



JOINT ECONOMIC COMMITTEE REPUBLICANS

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RECENT ECONOMIC DEVELOPMENTS

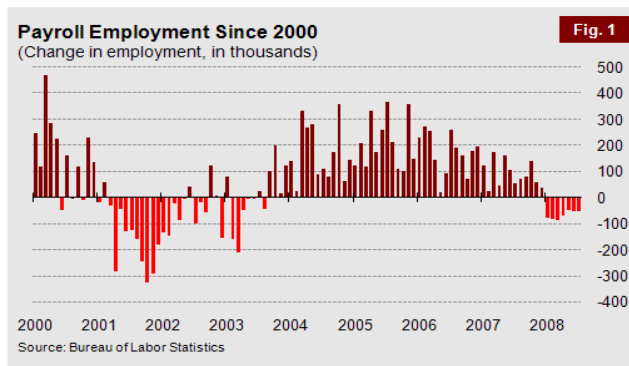
AUGUST 1, 2008

Unemployment Rate Up; Employment Down; GDP Growth Accelerates

The unemployment rate rose to 5.7%, in July, up from 5.5% in May and June and up from a near-term low of 4.4% in March of 2007. Payroll employment declined for the seventh consecutive month in July (by 51,000 jobs) and revised data on the inflation-adjusted (real) gross domestic product (GDP) show that real GDP declined in the 4th quarter of 2007, raising concerns about a recession. Perhaps buoyed by stimulus-payment effects on consumer spending, GDP growth was 1.9% in the 2nd quarter, up from 0.9% growth in the 1st quarter. Private forecasters see positive, though sluggish, growth throughout this year and a return toward more trend-like growth of close to 3.0% by the end of 2009. In light of rising risks of higher inflation, the Fed ended its recent campaign of cutting short-term interest rates at its policymaking meeting in late June, keeping its target overnight interest rate at 2.00%. Housing market adjustments continue.

Highlights

- The *unemployment rate* rose to 5.7% in July.
- Non-farm *payroll employment* declined by 51,000 in July, the 7th consecutive monthly decline (Fig. 1).
- *GDP growth* was 1.9% in the 2nd quarter and 0.9% in the 1st quarter. Revised data show that GDP declined in the 4th quarter of 2007 (Fig. 2, next page).
- *Sales and prices of existing and new homes* continue to decline, though there are glimmers of hope that levels of sales have stabilized (Figs. 3-5, next page).



Unemployment Rises to 5.7%; Seven Consecutive Months of Payroll Job Declines

The *unemployment rate* rose to 5.7% in July, from 5.5% in May and June and significantly above the near-term low of 4.4% in March 2007. *Payroll employment* fell by 51,000 jobs in July (Fig. 2, next page), the 7th consecutive monthly decline; over those seven months, there has been a decline of 463,000 payroll jobs. Reflecting adjustments in the housing sector, employment in the construction industry declined by 22,000 in July and has declined by 557,000 jobs since its recent peak in September 2006; (nearly three-fourths of the 557,000 decline in construction jobs has occurred since October of 2007).

1.9% Real GDP Growth in the 2nd Quarter; GDP Fell in the 4th Quarter of 2007

GDP growth was 1.9% in the 2nd quarter and 0.9% in the 1st quarter. The increase in 2nd quarter GDP primarily reflected consumer spending (up 1.5% at an annualized rate—perhaps buoyed by stimulus payments), exports (up 9.2%), non-residential structures (up 14.4%), federal government spending (up 6.7%), and state and local government spending (up 1.6%). Imports—a subtraction in the calculation of GDP—declined by 6.6%. Partly offsetting the factors contributing positively to growth were a decline in residential investment (down 15.6%), the real change in inventory investment (which subtracted 1.92 percentage points from the 2nd-quarter change in real GDP), and equipment and software spending (down 3.4%). Residential investment has fallen for 10 consecutive quarters, reducing growth in that period by an average of 0.96 percentage point. Over the same period, exports have added to growth by an average 1.03 percentage points. Revisions to GDP covering the 1st quarter of 2005 through the 1st quarter of 2008 showed that real GDP fell at a 0.2% rate in the 4th quarter of 2007, previously reported to be a 0.6% increase.

