The Economy in 1994

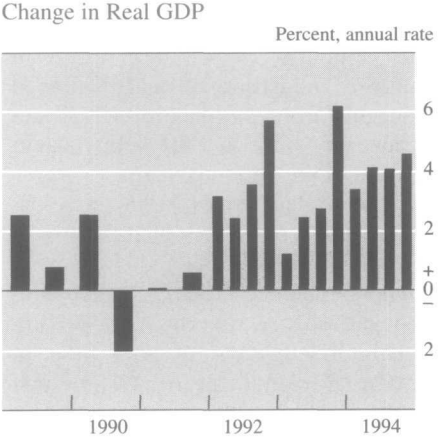
The economy recorded a third year of strong expansion in 1994. Real GDP grew 4 percent over the four quarters of the year, industrial output rose 6 percent, and the number of nonfarm payroll jobs increased about 3½ million, the largest gain in ten years. Labor and product markets tightened appreciably. Price pressures intensified in the markets for materials, but broader measures of price change showed inflation holding steady.

As in 1992 and 1993, the economic advance during 1994 was driven mainly by sharp increases in the real expenditures of households and businesses. Consumer purchases of motor vehicles rose further in 1994, and purchases of other consumer durables increased even faster than they had in the two previous years. Residential investment posted a small gain, on net, over the four quarters of the year, despite sharp increases in mortgage interest rates. Business investment in office and computing equipment slowed from the spectacular pace of 1993 but continued to rise rapidly nonetheless, and business investment in other types of equipment accelerated. Real outlays for nonresidential construction, which had been a weak sector of the economy in previous years, picked up in 1994; outlays for office construction ended a long slide that had stretched well back into the 1980s. Business investment in inventories, which had been quite restrained in previous years of the expansion, increased appreciably in 1994. Much of the inventory buildup apparently was intentional and reflected the desires of firms to stock up in anticipation of continued strength in sales or to build stronger buffers against potential delays in supply.

In contrast to the strength in private expenditures, government purchases of goods and services edged down on net over the four quarters of 1994. Federal purchases of goods and services, which had declined sharply in 1993, fell further in 1994 as a consequence of actions taken in recent years to reduce the size of the federal deficit. Meanwhile, the real purchases of state and local governments rose only modestly. Although the expanding economy provided states and localities with a stronger revenue base, many of these jurisdictions continued trying to hold spending in check; a number of states chose to cut taxes.

As in the two previous years, a significant portion of the rise in domestic spending in 1994 went for imports of goods and services, which increased about 14 percent in real terms during the

Change in Real GDP



NOTE. The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

year. Meanwhile, growth of real exports of goods and services picked up noticeably, with gains cumulating to about 11½ percent over the year.

Labor and product markets tightened in 1994. After ticking up in January in conjunction with the introduction of a new labor market survey, the civilian unemployment rate fell sharply over the remainder of the year, to 5.4 percent in December. In manufacturing, gains in production exceeded the growth of capacity by a sizable margin during 1994, and the rate of capacity utilization climbed 3 percentage points. Its level at year-end was in line with the highest level achieved during the economic expansion of the 1980s.

Inflation pressures picked up in some markets in 1994. Prices of raw industrial commodities rose even more rapidly than in 1993, and prices of intermediate materials accelerated sharply, especially after midyear. However, the inflation impulse in these markets did not carry through with any visible force to the consumer level, probably because unit labor costs, which make up by far the largest part of value added in production and marketing, continued to rise at a low rate. The employment cost index of hourly compensation in private nonfarm industries actually slowed noticeably from the pace of 1993, and productivity gains in 1994 held close to the pace of the previous year.

As for retail prices, 1994 was the fourth year in a row in which the rise in the total consumer price index has been around 3 percent. The CPI excluding food and energy rose just 2.8 percent over the four quarters of 1994, after an increase of 3.1 percent in 1993; the rate of rise in this index, which is widely used as an indicator of underlying inflation trends, was nearly halved from 1990 to 1994.

The Household Sector

Real personal consumption expenditures advanced 3½ percent over the four quarters of 1994, a rate about in line with the average of the two previous years. Support for the rise in spending came from rapid income growth, and, according to surveys, from sharp increases in consumer confidence. Outlays for durable goods continued to rise especially rapidly, seemingly little affected by rising interest rates. Nor did spending appear to be much affected, in the aggregate, by poor performance of the stock and bond markets, which cut into the real value of household assets. Credit generally was readily available during 1994; growth of consumer installment debt picked up substantially, to a pace comparable with some of the larger increases that were observed during the expansions of the 1970s and 1980s.

Real consumer expenditures for durable goods increased about 8½ percent in 1994, bringing the cumulative rise in these outlays over the past three years to nearly 30 percent. The stock of durable goods that households wish to hold apparently continued to rise quite rapidly in 1994, and at least some households probably were still making up for purchases that had been put off earlier in the 1990s, when the economy was sluggish and concerns about job prospects were widespread. Real expenditures for motor vehicles moved up an additional 3½ percent over the four quarters of 1994, after gains of about 9 percent in each of the two preceding years; increases in sales of vehicles in 1994 might have been a bit stronger still but for capacity constraints and various supply disruptions that sometimes limited the availability of certain models. Real outlays for durable goods other than motor vehicles rose about 12 percent over the four quarters of 1994, a pickup

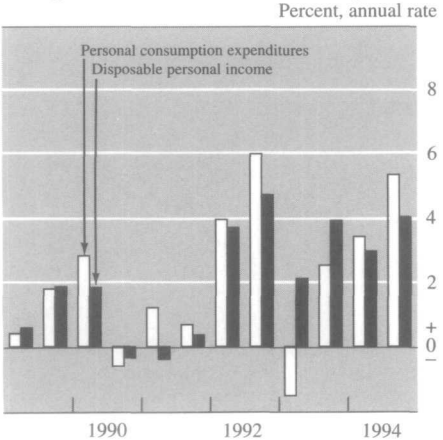
from the already rapid rates of expansion of the two previous years. Purchases of personal computers and other electronic equipment continued to surge in 1994, and spending on furniture and household appliances moved up further.

