



JOINT ECONOMIC COMMITTEE

ROBERT F. BENNETT, VICE CHAIRMAN

RECENT ECONOMIC DEVELOPMENTS

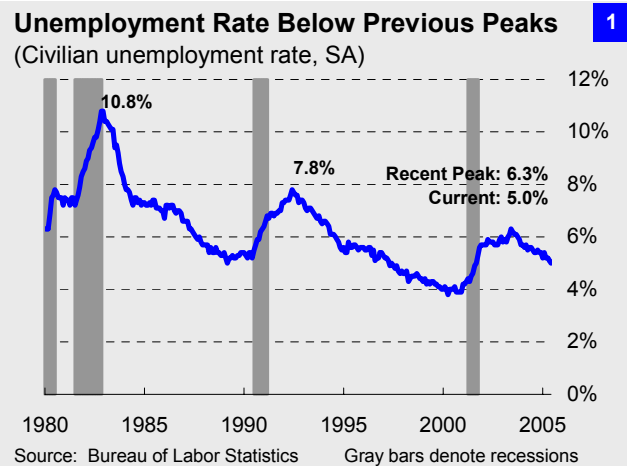
JULY 14, 2005

Robust Economic Growth and Modest Inflation

Economic growth continues at a healthy pace, inflation remains low, and twenty-five months of continuous employment gains have added over 3.7 million new jobs to payrolls. Last month, 146,000 new payroll jobs were created and the unemployment rate edged down to 5.0%. Annualized growth in the inflation-adjusted gross domestic product (GDP) was a robust 3.8% in the first quarter, matching the growth rate in the fourth quarter of 2004. Forecasters see a continuation of healthy growth in GDP and employment along with low inflation. Energy and some commodity prices remain elevated, but general inflation is tame. In light of healthy economic growth and modest overall inflation, the Federal Reserve is expected to continue its policy of increasing overnight interest rates at a measured pace.

Highlights

- Payroll employment rose by 146,000 in June, and the unemployment rate edged down to 5.0%, the lowest since September 2001 (Fig. 1).
- GDP growth was 3.8% in the 1st quarter, matching growth of the 4th quarter (Fig. 2). Forecasters see a continuation of healthy growth.
- Year-over-year Inflation in the “core” consumer price index, which excludes volatile energy and food prices, moderated to 2.2% in May.
- Markets expect the Fed to continue to raise its target overnight interest rate, which it has raised from 1.00% in late June 2004 to the current 3.25% in a sequence of quarter-point increases.



Over 3.7 Million New Jobs Have Been Added to Payrolls in the Past Twenty-Five Months

The economy added 146,000 new *payroll jobs* in June and over 3.7 million in the past twenty five months of consecutive job gains. Over one million new jobs have been added to payrolls so far this year. The *unemployment rate*, based on a survey of households, edged down to 5.0% in June, the lowest since September 2001 and below the average of each of the past three decades (Fig. 1).

GDP Grew at a 3.8% Annualized Rate in the First Quarter

Growth was led by *consumer spending* (which increased 3.6%), *inventory investment* (which added 0.72 percentage points to the first quarter change in GDP), *residential investment* (which increased 11.5%), *exports* (which increased 8.9%), and *business equipment and software investment* (which increased 6.1%). Forecasters see continued strong and steady growth with moderate inflation (Fig. 2, next page).

Consumer Price Inflation Remains Contained

Inflation remains generally contained. Year-over-year inflation in the core *consumer price index* (CPI) was 2.2% in May. Inflation in the core *personal consumption expenditure price index* (PCE), the Fed’s preferred measure of consumer price inflation, was 1.6% in May. Inflation had been mildly accelerating since around September 2003, but the acceleration has moderated in recent months.

The Fed is Expected to Raise Rates Again

The *Federal Reserve* has raised its target *overnight interest rate* from 1.00% to 3.25% in a sequence of nine quarter-point increases that began at the end of June 2004. The Fed's recent policy statement suggests that further increases in short-term interest rates are likely. Financial markets expect further increases. Despite increasing short-term rates, *long-term interest rates* have remained relatively low (Fig. 3).

