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OECD Economic Outlook 85

Chapter 2

DEVELOPMENTS IN INDIVIDUAL OECD COUNTRIES

UNITED STATES

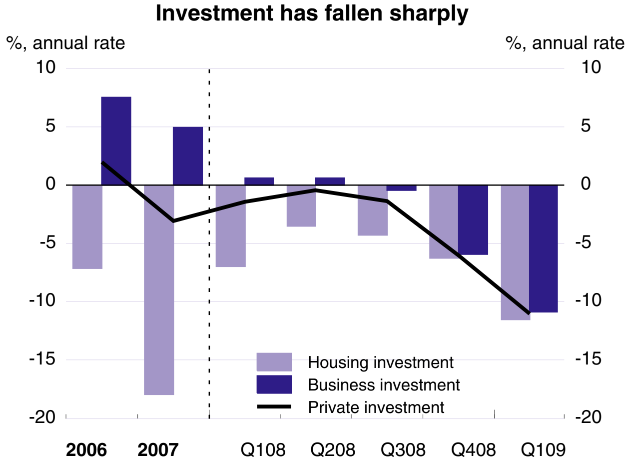
The US economy is going through a severe and protracted recession which is projected to bottom out later this year, as fiscal and monetary support takes hold and the housing cycle bottoms out. In 2010, even after a recovery gets under way, GDP growth is likely to remain weak because of the slowdown in capital accumulation, negative wealth effects and still adverse, albeit improving, financial conditions. In this environment, a considerable degree of economic slack, especially in the labour market, is likely to persist over the projection period, bringing inflation to very low rates.

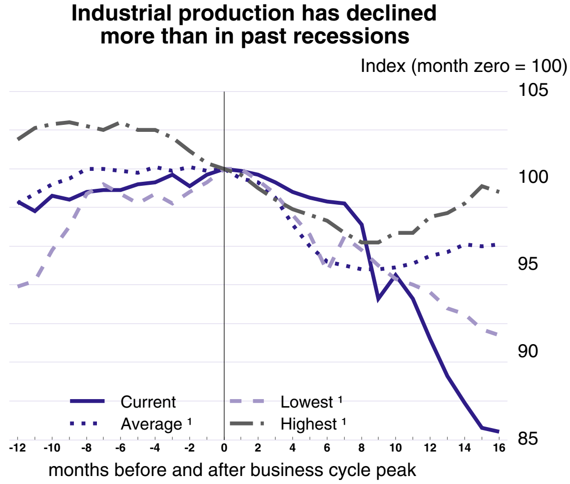
The Federal Reserve should continue to support activity by expanding the scale of its quantitative easing operations, if needed. The authorities should also go ahead with the planned measures to remove impaired securities from banks' balance sheets. While the large fiscal stimulus is needed to support domestic demand in the next several quarters, once the recovery is firmly in place fiscal sustainability should be restored by reducing the budget deficit and tackling the challenge of rising entitlement spending.

The recession has been deep and broad

The US economy has contracted sharply since the intensification of the financial crisis last September. Residential investment, in particular, has remained very weak, falling to its lowest share of GDP in more than 50 years. Manufacturing output has also fallen sharply as consumer spending, especially for durable goods, and global trade have slumped. The cumulative percentage decline in industrial production since December 2007 is significantly larger than in any other post-war recession. There have already been 6 million jobs lost, increasing the unemployment rate to a 26-year high. Incoming labour-market information suggests that employment is likely to decline further over the rest of 2009. In response to the opening of a substantial unemployment gap and a 25% drop in energy prices, the 12-month change in the consumer price index has become negative for the first time since 1955.

United States





1. Average, lowest and highest values of past six recessions.

Source: OECD Economic Outlook 85 database; Datastream; and OECD calculations.

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United States: **Employment, income and inflation**

Percentage changes

	2006	2007	2008	2009	2010
Employment[1]	1.8	0.9	-0.6	-3.4	0.0
Unemployment rate[2]	4.6	4.6	5.8	9.3	10.1
Employment cost index	2.9	3.1	2.8	1.5	0.8
Compensation per employee[3]	3.9	4.1	3.2	2.8	1.7
Labour productivity	1.0	1.1	1.7	0.6	0.9
Unit labour cost	2.9	3.1	1.9	2.7	1.3
GDP deflator	3.2	2.7	2.2	1.7	0.7
Consumer price index	3.2	2.9	3.8	-0.6	1.0
Core PCE deflator[4]	2.2	2.2	2.2	1.6	0.9
PCE deflator[5]	2.8	2.6	3.3	0.2	0.8
Real household disposable income	3.5	2.8	1.3	2.5	1.8

1. Nonfarm employment, based on the Bureau of Labor Statistics (BLS) Establishment Survey.
2. As a percentage of labour force, based on the BLS Household Survey.
3. In the private sector.
4. Deflator for private consumption excluding food and energy.
5. Private consumption deflator. PCE stands for personal consumption expenditures.

