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UNITED STATES ECONOMIC OUTLOOK

Quarterly Developments

UNITED NATIONS

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CONTENTS

I. OVERVIEW **1**

II. CURRENT ASSESSMENT **2**

- GDP Growth 2
- Sectoral Developments 4
- Inflation 5
- Monetary Policy 6
- Labor Markets 7
- Financial Markets 8
- External Sector 9

III. LOOKING AHEAD **10**

U.S. ECONOMIC OUTLOOK

I. OVERVIEW

The U.S. financial system faced its worst moment since the credit crisis began last August in the weekend of September 13, as regulators and chief executives of the major financial firms met over the weekend in an attempt to find a way to contain the spreading damage from the mortgage and housing crisis. Wall Street was in turmoil on Monday, following the announcement that Lehman Brothers had filed for bankruptcy protection and Merrill lynch agreed to a US$ 50 billion takeover from Bank of America. The discussions over the weekend extended beyond the problems at Lehman, with officials and private sector executives debating the systemwide stress and a succession of companies which were also under severe market pressure, among them the American International Group Inc. (AIG), one of the world's biggest insurers. At the end of the day on Monday, September 15, AIG's problems were exacerbated by a wave of credit rating cuts. Fearing a financial crisis worldwide, on Tuesday, September 16, the Federal Reserve agreed to lend US$ 85 billion in emergency funds in return for a government stake of 79.9% and effective control of the company. In a statement, the Fed said that *"a disorderly failure of AIG could add to already significant levels of financial market fragility and lead to substantially higher borrowing costs, reduced household wealth and materially weaker economic performance."*

Underscoring the urgency of the discussions over the weekend was the fear that Lehman's failure could present many of the same systemic risks that regulators sought to eliminate in March when they arranged the sale of Bear Stearns to JPMorgan Chase. However, from the federal authorities' point of view, Lehman's problems were different. While Bear Stearns was the victim of a bank run, as investors refused to continue lending it money, Lehman's problems have developed more gradually, giving the government and private firms time to draw up contingency plans for easing the collateral damage from a bankruptcy filing. Lehman's woes were seen as part of a broader problem, a business model that may no longer make reasonable profits and thus not be able to raise an adequate price from a buyer.

Government officials also drew distinctions between AIG's situation and that of Lehman. AIG's failure was a surprise – the company first went to the government for help Friday, September 12 – and its size and complexity made it hard to quickly prepare for its collapse. Moreover, AIG was too connected to fail, given that its short-term debt is held by institutions all over the world, including money-market mutual funds. An overnight collapse could have caused big losses in those funds, perhaps even risking a run on them, spreading financial contagion to the several businesses that counted on AIG's insurance.

In the eyes of Treasury Secretary Hank Paulson, there were also big differences between Lehman and Fannie and Freddie, the two government sponsored mortgage finance companies whose control was seized by the government in the weekend of September 6, in an attempt to stabilize lending. The mortgage giants were much more important to the global financial system, as a large portion of their liabilities (amounting to US$ 5.4 trillion) is held by foreign central banks whose support for the dollar is crucial. They were also much more important for the U.S. economy, since they account for about three-quarters of all new mortgages.

Fannie and Freddie's credit problems have been largely a reflection of the overall weakness in the housing market. The Fed has cut interest rates by 3.25 percentage points since last August in an effort to soften the impact of the credit crunch. However, despite these efforts, mortgage rates have hardly moved, remaining above 6%, while risk-averse banks continue to tighten lending standards. The federal takeover represented a dramatic move, essentially putting the government in charge of helping U.S. mortgages. If the intervention works, it will guarantee a continued flow of credit through the country's vulnerable mortgage system in the near term, but Congress and the U.S. Administration will have to agree on a longer term plan that will clarify the status of these two entities.

Despite the financial meltdown, the broader economy has not been severely hit so far. In the second quarter, boosted by a strong increase in international trade, the U.S. economy grew much faster than it first reported. The U.S. economy grew at an annualized 3.3%, following an increase of 0.9% in the first. The larger-than expected increase was a result of a larger improvement in net exports and smaller reduction in business inventories, with trade contributing 3.1 percentage points to the 3.3 percent growth. U.S. growth was the strongest among the G7 countries and it was above the economy's potential rate of 2.5% to 3%.

Selected Current Data

Gross Domestic Product	Q2-2008	3.3%
GDP Year-over-Year	Q2-2008	2.2%
Personal Consumption	Q2-2008	1.7%
Business Fixed Investment	Q2-2008	2.2%
Consumer Price Index	July - 2008	5.6%
"Core" CPI	July - 2008	2.5%
"Core"PCE Deflator	July - 2008	2.4%
Industrial Production	July - 2008	0.2%
Unemployment	August - 2008	6.1%
Federal Funds Target Rate	16-Sep-08	2.0%

