

# E NEWS

THE ECONOMIC NEWSLETTER OF EAST STROUDSBURG UNIVERSITY

FALL 2008

## The National Economy

By: David Miraglia

Real GDP increased modestly in the second quarter of 2008, 2.9 percent, compared to the even slower growth rate of 0.9 percent during the first quarter. The revised estimates from the United States Department of Commerce, Bureau of Economic Analysis actually showed a negative Real GDP growth of -0.7% for the fourth quarter of 2007. Many economists are expecting even more dismal news for the third quarter of 2008 when the anticipated recession is expected to set in. In the meantime, real disposable personal income (DPI) experienced negative growth of -0.7 percent during the first quarter of 2008, and then it increased by 11.4 percent in the second quarter, due to the Economic Stimulus Act of 2008, which gave back a portion of every individual's taxes. Since the unemployment rate is widely considered to be a lagging economic indicator, an increase in unemployment is expected on the 7<sup>th</sup> of November when the Bureau of Labor Statistics releases the latest information on Earnings and Employment.

References: [www.bea.gov](http://www.bea.gov)

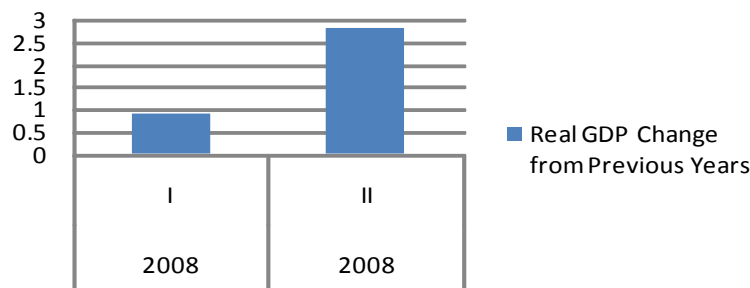
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## Real GDP Change from Previous Years



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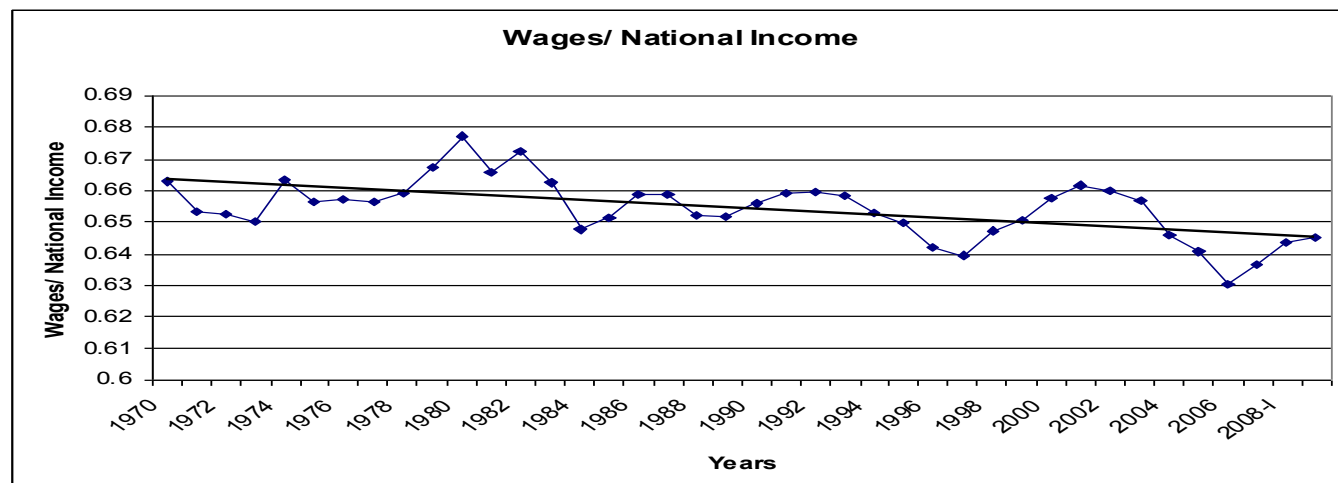
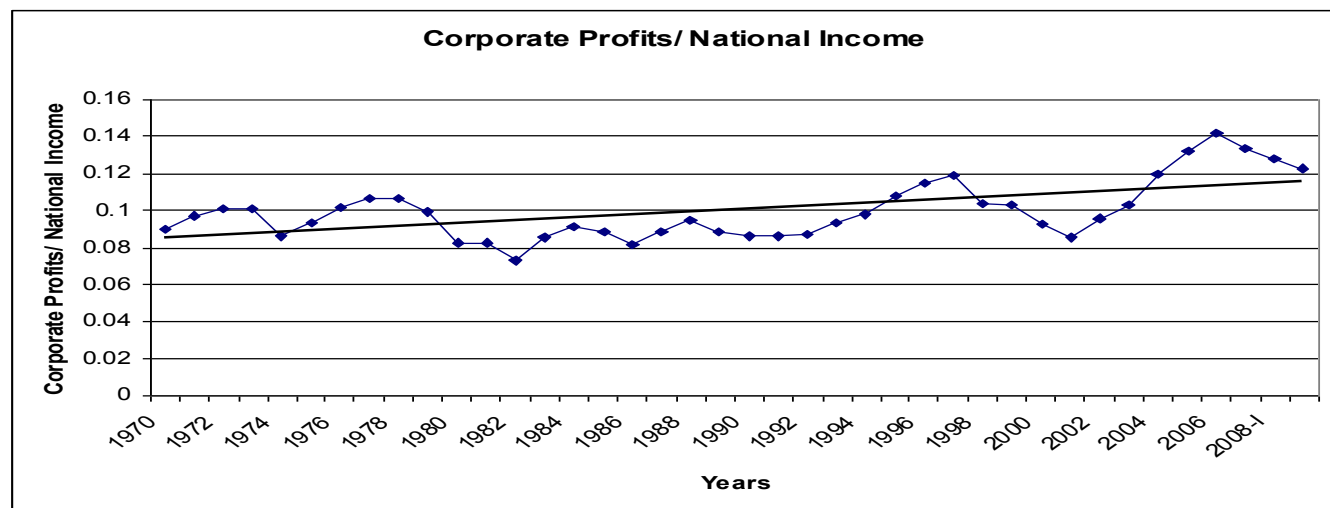
## National Income

