



Real value in a changing world

on.point

Americas Research

United States Economy Overview Winter 2010

The “great recession” is over, but the expansion underway will remain fragile as the overwhelming support from government stimulus begins to fade out in 2010.

Economic output increased by 2.8 percent in the third quarter led by consumer spending, residential investment, net private inventories and federal government spending.

The pace of monthly job losses abated significantly in recent months. Leading indicators such as a rebound in temporary employment and a decline in initial claims of unemployment now point towards employment growth resuming by mid 2010.



- ● ● *The fragile recovery now underway will be tested in 2010 as the effects of federal stimulus wind down. A self-sustained recovery hinges on the ability of the labor market to first stabilize and eventually return to trend-like growth.*

The “great recession” ended during the third quarter replaced by a fragile and uneven recovery

The United States economy expanded for the first time in a year during the third quarter, ending the longest streak of decline on record. Gross domestic product (GDP) grew at an annualized rate of 2.8 percent according to the second estimate from the Bureau of Economic Analysis (BEA). The positive result likely provided a technical end to the worst recession in a half century. Despite improved economic output, the impending recovery remains quite fragile, due to a persistently weak labor market and continued tight credit market particularly for consumers and small businesses.

Though much of the positive momentum came directly as a result of federal stimulus funding, the report provided the best evidence to date that the economy has stabilized and a slow recovery is now underway. Positive contributors to growth this quarter included consumer spending, federal government spending, residential investment, business investment and the net investment in private inventories. Countering the positive activity was a negative trade balance and a decline in state and local government spending.

Fueled mainly by consumer incentive programs and residual effects from the American Recovery and Reinvestment Act (ARRA), consumer spending rebounded substantially this quarter, growing by 2.9 percent annualized. This vital component, which makes up more than two-thirds of GDP, added 2.07 percentage points towards growth. However, the rebound in consumer spending will likely prove fleeting due to the substantial impact that the Cash for Clunkers program had on auto sales. Durable goods consumption, which includes spending on cars,

grew by an unsustainable 20.1 percent annualized in the third quarter. Also benefitting from government intervention was the housing market, aided by an \$8,000 tax credit for first-time home buyers, home sales

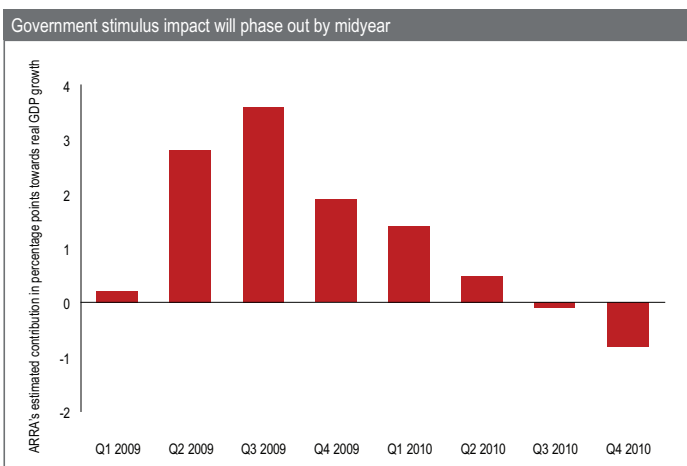
The rebound in consumer spending will likely prove fleeting due to the substantial impact that the Cash for Clunkers program had on auto sales

have been on the rise for most of the latter half of the year. Residential investment ended a string of 15 consecutive quarterly declines for an impressive rebound in the third quarter, as it grew by an annualized rate of 19.5 percent, contributing 0.45 percentage points towards growth.

Perhaps the two components of GDP that will be the most important to monitor going forward, however, are non-residential fixed investment and the net change in private inventories. The most positive news to come out of the third quarter report was the stabilization of non-residential fixed investment. This component, which measures capital spending on equipment, software and structures, is a key measure of business confidence in the economy. The component dropped by a staggering 39.0 percent annualized in the first quarter. In the third quarter, it increased marginally by 0.3 percent annualized, signaling that businesses have improved their outlook. Investment from this component was concentrated entirely on spending on equipment and software, which grew by 2.3 percent annualized during the quarter. Investment in structures continued to be a significant weight on the economy, declining by 15.1 percent annualized.

