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COUNCIL OF ECONOMIC ADVISERS
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THE CHAIRMAN

February 25, 2000

MEMORANDUM FOR: SEE DISTRIBUTION

SUBJECT: WEEKLY ECONOMIC BRIEFING – FEBRUARY 25, 2000

Please replace page 3 of the Weekly Economic Briefing dated February 25, 2000.

DISTRIBUTION:

The Honorable Sean Maloney
For the President

The Honorable Albert Gore
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THE PRESIDENT HAS SEEN
2-28-00

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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

February 25, 2000

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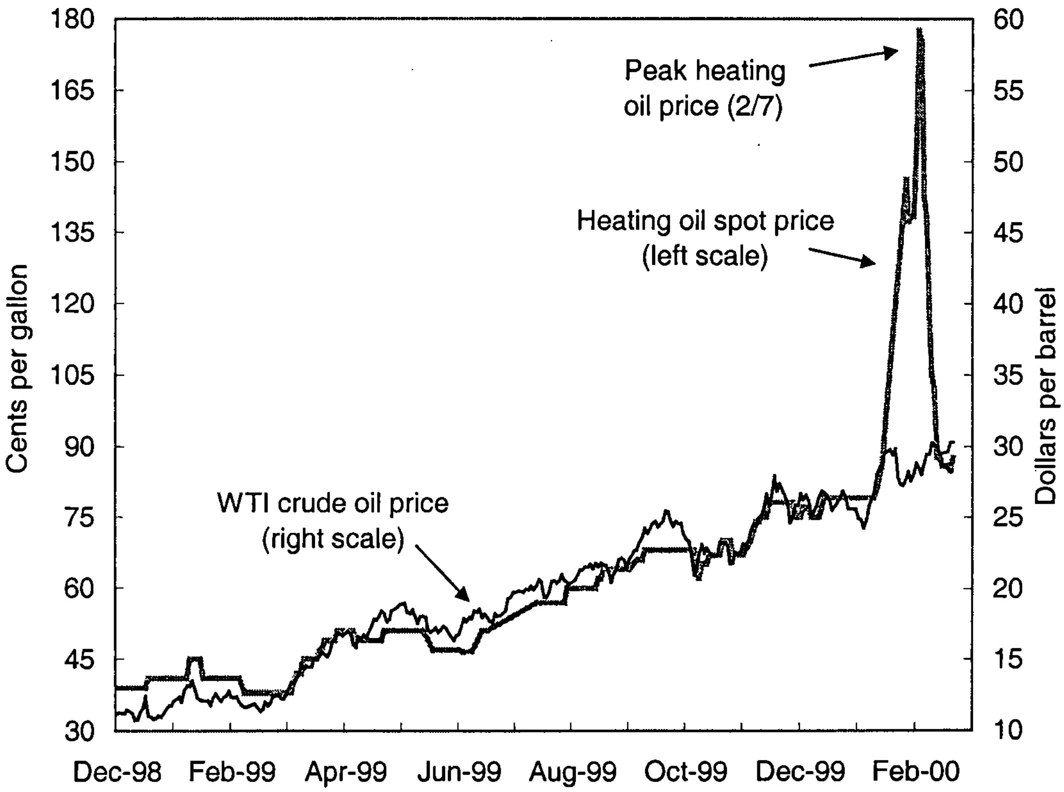
CHART OF THE WEEK

Heating Oil Prices Fall Back in Line with Oil Prices



The spot price for heating oil (and diesel fuel) skyrocketed in late January and early February, but has since dropped back to a level about 10 percent above that at the end of last year. Except for this short-lived spike, the prices of heating oil and diesel fuel have tended to follow closely the price of West Texas Intermediate crude oil, which has more than doubled during the past year.

