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cc: Joe Stiglitz

Weekly Economic Briefing of the POTUS (9-13-96)

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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

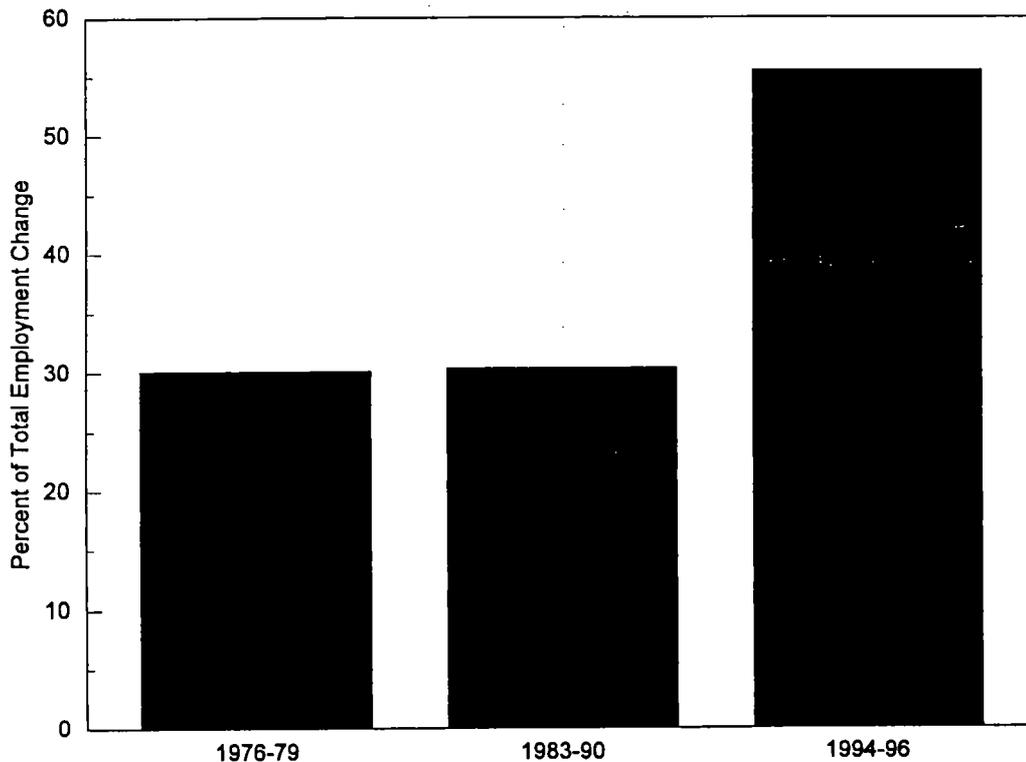
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

September 13, 1996

*For submission
Report - Admin
Loren Fisher
Mallett-Kuoyet
where is down
RJC*

CHART OF THE WEEK

Share of Employment Growth in High-Wage Service Sectors



A large proportion of recent job growth has come in high-wage managerial and professional occupations in service-producing industries. It is common for this sector to account for a large fraction of the new jobs created during periods of rapid job growth. But the share of new jobs coming from this sector has been substantially higher in recent years compared to expansions in the 1970s and 1980s. (Data discontinuities make it impossible to do a computation for the entire 1991-96 expansion.)

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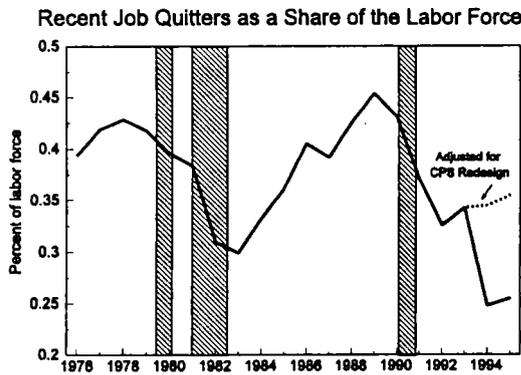
“Here’s a leading economic indicator, Dad. It’s only Tuesday and my weekly allowance is shot.”

CURRENT DEVELOPMENT

Worker Anxiety May Be Cause of Low Quit Rates

Currently, the rate at which workers quit to look for new jobs is unusually low. This might be a lingering manifestation of the worker anxiety that characterized earlier stages of this expansion.

