Economic Outlook: Fourth Quarter 2008 Summary and 2009 Expectations

According to advanced estimates, the economy shrank at a 3.8% annualized rate in the fourth quarter, following a .5% decline in the third quarter. On a year-over-year basis, the economy contracted .2%. Housing, investment, and consumption continue to slide even as the money supply and bank liquidity expands rapidly. The fourth quarter decline was widespread with only government spending and a narrower trade deficit contributing to positive GDP growth. Labor markets follow overall economic activity with a lag. The fourth quarter jump in the unemployment rate to 7.6% from 7.2% was consistent with a maturing economic slump. Additions to inventories boosted fourth quarter growth in 2008, but will have a negative influence on first quarter 2009 growth as firms scale back inventory and production. With the fourth quarter inventories-to-sales ratios moving higher in most industries and with demand plummeting, businesses will reduce production in the first quarter of 2009.

The combination of high levels of debt, declining wealth from housing, lower equity values, lower income, job losses, and weakening confidence makes the current economic environment unlike a normal business cycle downturn. Monetary policy initiatives to pump liquidity into the banking system generated rapid growth in the money supply that has been largely canceled out by a declining demand for money (velocity). Even with short term interest rates approaching zero, credit conditions remain stringent. Banks are hesitant to expand loans and the private sector is hesitant to take on more debt. The Government's role as the "spender of last resort" will not really begin until later in 2009. Even so, there is some concern about the ability of government spending to make meaningful inroads in permanent job creation and stimulate consumer spending in the current environment. The stimulus must be very high to move past consumer desires to save and pay down debt rather than boost consumption.

Real GDP growth for 2009 will likely hover around zero without a normal breakout recover. Unemployment will rise above 8% by year end. Short term interest rates will remain very low by historic standards with Fed Funds remaining about 0%. Longer term rates are likely to fall as the Fed switches to buying long term Treasury securities (driving prices up and yields down) rather than focusing on only short term government securities. Declining aggregate demand and falling capacity utilization should continue to beat down inflation to the point that deflation becomes an issue in the short run. The U.S. is not alone in this debacle, as the global recession becomes more entrenched. Leading economic indicators for the OECD global country groupings are all falling in unison.

The Great Social and Economic Experiments - Attacking the Downturn on two Fronts

The great debate between Monetary and Fiscal Policy theorists lives on. Monetarists, led by the late Milton Freidman, argue that the Great Depression occurred due to a contraction of the money supply. Once in process, monetarists argue that massive infusion of liquidity into the economy with a corresponding expansion of the money supply would have pulled the economy out of the depression. The current Fed Chair, Ben Bernanke, a long time student of the depression quickly moved to expand liquidity and subsequently the money supply grew rapidly in the latter part of 2008. Even though banks may be reluctant to lend out money at first, monetarists believe an aggressive expansion would eventually offer banks enough reserves to put them on track to expand lending, allowing short term economic activity to rebound. As private sector spending rises and capacity utilization increases, Fed policy must lower the growth of the money supply to ward off inflation. Timing of the growth rate of the money supply requires diligent monitoring and mistakes can build in an inflation bias in the longer run.

Fiscal policy theory, attributed to John Maynard Keynes, emphasizes government spending and tax relief as the cure to a slumping economy. The argument against relying on monetary expansion in a severe downturn is often called the “liquidity trap” where banks do not make loans with expanded reserves provided by the Fed. This trap may be due to bank reluctance to take risks or borrower reluctance to take on debt, even at low interest rates. The Fed’s typical approach to expanding the economy may continue to have a short circuit. While monetary policy may work well in cooling off an economy, attempts to stimulate the economy by putting more reserves in to the banking system is like “pushing on a string”

In our current downturn, both Monetarist and Keynesian theories are being implemented. Monetary policy has an advantage in that it can be initiated quickly and has shorter lags. So far, Bernanke’s Fed policy has been to push liquidity into financial markets and growth in the money supply has been dramatic. But, we have not seen the economic stimulation from increased spending. The demand for money, driven by private sector needs to borrow, has fallen to offset the increased money supply. High levels of outstanding debt, weak income growth, lost wealth in asset values, and declining sentiment have all reined in spending even in the face of the expanded money supply. Early tests of the effectiveness of monetary policy have not produced good results, suggesting that the liquidity trap has some validity.

Fiscal policy seeks a stimulation of aggregate demand by encouraging private spending with tax cuts and transfer payments. In addition, the government spends directly in ways to make up for the loss of private sector spending until the economy recovers. To cover government spending, fiscal deficits are financed by government borrowing conducted by the Treasury. Treasury securities are sold in the open market, often to foreign investors. When the economy recovers, government spending subsides in lieu of private spending. Tax revenues rise as the economy grows, allowing retirement of the accumulated government debt. We are now seeing the fiscal policy stimulation plan designed for the current downturn and will see the spending begin later this year. It will take a long time to see the consequences of fiscal policy. Even so, critics point to the lower productivity of government spending relative to private spending, arbitrary and inefficient spending targets and the one-time impact of government spending that would need to be repeated if the private sector does not improve. In the long run, there is concern that government entrenchment will prevent cuts in government spending that should be forthcoming when the private sector improves.

In the best case scenario, we may begin to see some improvement in the economy due to monetary policy if consumers and businesses begin to take advantage of low interest rates and ample credit. This will take time for the private sector to pay down debt and restore savings before spending picks up. Most likely, fiscal spending will not have a positive influence on the economy until midway in 2010. If fiscal policies do not create new jobs, transfer payments will have only a temporary impact and the recovery will not gain momentum until 2011. In any event, the recovery will take time given the current imbalances. A relatively quick rebound, typical of business cycle recessions, is not in the cards this time.

Summary of Recent Economic Data

GDP (Fourth Quarter 2008 Advance Estimate)……The downturn continues into 2009

- According to advance estimates from the Bureau of Economic Analysis, real GDP fell at an annualized rate of 3.8% in the fourth quarter of 2008, following a decline of .5% in the third quarter (see Figure 1 in the Attachment). The fourth quarter of 2008 was the biggest contraction in the economy since the first quarter of 1982. Consumer spending, business investment, and investment in housing all declined in the fourth quarter.

