BRIEFING MATERIALS ON THE ECONOMY

JOINT ECONOMIC COMMITTEE

Prepared for Vice Chairman Jim Saxton

Data as of July 28, 1999

Prepared by Dr. Robert Keleher, JEC Staff

CONTENTS

Briefing on the Economy[1]

Summary and Overview

- The economy continues to expand, albeit at a somewhat slower pace than earlier. The latest figures indicate that the economy's GDP expanded at a 2.3 percent rate in the second quarter after registering 4.3 and 6.0 percent rates in the first and fourth quarters, respectively. Key components of GDP -- consumption and investment -- remain relatively strong and are generally supported by strong data for employment, income and spending growth.

- Most key measures of broad price movements indicate that trends of inflation remain subdued. But the most recent data generally suggest that inflation is no longer falling. Further, very recently, there have been a few preliminary signs of increases in certain categories of prices causing some inflation measures to tick up (e.g., recent CPI, PPI, energy prices, and home prices).

- Several forward-looking indicators continue to suggest inflation and inflationary expectations should continue to remain subdued. But the long-term bond rate has increased significantly since late 1998. (Some of this increase in yield could reflect an advance in inflationary expectations.)

Role of Monetary Policy

- Federal Reserve monetary policy has produced many of the beneficial economic conditions we are experiencing today. Low inflation, low interest rates, low unemployment, and the consequent solid economic growth is the result of a gradual and credible disinflationary policy. To the extent governmental policy action has produced this benign set of circumstances, excellent monetary policy is the key reason.

Outlook

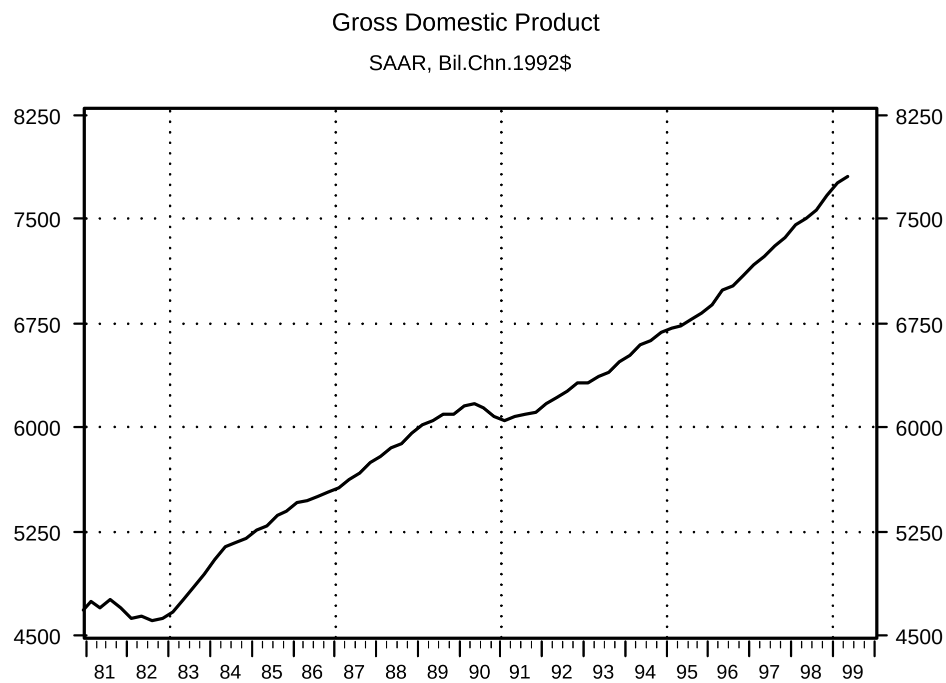
- Consensus quarterly forecasts indicate the following:

	1999		2000	
	Q3	Q4	Q1	Q2
Real GDP	2.8	2.7	1.8	3.0
Inflation	2.2	2.2	2.2	2.2

---

[1] The source for all graphs in these *Briefing Materials* is Haver Analytics.

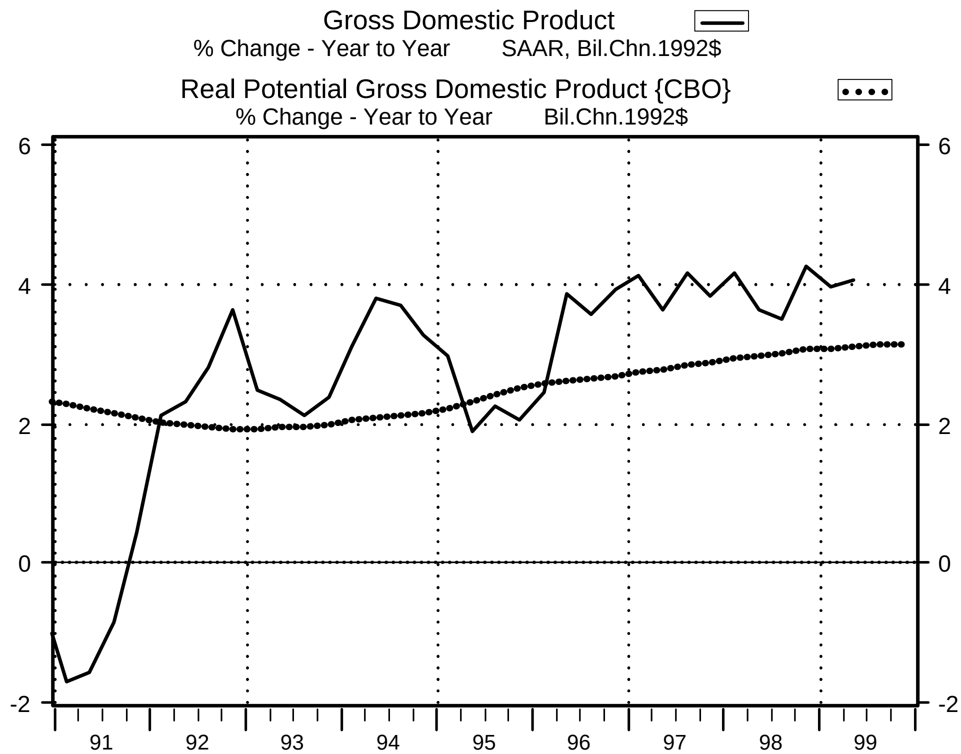
I. Output Measures



- The current expansion is now more than eight years old (99 months) and the longest peacetime expansion on record.