Consumer expenditures for nondurables and services exhibited mixed patterns of change in 1994. Real outlays for nondurables increased more than 3 percent over the year, a pickup from the subdued rate of growth recorded in the previous year and, for this category, a larger-than-average advance by historical standards. By contrast, real expenditures for services increased roughly 2¼ percent, a slightly smaller gain than that of 1993; growth of outlays for services was held down, to some degree, by a decline in real outlays for energy, as warm weather late in 1994 reduced the amount of fuel needed for heating.

Real disposable personal income rose nearly 4½ percent during 1994. Except for a couple of occasions in previous years when income growth was boosted temporarily by special factors, the rise in real disposable income in 1994 was the largest increase since the 1983–84 period. Growth of wages and salaries accelerated in 1994 in conjunction with the step-up of employment growth. Income from capital also rose: Dividends moved up along with corporate profits, and interest income turned back up after three years of decline. By contrast, transfer payments, the growth of which tends to slow as the economy strengthens, registered the smallest annual increase since 1987. The net income of nonfarm proprietors appears to have about kept pace with the average rate of growth in other types of income. Farm income rose moderately on an annual average basis, as an increase in the volume of output more than offset the effects of sharp declines in farm output prices that developed over the course of the year.

Change in Real Income and Consumption

Percent, annual rate



NOTE. The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

Consumers' perceptions of economic and financial conditions brightened considerably during 1994. By year-end, the composite measures of consumer confidence that are prepared by the Conference Board and the University of Michigan Survey Research Center had both moved to new highs for the current business expansion. Consumers became more optimistic over the year in regard both to current and to future economic conditions. Perceptions of employment prospects also improved, with a growing proportion of respondents saying that jobs were plentiful and a reduced proportion saying that jobs were hard to find.

In contrast to most other indicators for the household sector of the economy, household balance sheets—which had strengthened appreciably in previous years—showed little or no improvement in 1994. According to preliminary data, the aggregate net worth of households recorded a relatively small increase in nominal terms over the year, and, in real

terms, net worth may have declined. Household assets rose only moderately in nominal terms, and the growth of nominal liabilities picked up a bit as a result of the sharp increase in use of consumer credit.

With personal income growing faster than net worth during 1994, the ratio of wealth to income fell over the course of the year. In the past, declines in this ratio sometimes have prompted households to boost the proportion of current income that is saved, in an attempt to restore wealth to more desirable levels, and this same tendency may have been at work, to some extent, in 1994. After dipping in the first quarter of the year to the lowest level of the current expansion, the personal saving rate rose a full percentage point over the remainder of the year, to a fourth-quarter level of 4.6 percent. Even then, however, the saving rate remained quite low by historical standards. Rising levels of income and employment and increased confidence in the outlook apparently convinced consumers to push ahead with increases in outlays, most notably on consumer durables.

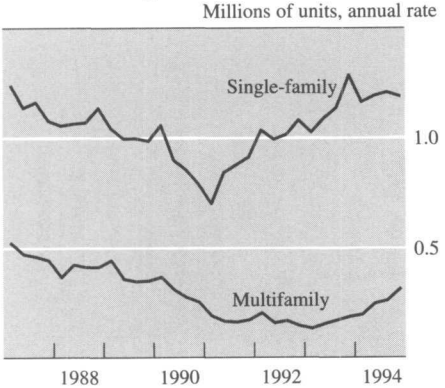
Despite the apparent flagging in the improvement in household balance sheets, signs of outright stress in household financial conditions were not much in evidence in 1994. Delinquency rates on mortgages and most other types of household loans generally remained quite low relative to their historical ranges. Credit card delinquencies moved up toward the end of the year, however.

Residential investment held up remarkably well in 1994 in the face of sharp increases in mortgage interest rates. In real terms, these investment outlays were up about 3 percent, on net, over the four quarters of the year, after gains of 17 percent in 1992 and 8 percent in 1993. In the market for single-family houses, the number of sales and the number of houses on which construction was started fell back from the exceptionally high peaks that were reached briefly in late 1993, but they remained at elevated levels. In total, construction began on 1.20 million single-family units in 1994, a figure that was slightly above the highest annual total of the 1980s. The number of sales of existing homes nearly matched the previous annual peak, reached in 1978; and although sales of new homes remained well short of previous highs, the 1994 total was in line with the number sold in the brisk market of 1993.

Declines in the starts and sales of single-family houses in early 1994 basically reversed the huge gains of late 1993. Whatever tendency there may have been for these indicators to exhibit at least a temporary setback after a period of unusual strength was probably reinforced by the initial reactions of builders and homebuyers to increases in mortgage interest rates that had begun in the final quarter of 1993. Exceptionally severe winter weather in the Northeast and Midwest early in 1994, coming on the heels of favorable conditions in late 1993, probably also helped to account for the sharpness of the downturn. In

Private Housing Starts

Millions of units, annual rate



NOTE. The data are seasonally adjusted and come from the Department of Commerce.

any event, starts of single-family homes ticked back up a bit in the second quarter of the year, sales of existing homes essentially flattened out, and the rate of decline in sales of new homes slowed.

