

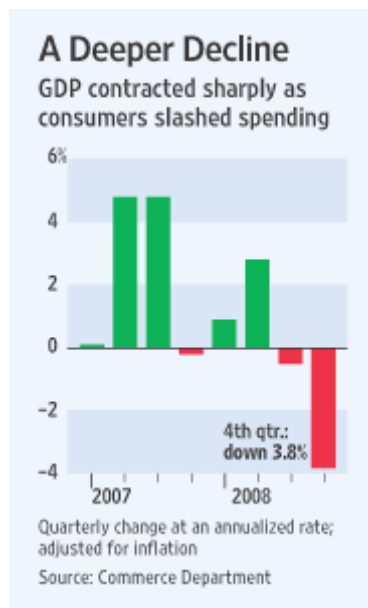
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# Economy Dives as Goods Pile Up

By [KELLY EVANS](#)

The U.S. economy turned in its worst performance in a quarter-century in the closing months of 2008, and risks are growing that the current months could be even worse.

Gross domestic product, a gauge of the nation's output, fell at a 3.8% annual rate in the fourth quarter, adjusted for inflation, from the previous quarter. The decline was the largest since 1982, though still well below the postwar record 10.4% quarterly drop seen in 1958.



While the fall was not as steep as expected -- most forecasts had GDP falling by 5% to 6% -- output was boosted somewhat by a rise in inventories of goods that were produced but not sold in the fourth quarter. Excluding the inventory adjustment, GDP fell at a 5.1% rate, which economists say more accurately reflects the nation's weakness.

President Barack Obama said Friday that the economic data underscore the urgency of passing the stimulus package. "This isn't just an economic concept, this is a continuing disaster for America's working families," he said. The House passed an \$819 billion stimulus bill Wednesday, a version of which is now being debated in the Senate.

This week alone saw announcements of more than 70,000 layoffs in sectors from trucks to technology. Many companies are likely to order less merchandise going ahead, particularly given the bleak outlook for 2009. That's a key reason why forecasters say the early months of this year could now bear the brunt of the recession. In turn, manufacturers might find they need to further ratchet down production -- and payrolls.

Coming off early gains this week, the Dow Jones Industrial Average fell 148.15 points Friday, or 1.8%, to close at 8000.86. The Dow ended down 8.8% for January, the worst performance in the first month of the year ever for the benchmark.



"I don't think anybody now with a straight face says we'll see a rebound over the next several months," says Robert Barbera, chief economist at Investment Technology Group, a New York brokerage firm.

Companies big and small are strategizing how they will get through the year. "With the economy the way it is, I'm lucky to still be in business," says Nancy Irwin, owner of Shoe Fetish, which sells mid-range boots and heels in downtown Boise, Idaho. "I have days with just three or four people coming in the store."

Shoe Fetish's sales in 2008 were down 35% from the previous year. As a result, Ms. Irwin is ordering less footwear and lower-priced models for this year's spring and summer season. She recently introduced a layaway option and says she's sold 10 or 12 pairs of shoes that way to people who otherwise wouldn't have been able to afford them.

The weak year-end performance was driven by a 3.5% drop in consumer spending, the largest component of GDP, and also included large declines in business and residential investment, exports and imports. Those declines were offset by an increase in government spending, which rose at a 1.9% rate in the fourth quarter, in addition to the boost from inventory levels.

The hard-hit auto sector illustrates the chain of events that helped fuel Friday's GDP number. Chrysler LLC was struggling for most of 2008, for example, but its troubles worsened in August when it stopped offering auto leases as a result of tightening credit markets. In October, as U.S. sales plunged, the company announced it had to cut 5,000 jobs, a quarter of its total, within a matter of weeks.

With vehicle sales slumping, inventory piled up on dealer lots, and by mid-December Chrysler shut down all of its plants for a month. The company's cash reserves dropped to just \$2.5 billion before the federal government stepped in to provide \$4 billion in emergency loans to keep the auto maker going.

WSJ economics reporter Kelly Evans tells colleague Phil Izzo the economy's 3.8% drop in the fourth quarter was better than what was expected, but only because U.S. counts an unwanted buildup of goods on store shelves as growth.

Though the market has failed to pick up this month, Chrysler nonetheless restarted production last week, and expects to produce about 25,000 vehicles in January, which is roughly one-half to one-third of a typical month's output, people familiar with the matter said.

A company spokesman declined to comment on how much revenue Chrysler generated in January. He added the production halt was intended to help dealers lower inventories.

In the past week, Chrysler executives have cut prices and fanned out across the country to plead with dealers to order more stock. Some dealers say they need to clear their 2008 backlog before they can take more vehicles. Tony Swain, the sales manager at Britt Chrysler Jeep in Fredericksburg, Va., says his dealership used to sell 50 to 60 new cars a month but is now selling only 20 or 30. He ordered around 80 new vehicles from Chrysler for 2009, compared to 100 or 120 in previous years. "Of course, they want you to order as many cars as you can because that drives their business," he said, but "demand isn't as great as it used to be."

