

CURRENT ECONOMIC CONDITIONS AND OUTLOOK (BRIEFING MATERIALS)



JOINT ECONOMIC COMMITTEE

Prepared for Chairman Jim Saxton

Data as of April 19, 2002

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Economic Performance and Outlook¹

- **Summary and Overview**

Currently, economic activity and especially final demand is rebounding smartly from the slowdown and recession as well as the terrorist events surrounding September 11, 2001. The expansion leaves one of the mildest recessions on record in its wake. This rebound has emerged sooner, more forcefully, and with broader-based support than most economic forecasters predicted. Indeed, these prognosticators have often revised up their near-term forecasts as stronger than expected data became available. The expansion has been importantly driven by the Federal Reserve move to sharply lower interest rates in 2001 as well as by a moderation of energy prices, a stabilization/firming of asset prices, timely tax relief, and a continued lack of new inflationary pressure. While the expansion's near-term prospects are favorable, a number of risks and uncertainties loom on the horizon and pose questions about its long-run sustainability. Nonetheless, the economy's remarkable resilience appears to outweigh these risks at this time.

- **The Economic Turnaround**

A wide array of indicators is now pointing toward economic expansion, suggesting that the rebound is gradually becoming more broad-based and well-entrenched. Real fourth-quarter GDP, for example, was recently revised up to 1.7 percent. Strong consumption growth supported this figure and has continued, along with ancillary variables such as consumer confidence, retail sales, and personal income, to hold up better than expected in recent months. Consumption, however, does appear to be running ahead of investment activity in supplying momentum to the expansion. Nonetheless, while actual investment remains weak, some early hints of a possible investment revival together with inventory restocking have emerged suggesting that an investment revival may not be too far off. Housing, on the other hand, remains firm at elevated levels, but is not expected to contribute significantly to further economic expansion. Recent advances in manufacturing activity and industrial production provide signs of a turnaround in that sector.

- **Causal Factors**

Several factors contributed to bringing about this economic expansion. The rebound, of course, is significantly related to the eleven-time, 475 basis point interest rate reduction from 6.5 percent to 1.75 percent undertaken by the Federal Reserve during the course of 2001. This substantial rate reduction clearly was a most important, dominant factor in explaining the faster-than-expected turnaround. But a significant energy price moderation, which also occurred during 2001, contributed significantly to this outcome. A stabilization or firming of asset (equity and home) prices along with well-timed tax relief and the maintenance of price stability all contributed to the turnaround as well.

¹ The source for all graphs in this publication is Haver Analytics.

- **Current Prospects, Risks and Uncertainties**

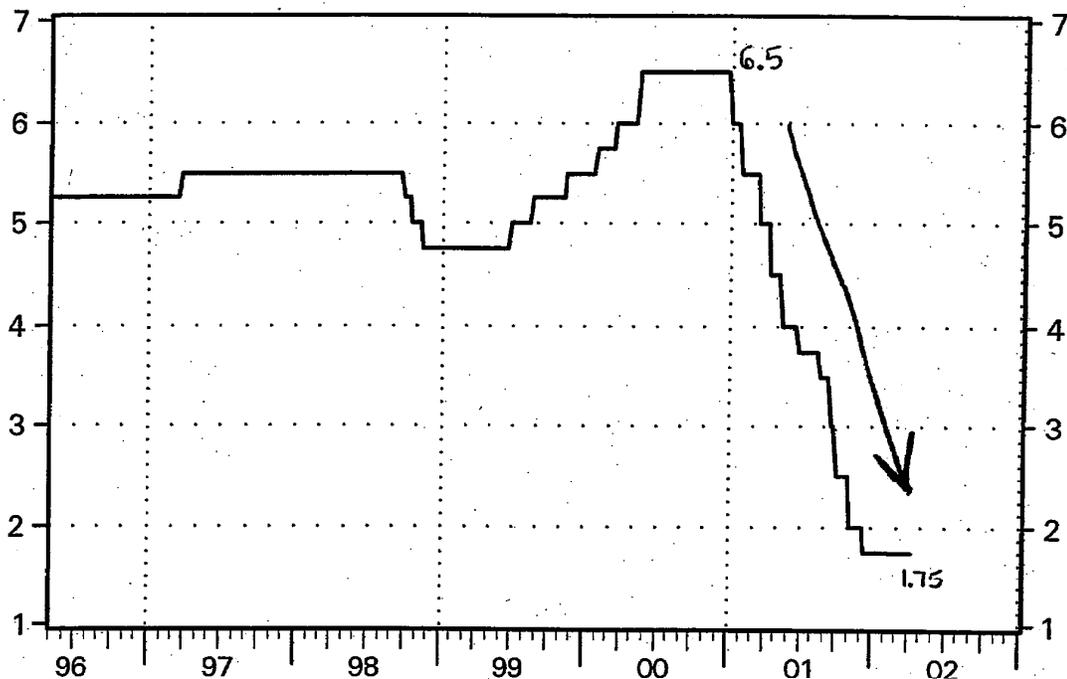
Prospects for a sustained expansion looks promising, especially in the near-term (over the next several quarters) as inventory rebuilding takes place. While likely sustained, however, the expansion may not be as rapid as some expect. Specifically, the economy remains vulnerable to a number of potential headwinds, risks, and uncertainties that could weigh on the economy over time and adversely affect growth. Energy prices increases, for example, pose a genuine risk in the near-term. In fact, oil and gasoline prices have increased in recent days. But while risky in the near-term, energy prices increases are not expected to remain a long-term problem, with alternative suppliers on stream and the U.S. economy less vulnerable than was the case in the past. Household and business debt burdens as well as significant costs imposed on the economy by the terrorist threat also pose potential risks to the sustainability of the recovery. Further, lagging profits, weak equity markets, and sluggish capital goods orders could impact investment and bring about a weaker-than-expected expansion. And a re-emergence of inflationary pressures is also a risk that needs to be continually monitored. But currently, all these potential risks and uncertainties appear to be outweighed by the remarkable resilience of the U.S. economy.

- **Prices and Inflation**

Broad measures of inflation continue to indicate that inflation is not an important problem at this time. This is also true of core measures of inflation that remove the influence of special factors. Most forecasters are projecting a continuation of current low rates of inflation. Forward-looking market prices indicators corroborate this view. While long-term interest rates have increased in recent months, this has occurred in concert with a stronger-than-expected recovery and building expectations of future Federal Reserve interest rate increases. Commodity prices, less special factors, remain benign. And the dollar remains strong. In short, when assessed over time and in conjunction with one another, forward-looking market prices indicators continue to suggest that an imminent and important resurgence of inflation is not in prospect.

Federal Open Market Committee: Fed Funds Target Rate

%

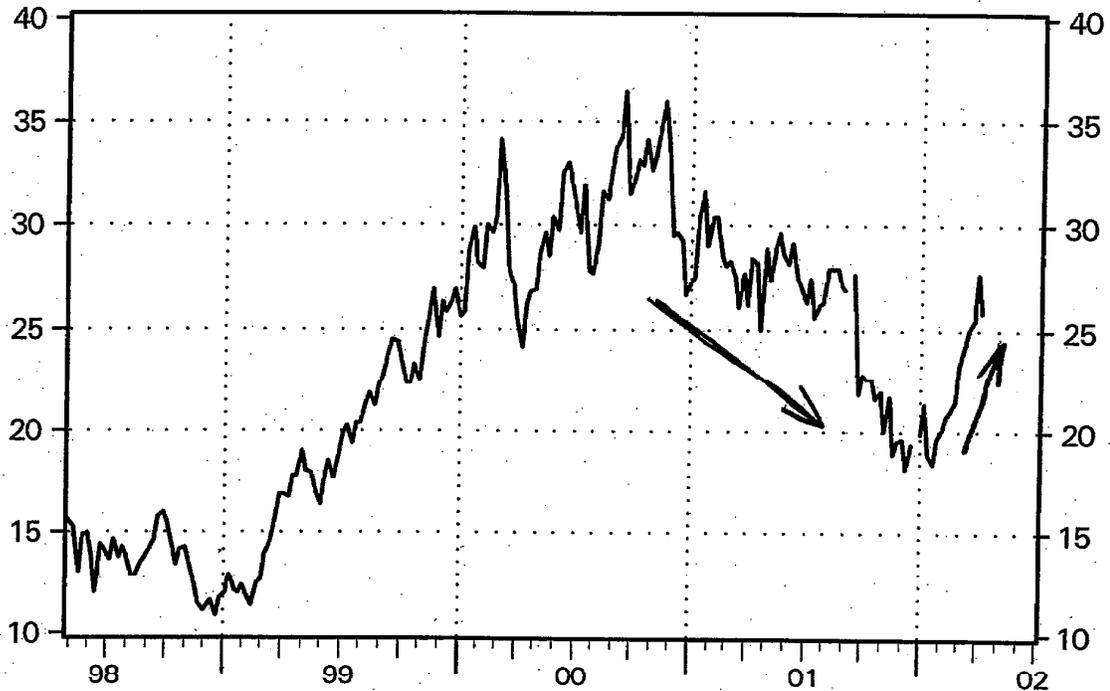


Source: Federal Reserve Board /Haver Analytics

- The Federal Reserve has maintained The fed funds rate at 1.75 %.
- The next Fomc meeting is May 7. The market currently does not expect the Fed to raise interest rates at that meeting.
- The MARKET does expect The Fed to raise rates by 25 basis points at their late June meeting.

