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001. routing slip	re: Weekly Economic Briefing (1 page)	03/24/2000	P1/b(1)

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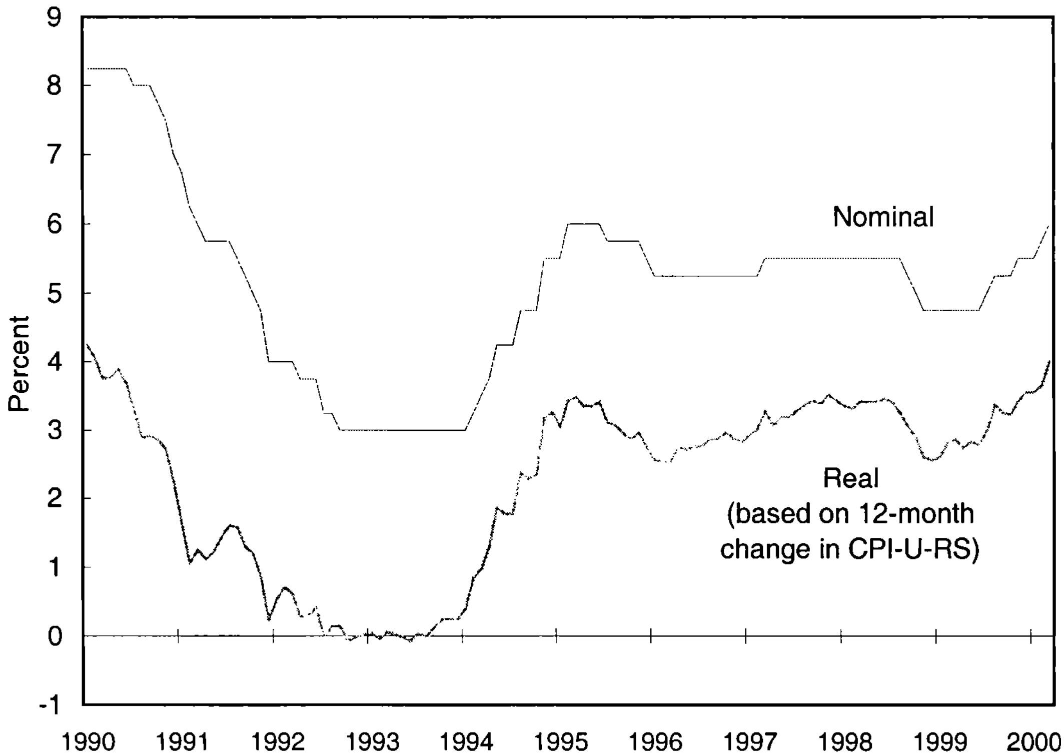
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 24, 2000

CHART OF THE WEEK

The Federal Reserve's Target Federal Funds Rate



This week the Federal Reserve raised its target for the federal funds rate for the fifth time since June. The current rate of 6 percent was last seen in June 1995. Trends in the real rate are sensitive to how inflationary expectations are measured, but according to one plausible measure, the real federal funds target is slightly higher now than it has been at any time since 1990.

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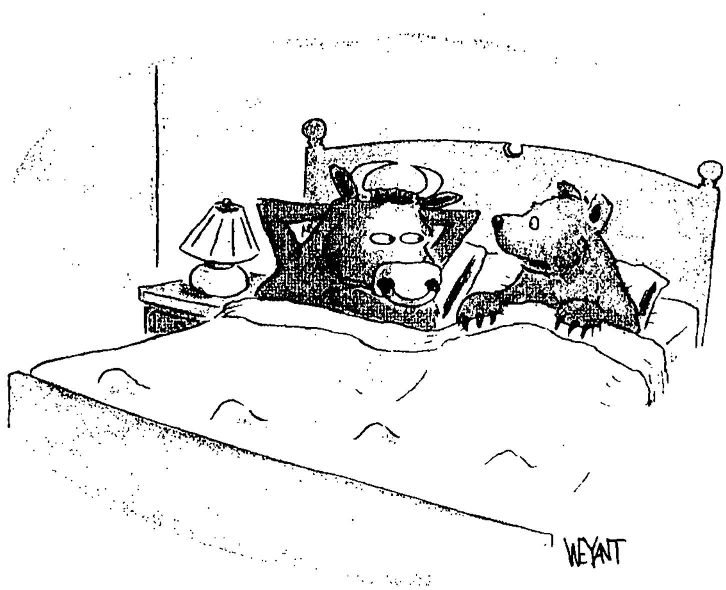


"Sure, it may be great for us, but it's hell on the markets."

