

THE ECONOMY

March / 2009
Vol. 76, No. 46

The U.S. economy contracted by an annualized 6.3% pace in the final quarter of 2008, mostly as a result of weak consumer spending and business investment. This was the largest quarterly decline since the second quarter of 1982 (-6.4%). Consumer spending fell 4.3% during the last three months of last year, subtracting about 3.0% from aggregate demand. Meanwhile, gross private domestic investment plunged 23.0% and shaved about 3.5% from the overall quarterly performance. Specifically, weak investment in equipment and software dealt the biggest blow to the overall economy.

Looking ahead, there appear to be several reasons for optimism: consumer spending has been surprisingly strong during the first two months of 2009, and many of the housing indicators have exhibited signs of stabilization. Stimulus is further down the pipeline, and retail, wholesale, and manufacturing inventories are looking lean.

We are encouraged by the better-than-expected gains we've seen in several tier-one indicators — but the primary driver, employment, still hasn't shown any convincing signs of improvement. As long as unemployment is atop the nation's worry list, consumers will likely resist the urge to spend. We are very aware that the labor market is a lagging indicator, but the level of joblessness has been so high that we can't help but believe it will take some time for the jobs machine to get working again. Still, there has been a great deal of encouraging economic news — and that shouldn't go unaddressed.

Consumer spending inched up 0.2% in February after soaring 1.0% in January — the largest one-month increase in about three-and-a-half years. This snapped a record six consecutive monthly declines. Unfortunately, these back-to-back gains were somewhat of an exaggeration. Once adjusted for inflation — the statistic used in the estimation of the quarterly

GDP report — the real value of spending fell 0.2%. Consumer spending during the first quarter may be on track for a slight 0.8% increase, which would go a long way in keeping the overall first-quarter performance at “better than expected.” Still, the level of joblessness suggests that March spending could be weak.

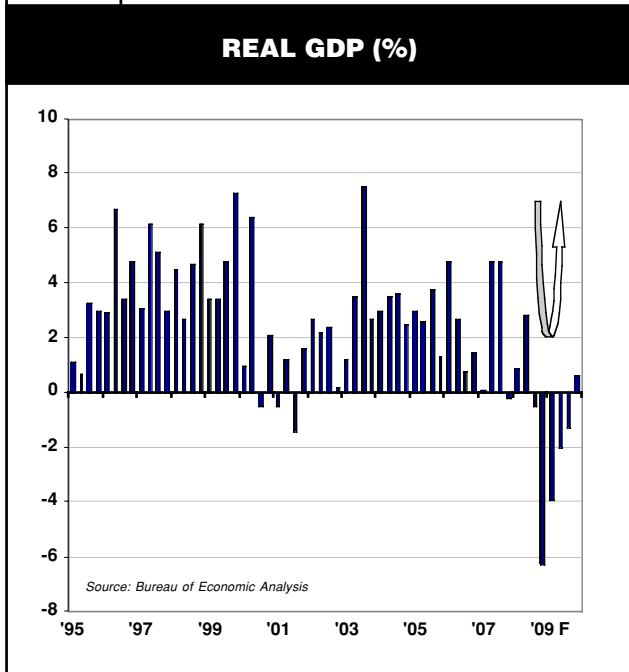
Data out of the housing area is looking as good as it has in years. Housing starts jumped 22% in February to a seasonally adjusted annual rate of 583,000 units — ending the longest consecutive string of monthly declines in 18 years. As a positive barometer of future activity, building permits rose 3.0%. Sales of existing homes climbed 5.1% to 4.72 million units in February. New home sales climbed 4.7% in February — the first increase in seven months. It is possible that all of these datapoints may improve since mortgage rates have headed lower. During the last week of March, the 30-year fixed mortgage rate averaged 4.85% — down from 4.98% a week earlier. This was the lowest level in the 40 years of recorded history. As a result, refinances and new mortgage applications have surged.

Looking ahead, we expect that the recession will carry on through the third quarter of 2009, with a slight positive posting in the fourth quarter. This should result in a “V-shape” recession, with a decline of 3.9% in the first quarter, a drop of 2.0% in the second quarter, a dip of 1.3% in the third quarter and an increase of 0.6% in the final quarter. For all of 2009, we expect real GDP to contract by 2.6% and expect a 1.1% increase in economic activity in 2010. This risk to our forecast is to the upside as so many indicators have surprisingly bettered sunken expectations.

