http://clevelandfed.org/research/trends
June 1996
Best available copy

The Economy in Perspective

Taking stock ... Luckey, Castalia, Delphos, Ada. Just back from a road trip to northwest Ohio, talking with community bankers about economic conditions and the banking business. Something to be said for seeing the fields, the housing stock, the truck traffic. Holiday Inn, Lima, Ohio: Breakfast is eggs, hash browns, bacon, coffee, coffee, coffee.

Concern about agriculture. In March, all was well. Corn prices high, Ohio farmers feeling good. Some contracted to sell their corn before they even planted it, to lock in that good price. April and May, very wet. Many farmers couldn't get into their fields to plant at all. By June, finally dry. Too late for corn in some places. Sugar beets? Forget about it. Some farmers switched to soybeans just to be sure of getting a crop in. Amazing thing is the variance in conditions. Even within the same county, depending on soil and exact precipitation, some farmers have seeded 95% of their fields, others only 10%. Those who contracted to sell corn they didn't plant are in a bind. Good thing so many have a few good years under their belts, otherwise they'd be in a world of hurt.

Consequences. High crop prices are driving up land prices. Bankers remember (so do seasoned farmers) when 1980s' speculation in acreage ruined so many. Bankers and seasoned farmers also know that $3,000 an acre won't price out when crop prices settle back down. They won't get involved in these deals. Yet acreage prices are still going north. Seems like some buyers either don't remember, or won't listen to reason. Probably the young, college-educated ones. The other consequence is beef. Expensive to feed cattle when corn is $4 a bushel. Liquidate your herds to drive beef prices down. Next year, small herds will push beef prices up. (CPI, fasten your seat belt.)

Productivity. Used to be, a farmer had to let the fields dry out, then till and plant. Get in too early, you compact the soil under those tractor wheels and nothing grows. Stays wet too late into the season, no crop at all. Now, farmer has a "no-till" technology. Uses new seed insertion method (without tilling first) and chemical sprays. You rig lights on your tractor, plant all night long if you have to. Listen to music in the cab. With no-till and late shift, farmer can get crop in pronto. (Question for the Bureau of Economic Analysis: Does no-till ability, versus not planting at all, show up in the productivity statistics?)

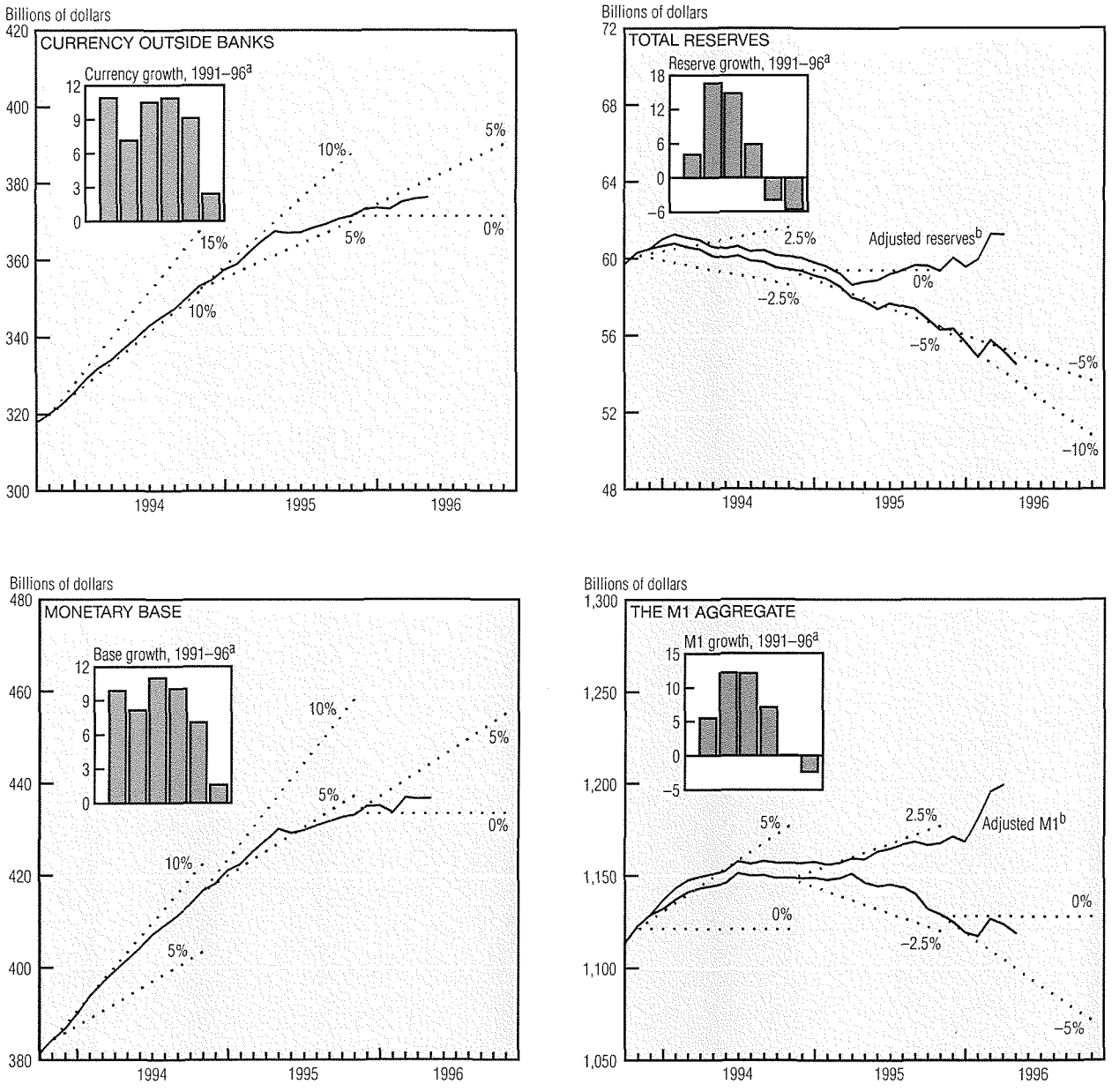
Breakfast again, Perrysburg. Eggs again, bacon again, hash browns again, coffee, coffee, coffee. Businesses keep expanding, labor markets tight as a drum. New plant here, new plant there, here a plant, there a plant ... you know the tune. Easy to find people to hire, hard to find the ones who want to work. Got to know how to use computer-controlled machines; got to know about TQM. Skilled wages keep edging up; unskilled wages follow. Engine pulls the caboose. More plants, stronger incomes, more housing. Construction hopping everywhere, putting more pressure on land prices. Consumers getting lulled into security—hope it's not false. People think nothing of filing for bankruptcy anymore. Sometimes send in Chapter 11 papers before the loans are even delinquent; no chance for a workout. Credit card debt all over the place, people just use one card to pay off another. When the music stops, POP goes the weasel!

Banking. Commercial lending's very strong. Customers shop their deals all over town. No such thing as loyalty anymore; they'll jump on an eighth of a point. Especially those young, college-educated ones. Looks like credit quality's holding up real well, but there are clouds on that horizon. Bankers have learned to lend on cash flows, not asset appreciation, but their borrowers are getting more leverage. That debt will bite you if you don't watch out. Heads, they win; tails you lose.

More banking. How to fund the loans when cheap deposits are hard to come by? Old customers may stick with the bank, but the new generation has other ideas. They've seen the bright lights of the big city, and its name is Stocks and Mutual Funds. The depositor has hit the road, Jack. Oh, sure, there's a financial disaster and it's back to the passbook account, but who wants to cut off their nose to spite their face? Face it, cheap deposits are history. Pretty soon small business loans will be packaged up and securitized like mortgages. Someone will figure it out, make it look easy. Then bankers will assess the credits, make the loans, and sell them off. But you don't need to be a bank to do that. What's banking coming to anymore?

Lunch, Huron County. Pork chops, spiced apples, iced tea. Bankers see monetary policy in different ways. Crop prices, wage pressures, land speculation, overextended consumers, stock market bubble. Bankers who've seen it all before say inflation may be gathering steam. Hard to quantify—something in the air. Another view is that monetary policy seems about right. Prices blip up, then down. Too early to tell. Some say, wait 'til you see the whites of their eyes. Maybe ask a few more bankers what they think. Especially those young, college-educated ones.

Monetary Policy



a. Growth rates are percentage rates calculated on a May over May basis. May 1996 data are estimated.
b. Adjusted for sweep accounts.
NOTE: All data are seasonally adjusted. Last plot is estimated for May 1996. Dotted lines represent growth ranges and are for reference only.
SOURCE: Board of Governors of the Federal Reserve System.

Except for the monetary base and currency, all of the narrow measures of money fell last month. Currency grew at a 1.7% annualized rate; total reserves continued to plunge, down 15.1% after April's 11.7% drop; and M1, which includes both currency and checkable deposits, fell 5.1%. The monetary base, which measures currency in the hands of the public plus reserves and currency held by banks, increased a paltry 0.6%.

One factor that is depressing both total reserves and M1 is the emergence of sweep accounts, which banks have initiated over the past few years to economize on their reserves. These arrangements "sweep" excess household checkable deposits, which are reservable, into money market deposit accounts, which are not. It is estimated that absent these sweep accounts, total reserves would have expanded 4.5% over the past calendar year instead of plummeting 5.7%. Similarly, M1 would have grown approximately 3.4% instead of falling 2.4%.

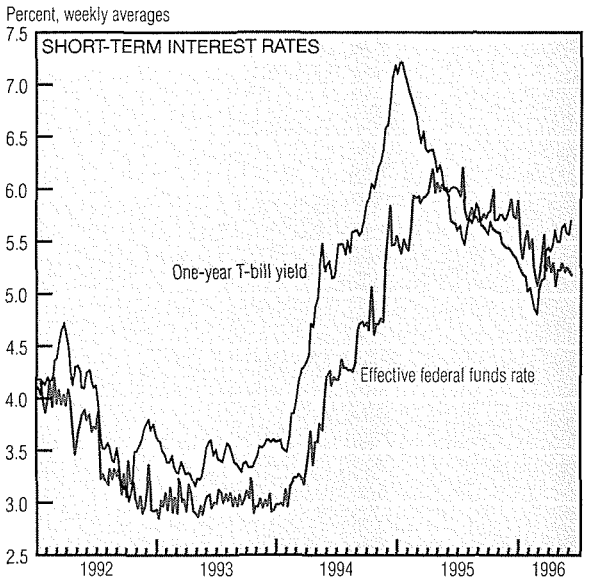
Over the past year, the federal funds rate has been cut repeatedly from 6% last June to 5.25% today. However, these Federal Reserve policy actions—and the ones that preceded them—closely followed changes in other market interest rates. For example, the one-year T-bill yield peaked in January 1995 and immediately started its descent. The fed funds rate peaked two months later and did not start declining until July 1995.

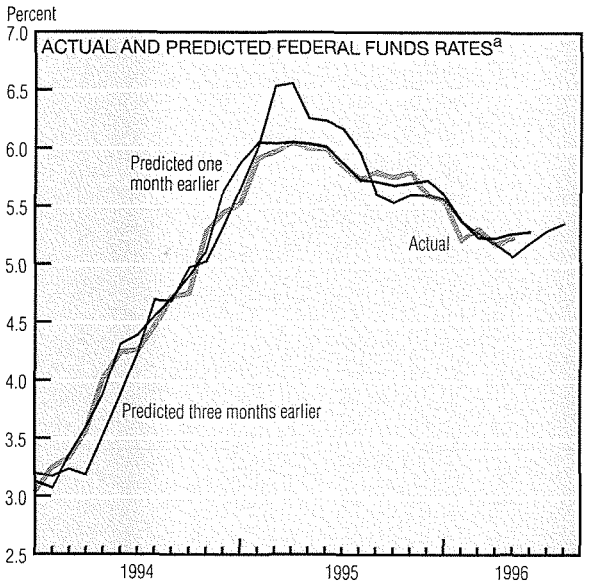
This suggests that it may be a mistake to characterize the Fed's

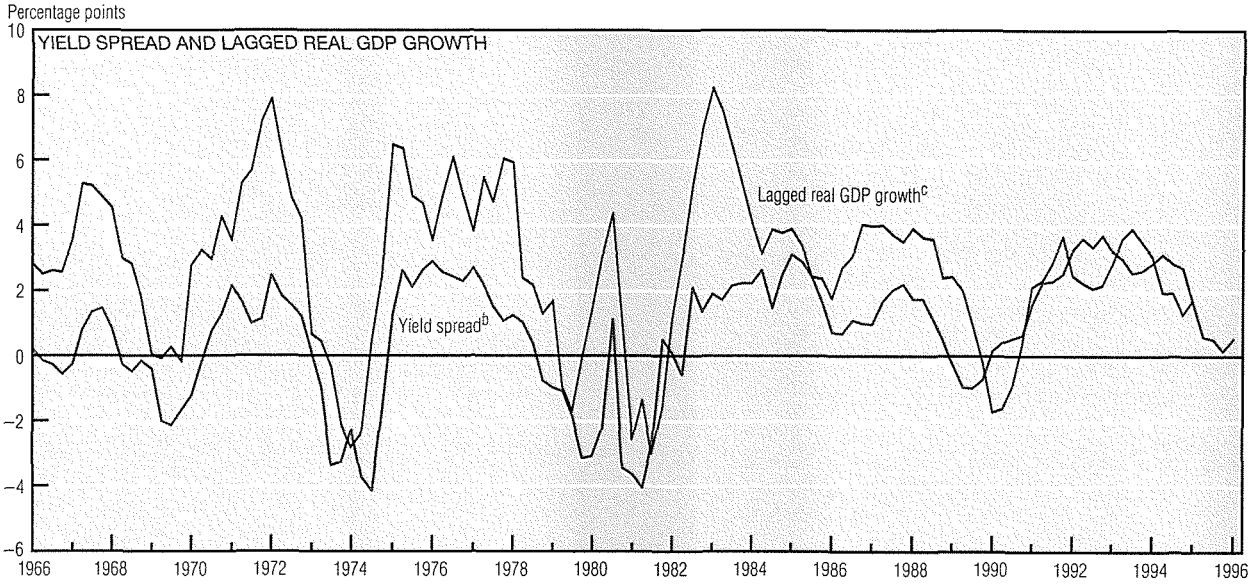
(continued on next page)

http://clevelandfed.org/research/trends
June 1996
Best available copy

Monetary Policy (cont.)







a. Predicted rates are federal funds futures.
b. The yield spread is defined as the 10-year Treasury yield minus the effective federal funds rate.
c. Real GDP growth is lagged one year and is a year-over-year change.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

recent actions as reflecting an overt easing in monetary policy. The latest increases in other short-term interest rates (the one-year T-bill yield recently advanced to 5.7% from 5.5% in April) imply that the fed funds rate will have to start rising shortly to prevent an indirect easing of monetary policy.

