

The Economy in Perspective

Once upon a time, a husband and wife lived alone in the country, far from the nearest town. Maynard and Philippa were a well-intentioned couple, serious and analytical. Before long, they learned that they were to be parents. The news excited them, but it also caused anxiety, for they knew how demanding parenthood would be.

Maynard and Philippa had not gotten on very well with their own parents, and did not find it easy to turn to them for advice. Being practical people, they reasoned that their own common sense would see them through. Sure enough, labor and delivery went smoothly, and they became the proud parents of a baby boy. They named him Econome, in honor of their own efficient manner of living.

As it turned out, young Econome was a precocious child; he was inventive, assertive, and highly mobile at just one year. Proud of him as they were, Maynard and Philippa worried. Their child had enormous potential, and they felt a heavy obligation to see that he constantly fulfilled it. Knowing that young people could get into plenty of trouble if left to their own devices, they were determined to find a parenting style that would keep Econome challenged, yet safe.

Sitting at the kitchen table one night, they reflected on their own childhood experiences. Maynard recalled feeling moody much of the time, alternating between shyness and aggression. Philippa complained that she never could understand her parents, nor they her. Both remembered feeling physically awkward, and having trouble learning to tell right from wrong.

After some discussion, Maynard suggested a plan. Both he and Philippa wanted Econome to have self-reliance and a strong sense of values. If accelerations and decelerations in his growth rate would cause mood swings and low self-esteem, why not find a way to moderate the extreme fluctuations in his growth cycle? The solution, he said, was simple. They would monitor Econome's height and weight. When he appeared to be growing too fast, they would simply keep him in smaller clothes, and when his growth stalled, they would put him in looser ones.

The couple assumed that their child would achieve the average of their own heights, 5 feet 11 inches. By their calculations, they should regulate his growth to an average of 2.4 inches every year for the next 20 years. They would know when to alter his clothes by being attentive to behavioral abnormalities, spotting them

just before they became entrenched. They would get the hang of the correct sizing by experiment and rigorous record-keeping.

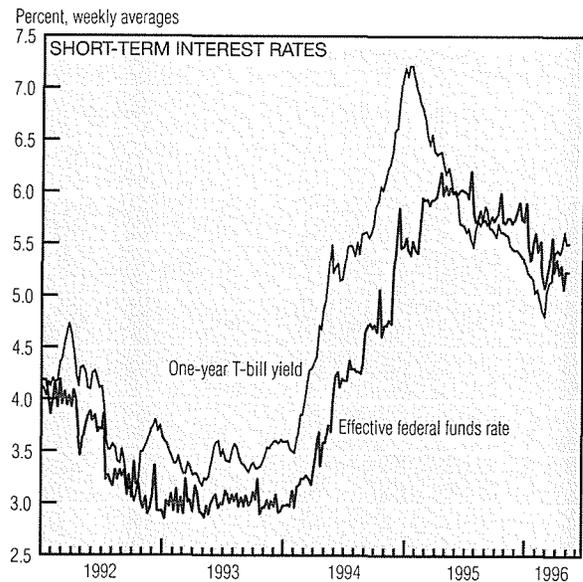
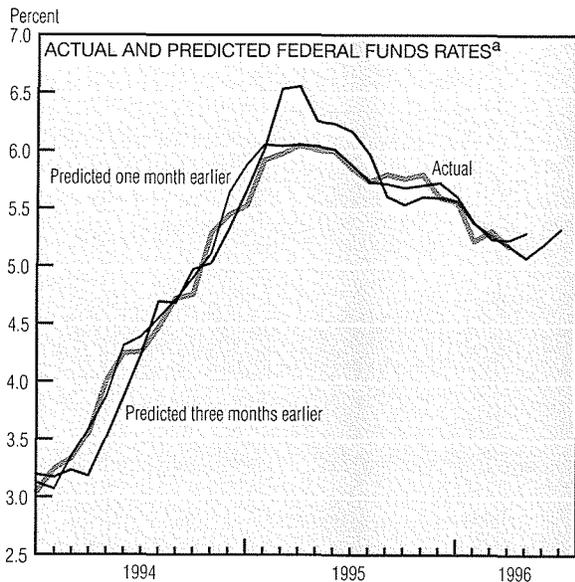
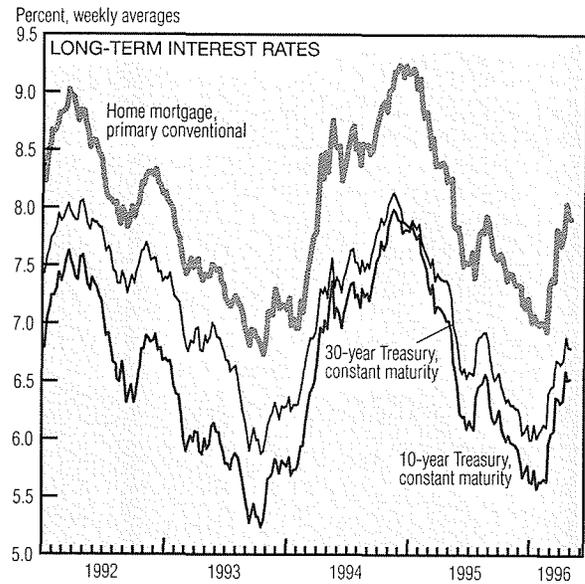
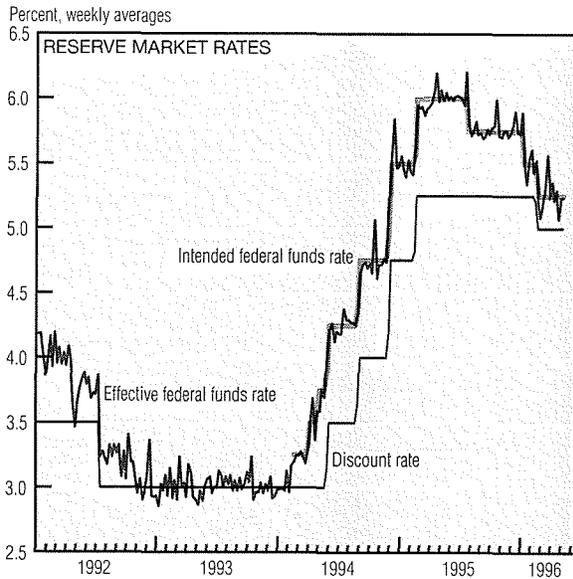
Maynard and Philippa put their plan into effect the next day. For years, Maynard predicted Econome's growth, and Philippa made clothing designed to restrict or encourage it according to the size of the gaps between his actual and ideal height and weight. They even learned how to fine-tune the sizing with elastic waists, pleats, and movable buttons. But Econome still had mood swings. When his clothing was restrictive, he became depressed; when it was loose, he lost his inhibitions. There were other difficulties as well. Econome was wearing skintight clothes when baggies were fashionable. He felt that his parents didn't understand him and would not let him be himself. He became prone to temperamental outbursts and unpredictable behavior.

This only caused Maynard and Philippa to become still more obsessed with managing Econome's development. They planned his wardrobe months in advance. They were deeply upset when the boy received a gift of baggy sweatpants from a relative for his eleventh birthday. He was already too tall for his age! When they took them away, Econome said they always stopped him from having fun whenever he began to feel good about himself. Family life was not going well at all.

Then one day these three had a surprise visit from Maynard's cousin Buck. After staying with them only a few days, Buck saw that something was terribly wrong. By questioning Maynard and Philippa about their clothing mania, he learned that they were trying to moderate their son's growth swings only in order to instill sound values. Buck told them that their intentions were laudable, but growth swings in a healthy child were natural. He said it was fine to keep an eye on Econome's height and weight, but to appreciate that those features could simply not be predicted or molded as precisely as they might wish. The best way to forge a good character for Econome was to work directly on his moral development. He urged them to be clear with their son about their expectations for him, and to set a good example through their own behavior. Growth is growth and values are values, he said.

From that day, these conscientious parents followed Buck's advice, raising a well-adjusted son who made them proud and was known as a man of constant purpose, sound judgment, and excellent taste in clothing.

Monetary Policy



a. Predicted rates are federal funds futures.
 SOURCES: Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

Since the Federal Open Market Committee's last meeting on March 26, interest rates have drifted up across all maturities. The initial turnaround in long-term rates occurred just before the February 1 reduction in the intended federal funds rate.

A harsh winter helped to push up energy prices and raised concerns about inflation. Subsequent employment reports have revealed a stronger-than-expected economy, despite the severe weather and the strike at General Motors. Measurable gains in retail sales and indus-

trial production have corroborated the economy's underlying vitality.

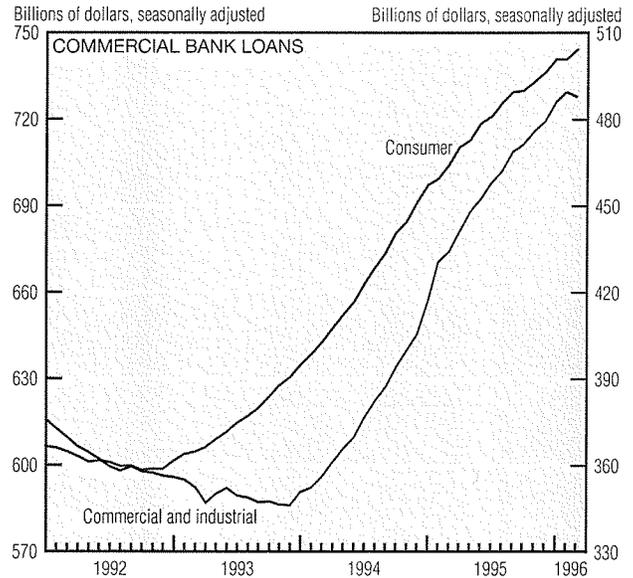
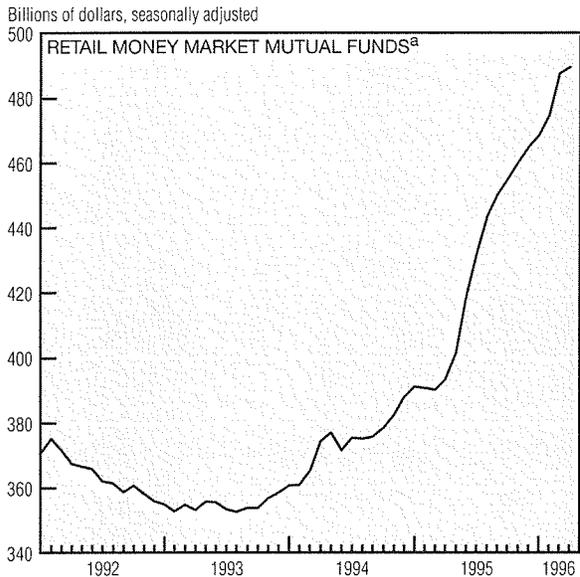
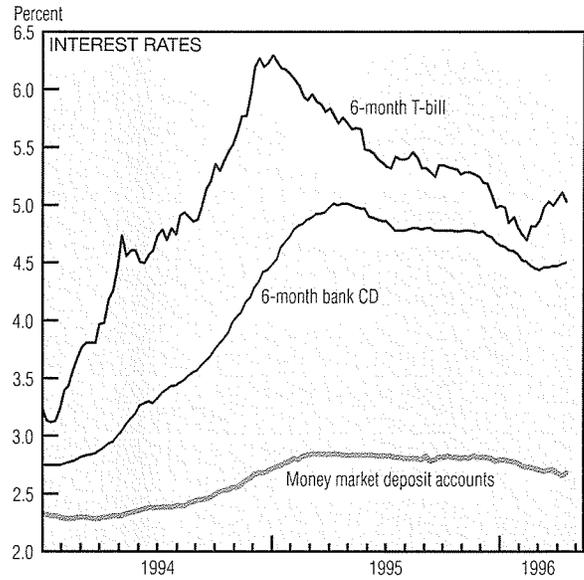
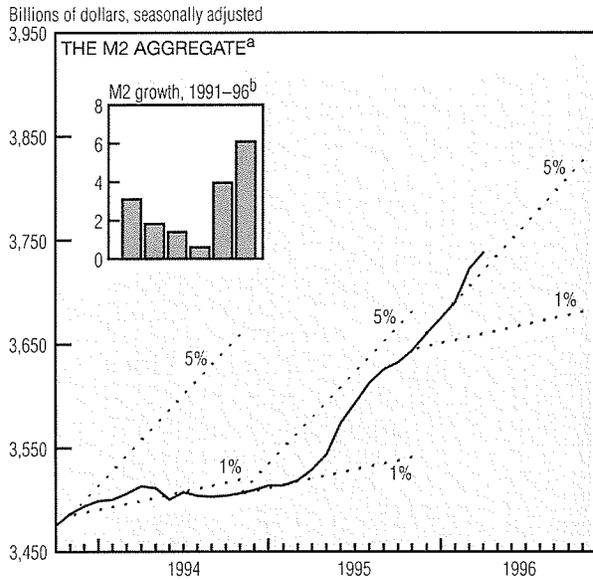
Strong economic activity is usually connected with higher rates of return on new business investment and, in turn, with a higher level of interest rates in general. Long-term rates have jumped substantially, with conventional mortgage rates surging about 100 basis points above their recent trough in February.

