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UNITED STATES ECONOMIC OUTLOOK

Quarterly Developments



UNITED NATIONS



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U.S. ECONOMIC OUTLOOK

I. HIGHLIGHTS

As the U.S. entered into its 18th month of official recession in May – the longest slowdown since the Great Depression – recent data have shown glimmers of stabilization. According to the Conference Board Consumer Confidence Index, consumer confidence edged higher in March and recovered further in April. Consumers continue to see current conditions as bleak but are becoming much more upbeat about the outlook, particularly for jobs and business conditions. The Institute of Supply Management (ISM)'s manufacturing survey, as well as most regional manufacturing surveys, showed signs of improvement in April. The pace of U.S. job losses also lessened in April, with nonfarm payrolls showing the smallest decline in six months.

The pace of economic contraction is expected to reduce in coming months. The economy is expected to shrink again in the current quarter, but at a slower pace, and level off in the second half of the year. Inventories are coming down, and both Chrysler and General Motors, the big U.S. automakers that are undergoing a process of substantial restructuring, have a considerable inventory overhang that should be pushed back in the coming months, helping to reduce the stock of cars and light trucks. Government spending is also poised to increase, as the stimulus package begins to make an impact. On average, markets expect growth to contract at an annual pace of about 1.8% in the second quarter, and to increase at an annual pace of 0.3% in the third.

Forecasts for U.S. Economic Growth

	Q2 2009(qoq)	Q3 2009(qoq)
<i>What Markets Say</i>		
National Association of Realtors	-1.7%	0.3%
Merrill Lynch	-5.0%	3.0%
Moody's Economy.com	-1.9%	-0.7%
J.P. Morgan	-0.5%	1.0%
Wachovia	-0.9%	-1.7%
Mortgage Bankers Association	-0.6%	0.0%
<i>Forecasts average</i>	-1.8%	0.3%

** All Forecasts as of April 2009.*

There has been a significant reversal in investment sentiment in recent weeks as investors start to see the U.S. economy approaching a bottom and recession coming to an end. JPMorgan, for example, said that it is raising its GDP forecast for the first time in a long time, as both the economic data and sentiment and financial market indicators are improving ahead of schedule. Markets seem somewhat more optimistic than the Fed, however. The Federal Open Market Committee (FOMC) met on April 29 and indicated that “although the economic outlook has improved modestly since the March meeting, partly reflecting some easing of financial market conditions, economic activity is likely to remain weak for a time.” According to the FOMC, “household spending has shown signs of stabilizing but remains constrained by ongoing job losses, lower housing wealth, and tight credit.” Given that unemployment and excess capacity are rising, deflation remains a concern. Going forward, “the Committee sees some risks that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.” However, although the economy has continued to contract, the FOMC acknowledges that “the pace of contraction appears to be somewhat slower.”

The Fed kept policy unchanged, signaling it will hold interest rates low and continue to buy up government bonds and other debt for a while. The Fed also left open the option of accelerating or extending these purchases at the next policy meeting, if required by changes to its forecast: “the Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.”

According to Paul Volcker, the head of President Obama's Economic Recovery Advisory Board, in a recent interview to Bloomberg Television, the U.S. economy is “leveling off at a low level” and doesn't need a second fiscal stimulus package. Christina Romer, head of the White House's Council of Economic Advisers, told lawmakers at the end of April that “glimmers of hope” for an economic recovery

were emerging. Still, she added, “in the short run we are still in for more bad news.” The large decline in inventories and an upturn in consumer spending after two consecutive quarters of decline suggest the economy may be closer to the day when it resumes growing. Moreover, as the impact of the fiscal stimulus kicks in, government spending should start to add to growth.

However, the current signs of stabilization are fragile, and large downside risks remain. Consumer spending may turn negative again if job losses intensify. Consumer confidence is also vulnerable, and a disorderly bankruptcy of Chrysler or GM, for example, could adversely affect it. Even if the economy does pick up in the second half of the year, it is unlikely to resume growth quickly enough to absorb the backlog of commercial property available (office, hotel and retail space that is now vacant). The consumer, therefore, will likely remain crucial for future growth prospects and the economy dependent on government support for a time.

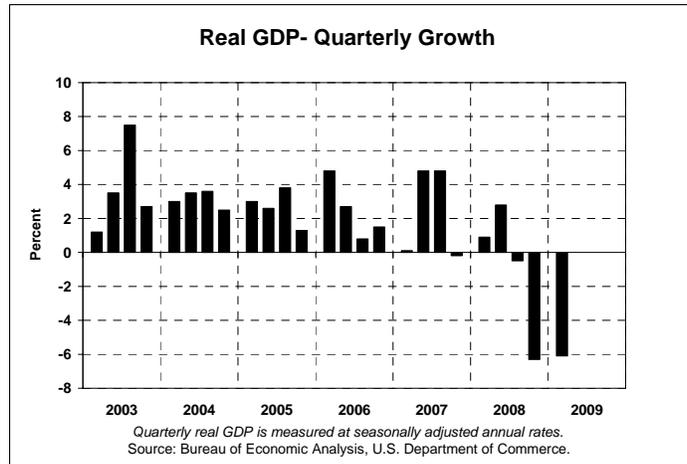
**U.S. Economic Outlook
Selected Current Data**

Gross Domestic Product	Q1-2009	-6.1%
GDP Year-over-Year	Q1-2009	-2.6%
Personal Consumption	Q1-2009	2.2%
Business Fixed Investment	Q1-2009	-37.9%
Consumer Price Index	March - 2009	-0.4%
"Core" CPI	March - 2009	1.8%
"Core"PCE Deflator	March - 2009	1.8%
Industrial Production	March - 2009	-4.1%
Unemployment	April - 2009	8.9%
Federal Funds Target Rate	29-Apr-09	0.25%