Analysis. Workers are generally reluctant to quit their job during a recession, when finding a new job is difficult, even if the job they have is a bad match for them. During an expansion, however, more workers tend to quit because they think they will be able to find a more suitable job relatively quickly.



In the past, the fraction of the labor force accounted for by unemployed workers who recently quit their job displayed just this kind of cyclical pattern (see chart). In the current expansion, however, the proportion of the labor force made up of unemployed recent quitters is unusually low. The big fall in quits in 1994 may be an artifact of the redesign of the Current Population Survey that year. But quits are still relatively low for this point in the business cycle even after adjusting for this redesign effect.

Although workers may fear they will have a harder time finding a job in this recovery, other evidence suggests they may, in fact, be too pessimistic. The most recent survey shows, for example, that in 1993-94 the fraction of displaced workers experiencing long unemployment spells was comparable to that of the 1980s expansion. Moreover, the prospect for re-employment appears better now than in the 1980s.

Conclusion. The relatively low amount of unemployment attributable to quits may indicate continuing worker anxiety over the state of the labor market. Yet these concerns are not consistent with other labor market indicators suggesting that workers, in fact, are no more at risk of experiencing longer unemployment spells than in the 1980s.

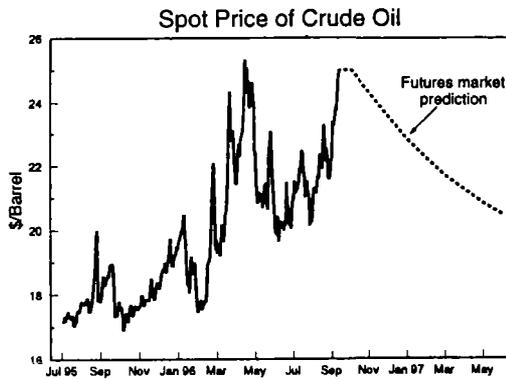
CURRENT DEVELOPMENT

Oil Prices Up after Attack on Iraq

Crude oil prices have risen sharply over the past 2 weeks in response to the situation in Iraq (see upper chart). Gasoline prices, which were on a downward trend, are now likely to remain relatively flat over the rest of the year (see lower chart).

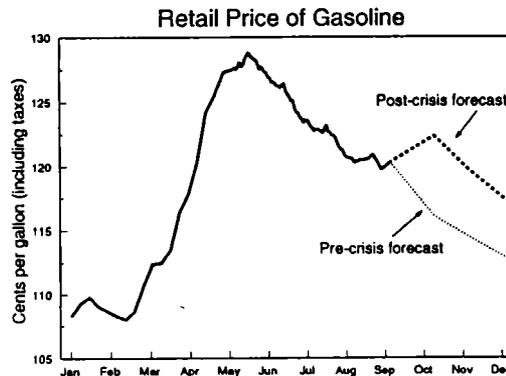
Implications for gasoline and heating oil prices. Changes in crude oil prices tend to show up at the gasoline pump with a lag of 6 to 8 weeks. Retail gasoline prices have been falling for the last 4 months

and they would normally be expected to drop further over the rest of the year as gasoline demand eases. Taking into account upward price pressures from rising crude prices (about 5 cents a gallon for a sustained \$2 a barrel increase in crude prices) and these normal seasonal factors, the Department of Energy is forecasting that prices will be slightly below today's level by the end of the year. Heating oil prices, by contrast, which normally rise 5 or 6 cents in the second half of the year, are now expected to rise somewhat faster than that.



The future. Crude oil futures prices suggest that market participants still expect the impact of the Iraqi

crisis on oil prices to be short-lived. Spring futures prices for crude oil are substantially lower than the spot price (see upper chart). The June futures price closed Thursday at \$20.48 a barrel, which is over \$4.00 a barrel below the spot price. Nine-month-out futures prices are normally just over a dollar a barrel below the spot price.



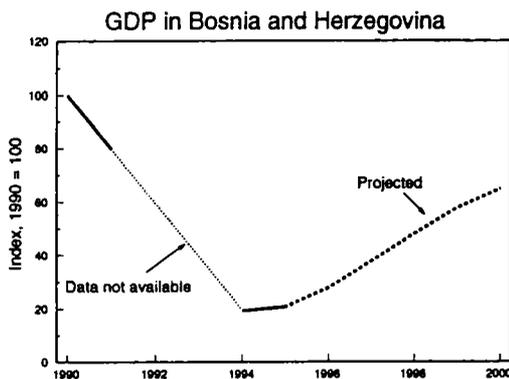
SPECIAL ANALYSIS

Bosnia: Economic Recovery Is Underway

Bosnians go to the polls tomorrow amid clear signs that an economic recovery is underway. After virtually grinding to a halt during the war, the economy of Bosnia and Herzegovina has been growing rapidly since the end of the war last year. The IMF projects that economic activity in Bosnia should climb back to about two-thirds of its 1990 level by 2000, provided economic reform, political integration, and international support continue.