THE PRESIDENT OF THE UNITED STATES

WEEKLY ECONOMIC BRIEFING

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

February 25, 2000

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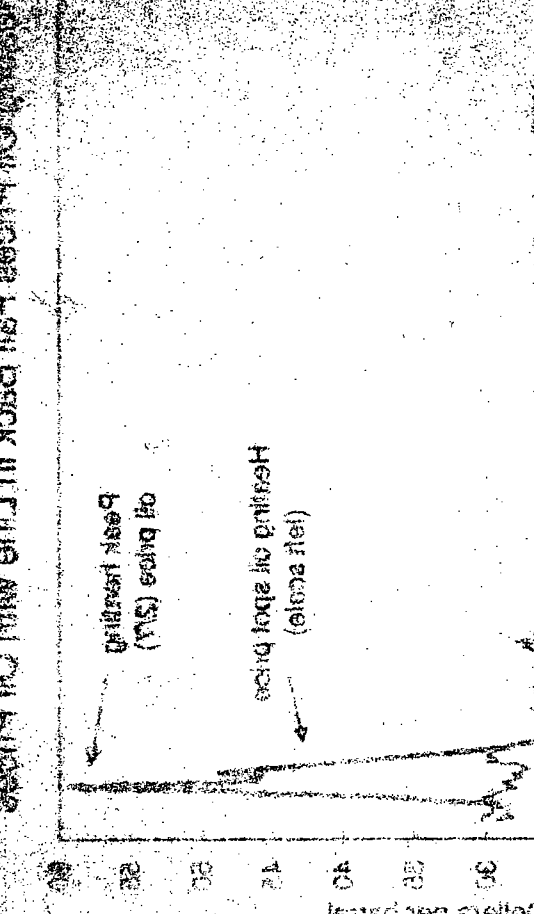

The spot price for heating oil (and diesel fuel) skyrocketed in late January and early February, but has since fallen back to a level of about 90 cents per gallon. Except for the early February spike, the spot heating-oil price has tracked closely the price of West Texas intermediate crude, which has more than doubled during the past year.

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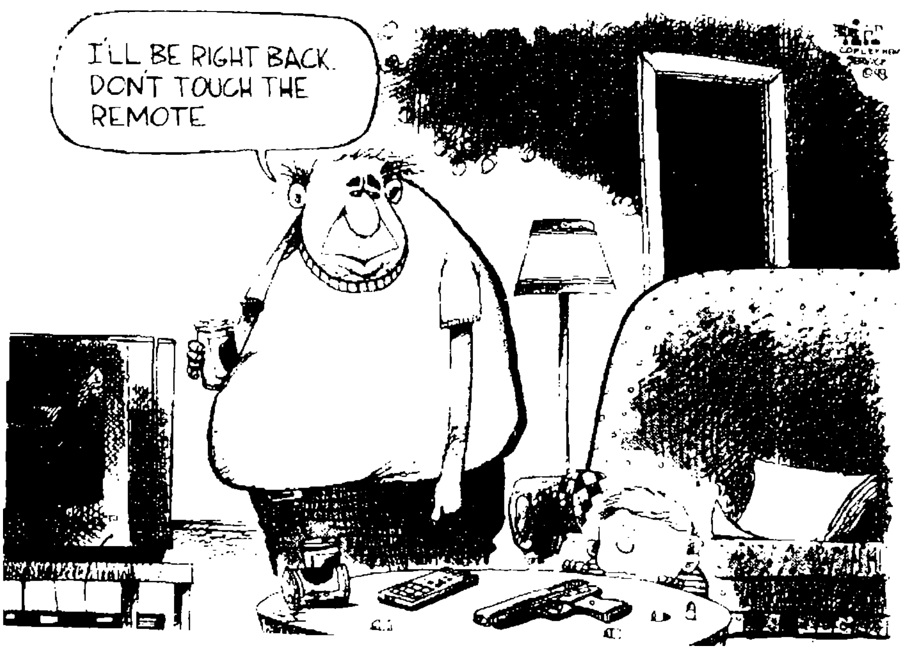
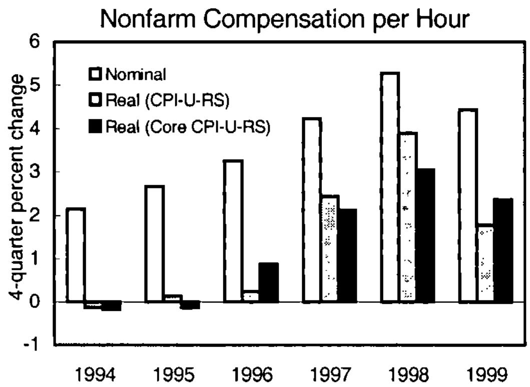