Concerns about inflation and growing evidence of economic strength have been associated with a change in market expectations

regarding the future course of monetary policy. Fed funds futures now suggest no likely policy action in the near term. However, futures contracts for late summer and early fall embed an increasing expectation of a modest rise in the intended funds rate. In recent weeks, the yield on one-year Treasury bills has moved persistently above the effective federal funds rate. Moreover, intermediate-term interest rates have tended to rise with maturity length.

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Monetary Policy (cont.)



a. Last plot is estimated for April 1996.

b. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1996 is calculated on an estimated April over 1995:IVQ basis.

NOTE: Dotted lines are target ranges.

SOURCES: Board of Governors of the Federal Reserve System; and *Bank Rate Monitor*, various issues.

M2 growth so far in 1996 has exceeded its average growth rate in each of the past five years. This strength has persisted since about mid-1995, largely reflecting the lagged effects of falling interest rates. Bank deposit rates adjust relatively slowly to market conditions. Thus, the opportunity cost of M2 (measured as the difference between the three-month Treasury yield and the share-weighted average yield paid on M2 components) tends to rise and fall with market rates.

The opportunity cost of M2 had been falling until the turnaround in short-term Treasury yields early this year. The recent rise in short-term rates is associated with a rise in M2's opportunity cost and hence with an expected moderation in M2 growth over the balance of the year.

Retail money market mutual funds are a key component driving the aggregate's recent strength. Money fund yields have tended to rise relative to savings and small time deposit rates, making these funds com-

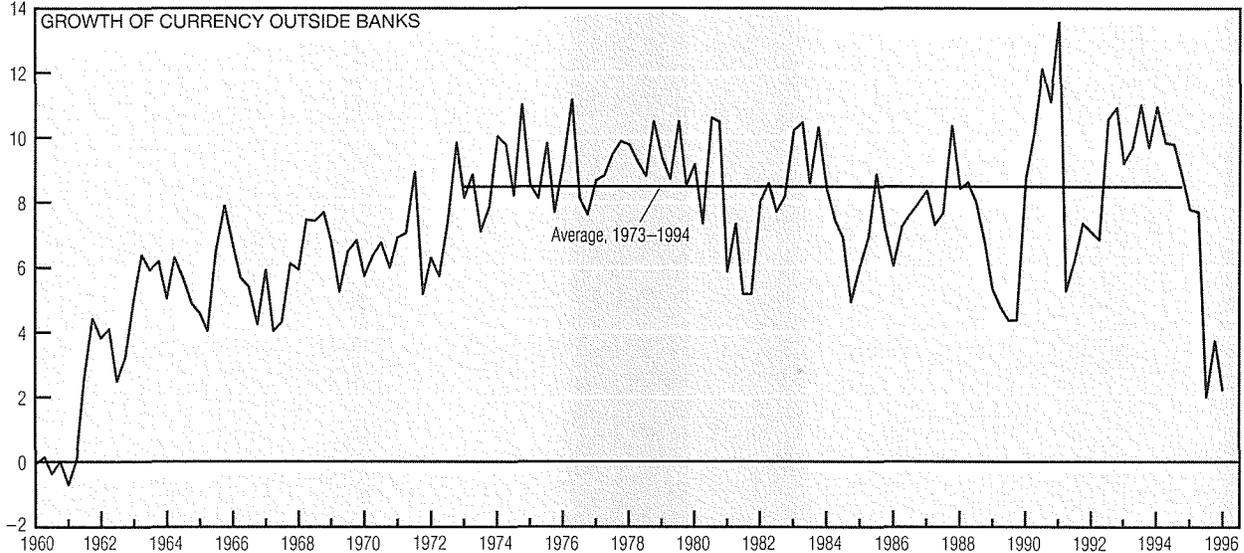
paratively attractive. Moreover, the flattening of the yield curve, which persisted through early 1996, induced some investors to shorten the maturity of their portfolios.

Bank loan growth continues to moderate. Commercial and industrial loans fell slightly in March, reflecting in part a reduction of inventories, often financed by a drawing down of bank credit lines. Consumer credit continues to grow, but at a slower rate than previously.

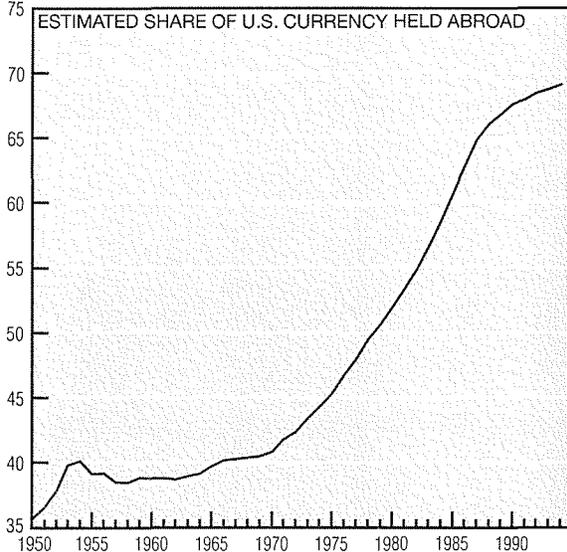
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Monetary Policy (cont.)

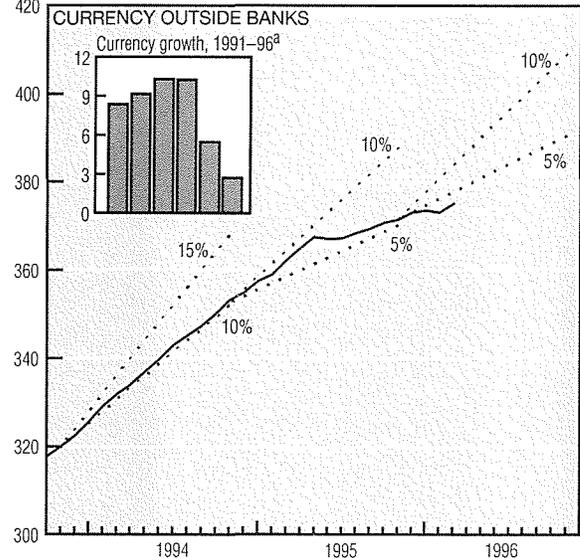
Percent change, seasonally adjusted annual rate



Percent



Billions of dollars, seasonally adjusted



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. Annualized growth rate for 1996 is calculated on a March over 1995:IVQ basis.

NOTE: Dotted lines represent growth ranges and are for reference only.

SOURCES: Board of Governors of the Federal Reserve System; and Richard D. Porter and Ruth A. Judson, "The Location of U.S. Currency: How Much Is Abroad?" manuscript, Board of Governors of the Federal Reserve System, June 1995.

One recent anomaly has been the sharp deceleration in currency, which has increased only 3% since June 1995. This compares with an average annual rate of nearly 8½% over the previous 22 years. During these years, currency grew slightly faster than GNP, despite periods of high inflation and the increasing use of alternative payment methods.

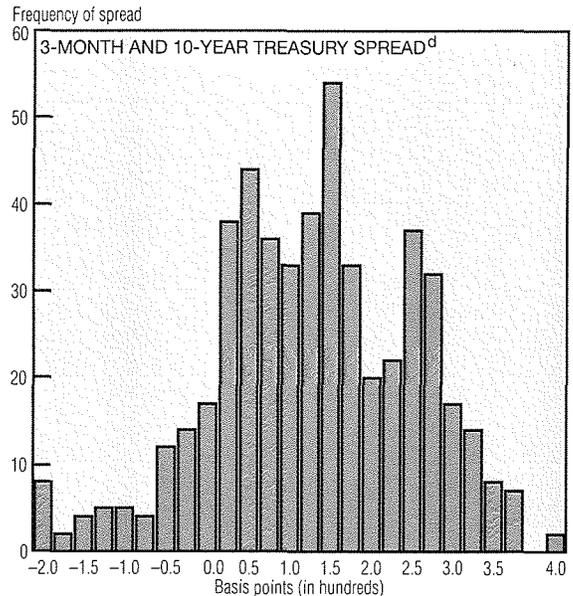
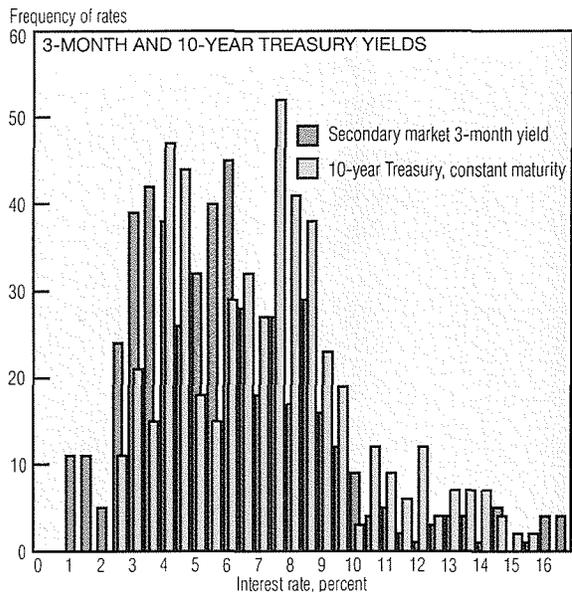
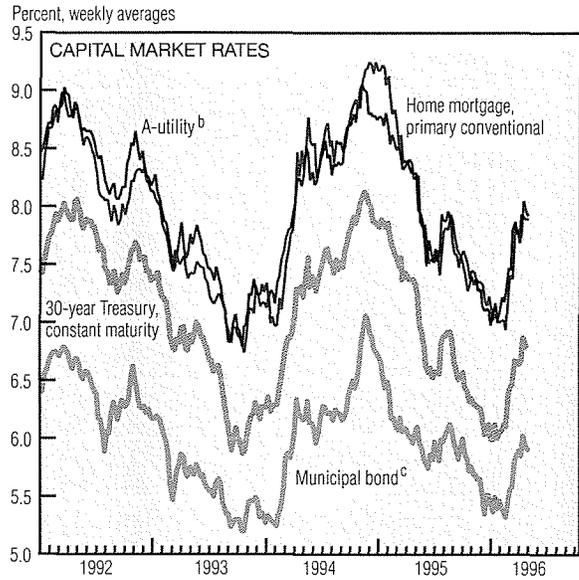
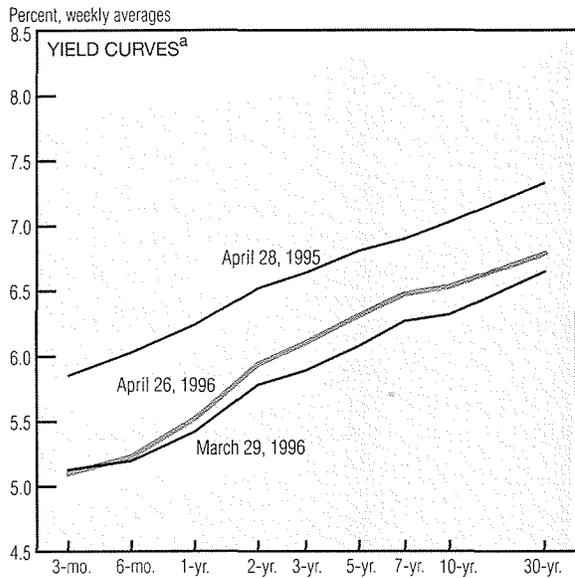
Recent evidence suggests that a growing share of U.S. currency is held outside the country by individ-

uals who are uncertain about their own currency's future value. To these investors, the dollar is a refuge during times of political and economic uncertainty. Moreover, the dollar is preferred in many countries as an acceptable medium of exchange and as a safe store of value. Some analysts have estimated that as much as 70% of U.S. currency is held abroad.

The recent slowdown in currency growth is believed to be related to foreign concerns surrounding the

March introduction of the redesigned \$100 bill, one of the most popular denominations held abroad. The new bill, introduced as an anti-counterfeiting measure, raised questions about the genuineness of existing foreign-held stocks and is believed to be the key explanation for the sudden slowdown in demand. Although March saw currency accelerate to its fastest rate in more than a year, growth remains well below its longer-term pace.

