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Economic Evaluation Group, Inc. Presents **Monthly Economic Update for January, 2008**

Quote of the month. “The knowledge of the world is only to be acquired in the world, and not in a closet.” – Lord Chesterfield

The month in brief. The Federal Reserve cut interest rates by a quarter-point to 4.25%, but it had little effect on Wall Street. New economic data indicated that inflation and consumer spending were increasing. But many economists polled believed the economy was growing at 1.5% or less, and former Fed chairman Alan Greenspan saw the odds of recession “clearly rising.”¹

The Fed proposed stricter standards for mortgage lending, and the White House rolled out a plan to help certain subprime borrowers freeze the interest rates on their mortgage loans for five years. Average home equity levels hit all-time lows and the U.S. foreclosure rate hit an all-time high. At the start of December, fixed-year mortgage rates were at their lowest in two years, climbing back over 6% by the end of the month. December ended with the dollar down again against major global currencies, and news of the weakest new home sales since 1995.

Domestic economic health. Perhaps the most surprising news came from the Labor Department: November brought 3.2% inflation, fueled by a 34.8% month-over-month jump in gasoline prices.² At the end of November, inflation was rising at a 4.2% annual pace, far above the 2.5% inflation of 2006 and outside the Fed’s targets.³

While the dollar climbed 1.5% against the euro and 1.6% versus the yen after word spread of the biggest month-over-month CPI increase in two years,⁴ it weakened again against benchmark currencies at the end of December after news of sluggish U.S. new home sales.

There was some good news. The American consumer appeared not only assured but resilient in an economy affected by foreclosure and high oil and gas prices. The Commerce Department reported retail sales up 1.2% for November, the biggest month-over-month increase since May.² Additionally, the Conference Board’s consumer confidence index rose to 88.6 for December, up from 87.8 in November.⁵

Global economic health. We learned that November Euro zone inflation was 3.3%, the highest inflation reading since the euro was introduced in 2002. That was up from 2.6% in October and 2.1% in September, well above the European Central Bank’s target margin. Germany’s November inflation clocked in at 3.1%, but dropped to 2.8% in December, a signal that inflationary pressures may have eased across the zone in the last month of 2007.⁶ But a late-December report showed retail sales in Europe declining for the third consecutive month.⁷

While concerns over an American recession curbed enthusiasm in Asia’s stock markets, Asian economies soldiered on largely unshaken by the headlines in the U.S. The region’s currencies posted gains against the dollar, and there were hints that deflation might be

coming to an end in Japan: November data was released showing core consumer prices up 0.4% for the month, the biggest increase since March 1998, fueled by soaring energy costs. But industrial output for the month fell short of expectations.⁸

World financial markets. On December 18th, the ECB pumped almost 350 billion euros into the Euro zone banking system, in the fashion of the Fed stateside.⁹ Recession fears affected the European stock markets, which posted declines in December. In fact, the Dow Jones Stoxx 600 Index was headed for its first annual decline since 2002, losing 0.1% for 2007.¹⁰

In mid-December, a major selloff occurred across Asian stock markets, prompted by fears over rising U.S. inflation that could hurt the export-oriented economies of the region. Asian markets shook again in late December with the assassination of Benazir Bhutto in Pakistan. While the big drivers like the Hang Seng and CSI indexes were again models of growth, the MSCI Asia Pacific Index was poised for an 11% annual gain, its smallest in five years, and Japan's Nikkei 225 Stock Average and Topix index registered their first annual declines since 2002.¹¹

Commodities markets. Gold prices continued their impressive climb. In late December, they reached \$840.80 per ounce, marching toward the record high of \$850 from January 1980. By month's end, silver prices stood at nearly \$15 per ounce.¹²

On December 1, oil was below \$89 per barrel on the New York Mercantile Exchange ... admittedly way up from \$65 per barrel in March, but well below the record high of \$99.29 from November 21. On December 31, oil prices ended above \$95 a barrel.¹³ Soybeans reached a 34-year high in late December, hitting \$12.48 per bushel.¹⁴

Housing & interest rates. Some said it was too little, others too late, but the White House rolled out a plan in December to respond to the housing sector crisis. Weeks after Treasury Secretary Henry Paulson had negotiated with lending industry leaders, the Bush administration announced the possibility of a five-year freeze on certain adjustable-rate mortgages scheduled to reset in 2008, 2009 and 2010.¹⁵

A week later, the Fed proposed stricter mortgage lending standards: an end to stated income loans, and

disclosures of bonuses that mortgage brokers receive for subprime loan origination.¹⁶

While homebuilder sentiment stayed at a record low – a reading of 19 according to the National Association of Home Builders/Wells Fargo Housing Market Index¹⁷ – the pace of existing home sales rebounded from an all-time recorded low in November, rising 0.4%. But they were still down 20% from November 2006 levels.¹⁸ New home sales hit a 12-year nadir during November, falling an appalling 9% versus October levels.¹⁹

Speaking of low, mortgage rates reached tantalizing lows in early December. Average rates on 30-year FRMs fell to 5.96%, 15-year FRMs to 5.65%, 5-year ARMs to 5.75%, and 1-year ARMs to 5.46% by the second week of the month, according to Freddie Mac. Rates climbed slightly over the rest of the month.²⁰

Major indexes. Where was Santa Claus? December was a down month on Wall Street, and the Dow not only had a bad December but a negative 4Q.²¹

% Change	1-Month	2007
DJIA	-1.49	+6.43
NASDAQ	-1.61	+9.81
S&P 500	-0.24	+3.53

Source: CNNMoney.com, USAToday.com, 12/31/07

January outlook. Currently, many economists believe the U.S. will narrowly skirt a recession in 2008, and that the economy – and the consumer – will ride out the lingering effects from the mortgage meltdown and inflationary pressures. While not a foregone conclusion, an interest rate cut for January looks likely to many economists, as the Fed seems primed to do whatever it takes to ward off recession. A panel of 16 economists from the Securities Industry and Financial Markets Association (SIFMA) predicts the benchmark U.S. interest rate will fall to 3.5% by the middle of 2008.²²

Here's what the economic calendar holds for January: the 12/11 FOMC minutes (January 2), November factory orders (January 3), December wages and unemployment data (January 4), November pending home sales (January 8), November wholesale inventories (January 10), December retail sales,

business inventories, PPI and core PPI (January 15),
December industrial production (January 16) ,
December housing starts (January 17), December
existing home sales data (January 24), December new
home sales data (January 28), December durable

goods orders and January consumer confidence
(January 29), 4Q advance GDP data and an FOMC
policy statement (January 30), and finally December
personal spending and personal income (January 31).

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The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is not possible to invest directly in an index. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx[®], and the Pacific Exchange). NYSE Group is a leading provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. (NYMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals, with trading conducted through two divisions – the NYMEX Division, home to the energy, platinum, and palladium markets, and the COMEX Division, on which all other metals trade. These views are those of Peter Montoya Inc., and not the presenting Representative or the Representative's Broker/Dealer, and should not be construed as investment advice. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance is historical and not indicative of future results. The market indices discussed are unmanaged. Investors cannot invest in unmanaged indices. Please consult your Financial Advisor for further information. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards.

Citations.

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