CURRENT DEVELOPMENT

What Is Really Happening to Wages?

An article in the *New York Times* this weekend noted that growth in real wages slowed markedly in 1999 and suggested that economists are floundering in their search for an explanation. Much of the mystery is removed, however, once changes in the inflation rate associated with volatility in energy prices are taken into account. Moreover, underlying trends in productivity and inflation augur well for continued solid growth in real wages.

Trends in real compensation. Following a period of acceleration between 1994 and 1998, nominal compensation per hour in the nonfarm business sector slowed somewhat during 1999 (see chart). Because consumer price inflation declined rapidly between 1996 and 1998 and then rose in 1999, the rise and subsequent decline in growth in real hourly compensation (the gray bars in the chart) is more exaggerated than that of nominal compensation. (Growth in average hourly earnings, which exclude nonwage compensation like employer health insurance contributions, shows a similar pattern.)



Analysis. While the CPI is an appropriate deflator for assessing year-to-year changes in the purchasing power of wages, the volatility of energy prices may obscure longer-term trends in inflation, and hence in real wages. This appears to have been the case in 1997-99. When real hourly compensation is computed using the core CPI (which removes the volatile food and energy components), the faster growth in 1998 and abatement in 1999 is much less pronounced (as shown by the black bars in the chart). Over the longer term, real wages tend to track productivity, which has been growing very strongly recently. The Administration forecast foresees continued strong productivity growth, with real hourly compensation increasing about 1.5 percent per year for the next several years.

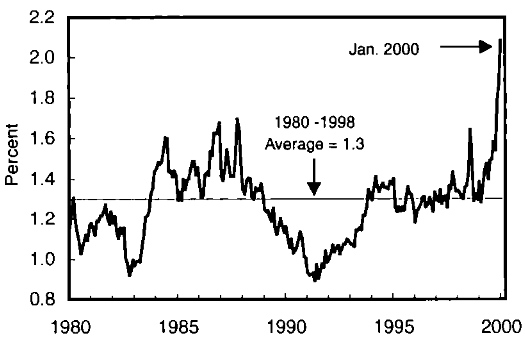
CURRENT DEVELOPMENT

Margin Debt

Margin debt at New York Stock Exchange (NYSE) member firms increased sharply in the last 4 months. Stock speculation has been suggested as a possible explanation for this rise in margin debt, but as yet we lack clear evidence to support this contention.

What is margin debt? Margin debt is money that investors borrow using financial investments for collateral, allowing them to leverage their investments. The Federal Reserve Board sets the maximum portion of the value of investments that investors can borrow, called the margin requirement (currently 50 percent). The industry then sets an additional requirement: if the ratio of the value of the debt to the value of the collateral rises above a specified value, the investor faces a margin call. She must then put up more money or sell her collateral investments to bring down the margin debt so that the ratio of debt to collateral is again below the specified level.

Margin Debt as Percent of Total Market Value



Source: New York Stock Exchange.

Margin mania. During most of the 1980s and 1990s, the total margin debt of NYSE member firms has been a tiny fraction of the total value of NYSE stocks, ranging from about 0.9 to 1.7 percent (see chart). Starting in November 1999, however, investors began borrowing more heavily against their equity holdings, pushing the ratio up to 2.1 percent in January of 2000.

