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UNITED STATES ECONOMIC OUTLOOK

Quarterly Developments



UNITED NATIONS



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U.S. ECONOMIC OUTLOOK

I. HIGHLIGHTS

The pace of the U.S. economy's contraction has started to ease and growth is now expected to resume in the third quarter. Manufacturing and housing, two sectors that have been hard hit in this recession and have suffered some of the largest job losses, have shown signs of strengthening in recently released data. Forecasts for U.S. GDP growth in the second half of the year have been revised higher as a result. While the market forecasts' average for third-quarter GDP growth was less than 1% in April, in August it jumped up to 3.3%.

Forecasts for U.S. Economic Growth

	Q3 2009(qoq)	Q4 2009(qoq)
<i>What Markets Say</i>		
National Association of Realtors	0.7%	1.3%
Mortgage Bankers Association	2.6%	2.3%
Goldman Sachs	3.0%	3.0%
J.P. Morgan	3.0%	2.5%
Merrill Lynch	2.5%	3.0%
Moody's Economy.com	2.6%	1.9%
RGE Monitor	2.0%	1.0%
Wells Frago/Wachovia	3.4%	2.6%
<i>Forecasts average</i>	3.3%	2.9%

** All Forecasts as of August 2009.*

The U.S. economy shrank less than expected in the second quarter, with GDP declining by an annualized rate of 1% after plunging by 6.4% in the first quarter.¹ Rapidly falling inventories shaved 1.4% from GDP growth as companies shed a massive US\$ 159.2 billion in stocks. The plunge in inventories in the second quarter was the largest on record and followed a year of inventory reductions.

There was a drop of 1% in personal consumption expenditure, as consumers cut back in the face of higher unemployment. Federal spending surged by 11%, on the other hand, filling the void left by consumers and businesses. Aggressive government spending contributed to reduce the pace of the economic contraction and to stimulate the housing market and the car industry. However, the stimulus measures will come with costs, and the U.S. Administration recently issued revised national debt projections showing federal debt rising to US\$ 9 trillion over the next decade, nearly US\$ 2 trillion more than it projected in February. That would represent 5.1% of the economy's estimated GDP for the decade. According to the Congressional Budget Office, in the fiscal year ending in September 2009 the federal budget deficit will reach US\$ 1.6 trillion, or 11.2% of GDP, the highest level since the Second World War.

While recent signs of recovery in housing and manufacturing along with a summer stock market rally suggest that the recession is receding, the labor market remains under pressure. In August, the unemployment rate rose to 9.7%, its highest level in 26 years. In the minutes of its August meeting, the Federal Reserve said that it expected the unemployment rate to continue to rise and break through the 10% mark by the end of the year. Nonfarm payrolls declined by 216,000 in August, the 20th consecutive month that the U.S. economy has eliminated jobs. However, despite being a huge loss by historical standards, this was the smallest monthly decline in a year and the result was better than expected, signaling that the pace of job losses is beginning to ease. The August job losses underscore the economic improvement from the beginning of the year, when an average of 691,000 jobs was lost each month in the first quarter. Analysts have credited the rescue efforts by the Treasury Department and the Federal Reserve with stabilizing the economy and slowing job losses.

The Federal Reserve has become more confident that the economy is stabilizing and expects the economy to grow slowly in the second half of the year. However, there is less certainty about what shape the recovery will take and the economy is "still vulnerable to adverse shocks." Conditions in the labor market remain poor and "business contacts indicated that firms would be quite cautious in hiring when

¹ In June, the U.S. recession that started in December 2007 reached its 20th month.

demand for their products pick up.” The Fed chose to leave their interest-rate target at a range of zero to 0.25%, and indicated it is likely to remain in that range for an “extended period.” The Fed also slowed the final pace of its program to buy US\$ 300 billion in Treasury securities, aiming to conclude the purchases by the end of October rather than September as previously planned to ease the transition for markets. In following up on that action, the Fed will likely face a difficult task in coming months: how and when to start unwind other unconventional programs that were created to support the economy in response to the financial crisis.

Testifying before Congress on September 10, Treasury Secretary Tim Geithner said that the program that guaranteed the share price of money-market mutual funds, which hold more than US\$ 3 trillion in assets, could be unwound because the threat to these funds has eased. The program was created in 19 September 2008 after the collapse of Lehman Brothers and the resulting shock to the commercial paper market. The guarantee helped prevent a devastating run on the money-market funds. The Federal Deposit Insurance Corporation (FDIC) has also reported that it plans to either end or sharply limit a US\$ 300 billion guarantee program for bank debt by the end of October. At the Federal Reserve, an emergency support program for commercial paper, set to expire in February, is dwindling because the markets are increasingly able to fund themselves. Mr. Geithner also said that the US\$ 700 billion Troubled Assets Relief Program (TARP) probably does not need another infusion of cash, as banks seemed to have recovered enough so that the toxic asset problem no longer needs massive federal treatment. Treasury’s “stress tests” also surprised many of their critics and are now credited as a turning point for big banks in the path toward financial health.

The fact that the unwinding of a few government programs has already started one year after Lehman Brother’s bankruptcy and subsequent unraveling of financial markets, is further evidence that the financial system is healing. It also suggests that the massive intervention by the Fed and the Treasury just less than a year ago prevented the crisis from reaching the catastrophic proportions many predicted at the time. In a recent briefing, Larry Summers, Director of the White House’s National Economic Council, compared the government’s actions to “a successful but evolving response to a natural disaster”(Washington Post). “We are making a clear transition from rescue as the priority of public policy to sustained recovery,” Larry Summers said to reporters. He added, however, that “the level of unemployment is stubbornly high”, and that this time “we will not make the mistake of prematurely declaring victory or prematurely withdrawing public support for the flow of credit.”

