



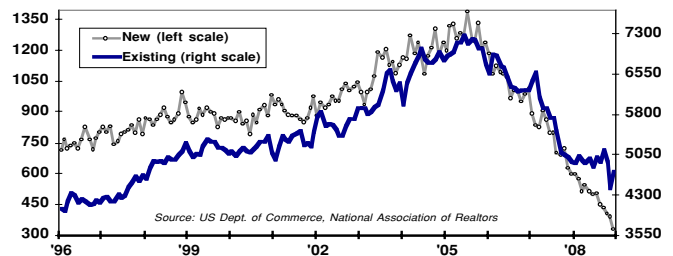
### ECONOMIC HIGHLIGHTS

February 23, 2009  
Vol. 76, No. 23

#### HOUSING RECESSION CONTINUES

The markets received a mixed message when the new and existing home sales reports were released. The promise of a potential bottom first appeared when the National Association of Realtors reported a 6.5% jump in the level of existing home sales in December, to 4.740 million units. Conversely, the level of new home sales plunged 15% to a seasonally adjusted annual rate of 331,000 units in December – the lowest level since records began in 1963.

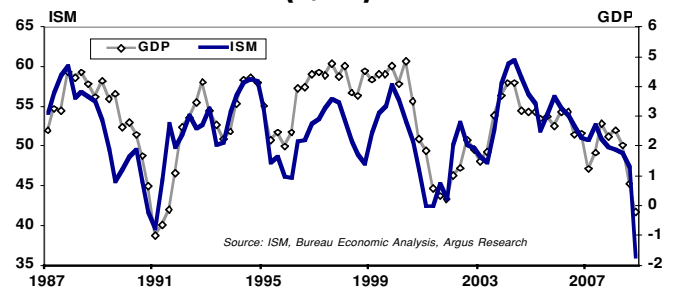
#### NEW & EXISTING HOME SALES



#### MANUFACTURING IN FREE-FALL

The Institute for Supply Management's (ISM) monthly Purchasing Managers Index (PMI) increased a bit more than two points to a reading of 35.6 in January. This was the first increase in the PMI since June, but still sends a signal that the manufacturing sector is mired in a very deep recession. The combination of a manufacturing free-fall, the housing market slump and the credit crisis are weighing heavily on the overall economy and has resulted in widespread joblessness.

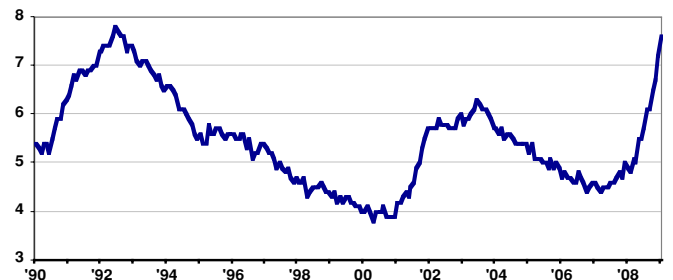
#### REAL GDP (Y/Y%) VS. ISM PMI



#### ECONOMY SHEDS 598,000 JOBS

The U.S. economy lost an astonishing 598,000 nonfarm payroll jobs during January – not too far from our expectation of 620,000. The manufacturing sector furloughed 207,000 workers, while business services eliminated 121,000 positions. The report was a bleak as any on the Street expected, and only one group (education and health) managed to register a gain in employment. Similarly disturbing, the unemployment rate surged to 7.6% in January from 7.2% in December – the highest level in 16 years.