- It followed the 1980s expansion (92 months) which is the second longest peacetime expansion on record. In short, we are now experiencing back-to-back the first and second longest peacetime expansions in American history.

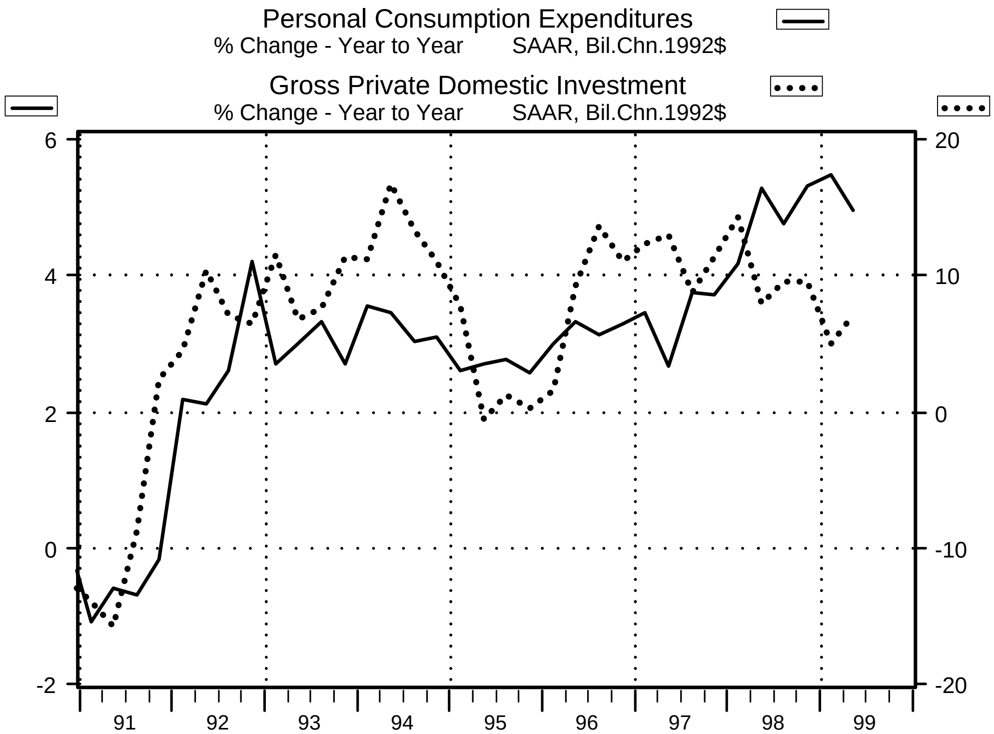
- The recession that occurred between these record-breaking expansions was exceptionally short (9 months).



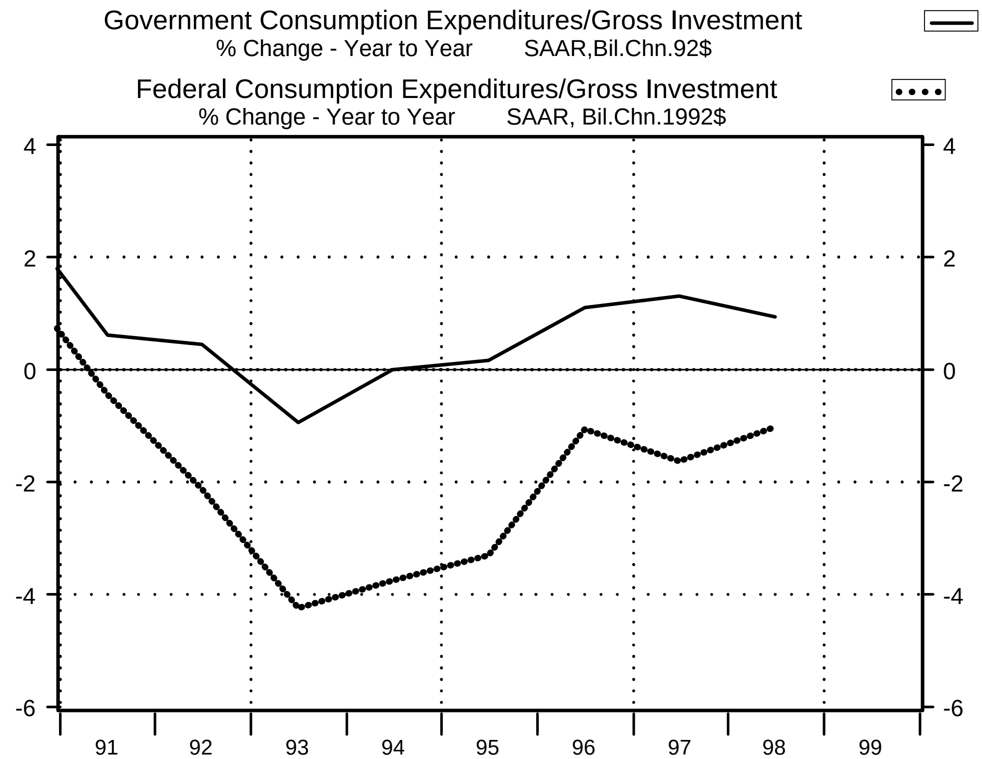
- This chart shows real GDP growth relative to "potential" GDP growth as calculated by the Congressional Budget Office (CBO) since the early 1990s (both on a year-over-year basis).

