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2Q09 GDP Advance Report



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The first or “advance” report on 2Q09 U.S. GDP, published by the Bureau of Economic Analysis, showed a less severe decline in economic activity than had been forecast. Personal consumption spending, however, declined at a greater than expected rate. Large-scale revisions to historic GDP data showed that the recession and the associated decline in consumption and housing have been more severe than previously believed. This is likely to be the last negative quarter for U.S. GDP in the current downturn, with slow but positive growth likely in the third quarter and growth of about 2.5% likely in the fourth.

- Real GDP contracted at a 1.0% annual rate in the second quarter, following a -6.4% rate in the first (revised from -5.5%) and a -5.4% rate in the fourth quarter of 2008 (revised from -6.3%). The mean forecast for 2Q09 GDP had been -1.5%, with individual forecasts ranging from a -2.9% rate to +0.7%.
- Inventory drawdowns once again contributed materially to the decline in GDP. Inventories fell at a \$141 billion annual rate in the second quarter, compared with a \$114 billion rate in the first and a \$37 billion rate in the fourth quarter of last year. (As part of the revisions, real GDP data have been rebased to 2005 currency, so that inflation-adjusted dollar amounts in this and future reports are not comparable to earlier data expressed in year 2000 currency.) Nevertheless, real final demand (final sales to domestic purchasers) fell at a 1.5% rate in 2Q09.
- Personal consumption fell at a 1.2% annual rate in the quarter, compared with a mean forecast of -0.5% and individual forecasts of -1.0% to +1.3%. Spending on all kinds of goods except food declined, with durable goods spending falling at a 7% rate after rising at a 4% rate in the previous quarter. Although unit sales of motor vehicles rose slightly in 2Q09, household spending on vehicles and parts fell at a 12% rate; spending on household durables fell at an 8% rate. Other discretionary spending was also weak, with apparel falling at a 7% rate and recreational equipment spending declining 4%. Spending on services was flat as increased spending on medical care and financial services offset declines in restaurant meals and lodging and in household services such as utilities.
- Business fixed investment fell at a 13.5% annual rate, a considerably slower decline than the 39% seen in the first quarter. IT equipment spending fell at a 4.5% rate vs. a nearly 20% rate in the first quarter, while spending on industrial equipment fell 16% vs. nearly 50% in 1Q09. Transportation equipment spending recovered, rising at a 34% rate, following five quarters with declines averaging an annualized 52%.
- Residential investment fell at a 29% annual rate, and represented 2.6% of GDP in the quarter. The revival in housing starts and building permits suggests that residential investment is likely to stabilize by the third quarter and to begin to grow at robust rates by year-end. As with auto sales, the level of home construction has declined so sharply that housing can grow rapidly for a few years before approaching a normal range.
- The trade deficit fell to -2.6% of GDP from -3.0% in the first quarter as exports fell less than imports (-7% vs. -15%). Until recently, it had appeared likely that the trade deficit would widen as the U.S. economy

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recovered because growth would revive in this country sooner than elsewhere. More recent data suggest, however, that aggressive policy moves in Asia have spurred a revival of demand there even before positive growth resumes in this country. It may thus be possible for the trade deficit to continue to shrink as U.S. exports revive sooner than previously expected and U.S. import growth remains muted.

- Government spending grew at a nearly 6% rate in the quarter, reflecting both the fiscal stimulus program and rapid growth in defense spending. This growth rate is unlikely to be sustained in the second half of this year, and may partially reverse after 2010 as the program comes to an end.
- The headline PCE price index rose at a 1.3% rate in the quarter, while the core index rose at a 2.0% rate (less than expectations for a 2.3% increase)..

Source: U.S. Department of Commerce

Today's release was accompanied by a major revision of the national income accounts, which involved reclassifying some types of spending as well as re-estimating historic data. The revised data now show that the current recession has been more severe than previously believed. Starting in 1Q08, the first full quarter of recession as determined by the NBER, U.S. real GDP has fallen by a cumulative 3.7%, as compared with -2.5% according to previous data. The new data also show that the weakness in personal consumption spending that began in the second quarter of 2007 has been more severe. The contraction in housing over the last three years is also sharper than previously believed. On the other hand, GDP growth for the ten years ending in 2008 was revised upward slightly (from a 2.7% annual rate to 2.8%), primarily because business capital investment is now estimated to have grown at a 4.5% rate over that decade instead of the previously reported 3.8% rate.

Although it is complicated by the revisions and reclassifications, today's report shows that the decline in U.S. economic activity clearly moderated in the second quarter even with a renewed decline in consumption. In the third quarter, consumption spending is likely to grow slowly, housing is likely to be flat, and investment spending to show a slower decline. Combined with further improvement in the trade balance (in which we now have more confidence due to greater signs of demand recovery around the world), this suggests that 3Q09 GDP growth should be slightly positive (at about a 1.0% annual rate), followed by closer to "trend" growth of about 2.5% in the fourth quarter. ■