Domestic Spot Oil Price: West Texas Intermediate

Avg, \$/Barrel

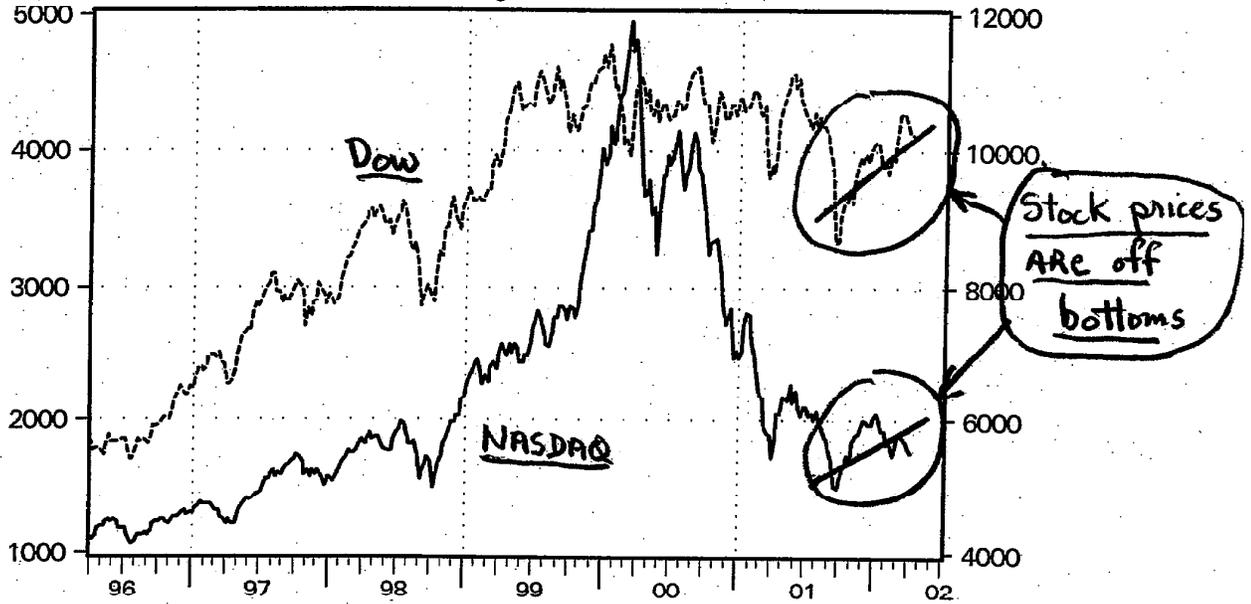


Source: Wall Street Journal /Haver Analytics

- The price of oil has increased sharply in recent weeks (from about \$19/barrel to \$26/barrel)
- This was related in part to the situation in the Middle East as well as in Venezuela and increased demand.
- But currently, this is seen as not enough to derail the economy:
 - > The U.S. less dependent on oil
 - > more potential suppliers ready to pump

← Stock Price Index: NASDAQ Composite
Avg, 2/5/71=100

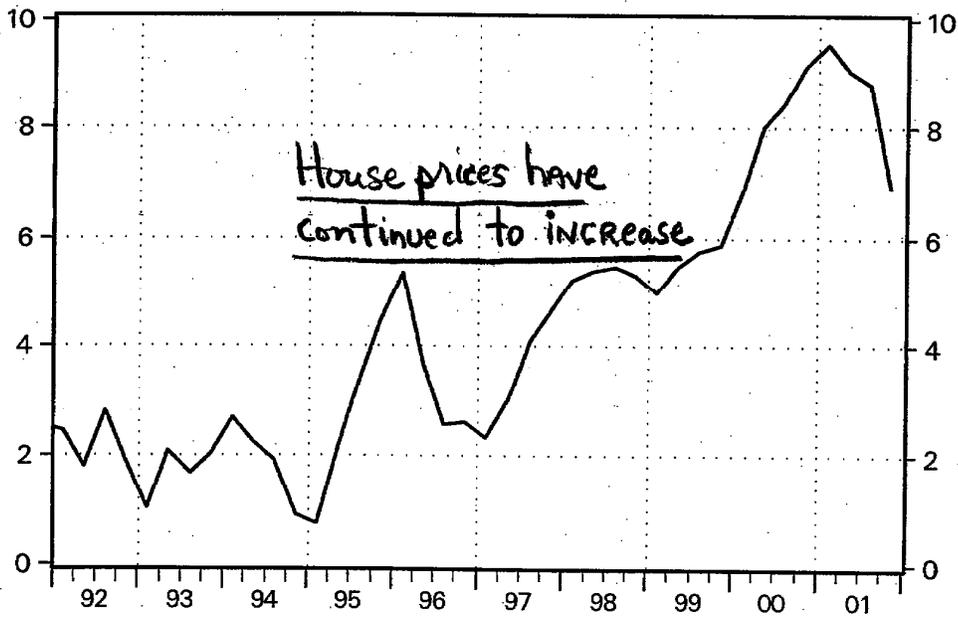
Stock Price Averages: Dow Jones 30 Industrials, NYSE -----
Avg, Close



