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Markit Economic Research

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United States

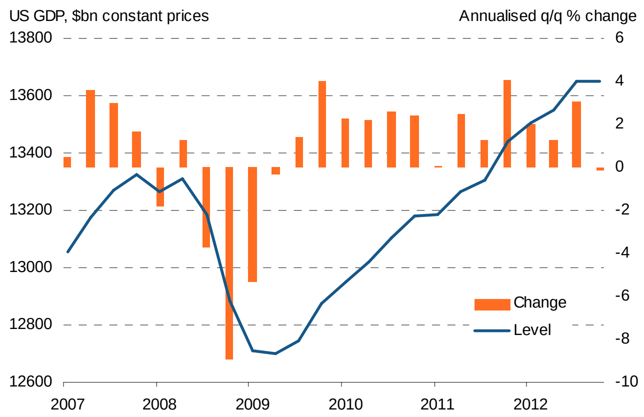
Surprise fourth quarter economic contraction

- **Official data show 0.1% rate of economic decline in Q4**
- **Downturn due to hurricane impact, inventory drag and lower defence spend**
- **Surveys raise hopes for Q1 recovery**

The US suffered a surprise economic contraction in the final quarter of last year, but this is not likely to be the start of a double-dip recession. While vindicating the Fed's aggressive policy stance, the economic weakness late last year should not be a cause of renewed concern for policymakers. The decline could be largely blamed on companies adjusting their inventories, falling government spend and disruption from Hurricane Sandy. More up-to-date economic data have also indicated that the recovery has regained traction as we move into 2013.

After a disappointing end to 2012, the first quarter of 2013 may well surprise on the upside as the economy rebounds from a temporary spell of weakness.

US gross domestic product

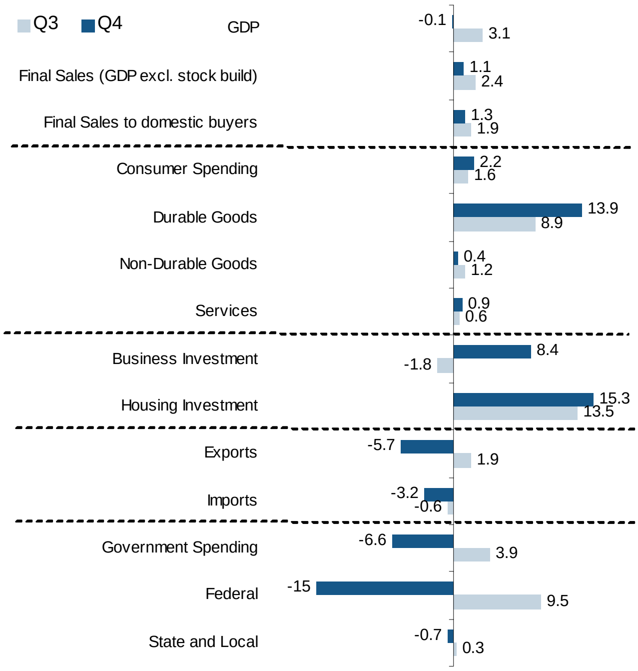


Source: Commerce Department (via Ecowin).

Official data showed GDP falling at an annualised rate of 0.1% in the final three months of last year, representing a sharp turnaround from the 3.1% expansion seen in the third quarter and confounding economists, who had on average expected to see 1.1% growth. The contraction was the first since the second quarter of 2009.

The details of the decline suggest that the underlying performance of the US economy is far better than the headline number suggests. In particular, companies sought to cut inventories which had built up in previous months, and if the stock reduction is excluded, the economy grew at a 1.1% annualised rate. That still represents an easing from a 2.4% pace seen in the third quarter, but if we also consider that government spending fell at a rate of 6.6%, after defence spending showed the largest drop since 1972, and if we bear in mind the impact of superstorm Sandy, which is thought to have knocked at least 0.5% off growth, a more reassuring picture emerges of an economy that is continuing to recover.

Annualised GDP growth by sector



Source: Commerce Department.

