Interest Rates Sink to Record Lows as Recession Intensifies

After expanding for 73 months, the economy slipped into recession in December 2007, according to the arbiter of business cycles -- the National Bureau of Economic Research. Looking only at the performance of gross domestic product (GDP), the current recession in was quite mild for the first three quarters. However, economic data for October and November showed marked deterioration in economic activity, suggesting that the decline in real GDP in the current quarter will likely be the largest since the 1981-82 recession.

Friday's employment report was nothing less than shocking. Payroll employment fell 533,000 in November, which surpassed the largest monthly drop in payrolls in the previous four recessions and is the biggest drop since the 1973-75 recession, which is currently the most severe recession in postwar history.

The revision to prior months' payrolls was also stunning. November job losses followed a 320,000 drop in October (initially reported as a 240,000 drop) and a 403,000 decline in September (initially reported as a 284,000 decline). Since the beginning of the year, about 1.91 million jobs have been lost, with the decline over the past three months accounting for nearly two-thirds of the total drop.

Consumers continued to hunker down as the labor market deteriorated. Auto sales sank in November to a 26-year low. Chain store sales (not seasonally adjusted) fell 2.7 percent in November from a year ago, the biggest drop since the International Council of Shopping Centers (ICSC) began tracking data in 1969. Following a 0.5 percent drop in real consumer spending in October, these two pieces of data pointed to another sizable drop in the current quarter's consumer spending, which accounts for about 70 percent of GDP. The 3.7 percent (annualized rate) drop of real consumer spending in the third quarter subtracted 2.7 percentage points from economic growth.

Two reports this week suggested a sharp deterioration in business investment. October factory orders posted the largest drop since July 2000. The Institute for Supply Management (ISM) Manufacturing Survey showed that the decline in manufacturing activity accelerated in November at the fastest pace since May 1982.

Activity in the service industries also showed a massive deterioration in November, according to the ISM Nonmanufacturing Survey, which plummeted to a new record low in the relatively short 11-year history of the survey. Service activity trends in the ISM survey are largely consistent with the employment report. About two-thirds of the recent job declines have occurred in the service-providing sector. During the first eight months of this year, job losses were largely confined to construction and manufacturing.

Finally, more borrowers are falling behind on their mortgage payments, according to the Mortgage Bankers Association's National Delinquency Survey. The total delinquency rate rose to a record high in the third quarter. Initiations of new foreclosure proceedings fell, however. The drop was likely influenced by increased loan modification efforts and various states' moratoria on foreclosure fillings.

Interest Rates

Investors flocked to Treasuries in a flight-to-quality in response to downbeat economic reports, pushing yields to record lows. The yield on the 10-year Treasury note slipped to 2.55 percent on Thursday, the lowest since Federal Reserve's daily records started in 1962 and also since 1955 as measured on a monthly basis. The 10-year yield rebounded and hovered around 2.63 percent mid-Friday afternoon -- 30 basis points lower than the rate on the previous Friday. Fixed mortgage rates declined about half a percentage point to about 5.5 percent after the Federal Reserve announced last week that it planned to purchase GSE debt and mortgage-backed securities, spurring tremendous demand for mortgages, especially for refinancing, according to the Mortgage Bankers Association's Weekly Applications Survey. Mortgage rates remained low through this week as the 10-year Treasury yield fell, which bodes well for housing and mortgage demand.

Housing and Mortgage Indicators:

Total construction spending fell 1.2 percent in October, as a 2.0 percent drop in private construction spending more than offset a 0.7 percent increase in public construction spending.

Private residential construction dropped 3.5 percent while private nonresidential construction spending fell 0.7 percent -- the third decline in the last four months. A large drop in utility construction spending was largely responsible for an overall decline in nonresidential construction spending. Commercial construction spending, office construction spending, and manufacturing construction spending all increased during the month.

