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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

BE

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

June 2, 2000

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Entire Report:
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Pg. 2
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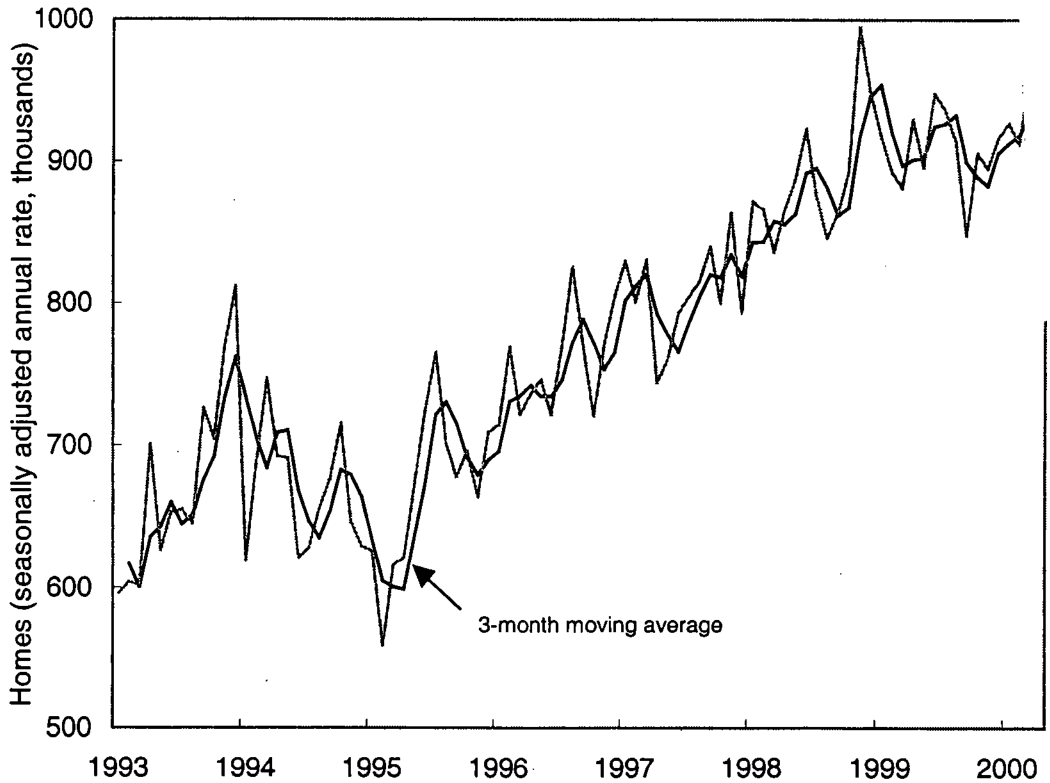
CHART OF THE WEEK

New Single-Family Home Sales



This week's data on new home sales in April showed a sharper-than-expected monthly drop of 5.8 percent. Although the level of new home sales remains high, the drop in April is consistent with other data on housing starts and existing home sales which suggest that the Federal Reserve's tightening of monetary policy may be beginning to affect the housing market.

