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Flash Notes

US: Reassessing the Growth Arithmetic in 1q09

- The incoming indicators on the US economy--at least on the headline-basis--appear relatively mixed. But more prudent scrutiny of the details suggests that the rate of contraction in real GDP in early 2009 is likely to be less intense than the over 6% decline observed in 4q08. The tone from the recent two Beige Book releases suggests that the economy "deteriorated further" in January through late February, but the rate of decline moderated--with "signs that activity in some sectors…stabilizing at a low level"--in more than 40% of the Fed Districts from late February through early April. While consumer spending was seen as "sluggish on net", though with traces of improvement in January and February from a "dismal holiday spending season", in the initial release, the most recent release shows that "sales rose slightly or declines moderated" in several Districts.

- Specifically, real GDP growth at this juncture appears to be tracking roughly in the neighborhood of -4.5% in 1q09, supported largely by the positive contributions from consumer spending and net exports (the advance 1q09 GDP has been scheduled to be released on April 29).

- Both consumer spending and net exports combined are assumed to add slightly more than 1.5 percentage-points to growth in 1q09. Notwithstanding the downside surprise in the March retail sales data, the relevant inputs in the calculation of real consumer spending imply a positive print of around 1% annualized in 1q09 after two consecutive quarters of 4% contraction on average. But the assumed positive contribution from net trade, which was solely due to the more significant narrowing in the February real trade deficit, could be more hesitant either because of the possibility of downward revision or some reversal in the data in the subsequent month.

- The other categories of aggregate demand, however, are expected to contribute negatively to the economy in 1q09, probably subtracting as much as 6.0 percentage-points from real GDP growth. The pullback in non-residential investment--essentially as a result of the marked contraction in structures and the continued decline in capital expenditures--should deepen some in 1q09, perhaps registering an annualized decline of 25%. The less dour figures on capital spending expectations from the regional manufacturing surveys in April, however, provide some tentative encouragement to the outlook.

- Similarly, the ongoing deterioration in residential investment, perhaps by as much as -40%, is also anticipated to intensify in 1q09. But the somewhat less extreme decline in the price-adjusted housing permits data in 1q09, according to my calculations, offers some tentative hints that the drag from residential investment might become gradually less noticeable in subsequent quarters.

- Although the ongoing inventory adjustment is expected to detract appreciably--possibly as much as 2.0 percentage-points--from growth in 1q09, it could also improve the growth dynamics in subsequent quarters. Theoretically, a mere stabilization or a mild recovery in consumer spending per se could lead to some inventory rebuilding, which would temporarily boost economic growth.

- Overall, however, I still expect economic growth in 2009 to register an average decline of around 2.5%, with the pace of contraction gradually diminishing through the first-half followed by some flattening-out initially, and subsequently a relatively mild recovery in the latter part of the year and into 2010.

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