

The Economy in Perspective

Summertime (and the livin' is easy) ... It's hard to get excited about U.S. economic conditions when we are headed for vacation, in the middle of vacation, or nearing the end of vacation. Now is the time for highway construction, long lines, and pulp fiction on the beach; hardly the time for deep thoughts about record car sales, the employment cost index, or the Japanese banking system. Some might be curious, but all it takes to stifle their interest is a reminder that last summer they were worrying about the collapse of Asian financial markets, and to what avail? They've seen *Jaws* and they're still swimming.

Not that there are no circumstances to worry about. Demands on the U.S. economy could continue expanding so vigorously as to initiate accelerated inflation. Not only is inflation itself harmful to the economy, but the Federal Reserve could overreact to the threat and cause an economic downturn. Or the Federal Reserve could *not* react to the threat, allowing inflation to drift up gradually until it had to respond, then overreacting to the reality and causing an economic downturn. Or the economy could slow of its own accord, raising a threat that the slowdown would eventually develop into an economic downturn. People who are predisposed to worry about downturns can find plenty of places to look.

Then there is the federal budget debate. We could worry that the \$1 trillion budget surplus projected to accumulate in the next decade will fail to materialize. This would become even more relevant if the economic downturn aficionados prove correct. We could fret that the tax cuts under consideration will not leave much room for outright debt reduction (interest on the debt comprises a healthy chunk of current federal outlays). We could fret that the spending proposals under consideration will not leave much room for debt reduction either. Debt reduction, after all, should lower interest rates and boost our capacity to deal with future spending needs such as Social Security and health care reform.

Even with all the worrying we have already done about it, we could stew some more about the stock market. Equity values remain high relative to current earnings, suggesting that future profits will stay strong and even strengthen further. Income from capital gains, along with additions to wealth generated by unrealized capital gains, has fueled consumption spending. Should we worry that if the stock market merely levels

out, then consumption spending will slow, perhaps causing an economic downturn? And what if—what if—the market should actually drop precipitously and not bounce back? Wouldn't the consequences be unspeakably horrible? Clearly, we would be justified in fearing an economic downturn under those circumstances.

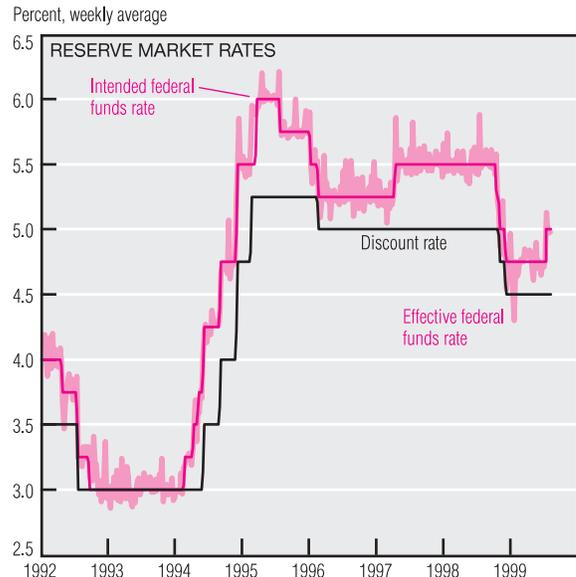
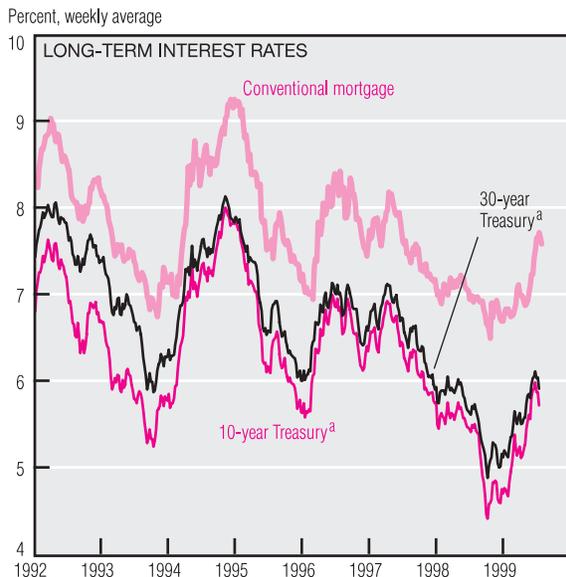
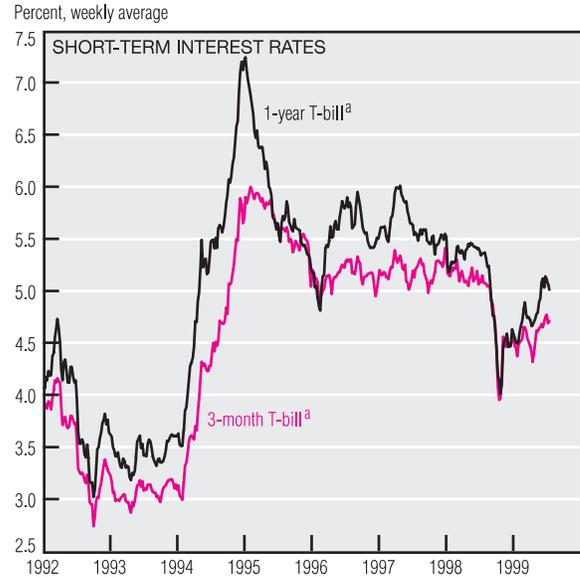
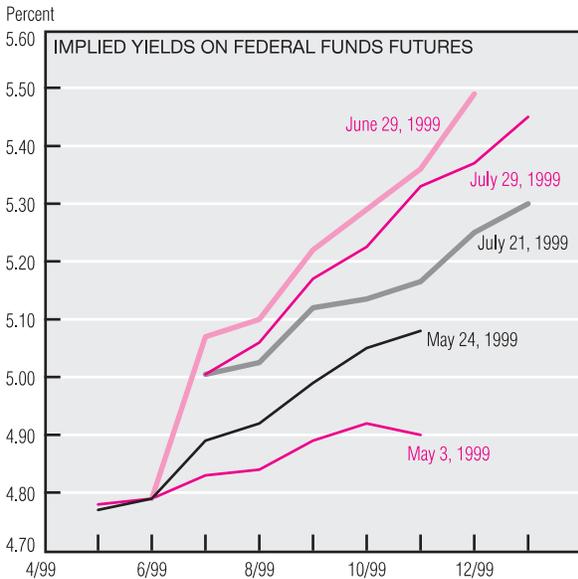
And if we don't have enough domestic worries, surely there are foreign problems worth wringing our hands over. Japan, for example. The Japanese economy still lies fallow, despite several years of remedial policy plowing. Surely national output will sprout anew, but when—and at what cost to the financial system and the government? What if the government is no longer willing or able to engineer a smooth workout of the bad debts on the books of Japanese financial institutions? And what if Japan's economic problems, left to fester, result in China's ascendance as the premier economic power in Asia? Like Japan, China runs substantial trade surpluses with the United States and it brings additional political issues to the table. Shouldn't we be worried about all of this?

And let's not forget Mexico and the rest of Latin America. Can we be sure the tumult that beset the region last year has really been calmed? Shouldn't we be concerned if Argentina doesn't abandon its currency in favor of the U.S. dollar? Shouldn't we be concerned if it does? Mexico faces a presidential election next year; if there ever was an event to worry about, surely this is one. Won't there be trouble no matter what happens?

If the rest of the world continues to limp along behind the United States, won't we eventually be dragged into a worldwide slump? If the rest of the world recovers its health, won't the U.S. economy be at risk of inflation? And if everything remains the same for a while longer, won't the inevitable (whatever that may be) only be postponed, but not prevented?

We're agreed then, that there is more than enough to worry about. One cannot listen to the financial press most days without concluding that storm clouds lurk just beyond the horizon of our sunny economic sky. But when you close your eyes and swear you smell barbecue sizzling on the grill and hear the rhythm of steel-drum music pulsing through a saltwater breeze, you can be forgiven a brief period of euphoria. Deep down inside, you can't forget that life's a beach.

Monetary Policy



a. Constant maturity.

SOURCES: Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

Implied yields on federal funds futures provide market participants' best estimate of future monetary policy. Current yields reveal that market participants continue to anticipate at least one more rate increase before the end of the year. After an upward adjustment in the weeks just prior to the Federal Open Market Committee's (FOMC) decision to raise the federal funds rate on June 29, expectations of further increases began to wane. As of July 21, the December contract

traded at 5.25%, which, although 25 basis points above the current target of 5.0%, was down from 5.5% one month earlier.

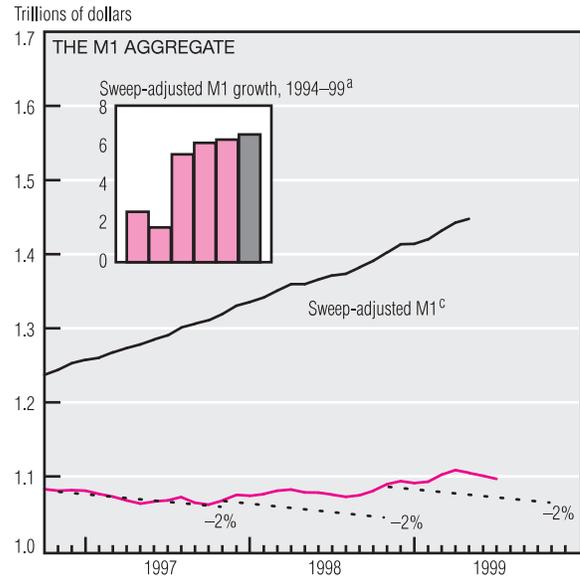
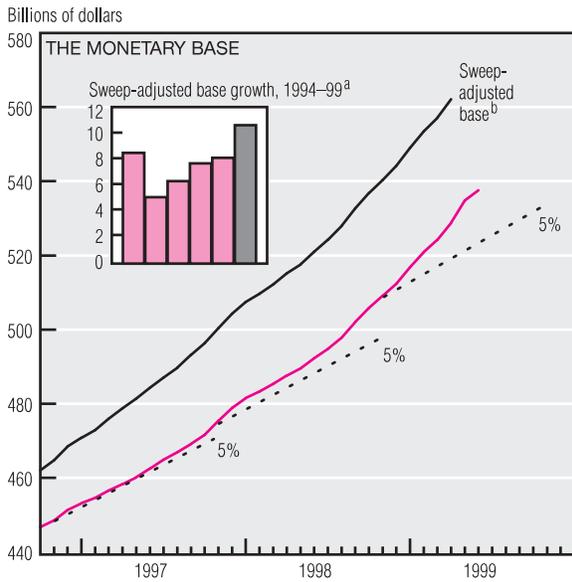
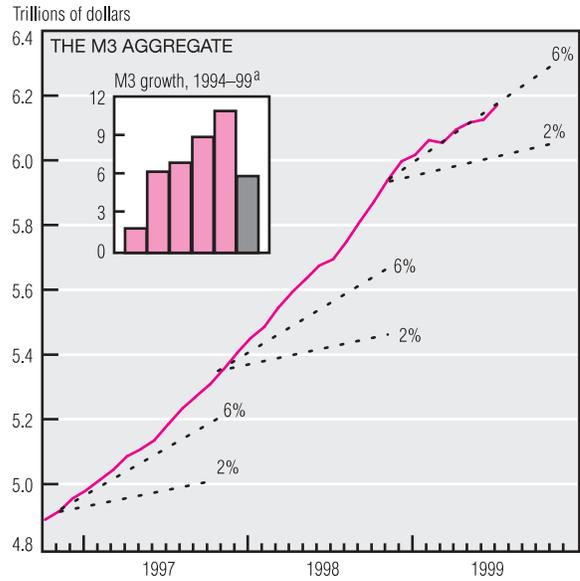
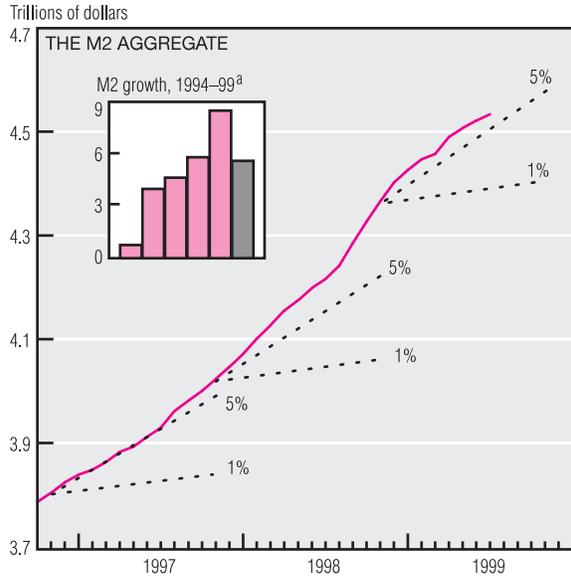
Expectations rallied once again to 5.45% following Chairman Alan Greenspan's biannual Congressional testimony on July 22. He explained that, although increases in productivity mitigated the need to raise rates above 5.0% at the time of the June meeting, continued improvement in the world economy and the tightness of the domestic labor market "suggest that the Federal Reserve

will need to be especially alert to inflation risks."