Richard Yamarone,
Director of Economic Research

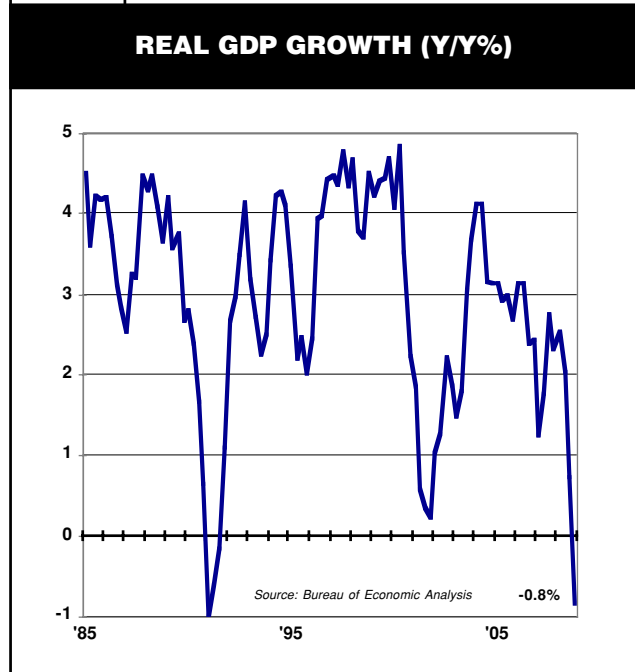
VIEWPOINT

TABLE 1



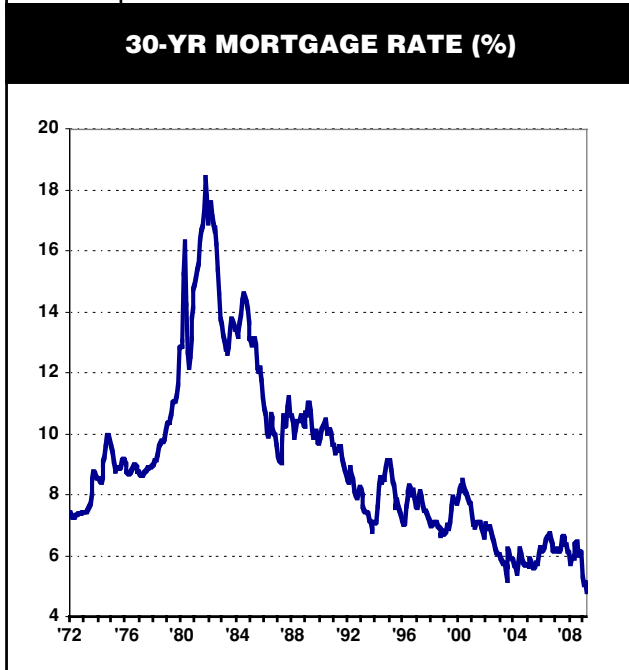
We continue to expect a V-shaped recovery.

TABLE 2



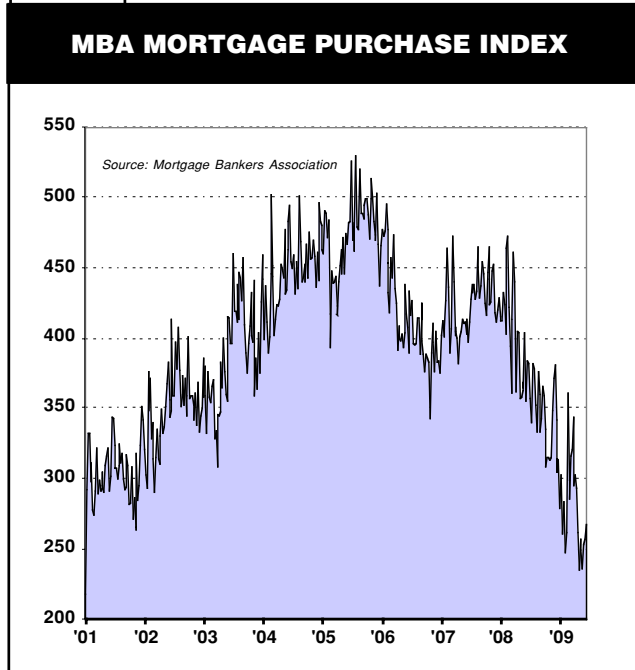
The year-over-year pace of real economic growth remains in a downward trend.