- As shown in the chart, real GDP has persistently grown at a rate above its "potential" as calculated by CBO.

- The latest data indicate that real GDP continues to expand, albeit at a slower pace than earlier. Real GDP grew at a 2.3 percent pace in the second quarter, after registering 4.3 percent and 6.0 percent rates in the first and fourth quarters, respectively.



- Both the consumption and investment components of real GDP have been leading sectors in this expansion. They have grown at rates exceeding aggregate GDP. The figures in the chart are year-over-year figures.
- Note that the left axis pertains to consumption growth while the right axis pertains to the growth of investment.
- One reason for the strength of investment in this expansion is that the decline of inflation (see below) reduced interest rates and increased the real value of investment tax deductions.

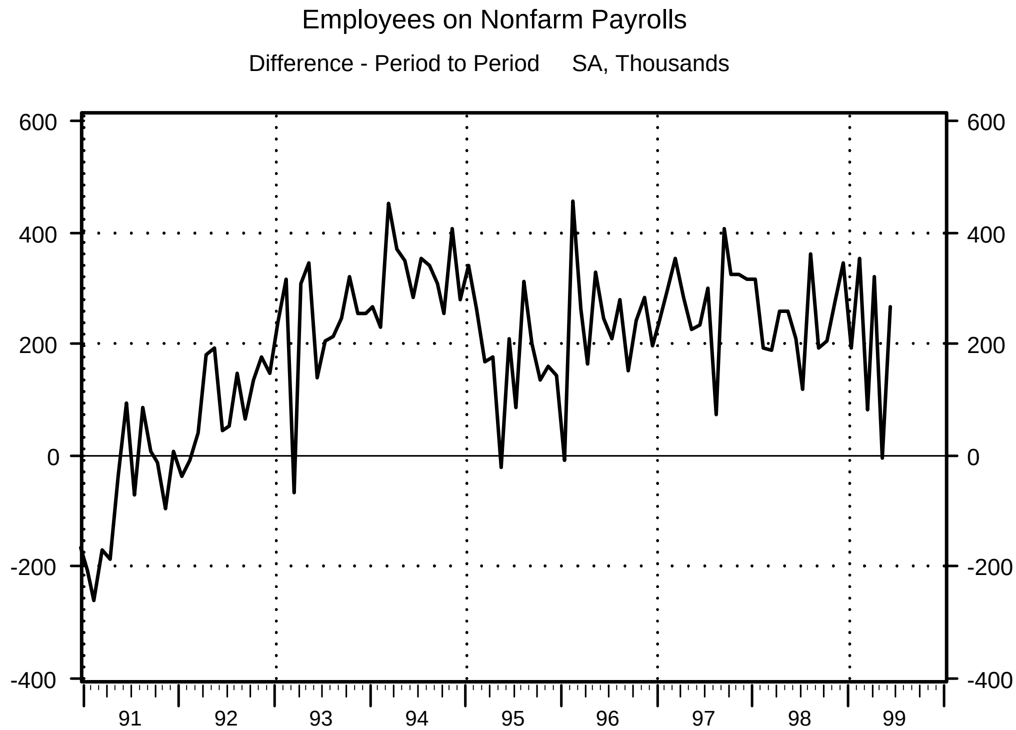


- One component of real GDP that has <u>not</u> grown rapidly during this expansion is real (inflation adjusted) government spending on goods and services. (This measure, from the national income and product accounts, excludes transfer payments).

- Both real total government (which includes state and local) and real federal government spending on goods and services have been constrained during this expansion by growing <u>less</u> than GDP.

- Federal government spending on goods and services has actually declined in real (inflation adjusted) terms during this expansion. An important reason for this has been the cutbacks in defense spending.

