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GDP Slowdown Won't Linger

There were good reasons the economy turned softer in the second quarter, and there are equally good ones why the pace will pick up for the rest of the year.

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Slower growth in the second quarter doesn't presage a return to recession, in our view. Growth will firm up in the third quarter, with the economy racking up a gain of a bit over 3% this year and half a percentage point better than that in 2011. True, that's subpar for a recovery period, but it's much improved over the 2.6% decline in 2009. The Commerce Department's first estimate of second quarter GDP pegs growth during the period at an annual rate of 2.4%. That follows an annualized increase of 3.7% in the first quarter and 5% in the fourth quarter of 2009.

The several causes for the slowdown are dissipating. Generous tax incentives to buy homes and energy efficient appliances faded during the spring, causing sales to drop. Government benefits to many long-term unemployed expired in the spring, crimping their ability to spend, and Congress didn't reinstate the benefits for several months. And last, the European financial crisis raised credit market worries and sent U.S. stock prices lower. Fears about a cascade of failures infecting global markets now seem to be easing.

Despite these drags, the engine kept moving in the second quarter, fueled by continued federal stimulus spending (rising at a 9% pace) and business investment in software and equipment (a nearly 22% rate of gain in the second quarter). Even nonresidential construction picked up (5.2% annualized), though we don't expect that to continue. Businesses also continued to rebuild inventory, contributing a bit more than one percentage point to GDP growth during the quarter.

And there are good reasons to believe the second half of the year should see improvement:

• Rock-bottom interest rates and a fiscal policy that is still stimulative.

• Businesses that will increasingly utilize the pile of cash they've been hoarding, spending more on equipment, software and information technology.
• The likelihood that lenders will loosen their grip on capital, allowing credit to flow more freely.
• Rising consumer spending as more jobs are created.
• A housing sector that is mending, though at a slow and uneven pace.
• And exports benefiting from superior growth abroad (except for Europe).

Note that the Commerce Department also now calculates that the recession was a bit deeper than previously reported, with GDP shrinking 4% instead of 3.5%. The revisions, based on additional data on consumer spending on services, make the downturn that began at the end of 2007 the deepest since the end of World War II (though it remains well off the 26.7% drop from 1929 into 1933). Another notable correction: Uncle Sam's tally of the personal savings rate was revised up for 2007, 2008 and 2009, putting the 2009 figure at 5.9%. According to the latest data, the rate briefly touched 7% in the second quarter of 2009.