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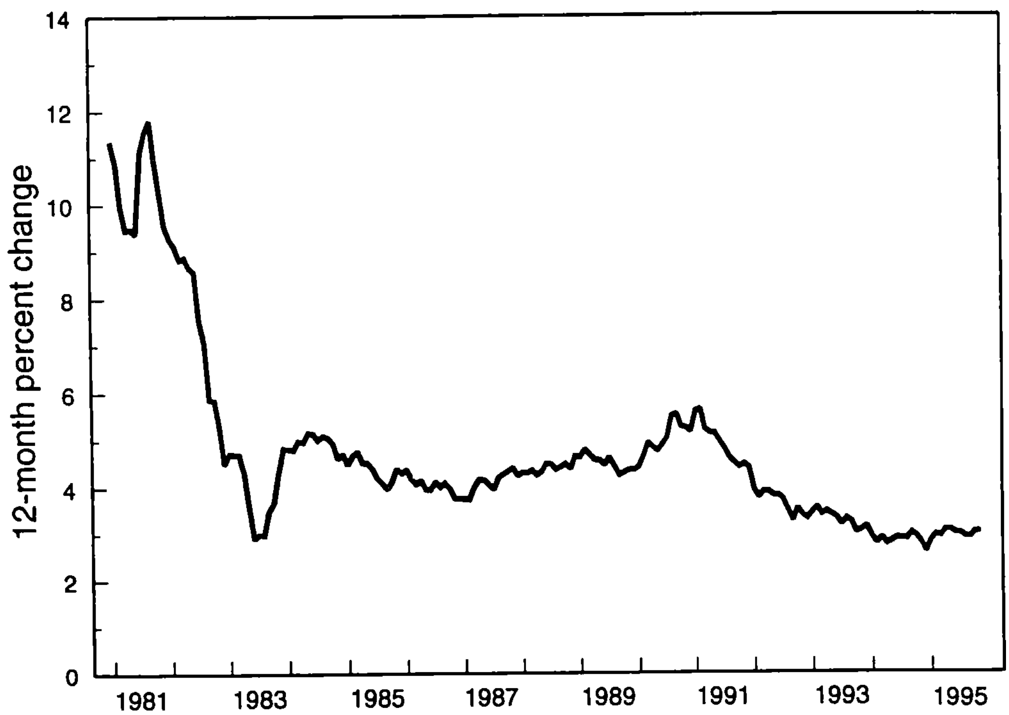
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 15, 1995

CHART OF THE WEEK

The Core Rate of Inflation



The core rate of consumer price inflation (which excludes energy and food prices) has been steady at an average of 3.1 percent over the past 3 years, the lowest 3-year period since 1968. The monthly rate of core inflation for November was reported this week at an impressively low 0.1 percent, or 1.5 percent on an annual basis. With labor costs rising very slowly and retailers unlikely to raise profit margins given sluggish consumer spending, the good news on price inflation should continue.

EYES ONLY

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SPECIAL ANALYSES

ARTICLE

DEPARTMENTS

BY JIM BORGMAN FOR THE CINCINNATI ENQUIRER

"I INSISTED ON A REAL, OLD-FASHIONED TREE THIS CHRISTMAS — SO HAROLD LOCATED ONE ON THE INTERNET AND WE HAD IT FEDEXED FROM SINGAPORE."

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SPECIAL ANALYSIS

Philanthropy and Deficit Reduction: Will States and Private Donations Provide a Social Safety Net?

The size of reductions in Federal spending on Medicaid, welfare, and other social safety net programs has become one of the most contentious issues in the current budget battle. Some advocates of reductions in such programs assert that cuts in Federal spending would be offset by increased private donations to charities as well as increased state and local government spending. Thus, they argue, Federal spending can be dramatically reduced with little adverse impact on the poor and disabled.

Private donations. Roughly three-quarters of American households contribute to charities (including religious charities), with an average annual contribution of about $900. Economists have studied how such private donations respond to changes in government spending on social programs. The studies generally suggest that for every dollar reduction in government spending, private donations increase by between zero and 35 cents. In other words, increases in private expenditure are not likely to significantly offset cuts in government expenditure.

State and local offsets. Reduced Federal spending on social programs could possibly be offset by higher state and local spending, so that overall government spending would not change. But the historical evidence suggests otherwise. Econometric studies generally find that state and local governments do not fully offset the behavior of the Federal Government.

Block grants. Turning AFDC and Medicare into block grants will make it even less likely that states will offset Federal spending cuts. These programs currently are funded through matching grants, which reduce the states' marginal cost of providing benefits. This is especially true for low-income states that receive more generous Federal matching. A move to block grants would therefore raise the marginal cost to state governments of providing the benefits. For example, an extra dollar in combined Food Stamps and AFDC benefits currently costs a low-income state only $0.35. But if AFDC is shifted to a block grant system, the net cost rises to $1.43, because Food Stamp benefits are reduced when AFDC payments are increased. The literature suggests that states cut benefits by 1 to 3 percent for every 10 percent increase in net cost.

Tax effects. Current tax rules make donations of appreciated assets particularly attractive: such donations are not subject to capital gains tax and are deductible at their appreciated value. The higher the capital gains tax rate, the more valuable the exemption from the capital gains tax and therefore the more attractive this option. Reductions in the capital gains tax rate would thus raise the net cost of donating appreciated assets.

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Summary. The available evidence strongly suggests that private donations and state and local government spending are unlikely to offset reductions in Federal spending on the social safety net. Cuts in tax rates (including a capital gains tax cut) and a shift to block grants would strengthen—rather than attenuate—this conclusion.

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SPECIAL ANALYSIS

CBO's Forecast, At Last!

The Congressional Budget Office (CBO) released its new forecast this week, showing a $288 billion reduction in its baseline deficit over 7 years compared with their previous forecast. Many of their revisions move their forecast in the right direction and some of the remaining problems involve hard to explain technical issues. Nevertheless, Administration economists believe the CBO forecast remains unduly pessimistic.

Where did the $288 billion improvement come from? Of the $288 billion decline in the baseline deficit, the bulk reflected updating for recent economic developments and a fuller accounting of the effects on the economy of balancing the budget. The remainder was attributable to lower anticipated growth for spending on Medicare and Medicaid, along with changes in other technical assumptions.

What are the problems with the new CBO forecast? Several of the economic assumptions used in the new CBO baseline continue to be pessimistic compared with other forecasts.

- **Nominal GDP growth is low.** Nominal GDP growth averages 4.9 percent over the next 7 years, and has been revised down by about 0.3 percentage point per year from the earlier forecast. Although forecasters are generally revising down nominal GDP in response to the low inflation, the new CBO number should be compared to our Mid-Session Review forecast of 5.4 percent and the Blue Chip consensus of 5.2 percent.

- **CPI inflation is too high.** Given CBO's projected low growth rate for nominal GDP, their CPI inflation projection is too high. This combination has an adverse impact on the budget, since low nominal GDP growth reduces tax revenues and high CPI inflation both reduces tax revenues and raises spending. The important flaw in the CBO forecast is <u>not</u> primarily their real GDP forecast but rather the difference between the GDP price index and the CPI.

- **Interest rates don't fall enough.** Long-term interest rates are now lower in the near term, but are actually higher in later years, as compared with the earlier CBO forecast. The net result of these two changes on the deficit is negligible. Nevertheless, the long-term 5.5 percent rate does not reflect the decline in inflationary expectations and produces too large a difference between long and short rates. Lowering the long-term rate to 5.0 percent (as in their earlier forecast) would help reduce the deficit.

- **The profit share should be higher.** For the first time, CBO has shown the effects of deficit reduction on the income distribution. The profit share, which is projected to increase early on, is assumed to fall back gradually in the later years. CBO argues that this is the result of higher depreciation which, in turn, results from the higher investment spending expected to accompany deficit reduction. There is room to argue here.

The new figures create very little slack in the Republican budget. Despite the substantial change in the baseline estimates, CBO reports that the cumulative 7-year deficits under the Republican budget plan are reduced by only $135 billion. Moreover, the revisions have virtually no effect on the deficit projection in 2002. This means that the new figures create very little room for additional spending under the Republican plan. Spending even a small amount of the $135 billion pushes the budget into deficit in 2002 because of higher interest payments on a larger national debt.

Why does the deficit change so little under the Republican plan? In large part, this is a consequence of their reliance on spending caps to define their proposals. Take Medicaid, for example: Under the Republican proposals, Medicaid becomes a capped block grant to the states. When CBO projects lower baseline Medicaid spending, the cap saves less money. Overall, the new estimates reduce the proposed policy cuts under the Republican plan from $903 billion to $750 billion. With $153 billion in lower cuts, the original $288 billion reduction in the baseline deficit is scaled back to $135 billion ($288 billion - $153 billion) in lower cumulative deficits.

CBO has re-scored our 7-year plan. CBO has scored our 7-year proposal with a deficit of roughly $115 billion in 2002. While the new CBO numbers bring our plan closer to balance in 2002, they still leave a large gap. The Coalition proposal, which was in balance under the old CBO assumptions, will likely show a modest surplus with the new figures.

EYES ONLY

ARTICLE

Corporate Contributions to Reducing the Deficit

Observers across the political spectrum have proposed reducing or eliminating corporate subsidies that benefit particular industries or firms without commensurate benefits to society as a whole. Such subsidies are often referred to as "corporate welfare," but this term is sometimes viewed as pejorative and anti-business. Although estimates of the budget savings vary, some have argued that cutting these corporate subsidies could reduce the deficit by several hundred billion dollars over the next 7 years.

A yardstick for measuring corporate subsidies and tax breaks. At a time when average Americans are being asked to accept government cutbacks, supporters of reducing corporate subsidies emphasize that it is only fair to ask businesses to share in this sacrifice. Corporate subsidies can take the form of tax preferences, direct Federal payments, or more subtle provisions such as quotas, below-market prices, and implicit government guarantees. Economists also point out that corporate subsidies can interfere with the ability of markets to properly allocate resources, thereby reducing economic efficiency (see box on next page). A useful yardstick for examining such subsidies, therefore, is the extent to which they "distort" the efficiency of markets.

What are these distortions? Business subsidies have three general effects:

- They can lead to overinvestment in certain industries, depriving other industries of scarce capital and labor.
- They can insulate industries from competitive pressures that may be important for raising productivity.
- They sometimes directly or indirectly raise prices to consumers, thereby redistributing income from consumers to producers.

Types of Corporate Subsidies. Each type of corporate subsidy (tax expenditures, direct government spending, and hidden subsidies) can produce some or all of these distortions. And the budgetary costs can be quite large. For example, estimates from the Progressive Policy Institute place the cost of selected tax subsidies at about $100 billion through the rest of this decade and the cost of selected spending subsidies at about $130 billion. The costs of hidden subsidies are more difficult to measure because they confer subtle benefits that are difficult to value. These subsidies, however, may be relatively straightforward to eliminate: user fees could be raised to cover full costs of providing services (timber sales, nuclear waste disposal, regulatory services) and auctions could transfer resources from the public sector to the private sector (broadcast spectrum, concessions at national parks, some agricultural quotas).

But will the sky fall if subsidies are eliminated? Some have argued that government subsidies are needed to prevent falling profits from threatening the existence of a "vital" industry. But this argument does not consider how:

- Markets usually adjust to reflect demand for vital products. If for some reason the market does not work, however, the issue is not the importance of the product, but whether the social benefit of the subsidy exceeds the cost.
- The ultimate beneficiaries are not always obvious. In some cases, the owners of assets at the time when the subsidy was introduced receive the bulk of the benefits. The value of subsidies is capitalized in the value of the assets used in the industry. New entrants into the industry do not benefit at all, since they have to pay more for their assets, and earn a lower net rate of return.
- Subsidies may induce additional firms to enter an industry, leading to increased production and lower prices, thereby limiting rates of return. Thus, the subsidies actually can lower before-subsidy returns.

Thus, eliminating subsidies need not turn profitable industries into unprofitable ones because economic forces will adjust rates of return to compensate for the loss of the subsidies.

Market Failures and Corporate Subsidies

The basic rationale for government intervention in the market is that sometimes markets fail to produce efficient outcomes: they produce too much of certain items (e.g., pollution) and too little of others (e.g., basic research). Subsidies to produce more of an underproduced item are thus designed to correct a market failure, and represent efficient subsidies. Programs to support research and development that because of market failures would not otherwise occur fall into this category. Subsidies that do not address (or are larger than necessary to address) a market failure should be viewed as inefficient and undesirable.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Improving Employment Situation For Recent College Grads. A recent survey of 527 businesses, industries, and governmental agencies projects a 4.7 percent increase in the hiring rate for new college graduates during 1995-96, according to the Career Services and Placement department at Michigan State University. This year is the third in a row for which surveyed employers predicted an increase in job openings for new college graduates. Nearly half of all new hires in surveyed organizations had career-related work experience, underscoring the importance of such experience to the competitiveness of labor market participants. Computer literacy and command of popular office technology continue to be much sought-after attributes in employees, making the capacity to adapt to changing technology an important qualification. Employers also stressed that new graduates should continue to keep current with the latest trends in their field, read trade journals, and update their skills.

Number of Black-Owned Firms Grows, but Most Are Small. The number of African American-owned businesses in the United States increased 46 percent (to about 621,000) from 1987 to 1992, compared to an increase of 26 percent for the country as a whole, according to a report the Census Bureau will publish later this year. While receipts per firm were $193,000 for all U.S. firms in 1992, black-owned businesses averaged just $52,000 in receipts. Moreover, the distribution of receipts among black-owned firms is highly skewed: while 56 percent of such firms had receipts under $10,000, only about 0.5 percent had receipts exceeding $1 million. The percentage of firms owned by African Americans was 29 percent in the District of Columbia, by far the most among the states (Maryland was next, with 11 percent), but these firms accounted for just 4 percent of all receipts in the District.

Mixed Reports on Holiday Shopping, Spending. Many retailers nationwide said sales for the period from Thanksgiving through the weekend ending December 10 were flat or down compared to last year's levels. According to anecdotal evidence, revenue rose only where stores promoted heavily with price-cutting or promotional gimmicks to lure bargain-hunting shoppers. The Commerce Department reported that retail sales grew strongly in November, but November included only 1 week of the holiday shopping season. On a positive note, the credit card-issuer Visa International reported that transactions at retail merchants through the first 16 days of this year's holiday shopping season were up nearly 25 percent over last year and the dollar volume of sales was up almost 20 percent.

EYES ONLY

INTERNATIONAL ROUNDUP

Discount Rates Fall in the UK and Germany. On December 13, the Bank of England lowered its discount rate by 25 basis points to 6.5 percent. The interest rate cut follows signs of slowing economic growth (GDP growth was sluggish in the third quarter) and lower-than-expected inflation. The Bank of England's move was followed on December 14 by a Bundesbank announcement of a 50 basis point cut in its discount and Lombard rates. Economic conditions remain relatively depressed in Germany, with no growth in real GDP between the second and third quarters. The market reaction in Germany was muted, as the anticipated rate cut had been widely anticipated.

Budget Balance by Extraordinary Means? Argentina's new Congress, which assumed office this week, is considering a controversial proposal which would temporarily allow President Menem to circumvent the Congressional approval process for future expenditure cuts and tax increases. Menem is seeking these extraordinary powers in order to scale back the bloated state sector and to reform the tax system. But Congress is not eager to surrender its recently enhanced powers, and passage of the extraordinary measure may therefore be difficult. In the midst of this power struggle, Argentina's economy seems to be strengthening after this year's estimated 2.5 percent fall in GDP. According to a household survey, unemployment in the greater Buenos Aires area dropped to 17.4 percent in October from 20.2 percent in May. And financial markets appear to be recovering from the aftershocks of the Mexican peso crisis: the Argentine stock market enjoyed a surge of 15 percent in the second half of November.

