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ECONOMIC NEWS UPDATE

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Apocalypse Later

It seems that the apocalypse has been postponed. Just a few weeks ago there was an emerging consensus that the American economy is doomed to below-trend growth in 2007 at best, and a recession at worst. The tale of woe went something like this.

The housing market is in a state of collapse. Never mind the figures suggesting that sales are recovering, or that the Federal Reserve Board's analysts see signs of stabilization in the housing market: the data don't reflect the large number of contracts that have been canceled as speculators and prospective homeowners walk away from their deposits. Lay-offs in the important construction industry are sure to follow. Worse still, with house prices dropping like stones, consumers will no longer be able to borrow against the rising value of their homes to finance trips to the malls. Wallets and purses will be zipped, and the economy will stall.

That will create pressure on the Fed to lower interest rates. But it will be

unable to oblige with that shot-in-the-arm. A falling dollar would have pushed inflation up by raising the price of imported goods, and easing the pressure on domestic producers to keep prices down. Meanwhile, an anti-business congress will be attacking "big business", causing CEOs to pull back their companies' investment programs. Add a congress flirting with recession-encouraging protectionist measures, and you have apocalypse now.

A funny thing has happened on the way to that disaster. Instead of declining to below the third-quarter rate of 2%, the rate of economic growth in the fourth quarter of 2006 is preliminarily estimated to have come in at a healthy 3.5%. For the entire year, growth clocked in at 3.4%: that's above the 20-year average of 3.1%. Instead of retreating from the malls, consumers continued to spend, proving once again that no one ever got rich betting against the American consumer. Instead of collapsing, the dollar has merely drifted down, spurring exports (up 10%) and

causing imports to fall (by 3.2%). This might, just might, be the first sign that the trade deficit is beginning to return to sustainable levels.

Equally important, the upward path of oil prices, predicted by many to end with economy-stagnating \$100 oil, was interrupted by a slow-down in consumption -- higher prices matter to consumers. This caught the attention of the Saudis, who are increasingly nervous that the Western consuming countries finally mean it when they say they will develop technologies and policies to begin the long process of withdrawing from total reliance on OPEC oil. Like all sensible analysts, the Saudis know President Bush's proposal to convert most of the world's acreage to corn is more a political crowd-pleaser than anything else, and that "oil independence" is a myth American politicians have repeatedly set as their goal, only to watch reliance on imported oil rise from 35% to 60% of total consumption.

But the mere possibility of the implementation of programs that will slow the growth of demand has been enough to make the Saudis promise to keep the price of oil at around \$50 per barrel, rather than the \$70 that their hated rivals, president Mahmoud Ahmadinejad's Iranians, are calling for, and that Hugo Chávez desperately needs to shore up Venezuela's shrinking economy. The Saudi royal family sees \$70 oil, headed to \$100, as a bridge too far into a nuclear-ethanol-and-conservationist future that will leave them scratching around to pay for the life styles of their 5,000 profligate princes.

It is true that Saudis have recently cut production by about one million barrels per day in the face of

rising inventories, driving prices above \$55. But they have made their point: anyone investing in alternative fuels faces the risk of Saudi price-cutting that will make such investments uneconomic.

Meanwhile, Fed watchers who confidently predicted that a slow-down is upon us, and that it would force the Fed to cut short-term interest rates by mid-year, have gone back to their models to seek reassurance or to make changes in the inputs. Edward Lazear, Chairman of the President's Council of Economic Advisers describes the economy as "indeed very strong." Better still, it seems that higher-than-forecast growth has not triggered a new round of inflation. "Price and wage data," report economists at Goldman Sachs, are "more benign than expected on balance."

As a consequence, the Federal Reserve Board's monetary policy committee did not raise short-term interest rates at this week's meeting. Instead, it held the line at 5.25%, but maintained a wary eye on incoming data, poised to act should the strong economy show signs of triggering a round of inflation.

If all of this sounds to you like Rosy Scenario is back on the economic scene, you are no different from American consumers. Consumer confidence is at its highest level in five years, reports The Conference Board, a private research group. If you want to know why some critics of the liberal American media accuse it of peddling unremitting gloom, consider this headline in the New York Times, "A Rise in Consumer Confidence May Not Last, A Survey Suggests." Rather than emphasize the five-year high in confidence, the paper picked up an

Associated Press report that found significance in the fact that those who expect business conditions to worsen increased from 7.8% to 8.0% of those surveyed, and those who expected an improvement decreased from 16.7% to 16.2%. Never mind that these numbers show that twice as many of those surveyed expect business conditions to improve as expect them to worsen.

A strong job market, good economic growth, low inflation, and oil prices off their peaks are a wonderful offset to falling house prices and continued unhappiness about developments in Iraq. That does not mean that the economy might not yet be in for a bit of a bumpy ride in coming quarters. But it does mean that even if 2007 proves not to be the very best of times, it will certainly not be the very worst of times.



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