Over & Done With

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…weekly since 1976

Your guide to understanding today's economy and financial markets

August 5, 2009

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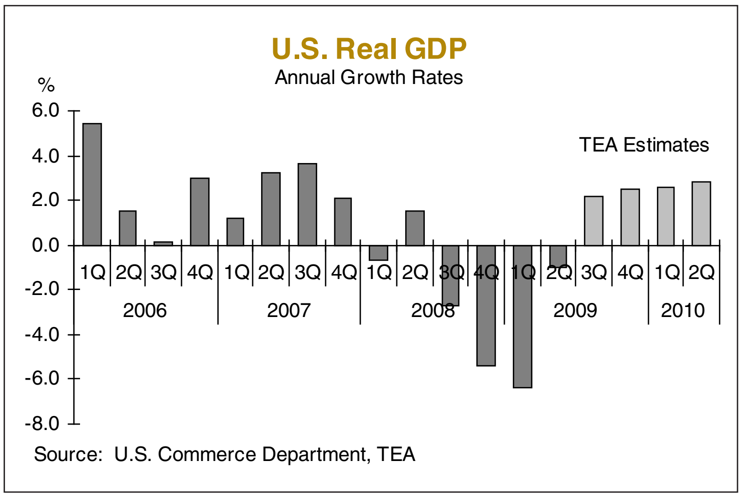
The "Great Recession" is no more… it's over…finished…kaput!

While this is good news, it *does not* mean that all of our problems with housing, foreclosures, bankruptcies, etc. are now behind us. It does not mean that impending challenges with commercial real estate valuations and financing are behind us. It does not mean that the nation's unemployment rate and overall job losses will immediately stop rising to even more painful levels…



…but a very likely return to positive U.S. economic growth this quarter…and next quarter…and throughout 2010 is a precondition to dealing with all of the serious issues noted above.

Why do I believe the U.S. recession is now history? The first reason is the second quarter 2009 economic data released on July 31 by the U.S. Commerce Department contained many favorable tidbits.

The second reason, as I have note frequently, is that the three national economic forecasting panels I serve on all suggest—by a wide margin—that U.S. GDP (the broadest measure of all goods produced and services provided in the American economy) will turn positive this quarter, with growth continuing at a positive if not exactly blockbuster pace.

The April – June Quarter

The American economy did contract…again…during 2009's second quarter. However, the modest 1.0% real (after inflation) annual rate of decline was much better than the revised 6.4% real annual rate of decline during 2009's first quarter, the worst quarter in 27 years (see chart). The U.S. economy has now recorded four consecutive quarters of economic contraction, the only such occurrence since recordkeeping began in 1947.

Forecasting economists had expected the economy to contract at a 1.5% real annual rate during the second quarter. Hence, the reported 1.0% decline was better than expected. And yes, the data will be revised at the end of August and at the end of September.

As usual, the numbers inside the report were a mix of both good and bad news. In many cases, critical data was much "less bad" than before, thereby subtracting less from overall economic performance…

- Consumer spending, which represents nearly 70% of all U.S. economic activity, was actually weaker than expected, declining at a 1.2% annual rate, versus a 0.6% rise during the prior quarter
- Business investment into equipment and software recorded a much less painful decline, falling at an 8.9% annual rate versus the 39.2% annual rate of decline during the first quarter
- Business investment into new offices and buildings also declined at an 8.9% annual rate, again better than the record 43.6% annual rate of decline during the first quarter
- Residential investment dropped at a still painful 29.3% annual rate, but again better than the 38.2% rate of decline during the January-March 2009 period
- Government spending rose at a 5.6% annual rate, the strongest pace since 2003

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- Business inventories actually declined at a $141 billion annual rate, worse than the $114 billion annual rate of decline during the first quarter. This is perhaps the most critical data within the report. What this means is that the quantity of goods "in the stores and in the back rooms" is now so low, so lean, so minimal, that manufacturing output needs to rise more quickly to catch up to demand. A good example here is the fact that Chrysler produced very few cars during the second quarter, but is now running various plants at or near full capacity in order to meet demand for new cars (Yes, part of this increased demand relates to the "Cash for Clunkers" program, but such production would have increased in any case)

The Current Quarter…and Beyond

The bottom line is that consumer spending is likely to be slightly better during the current quarter. Other sectors will again see less of a subtraction from growth. Rebuilding of inventories of goods will add to growth. And, no surprise, more government stimulus will be in play.

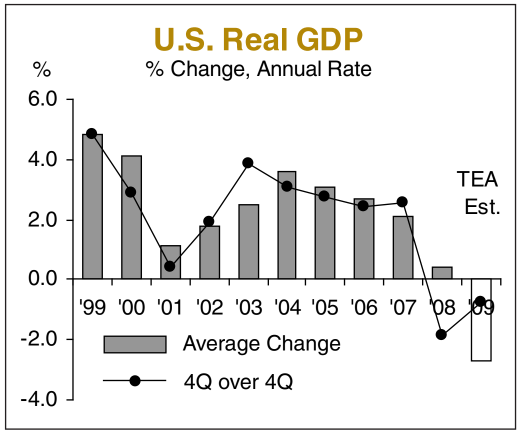
Numerous forecasters have raised their expectations of economic growth over the balance of the year. Barclays Capital raised its forecast of current quarter growth to a 2.5% real annual rate, with a 3.0% growth pace during the fourth quarter. Economists at JPMorgan Chase revised their third quarter growth forecast from 2.5% to 3.0% *(The Wall Street Journal)*. More bullish forecasters see even stronger growth in coming quarters. We have boosted our forecast for second half 2009 growth as well.

Major Revisions

In addition to the second quarter GDP report, the U.S. Commerce Department revised economic data…all the way back to 1929. No wonder I have a headache!

While revisions over the longer-time horizon were small, such was not the case for 2008. Revised data now indicates that the U.S. economy contracted at a more painful 1.9% real annual rate last year than the 0.8% real annual rate of decline reported earlier (when comparing 4th Quarter 2008 versus 4th Quarter 2007).

A different measure? Real *average* growth during 2008 versus 2007 was revised to a gain of 0.4%, versus the prior 1.1% growth estimate. Confusing? This is, after all, your government at work.



The revised greater contraction in the U.S. economy last year is more in line with the sharp rise in the nation's jobless rate than earlier data suggested. In addition, the peak-to-trough drop during the recession now stands at 3.9%, by far the largest drop in any recession since the 1930s *(Business Week)*.

More Job Pain

Even as we (finally!) talk about a U.S. economy very likely returning to growth this quarter, further pain is coming in regard to unemployment. The nation's current 9.5% jobless rate is expected to move higher.

While more bullish forecasters see the rate peaking out at or slightly below 10.0% later this year, more bearish forecasters see the rate reaching, or exceeding, 11.0% next year. Monthly reported job losses are likely over the balance of 2009.

Unfortunately, such is the norm, rather than the exception. Jim Cooper of *Business Week* notes that in each of the past four recessions, GDP growth has always turned up before payrolls have.

In fact, the lag has been increasingly greater since the 1973-75 recession, when payrolls hit bottom one quarter after real GDP did. In both the 1981-82 and 1990-91 downturns, employment didn't hit bottom until three quarters after real GDP hit bottom. And after the 2001 recession, it took seven quarters for jobs to stop falling…ouch!

Renewed economic growth…it's about time!

Jeff

"TEA"ser

I refuse to enter a battle of wits with an unarmed man.

—*unknown*

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