Current Economic Conditions and Selected Forecasts

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Summary

The National Bureau of Economic Research (NBER) declared on December 1, 2008, that the U.S. economy is now in a recession that began in December 2007. During that quarter (the fourth quarter of 2007), GDP contracted at an annual rate of 0.2%. It then grew at annual rates of 0.9% and 2.8% during the first and second quarters of 2008. During the third quarter, GDP again contracted at an annual rate of 0.5%.

Employment has reflected the slowdown in the economy. The unemployment rate rose to 6.5% in October from 4.8% a year earlier and, since peaking in December 2007, payroll employment has fallen by some 1.2 million.

Inflation is also on the rise. The headline inflation rate, measured by the CPI, rose 3.7% for the 12 months ending in October 2008. This is higher than the core inflation rate (which excludes food and energy) of 2.2%. However, for the three months ending in October 2008, the headline CPI fell at an annual rate of 4.4%. This was largely driven by the fall in the price of oil. Excluding food and energy, the CPI rose at an annualized rate of 1.1%.

The consensus among economists is that GDP growth for 2008 will, over the entire year, be positive. It is expected that fourth quarter will see a further contraction of GDP. During 2009, GDP growth is expected to range between -1.1% and 0.3%. The unemployment rate is expected to average between 6.4% and 6.7% during the fourth quarter of 2008, rising to between 7.1% and 8.0% during the fourth quarter of 2009. Inflation is expected to moderate over 2009.

While the international trade deficit is large, it has declined and the decline is expected to continue. During the first three quarters of 2008, this decline and the increase in government expenditures have been the two positive sources of support for GDP growth in the economy. They have not, however, been sufficiently large to offset the decline in consumer and business spending.

To contain the economic contraction and to ease the stress in national financial markets, the Federal Reserve has eased monetary policy over the past fifteen months. Between September 18, 2007, and October 29, 2008, the target for the federal funds rate has been incrementally reduced to 1.0% from 5.25%. This has involved an unprecedented increase in the reserves of depository institutions. In addition, the Federal Reserve has created a number of new means for injecting additional reserves and liquidity into the financial system including making loans to non-financial firms.

Additional fiscal stimulus has also been forthcoming. The structural measure of the budget deficit has increased from 1.1% of potential GDP in FY2007 to 2.4% in FY2008. New fiscal initiatives are expected to raise the structural deficit even higher during FY2009.

This report will be updated monthly.

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Current Economic Conditions

Overview

The National Bureau of Economic Research, the non-partisan, non-profit research institute that dates the business cycle for the United States, declared on December 1, 2008, that the U.S. economy has been in a recession since last December. In support of this decision, GDP growth in the U.S. has been negative during two of the last four quarters. During the fourth quarter of 2007, GDP contracted at an annual rate of 0.2% and during the third quarter of 2008, at an annual rate of 0.5%. During both the first and second quarters of 2008, GDP growth was positive at annual rates of 0.9% and 2.8%, respectively[1]

The rise in payroll employment peaked in December 2007. Since then, it has dropped by some 1.2 million. The unemployment rate is also on the rise and in October stood at 6.5% (compared with 4.8% a year earlier). These rates are above the 3.8% low during the 1990s expansion.

Measured or headline inflation remains high. As measured by the Consumer Price Index (CPI) it rose 3.7% for the 12 months ended in October 2008 compared with 4.1% during 2007 and 2.5% in 2006. The rise in the core rate for the 12 months ending in October, which excludes food and energy prices, was 2.2%. The broadest measure of inflation for the economy, the GDP price index, rose at an annual rate of 2.6% over the first three quarters of 2008, compared with 2.7% over 2007.

The Federal Reserve has responded to both the slowdown in economic activity and the financial crisis that began during the summer of 2007 in two ways. First it reduced the target rate for federal funds to 1.0% from 5.25%. This has involved unprecedented increases in the reserves of depository institutions (mainly commercial banks). Second, it has exploited a little used provision of the Federal Reserves Act to create a number of new means for expanding the reserves and liquidity of the nation's financial system including lending to financial firms that were not previously eligible for such loans and making loans directly to non-financial firms. In the process, the assets of the Federal Reserve have more than doubled over the past year from $900 billion to $2.2 trillion (mid-November 2007 to mid-November 2008).

Fiscal policy has also shifted from contraction to expansion. As a result of such measures as tax cuts and tax rebates, the structural measure of the budget deficit rose from 1.1% of potential GDP in FY2007 to 2.4% in FY2008. Additional fiscal measures to stimulate the economy should further increase the structural deficit during the current fiscal year.