The draw down of private inventories continued in the third quarter, as companies decreased inventories by an additional \$130.8 billion. This component of GDP actually provided a boost to economic output due to its improvement over the \$160.2 billion in inventories liquidated in the second quarter. The continued draw down of inventories is an important step towards recovery. Lean private inventories will allow production to ramp up quickly once demand returns, translating into positive economic output.

Government spending increased by 3.1 percent and contributed 0.63 percentage points towards growth. However, all of the positive output came from the federal government, which grew by 8.3 percent



annualized. State and local governments decreased spending by 0.1 percent, despite receiving significant federal stimulus funding, as many states face their most dire fiscal deficits in decades. Most states' main sources of revenue; property, income and sales taxes are dependent on consumer spending, stable home prices, and a growing job market. California, which has been the most prominent example of a state in fiscal crisis, recently announced it will sell off \$2 billion in

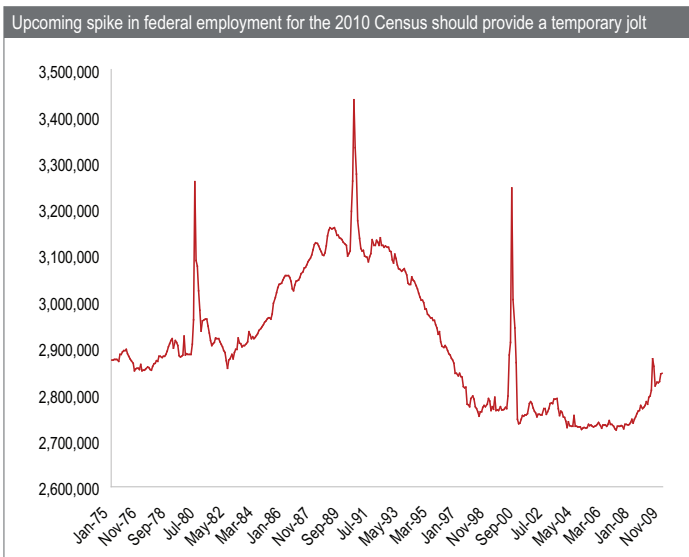
Many states face their most dire fiscal deficits in decades

state-owned property to help raise funds. All signs point to state and local governments remaining a significant drag on economic output until a self-sustaining recovery takes hold.

Labor market conditions improving, but long way from recovery

Although much improved from a dire outlook in the first few months of 2009, the employment situation remained troubled through November. Despite the return of positive economic output this quarter, payroll employment in the United States declined for a 23rd consecutive month. However, the last few months of 2009 may have finally provided some early indications of stabilization. November's net loss of 11,000 jobs was a substantial improvement over October's loss of 110,000 jobs. In fact, November's employment situation report from the Bureau of Labor Statistics (BLS) revised both the September and October periods to show 159,000 fewer net job losses than what had been previously reported.

It is too early to determine whether a recovery is imminent in the labor market. As seen from the recent employment report from the BLS,



Source: Bureau of Labor Statistics

monthly results are subject to significant revisions, which are typically volatile during turning points in the business cycle. Additionally, the recent positive employment report should be put into greater context as the economy emerges from its worst recession in the last half century. The U.S. has lost 7.2 million jobs since the start of the recession. Employment losses remained widespread with the education and health services sector the only major sector to avoid net job loss during this recession. Of positive note for the first half of 2010 is the federal government's plan to hire a significant amount of temporary workers for the upcoming decennial census in April.