TABLE 3



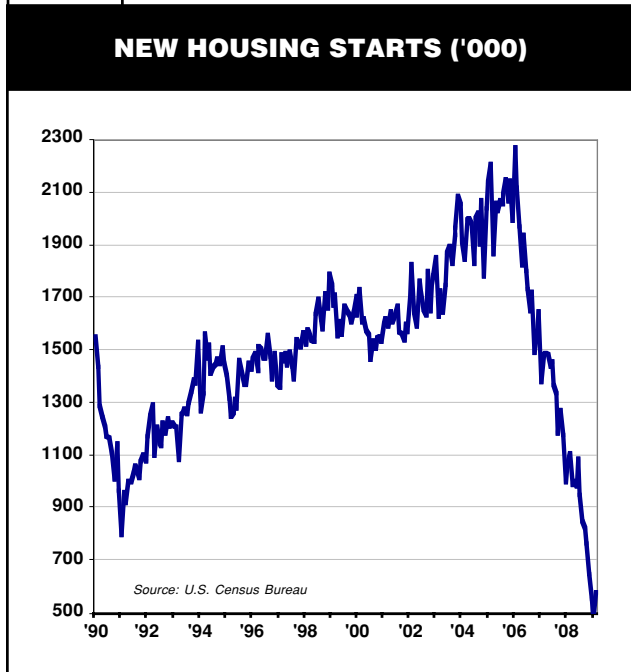
The Fed's recent announcements have led to a dramatic drop in mortgage rates.

TABLE 4



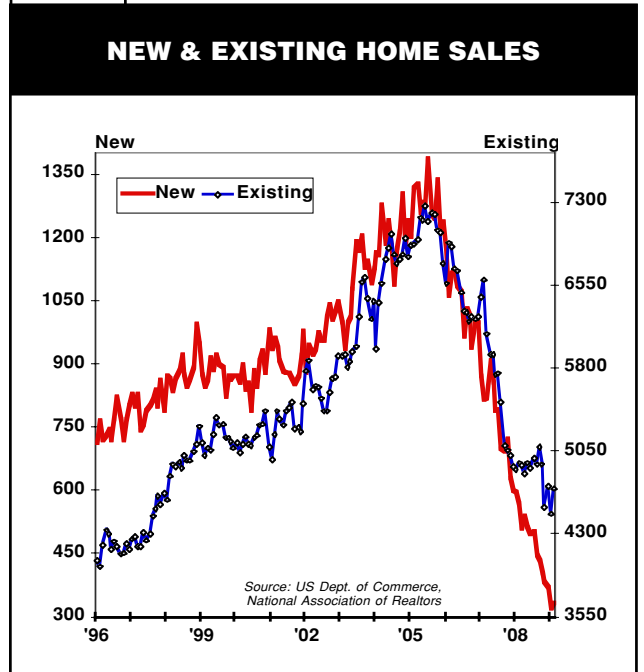
Mortgage purchases are expected to rise given sunken mortgage rates.

TABLE 5



The 22% uptick in housing starts during February was the most promising news in this statistic in years.

TABLE 6



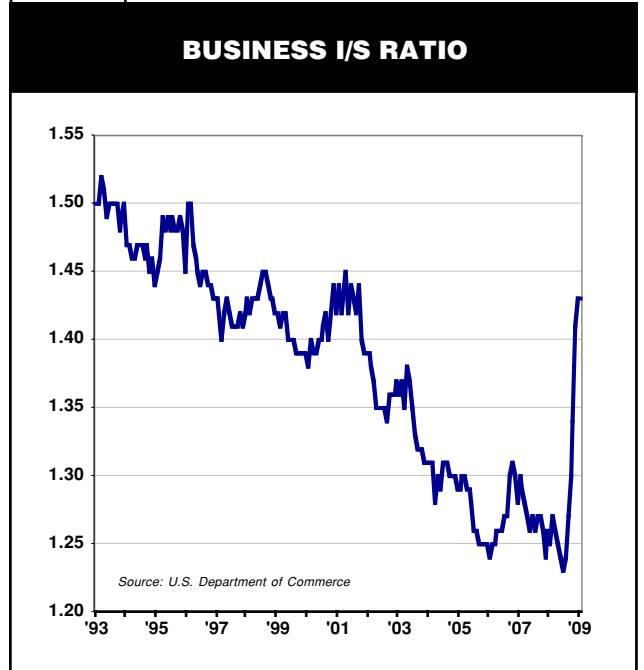
New and existing home sales appear to have stabilized in recent months.

