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The Economy's Year-End Fizz

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On January 4, the Bureau of Labor Statistics announced that 18,000 jobs were created in the month of December; private employment actually contracted by 13,000 jobs. The unemployment rate increased from 4.7 percent to 5 percent, a larger-than-expected increase and the highest rate in two years. The December employment report is of particular interest due to a softening economy. Today's report provides evidence that the economy has slowed and that the chances of a recession have increased. While the economy will probably continue to expand in the next year, the weaknesses in construction, the financial sector, and manufacturing could cause the economy to tilt into a short decline.

The December Report. Job growth has continued: 1.3 million more Americans are working than at the start of 2007. Over the last month, 18,000 Americans found jobs, which fell far short of the consensus estimate of 90,000. The numbers of new jobs created for the previous two months were revised upward by 10,000 jobs. The unemployment rate has increased from 4.4 percent to 5 percent over the last year. This rate is very low by historical standards. For non-teen workers, the rate is even lower—at 4.4 percent. Thirty-eight thousand Americans entered the job market looking for work, which did not change the labor force participation rate.

Sectors affected by the housing and credit crisis suffered job losses. The construction industry continued to shed jobs as it completed its second year of declining activity. Construction lost 49,000 jobs in December and a total of 236,000 jobs since the housing decline began in September 2006. Jobs focused on credit markets declined by 7,000 as banks struggle to deal with bad loans and few lending options. The writers' strike contributed to the loss of 15,000 jobs in the motion picture and broadcasting industry.

Despite these losses, other important sectors of the economy continued to add jobs last month. Mining added 5,000 jobs; leisure and hospitality added 22,000 jobs; professional and business services added 43,000 jobs (33,000 of them in professional services like accounting and architecture); and education and health added 44,000 jobs. These latter two sectors pay above average wages; they are not "burger-flipping" jobs.

In December, wages were up 7 cents over the previous month. Over the entire year, wages increased by 3.7 percent, greater than the 2.3 percent increase in core inflation during that time. Total compensation also increased in 2007, but only at a 1.8 percent rate.[1]

Current Economic Conditions. A cooling economy may explain some of the job losses. In the final

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quarter of 2007, economic growth cooled from the red-hot rate of 4.9 percent in the third quarter. Some economic models predict growth rates below 2 percent for the first and fourth quarters of 2008. The housing crash has spread to the financial industry, resulting in less private and business investment. Continuing high commodity prices have also slowed economic growth. Growth is predicted to be sluggish as the marketplace recovers from the financial morass that many lending institutions are in. The December jobs report is the latest in a continuing trend of indicators showing a slowdown but not a recession. While employment is a lagging indicator of economic trends, the last several employment reports have been surprisingly solid and exceeded some diminished expectations. The job growth in many sectors unconnected to the housing market suggests that the slowdown is concentrated in several prominent sectors of the economy but does not indicate a general economic contraction.

The federal government should be careful about trying to fix the current market conditions. Stimulus packages that increase government spending will only cause higher taxes and slower growth in the future. The government should focus on keeping tax rates on capital and investment low and trying to reassure businesses of the stability of the country and the economy. Without a doubt, Congress should not look to increase taxes on investors or businesses in this period of sluggish growth. Furthermore, Congress should be wary of increasing the regulations on business, which could overburden some industries. The Federal Reserve should not attempt to stimulate the economy by printing money. The Federal Reserve has already lowered interest rates rapidly in recent months. Expanding the money supply further has the potential to couple low growth with rising inflation, raising the specter of a return to the stagflation of the 1970s.

Conclusion. The final month of 2007 ended on a bit of a sour note; total employment growth for 2007 was only half that of 2006. The solid economic growth that the country has enjoyed during much of President Bush's tenure has slowed. The higher costs of fuel and food, the housing crash, and the decline in the credit industry significantly weakened the economy.

Policymakers should be careful not to overreact to this month's report. While it is not encouraging, it only provides a one-month snapshot of the economy. An overreaction could result in a more prolonged period of sluggishness or a downturn. Part of the economic slowdown is due to earlier decisions that lowered interest rates too low, which led to real estate speculation and the housing bubble. Policymakers should not repeat this mistake. Washington should focus only on policies, such as lower taxes and fewer regulations on business investment, that will enable long-term economic growth.

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1. Non-farm business compensation, inflation adjusted using the implicit price deflator. Growth from Q4 2006–Q3 2007 at an annualized rate.