The risks of leveraged stock buying. Some have suggested that the recent spike in margin debt demonstrates the willingness of some investors to use margin debt to purchase stocks that they otherwise could not afford. By leveraging the initial investment, this strategy holds the potential for big gains, but it also entails more risk than the outright purchase of stocks, especially because a margin call could necessitate selling when the market is down. Small investors who are heavily leveraged using margin debt and who lack other lines of credit may suffer significant losses and even have their holdings entirely wiped out. Moreover, if investors start a sell-off in response to margin calls, this could conceivably exacerbate a market downturn.

We just don't know. Stock market speculation is just one possible reason for rising margin debt. Other factors such as relatively low margin interest rates or increased convenience of margin borrowing could be at work. Because of the complexity and potential importance of these issues, the SEC has declared its intention to study and report on the matter.

THE PRESIDENT HAS SEEN
2-28-00

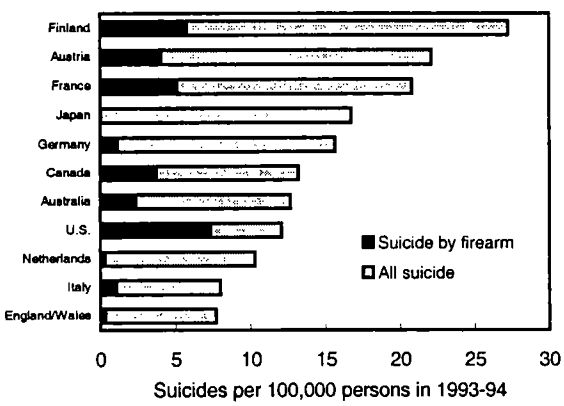
ARTICLE

Guns and Suicide

Although it is well known that the United States has high levels of gun violence and gun homicide, less publicized is the role of guns in suicide. In fact, far more Americans died from gun suicide in 1997 (17,566) than from gun homicide (13,252).

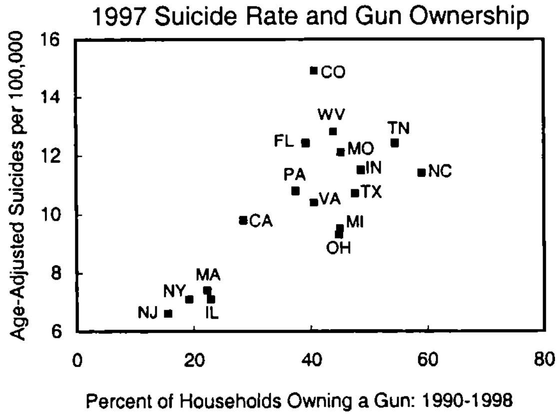
Suicide in the United States and abroad. Suicide is the eighth leading cause of death for all Americans and the third leading cause among young people aged 15 to 24. And while women are twice as likely to report a history of attempted suicide, men composed 80 percent of suicides in 1997. Although the U.S. suicide rate overall is not especially high relative to other industrialized countries, the rate of suicide by firearm is 5 times higher in the United States (see upper chart). Guns were used in 58 percent of U.S. suicides in 1997. Suicide is a growing problem among the young in America: from 1952 to 1995, the incidence of suicide among adolescents and young adults nearly tripled. The suicide rate for children in the United States is twice that of the average in other industrialized countries.

Suicide Rate: Selected Industrialized Countries



More guns, more suicides. The cross-country comparison does not show a strong relationship between the suicide rate and guns, but other evidence supports the conclusion that in the United States suicide is more likely to occur when guns are present, especially among youth. For example, comparisons of suicide attempts with suicide deaths demonstrate that having a gun in the home increases the likelihood of suicide death among adolescents. Similarly, state gun ownership rates in the 1990s are strongly correlated with state suicide rates in 1997 (see lower chart). The fact that overall suicide rates, and not just the incidence of gun suicides, is correlated with gun ownership suggests that guns are not merely another means of committing suicide, but instead contribute to the total incidence of suicides.