Short- and long-term interest rates, which had been rising steadily over the last six months, showed little change in July. As of July 23, yields on the 3-month and 1-year Treasury bills averaged 4.68% and 5.02%, respectively. Both instruments are down slightly from 4.71% and 5.1% during June. The 10-year Treasury bond also declined 13 basis points to average 5.77% over

(continued on next page)

Monetary Policy (cont.)



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 1999 growth rate for adjusted M1 and the adjusted base are calculated on a May over 1998:IVQ basis. The 1999 growth rates for M2 and M3 are calculated on an estimated July over 1998:IVQ basis.
 b. The sweep-adjusted base includes an estimate of required reserves saved when balances are temporarily shifted from reservable to nonreservable accounts.
 c. Sweep-adjusted M1 includes an estimate of balances temporarily shifted from M1 to non-M1 accounts.
 NOTE: Data are seasonally adjusted. Last plots for M1, M2, and M3 are estimated for July 1999. Dotted lines for M2 and M3 are FOMC-determined provisional ranges. All other dotted lines represent growth in levels and are for reference only.
 SOURCE: Board of Governors of the Federal Reserve System.

the same period. Although the 30-year Treasury bond and the 30-year conventional mortgage rate posted modest gains of eight and seven basis points over the previous month, there was a noticeable deceleration from the 15- and 40-basis-point gains that occurred from May to June.

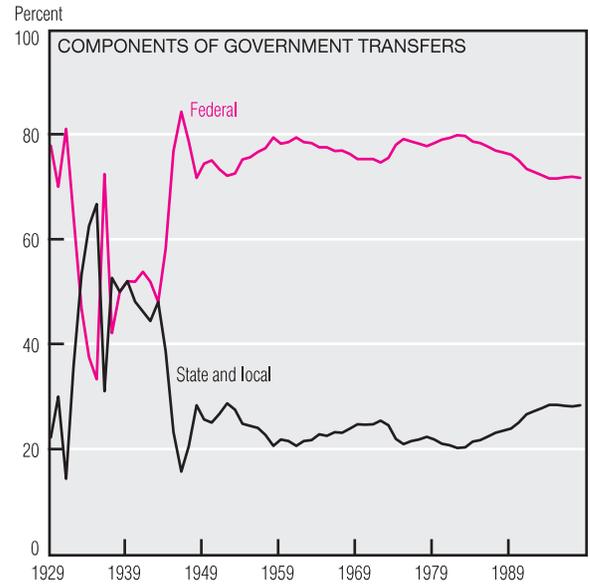
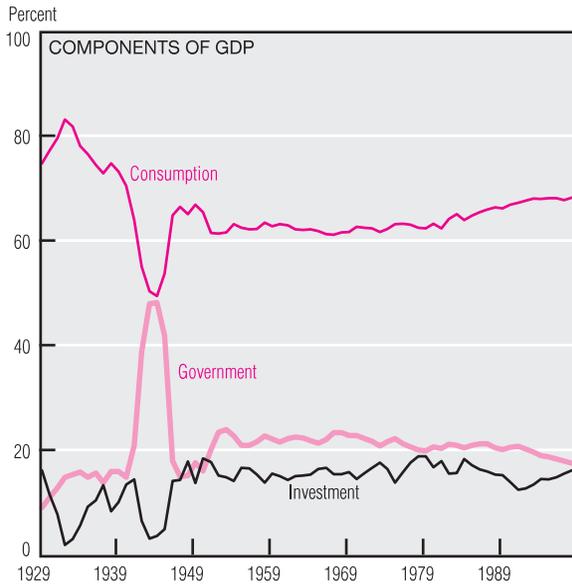
At its June meeting, the FOMC reaffirmed the established growth rate ranges for M2 and M3 at 1% to 5% and 2% to 6%, respectively. In addition, the Committee adopted the

same growth rate ranges for 2000 on a provisional basis. Growth rates in the broader money aggregates have been consistently at or above the upper bound of the established ranges over the past three years; however, growth rates have been moderating recently.

The FOMC lowered the target for the federal funds rate by a total of 75 basis points between August and December in response to financial market concerns. As opportunity costs fell, money demand

accelerated. The situation was exacerbated by the subsequent flight to quality that occurred when foreign and domestic investors, concerned about instability in developing markets, reallocated funds to U.S. Treasuries and money market funds. The well-documented recovery of many developing economies, as well as anticipated increases in the federal funds rate, have combined to reverse the rapid money growth which ensued.

Government in the Economy



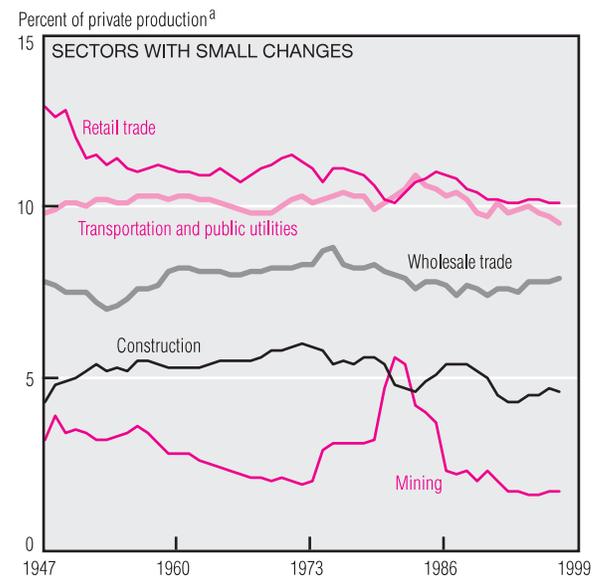
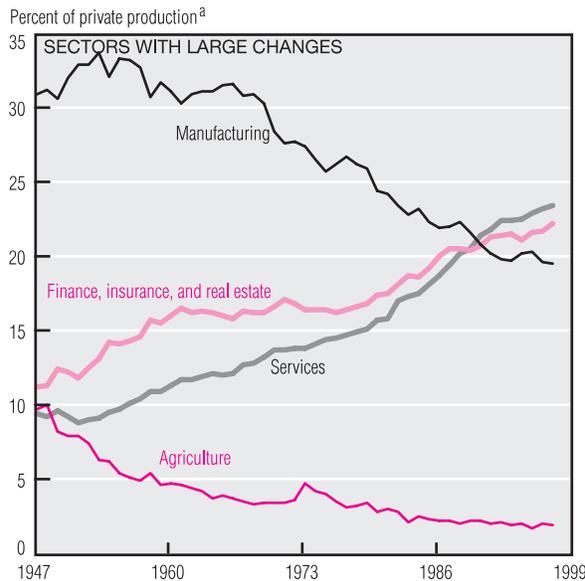
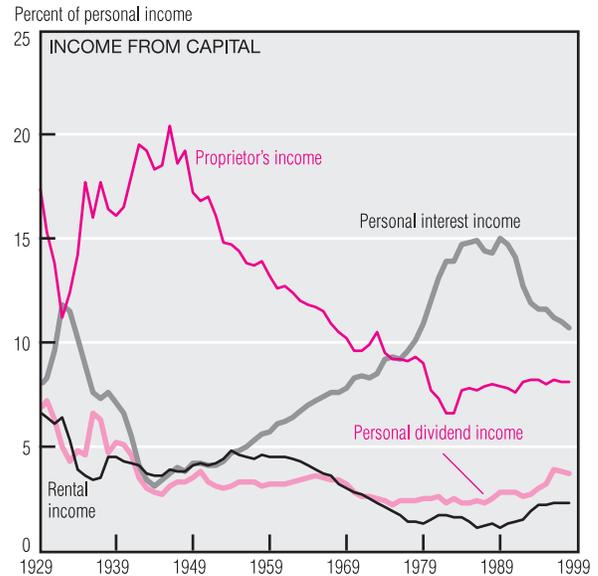
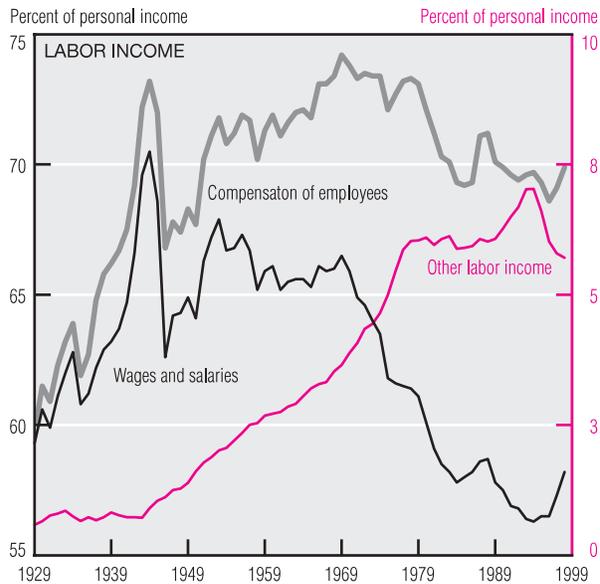
SOURCE: National Income and Product Accounts.

The major components of spending in the U.S. are consumption, investment, and government spending on goods and services; net exports are fairly small by comparison. It may surprise some to know that government's share of spending has remained fairly constant over the period 1929–98. (Reliable data prior to 1929 are not available.) With the notable exception of World War II, government's share of spending has been approximately 20% of the total.

Yet, as most Americans know, government takes a larger chunk of paychecks today than it did 70 years ago. Since 1929, the fraction of GDP collected in taxes has risen from 11% to 35%. State and local tax collection rose sharply through the 1930s and early 1940s, leveling off at around 20% of output. Between the end of World War II and the early 1970s, federal taxes rose from 5% to 13% of GDP, after which they leveled off.

It turns out that government today shuffles more money between Americans than in the past. In the 1930s, government transfers to persons were around 2% of GDP. Since the end of World War II, these transfers have risen fairly steadily to around 13.5% of output. Apart from the Great Depression and the war years, the federal government has made roughly 75% of total government transfers, with state and local governments making the remainder.

Income and Production



a. Private production is GDP minus federal, state, and local government.
SOURCE: National Income and Product Accounts.

What are the sources of American incomes? Since the end of World War II, labor income generally has averaged around 70% of total personal income. While wages and salaries form the bulk of labor income, various employee benefits have risen steadily since the 1940s, from less than 1% of personal income to a peak of 7% in 1994.

