

Suite 502

1150 Seventeenth Street, N.W., Washington, D.C. 20036

Telephone: (202) 777-3000 Facsimile: (202) 777-3010

ECONOMIC NEWS UPDATE

IRWIN M. STELZER

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Want to be a Central Banker? Think again.

If you ever get the feeling that you want to be a central banker, lie down until the feeling passes. Consider the problem of Federal Reserve Board chairman Ben Bernanke as he decides whether the economy is headed towards recession, in which case he should lower interest rates; whether inflation is taking hold, in which case he should raise them; or whether steady-as-she-goes might not be the wisest course.

Bernanke has made it known that he and his monetary policy committee will be guided by incoming data. So let's look at those numbers.

Preliminary figures show that first-quarter growth slowed to 1.3 percent. The housing market remains mired in slump. Sales of existing homes in March fell by over 8%, the biggest drop in 18 years, and sales of new homes were 25% below year-earlier levels. And those figures understate the problem, as they don't include cancellations of contracts as buyers try

to figure out how to run away without losing their deposits. House prices are down and inventories of unsold homes are up. The tightening of lending standards resulting from the mess in the subprime market has made it impossible for some potential buyers to get financing on manageable terms, and many buyers who can get acceptable financing are waiting for prices to fall further.

Many believe the housing sector's problems have only begun to affect both the jobs market and consumer spending. Some 100,000 construction workers have already been laid off, not counting the tens of thousands of illegal immigrants who have lost construction jobs but are not counted in the surveys. With for-sale signs decorating over two-million housing units, construction won't pick up very soon. And consumers are showing signs of becoming more miserly: the savings rate is markedly up.

All of which has helped to keep recorded inflation at relatively modest levels. The most closely watched figure, the “core personal consumption expenditure”, which excludes food and energy, was flat in March. Year-over-year, the index rose at an annual rate of 2.1% in March, down from 2.4% in February. That’s only a tad above Bernanke’s comfort range of 1%-2%.

So score one for those who want the Fed to lower interest rates to stimulate the economy. But a central banker’s life is never simple. True, job creation in April was the lowest since November 2004, a sign of cooling. But the unemployment rate, at 4.5% (up a tick from 4.4%, but would have gone higher had several hundred thousand not dropped out of the labor market), remains much below the 6% level that the Fed believes would ease pressures on wage rates. Equally worrying, productivity growth has fallen from around 4% earlier in the decade to well under 2%, so that higher wages eventually will be reflected in higher labor costs, putting pressure on prices. To prove that data-reading is never easy, emphasize “eventually”, since the employment-cost index has, at least so far, not rocketed up.

The Fed will also wonder whether it is any longer sensible to exclude food and energy prices from its considerations. That exclusion was created because of the volatility of those prices. But food prices might well be on a new plateau, as an insane dash to produce biofuels takes acreage out of food production and cuts into supply. And it is certainly arguable that OPEC’s new solidarity has pushed energy prices to a new plateau, and that those prices will permanently affect inflation trends. For example, gasoline prices, already

over \$3 per gallon nationwide -- the level that shocked the nation in the days immediately following hurricane Katrina -- are driving up shipping costs. That’s inflationary, and would be even more so if, as some are predicting, inadequate refining capacity pushes prices to \$4 per gallon.

But Wal-Mart’s income-limited customers are trying to beat higher petrol prices by making fewer trips to and purchases at its stores, and consumers are taking cars and light trucks off showroom floors at the slowest annual rate in almost a decade. That should slow the economy and ease inflationary pressures. So higher gasoline prices might or might not add to inflationary pressures, all things considered. As a central banker, you would have to decide.

Then there is the falling dollar, now at the lowest level it has reached in the 36 years the Fed has been keeping records. The cheap dollar is responsible for the growth in exports. Made-in-America business equipment is now more competitive in Europe and elsewhere. And bargain-crazed British and European consumers, among them one Leyre Gonzalez, my assistant, no fan of the “strong dollar” that Treasury Secretary Hank Paulson persists in pretending the administration favors, descend on New York in such numbers that an amused Guardian (the left-leaning British newspaper) reports a new pastime in the Big Apple -- a game of “spot the Brit” that New Yorkers are playing on major shopping streets.

Americans are less happy with the shriveled greenback than the new tourist wave -- airline bookings from London to New York are up 30%. Instead of boasting about house prices at dinner parties, Americans regale their

friends with reports of the prices they paid for a pizza or a cup of coffee on their recent trip to London. Personal experience at Pizza Hut in London: two small pizzas, a Diet Coke and a glass of plonk, £25, or \$50.

The lower dollar also makes imports more expensive than they have been in more than ten years, making it easier for domestic manufacturers to raise prices without fear of losing business to foreign competitors. That has the Fed inflation hawks worried.

Finally, there are indications that the economy is overcoming the downward drag of the housing sector. My guess is that the anemic preliminary first quarter GDP-growth figure of 1.3% will be revised upward to close to a respectable 2%. New orders for computers and other business equipment jumped in March. Thanks to rising overseas demand, the manufacturing sector recorded upticks in production and new orders in April, and the more important service sector grew at a brisk rate.

So if you were a central banker you might reasonably feel that tame inflation and slower job creation allow you to cut interest rates to stimulate the housing sector and offset slower consumer spending. Or you might decide that the economy is strong, rising wages are inflationary, high petrol prices are leaking through to fuel-consuming industries, and that the falling dollar will make it easier for domestic companies to raise prices by reducing competition from imports. So best to raise rates, especially since share prices seem to be bubbling to unsustainable levels.

Or you might be satisfied that relatively low inflation, strength in the manufacturing and service sectors, low unemployment, a weaker dollar that will

cut into the trade deficit, and a pricked housing bubble are just what you had in mind when you set rates at 5.25%, and do nothing. My guess is that Bernanke will do just that -- steady as she goes.



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