



Economic Update

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Robust Expansion Remains on Track

The U.S. economic expansion reached its 32nd month in July, with the economy recently growing at its strongest pace in 20 years. Widespread evidence and expectations point to continued robust growth for the foreseeable future. The strong growth and rebounding labor markets of the past year are a welcome turnaround from the uneven performance of the early recovery – which followed the bursting of the stock market bubble in 2000, the economic slowdown and recession of 2000-01, and the shock and uncertainty following the September 2001 terrorist attacks.

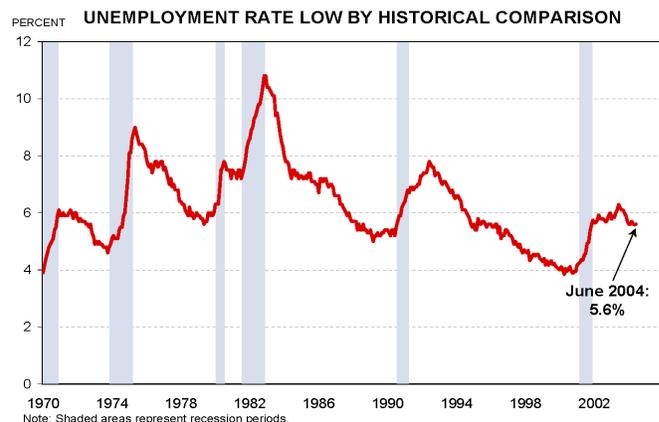
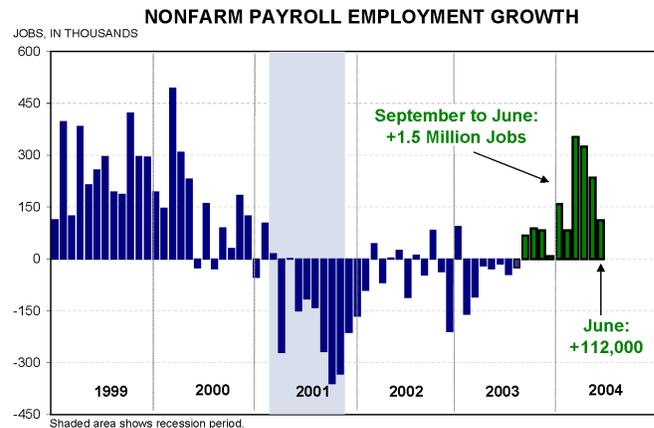
The general outlook of private analysts – considering overall trends and momentum – is for continued strong growth in the economy as a whole, and in labor markets particularly. Typically during such expansions, specific indicators may fluctuate from month to month, as the preliminary June jobs figures did. But growth in real gross domestic product is expected to exceed 4 percent for the balance of this year, and to be about 3½ percent during 2005.

Recent Data

- *Gross Domestic Product [GDP]*: Real GDP grew at a 3.9-percent annual rate in the first quarter, according to the revised, final estimate for the quarter. Real GDP growth over the past 3 quarters has been at a 5.4 percent annual rate – the highest in 20 years.
- *Labor markets* continue to show improvement, with rising employment, and lower unemployment rates and unemployment insurance claims:

- Payroll employment rose by 112,000 jobs in June, bringing the gain in net new jobs over the past 10 months to 1½ million (see chart above).

Several factors may have contributed to making the June payroll jobs figures less strong than anticipated, including possible effects of seasonal adjustments, potential sampling errors, and the natural month-to-month fluctuations in the figures. Further, because the estimate is preliminary, it is subject to potentially large revision. During the



period from January 1996 through May 2000 – when jobs growth averaged 250,000 per month – preliminary monthly jobs growth estimates came in below 125,000 on 14 different occasions. Thus, even in strong growth periods, a preliminary estimate of a lower monthly jobs growth number typically occurs once every 3 months to 4 months.