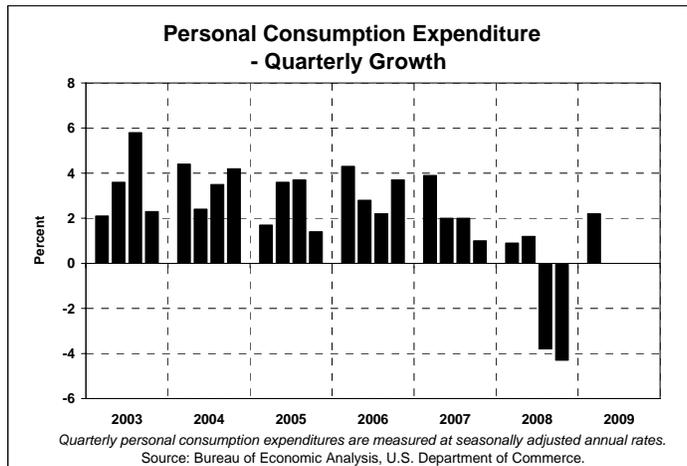
II. QUARTERLY DEVELOPMENTS

- **GDP Growth**

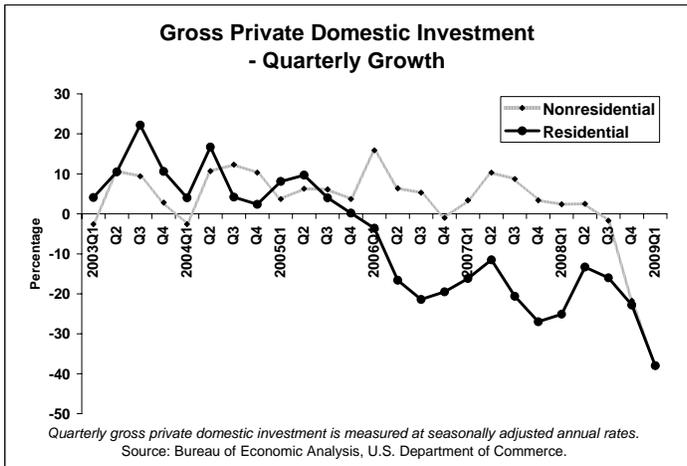
According to the “advance” estimates¹ released by the U.S. Department of Commerce on April 29, the U.S. economy contracted at an annual rate of 6.1% in the first quarter of 2009, following a contraction of 6.3% in the fourth quarter of 2008. The 6.2% annualized decline in real GDP over the past six months has been the steepest two-quarter drop in real GDP since 1958, and this is the first time since 1975 that the U.S. economy has contracted for three quarters in a row. Exports, inventories, government expenditures and investment subtracted from GDP growth in the first quarter, whereas consumption expenditures had a positive contribution.



Consumer spending rebounded slightly, growing at an annual rate of 2.2%, the most in two years. Spending on durable goods increased 9.4%, following a decrease of 22.1% in the fourth quarter. Nondurable goods increased 1.3%, following a decrease of 9.4%. Services increased 1.5%, the same increase as in the fourth. Boosted by tax cuts and greater government spending, consumer demand may be stabilizing. Personal consumption expenditures added 1.5% to growth in the first quarter.



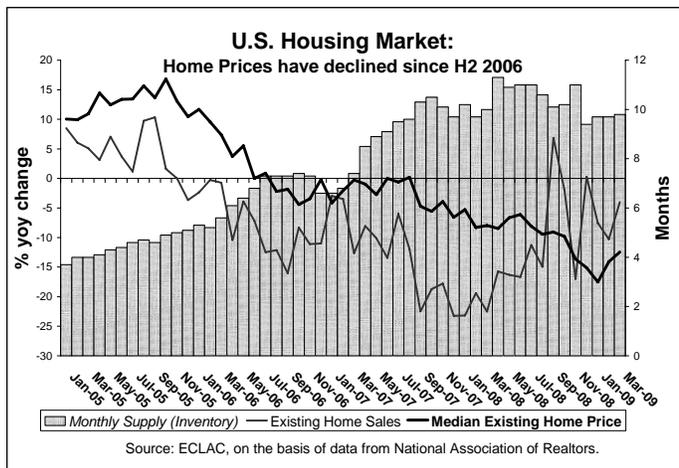
Real nonresidential fixed investment, which represents overall business spending, declined at an annual rate of 37.9%, the steepest decline since records began. It followed a decline of 21.7% in the fourth quarter. Spending on equipment and software declined by 33.8% after dropping by 28.1% in the fourth quarter. Investment in nonresidential structures plunged by 44.2%, following a smaller decline of 9.4% in the fourth quarter. Businesses are cutting back sharply on investment in equipment and software and in structures. Real nonresidential fixed investment subtracted 4.68% from first-quarter growth.



¹ The Bureau of Economic Analysis emphasized that the first-quarter “advance” estimates are based on source data that are incomplete or subject to further revision by the source agency.

The housing market continued to weigh on the economy, with residential investment contracting for the 13th consecutive quarter. The housing market downturn actually intensified in the first quarter, with real investment in residential structures plunging an annualized 38%, following a decrease of 28.1% in the fourth quarter. This was the weakest quarter in a housing downturn that started in early 2006. Real residential fixed investment subtracted 1.36% from growth.

