



Economic Update

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Economy Remains Hesitant, But Growth Policies Gain Ground

The “soft spot” in the U.S. economy became more pronounced early this year, with recent data showing sharp declines in payroll employment, manufacturing activity, and consumer and business confidence. Some hopeful signs exist for future activity, though, as improved expectations about Operation Iraqi Freedom have led to a decline in crude oil prices, a rebound in stock markets, and an initial bump-up in consumer sentiment. Overall, although economic forecasts generally anticipate a return to stronger growth and lower unemployment over the next several years, substantial risk remains for continued slow growth with persisting high unemployment.

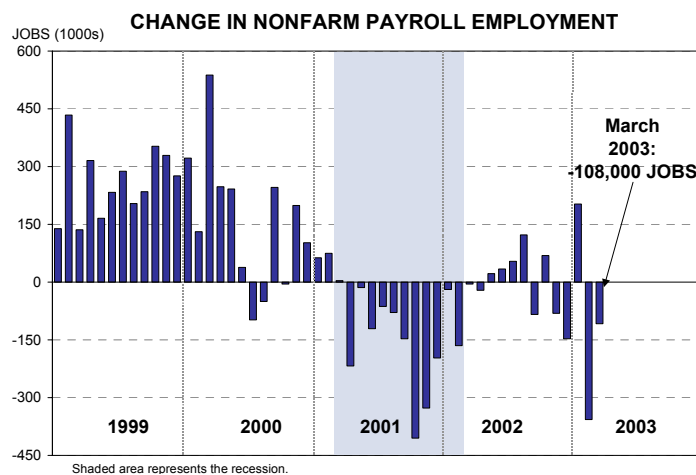
In congressional testimony two months ago, Fed Chairman Greenspan expressed his opinion that: 1) the economy’s lingering weakness was primarily related to “geopolitical” uncertainty; 2) the associated negative effects would be short-lived; and 3) further policies to promote growth were not needed. Many private analysts and forecasters have differed with that view; they remain concerned that the economy – particularly business investment and labor markets – will continue to struggle.

In such an environment, the House and Senate have adopted a compromise budget plan that includes policies to boost growth in the economy and in jobs.

Negative Data Surprises

Recent data show economic performance early this year to have been much weaker than previously expected.

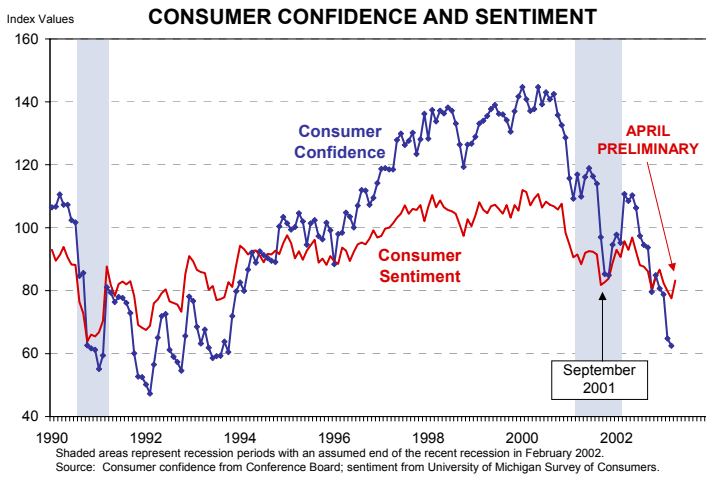
Employment: The employment report for March showed a further decline in payroll employment – a loss of 108,000 jobs – following a sharp decline of 357,000 jobs in February. These are the largest declines since the end of 2001 (in the midst of the recession). The unemployment rate remained at 5.8 percent in March, continuing at an elevated level relative to the lows of 3.8 percent to 4.0 percent in



2000. Total employee work hours declined in the first quarter at an annual rate of about ½ percent. Combining that rate of decline in labor hours with approximate labor productivity growth in the 2-percent to 3-percent range suggests the current outlook for growth in real gross domestic product [GDP] for the first quarter is roughly in the 1-percent to 2½-percent range – that is, a continuation of sluggish growth. That estimate coincides with the Blue Chip projection for real GDP growth at a 1.8-percent rate in the first quarter (see table on the next page).

