

# The Economy in Perspective

*What goes around comes around...* Before anyone gets the wrong idea, let's be clear about one thing: This is not another essay declaring that business cycles are dead. To paraphrase a popular bumper sticker, recessions happen. But business cycles are commonly thought of as recurring fluctuations in economic activity. Considering that we are now in the seventh year of an expansion, and have experienced growth for 14 of the last 15 years, who could fault us for reappraising the business cycle concept?

Business cycles have never been regarded as following a fixed periodicity. Their earliest chroniclers, Wesley Mitchell and Arthur Burns, found patterns of co-movement and sequencing in economic activity that tended to be stable over time. For example, in the recovery phase of the cycle, labor productivity rises sharply as firms expand output without having to expand labor hours proportionately. Furthermore, overtime hours tend to increase first, with additional employment coming only later, as confidence in the expansion deepens. Output gets an added boost from the need to restock inventories and increase distribution lines.

Analysis shows that a cycle tends to peak when imbalances develop. The classic end to the expansion phase materializes when firms seek to expand capacity and bolster inventories. They finance this spending by borrowing, and their capacity for repayment becomes increasingly dubious as pressures on resource availability push up interest rates and add to debt-service costs. Typically, inflation accelerates.

Eventually, economic conditions become substantially incompatible with people's prior expectations and plans: Consumers do not want what retailers are stocking, retailers do not need what manufacturers are producing, factories refuse to hire people who want to work, and debtors cannot repay creditors. The longer the inconsistency in planning persists, and the greater the resource mismatch, the sharper and deeper the correction period.

For most of the past 50 years, mainstream economists have tended to think that recessions could be explained by insufficient aggregate demand, and that monetary and fiscal policies could stimulate enough demand to put total spending on the full-employment path. Of course, policy mistakes could be responsible for both over- and undershooting this ideal output level, and quite often were blamed for inadequate macroeconomic performance.

Research conducted in the last 20 years has added new insights. For example, instead of regarding all business cycle fluctuations as disequilibrium events, it allows that a significant proportion might arise from people simply making decisions in their own self-interest, following random economic shocks. The prevailing levels of ag-

gregate supply and demand, although not always conforming to an idealized condition of full employment, might be the best the economy can do under the circumstances of the moment.

Some contemporary researchers have reached another conclusion: Disturbances in aggregate supply account for a considerable amount of the variation in economic activity. This observation implies that periods of slow growth may result from adverse supply conditions, such as those caused by an oil cartel, and that periods of fast growth may be due to favorable supply conditions, like those following large-scale technological innovation.

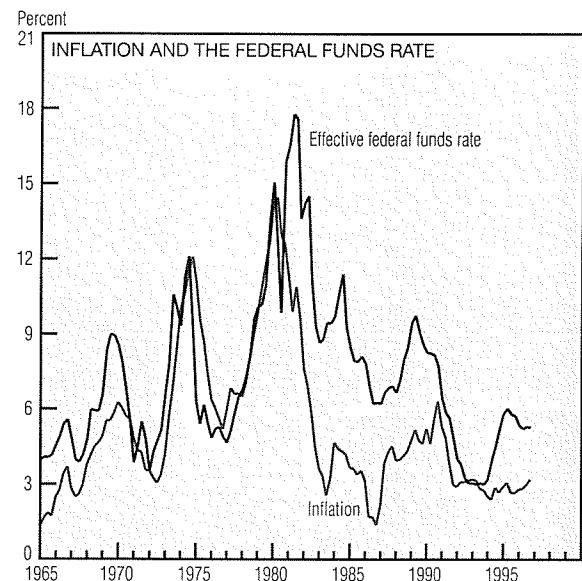
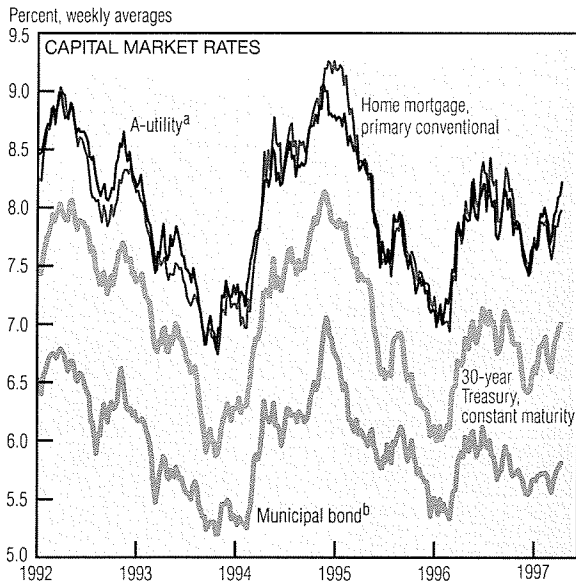
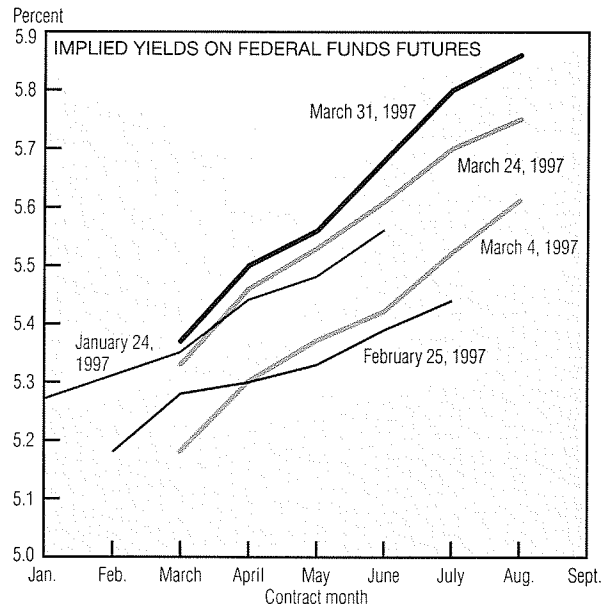
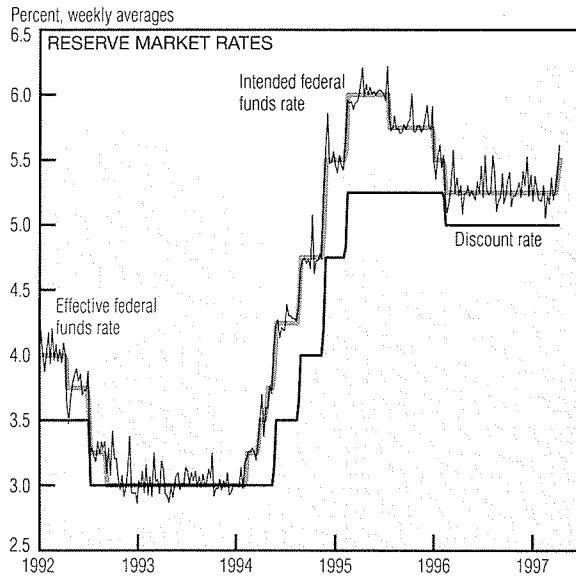
Why does the distinction between supply and demand disturbances matter? Consider economic conditions over the past two years. According to the traditional demand-oriented view, the economy reached full employment when the unemployment rate hit 6%; full employment could be maintained only if aggregate demand grew at the economy's potential rate of about 2%. More rapid growth would push aggregate demand beyond the economy's ability to supply output, creating inflation pressures. In this view, the Fed would need to dampen aggregate demand by allowing the federal funds rate to rise. Money growth would then slow down enough to keep inflation in check.

But economic growth has been exceeding 2% for a while, and the unemployment rate has fallen well below 6%. The absence of inflation pressures might result from transitory factors that will soon dissipate. Alternatively, we could be benefiting from positive developments in aggregate supply. The current expansion has been marked by a capital spending boom, which may signal the onset of productivity-enhancing business tools and practices. Moreover, this investment wave follows a period in which several important industries became deregulated, and trade restrictions were reduced, both of which improved marketplace flexibility. Labor force participation rates have reached record levels, and hours worked remain very strong. There are even some signs that productivity growth has finally picked up its pace. This is unusual for the latter stages of a demand-driven, supply-constrained expansion.

If aggregate supply is growing, and productivity trends are improving, the quickened pace of demand will now match that of supply, creating no interest rate pressure. In this case, however, the public would require more money to support increased spending, so an unchanged funds rate would actually reduce inflation.

Differentiating between these two possibilities is easy in theory, but difficult in practice. In announcing an increase in the funds rate last month, the Federal Open Market Committee seemed to favor the demand-side hypothesis. Whether it holds firmly to that view will depend on how *what goes around* comes down.

# Monetary Policy



a. Estimate of the yield on a recently offered, A-rated utility bond with a maturity of 30 years and call protection of five years.

b. Bond Buyer Index, general obligation, 20 years to maturity, mixed quality.

NOTE: All data are seasonally adjusted.

SOURCES: Board of Governors of the Federal Reserve System; U.S. Department of Labor, Bureau of Labor Statistics; and the Chicago Board of Trade.

Immediately after its March 25 meeting, the Federal Open Market Committee (FOMC) of the Federal Reserve System announced that it had "decided to tighten money market conditions slightly, expecting the federal funds rate to rise ¼ percentage point to around 5½ percent." This was the Committee's first policy move in almost 14 months and the first increase since January 1995.

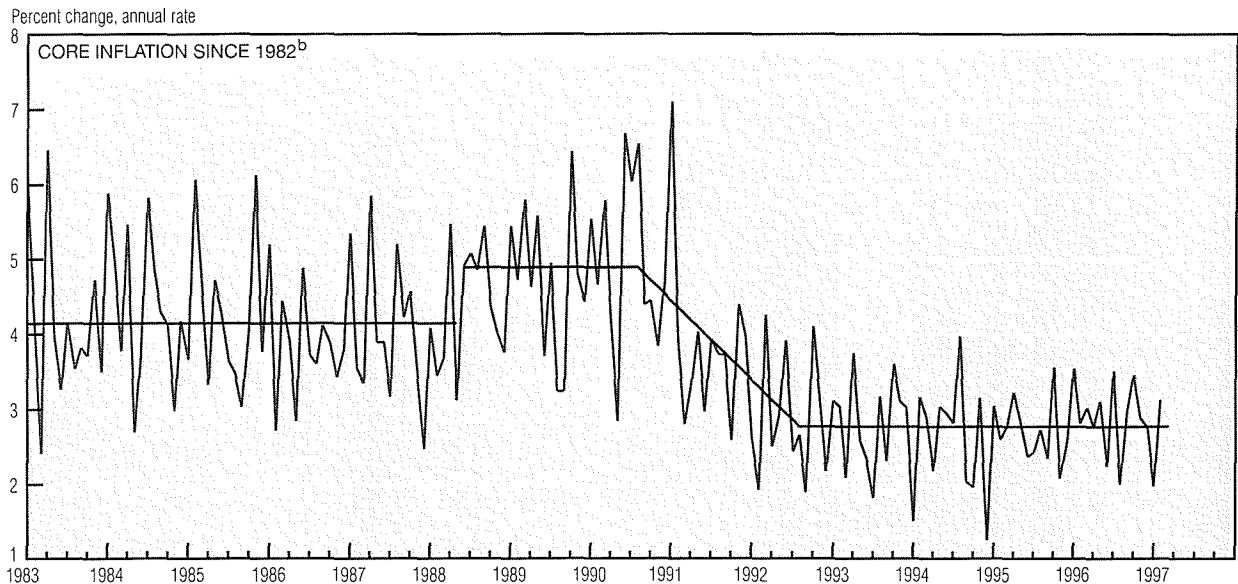
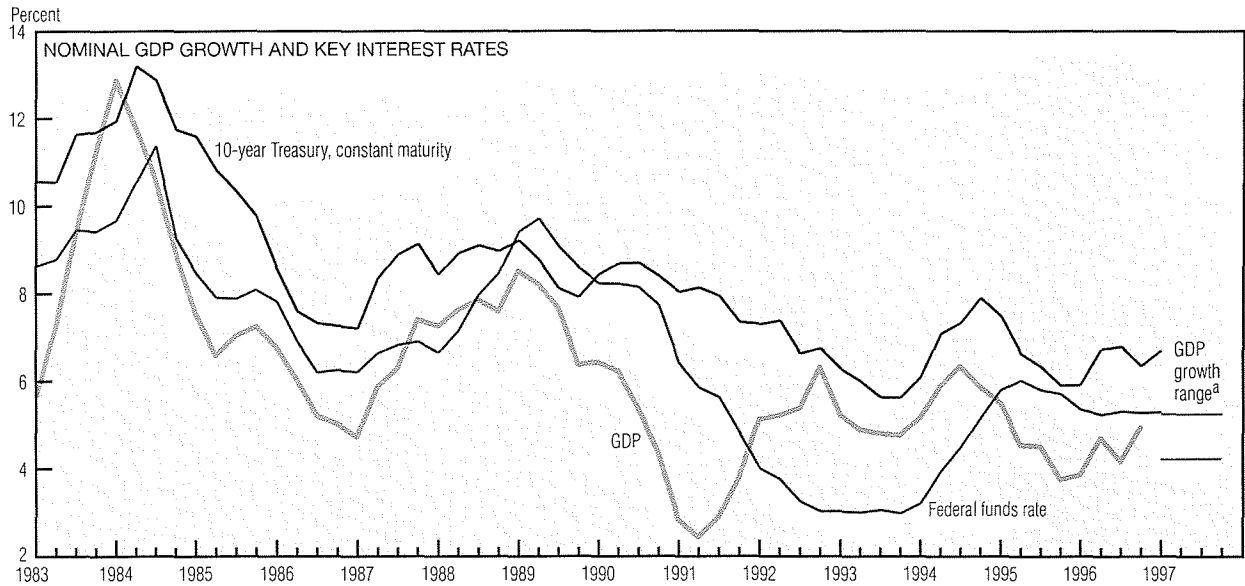
This action was no surprise to financial markets. The fed funds futures market, for instance, had come

to anticipate the rate increase in the weeks before the meeting. Although futures prices in January had indicated the likelihood of a rate hike in March, February events led futures investors to doubt that any policy action would occur before midyear. Capital markets in February also seemed to discount any immediate move by the FOMC. However, concerns about growing inflationary pressures arose by mid-March, and the likelihood of a modest rate hike increased.

