



Economic Trends

May 2009
(April 10, 2009 to May 14, 2009)

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March Price Statistics

04.23.09

by Brent Meyer

March Price Statistics

	Percent change, last					
	1mo. ^a	3mo. ^a	6mo. ^a	12mo.	5yr. ^a	2008 average
Consumer Price Index						
All items	-1.6	2.2	-5.4	-0.4	2.6	0.3
Less food and energy	2.1	2.2	1.2	1.8	2.2	1.8
Median ^b	2.0	2.3	2.0	2.7	2.8	2.9
16% trimmed mean ^b	0.4	1.7	1.0	2.3	2.6	2.7
Producer Price Index						
Finished goods	-13.1	-0.9	-13.8	-3.6	3.0	0.2
Less food and energy	0.0	2.6	2.6	3.8	2.5	4.3

a. Annualized.
 b. Calculated by the Federal Reserve Bank of Cleveland.
 Sources: U.S. Department of Labor, Bureau of Labor Statistics; and Federal Reserve Bank of Cleveland.

The CPI decreased at an annualized rate of 1.6 percent in March, pulling the 12-month growth rate down to -0.4 percent. Much of the decrease was due to reductions in energy prices, as fuel oil and other types of fuel prices fell 61.6 percent (annualized) and motor fuel prices decreased 42 percent during the month. Many food categories (dairy, meats, cereals, and fruits and vegetables) posted price declines as well.

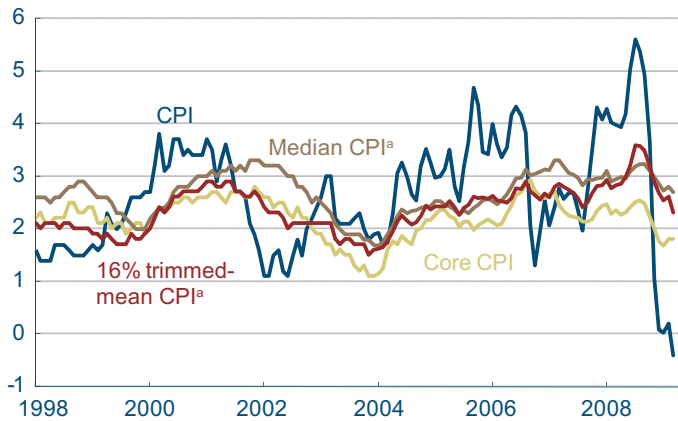
Excluding food and energy (core CPI), the index rose 2.1 percent in March. The Bureau of Labor Statistics cautions that over 60 percent of the increase in the core CPI was due to a nonannualized 11.0 percent jump (251.4 percent at an annualized rate) in the prices of tobacco and smoking products. Excluding tobacco prices, the core CPI rose just 0.7 percent. The core CPI is up 2.2 percent over the past three months, compared to 1.8 percent over the past year. The measures of underlying inflation produced by the Federal Reserve Bank of Cleveland, the median CPI and the 16 percent trimmed-mean CPI, rose 2.0 percent and 0.4 percent, respectively.

Even though the 12-month growth rate in the overall CPI is negative, the core measures are currently trending between 1.8 percent and 2.7 percent. However, it is fairly evident that the inflationary environment has changed dramatically since last July, when the CPI was growing at 5.6 percent and the underlying inflation measures were trending up between 2.5 percent and 3.6 percent.

The underlying price-change distribution in March looks less like that of the last two months and more like that of the fourth quarter of 2008, when the median rose 1.8 percent and the 16 percent trimmed-mean rose just 0.3 percent on average. While some of the similarity is due to energy-price patterns (falling in the fourth quarter and March, rising in January and February), a quick glance at the core CPI price-change distribution (which

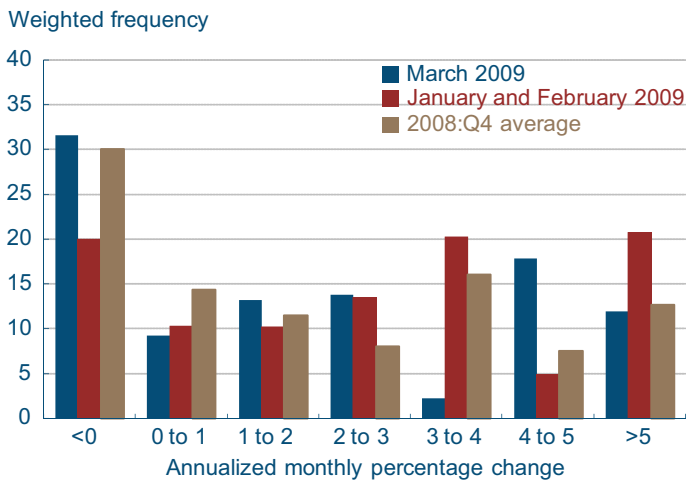
CPI, Core CPI, and Trimmed-Mean CPI Measures

12-month percent change



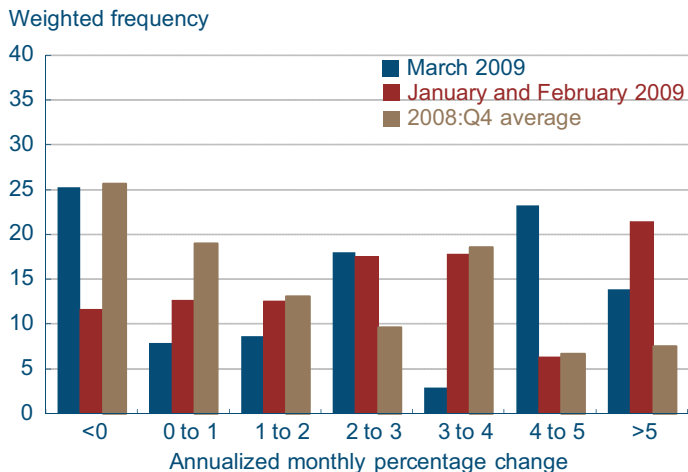
a. Calculated by the Federal Reserve Bank of Cleveland.
 Sources: U.S. Department of Labor, Bureau of Labor Statistics, Federal Reserve Bank of Cleveland.

CPI Component Price Change Distribution



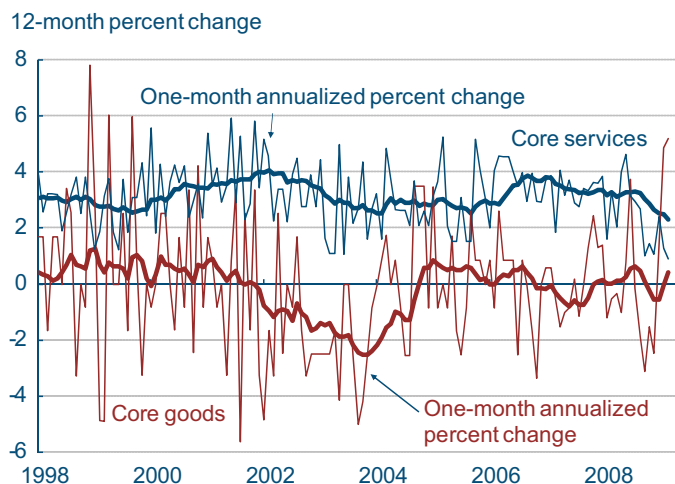
Source: Bureau of Labor Statistics.

Core CPI Component Price Change Distribution



Source: Bureau of Labor Statistics.

Core CPI Goods and Core CPI Services



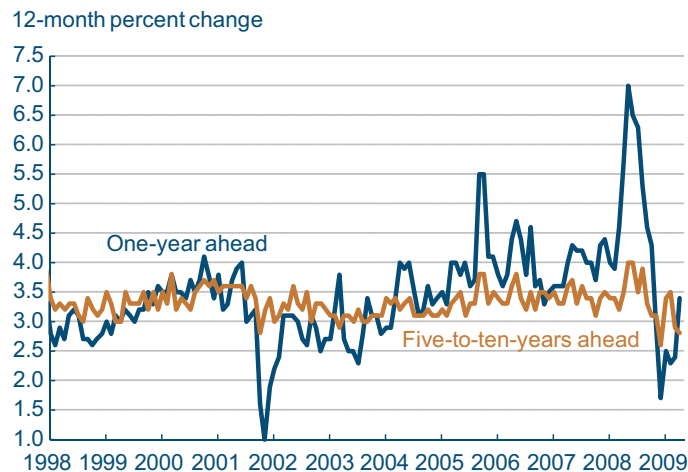
Sources: U.S. Department of Labor, Bureau of Labor Statistics.

removes food and energy prices) reveals that the pattern remains intact, even without these components.

In March, the 16 percent trimmed mean excluded most of the larger price increases, as only 12 percent of the consumer market basket rose at rates greater than 5.0 percent. The measure concurrently picked up on some of the downward price momentum, as roughly 32 percent of the index exhibited outright price decreases.

One-year-ahead average inflation expectations jumped up a full percentage point to 3.4 percent in April, perhaps suggesting a lessening in near-term deflation fears. However, April's jump was likely linked to recent increases in gas prices. In comparison, five-to-ten-year-ahead average inflation expectations ticked down to 2.8 percent from 2.9 percent, sliding further below the average over the past five years of 3.4 percent.

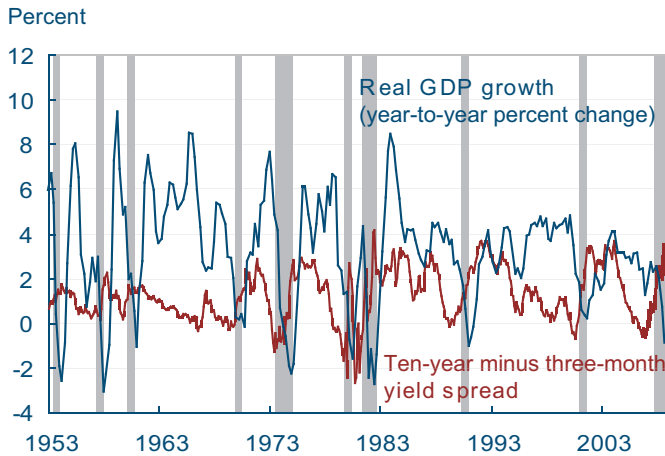
Household Inflation Expectations



Note: Mean expected change as measured by the University of Michigan's *Survey of Consumers*.
Source: University of Michigan.

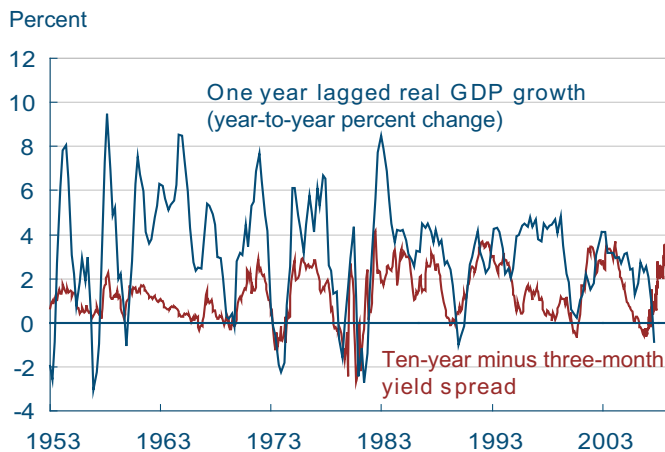
The Yield Curve, April 2009

Yield Spread and Real GDP Growth



Note: Shaded bars represent recessions
Sources: Bureau of Economic Analysis; Federal Reserve Board.

Yield Spread and Lagged Real GDP Growth



Sources: Bureau of Economic Analysis; Federal Reserve Board.

04.29.09

by Joseph G. Haubrich and Kent Cherny

Since last month, the yield curve has twisted steeper, with short rates dropping and long rates rising. The difference between short and long rates, the slope of the yield curve, has achieved some notoriety as a simple forecaster of economic growth. The rule of thumb is that an inverted yield curve (short rates above long rates) indicates a recession in about a year, and yield curve inversions have preceded each of the last seven recessions (as defined by the NBER). In particular, the yield curve inverted in August 2006, a bit more than a year before the current recession started in December, 2007. There have been two notable false positives: an inversion in late 1966 and a very flat curve in late 1998.

