

US economy shrinks at 6.2 percent rate

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The US economy contracted at an annualized rate of 6.2 percent in the last quarter of 2008, according to figures released yesterday by the Commerce Department. The figure was significantly greater than the department's original estimate of a 3.8 percent decline. The sharpest quarterly decline since 1982, it marks a significant deepening of the recession.

Aside from government spending, every sector of the economy contracted last quarter. The decline was led by exports, retail sales and business expenditures, with falling consumer spending also contributing.

Business spending led the decline. Investment in equipment and software, for example, fell at an annualized rate of 28.8 percent. Overall business outlays fell at a rate of 21.1 percent in the fourth quarter.

Exports also contracted far more than previously predicted, reinforcing the global nature of the crisis. Exports dropped at an annualized rate of 23.6 percent, instead of the anticipated 19.7 percent. According to the *Wall Street Journal*, the decline in trade shaved one half of a percentage point off the GDP growth rate.

The new figures indicate that inventories contracted by \$19.9 billion, instead of increasing by \$6.2 billion as previous figures had estimated. Prices fell sharply in the fourth quarter, devaluing the inventories in warehouses. These inventory reductions indicate that companies are cutting production in response to falling demand, which will result in more layoffs and reduced spending.

Spending by the federal government increased significantly, rising 6.7 percent, as compared to an earlier estimate of a 5.8 percent increase. State and local governments, facing budget crises throughout the US, cut their spending by 1.4 percent.

Consumer spending, which accounts for about 70 percent of GDP, fell by 4.3 percent. Previous figures

had estimated a 3.5 percent reduction in consumer spending. This decrease came on top of a 3.8 percent decline in the previous quarter. Sales of durable goods—expensive consumer products such as cars—fell by 22.1 percent. This decline will further exacerbate the crisis by forcing producers to reduce production, close factories, and lay off more workers. Consumer confidence this month plunged to its lowest level—56.3—since the Conference Board began measuring it in 1967.

Jobless claims reached their highest level in 27 years last month, leading many economists to expect the unemployment rate to break 8 percent when February figures are released.

The contraction in the fourth quarter comes on top of the half-percentage point contraction in the third quarter. The US economy grew by 1.1 percent in 2008, compared to 2 percent in 2007. Using inflation-adjusted figures, the downturn is the third worst in US history, following 1957, 1980, and 1982, when it contracted by 6.4 percent on an annualized basis.

All leading indicators of economic activity—from housing prices, to investment activity and consumer sentiment—appear to be in free-fall. "We are looking at what is almost certain to be the longest, and quite likely to be the deepest, recession of the postwar era," John Ryding, an economist at RDQ Economics, wrote in a note to clients.

Judged by nominal GDP, this is the second-deepest contraction in postwar US history, and the deepest downturn in over 50 years. Prices contracted rapidly in the fourth quarter, falling between 3 and 5 percent, depending on the index used. The fourth quarter of last year saw the sharpest deflation in postwar US history, raising echoes of the 1930s, when consumer prices fell by one third.

The Obama administration's proposed budget, released Thursday, assumes the US economy will

shrink by only 1.2 percent in 2009, and will return to 3.2 percent growth next year, thus estimating a yearly decline five times smaller than the current rate of contraction. Richard Moody, chief economist at Mission Residential, told the *Financial Times*: "The government is the only game in town, but government spending won't rise fast enough and by a large enough amount to offset contracting private sector spending."

Economists at Goldman Sachs predict the US economy will contract at a rate of 4.5 percent in the first quarter, while the National Association of Business Economists predicts a 5 percent contraction. There is little reason to believe the next quarter will fare any better.



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