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RECENT ECONOMIC DEVELOPMENTS

NOVEMBER 6, 2007

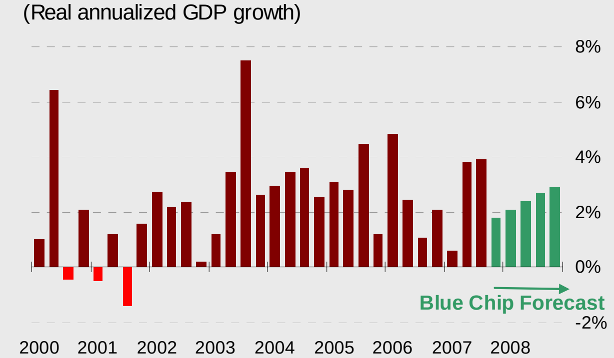
SOLID ECONOMIC AND JOBS GROWTH DESPITE THE DRAG FROM HOUSING

The inflation-adjusted (real) gross domestic product (GDP) increased at a robust 3.9% annualized rate in the 3rd quarter. Employment also continues to expand, with 166,000 new jobs added to payrolls in October. Strains in financial markets have eased since early August, yet still remain in some segments, and expectations are that the pace of economic expansion will moderate in the near term. With that backdrop, the Federal Reserve (Fed) cut its target for overnight interest rates by ¼ of a percent at its October policy meeting, on the heels of a more aggressive ½ of a percent cut at its September meeting. Housing market adjustments continue, including reductions in home sales and builder activities along with increased delinquencies and foreclosures on mortgages. Given those adjustments, declines in residential investment have shaved an average 0.83 percentage point from GDP growth over the past seven quarters. Offsetting the drag from housing, export growth has added an average 0.96 percentage point to GDP growth over the past seven quarters, perhaps reflecting effects of declines in the foreign-exchange value of the dollar.

Highlights

- *Payroll employment* rose in October by 166,000 new jobs. Over 8.3 million new jobs have been added in the past 50 consecutive months of job gains.
- The *unemployment rate* held at 4.7% in October.
- Real *GDP growth* was an annualized 3.9% in the 3rd quarter, on the heels of robust 3.8% growth in the 2nd quarter (Fig. 1).
- The Fed cut its target overnight interest rate by a quarter of a percent at its October policymaking meeting, in light of continued adjustments in financial and housing markets (Figs. 2-4, next page).

Economic Growth Since 2000 **Fig. 1**
(Real annualized GDP growth)



Sources: Bureau of Economic Analysis; 10/10/07 Blue Chip Economic Indicators

Over 8.3 Million New Jobs in 50 Months; Unemployment Rate at 4.7%

Payroll employment rose by 166,000 in October. In the past 50 consecutive months with job gains—a new record string of consecutive monthly gains—more than 8.3 million new jobs have been added to payrolls. Over the year ending in October, close to 1.7 million new payroll jobs have been created. The *unemployment rate* held steady at 4.7% in October, remaining well below the near-term peak of 6.3% in June 2003.

GDP Grew at a 3.9% Annualized Rate in the 3rd Quarter

GDP growth was 3.9% in the 3rd quarter, a slight acceleration from 3.8% growth in the 2nd quarter. Growth in the 3rd quarter primarily reflected continued resilience in consumer spending (which grew 3.0%—a solid rebound from 1.4% in the 2nd quarter), strong export growth (16.2%—the strongest since the 4th quarter of 1996), non-residential investment (which grew 7.9%), Federal and State and local government spending (which grew 6.8%), and inventory investment (which added 0.36 percentage point to the 3rd-quarter change in real GDP). Partly offsetting the factors that contributed positively to GDP growth were a decline in residential investment (which fell 20.1%, the 7th quarterly decline) and an increase in imports (which grew 5.2% and are a subtraction from GDP). Real GDP has grown for 24 straight quarters, with growth averaging 2.8% over that period.

Housing Adjustment Continues

Existing and new home sales have not risen for 22 consecutive months and the inventory of unsold new homes remains elevated (Fig. 2). *Home price* appreciation, by all available measures, has also slowed from the high rates observed in 2005. Some measures show declining home prices (Fig. 3). *Mortgage delinquency and foreclosure rates* have risen markedly since the start of last year, with large increases for subprime, adjustable-rate, mortgages.