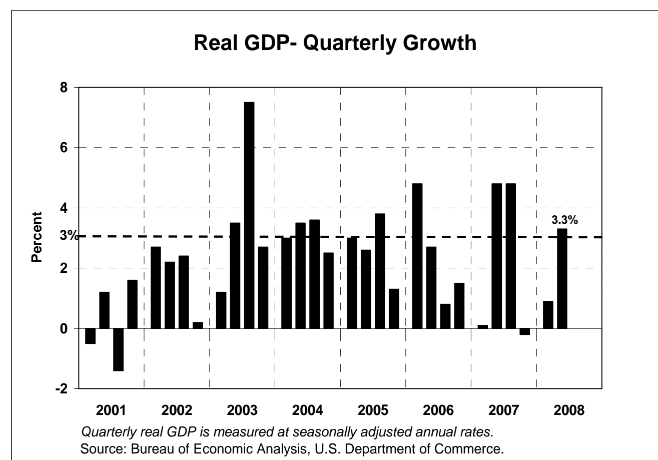
However, market analysts note that with global growth slowing and benefits from the fiscal stimulus waning, the second half of the year is bound to weaken significantly. The unexpected jump in the U.S. unemployment rate to 6.1% in August, the highest since September 2003, reinforced this perception.

On average, growth is expected to remain positive in the second half of the year although weak. The positive impact of tax rebates that were part of the government's stimulus plan is expected to wane, and anticipated slower global economic growth is expected to reduce trade's positive contribution to the U.S. economy. Still, there is a lot of uncertainty on how the U.S. and the global economy will fare in the coming months. The big question that remains is how much more of the financial meltdown the broader economy will be able to take.

II. CURRENT ASSESSMENT

- **GDP Growth**

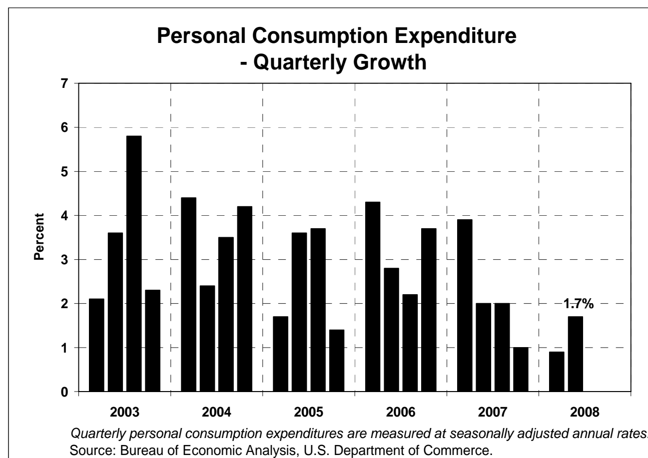
According to the preliminary estimates released by the U.S. Department of Commerce on August 29, the U.S. economy expanded at an annual rate of 3.3% in the second quarter of 2008, following an increase of 0.9% in the first quarter. The second-quarter growth rate was revised upwards 1.4 percentage points from the "advance" estimate released a month ago, thanks to much stronger exports and healthier business inventory figures. The boost in growth came in spite of a decline in the housing industry, high inflation, rising unemployment and a credit crunch. The sharp revision to second-quarter growth highlights the notion that the outlook for the U.S. economy may now be intertwined with growth conditions in other countries.



Consumer spending grew at 1.7%, slightly more than the earlier estimate of 1.5%, and up from a 0.9% pace in the first quarter. Underlying problems in the economy, particularly in the housing market,

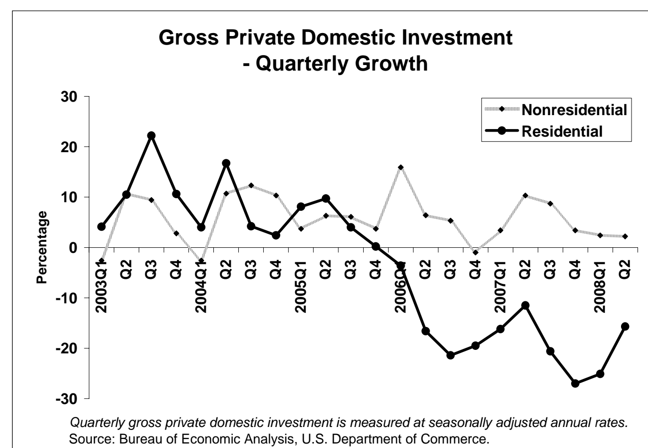
have made consumers more hesitant to spend, especially on large-scale purchases like cars and kitchen appliances. Spending on durable goods continued to drop in the second quarter (-2.5%), while spending on nondurable goods showed a rebound from the first quarter decline, increasing 4.2%.

Consumption in the second quarter was supported by the stimulus checks that began to be disbursed at the end of April. Despite the US$ 100 billion in tax rebates mailed out by the government during the quarter, second-quarter consumption spending was low by historical standards. The stimulus checks' impact on consumption should wane in the second half of the year and labor market concerns should persist, thus market analysts fear that consumer spending could contract in the third quarter. Real consumer expenditure, which accounts for more than two-thirds of GDP, added 1.2% to second-quarter GDP growth.



