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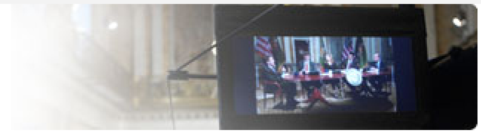

Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

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The ongoing economic recovery gained substantial momentum at the end of 2010. Real GDP growth accelerated in the final quarter of the year – the sixth straight quarter in which the economy expanded. Consumer spending rose at the fastest pace in nearly five years, residential investment edged up, and business investment grew for a fourth straight quarter. Improving economic conditions prompted private-sector employers to hire more than 1.3 million workers last year.

Although the pickup in private demand is encouraging, weakness persists in the labor market. The unemployment rate has started to ease, falling 0.5 percentage point over the course of 2010, but was still very high at 9.4 percent in December, with nearly 14.5 million Americans looking for work. The housing sector also remains a point of weakness, in part reflecting the high level of joblessness but also the large inventory of houses for sale.

The recovery is at a critical juncture. To help ensure that it is sustained, this past December Congress passed and the President signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. This legislation – which includes a 2 percent payroll tax cut and the extension of unemployment benefits through 2011 – will provide an important boost to the economy this year.

During 2010, real GDP expanded by 2.8 percent on top of a 3.3 percent annual rate gain in the second half of 2009. Growth slowed temporarily in the spring as imports (which are subtracted from GDP) jumped and the pace of inventory accumulation slowed sharply, but the economy picked up speed again in the second half of 2010. According to the advance report on fourth-quarter GDP released late last week, growth accelerated at the end of the year to a 3.2 percent annual rate from 2.6 percent in the third quarter. The level of real GDP at the end of 2010 was slightly higher than at the end of 2007, when the recession began.

The fourth-quarter pickup in GDP growth was due mainly to a jump in consumer spending, which rose 4.4 percent at an annual rate – the largest increase since early 2006. Residential investment rose slightly in the fourth quarter, following a decline in the third quarter that was related to the expiration of the homebuyer tax credit in late April. Business investment continued to increase at the end of the year, although at a slower pace than in the third quarter. Export growth remained solid but imports fell, causing the trade deficit to narrow sharply. The improvement in the net export balance contributed 3.4 percentage points to fourth-quarter real GDP growth. However, the large positive contribution from trade was more than offset by a negative contribution from the sharply slower pace of inventory accumulation. Private domestic final demand (consumption plus fixed investment excluding inventories) rose nearly 4½ percent at an annual rate in Q4, up from 2¼ percent in Q3 – a sign that the recovery is increasingly being powered by private demand rather than government stimulus.

Although residential activity made a small positive contribution to GDP growth in the fourth quarter, housing markets remained weak at year's end. Housing starts declined by 8½ percent in the fourth quarter, reflecting a steep drop in ground breakings for multi-family units. Single-family starts were flat in Q4 and appear to have stabilized at a low level. Home sales have started to recover from the steep slide that occurred after the home buyer tax credit expired on April 30, helped in part by record low mortgage rates in November. Sales of new and existing single-family homes rose about 15 percent in the fourth quarter, recouping almost 2/3 of the 25 percent drop recorded in Q3. The pickup in sales helped trim the stock of homes on the market, but inventories remain very high relative to sales. At the end of December, there was a 6.9-month supply of new single-family homes available for sale and an 8.1-month supply of existing single-family homes on the market. New residential construction will likely remain depressed until this overhang is reduced to a more "normal" level.

Home prices started to stabilize in the first half of the year but in recent months appear to be softening again. The S&P Case-Shiller 20-city house price index declined slightly on a year-over-year basis in both October and November following 8 months of growth. The FHFA house price index was flat in November but on a year-over-year basis posted its largest decline since July 2009. Prices will likely remain depressed given the large inventory overhang as well as the stock of homes in serious delinquency or foreclosure. Data from the National Association of Home Builders' January survey indicate that home builders remain pessimistic about the prospects for housing in the near term. These elements, combined with the still-high level of unemployment, suggest that recovery in the housing market will remain muted in the near-term.

The labor market continued to recover in the final months of 2010. According to the monthly establishment survey, nonfarm private-sector payrolls rose by 128,000 per month on average in the fourth quarter, up slightly from an average monthly gain of 124,000 in the third quarter. More than 1.3 million private-sector jobs were created between December 2009 and December 2010 – a dramatic turnaround from the nearly 4.7 million jobs lost in 2009. Nevertheless, unemployment remains high. Data from the separate household survey show that the unemployment rate fell 0.4 percentage point in December to end the year at 9.4 percent, 0.5 percentage point lower than in December 2009 and down from a peak of 10.1 percent in October 2009. The unexpectedly large decline at the end of 2010 was due in part to an increase in the household survey's measure of employment but it also reflected a drop in the labor force. The labor force participation rate has been trending down for about a decade, from a postwar high of 67.3 percent in early 2000. It stabilized around 66 percent from 2005 to 2008 but has been declining since and in December dipped to a 26-year low of 64.3 percent.

The large degree of slack in labor markets and low level of capacity utilization continue to restrain inflation. Headline consumer prices rose a moderate 1.5 percent over the 12 months of 2010, and core consumer prices were up just 0.8 percent. That was the lowest calendar year core inflation rate in the history of the series, which dates back to 1957. Wage pressures remain modest. The Employment Cost Index (ECI) for private-industry workers rose 2.1 percent over the year ending in December. Recent 12-month increases in this measure are among the smallest in the 30-year history of the data series.

Partly as a result of improving economic and financial conditions, the federal budget deficit narrowed to $1.3 trillion (8.9 percent of GDP) in FY2010 from $1.4 trillion (10 percent of GDP) in FY2009. The Administration remains committed to trimming the deficit substantially further and to putting the debt-to-GDP ratio on a sustainable path. The FY2012 budget, to be released in mid-February, will include updated assumptions about the future path of economic growth and new projections for the path of the deficit over the next ten years.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, signed by the President on December 17, is not expected to increase the deficit over the medium- to long-term relative to the Administration's FY2011 deficit projections. The tax relief legislation prevented both a large tax increase and the expiration of unemployment benefits, which would have been a major set-back for the recovery. It also included a 2 percent payroll tax cut for working families. All of these measures are temporary and will have expired by the end of 2012. Around the time the legislation was passed, private economists estimated it could add ½ to 1¼ percentage points to real GDP growth in 2011, translating to between 500,000 to over 1 million additional payroll jobs in 2011. By ensuring that we sustain and build on the progress we have already made, these measures will strengthen the expansion and help bring down future deficits. In sum, the recovery is gaining traction, but there is much room for improvement, especially in the housing and labor markets. The tax relief legislation signed by the President in mid December will help ensure that the strides made in 2010 are sustained and the recovery becomes a long-term expansion.