Interest Rates



- a. 3-month and 6-month instruments are quoted from the secondary market on a yield basis; all other instruments are constant-maturity series.
 - b. Estimate of the yield on a recently offered, A-rated utility bond with a maturity of 30 years and call protection of five years.
 - c. Bond Buyer Index, general obligation, 20 years to maturity, mixed quality.
 - d. 10-year Treasury constant maturity minus the secondary market 3-month yield.
- SOURCE: Board of Governors of the Federal Reserve System.

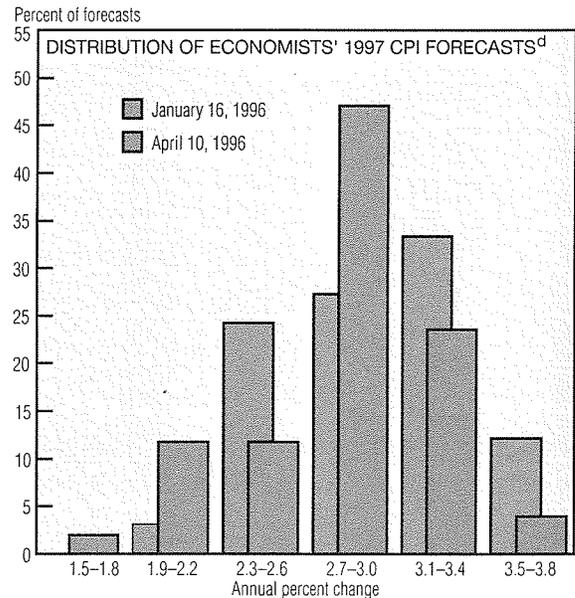
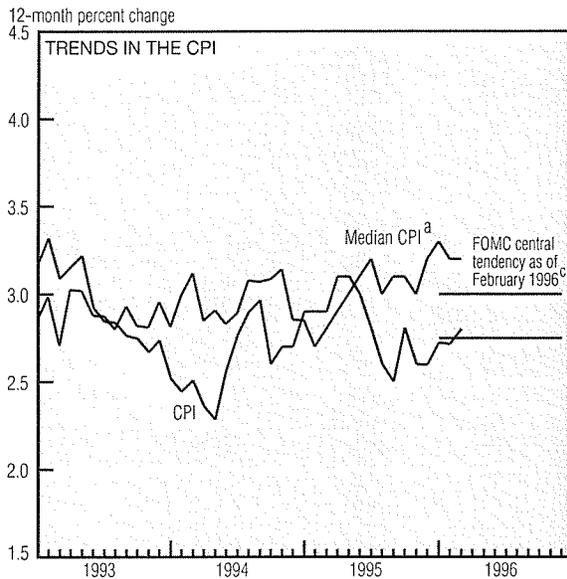
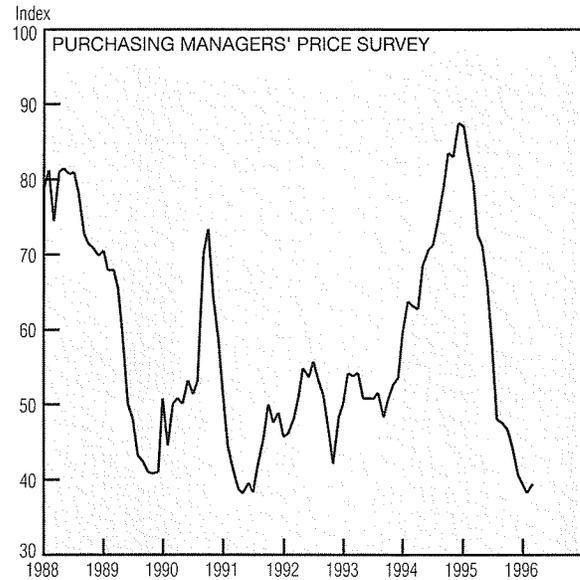
The yield curve has steepened slightly since last month. It remains nearly linear—much as it looked at this time last year. Clearly, fears of an inversion in January did not play out. Two closely watched spreads—the 10-year, 3-month and the 3-year, 3-month—stand at 143 and 100 basis points, above their historic averages of 125 and 85. Some observers attribute the rise in long rates to concerns about inflation and a strong economy (allegedly bad for bonds), but many advise a wait-and-see attitude.

Over the past month, other long rates—including mortgages, municipal bonds, and utility bonds—have edged up in step with 30-year Treasuries, but have fallen more recently. Spreads between these long bonds have remained fairly steady, but have closed slightly in recent weeks: The spread between mortgage and utility bond rates decreased from 14 basis points to 6 between April 12 and April 19.

One way to judge the “normalcy” of today’s interest rates is to look at the distribution of interest rates in

the recent past. Most yields on 3-month and 10-year Treasury bonds fall between 2% and 9%, placing current yields of 5.10% and 6.53% squarely in the normal range. Even the levels seen in late 1994, when the 10-year rate approached 8%, do not seem out of the ordinary (in 1981, rates exceeded 15%). The spread likewise shows a lot of variability. It commonly moves below zero and above two, making today’s level seem downright pedestrian.

	Annualized percent change, last:				1995 avg.
	1 mo.	3 mo.	12 mo.	5 yr.	
Consumer Prices					
All items	4.8	4.0	2.8	2.9	2.6
Less food and energy	3.7	3.5	2.9	3.2	3.0
Median ^a	2.9	3.1	3.2	3.1	3.2
Producer Prices					
Finished goods	6.7	2.8	2.4	1.5	2.1
Less food and energy	1.0	0.3	1.9	1.7	2.5
Commodity futures prices^b					
	-1.3	6.9	6.2	2.5	5.4



a. Calculated by the Federal Reserve Bank of Cleveland.
 b. As measured by the KR-CRB composite futures index, all commodities. Data reprinted with permission of the Commodity Research Bureau, a Knight-Ridder Business Information Service.
 c. Upper and lower bounds for CPI inflation path as implied by the central tendency growth ranges issued by the FOMC and nonvoting Reserve Bank presidents.
 d. Consensus forecast of the Blue Chip panel of economists.
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; the National Association of Purchasing Management; and *Blue Chip Economic Indicators*, January 16 and April 10, 1996.

After a string of small increases, consumer prices have risen more quickly in the past several months. During the first quarter of 1996, the Consumer Price Index (CPI) rose at an annualized rate of 4.0%, 1.4 percentage points above its 1995 average. Such large swings in price data are common, though, and do not necessarily mark the beginning of greater inflationary pressures. In fact, the median CPI—an estimate of the economy's underlying inflationary trend—rose an annualized 2.9% in March and 3.1% during the

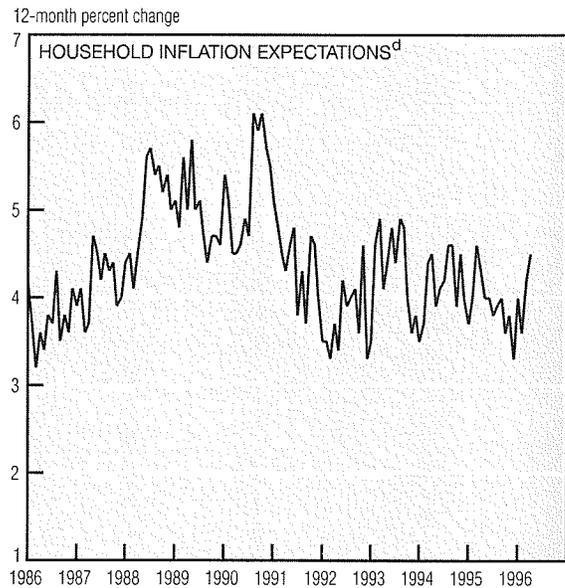
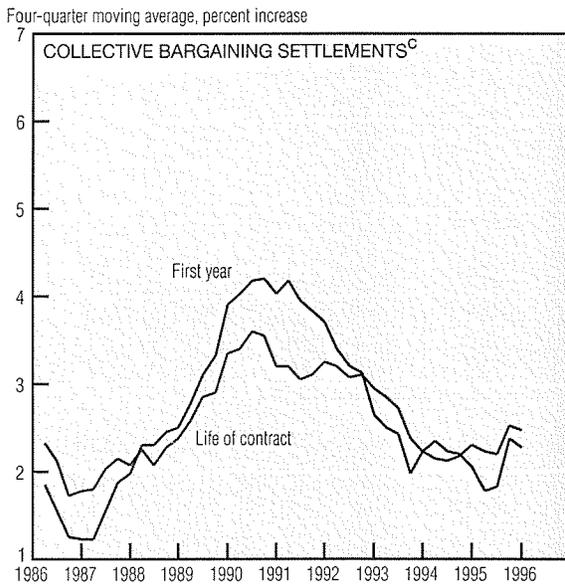
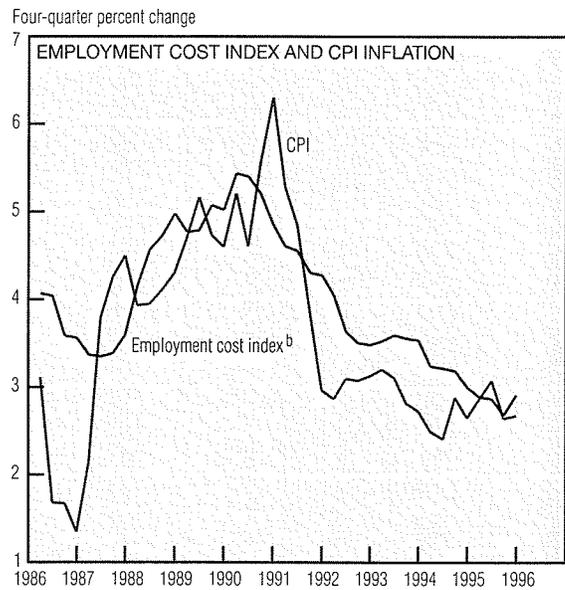
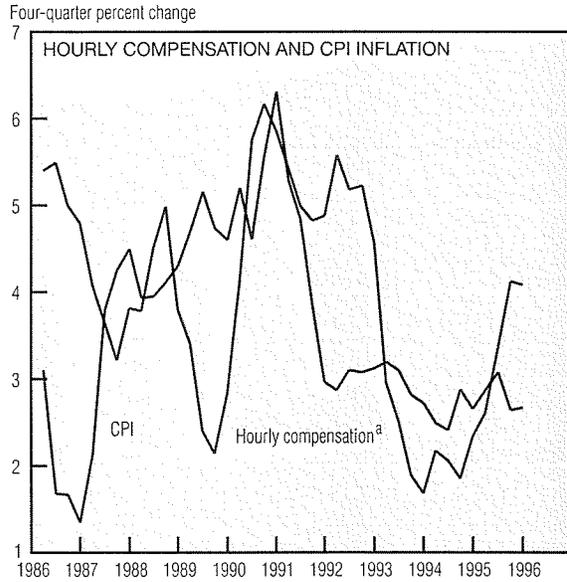
first three months of 1996, a pace virtually indistinguishable from its average of the past five years.

Price increases coming from the industrial sector, where production gains have been meager since last summer, have been more moderate. Excluding prices for food and energy (the latter commodity being particularly troublesome this year), producer prices showed essentially no change during the first quarter. Similarly, the share of purchasing managers reporting increasing price pressures remained at a five-year low.

The 12-month CPI trend, at 2.8%, is near the midpoint of the central-tendency range projected by Federal Reserve officials for 1996 (2.75% to 3%). While that view appeared somewhat optimistic earlier this year, an increasing number of economists now expect inflation to remain at, or very near, this range over the foreseeable future. In January, 45% of the Blue Chip panel thought that the rate of retail price increases would move above 3% in 1997; today, less than 30% hold that view.

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Inflation and Prices (cont.)



a. For all employees in nonfarm business.
 b. Includes wages, salaries, and employer costs of employee benefits for all civilian workers.
 c. Wage and benefit cost adjustments for collective bargaining settlements covering 1,000 or more workers.
 d. Mean expected 12-month change in consumer prices as measured by the University of Michigan's Survey of Consumers.
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; DRI/McGraw-Hill; and the University of Michigan.

Moreover, the expectation that inflation will be significantly reduced by next year seems to be gaining support. Compared with January, when only 3% of the economists surveyed saw 1997 retail inflation moving below 2.25%, April's results show 15% expecting this outcome.

