Order Code RL30329

Report for Congress

Received through the CRS Web

Current Economic Conditions and Selected Forecasts

Updated February 24, 2003

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Current Economic Conditions and Selected Forecasts

Summary

According to the National Bureau of Economic Research, the agency that dates the American business cycle, the longest economic expansion in American history ended in March 2001. The U.S. is now in a recession that is in its 20th month. The average length of the 10 recessions in the post-World War II era is 11 months.

The 2.75% rate of growth of Gross Domestic Product (GDP), our basic measure of economic activity, during 2002, probably signals that the recession is over. GDP grew only 0.3% during 2001. This included the contraction of GDP during the first 3 quarters of the year. However, about 40% of the additional GDP produced during 2002 was not sold but added to inventories.

The unemployment rate during the 1991-2001 expansion reached a low of 3.9% in September 2000. It has risen since then, reaching a high in April, November and December 2002 of 6.0%. During 2002 it varied between 5.5% and 6.0%. In January 2003, the rate declined to 5.7%. Over 1998 and 2000, the unemployment rate moved within a narrow band of from 4.7% to 3.9%. The monthly unemployment rates recorded during most of the past 4 years have been below those thought by many economists to characterize full employment. Since the contraction began in March 2001 employment has fallen by approximately 1.80 million.

The inflation rate has, on average, been low over most of the 1991-2001 expansion. Except for 1996, 1999, 2000, the rate of inflation measured by the Consumer Price Index has declined in each year of the expansion. During 2002 the CPI rose 2.4%. For the 3 months ending in January 2003 it rose at an annual rate of 2.2%. A similar pattern shows up in the two GDP price indexes. Both indexes rose 1.8% during 1997, 1.1% during 1998, 1.5% during 1999, 2.4% during 2000, and 1.8% during 2001. During 2002 the indexes rose 1.3% The rate of rise of per-unit labor costs, a possible indicator of future inflation, which rose 5.0% during 2000, fell -0.5% during 2001, and rose at a modest rate of 0.3% during 2002.

Fiscal policy was eased during 2001 and 2002. Monetary policy has been eased over the course of 2001 and late in 2002 and appears to be geared to promoting a real GDP growth rate of from 3.25% to 3.5% this year, a rate thought compatible with a stable rate of inflation.

Recent forecasts by private sector individuals and firms for 2003 suggest that GDP will grow between 2.2% and 3.3%, unemployment will range between 5.7% and 6.3%, and inflation will average between 1.3% and 2.6% (based on the consumer price index).

Contents

List of Figures

List of Tables

Current Economic Conditions and Selected Forecasts

Current Economic Conditions

On November 26, 2001, the National Bureau of Economic Research, the nonprofit, nonpartisan organization that dates the phases of the business cycle for the United States, declared that the longest expansion in American history had ended in March of that year and that the U.S. was now in a recession. The average length of the ten post-World War II recessions has been 11 months. The longest recession lasted 16 months, the shortest 6 months. The growth rate of Gross Domestic Product (GDP)[1] has been slow since mid-2000 and while it was barely positive for 2001 as a whole, it contracted during the first 3 quarters. Growth in the fourth quarter was at an annual rate of 2.7%. Growth over the 4 quarters of 2002 was, respectively, at annual rates of 5.0%, 1.3%, 4.0%, and 0.7%.

The unemployment rate reached a 30-year low of 3.9% in September 2000. Since then it has risen, reaching a contraction high of 6.0% in April 2002. During 2002 it fluctuated between 5.5% and 6.0%.

With the onset of the contraction the rate of inflation, as measured by the broad-based price indexes, has declined.

Beginning in January 2001 Federal Reserve policy has shifted to one of ease. On January 3 and 31, March 20, April 18, May 15, June 27, and August 21, 2001, in the face of a falling rate of GDP growth, the target rate for federal funds was reduced to 3.50%. On September 17, in the wake of the terrorist attacks on the U.S., the target rate was reduced to 3.0%. On both October 2 and November 6 it was reduced 1/2% and on December 11, 1/4%. Additional easing took place on November 6, 2002, when the target rate was reduced to 1-1/4% from 1-3/4%.