Details

GDP

The longer run perspective on GDP growth can be gleaned from **Table 1**. Even during the contraction year 2001, GDP growth, on the whole, was positive, but low. The annual data,

[1] The GDP data for the third quarter of 2008 come from the second or "preliminary" estimates.

however, fail to show that during certain quarters of 2001, GDP contracted. Similarly, GDP growth was positive on an annual basis during 2007, the last year of the expansion that got underway in 2002. However, during the fourth quarter of 2007, GDP contracted at an annual rate of 0.2%. The dimensions of this slowdown were obscured to a degree as positive GDP growth returned during the first and second quarters of 2008 and, until December 2007, the unemployment rate showed little tendency to change.[2] Final Sales, which is GDP without accounting for changes in inventories, also declined during the third quarter of 2008, but not during the fourth quarter of 2007.

Table 1. The Growth Rate of Real GDP v. Final Sales, 1999-2008:3Q

(percentages)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP Year-Year	4.5	3.7	0.8	1.6	2.5	3.6	2.9	2.8	2.0	1.1
4thQ-4thQ	4.7	2.2	0.2	1.9	3.7	3.0	2.6	2.4	2.3	NA
Final Sales Year-Year	4.5	3.8	1.6	1.2	2.5	3.3	3.3	2.8	2.4	1.5
4thQ-4thQ	4.2	2.9	1.5	0.8	3.7	2.8	2.7	2.8	2.5	NA

Source: U.S. Department of Commerce.

Productivity gains were an important part of the last expansion.[3] Many economists referred to that expansion as "productivity-led. Between 2002 and 2007, productivity growth was from 0.8% to 4.5% (on a 4/Q over 4/Q basis). To put this into perspective, the underlying productivity trend from 1973 to 1995 was for 1.4% annual growth; and the "step-up" in productivity from 1995 to 2000 was to a 2.5% annual rate of productivity growth. In the 1991-2001expansion, strong productivity gains were not part of the initial recovery phase after March 1991 and did not show up in the aggregate data until 1995.

Labor Markets

The economic recovery and expansion that began in 2002 was not one associated with a large amount of job creation relative to the two expansions that preceded it. The unemployment rate reached a low point of 4.4% compared with a low of 3.8% in April 2000 during the previous expansion (see **Table 2**). At 3.8%, the unemployment rate was at a 30-year low. With the weakening of growth that began in 2007, the unemployment rate began to rise and payroll employment, which had reached a peak in December 2007, began to fall. Over the past 12 months, the unemployment rate has risen to 6.5% (October) from 4.8% a year earlier and payroll employment has fallen by 1.2 million (between the peak in December 2007 and October 2008).

[2] Observers have noted that the NBER has generally waited to designated the onset of a recession until the economy experiences two consecutive quarters of negative growth. Unless data revisions show otherwise, this may be the exception to that observation.

[3] Productivity is measured by output per hour of all persons. In the current situation, change in both the numerator and denominator of this ratio have been contributing to higher productivity: output (the numerator) has been rising and hours (denominator) have been declining.

Table 2. Civilian Unemployment Rate, 1999-2008

(%, seasonally adjusted)

	J	F	M	A	M	J	J	A	S	O	N	D
1999	4.3	4.4	4.2	4.3	4.2	4.3	4.3	4.2	4.2	4.1	4.1	4.0
2000	4.0	4.1	4.0	3.8	4.0	4.0	4.0	4.1	3.9	3.9	3.9	3.9
2001	4.2	4.2	4.3	4.4	4.3	4.55	4.6	4.9	5.0	5.3	5.5	5.7
2002	5.7	5.7	5.7	5.9	5.8	5.8	5.8	5.7	5.7	5.7	5.9	6.0
2003	5.8	5.9	5.9	6.0	6.1	6.3	6.2	6.1	6.1	6.0	5.8	5.7
2004	5.7	5.6	5.8	5.6	5.6	5.6	5.5	5.4	5.4	5.4	5.4	5.4
2005	5.2	5.4	5.2	5.1	5.1	5.0	5.0	4.9	5.1	5.0	5.0	4.9
2006	4.7	4.8	4.7	4.7	4.6	4.6	4.8	4.7	4.6	4.4	4.5	4.5
2007	4.6	4.5	4.4	4.5	4.5	4.6	4.7	4.7	4.7	4.8	4.7	5.0
2008	4.9	4.8	5.1	5.0	5.5	5.5	5.7	6.1	6.1	6.5		

Source: U.S. Department of Labor.