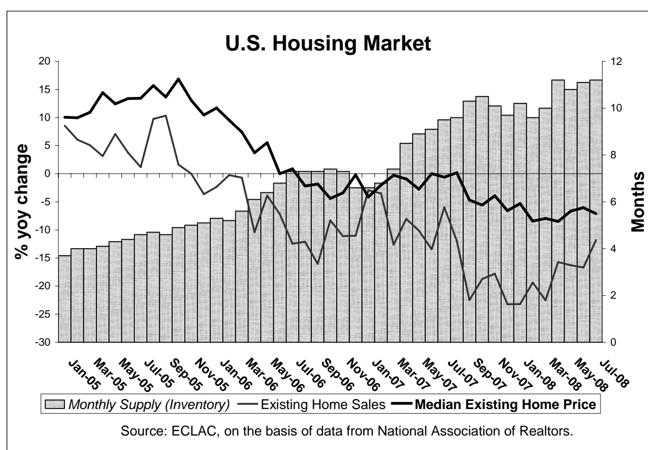
Quarterly personal consumption expenditures are measured at seasonally adjusted annual rates.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

More difficult financing conditions seem to have affected nonresidential construction, which continued to soften in the second quarter. Real nonresidential fixed investment, which represents overall business spending, increased 2.2% in the second quarter, compared to an increase of 2.4% in the first, with investment in equipment and software falling 3.2% and investment in nonresidential structures increasing 13.7%.



Quarterly gross private domestic investment is measured at seasonally adjusted annual rates.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

The housing market continued to weigh on the economy in the second quarter. Real investment in residential structures fell an annualized 15.7% in the second quarter, its tenth consecutive quarterly decline, following a decrease of 25.1% in the first quarter. It subtracted 0.62% from growth, less than in the previous three quarters. Market analysts believe the residential investment cycle has been showing signs of stabilization. However, they are not prepared to call a bottom to the housing slump yet because prices keep falling and inventories of unsold homes remain high. Total fixed investment (residential and nonresidential) subtracted 0.38% from overall GDP growth in the second quarter.



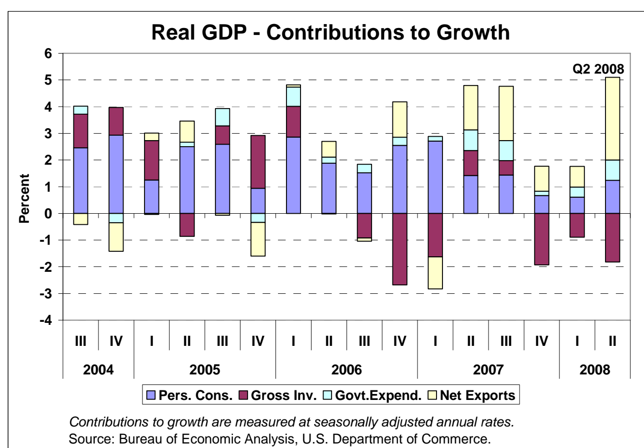
Source: ECLAC, on the basis of data from National Association of Realtors.

Investment in inventories fell in the second quarter of 2008 at a faster pace than in the first quarter, subtracting 1.44% from GDP growth after subtracting only 0.02% in the first quarter. Private businesses decreased inventories by US$ 49.4 billion in the second quarter, following a decrease of US$ 10.2 billion in the first quarter and of US$ 8.1 billion in the fourth. Overall, gross private domestic

investment subtracted 1.82% from GDP growth in the first quarter (-0.38% due to fixed investment and -1.44% due to inventories).

Federal spending increased 6.8% in the second quarter, following an increase of 5.8% in the first quarter. State and local spending increased 2.2%, following a drop of 0.3% in the previous quarter. Overall, government spending added 0.76% to growth in the second quarter.

A shrinking trade deficit added 3.1% to overall growth. Exports surged at a 13.2% pace, while imports fell at a 7.6% pace. Higher exports of goods and services contributed 1.65% to overall GDP growth, while imports added 1.45%. International trade was a positive for growth thanks to the expanding global economy and the weak dollar. Although the decline in imports helped nudge the GDP estimate up in the first and second quarters, some analysts highlight that demand for imports fell because the bleak economic outlook is making consumers more hesitant to spend, a factor that may lead the business sector to cut back expenditures in coming months.



Contributions to growth are measured at seasonally adjusted annual rates.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.

In summary, the major contributors to U.S. growth in the second quarter of 2008 were the same as in the first quarter: the narrower trade deficit, personal consumption expenditures, and state and local government spending, which were partly offset by decreases in residential and non-residential fixed investment. Over the period of the credit crisis, trade has contributed about three-quarters of growth on average, helping to more than offset the drag from residential investment. Housing was again the most significant problem faced by the U.S. economy in the second quarter, and the decline in residential investment represented a large burden on economic growth. Growth in personal consumption expenditures has slowed as a result. Given reduced access to home equity and a negative wealth effect from lower house prices, households have become more cautious with their expenditures. Businesses, uncertain about future market conditions, are also becoming more cautious, as concerns over growth and tighter credit are now weighting on investment.