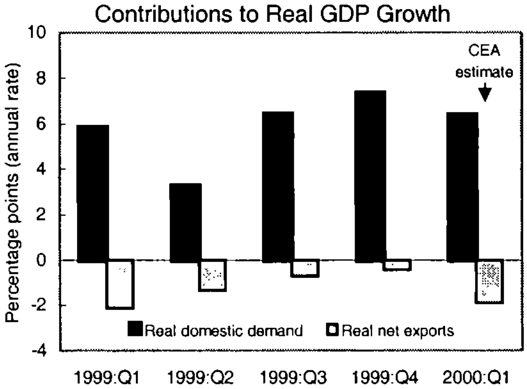
MACROECONOMIC UPDATE

The Boom Goes On

The economy continues to grow, with domestic demand remaining very strong. The consensus forecast for real GDP growth over the four quarters of 2000 has moved up to 3.4 percent, 0.7 percentage points above last November's consensus.

Domestic demand. Despite past concerns about a post-Y2K slump, real consumption appears to be growing at about a 6½ percent annual pace in the first quarter and is consistent with record levels of consumer confidence. Investment in computer-related equipment is also set for a solid gain after slowing in the fourth quarter. With domestic demand growing faster than domestic supply, imports are rising faster than exports so that net exports are reducing real GDP growth—at least based on January data (see upper chart).

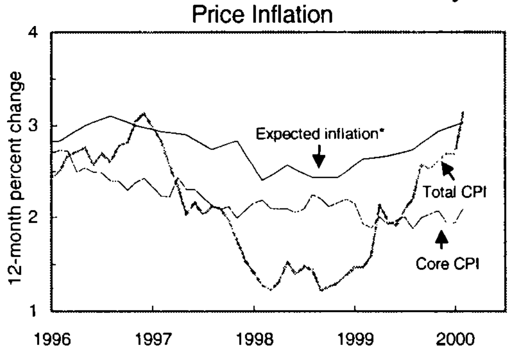
Contributions to Real GDP Growth



Jobs. Job growth was anemic in February (possibly because of unusual weather), but initial claims for unemployment insurance for the 4-week period through mid-March have fallen to the lowest level of this expansion. Despite the tight labor market, nominal increases in the ECI measure of hourly compensation have been stable for the past 3 years.

Inflation. Over the past 3 years, the recipe for low and stable inflation has included stable growth in hourly compensation offset by strong productivity growth and falling nonoil import prices. Thus far, the recent inflation pickup has been confined to petroleum products. The longer-term worry is that the boost to CPI inflation from petroleum prices will elevate wage demands and upset the balance between wages and productivity. Surveys of inflation expectations have started to move upward—but only modestly so far (see lower chart).

Price Inflation



* Quarterly average of median year-ahead expected inflation rate from the Michigan Survey of Consumers.

SPECIAL ANALYSIS

Where the Jobs Will Be in 2008

The latest Bureau of Labor Statistics projections of U.S. labor force, industrial, and occupational trends through 2008 show that the highest employment growth rates will be in job categories requiring higher levels of education. Nevertheless, most jobs will continue to require only a high school education.

Overall labor force growth. The labor force is projected to grow at 1.2 percent per year over the 1998-2008 period. Total growth in jobs is projected to be about 20 million. This labor force growth rate is roughly the same as that achieved over the 1988-98 period, but the demographic composition of the workforce will change.

