More Ugly

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

Forecasting economists were surprised during very late January 2009 when the U.S. Commerce Department announced that U.S. GDP (gross domestic product, the most inclusive measure of all goods produced and services provided in the American economy) declined at a 3.8% real (after inflation) annual rate. The surprise was that the announced economic measure was not closer to the 5.0%-6.0% real annual rate of decline that was the consensus view.

It turns out that the Commerce Department's first official revision to the data, based on more complete economic information, (with one more revision coming in late March), now suggests the U.S. economy contracted/fell/dived/dropped at a 6.2% real annual rate during the October to December 2008 quarter. By the way, once the Commerce Department officially revises the data again in late March, they will very likely do it again down the road…any time they feel the need.

Note that the major downward revision from a disgusting 3.8% annual rate of decline to a *really* disgusting 6.2% annual rate of decline was almost five times the typical average revision, and the largest revision in a generation…

…talk about adding insult to injury!

Ironically, a key factor that led the initial estimate to be a less-than-expected rate of decline, but was actually a negative development…was also a key factor in the new data, although it is actually a positive development in regard to growth in coming quarters…

…I'm well on my way to becoming a more traditional economist…even I don't understand what that statement just said!

Inventories

As noted frequently in the past, GDP is a measure of what is *produced*, not what is *sold*. As a result,

Obama Stocks

Let's see now…the stock market has been getting absolutely hammered & thrashed in recent days, weeks, and months. A serious bear market is well underway, with the Dow, and other stock indices, down more than 50% from their respective peaks roughly 17 months ago…

…as part of the painful decline, the Dow, the S&P 500, and the Nasdaq are down an average of 29% since election day, November 4, 2008.

There is no doubt that part of the sharp decline since now-President Obama was elected to the Presidency is the continuing weakness in the domestic and global economies. However, another major factor is in play…

- Could it be that the recently enacted $787 billion stimulus program, as well as the current $400+ billion spending resolution, is full of pork projects of all types and more focused on social spending than on "stimulus?"
- Could it be that a battle is brewing in Washington DC between the House of Representatives and the Senate as to who can spend taxpayers' money the fastest, with little regard to deficits?
- Could it be that those people who make over $250,000 annually—those people who primarily buy and hold U.S. stocks, and who traditionally create millions of jobs in the U.S.—don't appreciate their tax treatment by the new Administration? The President and his advisors take delight in suggesting that 95% of American taxpayers will receive a modest tax cut in coming years, while those anti-Americans (my word) who make more than $250,000 annually will see their income, dividend, and capital gains taxes move higher…

…naw…couldn't be that

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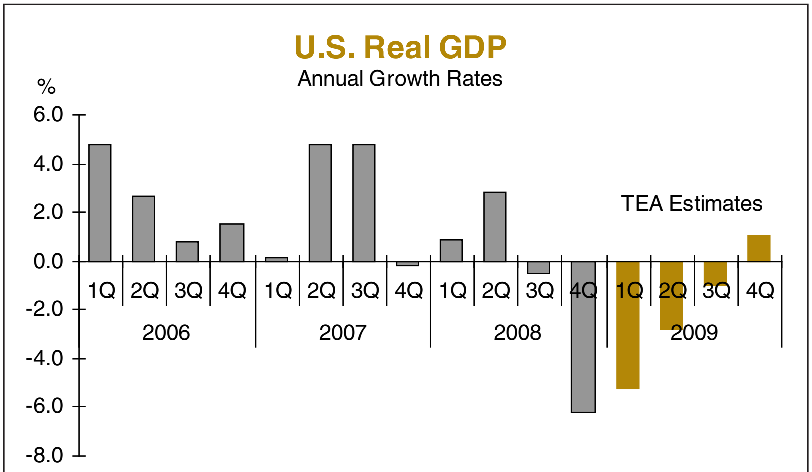
any time inventories of produced goods rise unexpectedly during a quarter, future goods production typically must be trimmed so as to avoid too many goods on the shelves.

Suffice to say that business inventories did not rise as had been reported in the first estimate, but actually fell. While it makes the fourth quarter GDP estimate worse, it actually bodes better for production in following quarters…

…again, a mouthful



Source: U.S. Commerce Department, TEA

Consumer Weakness

The other key factor in the downward revision was a larger-than-previously-reported drop in consumer spending. It seems that consumer spending, which represents roughly 70% of total U.S. economic activity, actually contracted at a 4.3% annual rate last quarter, the most since 1980.

The 4.3% rate of contraction, when combined with the 3.8% rate of decline during the prior quarter, was the first time consumer spending has weakened by at least a 3.0% annual rate during consecutive quarters since recordkeeping began in 1947…a mere 61 years *(bloomberg.com)*.

Since ’82

The revised 6.2% real annual rate of decline in the economy was the worst quarterly performance since 1982. Most estimates for the current quarter are around a 4.0% to 5.5% real annual rate of decline, with a decline closer to 1.5% - 2.0% during the April to June quarter.

As before, the consensus of forecasting economists still expects U.S. economic growth to return to weak, but at least positive, growth during the third and fourth quarters. I still think the first positive quarter will be 2009’s final quarter.

The Sky is Falling

Those who follow my weekly attempts at discussing the economy and financial markets know that I see a direct correlation between developments during the week including Friday, September 18, 2008 and the immediate surge in job losses. The weak fourth quarter GDP data also supports this view.

Again, think back to Friday, September 18, 2008. This was the day that Federal Reserve Chair Ben Bernanke and then-U.S. Treasury Secretary Hank Paulson held a news conference and emotionally asked the U.S. Congress for $700,000,000,000 to deal with a crisis in financial markets and among many Wall Street banks and investment firms…

…Oh, that’s right, they provided a two-and-a-half page memo to support their view

In prior weeks and months, Wall Street investors and lenders knew of major problems within the domestic and global financial markets. However, it was that weekend, in my view, when the average person on Main Street, who might have heard various and occasional rumblings about financial issues, was made much more aware of the problem…

…hearing from Bernanke and Paulson that “the sky was falling”…as well as what typical Americans gleaned from the emotional debate during the next week within the Congress, scared millions of people to death. The result is seen in the fourth quarter GDP data, as well as in the plunge in monthly employment totals beginning in October 2008.

Jeff

“TEA”ser

Money can’t buy you happiness, but it does bring you a more pleasant form of misery.

—Spike Milligan

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