Consumers: The poor employment reports coincided with sharp declines in consumer confidence and sentiment. The Conference Board’s index of consumer confidence fell 20 percent in February, and somewhat further in March, to its lowest level in nearly 10 years (see chart on the next page). A preliminary estimate for April shows consumer sentiment bumping up a bit, but continuing near the 10-year lows.

Uncertainty about the military conflict in Iraq has contributed to substantial volatility in the stock market and in crude oil prices, hampering consumer confidence and



consumer finances. Recent data indicate that consumer spending likely will rise at a slow pace in the first quarter, following the modest growth, at a 1.5-percent annual rate, in the fourth quarter of 2002. In contrast, residential investment has been at a high level – coinciding with low mortgage interest rates and continued income growth – but concerns persist about the possibility of a slowdown in housing markets. The recent rebound in stock markets (up about 8 percent from their pre-war lows) and decline in crude oil prices (down about \$10 a barrel from their pre-war highs of about \$38 per barrel) coincided with increasing confidence in the successful resolution of Operation Iraqi Freedom. Nevertheless, stock prices and crude oil prices are only roughly back to where they were at the turn of the year.

Business Investment: A recent report from the Institute for Supply Management shows that the purchasing managers index [PMI] for manufacturing declined sharply in March, to its lowest level since the end of 2001. The PMI reading of 46.2 was well below the neutral reading of 50, indicating that manufacturing activity was contracting significantly in March. Prior data had suggested that business investment in equipment and software had bottomed out and was beginning to rise modestly: real equipment and software spending rose at about a 6½-percent annual rate over the second half of 2002. The more-recent data on industrial production and manufacturers’ new orders and shipments suggest that equipment spending is largely stagnant. Further, business construction spending has been on a steady decline over the past 2 years.

The Blue Chip Outlook

The “consensus” projection from the Blue Chip economic forecasts shows continued slow growth in real GDP during the first half of this year, with a pickup to faster growth in the second half and through 2004. The unemployment rate is projected to peak in the second quarter and then gradually decline thereafter. Also, Blue Chip numbers reveal some of the risk in the outlook: the highest 10 forecasts of the 49 in the Blue Chip consensus project the unemployment rate increasing to 6.3 percent, and not falling back below 6.0 percent until the end of 2004.

Growth Policies Gain Ground in Congress

A significant risk remains that, without additional policy action, the economy could continue to exhibit sub-par performance, with ongoing slow growth and persisting high unemployment. In this climate, the House and Senate have passed a compromise budget providing for \$626 billion (for 2003-13) of growth-oriented tax policies, plus the potential for more than \$600 billion in additional tax relief for the same period. Although the exact nature of the tax relief will yet be determined by legislation that will emerge from the House Ways and Means and the Senate Finance committees, and additional congressional debate, the tax relief is expected to include key elements of the President’s growth proposals – including acceleration of the scheduled reductions in income taxes and tax rates from the tax relief legislation passed in 2001. Most forecasters expect such tax relief to provide a significant boost to growth in real GDP and jobs in the second half of this year and in coming years.

Blue Chip Economic Outlook, April 2003

	2002.4	2003.1	2003.2	2003.3	2003.4	2004 Avg.
	(percent)					
Real GDP Growth	1.4	1.8	2.2	3.6	3.8	3.6
Unemployment Rate	5.9	5.8	6.0	6.0	5.9	5.6
CPI Inflation	2.0	3.2	2.2	1.8	1.9	2.3
3-month Treasury Bill	1.3	1.2	1.2	1.3	1.5	2.6
10-year Treasury Note	4.0	3.9	4.0	4.2	4.4	4.9

Note: For 2004, rate of change is for 4th quarter 2003 to 4th quarter 2004; annual average levels for unemployment and interest rates.

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