Source: Wall Street Journal /Haver Analytics

House Price Index, United States

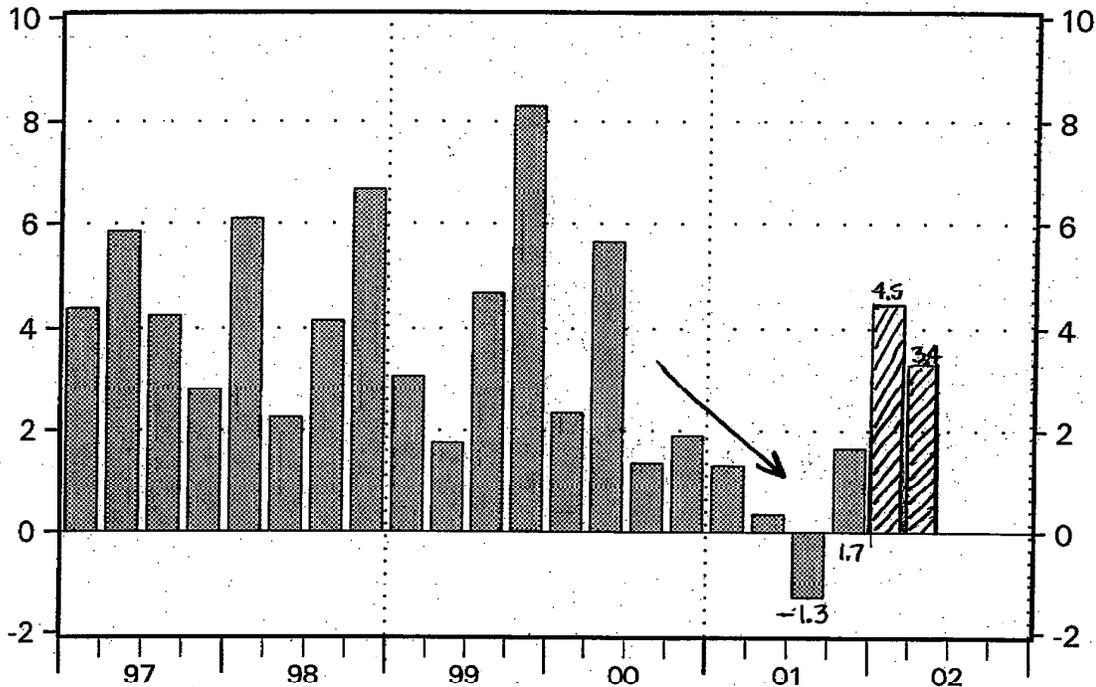
% Change - Year to Year 1980 Q1=100



Source: Office of Federal Housing Enterprise Oversight /Haver Analytics

Gross Domestic Product

% Change - Annual Rate SAAR, Bil.Chn.1996\$

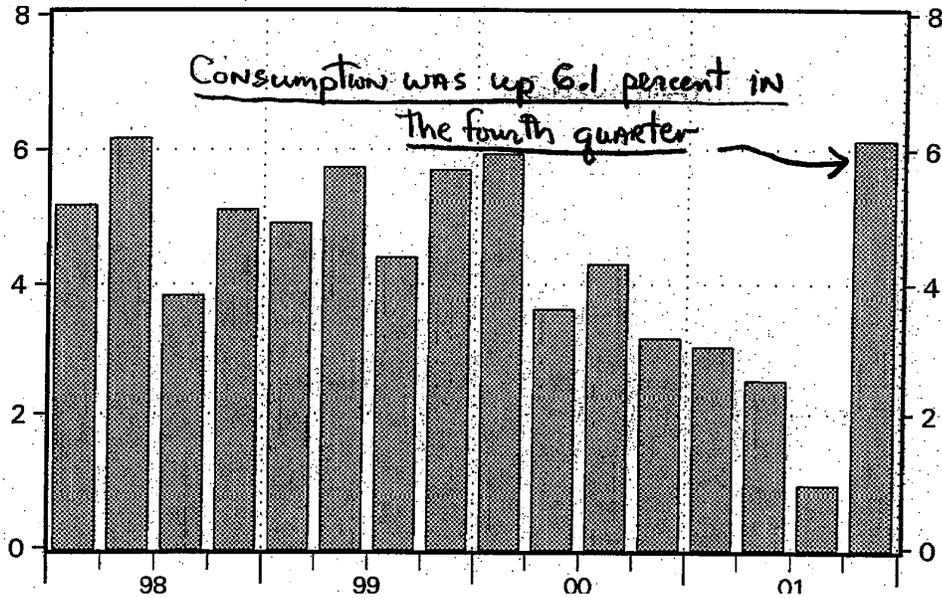


Source: Bureau of Economic Analysis /Haver Analytics

- Real GDP increased +1.7 percent in the fourth quarter
- Reasons for this increase:
 - > Strong Consumption
 - > government Spending increased
- Investment remained weak
- Inventories were reduced
- Consensus forecasts are for first quarter to be up +4.5%

Personal Consumption Expenditures

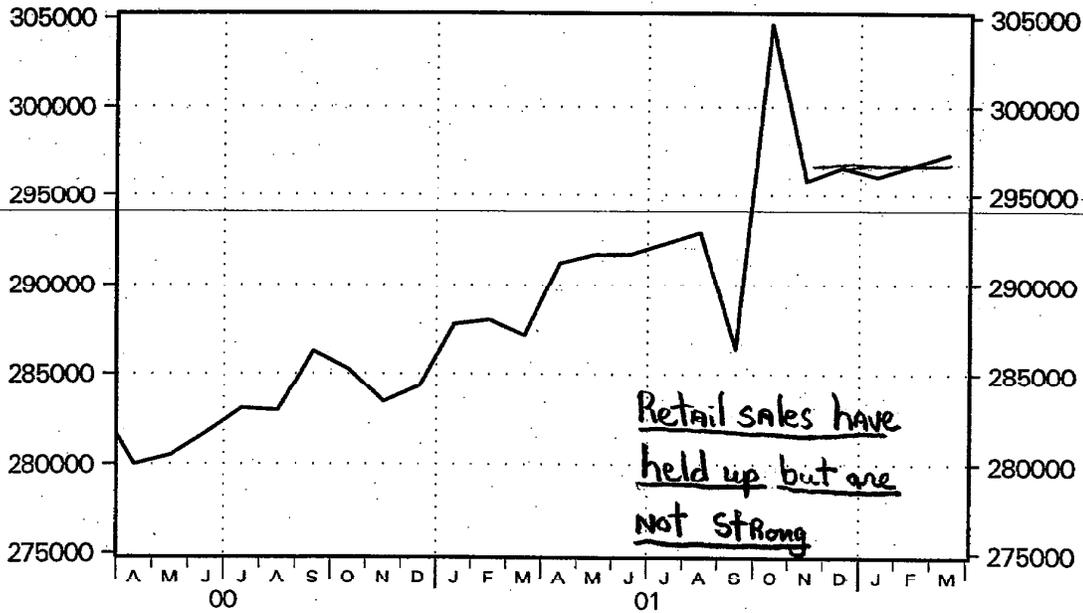
% Change - Annual Rate SAAR, Bil.Chn. 1996\$