#### UNEMPLOYMENT RATE (%)

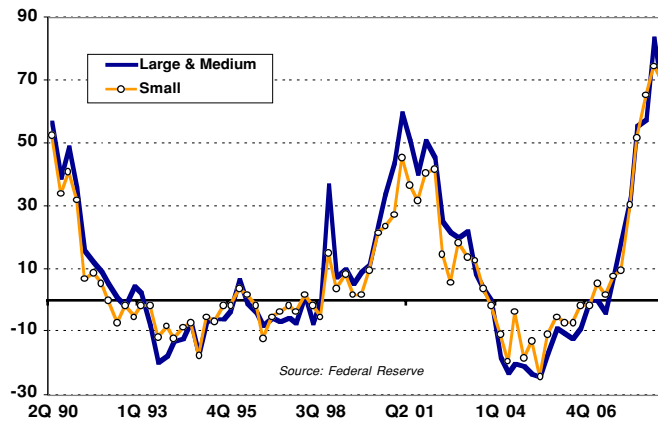


# MONETARY HIGHLIGHTS

## LENDING REMAINS TIGHT

According to the latest Federal Reserve Senior Loan Officer Survey on Bank Lending Practices report, the net fractions of respondents that reported tighter lending standards on all major loan categories was “very elevated” in 4Q08. Some 60% of those surveyed tightened standards on consumer loans while 40% claimed to have increased interest rates over their cost of funds for individual credit cards. Roughly 90% of banks boosted their spread on business loans over the cost of funds. The 76 banks polled (53 domestic, 23 U.S.-based foreign banks) received the survey on December 30, with responses due on January 13. The Fed said that 65% of U.S. banks tightened standards on commercial & industrial loans (C&I) to large and midsized firms, down from 84.0% in the previous three months.

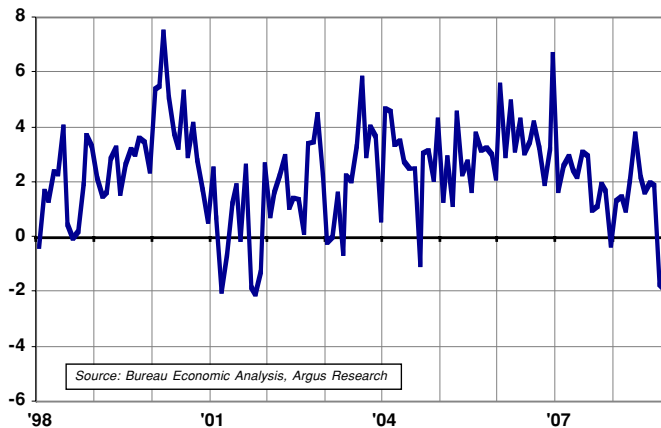
## NET % TIGHTENING STANDARDS FOR C&I LOANS



## FAB FIVE SINK AGAIN

The Bureau of Economic Analysis revised consumer spending data and wiped out the November gains in our ‘Fab Five’ indicators of discretionary spending. Further, during December, consumer spending fell 1.0%, while inflation-adjusted spending contracted by 0.5%. More importantly, real spending on cosmetics & perfumes fell 2.1% in December or 3.6% over the last year. Similarly, spending on jewelry & watches fell 2.77% — or 11.8% since December 2007. Spending on casino gambling slipped 2.4% in December, while expenditures on women’s & children’s apparel dipped 0.8%. Dining out, an excellent barometer of consumer spending, tumbled 26% in December and slumped 5.4% over the last 12 months. With the jobs market in a free-fall, we seriously doubt these indicators will reverse course any time soon.

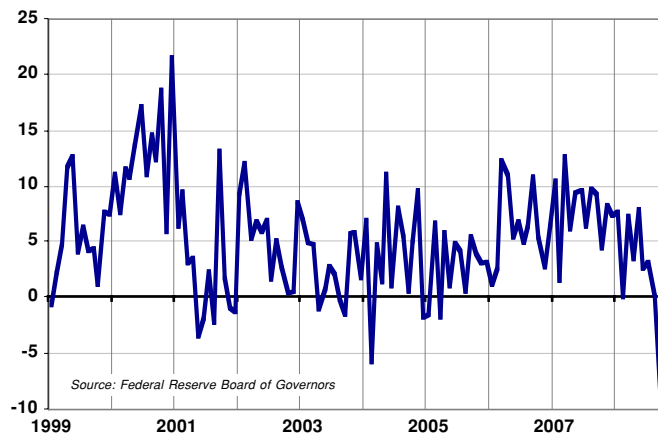
## SPENDING: MEALS AT OTHER EATING PLACES (Y.Y%)