U.S. Economic Outlook
Selected Current Data

Gross Domestic Product	Q2-2009	-1.0%
GDP Year-over-Year	Q2-2009	-3.9%
Personal Consumption	Q2-2009	-1.0%
Business Fixed Investment	Q2-2009	-13.5%
Consumer Price Index	July - 2009	-2.1%
"Core" CPI	July - 2009	1.5%
"Core"PCE Deflator	July - 2009	1.4%
Industrial Production	Q2-2009	-11.4%
Unemployment	July - 2009	9.4%
Federal Funds Target Rate	12-Aug-09	0.25%

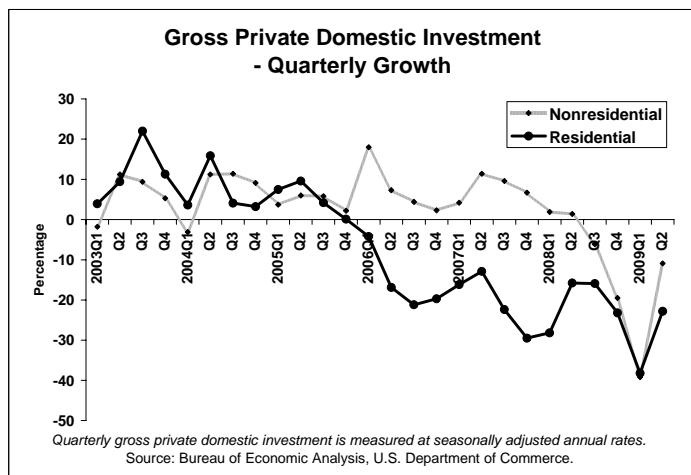
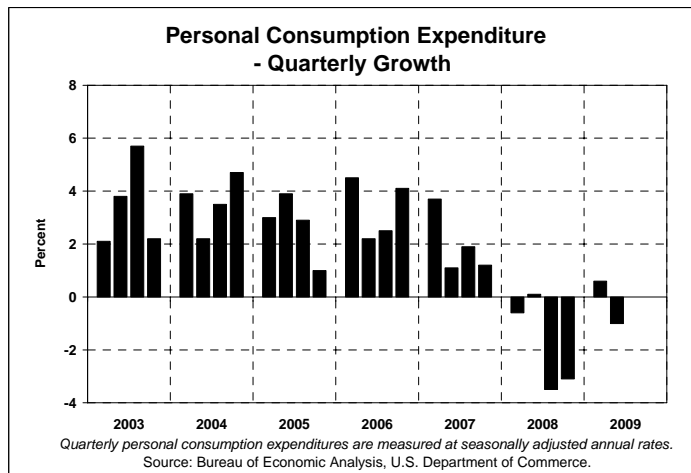
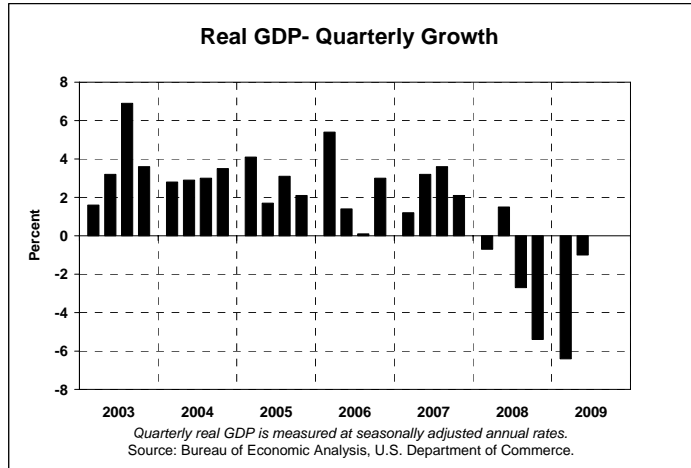
II. QUARTERLY DEVELOPMENTS

- **GDP Growth**

According to the second estimate released by the U.S. Department of Commerce on 27 August 2009, the U.S. economy contracted at an annual rate of 1% in the second quarter of 2009, following a contraction of 6.4% in the first quarter and of 5.4% in the fourth quarter of 2008. The second quarter figure reflected a drastic reduction in inventories, sharp declines in residential and nonresidential investment, as well as lower personal consumption expenditures and exports. Partial offsets were contributions from government spending at all levels. The revised release of second quarter real GDP was unchanged from the original estimate in July and was better than the 1.5% decline projected. The small overall decline suggests that the recession is now winding down.

Personal consumption expenditures decreased 1% in the second quarter, subtracting 0.7% from second-quarter growth. Data released for the first month of the third quarter on real personal consumption expenditures were encouraging, showing that they rose at a 2.6% annual rate in July, led by a 1.8% rise in durable goods spending. The “cash-for-clunkers” program, part of the stimulus package – a US\$ 1 billion government program that helps consumers buy or lease a more environmentally-friendly vehicle from a participating dealer when they trade in a less fuel-efficient car or truck – gave a big boost to auto sales in July and August.

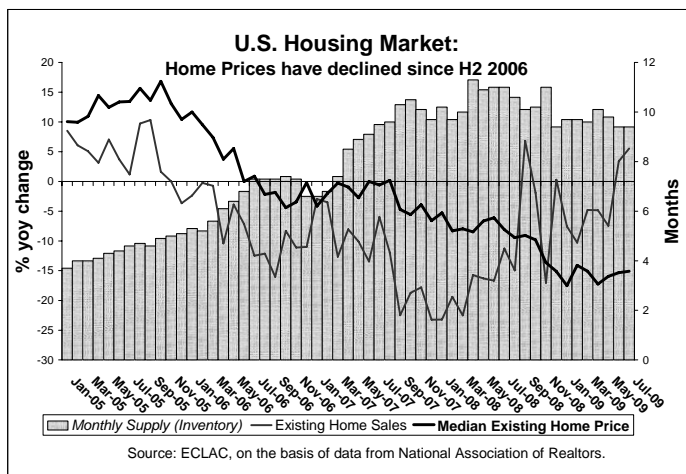
Real nonresidential fixed investment, which represents overall business spending, declined at an annual rate of 11%, a much slower rate than in the first-quarter.² Businesses are still cutting back on investment in equipment and software and in structures, but not as sharply as in the previous two quarters.



