GDP Declines Again In Second Quarter

Economy Remains Near Stall Speed

September 28, 2012 By William L. Pittenger, MAI, SRA

The U.S. economy remains dangerously close to stall speed as evidenced by the third estimate of second quarter 2012 Gross Domestic Product. The estimate showed growth at a very slow and disappointing 1.3% seasonally adjusted annual rate (SAAR). Expressed another way, the nation's economy grew 1.3% annualized. That is down from an also disappointing 2.0% in the first quarter and down from the first and second estimates of second quarter GDP at 1.5% and 1.7% respectively. The Bureau of Economic Analysis releases three estimates throughout each quarter as new information becomes available. These were previously referred to as the advance, preliminary and final estimates. Recently however, the terminology was changed to simply first, second and third estimate, presumably to be more descriptive and to recognize the reality that the estimates are never absolutely final.

The downward revisions were larger than usual and were led by declines in consumer service spending in finance and insurance as well as reduced spending on durable goods. Durable goods refers to those expected to last longer term such as automobiles and appliances. Spending on durables turned from rapid growth in the first quarter to no growth in the second. Similarly, spending on <u>non</u> durable goods (largely consumables), as well as equipment and software also slowed during the quarter.

Real gross domestic income increased at 0.2% annualized which was a steep decline from readings of 4.5% and 3.6% recorded in the preceding two quarters. It is also a downward revision from the 0.6% growth reported previously in the second quarter.

The 1.3% rate of GDP growth is the slowest since Q3 2011. Over the past year, the economy has grown at about 2.1%. While growth has been positive, it has been, and remains, insufficient to either return the economy to its potential or reduce unemployment below that psychologically important 8.0% mark where it has been for 43 consecutive months.

The Great Recession technically ended in June 2009, but the economy still can't gain the necessary traction to resume robust growth. The economic wheels are spinning but little is happening. By nearly every measure, this recovery is the weakest following any of the 11 recessions since World War II.

In our view, this continuing and painful level of slow growth is a product of fiscal, political and regulatory uncertainty as well as the looming fiscal cliff, middle east unrest and the lingering European debt crisis. Sadly, there are no leading indicators that suggest the economy will advance faster than near stall speed this year.

The same report also showed that inflation rose at 0.7% which is well below the first quarter rate of 2.5% and well within the Federal Reserve Board's tolerance zone. Inflation concerns remain small and are not likely to alter the Fed's loose monetary policy.

In a separate report, orders for durable manufactured goods plunged 13.2% after rising 3.3% a month earlier. That is significant because new orders had supported economic growth for the last several months. Most of the decline was in transportation which fell a staggering 34.9% with huge declines in aircraft, automobiles and parts. Part of that decline was expected as a result of auto plant closures for retooling plus 260 aircraft purchases in July which were not likely to be repeated. Excluding transportation, new orders fell much more modestly by about 1.6%. August data suggest slower contributions to GDP growth from business throughout the remainder of 2012.

Calculating GDP

GDP is the top line measure of economic activity as it measures total economic output; that is, the total of all goods and services. The formula appears simple but like most things, the devil is in the details. In calculating GDP, the Bureau of Economic Analysis (BEA) sub categorizes GDP into four major sub components. They are:

Personal Consumption Expenditures (PCE). More than 70% of what the U.S. produces is for personal consumption by consumers. That total was about $10.706 trillion in 2011. Add to that:

Business Investment which includes purchases that companies make to produce consumer goods. The major subcategories are fixed investment and inventories. Theses components totaled $746.5 billion and $66.9 billion respectively in 2011. Add to that:

Government Spending which added about $3.03 trillion or around 20% to GDP. The federal government contributed $1.2 trillion which included $825 billion in defense spending. Add to that:

NET Exports of Goods and Services. Exports add but imports subtract from GDP.

The total of the four components was total GDP of $15.094 trillion in 2011.

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