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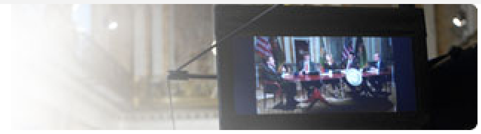

Statement by Assistant Secretary for Economic Policy Jan Eberly for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

2/4/2013

WASHINGTON - Economic recovery in the U.S. continued at a moderate pace over the course of 2012, with real GDP expanding by 1.5 percent following a 2.6 percent increase during 2011. After thirteen straight quarters of growth, real GDP edged down slightly in the final quarter of last year, as sharply lower defense spending, slower inventory growth, and a widening of the trade deficit offset a solid increase in consumer spending and strong growth of both residential investment and business capital spending. Job creation has accelerated in recent months. The unemployment rate declined notably over the first nine months of 2012 and has been little changed since September. The economy sustained a number of temporary shocks last year, such as a jump in energy prices early in 2012, a severe drought during the summer, and Hurricane Sandy in late October, and also contended with the ongoing sovereign debt crisis in Europe and a more general slowdown in global growth. Growth is expected to pick up in the first quarter of 2013, despite some fiscal drag. Other potential challenges this year include the risk of renewed setbacks in Europe, the impact of continued uncertainty about the U.S. fiscal situation, and the possibility of additional, sequester-related fiscal tightening. Even so, private forecasters anticipate a gradual acceleration in the pace of expansion as 2013 unfolds, as well as further progress in reducing unemployment.

According to the advance report released last week, real GDP edged down 0.1 percent at an annual rate in the fourth quarter, compared with a 3.1 percent advance in the third quarter. The swing was due in part to a 6.6 decline in government spending. Federal outlays fell 15.0 percent – the largest quarterly decline in four decades – as federal defense purchases plummeted 22.2 percent. In the third quarter, federal spending rose sharply, boosted by a jump in defense outlays. The composition of the pronounced swing between Q3 and Q4 suggests that uncertainty about the impending sequester played a role. State and local government spending, which has been falling nearly continuously since late 2009, declined 0.7 percent in Q4. Altogether, the decline in government expenditures cut 1¼ percentage points from real GDP growth in Q4.

GDP growth in late 2012 was also held back by a sharp slowdown in private inventory accumulation, which subtracted 1¼ percentage points from real GDP in the fourth quarter after adding 0.7 percentage point to growth in the third quarter. The drought-related drawdown in farm inventories, which reduced GDP growth in the prior two quarters, slowed. A wider trade deficit subtracted an additional ¼ percentage point from GDP growth in the fourth quarter.

Notwithstanding the slight dip in headline GDP, the main components of underlying private demand strengthened in the fourth quarter. Consumer spending, which accounts for roughly two-thirds of GDP, grew by 2.2 percent at an annual rate, accelerating from the third quarter's 1.6 percent rise, and adding 1.5 percentage points to real growth. Business fixed investment grew 8.4 percent in the fourth quarter, contributing 0.8 percentage point to growth. Equipment and software investment rose at a 12.4 percent pace after falling by 2.6 percent in the prior quarter. Residential investment grew by 15.3 percent at an annual rate in the fourth quarter, up from 13.5 percent in the third quarter, and contributed 0.4 percentage point to GDP growth. Residential investment has increased in each of the past seven quarters -- the first such string of advances in this sector since 2005 – and has grown at an average annual rate of almost 11 percent per quarter over this period.

Private domestic final purchases (the sum of consumption, business fixed investment, and residential investment) jumped by 3.3 percent at an annual rate in the fourth quarter, more than double the third's quarter's 1.5 percent pace. Over the past three years, this marker of a private-sector led, self-sustaining recovery has grown at an average annual rate of just under 3 percent.

Labor market conditions continue to improve at a steady but gradual pace, and the most recent data show that job creation at the end of 2012 was actually faster than initially reported. Private-sector job growth averaged 225,000 per month during the fourth quarter, up from 142,000 in the third quarter, and nearly double the 117,000 jobs per month created on average in the second quarter. More than 6.1 million new jobs have been created in the private sector since the employment trough in February 2010. Moreover, underlying labor demand appears to be improving. The average private-sector workweek stood at 34.4 hours in January, up from a low of 33.8 hours in 2009 and just 0.2 hour shorter than in December 2007. The unemployment rate stood at 7.9 percent in January, up slightly from a near four-year low of 7.8 percent in November and December. Measures of longer-term unemployment as well as marginal attachment to the labor force and part-time employment continue to trend lower. The median duration of unemployment fell by 4.8 weeks over the past year to 16.0 weeks in January and is down from a high of 24.8 weeks in mid-2010. It is worthwhile to look at progress across the country, too: in December, 25 states reported unemployment rates that were significantly below the national average. These are all positive signs that underlying labor market conditions continue to firm.

With the progress made in the housing market in the past several months, we now appear to be approaching important milestones. For example, total housing starts rose in December to a 4½ year high and the number of residential building permits issued reached their highest level since mid-2008. As of December, total existing home sales had retraced to a level about two-thirds of their 2005 peak, and the decline in new single-family homes during that month was actually attributed to a lack of supply, rather than a dearth of demand – sales in this category were still up nearly 9 percent year-over-year. The inventory of unsold new homes is just above record lows for the series, which dates to the early 1960s, and the inventory of existing homes available for sale continues to move lower and is now two-thirds below its July 2010 peak level. During 2012, residential investment climbed 14.4 percent – the strongest yearly increase since 1983. The major house price indexes have been moving higher on a year-over-year basis for the past ten months, and are now being supported by tighter supply and stronger demand conditions. Record or near-record lows in mortgage rates, a relatively high level of housing affordability, and improving household wealth are also helping to boost demand and to support broader-based improvement in the housing sector.

Looking ahead, downside risks to U.S. economic activity remain, including persistent concerns about instability in European sovereign debt markets. Here at home, consumer sentiment faltered at the turn of the year in the face of fiscal uncertainty and the expiration of tax cuts. Still, energy prices have eased in very recent months, and there are signs of reviving demand in Asia.

While downside risks create vulnerabilities in any economy, recent progress within the U.S. has improved the economy's resilience in the face of potential challenges. The underlying and consistent strength of private demand over the past three years constitutes an important foundation for that resilience, and the level of real GDP is now 2.4 percent higher than in the fourth quarter of 2007, at the time of the previous expansion's peak. After five years of decline, residential investment has added to growth in each of the past seven quarters. The workweek has lengthened to a duration close to that last seen in December 2007, the peak month of the previous upturn, and the unemployment rate is at a four-year low. These are important milestones for consumers as well as the housing and labor markets, and are evidence of a moderate and steady forward movement.

Despite the slight decline in real GDP in the fourth quarter and prospects for modest growth in the current quarter, growth is expected to accelerate during the balance of this year. Private forecasters generally predict real GDP growth of 2.2 percent over the four quarters of 2013. The Administration remains committed to shoring up the gains we've made thus far and fostering stronger growth and more rapid job creation in the near term. At the same time, we must continue to work toward a balanced approach to putting our nation's finances on a fiscally sustainable path over the medium to long run.

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