Housing Markets Remain Vibrant and Prices Soar

Low mortgage interest rates have helped fuel housing market activity. *New and existing home sales* remained at near-record high levels in May (Fig. 4). *Price appreciation* in housing has also been strong, according to data from the Office of Federal Housing Enterprise Oversight. Average U.S. single-family home prices increased 12.5% between the first quarter of 2004 and the first quarter of this year, the strongest growth since the 3rd quarter of 2004, when appreciation surpassed any increase in over 25 years.

Energy Prices Remain Elevated

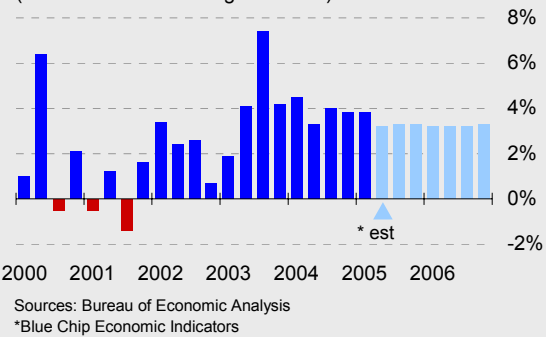
Oil and natural gas prices remain elevated, but have not been accelerating. Crude oil prices have hovered around \$50 a barrel throughout this year, high relative to historical prices, but well below the over-\$80-a-barrel prices (in 2005 dollars) in the early 1980s. The *Organization of Petroleum Exporting Countries (OPEC)* recently signaled a price target above \$50 a barrel for its new reference basket of crude-oil exports, citing strong global demand growth and refining bottlenecks as some of the reasons for elevated prices. Prices in *futures markets* have recently risen past \$60 a barrel, suggesting that energy prices will continue to remain elevated.

The Federal Budget Deficit Improves

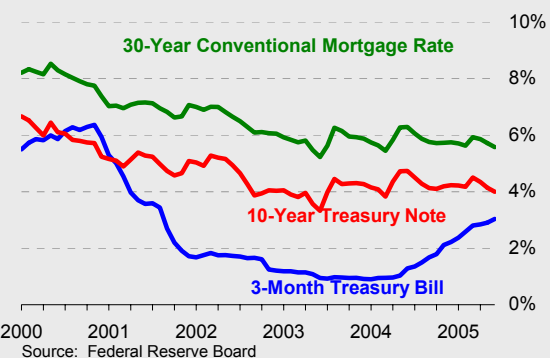
The Congressional Budget Office's (CBO) June *Monthly Budget Review* reports that in the first three-quarters of fiscal year 2005, the *federal government deficit* was \$251 billion, \$76 billion below the deficit recorded in the same period last year. CBO now estimates that, in light of "robust growth in revenues," the 2005 deficit will be significantly less than \$350 billion, perhaps below \$325 billion. Through the first three-quarters of fiscal year 2005, relative to the same period last year: total *receipts* are up 14.6% (corporate income tax receipts up 40.8%, individual income tax receipts up 17.6%, social insurance receipts up 6.9%) while total *outlays* are up 7.4%.

Strong Growth Expected Through 2006

(Real annualized GDP growth rate)

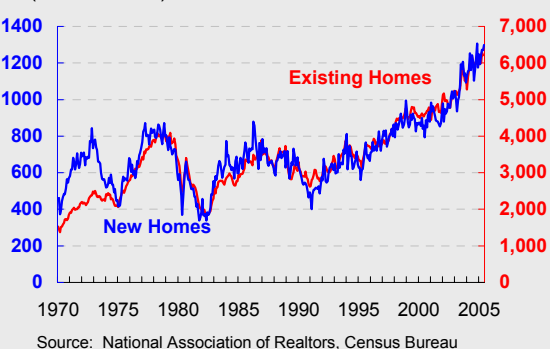


Interest Rates



Homes Sales

(In thousands)



Upcoming Indicators

Federal Reserve – The Fed's next meeting is *August 9*; markets expect another quarter-point increase in short-term interest rates.

Employment – The Bureau of Labor Statistics reports the July employment situation on *August 5*. Jobless claims data arrive every Thursday.

GDP – A first look at GDP for the 2nd quarter arrives *July 29*.

Inflation – The Consumer Price Index for July is scheduled to be released on *August 16* and July's Producer Price Index on *August 17*.