In announcing its action, the FOMC stated that "... the slight firming of monetary conditions is viewed as a prudent step that affords greater assurance of prolonging the current economic expansion by sustaining the existing low inflation environment through the rest of this year and next. The experience of the last several years has reinforced the conviction that low inflation is essential to realizing the economy's fullest growth potential."

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# Monetary Policy (cont.)



a. As projected by the FOMC and nonvoting Reserve Bank presidents in February 1997.  
 b. Core inflation is measured as the 15% trimmed mean of the CPI. Green lines represent trends.  
 SOURCES: Board of Governors of the Federal Reserve System; and the Federal Reserve Bank of Cleveland.

To understand this perspective, it is useful to review monetary policy over the past few decades. From the mid-1960s to the late 1970s, each business cycle ended with inflation higher than the previous peak and began with inflation higher than the previous trough. This upward trend was accompanied by increasing structural imbalance and a general deterioration in the economy's growth potential. Assets considered to be inflation hedges (such as housing and gold) appreciated beyond sustainable levels. In 1979, uncertainty about the future of the dollar led to a sharp decline in its value and

precipitated a significant FOMC commitment to a policy of disinflation.

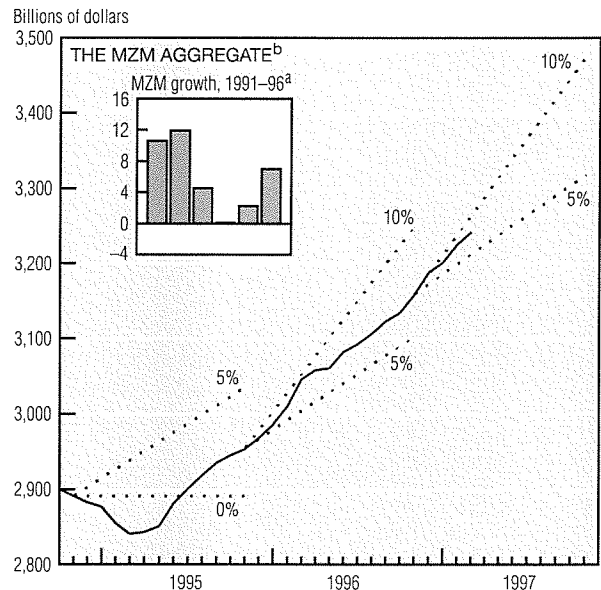
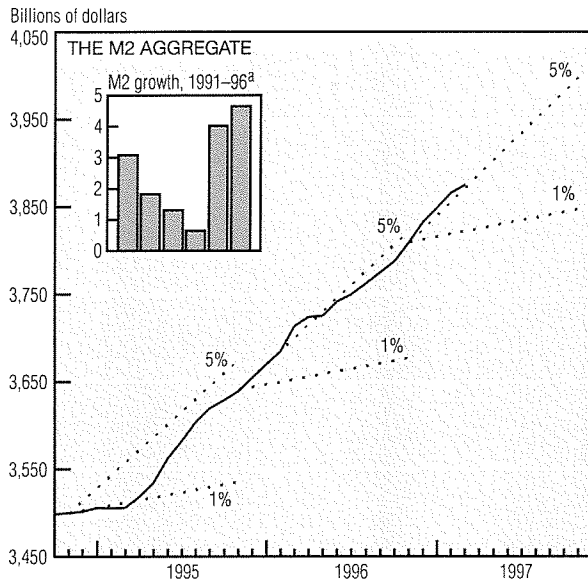
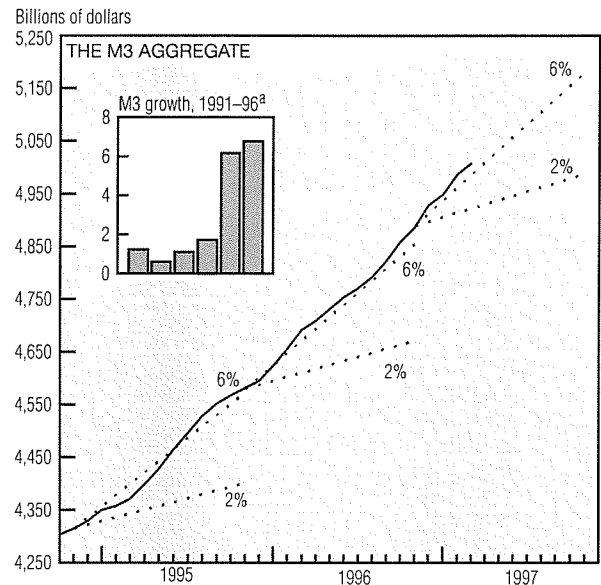
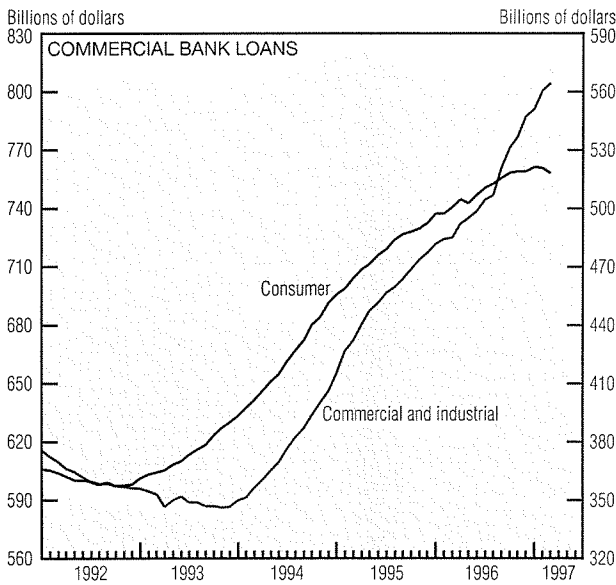
Disinflation climaxed in 1982 and was followed by a prolonged period of robust growth and relatively low inflation. Both nominal and real interest rates, however, stayed relatively high as investors in long-term debt instruments remained leery of the Fed's commitment to price stability. Indeed, market rates rose sharply throughout 1983 and early 1984. Many attributed this, in part, to a high rate of return on new business investment resulting from fiscal incentives and reduced tax rates. However, many also believed that

part of the increase reflected an inflation scare, as investors waited for evidence that inflation was not accelerating. In 1985, financial markets became more confident that inflation was contained, and interest rates generally fell.

Inflationary pressures emerged again in 1987, and the Fed adopted an anti-inflationary stance. A sharp drop in stock prices in October, however, aroused concern about market liquidity and interrupted anti-inflationary efforts. Eventually, policy was redirected to containing inflation, but not in time to head off a

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# Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis.  
 b. MZM is an alternative measure of money that is equal to M2 plus institutional money market funds less small time deposits.  
 NOTE: All data are seasonally adjusted. Last plot is estimated for March 1997. Dotted lines for the M2 and M3 aggregates are FOMC-determined provisional ranges. Dotted lines for MZM represent growth ranges and are for reference only.  
 SOURCE: Board of Governors of the Federal Reserve System.

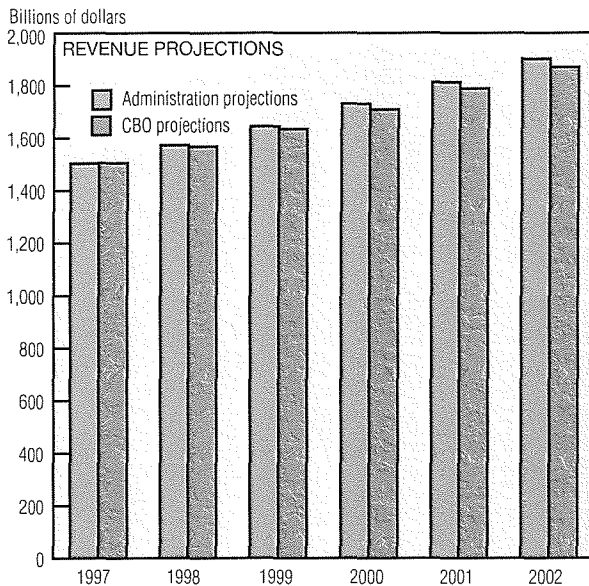
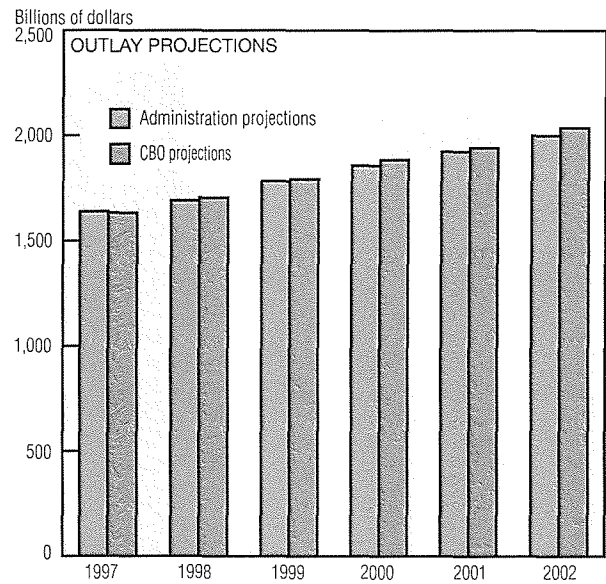
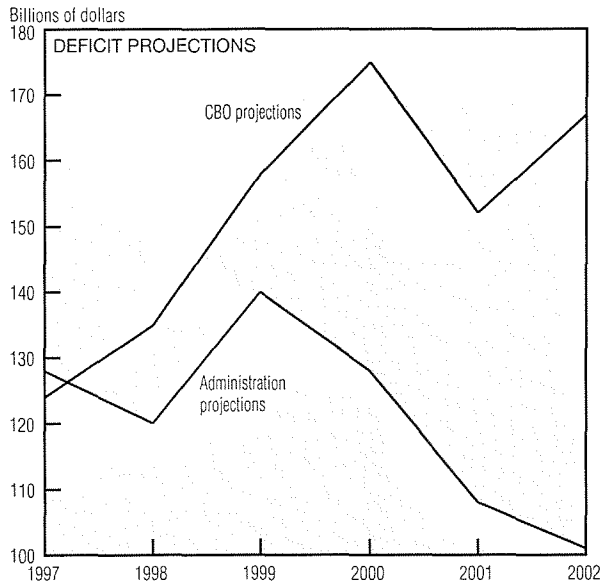
jump in the trend of core inflation to nearly 5% in the spring of 1988. The inflation rate eventually dropped sharply with the resolution of the Gulf War in 1991 and trended down to just below 3%, where it has remained since mid-1992.

Although the 1991 recovery started slowly, it gained momentum as the last vestiges of high inflation were worked out. In 1994, the threat of inflation produced a preemptive policy stance that did not interfere with continued economic expansion.

Indeed, the economy accelerated in 1996, while inflation remained well behaved. This experience demonstrates that the FOMC's commitment to price stability since 1982 has enabled extended periods of high growth and employment, along with low inflation. Consistent policy throughout this period has also been associated with a general decline in nominal GDP, but only one recession. Moreover, real interest rates have fallen from their 1980s highs as the Fed's credibility has increased.

Vigilance in the pursuit of price stability requires that policymakers pay close attention to any sign of inflationary pressures. Although the Fed de-emphasized money growth targeting in 1993, M2 growth since then has been in line with its historical relationship to economic activity. Over the past year, there has been an acceleration across the M2, M3, and MZM aggregates. The recent uptick in the federal funds rate reduces the likelihood that M2 and M3 will continue to exceed their announced growth ranges.

