

# *The Economy in Perspective*

by Mark Sniderman

*Time to take a load off...* Conventional wisdom—in other words, the central tendency of professional forecasters—holds that 2006 and 2007 will be decent years for the U.S. economy. Many economists expect real GDP to increase by about 3½% this year and next, keeping the economy on a path of nearly full resource utilization. The January employment report from the Bureau of Labor Statistics supports this comforting view: Net employment expanded at a solid rate in January; in fact, the revised figures for November and December show that job creation has been improving for some time now. And consumer confidence has been rebounding from its Katrina-induced lows.

Inflation, which has been elevated by energy price shocks, seems poised to gradually drift down to its longer-term trend. Considering the magnitude of the energy price shocks that have hit the economy, core inflation rates have been exceptionally stable. Moreover, inflation expectations five to ten years out have hardly budged in the face of these shocks, signaling a high degree of confidence in the future conduct of monetary policy.

On the surface, there are many reasons to have confidence in the U.S. economy's ability to continue providing its people with one of the highest living standards in the world. Beneath the surface, however, lie disquieting possibilities. The nation faces challenges that have the potential to slow the pace of economic growth if they are not managed effectively.

Fiscal policy is one of these challenges. The federal budget deficit looms large in proportion to the scale of the economy and shows no signs of shrinking. In fact, unless Congress can reign in expenditures for numerous entitlement programs, or demonstrate a greater willingness to pay for them from current taxes rather than with debt, the fiscal obesity that is our national debt will swell even further.

Marketing the national debt at an attractive price has been surprisingly easy for the past several years, primarily because of foreign buyers' powerful appetites for highly liquid, dollar-denominated assets. Some analysts contend that these appetites spring from certain foreign governments' desire to manage their exchange rates; other analysts argue

that the motive is to accumulate a stock of dollar reserves that a government could use to defend its exchange rate when it begins to float more freely. In either case, should these foreign appetites for U.S. Treasury obligations diminish, rolling over the national debt would probably become more expensive and take a bigger bite out of the budget.

There are those who say that the large and growing national debt is little more than an annoyance. After all, their argument goes, the nation has endured deficits and debts that were larger than this one, in proportion to the size of the economy. History shows that when the national waistline expands to the point where the pants no longer button, Congress will either let out some fabric, go on a diet, or devise a combination of the two. Consequently, the deficits will shrink and their potential for damaging the nation's health will dwindle.

But successful dieting requires a fundamental change in behavior, not reliance on quick fixes. No one likes to pay taxes, and everyone enjoys the benefits that come from federal spending. Politicians get re-elected by making people happy, and they know that the bigger the tax hike or expenditure cut they enact, the less happy their constituents will be. Yet, ironically, the longer we put off this adjustment, the more wrenching the changes could be.

Most obvious, U.S. businesses, households, and governments would likely have to pay more to borrow funds in world capital markets. As a result, capital equipment, housing, and durable goods would all become more expensive to acquire. Less obvious are the consequences that individuals and businesses might have to face in adjusting to higher tax rates or the loss of benefits that could accompany a fiscal rebalancing—or both. Decisions that made sense in the past, predicated on a certain set of beliefs about fiscal policy, could turn out badly.

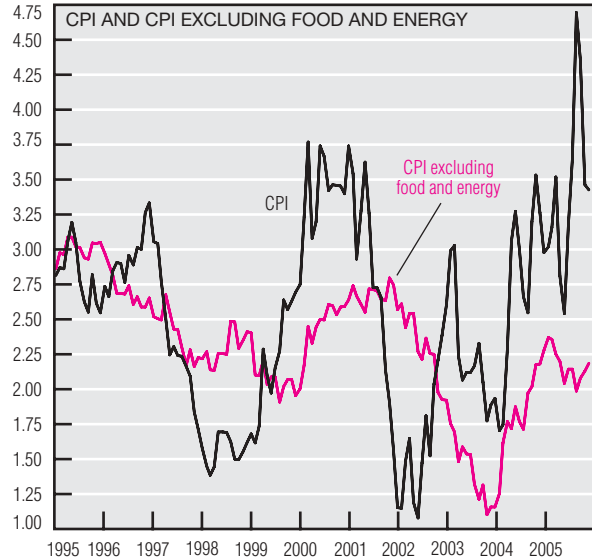
The problem with the ballooning national debt is not that it will necessarily strangle national commerce. Like obesity, it is a risk factor, and many people at risk live long and productive lives. But its bulky presence could make it all the more difficult for us at some future date to respond to circumstances that vitally affect our national welfare.

# Inflation and Prices

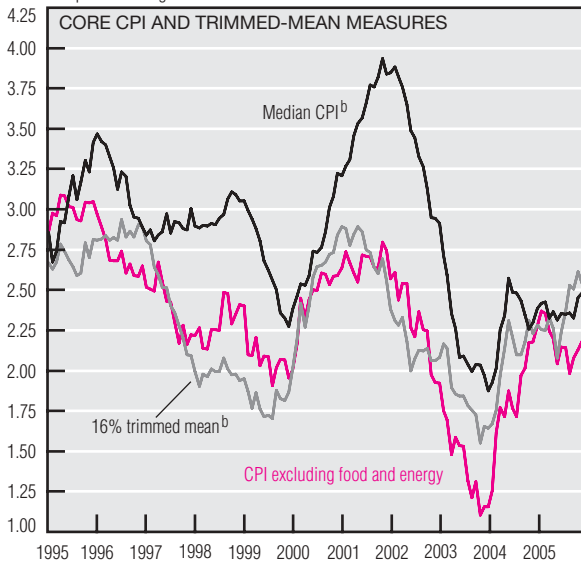
## December Price Statistics

	Percent change, last:				2005 avg.
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	
<b>Consumer prices</b>					
All items	-0.6	-1.6	3.4	2.5	3.5
Less food and energy	2.4	2.8	2.2	2.0	2.2
Median <sup>b</sup>	2.5	2.3	2.5	2.7	2.5
<b>Producer prices</b>					
Finished goods	11.1	3.6	5.4	2.6	6.0
Less food and energy	1.5	0.0	1.7	1.1	1.8

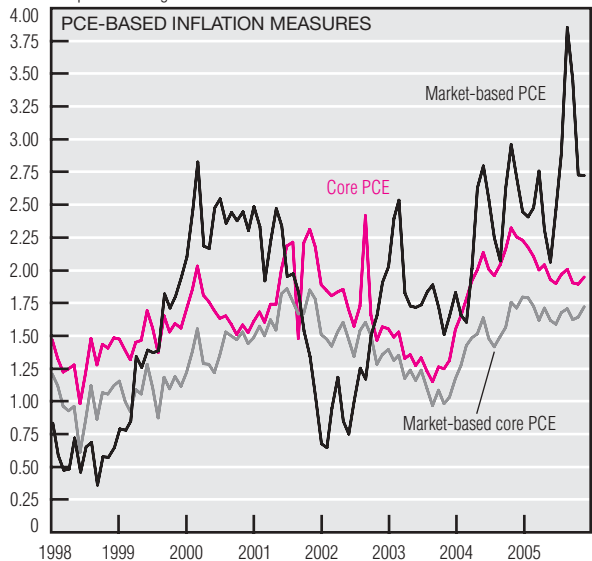
12-month percent change



12-month percent change



12-month percent change



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and Federal Reserve Bank of Cleveland.

The Consumer Price Index (CPI) continued its decline in December, falling at a 0.6% annualized rate, after plummeting 6.4% (annualized) in November. Growth in the core CPI measures moderated somewhat: The CPI excluding food and energy rose 2.4% (annualized), and the median CPI increased 2.5% (annualized).

The longer-term trends of underlying inflation inched higher in December but remain between 2.0% and 2.5%. The 12-month growth rate in the core CPI ticked up to 2.2%, while the

median CPI's 12-month growth rate rose from 2.4% to 2.5%. The growth rate of the 16% trimmed mean, which has accelerated from 2.1% since June 2005, was also 2.5% during the month. Other core inflation measures that use a slightly modified consumer goods market basket, which encompasses the PCE excluding food and energy, as well as the market-based core PCE (which excludes certain imputed items that cannot be observed directly from the marketplace) also suggest that inflation is holding steady but at a

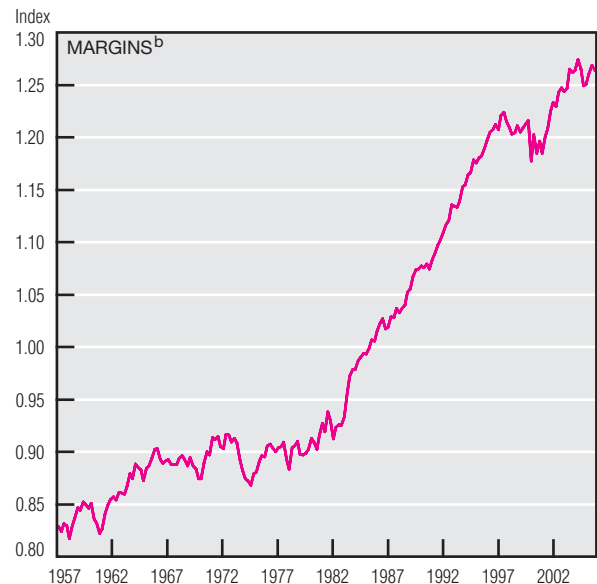
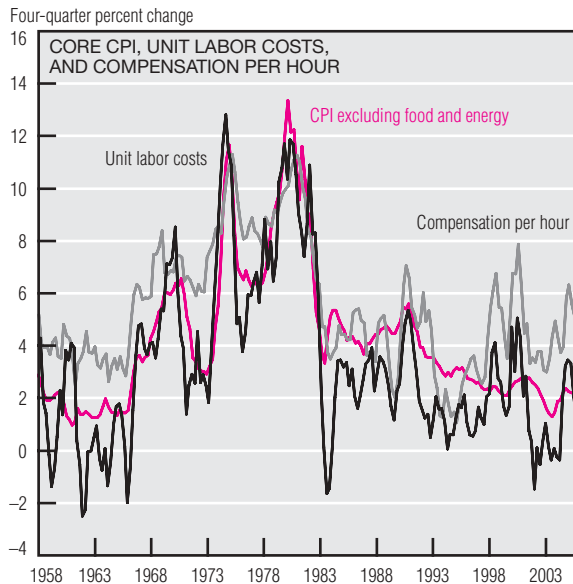
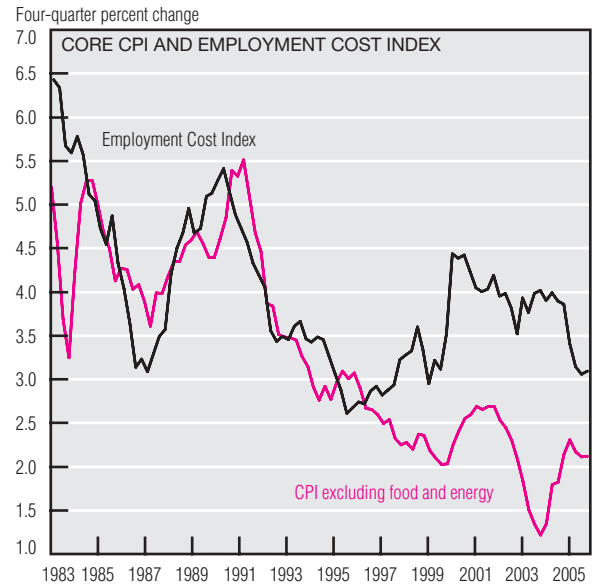
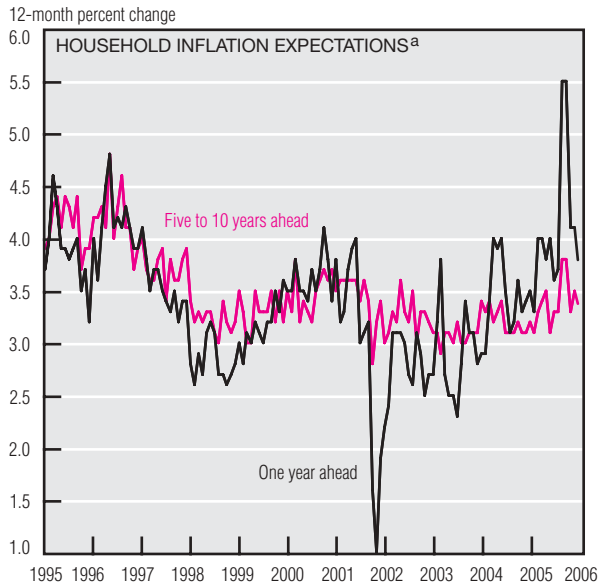
lower rate, remaining in the 1.5% to 2.0% range.

