

The Economy in Perspective

Worst-case scenarios....Most people pondering worst-case scenarios for the U.S. economy this year are likely to be concerned that the slowdown we have been experiencing will be unusually steep and protracted. We cannot know the future with certainty, and some U.S. contractions have indeed been marked by large declines in output and employment. A related concern is the possibility that economic growth could remain sluggish for a period, entailing not an absolute loss of output, but a loss relative to the economy's imagined growth potential.

Many hypothetical business cycle contours are plausible because the economy has generated a number of patterns during its history. The magnitude, duration, and composition of business cycle fluctuations have proven extremely difficult to forecast reliably. In fact, there is compelling evidence that even economic policymakers, who arguably have access to the best data and forecasting tools available, may not always recognize an economic contraction until after its onset. By then, of course, it is too late for any actions that might have prevented a downturn.

Whether policymakers can prevent economic contractions is debatable. Economists remain divided over how many of our past business cycles can be attributed to monetary and fiscal policy mistakes rather than exogenous disruptive events. They also debate how aggressively policymakers should respond to business cycles, by trying either to speed up or slow down the economy. Some prominent economists have concluded that once business cycle dynamics are set in motion by outside forces, a meaningful part of the subsequent volatility results from people responding rationally to changes in their environment.

Macroeconomists have also learned that when policymakers presume to know too much, they may unintentionally exacerbate business cycle fluctuations. During the 1970s, policymakers thought the economy was capable of expanding faster, and they repeatedly tried using monetary and fiscal policies to spur growth. Higher inflation was initially regarded as an acceptable price to pay, but as it kept accelerating, the government resorted to wage and price

controls for a solution. So many poor economic decisions were made in those years by households and businesses trying to shield themselves from runaway inflation that it took nearly a decade for the economy to regain its health.

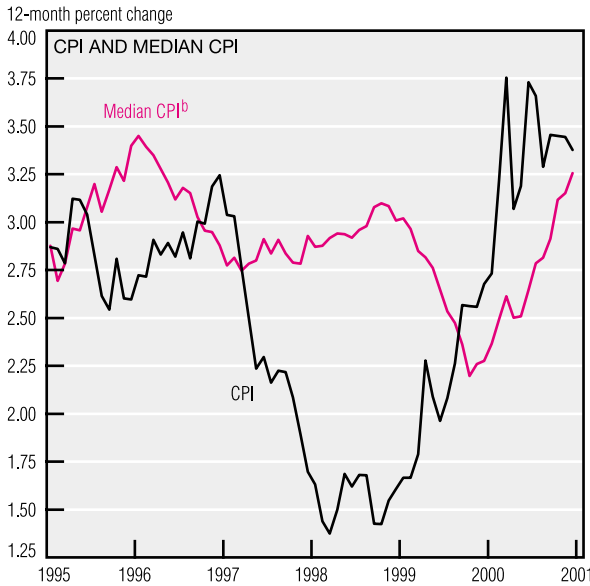
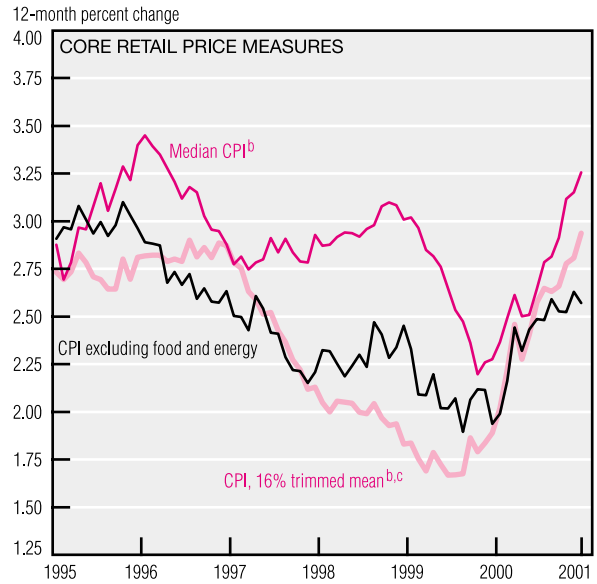
It is not surprising, therefore, that policymakers took a cautious view of the economy's growth potential in the 1990s. By then, they finally had learned that if there is any relationship at all between inflation and economic growth, it is that price stability promotes a strong economy. So it is probably fair to characterize the 1990s' stabilization policy as one that primarily tried to do no harm, and only attempted to "fine-tune" as a secondary matter. In practice, that meant containing inflation expectations and relying on the economy to expand, rather than assuming that policy actions were required to boost the economy to a preconceived pace.

With a suddenly emerging softness in the demand for durable consumer and investment goods, short-term interest rates have naturally declined. The Federal Open Market Committee responded by quickly reducing the federal funds rate target by 100 basis points. What comes next? It is not clear how soon and with what intensity economic growth will resume. Some analysts, claiming the economy's underlying growth potential has been exaggerated for several years, declare that unemployment has a long way to rise before reaching its new equilibrium rate. From this perspective, significant further easing in monetary policy seems appropriate.

But a truly worst-case scenario is one in which core inflation indicators continue to accelerate—as they did last year—while the economy works its way through the adjustments ahead. In a worst-case scenario, people become so convinced of what they "know" and so preoccupied with overriding ordinary business cycle dynamics that economic policy stimulus eventually proves to be excessive. Periods of below-par economic growth bring difficult conditions, but these usually pale in comparison to the ultimate damage that cyclical fine-tuning can inflict. Though such damage may seem remote today, now is the time to be alert to the prospect.

Inflation and Prices

December Price Statistics	Percent change, last:				1999 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	2.1	2.1	3.4	2.5	2.7
Less food and energy	0.7	2.0	2.6	2.4	1.9
Median ^b	3.6	3.7	3.3	2.9	2.3
Producer prices					
Finished goods	0.0	2.0	3.6	1.6	2.9
Less food and energy	3.3	0.8	1.2	1.0	0.8



a. Annualized.
 b. Calculated by the Federal Reserve Bank of Cleveland.
 c. The CPI 16% trimmed mean estimator eliminates the most extreme components in the price change distribution and computes a mean based on the remaining 84% of the distribution.
 d. Mean expected change in consumer prices as measured by the University of Michigan's Survey of Consumers.
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; and University of Michigan.

Consumer price inflation in December had a familiar look, matching the 2.1% annualized pace registered for the entire October–December period. This rate of price-level growth is well below the 3.4% advance for the year as a whole and is, in fact, somewhat lower than the trend for the past five years.

The inflation outlook indicated by the CPI less food and energy components—a typical measure of so-called

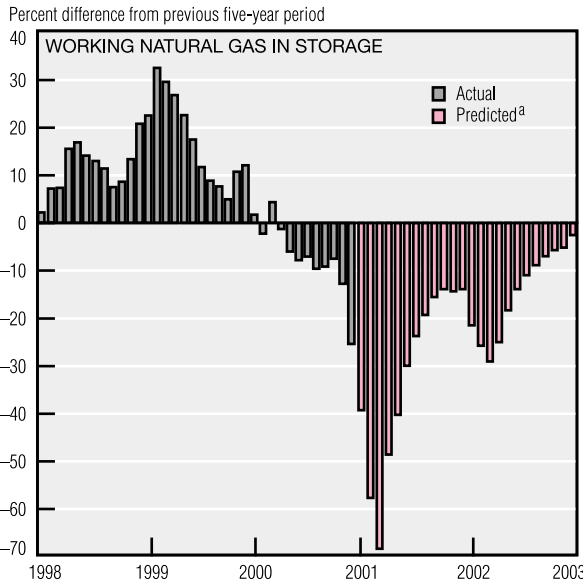
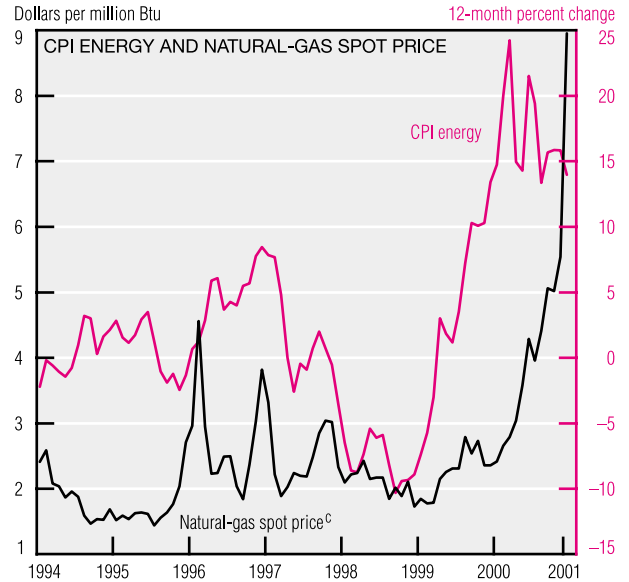
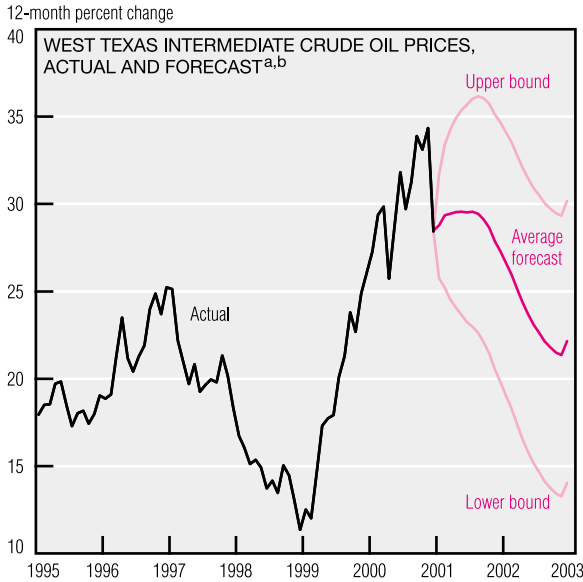
core inflation—drew an even more benign picture, registering a scant 0.7% annualized increase in December. This contrasts sharply with core measures based on trimmed estimators, like the median CPI, which continue to move northward.

The mixed signals generated by the different inflation figures bear some explanation. Unlike trimmed estimators, which remove both high and low extremes in the growth of individual goods

prices, the CPI less food and energy removes only food and energy components, regardless of where they lie in the price-change distribution. As it happens, food and energy categories have recently taken the honors for largest percentage price rises, so lopping them off has naturally led to a more muted reading of inflation than have core indicators that also remove goods registering price declines.

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Inflation and Prices (cont.)



Average Winter Natural Gas Usage and Costs for Midwest Households

	1997-98	1998-99	1999-2000	2000-01 ^a
Usage (thousands of cubic feet)	82.4	84.5	81.7	96.8
Dollars per thousand cubic feet	6.56	6.27	6.61	9.58
Cost (dollars)	541	530	540	927

a. Energy Information Administration forecast.
 b. Forecast bounds represent 95% confidence interval.
 c. Henry Hub.
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Energy, Energy Information Administration; Federal Reserve Bank of Cleveland; and Henry Hub.

Only time will tell which core inflation statistic is currently giving us the more accurate sense of longer-term trends. On the bright side, inflation expectations over the course of 2000 held fairly steady on average (although survey responses spiked upward in December).