² In the first-quarter real nonresidential fixed investment declined at an annual rate of 39%.

The housing market continued to weigh on the economy, with residential investment contracting for the 14th consecutive quarter. However, the housing market downturn softened somewhat in the second quarter, with real investment in residential structures declining by 23% after plunging an annualized 38% in the first quarter. Total fixed investment (residential and nonresidential) subtracted 1.8% from overall GDP growth in the second quarter.

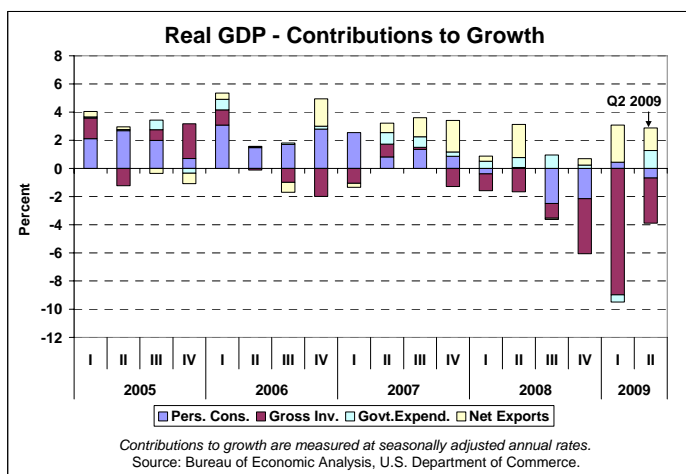
A series of recent reports indicate that the housing sector is slowly recovering. According to the Commerce Department, July's new-home sales rose to a seasonally adjusted annual rate of 433,000 homes, the highest pace since September of last year and 32% above the trough in January 2009. The improvement was supported by a US\$ 8,000 tax credit for first-time homebuyers, which expires in December – first-time buyers bought 30% of the existing homes sold in July – and by lower prices. Existing-home sales rose 7.2% in July, while the Case-Schiller home-price index posted its second straight monthly increase in June and an increase for the second-quarter – the first quarterly increase in three years.³ However, the U.S. housing market remains under pressure, as foreclosures continue to rise and home building activity remains at very low levels.



Private inventory investment declined sharply in the second quarter, subtracting 1.4% from second-quarter GDP growth. Private businesses decreased inventories by US\$ 159.2 billion in the second quarter, the largest on record. Inventory liquidation has been a drag on overall output, but with inventories now at such low levels, analysts believe that as soon as demand starts picking up businesses will need to ramp up production and rebuild inventories, which will then start to contribute to economic growth. Overall, gross private domestic investment subtracted 3.2% from GDP growth in the second quarter (with -1.8% due to fixed investment and -1.4% due to inventories).

Real federal government spending increased 11% in the second quarter, filling up the gap left by consumer and business spending. Real state and local government spending increased 3.6%. Overall, government spending contributed 1.3% to economic growth in the second quarter.

A shrinking trade deficit added 1.6% to overall growth. Exports fell at an annual rate of 5% in the second quarter, subtracting 0.5% from growth. Imports fell at an annual rate of 15%, adding 2.1% to growth.



In summary, the major contributors to U.S. growth in the second quarter of 2009 were government expenditures and trade, which were largely offset by decreases in gross private domestic investment and in personal consumption expenditures, leading to a net contraction in growth.

³ Since peaking in the second quarter of 2006, home prices are down by 30.2%.

Looking forward, small inventories are an indication that production will increase in the third and fourth quarters. Stocks are now so low that production will have to pick up quickly to answer to an increase in sales. Businesses aggressive slashing of inventories in the second quarter, following a year of inventory reductions, also helped fuel an increase in corporate profits. Profits from current production (corporate profits with inventory valuation and capital consumption adjustments) increased at a 5.7 % quarterly rate in the second quarter. As businesses become more profitable, they are more likely to resume making investments. Strong growth in corporate profits, combined with government revisions to second-quarter data showing a better than expected 1% GDP contraction, reinforced perceptions that the U.S. economy is rebounding from its longest, broadest and deepest economic contraction since the 1930s.

However, consumer credit declined at an annual rate of 10.4% in July 2009, falling by a record US\$ 21.5 billion. In the current recession, the finances of the U.S. consumer have been severely strained as a result of the erosion of housing and financial-sector wealth combined with sharp job losses. In response, consumers have embarked in a process of cutting borrowing and increasing savings in an attempt to repair their balance sheets. A rising savings rate and the difficult credit conditions bode ill for a quick rebound in consumer spending, weakening the prospects for a broader recovery in the near future.

- **Sectoral Developments**

Total industrial production declined at a slower rate in the second quarter (-10.5% SAAR),⁴ with manufacturing output falling 9%. There was a much smaller decline in auto output (motor vehicles and parts) in the second quarter – -13.8%, compared to -69.5% in the first quarter.

In July, output registered the first monthly increase since October 2008 (1%), which was followed by a 0.8% increase in August. A surge in vehicle output, combined with stabilization in other segments, led to a healthy rise in manufacturing output in July and August. The motor vehicle industry reported a 20% increase in auto production in July, following three months of decline, as automakers resumed production at many plants that were shut down for much of the second quarter. The rebound in the manufacturing sector has been supported by slower inventory liquidation, increased vehicle production, increasingly easier credit and increased foreign demand.