# The Federal Budget



Comparison of CBO and Administration Economic Projections			
	1998	2000	2002
<b>Real GDP growth<sup>a</sup></b>			
CBO	2.1	2.2	2.1
Administration	2.0	2.3	2.3
<b>CPI inflation<sup>a</sup></b>			
CBO	2.9	3.0	3.0
Administration	2.7	2.7	2.7
<b>Wage and salary share<sup>b</sup></b>			
CBO	47.7	47.4	47.3
Administration	47.9	47.8	47.7
<b>Corporate profit share<sup>b</sup></b>			
CBO	8.1	7.8	7.8
Administration	8.6	8.7	8.4

a. Percent change, year over year.  
 b. Percentage of GDP.  
 NOTE: All projections assume no change in policy.  
 SOURCE: Congressional Budget Office.

If economic models are economists' stock-in-trade, then the assumptions used to construct them are their critical raw materials. These assumptions have long provoked pointed barbs at the expense of the profession and its conclusions, but in the real world of policy, assumptions are no joke.

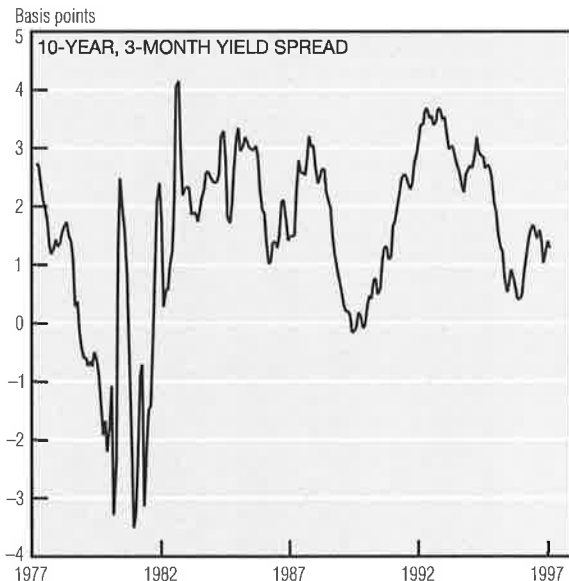
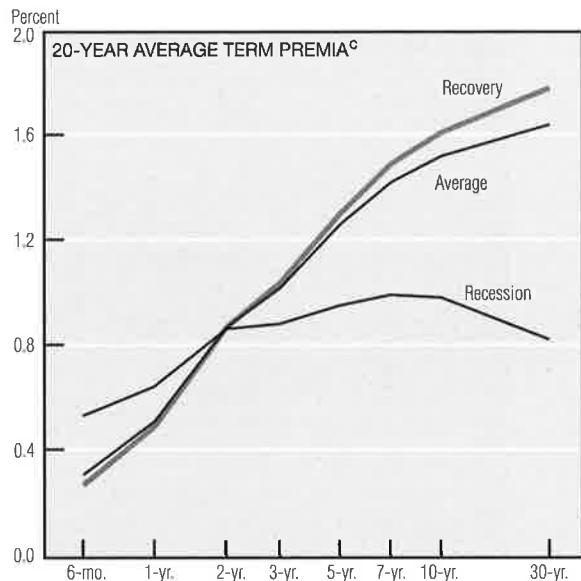
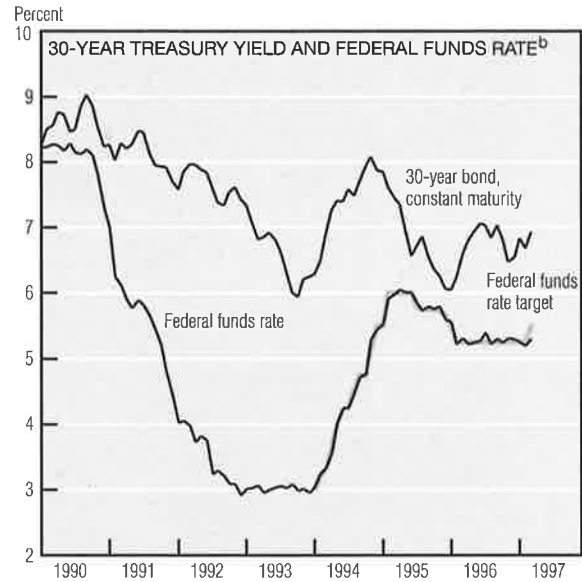
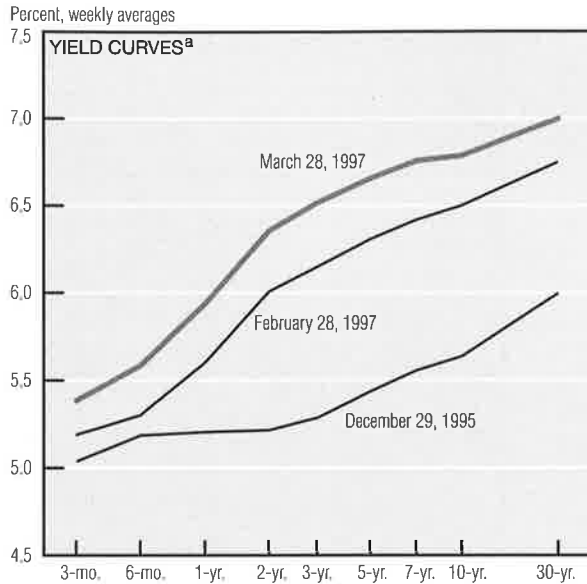
As the federal government's budget process begins in earnest, reconciling the underlying assumptions of competing proposals becomes an important condition for reaching an

agreement. In practical terms, this means reconciling the assumptions of the Clinton administration and the Congressional Budget Office (CBO).

In February, the CBO began analyzing the administration's preliminary budget proposals. The first step, of course, is to determine the starting point of the deliberations: Without any change in policy, what will be the path of the federal deficit? The answer depends critically on the assumed paths of economic growth, inflation, and income distribution.

Although they may appear slight, differences between the assumptions of the CBO and the administration have a significant impact on the projected path of outlays, revenues, and the deficit. Given its economic assumptions, the administration has projected that status quo policy would lead to a \$597 billion cumulative shortfall in revenues over the 1998–2002 period. Under the CBO's alternative assumptions, the corresponding projection is a deficit of about \$787 billion.

# Interest Rates



a. All instruments are constant-maturity series.

b. The last data point for each series is the average of the available weekly numbers for March 1997.

c. Term structure based on the average spread, for a given period, between the 3-month yield and each of the other maturities in the yield curve.

SOURCE: Board of Governors of the Federal Reserve System.

Since last month, the yield curve has shifted upward in a parallel fashion, with most of the increase following a rise of 25 basis points in the federal funds rate. The bellwether 10-year, 3-month spread stands at 140 basis points, and the 3-year, 3-month spread at 113 basis points, both well above their historical averages.

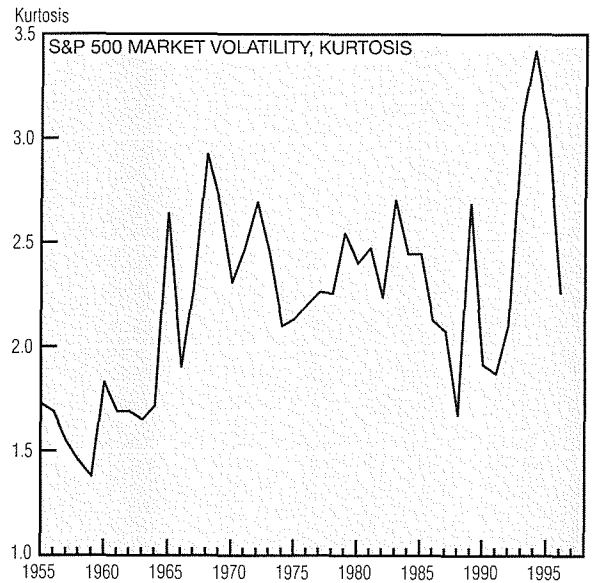
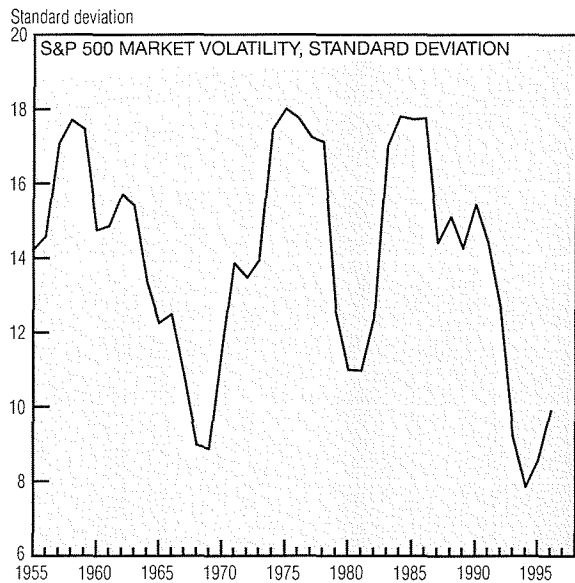
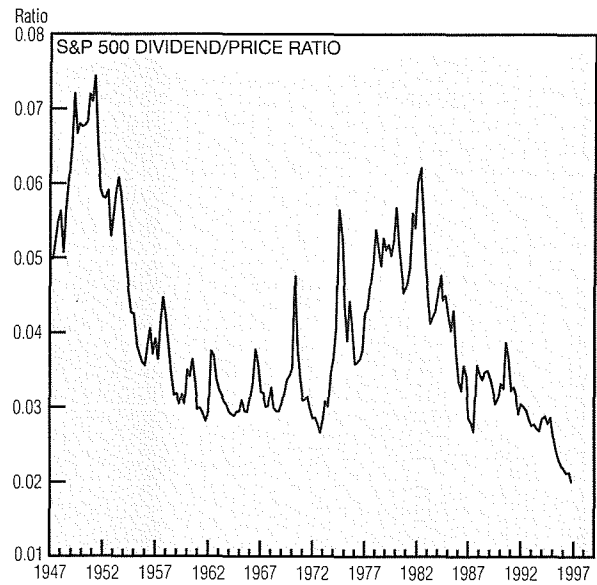
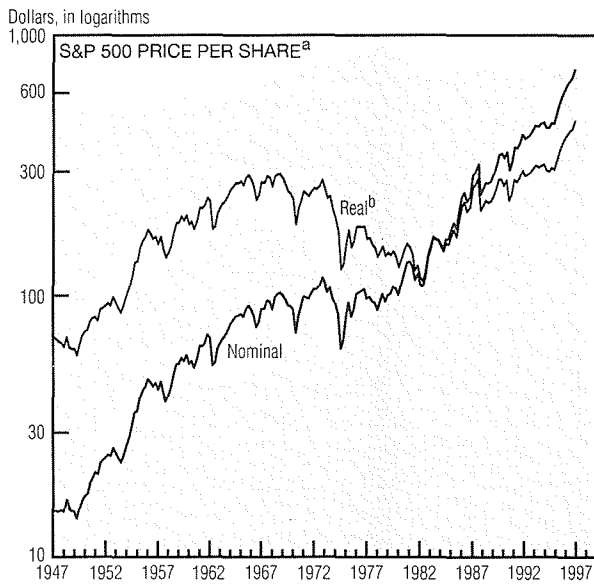
The figures are even more striking when compared to late 1995. Since then, long rates have moved up a full point, while short rates have risen only one-third. The rates themselves show clearly that the steady federal funds rate did not prevent

the long bond rate from fluctuating by nearly a point, although the chart also shows much greater fluctuations in previous years. This reinforces the point made in the first chart—that most of the recent shifts in the yield curve have come at the long end.

While people often focus on the average yield curve, it is important to recognize that yield curves change over the business cycle. Yield curve spreads have recently regained popularity as predictors of recessions, and they still have the most obvious relationship with business cycles. Such a comparison,

however, misses the interactions between different spreads, which a plot of average term premia reveals. In recessions, the yield curve not only is flatter, but also assumes a humped shape, in which long rates fall below medium-term rates. This reflects expectations about future interest rates, combined with increased uncertainty about the course of the economy, particularly over the medium term. No one expects a recession to last 30 years, but its length—and the strength of the ensuing recovery—are always uncertain.

# The Stock Market



a. Last plot is the December 31 closing price.  
 b. Real S&P 500 is the nominal S&P 500 divided by the Consumer Price Index.  
 SOURCE: DRI/McGraw-Hill.

The bull market of 1996–97 continues to garner headlines. The standard graphs may exaggerate recent gains, however, because they do not take account of the market's previous run-up. A logarithmic, or proportional, scale adds a useful perspective that makes recent gains, though noticeable, look less specular. Investors who bought the Standard and Poor's (S&P) 500 at 33 and held it to 100 tripled their money, but had to wait until the average hit 300 to triple their money again.