420697

THE PRESIDENT OF THE UNITED STATES

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June 2, 2005

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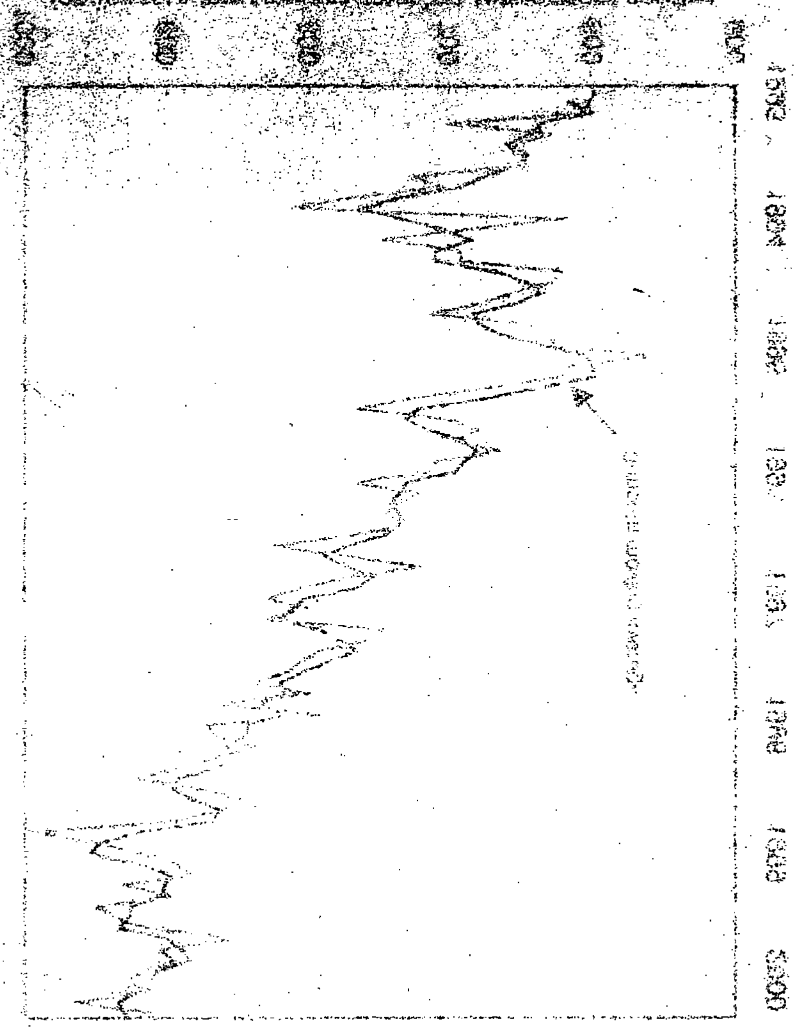

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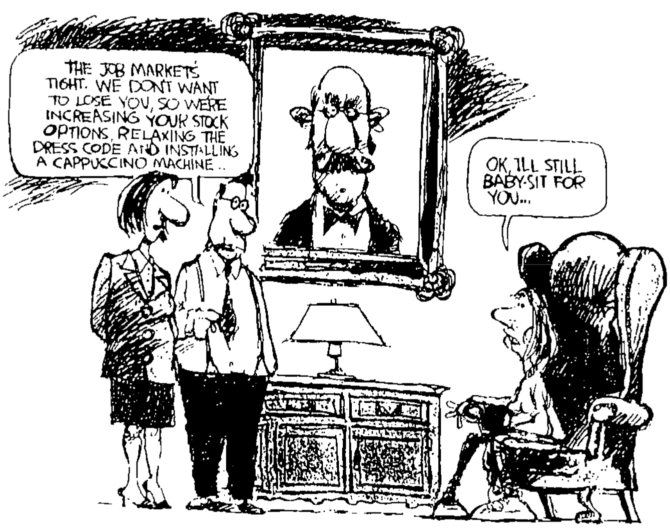

THE JOB MARKET'S TIGHT. WE DON'T WANT TO LOSE YOU, SO WE'RE INCREASING YOUR STOCK OPTIONS, RELAXING THE DRESS CODE AND INSTALLING A CAPPUCCINO MACHINE...
OK, I'LL STILL BABY-SIT FOR YOU...

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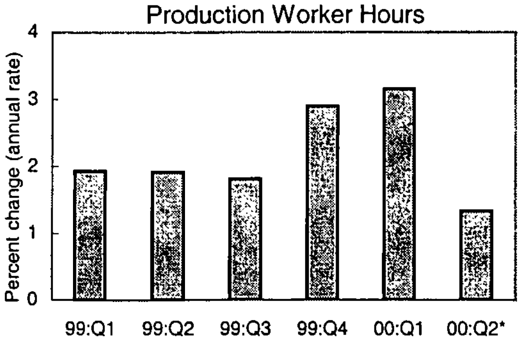
MACROECONOMIC UPDATE