After midyear, sales of existing homes began to exhibit a clear downtrend. However, sales of new homes strengthened through the summer and into the autumn, and single-family starts held firm. Sizable gains in employment and income and rising optimism about the future of the economy apparently helped to blunt the effects of increases in interest rates during this period. In addition, the availability of a widening variety of alternative mortgage instruments and, perhaps, some easing of loan qualification standards may have permitted some buyers, who otherwise would not have been able to obtain financing, to go ahead with their purchases.

Toward year-end a softer tone seemed to be emerging in some key indicators of single-family housing activity. Sales of new homes tailed off sharply in November and December, and the ratio of the number of unsold homes to the number of sales, which had turned upward in early 1994, continued to rise. By December the ratio had moved up to a level that was a little above its historical average. Nonetheless, starts of new single-family houses remained strong through year-end, rising to a December level that was moderately above the average for the year as a whole.

Increases in the various measures of house prices were of small to moderate size in 1994. The median transaction prices of new and existing homes that were sold in the first half of the year were roughly 3½ percent above the level of a year earlier, and a similar rise was reported during that period in price indexes that adjust for changes in the quality and regional mix of homes that are sold. After midyear, the four-quarter changes in median transaction prices slowed, but the rate of rise in the quality-adjusted indexes picked up somewhat. All told, prices have been firmer in the past couple of years than they were earlier in the 1990s.

After falling to exceptionally low levels in late 1992 and early 1993, construction of multifamily housing units increased throughout 1994. Although the level of activity in this part of the housing sector was not especially high, gains during the year were large in percentage terms: Starts of these units moved up about 65 percent from the fourth quarter of 1993 to the fourth quarter of 1994, at which point they were more than double the lows of a couple of years ago. The national average vacancy rate for multifamily rental units remained relatively high in 1994, but markets in some areas of the country had tightened enough to make construction of new multifamily units economically attractive. The August 1993 reauthorization of a tax credit on low-income housing units also provided some incentive for new construction. The financing of multifamily projects was facilitated through more ready availability of credit and increased equity investment.

The Business Sector

Robust expansion was evident in most of the economic indicators for the business sector of the economy in 1994. Real output of nonfarm businesses increased about 4¼ percent over the four quarters of the year, according to preliminary estimates. For a second year, business investment in fixed capital advanced exceptionally rapidly. Inventory investment also picked up appreciably, spurred by large, sustained increases in sales. Business finances remained on a sound footing: Invest-

ment expenditures continued to be financed predominantly with internal funds, and signs of financial stress were largely absent.

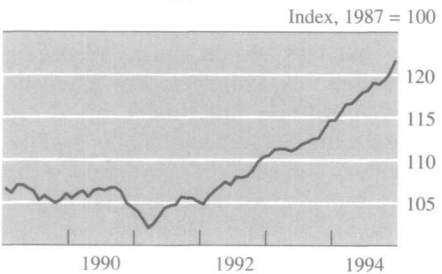
Industry entered 1994 with considerable momentum and maintained a rapid pace of expansion throughout the year. Industrial production rose 6 percent over the four quarters of 1994, a growth rate exceeded in only one of the past ten years. The production of business equipment advanced especially rapidly, buoyed by rising investment in the domestic economy and further large increases in exports of capital goods. Production of intermediate products—which consist mainly of supplies used in business and construction—also moved up substantially during 1994, as did the output of materials, especially those used as inputs in the production of durable goods.

The rate of capacity utilization in industry increased about 2½ percentage points over the twelve months of 1994, to a level that was about ½ percentage point above the peak of the late 1980s. In manufacturing, the operating rate rose 3 percentage points during the year. By year-end, utilization rates in some industries had moved to exceptionally high levels. Most notably, the average operating rate among manufacturers engaged in primary processing (basically, the producers of materials) had climbed to the highest level since the end of 1973, surpassing, by a percentage point or more, the peaks of the late 1970s and late 1980s.

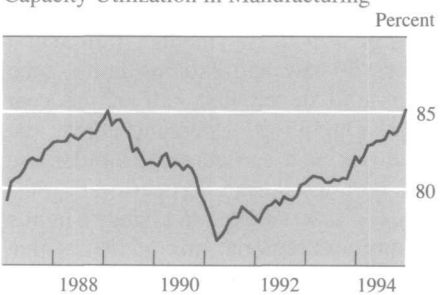
After rising 23½ percent during 1993, corporate profits increased another 4 percent over the first three quarters of 1994 (and as of mid-March 1995, indications are that profits also rose in the fourth quarter). The profits earned by nonfinancial corporations from their domestic operations increased about 7½ percent over the first three quarters of 1994, after a gain of 21½ percent in 1993. Although these 1994 gains were partly the result of increased volume, profits per unit of output also rose. In the second and third quarters, before-tax profits of nonfinancial corporations amounted to nearly 11 percent of the gross domestic output of those businesses—the highest level for this measure since the late 1970s. A reduced corporate reliance on debt, as well as the cyclical recovery of the economy, helped push up the profit share. In contrast to the experience of nonfinancial corporations, the profits of private financial institutions from their domestic operations fell about 7 percent over the first three quarters of the year, as net interest margins narrowed. The decline reversed some of the large rise in profits that these institutions had reported in 1993.