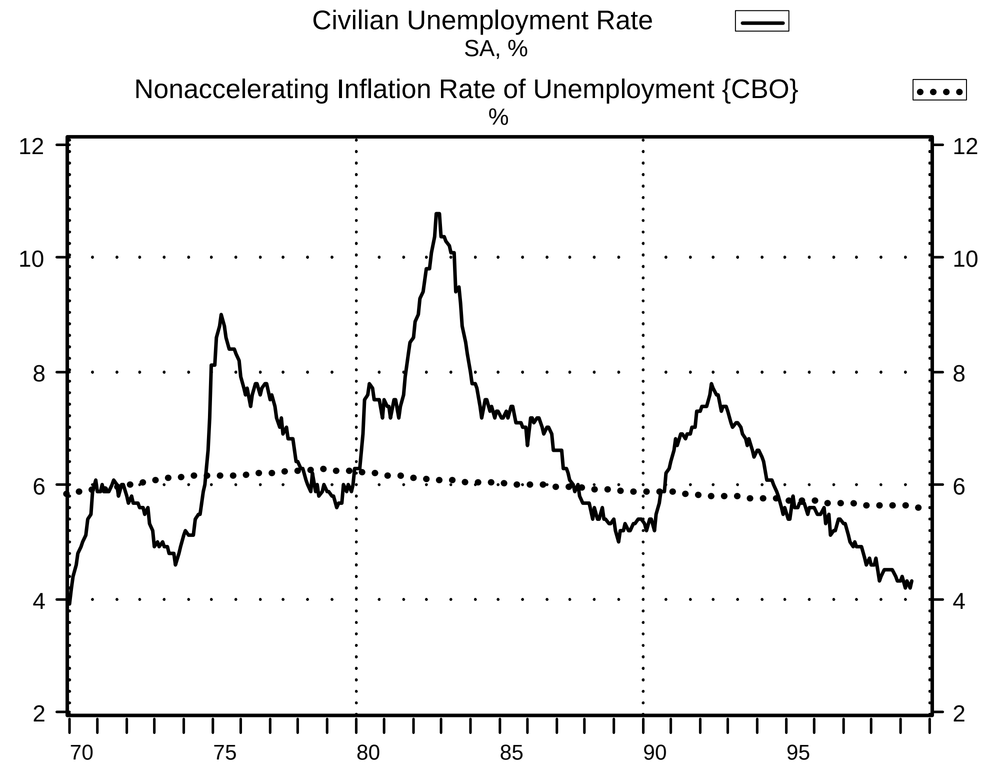
II. The Labor Market



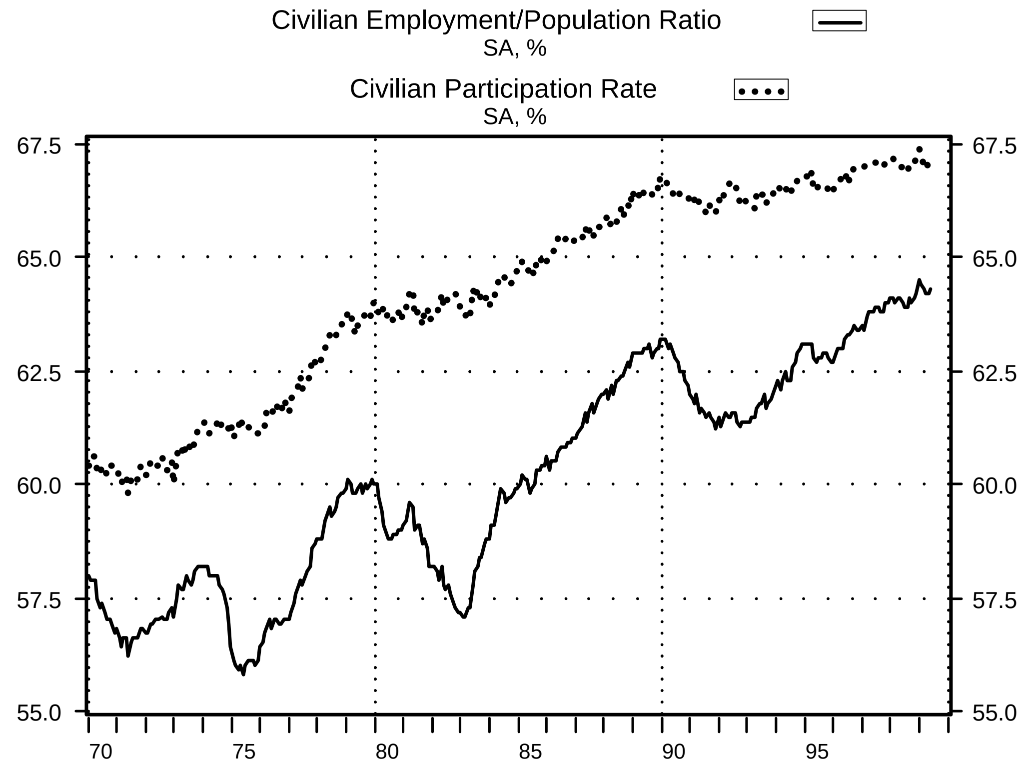
- Employment gains during this expansion have been substantial with about 20 million new jobs added.

- In the last six years of this expansion, monthly payroll gains have averaged about 240,000 per month. This has slowed to about 225,000 per month in the last 6 months.

- Last month's gain was 268,000. This was composed of healthy gains in service producing employment, but continued weakness in manufacturing employment.



- The June unemployment rose slightly to 4.3 percent, near the lowest rate of unemployment since 1970.
- This unemployment rate is well below the so-called Nairu (non-accelerating inflation rate of unemployment), yet trends in costs and prices remain relatively subdued.

