Economic Update

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Revised GDP Data Confirm Recent Growth Trends

The U.S. economy is growing strongly in the second half of 2003 – and relatively strong growth is expected to continue through 2004. Evidence of the robust performance is widespread across various economic indicators. Rising employment and the declining unemployment rate also reflect the improving economy – though government measures still provide inconsistent information, with the "household" survey showing large increases in employment, and the "establishment" survey showing more modest gains in payroll jobs.

Monetary policy is poised to maintain its support of the expanding economy: Federal Reserve policymakers continued to express their belief that a low-interest-rate policy could be maintained for "a considerable period."

Also this week, the Commerce Department's Bureau of Economic Analysis published revised historical data that largely confirm recent growth trends. The revised data show, however, that the economy was weaker in the third quarter of 2000 than previously thought, and growth in the first half of this year was slightly stronger.

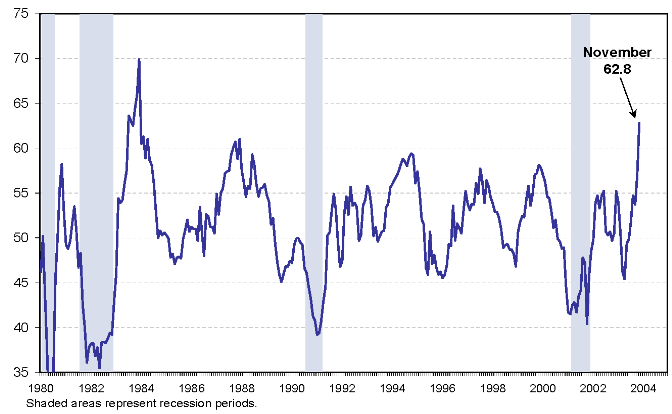
Data Show Strong Economy

The broad-based nature of the strong economic performance is revealed in recent economic data, including:

- *Manufacturing activity* in November grew at its strongest pace in 20 years, continuing the dramatic and sudden improvement in recent months after 3 years of declining or sluggish performance (see chart with Institute for Supply Management [ISM] data). The ISM survey also showed improving manufacturing employment – the best in 3 years.

- *New orders and shipments* of manufacturers' durable goods have surged in recent months; the data point to increases in inventories and business investment that will bolster growth in gross domestic product [GDP].

ISM PURCHASING MANAGERS MANUFACTURING ACTIVITY INDEX



Shaded areas represent recession periods.

- *The housing market and residential investment* continue to grow strongly – boosting the outlook for home-related spending, including consumer durable goods.

- *Labor productivity* grew at a 9.4-percent annual rate in the third quarter – its fastest pace in nearly 20 years. High productivity growth is important for maintaining firms' international competitiveness and for boosting the Nation's incomes and standards of living; but in the short run, higher productivity growth means output increases can occur without big gains in jobs.

- *Consumer confidence and spending*: Consumer confidence has rebounded from the lows preceding the conflict in Iraq, and is now at a level consistent with continued economic expansion. Consumer spending surged in the third quarter and is continuing to grow in the fourth quarter, as evidenced by the just-announced 0.9-percent increase in retail sales in November (led by strong auto and electronics sales).

- *The stock markets have gained*, pushing the Dow-Jones Industrial average and the S&P 500 up about 30 percent over the past 6 months. The NASDAQ composite index is up about 50 percent from its lows earlier this year.

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GDP Growth, and Employment Gains

Real GDP grew at an 8.2-percent rate in the third quarter – its fastest pace in nearly 20 years. Private forecasters expect growth at around a 4-percent annual rate in the fourth quarter and through next year. That above-trend growth performance should boost labor markets and help bring the unemployment rate down further.

- *The unemployment rate* continues on its downward trend, declining to 5.9 percent in November from the recent high of 6.4 percent in June. Weekly unemployment insurance claims have been about 365,000 – recently running at the lowest level in nearly 3 years (claims below 400,000 typically indicate increases in payroll jobs).

- *Payroll employment* recently has shown moderate gains – rising by 57,000 jobs in November and by 328,000 over the past 4 months. In contrast, the "household" measure of employment – from the survey used to determine the unemployment rate – has shown employment gains of more than 1 million in the past 2 months, and 2.8 million since the beginning of 2002. The difference may result from increases in the number of self-employed persons, and possible understatement of payroll jobs in startup businesses.

Despite the differences in the employment estimates, private forecasters expect an increase in payroll employment of around 2½ million jobs through the end of 2004 (National Association for Business Economics survey).

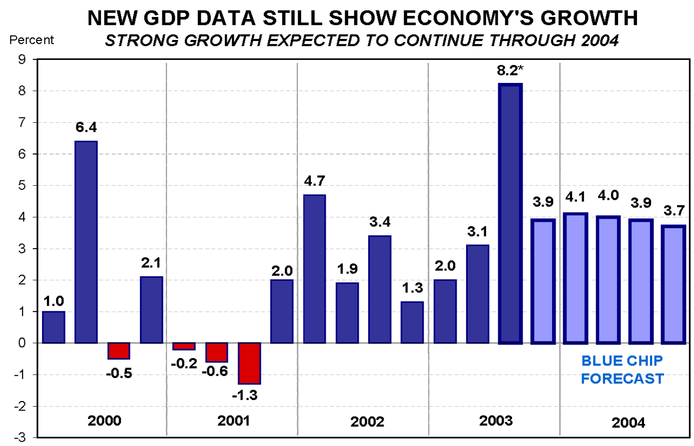
Monetary and Fiscal Policies, and the Economic Outlook

The tax relief this year boosted consumption and business investment, and will continue to provide stimulus through 2004. Because the income tax rate changes were made effective for the beginning of 2003, but the tax withholding adjustments only began at midyear, a significant portion of the tax relief will occur in early 2004, as taxpayers receive refunds for overpaid 2003 taxes. Continued increases in Federal Government discretionary spending in 2004 also will provide for a short-term boost to the economy.

The Federal Reserve's policy-making group, the Federal Open Market Committee [FOMC], announced this week: "The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. . . . However, with inflation quite low and resource use slack, the Committee believes that policy accommodation can be maintained for a considerable period." Consistent with this view, private forecasters expect real GDP to grow at a relatively strong pace – around a 4-percent rate through the end of 2004. Interest rates and inflation are expected to remain relatively low – but private forecasters expect that interest rates will begin to rise by the middle of next year as the economy strengthens and the unemployment rate falls.

Revised Historical Data

The Bureau of Economic Analysis [BEA] this week released revised historical data for GDP as part of a "comprehensive revision" of the national income and product accounts [NIPAs] – the set of measures the government uses to gauge the performance of the Nation's economy. As the BEA noted: "Comprehensive revisions, which are carried out about every 4 to 5 years, are an important part of BEA's regular process for improving and modernizing its accounts to keep pace with the ever-changing U.S. economy."



*Third quarter estimate will be revised December 23. Data source: Bureau of Economic Analysis, Department of Commerce.

Two key changes are worthy of particular note:

- Real GDP growth in the first half of this year is now slightly stronger than in the previous estimates.

- The economy was even weaker in the third quarter of 2000 than previously thought – with real GDP growth actually turning negative (now reported at -0.5 percent compared to +0.6 percent previously). The decline in real GDP during the recession is now estimated to have been only -0.5 percent – the mildest recession decline on record.

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