Structural Adjustment at the World Bank. World Bank President James Wolfensohn recently announced a reorganization of the financial institution's upper management as the first salvo in a restructuring of the development bank. In a memo released to staff on December 7, Wolfensohn outlined his plans to provide clear lines of authority for the main areas of World Bank business and to strengthen the World Bank Group's ability to address major issues. Five Managing Directors were appointed, and a new Executive Committee was set up. The World Bank, along with other international financial institutions, has been under increasing pressure to justify its use of contributions from member governments. The Bank is being encouraged to focus on its role as a mobilizer of resources essential to the development process—be they private or public, intellectual or financial—rather than on its role as a lender to governments.

EYES ONLY

RELEASES THIS WEEK

Consumer Price Index

The consumer price index was unchanged in November. Excluding food and energy, consumer prices increased 0.1 percent.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.2 percent in November. Capacity utilization declined 0.1 percentage point to 83.1 percent.

Retail Sales

Advance estimates show that retail sales increased 0.8 percent in November. Excluding sales in the automotive group, retail sales increased 0.9 percent.

Producer Price Index

The producer price index for finished goods increased 0.5 percent in November. Excluding food and energy, producer prices rose 0.4 percent.

MAJOR RELEASES NEXT WEEK

Gross Domestic Product (Tuesday)
Housing Starts (Tuesday)
U.S. International Trade in Goods and Services (Wednesday)
Personal Income (Thursday)

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U.S. ECONOMIC STATISTICS

	1970–1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
GDP implicit price deflator:					
Fixed weights	5.5	2.3	2.2	1.6	0.6
Chain weights*	5.4	2.7	2.8	2.2	1.9
Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.9	2.0
Chain weights	1.4	0.9	0.2	3.4	0.7
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.3	1.0
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	2.5	3.2
Chain weights*	1.2	0.7	1.8	1.4	1.8

* CEA estimates.

	1970–1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970–1993	1994	Sept. 1995	Oct. 1995	Nov. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.5	5.6
Payroll employment (thousands)					
increase per month			94	66	166
increase since Jan. 1993					7687
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.3	**0.0**
PPI-Finished goods	5.0	1.7	0.3	–0.1	**0.5**

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Oct. 1995	Nov. 1995	Dec. 14, 1995
Dow-Jones Industrial Average	3522	3794	4760	4936	5182
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.36	5.26
10-year T-bond	5.87	7.09	6.04	5.93	5.74
Mortgage rate, 30-year fixed	7.33	8.35	7.48	7.38	7.15
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level December 14, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.441	−0.2	−8.3
Yen-Dollar	101.5	+0.1	+1.2
Multilateral $ (Mar. 1973=100)	85.09	−0.1	−5.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.3 (Q3)	5.6 (Nov)	2.6 (Nov)
Canada	1.9 (Q3)	9.4 (Oct)	2.4 (Oct)
Japan	−0.2 (Q3)	3.3 (Oct)	0.2 (Sept)
France	2.1 (Q3)	12.1 (Aug)	1.8 (Oct)
Germany	1.5 (Q3)	6.6 (Sept)	2.0 (Aug)
Italy	2.9 (Q2)	12.0 (July)	5.8 (Oct)
United Kingdom	2.0 (Q3)	8.6 (Oct)	3.2 (Oct)

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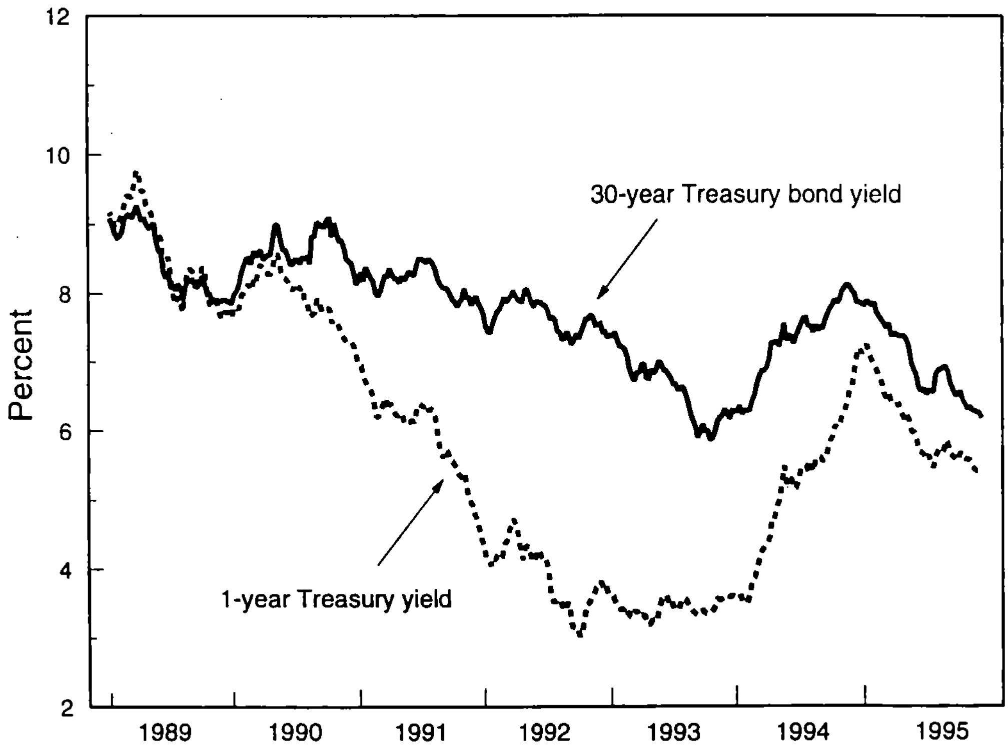
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 8, 1995

CHART OF THE WEEK

Interest Rates



The 30-year Treasury rate dipped below 6 percent this week for the first time in over 2 years. Since peaking late last year at just over 8 percent, the rate has fallen steadily. Although the 1-year Treasury rate also has fallen this year, the spread between the 30-year and 1-year rates is much smaller than the last time bond rates were this low. The narrowing of the spread, along with falling long-term rates, suggests that investors expect short-term interest rates to decline, possibly as soon as later this month following the Federal Reserve's next Federal Open Market Committee meeting.

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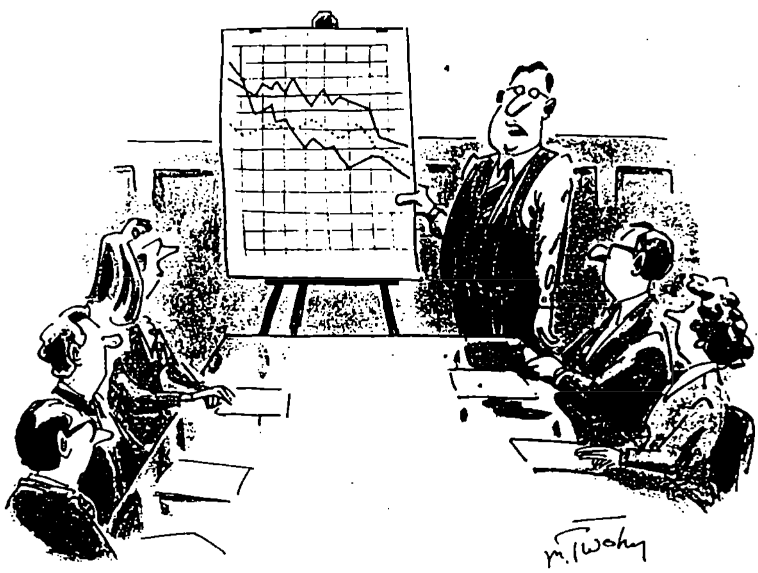


"So, we look to the fourth quarter as a time of healing."

EYES ONLY

TREND

Labor Force Growth Projected to Slow

The Bureau of Labor Statistics has released revised projections showing the labor force will grow at an annual rate of 1.1 percent over the period 1994-2005, down from the 1.4 percent rate recorded during 1982-93. Growth in the labor force at this lower rate entails creating about 1.5 million new jobs per year to keep unemployment from rising, somewhat less than the 2.5 million pace of the past 3 years.

Analysis. The labor force is projected to grow more slowly because:

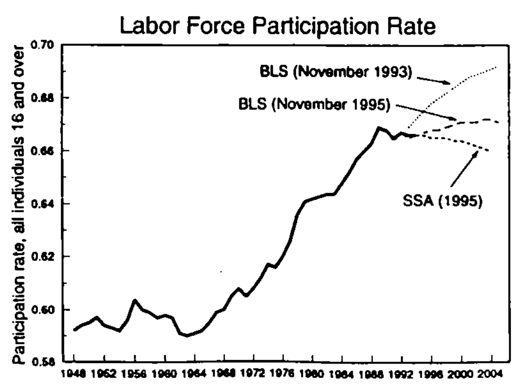
- Labor force participation is expected to rise more slowly, as the ongoing decline in participation by men accelerates and the ongoing increase in participation by women moderates (see table).
- The working-age population is expected to grow more slowly due entirely to a small decline in growth of men over the age of 16.

Growth in the Labor Force
(Average annual percent change)

1982-1993	All	Male	Female
Population 16 and over	1.1	1.2	1.0
Participation Rate	0.3	-0.2	0.8
Total Labor Force Growth	1.4	1.0	1.8

1994-2005	All	Male	Female
Population 16 and over	1.0	1.0	1.0
Participation Rate	0.1	-0.3	0.4
Total Labor Force Growth	1.1	0.7	1.4

The new BLS projections are significantly lower than those released previously, and are close to projections presently used by the Social Security Administration. They also are close to those used by the Council of Economic Advisers in developing our economic forecasts. The main reason for the downward revision is a lower projected rate of growth in labor force participation (see chart). The earlier BLS projections had assumed the drop in participation by men during the early 1990s would be reversed once the economic recession ended, but the new projections assume the drop is part of a long-term trend.



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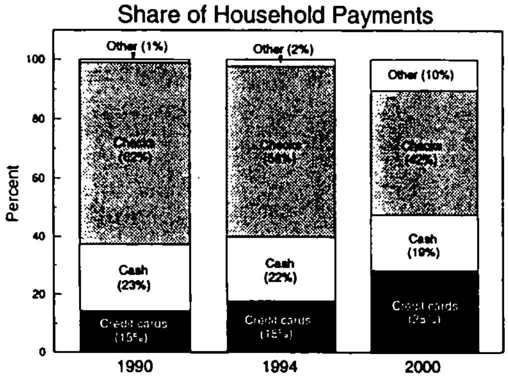
SPECIAL ANALYSIS

Credit Card Use Soaring

Credit card use by American households has skyrocketed in recent years, as the country moves toward a cashless economy. Close to 18 percent of payments by households were charged on credit cards in 1994, up from 15 percent in 1990, and this share is expected to grow to roughly 28 percent by 2000 (see chart). The dollar volume of these charges rose by 50 percent from 1990 to 1994, more than twice the rate of growth in overall consumer spending.

Share of Household Payments



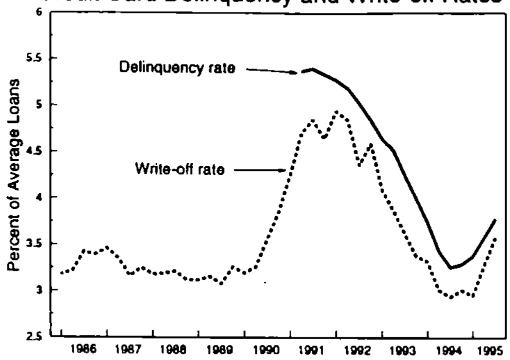
About three-quarters of all households now have at least one major credit card, and roughly a third have three or more. In total, households have a combined national credit limit of just over $1 trillion dollars, double the limit of 5 years ago. This sharp increase in easily available credit and the rapid growth in charge volume have sparked concern that households could quickly face debt difficulties if the economy were to weaken.

Convenience use versus debt use. Credit cards are both a convenient means of payment and a readily available source of funds for borrowing:

- The use of credit cards for convenience, where charges are paid off each month without interest, is growing more rapidly than debt use, where charges are not paid off each month and interest accrues.
- Convenience use has been propelled by the proliferation of rebates, frequent-flier miles, and credits toward auto purchase, and by the increasing acceptance of credit cards by supermarkets, health and dental clinics, college tuition offices, and even the postal service.
- Despite growth in convenience use, a survey this past July found roughly three-fifths of cardholders do not pay off their balances. On average, these cardholders carry a balance of about $3,200 and owe about $45 in interest each month.
- The share of total charges paid off each month is only about 25 percent. As a result, interest payments on credit card debt continue to be an important burden on consumers.

Will the holiday season be merry? Consumers generally load up on debt during the holiday shopping season. But this year rising delinquency rates on credit cards and increasing write-offs by banks of bad credit-card debts suggest that some consumers may have stretched beyond their means (see chart). Although early returns indicate a mixed overall start to holiday shopping, some individual retailers of large ticket items like big screen televisions and computers are reporting strong sales. Thus, it is still too early to say whether rising consumer debt will restrain spending this holiday season.

Credit Card Delinquency and Write-off Rates



EYES ONLY

ARTICLE

A Possible Fix for the CPI

Most economists now believe that changes in the consumer price index overstate changes in the cost of living. Part of this bias occurs because of difficulties accounting for new products and quality change in the index. Part of this bias occurs because the index does not adequately account for the way people substitute products whose prices are rising slowly for products whose prices are rising quickly—so-called "substitution bias." And the remainder of this bias occurs because of certain technical problems with the way the index is constructed—so-called "formula bias."

A method for simultaneously fixing substitution and formula bias has been developed, however, and would find broad support among economists and other experts. The new method is technically feasible and could be implemented with available data on a timely basis. We estimate that changes in such an index would be 0.6 percentage point lower per year compared to the current CPI.

What is the problem? It is helpful to think of the CPI as being put together in two stages representing two levels of aggregation. At the first level of aggregation, prices for individual items, such as McIntosh, Winesap, and Delicious apples, are collected and used to construct a price index for apples. The price index for apples is just a weighted average of the prices of individual varieties of apples. At the second level of aggregation, the price index for apples is combined with price indexes for other product categories (televisions, autos, etc.) to construct a price index for the entire market basket. Substitution bias occurs at the second level because the weight applied to each category is based on 1982 consumption patterns and therefore fails to account for the way consumers substitute products whose prices are rising slowly for products whose prices are rising quickly.

At the first level of aggregation (McIntosh-Winesap-Delicious), in addition to substitution bias, formula bias occurs. This formula bias arises because some of the data needed to construct the index at this level are not available and must be estimated, and the estimation procedure induces a built-in error that overweights rising prices (such as prices of items coming off of a sale) and underweights falling prices.

How would the new method work? The new method of computing the CPI would differ from the current method in two important ways:

- The new method would use weights that are updated regularly to combine prices of product categories (apples, televisions, autos) into a single index, rather than the current practice of constant weights held equal to their values in a base year. Continually updating the weights would directly

EYES ONLY

account for the way consumers substitute toward products that experience relatively low inflation.

- The new method would use a geometric average rather than an arithmetic average both to combine the prices of individual items into prices for product categories, and to combine prices of product categories into a single index. The use of a geometric average would reduce substitution bias and eliminate formula bias.

Is the new method feasible? The new method requires data on household expenditure patterns to update the weights used in computing the CPI. Although BLS collects these data, they are available only with a lag of 3 to 6 months. It would be possible, however, to update weights each month by using statistical techniques to project trends in expenditure patterns. Accordingly, the new method of computing the CPI could be implemented using data presently collected by the BLS.

What is BLS doing? Beginning in 1997, BLS plans to make adjustments in how they calculate the CPI which would only partially address these problems. These adjustments should reduce the change in the CPI by about 0.2 percentage point per year. BLS currently is not planning the major revamping of the CPI entailed by using a geometric rather than an arithmetic average. In fact, they would regard such a change as altering the basic nature of the CPI. As a result, it might be easier to introduce a new separate cost-of-living index based on geometric weights, rather than fix the existing CPI, which could continue to be produced and used in labor contracts. The decision could be made at the policy level to ask BLS to produce a new index and then to use the new index for adjusting taxes and benefits.