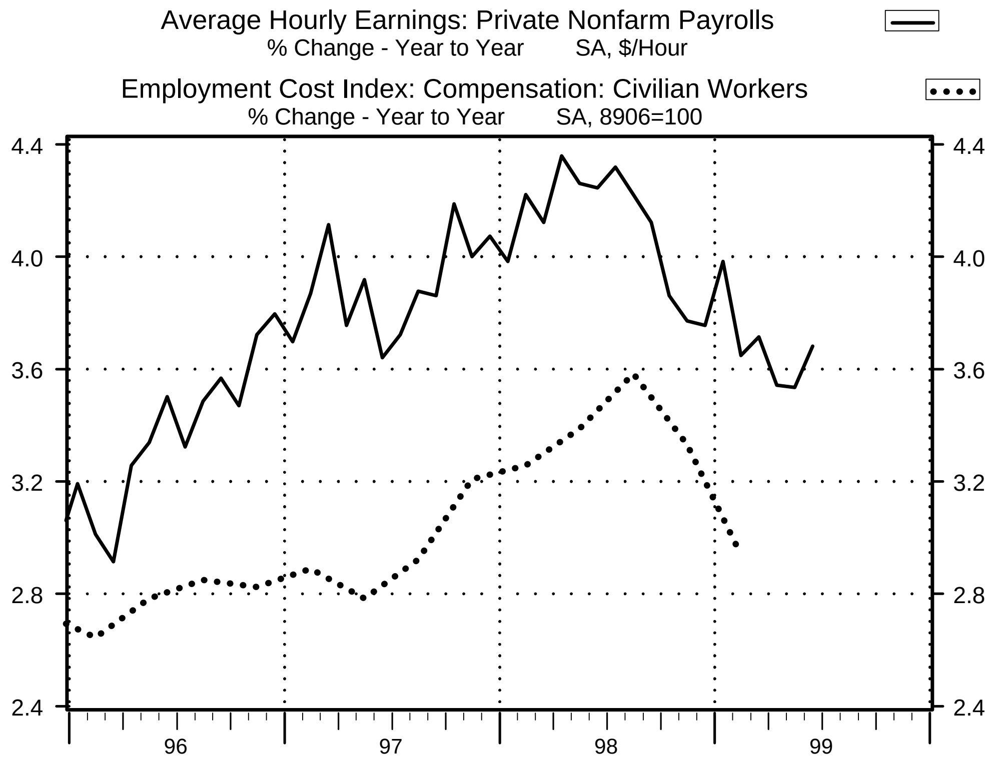


- Both the employment-to-population ratio and the participation rate remain close to all-time highs.

- The high employment-to-population ratio means that a higher proportion of the population has jobs now than in the past.

- The high participation rate means that more people are participating in the labor force (i.e., either have jobs or are seeking work) now than in the past.

- Both measures suggest the labor market is tight.



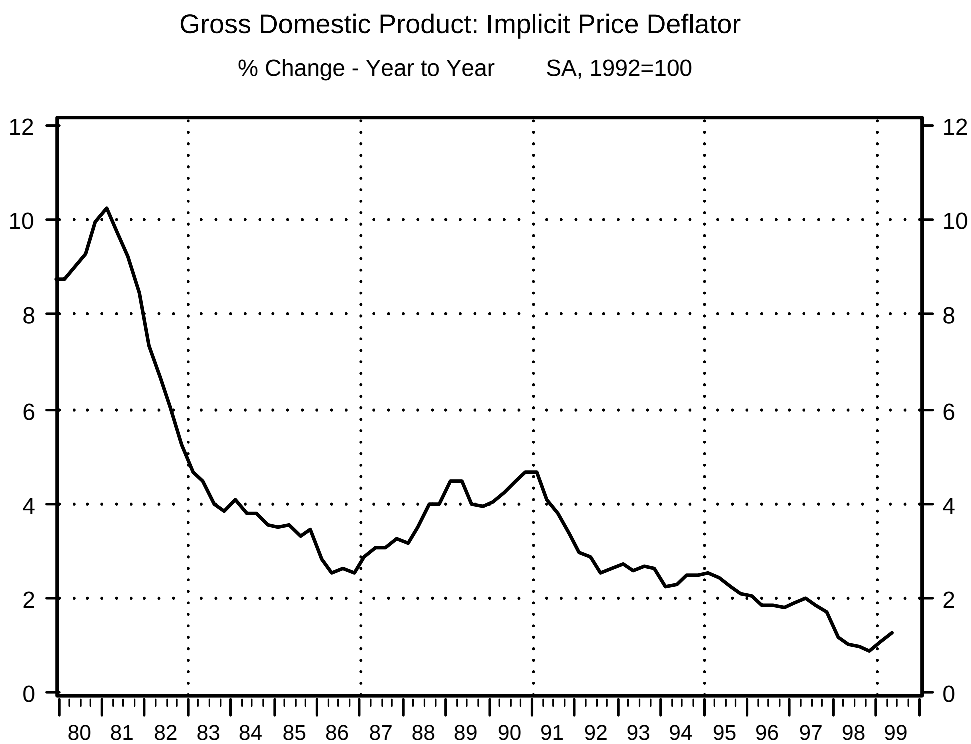
- Despite rapid job gains and a low unemployment rate, key measures of wage "inflation" have generally moderated from earlier periods.

- More specifically, June hourly earnings increased 0.38 percent over May and on a year-over-year basis was up at a 3.7 percent rate.

- Similarly, the employment cost index increased 3.1 percent on a year-over-year basis in the second quarter.

- With productivity increases taken into account, these increases translate into subdued wage cost pressures.