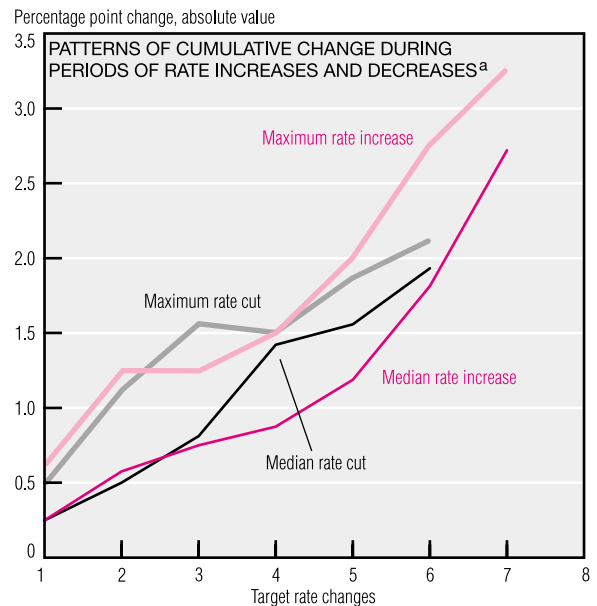
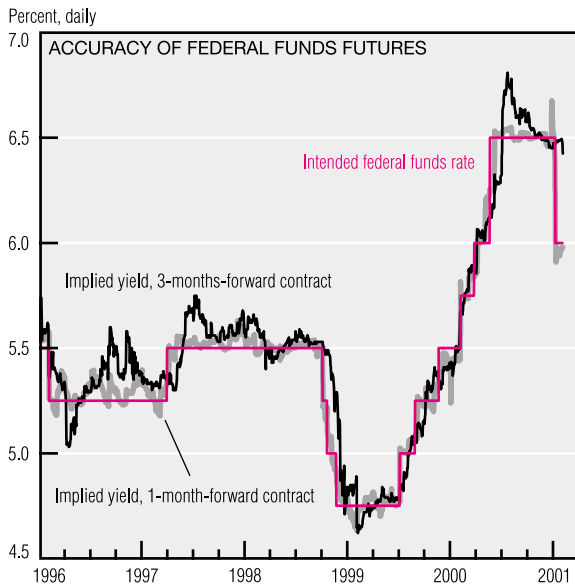
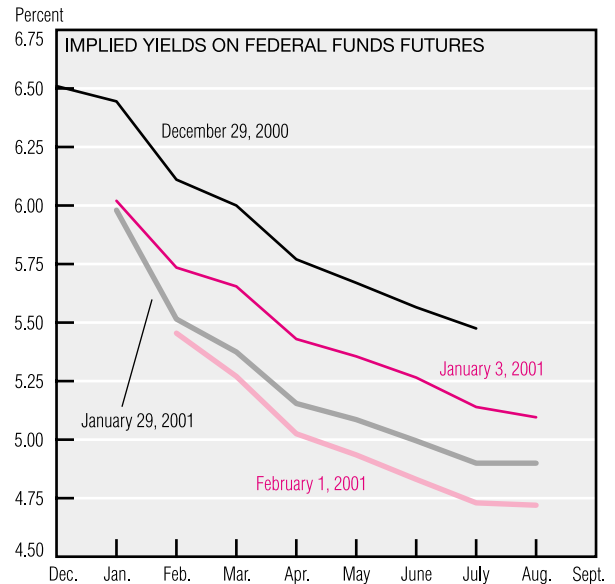
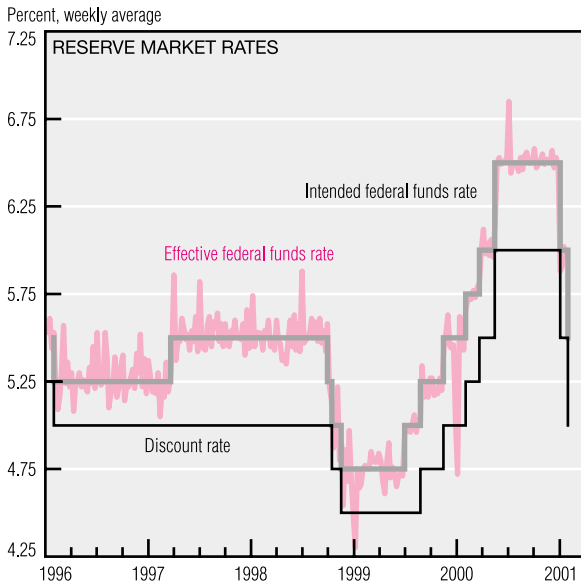
Whatever the long run may bring, prospective energy-price developments do not bode well for the immediate future. The upward trek of oil prices did reverse at the end of last year, and government projections

suggest that crude oil prices will stabilize near \$25 a barrel through mid-2001, and then decline into next year. Natural gas prices, however, accelerated sharply as 2000 closed, and the outlook is fairly dismal going forward. Relative to recent levels, inventories of natural gas shrank throughout most of last year. Worse yet, lower-than-normal inventories are expected to persist through 2002, with especially acute shortfalls anticipated in the first half of this year.

The laws of supply and demand suggest

a predictable outcome for retail natural gas prices. Average winter consumer prices for natural gas in the Midwest have fluctuated around \$6.50 per thousand cubic feet for the past three years. Government sources project that the rate for the 2000-01 heating season will rise to \$9.58 per thousand cubic feet and that total residential costs will jump 70% relative to last winter. It will be no surprise, then, if consumers find the modest advance in the CPI less food and energy statistic to be cold comfort indeed.

Monetary Policy



a. Subsequent target rate decreases (increases) are considered part of a single episode if they occur within four months of each other.
 SOURCES: Board of Governors of the Federal Reserve System; and Chicago Board of Trade.

At its January 31 meeting, the Federal Open Market Committee (FOMC) lowered the target federal funds rate 50 basis points (bp) to 5.5%. In a related action, the Board of Governors approved recommendations by most Reserve Banks' boards of directors to lower their discount rates a total of 50 bp to 5%. Reasons cited for the rate cuts included erosion in consumer and business confidence as well as weakness in retail sales and business capital equipment spending. This was the second decrease in the target federal funds rate in a

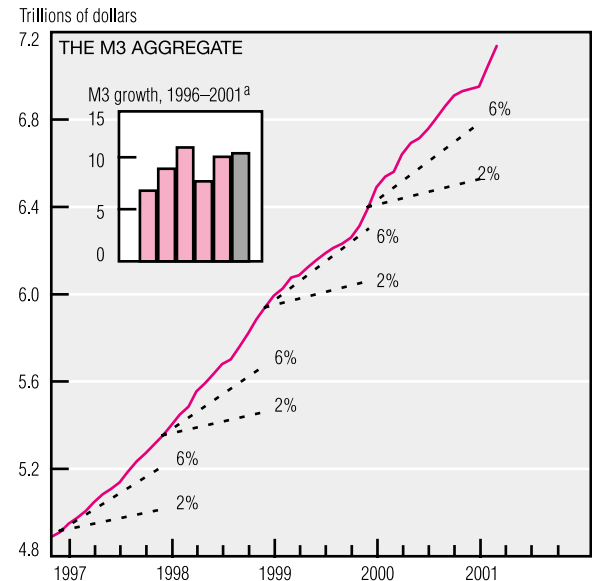
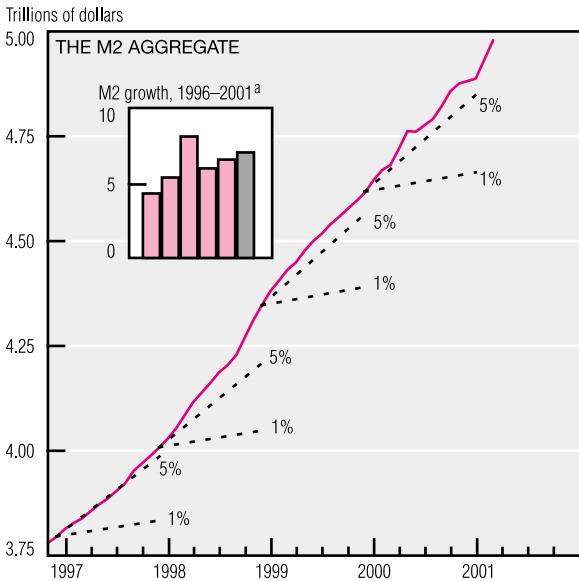
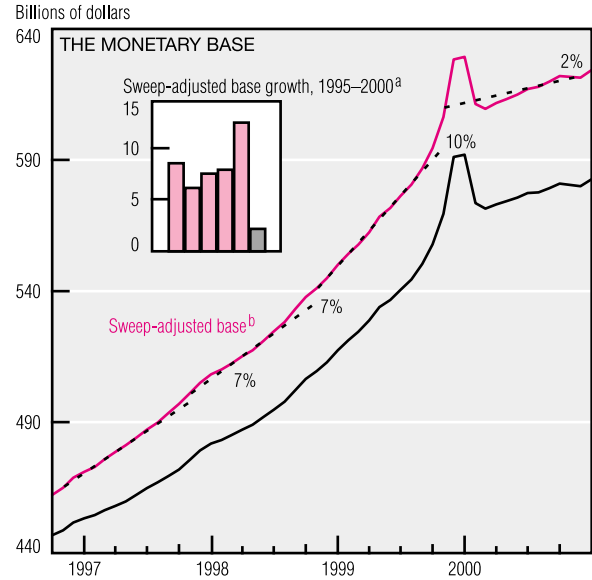
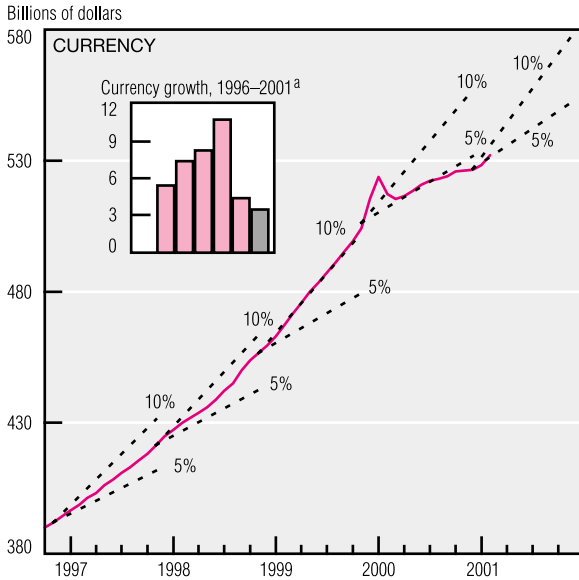
month, the first being a 50 bp rate cut on January 3.

Implied yields on federal funds futures often are used to gauge market participants' expectations of the future course of monetary policy. Participants placed a high probability on a 50 bp cut in the federal funds rate at the January 31 meeting; they have also revised upward the probability of future cuts. On February 1, the July contract traded at 4.73%, a decrease of nearly 75 bp since the end of last year. As predictors of movements in the target federal funds rate, federal funds futures perform well. The average error

for the period 1996–present is 11 bp on the 3-month future and only 5 bp on the 1-month future.

Before the current easing period, the last round of reductions in the federal funds rate occurred from September 1998 to November 1998, when the intended rate was cut by a total of 75 bp. The cumulative 100 bp decrease in the target has come relatively quickly in this round. Since 1985, the FOMC typically has taken between three and four moves to achieve a cumulative decline of 100 bp.

Money and Financial Markets



a. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 2001 growth rates for currency, M2, and M3 are calculated on an estimated January over 2000:IVQ basis. Data are seasonally adjusted.
 b. The sweep-adjusted base contains an estimate of required reserves saved when balances are shifted from reservable to nonreservable accounts.
 NOTE: Last plots for currency, the monetary base, M2, and M3 are estimated for January 2001. Last plot for the sweep-adjusted base is December 2000. Dotted lines for M2 and M3 are FOMC-determined provisional ranges.
 SOURCE: Board of Governors of the Federal Reserve System.

Now that 2000 is history, we can put its monetary and financial developments into perspective and, at the same time, use them to illuminate the current state of the economy.

Let's start with the growth rate of money, the key long-run determinant of inflation. We cannot discuss the monetary aggregates' behavior during 2000 without recalling the grave concerns that surrounded the century date change. These concerns led to the substantial run-up in

liquidity that characterized late 1999 and early 2000, as well as its subsequent fall-off when no significant problems occurred.