By: Rich Peterson

National income is defined as the total net value of all goods and services produced within a nation over a specified period of time, representing the sum of wages, rents, interest, and profits earned by the residents of the nation. In the year 2008, all these components was affected as the economy became weaker.

In the year 2000 wages were almost 66 percent of national income and corporate profits were at 9

percent. From 2000 to 2006 corporate profits increased to 14 percent while wages dropped to 63 percent of national income. Since 2006 corporate profits have been on a steady decline while wages incurred a constant increase as a percent of national income. Widening the gap between corporate profits and wages has become a trend over the past thirty eight years. Since 1970, with minor fluctuations, wages as a percent of national income has a negative or downward sloping trend while corporate profits has show an upward sloping trend.



## **Fed Watch: All about B. Bernanke**

By: Philip Vidal

Coming into the Federal Reserve, the new chairman Ben Bernanke had very large shoes to fill. Bernanke arrived into the story of the American economy right on the hot heels of Alan Greenspan, who held the longest Fed Chair tenure in history, approximately eighteen years. Immediately after becoming the Federal Chairman, Bernanke was faced with major economic meltdowns, with prospects of a recession on the horizon.

On January 22, 2008, Bernanke made his first real move as Fed Chair, surprisingly slashing interest rates by an unprecedented three quarters of a percentage point during an intermeeting session. Bernanke's actions certainly call for a page in the history books, as this was the largest rate cut since 1984. To Wall Street, this translated to an American economy facing an enormous financial crisis and pending recession.

Shortly after Bernanke's surprising move on January 22, 2008, he proceeded to cut the Federal Funds rate again, only seven days later, on January 30. The federal funds rate, which is an overnight bank lending rate that affects how much interest consumers pay on credit cards, home equity lines of credit and auto loans, was cut to 3.0% from 3.5%. The rate had stood at 5.25% only four months ago.

Under Bernanke, the Federal Reserve made very creative use of its tools. Prior Chairmen have primarily used the Fed Funds rate to either stem inflation or prevent recession. In 2008, a slow economy