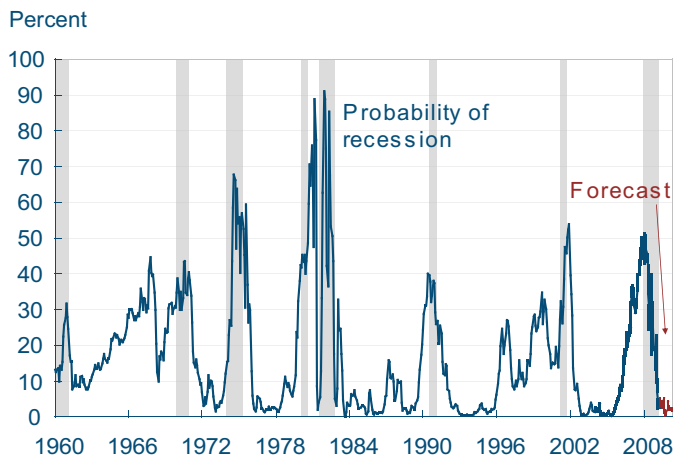
More generally, a flat curve indicates weak growth, and conversely, a steep curve indicates strong growth. One measure of slope, the spread between 10-year Treasury bonds and 3-month Treasury bills, bears out this relation, particularly when real GDP growth is lagged a year to line up growth with the spread that predicts it.

Since last month the 3-month rate edged downward from an already low 0.22 percent to an even lower 0.13 percent (for the week ending April 24). The 10-year rate increased from 2.75 percent to 2.96. This increased the slope to 283 basis points, a full 30 points higher than March's 253 basis points, and well above February's 258 basis points.

The flight to quality, the zero bound, and the turmoil in financial markets may impact the reliability of the yield curve as an indicator, but projecting forward using past values of the spread and GDP growth suggests that real GDP will grow at about a rate of 3.0 percent over the next year. This remains on the high side of other forecasts, many of which expect slower growth real GDP.

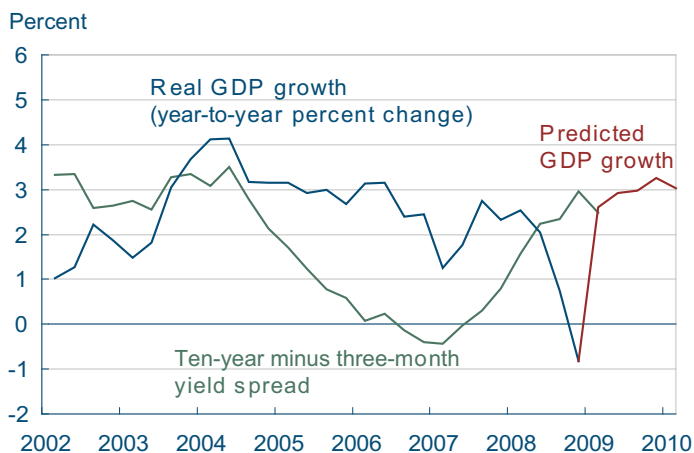
While such an approach predicts when growth is above or below average, it does not do so well in predicting the actual number, especially in the case of recessions. Thus, it is sometimes preferable to

Probability of Recession Based on the Yield Spread



Note: Estimated using probit model
Sources: Bureau of Economic Analysis, Federal Reserve Board, and authors' calculations

Predicted GDP Growth and Yield Spread



Sources: Bureau of Economic Analysis; Federal Reserve Board.

focus on using the yield curve to predict a discrete event: whether or not the economy is in recession. Looking at that relationship, the expected chance of the economy being in a recession next April stands at a very low 1.9 percent, up a bit from March's 1.1 percent and February's 0.98 percent.

The probability of recession coming out of the yield curve is very low and may seem strange in the midst of recent financial news. But one consequence of the financial environment has been a flight to quality, which lowers Treasury yields. Furthermore, both the federal funds target rate and the discount rate have remained low, which tends to result in a steep yield curve. Remember also that the forecast is for where the economy will be in a year, not where it is now. However, consider that in the spring of 2007, the yield curve was predicting a 40 percent chance of a recession in 2008, something that looked out of step with other forecasters at the time.

To compare the 1.9 percent probability of recession to what some other economists are predicting, head on over to the Wall Street Journal survey.

Of course, it might not be advisable to take this number quite so literally, for two reasons (not even counting Paul Krugman's concerns). First, this probability is itself subject to error, as is the case with all statistical estimates. Second, other researchers have postulated that the underlying determinants of the yield spread today are materially different from the determinants that generated yield spreads during prior decades. Differences could arise from changes in international capital flows and inflation expectations, for example. The bottom line is that yield curves contain important information for business cycle analysis, but, like other indicators, they should be interpreted with caution.

For more detail on these and other issues related to using the yield curve to predict recessions, see the Commentary "Does the Yield Curve Signal Recession?"

To read more on other forecasts:
http://www.econbrowser.com/archives/2008/11/gdp_mean_estima.html

For the *Wall Street Journal* survey:
<http://online.wsj.com/article/SB123445757254678091.html>

For Paul Krugman's column:
<http://krugman.blogs.nytimes.com/2008/12/27/the-yield-curve-wonkish/>

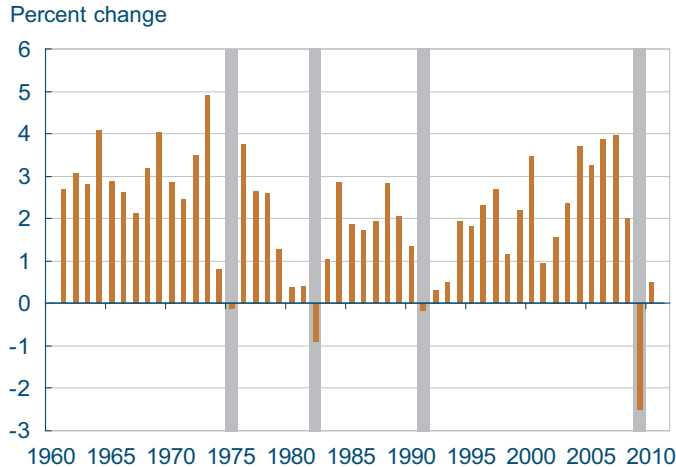
"Does the Yield Curve Yield Signal Recession?," by Joseph G. Haubrich. 2006. Federal Reserve Bank of Cleveland, *Economic Commentary* is available at: <http://www.clevelandfed.org/Research/Commentary/2006/0415.pdf>

Mighty Bad Recessions

05.04.09

by Owen F. Humpage and Michael Shenk

Real Per Capita World GDP Growth

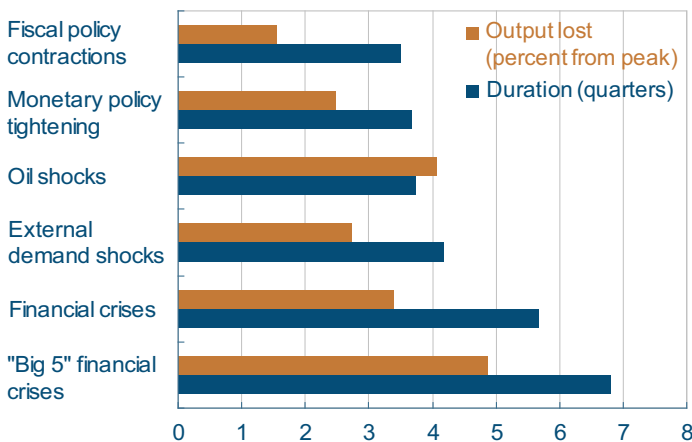


Source: International Monetary Fund, *World Economic Outlook*, April 2009.

No two recessions are exactly alike. They differ in terms of their depth and duration, their diffusion across various industries, and the economic shocks that set them off. Nevertheless, recessions often share basic characteristics that determine their severity and the pace of subsequent recoveries. Recently, the International Monetary Fund (IMF) has been studying two of these—association with a financial crisis and global reach—to see how they affect a recession’s contours. The implications for our current global economic malaise, which shares both of these characteristics, are sobering. They explain why the current global downturn is the worst since the Great Depression.

The IMF investigated business cycles which occurred between 1960 and 2007 in 21 advanced countries. Researchers wanted to know if recessions associated with financial shocks and recessions highly synchronized across countries were distinct in their depth and duration from recessions with different characteristics. The sample yielded 122 recessions, 15 of which were associated with financial crises, 37 of which were highly synchronized across the globe, and 6 of which got a double whammy.

Average Recession Statistics



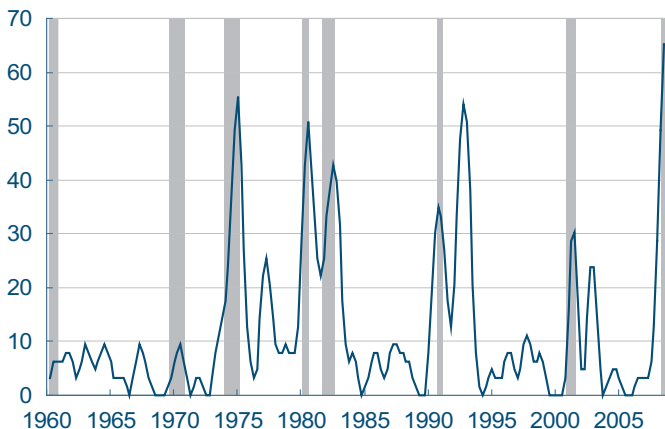
Source: International Monetary Fund, *World Economic Outlook*, April 2009.

Recessions associated with financial crises are deeper and longer lasting than recessions associated with other types of economic shocks. In addition, their recoveries are slow and prolonged. Such recessions tend to follow periods of rapid credit growth, involving overheated goods and labor markets, housing booms, and a loss of international competitiveness. Rapid credit growth often results in low household savings rates and a deterioration in household balance sheets. After the credit bubble bursts, a long period of retrenchment ensues. Demand remains weak, especially in areas of the economy dependent on credit, like residential and business investment.

Recessions that are highly synchronized across countries are likewise deeper and longer lasting

Highly Synchronized Recessions

Percent of countries in recession



Note: Shaded bars indicate U.S. recessions.

Source: International Monetary Fund, *World Economic Outlook*, April 2009.

than other recessions. When a good portion of the globe is in recession, exports cannot provide a way out, and hence recoveries are slow and protracted. The IMF found that highly synchronized global recessions typically followed or coincided with recessions in the United States. When the U.S. sneezes, the rest of the world catches cold.

Combine a global recession with a financial crisis, as is currently the case, and you have the worst of all possible situations. The current global contraction is deep and the recovery will be drawn out.

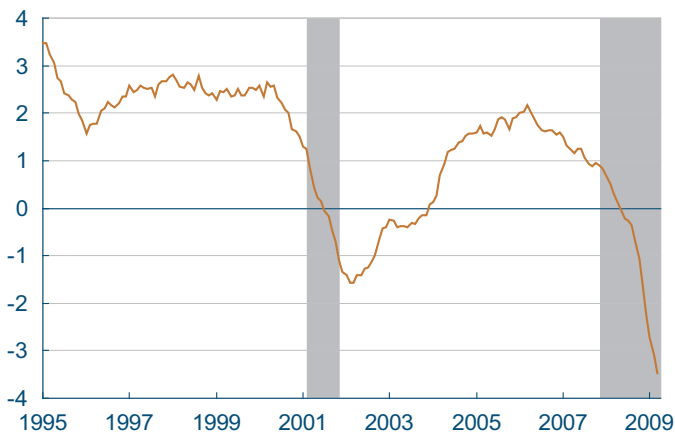
The IMF also compared the effectiveness of monetary and fiscal policies in recessions associated with financial crises to economic contractions triggered by other events. In recessions not associated with financial crises, expansionary monetary policies shortened the duration of the downturn and promoted faster recoveries, but fiscal policies have no noticeable effect. During recessions associated with a financial crisis, however, monetary policy, which operates mainly through banks and interest rates, is ineffectual, while fiscal policy gains some bite. That said, the effectiveness of fiscal policies wane rapidly during the recovery phase in countries saddled with high levels of public debt.