TABLE 7



Consumer spending data is signaling a potential trough in the first quarter.

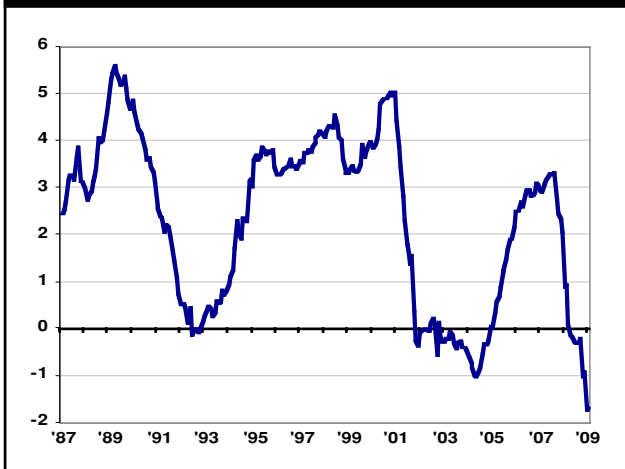
TABLE 8



A possible peak in the inventory/sales ratio implies a need for increased production.

TABLE 9

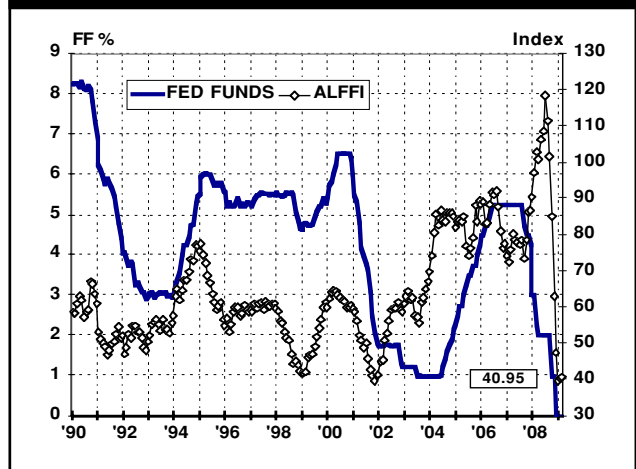
**REAL FED FUNDS RATE
PERSONAL CONSUMPTION DEFLATOR (%)**



Monetary stimulus is extremely easy by historical comparison.

TABLE 10

ARGUS LEADING FED FUNDS INDEX



A potential bottoming in our internal inflation measure suggests higher prices are in the offing.

