FEDERAL RESERVE BANK of ATLANTA

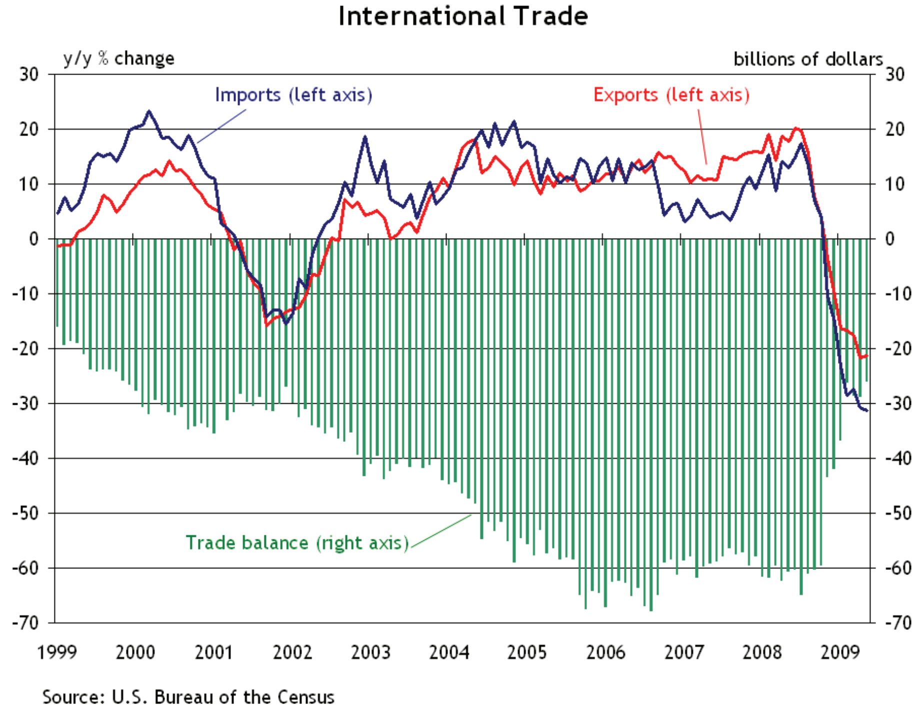
July 15, 2009

Economic Highlights

International Trade

Summary

The U.S. trade deficit narrowed in May to $26 billion as exports increased and imports declined from April. Compared to a year ago, both exports and imports were down more than 20% in May.