	Total Industrial Production		Capacity Utilization Rate
	Index 2002=100	Percentage Change From Previous Period	(%) Total Industry
2008 Q4	104.4	-13.0	74.2
October	106.2	1.3	75.4
November	104.8	-1.3	74.4
December	102.4	-2.3	72.7
Annual	108.8	-2.2	77.6
2009 Q1	99.1	-19.1	70.4
January	100.1	-2.2	71.1
February	99.3	-0.8	70.6
March	97.7	-1.6	69.5
2009 Q2	96.4	-10.5	68.6
April	97.2	-0.6	69.2
May	96.1	-1.1	68.5
June	95.8	-0.4	68.3
2009 Q3	n.a.	n.a.	n.a.
July	96.7	1	69.0
August	97.4	0.8	69.6

Source: Federal Reserve, Industrial Production and Capacity Utilization

Note: Quarterly changes are at annual rates. Annual changes are calculated from annual averages.

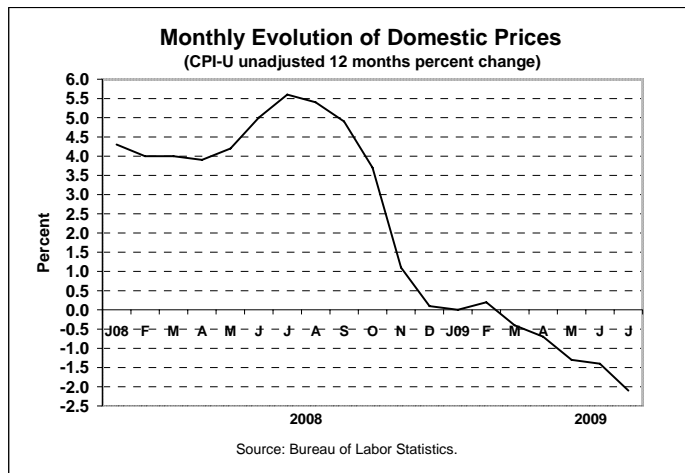
Recent manufacturing economic indicators show that manufacturing activity is indeed turning around. The Commerce Department reported that factory orders rose in July, the fifth increase in the past six months. Orders for durable goods surged at their fastest pace in two years. In addition, the Institute for Supply Management (ISM) manufacturing index, which has risen for eight consecutive months, increased

⁴The first-quarter decline (-19.15) was the largest quarterly decrease since 1975.

more than expected in August, crossing into expansionary territory for the first time since January 2008. The larger than expected August ISM increase is a positive for third-quarter growth. The manufacturing sector is expected to be one of the main drivers of GDP growth in the second half of the year.

- **Inflation**

The Consumer Price Index for All Urban Consumers (CPI-U) increased at a seasonally adjusted annual rate (SAAR) of 3.3% in the second quarter of 2009, following a 2.2% increase in the first quarter. This brings the year-to-date SAAR to 2.7% and compares to a 0.1% increase for all of 2008. The index for energy, which fell 21.2% in 2008 due to a collapse in prices in the second half of the year, advanced at a 14.8% annual rate in the first six months of 2009. The food index fell at a SAAR of 1.1% in the first semester of 2009, after rising 5.9% during 2008.



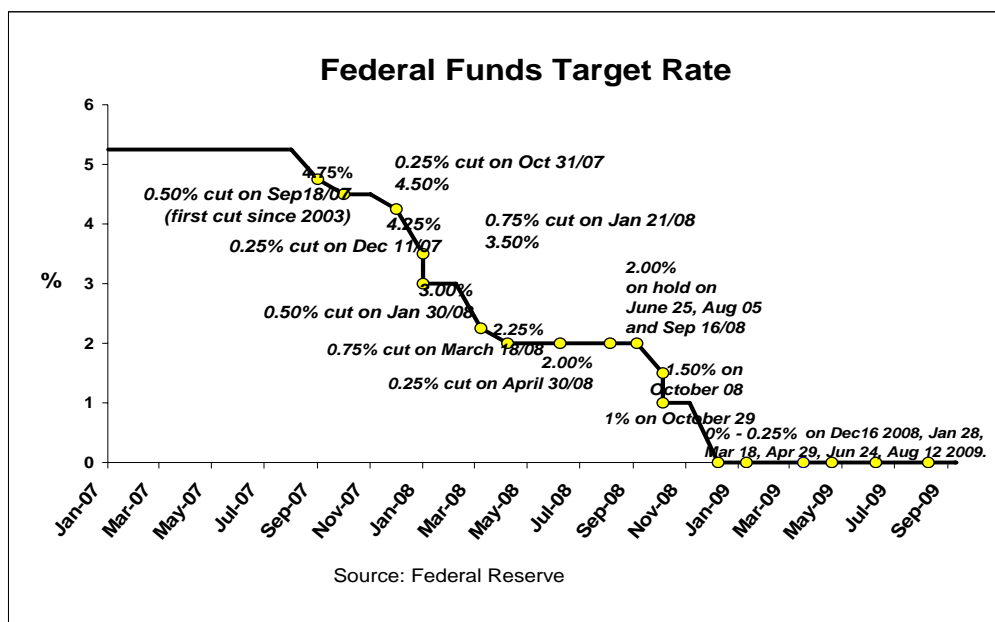
Excluding food and energy, the CPI-U advanced at a 2.4% seasonally adjusted annual rate in the second quarter, after rising at 2.2% in 2008. The increase of 2.3% over the first six months of 2009 compares to a 1.8% increase in 2008.

The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) price index excluding food and energy – advanced at an annualized 2.0% in the second quarter – considered the top threshold for the Federal Reserve (consistent gains above 2% are considered a concern for policymakers and investors) – increasing from a 1.1% rate in the first quarter. Government officials have so far worked on the assumption that inflation will remain sluggish, but will pay attention to data that could challenge this view. Key factors to focus on are inflation expectations and final demand, especially consumer spending. Likewise, if core inflation does not fall to about 1.5% by the end of this year, policymakers may reconsider their view on spare capacity and prices.

Following a monthly increase of 0.7% in June, the CPI-U was unchanged in July, mostly because gas prices stabilized after a steep increase in June. The energy index, which rose 7.4% in June, fell 0.4% in July. From July 2008 to July 2009 the CPI-U index has fallen 2.1% as a result of a 28.1% decline in the energy index since its July 2008 peak, which has more than offset increases of 0.9% in the food index and 1.5% in the index for all items less food and energy. The 12-month unadjusted core inflation rate in July was 1.5%.

