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ECONOMIC NEWS UPDATE

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In just eleven days voters will troop to the polls to elect all 435 members of the House of Representatives, 33 of the 100 senators, 36 of the 50 state governors, and hundreds of state, city and local officials. Opinion polls suggest that the Republicans are in for drubbing, due to a combination of unhappiness with the Bush team's conduct of the war in Iraq, its perceived incompetence in responding to hurricane Katrina, and a variety of scandals, sexual and financial.

The administration quite naturally wants to change voters' focus to other matters, and has dusted off the old Clinton slogan, "It's the economy, stupid." In a round of calls to opinion makers, high administration officials are laying out their case. It goes like this. Ignore the low third-quarter GDP growth figures, driven down by a decline in the housing market. That decline has bottomed out, and non-residential construction is picking up the slack: total employment in the construction industry is actually increasing. The final quarter of the year will see a bit of an uptick, bringing the full-year growth rate to

about 3%. That's just fine, since the strain that retiring baby-boomers will soon place on the economy makes 2.5%-3.0% the rate of growth the economy can realize in the future without triggering inflation.

The administration's economists go on to point out that the labor market remains strong, with unemployment at a low 4.6%, new claims for unemployment insurance at low levels, and the revised job creation figures showing that in the year ending this past March the economy created 2.8 million jobs. This has enabled real average hourly wages of production workers to increase by 2.2%.

To emphasize the non-trivial nature of such an increase, the White House offers the following bit of arithmetic. The average family has an annual income of \$37,000. So a 2.2% increase gives it an additional \$800 of income -- the same sum the average family spends during the Christmas season. Ho, ho, ho and Merry Christmas.

Or not. Some of that \$800 will go to cover health care costs, which are

both rising and being increasingly borne by families rather than employers. Americans mention these health care costs more often than any important financial problem they face, and most are convinced that all the administration's talk of prosperity and economic boom has nothing to do with them.

The good news on the jobs and income front won't make it into the papers in Detroit or other areas dependent for jobs on the shrinking US auto industry, or beset by competition from imports. Over half of Americans say they are merely treading water, and about a quarter tell pollsters their living standard is declining. Stories of wildly increasing CEO compensation, the backdating of options to enrich executives who failed to meet performance targets, the closing of pension plans for rank-and-file workers while executive plans are improved, and headline layoffs that often trump job-creation figures might just be too much for the administration's too-long delayed economic-news offensive to overcome.

What we don't know is just how the slowdown in the housing industry will affect consumer spending and voters' attitude towards incumbent politicians. Existing home sales continue to decline, in September by 1.9%, and prices of those homes are down, by 2.2% compared with last year, according to the National Association of Realtors. But new home sales jumped, perhaps in response to lower prices (down about 10% last month), and the supply of homes for sales fell, suggesting that the administration might just have it right when it argues that the market is stabilizing. Economists at Goldman Sachs certainly think so. Their latest advisory concludes, "The point of

maximum deterioration in housing activity has probably passed."

My own guess is that the decline in house prices is less noticeable to consumers than the plunge in gasoline prices, which may explain the recent decline in voter irritation with Bush's management of the economy. The drop in prices of new homes hurts builders, not consumers, and any homeowner unhappy with the price being offered for an existing house can merely sit out the soft market.

Economists at Wachovia Corporation estimate the drop in gasoline added \$3.7 billion to the amount consumers had available last month to spend on other things, hence the robust sales figures being reported by chain stores. There is a saying on Wall Street that anyone who bet against the American consumer in recent years lost a lot of money, and there is an increasing feeling that consumers will continue to favor current gratification of wants over long-term savings.

The administration's problem remains: almost nothing it can say about the economy can distract voters from Iraq, which they seem to see as an unwinnable war being fought because squabbling Iraqis and their leaders just can't get a grip on the security problem. Republicans received no help from Iraq's prime minister Nouri al-Maliki last week. He quite publicly told Bush and his military advisers that they have no right to impose a time table for the Iraqis to assume responsibility for their nation's security, and criticized the American military for attacking a Shia militia stronghold in Baghdad. It was a "Yankee, don't dare go home until we tell you, but we'll say when, not you" talk that won't play well in hotly contested congressional districts.

The best news coming out of the White House will have no effect on the 2006 mid-term elections, but might, just might, enable the administration to improve its economic policy-making in time for the 2008 presidential elections. It seems that the old squabbling for power and control of economic policy has come to an end. Insiders say that a quartet of Ed Lazear, chairman of the President's Council of Economic Advisers; Treasury Secretary Hank Paulson; director of the National Economic Council, Al Hubbard; and Commerce Secretary Carlos Gutierrez have worked out an amiable division of labor, with Lazear the intellectual point man. When things calm down after the mid-term election, we should begin to find out whether this is too little, too late in the administration's quest for a coherent economic policy, as its many critics are claiming.



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