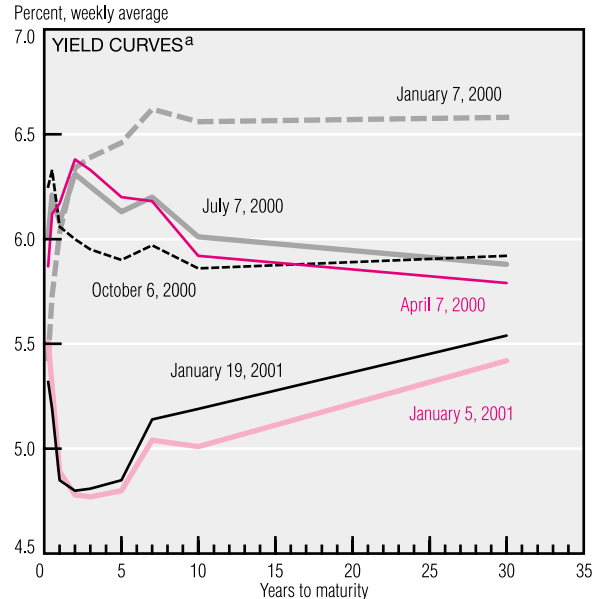
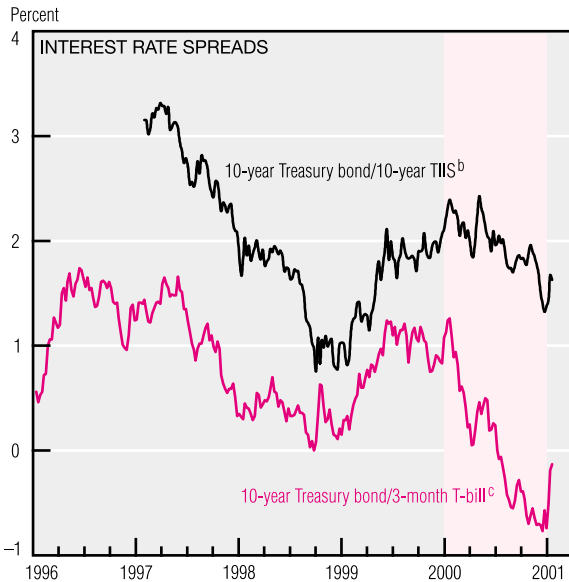
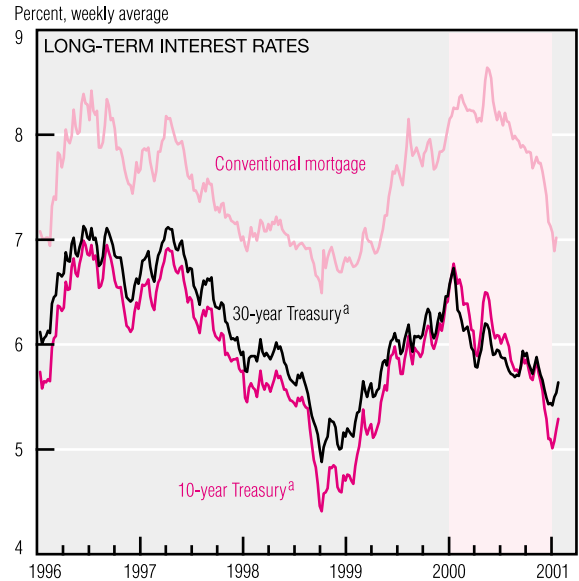
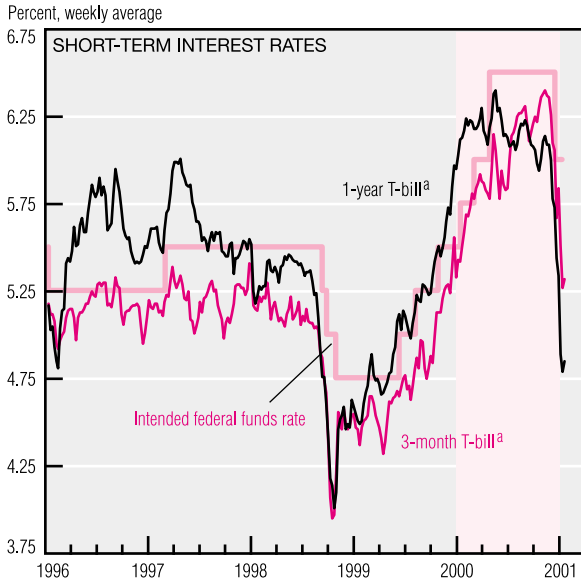
In retrospect, we see that Y2K dominated the behavior of the narrow monetary aggregates. Growth rates for currency and the sweep-adjusted base were 4.5% and 2.1% for the year. But it is important to recognize that these low rates are calculated relative to the elevated pre-Y2K levels that resulted in sizable growth rates during 1999. When the last two years are

combined, currency and the sweep-adjusted base have grown at annual rates of 7.9% and 7.5%, similar to the growth experienced in preceding years.

Y2K considerations had relatively little impact on the broad monetary aggregates, which grew robustly throughout 2000. M2 and M3 ended the year up 6.8% and 10%, respectively, and neither shows signs of slowing thus far in 2001. Year-to-date annualized growth rates for January are

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Money and Financial Markets (cont.)



- a. Constant maturity.
b. Last day of week.
c. Weekly average.

SOURCES: Board of Governors of the Federal Reserve System; and Bloomberg Financial Information Services.

estimated at 7.3% for M2 and 10.4% for M3. While these rates are in line with the experience of recent years, they arguably provide reason for concern. If the economy slows in 2001, as most analysts predict, the substantial money growth rates in 2000 may contribute to a significant rise in inflation rates later this year and into 2002.

Regarding interest rates, we see that yields on the shortest-term government securities rose during most of 2000, in tandem with an increase of 100 basis points (bp) in the intended federal funds rate.

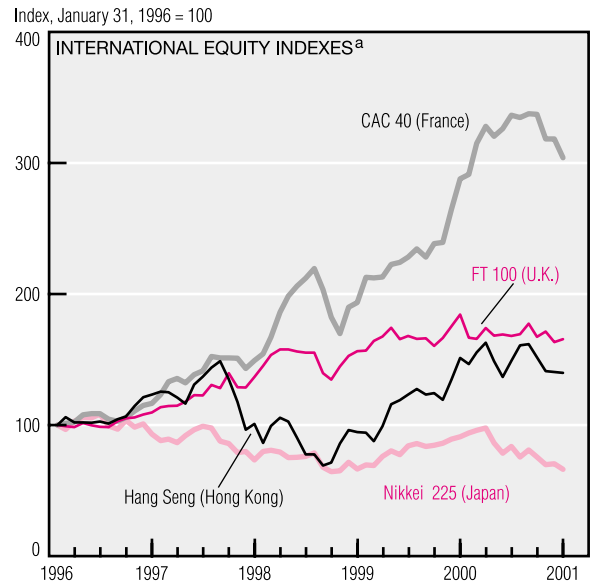
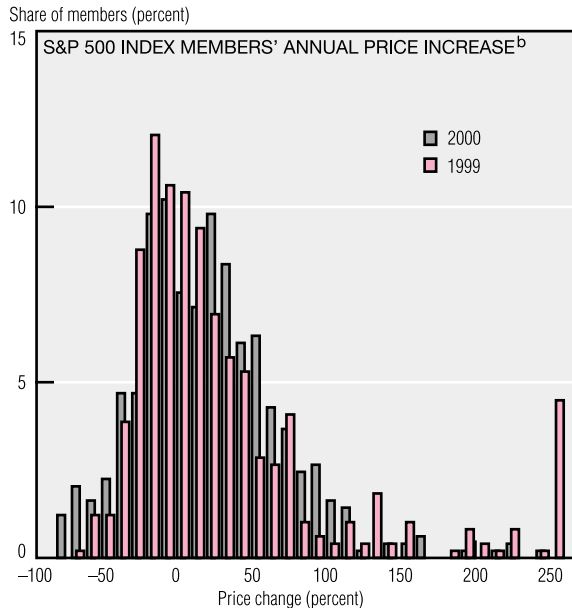
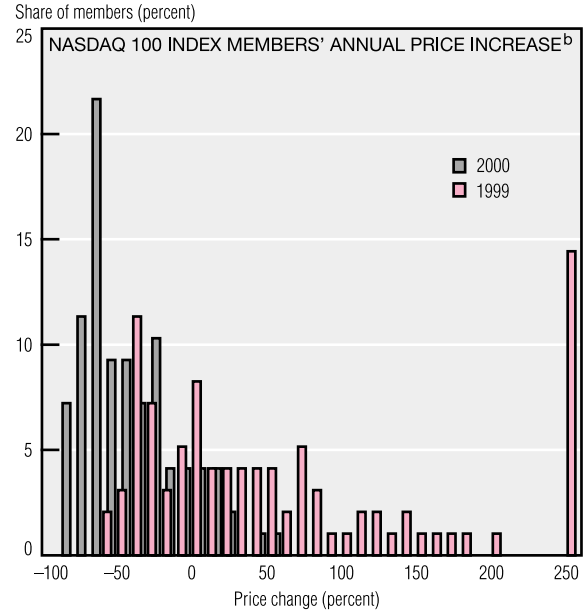
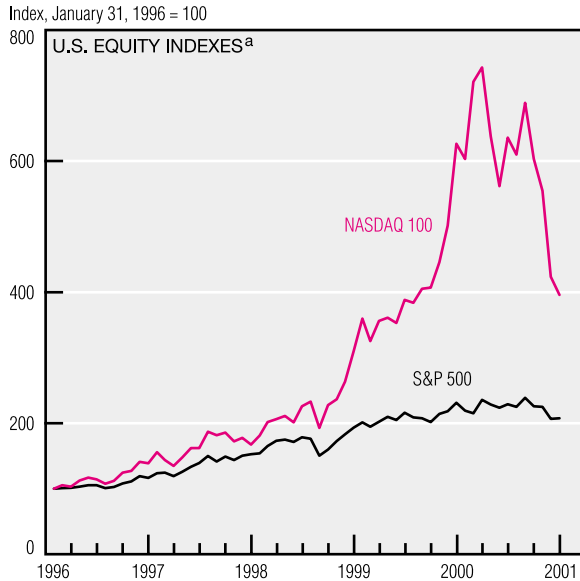
However, this trend reversed itself sharply at the end of the year as the economy weakened. The rate on the 3-month Treasury bill dropped substantially more when a 50 bp decline in the intended federal funds rate was announced on January 3. The 3-month rate has fallen roughly 100 bp since mid-November.

Medium- and long-term interest rates, on the other hand, fell steadily during most of 2000, even in the first half of the year when the news media were reporting that the Federal Reserve was “increasing inter-

est rates.” Rates on all Treasury securities with maturities of two years or longer fell more than 100 bp during the year, while rates on conventional 30-year mortgages fell 93 bp. All of these, except 30-year mortgages, have increased somewhat since the Federal Open Market Committee’s rate action, possibly reflecting market concerns about rising inflation. A recent increase in the difference between the 10-year Treasury rate and the 10-year TIPS rate (a spread that may indicate long-run

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Money and Financial Markets (cont.)



a. Closing price, last day of month

b. Index members as of January 26, 2001.

SOURCES: Bloomberg Financial Information Services; Wall Street Journal; and Financial Times.

inflation expectations) is consistent with that view. Finally, the 10-year, 3-month Treasury spread, which has been negative since mid-July and dipped as low as -77 bp, has narrowed to nearly zero. A negative spread sometimes signals an impending recession.

Finally, 2000 witnessed unprecedented fluctuations in equity markets. Most notably, the NASDAQ rose 15% between December 1999 and February 2000, fell 28% between February and May, gained 24% through August, then plummeted 41% between August and year's end (based on end-of-month closing

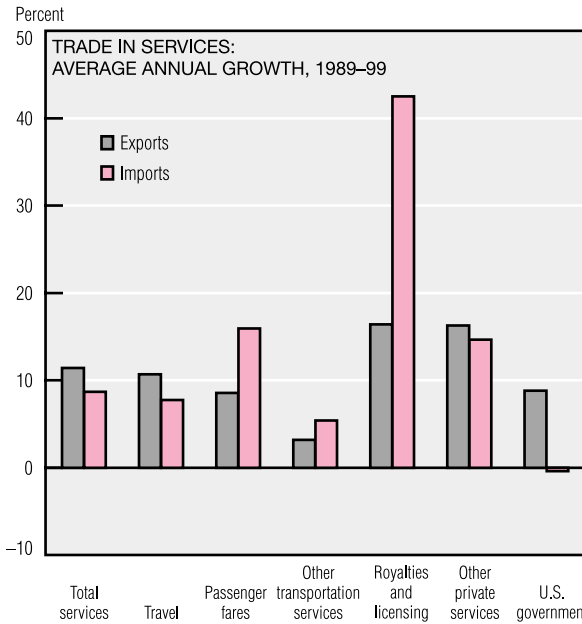
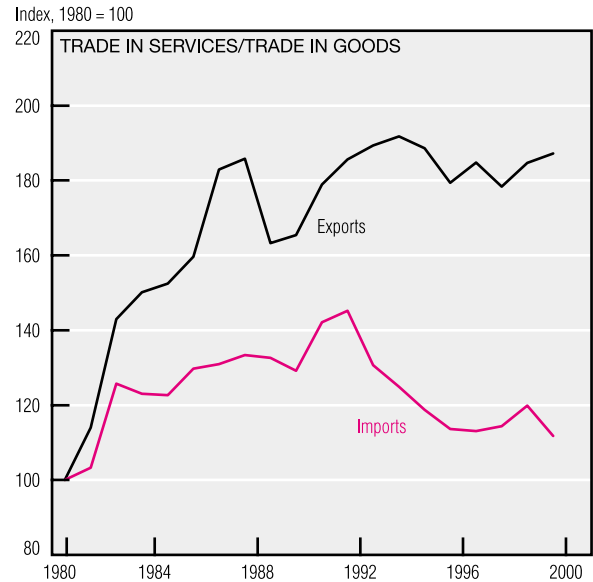
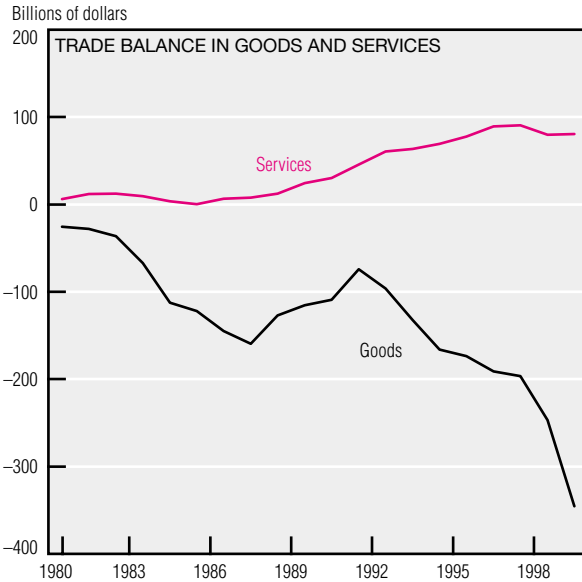
prices). Movements in the S&P 500 were much less dramatic, with the index down 10% for the year. These declines followed five annual increases of at least 19% each for both indexes.

