

Tea Leaf

...weekly since 1976

Your guide to understanding today's economy and financial markets

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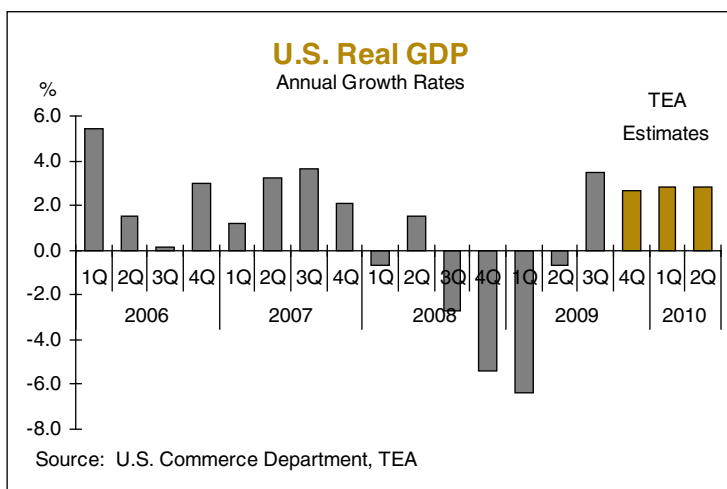
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U.S. Economic Growth!

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

Note: We delayed this issue of the Tea Leaf by one day in order to report on the GDP data released this morning.

The American economy returned to growth during 2009's third quarter, a welcome departure from an extended period of painful economic contraction. While the return to growth is obviously a positive development, it does not suggest that problems with housing, commercial real estate, rising unemployment and continuing job losses are behind us.



real annual rate of decline during 2009's first quarter and a 0.7% real annual rate of decline during the second quarter. The six-month swing from the first quarter decline was the largest six-month turnaround since 1980 (*CNNMoney.com*). The U.S. economy shrank 3.8% after inflation in the 12-months ended in June, the most painful decline since the Great Depression.

Overall consumer spending rose at a 3.4% annual rate, the strongest gain in nearly three years. No surprise, much of the growth was attributed to U.S. Government stimulus, including the Cash for Clunkers program and the \$8,000 first-time homebuyer's credit.

Another harbinger of future U.S. economic growth was the ongoing decline in business inventories. GDP is a measure of what is produced, not what is sold. Store shelves and warehouses are now so empty as to require additional manufacturing output in coming quarters.

The Bureau of Economic Analysis released its "advance" estimate of GDP this morning. GDP, or Gross Domestic Product, is the most complete measure of overall U.S. economic activity.

The estimated 3.5% real (after inflation) annual growth pace was in line with expectations. The data will be revised in late November, late December, and again whenever the number crunchers feel the urge.

Future Glimpses

Each of the three national forecasting panels I serve on, including the monthly *Blue Chip Financial Forecasts*, the quarterly USA TODAY forecast survey, and the thrice-annual National Association for Business Economics survey had forecast last January or February that a return to growth was likely during the third quarter. Imagine that!

The 3.5% real annual growth pace during July to September compared to a 6.4%

Keeping Score

The announced return to U.S. economic growth does not mean the recession is "officially" over. The scorekeeper for the economy, the National Bureau of Economic Research (NBER), will make that call sometime in 2010, and will likely suggest the recession officially ended during the just-concluded summer months. The NBER announced on December 1, 2008 that the current recession officially started in December 2007.

From Here

The U.S. economy is not off to the races. The economy is expected to maintain a modest growth pace during the fourth quarter, as well as during 2010 and 2011. A key to sustainable growth will be how the private sector rebounds—consumers and businesses—with the government then (hopefully) reining in its enormous expansionist ambitions.

Spend...or Save?

The most painful economic downturn since the Great Depression has had a major impact on consumer behavior. The spend, spend, spend days of 2003-2007 have given way to a bruised and battered American consumer, jarred by historic job losses, extremely weak gains (if any) in income, declining home values in most communities, and major volatility in investment markets.

Such factors have contributed to a rise in consumer savings, serious efforts by millions of consumers to pay down debt, and weak consumer spending. The fact that roughly one in four homeowners is “underwater” on their home, i.e. owing more on their home than its current value, has only added to weakness in consumer spending.

Holiday Spending?

As one might expect, forecasts for consumer spending during the imminent Holiday Season are mixed. Forecasts range from roughly a 3% decline in spending this year versus 2008 to more optimistic views expecting a 2%-3% rise.

Forecasters are being cautious, recognizing the flawed forecasts during September 2008 of the National Retail Federation and Deloitte suggesting 2008 Holiday sales would rise 3% versus the prior year (*USA TODAY*). Such sales actually fell 3.5%, tied to major U.S. and global economic upheaval that became front page news during last year’s final quarter.

What is clear is that bargain hunters will do well. Prices of consumer electronics are down sharply from a year ago. In addition, goods available online from Wal-Mart and Amazon will be very, very attractive, as these two behemoths battle for a rising share of e-commerce.

The Dilemma

American consumers, as well as those around the globe, are pushed in both directions as to whether now is a time to spend...or save. Cash for Clunkers? An incentive for consumers to spend money on new cars. First time homebuyers tax credit? An incentive for consumers to purchase a home.

At the same time, American consumers have been scolded for years in regard to

overspending...and saving too little for our Golden Years. How this dilemma is approached is extremely important to both short-term and long-term strength of the U.S. economy.

Stronger consumer spending *now* boosts current economic activity, but provides fewer assets down the road for retirement or funding a child’s education. Higher levels of savings *now* are good in the long-term, but detract from current economic activity.

Rising Share

U.S. consumer spending represented 71% of all U.S. economic activity during 2009’s second quarter, the highest level since WWII. The long-term average has seen consumer spending represent roughly 65% of all economic activity. Despite recent weakness in consumer spending, the consumer share rose because other components of GDP (overall economic activity), such as business investment in facilities and software, fell like a rock.

Efforts by this Administration and the prior Administration to stimulate consumer spending (remember those \$600-\$1,200 rebate checks mailed out to more than 120 million families during May-August 2008?) have seen muted results. The majority of the 2008 rebates were used to pay down debt or saved, as opposed to being spent.

Consumer spending is expected to rise modestly in coming quarters. However, the stiff headwinds of high joblessness and weak employment prospects, soft income gains, and rising levels of consumer anxiety about more and more government, higher taxes, and damaging budget deficits will limit those gains.

“TEA”ser

I thought I saw an eye doctor on an Alaskan island, but it turned out to be an optical Aleutian.

—from Bill Losey



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