Business fixed investment increased nearly 13 percent in real terms over

Industrial Production



Capacity Utilization in Manufacturing



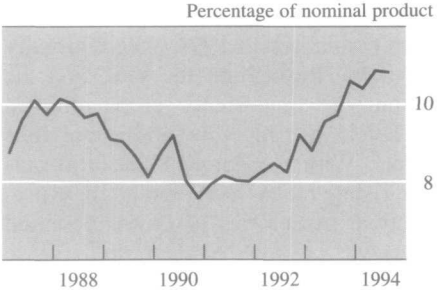
the four quarters of 1994, after a gain of 16 percent during 1993. Real expenditures for equipment, which had increased more than 20 percent in 1993, moved up an additional 15 percent over the four quarters of 1994, and investment in structures scored its biggest gain in several years.

In the equipment category, expenditures for office and computing equipment, which had registered an astonishing gain in 1993, slowed in 1994, but the rise in these outlays still amounted to nearly 20 percent in real terms. Meanwhile, the growth of real expenditures for most other types of business equipment picked up. Business investment in motor vehicles rose about 17 percent over the four quarters of 1994. With this gain coming on top of big increases in each of the two previous years, annual business outlays for vehicles reached a level nearly one-third higher than the peak year of the 1980s. Outlays for communications equipment also scored an especially big gain in 1994, more than 25 percent in real terms. Business purchases of industrial equipment advanced about 12 percent during 1994, one of the larger gains of the past two decades. By contrast, commercial aircraft once again was a notable area of weakness; the investment cycle in that sector has been sharply out of phase with those of most other industries because of persistent excess capacity and poor profitability in the airline business.

Business investment in nonresidential structures rose more than 4 percent during 1994, after an increase of 1½ percent in 1993 and declines in each of the three preceding years. Investment in industrial structures rose for the first time since 1990, more than likely in response to high—and rising—rates of capacity utilization. Investment in office buildings also picked up in 1994 after a long string of declines that, in total, had brought spending on these structures down about 60 percent from the peak of the mid-1980s; declining vacancy rates and a firming of property values provided additional evidence of improvement in this sector of the economy in 1994. The investment data for other types of structures showed a mix of pluses and minuses: Expenditures on commercial structures other than offices moved up further, after large gains in 1992 and 1993; however, outlays for drilling declined for a fourth year, to the lowest level since the early 1970s.

Corporate Profits before Taxes

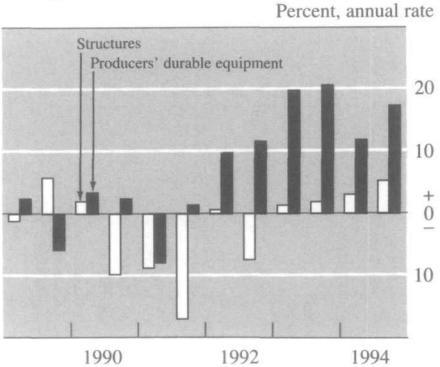
Percentage of nominal product



NOTE. Profits of nonfinancial corporations from domestic operations, with adjustments for inventory valuation and capital consumption, divided by GDP of nonfinancial corporate sector.

Change in Real Business Fixed Investment

Percent, annual rate



NOTE. The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

Because a large share of the growth in business fixed investment in recent years has gone for items that depreciate relatively quickly—computers being a prime example—net additions to the stock of productive capital have not been as impressive as the data on gross investment expenditures might seem to indicate. Nonetheless, with the further increase in gross investment in 1994, net additions to the capital stock appear to have become more substantial. Still unclear is the degree to which these increases will ultimately translate into faster gains in output per worker and in living standards; as discussed in more detail below, the trend of growth in labor productivity, which is affected by the amount and quality of capital that workers have available, seems to have picked up in recent years but by a relatively small amount.

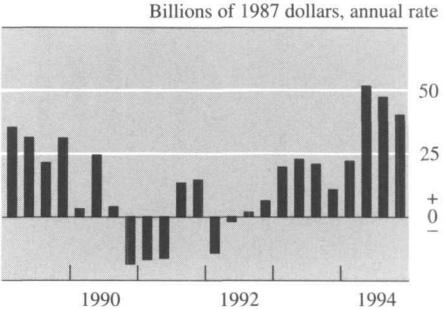
Business investment in inventories rose sharply in 1994. Earlier in the expansion, firms had refrained from building stocks, even as the economy strengthened. Increased reliance on "just in time" systems of inventory control reduced the level of stocks that firms needed to maintain their normal operations, and, with a degree of slack still present in the economy, businesses usually were able to quickly obtain goods from their suppliers and thus were probably reluctant to hold stocks in house. At the end of 1993, the level of real inventories in the nonfarm business sector was only 2 percent higher than it had been at the start of the recovery in early 1991.

Circumstances changed in 1994, however. Markets tightened as demand continued to surge, and delays in the delivery of supplies became more common. Anticipation of further growth in demand and increased concern about possible bottlenecks apparently prompted businesses to begin investing more heavily in inventories. Some firms may also have been trying to stock up on materials in advance of anticipated price increases. For the year as a whole, accumulation of nonfarm inventories was more than twice what it had been in 1993. This additional accumulation brought to a halt the previous downtrend in the ratio of nonfarm inventories to business sales, but the ratio remained quite low by the standards of the past quarter-century.

Inventory accumulation in the farm sector of the economy also picked up in 1994. Stocks of farm products had been drawn down in 1993, when farm production fell sharply because of floods in the Midwest and droughts in some other regions of the country. However, crop conditions in 1994 were unusually favorable throughout the year, and the output of some major crops climbed to levels considerably above previous peaks. With the demand for farm output rising much less rapidly than production, inventories of crops increased sharply. Livestock production also rose appreciably in 1994; inventories of livestock, which consist mainly of the cattle and hogs on farms and ranches, continued to expand.

