



GDP Observatory

October 21, 2008

GDP Growth in 3Q08

- PCE is likely to decline in 3Q08 for the first time in 17 years
- We have lowered our GDP growth forecast for both 2009 & 2010 to -0.2% and 0.7% respectively
- Financial strains impose significant downside risks and uncertainty to this outlook

Low economic growth in the third quarter

In 3Q08 GDP is likely to grow by a quarterly annualized rate of 0.2%. Recent economic indicators suggest that personal consumption expenditures will contract for the first time since 1Q91. This reflects a significant decline in purchases of durable goods as consumers adjust their budget in light of declining wealth, ongoing job losses and tighter credit conditions. Nonresidential investment will continue growing at a solid pace although slowing down from previous quarters as businesses adjust to lower sales and financial strains. Once again, net exports will add significantly to GDP growth as a result of the widening gap between solid exports and weaker imports. Moreover, government spending is also likely to show a notorious increase which will help to limit the effect of declining PCE.

We have revised down our forecast for 2009-10

We expect GDP to contract 0.2% in 2009, reflecting a widespread contraction in economic activity. Consumer spending will be severely affected by credit constraints, substantial losses in financial and real state wealth as well as job destruction. As a result, we expect personal savings to increase and expenditures to decrease in both in 2009 and 2010. We also expect non-residential spending to decrease over the next two years. Capital spending will be dampened by credit scarcity and lower business profits. Moreover, some industries will be affected by the global economic recession.

Residential investment will subtract further to overall economic growth. Still-high levels of unsold homes will discourage residential construction for several more quarters. We expect the housing market to bottom well into 2009. Although exports growth will decelerate due to slower economic growth abroad and dollar appreciation, we expect imports to decline significantly as a result of slower domestic spending. Consequently, net exports will have a significant contribution to GDP growth. In addition, we expect public spending to increase significantly in 2009-2010 and assign a high probability to a second stimulus package.

In our base scenario, the economy will take some time to fully recover and GDP growth will not return to potential before 2012. If credit conditions deteriorate further the current recession will be sharper and protracted. Therefore, a key element in our outlook is the magnitude and duration of the credit crunch. In our risk scenario, which assumes a prolonged period of financial stress, GDP is expected to decline 1.5% in 2009 and 0.9% in 2010.

3Q08 GDP Growth

Advance: October 30
Preliminary: November 25
Final: December 23

Gross Domestic Product

	Quarterly annualized rate, sa		forecasts in bold		
	3Q08	2Q08	1Q08	4Q07	3Q07
GDP	0.2	2.8	0.9	-0.2	4.8
Personal spending	-2.5	1.2	0.9	1.0	2.0
Nonresidential investment	2.7	2.5	2.4	3.4	8.7
Residential investment	-20.9	-13.3	-25.0	-27.0	-20.6
Inventories (\$ bn)	-41.1	-50.6	-10.2	-8.1	16.0
Public spending	4.2	3.9	1.9	0.8	3.8
Exports	13.8	12.3	5.1	4.4	23.0
Imports	1.0	-7.3	-0.8	-2.3	3.0
Deflator (YoY % change)	4.0	2.0	2.3	2.6	2.5

GDP Forecasts (YoY % change)