Recent Macroeconomic Developments

The growth rate of GDP since 1991 is shown in Table 1. Its most notable feature is that the growth rate of GDP averaged more than 4% per year during the final 4 years of the recent expansion. GDP growth began to slacken during the second half of 2000 and into 2001. GDP actually contracted during the first 3

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[1] Gross Domestic Product rather than Gross National Product is now used as the principal measure of economic activity for the United States. The two measures differ in their treatment of foreign-owned productive resources in the United States and similar U.S.-owned resources abroad.

quarters of 2001 at an annual rate of 0.8%. This was reversed during the fourth quarter, when GDP grew at an annual rate of 2.7% and during the 4 quarters of 2002, when it grew at annual rates of 5.0%, 1.3%, 4.0%, and 0.7%, respectively. The growth of Final Sales has not shown quite such a dramatic decline because it reflects the liquidation of inventories that has been on-going over the course of 2001. Inventory liquidation is a good sign. When inventories are liquidated, additional sales will come from additional production and this will assist the recovery. During 2002 inventories increased again as the annualized growth of final sales rose only 1.8%

Table 1. The Growth Rate of Real GDP v. Final Sales

(in percentages)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GDP Year Over Year	-0.5	3.0	2.7	4.0	2.7	3.6	4.4	4.3	4.1	3.7	0.3	2.4
4thQ Over 4thQ	0.9	4.0	2.5	4.1	2.3	4.1	4.3	4.8	4.3	2.3	0.1	2.8
Final Sales Year Over Year	-0.2	2.8	2.6	3.4	3.1	3.6	4.0	4.2	4.3	3.7	1.5	1.8
4thQ Over 4thQ	0.2	4.2	2.6	3.2	2.9	3.9	4.0	4.7	4.2	2.6	1.6	1.8

Source: U.S. Department of Commerce.

The unemployment rate shown in Table 2 fell from June 1992 through September 2000. At 3.9%, the unemployment rate in September was at a 30-year low. Since then, as the pace of economic growth contracted and then began to rise, the unemployment rate has risen and now stands at 6.0%, the same rate it reached in April 2002. Since the contraction began in March 2001, approximately 1.80 million jobs have been lost.

Table 2. Civilian Unemployment Rate

(in percentages)

	J	F	M	A	M	J	J	A	S	O	N	D
1992	7.1	7.3	7.3	7.3	7.4	7.7	7.6	7.6	7.5	7.4	7.3	7.3
1993	7.1	7.0	7.0	7.0	6.9	6.9	6.8	6.7	6.7	6.7	6.5	6.4
1994	6.7	6.6	6.5	6.4	6.1	6.1	6.1	6.0	5.8	5.7	5.6	5.4
1995	5.7	5.4	5.5	5.8	5.7	5.6	5.7	5.6	5.6	5.5	5.6	5.6
1996	5.7	5.5	5.5	5.5	5.6	5.3	5.4	5.2	5.2	5.2	5.3	5.3
1997	5.3	5.3	5.2	5.0	4.8	5.0	4.9	4.9	4.9	4.8	4.6	4.7
1998	4.6	4.6	4.7	4.3	4.4	4.5	4.5	4.5	4.5	4.5	4.4	4.3
1999	4.3	4.4	4.2	4.3	4.2	4.3	4.3	4.2	4.2	4.1	4.1	4.1
2000	4.0	4.1	4.0	4.0	4.1	4.0	4.0	4.1	3.9	3.9	4.0	4.0
2001	4.2	4.2	4.3	4.5	4.4	4.6	4.6	4.9	5.0	5.4	5.6	5.8
2002	5.6	5.5	5.7	6.0	5.8	5.9	5.9	5.7	5.6	5.7	6.0	6.0
2003	5.7											

Source: U.S. Department of Labor.

It is hard to find much evidence that the inflation rate accelerated as the previous expansion lengthened. The good inflation performance during 1997-1999, shown in Tables 3 and 4, was largely due to the collapse of petroleum prices. This was reversed in 2000 and the inflation rate accelerated once again, but not noticeably different from the earlier years of the expansion. The CPI rose 2.4% during 2002 and at an annual rate of 2.2% for the three months ended in January 2002.

The behavior of labor costs, regarded by some as an indication of future inflation, is shown in Table 5. The growth rate of per unit labor costs, which is heavily influenced by productivity, has been falling. This reflects both the easing in labor markets and the rise in productivity growth.[2] The rate of increase in the Employment Cost Index for private industry rose from 1995 through 2002. It then began to deccelerate. The rise in unit labor costs over the past two years has been slight. This reflects both the economic downturn and the continued rise in productivity.

Table 3. Rate of Change in the Consumer Price Index

(in percentages)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Dec. Over Dec.	3.1	2.9	2.7	2.7	2.5	3.3	1.7	1.6	2.7	3.4	1.6	2.4
Year Over Year	4.2	3.0	3.0	2.6	2.8	2.9	2.3	1.6	2.2	3.4	2.8	1.6

Source: U.S. Department of Labor.