The behavior of wage growth is sometimes presumed to indicate future inflationary pressure (although the evidence for such a belief is less than compelling). The theories linking wage increases to future inflation are among the most passionately debated by economists: Some view

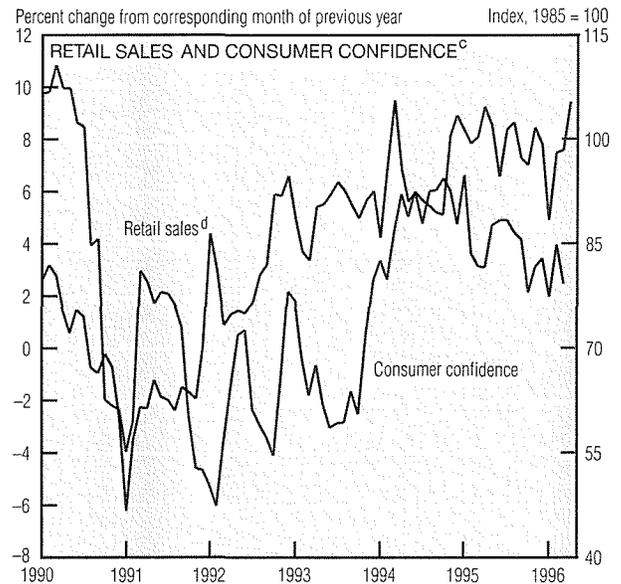
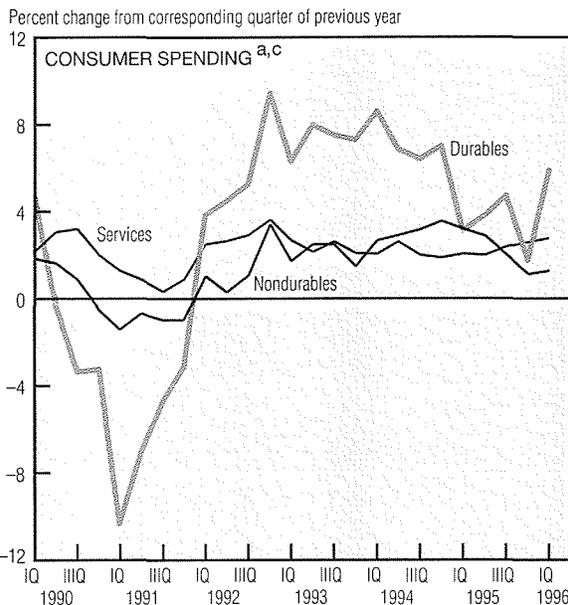
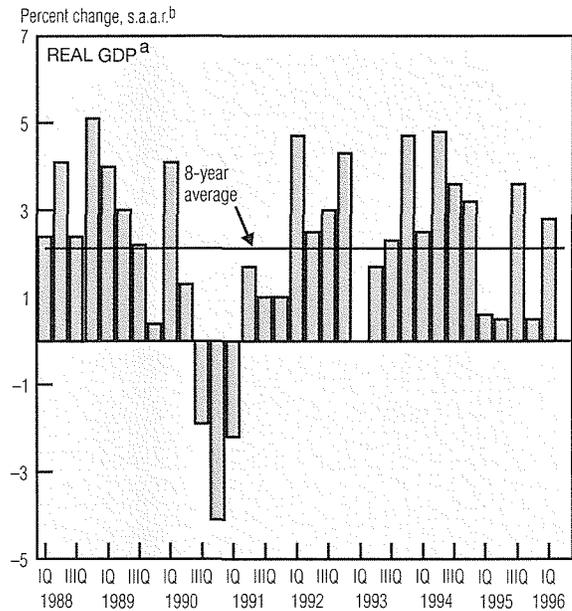
wage growth as a cost that ultimately "pushes" prices up, while others consider wages to be set by forward-looking workers, whose inflation forecasts tend to be fairly accurate. Regardless of cause, the recent growth pattern of wages provides little reason to anticipate substantial near-term inflation changes.

While hourly compensation has risen recently (up more than 4% during the past four quarters), compensation more broadly defined increased slightly less than 3% during that period (not much different from the recent CPI trend). Likewise, union-negotiated wage settle-

ments, though marginally higher in the past few years, have been holding steady at around 2.5% in recent quarters, even for life-of-contract increases extending over three years. Indeed, one of the few indications of higher near-term inflation comes from households, which anticipate inflation of over 4% for the next 12 months. While this is up a bit from a few months ago, and is substantially higher than the current inflation trend, household survey data have been warning of an (unrealized) inflationary uptick for most of the past four years.

Economic Activity

	Change, billions of 1992 \$	Percent change, last:	
		Quarter	Four quarters
Real GDP	47.1	2.8	1.8
Consumer spending	39.4	3.5	2.7
Durables	10.1	7.0	5.9
Nondurables	11.0	3.1	1.3
Services	18.5	2.9	2.8
Business fixed investment	21.0	12.1	5.9
Equipment	18.7	14.5	6.7
Structures	2.6	5.8	4.0
Residential investment	2.9	4.4	1.3
Government spending	5.7	1.8	-0.5
National defense	5.6	7.4	-3.2
Net exports	-14.4	—	—
Exports	5.4	2.7	6.5
Imports	19.8	9.1	4.7
Change in business inventories	-8.6	—	—



a. Chain-weighted data in 1992 dollars.
 b. Seasonally adjusted annual rate.
 c. Seasonally adjusted.
 d. March data are estimated by deflating nominal retail sales by the Consumer Price Index for commodities.
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and The Conference Board.

Advance estimates released by the Commerce Department show real GDP rising 2.8% in the first quarter, substantially above the 1.5% that analysts had generally anticipated. The lower forecast was based in part on the General Motors strike, the government shutdown, and the exceptionally hard winter. The Commerce Department estimated that real GDP would have increased 4.2% in the first quarter without the auto production figures, and that other special factors trimmed 0.2% off the

overall growth rate. Advance estimates are based on very preliminary data, but the size of past revisions suggests that the final estimates are unlikely to drop as low as 1.5%.

Over the past four quarters, real GDP advanced 1.8%. This rate is below historic norms, but is not substantially different from recent estimates of the economy's long-term growth potential (2.0%).

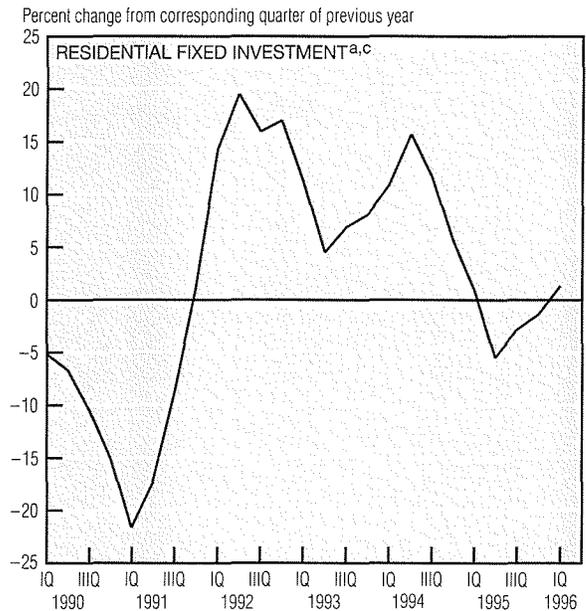
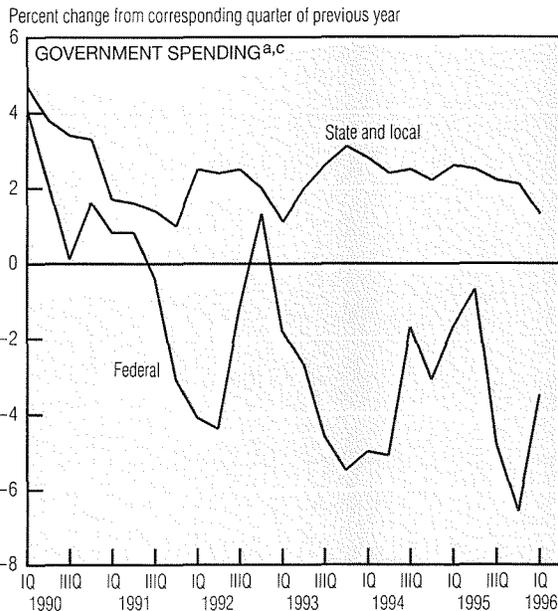
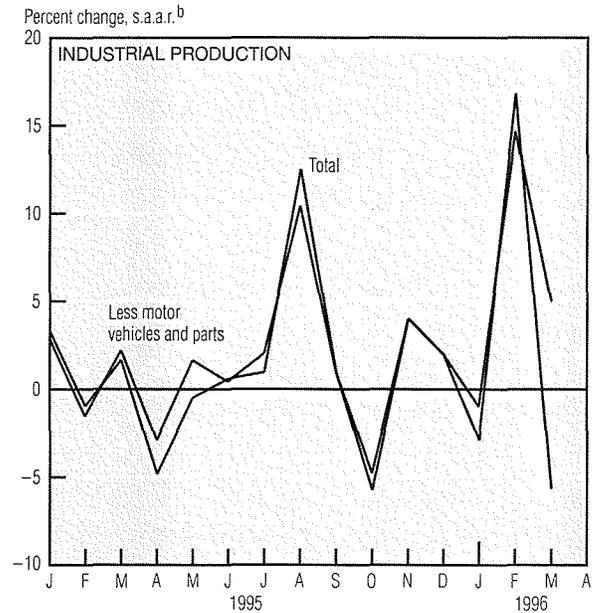
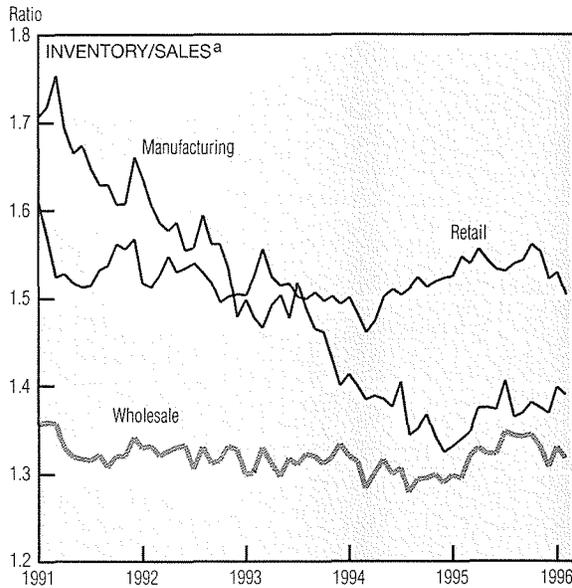
Consumer spending rose a strong 3.5% in 1996:1Q and 2.7% over the last four quarters, with big gains in consumer durables. Early concerns

about debt-burdened consumers and shrinking consumer confidence seem to have been unwarranted. (Adjusted for inflation, March retail sales fell slightly, but on a year-over-year basis seem consistent with moderate growth.)

Business fixed investment was a major component of the strong first-quarter showing. Over the past year, companies have purchased a large volume of information processing equipment, especially computers.

(continued on next page)

Economic Activity (cont.)



a. Seasonally adjusted.
 b. Seasonally adjusted annual rate.
 c. Chain-weighted data in 1992 dollars.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and Board of Governors of the Federal Reserve System.