Although these broad market indexes are so frequently reported, the wide disparity among their component stocks is not fully appreciated. It is true that the NASDAQ's decline reflected widespread decreases in the stocks included in the index. But consider the S&P 500, which rose 19.5% in 1999 before falling 10.1% last year. While this change seems fairly dramatic, note the overlap in the distribution of component stock price move-

ments over the two years. For example, in 1999 the stock prices of roughly 48% of S&P companies dropped, and 38% fell more than 10%, even as the index average was rising. And in 2000, when the index fell 10%, the stock price of 56% of its companies increased, and fully 49% rose more than 10%.

Many other countries' markets also had a rough 2000, although few matched the wild gyrations of the NASDAQ. Equity indexes in the U.K., Japan, and Hong Kong were down 10.2%, 7.5%, and 27%, respectively, while the index for France ended the year up 5.6%.

The US Trade Balance



Trade in Services, 1989-99
(Billions of dollars)

	Exports			Imports		
	1989	1999	Percent change ^a	1989	1999	Percent change ^a
Total services	127.1	271.9	11.4	102.5	191.3	8.7
Travel	36.2	74.9	10.7	33.4	59.4	7.8
Passenger fares	10.7	19.8	8.6	8.3	21.4	15.9
Other transportation services	20.5	27.0	3.2	22.2	34.1	5.4
Royalties and licensing	13.8	36.5	16.4	2.5	13.3	42.5
Other private services	36.7	96.5	16.3	18.9	46.7	14.6
U.S. government	9.2	17.2	8.8	17.2	16.5	-0.4

a. Average annual percent change.

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

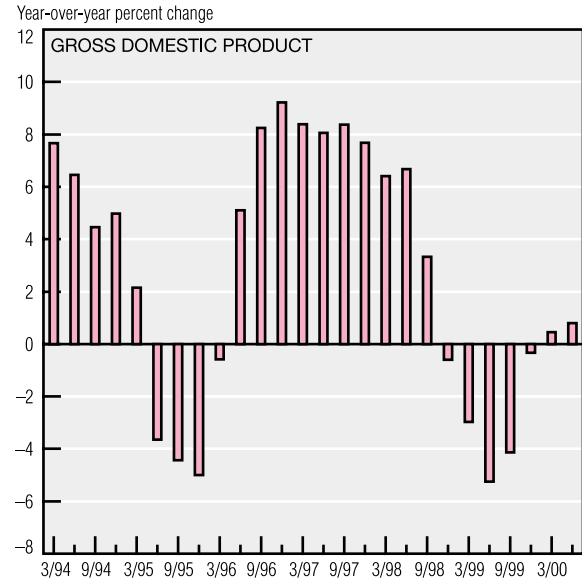
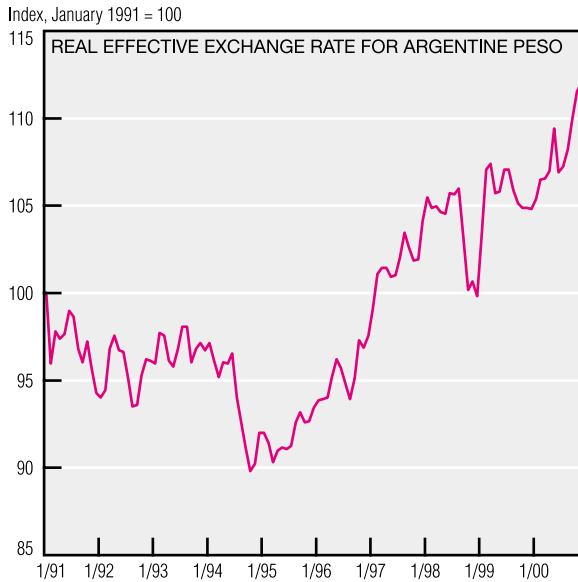
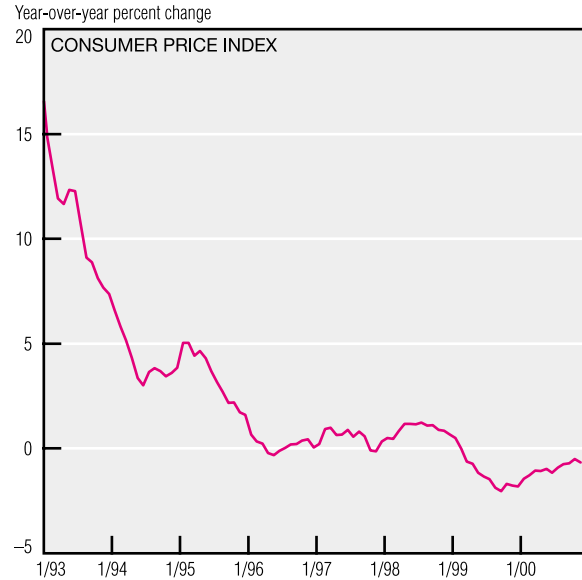
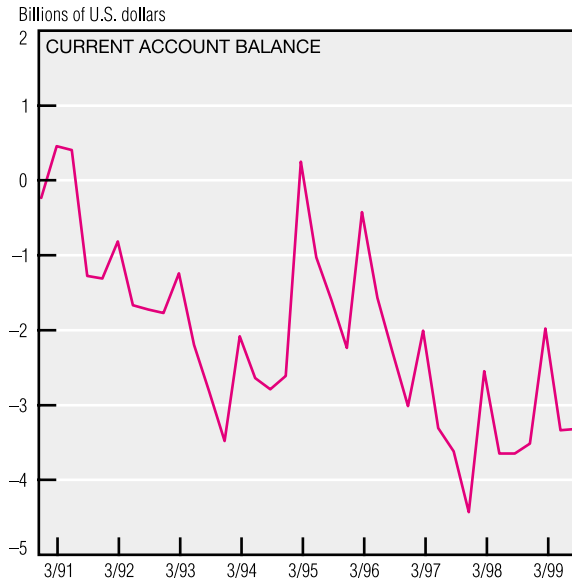
While many Americans are aware of the enormous overall U.S. trade deficit, few realize that our trade in services shows a surplus. The overall trade deficit results solely from our trade in goods. The trade balance in services has been in surplus for more than 15 years and has helped to offset the large and growing trade deficit in goods. In 1999, the U.S. had a surplus of \$80.6 billion on cross-border transactions in

private services, compared with a \$345.6 billion deficit on trade in goods.

The U.S. is one of the world's leading exporters of services, with most going to developed countries. Western Europe and Japan purchase 48% of U.S. services exports but only 32% of our goods exports. For Canada and Latin America, the pattern is reversed: These regions account for only 26% of U.S. services exports, but 45% of U.S. goods exports.

Royalties and licensing as well as other private services (such as financial services and business, professional, and technical services) make up 49% of total services exports. They have grown rapidly in the past decade and accounted for most of the services surplus in 1999. Other, more traditional services, such as tourism and transportation, constitute 45% of service exports.

Argentina's Currency Board



SOURCES: International Monetary Fund, International Financial Statistics; Standard and Poors Corporation; and DRI/McGraw-Hill.

Countries fare best with either a perfectly fixed or a completely floating exchange rate rather than a hybrid. Choosing the best arrangement for a particular country, however, is a difficult task. To gain insight into the decision, economists have been watching Argentina's currency board, which began in 1991.

The board pledges to exchange Argentine pesos freely, one-for-one, against U.S. dollars; it supports this promise by backing the monetary base with dollar reserves. So its monetary base cannot expand unless there is a net inflow of dollars, and that will happen only if the inflow of pri-

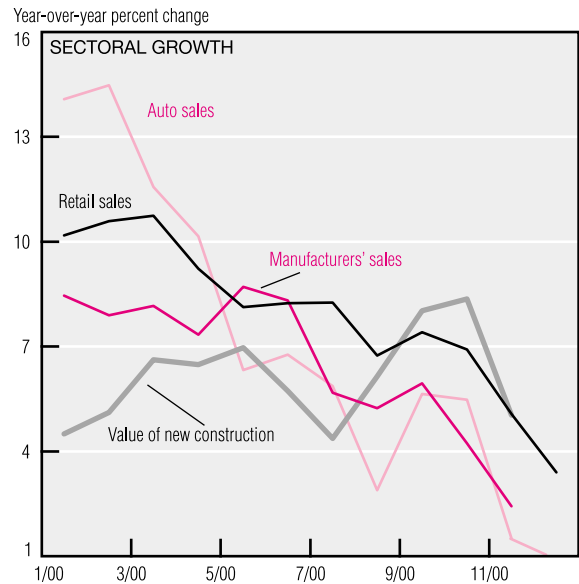
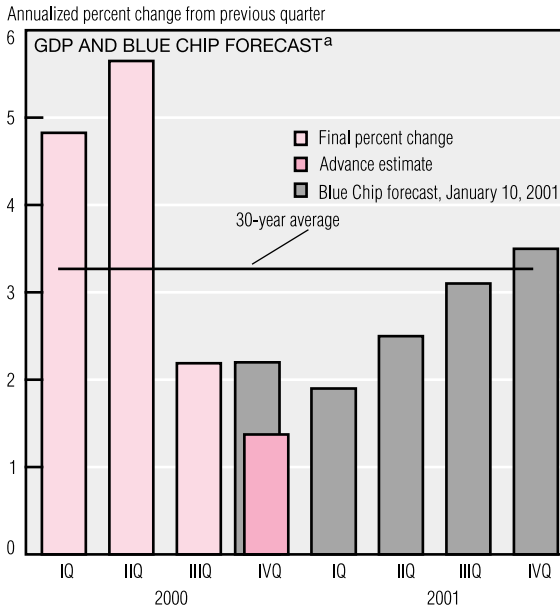
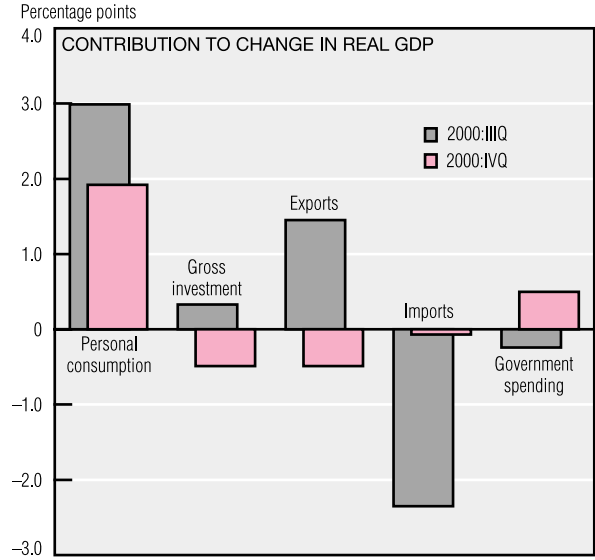
vate capital exceeds the country's current account deficit. Consequently, when former president Alfonsín suggested that Argentina might suspend repaying \$124 billion in foreign debts, he inadvertently threatened the currency board's viability. That crisis now seems to have passed. On January 12, 2001, the International Monetary Fund approved a package to help Argentina continue financing its external debts.

