



**RECENT ECONOMIC DEVELOPMENTS**

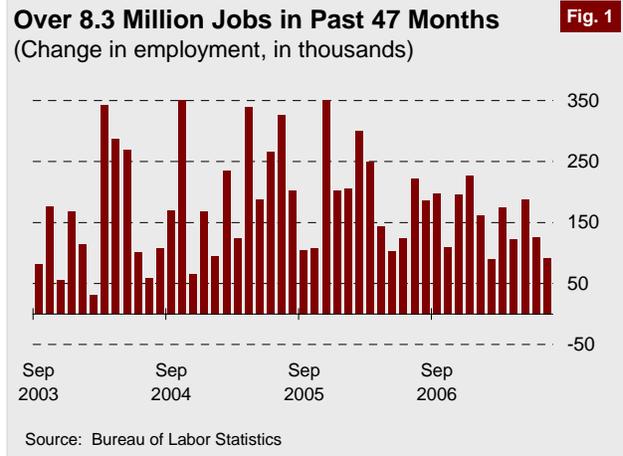
AUGUST 3, 2007

**GROWTH REBOUNDS, HOUSING CONCERNS REMAIN**

Economic growth rebounded in the 2<sup>nd</sup> quarter, with annualized growth in the inflation-adjusted (real) gross domestic product (GDP) rising to 3.4%. This is a significant acceleration from the modest 0.6% growth in the 1<sup>st</sup> quarter and represents the 23<sup>rd</sup> consecutive quarter of expansion of real GDP. Employment has also continued to expand; over 8.3 million new payroll jobs have been created in the past 47 months of consecutive job gains. Unemployment, at 4.6% in July, remains very low by historical standards. Private forecasters expect GDP growth to remain moderate in the near term as adjustments in the housing market continue and also expect growth to return to a more trend-like rate of around 3.0% next year. Housing market adjustments have included increased delinquencies on mortgages, causing some concern and, perhaps, re-pricing in financial markets.

**Highlights**

- Job gains continue; 92,000 new payroll jobs were created in July. Payrolls are up by over 8.3 million new jobs in the past 47 consecutive months of job gains (Fig. 1).
- The unemployment rate edged up to 4.6% in July and has ranged between 4.4% and 4.6% since last September (Fig. 2, next page).
- Real GDP growth rebounded to an annualized 3.4% rate in the 2<sup>nd</sup> quarter, up significantly from 0.6% 1<sup>st</sup>-quarter growth (Fig. 3, next page).
- Housing markets continue to cool: existing home sales fell 11.4% in June relative to a year earlier; new home sales fell by 22.3%.



**Over 8.3 Million New Jobs in 47 Months; Unemployment Rate at 4.6%**

*Payroll employment* increased by 92,000 new jobs in July – the 47<sup>th</sup> consecutive month with job gains (Fig. 1). More than 8.3 million new jobs have been added to payrolls in that period. Over the year ending in July, close to 1.9 million new jobs have been added to payrolls. During the past year, payroll job gains have averaged a healthy 156,000 per month. The *unemployment rate* edged up to 4.6% in July and has ranged between 4.4% and 4.6% since last September, well below the near-term peak of 6.3% in June 2003 (Fig. 2, next page).

**GDP Grew at a 3.4% Annualized Rate in the 2<sup>nd</sup> Quarter**

*GDP growth* was 3.4% in the 2<sup>nd</sup> quarter, a solid acceleration from the modest 0.6% 1<sup>st</sup>-quarter growth. The acceleration primarily reflected international trade (exports rose 6.4%, imports fell 2.6%), faster growth in federal government spending, an upturn in inventory investment, and a rapid acceleration in investment in non-residential structures. Consumer spending was notably slower in the 2<sup>nd</sup> quarter, growing 1.3% compared with 3.7% in the 1<sup>st</sup> quarter. Reflecting ongoing weakness in housing markets, residential investment fell, for the 6<sup>th</sup> consecutive quarter, by 9.2% in the 2<sup>nd</sup> quarter. That decline was, however, well below the average 16.4% in the previous four quarters. Real GDP has grown for 23 straight quarters and growth has averaged over 3.0% since the enactment of tax relief in 2003. The *Blue Chip* consensus of private forecasters sees a return to more trend-like growth of around 3.0% next year (Fig. 3, next page).

## Mortgage Delinquencies Continue to Rise

*Delinquency rates on mortgages* have generally been on the rise since the beginning of last year, with large increases in delinquencies on subprime mortgages with adjustable interest rates, which account for about 9% of mortgages outstanding. Rising delinquencies have begun to show through to new *foreclosures* (Fig. 4). Losses suffered by mortgage lenders and holders of securities backed by mortgage debt have increasingly led, many argue, to more general concerns in financial markets of spillovers to credit conditions outside the confines of the mortgage market. Recent easing of equity prices may reflect such concerns, with financial market participants re-evaluating and re-pricing risk.