- The unemployment rate has declined significantly over the past year – down to 5.6 percent from 6.3 percent last June. The current unemployment rate is below the average levels for the decades of the 1970s, 1980s, and 1990s (see chart above).

(continued on reverse side)

- The household survey measure of employment – which includes the self-employed and others not captured by the establishment jobs numbers – grew to a new record high of 139.031 million in June.
- As of the first week of July, the 4-week moving average in new claims for unemployment insurance – which smooths out weekly fluctuations – stood at 336,000, roughly equivalent to levels at the end of 2000, before the recession. Claims have trended downward for the past year, from a peak of nearly 450,000 in mid-April 2003, and have held below the 400,000 level (typically viewed as evidence of an expanding labor market) for 40 straight weeks.

- *Housing markets:* Housing starts and building permits are at their highest levels in 20 years; residential investment and sales of new and existing single-family houses are at record highs.
- *Manufacturing:* The Institute for Supply Management [ISM] index of manufacturing activity recently has been at 20-year highs. Industrial production – the output of the Nation’s factories, mines and utilities – increased 6.3 percent over the past year, the strongest growth in 6 years.
- *Consumer attitudes:* Consumer confidence (Conference Board) rose sharply in June, up to 101.9 from 93.2 in May. Over the past 15 months, consumer confidence – a survey-based measure of consumers’ views about current and expected business conditions, employment prospects, and household finances – has increased more than 40 points from its post-recession low of 61.4 in March 2003. Consumer sentiment (Michigan Survey of Consumers) increased in June to 95.6 from 90.2 in May. Historical comparisons show that recent levels of consumer confidence and sentiment are consistent with the economy being in a sustained expansion.

Other indicators across sectors also point to continued strong growth, including the strong increase in orders for manufacturers’ durable goods over the past year, and continued growth in business investment, disposable personal income, personal consumption spending, and exports of goods and services.

Economic Outlook

The Blue Chip private forecasters continue to expect the economy to grow at a relatively strong pace, with real GDP growth in the 4-percent to 4¼-percent range for the remainder of this year, and around 3½ percent during 2005, according to figures published on 12 July 2004 (see table). Labor markets are expected to continue improving, with the unemployment rate declining to 5.2 percent by the end of 2005. Reflecting that outlook, the Blue Chip forecasters cited “faster growth in employment” as the most important positive factor that will influence U.S. economic growth in 2005. Inflation is expected to moderate later this year and into 2005, following the increases early this year. Interest rates are expected to rise gradually through the end of 2005, consistent with the continued strong economy.

Blue Chip Economic Outlook, July 2004

	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	--- Actual ---		----- Projection -----						
Real GDP Growth	4.1	3.9	4.1	4.2	4.1	3.6	3.6	3.5	3.4
Unemployment Rate	5.9	5.6	5.6	5.5	5.4	5.3	5.3	5.3	5.2
CPI Inflation	0.7	3.5	4.2	2.5	2.0	2.2	2.3	2.3	2.3
3-month Treasury Bill	0.9	0.9	1.1	1.5	1.9	2.2	2.6	3.1	3.4
10-year Treasury Note	4.3	4.0	4.6	4.8	5.0	5.2	5.4	5.5	5.6

Note: Unemployment and interest rate values for 2004.2 are actuals and not projections.

Monetary Policy

The Federal Reserve’s Federal Open Market Committee [FOMC] at the end of June raised its target for the Federal funds rate – its lending rate for banks – by 25 basis points, to 1.25 percent (100 basis points equals one percentage point). In its policy statement, the FOMC addressed recent concerns about higher inflation: “Although incoming inflation data are somewhat elevated, a portion of the increase in recent months appears to have been due to transitory factors. . . . With underlying inflation still expected to be relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured.” The continued use of the word “measured” is widely viewed as indicating the Fed will raise rates *gradually*, as the economy continues to grow – largely consistent with the private consensus forecast.

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