The currency board has proven enormously successful at eliminating inflation and inflationary expectations, but it also restricts ability to adjust quickly to economic

shocks. The dollar's overall appreciation in recent years and the devaluation of Brazil's *real* in January 1999 adversely affected Argentina's competitive position, particularly in Latin American markets. To regain its edge without depreciating the peso, it has had to lower domestic goods prices. Since early 1999, consumer prices have been falling, but Argentina's economy, particularly its labor markets, is not very flexible. Prices adjust slowly and as they do, output and employment typically fall. Limiting exchange-rate flexibility seems to require increasing domestic price flexibility.

Economic Activity

	Change, billions of 1992 \$	Percent change, last:	
		Quarter	Four quarters
Real GDP	32.0	1.4	3.5
Personal consumption	44.8	2.9	4.5
Durables	-7.7	-3.4	5.1
Nondurables	3.7	0.8	3.8
Services	46.0	5.3	4.7
Business fixed investment	-5.2	-1.4	10.1
Equipment	-13.8	-4.7	9.4
Structures	6.5	9.4	12.5
Residential investment	-2.3	-2.5	-2.3
Government spending	11.4	2.9	1.3
National defense	8.5	10.2	-1.7
Net exports	-14.5	-	-
Exports	-12.6	-4.3	7.3
Imports	2.0	0.5	11.8
Change in business inventories	-5.4	-	-



a. Chain-weighted data in billions of 1996 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 and annualized.
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and Blue Chip Economic Indicators, January 10, 2001.

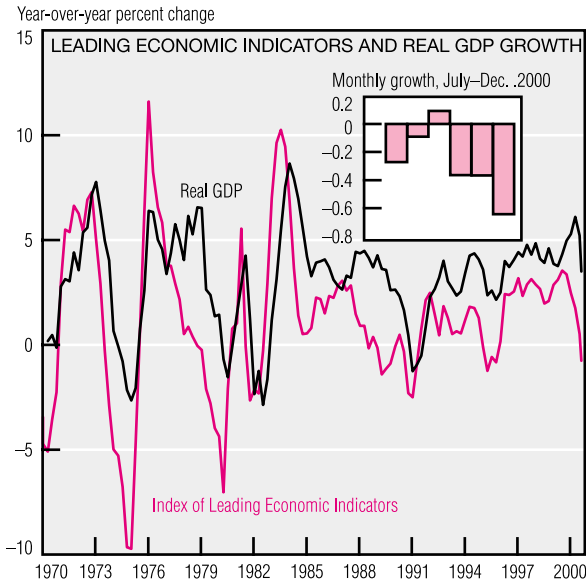
Gross domestic product (GDP) grew at a paltry 1.4% annual rate in 2000:IVQ. Despite this weak showing, the year still finished with a healthy fourth-quarter to fourth-quarter growth rate of 3.5%. Major contributors to the deceleration were business fixed investment and personal consumption, which fell to -1.4% and 2.9% from their respective third-quarter growth rates of 7.7% and 4.5%. The trade balance also contributed to slower growth, as exports contracted 4.3%. These declines were partly offset by an upturn in government

spending, which grew 2.9% after having fallen 1.4% in the third quarter. Blue Chip forecasters expect the downturn to be short lived; GDP growth should nearly equal its 30-year average by 2001:IIIQ. While growth in most sectors of the economy slowed last year, none was hit harder than manufacturing. Year-over-year manufacturing sales growth dropped from 8.4% in January 2000 to 2.4% during November. Retail sales were close behind, dropping from 10% to 5% over the same period. Of the December series available, retail sales have weakened fur-

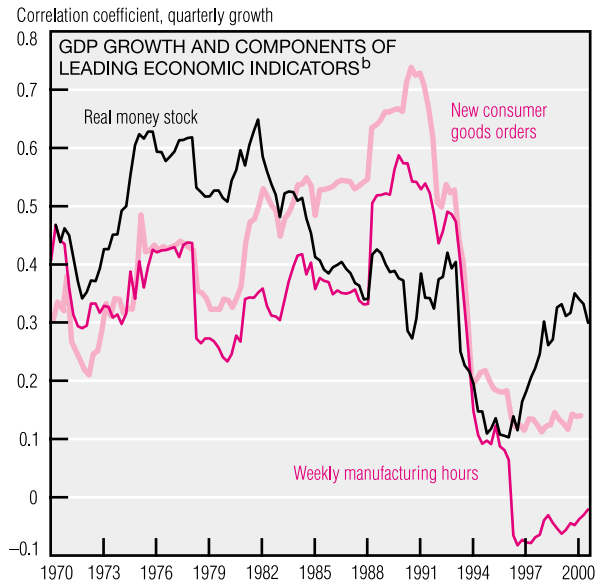
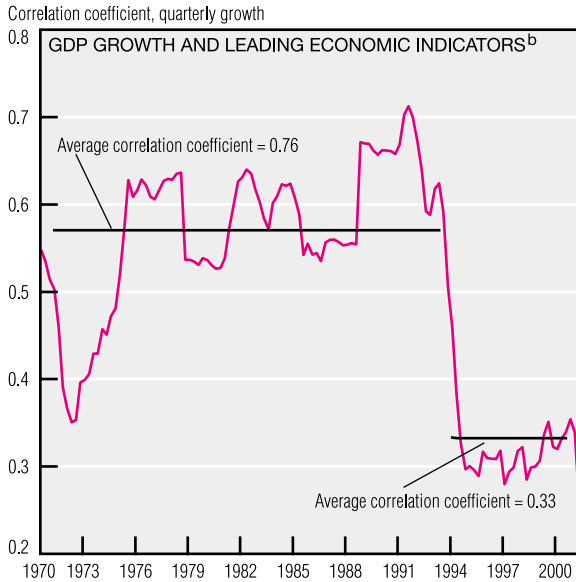
ther to 3.4% as year-over-year growth of auto sales decelerated from 14% in January 2000 to less than 1% in December. The Conference Board's Index of Leading Economic Indicators has dropped during five of the last six months, yielding a 0.76% decline over the past year. Historically, when the index's year-over-year growth has dipped below zero, a recession has followed in every case except 1995. The drop in the Leading Economic Indicator series prior to recessions is typi-

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Economic Activity (cont.)



	Index weight (percent)	Percent change, December	Percentage-point contribution, December
Interest rate spread ^a	32.7	-0.4	-0.12
Money stock, M2	30.3	0.7	0.22
Average weekly hours, manufacturing	19.0	-1.9	-0.37
New orders, consumer goods	4.9	0.2	0.01
Index of stock price	3.0	-3.2	-0.10
Vendor deliveries	2.7	5.7	0.15
Consumer expectations	1.8	-10.7	-0.20
Other	5.5	-17.5	-0.23
Total composite index			-0.64



a. Percent change in December imputed using percentage-point contribution and index weight.

b. Correlation coefficient computed using quarterly growth rates over a moving 10-year period.

NOTE: All data are seasonally adjusted and annualized.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and the Conference Board

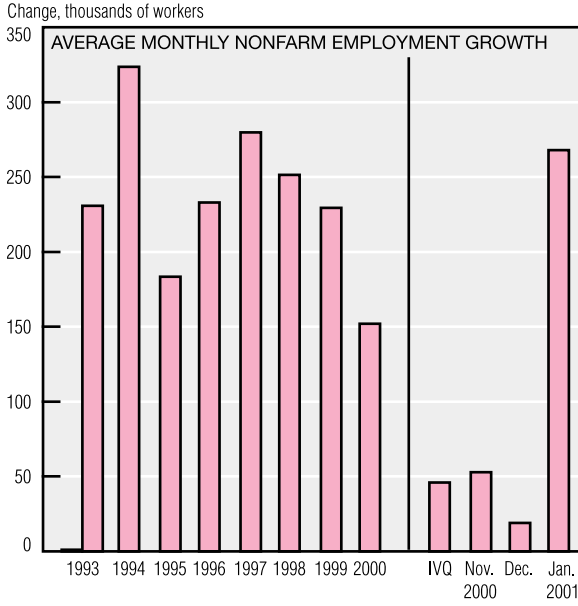
cally quite large—averaging 4.4% prior to every recession before 1990. The most recent 0.76% decline is in line with the 1995 experience and small compared to past recessions. Recently, however, the index has fallen more sharply, declining 0.64% in December alone. The leading contributors to the drop were average weekly hours of manufacturing firms, consumer expectations, and interest rate spreads. Changes in real M2 helped to offset some of these declines.

Even if this drop continues, it is diffi-

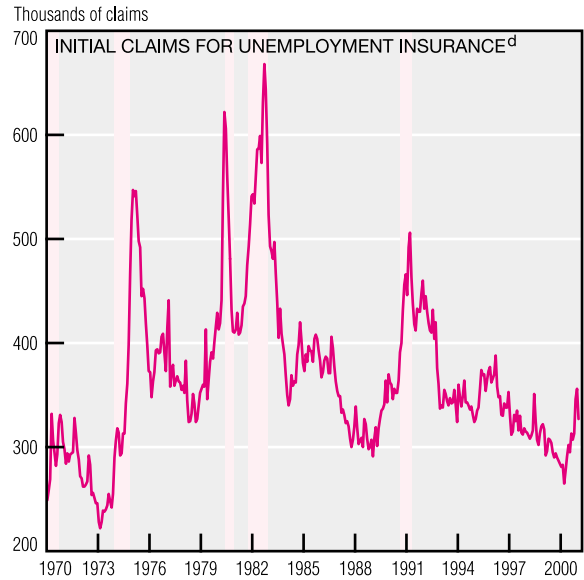
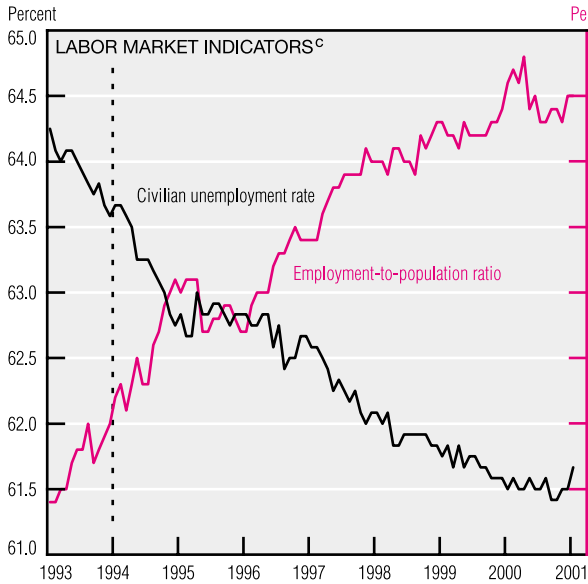
cult to gauge whether a recession is imminent. There is some indication that the correlation between changes in the Leading Economic Indicators and future GDP growth has not remained stable over the last three decades. During the 1970s and 1980s, the moving 40-quarter correlation between quarterly growth rates of the index and GDP growth averaged 0.76. After 1990, however, the correlation dropped precipitously and has averaged only 0.33 since 1994.

The correlation between GDP growth and the largest contributors to the index (in terms of weight) has also fallen significantly during this period. One hypothesis is that the 1990s' relatively stable GDP growth makes it *appear* that the Leading Economic Indicator series is now a poor predictor of oncoming recessions. However, when the large changes in GDP prior to 1990 are eliminated from the samples to mimic volatility since 1990, the correlation is still 0.6—significantly higher than the recent correlation of 0.33. The index's reliability appears to have declined substantially in the 1990s.

Labor Markets



	Average monthly change (thousands of employees)				
	1997	1998	1999	2000	Jan. 2001
Payroll employment	280	251	229	152	268
Goods-producing	48	22	4	0	85
Mining	1	-3	-3	1	5
Construction	21	37	25	14	145
Manufacturing	25	-12	-18	-15	-65
Durable goods	27	-2	-6	-5	-71
Nondurable goods	-2	-11	-12	-10	6
Service-producing	232	229	225	152	183
TPU ^a	16	20	16	15	-3
Retail trade	24	30	36	27	27
FIRE ^b	21	22	10	4	29
Services	141	120	124	91	81
Government	17	28	28	9	54
	Average for period (percent)				
Civilian unemployment	4.9	4.5	4.2	4.0	4.2



a. Transportation and public utilities
 b. Finance, insurance, and real estate.
 c. Vertical line indicates break in data series due to survey redesign.
 d. Shaded areas indicate recessions.
 NOTE: All data are seasonally adjusted.
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Unusual winter weather made for large seasonally adjusted employment gains in construction, contributing strongly to January's 268,000-job surge in nonfarm payrolls. Severe November and December weather initiated earlier-than-normal seasonal layoffs in construction, while mild weather last month brought lower-than-normal layoffs; the net result was a large employment gain. Similarly, unusually light holiday hiring at the post office meant fewer January layoffs, causing large seasonally adjusted net gains in government employment as well.