Growth is expected to slow significantly in the second half of the year. Slowing growth in Japan, Europe and U.K. suggests that foreign demand for U.S. goods could slowdown in coming moths, depressing economic growth. Moreover, consumer spending could decline in the second half of the year, as the boost from he rebate checks fades and labor-market concerns persist.

- **Sectoral Developments**

Total industrial production declined at a seasonally adjusted annual rate (SAAR) of 3.1% in the second quarter, after rising at a revised rate of 0.4% in the first quarter. This is the first quarterly decrease since the fourth quarter of 2006. The capacity utilization rate was 79.8% in the second quarter, lower than the 80.7% in the first quarter and the 81.0% in the fourth quarter of last year. Manufacturing output fell 3.9% at an annual rate in the second quarter, led by a 28.9% decline in auto output (motor vehicles and parts).

In August, after little movement in the previous three months, industrial production decreased 1.1%, and capacity utilization fell to 78.7%. Manufacturing production declined 1.0%. The decline in manufacturing was led by the motor vehicle and parts industry, but there was weakness across the entire sector. A plunge in utility output amplified weakness last month. Overall, the August report was the weakest industrial production report so far this year. Given the weakness in the domestic economy, manufacturing should continue to face significant difficulties in coming months.

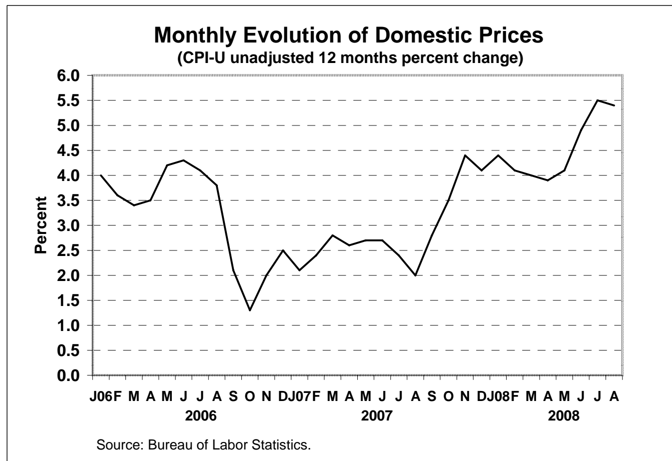
Industrial Outlook

	Total Industrial Production		Capacity Utilization Rate (%)
	Index 2002=100	Percentage Change From Previous Period	Total Industry
2008 Q1	**112.3**	**0.4**	**80.7**
January	112.6	0.2	81.0
February	112.3	-0.3	80.7
March	112.0	-0.2	80.4
2008 Q2	**111.4**	**-3.1**	**79.8**
April	111.4	-0.5	79.9
May	111.3	-0.1	79.7
June	111.5	0.2	79.7
2008 Q3	**n/a**	**n/a**	**n/a**
July	111.6	0.1	79.7
August	110.3	-1.1	78.7

Source: Federal Reserve.
Note: Quarterly changes are at annual rates.

- ## Inflation

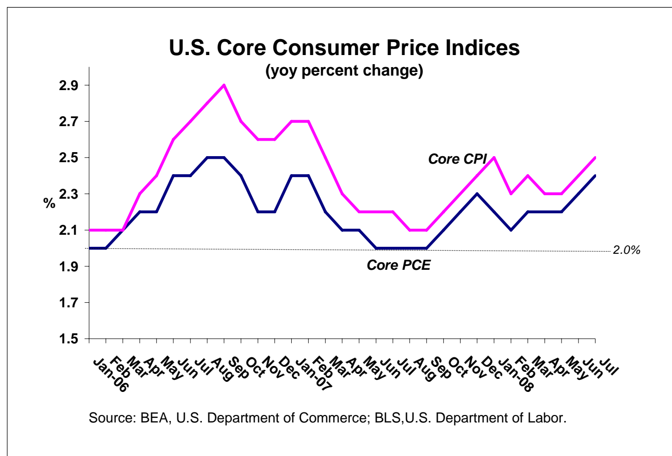
The Consumer Price Index for All Urban Consumers (CPI-U) increased at a seasonally adjusted annual rate (SAAR) of 7.9% in the second quarter, after increasing at a 3.1% rate in the first quarter. This brings year-to-date annual rate to 5.5% and compares with an increase of 4.1% in all of 2007. The energy price index, after rising at a 17.4% SAAR in 2007, advanced at a 29.1% annual rate in the first half of 2008, accounting for about half of the overall CPI-U increase in the period. The food index advanced at a 6.8% SAAR in the first half of 2008, accounting for about 17% of the overall increase in prices in the period.



Source: Bureau of Labor Statistics.

Excluding food and energy, the CPI-U advanced at a 2.5% seasonally adjusted annual rate in the second quarter, after rising at a 2.0% in the first quarter. Core CPI advanced at 2.3% SAAR over the first six months of 2008, what compares to a 2.4% increase in all of 2007. The deceleration in 2008 so far reflects a slower advance in the indexes for shelter and medical care, coupled with a larger decline in the apparel index.

