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Economic Evaluation Group, Inc. Presents **Monthly Economic Update for August, 2007**

Quote of the month. "Talent develops in quiet, character in the torrent of the world." – Goethe

The month in brief. July was a wild ride, a month in which triple-digit plunges and surges in the Dow Jones Industrial Average became practically old hat. The DJIA hit a new record high (14,000.41 on July 19), but the DOW, NASDAQ and S&P 500 all lost ground on the month. While Federal Reserve Chairman Ben Bernanke reassured Congress in mid-July that the Fed expected moderate growth and lessening inflation in the near future, that did little to assuage investor fear. Big fears drove the market downward at the end of the month: the perceived evaporation of easy credit and access to investment capital, murmurs over mediocre earnings reports, and worries about the real estate market. These fears ignited a spectacular global selloff at the end of the month. Stateside, the Dow dropped 226 points on the 24th, 311 points on the 26th, and 208 points on the 27th. The S&P 500 suffered its worst week since September 2002, and the DJIA had its worst week since March 2003.

Domestic economic health. The new GDP report showed the U.S. economy grew at 3.4% in the second quarter, a noticeable improvement over the preceding 0.6% mark. The jobless rate stayed flat at 4.5% during June, edging up to 4.6% in July. Retail sales dropped 0.9% in June to the lowest level in nearly two years. The dollar kept declining: by mid-July, the euro and pound had set new records against it. In late July, the dollar rallied against the euro and yen as investors shifted positions with market instability. Core inflation was within the target set by the Federal

Reserve: the Consumer Price Index rose 1.8%, and the Producer Price Index rose 2.2%.

Global economic health. The International Monetary Fund projected global growth at 5.2% for the rest of 2007 and into 2008 ... that was on July 25th. Will the great global boom continue? It would seem that the surging global economy will survive this shock as it has so many others; after all, overseas financial markets are sometimes more volatile than ours. However, the stock market bull run of the last few months was fueled by leveraged takeovers rooted in so-called "junk debt" – private equity firms capitalizing not only on opportunity, but on the availability of high-interest loans from banks and hedge funds. The worry is that the recent credit clamp could shrink the window of profit abroad as well as in America.

World financial markets. When American investors worry about the availability of credit and a wave of mortgage defaults, the anxiety can ripple outward. World financial markets have been "gripped by panic," notes Chen Zhao, managing editor of *Global Investment Strategy* in Canada. The big panic button, so to speak, would be the failure of one of America's big investment banks (a Bear Stearns, a Goldman Sachs). Of course, that has not happened; what did happen was a worldwide market decline at the end of the month, with Japan's Nikkei 225 stock average dropping more than 2%, erasing seven months of gains. Major indexes in Hong Kong and Australia fell more than 3% as July ebbed into August; England's

FTSE 100 sank 1.4%, Germany's DAX fell more than 1%, and France's CAC 40 fell nearly 2%.

Commodities markets. Gold and silver prices climbed on the New York Mercantile Exchange on July 23rd to \$684.70 an ounce, the highest close since May. Silver prices reached \$13.40 per ounce on the same day, helped by what seemed like an ever-weakening dollar. But at the end of the month, gold prices were at 676.60 per ounce and silver prices at \$12.90 per ounce.

Oil prices set records. They shot up 2.5% during the first week of July, closing at \$72.81 on the NYMEX on July 6, hitting an 11-month high on July 19 (\$76.13 per barrel), and then an all-time high of \$78.21 per barrel on July 31st, aided by the positive GDP reading from the U.S. and the sense that production would not meet demand. (Oil prices rose 28% during the first seven months of 2007; then, prices plunged to the \$72 level when speculators fled the market at the start of August.)

Housing & interest rates. When will we hit the bottom of the real estate slump? July brought the news that we certainly didn't bottom out at the conclusion of the second quarter: data from the Commerce Department and the National Association of Realtors showed new home sales down by 6.6% in June and residential resales down 3.8% in June. However, pending sales of existing homes did rise by 5%, and the year-over-year national median existing-home price rose 0.3% to \$230,100 from June 2006. Averages on 30-year fixed-rate mortgages went from 6.67% to 6.69% across July. At the end of the month, the Mortgage Bankers Association reported that mortgage applications had hit a five-month low and had sunk for the third straight week. On July 31st, American Home Mortgage Investment Corp. said it could no longer fund home loans. Its stock dropped 90%, and it let 90% of its workforce go days later. New home builders D.R. Horton Inc., Pulte Homes Inc. and Beazer Homes USA Inc. announced big 2Q losses.

Major indexes. July was a headline-grabbing month, and ultimately a negative month for the three major indexes. But the Y-T-D percentages through early August are still very positive.

% Change	1-Month	Y-T-D
DJIA	-1.84	+7.63
NASDAQ	-2.19	+5.40
S&P 500	-3.10	+4.07

Source: CNNMoney.com, 7/31/07 (1-Month) & 8/7/07 (Y-T-D)

August outlook. Talk about the new volatility. August has already emerged as a month of mood swings for the stock market, with the greatest one-day Dow Jones gains since 2002 (August 6th) followed by a 100+ descent in an hour over the Fed's decision to leave the federal funds rate unchanged, then nearly a 200-point rebound (August 7th). August is typically one of the quieter months of the year on Wall Street, but August 2007 may prove an exception with the "credit crunch" fresh on investors' minds. Oil prices remain above \$72 a barrel (with some analysts predicting \$100 per barrel prices sometime in 2008). Inflation is still a major concern: New Labor Department data reveals productivity rose 1.8% in the second quarter (below expectations) and unit labor costs rose 2.1% (above expectations), suggesting inflation is impacting manufacturing. Overseas, the European Central Bank kept its benchmark interest rate at 4.0% on August 3rd after the late-July stock market whiplash, but appears ready to raise rates to 4.25% in September, which would further chip away at the dollar and help the global economy weather the U.S. "subprime shock". Hopefully, the American economy will experience some stability – and momentum – in a month in which calm might be the best news of all.

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