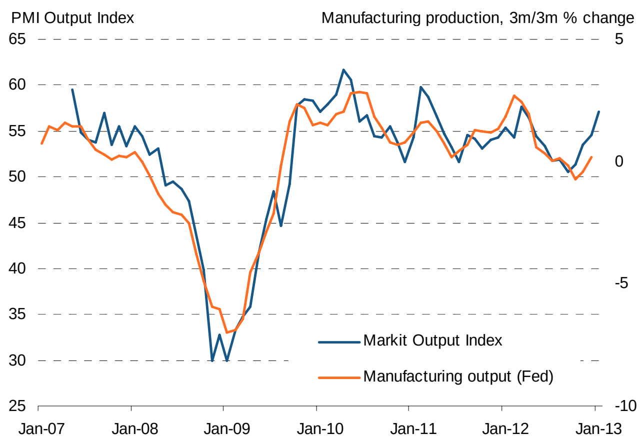
Falling exports, reflecting weakness in key export markets such as China and Europe, also offset some of the growth in domestic demand.

The brighter underlying picture is also supported by data from the report showing consumer spending rising at a 2.2% annualised rate, up from 1.6% in the third quarter, and business investment rebounding at an 8.4% rate. Residential construction also grew strongly.

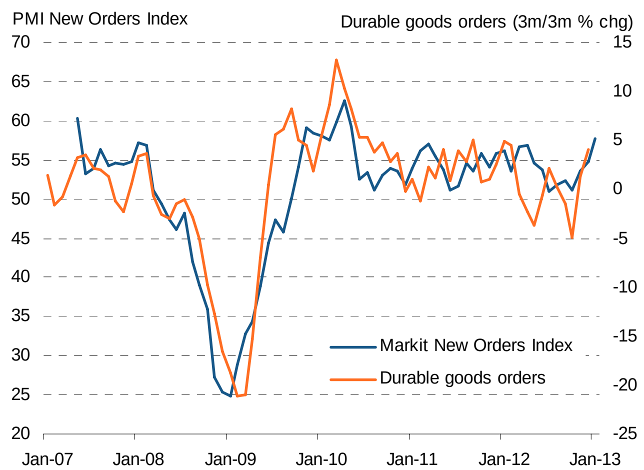
Stronger first quarter

Encouragingly, growth could pick up sharply in the first quarter, as more recent monthly data have pointed to the economy regaining momentum. The quarterly rate of growth of retail sales rose to its highest in over one-and-a-half years in the three months to December, a period in which durable goods orders also showed the largest quarterly rise for almost a year. January business survey data have also added to the better news flow, with Markit's flash Manufacturing PMI hitting a 22-month high as output and order book growth accelerated. With economic indicators for many other countries, notably China and even the Eurozone, also picking up in January, the US should also benefit from rising export sales, reversing the drag on growth from trade seen in the fourth quarter.

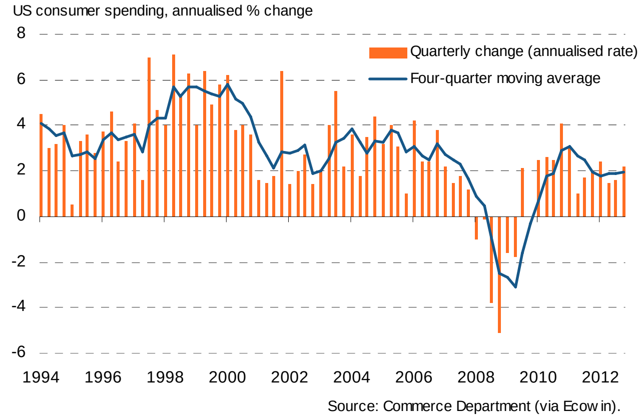
Manufacturing output



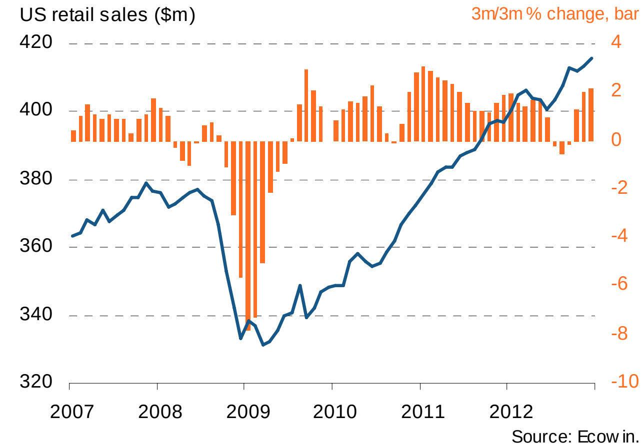
Durable goods orders



Consumer spending



Retail sales



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