Economic Update

HOUSE COMMITTEE ON THE BUDGET
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Strong Third-Quarter GDP Growth Expected

BUT UNEVEN NATURE OF RECOVERY EXPECTED TO CONTINUE

The past month has witnessed a diverse collection of economic data and information giving mixed signals about the direction of the economy. Although unemployment fell and the production workweek rose in September – both good signs – various other indicators suggested the economy was less robust heading into the end of the year.

Nonetheless, because of strong consumer spending growth during the summer, the Commerce Department is expected to report relatively strong third-quarter growth in real gross domestic product [GDP] when it releases its next estimates at the end of this month. The burst of spending and real growth is providing continued forward momentum as the economy recovers – albeit in an uneven pattern – from the economic slowdown and recession of 2000-2001.

Blue Chip Economic Outlook, October 2002

	2002.1	2002.2	2002.3	2002.4	2003 Avg.
			(percent)		
	------ (History) ------				
Real GDP Growth	5.0	1.3	3.6	2.2	3.4
Unemployment Rate	5.6	5.9	5.7	6.0	5.8
CPI Inflation	1.4	3.4	2.0	2.3	2.3
3-month Treasury Bill	1.7	1.7	1.7	1.6	2.1
10-year Treasury Note	5.1	5.1	4.3	4.0	4.6

Note: For 2003, rate of change is for 4th quarter 2002 to 4th quarter 2003; annual average levels for unemployment and interest rates.

Recent Data and the Economic Outlook

Recent data and information point to a continued modest pace of economic recovery, with growth proceeding in fits and starts.

Blue Chip Outlook: Historical data and the consensus projection from the October *Blue Chip Economic Indicators* (see table) show the uneven growth pattern. Real GDP growth initially rebounded strongly from the economic slowdown and recession of 2000-2001, with growth at a 5-percent annual rate in the first quarter of this year. But then it slowed in the second quarter to a 1.3-percent annual rate. The uneven pattern is expected to continue: the consensus of the private Blue Chip forecasters expects that real GDP growth bounced back up to 3.6 percent at an annual rate in the third quarter; but growth is expected to slow again to a 2.2-percent rate in the fourth quarter. (Some forecasters expect third-quarter growth to be well above 4 percent.) The general rate of growth reveals a moderate pace of expansion, with real GDP growth at a 3.0-percent annual rate from the fourth quarter of last year through the second quarter of this year. The private consensus forecast expects a similar rate over the second half of this year, and a small acceleration to 3.4 percent next year.

As discussed in earlier issues of *Economic Update*, real GDP growth at a 3-percent rate generally is not strong enough to significantly boost employment and lower the unemployment rate. The *Blue Chip* outlook reflects that, with the unemployment rate projected to increase in the fourth quarter and to only gradually decline next year as real GDP growth is expected to rise only slightly above the 3- to 3-1/4 percent range.

Recent Data: The most promising result in the recent data was the decline in the unemployment rate, to 5.6 percent for September (see chart on the next page). The decline was largely unexpected, and it may be a statistical phenomenon related to seasonal adjustments in the transition period from the summer to the fall. Nonetheless, the 0.4-percentage-point drop in the unemployment – down from the recent peak of 6.0 percent in April – was a welcome result and a desirable trend. It was accompanied by an increase in the workweek for production workers, a result indicating that businesses are using current workers more intensely and suggesting that future employment gains may be forth-coming. The most recent report for weekly unemployment insurance claims at the beginning of October also showed a sharp decline in initial claims.