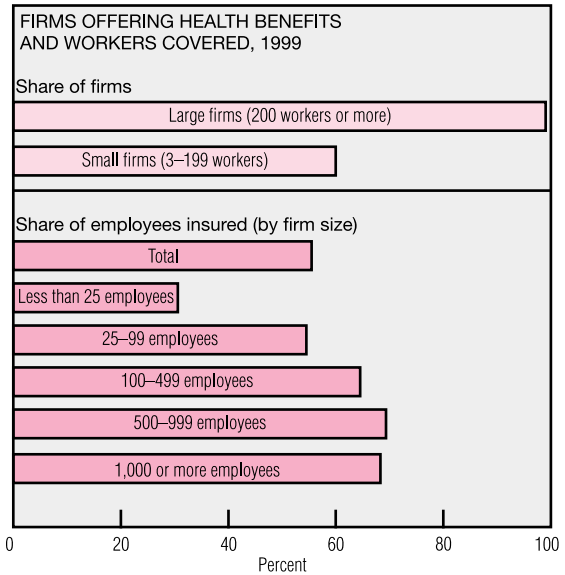
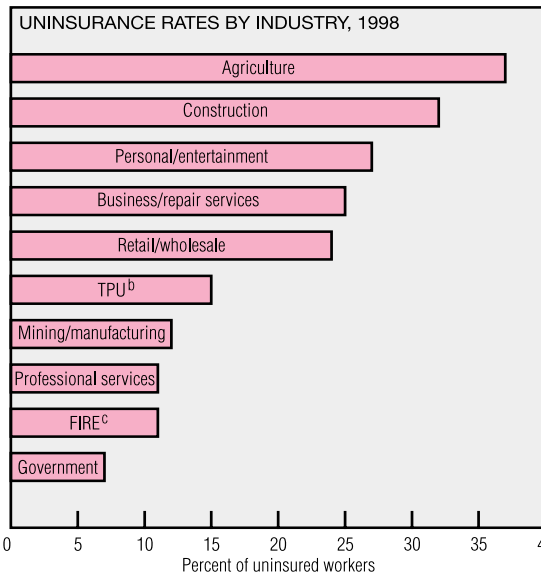
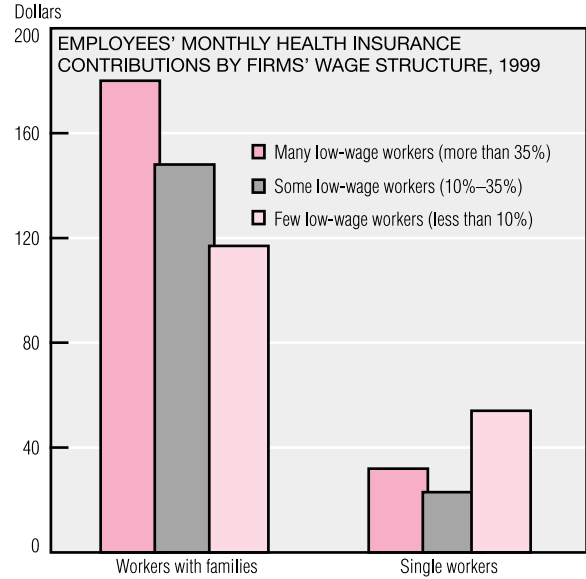
Overall nonfarm employment growth was strong last month, especially compared to the weak average monthly gain of 46,000 workers in 2000:IVQ, but manufacturing sector employment continued to decline precipitously, shedding 65,000 jobs in January for a total net loss of 254,000 since last June. Manufacturing employment declines were widespread, but the largest was in motor vehicles, which had a net loss of 38,000 jobs last month. On the other hand, the service-producing industry grew by a

healthy 183,000 jobs, led by net gains in services (81,000 jobs) such as health services (30,000 jobs).

Other January labor market measures were mixed. A large monthly increase in the number of jobless people (303,000) caused the unemployment rate to rise 0.2% to 4.2%, but the employment-to-population ratio remained unchanged at 64.5%, near its all-time high. Another measure, initial claims for unemployment insurance, showed the labor market to be weaker than last year but not at recession levels.

Worker's Health Insurance Costs

Percent of poverty line	Workers (millions)	Uninsured (millions)	Uninsured (percent of workers)
Full-time workers	93.4	14.0	15.0
Less than 100%	2.8	1.3	48.4
100-199%	10.3	3.8	37.2
200-299%	15.4	3.2	20.5
300% or more	64.9	5.7	8.7
Part-time workers	11.5	2.6	22.4
Less than 100%	1.2	0.5	41.7
100-199%	2.0	0.8	40.4
200-299%	1.9	0.5	23.9
300% or more	6.4	0.8	12.7



a. Workers aged 18-64.

b. Transportation and public utilities.

c. Finance, insurance, and real estate.

SOURCES: U.S. Department of Commerce, Bureau of the Census, Current Population Survey, March 2000; Kaiser Survey of Employer-Sponsored Health Benefits, 1999; Health Insurance Coverage, 1999; and the Urban Institute.

The incidence of health insurance coverage varies considerably by income. As the table above shows, full-time workers at or below the poverty line are over five times more likely to be uninsured than are workers whose income is at least 300% of the poverty line.

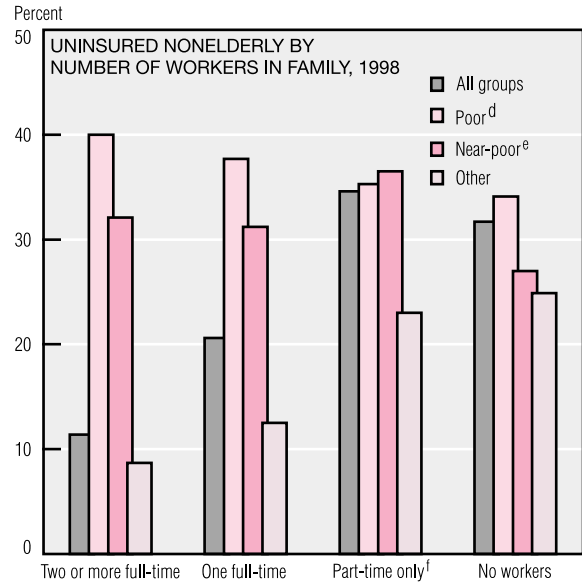
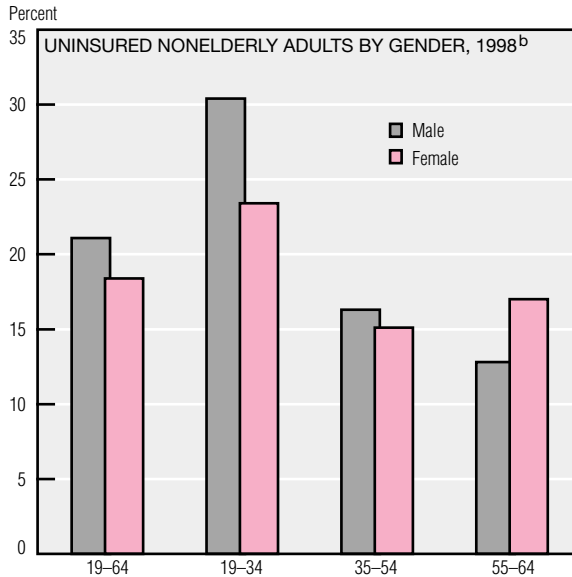
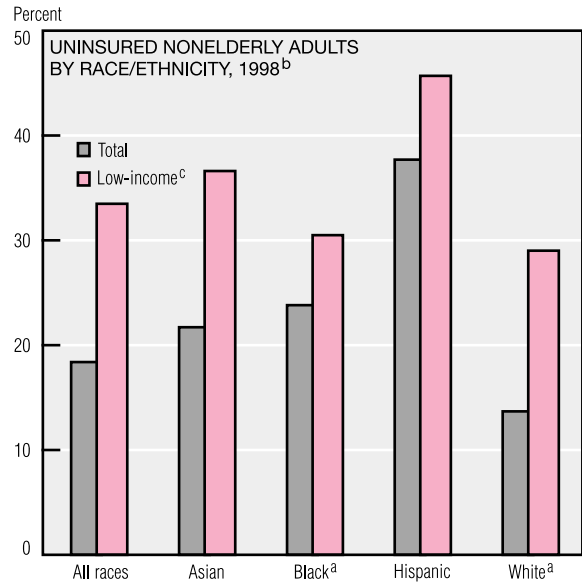
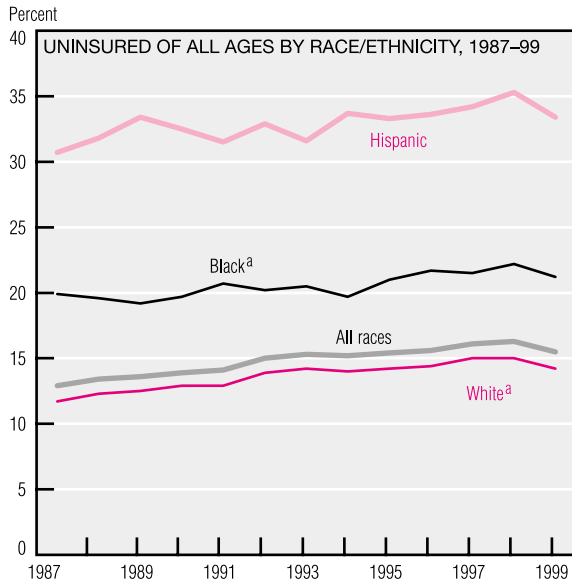
This has become an even greater problem because welfare reform and a strong economy have drawn many of the poor back into the labor force. The low-wage jobs they receive often lack employer-sponsored health insurance, yet frequently make them ineligible for Medicaid.

Even when employers do offer health insurance benefits, many low-income employees cannot afford to pay their portion of the premium. Moreover, for workers with families, the employee-paid portion varies widely, and not as one might expect. In fact, the employee's portion of the premium is 54% higher in firms with the largest shares of low-wage workers (where more than 35% of workers earn 200% of the poverty line or less) than in firms with the smallest share of low-wage workers (less than 10% of employees).

The incidence of coverage, like the cost

to employees, differs widely by industry. At one extreme, nearly 40% of the agriculture workforce is uninsured; at the other, only 7% of government workers lack health insurance. Coverage rates also vary by firm size. Perhaps because they can pool their risk, almost all firms of 200 or more employees offer health insurance benefits (although not all employees in such firms receive them or are even eligible), while only 60% of smaller firms, which employ 20% of the workforce, offer such benefits.

Health Care Coverage in the US



a. Includes only non-Hispanic members of the race.
 b. Nonelderly adults are those aged 19-64.
 c. Low-income is defined as less than 200% of the poverty line. In 1998, a person who made less than \$16,632 was classified as low-income. A family of four was low-income if its household income did not exceed \$33,320.
 d. Poor refers to those living at or below the poverty line. In 1998, the poverty line for an individual was \$8,316. For a family of four, the poverty line was \$16,660.
 e. Near-poor refers to those living in a household whose income is above the poverty line, but less than 200% of the poverty line.
 f. Working less than 35 hours per week.
 SOURCES: U.S. Department of Commerce, Bureau of the Census, Health Insurance Coverage, 1999; and the Urban Institute.

While all seniors in the U.S. are covered by Medicare, not all younger Americans have health insurance. After rising steadily throughout the 1990s, the share of the population not covered by health insurance declined in 1999. It now stands at roughly 15%.

Rates of uninsured nonelderly adults, broken down by race and ethnicity, show that whites have the smallest fraction of uninsured. One of every four blacks and more than one of every three Hispanics has no health insurance

coverage. Uninsured rates are higher among low-income individuals, with whites showing the most drastic income-related changes in incidence. Among low-income individuals, the rate of uninsured whites doubles, nearing the uninsured rate of low-income blacks. For low-income Hispanics, the uninsured rate rises to 45.7%.

