U.S. Economy Shrinks For First Time Since 2009

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WASHINGTON (AP) — The U.S. economy unexpectedly shrank from October through December for the first time since 2009, hurt by the biggest cut in defense spending in 40 years, fewer exports and sluggish growth in company stockpiles. The drop occurred despite stronger consumer spending and business investment.

The Commerce Department said Wednesday that the economy contracted at an annual rate of 0.1 percent in the fourth quarter. That was a sharp slowdown from the 3.1 percent growth rate in the July-September quarter.

Economists said the drop in gross domestic product wasn't as bleak as it looked. The weakness was mainly the result of one-time factors. Government spending cuts and slower inventory growth, which can be volatile, subtracted a total of 2.6 percentage points from GDP.

But the fact that the economy shrank at all, combined with much lower consumer confidence reported Tuesday, may raise fears about the economy's durability in 2013. That's because deep automatic government spending cuts will cut into domestic and defense programs starting in March unless Congress reaches a deal to avert them.

And Americans are coming to grips with an increase in Social Security taxes that has begun to leave them with less take-home pay.

Still, the government spending cuts and slack inventory growth in the fourth quarter offset a 2.2 percent increase in consumer spending. And business spending on equipment and software rose after shrinking over the summer.

Consumer spending added 1.5 percentage points to GDP, and business investment added 1.1 points — both stronger contributions than in the third quarter.

"Frankly, this is the best-looking contraction in U.S. GDP you'll ever see," Paul Ashworth, an economist at Capital Economics, said in a note to clients. "The drag from defense spending and inventories is a one-off. The rest of the report is all encouraging."

And for all of 2012, the economy expanded 2.2 percent, better than 2011's growth of 1.8 percent.

Exports fell by the most in nearly four years, a result of Europe's recession and slower growth in China and some other large developing countries.

Incomes, though, jumped last quarter as companies paid out special dividends and bonuses ahead of expected tax increases in 2013. Commerce estimated that businesses paid nearly $40 billion in early dividends. After-tax income, adjusted for inflation, rose 6.8 percent, the most in nearly four years.

Superstorm Sandy likely also dragged on growth by closing factories, disrupting shipping and shutting down retail stores. While the department did not specify its effects on GDP, it estimated that Sandy destroyed about $36 billion in buildings and other private property and $8.6 billion in government property.

Subpar growth has held back hiring. The economy has created about 150,000 jobs a month, on average, for the past two years. That's barely enough to reduce the unemployment rate, which has been 7.8 percent for the past two months.

Economists forecast that unemployment stayed at the still-high rate again this month. The government releases the January jobs report Friday.

The slower growth in stockpiles comes after a big jump in the third quarter. Companies frequently cut back on inventories if they anticipate a slowdown in sales. Slower inventory growth means factories likely produced less.

Heavy equipment maker Caterpillar, Inc. said this week that it reduced its inventories by $2 billion in the fourth quarter as global sales declined from a year earlier.

The biggest question going forward is how consumers react to the expiration of a Social Security tax cut. Congress and the White House allowed the temporary tax cut to expire in January, but reached a deal to keep income taxes from rising on most Americans.

The tax increase will lower take home pay this year by about 2 percent. That means a household earning $50,000 a year will have about $1,000 less to spend. A household with two high-paid workers will have up to $4,500 less.

Already, a key measure of consumer confidence plummeted this month after Americans noticed the reduction in their paychecks, the Conference Board reported Tuesday.