- **Monetary Policy**

The Federal Open Market Committee (FOMC) began to ease monetary policy in September 2007 and continued to ease in response to a weakening economic outlook, bringing the cumulative monetary policy easing to 425 basis points by October 2008 (from a rate of 5.25% in September 2007 to 1% in October 2008). In December 2008, the Committee set a range of 0 to 25 basis points for the target federal funds rate.



The FOMC has met four times since the end of the first quarter of 2009 (one of them unscheduled)⁵ and kept monetary policy unchanged. In its last meeting on 11-12 August, the Committee indicated that risks to the U.S. economy had eased “considerably”, but low interest rates would be needed for an “extended period” to bolster the recovery. According to the Fed, banks still face a “sizable risk” of additional credit losses, with small and medium-sized banks being particularly vulnerable to deteriorating commercial real estate performance. In August, the Federal Reserve and the Treasury extended the *Term Asset Backed Securities Loan Facility (TALF)* through 31 March 2010 (with some aspects running until the end of June) – a move that may cushion the commercial real estate industry – saying in a statement that consumer and business loan and commercial real estate markets were still “impaired” and were likely to remain so for some time.⁶

The Fed also discussed the timing and pace of exit policies in its August meeting, including whether the program for purchasing mortgage-backed securities (MBS) and agency bonds should be extended beyond the current end-year expiration date, as well as instruments to absorb excess liquidity in the future, including large-scale reverse repos and a term deposit facility. Taking a small step towards normalcy, the Fed announced it was winding down its program to buy US\$ 300 billion in Treasury securities and that it was also slowing its final pace, aiming to conclude the purchases by the end of October rather than September, as previously planned, in order to ease the transition for markets.

An internal estimate by the Federal Reserve – based on the difference between the fees and interest on the lending facilities, and the interest the Fed would have earned had it invested the funds in three-month Treasury bills – indicates that the Fed has made a US\$ 14 billion profit on loan programs that have provided liquidity to the financial system since the start of the crisis two years ago. The most profitable liquidity programs were the *Commercial Paper Funding Facility (CPFF)* and the foreign exchange swap agreements, followed by the *Term Auction Facility (TAF)*, according to the New York

⁵ On 3 June 2009, the Committee met by conference call in a joint session with the Board of Governors to review recent economic and financial developments, including changes in the Federal Reserve’s balance sheet.

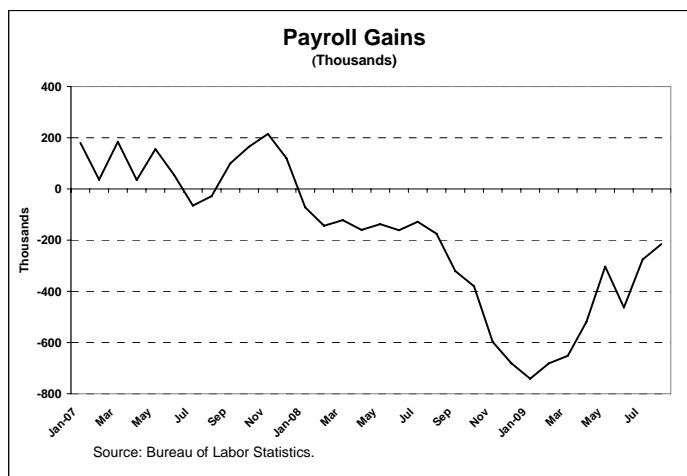
⁶ Under TALF the Fed makes low-interest loans to investors and offers them protection against losses; investors in turn use the cash to buy securities backed by a wide range of assets – from credit card debt to auto loans. The aim of the program is to get credit to consumers, businesses and commercial real estate borrowers. The Treasury provides financial support to the Fed for any losses on the loans.

Fed. The internal estimates suggest that the fees earned on the loans were high enough to not only cover defaults to date, but to also leave a cushion against future losses on these loans and other parts of the Fed portfolio.

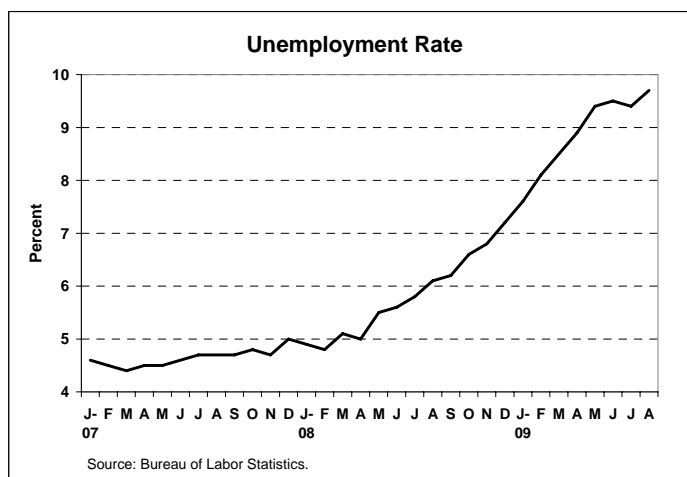
The September Beige Book was more upbeat than previous reports, showing a moderation in the pace of the economic contraction in all regions of the country. The “cash-for-clunkers” program supported auto production and auto sales in many districts, and manufacturing conditions showed signs of improvement. However, the report confirmed that the flow of credit is not back to normal yet and that the labor market is still in bad shape. Although job cuts are moderating, hiring has not resumed yet.

- **Labor Markets**

The latest nonfarm payrolls data indicates that the U.S. job losses slowed more than expected in August, but the unemployment rate soared to its highest level since June 1983. Nonfarm payrolls declined 216,000 in August – the 20th consecutive month that the U.S. economy has shed jobs – compared to a revised 276,000 drop in July. Job losses, although lower than in recent months, remained broad-based. The economy has come far since the beginning of the year, when an average of 691,000 jobs was lost each month in the first quarter (compared to a monthly average of 428,000 jobs lost in the second quarter). The overall economy has lost 6.9 million jobs since the recession started in December 2007, with 3.9 million being lost from January to August 2009.