GDP FORECAST TABLE

	2007 A				2008 A				2009 E				2010 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	0.0	4.8	4.8	-0.2	0.9	2.8	-0.5	-6.3	-3.9	-2.0	-1.3	0.6	2.2	2.2	2.0	1.5
Annual:				2.4				-0.8				-1.7				2.0
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.2	-3.8	-4.3	-0.3	-4.0	-1.3	0.5	1.6	0.9	1.4	0.9
Durables	9.2	5.0	2.3	0.4	-4.3	-2.8	-14.8	-22.1	-25.5	-11.2	-7.4	-1.6	1.2	1.9	2.3	3.0
Non-Durables	3.5	1.9	1.2	0.3	-0.4	3.9	-7.1	-9.4	0.2	0.5	-0.5	0.7	1.2	1.2	1.4	0.7
Services	3.1	1.4	2.4	1.4	2.4	0.7	-0.1	1.5	1.5	1.1	0.8	0.9	0.5	0.5	1.2	0.6
Gross Domestic Investment	-9.6	6.2	3.5	-11.9	-5.8	-11.5	0.4	-23.0	-12.2	2.6	-4.4	-0.5	7.7	8.4	1.3	0.7
Fixed Investment	-3.4	3.0	-0.9	-6.2	-5.6	-1.7	-5.3	-22.0	-15.5	-1.8	-1.3	-1.7	5.0	5.7	1.3	2.0
Non-Residential	3.4	10.3	8.7	3.4	2.4	2.5	-1.7	-21.7	-13.6	1.9	-0.4	-0.6	5.5	6.4	1.2	1.9
Structures	11.2	18.3	20.6	8.6	8.7	18.4	9.6	-9.4	-10.6	3.1	-2.4	-5.9	8.9	4.9	2.4	2.4
Equip. & Software	0.0	6.9	3.6	1.0	-0.5	-5.0	-7.5	-28.1	-3.3	1.5	0.3	1.3	4.4	6.9	0.8	1.8
Residential	-16.2	-11.6	-20.6	-27.0	-25.0	-13.3	-16.1	-22.7	-16.5	-15.4	-5.2	-6.5	1.9	1.9	1.8	1.7
Change in Pvt. Inventories	-15.0	-2.8	16.0	-8.1	-10.2	-50.6	-29.6	-25.8	-15.0	2.0	-10.0	-5.0	5.0	15.0	15.0	10.0
Net Exports	0.6	8.8	23.0	4.4	5.1	12.3	3.0	-23.6	-5.9	-1.1	1.7	1.7	1.8	1.4	4.5	3.5
Exports	2.1	6.8	21.8	5.1	4.6	16.3	3.6	-32.0	-8.4	-2.4	2.1	2.1	2.3	1.2	4.5	4.3
Goods	-2.7	13.3	26.0	2.7	6.4	3.7	1.4	-1.5	1.1	1.8	0.9	0.9	1.7	4.4	2.0	2.0
Services	7.7	-3.7	3.0	-2.3	-0.8	-7.3	-3.5	-17.5	-0.1	-0.7	1.1	1.5	1.5	0.9	1.0	1.0
Imports	8.4	-4.0	2.4	-2.6	-1.9	-7.1	-4.7	-19.6	-0.4	-1.3	0.5	1.1	1.3	0.3	0.8	0.8
Goods	4.2	-2.0	6.3	-0.8	5.5	-8.1	3.7	-6.7	1.6	2.7	4.1	4.1	2.1	3.9	2.0	2.4
Services	0.9	3.9	3.8	0.8	1.9	3.9	5.8	1.3	-2.0	2.8	1.5	1.5	0.1	2.5	2.3	2.7
Gov't Purch. of Goods & Svcs.	-3.7	6.7	7.2	-0.5	5.8	6.6	13.8	6.9	-6.2	6.6	3.2	3.4	-0.7	5.1	4.2	5.3
Federal	-5.9	8.4	10.1	-0.9	7.2	7.3	18.0	3.4	-7.0	3.3	1.8	0.3	2.7	-0.8	1.3	2.3
National Defense	1.3	3.1	1.1	0.5	2.7	5.0	5.1	15.3	-3.7	13.6	5.9	9.8	-7.1	17.6	9.9	11.1
Non-Defense	3.6	2.4	1.9	1.6	-0.3	2.5	1.4	-2.0	0.1	0.3	0.3	0.2	0.7	0.8	1.1	0.9
State & Local	1.1	4.3	4.0	0.8	0.9	4.4	-1.3	-6.2	-4.4	-2.6	-0.8	0.4	1.8	1.9	2.0	1.7
Final Sales of Domestic Prod.	2.2	2.5	1.9	-0.1	0.1	1.3	-2.2	-5.8	-3.2	-2.5	-0.8	0.4	1.8	1.8	1.5	1.4
Final Sales to Dom. Purch.																
Addendum:																
Nominal GDP	4.3	6.9	6.4	2.3	3.5	4.1	3.4	-5.8	-1.9	-0.1	2.0	3.6	5.4	5.8	5.5	4.7
Personal Con Exp Deflator	3.4	3.6	2.5	4.3	3.6	4.3	5.0	-4.9	2.2	2.0	3.0	2.9	2.9	3.2	2.9	3.3
GDP Price Deflator (implicit)	4.2	2.0	1.5	2.5	2.6	1.3	3.9	0.6	2.1	2.0	3.3	3.1	3.2	3.5	3.5	3.1

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