## CONSUMER BORROWING PLUNGES

Total outstanding consumer credit fell for the fourth time in five months. During December, total credit fell by \$6.6 billion (an annualized 3.1% drop), which followed an \$11 billion decline in November (which was the largest monthly decline since record keeping began in 1943!). We believe the already ugly situation will only get uglier. The best way to turn off the consumer spending spigots is to slash jobs, and that’s exactly what is driving the economy down today. With rising unemployment, banks don’t want to lend to risky borrowers, and consumers don’t want to take on additional debt. The pace of credit card, or revolving, debt fell an annualized 7.8% in December after tumbling 8.5% in November. The U.S. economy has hit a wall, and consumers have reacted accordingly.

## CONSUMER REVOLVING CREDIT (%)

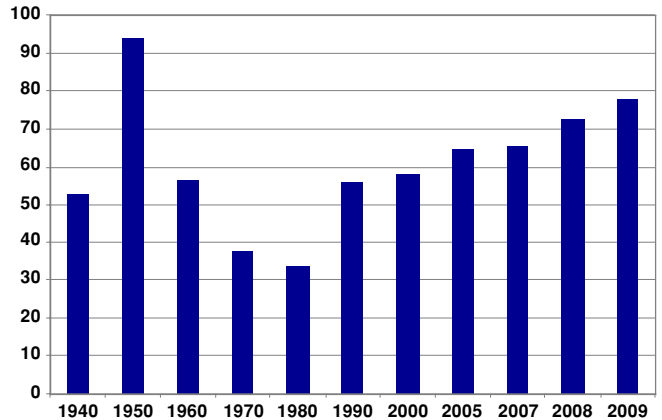


# FINANCIAL MARKET HIGHLIGHTS

## FINANCING THE BAILOUT

For 2009, the U.S. budget deficit is estimated to be more than \$1 trillion, and if we tack this on to the \$9 trillion already owed, and divide by the current GDP rate of \$14.3 trillion, we find that the debt is the highest percentage of GDP since the 1950s. In the near term, the U.S. could find itself with inflationary problems, as dollars are flooding the financial system. Moreover, the money the government spends to service the debt could crowd out other spending or lead to higher taxes. Over the long term, as foreign investors increasingly purchase U.S. government debt, the U.S. dollar could weaken and the nation's control over its destiny could slip. That said, the experience of the 1960s-1980s indicates that the current trend of rising debt as a percent of GDP can be reversed.

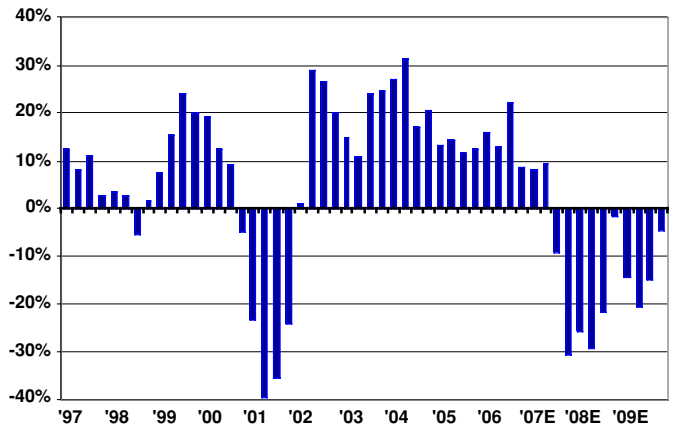
**US DEBT AS % OF GDP**



## EARNINGS STILL A CHALLENGE FOR STOCKS

We now expect S&P 500 earnings of \$50 per share in 2009, down from our previous forecast of \$56. Our \$50 forecast is just a bit greater than the fourth-quarter's annualized run rate of \$48. However, we believe earnings risks remain weighted to the downside. Earnings are on track for about \$62 per share for 2008, down 25% from 2007. Earnings in 2007 were down 6% from 2006. So, we expect a third consecutive year of earnings decline in 2009. For 2010, our preliminary EPS estimate is \$55, up 10% from 2009. The stock market is a leading indicator, and equity price trends should anticipate a rebound in earnings. Though we have reduced our 12-month target price for the S&P to 1100 from 1250, our target still implies a substantial rally in stocks over the next year.