For more information on the IMF's study on recessions:
<http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/c3.pdf>

The Changing Composition of Consumption

Nonfarm Payroll Employment

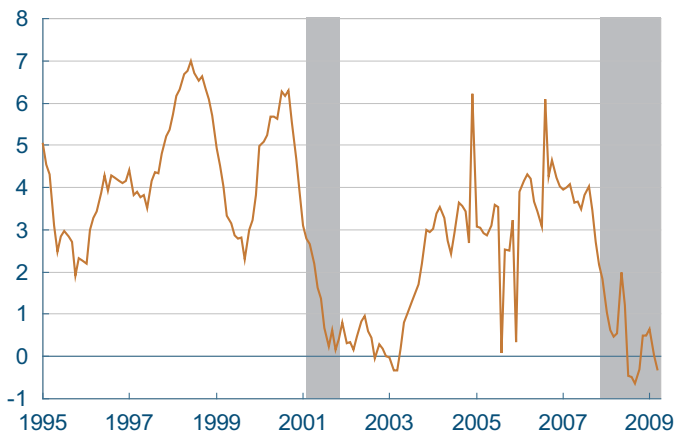
12-month percent change



Source: Bureau of Labor Statistics.

Real Personal Income

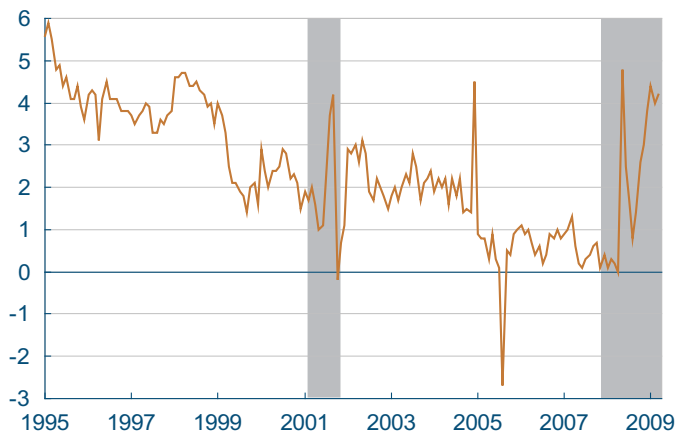
12-month percent change



Source: Bureau of Economic Analysis.

Personal Savings Rate

Percent of disposable personal income



Source: Bureau of Economic Analysis.

05.04.09

by Paul Bauer and Michael Shenk

It is no secret that some households are being hit hard in the current recession. Nonfarm payroll employment is down about 3.5 percent over the last year. Real personal income is down 0.3 percent over the same time period. Both of these phenomena are fairly typical of a recession, but in this recession they are particularly severe. The ongoing job losses, lower housing wealth, and tight credit of this financial crisis have led to some abrupt shifts in household consumption behavior.

The most prominent shift is that the personal saving rate leaped to over 4 percent from nearly zero in this recession. It did so temporarily when the first stimulus checks hit households in May 2008, but jumped up again, apparently more lastingly, after last fall's financial fireworks. While for years financial advisors have urged Americans to raise their personal savings rate, such a quick shift has had jarring effects elsewhere in the economy.

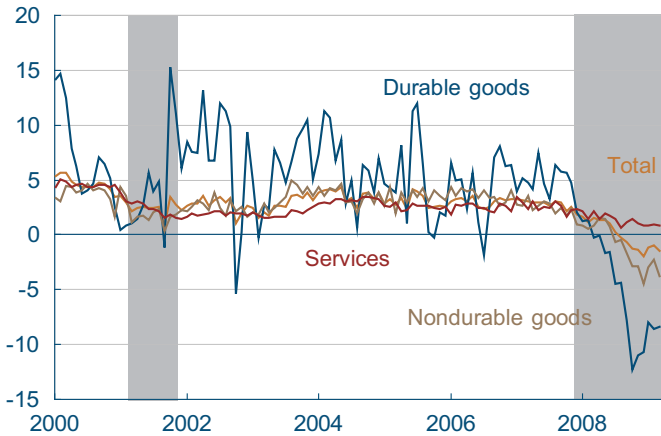
A related shift, driven by increased saving and the flat growth in real personal income, is a highly unusual drop in consumption. In the last recession, the growth in real personal consumption expenditures slowed but did not fall below zero. Real personal consumption expenditures (PCE) fell 3.8 percent and 4.3 percent in the last two quarters of 2008. It has since rebounded, expanding 2.2 percent in the first quarter of 2009.

Not only has consumption declined in this recession, but its composition has shifted as well. Looking at monthly data, the durable goods component (14 percent of PCE) has plummeted and is currently down over 8.4 percent from a year ago. Nondurable goods (about 28 percent of PCE) have slowed less, but they still declined an unusual 3.8 percent. Only services (58 percent of PCE) have managed to eke out a positive gain (0.9 percent).

The clear pattern is that consumers are saving by deferring consumption wherever they can, but this is easier to do with long-lived durable goods and

Real Personal Consumption Expenditures

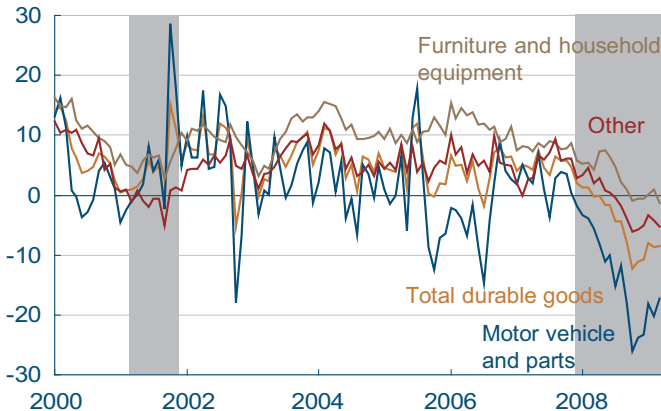
12-month percent change



Source: Bureau of Economic Analysis.

Real Personal Consumption Expenditures: Durable Goods

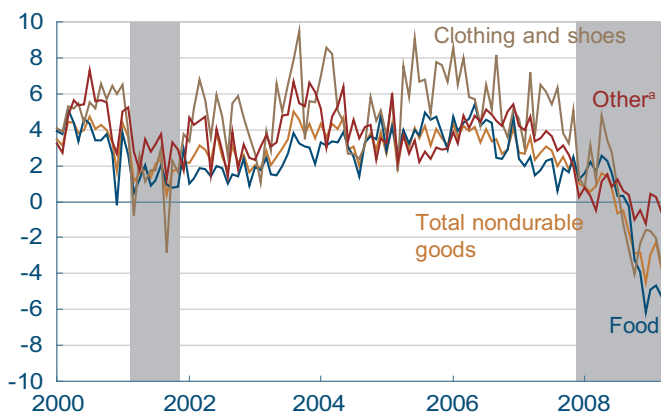
12-month percent change



Source: Bureau of Economic Analysis.

Real Personal Consumption Expenditures: Nondurable Goods

12-month percent change



a. Does not include gasoline, fuel oil or other energy goods.

Source: Bureau of Economic Analysis.

less so with services. For example, households can delay replacing their cars (a durable good) without too much difficulty, but deferring oil changes (a service) is not as wise. A consequence is that auto repair shops and other service providers that extend the life of goods are faring better than manufacturers of new goods.

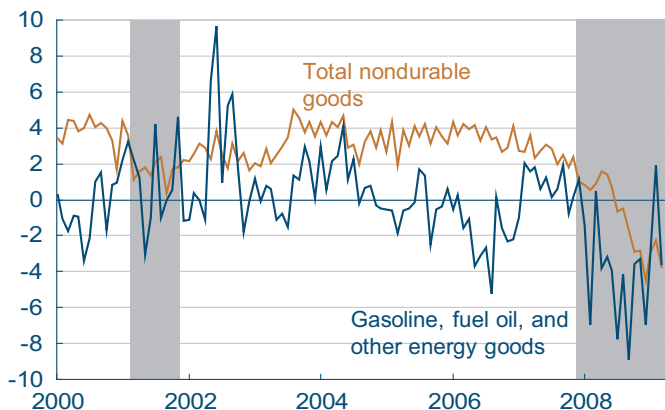
Looking at the components of durable goods, it should surprise no one that motor vehicles and parts (31 percent of durable goods) have been particularly hard hit. They are currently down about 17.2 percent year-over-year. Furniture and household equipment (54 percent of durable goods) has fared better and is essentially flat year-over-year.

All the main categories of nondurable good—food, clothing and shoes, and gasoline, fuel oil, and other energy goods—are down in this recession. Note the nondurable category “food” (46 percent of nondurables) includes restaurant meals, so food’s 5.3 percent year-over-year decline does not mean people are eating less, just that they are eating out less often and spending less when they do.

Although services have fared better, some have performed better than others. As typically happens in a recession, medical care (nearly 30 percent of services) has held up fairly well—it’s currently up 2.5 percent year-over-year—but it is not performing as well as in previous recessions. With many households securing their health insurance through their employers, the heavy employment losses in this recession have had an adverse effect on coverage and ultimately care and treatment. Real expenditures on recreation (7 percent of services) dropped early in this recession but are currently up 0.2 percent year-over-year. Transportation services (6 percent of services) continue to take it on the chin, dropping over 5 percent over the last year.

Real Personal Consumption Expenditures: Nondurable Goods

12-month percent change

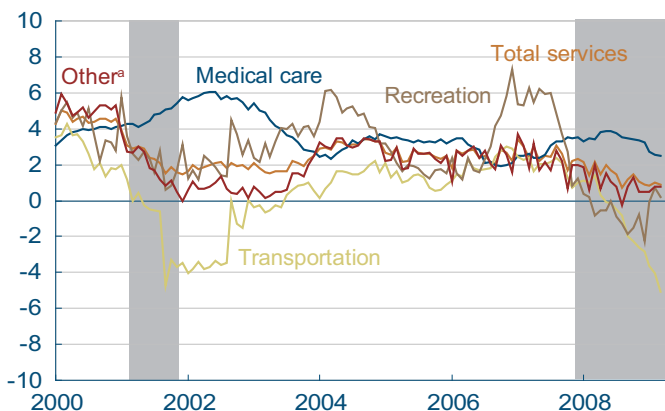


Source: Bureau of Economic Analysis.

How permanent will the shifts toward saving and thus slower consumption be, particularly for durable goods? While the life of durable goods can be extended, albeit at the cost of higher maintenance, at some point they have to be replaced. A higher savings rate is likely to persist, but demand for durable goods is likely to rebound at least partially. Having been burned once, households may be reluctant to spend as much on housing and autos as in the past.

Real Personal Consumption Expenditures: Services

12-month percent change



a. Includes housing, housing operation, and other.

Source: Bureau of Economic Analysis.