- On a year-ago basis, real GDP fell 0.2% in the fourth quarter; which is well below the 0.7% year-ago growth in the third quarter and far below the economy's potential growth rate of around 2.5%. For all of 2008 compared with 2007, real GDP increased 1.3%. Growth in 2007 was 2%.

- Real final sales of domestic product, measured as real GDP minus the change in inventories, fell 5.1% in the fourth quarter following a decline of 1.3% in the third quarter. The fourth quarter decline in sales of domestic product is the largest since the second quarter of 1980.

- Most major components of GDP declined from the third to the fourth quarter. Personal consumption expenditures fell 3.5% at an annualized rate, slightly better than the 3.8% drop in the third quarter. Consumer spending reduced growth by 2.5 percentage points in the fourth quarter. Over the past year, real consumer spending fell 1.3%, the largest drop since 1974.

- Real spending on durable goods fell at a 22% annualized rate in the fourth quarter following a 15% drop in the third quarter. This was the largest decline in durable goods spending since 1987. Over the past year, spending on durable goods fell 11%; the largest year-ago decline since 1980.

- Real spending on nondurable goods fell 7% at an annualized rate for both the third and fourth quarters of 2008. Real spending on services increased 2% in the fourth quarter, after a small decline in the third quarter.

- Fixed investment fell 20% at an annualized rate, subtracting 3.1 percentage points from growth. This was the sixth straight decline, and it is now down 10% from its peak. Investment in equipment and software fell 28%, and investment in nonresidential structures fell 2%. Housing investment continues to plunge, falling 24%, the 11th straight double-digit decline. Investment in residential structures is now down 45% from its peak.

- Inventory investment added 1.3 percentage points to growth in the fourth quarter, after adding 0.8 of a point in the third.

- Trade had a small positive for growth in the fourth quarter. Net exports added 0.1 of a percentage point to growth following a 1.1 percentage points in the third quarter. The 16% annualized decline of imports added to growth while exports fell 20%, subtracting from growth.

- Real government spending increased 2% annualized in the fourth quarter, adding 0.4 of a percentage point to growth. Federal government added to growth, while state and local governments were a small drag.

Durable Goods – hardest hit of all consumption goods

- Durable goods orders fell 2.6% in December and 3.7% in November. New orders have fallen for five consecutive months. Shipments of durable goods fell 0.7% in December, following a 4.2% decline in November (see Figure 2 in the Attachment). Unfilled orders were down 1.3% over the month, and inventories grew 0.4%. Orders of core capital goods were down 2.8% over the month, reflecting ongoing weak business investment conditions.

- Shipments of durable goods were down 2.7% on the year, the first decline since 2002 and the largest decline since 2001. Shipments also fell in the last five months of the year, though December's decline was smaller than in October or November.

- New orders excluding transportation were down 3.6% as a large increase in defense aircraft orders boosted the top-line number. Shipments excluding defense fell 0.6%.

- New orders for core capital goods fell 2.8% following a 1.7% increase in November. Capital goods orders finished the year up by 0.09% from 2007. Core goods shipments were also up over the year by 1.29% and rose by 0.9% over the month.

Production – low capacity utilization may lead to even softer prices

- Industrial production fell 2% in December, with output falling in all three major categories—utilities, mining and manufacturing—for the first time since October. For the fourth quarter as a whole, industrial production fell 11.5% at an annual rate, more than twice as fast as at any time during the 2001 recession.

- Capacity utilization continues to edge lower. For manufacturing capacity utilization fell from 71.8% in November to 70.1% in December, the lowest since 1983. Declining levels of resource utilization raise the risk that the economy may be headed toward deflation.

Productivity – productivity gains due to fewer hours worked in least productive activities

- Nonfarm business productivity grew 3.2% in the fourth quarter on a seasonally annual adjusted rate (SAAR), based on advanced data from the Bureau of Labor Statistics. This compares with a 1.5% increase in the third quarter, revised up slightly from a 1.3% increase. A sharp decline in hours worked more than offset the reduction in output during the quarter, supporting the gain in productivity. For all of 2008, nonfarm business productivity grew 2.8% following the 1.4% growth in 2007.

- Manufacturing productivity fell 3% (SAAR) in the fourth quarter as output plunged. Durable manufacturing productivity fell 13.4% in the fourth quarter, while nondurable productivity rose 7.6%.

- Nonfarm business unit labor costs rose 1.8% in the fourth quarter (SAAR). Unit labor costs were up just 0.5% for all of 2008, compared with a 2.7% increase in 2007.

Factory Orders – declining orders likely to continue as sales fall faster than inventories

- Factory orders fell 3.9% in December. The December drop comes on the back of a 6.5% decline in November (see Figure 3 in the Attachment). Factory orders have declined for five consecutive months now, which is the longest streak since the series began in 1992. Durable goods orders fell 3%, revised lower from the 2.6% decline first published. Nondurable goods orders were down 4.8% following an 8.7% drop in November, which was the largest on record.

- Nondurables shipments were weighed down by an 18.2% decline in petroleum products shipments. Shipments of food, textiles, apparel, paper, chemicals and plastics were also down over the month.

- The inventory-to-shipments ratio rose to 1.44 months from 1.42 months in December. This ratio has surged since July and now sits at its highest level since 1996.

- The ISM nonmanufacturing composite index rose to 42.9 from 40.1. With January's rise, the index has reversed about one-third, or 4.5 points of the cumulative 12.6-point drop in October and November. New orders rose from 38.9 to 44.2, a positive signal for next month's survey. The business activity component of the index improved, but it is still at the fourth lowest level in the survey's 11-year history.

- The ISM nonmanufacturing survey followed its manufacturing counterpart higher in January, offering some hope that the economy has reached a turning point. Specifically, the bottoming out in the business surveys indicates that the economy is at its maximum point of contraction in GDP.