The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) price index excluding food and energy – increased at an annualized 2.1% in the second quarter, falling from a 2.3% rate in the first quarter. Since October of last year the core PCE monthly readings have remained above 2%, considered to be the top threshold for the Federal Reserve (consistent gains above 2% are considered a concern for policymakers and investors).



Source: BEA, U.S. Department of Commerce; BLS,U.S. Department of Labor.

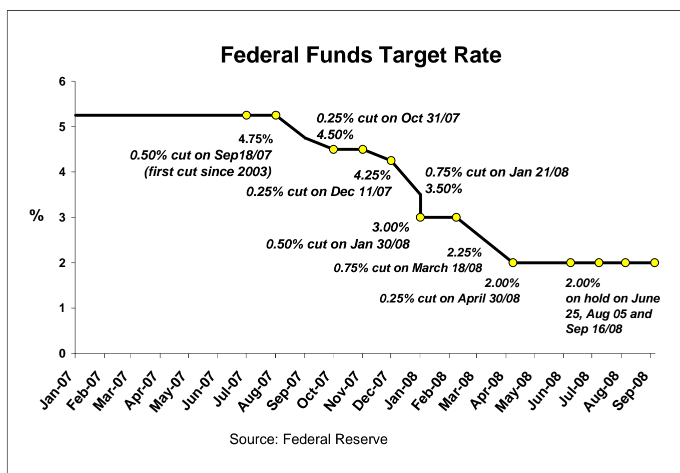
Despite the readings just above the threshold, recent inflation readings have not put additional pressure on the Fed to hike interest rates. In August, U.S. consumer prices fell for the first time in two years. On an annual basis, the consumer price index decreased to 5.4% in August, from 5.5% in July. Prices are still much higher than they were a year ago, however, and the one-month decline will not provide much relief for consumers.

The August number reinforced the notion that inflation has peaked, given the recent decline in world oil prices. Oil prices fell 4% to their lowest level in seven months one day after Lehman filed for bankruptcy and Merrill Lynch agreed to a takeover by Bank of America. Behind the decline were concerns that the turmoil in Wall Street would increase the global economic slowdown. The fall in oil prices is reducing the gap between headline and core inflation and contributing to a decline in inflation expectations, which should reduce pressure on the Federal Reserve to increase interest rates in the next two quarters.

- **Monetary Policy**

Since September of 2007, the U.S. Federal Reserve has cut the federal funds rate seven times, for a total of 325 basis points, to the current level of 2%. The FOMC met ten times since the beginning of 2008, and reflecting the volatile conditions in financial markets, four of those meetings were unscheduled. In the past three meetings (June 24-25, August 05 and September 16) the committee voted to hold its key policy rate, the fed funds rate target, steady at 2%.

In the wake of the demise of Lehman Brothers, the Federal Reserve announced a sharp easing of the terms under which it lends to primary dealers – most of whom are investment bankers – under the Primary Dealer Credit Facility (PDCF), taking a wider range of assets (equities, whole loans and sub-investment grade debt) as collateral. According to market analysts, the PDCF is now an almost perfect substitute for the "Tri-party repo market" – the market in which investment banks traditionally meet much of their short-term funding needs. However, other investment banks remain reluctant to borrow from this facility, fearing it would be seen as a sign of weakness, leading to increased market pressure.



The "stigma" problem with the PDCF explains why the Fed also announced it was broadening the range of assets that can be pledged in exchange for loans of government bonds under its Treasury Securities Lending Facility to include all investment-grade debt, increasing the facility's size from US$ 175 billion to US$ 200 billion and also increasing the frequency of its auctions. The two announcements were meant to calm markets as they head into a period of risky trading environment, with Lehman's massive market positions on the verge of being unwound.

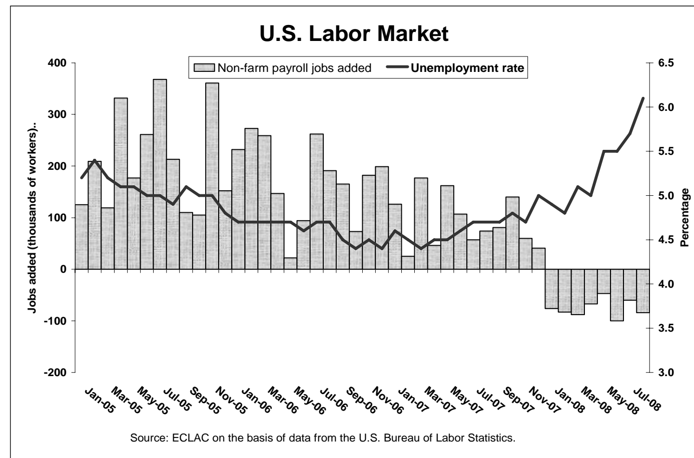
Faced with this series of shocks to the U.S. financial system, the FOMC left interest rates unchanged Tuesday, September 16, saying that it will be watching developments *"carefully."* In its statement, the Committee said *"strains in financial markets have increased significantly and labor markets have weakened further."* The decision was unanimous, the first fully unanimous vote since last

September, and gives the Fed more time to evaluate the effects of the last series of financial shocks on the overall economy.

