



# JOINT ECONOMIC COMMITTEE

ROBERT F. BENNETT, VICE CHAIRMAN

## RECENT ECONOMIC DEVELOPMENTS

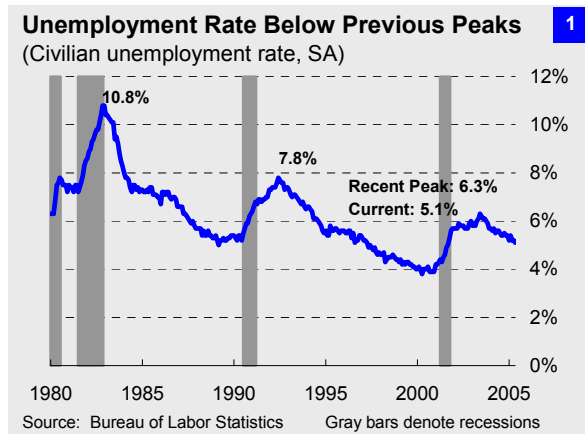
JUNE 21, 2005

### Healthy Economic Growth and Modest Inflation

Economic growth continues at a healthy pace, inflation remains low, and two years of continuous employment gains have added over 3.5 million new jobs to payrolls. 78,000 new payroll jobs were created last month, after a large gain of 274,000 in April, and the unemployment rate edged down to 5.1%. Annualized growth in the inflation-adjusted gross domestic product (GDP) was a robust 3.5% in the 1<sup>st</sup> quarter, only a minor easing from 3.8% growth in the 4<sup>th</sup> quarter of 2004. Forecasters see a continuation of robust growth in GDP and employment along with continued low inflation. Energy and some commodity prices continue to be elevated, but general inflation moderated last month and remains tame. In light of healthy economic growth and modest overall inflation, the Federal Reserve (Fed) is expected to continue its policy of increasing overnight interest rates at a measured pace.

#### Highlights

- Payroll employment rose by 78,000 in May. The unemployment rate edged down to 5.1% (Fig. 1).
- GDP growth was 3.5% in the 1<sup>st</sup> quarter, following 3.8% growth in the 4<sup>th</sup> quarter of 2004 (Fig. 2). Forecasters see a continuation of healthy growth.
- Inflation in the “core” consumer price index, which excludes volatile energy and food prices, moderated to 2.2% in May on a year-over-year basis.
- Markets expect that the Fed will continue to raise its target for overnight interest rates, which it has raised from 1% in late June 2004 to the current 3% in a sequence of quarter-point increases.



#### Over 3.5 Million New Jobs Have Been Added to Payrolls in the Past Two Years

The economy added 78,000 *payroll jobs* in May, the 24<sup>th</sup> consecutive month with job gains, following a much larger gain of 274,000 in April. Over 3.5 million new payroll jobs have been created over the past two years. The *unemployment rate*, based on a survey of households, edged down to 5.1% in May, the lowest since September 2001 and below the average of each of the past three decades (Fig. 1).

#### GDP Grew at a 3.5% Annualized Rate in the First Quarter

Growth was led by *consumer spending* (which increased 3.6%), *inventory investment* (which added 0.78 percentage points to the 1<sup>st</sup> quarter change in GDP), *exports* (which increased 7.2%), *residential investment* (which increased 8.8%), and *business equipment and software investment* (which increased 5.6%). 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 April. 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% to the current 3% in a sequence of eight quarter-point increases that began at the end of June 2004. Testimony by Chairman Alan Greenspan and the Fed's recent policy statement suggest that further increases in short-term interest rates are likely. Financial markets expect further rate hikes. Despite increases in short-term interest rates, *long-term interest rates* have remained relatively low (Fig. 3).

## Housing Markets Remain Vibrant and Prices Soar

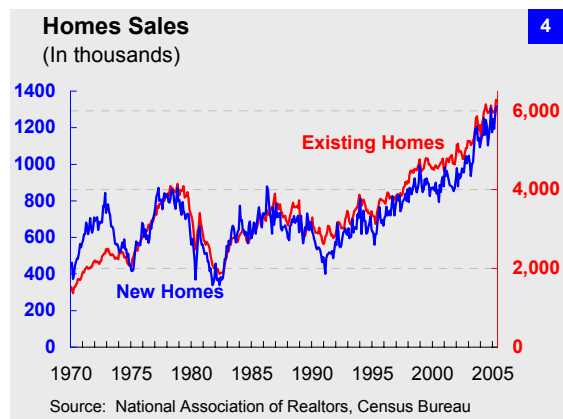
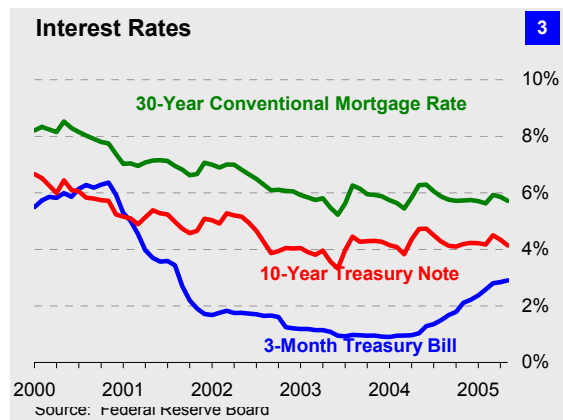
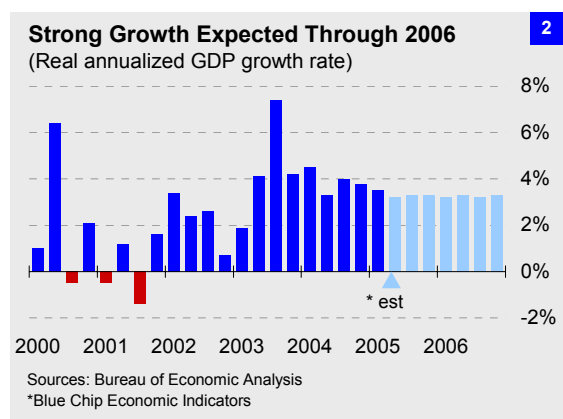
Low mortgage interest rates have helped fuel housing market activity. *New and existing home sales* each set new record-high levels in April (Fig. 4). *Price appreciation* in housing has also been strong, according to data from the Office of Federal Housing Enterprise Oversight. Average U.S. single-family home prices increased 12.5% between the first quarter of 2004 and the first quarter of this year, the strongest growth since the 3<sup>rd</sup> 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 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 suggest that energy prices will continue to remain elevated.

## The Current Account Deficit Widened

The U.S. *current account deficit* widened in the 1<sup>st</sup> quarter to a record high 6.4% of GDP. The current account deficit represents the portion of U.S. investment financed by savings from abroad. The current account deficit is dominated by the trade deficit, and U.S. *import growth* continues to outpace *export growth*. The *value of the dollar* has generally declined since a recent peak in mid-2001, though it has shown some appreciation in recent months. Declines in the dollar's value make U.S. imports more expensive and U.S. exports more competitive overseas, but weakness in economies abroad has hampered U.S. export growth.



### 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 June employment situation on *July 8*. Jobless claims data arrive every Thursday.

**GDP** – The final estimate of 1<sup>st</sup> quarter GDP arrives *June 29*. A first look at GDP for the 2<sup>nd</sup> quarter arrives *July 29*.

**Inflation** – The Consumer Price Index is scheduled to be released on *July 14* and the Producer Price Index on *July 15*.