



JOINT ECONOMIC COMMITTEE

CHAIRMAN ROBERT F. BENNETT

RECENT ECONOMIC DEVELOPMENTS

JULY 6, 2004

STRONG ECONOMIC GAINS CONTINUE

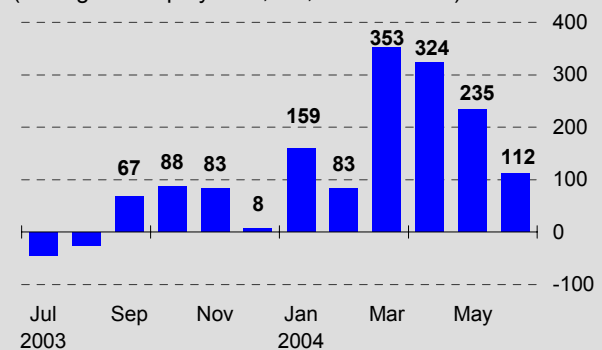
The economic expansion continues to be vibrant. Labor markets continue to generate new jobs. Housing markets have also helped fuel job creation and economic growth. Despite rising mortgage interest rates, new and existing home sales set new record highs in May. While mindful of recent mild accelerations in inflation measures, the Federal Reserve decided to increase short-term interest rates in light of its view that economic growth is robust, labor markets are continuing to strengthen, and idle capacity is shrinking. Energy prices have receded recently in the absence of major new international tensions. The economic outlook continues to be rosy; private forecasters expect continued robust job and economic growth.

Highlights

- Payroll employment rose by 112,000 in June, the tenth straight month of gains. Manufacturing jobs edged down after several months of gains. Unemployment held steady at 5.6%.
- The Fed announced a quarter-point increase in its target short-term interest rate to 1.25%, the first increase in four years.
- New home sales shot up 14.8% in May, the largest monthly increase since April 1993. Both new and existing home sales set new record highs in May.
- Crude oil prices fell to a three-month low of under \$36 per barrel in the absence of new, major geopolitical tensions. Gasoline prices have also been edging down.

1.5 Million New Jobs Since August 2003

(Change in employment, SA, in thousands)



Source: Bureau of Labor Statistics

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

After months of stellar job gains, *payroll employment* took a bit of a breather in June, yet still rose by 112,000 jobs, the tenth straight month of job gains. Payroll jobs are up by 1.5 million since August 2003. Jobs in manufacturing edged down in June following several months of increases, but indications from industry are that job gains will return. The *unemployment rate* remained steady at 5.6%, well below its peak of 6.3% a year ago.

The Federal Reserve Increases Short-Term Rates

As expected, the Fed increased its *target overnight interest rate* by a quarter percent to 1.25%, reversing a policy that had pushed short-term rates to 46-year lows. Higher short-term interest rates had been expected for some time; *longer-term interest rates* had already adjusted up well before this week's Fed announcement. Following signals from the Fed, markets expect further increases in short-term rates after upcoming Fed meetings. (Fig. 2, next page). The Fed sees a robust pace of economic growth, a further pickup in labor markets, and a shrinking of idle production capacity here and abroad. The Fed is also mindful of inflation, which has recently shown mild acceleration. (Fig. 3, next page). However, inflation and inflation expectations still remain well contained.

GDP Growth Remains Robust

1st quarter *GDP growth* was revised down to a still healthy 3.9% from an earlier estimate of 4.4%. Key revisions to the GDP data included a more rapidly expanding trade deficit, a slightly slower pace of business investment, and a bit less consumer spending than previously estimated. Corporate profits continued to improve in the 1st quarter, which bodes well for future hiring and business investment. Forecasters see above 4.0% growth in upcoming quarters.

Business Activity Remains Strong

The *Institute for Supply Management's* indices of *manufacturing activity* and *services activity* continue to indicate vigorous expansion. The manufacturing employment index also points to expansion in hiring in manufacturing. *Durable goods orders* surged 9.9% in February and March and then took a breather in the past two months. *Industrial production* jumped 1.1% in May, the largest gain since August 1998. Manufacturing production increased 0.9% in May and 6.4% over the past year.

Income, Spending, and Confidence are on the Rise

Led by strong gains in employee compensation and proprietor's income, *personal income* growth remained strong in May, up 0.6% for the second straight month after three months of 0.5% growth. *After-tax income* grew 0.6% in May for the second straight month, and *personal spending* grew 1%, its fastest growth since October 2001. Job and income gains helped boost *consumer confidence*; the Conference Board's confidence index jumped in June to its highest level in two years.

Inflation Has Mildly Accelerated

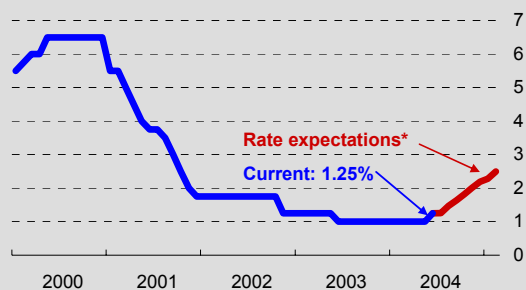
The *consumer price index* grew 2.3% over the past year and 1.8% when volatile food and energy prices are excluded. The *personal consumption expenditure index*, the Fed's preferred consumer inflation gauge, has risen 2.5% over the last year, but by a more moderate 1.6% excluding food and energy prices. While these are still historically low inflation rates, inflation has been mildly accelerating of late.

Energy Prices Retreat

Oil prices have retreated from levels over \$40 per barrel to around \$36 recently. *Gasoline prices*, too, have been edging down. However, oil futures markets and low energy inventories suggest that energy prices will remain elevated throughout the year.

U.S. Federal Funds

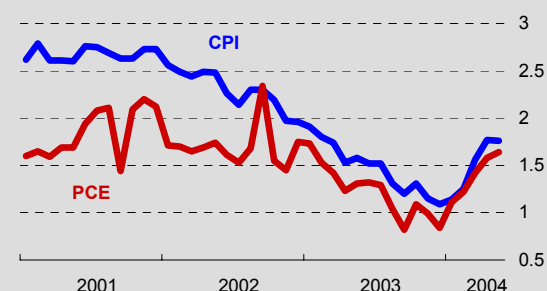
Target overnight interest rate, percent



* derived from federal funds future market data
Source: Haver Analytics, Inc.; The Wall Street Journal

Inflation Has Edged Up

Core measures*, year-over-year percent change



* excluding food and energy
Source: Haver Analytics, Inc

Upcoming Indicators

GDP – The first look at GDP growth for the 2nd quarter arrives *July 30*.

Employment – The Bureau of Labor Statistics reports July's employment situation on *August 6*. Jobless claims data arrive every Thursday.

Inflation – The Producer Price Index is scheduled to be released *July 15*, and the Consumer Price Index follows on *July 16*. The data will be watched closely by the Fed for signs of accelerating inflation.

Federal Reserve – The Fed next meets on *August 10*. Markets expect continued increases in short-term interest rates at a measured pace, which has most expecting another quarter point increase in the Fed's target overnight interest rate in August.