Construction Spending – will public construction from a stimulus package do the job?

- Construction spending in December fell by 1.4% below the revised November total. Construction spending of all types was down by 3.6% from December 2007. Private residential construction spending came in 3.2% below November spending, while private nonresidential construction fell by 0.4% from November. Public construction spending fell by 0.8% from November estimates. Construction spending continues to be led by residential construction, which still shows no sign of recovery.

Income and Spending – lost income and wealth may have a lasting effect on consumer spending

- Personal income fell 0.2% in December after falling 0.4% in November (see Figure 4 in the Attachment). Wage income fell for the third time in the last four months, driven by large job losses. Spending fell 1% after falling 0.8% the prior month, similar to expectations. Real spending fell 0.5%, led by declines in nondurable goods spending of 1.8% and durable goods spending of 0.8%. Real service spending grew a slight 0.1%.

- Real disposable income rose 0.3%. The saving rate rose to 3.6% from 2.8% in November.

Inflation- Deflation?

- The seasonally adjusted top-line CPI continued to retreat during December, falling 0.7% for the month and finishing 2008 down 0.1% from a year earlier (see Figure 5 in the Attachment). Non-seasonally adjusted CPI increased slightly by 0.1% for the year. The price decreases were led again by energy and transportation, while food prices remained level. The core CPI remained level during December, and finished the year 1.8% higher. Although overall consumer prices continue to flirt with deflation, spending has not yet fallen enough for most non-energy consumer items to show price declines.

- The overall GDP price index fell 0.1% annualized in the fourth quarter, down sharply from a 3.9% increase in the third quarter. The price index for gross domestic purchases, a measure of prices paid by U.S. businesses and consumers, fell 4.6% annualized in the fourth quarter, down from a 4.5% increase in the third quarter. Falling energy prices are behind the drop in overall prices.

- Consumer prices, as measured by the consumer spending deflator, fell in 0.5% in December. Core prices were unchanged again. The market-based deflator, which is based on observable prices and excludes most implicit prices and expenses of nonprofit institutions, posted similar readings of -0.6% and unchanged, respectively.

- The Federal Reserve's preferred inflation measure, the core PCE deflator, which excludes food and energy prices, was up 0.6% in the fourth quarter, a substantial slowing from 2.4% inflation in the third quarter. This is the slowest quarterly core inflation since the early 1960s.

- Producer prices for finished goods gave up ground for the fifth month in a row in December, falling by 1.9% in response to weakening demand. The decline in top-line producer prices continues to be largely driven by falling prices for energy products, which dropped by 9.3% on the month. When food and energy prices are excluded, core inflation remained positive at 0.2%. Core prices among intermediate and crude products both fell sharply for the third month in a row.

Fed Policy

- In its most recent meeting, The Federal Open Market Committee (FOMC) announced that the fed funds target rate will remain in the range from 0% to 0.25% "for some time." The FOMC expects economic growth to resume later in 2009, "but the downside risks to that outlook are significant." The statement expressed concern about possible deflation.

- The statement said that "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time."

Housing

- Sales of new homes fell by 14% on a month over month basis in December to 331,000 annualized units. This decline is far worse than expected. Census also revised downward November sales by 4.6%. The December pace of sales is the worst in about 45 years of recorded data, just beating out the 338,000 units sold in September 1981 during the depths of the 1980s housing correction. In December, sales were down by 45% year over year. For the fourth quarter, new-home sales declined by 57%. For all of 2008, sales declined by 38% (Figure 6 in the Attachment).

- The inventory of new homes available for sale continues to decline, a positive trend that is occurring because homebuilders have been curtailing new construction sharply. The level of inventories has been descending nonstop for more than one year, for a 28% year over year decline. Nevertheless, the sharp drop in sales has caused the months of available inventory to soar to a new high of 12.9. The rise in pending home sales in December ended three months of decreases that followed the financial panic in the fall.

- Housing prices continue to erode. The median new-house price is down by 9% y/y as homebuilders are forced to discount to compete with foreclosures. The descent of house prices slowed somewhat during the three months ending in November. Although house prices declined at the greatest year-ago rate on record in November, the rate of decline did not increase significantly from that recorded during October.

- The S&P/Case-Shiller housing price indices show broad-based declines with most of the metro areas tracked by the index reporting price decreases in excess of 10%. The 10-city index declined 19.1% from a year ago, unchanged from the decline recorded in October. The 20-city index decreased by 18.2% from November 2007.

- Foreclosure sales threaten to drive up the inventory of existing homes for sale while depressing home values further. According to the National Association of Realtors, about 45% of existing-home sales in December were distress sales. Existing-house prices are expected to decline until at least the second half of 2009.

Sentiment and Confidence

- The Conference Board's index of leading indicators rose 0.3% in December, following a 0.4% decrease in November (see Figure 7 in the Attachment). This was the first increase in the index since last April and the largest monthly gain since July 2007. However, much of the improvement occurred due to the dramatic increase in the money supply due to Fed policy. For all of 2008, the index fell 2.5%, the steepest annual decline since 1980, when the index fell 5.6%. From its January 2006 high, the index is down 5%, surpassing the 3.6% peak-to-trough decline recorded for the 2001 recession and down almost as much as in the 1990-1991 recession, when the index fell 5.9% from top to bottom.

- The Conference Board’s coincident index fell 0.5% in November, verifying the damage being done to the economy. The coincident index peaked in October of last year.

- The Conference Board index of consumer confidence retreated slightly to another record low in January. The index fell to 37.7 from December's 38.6 (upwardly revised from 38). The expectations component was responsible for the bulk of the decline, falling to 43 from 44.2 (previously 43.8). The present situation fell to 29.9 from 30.2 (previously 29.4). Assessments of current labor market conditions remained very poor but improved slightly from December.

- The University of Michigan Consumer Sentiment Index fell more than expected in February. The index fell 5 points to 56.2 in early February, marking two consecutive periods of declining confidence. The index is at its lowest level since November. Inflation expectations were mixed, falling in the short term but inching up for the longer run. The expected inflation rate one year ahead dropped to 1.6% from 2.2% last month and readings above 5% in May through July. Five-year expectations rose to 3% from 2.9%. The University of Michigan index is now close to its lowest level since 1980. The index was also at about this level last June.