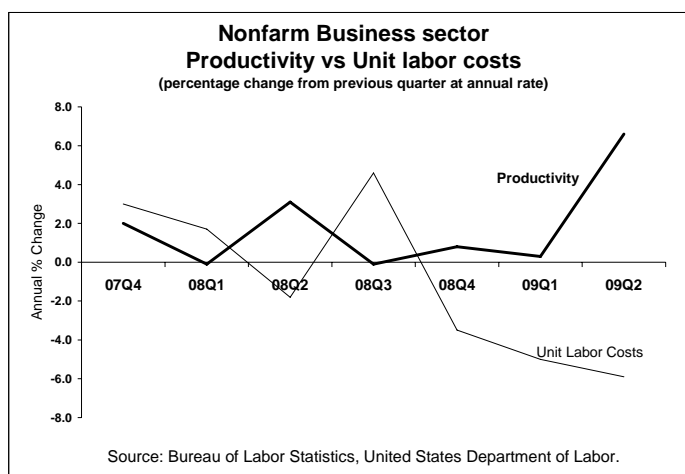


The unemployment rate, calculated in a separate survey, resumed its climb in August after dipping in July. It rose to 9.7% from 9.4%, its highest level in 26 years, offering a bleak reminder that the labor market remains under pressure, even as other data suggest that the pace of the economic contraction is slowing.⁷ The labor force participation rate was at 65.5% in August. Policymakers are fearful that high levels of unemployment will persist, as companies that aggressively cut jobs in the past year remain cautious about rehiring. The Federal Reserve in its latest meeting’s minutes, and Christina Romer, head of the President’s Council of Economic Advisers, have recently said that they see unemployment breaching 10% by the end of the year.



⁷ According to the Wall Street Journal, by broader measures, unemployment increased even more. When involuntary part-time and marginally attached workers are included, the rate of unemployment or underemployment reached 16.8% in August, 0.5% higher than in July.

While unemployment has climbed in recent months, as firms continued to shed workers and cut back on the number of hours worked in response to the economic crisis, U.S. workers who still have jobs have become more productive. According to government figures, productivity for the nonfarm business sector, a measure of business efficiency, increased by an annualized rate of 6.6% (SAAR) in the second quarter. This was the largest productivity increase since the third quarter of 2003, and reflects declines of 1.5% in output and 7.5% in hours worked. Year-on-year productivity (from the second quarter of 2008 to the second quarter of 2009), which measures output per hour, was up by 1.9%, reflecting declines of 5.5% in output and 7.2% in hours worked.



Hours worked declined at a 7.6% annual rate in the second quarter, and output fell at a 1.5% annual rate. Labor costs decreased at a 5.9% annual rate in the second quarter, the largest quarterly decline in unit labor costs in nine years. With strong productivity gains, combined with weak growth in compensation, unit labor costs are falling.

Productivity and costs: Revised second quarter 2009 annual averages

(Seasonally adjusted annual rates)

Sector	Productivity	Output	Hours	Hourly compensation	Real hourly compensation	Unit labor costs
Percent change from preceding quarter						
Business	6.5	-1.4	-7.5	0.2	-1.2	-6.0
Nonfarm business	6.6	-1.5	-7.6	0.3	-1.0	-5.9
Manufacturing	4.9	-9.8	-14.0	5.1	3.7	0.2
Durable	3.1	-16.4	-18.9	7.9	6.5	4.6
Nondurable	2.2	-3.2	-5.3	1.5	0.2	-0.7

The final report on productivity and costs for the second quarter shows that with aggressive job cuts in the first half of this year, and with the pace of economic contraction slowing in the second quarter, productivity growth was very strong. Firms met lower demand with even lower hours, leading to productivity gains. The strong second-quarter productivity report suggests that when demand starts to increase as the U.S. economy comes out of recession, likely sometime in September, employers may need to quickly start adding hours and workers to match demand.

- **Financial Markets**

Capital markets have shown a remarkable recovery. While in the last months of 2008 some of the safest companies were shut out of the market, debt issuance since the beginning of the year has soared. In face of recent data pointing to a slower pace of contraction, investors now have to evaluate if they still want to buy bonds issued by companies or whether confidence in an economic recovery translates into stronger demand for equity offerings. Although the amounts of debt and equity issuance remain lower

than during boom years for riskier companies, the pace has picked up for these companies too and there are many plans for new deals. After reaching a bottom in March, equity prices picked up, with the Dow Jones, the S&P 500 and the NASDAQ gaining 12%, 15% and 23%, respectively, in the second quarter.

After reaching a peak in June, U.S. Treasury yields have started to fall. As confidence in the economic rebound increases, investors have started to move away from government bonds towards riskier assets in search for yield. However, some bond bulls suggest that investors will actually cut risky assets and move money to government bonds in coming months, because stocks have become less attractive in the wake of the powerful rally since March. Indeed, some who called a bottom in March, when the markets hit their worst levels in more than a decade, now say they are detecting a peak in share prices, and they warn that stocks may be headed for a pullback.

Stock Prices			
Monthly Stock prices			
	Dow Jones Industrial Average	S&P 500	Nasdaq
2009			
January	8396.2	865.58	1537.2
February	7690.5	805.23	1485.98
March	7235.47	757.13	1,432.23
April	7,992.12	848.15	1,641.15
May	8,398.37	902.41	1,726.08
June	8,593.00	926.12	1,826.99
July	8,679.75	935.82	1,873.84

Source: Economic Indicators, U.S. Government Printing Office.

