

U.S. Economic Report 1H-2009

(Source: Board of Governors of the Federal Reserve System's Monetary Policy Report to the Congress, July 21, 2009)

Summary

Amid a severe global economic downturn, the U.S. economy contracted further and labor market conditions worsened over the first half of 2009. In the early part of the year, economic activity deteriorated sharply, and strains in financial markets and pressures on financial institutions generally intensified. More recently, however, the downturn in economic activity appears to be abating and financial conditions have eased somewhat, developments that partly reflect the broad range of policy actions that have been taken to address the crisis. Nonetheless, credit conditions for many households and businesses remain tight, and financial markets are still stressed. In the labor market, employment declines have remained sizable--although the pace of job loss has diminished somewhat from earlier in the year--and the unemployment rate has continued to climb. Meanwhile, consumer price inflation has remained subdued.

Gross Domestic Product

U.S. real gross domestic product (GDP) fell sharply again in the first quarter of 2009, but the contraction in overall output looks to have moderated somewhat of late. Consumer spending--which has been supported recently by the boost to disposable income from the tax cuts and increases in various benefit payments that were implemented as part of the 2009 fiscal stimulus package--appears to be holding reasonably steady so far this year. And consumer sentiment is up from the historical lows recorded around the turn of the year. In the housing market, a leveling out of home sales and construction activity in the first half of 2009 suggests that the demand for new houses may be stabilizing following three years of steep declines. Businesses, however, have continued to cut capital spending and liquidate inventories in response to soft demand and excessive stocks. Economic activity abroad plummeted in the first quarter and has continued to fall, albeit more slowly, in recent months. Slumping foreign demand led to a sharp drop in U.S. exports during the first half of the year. However, the ongoing contraction in U.S. domestic demand triggered an even sharper drop in imports.

Job Markets

The further contraction in domestic economic activity during the first half of 2009 was accompanied by a significant deterioration in labor market conditions. Private-sector payroll employment fell at an average monthly rate of 670,000 jobs in the first four months of this year before declining by 312,000 jobs in May and 415,000 jobs in June. Meanwhile, the unemployment rate moved up steadily from 7-1/4 percent at the turn of the year to 9-1/2 percent in June. With the sharp reductions in employment, the wage and salary incomes of households, adjusted for price changes, fell during this period.

Inflation

Overall consumer price inflation, which slowed sharply late last year, remained subdued in the first half of this year as the margin of slack in labor and product markets widened considerably further and as prices of oil and other commodities retraced only a part of their earlier steep declines. All told, the 12-month change in the personal consumption expenditures (PCE) price index was close to zero in May, while the 12-month change in PCE prices excluding food and energy was 1-3/4 percent. Survey measures of longer-term inflation expectations have remained relatively stable this year and currently stand at about their average values in 2008.

Financial Markets

During the first few months of 2009, pressures on financial firms, which had eased late last year, intensified again. Equity prices of banks and insurance companies fell amid reports of large losses in the fourth quarter of 2008, and market-based measures of the likelihood of default by those institutions rose. Broad equity price indexes also fell in the United States and abroad, and measures of volatility in such markets stayed at near-record levels. In addition, bank funding markets were strained, flows of credit to businesses and households were impaired, and many securitization markets remained shut.