University of Michigan Consumer Confidence (Index, 1966Q1=100, SA)

	Feb 09	Jan 09	Dec 08	Nov 08	Oct 08	Sep 08	Aug 08	Jul 08
Overall	56.2	61.2	60.1	55.3	57.6	70.3	63.0	61.2
Expectations	49.1	57.8	54.0	53.9	57.0	67.2	57.9	53.5

Source: University of Michigan

Inventories

- Total business inventories fell 1.3% in December (see Figure 8 in the Attachment). Retail inventories were the only new data in this report, falling 1%. Manufacturing inventories declined 1.4%, while wholesale inventories decreased 1.4%. Despite the large decline in inventories, the sales decline was even greater, which sent the inventory-to-sales ratio to 1.44, a multiyear high. Total business sales were down 3.2%, spread across all three segments. For December, retail sales were down 3.3%, while manufacturer and wholesaler sales fell 2.9% and 3.6%, respectively.

Sales

- Retail sales posted a surprising gain in January, the first gain since June and the largest since November 2007. It is important not to read too much into this one data point. January is a particularly unimportant month for retailers and he level of sales is very low.

- With revisions to prior months, January sales remain nearly 10% below their year-ago level for all segments except for those selling food and healthcare goods.

- Consumers continued to cut spending in January but at a slower pace than in recent months. Chain store sales fell 1.6% for the month, according to the ICSC, compared with December's 2% decline. Excluding Wal-Mart, sales tumbled 4.8%, slightly more than December's 4.6% drop but still less than November's sharp decline. Gasoline prices again were a significant drag on sales for the month, undermining sales at warehouse clubs. The few bright spots were discounters selling food and drug stores.

- Sales growth remained concentrated in necessities. Growth was led by nonfuel sales at wholesale clubs, discount stores and drug stores. Sales continued to plunge at apparel and department stores, especially luxury department stores. Gasoline prices that are 40% below their year-ago level remain a major drag on sales at retailers that sell gasoline.

- Wal-Mart, with its focus on necessities and low prices, continues to outperform. Excluding Wal-Mart, sales fell 4.8%, the fourth consecutive month with a 4% or greater decline in sales excluding the discount giant.

Vehicle Sales

- Vehicle sales fell below 10 million annual sales in January. Much of the decline was due to a sharp decline in sales to fleets. GM and Chrysler sold 80% fewer vehicles to fleets than a year ago and Ford sold 65% fewer. Fleet sales declined both due to weaker demand on the part of businesses and because orders could not be filled due to the sharp cuts in auto production.

- The largest declines on a year-ago basis were suffered by domestic manufacturers. GM sales were off 49%, Ford sales declined by 42%, and Chrysler sales fell by 55%. However, sales of the major Japanese manufacturers also fell off sharply: Toyota by 32%, Honda by 28%, and Nissan by 30%. The only manufacturers that saw increased sales on a year-ago basis were Hyundai and Subaru.

- The proportionally larger decline in Detroit Three sales led to a new record low for the Detroit Three share of total vehicle sales, only 43.7%, down from 49.4% in December and 52.2% a year ago.

Labor and Unemployment

- The unemployment rate increased to 7.6% from 7.2% in December. This was the highest rate since 1992. A more comprehensive measure, which includes those working part-time because full-time work is unavailable and those out of the labor force but who would like work, has increased to 13.9%. The average workweek was unchanged at 33.3 hours, which is still a record low. The index of weekly hours declined by 0.7%, following declines of 0.8% and 0.9% during the prior two months.

- Initial claims for jobless benefits dropped back 8,000 to 623,000 for the week ending February 7, in line with expectations for a small decline (see Figure 9 in the Attachment). Continuing claims rose by 11,000 to 4.81 million for the week ending January 31 and are at previously unseen highs. Both continue to point to a rapidly weakening labor market.

- The insured unemployment rate remained at 3.6% for the week ending January 31. No sign of relief for the labor market. Continuing claims have now risen in each of the last four weeks. At 4.8 million, there has been a considerable climb in the number of laid-off workers claiming unemployment insurance benefits over the last several months.

- The December Job Openings and Labor Turnover Survey revealed a sudden shift as separations soared, although the number of hires improved slightly. The number of workers who left their jobs increased to 5 million, while the number of people hired increased to 3.9 million. As a result, the gulf between hires and separations widened. The number of separations far exceeded the numbers during the recession at the beginning of the decade.

- The separation rate increased to 3.7% from 3.3% for all parts of the economy and from 3.7% to 4.2% in all industries. The largest increases were in construction (7.5%), manufacturing (4%), and professional/business services (5.6%).

- Job availability dropped throughout 2008 (see Figure 10 in the Attachment. Job availability is highest in professional/business and education/healthcare and is by far the lowest in construction and manufacturing. This suggests that these two industries, which have suffered the largest job losses, will not turn around soon.

- While there were expectations for a disastrous January for the labor market, the preliminary numbers exceeded these expectations. The labor market shed 598,000 jobs on net. Further, revisions increased the losses for November and December to 577,000 and 597,000, respectively. January's loss was the largest since 1974. Meanwhile, the unemployment rate increased by 0.4 of a percentage point to 7.6%.

- Since the labor market began to shed jobs a year ago, 3.6 million payroll jobs have been lost.

- Growth in wages and salaries slowed from the prior two quarters of 2008 due to the weakening economy. Wages and salaries costs rose 1.8% at an annual rate in the fourth quarter, down from a 3% gain in each of the second and third quarters.

- Benefits advanced 0.4%, a slowdown from the first three quarters of the year. Compared with one year ago, benefits were up 2.2%, versus 2.6% the previous quarter.

Consumer Credit

- Consumer credit balances fell in December for the fourth month in a row. Total credit fell by $6.6 billion, which translates to a 3.0% decline on an annualized basis. Declining credit balances illustrate the effects of both tight lending standards and falling consumer spending.