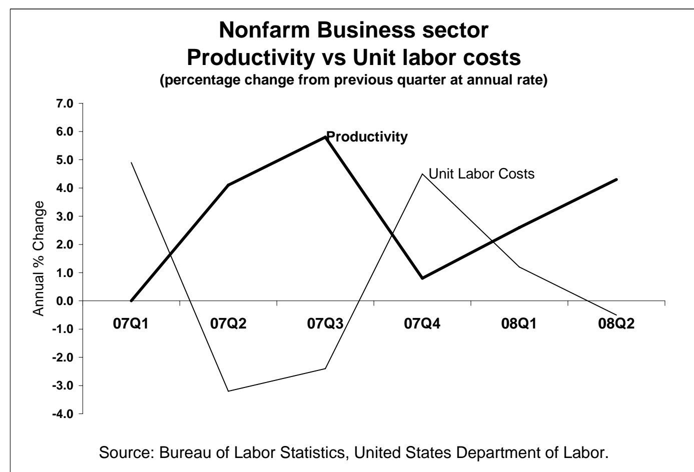
- **Labor Markets**

Conditions in the job market deteriorated sharply in August. The Labor Department report was weaker than anticipated, showing monthly job losses of 84,000. The job losses in August came in every sector, with manufacturing and business services the hardest hit. It was the eighth consecutive month of job losses. The unemployment rate jumped by a 0.4 percentage point to 6.1%, which is the highest it has been since September 2003. As recently as February, the unemployment rate was under 5%.

Employers have shed 605,000 positions year-to-date at an average rate of about 76,000 jobs a month. In the second quarter, 214,000 jobs were eliminated, at an average of 71,000 positions a month. 100,000 jobs were lost in June alone, the first time the economy has seen six-digit losses in years. The labor market data confirms the view that the economy is in for an extended period of weak growth, and raises a warning that risks for a more accentuated downturn are rising, as households face a struggling labor market and higher inflation.



Despite the weak job market, U.S. productivity soared and labor costs fell in the second quarter. The productivity and labor costs figures make it easier for the Fed to remain on hold as they assess economic and inflation risks. Second quarter productivity growth for the nonfarm business sector, a measure of business efficiency, was 4.3% (SAAR), almost double the initial estimate of 2.2%. From the second quarter of 2007 to the second quarter of 2008 productivity increased by 3.4%, which is much faster than the average 2.5% growth rate between 2000 and 2007.



Companies have been adjusting quickly to the economic slowdown by shedding workers and cutting back on the number of hours worked. Hours worked declined at a 0.8% annual rate in the second quarter, but output rose at a 3.4% annual rate. Meanwhile hourly compensation, adjusted for inflation, fell 1.3%, a sign that workers wages are not keeping up with inflation. That could dampen consumer spending in coming months. Companies have been successful in keeping wage demands under control, in spite of the growing cost pressures on consumers. Nonfarm unit labor costs, a key gauge of inflationary pressures, fell an annualized 0.5%. From the second quarter of 2007 to the second quarter of 2008 unit labor costs increased by only 0.6%.

Productivity and costs: Revised Second-Quarter 2008 measures
(Seasonally adjusted annual rates)

Sector	Productivity	Output	Hours	Hourly compensation	Real hourly compensation	Unit labor costs
	Percent change from preceding quarter					
Business	4.3	3.2	-1.0	4.0	-1.0	-0.4
Nonfarm business	4.3	3.4	-0.8	3.7	-1.3	-0.5
Manufacturing	-2.2	-3.7	-1.5	3.9	-1.1	6.2
Durable	-4.5	-5.9	-1.5	4.1	-0.8	9.0
Nondurable	0.2	-1.3	-1.6	3.3	-1.6	3.1

Source: Bureau of Labor Statistics.

- **Financial Markets**

Financial markets are bracing for increased volatility after Lehman Brothers filed for bankruptcy protection and Merrill Lynch agreed to be sold to Bank of America on Monday, September 15. After efforts to save Lehman were abandoned because of the absence of support from the federal government to potential buyers, Bank of America bid for Merrill Lynch. The U.S. government, which had bailed out Fannie Mae and Freddie Mac a week earlier and orchestrated the sale of Bear Stearns to JPMorgan Chase in March, refused to provide a financial backstop to potential buyers for Lehman. This time around federal authorities believe that Lehman's assets will likely be liquidated in an orderly fashion, given that financial institutions have had six months to prepare for the possible failure of Lehman. Moreover, since March the Fed has put in place an emergency liquidity facility to guard against the problem that hit Bear, the risk of a sudden funding strike in the repo market. However, although they did not provide federal money this time, the Federal Reserve took steps to stabilize the broader financial system, making it easier for banks and security firms to borrow from the central bank by using a wider range of collateral. In addition, eleven of the world's biggest banks created a US$ 77 billion liquidity fund to support other vulnerable institutions, another initiative intended to mitigate the impact of Lehman's failure.