Source: Bureau of Economic Analysis /Haver Analytics

Retail Sales & Food Services

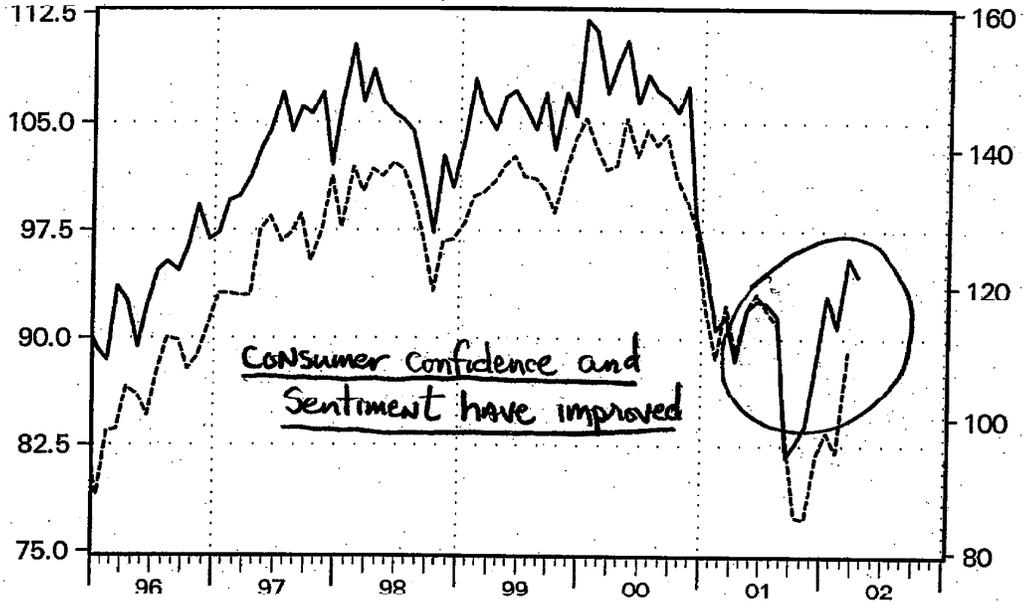
SA, Mil. \$



Retail sales have held up but are not strong

← University of Michigan: Consumer Sentiment
66Q1=100, NSA

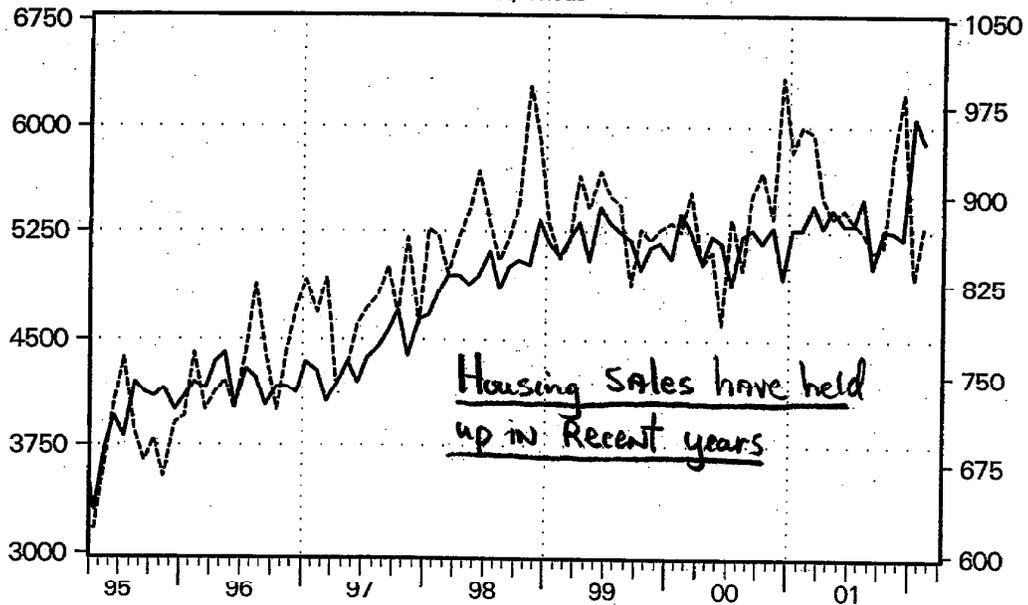
Conference Board: Consumer Confidence
SA, 1985=100 →



Sources: University of Michigan, The Conference Board /Haver Analytics

← Existing 1-Family Home Sales: United States
SAAR, Thous

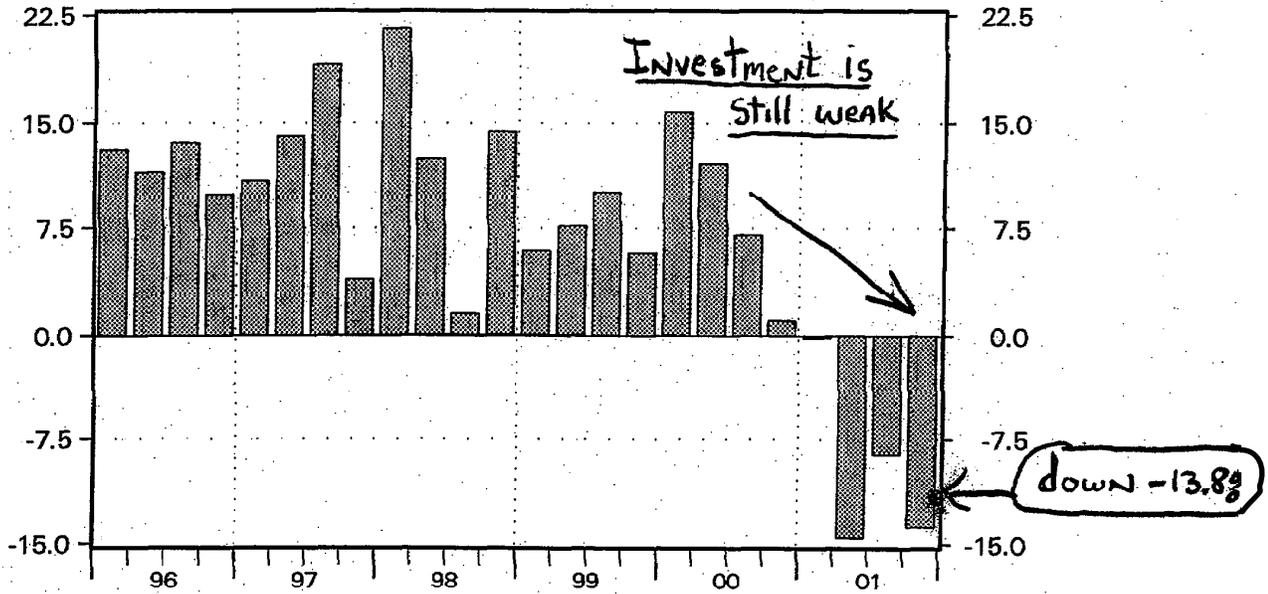
New 1-Family Houses Sold: United States
SAAR, Thous →



Sources: National Association of Realtors, Bureau of the Census /Haver Analytics

Fixed Private Nonresidential Investment

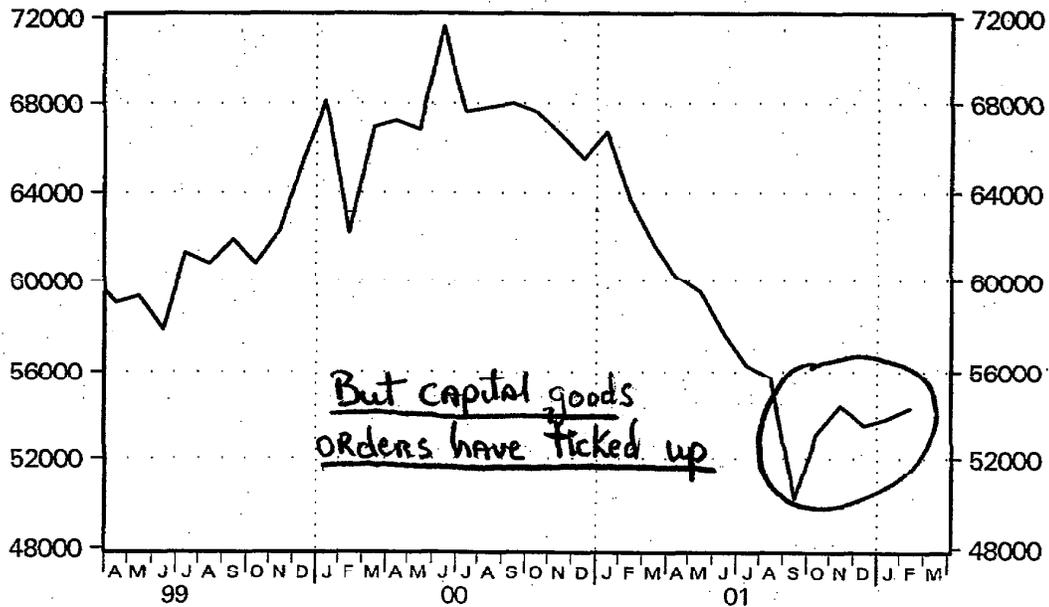
% Change - Annual Rate SAAR, Bil.Chn.1996\$