III. Inflation Measures

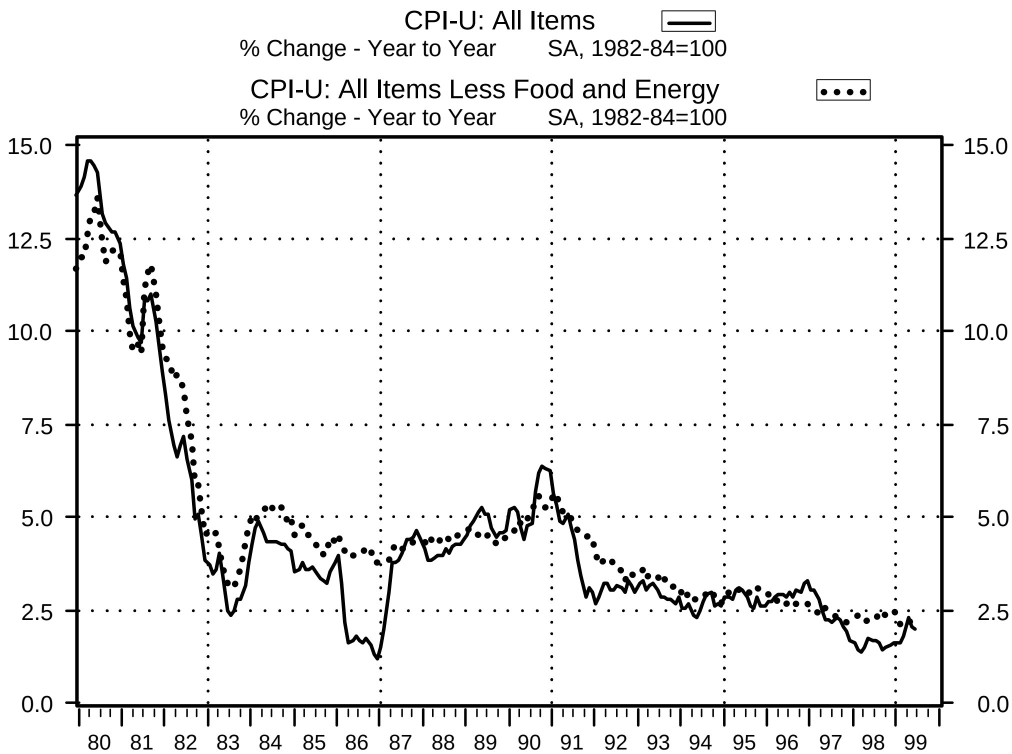


- Despite solid economic growth, inflation trends remain subdued.

- This chart shows the broad GDP deflator, on a year-over-year basis over a long-term time frame.

- According to this measure, inflation is close to its lowest level since the early 1960s.

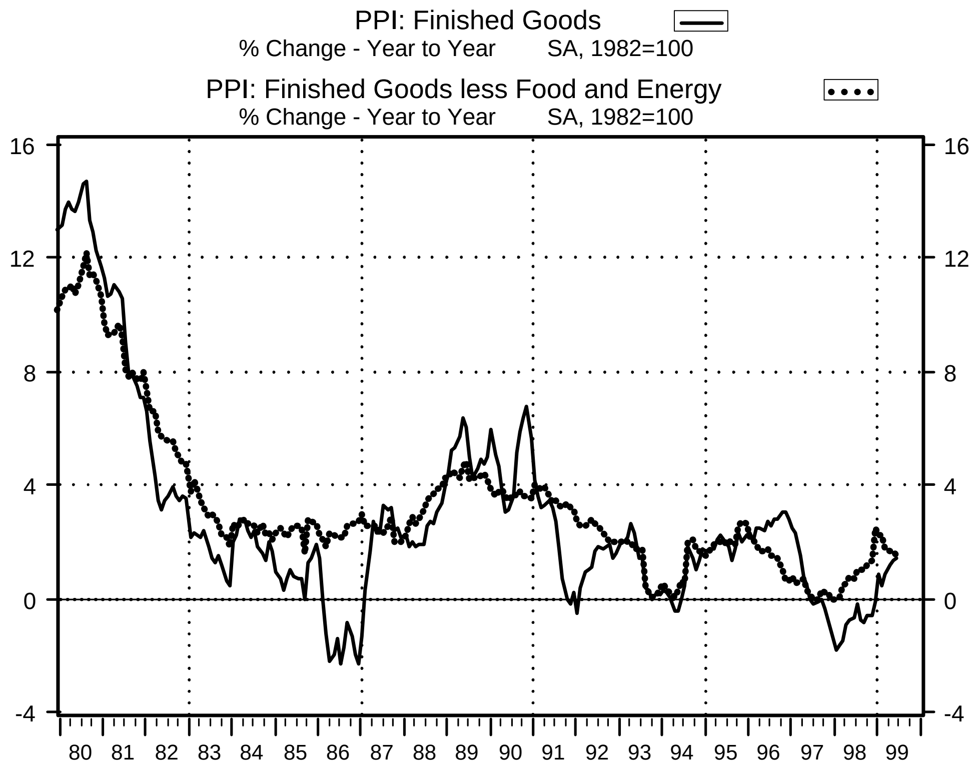
- This decline of inflation is due to persistent Federal Reserve anti-inflation monetary policy which has reduced inflation, lowered interest rates, and thereby fostered the economic expansion.



- Consumer price inflation has continued to post modest increases on a year-over-year basis.

- This graph shows that both total (all component) CPI and core (ex-food and energy) CPI increases have remained relatively subdued.

- The latest data for both May and June show this good performance continues despite an abberational increase in April. Total CPI increased 2.0 percent on a year-over-year basis in June while core CPI expanded 2.0 percent year-over-year, the lowest rate since 1966.