Comparing Geometric and Arithmetic Averages

Suppose the price of a product increases from $1 to $1.50 this year, and then decreases to $1 next year. The price increase is 50 percent this year and the price decrease is 33 percent next year. An arithmetic average of the price change over the 2 years would equal 8.5 percent (0.5 x [50-33]). A geometric average of the price change over the 2 years would give 0 percent change (1 - [1+0.5]x[1-0.33]). The reason for this difference is that an arithmetic average weights each percentage change equally, whereas a geometric average weights larger changes proportionately less than smaller changes. And they say economics isn't interesting!

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Record Growth in Prison Population. The size of the U.S. prison population continues to soar, with the Bureau of Justice Statistics recently recording the largest 1-year prison population increase ever. The number of state and Federal inmates grew by 89,707 during the 12 months ending June 30, 1995, putting the prison population at 1,104,074. Large racial differences again were evident. For the first time ever, the number of blacks incarcerated (in both prisons and jails) actually surpassed the number of whites: 735,200 blacks were incarcerated in 1994, compared to 725,100 whites. In all, BJS reports that roughly 4.3 million adult males were in prison, jail, on probation or on parole in 1994—a number approximately equal to the average number of males who were unemployed in 1994.

Beige Book Indicates Moderate Growth, Little Price Pressure. The recent Current Economic Conditions survey published by the Federal Reserve indicates that the economy continues to expand, but at a somewhat slower pace than last month. Although retail sales picked up in November, early returns on sales for the holiday season were mixed, with some regions reporting lower-than-expected sales while others reported encouraging results for the day-after-Thanksgiving sales. Other indicators—such as manufacturing production and single-family home construction—were mixed as well. Continued tight labor markets for both skilled and unskilled workers in entry-level jobs appear to be contributing to some wage pressure, and some regions report employers are having difficulty filling temporary service positions.

The Rich and the Poor, Again. New statistics, based on unpublished data from the Congressional Budget Office, further document the large gains of the richest and the large losses of the poorest Americans since the late 1970s. In 1992, the wealthiest 1 percent of the population (2.5 million people) earned almost as much after-tax income as the bottom 40 percent of the population (100 million people). This contrasts sharply with 1977, when the total after-tax income of the top 1 percent was less than half that of the bottom 40 percent. In 1992, the top 20 percent of the population earned the same amount of after-tax income as the bottom 80 percent of the population. Between 1977 and 1992, the top 1 percent saw its average after-tax income increase 91 percent, while the poorest 20 percent saw its average after-tax income fall by 17 percent.

EYES ONLY

INTERNATIONAL ROUNDUP

Japanese Economy Continues to Stagnate. Japan's GDP expanded by a weak annualized rate of 0.6 percent in the third quarter, slightly above private sector expectations, as the banking-sector crisis and subdued confidence continued to suppress activity. Strong growth in personal consumption expenditure was offset by the continued weakness of capital spending and housing. Net exports declined dramatically, falling by 32 percent in the third quarter, in part reflecting a narrowing in the bilateral trade surplus with the United States. Deflation continued, as prices fell for the fifth consecutive quarter. Japan is unlikely to attain the 2.8 percent real growth rate forecast by the government for the 1995-96 (April-March) fiscal year. The government's Economic Planning Agency has recently suggested that growth of only 1 percent is more likely.

German Economy Sluggish. Real GDP in Germany was essentially unchanged in the third quarter, and was up only 1.5 percent over the same period in 1994. Unemployment (including the self-employed) rose to 9.3 percent during November from 9.2 percent in October. Labor market conditions differ significantly between the new and the old states of Germany: unemployment is 14 percent in the east and 8.2 percent in the west. The German government, engineering employers, and the influential union of metal-workers have agreed to reach consensus on a "jobs pact" by late January. The pact drafted by the union proposes wage freezes in return for job creation and security measures. Renewed growth in Germany and Japan—two of our top trading partners—would boost U.S. exports.

Venezuela Faces Tough Challenges. Problems faced by Venezuela's current government were highlighted this week when the opposition party won a majority of the regional governorships at stake. Poor economic performance has produced strong criticism of President Rafael Caldera's government: the budget deficit stands at 7 percent of GDP, inflation is expected to remain high at 50 percent for 1995, and more than 40 percent of Venezuelans live in abject poverty. The Venezuelan government is seeking an agreement with the International Monetary Fund (IMF) in order to bolster its foreign exchange reserves. But the IMF does not seem satisfied with the government's economic plan for 1996. In particular, the government is hesitant to meet the IMF requirement that gasoline prices be increased. Past attempts to reform the Venezuelan economy resulted in violent riots in February 1989 which left hundreds dead.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment
****Embargoed until 8:30 a.m., Friday, December 8, 1995****

In November, the unemployment rate rose to 5.6 percent from 5.5 percent in October. Nonfarm payroll employment increased by 166,000 in November.

Leading Indicators

The index of leading economic indicators fell 0.5 percent in October.

Domestic Auto Sales

Domestic autos were sold at an annual rate of 7.1 million units in November.

MAJOR RELEASES NEXT WEEK

Producer Prices (Tuesday)
Retail Sales (Wednesday)
Consumer Prices (Thursday)
Industrial Production and Capacity Utilization (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
GDP implicit price deflator:					
Fixed weights	5.5	2.3	2.2	1.6	0.6
Chain weights*	5.4	2.7	2.8	2.2	1.9
Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.9	2.0
Chain weights	1.4	0.9	0.2	3.4	0.7
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.3	1.0
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	2.5	3.2
Chain weights*	1.2	0.7	1.8	1.4	1.8

* CEA estimates.

	1970–1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970–1993	1994	Sept. 1995	Oct. 1995	Nov. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.5	**5.6**
Payroll employment (thousands)					
increase per month			**94**	**66**	**166**
increase since Jan. 1993					**7687**
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.3	N.A.
PPI-Finished goods	5.0	1.7	0.3	–0.1	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, December 8, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Oct. 1995	Nov. 1995	Dec. 7, 1995
Dow-Jones Industrial Average	3522	3794	4760	4936	5159
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.36	5.34
10-year T-bond	5.87	7.09	6.04	5.93	5.72
Mortgage rate, 30-year fixed	7.33	8.35	7.48	7.38	7.18
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level December 7, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.444	−0.2	−8.2
Yen-Dollar	101.4	−0.4	+1.3
Multilateral $ (Mar. 1973=100)	85.15	−0.2	−4.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.3 (Q3)	**5.6** (Nov)	2.8 (Oct)
Canada	1.9 (Q3)	9.2 (Sept)	2.4 (Oct)
Japan	0.6 (Q2)	3.2 (Sept)	0.2 (Sept)
France	2.1 (Q3)	12.1 (Aug)	1.8 (Oct)
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Italy	2.9 (Q2)	12.0 (Jul)	5.8 (Oct)
United Kingdom	2.0 (Q3)	8.6 (Sept)	3.2 (Oct)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, December 8, 1995.**

EYES ONLY

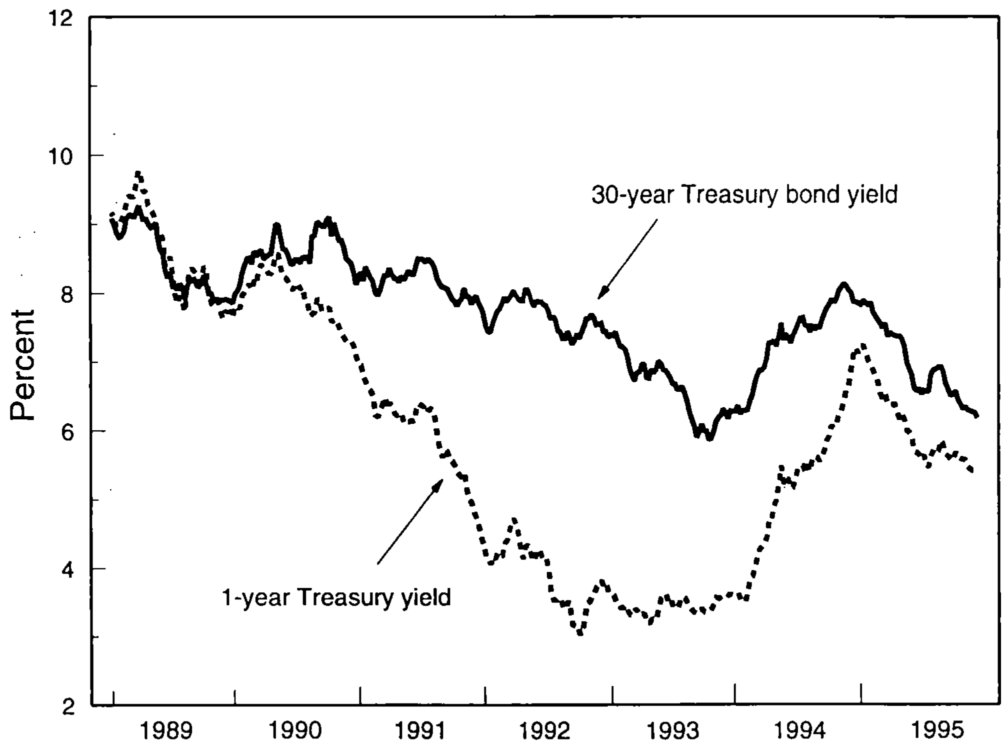
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 8, 1995

CHART OF THE WEEK

Interest Rates



The 30-year Treasury rate dipped below 6 percent this week for the first time in over 2 years. Since peaking late last year at just over 8 percent, the rate has fallen steadily. Although the 1-year Treasury rate also has fallen this year, the spread between the 30-year and 1-year rates is much smaller than the last time bond rates were this low. The narrowing of the spread, along with falling long-term rates, suggests that investors expect short-term interest rates to decline, possibly as soon as later this month following the Federal Reserve's next Federal Open Market Committee meeting.

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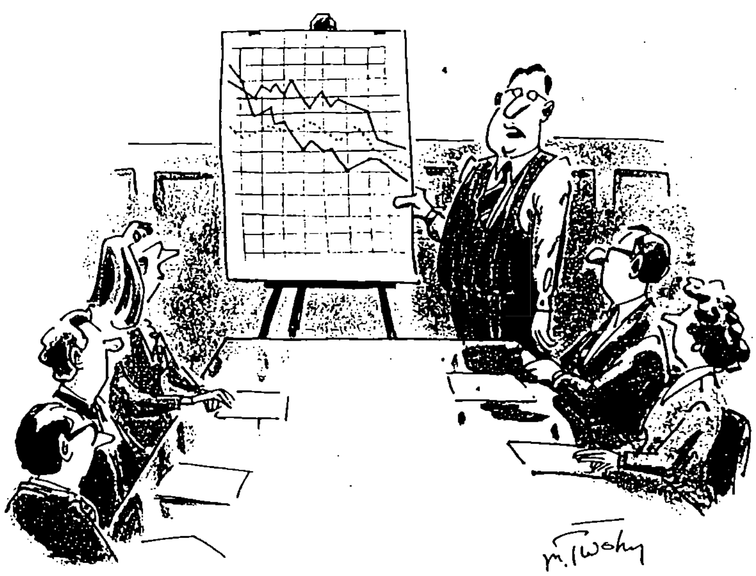


"So, we look to the fourth quarter as a time of healing."

EYES ONLY

TREND

Labor Force Growth Projected to Slow

The Bureau of Labor Statistics has released revised projections showing the labor force will grow at an annual rate of 1.1 percent over the period 1994-2005, down from the 1.4 percent rate recorded during 1982-93. Growth in the labor force at this lower rate entails creating about 1.5 million new jobs per year to keep unemployment from rising, somewhat less than the 2.5 million pace of the past 3 years.

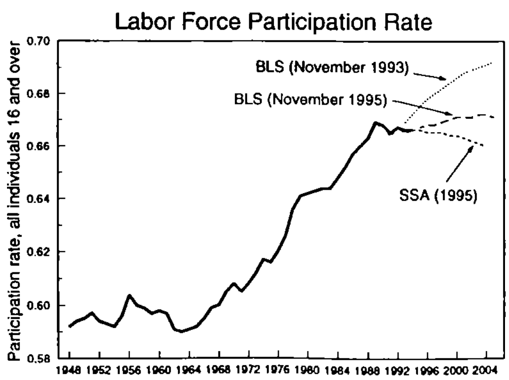
Analysis. The labor force is projected to grow more slowly because:

- Labor force participation is expected to rise more slowly, as the ongoing decline in participation by men accelerates and the ongoing increase in participation by women moderates (see table).
- The working-age population is expected to grow more slowly due entirely to a small decline in growth of men over the age of 16.

Growth in the Labor Force
(Average annual percent change)

1982-1993	All	Male	Female
Population 16 and over	1.1	1.2	1.0
Participation Rate	0.3	-0.2	0.8
Total Labor Force Growth	1.4	1.0	1.8
1994-2005	**All**	**Male**	**Female**
Population 16 and over	1.0	1.0	1.0
Participation Rate	0.1	-0.3	0.4
Total Labor Force Growth	1.1	0.7	1.4

The new BLS projections are significantly lower than those released previously, and are close to projections presently used by the Social Security Administration. They also are close to those used by the Council of Economic Advisers in developing our economic forecasts. The main reason for the downward revision is a lower projected rate of growth in labor force participation (see chart). The earlier BLS projections had assumed the drop in participation by men during the early 1990s would be reversed once the economic recession ended, but the new projections assume the drop is part of a long-term trend.



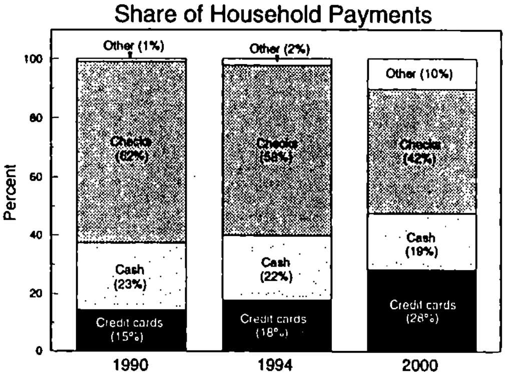
EYES ONLY

SPECIAL ANALYSIS

Credit Card Use Soaring

Credit card use by American households has skyrocketed in recent years, as the country moves toward a cashless economy. Close to 18 percent of payments by households were charged on credit cards in 1994, up from 15 percent in 1990, and this share is expected to grow to roughly 28 percent by 2000 (see chart). The dollar volume of these charges rose by 50 percent from 1990 to 1994, more than twice the rate of growth in overall consumer spending.

Share of Household Payments



About three-quarters of all households now have at least one major credit card, and roughly a third have three or more. In total, households have a combined national credit limit of just over $1 trillion dollars, double the limit of 5 years ago. This sharp increase in easily available credit and the rapid growth in charge volume have sparked concern that households could quickly face debt difficulties if the economy were to weaken.

Convenience use versus debt use. Credit cards are both a convenient means of payment and a readily available source of funds for borrowing:

- The use of credit cards for convenience, where charges are paid off each month without interest, is growing more rapidly than debt use, where charges are not paid off each month and interest accrues.
- Convenience use has been propelled by the proliferation of rebates, frequent-flier miles, and credits toward auto purchase, and by the increasing acceptance of credit cards by supermarkets, health and dental clinics, college tuition offices, and even the postal service.
- Despite growth in convenience use, a survey this past July found roughly three-fifths of cardholders do not pay off their balances. On average, these cardholders carry a balance of about $3,200 and owe about $45 in interest each month.
- The share of total charges paid off each month is only about 25 percent. As a result, interest payments on credit card debt continue to be an important burden on consumers.

