JOINT ECONOMIC COMMITTEE
ROBERT F. BENNETT, VICE CHAIRMAN

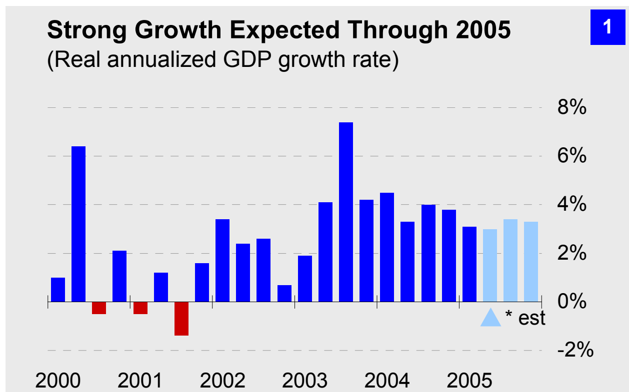
RECENT ECONOMIC DEVELOPMENTS
MAY 10, 2005

Economic Growth Eased, But Remains Healthy

Job gains and economic growth continue at a healthy pace. 274,000 new payroll jobs were created last month and the unemployment rate stayed at 5.2%. Twenty-three consecutive months of job gains have added almost 3.5 million new jobs to payrolls. The gross domestic product (GDP) grew at a healthy 3.1% annualized rate in the 1st quarter, an easing from 3.8% growth in the 4th quarter of 2004. Inflation remains tame, but has crept up over the past year, partly because of escalating energy prices. In light of healthy growth and slight increases in inflation, the Federal Reserve increased overnight interest rates last week. Forecasters see continued low inflation and robust economic growth throughout this year.

Highlights

- GDP growth was 3.1% in the 1st quarter, following 3.8% growth in the 4th quarter of 2004 (Fig. 1). A slowdown in consumer spending growth, from 4.2% in the 4th quarter to 3.5% in the 1st quarter, contributed to the easing of growth.
- Payroll employment rose by 274,000 in April. The unemployment rate stayed at 5.2%.
- The Fed increased its overnight interest rate target from 2.75% to 3.00%. The Fed's policy statement suggests that further increases are likely.
- The current account deficit, a broad measure of wealth flows between the U.S. and other countries, was at a record high 6.3% of GDP in the 4th quarter of 2004.



Sources: Bureau of Economic Analysis
*Blue Chip Economic Indicators

Close to 3.5 Million New Jobs Have Been Added to Payrolls in the Past 23 Months

The economy added 274,000 *payroll jobs* in April, the 23rd consecutive month with job gains (Fig. 2, next page). Close to 3.5 million new payroll jobs have been created over the past 23 months. The *unemployment rate*, based on a survey of households, remained at 5.2% in April, below the average of each of the past three decades. Productivity (output per hour) in the non-farm business sector of the economy grew at a healthy 2.6% annualized rate in the 1st quarter, above expectations. Productivity growth is the engine of gains in wages and living standards over time.

GDP Grew at a Healthy 3.1% Annualized Rate in the First Quarter

Growth was led by *consumer spending* (which increased 3.5%), *inventory investment* (which added 1.21 percentage points to the 1st quarter change in GDP), *exports* (which increased 7.0%), *business investment* (which increased 4.7%), and *residential investment* (which increased 5.7%). Growth eased from the 3.8% pace of the 4th quarter of last year because of slower *business investment in equipment and software*, acceleration in *imports*, and slower consumer spending. Forecasters see a continuation of strong and steady economic growth; the Blue Chip consensus forecast is for GDP to grow at an average annualized rate of around 3.25% through the remainder of 2005.

The Federal Reserve Raised Rates Again

The Fed raised its target *overnight interest rate* from 2.75% to 3.00% last week, reiterating that pressures on inflation have picked up in recent months. Continuing a message that began last May, the Fed stated again that its policy of keeping interest rates low to accommodate economic growth can be removed at a pace that is likely to be measured. The Fed's policy statement suggests that further increases in short-term interest rates are likely. The Fed has raised its target for overnight rates in a sequence of 8 quarter-point hikes that began in June. Despite increases in short-term interest rates, *longer-term rates* have remained relatively low (Fig. 3). Low mortgage interest rates have helped fuel the still-vibrant housing markets.