Economy Likely to Slow in the Second Quarter

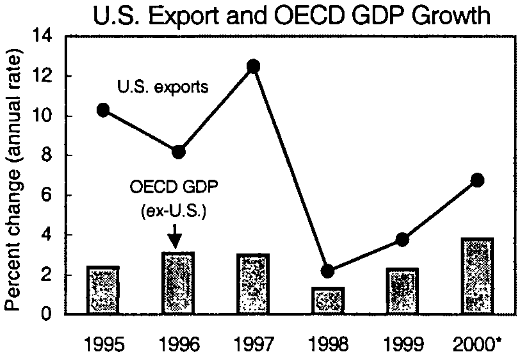
The decline of 116,000 in private payroll employment in May indicates a slowing of labor demand in the second quarter. Hours worked by production workers appear to be up about 1¼ percent at an annual rate from the second quarter, a slowing from their earlier pace (see upper chart). This growth in hours could support real GDP growth in the 3 to 4 percent range.

Production Worker Hours



* Second-quarter estimate based on April and May data.

U.S. Export and OECD GDP Growth



* 2000 figures for export and GDP growth are first-half estimates.

The shape of demand. Domestic demand has grown faster than domestic production for most of the past 4 years, with imports growing faster than exports. But domestic demand may have moderated in the second quarter according to fragmentary data on consumption, housing, and equipment investment.

Exports. Prospects for U.S. export growth in 2000 are improving. GDP growth in the rest of the OECD, which had averaged only 1.8 percent in 1998 and 1999, is now expected to increase at a 3¾ percent annual rate in the first half of 2000. The acceleration in foreign GDP may account for a pickup in U.S. exports to about a 7 percent annual rate (see lower chart).

Inflation. After years of low and stable inflation, it appears that price inflation has edged up—but only slightly. The four-quarter change in the GDP price index—at 1.8 percent—was 0.5 percentage point above its year-earlier rate, although the core CPI has shown only a 0.2 percentage point acceleration. One measure of hourly compensation, the Employment Cost Index, has accelerated much more (1.5 percentage points). Thus far, these wage increases have been largely offset by higher productivity growth.

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SPECIAL ANALYSIS

The Economics of Standards

One goal of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) was to reduce health care costs and administrative burdens by setting standards for the electronic transmission of many administrative and financial transactions between insurers, providers, and other health care institutions. This month the Department of Health and Human Services is expected to issue its first final rule to begin establishing such standards. In this particular case, standards may result in substantial cost reductions. But across industries, the question of when or whether the government should intervene to set standards can pose serious policy challenges.

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VP

Are market forces enough? Developing a standard requires solving a coordination problem among a potentially diverse set of consumers and producers. At times, a standard can emerge as a result of technological or market dominance. In some areas of today's economy, firms may seek an advantage by encouraging the adoption of their own technology rather than that of others. As firms compete to improve their products, new technologies may lead to better designs that then supplant the prevailing market standard. To the extent, for example, that a large majority of video cassette recorder consumers decided that they preferred the properties of VHS technology to those of Betamax, no explicit coordination was required for a de facto standard to emerge. Another way that firms may be able to overcome coordination issues is to use industry-based standard setting bodies. In other cases, however, the distribution of costs and benefits may be sufficiently uneven that voluntary coordination is not achievable. Even where the total industry-wide benefits exceed costs, some participants may incur net costs and be unwilling to switch to a new standard voluntarily. Government intervention may be necessary for a standard to be adopted.

The case of HIPAA. Insurance companies, health care plans, and providers currently use many different types of forms to transmit similar information. To receive payment, hospitals must support each insurance company's forms. Although hospitals may benefit on balance from reducing this administrative burden by having one standard way of transmitting information, each insurance company would also have to incur the costs of switching to a new system. Studies suggest that the long-run savings from adopting a standard might greatly exceed the additional costs imposed by requiring a common form. The uneven distribution of costs and benefits may have hindered the development of a voluntary industry-wide standard. The HIPAA legislation breaks this deadlock by requiring all firms to adopt a standard format for transferring information. An early industry analysis estimated annual savings for the transactions covered by HIPAA to range between $8.9 and $20.5 billion.

Conclusion. As the HIPAA example illustrates, firms may not always have the incentive to develop standards that would generate cost savings to the entire

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industry due to the costs of coordinating such a move. While government intervention can resolve this type of deadlock and increase economic efficiency, the imposition of standards by the government does carry some risks. For example, whenever the government chooses a standard, even one that is the best available at any point in time, the incentives to develop a better standard may be diminished. In addition, since government standards are typically slow to develop, government standards may sometimes take longer to develop than market-based solutions.