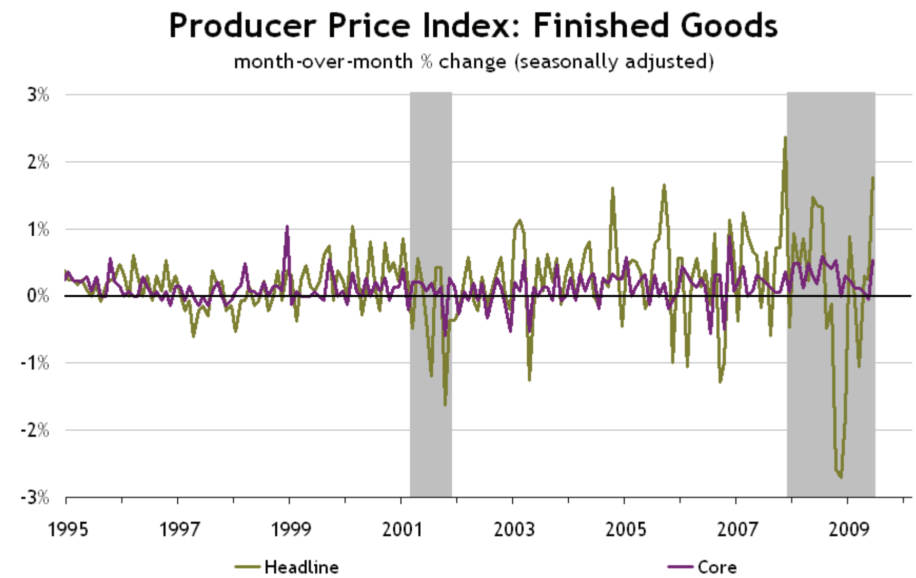


- The U.S. **nominal trade deficit narrowed** in May to $26 billion from $28.8 billion in April, contrary to Bloomberg's market consensus expectations of a slight widening in the deficit.
- In May, **nominal exports rose 1.6% month over month,** while **nominal imports fell 0.6% month over month.** Compared to a year earlier, nominal exports were down 21.3% in May, while imports declined a larger 31.3%.
- In real terms, the merchandise trade deficit also decreased. **Real merchandise exports rose 1.9%, while imports fell 2%.** Import declines were concentrated in the industrial materials and supplies category, which also includes petroleum products. Petroleum imports in real terms fell nearly 13% in May compared to April. Outside of the declines in the automotive sector, export growth was relatively broad based, with the largest gain, by far, in the industrial supplies and materials category.
- The unexpected narrowing in the trade deficit in May has led many commercial forecasters to revise higher their estimates of Q2 real GDP growth. According to some forecasters, **net exports now appear to have been a positive contributor to output growth in Q2** as imports are estimated to have declined more than exports last quarter.
- While a decline in imports results in a positive contribution to GDP growth (more of existing domestic demand is met by domestic production), falling imports may be a sign of soft domestic demand and may not bode well for Q3.

Prices

Summary

June producer price numbers presented somewhat of a paradox, showing broad-based price increases despite continuing indications of industry weakness.



Source: U.S. Bureau of Labor Statistics

- The **headline producer price index** (PPI) for finished goods **rose 1.76%** month over month in **June**, well above the Bloomberg consensus expectation of a 1.0% increase, marking the **sharpest monthly rise since November 2007**. The headline gain was **mostly driven by** the **energy** component, with gasoline up 18.5% and home heating oil and distillates increasing 15.4%. Headline PPI was down 4.31% in June from a year earlier.
- **Core PPI jumped 0.53%** month over month in June (while the Bloomberg consensus expected a 0.1% gain), the largest increase in eight months. In June producer prices for durable goods increased 0.90% month over month, and capital equipment prices rose 0.51% after three consecutive months of 0.1% month-over-month declines.
- **Sharp increases in prices for light motor vehicles** accounted for nearly one-third of the increase in core PPI in June—a boost that is hard to reconcile with the underlying weakness in the auto sector. Prices for passenger cars rose 2.0% in June (+3.4% year over year); light motor trucks prices were up 3.4% for the month (+8.4% year over year).

All stages of processing represented in the PPI posted large one-month gains in June on both a headline and core basis.

Nearly all components remain well below year-earlier levels.

PPI by Stage of Processing

	1-month*	3-month*	12-month*
Finished	23.3	9.5	-4.3
Less food and energy	6.5	2.1	3.4
Intermediate	25.4	6.8	-12.4
Less food and energy	4.3	-3.0	-6.5
Crude	72.0	55.2	-40.2
Less food and energy	35.9	40.3	-35.4

*Seasonally adjusted annual rates of change in price indices for given period ending June 2009

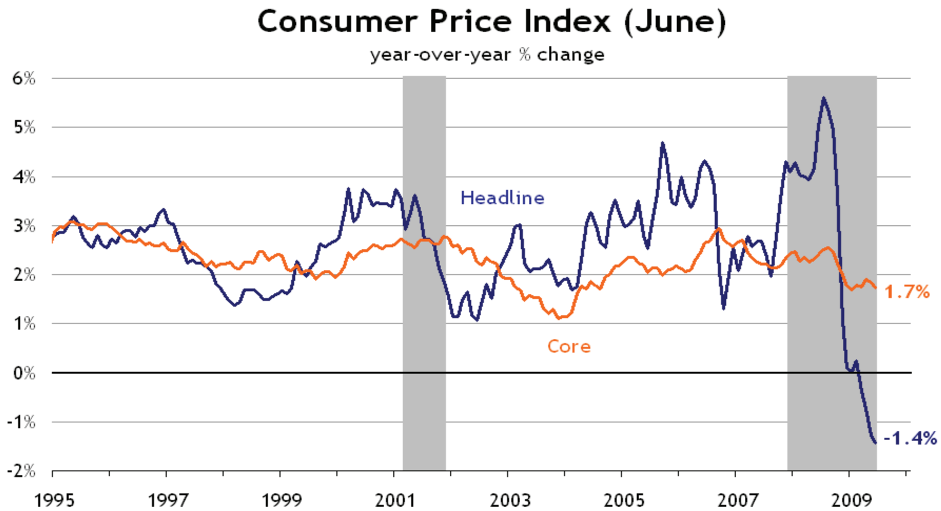
Source: U.S. Bureau of Labor Statistics

- Core (less food and energy) commodity prices, seen by economists as a leading inflation indicator, posted monthly gains in both May and June following three consecutive months of declines; however, monthly commodity price indices are notoriously volatile measures.