Following the announcements that Lehman had filed for bankruptcy protection and Merrill Lynch had been sold on Monday, September 15, the U.S. stock market reported its biggest one-day decline since the September 11 terrorist attacks. Fears about the health of the U.S. financial system continued to reverberate, with investors turning their focus to the fate of other troubled companies. Investors grew increasingly concerned about the futures of AIG and Washington Mutual after both suffered brokerage downgrades after the markets closed Monday, September 15. AIG's problems result from its US$ 441 billion exposure to credit-default-swaps and other derivatives. Losses on these contracts have led AIG to seek ever more cash to remain a highly-rated counterparty.

The U.S. government seized control of AIG in an $85 billion deal on Tuesday, September 17, highlighting its concerns about the danger a collapse could pose to the financial system. Under the terms agreed, the Fed will lend up to $85 billion to AIG, and the U.S. government will effectively get a 79.9% equity stake in the insurer in the form of warrants called equity participation notes. The two-year loan will carry an interest rate of 8.5% over the Libor (the London interbank offered rate, which is a common short-term lending benchmark). The loan is secured by AIG's assets, including its profitable insurance businesses, giving the Fed some protection even if markets continue to sink. And if AIG rebounds, taxpayers could reap a big profit through the government's equity stake. *"This loan will facilitate a process under which AIG will sell certain of its businesses in an orderly manner, with the least possible disruption to the overall economy,"* the Fed said in a statement. On Wednesday, September 27, the U.S. Treasury announced it was creating a supplemental funding program to ensure that the Fed has the cash it needs, and that its ability to provide markets with emergency liquidity support is not constrained.

Treasury Secretary Hank Paulson said housing was *"at the heart of the turmoil and stress for our financial markets and financial institutions."* Over the weekend of September 6, the Treasury and Federal

Housing Finance Authority (FHFA) announced plans to place the two largest housing government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, into "conservatorship" (under the legal control of the U.S. government) and replace senior management and the boards of directors at both enterprises. The aim, in the words of Secretary Paulson, was *"to protect the stability of the financial market, and to protect the taxpayer to the maximum extent possible."* According to him, *"Fannie Mae and Freddie Mac are so large and interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the globe."* The move would *"accelerate stabilization in the housing market"* by bringing down the cost of home loans.

As part of the plan, FHFA was granted direct oversight of the two companies, and the Treasury was given authority to inject capital into them in the form of senior preferred shares and warrants (senior to existing shareholders), while dividends on existing common and preferred stock will be immediately suspended. In addition, the Treasury was granted temporary authority to purchase agency-backed Mortgage-Backed Securities (MBS). Thus the U.S. government is now committing public money to buy mortgages. The announcement intended to offer a potential solution to the soaring risk spreads in home loans, which are higher today than they were a year ago, in spite of 325 basis points of Fed rate cuts.

The U.S. government hopes that after the rescue of the two mortgage giants, which have been financing some three-quarters of U.S. mortgages, the risk spreads on their debt – a key input into mortgage costs – will sharply decline. It will also look to cut the fees Fannie and Freddie charge on the loans they guarantee. Lower mortgage rates, it expects, should help the housing market to stabilize sooner and prompt a refinancing boom, putting cash in consumers' hands. However, there is a growing sense that it may be some years, and possibly more rescues and interventions, before the financial crisis has subsided.

Equity prices fell in the second quarter (June losses more than compensated for gains in April and May), with Dow Jones loosing 1.13%, the S&P 1.85% and the NASDAQ 7.66%. They continued to fall in July and August, and have lost 13.99%, 13.37% and 10.23% year-to-date, respectively. Treasury Yields increased in the second quarter, but fell in July and August.

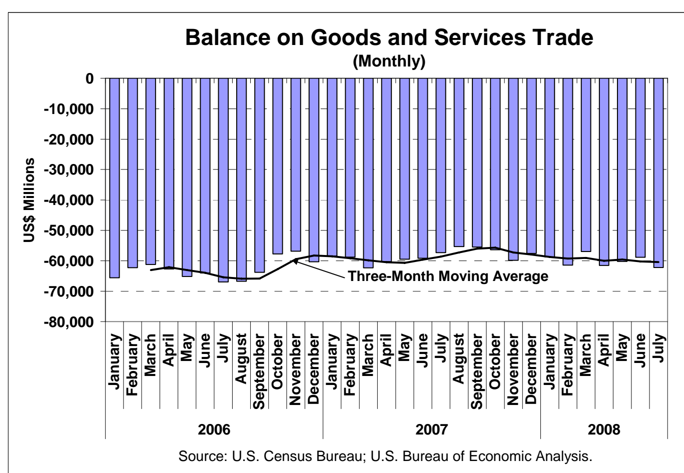
There were net long-term flows in the second quarter of US$ 253 billion according to the Treasury International Capital (TIC) report. Despite the weaker dollar, the U.S. trade deficit widened in the second quarter to US$ 186 billion from US$ 177 billion in the first quarter. Capital flows were thus more than enough to finance the trade deficit. In July, however, net capital flows dropped to US$ 6.1 billion from US$ 53.4 billion in June. This was the third straight monthly decline, and it is worrying because the trade deficit widened in July to US$ 62.2 billion, thus capital flows were far from being able to finance the monthly trade deficit. The turmoil in July's international capital flows anticipated the subsequent meltdown in U.S. financial markets that finally led to the de facto nationalization of Fannie Mae and Freddie Mac, as well as AIG.