1997 Suicide Rate and Gun Ownership



Guns are different. A gun is an especially lethal means of suicide. One Canadian study found that 92 percent of suicide attempts using guns resulted in death compared with 78 percent for carbon monoxide and 23 percent for drug overdoses. Considering that an estimated 8 to 25 attempts are made for each suicide, the lethality of gun suicide suggests that the prevalence of guns may increase the rate of suicide death. Furthermore, evidence that suicide attempts are often impulsive, especially for youth, implies that guns may increase the overall suicide rate.

Conclusion. Research indicates that the prevalence of guns may lead to more deaths by suicide than would otherwise be the case. Moreover, with approximately one-third of handguns stored loaded and unlocked, guns present a risk not just to the owner, but to family and friends as well. Not surprisingly, one study finds that the majority of young people attempting suicide with a firearm used a parent's gun. One potential means of reducing such tragedies is to restrict access to firearms through secure storage and "smart gun" technologies.

THE PRESIDENT HAS SEEN
2-28-00

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Long Work Hours Have Small Effect on Divorce. Many believe that long work hours are a major contributing factor to divorce; however, a study concludes that while long hours do have some effect on the divorce rate, their importance may not be as large as commonly thought. Adding 10 hours to a married man's work week raises the probability of divorce within 2 years by between one-tenth and one-half of 1 percentage point while increasing a wife's hours by the same amount leads to an increase of two-tenths of 1 percentage point, according to a recent study. Income is also a determinant of divorce; an increase in the husband's income decreases the probability of divorce whereas an increase in the wife's income raises the probability of divorce. The author notes, however, that it is often difficult to establish whether long hours are the cause or the effect of a divorce. People who are getting divorced may work long hours for financial reasons, or to avoid their spouse.

States Offer Housing Subsidies in Welfare to Work Programs. In the last 2 years, several states and two counties in California have used Federal TANF or state Maintenance of Effort funds to establish programs providing housing assistance to families attempting to make the transition from welfare to work. Research suggests that affordable housing can be an important component of economic self-sufficiency. Recent studies have shown that families who receive housing subsidies work more hours and have greater earnings than families without such assistance. One possible explanation is that housing subsidies help stabilize the lives of low-income families by preventing repeated moves, thereby improving their ability to secure and retain jobs. Also, housing subsidies allow families to move to areas with greater job opportunities and free up funds for work-related expenses such as child-care, work clothes, and transportation.

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welfare surplus

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Are Oil Shocks Inflationary? A recent study suggests that although changes in oil prices affected overall inflation, they had little effect on core CPI (CPI excluding food and energy) inflation during the 1980s and 1990s. In contrast, oil price changes were found to contribute substantially to core inflation in the 1960s and 1970s. An oil price hike can, in principal, initiate a wage-price spiral as the increase in energy costs causes workers to demand higher wages to protect their standards of living; businesses, facing higher energy and wage costs, are then under pressure to raise prices to preserve profit margins. In the 1970s and early 1980s, the greater prevalence of automatic cost-of-living adjustments (COLAs) indexed to the rate of inflation may have facilitated this process of escalating wage and price increases. In addition, energy used to make up a much larger share of consumer spending then it does today. Another possible explanation for the change in behavior of core inflation is that monetary policy became much less accommodative of oil price shocks during the last two decades. In this view, the Fed reacted quickly to snuff out incipient inflationary pressures resulting from oil price changes. If this pattern continues, this research suggests that the recent rise in oil prices should have little effect on core inflation, even as overall inflation rises for a time.