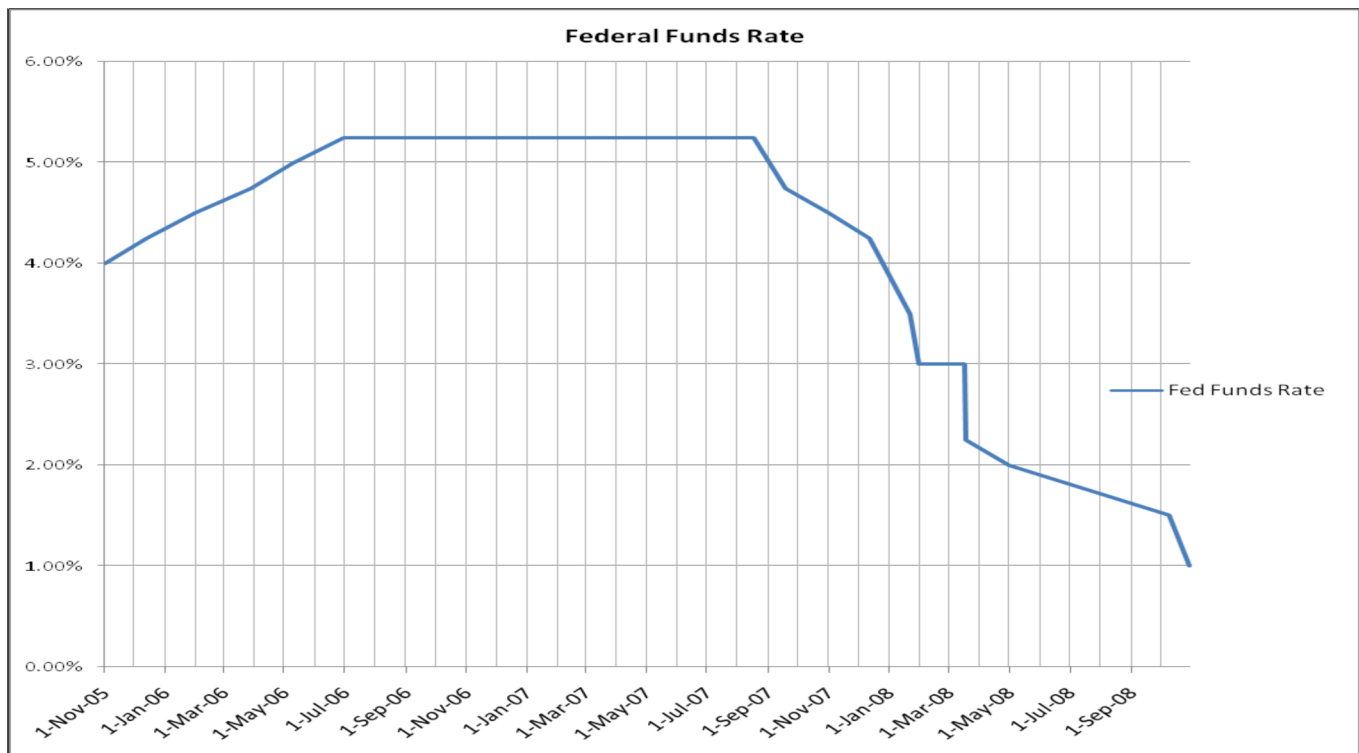
combined with creeping inflation, due to sky-rocketing oil prices, prevented much change in the rate. The economy slowed as a result of the Subprime Mortgage Crisis; in which banks had purchased subprime mortgages, repackaged and sold them in mortgage-backed securities that were so complicated that no one really understood who had the bad loans. When these loans defaulted, banks started to panic.

As a result, banks stopped short-term lending, which had been done routinely as a way to meet Fed's reserve requirement. In response, the Fed started relaxing the requirements, lowering the discount rate, and then finally providing credit itself via the discount window.

In December 2007, the traditional Fed tools were no longer enough to stem the loss of confidence that banks had in each other. Therefore, the Fed created the Term Auction Facility, which lent billions of dollars to banks and took on their possibly bad debt as collateral. The Auction was meant to be temporary, until the banks marked down the bad debt and started lending to each other again. However, this didn't happen, and the Auction grew larger and larger. By June, the Fed had auctioned over \$1 trillion, and the Auction Facility had become a permanent fixture.

In April, the Fed held its first emergency weekend meeting in thirty years to guarantee Bear Stearns bad loans so that JP Morgan would agree to purchase the company and prevent its bankruptcy. Bear Stearns' had on its books about \$10 trillion in securities which, if the company had gone under, would have become worthless and jeopardized the global financial system.

In September, the Fed took over AIG, which insured trillions of dollars of mortgages throughout the world. If it had fallen, it would have disrupted every bank, hedge fund and pension fund that had mortgage-backed securities as an asset.



## **Economic Recessions**

By: Samer Alnaham

Since the Great Depression of 1929, there have been numerous recessions in the U.S. as recorded by the National Bureau of Economic Research. Economic recessions are triggered by shocks which are either exogenous or stem from a country's own economy. "Economic shocks cause unpredictable changes in aggregate demand and short run aggregate supply which lie outside normal macroeconomic models. As a result, a new equilibrium level of output is achieved."

There are two types of shock, demand side and supply side. A supply side shock is caused by an event that influences production capacity and costs in an economy. Only two recessions since the Great Depression were the cause of supply shocks, those being the recessions of 1973 and 1980. "These were brought about by sudden interruptions in oil supplies, like the 1973 Arab oil embargo, the Iranian revolution of 1979 or the outbreak of the war between Iran and Iraq in 1980." All other recessions in the United States, including our current one, were under the influence of demand shocks which are typically caused by an event that affects the demand for goods and services in an economy.

At the root of the current economic crisis is the impoverished housing market that was caused by irrational subprime lending. Along with the burst of the housing bubble came the downfall of companies such as Fannie Mae and Freddie Mac who owned nearly half of the U.S.'s \$12 trillion mortgage market. Other companies such as Merrill Lynch, AIG and

Lehman Bros have also failed causing distress on Wall Street. Combined with rising oil prices in a period of stagflation, which is "a condition of slow economic growth and relatively high unemployment accompanied by inflation", consumer confidence has continued to deteriorate in an already weakened economy.

| <b>Periods of Economic Recessions Since 1929:</b> |                     |
|---|---------------------|
| <b>Beginning Date:</b>                            | <b>Ending Date:</b> |
| Aug-29  | Mar-33              |
| May-37  | Jun-38              |
| Feb-45  | Oct-45              |
| Nov-48  | Oct-49              |
| Jul-53  | May-54              |
| Aug-57  | Apr-58              |
| Apr-60  | Feb-61              |
| Dec-69  | Nov-70              |
| Nov-73  | Mar-75              |
| Jan-80  | Jul-80              |
| Jul-81  | Nov-82              |
| Jul-90  | Mar-91              |
| Mar-01  | Nov-01              |

## **Summary of Employment and Earnings Report**

By: Tammy Van Why

On October 3, 2008 the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor released employment survey data for the month of September. The findings are grim. 159,000 jobs were lost in the month of September. 760,000 jobs were lost during the first nine months of 2008. With a .4% increase in August, the unemployment rate remained the same in September at 6.1%.

