JOINT ECONOMIC COMMITTEE

Senator Sam Brownback, Ranking Republican

FEBRUARY 3, 2009

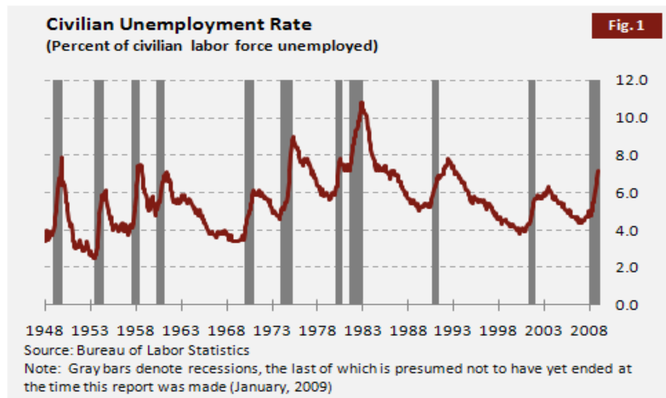
RECENT ECONOMIC DEVELOPMENTS

SIGNIFICANT CONTRACTIONS IN EMPLOYMENT AND OUTPUT

The unemployment rate rose significantly in December to 7.2%, up from 6.8% a month earlier and 4.9% a year earlier, and the highest since January of 1993. Payroll employment declined by 524,000 in December and has fallen by almost 2.6 million over the past 12 months. Output, measured by the inflation-adjusted (real) gross domestic product (GDP), fell at a 3.8% annualized rate in the 4th quarter, dragged down by a significant 19.7% annualized decline in exports—the first decline since 2003—and a significant 3.5% decline in consumer spending. Reflecting ongoing adjustments in housing markets, residential investment has fallen for 12 straight quarters, home prices and building activities continue to decline, and mortgage delinquencies and foreclosures continue to climb. In light of weakness in housing, economic activity, and labor markets, the Federal Reserve decided last month to keep its target overnight interest rate in a "target range" of 0% to ¼% and identified "credit easing" plans to continue expansion of the asset side of its balance sheet.

Highlights

- The *unemployment rate* rose to 7.2% in December, the highest since 1993 (Fig. 1).
- Non-farm *payroll employment* declined by 524,000 in December. The economy has shed almost 2.6 million jobs over the past 12 months (Fig. 2, next page).
- *GDP* declined at a 3.8% annualized rate in the 4th quarter, led by significant downturns in exports and consumer spending (Fig. 3, next page).
- *Housing market adjustments* continue, including continuing declines in *home prices* (Fig. 4, next page).



Unemployment Rises to 7.2%; Twelve Consecutive Months of Payroll Job Declines

The *unemployment rate* rose to 7.2% in December—the highest since January of 1993 (Fig. 1). *Payroll employment* fell by 524,000 jobs in December, following declines of 584,000 in November and 423,000 in October. December was the 12th consecutive month with job declines, a period over which the economy has shed close to 2.6 million payroll jobs (Fig. 2, next page).

GDP Declined at a 3.8% Annualized Rate in 4th Quarter

Real GDP fell at a 3.8% annualized rate in the 4th quarter, following a 0.5% annualized decline in the 3rd quarter (Fig. 3, next page). The decline in 4th quarter GDP primarily reflected exports (down 19.7%), consumer spending (down 3.5%), residential investment (down 23.6%), and equipment and software spending (down 27.8%). Those declines were partly offset by positive contributions from inventory investment (which added 1.32 percentage points to the 4th quarter change in GDP) and federal government spending (up 5.8%). Imports—a subtraction in the calculation of GDP—fell 15.7%. Residential investment has declined for 12 consecutive quarters, reducing real GDP growth over that period by an average 0.91 percentage point. Over that same period, export growth has added to real GDP growth by an average of 0.68 percentage point. However, exports pulled growth down in the 4th quarter by 2.84 percentage points, after having added to growth in each prior quarter beginning in the 2nd quarter of 2003. These data reveal the importance of international trade for the evolution of the U.S. gross domestic product. Many fear that recent protectionist sentiments, including "buy American" provisions in stimulus packages could fuel trade wars.

Housing Market Adjustments Continue

Existing home sales have fallen on a year-over-year basis in all but one month since November 2005, and *new home sales* have fallen continuously over that period. The inventory of unsold new homes remains elevated at 12.9 months, above the long-term average of 6.1 months. *Home prices* have been falling for at least the past three quarters on a year-over-year basis (some measures show declines beginning in the second half of 2006) (Fig. 4). *Mortgage delinquency and foreclosure rates* have risen markedly, especially for sub-prime adjustable-rate mortgages, since the beginning of 2006.

