

ECONOMIC UPDATE—JULY 11, 2006

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THE U.S. ECONOMY AT A GLANCE: SOME KEY INDICATORS

| Indicator | Latest | Previous | | Comments | |
|--------------------------------|---------------|-----------------|-------|-----------------|---|
| CPI % change | May | 0.4 | Apr | 0.6 | Bothersome...up 4.2% year/year |
| Core (ex food & energy) | | 0.3 | | 0.3 | Ditto...now 2.4% year/year |
| PCE* Price Index | | 0.4 | | 0.5 | Not much better than CPI |
| Core | | 0.2 | | 0.2 | Still 2.1% year/year |
| Nonfarm jobs change thousands | June | 121 | May | 92 | Soft: confirming slowdown |
| Unemployment rate % | | 4.6 | | 4.6 | Still close to full employment |
| Average Hourly Earnings % ch | | 0.5 | | 0.1 | Now up about 4% year/year |
| Consumer Confidence (1985=100) | | 105.7 | | 104.7 | Flattish |
| Light vehicles millions saar | June | 16.3 | May | 16.5 | Flattish...incentives are back! |
| Housing starts | May | 1.96 | Apr | 1.86 | May rose but still trending down |
| New home sales | | 1.23 | | 1.12 | Ditto |
| Real Consumer spending | | 0.1 | | 0.2 | Quite soft since February |
| Real GDP % change saar | Q1:06 | 5.6 | Q4:05 | 1.7 | Rest of '06 like to be only half as fast as the first quarter |

Data are seasonally adjusted. Saar: seasonally adjusted annual rate. *Personal Consumption Expenditures.

Commentary: The economy is pretty clearly shifting into lower gear. Higher gasoline prices and interest rates have taken their toll on spending for housing and motor vehicles. During the past three months, real consumer spending—which is two-thirds of GDP—has risen at less than a 2% annual rate. This is down considerably from the 3 to 4% pace of 2004 and 2005. Over the same time span, nonfarm jobs have increased only 108,000 per month vs. 169,000 in the previous 12 months. Overall, CPI inflation has been running better than 4%. Core inflation (ex food and energy) now exceeds 2%—which is above what most observers feel in the Federal Reserve’s target or tolerance range. Looking ahead, GDP should grow about 2½% during the next four quarters, and the overall CPI should stabilize at 3%, providing oil prices stop rising.

Give Ben A Break! On August 1, Ben Bernanke will “celebrate” six months as Fed Chairman. He’s made a few missteps, but so did Greenspan in his early days. Some observers have been unnecessarily harsh in their criticism of the new Chairman. He has a well-deserved reputation as a much clearer speaker and writer than his predecessor, who not only liked to obfuscate, but had a penchant for awkward phrasing. However, anyone who expected Bernanke to clearly broadcast the Fed’s interest rate intentions should try some other line of work. His notion of “transparency” is a willingness to discuss Fed goals and strategies, not the next Fed Funds move. Plus, Bernanke took over at the very end of the tightening cycle that has spanned more than two years. Hence, Bernanke and the Fed do NOT know what they will have to do from here on out. Financial markets are betting that they’ll raise Fed Funds a final quarter point. That’s as good a guess as any. Meanwhile, the Fed will do as it said and clearly monitor the incoming data. If, as seems likely, GDP and jobs continue to grow slowly, they may have already finished the tightening cycle. Inflation is certainly not a big enough problem to risk tipping the economy into a recession by too much tightening.