The market does appear to expect a moderate upturn in the funds rate before the summer is out. The average fed funds futures rate over the last month implies that investors are expecting the funds rate to be trading at 5.4% by August.

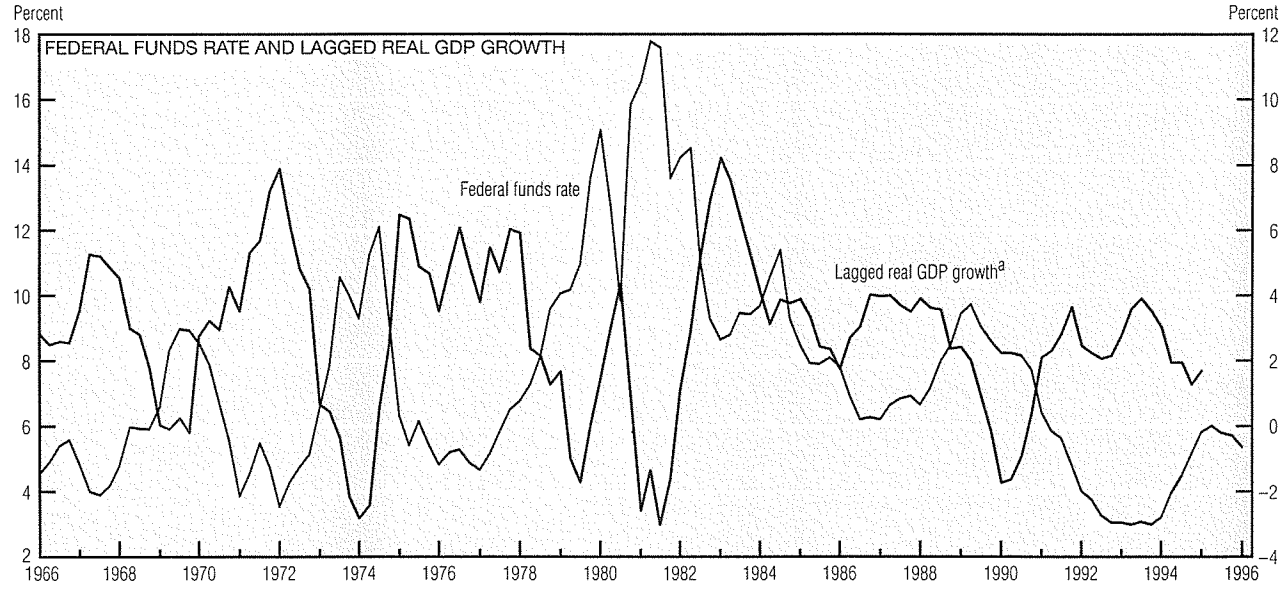
Surprisingly, a strong signal of future GDP growth is given by the difference between the yield on a 10-year Treasury bond and the fed funds rate. Movements in the yield spread can significantly predict output growth four quarters into the future. There are two possible reasons for this phenomenon. The first is that the spread primarily arises because of policy actions undertaken by the Fed. That is, increases in the fed funds rate today cause GDP to decrease nearly one year later. The second theory posits that this correlation does not reflect the ability of deliberate policy actions to affect real growth, but occurs because long-term bond yields are positively associated with future GDP growth. That is, if people expect future output growth to be high, savings will decline today and thus put upward pressure on the real interest rate.

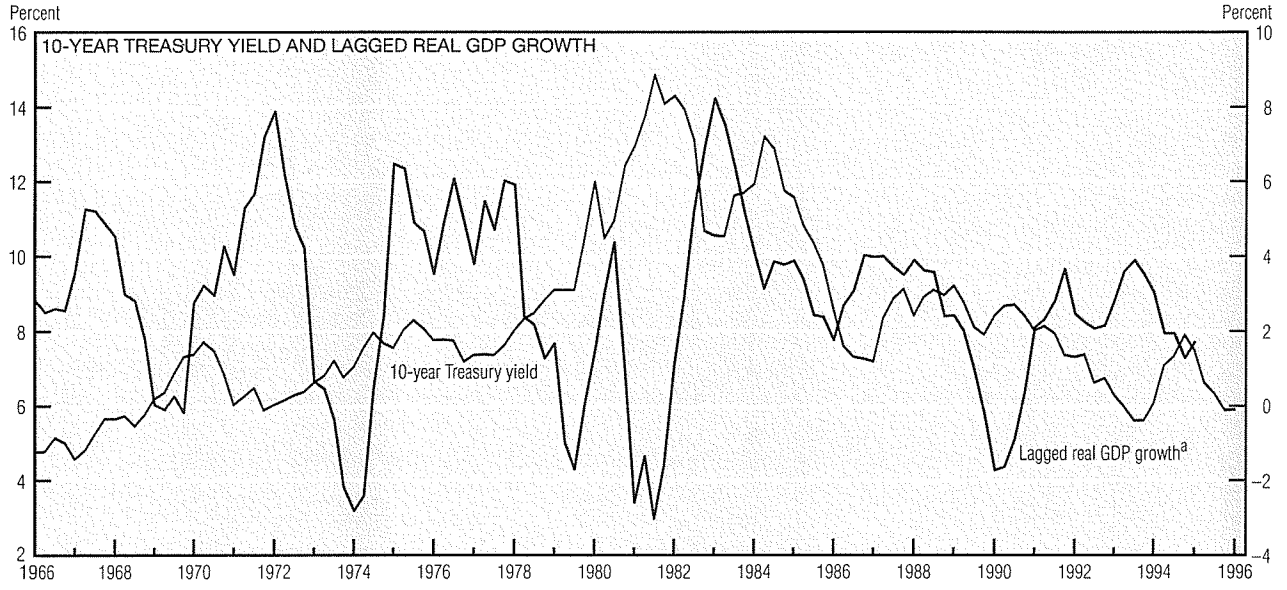
A simple way to distinguish between these alternative explanations is to examine whether the strong correlation is coming from a positive

(continued on next page)

http://clevelandfed.org/research/trends
June 1996
Best available copy

Monetary Policy (cont.)





a. Real GDP growth is lagged one year and is a year-over-year change.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

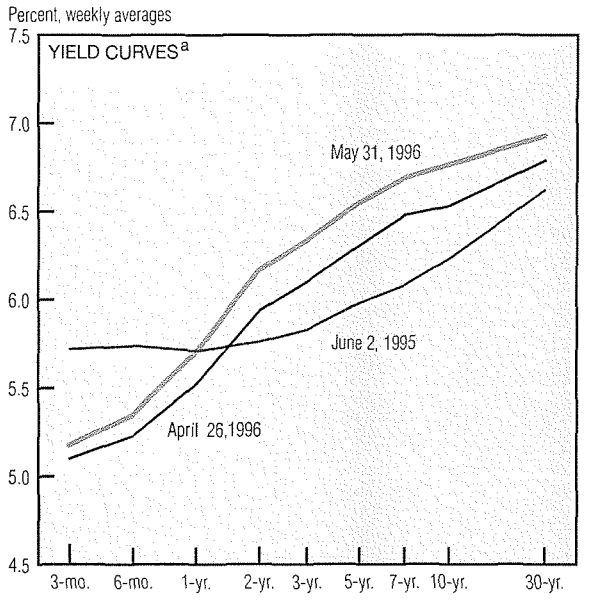
association between GDP growth and long-term yields, or from a negative association between the fed funds rate and future GDP growth. The charts presented here indicate that there is indeed a strong negative correlation between the funds rate and future GDP growth, and dispute the story that long-term yields rise when future output is expected to increase.

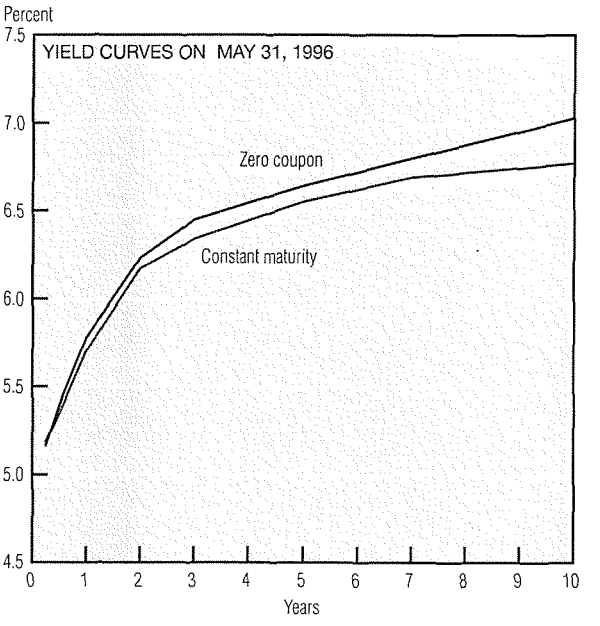
Why, then, is the yield spread a better predictor of future output growth than the fed funds rate alone? The answer may be found in the fact that decreases in the real funds rate—the nominal rate adjusted for inflation—should be a better predictor of future increases in output than are decreases in the nominal funds rate. If the yield on long-term bonds is a good proxy for changes in near-term inflation expectations, then increases in the yield spread could be a better gauge of decreases in the real funds rate than are decreases in the nominal funds rate.

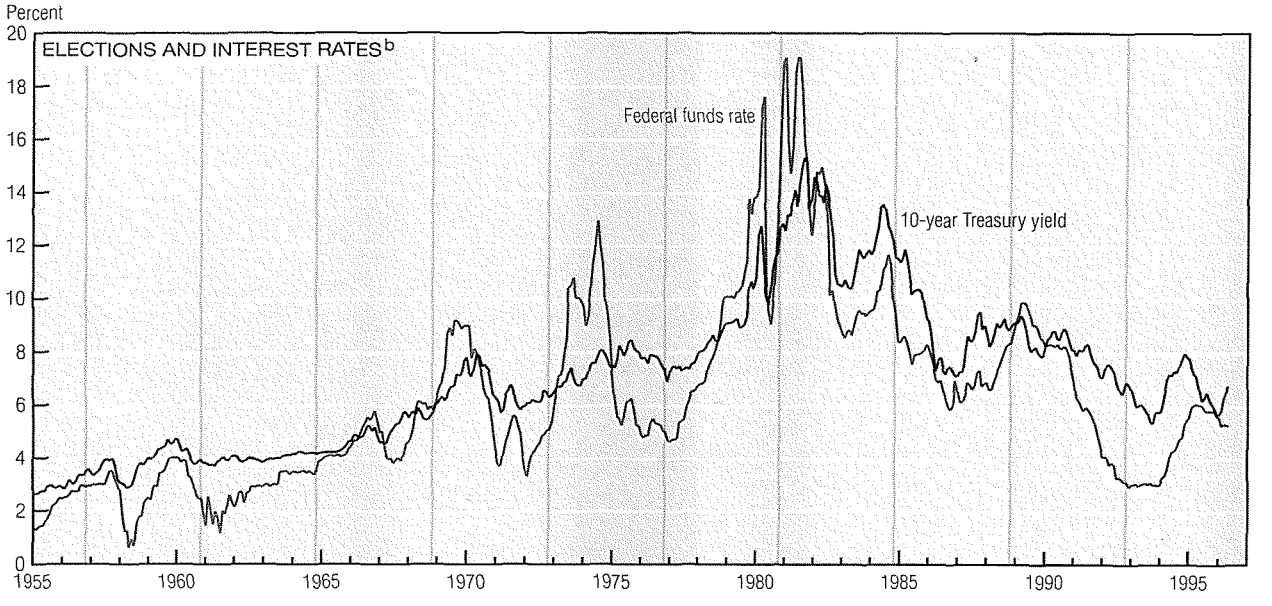
Two conditions must hold for this to be the case: First, changes in long bond yields must primarily reflect changes in expected inflation. This seems reasonable, since real interest rates remain fairly constant over long periods. Second, recent inflation developments must weigh heavily in the formation of long-term inflation expectations. Many economists believe this to be true. Essentially, then, revisions in inflation expectations dominate changes in the 10-year Treasury yield, and increases in the yield spread will reflect decreases in the real federal funds rate.

http://clevelandfed.org/research/trends
June 1996
Best available copy

Interest Rates







a. All instruments are constant maturity series.
b. Vertical lines indicate presidential elections.
SOURCES: Board of Governors of the Federal Reserve System; U.S. Department of the Treasury; and *The Wall Street Journal.*

Since last month, the yield curve has shifted up across all maturities and has steepened slightly. The 3-year, 3-month spread stands at 116 basis points, and the 10-year, 3-month spread is at 159 basis points—both above their historical averages.

