



JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

JUNE 8, 2004

More Jobs and Strong Growth

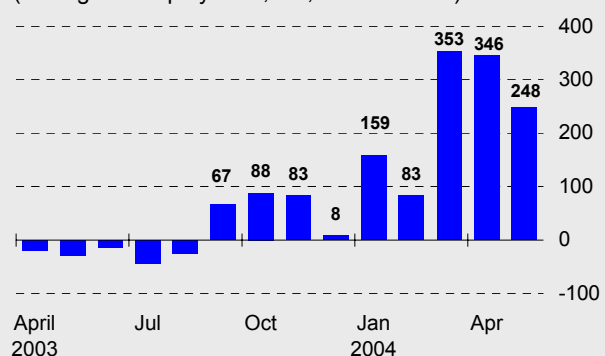
The economic expansion continues to run on all cylinders. Vibrant activity in manufacturing, services, and construction brought substantial job gains in May, while new data for the 1st quarter indicate that gross domestic product (GDP) and productivity have been growing even faster than originally thought. The booming economy has brought with it some challenges – higher mortgage interest rates, elevated energy prices, and upward pressure on inflation – but the economic outlook remains strongly positive. Private forecasters expect continued low inflation, robust economic growth, and further job growth.

Highlights

- Payroll employment rose by 248,000 in May, the ninth straight month of gains. Manufacturing jobs grew for the fourth straight month, and unemployment held steady at 5.6%.
- The economy grew at a 4.4% annual pace in the 1st quarter. Private forecasters see growth of 4.6% in 2004, the highest in 20 years.
- Energy prices, including gasoline, remain elevated and are expected to remain high at least through the summer driving season. Oil has risen to around \$40 per barrel.
- First quarter productivity growth was revised up to 3.8%, accelerating from 2.5% in the 4th quarter of 2003. Real hourly compensation for the 1st quarter was also revised up.

1.4 Million New Jobs Since August 2003

(Change in employment, SA, in thousands)



Source: Bureau of Labor Statistics

Strong Job Gains Continued in May

Payroll employment rose by 248,000 jobs in May. Nine straight months of job gains have now added 1.4 million jobs to payrolls (Fig. 1). Manufacturing payroll jobs have risen by 91,000 over the past four months. The *unemployment rate* remained steady at 5.6%, well below its peak of 6.3% a year ago. The *household survey*, used to calculate the unemployment rate, showed a 195,000 job gain in May.

Strong GDP Growth Continues

1st quarter *GDP* growth was revised up to a 4.4% annual rate on stronger than previously reported inventory investment, state and local spending, and exports. Private forecasters see continued strong growth in the rest of the year. Corporate profits have increased by more than 30% over the past year, helping to boost new investment.

Productivity Gains Remain Vibrant

Productivity grew at an impressive 3.8% annual rate in the 1st quarter, up from the 2.5% pace of the 4th quarter of 2003. Productivity growth in recent years has been remarkably strong compared to recent decades (Fig. 2, next page), boosting incomes and limiting inflation pressures.

Business Activity Remains Strong

The *Institute for Supply Management's (ISM) indices of manufacturing activity and services activity* have each been above 60 for many months, indicating vigorous expansion. The manufacturing employment index has been steadily rising and rose above 60 in May, suggesting more job gains in manufacturing. *Orders from factories* took a breather in April after two very strong months, and *durable goods orders* paused following two boom months. April's *industrial production* registered its third major increase in the first four months of 2004.

Income and Spending are on the Rise

April's *personal income* grew 0.6%, *after-tax income* grew 0.5%, and *personal spending* grew 0.3%. April's personal income growth was the fastest since November. Income growth was led by strong compensation of employees and another large gain in proprietor's income. The savings rate rose to 2.4%.

Some Inflation Pressures are Evident

The *consumer price index (CPI)* grew 2.3% over the past year. Taking out volatile food and energy prices, the "core" CPI grew 1.8% over the last year. The *personal consumption expenditure (PCE) index*, the Fed's preferred consumer inflation gauge, rose at a 3% rate in the 1st quarter, but year-over-year inflation is a moderate 1.4%. These are still historically low rates, but accelerations from the recent past. *Producer price inflation* has also accelerated of late.

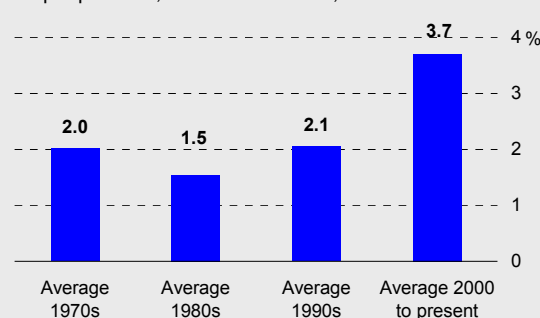
Energy Prices Remain Elevated

Oil prices have spiked in recent weeks—to over \$40 per barrel—because of lean inventories, strong global demand, and heightened risks in the Middle East. Futures markets see oil prices above \$35 per barrel until late summer of 2005 (Fig. 3). The average price of self-serve regular unleaded gasoline rose above \$2.00, a record dollar amount but below record levels when adjusted for inflation.

Mixed Messages from Housing Markets

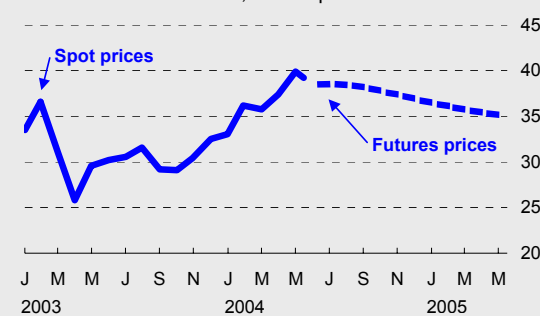
New home sales fell 12% in April, the largest decline since 1994, but low mortgage rates in the early spring boosted *existing home sales* to a near record. April's *construction spending* soared 1.3%. Many expect that rising mortgage rates will cool housing activity.

The Recent Surge in Productivity Growth
Output per hour, nonfarm business, annualized



Source: Haver Analytics, Inc.

Crude Oil Prices Rose Above \$40 per Barrel
West Texas Intermediate, dollars per barrel



Source: Bloomberg, LP

Upcoming Indicators

GDP – The final look at GDP growth for the 1st quarter arrives *June 25*.

Employment – The Bureau of Labor Statistics reports June's employment situation on *July 2*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index is scheduled to be released *June 11*, and the Consumer Price Index follows on *June 15*. The data will be watched closely by the Fed for signs of inflation.

Federal Reserve – The Fed meets *June 29 & 30*. Markets expect the Fed to increase short-term interest rates by a quarter of a percent with further hikes expected to follow in future meetings.