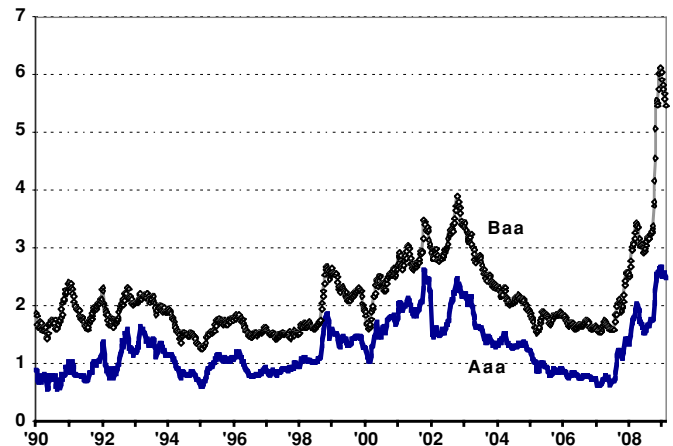
**S&P 500 QUARTERLY EARNINGS GROWTH**



## THE FEAR REMAINS

While investors – including the Fed – snap up Treasury bills and bonds, driving yields low, the spreads between corporate and government bonds remain extraordinarily high and are showing few signs of narrowing. Since 1990, the average spread between an AAA-rated bond and a government bond has been 126 basis points; the current gap is 248 basis points. For Baa bonds (one step above junk) the normal spread has been 216 basis points and the current spread is 547 bps. Investors are clearly anticipating numerous defaults in coming months. Industries that we think are particularly at risk include retailers, newspapers/media, restaurants and autos. Abnormally high-yielding corporate bonds in industries such as pharmaceuticals, medical devices or utilities could represent investment bargains.