- The majority of December's decline came from revolving credit balances, which fell by $6.3 billion or 7.5% annualized. Demand for revolving credit has contracted sharply over the past two months, as cash-strapped consumers are spending less rather than relying more on credit cards.

- Nonrevolving credit balances were virtually unchanged in December from the previous month, slipping by just $0.3 billion, or 0.2% annualized.

- Both revolving and nonrevolving credit balances are expected to continue declining significantly over the months ahead. The pullback in consumer spending is already a major drag on the economy, subtracting 2.5 percentage points from fourth quarter GDP growth. The decline in credit balances reinforces the outlook that consumers will continue to cut back until the labor market improves and they regain confidence.

International Trade

- The U.S. trade deficit narrowed to $39.9 billion in December, marking the fifth straight month of a narrowing trade deficit (see Figure 11 in the Attachment).

- Net imports of petroleum in December fell by 4.3% to $18.8 billion. Crude oil sold for an average of $41.02 per barrel in November, down 28.6% from November's average of $57.44 per barrel.

- The trade deficit with Canada, the U.S.'s largest trading partner, narrowed by 17.6% to $2.8 billion in December. The trade deficit with Mexico, the U.S.'s second-largest trading partner, widened by 16% to $4.1 billion.

- The trade deficit with China narrowed by 13.8% to $19.9 billion, and the trade deficit with Japan widened by 6% to $5.3 billion. The narrowing of the trade deficit with China is almost entirely due to reduced imports from that country, reflecting the growing global recession.

- The slowdown in the narrowing of the overall trade deficit speaks to the dramatic depreciation of the dollar in December, particularly the 10% depreciation against the euro and the 3% depreciation against the yen..

Global Economy – A global downturn

- The country leading indicators (CLI) of the OECD are meant to predict developments in the global economy's growth cycle. A CLI has a long-term average of 100. A reading that is above 100 and is rising predicts expansion. A CLI that is above 100 but is falling predicts a downturn. A CLI below 100 that is falling signals a slowdown and a CLI below 100 that I increasing signals recovery.

- The outlook for the global economy based on the OECD CLI is deteriorating (see Figure 12 in the Attachment). The composite leading indicator (CLI) plummeted to 92.9 in December from 94 the prior month, dragged down by a strong slowdown in the euro zone and the G7 economies, and major Asian economies. Non-OECD members except for Brazil are now also showing strong slowdowns.

- The CLI for the U.S. dipped to 91.3 in December from 92.7 in the prior month. The OECD expects a strong slowdown in the U.S. economy.

- The CLI for the euro zone slipped to 93.8 in December from 94.7 the prior month. The German CLI fell to 90.9 from 91.6 in November. The U.K.'s CLI slipped to 95.6 from 96 in November, the 13th month of decline.

Attachment
Key Figures and Relationships through the Fourth Quarter of 2008

Figure 1. Real GDP fell 3.8% in the fourth quarter of 2008 following a decline of .5% in the third quarter.

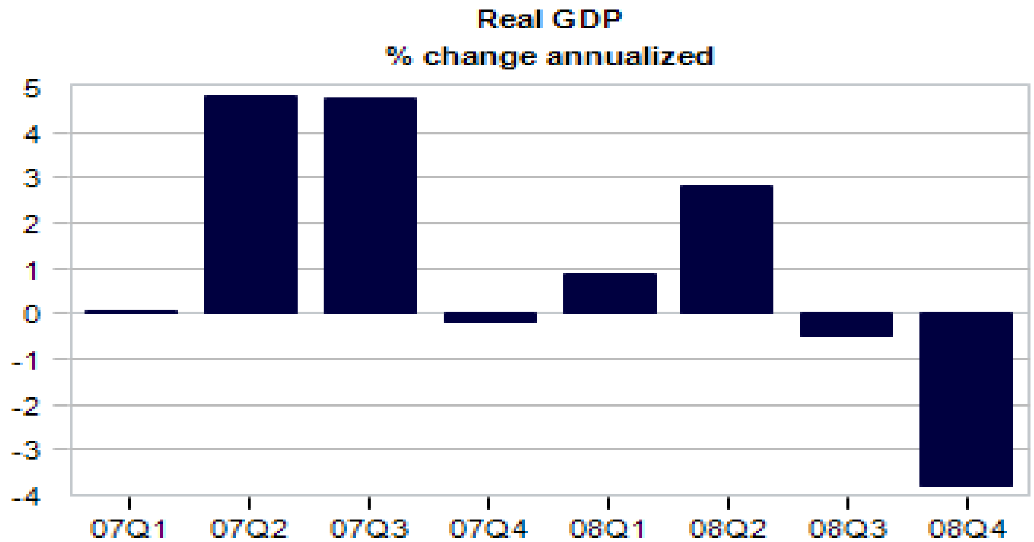

Figure 2. Durable Goods Orders for 2008 were dismal.

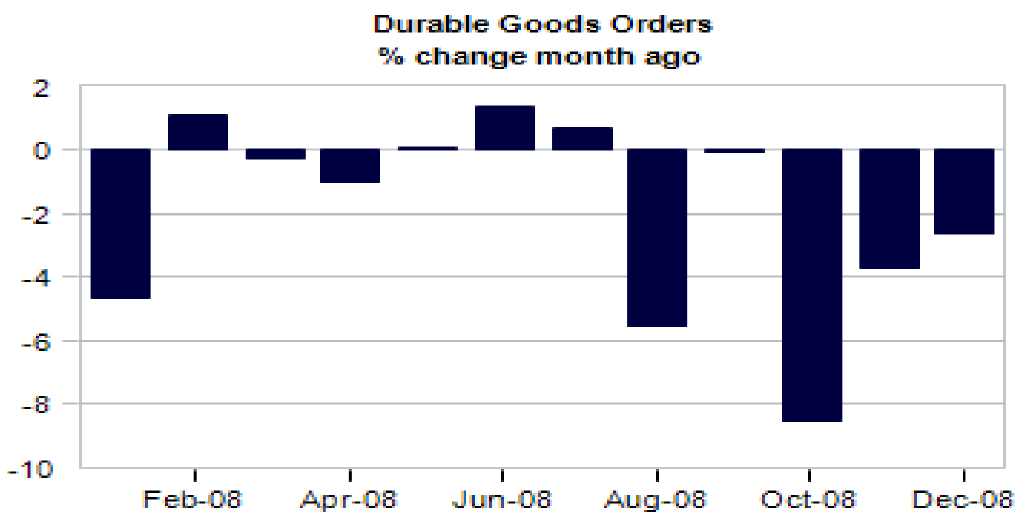

Figure 3. Factory Orders Collapsed in the Second Half of 2008.

