GDP, consumer spending contract as US plunges into recession

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Gross domestic product (GDP) figures released yesterday by the Commerce Department show that the US economy shrank by 0.3 percent on an annualised basis in the three months from July to September. With economists expecting even poorer GDP figures for the fourth quarter, the latest data confirms that the economy has now entered into severe recession.

Negative GDP growth for the third quarter was driven by a 3.1 percent decline in consumer spending, the first such contraction since 1991 and the largest fall recorded since 1980.

Consumer spending, partly fuelled by personal debt, has accounted for more than two-thirds of all economic activity in the last period. But mounting layoffs, home foreclosures, credit card defaults, the rising cost of living and the declining value of retirement savings have had a devastating impact on broad layers of the population. The Commerce Department reported an extraordinary 8.7 percent third quarter decline in disposable personal income—that is, income after taxes and adjusted for inflation. This is the largest fall ever recorded since figures were first kept in 1947.

Disposable income in the second quarter had increased by 11.9 percent on an annualised basis due to tax rebates from the Bush administration's emergency economic stimulus package.

Unsurprisingly, spending has declined together with incomes. In the three months up to October, purchases of non-durable goods—smaller purchases such as food and clothing items—plunged by 6.4 percent, the biggest decline since 1950. Spending on durable goods, such as cars and furniture, declined by 14.1 percent.

Housing investment plunged 19.1 percent on an annualised basis. Also recorded in the GDP data was a decline of 1 percent in "real non-residential fixed investment," that is, business investment in capital items including machinery, vehicles, and computers. The *New York Times* described this as "a worrying sign of a new, potentially pernicious phase of the downturn."

The third quarter 0.3 percent GDP decline was not as severe as had been anticipated. Stock markets lifted marginally yesterday, with the Dow Jones closing 2.1 percent higher. Goldman Sachs economists, however, warned their clients that the GDP report was "weaker than implied by the initial market reaction."

The data would have been significantly worse had it not been for a narrower trade deficit caused by continuing export growth to Europe and Asia. This growth has since ceased and exports are in decline as the world economy follows the American into steep recession. Also preventing a sharper drop in third quarter GDP was federal government spending and investment, which was up 13.8 percent on an annualised basis, largely due to an 18.1 percent rise in military expenditure.

The *Wall Street Journal* noted that the latest data indicated that the economy probably entered into recession "before the mid-September credit freeze," and that fourth quarter GDP growth could be as low as negative 4 percent.

"The economy has taken a turn for the worse, big time," Allen Sinai, chief global economist for Decision Economics, told the *New York Times*. "Consumption literally caved in. It is a prelude to much worse news on the economy over the next couple of quarters. The fundamentals around the consumer are all negative, and there are no signs of any help anytime soon, from anywhere."

Paul Ashworth, of London-based Capital Economics Ltd, told Reuters he expects the US economy to shrink

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by 1.5 percent in 2009 and remain stagnant in 2010. "Overall, we expect the level of GDP to shrink by a total of 2.5 percent, which would make this one of the worst recessions since the Great Depression," he said.

Labor Department data showed 479,000 new jobless claims in the week ending October 25, steady from the week before. Economists generally regard a figure above 400,000 as an indicator of recession. Reuters added: "Analysts estimated so-called continued claims would be 3.74 million. It was the 27th straight week that claims were above three million in a sign that the ailing economy is making it harder for US workers to find employment."

An estimated 760,000 jobs have been slashed this year, and the rate of layoffs is accelerating.

Yesterday saw the following job cuts and corporate earnings announcements:

* Credit card giant American Express is to lay off nearly 10 percent of its workforce, or 7,000 workers, as part of a restructuring plan aimed at reducing costs by $1.8 billion by the end of 2009.

* Electronics and phone company Motorola reported a $397 million loss for the third quarter, largely due to falling mobile phone sales. It plans to sack an additional 3,000 staff.

* Computer gaming company Electronic Arts will cut 6 percent of its workforce amid falling retail sales that delivered a net loss of $310 million for the quarter.

* Photographics company Eastman Kodak released lower than expected quarterly profit figures and said it would eliminate an unspecified number of jobs in coming months.

* Broadcaster CBS recorded a $12.6 billion quarterly loss after it wrote down the value of its media assets by $14 billion.

* Paper and packaging company International Paper reported a 31 percent quarterly profit decline compared to 2007. The company laid off workers and closed plants earlier this year in Georgia, California, Ohio and Oregon, but warned that falling demand "could mean more capacity cuts."

Job losses continue to mount in the devastated auto industry. Three Michigan-based auto suppliers made layoff announcements yesterday:

* Visteon Corp., a Ford auto-parts spin-off, said yesterday it suffered a $188 million net quarterly loss. The company cut about 2,000 hourly and salaried jobs in the last three months, and plans to cut its salaried workforce by a further 800.

* TRW Automotive Holdings Corp. posted a third-quarter loss of $54 million. CEO John Plant said the company would continue to "right size" its workforce. About 1,000 salaried positions are being cut, with the majority to take effect by the end of this week.

* Citing "recessionary conditions in North America and increasing weakness in Europe," Lear Corp. reported a $98 million quarterly loss. The company said it aims to save $150 million over the next year through layoffs, but has not yet announced the number of jobs to be cut.

Layoffs in the auto sector are set to massively escalate in the aftermath of a potential government-funded merger between General Motors and Chrysler.

Kimberly Rodriguez of the accounting firm Grant Thornton LLP told the *Wall Street Journal* she expects such a merger to result in between 30,000 to 40,000 Chrysler job losses, with another 50,000 auto suppliers' jobs affected. The auto analyst predicted that 7 of Chrysler's 14 auto assembly plants would close and 19 of the company's 26 car models would be eliminated.

If the merger deal failed to go through, Rodriguez said, Chrysler could collapse, in turn leading to bankruptcies of auto suppliers upon which GM and Ford also depend. "What you would have is a shutdown of the auto industry," she concluded.

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