The pace of inventory accumulation slowed in the first quarter. On balance, businesses added \$7.9 billion (1992 dollars) to their stocks, compared with \$16.5 billion in 1995:IVQ. The retail sector actually drew down inventories. Inventory/sales ratios suggest that further substantial inventory corrections are unlikely, especially at the retail and wholesale levels. Manufacturing inventories, however, may still be a bit high relative to shipments. Industrial production slowed in 1995 as inven-

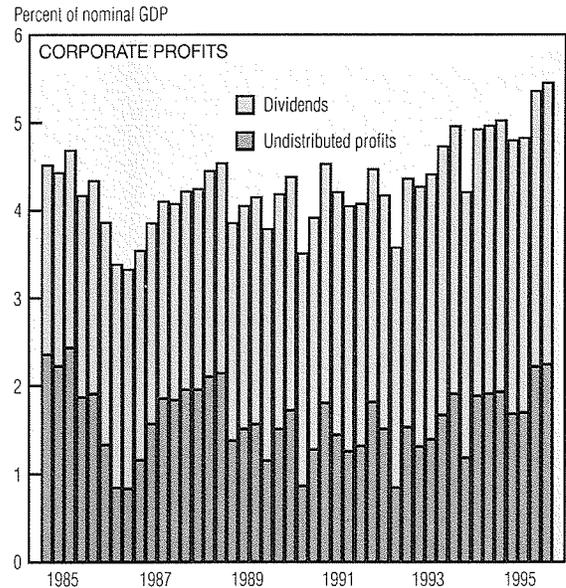
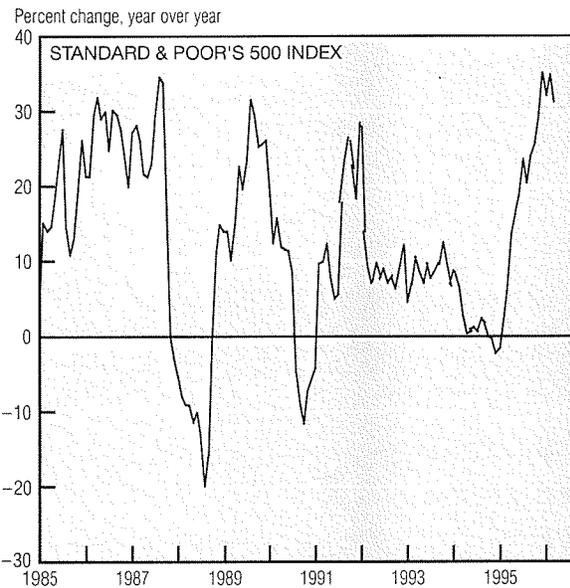
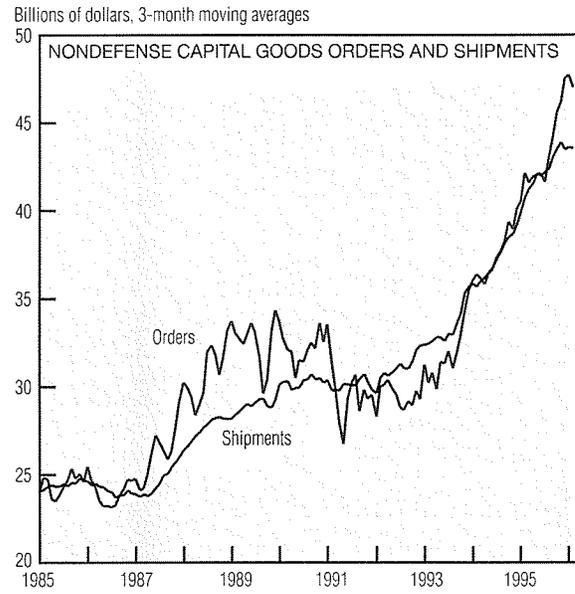
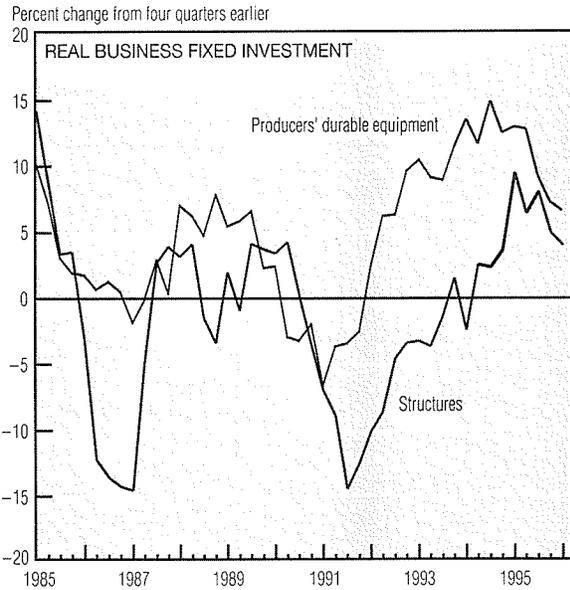
tories rose relative to shipments. Excluding the production of automobiles and parts, which the GM strike affected, industrial production advanced 4.2% in the first quarter.

Federal government purchases of goods and services increased 6.7% in 1996:IQ, but continued to decline on a year-over-year basis (down 3.5%). The persistent reductions in federal expenditures have been concentrated in the defense category. State and local government outlays have grown a fairly steady 2% in

each of the last few years.

Residential fixed investment advanced in the first quarter after declining on a year-over-year basis throughout 1995. Housing starts dropped 3.9% in March, but, discounting the extreme month-to-month volatility in this series, have remained moderately high since early 1995. Existing home sales were up a strong 6.9% in March, bringing the median U.S. home price to \$115,300—a 6.8% increase from last year.

Business Fixed Investment



SOURCES: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; and Standard and Poor's Corporation.

Business fixed investment—necessary to build capital, promote innovation, and boost living standards—rose 7.4% in 1995, capping three years of above-average growth. Investment in producers' durable equipment, especially computers, accounted for much of the increase. Investment in nonresidential structures, which was constrained by overbuilding during the 1980s, also increased at an above-average pace in 1995.

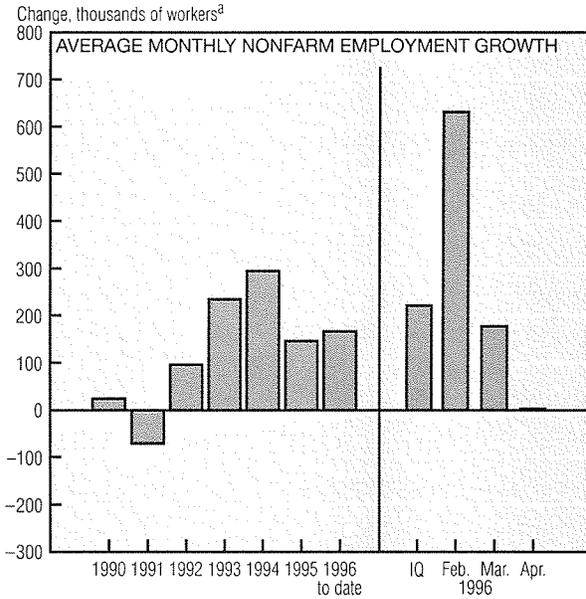
Most forecasters, who substan-

tially underestimated the strength of business spending in 1994 and 1995, expect business fixed investment to continue advancing this year and next, but at a rate nearer to its 25-year average of 3.7%. They base this expectation on a slowing in real economic growth and on last year's slight decline in the rate of capacity utilization. Nevertheless, new orders for capital goods have recently exhibited strong growth and continue to exceed shipments.

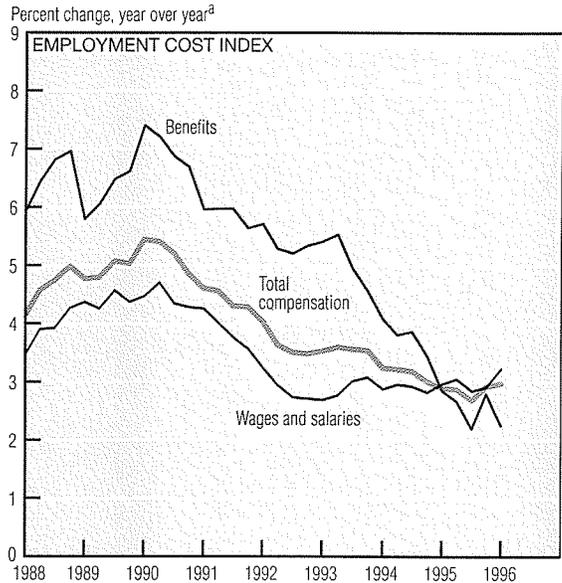
Rising interest rates are also a concern in the forecast, but their rela-

tionship with business fixed investment is difficult to discern. Although they increase the opportunity cost of financing investment projects, higher real interest rates tend to reflect greater productivity of capital itself. Indeed, the behavior of stocks over the past year suggests that investors foresee increasing profits from the economy's capital stock, which should encourage investment. The strong performance of corporate profits also bodes well for additional investment.

Labor Markets



	Average monthly change (thousands of employees)				
	1995	1996			
	Year	IQ	Feb.	Mar.	Apr.
Payroll employment	144	221	631	178	2
Goods-producing	-5	12	148	-54	-71
Manufacturing	-14	-34	30	-61	-17
Construction	11	45	112	5	-53
Service-producing	149	209	483	232	73
Services	93	125	273	117	20
Computer	9	7	10	11	11
Retail trade	19	33	107	40	20
Household employment	34	390	437	438	-56
		Average for period			
Civilian unemployment rate (%)	5.6	5.6	5.5	5.6	5.4
Mfg. workweek (hours) ^b	41.6	41.0	41.6	41.4	41.5



a. Seasonally adjusted.
 b. Production and nonsupervisory workers.
 c. Vertical line indicates break in data series due to survey redesign.
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Employment continued its seesaw pattern in April, as nonfarm payrolls edged up by only 2,000. The unusually small rise has been attributed to myriad factors, including the timing of the survey, the implementation of new seasonal adjustment factors, and the weather.

Manufacturing employment continued to decline in April (down 17,000), while the factory workweek lengthened slightly. Year-to-date job losses in manufacturing

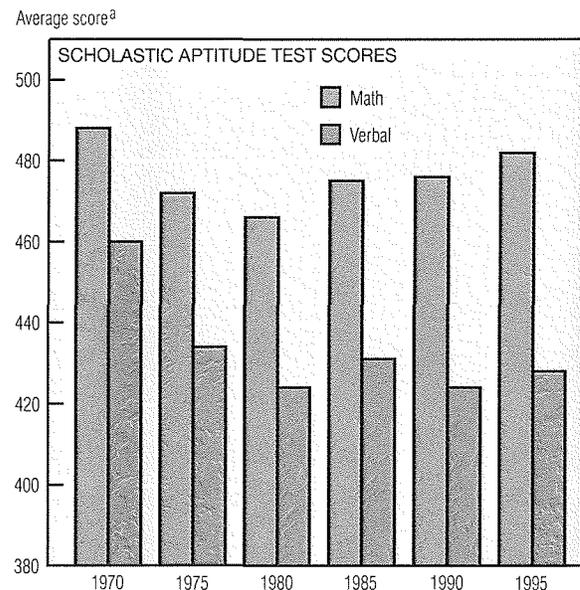
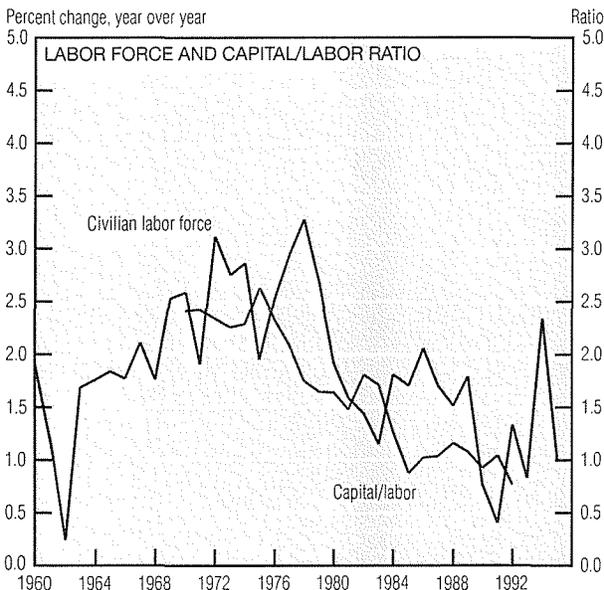
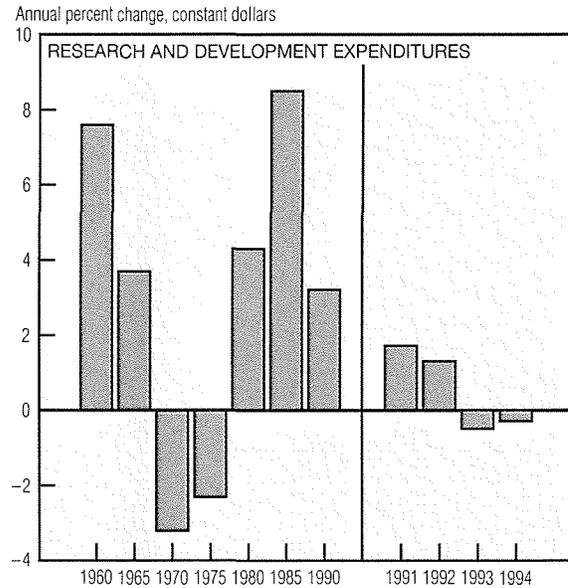
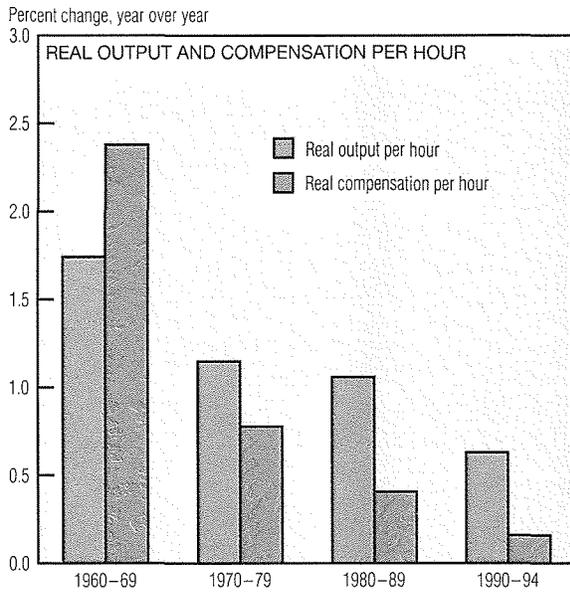
now total 120,000, about 75% of which occurred in nondurable goods. Just offsetting April's loss in the goods-producing sector was a 73,000 gain in service-producing employment. Notably, a solid rate of job additions has been evident in the quickly growing computer and data processing industry.

