

Published July 28, 2007

Economy puts end to slump Gross domestic product grows by 3.4 percent

JEANNINE AVERSA

By JEANNINE AVERSA

WASHINGTON - The economy popped out of its rut this spring and grew at the strongest pace in more than a year, giving President Bush something to crow about.

The best barometer of the country's economic fitness - gross domestic product - increased at a 3.4 percent annual rate in the second quarter, the Commerce Department reported Friday.

Businesses regained their appetite to spend and sold more goods overseas, contributing to the improved performance. Stronger government spending also helped out.

Individuals, however, took a breather as they coped with high gasoline prices and the ill effects of the housing slump, including spiking foreclosures and late mortgage payments. The sour housing market continued to weigh on the economy but not nearly as much as it had in previous quarters.

Economic growth in the first three months of the year had slowed to a near crawl of just 0.6 percent, the slowest in more than four years.

At the White House, Bush was quick to hail the rebound in national economic activity. "I want the American people to take a good look at this economy of ours," boasted Bush, whose economic stewardship has received weak marks. "It's an economy that is large, flexible and resilient."

But Sen. Charles Schumer, D-N.Y., called the bounce back "a temporary oasis." He fretted that problems with risky mortgages could drag on and hurt the housing market's ability to recover.

On Wall Street, the GDP report failed to ease investors' fears about housing. The Dow Jones industrial average tumbled 208.10 points on Friday. One day earlier, the index suffered its second biggest drop of the year, plunging by 311.50 points. The culprit: investors' heightened anxiety that troubles in the housing and home-mortgage markets could spread.

Treasury Secretary Henry Paulson called the market turbulence a "wake-up call" to investors to re-examine their degree of risk. The economy's fundamentals, he stressed, remain solid.

"Lenders need to be very aware of the risk. Borrowers need to be aware of risk. I would submit that people are more aware of those risks and the need for discipline today than maybe they were a month or two ago," Paulson said.

"So again let's keep our eye on the very strong underlying economy, which puts us in a position of strength," he added.

The second quarter's GDP was better than the 3.2 percent growth rate economists were expecting.

It was the strongest showing since the first quarter of 2006, when the economy expanded at a brisk 4.8 percent pace. GDP measures the value of all goods and services produced in the United States.

Inflation - outside a burst in energy and food prices - moderated.

An inflation gauge closely watched by the Federal Reserve showed "core" prices - excluding food and energy - rose at a rate of just 1.4 percent in the second quarter. That was down sharply from a 2.4 percent pace in the first quarter and was the smallest increase in four years.

That should help ease some inflation concerns. Fed Chairman Ben Bernanke has said the biggest threat to the economy is if inflation doesn't recede as policymakers anticipate. Out-of-control prices are bad for the economy and the pocketbook. They eat into paychecks, erode purchasing power and reduce the value of investments.

The Fed has kept a key interest rate at 5.25 percent for more than a year.

Economists predict that rate will stay where it is through the rest of 2007 now that the economy is gaining strength and underlying inflation is calming down.

Bush has been trying to counter weak public-approval ratings for his handling of the economy. Only 37 percent approve of his performance, close to a record low, according to a recent AP-Ipsos poll.

Problems in the troubled housing and mortgage markets have rattled investors in recent days. Friday's report showed that the ailing housing market is still crimping economic activity, but not as much as it had.

Investment in home building was cut by 9.3 percent, on an annualized basis, in the second quarter. That wasn't nearly as deep as the 16.3 percent annualized drop in the first quarter. It was the smallest cut in just over a year.

Businesses ramped up investment elsewhere.

They boosted their spending on new plants, buildings and other commercial construction at a whopping 22.1 percent rate, the most in 13 years. Investment on equipment and software posted a 2.3 percent growth rate, an improvement from a meager 0.3 percent growth rate in the first quarter.

"I think the confidence level of companies has come back. That's why there was a modest pickup in capital spending," said Ken Mayland, president of ClearView Economics.

Businesses also replenished their inventories in the second quarter, adding to overall economic growth. Stronger export growth helped the nation's trade picture and added to the economy's momentum.

Also contributing to the second quarter's rebound: Government spending increased at a 4.2 percent pace. That compared with a 0.5 percent annualized drop in the first quarter.

However, consumers, whose spending largely prevented the economy from stalling out in the first three months of this year, lost energy in the second quarter. They boosted spending at a pace of just 1.3 percent, the smallest since the final quarter of 2005.

High gas prices and fallout from the housing slump are beginning to take their toll on peoples' appetite to spend. Still, a solid jobs climate - the nation's unemployment rate is at a relatively low 4.5 percent - should help cushion some of the negative forces.

Some economists wondered whether the overall economic momentum can be sustained.

"With energy prices high, the housing market reeling and the stock market uncertain, is there really a reason to think growth will accelerate sharply?" asked Joel Naroff of Naroff Economic Advisors.

The government also issued annual revisions that showed the economy grew at an average annual rate of 3.2 percent from 2003 through 2006, or 0.3 percentage point less than previously estimated. The revisions are based on more complete data.

Last year the economy grew by 2.9 percent - slower than the 3.3 percent increase previously calculated. The new figure marked the weakest annual growth since 2003 and underscored the depth of the housing slump.