

# Economists downplay weak growth as temporary; but gas prices keep rising, housing remains weak

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WASHINGTON — Higher gas prices, severe storms and belt-tightening at the Pentagon slowed the economy in the first three months of the year. Most economists say the weak January-March growth was a temporary setback that will be followed by stronger expansion the rest of the year.

But will it?

Gas prices keep rising, real estate remains depressed and the federal government seems about to adopt some of the deepest spending cuts in a generation. Those spending cuts will also filter down to state and local governments, already squeezed by their own budget crises

All of that could drag on the U.S. economy through the rest of the year, despite a pickup in hiring.

“Just about every piston in the engine lost its power during the quarter,” said Sung Won Sohn, economist at California State University. “I don’t think all those negative factors are going to disappear.”

The economy grew at a 1.8 percent annual rate in the January-March quarter, weaker than the 3.1 percent growth in the previous quarter, the Commerce Department said Thursday. It was the worst showing since last spring, when Europe’s debt crisis slowed U.S. growth to a 1.7 percent annual pace.

U.S. growth, as gauged by the gross domestic product, is the output of all goods and services. It’s affected each time someone buys a car, has a manicure, sees a doctor or fills a gas tank.

To calculate GDP, the government adds consumer spending, business investment and government spending — and then subtracts the trade deficit. The United States has a trade deficit because the value of its imports exceeds that of its exports.

A big reason for the slower growth at the start of this year is the sustained surge in gas prices, which is siphoning money away from other purchases, from cars and appliances to clothing and vacations. Unlike other consumer spending, gasoline purchases deliver less benefit for the U.S. economy. About half the revenue flows to oil-exporting countries, though U.S. oil companies and gasoline retailers also benefit.

The rise in gas prices has shown no sign of slowing since the first quarter ended in March. Consumers paid an average of \$3.89 for a gallon nationally Thursday. That’s 30 cents more than a month ago and \$1.02 more than a year ago.

Federal Reserve Chairman Ben Bernanke and some other economists are downplaying the impact of high gas prices on the economy for the rest of the year. They predict gas prices will stabilize and the economy will grow at a 3 percent pace in each of the next three quarters.

Oil analyst Jim Ritterbusch predicts average gas prices nationally will peak at \$4.25 a gallon by the end of May. At that point, he says, people will likely cut back on driving, and gas prices

should fall to \$3.75 a gallon over the summer. By year's end, Ritterbusch says prices should fall to \$3.25 a gallon.

"We will have some zigs and zags, but that's where we are headed," Ritterbusch says.

Sohn isn't as optimistic. He says gas prices will rise, not stabilize, through the summer because turmoil in the Middle East could spread. That would push prices above \$4.50 a gallon nationwide by late summer, he says.

Partly as a result, he expects growth amounting to only about a 2.5 percent annual pace for the rest of the year. At that rate, unemployment, now at 8.8 percent, would likely decline only slowly.

Rising gas prices are draining most of the extra money Americans are receiving this year from a cut in Social Security taxes. That's the main reason why consumer spending cooled in the January-March quarter.

Consumers boosted spending at a 2.7 percent pace. That was down from the previous quarter's 4 percent pace and was the weakest rate since last summer. Consumer spending is important because it accounts for roughly 70 percent of overall economic activity.

Harsh winter weather in the January-March quarter also kept people from shopping. And it forced builders to delay construction projects. That led to the deepest cuts in commercial construction, such as office buildings and factories, since late 2009.

Builders also cut spending on housing projects. Weather was partly to blame. But the bigger reason is the home-building industry is on pace to suffer the worst two years for new-home sales since the government began keeping records in 1963.

Economists foresee a slight bounce-back in spending on home building and commercial construction this spring, one reason many are more optimistic about growth in the April-June quarter. Better weather would allow builders to move forward on delayed projects from the winter. That would help economic growth a little in the quarter.

But through the rest of the year, housing is likely to drag on the economy. Economists say it will take years for the industry to return to normal.

Home construction rose 7.2 percent in March from February to a seasonally adjusted 549,000 units. But the pace is still far below the 1.2 million units a year that economists consider healthy.

The devastating tornadoes that swept across Alabama, Mississippi, Georgia and other southern states this week are likely to impact economic growth in those areas. But most economists say the natural disasters won't have significant effects on the national economy.

The Obama administration will almost certainly spend money to assist those states. But that's likely to be a small amount, and it will happen at a time when all levels of government are preparing to spend less elsewhere.

The federal government cut military spending at an annualized rate of 11.7 percent last quarter — the deepest cut since 2005. And state and local government spending fell 3.3 percent. That's not as bad as last year, but economists don't see it improving soon.

Economists think the federal government will boost defense spending in coming quarters because of the war in Afghanistan. Increased spending would support the economy.

A bigger question is what happens in the new budget year, which begins on October 1.

President Barack Obama and Republicans are fighting over how deep to cut spending in the 2012 budget. House Republicans' have proposed cutting nearly \$6 trillion over 10 years by making sweeping changes to Medicare and Medicaid.

Obama has proposed cutting \$4 trillion through spending cuts and by ending the Bush-era tax cuts for higher-income Americans. Some economists say most of the cuts would affect future budgets.

But some say the likelihood of federal spending cuts, along with uncertainty over gas prices and the prospect of further home-price declines, are reason enough to be wary about the overall economy's growth through the rest of 2011.

"The economy has lost its modest upward momentum, and headwinds such as rising gasoline prices and further budget cuts suggest the recovery will continue at only a moderate pace going forward," said Sal Guatieri, senior economist at BMO Capital Markets.