JOINT ECONOMIC COMMITTEE
CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS
JUNE 3, 2003

Looking Ahead to Stronger Growth

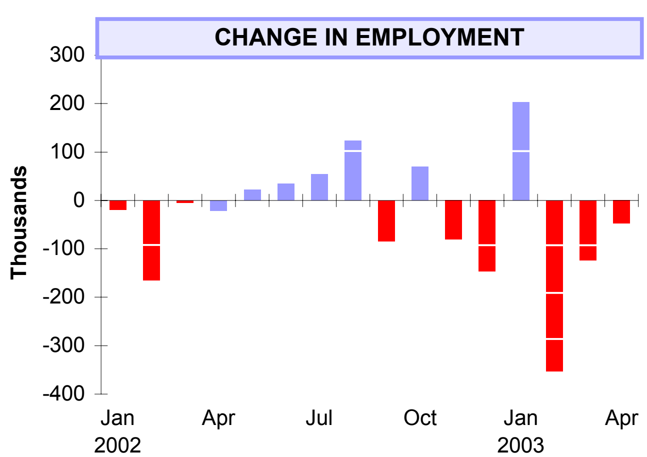
Recent data point to a weak second quarter, with much of this weakness reflecting decisions made during the uncertainty surrounding the war in Iraq. With concerns about Iraq now diminished, many timely economic measures have begun to improve (e.g., financial markets, oil prices, and consumer sentiment). In light of these improvements and the recent jobs and growth tax package, forecasters see much faster growth in the second half of the year. While somewhat less certain about the timing of that upturn, Fed Chairman Alan Greenspan echoed the outlook in recent testimony before the JEC, stating that "economic fundamentals—including the improved conditions in financial markets and continued growth in productivity—auger well for the future."

Growth, Employment, and the Outlook

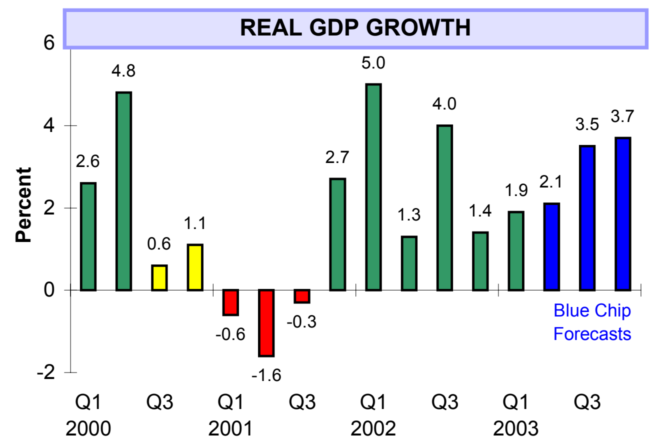
Forecasters anticipate that growth in the **gross domestic product** will accelerate in the second half, up to around 3.7 percent by the fourth quarter. Future acceleration will reflect continuing recovery from the past recession, reduced uncertainty related to Iraq and the benefits of **tax relief** from the jobs and growth package.

First quarter growth was recently revised up to a still-tepid 1.9 percent, and forecasters expect a similarly slow pace in the current quarter.

Labor markets continue to be weak. April's **unemployment rate** rose from 5.8 percent to 6.0 percent. **Payroll employment** fell by 48,000 jobs in April. Total job losses this year exceed 300,000.



Source: Bureau of Labor Statistics, nonfarm payroll, seasonally adjusted



Sources: Bureau of Economic Analysis, Blue Chip Economic Indicators May 2003

Recent Consumer Data

There are two signs of strength on the consumer side. First, **consumer confidence** continued to rise into May, as consumers rebounded from concerns surrounding the war in Iraq. Second, the **housing market** remains strong, assisted by record low mortgage rates. Low rates have also fueled continued mortgage refinancing. This helps support future spending as households extract equity from their homes, partly to fund consumption spending.