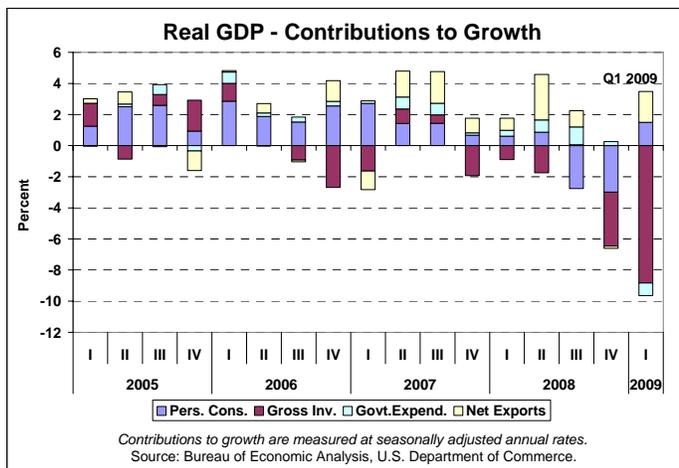
Market analysts believe the residential investment cycle has been showing signs of stabilization, however. Mortgage rates are at record lows – the average interest rate on conforming 30-year fixed-rate mortgages has dropped almost 1¾ percentage points since August 2008, to about 4.8% – and national prices have declined more than 30% from their 2005 peak. National sales of existing and new homes in February rose by 5.1% and 4.7% respectively (% mom). Those figures fell again in March, but at a slower pace than in previous months, suggesting that activity may be coming close to a bottom. According to the Fed’s Chairman Ben Bernanke in a recent speech, “with sales of new homes up a bit and starts of single-family homes little changed from January through March, builders are seeing the backlog of unsold homes decline – a precondition for any recovery in homebuilding.” However, he has pointed out that conditions in the commercial real estate sector are poor: the number of vacancy rates for existing office, industrial, and retail properties has been rising, prices continue to decline and credit conditions remain strained.



Total fixed investment (residential and nonresidential) subtracted 6.04% from overall GDP growth in the first quarter. This was the biggest one-quarter decline in fixed investment in the history of the series. According to *Nomura Global Economics*, this decline underscores the lagged feedback effect of the collapse in consumer spending during the second half of last year.

Investment in inventories fell in the first quarter at a faster pace, subtracting 2.79% from GDP growth after subtracting only 0.11% in the fourth quarter 2008. Private businesses decreased inventories by US\$ 103.7 billion in the first quarter, following a decrease of US\$ 25.8 billion in the fourth quarter and of US\$ 29.6 billion in the third. Overall, gross private domestic investment subtracted a staggering 8.83% from GDP growth in the first quarter (-6.04% due to fixed investment and -2.79% due to inventories).

Additional weakness came from government spending, which declined 3.9% in the first quarter after 12 consecutive quarters of increase. Federal spending decreased 4.0% in the first quarter, following an increase of 7.0% in the fourth quarter. The decline was a result of a surprising reduction in national defense spending, which fell at an annual rate of 6.4%. State and local spending declined 3.9%, following a drop of 2.0% in the previous quarter. Overall, government spending subtracted 0.81% from growth in the first quarter.



A shrinking trade deficit added 1.99% to overall growth, after having subtracted 0.15% from growth in the fourth quarter. The real net trade deficit shrank to US\$ 308.4 billion in the first quarter, from US\$ 364.5 billion previously. Exports fell at an annual rate of 30% in the first quarter, as demand overseas remained weak, subtracting 4.06% from growth. Imports fell at an annual rate of 34.1%, adding 6.05% to growth.

In summary, the major contributors to U.S. growth in the first quarter of 2009 were personal consumption expenditures and trade, which were largely offset by drastic decreases in residential and non-residential fixed investment, and a decline in government spending, leading to a net contraction in growth. Housing was again a large burden on economic growth. According to JPMorgan, housing activity is now down to 2.7% of GDP, the smallest share in more than 50 years, from a high of 6.2% of GDP in the fourth quarter of 2005, its largest share in more than 50 years. Businesses, following the collapse in consumer spending in the second half of 2008 and facing tighter credit and uncertain market conditions, slashed spending in an unprecedented manner in the first three months of the year.

According to market sources, however, although the first quarter's decline was almost as deep as the fourth quarter's, the composition was different, likely marking the end of the economy's free fall, which began when Lehman Brothers declared bankruptcy. The sharp decline in inventories, a US\$ 103.7 billion plunge that subtracted 2.8% from GDP growth – the most since records began in 1947 – is a positive factor for future quarters, meaning that if demand starts to accelerate, businesses will need to increase production to meet it. The drop in inventories paves the way for a rebound in manufacturing orders and output. In addition, consumer spending rose 2.2% (the most in two years). The biggest threat in the real GDP report was business investment, which declined at an annual rate of 38%, the sharpest decline since records began.

- **Sectoral Developments**

Total industrial production declined at a seasonally adjusted annual rate (SAAR) of 20% in the first quarter – the largest quarterly decrease since 1975 – following a decline of 12.7% in the fourth quarter of 2008, and of 2.2% for 2008 as a whole. The capacity utilization rate was 70.3% in the first quarter, lower than the 74.3% in the fourth quarter and the 77.6% for last year as whole. Manufacturing output fell 22.5% at an annual rate in the first quarter, also the largest fall since 1975, led by a 66.9% decline in auto output (motor vehicles and parts).

In March, at 97.4% of its 2002 average, output fell to its lowest level since December 1998 and was nearly 13% below its level a year earlier. Production in manufacturing declined by 1.7% and has registered five consecutive quarterly declines. The capacity utilization rate for total industry fell further to 69.3 %, a historical low for the series, which begins in 1967. The motor

Industrial Outlook

	Total Industrial Production		Capacity Utilization Rate
	Index 2002=100	Percentage Change From Previous Period	(%) Total Industry
2008 Q1	112.0	0.2	80.1
January	112.3	-0.1	80.5
February	112.0	-0.3	80.2
March	111.6	-0.4	79.8
2008 Q2	110.7	-4.6	78.9
April	111.0	-0.6	79.2
May	110.7	-0.3	78.9
June	110.4	-0.2	78.7
2008 Q3	108.1	-9.0	76.9
July	110.4	-0.1	78.6
August	109.2	-1.1	77.6
September	104.8	-4.0	74.5
2008 Q4	104.5	-12.7	74.3
October	106.2	1.3	75.4
November	104.8	-1.4	74.5
December	102.5	-2.2	72.8
Annual	108.8	-2.2	77.6
2009 Q1	98.8	-20.0	70.3
January	100.3	-2.1	71.3
February	98.8	-1.5	70.3
March	97.4	-1.5	69.3

Source: Federal Reserve, Industrial Production and Capacity Utilization

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

vehicle industry reported a 1.5% increase in auto production following February's 9.5% increase, however. In January, automakers had drastically cut output (25% decline), and it seems that now there is room to increase production while still bringing down inventories.