Indeed, the inflation anxieties that households reported in the aftermath of last summer's hurricanes have continued to dissipate: Survey data show household inflation expectations at 3.8% one year ahead. Long-term inflation expectations, at 3.4%, marked a return to the 3.0% to 3.5% range in which they had remained for nearly a decade.

One indicator of potential inflation pressure in the economy is the cost of

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## Inflation and Prices (cont.)



a. Mean expected change as measured by the University of Michigan's *Survey of Consumers*.

b. Ratio of the core CPI to unit labor cost, indexed to the average ratio over the entire period.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and University of Michigan.

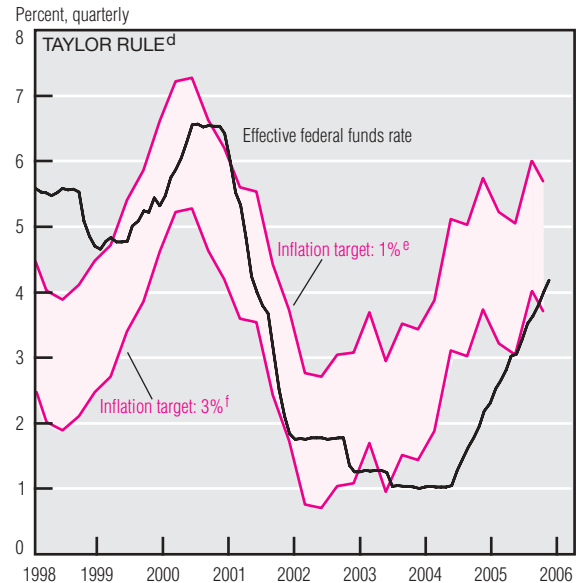
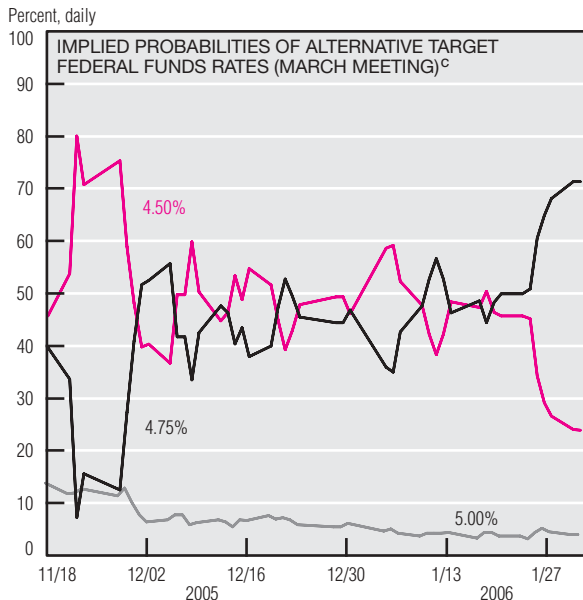
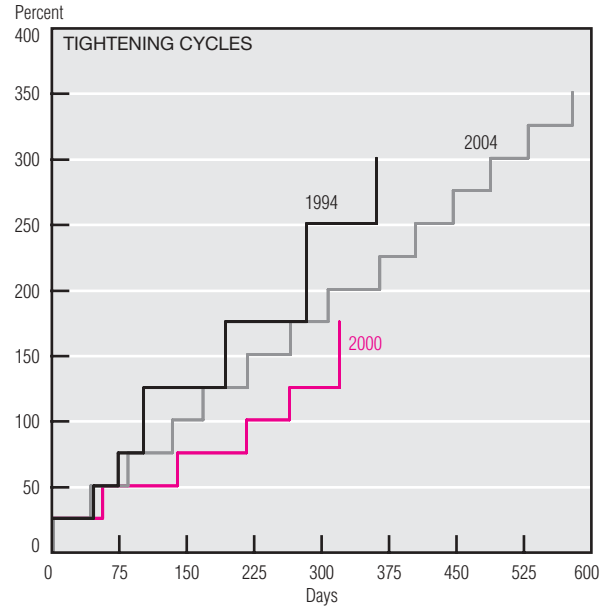
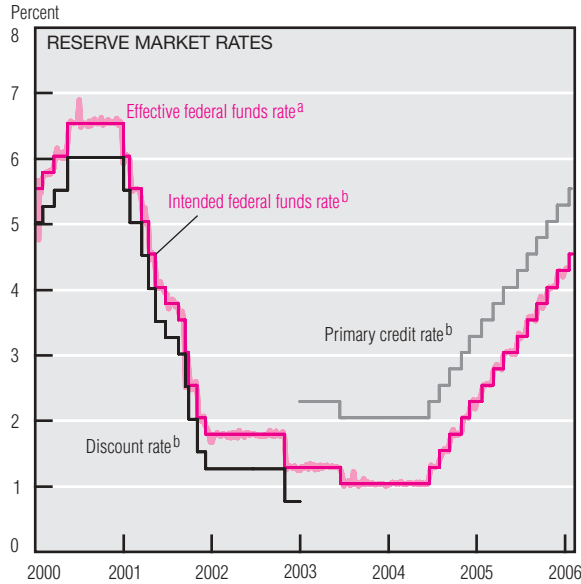
labor. Higher wage costs, the theory goes, mean that firms will soon boost prices. The change in employment costs, as measured by the Employment Cost Index, has averaged about 3.7% over the past 15 years but slowed in 2005. However, the historical link between employment cost pressures and inflation, which was strong throughout the higher-inflation era of the 1970s, is otherwise weak. It is possible that productivity growth, which has remained high and less volatile over the

past decade, has weakened this link. But the productivity-adjusted measure of compensation—unit labor costs—has also proved to be a comparatively poor indicator of changing inflation rates in recent years.

Some argue that the relationship between labor costs and inflation is weak because firms may be experiencing higher-than-usual profit margins, which could allow them to hold the line on prices despite rising labor costs. That is, firms could reduce these margins as competition for

workers heats up. Perhaps. Margins, as measured by the ratio of prices to unit labor costs, would indeed seem unusually high. But what firms' responses to rising labor costs would be, should they occur, and whether firm margins are really as high as this measure would indicate, are highly speculative matters. One thing is clear, however: Current readings from the labor market do not provide very compelling evidence about changes in the economy's inflationary potential.

# Monetary Policy



a. Weekly average of daily figures.

b. Daily observations.

c. Probabilities are calculated using trading-day closing prices from options on March 2006 federal funds futures that trade on the Chicago Board of Trade.

d. The formula for the Taylor rule is taken from Sharon Kozicki, "How Useful Are Taylor Rules for Monetary Policy?" Federal Reserve Bank of Kansas City, *Economic Review*, 1999 IIQ, volume 84, number 2. The weight on inflation is 1.53 and the weight on the output gap is 0.27. The baseline Taylor rule assumes the inflation target is 1.50% and the real interest rate is 1.75%.

e. This line assumes an interest rate of 2.5% and an inflation target of 1%.

f. This line assumes an interest rate of 1.5% and an inflation target of 3%.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Selected Interest Rates,"

*Federal Reserve Statistical Releases*, H.15; Chicago Board of Trade; and Bloomberg Financial Information Services.

On January 31, 2006, in its last meeting under Chairman Alan Greenspan, the Federal Open Market Committee raised the target federal funds rate by 25 basis points (bp) to 4.50%. This marks the fourteenth consecutive increase of 25 bp since June 2004; it brings the funds rate up a total of 350 bp from 1.00%, where it stood at the beginning of the period. This cycle of rising rates has now lasted longer and brought a larger total increase than the previous cycles, which began in

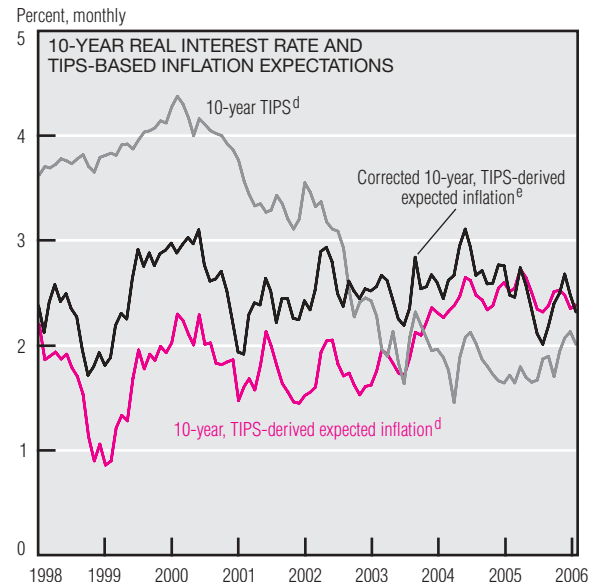
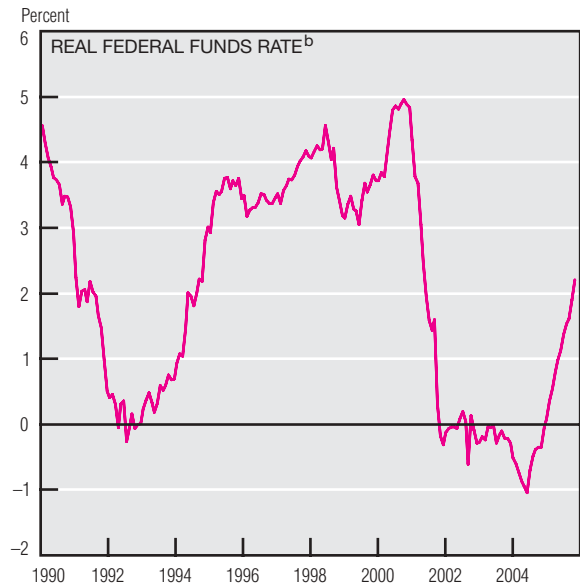
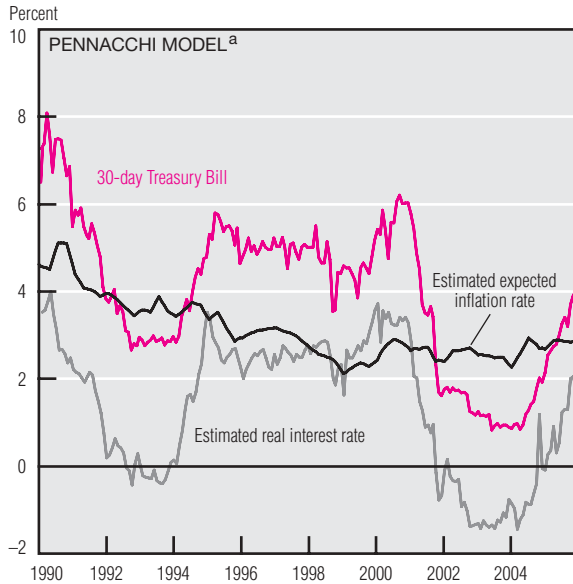
1994 and 2000. The increases since 2004 have proceeded at a much more measured pace, however, coming at 25 bp at each FOMC meeting and avoiding the jumps of 50 bp and 75 bp of the previous two cycles.

Market participants see at least a chance that the tightening cycle will end soon: Implied probabilities from options on fed funds futures show a 25% chance that the target will stay at 4.50% in March. However, much of the market sentiment (70%) sees rates rising again to 4.75%.

A proper appreciation of policy requires putting the rate increases into a broader context. One such context is the Taylor rule, which views the fed funds rate as reacting to a weighted average of inflation, target inflation, and economic growth. Despite the steady increases, the funds rate has generally stayed below the level recommended by the Taylor rule, although in recent months it has broken into the lower end of its range.

