Economic Update

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Weak Job Market Continues

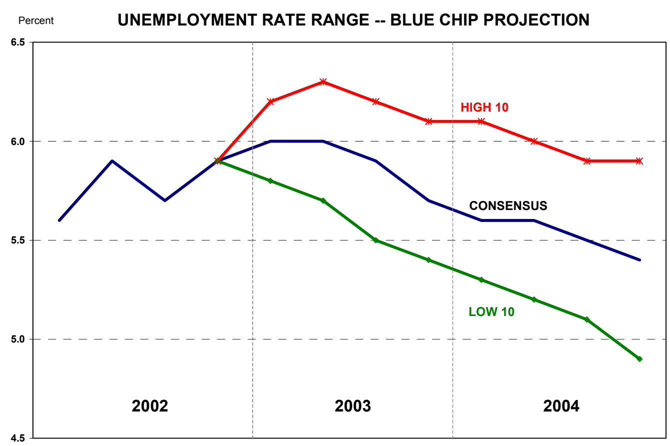
The Department of Labor's December employment report underscores the Nation's ongoing economic problem: though the recovery continues, economic growth is not fast enough to reduce unemployment or boost job creation. The report shows the unemployment rate stayed at 6.0 percent in December, and payroll employment falling by 101,000 jobs.

These troubles have persisted over the past year, with the economy in a sluggish recovery from the slowdown and recession of 2000-01. Further, at the turn of the year, private forecasters were expecting the pace of economic growth to improve only gradually during 2003, and the unemployment rate to remain near 6.0 percent for much of the year. In this environment, Congress and the President quickly worked to enact legislation extending unemployment benefits; and the President proposed a package of tax cuts in a "growth and jobs plan to strengthen the American economy."

Blue Chip Economic Outlook, January 2003

	2002.4	2003.1	2003.2	2003.3	2003.4	2004 Avg.
	(percent)					
Real GDP Growth	1.4	2.7	3.2	3.6	3.8	3.5
Unemployment Rate	5.9	6.0	6.0	5.9	5.7	5.5
CPI Inflation	2.4	2.3	2.0	2.0	2.2	2.4
3-month Treasury Bill	1.3	1.3	1.4	1.6	2.0	2.9
10-year Treasury Note	4.0	4.1	4.3	4.5	4.8	5.2

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



The *Blue Chip* Outlook

The January *Blue Chip* survey of private forecasters (conducted prior to the President's proposals) showed that the sluggish performance of the economy is expected to continue into 2003. Growth in real gross domestic product [GDP] is expected to have been only 1.4 percent at an annual rate in the fourth quarter of 2002, and growth is expected to rise modestly to 2.7 percent and 3.2 percent in the first two quarters of 2003. With real GDP growth expected to average just less than 3 percent through the first half of 2003, the unemployment rate is expected to remain near 6.0 percent through much of the year.

A further concern is that the economy could underperform the *Blue Chip* "consensus" forecast (actually the average of the 54 forecasts). The accompanying chart shows the range of unemployment rate projections for the Blue Chip forecasts – the consensus, and the averages for the 10 highest and 10 lowest forecasts. The "high 10" projection – roughly 20 percent of the Blue Chip forecasters – expects the unemployment rate to increase significantly over the first half of 2003, and to remain above 6.0 percent through the middle of 2004. The point is that a substantial risk exists that the economy will continue to struggle to regain

(continued on reverse side)

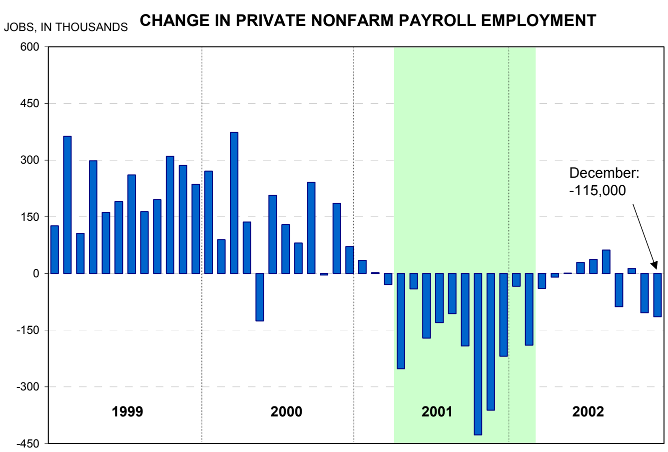
sustained higher growth, and the unemployment rate could remain stubbornly high. (The "low 10" path – showing the possibility of better-than-expected economic performance – should be viewed not as a "risk" to the forecast, but as a welcome outcome.)

Recent Data

Recent data generally reinforce the view that the economy continues to grow sluggishly, with labor markets, the manufacturing sector, and investment remaining stagnant.

Employment and Unemployment: As noted above, the unemployment rate remained at 6.0 percent in December, unchanged from November. Payroll employment fell by 101,000 jobs, following a decline of 88,000 in November. Private payrolls fell by 115,000 jobs, continuing the ragged performance of the past year (see chart below). Job losses were particularly acute in manufacturing (65,000 jobs lost) and in retail trade (104,000 jobs lost).

Manufacturing and Investment: A report from the Institute for Supply Management on the purchasing managers index [PMI] for December provides some good news: the PMI rose to 54.7 percent in December, a sharp rebound from the sub-50 levels of the preceding three months (a PMI value above 50 indicates the manufacturing sector is expanding). Even so, new orders and shipments of durable manufacturing goods both declined in November, and remained at levels only slightly above their recession lows. A key component, shipments of nondefense capital goods – a measure of investment spending in the economy – also remained near recession lows. Industrial production has stagnated in recent months, following a positive trend in the first half of 2002. Private, nonresidential construction spending has been flat for the past several months, but it at long last appears to have bottomed out, no longer declining at double-digit annual rates, as it did over the past year and a half. In short, manufacturing and business investment simply appear to be stagnant – neither declining nor rising.



Households and Consumers: The American consumer appears to have finally taken a bit of a break at the end of 2002, following sustained increases in spending that continued even through the recession. Consumer sentiment and confidence measures have remained at near-recession low levels over the past several months. Initial data on the end-of-year sales by major retailers indicate that spending was subdued, although auto sales continue at relatively high levels. As a result, consumption spending likely rose modestly in the fourth quarter as a whole. In contrast, the housing sector continues to be robust, with housing starts continuing at high levels and residential investment making positive contributions to GDP. Despite the sluggish job market, personal income growth continues at relatively robust levels, reflecting continued growth in real hourly wages (a byproduct of high productivity growth).

With consumer spending accounting for two-thirds of GDP, and investment another 10 percent to 15 percent, modest growth in consumption spending coupled with stagnant investment, translates into sluggish overall GDP growth.

Policy Focus Turns to Jobs and Growth

Against this backdrop of economic uncertainty – uncertainty about the investment outlook, the strength of the economic recovery, and the international environment – Congress and the President are undertaking and considering policy efforts to support a stronger recovery. On the first day of the new 108th Congress, new legislation was enacted to extend unemployment insurance benefits. Also, the President has proposed a "growth and jobs plan to strengthen the American economy." The President's plan includes: advancing scheduled income tax rate cuts; eliminating taxation of personal dividend income; reducing the marriage penalty; increasing child tax credits; and holding harmless taxpayers affected by the alternative minimum tax. The plan also includes additional investment incentives (increasing the allowable expensing of equipment from $25,000 to $75,000) and the creation of Personal Re-employment Accounts to aid unemployed workers.

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