6-6-00

ARTICLE

Education and the Economic Success of Hispanics

Hispanics are a growing segment of the U.S. population. In 20 years about one in six U.S. residents will be of Hispanic origin, and by the middle of this century—when today's young children are middle aged—this ratio will increase to about one in four. Given the current educational attainment gap between Hispanics and other groups, a key to the future productivity of the U.S. labor force will be our ability to raise education levels among this expanding pool of workers. A forthcoming CEA analysis of Hispanics in the rapidly growing information technology (IT) sector illustrates the potential payoff to such an effort.

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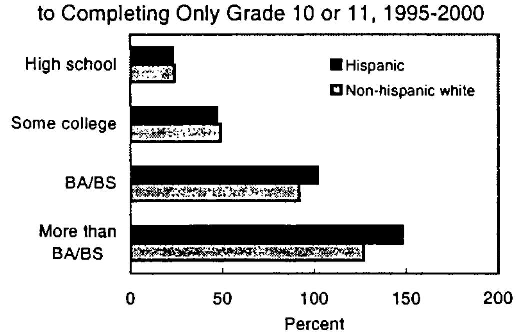
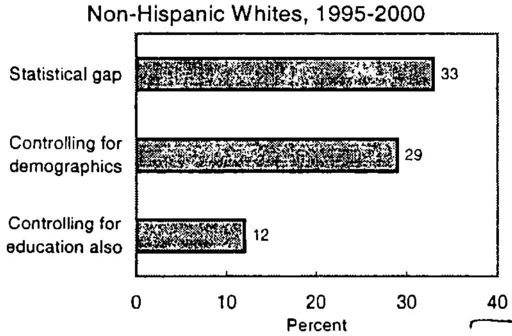
Educational lags among Hispanics. Compared with non-Hispanic groups, there are now substantial education gaps at all levels. The high school graduation rate for Hispanics aged 25 to 29 is about 63 percent—compared with about 90 percent for non-Hispanics (both black and white). The fraction of Hispanics who graduate from 4-year colleges is less than half that of non-Hispanic whites. Part of this education gap is attributable to low educational attainment of immigrants, but native-born Hispanics also drop out of high school at much higher rates than non-Hispanic whites.

Earnings Premium by Education Level Relative to Completing Only Grade 10 or 11, 1995-2000



Difference in Earnings between Hispanics and Non-Hispanic Whites, 1995-2000



Consequences for economic success. For Hispanics and non-Hispanics alike high school and college educated individuals have far higher earnings than those who complete 10 or more years of education, but fail to graduate from high school (see upper chart). However, analysis of data from 1995 to 2000 indicates that Hispanics earn 33 percent less than non-Hispanic whites.

A very small part of this gap is due to differences in gender and age composition; after adjusting for these demographic factors the gap is 29 percent (see lower chart). Rather, most of the earnings disparity is due to differences in educational attainment. After controlling for educational attainment, the gap declines to 12 percent.

Information technology: A case study. Analysis of employment and earnings in IT provides a vivid illustration of the importance of education in the new economy. (IT is defined here to comprise the following five occupations:

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electrical and electronic engineering, computer system analysts and scientists, operations and systems researchers and analysts, computer programmers, and computer operators.) IT is an important sector of the U.S. economy, characterized by both high employment growth and relatively high pay.

- Earnings. CEA analysis indicates that in IT Hispanics earn only slightly less than non-Hispanic whites (about 7 percent less after controlling for age, education, and gender), and that earnings of individuals in both groups are far higher than in other occupations. While the differential in median hourly earnings between the IT and non-IT occupations is 62 percent for non-Hispanic whites, it is 100 percent for Hispanics—reflecting the low earnings of Hispanics in non-IT jobs.

- Employment. While earnings are similar, there is a striking digital divide in the IT workforce, with Hispanics significantly underrepresented (4 percent of workers in IT occupations, compared with 11 percent of the full-time labor force). This Hispanic digital divide in IT does not reflect a marked lack of success of well-educated Hispanics who take IT jobs. Rather, it is indicative of a lack of the education needed to prepare Hispanics for these occupations. In particular, the digital divide in IT employment seems to stem from the low levels of college attendance among Hispanics.