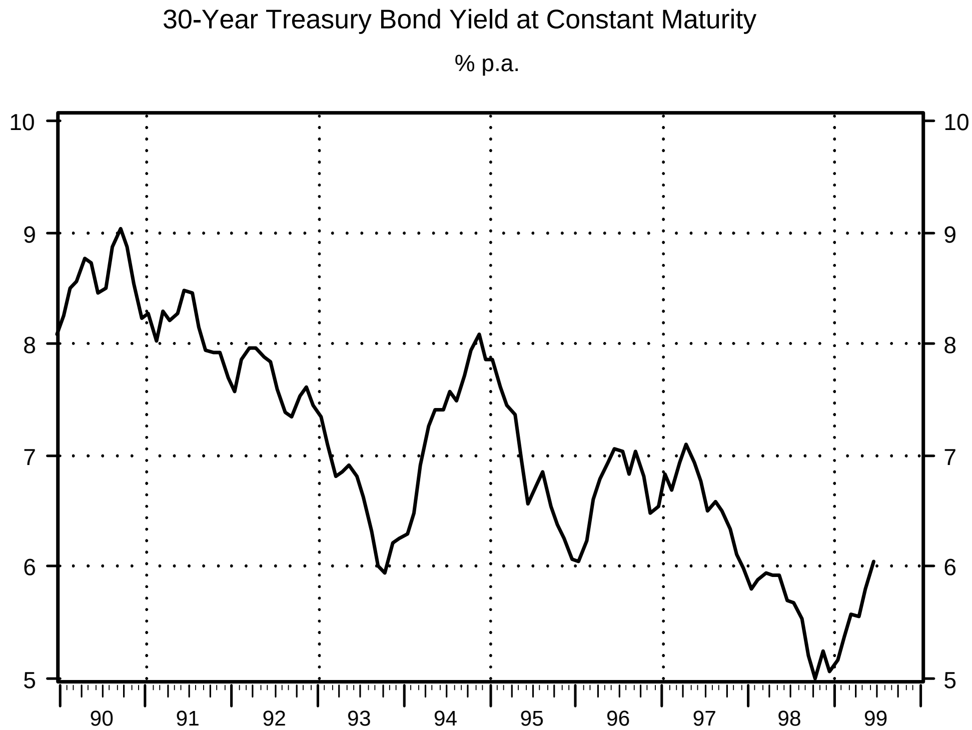


- Producer price increases as measured by both the total finished good producer price index and the core (less food and energy) finished good producer price index have generally been subdued.

- Latest figures (June) indicate that the total PPI finished good category was up 1.46 percent on a year-over-year basis.

- Recent upticks are largely accounted for by temporary factors, such as abnormally sharp energy and tobacco price increases, as well as seasonal problems.

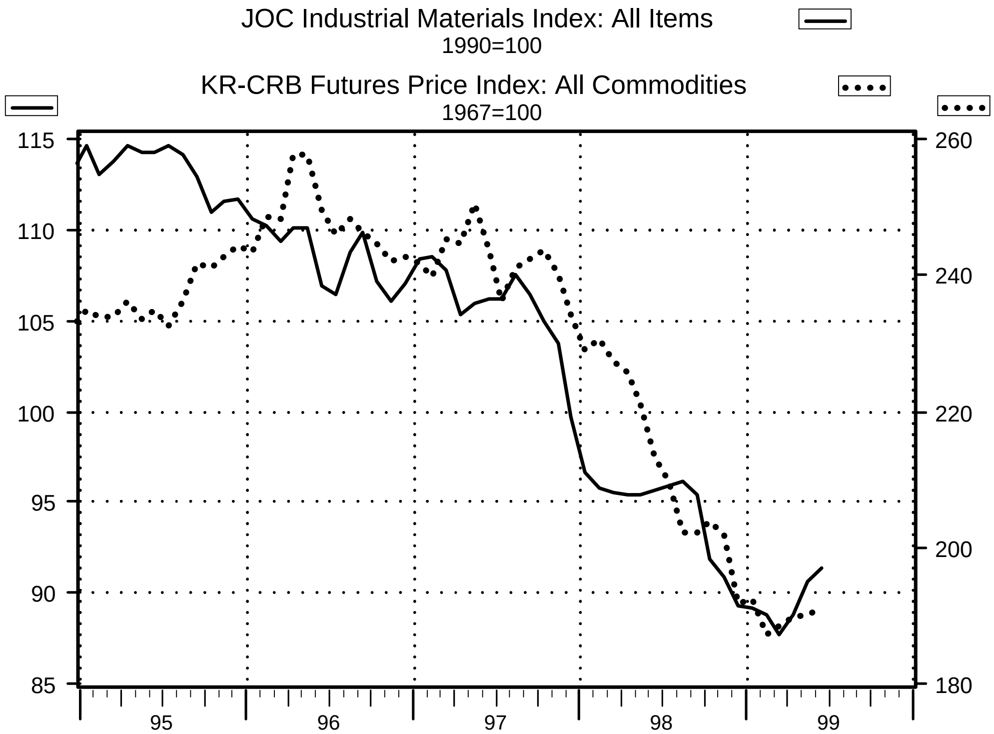
IV. Forward-Looking Market Price Indicators



- Long-term interest rates have fallen in recent years. Since late last year, however, long-term interest rates have increased.

- This chart shows the long-term Treasury bond yield.

- This interest rate has recently ticked up more than 100 basis points since late last year. This increase is partly related to market concerns about future Federal Reserve interest rate increases, but may also be partly related to increases in inflationary expectations.



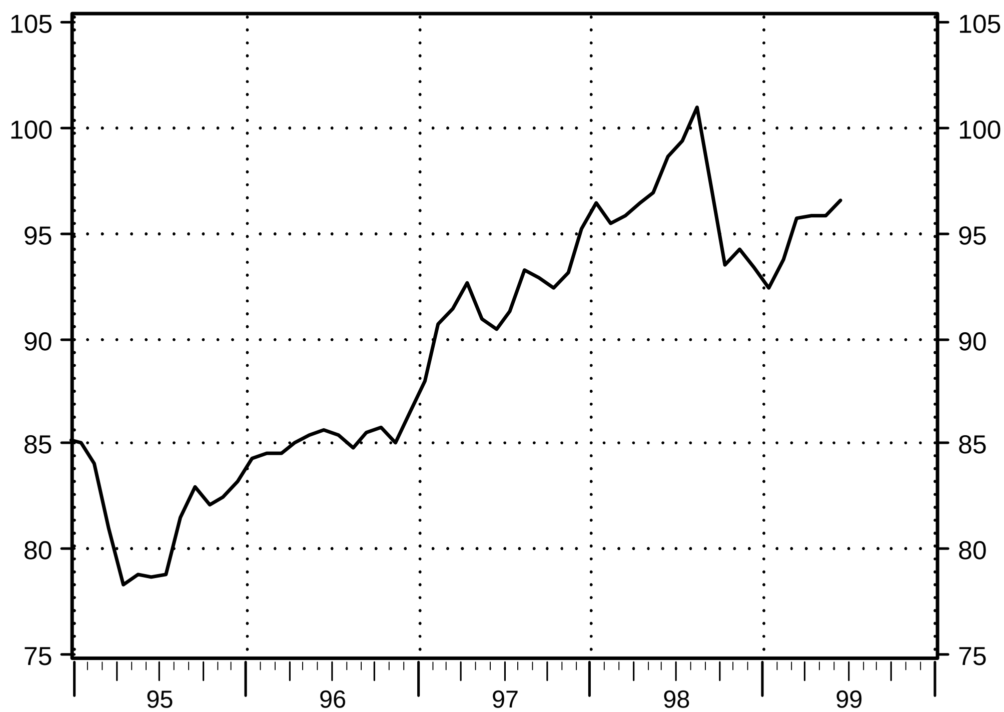
- Commodity prices remain relatively weak. While commodity prices have fallen in recent years, they have ticked up in the most recent months.

