JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

AUGUST 11, 2004

Soft Patch Appears Temporary

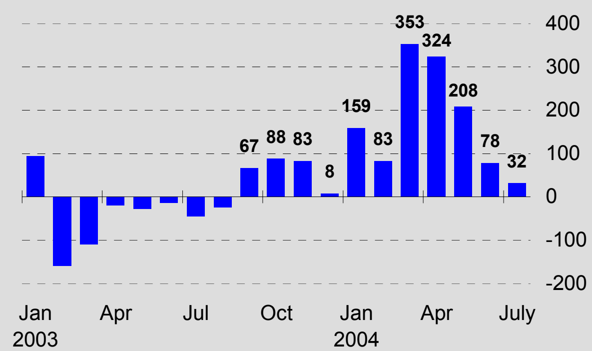
The economic expansion continues to be vibrant, but growth in employment and gross domestic product (GDP) moderated this summer. Much of the moderation in GDP growth was from slower consumer spending after rapid spending earlier this year. The recent economic soft patch is attributed by the Federal Reserve (Fed) "importantly to the substantial rise in energy prices." Many, including the Fed, believe that the economy is poised to resume sustained robust growth in jobs and output. Consistent with that belief, recent indicators show rising consumer confidence, vigorous activity in manufacturing and service industries, still-vibrant housing markets, strong business investment, and continued low inflation.

Highlights

- Payroll employment rose by 32,000 in July, the 11th straight month of gains (Fig. 1). Manufacturing jobs rose by 10,000 and unemployment fell to 5.5% from 5.6%.
- GDP growth moderated to 3.0% in the 2nd quarter—the 11th straight quarter of growth.
- The Fed increased its target short-term interest rate from 1.25% to 1.5% on August 10.
- Crude oil prices have risen once again, setting new dollar-value records of over $44 per barrel. Geopolitical tensions and jitters over the faltering Russian oil giant Yukos pushed prices up.

11 Consecutive Months of Job Growth 1

(Change in employment, SA, in thousands)



Source: Bureau of Labor Statistics (Payroll Survey)

Eleven Straight Months of Job Gains Have Added 1.5 Million Jobs to Payrolls.

The economy added an unexpectedly low 32,000 payroll jobs in July, the 11th straight month with payroll job gains, according to the Bureau of Labor Statistics' (BLS) *payroll survey.* In marked contrast, the BLS *household survey*, used to calculate the unemployment rate, showed job gains of 629,000. The discrepancy between the two survey measures of employment in July was unusually large. The low payroll job gain seemed at odds with *unemployment claims* data, which suggested a stronger gain. Manufacturing continued its rebound in July, adding 10,000 payroll jobs. With 91,000 jobs added since February, manufacturing employment has registered its best six-month performance in six years. The *unemployment rate* fell to 5.5% in July, the lowest since October 2001.

Eleven Straight Quarters of GDP Growth.

GDP grew in the 2nd quarter at an estimated 3.0% annual rate, the 11th straight quarter of growth. Growth moderated from an upwardly revised 4.5% annual rate in the 1st quarter, due largely to a pause in consumer spending. Consumer spending growth slowed to a 1.0% annual pace in the 2nd quarter following a rapid 4.1% pace in the 1st quarter. Business investment spending helped boost 2nd quarter growth, growing at a robust 8.9% annual rate following four consecutive prior quarters of growth. The housing market, especially residential investment spending, and strong export growth also added to overall GDP growth in the 2nd quarter.

Annual GDP Revisions Show Steadier Growth. The Bureau of Economic Analysis released annual revisions to past GDP data using more complete data than previously available. The revisions show that: inflation-adjusted GDP increased at a robust 4.8% pace over the past year, growth was steadier over the past year than previously thought, and the 2001 recession was milder than previously thought. (Fig. 2).

The Economy Was in a Soft Patch in June. In June, *personal consumption spending* fell 0.7%, *construction spending* fell 0.3%, *vehicle sales* were disappointing, *new home sales* edged down, and *job growth* moderated.

The Soft Patch Appears to be Temporary. Many, including the Fed, believe that the summer economic lull was temporary. Positive indicators for future growth include still-lean *business inventories*, which need rebuilding, July's rebound in auto sales, June gains of 0.7% in both *durable goods orders* and *factory orders*, and rising *consumer confidence*.

Indices of Business Activity Remain Robust. The *Institute for Supply Management's indices of manufacturing activity* and *services activity* were above 60 in July, indicating vigorous expansion. The manufacturing index has been above 60 for nine straight months through July and the services index jumped almost 5 points in July, marking the sixth time in seven months the index has topped 60. Employment components of the indices point to further expansion in hiring in manufacturing and services.

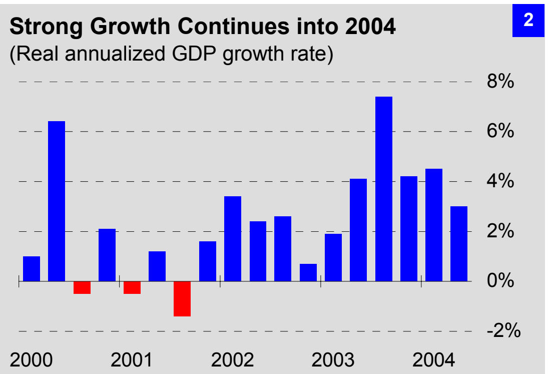
The Fed Increased Short-Term Rates Again.

As expected, the Fed increased its target overnight interest rate by a quarter of a percent to 1.5% on August 10. The Fed acknowledged recent moderation of output growth and a slowdown in improvements in labor markets, but sees the soft patch as temporary. According to the Fed, the economy is "poised to resume a stronger pace of expansion going forward."

Moderating Inflation Eases Fears. *Consumer prices* grew 3.2% over the past year, but inflation in *"core"* consumer prices, which exclude volatile food and energy prices, has moderated to only 1.8%. Inflation in the core *personal consumption expenditure index*, the Fed's preferred consumer inflation gauge, has stabilized at around 1.6% in the past four months (Fig. 3).

Strong Growth Continues into 2004

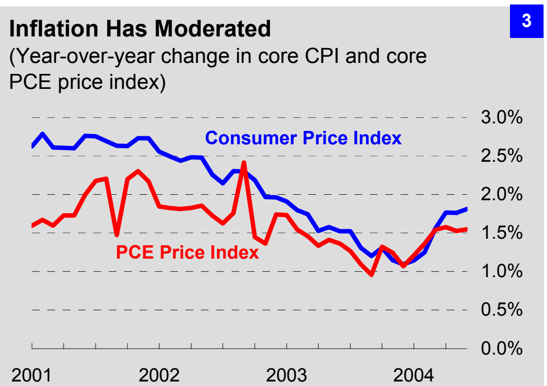
(Real annualized GDP growth rate)



Source: Bureau of Economic Analysis

Inflation Has Moderated

(Year-over-year change in core CPI and core PCE price index)



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis

Upcoming Indicators

Inflation – The Producer Price Index is scheduled for an *August 13* release, and the Consumer Price Index follows on *August 17*.

GDP – A second look at GDP growth for the 2nd quarter arrives *August 27*.

Employment – The Bureau of Labor Statistics reports on the August employment situation on *September 5*. Jobless claims data arrive every Thursday.

Federal Reserve – The Fed's monetary policy committee meets three more times this year: *September 21*, *November 10, and December 14.*