US: Retail sales fall as tax stimulus wears off

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14 August 2008

Retail sales fell in July for the first time in five months as the effects of the US government's $160 billion consumer tax stimulus began to fade.

The 0.1 percent fall in retail sales was due primarily to a 2.4 percent fall in auto sales. Sales of cars and auto parts are down by 10.5 percent over the last year, as rising gas prices, falling real wages, and tightening credit have reduced the number of Americans who can afford to drive.

Meanwhile, the price of imports rose by 1.7 percent in July as the dollar weakened and crude oil prices continued to increase. Import prices have risen by 21.6 percent in the past year, the highest increase since record keeping began in 1982, according to the Labor Department.

The fading of the tax stimulus will exacerbate the hardships already weighing down consumer demand—which accounts for more than two-thirds of the economy—from rising unemployment and falling home values. By all indications, even the slow 1.9 percent growth of the second quarter is unlikely to last as the US economy heads into a "double-dip" recession in the second half of the year. A Bloomberg survey of economists predicted that the US economy would expand at an average annual rate of 0.7 percent in the last six months of the year, half the pace of January through June.

Amid skyrocketing default rates, banks have become reluctant to lend to consumers. Most US lenders "reported having tightened their lending standards and terms on all major loan categories over the previous three months," the Federal Reserve observed this week in a survey of loan officers.

Former San Francisco Fed Bank President Robert Parry said, "When the Fed started to cut rates [11 months ago], mortgage rates and other rates were actually lower than they are today." He added: "To say that things are easier in many areas of credit would be mistaken." Higher credit costs have eaten into consumer spending, particularly in car sales, directly contributing to July's sharp decline.

The rise in default rates has been driven by falling home values, which have plummeted by 15.8 percent in the past year, according to the S&P Case-Shiller index of 20 metropolitan areas. As a result, delinquencies on home loans to borrowers with poor credit histories have reached 18.8 percent, up from 13.8 percent a year ago.

No other country can help pull the US economy out of doldrums. The Japanese economy contracted at a 2.4 percent annualized rate in the second quarter, after expanding at a rate of 3.2 percent in the first quarter. Government officials in Tokyo hinted Wednesday that the country's longest post-war expansion, lasting six years, has come to an end. Underlining the world character of the downturn, the Japanese contraction was led by a sharp fall in exports, the biggest since 2001.

Jean-Claude Trichet, president of the European Central Bank, said that Euro-area growth would be "particularly weak" in the third quarter. The Eurozone economy likely contracted for the first time since 1999, according to a survey of economists conducted by Bloomberg News. Industrial output in the 15 countries that make up the Eurozone stalled in July, after falling 1.8 percent in June, according to Wednesday's announcement by the European Union's statistic office.

Output in the 15 nations that share the currency was unchanged from the previous month, when it dropped 1.8 percent. From a year earlier, production fell 0.5 percent, the biggest decline since September 2003.

JPMorgan Chase, the second-largest US bank, reported a $1.5 billion write-down on mortgage-backed securities Monday, which triggered a sell-off of its stock. Its shares dropped by 9 percent Tuesday in the sharpest fall in six years, followed by a further 2.4 percent fall Wednesday.

Goldman Sachs, which had heretofore performed better than other investment banks, suffered a six percent fall in its share values after analysts warned that it would experience a severe slowdown. Shares in Morgan Stanley and Wachovia fell this week after similar downgrades. Stocks were down for the second day in a row on Wednesday

Meanwhile, the Securities and Exchange Commission began investigating allegations of trading abuses at Bear Stearns, Lehman Brothers, Fannie Mae and Freddie Mac. Lehman lost more than 75 percent of its share value this year, while Fannie and Freddie have lost 80 percent, leading to a multi-billion-dollar guarantee by the US Treasury.

The Federal Reserve Board kept its benchmark Federal Funds Rate steady at 2 percent at its August 5 meeting. It provided no signals that it would raise rates at its next meeting in September.

A recent survey of institutional investors—firms such as banks, pension and hedge funds—suggested the reason to the Fed’s hesitance to raise rates. Some 60 percent of the firms surveyed said they think another big financial firm will fail during the next six months. A further 15 percent think this will happen within six to twelve months.

In an article published last week in the *Financial Times*, Former Federal Reserve Chairman Allan Greenspan observed that financial conditions are only likely to get worse, and that “there may be numbers of banks and other financial institutions that, at the edge of defaulting, will end up being bailed out by governments.”