Real GDP: First-Quarter 2009 Advance Estimate

05.04.09

by Brent Meyer

Real GDP and Components, 2009:Q1 Advance Estimate

	Quarterly change (billions of 2000\$)	Annualized percent change, last:	
		Quarter	Four quarters
Real GDP	-181.2	-6.1	-2.6
Personal consumption	43.7	2.2	-1.2
Durables	25.3	9.4	-8.3
Nondurables	7.6	1.3	-3.0
Services	17.1	1.5	0.9
Business fixed investment	-150.5	-37.9	-16.36
Equipment	95.2	-33.8	-19.6
Structures	-46.0	-44.1	-10.0
Residential investment	-37.4	-38.0	-23.2
Government spending	-20.9	-3.9	1.7
National defense	-9.1	-6.4	5.2
Net exports	56.1	—	—
Exports	-123.9	-30.0	-11.3
Imports	-179.9	-34.1	-16.5
Private inventories	-103.7	—	—

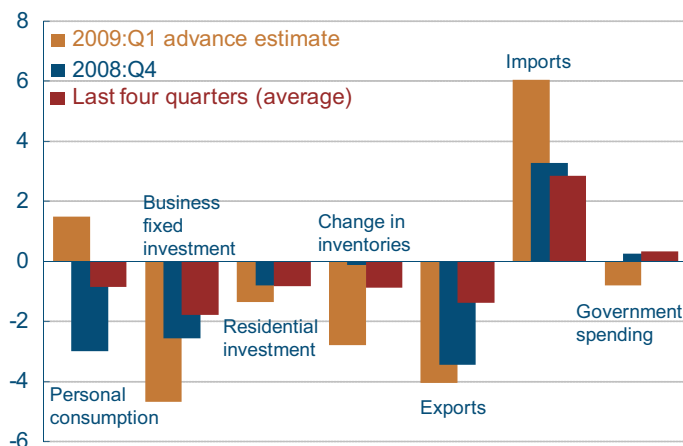
Source: Bureau of Economic Analysis.

Real GDP decreased at an annualized rate of 6.1 percent in the first quarter of 2009, slightly less negative than the fourth quarter's -6.3 percent, but coming in worse than consensus expectations. The resulting four-quarter growth rate in real GDP fell to -2.6 percent, its lowest growth rate since the 1982 recession. The first-quarter decrease was driven by negative contributions from business fixed investment, exports, and private inventories, and it was partially offset by consumption gains and a decrease in imports (which adds to real GDP).

Nonresidential fixed investment posted its sharpest postwar decrease, plummeting 37.9 percent in the first quarter and taking 4.7 percentage points away from real GDP growth. Real exports decreased 30.0 percent in the first quarter, subtracting 4.1 percentage points from growth and pushing the year-over-year growth rate down to -11.3 percent. However, imports fell even further, declining 34.1 percent during the quarter, which led to net exports actually adding 2.0 percentage points to real GDP growth.

Contribution to Percent Change in Real GDP

Percentage points



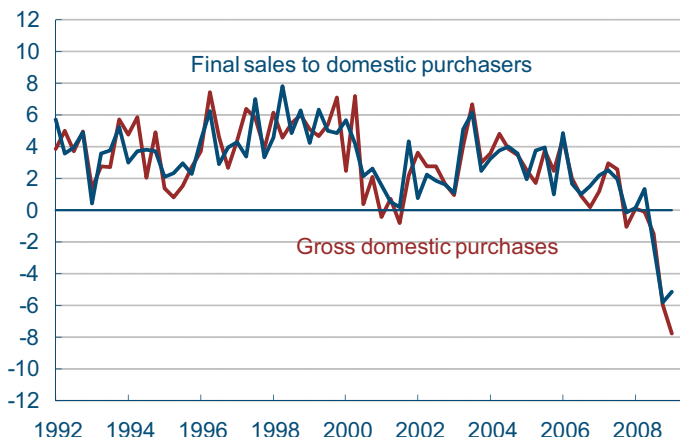
Source: Bureau of Economic Analysis.

Real personal consumption expenditures increased 2.2 percent (more than was expected), following two consecutive quarterly decreases. Spending on consumer durables jumped up 9.5 percent during the quarter, after four consecutive quarterly decreases. Embedded in the upside surprise in the quarterly consumption data were upward revisions to the monthly series. In fact, January's estimate was revised up from an initial estimate of 4.6 percent to 10.8 percent. The sell-off in private inventories accelerated in the first quarter, subtracting 2.8 percentage points from growth, compared to a mere 0.1 percentage point in the fourth quarter.

Given the wild swings in the international trade data and private inventories, it might be useful to examine output changes that exclude those series. Real gross domestic purchases—which ignore net exports—fell 7.8 percent in the first quarter, fol-

Gross Domestic Purchases and Final Sales

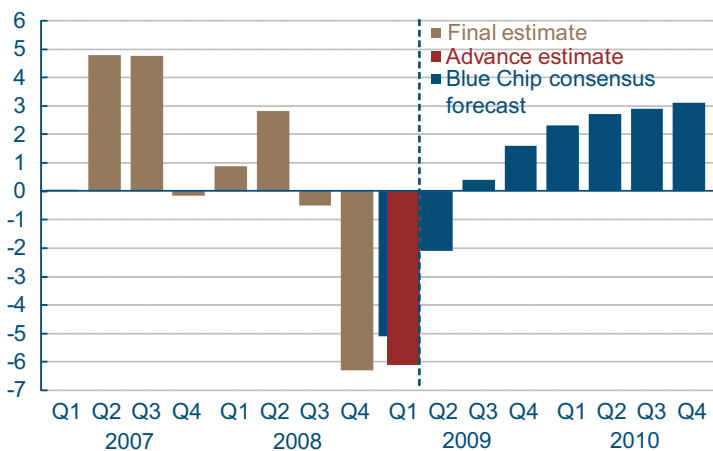
Annualized percent change



Source: Census Bureau.

Real GDP Growth

Annualized quarterly percent change



Sources: *Blue Chip Economic Indicators*, April 2009; Bureau of Economic Analysis.

lowing a 5.9 percent decrease last quarter. However, this series still includes the change in private inventories, which decreased dramatically in the first quarter. Final sales to domestic purchasers, a measure of domestic demand, excludes inventory changes in addition to subtracting net exports. Final sales decreased 5.1 percent in the first quarter, improving over the 5.8 percent falloff in the fourth quarter, and may offer some hope that demand is starting to return.

Panelists on the Blue Chip survey actually revised up their first-quarter growth estimate in the April survey (which takes place during the first week of April)—from -5.3 percent to -5.1 percent. Unfortunately, real GDP came in below expectations. That said, the consensus viewpoint is for the recession to end by midyear and to rebound toward trend growth by the fourth quarter of 2010.

Involuntary Part-Time Workers and the Deficiencies of the Unemployment Rate

05.07.09

by Yoonsoo Lee and Beth Mowry

The Bureau of Labor Statistics' March employment report had very few positive things to say about the labor market. Employers slashed an additional 663,000 jobs, and the unemployment rate climbed 0.4 percentage point, from 8.1 percent to 8.5 percent, the highest rate since late 1983. As dismal as 8.5 percent sounds, the unemployment rate actually gives a rosier take on the labor market than alternative measures do. Now appears to be a time when this rate, the government's most publicized statistic on employment conditions, offers an incomplete view of the state of the labor market.

The unemployment rate is often criticized for leaving some people out of the count. The rate is defined as the percentage of those in the labor force who are unemployed, and to be in the labor force, one needs to be employed or actively seeking work. Not included are people who are willing and able to work but who have stopped searching.

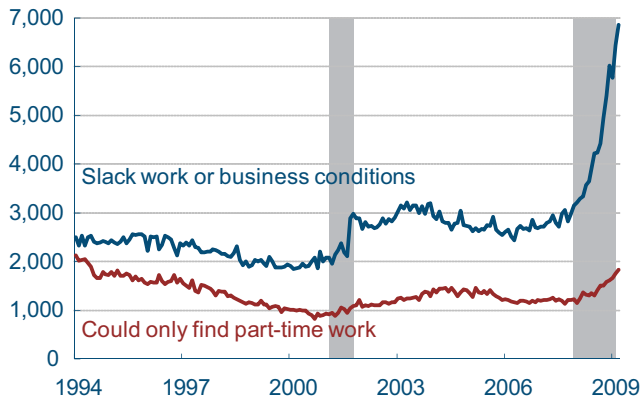
There are a variety of reasons these so-called marginally attached workers may have stopped looking for work. Discouraged workers are considered part of the marginally attached group, for instance, because they believe searching for a job would not be worthwhile. As gloomy economic conditions discourage workers from hunting for new jobs, the official unemployment rate may understate slack in the labor market during recessions.

Involuntary part-time workers are another group whose status is not captured entirely in the official unemployment rate. These underemployed workers would like to have full-time jobs but instead are working fewer than 35 hours a week, either because their hours have been reduced or because part-time work was all they could find.

The employment report showed that the number of people employed part-time for economic reasons (rather than by choice) increased by 423,000

Involuntary Part-Time Employment

Thousands of workers



Notes: Shaded bars represent recessions. Seasonally adjusted data.
Source: Bureau of Labor Statistics.

last month. This increase followed on the heels of a 787,000 increase in February, the second-largest monthly jump since records began in the 1950s (the largest was September 2001). The total number of involuntary part-timers is now the highest it has ever been, standing at 9 million—nearly double what it was just a year ago (4.9 million).

The BLS's Current Population Survey categorizes involuntary part-timers into those working part-time due to "slack work or business conditions" and those who "could only find a part-time job." In other words, some workers had full-time jobs but went to part-time when their employers cut hours because business was falling off, while other workers had to start out in part-time jobs even though they were looking for full-time work, because that's all that was available.

Average Job Openings and Labor Turnover by Industry

	April 2006		March 2009		Change	
	Total (thousands)	Percent	Total (thousands)	Percent	Total (thousands)	Percent
Total part-time for economic reasons	3908	100.0	9049	100.0	5141	100.0
Slack work or business conditions	2440	62.4	6857	75.8	4417	85.9
Could only work part-time	115	132	370	385	388	383
Manufacturing	232	282	340	352	457	367

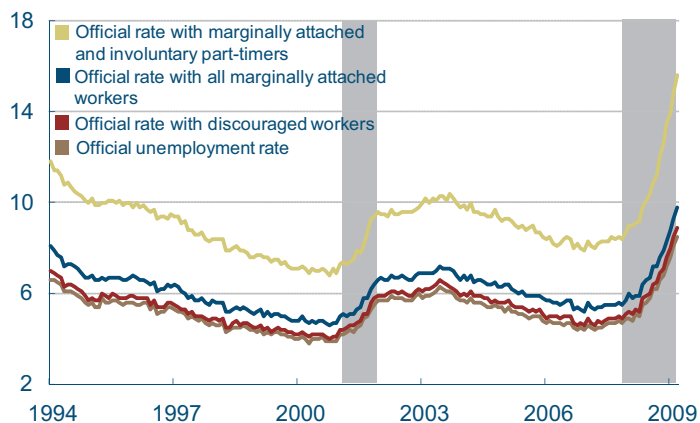
Note: Data are seasonally-adjusted.
Sources: Bureau of Labor Statistics, Current Population Survey.

The 5.1 million rise in involuntary part-time employment from its recent low in April 2006 to the present was mainly due to an increase in workers whose hours were cut back because of slack work conditions. In fact, the number of those working part-time for this reason more than doubled since the beginning of the recession. They accounted for 62 percent of all economic part-timers in 2006, and now they constitute 76 percent of the group.

This large uptick is important to note because it fills in some of the gaps of the labor market story that the official unemployment rate leaves open. When marginally attached workers and involuntary part-time workers are added to the official unemployment rate, the unemployment rate nearly doubles, from 8.5 percent to 15.6 percent.

Alternative Measures of Unemployment Rate

Percent



Notes: Shaded bars indicate recessions. The official unemployment rate is the ratio of unemployed persons to the labor force. The other rates include the additional worker classifications in the numerator and denominator.

Source: Bureau of Labor Statistics.

More and more people appear to be working part-time jobs for economic reasons, rather than by choice. The unemployment measure that accounts for these people and other marginally attached workers has increased even more than the official unemployment rate over the past year.

The official unemployment rate rose from 4.9 percent at the start of the recession in December 2007 to its present 8.5 percent, an increase of 3.6 percentage points. The unemployment rate including marginally attached workers and the underemployed increased 6.9 percentage points in the

To read more on the Bureau of Labor Statistics' March employment report:

<http://www.bls.gov/news.release/empsit.nr0.htm>

The Employment Situation, April 2009

05.12.09

by Yoonsoo Lee and Beth Mowry

Nonfarm payroll employment declined by a less-than-expected 539,000 in April, boosted by federal government hiring and smaller-than-expected losses across many private industries. While still very large, the loss was the smallest since last October. Revisions to the data for the previous two months, however, continued to be on the downside, adding 66,000 additional losses to the earlier figures for February and March. Those months have now seen respective losses of 681,000 and 699,000, bringing total payroll losses since the start of the recession to 5.7 million.