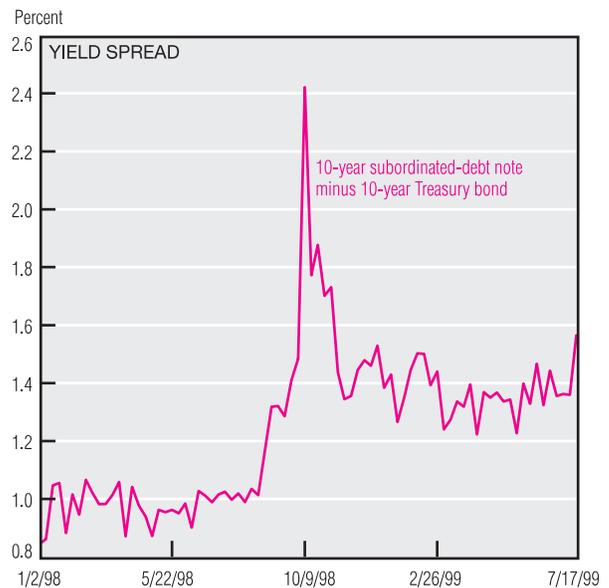
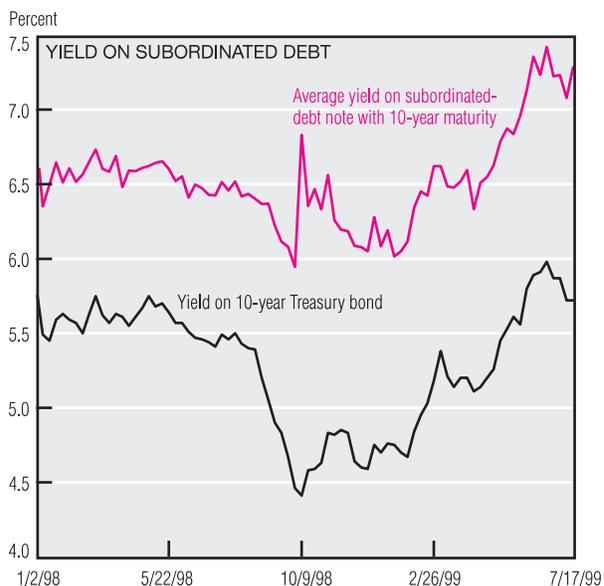
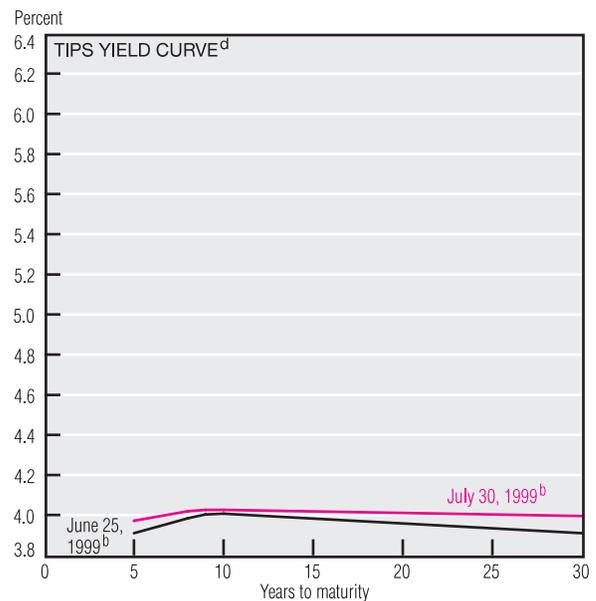
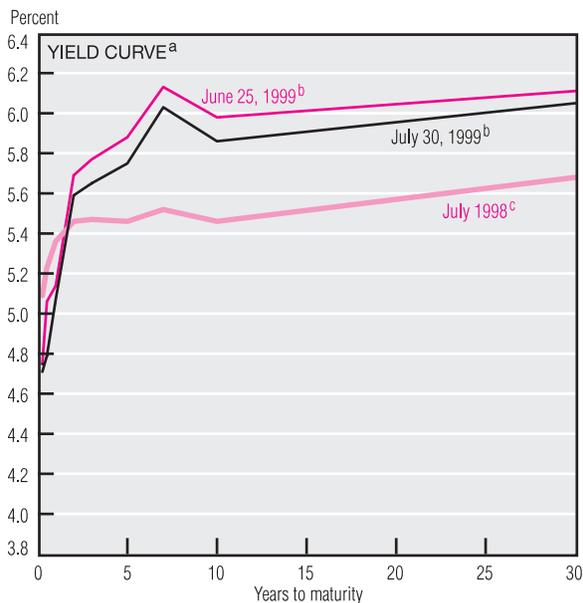
The remaining 30% of income is earned by capital. Since the end of World War II, proprietor's income has fallen steadily from 20% to 8%,

possibly as the result of a drop in small businesses. Interest income has exhibited a continual climb through the 1980s, when interest rates were high, but has fallen off more recently. Rental and dividend income are both fairly small components of total income and have not shown much by way of trend.

Which sectors of the economy generate U.S. output? Excluding government, the largest sectors are services, finance, insurance, and real estate (FIRE), and manufacturing, each

accounting for 19% to 23% of private production. However, both services and FIRE have been growing over time, while manufacturing has been shrinking. Agriculture's share of production has fallen from 10% of the total in 1947 to around 2% today. The remaining sectors of the economy show little trend in the postwar period. The rise in mining in the mid- and late 1970s is due to the run-up and subsequent decline in the real price of oil.

Interest Rates



- a. All yields are from constant-maturity series.
- b. Weekly averages.
- c. Monthly averages.
- d. Treasury inflation-protection securities.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

The yield curve has flattened slightly since last month. Short rates have fallen a mere nine basis points, but long rates have fallen more: The 3-year, 3-month spread has slipped from 101 to 94 basis points, and the 10-year, 3-month spread has dropped from 122 to 107. The curve retains its recent hump shape, with 7-year rates higher than 10-year rates. Interestingly enough, a yield curve of real rates based on Treasury inflation-protection securities (TIPS) shows no hump at all between five and 10 years. This may

suggest some market concern about inflation at intermediate horizons.

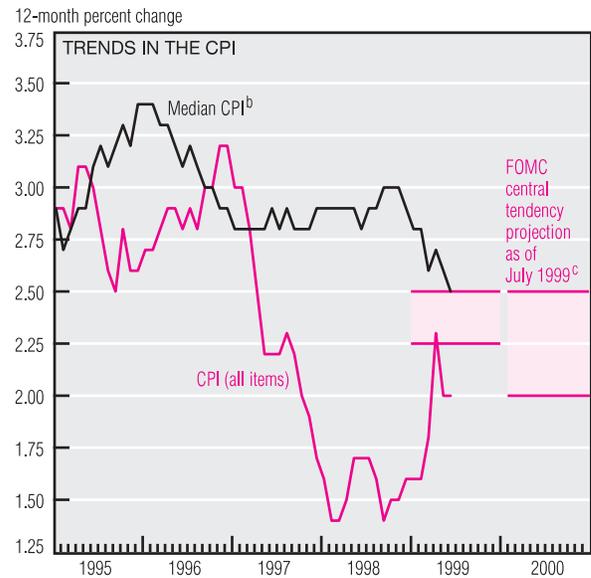
Not all securities are as safe as U.S. Treasuries, and that's why most of them bear higher yields. The spread between the yields is often taken as a measure of private bonds' default risk, and by extension as a measure of the issuing firm's health. Recently, academic economists and others have floated proposals to use the spread as a device for assessing the health of banking organizations.

The idea is that regulators could

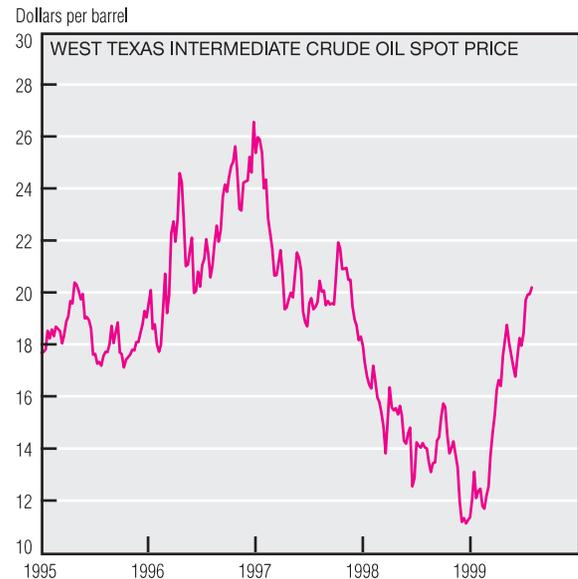
use the spread on bank holding companies' subordinated debt (it is "subordinated" to deposits because depositors get repaid first) as a possible early-warning device. The spread between the average subordinated-debt yields on five money-center banks increased after the Russian default in August 1998 and spiked upward shortly after the rescue of Long Term Capital Management in late September. Though currently below last fall's levels, the spread remains approximately 50% higher than it was before those difficulties.

Inflation and Prices

	Percent change, last:				1998 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
June Price Statistics					
Consumer prices					
All items	0.0	2.9	2.0	2.3	1.6
Less food and energy	0.7	2.3	2.0	2.5	2.5
Median ^b	1.3	2.4	2.5	2.9	2.9
Producer prices					
Finished goods	-0.9	2.1	1.2	1.1	-0.1
Less food and energy	-2.4	-0.3	1.6	1.2	2.5



	12-month percent change as of December 1999		12-month percent change as of December 2000	
	CPI (all items)	CPI (excluding food and energy)	CPI (all items)	CPI (excluding food and energy)
Blue Chip CPI Forecast^d				
Consensus	2.4	2.2	2.4	2.4
Top 10 average	2.7	2.6	2.9	2.8
Bottom 10 average	2.0	1.8	1.9	2.0



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. Upper and lower bounds for CPI inflation path as implied by the central tendency growth ranges issued by the FOMC and nonvoting Reserve Bank presidents.

d. Blue Chip panel of economists.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; *Journal of Commerce*, and *Blue Chip Economic Indicators*, July 10, 1999.

In June, the Consumer Price Index (CPI) remained unchanged for the second straight month. The flat price-index numbers, following an annualized 9.1% jump in April, resulted in a 2.9% increase (annualized) over the three-month period. The trend in median CPI growth—an alternative measure of price inflation—has slowed somewhat (up only 2.4% over the past three months), although this measure remains ½ percentage point above both the CPI and the CPI excluding food and energy over the past 12 months.

In his semiannual Humphrey-Hawkins report, Federal Reserve

Chairman Greenspan indicated that the Federal Open Market Committee (FOMC) had revised its central tendency growth range for the CPI upward slightly—for 1999, the CPI is expected to increase between 2.25% and 2.5%. The Committee expects retail price growth for 2000 to remain in roughly the same range again, with the CPI increasing between 2% and 2.5%. Economists responding to the latest Blue Chip survey expressed inflation expectations similar to those of the FOMC—the consensus shows CPI growth of 2.4% this year and next.

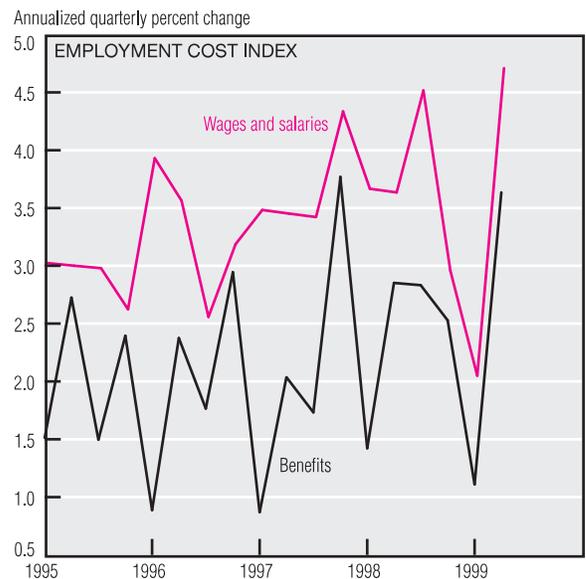
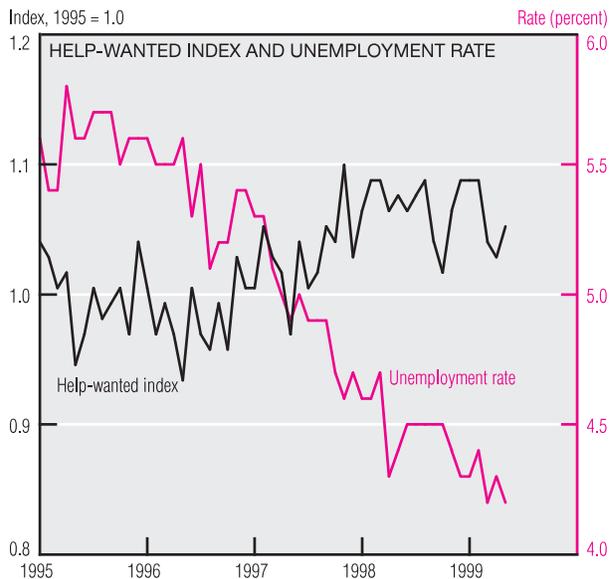
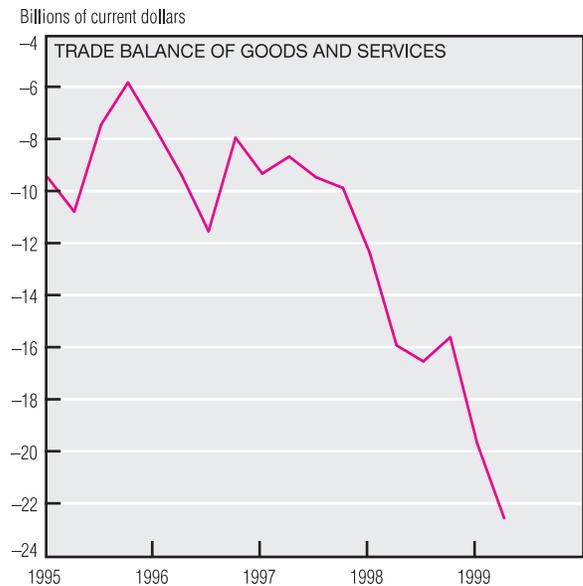
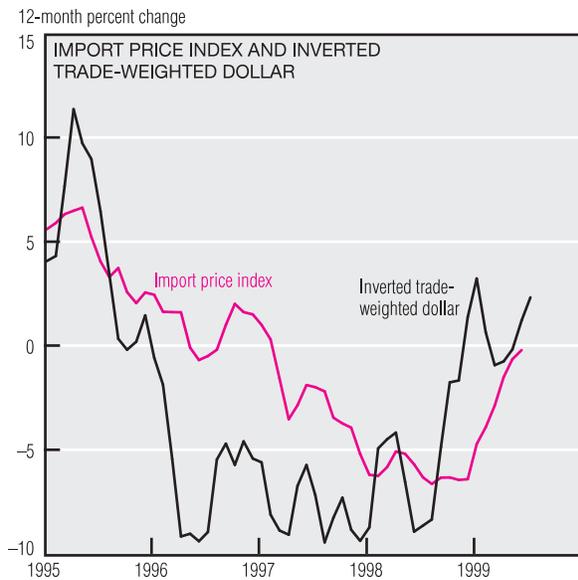
Neither the FOMC nor the Blue

Chip panel of economists expects the recent jump in energy prices to have much influence on consumer prices. Nevertheless, while crude oil prices showed little movement immediately after the OPEC-orchestrated production cut, they have risen sharply over the past few months. After sinking to around \$11 per barrel in the third week of December 1998, crude oil prices recovered, topping \$20 per barrel for the first time since November 1997.

