

Real GDP decreased 0.3% in the third quarter to only 0.8% above the year ago level. The economy last expanded more slowly over four quarters in 2001. The 0.3% decline was the second in four quarters. Real GDP decreased 0.2% in the fourth quarter of 2007, before rising 0.9% and 2.8% in the first two quarters of 2008.

The behavior of major sectors suggests that the economy was weaker than the 0.3% decrease reveals and will sink further in subsequent quarters. Personal consumption expenditures decreased 3.1% – the fastest quarterly decline since 1980 – as spending in all three categories decreased, led by an 11.1% drop in spending on durable goods.

Mounting job losses and the rising rate of unemployment are expected to combine with tight credit to restrain spending through at least the winter despite the sharp decrease in the price of gasoline and other energy products.

Investment in equipment and software decreased 5.5% in the third quarter for the third consecutive quarterly decline. Investment in nonresidential structures increased 7.9%, but that was down from double-digit gains during much of the previous two and a half years. In addition, billings at architectural firms are down, indicating that the weakness in nonresidential construction that typically follows weakness in housing is finally materializing.

Business inventories added to real GDP growth by falling by less than in the second quarter. In all likelihood, the abrupt drop-off in consumer spending left businesses with more inventories that will be worked off in coming months by reducing production. Investment in residential structures decreased 19.1% – the tenth double-digit quarterly decline in a row.

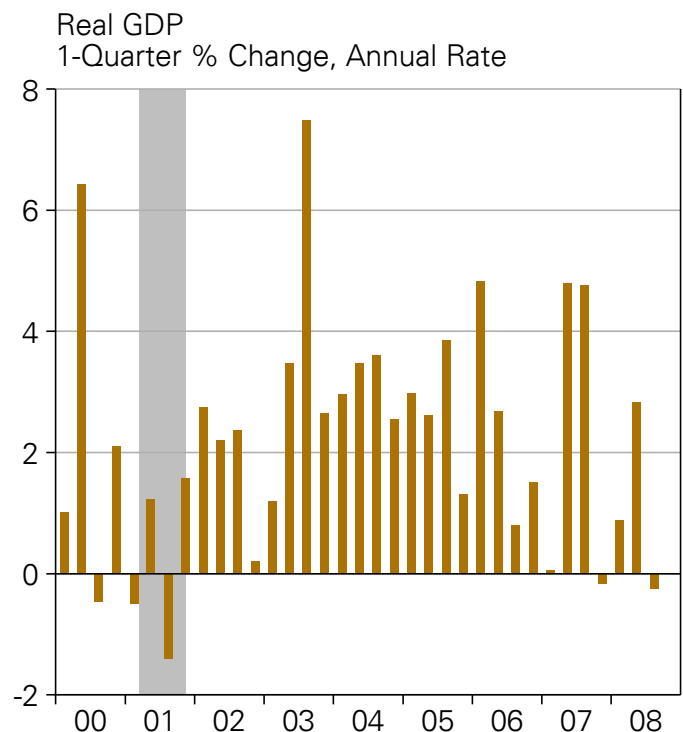
Exports increased 5.9% in the third quarter, but are not likely to be a source of strength going forward, as foreign economies have begun to weaken. Finally, real GDP was propped up by an 18.2% surge in defense spending that lifted government purchases by 5.8%. Budget constraints and a return to more-normal defense spending patterns are likely to restrain government spending in the quarters ahead.

Real GDP fell 0.3% in the third quarter. The decline probably will be revised lower and almost certainly will be followed by a larger decrease in the fourth quarter.

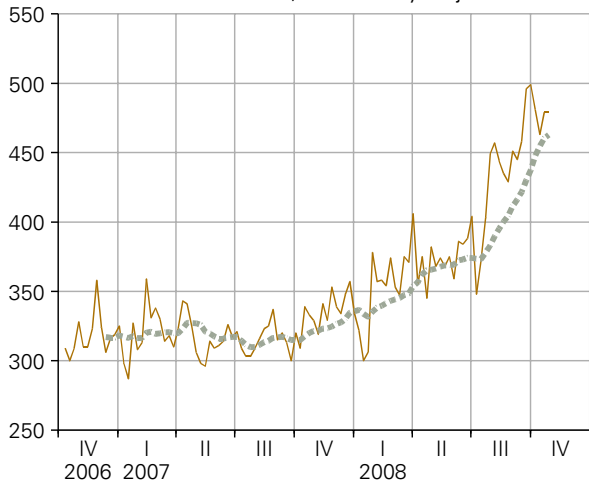
Leading economic indicators deteriorated further. The smoothed 6-month rate of change in the Weekly Leading Index from the Economic Cycle Research Institute (ECRI) decreased to 21.9% in late October – the fastest rate of decline on record dating back to 1967.

The *Blue Chip Financial Forecasts* consensus, which was compiled after the real GDP data were released, is for a decline in real GDP of 2.2% in the fourth quarter, followed by a decline of 1.3% in the first quarter and growth of 0.4% in next year's second quarter.

Jim Coons



Initial Claims for Unemployment Insurance
Thousands Per Week, Seasonally Adjusted



U. S. Dollar Exchange Rate
FRB Major Currency Index, 1973 = 100



Price of Oil
West Texas Int, \$/bbl



Price of Gold
London PM Fixing, \$/oz



S&P 500 Stock Prices
Daily Close, Index 1941-43 = 10



Mortgage Loan Originations
MBA Purchase Index 3/16/90=100 SA

