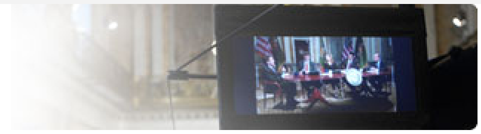
U.S. DEPARTMENT OF THE TREASURY

Press Center



Statement for the Treasury Borrowing Advisory Committee

7/30/2012

Economic activity has moderated in recent months, with growth held back by a number of temporary factors, including the run-up in energy prices earlier this year, unusually warm winter weather, and the ongoing sovereign debt crisis in Europe. Nonetheless, the U.S. economy continues to heal and grow, and evidence of improvement continues to emerge, particularly from the housing sector. While the unemployment rate remains unacceptably high, underlying labor market conditions are recovering gradually. Private-sector forecasters continue to expect growth to strengthen over the second half of 2012 and into 2013, although forecasters expect additional progress in reducing the unemployment rate further this year will be limited. The Administration has proposed a variety of measures to create jobs and boost growth in the near term, including job training, incentives for small businesses to invest and hire, support for state and local governments to keep teachers, firefighters, and police on the job, as well as building and growing our essential infrastructure. The facilitation of mortgage refinancing for troubled homeowners is also expected to support economic activity. At the same time, the Administration remains firmly committed to restoring fiscal sustainability in order to preserve the economy's long-run growth potential. According to the just-released Mid-Session Review of the FY2013 Budget, the federal budget deficit is projected to decline from 7.8 percent of GDP in FY2012 to 6.1 percent of GDP in FY2013, and then narrow to about 2.6 percent of GDP, achieving primary balance, by the end of the decade.

In the advance report released late last week, real GDP growth moderated to a 1.5 percent annual rate in the second quarter from a 2.0 percent pace in the first quarter. The deceleration was largely due to a slowdown in consumer spending. Business investment in structures and residential investment also slowed in the second quarter, but both made positive contributions to growth. Notably, residential investment grew 9.7 percent in the second quarter, a solid pace in the wake of a nearly 21 percent surge in the previous quarter. This was the fifth consecutive quarter of growth in residential investment and the first such string of advances in this sector since 2005. Business investment in equipment and software, which has been an important source of strength during the recovery, picked up in the second quarter, and firms added to their inventories, which provided a small boost to growth.

Looking at other components of GDP, continued cuts in government spending continued to weigh on activity in the second quarter, though Federal spending was less of a drag on growth than in Q1. State and local outlays fell for the 11th straight quarter – the longest string of cuts in state and local expenditures in post-war history. Net exports also posed a drag on growth in the second quarter, as imports rose faster than exports. The wider trade deficit reduced real GDP growth by 0.3 percentage point.

Private domestic final purchases (the sum of consumption, business fixed investment, and residential investment) rose at a 2.2 percent annual rate in the second quarter, slowing from gains in the 3 to 3½ percent range in the prior three quarters. At a time when near-term fiscal support for the recovery is limited and prospects for additional reductions in government expenditures lie ahead, the consistently solid nature of underlying private demand, which has grown at a quarterly average of just over 3 percent over the past two years, reflects the ongoing formation of a private-sector led, self-sustaining recovery.

Newly-revised data released last week by the Bureau of Economic Analysis show that the overall decline in output during the recession from December 2007 through June 2009 was 4.7 percent, slightly smaller than the 5.1 percent decline previously estimated, but the downturn was still the deepest in post-war history. The increase in real GDP during the first 2½ years of the current expansion was also revised lower to 5.8 percent from 6.2 percent previously. The pace of growth during 2010 was revised down, reflecting slower growth of equipment and software investment and a smaller build in private inventories than initially reported. However, growth during 2011 was revised higher. The economy has now grown for twelve straight quarters since the recession ended in June 2009, at a 2.2 percent average annual rate, bringing the cumulative increase in economic output so far in this expansion to nearly 7 percent.

Recent employment reports show the pace of job creation slowed markedly during the second quarter to 75,000 jobs per month from 226,000 jobs per month during the first quarter. Despite the slower pace of employment growth, underlying labor demand appears relatively stable. Temporary help employment – a leading indicator of permanent hiring – continues to rise. In June, this industry added 25,000 workers – the most since February. The average private-sector workweek ticked up 0.1 hour in June to 34.5 hours. The workweek has held fairly steady in the neighborhood of 34.5 hours since the start of the year – just 0.1 hour shorter than in December 2007. In terms of labor input, the 0.1 hour increase is roughly equivalent to more than 300,000 full-time jobs. The unemployment rate held steady at 8.2 percent in June, and measures of longer-term unemployment as well as marginal attachment to the labor force and part-time employment are trending lower. Finally, the five-week string of declines in the four-week moving average of initial unemployment claims is another encouraging sign that underlying labor market conditions are becoming more positive.

The housing market appears to be stabilizing. New home sales have been on a modest upward trend since last fall, and existing home sales are also moving higher. A wide variety of house price measures have posted gains in recent months, and a few major indexes have shown year-over year gains. The inventory of homes available for sale has also trended lower and is approaching the levels that prevailed in the years prior to the housing bubble. Record-low mortgage rates, the Administration's efforts to help troubled homeowners, and a high level of housing affordability are all supporting activity in the housing sector.

Looking at the downside risks to U.S. economic activity, a slowdown in global growth is already underway, and persistent uncertainty about sovereign debt markets in Europe has contributed to volatility in U.S., as well as global, financial markets. Worsening drought conditions in the United States are adversely affecting a variety of U.S. crops, prompting the U.S. Department of Agriculture to predict an increase in food price inflation next year, anticipation of which is already being reflected in some measures of consumer sentiment. The prospects of the expiry of existing tax cuts and automatic reductions in public spending at the end of the year appear to be weighing on business sentiment and could be delaying hiring and investment decisions.

Although the U.S. economy remains vulnerable to a variety of downside risks, it is also relatively well-positioned to cope with these challenges. The fundamentals of private demand are supportive of an improved pace of activity. In particular, energy prices are down, which has translated into faster growth in real disposable personal income. Household wealth has risen as a share of income recently, as the stock market has retraced losses posted earlier in the year and housing prices have started to stabilize. We expect these developments to put consumers on a stronger footing going forward.

Despite the recent moderation in growth, we continue to expect the economy to expand at a moderate pace through the end of this year. Private forecasters generally see real GDP growth strengthening to a 2.1 percent pace in the third quarter and 2.3 percent in the fourth quarter. Growth over the four quarters of 2012 is projected to be 2.0 percent, matching the gain posted during 2011. The Administration's most recent economic forecast in the Mid-Session Review, which includes implementation of the initiatives in the President's Budget, is for 2.6 percent growth during both 2012 and 2013. Growth is expected to accelerate in the middle of the decade to an average pace of 4 percent from 2014-2017, and then return to a 2.6 percent pace for the remaining five years of the budget window.

The economy in the first half of 2012 has been characterized by moderating but persistent growth and further gradual improvement in the labor and housing markets. Job creation continues apace, home prices have started to turn up in the aggregate, homes are selling, and record-low mortgage rates are facilitating mortgage refinancing for a growing group of homeowners. These developments are putting more disposable income in the hands of consumers. The Administration is working to solidify those gains and has put forth an agenda that would continue to provide near-term support for disposable income and job growth. If passed, these measures would build on positive trends already in train to develop a more solid foundation for current growth and long-run competitiveness.