Will the holiday season be merry? Consumers generally load up on debt during the holiday shopping season. But this year rising delinquency rates on credit cards and increasing write-offs by banks of bad credit-card debts suggest that some

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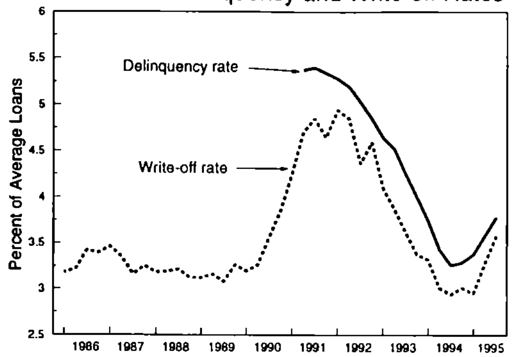
consumers may have stretched beyond their means (see chart). Although early returns indicate a mixed overall start to holiday shopping, some individual retailers of large ticket items like big screen televisions and computers are reporting strong sales. Thus, it is still too early to say whether rising consumer debt will restrain spending this holiday season.

Credit Card Delinquency and Write-off Rates



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EYES ONLY

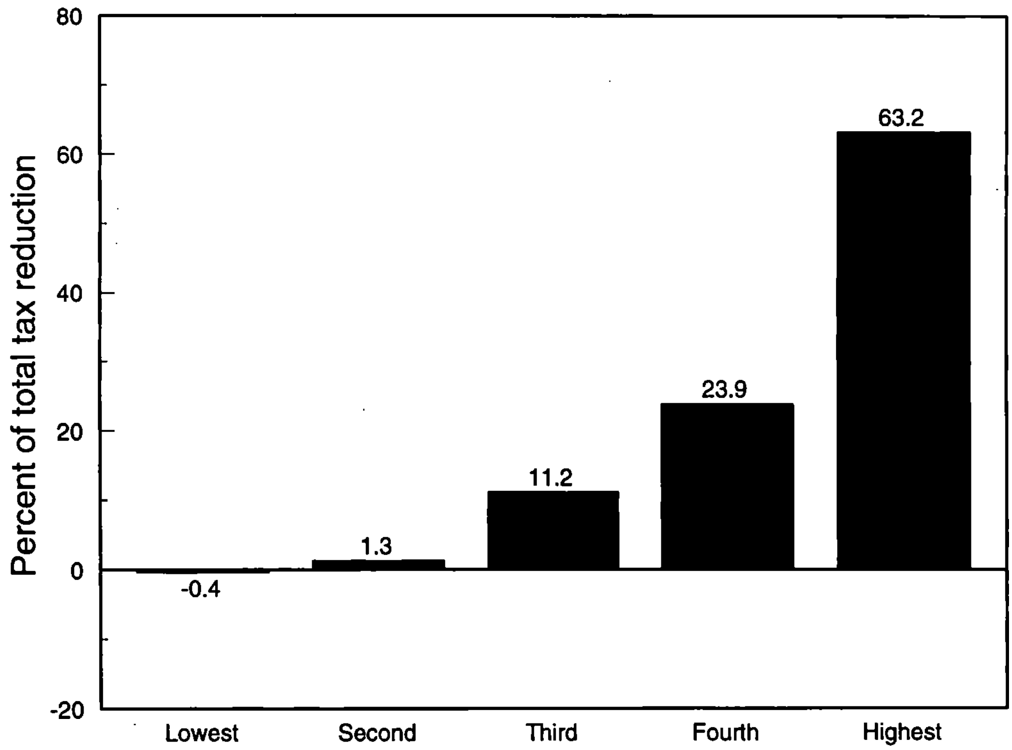
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 1, 1995

CHART OF THE WEEK

Tax Breaks By Family Income
Quintile Under the Republican Tax Plan



Treasury estimates that tax provisions in the Reconciliation Bill's Conference Agreement, if fully phased in, would give roughly two-thirds of all tax reductions to households with the highest incomes (over $79,000 in 1996 dollars), but would give only a minuscule share of the tax breaks to those in the second quintile, and actually would raise taxes for those with the lowest incomes. A Special Analysis in this issue of the Weekly Briefing discusses how the budgetary cost of tax breaks affecting mainly upper-income households rises sharply after the year 2002.

EYES ONLY

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"We jacked up our prices to insure that you receive the same quality and service in the future."

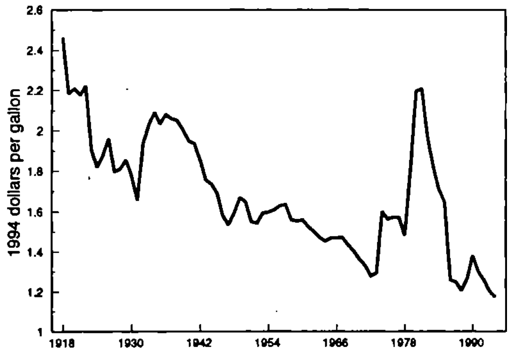
EYES ONLY

CURRENT DEVELOPMENT

Gas Prices Lowest Since Model T

Gasoline prices have fallen to their lowest level in real terms in the entire 75-year history of recorded pump prices (see chart). After a slight increase during the first half of 1995 compared with a year earlier, gasoline prices plunged in August below their 1994 levels and have continued to fall since then. Last month, consumers paid an average of $1.19 per gallon of gasoline, compared to $1.25 (adjusted for inflation) one year ago. The fall in gasoline prices has occurred despite the small rise of 4 cents in the Federal gasoline tax in 1993.

Retail Price of Motor Gasoline



Fuel cost of travel at all-time low. The low gasoline prices, coupled with steadily increasing motor fuel efficiency, have made the cost of auto travel the lowest ever for consumers. The cost per mile driven was 5.4 cents in 1994, compared to 9.6 cents 10 years earlier, and 11.4 cents in 1950, all measured in 1994 dollars.

Analysis. The recent drop in pump prices is somewhat puzzling, given the apparent tight supplies of producers and strong demand by households and businesses in conjunction with growth in the economy. This is even more surprising given that motorists in nine large cities have been required to use a new and more expensive cleaner-burning gasoline starting this year.

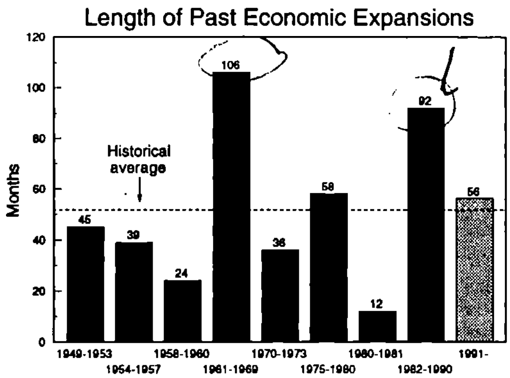
EYES ONLY

SPECIAL ANALYSIS

Is the Economic Expansion About to End?

The current economic expansion has run for 56 months, a little beyond the 52-month average for post-war expansions. As the expansion lengthens, analysts increasingly have raised the possibility that it might soon falter, with the economy dipping into recession. Although the current expansion is typical of other expansions in many ways, the current expansion will not end simply because it has gone on for a long period of time. Rather, economic indicators at present suggest that the expansion will continue into the foreseeable future.

The length of expansions has varied. Post-war economic expansions have varied substantially in length, with the shortest (1980-81) lasting only 12 months, and the longest (1961-69) lasting 106 months (see chart). Such large differences in the actual length of past expansions make the 52-month average a relatively uninformative guide to the life expectancy of the current expansion. The likelihood of the expansion ending depends on whether economic developments that typically precede an economic downturn—increasing inflation, rising interest rates, financial imbalances, and inventory buildup—have begun to appear.



- **Core inflation.** Most post-war downturns have been preceded by a rise in the core rate of inflation—the rate of inflation after eliminating the effects of volatile food and energy prices. The rise sometimes has been precipitated by external events—such as increased oil prices—and sometimes by overly stimulative fiscal or monetary policies. Although core inflation jumped up earlier this year, it since has moved down and stabilized at about 3.0 percent. Inflation remains firmly under control.

- **Interest rates.** Another feature preceding economic downturns is rising interest rates, typically because the Federal Reserve tightens credit policy in response to an increase in the rate of inflation. During 1995, however, interest rates have fallen, especially during the last part of the year, unlike the pattern usually seen prior to a downturn. Furthermore, as interest rates have fallen, the housing and auto sectors have recovered from the slowdown earlier in the year, so that these sectors should not develop overcapacity problems as they did early in 1995.

- **Bank problems.** Unlike the late 1980s and early 1990s, when the savings and loan crisis and general weakness of the banking sector represented a strong downside risk, the banks today are on a more stable footing. The better financial situation of the banks means that the system should be able to adapt more easily today to any adverse shift in interest rates or real estate values, thereby limiting the consequences for the overall economy.

- **Business inventories.** The inventory buildup in the auto and housing sectors that was evident earlier this year has now been mostly worked off, primarily as a result of the slowdown in the second quarter. Accordingly, the possibility in the near future of a downturn due to an inventory overhang appears remote.

- **Financial imbalances.** The recession of 1990-91 was preceded by a period during which the financial balance sheets of households became burdened by debt. These debt loads became unmanageable when interest rates increased and the real estate market weakened sharply, sending delinquency rates and personal bankruptcy filings soaring. Even though debt loads of households today have reached historic highs, lower interest rates presently are allowing households to manage their debts with a bit more ease. Given current debt levels, however, a rise in the average interest rate on outstanding household debt of about two percentage points could push the debt service burdens to the levels in the late 1980s. Although continuing goods news on inflation should keep interest rates low, an impasse on the budget, if it persisted, could raise interest rates sharply.

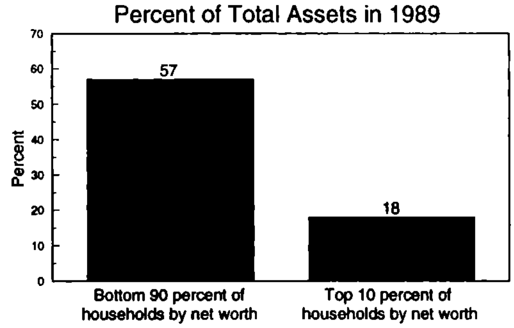
EYES ONLY

ARTICLE

House Rich and Cash Poor: Reverse Mortgages Can Help

The largest component of wealth for most Americans is, by far, the value of their homes. Housing wealth made up almost 60 percent of household assets in 1989 for homeowners below the 90th percentile of net worth, compared with a much smaller share for the richest homeowners (see chart). Although home-equity loans have made borrowing against this wealth possible for many working-age Americans, such loans have not been an option for retired Americans who cannot meet the associated income qualification standards. Soon, however, as many as 3 million retiree households may be able to turn the equity in their homes into cash under a new program offered by the Federal National Mortgage Association (Fannie Mae).

Housing Wealth as a Percent of Total Assets in 1989



Reverse mortgages. The new program, dubbed the "Home Keeper Mortgage," will set national standards for reverse mortgages, which differ from conventional mortgages by having no payments due until the homeowner dies or moves from their home. Fannie Mae will purchase reverse mortgages meeting these national standards from its network of lenders, bundle them together, and sell them to investors. In this way, Fannie Mae will create a national market for this type of mortgage, similar to the role it plays in conventional mortgage markets.

How will these mortgages work? Fannie Mae's Home Keeper Mortgage will allow people 62 or older to convert equity in their home into a lump-sum payment or a monthly income payment (or a mixture of both). Interest accrues on the mortgage but no payments are due until the homeowner dies, moves out of the home, or transfers ownership to another person. If a homeowner lives so long that total payments plus interest exceed the value of the home, the amount owed remains at most equal to the value of the home. Fannie Mae will use fees paid by the borrower to purchase insurance from mortgage insurance companies to cover this possible shortfall. The amount homeowners can borrow will depend on their life expectancy, marital status, and the value of their home. In addition, the amount available for borrowing depends on interest rates and origination fees.

Who will benefit? Among American seniors, over 62 percent own their home outright and thus could qualify for the program. Another 21 percent have a home with a remaining mortgage balance, but could qualify if the balance were paid off with proceeds of the reverse mortgage. The funds can be used for any purpose, and are seen as making it possible for seniors to stay in their homes and remain independent.

How important could this be? One way to gauge the potential importance of reverse mortgages is to compare the size of the monthly payment or lump-sum payment for which a borrower can qualify to their income or wealth. A recent Federal Reserve Bank study performed these calculations using Census Bureau data to estimate that:

- The monthly payment would equal at least 20 percent of other monthly income for about a quarter of homeowners 62 or over, while for about a tenth of such homeowners the share would be over half of their other income.
- The lump-sum payment would equal at least half of liquid wealth (checking accounts, stocks, bonds, etc.) for about 60 percent of homeowners age 62 or over.

These estimates suggest that for a significant portion of senior homeowners, availability of reverse mortgages may represent an important way for them to supplement their income and wealth.

But will seniors want to borrow against their homes? In the end, of course, reverse mortgages may not be a solution that seniors embrace. The limited experience with reverse mortgages to date suggests strong reluctance on the part of many seniors to "re-mortgage" their homes after working for so many years to pay off the original mortgage. Also, lenders often have charged high loan fees in the past. The new Fannie Mae program, however, should make reverse mortgages more widely available and more competitively priced, perhaps getting seniors to take a second look. With the number of senior households projected to increase sharply in the next 25 years, lenders likely will find this a market worth pursuing.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

More on Education and Racial Wage Inequality. In a recent study by the Economic Policy Institute cited in the Washington Post, the average black male aged 25-34 ~~continued to earn only~~ about 80 percent of the average wage for whites, despite gains in educational attainment. Two facts nullified their gains. First, an increase in the payoff to education made the remaining racial difference in educational attainment even more glaring. Despite progress, blacks continued to be less likely to graduate from high school or college. As the payoff to education grew, such differences became even more important. Second, mean wages for blacks fell relative to whites even among those with similar levels of education. This latter trend seems to have reversed since 1989 for male college graduates. (Black women continued to lose ground relative to white women with the same ~~educational~~ attainment.) Given current trends in college enrollment rates for blacks and whites, the outlook for racial equity in the future may ~~be more~~ gloomy. The racial gap in college enrollment among 18-24 year-olds, which began to close during the Seventies, actually widened during the 1980s and 1990s.

Christmas Price Index Takes A Swan Dive. The cost of "The 12 Days of Christmas" dropped sharply this year, according to PNC Bank of Pittsburgh, keeper of this seasonally adjusted "CPI". PNC says the cost of giving a partridge in a pear tree, two turtle doves, etc., has dropped to just $12,482, down 22 percent. The decrease was driven by a first-ever 50 percent drop from last year's $7,000 price tag for seven swans-a-swimming. The PNC report confirms the Administration's view of troubling wage distribution trends: while the unchanged minimum wage of $4.25 kept the cost of eight maids-a-milking at $34, the index's only increase was due to a 6 percent uptick in the cost of 10 Lords-a-leaping.

"Murphy Brown Syndrome" Documented. While much of the welfare reform debate has focused on out-of-wedlock births among poor women, unmarried women (particularly whites) in their thirties have displayed a growing trend toward having babies. The birth rate for white unmarried women in their thirties grew by 100 percent between 1983 and 1993. The growth in birth rates for black unmarried women was slower, at 26 percent, although the birth rate for unmarried black women in their thirties was still 1.7 times higher than for white women in their thirties. Also, the teen birth rate seems to be leveling off after a prolonged period of increase. After rising by 50 percent between 1983 and 1991, the birth rate for teens has been 45 per thousand for three consecutive years.

EYES ONLY

INTERNATIONAL ROUNDUP

Czech Republic Joins OECD. On November 28, the Czech Republic became the first post-communist economy to join the 26-member OECD (Organization for Economic Cooperation and Development). The Czech Republic has made significant progress since its "Velvet Revolution" six years ago. After experiencing a contraction of roughly 20 percent between 1989 and 1993, the economy is now growing again: It expanded by 2.6 percent in 1994, and is expected to grow by 4 percent this year. Other signs are also encouraging. The private sector accounts for roughly 70 percent of national output. The government budget has been in surplus since 1993, and inflation has fallen to an annual rate of 10 percent. And, unlike many other transition economies, the Czech Republic has managed to enjoy strong economic growth without high unemployment. The registered unemployment rate in 1994 was 3 percent.