Table 4. Rate of Change in the GDP Deflators

(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Implicit Price Deflator	4.2	3.1	2.3	2.4	2.1	2.1	1.9	1.8	1.1	1.6	2.3	2.0	1.3
Chain Type Deflator	4.2	3.1	2.3	2.4	2.1	2.1	1.9	1.8	1.1	1.6	2.3	2.0	1.3

Source: U.S. Department of Commerce.

[2] On a year over year basis, the rise in per unit labor costs for 1990 through 2002 was respectively, 4.3%, 3.3%, 1.6%, 1.7%, 0.8%, 1.2%, 0.5%, 0.9%, 2.7%, 2.0%, 3.9%, 1.6% and -1.8%.

Table 5. Rate of Change in Labor Costs

(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Unit Labor Costs	5.3	1.7	0.4	1.5	1.1	1.5	0.7	1.1	2.4	1.4	5.0	-0.5	0.3
Employment Cost Index	4.6	4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.5	3.4	4.4	4.2	3.2

Source: U.S. Department of Labor.

Table 6. U.S. Foreign Trade Deficit

(as a percent of GDP)

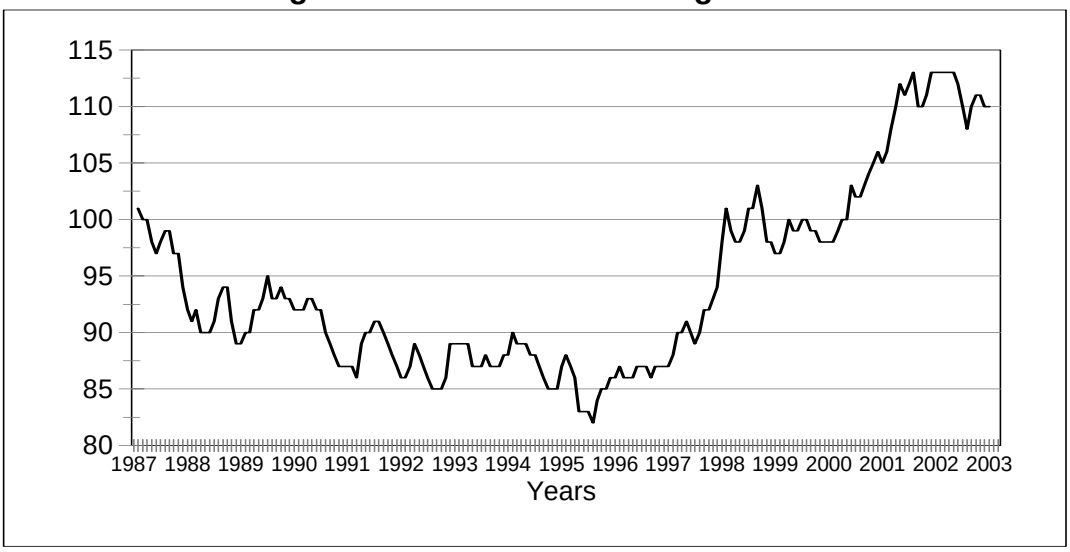
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Trade Deficit	1.8	1.2	0.8	0.2	0.3	0.8	1.2	1.0	1.1	1.4	2.6	3.6	4.3	4.4	5.1

Note: Percentages measure the real trade deficit divided by real GDP.

The U.S. foreign trade deficit (net imports), as shown in Table 6, recorded a continued and dramatic fall from 1988 through 1991. In each of these years the trade deficit declined as export growth exceeded import growth. During 1992 the trade deficit began to grow as a fraction of GDP and is now running at a rate in excess of its previous high in 1987. The increase in the U.S. foreign trade deficit during 1992–2002 reminds us that the United States still receives a substantial net inflow of capital from abroad.

Figure 1 records the movement in the foreign exchange value of the dollar over the past 15 years. After a low in early 1995, the dollar has risen in real or inflation-adjusted terms (or appreciated) by nearly 35%.

Figure 1. Real Dollar Exchange Rate



Source: Board of Governors of the Federal Reserve System

Posture of Monetary and Fiscal Policy

The course of GNP growth can respond significantly to changes in fiscal and monetary policy. The posture of fiscal policy depends on how it is measured. A generally accepted method is to examine the ratio of the structural or full employment budget deficit to full employment GDP. When that is done, as shown in Table 7, fiscal policy during 2001 was expansionary as the full employment surplus fell from 1.3% to 0.6% of potential GNP. An alternative, although inferior measure, is the ratio of the actual budget deficit to actual GDP. When examined, fiscal policy in 2001 was also expansionary as the actual surplus fell from 2.4% to 1.3% of actual GDP.