Inflation

The inflation rate over the past several years has generally been rising with the rate of increase greatly influenced by large movements, both up and down, in energy prices (see **Table 3** and **Table 4)**. Indeed, observers claim that the rise in the inflation rate appears to have influenced the Federal Reserve to tighten monetary policy beginning in 2004.

Table 3. Rate of Change in the GDP Deflators, 1999-2008:3Q

(%, 4Q-4Q)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP Price Index	1.6	2.2	2.5	1.7	2.2	3.2	3.5	2.8	2.6	2.0
PCE Price Index	2.1	2.3	1.7	1.9	1.8	3.1	1.9	1.9	3.5	4.4

Source: U.S. Department of Commerce.

Because energy and food prices are largely determined on auction markets and, hence, fluctuate frequently in response to immediate changes in supply and demand, economists seek a measure of price inflation that reflects underlying conditions. Thus, a distinction is made between "headline" inflation and "core" inflation with the latter being measured by a price index purged of its energy and food component. This distinction has been especially important during 2007-2008 as energy prices first rose sharply and, then, declined noticeably.

The broadest measures of inflation in the economy, known as the *GDP Price Index* has not reflected the dramatic shifts in energy prices while the price index for its major component, consumption (the *PCE Index*), has. Over the first three quarters of 2008, the GDP Price Index rose at an annual rate of 2.0% compared with 2.6% over the four quarters of 2007. The PCE Index rose at an annual rate of 4.4% over the first three quarters of 2008 compared with 3.5% over 2007. Energy prices have had a substantial influence on the month-to-month changes in the *Consumer Price Index*. This is shown in **Table 4** where both the headline and core rates are

recorded. During the twelve months ended in October 2008, the headline rate was 3.7% while the core rate was 2.2%. However, for the three months ended in October, the headline rate fell at an annual rate of 4.4%, while the core rate rose at an annual rate of 1.1%.

Table 4. Rate of Change in the Consumer Price Index (CPI), 1999-2007

(in percentages)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Dec. over Dec.	2.7	3.4	1.6	2.4	1.9	3.3	3.4	2.5	4.1
Excluding food and energy	1.9	2.6	2.7	1.9	1.1	2.2	2.2	2.6	2.4
Year Over Year	2.2	3.4	2.8	1.6	2.3	2.7	3.4	3.3	2.8
Excluding food and energy	2.1	2.4	2.6	2.4	1.4	1.7	2.2	2.5	2.3

Source: U.S. Department of Labor.

Since wages and salaries account for approximately two-thirds of the cost to produce GDP, some economists think that their rate of growth provides insight into future inflation rates. Two measures of labor cost growth are shown in **Table 5**. Except for 2006, the rate at which Unit Labor Costs have grown over the past six years has been low whether measured by Unit Labor Costs or the Employment Cost Index for private industry.

Table 5. Rate of Change in Labor Costs, 1999-2007

(in percentages)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Unit Labor Costs	1.6	4.2	0.3	0.2	0.5	2.1	1.6	4.2	1.4
Employment Cost Index	3.4	4.4	4.2	3.2	4.0	3.8	3.0	2.7	3.1

Source: U.S. Department of Labor.

Notes: Unit labor costs are for the nonfarm business sector, 4th quarter-4th quarter. The Employment Cost Index is for private industry on a December-December basis. During the first three quarters of 2008, Unit Labor Costs in the non-farm business sector rose at an annual rate of 1.6%.

The U.S. Foreign Trade Deficit

While the U.S. foreign trade deficit (net imports as a share of GDP), shown in **Table 6**, has been a large fraction of GDP during 2002-2006, it has recently began to decline. In 2007, it declined to 4.8% of GDP whereas over the three quarters of 2008 it declined to 3.4% of GDP.[4] Since the net inflow of capital from abroad comes to the United States in the form of a trade deficit, it serves as a reminder that capital formation in the United States depends on other than domestic saving.

[4] The foreign trade deficit shown in **Table 6** differs from the headline trade deficit reported in the financial press. In Table 6, the "trade deficit" refers to exports and imports from the U.S. National Income and Product Accounts which serve as the basis for GDP. These data are adjusted for inflation. The NIPA accounts also report exports and imports on a non-inflation adjusted basis. When these data are compared with similar GDP numbers, the fall in the trade deficit is not nearly so dramatic. In both 2005 and 2006, the "nominal" trade deficit was 5.7% of GDP. This declined to 5.1% in 2007 and 5.0% over the first three quarters of 2008.