Prices

Summary

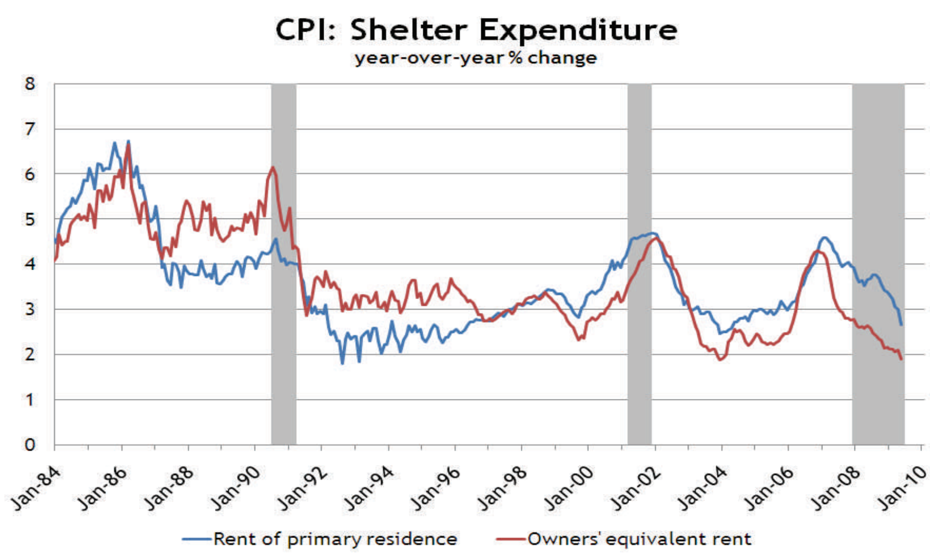
The headline and core CPI increased 0.7% and 0.2%, respectively, in June from the month before. Both gains were 0.1 percentage point above the Bloomberg consensus forecast.



Source: U.S. Bureau of Labor Statistics

- The **headline consumer price index** (CPI) **increased 0.7%** month over month in **June** after growing by only 0.1% in May and posting monthly declines in both March and April. In June the index had fallen 1.4% since year-earlier levels, with 25.5% year-over-year declines in energy more than offsetting increases in all other major categories of the index.
- The **core** (excluding food and energy) measure of consumer prices **increased 0.2%** month over month, led by increases in motor vehicle, recreation, and apparel prices, while shelter and medical care prices remained subdued.
- Of note, the **seasonal adjustment** performed on the monthly CPI numbers in June increased the core index from a 0.07% increase to a 0.20% gain, with large adjustments in the apparel (downward), housing (upward), and medical care (downward) categories. The remaining question is whether the seasonal factor adjustments appropriately depict pricing pressures given the unusual economic environment the United States is currently facing.
- Owners' equivalent rent, which makes up about a quarter of the total CPI index, was up by only 1.9% year over year in June, matching a 25-year low for the series. Weakness in the residential real estate sector is putting downward pressure on home rental prices as well, a dynamic that could linger for some time.

Gross rates for shelter price components of the CPI are down considerably from year-earlier levels, reflecting weakness in the housing market.