One possible reason for the mar-

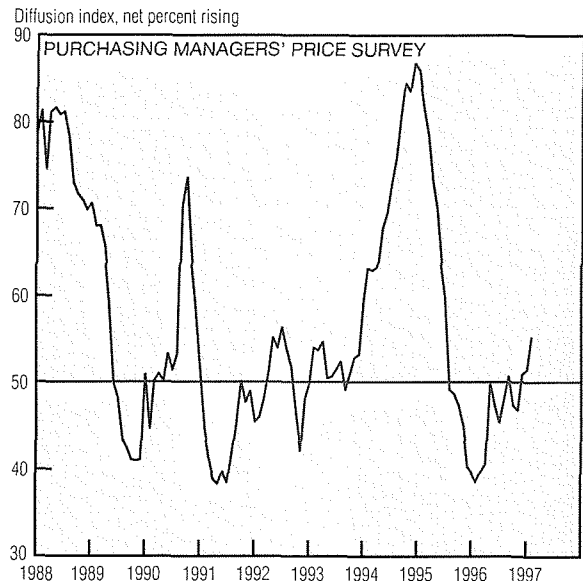
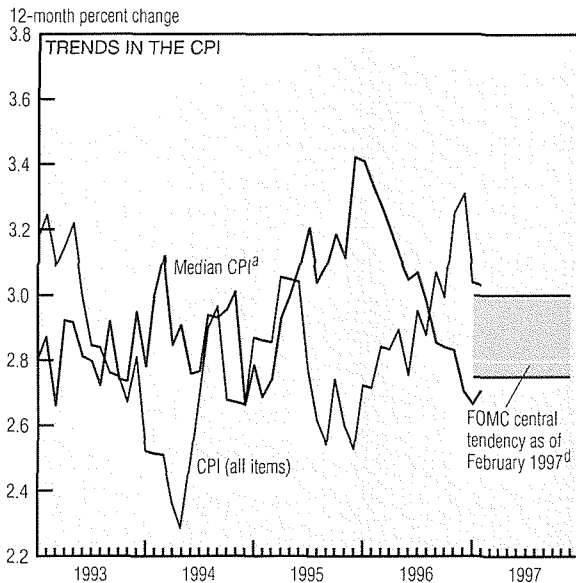
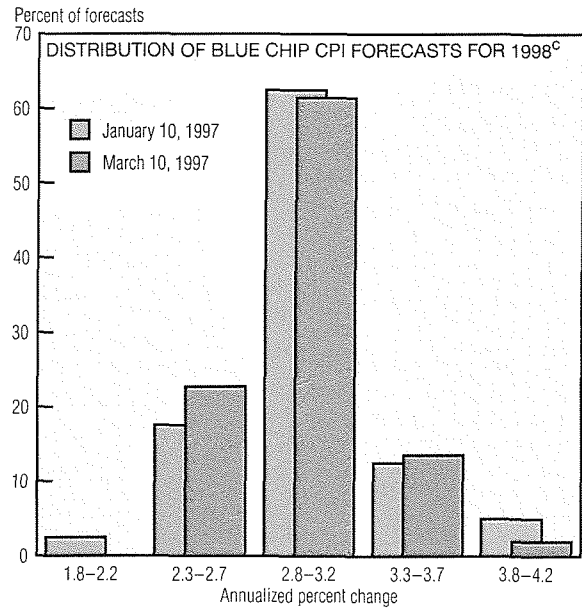
ket's recent gains is that it is moving up to a higher plateau with lower future returns. This view is corroborated by the dividend/price ratio, a fairly accurate predictor of stock market returns, particularly over periods of two to seven years. This ratio is at a post-World War II low, suggesting small returns in the future.

To explain the drop in market returns, some analysts cite the possibility that investing in stocks has gotten safer, and investors thus bear less risk. The standard deviation is at a low level relative to most years, al-

though the bull market coincided with a small recent increase. The kurtosis gives a slightly different picture of risk: High kurtosis implies a greater probability of market extremes, both jumps and crashes. This measure indicates that risk did fall over the past two years, but this drop merely returned the risk to average levels. Perhaps some combination of factors is driving the results: People see the low standard deviation, along with less chance of market extremes, and feel safer.

# Inflation and Prices

	Annualized percent change, last:			Year avg.:	
	1 mo.	6 mo.	5 yr.	1995	1996
	<b>February Price Statistics</b>				
<b>Consumer Prices</b>					
All items	3.1	3.1	2.9	2.5	3.3
Less food and energy	2.9	2.5	2.9	3.0	2.6
Median <sup>a</sup>	3.4	2.8	2.9	3.4	2.7
<b>Producer Prices</b>					
Finished goods	-4.4	1.4	1.6	2.2	2.9
Less food and energy	-1.7	0.0	1.3	2.6	0.6
<b>Commodity futures prices<sup>b</sup></b>					
	-8.8	-6.7	2.6	5.4	-0.7



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. Forecast of the Blue Chip panel of economists.  
 d. 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; Board of Governors of the Federal Reserve System; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; National Association of Purchasing Management; and *Blue Chip Economic Indicators*, January 10 and March 10, 1997.

On March 25, the Federal Open Market Committee (FOMC) took a small and perhaps cautious step toward monetary restraint by raising the federal funds target by ¼ percentage point, its first overt policy action since January 1996. In a press release, the Committee described the rate hike as a prudent step aimed at prolonging the business expansion by maintaining the existing low inflation rate through the end of this year and next.

At the moment, the inflation indicators are showing no clear sign of moving away from the 3% trend they have followed over the course of the current expansion. In February, the Consumer Price Index (CPI) rose at a 3.1% annual rate, just a shade above its average since 1991 (2.9%). The median CPI, which measures underlying inflation, advanced at a 3.4% pace, but was still not far from its five-year trend.

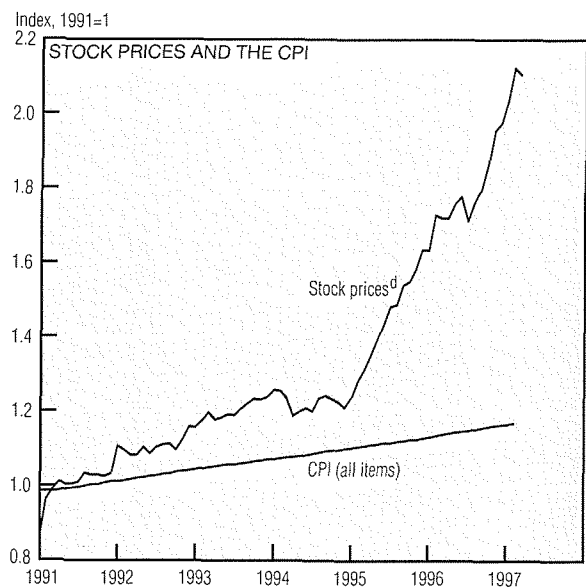
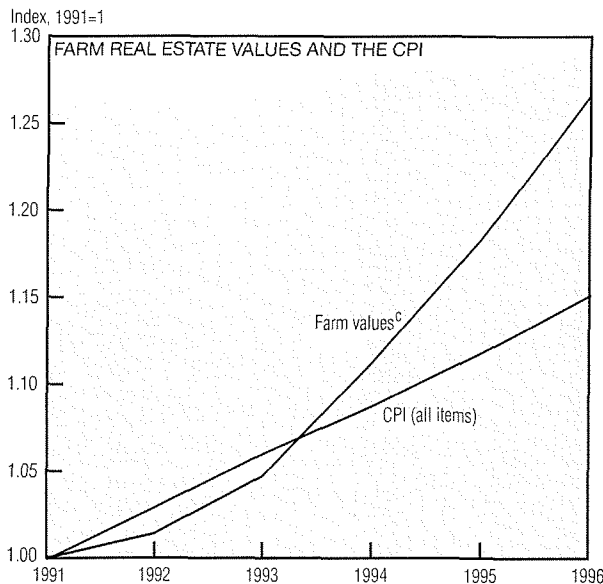
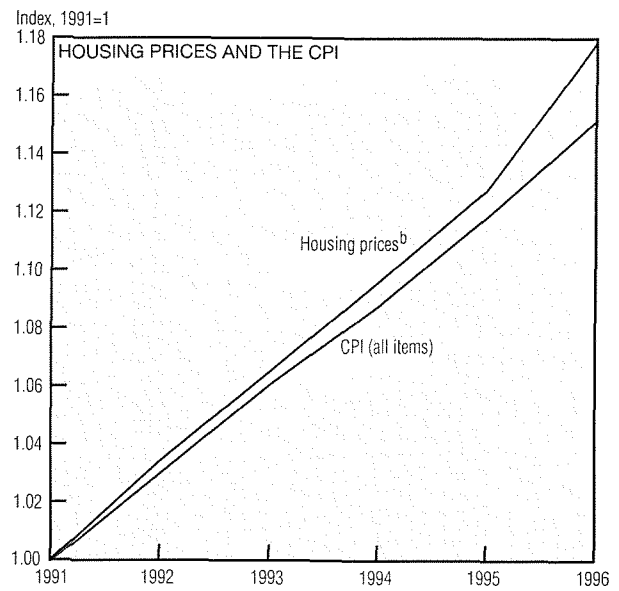
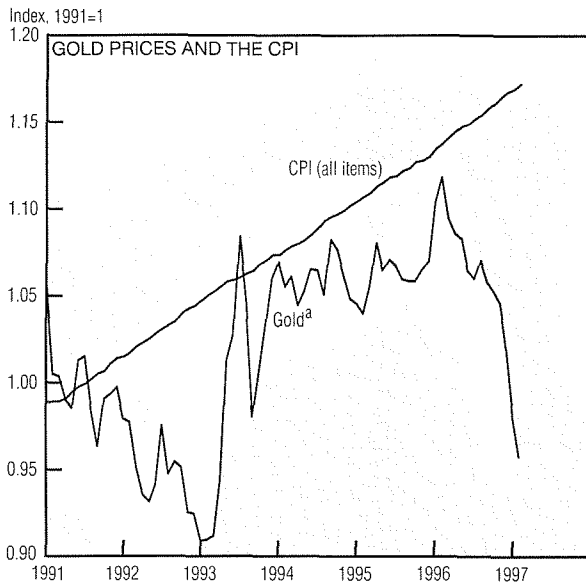
The consensus among economists, however, is that it can take two years or more for inflation to re-

spond to a monetary policy action, and that this lag forces policymakers to be forward-looking in their fight to keep prices stable. Indeed, the commentary accompanying the rate hike suggests that the FOMC's move was intended to head off a growing *potential* for higher inflation, rather than to stem an immediate uptick in the price data.

The FOMC's central tendency projection shows CPI growth holding at just under 3% this year—a  
*(continued on next page)*



# Inflation and Prices (cont.)



- a. Handy and Harman base price, New York.
- b. Median sales price, existing single-family homes.
- c. Nominal value of land and buildings, per acre.
- d. Standard & Poor's stock price index, composite.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Agriculture, Economic Research Service, Natural Resources and Environment Division; National Association of Realtors; Standard & Poor's Corporation; and *Metals Week*, various issues.

few tenths of a percentage point below last year's rise. The latest Blue Chip survey of economists predicts the inflation trend will remain steady at around 3% in 1998 as well.

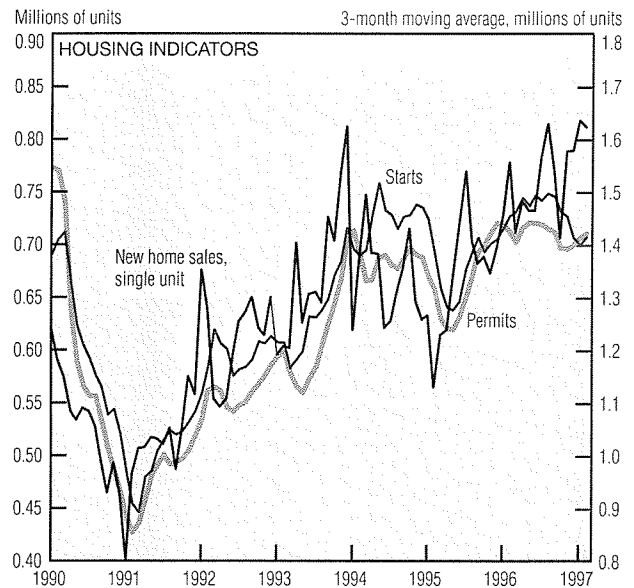
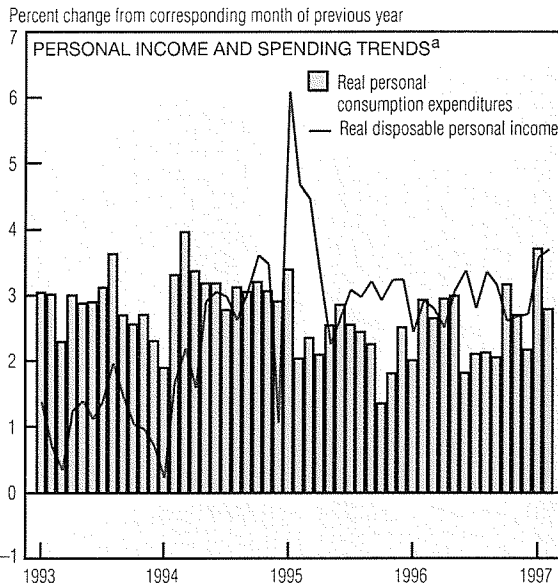
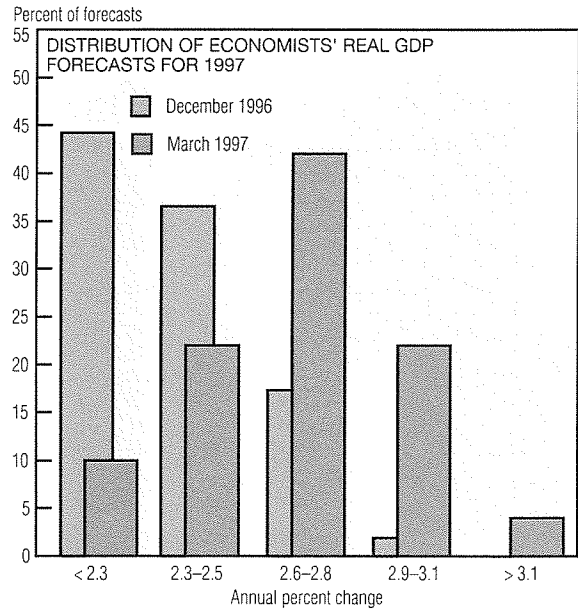
The leading indicators of inflation continue to be inconclusive and extremely mixed. Survey data from purchasing managers indicate that the net downward pressure on costs may have dissipated, but as of yet, there has been no significant acceleration in industrial prices.