Housing Market Adjustments Continue

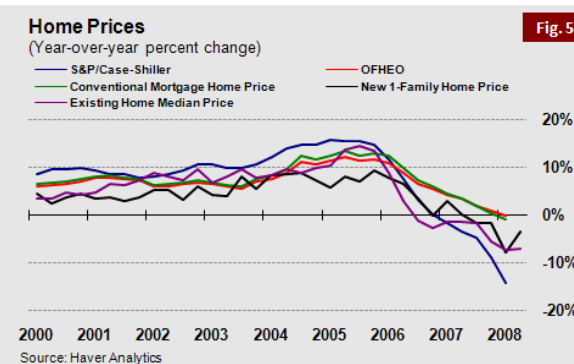
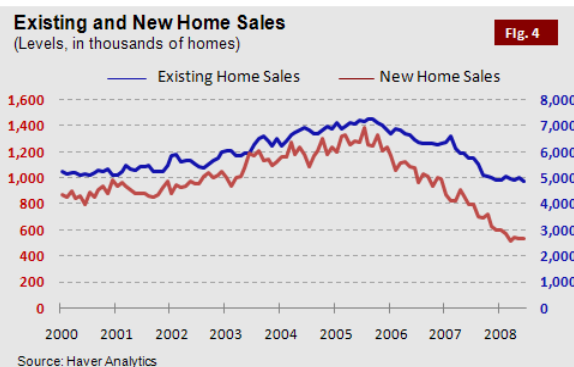
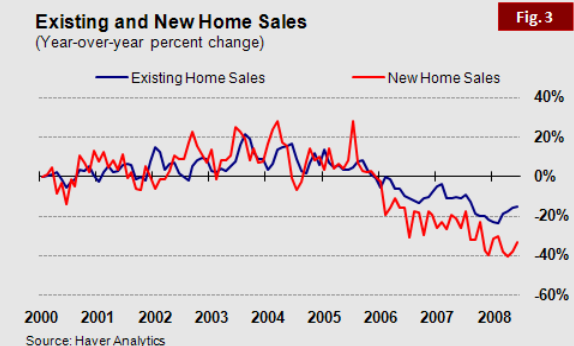
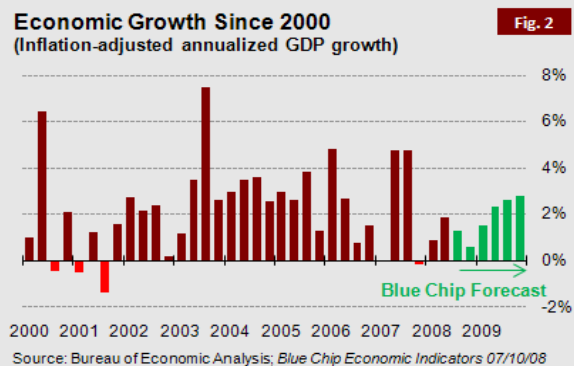
On a year-over-year basis, *existing and new home sales* have not risen since November of 2005 (Fig. 3). The inventory of unsold new homes remains elevated at 10 months, above the long-term average of 6 months. There is hope that levels of sales have stabilized, though it is premature to declare a trend (Fig. 4). *Home price* appreciation, by all measures, has slowed from the high rates in 2005 and most measures recently show declining home prices (Fig. 5). *Mortgage delinquency and foreclosure rates* have risen markedly, especially for sub-prime adjustable-rate mortgages, since the beginning of 2006.

Inflation Fears

Inflation in the core consumer price index (CPI), which excludes volatile energy and food prices, was 2.4% in June, an increase from the near-term low of 2.1% in August of 2007. Inflation in the overall CPI was 4.9% in June, up significantly from a 2.9% average last year. Much of the increase reflects rapid increases in energy prices; year-over-year inflation in the energy component of the CPI averaged 18.9% in the first half of this year. Year-over-year growth in the price of a barrel of West Texas Intermediate crude averaged close to 80% in the first half of this year, though the spot price level has fallen in recent trading weeks from over \$145 to below \$125. Gasoline prices have also retreated recently, from record nominal and real highs above \$4.11 per gallon of regular in the weeks ending July 7 and July 14 to \$3.96 in the week ending July 28.

Fed Expected to Hold Short-Term Rates Steady

Markets expect the Fed to keep its target overnight interest rate steady at 2.0% at its monetary policy meeting on August 5. The expectation for continued policy ease reflects ongoing adjustments in housing and financial markets along with concern about economic weakness. However, some members of the Fed's policymaking committee—the Federal Open Market Committee (FOMC)—have indicated concern about increasing consumer price inflation. In continuing efforts to soothe the financial markets, the Fed announced on July 30 that it will extend its new lending facilities (the Primary Dealer Credit Facility—PDCF—and Term Securities Lending Facility—TSLF) through January 30 of next year. The PDCF provides collateralized loans from the Fed's "discount window" to primary dealers at the Fed's primary credit rate, currently 2.25%. Under the TSLF, the Federal Reserve Bank of New York conducts weekly auctions of 28-day loans of Treasury securities to primary dealers, collateralized by private and government securities (the Fed is lending securities here, not cash). The Fed has also decided to introduce 84-day Term Auction Facility (TAF) loans as a complement to existing 28-day TAF loans. Under the TAF, the Fed auctions term funds to depository institutions, secured by collateral.



Upcoming Indicators

Federal Reserve – The Fed's next policy meeting is scheduled for *Aug. 5*.

Inflation – The Consumer Price Index for July is scheduled for release on *August 14*.

GDP – The second estimate of 2nd quarter GDP growth is scheduled for release on *Aug. 28*.

Employment – The Bureau of Labor Statistics reports August employment situation on *Sept. 5*.