



GDP Observatory

October 29, 2009

GDP expanded 3.5% in 3Q09, indicating recovery has begun

- First quarter of economic growth since 2Q08
- PCE, residential investment, exports and inventories supported GDP
- Risks to PCE remain due to rising unemployment, low household wealth and limited access to credit

The economy grew at a rate of 3.5% in 3Q09, marking the beginning of the recovery from the recession that began in 4Q07. While growth was expected, the actual results came in below our forecast of 4.1%, mainly due to a more optimistic estimation of the contribution of the change in private inventories.

As expected, growth was driven by personal consumption expenditures (PCE), which contributed 2.36pp to overall output. Motor vehicles and parts, which were supported by the federal Cash for Clunkers program, contributed significantly with 1.01pp, compared to subtracting 0.14pp in the prior quarter. While this quarter's consumption was supported by fiscal stimulus, subsequent growth in non-durable goods and services indicates that organic demand is picking up, albeit modestly.

The worst for non-residential investment (NRI) is over as the decline slowed more than expected. While NRI in equipment and software rose as anticipated, signifying that demand is growing in some areas, investment in structures continued to decline, largely due to excess capacity in existing structures, limited access to credit and declining fundamentals in the commercial real estate market. All of these trends are expected to continue in 4Q09.

A big surprise came from residential investment, which increased 23.4% for the first time since 4Q05. Nevertheless, residential investment remains extremely weak at levels 18.1% below those of last year. Furthermore, demand for new homes remains subdued, which leads us to expect that the investment will recovery slowly.

Net exports surprised by contributing negatively, but the growth in both imports and exports indicates that global demand is resuming. Looking forward, we still anticipate net exports to support GDP growth as stronger growth in emerging markets will stimulate foreign demand for U.S. goods.

Lastly, while the federal government increased its spending, state and local governments pulled back due to the budget problems faced by these entities.

Bottom-line: Positive signs across all components show that the economy is beginning to recover from the recession, but many challenges remain. While PCE drove growth in 3Q09, without another targeted stimulus program, consumption could remain subdued due to rising unemployment, low household wealth and tight credit markets. Furthermore, recovery in residential investment happened sooner than expected, but growth could be slow as demand is forecasted to remain weak. A positive sign is the increase in NRI in equipment and software, which means further growth could pull the component out of negative territory. Nevertheless, investment in structures could continue to be an obstacle. Given this assessment, we maintain our GDP forecasts of -2.5% for 2009 and 1.5% for 2010.

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3Q09 GDP Growth

Advance: 3.5%

Preliminary: November 24, 2009

Final: December 22, 2009

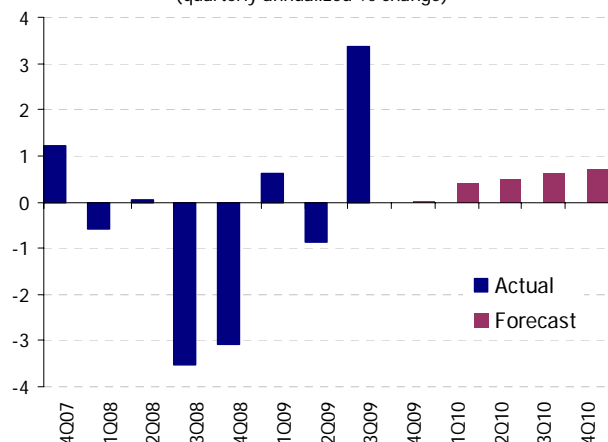
Gross Domestic Product

Quarterly annualized rate, sa

	3Q09 Forecast	3Q09 Actual	2Q09	1Q09
GDP	4.1	3.5	-0.7	-6.4
Personal spending	2.3	3.4	-0.9	0.6
Nonresidential investment	-8.8	-2.5	-9.6	-39.2
Residential investment	-7.8	23.4	-23.2	-38.2
Inventories (\$ bn)	-85.3	-130.8	-160.2	-113.9
Public spending	3.2	2.3	6.7	-2.6
Exports	10.7	14.7	-4.1	-29.9
Imports	5.7	16.4	-14.7	-36.4

Personal Consumption Expenditures

(quarterly annualized % change)



Source: BEA and BBVA ERD