The Economy in Perspective

My dinner with André…I had seen my old friend André just last July, when he astonished me with the news that he had returned to politics in Nedlaw, his native land. Delighted to be meeting again so soon, I raised my glass in a toast as we sat in the Endless Bounty, a trendy new restaurant on the harbor.

"À l'avenir, mon ami," André chirped as our glasses clinked. "Here's to better days ahead. I hadn't planned to return to your country quite so soon, but the events of the past few months have made my special expertise, well, indispensable to your government." Pausing, he ordered with assurance. Then, turning back to me, he declared, "If your country wants its growth machine moving again, it must start greasing some…wheels, so to say."

André is not always the easiest person to follow, but I grasped his intent immediately. Late last summer, Nedlaw suffered a series of earthquakes and floods. The prime minister appointed André director of the Nedlaw Economic Reconstruction Department. As head NERD, he had broad authority to use the government's resources and powers to stimulate economic growth.

I pointed at him, exclaiming "NERD!" The waiter, alarmed, abruptly set down my friend's fresh Washington oysters and retreated to the kitchen.

André pointed back at me, obviously delighted at my quickness, and shouted, "*Oui*, NERD!" Several pairs of eyes rotated in our direction. The Endless Bounty's patrons, who are serious gourmets, are unaccustomed to such levity at table. Ignoring their stares, André continued. "After the tragic events in your country, people have become leery of traveling. Insurance companies feel compelled to raise premiums on their property and casualty risks. Everyone is spending more on security. And governments are using their funds to improve the reliability and safety of their infrastructure and public services. *Par conséquence*, normal patterns of commerce have seized up, throwing your economy into disarray. I'm here to fix it." With that, André appreciatively spooned some bouillabaise into his mouth.

"But André, what can you suggest that we haven't already thought of? Congress has passed legislation to bolster the airline industry because of its importance to commerce and tourism, and it is considering relief for the insurance industry as well. Defense and security appropriations will escalate, providing some lift to the economy. And the central bank has lowered its interest rates several times. Surely the economy will improve soon. It just takes a little time."

"Forgive my s*kepticisme*," André said after downing a mouthful of crab escabeche. "I know what worked in Nedlaw, and you are not greasing enough wheels, *mon ami*. You must do all of those things, and much, much more. In Nedlaw, after the floods and earthquakes, people were also slow to return to the life they used to live, so my fellow NERDs and I swung into action. First, we gave free flood and earthquake insurance to everyone. Then we subsidized air, rail, and bus transport companies so that businesses along their routes could remain viable. In fact, we cut taxes for those other businesses, too, to help them out for a while. Finally, to get people shopping again, we established a tax holiday so nobody had to pay sales taxes for a whole month. It was, I must say, an ingenious plan!

Once again, my friend seemed to have turned a sow's ear into yet another silk purse. "André," I remarked, "you seem to have thought of everything. Tell me, how quickly did the economy improve?"

"Almost overnight!" André exclaimed. The free insurance had the desirable effect of encouraging new construction, especially on the flood plains and along the fault lines where the damage had been most severe. More people are living there now than before the disasters! The transport subsidies and business tax cuts restored profitability, and those companies will be ready for their customers if and when they return. But our most successful measure was the tax holiday for retail shops. You should have seen the jewelry and other imported luxury goods fly out the doors!"

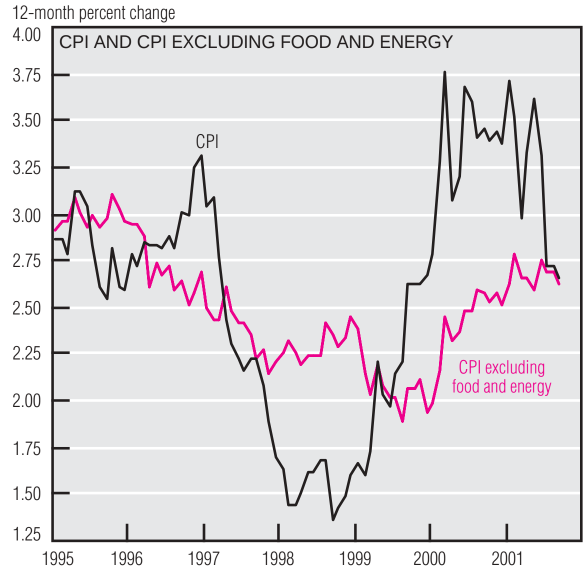
"André," I suddenly thought to ask, "how could Nedlaw afford all these subsidies and tax breaks? Who is paying the bill?"

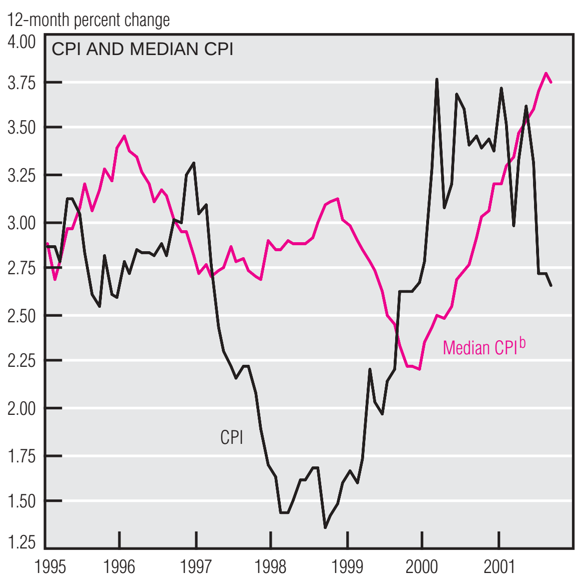
"That's the best part," André chortled as he gazed affectionately at his mousse aux framboises. "The Treasury issued an enormous amount of debt, which for some reason no one wished to buy. So I told the central bank to purchase it and convert it into money. Because, as we say in Nedlaw, you can't grease a wheel with empty pockets."

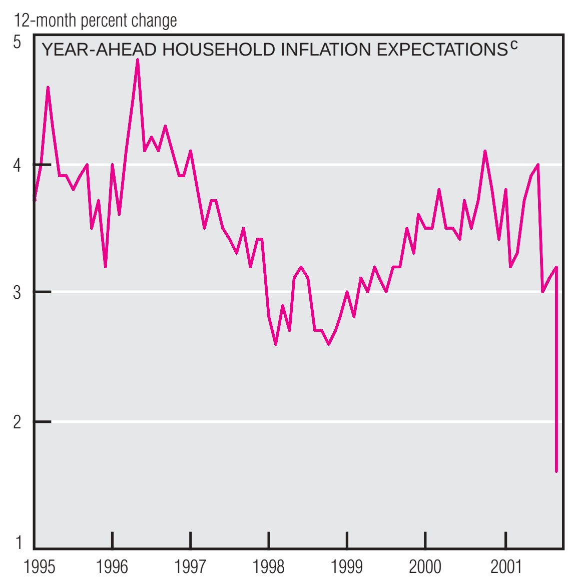
Inflation and Prices

September Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	2000 avg.
Consumer prices					
All items	4.8	0.7	2.6	2.5	3.4
Less food and energy	2.6	2.4	2.6	2.4	2.5
Median[b]	2.9	3.6	3.7	3.0	3.2
Producer prices					
Finished goods	4.3	–0.8	1.7	1.4	3.6
Less food and energy	3.2	1.6	1.3	1.2	1.3







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. 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.

After a modest August increase, the Consumer Price Index (CPI) rose sharply in September (4.8% annual rate). A marked acceleration in energy price inflation was partly responsible for the dramatic rise. The CPI's energy index, having declined in each of the previous three months, rose 36.2% (annual rate) in September.

However, excluding the typically volatile food and energy components, the CPI showed no acceleration between August and September (2.6% annual rate). This may suggest that the underlying inflation rate in the economy is still in check. Indeed, during 2001, the 12-month rate of change in this so-called core CPI has remained relatively stable. Unfortunately, the median CPI, another statistic intended to reflect underlying inflation in the economy, has shown a different trend throughout 2001. This measure's 12-month rate of change, in fact, has risen almost every month since the beginning of 2000.

The long-term economic effects of the attacks on September 11 are difficult to determine. It appears, however, that the attacks may have caused households to dramatically alter their expectations of inflation in the months ahead. According to the University of Michigan's *Survey of Consumers*, year-ahead household inflation expectations fell from 3.2% in September to 1.6% in October. The decline of 1.6 percentage points was the most dramatic monthly drop reported by the survey since December 1981.

The attacks were associated with unusual movements in many of the

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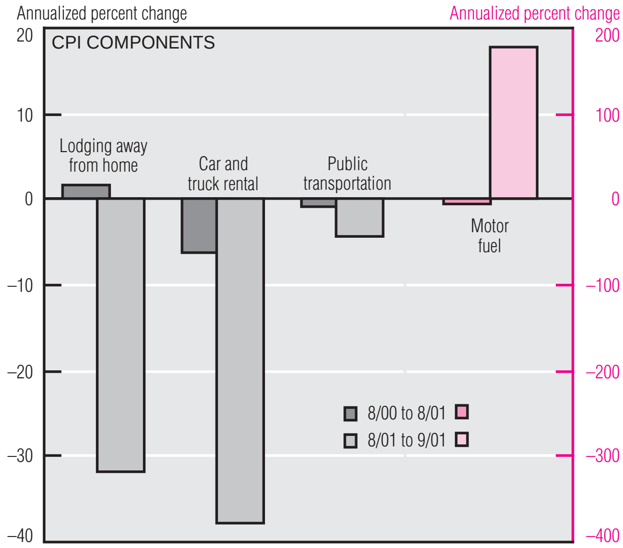
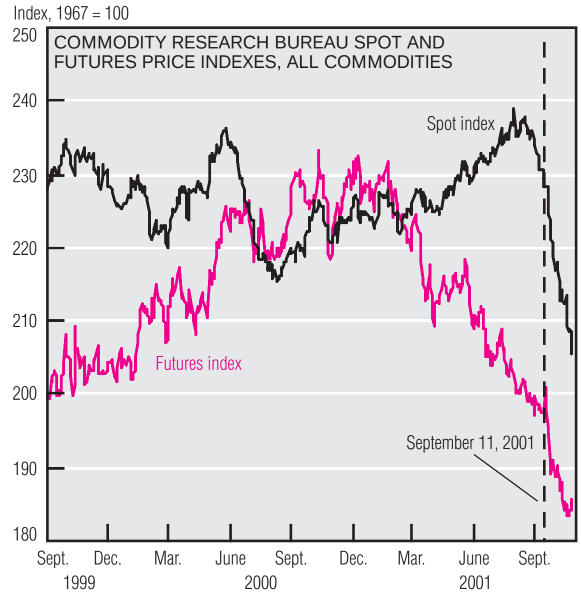
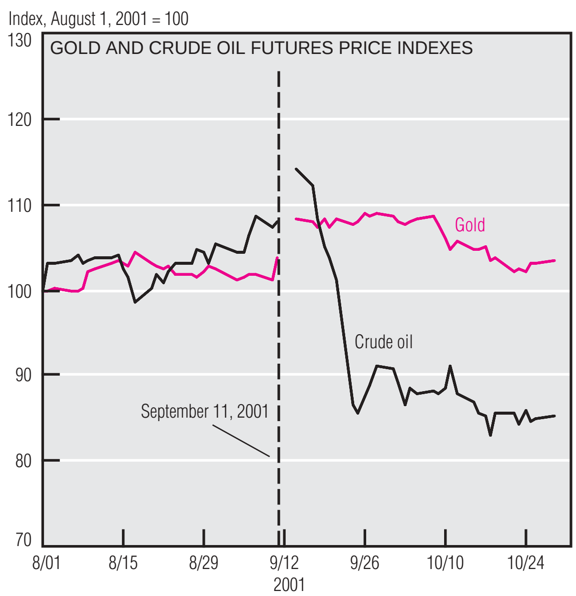
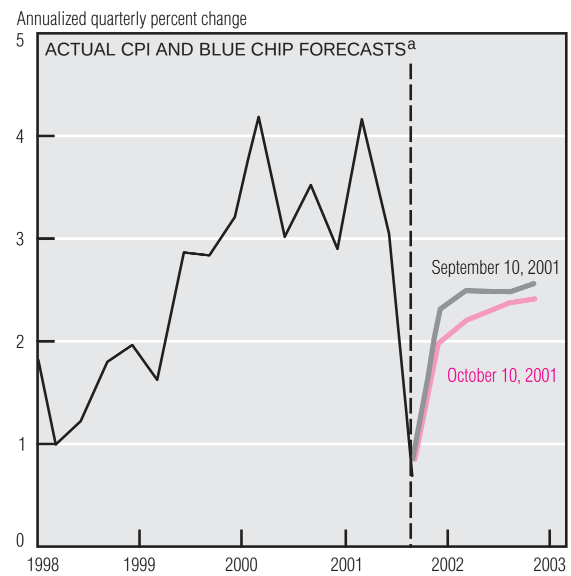
Inflation and Prices (cont.)









a. Blue Chip panel of economists.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; *Blue Chip Economic Indicators*, September 10, 2001 and October 10, 2001; and Bloomberg Financial Information Services.