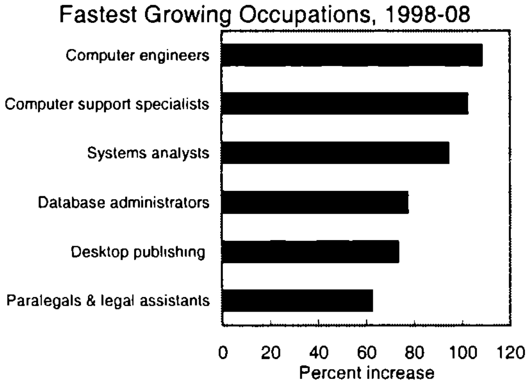
- More women. Women's labor force participation rates will continue to rise while those for men remain steady in most age groups, boosting the share of women in the labor force from 46 percent in 1998 to an estimated 48 percent by 2008. Women will account for an estimated 58 percent of the growth in the labor force during the period.

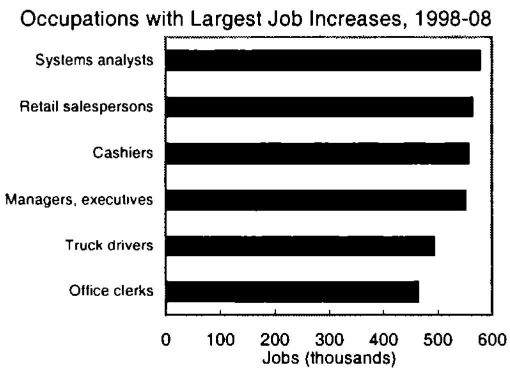
- More foreign born. Immigration will continue to play a major role in the growth of the labor force. The Hispanic labor force will expand nearly four times faster than the rest of the labor force, so that Hispanics will be 13 percent of the labor force by 2008, compared with 10 percent in 1998. Hispanics will account for an estimated 31 percent of the growth in the labor force during the period.

- An older workforce. The fastest growth in the labor force will be among those age 45 and older, reflecting the aging of the baby-boom cohort. This is expected to push the median age of the labor force to almost 41 years by 2008, a level not seen in several decades.

Growth by industry. As in the recent past, almost all of the increase in jobs will occur in the service-producing sectors. The computer and data processing services industry is expected to lead all others in the rate of employment growth, expanding by nearly 2 million jobs though 2008 (twice the gain of the 1988-98 period). The health services industries are also projected to experience substantial increases, adding nearly 3 million jobs. Rapid employment gains are also expected across a broad range of business and professional services. Employment in manufacturing, however, is expected to remain at current levels, as growth in output (especially in computers and other technology-intensive areas) is driven primarily by strong growth in productivity.

Growth by occupation. Of the top 30 occupations with the fastest projected employment growth rates from 1998-2008, two-thirds are computer or health-related occupations. The top five are all expected to be computer-related (see





upper chart). At the same time, however, other occupations, because of their large size, will experience large numbers of net new jobs even though they are expected to grow at average or below-average rates. Among the six occupations with the largest projected job increases, systems analysts will add the largest number over the period with a gain of nearly 600,000 (see lower chart). More broadly, the top 30 occupations with the largest job increases are concentrated in four industry sectors: retail trade (including salespersons, cashiers, and food service workers), business services, health services, and public and private education.

Education requirements. Many of the fastest growing occupations and those with the largest projected increases require post-secondary education. In fact, occupations requiring at least an associate degree, which accounted for one-fourth of all jobs in 1998, are projected to account for about 40 percent of total job growth from 1998 to 2008. However, the economy will continue generating jobs for workers of all levels of education and training: 57 percent of new jobs are projected to require no post-secondary education or training other than short-term on-the-job training, even though many of these occupations are projected to have below-average job growth rates.