Table 7. Alternative Measures of Fiscal Policy
($ in billions per fiscal year)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Standardized Budget Deficit	$154	$127	$116	$120	$151	$185	$183	$141	$139	$92	$63	$25	$+11	$+120	$+61
Full Employment GDP	4,692	4,998	5,347	5,710	6,093	6,411	6,724	7,046	7,396	7,764	8,166	8,563	8,986	9,508	10064
Ratio	0.033	0.025	0.022	0.021	0.025	0.029	0.027	0.020	0.019	0.012	0.008	0.003	+0.001	+0.013	+0.006
Actual Budget Deficit	$150	$155	$152	$221	$269	$290	$255	$203	$164	$108	$22	$+69	$+124	$+236	$+127
Actual GDP	4,654	5,017	5,407	5,738	5,928	6,222	6,561	6,949	7,323	7,700	8,194	8,666	9,153	9,828	10150
Ratio	0.032	0.031	0.028	0.039	0.045	0.047	0.039	0.029	0.022	0.014	0.003	+0.008	+0.014	+0.024	+0.013

Source: Congressional Budget Office (January 2002).

Traditionally, the posture of monetary policy has been judged either by the growth of the monetary aggregates or by movements in interest rates.[3] In fact, neither is an unambiguous indicator. The monetary aggregates, for example, give a confused picture. Although M1 could explain how the most recent economic expansion got underway, it could not explain the expansion's continuation. It can, however, explain how it ended. The opposite appears to be the case for both M2 and M3.

Although the contraction of reserves could indicate monetary tightening, it is, in fact, compatible with monetary expansion. This occurs because over much of the most recent expansion, demand deposits declined and it is against these deposits that banks are legally obligated to hold reserves. Each dollar of decline frees up about 10 cents in reserves that banks can lend. Thus, even though reserves declined, they declined by less than the reserves set free by the contraction of demand deposits. This increased the net lending powers of banks.

Some of the dollars that were in checking accounts have found their way into passbook savings and CDs. These shifts can explain why M1 falls without a commensurate fall in M2 and M3. For the latter to grow, however, funds must be added to passbook savings and CDs that were not originally in checking accounts.

Table 8. The Growth Rates of the Monetary Aggregates

(annualized rates of change)

Time Period	Aggregate Reserves	Monetary Base	M1	M2	M3
88:12–89:12	0.8%	4.2%	0.8%	5.4%	4.0%
89:12–90:12	3.1	9.5	4.0	3.8	1.6
90:12–91:12	9.0	8.3	8.7	3.0	1.3
91:12–92:12	19.6	10.5	14.3	1.6	0.3
92:12–93:12	11.3	10.5	10.3	1.6	1.4
93:12–94:12	-1.8	8.2	1.8	0.4	1.7
94:12–95:12	-5.0	3.9	-2.0	4.1	6.0
95:12–96:12	-11.2	4.0	-4.1	4.7	7.3
96:12–97:12	-6.6	6.1	-0.7	5.7	9.1
97:12–98:12	-3.5	7.0	2.2	8.8	11.0
98:12–99:12	-7.6	15.3	2.3	6.0	8.3
99:12–00:12	-7.3	-1.5	-3.0	6.2	8.6
00:12–01:12	6.7	8.7	8.3	10.5	12.9
01:12-02:12	2.8	7.2	3.4	6.5	6.4
02:10-03:01	20.3	7.1	3.2	5.6	8.1

Source: Board of Governors of the Federal Reserve System.

The growth in the reserves of depository institutions results to a large degree from decisions to move the key federal funds' interest rate (shown in **Figure 2**). These moves have been motivated primarily by a desire to bring the economy to full employment (1990-94) and then keep it growing at a rate sufficient to maintain full