French Transport Workers Strike to Protest Budget Cuts. Public transportation in France has come to a standstill as rail workers protest the Juppé government's plans to cut welfare spending and reform the pensions system. The national rail service has been on strike since November 24. Virtually all public transport across the country remained out of service on November 30, forcing many commuters to walk, hitchhike, and even rollerblade to work. In Paris 10,000 students protested on Thursday against underfunding of higher education; in Toulouse as many as 30,000 students took to the streets. The government's spending cuts are part of its effort to reduce the budget deficit from 5 percent of GDP to the limit of 3 percent required for participating in the European Union's move to a single currency.

U.K. Announces Budget Package. Chancellor of the Exchequer Kenneth Clarke unveiled the United Kingdom's 1996-7 budget on November 28. The budget deficit is currently 5 percent of GDP, but the new package nevertheless includes a small reduction in taxes. The basic income tax rate will be lowered from 25 to 24 percent, and the tax rate on investment income will fall from 25 to 20 percent. The income tax exemption level will also be raised, relieving an estimated 220,000 low-income people from having to pay income tax. The budget also includes some spending cuts, with increases in real expenditure on social insurance and welfare programs, the single largest budget item, restricted to 1 percent per year, by eliminating benefit eligibility for illegal immigrants and by reducing housing benefit for single people under 25. The government has also pledged to reduce the share of public spending from 42 percent of GDP to below 39 percent within the next three years.

EYES ONLY

RELEASES THIS WEEK

Advance Durable Orders

Advance estimates show that new orders for durable goods decreased 1.0 percent in October, following increases of 2.9 percent in September and 5.1 percent in August.

Housing Starts

Housing starts declined 4 percent in October to 1.34 million units at an annual rate.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, increased 5.1 index points in November, to 101.4 (1985=100).

MAJOR RELEASES NEXT WEEK

Leading Indicators (Wednesday)
Employment (Friday)
GDP Benchmark Revisions for
1959-92 (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
GDP implicit price deflator:					
Fixed weights	5.5	2.3	2.2	1.6	0.6
Chain weights*	5.4	2.7	2.8	2.2	1.9
Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.9	2.0
Chain weights	1.4	0.9	0.2	3.4	0.7
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.3	1.0
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	2.5	3.2
Chain weights*	1.2	0.7	1.8	1.4	1.8

* CEA estimates.

	1970–1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970–1993	1994	Aug. 1995	Sept. 1995	Oct. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.6	5.5
Payroll employment (thousands)					
increase per month			263	50	116
increase since Jan. 1993					7527
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.1	0.3
PPI-Finished goods	5.0	1.7	–0.1	0.3	–0.1

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

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Sept. 1995	Oct. 1995	Nov. 30, 1995
Dow-Jones Industrial Average	3522	3794	4747	4760	5074
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.28	5.30
10-year T-bond	5.87	7.09	6.20	6.04	5.76
Mortgage rate, 30-year fixed	7.33	8.35	7.64	7.48	7.33
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 30, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.447	+2.9	−7.8
Yen-Dollar	101.8	+1.3	+2.9
Multilateral $ (Mar. 1973=100)	85.31	+2.2	−4.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.3 (Q3)	5.5 (Oct)	2.8 (Oct)
Canada	1.9 (Q3)	9.2 (Sept)	2.4 (Oct)
Japan	0.6 (Q2)	3.2 (Sept)	0.2 (Sept)
France	2.1 (Q3)	12.1 (Aug)	1.8 (Oct)
Germany	2.1 (Q2)	6.6 (Aug)	2.0 (Aug)
Italy	2.9 (Q2)	12.0 (Jul)	5.8 (Oct)
United Kingdom	2.0 (Q3)	8.6 (Sept)	3.2 (Oct)

WEB Dec. 1995

EYES ONLY

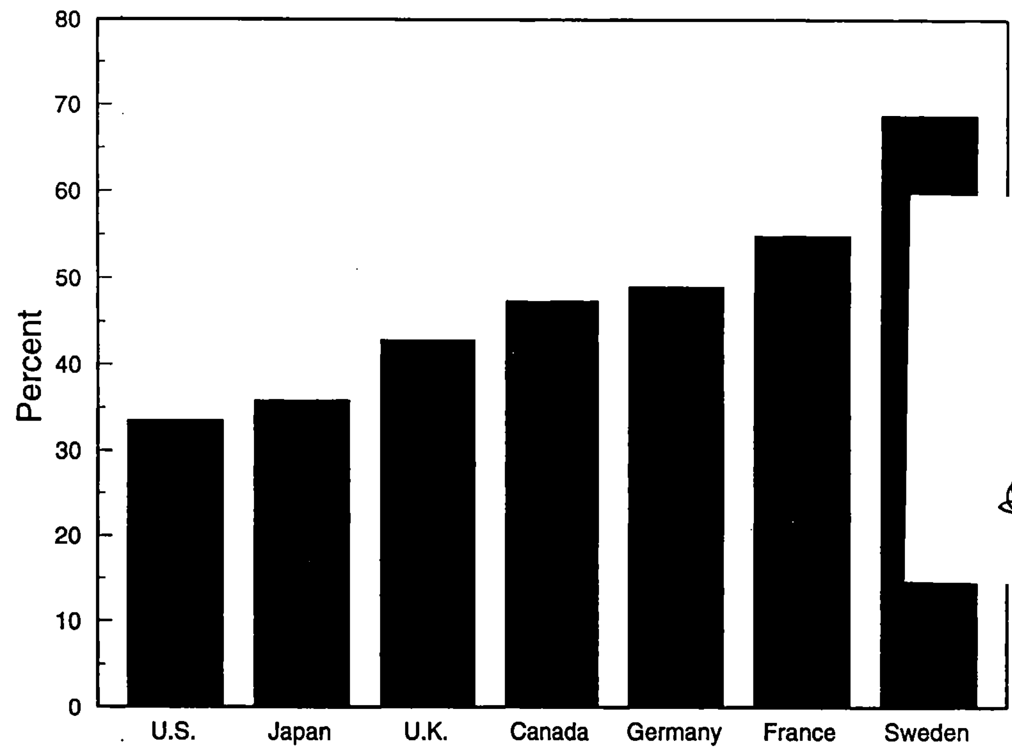
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 24, 1995

CHART OF THE WEEK

Government Spending as a Share of GDP in 1994



If you took out

Government spending (Federal, state, and local levels) as a share of GDP is lower in the United States than in any other major ~~industrial country. The~~ differences across countries are striking: the U.S. share, which has fallen to 33 percent, ~~is~~ far below the roughly 50 percent share in Germany and France, and the nearly 70 percent share in Sweden.

medical — If you took out health what would the be —

what was the high

EYES ONLY

CONTENTS

EYES ONLY

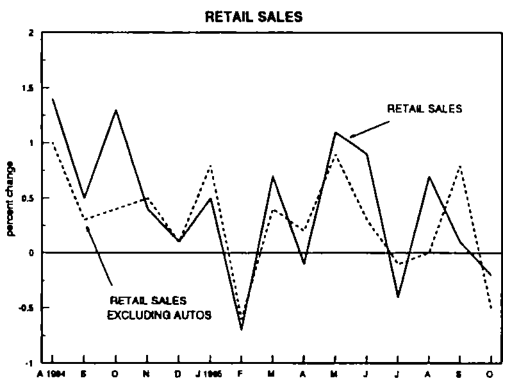
MACROECONOMIC UPDATE

Expansion Settling Back into Stride

The economy had a very strong third quarter: real GDP grew by 4.2 percent, exceeding most private and government forecasts. On the basis of currently available data, growth should return to a more sustainable pace of 2.0 to 2.5 percent in the fourth quarter. Even with a possible downward revision to the third quarter figures, this would imply growth for 1995 of about 2.5 percent (fourth quarter over fourth quarter), well above the Administration's forecast of 1.9 percent and roughly in line with estimates of the economy's long-run growth capacity. Inflation should remain low and stable.

Several developments support the view that we will return to a more sustainable growth rate in the fourth quarter:

- **Employment.** A moderate rise in employment during October helped lower the unemployment rate to 5.5 percent, but in recent weeks initial claims for unemployment insurance have risen, possibly foreshadowing slower employment growth for November.



- **Retail sales.** Retail sales fell in October, as non-auto sales declined sharply, suggesting that consumers may be restraining their spending just as the holiday shopping season is about to begin (see chart). Auto manufacturers report a larger-than-forecast drop in the number of autos sold, sparking concern that auto inventories are increasing and that manufacturers may soon cut production to reduce excess inventories.

what's happened to consumers?

- **Manufacturing.** Output of the nation's factories fell in October, reversing the pickup in activity seen during the late summer and confirming other reports of a softening in the manufacturing sector. Most of the October decline, however, was due to the continuing strike at Boeing. Without the strike-induced decline, output would have been roughly unchanged.

And strike is over

At the same time, two developments should cushion the fallback in growth:

- **Housing.** Sales of new homes have been strong in recent months, reflecting the decline this year in mortgage lending rates. With building permits up for five consecutive months, housing should remain strong through the fourth quarter.

EYES ONLY

- **Investment.** Factory orders for durable goods, such as machinery and equipment, have been strong recently, and should help sustain the pace of business investment in the fourth quarter.

Budgetary implications

The unexpectedly strong growth in real GDP this year has a positive impact on the budget. However, growth in nominal GDP is likely to be lower than projected because of slow growth in the GDP deflator. This lowers tax revenue and is only partially offset by the lower expenditures resulting from subdued CPI inflation. The Troika is currently analyzing the budgetary implications of these and other data issues.

EYES ONLY

SPECIAL ANALYSIS

The Economic Effects of a Long-Term Budget Impasse

What is the outlook for economic growth if the budget battle deadlocks and part of the government operates under a Continuing Resolution for a full year? The answer hinges in large part on the size of the cuts and the response of the financial markets.

The size of the cuts. Most forecasts (including the Administration's) include some deficit reduction for 1996. But a Continuing Resolution could produce slightly more than expected. For example, suppose outlays in 1996 are $10 billion lower than in the President's deficit reduction plan. This by itself would reduce 1996 GDP growth by about 0.15 percent. The normal feedback or "multiplier" effects (as the impact of lower government spending spreads throughout the economy) could then take another 0.1 percent off growth, slowing growth to 2.25 percent from the currently projected rate of 2.5 percent.

contraction from spending itself

Response of the financial markets. Moderately lower interest rates could compensate for the contractionary effect of the budget cuts. A rough estimate is that a decline of about 0.2 percentage points in long-term interest rates would offset the fiscal contraction's effect on economic growth.

Unfortunately, if the financial markets were to conclude that a budget impasse reduces the prospects for a substantial deficit reduction plan, long-term interest rates might rise, rather than fall. Such a market reaction is consistent with the view that a significant proportion of the decline in long-term interest rates since their peak last November (10-year Treasury debt yields have fallen 203 basis points) and of the increase in the stock market since last December (the S&P 500 has risen over 31 percent) is due to expectations that a balanced budget plan will be enacted. If the markets believe that no budget plan is forthcoming, bond and stock prices could fall even as near-term growth slows and output slips slightly below potential.

How much could growth slow during 1996? Adverse movements in long-term interest rates and the stock market would amplify the effect of the budget cuts. Assuming a 0.5 percentage point rise in long-term rates and an equivalent correction in stock prices, these additional effects could shave an additional 0.5 percentage points off growth, reducing 1996 growth to about 1.75 percent. The reaction of consumer confidence represents an additional downside risk: confidence could deteriorate because of a budget impasse, so that consumer spending might be even weaker than expected given reduced income levels and higher interest rates.

financial market contraction

Potential offset factors. Several factors could dampen the negative effects on growth of a budget impasse.

EYES ONLY

• How the **Federal Reserve** reacts could affect the extent to which the economy slows during 1996. The Fed may not lower interest rates if there is a budget impasse. If it were to cut short-term interest rates, the rise in long-term interest rates might be attenuated, somewhat cushioning the slowdown in growth. But given the usual lags between changes in short-term and long-term rates, such a decline in long rates might not occur immediately. In any case, increased uncertainty for investors could raise the long-term risk premium.

autonomy * reversal - there is a view Fed should act now anyway could always reverse -- the rate is high now

• The **dollar** could fall, reflecting a lapse in confidence about our ability to effect significant deficit reduction. The conventional expectation is that a rise in U.S. interest rates strengthens the dollar. But if the increase in interest rates reflects a higher risk premium, the dollar could fall. Were this to happen, the ensuing increase in net exports would help cushion the decline in economic growth.

Fed concern about market reaction if it lowers rates before a budget deal

EYES ONLY

ARTICLE

How Does CPI Mismeasurement Affect Our View of Economic Performance?

Increases in the consumer price index, as presently calculated, overstate increases in the cost of living. An important implication of mismeasurement in the CPI is its effect on the Federal budget, through spending and revenues that are indexed for inflation. According to the Congressional Budget Office, every 0.5 percentage point per year overstatement in the CPI (which is at the low end of most estimates of the bias) adds $140 billion dollars to the deficit over the next 7 years.

In addition to affecting future budget deficits, mismeasurement in the CPI affects our measures of real wages and incomes. To the extent that past increases in the cost of living were lower than we thought, increases in the standard of living measures have been correspondingly higher. Our analysis below shows that accounting for mismeasurement in the CPI has important quantitative, but not qualitative, effects on our view of the past.

A new look at the past. While there is a range of opinions over the precise magnitude of the CPI measurement bias, a reasonable estimate is roughly 1.2 percentage points per year. Relatively easy-to-fix problems of constructing the index account for 0.7 percentage points. It is more difficult to estimate the impact of hard-to-fix problems such as accounting for quality changes in new and existing products, but a reasonable number is roughly 0.5 percentage points. If we assume that the total bias in the index has been constant over time at either the full 1.2 percentage points or a smaller 0.7 percentage points:

This is huge

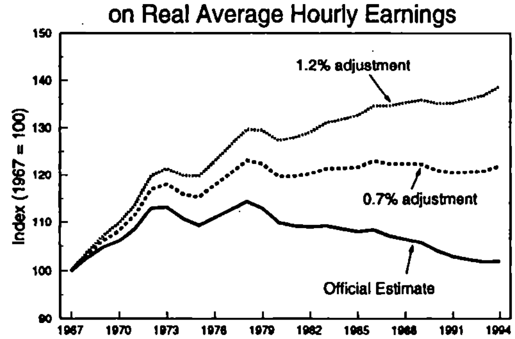
I disagree strongly

...lem anytime .5 each year on quality

Real average hourly earnings actually grow instead ~~of stagnating since~~ 1973 (see chart). Official data indicate an average decline of 0.5 percent per year between 1973 and 1994. But assuming a CPI bias of 1.2 percentage points per year, real average hourly earnings grow by 0.6 percent per year over the same period. Real family incomes are also higher across all income classes.

If bias were only 0.7 - stagnation

The Effect of CPI Mismeasurement on Real Average Hourly Earnings



Real GDP and productivity grow a bit faster. Some of the measurement biases in the CPI affect the GDP deflator, which is used to convert nominal GDP into real GDP. If the measured GDP deflator is too high, real measured GDP is too low.

Inequality is not affected by a CPI adjustment. Although adjusting the CPI changes our view of the absolute level of real wages and productivity over the past two decades, it does not change our view of the relative disparity of wages across occupations, education levels, or industries, since all wages would be adjusted upward by the same percentage in a given year. For example, the recent widening in the gap between wages paid to college graduates and wages paid to non-college graduates would be unaffected by adjustments to the CPI. And income inequality does not change, because all incomes would be adjusted upward by the same proportion. For example, the ratio of the income of the top fifth of the distribution to the bottom fifth is unchanged after adjusting the CPI.