Over the past year, the tilt in the yield curve has come primarily from the short end. Since last June, short rates have declined 54 basis points, while long rates have risen only 31 basis points, bringing the yield curve back to its more characteristic concave shape. Rates on zero-coupon bonds continue to track those of standard coupons. With an upward-sloping yield curve, a pure "zero" should have a higher yield, as it currently does.

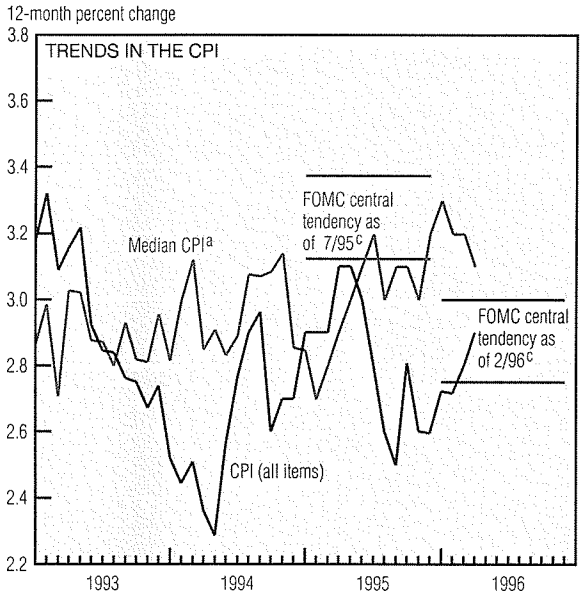
Analysts often suggest that in presidential election years, the government pressures the Federal Reserve to keep interest rates low in an effort to boost the President's chances of reelection. This explanation has at least three problems: 1) the Federal Reserve is independent of the government, 2) different parties often control Congress and the White House, and 3) the effect of interest rates on the economy is unclear. The federal funds rate (controlled by the Federal Reserve) and the 10-year Treasury yield have often risen before elections. At other times, such as in 1992, declines are part of a long downward trend that hardly seems related to election-year politics. Certainly, interest rates have dipped around the time of national elections (such as in 1968 and 1976), and political pressure may hold down increases, but no strong pattern emerges to set election years apart.

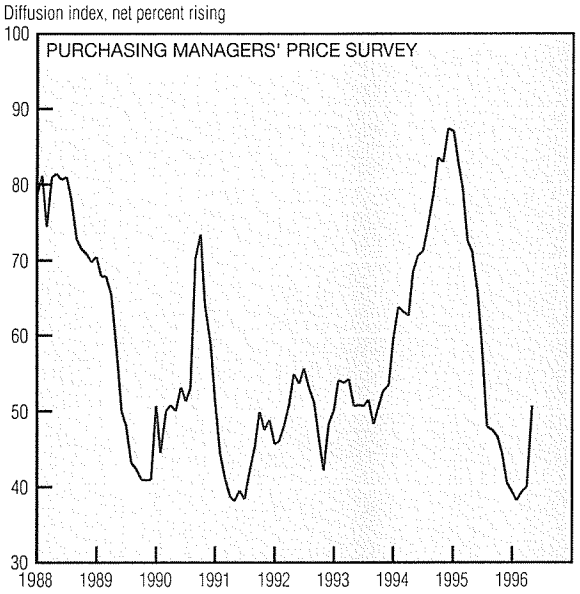
http://clevelandfed.org/research/trends
June 1996
Best available copy

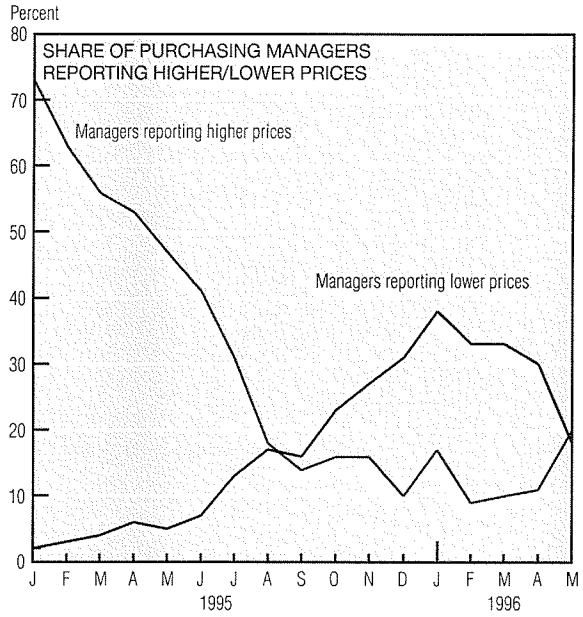
Inflation and Prices

April Price Statistics

	Annualized percent change, last: 1 mo.	12 mo.	5 yr.	1995 avg.
Consumer Prices				
All items	4.7	2.9	2.9	2.6
Less food and energy	1.5	2.7	3.2	3.0
Median[a]	2.9	3.1	3.1	3.2
Producer Prices				
Finished goods	4.7	2.6	1.5	2.1
Less food and energy	0.9	1.8	1.7	2.6
Commodity futures prices[b]	56.6	9.2	3.3	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.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; and National Association of Purchasing Management.

Retail prices continued to climb sharply in April, rising at an annualized rate of 4.7%. Since last December, the Consumer Price Index (CPI) has averaged about a 4% pace. This year's firm-level price rises have also been on the increase, leading analysts to wonder whether the new data presage a higher inflationary trend.

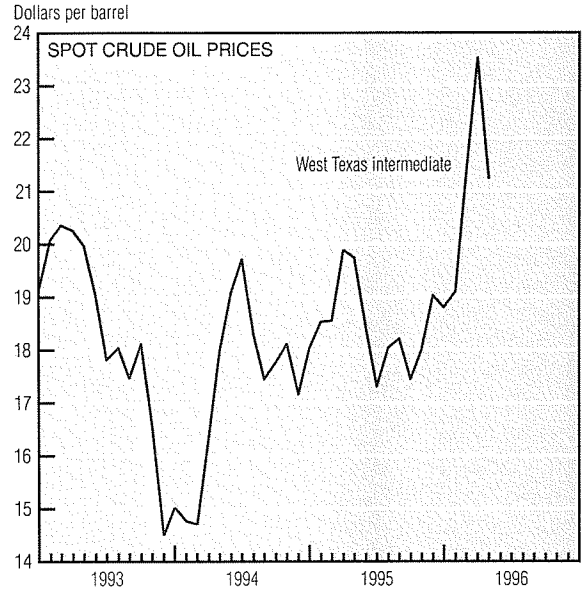
At the moment, those concerns seem premature. The median CPI (the core inflation estimate) is still running in the neighborhood of 3%, as it has for about three years. The 12-month trend in the core retail price measures, which was 3.1% in April, slightly exceeds the Federal Reserve's central tendency projection for the CPI this year.

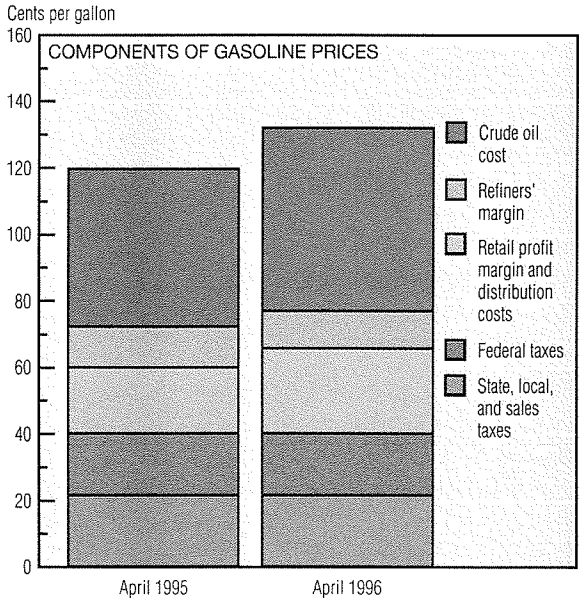
Purchasing managers' data indicate some increased cost pressure from industry, although this mostly represents a dissipation of the downward price pressures seen since December. The overall purchasing managers' price index of about 50 in May (up from about 40 in January) is a sign of generally balanced price movements.

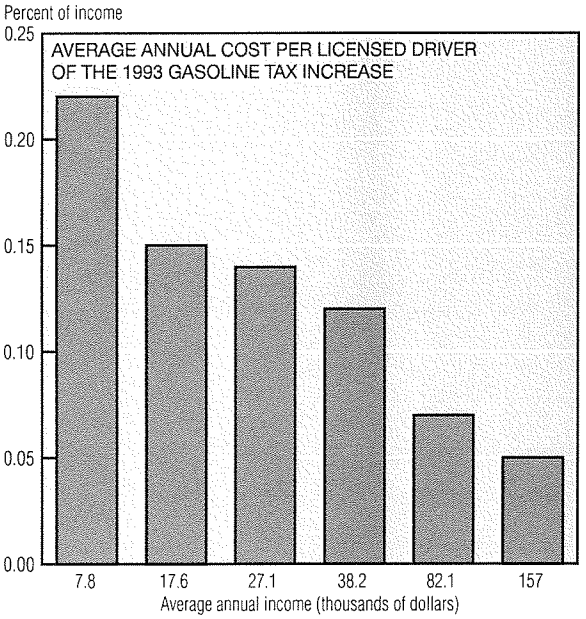
One major influence on this year's price climb was the unexpected surge in gasoline prices. Rising at an annualized rate of over 40% since December, gas has added roughly ½% to the average household budget. A jump in crude oil prices contributed to higher gas costs: Between early January and mid-April,

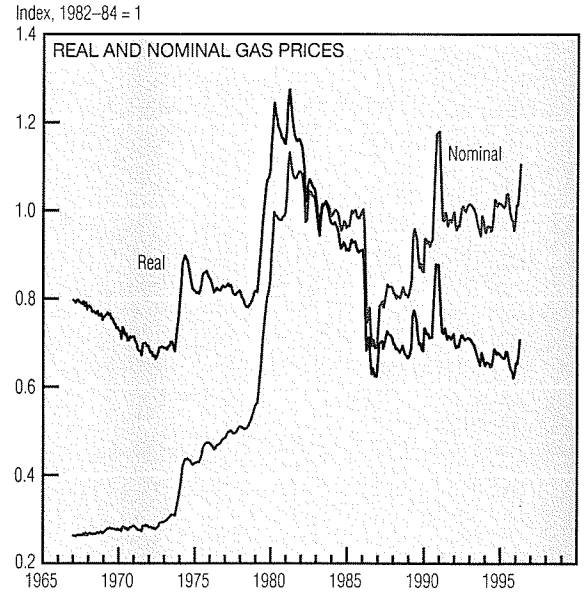
(continued on next page)

Inflation and Prices (cont.)









SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Congressional Budget Office; Platt's *Oilgram Price Report*; and *The New York Times*, May 13, 1996.

crude oil went from about $19.50 to more than $23 a barrel. But that is not the whole story. Though a gallon of gas cost 12.3 cents more in April 1996 than in April 1995, higher crude oil prices account for only 7.5 cents of that increase. Retailing and distribution costs (which are profit margins for gas stations and wholesalers) represent the remainder. Gasoline inventories are reportedly low, perhaps because of refiners' slowness in shifting production from heating oil to gasoline.

The rise in gasoline costs has inspired some members of Congress to call for gasoline tax rollbacks. However, a number of economists have criticized this proposal, observing that environmental and health issues, the deteriorating national infrastructure, and U.S. dependence on foreign oil all argue for higher—not lower—gas taxes. Indeed, other nations have used tax disincentives much more aggressively to curtail gas consumption. In western Europe, a gallon of gas costs $3 to $4.50, of which roughly 65% to 80% represents taxes.

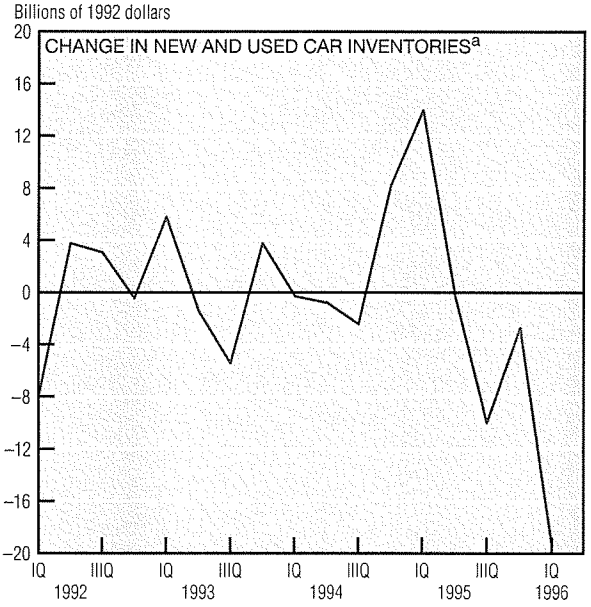
However compelling, such arguments often overlook gasoline taxes' regressive nature. In 1993, gas taxes accounted for 0.22% of poor Americans' annual income ($7,800), and 0.12% of middle-income people's earnings ($38,200), but only 0.05% of the incomes of those making $157,000 a year.