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## Monetary Policy (cont.)



a. The estimated expected inflation rate and the estimated real interest rate are calculated using the Pennacchi model of inflation estimation and the median forecast for the GDP implicit price deflator from the *Survey of Professional Forecasters*. Monthly data are used.

b. Defined as the effective federal funds rate deflated by the core PCE.

c. The Berk rate is calculated as the 30-year Government National Mortgage Association yield plus the 10-year TIPS yield minus the 10-year Treasury yield.

d. Treasury inflation-protected securities.

e. 10-year, TIPS-derived expected inflation adjusted for the liquidity premium on the market for 10-year Treasuries.

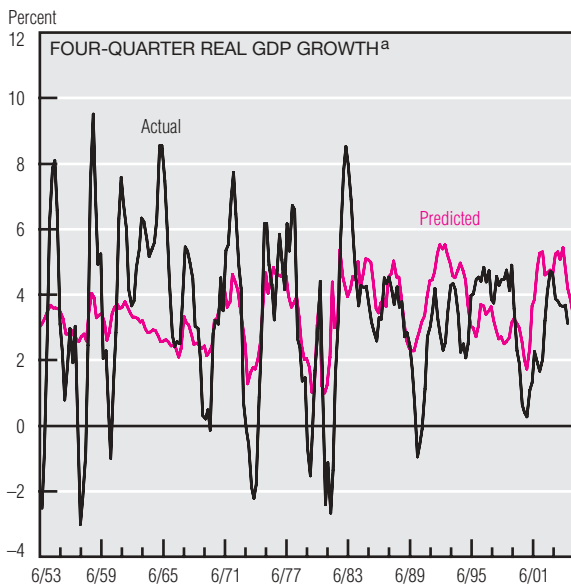
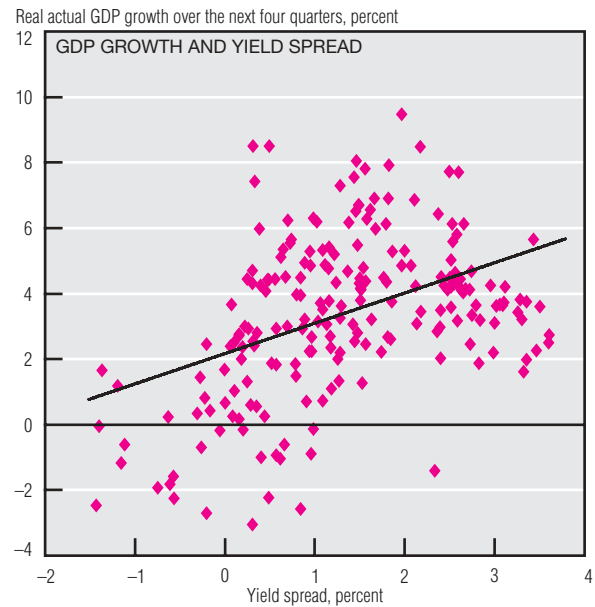
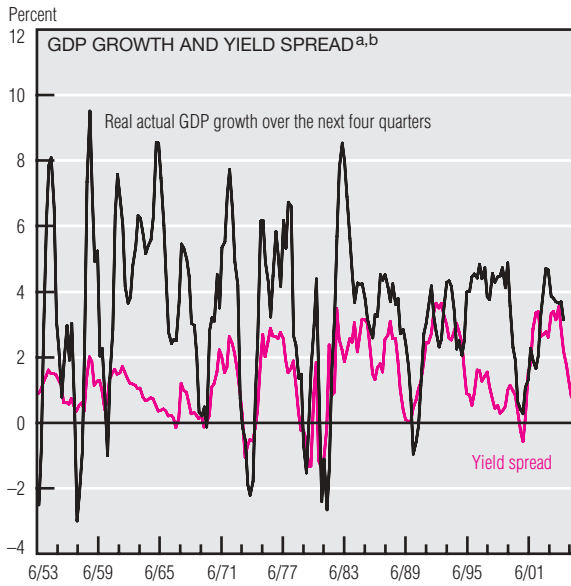
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Federal Reserve Bank of Philadelphia; and Bloomberg Financial Information Services.

Another way to gauge policy is to look at real yields, that is, interest rates adjusted for inflation. The effect of the fed funds increases can be seen in the real fed funds rate, which, after remaining negative for several years, moved rapidly upward and now stands above 2%. An alternative measure of the short rate, derived from the Pennacchi model, which statistically adjusts for inflation using survey expectations, showed a similar pattern.

Longer real rates showed a somewhat different pattern. Although they too showed a substantial drop over the 2000–02 period, they have stayed strongly positive and have held relatively steady over the past 18 months of tightening. Even the Berk rate, an alternative measure of the real rate with an adjustment for the firm's ability to delay investment, has shown little upward drift. Thus the real yield curve appears relatively flat.

The flip side of looking at real rates is looking at inflation expectations, which can be backed out of comparing the yields on real and nominal bonds. Neither short- nor long-term expectations show major changes. The Pennacchi model puts one-month expected inflation at 2.85%, the same level it held in June 2005 and August 2004, whereas the TIPS spread puts 10-year expected inflation at a 2.37% annual rate.

# Money and Financial Markets



## Yield Curve Predictions for 2006<sup>c</sup>

	Real GDP growth (percent)	Probability of recession (percent)
Based on data from 1954–2005		
Current prediction	2.23	34
Historical average	3.39	18
Based on data from 1990–2005		
Current prediction	2.49	45
Historical average	2.99	11

a. Quarterly data.

b. Yield spread: 10-year Treasury note minus three-month Treasury bill.

c. Author's calculations.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; National Bureau of Economic Research; and Bloomberg Financial Information Services.

The recent flattening of the yield curve has generated significant controversy. In the past several weeks, the yield curve has inverted, with both two-year and three-month rates rising above 10-year rates. For the past 50 years, the slope of the yield curve has been among the most reliable predictors of future economic growth, with steep curves indicating high growth and flat curves indicating low growth. A scatter plot of real GDP growth against the spread, however, indicates that the yield curve's

predictions show a great deal of dispersion and often miss the mark both on the high and low sides.

Plotting the quantitative predictions that emerge from using the yield curve highlights both its strengths and weaknesses as a predictor. The predicted values clearly move in the right direction and track changes in the economy, but they rarely rise as high or fall as low as actual GDP growth. That is why some forecasters prefer an alternative approach that relates the slope to

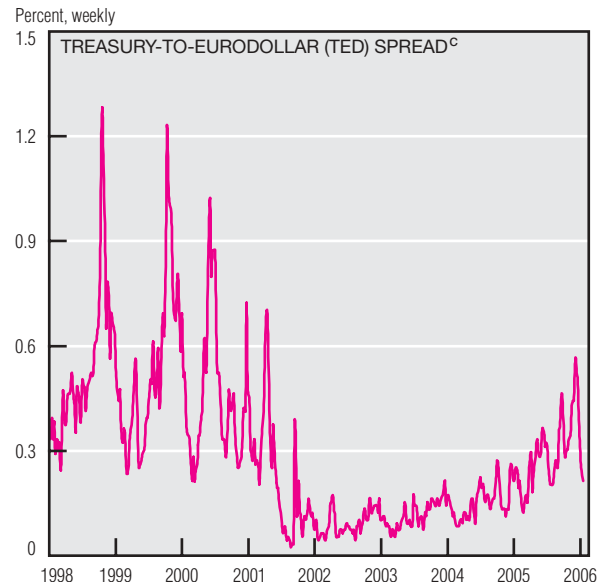
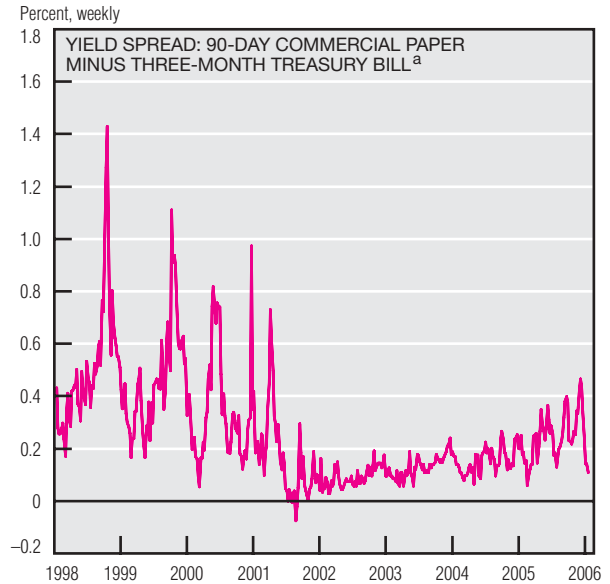
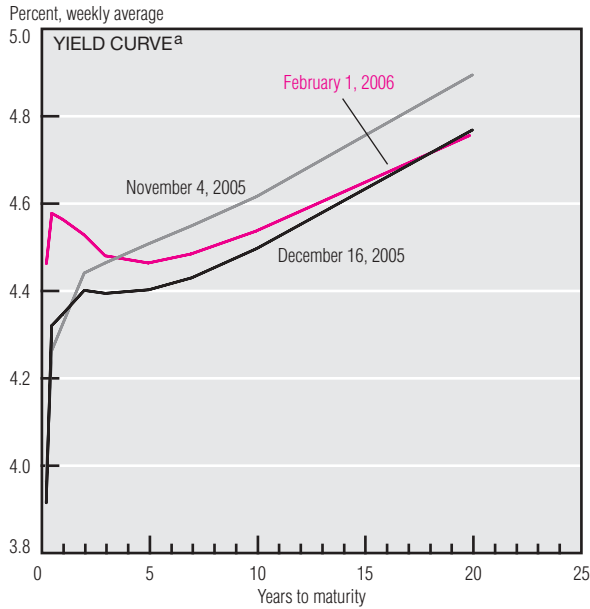
whether or not the economy is in recession; this approach uses the probit technique, which estimates the probability of being in recession.

Predictions based on the current state of the yield curve suggest that 2006 growth will slow from 2005 levels, and, although the odds of a recession are well above average, the odds of a continued recovery are still greater.

The Treasury yield curve has been in the news because its inversion might herald a recession, but Treasury

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## Money and Financial Markets (cont.)



a. All yields are from constant-maturity series.

b. Merrill Lynch AA and BBB indexes, each minus the yield on the 10-year Treasury note.

c. Yield spread: three-month Eurodollar deposit minus the three-month, constant-maturity Treasury bill.