The unemployment rate stood at 5.4% in April, compared to 5.6% in March. Much like the establishment survey, household-reported employment may exhibit wide month-to-

month swings. However, the long-run averages of the two series reflect similar trends in the labor market.

Increases in civilian workers' wages and salaries have hovered around 3% for the past few years, and continued to do so during the year ended March 1996 (3.2%). Meanwhile, growth in benefit costs (which account for roughly one-third of total compensation) resumed its downward trend, falling from 2.8% to 2.2% over the same period.

Productivity Trends



a. Minimum score, 200; maximum score, 800.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; Citibase; and College Entrance Examination Board.

Growth in hourly output has decelerated significantly since the early 1970s, reflecting a decline in labor productivity growth. Sluggish labor productivity growth is associated with slack gains in hourly compensation, which suggests that progress in U.S. living standards has slowed to a crawl.

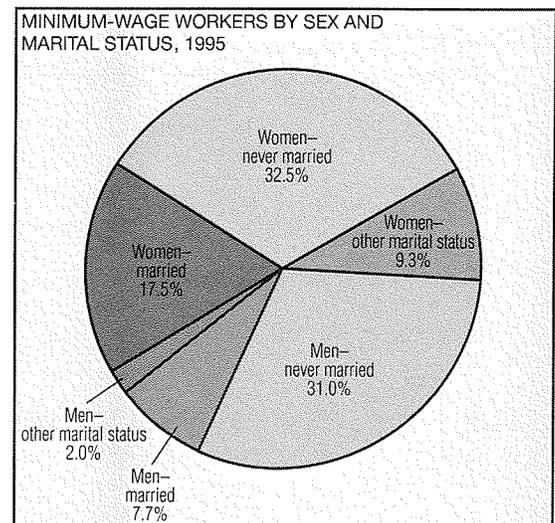
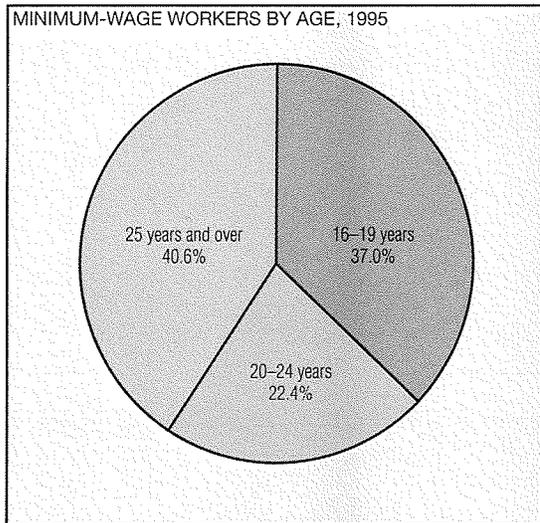
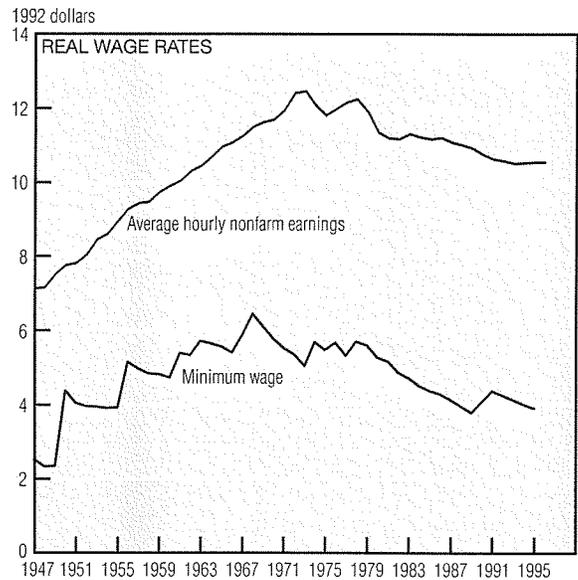
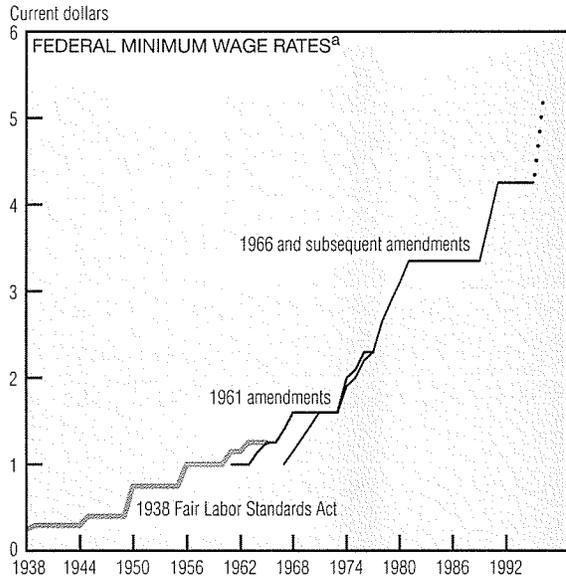
Labor productivity changes can be divided into those arising from technological changes and those due to changes in the amount of capital per worker (capital deepening), both of which are difficult

to measure. A proxy for technological change—growth in research and development spending—indicates that this factor may have contributed to slower productivity growth during the mid-1970s. R&D outlays surged during the 1980s, but have slowed again in recent years. The rate of capital deepening, calculated with an all-inclusive measure of capital, shows considerable decline after the mid-1970s, some of it attributable to baby boomers' entry into the labor force.

Just as important, however, is the

quality of the labor force. More young entrants and fewer older workers—a consequence of the growing trend toward earlier retirement—meant that the post-1970 workforce was less experienced than before. Moreover, Scholastic Aptitude Test scores indicate that new entrants were less accomplished than their predecessors. Because skills and experience are forms of capital, these data suggest that the measured decline in the capital/labor ratio may understate its true extent.

The Minimum Wage



a. Dotted line indicates the proposed increase in the minimum wage.
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Economists prefer solutions to social problems that make some people better off without making others worse off. Using this criterion, few economists find the minimum wage attractive.

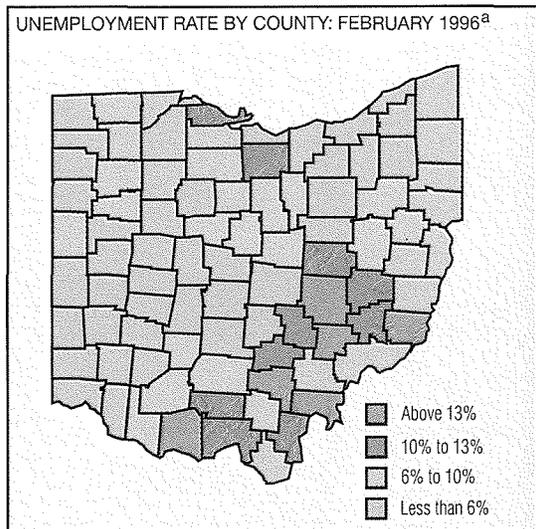
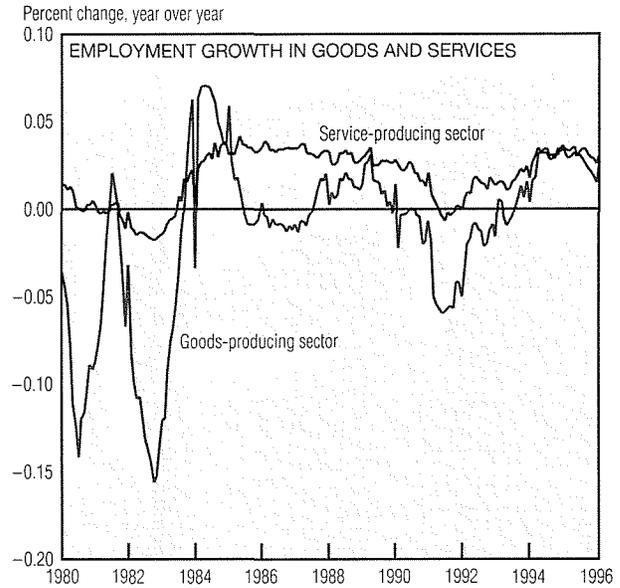
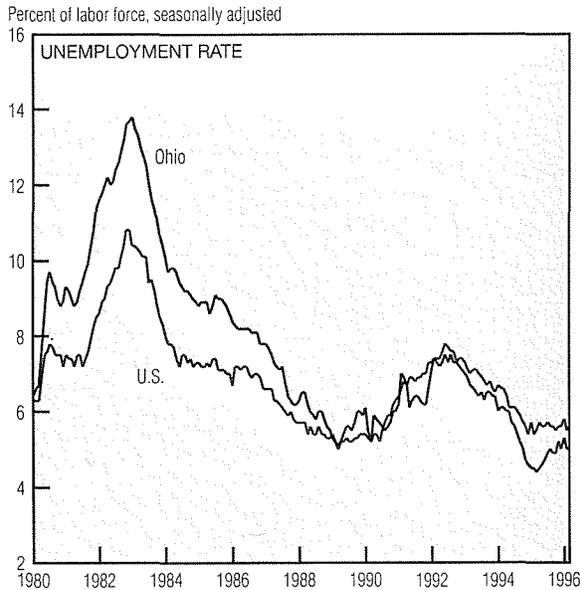
Nearly 2 million workers received the \$4.25 federal minimum wage in 1995. Approximately 60% of them are under 25, most (64%) work part time, and their jobs feature very high rates of turnover. Compared to workers receiving hourly wages, minimum-wage earners include a

disproportionate share of minority workers. Almost 42% of minimum-wage earners are unmarried women.

Studies suggest that a 10% hike in the minimum wage will reduce employment rolls by 1% to 3%. This implies that the proposed 21% increase (to \$5.15) will cut between 41,400 and 124,000 minimum-wage jobs. Assuming that the approximately 1.8-1.9 million workers who remain employed work 27 hours per week (the current average), each will receive an additional \$24 weekly, or \$1,251 per year.

These rough calculations assume that all else remains constant. But a higher minimum wage will induce further substitution of capital for unskilled labor and will encourage the practice of working "off the books." Eventually, as economic growth and inflation advance the average wage rate, the relative size of the minimum wage will dwindle and demand for unskilled workers will rise. Both the positive and negative effects of the minimum wage will prove temporary.

The Ohio Economy



Unemployment Rate by Metropolitan Area^a
(Percent of labor force)

	February 1996	February 1995
Akron	5.3	4.9
Canton–Massillon	6.2	5.4
Cincinnati	4.6	4.5
Cleveland–Lorain–Elyria	5.3	5.3
Columbus	3.5	3.3
Dayton–Springfield	4.6	4.2
Hamilton–Middletown	4.8	4.4
Lima	6.5	5.5
Mansfield	6.5	6.1
Steubenville–Weirton	6.8	7.2
Toledo	5.3	5.1
Youngstown–Warren	6.7	6.5

a. Data are not seasonally adjusted.

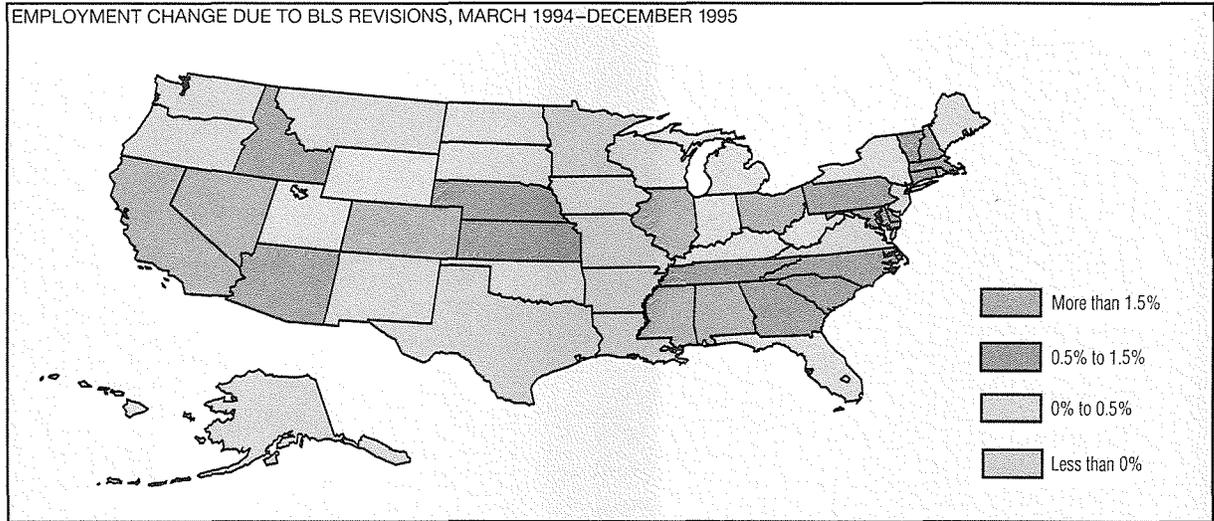
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Ohio Bureau of Employment Services.