Table 6. U.S. Foreign Trade Deficit, 1995-2008:3Q

(as a percentage of GDP)

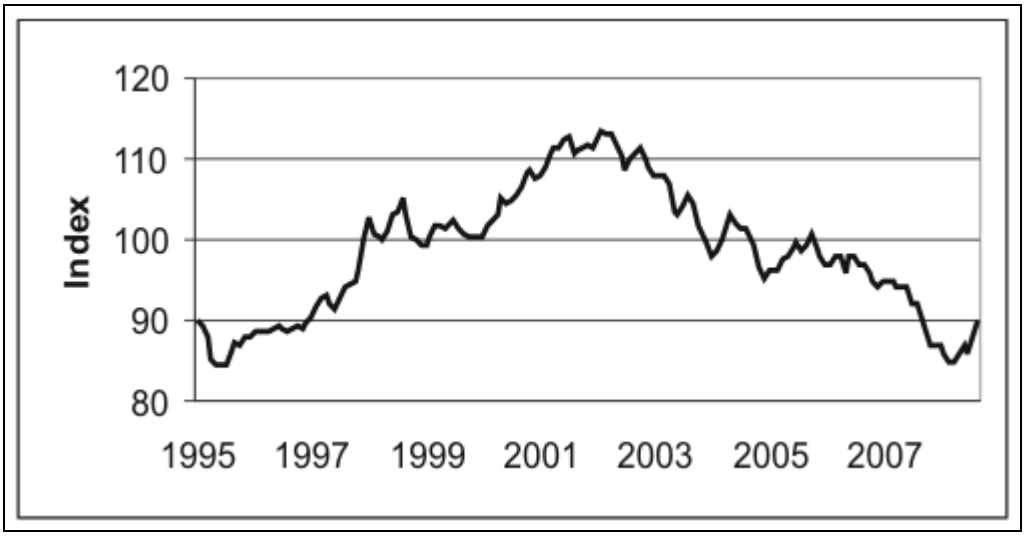
1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
0.9	1.0	1.2	2.2	3.1	3.9	4.0	4.7	5.0	5.6	5.6	5.5	4.8	3.4

Source: U.S. Department of Commerce.

The U.S. Dollar

Figure 1 records the movement in the foreign exchange value of the dollar measured against a trade-weighted and inflation adjusted index of the currencies of many U.S. trade partners over the past 15 years. After hitting a low in the second quarter 1995, the dollar rose (or appreciated) by more than 34% to its peak in February 2002. From then until March 2008, the dollar slowly depreciated, ending up where it was in July 1995. Between March and November 2004, the dollar has appreciated about 14%.[5]

Figure 1. Real Dollar Exchange Rate (Broad Dollar Index)



Source: Board of Governors of the Federal Reserve System.

[5] In **Figure 1**, the dollar is measured against an index of the currencies of many of the major trading partners of the United States weighted according to the proportion of trade account by each. This is referred to as the "broad dollar index." The Board of Governors also publishes the exchange rate of the dollar with the currencies of smaller groups of countries and individual countries. A dollar index is also computed using the major world currencies. It shows a movement of the dollar similar to that above except that its low point occurred in November 2007. Since then, it shows that the dollar has appreciated by some 15%.

Stance of Fiscal and Monetary Policy

Fiscal Policy

The stance of fiscal policy depends on how it is measured. A generally accepted method is to compute the ratio of the structural or full employment federal budget deficit (or surplus) to full employment GDP, also called "potential GDP." When that is done, as shown in **Table 7**, fiscal policy was contractionary between FY2003 and FY2007 as the structural budget deficit declined to 1.1% of potential GDP from 2.6%. Fiscal counter-cyclical initiatives undertaken during FY2008, such as the tax cuts and rebates, reversed this trend and the projected structural deficit is expected to rise to 2.4% of potential GDP. When the actual budget deficit and actual GDP are used, the conclusion is similar in direction to that obtained when the structural measures are used although the magnitudes differ.