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

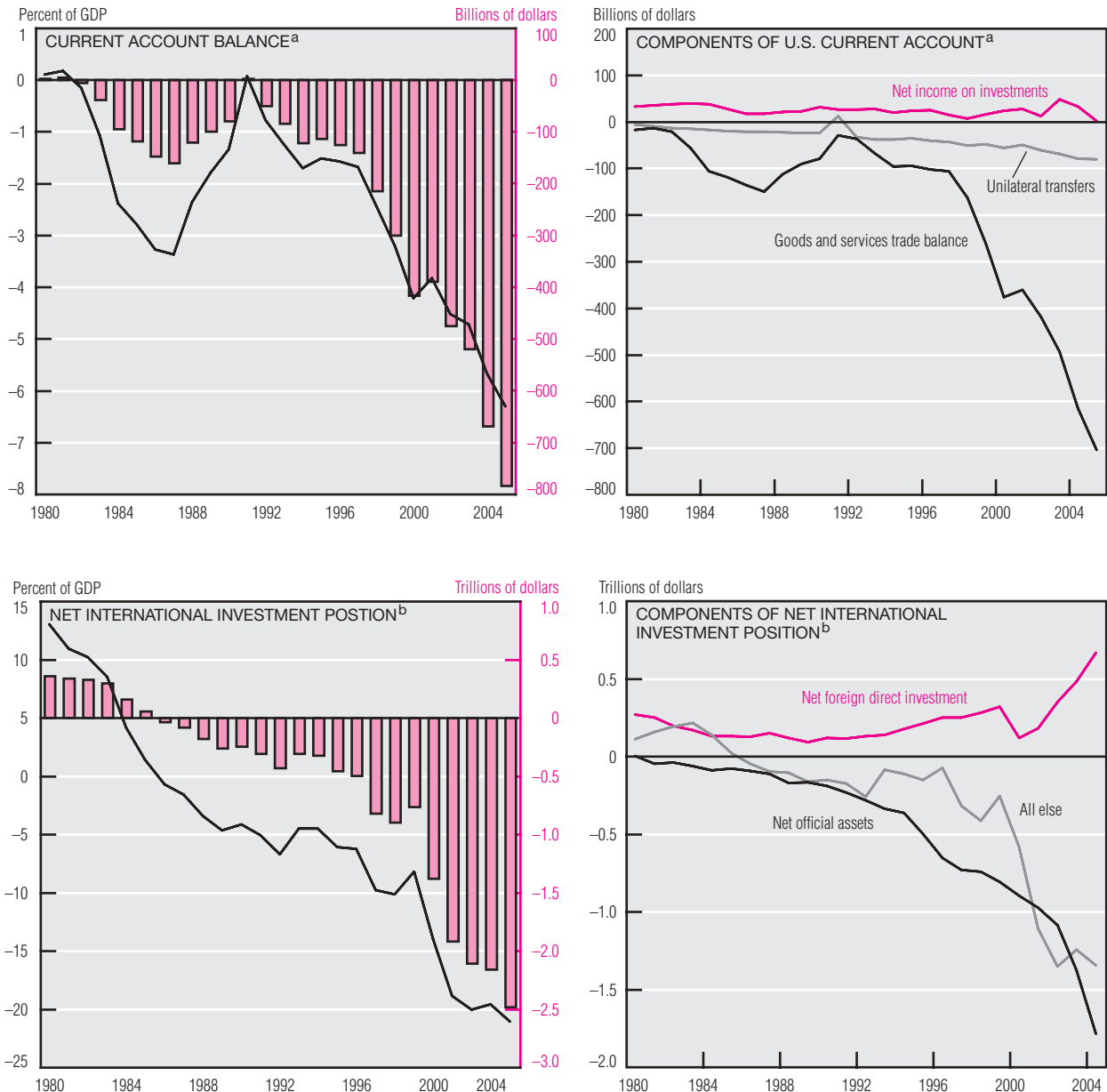
yields are not the only rates with a name for prognostication. Besides term spreads (between different maturities of the same sort of bonds) one can look at risk spreads (between different bonds of the same maturity). The thought is that since bankruptcies and insolvencies rise during recessions, an increase in the risk spread may warn of tough times ahead as lenders demand higher rates to offset the greater chance of loss. Short-term risk spreads (between

90-day commercial paper and three-month Treasury bills) have been trending upward since 2002 but remain far below the levels posted in the late 1990s. Longer-term spreads (between corporate bonds and 10-year Treasury bonds) have also drifted upward since 2003, although again not reaching their previous levels. Thus risk spreads may inject a note of caution about the economy, but hardly signal any major concerns.

Given the many foreign policy concerns about Iraq, Afghanistan, Nigeria,

and other nations, the Treasury-to-Eurodollar (TED) spread deserves some emphasis. As the spread between the rate on dollar-denominated deposits in Europe and Treasury yields, it provides a measure of international risk without the added uncertainty of exchange rate movements. Like the other risk spreads, it has trended upward, but still indicates less risk than in the 1998–2001 period.

# Dark Matter and the International Payments Problem



a. 2005 is estimated using data from the first three quarters.

b. With direct investment on a current-cost basis.

NOTE: See Ricardo Hausmann and Federico Sturzenegger, "U.S. and Global Imbalances: Can Dark Matter Prevent a Big Bang?" (November 13, 2005) [http://www.cid.harvard.edu/cidpublications/darkmatter\\_051130.pdf](http://www.cid.harvard.edu/cidpublications/darkmatter_051130.pdf).

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

A 23-year string of current account deficits has left foreigners holding substantial—and still growing—financial claims against the U.S. Although this pattern seems unsustainable, those who perennially predict a bone-jarring correction have so far been wrong. Recently, economists Ricardo Hausmann and Federico Sturzenegger suggested that no reversal has taken place simply because none is needed. They claim that international accounts do not measure

certain intangible U.S. assets, which they call dark matter. Accounting for dark matter virtually wipes out the threatening imbalance.

When a nation imports more than it exports, it finances the difference by issuing net financial claims to the rest of the world. Because of our persistent trade deficit, by 1986, outstanding foreign claims on the U.S. began to exceed our claims on the rest of the world, giving us a negative net international investment position.

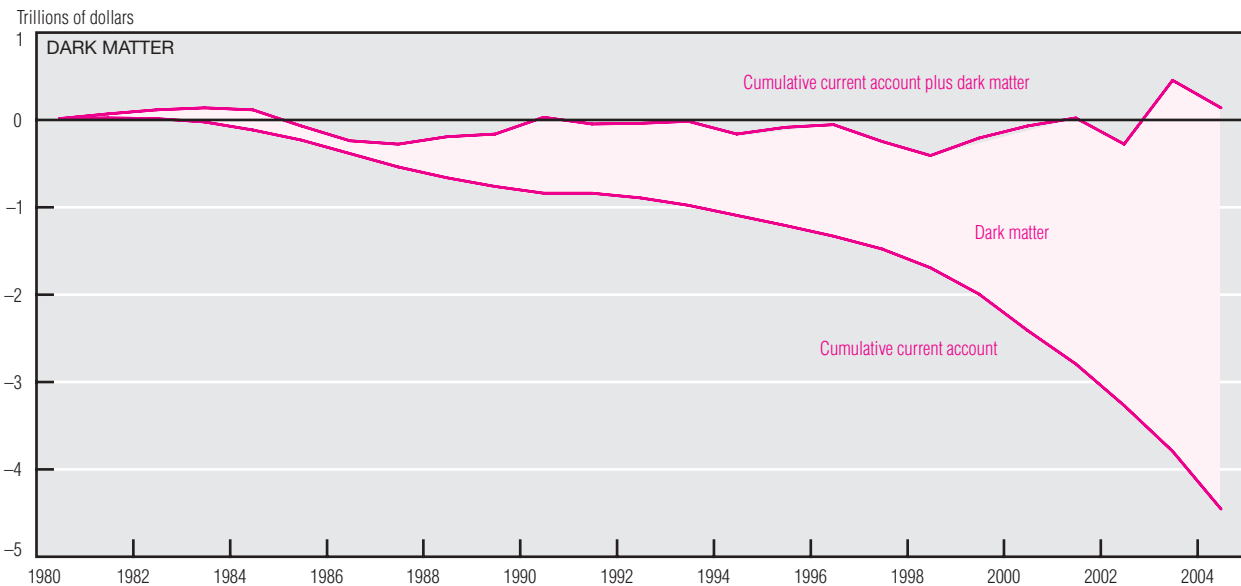
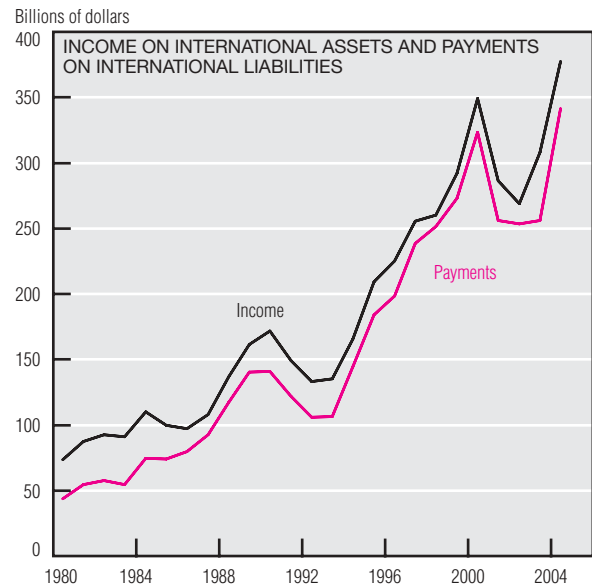
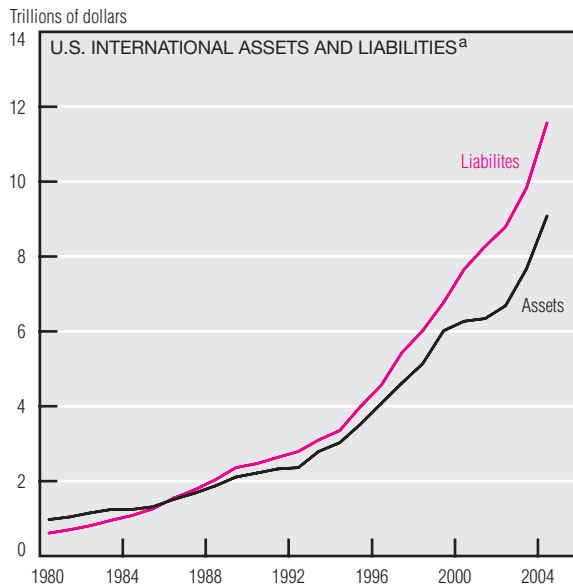
In 2004, our negative net international investment position grew to \$2.5 trillion or 21% of GDP. These claims cannot rise indefinitely relative to GDP, which is a standard proxy for our ability to service them.

Despite our large and growing negative net international investment position, U.S. residents' income from assets that they hold abroad is consistently higher than foreigners' income from claims that they hold on the U.S. This seems anomalous to Hausmann

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## Dark Matter and the International Payments Problem (cont.)



a. With direct investment on a current-cost basis.

NOTE: See Ricardo Hausmann and Federico Sturzenegger, "U.S. and Global Imbalances: Can Dark Matter Prevent a Big Bang?" (November 13, 2005) [http://www.cid.harvard.edu/cidpublications/darkmatter\\_051130.pdf](http://www.cid.harvard.edu/cidpublications/darkmatter_051130.pdf).

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

and Sturzenegger, who contend that any asset that consistently pays more than another must be worth more. Accordingly, they revalue our net international investment position and find that the implied cumulative current account deficit virtually disappears. They attribute the resulting difference to dark matter, which they trace to three sources.

First, U.S. foreign direct investments often infuse operations abroad with business acumen, financial know-how, and a brand name, which raise their

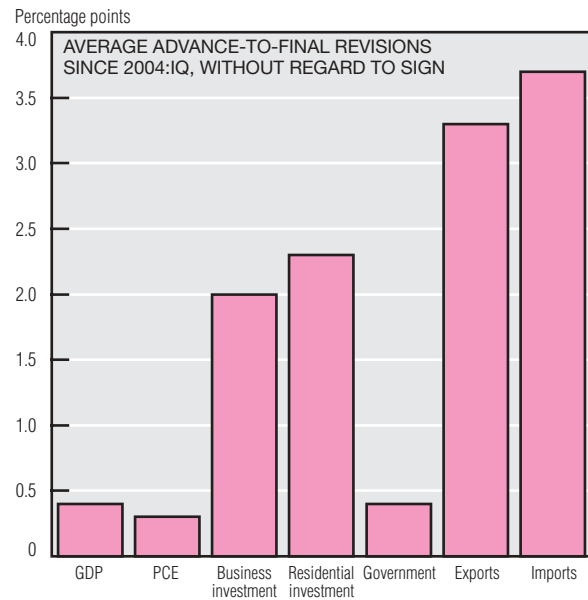
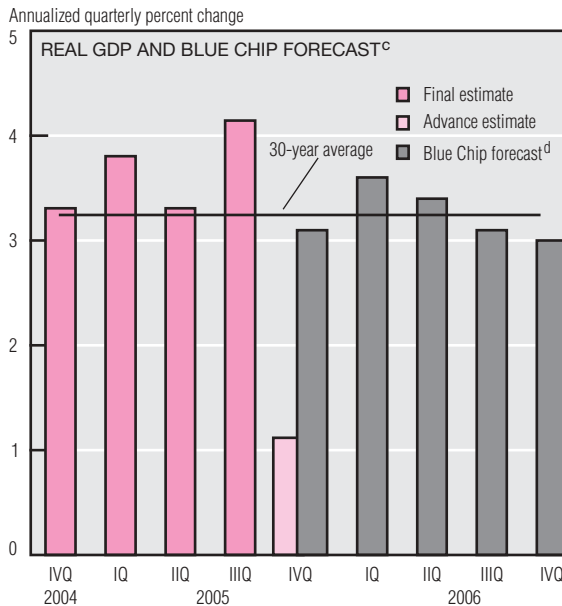
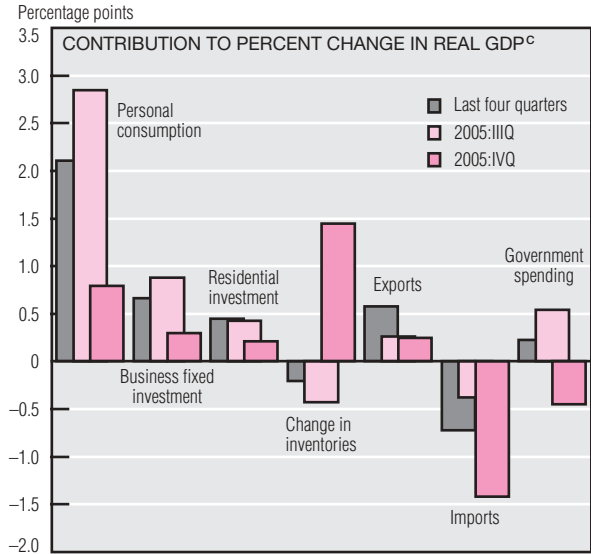
value in nonmeasurable ways. Second, when the U.S. issues safe Treasury securities to the rest of the world and buys higher-yielding—but riskier—emerging-market debt, the transaction is tantamount to the sale of insurance whose value is only captured in the rate differential. Similarly, foreigners hold cash and other liquid dollar-denominated assets in exchange for less-liquid but higher-yielding assets. The rate differential reflects the value of exported U.S. liquidity services that we otherwise fail to measure.

