Wesbury, First Trust Advisors; David Wyss, Standard & Poor's; Richard Yamarone, Argus Research; Mark Zandi, Moody's Economy.com

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