Analysis. Even before the war, Bosnia was one of the two poorest Yugoslav republics, with the per capita income of a middle income developing country like Mexico. The 1992-95 war devastated the economy, particularly industry, and cut per capita income to a quarter of its prewar level. In 1994, industrial production in the Muslim-majority area was only about 1 percent of its 1991 level. Hyperinflations in both the Muslim and Serbian areas resulted when both governments ran their printing

presses overtime to finance war expenses. As a result, people have developed the habit of using the deutsche mark alongside domestic currencies.



After the peace between the Muslim and Croat areas in 1994 and particularly after the Dayton accords of late 1995, the Bosnian economy has recovered rapidly. Factories in the Muslim area began coming back on line late in 1994, and industrial production is up tenfold since

mid-1994 (although it is still only about 8 percent of its 1991 level). The Bosnian economy as a whole is estimated to have grown 7 percent in 1995 (see chart), and ballpark forecasts call for 30 to 40 percent growth this year. Prices fell some 40 percent last year in the Muslim-Croat area, as shortages diminished, and inflation throughout Bosnia has been moderate this year. Employment is rising, although more than half the workforce remains jobless. In the Muslim area, after-tax wages (measured in deutsche marks) have tripled in the last year.

Continued economic recovery depends on a number of factors besides peace and political security. The Bosnian economy has been based on a system of state ownership and worker management of factories. Sustained growth depends on the transition to a market economy. Growth also depends on the development of economic institutions, most notably a nationwide central bank to administer monetary policy and coordinate transaction flows.

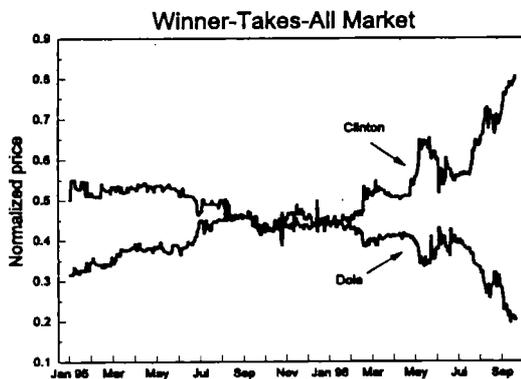
SPECIAL ANALYSIS

Predicting the Presidential Election Outcome through Markets and Econometrics

Public opinion polls are not the only way to predict election outcomes. Economists have developed statistical models that include economic variables. But another approach might be even better: a market test.

Econometrics and elections. Econometric models of election outcomes find that economic variables like GDP growth and inflation have important explanatory power. But at least one leading model, which worked quite well in predicting the 1984 and 1988 elections, went badly wrong in 1992. Efforts to adjust the model to explain the 1992 result may, however, be producing misleading predictions for 1996. The latest version of the model, which incorporates changes to explain 1992, predicts a narrow Democratic victory (51 percent of the two-party vote). But based on the model that worked well through 1988, the Democratic share of the two-party vote is predicted to be about 55 percent.

The Iowa Electronic Market. In January 1995, a little over 30 cents was enough to buy a contract that paid a dollar in the event of a Clinton victory in the 1996 Presidential election. Now that same contract costs almost 80 cents. A contract

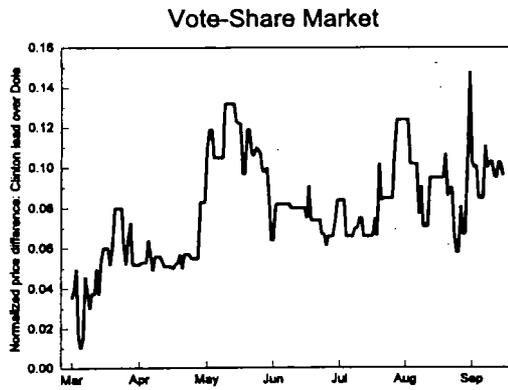


paying a dollar in the event of a Republican victory fell from over 50 cents to less than a quarter in the same time period (see chart). In horserace terms, the President has moved from a better than 2-to-1 underdog to a 1-to-4 odds-on favorite.