Extending their analysis to other countries, the authors find that, with the exception of Japan, the world is more closely in balance than previously thought. Japan remains a substantial net creditor, while the European Union and the rest of the world have small negative net international investment positions.

The idea of dark matter is controversial, but its focus on intangibles and measurement issues might explain why the oft-predicted current account crash has not yet become visible.

# Economic Activity

	Change, billions of 2000 \$	Annualized percent change	
		Current quarter	Four quarters
Real GDP	31.2	1.1	3.1
Personal consumption	22.3	1.1	3.0
Durables	-55.0	-17.5	0.0
Nondurables	28.9	5.1	4.4
Services	35.6	3.2	2.9
Business fixed investment	9.0	2.8	6.4
Equipment	9.3	3.5	8.3
Structures	0.4	0.6	0.9
Residential investment	5.2	3.5	7.7
Government spending	-11.9	-2.4	1.2
National defense	-17.4	-13.1	0.5
Net exports	-32.8	—	—
Exports	7.1	2.4	5.7
Imports	39.9	9.1	4.6
Change in business inventories	39.0	—	—



a. Chain-weighted data in billions of 2000 dollars.

b. Components of real GDP need not add to the total because the total and all components are deflated using independent chain-weighted price indexes.

c. 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*, January 10, 2006.

The Commerce Department's advance reading of real GDP growth for 2005:IVQ was 1.1%, well below expectations. GDP growth was 3.0 percentage points (pp) lower than the final 2005:IIIQ growth of 4.1%. The deceleration resulted primarily from slower growth in personal consumption expenditures (PCE), business fixed investment, and residential investment. In addition, government spending decreased, whereas imports, which subtract from GDP, increased.

Almost every component's contribution to the change in real GDP

decreased in 2005:IVQ. The only exception was changes in private inventories, which contributed 1.9 pp more than in 2005:IIIQ. PCE, which traditionally makes the largest positive contribution to GDP, added only 0.8 pp, compared to 2.9 pp the previous quarter.

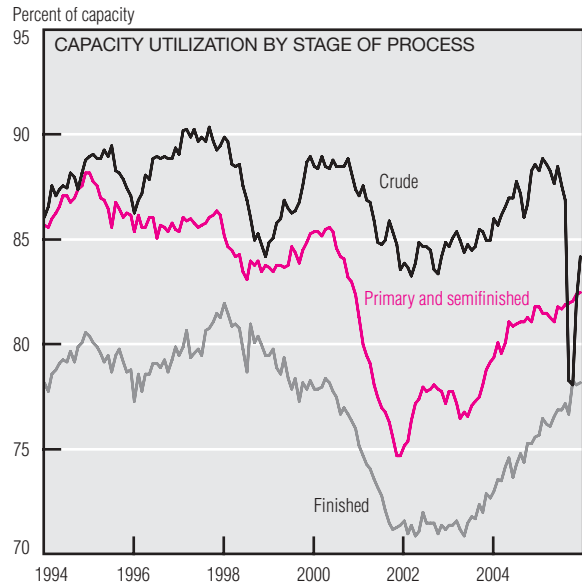
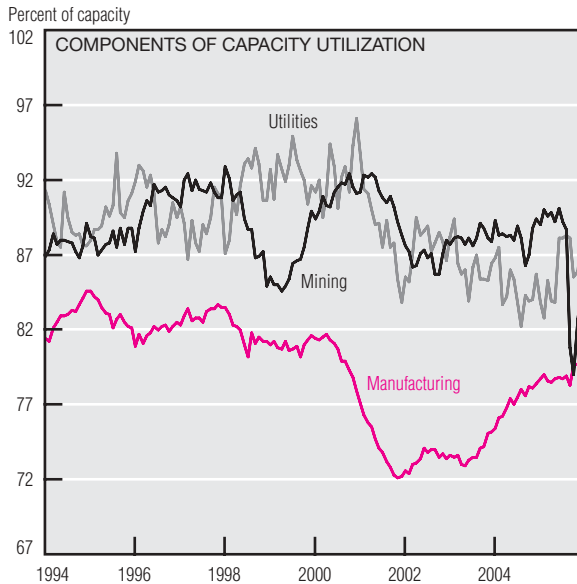
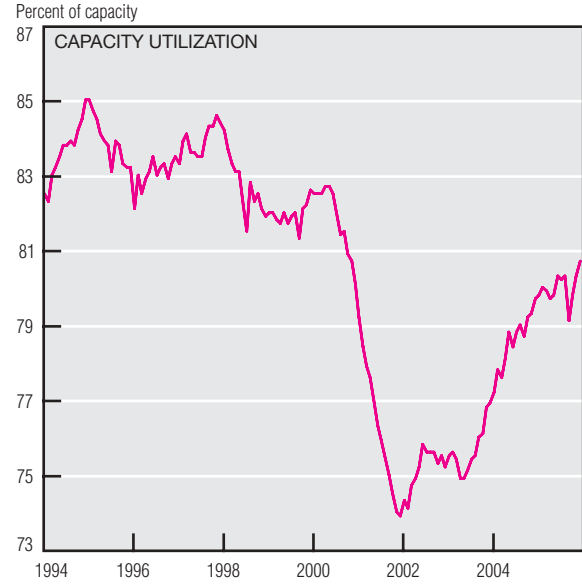
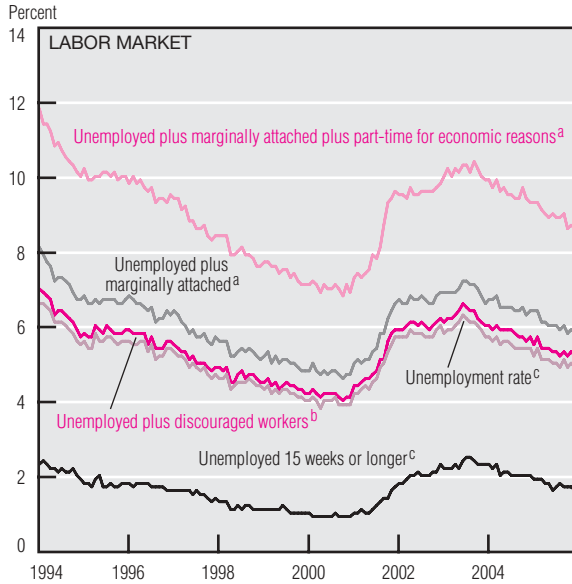
January's advance estimate of GDP growth was the slowest since 2002:IVQ, when the economy was only one year removed from the 2001 recession. The January 10 Blue Chip forecast predicted growth of 3.1% for 2005:IVQ and between 3.0% and 3.6%

for each quarter in 2006. This forecast is in line with the previous 30-year average of 3.2%.

Although the GDP reading was disquieting, it is not uncommon for significant revisions to occur between the advance and final estimates. Imports, in particular, surged 6.7 pp in the 2005:IVQ advance report. Of all the GDP's main components in the last two years, imports have had the largest average advance-to-final revision (3.7 pp). So it is very possible that the final GDP estimate will be considerably higher than the current 1.1%.

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## Economic Activity (cont.)



a. Percent of the civilian labor force and marginally attached workers.  
 b. Percent of the civilian labor force and discouraged workers.  
 c. Percent of the civilian labor force.  
 NOTE: All data are seasonally adjusted.  
 SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

As the expansion continues, the availability of resources to fuel it becomes an issue. Consider labor utilization. A conventional measure of labor market tightness is the unemployment rate, which has fallen from its recessionary peak to a level not seen since the middle of the last expansion. Some may think that at 5%, the unemployment rate is quite low and the pool of available workers is becoming small. An alternative measure of unemployment adds discouraged workers (people who have looked for a job within the past 12 months but have ceased actively looking because

they perceive that they will not find a job). Another measure adds marginally attached workers (those who have sought employment in the past 12 months but not in the last four weeks). Both measures present much the same picture. Adding part-time workers who would prefer to work full time brings the rate to 8.6%.

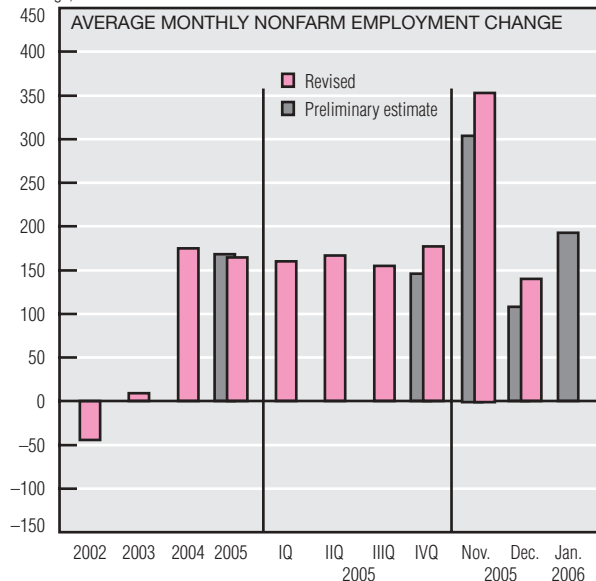
Capital utilization (CU) has risen sharply since the recession. However, industrial CU is still below the levels seen in the previous expansion. All of CU's constituent components fell during the recession, although the manufacturing sector

clearly dominated developments in the aggregate. Electric and gas utilities' CU has dropped relative to the previous expansion, whereas mining's is little changed (apart from a recent downward spike).

Another way to slice the utilization data is with respect to stage of process. CU in the crude sector follows that in the mining sector; more capacity is available at later stages of processing. The overall decrease in industrial CU is reflected across all levels of processing, but most markedly at the more advanced ones.

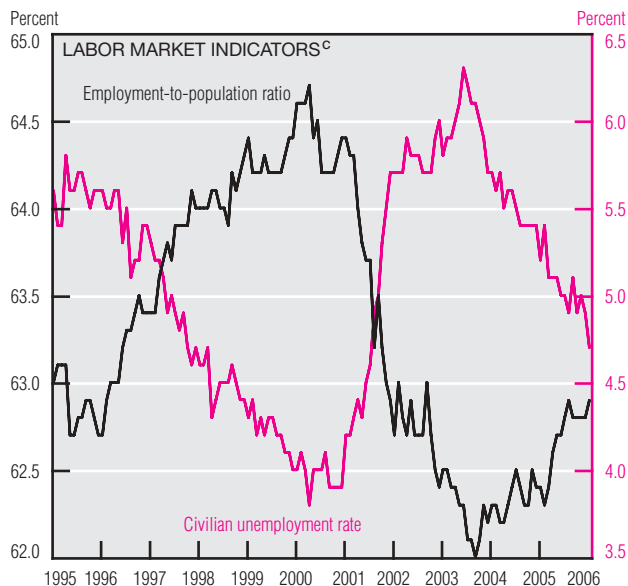
# Labor Markets

Change, thousands of workers



## Labor Market Conditions

	Average monthly change (thousands of employees, NAICS)				
	2002	2003	2004	2005	Jan. 2006
<b>Payroll employment</b>	-45	9	175	165	193
<b>Goods producing</b>	-76	-42	28	21	58
Construction	-8	10	26	24	46
Manufacturing	-67	-51	0	-7	7
Durable goods	-48	-32	9	1	7
Nondurable goods	-19	-19	-9	-8	0
<b>Service providing</b>	32	51	147	143	135
Retail trade	-9	-4	17	14	-2
Financial activities <sup>a</sup>	6	7	8	12	21
PBS <sup>b</sup>	-17	23	40	42	24
Temporary help svcs.	2	12	13	15	14
Education & health svcs.	40	30	33	30	39
Leisure and hospitality	12	19	26	21	26
Government	21	-4	13	13	-1
	<b>Average for period (percent)</b>				
Civilian unemployment rate <sup>c</sup>	5.8	6.0	5.5	5.1	4.7



NOTE: All data are seasonally adjusted.

a. Financial activities include the finance, insurance, and real estate sector and the rental and leasing sector.

b. Professional and business services include professional, scientific, and technical services, management of companies and enterprises, administrative and support, and waste management and remediation services.

c. Beginning in January 2006, the data reflect the household survey's revised population controls.