## The Housing Sector Continues to Cool

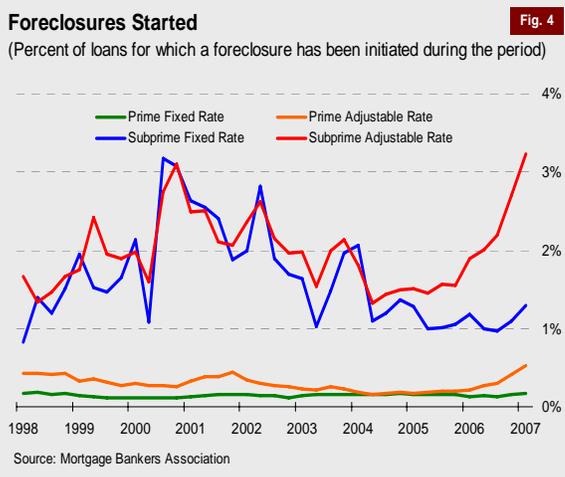
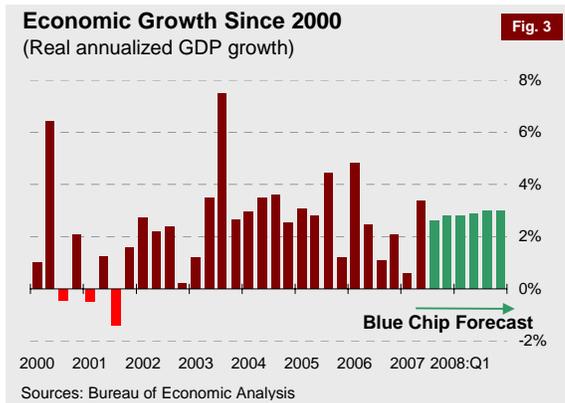
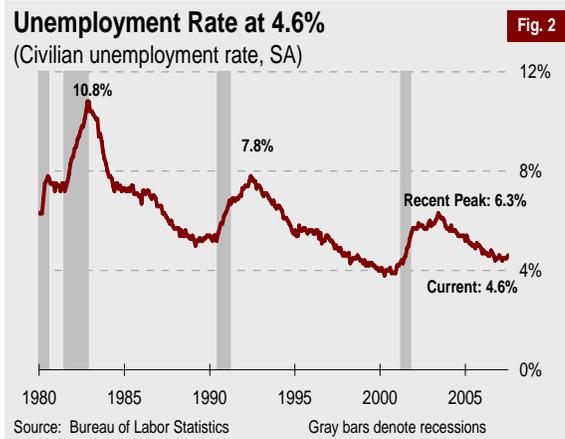
*Existing home sales* fell by 11.4% and *new home sales* fell by 22.3% in June relative to a year earlier. Home sales have not risen for 19 consecutive months. *House-price* appreciation has slowed and by some measures has turned negative. *Housing starts and permits* have each declined for 15 consecutive months through June on a year-over-year basis.

## The Fed Remains on Hold

The *Fed* kept its *target overnight interest rate* at 5¼% at its June policymaking meeting, the 8<sup>th</sup> consecutive meeting in which the target was unchanged. The Fed's last target-rate change was on June 29 of last year, when the target was increased by a quarter percent for the 17<sup>th</sup> consecutive time. That capped a two-year period in which the Fed pushed its target rate up from 1% to the current 5¼%, presumably in an effort to restrain inflation pressures. Despite those actions, long-term interest rates remain low. The Fed's monetary policymaking committee is scheduled to meet next on August 7.

## Weaker Dollar, Improved Trade Balance

The *U.S. dollar* has depreciated around 20% against a broad, trade-weighted basket of currencies since its recent peak in 2002 and has fallen close to 40% against the euro since its recent peak in 2000. Reflecting declines in the value of the dollar and strengthening of economies of many of our trading partners, the *U.S. trade and current account balances* have improved. The current account deficit (dominated by the trade deficit, but a broader measure of wealth flows between the U.S. and its trading partners) has fallen to 5.7% of GDP, an improvement from the all-time high of 6.8% in the 4<sup>th</sup> quarter of 2005. Net exports contributed a full 1.18 percentage points to overall GDP growth in the 2<sup>nd</sup> quarter of this year. Annualized export growth has averaged over 12% since the 3<sup>rd</sup> quarter of 2003.



### Upcoming Indicators

**Federal Reserve** – The Fed's next policy meeting is scheduled for *August 7*.

**Inflation** – The Consumer Price Index for July is scheduled for released on *August 15*.

**GDP** – A second look at GDP for the 2<sup>nd</sup> quarter is scheduled for release on *August 30*.

**Employment** – The Bureau of Labor Statistics reports the August employment situation on *Sept. 7*.