JOINT ECONOMIC COMMITTEE

ROBERT F. BENNETT, VICE CHAIRMAN

RECENT ECONOMIC DEVELOPMENTS

MARCH 8, 2005

Job Gains and Economic Growth Continue

Job gains and economic growth continue at a healthy pace. 262,000 new payroll jobs were created last month. Twenty-one consecutive months of job gains have added over three million new jobs to payrolls. Growth in the gross domestic product (GDP) in the 4th quarter of last year was revised up to an annualized 3.8% rate from a prior estimate of 3.1%. While economic growth has been robust, inflation remains tame, but has crept up over the past year. In light of strong growth and slight increases in inflation, the Federal Reserve increased overnight interest rates last month. Forecasters see continued low inflation and robust economic growth throughout this year.

Highlights

- Payroll employment rose by 262,000 in February (Fig. 1). The unemployment rate edged up to 5.4% in February, from 5.2% in January.
- GDP growth was revised up to 3.8% for the 4th quarter of 2004 from a prior estimate of 3.1%, led by a sharp upward revision in exports.
- The trade deficit remains elevated, but narrowed in December to $56.4 billion as a large drop in oil prices lowered the value of imports.
- The Fed increased its target for overnight interest rates from 2.25% to 2.50% last month. The Fed's policy statement suggests that further increases are likely.

21 Straight Months of Job Gains Have Added Over 3 Million New Jobs to Payrolls

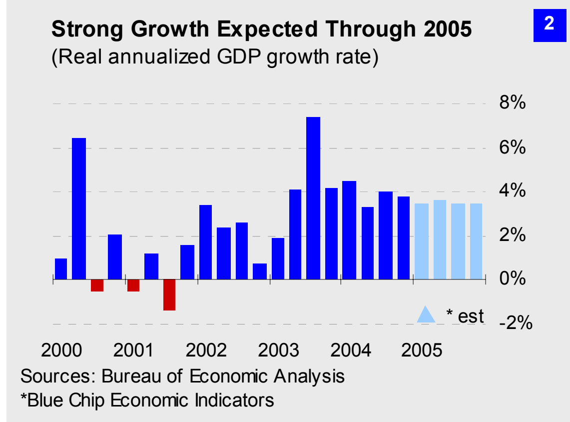
The economy added 262,000 *payroll jobs* in February, the 21st consecutive month with job gains. Manufacturing employment rose by 20,000 jobs in February. The *unemployment rate*, based on a survey of households, edged up to 5.4% in February from 5.2% a month earlier. The unemployment rate remains well below the average of each of the past three decades.

3.8% Annualized GDP Growth in the Fourth Quarter and 4.4% Growth in 2004.

GDP growth was revised up to a 3.8% annual rate in the 4th quarter of last year, from a prior estimate of 3.1%. Much of the revision reflected a sharp upward revision to exports caused by an accounting error by Statistics Canada. Robust consumer and business investment spending continued to fuel growth in the 4th quarter. *Personal consumption expenditures* grew at an annualized 4.2% rate and *business investment spending* grew at an annual 14% rate, including 18% growth in equipment and software spending. Inventory buildups by businesses added 0.6 percentage point to 4th-quarter growth. Inflation-adjusted GDP growth was 4.4% in 2004, the fastest since 1999. 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 3.5% throughout 2005 (Fig. 2, next page).

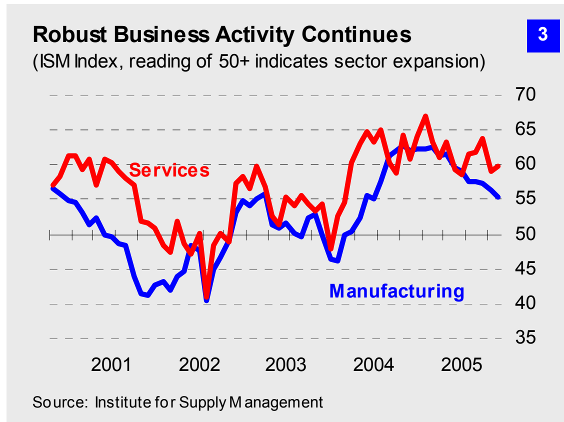
The Trade Deficit Narrowed, But Remains Large

The U.S. *trade deficit* narrowed in December as the biggest drop in oil prices in 14 years lowered the value of imports. However, the trade deficit remains large, totaling an annualized $623.4 billion in the 4th quarter, the largest dollar value on record. 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. Euro zone GDP grew at a modest 1.6% annual rate in the 4th quarter and Japan posted declines in GDP in the last three quarters.



The Federal Reserve Raised Rates Again

The *Federal Reserve* increased its target for overnight interest rates from 2.25% to 2.50% last month. 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 indicates that further increases in short-term interest rates are likely. The Fed has raised its target for overnight rates in a sequence of quarter-point increases that began in June, bringing the target rate from 1.00% to the current 2.50%.



Inflation Has Remained Tame

Inflation remains generally contained, but has crept up since the beginning of last year. Year-over-year inflation in the core *consumer price index* was 2.2% in January; almost double the 1.2% rate at the start of last year. Inflation in the core *personal consumption expenditure price index*, the Fed's preferred measure of consumer price inflation, is up from 1.1% at the start of last year to 1.6% in January.

Business Activity Has Remained Vibrant

The *Institute for Supply Management (ISM) manufacturing index* declined last month, but has remained above 50 for 22 straight months. A reading above 50 indicates expansion in the manufacturing sector of the economy. The *ISM non-manufacturing index* rose last month to almost 60, indicating a vigorous pace of expansion in the service-producing sector of the economy. The non-manufacturing index has been above 50 for 23 straight months (Fig. 3).

Upcoming Indicators

Federal Reserve – The Fed's next meeting is on *March 22*; markets expect another quarter-point increase in short-term interest rates.

Employment – The Bureau of Labor Statistics reports the March employment situation on *April 1.* Jobless claims data arrive every Thursday.

GDP – The final estimate of GDP growth for the 4th quarter arrives *March 30*. The first look at GDP growth for the 1st quarter of this year is scheduled to be released *April 21.*

Inflation – The Consumer Price Index is scheduled to be released *March 23.* The Producer Price Index is scheduled to be released *March 22.*