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

## Unemployment by Worker's Last Industry, 2005

	Thousands of persons	Unemployment rate (percent)
Nonagricultural, private wage and salary workers	5,989	5.2
Mining	20	3.1
Construction	712	7.4
Wholesale and retail trade	1,137	5.4
Transportation and utilities	232	4.1
Information	163	5.0
Financial activities	272	2.9
Professional and business services	792	6.2
Education and health services	627	3.4
Leisure and hospitality	921	7.8
Other services	301	4.8

Nonfarm payrolls grew by 193,000 in January, reflecting the annual benchmarking process and updated seasonal factors. November's increase was revised to 354,000 jobs and December's to 140,000.

The construction industry was particularly strong in December, with net growth of 46,000 jobs; it grew by 345,000 jobs over the year. Food services and drinking places (31,000), health care (29,000), and financial activities (21,000) added jobs at rates higher than their 2005 averages. In January, accounting services lost jobs,

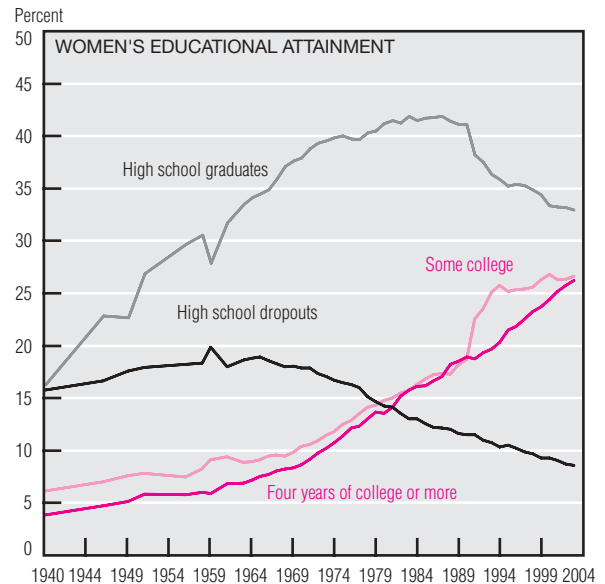
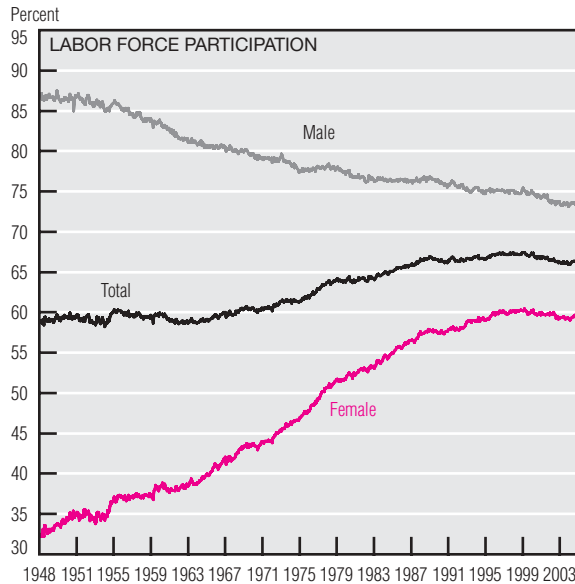
while the number in manufacturing and retail changed only slightly.

The national unemployment rate was 4.7% in January, down from 4.9% in December. The labor force participation rate (66.0%) and the employment-to-population ratio (62.9%) showed little or no change over the month. Long-term jobless persons—those without work for 27 weeks or more—fell to 1.2 million or 16.3% of all unemployed persons, down from 21.0% a year earlier.

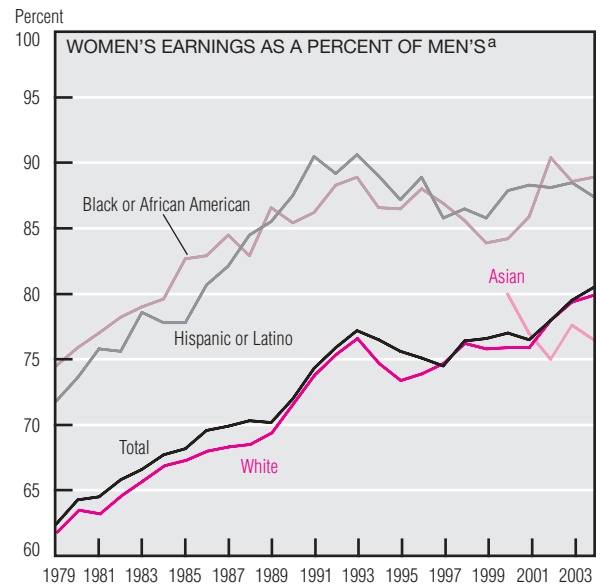
Unemployment rates by industry measure the number of jobless people

by the industry of the person's last job. Although overall unemployment can be thought of as a measure of labor force slack, industries cannot rely on workers returning to their previous industry. Breaking down the jobless numbers by industry shows which industries have recently shed workers. In 2005, unemployment rates exceeded 7% in construction and in leisure and hospitality. Mining and the financial services industries enjoyed unemployment rates of about 3%.

# Women in the Workforce



Women's Occupations, 2005	Total employed (thousands)	Percent women
<b>Total, 16 years and over</b>	<b>141,730</b>	<b>46.4</b>
<b>Management, professional, and related occupations</b>	<b>49,245</b>	<b>50.6</b>
Business and financial operations	14,685	37.2
Computer and mathematical	5,765	55.9
Architecture and engineering	3,246	27.0
Life, physical, and social services	2,793	13.8
Community and social services	1,406	42.5
Legal	2,138	61.3
Education, training, and library	1,614	49.4
Arts, design, entertainment, sports, and media	8,114	73.8
Healthcare practitioner and technical	2,736	47.8
<b>Service occupations</b>	<b>23,133</b>	<b>57.3</b>
Healthcare support	3,092	89.0
Protective service	2,894	22.4
Food preparation and serving related	7,374	56.6
Building and grounds cleaning and maintenance	5,241	40.6
Personal care and service	4,531	78.3
<b>Sales and office occupations</b>	<b>35,962</b>	<b>63.3</b>
Sales and related occupations	16,433	49.1
Office and administrative support	19,529	75.3
<b>Natural resources, construction, and maintenance</b>	<b>15,348</b>	<b>4.6</b>
<b>Production, transportation, and material moving</b>	<b>18,041</b>	<b>22.9</b>



a. Women's median usual weekly earnings for full-time wage and salary workers as a percent of men's.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and U.S. Department of Commerce, Bureau of the Census.

Women's labor force participation rose from about 43% in 1970 to roughly 59% in December 2005. In fact, their participation has been on the increase since the late 1940s. At the same time, women have obtained higher education levels because of greater returns to higher education: Women's high school dropout rate has fallen from nearly 18% in 1940 to about 7% in 2004, while the share pursuing a college degree or higher has climbed dramatically from about 4% in 1940 to nearly 31% in 2004.

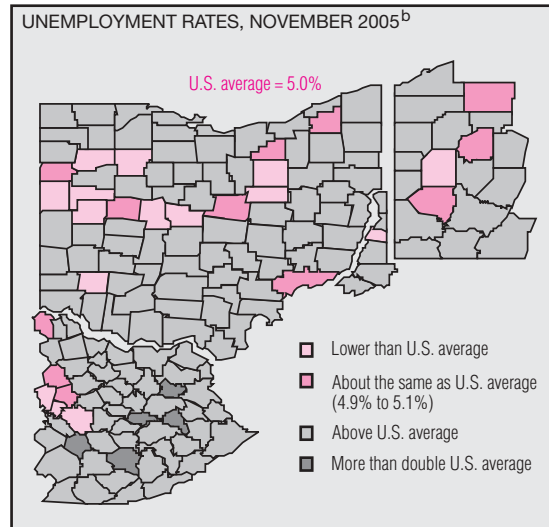
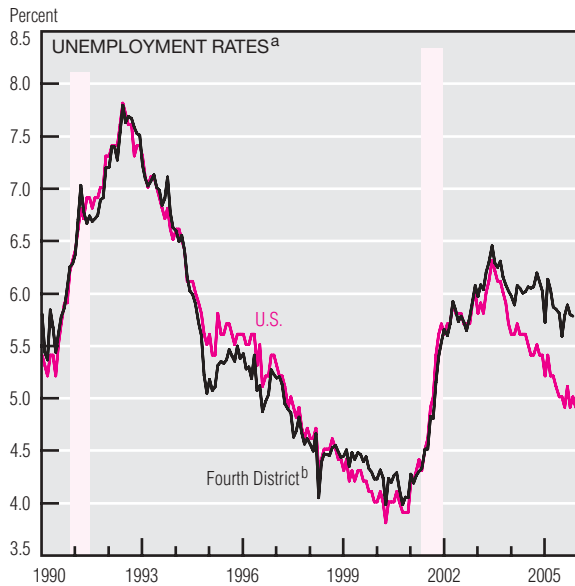
Accordingly, women have been able to pursue better-paying occupations than before. By 2005, they held about half of all management, professional, and related occupations, up about 2 pp from 2000.

Women continue to have a majority share in business and financial operations; community and social services; education, training, and library; and healthcare practitioner and technical occupations.

Meanwhile, the income disparity between men and women has

narrowed considerably. In 1979, women's median earnings were 62% of men's; by 2004, this figure had climbed to nearly 80%. The lessening of gender inequality may result partly from women moving into higher-paying occupations. Interestingly, within some minority groups, earnings inequality is less than in the workforce as a whole. For example, African American women make nearly 89.0% as much as African American men.

## Fourth District Employment



### Payroll Employment by Metropolitan Statistical Area

	12-month percent change, December 2005							
	Cleveland	Columbus	Cincinnati	Dayton	Toledo	Pittsburgh	Lexington	U.S.
Total nonfarm	-0.1	0.9	1.1	-1.2	0.4	0.1	1.2	1.5
Goods-producing	0.5	1.6	2.2	-4.2	-1.4	-4.1	1.3	1.1
Manufacturing	0.8	-0.2	0.5	-5.1	-2.2	-3.9	0.3	-0.3
Natural resources, mining, and construction	-0.7	5.4	6.1	-0.6	1.3	-4.4	4.0	3.7
Service-providing	-0.2	0.7	0.9	-0.6	0.8	0.7	1.1	1.6
Trade, transportation, and utilities	-1.2	-0.4	-1.4	-1.6	1.7	-0.2	0.9	0.9
Information	-1.0	-1.5	0.0	-4.5	-4.2	-0.4	-2.2	0.7
Financial activities	0.1	-0.7	0.2	-3.2	0.8	0.3	-0.9	2.4
Professional and business services	-0.1	2.5	2.4	0.6	2.9	0.8	-0.3	3.0
Education and health services	1.1	1.9	3.1	0.9	0.2	3.3	1.3	2.1
Leisure and hospitality	1.0	1.4	1.4	-1.3	0.0	1.5	1.2	1.8
Other services	0.2	0.3	2.4	4.6	4.5	1.2	1.0	0.5
Government	-1.6	0.6	0.4	-1.4	-1.3	-2.0	3.3	0.9
November unemployment rate (percent)	6.0	5.2	5.4	5.9	6.4	5.2	5.0	5.0

a. Shaded bars represent recessions.

b. Seasonally adjusted using the Census Bureau's X-11 procedure.

