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Your guide to understanding today's economy and financial markets

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GDP Stink

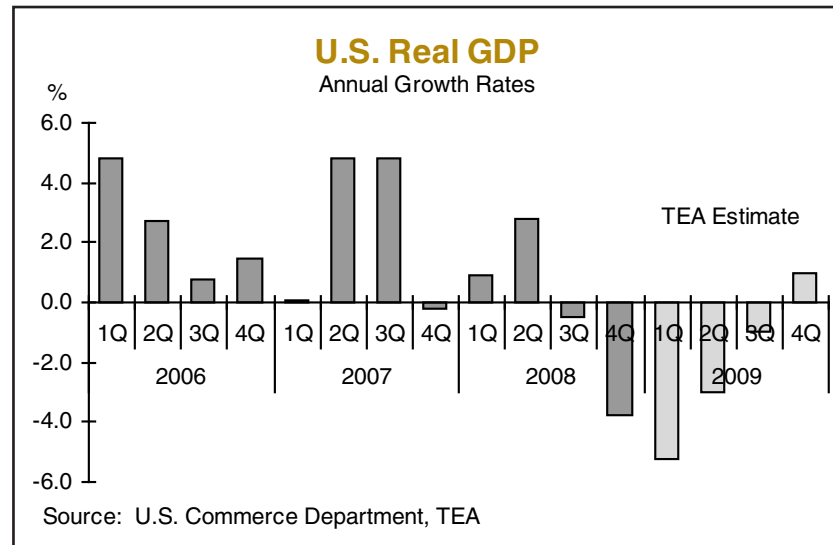
Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

American economic pain was widespread during 2008's final quarter, with the overall economy contracting at a 3.8% real (after inflation) annual rate. The economy's decline was the sharpest since the first quarter of 1982—a period of 26 years. GDP, or gross domestic product, is the broadest and most complete measure of the nation's overall economic activity.

(and hopefully) runs its course by late in the year.

The U.S. economy officially grew at a 1.3% real rate during 2008, versus a 2.0% real growth pace during 2007, with essentially all of the growth occurring during the January to June 2008 period. The 1.3% growth pace was the weakest

since the last recession during 2001. The U.S. economy is expected to contract at a 2.0% - 2.5% real rate during 2009.



On the surface, the 3.8% annual rate of shrinkage was “good” news, since the consensus view of forecasting economists was for a 5.0% - 5.5% real annual rate of decline. However, the lesser rate of decline occurred for the wrong reason, one which actually suggests that the U.S. economy will be weaker in 2009's first half than was the prior view (see *Inventory Blip* on page 2).

The 3.8% rate of decline followed a 0.5% real annual rate of decline during 2008's third quarter. As such, the U.S. economy finally met the media's simplistic definition of recession, i.e. two consecutive quarters of declines in U.S. GDP.

As noted frequently, however, the American economy has “officially” been in recession since December 2007, a period already reaching 14 months. Recessions are defined by the Business Cycle Dating Committee of the National Bureau of Economic Research. The current recession will likely be the longest since the Great Depression when it presumably

If misery loves company the U.S. has plenty, with much of the developed world also in the tank. For the first time since WWII, the U.S., Europe,

and Japan are in recession at the same time.

Wherever You Look

It would be difficult to find much in the way of good news in the GDP report. To add insult to injury, the data will be revised at the end of February and again at the end of March, with the U.S. Commerce Department then working in further revisions as they see fit down the road:

- Overall consumer spending, which represents nearly 70% of total U.S. economic activity, dropped at a 3.5% annual rate, the seventh biggest drop on record. The decline, combined with the 3.8% annualized spending contraction during the prior quarter, was/were the first back-to-back declines exceeding 3.0% since such recordkeeping began in 1947, a period of 61 years (*cnbc.com*).
- Spending by consumers on “big ticket” durable goods (those designed to last more than three years, such as cars and

appliances) dropped at a 22.4% annual rate, the most painful decline since 1987

- Consumer spending on nondurables, including food and clothing, dropped 7.1% during the fourth quarter, the largest decline since 1950, a period of 58 years
- Spending by businesses on equipment and software plunged at a 27.8% annual rate, the most severe drop in 50 years
- Homebuilders cut spending at a 23.6% annual rate
- U.S. exports to the world, one of the economy's few saving graces during much of the past two years, fell at a 19.7% annual rate, the sharpest decline since 1974
- Government spending increased 1.9% during the fourth quarter, after rising at a 5.8% rate during the prior quarter

Better news saw prices paid by consumers decline at a 5.5% annual rate, the sharpest decline since quarterly data became available beginning in 1947. The decline, driven by sharply lower gasoline prices, did boost consumer "purchasing power" during the quarter. However, the sharp decline also raised the specter of deflation, a highly unfavorable development, despite what one might think.

Inventory Blip

Note that GDP is a measure of what is *produced*, not what is *sold*. Consumer spending fell so quickly during the fourth quarter that manufacturers were not able to trim production fast enough.

The resulting rise in inventories led the GDP measure to be 1.3% less painful than expected, resulting in the 3.8% rate of decline. GDP would have fallen at a 5.1% real annual rate with inventory data excluded. Such an inventory rise suggests that production will be curtailed even further in coming months, contributing to even weaker U.S. economic performance.

What It All Means

The current recession—already long in the tooth—will be with us for some extended time to come. Surveys of

seasoned economists of the past two weeks by *Blue Chip Financial Forecasts* and *USA TODAY*, both of which I participated in, suggest that the recession will give way to weak, but at least positive, U.S. economic growth beginning in 2009's third quarter. I have felt that such growth would not return until the fourth quarter. That still seems a reasonable view.

In the meantime, the U.S. economy will likely be weaker statistically during the current quarter than was the view a couple of weeks ago. Current quarter weakness could reach a 5.0% real annual rate of decline...or more (or is that less?)

The Turn

- At some point, however, the enormity of Federal Reserve monetary stimulus will kick in
- At some point, the unprecedented amount of fiscal stimulus will kick in. Financial assistance to states will help trim additional layoffs, while the enormous amount of earmarks (pork barrel spending) in the proposed stimulus plan will have a minor impact. Any move toward additional tax cuts in the plan, and less pork-flavored spending, would be an improvement
- At some point—likely sooner rather than later—the stock market will begin to rally in a meaningful way
- At some point, the *Business Weeks* and the *Newsweeks* and the *Fortunes* of the world will run positive, upbeat covers—rather than trashing the economy—such as "*What a Great Time to Buy a House*" or "*What a Great Time to Hire Talented People*" or "*What a Great Time to Buy Stocks.*"

This sea change in reporting will help boost consumer and corporate confidence. A more balanced, more positive approach by the national media—what a concept!—will help establish a foundation for a return to positive, if meager, U.S. economic growth.

Meager U.S. economic growth doesn't seem all that exciting...

...but it's a start



"TEA"ser

Morris, an 82 year-old man went to the doctor to get a physical. A few days later the doctor saw Morris walking down the street with a gorgeous young lady on his arm.

A couple of days later the doctor spoke to the man and said, "You're really doing great, aren't you?"

Morris replied, "Just doing what you said, Doctor: 'Get a hot mamma and be cheerful.'"

The doctor said, "I didn't say that. I said you got a heart murmur. Be careful."



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