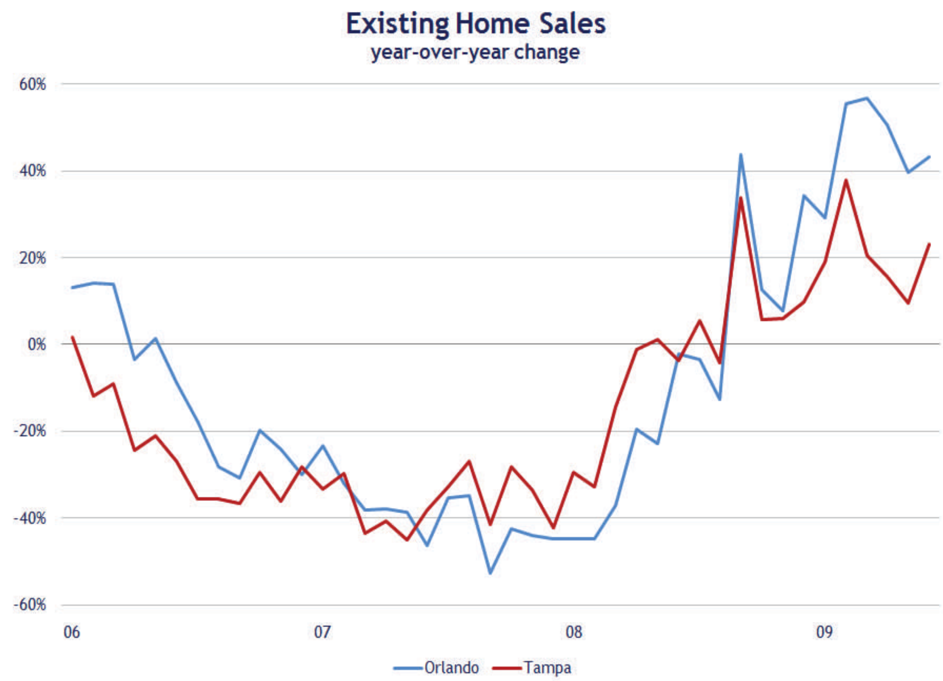


Source: U.S. Bureau of Labor Statistics

Housing

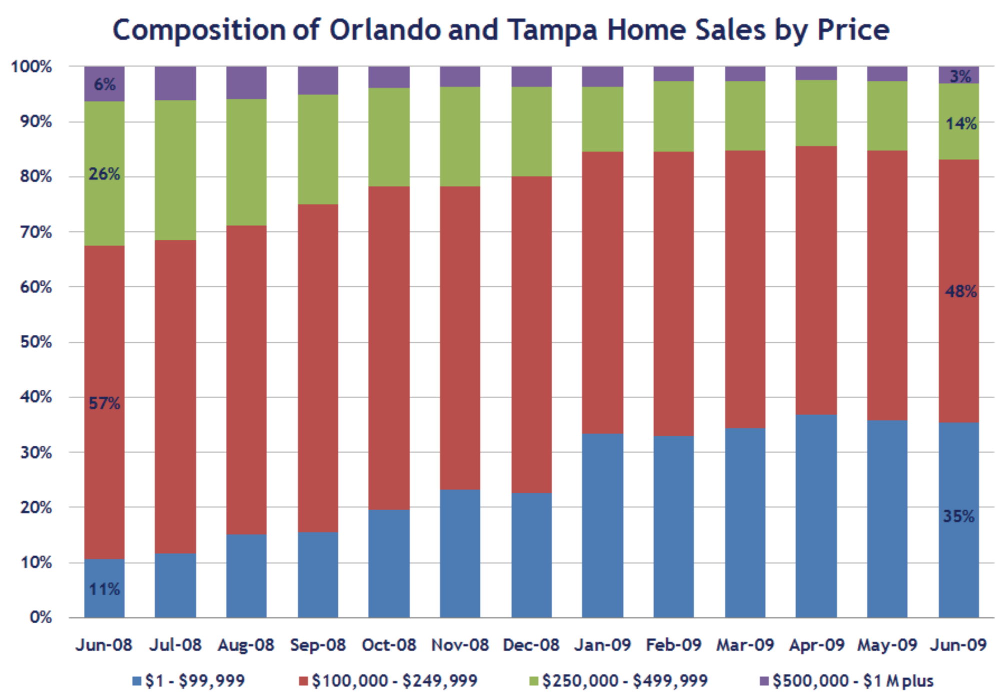
Summary

The Orlando Regional Realtors Association and Greater Tampa Association of Realtors reported that home sales growth improved during June, up 43% and 23%, respectively, compared with weak levels a year earlier.



Source: Orlando Regional Realtors Association, Greater Tampa Realtors Association

Furthermore, sales data confirmed the shift in home buying to the low end of the market reported anecdotally by Southeastern contacts and by the National Association of Realtors.



Source: Orlando Regional Realtors Association, Greater Tampa Association of Realtors

Orlando Regional Realtors Association	www.orlrealtor.com
Greater Tampa Realtors Association	www.gtar.org

Housing

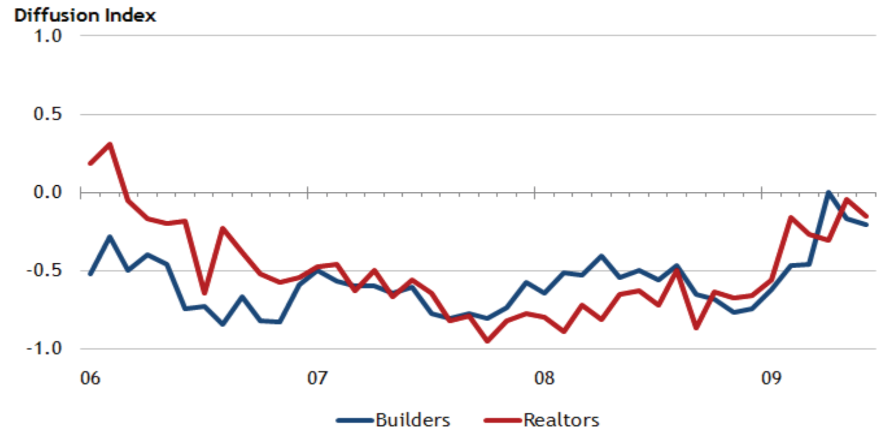
Summary

In our informal survey of Southeastern homebuilders and Realtors, contacts indicated that the home sales diffusion index* in June softened somewhat compared with a year earlier.