Recent manufacturing surveys suggest that as of the end of the first quarter and beginning of the second, the sector was contracting at slower rates than at the end of 2008 and beginning of the first quarter. The April ISM manufacturing index rose to 40.1 from 36.3 in March. April marked the index's 15th month in contraction territory, but the pace of contraction has slowed since December 2008, when the index fell to a low of 32.9. The details of the survey were encouraging, showing that new orders have increased from a recent low of 23.1 in December to 47.2 in April, getting closer to approach the neutral 50 mark. Moreover, inventories have come down, with the index falling to 33.6. However, risks remain, and turmoil in the car industry could derail the manufacturing sector.

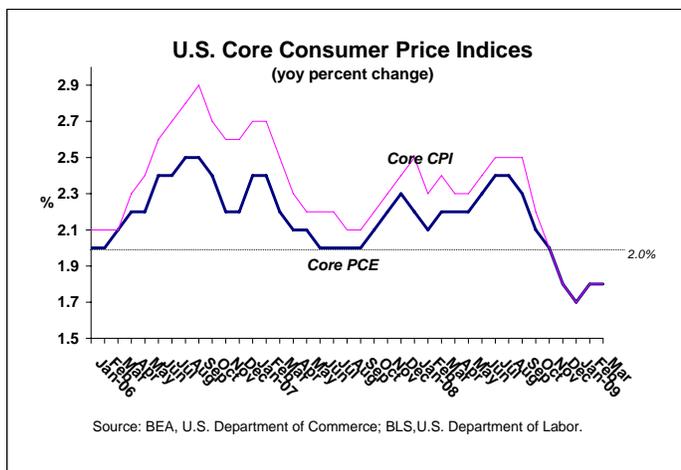
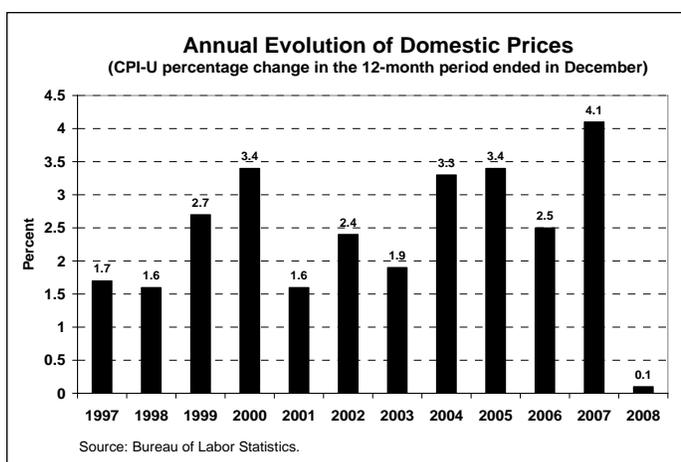
- **Inflation**

The Consumer Price Index for All Urban Consumers (CPI-U) increased at a seasonally adjusted annual rate (SAAR) of 2.2% in the first quarter. This 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 7.9% annual rate in the first quarter of 2009. The food index fell at a SAAR of 0.8% in the first quarter of 2009, after rising 5.9% during 2008.

Excluding food and energy, the CPI-U advanced at a 2.2% seasonally adjusted annual rate in the first quarter, after rising at 1.8% in 2008.

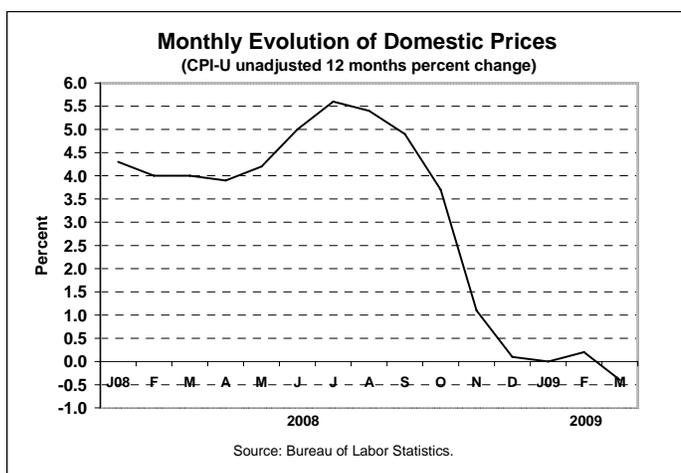
The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) price index excluding food and energy – advanced at an annualized 1.5% in the first quarter, increasing from a 0.9% rate in the fourth quarter of last year. After a period of months in which the core PCE monthly readings remained above 2%, considered the top threshold for the Federal Reserve (consistent gains above 2% are considered a concern for policymakers and investors), readings have now come down and are firmly within the Fed's comfortable zone. In its latest statement, the FOMC said it expected

inflation to remain subdued, and warned that deflation is still a risk. According to *Moody's.com*, reduced consumer spending has been exerting downward pressure on prices, leaving only the most expensive services – education and medical care – with prices rising at their normal rates. That these and other



services are still experiencing rising prices, they say, is however a good sign that the economy, at this point, is not in danger of deflation.