CPI's individual components. Motor fuel prices showed a sharp increase in September. Immediately after the attacks, gasoline prices reportedly quadrupled and quintupled in some spots around the country.

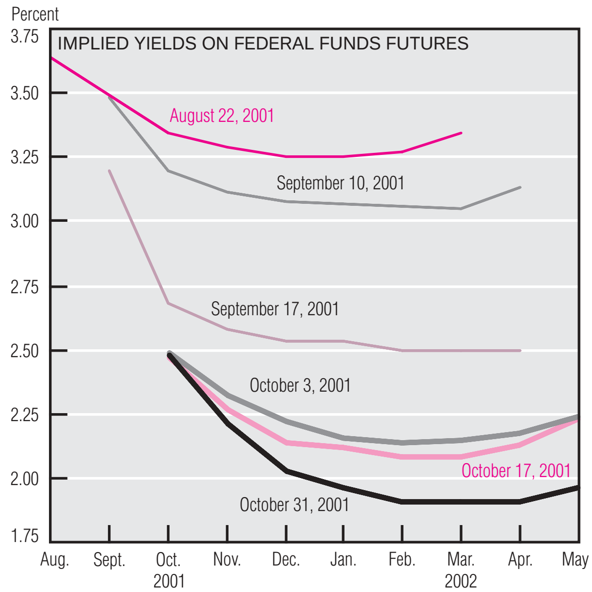
The indexes for other CPI components swung sharply in the opposite direction in September. As people traveled less, prices for many travel-related components declined sharply. For instance, car and truck rentals and lodging away from home showed annualized price drops of about 30%. Prices for public transportation, which includes air fares, also fell more sharply in September than in the 12-month period between August 2000 and August 2001.

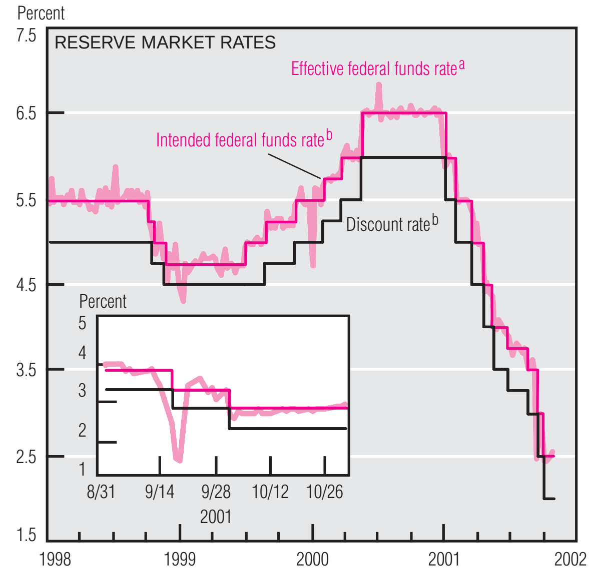
The rate of decline in the spot and futures prices of industrial commodities also accelerated after the attacks. Gold futures prices, after ticking up slightly following the attacks, have returned almost to pre-attack levels. This is unusual; gold prices generally rise in times of economic and political uncertainty, reflecting a widespread desire to find safer stores of value.

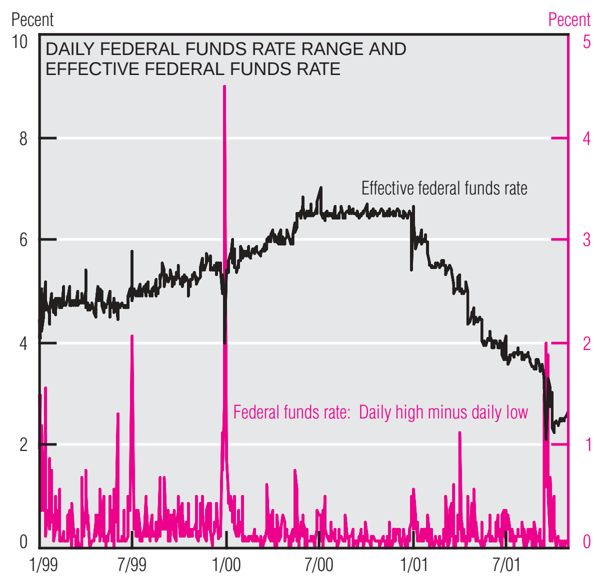
The marked decline in prices for crude oil futures contracts is also notable. It may reflect expectations of significantly poorer worldwide economic performance in the months ahead that would slacken crude oil demand.

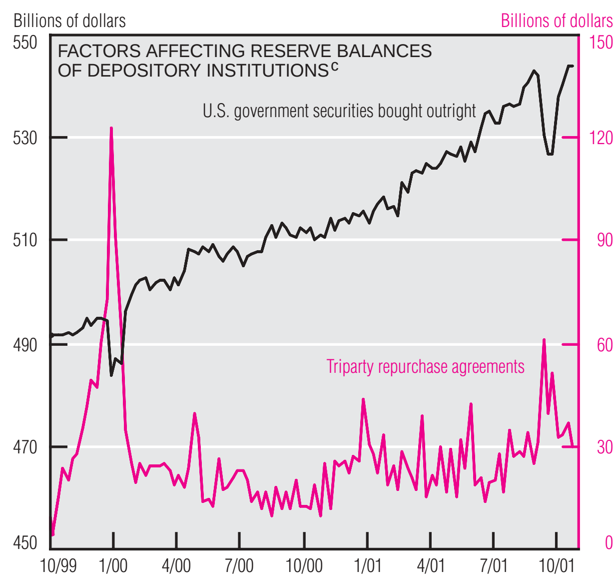
Professional economic forecasters also seem to expect a weaker worldwide economy in the months ahead. Accordingly, the consensus forecast for inflation over the next 15 months has fallen several tenths of a percentage point since September.

Monetary Policy









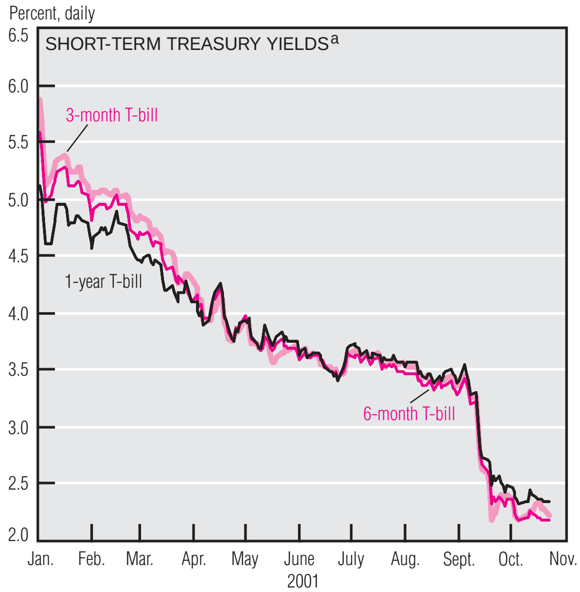
a. Weekly average of daily figures.
b. Daily.
c. Weekly, Wednesday, close of business.
SOURCES: Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Releases*, “Selected Interest Rates,” H.15, and “Factors Affecting Reserve Balances,” H.4.1; Chicago Board of Trade; and Bloomberg Financial Information Services.

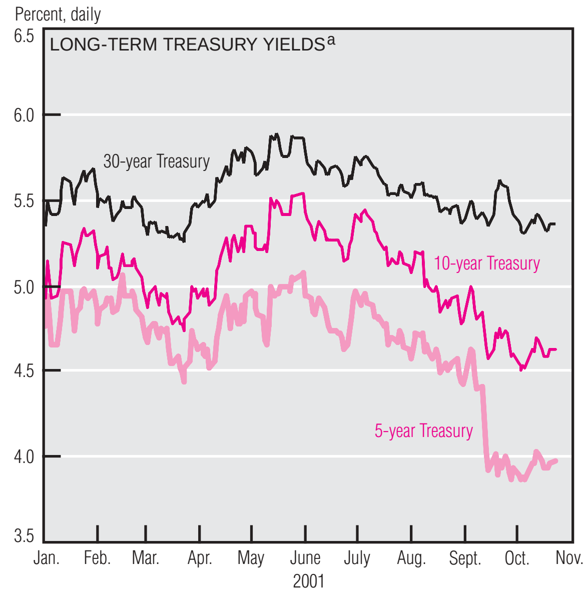
Implied yields on federal funds futures often are used to gauge market participants’ expectations of the future course of monetary policy. Activity in this market has increased in 2001, with average daily trading volume nearly 200 percent higher than last year. Implied yields had stabilized for much of October, but fell about 25 basis points (bp) across maturities in the latter half of the month. Market participants expect at least a 25 bp rate cut at the November meeting, and most expect the rate to drop 50 bp by year’s end.

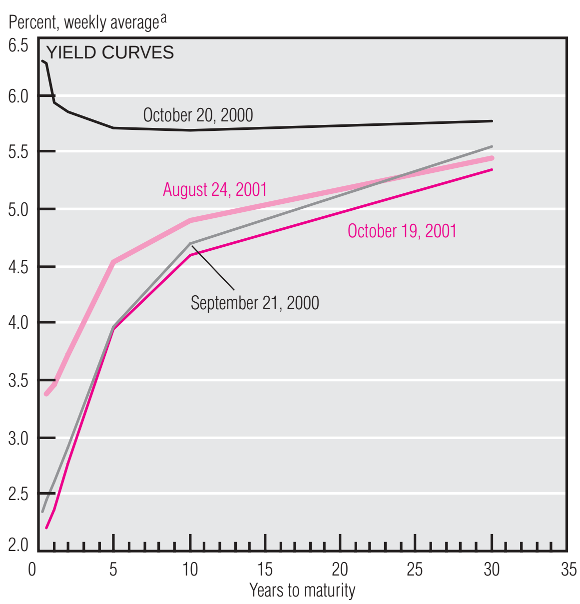
Although the effective federal funds rate drifted below the intended rate for six days after September 11, it has remained near its intended value for the last several weeks. Since early 1999, the funds rate’s average range has been about 20 bp; occasionally, the range widens to 200 bp or more. In recent weeks, the funds rate has tended to open firm, softening near the close.

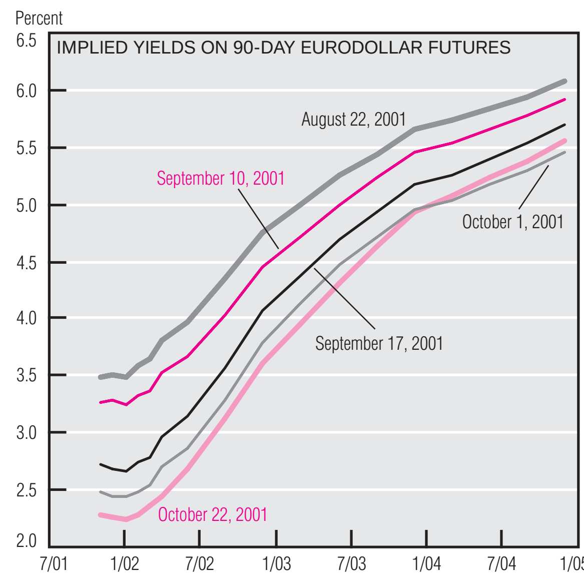
By conducting open market operations, the Trading Desk at the New York Fed attempts to supply a level of bank reserves that is consistent with keeping the effective federal funds rate near its intended rate. The Desk purchases government securities outright to accommodate long-run changes in the need for bank reserves, generally following an upward trend. It reduces the portfolio by redeeming a portion of holdings as they mature. Repurchase agreements and matched sale-purchases are used to meet seasonal and daily fluctuations in the factors affecting bank reserves. For several weeks after September 11, the Desk refrained from outright purchases due to market disruptions. It responded to liquidity needs by expanding the level of repurchase agreements vigorously.

Money and Financial Markets









a. Constant maturity.