Economists often cite the price movements of "inflation-hedged" assets as evidence of a growing inflationary psychology among investors. But of these, there appears to be an indicator for every conceivable point of view. Gold prices, a highly touted inflation predictor, have fallen in real terms since 1991, and sharply so since early last year. By contrast, median home sale prices have climbed at approximately the same rate as the CPI since 1993, and the price of

farm land has risen twice as fast. But perhaps the most troubling indicator of potential inflation has been the dramatic rise in equity prices. Although higher equity values (or any asset price rise, for that matter) may reflect "real" developments like greater economic potential, some part of this increase may be associated with investor anticipation of higher *nominal* earnings due to future inflation.

# Economic Activity

Real GDP and Components, 1996:IVQ <sup>a</sup> (Final estimate)	Change, billions of 1992 \$	Percent change, last:	
		Quarter	Four quarters
Real GDP	65.2	3.8	3.1
Consumer spending	39.0	3.4	2.7
Durables	7.5	5.0	5.4
Nondurables	6.4	1.8	1.8
Services	25.0	3.8	2.6
Business fixed investment	10.6	5.5	9.5
Equipment	-1.3	-0.9	9.7
Structures	11.2	26.0	9.1
Residential investment	-1.2	-1.7	3.9
Government spending	-2.7	-0.8	1.9
National defense	-5.5	-6.8	0.2
Net exports	39.0	—	—
Exports	46.8	25.0	7.4
Imports	7.8	3.3	8.3
Change in business inventories	-17.2	—	—



a. Chain-weighted data in billions of 1992 dollars.

NOTE: All data are seasonally adjusted.

SOURCES: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; and *Blue Chip Economic Indicators*, December 10, 1996 and March 10, 1997.

The nineteenth-century historian Thomas Carlyle once suggested that economics was simply a matter of supply and demand. Although this may be true, determining whether economic changes reflect supply or demand is no simple matter. The distinction is crucial, however, because demand pressures raise output and lift prices, whereas supply pressures raise output and lower prices. The fact that recent strength in actual (and projected) output growth was not accompanied by accelerating inflation suggests that

supply effects may be especially important. The difficulty, of course, lies in assessing their future strength and contribution to growth.

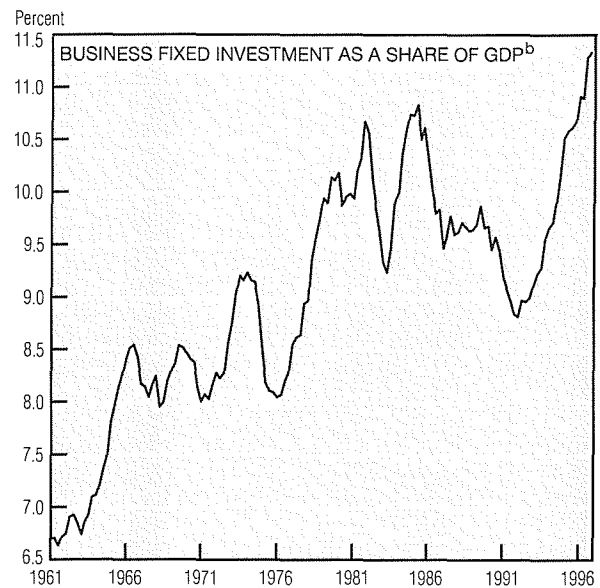
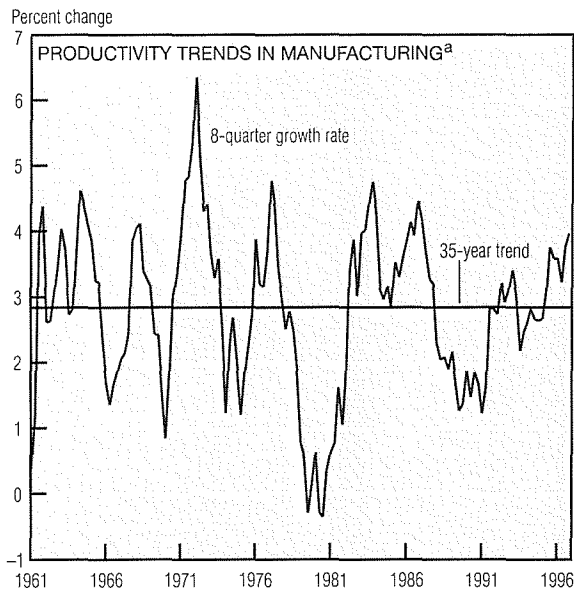
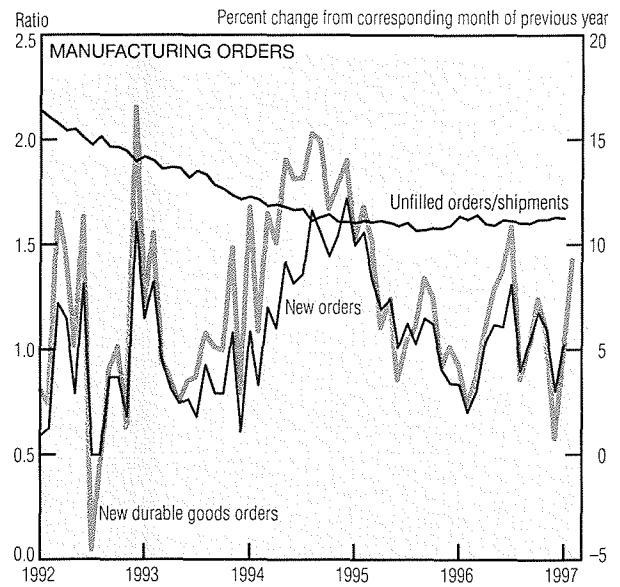
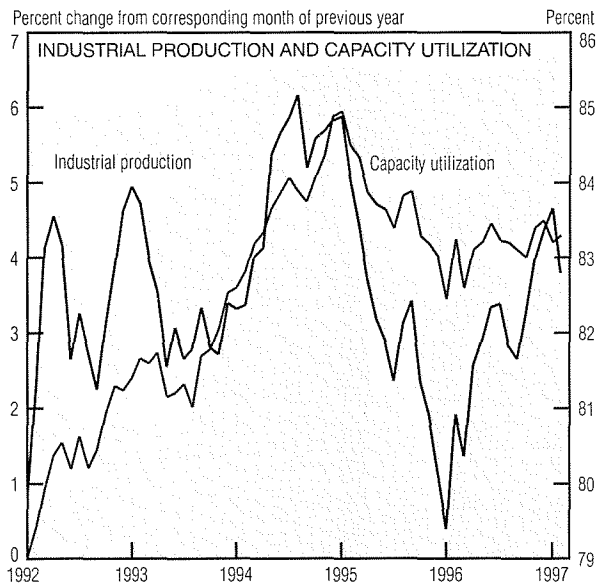
With a strong push from exports and consumer spending, real GDP advanced 3.8% in 1996:IVQ, raising last year's overall GDP growth to 2.4% (year over year) from 2.0% in 1995. Despite the faster pace of output growth, the GDP price index increased only 2.1% in 1996, compared with 2.4% in 1995. Continued strength in the consumer and manufacturing sectors, together with low

inventory levels, have prompted economists participating in March's Blue Chip survey to revise their outlook for 1997 economic growth upward, without raising their inflation projections.

Real disposable personal income continued to climb in February, advancing 3.7% on a year-over-year basis, while consumer outlays, slowing slightly, were up 2.8%. Consumer attitudes remain positive, as sales of new and existing homes attest. Housing starts climbed 12.2% in

*(continued on next page)*

## Economic Activity (cont.)



a. Output per hour.

b. Chain-weighted data in 1992 dollars.

NOTE: All data are seasonally adjusted.

SOURCES: 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.

February, their highest level in almost three years, while permits grew 3%, reversing January's decline.

Industrial output continued to show surprising strength in February, rising 3.8% on a year-over-year basis. New orders for durable goods were up 1.5%, following January's 4.1% gain. Factory orders for all manufactured products increased 2.5% in January. The ratio of unfilled orders to shipments remains low, giving little evidence that bottlenecks are developing. Indeed,

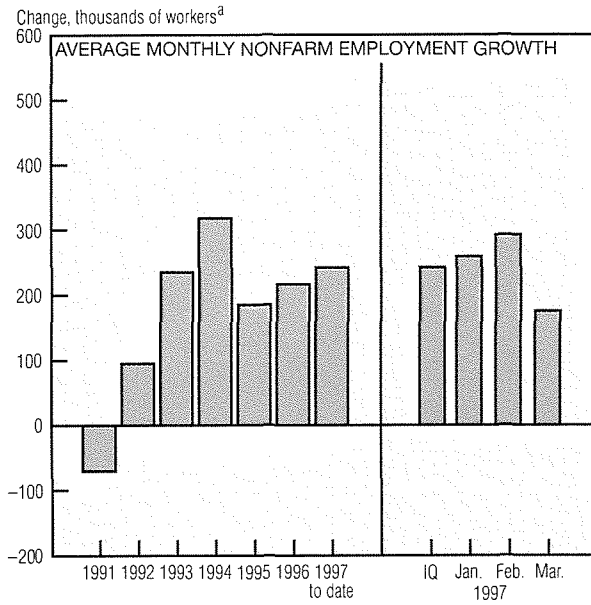
capacity utilization remains under 85%, a level often associated with capacity constraints.

The economy's ability to accommodate growing demand without price increases depends largely on the pace of labor productivity and the accumulation of capital. Overall nonfarm productivity growth has been a lackluster 1.1% per year over the current business expansion. The nonfarm sector, however, includes a growing service component, in which productivity is notoriously difficult to measure and probably un-

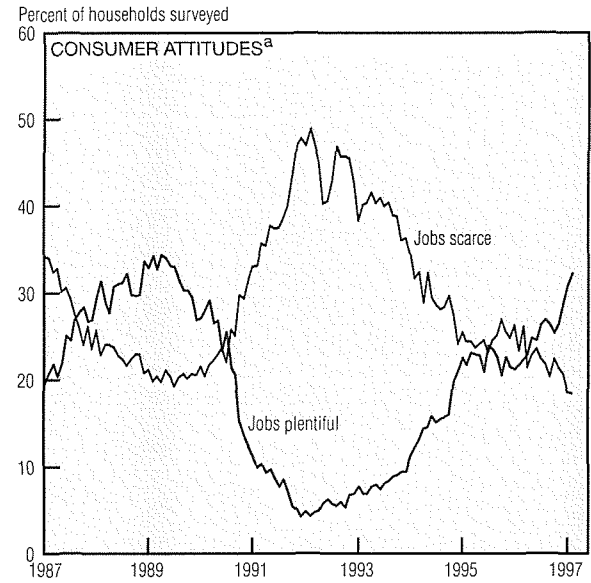
derstated. Productivity in the manufacturing sector, which is easier to gauge, has grown at a healthy 3.4% annual rate over the same period.

In addition, the U.S. is experiencing an unprecedented boom in business fixed investment. Most of this is attributable to computers, which should enhance workers' productivity, especially in many service industries. In view of these developments, many economists now wonder whether we accurately capture supply-side contributions to the economic outlook.