The unemployment rate jumped from 8.5 percent to 8.9 percent in April, largely due to a labor force increase of 683,000 people, which pushed up the participation rate 0.3 percentage point to 65.8 percent. The employment-to-population ratio, often considered a more stable measure of labor market dynamics, remained at 59.9 percent.

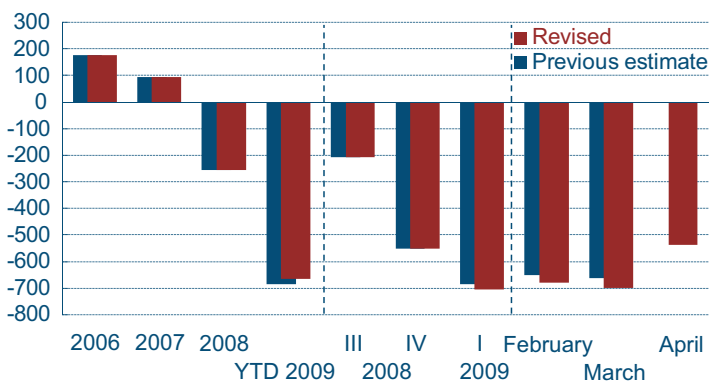
The diffusion index of employment change, which tracks the percentage of industries that are increasing their employment, saw its largest monthly increase since September 2007, jumping from 20.3 to 28.2. This reading is still well below the 50 threshold, which would indicate an equal balance between industries with increasing and decreasing employment.

Goods-producing payrolls decreased by 270,000 in April, compared to average monthly losses of 322,000 for year-to-date 2009. Manufacturing and construction losses (-149,000, -110,000) were both the smallest seen for any month this year. Durable goods (-127,000) continued to be a heavier drag on the manufacturing figure than nondurable goods (-22,000). Within durable goods, motor vehicles and parts manufacturers alone were responsible for 29,000 of the payroll losses.

The private service-providing sector shed 341,000 jobs in April, after larger drops in February (-393,000) and March (-375,000). Of all the ma

Average Nonfarm Employment Change

Change, thousands of jobs



Source: Bureau of Labor Statistics.

jor service industries, only information (-17,000) and leisure and hospitality (-44,000) fared slightly worse than they had in March. Other service industries shed fewer jobs last month: Trade, transportation, and utilities lost 126,000, financial activities lost 40,000, and professional and business services dropped 122,000. Payroll losses in temporary help services lessened slightly but are still elevated compared to most months over the course of the recession. As has been the case over the past year, education and healthcare is the only service industry to add to payrolls, with a net gain of 15,000. The government sector experienced its largest monthly gain since June 2001, due to the hiring of 140,000 federal employees in preparation for the 2010 Census.

Labor Market Conditions and Revisions

	Average monthly change (thousands of employees, NAICS)				
	February current	Revision to February	March current	Revision to March	April 2009
Payroll employment	-681	-30	-699	-36	-539
Goods-producing	-295	-10	-318	-13	-271
Construction	-113	-6	-135	-9	-110
Heavy and civil engineering	-7.6	-2	-12	-2	-17
Residential ^a	-51.1	2	-62	-3	-52
Nonresidential ^b	-54.1	-6	-61	-4	-41
Manufacturing	-172	-3	-167	-6	-149
Durable goods	-128	0	-127	-2	-127
Nondurable goods	-44	-3	-40	-4	-22
Service-providing	-386	-20	-381	-23	-269
Retail trade	-57	-6	-64	-16	-47
Financial activities ^c	-56	-12	-43	0	-40
PBS ^d	-176	2	-130	3	-122
Temporary help services	-73	4	-72	0	-63
Education and health services	19	-3	10	2	15
Leisure and hospitality	-32	-4	-42	-2	-44
Government	7	4	-6	-1	72
Local educational services	6	-4	-4	-4	4

a. Includes construction of residential buildings and residential specialty trade contractors.

b. Includes construction of nonresidential buildings and nonresidential specialty trade contractors.

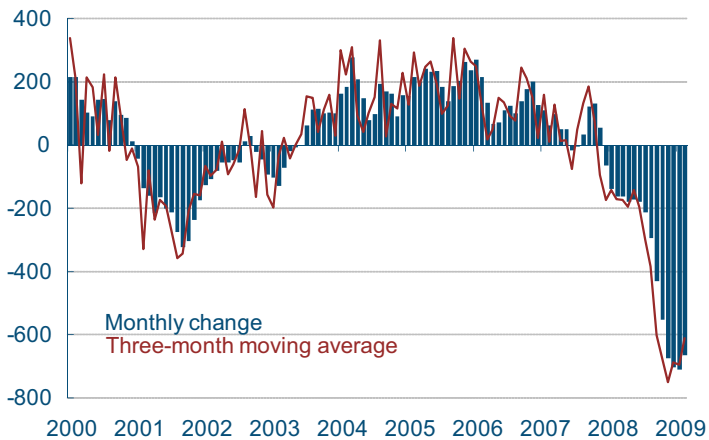
c. Includes the finance, insurance, and real estate sector and the rental and leasing sector.

d. PBS is professional business services (professional, scientific, and technical services, management of companies and enterprises, administrative and support, and waste management and remediation services).

Source: Bureau of Labor Statistics.

Private Sector Employment Growth

Thousands of jobs

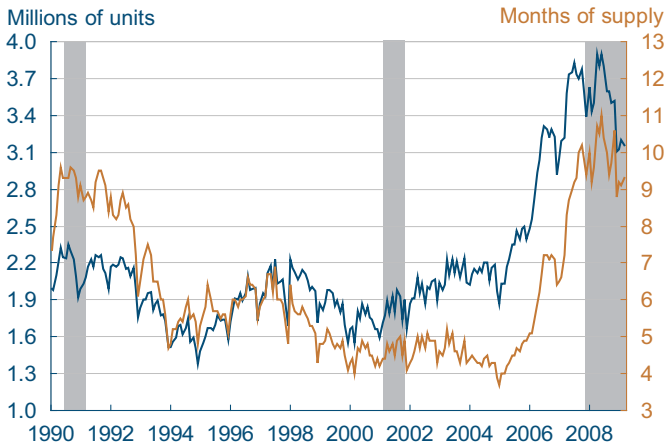


Source: Bureau of Labor Statistics.

Total private sector employment dropped by a milder 611,000 jobs last month, compared to March's loss of 693,000. Still, monthly private-sector losses this year have been considerably worse for several months running compared to past recessions. The only months in the series with comparable losses were December 1974 and October 1949, which saw respective private sector losses of 629,000 and 814,000.

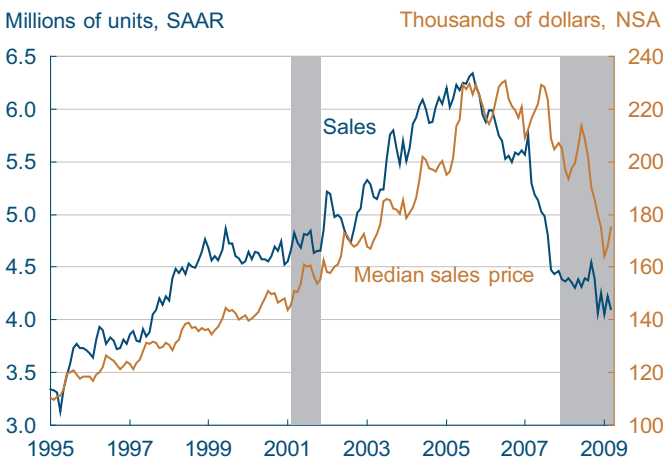
Is the Housing Bust Over?

Existing Single-Family Homes for Sale



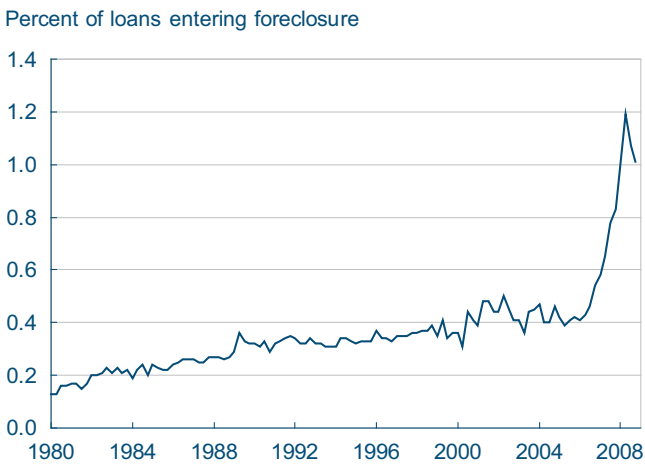
Source: National Association of Realtors.

Existing Single-Family Home Sales



Source: National Association of Realtors.

Foreclosure Starts



Source: Mortgage Bankers Association.

05.12.09

by Michael Shenk

It was early 2006 that housing markets did their abrupt turnaround, transitioning from a period of increasing prices and sales to one where both prices and sales were in a near freefall. The fallout of the housing market bust has been well documented, and the boom-bust cycle is often cited as a leading cause of the current recession.

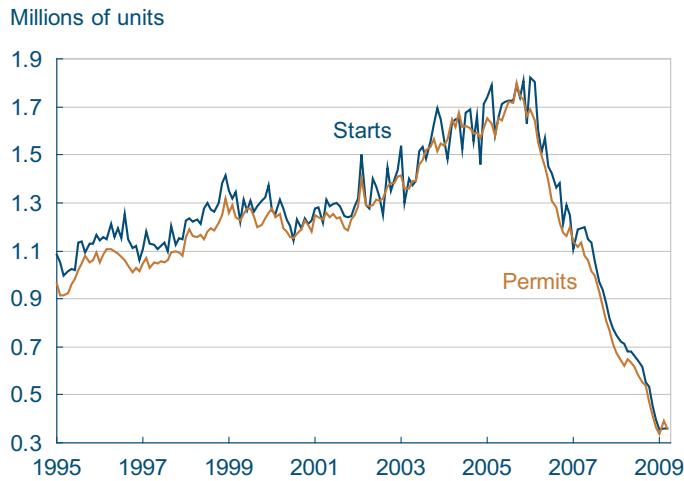
It's been three years—is the housing market correction finally over? The short answer is probably no, but there are some encouraging signs of improvement.

Existing single-family home sales, by far the largest segment of the housing market, have been relatively stable for the past five months. Prior to a steep drop off in November, sales had held steady for roughly 14 months. This stability has come at a cost though, as the median price of homes sold has fallen drastically over the past year and a half.

Part of the reason that existing home prices seem to be falling so rapidly is that an increasing percentage of homes being sold are distressed. In April, the National Association of Realtors reported that just over half of March's home sales were in this category. While this may not seem encouraging for homeowners, working off the bloated supply of foreclosures is an important step in the return to normalcy. So far, inventories of existing homes have yet to come down significantly, but with sales showing signs of stability, it appears that inventories may have turned a corner. In addition, the Mortgage Bankers Association reported that the percent of loans entering foreclosure fell in the second half of 2008.