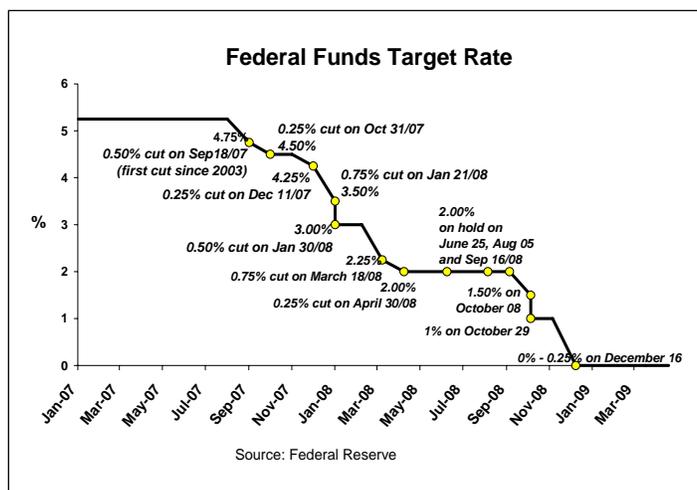
Recent inflation readings seem to confirm the notion that inflation will remain low. In March, U.S. consumer prices fell 0.4% over the last year, the first 12 month decline since August 1955 according to the Bureau of Labor Statistics. The return of the headline CPI to deflation territory is a result of falling energy prices. The energy CPI fell by 3% in March compared with February.



- **Monetary Policy**

The Federal Open Market Committee (FMOCC) 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 met five times in the first quarter of 2009 (two of them unscheduled)² and kept monetary policy unchanged. In its last meeting on 29 April, the Committee said that it expects to keep the fed funds rate target in the 0% to 0.25% range "for an extended period." The remarks on current economic conditions were less pessimistic than in recent months; the statement said that the pace of economic contraction "appears to be somewhat slower," and that "the economic outlook has improved modestly" since March. For the first time the Committee referred to the prospect that "market forces will contribute to a gradual resumption of sustainable economic growth in a context of price stability," indicating greater confidence in the self-repairing capacity of the economy.



In addition to cuts in the interest rate, the Federal Reserve has employed at least three types of additional tools to improve the functioning of credit markets, ease financial conditions, and support

² On January 16, 2009, the Committee met by conference call to discuss issues associated with establishing an explicit numerical objective for inflation. The Committee made no decisions on whether to establish such an objective. On February 7, 2009, the Committee met by conference call in a joint session with the Board of Governors to discuss the potential role of the Federal Reserve in the Treasury's forthcoming financial stabilization plan. The Fed's primary direct role in the plan would be through an expansion of the previously announced TALEF, which would be supported by additional funds from the Troubled Asset Relief Program (TARP).

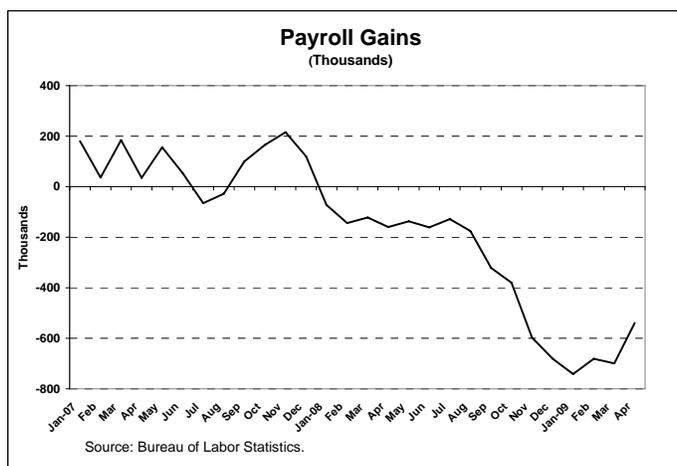
economic activity since September 2007. The first included initiatives to provide short-term liquidity: the *Primary Credit Program*; the *Term Auction Facility (TAF)*; the *Term Securities Lending Facility (TSLF)*; the *Primary Dealer Credit Facility (PDCF)*; and the *Currency swap lines* (bilateral temporary currency liquidity agreements with 14 foreign central banks to relieve funding pressures in the global market for dollar liquidity). The second aimed to provide liquidity to key credit markets, and included the support given to specific institutions (Bear Stearns, American International Group (AIG), and Citigroup); the *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)*; the *Temporary Guarantee Program for Money Market Funds*; the *Commercial Paper Funding Facility (CPFF)*; the *Money Market Investor Funding Facility (MMIFF)*; and the *Term Asset-Backed Securities Loan Facility (TALF)*.

The *Term Asset-Backed Securities Loan Facility (TALF)*, which was announced on 25 November 2008, was launched during the first quarter, on 3 March 2009. The TALF is intended to assist the financial markets in accommodating the credit needs of consumers and small businesses by facilitating the issuance of asset-backed-securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA) and to improve the market conditions for ABS more generally (US\$ 200 billion initially).

The third type of tools employed by the Fed included the purchase of long-term securities, such as direct obligations of housing-related government-sponsored enterprises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, and mortgage-backed securities (MBS) backed by Fannie Mae, Freddie Mac and Ginnie Mae, in order to reduce cost and increase the availability of credit for the purchase of housing. These purchases were initially announced in November 2008, and on 18 March 2009, when the FOMC met for its second scheduled time during the first quarter, the Committee announced it was increasing its purchases of agency debt (from US\$ 100 billion to US\$ 200 billion) and of agency MBS (from US\$ 500 billion to US\$ 1.25 trillion) in 2009. In addition, to help improve conditions in private credit markets, the Committee also announced plans to purchase up to US\$ 300 billion of longer-term Treasury securities over the following six months, with the intention to influence yields on these securities, thus helping to spur aggregate demand. With its decision to purchase long-term Treasuries, the FOMC has now officially moved to quantitative easing. The initiative was designed to use the central bank's ability to create money to bring down long-term interest rates in an effort to stimulate the economy.

