JOINT ECONOMIC COMMITTEE
REPUBLICANS

Representative Jim Saxton, Ranking Republican Member

Senator Sam Brownback, Senior Republican Senator

RECENT ECONOMIC DEVELOPMENTS

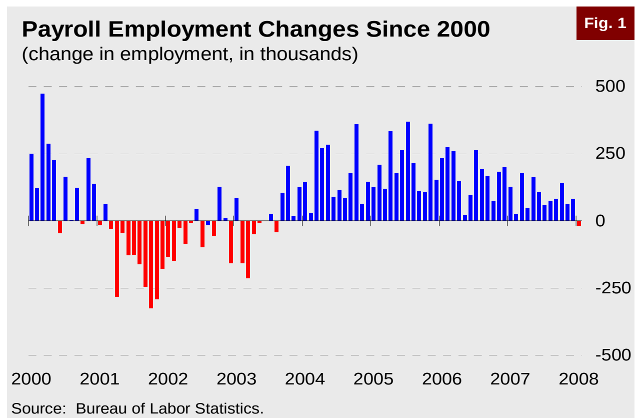
FEBRUARY 5, 2008

SOME SIGNIFICANT SIGNS OF SLOWING

The inflation-adjusted (real) gross domestic product (GDP) increased at a sluggish 0.6% annualized rate in the 4th quarter of last year. Payroll employment declined in January, the first month with a decline since August 2003. Financial markets remain under stress, which has led to tightening of credit for some businesses and households. With that backdrop, the Federal Reserve (Fed) cut its target for overnight interest rates by 50 basis points (a basis point is one hundredth of a percent) at its scheduled monetary policymaking meeting on January 30, following a more aggressive 75-basis-point inter-meeting cut. Housing market adjustments continue, including reductions in home sales and builder activities along with increased delinquencies and foreclosures on mortgages.

Highlights

- *Payroll employment* fell in January by 17,000, after a record 52 straight months with gains. (Fig. 1).
- The *unemployment rate* fell to 4.9% in January, from 5.0% in December. (Fig. 2, next page).
- Real *GDP growth* was an annualized 0.6% in the 4th quarter, following rapid 4.9% growth in the 3rd quarter and 3.8% in the 2nd. (Fig. 3, next page).
- The Fed cut its target overnight interest rate by 125 basis points in January amid signs of financial market stress, a slowing economy, and moderate "core" inflation. (Fig. 4, next page).



First Decline in Payroll Jobs in 53 Months; Unemployment Rate Edges Down to 4.9%

Payroll employment fell by 17,000 in January, after a record 52 straight months with job gains (Fig. 1). As a sign of slowing in labor markets, payroll job gains were an average 95,000 per month in 2007, compared with an average 175,000 per month in 2006. Reflecting adjustments in the housing sector, employment in *construction* declined by 27,000 in January and by 284,000 since peaking in September 2006. Payroll employment in *manufacturing* continues on its long-term trend downward, declining by 28,000 jobs in January and 269,000 in the past 12 months. The *unemployment rate* edged down to 4.9% in January, from 5.0% in December, but has risen by half a percent since a recent low of 4.4% in March of last year (Fig 2, next page).

GDP Grew at a 0.6% Annualized Rate in the 4th Quarter

GDP growth was 0.6% in the 4th quarter of 2007, down sharply from the rapid 4.9% growth in the 3rd quarter (Fig. 3, next page). Growth in the 4th quarter primarily reflected consumer spending (up 2.0% at an annualized rate, compared with 2.8% in the 3rd quarter), business investment (up 2.0%), state and local government spending (up 4.0%), and exports (up 3.9%). Partly offsetting the positive contributions to growth from those factors was a decline in residential investment (down 23.9%) and reduced inventories (which subtracted 1.25 percentage points from the 4th-quarter real GDP change). Residential investment has declined for eight straight quarters, reducing growth over that period by an average 0.87 percentage point. Over the same period, export growth has added an average 0.93 percentage point to GDP growth. Real GDP has grown for 25 straight quarters, with growth averaging 2.7%. Annual growth in 2007 was 2.2%, compared with 2.9% in 2006.