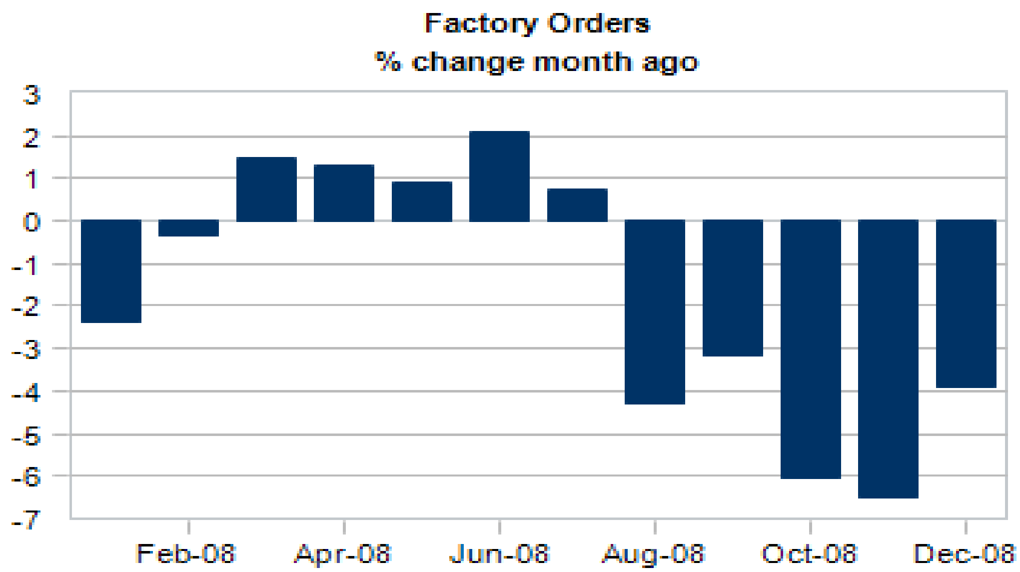

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Figure 4. Total Personal Income Tanked in the 2008.

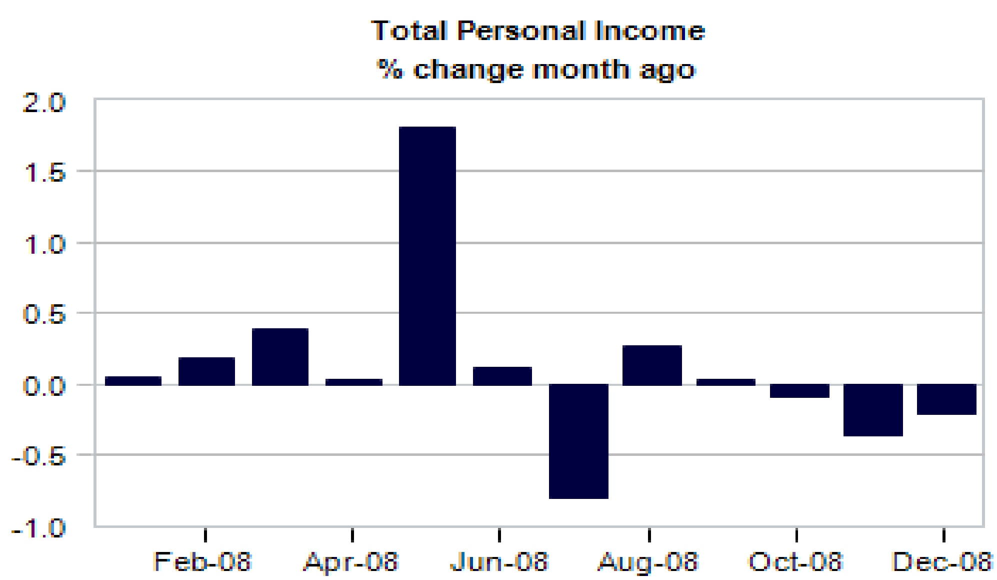

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Figure 5. Slumping Economic Activity takes out Inflation.

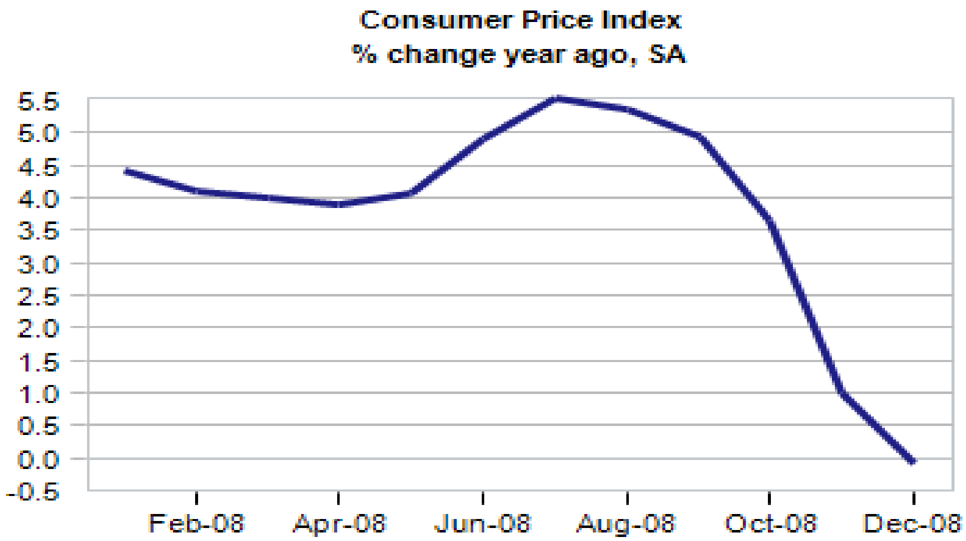

Figure 6. Sales of New Family Housing Continue to Slide.