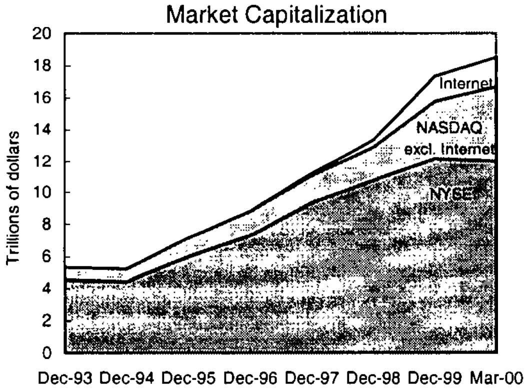
Implications. These BLS projections suggest that less-skilled workers will continue to have employment opportunities even as the proportion of jobs requiring more skills increases. Nevertheless, the substantial rewards to acquiring better skills and education are likely to continue.

ARTICLE

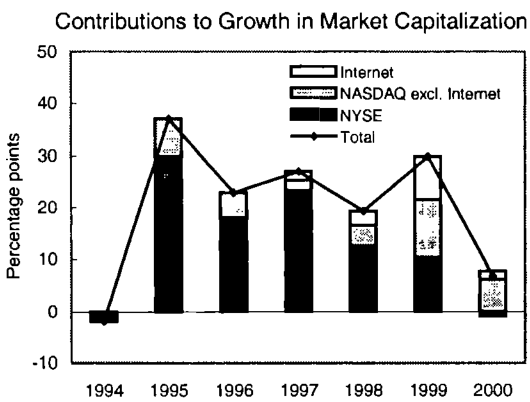
The Changing Stock Market and the Economy

Over the past 2 years, increases in stock market wealth have come disproportionately from technology and Internet stocks. It remains an open question, however, whether this has made the market more or less vulnerable to shocks or corrections and how the market will respond if interest rates keep rising.

Market capitalization. Stocks listed on either the New York Stock Exchange (NYSE) or the NASDAQ account for almost all of the market capitalization of U.S.-listed stocks. At the end of 1994, NYSE stocks had a market capitalization of about $4.4 trillion, with NASDAQ stocks adding another $0.8 trillion (see upper chart). In 1995-97, the market capitalization of each approximately doubled. Since 1998, however, the market capitalization of NASDAQ stocks generally and Internet stocks in particular have grown much faster than that of NYSE stocks. (Internet stocks are treated in the chart as a subset of NASDAQ stocks, because AOL is the only significant non-NASDAQ Internet stock). With a market capitalization of about $1.9 trillion (up from less than $0.2 trillion in December 1997), Internet stocks now represent about 10 percent of the combined NASDAQ and NYSE market capitalization of roughly $19 trillion. The share of NYSE stocks has fallen from 85 percent in December 1994 to 65 percent today.



Patterns of growth. With their larger initial market capitalization and roughly balanced growth across the two exchanges, NYSE stocks accounted for the bulk of the increase in stock market wealth in 1995-97 (see lower chart). By 1999, however, the bulk of the increase came from NASDAQ stocks. Looking at technology stocks more generally, almost half of the growth in the market capitalization of the Standard and Poor's 500 stocks (from about $4.6 trillion in 1995 to $11.5 trillion today) came from technology stocks, which now account for roughly a third of the S&P 500's market capitalization.



Is there froth? Although the stock market is at very high levels based on historical values of measures such as price-earnings ratios, no one can be certain that it is fundamentally overvalued. But suppose Internet stocks were to lose half their value. This would reduce stock market wealth by about $1 trillion. Based on the "wealth effect" rule of thumb that each dollar change in stock market wealth translates into a permanent change in consumption of about 3½ cents, this would cut consumption by about $35 billion, and knock perhaps a third to a half percentage point off GDP once investment and other effects were taken into account. Any assessment of how the overall market would react to such a sharp decline in Internet stocks is highly speculative. At times this year, investors have acted as though they regard technology and blue chip stocks as substitutes—when the NASDAQ falls the Dow goes up and vice versa. This would imply that a correction focusing on Internet stocks would not have a negative effect on the rest of the market and might even be offset by rallies elsewhere. But at other times, stocks have tended to move together suggesting that a decline could spread.

