



JOINT ECONOMIC COMMITTEE

ROBERT F. BENNETT, VICE CHAIRMAN

RECENT ECONOMIC DEVELOPMENTS

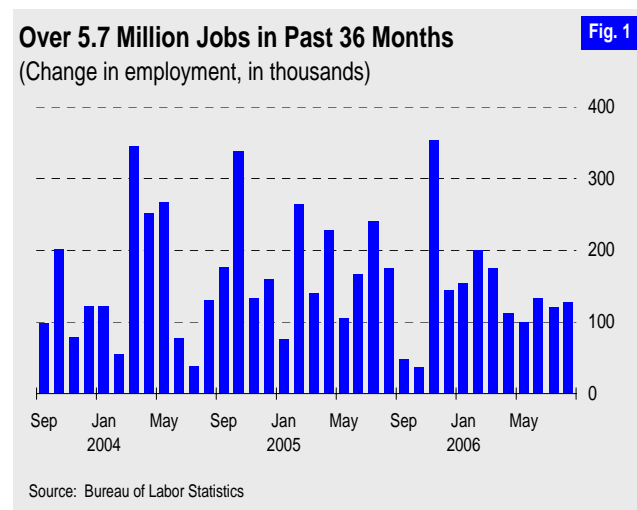
SEPTEMBER 12, 2006

Growth, Housing, and Energy Prices Moderate

Annualized growth in the inflation-adjusted (real) gross domestic product (GDP) was revised up to 2.9% for the 2nd quarter, from an earlier estimate of 2.5%. While variable in recent quarters, GDP growth has averaged a robust 3.6% over the past four quarters. According to the Federal Reserve (Fed), growth has been moderating from its rapid pace earlier in the year partly as a reflection of a cooling housing market and lagged effects of increases in energy prices and interest rates. The Fed opted to end its streak of 17 consecutive quarter-point increases in its target overnight interest rate by keeping its target at 5¼% at its policymaking meeting in early August. The Fed continues to weigh incoming data to determine whether inflation, too, will moderate over time as growth moderates and effects of interest rate increases accumulate. A welcome sign on the inflation front is recent declines in prices of oil and gasoline.

Highlights

- Employment gains continue; 128,000 new payroll jobs were created in August (Fig. 1). The unemployment rate edged down to 4.7%.
- GDP growth for the 2nd quarter was revised up to 2.9% from an earlier estimate of 2.5% (Fig. 2, next page).
- Housing markets continue to cool; new home sales fell by over 22% and existing homes by over 11% in July relative to a year earlier (Fig. 3, next page).
- Gasoline prices have fallen recently; the average price of regular unleaded gasoline fell to around \$2.70 per gallon from summer prices in the \$3.00 range. Oil prices are also down.



Over 5.7 Million New Jobs in 36 Consecutive Months of Job Gains

The economy added 128,000 new *payroll jobs* in August, the 36th consecutive month with job gains (Fig. 1). Over 5.7 million new jobs have been added to payrolls in that period, and 1.7 million new jobs were created in the last year alone. The *unemployment rate* edged down to 4.7% in August from 4.8% a month earlier, remaining well below the near-term peak of 6.3% in June 2003.

GDP Growth Revised up to a 2.9% Annualized Rate for the 2nd Quarter

GDP growth was 2.9% in the 2nd quarter, an expected moderation from the rapid 5.6% 1st-quarter growth. Positive contributions to 2nd-quarter growth came primarily from consumer spending, inventory investment, non-residential structures, exports, and state and local government spending. Declines in residential investment and federal spending partially offset those contributions. Real GDP growth has averaged over 3.6% in the year ending with the 2nd quarter. Growth has averaged over 3.7% since tax relief was enacted in 2003, in contrast to the tepid 1.1% average between the beginning of 2001 and the 2nd quarter of 2003. The *Blue Chip* consensus of private forecasters sees growth moderating to 2.7% in the 3rd quarter, 2.4% in the 4th quarter, and rising to 3.0% by the end of 2007 (Fig. 2, next page).

The Housing Sector Continues to Cool

Existing home sales were down 11.2% on a year-over-year basis in July, the 8th consecutive month with falling sales. *New single family home sales* fell 21.6% on a year-over-year basis in July, the 7th consecutive month of falling sales (Fig. 3). House-price appreciation has also fallen (Fig. 4). *Housing starts and permits* have declined for four consecutive months through July. While home sales have been trending downward from the rapid pace of last summer, levels of sales remain strong, supported by still-low mortgage interest rates.