Ohio started 1995 with one of its lowest unemployment rates in recent years—4.5%. While that rate was not sustained, the state stayed consistently below the U.S. average throughout 1995 and into 1996. This represents a major turnaround from last decade's Rust Belt period, when Ohio had one of the highest jobless rates in the nation.

The source of this improvement is the increased stability of goods-producing employment at all points

in the latest business cycle. Jobs in this sector (approximately 80% of which are in manufacturing in Ohio) fell much less in the 1990 recession than in the early 1980s' downturns. Employment in goods production also grew more slowly, but at a steadier pace, in the current recovery, and in 1995 expanded at nearly the same rate as service jobs. The latter is noteworthy because nationally, service-producing employment continued to grow in 1995, while goods employment actually shrank.

Even though the state as a whole has posted exceptionally low jobless rates in recent years, February data show that some pockets of high unemployment remain. The weakest areas are the counties near the Ohio River and the Pennsylvania border. By contrast, many rural counties (particularly in western Ohio) and the six largest metropolitan areas were well below February's national jobless rate of 6% (not seasonally adjusted).



Employment Revisions in Fourth District and Other States^a
 (Number of jobs)

	Original jobs growth	Revised jobs growth
Kentucky	101,700	106,600
Ohio	262,500	354,700
Pennsylvania	167,100	201,800
West Virginia	42,400	42,600
California	389,900	590,600
Illinois	245,500	325,800

Employment Revisions in Fourth District Metropolitan Areas^a
 (Number of jobs)

	Original jobs growth	Revised jobs growth
Cincinnati	39,200	46,600
Cleveland	73,500	65,200
Columbus	57,300	60,000
Erie	6,200	8,400
Lexington	20,400	21,400
Pittsburgh	21,400	42,600
Toledo	29,000	15,700

a. Jobs growth from March 1994 through December 1995.
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Every year, the Bureau of Labor Statistics (BLS) corrects the employment series for jobs missed by the monthly establishment survey, which covers more than 350,000 workplaces. The corrections are based on data from nearly all U.S. employers, collected quarterly at the state level and used to administer the unemployment insurance system.

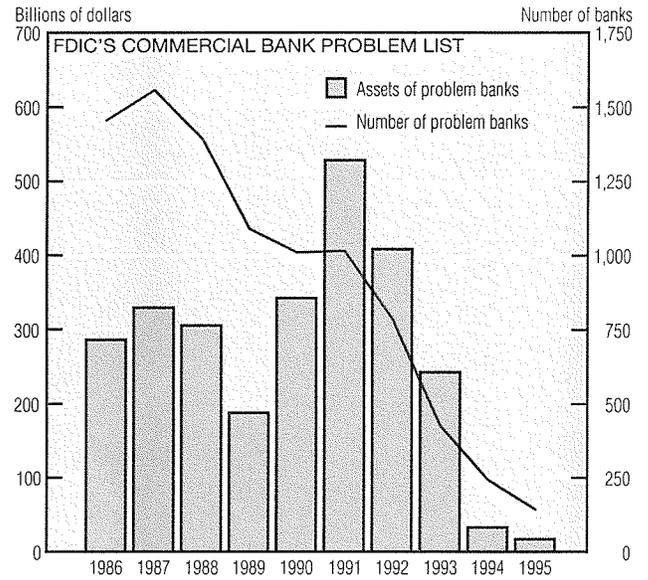
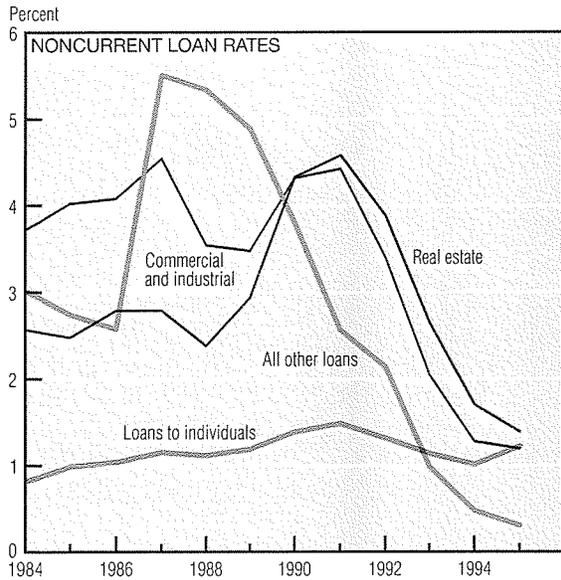
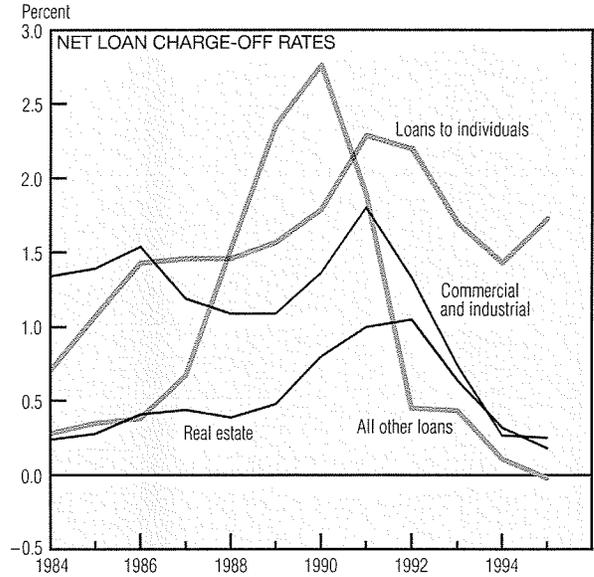
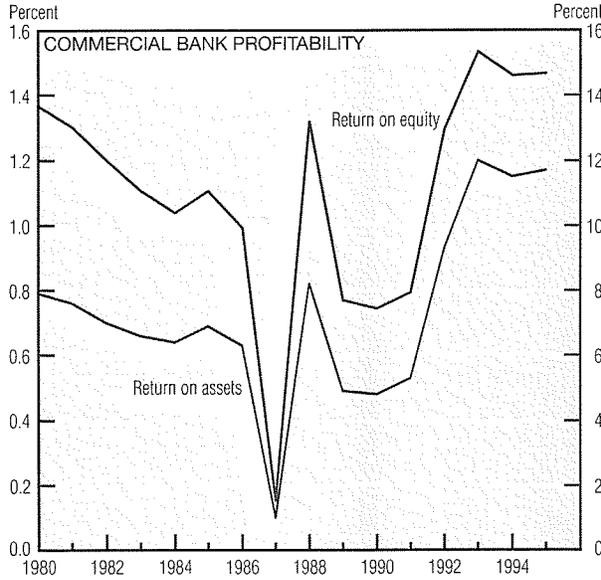
The establishment survey misses new locations as they open and cannot distinguish closures from other nonrespondents, so the BLS

figures include state-specific adjustment factors to account for the average effect of openings and closings. Thus, large changes in the rebenchmark figures occur when states are breaking with their recent employment histories.

This year's national rebenchmark will likely be minor when officially announced in June. On March 6, the BLS commissioner released a preliminary figure of just over half a million more jobs. Despite a state revision average of only 0.3% of employment, several states had signifi-

cant changes. Ohio's revision, while smaller than last year's, was one of the largest of any state at 92,200 added jobs between March 1994 and December 1995. In levels, only California's increase of 200,700 was higher. The other Fourth Federal Reserve District states also gained jobs, but at a lesser rate. Metropolitan employment throughout the District was generally revised upward, with the exception of Cleveland and Toledo (which still grew at reasonable rates).

Banking Conditions



NOTE: All data are for FDIC-insured commercial banks.
 SOURCE: Federal Deposit Insurance Corporation.

The latest statistical information on insured commercial banks confirms the strength of the banking industry. In 1995, about 97 percent of commercial banks reported profits, and 68 percent of them posted higher profits than in 1994. Commercial bank profits reached \$48.8 billion in 1995, topping 1994's record level by \$4.2 billion. Banks' improved financial performance last year is explained by year-over-year increases

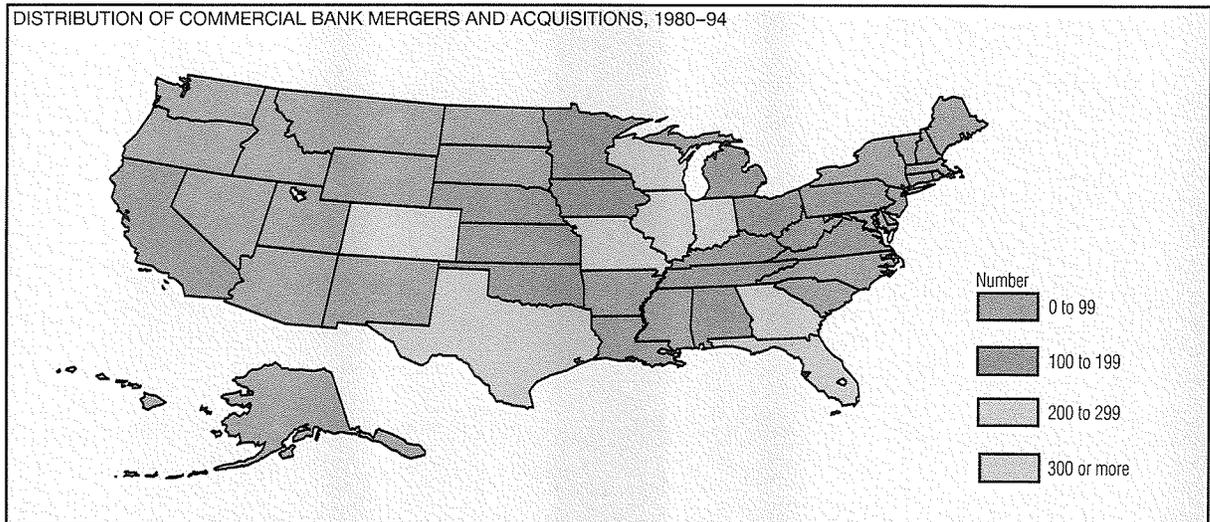
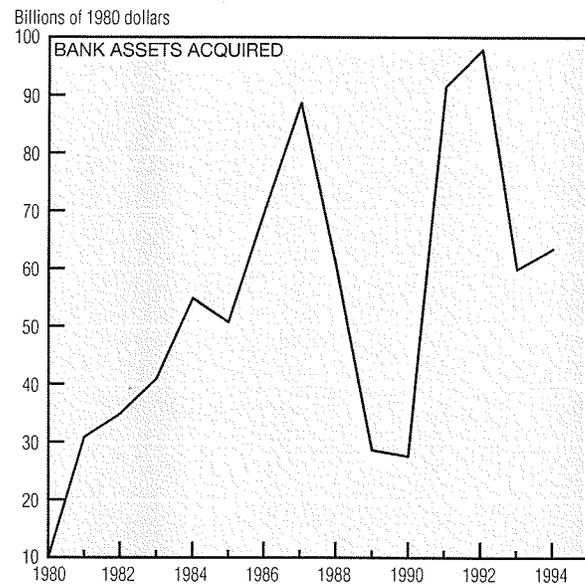
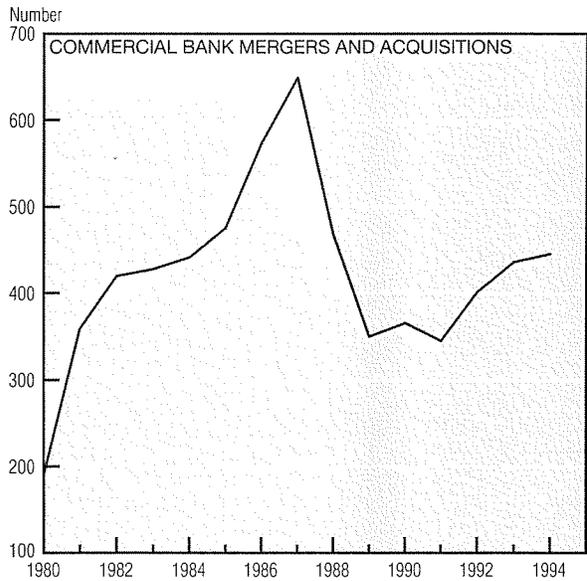
of \$7.7 billion in net interest income, \$6.2 billion in non-interest revenues, and \$1.1 billion in securities sales.