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

Short-term Treasury yields plummeted immediately after the September 11 terrorist attacks and have declined further since then, at least for maturities longer than three months. Much of the initial decrease showed that actual and anticipated cuts in the target federal funds rate had already been priced in. Stock indexes also performed fairly well after dropping steeply the first week after the New York Stock Exchange reopened.

Yields on longer-term Treasuries fell less precipitously than short-term rates during the week after the attacks. In fact, the 30-year Treasury yield is now about the same as it was before September 11. Longer-term Treasury yields recently bounced up after the Treasury sold $6 billion in 10-year notes in an unscheduled auction on October 5. This apparently relieved a supply scarcity that was leading to an inordinate number of failed trades in the repo market.

The yield curve, which assumed its conventional upward slope almost a year ago, has been steepening over the past several months. A steepening yield curve often is viewed as a prelude to economic recovery, but it is unclear whether this scenario will play out. With inflation pressures apparently under control, speculation about renewed government debt financing may be buoying long-term yields.

Euro futures are used to hedge against funds rate movements, especially at longer maturities where they are more heavily traded than federal funds futures. Year-end forecasts of the funds rate implied by euro futures

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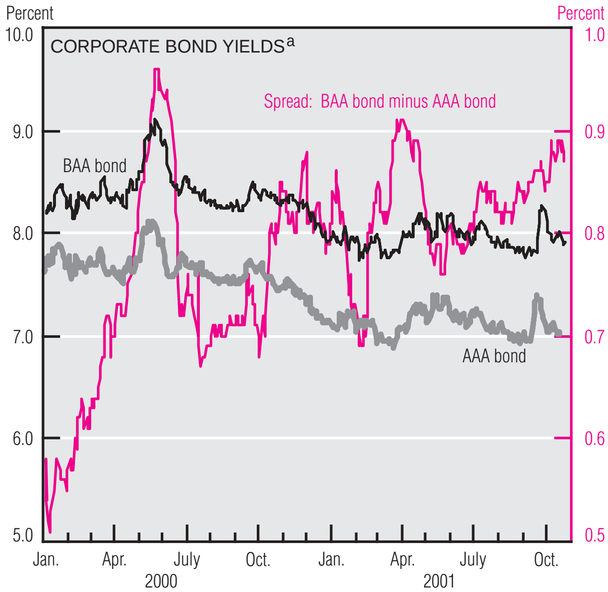
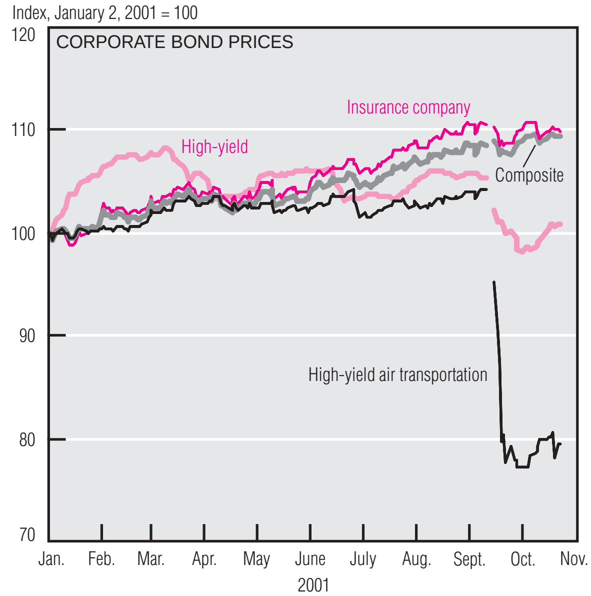
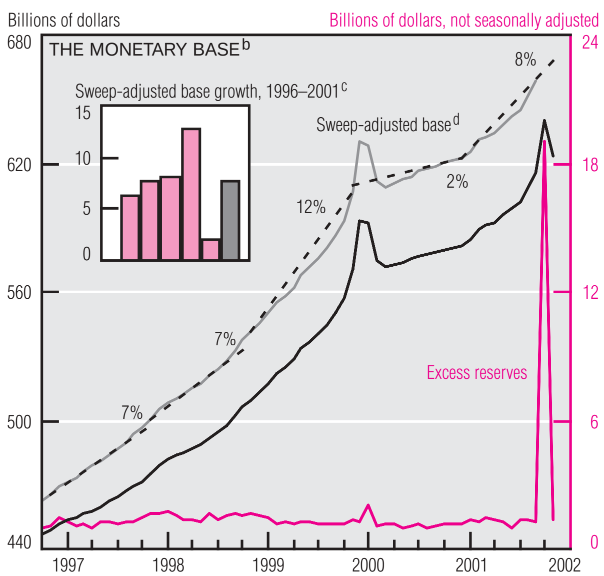
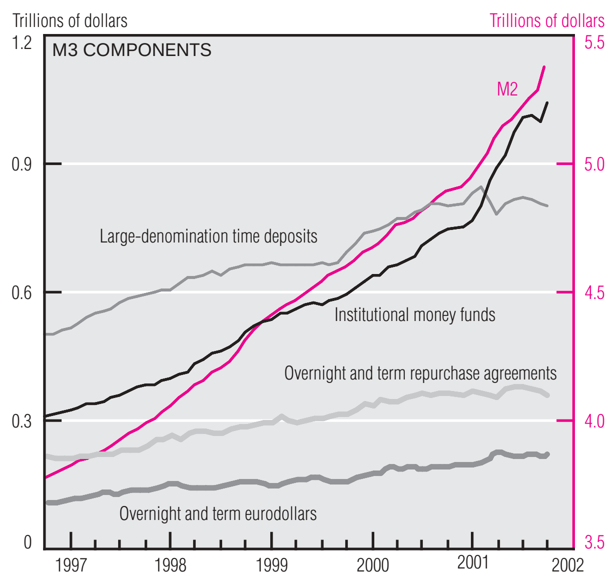
Money and Financial Markets (cont.)









a. Daily average of seasoned bonds with remaining maturities of at least 20 years.

b. Last plots for the monetary base and excess reserves are estimated for October 2001. Last plot for the sweep-adjusted base is August 2001.

c. Growth rates are percentage rates calculated on a fourth-quarter over fourth-quarter basis. The 2001 growth rate for the sweep-adjusted base is calculated on an August over 2000:IVQ basis.

d. The sweep-adjusted base contains an estimate of required reserves saved when balances are shifted from reservable to nonreservable accounts. Dashed lines represent growth rates and are for reference only.

SOURCES: Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Releases*, "Aggregate Reserves of Depository Institutions and the Monetary Base," H.3, "Money Stock and Debt Measures," H.6, and "Selected Interest Rates," H.15; Bloomberg Financial Information Services; and Merrill Lynch and Co., Inc.

declined both before and after September 11. Throughout the past two months, however, market participants have continued to expect that rates would begin rising sometime early next year.

Corporate bond yields spiked for several weeks after the attacks but have since moved down, approaching their pre–September 11 levels. Companies reportedly found it unusually difficult to raise financing in the debt markets without offering premium interest rates. This was how Ford Motor Co. was able to issue $9.4 billion in debt on October 22, the largest corporate debt issuance to date.

The spread between AAA corporate bond yields and BAA corporate bond yields has widened somewhat since September 11, but by then the spread already had been widening for almost two years. Companies that are rated below investment grade—airlines being perhaps the most highly publicized—continue to be downgraded at a higher rate than investment-grade firms. After plunging in the week following the attacks, airline bonds stabilized and even rebounded slightly. Prices of insurance companies' bonds dropped less dramatically and are back to their pre–September 11 levels. The airline industry is relatively worse off in that added cost pressures are joined with reduced travel demand.

Growth rates of monetary aggregates, both broad and narrow, surged during September in the wake of the

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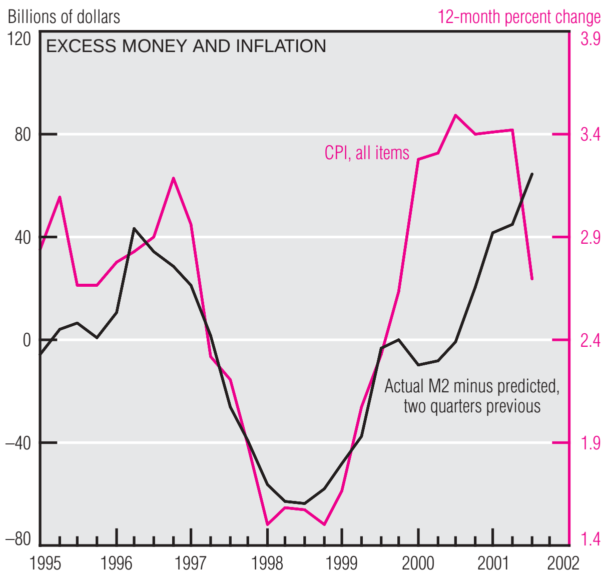
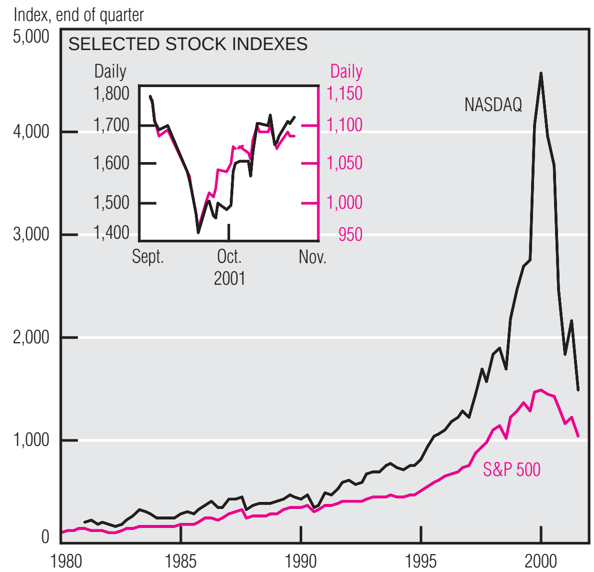
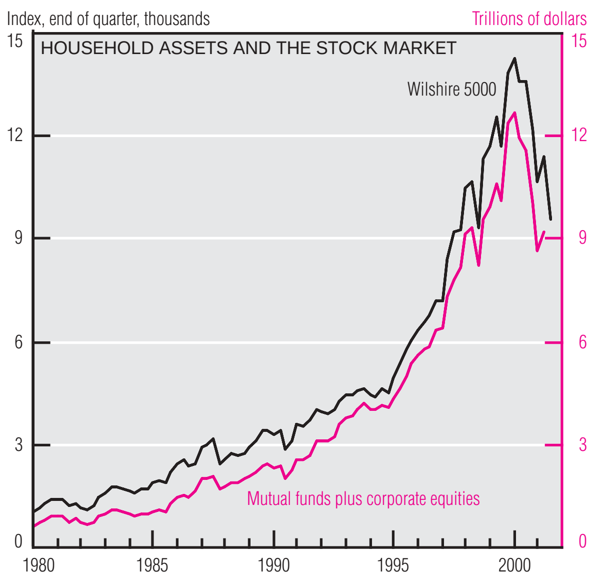
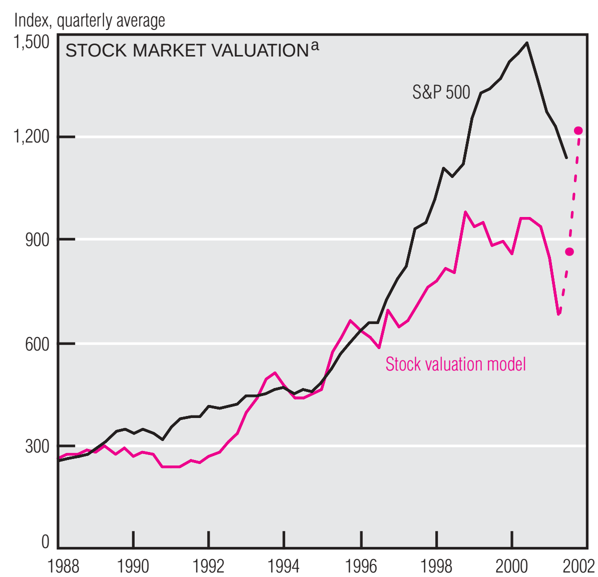
Money and Financial Markets (cont.)









a. Stock valuation is calculated as the annualized operating earnings per share divided by the 10-year constant maturity Treasury bond yield. Dashed lines indicate earnings estimates provided by Standard and Poor's.

