RESCUING THE ECONOMY

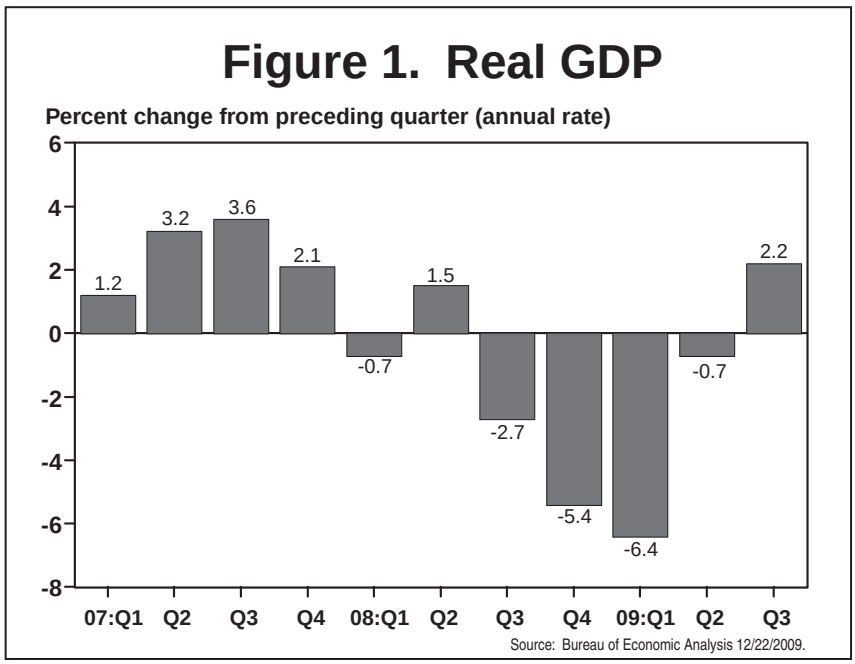
When the President took office on January 20, 2009, the economy was on the brink of a potentially severe depression. Real GDP fell at a 5.4 percent annual rate in the fourth quarter of 2008 and at a 6.4 percent annual rate in the first quarter of 2009 (see Figure 1, Real GDP).

Employment, which had been falling by less than 150,000 jobs per month before September 2008, declined by an average of 622,000 jobs per month from October through March. Altogether, in the fourth quarter of 2008, the country lost 1.7 million jobs—the largest quarterly decline since the end of World War II and a number only to be exceeded by the next quarter, when 2.1 million jobs were lost (see Figure 2, Nonfarm Payroll Employment). By January 2009, the underemployment rate, which measures all those out of work or underemployed for economic reasons, rose to 14 percent. Consumer confidence plummeted. Housing starts hit a record low, and the number of homes in foreclosure grew significantly. As financial markets collapsed, Americans lost their jobs, and the economy shrank, household net worth fell from the third quarter of 2007 to the first quarter of 2009 by $17.5 trillion or 26.5 percent, which is the equivalent to more than one year's GDP.

This decline was not simply the result of a normal downturn in the business cycle; indeed, the more fundamental cause was a meltdown in our credit and capital markets precipitated by a perfect storm of excessive risk-taking, inadequate disclosure, non-existent or myopic oversight, market gatekeepers compromised by conflicts of interest, and irresponsible lending to hundreds of thousands of Americans. Through sophisticated financial engineering, these bad loans made their way onto the books of some on Wall Street, and were then sold to investors all over the world. Once the real estate market cooled, loans defaulted at alarming rates, and the credit boom unraveled.

The resulting collapse laid low some of the most prominent financial institutions in the American economy, wiped out trillions of dollars in wealth and retirement savings, and created a level of uncertainty that brought our financial system to the brink of collapse. A lack of confidence in the economy and in the financial system effectively froze the credit markets, preventing businesses from expanding, and families from financing a new home or college education; and caused massive job loss and economic contraction.

The Administration, consequently, entered office facing twin trillion-dollar deficits. The first was the gap between what the economy could be producing and what it was producing; this GDP gap totaled $1 trillion for 2009, or approximately 7 percent of the economy. The second was the budget deficit, estimated to be $1.3 trillion on the day the President took office, or 9.2 percent of GDP. And the budget deficit over the following decade—driven by the previous Administration's decisions not to offset three large domestic initiatives (the tax cuts of 2001 and 2003, as well as the Medicare prescription drug benefit) and the effects of the economic collapse and the efforts needed to combat it—produced this historically large 10-year deficit, totaling more than $8 trillion.