In his recent testimony, Chairman Greenspan gave what some market analysts dubbed a “warning”

(continued on next page)

Inflation and Prices (cont.)



SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; International Monetary Fund, *International Financial Statistics*; and DRI/McGraw-Hill.

—that the Fed stands ready to react promptly and forcefully to any inflationary signals. He noted that an improving world economy implies that U.S. producers cannot count on continued declines in basic commodity and import prices, which have helped to hold down inflation in the past few years.

Low and falling foreign goods prices suggest that foreign producers have given the U.S. economy a noninflationary safety valve to displace some of its rapid growth in domestic demand. Its trade deficit widened to more than \$22 billion in

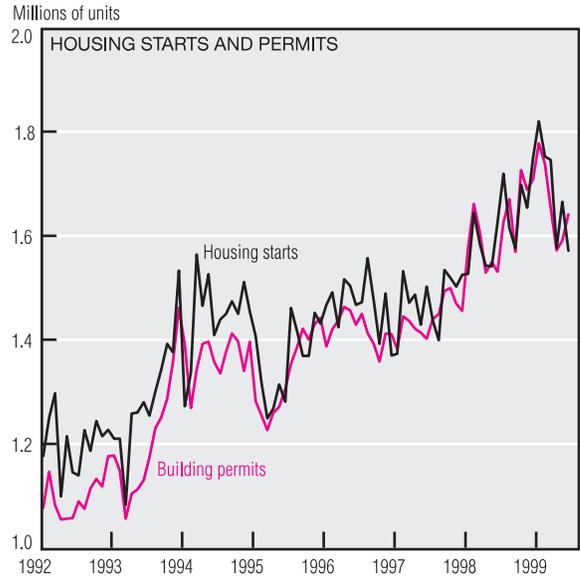
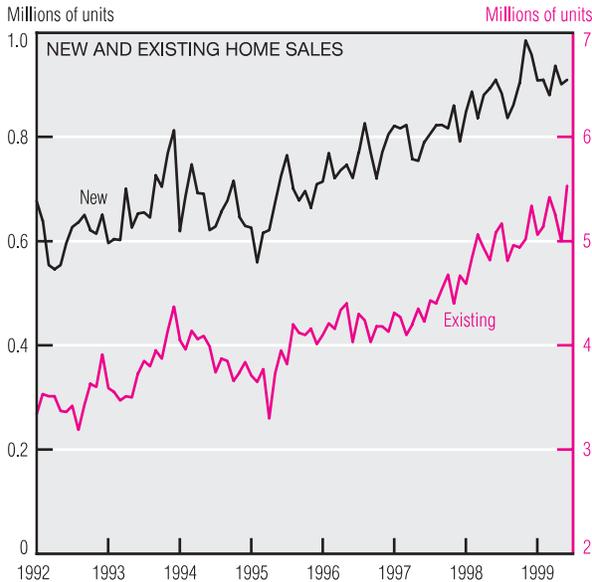
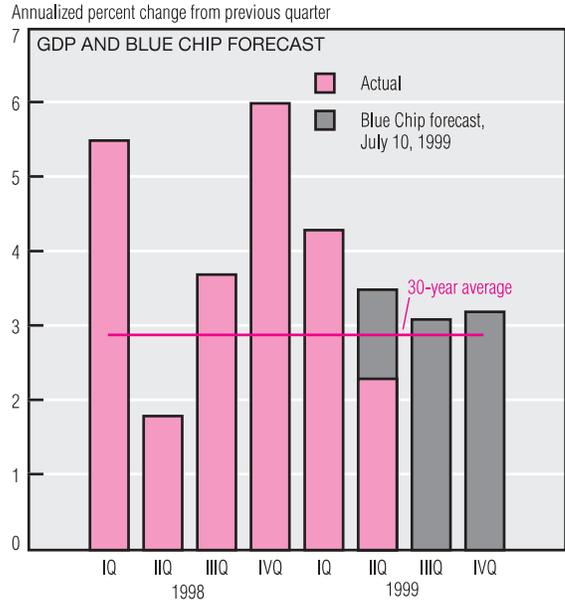
the second quarter. But import prices have stopped falling and could soon begin rising in response to the downward pressure exerted on the dollar in recent months.

Chairman Greenspan also challenged the sustainability of the low inflation environment as U.S. labor markets struggle to keep pace with domestic demand. “There can be little doubt that, if the pool of job seekers shrinks sufficiently, upward pressures on wage costs are inevitable, short—as I have put it previously—of a repeal of the law of supply and demand. Such cost in-

creases have invariably presaged rising inflation in the past, ...which would threaten the economic expansion.” Indeed, labor markets are tight by conventional measures: The U.S. unemployment rate is close to a 30-year low, and the number of help-wanted advertisements is holding at a high level—presumably a sign that some jobs are going unfilled. In light of the Chairman’s remarks, financial markets roiled at the announcement that employment costs had jumped an annualized 4.7% during the second quarter, their largest rise in nine years.

Economic Activity

	Change, billions of 1992 \$	Percent change, last:	
		Quarter	Four quarters
Real GDP	44.0	2.3	4.1
Consumer spending	52.8	4.0	5.0
Durables	10.9	5.6	11.0
Nondurables	12.1	3.1	4.7
Services	30.4	4.2	3.9
Business fixed investment	26.3	10.8	8.1
Equipment	29.8	15.4	10.2
Structures	-0.6	-1.1	2.6
Residential investment	4.2	5.1	10.0
Government spending	-3.9	-1.2	1.9
National defense	-2.5	-3.3	-1.1
Net exports	-19.4	—	—
Exports	11.1	4.5	3.7
Imports	30.5	9.7	9.3
Change in business inventories	-19.3	—	—



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

b. Components of real GDP need not add to totals because current dollar values are deflated at the most detailed level for which all required data are available.

NOTE: All data are seasonally adjusted.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; National Association of Realtors; and *Blue Chip Economic Indicators*, July 10, 1999.

The advance estimate of GDP growth for 1999:IIQ is 2.3%, significantly slower than the 3.4% expected by analysts. The deceleration from the 1999:IQ growth rate of 4.3% primarily reflected a decline in inventory investment and a lower rate of increase in consumer and government spending. Nevertheless, consumer spending grew at a brisk pace (4.0%), indicating that domestic demand is still quite strong. Blue Chip forecasts predict that economic

growth for 1999 will exceed the 3.0% historical average rate of economic growth.

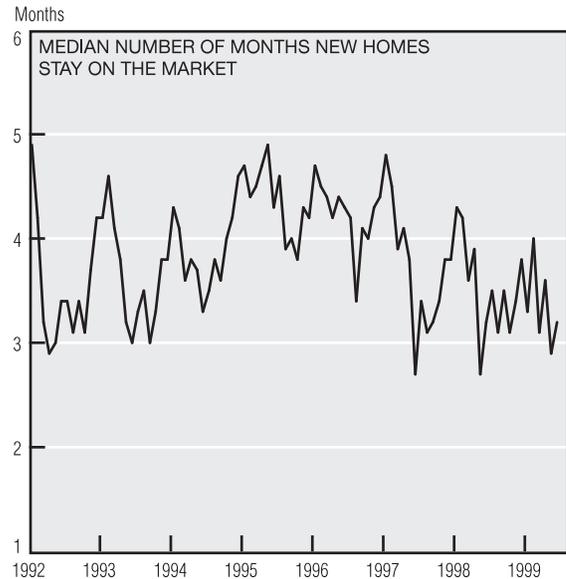
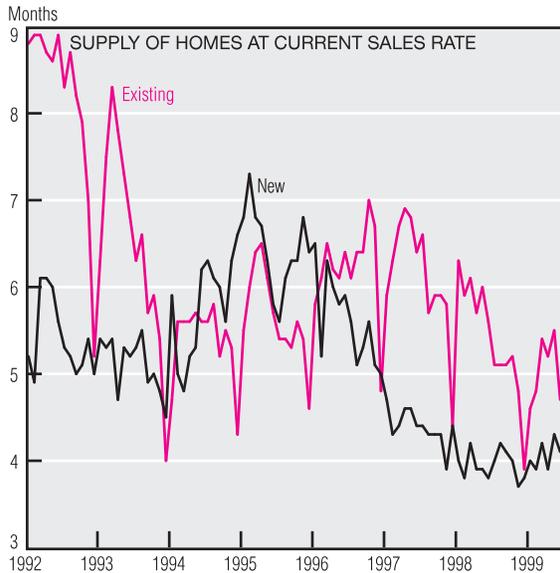
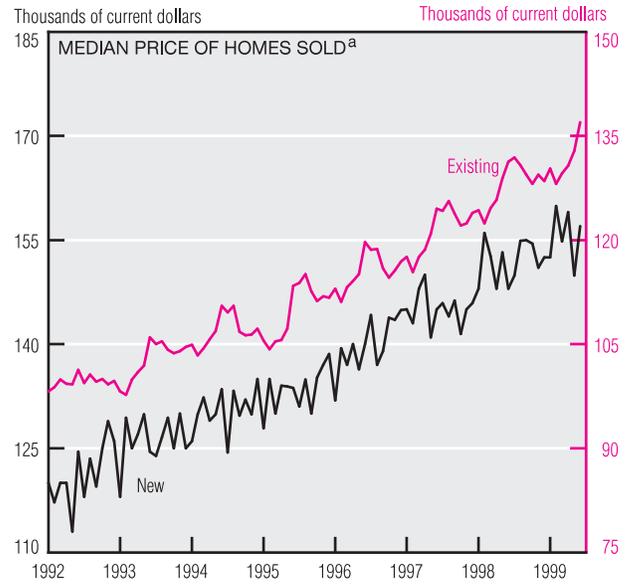
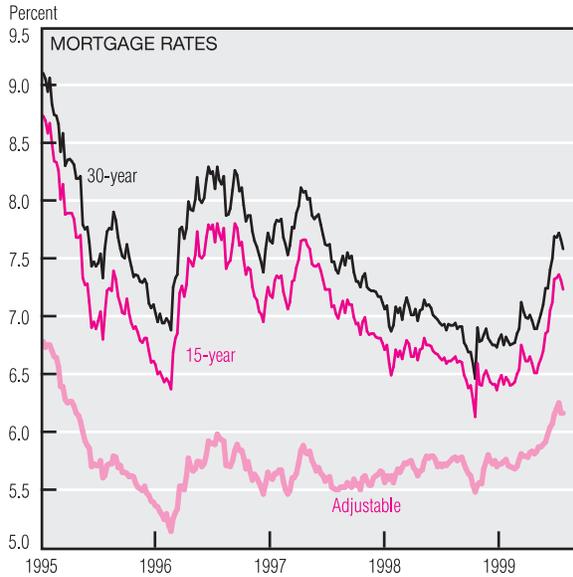
Existing home sales set an all-time record in June of 5.53 million units on an annualized, seasonally adjusted basis, a 10.6% increase from May's level of sales. New home sales also were quite strong in June, posting an annualized, seasonally adjusted rate of 929,000 units. Housing starts, however, fell to their lowest level since May of last year. Permits

did increase slightly in June, indicating that housing starts may rebound somewhat in July or August. Overall, the housing market remains robust, and buying activity remains surprisingly high considering recent increases in mortgage rates.