Improving outcomes for Hispanics. Research has established that the gap in educational achievement between Hispanics and non-Hispanics begins at young ages. Research also indicates that ultimate educational outcomes are determined to a considerable extent by educational success at young ages. Programs aimed at older disadvantaged youth—for example, policies that lower economic barriers to higher education—may well be helpful for improving prospects of Hispanics. However, it is particularly crucial that educational policies address the ethnic, racial, immigrant-status, and economic-based education gaps that exist for young children.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Don't Rain on My Parade. Most states are currently enjoying the best fiscal health they have had in years. Annual budget surpluses have been substantial in many states, and some states have accumulated growing fund balances. Budget reserves and "rainy day funds" can serve an important function in protecting state budgets against the need to raise taxes or cut spending sharply in a downturn, limiting the kind of pro-cyclical fiscal policy that has often characterized state budgets in the past. However, the Center on Budget and Policy Priorities found that in fiscal 1999 only eight states had enough savings to maintain services through a 3-year recession without raising taxes. Since then, five of those states have enacted tax cuts. The shortfalls in these five states are now projected to range from 2.7 percent of general fund expenditures in Massachusetts to 10.4 percent in Michigan. Other states start out in an even less favorable position.

Changes in New Home Inventories. For much of the last four decades, the stock of unsold new homes has tracked new home sales very closely, including rising in boom years. But a recent study finds that since 1995 inventories have fallen behind rapidly rising sales. In part, the study argues, this decline reflects longer-term trends toward building larger and higher quality homes that require longer construction times (thereby slowing the response of inventories to cyclical fluctuations in sales and reducing desired inventories). For example, average square footage for new single-family homes rose from 1,700 in 1980 to 2,170 in 1998, and new homes are more likely to have extras such as central air conditioning, fireplaces, and multi-car garages. A second longer-term trend is the growing practice of selling homes before construction has begun. The study also notes that very strong demand in the current expansion may be straining industry capacity. The study concludes that the current low level of inventories offers some assurance that the homebuilding sector could weather a slowdown in sales without the dramatic decline in construction activity that has been seen in the past.

Unmarried Parents Are Not Necessarily Single, at Least at First. Most new unmarried parents agree substantially with the view that marriage and father involvement are important, according to a recent study. And despite not being married, about half of all such parents live together, and another 30 percent are romantically involved at the time of their child's birth. More than two-thirds believe that their chances of marrying are 50 percent or better and that it is better for children if their parents are married. The study argues that public policies and programs should build upon and maintain this commitment that exists at the "magic moment" of a child's birth. However, other findings suggest that this may be difficult. When asked about the qualities of a successful marriage, 90 percent of parents in Austin and more than three-quarters of parents in Oakland rated "husband having a steady job" as very important. Yet the study found that unmarried fathers had an average income of only $12,500 and about half lacked a high school degree, suggesting that increases in human capital and employment could play critical roles in the development and maintenance of stable families.

INTERNATIONAL ROUNDUP

OECD Economic Prospects Bright. OECD-wide output growth for this year is projected to be 4 percent, the fastest pace in a decade, according to the June 2000 *OECD Economic Outlook.* Aggregate unemployment is expected to decline by more than 2 million between 1999 and 2001, falling to 6.1 percent of the labor force. The euro area should see a particularly strong decrease in unemployment, from 10.1 percent in 1999 to 8.5 percent in 2001. This reflects projected real GDP growth of 3.5 percent this year and 3.3 percent in 2001. Japan is expected to grow 1.7 percent this year and 2.2 percent next year. The report warns that the recent strength of domestic demand in the United States is not sustainable and points to signs of inflationary pressure and the deterioration of the current account and net international investment position. OECD projections for U.S. growth are 4.9 percent this year slowing to 3.0 percent in 2001.