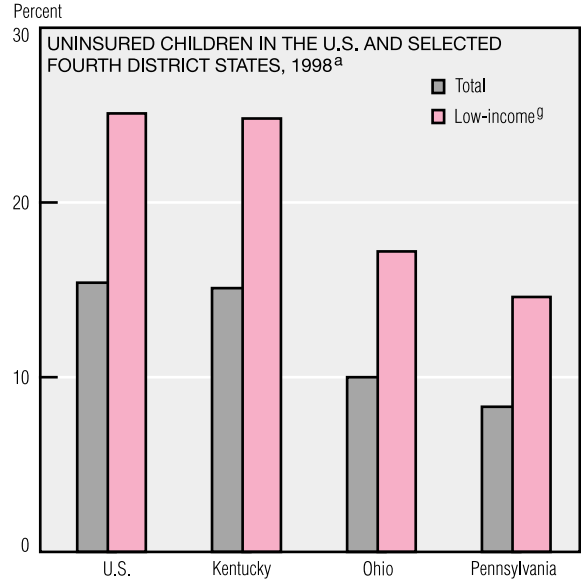
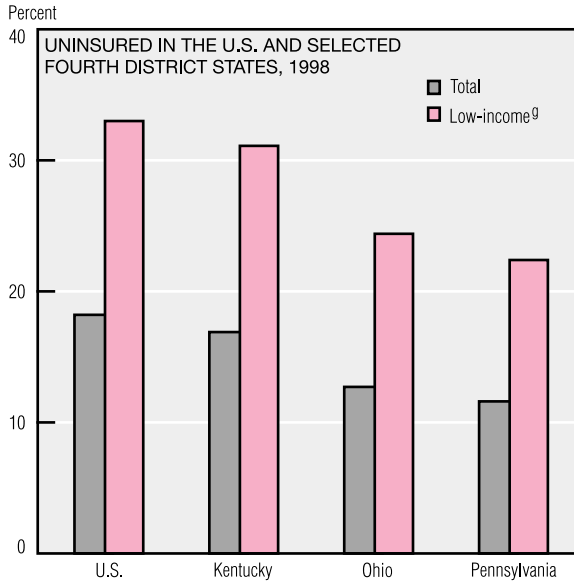
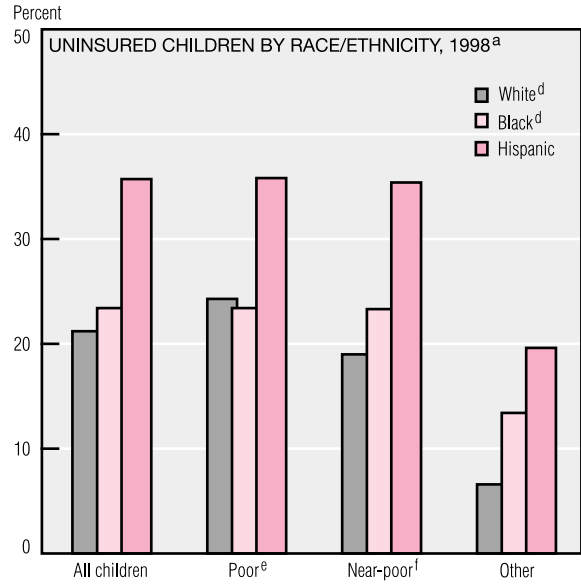
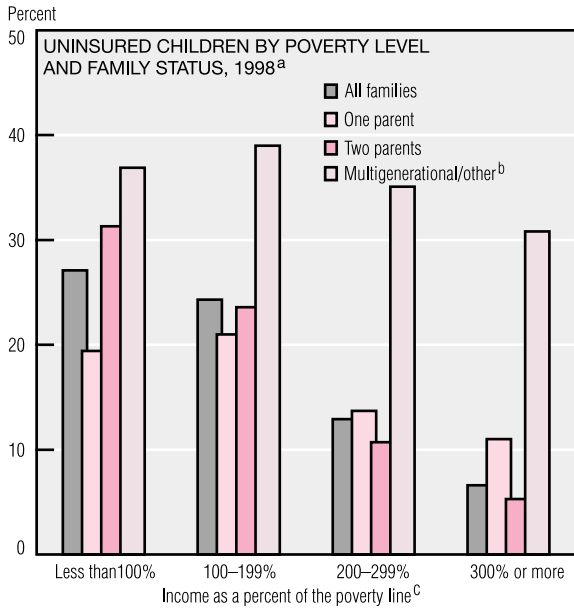
Although females tend to have higher poverty rates, males are less likely to be insured. A breakdown of categories by age shows that young adult males (19-34) have the highest percent of uninsured individuals. Surprisingly, near-elderly females

(55-64) have a higher percent of uninsured than males of the same age.

Past welfare efforts have been criticized for not allowing the working poor or near-poor to retain supplemental benefits (such as health care benefits) when they enter the workforce or improve their financial situation slightly. A breakdown of uninsured nonelderly adults by family work status supports this contention: The poor and near-poor have higher uninsured rates when at least one person in the house is working than if no one in the family has a job. Unin-

(continued on next page)

Health Care Coverage in the US (cont.)



a. Children are defined as those younger than 19.
 b. Multigenerational/other families include at least three generations in a household and/or families where adults are caring for children other than their own.
 c. In 1998, the poverty line for an individual was \$8,316. For a family of four, the poverty line was \$16,660.
 d. Includes only non-Hispanic members of the race.
 e. Poor refers to those living at or below the poverty line.
 f. Near-poor refers to those living in a household whose income is above the poverty line, but less than 200% of the poverty line. In 1998, an income of \$16,632 was 200% above the poverty line for a single person. A family of four was 200% above the poverty line if its household income was \$33,320 or more.
 g. Low-income is defined as less than 200% of the poverty line.
 SOURCES: U.S. Department of Commerce, Bureau of the Census, Health Insurance Coverage, 1999; and the Urban Institute.

sured rates among the poor appear to rise with the number of workers in the family.

Children's coverage rates show a similar pattern. In the aggregate and for two-parent families, the percent of uninsured children falls as family income rises. However, in one-parent households and multigenerational/ other households, poor children have a higher rate of coverage than do the near-poor.

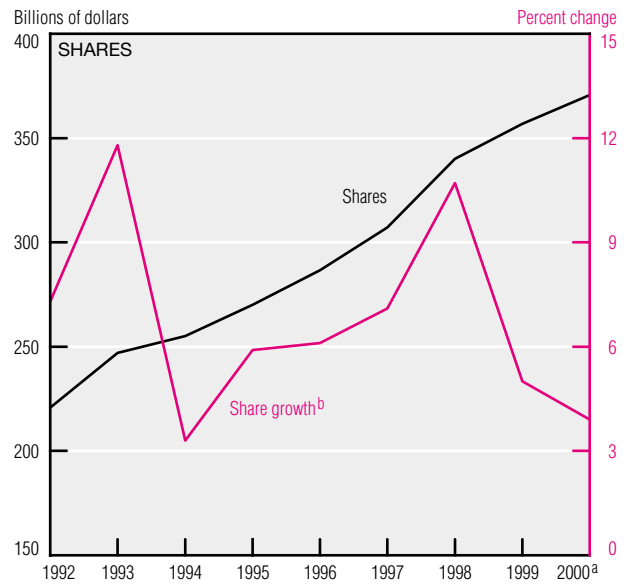
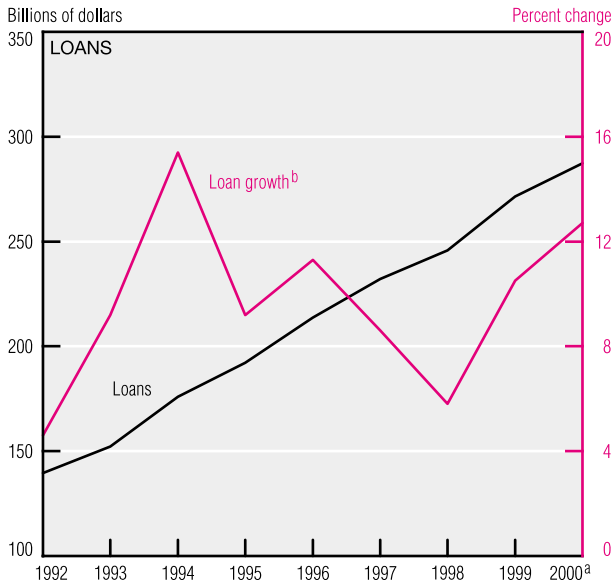
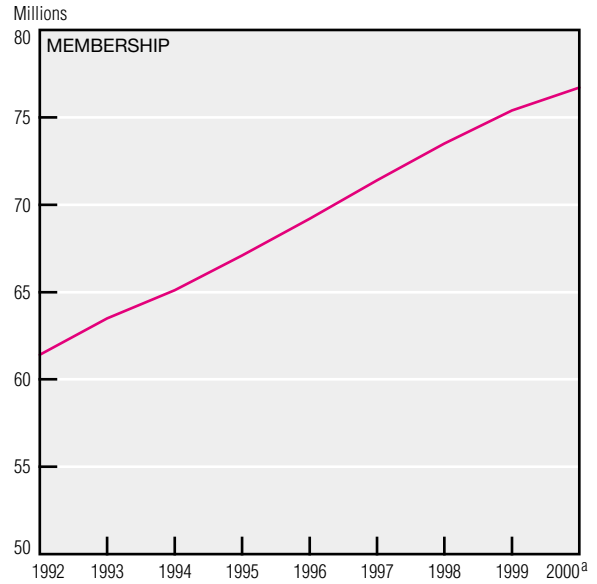
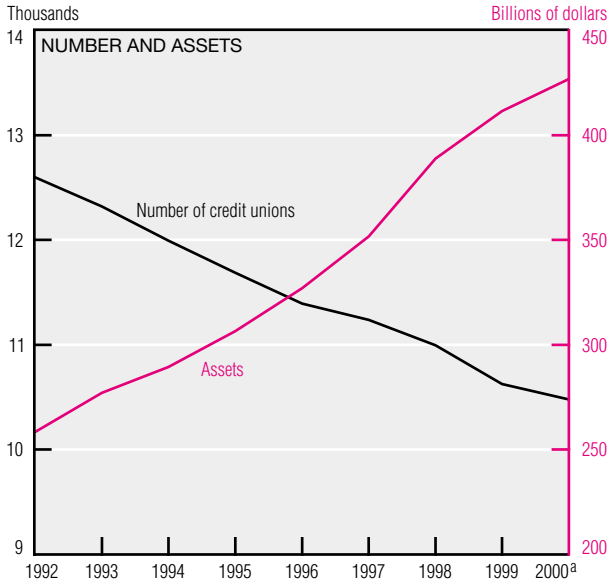
Distinguishing between poor and near-poor does not yield a difference for black or

Hispanic children in terms of coverage rates. Among white children, however, those from poor families have lower coverage rates than those whose families are classified as near-poor. Among poor families, the percent of uninsured children is higher for whites than for blacks. Like the larger nonelderly population of Hispanics, more than one of every three Hispanic children living in poverty or near-poverty lacks health insurance.

In the Fourth District states of Kentucky, Ohio, and Pennsylvania, as in the

nation as a whole, the share of low-income individuals without health insurance is considerably higher than the share of all individuals without insurance. These Fourth District states show better rates of coverage for the nonelderly, and more specifically for children, than does the U.S. While the percents of uninsured adults and children in Kentucky are fairly close to those for the nation, Ohio and Pennsylvania enjoy considerably lower rates.

Credit Unions



a. Through June 2000.

b. Annualized.

NOTE: Data are for federally insured credit unions.

SOURCES: National Credit Union Administration, Year-End Statistics for Federally Insured Credit Unions and Mid-Year Statistics for Federally Insured Credit Unions.

Credit unions are mutually organized depository institutions that provide financial services to their members. Like banks and savings associations, credit unions seem to be consolidating. Their numbers fell from 12,596 in 1992 to 10,479 at mid-2000. However, their total assets rose nearly 65% over the same period, from \$258.4 billion to \$426.8 billion. The number of credit union members also increased steadily from 61.4 million in 1992 to 76.7 million at the end of 2000:IIQ.