The fixed rate for a 30-year mortgage averaged 7.6% in June, up from 7.1% in May and 6.9% in April. Potential homebuyers may have interpreted recent increases in mortgage

(continued on next page)

Economic Activity (cont.)



a. Data are not seasonally adjusted.

NOTE: All data are seasonally adjusted, unless otherwise noted.

SOURCES: U.S. Department of Commerce, Bureau of the Census; National Association of Realtors; and *Bank Rate Monitor*.

rates as the start of an upward climb and purchased homes quickly to lock in a rate. With the labor market so strong and consumer confidence so high, rising interest rates apparently were not enough to discourage would-be homebuyers.

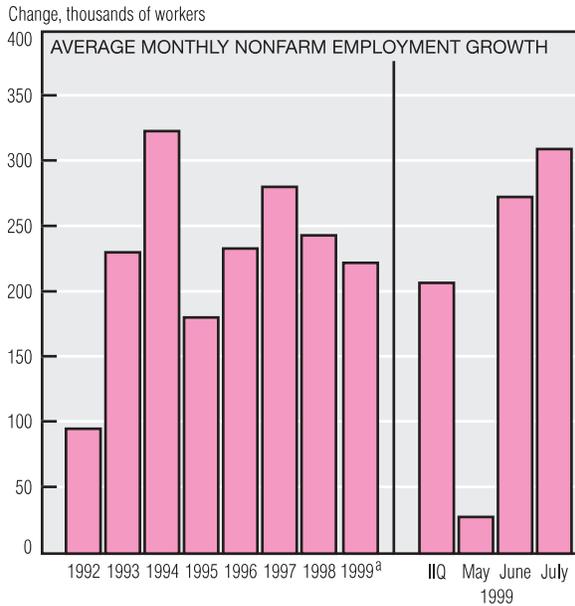
Indeed, people have been spending more on housing. Although the median sales price of new homes fell to about \$150,000 in May, it rebounded in June to \$157,000, about \$9,000 higher than the median price

in June last year. For existing homes, June's median price was roughly \$6,000 higher than a year earlier; in fact, it has increased at an average rate of around 4.0% so far in 1999, and at about 5.4% in 1998. The pace of growth in the median sales price far exceeds the rate of inflation, which has hovered around 2.0% in 1998 and 1999.

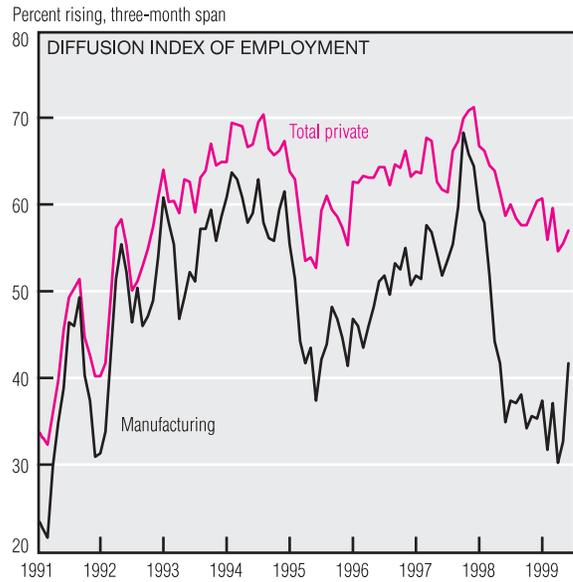
The brisk pace of home sales has brought down the supply of homes on the market. At June's rate of sales,

the current supply of existing homes will last 4.7 months, while the supply of new homes will last only 4.1 months. Certainly, the recent decline in housing starts has affected the supply of new homes. Perhaps builders have been more sensitive than consumers to rising interest rates. The median length of time new houses have been on the sales market (3.2 months in June) is also quite low.

Labor Markets



	Average monthly change (thousands of employees)				
	1996	1997	1998	YTD ^a	July
Payroll employment	234	281	244	223	310
Goods-producing	32	48	8	-18	50
Mining	1	2	-3	-7	-3
Construction	28	21	30	16	22
Manufacturing	3	25	-19	-27	31
Durable goods	10	27	-9	-11	39
Nondurable goods	-7	-2	-10	-16	-8
Service-producing	202	233	235	240	260
Retail trade	43	24	32	51	91
FIRE ^b	14	20	26	16	13
Services	117	141	119	121	110
Help-supply svcs.	19	28	10	15	31
Household employment	228	235	157	112	-125
	Average for period (percent)				
Civilian unemployment	5.4	4.9	4.5	4.3	4.3



a. Year to date.
 b. Finance, insurance, and real estate.
 c. Vertical line indicates break in data series due to survey redesign.
 NOTE: All data are seasonally adjusted.
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Labor markets showed no signs of weakening in July. The unemployment rate remained a low 4.3%, and nonfarm payrolls showed a solid increase. The strong labor market report may be the first sign of continued robust economic growth in 1999:IIIQ.

Jobs rose 310,000 in July, the second month of above-average growth. Despite its loss of nearly a half-million jobs since March 1998, the manufacturing sector rebounded

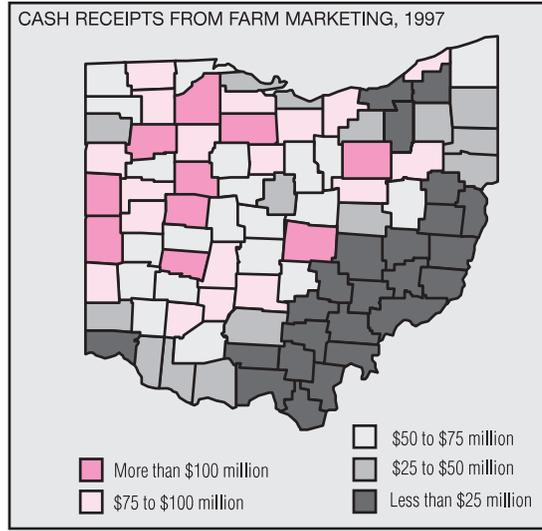
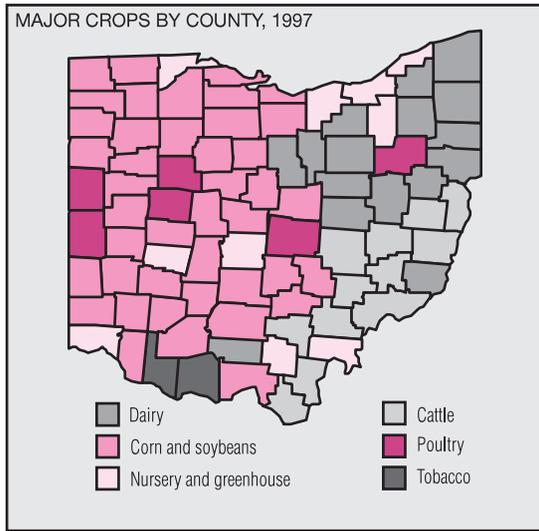
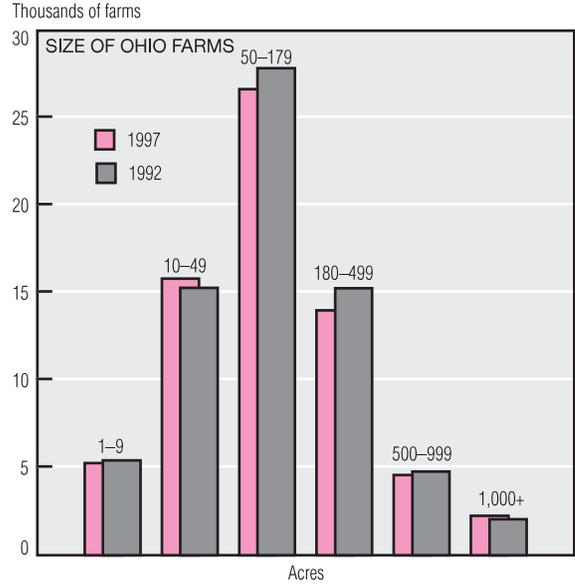
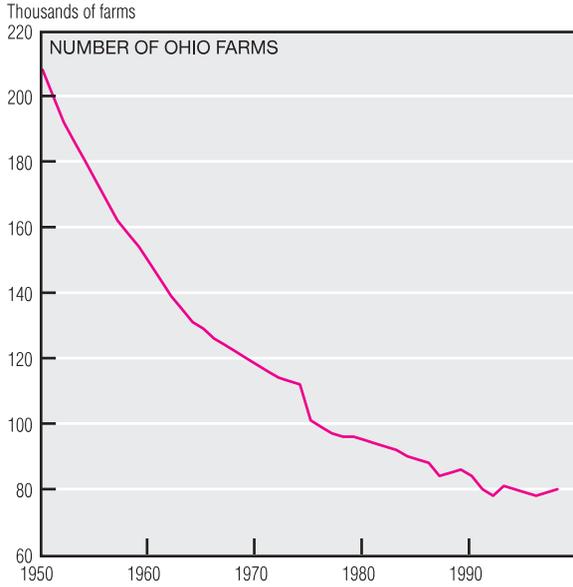
in July by adding 31,000 (after seasonal adjustment). This was the first increase since August 1998, when striking General Motors employees returned to work. All of the rise in manufacturing jobs came in durable goods industries, notably electronics equipment and furniture.

Although manufacturing jobs rose, only 42% of 139 manufacturing industries reported payroll increases for the three months ending in July. Service-producing industries

continued to make impressive gains, increasing their payrolls about 1.5 million for the year to date. Help-supply services (temporary employment agencies) posted their largest jobs increase in 18 months. Overall, 57% of the industries surveyed reported adding jobs to their payrolls.

The unemployment rate was unchanged in July, while the employment-to-population ratio fell slightly to 64.1%.

Regional Conditions



SOURCES: U.S. Department of Agriculture, 1997 Census of Agriculture and Ohio Agricultural Statistics Services.