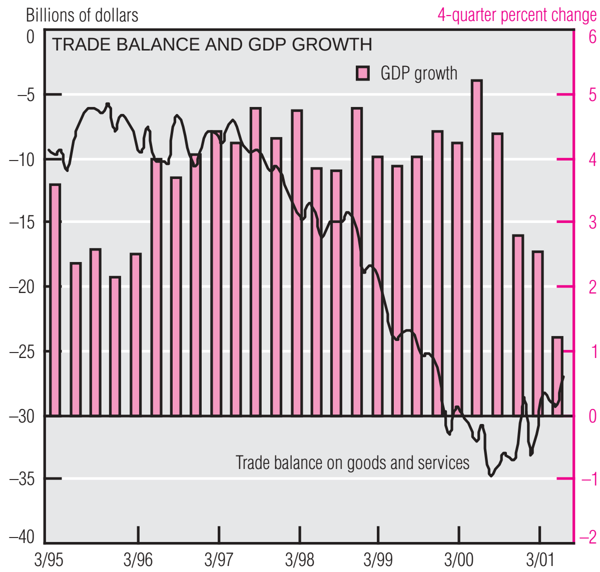
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Releases*, "Money Stock and Debt Measures," H.6, and "Flow of Funds Accounts of the United States," Z.1; Federal Reserve Bank of Cleveland; Standard and Poor's; Bloomberg Financial Information Services; and the *Wall Street Journal*.

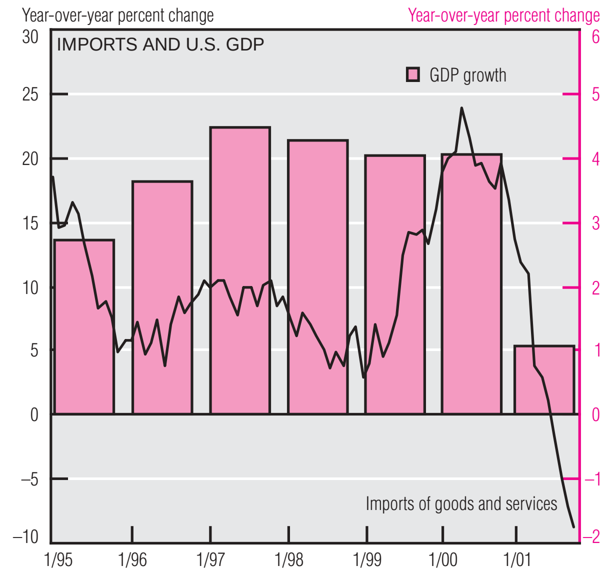
terrorist attacks. M3 spurted as asset owners accumulated transaction deposits and shifted into both retail and institutional money funds. The Federal Reserve supplied an enormous increase in bank reserves. The extraordinary scale of that action can be seen by comparing excess reserves (reserves not needed to meet reserve requirements) supplied during September 2001 to those supplied in the months leading up to the century date change. Estimates show October excess reserves and the monetary base reverting to more normal levels as the Fed drains excess reserves from the banking system.

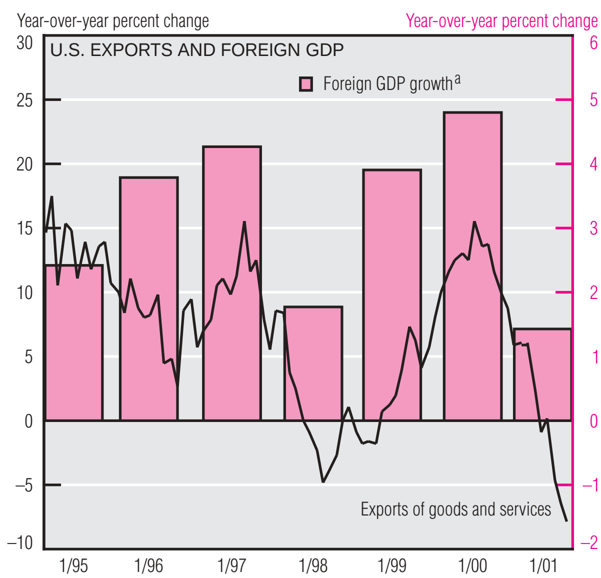
However, October data still do not show monetary policy exerting much of an effect on the monetary aggregates. Recent cuts in the fed funds rate will lead to reductions in their opportunity costs, so money growth will probably accelerate. So far, though, the increase in excess money growth (the excess of actual money over that predicted by a money demand model adjusted for the 1990s shift in velocity) has not been reflected in rising inflationary pressures.

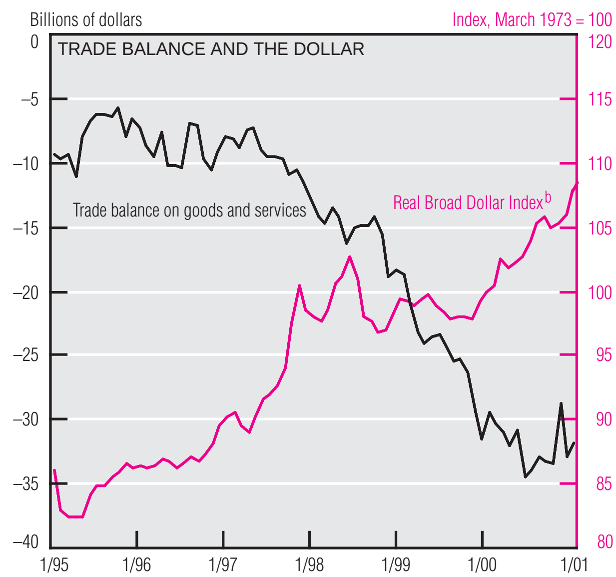
Many stock market indexes have rebounded after declining sharply following September 11. However, a broad stock market decline had begun long before that as the result of weakening economic conditions. By one measure, the stock market now is fairly valued. If consumers consider stock market gains in making spending decisions—a debatable assumption—the market's decline may affect future consumption adversely.

The U.S. Trade Balance









a. Foreign GDP growth is the trade-weighted average growth rate for the top 15 U.S. trading partners in 1992–97: Canada, Japan, Mexico, Germany, U.K., China, Taiwan, Korea, France, Singapore, Italy, Hong Kong, Malaysia, the Netherlands, and Brazil.

b. The Broad Dollar Index is a trade-weighted average of the foreign exchange values of the dollar against 26 important trading partners, including those in the euro area.

SOURCES: Board of Governors of the Federal Reserve System; U.S. Department of Commerce, Bureau of Economic Analysis, *International Financial Statistics; Blue Chip Economic Indicators*, October 10, 2001; Organisation for Economic Co-operation and Development, *World Economic Outlook*, May 2001; and the *Economist*.

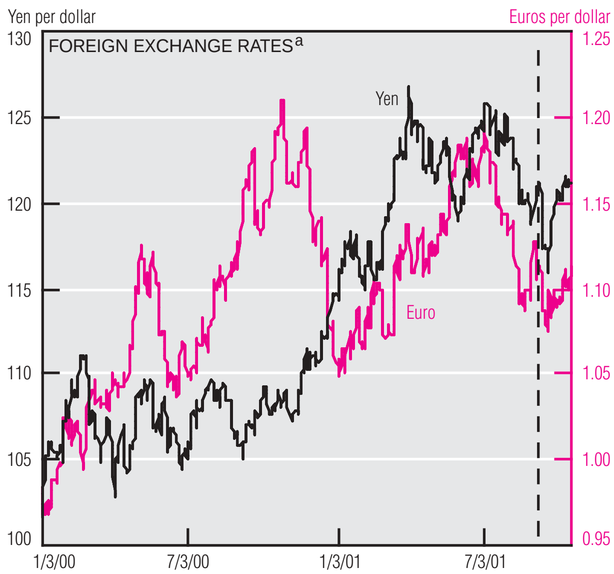
The U.S. trade deficit shrank from $29.2 billion in July to $27.1 billion in August. This reflects a monthly improvement for goods, both exports and imports, in the balance of goods and services.

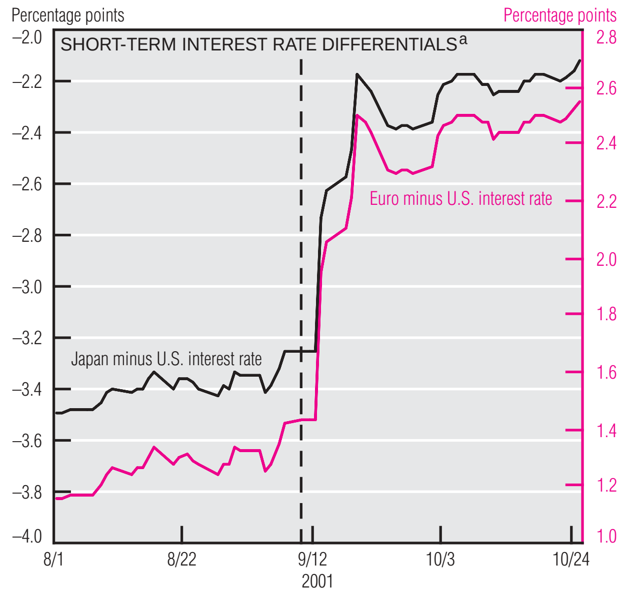
Under some circumstances, a decreasing trade deficit might be a positive development; the recent decline in U.S. imports, however, probably reflects declining domestic incomes, while the improvement in U.S. exports is hard to reconcile with declines in foreign GDP. Thus, the improvement in U.S. exports might not be sustainable.

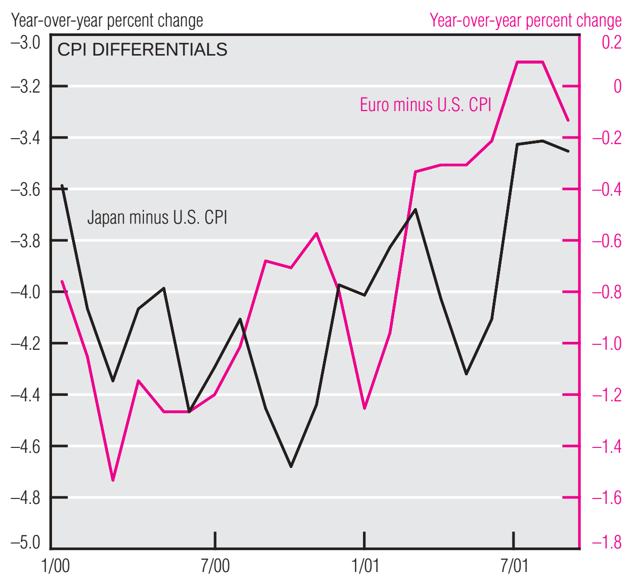
From early 1995 until the current slowdown began, the U.S. trade balance was deteriorating while U.S. growth rates were generally rising. The recent coincidence of deficit improvements and slower U.S. growth is consistent with U.S. GDP movements leading the rest of the world (otherwise, monthly U.S. exports would be falling and the trade balance not changing much). The prospect that slower U.S. growth could spread worldwide may explain why the improved trade balance has not been loudly applauded.

The dollar's value abroad also affects the trade balance. An improving trade deficit, accompanied by a strengthening dollar, is a change from the last five years, when the balance deteriorated and the dollar strengthened. That five-year record could be explained by viewing capital inflows into the U.S. (the counterpart of a current account deficit) as a sign that foreigners wished to invest here. This may still be so, but an improved trade balance, all things being equal, implies a smaller current account deficit and smaller capital inflows.

International Financial Markets







a. Dashed line indicates September 11.

SOURCES: Board of Governors of the Federal Reserve System; European Central Bank; Bank of Japan; Association of Call and Discount Companies/Nihon Keizai Shinbun (NIKKEI); and Bloomberg Financial Information Services.

The yen/dollar and euro/dollar exchange rates, which fell sharply soon after September 11, have largely recovered. An increase in the risk-premium component of the rate of return required by international investors may have been an important factor in their decline.

Both exchange rates were probably also affected by the sharply increased difference between foreign and U.S. interest rates resulting from U.S. rate reductions made immediately after the tragedy. The theory of uncovered interest parity says that the currency of a country with high interest rates is expected to decline by an amount equal to the differential in rates over a horizon equal to the rates' maturity. U.S. short-term rates exceed Japan's, so the U.S. rate's decline implies that the dollar is expected to depreciate over the short term. A drop in the dollar's value, if there is no change in its expected future level, would accomplish this adjustment.