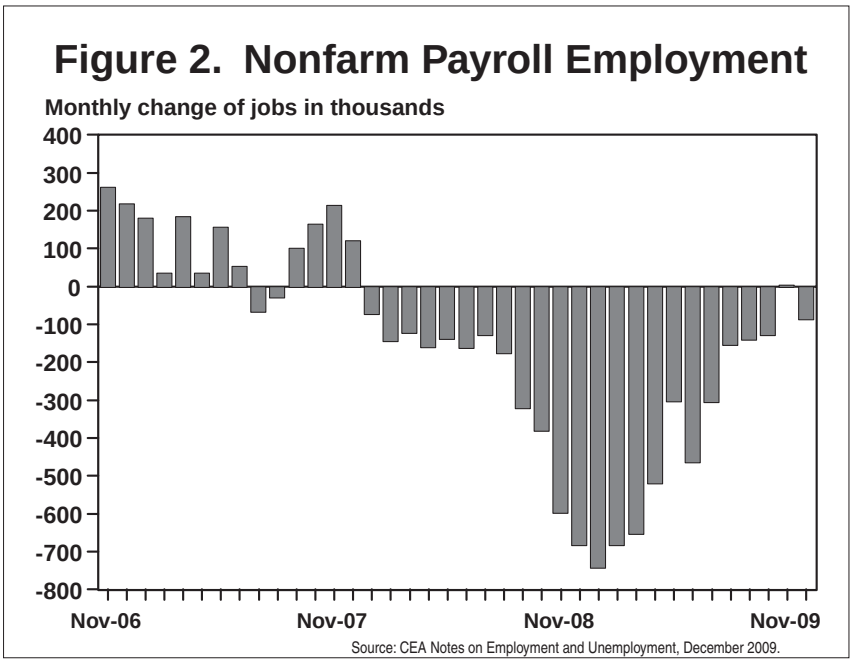


Facing this economic crisis, the Administration moved swiftly to take a series of extraordinary, but necessary, steps to pull the economy back from the brink. Because of these efforts, the immediate crisis has passed, the economy is on the path toward recovery, and we are laying a new foundation for long-term economic growth.

Jumpstarting the Economy: The American Recovery and Reinvestment Act

When the Administration took office, it became clear that there was a substantial shortfall between what the economy could produce and what it was producing. Economists across the spectrum agreed that substantial steps needed to be taken to bolster macroeconomic demand, jumpstart economic activity, and break a potentially vicious recessionary cycle. With traditional monetary policy levers largely exhausted, the Administration moved rapidly to sign into law, just 28 days after taking office, the American Recovery and Reinvestment Act (the Recovery Act) to create and save jobs, as well as transform the economy to compete in the 21st Century.

The Recovery Act contains three parts. Approximately one-third—or $288 billion—is dedicated to tax cuts for small businesses and 95 percent of working families. Another third—or $224 billion—is for emergency relief for those who have borne the brunt of the recession; for example, more than 17 million Americans benefited from extended or increased unemployment benefits and health insurance was made 65 percent less expensive for laid-off workers and their families who rely on COBRA. In addition, aid to State and local governments helped them to close budget shortfalls, saving the jobs of hundreds of thousands of teachers, firefighters, and police officers. The final third is for investments to create jobs, spur economic activity, and lay the foundation for future sustained growth.



The Administration committed itself to implementing the Recovery Act with unprecedented accountability and transparency. In addition to an independent Recovery Board to monitor the program, the Act required recipients of Recovery funds to report quarterly on the amount of monies spent, the status of each project, the number of jobs created and/or saved, and other relevant details. This information is available for public scrutiny on the *Recovery.gov* website.

The effects of the Recovery Act on families, businesses, and the economy as a whole have been significant. In the 10 months since the Recovery Act was signed into law, the Administration cut taxes for 95 percent of working families through the Making Work Pay Tax Credit, which amounted to $37 billion in tax relief for 110 million working families over that time period. To help prevent cuts to Medicaid programs across the country, more than $40 billion was disbursed. Also, nearly $60 billion in funding for education was provided which helped to create or save more than 300,000 education jobs nationwide.

To create jobs now and build the infrastructure needed to support the jobs of the 21st Century, the Recovery Act already has funded more than 12,000 transportation construction projects nationwide, ranging from highway construction to airport improvement projects; begun or accelerated work at more than 50 Superfund sites from the Environmental Protection Agency's National Priority List; and started more than 2,000 construction and improvement projects at over 350 military facilities nationwide. To build America's competitiveness in the emerging industries of tomorrow, the Administration has made multi-billion dollar investments in innovation, science, and technology including: $2.4 billion in grants to companies and educational institutions in over 20 States to fund 48 new advanced battery manufacturing, transportation electrification, and electric drive vehicle projects that will help power the next generation of advanced vehicles; $3.4 billion in grants to private companies, utilities, manufacturers, and cities to fund smart energy grid projects that will support tens of thousands of jobs and benefit consumers in 49 States; and more than $5 billion in grants to fund 12,000 cutting-edge medical research projects at research and educational institutions in every State across the country.

It is worth noting that in several cases, the Government Accountability Office has found that Recovery Act projects are coming in under budget, allowing funds to support more projects, assist more communities, and help create more jobs. For instance, the Federal Aviation Administration (FAA) initially committed $1.1 billion to 300 airport improvement projects; since those projects have come in $200 million below estimate, the FAA can now fund an additional 60 airport projects. Similarly, Department of Defense construction contracts are coming in about 12 percent under-budget, representing hundreds of millions of dollars in savings that will fund additional projects and further spur economic growth.

All told, as of the end of November 2009, about 50 percent of Recovery Act funds—or $395 billion—has been either obligated or is providing assistance directly to Americans in the form of tax relief. By design, the bulk of the remaining 50 percent of Recovery Act funds will be deployed in the coming months of 2010 and during the beginning of 2011 to support additional job creation when our economy continues to need a boost. Many of the programs slated to receive additional funding in the near future are those with significant promise of job creation. These include more than $7 billion in broadband expansion, approximately $8 billion in funds to lay the foundation for a high-speed rail network, and continued funding for other transportation projects. All told, the Recovery Act is on track to meet the goal of disbursing 70 percent of its funds in the first 18 months of its life.

Taken together, the fiscal relief, tax cuts and other direct assistance, and funding of critical infrastructure projects have had a substantial effect on the economy. Following implementation of the Recovery Act, the trajectory of the economy changed dramatically. Government and private-

sector estimates suggest that the Recovery Act added two to three percentage points to real GDP growth in the second quarter of 2009, and three to four percentage points to growth in the third quarter of that year. Considering that real GDP growth for the third quarter of 2009 was 2.2 percent, many independent experts and forecasters agree that all the economic growth in that quarter was attributable—either directly or indirectly—to the Recovery Act.

