

A Look Back

There were several significant developments this past week. The most significant was the passage of the Financial Reform legislation. As with health care, this legislation significantly increases the power, influence and cost of government. Early analysis of the rules and regulations indicates that it's thirty times larger than Sarbanes-Oxley (SOX).

SOX was the previous legislative effort to prevent financial problems that was passed only eight years ago. Its cost for compliance was over \$50 billion. Based on the magnitude of Financial Reform II, the tab could well be over \$1.5 trillion. That's enough to cause another financial meltdown.

After soaring earlier in the year, retail sales are struggling. They were down ½% in June and have fallen at a 5% annual rate over the past three months. The recent weakness is the reason many economists (including those at the Fed) are lowering their forecasts for the economy.

On a more positive note, initial unemployment claims fell in the second week of July to 429,000. While the decline is a welcome development, my guess is that it's an aberration.

A Look Ahead

Most of the economic numbers this coming week relate to activity in the housing market. The two most significant reports will be the Homebuilders' survey (due 7/19) and existing home sales and

inventories (due 7/22). I expect the housing news will continue to reflect serious problems associated with the excess supply of existing homes.

Minutes from the FOMC meeting of June 22-23 indicate that Fed members remain confused over economic developments. They are convinced that monetary policy has been unusually accommodative. At the same time, they are concerned that the pace of economic activity is weakening and that inflation is below what they would like it to be.

If my interpretation of Fed policy is correct, signs of an easing in economic conditions will become more prevalent in the months ahead. If so, look for the Fed to explore new ways to provide for more liquidity.

If the Fed were to stop paying banks to hold reserves (or even charge banks to keep their deposits with the Fed), those excess reserves would quickly be used for loans and investments. Liquidity would immediately increase and stock price would move sharply higher.

The Lighter Side of Political Economy

Leno: *President Obama announced the appointment of a new White House budget director, which is pretty surprising. You know the White House has a budget director? What the hell has he been doing?*