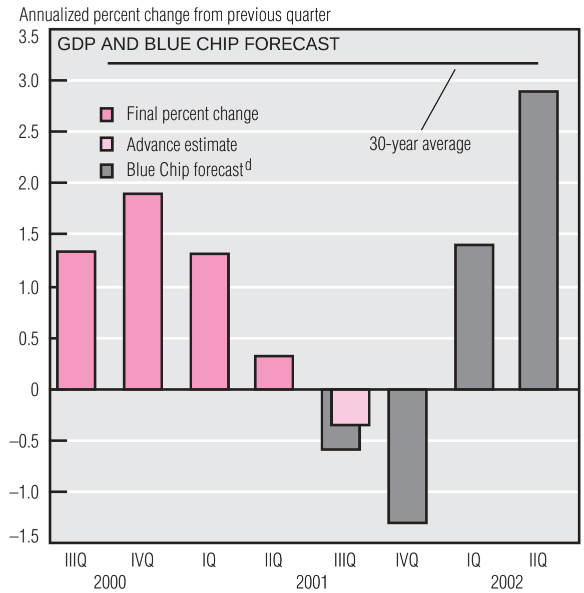
European short rates are higher than those of the U.S., implying that a larger appreciation is expected for the dollar. This could also be accomplished by a decline in the dollar's value, if expectations about its future value remain unchanged. Any deviation from the relationship between interest differentials and expected changes in exchange rates might be explained by an alteration in the risk premium.

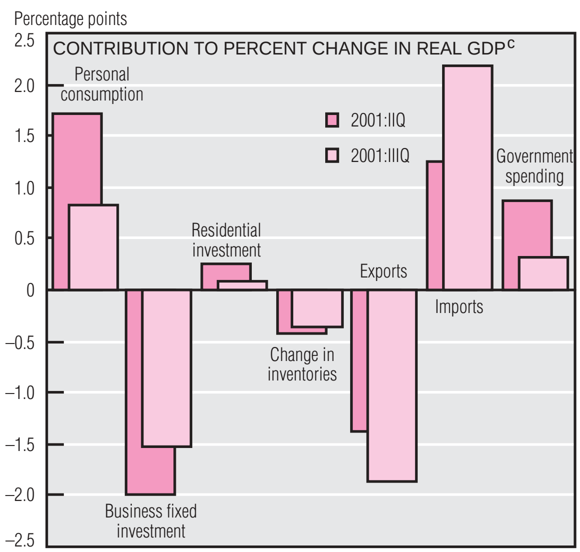
The market also has focused on possible global economic weakening. The widening gap between U.S. and foreign long-term rates supports the view that future reductions are more likely in the U.S. than abroad. Prospects for moderating inflation could influence foreign rate reductions strongly.

Economic Activity

Real GDP and Components, 2001:IIIQ[a,b,c]
(Advance estimate)

	Change, billions of 1996 $	Percent change, last: Quarter	Percent change, last: Four quarters
Real GDP	–8.3	–0.4	0.8
Personal consumption	19.4	1.2	2.5
Durables	3.9	1.7	4.2
Nondurables	2.7	0.6	1.0
Services	12.8	1.4	2.9
Business fixed investment	–41.1	–11.9	–6.7
Equipment	–32.2	–11.8	–8.3
Structures	–9.0	–12.1	–1.7
Residential investment	1.7	1.9	3.7
Government spending	7.1	1.8	3.8
National defense	4.4	5.0	6.3
Net exports	11.7	—	—
Exports	–49.3	–16.6	–8.6
Imports	–61.0	–15.2	–7.4
Change in business inventories	–12.1	—	—





Per Capita Personal Income, 1960 and 2000

	State rank	2000: 1-10	11–20	21–30	31–40	41–50
1960	1–10	6	4	0	0	0
	11–20	2	5	3	0	0
	21–30	2	0	3	3	2
	31–40	0	1	3	3	3
	41–50	0	0	1	4	5

Per Capita Disposable Personal Income, 1960 and 2000

	State rank	2000: 1-10	11–20	21–30	31–40	41–50
1960	1–10	6	4	0	0	0
	11–20	2	4	4	0	0
	21–30	2	0	3	3	2
	31–40	0	2	2	3	3
	41–50	0	0	1	4	5

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.
c. All data are seasonally adjusted and annualized.
d. Blue Chip panel of economists.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and *Blue Chip Economic Indicators*, October 10, 2001.

According to the advance estimate for 2001:IIIQ, real GDP fell at an annualized rate of 0.4%, the first economic contraction since 1993. This figure suggests the economy may have slipped into a recession for the first time since 1991. The fall in output was somewhat less than the consensus Blue Chip forecast of –0.6%. An even larger decline in real output is forecast for 2001:IVQ, but the economy is expected to pick up again in 2002.

Business investment and exports were the largest drags on the U.S. economy. However, the positive effect of consumption was smaller in the third quarter than in the second. According to Commerce Department figures (not annual rates), real consumer spending fell 1.3% in September following a 0.3% rise in August; likewise, real personal disposable income fell 0.6% in September compared with a 1.9% rise in August. The September data undoubtedly reflect the aftermath of the terrorist attacks.

State per capita personal income varies considerably across the U.S. In the richest state, Connecticut, income averaged $40,870 in 2000—almost double that of the poorest state, Mississippi, where average income was $20,856. Only 17 states have per capita incomes above the U.S. average of $29,451. Among the Fourth District states, only Pennsylvania exceeds the U.S. average; West Virginia has the second-lowest per capita personal income in the nation.

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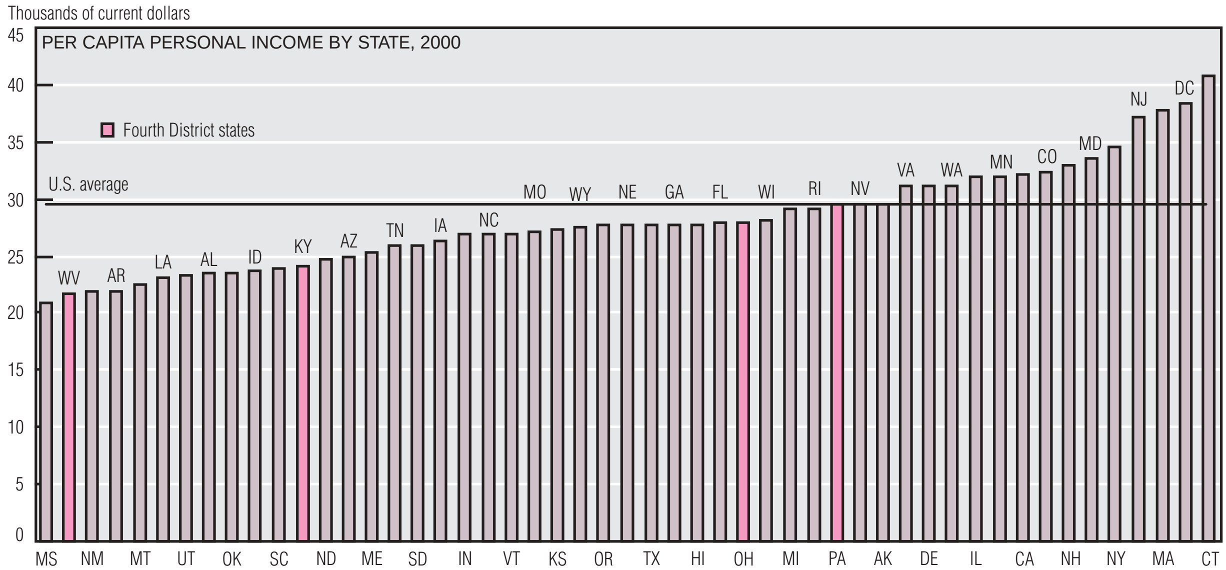
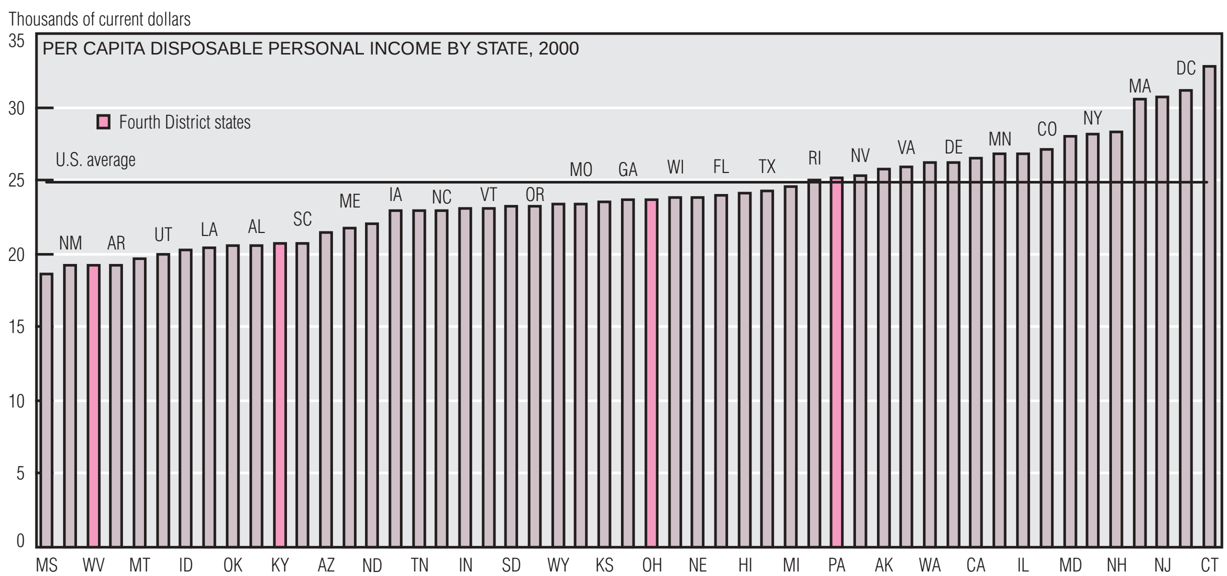
Economic Activity (cont.)





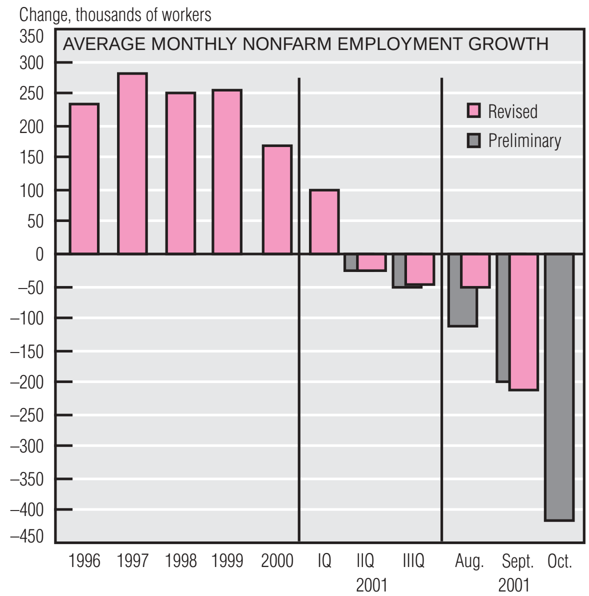
SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

Per capita disposable personal income (personal income adjusted for tax and other payments) shows a similar trend. Connecticut, at $32,820 remains the richest state, while Mississippi, at $18,612, is still the poorest. In terms of disposable personal income, then, people in Connecticut earn, on average, 75% more than people in Mississippi. Once again, Pennsylvania is the only Fourth District state that exceeds the U.S. average of $24,891.

Whichever income measure is used, state per capita income varies more at the top and bottom of the distribution, whereas states in the middle tend to have similar incomes. In other words, the plot of per capita incomes is fairly flat in the middle and steeper at the ends.

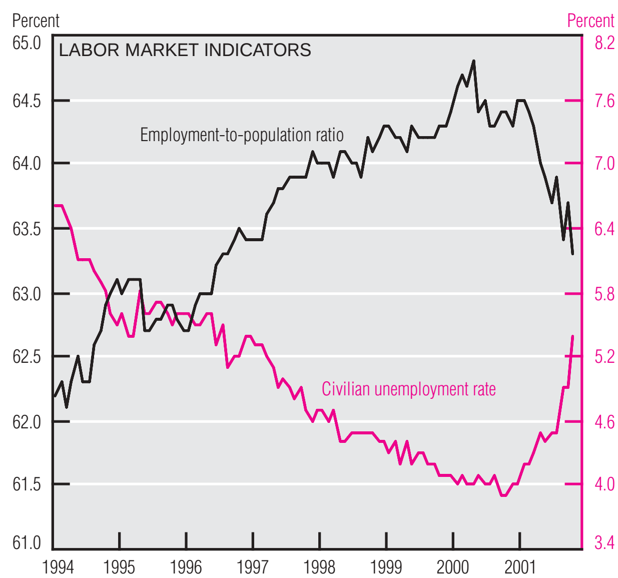
To gauge income mobility among states, we divided them into quintiles, based on their income rankings in 1960. Next, we asked which quintile these states occupied in 2000. Six states that were in the top quintile in 1960 remained there in 2000; the other four had fallen to the second quintile. Likewise, five states in the bottom quintile in 1960 were still there in 2000; four had advanced to the fourth quintile, while one had reached the third quintile. States in the middle quintiles exhibit somewhat greater mobility; for example, two states that were in the middle quintile in 1960 had reached the top quintile in 2000, while two had fallen to the bottom quintile.

