



JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

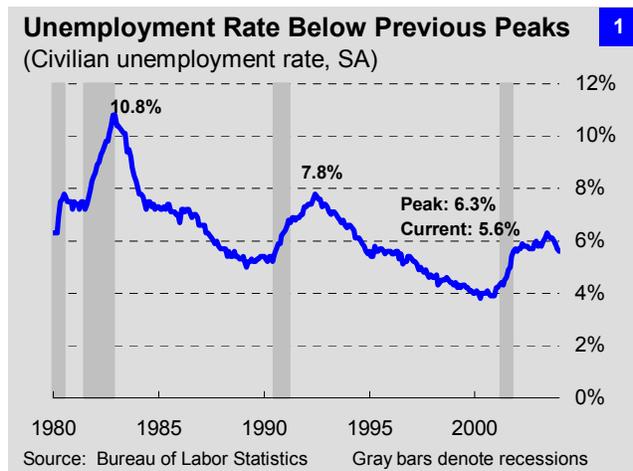
FEBRUARY 10, 2004

Strong and Sustainable Growth

The recovery continues at a strong pace. Payrolls increased by over 100,000 jobs in January, as activity in manufacturing and services industries accelerated. Last year closed with the economy growing at a 4% annual rate and productivity growing at a 2.7% annual rate, well above long-run averages. Inflation remains benign, allowing the Federal Reserve to maintain short-term interest rates at historical lows, and recent tax relief continues to benefit consumers and businesses. Forecasters see continued robust growth, low inflation, and accelerating job gains throughout the year.

Highlights

- Payroll employment increased by 112,000 jobs in January, the largest monthly gain since 2000, and the unemployment rate fell to 5.6% (Figure 1).
- The economy grew at a robust 4% annual rate in the 4th quarter of 2003. Forecasters see continued growth of around 4% throughout this year.
- Productivity—output per hour of labor—grew at a 2.7% pace in the 4th quarter, above historical averages.
- The Federal Reserve kept short-term interest rates unchanged at 1%.



Employment Rises and the Unemployment Rate Continues to Fall

The *unemployment rate* fell to 5.6% in January, well below its recent peak of 6.3% last June, and *payroll employment* increased by 112,000 jobs. Five straight months of job gains have now added 366,000 jobs to U.S. payrolls. The *household survey*, used to calculate the unemployment rate, showed employment gains of almost 500,000 in January; the gap between the household and payroll measures of employment continues to widen. Confirming labor market improvements, both *initial and continuing jobless claims* for unemployment insurance benefits have been trending downward.

GDP and Productivity Grow at Strong and Sustainable Rates

Real gross domestic product (GDP) grew at a solid 4% annual rate in the 4th quarter, following the 3rd quarter's remarkable 8.2% growth (Figure 2, next page). In the second half of 2003, the economy grew at the fastest six-month pace in almost 20 years. Over 2003 as a whole, GDP grew at a robust average rate of 4.3%. By way of comparison, the economy grew at an average rate of 3.7% during the expansion of the 1990s. *Productivity* also advanced, growing at a 2.7% annual rate in the 4th quarter and in excess of 4% for the second consecutive year, well above historical averages. Forecasters believe that GDP growth will be sustained at around 4% throughout this year.

Business Activity Continues to Strengthen

Increases in *average weekly hours* of work and moderation of job losses in manufacturing indicate rising activity. Confirming this trend, the *Institute for Supply Management's (ISM) manufacturing index* has risen since May to its highest value since 1983. The *ISM services index* has also been rising and in January was the highest in its history (Figure 3). An index value above 50 means that the relevant sector is expanding. Current values of well above 60 indicate vigorous expansion in manufacturing and services.

Consumer Confidence and Spending Grow

The *University of Michigan's Consumer Sentiment Index* rose in January to its highest value since 2000. The *Confidence Board's index* rose to the highest in 18 months. *After-tax incomes* also continue to grow, boosted by tax cuts. Improved sentiment and incomes have boosted *consumer spending*, which grew at a 2.6% annual pace in the 4th quarter after hearty spending in the 3rd quarter. After-tax incomes will improve further as taxpayers receive higher refunds.

The Fed Holds Monetary Policy Unchanged

In January, the Fed kept *short-term interest rates* at the five-decade low of 1% but changed its policy statement to set up flexibility to raise rates if it sees signs of *inflation*. Many measures of inflation are at their lowest since the 1960s, a key reason the Fed has “accommodated” strong growth without raising rates.

The Housing Market Remains Robust

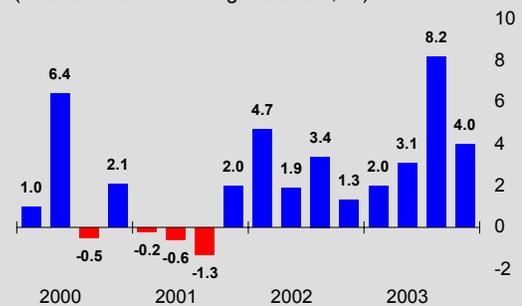
Remarkably strong home sales have boosted the *homeownership rate* to a new high of 68.5%. Many signs point to more strength in housing in the near term. *Mortgage applications* have risen again on a renewed dip in mortgage rates; *housing starts* rose in December to the highest in about 20 years; and *permits* for home construction were up in the 4th quarter.

Finance Ministers Met to Discuss Exchange Rates

Ministers from major industrialized countries met last weekend to discuss currency issues, including the dollar's recent decline and China's dollar peg. *The dollar* fell 10% against *Japan's yen* and 17% against *the euro* last year, making U.S. exports less costly in world markets and imports more costly. Ministers again called for flexible, “orderly” exchange rates.

Strong Growth in Second Half of 2003

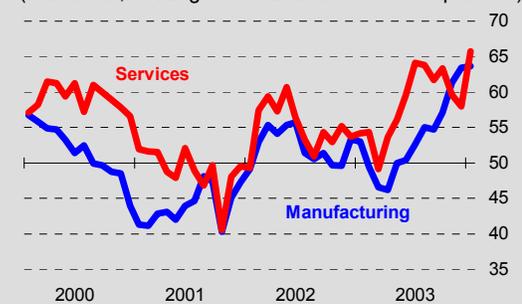
(Real annualized GDP growth rate, %)



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 – A revised estimate of GDP growth for the 4th quarter arrives *February 27*. The initial estimate was 4% growth.

Employment – The Bureau of Labor Statistics reports February's employment situation on *March 5*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index is announced *February 19*, and the Consumer Price Index follows on *February 20*. This month's data should show a continuation of very low inflation.