# JOINT ECONOMIC COMMITTEE

JIM SAXTON, CHAIRMAN

RESEARCH REPORT #109-19
October 2005

## ECONOMIC VITAL SIGNS: OCTOBER 2005

The economic effects of the hurricanes will reduce the rate of economic growth in the third quarter by as much as 1.5 percentage points, according to the Congressional Budget Office. Once the initial negative economic effects of Katrina and Rita dissipate, economic activity associated with rebuilding will result in an up-tick in the rate of economic growth.

**Economic Indicators**

- Economy grew at 3.3% in the 2nd Quarter
- Employment
  - Payroll jobs fell by 35,000 in September, but this is not statistically meaningful
  - 411,000 payroll jobs added in July & Aug
  - 5.1% unemployment rate as of Sept. 30
- Business fixed investment rose 8.8% in 2nd Q
- Industrial production rose 3.1% in August
- Compensation of employees increased $14.1 billion from July to August
- New home sales rose 6.2% from 8/04 to 8/05
- Inflation, from 8/04 to 8/05
  - 2.9% increase in prices for PCE
  - 1.7% increase excluding energy & food
- Interest rates in September
  - Home mortgage rates averaged 5.77%
  - As of Sept. 20, the prime rate is 6.75%

### REAL GDP

Third quarter g**ross** domestic product (GDP), the measure of current output of goods and services produced by labor and property located in the U.S., will be reported on October 28. The GDP growth rate will depend upon the extent of economic disruption created by the hurricanes. GDP itself is not affected by the destruction of property. (Loss of property is treated like unscheduled depreciation and is subtracted from income and profits.) Hurricanes and other disasters negatively affect current GDP if businesses close, tourism expenditures are postponed or cancelled, and other business and consumer spending patterns change. In the fourth quarter of 2005 and in early 2006, however, GDP will reflect the increased economic activity associated with rebuilding.

### EMPLOYMENT

During the months of July and August, the economy created 411,000 (non-farm) payroll jobs and the rate of unemployment stood at 4.9%. Katrina changed this rosy employment picture. The hurricane closed businesses throughout the Gulf Region and, as a result, September's non-farm payroll was essentially unchanged and unemployment edged up.

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

### INDUSTRIAL PRODUCTION

Industrial output continued its forward momentum and rose 0.1% in August. This is 3.1% above the level of a year earlier. Hurricane Katrina severely curtailed output in the Gulf Coast, reducing the rate of change in total industrial production in August by an estimated 0.3%. Capacity utilization was also 1.5% greater than its August 2004 value.

The Institute for Supply Management index of manufacturing activity reflects strong economic expansion. The 27 month growth trend in manufacturing picked up in September, increasing by 2.4% since June.

Statistics for new orders for durable goods can be volatile. The opening quarter for 2005 was weak, but in four of the last five months, new orders for manufactured durables have increased.

**PERSONAL INCOME AND CONSUMPTION**

In the second quarter, real disposable personal income increased by 1.4% and continued to rise in June and July. Because of the loss in property-related income due to Katrina, real disposable personal income declined 0.5% in August. On the other hand, compensation of employees grew in August, albeit more slowly than in previous months.

Automobile sales fell 12.9% from July to August. This made a significant contribution to the 0.5% decline in personal consumption expenditures in August. Detailed data on consumer expenditures for the third quarter – released October 31 – will reveal the degree to which hurricanes and energy prices have changed consumer spending patterns.

**HOUSING SECTOR**

On the whole, the trends for housing permits, starts, completions and sales continue to be positive. One might think that the housing market has softened if one were to focus on the month over month changes in housing permits. Yet housing permit issuances increased by 3.2% in August compared to a year earlier. Likewise, the sales of new residential houses increased 6.2% in August compared to August 2004.

Statistics for the sales of existing homes do not show that the housing market is cooling off. Existing home sales rose 2.0% from July to August and were 7.8% higher than August of 2004. Pending home sales contracts signed from July to August rose 3.2 percent.

**INFLATION**

Core inflation, or the change in the level of prices that excludes volatile energy and food prices, remains low. For the month of August, the core market-based personal consumption expenditures (PCE) price index increased by 1.7% from August of 2004. The change in the market-based PCE index that includes food and energy increased by 2.9% from August one year ago.

**INTEREST RATES**

The prime rate rose 0.25 percentage points to 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 3.75% on September 20.

Treasury interest rates and mortgage rates remain at historically low levels. Rates on 10-year Treasury notes appear to be trending up in the third quarter, from a June average of 4.00% to average 4.23% in the week ending September 23. Yields on these Treasury securities have fluctuated between 4.8% and 3.95% over the course of the last year. Mortgage rates fluctuated over the course of the last three months, starting at 5.5% in early July and standing at 5.9% at the end of September (not including points and fees) for the standard 30-year mortgage.

**ENERGY COSTS**

Immediately after Katrina disrupted fuel supplies, gasoline prices hit an all time high. Even before the hurricanes, rising gasoline prices were putting pressure on consumer budgets. Depending on how consumers respond to record high energy costs, consumer spending may weaken to such a degree that it dampens economic growth. If consumers drive less and conserve fuel in order to maintain their other typical spending patterns, it will reduce the negative economic consequences of higher energy prices.

**CLOSING THOUGHTS**

Before Katrina, the economy was on track to maintain the healthy rate of economic growth experienced in the second quarter. The hurricanes will cause a brief dip in the rates of economic and employment growth, but most indicators still point to solid economic growth in the near future.