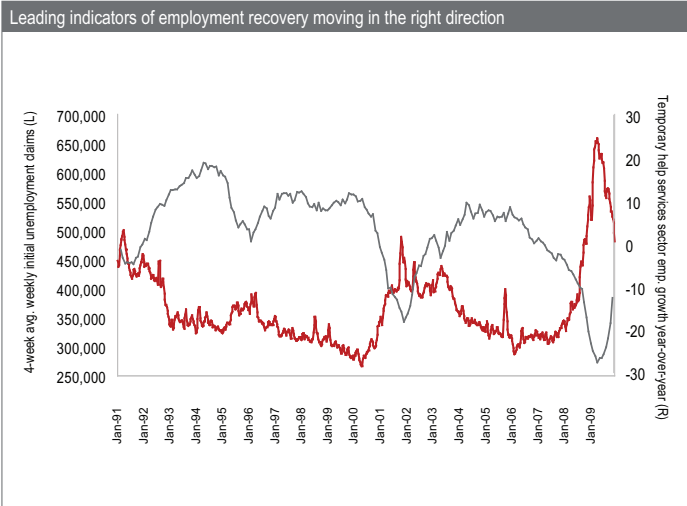
The U.S. unemployment rate was 10.0 percent in November, and would have been higher if not for the shrinking labor force due to discouraged job seekers postponing job searches. October marked the first time since 1983 that the unemployment rate had surpassed 10.0 percent. Despite the psychological milestone of surpassing double-digit unemployment, the labor market has been in dire straits for the balance of 2009. The Bureau of Labor Statistics' U-6 unemployment rate, a more inclusive indicator that counts discouraged workers not actively searching for employment but would accept a job if offered, as well as persons working part-time that would prefer to work full-time, stood at 17.2 percent in November.

Re-enforcing the significant slack that currently exists in the labor market is the low number of hours worked per week. The average hours worked per week recorded an all-time low of 33.0 hours in October. At the beginning of a recovery in the labor market, employers first increase the utilization of their current workforce before hiring new employees. In November, the average work week increased slightly, however more data points are needed to know whether this indicator has stabilized from its historic low.

In addition to increasing existing worker hours, employers will explore hiring temporary workers before expanding permanent payrolls. Thus employment trends in this sector serve as a leading indicator of future employment growth, particularly during inflection points in the business cycle. Indeed, after sharply declining by as much as 27.7 percent year-over-year in April, this sector has stabilized in recent months and may be poised for recovery. The temporary help services sector on a seasonally adjusted basis has expanded for four consecutive months,

Employers will explore hiring temporary workers before expanding permanent payrolls

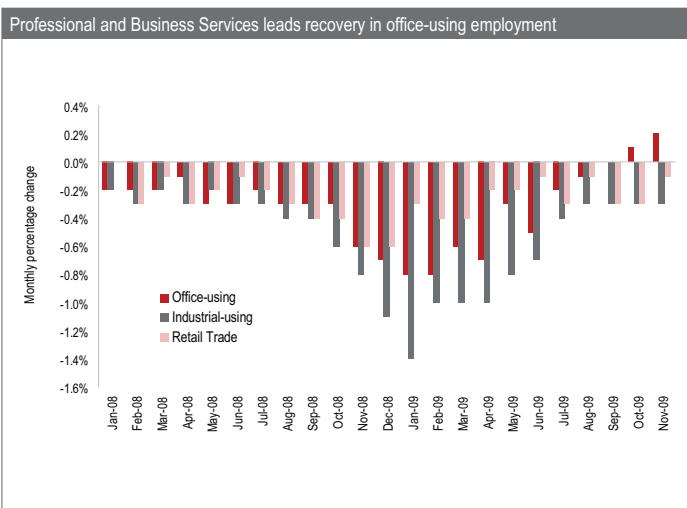
adding 116,900 net jobs and growing 6.7 percent since August. This trend is a major step in the right direction and bodes well for a recovery



Source: Bureau of Labor Statistics; Moody's Economy.com

in total employment. Also, buoying hopes that the employment situation has turned the corner has been the improvement in initial claims of unemployment insurance. The four-week moving average of initial claims of unemployment insurance peaked in March at 658,750, its highest level since 1982. Since that time, this indicator has gradually declined to its current rate of 481,250. Putting this into perspective however, the current level of claims remains above previous peaks in 2001 and 1991, and will need to fall to between 350,000 and 400,000 before employment can resume expanding. Office-using employment appeared to stabilize in recent months.