- This chart shows two commonly used commodity price indices (the Journal of Commerce and CRB indices). Both of these measures have been falling for several years, but very recently have ticked-up.

- Despite these latest readings, there is little sign of any meaningful persistent inflation resurgence from these measures of commodity prices.

Nominal Trade-Weighted Exch Value of US$ vs Major Currencies

3/73=100

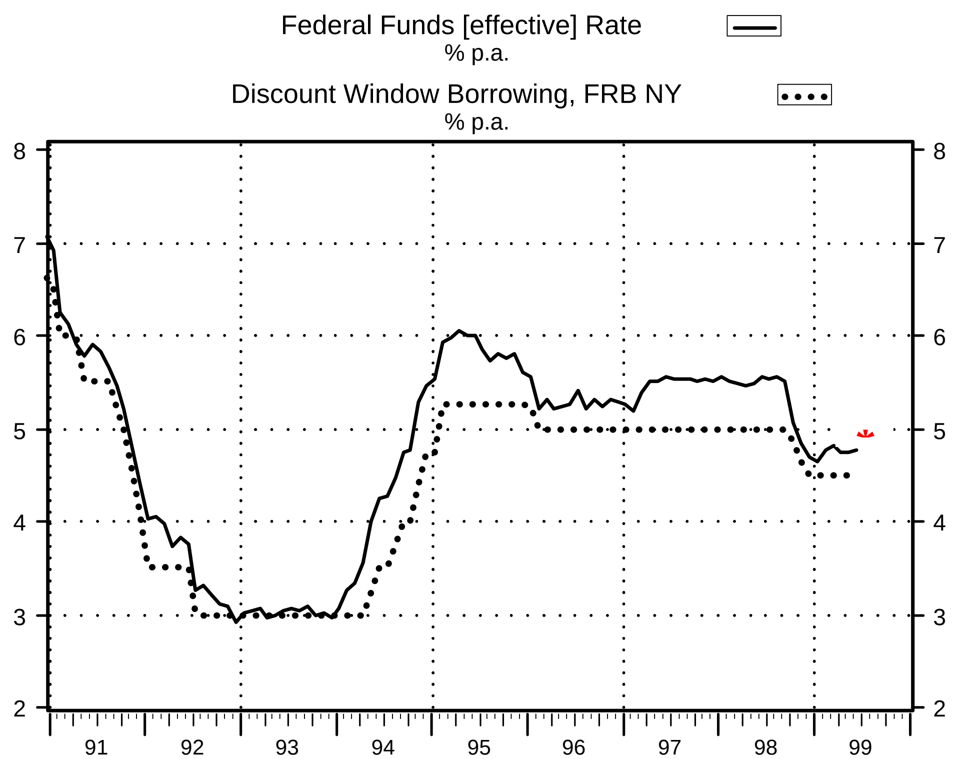


- The foreign exchange value of the dollar has generally trended up in recent years, although it dipped against a few individual currencies last year.

- The chart shows the trade-weighted value of the dollar against 17 major currencies.

- Recently, the dollar has strengthened against European currencies and the Euro.

V. Federal Reserve Monetary Policy



- Short-term interest rates are importantly influenced by Federal Reserve monetary policy.

- This chart shows the federal funds rate (an interest rate closely controlled by the Fed) as well as the discount rate (the rate the Federal Reserve charges banks for borrowing from the discount window).

- The Fed lowered the federal funds rate three times last fall. After keeping the Fed Funds rate unchanged for several FOMC meetings, the Federal Reserve increased the Federal Funds Rate by 25 basis points at the June meeting.

- The next FOMC meeting is scheduled for August 24.

VI. Reasons for Circumstances of Healthy Growth with Low Inflation

Lower Inflation Actually Improves Growth.

- Lowers interest rates
- Reduces unnecessary uncertainty and volatility in financial markets
- Causes price system to work better
- Acts like a tax cut (especially for those portions of the tax code that are not indexed for inflation)

Government Spending has Fallen as a Percentage of GDP.

- We have experienced a significant decline in federal government spending as a percent of total output. The federal government spent over 22 percent of GDP in 1992, compared with about 19.5 percent today.
- This enables resources to be used more productively, fostering more growth without inflation.

Lower Marginal Tax Rates Remain in Place.

- We are reaping long-run effects of lower tax rates (despite increases in 1990 and 1993)
- Marginal tax rates remain lower than they were in the 1950s, 1960s, and 1970s

Investment Has Worked to Expand Capacity.

- Investment in equipment has been a leading sector in this expansion
- This helps growth without causing inflation
- Information revolution/computers has increased productivity
- Technological change has improved productivity

Global Competition and Freer Trade have Fostered Growth.

- Reduction in tariff barriers helps economic growth while promoting lower prices
- The international sector has increased in size and exports have been a leading sector in this expansion
- Inflation is declining in many countries
- The combination of global competition and technological change has corporate restructuring making the economy more efficient