



JOINT ECONOMIC COMMITTEE

ROBERT F. BENNETT, VICE CHAIRMAN

RECENT ECONOMIC DEVELOPMENTS

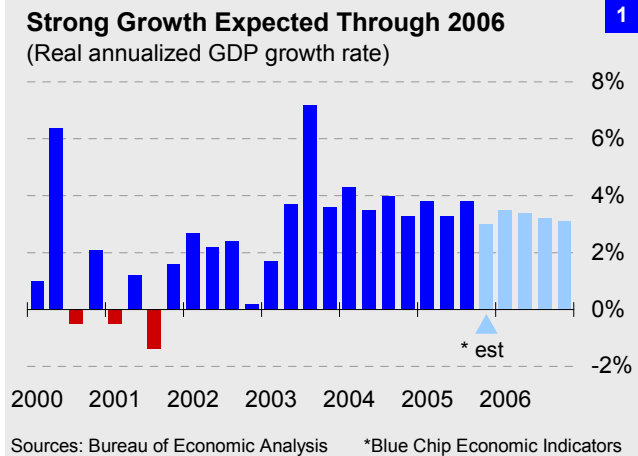
NOVEMBER 15, 2005

Strong Economic Growth Continues

Despite the effects of hurricanes Katrina and Rita the U.S. economy continues to grow at a robust pace. Preliminary third quarter GDP numbers show output increased at an annual rate of 3.8 percent, with employment also climbing steadily. The main area of concern remains energy prices, especially as we approach the winter heating season, and a drift upward of the rate of inflation. A decline in consumer confidence that came on the heels of the Gulf Coast disaster also concerns some economists.

Highlights

- Third quarter real GDP growth was even stronger than expected at a 3.8 percent annualized rate.
- Mild weather and reconstruction in the Gulf region reduced energy prices. Crude oil futures fell to near \$60 a barrel, gasoline futures dropped to around \$1.60 a gallon, and natural gas futures decreased close to \$12 per MMBtu. Prices have declined, but remain high.
- The core personal consumption expenditure price index (core PCE), the Fed's preferred measure of inflation, is up nearly 2.0 percent over the past twelve months.



Output Growth Continues to Be Strong

The 3.8 percent third quarter GDP growth followed a 3.3 percent growth in the previous quarter. The economy is now in the fifth year of the current economic expansion. The third quarter numbers do not capture much of the impacts from the hurricanes, given that both occurred in the very end of the survey period. The effects of the hurricanes will be seen primarily in the fourth quarter GDP, although the momentum of the economy before the hurricane, and the economic activity generated by reconstruction may result in only a slight diminution of output. The current Blue Chip Forecast of economic growth for the fourth quarter of 2005 and the first quarter of 2006 still show a consensus forecast of growth somewhere around 3.4 percent, above the average long-run growth of the past 30 years and especially strong for an economy entering its fifth year of expansion. Productivity swelled above the consensus expectation of 2.6 percent by growing 4.1 percent in the third quarter of 2005. Strides in productivity provide a foundation for future economic growth.

Employment Is Expanding as Well

Despite the disaster in the Gulf Coast, the economy continues to create new jobs. The Bureau of Labor Statistics (BLS) reported that the economy created 56,000 new jobs in October, with 1.675 million new jobs having been created in 2005 thus far. The unemployment rate remains low at 5.0 percent. The BLS estimates that the damage from the hurricanes destroyed roughly 300,000 jobs. The weekly jobless claims also indicate a healthy labor market. Initial jobless claims for the week ending November 5th were 326,000, a number consistent with pre-hurricane levels.

Will The Recent Upturn in Inflation Persist?