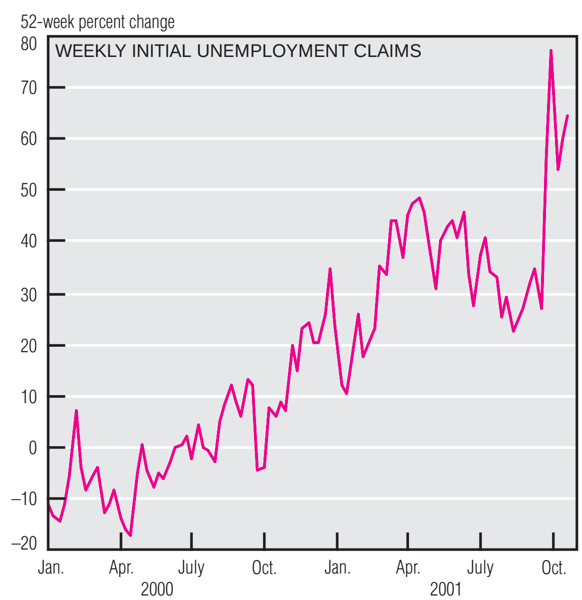
Labor Markets



Labor Market Conditions

	Average monthly change (thousands of employees)				
	1997	**1998**	**1999**	**2000**	**Oct. 2001**
Payroll employment	280	251	257	167	–415
Goods-producing	47	22	7	8	–174
Mining	2	–3	–3	1	–2
Construction	21	37	26	18	–30
Manufacturing	25	–13	–16	–12	–142
Durables	26	–2	–5	1	–108
Nondurable goods	–2	–11	–11	–13	–34
Service-producing	232	230	250	159	–241
TPU[a]	16	20	18	14	–55
Retail trade	24	30	49	26	–81
FIRE[b]	21	22	7	0	5
Services[c]	141	120	131	93	–111
Government	17	28	35	18	24
	Average for period (percent)				
Civilian unemployment rate	4.9	4.5	4.2	4.0	5.4





a. Transportation and public utilities.
b. Finance, insurance, and real estate.
c. The services industry includes travel; business support; recreation and entertainment; private and/or parochial education; personal services; and health services.
NOTE: All data are seasonally adjusted.
SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

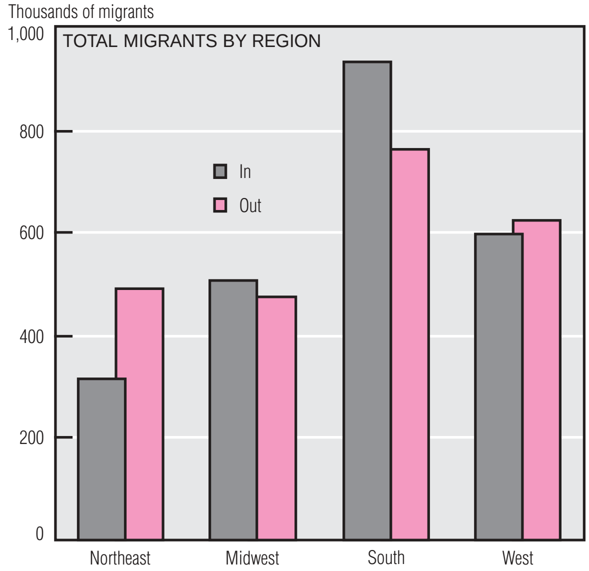
Payroll employment dropped sharply in October, posting an unusually large preliminary loss (415,000 jobs net). This decline is twice as large as September's and the largest recorded since May 1980. Revisions for August, however, show that job losses were only half of what had been reported earlier, although September's revisions were minor.

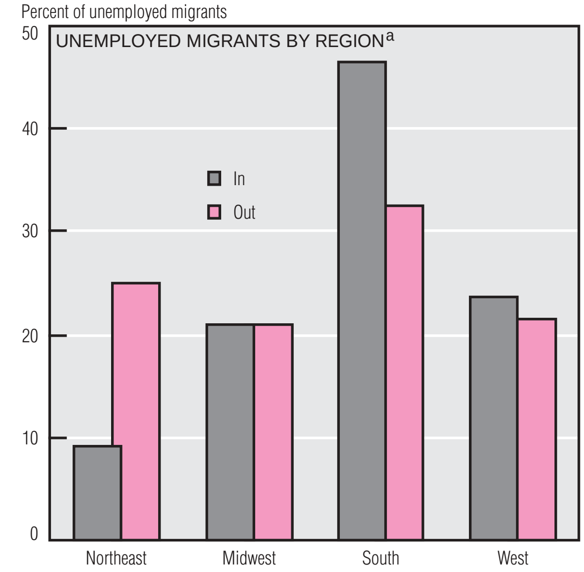
Declines in payroll employment were recorded in every industry except government and finance, insurance, and real estate, which made net gains of 24,000 and 5,000 jobs, respectively. Manufacturing continued its downward slide with a net loss of 142,000 jobs; overall, the goods-producing industries lost 174,000 jobs. Service producers were hardest hit, with a 241,000 net job loss for the month. This was the fourth and most drastic decline this year in a sector that previously had experienced only one monthly decline since 1991. It was the sector's largest drop since August 1983. Retail employment fell by 81,000; many businesses do not seem to be adding the holiday jobs that typically start in October.

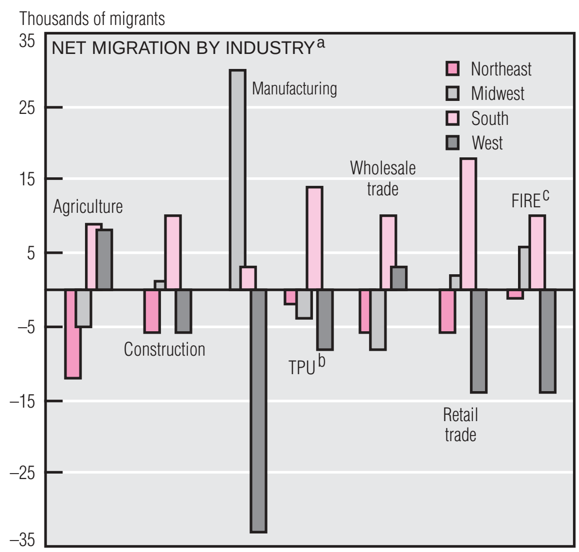
In the household employment survey, the unemployment rate soared to 5.4%, half a percent more than last month and the highest rate in nearly five years. The employment-to-population ratio fell to 63.3%, 0.4% lower than September.

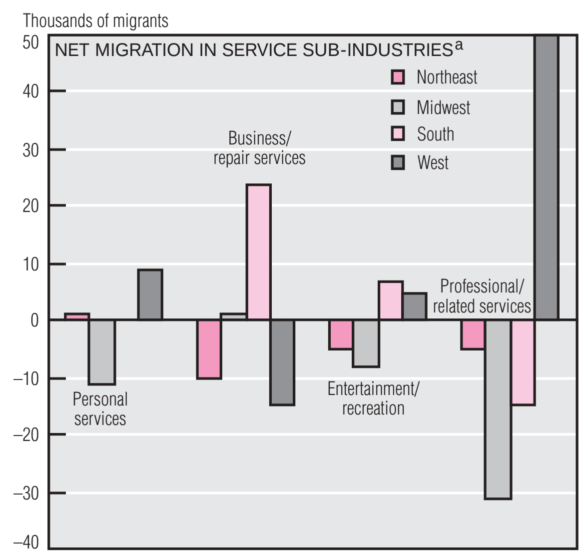
The 52-week percent change in initial unemployment insurance claims shows that every week of 2001 has had more claims than the corresponding week in 2000. In the weeks following September 11, nearly 80% more claims were made than in the corresponding weeks last year.

Migration in the U.S.









a. Shows post-migration responses.
b. Transportation and public utilities.
c. Finance, insurance, and real estate.
SOURCE: U.S. Department of Commerce, Bureau of the Census, mobility data from *Current Population Survey*, March 1999 to March 2000.

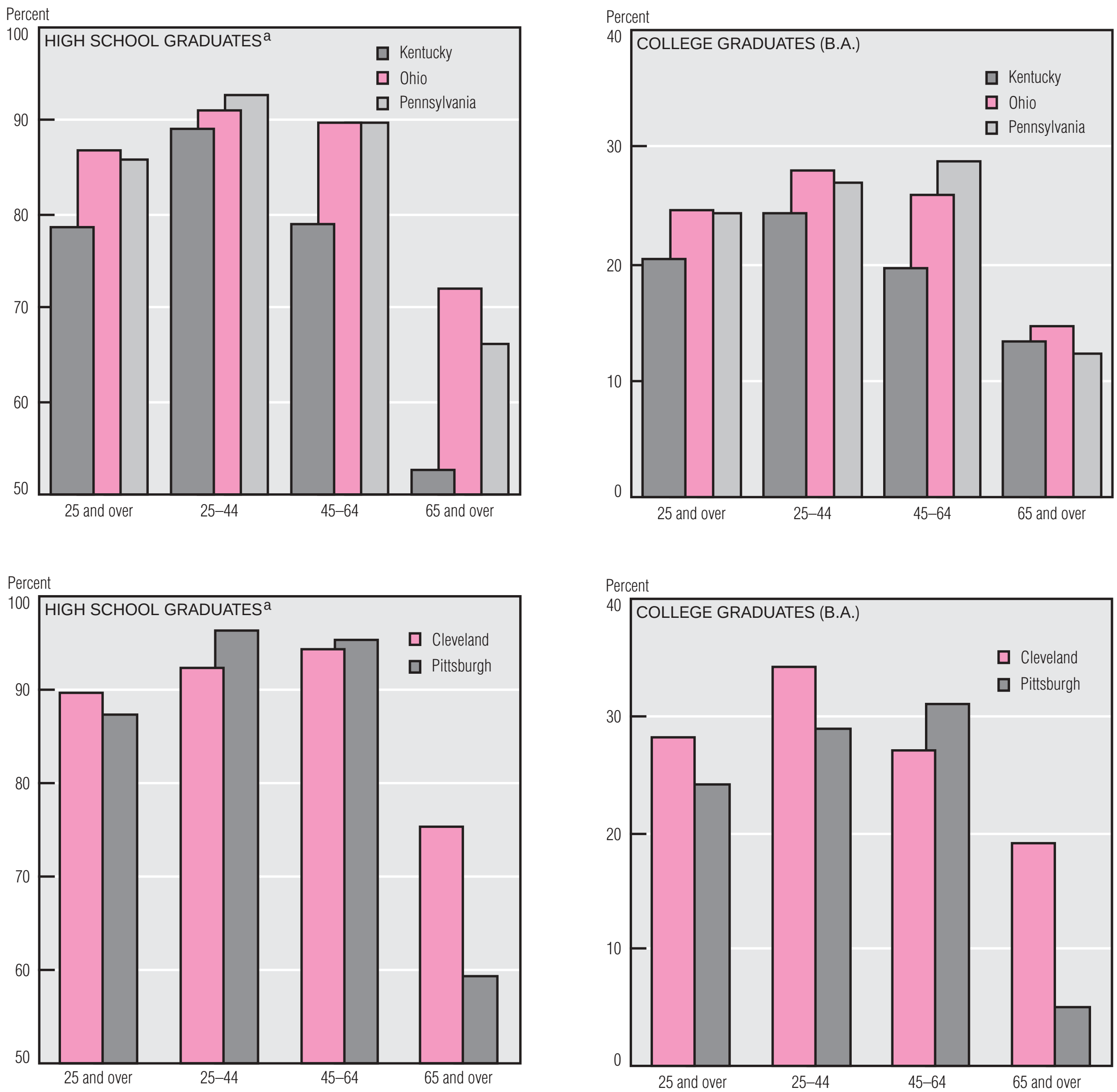
Typical U.S. migration patterns show that for any year, gross flows into and out of a given region are large relative to net flows. In 1999–2000, the South accounted for the largest numbers of both in- and out-migrants. The Northeast had far fewer in- than out-migrants. In the West and Midwest, the number of people entering roughly equaled those leaving, which produced a small net change.