New single-family home sales have also shown tentative signs of stabilizing over the past few months. However, since they began their decline in late 2005, new home sales have shown quite a few signs of stability over short periods, only to be followed by more declines. Of course, one might not expect new home sales to stabilize as rapidly

Housing Starts and Permits



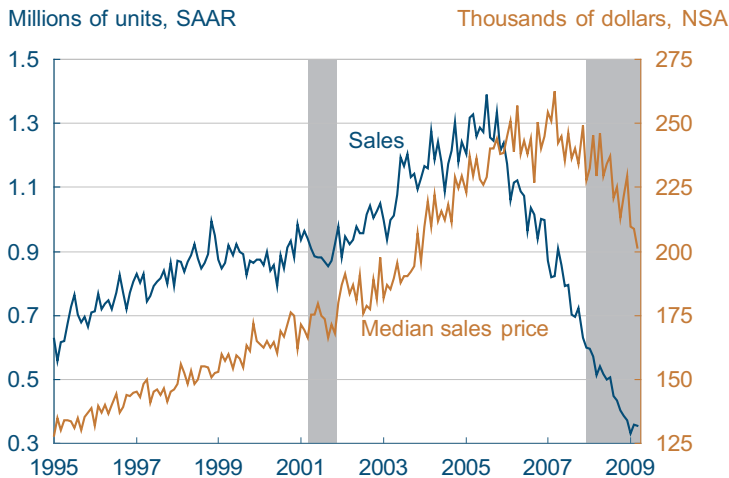
Source: Census Bureau.

as existing home sales, since an excess supply of homes usually means homebuilders will be adding fewer homes to the market. With fewer new homes on the market, there should be fewer sales as well. Looking at housing starts and the level of inventory for new homes, it is pretty clear that builders are scaling back. In fact, the current level of inventory is roughly in line with the average seen from 1980 to 2000.

Perhaps the most positive sign for housing markets is that the home-price indexes are beginning to suggest that price declines may be slowing. Both the latest S&P/Case-Shiller indexes and the FHFA index indicate some stability in the 12-month growth rate of prices as of February. The FHFA index shows prices actually improving in February, while the Case-Shiller index, which is narrower than the FHFA index in terms of geographic coverage but also includes nonconforming loans which the FHFA index leaves out, simply has prices falling at a slower pace.

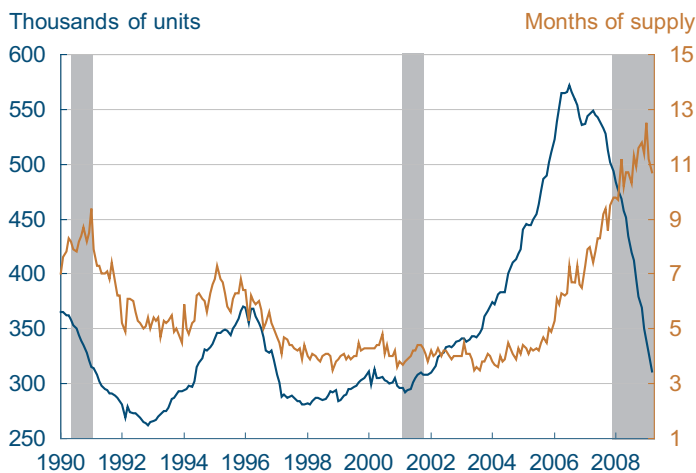
While there are some tentative signs that the housing market is stabilizing, it is important to note that things are still far from normal. Home prices, for example, are currently down 30.7 percent and 9.5 percent from their respective peaks in the Case-Shiller and FHFA indexes. Also, given the still-bloated inventories of unsold homes, it might be some time before things return to what we remember as normal. That being said, any positive signs in the market are certainly welcome after such a long period of dreary news.

New Single-Family Home Sales



Source: Census Bureau.

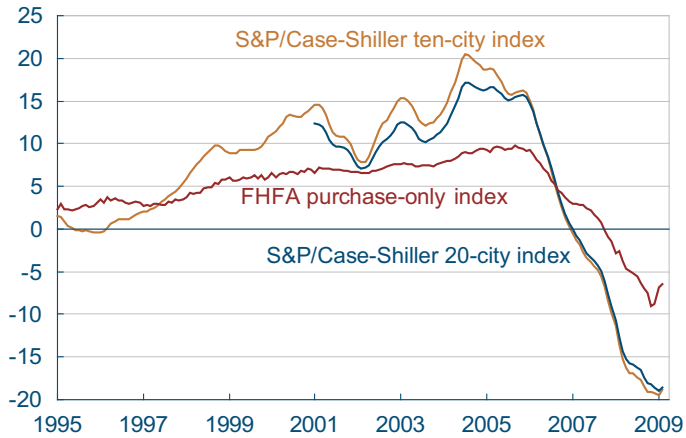
New Single-Family Homes for Sale



Source: Census Bureau.

Monthly Home Price Indexes

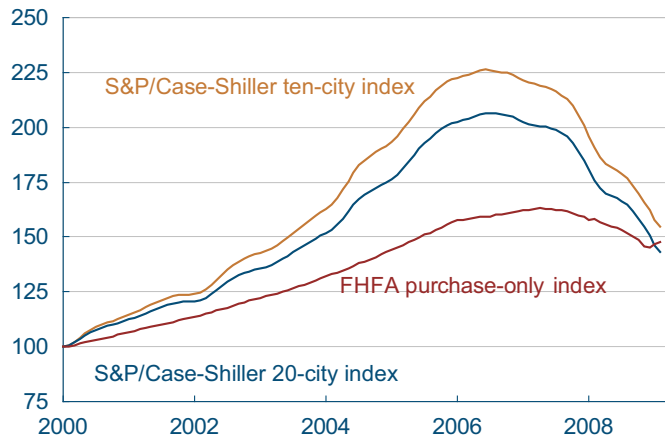
12-month percent change



Sources: S&P, Fiserv, and MacroMarkets LLC, Federal Housing Finance Agency.

Monthly Home Price Indexes

Index, January 2000=100

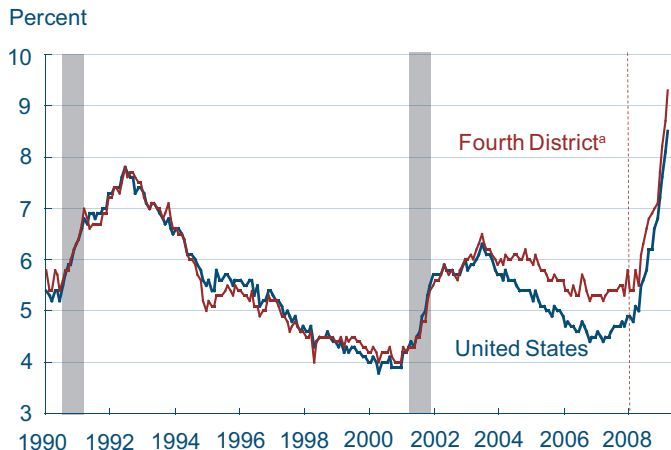


Sources: S&P, Fiserv, and MacroMarkets LLC, Federal Housing Finance Agency.

Fourth District Employment Conditions, March 2009

04.30.09
by Kyle Fee

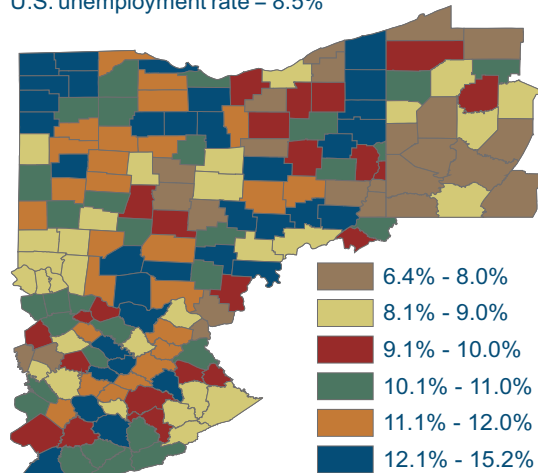
Unemployment Rates



a. Seasonally adjusted using the Census Bureau's X-11 procedure.
Note: Shaded bars represent recessions. Some data reflect revised inputs, reestimation, and new statewide controls. For more information, see <http://www.bls.gov/lau/launews1.htm>.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

County Unemployment Rates

U.S. unemployment rate = 8.5%



Note: Data are seasonally adjusted using the Census Bureau's X-11 procedure.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

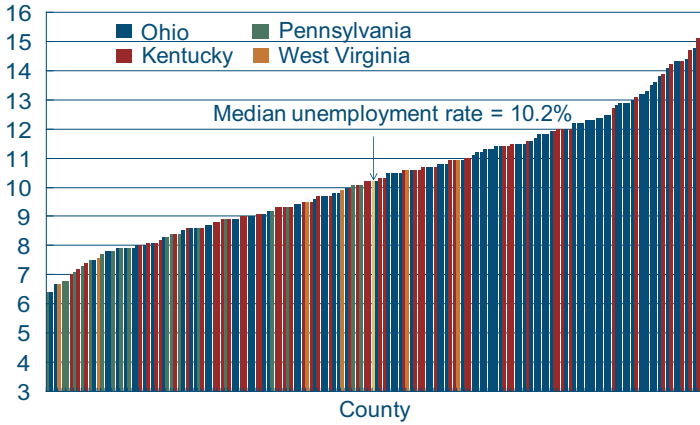
The District's unemployment rate increased 0.5 percentage point to 9.3 percent for the month of March. The increase in the unemployment rate is attributed to an increase of the number of people unemployed (5.4 percent) and a decrease in the number of people employed (-0.8 percent). The District's unemployment rate was again higher than the nation's (0.8 percentage point), as it has been consistently since early 2004. Since the recession began, the nation's monthly unemployment rate has averaged 0.6 percentage point lower than the Fourth District unemployment rate. Year over year, the Fourth District and the national unemployment rates have increased 3.5 percentage points and 3.4 percentage points, respectively.

There are significant differences in unemployment rates across counties in the Fourth District. Of the 169 counties that make up the District, 36 had an unemployment rate below the national rate in March, and 133 counties had a higher rate. There were 92 District counties reporting double-digit unemployment rates, 63 percent of which were in the state of Ohio. Rural counties continue to experience higher levels of unemployment, as do counties along the Ohio-Michigan border. More recently, counties on the Ohio side of the Ohio-Pennsylvania border have seen spikes in unemployment rates. Outside of Pennsylvania, lower levels of unemployment are limited to the interior of Ohio or the Cleveland-Columbus-Cincinnati corridor.

Unemployment rates across Fourth District counties range from 6.4 percent (Allegheny County, Pennsylvania) to 15.2 percent (Williams County, Ohio), with a median county unemployment rate of 10.2 percent. Counties in Fourth District Pennsylvania generally populate the lower half of the distribution of unemployment rates across counties, while the few Fourth District counties in West Virginia moved to the middle of the distribution in March. Fourth District Kentucky and Ohio counties continue to dominate the upper half of the

County Unemployment Rates

Percent



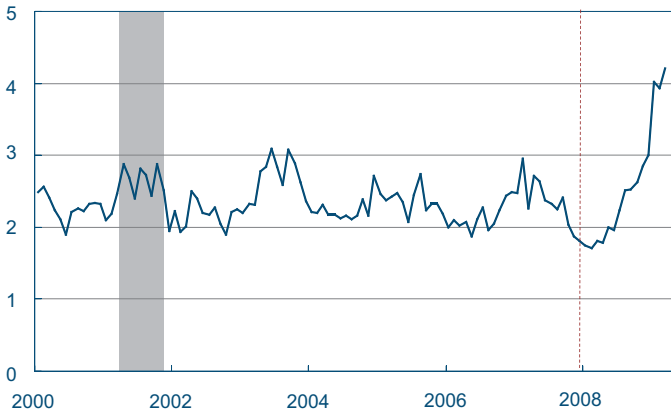
Note: Data are seasonally adjusted using the Census Bureau's X-11 procedure.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

distribution. These county-level patterns are reflected in statewide unemployment rates, as Ohio and Kentucky have unemployment rates of 9.7 percent and 9.8 percent, respectively, compared to Pennsylvania's 7.8 percent and West Virginia's 6.9 percent.

Unemployment rates vary now more across Fourth District counties than they did earlier this decade. Increased dispersion of unemployment rates supports the notion that labor markets in some Fourth District areas are holding up relatively well, while other areas have experienced much higher levels of unemployment.