In addition, there is evidence that the Recovery Act helped prevent the unemployment rate from climbing even higher over the past year. The Council of Economic Advisers (CEA), Congressional Budget Office (CBO), and private forecasters estimate that the Recovery Act increased employment relative to what would have occurred without the Act by between 900,000 and 1.5 million jobs over the second and third quarters of 2009.

Health Insurance Reform

As part of the Recovery Act, the Administration made a down payment on one of the most important unmet challenges facing the Nation and burdening the economy: the rising costs of health care.

Health care is consuming an ever-increasing amount of our Nation's resources: in 1970, health care expenditures were 7 percent of GDP; as of 2008, they exceeded 16 percent; and at this rate are projected to hit 20 percent by 2017. For individuals with health insurance, there is a strain on their family budgets. In fact, the past decade saw dramatic increases in premiums that far outstripped gains in wages. Not only is this burden felt directly when these bills are due, but it also is felt indirectly as take-home pay is constrained by these increasing health insurance costs. Moreover, many with insurance run the risk that when they need care, their coverage could be dropped; that if they leave their job, they will not be able to find affordable coverage or any coverage at all because of a pre-existing condition; or that they will be forced into bankruptcy due to huge unpaid medical bills. Finally, those without any health insurance present both a moral burden and real financial cost on us all as every time an uninsured person walks into an emergency room because there is nowhere else to turn, a hidden tax is imposed on other citizens as premiums go up. For State governments, these rising costs crowd out expenditures on other vital services such as higher education and law enforcement.

While the United States spends more per capita on health care than any other developed nation, it is not always clear that we are receiving better care. On many metrics, other developed nations surpass us on health outcomes. In addition, several academic studies suggest that we spend as much as $700 billion a year on health care that does little or nothing to improve patients' health. Wide variation in health care practices among regions, States, cities, and even among health care providers within these localities generates significant differences in health outcomes and costs—with the high-cost medical centers not necessarily generating better outcomes than the lower-cost ones.

Recognizing that the current situation is not sustainable for families, businesses, and the Nation as a whole and that our long-term fiscal and economic health depend on bringing down the costs of health care, the President launched a health insurance reform effort last year.

First, in the Recovery Act itself, the Administration included funding critical to transforming the health care system into one that delivers better care, not just more care. Specifically, it included a program to spur an effort to computerize Americans' health records in five years, and do so in a way that rigorously protects patient privacy and helps to reduce health care costs in the long run. Because in so many areas of medical care, providers lack basic data on which interventions work and which do not, the Act provided $1.1 billion for patient-centered health research. And since chronic diseases that are manageable and preventable contribute disproportionately to poor health and rising costs, the Administration

made an unprecedented $1 billion investment in prevention and wellness interventions.

Second, working with the Congress, the Administration has brought the Nation closer to health insurance reform than ever before. The bills passed by both chambers of Congress will give Americans with health insurance the stability and security they need by protecting consumers from being denied coverage based on pre-existing conditions or seeing it dropped or diluted once one falls ill. The legislation creates a health insurance exchange to increase consumer choice and provide affordable coverage for individuals and small businesses, and expands coverage to more than 30 million Americans. It will reduce the growth of health care costs for American families, seniors, and businesses. The bills also include important reforms that will end insurer abuses, hold insurance companies accountable, and enhance consumer rights. They include overdue reforms of the health care delivery system that will strengthen Medicare and improve quality of care for all Americans. And they put in place mechanisms to keep the system dynamic and responsive to changing market conditions.

Finally, the legislation meets the President's standard of changing the way Washington is doing business by paying for major new initiatives so they do not add to our Nation's debt. Indeed, the legislation meets the President's demand that health care reform not add to budget deficits in the first 10 years (and, in fact, it reduces them), and of reducing deficits thereafter. Deficit neutrality is accomplished by relying on tangible, accountable savings—as scored by the independent CBO—to pay for health insurance reform, such as savings from Medicare and revenue measures. The legislation also includes potentially more important cost-savings from transforming the health care delivery system, which will undoubtedly help to improve our long-term fiscal standing—even if it is challenging to quantify by precisely how much.

Fiscally-responsible health insurance reform is a critical part of the recovery of the Nation's economy. Our fiscal future is so dominated by health care that if we can slow the rate of cost growth by just 15 basis points per year (0.15 percentage points per year), the savings on Medicare and Medicaid alone would equal the impact from eliminating Social Security's entire 75-year shortfall. Undertaking health insurance reform at this moment is an important step toward putting the country on a more solid foundation for economic growth.

Reviving the Financial System and Critical Sectors of the Economy

Along with reviving macroeconomic demand, the Administration was forced to take extraordinary, and sometimes understandably unpopular, steps to help revive the credit and capital markets and restore trust in the financial system. At the beginning of 2009, the financial system was extremely fragile. The viability of major financial institutions remained in doubt and vital aspects of the financial system were deeply impaired—preventing the flow of credit that small firms need to grow and families need to buy a home or car, attend college, or start a business. With the risk that inaction could lead to an even deeper downturn, the Administration implemented a plan to restore financial stability that, in conjunction with fiscal stimulus, has helped to stabilize financial markets and the economy and pull the financial system back from the brink of systemic collapse.

