JOINT ECONOMIC COMMITTEE

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RESEARCH REPORT #109-47
December 19, 2006

ECONOMIC VITAL SIGNS: DECEMBER 2006

Third quarter GDP growth for 2006 was revised up to 2.2%. The annual rate of economic growth for the last year – from the third quarter of 2005 to the third quarter of 2006 – was 3.0%. More than six million non-farm payroll jobs have been added since August of 2003.

Economic Indicators

- The economy has grown 3.0% in the last year
- Employment in November
  - 132,000 payroll jobs were added
  - 4.5% unemployment rate
  - Weekly earnings rose 4.4% in the last year
- 3rd quarter real fixed business investment rose 10.0%
- Industrial production rose 4.9% from October '05 to October '06
- Real disposable personal income per capita increased 2.1% from the 3rd quarter of '05
- Price level increase from November 2005
  - 2.0% increase in the CPI for all items
  - 2.6% increase in the core CPI
- Interest rates in November
  - Home mortgage rates averaged 6.24%
  - 10-year Treasury notes averaged 4.6%
  - Prime rate remained 8.25%

REAL GDP

The Commerce Department revised third quarter growth in real gross domestic product (GDP) – the inflation-adjusted measure of current output of goods and services produced by labor and property located in the U.S. – to 2.2%. The growth in real GDP growth can largely be attributed to increases in personal consumption expenditures, private nonresidential fixed investment and exports. The decline in residential investment is the principle cause of third quarter real GDP growth falling below the long-term trend.

While certain sectors of the economy have experienced some cooling lately, namely, residential housing and automobile manufacturing, preponderance of economic sectors continue to expand.

EMPLOYMENT

The economy added 132,000 non-farm payroll jobs in November. Since the beginning of the year, the economy has created, on average, 149,000 non-farm payroll jobs per month. The unemployment rate stood at 4.5% in November. Since August of 2003, the economy has created over six million jobs.[1]

INVESTMENT

Real fixed nonresidential investment spending accelerated from 4.4% in the second quarter to 10.0% in the third. Investment in nonresidential structures was particularly strong. On the other hand, residential investment dropped significantly, dampening the growth in the broad measure of investment.

INDUSTRIAL PRODUCTION

According to the Institute for Supply Management (ISM), the index for manufacturing activity did not indicate an expanding sector in November, for the first time in 41 months. In contrast, the non-manufacturing sector continues to expand at a healthy rate, having grown for 44 consecutive months. In 2005, the non-manufacturing sector, as defined by the ISM, accounted for about 86 percent of GDP (not including federal, state and local government services).

[1] The Bureau of Labor Statistics will revise the benchmark employment figures in February of 2007. After this revision, the job creation statistic is expected to be seven million jobs.

According to the Federal Reserve, November industrial production increased 0.2%. Total output has increased by 3.8% since November of last year.

PERSONAL INCOME

The Bureau of Labor Statistics reported that average weekly earnings – not accounting for changes in the price level – have risen by 4.4% since November of last year. According to the Bureau of Economic Analysis, real disposable personal income per capita increased 2.1% from the third quarter of 2005 to the third quarter of 2006.

HOUSING SECTOR

After a couple years of rapid price acceleration, the increase in home prices has leveled off and, in some regions, has declined slightly. The national average price of an existing home in October was about the same as the average price for the year 2005. The volume of existing home sales has also diminished over the course of the last year.

The Census Bureau reported that the November estimates for building permits and housing starts are below the November 2006 estimates. The housing sector may be stabilizing, however. November's estimate for housing starts is 6.7% above the estimate for October.

The cooling residential housing market has tempered the rate of economic growth, and, in some quarters, the cooling has been a source of concern. Many industry experts, however, are sanguine about the housing market through 2007. For example, David Lereah, the National Association of Realtors chief economist, said that the market appears to be stabilizing and that home sales are still at historical highs. Home sales for 2006 are expected to be the third highest on record.

INTEREST RATES

The Federal Reserve, in an effort to restrain potential inflationary pressures, raised the federal funds rate to 5.25% on June 29. To the relief of many investors and economists, Federal Reserve policy makers have not increased interest rates since. The prime rate also stabilized and stands at 8.25%.

Long-term interest rates are low. The rate on 10-year Treasury notes has been on a gradual descent since June, averaging 4.60% in November. The standard 30-year mortgage rate has also moved down from its July high, averaging 6.24% in November.

INFLATION

Both headline and core inflation measures for November appear to reflect declining energy prices. The headline Consumer Price Index, which includes all types of consumer items, and the core index, which excludes volatile energy and food prices, were unchanged in November. Over the last twelve months, the headline inflation measure has increased 2%. The core inflation measure was 2.6% higher than in November of 2005.

Energy prices have edged up in the last month. Many energy analysts, however, do not expect a dramatic increase in crude oil prices. The Energy Information Administration, for example, has forecast the benchmark crude oil price to stabilize around $65 a barrel in 2007.

CLOSING THOUGHTS

The economy is still adding jobs at a healthy rate despite several factors that have dampened recent economic growth – the automobile industry undergoing significant restructuring, the housing market cooling and energy prices being elevated. Inflationary pressures, in part reflected in rising energy prices or an overheated labor market, seem to have abated. As a result, most analysts do not expect the Federal Reserve to increase interest rates in the foreseeable future. That, in turn, bodes well for moderate economic growth to continue.