This segment which includes the information, financial activities and professional and business services sectors has expanded for each of the past three months according to the BLS Employment Situation report for November. For the months of September through November office-using employment grew by 98,000 jobs. During the recession, this segment peak-to-trough declined at a greater rate than total



Source: Bureau of Labor Statistics

employment shedding 2.2 million jobs which represented a 7.5 percent decline. By comparison, total employment has declined by 5.3 percent since the recession began. Employment in the industrial segment, which includes the manufacturing, trade, transportation, and utilities sectors stabilized in recent months, but remains down 6.8 percent on a year-over-year basis. Likewise, employment in the retail sector remains stable, but was down 3.8 percent year-over-year in October. Despite stabilizing in recent months, neither the retail nor industrial sectors have shown signs of increased hiring to date.

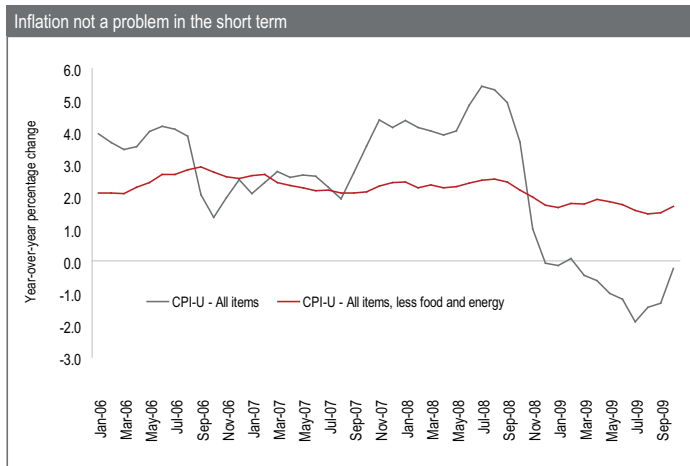
The government sector, which had resisted employment declines during this recession through the second quarter of the year, began to decline during the third quarter. The declines were entirely concentrated in the state and local government sectors. With the new fiscal year for most local governments beginning on July 1st and a severe budget crisis in place for a vast majority of municipalities, many local governments looked to cut operating costs through layoffs. Finally, the construction sector continued to be the most impacted during this recession. This sector began shedding jobs in February 2007, nearly a year before total employment, as a result of its exposure to the bursting of the housing-bubble, a major catalyst for the recession. Year-over-year the construction sector has lost 1.1 million jobs representing a 15.6 percent rate of decline. Cumulatively, the sector has lost 1.8 million jobs since February 2007, down 23.7 percent from its peak. The current level of construction employment is at an eleven year low.

Consumers stimulated into spending, but remain skeptical of recovery

Retail sales have been on the rise for three of the past four months and appear to have turned the corner. The latest report from November showed sales growth across a broad range of sub-sectors. However, the recovery in retail sales remains fragile due to a number of factors including weak wage growth; household wealth in the early stages of recovery; and a lack of consumer credit availability. A recovery in the overall economy will help prevent retail sales from relapsing to the depths of early 2009, but continued improvement will be slow and steady.

After bouncing back from a historic low during the first quarter, consumer confidence has reached a plateau virtually unchanged since June. Improvements in the future expectations portion of the index in recent months have been countered by a continued deterioration of present conditions. The latest reading of The Conference Board's Consumer Confidence Index was 49.5 in November. Problems continuing to weigh on consumers include a continued weak labor

market, little to no wage growth, limited access to credit, and negative home equity for a significant percentage of homeowners. Giving hope to consumers has been the rebound in the stock market and subdued inflation. Core inflation, which excludes food and energy prices,



Source: Bureau of Labor Statistics

continued to remain in the Federal Reserve's target range of between one and two percent. The Consumer Price Index, which includes volatile food and energy prices, has been negative on a year-over-year basis for much of 2009, declining by its highest rate since 1950 in July. However, prices have steadied in recent months and neither inflation nor deflation remains a concern in the short term.

