Payden&Rygel

# Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

JULY 29, 2011

## THE "CAR WRECK" WAS EVEN WORSE THAN WE THOUGHT

The "car wreck" was even worse than we thought.

We received two key pieces of information from the Bureau of Economic Analysis (BEA) on Friday morning: the advanced estimates of second quarter real gross domestic product (GDP) growth and revisions to prior data releases. First, real GDP grew at an annual rate of just 1.3% in Q2 2011, a disappointing result relative to expectations for growth closer to 2%. In terms of the components that drive GDP, consumer spending slowed to just 0.1% at an annual rate during the quarter. That means consumer spending, which comprises 71.2% of GDP, contributed almost nothing to overall Q2 growth.

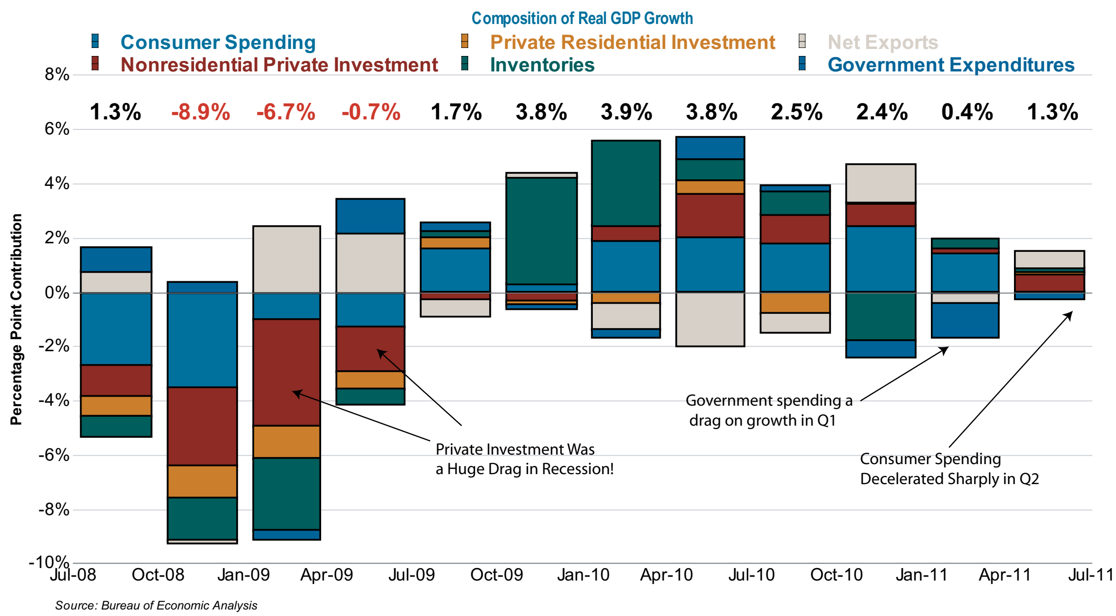
Second, the BEA released data revisions, knocking down prior estimates of GDP dating back as far as 2003. As a result, downward revisions to consumer spending, inventories and government spending pushed **Q1 2011 GDP growth to just 0.4% at annual rate (from 1.9% prior to revisions).** Going even further back in time, **we now know that from peak-to-trough, GDP fell -5.1% from Q4 2007 to Q2 2009 compared to 4.1% in prior data.** That's a measure of the depth of the recession.

The conclusion: the "car wreck" (depth of the US recession) was even worse than we thought and putting the pieces back together (current GDP growth rate) is taking longer than anticipated by the marketplace. To date, the current level of real GDP is still below the pre-recession peak (prior data showed the US exceeded the pre-recession peak in Q42010).

**Are there any positive signs?** At least some of the slowdown in consumer spending activity in Q2 may prove temporary. Auto sales declined sharply (at a 20%+ annual rate) during Q2 meaning growth could return in the second half of the year. However, expectations of a sharp bounce back in second half GDP numbers still seem far too optimistic. Consider this: **even a 2% GDP growth rate for the full year 2011 seems like a high hurdle given growth over the first half of 2011 has averaged just 0.8% at an annual rate.**

With another disappointing patch of economic data, the question again arises: **what will the Federal Reserve do next?** Sticking with our "car wreck" analogy, additional monetary easing is akin to pouring more gasoline into an already filled gas tank – coupled with the fact that

A DISAPPOINTING FIRST HALF OF 2011: GDP GROWTH AVERAGES JUST 0.8%




Source: Bureau of Economic Analysis

wheels on the car are still off. More monetary easing is unlikely to help boost real economic activity. It also important to keep in mind what's going on in the heads of policymakers. For now, the Federal Reserve thinks its hefty $2.9 trillion balance sheet provides sufficient quantitative accommodation (or QA?) to help foster growth even though QE2 purchases have ended.

## REAL GDP BREAKS BELOW 2% ON A YEAR-OVER-YEAR BASIS