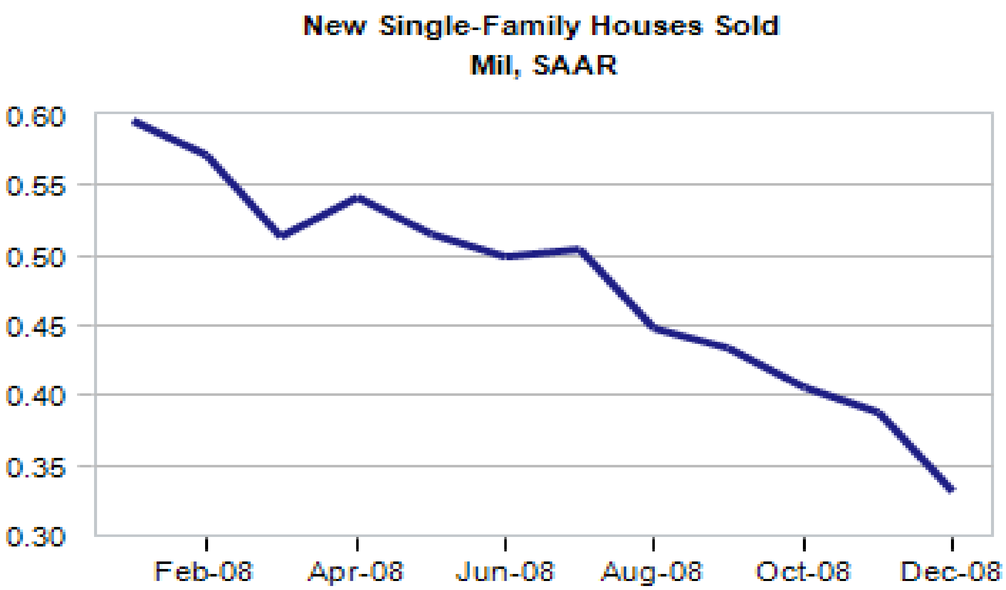

Figure 7. Conference Board's Consumer Confidence Index Seeks a Bottom.

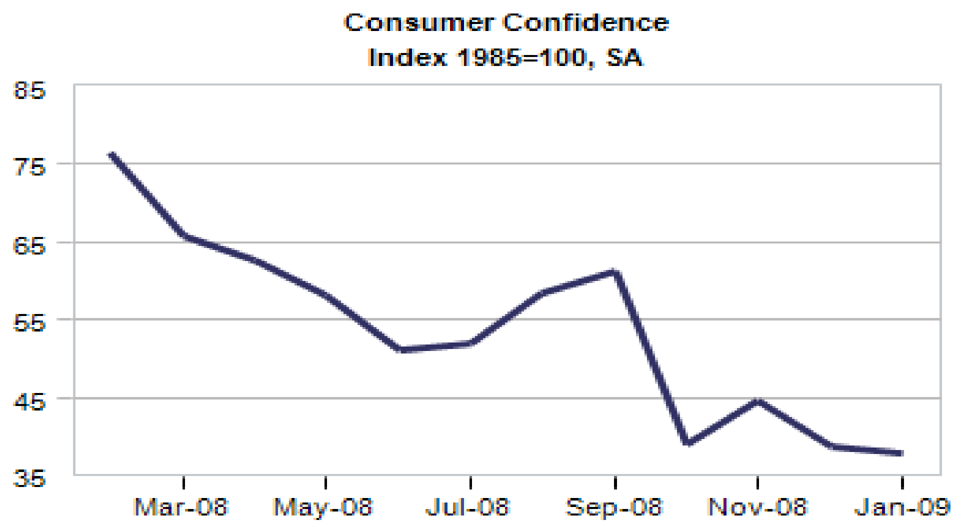

Figure 8. Business Inventories Adjust to Slumping Sales.

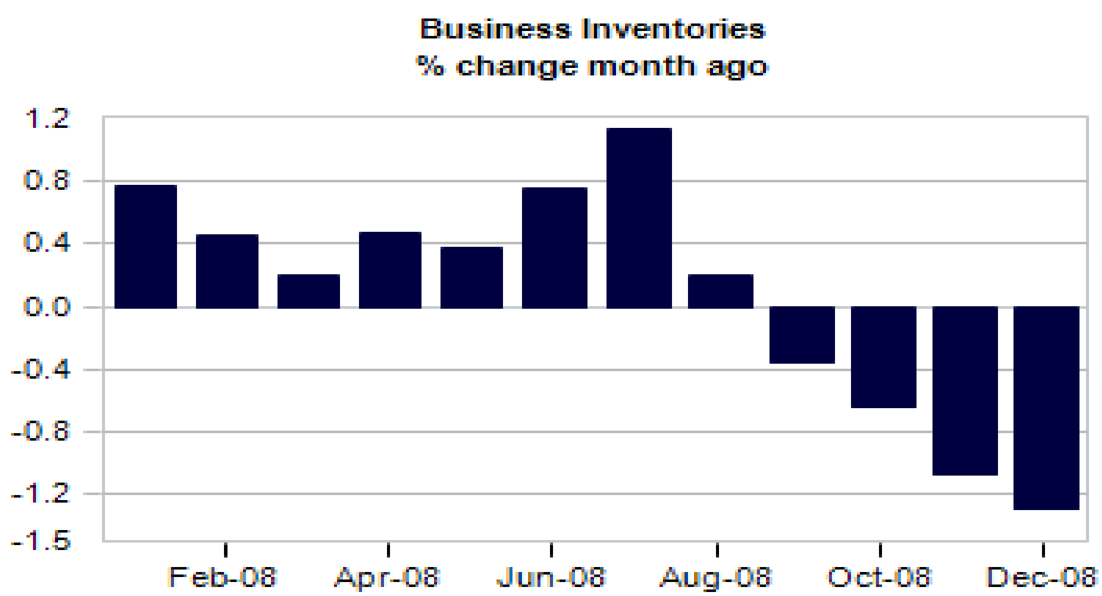

Figure 9. The Labor Feels the Pain of a Collapsing Economy.

