



# Weekly Economic Commentary

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## ECONOMIC CALENDAR

### Monday, Oct 27

New Home Sales  
*September*

### Friday, Oct 31

Personal Consumption  
*September*

### Tuesday, Oct 28

Consumer Confidence  
*October*

Personal Income  
*September*

### Wednesday, Oct 29

Durable Goods  
*September*

Employment Cost Index  
*Q3*

### Thursday, Oct 30

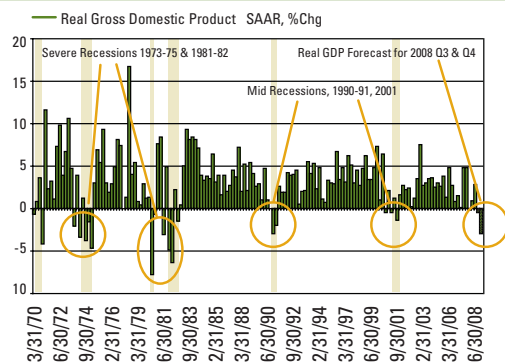
GDP  
*Q3*

Chicago PMA  
*October*

Initial Claims  
*wk 10/25*

U of Mich  
Consumer Sentiment  
*Q3*

## 1 The U.S. Economy Likely Contracted in Q3 2008 for the First Time Since the 2001 Recession



Source: Bureau of Economic Analysis / Haver Analytics 10/27/08

## Executive Summary:

**Q3 2008 Gross Domestic Product Likely to be Negative; Q4 Likely to be Worse**

For most of 2008, the daily, weekly and monthly drumbeat of U.S. economic data has largely been ignored by financial market participants. While there were times this year that the economic data “mattered” to the financial markets, for the most part investors were more intently focused on the problems in the heretofore more obscure corners of the financial markets, including the credit default swap market, the overnight interbank lending market, and the collateralized debt obligation (CDO) market.

Of course that lack of concern for the economy among financial market participants was not shared by Main Street America, which has suffered through soaring consumer energy prices (until recently), a flatlining housing market and a shaky labor market. Financial markets began to take note of the weak economic data right around the time the “acute phase” of the financial crisis began—when Lehman Brothers filed for bankruptcy on September 15. The economic data released since then, especially the data released in October for September, has been universally weak, but we had not yet seen a reading on the full U.S. economy for Q3. Until now.

This week, for the first time, both Main Street and Wall Street will get a taste of just how much damage the global financial crisis did to the broad economy in the recently completed third quarter (July, August and September). The gross domestic product (GDP) data for Q3 2008 are due out on Thursday, October 30. Given that the equity market has adopted a less forward looking and more “reactionary” mentality of late, the Q3 GDP report could draw more attention than usual from market participants. It will certainly draw intense media attention, especially since the report is set to be released just five days before the November 4 presidential election in the United States.

The good news is that the worst of the global financial crisis didn’t hit until the collapse of Lehman Brothers and AIG in mid September, which will limit the damage to the economy in the third quarter, keeping real GDP growth near zero. Economists’ estimates for third quarter GDP range from -1.9% to +1.2%, with a median forecast of -0.5%. The last time the U.S. economy experienced a negative quarter of GDP growth was in the third quarter of 2001, when the real economy shrunk by 1.4% at the tail end of the mild 2001 recession that ended in November 2001 [chart 1].

The bad news is that financial market conditions deteriorated markedly in the first few weeks of October, with large declines in U.S. and especially



emerging market equity markets, further eroding wealth and confidence. Thus, it is quite likely that the Q3 2008 GDP report won't be the end of the bad news on the economy. In our view, barring a substantial improvement in financial market conditions in the next few weeks, real GDP in the current (fourth) quarter of 2008 is likely to contract by between 2.5% and 3.5%, which is close to the consensus view. The U.S. economy has not experienced a decline in GDP of that magnitude since the severe 1981-82 recession [chart 1].

Looking ahead into 2009, we expect sluggish growth to continue, although at this point, we certainly don't foresee a deep and prolonged recession like we saw in 1973–75 and again in 1980–82 [chart 1]. The imbalances and high inflation that preceded those prior periods are not in place today. But, each week that passes with still frozen credit markets pushes the economy further into the red and closer to a deep recession such as we saw unfold in the early 1970s and again in the early 1980s.

Still, we expect the unemployment rate to rise from current levels (the unemployment rate stood at 6.1% in September 2008), and we are likely to see further erosion in consumer spending and business capital spending over the remainder of 2008 and into the first half of 2009. Housing will remain stagnant as well, while the net export sector—which has almost single-handedly kept the U.S. economy out of recession over the past year or so—will continue to be a plus for real GDP growth, but slowing economic growth overseas as a result of the credit crunch and massive declines in overseas equity markets and wealth will dampen our export performance.

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