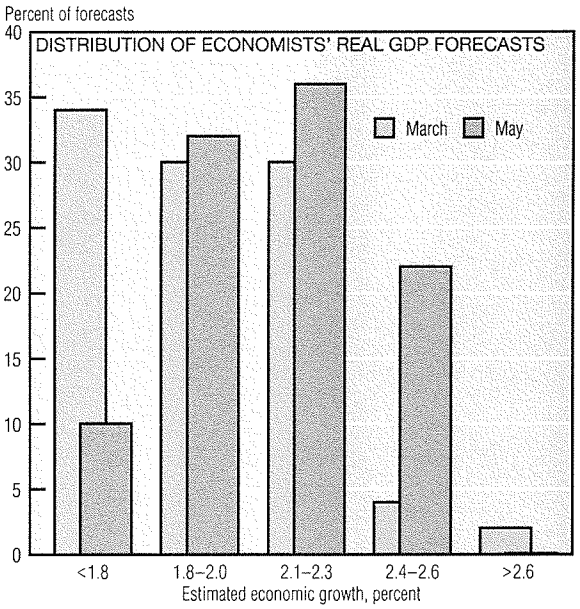
Finally, we should note that gasoline remains cheap compared to other goods in the U.S. Adjusted for inflation, the real price of a gallon of gas is about the same now as it was 10 years ago, and about 30% below its 1970s average.

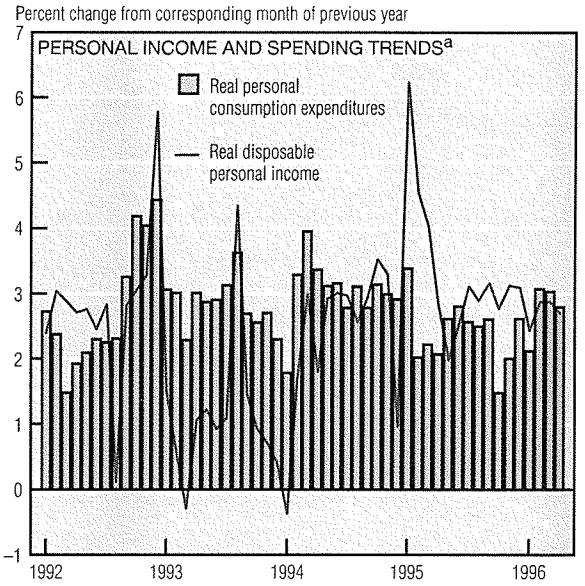
http://clevelandfed.org/research/trends
June 1996
Best available copy

Real GDP and Components, 1996:IQ[a]
(Preliminary estimate, s.a.a.r.[b]**)**

	Change, billions of 1992 $	Percent change, last: Quarter	Four quarters
Real GDP	39.0	2.3	1.7
Consumer spending	41.0	3.6	2.7
Durables	11.5	8.0	6.1
Nondurables	13.1	3.7	1.4
Services	16.6	2.6	2.7
Business fixed investment	21.3	12.3	6.0
Equipment	17.1	13.2	6.4
Structures	4.2	9.5	4.9
Residential investment	4.3	6.6	1.8
Government spending	8.2	2.6	−0.3
National defense	5.6	7.4	−3.2
Net exports	−14.0	—	—
Exports	9.5	4.8	7.1
Imports	23.5	10.9	5.1
Change in business inventories	−22.2	—	—







a. Chain-weighted data in 1992 dollars, seasonally adjusted.
b. Seasonally adjusted annual rate.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and *Blue Chip Economic Indicators,* March 10 and May 10, 1996.

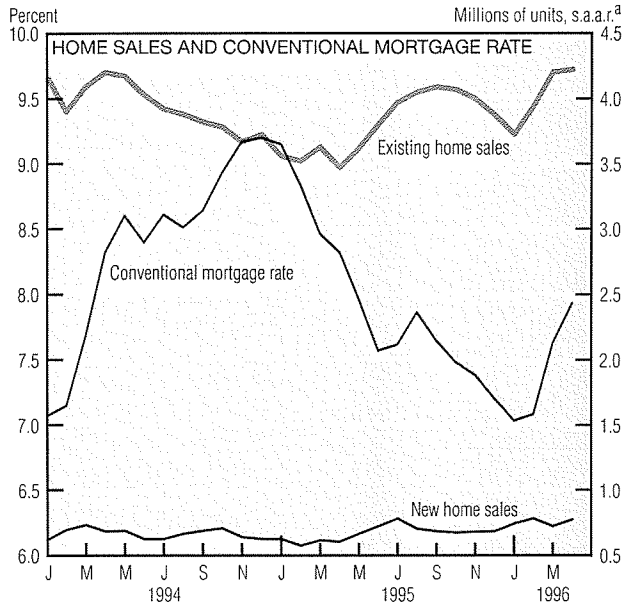
Recent economic data, including downward revisions in first-quarter GDP estimates, suggest continued moderate growth with high levels of resource utilization. The Commerce Department lowered its 1996:IQ growth estimates from 2.8% to 2.3% due to downward revisions in business inventories. Estimates of both consumer spending and business fixed investment were revised upward. The sharp decline in business inventories, the first in four years, primarily reflects a strike-induced drop in automobile stocks. Stronger consumer and business spending, together with lower inventories, favor continued growth.

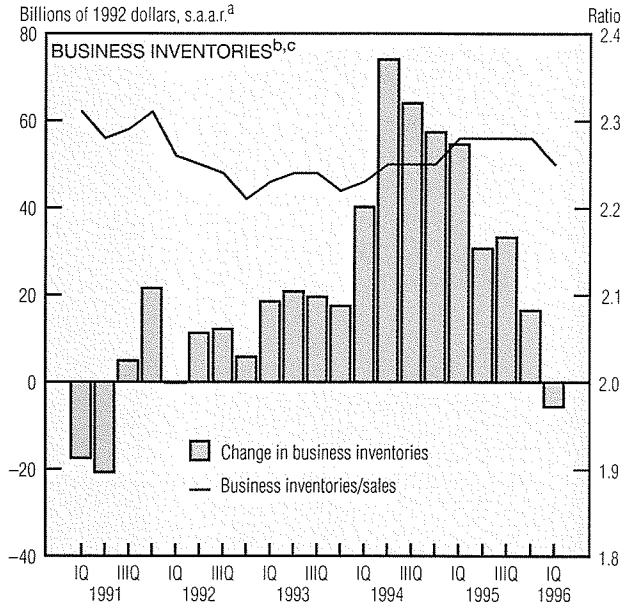
The median forecast of economists participating in the most recent Blue Chip survey anticipates economic growth of 2.1% this year. Although the median forecast is little changed since March, when confidence was on the ebb, the distribution of forecasts shifted upward with the release of stronger first-quarter GDP estimates. (The most recent Blue Chip forecast, however, precedes first-quarter GDP revisions.)

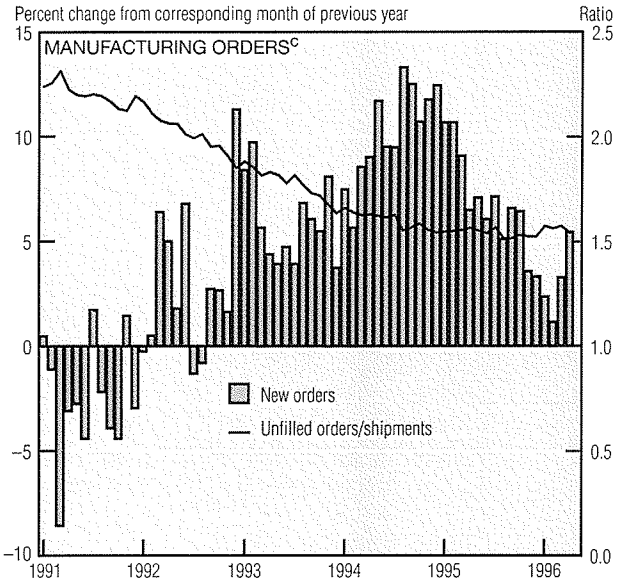
Consumer spending slowed in April as households cut back on purchases of durables, particularly automobiles. However, on a 12-month basis, consumer spending was up a solid 2.8%. Since February, year-over-year consumer spending has outpaced income growth, which

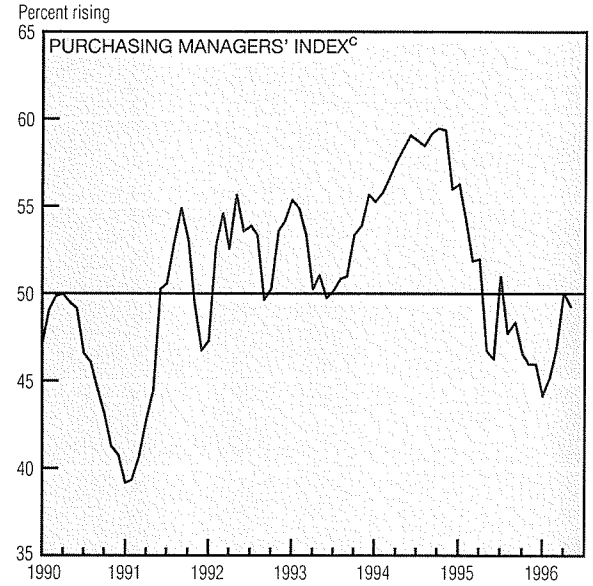
(continued on next page)

Economic Activity (cont.)









a. Seasonally adjusted annual rate.
b. Chain-weighted data in 1992 dollars.
c. Seasonally adjusted.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; the National Association of Purchasing Management; the National Association of Realtors; and the Federal Home Loan Mortgage Corporation.

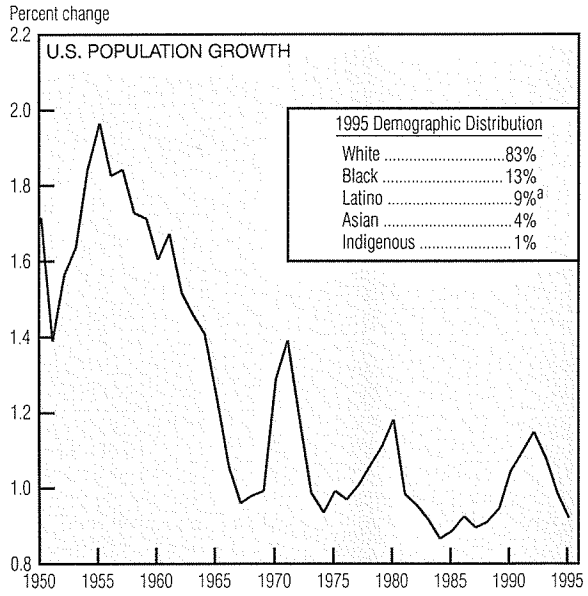
suggests a decline in the savings rate. Although consumers' debt burdens continue to generate concern, the asset side of household balance sheets and consumers' net worth seem healthy.

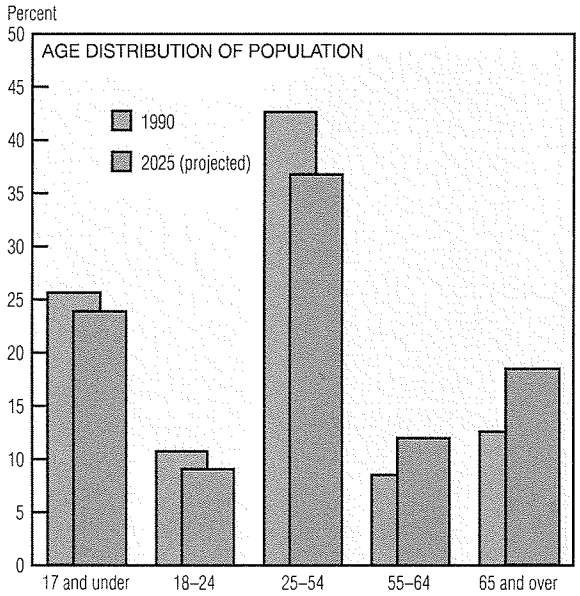
Sales of existing homes rose 0.5% in April, up 22% over the past year. New home sales also increased, up 6.7% in April and 28% over year-ago levels. The recent pattern of home sales and mortgage rates cautions against an uncritical acceptance of the notion that high mortgage rates diminish housing activity. Instead, strong housing markets can *raise* mortgage rates.

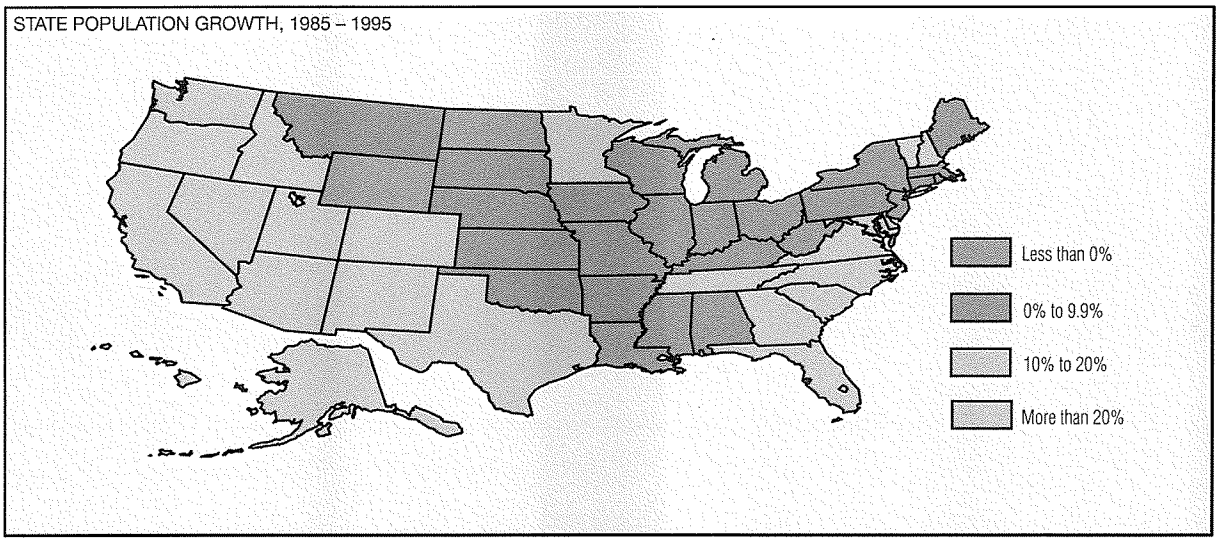
The recent weakness in manufacturing activity is abating. An improved relationship between inventories and sales at all levels of business favors increased production. New orders were up 5.5% in April over the last year, while the ratio of unfilled orders to shipments remained little changed. The National Association of Purchasing Management's index of manufacturing activity stood at 49.3% in May. The ratio has generally improved in recent months, but at 50% still indicates neither strengthening nor declining manufacturing activity.

http://clevelandfed.org/research/trends
June 1996
Best available copy

Demographics







a. Latino is not a racial category.
NOTE: All data refer to resident population.
SOURCE: U.S. Department of Commerce, Bureau of the Census.

