Joint Economic Committee

WEEKLY ECONOMIC DIGEST

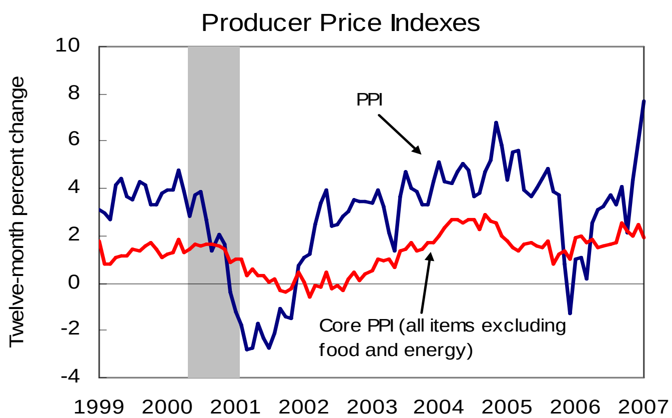
Senator Charles Schumer, Chairman
Congresswoman Carolyn Maloney, Vice Chair

December 17, 2007

ECONOMIC NEWS

Energy Drives Inflation Rates

Consumer prices rose in November. The consumer price index for urban consumers (CPI-U) rose by 0.8 percent on a seasonally adjusted basis in November, its largest monthly increase since a 1.2 percent rise after Hurricane Katrina in September 2005. Nearly 70 percent of the November increase was the result of rising energy costs. For the first eleven months of 2007, the CPI-U increased 4.2 percent at a seasonally adjusted annual rate (SAAR), compared to a 2.1 percent increase for all of 2006. The CPI-U excluding food and energy rose 0.3 percent for the month, and 2.4 percent for the first eleven months SAAR.



Note: The gray area indicates a period of recession as defined by the National Burea of Economic Research.
Sources: U.S. Department of Labor and National Bureau of Economic Research.

Producer prices also increased for the month. The producer price index for finished goods (PPI) rose 3.2 percent SAAR in November, following an increase of 0.1 percent in October. The acceleration in the PPI was led by a 14.1 percent surge in the price of energy goods for the month – gasoline prices rose 34.8 percent, and the prices of diesel fuel and asphalt also rose. Excluding food and energy, the monthly increase was 0.4 percent. The last time the PPI rose this much was in July 1974, during the oil crisis, when it rose 2.7 percent from the previous month. (See above).

Real earnings declined in November. Preliminary data from the Bureau of Labor Statistics show that real average weekly earnings declined by 0.4 percent on a seasonally adjusted basis in November. The 0.5 percent increase in average hourly earnings was more than offset by an increase in the CPI-W, the Consumer Price Index for Urban Wage Earners and Clerical Workers, the price index used by the BLS. (Using the CPI-U, the decline in the real wage would be 0.3 percent.) Real average weekly earnings have declined 0.8 percent over the past year.

IN FOCUS

Fed Acts on Slow Economic Growth, Problems in the Banking System

Last week the Federal Reserve took action on two problems, trying to head off an economic downturn and trying to help distressed banks. On Tuesday the Federal Open Market Committee announced a ¼ percent reduction in the target Federal Funds rate – the rate at which banks make overnight loans of reserves to each other. The reason given for the rate cut was slowing economic growth. The FOMC statement also cited a continuing risk of inflation, which may explain why the reduction was smaller than anticipated. (see Economic News for inflation data).

Wednesday brought a surprise policy change. The Fed announced a coordinated action with four other central banks. For its part, the Fed will conduct four auctions in which banks can bid for short term funds, pledging the kinds of collateral that are accepted for loans through the Fed's discount window. The first auction through the newly created Term Auction Facility (TAF) was scheduled for Monday, December 17, and was for $20 billion of 28-day funds. The second auction, on Thursday, December 20, will provide $20 billion of 35-day funds. More auctions are planned.

The central banks of the European Union, Britain, Switzerland and Canada will also hold dollar denominated auctions. The Fed is providing auction dollars through currency swaps to all but Canada.

