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Economy expected to remain sluggish

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WASHINGTON --
After ending 2006 lethargically, the economy is expected to remain sluggish most of this year as businesses and consumers cope with fallout from the painful housing slump.

The broadest barometer of the country's economic health, gross domestic product, grew at a 2.5 percent annual rate in the final three months of last year, the Commerce Department reported Thursday.

It was a small improvement from the 2.2 percent pace previously estimated for the fourth quarter and a 2 percent growth rate logged in the third quarter. However, the new reading still marked a lackluster showing that reinforced economists' predictions for similarly listless activity in the coming quarters.

"I see the economy continuing this well-entrenched, below-trend economic groove that we are in," said Stuart Hoffman, chief economist at PNC Financial Services Group.

According to various projections, GDP growth will remain mediocre, hovering at around the 2 percent to 2.5 percent pace in the first half of this year. In contrast, the economy's average, or trend, growth rate is closer to 3.25 percent, economists said. Gross domestic product measures the value of all goods and services produced in the United States.

On Wall Street, though, the slightly upgraded fourth-quarter GDP reading helped quell investors' fears that the economy could be in danger of losing too much momentum. The Dow Jones industrials gained 48.39 points to close at 12,348.75.

In other economic news, the Labor Department said new claims filed for unemployment insurance dropped by 10,000 to 308,000 last week. That suggests the jobs market is still in good shape.

Economists, however, predict the nation's unemployment rate, now at relatively low 4.5 percent, is likely to climb higher - perhaps closer to 5 percent by the end of this year - as businesses become more cautious in hiring in response to slower economic activity.

For all of 2007, analysts expect the economy to expand by 2.7 percent, which would be the slowest in four years. The crumbling housing market will cause some belt tightening by consumers and businesses alike, tamping down overall economic activity, analysts predict. The lingering toll of two years of interest rate increases ordered by the Federal Reserve to thwart inflation also figures into the expected cooling of economic growth.

The new GDP report comes amid growing anxiety about mounting troubles with risky mortgages, the severity of the housing slump and weakness in business investment. Those things have raised fresh questions about the country's economic health and contributed to turbulence in the stock market.

In the fourth quarter alone, investment in home building was slashed by 19.8 percent, on an annualized basis, the most in 15 years. Pain will continue from the housing slump that started to grip the economy last year, ending a five-year housing boom.

Federal Reserve Chairman Ben Bernanke, in a congressional appearance Wednesday, said he doesn't expect the economy to fall into a recession this year. His predecessor, Alan Greenspan, puts the odds of a recession at one in three.

Bernanke stuck to the Fed's forecast for the economy to log moderate economic growth in the coming quarters. But he acknowledged risks to the economy have grown.

One of those risks is that business investment could get weaker. Businesses cut back sharply on capital spending in the last year's final quarter - from home building to investment in equipment and software, key factors for the GDP's overall sluggish showing.

"Companies have turned more cautious. With the bursting of the housing bubble, they are fearful that those problems will spill over into other areas," said Ken Mayland, president of ClearView Economics.

Companies' profits lost ground. One measure showed that after-tax profits edged up by just 0.8 percent in the fourth quarter, compared with a 4.2 percent increase in the third quarter.

"Weak corporate profits and concerns about faltering growth will make corporations even more risk averse," said Nariman Behravesh, chief economist at Global Insight.

Consumers, however, showed their resiliency and boosted spending in the fourth quarter.

Inflation, meanwhile, indicated signs of improvement. An inflation gauge tied to the GDP report showed that core prices - excluding food and energy - rose at a rate of 1.8 percent. That's down from a 2.2 percent increase in the third quarter but still higher than the Fed would like.

Fed policymakers held a key interest rate steady last week at 5.25 percent, where it has been since June, and are keeping their options open about any future rate moves. The Fed had boosted rates for two years to fend off inflation. Its goal is to slow the economy sufficiently to combat inflation but not so much as to cripple business activity.

- GDP report