U.S. Treasury Security Yields			
Constant Maturities			
Monthly Yields			
2009	3-year	10-year	30-year
January	1.13	2.52	3.13
February	1.37	2.87	3.59
March	1.31	2.82	3.64
April	1.32	2.93	3.76
May	1.39	3.29	4.23
June	1.76	3.72	4.52
July	1.55	3.56	4.41

Source: Economic Indicators, U.S. Government Printing Office.

President Obama delivered a speech on the occasion of the first anniversary of the Lehman Brothers' collapse urging Wall Street to cooperate with Congress on the "most ambitious overhaul of the financial system since the Great Depression." His intention was to breathe life into the Administration's regulatory reform proposal which has been sent to Congress. With concerns about rising government debt and deficits growing, he wanted to reassure the public that the era of big government bail-outs was drawing to a close. Senior lawmakers hope to introduce the legislation by late October, with a series of hearings to be announced soon.

With regards to the banking sector, the Federal Deposit Insurance Corporation (FDIC) announced at the end of August that the number of "problem" banks, those considered at risk of failure, jumped to 416 during the second quarter, reaching a 15-year high. Meanwhile, the agency's deposit insurance fund, which insures up to US\$ 250,000 per depositor in each bank, fell to US\$ 10.4 billion at the end of June, which FDIC officials said was the lowest level since March 1993, down from more than US\$ 50 billion last year. The FDIC has already charged the banking industry an emergency fee during the second quarter to raise US\$ 5.6 billion and bolster the insurance fund, but it may be forced to impose another fee before the end of the year. FDIC-insured banks reported a net loss of US\$ 3.7 billion in the second quarter, compared with US\$ 4.8 billion in profits the industry reported in the second quarter of 2008. Regulators have shut 81 banks so far this year.

FDIC Chairman Sheila Bair said that "while changes remain, evidence is building that the U.S. economy is starting to grow again," adding that "Banking industry performance is – as always – a lagging indicator. The banking industry, too, can look forward to better times ahead."

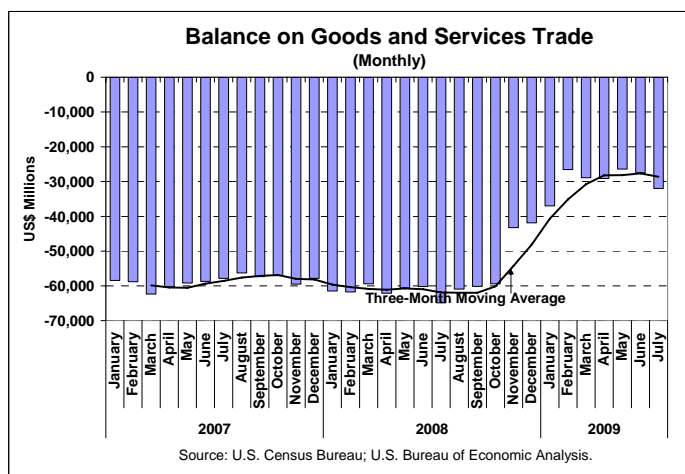
Another increasing concern regarding the banking sector has been that since the credit crisis struck last year, tens of billions of dollars have been pumped into leading financial institutions on the fear of a systemic effect. Since these interventions many smaller banks have failed, causing the biggest banks,

which have not been allowed to fail, to now keep an even bigger share of the market. Regulators now worry that consumers may wind up with fewer choices for services and that big banks will assume they always have the government’s backing. According to Treasury Secretary Tim Geithner, “The dominant public policy imperative motivating reform is to address the moral hazard risk created by what we did, what we had to do in the crisis to save the economy”, he said recently.

Net long-term flows, according to the Treasury International Capital (TIC) report, jumped to US\$ 90.7 billion in June, as foreigners increased their holdings of U.S. financial assets. The U.S. trade deficit in June was US\$ 27.5 billion, thus capital flows were more than enough to finance it. Foreigners’ net purchases of U.S. Treasury bonds and notes were US\$ 22.5 billion, up from –US\$ 21.8 billion in May, while net purchases of equities came in at US\$ 2.2 billion; their net purchases of other U.S. financial assets – government agency bonds and corporate bonds – were negative, however. Foreign private investors’ appetite for U.S. long-term financial assets continued to be healthy in June: they purchased US\$ 78 billion of Treasury bonds and notes. Reflecting overseas participation in the U.S. stock market rally, foreign private investors’ net purchases of U.S. equities came at US\$ 16.9 billion in June, following purchases of US\$ 16.9 billion in May.

- **External Sector**

According to the second GDP estimate released by the U.S. Department of Commerce on 27 August, trade deficit, as a percent of GDP, fell to 2.4% in the second quarter of 2009 from 2.7% in the first. This is the smallest deficit in a decade, and it is less than half of the deficit shown in the second quarter of 2008 (5.1%), when recession in the U.S. was just starting and the economic downturn was not yet hammering other economies. The U.S. trade deficit declined in the second quarter as a result of a worldwide recession that has contributed to reduce the global economic imbalances that have grown to unprecedented sizes in the past few years. The shrinking trade deficit was not the result of a rebound in exports. Quite the contrary, exports fell at a 5% rate in the second quarter. Imports, however, are declining even more, and fell at an annual rate of 15.1% in the second quarter of 2009.



In July, according to the latest Department of Commerce’s report on International Trade in Goods and Services, exports of US\$ 127.6 billion and imports of US\$ 159.6 billion resulted in a goods and services deficit of US\$ 32 billion in July. The July increase in trade volumes is a sign of the long-awaited recovery in international trade. Much of July’s increase is focused on automobiles, parts and engines. These increases, with imports outpacing exports, help explain much of the increasing trade deficit with Canada, as U.S. auto manufacturing is well-integrated across the U.S.-Canadian border. The U.S. bilateral trade with China grew in July to US\$ 20.4 billion, the trade gaps with Japan and the European Union also grew, but the trade deficit with Mexico narrowed.

