HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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June 23, 2003

Data Still Show Far Weaker Economy Than Assumed in Republicans' Budget

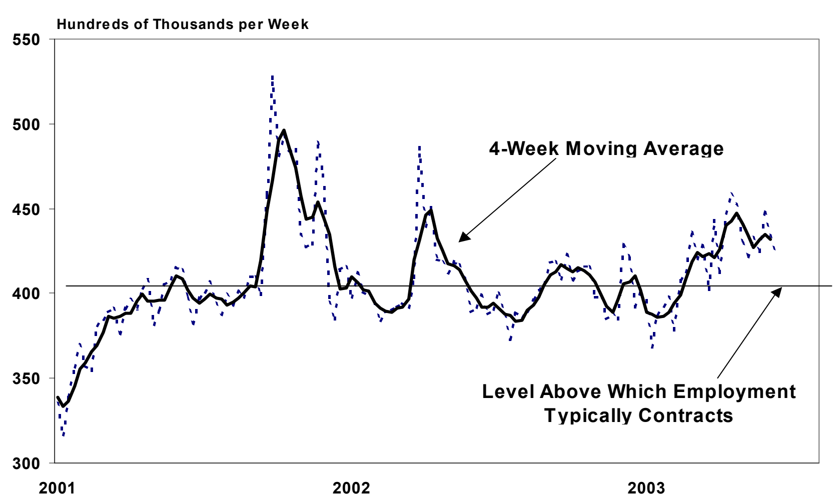
Dear Democratic Colleague:

Despite minor improvements recently in some economic indicators, near-term growth will fall well short of that needed to keep deficits from swelling further. Current deficit projections by both CBO and the Administration assume that real GDP growth will accelerate to more than a 3-percent rate in the second half of 2003. However, there are no credible signs of this in the data as yet.

Real growth in the quarter just ending will only be about 1.5 percent, and the spotty improvement in some forward-looking indicators is not consistent with more than doubling that pace. Indeed, there is a consensus among forecasters and market-watchers that the Federal Reserve will cut short-term interest rates again this week, because it is unconvinced that stronger growth is imminent. This means that this summer CBO and OMB will again have to revise their budget projections to show larger deficits this year, next year, and beyond.

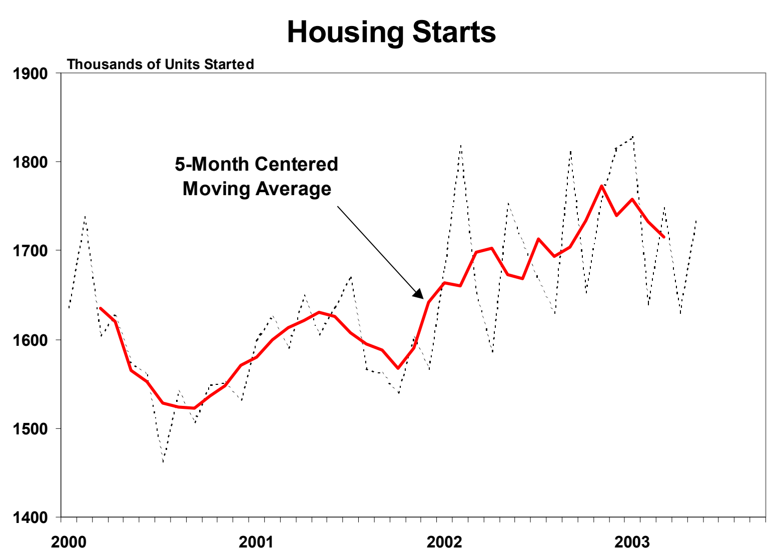
- For 18 consecutive weeks, initial claims for unemployment insurance have been above the benchmark level of 400,000, indicating that the pace of job loss remains quite high. Meanwhile, help-wanted advertising has fallen to its lowest level since 1961, indicating that those who lose their jobs will find it difficult to get new ones. Similarly, the most recent Manpower Inc. hiring survey shows that employers plan to add fewer new workers in the next three months than at any time in the last twelve years.

