JOINT ECONOMIC COMMITTEE

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ECONOMIC VITAL SIGNS: JULY 2005

The economy expanded and added jobs at a healthy rate in the second quarter of 2005.

Economic Indicators

- Economy grew at 3.4% in the 2nd Quarter
- Employment
  - 146,000 payroll jobs added in June
  - 542,000 payroll jobs added in 2nd Q
  - 5.0% unemployment rate
- Business fixed investment rose 9.0% in 2nd Q
- Industrial production rose 2.1% in 2nd Q
- Real disposable personal income increased at an annual rate of 1.4% in 2nd Q
- Housing starts rose 9.7% from 6/04 to 6/05
- Inflation for the 2nd Quarter
  - 3.3% increase in prices for PCE
  - 1.8% increase excluding energy & food
- Interest rates in June
  - Home mortgage rates averaged 5.58%
  - Prime rate was 6.0% until June 30

REAL GDP

On July 29, the Bureau of Economic Analysis released its second quarter advanced estimate of gross domestic product, the measure of output of goods and services produced by labor and property located in the U.S. The economy grew at the healthy rate of 3.4% in the 2nd quarter of 2005.

Despite business inventory reductions – recorded as a reduction in gross investment and GDP growth – 2nd quarter GDP expansion was well above the 30-year average of 3.1%. Solid GDP growth in the second half of the year appears likely because businesses are expected to expand production in order to replenish inventories.

EMPLOYMENT

The economy created 146,000 (non-farm) payroll jobs in June. On average, employment expanded by 181,000 jobs each month in the second quarter. Service industries provided the bulk of the new employment, with the construction sector also significantly contributing to the job growth. Payroll employment has increased by 3.7 million jobs since May of 2003. The unemployment rate trended downward in the first half of 2005 and stands at 5.0%.

INVESTMENT

Business fixed investment increased by 9.0%, with investment in structures increasing 3.1% and investment in equipment and software increasing 11.0%.

INDUSTRIAL PRODUCTION

Industrial output registered a strong conclusion to the second quarter. In June, industrial production rose by 0.9%. In June 2005, industrial output was 3.9% higher than it was a year earlier. Total output advanced 2.1% for the quarter. Capacity utilization also rose to a level 2.2% greater than its June 2004 value.

Statistics for new orders for durable goods can be volatile. The opening quarter for 2005 was weak, but May and June recorded a strong pick-up in new orders for durable goods, increasing 6.4% and 1.4% respectively.

The Institute of Supply Management (ISM) indexes of business activity also show that the economy continues to grow. Moreover, the 25 month trend in manufacturing growth gained momentum in June, increasing by 2.4 percentage points from May to June.

PERSONAL INCOME AND CONSUMPTION

In the second quarter, real disposable personal income increased by 1.4%. In the first quarter of 2005, real disposable personal income appeared to decline relative to the 4th quarter of 2004 due to the unparalleled Microsoft dividend payout in December 2004.

Consumer spending stayed on track in the second quarter, although purchasing patterns did re-align in favor of durable goods.

HOUSING SECTOR

Housing permits, starts and completions has been strong over the last year. If one were to focus on the month over month changes in housing starts in May and June, one might mistakenly think that the housing market has softened. Yet from June 2004 to June 2005 housing starts increased by 9.7%. Likewise, housing completions increased by 5.2%, year over year.

New home sales, a related statistic, rose by 4.0% from May to June. The year to date increase in new homes sales for 2005 is 7.3% higher than the same period in 2004. Existing home sales were also at record levels.

INFLATION

Core inflation, or the change in the level of prices that excludes volatile energy and food prices, remains low. For the second quarter, the core *market-based* personal consumption expenditures (PCE) price index – the index that the Federal Reserve watches for increases in consumer prices – increased by 1.6%. The change in the market-based PCE index that includes food and energy was reported to be 3.5%. (The PCE price index, the index frequently reported in the press, increased by 3.3% and core PCE increased by 1.8%.)

INTEREST RATES

The prime rate rose 0.25 percentage points to 6.25% on June 30. The move in the prime rate follows the Federal funds rate. In an effort to restrain inflationary pressures, the Federal Reserve raised the Federal fund rate by 0.25 percentage points on May 3 and again on June 30.

Treasury interest rates and mortgage rates remain at historically low levels. Rates on 10-year Treasury notes trended down in the second quarter, from an April average of 4.34% to June's average of 4.00%. In early July, however, the rate edged up slightly. Yields on these Treasury securities have fluctuated between 4.8% and 3.95% over the course of the last year. Mortgage rates also trended down over the course of the quarter, averaging 5.86% in April to 5.58% in June (not including points and fees) for the standard 30-year mortgage. Early to mid July, however, the downward trend ended.

ENERGY COSTS

In April, gasoline prices hit an all time high, in nominal terms, of $2.33 a gallon. Over the course of May and June, gasoline prices eased but, as of mid July, motorists were paying, on average, $2.32 per gallon, according to the Energy Information Administration. The summer is peak driving season and, typically, gasoline prices, demand and supply reach their annual maximum.

Adjusted for inflation, the price of gasoline is still below the 1981 historical high. Even at an average nominal price of $2.33 per gallon, the share of consumer purchases devoted to gasoline in 2005 is approximately half what it was in 1981. Despite the recent escalation in price, gasoline takes a much smaller bite out of the average consumer's budget today than in 1981.

CLOSING THOUGHTS

Economic growth in the second quarter continued at a healthy pace. Sustained by robust consumption and business investment, economic activity is, and looks to remain, strong. Inflation is also restrained and employment continues to expand.