From a year ago, private residential construction spending has declined 24.2 percent. By contrast, private nonresidential construction spending was up 9.1 percent over the past year. Residential investment will continue to be a drag to economic growth again in the fourth quarter. During the third quarter, residential investment subtracted 0.7 percentage points from economic growth.

The Mortgage Bankers Association's National Delinquency Survey showed that the delinquency rate for mortgage loans on one-to-four-unit residential properties rose 58 basis points to a record 6.99 percent of all loans outstanding at the end of the third quarter. The increase in the overall delinquency rate was driven by increases in the number of loans 90 or more days past due, primarily in California and Florida. The 30 day delinquency percentage remains below levels seen as recently as 2002.

The percentage of loans in the foreclosure process at the end of the third quarter rose 22 basis points to 2.97 percent -- also a record high. The percentage of loans on which foreclosure actions were started during the third quarter was 1.07 percent, down one basis point from last quarter on a non-seasonally adjusted basis.

Economic Indicators:

The Institute for Survey Management (ISM) Manufacturing Index fell to 36.2 in November from 38.9 in October. A reading below 50 indicates a contraction in the manufacturing sector. The index has declined nearly 14 points over the past three months to its lowest level since May 1982.

Details of the report showed widespread declines in major subcategories of the index. New orders fell 4.3 points to 27.9, which was the lowest since June 1980. New orders have been below 30 only four times in the 53-year history of the survey. The production index dropped to 31.5 from 34.1 in October, while new export orders remained at a record low of 41.0 in November. The employment index posted a 0.7 point decline in November.

The report continued to show moderation in prices firms paid for raw materials. The price index fell 11.5 points to 25.5 -- the lowest reading since June 1949. This was the fifth consecutive drop in the index, reflecting the sharp decline in energy and other commodity prices. The prices-paid index was near 90 earlier this year.

New orders for manufactured goods declined 5.1 percent in October -- the third consecutive monthly drop and the largest since July 2000. The factory orders report included a downward revision of durable goods orders data released last week and contained new data on nondurable goods shipments.

Nondurable goods shipments fell 3.2 percent. The drop in nondurable goods shipments reflected a large decline in petroleum prices as well as a weakening economy. Petroleum shipments fell 12.2 percent. Excluding petroleum, nondurable shipments fell 0.6 percent.

Durable goods orders fell 6.9 percent during the month -- a downward revision from the advance estimate drop of 6.2 percent. All components of durable goods were revised down except for electrical equipment, with primary metals, machinery and transportation equipment posting the largest downward revisions.

The outlook for business investment spending was gloomier with the downward revision. Orders for nondefense capital goods excluding aircraft -- a proxy for business investment in equipment and software in the coming quarters -- were revised to a drop of 5.0 percent from an earlier report of a 4.0 percent decline.

The ISM Nonmanufacturing Index dropped to a new record low of 37.3 in November from the previous record low of 44.4 in October.

The details on new orders and employment were dismal. The employment index fell to a record low of 31.3 from 41.5. The new orders and export order indices both fell by 8 points and 15.5 points, respectively and are both far below their prior record lows. The prices-paid index plunged to 36.6, edging past its previous all-time low of 41.3 in November 2001.

Payroll employment fell 533,000 in November. During the past three months, the employment base shrank by 1.256 million. Losses were broad-based. Job losses more than doubled in service-producing industries, to 370,000 in November from 153,000 in October. Weak retail spending led to a loss of 91,000 jobs in retail. Builders and manufacturers cut 82,000 and 85,000 jobs, respectively. Average hourly earnings increased 0.4 percent, while the average workweek declined to 33.5 hours, its lowest on record. The unemployment rate rose to 6.7 percent from 6.5 percent.

Next Week:

Tuesday — The National Association of Realtors Pending Home Sales Index

Thursday — October trade deficit and November import prices

Friday — November retail sales, November Producer Price Index and the preliminary estimate of the University of Michigan's Survey of Consumer Sentiment for December

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