Inflation Has Remained Tame

Inflation remains generally contained, but has been creeping up. Year-over-year inflation in the core *consumer price index* (CPI) was 2.35% in March; almost double the rate at the start of last year. Inflation in the core *personal consumption expenditure price index* (PCE), the Fed's preferred measure of consumer price inflation, is up from 1.21% at the start of last year to 1.67% in March (Fig. 4).

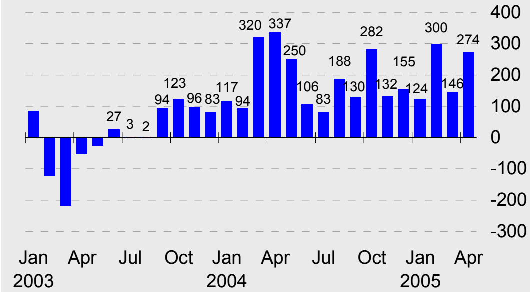
Business Activity Has Remained Vibrant

The *Institute for Supply Management (ISM) manufacturing index* has edged down for five months through April, but has remained above 50 for two straight years. A reading above 50 indicates expansion in the manufacturing sector of the economy. The *ISM non-manufacturing index* was at a value of 61.7 last month, indicating a vigorous pace of expansion in the service-producing sector. The non-manufacturing index has been above 50 for 25 straight months.

The Trade and Current Account Deficits Widen

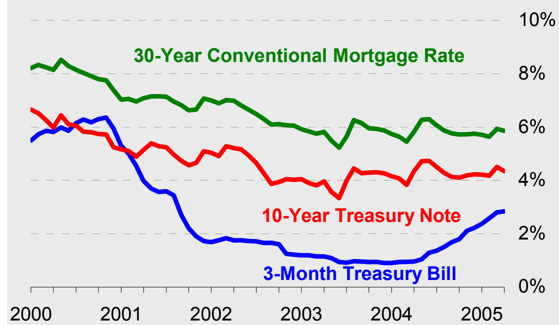
The U.S. *trade deficit* widened in February to a record high \$61 billion as import growth outpaced export growth. Elevated prices of oil imports contributed to the higher deficit. The *current account deficit,* which is dominated by the trade deficit, also widened, to a record high 6.3% of GDP in the 4th quarter of 2004. The current account deficit represents the portion of U.S. investment financed by savings from abroad. Declines in the dollar's value have made U.S. imports more expensive and U.S. exports more competitive overseas, but weakness in economies abroad has hampered U.S. export growth.

Close to 3.5 Million New Jobs in 23 Months **2**
(Change in employment, SA, in thousands)



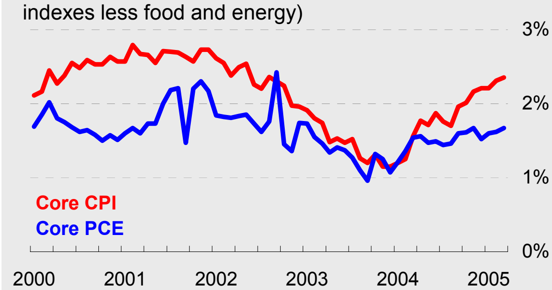
Source: Bureau of Labor Statistics

Interest Rates **3**



Source: Federal Reserve Board

Inflation **4**
(Year-over-year percent change in PCE and CPI indexes less food and energy)



Source: Bureau of Labor Statistics

Upcoming Indicators

Federal Reserve – The Fed's next meeting is *June 29-30*; markets expect another quarter-point increase in short-term interest rates.

Employment – The Bureau of Labor Statistics reports the May employment situation on *June 3.* Jobless claims data arrive every Thursday.

GDP – A second look at GDP for the 1st quarter arrives *May 13.*

Inflation – The Producer Price Index is scheduled to be released on *May 17* and the Consumer Price Index on *May 18.*