Better than it looks?

America's economy shrank at an alarming rate in the first quarter.

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It would be tempting to use America's grim first-quarter GDP figures, released on Wednesday April 29th, to squelch talk of green shoots in the global economy. In fact, the figures contain flickers of hope, as well as one looming threat in the form of a massive slump in business investment.

The economy shrank at a 6.1% annual rate in the first quarter, the third quarterly decline. That outcome is worse than economists had expected and it brings the cumulative drop since mid 2007 to 3.3% (not annualised). That already exceeds the worst downturns of the post-war period in 1973-75 and 1981-82. There was a sharper decline in 1957 but it was mercifully brief.

The magnitude of the first quarter contraction was similar to that of the fourth quarter, but the composition was less discouraging. Nearly half of it was because of businesses slashing production in order to bring inventories in line with shrunken sales. The process, although perhaps not yet complete, is well advanced. Businesses may soon have production levels where they want them, assuming sales to customers do not fall further.

Another source of the shrinkage was a surprising reduction in national defence spending. Such outlays depend far more on the vagaries of Pentagon purchasing than the state of the business cycle and say very little about the strength of the underlying economy. More worrying was a drop in state and local spending, but that too may soften as federal dollars flow from the recently enacted $787 billion stimulus package.

The most encouraging sign came from consumers, whose spending actually rose by 2.2% at an annual rate, led by rising purchases of cars and other durable goods after a disastrous 2008. They may have had help from one-off cost-of-living adjustments to government pensions. The monthly data on home, car and retail sales confirm that consumption has broadly stabilised, and a rise in share prices and consumer confidence also bodes well. Although home construction has tumbled, the worst is probably over: in any case, the sector is now so small that further declines mean little to overall output.

The big looming threat in the report is business investment, which sank by a sickening 38% at an annual rate. That is the steepest decline since records began, beating the old record set back in 1952, according to Morgan Stanley. Businesses react with a lag to sales on the way up and down; the latest drop dramatically illustrates this "accelerator effect". It could be that the first quarter fall was a form of capitulation, with businesses rushing to cut all at once, muses

Stephen Stanley of RBS Greenwich Capital, a brokerage. For equipment spending, that is entirely possible.

But for commercial property, the outlook is bleaker and, given its sizable share of the debt markets, more worrisome for the broader economy. Towards the end of the expansion, construction and leverage in commercial property began to take on some of the frenzied hue that had already marked housing. A recent bankruptcy filing by General Growth Properties, a huge shopping-mall operator, and the potential for one by CityCenter, a massive Las Vegas casino project being developed by MGM Mirage and Dubai World, illustrate the risks to the financial firms which hold billions of dollars of commercial-property debt. The Federal Reserve is widely expected to help by making commercial mortgage-backed securities eligible for its programme (known as the TALF) to support the securitisation market with subsidised loans.

Even if the economy does pick up in the second half of the year, it is unlikely to do so quickly enough to absorb all the office, hotel and retail space now coming on stream. Recovery will thus have to depend on consumers not growing faint of heart and on the Fed and Treasury successfully recapitalising banks and hiving off banks' bad debts.

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