Financial Stabilization

Upon taking office, the Administration undertook a comprehensive, forceful, and sustained commitment to stabilize the financial system, assist in the cleanup of legacy assets, jumpstart the provision of new credit for households and businesses, and support distressed housing markets. The Administration's Financial Stability Plan helped to shore up confidence in our financial institutions and markets, while mobilizing private capital—especially in the wake of the "stress test" conducted of major financial institutions. The Administration also redirected the focus of the

Figure 3. TARP Investments in Banks

(In billions of dollars)

	Commitments			
	Pre-Jan 20th	Jan 20-Present[1]	Total[2]	Repayments
Existing Programs:				
Large Banks[3]	230	2	232	114
Small Banks[4]	9	5	14	2
Total	239	7	246	116
Common Equity and Other Regulatory Capital Raised by the Largest Banks Since "Stress Test" Results Were Announced in May				114

[1] Estimates as of December 9, 2009.

[2] Estimates may not sum to total due to rounding.

[3] CPP, AGP, TIP. Large banks are defined as banks with total assets of over $10 billion.

[4] CPP.

Source: Department of the Treasury.

Troubled Asset Relief Program (TARP) from large financial institutions to households, small banks, and small businesses (see Figure 3, TARP Investments in Banks). Indeed, since the President took office, only $7 billion in TARP funds have been provided to banks—much of it to smaller institutions—while major banks subject to the "stress test" have raised more than $140 billion in high-quality capital from the private sector.

As financial markets have stabilized and private capital has replaced Government capital, many of the initial programs created under TARP have become unnecessary, and institutions have begun to repay Federal money deployed through TARP programs. As of December 31, 2009, Treasury received $165 billion in TARP repayments, and taxpayers also have received about $17 billion in interest, dividends, and capital gains through the sale of warrants.

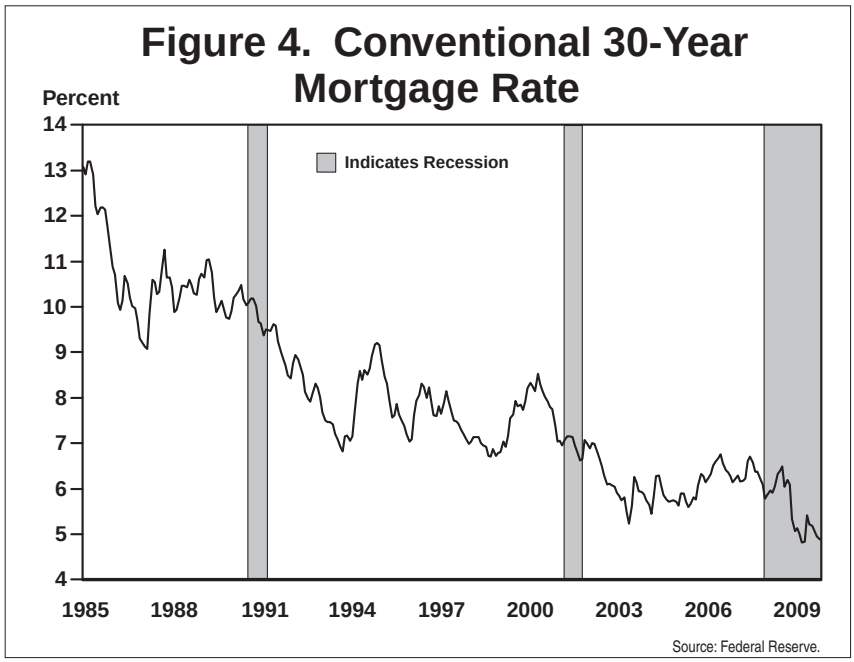
At the height of the crisis, the Treasury guaranteed that Americans would get back at least what they had invested in money market funds that participated in its temporary guarantee program. The program achieved its purpose, and it was terminated in September 2009. Not only did it not cost the taxpayers a dime; it earned them $1.2 billion in fees.

As we move from rescue to recovery and as financial stabilization funds are being repaid, the Administration has developed a four-step exit strategy for modifying TARP to assist in rebuilding of the economy. First, we will continue winding down or terminating many of the Government programs put in place to address the crisis—a process that already is well underway. Second, we will limit future commitments to preserving home ownership, stimulating credit for small businesses, and supporting securitization markets which facilitate consumer and small business loans that promote job creation and economic growth. Third, beyond these limited new commitments, we will not use remaining stabilization funds unless necessary to respond to an immediate and substantial threat to the economy stemming from financial instability. Fourth, we will continue to carefully manage the equity investments acquired during this extraordinary period in a cost-effective manner, while protecting taxpayers and unwinding those investments as soon as practicable.

Housing

The steps taken to stabilize housing markets and help distressed homeowners represent another important element of the Administration's policy response. For the thousands of responsible homeowners who are facing foreclosure or are at risk of losing their homes, the Administration undertook a number of efforts to help them. On

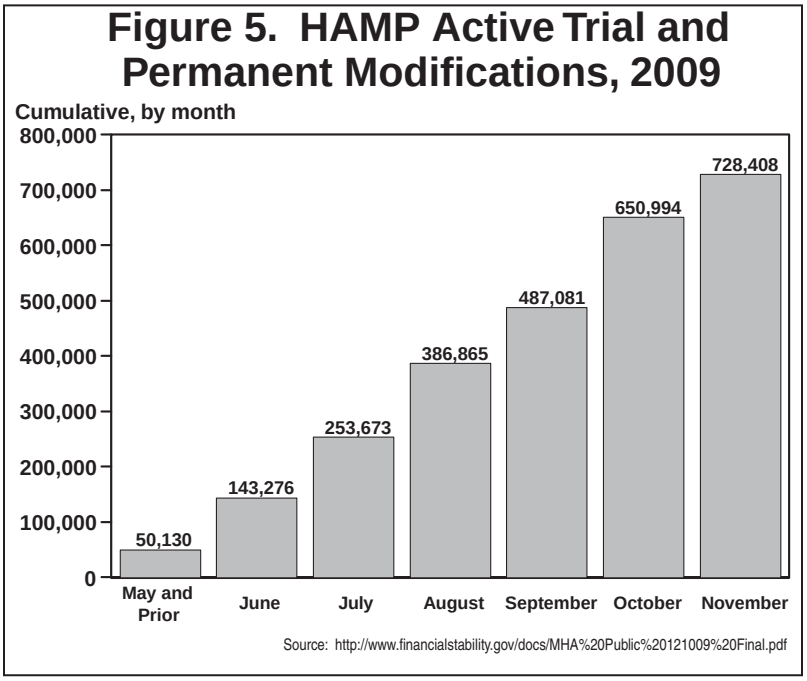
February 18, 2009, the Administration announced the Homeowner Affordability and Stability Plan, a broad set of programs designed to stabilize the U.S. housing market and keep millions of homeowners in their homes.