- **External Sector**

Trade has turned into a boost to real GDP growth since the second quarter of 2007, and it was a particularly strong boost in the second quarter of 2008. While net exports contributed only 0.8% to GDP growth in the first quarter, in the second net exports contributed 3.1%.[1] According to the Bureau of Economic Analysis and the Census Bureau, the U.S. goods and services deficit widened by US$ 3.44 billion in the second quarter of 2008 (1.94%), from US$ 177.11 billion in the first quarter to US$ 180.55 billion. The trade deficit jumped in April, but declined both in May and June.

[1] From 1996 to 2006 trade was a consistent drag on economic growth according to Moody's Economy, shaving from 0.1 to 1.2 percentage points from real GDP growth.

The trade deficit widened more than expected in July, however, to US$ 62.2 billion. While U.S. exports surged and continued to contribute to economic growth, record-high oil prices pushed the July trade deficit to its highest level since March 2007. Trade with most U.S. partners has fallen further into deficit. The trade deficit with China grew by 16% to US$ 24.9 billion and by 15.3% to US$ 8.3 billion with Canada, the U.S.'s biggest trading partner, while the trade deficit with Mexico narrowed by 4% to US$ 5.5 billion. The larger trade deficit in July is bad news for the hope that the U.S. economy may experience an export-driven rebound. There was a large increase in imports, suggesting that the U.S. consumer is still spending on imported goods.



III. LOOKING AHEAD

- Current market projections for real GDP growth in 2008 now range from 0.6% to 1.7%. These forecasts were made mostly in August. If the rescue of the two mortgage lenders by the U.S. Treasury works, making mortgages cheaper and more accessible to prospective buyers, this could be an important step in the path towards the recovery of the housing market. However, labor-markets conditions continue to weaken, and financial jitters are high, thus the outlook for the U.S. economy remains highly uncertain.

Forecasts for Annual U.S. Economic Growth

	Real GDP		
	2008	Date of Forecast	Previous Forecasts
A. What Government Agencies Say			
FED*	1.0 to 1.6%	*Jun-08*	*1.3-2.0% in Jan-08; 0.3 to 1.2 in Apr-08*
Council of Economic Advisors*	2.7%	*Nov-07*	*2.7% in Jun-07*
CBO	1.9%	*Feb-08*	*2.9% in Aug-07*
B. What Markets Say			
Goldman Sachs	1.7%	*Aug-08*	*0.9% in Mar-08, 1.1% in May-08, 1.5% in Jul-08*
National Association of Realtors	1.7%	*Aug-08*	*2.2% in Feb-08, 1.5% in Mar-08*
Merrill Lynch	1.5%	*Aug-08*	*0.8% in Mar-08, 1.2% in May-08, 1.4% in Jun-08*
Moody's Economy.com	1.7%	*Aug-08*	*2.3% in Nov-07, 1.5% in Mar-08, 1.6% in Jun-08*
The Economist Intelligence Unit	1.5%	*Aug-08*	*1.5% in Dec-07, 0.8% in Mar-08, 1.25 in Jul-08*
JPMorgan	1.5%	*Aug-08*	*1.9% in Feb-08, 1.2% in Mar-08, 1.4% in May*
Securities Industry and Financial Markets Association (SIFMA)	1.6%	*Jun-08*	*2.1% in Dec-07*
Wachovia	1.8%	*Aug-08*	*2.7% in Nov-07, 1.7% in Mar-08, 1.6% in Jun-08*
Mortgage Bankers Association*	0.8%	*Aug-08*	*1.6% in Feb-08, 1.3% in May-08,1.4%in Jun-08*
Market Average	***1.5%***		
C. What International Organizations Say			
United Nations DESA (Baseline)	-0.2%	*May-08*	*2.0% in Jan-08*
OECD	1.2%	*Jun-08*	*2.0% in Dec-07*
IMF	1.3%	*Jul-08*	*1.5% in Jan-08, 0.5% in Apr-08, 1.1% in Jun-08*

* forecast on a Q4 to Q4 basis.

Note: the CBO, IMF, and SIFMA forecasts on a Q4 to Q4 basis are 1.6%, 0.3%, and 1.1%, respectively.

- The CBO estimates that the U.S. budget deficit will increase to US$ 407 billion this year from US$ 162 billion in 2007. The CBO expects a record US$ 438 billion deficit in 2009. The deterioration has nothing to do with Fannie and Freddie's rescue, but is a result of weak tax receipts in a slowing economy, along with increased spending on fiscal rebates and covering the insured deposits of failed banks, among other things. However, the takeover of Fannie and Freddie has increased apprehension towards the federal balance sheet.

- Regulatory issues will now be the focus of much debate: which role should the government and regulators take, which agencies should oversee financial institutions. Treasury Secretary Hank Paulson has offered a blueprint to overhaul the current financial regulation framework, and Congress plans to discuss it next year. The recent turn of events should make this effort even more pressing.