Variance of County Unemployment Rates

Percent (squared)



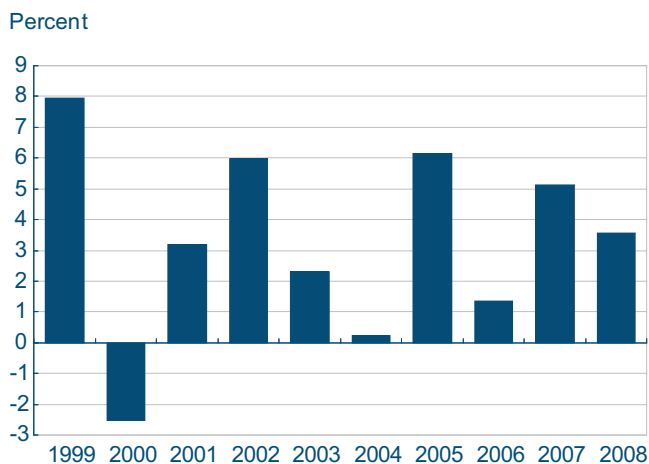
Source: U.S. Department of Labor, Bureau of Labor Statistics.
Note: Shaded bars represent recessions.

Fourth District Bank Holding Companies

04.13.09

by Joseph Haubrich, Kent Cherny, and Saeed Zaman

Annual Asset Growth



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

A bank holding company (BHC) is a legal entity that owns a controlling interest in a commercial bank, often in addition to other financial and nonbank subsidiaries. BHCs range in size, but all are regulated by the Federal Reserve System (each BHC is supervised by the Federal Reserve Bank in the region where the BHC has its headquarters).

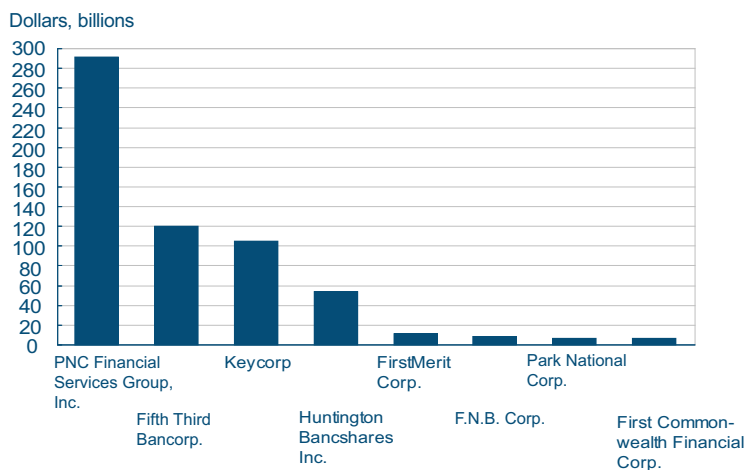
Of those BHCs with consolidated assets of more than \$1 billion, 20 were headquartered in the Fourth District, including 4 of the top 50 BHCs in the United States, as of the fourth quarter of 2008.

Annual asset growth of Fourth District BHCs was 3.5 percent last year, down from 2007's 5.1 percent growth rate. With regard to national trends, the commercial banking sector saw a reduction in total assets during the fourth quarter of 2008, as the financial crisis prompted banks to deleverage or slow their rate of asset growth. Nevertheless, total assets nationally and in the Fourth District did grow over the course of 2008.

The landscape of Fourth District BHCs has changed slightly since our last update. In particular, the Pittsburgh-based bank PNC closed on its purchase of Cleveland-based National City during the fourth quarter of last year, becoming the eighth largest BHC in the country (with assets of \$291 billion). Fifth Third, Key, Huntington Banks, and other large BHCs located in the District, are also among the top 50 U.S. BHCs. The assets of all Fourth District BHCs account for 4.6 percent of the nationwide total.

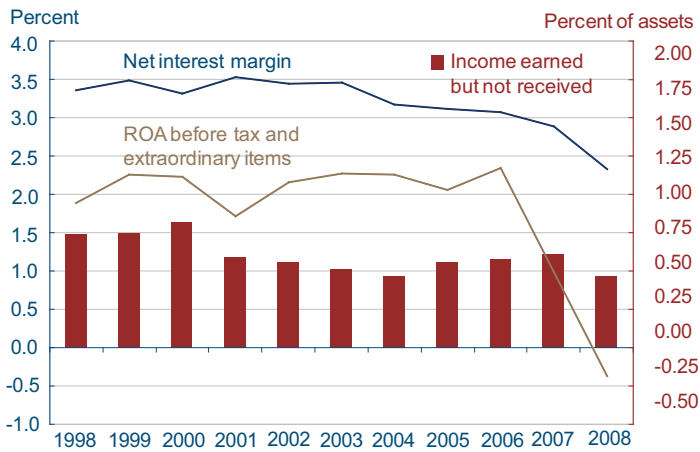
Banks' aggregate return on assets fell below zero during 2008, as the industry continued to grapple with souring loans and a worsening economic climate. In the Fourth District, bank holding companies booked a -0.37 percent return on assets. The net interest margin (NIM)—the spread between the rate at which banks lend and the rate at which they borrow—fell to 2.33 percent from 2.89

Largest Fourth District Bank Holding Companies by Asset Size



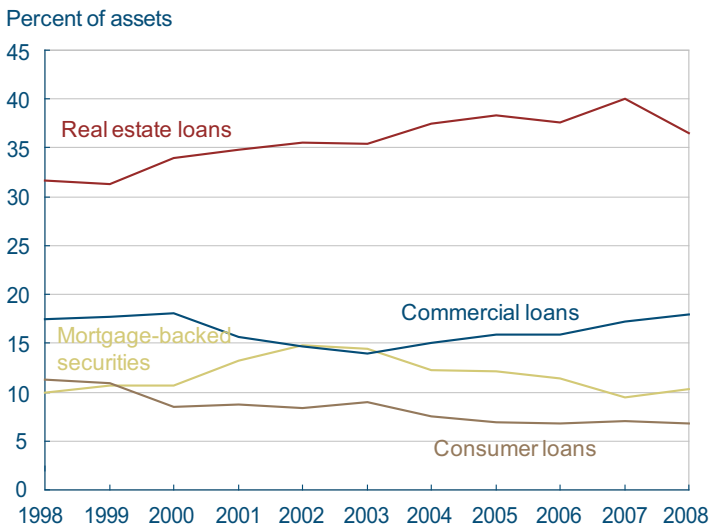
Note: Rank is as of fourth quarter 2008.
Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

Income Stream



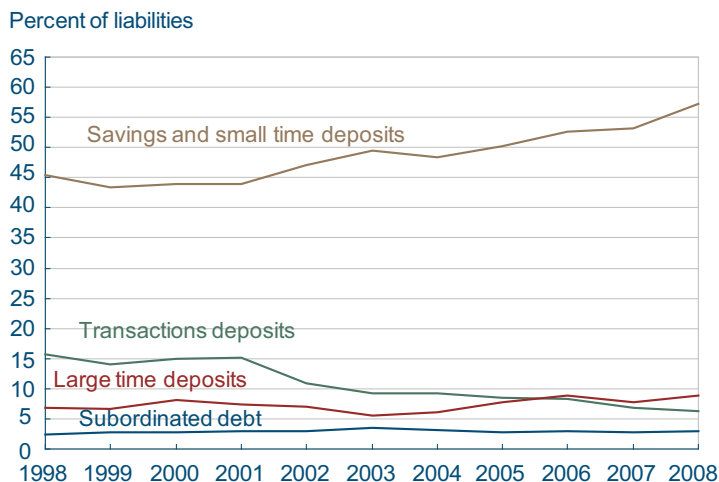
Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

Assets



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

Liabilities



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

percent in 2007. Notice that the NIM's decline accelerated during 2007 and into 2008, roughly tracking the fall of short-term interest rates. Since September 2007, the Federal Reserve has lowered the target federal funds rate from 5.25 percent to a range of 0.00 percent –0.25 percent. Although banks benefit from a lower borrowing cost as short-term rates decrease, long-term rates have also stayed relatively low by historical standards, and banks also base many of their loans (especially consumer loans) on the prime rate, which is tied to the fed funds rate.

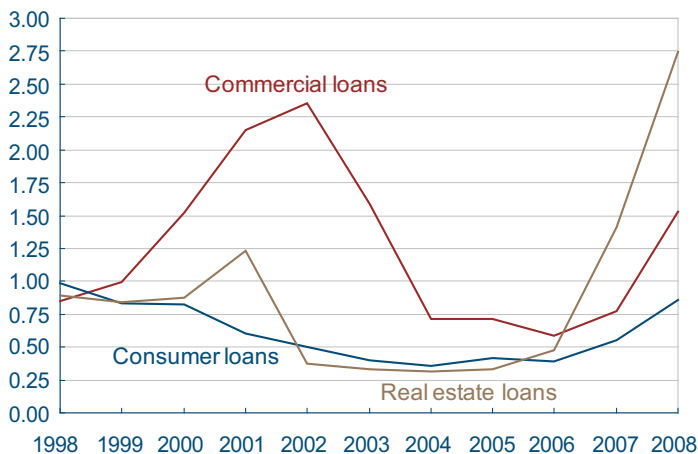
Another indicator used to measure the strength of earnings is the level of income earned but not received. If a loan allows the borrower to pay an amount that does not cover the interest accrued on the loan, the uncollected interest is booked as income even though there is no cash inflow. The assumption is that the unpaid interest will eventually be paid before the loan matures. However, if an economic slowdown forces an unusually large number of borrowers to default on their loans, a bank's capital may be unexpectedly impaired. The levels of Fourth District BHC income earned but not received ticked up modestly from 2005 to 2007 but fell back to 2004 levels (0.46 percent of assets) in 2008.

Real estate continues to be the dominant loan class for Fourth District BHCs, although there was a clear decrease in the portion of assets represented by real estate loans in 2008. Real estate fell to 36.6 percent of assets, from 40.0 percent in 2007. At the same time, commercial loans and mortgage-backed securities saw a slight rise in their representation in loan portfolios. It is not clear whether these increases were the result of concerted portfolio rebalancing at banks; equally likely is the possibility that the rebalancing occurred naturally as the volume of real estate originations (and loan volume generally) slowed during 2008.

Deposits became an increasingly important source of funding for banks in 2008, particularly in the fourth quarter, as individuals shifted assets into savings in a flight-to-quality move, and for liquidity. Savings and small time deposits accounted for 57.3 percent of BHC liabilities, an 8.0 percent increase

Problem Loans

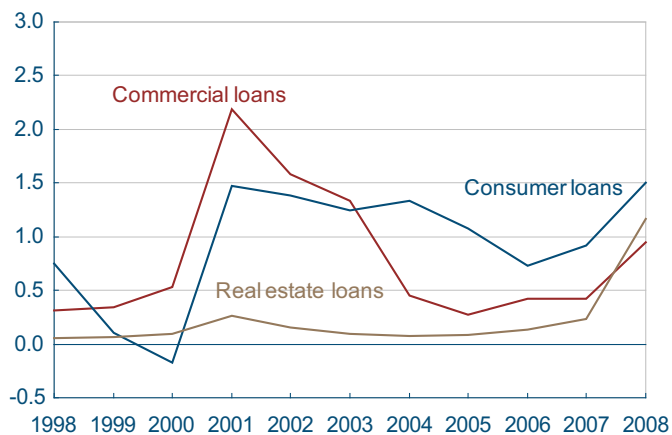
Percent of loans



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

Net Charge-Offs

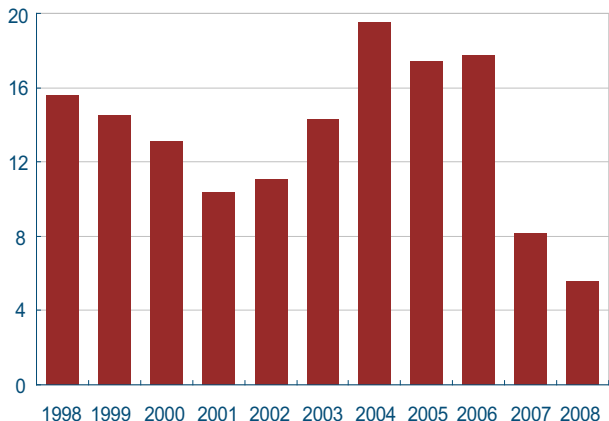
Percent of loans



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

Coverage Ratio

Dollars



Note: Ratio of capital and loan loss reserves to problem assets.
Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

from 2007. Transaction deposits saw a slight decline of 0.67 percent of liabilities, and large time deposits increased to 8.83 percent of liabilities from 7.70 percent in 2007.

