

# Anatomy of a Slow Down

July 31, 2006

According to the first draft of the 2<sup>nd</sup> quarter, real GDP numbers confirmed our often predicted slow down in consumer spending. It is estimated that the growth rate of consumer spending in the just completed quarter, was only half of the first quarter (2.5% vs. 4.8%). To add insult to injury, Wall Street's "savior" of the economy, capitol spending, fell well short of expected. The numbers were 2.7% vs. 13.7% during the first quarter. While we are at it, let's throw more fuel on the fire of an economy which is drastically slowing. Inventory building amounted to \$52.6 Billion, the largest build in over a year. The question becomes who is going to buy all this inventory?

OK, so maybe we are overemphasizing this drastic change. After all, the real GDP growth is also 2.5%, which is only slightly below 3.2% the average growth rate over the last 3 years ended 12/31/05. But, as Herb Stein (Nixon's economist) once said, "the difference between 2.5% and 3.2% is not 0.7% but 22%."

One of the most telling aspects of the 2<sup>nd</sup> quarter was the import number. There was practically no change from the first quarter which is where the consumer is drastically slowing his spending. On the other hand exports had a nice positive move, which indicates that the corporate sector of our economy is still moving forward. This, of course, is what one would expect in a slowing to recession economy. Our imports lead and our exports lag prior to an oncoming slow to no growth period.

Guess what?  
"Things go together like a horse and a carriage"



Source: National Association of Home Builders (NAHB) and BEA

Again housing is the key. Most all the economic gain we have seen since 2001 has centered around the housing sector. Each day reveals more and more evidence that the housing boom topped out in the 3<sup>rd</sup> quarter of 2005 and is still descending.

**We seem to be in that psychological period between relief from raising interest rates and the possibility of recession. The former encourages the stock market: the latter the bond market. The latter will prevail.**