

Is the Great Recession Over?

By Dr. Edmond J. Seifried

Tricks and treats are common during Halloween Week, but perhaps the best treat was an announcement that the 2007-09 Great Recession was unofficially declared over. The Gross Domestic Product (GDP) scored its first quarter of growth since the second quarter of 2008, concluding the longest and deepest recession since the Great Depression. The Real GDP increase was 3.5% for the third quarter!

More good news hit the wires the first week of November! The Institute of Supply Management's release of their PMI index on the health of the manufacturing sectors showed a healthy increase in October 2009. The index climbed from 52.6 in September to 55.7 for October—recall anything over 50.0 represents an expanding manufacturing sector.

On the surface, the strength of the GDP advance suggests the economy will not stall in the near-term quarters. The experts hadn't expected this much growth this fast; economic analysts had forecast a 3.2 percent rise in third quarter GDP, and Goldman Sachs' forecasting department lowered its estimate to 2.7 percent only one day prior to the GDP's good news. Remember that GDP in the previous quarter fell 0.7 percent.

Federal Stimulus Programs Propel GDP Growth

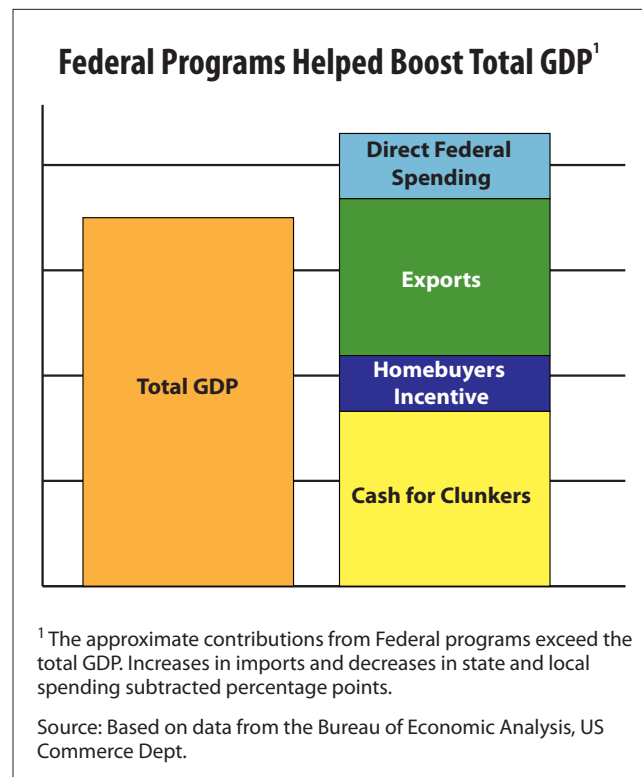
Like sugary Halloween candy that gives a quick energy boost but no long-term nutrition, the headline of GDP growth may prove to be sweet but short-lived. Much of the growth can be attributed to federal stimulus programs as well as the Federal Reserve's policy to keep interest rates at bargain basement levels.

An analysis of the composition of the GDP reveals growth that may be hard to sustain without federal fortifications. These federal lifelines were programs initiated by the Federal Reserve to shore up the financial markets. Many of those temporary

fixes are set to be dismantled in the months ahead. The Cash for Clunkers program, one of the more visible programs that ended recently, contributed about half of the total gain during the quarter. See the discussion below for a breakdown of this quarter's GDP.

Given the dependence on fiscal stimulus for economic growth, politicians on both sides of the aisle may find it difficult to oppose measures that call for more, not less, government intervention. Witness the temporary tax incentive for first-time home buyers. Moves to extend that program may be politically hard to resist.

The chart represents a rough sketch of how federal stimulus programs and policies contributed to portions of the 3.5% change in the third quarter GDP.



The Four Elements of Growth

The four major components of GDP—consumer spending, private investment, international trade and government spending—reveal the extent to which fiscal and monetary policy influenced the third quarter GDP.

- **Consumer Spending:** The category of real personal consumption expenditures registered a 3.4-percent increase compared to the 0.9-percent decline in second quarter GDP. The “Cash-for-Clunkers” program, which was designed to fuel inject the auto industry and spark consumer spending, appeared to work. The automotive component added 1.66 percentage points to the third-quarter change in GDP compared to only 0.19 percentage points in the second quarter.
- **Private Investment:** This category includes residential investment—a.k.a., home purchases—and business investments such as inventories. The business investment component fell 2.5 percent in the third quarter, with private inventories declining by \$130 billion. That was an improvement over the 9.6-percent decline in the second quarter with the \$160.2 billion inventory drop, but it still represents a drag on the economy.