Inflation Edges Down; Energy & Commodity Prices Easing

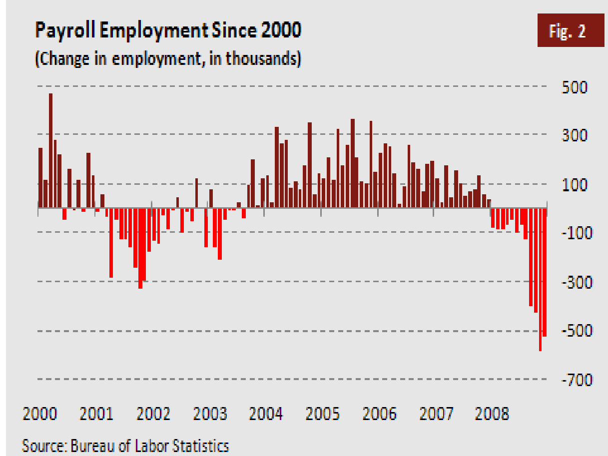
The overall *consumer price index (CPI)* declined 0.7% in December relative to a month earlier, the 5th consecutive monthly decline. Excluding volatile food and energy prices, the *"core" consumer price index* declined 0.2% in December, and has fallen in two of the past five months. The overall *personal consumption expenditures (PCE) price index*, one of the Fed's preferred measures of consumer prices, fell 1.1% in November relative to a month earlier, the 2nd consecutive monthly decline. The *core PCE price index* has also fallen in two consecutive months, by 0.01 % in October and November. On the basis of year-over-year growth in consumer prices, the overall and core CPI and PCE price indexes show significant declines in inflation, but do not yet indicate persistent *deflation.*

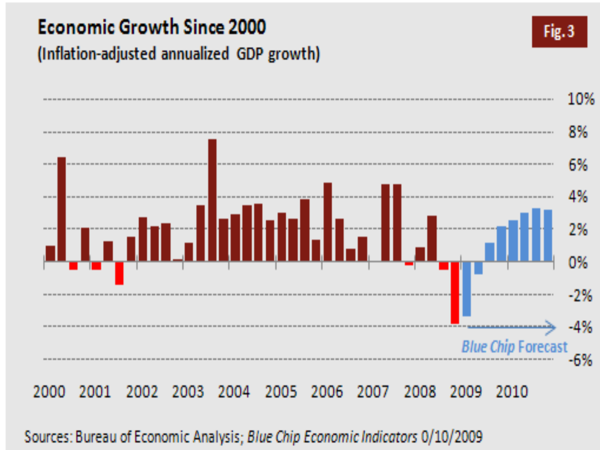
Fed Keeps Rates Low; Plans Further "Credit Easing"

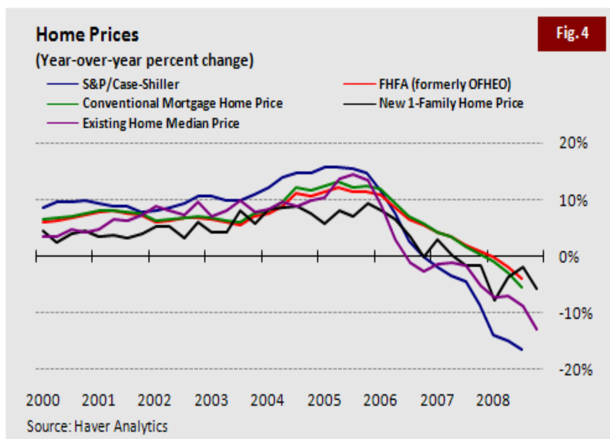
The Fed kept its "target range" for overnight interest rates at 0% to ¼% at its January policy meeting and said that it plans to expand its "credit easing" policies. *Credit easing* describes Fed moves to expand its holding of assets by purchasing securities and making loans. The Fed continues to buy large quantities of agency debt and mortgage-backed securities; is prepared to purchase longer-term Treasuries; and will be implementing a Term Asset-Backed Securities Loan Facility to facilitate extension of credit to households and small businesses.

"Credit Easing vs. Quantitative Easing"

The Fed's *credit easing* policy is conceptually distinct from the "*quantitative easing*" approach used by the Bank of Japan from 2001 to 2006. Quantitative easing focuses on the quantity of bank reserves, which are central bank liabilities, and not on the compositions of loans and securities on the central bank's asset side. The amount of bank reserve liabilities of the central bank is the focus in quantitative easing, and the asset side of the balance sheet is incidental. By contrast, credit easing focuses on the mix of loans and assets held by the central bank, with the composition reflective of the segments of financial markets in which the central bank seeks to ease credit conditions. The composition of the asset side of the balance sheet is the focus in credit easing, and the quantity of bank reserves is incidental.







Upcoming Indicators

Employment – The Bureau of Labor Statistics reports January's employment situation on *February 6.*

Inflation – The Consumer Price Index for January is scheduled for release on *February 20*.

GDP – A revised estimate of 4th quarter GDP growth is scheduled for release on *February 27.*

Federal Reserve – The Fed's next policy meeting is scheduled for *March 17.*