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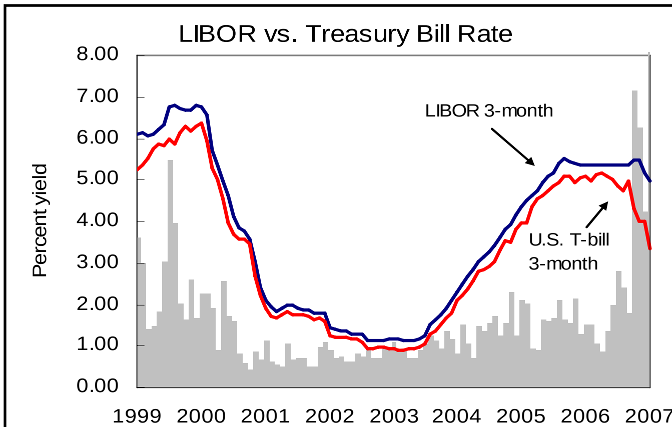
SNAPSHOT



Note: The gray area indicates the magnitude of the spread betw een the 3-month LIBOR and Treasury Bill rates.
Sources: Financial Times, Federal Reserve Board, and the National Bureau of Economic Research.

THE WEEK AHEAD

DAY	RELEASE
Tuesday, Dec 18	U.S. International Transactions (Third Quarter 2007) Building Permits and Housing Starts (November 2007)
Wednesday, Dec 19	State Quarterly Personal Income (First Quarter through Third Quarter 2007)
Thursday, Dec 20	Gross Domestic Product and Corporate Profits (Third Quarter 2007, Final) Leading Indicators (November 2007)
Friday, Dec 21	Regional and State Employment and Unemployment (November 2007) Personal Income and Outlays (November 2007) Core Personal Consumption Expenditures (PCE) Inflation (November 2007)

Friday Dec 21st: State Employment Numbers

THE ECONOMY AT A GLANCE

KEY INDICATORS	MONTH			QUARTER			YEAR	
	Nov	Oct	Sep	2007 Q3	2007 Q2	2007 Q1	2006	2005
Real GDP Growth (%)	—	—	—	4.9	3.8	0.6	2.9	3.1
Unemployment (% of labor force)	4.7	4.7	4.7	4.7	4.5	4.5	4.6	5.1
Labor Productivity Growth (%)	—	—	—	6.3	2.2	0.7	1.0	1.9
Labor Compensation Growth (%)	—	—	—	3.1	3.5	3.1	3.1	3.3
CPI-U Inflation (%)	10.0	3.7	3.7	1.9	6.0	3.8	3.2	3.4
Core CPI-U Inflation (%)	3.7	2.4	2.4	2.5	1.9	2.3	2.5	2.2

Sources: Bureau of Economic Analysis, U.S. Department of Commerce; Bureau of Labor Statistics, U.S. Department of Labor.

Notes: Except where otherwise noted, values in the table represent percent changes at seasonally adjusted annual rates. Productivity is output per hour worked in private nonfarm businesses. The Employment Cost Index is for civilian workers in government and business. Core CPI-U inflation is the percent change in the CPI-U excluding food and energy as reported by the Bureau of Labor Statistics. The designation "n.a." denotes that data are not yet available.

IN FOCUS (Continued)

So why did the Fed make these moves? Banks that have lost (and are losing) billions on failing subprime mortgage portfolios or structured investment vehicles (SIVs) are experiencing liquidity problems. Some of these banks have sold assets, and others have received large cash infusions from investors, but there are continuing needs for cash.

The overall liquidity problem is reflected in the market for interbank borrowing. Banks can turn to this market for unsecured loans when they need cash. But since the first rule of banking is "never lend money to someone who really needs it," banks now view each other as possibly undesirable counterparties. This, and the desire of banks to hoard cash during difficult times, has made interbank borrowing increasingly expensive. For example, the spread between the London Interbank Offer Rate (LIBOR) for three month loans and the three month Treasury bill rate has risen significantly since August. (See Snapshot).

The Fed created TAF because previous attempts to help liquidity-constrained banks have proved unsuccessful. The Fed Funds rate has been reduced by at total of 1 percent since September, without much impact. The discount rate has been reduced by 1.5 percent since August, and the permissible borrowing period has been extended from very short term to 30 days. But banks have not have not made significant use of the discount window, because discount borrowing has the stigma of financial distress. Hence the Fed introduced a new lending facility that avoids the opprobrium of the discount window, but allows banks to borrow against the same range of collateral.

But while TAF may have a positive impact by providing a new source of term borrowing, it may not be sufficient to fix the problems facing the banking system. If banks should prove to be insolvent, term lending cannot help them. In that case we will be talking about the moral hazard created by bailing out badly managed banks.