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FINANCIAL SECTOR

The financial sector has become an increasingly large part of the economy, reaching 5.8% of GDP in the third quarter of 2009.

Short-term interbank funding markets have improved. For example, the 1-month LIBOR rate (the rate at which banks borrow unsecured funds from each other) is usually quite close to the Federal Funds rate. On September 15, 2008, the 1-month LIBOR rate was 2.50%, and the Federal Funds rate was 2.00%. By October 9, the 1-month LIBOR rate had jumped to 4.51%, while the Federal Funds rate had been cut to 1.50%. The LIBOR rate has been relatively stable since December 2008 and now stands at about 0.25%, while the Federal Funds rate target has been cut to between 0% and 0.25%.

According to the Federal Reserve’s most recent October 2009 survey of senior loan officers, “domestic banks indicated that they continued to tighten standards and terms over the past three months on all major types of loans to businesses and households.”
The S&P 500 index ended 2007 at a level of about 1500. In 2008, the index fell 40%, reaching about 900 by the end of the year. In early 2009, the index fell further, reaching a low of about 680, for an overall decline of 55% since the end of 2007. Since then, the stock market has partly recovered, with the S&P 500 rising to about 1150 as of January 8.

Financial sector corporate profits have also improved since the depths of the crisis. After rising from $199 billion in 2001 to $417 billion in 2005, profits fell to a recent low of $89 billion at an annual rate in 2008Q4. Since then, financial sector profits have risen and were $305 billion at an annual rate in the latest data from 2009Q3.
In general, for Goldman Sachs, JP Morgan, and Bank of America, net revenue, pretax earnings, net income, and compensation are up in the latest figures relative to 2008. In contrast, Morgan Stanley has seen declines in all four areas.
HOUSEHOLD SECTOR

Consumer spending accounts for over 70% of Gross Domestic Product (GDP), the market value of goods and services produced in the United States, and is one of the most closely watched indicators of economic activity. In 2008, consumer spending, adjusted for inflation, fell by the largest amount since the Great Depression and for the first time since 1980. This decline was a primary cause of the 1.9% drop in real GDP growth in 2008, the worst year since 1974.

Since 2008, consumer spending has mostly stabilized. In fact, real consumer spending rose 2.8% at an annual rate in the third quarter, boosted by strong sales of motor vehicles reflecting the popular “Cash-for-Clunkers” program. More recently, retail sales (excluding autos and gasoline, a useful gauge of the underlying strength in consumer spending) was up 0.6%, following a 0.1% uptick in October.

In the latest data, real GDP grew at an annual rate of 2.2% in the third quarter of 2009.

Consumer confidence is still considerably lower than in 2006, but has been inching upward recently.

But the personal saving rate averaged 4.5% in the third quarter of 2009, up from a low of 1.2% in the first quarter of 2008. The Federal Reserve reports that households lost over $11 trillion in household net worth from 2007 to the third quarter of 2009. Households have cut back on spending in order to replace this lost wealth.
HOUSING MARKET

According to the Mortgage Bankers Association, foreclosure starts were at an all time record high of 1.42% in the third quarter of 2009, suggesting that foreclosure proceedings were initiated on over 750,000 homeowners between July and September. According to the Hope Now Alliance, roughly 2 million foreclosures have been completed since July 2007.

The First American CoreLogic LoanPerformance Home Price Index reflects a broad range of mortgages nationally. According to this index, home prices have fallen 30% from their peak in 2006. Notably, home prices have shown signs of stabilization in the recent data, according to this and other home price series.
The S&P/Case-Shiller home price index reflects comprehensive house price data on 20 major cities back to the year 2000. Some markets experienced much greater price volatility than others. The graph above shows price movements in the “Sand States” (Arizona, California, Florida, and Nevada).

In contrast, the chart above shows price movements in a few cities that saw less home price volatility. Sales of existing homes have been on the rise while the new-home market has mostly stagnated. Measures of the months’ supply of inventory are down from recent highs but are still higher than pre-crisis levels. In addition, a potentially huge overhang of vacant homes not currently for sale may come on the market if prices begin to rise in earnest.
Housing starts have stabilized recently, but they are still down 75% from their recent peak in early 2006.

Federal Reserve purchases of longer-term Treasury and agency securities, including agency mortgage-backed securities, have helped to bring mortgage rates down to 5%–a historical low. The rate of refinancing has been strong but not as strong as it might be, at least in part reflecting households’ impaired credit.
LABOR MARKET

The December employment report showed that nonfarm payroll employment fell 85,000 since November. (In November, employment ticked up 4,000; November’s gain was the first increase since December 2007.) In addition, the unemployment rate remained at 10.0%. The unemployment rate was 4.9% in December of 2007. In December 2008, 15.3 million people were unemployed. By contrast, in December 2007, 7.7 million were unemployed. The recession has produced an extraordinary number of long-term unemployed: over 6 million people have been out of work for at least six months.

While the unemployment rate is 10.0%, the fraction of “underemployed” is much larger. The fraction of those unemployed, discouraged or otherwise not looking for work but willing to work, and those working part time for economic reasons was 17.3% last month.

According the report, “Temporary help services added 47,000 jobs in December. Since reaching a low point in July, temporary help services employment has risen by 166,000.” After a downturn, firms typically hire additional temporary workers before hiring additional permanent workers, in order to be sure that an economic recovery will be sustained. As a result, temporary hiring one closely watched indicator for signs of improvement in the labor market.
Business Sector

Construction of nonresidential properties fell in November for a seventh straight month, while spending on residential projects has shown some signs of life recently. Nonresidential construction is 10% below its level in April 2009, when it began declining. The Moody’s/REAL Commercial Property Price Index showed a 1.5% decline in prices in October. According to the data release, “The National All Property Type Aggregate Index now stands 36.4% below the level seen one year ago. The peak in prices was reached two years ago, in October 2007, and prices have since fallen 43.7%.”

More optimistically, the Institute for Supply Management indicated that its index of new orders, a signal of future production, jumped last month to 65.5 from 60.3 in November, the highest level in five years. The index fell to a low of 32.9 in December 2008. In addition, the Federal Reserve index of industrial production has risen in four of the past five months, and business sentiment improved over the second half of 2009. Nonetheless, firms still have a significant amount of unused capacity, which will put downward pressure on business investment for some time to come.

Federal Reserve data show that bank loans fell at an annual rate of more than 11% in the third quarter of 2009, reflecting declines in all loan categories. In addition, the National Federation of Independent Business reports that loans remain difficult to get.

Some large firms are replacing bank debt with loans from the bond market. Through November, corporate bond issuance was up considerably from the lows at the depth of the crisis, although recent issuance is still well below pre-crisis levels. In addition, interest rate spreads on corporate bonds have narrowed significantly.