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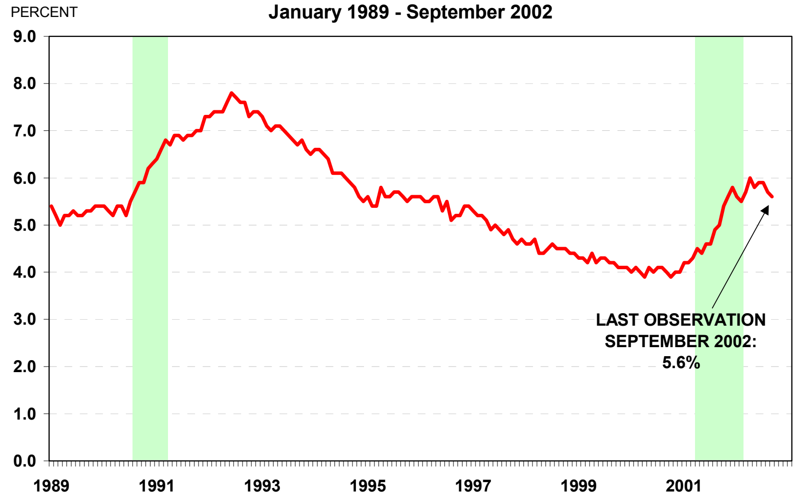
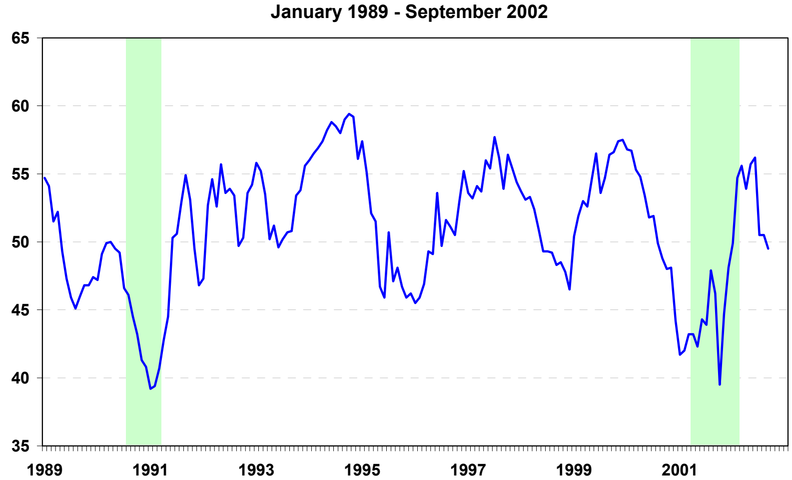
Other data are less promising. Payroll employment fell by 43,000 jobs in September and the Institute for Supply Management's [ISM] purchasing managers' index for the manufacturing economy fell to 49.5 – a reading below 50 indicates a contracting manufacturing economy. (It should be noted, though, that the purchasing managers index often undergoes periods of "ups and downs" even when the economy is in solid expansion phases. Only deep drops are associated with recessions in the general economy.) Consumer confidence and consumer sentiment slipped a bit in September, the fourth month of decline in those indexes. Industrial production and orders and shipments for durable manufacturing goods fell slightly, after trending upward for the past 7 months. In general, the data suggest that the economy slowed significantly at the start of the fourth quarter following a surge in the third quarter.

CIVILIAN UNEMPLOYMENT RATE
January 1989 - September 2002



Note: Shaded areas represent recession periods.

ISM PURCHASING MANAGERS MANUFACTURING INDEX
January 1989 - September 2002



Shaded areas represent recession periods with an assumed end of the recent recession in February 2002.

Are We Headed for a Double-Dip Recession?

The short answer is "No." It is unlikely that the economy will fall back into recession in the near future. In last month's *Blue Chip* survey, for example, 95 percent of the respondents thought that there was a 25 percent-or-less chance that the U.S. economy would experience another negative quarter of real GDP growth before the end of next year. That answer assumes that no significant unanticipated negative shocks hit the economy.

Still, a major factor acting as a drag on the economy is a heightened level of uncertainty about such shocks and other factors. The uncertainty factors include:

- The prospects for military conflict with Iraq, and resulting implications for the international economy and the price of oil.
- The possibilities of further terrorist attacks targeted at key parts of the economy.
- How personal consumption and business investment spending will respond to the declines in the stock market from its bubble levels of the late-1990s.
- The outlook for corporate profits and how it might affect business decisions on investment and the hiring of new workers.

Over the past year and a half, the President and Congress have proposed and adopted policies to enhance the Nation's domestic and economic security – helping to reduce the uncertainties. These policies included last year's tax cuts, this year's stimulus legislation, and increased emergency spending for homeland security and military preparedness. Additional policies under consideration and in need of adoption include homeland security legislation, and terrorism risk insurance.

In short, notwithstanding policymakers' efforts to promote homeland and economic security, the post-September 11 environment remains more uncertain for the Nation as a whole – and economic forecasters, as well. Despite the recent shocks and the increased uncertainty, the U.S. economy has proved quite resilient; and barring another severe shock, forecasters continue to envision a return to sustained expansion.