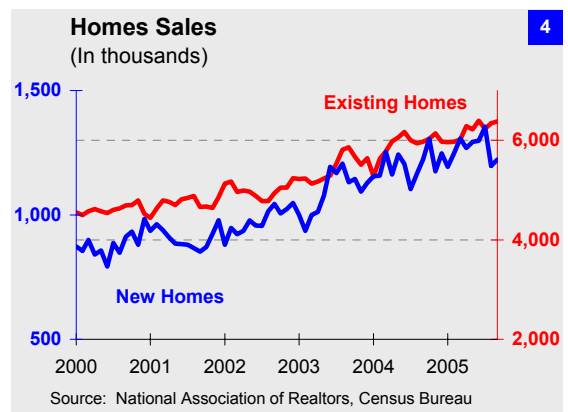
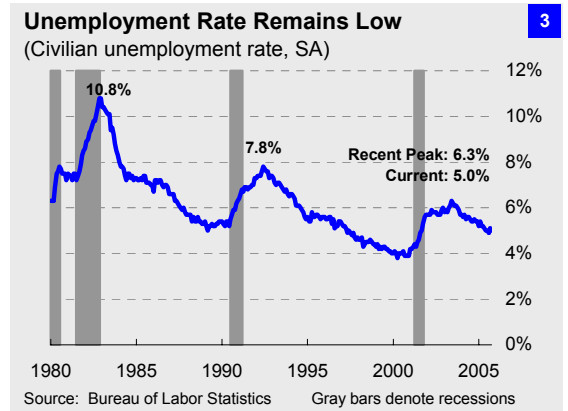
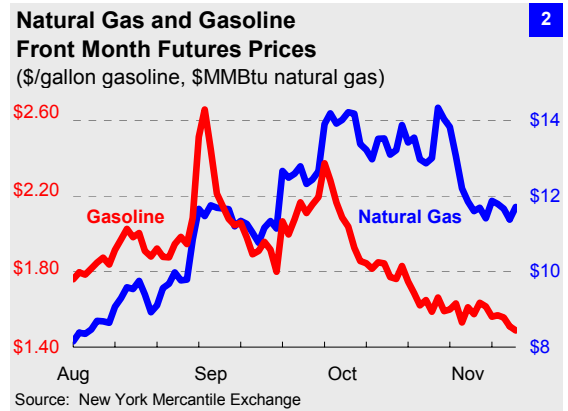
The personal consumption expenditure price index is up by 3.09 percent over the past twelve months. The personal consumption expenditure (PCE) is a price index that is generally less volatile than the consumer price index (CPI). Even when we strip out the volatile energy and food sectors, the core PCE, which is the Federal Reserve's preferred measure of inflation, has increased 1.95 percent over the previous year, which is at the upper limit of the Fed's informal inflation target of 1.0 to 2.0 percent. On November 1st the Fed increased the target interest rates by ¼ point to 4.0 percent. The current conventional wisdom is that the Fed will continue to raise the short term rate up to 4 ½ percent by January 31st when Alan Greenspan departs the Fed. Fed nominee Ben Bernanke is not expected to make any significant shifts in Fed policy and further tightening may occur early in his tenure.

Energy Prices Are Receding But Remain High

Crude oil and gasoline prices seem to have met their peaks this year as progress continues in rebuilding the Gulf region. The beginning of October showed futures gasoline prices near \$2 a gallon and crude oil futures prices at \$65 a barrel. Since that period prices have fallen to \$1.50 for gasoline futures and \$57 for crude oil futures. Diesel fuel continues to sell at prices much higher than average, however, prices have decreased as more refinery capacity comes back online. Natural gas prices will likely see periods of tremendous volatility as the winter season begins. It is likely that the gas market will follow closely the whims of Mother Nature. Consequently, recent mild weather throughout the country and strong natural gas inventories reduced the futures prices of natural gas below \$12 per MMBtu for the week of November 7th. Additionally, if mild weather continues, withdrawals from storage could begin a week or two later than expected.

The Housing Market Seems to Be Cooling

Indicators are signaling a slight cooling in the housing market. New unsold home inventories were at their highest level since 1996 and existing unsold home inventories are also up from last year. Existing home sales were unchanged in September from August. New home sales were up 2.1 percent in September from their 11.6 percent drop in August. Housing starts however, have remained strong, increasing 3.4 percent in September to 2.108 million annualized units. Housing starts have maintained a level above 2 million annualized units each month for six consecutive months.



Upcoming Indicators

Federal Reserve – The Fed's next meeting is *December 13*.

Employment – The Bureau of Labor Statistics reports the September employment situation on *December 2*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index for October is scheduled to be released on *November 15* and the Consumer Price Index on *November 16*.