Table 7. Alternative Measures of Fiscal Policy

($ in billions per fiscal year)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Standardized Budget Deficit	10	+88	+76	-139	283	289	236	230	153	347
Full Employment GDP	8,921	9,433	10,001	10,513	11,019	11,600	12,286	13,043	13,761	14,455
Percentage	0.000	+0.9	+0.8	1.3	2.6	2.5	1.9	1.8	1.1	2.4
Actual Budget Deficit	+126	+236	+128	158	378	413	318	248	162	455
Actual GDP	9,127	9,708	10,060	10,378	10,804	11,504	12,245	13,023	13,670	14,227
Ratio	+1.4	+2.4	+1.3	1.5	3.5	3.6	2.6	1.9	1.2	3.2

Source: Congressional Budget Office (January, September, and October 2008).

Monetary Policy

The Federal Reserve conducts monetary policy by targeting an overnight interest rate at which depository institutions (primarily commercial banks) buy and sell reserves. To ensure that the target prevails, the Fed must be prepared to buy and sell seasoned (or already issued) U.S. Treasury securities. When it buys these securities in support of a lower target, it supplies reserves to this market and when it sells these securities to support a target increase, it reduces reserves.[6] As shown in **Figure 2**, other short-term interest rates tend to mimic the federal funds rate. This is not usually true for longer term rates. Their changes, as well as the magnitude of their changes, are often different, due in part to the fact that they respond to the longer term outlook for inflation, the financing requirements of the federal budget, and the international flow of capital.

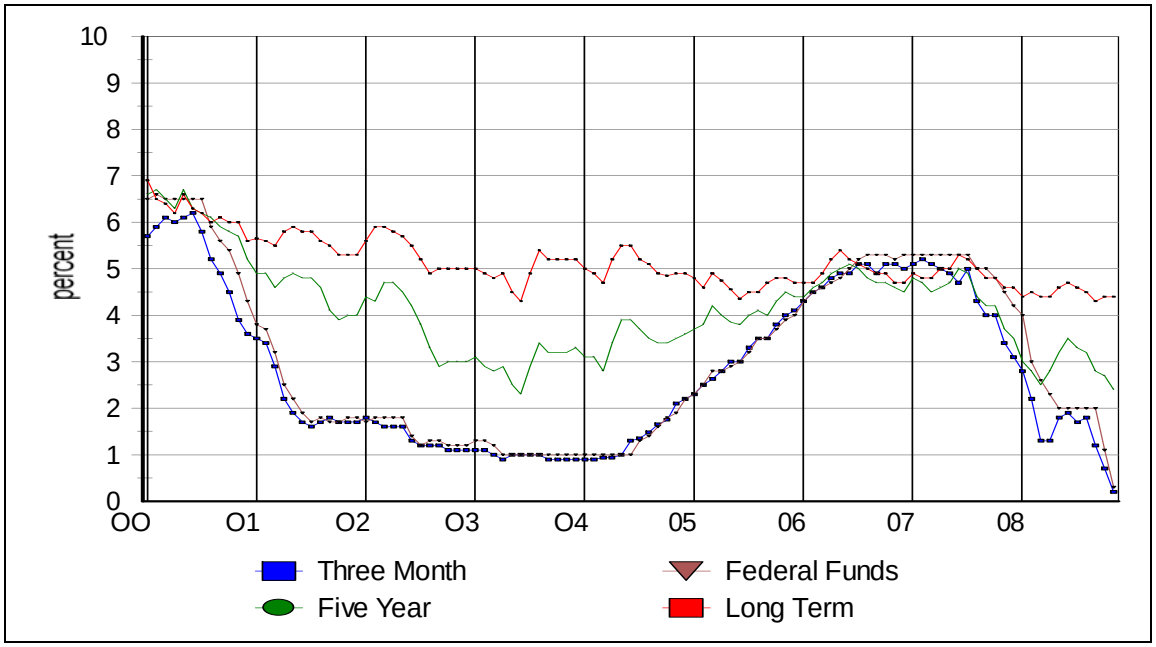
An examination of **Figure 2** reveals that over the past eight years, the federal funds target has been on a sort of roller coaster path—down, up, and down. The initial decline in the target was to set in motion a recovery from the 2001 recession and to deal with the uncertainties from the 9/11

[6] For a more comprehensive discussion of this process, see CRS Report RL30354, *Monetary Policy and the Federal Reserve: Current Policy and Conditions*, by Gail E. Makinen and Marc Labonte.

attack on the United States. The rate was then held low for nearly three years because of the slowness of the economy to recover and expand and because of a fear that the U.S. might experience price deflation similar to that experienced by Japan. This policy may have had serious unintended consequences. The shift in housing finance in the U.S. from fixed rate to variable rate mortgages meant that the housing sector was now far more vulnerable to short-term interest rates. A number of analysts now believe that a consequence of keeping the target rate low for three years was to set in motion a housing price "bubble." A bubble that began to burst as the Fed tightened monetary policy. Between June 2004 and June 2006, the target was raised incrementally 17 times to 5¼% from 1%.

