GDP Soars at a 7.2% Rate, Fastest in Nearly 20 Years

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The U.S. economic recovery has entered a new phase of stronger growth.

The economy expanded at a 7.2% annual rate in the third quarter, the Commerce Department reported Thursday. That was the fastest rate of expansion since the first quarter of 1984. While few economists believe the U.S. economy can keep up such a blistering pace in the months ahead, many are confident the third-quarter spurt marked a distinctive shift into a more robust and sustainable stretch of the expansion.

"We're not going to see 7% growth again, but we could well see over 4% over the course of the next year," said Richard Berner, economist with Morgan Stanley in New York.

That could help to create the one ingredient that has been glaringly missing so far from the recovery: job growth. In a positive sign, the Labor Department reported Thursday that fewer people filed initial claims for unemployment insurance in the week ending Oct. 25. At 385,000, the level of claims suggests that the job market has at least stabilized. Yet because many companies are satisfying a rising demand for their goods and services by squeezing more productivity out of existing work forces, few economists expect the unemployment rate to fall much in the months ahead.

Economic growth during the third quarter was broad-based. Consumer spending grew at a 6.6% rate, the fastest pace in six years, thanks in part to tax cuts and the benefits of a spring-time mortgage-refinancing boom. Exports, which rose at a 9% rate, registered their fastest growth in more than a year. Residential construction, which grew at a 20% rate, posted its fastest growth rate since 1996.

Perhaps most importantly, business investment, which grew at an 11% rate, rose at its fastest clip since the first quarter of 2000, the waning months of the economic boom of the 1990s. Executives continued to pare inventories during the summer, but many economists argue that...
with inventories at record lean levels, businesses will now be compelled to slow these reductions, and possibly start restocking.

For months, economists have argued that a real recovery wouldn't take hold until business executives had confidence to start investing again. A variety of surveys of executives in recent months suggest that they are becoming more confident, while still cautious after the stock market bust and accounting scandals of recent years. For example, the Business Roundtable, an association of large companies, said earlier this month that 23% of its executives expected to increase capital spending in the months ahead, while only 12% were cutting. Just three months earlier, the percentage of those planning additional spending was roughly equal to the percentage that planned to cut. The percentage of executives planning to pare their payrolls has also declined.

"Almost everybody you talk to will say, 'I see very definite positives in the economy,' " said Phil Condit, chief executive of Boeing Corp. and chairman of the Business Roundtable. "But they will follow that by recognizing that they are going to be careful in terms of making sure that their business spending is where it produces results."

Many executives have felt burned at other stages of this inconsistent recovery. In the first quarter of 2002, for example, growth surged but then quickly faltered. A repeat of that happened last summer.

But economists say a few factors have changed the outlook of executives. Business profits are now clearly on an uptrend after a slow start. Profits were up 14% in the second quarter compared to a year earlier, based on the Commerce Department's broadest measure of nationwide profitability. After the blistering growth of the third quarter, profits almost certainly were up strongly again. Meanwhile, stock prices are rising now after faltering in the early stages of recovery. In early trading, the Dow Jones Industrials rose on the news of strong growth in the third quarter and are up more than 17% on the year. The tech-heavy Nasdaq stock index is up more than 45% on the year. Finally, the dollar is weaker now than it was at earlier stages of the recovery, which is improving the export opportunities of companies because a weak dollar makes U.S. products cheaper abroad.

There are reasons for some caution. Consumer spending has already begun to show signs of slowing after surging during the summer. Sales of cars and light trucks, for instance, slowed to an annual rate of 16.7 million units in September from 19 million units in August. J.D. Power & Associates, which tracks sales at more than 6000 dealer franchises around the country, says the slowdown continued into October.

"Auto-industry sales are going to be a lot weaker in the fourth quarter than they were in the third quarter, unless there is a substantial turnaround in incentives," says Van Busman, head of global forecasting at the research firm.

Yet the economy as a whole is expected to grow at a 4% rate during the fourth quarter, according to an October survey of forecasters by WSJ.Com. That marks a noticeable slowdown from the third quarter, though it is still faster than the 2.7% growth rate that prevailed between the recession's end in the final months of 2001 and the most recent quarter. The economy is expected to grow at a rate of a little more than 3.8% in the first half of 2004.

Chris Varvares, an economist with Macroeconomic Advisers, a St. Louis forecasting firm, said tax cuts, which played a big role in the third quarter growth spurt, will continue to underpin growth through 2004. During the first half of the coming year, he noted, many households will receive large refund checks. That is because tax cuts enacted earlier this year were retroactive to Jan. 1, 2003. The government
lowered withholding from paychecks in the middle of the year, but millions of households will find they withheld more than was necessary from the first part of the year.

Mr. Varvares estimates that real disposable incomes in the U.S. will be up 4.4% during the second quarter of 2004 from a year earlier, compared to an average of 3.5% disposable income growth during the last five years. "The bottom line is very strong growth in income," he says.

Economists note that businesses also will have a strong incentive to invest in new equipment in the months ahead. The new tax law allows companies to accelerate their depreciation of new equipment through 2004, an act which improves their cash flow. This will give many businesses an incentive to squeeze new equipment purchases into the next 15-month period.

Mr. Varvares says, the economy, "is in really good shape to maintain above-trend growth through the next year."

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