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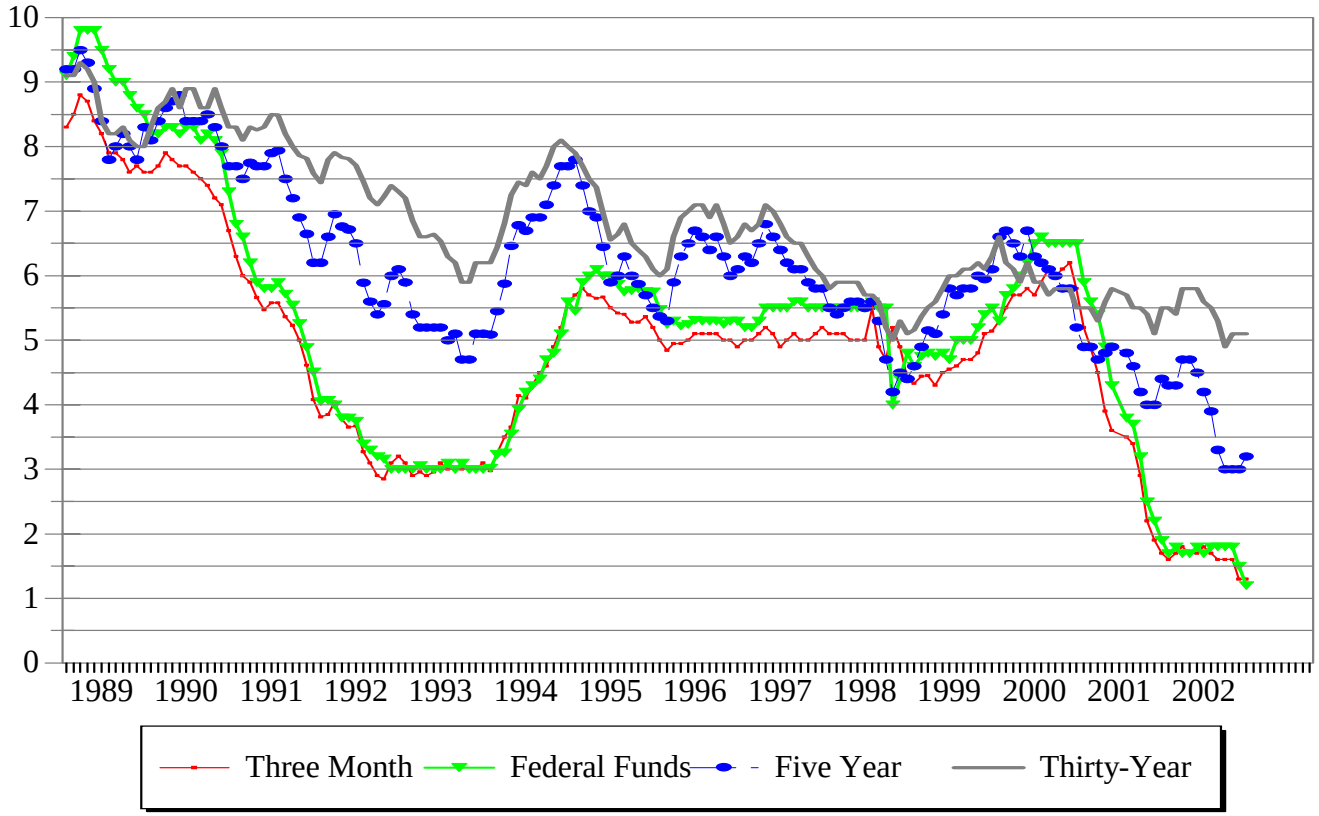
[3] For a more comprehensive discussion of monetary policy, see CRS Report RL30354, *Monetary Policy: Current Policy and Conditions*, by Gail Makinen.

employment. From time to time other factors may influence the movement of this rate. For example, the turmoil in both domestic and international financial markets cause the rate to be reduced 1/4% on September 29, October 15, and November 17, 1998 at which point it stood at 4.75%. In three equal moves of 1/4% during June, August, and November 1999, the rate was returned to its pre-crisis level of 5.5%. On both February 2 and March 21, 2000, in the face of mounting evidence that the economy was growing at an unsustainable rate, the federal funds rate was raised an additional 1/4%, and on May 16 it was raised ½%, bringing the rate to 6.5%. In six equal cuts of 1/2% (January 3 and 31, March 20, April 18, May 15 and June 27), and a seventh cut of 1/4% (August 21), the rate was reduced to 3.50%. In response to the terrorist attacks, the rate was reduced to 3.0% on September 17 and in a further move toward easing, it was reduced to 2.5% on October 2, to 2.0% on November 6, and to 1-3/4% on December 11. On November 6, 2002, the target was reduced to 1-1/4% in the face of a softening of demand growth.

As Figure 2 shows, movements in short-term interest rates mimic closely movements in the federal funds rate. This is not as true for longer-term rates. Their rise and fall as well as the magnitude of their shifts is often different from the timing and magnitude of shifts in the federal funds rate. This is due in part to the fact that they respond to the longer run outlook for inflation, the financing requirements necessitated by the budget deficit, both current and prospective, and the international flow of capital.

Figure 2. Yield on Selected U.S. Treasury Securities and Federal Funds



Source: Board of Governors of the Federal Reserve System.