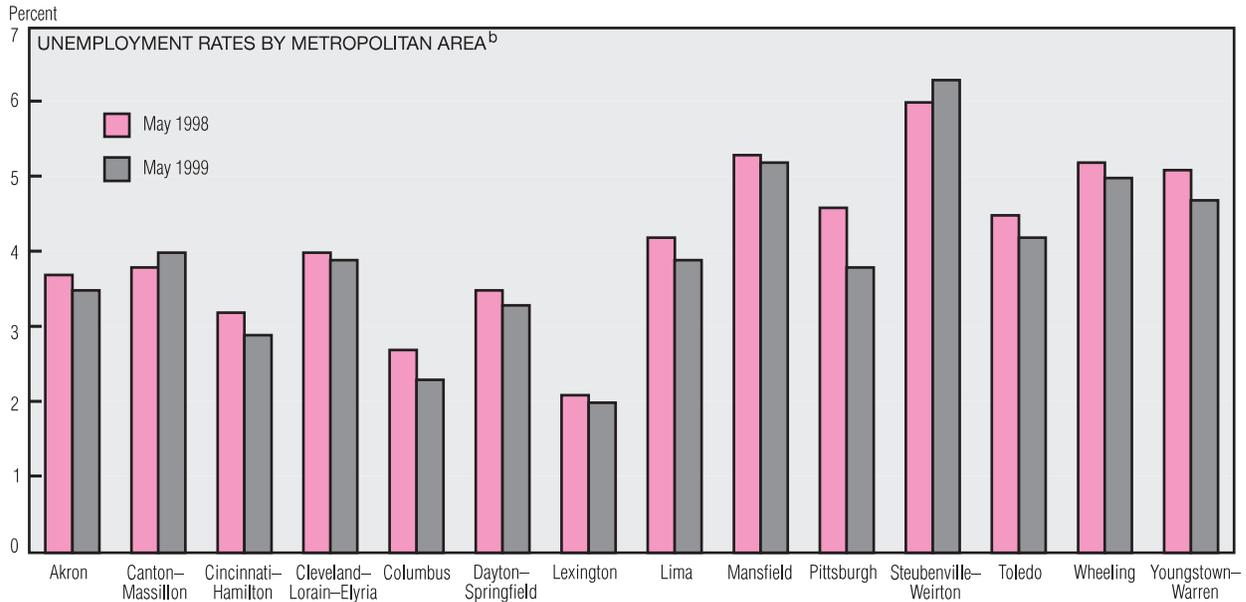
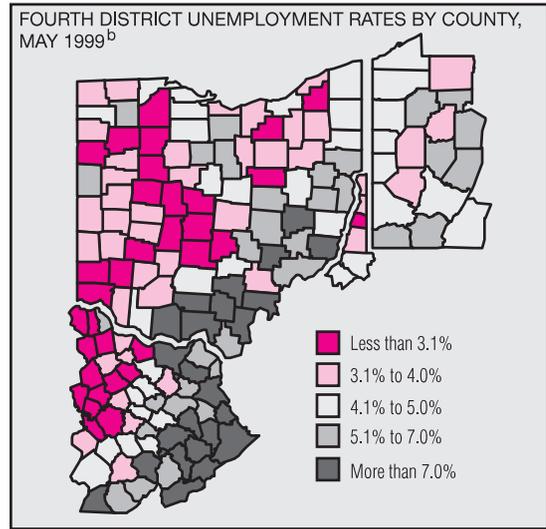
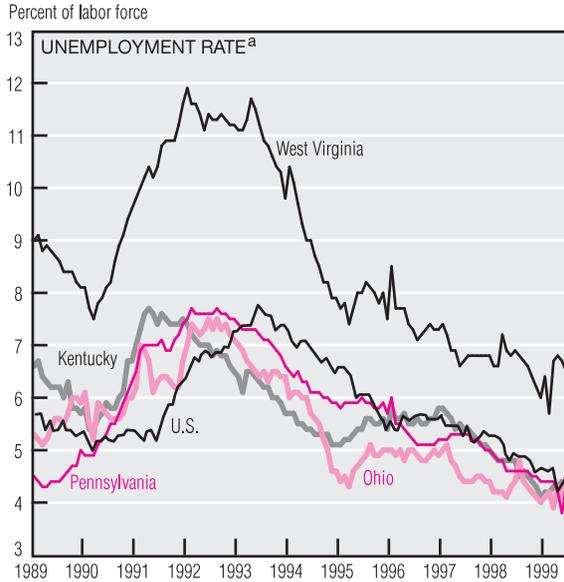
The long-term trend of Ohio agriculture—reducing the number of farms while increasing their average acreage—reversed during the 1990s. Although the last half of the twentieth century saw the number of farms decline by nearly two-thirds, this process was complete a decade ago. Since then, the number of farms has actually increased, but only a tiny amount. Indeed, when compared to the radical changes of the preceding decades, when small- and medium-sized farms were

consolidated into large businesses, the size distribution of Ohio farms has changed very little in the last five years. There has been a slight increase in the number of nurseries and greenhouses (with less than 50 acres), and an increase in farms of 1,000 acres or more, but these changes remain so slight as to be insignificant. Incidentally, Ohio's farms are classically Midwestern, with much of the acreage still in farms of less than 1,000 acres, as opposed to being Western, where much of the acreage is in very large farms.

The distribution of crops in Ohio also is typical of a Corn Belt state. Urban areas have concentrations of nurseries and greenhouses, as one would expect. The southern part of the state produces tobacco. The Ohio counties that border West Virginia are poor agricultural producers. Most of the agricultural receipts come from the northwestern, corn- and soybean-producing part of the state, which is why Ohio is considered part of the Corn Belt.

(continued on next page)

Regional Conditions (cont.)



a. Seasonally adjusted.

b. Data not seasonally adjusted.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Kentucky Department of Employment Services, Labor Force Estimates Division; Ohio Bureau of Employment Services, Labor Market Information Division; Pennsylvania Department of Labor and Industry, Bureau of Research and Statistics; and West Virginia Bureau of Employment Programs, Labor Market Information.

Unemployment in the region remains quite low and with the exception of West Virginia, is even lower than the rates experienced on average in the rest of the country. Even West Virginia, which typically has had high unemployment rates due to the vicissitudes of the eastern coal industry, has experienced historically low rates in the last year.

Within the Fourth District, unemployment is concentrated in eastern Kentucky's coal-producing counties and in the rural counties bordering the Ohio River. Both are areas

of historically high unemployment. What is notable is how much this unemployment has tapered off in recent years. Coal mines in particular contributed to high unemployment through their widely fluctuating employment demands, but many mines shut down permanently in the early 1990s. That industry, where each firm has a wide variation in its demand for workers, has a higher unemployment rate as workers laid off in one mine look for work in another. The steadier employment in the current industries is reflected in the low unemployment rates

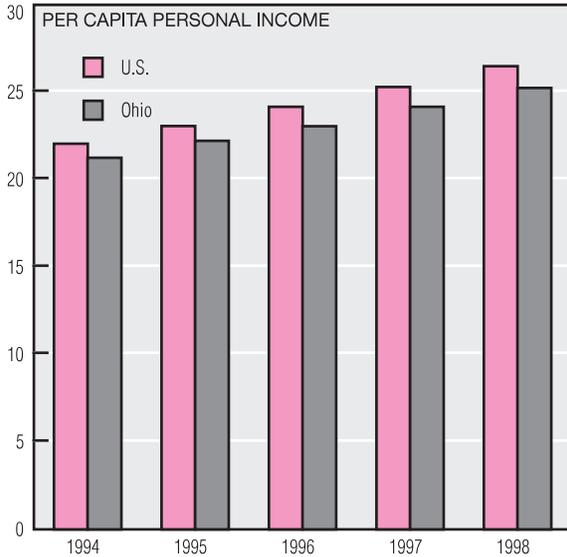
(compared to the historical average) of cities such as Wheeling.

Whereas the two largest urban areas of the district, Cleveland and Pittsburgh, have unemployment rates that are slightly below the national average, rates in several other large urban areas, notably Cincinnati, Columbus, and Lexington, are considerably lower than the U.S. average. This reflects hot labor markets created by the modern white-collar industries that are growing so quickly in these cities.

(continued on next page)

Regional Conditions (cont.)

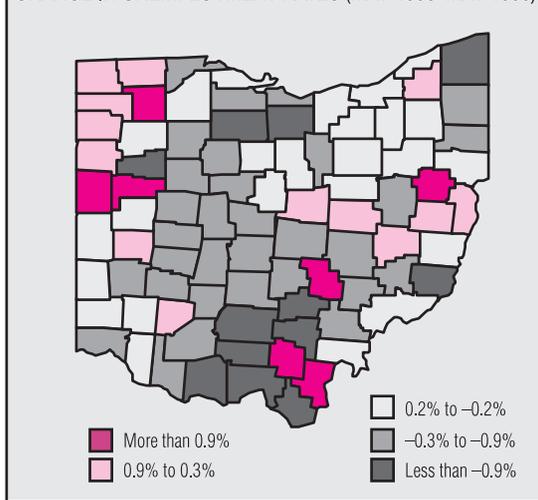
Income, thousands of current dollars



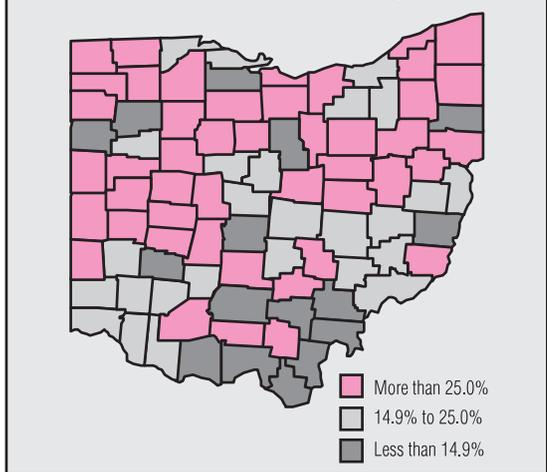
Employment by Industry

	Percent of nonfarm employment, 1998	
	Ohio	U.S.
Mining	0.2	0.5
Construction	4.1	4.7
Manufacturing	20.0	14.9
Durable goods	13.5	8.8
Nondurable goods	6.5	6.1
TPU ^a	4.4	5.2
Wholesale and retail trade	24.2	23.3
FIRE ^b	5.5	5.8
Services	27.6	29.8
Government	13.9	15.8

CHANGE IN UNEMPLOYMENT RATES (MAY 1998–MAY 1999)



MANUFACTURING INTENSITY (SHARES OF TOTAL EMPLOYMENT, 1998:IIQ)



a. Transportation and public utilities.

b. Finance, insurance, and real estate.

SOURCES: U.S. Department of Labor, Bureau of Economic Analysis; and Ohio Bureau of Employment Services, Covered Employment Services, Labor Force Estimates.

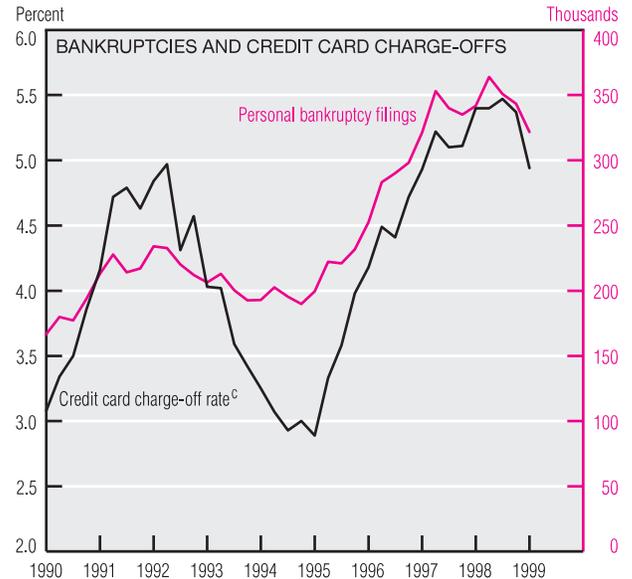
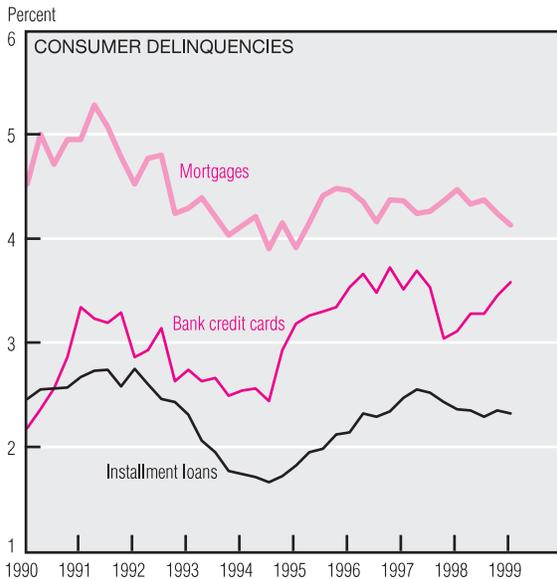
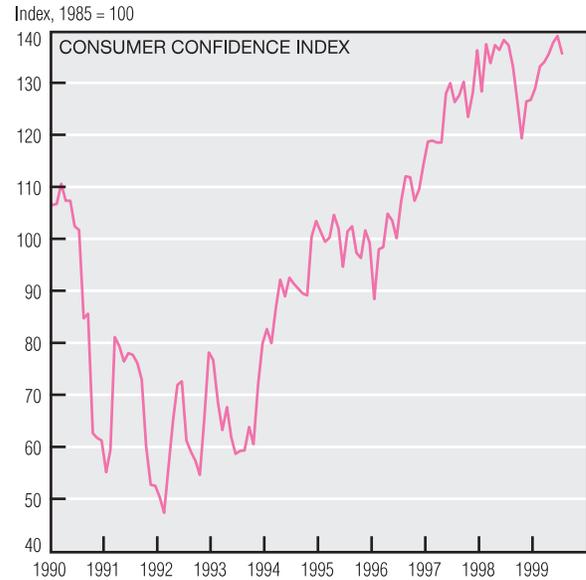
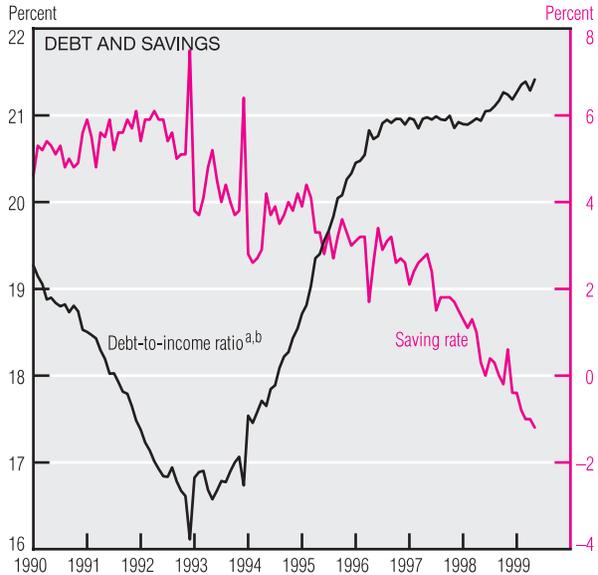
Ohio's experience provides a counterexample to the belief that the best jobs are in manufacturing. In many ways, Ohio is the archetype of a desirable job mix. Not only are there more manufacturing jobs as a percent of total employment, but they are heavily weighted toward the durable goods sector—precisely the type of jobs that have been lost in the rest of the country through the 1980s and 1990s. Much of the offset comes in the service sector, where Ohio employment is 2.2 per-

centage points less than the service-sector share nationally. Thus, the “autoworker-turned-short-order-cook” description of jobs does not seem to hold true for Ohio, but the state's per capita personal income, while growing at a steady rate, remains below that of the nation as a whole. Apparently, service-sector jobs are not necessarily bad after all.