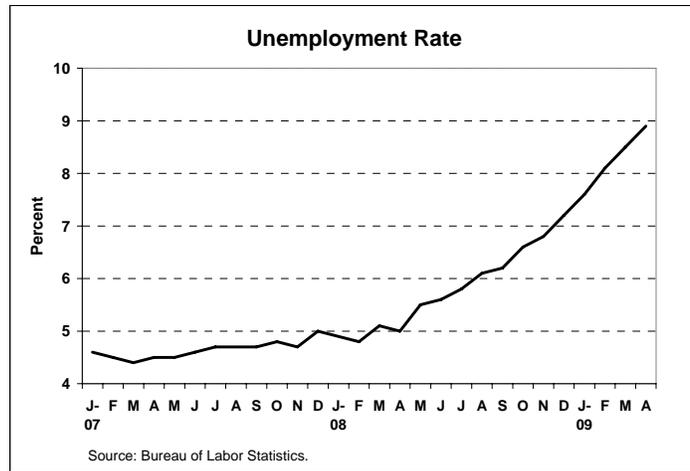
- **Labor Markets**

The latest nonfarm payrolls data indicates that the U.S. job losses in April lessened a bit, supporting the notion that although the economy remains in a prolonged recession, the pace of the contraction may be finally starting to slow. Job losses eased in April to 539,000, the smallest decline since October of last year. There were smaller job losses across most private industries. However, a good part of the improvement came from temporary government hiring in advance of next year's Census. The still substantial decline in employment drove the unemployment rate up by 0.4%, to 8.9%, the



highest level in 25 years.³ The labor force participation rate increased to 65.8%, from a cyclical low of 65.5% in March. The labor market data confirms the view that the economy is in for an extended period of weak growth, but that the pace of the economic contraction seems to be slowing.

Construction and manufacturing shed 48,000 fewer jobs than in March; net payrolls declined by 270,000. Government employment increased by 72,000 on net. The increase was due, to a large extent, to the hiring of 140,000 census workers. Private service employment declined by 341,000, compared to the loss of 375,000 in March. Education/healthcare, which has been the only service industry to add payrolls since last year, showed a net gain of 15,000 in April, although this is well below the pace of a year ago. Most other service industries shed fewer jobs. While much of the improvement in payroll employment in April was due to the temporary hiring in advance of workers for the decennial census, private losses ease somewhat as well.



Employers have shed 2.7 million positions year-to-date at an average rate of about -665,000 jobs a month. In the first quarter, 2.1 million jobs were eliminated, at an average of -707,000 positions a month, and unemployment rate was 8.1%, compared to 6.9% in the fourth quarter of 2008. In 2008, 3.1 million jobs were eliminated. Over the past 12 months, the number of unemployed persons has risen by 6.0 million, and the unemployment rate has grown by 3.9%.

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 0.8% (SAAR) in the first quarter of this year from the last quarter of 2008. Year-on-year productivity (from the first quarter of 2008 to the first quarter of 2009), which measures output per hour, was up by 1.8%, down from a 2.2% gain in the quarter before. Ian Sheperdson, chief U.S. economist at High Frequency economics, notes that in the 1980 recession, productivity fell by 4.4 per cent. The resiliency during this recession is a sign that companies reacted quickly to the sharp drop in consumer demand, and the fact that productivity increased in the midst of this deep downturn is an encouraging sign.

Hours worked declined at a 9.0% annual rate in the first quarter, and output fell at an 8.2% annual rate. Labor costs increased at a 3.3% annual rate in the first quarter, a higher than expected increase. The increase in unit labor costs was quite strong given the depth of the recession, but it is expected to go down as hourly compensation growth weakens and as rising joblessness reduces wage pressures.

The productivity results were better than analysts predicted, but proved to be direr for the manufacturing sector, where productivity fell by 3.4% in the first three months of the year, as companies

³ According to the Wall Street Journal, by broader measures, unemployment is already into double digits. When involuntary part-time and marginally attached workers are included, the rate of unemployment or underemployment reached 15.8% in April, up from 15.6% in March and 6.6% higher than a year ago.

cut back on capital spending amid eroding demand. Manufacturing output plunged by 22.4% in the quarter, trailed by a 19.7% drop in hours worked.

Productivity and costs: Preliminary first 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	1.1	-7.8	-8.8	4.1	6.6	2.9
Nonfarm business	0.8	-8.2	-9.0	4.1	6.6	3.3
Manufacturing	-3.4	-22.4	-19.7	12.8	15.5	16.7
Durable	-10.0	-31.0	-23.4	15.7	18.4	28.5
Nondurable	-0.1	-13.1	-13	8.6	11.2	8.8

Source: Bureau of Labor Statistics.

• Financial Markets

The new U.S. Administration was active in the first quarter of the year trying to stabilize financial markets and respond to the economic crisis. On 10 February 2009, it announced the Financial Stability Plan (FSP), which consisted of:

- i) Financial Stability Trust, including:
 - *A Comprehensive Stress Test for Banks*: all banks with assets in excess of US\$ 100 billion were required to participate in a comprehensive stress test that will determine what banks have and what they really need.
 - *Capital Assistance Program (CAP)*: institutions that have been thoroughly tested will then have access to funds provided by the Treasury under this program.
 - *Financial Stability Trust*: a separate entity set up to manage the government's investments in U.S. financial institutions. Any capital investments made by Treasury under the CAP will be placed in this trust.
- ii) Public-Private Investment Fund (PPIF): containing up to US\$ 500 billion in public funds (with the potential of expanding up to US\$ 1 trillion); designed to provide greater means to financial institutions to cleanse their balance sheets of "legacy" assets, so that they can attract more private capital gain, and to bring private sector equity contributions to make large-scale asset purchases, allowing private sector buyers to determine the price for current troubled and previously illiquid assets.
- iii) Consumer and Business Lending Initiative (CBLI): an expansion of TALF up to US\$ 1 trillion from US\$ 200 billion to encourage new consumer/business lending. The TALF's initial reach is also expanded to include commercial mortgage-backed securities (CMBS).
- iv) New Era of Transparency, Accountability, Monitoring and Conditions: the firms will have to show how public funds are enabling them to preserve or generate lending compared to what would have been possible without assistance; all recipients are committed to undertake measures to mitigate mortgage foreclosures; the participating firms are restricted from paying dividends, repurchasing shares and pursuing acquisitions until the government's investment has been repaid; the recipients are obliged to comply with the senior executive compensation restriction announced 4 February 2009; lastly, the Treasury will guarantee the highest possible degree of transparency by posting all relevant information on the Internet.
- v) Housing Support and Foreclosure Prevention: a US\$ 50 billion fund to prevent avoidable foreclosures.