Summary of Current Developments

The NBER decided on November 26 2001 that the longest economic expansion in U.S. history was over and that the United States had been in a recession since March 2001. This decision was unprecedented in the sense that in March the U.S. economy–according to the data then available–was still expanding. We now know that GDP was contracting, a contraction that would run 3 quarters. The unemployment rate reached a low of 3.9% in September 2000. It began to rise and in April 2002 reached a contraction high of 6.0%. After declining to 5.6% in September, it began to rise reaching 6% again in November and December. Since the contraction began, approximately 1.80 million jobs have been lost. On the positive side, the rate of inflation has fallen considerably although some of the decline can be attributed to the sharp fall in oil prices. To combat the economic slump, both fiscal and monetary policies have become expansionary. In eleven separate moves during 2001, the target for the federal funds rate was reduced to 1-3/4% on December 11, from a high of 6-1/2% on January 3. On November 6, 2002, the rate was reduced to 1-1/4% in the face of evidence suggesting that demand growth had softened. Signs of revival are beginning to show. GDP grew during each of the past 5 quarters.

Sources of GDP Growth

Table 9 records the sources of growth in GDP over the 1991-2001 expansion. These data record two interesting developments. First, investment spending played an important role in that expansion. And among the categories of investment, outlays for personal computers were important. This bodes well for the longer run growth in productivity. Second, purchases by all levels of government played only a small role in that expansion.

Table 9. Sources of GDP Growth: 1992 through 2002

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Real GDP Growth*	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	**	100.0%
Consumption	71.2	87.7	59.3	86.2	51.5	63.3	71.1	80.0	105.1		90.0
Investment	28.8	41.5	46.7	1.2	42.4	45.5	44.4	30.3	21.6		7.2
Govt. Purchases	6.2	-6.4	0.8	-6.8	12.0	10.2	10.1	16.3	7.3		33.3
Net Exports	-6.3	-25.9	-6.97	19.4	-5.9	-19.0	-25.6	-26.4	-34.0		30.5

Source: Department of Commerce.

* Computed using real GDP at 1996 chained dollars on a 4th quarter over 4th quarter basis.
** When the small change in GDP is compared with the large change in components, the resulting percentages are so large as to be meaningless.

Economic Forecasts, 2002-2003

The forecasts in **Table 10** come from three sources. OMB and CBO are well known. BC stands for Blue Chip, a firm that collects the forecasts from about 50 forecasters in finance, business, and universities. BC Con represents the consensus or average forecasts of this group. BC T-10 is the average of the high ten among these forecasts, while BC B-10 is the average of the low ten forecasts.

The consensus of the forecasts summarized in Table 10 is a somewhat higher rate of GDP growth will occur during 2003. The rate of GDP growth, according to the consensus forecast, will be insufficient to have much of an effect on the unemployment rate. The inflation rate is expected to remain below 2.0%. Both short-term and long-term interest rates are expected to be at or near their 2002 levels.

The *Wall Street Journal* published the results of its survey of 55 economic forecasters in its January 2, 2003 edition. These forecasters, on average, expect real GDP to grow at an annual rate of 2.7%, 3.2%, 3.7% and 3.7% over the four quarters of 2003. The CPI is expected to rise 2.2% for the year ended in May. The 3-month Treasury bill rate and 10-year note rate are expected to be 1.8% and 4.42% in June 2003 and the unemployment rate in May is expected to be 6.0%.

Table 10. Economic Forecasts 2003

	2002				2003				2001*	2002*	2003
	1*	2*	3*	4*	1	2	3	4			
Nominal GDP[a]											
OMB	6.4	2.5	5.0	2.5	NA	NA	NA	NA	2.6	3.6	4.2
CBO	6.4	2.5	5.0	2.5	NA	NA	NA	NA	2.6	3.6	4.6
BC T-10	6.4	2.5	5.0	2.5	6.1	6.6	7.1	7.2	2.6	3.6	5.4
BC Con.	6.4	2.5	5.0	2.5	4.4	4.9	5.4	5.6	2.6	3.6	4.5
BC B-10	6.4	2.5	5.0	2.5	2.9	3.2	3.5	4.0	2.6	3.6	3.8
Real GDP[a]											
OMB	5.0	1.3	4.0	0.7	NA	NA	NA	NA	0.3	2.4	2.9
CBO	5.0	1.3	4.0	0.7	NA	NA	NA	NA	0.3	2.4	2.5
BC T-10	5.0	1.3	4.0	0.7	3.7	4.4	4.9	4.9	0.3	2.4	3.3
BC Con.	5.0	1.3	4.0	0.7	2.6	3.2	3.7	3.8	0.3	2.4	2.7
BC B-10	5.0	1.3	4.0	0.7	1.7	2.1	2.5	2.8	0.3	2.4	2.2
Unemployment[b]											
OMB	5.6	5.9	5.7	5.9	NA	NA	NA	5.6	4.8	5.8	5.7
CBO	5.6	5.9	5.7	5.9	NA	NA	NA	NA	4.8	5.8	5.9
BC T-10	5.6	5.9	5.7	5.9	6.2	6.3	6.3	6.1	4.8	5.8	6.3
BC Con.	5.6	5.9	5.7	5.9	6.1	6.0	5.9	5.8	4.8	5.8	6.0
BC B-10	5.6	5.9	5.7	5.9	5.9	5.7	5.6	5.5	4.8	5.8	5.7