The Census Bureau estimates that the U.S. population now stands at 265 million—roughly 66 times larger than in 1790, when the first census was taken. This total implies a density of 70 individuals per square land mile. Approximately 83% of the population is white, nearly 13% is black, and about 9% is of Latino background. Women constitute slightly more than half of the total.

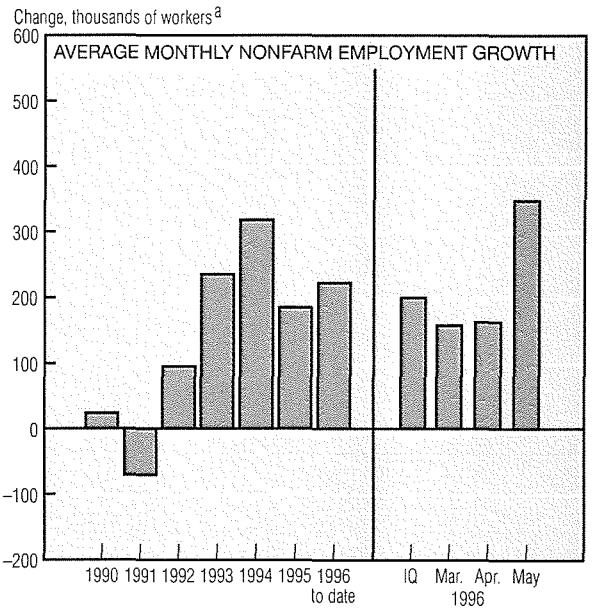
Over the last 30 years, the population has expanded at a rate of about 1% annually. Most of the upturn stems from natural growth, but there has also been a steady rise in immigration. On average, 332,000 individuals immigrated each year in the 1960s, whereas 1.2 million arrived yearly between 1991 and 1993. Approximately 42% of recent immigrants are from North America (notably Mexico and the Caribbean), while 35% come from Asia.

The median age of Americans is currently 34 years, but the population is growing older. In 1990, almost 43% of Americans were of prime working age (25 to 54 years), 13% were over 64, and 25% were under 18. Census projections show that by 2025, the proportion in their prime working years will fall to 37%, while those of retirement age will rise to 18%.

The population center of the U.S. continues its southwesterly drift. Over the past 10 years, Nevada, Arizona, Washington, Florida, and Georgia have been the fastest-growing states.

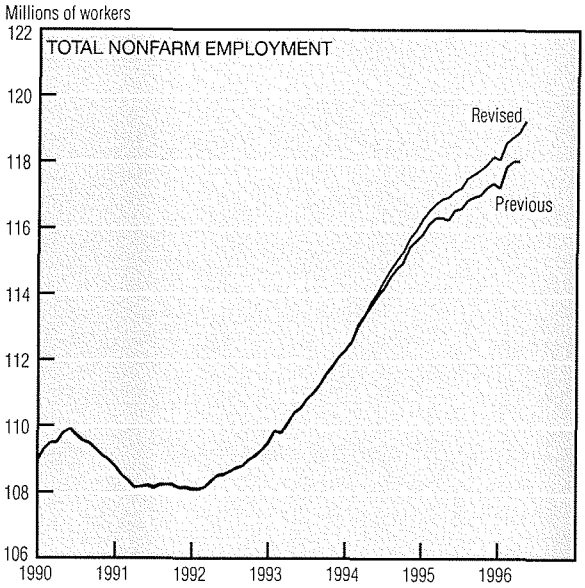
http://clevelandfed.org/research/trends
June 1996
Best available copy

Labor Markets



Labor Market Conditions[a,b]

	Average monthly change (thousands of employees)			
	1995	1996		
	Year	March	April	May
Payroll employment	185	158	163	348
Goods-producing	–5	–58	7	35
Manufacturing	–14	–50	–4	6
Durables	3	–36	29	17
Nondurables	–17	–14	–33	–11
Construction	11	–9	11	28
Service-producing	149	216	156	313
Services	93	133	65	181
Business services	26	32	17	67
Health services	24	36	23	39
	Average for period			
Civilian unemployment rate (%)	5.6	5.6	5.4	5.6
Mfg. workweek (hours)[c]	41.6	41.4	41.5	41.7



a. Seasonally adjusted.
b. Industry-level data for 1995 are unrevised.
c. Production and nonsupervisory workers.
d. Vertical line indicates break in data series due to survey redesign.
SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Nonfarm payroll employment surged by 348,000 in May, about twice as high as expected, while April's figure was revised upward from 2,000 to 163,000. Labor markets have added an average of 222,000 jobs per month this year.

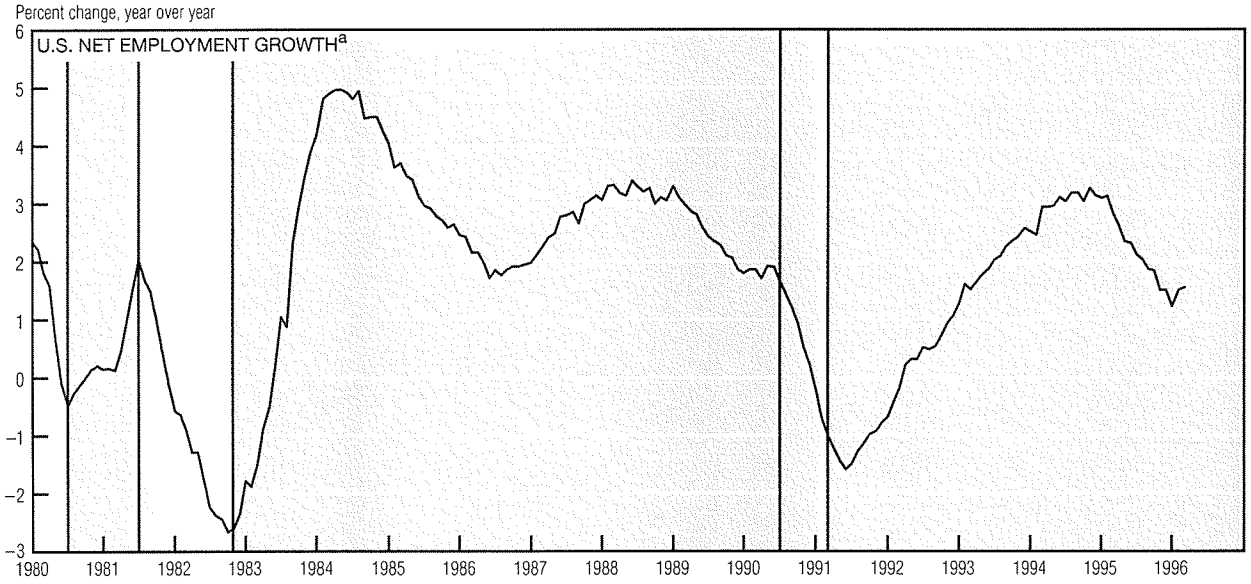
The Bureau of Labor Statistics' annual rebenchmarking and updated seasonal adjustment factors also boosted earlier figures. A total of 737,000 jobs were added to the previous employment tally—399,000 as a result of rebenchmarking that revised data collected between April 1994 and December 1995, and 338,000 due to improved seasonal adjustment methodology that was applied to data from January 1988 to February 1996.

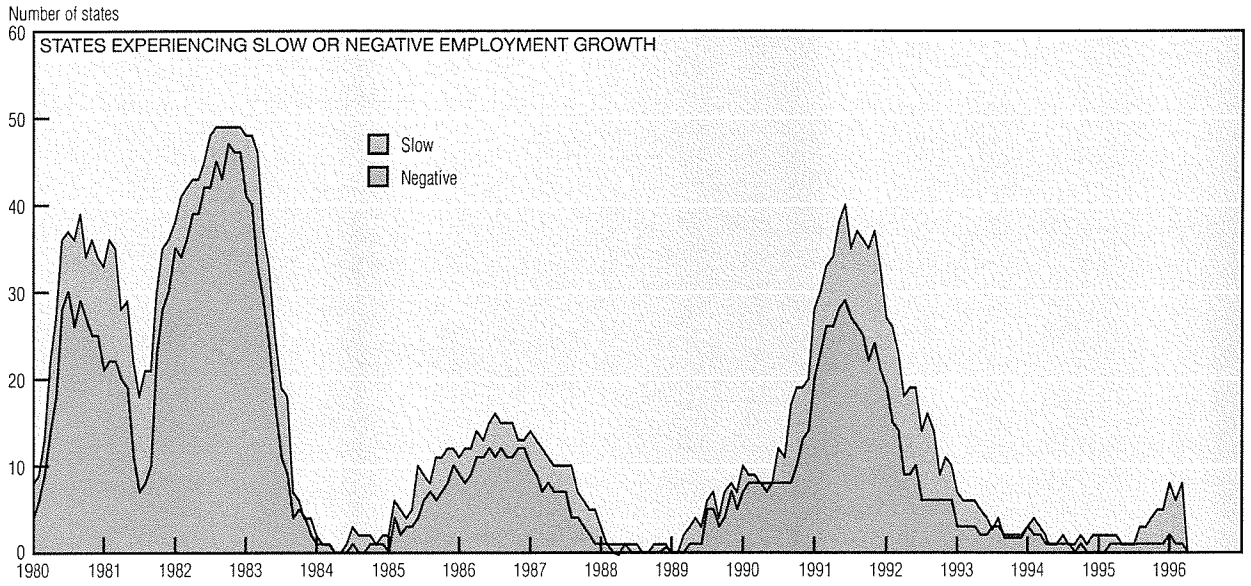
Employment in the goods-producing sector improved slightly last month. Manufacturers posted a small net increase of 6,000, while construction added another 28,000 workers. The service-producing industries created 313,000 jobs on net, with more than half of this increase concentrated in the narrow services category (including hospitals, hotels, auto repair shops, and computer/data processing firms).

The unemployment rate edged up to 5.6% in May from 5.4% in April, due mostly to a surge of reentrants into the labor force. Nonetheless, the employment-to-population ratio (the proportion of the working-age population holding a job) edged up to 63.1%, high by historical standards.

http://clevelandfed.org/research/trends
June 1996
Best available copy

State Labor Trends





a. Not seasonally adjusted. Shaded bars indicate recessions.
SOURCES: Mark E. Schweitzer and Kristin M. Roberts, "State Employment 1995: Slowing to a Recession?" Federal Reserve Bank of Cleveland, *Economic Commentary,* March 15, 1996; and U.S. Department of Labor, Bureau of Labor Statistics.

U.S. employment growth stalled during the past year. Despite some recent episodes of relatively strong job additions, net employment growth dropped from a year-over-year change of 3% in January 1995 to only 1.5% in March 1996. Historically, such decelerations often occur before recessions, but this is not always the case, as the mid-eighties showed. Currently, the market and professional forecasters seem to believe that the economy is experiencing a temporary slowdown, rather than a full-blown recession.

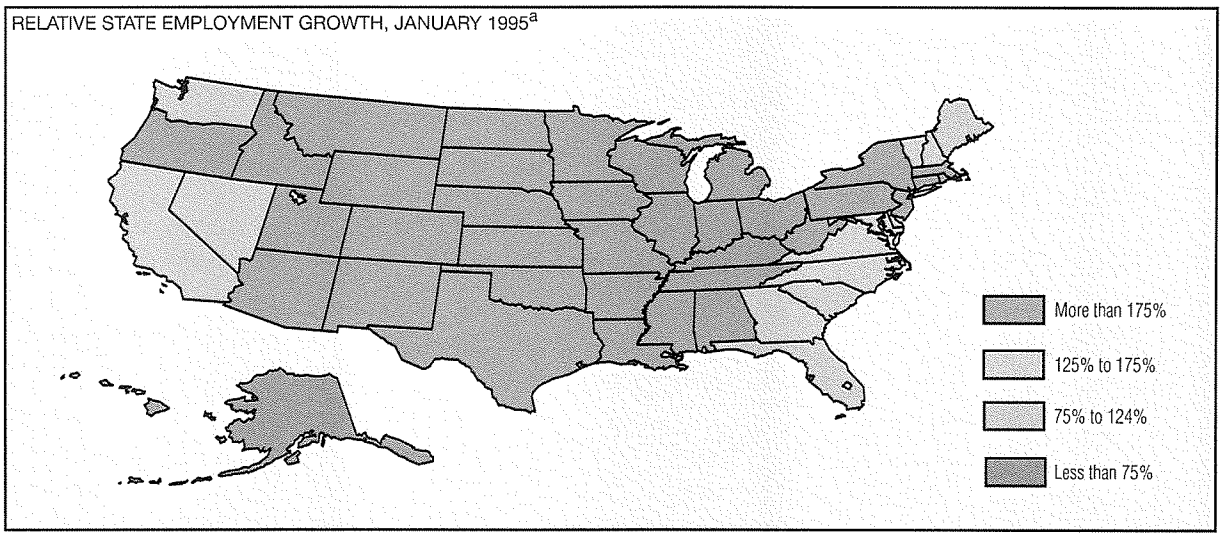
A review of the past year's state employment figures supports this impression. Almost by definition, recessions reflect employment reductions in a significant number of states. One useful way to gauge the health of state labor markets is to measure their current rate of employment growth relative to their long-run growth (over the past 15 years). This accounts for trend differences, like migration toward the Sunbelt states, that are not features of the business cycle.

