EXCERPTS FROM THE BOARD

The global economy is slowing dramatically. The United States economy deteriorated in rapid fashion during the fall months, and some are calling this recession the most serious since the 1930s. Problems have spread from the U.S. housing market into global credit markets, and are now spreading rapidly into global product and labor markets. The Eurozone (the fifteen European Union countries that officially use the Euro) and the United Kingdom are already in recession. The economies of Asian nations, including China, are slowing markedly, and Japan is on the threshold of recession. For 2009, the International Monetary Fund now projects a global recession, defined as total worldwide economic growth below 2.5 percent.

Confidence in the financial system's ability to evaluate and manage risk has eroded sharply. Wealth has declined badly with the massive drops in stock markets around the world. Households and financial managers alike are trying to limit their risk exposure and protect themselves. But what makes sense for the individual risks a vicious downward spiral in the economy as a whole.

Fortunately, governments around the world seem to recognize the dangers and are acting aggressively, more or less in concert, to support the financial and economic systems. These initiatives are highly innovative, and we should not be surprised that their effects are not yet apparent.

Turning to Massachusetts, the state's economy seemed to be holding up fairly well through August. Since then, economic indicators have deteriorated precipitously. Claims for unemployment insurance have surged and state tax revenues are falling across all major categories. Employment is declining in a wide variety of sectors, for the time being excluding only education and health care. It is likely that reported employment declines are actually understating the true extent of job losses in the state, and that the numbers being currently reported will be revised downward by early 2009. On another front, the state government's budget picture seems to worsen by the moment, with large additional spending cuts imminent.

State exports had been one buoyant part of the economy in recent years, bolstered in part by the declining value of the dollar in international exchange markets, which made U.S. goods and services more price-competitive in foreign markets. During the fall, the dollar appreciated against some important currencies, diminishing the price-competitiveness of the state's exports. Furthermore, any remaining price advantage cannot overcome precipitous declines in investment expenditures that are international in scope.

The financial services sector, both in the state and nationwide, has been especially hurt by events this fall. Since financial services firms are major purchasers of information-related products and services, their difficulties are leading to sharp declines in purchases from the Information Technology (IT) sector, an important component of the Massachusetts economy. On the other hand, there is anecdotal evidence that businesses are hiring IT consultants in order to use technology to cut costs in response to problems with the bottom line. This may cause the IT sector to outperform other technology sectors in this recession.

In the last two recessions, the recovery in Massachusetts lagged that of the nation. Although each cycle is different, it is quite possible that job growth could again turn around somewhat later here than in the U.S. as a whole. One reason is a slower underlying rate of population and labor force growth; another is the state's somewhat higher concentration in supplying business investment products and services as opposed to consumer goods. In a recession driven by a fall-off in home purchases and consumer spending, businesses are likely to wait for evidence of an economic pickup before they make investments to expand capacity or accelerate new product development.

January 15, 2009