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Introduction:

During early-June 2006, a memo was submitted by this student demonstrating that the American economy could be expected to grow in excess of 3 percent during the succeeding 12 months. Now, 5 months later, dynamic changes have taken place in the economy such that some of the economic indicators have been negatively trending during the subsequent period; however, the overall outlook for the year is in keeping with earlier predictions. This paper will provide an update to the figures contained in the June memo, along with an analysis of the causes for the adjustments, and a conclusion about the continuing prediction for an approximate 3.1% annual growth rate. Included will be a discussion of several key economic indicators, such as business investment, new job creation, unemployment rates, production of goods, mortgage rates and new housing starts.

Analysis:

- Business investment. Business investment continued robustly, increasing at an 8.6% rate, compared with a 4.4% increase in the second quarter. Investments in equipment and software increased at a 6.4% rate, after falling 1.4% in the previous quarter (Robb, 2006). This business expansion has led to a substantial increase in employment, a prime mover of economic growth since more jobs equals more money being spent on consumer goods and services. Wages and salaries, the largest component of personal income, increased 0.2 percent during August and 0.5 percent in September, as reported by the Bureau of Economic Analysis (BEA, 2006). Growth turned up in private industries, reflecting an overall upturn in services industries. The upturn in real consumer spending reflected upturns in spending for durable and nondurable goods (Ibid).

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- Employment increased in October, and the unemployment rate declined to 4.4 percent. The table below shows the steady growth in jobs during the past several months, according to the Bureau of Labor Statistics of the U.S. Department of Labor (BLS, 2006).

(Numbers in thousands)

Category	Quarterly averages		Monthly data		
	2006		2006		
	II	III	Aug.	Sept.	Oct.
Civilian labor force.....	151,041	151,677	151,698	151,799	151,998
Employment.............	144,009	144,586	144,579	144,850	145,287
Unemployment...........	7,032	7,091	7,119	6,949	6,711
Not in labor force.......	77,392	77,490	77,469	77,621	77,677
	Unemployment rates				
All workers.............	4.7	4.7	4.7	4.6	4.4

- The output of goods and services produced by labor and property located in the United States is termed the “Gross Domestic Product” (GDP). During the first quarter of 2006, the GDP increased at an annual rate of 5.3 percent. After a 2.6% increase in the second quarter, however, U.S. economic growth slowed sharply, when the GDP increased at a seasonally adjusted annual rate of just 1.6%, according to the Bureau of Economic Analysis (BEA, 2006). It is notable that disposable personal income made a healthy 0.5% gain in nominal terms; and, with inflation working in the consumer’s favor for a change, the real gain was 0.8%. This would be consistent with the uptick in October consumer confidence as measured by the University of Michigan, which was at its highest rate in 15 months during October.

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- The housing market continues to suppress the overall pace of growth, subtracting 1.1 percentage points for third-quarter growth. Investments in housing fell 17.4% in the third quarter, the largest decline since the first quarter of 1991. "The housing market did a real number on economic growth in the summer, overwhelming solid consumer and business spending," said Joel Naroff, president of Naroff Economic Advisors (2006).
- With regard to mortgage interest rates, during the period from February 2005 through October 1, 2006, the Federal Reserve attempted to stem the inflation rate by progressively increasing the Fed Funds rate from 2.5% to 5.25%, causing the Prime Rate to increase from 5.5% to 8.25%, where it has held steady since Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke's (2006), July Monetary Policy Report to the Congress. The annual inflation rate is still above the Federal Reserve's 1.5% to 2% comfort zone, and Fed officials have stressed their discomfort with the continued high inflation rate, but have said they expect inflation gradually to ease as the economy continues to grow at a moderate pace in coming quarters. It is probable that the Fed will not cut rates with the unemployment rate falling.
- The rise in mortgage rates has resulted in a concurrent slowing of home purchases. As home sales slowed and the inventory of unsold homes climbed, home prices declined. Spending on home building dropped at a rate of 17.4 percent in the third quarter. That was the biggest drop since the first quarter of 1991 when such spending was sliced at a 21.7 percent pace. Further, weak inventory building by businesses and the bloated trade deficit also played roles in weighing down economic activity in the third quarter. That, in turn, contributed significantly to the slowdown in economic growth to below the 5+ percent rise of the GDP experienced during the preceding 12-month period.

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Conclusion:

The combination of the economic indicators presented in this memo demonstrates that the United States topped off its upward growth during the second quarter and is now experiencing a downward trend in the state of the economy, overall, led primarily by the slowdown in the housing market. The mid-2006 consensus forecast of 56 economists surveyed by The Wall Street Journal (Annett, 2006) indicated that the nation's gross domestic product -- the broadest measure of economic output -- would grow at an annual rate of 3.1% in the second half of 2006. The actual average through the first 3 quarters has been 3.27%, so, in order for overall 2006 growth to average 3.1%, as predicted by this student in June, the GDP will need rise to a 2.6% annualized rate during the final quarter of 2006.

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