Source: OECD Economic Outlook 85 database.

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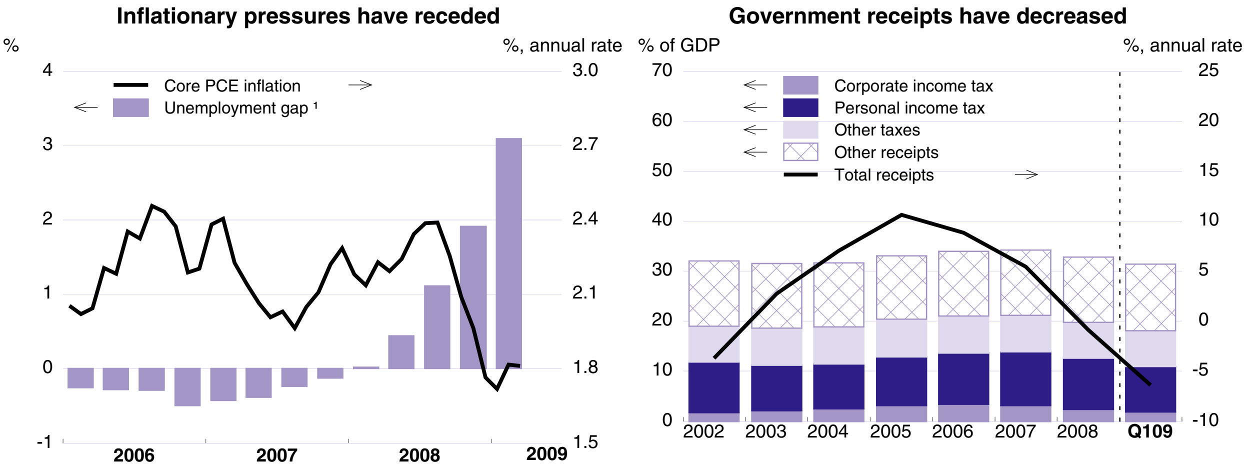
Core inflation has remained positive but is also falling – the recent blip being mostly accounted for by an increase in the excise tax on cigarettes. The current-account deficit had fallen to 3.7% of GDP by the end of 2008, and it is estimated to have fallen further thus far in 2009 as the trade balance has continued to improve.

Consumer spending and housing activity may be stabilising…

Consumer spending fell sharply in the second half of 2008, and then bounced back in the first quarter of 2009. In the second quarter, tax cuts boosted households' disposable income and consumer sentiment further improved. Nonetheless, a number of factors are likely to continue to

United States



1. Defined as the difference between actual unemployment rate and the OECD NAIRU estimate.

Source: OECD Economic Outlook 85 database.

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United States: **Financial indicators**

	2006	2007	2008	2009	2010
Household saving ratio[1]	0.7	0.6	1.8	5.4	6.5
General government financial balance[2]	-2.2	-2.9	-5.9	-10.2	-11.2
Current account balance[2]	-6.0	-5.3	-4.7	-2.3	-2.4
Short-term interest rate[3]	5.2	5.3	3.2	1.0	0.5
Long-term interest rate[4]	4.8	4.6	3.7	3.4	4.1

1. As a percentage of disposable income.
2. As a percentage of GDP.
3. 3-month euro-dollar.
4. 10-year government bonds.

Source: OECD Economic Outlook 85 database.

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weigh on consumer spending, among them the weak labour market, the declines in equity and housing wealth over the past two years, and continuing tight credit conditions. The ongoing deterioration in the housing market since 2006 may be approaching an end. Most importantly, as home sales have stabilised, the supply of unsold new homes has declined relative to demand – a precondition for any recovery in homebuilding. Prospects for a recovery in the commercial real estate sector are worse, with rising vacancy rates, falling prices and very tight financial conditions.

… but business investment is likely to drop further

Despite the sharp contraction over the past two quarters, equipment investment is likely to drop further in the near term, despite improved

United States: **Demand and output**

	2005	2006	2007	2008	2009	2010
	Current prices $ billion	Percentage changes, volume (2000 prices)				
Private consumption	8 694.1	3.0	2.8	0.2	-1.0	0.5
Government consumption	1 957.5	1.6	1.9	2.8	2.0	2.6
Gross fixed investment	2 440.6	2.0	-2.0	-3.5	-16.0	-0.6
Public	397.8	2.1	3.0	3.3	-1.7	2.6
Residential	769.7	-7.1	-17.9	-20.8	-20.7	0.4
Non-residential	1 273.1	7.5	4.9	1.6	-19.2	-2.1
Final domestic demand	13 092.2	2.6	1.8	0.0	-3.1	0.7
Stockbuilding[1]	43.3	0.0	-0.4	-0.3	-0.4	0.1
Total domestic demand	13 135.5	2.6	1.4	-0.3	-3.5	0.8
Exports of goods and services	1 311.5	9.1	8.4	6.2	-13.8	1.6
Imports of goods and services	2 025.1	6.0	2.2	-3.5	-15.7	1.2
Net exports[1]	- 713.6	0.0	0.6	1.3	1.0	0.0
GDP at market prices	12 421.9	2.8	2.0	1.1	-2.8	0.9

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods)*.