Masked behind these improvements, banks' net charge-offs were \$920 million larger in 1995 than in 1994, despite lower net charge-offs in real estate loans, commercial and industrial loans, and "other" loans. The increase in this category resulted solely from higher consumer loan losses, particularly those on

credit card loans, where net charge-offs rose \$1.8 billion (or 36.1 percent) over their 1994 value.

Nevertheless, 1995 continued the recent downward trend in the number of problem banks as well as their assets, taking both of these variables to their lowest levels since 1986. Following the same trend, only six FDIC-insured commercial banks failed in 1995, all of them during the first three quarters of the year.

Bank Mergers and Acquisitions



SOURCES: Stephen A. Rhoades, "Bank Mergers and Industrywide Structure, 1980-94," Board of Governors of the Federal Reserve System, Staff Study No. 169 (January 1996); and "Mergers and Acquisitions by Commercial Banks, 1960-83," Board of Governors of the Federal Reserve System, Staff Study No. 142 (January 1985).

Between 1960 and 1979, U.S. bank mergers and acquisitions totaled 3,404. This consolidation continued in the 1980s and early 1990s, largely due to state regulatory changes that allowed out-of-state bank holding companies to acquire home-state banks. From 1980 to 1994, bank mergers swelled to 6,345. Moreover, other data available for 1995 provide additional evidence that this latest wave of mergers and acquisitions is continuing.

The banking sector's recent

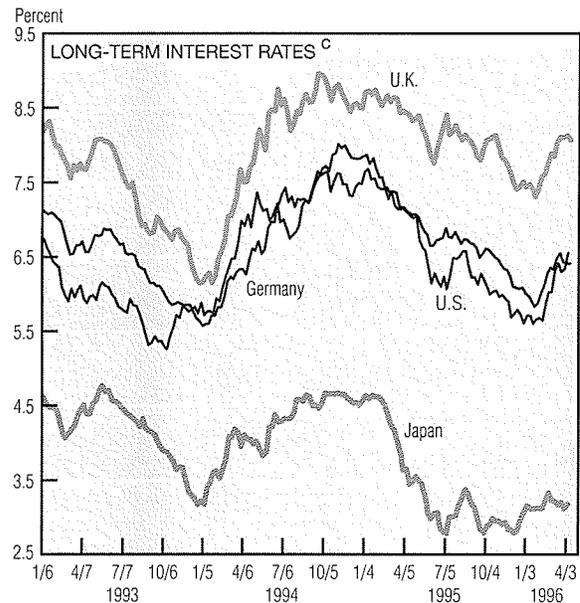
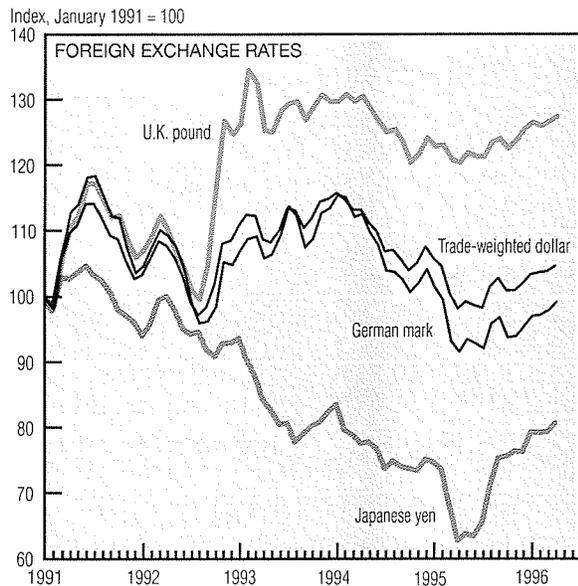
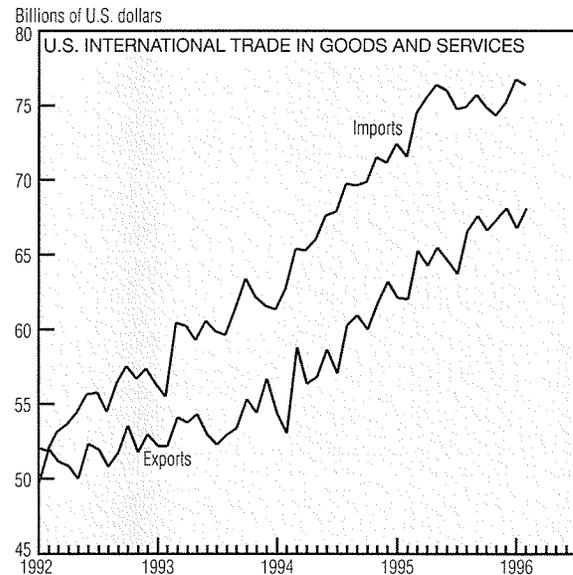
merger activity is explained by the Interstate Banking and Branching Efficiency Act. Enacted in 1994, this legislation made interstate branching easier and more attractive, particularly when pursued through the acquisition of existing banks. It defined nationwide standards for a bank holding company's acquisition of a bank in any state (implying that state laws on out-of-state acquisitions would no longer apply) and created the necessary conditions by which bank holding companies will

soon be able to convert their subsidiaries into a single network of branches.

This industry consolidation affects how some banks conduct business. Significant changes occur within an acquired bank, making it more similar to its acquirer in both usual performance measures and its asset portfolio. This suggests that economies of scale and cost savings due to the acquirer's greater managerial efficiency have been important motivations for bank mergers.

International Developments

Output and Inflation (Percent change, s.a.a.r. ^a)				
	Real GDP		Consumer Price Index	
	Year over year	Quarterly change (1995:IVQ)	Year over year	Monthly change (Mar. 1996)
Germany	1.0	-1.6	1.6	1.0
Japan ^b	2.2	3.6	0.3	4.6
U.K. ^b	4.1	4.0	2.7	4.9
U.S.	1.3	0.5	2.8	4.7
Average	2.2	1.6	1.9	3.8



a. Seasonally adjusted annual rate.
 b. CPI is not seasonally adjusted.
 c. Three-month interbank rate or nearest equivalent; weekly average of daily rates.
 SOURCES: DRI/McGraw-Hill; U.S. Department of Commerce, Bureau of the Census; U.S. Department of Labor, Bureau of Labor Statistics; and Board of Governors of the Federal Reserve System.

In January, the gap between U.S. imports and exports narrowed. It's too soon to tell whether this represents a break in what appears to be an almost uninterrupted decline in net exports since 1992. (Actually, since early 1995—around the time the dollar's decline was reversed—net exports have been relatively constant).

The past year's stronger dollar

may reflect lower U.S. inflation compared to the rest of the world or a change in the real terms of trade. (The trade-weighted dollar averaged 104.5 in April versus 103.7 in March.) Since the latest inflation numbers are almost uniformly higher—with U.S. inflation approximately constant relative to the rest of the world—the change in the terms of trade points to real, not nominal, factors. Although most people have

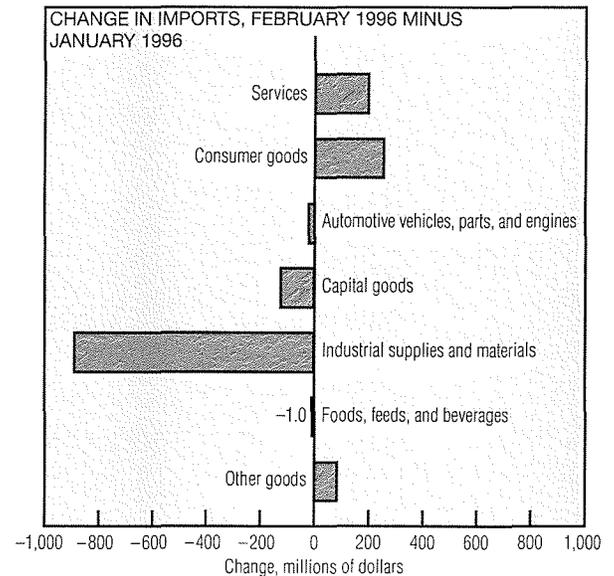
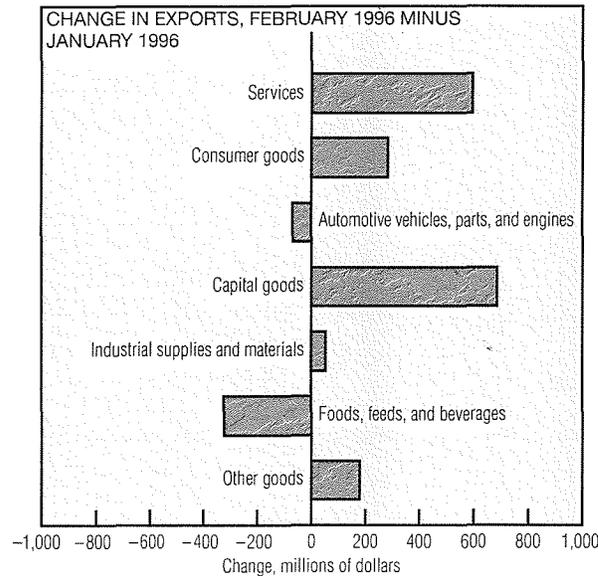
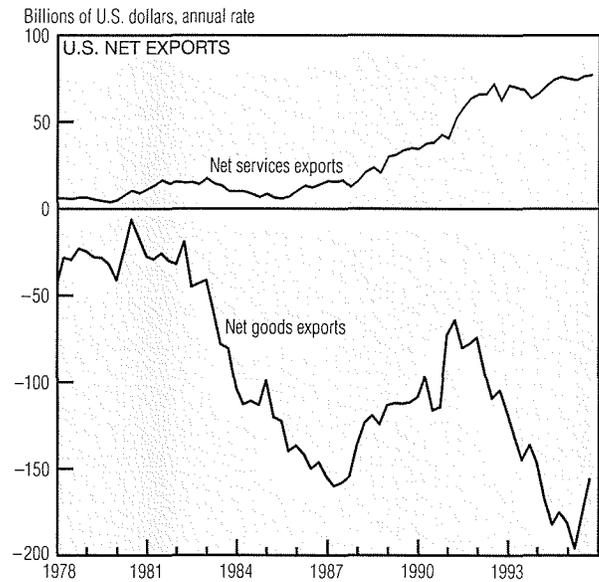
been trained to disfavor a widening trade deficit, the U.S. trade deficit simply reflects a desire to borrow goods and services from the rest of the world. Therefore, reversal of the decline in net exports since early 1995 implies a lessening of the nation's desire to borrow from abroad.

U.S. output is currently growing more slowly than that of most of its

(continued on next page)

International Developments (cont.)

U.S. International Trade (Billions of U.S. dollars)				
	Feb. 1996	Jan. 1996	Feb. 1995	Feb. 1996 minus Feb. 1995
Net services exports	5.60	5.19	4.75	0.85
Services exports	18.38	17.78	16.44	1.94
Services imports	12.78	12.59	11.69	1.09
Net goods exports	-13.81	-15.08	-14.22	0.41
Goods exports	49.70	49.01	45.58	4.12
Goods imports	63.51	64.09	59.80	3.71



SOURCE: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.

trading partners. If today's slow growth portends slow future growth, the diminished U.S. desire to borrow from other countries may simply indicate that the future does not look rosy enough to ensure repayment of the loan. Therefore, the narrowing of the trade deficit can actually reflect bad news—a slowing of U.S. growth relative to that of its trading partners.

About 67% of last year's increase in net exports of goods and services

came from an expansion of net services exports. Even net goods exports rose in 1995, reversing a four-year decline. Trade in goods continued to account for 83% of the nation's imports of goods and services and about 73% of its exports.

Imports fell slightly from January to February, largely due to a decline of almost \$900 million in industrial supplies and materials imports. Conversely, exports of American

goods and services rose over the month in a broad-based advance.

Much of the export gain was accounted for by capital goods and services. This is welcome news for the Fourth Federal Reserve District, whose businesses are key players in the capital goods sector. Apart from consumer goods, which also posted a healthy increase, most export categories changed only slightly from January to February.