These are results from a real market in which people put their money where their opinions are—the Iowa Electronic Market (IEM). Transactions can be made over

the Internet and recent days have sometimes seen trading volume well over \$1000.

Besides the “winner takes all” market, the IEM also allows trading in “vote share” contracts that promise to pay a dollar times the candidate’s share of the two-party popular vote. This market, which was instituted in February, has shown a consistent 5 to 15 percent premium of Clinton contracts over Dole contracts (see chart on next page). On September 12, Clinton share contracts were trading at 55 cents and Dole share contracts at 45 cents, implying this market believes Clinton will capture 55 percent of the two-party vote. In the 1992 Presidential election, November 2 closing prices on the Iowa market provided better predictions than the major election-eve polls.



Summary. Unlike public opinion polls, which tell how people feel today, econometric models and IEM prices provide forecasts of the actual election results. The variables that drive the econometric forecasts are now largely known. But the Iowa Electronic Market may be the best place to look for an up-to-the minute election forecast.

Election Predictions on the Internet

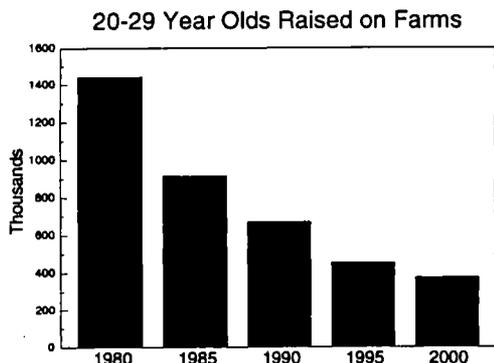
Up-to-date information on the Iowa Electronic Market is available on the Internet at: http://www.biz.uiowa.edu/iem/markets/1996_pre.html

The latest results of the econometric vote equation can be found on the Internet at: <http://fairmodel.econ.yale.edu/vote/vote.htm>

ARTICLE

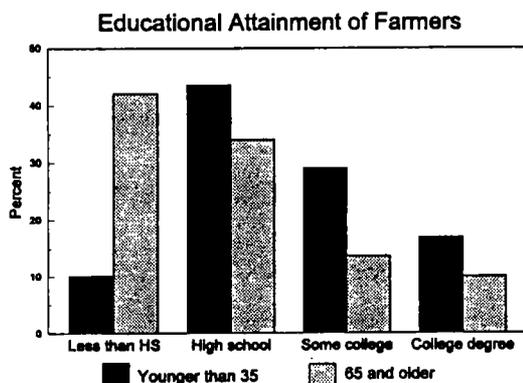
Demographic Changes and Technology Adoption in Farming

As discussed in the last *Weekly Economic Briefing*, nearly half of America's farmers are 55 or older. As these older farmers pass the torch to a younger generation, farms should become larger and more productive. The accession of a younger generation may also portend more environmentally friendly farming.



The New Generation. The next generation of farmers is quite different from those on the verge of leaving the industry. First, it is smaller. Historically, the most important group of potential farm entrants has been individuals in their twenties who were raised on farms. But this pool is shrinking dramatically (see top chart) as a result of off-farm migration and

because rural women are having substantially fewer children than they once did. One implication of the shrinking pool of farm entrants is that average farm size should increase over the next decade as farms get consolidated. This trend is reinforced by the newest agricultural technologies, which have substantial scale economies that impart a cost advantage to large farms.



The next generation is also more educated than its older counterpart (see lower chart). Nearly 90 percent of the nation's farmers under 35 have graduated from high school, and young farmers are also roughly twice as likely as farmers aged 65 and older to have at least some college experience.

A final difference is that younger farmers seem to be more than twice as productive as older farmers. In 1993, farmers under 35 produced \$198 worth of farm products per acre, compared to \$93 worth per acre for farmers 65 and over.

Age and technology adoption. The transition to a smaller but more productive population of farmers may have some impact on how much food is produced in the United States, but it will probably have an even more important effect on how food is produced. Demographic changes in agriculture should spread the adoption of new farming technologies. Young people entering farming are more educated and more

familiar with computers and basic science than are their exiting counterparts. Numerous studies of technology adoption have found educational attainment to be a leading factor encouraging the use of new methods.