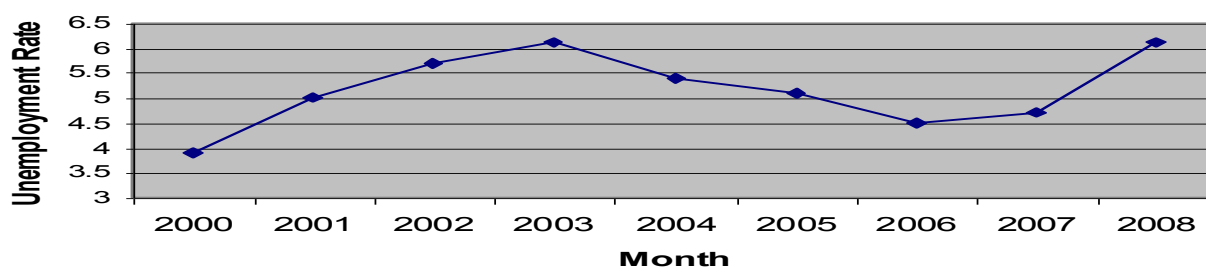
The BLS measures employment through the Payroll or Establishment Survey. The information in the survey is collected from payroll records from a sample of individual nonfarm businesses as well as federal, state and local government agencies.

September's survey concluded that 51,000 jobs were lost in the manufacturing sector, 35,000 jobs were lost in construction, and 40,000 jobs were lost in retail trade. On a positive note, 17,000 jobs were added in the health care industry and 8,000 jobs were added in the mining industry. An additional 18,000 jobs were added in the computer systems design, management and technical consulting service industry. Unfortunately the employment losses far out way the gains in September. Employment decreased in both durable goods manufacturing (motor vehicles and parts, fabricated metals, wood and furniture products) and nondurable

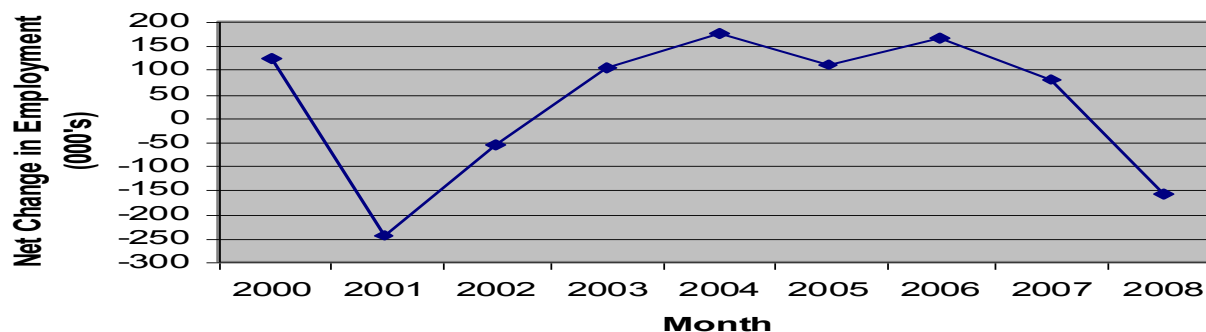
good manufacturing (paper, plastics, and rubber products). 16,000 jobs were lost in transportation and warehousing; air transportation lost 5,000 jobs. All areas of the construction sector have encountered a drop in employment with most losses occurring in residential construction. In the retail sector, jobs were lost in department stores, motor vehicle and parts dealers, and gasoline stations.

The Payroll Survey also measures hours worked and hourly and weekly earnings. In September the workweek hours declined to 33.6 hours from 33.7 for private nonfarm payrolls. For the manufacturing sector specifically, the workweek hours decreased by .2 hour to 40.7 hours per week and overtime decreased by .1 hour to 3.6 hours per week. Hourly earnings increased .2% for private nonfarm payrolls to \$18.17

**Unemployment Rate (September Data)**



**One Month Net Change (September Data)**



per hour. Since July, the average hourly and weekly earnings have been increasing.

The BLS measures unemployment through the Household Survey. The information from the survey is collected by the U.S. Census Bureau for the BLS using a sample size of approximately 60,000 households.

Although the unemployment rate remained the same for the month of September (6.1%), the unemployment rate has increased by 1.4% in the last 12 months.

347,000 people became unemployed either by dismissal or by completing a temporary position, increasing the number of people unemployed to 5,171,000 in September. The number of people who have been jobless for 27 weeks or longer also increased by 167,000.