Unlike previous expansions, consumers will not be leading the way towards recovery this time around. The labor market, despite gradual improvement since the first quarter, remains very weak. The slow recovery in the job market will continue to impair consumers' ability to sustain current spending levels, which have been substantially

The slow recovery in the job market will continue to impair consumers' ability to sustain current spending levels

aided by federal stimulus and incentive programs. The all important holiday shopping season will serve as a litmus test to help determine consumer resiliency. Consumer resiliency will be tested further in 2010 as government stimulus efforts begin to fade and consumers continue to keep savings rates high in an effort to repair their badly damaged balance sheets. Ultimately, a recovery in the job market will be the key to giving consumers the confidence they need to increase spending levels into next year.

Business confidence improves, but not ready for robust expansion

Business confidence has rallied back in recent months due to several factors including a recovery in stock prices, record corporate bond issuance, and increased profitability all of which have helped company balance sheets broadly remain in good shape. That said, business confidence remains below the level needed for a self-sustained expansion. The most recent four-week moving average of Moody's Economy.com's Survey of Business Confidence Diffusion Index recorded a reading of 11.2, which is consistent with an economy in equilibrium. A reading of 25.0 or higher on this index indicates an economy in robust expansion. Corporate profits have recovered substantially in recent months due mostly to large increases in productivity and decreases in labor costs. Corporations will need to sustain profit growth in order for recent improvements in capital spending to continue.

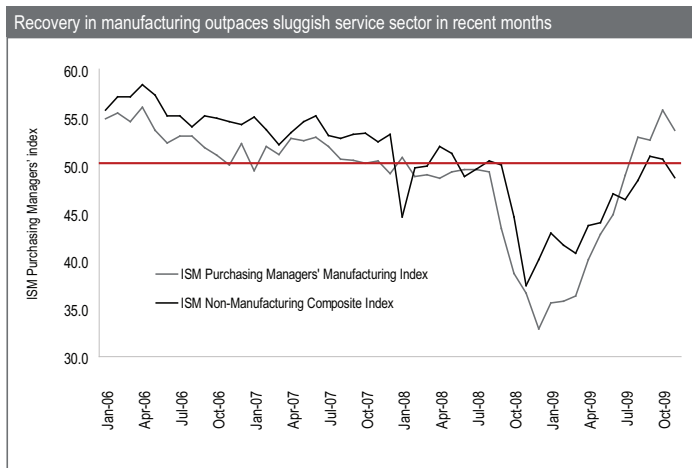
Policy intervention working, but risks remain

The federal government's intervention in the financial system has stemmed the financial crisis and worked to stabilize the banking system. This has helped to set the stage for the recovery in equity markets currently underway. The Federal Reserve has continued to keep the target federal funds rate unchanged between zero and 0.25 percent and has yet to signal when this policy might change. Inflation has remained in check due to sluggish wage growth, which has taken off some of the pressure that would normally exist with such aggressive policy action. Despite the easing of credit conditions by the Federal Reserve, credit continues to remain tight particularly for consumers and small businesses. A main reason for this is the significant risks that remain in place for smaller regional banks and credit card companies, which are the main lenders to consumers and small businesses. Both entities are exposed to consumers defaulting on loans whether it is a mortgage or a line of credit and regional banks additionally have significant exposure to commercial real estate loans, many of which are in danger of defaulting over the next few years. The federal government is left in a precarious position if a sustained recovery

Inflation has remained in check due to sluggish wage growth.

doesn't take hold towards the end of next year. With the federal funds rate at virtually zero, there is no room left for rate cuts. While the federal government is unlikely to introduce further stimulus efforts on the scale of ARRA, smaller programs will likely be introduced potentially targeting consumers and small businesses, particularly if the current

recovery begins to fade next year. The federal government faces increased pressure to tame a rapidly expanding federal deficit, which will limit additional policy response. With that said, the first reports on the economic impact of ARRA were released recently. The nonpartisan



Source: Institute for Supply Management; Note: Above 50.0 on the index indicates expansion

Congressional Budget Office (CBO) released a report in December estimating that during the third quarter between 600,000 and 1.6 million jobs were saved directly as a result of ARRA.