Housing Adjustment Continues

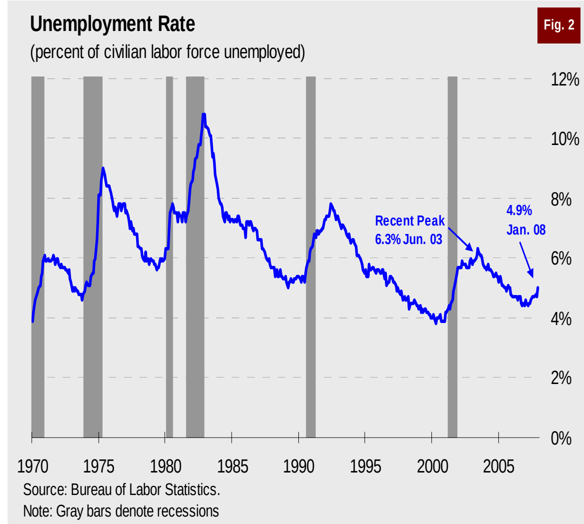
Existing and new home sales have not risen for 25 straight months on a year-over-year basis and the inventory of unsold new homes remains elevated at close to 10 months, well above the long-term average of 6 months. *Home price* appreciation, by all available measures, has also slowed from the high rates in 2005 and some measures show declining home prices. *Mortgage delinquency and foreclosure rates* have risen markedly, especially for sub-prime adjustable-rate mortgages, since the beginning of 2006.

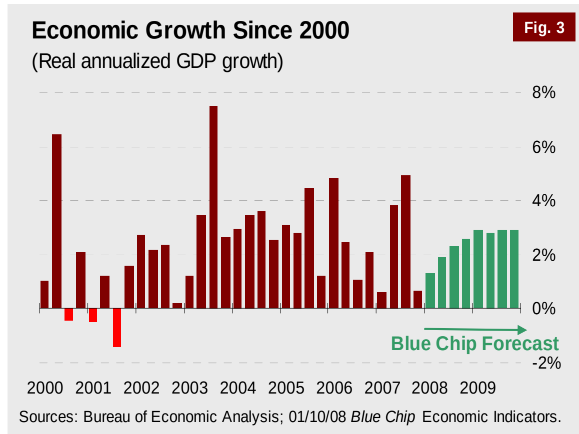
Fed Eases Given Market Stresses and Slower Economy

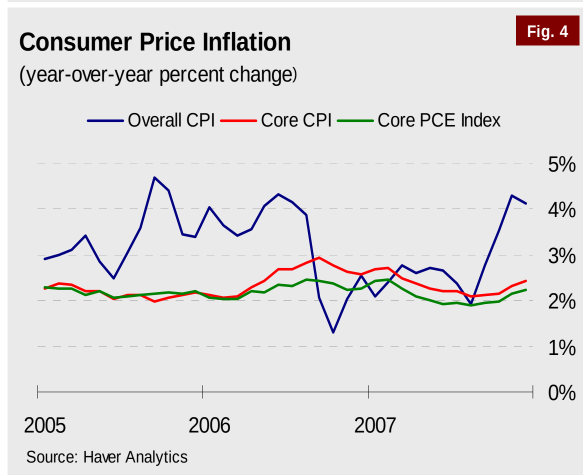
The *Federal Reserve* cut rates aggressively in January in efforts to ease stress in financial markets and promote economic growth amid signs of a slowdown. The Fed's January 30 policy statement said that, "…recent information indicates a deepening of the housing contraction as well as some softening in labor markets…" and that "…financial markets remain under considerable stress, and credit has tightened further for some businesses and households." With that sentiment, the Fed cut its target overnight interest rate by 50 basis points at its January 30 meeting, after a more aggressive inter-meeting cut of 75 basis points on January 22 which followed large declines in overseas equity markets on Martin Luther King Day. The Fed has also cut its discount rate—the rate it charges on secured loans to banks. The Fed expects inflation to moderate in coming quarters.

Energy and Food Price Inflation Remain High

Partly reflecting robust global energy demand, average *crude-oil prices* in 2007 rose 9.5% relative to a year earlier, the average price of a *gallon of regular gas* at the pump rose 8.9%, and the average price of a gallon of heating oil rose 12.8%. Food price inflation has also been elevated; inflation in the food component of the consumer price index (CPI) was nearly 5% in December 2007 and has been above 4% for six straight months, compared with rates averaging around 2.4% in 2005 and 2006. Inflation in the overall CPI was 4.1% in December 2007 and inflation in the "core" CPI, which excludes volatile food and energy prices, was 2.4% (Fig. 4). Inflation in the personal consumption expenditures (PCE) price index, the Fed's preferred measures of consumer prices, was 3.5% in December; inflation in the core PCE was 2.2%, remaining above what many take to be the Fed's 1-2% comfort zone for core PCE inflation.







Upcoming Indicators

Inflation – The Consumer Price Index for January is scheduled for release on *February 20*.

GDP – A second estimate of GDP for the 4th quarter arrives on *February 28.*

Employment – The Bureau of Labor Statistics reports February's employment situation *March 7.*

Federal Reserve – The Fed's next policy meeting is scheduled for *March 18.*