A frequently cited reason for migration is improved job opportunities. Among migrants who were unemployed after their move, the largest share (47%) moved to the South, where job growth has been robust for several years. A substantial share (25%) of unemployed migrants came from the Northeast, whereas only 9% moved into that region.

The simultaneous movement into and out of regions may result from the types of jobs that are being gained and lost in each. Looking at net regional migration (the difference between the total number of migrants moving into and out of a region), the South posted significant net gains in every major industrial sector except mining and public administration. In manufacturing, the Midwest posted a net addition of 30,000 workers, while 33,000 left the West. The Northeast had net losses or no change in every sector, with the largest loss in agriculture (roughly 10,000 workers). The South's largest gain was in retail trade.

Within the service industries, migration gave the West a net positive gain of 50,000 workers in professional and related services, the counterpart of net losses in this category in every other region.

Educational Attainment



a. Includes general equivalency diploma.
SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, *Current Population Survey,* March 2000.

The *Current Population Survey* (CPS) allows analysis of educational attainment for the 25 largest states and 15 largest metropolitan areas in the country. The Fourth District states included in this group are Kentucky, Ohio, and Pennsylvania, as are the Pittsburgh and Cleveland–Akron metropolitan areas.

Since the CPS began tracking educational attainment in 1949, the high school graduation rate has risen steadily, as has the share of the population completing bachelor's degrees. The most recent CPS (March 2000 data) gives a cross-sectional view of this trend: The younger the age cohort, the larger the share of high school graduates within it. The CPS data suggest that secondary education is now almost universal among individuals aged 25 to 44.

Generational differences in both high school graduation rates and the share of individuals with bachelor's degrees reflect an evolving workforce with changing needs. The Fourth District, long dominated by manufacturing and heavy industry in the north and mining and agriculture in the south (all with extensive on-the-job training), has more recently begun to need workers with skills gained in an academic setting. People who are now 65 or older found it more profitable to start work in high-skill positions providing on-the-job training than to get a college degree or, to a lesser extent, a high school diploma. This was especially true in Pittsburgh, where the steel industry dominated in the first half of the twentieth century.

Technological advances and the 1980 recession reduced the availability of skilled, high-paying jobs in industry,

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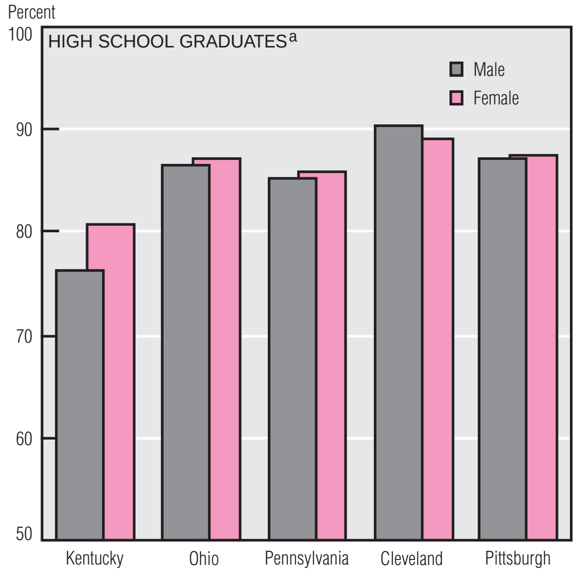
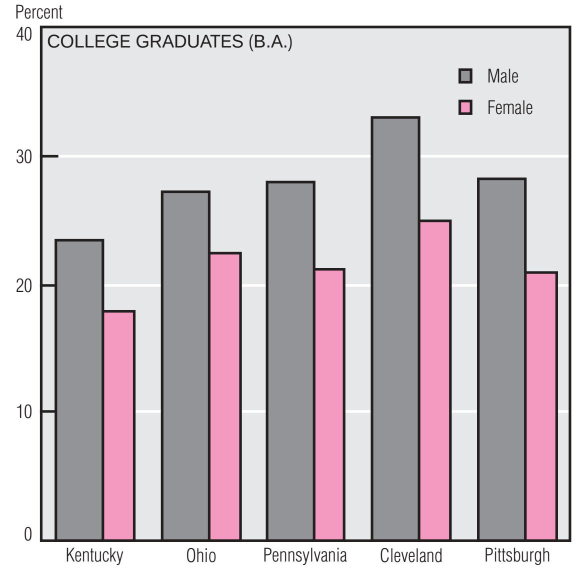
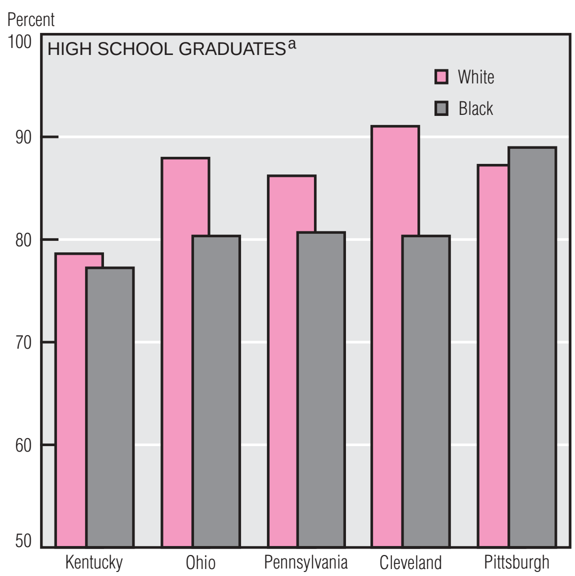
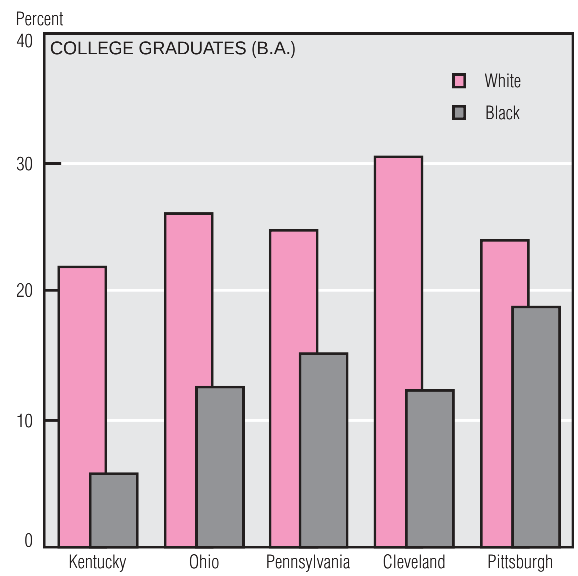
Educational Attainment (cont.)









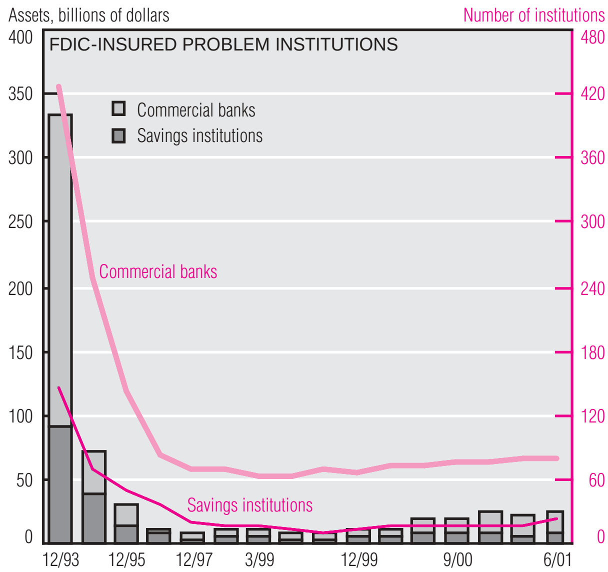
a. Includes general equivalency diploma.
NOTE: All data are for individuals aged 25 or older.
SOURCE: U.S. Department of Commerce, Bureau of the Census, *Current Population Survey,* March 2000.

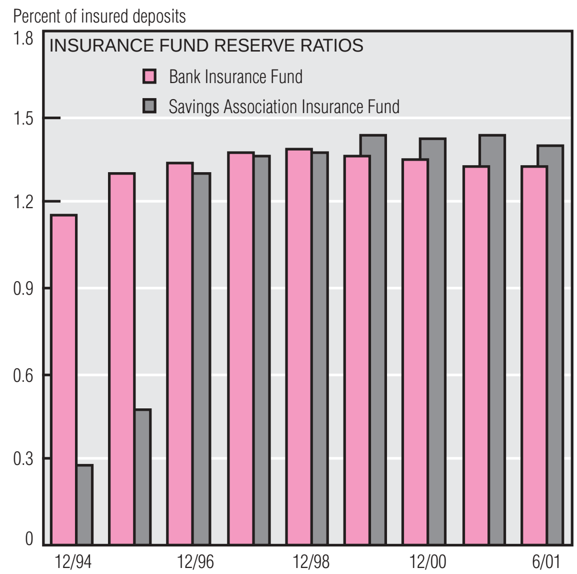
so people of all ages looked to education to improve their positions and pay. Kentucky made this transition later than the northern part of the District. Kentucky's base industries, agriculture and mining, gave way to heavy industry (primarily automobiles) just as high-paying jobs in heavy manufacturing were becoming less available in the District's northern region. The same change occurred much later in Kentucky, a delay reflected in the state's significantly lower share of people aged 45–64 with high school diplomas compared to Ohio or Pennsylvania.

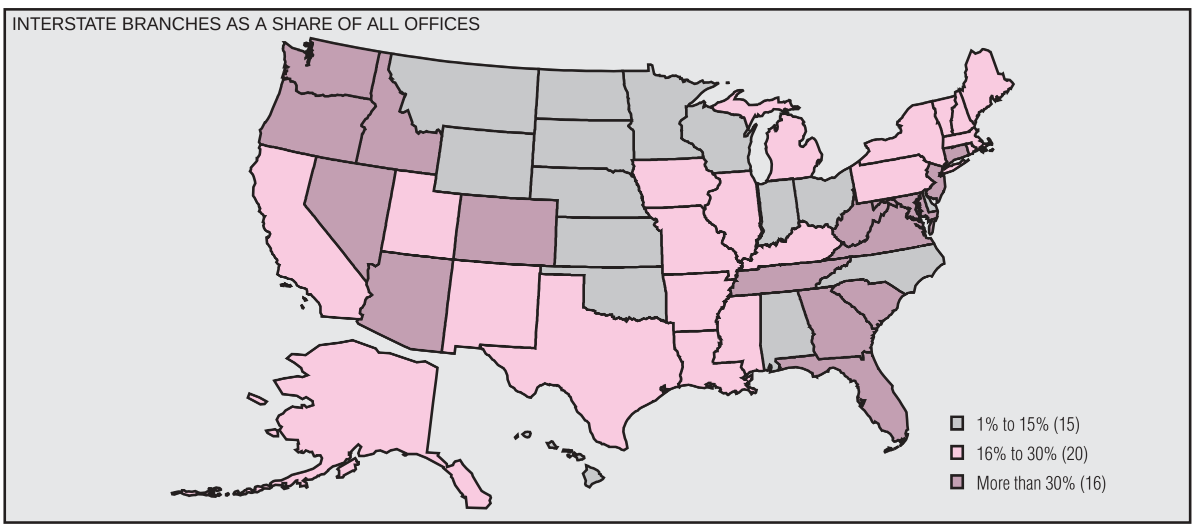
In most areas, females have higher high school graduation rates, indicating that a larger share of young males would rather start work than attend school in the hope of attaining a better job in the future. While a larger share of females start college, the males who start have a higher rate of graduation with a bachelor's degree. The reasons for this are unclear.

Although the CPS samples are too small to compare educational attainment among all race categories, they do allow comparison between blacks and whites. Differences in high school graduation rates in the Fourth District's two largest metropolitan areas are notable: Whites have a far higher graduation rate in Cleveland, while in Pittsburgh blacks have a significantly higher rate. Differences between races at the state level become more pronounced between high school and college graduation, especially in Kentucky, where the shares of blacks and whites graduating from high school are nearly equal, but the share of whites who obtain a bachelor's degree is four times that of blacks.