# Labor Markets



	Average monthly change (thousands of employees)				
	1996 Year	1997 IQ	1997 Jan.	1997 Feb.	1997 Mar.
Payroll employment	216	242	259	293	175
Goods-producing	16	48	43	114	-12
Manufacturing	-8	15	26	3	16
Construction	25	32	15	108	-27
Service-producing	199	194	216	179	187
Services	100	109	150	67	111
Retail trade	50	13	-9	6	43
Government	15	15	20	43	-19
Household employment	232	440	725	-150	745
Average for period					
Civilian unemployment rate (%)	5.4	5.3	5.4	5.3	5.2
Manufacturing workweek (hours) <sup>b</sup>	41.5	41.9	41.7	41.9	42.1
Labor force participation rate (%)	66.8	67.2	67.2	67.0	67.3



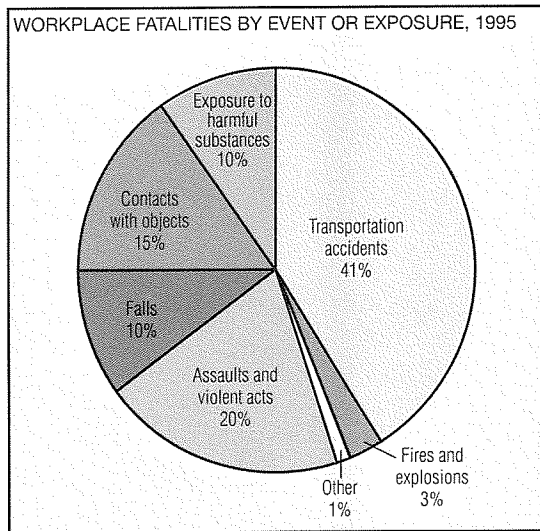
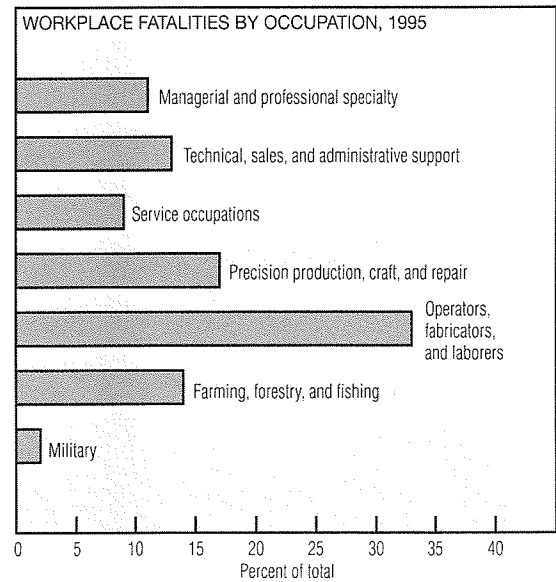
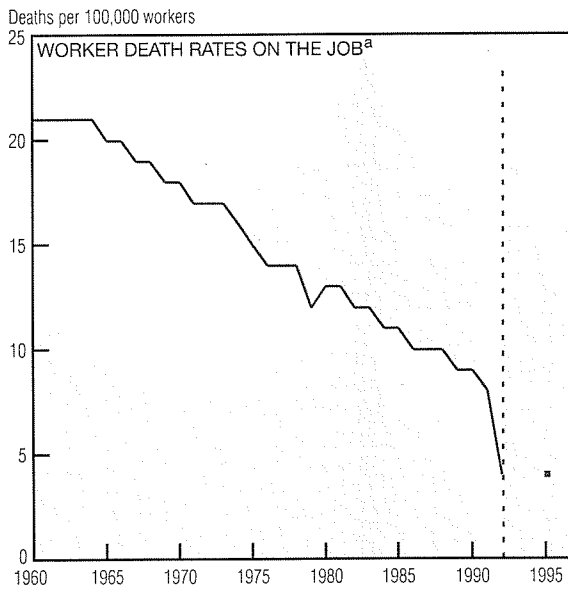
a. Seasonally adjusted.  
 b. Production and nonsupervisory workers.  
 c. Vertical line indicates break in data series due to survey redesign.  
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics; and The Conference Board, *Consumer Confidence Survey*, March 1997.

Despite slower employment growth in March, the labor situation continues to brighten. Nonfarm payrolls advanced at a moderate pace (175,000 net new jobs). Average hourly earnings showed their largest year-over-year increase since 1990 (up 4.0%, to \$12.15), while the unemployment rate declined 0.1%, to 5.2%. In addition, the labor force participation rate (67.3%) and employment-to-population ratio (63.8%) hit record highs last month.

Goods-producing employment was weak in March (down 12,000), as the construction industry pared 27,000 jobs. This drop followed an unusually large February gain. With an overall increase of 187,000, the service-producing sector more than accounted for jobs growth in March. Within the narrow services category, which encompasses a range of establishments, including hospitals, engineering firms, and hotels, the gain resulted primarily from growth in

health and business services. In contrast, government trimmed its payrolls by 19,000 last month, after adding 43,000 jobs in February. Overall, the public appears more optimistic about the employment picture. A survey of consumer confidence put the percentage of respondents who believe jobs are plentiful at 32.3%, about 14 percentage points above those who think jobs are scarce. This is the survey's most favorable showing since July 1989.

# Workplace Fatalities



Occupation	Leading fatal event	Percent of occupational group deaths
Truck drivers	Highway crashes	68
Farm workers	Vehicular	50
Construction laborers	Vehicular	28
Supervisors, proprietors, and sales workers	Homicide	63
Nonconstruction laborers	Vehicular	36
Police, detectives, and supervisors	Homicide	47
Electricians	Electrocutions	59
Cashiers	Homicide	92
Airplane pilots	Plane crashes	98
Taxicab drivers	Homicide	70

a. Dotted line represents break in data series due to change in estimating procedure.  
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics, Census of Fatal Occupational Injuries; and National Safety Council.

Real wages represent only one aspect of the employment contract. Another aspect is working conditions, especially the safety of the environment. An extreme measure of safety is fatalities on the job. These have fallen inexorably since 1965, so that the chance of dying on the job is now only one-fifth of what it was a generation ago.

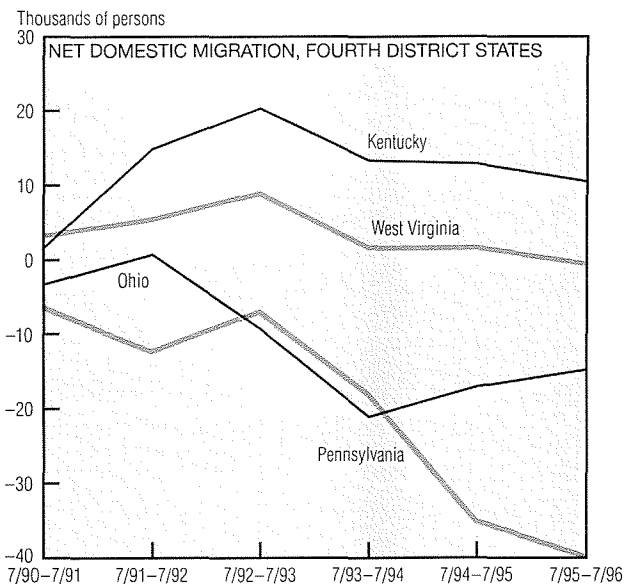
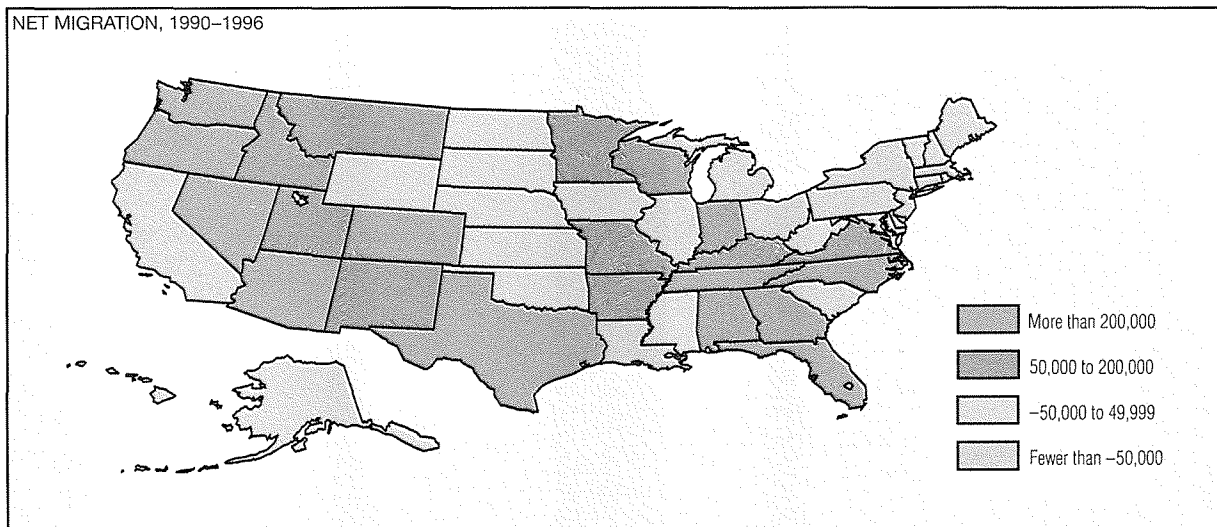
The number of total workplace fatalities is very low (4 per 100,000 workers in 1995). This is less than the rate of deaths from accidental

falls (5.1) and is much smaller than the death rates from accidents or violence (57.3) when measured for the entire population during both working and nonworking hours. The workplace of today clearly is a safer place when measured by fatalities.

The composition of fatalities has also changed, partly because of shifts in the composition of the labor force. Forestry and fishing remain very dangerous occupations, but they employ less of the workforce, so that accidents associated with

them (being struck by an object or drowning) are now a small proportion of total workplace deaths. In spite of their prominence on television newscasts, fires and explosions cause only a minor fraction of deaths. Even without the occupational shifts, data from dangerous occupations such as mining, when available, indicate a decline in fatality rates. Now, the top two causes of workplace deaths are transportation accidents and homicides, by a fairly large margin.

# Interstate Population Migration



	OH	PA	KY	WV
Mining	-0.1	-0.2	-1.0	-1.5
Construction	-0.3	-0.6	-0.1	0.7
Manufacturing	-3.0	-1.8	-0.5	-1.2
Durable goods	-2.0	-1.0	0.1	-0.7
Nondurable goods	-1.0	-0.8	-0.6	-0.6
Transportation and public utilities	-0.1	0.0	0.3	-0.3
Trade	-1.0	0.0	0.2	1.4
FIRE <sup>a</sup>	-0.2	-0.1	-0.2	0.0
Services	2.2	2.5	1.7	1.5
State and local government	1.8	0.4	-0.5	-0.7

a. Finance, insurance, and real estate.  
 SOURCES: U.S. Department of Commerce, Bureau of the Census; Ohio Bureau of Employment Services; Kentucky Department of Employment Services; Pennsylvania Department of Labor and Industry; and West Virginia Bureau of Employment Programs.

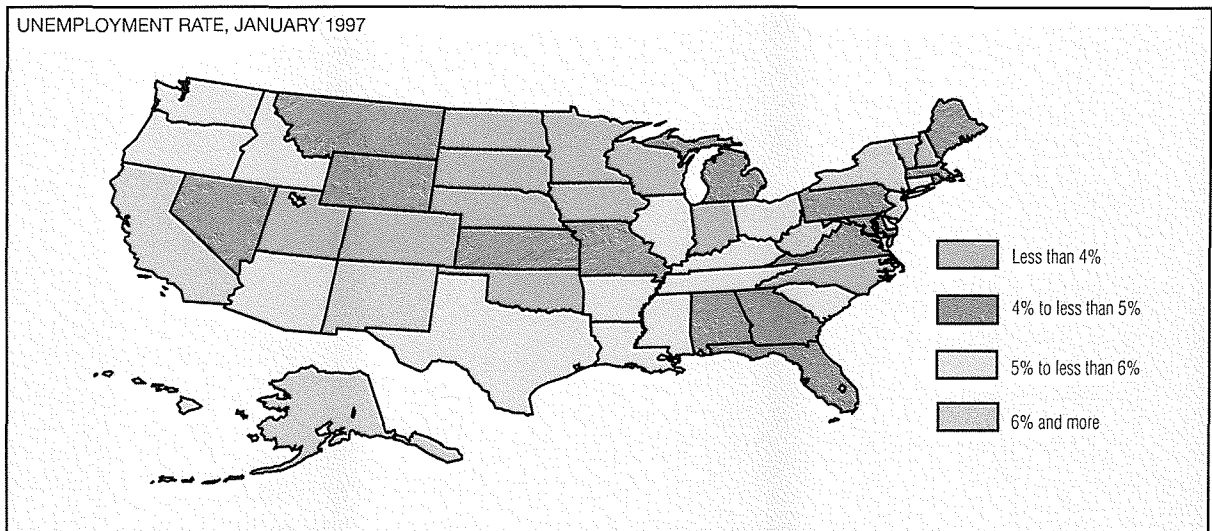
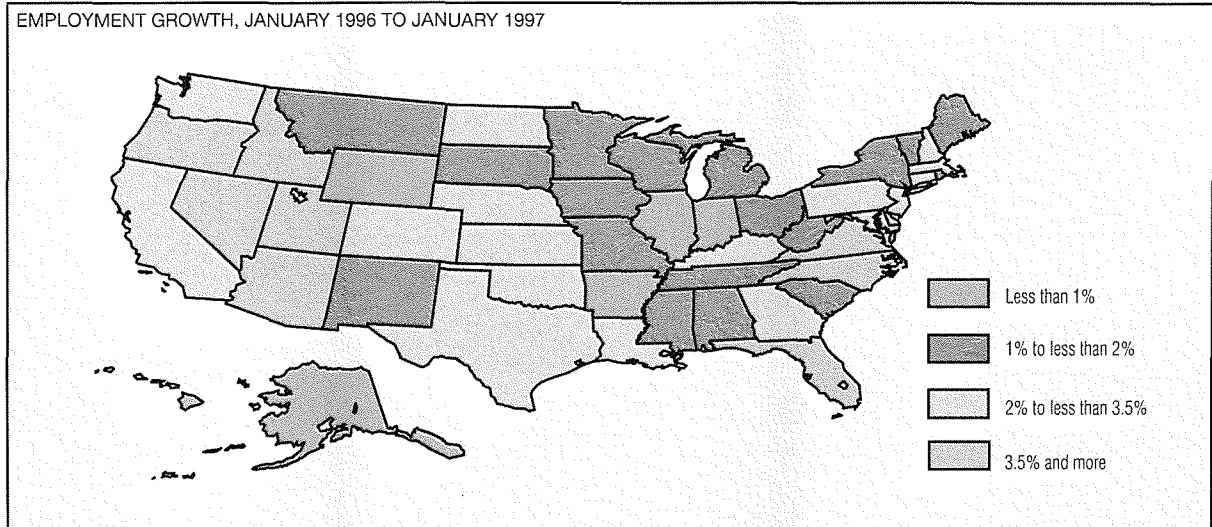
Migration patterns over the past seven years show that Rust Belt states continue to experience out-migration. The largest net loss, however, occurred in California, where nearly 2 million more people left the state than entered. The other big losers were New York, Illinois, and New Jersey. The Southeast and Southwest were the biggest population gainers. The state with the largest in-migration was Florida, which gained nearly 800,000 more people than it lost.