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

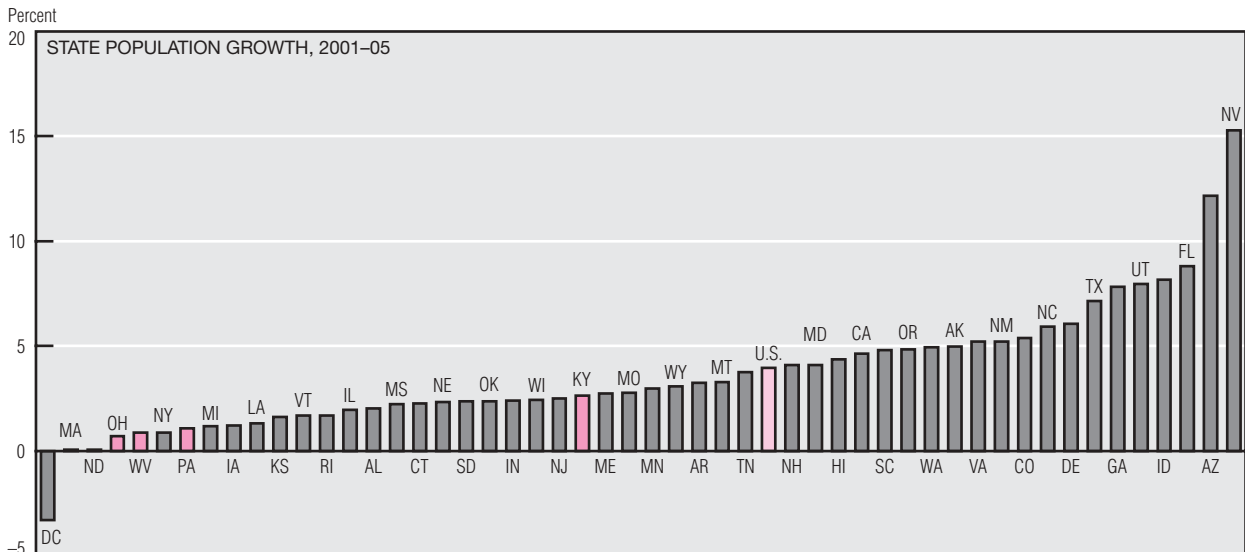
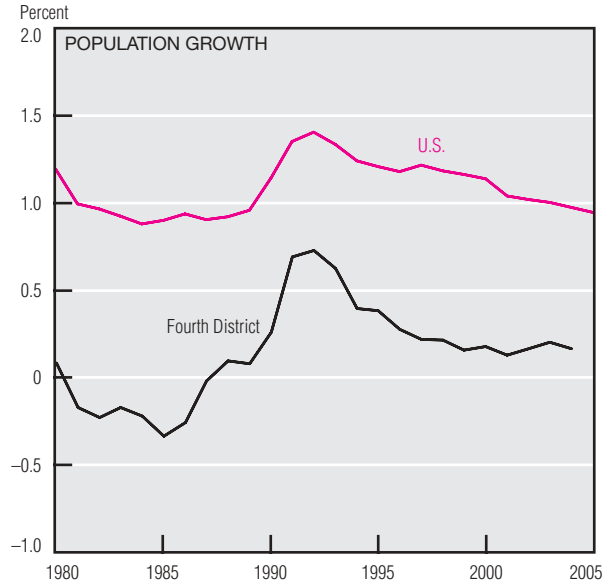
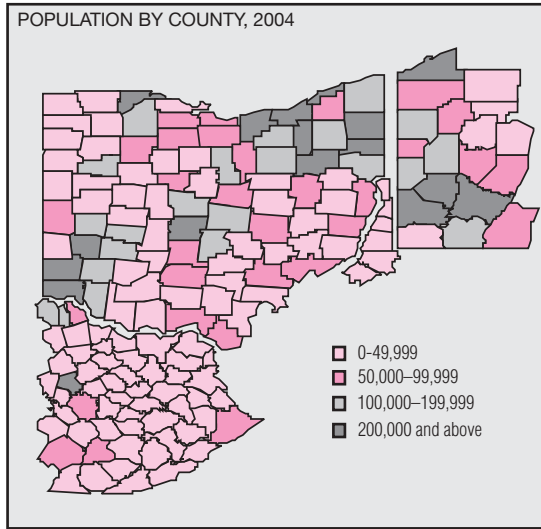
The Fourth District's unemployment rate remained at 5.8% in November. Over the month, both the number of employed people and the size of the labor force fell 0.1%. Over the year, employment increased 0.6% and the labor force increased 0.3%. The U.S. unemployment rate fell from 5.0% in November to 4.9% in December.

Unemployment rates in almost all Fourth District counties continue to exceed the national average. However, there are signs of improvement: From October to November, unemployment

rates fell in 89 counties, stayed the same in 19, and rose in 61. Compared to November 2004, rates fell in 103 counties, stayed the same in six, and rose in 60. In every major metropolitan area in the District, unemployment rates were equal to or greater than the U.S. average; in most of them, rates changed only slightly from October to November. In Columbus, Cincinnati, Dayton, and Toledo, unemployment rates fell by 0.1%; however, rates rose 0.4% in Pittsburgh and 0.2% in Lexington.

In some industries, the District's major metro areas experienced employment growth trends similar to the nation's. However, this was not the case in some other industries. For instance, like the nation, every major metro area in the District enjoyed increased employment in both the education and health services and the other services industries over the year. However, in the trade, transportation, and utilities and the information industries, where the U.S. posted gains over the year, most of the District's major metro areas lost employment.

# Fourth District Population



NOTE: Annual population estimates are for July. Similarly, changes in population are calculated from one July to the next.  
SOURCE: U.S. Department of Commerce, Bureau of the Census.

In 2004, 16.9 million people—or 5.7% of the U.S. population—called the Fourth District home. The majority of District residents (77.5%) lived in metropolitan areas. Of the 169 District counties, Cuyahoga had the largest population (nearly 1.4 million) and Kentucky’s Robertson County had the smallest (2,300). Like many counties in Fourth District Kentucky, Robertson’s relatively low population resulted from its slight dimensions and its rural nature.

For the past 25 years, the District’s rate of population growth has been trailing the nation’s by about 1%. In fact, the District’s population actually posted a net loss in the early 1980s. In each of the last several years, however, its population grew at an average rate of 0.2%.

This low population growth affects every District state. Ohio’s 0.7% total growth over the last four years has been the third-smallest of any state, and rates in West Virginia and Pennsylvania were similarly low. Kentucky’s

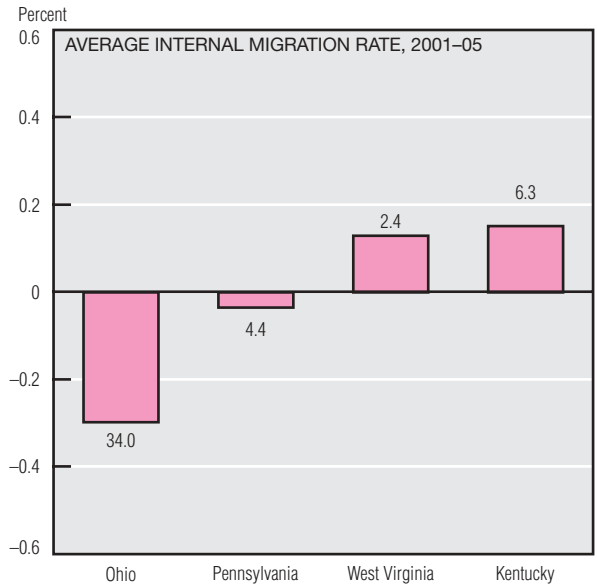
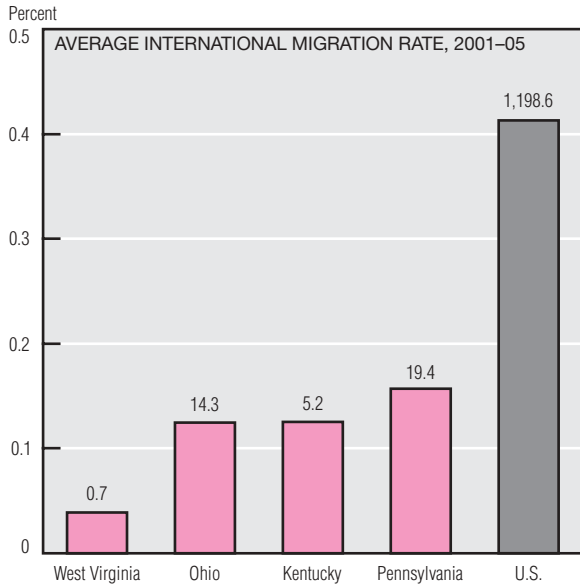
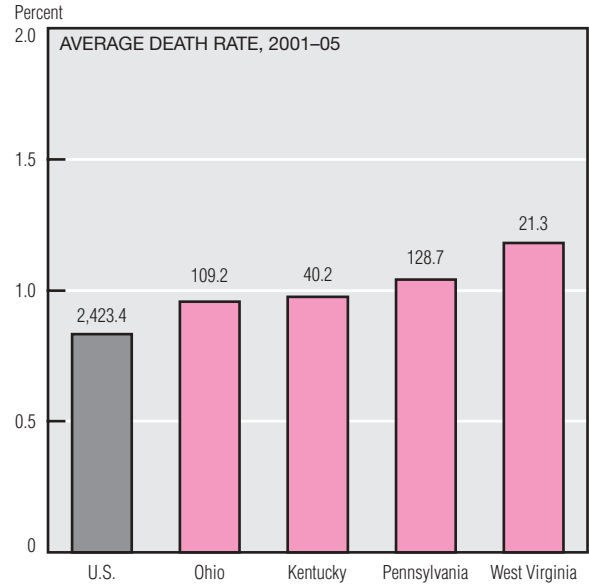
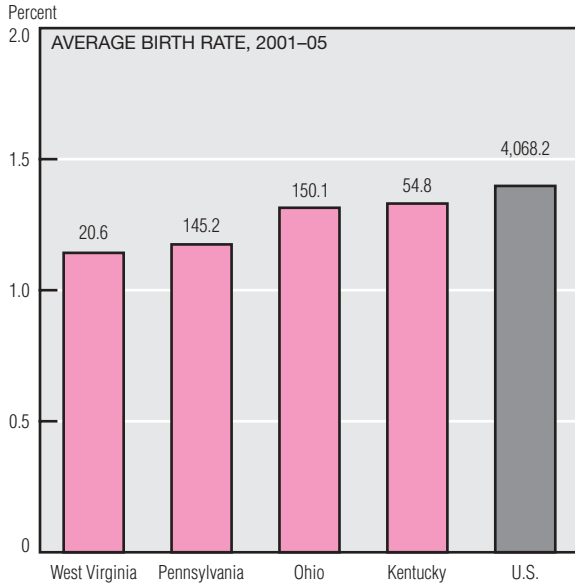
population growth, although higher than other District states, was still well below the national average.

Why has population growth in the District been slower than in many other areas of the country? We can explore this question by individually examining four components: births, deaths, net international migration, and net internal migration (that is, net migration within the U.S.).

There are a number of reasons for the Fourth District states’ low population growth. Because their residents

*(continued on next page)*

## Fourth District Population (cont.)



NOTE: Annual population estimates are for July. Similarly, changes in population are calculated from one July to the next. The numbers above or below the bars represent the average population change in thousands.  
 SOURCE: U.S. Department of Commerce, Bureau of the Census.

are older, they have relatively low numbers of births and high numbers of deaths. The U.S. as a whole added an average of 1.4% to its population over the last few years as a result of births. By comparison, West Virginia added 1.1% and Pennsylvania added 1.2%; Ohio and Kentucky each added 1.3%. Birth rates in West Virginia and Pennsylvania were the fourth- and fifth-lowest of any state in the nation.