Some of the most important new technologies are known as “precision agriculture,” which refers to farming where input use is tailored to local environmental conditions. For example, a precision irrigation system will deliver less water to clay soil with greater water-holding capacity than to sandy soil that does not retain water as well. Computers, farm machinery, and “software” like consulting and input scheduling programs are all important parts of precision agriculture. Precision agriculture improves productivity and also reduces the negative environmental consequences of farming by delivering inputs at the right time to just where they are needed.

Finally, younger farmers have a longer planning horizon than older farmers. Many technologies, especially environmentally friendly technologies, pay off over a long period. A technology that slows soil erosion, for example, may only preserve a fraction of an inch of topsoil in any given year, with scarcely any effect on profits in the short-run. Over decades, however, preventing erosion of soil also prevents erosion of profits.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Fed's Beige Book Shows Moderate Growth. Wages are rising as the economy continues to grow at a modest pace, but there is little evidence of inflation taking root, according to the Fed's latest regional survey. Somewhat slower growth was evident in several regions, but the San Francisco bank reported strong growth on the West Coast. Several regional banks reported "widespread" tightness in labor markets, especially in the Midwest. But higher wages do not seem to be putting much pressure on employers to raise prices. The Fed found that reports of substantial price increases were "notably absent," suggesting that the economy remains on a path of balanced, sustainable growth.

Good Environmental News from the Everglades. Sugar farming in Florida provides an illustration of how import restrictions that create economic distortions may also have undesirable environmental effects. But at least these sugar farmers have begun cleaning up their acts—and the water—in the Everglades. A recent report by the South Florida Water Management District shows that farmers have reduced the amount of phosphorus fertilizer discharged from their fields by 68 percent. Phosphorus runoff upsets the balance of the Everglade ecosystem and encourages the invasion of pests and plants that have suffocated thousands of acres of marshland. To reduce phosphorus runoff, farmers have been employing "precision agriculture" equipment that applies fertilizer in narrow bands directly on the roots; leveling their fields; and deploying sediment traps. Although this year's cleanup is substantial, the true success of phosphorus reduction will be seen only over a longer period of time.

Consumer Credit Still Climbing, but More Slowly. Consumer borrowing, which has been on the rise for 4 years, has grown at a slower pace in recent months. Over the 4 months ending in July, consumer credit expanded at a 7.3 percent annual rate, down from 11.6 percent in the first quarter and 13.3 percent last year. In part the slowdown likely reflects efforts by households to limit new borrowing following 2 years of very rapid credit growth. In addition, some banks have reported tightening standards and terms for consumer loans, especially in the fast-growing credit card sector, in response to a deterioration in average loan quality. Delinquency rates for consumer loans on banks' books have increased substantially in recent quarters, with the share of such loans 30 days or more past due rising to nearly 3.5 percent by the end of the second quarter, up about $\frac{3}{4}$ of a percentage point since late 1994. Nonetheless, with bank profits strong, bank capital levels robust, and overall troubled loan ratios near their lowest level in the last decade, the supply of credit from banks should remain ample. Moreover, despite the rise in consumer borrowing, household net worth remains at record levels.

9-14-96

INTERNATIONAL ROUNDUP

Club of World's Senior Central Bankers Opens Doors to Counterparts from Emerging Markets. The Bank for International Settlements (BIS), which calls itself the only international central banking institution, this week invited the central banks of nine countries to become members: Brazil, China, Hong Kong, India, Korea, Mexico, Russia, Saudi Arabia, and Singapore. This membership expansion, which brings the total number of members to 41, mirrors the increased economic and financial weight of a number of emerging markets over the last decade. Founded in 1930, the BIS is the world's oldest international financial institution. Its primary responsibility is to promote the cooperation of central banks and to foster international financial stability. The BIS can use its reserves of \$97 billion, equivalent to 7 percent of global foreign exchange reserves, to help central banks manage their external reserves.

U.S. Current Account Deficit Widens in Second Quarter. According to preliminary estimates released this week, the U.S. current account deficit increased to \$38.8 billion in the second quarter from a revised \$34.9 billion in the first quarter. The deficit on goods and services increased 15 percent over the first quarter, to \$27.9 billion. In goods trade, a slight increase in exports was outstripped by a 4 percent rise in imports, so that the goods deficit expanded by 10 percent to \$46.8 billion. The U.S. surplus in services trade increased somewhat, to \$19 billion. Investment income transactions shifted from a surplus of \$0.3 billion in the first quarter, to a deficit of \$1.6 billion in the second quarter. Much of this shift can be accounted for by a rise in direct investment payments to foreigners, which resulted from a surge in earnings of U.S. corporations.

