Where Did the Money Go?

BY CHARLES GERENA

"Credit Flows to Businesses During the Great Recession." Pedro Amaral, Federal Reserve Bank of Cleveland Economic Commentary No. 2011-15, August 2011.

In a typical recession, businesses tend to reduce their borrowing from financial institutions. But the downturn in credit flows during the 2007-09 recession was the largest in the post-World War II era.

In a recent report, Cleveland Fed economist Pedro Amaral writes that a variety of interrelated factors could have constrained the flow of credit. "The funds available for lending were scarcer, financial institutions presumably became more risk averse as their balance sheets worsened, and their attitudes toward risk changed," he explains.

Also, feedback mechanisms were at work. "As economic conditions worsened, the businesses that financial institutions would lend to became less creditworthy since their own balance sheets and future prospects had deteriorated," notes Amaral. "Moreover, for this same reason, their demand for funds also retracted."

Using data from the Federal Reserve Board's Senior Loan Officer Opinion Survey on Bank Lending Practices, Amaral found that while standards for commercial and industrial lines of credit appeared to tighten, demand for these loans also fell. He also looked at the spreads between corporate bonds and U.S. treasuries, as well as the spreads between different types of bonds. He wanted to see if financial institutions pursued safer, more liquid investments to help stabilize their balance sheets, or saw higher risks for lending.

"There was a flight to liquidity"... as overall uncertainty jumped," notes Amaral. But nonfinancial companies also "became worse risks, as the market for corporate bonds shows, which contributed to further declines in credit flows."

"The U.S. Content of 'Made in China.'" Galina Hale and Bart Hobijn, Federal Reserve Bank of San Francisco Economic Letter No. 2011-25, August 2011.

While studying the implications of inflation in China on prices in the United States, economists Galina Hale and Bart Hobijn of the San Francisco Fed unearthed a wealth of details on how much we spend on Chinese imports and what fraction of that spending actually goes to China. The results show that while we continue to have a trade imbalance with China, not as much of our spending goes abroad as is commonly believed.

For example, most of the stuff Americans buy is still produced here — about 88.5 percent of personal consumption expenditures (PCE) went toward U.S.-made goods and services in 2010. This is largely because services — which are produced locally, for the most part — made up two-thirds of PCE. Chinese goods were only 2.7 percent of overall expenditures, though they accounted for larger chunks of spending in certain categories, such as clothing (35 percent) and furniture (20 percent).

Furthermore, not all of the money spent on Chinese goods goes toward the cost of those imports. Take a pair of sneakers made in China. "The bulk of the retail price pays for transportation of the sneakers in the United States, rent for the store where they are sold, profits for shareholders of the U.S. retailer, and the cost of marketing the sneakers," note Hale and Hobijn. Then there are the salaries, wages, and benefits of the people who run these operations.

When the researchers took into account the inputs of production that were imported from foreign countries, including China, the domestic share of U.S. personal consumption expenditures was somewhat lower: 81.9 percent of PCE went to goods and services produced in the United States using U.S.-made parts. The other 6.6 percent were for U.S.-made goods that used imported parts.

And of the 2.7 percent of PCE that went to Chinese goods, 1.5 percent was spent on goods with U.S.-made parts. That leaves less than 2 percent of consumer spending which went into China's economy.

"The Production Impact of 'Cash-for-Clunkers': Implications for Stabilization Policy." Adam Copeland and James Kahn, Federal Reserve Bank of New York Staff Report No. 503, July 2011.

Among the many efforts to boost consumer spending in recent years, the "cash-for-clunkers" program offered $2.8 billion in rebates on new-car purchases to people who traded in their fuel-inefficient vehicles during July and August 2009. New York Fed economist Adam Copeland and James Kahn at Yeshiva University looked at how the program affected both U.S. automobile sales and production.

About 450,000 additional sales were initially generated, but most of them resulted from people either delaying purchases they would have made before the program started or accelerating purchases they would have made later in the year. As a result, the cumulative effect on car sales by January 2010 was zero.

The cash-for-clunkers program had a modest and short-lived effect on production, as well; carmakers had to produce only 200,000 additional units to fulfill the 450,000 additional orders they received. "A large portion of the sales increase came out of inventories," note Copeland and Kahn, "and even the modest step-up in production in July and August was partly offset by retrenchment in September." **RF**