JOINT ECONOMIC COMMITTEE

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RECENT ECONOMIC DEVELOPMENTS

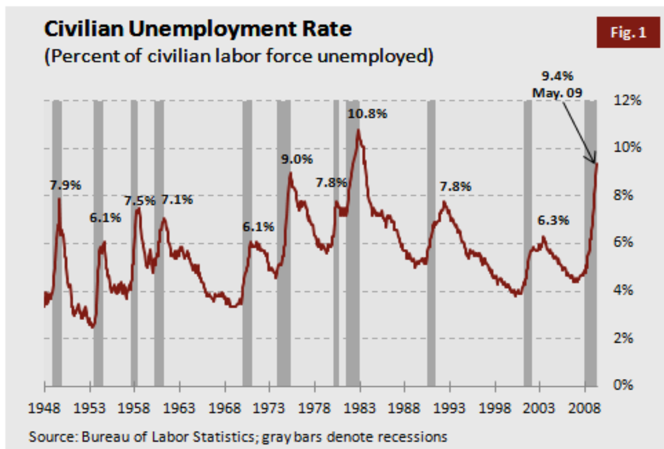
JUNE 23, 2009

Significant Downside Risks Remain Amid the "Green Shoots"

The unemployment rate rose to 9.4% in May and has risen by 4.5 percentage points since the start of the recession. Non-farm payroll employment fell by 345,000 jobs in May, moderation from an average decline of around 643,000 over the prior six months. Output in the economy, measured by the inflation-adjusted (real) gross domestic product (GDP) fell at a 5.7% annualized rate in the 1st quarter, following a 6.3% decline in the 4th quarter of 2008. While there have been tentative signs (green shoots) that the pace of economic contraction is diminishing and financial markets are in repair, significant downside risks remain. Threats to consumer spending, which accounts for over 70% of GDP, include continued declines in wealth and employment along with rising energy prices. There also remain risks to stabilization in financial markets, including, especially for mid-sized and small banks, rising delinquencies in commercial real estate loans.

Highlights

- The *unemployment rate* rose to 9.4% in May, the highest in over 25 years (Fig. 1).
- *Payroll employment* fell by 345,000 in May and by six million over the past 17 months (Fig. 2, next page).
- *GDP* declined at a 5.7% annualized rate in the 1st quarter, the third consecutive quarterly decline in real GDP (Fig. 3, next page).
- The *net worth* of households and nonprofits fell by $1.3 trillion in the 1st quarter and by $13.9 trillion over the past seven quarters (Fig. 4, next page).
- *Oil and other commodity prices* have trended up in recent months (Fig. 5, next page).



Unemployment Rises to 9.4%; 17 Consecutive Months of Payroll Job Declines

The *unemployment rate* rose to 9.4% in May (Fig. 1). *Payroll employment* fell by 345,000 jobs in May, moderation from declines of 504,000 in April, and 652,000 in March (Fig. 2, next page). There have been 17 consecutive months with job losses in which payroll employment has declined by a total of 6 million jobs. Reflecting adjustments in the housing sector, construction employment has fallen by 1.2 million jobs since the start of the recession. Job losses have been fairly evenly distributed across the service-producing and goods-producing sectors, with each losing around 3 million jobs. However, the goods sector has been hit disproportionately hard given that it accounts for only 17% of total nonfarm employment.

GDP Declined at a 5.7% Annualized Rate in the 1st Quarter

Real GDP fell at a 5.7% annualized rate in the 1st quarter, following a 6.3% rate of decline in the 4th quarter of last year and a 0.5% decline in the 3rd quarter (Fig. 3, next page). The drop in 1st-quarter GDP reflected negative contributions from: exports (down 28.7%); business investment (down 37%); inventory investment (the change in which subtracted 2.34 percentage points from the 1st-quarter real GDP change); and residential investment (down 38.7%). Residential investment has fallen for 13 straight quarters. Nonresidential (business) investment has declined for three consecutive quarters; the decline in the 1st quarter being the largest on record since the data began in 1947. Consumer spending rose at an annualized 1.5% rate in the 1st quarter, following declines of 4.3% in the 4th quarter of last year and 3.8% in the 3rd quarter. Exports fell at a 28.7% annualized rate in the 1st quarter and a 23.6% rate in the 4th quarter of last year.

Household Wealth Takes Another Hit in 1st Quarter

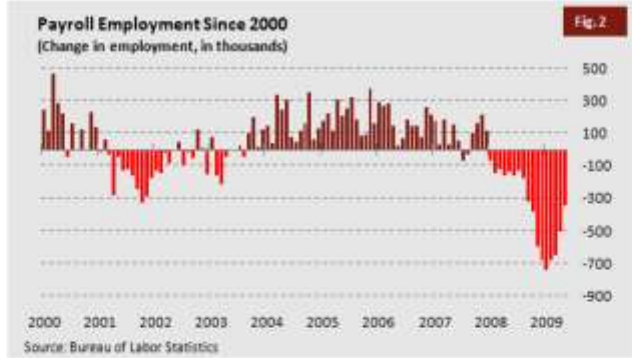
Net worth of households and nonprofit organizations fell by $1.3 trillion in the 1st quarter, following a $4.9 trillion decline in the 4th quarter of 2008 (Fig. 4). Over the past seven quarters, net worth has fallen by $13.9 trillion. Declines in financial asset values accounted for around 70% of the overall wealth decline, while declines in tangible assets, including real estate, accounted for around 30%. In the face of declining wealth, households have trimmed consumption spending and increased personal savings to shore up their balance sheets; personal saving as a percentage of disposable (after-tax) income has climbed from a near-term, pre-Lehman-collapse low of 0.8% in August 2008 to 5.7% in April 2009. The long-term average saving rate, from 1959 to the present, is 6.8%.