## Slumping Across the Board

Collapsing demand at home and from overseas pushed the U.S. economy into a second straight quarter of contraction, its deepest since 1982.

### Pluses and minuses

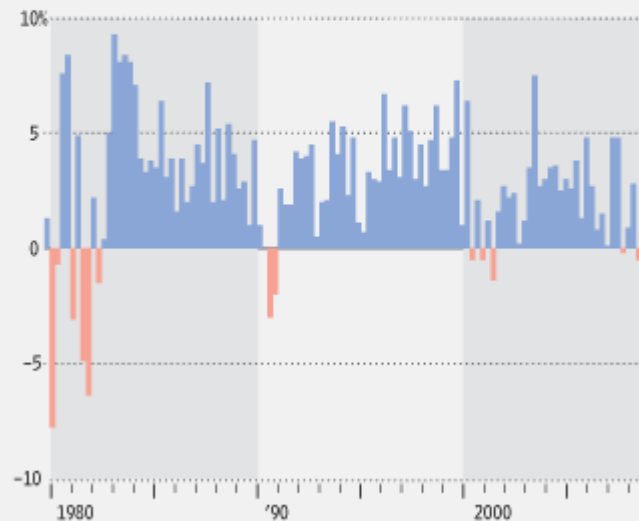
Contribution to fourth-quarter GDP growth, in percentage points

Shrinking imports	2.93
Increase in private inventories	1.32
Government spending and investment	0.38
Commercial real-estate sector activity	-0.07
Housing-sector and construction activity	-0.85
Business investment in equipment and software	-2.19
Consumer spending	-2.47
Shrinking exports	-2.84

Source: Commerce Department

### Inflation-adjusted GDP

Quarterly change at an annualized rate



Spending and investment held up reasonably well for most of last year at U.S. companies, but the credit crunch and decline in spending at the end of 2008 resulted in the worst earnings season in years. Exports fell at nearly a 20% annual rate in the fourth quarter as demand from foreign countries slowed, while total sales to U.S. purchasers fell at a 9.4% rate. Business spending and investment dropped at a 12.3% rate in the fourth quarter, with particular weakness in spending on equipment and software, which fell at an almost 30% rate, the most in 50 years.

The unemployment rate, currently 7.2%, is expected to hit nearly double digits by next year as companies respond to the recession by laying off more workers.

In turn, consumers are changing their behavior. The U.S. saving rate, which has fallen steadily since the early 1980s, dipping below zero in 2005, is now expected to rebound in 2009. Already, saving rose to nearly 3% of disposable income in the fourth quarter, from 1.2% in the previous quarter.

Weakness in consumer spending is expected to persist, following a 3.5% drop in the fourth quarter and a 3.8% decline in the previous quarter -- the worst back-to-back drops in more than 50 years.

The recession and retreat from last summer's oil price spike is quickly reversing fears of inflation and creating new worries over prices falling too low for comfort, or deflation.



*European Pressphoto Agency*

Many retailers are now slashing prices and trimming orders for new merchandise. Macy's Inc. began talking about reducing orders for spring and fall 2009 as early as November.

"If trends improve, we will be able to add back some of these capital projects and order more merchandise. But at this point, we don't see any upside in being optimistic," Macy's Chief Financial Officer Karen Hoguet said in a November conference call. Macy's declined to comment further on Friday.

Fearing that consumers won't go back to paying full price anytime soon, apparel chains such as J. Crew Group Inc. and Bebe Stores Inc. have also cut opening prices on some spring merchandise.

With consumers and businesses in pullback mode, imports from other countries fell at about a 15% pace in the fourth quarter, the fifth-straight decline and a poor sign for nations like Japan whose growth has been fueled by manufacturing goods for the U.S.

If U.S. consumers' and companies' appetite for imports stay low in 2009, that could buoy GDP growth, but it won't bode well for economic growth world-wide.

Some economists are skeptical about whether the Obama administration's stimulus package will provide much of a boost to the economy in 2009. Richard Berner, co-head of global economics at Morgan Stanley, says members of Congress "like to think they can pass some legislation and take a victory lap, and it's not going to work that way." Mr. Berner says he doesn't expect to see a return to growth in the U.S. until the final three months of this year at the earliest.

Some say a benefit of the stimulus package could simply be to lift confidence, which has fallen sharply in recent months. Consumer sentiment rose in January, according to a survey released Friday by Reuters and the University of Michigan, to a level of 61.2 from 60.1 in December and 55.3 in November. Even so, consumers on average expect the unemployment rate will hit 9% by year end, which could keep a lid on their spending until their outlook improves.