Tea Leaf

…weekly since 1976

Your guide to understanding today's economy and financial markets

February 2, 2010

view previous issues

Solid Growth

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

…the fastest U.S. economic growth pace in six years!

The American economy (GDP) grew at a 5.7% real (after inflation) annualized growth rate during 2009's final quarter, the strongest growth pace since the third quarter of 2003. Most forecasts were closer to a 4.7% real annual pace. GDP, or gross domestic product, is the most broad-based measure of goods produced and services provided within U.S. borders.

Before etching the 5.7% number into our long-term memories, note that the number will be revised at least twice in coming months. Remember that the initially reported 3.5% real annual growth pace of 2009's third quarter was revised a month later to a less robust 2.8% pace, only to be revised after another month to a meager, but still positive, 2.2% real annual growth pace.

It would be great if the fourth quarter's strong growth pace was a clear indication of what to expect regarding the 2010 economy. However, real U.S. economic growth this year is likely to be about half as strong.

Worst in 63 Years

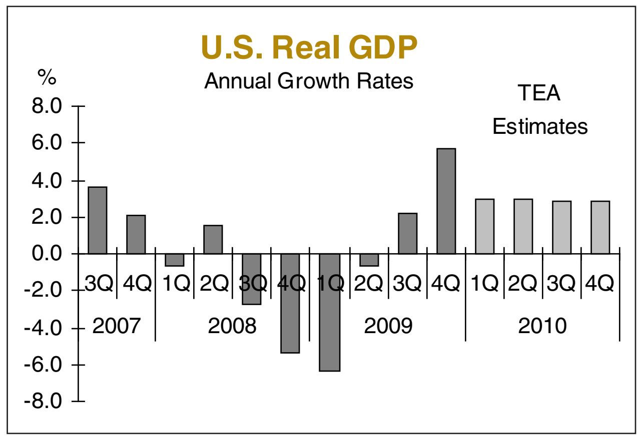
Still, the almost sizzling economic growth pace last quarter was a most welcome departure from the painful economic decline of the past two years. Note that even with the strong fourth quarter performance, the U.S. economy saw real output fall 2.4% last year, the first annual decline since 1991, and the largest drop since 1946, a period of 63 years.

Perhaps the best news in the report was the solid 13.0% rise, annual rate, in business investment into new equipment and software, the strongest increase in four years. More aggressive business investment usually portends an imminent rise in business hiring.

The largest component of GDP is consumer spending, which represents roughly 70% of all U.S. economic activity. Such spending rose at a modest 2.0% annual rate during the fourth quarter, actually weaker than the 2.8% pace of the prior quarter.

The Inventory Role

The largest impact upon fourth quarter growth (when compared to the prior quarter) was a lesser rate of decline in business inventories. Businesses drew down the value of goods on shelves and in warehouses at a $33.5 billion annual rate, much less than the $139.2 billion annual rate of inventory decline during the prior quarter. Such a change added 3.4% to the fourth quarter data, versus the prior quarter.



Businesses have reduced inventories of goods for seven straight quarters, with such goods levels becoming more scarce. As noted frequently, GDP is a measure of what is produced, not what is sold. When businesses begin actually adding to goods levels, such increased production will be a solid contributor to GDP measures in coming quarters.

Export Gains

Solid growth in U.S. exports to an improving global economy also contributed to the strong economic growth pace. Such exports rose at an 18.0% annual rate, almost twice the rise in imports to the U.S. Strong U.S. exports to the world are one of the key components of solid, if not spectacular, U.S. economic growth this year.

