Tea Leaf

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Your guide to understanding today's economy and financial markets

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Similar Numbers…Different Stories

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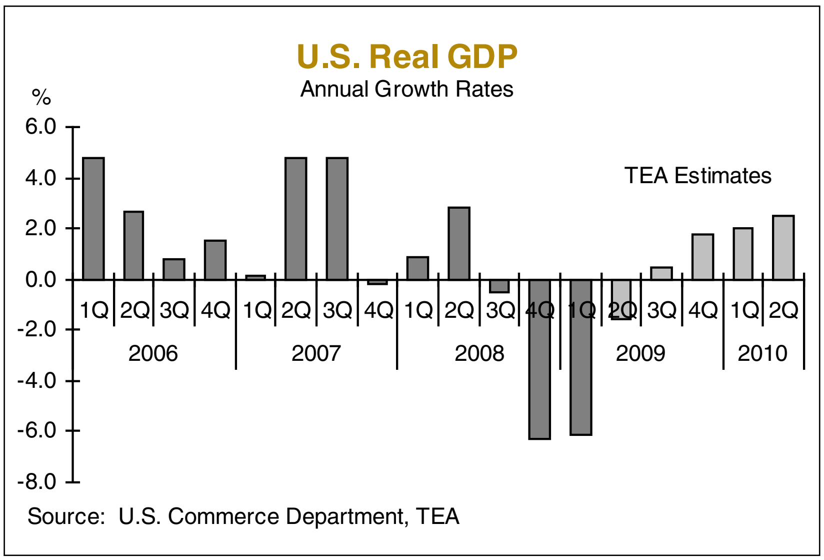
The American economy contracted at a 6.1% real (after inflation) annual rate during 2009's first quarter, very close to the 6.3% real annual rate of decline during the prior quarter…

…that's where the similarity ends

While the fourth quarter's various economic components were almost all scary, the more recent data had numerous elements of optimism as to where we go from here…

…the overall message is that this painful recession has about run its course, with a return to positive (yea!) if modest U.S. economic growth perhaps by late summer, one reason stocks continue to move higher



The Data

The 6.1% real annual rate of decline in the nation's gross domestic product (GDP) during the January-March period was weaker than the consensus 4.8% rate of decline expected by forecasting economists. GDP is the most complete measure of all goods produced and services provided within U.S. borders. The data will be revised in late May and late June as more complete information is available.

However, various components which led the overall measure lower actually suggest stronger performance in coming quarters. In addition, select components of the U.S. economy wherein spending declined are highly unlikely to do so again in coming quarters:

- Consumer spending, which represents 70% of all U.S. economic activity, actually rose at a 2.2% annual rate during the first quarter, after declining sharply during the two prior quarters. Such spending seems to have largely stabilized, although weak labor markets and eroding home values will limit any meaningful upside to consumer spending in coming quarters. Stronger consumer spending added 1.5% to first quarter GDP, versus the prior quarter

- Government spending (believe it or not!) actually declined in the first quarter, led by declines in defense spending and lesser state and local spending. However, government spending will surge in coming quarters as the $787 billion economic stimulus program kicks in. Lesser government outlays subtracted 0.8% from GDP versus the prior quarter

- Companies slashed capital spending at a 38% annual rate during the first quarter, with investment in software and equipment down at a 34% annual rate. Business investment in new buildings was down at a 44% annual rate. Weak business investment pulled GDP down 2.6% from the prior quarter

- Businesses also slashed the level of inventories of goods by $104 billion during the first quarter, the largest quarterly decline on record. This factor alone subtracted 2.8% from first quarter GDP. The sharp reduction of goods "on the shelves and in the storerooms" suggests that manufacturing output will be ramped up faster than previously

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thought when overall spending by consumers and businesses strengthens

- U.S exports to the world fell at a 30% annual rate during the first quarter, the largest decline in 40 years. The plunge in exports illustrates how a global economy in recession buys less in the way of U.S.-made goods. This factor subtracted 4.0% from GDP. However, U.S. imports also fell sharply, adding 6.0% to GDP

- Housing investment fell at a 38% annual rate, the largest decline since 1980, and the 13th consecutive quarter of decline. Housing weakness subtracted 1.4% from GDP, when compared to the prior quarter

Rising Consumer Confidence

With consumer spending representing 70% of the U.S. economy, rising confidence levels are important. The Conference Board's latest monthly measure of consumer confidence rose sharply to 39.2 in April, versus 26.9 in March. The index is based on a representative sample of 5,000 U.S. households.

The latest measure was the second consecutive rise, and was at its highest level since last November. In contrast, the index hit a record low in February near 25.

We still have a long way to go. For the index, 1985 equals 100. The index averaged 57.9 in 2008 and was at 90.6 in December 2007, the month the economy officially entered the recession.

The primary index is split into two components, the Present Situation index and the Expectations index for the next six months. While the Present Situation index had a slight gain from 21.9 to 23.7, the Expectations index rose sharply from 30.2 to 49.5.

Those anticipating business conditions will worsen over the next six months declined to 25.3 percent from 37.8 percent, while those expecting conditions to improve increased to 15.6 percent from 9.6 percent in March. The employment outlook was also considerably less pessimistic. The percentage of consumers anticipating fewer jobs in the months ahead decreased to 33.6 percent from 41.6 percent, while those expecting more jobs increased to 13.9 percent from 7.3 percent.

Plenty of Pain…

Even as more rays of hope are appearing in the American economy, its dismal performance in recent quarters has been one for the record books. The past two quarters represent the sharpest six month contraction in 51 years.

When including the 0.5% real annual rate of decline during 2008's third quarter, the economy contracted for three consecutive quarters for the first time since 1974-75. The current recession, which officially started in December 2007, is now into its 18th month. By comparison, the two prior recessions each lasted eight months.

…But Likely To Improve

Last week's *Tea Leaf* included the latest USA TODAY quarterly survey of roughly 50 national economists (including yours truly). It noted the consensus view that the U.S. economy will return to slightly positive economic growth in the third quarter…now just two months away.

The latest monthly survey of *Blue Chip Financial Forecasts* (where I serve as one of 50 surveyed economists) provides a very similar forecast. Both forecasts see the U.S. economy growing at an increasingly stronger rate each quarter through the end of 2010.

Even the Federal Reserve has climbed more solidly aboard the "economic growth is coming" bandwagon. The Fed's Open Market Committee concluded its two-day meeting last week with perhaps the most optimistic view of the economic and financial landscape in 18 months. The FOMC's statement noted that "the economic outlook has improved modestly since the March meeting" and "some easing" of tough financial conditions has occurred…

…Don't bring out the marching bands just yet, but the economy's darker days seem to be behind us

Jeff

"TEA"ser

Golf: A good walk ruined.

—Mark Twain

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