Change in Real Business Inventories

Billions of 1987 dollars, annual rate



NOTE. Total nonfarm sector. The data are seasonally adjusted and come from the Department of Commerce.

The Government Sector

Federal purchases of goods and services, the part of federal spending that is included in GDP, fell almost 6 percent in real terms over the four quarters of 1994. Real outlays for defense remained on a sharp downtrend, and nondefense outlays, which had declined moderately in 1993, were little changed, on net, over the four quarters of 1994.

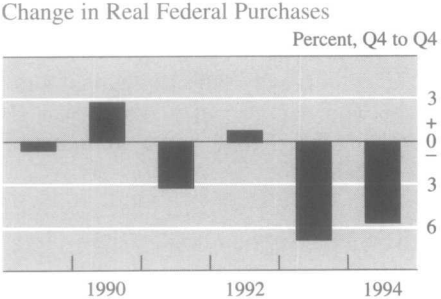
Total federal outlays, measured in nominal dollars in the unified budget, increased 3.7 percent in fiscal 1994 after a rise of 2.0 percent the previous fiscal year. These increases are among the smallest of recent decades. Nominal outlays for defense fell again in fiscal 1994. In addition, the growth of outlays for income security (a category that includes the expenditures on unemployment compensation and welfare benefits) slowed further as the economy continued to strengthen. Increases in social security outlays also slowed somewhat in fiscal 1994; the rise was about 1 percentage point less than that of nominal GDP. Outlays for Medicaid slowed as well, but the rate of rise in those expenditures once again exceeded the growth of nominal GDP.

Federal receipts were up 9 percent in fiscal 1994, the largest rise in several years. With rapid expansion of the economy giving a strong boost to almost all types of income, the major categories of federal receipts all showed sizable gains. Combined receipts from individual income taxes and social insurance taxes increased a bit more than 7 percent in fiscal 1994, after moving up 5.4 percent in the previous fiscal year. Receipts from taxes on corporate profits increased nearly 20 percent, slightly more than the gain of 1993.

The federal budget deficit declined to $203 billion in fiscal 1994, an amount that was equal to 3.1 percent of nominal GDP. Earlier in the 1990s, when the economy was sluggish, the federal deficit had climbed to a cyclical peak of 4.9 percent of nominal GDP. The previous cyclical low in the ratio of the deficit to nominal GDP, 2.9 percent, was reached in fiscal 1989. Since fiscal 1989, defense spending as a share of GDP has dropped appreciably, but this source of deficit reduction has been essentially offset by increased outlays for health and social insurance. Thus, the ratio of total federal outlays to GDP has changed little, on net; it was about 22 percent in both fiscal 1989 and fiscal 1994. The ratio of federal receipts to nominal GDP was about 19 percent in both of those fiscal years.

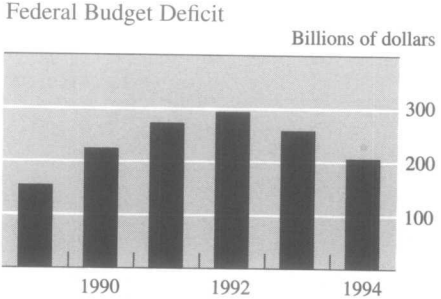
The stronger economy of recent years has provided state and local governments with a growing revenue base and a broadening set of fiscal options. Some

Change in Real Federal Purchases



NOTE. The data are from the Department of Commerce.

Federal Budget Deficit



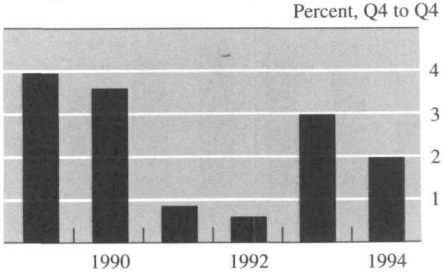
NOTE. The data are for fiscal years. They are on a unified budget basis and are from the Department of the Treasury.

governments have responded to these developments by cutting taxes, in most cases by small amounts. Effective tax rates of state and local governments appear to have edged down a bit, on average, over the four quarters of 1994, and nominal receipts apparently rose somewhat less rapidly than nominal GDP over that period.

Many states and localities also have been trying to restrain the growth of expenditures, but success on that score has been difficult to achieve because of increased outlays for entitlements and rising demand for many of the public services that traditionally have been provided by state and local governments. Transfers of income from state and local governments to persons rose about 9 percent in nominal terms over the four quarters of 1994, roughly the same as the rise during 1993 but less than the increases of previous years; from 1988 to 1992, the average compound rate of growth in these transfers was about 15 percent a year. In categories other than transfers, increases in spending have been fairly restrained in recent years; nominal purchases of goods and services (which account for about 80 percent of the total expenditures of state and local governments) have been trending up less rapidly than nominal GDP since the early 1990s.

Change in Real State and Local Purchases

Percent, Q4 to Q4



NOTE. The data are from the Department of Commerce.

