



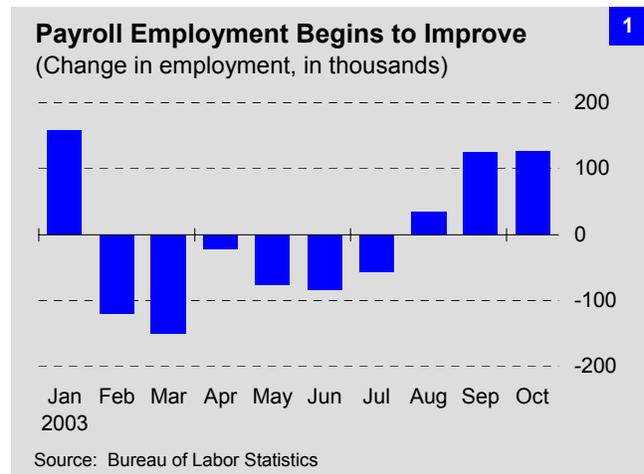
RECENT ECONOMIC DEVELOPMENTS

Payrolls Revive, Economic Growth Soars

The economy is beginning to run on all cylinders, as economic growth translates into significant job creation. Payroll employment has now increased for three straight months. Economic growth soared in the third quarter and was very broad based. Strengthening demand and well-timed tax relief lifted both consumer and business spending, while the declining dollar helped exports. Productivity continues to grow rapidly, boosting profits and wages. Analysts expect continued job gains and strong, sustainable economic growth.

Highlights

- The economy is creating jobs. Payrolls have expanded for three straight months, adding 286,000 new jobs (Figure 1). The unemployment rate has fallen back to 6.0%.
- Growth soared in the third quarter, with gross domestic product (GDP) increasing at a 7.2% annual rate, the fastest since 1984 (Figure 2, next page). Analysts expect more sustainable, yet still very robust, growth of close to 4.0% in coming quarters.
- Productivity continues to impress, with third quarter growth at an 8.1% annual rate. Productivity growth has been remarkably strong since the beginning of 2001.



Labor Markets are Reviving

Payroll employment increased by 126,000 in October, following similar gains in September (Figure 1). The *household survey* found even greater job gains – 441,000 in October – again widening the disparity between the two employment surveys. The household survey indicates that the number of jobs is now higher than it was at the start of the recession; however, the payroll survey reports cumulative job losses of about 2.4 million. *Jobless claims* have shown substantial declines, and both initial claims and continuing claims for unemployment benefits are trending down—strong signs of renewed job creation. Job losses in manufacturing have lessened.

Helped by Recent Tax Relief, Growth Soared in the Third Quarter

GDP growth accelerated to a 7.2% annual rate (Figure 2, next page). Consumer spending, business investment, residential construction, and exports all showed large gains. *Business investment* posted double digit growth and has been strong for two quarters now, in part because of the pro-investment components of recent tax relief. *Consumer spending* also posted significant gains, driven by strong growth in *after-tax incomes*; the expanded child tax credit and lower tax rates have played a key role in supporting consumer spending. The recent surge in demand has driven *inventories* down to record low levels; future growth will receive a significant boost when businesses begin to replenish their shelves and restock their warehouses.

Business Activity is Rebounding

A host of recent reports indicate that business activity is on the rebound. Surveys by the *Institute for Supply Management (ISM)* indicate that both the manufacturing and the service sectors have been expanding in recent months – and at an increasing pace (Figure 3). *New orders* and *unfilled orders* for investment goods have both been rising, suggesting that more business spending is in the pipeline. And the Federal Reserve’s latest *beige book* reports accelerating activity around the country.

Housing Markets are Still Strong

New home sales remain strong, *existing home sales* continue to set records, and *housing starts*, an indicator of future residential construction activity, remain solid. Low mortgage rates, strong gains in household incomes, and continued builder optimism have fueled the housing market. There are some signs that *mortgage demand* is stabilizing, but with 30-year fixed mortgage rates averaging below 6.0%, housing activity is expected to remain strong.

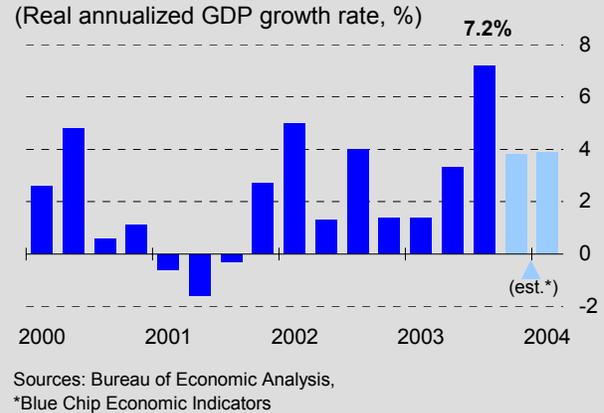
Fed Policy is on Hold

The *Federal Reserve* specifically noted the reviving labor market in its October monetary policy statement. Despite strong economic growth and some upward movements in measures of *inflation expectations*, the Fed indicated that low short-term interest rates can be maintained for a considerable period in light of very low *inflation*.

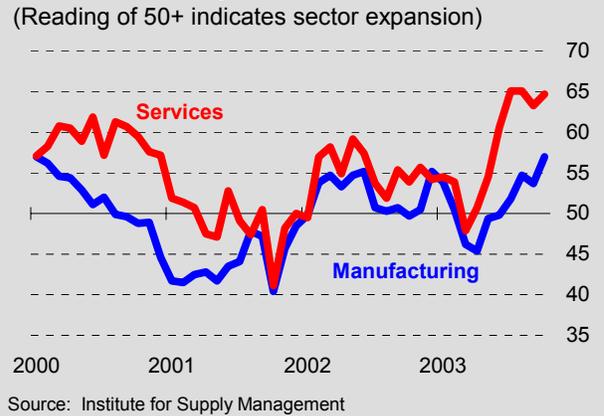
Financial Markets Continue to Strengthen

Stock prices have been rising, boosted by increasing profits and the improving economic outlook. Since October 1, the Dow is up 3% and the NASDAQ is up nearly 6%, adding to the substantial gains registered earlier this year. Encouraged by rising profits and lessening concern about corporate scandals, lenders are no longer tightening *lending standards* for businesses, and businesses are borrowing more.

Remarkably Strong GDP Growth in Q3 2003 2



Business Activity Continues to Increase 3



Upcoming Indicators

GDP – Revised estimates of third quarter GDP growth will be reported on Nov. 25th, reflecting additional data.

Federal Reserve – The Federal Open Market Committee meets on Dec. 9. Analysts expect no change in short-term interest rates, but will carefully review the policy statement for any indication of when the Fed will begin to raise rates.

Employment – Employment data for November are due Dec. 5th, while weekly jobless claims are reported each Thursday.