This analysis assumes that the CPI bias has been constant over time. Any change in the CPI bias could explain at most a modest part of the productivity slowdown since 1973 (this slowdown amounts to roughly 1.5 percentage points per year).

What does this mean? The main message of these results is that reasonable adjustments to the CPI would have small but important effects on historical average annual growth rates of output, incomes and wages. Given the power of compounding, small differences in growth rates have increasingly large effects on levels of real output, incomes, and wages over time. While these adjustments affect our perception of the economy's performance, other factors are also important in assessing economic well-being. For example, increased income disparities and extensive down-sizing may contribute more to economic insecurity than any offsetting increases in real income. And the relative ranking of incomes or wages across income groups is completely unaffected by the CPI adjustments, preserving our view of shifts over time in the distribution of incomes.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

"Japan Premium" Pinches U.S. Municipal Borrowers. Japan's banking crisis is imposing higher borrowing costs on U.S. cities and counties with bonds guaranteed by Japanese banks. Municipal borrowers need bank guarantees to assure investors that cash will be available to redeem variable-rate bonds upon demand. Because of the large burden of bad loans held by Japanese banks, investors in municipal bonds are charging a premium to offset the added risk of holding Japanese-backed bonds. According to media reports, New York City has had to pay as much as a 20 basis point premium on city bonds backed by Japanese banks. The problem seems especially serious in California, where about 36 percent of weekly, variable-rate bonds issued are backed by Japanese banks.

can't they move to other source of bank guarantees

Education Panel Reports Mixed Results. The 10-year campaign by the nation's governors to improve American educational performance has achieved only modest gains and has suffered some discouraging setbacks, according to the halfway report of the National Education Goals Panel (the precursor of the Administration's GOALS 2000 initiative). Math achievement has improved at Grades 4, 8 and 12 (though by less than was hoped at Grade 12), while reading achievement has slipped for Grade 12 and remained constant at Grades 4 and 8. More preschoolers are read to and told stories regularly, and the incidence of threats and injuries to students at school has declined. At the same time, student drug use and the sale of drugs at school have increased. The high school completion rate has not increased, and a large gap remains between white and minority college enrollment and completion rates.

Set goal of HS completion rate — set goal of college completion rate — do a Governors type affair

Fiscally Healthy States Prepare for Budget Uncertainty. States are doing better fiscally than at any time since before the 1990-91 recession, but nonetheless are preparing for significant changes likely to result from Federal budget cuts, according to the semiannual Fiscal Survey of States. The report, prepared jointly by the National Governors' Association and the National Association of State Budget Officers, found that state spending rose by 6.3 percent during fiscal year 1995 and that few states were forced to reduce their budgets at midyear. Many states reported that their preparations for the expected Federal cutbacks include the elimination of services, commissions, and boards, as well as the privatization of state government operations.

EYES ONLY

RELEASES LAST WEEK

Retail Sales

Advance estimates showed that retail sales decreased 0.2 percent in October following an increase of 0.1 percent in September. Excluding sales in the automotive group, retail sales decreased 0.5 percent in October.

Consumer Price Index

The consumer price index increased 0.3 percent in October. Excluding food and energy, consumer prices also increased 0.3 percent.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production decreased 0.3 percent in October following a 0.1 percent increase in September. Capacity utilization decreased 0.5 percentage point to 83.6 percent.

MAJOR RELEASES THIS WEEK

U.S. International Trade in Goods and Services (Wednesday)

MAJOR RELEASES NEXT WEEK

Housing Starts (Tuesday)
Consumer Confidence—Conference Board (Tuesday)
Advance Durable Orders (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
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Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.9	2.0
Chain weights	1.4	0.9	0.2	3.4	0.7
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.3	1.0
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	2.5	3.2
Chain weights*	1.2	0.7	1.8	1.4	1.8

* CEA estimates.

	1970–1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970–1993	1994	Aug. 1995	Sept. 1995	Oct. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.6	5.5
Payroll employment (thousands)					
increase per month			263	50	116
increase since Jan. 1993					7527
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.1	**0.3**
PPI-Finished goods	5.0	1.7	–0.1	0.3	–0.1

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Sept. 1995	Oct. 1995	Nov. 20, 1995
Dow-Jones Industrial Average	3522	3794	4747	4760	4983
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.28	5.35
10-year T-bond	5.87	7.09	6.20	6.04	5.93
Mortgage rate, 30-year fixed	7.33	8.35	7.64	7.48	7.35
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 20, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.410	−0.6	−9.3
Yen-Dollar	101.4	−0.3	+2.9
Multilateral $ (Mar. 1973=100)	83.90	−0.5	−5.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.3 (Q3)	5.5 (Oct)	2.8 (Oct)
Canada	2.5 (Q2)	9.2 (Sept)	2.3 (Sept)
Japan	0.6 (Q2)	3.2 (Sept)	−0.3 (Aug)
France	2.9 (Q2)	12.1 (Aug)	2.0 (Sept)
Germany	2.1 (Q2)	6.6 (Aug)	2.0 (Aug)
Italy	2.9 (Q2)	12.0 (Jul)	5.8 (Sept)
United Kingdom	2.3 (Q3)	8.6 (Sept)	3.8 (Sept)

(1) DC issue
(2) CEA - CPI report
(3) Charts for TBTW

EYES ONLY

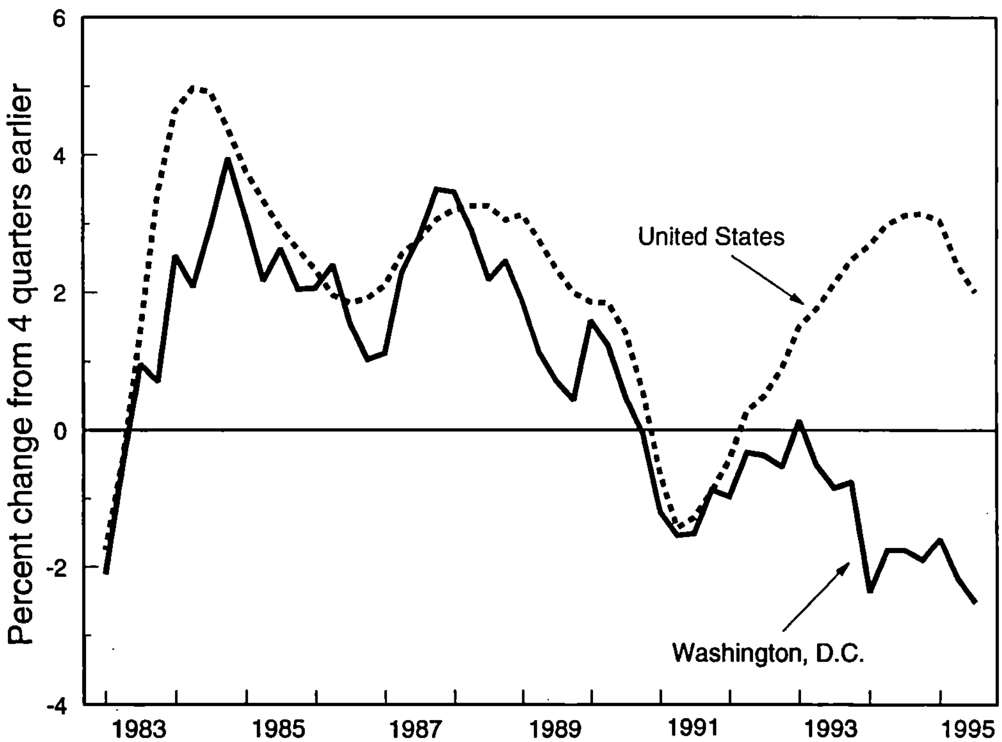
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 10, 1995

CHART OF THE WEEK

Employment Growth in
the District of Columbia and the United States

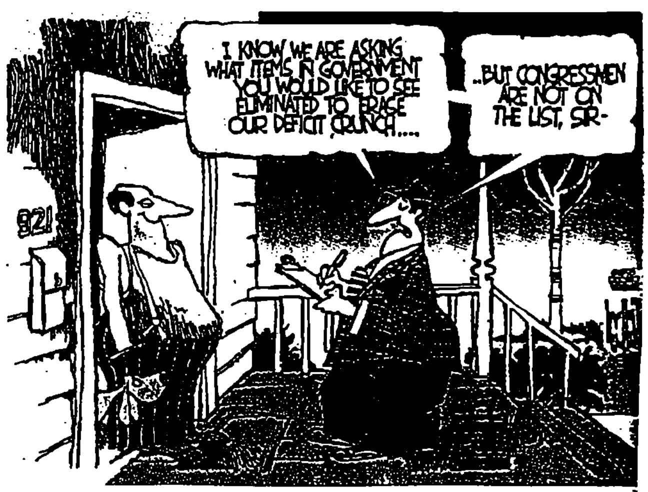


Need DC Category - why don't we have one?

Employment growth in the District of Columbia closely tracked the national pattern during the 1980s. Since 1991, however, employment growth in the District has fallen sharply relative to the nation, with employment actually contracting over the past 5 years. An Article in this issue of the Weekly Economic Briefing discusses the recent deterioration in job prospects for District residents.

EYES ONLY

CONTENTS



EYES ONLY

CURRENT DEVELOPMENT

Preliminary Data Show Eight Million Jobs Created

The Bureau of Labor Statistics reported recently that its official measure of employment rose by 7.5 million jobs from January 1993 through October of this year. BLS has already started the process of revising the 1995 employment data, and has released its estimate of revisions through March 1995 with the recent report. BLS estimates that the gain in employment through March will be revised upward by 590,000, which would push the total gain from January 1993 through October 1995 to 8.1 million.

Two caveats. This estimate is still unofficial and could change:

- The revision ~~for March~~ will not become official until June 1996 when revised data for all of 1995 are released.
- Although it is unlikely, employment gains between March 1995 and December 1995 could be revised downward.

Should be official by April. Even without these revisions (to be announced in June 1996), it is highly likely that the official, ~~regularly reported~~ gain in jobs will surpass 8 million by early 1996. With most analysts estimating that the economy will create about 100,000 jobs per month for the near future, it should take about 5 months to raise the official estimate of employment from 7.5 million to 8 million. This should occur when the March employment numbers are released by BLS in early April.

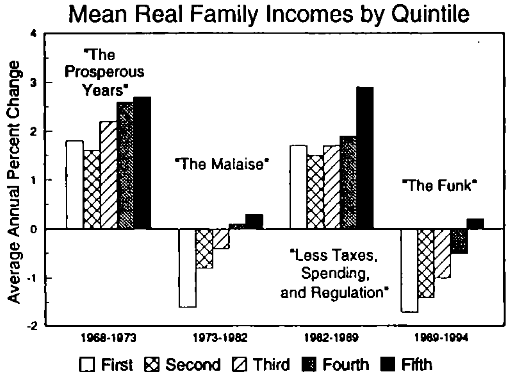
EYES ONLY

CURRENT DEVELOPMENT

Lies, Damn Lies, and Statistics

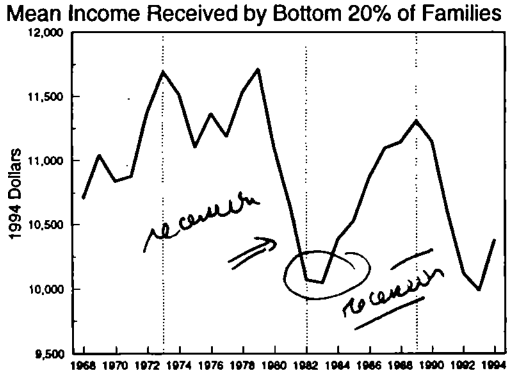
A recent opinion piece by Senator Connie Mack argued that real family incomes declined from 1973 to 1982, grew significantly from 1982 to 1989, and declined or stagnated from 1989 to 1994 (see top chart). The article attributed the differences in performance to economic policies, claiming, for example, that the gains from 1982 to 1989 were the result of less government spending, lower taxes, and less government regulation.

Mean Real Family Incomes by Quintile



Analysis. A problem with income comparisons of ~~the sort presented~~ in the article is that fluctuations over the business cycle can overwhelm underlying trends in income. One way to adjust for this problem is to make sure the starting and ending points for different time periods represent similar stages of the business cycle.

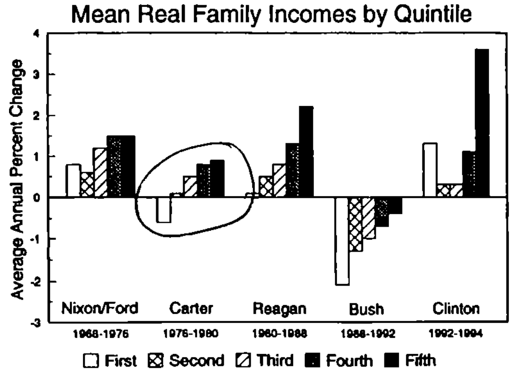
Mean Income Received by Bottom 20% of Families



The Mack article does not make this adjustment. In fact, the article picks time periods that accentuate the effects of the business cycle. As the middle chart shows, the period 1973 to 1982 starts with a high point and ends with a low point of a business cycle, 1982 to 1989 starts with a low point and ends with a high point, and 1989 to 1994 starts with a high point and ends during an on-going economic expansion.

cycles matter

Mean Real Family Incomes by Quintile



A different view. By choosing time periods to match presidential administrations, a very different picture emerges (see bottom chart). In particular, incomes declined from 1988 to 1992, but rose from 1992 to 1994. The gain from 1992 to 1994 for the bottom quintile helped lower the poverty rate during 1994.

EYES ONLY

SPECIAL ANALYSIS

The Rising Cost of Tuition at Public Universities

Between 1986 and 1992, tuition at public 2-year and 4-year colleges grew by 21 and 37 percent, respectively, even after accounting for inflation. The primary cause of the increase was not higher costs of education. Educational expenditures per full-time equivalent student rose by only 2.6 percent at public 4-year colleges and actually fell by 3.8 percent at public 2-year colleges. Rather, tuition increased because of a decline in state support for higher education as budgetary constraints forced states to reorient ~~their~~ spending priorities. In 1986, state and local governments paid about 71 percent of educational ~~expenses per student at~~ public colleges. By 1992, ~~these subsidies~~ covered only 63 percent of these costs. As state and local governments have cut the share of ~~costs~~ covered by their subsidies, tuition costs have risen accordingly.

What Do Students Actually Pay? The total costs of a year at public 2-year and 4-year colleges in 1992 were approximately \$5,400 and \$10,000 respectively. Even with the decline in state support, however, students at public institutions usually pay much less than the full cost of their education (see table).

comparison public v private — has private sty become even more expensive? one year

Educational Costs and Tuition at Public Colleges in 1992

	Public 2-Year Colleges	Public 4-Year Colleges
Average Educational Expenditure per Full-Time Student	\$5,361	\$9,938
Tuition and fees minus grant aid, by family income:		
First quartile	-\$79	\$518
Second quartile	740	1,767
Third quartile	1,012	2,337
Fourth quartile	1,228	3,028

Nevertheless, students' out-of-pocket cost can be a significant burden, particularly for lower-income students. Loan programs often help to meet this additional need. With states likely to continue shifting more of the costs of a college education onto students, the demand for Federal loan programs is likely to continue to grow.

EYES ONLY

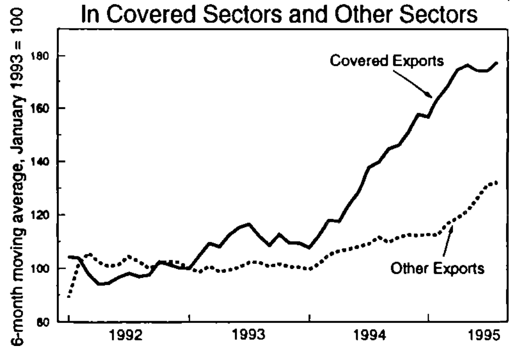
SPECIAL ANALYSIS

U.S. Trade Policy with Japan: Assessing the Record

The Council of Economic Advisers and the Treasury Department recently released an interim assessment of the Administration's trade policy with Japan that finds evidence of improved access to Japan's markets. Although the solid export performance detailed in the report has been influenced by a variety of factors, the Administration's trade agreements with Japan appear to have contributed to the growth in exports.

