JOINT ECONOMIC COMMITTEE

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ECONOMIC VITAL SIGNS: NOVEMBER 2005

The fear that hurricanes would significantly reduce economic output in the third quarter has proven to be unfounded. The economy grew at a healthy pace. Job growth was sufficiently strong in the country overall that the expected post-hurricane drop in national employment did not materialize.

Economic Indicators

- Economy grew at 3.8% in the 3rd Quarter
- Employment
  - 56,000 payroll jobs were added in Oct.
  - 417,000 payroll jobs were added in 3rd Q
  - 5.0% unemployment rate in October
- Equipment & software investment rose 8.9%
- Industrial production dropped 1.3% from Aug. to Sept. mostly due to the hurricanes
- Real disposable personal income increased 1.0% from August to September
- New home sales rose 2.1% Aug. to Sept.
- Inflation, from 9/04 to 9/05
  - 3.8% increase in prices for PCE
  - 1.7% increase excluding energy & food
- Interest rates in October
  - Home mortgage rates rose to 6.15%
  - The prime rate was 6.75% until Nov. 1

REAL GDP

On October 28, the Bureau of Economic Analysis reported the advanced estimates of economic activity for the third quarter. Third quarter g**ross d**omestic product (GDP)**, the measure of** current **output of goods and services produced** by labor and property located in the U.S., increased at an annual rate of 3.8%. The destruction of property is not included in the measure of GDP. Hurricanes and other disasters negatively affect current GDP if businesses close, tourism expenditures are postponed or cancelled, or other commerce is curtailed. The advanced estimates of GDP show that the hurricanes could not significantly reduce the momentum of the national economy.

EMPLOYMENT

Since the beginning of the year, the economy has created 1.6 million payroll jobs (non-farm). At the end of October the rate of unemployment stood at 5.0%. The hurricanes did create significant employment dislocations in the affected regions and as a result, national payroll gains in recent months have been below the employment growth trend.

Within the next few months, however, the initial payroll employment losses in the affected region will convert to employment gains as businesses repair and rebuild their productive capacity.

INDUSTRIAL PRODUCTION

Industrial production declined 1.3% in September due to the effects of the hurricanes and a strike at a major aircraft producer. If allowance is made for these events, industrial production increased at an annual rate of 5.5% in the third quarter.

The Institute for Supply Management index of manufacturing activity still reflects an expanding sector. While the index edged down 0.3 of a percentage point from September to October, the manufacturing index still points to solid economic expansion.

Statistics for new orders for durable goods can be highly volatile. While new orders for durable goods decreased 2.1% in September, it follows a 3.8% increase in August. In four of the last six months, new orders for manufactured durables have increased.

Personal Income and Consumption

In September, real disposable personal income increased by 1.0%. The growth in employee compensation and other personal income was overwhelmed by the loss in property-related income caused by hurricane damage. As a result, real disposable personal income declined in the third quarter.

Real personal consumption expenditures (PCE) fell in 1.0% in August and 0.4% in September. These decreases are mostly attributed to declining motor vehicle sales. Despite the two month decline, auto motor vehicle and parts expenditures increased 17.6% from the second to the third quarter due to the exceptionally strong July activity.

Housing Sector

Based on the trends in housing permits, starts, completions and pending sales, the overall outlook of the housing market continues to be positive. Housing permit issuances increased by 7.4% in September compared to a year earlier. The sales of new residential houses increased 2.1% from August to September. While September's index of home sales contracts signed but not consummated slipped slightly from August, it was 3.3% higher than September of 2004.

Inflation

Core inflation, or the change in the level of prices that excludes volatile energy and food prices, remains low. For the month of September, the core market-based personal consumption expenditures (PCE) price index increased by 1.7% from September of 2004. The change in the market-based PCE index that includes food and energy increased by 3.8% from September one year ago.

Interest Rates

On November 1, the prime rate rose to 7.0% from 6.75%. The prime rate moves with the federal funds rate. In an effort to restrain inflationary pressures, the Federal Reserve raised this rate to 4.0%.

Treasury interest rates and mortgage rates have edged up lately. Rates on 10-year Treasury notes have moved from a June average of 4.01% to an October average of 4.46%. Treasury securities have fluctuated between 4.59% and 3.95% in the course of last year. The standard 30-year mortgage rate has moved from 5.5% in early July to 6.15% in late October.

Energy Costs

Crude oil and gasoline prices have returned to their pre-Katrina level. Even before Katrina pushed up the price of a gallon of gasoline by 46 cents, gasoline prices were rising through the summer, putting pressure on consumer budgets. Since 1986, gasoline purchases have averaged 2.5% of total personal consumption expenditures (PCE). In the third quarter, gasoline purchases accounted for 3.5% of PCE. This is still significantly lower than the 5% of PCE attributed to gasoline purchases in 1981, the year with the highest inflation-adjusted gasoline prices. The smaller share of gasoline purchases in PCE today may account for consumer spending holding up well even as gasoline prices were quickly rising.

While gasoline prices have moderated, significantly higher heating oil and natural gas prices will confront consumers in the coming months. As a result, consumers may adjust their budgets by cutting back on buying other goods and services. If they do, it will have a dampening effect on economic growth.

Closing thoughts

Because of the economy's resilience and favorable conditions for capital investment, the economy registered healthy economic growth despite higher energy prices and the loss of production due to the hurricanes. While higher energy costs may dampen the rate of economic expansion in the coming months, most indicators still point to solid economic growth in late 2005 and early 2006.