Regional manufacturing intensity shows some interesting patterns. The large urban centers (Columbus, Cleveland, and Cincinnati) do not

display the highest manufacturing intensity. They have many of the service-sector jobs needed to support the manufacturing industries in adjacent regions. The areas with the highest manufacturing intensity are the old steel, chemical, and rubber centers of the state's northeastern section, and the auto corridor of the western portion. The auto parts manufacturers of western Ohio have experienced the largest increase in unemployment since May 1998.

Household Financial Conditions



a. Ratio of total consumer credit to disposable personal income.

b. Seasonally adjusted.

c. The net charge-off rate is the percentage of total credit card debt that banks remove from their balance sheets because of uncollectibility, less the amount of credit card debt charged off but subsequently recovered, expressed as an annual rate.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation, *Quarterly Banking Profile*; American Bankers Association, *Consumer Credit Delinquency Bulletin*; American Bankruptcy Institute; Mortgage Bankers Association of America, *National Delinquency Survey*; and The Conference Board, Inc.

After holding steady since 1996, household consumer debt levels resumed their upward trend last year. In May (the latest month for which data are available), the ratio of outstanding consumer credit to disposable personal income climbed to 21.41%, the highest level in this decade. Meanwhile, the dissaving pattern of 1999 persists, with a negative 1.2% saving rate in May.

Do these numbers indicate

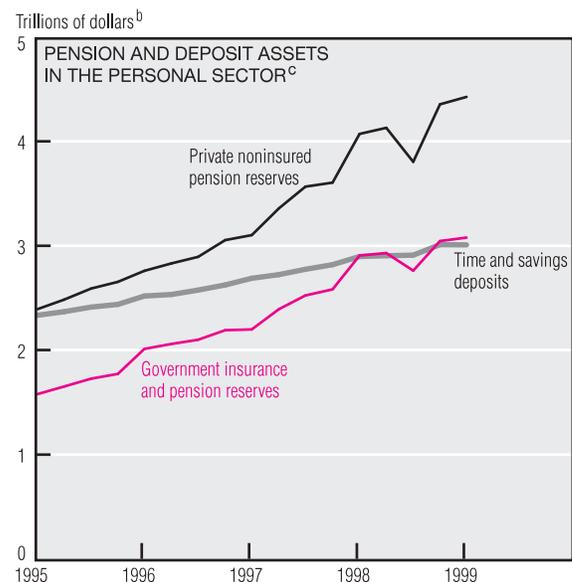
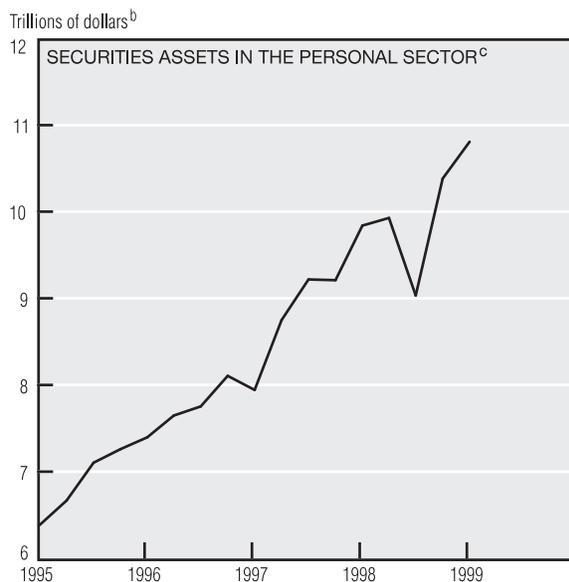
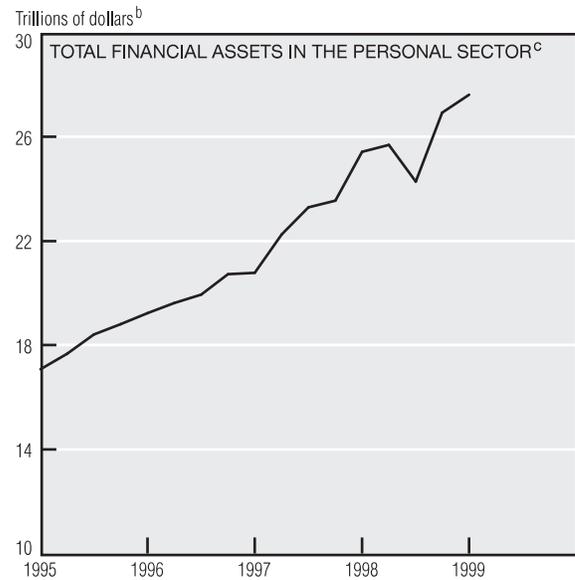
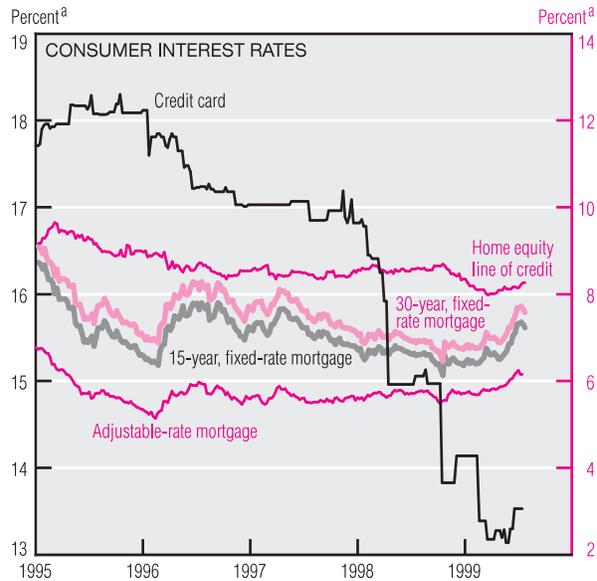
impending doom—or consumers' continued confidence in the resiliency of today's economy? After all, the Consumer Confidence Index, which measures households' optimism about the economy, stayed on the rise from last November through this June. Although the index dipped slightly in July, the representative household is still quite confident about the future.

Other measures of household

financial conditions seem to support this view. Delinquency rates on installment and mortgage loans are stable or declining, and although credit card delinquencies have risen over the last 18 months, their levels are still lower than they were in 1996. Similarly, personal bankruptcy filings and credit card charge-offs are showing their first substantial declines in more than five years.

(continued on next page)

Household Financial Conditions (cont.)



a. Weekly data.

b. Quarterly data.

c. Combined statement for household sector, nonfarm noncorporate business, and farm business.

SOURCES: Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States*; and *Bank Rate Monitor*.

Another possible explanation for the recent rise in consumer indebtedness is that households simply took advantage of historically low interest rates earlier this year. With these lower rates, the fraction of household income devoted to debt service may hold steady or even fall, despite higher overall debt levels. If this explanation is correct, we would expect to see debt levels taper off in the coming months as a result of the recent increase in borrowing costs.

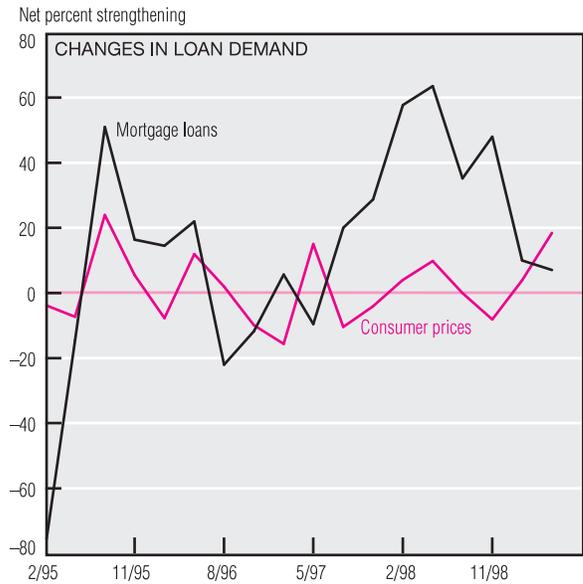
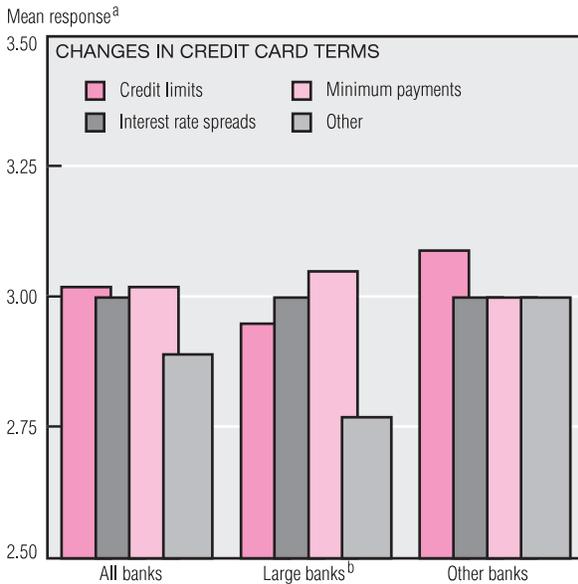
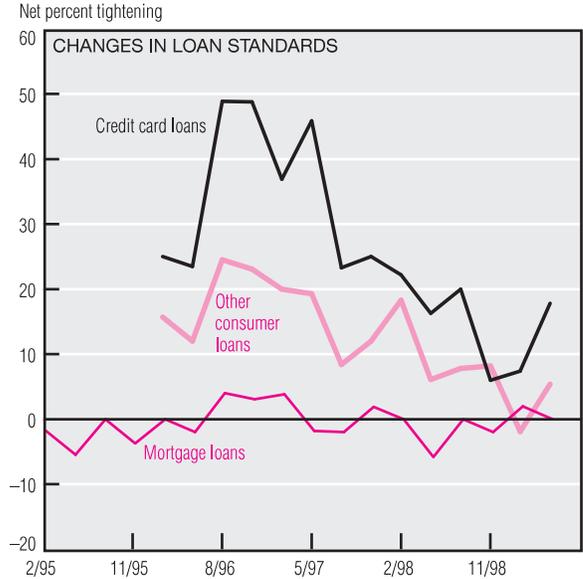
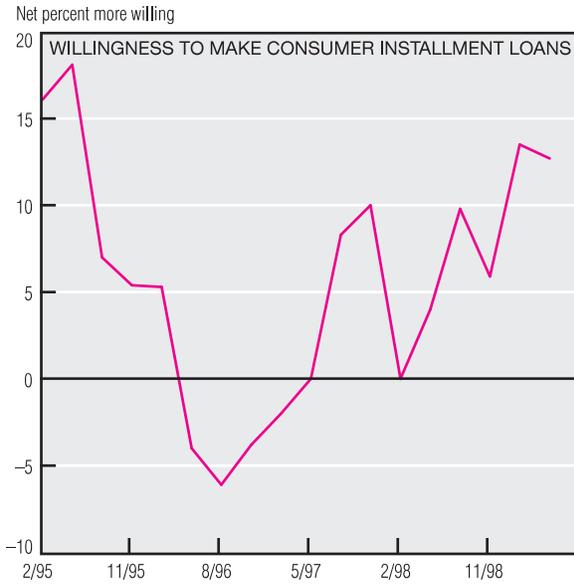
Of course, one cannot get a complete view of household financial conditions without looking at both debt burdens and the assets that complement that debt. Total financial assets in the personal sector (including households, nonfarm noncorporate businesses, and farm businesses) has continued its strong upward trend. In large part, this reflects the spectacular performance of the stock market, which, after its brief dip late last summer, has continued the hectic growth of recent

years. Total personal financial assets have doubled since the first quarter of 1995, providing solid evidence of strong household balance sheets.