The Poor Suffer More from Inflation. The poor are more concerned about inflation than the rich, and inflation tends to reduce the relative income of the poor and increase poverty, according to a recent study co-authored by IMF First Deputy Managing Director Stanley Fischer. These findings complement those of World Bank researchers described in a recent *Weekly Economic Briefing.* Survey data for over 30,000 households in 38 countries—19 industrialized and 19 developing—show that within a country, the poor and less educated are more likely than the more advantaged to mention inflation as a top national concern. This is probably because the poor tend to hold relatively more cash, be less aware of or have less access to financial instruments that hedge against inflation risk, and depend more heavily on income that is not fully indexed to inflation. In addition, the study shows that several more direct indicators of the well-being for the poor—their share of national income, poverty rates, and real minimum wage—tend to deteriorate with high inflation.

Healthy Foreign Banks Can Be Stabilizing. A new study of the experiences of Mexico and Argentina in the 1990s finds that diversity of bank ownership contributed to greater stability of credit in recent crises and times of financial system weakness. In both countries, foreign banks had stronger loan growth rates than their domestically owned counterparts, with lower associated volatility contributing to greater stability in overall financial system credit. Importantly, the study found that bank health—not national ownership *per se*, has been the critical determinant of the growth, volatility, and cyclicality of bank credit. In Mexico, banks with higher impaired loan ratios (ILRs) had lower and more volatile rates of portfolio expansion than banks with less problematic portfolios. While the banking system overall showed a small contraction in credit during the 1995-99 period following the Tequila crisis, both domestic and foreign banks with low ILRs continued to extend credit steadily during this period, though their share of total lending was small. The study concludes that healthy foreign banks have emerged as an important source of funding for local investment and growth opportunities without raising the volatility of the financial system.

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, June 2, 2000****

In May, the unemployment rate was 4.1 percent; it was 3.9 percent in April. Nonfarm payroll employment increased by 231,000.

NAPM Report on Business

The Purchasing Managers' Index decreased 1.7 percentage points in May to 53.2 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

Leading Indicators

The composite index of leading indicators declined 0.1 percent in April.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 6.7 index points in May, to 144.4 (1985=100).

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)
Producer Prices (Friday)

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:3	1999:4	2000:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	4.6	5.7	7.3	5.4
GDP chain-type price index	5.2	1.6	1.1	2.0	2.7
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.7	5.0	6.9	2.4
Real compensation per hour:					
Using CPI	1.0	1.7	2.0	0.9	0.3
Using NFB deflator	1.5	2.9	4.0	1.8	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.7	12.5	13.0
Residential investment	4.5	4.4	4.4	4.4	4.4
Exports	8.2	10.8	10.8	10.9	10.9
Imports	9.2	13.5	13.8	14.0	14.3
Personal saving	6.6	1.7	1.5	1.3	0.4
Federal surplus	-2.8	1.2	1.4	1.2	1.9

	1970-1993	1999	March 2000	April 2000	May 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	3.9	**4.1**
Payroll employment (thousands)					
increase per month			**527**	**414**	**231**
increase since Jan. 1993					**22152**
Inflation (percent per period)					
CPI	5.8	2.7	0.7	0.0	N.A.
PPI-Finished goods	5.0	2.9	1.0	-0.3	N.A.

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, June 2, 2000.**

FINANCIAL STATISTICS

	1998	1999	April 2000	May 2000	June 1, 2000
Dow-Jones Industrial Average	8626	10465	10944	10580	10652
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.66	5.79	5.57
10-year T-bond	5.26	5.65	5.99	6.44	6.20
Mortgage rate, 30-year fixed	6.94	7.43	8.15	8.52	8.54
Prime rate	8.35	8.00	9.00	9.24	9.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 1, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.931	2.6	-10.9
Yen (per U.S. dollar)	108.7	1.2	-9.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	98.52	-1.0	2.5

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	5.0 (Q1)	**4.1** (May)	3.0 (Apr)
Canada	4.9 (Q1)	6.8 (Mar)	2.1 (Apr)
Japan	0.0 (Q4)	5.0 (Mar)	-0.8 (Apr)
France	3.3 (Q1)	9.8 (Mar)	1.3 (Apr)
Germany	2.3 (Q1)	8.4 (Mar)	1.6 (Apr)
Italy	2.1 (Q4)	11.3 (Jan)	2.3 (Apr)
United Kingdom	3.1 (Q1)	5.9 (Jan) [2]	3.0 (Apr)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, June 2, 2000.**

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.