

ECONOMIC NEWS UPDATE

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Labor Day 2007: Americans Grill While Bernanke Ponders

As you read this, the backyards of America are alive with the sound of happy families. Outdoors, hot dogs and hamburgers are being grilled; indoors, couch potatoes are watching their favorite baseball team, the tennis matches at the US Open, and -- if the remote has been misplaced -- Fred Thompson announcing his plan to announce his candidacy later in the week to gasps of surprise from anyone who has been on Mars while the television star campaigned around the country in recent months.

Those of you who depend on the liberal media for your news might be surprised at the ability of Americans to enjoy this end-of-summer respite. After all, you know that the government is in disarray, with the President's most trusted advisers jumping ship in increasing numbers. And that we are finally getting our comeuppance for years of too-much-borrowing for too-big cars and McMansions that gobble energy and warm the globe. House prices are falling, 401ks just aren't worth

what they were a few months ago, the Iraqi government can't seem to capitalize on the successful surge, and not only London bridges are falling down. Indeed, the collapse of one of the tens of thousands of bridges in the United States received more press coverage than any event with the possible exception of the in-and-out rehab experiences of various celebrities, or the map-reading skills of a southern beauty.

No wonder, then, that Americans are in a deep funk. Except we aren't. The latest Harris Interactive poll shows that "Overall, Americans are definitely satisfied with the life they lead." Almost all -- 94% -- are either very satisfied (56%) or somewhat satisfied (38%). This is not only a very high figure. It is increasing -- from 91% in 2003.

Heard tales from various Democratic wannabees about "the other America", and about the huge numbers of Americans who have not shared in the nation's recent increasing economic prosperity? Odd, then, that over half of

all adults say their situation has improved in the past five years, and only 17% say it has gotten worse (about one-quarter say they are in about the same place as they were five years ago). The increasingly happy folks are concentrated in the South and the West, where over 60% of people say their lives have improved; only 42% of Easterners think they are better off than they were five years ago. That might be because those are the very people who are daily exposed to the relentlessly negative and gloomy New York Times, Washington Post and Boston Globe. Or, as my Hudson colleague, Diana Furchtgott-Roth, puts it, because there are more liberal Democrats in the East, and they are unhappy "even when they are well off". For them, the Bush administration is just not moving quickly enough to establish universal government-run health care, adopt anti-global warming measures, and higher taxes on the rich. But even the East's Gloomy Gusses expect life to improve: 56% expect things to get better, with the young leading the optimists' parade and the majority of older people expecting to maintain their current positions.

Note that all of these data relate to how people feel about their personal lives. When it comes to the country, only 19% say America is moving in the right direction. This is one of those odd phenomena -- most people are satisfied with their own school systems but say U.S. education is a mess; most people like and re-elect their own congressmen, but hold Congress in low repute (18% approval rating); most people like the immigrants, legal and illegal, who work for them, but are against immigration in general. Familiarity breeds enchantment, and distance lends

contempt when it comes to voters' assessments of American institutions.

And of those institutions, the one that is far and away held in the greatest respect is the military. Abu Ghraib, difficulties on the ground in Iraq, Guantanamo, extension of service stints -- none have dented the high standing of the military in the eyes of Americans, points out poll-analyst Karlyn Bowman.

Meanwhile, on the economic front the good news is that not all of the news is bad. Yes, the housing market is in disarray, with inventories of unsold houses rising, prices falling, and many families unable to meet their mortgage obligations. And yes, more bad news is to come when low, initial mortgage interest rates are "reset" at higher levels. By that time, many hedge funds will have taken big losses, many one-time mortgage brokers will be bagging groceries, and deal-makers will have settled for merely ample, rather than obscene profits. More important, the excesses of the age of too-cheap credit will have been sweated out of the system, in still another example of the market's capacity for self-correction.

Whether the troubles in the credit and financial markets will do more than slow the growth of the "real" economy is the subject of considerable debate. The economy grew at an annual rate of a healthy 4% in the second quarter, driven by an 11.1% jump in business investment, but that was before recent upsets in financial markets. Last month sales of durable goods rose by a healthy 5.9%, but other indicators suggest consumers are starting to rein in their spending. The unemployment rate has been a low 4.6%, but that was before the lay-offs in the financial services and residential construction industries were

tallied. Banks' balance sheets seem healthy, but the markdowns in the value of some of the dicier assets have not yet been factored in. World growth has been robust and driven US exports, but that was before the problems in German, UK and other financial markets made themselves felt, and before the Chinese authorities decided to put their foot on the brakes with a bit more force.

Some analysts are convinced that unless the Federal Reserve Board's monetary policy committee cuts interest rates no later than its September 18 meeting -- sooner would make nervous Wall Streeters happier -- the economy will lapse into recession. The Fed is listening: Chairman Ben Bernanke says he is "prepared to act as needed."

But the Fed has to worry about two things. First, Bernanke does not want to send a signal to the markets that no matter how imprudent its lenders might have been, he will bail them out. That would create what economists call "moral hazard". Second, he has to consider whether a cut in interest rates might add to inflationary pressures. Core inflation -- excluding food and energy -- is tame. But include those items -- people do eat and do drive -- and the situation becomes complicated. The original reason for excluding food and energy was that prices of those commodities tended to be volatile, making monthly changes unrevealing of underlying trends. But that was then and this is now. We might be witnessing -- not volatility -- but a long-term upward trend in oil and food prices. The OPEC cartel has learned to gear its members' output to the level of crude and petrol inventories, putting a floor under prices at a time when production is not keeping pace with demand.

And food prices are now reflecting the decision of several governments to convert corn and other products to petrol in the tank rather than food on the table. This creates a new source of demand, which will drive food prices up, at least until supply can catch up.

Bernanke knows all of this. He knows, too, that an unnecessary cut in rates would scupper his anti-inflation policy, and a too-long delayed reduction will tip the economy into recession. So he will have a somewhat more fraught Labor Day weekend than the vast majority of satisfied-with-life Americans. But my guess is that in the end he will take comfort from Friday's report that incomes and spending are rising at a rate that suggests the economy will grow nicely for the rest of the year, with inflation at unworrying levels, and conclude that his current policy is just about right.