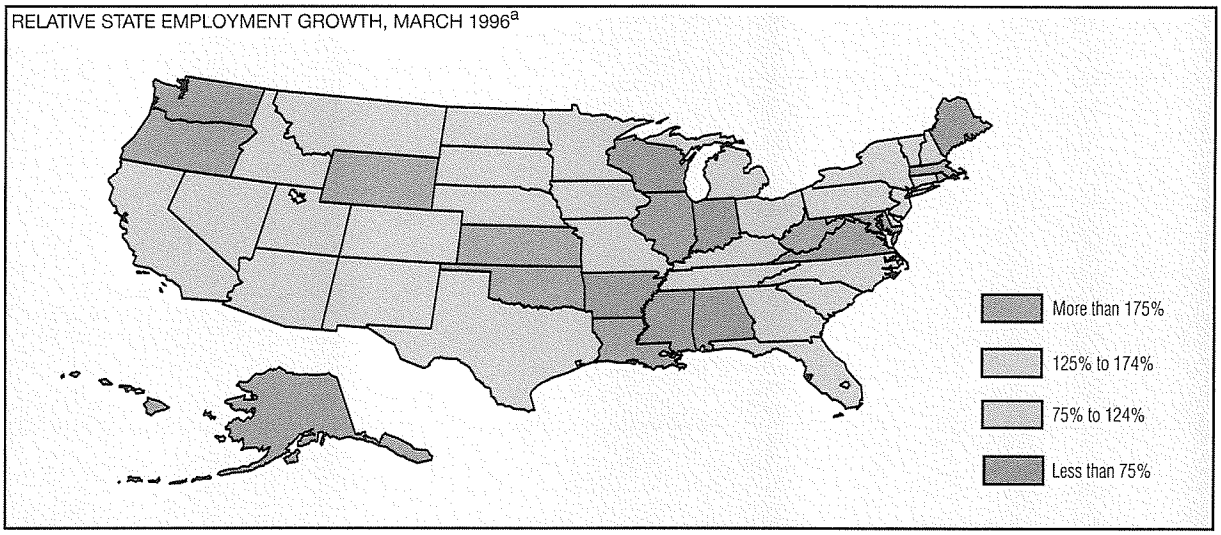
In each recession of the past 16 years, as dated by the National Bureau of Economic Research, a majority of states experienced slow or negative employment growth. ("Slow" is defined as a rate that is less than half of what a state typically experiences.) During the mid-eighties, although there were 16 such states, the economy ultimately

(continued on next page)

http://clevelandfed.org/research/trends
June 1996
Best available copy

State Labor Trends (cont.)





a. Percent of average employment growth from 1980 to 1995.
SOURCES: Mark E. Schweitzer and Kristin M. Roberts, "State Employment 1995: Slowing to a Recession?" Federal Reserve Bank of Cleveland, *Economic Commentary,* March 15, 1996; and U.S. Department of Labor, Bureau of Labor Statistics.

picked up again without entering a recession.

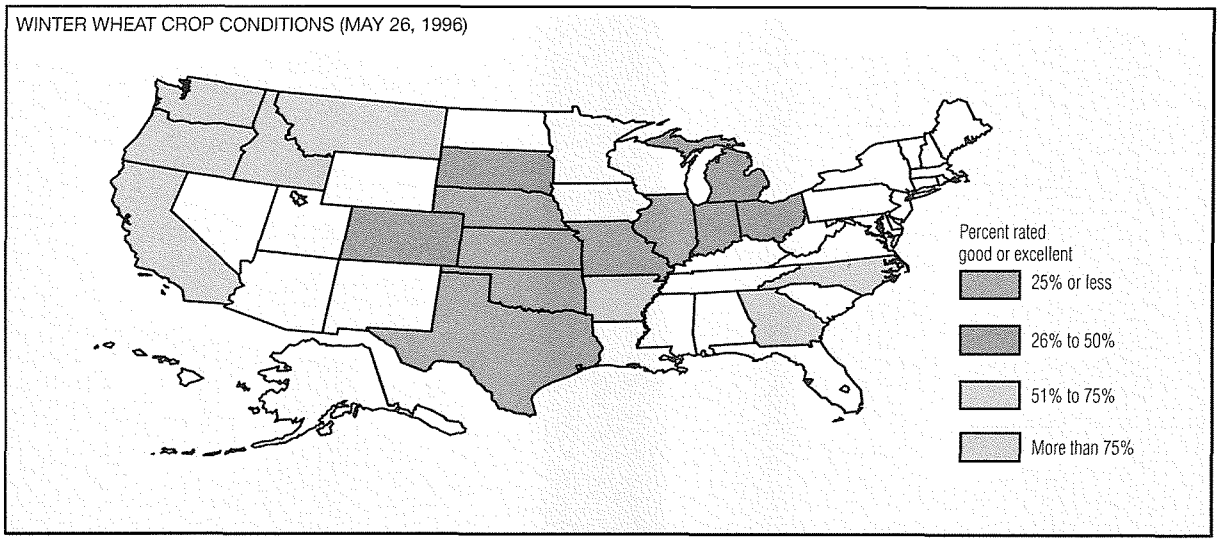
The current distribution of state growth rates is remarkably balanced. As of March 1996, 23 states had employment gains that were below their 15-year growth rate, while five states were at less than half their average rate: Alaska, Maine, Maryland, Wisconsin, and Hawaii (where the change was negative). The slower-growing states were offset by eight whose net jobs growth was more than double their long-run rate, including Illinois, Louisiana, and Oregon.

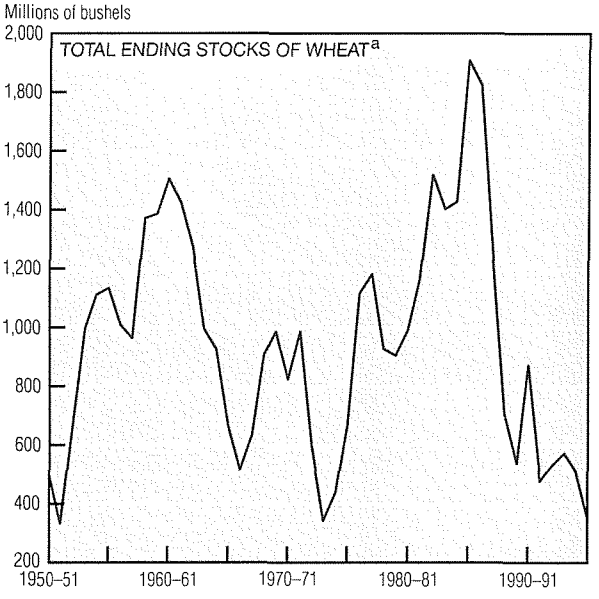
In any case, this pattern suggests a substantial slowdown from January 1995, when more than half of all states were growing at rates that more than doubled their long-run averages, and only two had slow growth. Some major states, like Pennsylvania, Michigan, and Ohio, were exhibiting net job additions as high as three times their long-run averages. Jobs growth in these three states is now proceeding at about half that pace. Indeed, these states probably could not sustain such robust growth rates, which would rapidly deplete their slow-growing labor forces.

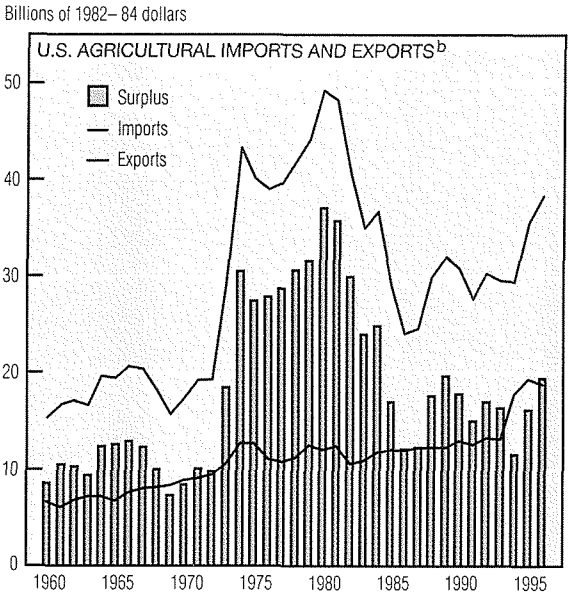
In general, the current employment slowdown has occurred fairly evenly, with states maintaining their relative rankings, albeit at a lower rate of jobs growth.

http://clevelandfed.org/research/trends
June 1996
Best available copy

Regional Conditions







a. Based on existing stocks, not including the current season's harvest, as of June 1. The wheat crop season is June 1 to May 31.
b. Fiscal years are July 1 to June 30 for 1960–76; and October 1 to September 30 for 1977–96. 1996 figures are projections.
SOURCES: U.S. Department of Agriculture (USDA), National Agricultural Statistics Service, Economic Research Service; and Mike A. Singer, Federal Reserve Bank of Chicago, "A Banner Year for Agricultural Exports," *AgLetter* No. 1871 (December 1995).

Every week, the U.S. Department of Agriculture reports on weather conditions and crop progress. There has recently been considerable concern, in both the Fourth Federal Reserve District and other regions, about the weather's negative effects. The harsh winter damaged crops that were already planted, while rain, flooding, and persistent cold have delayed planting in a wide area.

Ohio is one of the 19 states that produced 92% of the 1995 winter wheat crop and is the largest producer of soft red winter wheat. As of May 26, only 32% of Ohio's crop was rated good or excellent, compared to 81% last year. For the other major producers of winter wheat, acreage with crop ratings of good or excellent ranged from only 6% in Texas to 96% in Oregon (versus last year's 23% and 52%, respectively).

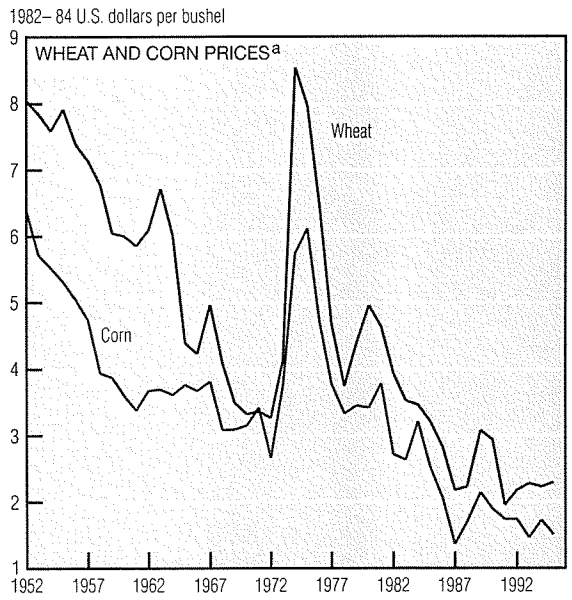
Wheat can be stored from season to season, offsetting temporary setbacks. However, wheat stocks nationwide are at their lowest levels since 1973–74 and are only slightly higher than the previous lows of 1950–51. This dearth results from the smaller harvests of the past five years and the increased demand for grain in Asia, and to a lesser extent in Africa and western Europe.

