



# GDP Observatory

October 30<sup>th</sup> 2008

## 3Q08 GDP Growth

- GDP declined reflecting ongoing weakness in private domestic demand. As expected, PCE declined in 3Q08 by the steepest rate since 3Q80.
- Nonresidential investment surprised on the downside while net exports and government spending remained buoyant.
- GDP growth is likely to drop by more in 4Q08.

In the third quarter, GDP declined 0.3% on a quarterly annualized basis. This drop was the largest since 3Q01 and primarily reflected a sharp adjustment in private domestic demand, which was partially offset by solid exports' growth and strong government spending. On a year-over-year basis, GDP increased 0.8%, similar to our forecast of 0.9%.

Private final sales to domestic purchasers declined 1.1%, the fifth consecutive drop and the biggest since 4Q90. This reflected a sharp and broad base decline in PCE (-3.1%), the largest in 28 years. In fact, purchases of motor vehicles fell 25.6%, the second worst since 4Q89. Spending on furniture and equipment edged down 7.6%, the first drop since 4Q91 and the steepest since 4Q81. In addition, food purchases dropped 8.6%, the lowest rate in 60 years while those of clothing suffered its worst performance since 4Q74 after decreasing 11%. These trends reflect the weak environment faced by households: job losses, declining wealth, low real income gains and particularly during 3Q08, a substantial increase in energy prices. In fact, gasoline spending reached 4.6% of total PCE, the highest share since 3Q83.

Nonresidential investment was notably affected by a significant reduction in computer spending (-11.7%), transportation (-51%, the worst since 4Q70) and industrial investment (-10.6%). These trends reflected lower demand for IT equipment, spillover effects from the residential meltdown and a slowdown in foreign sales. Meanwhile, residential investment declined for the 11<sup>th</sup> consecutive quarter and accumulated a 42% drop since 4Q05.

In contrast, government spending on national defense rose 18.1% and contributed 0.9 percentage points (pp) to GDP growth. This was the second highest contribution since 3Q86. Net exports remained solid and contributed with 1.1pp to growth. Nonetheless, foreign demand appears to be slowing down and thus, net exports contribution is likely to moderate.

### Bottom line

3Q08 GDP figures are in line with our base scenario which assumes a significant correction in PCE and a slowdown in both nonresidential investment and exports. GDP growth in 4Q08 is likely to drop even more if some of the positive elements in 3Q08 fade away. Going forward, this trend is likely to continue in 2009, although the magnitude of the downturn depends heavily on the extent and duration of the financial crisis; and could be partially mitigated by the recent decline in energy prices and the possibility of another fiscal stimulus package, which could help to absorb some negative pressures.

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**Advance: -0.3%**  
**Preliminary: November 25**  
**Final: December 23**