First, the Administration took action to stabilize the housing market, in part by making mortgages more affordable. Continued support for Fannie Mae and Freddie Mac and the Treasury's Mortgage Backed Securities (MBS) purchase program, along with $1.1 trillion in MBS purchases by the Federal Reserve, have helped to keep interest rates at historic lows (see Figure 4, Conventional 30-year Mortgage Rate). More than 3 million Americans have taken advantage of these lower rates in 2009 to save money through refinancing. In addition, the Federal Housing Administration has increased its market presence significantly to enable many Americans to purchase homes.

Second, the Administration is working to provide increased access to financing for State and local housing finance agencies, which provide sustainable homeownership and rental resources, for working Americans in all 50 States. In addition, the $8,000 first-time homebuyer tax credit has helped hundreds of thousands of Americans purchase homes. The Recovery Act also supported the Low Income Housing Tax Credit market by creating an innovative Treasury Tax Credit Exchange Program and providing gap financing through the Department of Housing and Urban Development's Tax Credit Assistance Program. In combination, these programs are estimated to provide over $5 billion in support for affordable rental housing. In addition, the Recovery Act provided $2 billion in support for the Neighborhood Stabilization Program, which is designed to rebuild value in areas hardest hit by foreclosures; this amount is on top of the $4 billion provided for the program in the Housing and Economic Recovery Act of 2008.

Third, the Administration initiated the Home Affordable Modification Program (HAMP), which provides eligible homeowners the opportunity to



significantly reduce their monthly mortgage payment, remain in their homes, and prevent avoidable foreclosures (see Figure 5, HAMP Active Trial and Permanent Modification). Through November 2009, more than 725,000 borrowers are in active modifications, saving an average of more than $550 a month on their monthly mortgage payments. Servicers report that more than 1 million borrowers have received offers to begin trial modifications. HAMP is designed to offer a second chance to as many as 4 million borrowers by the end of 2012, averaging more than 20,000 trial modifications started per week. To facilitate this and other efforts, the Administration is working to improve the application process, develop operational measurements to hold servicers accountable for their performance, and enhance borrower resources to provide direct access to tools and housing counselors. Finally, the Administration is working with homeowners to help them through the process of converting temporary modifications into permanent ones.

More work needs to be done, and there are still market risks. But there are clear signs that our efforts are having an impact. We will continue to monitor this key component of the economy and work to keep responsible homeowners in their homes.

Automobile Industry

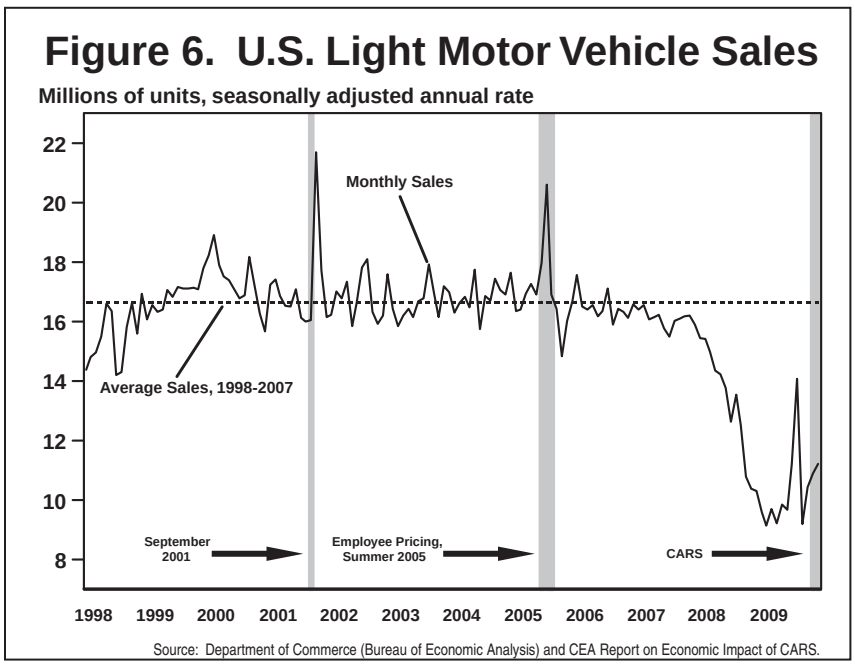
The freezing up of the credits markets in the fall of 2008 made it hard for many households to finance the purchase of motor vehicles. This difficulty, exacerbated by the rapid deterioration in the broader economy, led to reduced demand for motor vehicles, causing considerable financial stress to automobile companies, particularly General Motors (GM) and Chrysler. Without Government intervention, GM and Chrysler would have liquidated, causing widespread and devastating effects throughout the auto industry. Importantly, the repercussions of such liquidations could have included immediate and long-term damage to the U.S. manufacturing/industrial base, a significant increase in unemployment with direct harm to those both directly and indirectly related to the auto sector, and further damage to our financial system, since automobile financing constitutes a material portion of overall financial activity. Facing what risked becoming the last straw for an economy already severely weakened, the President made the difficult decision to offer assistance to the auto industry in an effort to prevent a further economic meltdown that could have hurt millions of families.

