Posted on Friday, 01.30.09

Economy shrinks at 3.8 percent pace in 4Q

By Jeannine Aversa

AP Economics Writer

WASHINGTON -- The economy shrank at a 3.8 percent pace at the end of 2008, the worst showing in a quarter-century, as the deepening recession forced consumers and businesses to throttle back spending.

Although the initial result was better than economists expected, the figure is likely to be revised even lower in the months ahead and some believe the economy is contracting in the current quarter at a pace of around 5 percent. The current January-March period, they said, will probably turn out to be the worst quarter for the recession.

American consumers and businesses cut back everywhere in the final three months of 2008. Shoppers chopped spending on cars, furniture, appliances, clothes and other items. Businesses dropped the ax on equipment and software, home building and commercial construction. And overseas sales of U.S.-made goods and services tanked as foreign buyers grappled with their own economic woes.

"The downturn is intensifying. The fourth quarter is worse than it looks," said Mark Zandi, chief economist at Moody's Economy.com.

The new figure, released Friday by the Commerce Department, showed the economy sinking at a much faster clip in the October-December period than the 0.5 percent decline logged in prior quarter.

The report tallies gross domestic product, the value of all goods and services produced within the United States. It is considered the broadest barometer of the country's economic health.

A build-up in business inventories - which in calculating GDP adds to economic activity - masked the fourth-quarter's true weakness. When inventories are stripped out, the economy would have contracted at a 5.1 percent pace in the fourth quarter, closer to the 5.4 percent drop that economists expected. Businesses couldn't cut production fast enough in response to waning customer demand and got stuck with excess inventories, economists explained.

On Wall Street, stocks dipped. The Dow Jones industrial average slid more than 60 points in morning trading, and broader indexes also fell.

Still, the fourth quarter was by far the weakest three-month period in 2008, and the 3.8 percent figure is likely to be revised even lower as the government makes new estimates based on more complete data. The economy will stay very weak for much of this year, analysts predict.

A massive pullback by consumers played a prominent role in the economy's worsening backslide. They are cutting back on spending as jobs disappear and major investments - homes, stocks, retirement accounts - tank in value. Businesses are retrenching, too, as profits shrivel and demand wanes from customers in the U.S. and overseas.

Battered consumers slashed spending at a 3.5 percent pace at the end of 2008, following a bigger 3.8 percent annualized cutback in the third quarter. The last time consumers chopped spending for two straight quarters was in the closing quarter of 1990 and the opening quarter of 1991.

In the fourth quarter of 2008, Americans cut back spending especially hard on big-ticket "durable" goods, including cars, appliances and furniture. Spending on durables plunged at rate of 22.4 percent, the most since early 1987.

A 7.1 percent annualized cutback in spending on "nondurables," such as food and clothing was the deepest since the end of 1950.

Americans newfound frugality was clearly visible. The savings rate rose to 2.9 percent in the fourth quarter. That was up from 1.2 percent in the third quarter and matched the rate in early 2002 when the country was still struggling to get back to full economic health after the 2001 recession.

Big cutbacks by homebuilders - reeling from the collapsed housing market - and other companies also figured into the fourth-quarter weakness. Homebuilders slashed spending at a 23.6 percent pace, even deeper than the 16 percent annualized cut in the prior three months.

Spending by businesses on equipment and software dropped at a whopping 27.8 percent annualized pace in the fourth quarter, the most since early 1958.

Meanwhile, U.S. exports, whose growth earlier last year helped to keep the economy afloat, turned negative. Exports plunged at a rate of 19.7 percent in the fourth quarter, the most since the third quarter of 1974. Economic slowdowns in other countries has cut into demand for U.S goods and services.

The report provided clear evidence of the economy's rapid deterioration as the housing, credit and financial crises - the worst since the 1930s - feed on each other. It's a vicious cycle that has proven difficult for Washington policymakers to break.

The 3.8 percent annualized drop marked the weakest quarterly showing since a 6.4 percent annualized plunge in the first quarter of 1982, when the country was suffering through a severe recession.

For all of 2008, the economy grew by just 1.3 percent. That was down from a 2 percent gain in 2007 and marked the slowest growth since the last recession in 2001.

To jolt life back into the economy, President Barack Obama and Congress are racing to enact a multibillion-dollar package of increased government spending that includes big public works projects and tax cuts. The House passed a $819 billion package on Wednesday and the bill is working its way through the Senate. Economists say the money needs to be quickly pumped into the economy to help stop the free-fall.

The White House was bracing for bad news. On the eve of the report's release, press secretary Robert Gibbs thought the fourth-quarter results would be "fairly staggering."

The economy plunged deeper into recession despite a $700 billion financial bailout program run by the Treasury Department and a slew of radical programs by the Federal Reserve and others designed to bust through a debilitating credit clog and get banks to lend more freely. The Fed last month slashed a key interest rate to a record low, and on Wednesday signaled that it would use other unconventional tools to turn the economy around. The central bank acknowledged that its hope for a gradual economic recovery later this year faced "significant" downside risks.

Trying to survive the downturn, businesses are scrambling to cut costs and that's taking a painful toll on the nation's labor market.

The unemployment rate jumped to a 16-year high of 7.2 percent in December and could hit 10 percent or higher at the end of this year or early next year. A staggering 2.6 million jobs were lost last year, the most since 1945, though the labor force has grown significantly since then. Another 2 million or more jobs will vanish this year, economists predict.

This week alone, tens of thousands of new layoffs were announced by companies including Ford Motor Co., Eastman Kodak Co., Black & Decker Corp., Boeing Co., Pfizer Inc., Caterpillar Inc., Home Depot Inc. and Target Corp.

The economy's slowdown also has caused once surging prices to retreat, and companies are discounting to lure buyers.

An inflation gauge tied to the report showed prices dropping at a rate of 5.5 percent in the fourth quarter, a turnaround from the 5 percent growth rate logged in the prior period. Stripping out food and energy, prices inched up at a rate of just 0.6 percent, a big moderation from the 2.4 percent growth rate in the third quarter.

The recession also is keeping a lid on employment costs. The Labor Department said Friday its employment cost index rose 0.5 percent for the fourth quarter, the slowest pace in nearly a decade. For the whole year, employment costs, including wages and benefits, showed an increase of 2.6 percent, an all-time low for records that go back to 1982.

The most severe spending pullback in decades is sending a number of stores, including Circuit City and discount clothing chain Goody's Family Clothing, into liquidation. Stores were battered by the weakest holiday period in four decades by one measure, and retail sales appear to be deteriorating this month. The National Retail Federation, the world's largest retail trade group, predicts that sales will fall 0.5 percent this year, well below last year's meager 1.4 percent gain.