INTERNATIONAL ROUNDUP

Participatory Democracy Brings High-Quality Growth. To receive the full benefits of a market economy, countries need a supportive institutional framework—one that, among other things, protects property rights, curbs corruption and anti-competitive behavior, and mitigates risks and social conflicts. A recent study examines how developing countries may acquire the appropriate institutions to facilitate market-based development and argues that it is important to recognize the importance of "local knowledge." It argues that strategies for institution-building must not over-emphasize an inflexible best-practice "blueprint" at the expense of experimentation at the local level. Furthermore, the study presents evidence that, compared with other political regimes, participatory democracies are associated with more predictable and stable growth, greater resilience to shocks, and a better income distribution. It concludes that participatory political systems are more effective at incorporating local knowledge, and recommends democracy as a general strategy for building good institutions to support economic development.

UNDP on China's Human Development. The latest China's Human Development Report released by the United Nations Development Program examines how the how the movement toward a market-based economy and the relaxation of state controls have affected people's livelihoods in China. Since reforms began in 1978, individuals have gained increased freedom in their daily lives as well as greater access to goods, services, and information; indicators of life expectancy, health, and literacy have also continued to improve. However, the report notes that despite rapid growth and substantial efforts in rural poverty alleviation, major challenges remain. Urban unemployment and poverty have surged. This development is in part attributable to increasing migration from rural to urban areas and to the reform of state-owned enterprises, which has led to layoffs of millions of state employees. Moreover, the disintegration of the social safety net is a growing cause of concern for the more socially vulnerable groups, including the aged, the ill, and the unemployed.

Agricultural Performance Weak in Africa. Africa was the only region in the developing world where per capita food production declined between 1961 and 1997, putting the food security of a large segment of the population in a precarious position. Growth rates in crop yields over that period lagged behind those of other developing regions, and Africa's market share for traditional export crops fell significantly. A new report by the UN Food and Agriculture Organization (FAO) attributes the declining performance of agriculture in Africa to price distortions, overvalued currencies, and abnormally low investment in infrastructure and institutional development. Agriculture in sub-Saharan Africa accounts for 70 percent of total employment, 40 percent of merchandise exports, and 34 percent of GDP, yet it received less than 10 percent of public expenditures over 1961-97. To increase productivity, the FAO proposes that African governments focus investment on infrastructure such as irrigation, dams, and transportation as well as providing better market information.

RELEASES THIS WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, February 25, 2000****

According to revised estimates, real gross domestic product grew at an annual rate of 6.9 percent in the fourth quarter of 1999.

Advance Durable Orders

Advance estimates show that new orders for durable goods decreased 1.3 percent in January, following an increase of 6.3 percent in December.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
NAPM Report on Business (Wednesday)
Leading Indicators (Thursday)
Employment (Friday)

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	3.3	0.6	5.0	5.0
Real compensation per hour:					
Using CPI	1.0	1.8	1.2	2.0	1.1
Using NFB deflator	1.5	2.9	2.9	4.0	1.8
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	November 1999	December 1999	January 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	4.0
Payroll employment (thousands)					
increase per month			257	316	387
increase since Jan. 1993					20790
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	0.2
PPI-Finished goods	5.0	3.0	0.2	0.1	0.0

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

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, February 25, 2000.**

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 24, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	10093
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.63
10-year T-bond	5.26	5.65	6.28	6.66	6.36
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.31
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level February 24, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.993	0.7	-9.5
Yen (per U.S. dollar)	111.0	0.6	-9.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.52	0.1	0.5

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)	4.0 (Jan)	2.7 (Jan)
Canada	4.2 (Q3)	6.9 (Dec)	2.6 (Dec)
Japan	1.0 (Q3)	4.6 (Nov)	-1.1 (Dec)
France	2.9 (Q3)	10.4 (Dec)	1.3 (Dec)
Germany	2.3 (Q4)	8.8 (Dec) 2/	1.2 (Dec)
Italy	1.2 (Q3)	12.1 (Apr)	2.1 (Dec)
United Kingdom	1.8 (Q3)	5.9 (Oct)	1.8 (Dec)

U.S. GDP data **embargoed until 8:30 a.m., Friday, February 25, 2000.**

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.

2/ Rate for unified Germany.