Export growth is strong. The report shows that, since the be~~ginning of the~~ Administration, growth in U.S. exports to Japan has been strong—more than twice the growth in U.S. exports to ~~the~~ European Union. Moreover, export growth in sectors covered by Clinton Administration trade agreements has been even stronger. U.S. exports to Japan in sectors covered by Clinton ~~Administration~~ agreements have grown nearly 80 ~~percent since January 1993,~~ ~~or about~~ twice as fast as other exports to Japan (see chart). ~~Furthermore,~~ growth in U.S. exports ~~to Japan in~~ these sectors has been accelerating— so has growth of all the years. exports in these sectors grew one-seventh in 1993, one-quarter in 1994, and by nearly one-third in the first 8 months of 1995.

U.S. Exports to Japan
In Covered Sectors and Other Sectors



Sectoral successes. The report also details gains in specific sectors where there has been sufficient time since the agreements were signed to judge the results:

- U.S. exports to Japan of medical instruments have grown over 50 percent since an agreement on public sector procurement of medical technology was signed in November 1994. This is over twice the rate of growth of U.S. medical-instrument exports to the European Union.
- Since the agreement on cellular telephones was signed in March 1994 and the Japanese Government instituted deregulation measures, subscribers in the Tokyo-Nagoya region have grown from 22,000 to 500,000. Motorola, which had tried unsuccessfully for years to break into this market, provides the bulk of equipment to build and maintain this system, with sales in the hundreds-of-millions of dollars per year.
- The Administration targeted apples as one of its first bilateral trade initiatives with Japan. Whereas U.S. apple exports to Japan were once banned, apple exports are now expected to reach $15 million in 1995.

Analysis. U.S. exports worldwide have been growing rapidly during the past several years. Some of the recent growth in exports to Japan likely reflects this overall upward trend in U.S. exports, and thus the Japanese gains cannot be entirely attributed to changes in trade policy. For example, the rise in exports for many of the sectors covered by Administration trade agreements began prior to implementation of those agreements. Even so, the evidence supports the view that these agreements have contributed to export growth:

- Export growth in sectors covered by agreements has been twice as high as growth in other sectors.
- Export growth in sectors covered by agreements has been accelerating as more agreements have been signed.

Bilateral deficit is not a useful scorecard. Despite the strong performance of exports and a resurgence in U.S. competitiveness, some critics will mistakenly point to the bilateral trade deficit with Japan as a scorecard of U.S. trade policy. The bilateral deficit is attributable to macroeconomic factors such as slower economic growth and higher domestic saving in Japan compared with faster growth and lower saving in the United States, and does not gauge the success or failure of trade policies. As Japan's growth rate rises and the U.S. budget deficit continues to decline (raising domestic saving in the United States), we should see improvement in the bilateral trade balance.

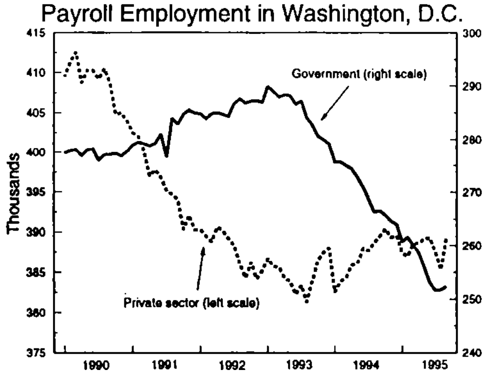
EYES ONLY

ARTICLE

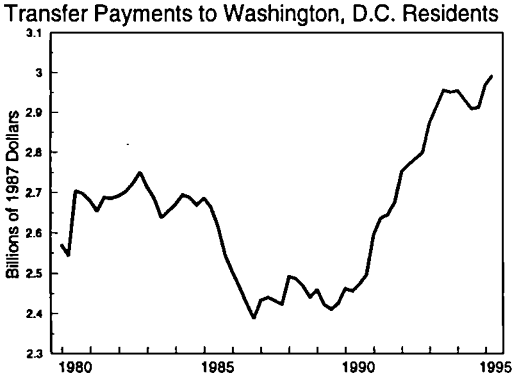
District of Columbia's Economy Struggles with Job Loss

A bill recently passed by the House would set spending for the District of Columbia at $4.9 billion for fiscal year 1996, representing a reduction of $256 million below the budget level recommended by the District's financial control board. This proposed cut comes at a time when the District's economy is struggling to cope with substantial job loss due to continuing downsizing of the Federal and local governments, as well as its ongoing budgetary and social problems.

Payroll Employment in Washington, D.C.



Transfer Payments to Washington, D.C. Residents



Analysis. The District has shed nearly 45,000 jobs—about 6.5 percent—over the past 5 years. While a fall in private-sector jobs drove the decline during the early 1990s, a sharp reduction in government jobs (24,000 Federal and 7,000 local) was responsible for the decline over the past 2 years (see chart).

Jobs in the District, of course, can be held by residents of neighboring states, and District residents likewise can hold jobs outside the District, so changes in jobs don't translate directly into changes in employment of District residents. In fact, the drop in employment of District residents has been relatively greater than the number of jobs eliminated in the District would suggest. Employment has declined 18 percent over the past 5 years, and about 20 percent since it peaked in 1988.

This drop in employment has nearly doubled the District's unemployment rate, from 4.8 percent in 1988 to 9.1 percent today. By comparison, the national rate was 5.5 percent in 1988, the same as today. The weak job market has been one factor pushing more residents on to public assistance, and causing Federal and local government transfer payments to increase 20 percent since 1988 (see chart).

Outlook. With further cutbacks in Federal employment likely, the District's future employment prospects depend on job creation in the private sector. On this score the outlook is uncertain: although activity appears to have picked up

EYES ONLY

modestly in some sectors, the hospitality industry—the District's largest private employer—continues to struggle to compete against cities with larger convention facilities, as well as cheaper lodging available in the suburbs. More importantly, the District continues to suffer from the problems of an urban center—poor schools, high crime, and drugs—that have caused jobs and people to locate in the suburbs.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Budget Cuts Threaten Federal Statistics Agencies. Both the House and Senate Appropriations bills include sizable cuts (relative to Administration requests) in the budgets for the major Federal statistics agencies. The Bureau of the Census has said these cuts will require a large reduction in preparatory activities for the 2000 Decennial Census and elimination of some data gathering necessary for scheduled improvements of the National Accounts. The Bureau of Economic Analysis will have to end tabulation of regional, state, and local data. Perhaps the highest profile cut, however, is to the Bureau of Labor Statistics, for which the Administration requested $377 million, while the House budget was $30 million less, and the Senate Appropriations Committee was $46 million less. If such cuts are enacted, BLS likely will be forced to slow its research into correcting ways in which the Consumer Price Index overstates rises in the cost of living. Such corrections would have powerful effects on budget projections. In reaction, Republican Congressional leaders recently have changed their tune and asked the BLS whether it needs more funding to carry out such research.

Official Warns Banks About Increasing Loan Risk. The nation's 40 largest federally chartered banks have relaxed standards for consumer loans, according to a survey and letter released by the Comptroller of the Currency. The survey found that 48 percent of the banks had eased home equity lending standards. Of the banks loosening standards, more than half said they are lowering collateral requirements, with some reporting higher maximum credit lines. Standards for indirect consumer lending (e.g., credit card balances) eased at 33 percent of the surveyed banks, while 35 percent reported somewhat increased credit risk in this area. The study also found that banks made more exceptions for individual loans not conforming to the banks' established policies. The Comptroller concluded his letter to the banks by expressing concern that banks not lose sight of the added risk.

Education Department Releases Annual Report. In its annual study entitled, "The Condition of Education," the Department of Education reports that the drop-out rate for students in grades 10 to 12 held steady between 1992 and 1993. The study also finds that high school graduates have taken more courses overall, particularly in core academic fields. While the share taking remedial math courses fell from 33 percent in 1982 to 17 percent in 1992, the proportion taking both advanced algebra and geometry rose from 29 percent to 50 percent. In addition, the study finds that more high school graduates are choosing to go to college immediately after high school graduation, though it is very common for college students to enroll, leave, possibly return, and thus not finish within the expected period of time.

EYES ONLY

INTERNATIONAL ROUNDUP

Concern over Russian reforms in run-up to December elections. The dismissal of the head of the central bank and slightly higher budget deficit projections are raising questions about Russia's economic prospects. On November 8, President Boris Yeltsin dismissed acting central bank chairwoman Paramonova, who had twice failed to be confirmed by Russia's parliament because of her anti-inflation zeal. Alexander Khandruyev, a central bank deputy whose commitment to fighting inflation seems uncertain, was appointed as interim chairman. Meanwhile, debate in the parliament continues to focus on the 1996 budget. There is considerable pressure to pass the budget before the December elections. Media reports indicate that a new budget was approved by a reconciliation committee on November 8. The budget includes deficit projections which are slightly worse than originally planned by the government.

The peso reaches an all-time low. Turmoil intensified on Mexico's markets this week as the peso fell to a record closing low of 7.85 pesos per dollar on November 8. Interest rates have risen sharply: the yield on new 3-month government debt rose from 44 percent during last week's auction to 52 percent this week. The upheaval in financial markets seems to be the result of an apparent crisis of confidence, as well as continuing concerns about banking sector problems and political unrest.

Markets react positively to French government reshuffle. Financial markets reacted positively to a government reshuffle announced by French Prime Minister Juppé on November 7. The reshuffle is being interpreted as a signal that the government intends to address France's persistent budget deficit. The government has suffered a sharp drop in popularity since President Chirac took office 6 months ago, as pledges to reduce unemployment and taxes have failed to be fulfilled (see Weekly Economic Briefing, October 27, 1995). Plans to reform the welfare system are crucial to improving the country's public finances, and proposals for cutting welfare expenditures are expected next week. France must reduce its current budget deficit from 5.2 percent of GDP to no more than 3 percent in order to meet the fiscal criterion for European Monetary Union.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

The producer price index for all finished goods decreased 0.1 percent in October. Excluding food and energy, producer prices were unchanged.

Productivity

Nonfarm business productivity increased at an annual rate of 2.0 percent in the third quarter. Manufacturing productivity increased 6.2 percent.

MAJOR RELEASES NEXT WEEK

Advance Retail Sales (Tuesday)
Consumer Prices (Wednesday)
Industrial Production and Capacity Utilization (Wednesday)
Housing Starts (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
GDP implicit price deflator:					
Fixed weights	5.5	2.3	2.2	1.6	0.6
Chain weights*	5.4	2.7	2.8	2.2	1.9
Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.9	**2.0**
Chain weights	1.4	0.9	0.2	**3.4**	**0.7**
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.3	**1.0**
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	**2.5**	**3.2**
Chain weights*	1.2	0.7	1.8	1.4	**1.8**

* CEA estimates.

	1970–1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970–1993	1994	Aug. 1995	Sept. 1995	Oct. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.6	5.5
Payroll employment (thousands)					
increase per month			263	50	116
increase since Jan. 1993					7527
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.1	N.A.
PPI-Finished goods	5.0	1.7	–0.1	0.3	**–0.1**

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

New or revised data in **boldface.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Sept. 1995	Oct. 1995	Nov. 9, 1995
Dow-Jones Industrial Average	3522	3794	4747	4760	4864
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.28	5.39
10-year T-bond	5.87	7.09	6.20	6.04	5.97
Mortgage rate, 30-year fixed	7.33	8.35	7.64	7.48	7.37
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	November 9, 1995	**Week ago**	**Year ago**
Deutschemark-Dollar	1.412	−0.4	−7.6
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EYES ONLY

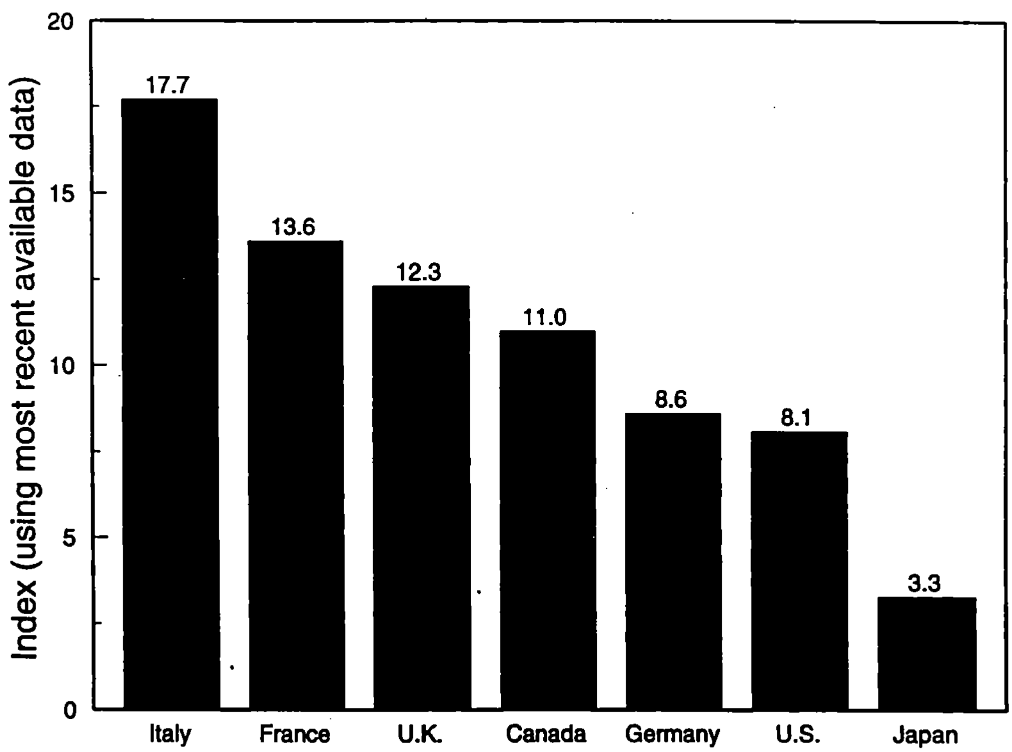
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 3, 1995

CHART OF THE WEEK

The Misery Index



The Misery Index—the sum of the unemployment and inflation rates—currently is lower in the United States than in any other G-7 country, except in Japan where economic recession has brought inflation to a standstill and unemployment has historically been extremely low. On a 12-month basis, the index for the United States is currently at its lowest level since 1969.

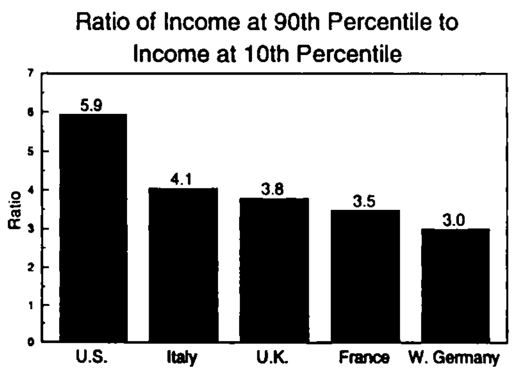
EYES ONLY

CONTENTS

TREND

U.S. Income Inequality Highest in OECD Survey of Countries

A recent study commissioned by the OECD finds that during the mid-1980s, income inequality in the United States was greater than in any other industrialized country surveyed.