However, the President's offer of financial assistance was coupled with a requirement that GM and Chrysler develop serious restructuring plans that would address prior business failings and put the companies on a path to financial viability without Government assistance. After rejecting GM and Chrysler's initial plans and requiring all stakeholders to make additional sacrifices, the Administration accepted new restructuring plans from these two manufacturers.

In exchange for the assistance provided, the Government obtained from GM $8.8 billion in debt obligations and preferred stock along with a 60.8 percent share of the common equity in the new GM. From Chrysler, the Government obtained a $7.1 billion debt security note and 9.9 percent of Chrysler's common stock. In November 2009, GM announced that it would begin repaying the U.S. Treasury faster than anticipated, and made its first $1 billion repayment in December 2009.

To further assist the auto industry as well as the economy as a whole, the Administration also launched the Car Allowance Rebate System (CARS)—or "Cash for Clunkers"—program to accelerate demand for new automobiles. The program, signed into law by President Obama on June 24, provided bonuses of $3,500 to $4,500 to buyers who traded in automobiles with mileage ratings of 18 miles per gallon or below, if they purchased a new car or truck with improved mileage ratings. The Cash for Clunkers program boosted auto sales by nearly 500,000 units between July and August 2009, adding about $3.5 billion to the GDP. The CEA estimates that because of the program, employment in the second half of 2009 was about 70,000 job-years higher than it would otherwise have been. As an additional benefit, the program accelerated the replacement of high-polluting "clunker" motor

vehicles with cleaner, higher-efficiency vehicles (see Figure 6, U.S. Light Motor Vehicle Sales).



While there is more to be done to assure financial stability, these steps have allowed us to move from the rescue phase to the next phase of rehabilitation and rebuilding. Even as we roll back emergency measures that are no longer needed, the Administration remains steadfast in its commitment to preserve the stability of the financial system. Some Government programs will stay in place to serve as a bulwark against unforeseen events and to provide confidence in our financial markets. Overall, however, the Administration believes that we are past the point of having to provide emergency relief, and looks forward to recouping the costs of these extraordinary efforts.

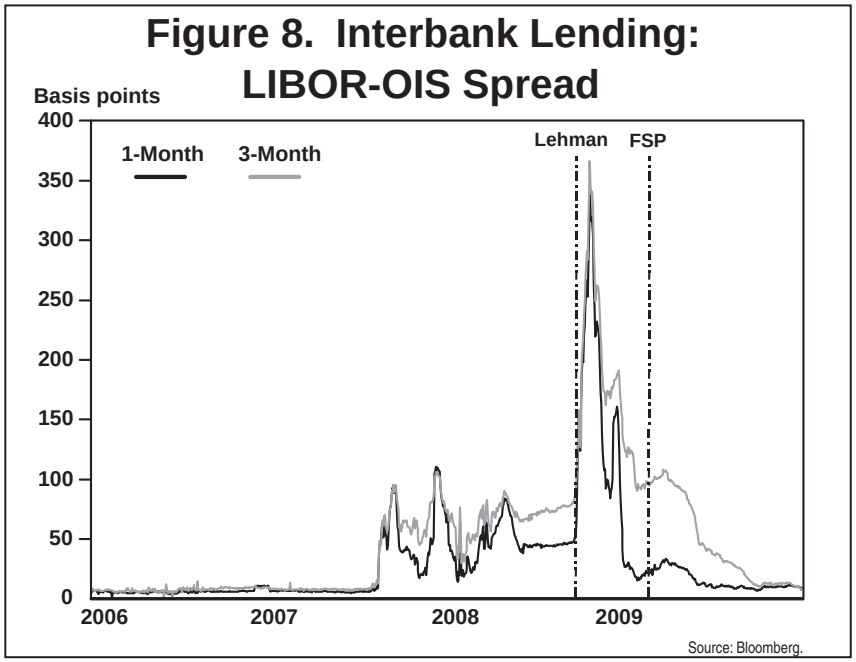
Rising to the Challenges Ahead

As a result of our steps to support the financial system, confidence has improved, credit is easing, and the economy is growing. Moreover, the Government is exiting from its emergency financial policies, and taxpayers are being repaid. Indeed, the ultimate cost of those policies is likely to be significantly lower than previously expected. The Administration now estimates that TARP will cost about $117 billion—$224 billion less than was projected in the 2010 Mid-Session Review (see Figure 7, Costs of Troubled Asset Relief Program Actions). For example, we now expect that there will be a positive return on $248 billion of investments in

Figure 7. Costs of Troubled Asset Relief Program Actions (Excluding Debt Service) [1]
(In billions of dollars)

TARP Actions	2010 MSR		2011 Budget		Change from 2010 MSR to 2011 Budget	
	TARP Obligations	Subsidy Cost	TARP Obligations	Subsidy Cost	TARP Obligations	Subsidy Cost
Equity Purchases	383.7	158.1	344.1	55.9	–39.6	–102.2
Structured & direct loans and asset-backed security purchases	330.5	133.6	148.6	25.0	–181.9	–108.6
Guarantees of troubled asset purchases [2]	12.5	–0.8	5.0	–3.0	–7.5	–2.2
Home Affordable Modification Program (HAMP)	50.0	50.0	48.8	48.8	–1.2	–1.2
Total	**776.7**	**340.9**	**546.4**	**126.7**	**–230.3**	**–214.2**
Memorandum:						
Deficit impact before administrative costs and interest effects [3]		*340.9*		*116.8*		*–224.1*