During the summer of 2007, the bubble burst and the economy began to slump. As noted above, the Fed responded with a substantial easing of monetary policy. Between October 2007 and mid-November 2008, the reserves of depository institutions increased from $42.4 billion to $652.9 billion; an unprecedented expansion over such a short period. Still, this was not enough to deal with the financial crisis. The Fed initiated a number of new way to supply additional reserves and liquidity to the financial system and to some non-financial firms as well.[7] The magnitude of this is also unprecedented. During October 2007, total borrowing from the Federal Reserve was $254 million. By mid-November, 2008, it had grown to $725.2 billion.

Figure 2. Yield on Selected Securities and Federal Funds



Source: Board of Governors of the Federal Reserve System.

[7] For a discussion of these new initiatives, see CRS Report RL34427, *Financial Turmoil: Federal Reserve Policy Responses*, by Marc Labonte.

Economic Forecasts, 2008-2009

The forecasts in **Table 9** come from three sources. OMB and CBO are well known. BC stands for the Blue Chip Economic Indicators, 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 10 among these forecasts, while BC B-10 is the average of the low 10 forecasts.

The consensus view from forecasts summarized in **Table 9** is that GDP growth should be between -1.1% and 0.3% during 2009. Positive growth is expected to resume during either the second or third quarter of the year. The forecasted 2009 rate of GDP growth will be insufficient to keep the unemployment rate from rising and it is expected to reach between 7% and 8% during the third quarter. The headline inflation rate for the entire economy is expected to range from near zero to about 3% (depending on the price index used). Both short-term and long-term interest rates on Treasury securities are expected to be about comparable to the rates prevailing in 2008.

In the *Minutes* to the Federal Open Market Committee Meeting of October 28-29, 2008, the Federal Reserve presented new economic projections for 2008 and 2009. It projected that from the fourth quarter 2007 to the fourth quarter 2008, real GDP will grow from 0.0% to 0.3% and that prices[8] will increase from 2.8% to 3.1%. The civilian unemployment rate is projected to average between 6.3% and 6.5% during the remainder of the year. For 2009, real GDP, on a fourth quarter over fourth quarter basis, is projected to grow between -0.2% and 1.1%, prices are expected to rise between 1.3% to 2.0%, and unemployment during the fourth quarter of the year is projected to average from 7.1% to 7.5%.

Table 8. Economic Forecasts, 2008-2009

	2008			2009					
	2[a]	3[a]	4	1	2	3	2007[a]	2008	2009
Nominal GDP[b] (Rate of Change)									
OMB	3.9	3.6	NA	NA	NA	NA	4.8	3.8	4.4
CBO	3.9	3.6	NA	NA	NA	NA	4.8	3.8	3.8
BC T-10	3.9	3.6	-2.8	2.9	1.0	5.3	4.8	4.0	2.7
BC Con.	3.9	3.6	-1.1	0.4	1.0	3.3	4.8	3.7	1.6
BC B-10	3.9	3.6	-5.0	-.2.2	-1.0	1.1	4.8	3.5	0.2
Real GDP[b] (Rate of Change)									
OMB	2.8	-0.5	NA	NA	NA	NA	2.0	1.6	2.2
CBO	2.8	-0.5	NA	NA	NA	NA	2.0	1.5	1.1
BC T-10	2.8	-0.5	-1.5	-0.1	1.7	2.7	2.0	1.4	0.3
BC Con.	2.8	-0.5	-2.8	-1.5	0.2	1.5	2.0	1.4	-0.4

[8] The Federal Reserve features in its projections a measure of inflation derived from the Personal Consumption Expenditure (PCE), less food and energy, index found in the GDP accounts. This price index attempts to measure inflation with regard to consumer spending. The PCE covers about two-thirds of GDP.