Source: Bureau of Economic Analysis /Haver Analytics

Mfrs' New Orders: Nondefense Capital Goods ex Aircraft

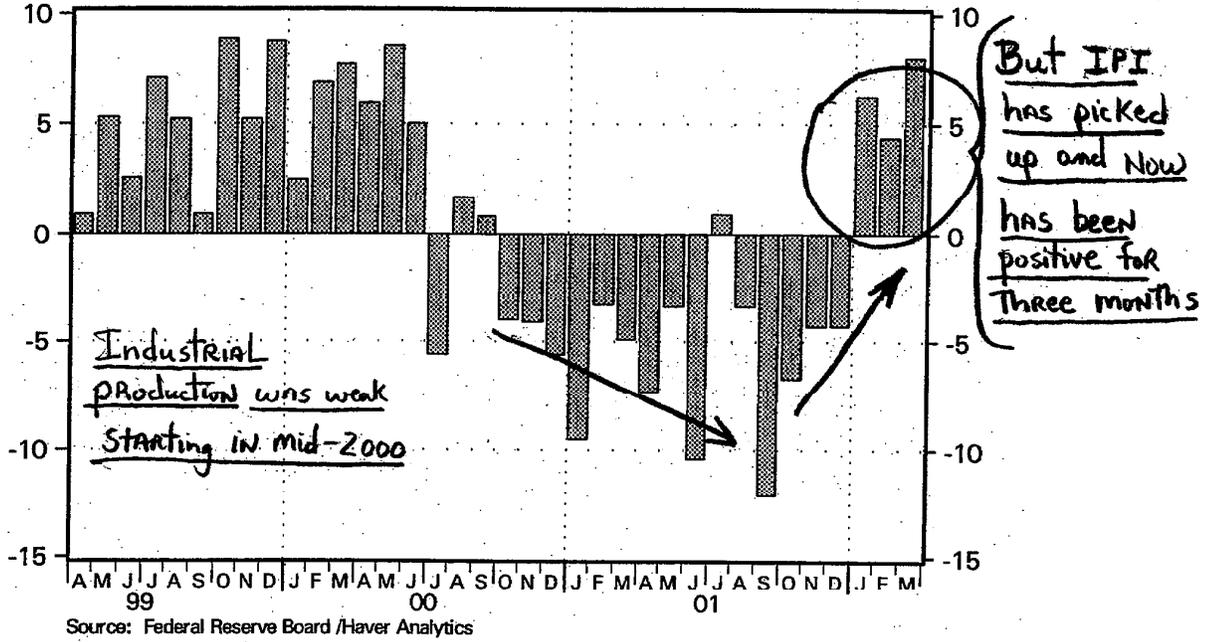
SA, Mil. \$



Source: Bureau of the Census /Haver Analytics

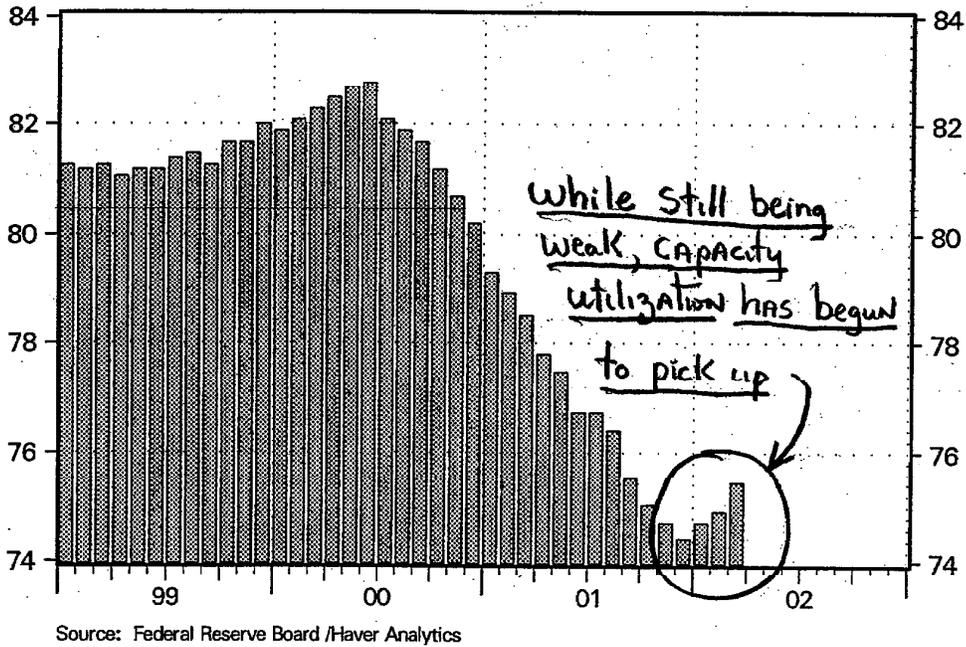
Industrial Production Index

% Change - Annual Rate SA, 1992=100



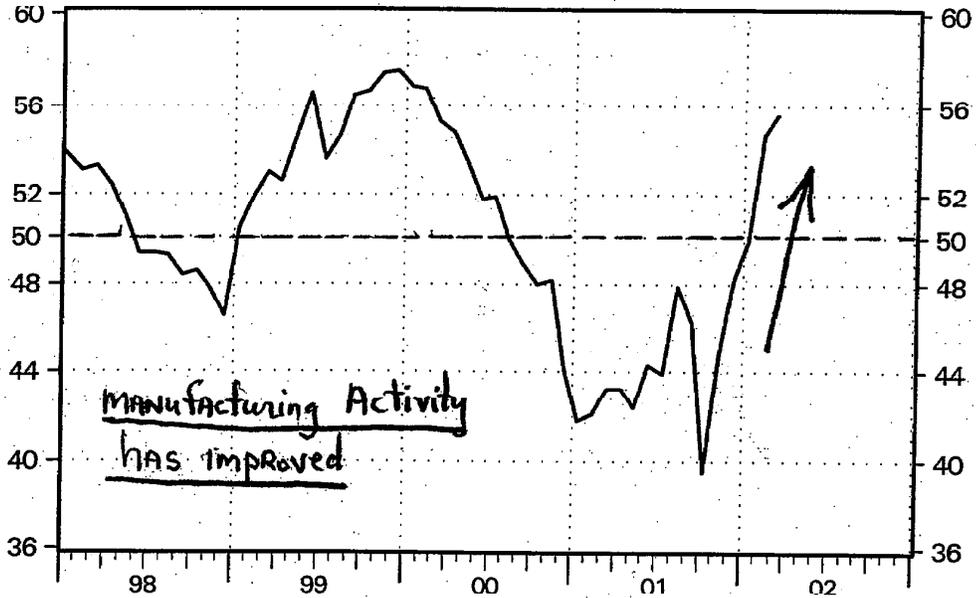
Capacity Utilization: Industry

SA, Percent of Capacity



ISM Mfg: PMI Composite Index

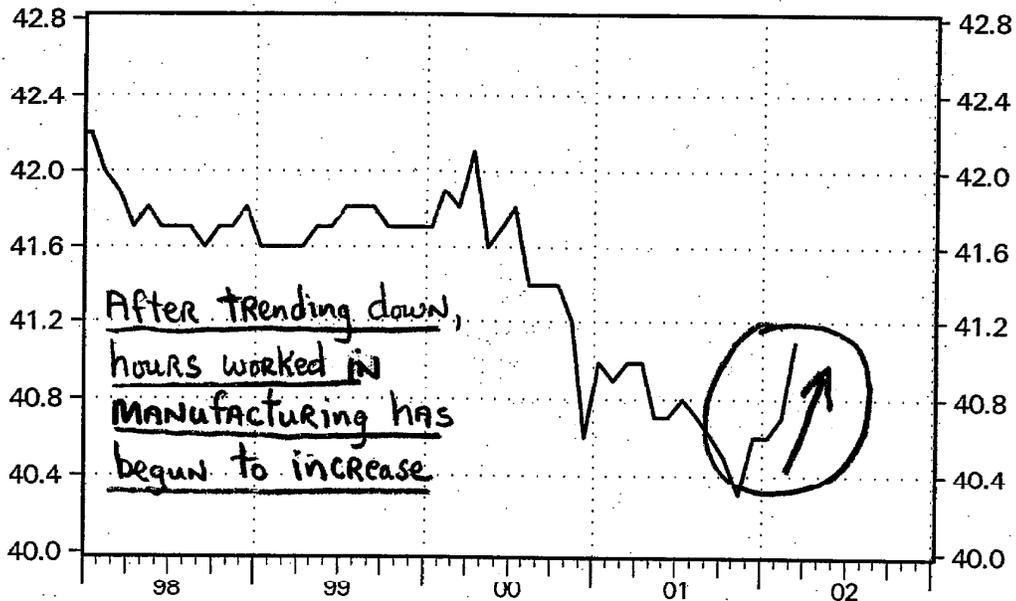
SA, 50+ = Econ Expand



Source: National Association of Purchasing Management /Haver Analytics.