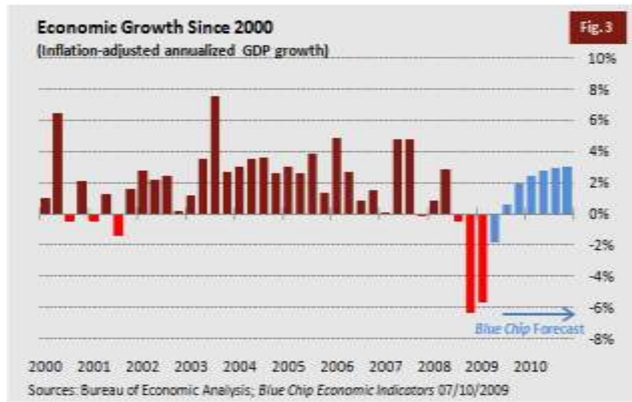
Oil and Commodity Prices Have Trended Up Recently

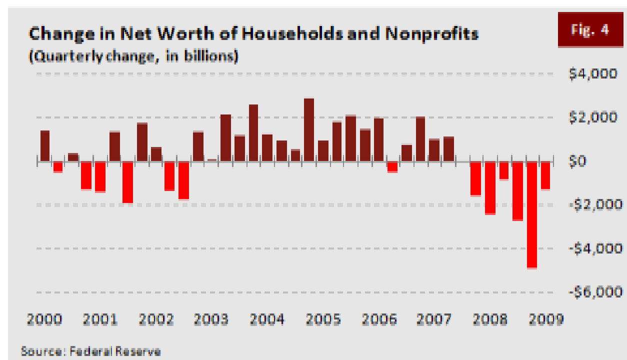
Prices of oil and other commodities (metals, textiles and fibers, raw industrial materials, foodstuffs, fats and oils, livestock products) have trended up since the beginning of the year, following sharp declines from the run-ups that preceded the collapse of Lehman Brothers. The Commodity Research Bureau's spot commodity price index, for example, has risen to a value of around 370, well below the recent high of 479 in the beginning of July 2008, but a 17% increase from 310 at the beginning of the year. The price of West Texas Intermediate Crude has risen to around $70 a barrel, well below the recent high of over $140 in the beginning of July 2008, but an increase of around 80% from around $40 per barrel at the start of the year. Possible reasons for the increases include expectations of global economic recovery, a weaker dollar, and increasing investor appetites for risk.

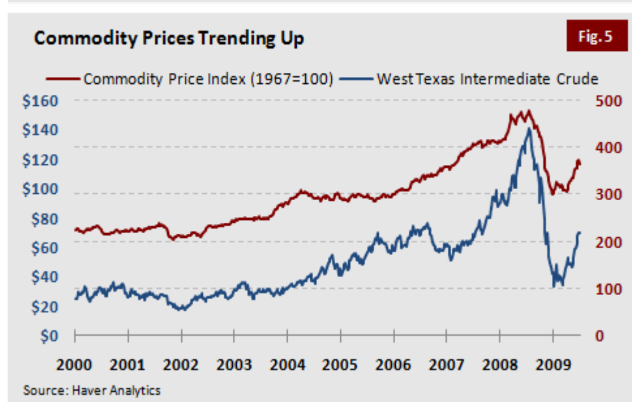
Commercial Real Estate and Banks

The delinquency rate on commercial real estate (CRE) loans doubled in each of the past two years, reflecting deterioration of market fundamentals, including falling rents, rising vacancies, and rapid declines in CRE prices. Increased CRE losses could have substantial adverse effects on regional banks and other financial institutions with large concentrations of CRE loans. CRE loans constitute around 13% of the assets of all commercial banks, but are around 47% of all loans for medium-sized and small banks. In mid-2008, issuance of commercial mortgage-backed securities (CMBS) essentially ceased, making it difficult for borrowers to obtain new financing. CMBS accounted for close to half of new commercial mortgage originations in 2007. The Federal Reserve has announced that, starting this month, CMBS will be eligible collateral under the Fed's Term Asset-Backed Securities Loan Facility (TALF), in an attempt to help prevent CRE loan defaults, increase abilities of current holders of maturing mortgages to make additional loans, and facilitate sales of distressed properties.









Upcoming Indicators

Employment – The Bureau of Labor Statistics reports on the June employment situation on *July 2.*

Inflation – The Consumer Price Index for June is scheduled for release on *July 15.*

Federal Reserve – The Fed's next policy meeting is scheduled for *June 23 and 24.*

GDP – The final estimate of the 1st quarter GDP is scheduled for release on *June 25.*