



# JOINT ECONOMIC COMMITTEE

## ROBERT F. BENNETT, VICE CHAIRMAN

### RECENT ECONOMIC DEVELOPMENTS

MARCH 14, 2006

## Economy Poised for a Growth Rebound

Strong job gains and a continuation of low unemployment last month support the consensus forecast of a resumption of rapid growth in the current quarter. Despite a slowdown in the 4<sup>th</sup> quarter, growth in the inflation-adjusted (real) gross domestic product (GDP) was a robust 3.5% last year. Forecasters see a sharp rebound in economic growth this quarter, and sustained healthy growth throughout the year. They also see healthy job gains, historically low unemployment, and low inflation and interest rates.

### Highlights

- Payroll employment rose by a robust 243,000 new jobs in February, the 30<sup>th</sup> consecutive month of employment gains (Fig. 1). The unemployment rate edged up to 4.8% in February, from a 4½ - year low of 4.7% in January.
- Annualized real GDP growth was revised up to 1.6% for the 4<sup>th</sup> quarter of 2005 from a prior estimate of 1.1%. Forecasters believe that the economy is poised for a surge in growth to 4.7% this quarter (Fig. 2, next page).
- The trade deficit remains elevated, rising by 5.3% in January to a new record dollar-value high of \$68.5 billion.



### 30 Straight Months of Job Gains Have Added Close to 5 Million New Jobs to Payrolls

The economy added 243,000 *payroll jobs* in February, the 30<sup>th</sup> consecutive month with job gains (Fig. 1). Close to 5 million new jobs have been added to payrolls in that period, and 2.3 million new jobs have been created in the last year alone. The *unemployment rate*, based on a survey of households, edged up to 4.8% in February from a 4½-year low of 4.7% a month earlier. The unemployment rate remains well below the averages of the 1970s, 1980s, and 1990s and is well below the near-term peak of 6.3% in June 2003.

### 1.6% Annualized GDP Growth in the Fourth Quarter and 3.5% Growth in 2005.

*GDP growth* was revised up to a 1.6% annual rate in the 4<sup>th</sup> quarter of last year, from a prior estimate of 1.1%. The disappointing growth performance broke a 10-quarter string of growth at 3.3% or more. The slowdown in growth from the rapid 4.1% rate posted in the 3<sup>rd</sup> quarter is attributed to factors that most analysts believe are likely to prove temporary, such as a lull in consumer spending on vehicles and a sharp downturn in Federal Government spending. Despite the 4<sup>th</sup>-quarter slowdown, real GDP growth was a robust 3.5% last year. The *Blue Chip* forecast—a monthly consensus of private forecasters—is for real GDP growth to surge to a rapid 4.7% this quarter, followed by a return toward healthy, trend-like growth between 3.4% and 2.9% during the remaining quarters of this year (Fig. 2, next page).

## The Trade Deficit Rises to New Record High

The U.S. *trade deficit* rose by 5.3% in January to a new record dollar-value high of \$68.5 billion, surpassing the old monthly record of \$67.8 billion set last October. Import growth in January grew by 3.5%, outstripping export growth of 2.5%. The U.S. trade deficit was \$723.6 billion for all of 2005, a record high.

## The Fed is Expected to Raise Rates Again

Markets expect that the *Federal Reserve* will continue its recent course of monetary policy by increasing its target for overnight interest rates again by a quarter percent at its policymaking meeting scheduled for March 27 and 28. Markets also assign high odds to yet another quarter-point increase at the Fed's May 10 meeting. The Fed has raised its target overnight interest rate from 1.0% to the current 4.5% in a sequence of quarter-point increases that began at the end of June 2004.

## Inflation Has Remained Tame

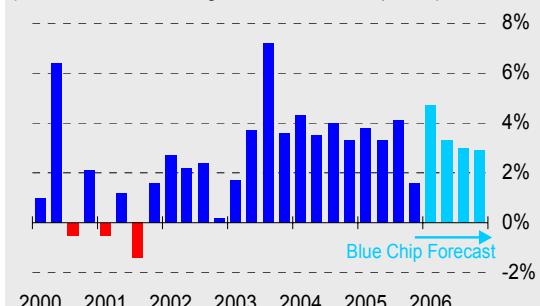
Year-over-year *inflation* in the "core" *consumer price index*, which excludes volatile energy and food prices, was 2.1% in January, slightly below the average of roughly 2.2% throughout last year. Annual inflation in the core *personal consumption expenditure price index*, the Fed's preferred measure of consumer price inflation, was 1.7% in the 4<sup>th</sup> quarter of last year, little changed from earlier quarters. Surges in energy prices have been the dominant factor affecting inflation in recent years. According to recent remarks by Fed Vice Chairman Roger W. Ferguson, Jr., "...increases in energy prices over the past couple of years probably added about ½ percentage point to core inflation in 2005..."

## Business Activity Has Remained Vibrant

The *Institute for Supply Management (ISM) manufacturing index* increased to 56.7 in February, from 54.8 a month earlier, indicating robust expansion in the manufacturing sector. A reading above 50 indicates expansion. The ISM manufacturing index has been above 50 for 33 consecutive months. The *ISM non-manufacturing index* also rose last month, to 60.1, indicating a vigorous pace of expansion in the service-producing sector of the economy. The non-manufacturing index has been above 50 for 35 consecutive months of expansion (Fig. 3).

### Economic Growth Since 2000

(Real annualized GDP growth rate in each quarter)

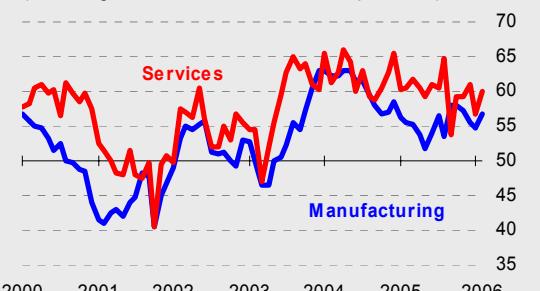


Sources: Bureau of Economic Analysis

Fig. 2

### Business Activity Continues to Increase

(Reading of 50+ indicates sector expansion)



Source: Institute for Supply Management

Fig. 3

### Upcoming Indicators

**Inflation** – The Consumer Price Index for February is scheduled to be released on *March 16*.

**GDP** – The final estimate of GDP growth for the 4<sup>th</sup> quarter is scheduled for release on *March 30*. The first look at GDP growth for the 1<sup>st</sup> quarter of this year arrives *April 28*.

**Employment** – The Bureau of Labor Statistics reports the March employment situation on *April 7*.

**Federal Reserve** – The Fed's next monetary policy meeting is scheduled for *March 27 and 28*.