World Wheat and Corn Production and Stock Forecasts Up. Projections of global wheat stocks are up slightly over last month's estimates, according to the latest World Agricultural Supply and Demand Estimates from the United States Department of Agriculture. Increased projections of domestic production and reduced projections for exports have led the USDA to increase its estimate of U.S. wheat stocks for next August, in advance of the 1997 harvest. Forecasts for domestic corn production show a slight increase over last month's projections. While the latest production projections are better than last month's, wheat and corn prices are still high due to low stocks.

RELEASES THIS WEEK

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, September 13, 1996****

The consumer price index increased 0.1 percent in August. Excluding food and energy, consumer prices also increased 0.1 percent.

Retail Sales

****Embargoed until 8:30 a.m., Friday, September 13, 1996****

Advance estimates show that retail sales increased 0.2 percent in August following an increase of 0.1 percent in July. Excluding sales in the automotive group, retail sales increased 0.2 percent in August following a 0.2 percent increase in July.

Producer Price Index

The producer price index for finished goods increased 0.3 percent in August. Excluding food and energy, producer prices declined 0.1 percent.

Productivity

Nonfarm business productivity increased 0.5 percent at an annual rate in the second quarter of 1996. Manufacturing productivity increased 2.2 percent.

MAJOR RELEASES NEXT WEEK

Industrial Production and Capacity Utilization (Tuesday)
U.S. International Trade in Goods and Services (Wednesday)
Housing Starts (Thursday)

U.S. ECONOMIC STATISTICS

	1970– 1993	1995	1995:4	1996:1	1996:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	1.3	0.3	2.0	4.8
GDP chain-type price index	5.3	2.5	2.1	2.3	2.2
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.5	0.3	-1.1	1.8	0.5
Real compensation per hour:					
Using CPI	0.6	1.4	1.6	0.0	-0.1
Using NFB deflator	1.3	2.1	2.8	2.0	1.6
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	10.2	10.2	10.4	10.3
Residential investment	4.5	4.0	4.0	4.1	4.2
Exports	8.2	11.1	11.4	11.3	11.2
Imports	9.2	12.4	12.3	12.5	12.6
Personal saving	5.1	3.4	3.8	3.6	3.2
Federal surplus	-2.7	-2.2	-2.1	-2.1	-1.7
<hr/>					
	1970– 1993	1995	June 1996	July 1996	August 1996
Unemployment Rate	6.7**	5.6**	5.3	5.4	5.1
Payroll employment (thousands)					
increase per month			219	228	250
increase since Jan. 1993					10508
Inflation (percent per period)					
CPI	5.8	2.5	0.1	0.3	0.1
PPI-Finished goods	5.0	2.3	0.2	0.0	0.3

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.

CPI data **embargoed until 8:30 a.m., Friday, September 13, 1996.**

FINANCIAL STATISTICS

	1994	1995	July 1996	Aug. 1996	Sept. 12, 1996
Dow-Jones Industrial Average	3794	4494	5496	5686	5772
Interest Rates					
3-month T-bill	4.25	5.49	5.15	5.05	5.14
10-year T-bond	7.09	6.57	6.87	6.64	6.88
Mortgage rate, 30-year fixed	8.35	7.95	8.25	8.00	8.28
Prime rate	7.15	8.83	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	Current level	Percent Change from	
	Sept. 12, 1996	Week ago	Year ago
Deutschemark-Dollar	1.515	2.0	3.0
Yen-Dollar	110.3	1.1	9.3
Multilateral \$ (Mar. 1973=100)	87.86	1.4	2.1

International Comparisons	Real GDP growth	Unemployment rate	CPI inflation
	(last 4 quarters)		(last 12 months)
United States	2.7 (Q2)	5.1 (Aug)	2.9 (Aug)
Canada	1.2 (Q2)	9.8 (Jul)	1.2 (Jul)
Japan	5.5 (Q1)	3.4 (Jul)	0.0 (Jun)
France	0.4 (Q2)	12.2 (Jun)	2.2 (Jul)
Germany	1.1 (Q2)	7.1 (Jun)	3.5 (Jul)
Italy	1.6 (Q1)	12.5 (Apr)	4.0 (Jun)
United Kingdom	1.8 (Q2)	8.1 (Jul)	2.2 (Jul)

U.S. CPI data embargoed until 8:30 a.m., Friday, September 13, 1996.