Inventory right-sizing nears completion

The draw down of business inventories over the past two quarters, while a substantial drag on output during the recession has provided a significant lift to growth prospects next year. The right-sizing of inventories throughout 2009 should set the stage for this indicator to return as a positive contributor to growth starting in the fourth quarter. The inventory/sales ratio, a key measure of the health of business inventories, has come down significantly from the spike of 1.46 recorded in January. In September the ratio had declined to 1.34. IHS Global Insight estimates that the correction in inventories as of September was two-thirds of the way back to normal.

The Institute of Supply Management's (ISM) Purchasing Managers Index continued to show deviating characteristics between its manufacturing and non-manufacturing indices. The manufacturing index surpassed 50.0, the threshold between expansion and contraction, back in July. The index, which had bottomed out at a woeful 32.9 back in December 2008, has now recorded four consecutive months above 50.0 to its current rate of 53.6 in November. By contrast, the non-manufacturing services industries composite index after recovering from a nadir of 37.4 in November 2008 remains muddled around the 50.0 barrier. The current reading from November

was 48.7. The low reading of 41.6 on the employment component of the index appears to be the main reason for the return into negative territory.

In a sign that the global recession has come to an end, international trade grew substantially during the third quarter. After four consecutive quarters of decline, including the sharpest drop in both imports and exports on record during the first quarter, imports expanded by 20.8 percent and exports by 17.0 percent annualized during the third quarter.

Next year poses significant challenges to the recovery, but recession now in rear view mirror

The third quarter marked an end to a historic recession, but the early recovery remains fragile. A self-sustained recovery hinges on the ability of the labor market to first stabilize and eventually return to trend-like growth. A gradual decline in employment will continue through the first half of 2010. Job losses will approach a decline of approximately 6.0 percent from the peak. Unemployment will peak near 11.0 percent by mid-2010, but will undergo a slow recovery due to the level of structural unemployment present in the current economy. Many jobs lost during this recession were permanent, the result of consolidation amongst sectors as varied as home construction, auto manufacturing and financial services. The federal government will extend current policies aimed at stimulating the economic expansion in 2010. However, further stimulative efforts on a large scale would be politically and fiducially difficult. In addition, constrained credit availability particularly for consumers and small businesses will continue to weigh on recovery

The right-sizing of inventories throughout 2009 should set the stage for this indicator to return as a positive contributor to growth

prospects in the near term. Economic output will continue to be positive in 2010, but will remain below trend-like growth. As the caboose of the train, commercial real estate lags economic growth and fundamentals in the sector will likely be predominantly negative again in 2010. For that reason, stabilization and initial recovery is unlikely to take hold until 2011. While the downturn in the U.S. economy and commercial real estate markets were highly synchronized geographically, the recovery will likely be uneven. Some markets will start to see growth much sooner than others.

- ● ● *The downturn in the U.S. economy and commercial real estate markets were highly synchronized geographically, but the recovery will likely be uneven. Select markets will start to see growth much sooner than others.*



Real value in a changing world

About Jones Lang LaSalle

Jones Lang LaSalle (NYSE:JLL) is a financial and professional services firm specializing in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2008 global revenue of \$2.7 billion, Jones Lang LaSalle serves clients in 60 countries from 750 locations worldwide, including 180 corporate offices. The firm is an industry leader in property and corporate

facility management services, with a portfolio of approximately 1.4 billion square feet worldwide. LaSalle Investment Management, the company's investment management business, is one of the world's largest and most diverse in real estate with more than \$37 billion of assets under management. For further information, please visit our Web site, www.joneslanglasalle.com.

Contacts for United States Economy Report

Ben Breslau

Director of Research—Americas
+ 1 617 531 4233
benjamin.breslau@am.jll.com

Lauren Picariello

Vice President, Director of Occupier Research
+1 617 531 4208
lauren.picariello@am.jll.com

Paul Leonard

Research Manager
+1 617 316 6523
paul.leonard@am.jll.com

Justine Morrison

Senior Analyst
+1 202 719 5793
justine.morrison@am.jll.com

www.us.joneslanglasalle.com