However, some recent consumer data have been weak. **Personal incomes** were flat in April and **personal consumption spending** edged down. April also witnessed broad-based declines in **retail sales**, offsetting some of the gains achieved in prior months. Some of the decline in the value of sales in April reflects lower energy prices.

Recent Business Data

Recent data on business activity have been mixed. The manufacturing sector continues to struggle. **Industrial production** declined in both March and April, and April declines in **durable goods orders** more than offset gains in March.

On the other hand, **business inventories** have increased for seven consecutive months through March, and the inventory to sales ratio remains low. Low inventory levels mean that inventory growth can be a significant source of strength—driving up production and GDP—as business sales pick up.

As noted by Chairman Greenspan, growth in **productivity**—output per hour—continues to help businesses and support long-run economic growth. First-quarter productivity growth was only slightly above the low levels of the previous quarter, but the long-run growth trend appears strong.

International Developments

The **dollar** has fallen significantly against major currencies. Since its recent peak in February 2002, the greenback has declined by 25 percent against the euro and 10 percent against the yen. A declining dollar makes imports more costly and less competitive in U.S. markets and makes U.S. exports more competitive in world markets.

The **trade deficit** continued to widen in March as the value of imports was driven up by higher energy prices. A declining dollar may eventually lead to a smaller trade deficit. However, foreign demand for U.S. products continues to be weak.

Financial Markets

Stock prices have continued to rise after the early conclusion of the war in Iraq. Since early March, the Dow has risen by just under 15 percent and the Nasdaq by over 20 percent.

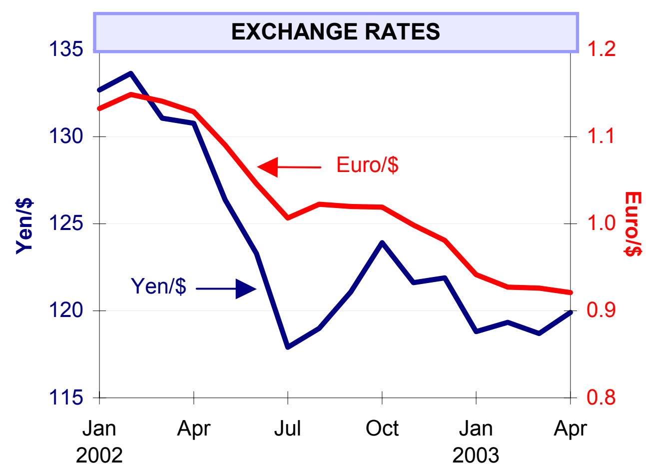
Credit conditions have also continued to improve. **Long-term interest rates** have fallen to their lowest levels since the 1950s. **Interest rates** facing many businesses have also fallen, but remain high relative to rates on less risky government securities.

Inflation, Deflation, and Energy Prices

In a series of statements, including Chairman Greenspan's recent appearance before the JEC, the **Federal Reserve** emphasized its concern about a small risk of **deflation**—systematically falling prices—and that it stands ready to combat that risk. Financial markets have concluded that the Fed is committed to low interest rates until deflation risks subside. Interest rates have declined accordingly.

Consumer and producer prices both fell in April, largely because of declines in energy prices. Most observers expect continued low rates of **inflation** rather than deflation.

Oil prices fell after the war, but remain elevated at close to $30 per barrel. **Natural gas prices** are also elevated. Futures markets indicate declining oil prices but increasing natural gas prices through the remainder of the year.



Source: Federal Reserve Board, monthly average

Looking Ahead:

- June 6: May Employment report; analysts expect losses of 25,000 jobs in May, and many think that the Unemployment Rate may edge up in the near future.
- June 13 and 17: Producer and Consumer Prices; analysts expect continued price declines–reflecting energy prices not systematic deflation.
- June 24-25: Federal Reserve meeting; financial markets project a high chance of a rate cut.