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National Economy Grows in Third Quarter, but will Retailer Holiday Sales do the same?
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During the third quarter of 2009 we saw Gross Domestic Product (GDP) turn upward after four quarters of decline, leading many to declare an end to the "great recession." This is certainly good news, but does it mean a strong holiday shopping season and a solid recovery in 2010? Not necessarily, and a look at what constitutes GDP helps show us why.

GDP is comprised of the following elements: 1) personal consumption, which is what households spend on goods and services, including food, cars, fuel, appliances, healthcare, financial services, etc; 2) domestic investment, which is what businesses invest in new equipment, buildings, and inventory, as well as spending by households on new homes; 3) government spending, which is the sum of government spending on goods and services, government employee wages, and investment spending on military equipment, road projects, etc.; and 4) the value of exported goods and services less the value of imported goods and services.

In the third quarter of 2009 personal consumptions accounted for 71 percent of all GDP in the third quarter of 2009. This shows just how important consumer activity is to the overall economy. In fact, had personal consumption not increased in the third quarter, overall GDP would have declined.

Within the personal consumptions category there were increases in every subcategory from the second quarter to the third quarter. At face value, this sounds good for retailers. However, a closer look reveals increased spending for motor vehicles and parts, and for gasoline and other energy goods, accounted for more than 60 percent of the total increase in personal consumption. "Cash for clunkers" provided a significant boost for automotive sales, and increasing costs at the pump resulted in more spending on gasoline. As we look ahead, new automotive related spending will likely curtail with the end of "cash for clunkers," but those who bought the vehicles will still have payments to make on them. Gasoline prices are also likely to remain at current levels. These two factors, along with a still growing unemployment rate and stagnant wage growth, mean fewer discretionary dollars in the pockets of shoppers.

Domestic investment, which accounted for just over 12 percent of GDP in the third quarter of 2009, remains a weakness, especially on the nonresidential side. Businesses spent $26 billion less on structures, equipment, and software in the third quarter compared to the second quarter. However, the amount of inventory held by businesses did fall, so their investment spending may pickup once they begin producing more to make up for dwindling inventories.

On the residential side of domestic investment the economy saw a $15 billion increase, offering some evidence that the residential real estate market has hit bottom. In terms of overall contribution to GDP, residential investment accounted for 2.5 percent of total GDP in the most recent third quarter. For the third quarter in 2008 residential investment accounted for 3.2 percent of total GDP, showing that despite some improvement, the residential sector remains weak. For retailers this should offer a sign of cautious optimism, as new home buyers are likely to increase their consumption of household goods and appliance.

Government spending accounted for nearly 21 percent of total GDP in the third quarter, with growth in federal spending leading the way. This spending has clearly been fueled by the stimulus plan, and will be difficult to maintain over the long-run. The stimulus is also putting significant stress on the national budget deficit, which in turn is causing worries over the value of the dollar and inflation. At some point this will translate to a mixture of higher taxes and higher prices, which will hit retailers both on the expenditure side, as operating costs increase, and on the revenue side, as consumers cope with higher prices and tax levies.

The final element of GDP accounts for trade activity. In the third quarter of 2009 we saw the value of exported goods and services from the U.S. grow by $69.5 billion. This trend will hopefully continue, as the dollar remains relatively weak against our trading partners' currencies, and economic growth resumes around the world. On the import side of the equation we continued to bring in more than we send out, which results in a detraction from total GDP. The value of imported goods and services, however, is significantly down from the third quarter of 2008, which is indicative of the decline in consumer spending.

The return to GDP growth is certainly welcome news, but as we see above, retailers should continue to tread carefully in the holiday season and New Year.

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