

Economy Shrinks at Worse-Than-Expected Pace

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WASHINGTON - The economy shrank at a worse-than-expected 6.1 percent pace at the start of this year as sharp cutbacks by businesses and the biggest drop in U.S. exports in 40 years overwhelmed a rebound in consumer spending. The Commerce Department's report, released Wednesday, dashed hopes that the recession's grip on the country loosened in the first quarter. Economists surveyed by Thomson Reuters expected a 5 percent annualized decline.

Instead, the economy ended up performing nearly as bad as it had in the final three months of last year when it logged the worst slide in a quarter-century, contracting at a 6.3 percent pace. Nervous consumers played a prominent role in that dismal showing as they ratcheted back spending in the face of rising unemployment, falling home values and shrinking nest eggs. In the January-March quarter consumers came back to life, boosting their spending after two straight quarters of reductions. The 2.2 percent growth rate was the strongest in two years.

Much stronger demand for big-ticket "durable" goods, including cars, furniture and household appliances led the increase. That spending rose at a 9.4 percent pace, the most in a year. Consumers also boosted spending on clothing, shoes, recreation services, medical care, gasoline and other energy products. But not on food, where spending dipped slightly. Still, the consumer rebound was swamped by heavy spending cuts in virtually every other area.

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Businesses cut spending on home building, commercial construction, equipment and software, and inventories of goods. Sales of U.S. goods to foreign buyers plunged as they retrenched in the face of economic troubles in their own countries. Even the government trimmed spending. It was the first time that happened since the end of 2005. All told, the economy logged its worst six-month performance since the late 1950s.

The sharp cuts underscore the toll the housing, credit and financial crises — the worst since the 1930s — are having on the country. The recession, which began in December 2007, has taken a big bite out of national economic activity and snatched 5.1 million jobs. To cushion the impact of the downturn, the Federal Reserve has slashed a key bank lending rate to a record low near zero and rolled out a string of radical programs to spur lending. The Fed at the end of its two-day meeting Wednesday is expected to keep its key rate near zero and probably hold it there well into next year.

Wall Street shook off the weak gross domestic product reading as it awaited the Fed's assessment of the economy. The Dow Jones industrial average added more than 150 points in morning trading and broader indices also rose. President Barack Obama is counting on his \$787 billion stimulus of tax cuts and increased government spending on big public works projects to help bolster economic activity later this year. The administration also has put forward programs to rescue banks and curb home foreclosures — big negative forces weighing on the economy.

White House spokesman Robert Gibbs called the first-quarter's showing a "pretty severe contraction," but added that some more up-to-date signals on the economy have been more encouraging.

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"We continue to get, as the president said, some glimmers of hope," he said. Even in the face of Wednesday's weaker-than-expected report, some analysts stuck to predictions that the economy would shrink less in the current April-June period — at a pace of 1 to 2.5 percent — as Obama's stimulus begins to take hold. Those analysts also continue to hope the economy would start to grow again in the final quarter of this year.

"The recession was bad in the first quarter but won't be as bad going forward," said John Silvia, chief economist at Wachovia. "I don't think this lessens the expected pattern that the economy will be entering a recovery by the end of this year." However, the recent outbreak of the swine flu, which started out in Mexico and has spread to the United States and elsewhere, poses a new potential danger. If the flu stifles trade and forces consumers to cut back further, those negative forces would worsen the recession.

Before the flu outbreak, Fed Chairman Ben Bernanke said the recession could end this year if the government succeeds in stabilizing the shaky financial system and getting banks to lend again. In recent weeks, Bernanke and his colleagues had cited "tentative signs" of the recession easing in some consumer spending, home building and other reports. Finance officials from the U.S. and other top economic powers meeting here last week also saw some hopeful signs for the global economy.

Fresh glimmers of hope emerged in the U.S. Tuesday. The Conference Board's Consumer Confidence Index rose far more than expected in April, jumping more than 12 points to 39.2, the highest level since November. And a housing index showed that home prices dropped sharply in February, but for the first time in 25

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months the decline was not a record. However, in the first quarter there was much weakness in those areas and others. Spending on home building fell at a 38 percent annualized rate, the most since the second quarter of 1980. Businesses cut spending on equipment and software at a 33.8 percent pace, the most since the first quarter of 1958. Inventory reductions shaved 2.79 percentage points off overall first-quarter economic activity. U.S. exports plunged at a rate of 30 percent, the biggest drop since the first quarter of 1969, reflecting the crimped appetite of struggling foreign buyers. The government also cut spending 3.9 percent, the most since the end of 1995.

Even if the recession were to end this year, the economy will remain feeble and unemployment will keep climbing, government officials and analysts say. The Labor Department on Wednesday said that all 372 metropolitan areas tracked saw their jobless rates rise in March from a year earlier. The rate in Indiana's Elkhart-Goshen region soared to 18.8 percent, up 13 percentage points, which was the biggest gain in the country. The national jobless rate is now at a quarter-century high of 8.5 percent and is expected to hit 10 percent by the end of this year. It will probably rise a bit higher in early 2010 before starting to slowly drift downward. Still, the Fed predicts unemployment will stay elevated into 2011, and economists don't think it will return to normal — around a 5 percent jobless rate — until 2013.

More layoffs were announced this week. General Motors Corp. laid out a massive restructuring plan that includes cutting 21,000 U.S. factory jobs by next year. Clear Channel Communications Inc., the largest owner of U.S. radio stations, said it's cutting 590 jobs in its second round of mass layoffs this year amid pressure from

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the recession and evaporating advertising budgets. And bearings and specialty steels maker Timken Co. indicated it will cut about 4,000 more jobs by the end of this year after earlier suggesting about 3,000 jobs already had been targeted.

Elsewhere, construction equipment maker Bobcat Co. told nearly 250 workers at its two North Dakota plants they will be laid off indefinitely, executive search firm Heidrick & Struggles International Inc. announced plans to cut more jobs and reduce bonuses and salaries, and Lockheed Martin Corp. said it's cutting 225 jobs at a plant in upstate New York.

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