Financial Markets Remain Jittery

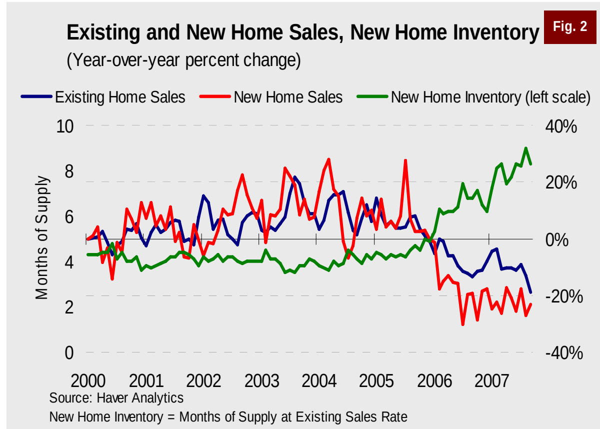
Losses suffered by mortgage lenders and mortgage-backed security holders, and uncertainty about risk exposures, led to a systemic *liquidity event* that began around August 9. While financial market strains have eased since that event, heightened risk aversion of lenders remains. Some markets remain disrupted, such as the market for asset-backed (AB) commercial paper. Some such paper represents financing used to acquire mortgage-backed securities. AB commercial paper outstanding fell by over 25% from a recent peak of $1.2 trillion in the week of August 8 to $875 billion in the week of October 31 (Fig. 4).

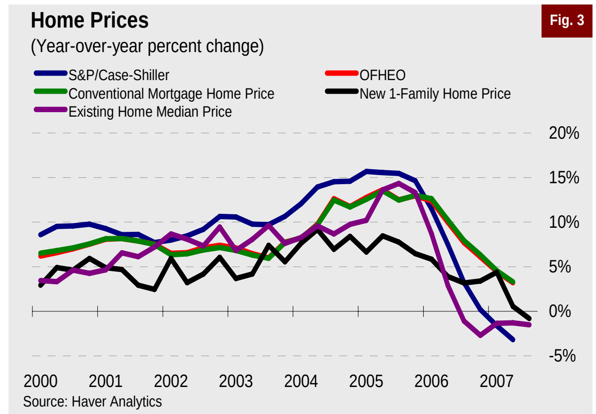
The Fed Eased Again

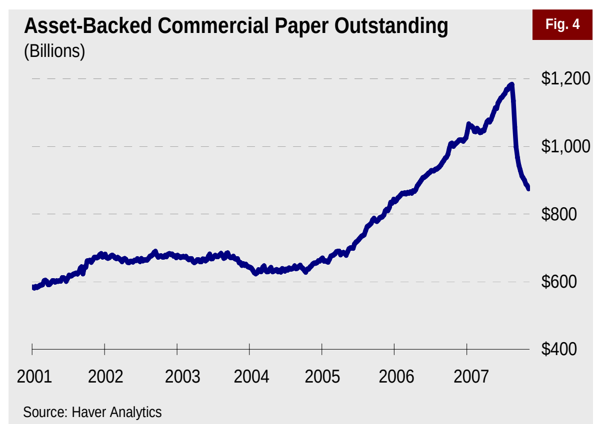
In efforts to help ease strain in financial markets that began in early August, the *Federal Reserve* cut its target for overnight interest rates by a quarter of a percent at its October policy meeting, on the heels of a half-a-percent cut at its mid-September meeting. The Fed has also cut its discount rate—the rate it charges on fully secured loans to commercial banks and other depository institutions. According to the Fed's October policy statement, those actions should "…help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets…" The Fed also acknowledged risks to inflation, including "…recent increases in energy and commodity prices…"

Energy and Commodity Price Inflation Escalates

Partly reflecting robust global energy demand, *crude-oil prices* have risen by roughly 50% this year to establish new record highs that reached over $90 per barrel. Strong global demand has also contributed to recent brisk *commodity price inflation.* The Commodity Research Bureau's spot commodity index, for example, has risen at year-over-year rates in excess of 20% for eight consecutive months through October.







Upcoming Indicators

Inflation – The Consumer Price Index for October is scheduled for released on *November 15*.

GDP – A second look at GDP for the 3rd quarter is scheduled for release on *November 29.*

Employment – The Bureau of Labor Statistics reports the November employment situation on *December 7.*

Federal Reserve – The Fed's next policy meeting is scheduled for *December 11.*