Banking Conditions







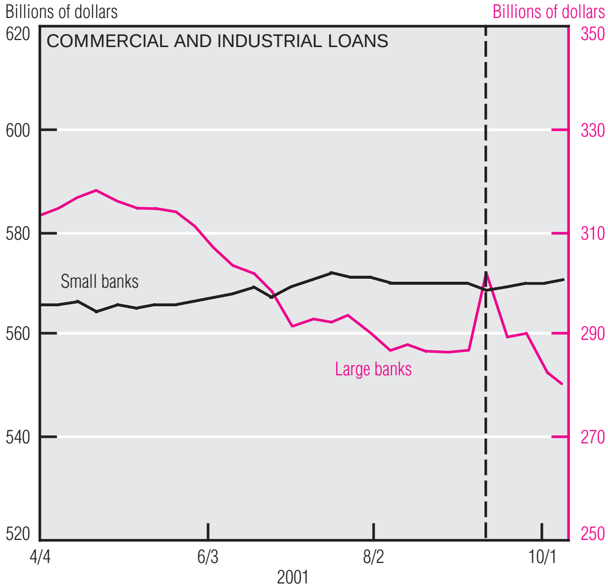
NOTE: All data are seasonally adjusted.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

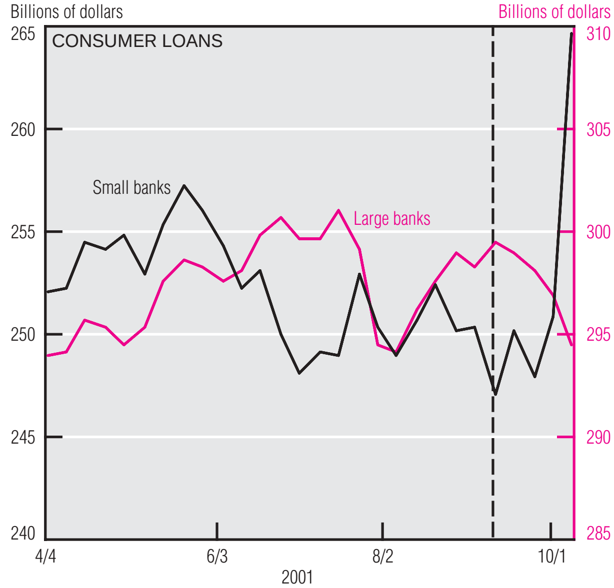
The number of FDIC-insured commercial banks has continued to decline, dropping to 8,178 at the end of 2001:IIQ. Merger activity has remained fairly steady over the past year, with 193 mergers reported in the first half of 2001. In 2001:IIQ, 64 new charters were recorded, compared to 108 in the corresponding period last year. The country's Central East region showed the greatest growth in mergers and new charters.

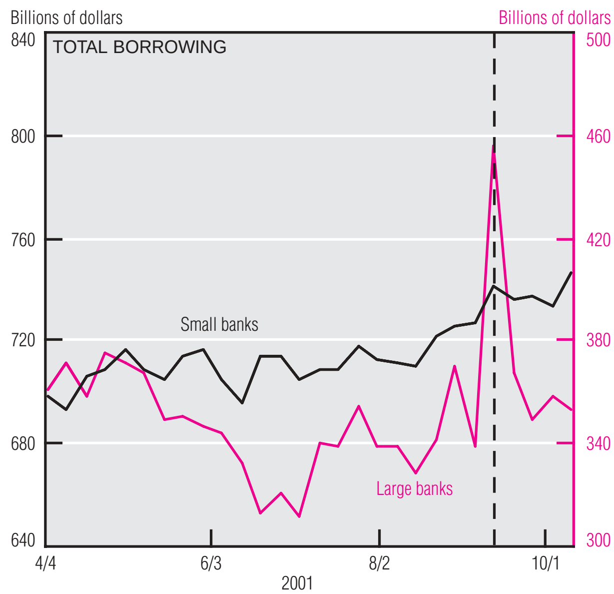
Two banks had failed by midyear, but no thrifts have failed. As of June 2001, numbers of FDIC-listed "problem" institutions had declined to 22 savings institutions and 80 commercial banks. (Problem institutions are those with financial, operational, or managerial weaknesses that threaten their continued financial viability.) The insurance funds for both commercial banks and savings institutions exceeded the levels mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. In June 2001, the ratio of fund balances to insured deposits stood at 1.33% for the Bank Insurance Fund and 1.40% for the Savings Association Insurance Fund. The target ratio for both is 1.25%.

Banks' interstate branching continues to be uneven across regions. The Southeast and Southwest (except California) still have the highest share of interstate branches as a percent of total offices. In Fourth Districts states, that share is somewhat higher than it was a year ago. The ratio of interstate branches to all offices increased slightly for Ohio and decreased slightly for Kentucky, but grew significantly for Pennsylvania and West Virginia.

Commercial Banks







NOTE: All data are seasonally adjusted. Dashed vertical lines mark the week of September 11.
SOURCE: Board of Governors of the Federal Reserve System, "Assets and Liabilities of Commercial Banks in the United States," *Federal Reserve Statistical Releases*, H.8.

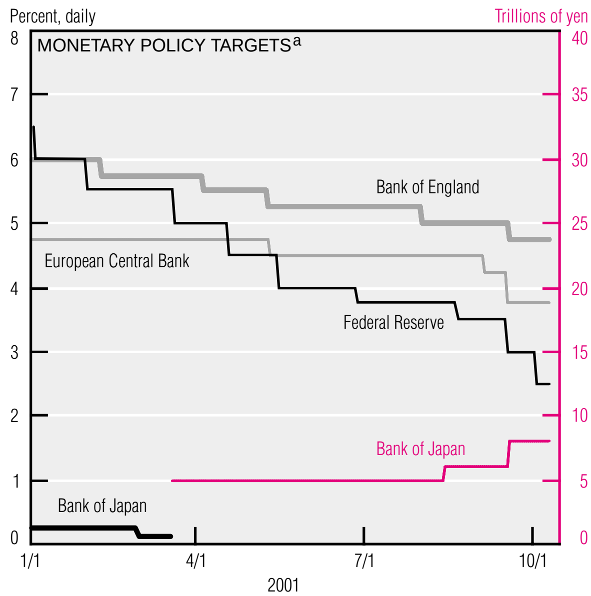
Commercial and industrial (C&I) loans made by large banks have been declining steadily since the beginning of 2001:IIQ because of the slowing economy. During the week of September 11, C&I loans made by all banks increased 1.6%, but they dipped below their earlier levels in the following weeks. The current level, $849 billion, is the lowest weekly level since May 2000.

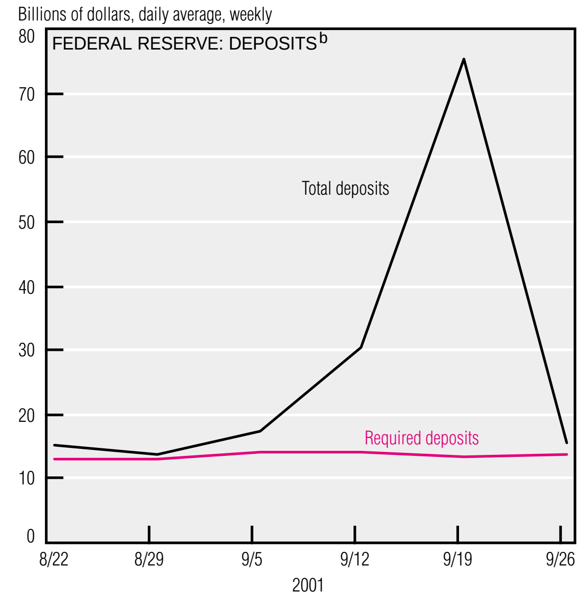
Large banks' consumer loans changed very little between April and early September, while those of small banks declined. Tighter lending standards and declining consumer confidence were among the reasons for weak consumer loan demand. In late September–early October, however, consumers made a comeback; in the week of October 10, the total amount of consumer loans reached $559 billion, the highest weekly demand ever recorded.

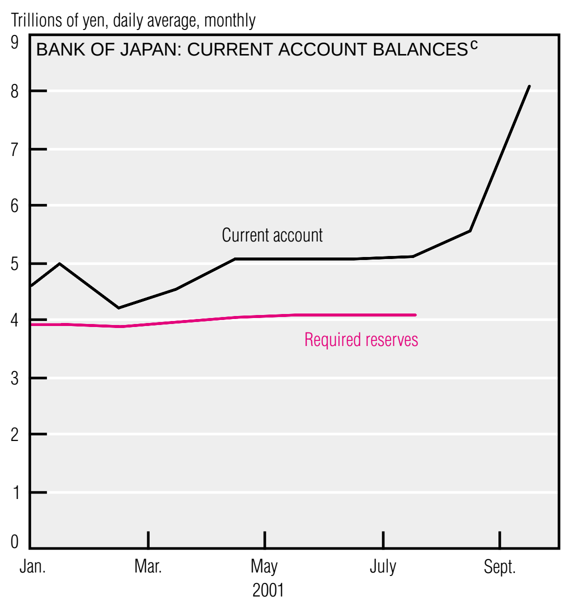
While coping with the interbank payment problems that hit the industry in the week of September 11, banks increased their cash assets 26% to $334 billion, the largest weekly increase on record. As operations returned to normal, banks reduced their cash assets to more normal levels. By the second week of October, banks had about $273 billion in cash assets.

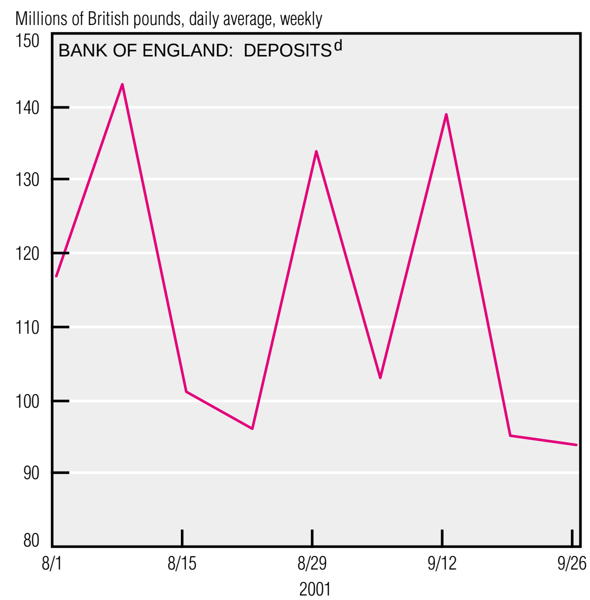
Banks borrowed heavily from various sources in the week of September 11. The first week of the month, their borrowing totaled about $1,022 billion; the next week, it reached an unprecedented $1,147 billion, a 12% increase. By the first week of October, banks' borrowing stood at $1,047 billion, which is still high by historical standards.

Foreign Central Banks









a. Federal Reserve and Bank of Japan: overnight interbank rates (since March 19, 2001, the Bank of Japan has targeted a quantity of current account balances). Bank of England and European Central Bank: two-week repo rate.

b. Total deposits are the sum of reserve balances with the Federal Reserve Banks and required clearing balances. Required deposits consist of required clearing balances and required reserves less vault cash used to satisfy required reserves.

c. Current account balances equal required reserves plus excess reserves plus deposits of financial institutions not subject to reserve requirements.

d. Banks' operational deposits with the Bank of England, which has no reserve requirements.

SOURCES: Board of Governors of the Federal Reserve System; Bank of Japan; European Central Bank; and Bank of England.

Major central banks supplied the liquidity their banking systems needed to remain open and to make payments after the September 11 attack.

In the U.S., massive injections of base money began even before two 50-basis-point reductions in policy rates. While most Wall Street money center banks were able to transfer operations quickly to contingency sites, a few banks had difficulty making payments, causing their Reserve Bank deposits to grow rapidly. Meanwhile, other banks' deposits were declining just as rapidly or their inflows were too uncertain for continued operation without additional funding. This might have been difficult to obtain in shaken markets, or its need apparent only after markets had closed for the day.

The Reserve Banks kept their interbank online payments system open almost around the clock to facilitate off-hours transactions. Still, more was needed. On September 12, for example, more than $45 billion in Reserve Bank lending to banks, plus slightly less in open market operations, and a build-up in check float allowed banks' Reserve Bank deposits to mushroom to $95 billion from a typical $15 billion. However, with the immediate crisis contained, banks' deposits were close to normal again by the end of September.

Data from the Bank of Japan suggest a similar story there, but no crisis is apparent from banks' working deposits at the Bank of England.