- vi) Small Business and Community Lending Initiative: intended to finance the purchase of AAA-rated Small Business Administration (SBA) loans to unfreeze secondary markets for small business loans.

The Plan was not well received by the markets, which complained about the lack of details. Meanwhile, Congress approved the American Recovery and Reinvestment Act (ARRA) on 17 February 2009, a fiscal package with an estimated cost of US\$ 787 billion (5.5% of GDP) over the fiscal years 2009-19. The package included **tax provisions** accounting for 38% of the stimulus in the next three years; **aid** to states, the unemployed, for access to health care and to students accounting for about 35%; and **spending** accounting for 27%, including on modernization of the electric grid, road and bridge infrastructure, public transit improvements, high-speed rail investments, health information technology, health research, investments in energy and water, upgrading government buildings, and homeland security and defense.

On 16 March 2009, as part of the FSP and the CBLI, the Treasury announced it would jumpstart credit markets for small businesses by purchasing up to US\$ 15 billion in securities; temporarily raise guarantees to up to 90% in SBA's 7(a) Loan Program; temporarily eliminate certain SBA loan fees to reduce the cost of capital; require the 21 largest banks receiving FSP assistance to report their small business lending monthly and call for all banks to increase small business lending; issue guidance for an expanded carry back provision as part of the American Recovery and Reinvestment Act's tax cut package for small businesses.

On 23 March 2009, the U.S. Treasury announced the Public-Private Investment Program (PPIP), releasing details of the program first mentioned in February with the announcement of the FSP, and this time around the details were well received by the markets. Under the PPIP the Treasury will make targeted investments in multiple Public-Private Investment Funds (PPIFs) that will purchase legacy real estate-related assets, using up to US\$ 100 billion from the TARP to generate US\$ 500 billion in purchasing power to buy these assets, with the potential to expand to US\$ 1 trillion over time. The plan has two key elements:

- i) *Legacy Loans Program*: combines an FDIC guarantee of debt financing with equity capital from the private sector and the Treasury to support the purchase of troubled loans from insured depository institutions.
- ii) *Legacy Securities Program*: combines financing from the Fed and Treasury through the TALF with equity capital from the private sector and the Treasury to address the problem of troubled securities.

The results of the Stress Test announced in February were released on 7 May 2009. The government projected that 19 of the country's biggest banks could suffer losses up to US\$ 599 billion through the end of 2010 if the economy performs worse than expected. The government's "more adverse" scenario includes two-year cumulative losses of 9.1% on total loans, worse than the peak losses of the 1930s. Ten of these banks were ordered to raise a combined US\$ 74.6 billion in capital to cushion themselves, less than the US\$ 110 billion that is left in the Trouble Assets Relief program (TARP). Some investors said that the worst-case estimates of banks' total losses and capital shortfalls were smaller than they feared. Treasury Secretary Timothy Geithner said he is "reasonably confident" that banks will be able to obtain private infusions of capital to cover the gaps.

According to the released results, nine of the stress-tested banks have adequate capital, including JPMorgan Chase and Goldman Sachs, as well as several regional institutions. Among the institutions that will need to bolster their finances is Bank of America (with a US\$ 34 billion shortfall), Wells Fargo (US\$ 14 billion), Morgan Stanley (US\$ 1.8 billion) and Citigroup (US\$ 5.5 billion). Bank of America said that it would add equity through a share sale and the conversion of preferred shares held by non-government investors. It also plans to raise the money through earnings and the possible sale of assets,

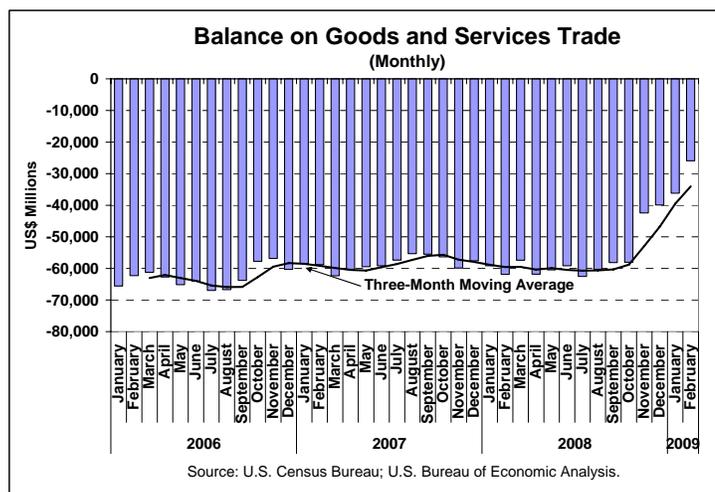
including asset manager Columbia Management and First Republic Bank. Citigroup said that it would expand an existing offer to convert preferred shares. Wells Fargo and Morgan Stanley announced that they raised US\$ 7.5 billion and US\$ 8.0 billion, respectively, the day after the U.S. government's stress test showed they faced capital shortfalls. Wells Fargo priced a US\$ 7.5 billion offering of 341m shares at US\$ 22 per share. Morgan Stanley sold approximately US\$ 4 billion in equity and US\$ 4 billion in non-government backed debt in an effort to cover its US\$ 1.8 billion capital shortfall and repay the US\$ 10 billion in federal TARP aid it received last year. These offerings may be an important step towards restoring confidence in the banks, but the success of the government's efforts will depend on how the economy will actually perform from now on.

