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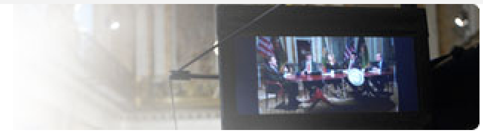

Treasury Assistant Secretary for Economic Policy Phillip Swagel Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

1/28/2008

Washington- Economic growth appears to have slowed in late 2007, and is likely to remain sluggish through the first half of 2008. Labor market conditions softened notably in December, as job growth slowed and the unemployment rate jumped to 5.0 percent. Core inflation has remained contained, even as a pickup in energy prices boosted headline inflation at the end of the year. Against this background, the bipartisan tax relief proposal agreed to by the Administration and House leadership has the potential to provide meaningful and well-timed support for economic activity in mid-2008 and into 2009.

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Data already in hand suggest that Q4 GDP moderated substantially from growth of nearly 4 and 5 percent in Q2 and Q3, respectively (the first read on Q4 GDP data will be released on Wednesday, January 30). Slower growth of both consumption and investment appear to have offset continued support from exports and government purchases. The December retail sales report points to a slower pace of consumer spending, and housing market indicators suggest that residential investment posted another substantial decline in the fourth quarter. Shipments of core capital goods through November point to a modest pace of spending on business investment in the fourth quarter. (Data on orders and shipments of durable goods in December to be released on Tuesday, January 29 will provide further evidence on the trajectory of business spending.)

Exports remain a source of strength, with exports of goods and services up by 13 percent over the 12 months ending in November. Despite the solid export performance, recent increases in imports, including a higher volume of oil imports, suggest that the contribution of net exports to real GDP will be smaller than the 1.4 percentage point boost seen on average in the second and third quarters.

Early data for the first quarter of 2008 are mixed. Initial claims for state unemployment insurance dropped back to just over 300,000 per week after having risen above 350,000 per week in November and December, and consumer sentiment rebounded in the first half of January, recouping nearly all of the loss recorded over the previous two months. At the same time, regional measures of manufacturing activity point to a weakening factory sector, and homebuilder confidence remains close to a record low. Private forecasters generally expect growth to remain sluggish, with consensus forecasts around 1-1/2 percent for the first half of 2008.

While the economy is expected to continue to grow, the risks of a broader slowdown have increased. Financial markets have deteriorated considerably since the start of the year and credit conditions for households and businesses remain tight. In the first three weeks of January, U.S. equity markets gave up all of last year's gains; since the end of October 2007, total equity market capitalization has fallen about $3 trillion. Together with declining home prices, the drop in household wealth will have an adverse effect on consumer spending and business investment.

Energy costs remain a concern for households and businesses and a downside risk for growth. The retail price of gasoline remained about $3 per gallon in the most recent weekly statistics, about 85 cents higher than a year earlier. Reflecting expectations that economic growth and thus oil demand will ease in early 2008, oil prices have retreated somewhat in recent weeks, with the one-month futures price for West Texas Intermediate crude down by about $10 per barrel from its early January peak of just under $100 a barrel.

Higher energy prices do not appear to have appreciably boosted underlying inflation. Core consumer prices (which exclude food and energy) rose by 2.4 percent over the year ended in December, compared to the year-earlier pace of 2.6 percent. The spread between yields on five-year inflation-protected government securities and five-year constant maturity government securities, often used as a measure of inflation expectations, suggests that financial market participants look for inflation just above 2 percent, consistent with a retreat in headline inflation going forward. As the impact of higher energy prices on overall inflation wanes, workers who have seen real wage gains erased by energy-led increases in inflation will benefit. Nominal wage growth has been solid, and slower headline inflation would imply a resumption of real wage gains.

The housing market is likely to remain weak well into 2008. Inventories of unsold homes, both new and existing, remain substantially above levels that were typical before or during the housing sector boom. The inventory of unsold new homes rose to 9.6 months of supply in December; inventories averaged just above a 4 month supply from 2000 to 2005. The inventory overhang will weigh on both housing prices and construction. Nationwide, home prices are roughly flat over the past year, with some regions that experienced the highest house price appreciation during the boom now seeing outright price declines. Residential investment has subtracted nearly a full percentage point from annualized GDP growth during each of the previous four quarters and looks to remain a drag on the economy into 2008. Housing starts totaled 1.006 million at an annual rate in December, down more than 38 percent from a year earlier, and are at their lowest level since May 1991. Permits for the single-family sector remain below starts, indicating continued future weakness in residential investment. Homebuilder optimism, which is closely correlated with homebuilding activity, is still near a record-low level.

The housing market slump and broader economic weakness has contributed to an increase in mortgage delinquencies and foreclosures. New foreclosures jumped to 0.8 percent of all loans serviced in 2007Q3, according to a survey by the Mortgage Bankers Association, totaling slightly more than 350,000 loans in the Q3 survey alone. Subprime adjustable rate mortgages (ARMs) are largely responsible for this trend, but an increase in prime ARM foreclosure starts suggests that credit difficulties are broader than just subprime. Overall, about 1.3 percent of all mortgages serviced in the Mortgage Bankers survey were more than 90 days delinquent in 2007Q3, amounting to nearly 575,000 loans. Foreclosures are expected to rise further as an estimated 1.8 million U.S. owner-occupied subprime mortgages face interest rate resets in 2008 and 2009.

The Administration has taken steps to help prevent avoidable foreclosures and minimize the impact of the housing downturn on markets and the economy. Through FHASecure, the Administration has expanded affordable mortgage options; last fall, the Administration encouraged the creation of the HOPE NOW alliance to reach and help struggling homeowners. These efforts have resulted in progress. According to HOPE NOW, the industry assisted 370,000 homeowners in the second half of 2007, and mortgage servicers modified subprime loans during the fourth quarter at a rate three times faster than in the third quarter.

Working with Congress, the Administration has also temporarily eliminated taxes on forgiven mortgage debt so homeowners facing difficult mortgage situations do not also face adverse tax consequences. The Administration has urged Congress to pass legislation to modernize the Federal Housing Administration, allow states to issue tax-exempt bonds to fund refinancing programs, and undertake comprehensive reform of the housing government sponsored enterprises.

On Thursday, January 24, the President and the bipartisan leadership of the House of Representatives reached agreement on a package of personal and business tax relief to support economic growth while credit and housing markets continue to adjust. Together, the proposal will inject about $150 billion into the economy in 2008, creating over half a million additional jobs by the end of this year. In sum, growth is expected to continue, albeit at a modest pace and with increased downside risks. Rapid enactment of the bipartisan fiscal package would support growth and help to ensure continued economic expansion and job creation in 2008.

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