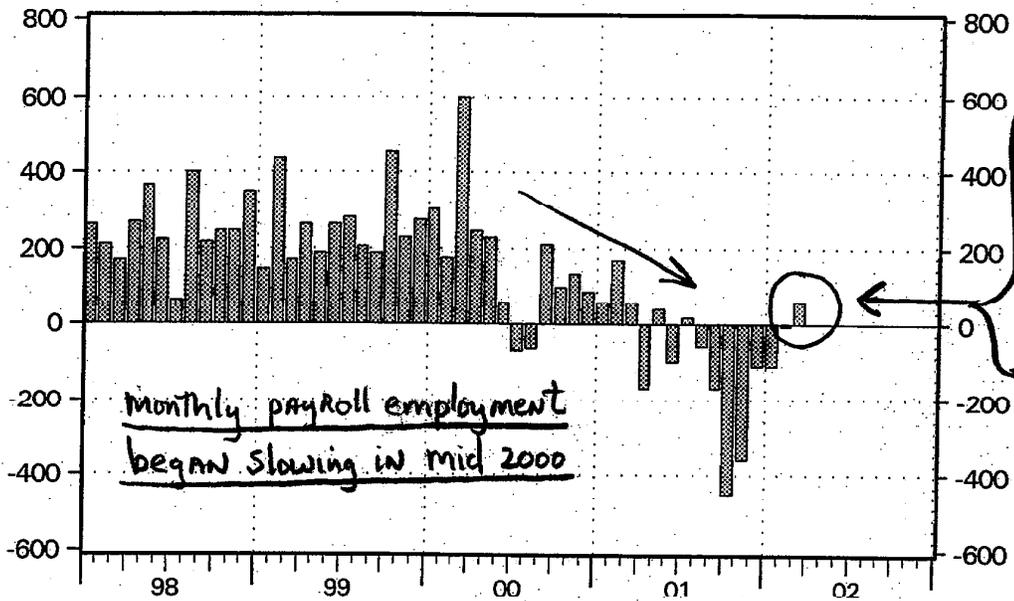
Average Weekly Hours: Manufacturing

SA, Hours



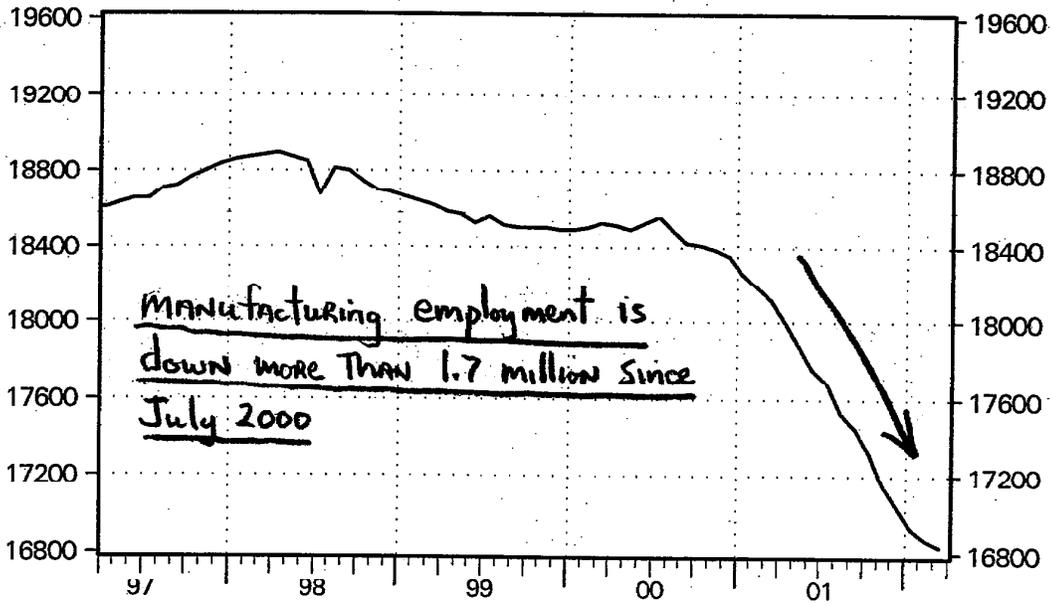
Source: Bureau of Labor Statistics /Haver Analytics

Employees on Nonfarm Payrolls
Difference - Period to Period SA, Thousands



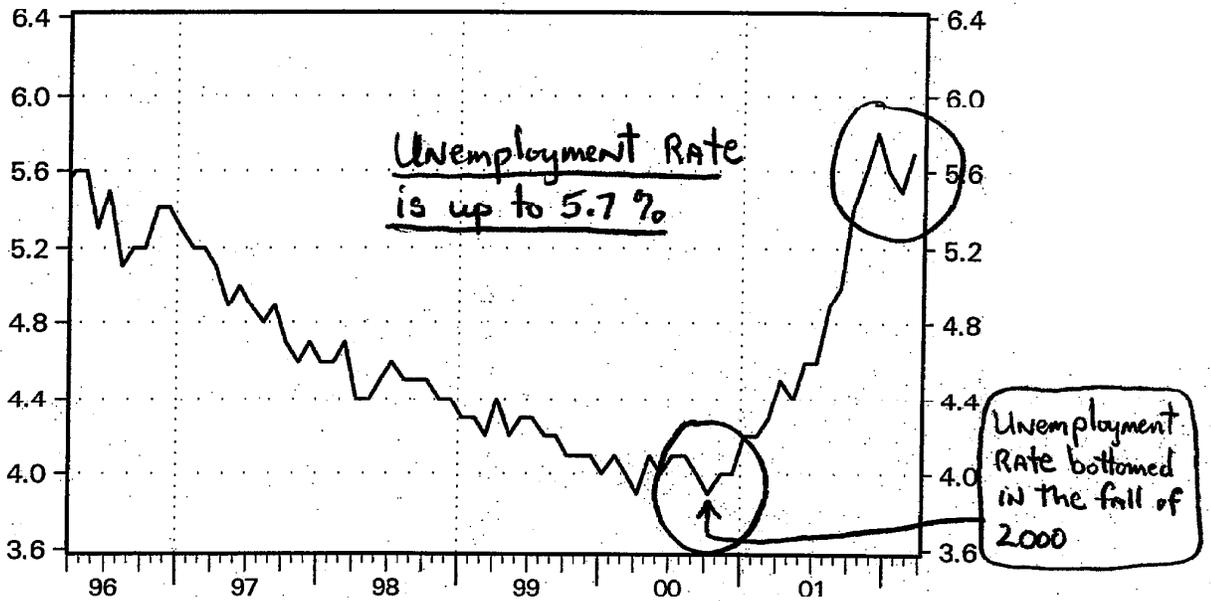
Source: Bureau of Labor Statistics /Haver Analytics

All Employees: Manufacturing
SA, Thous



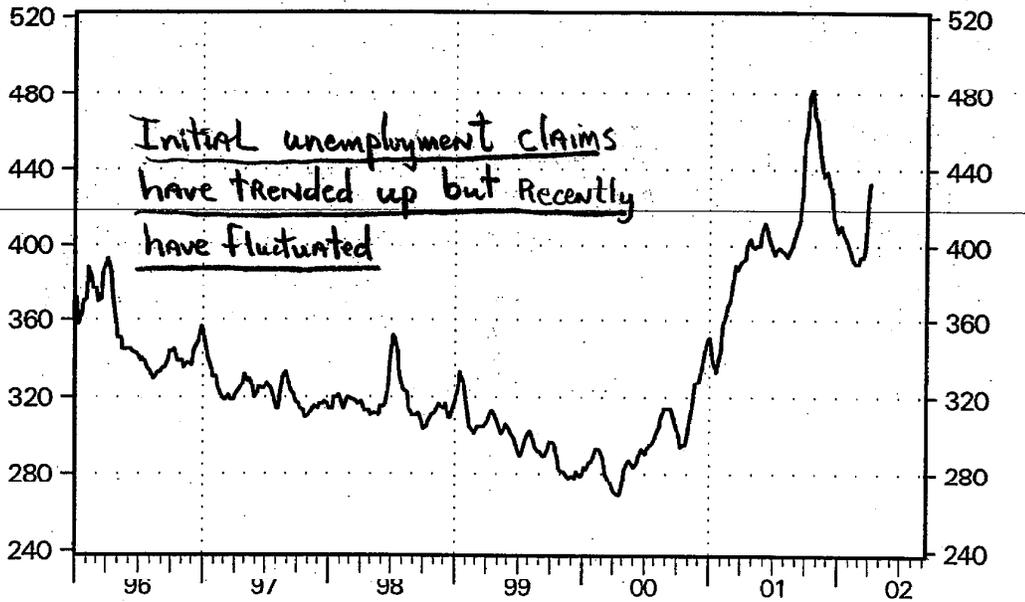
Source: Bureau of Labor Statistics /Haver Analytics