** The housing survey's diffusion indexes are calculated as the percentage of total respondents reporting increases minus the percentage reporting declines. Positive values of the index indicate increased activity among the majority of contacts while negative values indicate decreased activity.*

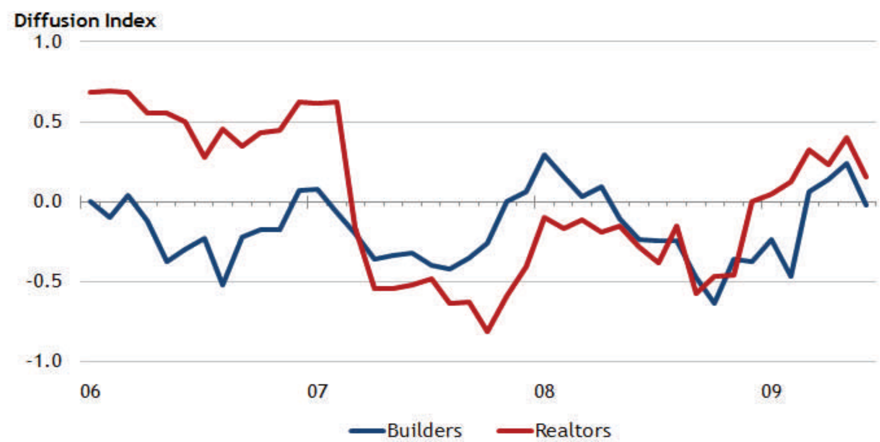
The outlook for sales in coming months pulled backed notably in June.

Home Sales vs. a Year Earlier



Source: FRBA business contact survey

Home Sales Outlook



Source: FRBA business contact survey

Preliminary June survey results:

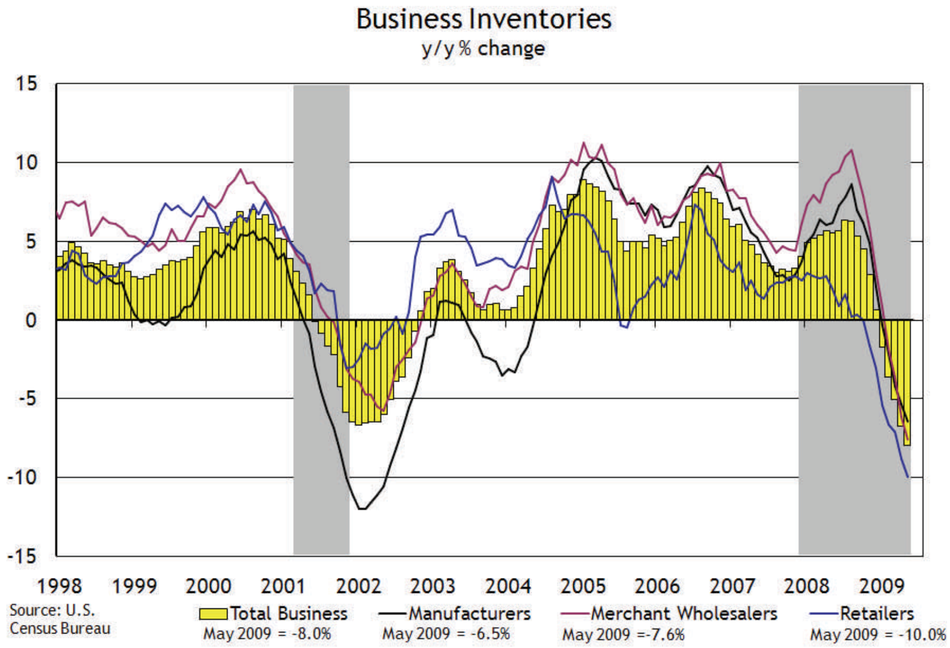
64 Realtors
54 home builders

- Florida builders and Realtors reported sales improved in June. But most builders said sales remained below year-earlier levels, while Realtors reported that sales continued to exceed year earlier levels.
- Outside of Florida, most Southeastern builders and Realtors reported that sales growth weakened in June and fell below year-earlier levels.
- Contacts continued to note strong demand at the low end of the market.
- Many contacts across the Southeast reported problems with property appraisals that they said have stalled sales. Generally these comments have been concentrated among Florida contacts but in recent months have been more generally observed.