Deaths have caused the loss of about 0.8% of the U.S. population

every year since 2001. Ohio, Kentucky, and Pennsylvania each lost about 1.0% of their population because of deaths; West Virginia lost almost 1.2%, making its death rate the highest in the U.S.

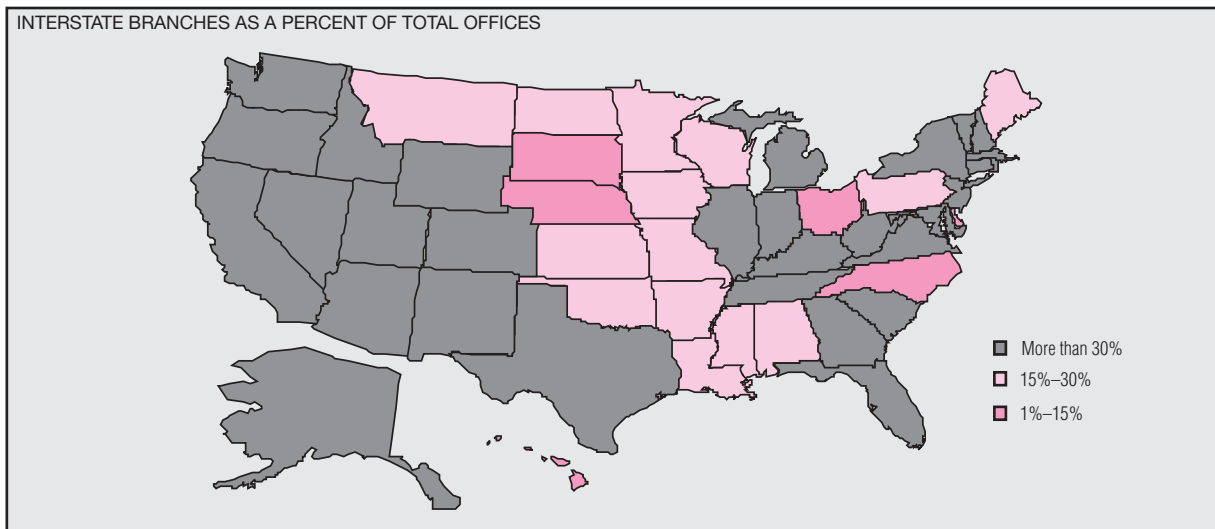
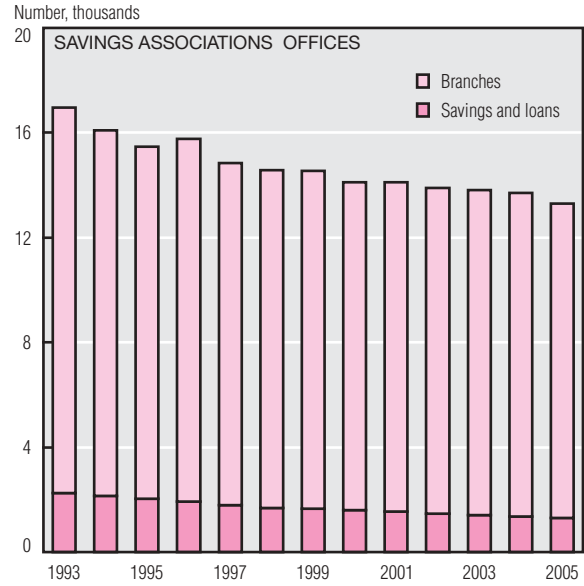
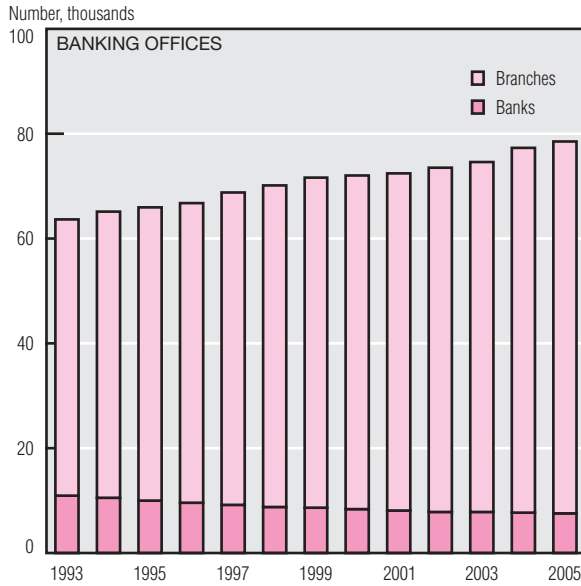
Birth and death rates are not the only contributors to lagging state population growth in the Fourth District; international migration is also a factor. Although net international migration has been positive for every state, the District states are adding residents from abroad at slower rates than the U.S. as a whole.

West Virginia had the lowest average international migration rate of any state, with movement to and from other countries adding just 0.04% to its population each year.

Internal migration, however, shows a different pattern. Ohio has lost about 0.3% of its residents to other states in each of the past four years, and Pennsylvania has lost 0.04%. However, on net, West Virginia and Kentucky have gained population from other states.



# Banking Structure



NOTE: All 2005 data are as of the end of the third quarter.  
 SOURCES: Federal Deposit Insurance Corporation, *Quarterly Banking Profile* and *QBP Graph Book*, September 30, 2005.

Passage of the 1994 Reigle–Neal Act, which regulates interstate banking, has spurred the consolidation of depository institutions. The number of FDIC-insured commercial banks fell from 9,971 at the end of 1995 to 7,541 at the end of 2005:IIIQ, a decline of more than 24%. Over the same period, the number of FDIC-insured savings associations fell by more than 35%, from 2,030 in 1995 to 1,314 at the end of 2005:IIIQ.

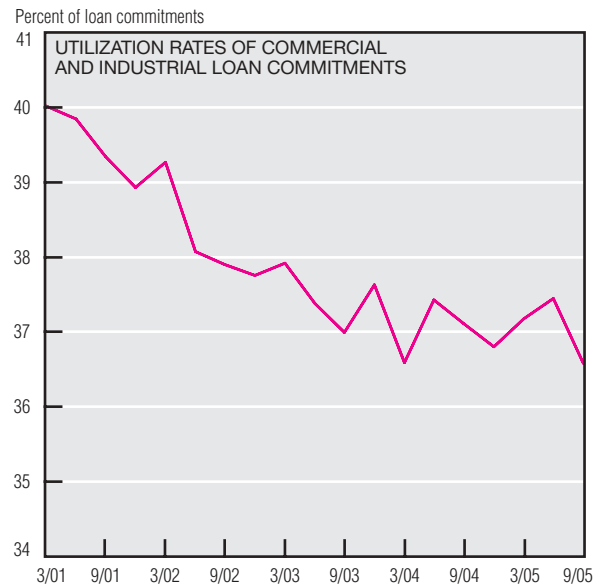
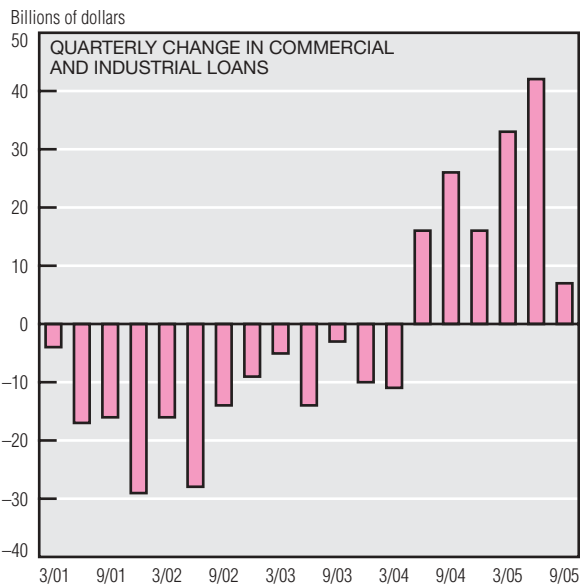
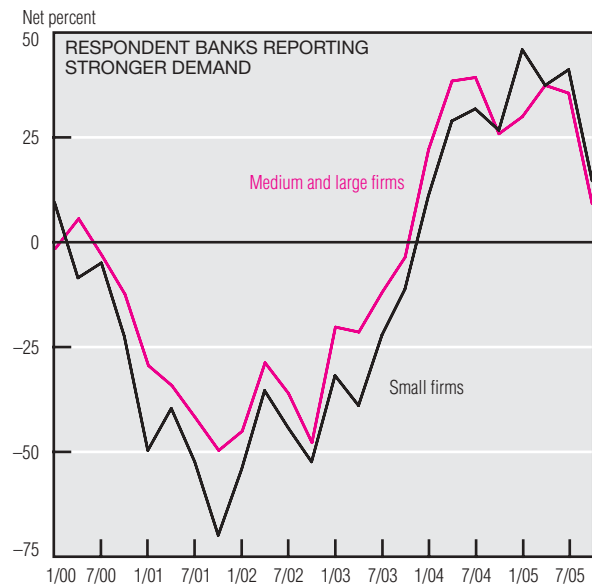
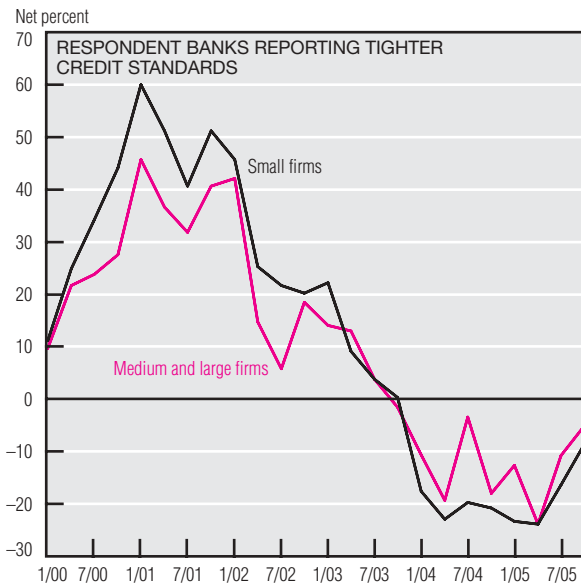
The number of savings associations’ offices also declined, but less

sharply than the number of institutions (only around 14%, from 15,462 in 1995 to 13,291 at the end of 2005:IIIQ.) The total number of banking offices, however, increased about 19% over that period, from 65,888 to 78,492. From the end of 1995 to September 30, 2005, the total number of FDIC-insured depository institutions’ offices increased nearly 13%, from 81,350 to 91,783. This count does not include other channels for delivering banking services, such as automated teller machines, telephone banking,

and online banking. Hence, the reduction in the number of insured depository institutions has not decreased the availability of bank services for most consumers.

The effects of the banking industry’s interstate consolidation are evident: All but six states now report that more than 15% of depository institutions’ branches are part of an out-of-state bank or savings association. And in over half the states, 30% or more of all branches are offices of out-of-state depository institutions.

## Business Loan Markets



SOURCES: Board of Governors of the Federal Reserve System, *Senior Loan Officer Survey*, October 2005; and Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

Credit availability for businesses continued to improve in 2005, according to the Federal Reserve's *Senior Loan Officer Survey*. In the October 2005 survey (covering August, September, and October), respondent banks reported further easing of lending standards for commercial and industrial loans, although a slightly smaller fraction reported easing than in recent surveys. Respondents had narrowed their lending spreads, reduced collateral requirements, and increased the size of credit lines. This relaxation was partly due to stronger competition from other banks and other

sources of business credit and partly due to credit terms that eased because of increased risk tolerance or a less uncertain economic outlook.

While demand for commercial and industrial loans by businesses of all sizes continues to be strong, there are signs that demand may be softening: The share of respondent banks reporting stronger demand for business loans from medium and large businesses has fallen from 40.8% in the July survey to 14.3% in October. Demand for small-business loans showed a similar decline, with the share of respondents who reported stronger demand falling from 35.2% to 8.9%.

Relaxed lending standards continued to translate into more commercial and industrial loans. Bank and thrift holdings of such loans increased \$7 billion in 2005:IIIQ, the sixth consecutive quarter of expanding business loan portfolios, although the current gain was the smallest of the six quarters. This increase coincided with little change in the utilization rate of business loan commitments (credit lines extended by banks to commercial and industrial borrowers), further evidence of an ample supply of business credit.