Imports were driven by a jump in demand for foreign cars, oil and consumer goods, signaling a welcome increase in domestic demand for car parts and computers (imports of autos and auto parts spiked by 21.5%), while increases in price and volume of crude-oil imports also contributed. Much of the demand for car parts was encouraged by the “cash-for-clunkers” program, as auto makers increased production.

III. LOOKING AHEAD

- The U.S. economic outlook improved in the second quarter, as manufacturing activity and the housing sector showed signs of strengthening. Despite uncertainty regarding the shape of the future recovery, conditions are better than many anticipated, and at the end of July forecasters began to increase their estimates for U.S. GDP growth in 2009 and 2010. Current market projections for real GDP growth in 2009 now range from -2.9% to -2.5% (these forecasts were made mostly in August). For 2010 they forecast growth between 1.4% and 3.0%.

Forecasts for Annual U.S. Economic Growth

		Real GDP (year-over-year growth)			
		2009	2010	Date of Forecast	Previous Forecasts
A. What Government Agencies Say					
Administration (Office of Management and Budget)		-2.8%	2.0%	Aug-09	-1.2%/3.2% in Feb-09
FED*		-1.5 to -1.0%	2.1 to 3.3%	Jun-09	-2.0 to -1.3%/2.0 to 3.0% in Apr-09
CBO		-2.5%	1.7%	Aug-09	-3.0%/ 2.9% in Mar-09
B. What Markets Say					
Morgan Stanley		-2.5%	2.7%	Sep-09	
National Bank of Canada		-2.5%	2.5%	Aug-09	-2.8%/2.5% in Jul-09
National Association of Realtors		-2.9%	1.5%	Aug-09	-2.7%/1.6% in Jun-09
Bank of America/Merrill Lynch		-2.7%	2.5%	Aug-09	-2.5%/ 1.7% in Jun-09
Moody's Economy.com		-2.7%	1.7%	Aug-09	-3.0%/ 1.2% in Jun-09
The Economist Intelligence Unit		-2.5%	1.4%	Aug-09	-2.9%/ 1.0% in Jun-09
JPMorgan		-2.6%	3.0%	Aug-09	-2.4%/ 1.8% in Jun-09
Wells Fargo/Wachovia		-2.5%	2.1%	Aug-09	-2.7%/ 2.1% in Jun-09
Mortgage Bankers Association*		-0.7%	2.2%	Aug-09	-1.6%/ 2.5% in Jun-09
Market Average**		-2.6%	2.2%		
C. What International Organizations Say					
United Nations DESA (Baseline)		-3.5%	1.0%	May-09	
World Bank		-3.0%	1.8%	Jun-09	-2.4%/ 2.0% in Mar-09
OECD		-2.8%	0.9%	Jun-09	-4.0%/ 0.0% in Mar-09
IMF		-2.6%	0.8%	Jul-09	-2.8%/ 0.0% in Apr-09; -2.5%/0.75% in Jun-09

* forecast on a Q4 to Q4 basis.

Note: the CBO, IMF, and OECD forecasts on a Q4 to Q4 basis are -1.0%, -1.4%, and -1.7%, respectively, for 2009; and 2.8%, 1.7%, and 1.5% for 2010.

** average does not include the Mortgage Bankers Association.

- A rebound is now expected in the third quarter. The issue now is how sustainable this rebound will be, and to what extent the current growth momentum could be more closely linked to improvement in final demand as opposed to inventory restocking and/or government spending.
- In July, consumers borrowed less for the sixth consecutive month, fueling concerns that strained consumers will stall an economic recovery. The current credit conditions do not bode well for a quick rebound in consumer spending, and economists predict that the savings rate will continue to rise as consumers cut back on borrowing. The economy's recovery in coming months is seen driven by the rebuilding of inventories – following an aggressive reduction in inventories by companies – and increased government spending.
- However, as a summer stock rally and recent signs of economic stabilization raises optimism that the recovery could be in sight, U.S. consumer confidence hit a three-month high according to the September preliminary Reuters/University of Michigan consumer survey. Consumer sentiment is closely watched as a gauge of future consumer spending, but economists warn that the rise in confidence could be largely due to temporary stimulus measures, such as the recent “cash-for-clunkers” car rebate program and the tax credit for first-time homebuyers. Consumer weakness may persist for some time, and consumer spending may be less representative of broader demand than in the past.

- The recession has reduced families' earnings, increased poverty and left more people without health insurance, according to the Census Bureau's annual snapshot of living standards. Media household income, adjusted for inflation, fell 3.6% last year to US\$ 50,303, the steepest year-over-year decline in forty years. The poverty rate, at 13.2%, was the highest since 1997. About 700,000 more people did not have health insurance in 2008 than in the year before, although the share of the population without coverage remained the same.
- The impact of the economic recession on jobs, income and poverty combined with more difficult credit conditions has left the finances of the U.S. consumer strained, but the recent release of retail sales in August brought some good news on the consumer front. Sales rose 2.7%, with the expected boost from the "cash-for-clunker" car rebate program, but accompanied by a surprise increase in other spending as well. The August rate was the highest monthly rate in three years and showed consumers returning to stores. This raised hopes that U.S consumers might be re-emerging from the recent economic slump, and prompted Fed Chairman Ben Bernanke to declare that the recession is "very likely over."
- Top officials are still hesitant to bank on a strong recovery, however. The considerable growth expected in the third quarter is due in part to short-term effects such as companies replenishing inventories and government's programs. Higher savings by households is still casting doubt on consumer spending. And even the moderate growth officials expect next year would not be enough to bring the unemployment rate down substantially. The economy has so much slack that Fed officials expect core inflation to drift lower in 2010, although they vow to keep an eye for any changes that may alter this view. The recovery is so far expected to be moderate at best, and is expected to remain vulnerable to shocks.
- One of the large unknowns is how well the U.S. economy will fare once the huge fiscal and monetary stimulus supplied by the government is removed. It seems that there is a consensus among policymakers that erring by keeping an easy monetary policy for a longer period is preferable to cut the incipient rebound short by tightening too early.