Civilian Unemployment Rate: 16 yr +
SA, %



Source: Bureau of Labor Statistics /Haver Analytics

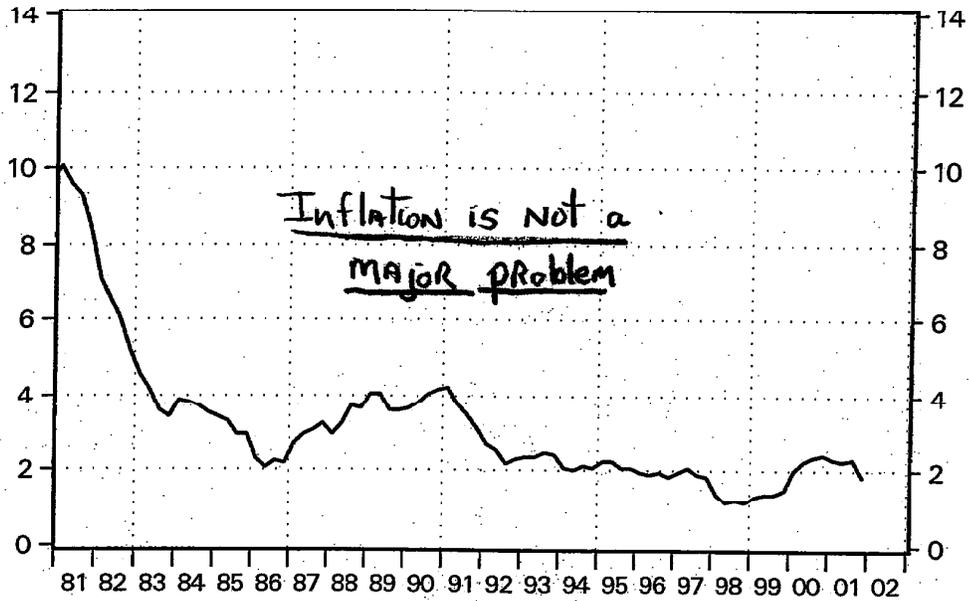
Unemployment Insurance: Initial Claims, 4-Week Moving Average
SA, Thous



Source: Department of Labor /Haver Analytics

Gross Domestic Product: Implicit Price Deflator

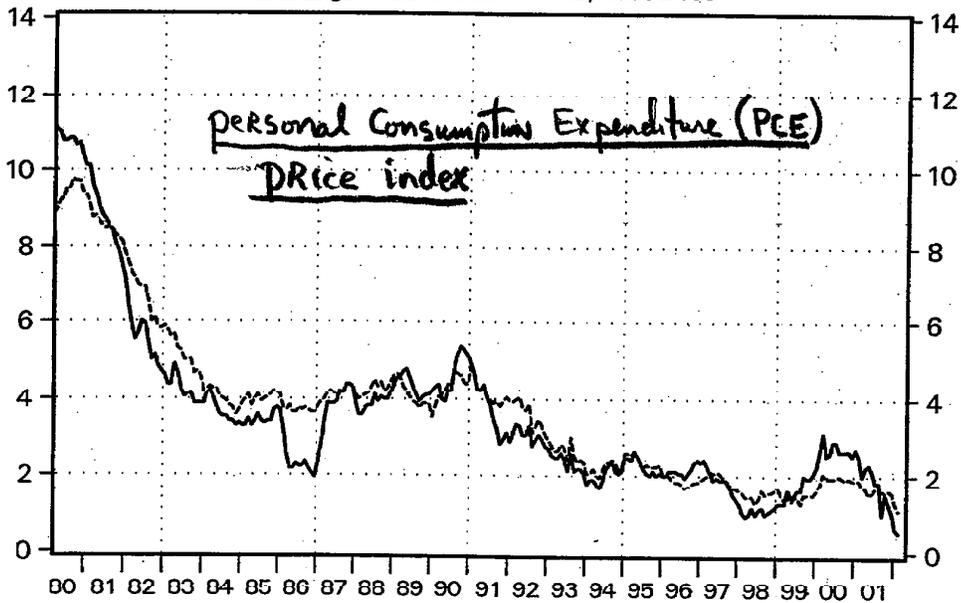
% Change - Year to Year SA, 1996=100



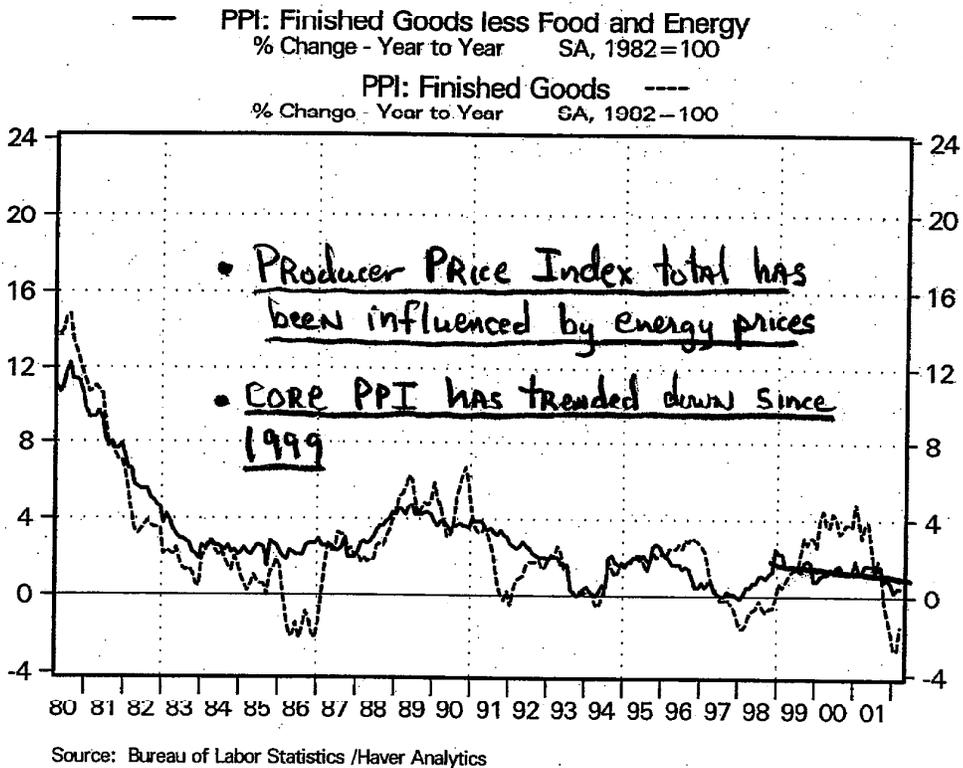
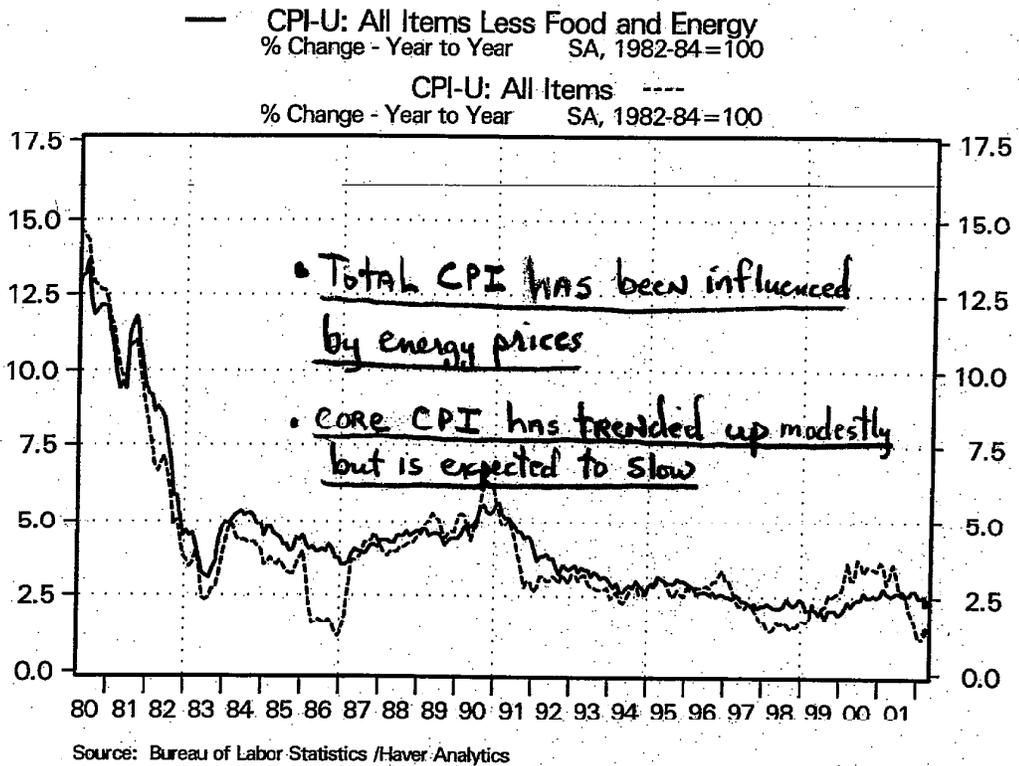
Source: Bureau of Economic Analysis /Haver Analytics