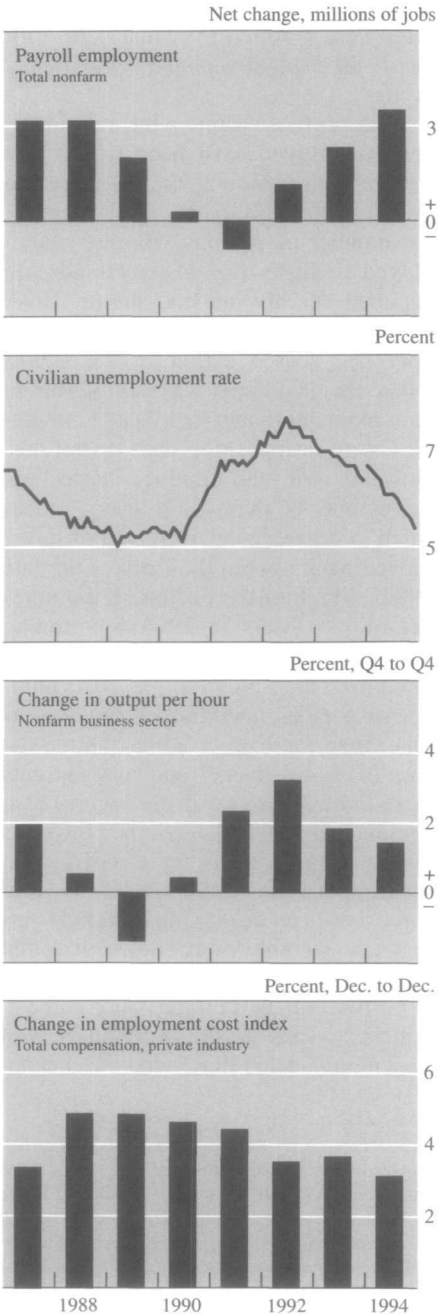
In real terms, the 1994 rise in purchases of goods and services by state and local governments amounted to just 2 percent. Compensation of employees, which accounts for about two-thirds of total state and local purchases, increased 1½ percent in real terms over the four quarters of 1994. Construction outlays declined slightly in real terms, as gains over the final three quarters of the year were not sufficient to offset a first-quarter plunge. Nonetheless, real outlays for structures remained at high levels; a strong uptrend in construction expenditures over the past ten or twelve years has more than reversed a long contraction that began in the latter half of the 1960s and bottomed out in the first half of the 1980s.

The deficit in the combined operating and capital accounts of all state and local governments (a measure that excludes the surpluses in state and local social insurance funds) amounted to about 0.6 percent of nominal GDP in calendar 1994, little changed from the corresponding figure for 1993 and down only slightly from a cyclical peak of 0.8 percent in 1991. The recent cyclical peak in this measure was larger than the peaks reached in recessions of the 1970s and 1980s, and declines in the deficit during this expansion have not been as large as the declines that occurred during other recent expansions. Historically, the combined operating and capital accounts of state and local governments have been in deficit more often than they have been in surplus; as a share of nominal GDP, the annual surpluses and deficits since World War II have averaged out to a deficit of 0.3 percent.

Labor Markets

Employment rose substantially in 1994. The total number of jobs in the nonfarm

Labor Market Conditions



NOTE. The data are from the Department of Labor. The department introduced a new survey of households in January 1994; unemployment data from that point on are not directly comparable with those of earlier periods.

sector of the economy increased 3.5 million over the twelve months ended in December, after a gain of 2.3 million during 1993.[1] About a quarter of a million of the rise in jobs during 1994 was in the government sector, mostly at the local level. Job growth in the private nonfarm sector amounted to 3.3 million, the largest gain since 1984. Increases in employment at nonfarm establishments were sizable in each quarter of 1994.

Producers of goods boosted employment more than half a million in 1994. The job count in construction increased about 310,000 over the year; employment at general building contractors rose briskly for a second year, as did the number of jobs at firms involved in special trades related to construction. The number of jobs in manufacturing increased about 285,000 during 1994, after five years of decline. Producers of durables accounted for most of the rise in manufacturing employment; among these producers, job gains were widespread. Employment at factories that produce nondurables rose slightly in total, as advances in some industries—such as printing and publishing and rubber and plastics—were partly offset by continued secular declines in the number of jobs in industries such as apparel, tobacco, and leather goods. The average workweek in manufacturing, which had stretched out in 1992 and 1993 when factory employment was declining, lengthened further in 1994, rising to new highs for the postwar period. The high fixed costs that are associated with adding new workers probably continued to be an important factor in firms'

1. The Bureau of Labor Statistics has announced that the level of nonfarm payroll employment in March 1994 will be raised 760,000 when revised estimates are released in the summer of 1995. The revision may lead to larger estimates of job growth in both 1993 and 1994.

decisions to rely still more heavily on a longer workweek as a way to boost labor input. Growth of factory output surpassed the rise in labor input by a sizable amount in 1994, a reflection of substantial gains in productivity that were realized in this sector of the economy in the most recent year.

Employment in the private service-producing sector rose nearly 2¾ million during 1994, after a gain of 2 million in 1993. The number of jobs in retail trade increased about 820,000 over the year. Auto dealers, stores that sell building materials, and those that sell general merchandise were among the retail outlets that reported impressive gains. Hiring at eating and drinking places also moved up briskly; after three years of slow growth around the start of the decade, hiring at these establishments has increased substantially in each of the past three years. Employment at firms that supply services to other businesses rose about 710,000 in 1994, even more than in 1993. Once again, job growth within this category was especially rapid at personnel supply firms—those that essentially lease the services of their workers to other employers, often on a temporary basis. Employment at businesses that supply health services increased a quarter of a million in 1994, about the same as the gain in 1993; hiring at hospitals has flattened out over the past couple of years, but elsewhere in the health sector job growth has continued at a rapid clip.

Strength also was evident in 1994 in data from the monthly survey of households. After ticking up in January 1994, when a redesigned household survey was implemented and new population estimates were introduced, the civilian unemployment rate turned back down in February and declined in most months thereafter. The rate in December, 5.4 percent, was 1.3 percentage points below that of January.[2] Appreciable net declines in unemployment rates were reported over that period for nearly all occupational and demographic groups.