Interest rates and stock prices. Economic theory suggests that the value of a stock varies directly with the company's earnings prospects but inversely with interest rates (because the present value of future profits goes down when interest rates rise). This would suggest that higher interest rates would cause the prices of Internet stocks to go down since most of their expected profits are in the future. Nevertheless, fluctuations in the price of Internet stocks (and technology stocks generally) may be more sensitive to changing expectations about future profits than about changes in interest rates in the short run. Higher interest rates (particularly in the context of tighter monetary policy and slower growth) might, however, have a depressing effect on "old economy" stocks to the extent that real near-term profits are expected to go down.

What is the Fed up to? These considerations suggest that tightening monetary policy might affect spending through a stock market effect. However, any concern that the Federal Reserve is conducting monetary policy with an eye to cooling off the stock market appears to be misplaced. Rather, the Fed seems to be conducting monetary policy the old-fashioned way. Recent tightening seems motivated by a general concern that demand is growing faster than potential supply, threatening a buildup of inflationary pressures. Higher interest rates might or might not affect stock prices, but they would likely have the usual effects of slowing housing and other interest-sensitive spending. As these sectors slowed, the impact would then spread more widely.

Conclusion. Increases in stock market wealth, which recently have come disproportionately from technology and Internet stocks, are one factor that has fostered the ongoing strong growth in spending that the Fed is now trying to slow. But the Fed does not appear to be targeting the stock market per se, and it certainly is not trying to discourage the acceleration in productivity and future growth in potential supply that is probably an important factor contributing to the rise in stock prices.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

"Living Wage" Has Mixed Effects. A growing number of cities have recently implemented "living wage" ordinances mandating that companies with city contracts or receiving city assistance pay their workers a wage sufficiently high to support a family. These wages are typically much higher than Federal and state minimum wages, including the proposed higher Federal minimum wage. A recent study found that living wage ordinances do indeed boost the wages of low-wage workers. However, they also appear to raise the costs to employers of hiring such workers enough that employment rates of low-wage workers and the number of hours worked fall. These countervailing forces suggest there are winners and losers following a large legislated increase in wages. Those who remain employed earn a higher wage, but others are no longer employed or work fewer hours as a result. On balance, the study finds modest reductions in poverty rates associated with living wage ordinances. Thus, these findings suggest that living wage ordinances may help to achieve the goal of reducing urban poverty in the aggregate, but at the cost of lost employment and hours of work for some low-wage workers.

Railroad Mergers Stuck in the Station. Unlike most mergers, which are reviewed by the Federal Trade Commission or the Department of Justice (DOJ), railroad mergers fall under the jurisdiction of the Surface Transportation Board (STB), an independent agency in the Department of Transportation. Historically, critics have accused the STB of being too lax, for instance in approving mergers over the objections of the DOJ. Last week, however, the STB suspended all merger activity in the railroad industry for 15 months while it develops new guidelines. The move was prompted by advance notice of the proposed merger between the Burlington Northern and Santa Fe Railway Company (BNSF) and the Canadian National Railway Company (CN). The Board noted that the last round of railway mergers was accompanied by a number of serious service problems and that railroad stocks have been falling since. It also expressed concern that the merger between BNSF and CN will prompt another round of mergers that could leave the industry with only two major railroads serving North America.

How Wide is the Earnings Gap between Black and White Men? Following a substantial narrowing between the 1940s and the 1980s, the earnings gap between African American and white male workers remained stuck at 31 to 33 percent between 1982 and 1996, according to a recent study. In fact, the gap between comparable workers might be even wider. The study notes that African American men are more likely than whites not to be working or to be incarcerated. To the extent that those who are incarcerated or not in the labor force are relatively low wage workers, their absence from the labor force raises the average earnings of those who are working. The study estimates that if employment-to-population rates were the same for African American and white male workers, the earnings gap between them would be nearly 40 percent. It is worth noting that the study ends with 1996 data, and thus misses any improvement in the past few years when labor markets have been especially strong.