	2002				2003				2001*	2002*	2003
	1*	2*	3*	4*	1	2	3	4			
GDP Deflator[a] (chain weights)											
OMB	1.3	1.2	1.0	1.7	NA	NA	NA	NA	2.4	1.1	1.3
CBO	1.3	1.2	1.0	1.7	NA	NA	NA	NA	2.4	1.1	1.6
BC T-10	1.3	1.2	1.0	1.7	2.4	2.2	2.2	2.3	2.4	1.1	2.1
BC Con.	1.3	1.2	1.0	1.7	1.8	1.7	1.7	1.8	2.4	1.1	1.7
BC B-10	1.3	1.2	1.0	1.7	1.2	1.1	1.0	1.2	2.4	1.1	1.3
CPI-U[a]											
OMB	1.4	3.4	1.9	2.4	NA	NA	NA	NA	2.8	1.6	2.2
CBO	1.4	3.4	1.9	2.4	NA	NA	NA	NA	2.8	1.6	2.3
BC T-10	1.4	3.4	1.9	2.4	3.3	2.6	2.6	2.8	2.8	1.6	2.6
BC Con.	1.4	3.4	1.9	2.4	2.4	2.0	2.0	2.2	2.8	1.6	2.3
BC B-10	1.4	3.4	1.9	2.4	1.6	1.3	1.1	1.6	2.8	1.6	1.9
T-BILL Rate[b]											
OMB	1.7	1.7	1.6	1.3	NA	NA	NA	NA	3.4	1.6	1.6
CBO	1.7	1.7	1.6	1.3	NA	NA	NA	NA	3.4	1.6	1.4
BC T-10	1.7	1.7	1.6	1.3	1.4	1.5	1.9	2.4	3.4	1.6	1.8
BC Con.	1.7	1.7	1.6	1.3	1.2	1.3	1.5	1.8	3.4	1.6	1.5
BC B-10	1.7	1.7	1.6	1.3	1.1	1.1	1.1	1.3	3.4	1.6	1.2
10-Year Rate[b]											
OMB	5.1	5.1	4.1	4.0	NA	NA	NA	NA	5.0	4.6	4.2
CBO	5.1	5.1	4.1	4.0	NA	NA	NA	NA	5.0	4.6	4.4
BC T-10	5.1	5.1	4.1	4.0	4.2	4.5	4.9	5.3	5.0	4.6	4.7
BC Con.	5.1	5.1	4.1	4.0	4.1	4.2	4.4	4.7	5.0	4.6	4.3
BC B-10	5.1	5.1	4.1	4.0	3.9	3.9	3.9	4.1	5.0	4.6	4.0

Sources: *Blue Chip Economic Indicators*, January 10, 2003. Congressional Budget Office, January, 2003; and, the Office of Management and Budget, February, 2003.
* Actual data, subject to revisions. The annual data for nominal GDP, real GDP, the GDP deflator and the CPI are on a year over year basis; and the unemployment and interest rate data are either quarterly or annual averages.
a. Annualized quarterly rates of change.
b. Quarterly averages.

The Chairman of the Board of Governors of the Federal Reserve presented the economic projections of the Federal Reserve for 2003 in testimony before the Senate Banking Committee on February 11, 2003. The Federal Reserve projections for 2003 are that over the 4 quarters of the year real GDP will grow between 3.25% and 3.55% and that prices will increase about 1.25% to 1.55%. The civilian unemployment rate is projected to be between 5.75% and 6.0% during the fourth quarter of the year.

Promotion of Economic Growth

Over the longer run, the economic well-being of a nation depends on the growth of potential output or GDP per capita. Crucial to this growth is the fraction of a nation's resources devoted to capital formation. The ability to add to the capital stock through investment depends on a nation's saving rate.

Saving comes from several sources. In the private sector individuals (households) and businesses are responsible for saving. The former save when all of their after tax income is not used for consumption. Businesses save through retained earnings and capital consumption allowances.

The public sector can also be a source of national saving and this occurs when government revenues are larger than expenditures. Budget surpluses, then, can be viewed as a source of national saving.

Table 11 shows the sources of saving for the United States during the past 40 years. There are several things to note about these data. First, except for the decade of the 1990s, the gross private sector savings rate has averaged a remarkably stable 17%-19% of GDP, with most of the saving being done by businesses. More significantly, however, the private sector saving rate net of depreciation, representing saving available for additions to capital, declined considerably in the 1990s. Thus, even without a federal budget deficit, the United States would have had a "saving problem."