The Household Survey also measures total employment and the number of people not in the labor force. In September, 145.3 million people were employed and there were no significant changes in the labor force participation rate or the employment population ratio. For economic reasons more people did work part time in September, including those whose hours were cut or those who could not find full-time employment. Perhaps due to availability of employment, the number of people working multiple jobs decreased. Of the 1.6 million people considered to be marginally attached to the labor force but not unemployed in September, 467,000 were considered discouraged.

October's employment data was released on Friday November 7, 2008. More information on employment and unemployment data can be found at the BLS website, [www.bls.gov](http://www.bls.gov).

Reference:

U.S. Department of Labor: Bureau of Labor Statistics: Economic News Release,

"Employment Situation Summary" October 3, 2008.

## **The Relationship between Unemployment Rate and Real GDP**

By: Matthew Belles

Arthur Okun was the first to notice the relation between the unemployment rate and the change in real GDP. He did his study in 1966; his results have been a rule of thumb for economist today. He discovered empirically that when Real GDP declines by 1% below the long run growth rate of 3.5%, the unemployment rate would increase by .3% to .4%. This law shows that there is an inverse relationship between the unemployment rate and the change in real GDP

Okun found several reasons why the change in real GDP was a more drastic change than the change in unemployment. First is the fact that if there is higher output then total hours worked in a week will increase. If employees are working more they would have more money to spend on final goods, but companies will only hire a certain amount of workers. The second factor is because of cyclical employment. During the periods when workers are underemployed total output would increase and the demand for additional employee work-hours would increase. Discouraged workers also affect the ratio because they end up leaving the labor force and not being counted.

The inverse relationship between GDP growth and changes in the unemployment rate can be seen in

Figure 1 below. During the recession of 1982 real GDP changed by -2% (5.5% less than the long run growth rate of 3.5%). The Unemployment rate that year increased by 2.1%. The unemployment rate grew a total of .38% for every 1% increase in real GDP below the long run growth rate. Okun's law appears to hold true throughout the entire period 1982-2007.

Okun's law is generally used today more as a rule of thumb than as a theory. It is applicable in all countries even though the ratio may vary slightly from country to country. Okun's law explains why countries with a high growth rate will have a decreasing rate of unemployment and countries with sluggish growth rates will see increasing unemployment rates. Okun's law can also be used as a forecasting tool for unemployment, since the unemployment rate lags behind real GDP.

A timely example is the slow-down of the US economy during part of 2007 and 2008 where the below average growth of real GDP has been followed by a steady increase in the unemployment rate.

### Unemployment Rates

By: Samer Alnaham

The Bureau of Labor Statistics has six measures of labor unemployment ranging from a very specific narrow measure to a very broad measure. Of those six, four are shown here ranging from U3 – U6. U3 is what is known as the official unemployment rate. U4 is a broader measure including the total unemployed plus discouraged workers. U5 is total unemployed plus discouraged workers plus all other marginally attached workers and finally U6 is the broadest measure which includes total unemployed plus all other marginally attached workers plus total employed part time for economic reasons.





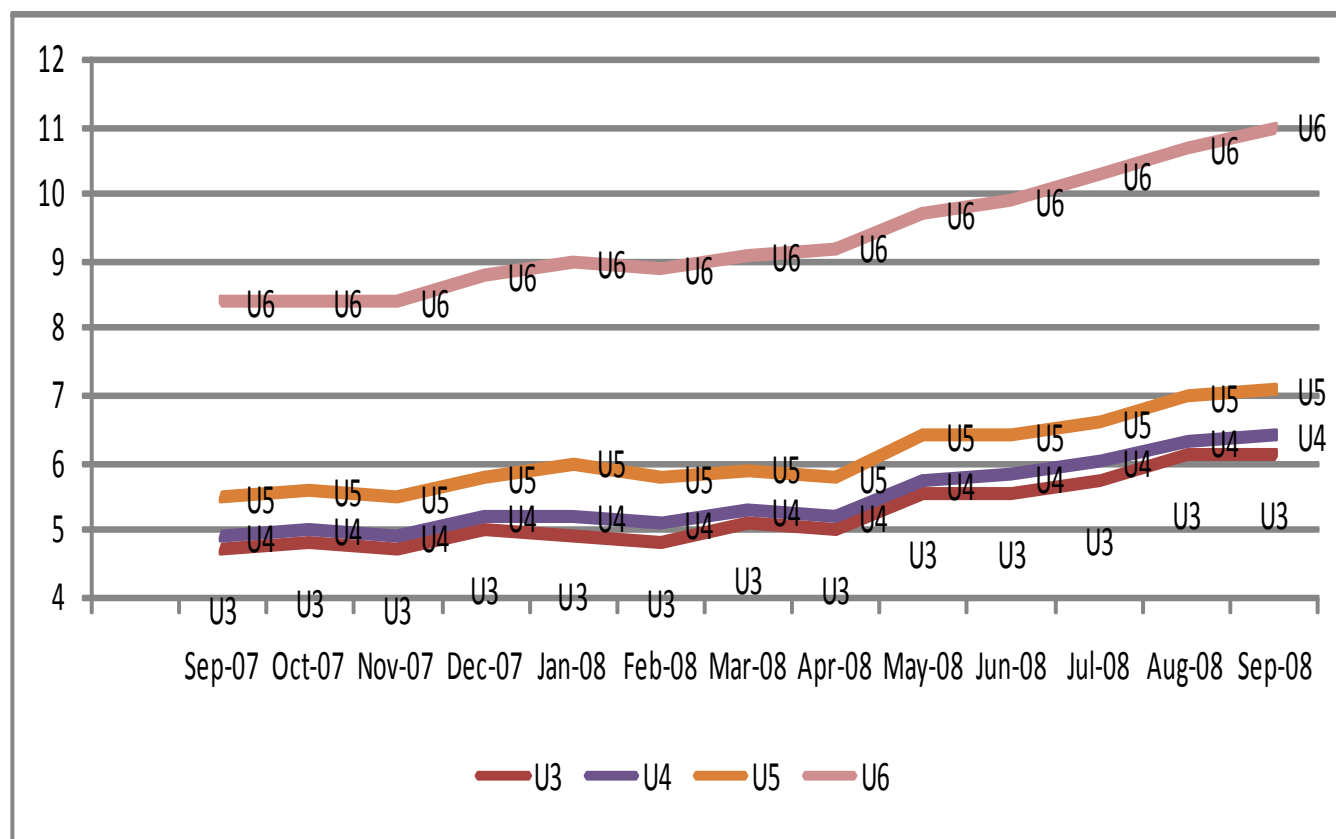
The following graph included plots unemployment as a percentage of the labor force from September 2007 – September 2008. U3, the official unemployment rate, shows a lower unemployment percentage rate than U6 which is the broadest measure. This is obviously because U6 takes more circumstances into account than U3 does. The differences between U3, U4 and U5 are not that great. In fact, they differ by a single percentage point or less. However, all measures U3 – U6, move at the same rate regardless of what they include. There is very little difference in the trajectory of the line. Where one experiences a peak or a trough, the others do as well. The only actual difference between these measures of unemployment is

