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GDP: Over-Hiring?

First-quarter GDP rises a less than generally expected 1.3% (Consensus: +1.8%; Decision Economics: +1.4%), following on a first-quarter increase revised down to +0.4% from +1.9%.

The new quarter suffered from an even weaker-than-expected 0.1% rise in personal consumption, which swamped quite positive performances in business investment (+6.3%), housing investment (+3.8%), and net exports (improving enough to add 0.6 percentage point to the total). Total government purchases (-1.1%), were a negative, but not of great consequence in shaping the total.

The first quarter revision reflected a 0.6 percentage point downward restatement of final sales to domestic purchasers, plus a near-one-percentage point total downward revision in the positive contributions of inventories and net exports, weighted heavily towards the inventories.

The whole picture is of an economy in reasonably good shape recently--except in the important case of consumer spending. Notably, inventories are not in threatening condition, and export growth (+6.0%) is solid.

For the consumer, the problem has been one mainly of disposable income growth, which grew only 0.7% in both the first and second quarters. Savings behavior was not extreme--with the 2.1% real consumer spending growth in the first quarter supported by a decline in the savings rate from 5.2% to 4.9%, while the big second-quarter slowdown was only slightly attributable to a rise in the savings rate from the 4.9% back to 5.1%.

The weakness of income growth, in turn, comes down to the weakness in employment growth--which now seems a bit more explicable, given what the sharp downward revision to first quarter growth says about what productivity really did in the first quarter.

Where consumption goes in the third quarter will determine where the economy goes--even whether a double-dip looms. Some of the second-quarter consumer weakness was probably transitory, reflecting gasoline prices and new-car shortages, but more than a return to normalcy there will be required to get growth back on track.

The issue will be whether employers decide that the over-hiring now evident in the early part of the year has been sufficiently offset by the restrained hiring growth of recent months--allowing for some pickup reasonably soon.

Optimists will look at the downtrend in initial claims as evidence that things are getting back in line. But, pessimists have not been disappointed yet.

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