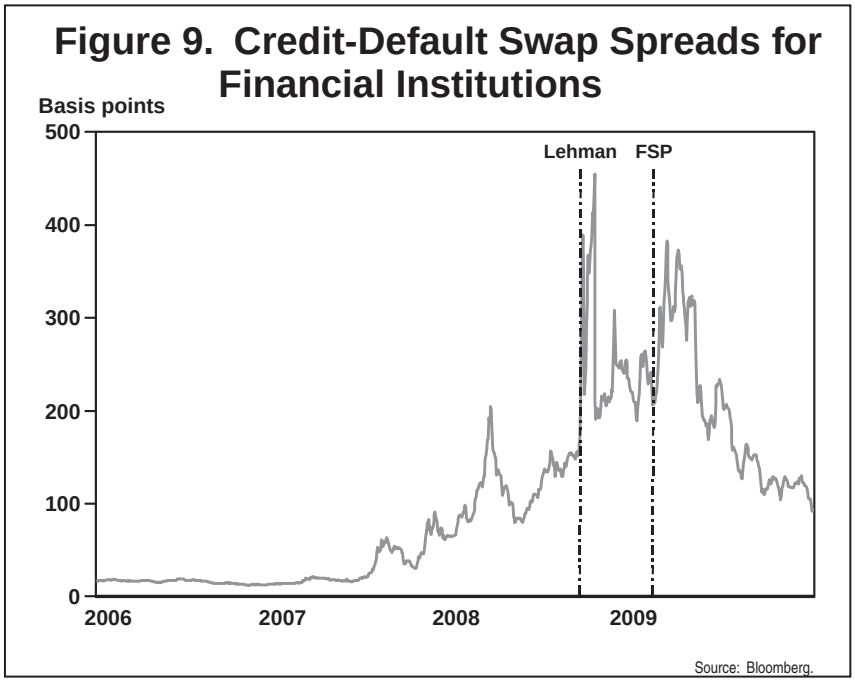
1 Total reflects estimated lifetime TARP obligations and costs through 2020.
2 The 2010 MSR reflected total face value of guarantees of $419 billion. The 2011 Budget reflects the actual face value of $301 billion.
3 The 2011 Budget total dficit impact includes interest on downward reestimates of $9.9 billion.

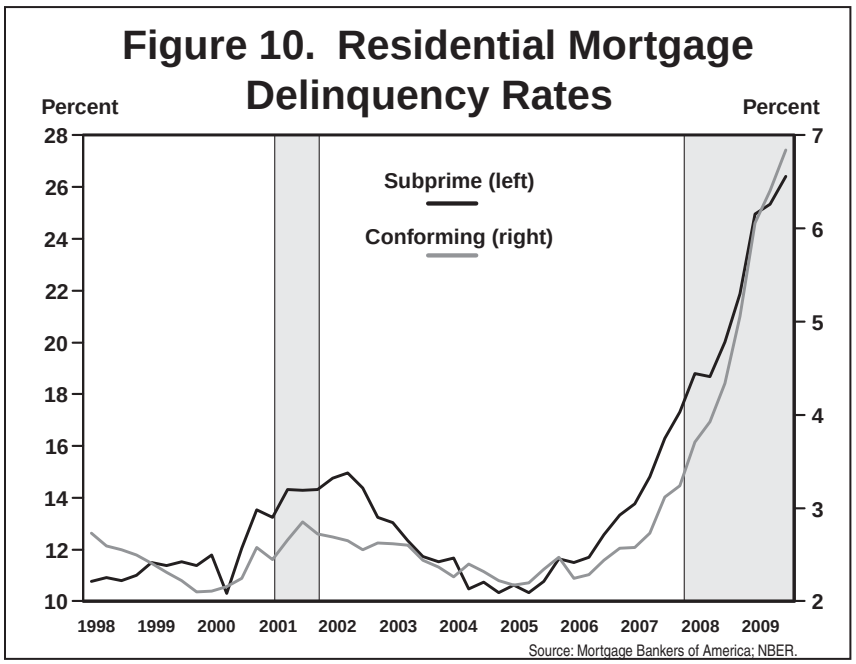


As borrowing costs have come down, businesses have raised substantial capital from private sources. Corporations have raised more than $900 billion in investment-grade debt and in excess of $100 billion in high-yield debt this past year. While much of the new issuance early this year was supported by Government guarantees, in recent months private investors have funded most new corporate debt without public support: only 14 percent was guaranteed in October, whereas nearly 50 percent of new issuance was guaranteed by the Government in January 2009. The U.S. banking system is much better capitalized today than it was at the height of the crisis. Since the announcement of the stress test results, the largest banking institutions have raised over $140 billion in high-quality capital and over $60 billion in non-guaranteed unsecured debt in the private markets. Banks have used private capital to repay TARP preferred equity, allowing TARP to fulfill its function as a bridge to private capital.

banks, about two-thirds of which have already been repaid over the past year.

Confidence in the stability of our financial markets and institutions has improved dramatically over the past year. Interbank lending rates, which reflect stress in the banking system, have returned to levels associated with more stable times. For example, the spread of one-month LIBOR to the overnight index swap—a measure of liquidity in the banking system—has fallen from a peak of about 340 basis points in October 2008 to roughly 10 basis points today (see Figure 8, Interbank Lending: LIBOR-OIS Spread). Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly. An aggregate measure of credit-default swaps for the largest U.S. banks reached over 450 basis points in October 2008; it is roughly 100 basis points today (see Figure 9, Credit-Default Swap Spreads for Financial Institutions).