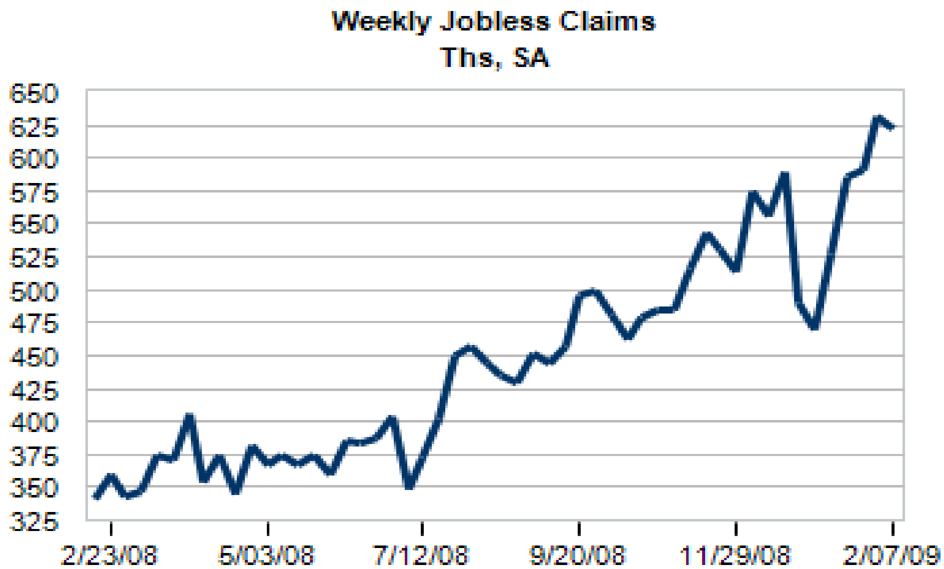

Figure 10. Jobs are Disappearing.

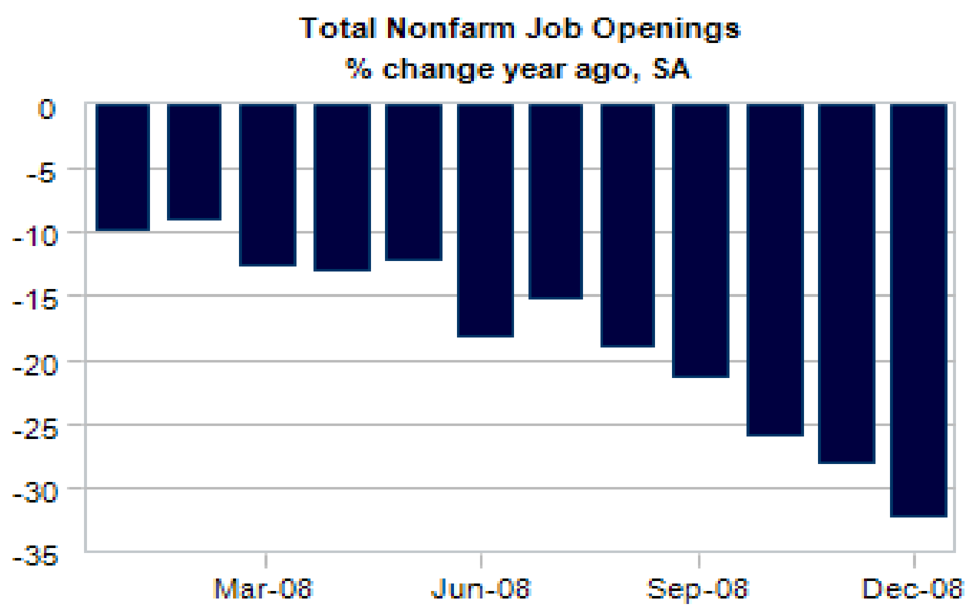

Figure 11. The Trade Account Improves.

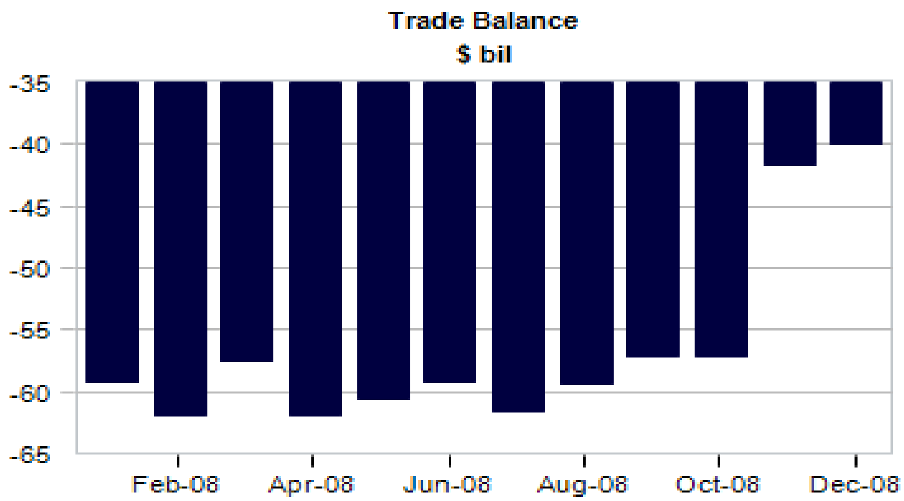

Figure 12. Global Leading Indicators Plummet as Economic Woes Expand.