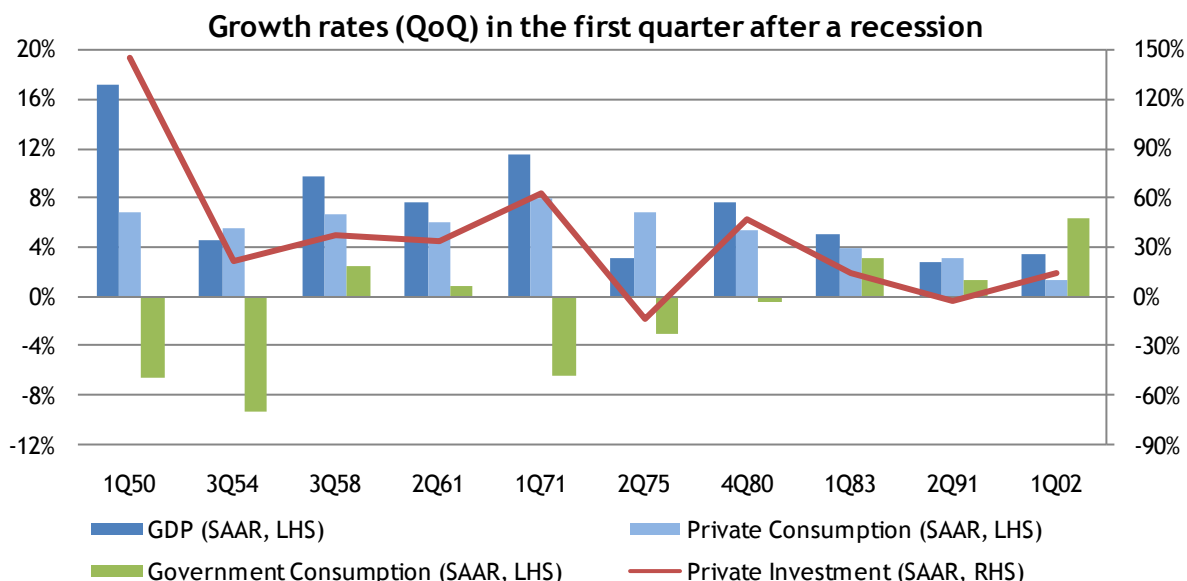


Saxo Bank Research Note. 28 October, 2009. Market Strategist Mads Koefoed

Tomorrow (29 October), the US will release its third quarter GDP report and disclose that **the economy grew at around 3.6%, we believe (consensus: 3.2%)**. While this should be enough to keep alive the widespread belief that the US economy is recovering, the underlying private economy is still sick. Growth will be achieved due to the combination of a big-spending government, consumers on life-support, and a less brutal destocking of inventories.

The average growth rate in the US economy in the first quarter for all post-WWII recessions has been 7.3%, and typically the private part of the economy acts as the catalyst. Private consumption usually grows 5.4%, while private investment increases 36.1%.

