Popular Economics Weekly

WEEK OF FEBRUARY 12, 2007—BERNANKE MOVES MARKETS

New Fed Chairman Ben Bernanke seems to be wearing the Greenspan mantel very well. The Chairman's congressional testimony was notable for its strong pronouncements on the health and vitality of the U.S. economy—strong consumer spending, good job growth, and falling inflation. Bernanke even predicted that the core inflation rate (without food and energy prices) would fall below 2 percent in 2008—which he pegged as the upper inflation limit that would allow 'sustainable economic growth".

On the other hand, (Why are there no one-armed economists? goes the old joke.) he continued to warn about the dangers of inflation. This prompted Barney Frank, Massachusetts Democrat, to ask him if this wasn't a contradiction, since how could waning inflation be dangerous? Bernanke's answer was that he couldn't be sure that economic activity would not strengthen and cause higher inflation later in the year.

Be that as it may, January's numbers show substantial weakening in economic activity. The unemployment rate ticked up to 4.6 percent and job loss announcements are picking up—witness Daimler Chrysler, Pfizer, Ford and other major corporations' planned downsizings.

Industrial production, wholesale prices (PPI) and new home construction also plunged in January. The decline in PPI is a sign of falling raw materials' prices, including oil and gas, which means a lower demand for goods and services. Chairman Bernanke also voiced concern over the falling level of inventories that businesses are in no hurry to replenish.

Bernanke cited robust consumer spending and incomes in Q4 2006 in his recent testimony as the reason for his inflation fears. Consumer spending increased 3.5 percent annually, yet incomes rose just 3.0 percent. This means consumers continue to borrow more than they earn.

But retail sales were unchanged in January. All of this makes the case for far less certainty in the direction of economic growth. The Federal Reserve should be talking about the prospect of slower growth, not rattle consumers with threats of higher interest rates. Such talk probably caused consumer sentiment index to fall in February after rising to a 2-year high in January.

CONSUMER SENTIMENT—The U. of Michigan's February sentiment index fell to 93.3 from January's 96.9, as consumers had anticipated more job growth and higher incomes in the new year, according to survey director Richard Curtin. But uncertainty about future job prospects is beginning to weigh in.

HOUSING STARTS--U.S. home builders started the fewest homes in nearly a decade last month, as housing starts plunged 14.3% to a seasonally adjusted annual rate of 1.408 million, the Commerce Department reported Friday. January's rate was the lowest for housing starts since August 1997. Starts were down 37.8% compared with January 2006, the largest year-over-year decline since early 1991.

WHOLESALE PRICES--U.S. wholesale prices fell in January because of sharply lower energy prices, while core producer prices increased modestly, reported the Labor Department. Wholesale prices fell 0.6% in January, after two sizable gains in November and December, as energy prices fell 4.6%.

INDUSTRIAL PRODUCTION--U.S. industrial production fell in January by the largest amount since Hurricane Katrina devastated the Gulf Coast in September 2005, the Federal

Reserve reported Thursday. Industrial output of the nation's factories, mines and utilities fell 0.5% in January, the fourth decline in the past five months.

Automakers and other producers are slashing production to bring down their inventories of unsold goods. The decline in factory output was even steeper, with production down 0.7%. Production of motor vehicles and parts fell 6%. Vehicle assemblies fell to their lowest level in nearly a decade.

The future of interest rates controlled by the Fed will certainly be governed by what happens to jobs in manufacturing. Seasonally adjusted initial jobless claims increased by 44,000 to 357,000 in the week ending Feb. 10, the Labor Department said. It's the highest level since late November. And it's the largest weekly increase since September 2005, just after Hurricane Katrina devastated New Orleans.

So we wonder how much longer Chairman Bernanke can maintain that inflation remains a danger.