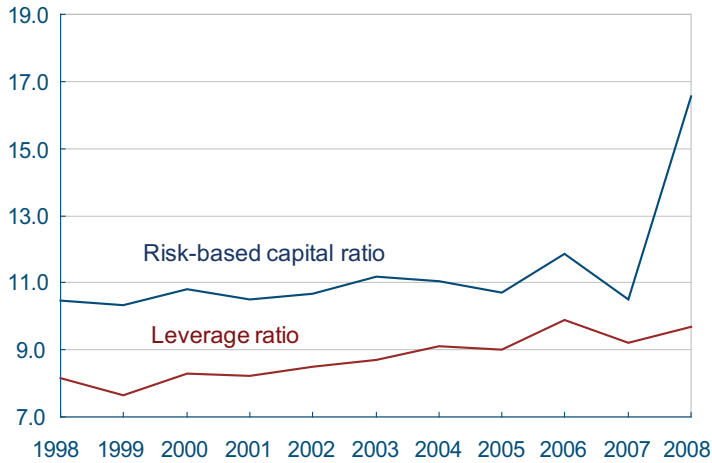
Problem loans are loans that are past due for more than 90 days but are still accruing interest payments, as well as loans that are no longer accruing interest. Last year, problem real estate loans hit 2.75 percent of all loans—nearly double the 1.41 rate in 2007. Consumer (credit card, installment) loans and commercial loans also became problematic at a much faster rate in 2008 with the effects of the recession. Approximately 1.53 percent of commercial loans and 0.86 percent of consumer loans were problematic in 2008, up from 0.78 percent and 0.55 percent in 2007, respectively.

BHCs in the Fourth District also charged off more souring loans in 2008 than in previous years. Consumer loan charge-offs, at 1.50 percent, were the highest of the three categories shown. Bad credit card debt, a component of consumer loans, likely accounts for most of this category. Credit card lines were clearly hit by worsening economic conditions, and banks also tend to charge off problematic credit card lines at a faster rate than secured commercial or real estate loans.

Capital is a bank's cushion against unexpected losses. The risk-based capital ratio (a ratio determined by assigning a larger capital charge on riskier assets) for Fourth District BHCs saw a dramatic rise from 10.5 percent of assets in 2007 to 16.5 percent in 2008. During 2008, asset growth slowed, and many banks sought additional capital, including from the government's TARP program. The leverage ratio stayed relatively flat at 9.7 percent (from 9.2 percent in 2007).

Capitalization

Percent



Source: Authors' calculation from Federal Financial Institutions Examination Council, Quarterly Banking Reports of Condition and Income, Fourth Quarter 2008.

An alternative measure of balance sheet strength is the coverage ratio. The coverage ratio measures the size of a bank's capital and loan loss reserves relative to its problem assets. This ratio has been falling since 2006, and in 2008, BHCs held about \$5.52 of capital and loss reserves per dollar of problem assets. Last year, that number was \$8.15.

To read more on the Fourth Quarter 2008 Quarterly Banking Profile: <http://www2.fdic.gov/QBP/index.asp>

To read more on the flight-to-quality move: <http://www.clevelandfed.org/research/trends/2009/0109/01banfin.cfm>

How Realistic Were the Economic Forecasts Used in the Stress Tests?

05.12.09

by Ken Beauchemin and Brent Meyer

The results of the “stress tests” came out last Thursday, and we can now see what three months of intense scrutiny of 19 of the countries’ largest bank holding companies has revealed about the amount of capital they are likely to need to withstand a worse-than-expected recession. Since the April 24 release of the Federal Reserve white paper describing the process, a number of observers have suggested that the economic forecasts used in the tests are not severe enough, and may result in insufficient capital requirements.

Regulators tested the banks against two sets of assumptions for GDP, unemployment, and housing prices. The “baseline” scenario averaged the February forecasts of real GDP and the unemployment rate from the Blue Chip Survey, Consensus Forecasts, and the Survey of Professional Forecasters. The assumptions for house prices followed a path implied by futures on the Case-Shiller Housing Price Index. The second, “more adverse” scenario represented a longer and deeper recession than the baseline scenario.

In the baseline case, real GDP falls by 2.0 percent in 2009 before rebounding to 2.1 percent in 2010; the unemployment rate averages 8.4 percent in 2009 and 8.8 percent in 2010. House prices decline 14.0 percent in 2009 and fall an additional 4.0 percent in 2010.

The more adverse (but not necessarily “worst-case” scenario) assumes a sharp 3.3 percent real GDP contraction in 2009 followed by scant 0.5 percent growth in 2010; the unemployment rate averages 8.9 percent in 2009 and 10.3 percent in 2010. House prices drop 22.0 percent in 2009 and 7.0 percent in 2010.

At the time the assumptions were determined, the advance estimate on fourth-quarter 2009 real GDP growth was -3.8 percent (annualized), and the February employment figures were not known. Subsequently, the Bureau of Economic Analysis slashed

the fourth-quarter growth estimate by a stunning 2.5 percentage points, to -6.3 percent. Given the large downward GDP revision, an exceptionally rapid deterioration in the labor market, and yet another large GDP decline (in the first quarter), it is, of course, natural to question the validity of the bank stress tests. It turns out, however, that the most recent forecasts remain in line with the two stress-test scenarios.

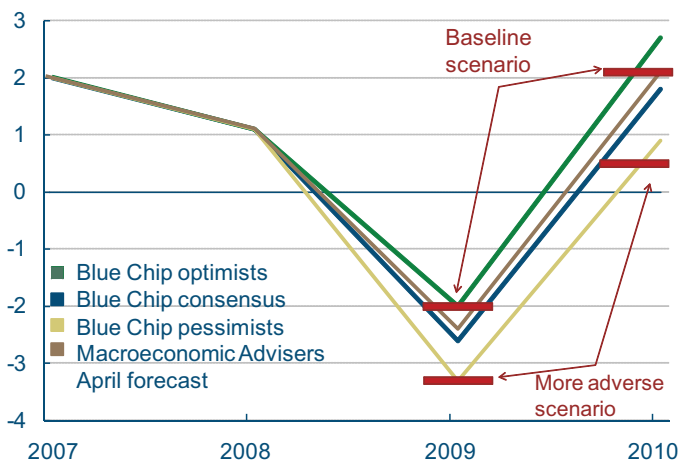
First, the most recent GDP growth forecasts still lie within the range covered by the stress-test scenarios. While both the Blue Chip consensus and Macroeconomic Advisers forecasts dip below the baseline-scenario projection for 2009 growth of -2.0 percent, they are quite close to the 2010 baseline and remain firmly within the range between the baseline and more adverse scenarios in both years. Furthermore, only the Blue Chip pessimists' forecast hits the lower bound of the stress-test scenarios in 2009, and it is 0.4 percentage point above the more adverse scenario for 2010.

Second, while rapid deterioration in the labor market has led to a near-term path for the unemployment rate that will most likely generate a 2009 average in excess of the 8.4 percent rate assumed by the baseline scenario, both the most recent Macroeconomic Advisers and Blue Chip forecasts predict an unemployment rate slightly lower than the 8.9 percent rate assumed by the more adverse scenario. The forecasts for 2010 are also less dire than assumed by the more adverse scenario. As the Federal Reserve noted in its April 24 white paper, "Although the likelihood that unemployment could average 10.3 percent in 2010 is now higher than had been anticipated when the scenarios were specified, that outcome still exceeds a more recent consensus projection by professional forecasters for an average unemployment rate of 9.3 percent in 2010."

Finally, recent forecasts for house prices remain consistent with those of the stress-test scenarios and even hold out some hope that house prices may rise faster than the baseline forecast. This result is particularly encouraging since further declines in house prices will be a leading cause of any additional losses. Home prices are an important indicator

Real GDP Growth Forecasts and Stress Test Scenarios

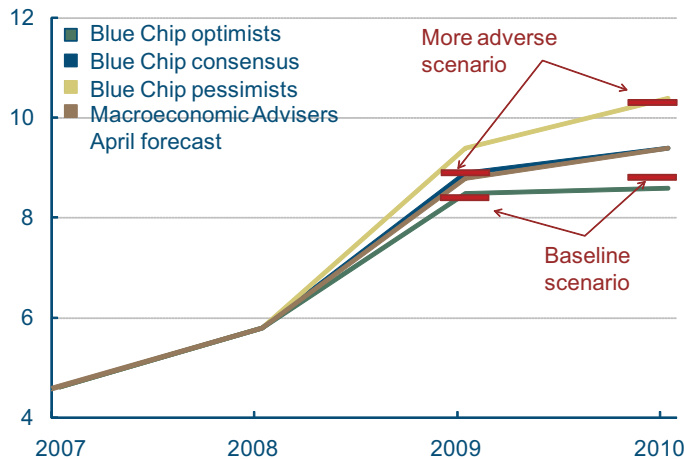
Annual average percent change



Sources: Blue Chip Newsletter, April 2009; Macroeconomic Advisers, April 2009; Bureau of Economic Analysis; Federal Reserve Board.

Unemployment Rate Forecasts and Stress Test Scenarios

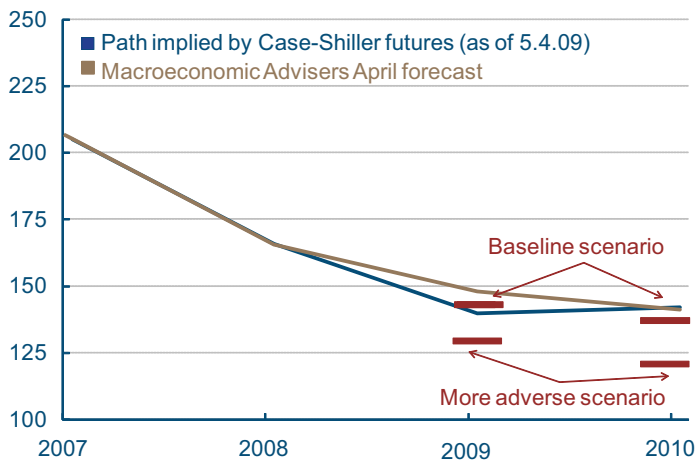
Percent, annual average



Sources: Blue Chip Newsletter, April 2009; Macroeconomic Advisers forecast, April 2009; Bureau of Labor Statistics; Federal Reserve Board.

House Price Forecasts and Stress Test Scenarios

Fourth-quarter levels (index, January 2000=100)



Sources: Macroeconomic Advisers forecast; Chicago Mercantile Exchange; S&P, Fiserv, & Macromarkets; Federal Reserve Board.

the fourth-quarter growth estimate by a stunning 2.5 percentage points, to -6.3 percent. Given the large downward GDP revision, an exceptionally rapid deterioration in the labor market, and yet another large GDP decline (in the first quarter), it is, of course, natural to question the validity of the bank stress tests. It turns out, however, that the most recent forecasts remain in line with the two stress-test scenarios.

In summary, notwithstanding further unexpected and dramatic declines in the economy, recent projections by professional forecasters indicate that the stress-test scenarios remain viable and relevant to the task of assessing the potential losses faced by nation's largest bank holding companies. While the adverse scenario may seem more likely than when it was first drawn up, it is only the near-term outlook for unemployment that has significantly strayed from baseline assumptions. Furthermore, the alternatively adverse scenario looks to be plenty adverse, and exposes the wisdom of planning for a more stressful outcome in the first place.

To read the April 24 release from the Federal Reserve:
<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090424a1.pdf>

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