— PCE: Chain Price Index
% Change - Year to Year SA, 1996=100

--- PCE less Food & Energy: Chain Price Index excl Insurance Adj
% Change - Year to Year SA, 1996=100

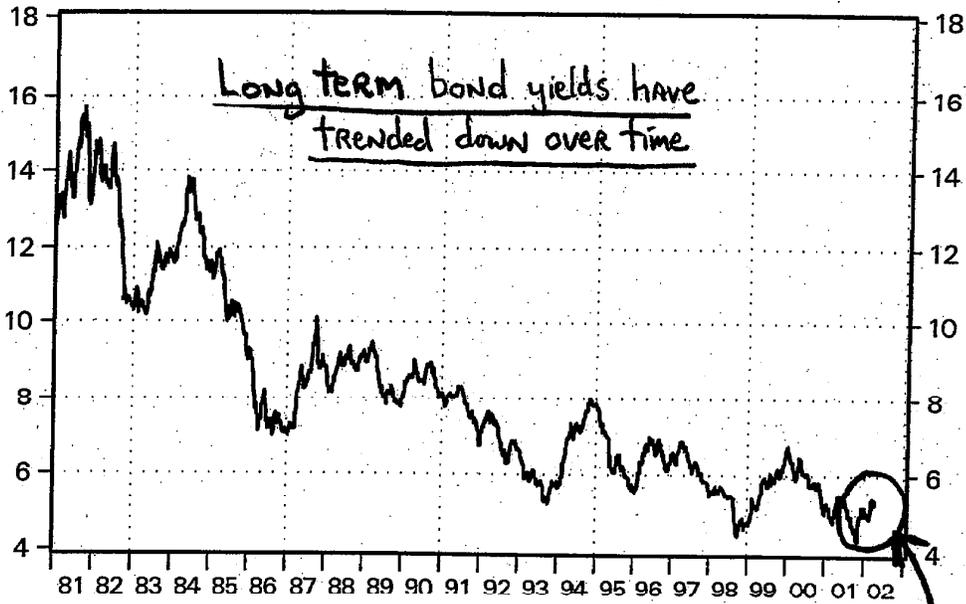


Sources: Bureau of Economic Analysis, /Haver Analytics



10-Year Treasury bond yield at constant maturity

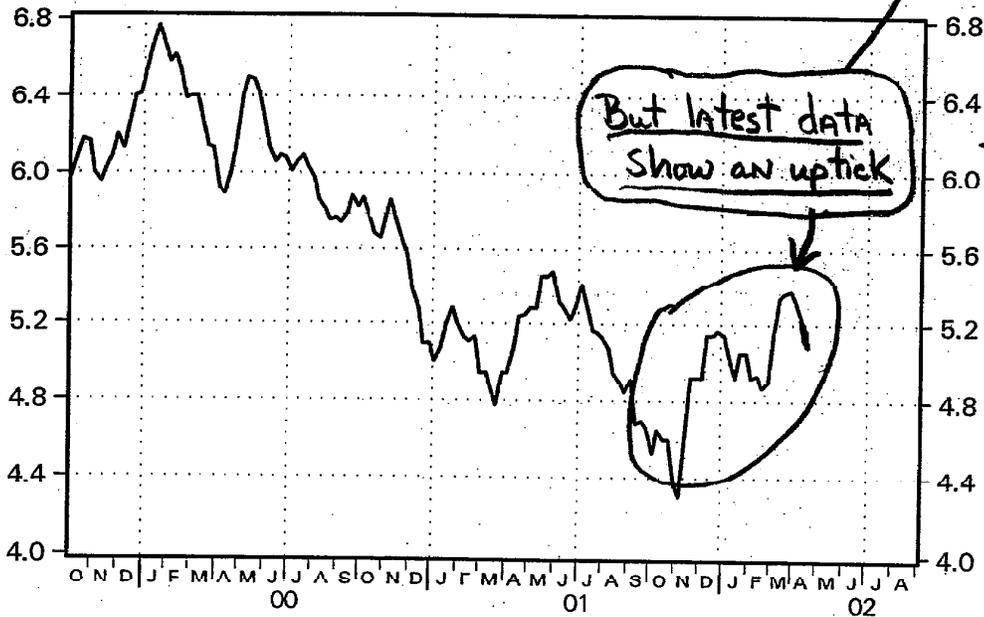
Avg, %



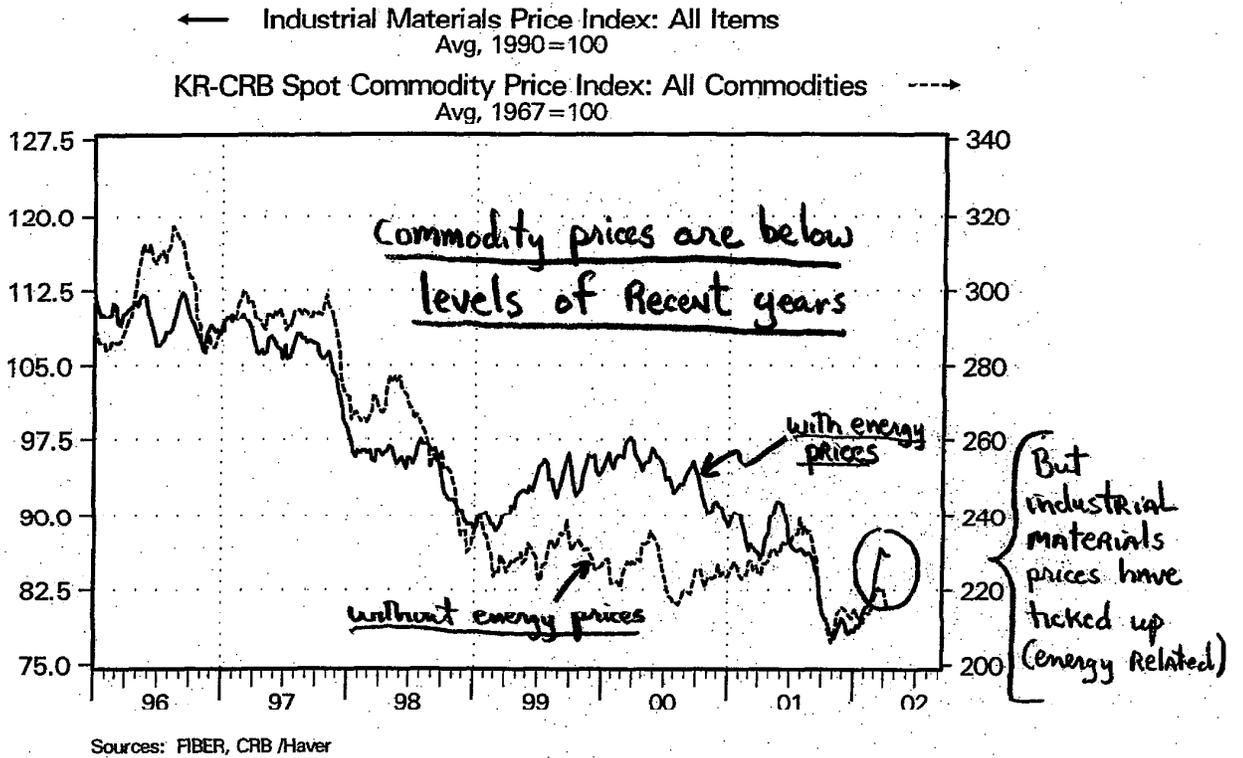
Source: U.S. Treasury /Haver Analytics

10-Year Treasury bond yield at constant maturity

Avg, %



Source: U.S. Treasury /Haver Analytics



Nominal Broad Trade-Weighted Exchange Value of the US\$
Avg, 1/97=100

