

Recent economic news points to a 2% federal funds rate target as far as the eye can see. The deterioration in labor markets appears to have intensified. The special tax rebates have had only a modest effect on real consumer spending so far.

The Federal Reserve left its target for the federal funds rate at 2% for the second consecutive policy meeting. Dallas Fed President, Richard Fisher, dissented from the decision in favor of raising the target. He and Philadelphia Fed President, Charles Plosser, both dissented from the decision to leave rates unchanged at the late June meeting.

The announcement recognized that “although downside risks to growth remain, the upside risks to inflation are also of significant concern to the Committee.” As indicated by pricing of federal funds rate futures contracts, the market sees the Committee leaning toward raising the target. The probability of a 25 basis point increase in the target at the December meeting implied by futures prices at the close on Friday was 69%.

At the same time, economic activity continues to weaken. Despite the issuance of the about \$78 billion in special tax rebate checks during the second quarter, real consumption fell in June. Sales of light motor vehicles have dropped precipitously, presumably in response to weakness in labor markets and higher gasoline prices. Unit sales collapsed to 12.5 million at an annual rate in July – the slowest pace in any month since April 1992 – from 16.2 million units last December. The share of light trucks in total light vehicle sales has also fallen sharply in response to the high price of gasoline.

Both initial and continuing claims for unemployment insurance surged in the past two weeks. Initial claims jumped to 455,000 thousand – the highest one-week tally since very early in the recovery from the 2001 recession. (See chart of following page.) Continuing claims also hottest their highest weekly mark since early in the expansion. Filings might have been boosted by attention to the program generated by an extension of benefit periods.

The price of oil dropped to almost \$115 per barrel at the close on Friday. The peak daily closing price was \$145.66

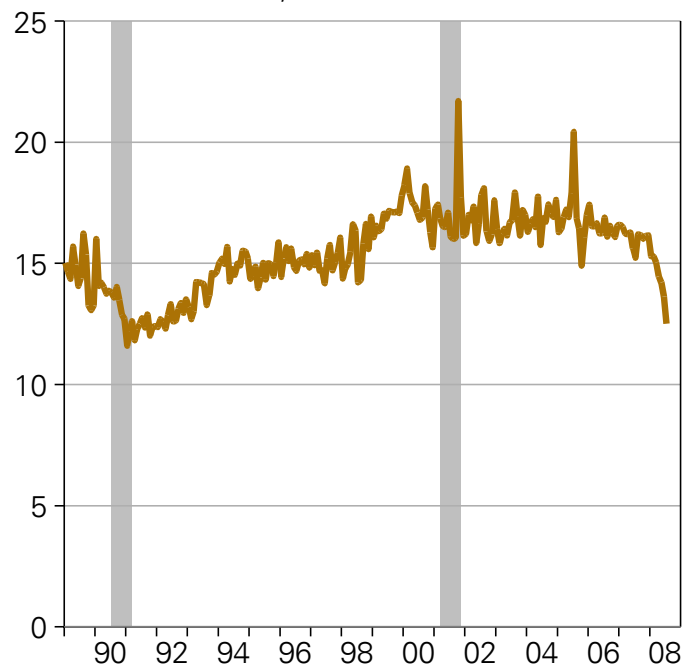
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on July 11. The price of gold fell to the low end of its range for the year and the dollar strengthened. The stock market responded positively despite the still-deteriorating economic backdrop.

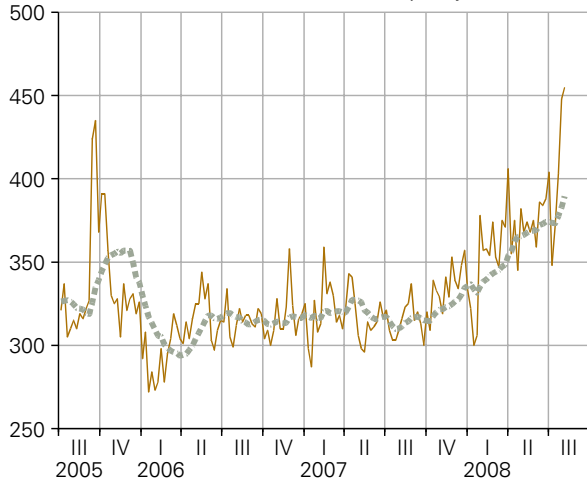
The rate of change in the Weekly Leading Index compiled by the Economic Cycle Research Institute fell deeper into negative territory in the latest week for the seven consecutive week. The recent pattern points to additional economic weakness ahead.

Jim Coons

Sales of Light Motor Vehicles
Millions of Units, SAAR



Initial Claims for Unemployment Insurance
Thousands Per Week, Seasonally Adjusted



U. S. Dollar Exchange Rate
FRB Major Currency Index, 1973 = 100



Price of Oil
West Texas Int, \$/bbl



Price of Gold
London PM Fixing, \$/oz



S&P 500 Stock Prices
Daily Close, Index 1941-43 = 10



Mortgage Loan Originations
MBA Purchase Index 3/16/90=100 SA