Manufacturing

Summary

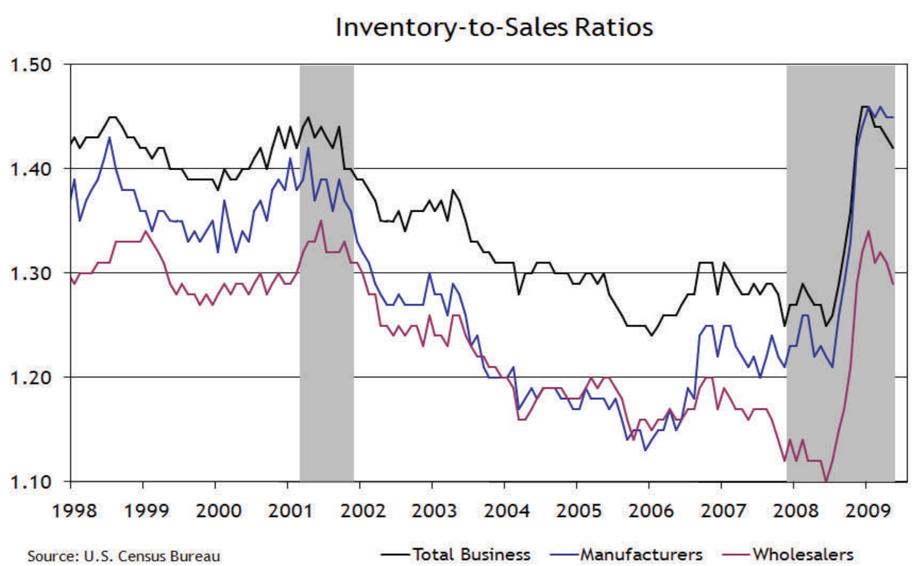
Business inventories continued their descent in May.



- **Total business inventories** were down 1.0% from April to May and down 8.0% year over year.
- The decline of **retail inventories** continued in May, dropping 4.9% year over year (excluding motor vehicles and parts).
- **Manufacturers' sales** (-0.9% month over month) are falling faster than their inventories (-0.6% month over month). In May manufacturers' sales were down a substantial 21.0% year over year.

During recessions, inventory-to-sales (I/S) ratios typically experience a jump and an eventual decline. Comparing this recession with the last, one can see the magnitude of this recession's change in I/S.

Most I/S ratios are declining in 2009, though. However, the manufacturing I/S ratio remains high and level with the previous month's reading.

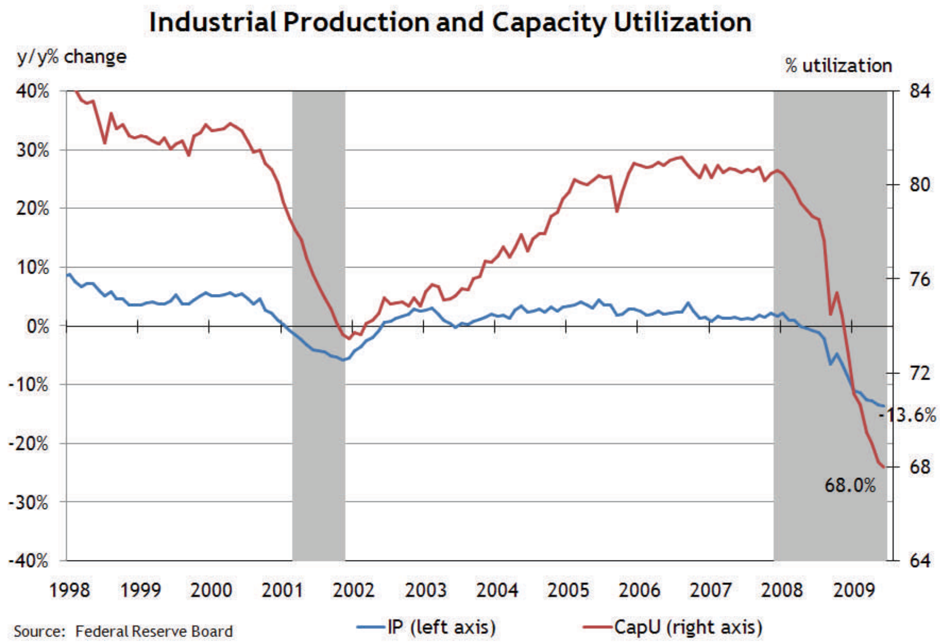


- The **total business I/S ratio** was 1.42, continuing its six-month declining trend.
- In May retailers had an I/S ratio of 1.33 (excluding motor vehicles and parts), with sales improving 0.4% month over month and inventories declining 0.6% month over month, slightly less than April's decline.

