



WEEKLY ECONOMIC DIGEST

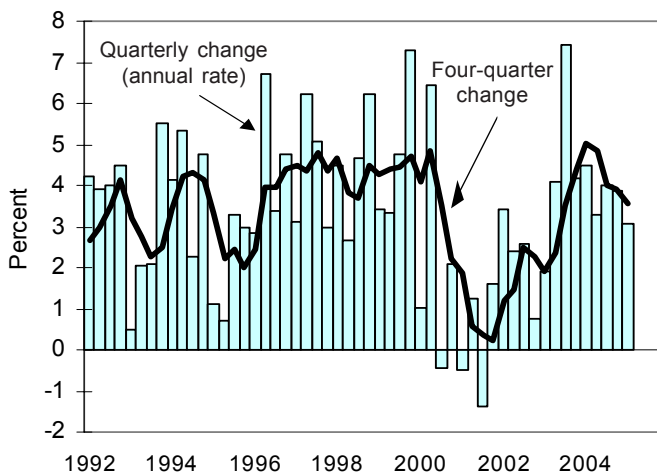


JOINT ECONOMIC COMMITTEE – DEMOCRATIC STAFF
SENATOR JACK REED (D-RI) – RANKING DEMOCRAT

May 3, 2005

Fed Bets Weaker Growth is Temporary

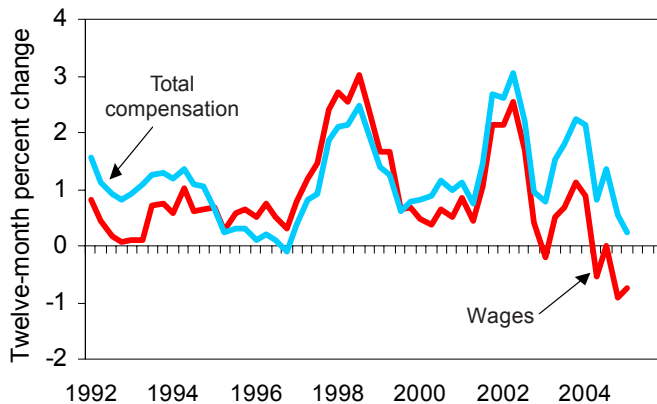
Growth of Real Gross Domestic Product



Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Economic growth slowed in the first quarter. Real (inflation-adjusted) gross domestic product (GDP) grew at a 3.1 percent annual rate in the first three months of the year, following a 3.8 percent advance in the fourth quarter of last year (see top chart). Real GDP was 3.6 percent higher than its level a year earlier. The first-quarter slowing reflected slower growth of business investment in plant and equipment, slower growth in personal consumption expenditures, and a larger trade deficit. Sizeable inventory building worked to prop up overall growth, as final sales, a measure of the strength of underlying demand, grew at an anemic 1.9 percent annual rate, the slowest quarterly advance since the end of 2002.

Employment Cost Index
Private Industry Workers



Source: Bureau of Labor Statistics, U.S. Department of Labor and JEC staff calculations.

The Fed raised short term interest rates again. The Federal Reserve continued to tighten monetary policy at the “measured pace” it adopted in the middle of last year, raising its target for the federal funds rate by ¼ percentage point to 3 percent. While that increase was widely anticipated, the Fed also recognized that economic growth has slowed somewhat. The slowing in growth and the remaining softness in the labor market complicate the Fed’s plan to tighten monetary policy steadily so as to contain inflation without slowing the economy unduly.

Employment costs have lagged behind inflation. The employment cost index (ECI) for private industry workers—a measure of employee compensation that includes both wages and benefits—grew at a 2.4 percent annual rate over the first three months of the year, but that was well below the 4.3 percent advance in consumer prices. Over the past year, the total ECI grew by just 0.2 percent after accounting for inflation (see bottom chart). Moreover, the wage component of the ECI has fallen by 0.7 percent in real terms over the past twelve months.

The Economy at a Glance	Apr	Mar	Feb	Jan	2005 Qtr 1	2004 Qtr 4	2004 Qtr 3	2004 Qtr 2	2004	2003
Economic Activity										
Real GDP (% growth)	—	—	—	—	3.1	3.8	4.0	3.3	4.4	3.0
Industrial Production (% growth)	n.a.	3.7	2.4	0	3.6	4.5	2.7	4.3	4.2	0
Capacity Utilization (level, %)	n.a.	79.4	79.3	79.2	79.3	78.8	78.2	77.9	78.1	75.5
Civilian Unemployment Rate (level, %)*	n.a.	5.2	5.4	5.2	5.3	5.4	5.5	5.6	5.5	6.0
Housing Starts (thousands)	n.a.	1837	2229	2189	2085	1975	1969	1920	1952	1853
Real Disposable Personal Income (% growth)	n.a.	0.1	1.5	4.7 [#]	4.3 [#]	3.5 [#]	2.9	2.8	3.2 [#]	2.3
Retail Sales (% growth)	n.a.	3.2	6.0	0.7	5.4	10.2	6.2	7.0	7.3	4.3
Personal Saving Rate (level, %)	n.a.	0.4	0.5	0.8	0.6	0.5 [#]	0.7	1.3	0.9 [#]	1.4
Inflation & Productivity										
CPI-U Inflation, all items (% growth)	n.a.	7.4	4.9	1.2	2.4	3.6	1.6	4.4	2.7	2.3
Core CPI-U Inflation (% growth)	n.a.	4.9	3.7	2.4	2.6	2.3	1.7	2.6	1.8	1.5
Employment Cost Index (% growth)	—	—	—	—	2.4	3.2	4.1	3.6	3.9	4.0
Output per Hour (% growth)*	—	—	—	—	n.a.	2.1	1.3	3.9	4.0	4.4
Financial Markets										
T-bill Rate, 3-month (level, %)	2.78	2.74	2.54	2.33	2.54	2.01	1.49	1.08	1.37	1.01
T-note Rate, 10-years (level, %)	4.34	4.50	4.17	4.22	4.30	4.17	4.30	4.60	4.27	4.01
Federal Funds Rate (level, %)	2.79	2.63	2.50	2.28	2.47	1.95	1.43	1.01	1.35	1.13
Dow Jones Industrial Avg (index level)	10283	10682	10724	10540	10648	10362	10130	10289	10317	8994
Sources: Bureau of Economic Analysis, U.S. Department of Commerce; Bureau of the Census, U.S. Department of Commerce; Bureau of Labor Statistics, U.S. Department of Labor; Board of Governors of the Federal Reserve System; Wall Street Journal; and Haver Analytics.										
Notes: Except where otherwise noted, values in the table represent percentage growth measured at seasonally adjusted annual rates. Growth in retail sales includes food services. Core CPI-U inflation is the percentage change in the CPI-U excluding food and energy as reported by the Bureau of Labor Statistics. The Employment Cost Index is for workers in private industry. Productivity is output per hour for private nonagricultural establishments. The 3-month Treasury bill rate is the secondary market rate.										
n.a. Denotes that data are not yet available.										
* Subject to revision over the next week.										
# Adjusted by the JEC staff to exclude the temporary effects of Microsoft's special dividend payment in December 2004.										

Upcoming Economic Releases:

- **Productivity and Costs: First Quarter 2005, Preliminary** [Release: Thursday, May 5]
- **The Employment Situation: April 2005** [Release: Friday, May 6]
- **Consumer Credit: March 2005** [Release: Friday, May 6]
- **Monthly Wholesale Trade: March 2005** [Release: Monday, May 9]