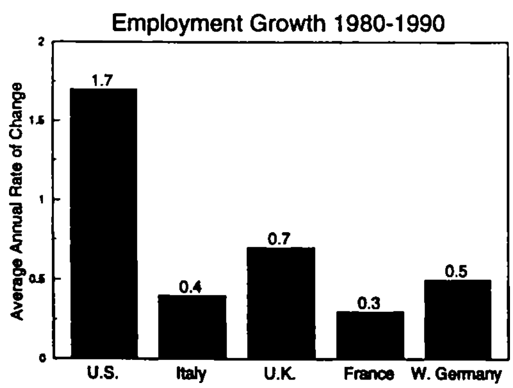


Note: U.S., Italy, and U.K. in 1986; France and W. Germany in 1984

The study compares disposable incomes of individuals (excluding in-kind benefits) and finds that individuals near the top of the income distribution in the United States received 5.9 times as much as individuals at the bottom of the income distribution (see chart). In West Germany, by comparison, individuals at the top received 3 times as much as individuals at the bottom.

Analysis. Three main factors explain the cross-country differences in income inequality:

- **Institutional differences.** Countries differ in institutional features such as collective bargaining arrangements, minimum wage laws, and education and training programs. As a result, economies respond differently to worldwide economic forces—such as technological change and increased international competition. For example, the greater flexibility of labor markets in the United States often has been credited as the driving force behind strong job creation and low unemployment relative to Europe (see chart). At the same time, this flexibility also has been cited as a cause of the decline in real wages for the less-skilled.



- **Social differences.** Differences in family structure across countries can probably also explain some of the difference in income inequality. For example, changes in family composition, declining male labor-force participation, and the increased number of single-parent families in the United States each appear to have played a large role in increasing income inequality over time. Another important difference is the fact that the United States has a less homogeneous population and a larger number of immigrants compared with other countries.

EYES ONLY

- **Policy differences.** Differences in income redistribution through government transfer and tax policies are an important determinant of differences in income inequality. Relative to many other countries, the United States has only modest income redistribution through government tax and transfer programs. Accordingly, when income before taxes and transfers is measured, the difference between inequality in the United States and in other countries generally is much smaller, with inequality in some countries actually exceeding that in the United States. Furthermore, the exclusion of health benefits from the OECD's estimates of income likely paints an even bleaker picture of U.S. inequality than if health benefits had been included. This is because government-provided health benefits are targeted toward the very poor in the United States, while health benefits in other countries usually cover the entire population.

EYES ONLY

ARTICLE

Inflation and the Capital Gains Tax

The Budget Reconciliation bills recently passed by both the House and the Senate include legislation to reduce the tax on income from capital gains. The House version would allow a deduction of 50 percent of capital gains in calculating taxable income, and would index the basis of capital assets for inflation. The Senate version allows the 50 percent deduction, but would not index for inflation. One frequently cited—but not the only—reason for cutting the capital gains tax is that much of the increase in the value of stocks and other assets is due to inflation and does not reflect an increase in real wealth. As a consequence, some observers argue that reducing the tax on income from capital gains would improve the fairness of our tax system.

Inflation and the real return from investment. The current system for taxing capital income—rents, dividends, royalties, and capital gains—does not adjust investment returns for inflation. As a result, the higher the inflation rate, the higher the effective tax rate on the real return. Two aspects of our tax system, however, actually reduce the effective tax rate on capital income, thereby offsetting some of the effects from inflation:

- **Deferral of capital gains offsets the effects of inflation.** Income earned on corporate stock can be in the form of capital gains or dividends. Investors do not have to pay any tax on capital gains until an asset is sold. This deferral of tax reduces the effective tax rate on capital income and partially offsets the effects of inflation. The higher the fraction of earnings in the form of capital gains (and the lower the fraction in the form of dividends), the lower the effective tax rate.

- **Borrowing offsets the effects of inflation.** Investors can borrow funds to invest and deduct nominal interest payments each year (which reflect compensation for inflation), but only pay tax on the capital gain when the asset is sold. The more borrowing that is used to finance investments, the smaller the impact of inflation.

How much of an exclusion do investors currently get? Under current law, the maximum capital gains tax rate of 28 percent provides investors significant advantages that are equivalent to an exemption of part of their gain. This exemption amounts to 30 percent of capital gains for investors in the 39.6-percent tax bracket, 22 percent for those in the 36-percent bracket, and 10 percent for those in the 31-percent bracket. Investors with marginal tax rates of 28 percent or below, who in 1993 earned about 44 percent of total capital gains, do not benefit from this provision.

What is the bottom line? To assess the extent to which deferral and borrowing offset the effects of inflation, we have calculated the fraction of the capital gain on a stock portfolio that would have to be excluded from tax so that the after-tax return equals the return under a hypothetical system with indexing and no deferral of capital gains (see chart on next page). While the exact results depend on the years the investment is held, the fraction of the total return due to capital gains, and the fraction of the investment financed by borrowing, some conclusions can be drawn:

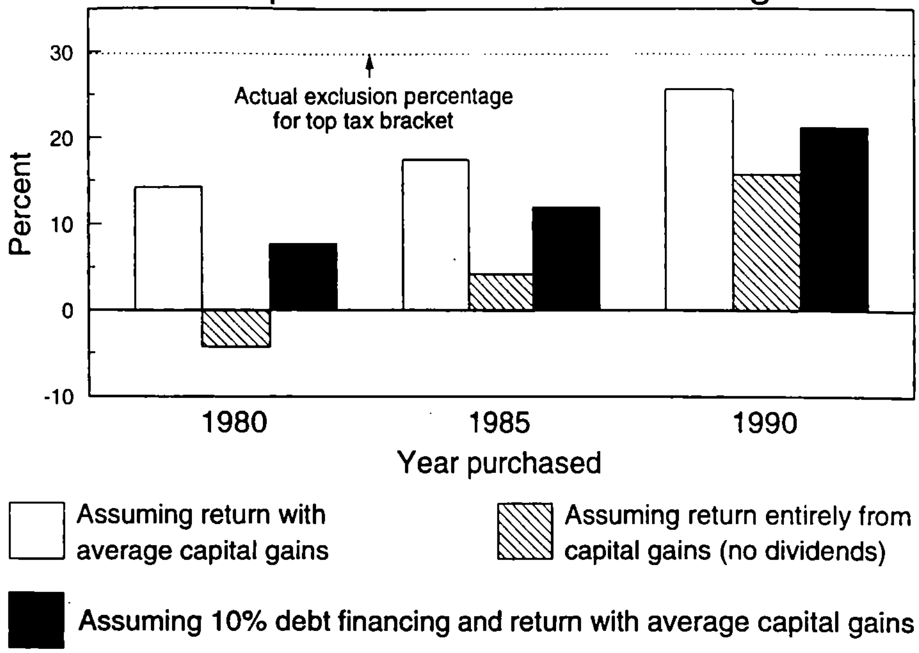
- In most cases, the exclusion presently received by investors with marginal tax rates of 36 percent or higher (a 22-percent exclusion) was more than enough to offset the effects of inflation.
- Investors with marginal tax rates of 31 percent or below may have been overtaxed on their capital gains, unless they had a significant amount of debt financing or held stocks that had most of their return paid in the form of capital gains.

Of course, these results depend on actual historical experience. Looking forward, the exact exclusions could be quite different.

Policy implications. Because the present tax system already compensates many investors generously for the effects of inflation, the case for further reducing taxes on income from capital gains cannot be based primarily on fairness. Instead, changes in the way capital gains are taxed should be based on considerations of economic efficiency, such as whether the current tax system helps allocate capital resources into their best possible use. In this regard, the Administration-sponsored 1993 reduction in capital gains tax for long-term investments in small businesses was designed to improve economic efficiency by encouraging investments that credit markets on their own often fail to finance.

EYES ONLY

Required Exclusion Percentage



Calculations of Exclusion Percentages

We first calculated the total after-tax return under a hypothetical system that imposed tax each year (no deferral) on the annual real return to a portfolio of the S&P 500 stocks purchased in a given year and sold in 1994. The chart reports the percentages of the capital gain on the same portfolio that would have to be excluded from tax in order for the total after-tax return to equal the return under the hypothetical tax system (assuming a real discount rate of 4 percent). We assumed that the tax rate was the same in each year; the same qualitative pattern would emerge if actual tax rates were used. A negative exclusion percentage means that the current tax system is more favorable than the hypothetical tax system.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Fed District Survey Shows Slowing Economy. Economic growth probably slowed somewhat in early fall, according to the Federal Reserve's regular survey of business conditions. The dropoff, driven in part by slower consumer spending, reflects an inevitable decline in economic growth after last quarter's unsustainable 4.2 percent real GDP growth. While the Fed survey found that manufacturing activity remained stable or increased in most districts, the National Association of Purchasing Management reported that the manufacturing sector continued to contract in October. As for other sectors of the economy, loan demand reportedly increased in most districts, while residential building activity varied widely by geographic area but changed little overall. Wage increases generally remained moderate, despite reports from some districts that labor demand had tightened relative to supply. At the same time, many districts emphasized that skilled workers have been commanding larger-than-average wage gains, suggesting that unskilled workers may be seeing further erosion in their wages.

Economic Performance Brightens in the Golden State. Employment in California grew 2.3 percent from September 1994 to September 1995, compared to 1.2 percent for the nation as a whole, according to the Labor Department. Over that period, the unemployment rate in the Golden State fell to 7.2 percent from 8.3 percent. As recently as January 1994, California's unemployment rate exceeded 10 percent. The good news on the employment front is reflected in several recent private-sector reports that suggest the California economy is picking up steam and will do better in 1996 than it has done in 1995.

The Distribution of Income and Wealth in the United States. As we move into budget discussions, it may be useful to examine the distribution of income in the United States.

Quintile	Family Income Range (1994)	Share of Aggregate Family Income (1994)	Share of Total Household Wealth (1989)
Highest fifth	$70,000+	47%	65%
4th	$47,000 - $70,000	23%	14%
3rd	$31,000 - $47,000	16%	11%
2nd	$18,000 - $31,000	10%	7%
Lowest fifth	$0 - $18,000	4%	2%
Top 5 Percent	$120,000+	20%	45%

EYES ONLY

INTERNATIONAL ROUNDUP

The "Pacto" Agreement and Renewed Turmoil in Mexico. Last weekend, the Government of Mexico signed a new pact with labor and business to control inflation, boost growth, and cut public spending. The so-called "Pacto" seeks to achieve growth of at least 3 percent and limit inflation to 20 percent in 1996. It maintains a floating exchange rate, cuts current public spending by 5 percent while boosting public investment, and reduces taxes for small- and medium-sized businesses. The government also announced its intention to restructure the social security system (by moving towards individual retirement accounts) and to liberalize foreign investment regulations. The financial markets initially reacted positively to the package: The peso strengthened from 7.13 per dollar on Friday to 6.92 on Monday. But this proved temporary, and the markets turned turbulent again in advance of a holiday on Thursday. The stock market dropped by 2 percent on Tuesday, and the peso weakened to 7.33 per dollar on Wednesday.

Daiwa Bank Ordered to Halt U.S. Operations. Federal and state banking regulators issued a joint order on Thursday requiring Daiwa Bank to halt its U.S. operations as of February 2, 1996. The agencies argued that Daiwa "engaged in a pattern of unsafe and unsound banking practices and violations of law over an extended period of time." On September 18, the bank revealed losses of over $1 billion from activities at its New York branch. Senior management apparently had learned of the losses in late July, but concealed them for almost 2 months. The U.S. District Attorney in New York announced a 24-count indictment on Thursday for conspiracy, fraud, falsification of bank records, and failure to disclose Federal crimes.

A Close Vote in Quebec. The Federalist's slim victory in Monday's referendum has temporarily bolstered financial markets in Canada. Following the vote, short-term interest rates fell by over 100 basis points, the exchange rate strengthened, and the stock market rose by 2 percent. But analysts remain concerned that the slim margin of victory portends continued trouble ahead. And economic growth remains subdued: Data released on Tuesday indicate that the economy expanded by just 1.2 percent in the year to August 1995.

Middle East Development Bank. International leaders met for a Middle East economic summit in Amman, Jordan early this week. They announced plans to create the Bank for Economic Cooperation and Development in the Middle East and North Africa, capitalized at about $5 billion, to promote private sector growth, support regional development projects (especially transborder infrastructure), and enhance regional dialogue on economic policy. Officials from the State and Treasury Departments played an instrumental role in championing the development bank, and over 125 U.S. companies were represented at the conference.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, November 3, 1995****

In October, the unemployment rate declined to 5.5 percent. Nonfarm payroll employment increased by 116,000.

Personal Income and Expenditures

Personal income increased 0.4 percent (monthly rate) in September. Disposable personal income also increased 0.4 percent. Personal consumption expenditures increased 0.2 percent.

Employment Cost Index

The employment cost index for private industry workers rose 2.6 percent for the 12-month period ending in September.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, decreased slightly (0.3 index point) in October, to 97.0 (1985=100).

Leading Indicators

The index of leading economic indicators decreased 0.1 percent in September.

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)
Producer Prices (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1994	1995:1	1995:2	1995:3
Percent growth (annual rate)					
Real GDP:					
Fixed weights	2.5	4.1	2.7	1.3	4.2
Chain weights	2.7	3.7	1.7	0.7	3.0
GDP implicit price deflator:					
Fixed weights	5.5	2.3	2.2	1.6	0.6
Chain weights*	5.4	2.7	2.8	2.2	1.9
Productivity, nonfarm business (NFB):					
Fixed weights	1.2	1.8	2.5	4.8	N.A.
Chain weights	1.4	0.9	0.2	2.9	N.A.
Real compensation per hour (NFB):					
Using CPI	0.6	0.6	1.0	0.1	N.A.
Using NFB deflator:					
Fixed weights*	1.1	1.1	2.9	2.1	N.A.
Chain weights*	1.2	0.7	1.8	1.4	N.A.

* CEA estimates.

	1970-1993	1994	1995:1	1995:2	1995:3
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	13.6	13.9	14.1
Residential investment	4.7	4.3	4.2	4.0	4.1
Exports	8.0	12.3	12.9	13.1	13.3
Imports	9.2	14.4	15.1	15.4	15.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.8	2.9	3.1
Federal surplus	–2.8	–2.4	–2.1	–1.8	N.A.

	1970-1993	1994	MONTHLY DATA Aug. 1995	Sept. 1995	Oct. 1995
Unemployment Rate	6.7**	6.1**	5.6	5.6	**5.5**
Payroll employment (thousands)					
increase per month			**263**	**50**	**116**
increase since Jan. 1993					**7527**
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.1	N.A.
PPI-Finished goods	5.0	1.7	–0.1	0.3	N.A.

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

New or revised data in **boldface.**

EYES ONLY

Employment and unemployment data **embargoed until 8:30 a.m., Friday, November 3, 1995.**

FINANCIAL STATISTICS

	1993	1994	Sept. 1995	Oct. 1995	Nov. 2, 1995
Dow-Jones Industrial Average	3522	3794	4747	4760	4809
Interest Rates					
3-month T-bill	3.00	4.25	5.28	5.28	5.31
10-year T-bond	5.87	7.09	6.20	6.04	5.92
Mortgage rate, 30-year fixed	7.33	8.35	7.64	7.48	7.44
Prime rate	6.00	7.15	8.75	8.75	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 2, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.418	+1.1	–5.7
Yen-Dollar	103.6	+1.8	+6.8
Multilateral $ (Mar. 1973=100)	84.23	+0.3	–1.9

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.3 (Q3)	5.5 (Oct)	2.5 (Sept)
Canada	2.5 (Q2)	9.6 (Aug)	2.3 (Sept)
Japan	0.6 (Q2)	3.2 (Jul)	–0.3 (Aug)
France	2.9 (Q2)	12.2 (Jul)	2.0 (Sept)
Germany	2.1 (Q2)	6.6 (Aug)	2.0 (Aug)
Italy	2.9 (Q2)	12.0 (Jul)	5.8 (Sept)
United Kingdom	2.8 (Q2)	8.7 (Aug)	3.8 (Sept)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, November 3, 1995.**

WEB Nov. 1995