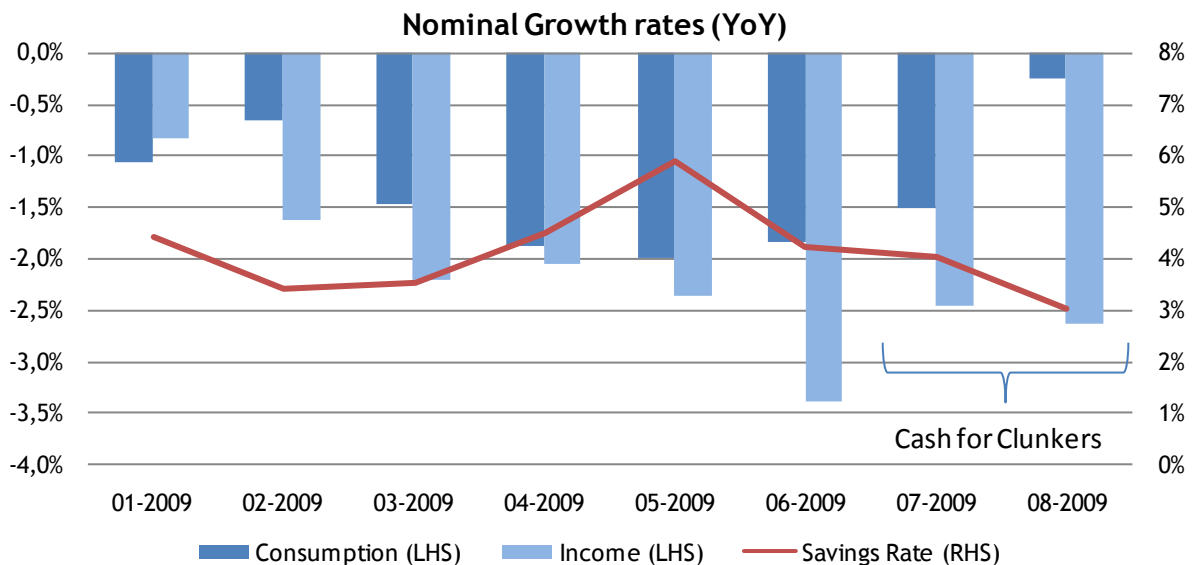


While we believe that these averages won't be reached in Q3, private consumption will rebound strongly from the sluggish Q2; aided by Cash for Clunkers and the tax credit to first time homebuyers. These programs turned out to be too hard to resist even for cash-strapped American consumers. Judged on narrow terms, the programmes did what they were supposed to do, namely stimulate demand. Despite deleveraging consumer credit at a 7.1% annualized pace in July and August, consumers could not withstand the lure of taxpayer-subsidised goods and emptied their wallets (and piggybanks) in the third quarter. The savings rate is now down to a more manageable rate, it seems, after its detour into old-school territory (+5%) in the spring.

Stimulating demand by pulling it forward will result in lower demand in the future. An early warning of the fact that subsidies will be accountable for a large part of the surge in private expenditures came in September when vehicle sales recorded their worst month since February. Retail sales less autos grew 0.5% month-on-month, but total sales suffered from the post-Clunkers hangover and fell 1.5%.

Adding to the story of stimulated demand is the President's very own Council of Economic Advisors. They believe that Q2 GDP was supported by the programme laid out in ARRA (the American

Recovery and Reinvestment Act) to the tune of 2%-3% and they expect the contribution from stimulus programs to rise to 3%-4% in Q3. The stimulus will thereafter slowly fade out and the third quarter will likely be the peak quarter in terms of stimulus-induced GDP growth. Not only will the contribution to GDP growth tend to zero from now on, but we can even expect it to be a drag on growth in late 2010.



Private investment traditionally leads the way out of a recession and should also lead this time, but it will not be anything close to historical levels, around 36%. Rather, it will be due to the now famous second derivative improvement as private investment will fall less violently than it did in the last couple of quarters. In particular, inventories should post a smaller negative change than in the previous GDP report, which is a net positive. Inventories in some parts of the economy, such as the auto industry, are already being replenished which will spur growth in both of the remaining quarters in 2009.

Government spending was vital for GDP in the second quarter and it will prove important in the third. But with the Treasury auctions regularly running in excess of \$100bn. this sort of growth cannot continue indefinitely. State and local spending is another puzzle still unsolved. Tax revenues are way down in many states and unemployment is rampant. A continuation of the second quarter consumption growth is nevertheless necessary in order to avoid a negative impact on future GDP growth rates.

The GDP report will be shaped by different stimulus packages, all of them short-term fixes. The consumer is kept alive on an expensive prescription drug of new cars and houses (the latter now looks likely to be extended). In addition, more deleveraging at the consumer level is needed to bring debt and income more in line with each other. If the objective of the stimulus was to jumpstart the private economy, that's a fail! It will achieve nothing but a couple of quarter's worth of positive growth generated by forward-pulled demand.

We expect GDP to come in around 3.6% - above the consensus of expectations, which currently reads 3.2%. Consumption, both private and public, will lead the way alongside investments while net exports will assume a more withdrawn role. Fourth quarter GDP growth will also be positive, but with the impact from stimulus waning more is required of private investment and government consumption. The consumer will remain in the vegetative state we have come to know this year, resulting in Q4 quarter-on-quarter growth of 2.9%.