U.S. economic growth will remain moderate

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Despite solid growth the past three years, America's economy will be subdued through 2008, say University of Michigan economists.

Moderate job gains, rising interest rates and the continuing slump in housing starts and vehicle sales will account for a somewhat restrained economy over the next two years, they say.

"The economy will expand in 2007 and 2008, but at a pace well below the 3.2 percent increase in real GDP growth of this year and last year," said Saul Hymans, U-M professor emeritus of economics. "The expansion of the past couple of years has been accompanied by healthy job gains that have brought the unemployment rate down to an expected average of 4.6 percent this year. Though job gains will shrink from their 2005-06 pace, they will remain strong enough to keep the unemployment rate in the same range."

In their annual forecast of the U.S. economy, Hymans and colleagues Joan Crary and Janet Wolfe predict employment growth of 1.5 million jobs in 2007 and 1.2 million jobs in 2008, down from this year's 1.9 million job gains and last year's 2 million. Even so, unemployment is expected to remain steady next year and tick upward to 4.7 percent in 2008.

National economic output (as measured by real Gross Domestic Product) is predicted to grow by 2.4 percent in 2007 and 2.5 percent the following year.

According to the forecast, long-term interest rates are projected to continue their gradual upward climb, even as the Federal Reserve keeps short-term rates about where they are now. The 30-year conventional mortgage rate will increase from last year's average of 5.9 percent to 6.5 percent this year, 6.6 percent next year and 7 percent in 2008.

In addition, the rate for three-month Treasury bills is expected to jump from last year's 3.1 percent to 4.7 percent this year, 4.8 percent next year and 5 percent the following year. The 10-year Treasury bond rate, which was 4.3 percent last year, will rise to 4.8 percent this year, 5.2 percent in 2007 and 5.6 percent in 2008.

Inflation, however, will be held in check over the next two years, the forecast shows. The all-items Consumer Price Index will move down from this year's 3.3 percent to 2 percent in 2007, before creeping up to 2.4 percent the year after.

With inflation expected to be contained, Hymans and colleagues believe the Federal Reserve Board will retain its "wait-and-see" approach that it has had since it last raised the federal funds rate last June.

"We do not expect inflationary outcomes that would cause the Fed to tighten monetary policy any further in the near term," Hymans said. "Indeed, the monetary policy consistent with our overall economic forecast is no significant changes, either up or down, in the federal funds rate for about another year-and-a-half."

Overall, Hymans and colleagues say that the outlook for economic growth seems to begin with what happens to the residential and vehicle sectors early next year.

"The housing market retreat remains orderly over the next two years, with prices flat in 2007 and housing activity bottoming out in early

2008," Hymans said. "Although home-building is in a slump, there's evidence that its rate of decline might be leveling off. Further, vehicle demand has weakened and the domestic producers are still trying to align production and sales."

Private housing starts are expected to fall from last year's 2.07 million units—the most since 1972—to 1.85 million this year, 1.61 million in 2007 and 1.57 million in 2008. Existing home sales, which set a new record at 6.17 million homes in 2005, are forecast to drop to 5.65 million this year, 5.05 million next year and 4.95 million the year after.

Sales of light vehicles are predicted to edge down from last year's 16.9 million units to 16.5 million in both this year and next and fall further to 16.4 million in 2008.

"With employment growth moderating, interest rates rising and fewer homeowners still able to take money out of home equity, sales of cars and light trucks will sit near 16-and-a-half million, but sales will begin to recover by late 2008," Hymans said.

The U-M forecast is based on the Michigan Quarterly Econometric Model of the U.S. Economy and compiled by the U-M Research Seminar in Quantitative Economics.

Source: University of Michigan

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