what is included in those measurements as a percentage of the labor force.

### **Stock Market Volatility**

By: Rich Peterson

The year 2008 is nearly over; however, the economic problems associated with the current year unfortunately will not leave as 2009 arrives. Currently the new sign of this is the dramatic drops in the stock market. The most recent and similar stock market changes experienced by the United States other than now occurred in October of 1987. Within the last month the stock market dropped by 20% while the



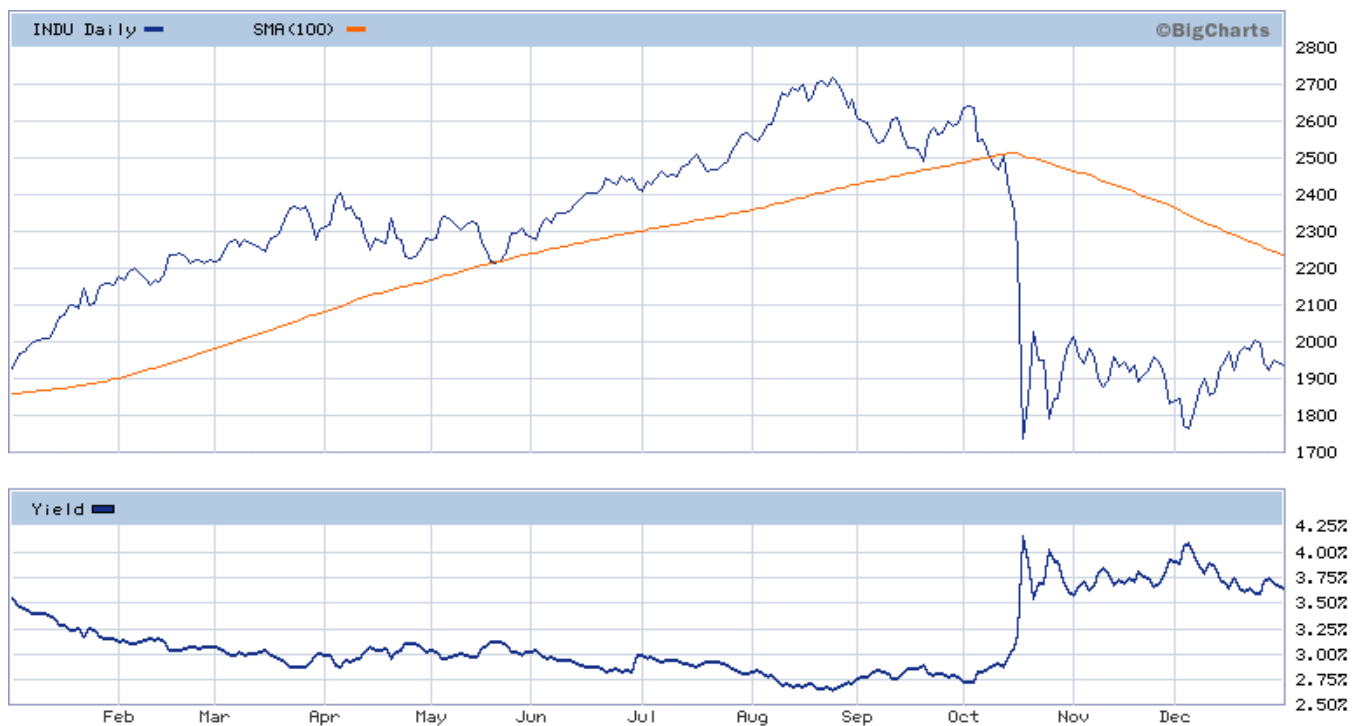
stock market dropped by 22% in October of 1987. Within these 30 days periods is the where the similarity diminishes. In 1987 the stock market dropped by 30 percent within one week in the month of October. The stock market dropped by 14.82 ten days. In addition