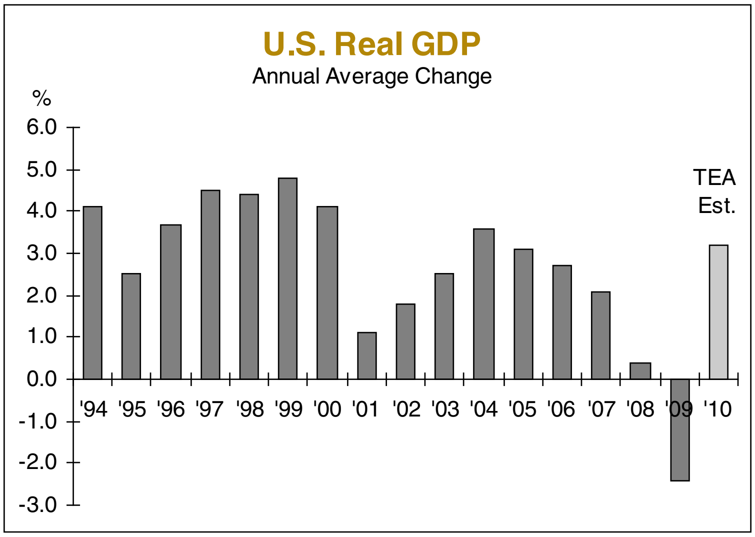
Residential investment rose at a 5.7% annual rate, following a larger contribution the prior quarter. No surprise, investment in housing had declined sharply between 2005 and the middle of last year.

jeff thredgold, CSP
ECONOMIC FUTURIST

THREDGOLD ECONOMIC ASSOCIATES

The TEA Company
A Professional Speaking and Economic Consulting Company
1366 S Legend Hills Drive, Suite 150
Clearfield, Utah 84015
801-614-0403
www.thredgold.com

Concern is rising that housing investment could weaken sharply when home-buyer tax credits for both new and existing homes expire in coming months, However, given high levels of anxiety among members of Congress of both parties, don't be surprised if such credits are conveniently extended through Election Day on November 2, 2010.



Overall government spending actually declined very slightly during the fourth quarter, led by lesser military spending and weaker state and local government expenditures. No surprise, federal non-military spending (can you say stimulus?) rose at an 8.1% annual rate, after rising at a 7.0% annual rate during 2009's third quarter.

Manufacturing Bounce

Good news reported on Monday, February 1, saw the key index of manufacturing activity rise to its strongest level in four years. The Institute for Supply Management's Factory Index rose to 58.4 in January (above market expectations), versus 54.9 in December. The ISM report is always the first indicator released monthly regarding the prior month's economic activity. Any number over 50 suggests growing manufacturing activity. The solid increase in January bodes well for manufacturing sector job gains sooner rather than later.

Spend, Spend, Spend

Less positive was the bloated and deficit-heavy budget proposed by the President for fiscal year 2011, which starts on October 1, 2010. Spending of $3.8 trillion is simply mind-boggling, with little in the way of any spending restraint. The proposed budget deficit would be $1.3 trillion.

The Administration also noted that the proposed budget deficit for the current fiscal year, ending on September 30, will be higher…a modest $1.6 trillion. Such a total is a mere $183,000,000 deficit every 60 minutes!

The President noted, with a straight face, that *"We simply cannot continue to spend as if deficits don't have consequences, as if waste doesn't matter, as if the hard-earned tax money of the American people can be treated like Monopoly money…"*

…do as I say, not as I do

Keys to Growth

The keys to U.S. economic growth this year are primarily found in two sectors… confidence and jobs. The two primary measures of consumer confidence/sentiment both rose in recent days. The Conference Board's measure of Consumer Confidence rose to 55.9 in January versus 53.6 during December. The Reuters/University of Michigan Consumer Sentiment index rose to 74.4 in January, up from 72.5 in December.

Whether the U.S. economy grows at a sub-par pace or a more acceptable pace this year and next is all about jobs. The loss of 7.2 million net jobs since the Great Recession officially began in December 2007 devastated prior confidence and consumer spending, while also leading foreclosures and personal bankruptcies to extremely painful levels. Fortunately, most forecasting economists see net job gains as the norm in coming months, with a preliminary estimate of a modest 20,000-40,000 net job gain during January, to be reported on Friday, February 5th.

As noted in previous weeks in the *Tea Leaf*, a redirected Administrative and Congressional focus on enhancing job creation for American businesses, while also minimizing the current and feared disincentives to create new jobs, must be Job One in DC.

Jeff

"TEA"ser

He can compress the most words into the smallest idea of any man I know.

—Abraham Lincoln

To receive the *Tea Leaf* free via email, sign up at
www.thredgold.com

Thredgold Economic Associates
1366 S Legend Hills Drive, Suite 150
Clearfield, Utah 84015
www.thredgold.com

Graphics and layout by Kendall Oliphant
Research assistance by Shawn Thredgold