Manufacturing

Summary

Industrial production continued its descent in June but at a lower rate than in May. Capacity utilization also continues to creep lower, even beneath May's historically low figure.



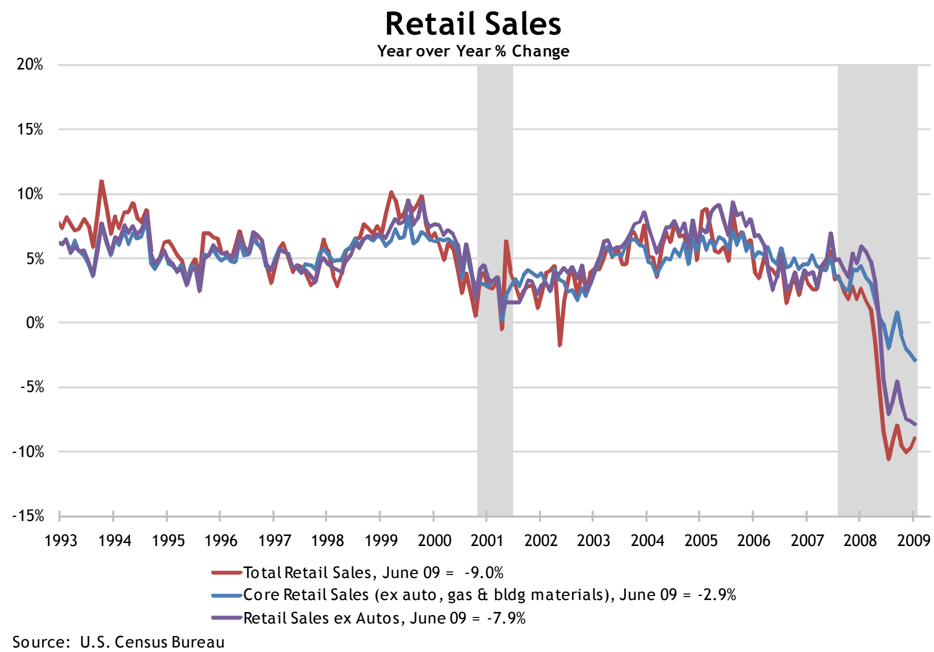
- **Industrial production (IP)** witnessed a 0.4% decline in June, smaller than May's drop of 1.2%.
- Though still a decline, June's decline was the smallest in eight months, suggesting the pace of decline in output is moderating.
- In the second quarter, output fell 11.9% annualized, compared with the first quarter's decline of 19.1%. Similarly, the first quarter of 2009 saw a 22.1% annualized decrease in manufacturing IP whereas the second quarter revealed a decline of 10.5%.
- Declines in production for both durable and nondurable goods producers brought **manufacturing output** down 0.6% month over month in June, while the **output of utilities** increased 0.8% month over month. **Mining** declined by 0.5% month over month in June.
- Each month since February 2009 has brought a new low to the **capacity utilization** series, which began in 1967. June was no exception at 68%, down from 68.3% in May. To put this figure in perspective, the average for the data set before the current recession was 80.9%.

Consumer Spending

Summary

June retail sales increased 0.7% from May, slightly higher than analysts' expectations of 0.4%.

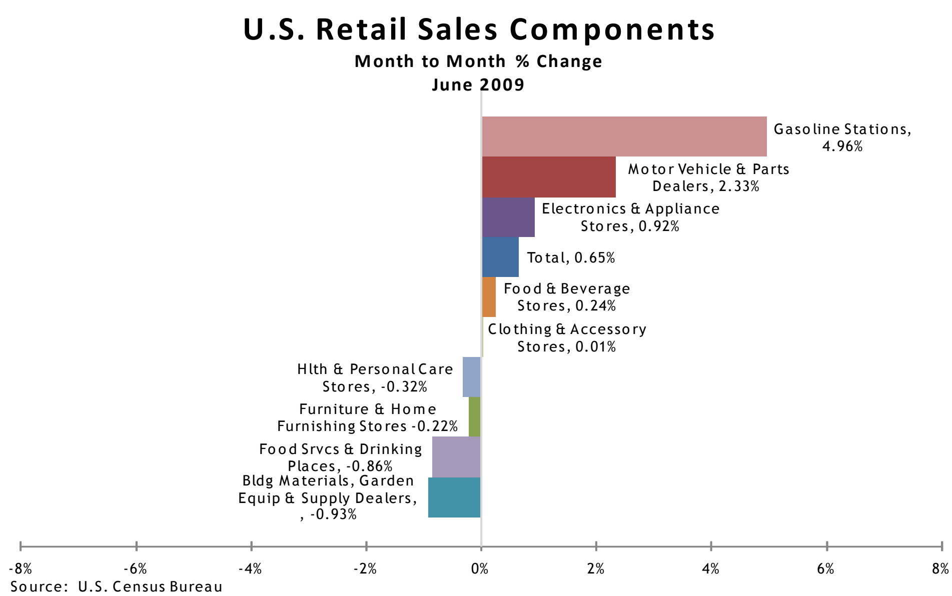
However, retail sales excluding autos increased below an expected 0.5% gain to 0.3% in June.



