JOINT ECONOMIC COMMITTEE
CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

JULY 8, 2003

Poised for a Pickup in Growth

The economy is improving, and many recent indicators suggest that growth will accelerate beginning in the third quarter. Labor markets, however, have remained lackluster. But historically low interest rates, tax cuts for families and businesses, and improving business conditions should lead to a long-awaited economic rebound in the second half of the year.

Highlights

- The economy received major boosts from fiscal and monetary policies in the form of tax cuts for families and businesses and a cut in the Fed's short-term interest rate target to a 45-year low.
- Employment data for June indicate that the labor market is struggling to create new jobs; the unemployment rate rose to 6.4% (Figure 1, right) as more job seekers entered the labor force.
- Stock markets have posted strong gains, with the Dow up 8% and the NASDAQ up 21% in the first half of the year.

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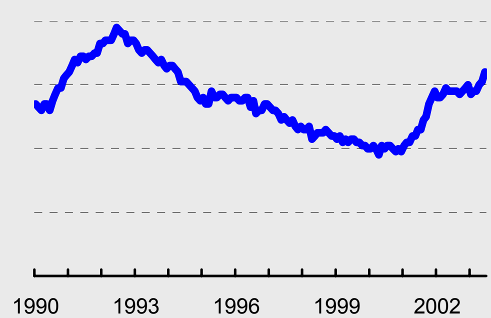
Unemployment Rate

(% of U.S. civilian labor force without work, SA)



Source: Bureau of Labor Statistics

Economic Growth is Expected to Rebound

Gross Domestic Product (GDP) growth was revised down to 1.4% for the first quarter (Q1), the same tepid rate as Q4 of last year. Growth during the second quarter will be announced at the end of July and is likely to be sluggish, but a major pickup is forecast starting in Q3. For example, the Wall Street Journal's July survey of forecasters shows expected annualized growth of 3.5% in Q3 and then 3.8% through the first half of 2004.

> Forecasters expect a strong pickup in growth assisted by major tax cuts, improving business conditions, and historically low interest rates.

Labor Markets Continue to Struggle

The Labor Department reported a decline of 30,000 in *payroll employment* in June, based on its survey of businesses. *Initial claims* for unemployment benefits remain elevated at over 400,000 per week, but they have been on a downward trend in recent months, suggesting stabilizing labor markets (Figure 2, next page).

The *unemployment rate* rose to 6.4% in June from 6.1%, according the Labor Department's *household survey*. This rise should be interpreted carefully because the survey also recorded a significant increase—251,000—in the number of people employed. The unemployment rate rose, despite increased employment, because of an even larger increase in the *labor force* (i.e., the number of people employed or looking for work). Looking ahead, forecasters expect the unemployment rate to be just over 6.0% for the rest of this year, and then to fall to 5.8% by June 2004.

Stock Markets Show Strong Gains
The Dow Jones Industrial Average rose 8% in the first half of the year, and the NASDAQ rose 21% (Figure 3, right). Improving *business profits* and declines in business interest rates helped lift stocks. Tax cuts for businesses will help future profits.

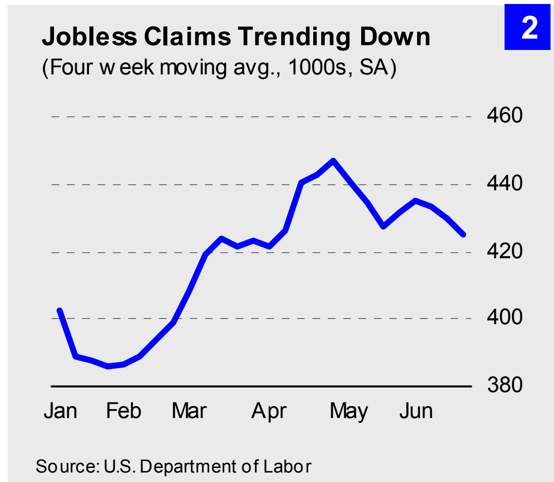
Consumers Continue to Support the Recovery
Seven months of growth in *personal income*, support for family cash flows from tax cuts and lower mortgage-interest rates, and generally improving *consumer confidence* suggest continued support for the recovery from consumer spending.

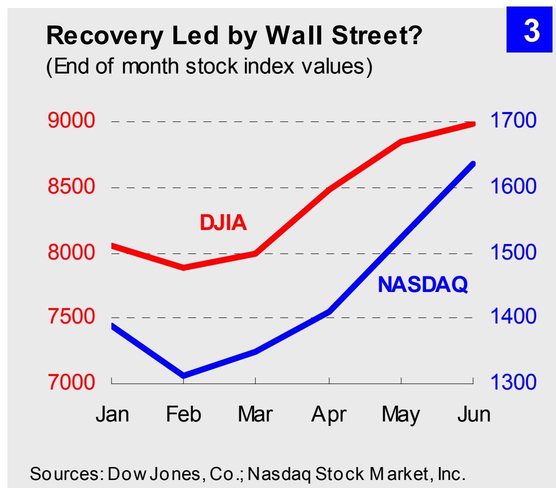
Business Activity is on the Mend
Industrial production, *factory orders*, and reports from business managers have recently been positive.

- According to the *Institute for Supply Management* (ISM), business managers report continuing contraction in *manufacturing*, but at slower and slower rates over the past three months.
- The ISM also received reports that activity in the *service sector* of the economy continues to expand, at an accelerating pace since March.
- Production of services continues to provide strong support to the economic expansion.

The Fed Eases and the Deflation Threat Recedes
The *Federal Reserve* cut its target *short-term interest rate* from 1.25% to 1.0%, the lowest in 45 years. While the Fed remains concerned about a minor threat of *deflation*—sustained general price declines, recent *consumer price index* (CPI) and *producer price index* (PPI) data show a receding threat of deflation.

International Developments
The dollar has been falling against other major currencies. A weaker dollar means that U.S. *imports* become more expensive and U.S. *exports* become more competitive in world markets. However, weakness abroad has hampered exports, contributing to U.S. *trade deficits*. Trade deficits have helped fuel a record high U.S. *current account deficit* of 5.1% of GDP. A current account deficit means that U.S. savings are not enough to fund U.S. investment, which requires that the U.S. borrow surplus savings of other countries.





Upcoming Indicators

GDP – The preliminary estimate of GDP growth for the second quarter will be announced on *July 31*. The consensus expectation is for sluggish growth, so anything above 2% will be surprisingly good news.

Prices – The PPI is announced *July 11*, and the CPI follows on *July 16*. This month's data should calm chatter about deflation.

Confidence – Given the resolution of some of the uncertainty surrounding the war in Iraq, this month's confidence numbers are expected to reflect continued confidence in the positive economic outlook.