



JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

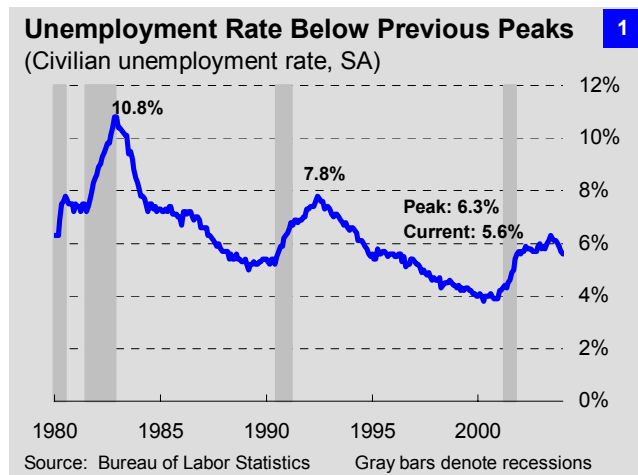
MARCH 9, 2004

Rapid Economic Growth, But Slow Job Gains

The economy continues to strengthen, but payroll employment continues to lag. Business activity in manufacturing and service industries remains very strong as profits and cash flow continue to improve, but the recent pace of job growth has been sluggish. Households continue to benefit from recent tax relief and healthy gains in housing and stock-market wealth. Inflation remains benign, helping keep interest rates at historic lows. Last year's GDP growth averaged 4.3%, the strongest in four years and well above the average of 3.7% in the expansion of the 1990s. Forecasters expect sustained and robust growth, low inflation, and accelerating job gains.

Highlights

- Payroll employment increased by 21,000 jobs in February, below expectations. The unemployment rate remained at 5.6% (Figure 1).
- The economy grew at a robust 4.1% annual rate in the 4th quarter of 2003. Forecasters project sustained growth of over 4% throughout this year.
- The employment component of the Institute for Supply Management's manufacturing index is at its highest since 1988, suggesting that manufacturers may accelerate hiring.



Employment Rises and the Unemployment Rate Continues to Fall

The *unemployment rate* held steady at 5.6% in February, well below its recent peak of 6.3% last June; *payroll employment* edged up by 21,000 jobs. Six months of job gains have now added 364,000 jobs to U.S. payrolls, but the pace of job gains remains sluggish. The *household survey*, used to calculate the unemployment rate, showed job losses in February after large gains in January; over the last six months, the household measure has increased by about 1 million jobs. Manufacturing employment fell by 3,000 jobs, but the pace of job losses has subsided substantially. Both *initial and continuing jobless claims* have fallen to levels consistent with an improving labor market.

GDP and Productivity Grow at Strong and Sustainable Rates

The revised estimate of 4th quarter growth in the *real gross domestic product (GDP)* was a robust 4.1% annual rate, following the 3rd quarter's remarkable 8.2% growth (Figure 2, next page). The 6.2% growth in the second half of 2003 was the fastest in almost 20 years. Boosted by profit growth and tax cuts, *business investment* in equipment and software posted very rapid growth in 2003 as a whole, rising over 15% in each of the last two quarters of the year. Exports also expanded rapidly in the last two quarters, reflecting declines in the value of the dollar. Forecasters believe that GDP growth will be sustained at above 4% this year.

Business Activity is Robust

The *Institute for Supply Management's (ISM) manufacturing index*, which measures activities of manufacturers, has been above 60 for four months; above 50 indicates expansion and above 60 indicates vigorous expansion (Figure 3). February's employment component of the index was at the highest since 1988, suggesting that manufacturers may accelerate hiring. Expansion in services is also rapid. The *ISM services index* was above 60 in February for the sixth time in the last eight months.

Consumers are Resilient

After large January gains, *consumer confidence* retreated in February as expected. Confidence measures remain well above last summer's readings and *consumer spending* continues to advance, rising 0.4% in January and 0.5% in December. January's *personal income* gains were moderate, but after-tax income and wage and salary growth were strong. Consumer spending is expected to stay healthy, aided by after-tax income gains from higher tax refunds.

Inflation Remains Tame

Core consumer price *inflation*, which omits volatile food and energy prices, remained at annualized 1.1% last month, the lowest since 1966. *Energy prices* remain high and inventory concerns have lifted prices of some commodities, including gasoline, industrial metals, and soybeans. Natural gas prices have risen above last year's already-high average price. Crude oil prices are up by around 25% in the past 6 months, touching almost \$37 a barrel recently. Persistently high energy prices could inhibit economic growth.

Household Wealth has Risen

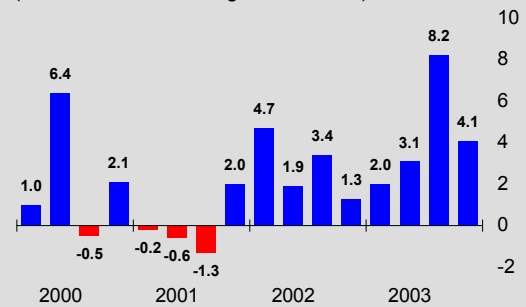
Last year's blistering pace of *home sales* lifted the *homeownership rate* to a record 68.6%. Strong gains in home prices have lifted *housing wealth*. Families have also benefited from restoration of \$4 trillion of *stock market wealth* since October 2002. Over half of households own stocks directly or indirectly, compared to less than one-third at the end of the 1980s.

The Dollar has Strengthened

The dollar has strengthened this year, by around 2.5% against *Japan's yen* and 3.1% against *the euro* on the strength of the U.S. recovery. Slow economic recoveries abroad limit markets for U.S. exports.

Strong Growth in Second Half of 2003

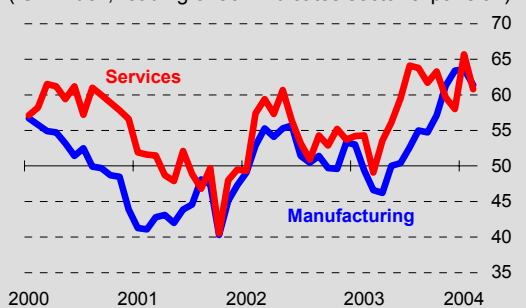
(Real annualized GDP growth rate, %)



Source: Bureau of Economic Analysis

Business Activity Continues to Increase

(ISM Index, reading of 50+ indicates sector expansion)



Source: Institute for Supply Management

Upcoming Indicators

GDP – The “final” estimate of GDP growth for the 4th quarter arrives *March 25*. The “preliminary” estimate was 4.1% growth.

Employment – The Bureau of Labor Statistics reports March's employment situation on *April 2*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index is announced *April 8*, and the Consumer Price Index follows on *April 14*. The data should show a continuation of very low inflation.