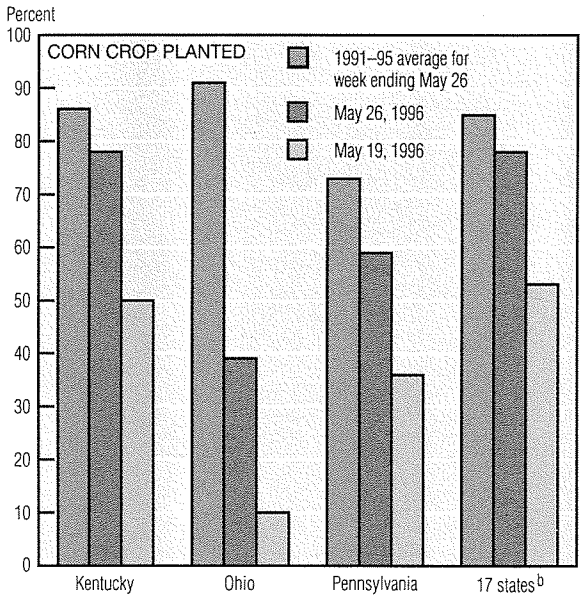
The Department of Agriculture's most recent forecast for 1996 shows exports rising $5.9 billion over their 1995 level and imports remaining about the same as before. The

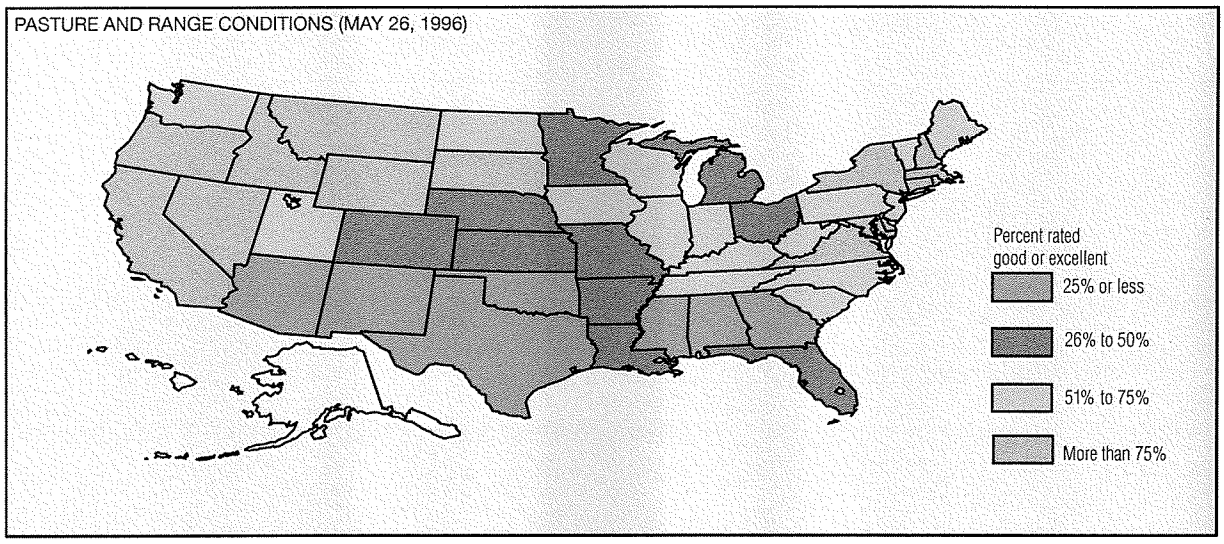
(continued on next page)

http://clevelandfed.org/research/trends
June 1996
Best available copy

Regional Conditions (cont.)







a. For wheat prices, the year begins June 1 and ends May 31. For corn prices, the year begins September 1 and ends August 31.
b. These 17 states accounted for 91% of the 1995 corn crop.
SOURCES: U.S. Department of Agriculture; National Agricultural Statistics Service; and Agricultural Statistics Board.

recent gain in export prices, associated with the tight supply of commodities like wheat, is expected to offset the decline in export volume. While real grain prices are at a historic low, production cost has also declined, making grain a relatively important source of farm income.

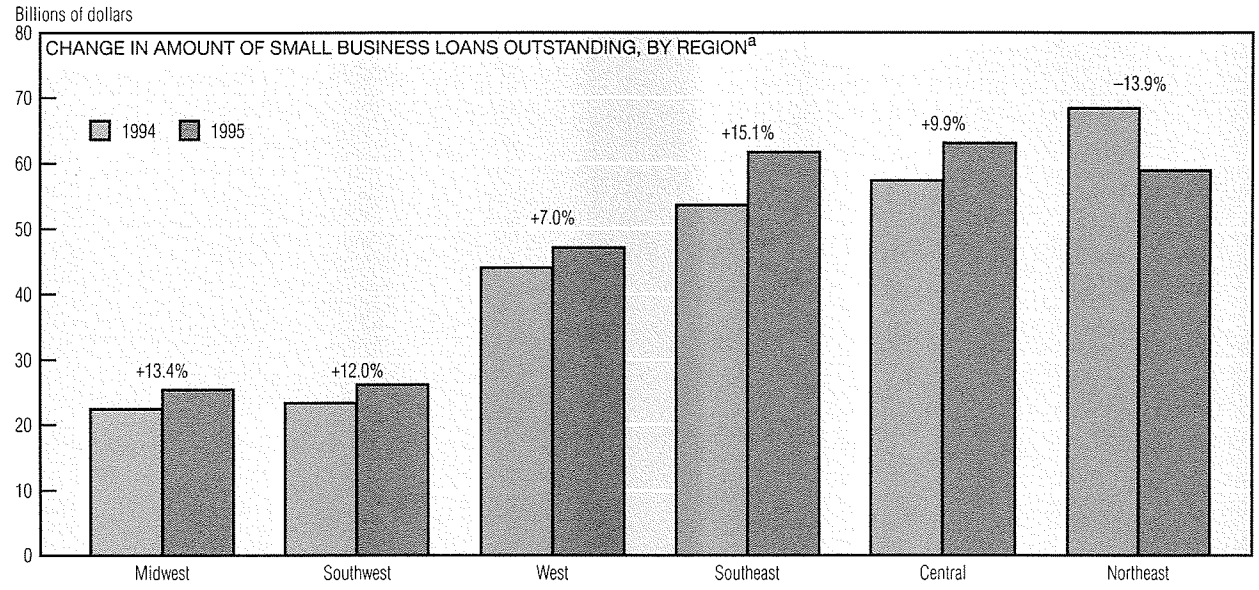
Farmers in many states are also far behind schedule in corn planting, threatening fall crop yields. Ohio is one of 17 major corn-producing states. Corn, along with pasture and range conditions, is vitally important to the state's large dairy industry.

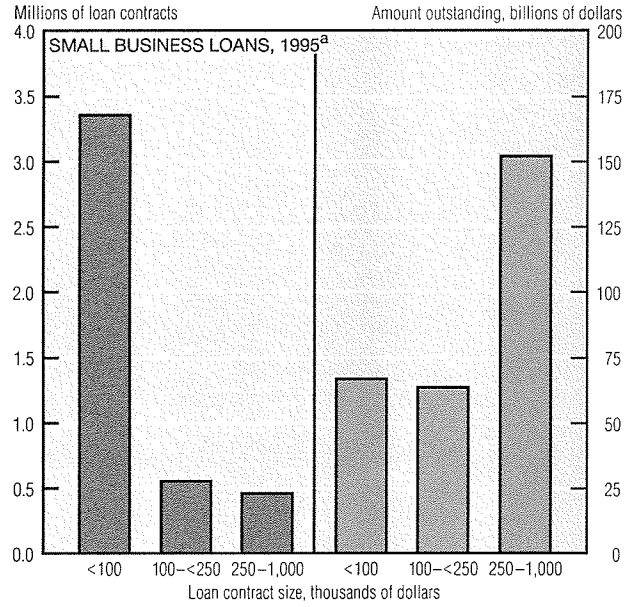
In a typical year, Ohio farmers plant 91% of their corn crop by May 26. This year, they have been able to plant only 39%, putting this state last among the major corn producers. Georgia and North Carolina have planted 99% of their crop, while in Michigan only 49% of the crop has been planted, compared to 84% in a normal year. However, the corn outlook has brightened somewhat with the recent improvement in weather conditions.

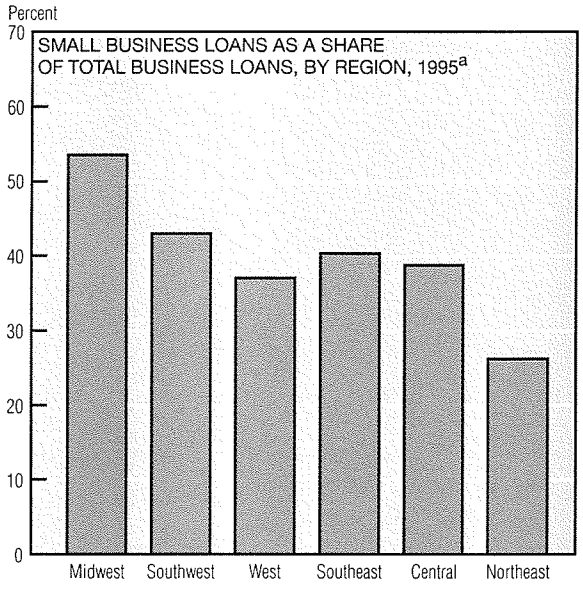
Pasturage is another food source for livestock. In Ohio, 50% of pasturage is rated good or excellent, compared to 76% last year. In the 48 contiguous states, 49% of pasturage was rated good or excellent, versus 71% last year.

http://clevelandfed.org/research/trends
June 1996
Best available copy

Small Business Lending







a. Includes loans secured by nonfarm, nonresidential properties, plus commercial and industrial loans to U.S. addressees.
NOTE: All data are for FDIC-insured domestic depository institutions. Small business loans are those with original amounts of $1 million or less.
SOURCE: Federal Financial Institutions Examination Council, *Consolidated Reports of Condition and Income,* June 1994 and June 1995.

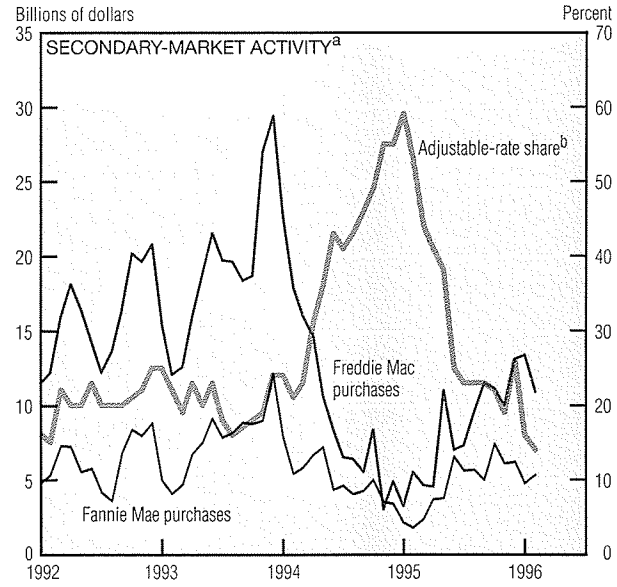
Between June 1994 and June 1995, small business lending increased 4.9% nationwide (to $282.3 billion), but it showed striking regional variations.

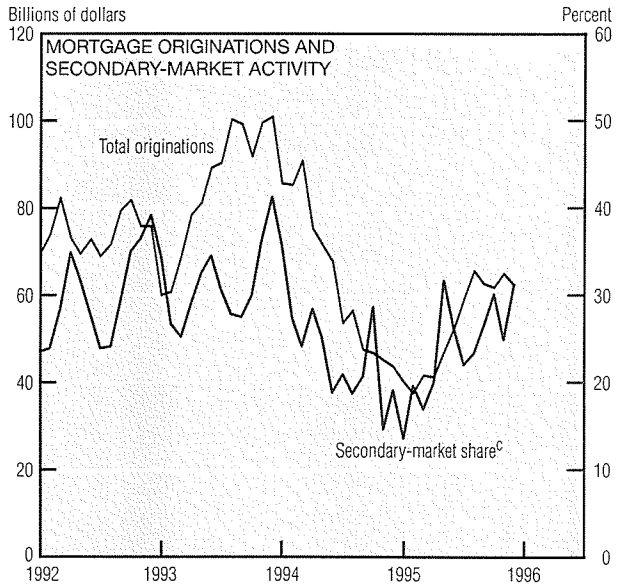
The Southeast and Midwest posted the strongest gains. At the other extreme, lending in the Northeast, which had the largest dollar volume in 1994, fell by 13.9%. Such a decline is perhaps less worrisome here than it would be in the rest of the country, since small business lending comprises a relatively minor fraction of this region's total business credit extended (26.2%). In contrast, although small business lending was only $25.4 billion in the Midwest, it constituted 53.5% of all business loans outstanding in the region in June 1995.

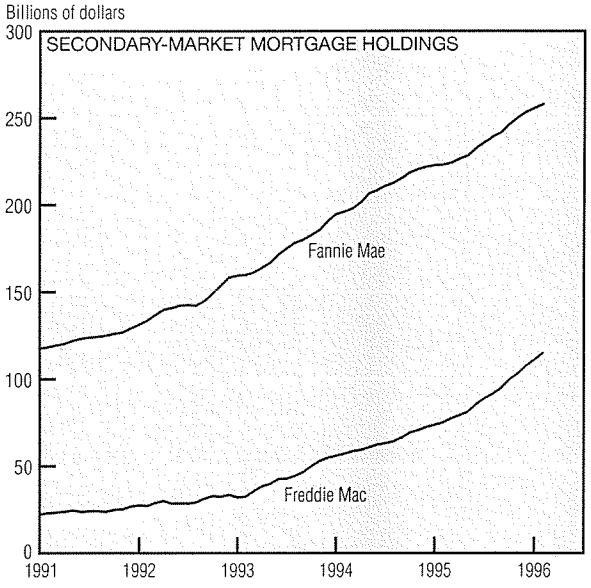
Compared to 1994, there has been little change in the composition of small business lending. Loans for amounts less than $100,000 account for 76.8% of all contracts outstanding. This is slightly higher than in 1994 (75.1%), perhaps reflecting the shift away from lending in the Northeast. On the other hand, contracts for more than $250,000 still account for over half of all dollars lent to small businesses.

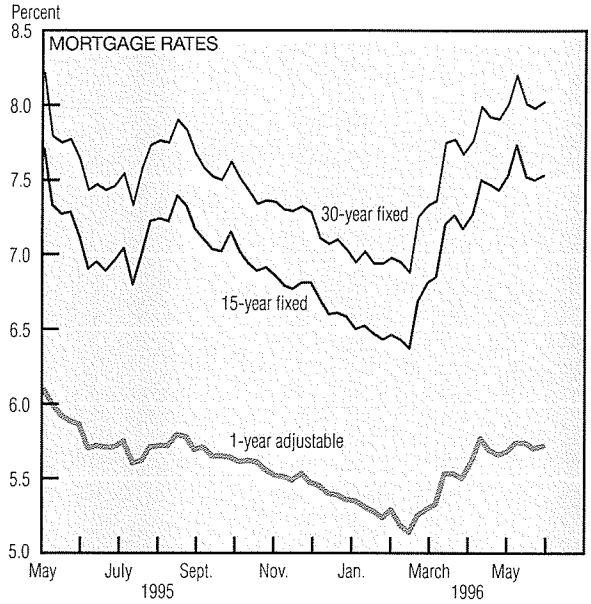
http://clevelandfed.org/research/trends
June 1996
Best available copy

Secondary Mortgage Market Activity









a. Purchase data include both conventional and government-insured mortgages.
b. Percent of new conventional mortgage originations with adjustable rates.
c. Secondary-market purchases by Fannie Mae and Freddie Mac as a percent of total mortgage originations.
SOURCES: Board of Governors of the Federal Reserve System; Office of Thrift Supervision; U.S. Department of Housing and Urban Development; and *Bank Rate Monitor,* various issues.