	2008			2009					
	2[a]	3[a]	4	1	2	3	2007[a]	2008	2009
BC B-10	2.8	-0.5	-3.9	-2.7	-1.3	0.2	2.0	1.3	-1.1
Unemployment[c]									
OMB	5.3	6.0	NA	NA	NA	NA	4.6	5.3	5.6
CBO	5.3	6.0	NA	NA	NA	NA	4.6	5.4	6.2
BC T-10	5.3	6.0	6.7	7.3	7.7	8.0	4.6	5.7	7.8
BC Con.	5.3	6.0	6.5	6.9	7.3	7.6	4.6	5.7	7.4
BC B-10	5.3	6.0	6.4	6.6	6.9	7.1	4.6	5.6	7.0
GDP Price Index (chain-weighted)[b]									
OMB	1.1	4.2	NA	NA	NA	NA	2.7	2.3	2.6
CBO	1.1	4.2	NA	NA	NA	NA	2.7	2.2	2.2
BC T-10	1.1	4.2	3.3	3.0	2.7	2.6	2.7	2.7	2.6
BC Con.	1.1	4.2	1.7	1.9	1.7	1.8	2.7	2.4	2.0
BC B-10	1.1	4.2	-1.1	0.5	0.3	0.9	2.7	2.1	0.9
CPI-U[b]									
OMB	5.0	6.9	NA	NA	NA	NA	2.9	3.8	2.3
CBO	5.0	6.9	NA	NA	NA	NA	2.9	4.7	3.1
BC T-10	5.0	6.9	2.0	2.6	3.0	3.4	2.9	4.5	2.8
BC Con.	5.0	6.9	-2.1	0.8	1.6	2.2	2.9	4.2	1.5
BC-10	5.0	6.9	-6.0	-1.3	-0.2	1.1	2.9	3.8	0.1
T-BILL Interest Rate (three-month)[c]									
OMB	1.7	1.5	NA	NA	NA	NA	4.4	1.9	2.8
CBO	1.7	1.5	NA	NA	NA	NA	4.4	1.9	2.7
BC T-10	1.7	1.5	1.2	1.3	1.5	1.8	4.4	1.6	1.6
BC Con.	1.7	1.5	0.8	0.8	0.9	1.1	4.4	1.5	1.0
BC B-10	1.7	1.5	0.5	0.3	0.4	0.6	4.4	1.4	0.6
10-year Treasury Note[c]									
OMB	3.9	3.9	NA	NA	NA	NA	4.6	4.0	4.6
CBO	3.9	3.9	NA	NA	NA	NA	4.6	3.9	4.4
BC T-10	3.9	3.9	3.9	4.0	4.2	4.4	4.6	3.8	4.2
BC Con.	3.9	3.9	3.7	3.7	3.8	3.9	4.6	3.8	3.9
BC B-10	3.9	3.9	3.5	3.4	3.3	3.3	4.6	3.7	3.4

Sources: Blue Chip Economic Indicators, November 2008; Congressional Budget Office, July 2008; and the Office of Management and Budget (CEA), September, 2008.

a. Actual data, subject to revisions. The annual data for nominal GDP, real GDP, the GDP price index and the CPI are on a year over year basis; and the unemployment and interest rate data are either quarterly or annual averages.

b. Quarterly rates of change are annualized.

c. Quarterly averages.

Special Topics

Accounting for GDP Growth

Table 9 records contributions to growth in GDP from 1995 to 2006. These data record two interesting developments. First, except for 2001, 2002, and 2007, investment spending has played an important role in both the 1991-2001 and 2001-2007 expansions. Among the categories of investment spending, outlays for personal computers were important. This bodes well for the longer run growth in productivity. Second, with the exception of 2001, 2002, and 2008:3Q purchases by all levels of government have played only a small role in both expansions. Net export growth was an important component of growth in 2007 and especially 2008:3Q. Except for 2008:3Q, consumption expenditures remain the largest single contributor to GDP growth.

Table 9. Accounting for GDP Growth: 1995-2008:3Q

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008:3Q
Real GDP Growth	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Consumption	73.6	63.5	57.4	81.2	81.6	87.2	234.2	122.7	78.3	69.9	75.6	67.6	71.6	-48.0
Investment	17.7	34.3	41.5	37.7	26.2	26.9	-187.8	-26.8	22.4	39.1	27.4	21.3	-16.2	-102.9
Govt. Purchases	4.3	5.2	7.9	8.4	16.3	10.1	80.4	51.0	18.3	8.9	5.0	10.9	17.7	75.1
Net Exports	4.3	-2.9	-6.8	-27.4	-24.1	-24.1	-26.8	-46.9	-19.0	-17.9	-8.1	0.1	27.1	175.8

Source: U.S. Department of Commerce.

Note: Computed using real GDP at 2000 chained dollars on a year-over-year basis.

