



JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

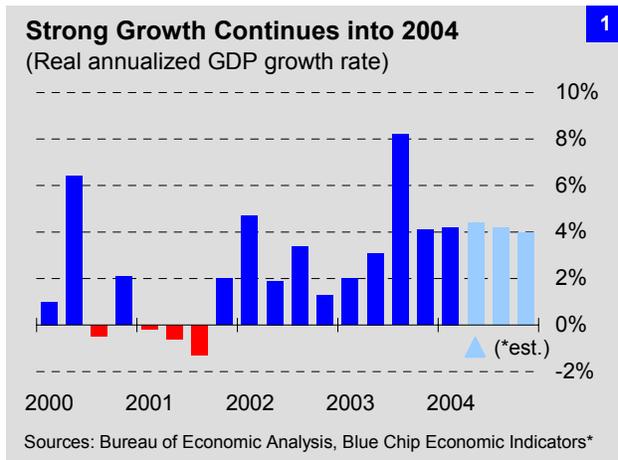
MAY 11, 2004

The Economy is Firing on All Cylinders

Employment surged again in April as the economy continued its brisk expansion. Payrolls have added more than one million jobs over the last eight months, and the unemployment rate has edged down to 5.6%. Economic growth remained strong in the 1st quarter, the tenth straight quarter of growth, and recent activity in manufacturing, services, and housing continues to be vibrant. Consumer prices show slight acceleration in inflation, even outside of food and energy prices. But private forecasters expect low inflation, continuing economic growth, and robust jobs growth.

Highlights

- GDP grew at a 4.2% annual pace in the 1st quarter. Private forecasters see growth of 4.6% in 2004, the highest in 20 years (Fig. 1).
- Payroll employment increased by 288,000 in April, bringing job gains to 1.1 million over the last eight months. Unemployment fell to 5.6%.
- Consumer price inflation has risen. Excluding food and energy, *core* consumer price inflation accelerated in March to 1.6% from 1.2%.
- The Federal Reserve kept its short-term interest rate at 1%, a 45-year low, but hinted that rates will soon gradually rise.



Job Gains Continued in April

Payroll employment rose by 288,000 jobs in April. Eight straight months of job gains have now added 1.1 million jobs to payrolls. Manufacturing payroll jobs have risen for three consecutive months after almost four years of declines. The *unemployment rate* fell to 5.6%, well below its recent peak of 6.3% last June. The *household survey*, used to calculate the unemployment rate, showed 278,000 job gains in April; the household measure puts job gains at 1.3 million over the last eight months. *Initial jobless claims* have fallen to a three and a half year low.

GDP Growth Continued Above 4% into 2004

GDP grew at a 4.2% annual rate in the 1st quarter. The average annual 5.5% pace of growth in the past three quarters is the strongest such performance in twenty years. *Consumer spending* fueled growth in the 1st quarter, driven by gains in wages and salaries and after-tax income. *Business investment* grew at a 7.2% annual rate as double-digit growth in equipment and software spending again offset declines in commercial construction. Inventory investment added to growth, but by less than some had expected. *Government spending* also contributed, with rising defense spending more than offsetting declining state and local spending. *Export and import* growth slowed but, on balance, trade also added to growth.

Business Activity Remains Strong

The *Institute for Supply Management's (ISM) index of manufacturing activity* has been above 60 for six months, indicating vigorous expansion (Fig. 2). The employment index has been steadily rising, suggesting increased hiring in manufacturing. Expansion in services, too, is vigorous; the *ISM services index* set a new record high in April. *Durable goods orders and orders from factories* showed surges in March, with broad-based gains across

Consumer Price Inflation Has Increased

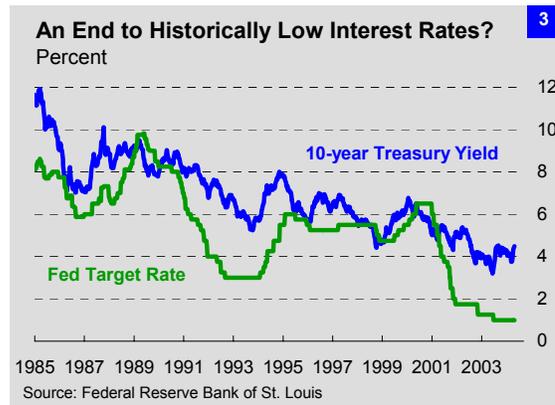
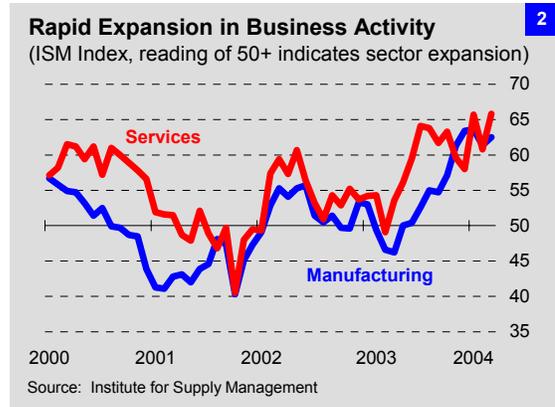
Inflation in consumer prices has accelerated, even when energy and food prices are excluded. Inflation in the *personal consumption expenditures (PCE) price index*, the Federal Reserve's preferred measure of consumer inflation, was an annual 3.2% in the 1st quarter, up from 1.0% in the prior quarter. Excluding significant contributions from higher energy and food prices, the "core" PCE index showed 2.0% inflation in the 1st quarter, up from 1.2% a quarter earlier. Inflation in the *consumer price index* also accelerated, but *producer price inflation* remains in check, except for crude materials prices. Prices of many metals remain elevated, and oil has neared \$40 per barrel.

Fed Keeps Rates Steady; Warns of Future Hikes

Despite some acceleration of inflation, the *Federal Reserve* kept its target short-term interest rate at 1% at its May meeting. The Fed no longer fears deflation, believes that long-term inflation expectations remain contained, and now sees risks as balanced between higher and lower inflation. Noting that "hiring appears to have picked up," the Fed sent its strongest signal yet that *short-term interest rates* will begin to rise soon and continue to rise at a "measured" pace. Markets expect a series of quarter-point increases in the Fed's target interest rate this year. *Long-term interest rates* have moved up somewhat (Fig. 3).

Housing Remains Resilient

Residential construction spending remains strong. In March, *existing home sales* grew at the fastest pace in over two years and *new home sales* accelerated 8.9% to set another record high. The 1st quarter national homeownership rate stayed at a record high 68.6%.



Upcoming Indicators

GDP – An updated look at GDP growth for the 1st quarter arrives *May 27*.

Employment – The Bureau of Labor Statistics reports May's employment situation on *June 4*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index is scheduled to be released *May 13*, and the Consumer Price Index follows on *May 14*. The data will be watched closely by the Fed for signs of inflation.

Federal Reserve – The Fed meets *June 24* to decide about short-term interest rates. An increase in rates is expected by markets at least by the Fed's August meeting.