It is interesting to note that the four states listed above as big net migration losers had higher-than-average unemployment rates. The states with the lowest unemployment rates, however (which are mainly in the Midwest) were not the biggest gainers of net migration.

In the Fourth Federal Reserve District, both Ohio and Pennsylvania have seen more people leave than enter since the beginning of the decade, while for Kentucky and West Virginia the reverse was true. Ohio

and Pennsylvania also experienced the largest manufacturing sector declines, with employment shares in manufacturing industries falling 3.0 and 1.8 percentage points, respectively. West Virginia gained employment in wholesale and retail trade, and all the Fourth District states increased their shares of employment in the service sector. Government was the only other sector to show any substantial employment gains, but these were limited to Ohio and Pennsylvania.

# State Employment Patterns



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Regional labor market data from January 1996 to January 1997 show a pattern of widespread growth across the country, with a 2.2% overall increase in employment. By far the largest gain was posted in Nevada (nearly 7.5%).

The January figures show a much more balanced regional distribution of growth than the comparable statistics for May 1994 to May 1995. During that earlier period, 19 states grew at about twice the national average of 1.3%, while six states registered employment declines.

The recent numbers show that only four states had employment

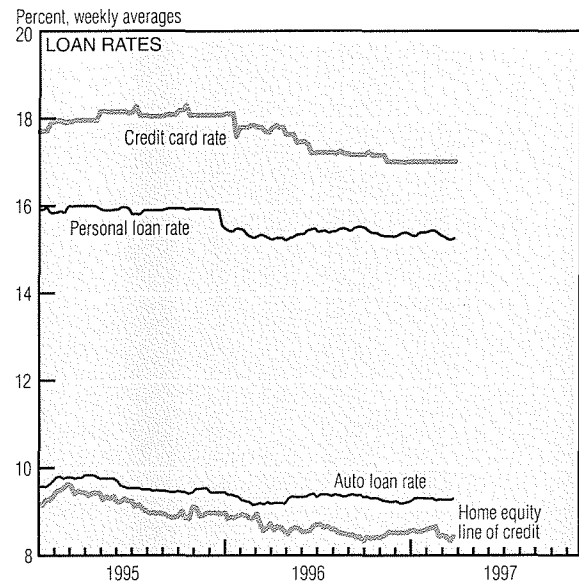
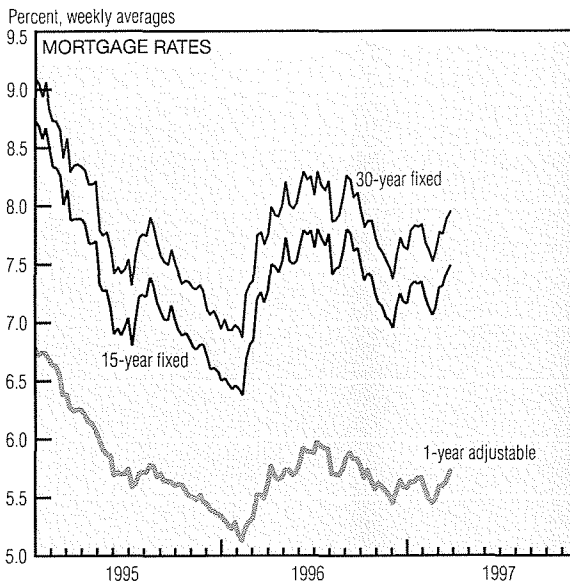
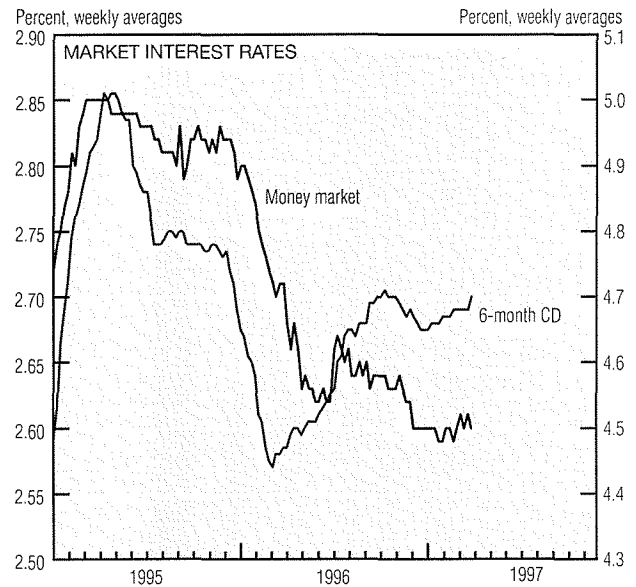
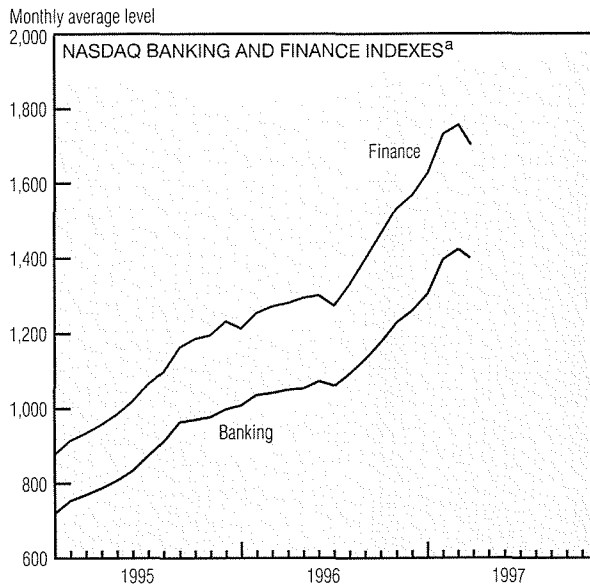
growth at or above twice the national average, and only the District of Columbia experienced a decline, losing nearly 2% of its jobs. The three largest increases came from the West: Nevada, Arizona, and Utah. Even California, which has suffered job declines over the past several years, boosted employment by nearly 3%. However, after the District of Columbia, the three states with the slowest growth—Wyoming, Hawaii, and Alaska—were also in the West.

In the Fourth Federal Reserve District, only Pennsylvania's growth surpassed the national average. The

smallest employment gains (about 1.5%) occurred in Ohio.

Another indicator of regional labor market conditions is the state unemployment rate. Although there are several instances where low growth and high unemployment coincide—such as in the District of Columbia and Alaska—there are other cases where they are positively related. Indiana and South Dakota have unemployment rates much below the national average, but have experienced sluggish job growth compared to the nation as a whole. California, on the other hand, has relatively high unemployment but brisk jobs growth.

# Banking Conditions



a. The last data point in both series is a daily quote for March 27.  
 SOURCES: DRI/McGraw-Hill; and *Bank Rate Monitor*, various issues.

The run-up in bank share prices has recently abated. This is consistent with concerns about possible overvaluation of bank stocks and reports that bank insiders have been selling stocks for months. Insider sales may indicate that those with superior information about bank prospects anticipate weaker earnings down the road. Once made public, this infor-

mation could precipitate a drop in prices. If this interpretation is correct, news of insider selling could itself trigger a sell-off and price decline.

Anticipation of higher interest rates and tighter loan markets may also be dampening investors' enthusiasm. However, short-term market interest rates have shown little movement in the last few months. Some commentators indicate that

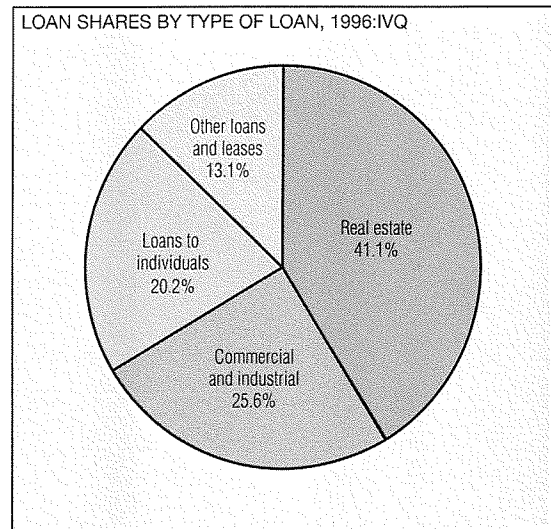
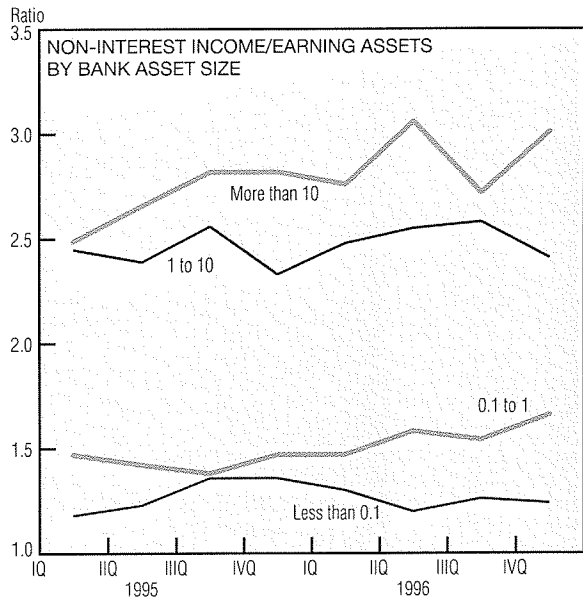
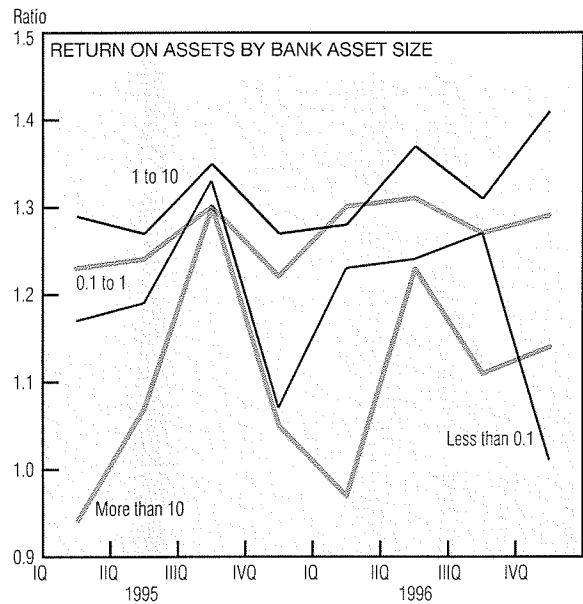
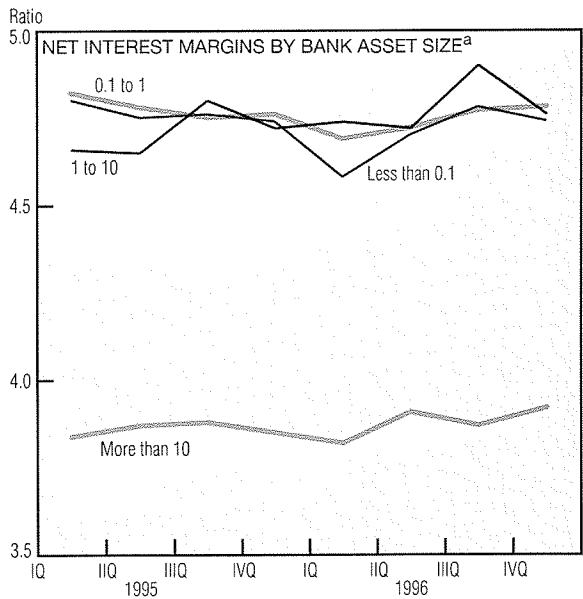
the recent firming of mortgage rates may have been related to anticipation of short-term interest rate hikes. On the other hand, rates for both personal and home-equity loans have dropped.