The rush to take advantage of the generous federal tax incentive spurred residential investment by 23.4 percent following a similar decline of 23.3 percent in the second quarter. That translates into an additional 0.53 percentage points in the latest quarter, in contrast to the subtraction of 0.67-percentage points in the previous quarter.

- **Government Spending:** Federal spending added only 0.62 percentage points to third quarter GDP compared with 0.85 percentage points in the second quarter.

Federal stimulus via tax incentives does not directly impact GDP in the government spending category, but it does increase the federal budget deficit and serves to put downward pressure on the U.S. dollar.

Fewer federal dollars funneled to state and local governments pushed that spending lower. State and local government shaved GDP in the third quarter by 0.14 percentage points in contrast to the boost of 0.48 percentage points to second quarter GDP.

- **International Trade:** Exports provided the second largest boost to GDP, behind first-place consumer spending. The 14.7 percent jump in exports added 1.49 percentage points to third quarter GDP. In contrast, second quarter GDP was clipped 0.45 percentage points by the 4.1 percent decline in exports.

Falling Dollar Boosts Exports

Export growth was aided by the falling U.S. dollar and demand for cheap U.S. goods and services from countries that are posting higher growth than the United States. Of course, the decline in the U.S. dollar is due, in part, to the swelling U.S. budget deficit. Another pressure point comes from the public pronouncements emanating from government officials in China, oil-exporting nations and the euro-based economies. The chorus line is the U.S. dollar is poised to be replaced as the international currency of choice. That also has added downward pressure on the dollar, although it is difficult to determine if the weak dollar is the chicken or the egg in these discussions. The short-term impact of a weak dollar on the U.S. economy, which needs every lifeline available for the recovery to take hold, is very positive, but the long-term impact of a falling U.S. currency is troubling.

Few Treats from Other Indicators

Without the upbeat GDP news, the economic indicators recently released were downright disappointing. For example, The Conference Board announced a surprise decline in the consumer confidence index. Fears surrounding the employment climate pushed the index to 47.7 for October from the 53.4 level in September. The October decline was much larger than the forecasted down tick to 53.2.

Adding gray clouds to the economic outlook was the lackluster durable goods orders report

released by the government. Although total durable goods orders hit the 1.0-percent targeted increase, orders that excluded autos and trucks were only 0.9 percent higher compared with the 1.2-percent advance in the previous month.

The surprise fall in new home sales in September further darkened the economic outlook. Actual sales, at an annual rate of 402,000 homes, fell substantially below the forecasted 438,000 annual rate and the August annual rate of 417,000. The bulk of the sales that did occur were for lower priced homes. Only 10 percent of the homes sold were priced above \$500,000, as shown here :

- Sales under \$150,000 15 percent
- Sales from \$150,000 to \$199,000 32 percent
- Sales from \$200,000 to \$299,000 28 percent
- Sales from \$300,000 to \$399,999 10 percent
- Sales from \$400,000 to \$499,999 5 percent
- Sales from \$500,000 to \$749,999 6 percent
- Sales from \$750,000 and over 4 percent

In conclusion, Halloween week might have signaled the death of the Great Recession, but also the beginning of a very weak recovery!



Dr. Edmond J. Seifried

Executive Director – Affiliation Programs

eseifried@smslp.com

Dr. Seifried served as Professor of Economics and Business at Lafayette College in Easton, Pennsylvania for over 25 years and is currently Executive Director of the Sheshunoff Affiliation Programs. In addition, Dr. Seifried is the Chief Economist for m.rae resources, inc., a strategic and financial services firm for community banks. He received his doctorate in economics and business from West Virginia University.

Dr. Seifried serves as the dean of the Virginia and West Virginia Banking Schools and is a faculty member of numerous banking schools including: Stonier Graduate School of Banking, and the Graduate School of Retail Bank Management.

He frequently appears as a guest speaker at regional and national conferences and has delivered over 2000 presentation to various groups both in the United States and abroad. Dr. Seifried is a consultant to the banking industry, and is well known as a speaker at bank customer events and as a strategic planner. Dr Seifried is the author of the book “The Art of Strategic Planning for Community Banks.” In addition to his academic and consulting experience, Dr. Seifried has also served as a director of a community bank.

Dr. Seifried has traveled extensively in the former Soviet Bloc countries where he served as an advisor and consultant to the newly privatized commercial banks.