GDP growth rate of 2.8% predicted for 4Q 2012: Prudential

By Editor Test *Tue, Jul 31, 2012*

The 1.5% GDP growth in Q2 was due to weaker consumer and government spending and a negative trade balance. Bright spots were solid business investment spending and housing as well as a rise in inventories, according to Prudential strategist John Praveen.

Thanks to a slowdown in spending by consumers, businesses and government, the U.S. economy barely registered a pulse in 2Q 2012, according to the latest report from John Praveen, chief investment strategist of Prudential International Investments Advisors.

Concern over the economic slowdown, complicated by the pressure of the impending presidential election, is likely to compel the Fed to announce another round of qualitative easing at its August or September meeting, Praveen wrote.

Indeed, Praveen says, there's plenty to worry about in the near future, including the approach of the so-called "fiscal cliff" and the unresolved sovereign debt crisis in Europe. But he expects U.S. growth to rise in the second half of 2012, predicting an annualized GDP rate of 2.8% in the fourth quarter.

Highlights of the report included:

- U.S. GDP growth decelerated to 1.5% QoQ annualized pace in Q2, in line with expectations, slowing from 2% GDP growth in Q1 (revised from 1.9%) and 4.1% in Q4 2011 (revised from 3%). On an annual basis, GDP growth moderated to 2.2% YoY after 2.4% in Q1.
- The slower pace of GDP growth in Q2 was due to the drag from weaker consumer spending and government spending. In addition, trade subtracted from growth with imports outpacing exports. However, GDP growth was boosted by solid business investment spending and housing as well as a rise in inventories.
- U.S. Q2 GDP growth was driven by contributions from consumer spending (1.05%), business investment (0.54%), inventories (0.32%), and residential investment (0.22%). Meanwhile, the largest drags came from government spending (-0.28%) and net exports (-0.31%).
- Consumer spending slowed to 1.5% pace in Q2 from the stronger 2.4% increase in Q1 and contributed 1% after the 1.7% contribution in Q1. Consumer spending was dragged lower by a sharp correction in durable goods spending (to -1% after 11.5% in Q1) mainly led by a decline in Autos. Services spending, the largest component of consumer spending, improved to 1.9% after 1.3% in Q1. Non-durable spending rose 1.5% after 1.6%.
- Business investment spending growth slowed to 5.4% from 7.4%, but still added 0.5% to Q2 GDP growth. Equipment and software strengthened to 7.2%, but investment in structures weakened to 0.9% after the strong growth the past four quarters. However, residential investment grew 9.8%, slowing from 20.6% in Q1, but added only 0.2% to growth since it is a relatively smaller component of GDP. Inventories added 0.3% to growth after subtracting -0.4% in Q1.
- Government spending contracted -1.4%, subtracting -0.3% from growth, after falling -3% in Q1. State and local spending sunk -2.1%, compared to a more modest -0.4% decline in Federal spending. Net trade subtracted -0.3% with exports adding 0.7%, but imports subtracting -1%. Exports grew

5.3%, while imports grew a stronger 6%.

- U.S. Q2 GDP growth came in largely in line with current lowered expectations though sharply lower than expectation at the beginning of the Q2 (2.5%). The details of the GDP report do not indicate that the economy is on track to slow further in coming quarters. In addition, GDP growth for earlier two quarters has been modestly revised higher. However, the Q2 U.S. GDP growth slowdown is likely to increase the odds of the Fed undertaking QE3 at the August/September FOMC meetings. With the U.S. Presidential elections due in November, the window for Fed action is narrow, forcing the Fed to announce additional QE measures over the next two meetings to protect the economy from downside risks.
- Looking ahead, U.S. GDP growth is likely to rebound modestly to around 2.2%, in Q3 and further to 2.8% in Q4. Consumption spending is likely to recover to over 2% in Q3 from the anemic pace in Q2 with support from lower oil prices and stabilizing financial markets. Business investment spending remains supported by solid profits and cash levels, but policy uncertainty going into the Presidential election is likely to dampen business spending. Trade is likely to remain a drag with Europe in recession and the dollar appreciation.
- Further, there are significant risks to the U.S. economy in late 2012 with the potential massive fiscal cliff of large spending cuts and tax increases in 2013 resulting from expiring tax cuts and spending cuts set to be triggered at the end of 2012. The ongoing European debt crisis and struggling Eurozone economic activity is another risk.