What conclusions can we draw from looking at households' debts and assets side by side? Is it safe to assume that households' ongoing debt binge is innocuous, given the spectacular growth in their assets? Before we become too sanguine about the current situation, we

(continued on next page)

Household Financial Conditions (cont.)



a. Mean response of banks where: 1 = tightened considerably, 2 = tightened somewhat, 3 = remained basically unchanged, 4 = eased somewhat, 5 = eased considerably.

b. Total domestic assets over \$15 billion.

SOURCE: Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices*.

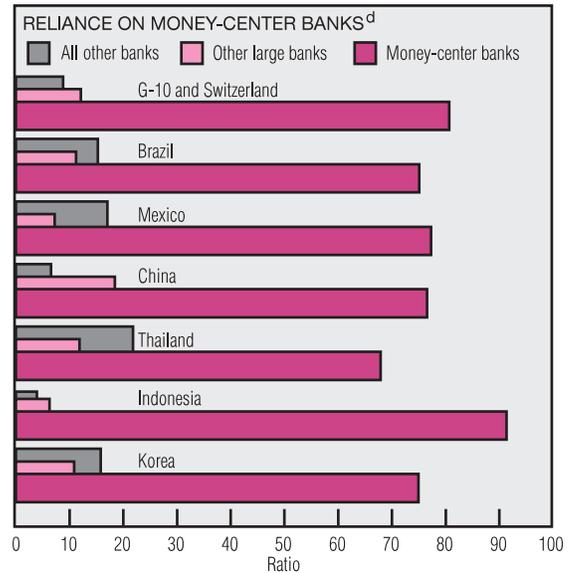
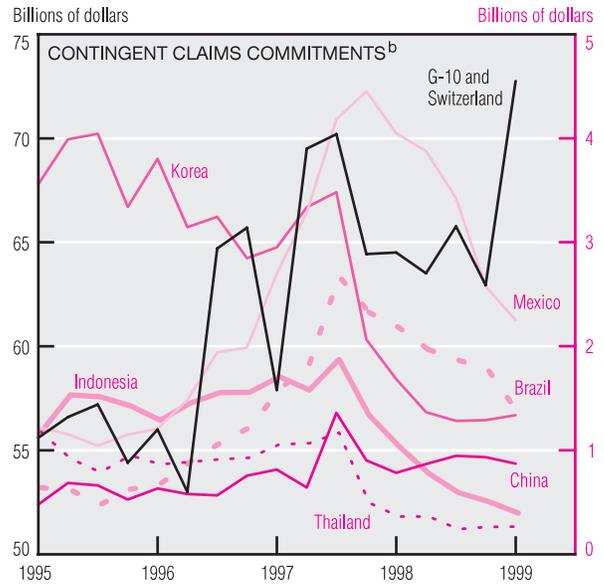
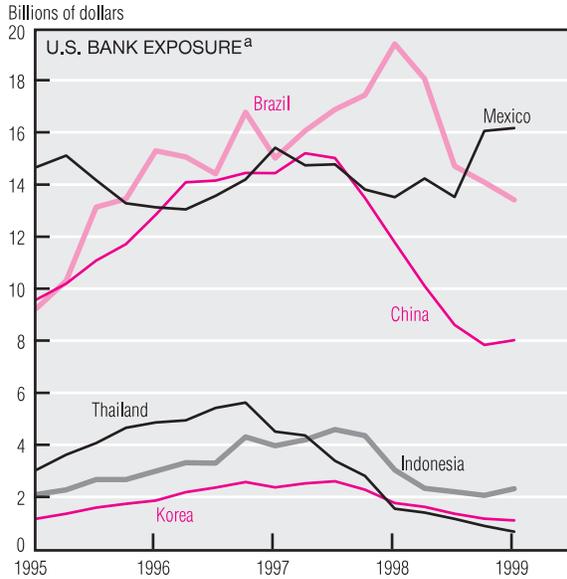
should remind ourselves that the households owing the liabilities are not guaranteed to be the same as those owning the assets. As a result, some caution is necessary when working with aggregates.

An alternative perspective on household financial conditions can be gathered from the Federal Reserve's quarterly *Senior Loan Officer Opinion Survey on Bank Lending*

Practices. Banks surveyed most recently (in May) seem similarly unconcerned about households' rising debt levels, with a strong majority of respondents indicating increased willingness to make consumer installment loans. Some tightening is evident in the terms of credit card loans (not surprising, given the recent rise in credit card delinquencies), but other types of consumer credit have seen very little or no

tightening. As to changes in credit card terms, minimum payment requirements have become more favorable, whereas interest-rate spreads are virtually unchanged. Credit limits are easing with the exception of large banks, which tightened their limits slightly. On the whole, the survey suggests that creditworthy borrowers currently enjoy ready access to credit.

International Developments



a. Total amount owed by borrower country after adjustment for guarantees and external borrowing (except derivative products).
 b. Commitments of cross-borrower and nonlocal-currency contingent claims after adjustment for guarantees.
 c. Ratio of guarantees for third-country borrowing from U.S. banks to total amount owed to U.S. banks.
 d. Share of the total amount owed to U.S. banks after adjustment for guarantees and external borrowing (except derivative products).
 SOURCE: Federal Financial Institutions Examination Council, *Country Exposure Lending Survey*, various issues.

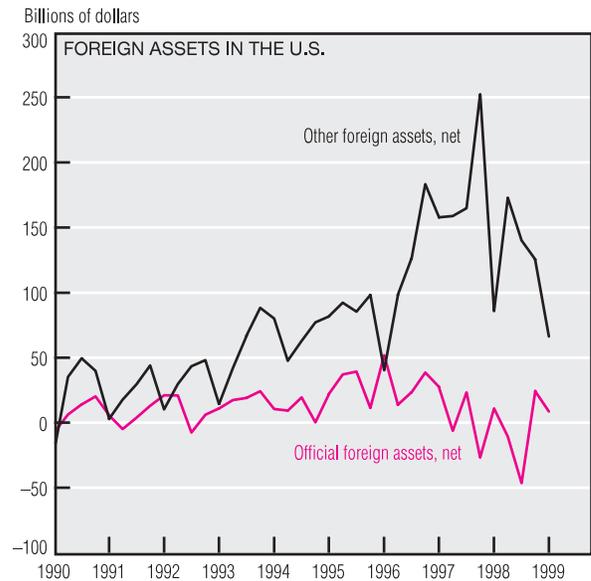
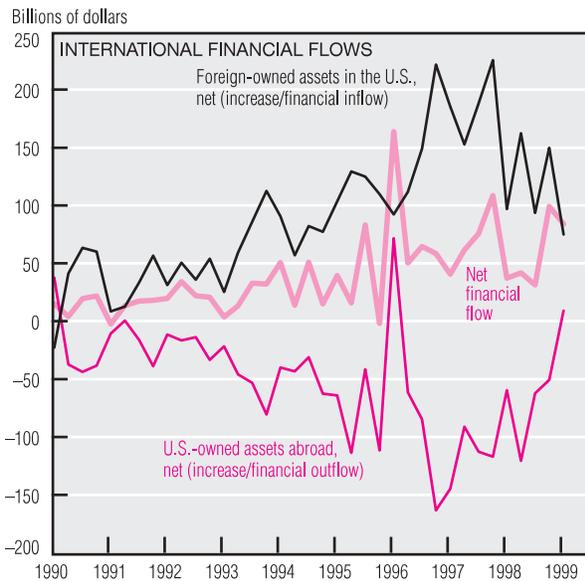
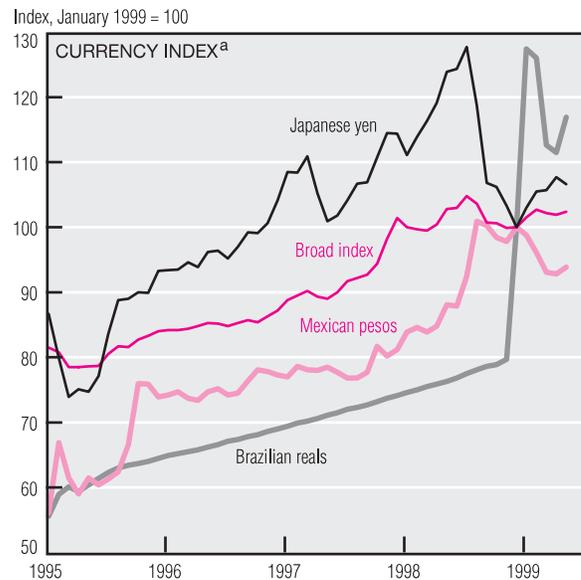
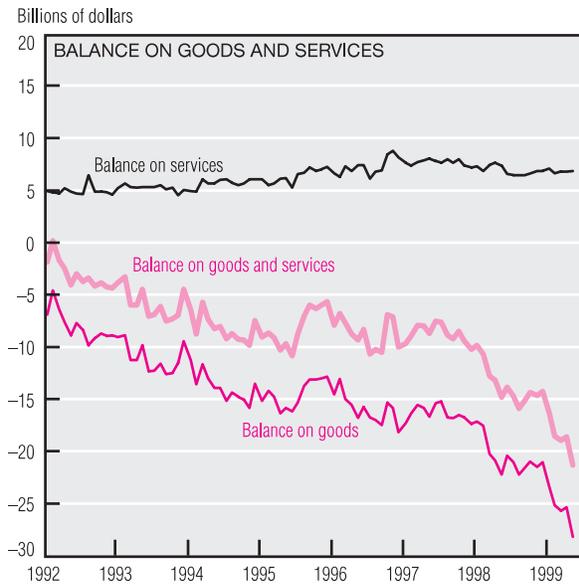
Data for 1999:1Q reveal a continued drop in the exposure of U.S. banks to key developing economies. Exposure to Brazil has continued its sharp decline, consistent with concerns about the impact of Brazilian fiscal policy on the value of the country's currency. However, despite concerns about contagion effects within Latin America, exposure to Mexico has increased. This may be related to Mexican policy changes, such as the decision to facilitate foreign ownership of Mexican banks. On the other hand,

developments in the U.S. economy might have affected the foreign-lending exposure of our banks. In particular, the strong U.S. stock market has made foreign lending relatively less attractive and might explain why, contrary to speculation, flows do not appear to have been diverted from Latin America to Asia. The perception of increased risk in emerging markets and the associated relatively low lending volume might explain other trends in these markets. For example, the use of contingent claims commitments, associated with off-balance-sheet

activities of U.S. banks, has declined for all borrowers except the G-10 countries and Switzerland. In addition, the public sectors of the G-10 countries and Switzerland have taken on an increased proportion of the guarantees those countries provide on U.S. loans to third countries. Finally, there has been no perceptible decrease in the money-center banks' share of lending, which might indicate that smaller banks do not find the market profitable enough to enter or to justify expanding their level of involvement.

(continued on next page)

International Developments (cont.)



a. Foreign currency price of U.S. dollar.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* and *U.S. International Trade in Goods and Services*; and Board of Governors of the Federal Reserve System.

In May, the U.S. deficit in the balance on goods and services increased \$2.7 billion to \$21.3 billion. This reflected a \$2.9-billion deterioration in the goods balance, most significantly for Western Europe (\$0.7 billion), China (\$0.5 billion), and Mexico (\$0.5 billion); the last two of these changes resulted mainly from import increases. The continued strengthening of the U.S. dollar against most currencies contributed to these trends.

Balance-of-payments data for 1999:1Q show a decline in recorded

net financial inflows from \$99.2 billion to \$84.1 billion. On one hand, this reflects the change in net U.S.-owned assets abroad, which went from an increase of \$50.6 billion in 1998:IVQ to a decrease of \$9.2 billion in 1999:IQ, mainly because of a shift to net U.S. sales of foreign securities. On the other hand, the decline in net financial inflows reflects the movement in net foreign-owned assets in the U.S., which increased \$74.9 billion in 1999:IQ following an increase of \$149.8 billion in 1998:IVQ. However, last year's fourth-quarter data for net financial

inflows were strongly affected by extensive acquisitions of U.S. companies by foreign ones.

The slower growth in net foreign-owned assets in the U.S. is due partly to a slower increase in net foreign official assets in the U.S. Another key development, however, was the shift from net foreign purchases of U.S. Treasury securities to net foreign sales that occurred when U.S. Treasury bond prices declined. Net foreign purchases of U.S. stocks rose, possibly indicating the strength of the U.S. economy relative to Europe.