Economic Research Department

BBVA

GDP Observatory

July 31, 2009

2Q09 GDP Growth

- **GDP decreased at a slower rate than in 1Q09**
- **Widespread weakness across components but contraction eased**
- **Rising unemployment and savings could present risks to PCE**

As expected, GDP contraction slowed in 2Q09 with economic activity declining 1.0%, compared to the 6.4% drop in the first quarter. While non-residential investment was a significant driver of the first quarter's decline, it moderated to -8.9% from -39.2% in 2Q09. Equipment and software dropped 9.0%, the slowest rate since 3Q08, due to an increase in investment in transportation equipment and dampened declines in the other components. Furthermore, contraction in the structures component tempered to 8.9% from 39.2%. After declining for three consecutive quarters, investment in power and communications and other structures rose, while mining and commercial structures declined at a slower pace.

Meanwhile, contraction in residential investment slowed to 29.3% from 38.2%, but the decline remained steep despite some improvement in short term indicators. The component subtracted 0.8pp from GDP compared to 1.1pp in 1Q09. Inventories also had a less negative contribution of 0.8pp, in contrast to 2.4pp in the previous quarter.

Although demand continued to dwindle both at home and abroad, the decline in imports and exports moderated to -15.1% and -7.0% from -36.4% and -29.9% respectively. On the other hand, the 5.6% increase in government spending boosted GDP by 1.1pp as federal, state and local governments raised expenditures.

In contrast, PCE yielded a negative surprise by dropping 1.2% after rising 0.6% in 1Q09, supporting the view that rising unemployment is continuing to affect consumer behavior. Spending on goods dropped 4.0%, proving that the 2.5% first quarter rise was only transitory. In contrast, services rose 0.1% after falling 0.3%.

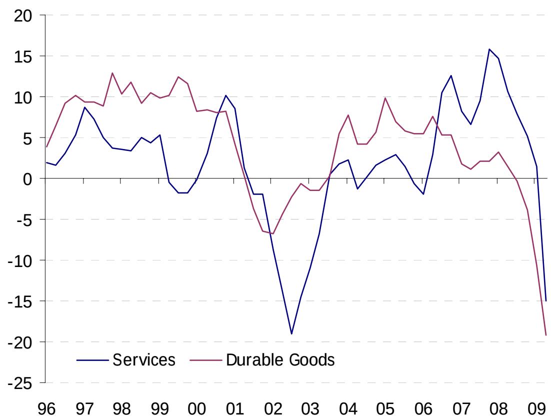
Along with the GDP report, the BEA released a comprehensive revision of all figures from 1929 through 1Q09. While the previous data showed that the largest economic contraction occurred in 4Q08, the new figures show the steepest fall taking place in 1Q09 (-6.4%).

Bottom-line: Although the less negative decline in GDP signifies that the worst may have passed, the overall economic condition remains weak. Risks to PCE remain with expectations of further drops in non-farm payrolls, increases in the savings rate and declines in personal income. In addition, durable goods orders remain weak and industrial production has yet to show signs of a bottom, which indicates non-residential investment could drop further in the third quarter. Meanwhile, the recent rise in housing starts could indicate that the decline in residential investment could ease. Lastly the downward trend in private inventories is still accelerating, but once they bottom out, businesses could increase orders and drive production.

Kristin.Lomicka@bbvacompass.com

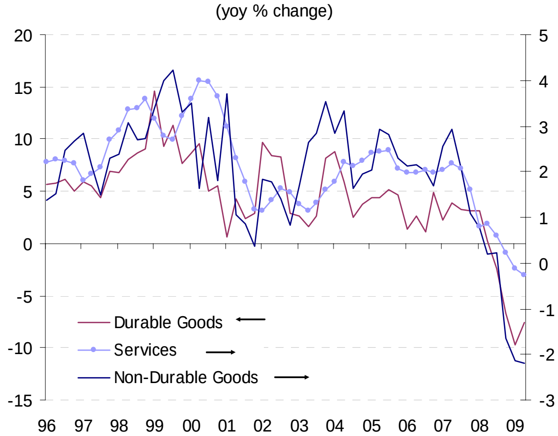
2Q09 GDP Growth
Advance: -1.0%
Preliminary: August 27, 2009
Final: September 30, 2009

Non-Residential Investment
(yoy % change)



Source: BEA

Personal Consumption Expenditures
(yoy % change)



Source: BEA