Data on the reasons why individuals are unemployed have been tracing out patterns fairly similar to those seen in previous business cycles. Most notably, the number of persons who are unemployed because they lost their last job declined sharply, on net, during 1994. The number of individuals in this category had soared earlier in the 1990s, when the economy was struggling to gain momentum and many large companies were restructuring their operations. However, with the more recent decline, the number of these "job losers," measured as a percentage of the labor force, moved back toward the lows of the late 1980s. Much of the decline in the number of job losers in 1994 was among workers who were permanently separated from their previous jobs. The number of persons unemployed for reasons other than the loss of a job (that is, the sum of "job leavers" and new entrants or re-entrants unable to find work) also declined in 1994. As in other business cycles, the number of these individuals, measured relative to the size of the labor force, has been displaying a cyclical pattern considerably more muted than that of job losers.

Growth of the civilian labor force—which consists of the individuals who are employed and those who are seeking

2. Research by the Bureau of Labor Statistics suggests that the unemployment rate would have run about two-tenths of a percentage point lower in 1994 but for the changes that were introduced in January of that year. Other series from the household survey were also affected by the introduction of the new survey and the revised population estimates; therefore, data for the period starting in January 1994 are not directly comparable with those for the period ended in December 1993.

employment but have not yet found it—picked up a bit in the second half of 1994. However, even with this increase, the cumulative rise in the labor force in the current business expansion has been relatively small compared with the gains recorded in other recent expansions; growth of the working-age population has been slower this decade than it was in the expansions of the 1970s and 1980s, and the share of the population participating in the labor force, which trended up in earlier expansions, has changed little, on net, during this one.

According to preliminary data, output per hour of labor input in the nonfarm business sector increased 1.4 percent over the four quarters of 1994, after a rise of 1.8 percent in 1993 and still larger gains in 1992 and 1991. Over the business cycle, productivity gains typically are largest in the early years of expansion, and, in that regard, the recent experience does not appear to be unusual. Abstracting from cyclical variation, the trend of productivity growth in recent years seems to have picked up somewhat from the unusually sluggish pace that prevailed through much of the 1970s and 1980s, but, at the same time, the pickup has not been nearly so large as some anecdotal reports might appear to suggest. For example, from late 1988 to late 1994, an interval of time that is long enough to capture all the phases that productivity goes through during the business cycle, the average rate of rise in output per hour in the nonfarm business sector amounted to slightly more than 1¼ percent, up only modestly from an average rate of rise of about ¾ percent during most of the 1970s and 1980s.[3]

The rate of increase in hourly compensation moved down another notch in 1994. The employment cost index for private industry, a measure of hourly labor costs that comprises both wages and benefits, rose 3.1 percent during the twelve months ended in December 1994, after increases of 3.6 percent in 1993 and 3.5 percent in 1992. The rise in the wage component of compensation was slightly less than that of 1993, and the rate of increase in hourly benefits slowed appreciably. Increases in benefits were restrained, in large part, by another year of deceleration in health care costs and a further slowing in workers' compensation insurance costs. The rise in nominal compensation per hour in 1994 was the smallest yearly increase in the fifteen-year history of the series, the previous low of 3.2 percent having come midway through the expansion of the 1980s. Toward the end of that decade, as bidding for labor resources intensified, increases in compensation moved up for a time to around 5 percent a year.

Unit labor costs in the nonfarm business sector rose 1.9 percent over the four quarters of 1994, after an increase of just 0.6 percent over the four quarters of 1993. In manufacturing, a sector of the economy in which productivity has advanced quite rapidly in recent years, a rise in output per hour of 4.6 percent during 1994 more than offset a modest

3. Whether even this small degree of improvement in the productivity trend will withstand future revisions of the data is not clear. For example, among the many difficult issues that are involved in the measurement of productivity is the choice of an appropriate set of prices for valuing the output of goods and services. Currently, aggregate output is tallied by using the prices of 1987, but some major changes in relative prices have taken place since then, the most notable of which is the huge decline in the price of office and computing equipment. Using the prices of a more recent year to gauge real output would result in a reduced increment to growth from office and computing equipment. All else equal, the growth of productivity would also be negatively affected by a switch to the prices of a more recent year.

increase in hourly compensation, and unit labor costs declined noticeably for a second year.

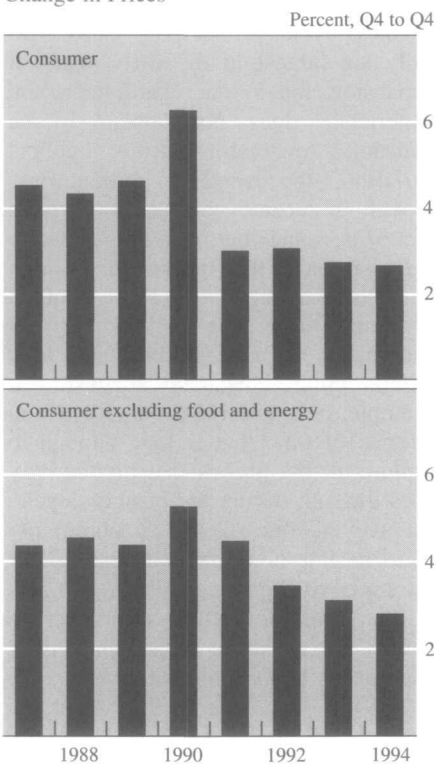
Price Developments

Although price increases picked up in some parts of the economy in 1994, the broader measures of price change continued to yield readings that were quite favorable. The rise in the total CPI was about 2¾ percent in 1994, the same as the increase during 1993. The CPI excluding food and energy also rose about 2¾ percent over the four quarters of 1994, after increasing slightly more than 3 percent in 1993. The producer price index for finished goods increased 1¼ percent during 1994, after edging up just ¼ percent during the previous year. As in 1992 and 1993, the past year's increases in all these price indexes were among the lowest readings of the past quarter-century. Measures of inflation expectations held steady in 1994, but continued to show readings that were somewhat higher, on average, than the actual rates of price increase.