The market for municipal bonds is also recovering from the financial crisis. The Recovery Act included an innovative new tool for municipal financing, Build America Bonds, which are taxable bonds for which Treasury pays a 35 percent direct subsidy to the issuer to offset borrowing costs. Build America Bonds are now providing State and local governments with access to low-cost financing that is providing them with a much needed economic boost.

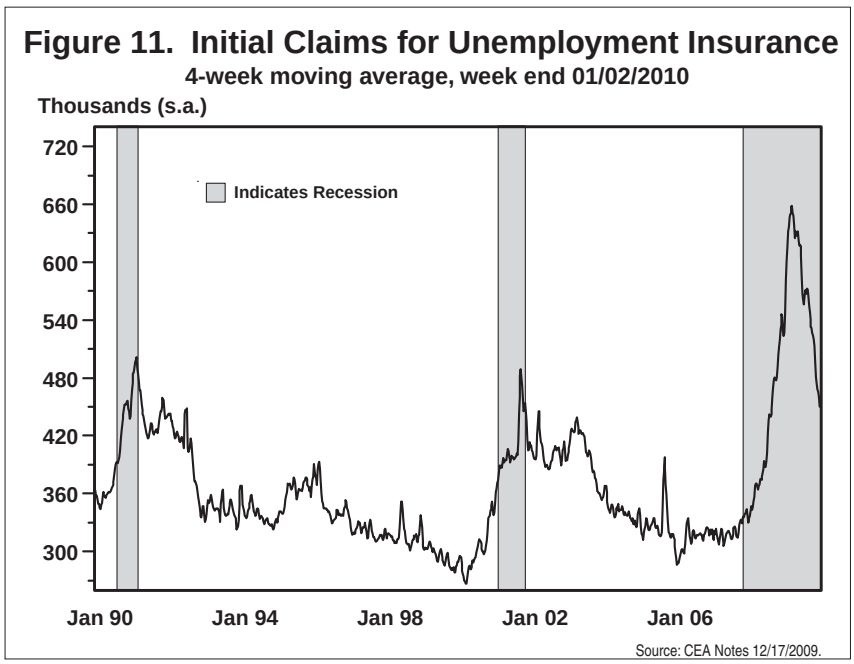
Housing markets likewise are showing some signs of stabilizing, and wealth is recovering; these real improvements in individual-level finances should stimulate consumer spending, which is a vital component to American economic growth. For example, household net worth increased by $2 trillion in the second quarter of 2009, the first increase since the second quarter of 2007.

As credit conditions have improved and with the macroeconomic boost of the Recovery Act, the economy has started to grow again. The economy expanded at an annual rate of 2.2 percent in the third quarter of 2009, and the Blue Chip consensus is for 4 percent growth in the fourth quarter. Private economists generally expect moderate growth over the next year, and in line with their estimates the Budget assumes that the economy will grow by an annual rate of 3.0 percent in 2010, and accelerate to approximately 4.25 percent annually over 2011 to 2013.

While the economy has turned a corner, there are still significant challenges that must be addressed.

Home foreclosure and delinquency rates remain too high (see Figure 10, Residential Mortgage Delinquency Rates), placing enormous pressure on American families and homeowners. Bank lending continues to contract overall, although the pace of contraction has moderated and some categories of lending are growing again. For example, commercial and industrial loans contracted at an annual rate of 27 percent in the third quarter, but 16 percent since then. Such loans are particularly important for small businesses, which generally cannot raise money by issuing debt in securities markets. Without access to capital, business expansion and job creation will be limited.

Perhaps the biggest challenge facing the economy, as we move from rescue to recovery, is the weak labor market. Far too many workers who would rather be earning a paycheck are on unemployment, left worrying about how to pay their mortgage or the rent, keep their health insurance, and continue to provide for their families. In November 2009, the unemployment rate fell to 10 percent and payrolls increased—for the first time since 2007—by 4,000 jobs. In December the unemployment rate remained constant at 10 percent, with a loss of 85,000 jobs. The fact that a single month of job gains, followed by a steady unemployment rate, is seen as progress points to the severe job loss the economy had experienced over the course of the recession (see Figure 11, Initial Claims for Unemployment Insurance).



The typical progression in a recovery is, first, that worker productivity increases as firms try to do more with their existing staff. Then, the number of hours worked increases for already employed workers as the economy picks up. Finally, as growth is sustained, companies begin hiring again. There are signs that this process is beginning to happen with this recovery as well. In the third quarter of 2009, non-farm business sector labor productivity increased by 8.1 percent on an annualized basis, the largest gain in productivity since the third quarter of 2003. There are signs that hours worked began to rebound in the fourth quarter of 2009. And hiring of temporary workers—a reliable leading indicator of full-time hiring—increased substantially in the fourth quarter as well.

Unfortunately, the progression to consistent and substantial job growth is not coming soon enough. Sparking job creation in the private sector is an urgent priority, one reflected throughout the Budget and in the policies put forth by the Administration. Americans are willing to work hard, and in return, they expect to be able to find a good job, afford a home, send their kids to a good school, receive high-quality and affordable health care, and enjoy retirement security in their later years. These are the building blocks of the middle class that makes America strong, and together they constitute the new foundation we seek for our economy. Our challenge is to put politics aside and take the steps now that will deliver on this promise for all Americans now and in generations to come.