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ECONOMIC TALKING POINTS

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Bulletin:
Kevin Hassett's Prediction of 4% to 5% GDP Growth in Q2. Is it a Forecast or Prayer?

Just a brief comment following CEA's chair Kevin Hassett's assessment of how much the government shutdown will impact economic growth.

He's quite correct to warn that GDP growth will edge close to zero in Q1 should the shutdown last all three months. Our own projection for such a scenario is that real growth would be a miniscule 0.6% for the period.

BUT... then came his astonishing forecast that once the government reopens the economy will bounce back strongly in Q2. Hassett's projection of GDP growth rebounding by 4% or 5% looks more like a full-throated prayer, than a realistic forecast. The White House should be grateful if the economy manages to squeak out a 3% handle that period.

What the CEA apparently missed or grossly underestimated is the extent households will work to rebalance their finances in the second quarter after ramping up credit card debt and depleting savings during the first three months of the year.

A safe assumption is that credit card usage by the 800,000 unpaid government workers and millions of contractors will climb sharply in Q1 to pay for essentials. Others will dig deep into their savings to raise the necessary cash.

Given the sharp jump in credit card rates --- with the average APR just hitting a record high 17.51% --- you can bet a hefty portion of the balloon payment these government employees will receive once the shutdown ends will go to paying down that debt and to replenish lost savings. This restoration of household balance sheets by will thus dampen consumer spending in Q2 as well.

Moreover, most of the 4.1 million government contractors won't see any back pay at all! So they will have to manage their expenditures more carefully even after the government reopens.

Adding to all this turmoil is the likelihood that outgoing tax refunds will be delayed in the first half of the year because IRS workers need time to recover from the disruption caused by the shutdown. Longer waits for these government checks will further scale back consumption this spring.

And then there are the intangibles factors. The government shutdown and political polarization in Washington vividly highlights the tortuous relationship between the White House and the Democratically-controlled House, which is likely to drag on for perhaps the next two years.

That certainly does not create an atmosphere that's conducive to robust consumer and business spending.

Case in point: The University of Michigan's Consumer Sentiment measure suddenly collapsed mid-January, with the index plunging to its lowest level in more than two years! Look for more of the same in Michigan's end of month survey and with the Conference Board's Consumer Confidence series.

So, painful as the shutdown is becoming in the first quarter, any forecast that projects a vigorous 4% - 5% bounce back in GDP growth in Q2 is richly optimistic --- and that is being kind.

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