Wall Street responded positively as banks rushed to the market to offer new equity after the results of the government's stress tests. Wells Fargo sold its shares at US\$ 22, but its stock traded higher than that. By midday its shares were up 6% at US\$ 26.25. Morgan Stanley fell 0.2% to US\$ 27.20. Other banks saw sharp rises after the results of the tests showed they had to raise less money to survive the government's more adverse scenario than many had feared. Citigroup rose 7.9% after it said it would raise the additional US\$ 5.5 billion of capital it needed by expanding its scheme to convert preference shares into common stock. Bank of America also jumped higher, building on gains of over 55% for the week. The bank said it would raise the money without converting any of its government-held preferred shares into common stock, so avoiding a majority-government holding. That helped its shares pick up 3.2%. Regional banks also performed well, even though several were found to need to bolster their balance sheets.

- **External Sector**

According to the "advance" estimates released by the U.S. Department of Commerce on April 29, trade deficit, as a percent of GDP, fell to 2.4% in the first quarter of 2009 from 3.8% in the fourth quarter of 2008. This is the smallest deficit in a decade, and it is less than half of the deficit shown in the first quarter of 2008 (5%), when recession in the U.S. was just starting and the economic downturn was not yet hammering other economies. The U.S. deficit is declining at a fast rate, a result of a worldwide recession that is intensifying and contributing to reduce the global economic imbalances that have grown to unprecedented size in the past few years.

The shrinking trade deficit is not the result of a rebound in exports. Quite the contrary, exports fell at a 30% rate in the first quarter. Imports, however, are declining even more, and fell at an annual rate of 34.1% in the first quarter of 2009. Exports peaked in the third quarter of 2008, at 13.7% of GDP, and are down to 10.9% in the first three months of this year. Over the same period, imports fell to 13.3% of GDP from a peak of 18.6%. Those figures are based on nominal dollars values, and, in part, reflect the decline in oil prices, but even after adjusting for inflation, imports are down sharply. However, this same GDP report, as we have seen, showed a tentative rebound in consumer spending. If this trend continues, the trade deficit may soon start to widen again.



III. LOOKING AHEAD

- Market sentiment has improved over the past few weeks, buoyed by some incipient positive data pointing to a slowdown in the pace of economic contraction in the United States. The most recent data for labor markets pointed to smaller job losses in April, and manufacturing reports also showed signs of improvement in April. However, unemployment rate reached a 25-year high of 8.9%, highlighting that even if the pace of economic contraction is indeed slowing, the road to recovery will still be difficult and long.
- Current market projections for real GDP growth in 2009 now range from -2.5% to -3.2%. These forecasts were made mostly in May. For 2010 they forecast growth between 0.7% and 2.7%. Many private market forecasters believe that the economy is turning, and expect it to start growing again in the second half of the year as a result of the economy's normal self-correcting mechanism, the stimulus plan and the government's efforts to reduce the cost of borrowing.
- The international financial organizations are more pessimistic than the markets for the most part. Their forecasts for real U.S. GDP growth in 2009 range from -2.4% to -3.5%, while the majority expects growth to be flat in 2010 (forecasts range between 0% and 2%).

Forecasts for Annual U.S. Economic Growth

		Real GDP		
		2009	2010	Date of Forecast
A. What Government Agencies Say				
	FED*	-1.3 to -0.5%	2.5 to 3.3%	Jan-09
	CBO	-3.0%	2.9%	Mar-09
B. What Markets Say				
	Goldman Sachs	-3.2%	1.2%	Mar-09
	National Association of Realtors	-2.9%	1.4%	May-09
	Bank of America/Merrill Lynch	-3.0%	2.0%	May-09
	Moody's Economy.com	-3.0%	1.4%	May-09
	The Economist Intelligence Unit	-3.1%	0.7%	Mar-09
	JPMorgan	-2.5%	2.7%	May-09
	Wachovia	-2.9%	0.9%	May-09
	Mortgage Bankers Association*	-1.1%	2.8%	Apr-09
	Market Average**	-2.9%		
C. What International Organizations Say				
	United Nations DESA (Baseline)	-3.5%	1.0%	May-09
	World Bank	-2.4%	2.0%	Mar-09
	OECD	-4.0%	0.0%	Mar-09
	IMF	-2.8%	0.0%	Apr-09

* forecast on a Q4 to Q4 basis.

Note: the CBO, IMF, and OECD forecasts on a Q4 to Q4 basis are -1.5%, -2.2%, and -3.5%, respectively, for 2009.

** average does not include the Mortgage Bankers Association.

- The results of the stress tests have finally been released, and the banks' capital shortfall was smaller than expected. The stress tests are an attempt to determine how much capital banks might need if the economic situation deteriorates at a faster rate than it currently is. How the economy will perform in the coming months is thus a crucial variable to determine if this exercise will prove to be successful. If the economy is really approaching a bottom, the government's estimates of banks' capital shortfalls may look unnecessarily gloomy a few months from now. However, if the government's worst-case scenario turns out to be optimistic, then the banks will need more

capital down the road, and the Administration will have to ask a reluctant Congress for more bailout money.

- Although market sentiment has improved and signs of stabilization have emerged, there are serious downside risks to the current outlook. Consumer confidence is still fragile, the financial sector has not yet recovered, although credit seems to be unlocking, the unemployment rate is very high and poised to increase even further before the labor market starts to stabilize. Because of these risks, the economy will likely remain dependent on government support in the near future, and consumer spending will likely continue to be crucial for future growth.
- Consumer spending actually rose in the first quarter after two quarters of decline, but it is unlikely that consumers will go back to the spending pattern prevalent before the crisis. The saving rate rose to 4.2% in the first quarter, the highest quarterly saving rate since 1998. Consumers will continue to keep their spending in check, limiting spending growth and keeping saving high, at least until conditions improve. However, support from the government stimulus will keep spending from falling at the pace seen in the second half of last year at least until late summer.