JOINT ECONOMIC COMMITTEE

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RECENT ECONOMIC DEVELOPMENTS

MAY 15, 2006

Robust Economic Growth

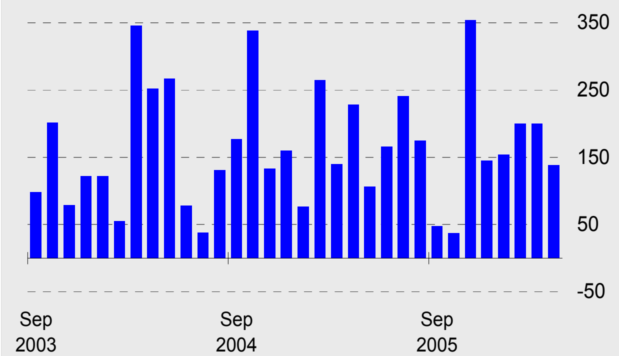
Recent trends in the U.S. economy have been quite favorable, with robust growth in jobs and output, historically low unemployment and interest rates, and low general inflation despite rises in energy prices. Inflation in overall consumer prices has been boosted by increases in energy prices. Yet increases in prices of energy and other commodities have so far only had a modest effect on prices of non-energy goods and services. The inflation rate for prices of consumer goods and services excluding food and energy, as measured by the "core" personal consumption expenditures price index, the Fed's preferred measure of core consumer prices, has been at or slightly below 2.0% over the past year. Forecasters see a continuation of healthy growth with core inflation remaining well contained. They also see continued healthy job gains and historically low unemployment and interest rates.

Highlights

- Payroll employment rose by 138,000 net new jobs in April, the 32nd consecutive month of employment gains (Fig. 1). The unemployment rate held steady at 4.7% in April.
- Annualized real GDP growth was a rapid 4.8% in the 1st quarter of 2006. Forecasters believe that growth will average a trend-like 3.0% through the end of next year (Fig. 2, next page).
- Productivity (output per hour) in the business sector grew at a robust 3.4% annual rate in the 1st quarter and real hourly compensation grew at an annual 3.6% rate.
- The trade deficit fell in March to $62 billion, the narrowest in 8 months.

Job Growth in the Past 32 Months Fig. 1

(Change in employment, in thousands)



Source: Bureau of Labor Statistics

32 Consecutive Months of Job Gains Have Added Close to 5.3 Million New Jobs to Payrolls

The economy added 138,000 net new *payroll jobs* in April, the 32nd consecutive month with job gains (Fig. 1). Close to 5.3 million new jobs have been added to payrolls in that period and nearly 2 million new jobs have been created in the last year alone. The *unemployment rate*, based on a survey of households, held steady at 4.7% in April. The unemployment rate remains below the averages of the 1960s (4.8%), 1970s (6.2%), 1980s (7.3%), and 1990s (5.8%) and is well below the near-term peak in the unemployment rate of 6.3% in June 2003.

Rapid 4.8% Annualized GDP Growth in the First Quarter

GDP growth was a rapid 4.8% in the 1st quarter, a sharp rebound from the lull to 1.7% growth in the final quarter of last year. The acceleration in growth from the final quarter of last year reflected faster growth in consumer spending on durable goods, an upturn in federal government spending, and faster growth in exports and in equipment and software spending by businesses. GDP growth has averaged 3.9% since the tax relief measures were enacted in 2003, faster than the averages of the 1970s (3.4%), 1980s (3.1%), and 1990s (3.3%). The *Blue Chip* forecast—a monthly consensus of private forecasters—is for trend-like 3.0% real GDP growth, on average, through 2007 (Fig. 2, next page).

Robust Productivity and Compensation Gains in Q1

Productivity grew at a robust annualized 3.4% rate in the business sector and a rapid 4.2% rate in manufacturing in the 1st quarter. Business sector productivity growth has averaged 3.3% since the 1st quarter of 2001, above the averages of the 1960s (3.1%), 1970s (2.1%), 1980s (1.6%), and 1990s (2.2%). Annualized growth in *real compensation per hour* in the business sector was a rapid 3.6% in the 1st quarter. Real compensation per hour has grown at an average 1.8% annual rate since the 1st quarter of 2001, above the averages of the 1970s (1.3%), 1980s (0.7%), and 1990s (1.4%).

The Trade Deficit Narrowed in March

The U.S. *trade deficit* fell to $62 billion in March on stronger-than-expected demand for U.S. goods abroad and a since-reversed decline in energy prices. Exports grew by 1.9% from February while imports fell 0.8%. Oil continued to be a big part of the trade imbalance in March, with the value of imported crude rising to $16.3 billion in March, from $15.6 billion a month earlier. The gain reflected a higher volume of energy imports, partially offset by a slightly lower price.

The Fed Raised Rates Again, As Expected

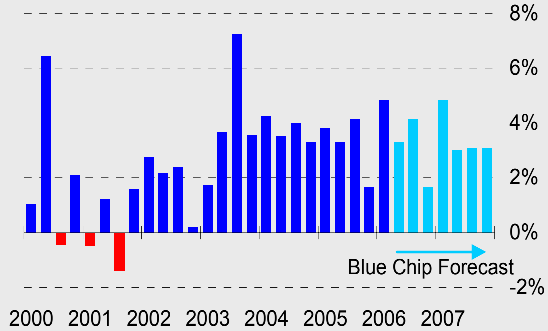
The *Federal Reserve*, as expected, increased its target for overnight interest rates on May 10 from 4.75% to 5.00%, the sixteenth increase in as many meetings of the Fed's policymaking committee. The Fed noted that "…some further policy firming [higher short-term interest rates] may yet be needed to address inflation risks but…the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information." This signals that future interest rate decisions will be more "data driven" than the past sixteen decisions to hike rates.

Business Activity Has Accelerated

The *Institute for Supply Management (ISM) manufacturing index* increased to 57.3 in April, from 55.2 a month earlier, indicating robust expansion in the manufacturing sector. A reading above 50 indicates expansion; around 60 indicates a vigorous pace of expansion. The ISM manufacturing index has been above 50 for 35 consecutive months. The *ISM non-manufacturing index* also rose last month, to 63.0, from 60.5 a month earlier, indicating a vigorous pace of expansion in the service-producing sector of the economy. The non-manufacturing index has been above 50 for 37 consecutive months of expansion (Fig. 3).

18 Consecutive Quarters of Growth **Fig 2**

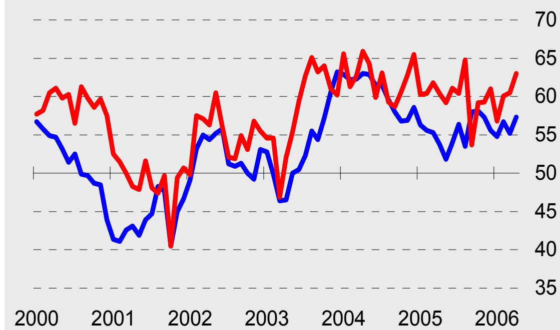
(Real annualized GDP growth rate in each quarter)



Sources: Bureau of Economic Analysis

Business Activity Continues to Expand **Fig 3**

(50 or above indicates sector expansion)



Source: Institute for Supply Management

Upcoming Indicators

Inflation – The Consumer Price Index for April is scheduled to be released on *May 17*.

GDP – A second look at GDP growth for the 1st quarter is scheduled for release on *May 25.*

Employment – The Bureau of Labor Statistics reports May's employment situation on *June 2.*

Federal Reserve – The Fed's next monetary policy meeting is scheduled for *June 28 and 29.*