JOINT ECONOMIC COMMITTEE
ROBERT F. BENNETT, CHAIRMAN SEPTEMBER 10, 2003
RECENT ECONOMIC DEVELOPMENTS

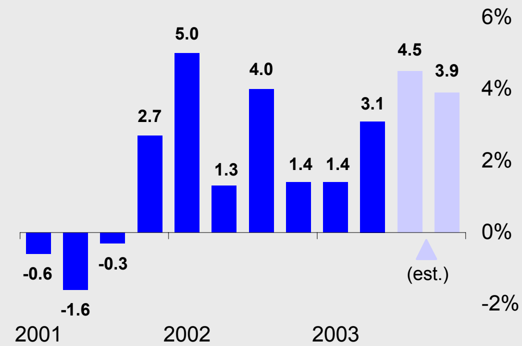
The Economy Builds Momentum

The long-awaited economic rebound appears at hand. Economic indicators are accelerating, financial markets are signaling faster growth, and government policy – both fiscal and monetary – remains highly stimulative. The great test in coming months is whether accelerating growth will finally translate into robust job growth.

Highlights

- The economy is accelerating. Second quarter growth was revised up to 3.1 percent, and forecasters expect growth to average more than 4.0 percent in the rest of the year (Figure 1).
- But employment continues to lag. Payroll employment fell again in August, as it has every month this year. But the unemployment rate ticked down to 6.1 percent, below its recent peak of 6.4 percent (Figure 2, next page).
- Productivity growth continues to surprise, reaching a 6.8 percent annual rate last quarter. In the long run, productivity growth leads to higher wages, more jobs, and higher living standards. In the short run, however, it raises the bar for job creation: GDP must grow faster than productivity to create new jobs.

The Recovery Should Strengthen 1
(Real annualized GDP growth)



Sources: Bureau of Economic Analysis, Blue Chip Economic Indicators

GDP Growth is Accelerating

The *gross domestic product* (GDP) grew at a 3.1 percent annual rate in the second quarter, higher than originally estimated. Consumers contributed a significant portion of the growth, as they have throughout the recovery, but the big news was the rebound in business spending. *Business fixed investment* grew at a robust 8.0 percent annual rate during the second quarter.

> Current indices of business activity report major expansions in both the service *and* manufacturing sectors.

Forecasters expect that economic growth will accelerate to 4.5 percent in the current quarter and average almost 4.0 percent through next year. Faster growth will be driven by several factors: recent *tax relief* is boosting household disposable incomes and, thereby, consumer spending. At the same time, business spending is expected to strengthen, as businesses resume their capital investment and begin to rebuild *inventories* that have fallen to historic lows.

But Labor Markets Have Been Lagging

The unemployment rate fell to 6.1 percent in August, down from its recent peak of 6.4 percent and well below the levels of past recoveries (Figure 2, next page). The oft-cited numbers from the *payroll survey* showed a loss of 93,000 jobs in August; payroll employment has fallen by 1.1

million since the recession ended in November 2001. However, the *household survey*, from which the unemployment rate is calculated, has continued to register job gains. Even allowing for methodological issues with the survey, household employment appears to have increased significantly since the end of the recession. One explanation is rising *self-employment*, which is not included in the payroll survey.

Business Activity is on the Mend

Industrial production, factory orders, and reports from business managers have recently been positive. According to the Institute for Supply Management (ISM), for example, both *manufacturers* and *service companies* reported increased activity in July and August.

Stock Markets Surge

Strengthening economic growth, a rosier outlook on corporate profits, and investor tax relief have all helped to boost *stock prices* this year. The Dow is up 14 percent this year, the S&P 500 is up 16 percent, and the NASDAQ is up almost 40 percent.

Long Term Interest Rates Climb

Long term interest rates have spiked up more than one percentage point since late June, but still remain low by recent standards (Figure 3). The increase reflects a combination of factors, including increased growth expectations and reduced expectations that the Federal Reserve will begin to buy long-term bonds.

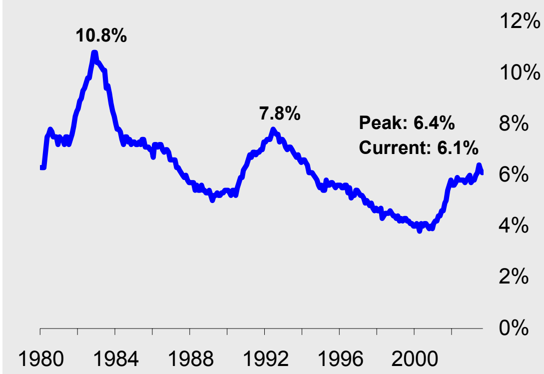
Although Strong, Housing Will Likely Slow

Mortgage rates have risen in tandem with long-term bond rates. Recent housing data have been strong, but the rise in rates suggests that housing may not buoy the economy as it has in recent years; *refinancing* activity has already fallen sharply.

International Developments

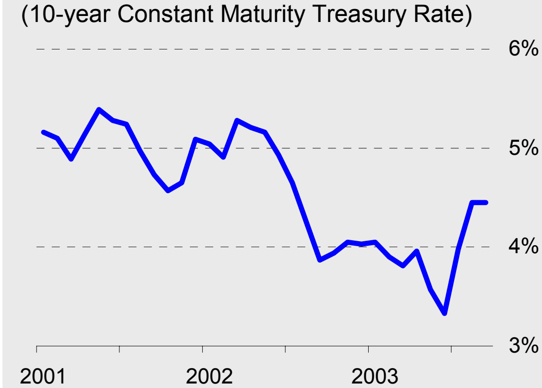
The weak *global economy* has been a significant brake on the U.S. recovery. Recent data have been mixed – Japan has showed some signs of accelerating, while major European economies remain weak. Faster growth abroad would help the U.S. economy by increasing *exports* and lowering the *current account deficit*, which remains at record highs of more than 5.0 percent of GDP.

Unemployment Below Previous Peaks 2
(Civilian unemployment rate, seasonally-adjusted)



Source: Bureau of Labor Statistics

After Declines, Interest Rates Climb 3
(10-year Constant Maturity Treasury Rate)



Source: Federal Reserve

Upcoming Indicators

Employment – With monthly labor surveys pointing in opposite directions, there is heightened interest in weekly Jobless Claims. Reported *each Thursday*, new claims for unemployment insurance had trended below 400,000, but rose last week.

Federal Reserve Meeting – The Federal Reserve meets on *Sept. 16th*. No interest rate changes are expected, so the main focus will be the Fed's characterization of the economy.