



JOINT ECONOMIC COMMITTEE

JIM SAXTON, CHAIRMAN

RESEARCH REPORT #109-10
June 2005



ECONOMIC VITAL SIGNS: JUNE 2005

The economy continued to expand and add jobs at a healthy rate in the first quarter of 2005. The indicators of economic activity for the months of April and May are, generally speaking, also positive. Over the last two months, government statistical agencies, the Federal Reserve Bank and research institutions released key indicators showing that the health of the economy is robust.

Economic Indicators

- Economy grew at 3.5%, 1st Quarter
- Employment
 - 274,000 jobs added in April
 - 78,000 jobs added in May
 - 5.1% unemployment rate
- Inflation for the 1st Quarter
 - 2.3% increase in prices for PCE
 - 1.6% increase excluding energy & food
- Industrial production increased 3.6%, 1st Q
- Housing starts increased 4.9%, 1st Q
- Interest rates in May
 - Home mortgage rates averaged 5.9%
 - Prime rate was 6.0% at the end of May
- Real personal income per capita increased 2.7% 1st Q compared to 1st Q 2004
- Investment increased 10%, 1st Q

REAL GDP

On May 26, the Bureau of Economic Analysis revised its estimate of gross domestic product, the measure of output of goods and services produced by labor and property located in the U.S. The economy grew 3.5% in the first quarter of 2005. Imports in the first quarter were lower than reported in April's advanced estimates and, as a result, the 3.1% growth reported in April was revised upward.

An annual economic expansion rate of 3.5% registers healthy growth. The 30-year average of GDP growth is 3.1%. The growth rate through the 1990s averaged 2.9%.

INFLATION

The personal consumption expenditure (PCE) price index measures the change in prices of goods and services for all consumer purchases. The change in the PCE price index for the first quarter was reported to be 2.3%. Excluding changes in highly volatile food and energy prices – the core PCE price index – prices of consumer purchases increased by 1.6% compared to the first quarter of 2004.

INVESTMENT

Investment in information processing equipment and software – 57% of all non-structural investment – maintained its strong 2004 pace. The 10% growth in gross private investment is primarily due to increases in investment in computer equipment and software, and inventories. The typical first quarter downturn in transportation equipment, together with a slowdown in purchases of other types of business equipment, resulted in total investment easing from its 2004 pace.

EMPLOYMENT

The economy created an additional 274,000 (non-farm) jobs in April and 78,000 jobs in May. Service industries provided the bulk of the new employment, with the construction sector also significantly contributing to the job growth. Since May of 2003, the economy added a total of 3.5 million jobs.

The unemployment rate stands at 5.1%. The rate of unemployment since 1990 has averaged approximately 5.6%.

INDUSTRIAL PRODUCTION

Industrial output in the first quarter of 2005 rose at the annual rate of 3.6%, although the output index for industrial output declined 0.2% in April. Despite this hiccup, overall output was 3.2% higher in April of 2005 than it was in April of 2004. Statistics for new orders for durable goods tend to be volatile. While showing a weak opening quarter for 2005, new orders for durable goods rose by a strong 1.9% in April.

The Institute of Supply Management (ISM) indexes of business activity show a growing economy, albeit at a slower rate than in 2004. It should be noted that the various indexes of industrial production may not be the barometer for economic activity they once were. The relative decline in the manufacturing sector's significance in economic output and employment may limit the usefulness of these once important indicators of economic performance.

HOUSING STARTS

Housing starts, on the other hand, will continue to be an important indicator of current and future economic activity. Building a house starts a wide array of production in motion, whether it is excavating the house site or manufacturing household appliances. The year to date increase in the number of new privately-owned housing unit starts increased 4.9% since the beginning of the year.

New home sales, a related statistic, rose by 6.4% since the beginning of the year.

INTEREST RATES

The prime rate rose in the month of May to 6.0%, inching up from the April average rate of 5.75%. The move in the prime rate follows the Federal funds rate. The Federal Reserve raised the Federal funds rate by 0.25% at the end of March and another 0.25% in early May in an effort to restrain inflationary pressures.

Mortgage rates and key Treasury rates remain at historically low levels. Adjusted for points and other fees, mortgage rates edged up slightly in April to almost 6% for the standard 30-year mortgage. In May, mortgage rates retreated from the 6% mark to approximately 5.9%. Rates on 10-year Treasury notes were trending down the month of May, eventually falling below 4%. Yields on these Treasury securities have fluctuated between 4.75% and 3.25% since mid 2002.

ENERGY COSTS

April was a tough month for motorists as the average price of gasoline reached over \$2.25 a gallon, although gasoline prices did ease in May. Adjusted for inflation, the price of gasoline, as well as the price of a barrel of oil, is still below the 1981 historical high. For this reason, and because gasoline purchases comprise a much smaller share of the typical consumer budget in 2005 than in 1981, the current gasoline prices are not expected to negatively influence consumer spending to a significant degree. The average consumer in 1981 spent over 5% of her or his budget on gasoline. Today, gasoline purchases represent about 2.7% of the average consumer budget.

PERSONAL INCOME

The rate of growth in personal income is particularly encouraging. Per capita real disposable personal income – personal income from all sources after personal taxes – increased by 2.7% in the first quarter of 2005 compared to first quarter of 2004. The 2.7% increase is analogous to the annual rate of growth in real personal income per capita for 2004. April 2005 also registered a strong increase in personal disposable income.

CLOSING THOUGHTS

By almost every indication, the economy is expanding at a strong, measured pace. Rising disposable personal income will help stimulate further economic expansion.