Second recession fears ebb

Modest growth seen as encouraging

By Martin Crusinger
The Associated Press

WASHINGTON — A summer of modest economic growth is helping dispel lingering fears that another recession might be near. Whether the strength can be sustained, though, is far from clear.

Buoyed by a resurgent consumer and strong business investment, the economy expanded at an annual rate of 2.5 percent in the July-September quarter, the government said Thursday.

The expansion, the strongest quarterly growth in a year, came as a relief after anemic growth in the first half of the year and weeks of wild stock market shifts.

The economy must grow at nearly double the third-quarter pace to lower high unemployment, which has been near 9 percent for the more than two years since the recession officially ended.

And though consumer spending was triple the level of the second quarter, Americans earned less, on an inflation-adjusted basis, in the July-September period. That meant that many people financed their spending binges by cutting back on savings. Few economists think that can continue.

Economists believe that growth in consumer spending, which accounts for about 70 percent of economic activity, will be restrained until incomes start growing at healthier levels. That is unlikely until hiring picks up.

Gains in consumer spending and business investment support the case for sustained growth going forward, said John Silvia, chief economist at Wells Fargo Securities.

"Unfortunately, inflation exceeds the perceived Fed target," he said.

Paul Ashworth, chief U.S. economist for Capital Economics, predicts that growth will cool off in the fourth quarter and next year.

Nonetheless, the report on U.S. gross domestic product, or GDP, sketched a more optimistic picture for an economy that only two months ago seemed destined for another recession.

And it was delivered on the same day that European leaders announced a deal in which banks would take 50 percent losses on Greek debt and raise new capital to protect against defaults on sovereign debt.

Stocks surged on the European deal and maintained their gains after the report on U.S. growth was released.

"This has been a morning of encouraging news," said Jennifer Lee, a senior economist for BMO Capital Markets.

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"The fourth quarter may see some pullback in U.S. economic growth ... but the positive details underlying the GDP report should help ease fears of a U.S. recession ... somewhat."

Consumers helped drive much of the growth. They spent at an annual rate of 2.4 percent. Many bought more furniture and clothing.

And spending on services rose 3 percent, the most in more than five years. Much of the gain was due to consumers paying more for health care and to cool their homes during an unseasonably hot summer.

Still, after-tax incomes adjusted for inflation fell at a rate of 1.7 percent in the summer. It was the biggest decline since the third quarter of 2009 — just as the recession was ending.

Businesses also helped boost third-quarter growth by stepping up their investment in equipment and software. That category surged 17.4 percent — nearly three times the rate from spring. They also invested more in building, a sign that some businesses could be expanding despite the sluggish economy.

The GDP report measures the country's total output of goods and services. It covers everything from bicycles to battleships, as well as services such as haircuts.

In August, many feared the economy was destined for another recession after the government said growth fell to less than 1 percent for the first six months of the year.

High gas prices, the growing debt crisis in Europe and wild fluctuations in the stock market also contributed to those fears, which have receded in recent weeks after reports showed improvements in hiring and consumer spending.

Economists project an annual growth rate of 2.5 percent to 3 percent for the October-December quarter and for all of next year — just enough to keep the unemployment rate from rising.

For the 14 million people who are out of work and want jobs, that's discouraging news. And it's an ominous sign for President Barack Obama, who will be facing voters next fall.

There have been some encouraging signs.

A measure of business investment plans rose in September for the second straight month and by the most in six months, according to a government report Wednesday on orders for longer-lasting manufactured goods.

And consumers stepped up their spending on retail goods in both July and September. The main reason for the September gain was more people bought new cars, a purchase people typically make when they are confident in their finances.

Economists warned that even their modest assessment of growth of around 2.7 percent for next year will fall short if the European debt crisis isn't resolved.