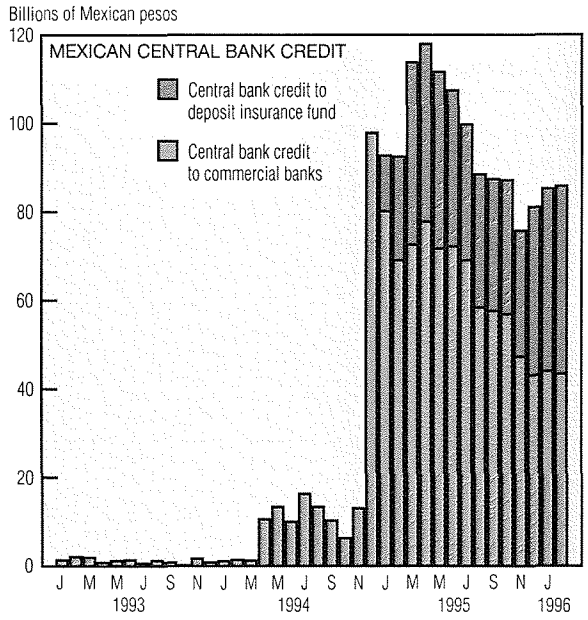
The rapid rise in interest rates during 1994 led to a marked drop in mortgage purchases by the two major players in the secondary market, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These purchases reached a low of $5.4 billion in January 1995. Since then, they have rebounded somewhat, without coming anywhere near their combined $41.5 billion high of December 1993.

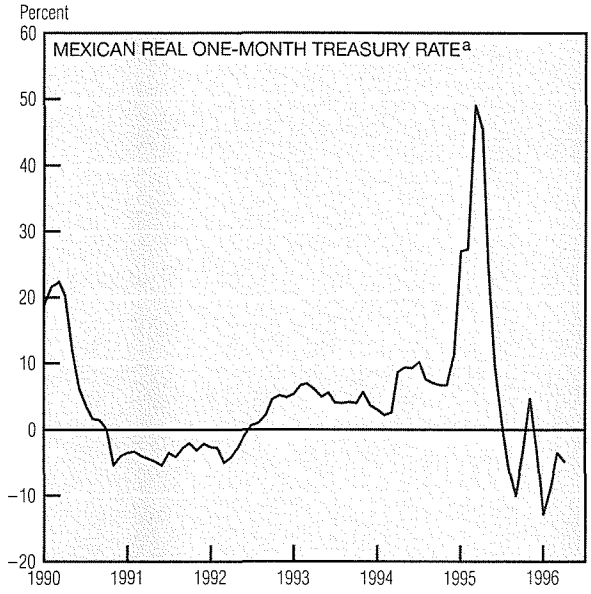
These changes can be attributed to two factors. First, rising interest rates in 1994 led to an overall decline in mortgage originations. At the same time, these rising rates shifted borrower preferences toward adjustable-rate mortgages. Since such mortgages tend to be held in portfolio by loan originators (particularly savings banks), the fraction of originations purchased by the secondary market necessarily fell substantially.

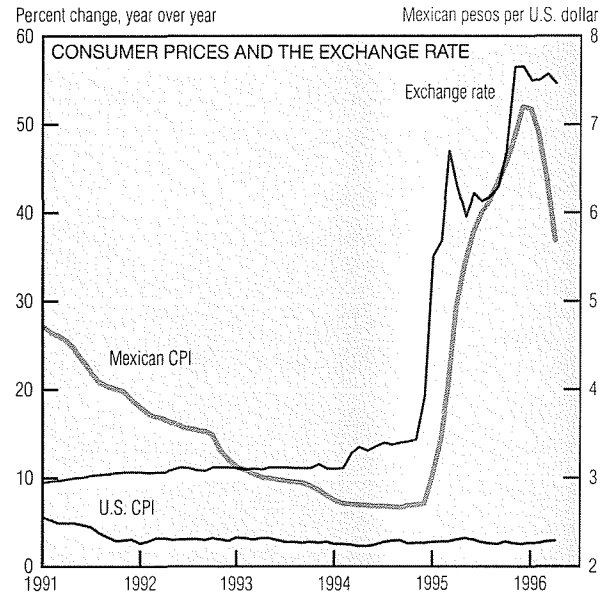
Both of these factors reversed themselves in 1995, leading to a rebound in secondary-market activity. Despite these fluctuations in purchases, the total mortgage holdings of Fannie Mae and Freddie Mac have continued their steady growth, increasing 25.0% (to $372.8 billion) between February 1995 and February 1996.

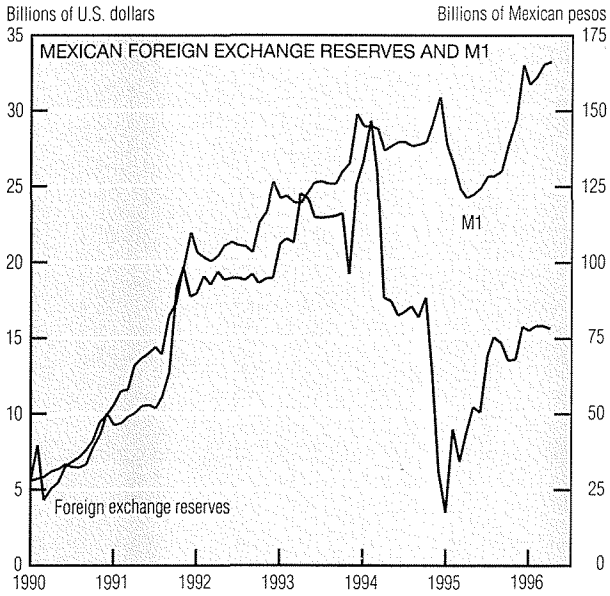
http://clevelandfed.org/research/trends
June 1996
Best available copy

The Mexican Economy









a. One-month Treasury rate minus 12-month consumer price change.
SOURCES: DRI/McGraw-Hill; and Bank of Mexico.

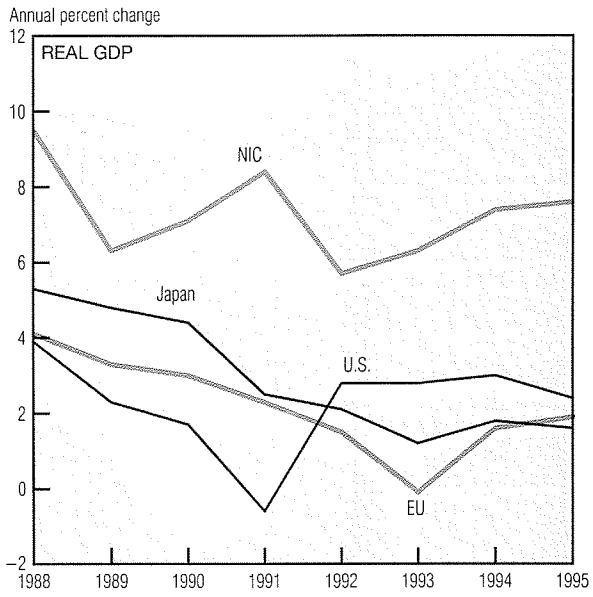
Observers were surprised by first-quarter data showing that the Mexican economy shrank only 1% compared to the first quarter of 1995, but they remain concerned that this strength is limited to the export sector, which has benefited from a sharp decrease in the international value of the peso since December 1994. A continued general weakness in economic activity may be related to the burden of unpaid loans on consumers and banks.

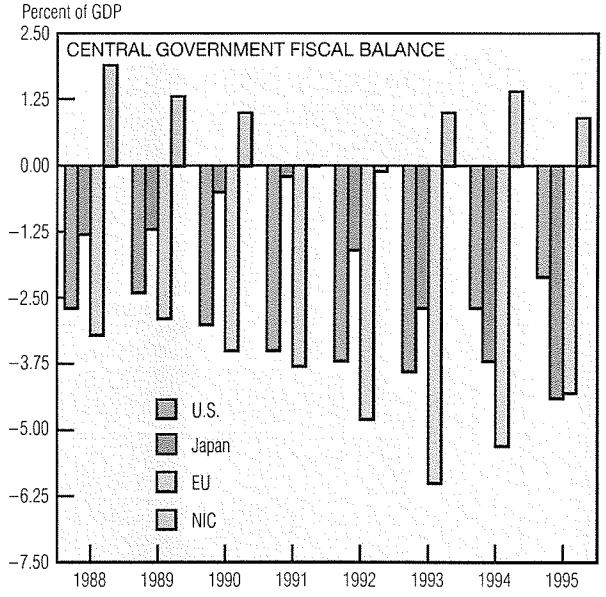
The Mexican central bank has supported a series of programs dealing with bad-debt problems. The deposit insurance fund has been used to buy back debt from banks and to provide credit for recapitalization. Other programs include helping banks index debts to inflation and supporting debt renegotiations between banks and consumers.

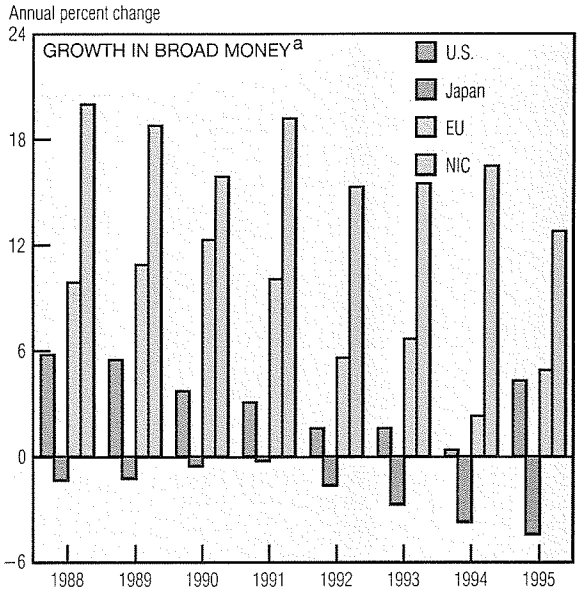
Lower interest rates help consumers meet loan payments and increase their willingness to renegotiate overdue debts. However, the recent negative real interest rates enable borrowers to fund uneconomic projects. Rapid price increases since December 1994 may result partly from the weakening of the peso. Rising inflation due to central bank efforts to support banks, on the other hand, may undermine confidence in Mexican policy reforms. Any consequent loss of reserves or rise in interest rates would damage both the banking sector and the economy.

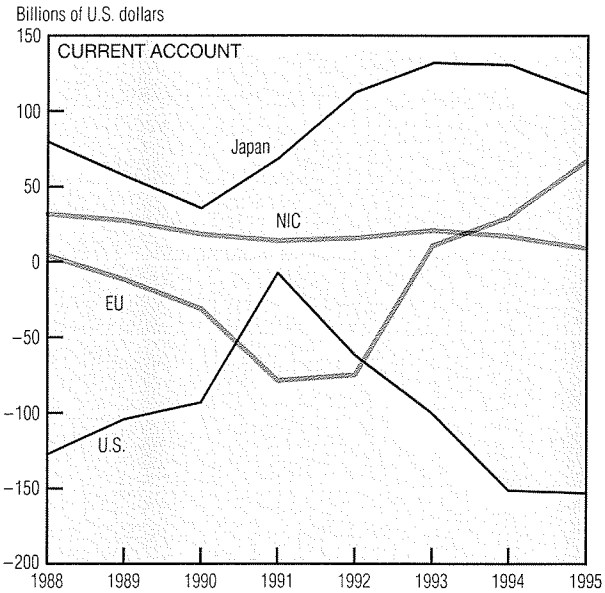
http://clevelandfed.org/research/trends
June 1996
Best available copy

Fiscal Balances and World Economic Growth









a. Broad money equals M2, except in Japan, where it equals M2 plus certificates of deposit.
NOTE: EU stands for European Union; NIC stands for newly industrialized countries.
SOURCE: International Monetary Fund.

Fiscal deficits (or surpluses) influence economic growth, and public spending can boost productivity through wise investments in infrastructure. However, industrialized countries increasingly view persistent fiscal deficits and the resulting accumulation of public debt as detrimental to long-term growth and competitiveness. Although reducing government expenditures is often politically difficult and can slow growth temporarily, current deficit levels may not be sustainable as industrial countries' populations grow older.

In the European Union (EU), the absence of widespread, effective programs of fiscal consolidation threatens to limit monetary policy's independence and credibility. In Japan, calls for fiscal consolidation may become louder once economic growth has recovered more fully from asset quality problems at major financial institutions.

In the U.S., the current-account deficit is sometimes viewed as a source of savings from abroad that partly offsets the fiscal deficit's drain on private savings. Progress on the fiscal side may permit a more credible monetary policy and, hence, a stronger dollar. In contrast, fiscal and current-account surpluses in the newly industrialized countries (NIC) of East Asia—Hong Kong, Singapore, South Korea, and Taiwan—have been associated with strong growth in both monetary aggregates and real economic activity.