Promotion of Economic Growth: The Importance of Saving

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 10 shows the sources of saving for the United States during the past 45 years. There are several things to note about these data. First, except for the decade of the 1990s and 2000-2007, 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 beginning in the 1990s. The drop in the household (personal) savings rate has been the major factor in the decline in the private sector saving rate. Thus, even without a federal budget deficit, the United States would have had a "saving problem."

Second, over this 45-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 and 2002-2005 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 was reversed during the period 1993-2001. The improved budget position of the federal government during this period added to national saving.

Third, the data show that for 20 of these 45 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 began to import the savings of the rest of the world.

The United States has been able to sustain its growth and standard of living since the 1980s because we have been able so far to attract sufficient capital (saving) from international investors. Without these savings, the United States would have had a "financing gap" in view of its domestic saving shortfall relative to its demand for investment capital. In the absence of sufficient capital, U.S. interest rates would have had to rise in order to restore balance between investment and a now smaller amount of saving. Higher interest rates would have choked off investment and dampened U.S. growth.[9]

Should efforts to correct the international trade deficit prove fruitful, the net inflow of foreign saving will diminish or perhaps on net cease (that is, stabilize). 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 or lower public sector net spending, both of which depress aggregate demand. Moreover, in either case, the demand for some types of output would decline 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.

[9] See also CRS Report RL30534, *America's Growing Trade Deficit: Its Cause and What It Means for the Economy*, by Marc Labonte and Gail E. Makinen; and CRS Report RL31032, *The U.S. Trade Deficit: Causes, Consequences, and Cures*, by Craig K. Elwell.

Table 10. U.S. Savings By Sector

(as a percentage of GDP)

	Private Sector				Public Sector					
Year	Pers.	Bus.	Total	Net of Deprec.	Fed.	State/ Local	Total	Net of Deprec.	Net Private/ Public[a]	Net Foreign[b]
1960-69	5.7	11.4	17.1	9.6	2.2	1.7	4.0	1.3	10.9	-0.6
1970-79	6.8	11.6	18.4	9.8	-0.5	1.8	1.3	-1.2	8.6	-0.2
1980-89	6.7	12.6	19.2	9.0	-2.2	1.4	-0.8	-3.0	6.0	1.5
1990-99	3.8	12.3	16.1	6.4	-1.1	1.3	0.2	-2.0	4.5	1.3
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	5.2	11.6	16.8	7.3	-1.8	1.2	-0.6	-2.8	4.4	1.2
1991	5.4	12.0	17.4	7.6	-2.4	1.0	-1.4	-3.6	4.0	-0.2
1992	5.8	11.8	17.6	8.0	-3.5	1.1	-2.4	-4.7	3.3	0.6
1993	4.3	11.9	16.2	6.8	-2.9	1.1	-1.8	-4.1	2.8	1.1
1994	3.5	12.0	15.5	6.0	-1.9	1.3	-0.6	-2.9	3.1	1.5
1995	3.4	12.7	16.1	6.7	-1.6	1.3	-0.3	-2.5	4.1	1.2
1996	2.9	12.9	15.8	6.2	-0.8	1.4	0.6	-1.5	4.8	1.3
1997	2.6	13.1	15.7	6.1	0.3	1.6	1.9	-0.2	5.9	1.3
1998	3.2	12.0	15.2	5.5	1.4	1.7	3.1	1.0	6.5	2.1
1999	1.7	12.6	14.3	4.5	2.0	1.6	3.7	1.7	6.2	3.0
2000	1.7	11.9	13.6	3.5	2.8	1.6	4.4	2.4	5.9	4.0
2001	1.3	12.5	13.8	3.2	1.3	1.2	2.5	0.5	3.7	3.7
2002	1.8	13.1	14.9	4.6	-1.5	0.8	-0.7	-2.7	1.9	4.4
2003	1.6	13.2	14.8	4.6	-2.6	1.0	-1.6	-3.6	1.1	4.7
2004	1.6	13.6	15.2	4.8	-2.4	1.2	-1.2	-3.2	1.6	5.3
2005	0.4	14.0	14.3	3.4	-1.8	1.4	-0.4	-2.4	1.0	5.9
2006	0.3	13.3	13.5	3.3	-0.9	1.4	0.5	-1.5	1.9	6.0
2007	0.3	12.5	12.8	2.7	-0.8	1.2	0.4	-1.7	1.2	5.1

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 indicates the export of saving from the United States. Positive indicates the import of saving from abroad.

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