- Total retail sales exceeded market expectations in June. This was the second consecutive monthly increase, but sales are still down 9.0% from a year earlier.
- On a year-over-year basis, the decline in retail sales excluding autos continued to accelerate, falling to -7.9%.
- Consumers continue to be very conservative in their spending, as demonstrated by May's personal savings rate, which climbed to 6.9%, the highest rate in almost 16 years.

Although retail sales posted a gain in June, gasoline stations were responsible for more than half of the increase.

The auto and gasoline stations sales increase was likely the result of rising prices.



- This increase in total sales was extremely variable across its components. Gas stations, motor vehicles and parts, electronics, and appliances all experienced large gains, while equipment and supply dealers, building materials and garden, and food and drinking places experienced decreases from May to June.

Consumer Spending

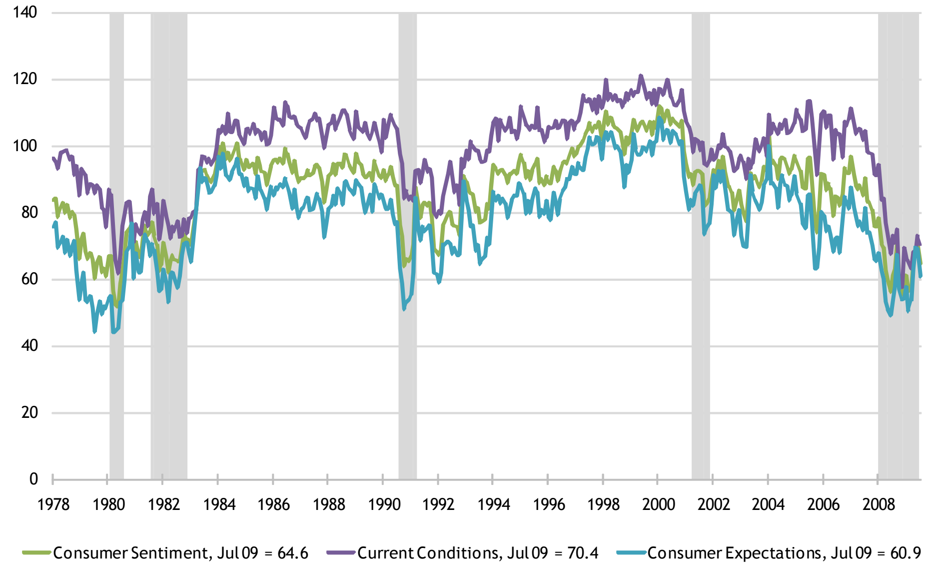
Summary

The July preliminary Consumer Sentiment Index fell after four months of consecutive gains.

Although analysts were expecting consumer sentiment to fall, a decline of this magnitude was not anticipated.

Both components of the index fell, with the future expectations component leading the decline.

Reuters/University of Michigan Consumer Sentiment Index
1966Q1= 100



Source: Reuters/University of Michigan

- July preliminary numbers show that the Reuters/University of Michigan Consumer Sentiment Index fell 6.2 points to 64.6; Bloomberg's market consensus was a decrease of 0.2 to 70.6 points. Present conditions fell 2.8 points to 70.4, and July future expectations fell 8.3 points, from 69.2 to 60.9.
- The public's outlook on the job situation continued to worsen in July. The percentage of respondents expecting increasing unemployment over the next 12 months rose for the third consecutive month to 52% from 48% in June.
- The percentage of respondents that expected the unemployment rate to diminish over the next 12 months declined from 15% in June to 13% in July. Apart from May's (15%) and June's 12-month unemployment outlook, this is the highest percentage of respondents expecting the unemployment rate to drop since December 2006.
- Expected inflation levels remained virtually unchanged in July. The median one-year-ahead inflation rate fell from 3.1% in June to 3.0% in July. The median five-to-ten-year outlook rose 0.1% to 3.1%.