Credit card rates have shown little movement since last November; such loans remain one of commer-

*(continued on next page)*



# Banking Conditions (cont.)



a. Net interest margin is the difference between the yield on earning assets and the cost of earning assets, expressed as a percentage of average earning assets.  
 NOTE: All bank asset size ranges are expressed in billions of dollars.  
 SOURCE: FDIC, *Quarterly Banking Profile*, various issues.

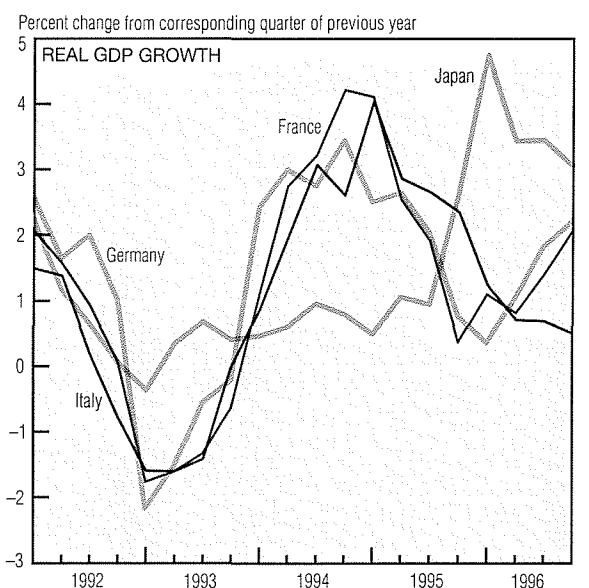
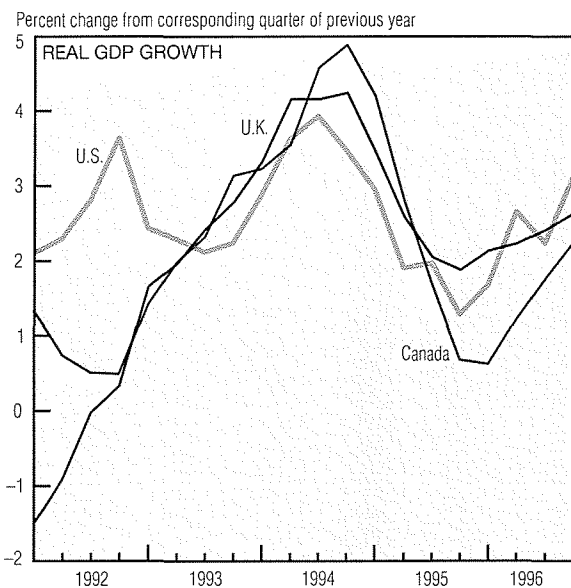
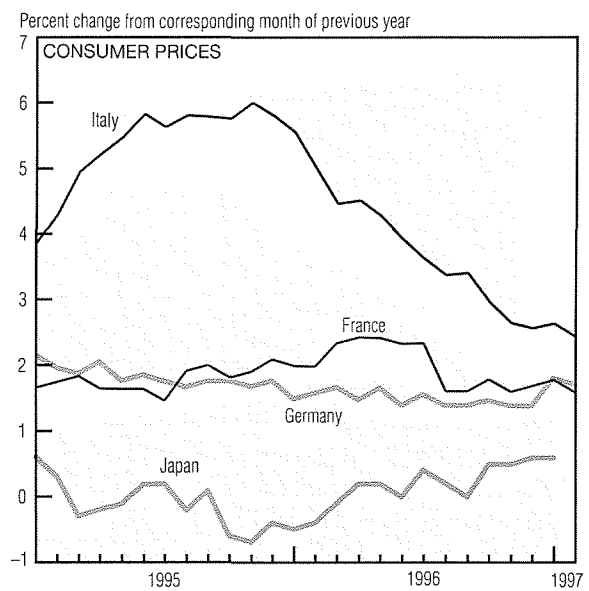
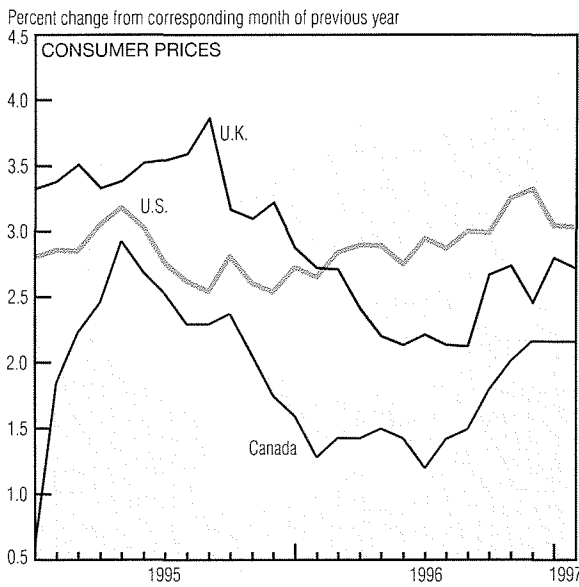
cial banking's most profitable areas. News that credit card delinquencies reached a record high at the end of 1996 comes as a disappointment in the wake of some banks' efforts to tighten credit card standards and reduce mail solicitations.

Insured commercial banks reported the third-highest earnings total in history for 1996:IVQ, and the

return on assets was the second-highest ever. The largest boosts to earnings came from increased non-interest income (up 13.3% since 1995:IVQ) and net interest income (up 6%), the latter being boosted by both wider interest margins and greater interest-earning assets. Net interest margins at large banks rose the most, mainly because of lower funding costs.

Noncurrent loans (those 90 days or more past due and those in nonaccrual status) declined, mainly as a result of higher net charge-offs. However, noncurrent consumer loans increased, and consumer loans also had the largest share of the increase in delinquent loans (those with interest payments 30 to 89 days past due).

# Foreign Output and Prices



SOURCES: Statistics Canada; Institut National de la Statistique et des Études Économiques (France); Statistisches Bundesamt; Deutsche Bundesbank (Germany); Instituto Centrale di Statistica (Italy); Statistics Bureau of the Japanese Prime Minister's Office; Bank of Japan; Office of National Statistics (U.K.); U.S. Department of Labor; and U.S. Department of Commerce.

Foreign economic activity continues its moderate expansion, while inflation pressures remain subdued. Economists, who notched up their outlook after a better-than-expected fourth quarter, anticipate that growth among our 10 largest industrial trading partners will average approximately 2.5% this year and next.

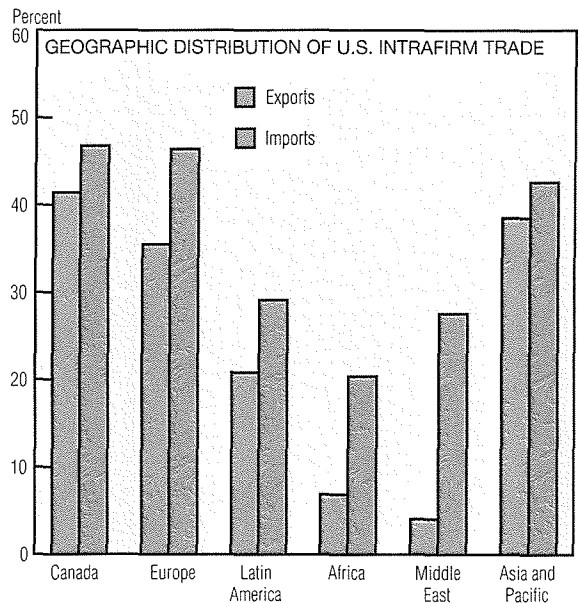
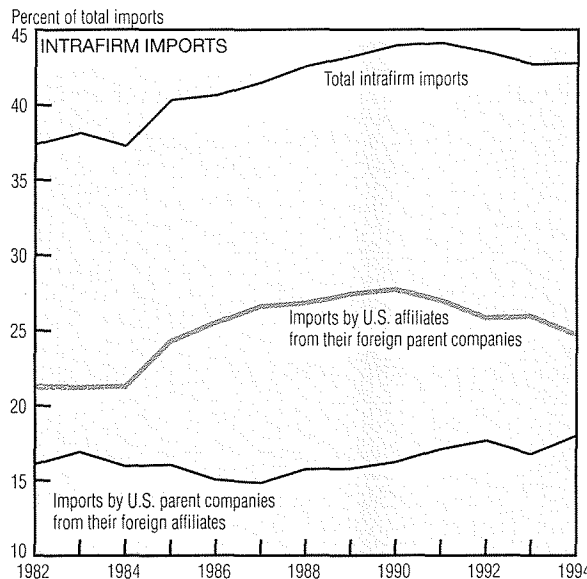
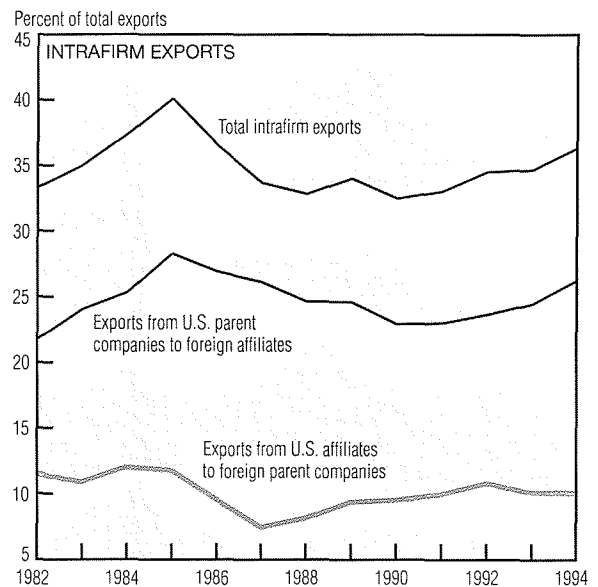
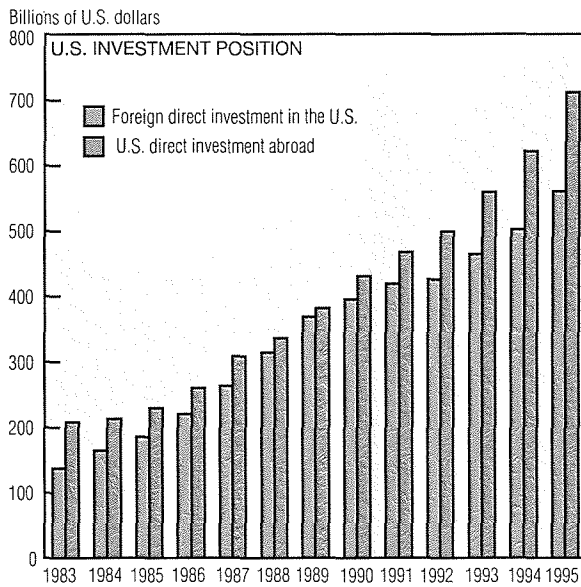
Japanese real GDP rose 3% over the four quarters ending in 1996:IVQ, with consumer spending and net exports leading the gains.

Investment spending slowed. Industrial production increased a brisk 5.3% in January, while the unemployment rate for the month remained at 3.3%, only slightly below its post-World War II high of 3.5%. Inflation in Japan remains below 1%.

German output expanded at a sluggish 2.0% in 1996:IVQ (on a year-over-year basis). Concurrently, net exports and consumption spending (both private and government) weakened. Industrial production fell 1.7% in January, largely be-

cause bad weather slowed down construction activity. Germany's unemployment rate rose to a record post-World War II high of 11.3% in January and remained there in February. Its budget deficit widened to 3.9% of GDP in 1996 from 3.5% the previous year. With unemployment running at historically high levels, the country will have difficulty meeting the 3% deficit target for the European monetary union. Inflation in Germany remains below 2%.

# Intrafirm Trade



SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Survey of Current Business, February 1997, pp. 23-28.

International direct investment surged in the late 1980s. Both U.S. direct investments in foreign countries and foreign investments in the U.S. have been growing rapidly, with the former exceeding the latter by a widening margin. Multinational corporations undertake most of these worldwide investments in order to remain competitive in foreign markets, to lower their resource and labor costs, and to gain tax advantages.

Multinational firms also play a significant role in global trade flows. Intrafirm trade, for example, accounts for over 35% of U.S. exports and more than 40% of imports. This trade seems to originate at the parent firm. U.S. intrafirm exports consist mainly of shipments from parent firms to their foreign affiliates, as opposed to exports of foreign-owned firms in the U.S. Similarly, U.S. intrafirm imports flow from a foreign parent to its domestic affiliate.

U.S. intrafirm exports travel mainly to developed parts of the globe, whereas the nation's intrafirm imports are more widely dispersed. The U.S. has maintained a deficit in its intrafirm trade. In 1994 (the latest year for which data are available), that deficit amounted to \$97 billion, or 65% of the total trade deficit. The deficit is at its widest in our intrafirm trade with Africa and the Middle East.