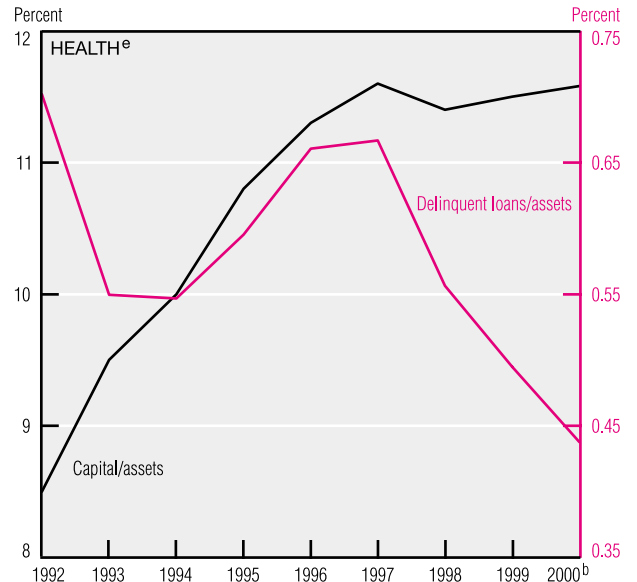
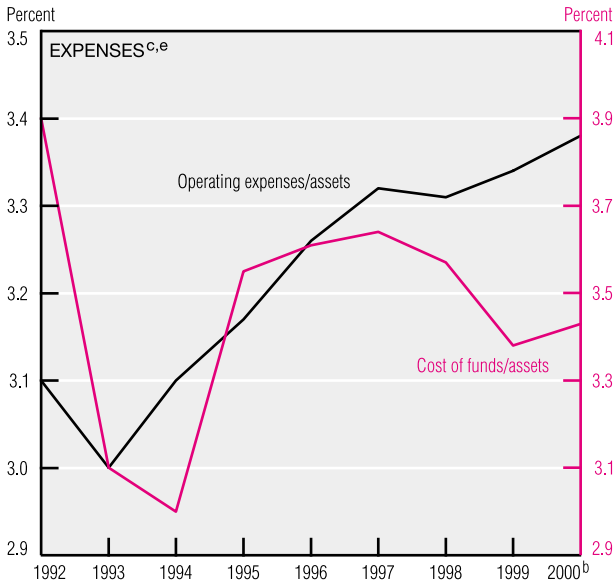
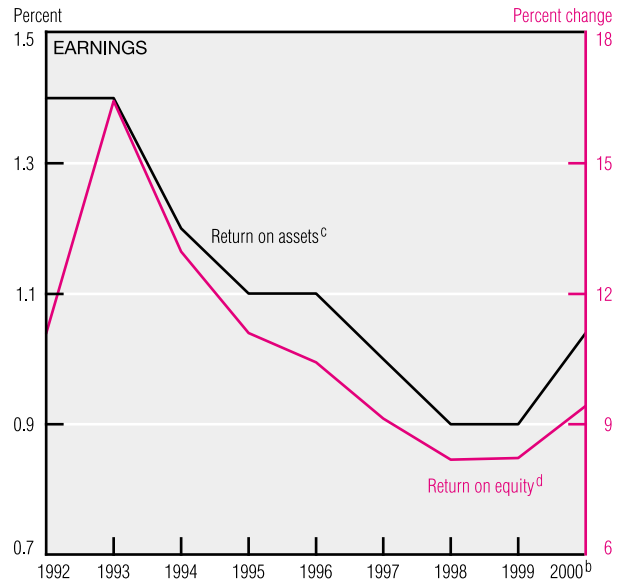
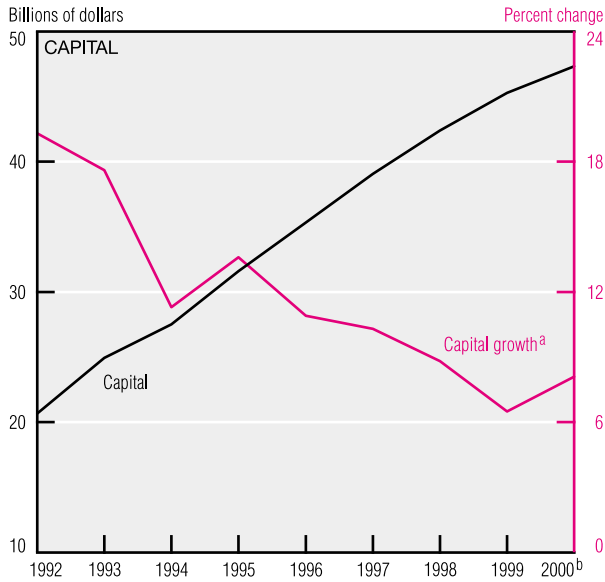
Credit unions' asset growth was fueled by positive loan growth throughout the period. Loans rose from \$139.5 billion at the end of 1992 to \$287.4 billion through June 2000; loans as a share of assets grew from 54% to 67.3% over the same period. Loan growth was remarkably strong in the early 1990s but tapered off in the middle of the decade; however, it has accelerated since 1998, reaching 12.7% for the 12 months ending June 30, 2000.

Credit union shares have also risen

steadily since 1992. Shares (the equivalent of deposits in banks and savings associations) are the primary source of funds for credit unions, accounting for roughly 87% of total funds. Share growth increased every year from 1994 to 1998, when it peaked at 10.7%. It then fell in 1999 and the first half of 2000. This may be the result of high stock-market returns during 1998 and 1999.

(continued on next page)

Credit Unions (cont.)



a. Annualized.
 b. Through June 2000.
 c. All returns and expenses are for the average quarterly level of assets during the year.
 d. Return on equity is for average equity.
 e. All ratios are for total assets.

NOTE: Data are for federally insured credit unions.

SOURCES: National Credit Union Administration, Year-End Statistics for Federally Insured Credit Unions and Mid-Year Statistics for Federally Insured Credit Unions.

Credit unions continued to accumulate capital from the end of 1992 through mid-2000, more than doubling over the period. However, the rate of capital growth fell from 19.3% in 1992 to 8.1% at the end of 2000:IIQ. However, the 8.1% growth rate in capital represented its first increase since 1995.

Because retained earnings are credit unions' only source of capital, the pace of capital accumulation since 1995 has mirrored the decline in return on assets and return on equity. Return on assets

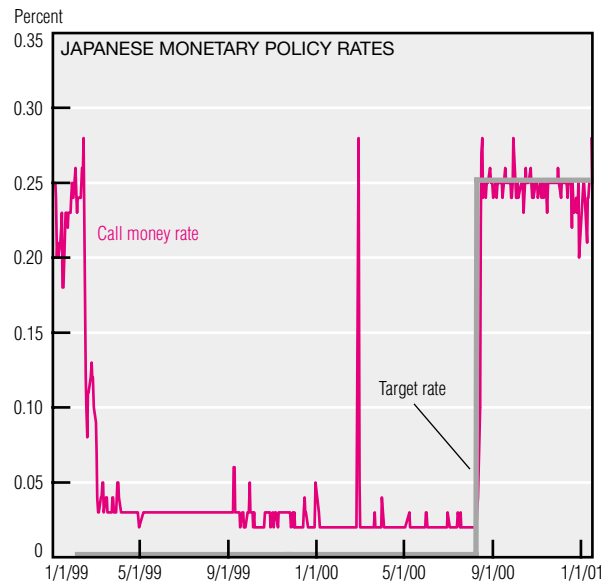
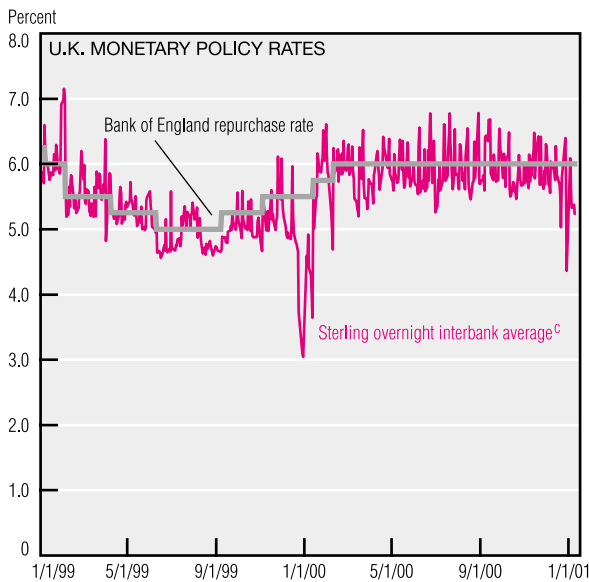
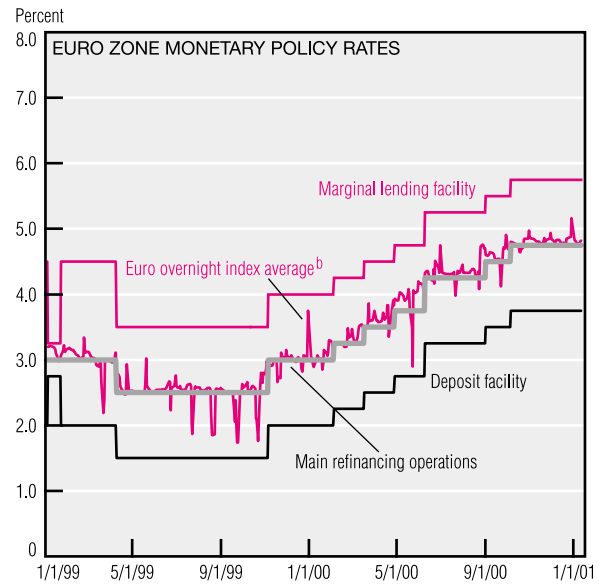
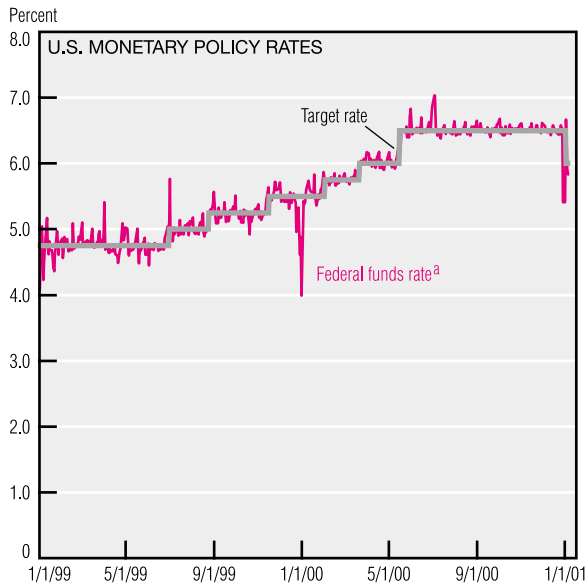
fell from a high of 1.4% in 1992 to 0.9% in 1999 before rising to 1.0% in mid-2000. Return on equity peaked at 16.4% in 1993 and fell steadily to 8.2% in 1998 before increasing to 9.4% at the end of 2000:IIQ. The decline in credit unions' profitability during most of the 1990s resulted partly from a steady increase in operating expenses per dollar of assets after 1993 and a sharp increase in the cost of funds in 1995, a consequence of monetary policy actions in 1994.

Overall, the credit union industry's health appears to be good. Capital as a

percent of assets stood at 11.1% at mid-2000, equaling its 1997 peak. On the other hand, delinquent loans as a percent of assets fell from 0.67% in 1997 to 0.44% at mid-2000. In other words, at the end of 2000:IIQ, credit unions held more than \$25 of capital for every \$1 of delinquent loans.

Credit unions remain a viable alternative to commercial banks and savings associations for basic services such as consumer loans, checking accounts, and savings accounts.

Foreign Central Banks



a. The weighted average of rates on trades made through New York City brokers.

b. The weighted average rate on all overnight unsecured lending transactions in the interbank market, initiated within the euro area by contributing panel banks.

c. The weighted average rate of all brokered unsecured sterling overnight deals between money market institutions and their overseas branches, transacted between midnight and 3:30 p.m. GMT.

SOURCES: Board of Governors of the Federal Reserve System; and Wholesale Markets Brokers Association.

Central banks for the major currencies use somewhat different institutional and market devices to implement policy. Despite these differences, in the very short run they all operate in ways that lead daily overnight market interest rates along a desired path—albeit with more or less interday volatility.

In the U.S., the first of two January reductions (50 basis points each) in the intended federal funds rate was largely unexpected, but the market rate immediately dropped and has remained near 6%. The

European Central Bank, at its regular bi-weekly meeting the next day and again on January 18, kept the rate on its main refinancing facility unchanged at 4.75%. Consequently, the European overnight index average has shown no clear change.

The sterling overnight interbank rate seemed to move in the same direction as the federal funds rate early in January, perhaps in anticipation of a similar policy move by the Monetary Policy Committee. The Committee, however, made no change in the 6% Bank of England RP rate at its

regular monthly meeting on January 11. The Japanese call money market seemed to be anticipating a Bank of Japan rate cut at the end of last year. But after the Bank's regular monetary policy meeting on January 19, Governor Hayami instructed its staff to "examine the possible room for further improvements in the way of liquidity provision to the market, with a view to ensuring the smooth functioning and stability of the financial market" and to report the results to the Policy Board by its next meeting on February 9.