investments as a part of gross domestic product have decreased by three percent, while it only decreased by one percent in 1987. The major difference between the two years is the sudden decline in the stock market of 1987. A 30 percent decrease in a week is more volatile

2008



1987



than 22% decrease over a month. Hopefully this might mean that investors have more confidence in the current economy than those in 1987. The current economy has left many businesses and households struggling. Many have lost substantial amount of money through investments and lost jobs which has been shown by the stock market. Though the current stock market is declining, the United States has incurred more extreme declines in the stock market. Fortunately, we are more knowledgeable now due to learning from past experiences.

### **The Local Economy**

By: Constantinos Christofides, Ph.D.

The unemployment rate in Monroe County was 5.9% in September. This rate was the same as Pennsylvania's state average and lower than the national unemployment rate of 6.1% in September and 6.5% in October. The county unemployment rate actually decreased from the 6.6% rate in August 2008.

The total number of jobs in Monroe County increased since September of 2007 from 78,100 to 80,400. In spite of the job growth the unemployment rate increased from 4.6 to 5.9% over the same period because of a 4.3% growth in labor force from 81,900 to 85,400.

As expected, the local economy is feeling the effects of the national economy's slow-down and things may still get worse before they get better. According to the Center for Workforce Information and Analysis, the number of initial unemployment claims reached 731 in Monroe, 183 in Wayne and 105 in Pike

County in September 2008. These were the highest September levels of initial claims since 2003 for all three Pocono Counties. Since initial claims are considered to be a leading indicator for unemployment, and since the national unemployment rates are expected to rise through 2008 and perhaps deep into 2009, the local unemployment rate may rise even more.

### **The Local Housing Market: Stroudsburg vs. the Pocono Mountains**

By: Issac Teeple

The following article provides information on the local housing market between 1999 and 2007. When comparing Stroudsburg Township to the entire Pocono Mountains area which includes the counties of Carbon, Monroe, Pike, Lackawanna, Northampton, Wayne, and Luzerne, we focus on four categories, the trend of the number of all sold listings, amount of volume sold, average sale price, and average DOM (days on market). With the economy fluctuating the way it has over the past few years, we can see that the housing market is directly affected.

Notice that the overall trend in the four categories rise and fall at a relatively similar rate when comparing Stroudsburg to the Pocono Mountain area. Note that the peak for housing since 1999 was between 2003 and 2005. Since 2005, the housing market has had a very significant decline. Starting with the sub prime mortgage crisis, when people were being approved for loans they could not afford to pay back, housing purchases increased quite dramatically. At this time, the number of homes sold, volume amount, and average sale price increased, while DOM decreased. The housing market seemed to be in great shape, but

fell even quicker than it rose when home buyers started to default on their mortgages. The mortgage companies and banks became less willing to lend to creditable businesses, individuals with high credit scores, and even other banks. This created a domino effect on the entire economy, making it nearly impossible to qualify for a loan.

## **U.S Bail-Out Plan**

By: Bassam Jouney

### **Main Source of the Problem:**

The subprime mortgage crisis caused critical problems during September 2008, characterized by severely contracted liquidity in the global credit markets and insolvency threats to investment banks and other institutions. In response, the U.S. government announced a series of comprehensive steps to address the problems, following a series of interventions such as the AIG, Fannie Mae, Freddie Mac, and the Bear Stearns rescue plans.

### **The Sweden Model**

In 1992 the Swedish banking system fell into crisis after the collapse of a housing bubble. Housing property prices plunged. The housing bubble deflated rapidly in 1991 and 1992. An ineffective effort to defend Sweden's currency, the koruna, caused overnight interest rates to spike at one point to 500 percent. The Swedish economy contracted for two consecutive years after a long expansion, and the unemployment rate was 3 percent in 1990.

Sweden bailed out its financial institutions by having the government take over the bad debts. It pooled Koruna from bank shareholders before writing checks. The Banks had to write down losses and issue warrants to the government.

The Swedish bailing-out strategy held banks responsible for their actions and turned the government into an owner. When troubled assets were sold, the profits flowed to taxpayers, and the government was able to earn more money later by selling its shares to the companies as well. Sweden spent 4 percent of its gross domestic product or 65 billion koruna, the equivalent of \$11.7 billion at the time (\$18.3 billion in today's dollars) to rescue poorly run banks. That is somewhat less proportionate to the national economy, than the \$700 billion, or roughly 5 percent of gross domestic product, which is the plan of the U.S. The final cost to Sweden ended up being less than 2 percent of its Gross Domestic Product or GDP. After the plan was announced, the Swedish government found that international confidence returned more quickly than expected, reducing pressure on its currency and bringing money flows back into the nation.