**CORPORATE BOND SPREADS (%)**



# THE ARGUS ECONOMIC OUTLOOK

	February 18, 2009															
	2007 A				2008 A				2009 E				2010 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	0.0	4.8	4.8	-0.2	0.9	2.8	-0.5	-3.8	-4.7	-1.3	0.0	1.6	2.9	2.0	1.9	2.3
Annual:				2.4			-0.2					-1.1				2.3
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.2	-3.8	-3.5	-0.7	-1.8	-1.0	0.6	2.2	1.6	1.6	2.3
Durables	9.2	5.0	2.3	0.4	-4.3	-2.8	-14.8	-22.4	-14.6	-20.8	-7.3	0.0	2.5	2.0	2.0	5.3
Non-Durables	3.5	1.9	1.2	0.3	-0.4	3.9	-7.1	-7.1	4.2	2.3	0.5	0.3	0.8	0.7	0.7	0.7
Services	3.1	1.4	2.4	1.4	2.4	0.7	-0.1	1.7	1.6	0.9	0.8	0.9	1.6	1.9	2.0	2.5
Gross Domestic Investment	-9.6	6.2	3.5	-11.9	-5.8	-11.5	0.4	-12.3	-20.6	-2.5	2.3	5.9	5.8	4.6	2.1	1.0
Fixed Investment	-3.4	3.0	-0.9	-6.2	-5.6	-1.7	-5.3	-20.2	-9.5	-4.9	0.9	0.6	3.2	2.0	2.1	2.3
Non-Residential	3.4	10.3	8.7	3.4	2.4	2.5	-1.7	-19.1	-6.7	-4.1	2.1	0.4	3.5	1.8	1.6	1.8
Structures	11.2	18.3	20.6	8.6	8.7	18.4	9.6	-1.7	2.4	-17.1	2.1	6.5	2.9	1.2	4.0	2.0
Equip. & Software	0.0	6.9	3.6	1.0	-0.5	-5.0	-7.5	-27.8	3.5	0.8	2.1	-1.6	3.7	2.0	0.8	1.8
Residential	-16.2	-11.6	-20.6	-27.0	-25.0	-13.3	-16.1	-23.6	-15.6	-7.4	-3.8	1.3	1.3	2.6	3.9	3.9
Change in Pvt. Inventories	-15.0	-2.8	16.0	-8.1	-10.2	-50.6	-29.6	6.2	-40.0	-30.0	-25.0	-5.0	5.0	15.0	15.0	10.0
Net Exports																
Exports	0.6	8.8	23.0	4.4	5.1	12.3	3.0	-19.8	2.2	0.6	2.1	1.8	2.9	1.5	3.0	2.9
Goods	2.1	6.8	21.8	5.1	4.6	16.3	3.6	-27.7	2.4	0.5	0.9	1.9	3.2	1.1	1.9	2.5
Services	-2.7	13.3	26.0	2.7	6.4	3.7	1.4	0.6	2.9	0.8	4.8	1.5	2.3	2.3	5.3	3.6
Imports	7.7	-3.7	3.0	-2.3	-0.8	-7.3	-3.5	-15.7	0.4	-0.1	0.3	1.1	0.6	0.6	1.3	1.2
Goods	8.4	-4.0	2.4	-2.6	-1.9	-7.1	-4.7	-18.8	-0.5	-0.3	-0.1	0.7	0.4	0.2	0.8	0.8
Services	4.2	-2.0	6.3	-0.8	5.5	-8.1	3.3	0.9	4.8	0.9	2.4	3.2	1.8	2.6	3.4	3.5
Gov't Purch. of Goods & Svcs.																
Federal	0.9	3.9	3.8	0.8	1.9	3.9	5.8	1.9	-2.6	1.5	1.1	1.4	1.2	0.8	1.6	1.8
National Defense	-3.7	6.7	7.2	-0.5	5.8	6.6	13.8	5.8	-5.2	3.2	2.2	3.3	2.1	0.9	2.3	3.0
Non-Defense	-5.9	8.4	10.1	-0.9	7.2	7.3	18.0	2.1	-5.9	3.3	0.4	1.8	2.7	-0.8	1.3	2.3
State & Local	1.3	3.1	1.1	0.5	2.7	5.0	5.1	14.4	-2.9	3.0	6.1	6.6	0.9	4.4	4.3	4.4
Final Sales of Domestic Prod.	3.6	2.4	1.9	1.6	-0.3	2.5	1.4	-0.5	-1.5	0.3	0.3	0.2	0.7	0.8	1.1	0.9
Final Sales to Dom. Purch.	1.1	4.3	4.0	0.8	0.9	4.4	-1.3	-5.1	-3.0	-1.6	-0.2	0.8	2.5	1.6	1.9	2.5
Final Sales to Dom. Purch.	2.2	2.5	1.9	-0.1	0.1	1.3	-2.2	-4.9	-2.7	-1.7	-0.4	0.8	2.2	1.5	1.7	2.2
Addendum:																
Nominal GDP	4.3	6.9	6.4	2.3	3.5	4.1	3.4	-4.1	-4.6	1.8	3.6	4.7	6.2	5.6	5.4	5.5
Personal Con Exp Deflator	3.4	3.6	2.5	4.3	3.6	4.3	5.0	-5.5	0.3	3.0	3.3	3.0	2.9	3.2	2.9	3.3
GDP Price Deflator (implicit)	4.2	2.0	1.5	2.5	2.6	1.3	3.9	-0.3	0.1	3.1	3.6	3.1	3.2	3.5	3.5	3.1

Richard Yamarone, Director of Economic Research

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