Second, over this 40-year period, the saving done by the public sector, as a whole, has declined. There is, however, diversity as to the contribution made by the level of government. The large negative contribution made by the federal government during the 1980s reflects the widely publicized budget deficit. Even though state and local governments have been running budget surpluses, they have not been large enough to offset the federal deficits. This has been reversed beginning in 1993. The improved budget position of the federal government has been adding to national saving.

Third, the data show that for 20 of these 40 years, the United States exported a small fraction of its savings to the rest of the world (i.e., was a net exporter of capital). This changed during the 1980s when the United States started to import the savings of the rest of the world.

Table 11. U.S. Saving By Sector
(as percent of GDP)

Year	Private Sector				Public Sector				Net Private & Pub.[a]	Net[b] Foreign
	Pers.	Bus.	Total	Net of Deprec.	Fed.	State & Local	Total	Net of Deprec.		
1960-9	5.7	11.4	17.1	9.6	2.2	1.7	4.0	1.3	10.9	-0.6
1970-9	6.8	11.6	18.4	9.8	-0.5	1.8	1.3	-1.2	8.6	-0.2
1980-9	6.7	12.6	19.2	9.0	-2.2	1.4	-0.8	-3.0	6.0	1.5
1990-9	4.3	12.5	16.9	6.8	-1.0	1.3	-0.3	-2.0	4.8	1.4
1984	7.8	13.2	21.0	11.0	-3.1	1.7	-1.4	-3.7	7.3	2.2
1985	6.7	13.1	19.8	9.8	-3.0	1.6	-1.4	-3.7	6.1	2.6
1986	6.0	12.1	18.1	8.0	-3.1	1.5	-1.6	-3.8	4.2	3.2
1987	5.3	12.3	17.7	7.6	-1.9	1.3	-0.6	-2.9	4.7	3.2
1988	5.7	12.7	18.5	8.4	-1.5	1.4	-0.1	-2.4	6.0	2.2
1989	5.5	11.9	17.4	7.3	-1.2	1.4	0.2	-2.0	5.3	1.6
1990	5.8	11.8	17.5	7.5	-1.8	1.1	-0.7	-2.9	4.6	1.2
1991	6.2	12.1	18.4	8.2	-2.4	1.0	-1.4	-3.7	4.5	-0.2
1992	6.5	12.1	18.4	8.3	-3.5	1.0	-2.5	-4.8	3.5	0.6
1993	5.3	12.1	17.5	7.5	-2.9	1.1	-1.8	-4.1	3.4	1.1
1994	4.5	12.3	17.0	6.9	-1.9	1.2	-0.6	-2.9	4.0	1.5
1995	4.1	12.8	17.1	7.1	-1.5	1.3	-0.1	-2.4	4.7	1.3
1996	3.5	13.0	16.5	6.5	-0.7	1.4	0.8	-1.5	5.0	1.4
1997	3.0	13.1	16.2	6.1	0.4	1.5	1.9	-0.3	5.8	1.5
1998	3.0	12.6	15.7	5.5	1.6	1.6	3.2	1.0	6.5	2.3
1999	1.6	12.8	14.4	4.1	2.3	1.7	4.0	1.9	6.0	3.4
2000	0.7	12.7	13.4	3.0	3.2	1.5	4.7	2.5	5.5	4.4
2001	1.2	12.4	13.5	2.5	2.1	1.4	3.5	1.3	3.8	3.8
2002*	2.8	12.5	15.3	4.2	-0.7	0.7	0.0	-2.2	2.04	4.5

Source: U.S. Department of Commerce.

a. Equal to the sum of private sector saving net of depreciation and total public sector saving net of depreciation.
b. Negative sign indicates the export of saving from the United States. Positive sign indicates the import of saving from abroad.

* Data for first three quarters of the year.

Should efforts to correct the international trade deficit prove fruitful, the net inflow of foreign saving will cease. Should this occur without a significant improvement in either the private sector saving rate or the negative saving rate of the public sector, the rate of new investment will fall to a very low level in the United States and with it the means for improving the well-being of future generations of Americans.

A sudden increase in the national saving rate is, however, not without some possible adverse consequences. In the short run, a sudden increase in the saving rate means decreased consumption and/or lower public sector net spending, both of which depress aggregate demand. Moreover, in either case, the demand for some types of output would fall to be replaced by an increased demand for other types of output. As a result, some industries and firms would have to contract while others expand. Resources would have to transit from declining to growing industries. These short-run dislocations should be borne in mind if a higher national saving rate becomes the object of public policy.