INTERNATIONAL ROUNDUP

High Oil Prices and Developing Countries. Oil consumption in developing countries has risen 5 percent per year over the last three decades, compared with 1 percent per year in OECD countries. Developing economies also rely more on energy-intensive manufacturing sectors to spur economic growth than do OECD economies, and they use on average more than twice as much oil to produce each unit of economic output. Thus, high oil prices may impose a particular burden on some developing countries. Indeed, the International Energy Agency (IEA) reports that the oil import bills of several developing countries, including India, the Philippines, and Thailand, have risen by more than 160 percent with the increase in oil prices of some 80 percent since April 1999. Higher oil import bills reduce trade surpluses, increase inflationary pressure, and may lessen the benefits of international development assistance. In the case of Thailand, the Philippines, and China, the extra oil bills are twice or more as large as foreign aid received. Higher oil prices may also weaken government budgets in countries that subsidize oil prices for domestic users. The IEA reports, for example, that the Indian Oil Pool Account, which manages the balance between domestic and international oil prices, has been drained by the high cost of oil imports.

FDI on the Rise in Mexico. Foreign direct investment into Mexico is expected to reach $12.4 billion in 2000, a 24 percent increase over last year, according to a survey of over 350 major foreign companies released by the Mexican Investment Board this week. About 200 new foreign plants will be built this year—a 36 percent increase. The industries with the largest projected investments are telecommunications (26 percent), automotive (18 percent), electronics (10 percent), and energy (10 percent). The release of this survey follows a recent upgrading of Mexico's foreign debt by Moody's Investor Service to investment grade. These positive developments in investor confidence are being hailed as a reflection of Mexico's global free trade alliances such as the free trade agreement with the European Union that Mexico will formally sign this week.

Addressing Inadequate Nutrition. Nearly a quarter of all newborns (30 million babies) in developing countries are low birthweight, and more than 150 million preschool children worldwide are underweight, according to a new report by the United Nations. As the report highlights, however, several countries have had considerable success in reducing the incidence of malnutrition. In Thailand, for example, the prevalence of underweight preschool children fell from over 50 percent in 1982 to 10 percent in 1996, and maternal death rates fell by over 90 percent. This was achieved through an approach that included weighing all pre-school children every 3 months; a program of nutrition education that encouraged breastfeeding and the timely introduction of foods and proper hygiene; the establishment of 5,000 school lunch programs; and the training of volunteers who monitored mothers and children in their communities. The UN report also suggests dietary changes, including increased vegetable and fruit consumption to prevent childhood blindness and other poor health outcomes and a major increase in fish and lean meat consumption in some communities, particularly South Asia.

RELEASES THIS WEEK

Advance Durable Orders

****Embargoed until 8:30 a.m., Friday, March 24, 2000****

Advance estimates show that new orders for durable goods decreased 2.3 percent in February, following a decrease of 2.2 percent in January.

U.S. International Trade in Goods and Services

The goods and services trade deficit increased to $28.0 billion in January from $24.6 billion in December.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—The Conference Board (Tuesday)
Gross Domestic Product (Thursday)

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.6	0.6	5.0	6.4
Real compensation per hour:					
Using CPI	1.0	1.7	1.4	2.1	0.8
Using NFB deflator	1.5	3.0	2.9	4.0	2.1
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	0.5
PPI-Finished goods	5.0	3.0	0.1	0.0	1.0

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

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 23, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	11120
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.73
10-year T-bond	5.26	5.65	6.66	6.52	6.08
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.23
Prime rate	8.35	8.00	8.50	8.73	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	March 23, 2000	**Week ago**	**Year ago**
Euro (in U.S. dollars)	0.969	-0.2	-11.2
Yen (per U.S. dollar)	107.5	1.7	-9.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.95	0.4	1.6

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.5 (Q4)	4.1 (Feb)	3.2 (Feb)
Canada	4.7 (Q4)	6.8 (Jan)	2.3 (Jan)
Japan	0.0 (Q4)	4.7 (Dec)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.7 (Jan)	1.7 (Jan)
Italy	2.1 (Q4)	11.1 (Oct) [2]	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Nov)	1.9 (Jan)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.
2/ Data from OECD standardized unemployment rates.

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