COMMENTARY COVERSHEET

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Candidate name: **Juraj Masár**

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US GDP growth fastest in six years

By James Politi in Washington and Alan Rappeport in New York

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The US economy grew at its fastest rate since 2003 in the fourth quarter as investment by business picked up and consumer spending continued to grow, raising hopes that a sustainable recovery is under way.

The economy expanded at an annualised rate of 5.7 per cent between October and December, data released on Friday revealed. The strength of the growth surpassed market expectations and marked a sharp acceleration compared with the 2.2 per cent expansion seen in the third quarter.

The pick-up in growth was driven by companies increasing spending on equipment and software in preparation for an upturn, and slashing inventories much less aggressively than they had during the downturn.The strong fourth quarter provided a brighter end to a grim year for the US economy, when output fell by 2.4 per cent, its biggest annual drop since the end of the second world war.

As the inventory-slashing is only a temporary boost to growth, most economists are not expecting the growth rate of 5.7 per cent in the fourth quarter to continue into 2010. Most projections estimate that it could drop to below 3 per cent again in the first quarter.

But much of the economic data, released by the commerce department, were surprisingly positive, raising hopes that employment growth, which has been lagging behind the rest of the economy, and has risen to the top of the political agenda, could soon follow.

As well as the strong figures on business investment and inventories, there was evidence of an upturn in exports, which rose 18.1 per cent in the fourth quarter against the previous quarter, and outstripped imports. Consumer spending rose by a solid 2 per cent over the same period.

At a meeting with House Republicans in Baltimore, Barack Obama, president, said: "This morning we received a report that affirms our progress and the swift and aggressive actions that made it possible."

The administration has promised to make job growth is top priority following criticism that it devoted too much of its first year in office to healthcare reform.

Ethan Harris of BofA Merrill Lynch said the report boded well for jobs, but said the US was still in the "rehab" stage of its recovery. "We are still healing the wounds."

US shares initially rose strongly on the economic data, but later fell sharply amid broader global concerns about sovereign debt risk. The S&P 500 closed down 1 per cent to 1,073.87, notching up its deepest monthly losses since February last year. The benchmark US 10-year Treasury initially saw its yield rise 3 basis point to 3.67 per cent as stronger US economic growth was priced in. But the Wall Street pull-back also delivered a bid to bonds and the 10-year yield was later down 4 basis points at 3.59 per cent.

Commentary

The article "US GDP growth fastest in six years" describes the situation in a economy, when an increase in country's output occurs. When this happens, economists say there is an **Economic growth**.

Economic growth can be simply described as an increase in real Gross Domestic Product (**GDP**), which is a GDP adjusted to inflation.

GDP is a measure of country's national income and it is usually measured over 1 year.[1] Since country's national output is equal to its national income which is as well equal to national expenditures, it logically follows that there are three main ways of measuring GDP: *the output method* – which measures the actual value of the goods and services produced in a economy; it is calculated by summing all the values of value added by all firms. The second one is *the income method*, which measures the value of all incomes earned (profit, wages, rent, interest) and the last one is *the expenditure method.* This method is measured by summing all spending on goods and services done by various sectors; spending of households, known as **consumption**, spending of firms, **investments**, **government spending**, and **net export** (which is the difference between spending by foreigners on export and spending on imports).

The article deals with a rise in United States' GDP. As it says "*The US economy grew [...] as investment by business picked up and consumer spending continued to grow*". Since expenditure method counts with the investment and consumer spending, the grow in these areas indeed implicates the rise of Gross Domestic Product. The article reveals that companies were mainly spending money on new equipment and software in preparation for an upturn – as I have said before, everything mentioned is considered to be a investment. Another factor, besides growing consumer spending, which contributed in the rising of GDP was an increase in exports, which outstripped imports.

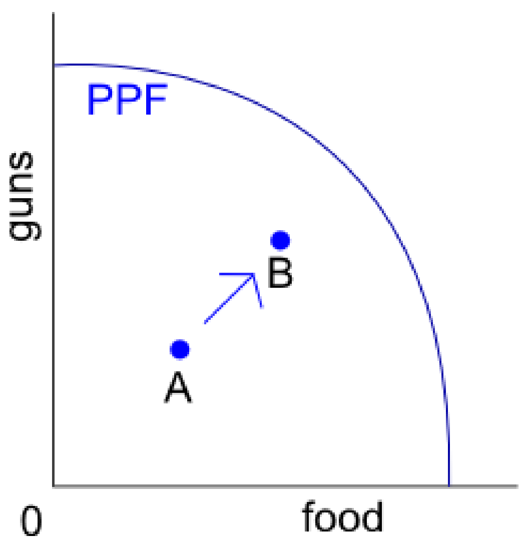

Figure 1: Economic Growth

In order to illustrate the Economic growth graphically, I will use an economic model known as Production Possibility Frontier **(PPF)** – Figure 1. In this model we assume that the country we are dealing with can produce only two products[2], therefore the curve shows us all combinations of quantities of these products which might be produced in an economy in a given time when all the resources in economy are used fully (which also means that there is full employment level of output) and the state of technology is fixed. The point A is a certain combination between production of food and guns. Since the point B is closer to the PPF and it maintains the same ration between products, if the output moves from point A to the point B an increase in economy's output occurs at no opportunity cost. If there is an increase in national output, therefore we say there is an Economic growth.

1 Jocelyn Blink & Ian Dorton, Economics Course Companion (1th Edition, Oxford University Press, Oxford 2007) p. 151
2 Allan Glanville, Economics from a global perspective (2th Edition, Glanville Books Ltd, Oxford 2003) p.12

For indicating the change in GDP a **GDP growth rate** is used. The GDP growth rate is a percentage change in GDP from one year to the next.[3] As we can see there was an expansion of the economy at the annualized rate of 5.7 percent between October and December 2009.

The effect of publishing of such data as our article is dealing with might be various. However, when data are positive it is likely that the general effect will be positive as well. The article mentions raising hopes that employment growth in the US could follow soon as the result of these data. The US shares naturally reacted as well; as it is said they rose strongly after data were published, but then fell sharply. When such positive data appear, even reactions from top politicians, such as Barrack Obama, are not unusual.

3 The Encyclopedia of Earth (2006, November 13) *Economic growth*. Retrieved May 30, 2010, from http://www.eoearth.org/article/Economic_growth