### **The American Model**

In September 2008, leaders of the U.S. Treasury and Congress proposed a three-page concept called The Troubled Asset Relief Program. The original concept was greatly modified, expanded to 110 pages, and renamed the Emergency Economic Stabilization Act of 2008. The act is intended to bail out the U.S. financial system. This plan involves the federal

government acquiring or insuring as much as \$700 billion of troubled mortgage-backed securities. The objectives of the plan are to reduce uncertainty regarding these assets and restore confidence in the credit markets. The proponents of the plan claimed that the immediate action and the dramatic intervention would be vital to prevent further erosion of confidence in the U.S. credit markets and that failure to act could lead to a significant downturn in the economy. The opponents objected to the huge cost of the bail out plan and pointed to polls that showed little support among the public for bailing out Wall Street investment banks.

The proposed law was put forward as an amendment to H.R. 3997. The amendment was not approved by a vote of the United States House of Representatives on September 29, 2008, losing by a margin of 228 to 205. After the vote, the Dow Jones Industrial Average dropped over 777 points in a single day, its largest point drop ever. The S&P lost 8.8%, its seventh worst day in percentage terms and its worst day since Black Monday in 1987. The NASDAQ composite index also had its worst day since Black Monday, losing 9.1 percent in its third worst day ever. TED spread, the difference between what banks charge each other for a three-month loan and yields on Treasury notes, hit a 26-year high of 3.58 percent. A higher rate for inter-bank loans than Treasury rates is a sign that banks fear that their fellow banks won't be able to pay off their debts. In the same time the price of U.S. light crude oil for November delivery fell \$10.52 to \$96.37 a barrel, its second largest one-day drop ever. Also, Wachovia Bank was being bought out by Citigroup (now Wells Fargo) to avoid collapse. The events were

compounded by news from Europe that the Dutch-Belgian Fortis Bank was given a \$16.4 billion lifeline to avoid collapse, failing British mortgage bank Bradford & Bingley was nationalized, and Germany extended banking and real estate giant Hypo Real Estate billions to ensure its survival.

The U.S. Senate passed the controversial financial bailout plan. The measure was passed by a vote of 74 to 25. The new package was based in part, on temporarily raising the FDIC insurance cap to \$250,000 from \$100,000. The bill allows the FDIC to borrow from the Treasury to cover any losses that might occur as a result of the higher insurance limit. It would extend a number of renewable energy tax breaks for individuals and businesses. In addition, the bill includes relief for another year from the Alternative Minimum Tax.

Finally, after two weeks of debate and negotiations, the US House of Representative passed the bill; 172 Democrats voted in favor of the bill while 62 opposed it; and 91 Republicans voted for it and 108 voted against it. On the same day, President Bush signed the historic plan, hoping that the U.S. bail-out plan's results match the success of the Sweden experience.

References: CNN, New York Times

### **Noble Prize Awarded For Economics**

Paul Krugman was awarded the Nobel Prize for his pioneering work in trade and the New Economic Geography. The following excerpt from the 2008 Nobel economic citation summarizes the New Economic Geography:

“Krugman’s approach is based on the premise that many goods and services can be produced more cheaply in a long series, a concept generally known as economies of scale. Meanwhile, consumers demand a varied supply of goods. As a result, small-scale production for a local market is replaced by large-scale production for the world market, where firms with similar products compete with one another.”

For more information on Paul Krugman’s work, visit <http://nobelprize.org>

### **Department News**

- Our department has put together a “Student Handbook” for Economics students and those interested in Economics. The handbook outlines career opportunities and other relevant information that students will find very helpful. If you want a copy of the handbook, please see our department secretary, Sue Prutzman.
- The Economics faculty held a Panel discussion on the current “Economic Crisis” in Beer’s Lecture hall on Nov. 6<sup>th</sup>. It was well attended by students, faculty, staff and community members. The event also received wide publicity on local cable TV news and front page coverage the next day in the Pocono Record.
- The Desi Student Organization, under the guidance of Professors Shiv Bunjun and Pats Neeklakantan, celebrated “Diwali” on Nov. 7th in the Keystone Room. This popular annual event, which features authentic Indian food, a fashion show and professional dancers attracted more than 200 people. It also received front page coverage in the Pocono Record. If you would like to see photos of these colorful events, they may be viewed on the photo gallery portion of the ESU website, [www.esu.edu](http://www.esu.edu).
- Every spring, the department takes some of our best students to present research papers at the Undergraduate Research Conference at Ursinus College. If you are interested in conducting economic or business research, please contact one of the faculty members for further details.
- Finally, Prof. Shiv Bunjun will be going on Sabbatical during Spring 2009, and spending a semester at the University of Mauritius. We wish him Bon voyage.

**E-News is a quarterly publication developed by students from the ESU Department of Economics and others interested in the field. It is a service to ESU and the local community.**

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