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

Source: OECD Economic Outlook 85 database.

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United States: **External indicators**

	2006	2007	2008	2009	2010
			$ billion		
Goods and services exports	1 480.8	1 662.4	1 859.4	1 508	1 543
Goods and services imports	2 238.1	2 370.2	2 528.6	1 852	1 894
Foreign balance	- 757.3	- 707.9	- 669.2	- 343	- 351
Invisibles, net	- 30.8	- 23.4	- 4.1	25	8
Current account balance	- 788.1	- 731.2	- 673.3	- 318	- 343
			Percentage changes		
Goods and services export volumes	9.1	8.4	6.2	- 13.8	1.6
Goods and services import volumes	6.0	2.2	- 3.5	- 15.7	1.2
Export performance[1]	- 0.1	1.0	2.6	3.1	- 0.9
Terms of trade	- 0.8	- 0.1	- 4.7	8.4	- 0.4

1. Ratio between export volume and export market of total goods and services.
Source: OECD Economic Outlook 85 database.

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business conditions; new orders for capital goods remain below the level of shipments and capital spending plans are restrained. The April survey of bank loan officers reported further weakening of demand for commercial and industrial loans. The same survey also indicated that the net fraction of banks that tightened their business lending policies remained high, although it has been declining. Firms have also reduced inventories, although inventory-sale ratios are still high.

Financial conditions remain fragile

Conditions in a number of financial markets, including the interbank markets and the commercial paper market, have recently improved. Furthermore, mortgage rates have fallen since late last year as the Federal Reserve purchased agency debt and agency mortgage-backed securities. However, the supply of mortgage credit is still relatively tight and mortgage activity remains heavily dependent on government support. More generally, financial markets and financial institutions remain under considerable stress, and cumulative declines in asset prices, tight credit conditions and high levels of risk aversion continue to weigh on the economy. Restoration of trust in financial intermediaries and markets is vital for a sustained and strong economic recovery to occur.

Fiscal policy will provide a considerable boost

The new Administration has quickly enacted a fiscal stimulus package, which is estimated to add more than 2% of GDP to the federal government deficit in each of 2009 and 2010 and should help to jumpstart the economy over the next few quarters. The boost from these measures will gradually wane over the course of 2010, and, beyond that, measures to restore fiscal sustainability need to be implemented when economic recovery is firmly in place.

Monetary policy is focused on avoiding deflation

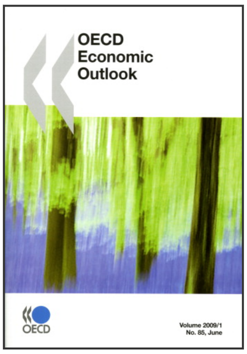
The monetary policy stance has quickly been loosened. The Federal Reserve reduced its policy rate to near zero late last year and implemented credit easing measures to support key credit markets, such as those for commercial paper and mortgages. These policies should remain in place until the recovery has firmed. Moreover, the scale of quantitative easing operations could be increased to further support growth. The announcement of an explicit inflation target would more firmly anchor inflation expectations.

The recession is projected to end later this year…

The US economy is projected to contract further in the second quarter and then to stabilise during the second half of the year, as the retrenchment of housing construction bottoms out and the decline in inventory investment slows. A gradual recovery should take hold in 2010, as consumer spending picks up with the job market stabilising. However, GDP growth is likely to remain moderate, as potential growth has been reduced by the slowdown in capital accumulation and households continue to increase their savings to rebuild wealth.

… if financial conditions do not relapse

Recovery will depend on financial conditions remaining stable for the remainder of 2009 and gradually improving thereafter, underlining the importance of the authorities' efforts to restore confidence in the financial system. Recent stress tests indicate that some major banks will need more capital, and it is assumed that they will be recapitalised, including by an injection of public funds if needed. Nevertheless banks' balance sheets remain encumbered with impaired assets. Overall, the fragility of the financial system still represents a downside risk to the outlook. On the other hand, the recovery could be faster than projected if the boost from the fiscal stimulus is larger than anticipated – according to OECD estimates, the US fiscal multipliers are about 0.6 in the current circumstances – or if firms turn out to be less reluctant to hire workers next year.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