The pickup of price increases in 1994 was confined largely to markets for materials. Prices of primary industrial inputs, which had moved up sharply during 1993, continued to surge in 1994, and price increases for intermediate materials accelerated as the year progressed. By year-end, the PPI for intermediate materials other than food and energy had moved to a level more than 5 percent above that of a year earlier, the largest such increase since the late 1980s. Prices of imports also picked up somewhat in 1994, influenced by the depreciation in the exchange value of the dollar; as was true in the domestic economy, the largest price increases for imported goods were those for materials. Gains in productivity apparently enabled manufacturers of finished goods to absorb these increases in the costs of domestically produced and imported materials without raising their own prices very much.

In the CPI, the prices of commodities other than food and energy rose 1½ percent over the four quarters of 1994, about the same as the rise of 1993. Prices of new cars and new trucks, responding to strong demand and, at times, shortages in the supply of some models, moved up faster than prices in general; prices of used cars rose especially rapidly for a third year. The prices of tobacco products, which had fallen sharply in 1993 when producers made steep one-time price reductions, turned

Change in Prices



NOTE. Consumer price index for all urban consumers. The data are seasonally adjusted and are from the Department of Labor.

back up in 1994, rising moderately over the four quarters of the year. By contrast, prices of home furnishings changed little over the year, and the CPI for apparel fell noticeably.

The CPI for non-energy services, a category that accounts for about half of the total CPI, rose slightly less than 3½ percent over the four quarters of 1994, after an increase of about 3¾ percent in 1993. The increase in these prices in 1994 was just a bit more than half the rise that was recorded in 1990, when CPI inflation hit its most recent peak. Prices of medical services continued to slow in 1994, and airline fares, which have been an especially volatile category in the CPI in recent years, fell appreciably after having risen sharply the previous year. However, auto finance charges turned up, and the rate of rise in owners' equivalent rent, a category that has a weight of nearly 20 percent in the total CPI, rose slightly faster over the four quarters of 1994 than it had during the corresponding period of 1993.

In 1994, for a fourth year, neither food prices nor energy prices provided much impetus to the inflation process. The consumer price index for food rose a shade more than 2½ percent over the four quarters of 1994, about the same as the rise of 1993. Food prices in 1994 were restrained, in part, by sharp declines in the prices of domestically produced farm products, which, in turn, were pulled down by the huge increases in crop and livestock production noted previously. With beef and pork prices declining over the year, the CPI for meats, poultry, fish, and eggs changed little in total. Retail prices of dairy products rose only a small amount. Prices of foods that are more heavily influenced by the costs of nonfarm inputs also showed only small to moderate advances in 1994: The increase in the CPI for prepared foods amounted to about 2½ percent, slightly less than the previous year's increase, and, for a third year, the rise in the price index for food away from home was less than 2 percent. Coffee was the only item in the CPI for food to show sustained price acceleration; freeze damage to the crop in Brazil caused world prices of raw coffee to surge and led to a price rise of more than 50 percent at retail over the four quarters of 1994. Prices for fresh vegetables jumped toward year-end after Hurricane Gordon had damaged crops in Florida; run-ups in these prices typically are reversed within a few months as new supplies become available.

The CPI for energy rose about 1½ percent during 1994, after edging down ½ percent in 1993. Gasoline prices increased 4½ percent over the four quarters of 1994, reversing the decline of the previous year. Much of the increase in gasoline prices came in the third quarter and followed, with a short lag, a second-quarter rise in crude oil prices, which were moving back up from the low levels of late 1993 and early 1994. Prices of other energy products exhibited brief periods of rapid increase, but sustained upward pressures in these prices did not materialize. Fuel oil prices shot up temporarily early in 1994, when stocks were pulled down for a time by cold weather in the Midwest and the Northeast; later in the year, however, stocks were replenished and the earlier price increases were more than reversed. Natural gas prices followed a pattern similar to the price of fuel oil, rising sharply in the first quarter of the year but falling back thereafter, to a fourth-quarter level that was about 2¼ percent lower than that of a year earlier. Electricity prices rose only slightly during the year.

With the favorable inflation performance of 1994, the average rate of rise in the total CPI from the business cycle

trough in early 1991 to December 1994 amounted to 2.9 percent at an annual rate. Excluding food and energy, the rate of rise was 3.2 percent at an annual rate. Inflation rates lower than these have not been sustained through the first few years of any business expansion since that of the 1960s, when both the CPI and the CPI excluding food and energy showed average rates of increase of less than 1.5 percent during the first four years after the business cycle trough of early 1961. Average rates of price increase during the current expansion have been much smaller than those reported during the expansion that began in the mid-1970s. They also have been somewhat smaller than those reported during the first few years of the expansion that began in late 1982, a period when price increases were braked in part by unusually steep declines in oil prices. In measuring the progress that has been made toward bringing the economy closer to the goal of long-run price stability, the ratcheting down of the rate of price advance from cycle to cycle since the 1970s is perhaps an even more meaningful indicator than the favorable trends in the annual price data of recent years. ■