How Important is Housing for GDP Growth?

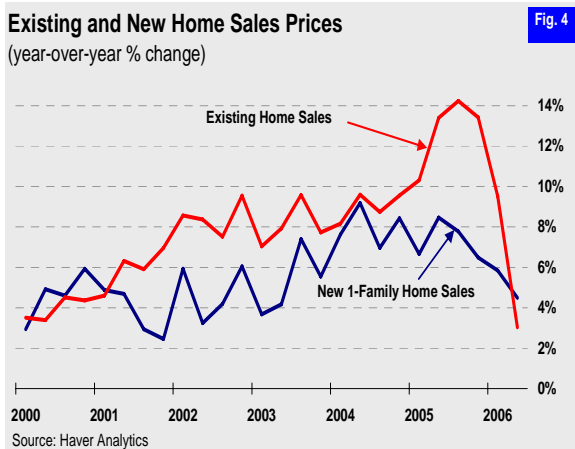
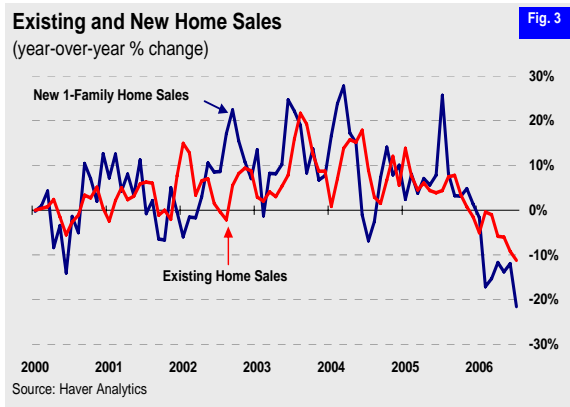
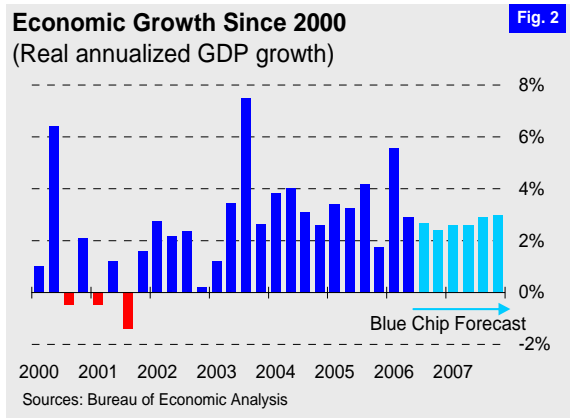
Residential investment accounts directly for roughly 6 percent of GDP. In terms of growth, residential fixed investment accounted for roughly half a percentage point of real GDP growth per year over the past three years of strong activity in the housing sector. The housing sector has also contributed to GDP growth indirectly as the rapid house price appreciation in the past few years has boosted *household wealth* and supported sustained, robust growth in consumer spending. The extent to which this wealth effect has buoyed consumer spending and the effects of slower house price appreciation on consumer spending are difficult to gauge. The effects are important, however, given that consumer spending accounts for around 70% of GDP.

The Fed Paused

The *Fed* halted its recent policy of short-term interest rate increases at its August 8 meeting. Prior to that meeting, the Fed raised its target *overnight interest rate* from 1.00% to the current 5.25% in a sequence of quarter-point increases that began in June 2004. In its August policy statement, the Fed noted the recent moderation in economic growth and a gradual cooling of the housing market. The Fed also acknowledged that some inflation risks remain but: "...inflation pressures seem likely to moderate over time..."

Energy Prices Have Eased Recently

The average U.S. retail price for regular *gasoline* has fallen over 31 cents, from \$3.04 per gallon in early August to \$2.73 as of September 4. Several states have average gasoline prices below \$2.50 per gallon, according to the Energy Information Administration. *Crude oil* prices have also been falling; the futures price for October deliver of light crude oil on the New York Mercantile Exchange recently fell below \$67 a barrel from near-term highs last month of over \$78.



Upcoming Indicators

Inflation – The Consumer Price Index for August is scheduled to be released on *September 15*.

Federal Reserve – The Fed's next monetary policy meeting is scheduled for *September 20*.

GDP – A final look at GDP for the 2nd quarter is scheduled for release on *September 28*.

Employment – The Bureau of Labor Statistics reports the September employment situation on *October 6*.