



# Popular Economics

*Promoting the Popular Understanding of Economics*

## Popular Economics Weekly

*Week of August 6, 2007*

### Good Employment Picture

Last week's unemployment report confirmed that "moderate" economic growth will continue for the rest of this year. It also confirmed the Federal Reserve's decision not to change interest rates at its August FOMC meeting. But fast changing conditions in the credit markets could cause the Fed to lower their rates come September. "Economic growth was moderate during the first half of the year. Financial markets have been volatile in recent weeks, credit conditions have become tighter for some households and businesses, and the housing correction is ongoing," said the FOMC press release. "Nevertheless, the economy seems likely to continue to expand at a moderate pace over coming quarters, supported by solid growth in employment and incomes and a robust global economy."

The Fed's inaction disappointed some analysts who had been calling for the Fed to acknowledge the plight of homeowners caught in the credit crunch. Some lenders are now only offering conforming mortgages that fit Freddie Mac and Fannie Mae guidelines. But good jumbo fixed and adjustable interest rates and programs are still available at lending institutions that did not leverage themselves too highly.

The July unemployment rate rose slightly to 4.6 percent, but that is still considered full employment. This may be one reason the Fed is reluctant to lower interest rates at this time. Fed officials are still seeing strong growth, in other words. Payrolls added just 92,000 jobs, below the 136,000 monthly average for 2007, but wages are rising and the consumer is still borrowing as if there is no tomorrow.

In fact, two crucial sectors in real estate—construction and financial services—have not had a net loss of jobs in 2007 to date, while two other sectors—insurance and securities—have continued to add jobs. This is not surprising in view of the fact that commercial real estate is booming, as new construction is finally catching up to the demand from the continued business expansion.

### Consumer Credit

Consumers borrowed another \$13 billion, up 6.5 percent in June. Credit card debt has averaged a whopping 10 percent jump in May and June, biggest increase since 2006, which means the housing slump hasn't done much to diminish consumers' so-called wealth-effect!

### Economic Growth

The initial estimate of real (inflation adjusted) second quarter Gross Domestic Product (GDP) growth jumped 3.4 percent, showing the economy had recovered from near zero growth in Q1. And inflation was tame, with the PCE core inflation that measures all consumer prices up just 1.9 percent. The growth spurt was mainly due to surging exports, which is helping to keep the U.S. economy at full employment.

We still have a 'goldilocks' that is not too hot or too cold, in other words, as we have said in the past. This GDP estimate also included revisions over the past 3 years, which showed that consumers had actually saved more and spent less than previously thought. In fact, the revisions show that our personal savings rate has been positive over the past 2 years. This is another reason to be optimistic about future economic growth (with little inflation).

The Federal Reserve has already begun to inject additional monies into the banking system to ease the credit crunch--\$38 billion as of this writing—while European banks have injected almost \$200 billion. This is an early sign that several central banks may begin to lower their interest rates. In fact, the odds continue to grow that the Fed will begin easing even before the September 18 FOMC meeting. This writer believes it now is a foregone conclusion.

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