New Claims for Unemployment Insurance



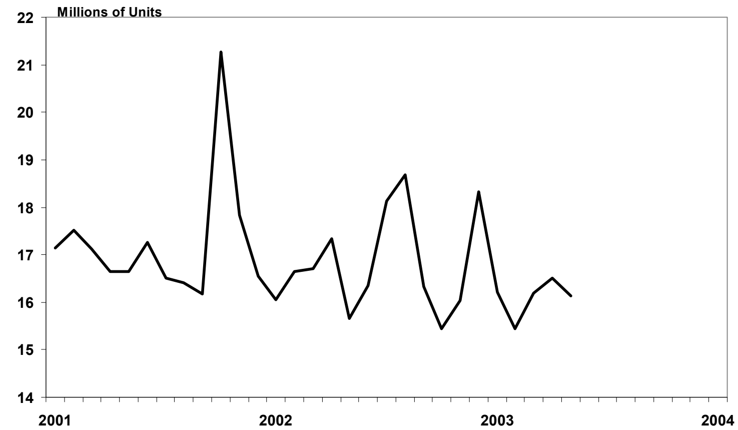
- The one-month increase of the index of leading indicators in May is unconvincing. Typically, economists like to see three months of consecutive gains in the leading index before concluding that better growth is imminent. However, this chart shows that even that standard can be misleading. The leading index increased smartly in the last four months of 2001, but private-sector employment posted eight consecutive monthly declines in the first part of 2002. The private-sector job count then managed only three months of very weak improvements, before heading down again at the end of the year.

- Although housing starts also posted a one-month increase in the most recent data, new home construction actually appears to be on a declining trend. The Federal Reserve has kept short-term interest rates below 2 percent for the last year and a half, and this boosted new home building over that period. However, with short-term interest rates already close to zero, it is unlikely a renewed burst of residential construction will contribute to an economic recovery, as it has in the past. In fact, this chart shows that home building may be petering out.



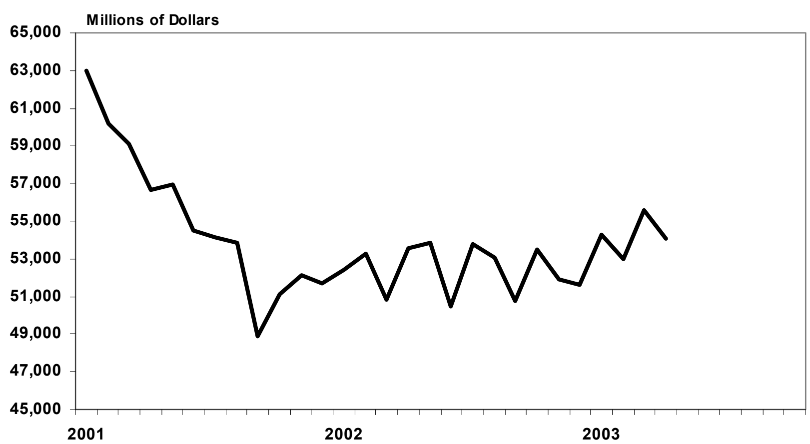
- Motor vehicle production is another sector that typically leads the economy to faster growth, but it too appears unlikely to assume its usual role. The chart below shows that sales of autos and light trucks have, if anything trended downward over the last year and a half.

Sales of Autos and Light Trucks



- New orders for nondefense capital goods have been essentially flat for the past year and a half. This indicator of future business investment suggests that firms have little reason to invest as long as existing capacity is unused. Thus, a boost in business investment seems unlikely to lead to faster GDP growth anytime in the near future.

New Orders for Non-Defense Capital Goods



The economy may yet recover in the second half of this year in response to the aggressive easing of monetary policy and three tax cuts in two years. However, data about what is happening in the economy ***right now*** show no convincing evidence of that. The assumed recovery that underlies our current deficit projections will therefore have to begin immediately if we are to avoid still more deterioration than budget official figures now show.

Sincerely,

John M. Spratt, Jr.
Ranking Member