

The Economy in Perspective

by Mark Sniderman

Data dependent... Last Saturday morning, when I asked my teenage daughter what her plans were for the evening, she told me she wasn't sure.

"Dad," she said, "I think I'll just have to be data dependent. My econ teacher told us yesterday that the Federal Reserve has become more 'data dependent,' and it sounds way cool."

I didn't want to seem clueless, but I had to ask for an explanation.

"Well," Courtney said, "The Fed has raised its policy rate quite a lot during the past two years, but at first raising the rate always seemed like a no-brainer. After a while, everyone realized that they would have to stop, or pause, *sometime!* The financial press says the Fed is getting close and that their next moves will depend heavily on how they see the outlook taking shape, based on the incoming data."

"And that relates to tonight exactly how?" I puzzled.

"I'm pretty sure I'll go over to Molly's house, but that depends on how the evening is shaping up," Courtney explained. "I need more information about who else will be there before I can decide."

"That makes sense," I said. "But when will you find out? Your mother and I want to make plans for the evening too, and our decision could depend on yours."

Courtney smiled. "I've got it all figured out. Molly is scheduled to call me at 10:00 this morning with a preliminary report, and she'll give me a revised report at 1:00 this afternoon. I can tell you what I'm thinking at lunchtime based on the early data, and I'll be able to give you a final decision at 2:15."

"Great," I smiled back. "We can reconvene in a few hours at the kitchen table."

The time passed quickly, and before long I was calling Courtney down from her room. "What's up, Ms. Data Dependent?" I asked.

"What's up is that deciding what to do is becoming more complicated than I thought it would be," she frowned. "Jeff, Charlie, Loretta, Craig, Helen, and the two Bobs all said they are going, which is great. But you-know-who will be there, and he gives me the creeps. Plus, he's like a leading indicator for more bad news, if you know what I mean. Molly

said that he surprised her by calling last night, and when he practically invited himself over she just couldn't say no."

"And what about Art?" I asked. "Will he be there?"

"That's one of the things I still don't know," Courtney replied. "Art is such a dreamy dancer, I'd go for sure if I knew he was coming, but Molly hasn't heard from him yet."

"I know how you feel about Art, Courtney, but I'm not sure it's such a good idea to base your decision on just one person. What if you thought he was going to be there and then he didn't show up? I'm not saying that he is unreliable, but..."

"I know you're right about Art, Dad—he is very hard to predict, but then he's so much fun when he does show up. Anyway," she reminded me, "I'll hear from Molly again in a couple of hours, and I'm sure I'll have all the information I need after that. Let's make lunch."

At 1:30, Courtney trudged down the stairs and plopped herself into a chair on the back porch, where I was mixing some paint.

"Dad," she sighed, "I thought that being data dependent would be a cinch, but it's really, really complicated. Now it turns out that Christine, who I hadn't counted on at all to be there, will be coming. At the same time, I found out that Molly's older brother, Harvey, who I had thought would be there, won't. She said, 'He's revised his plans.' The cast of characters keeps changing, and I'm having a hard time figuring out how to react. Some of these people can be pretty boisterous when they get together, and I can usually help cool things down when it's needed. But sometimes I have the effect of putting too much of a damper on the evening—I'll admit I'm kind of square."

"And Art?" I asked, trying to sound nonchalant.

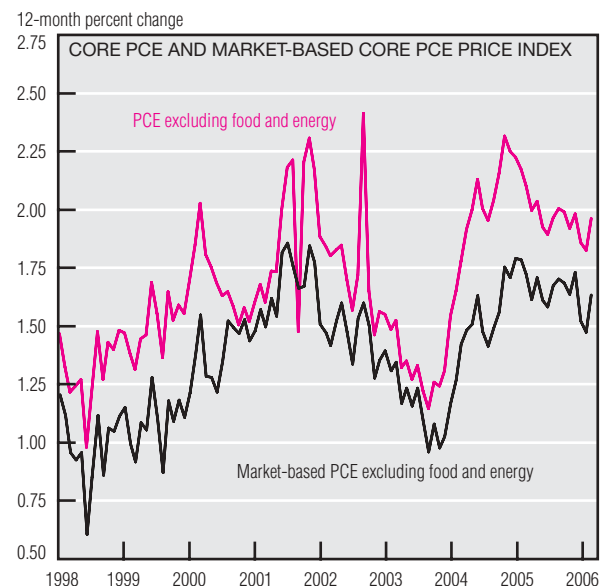
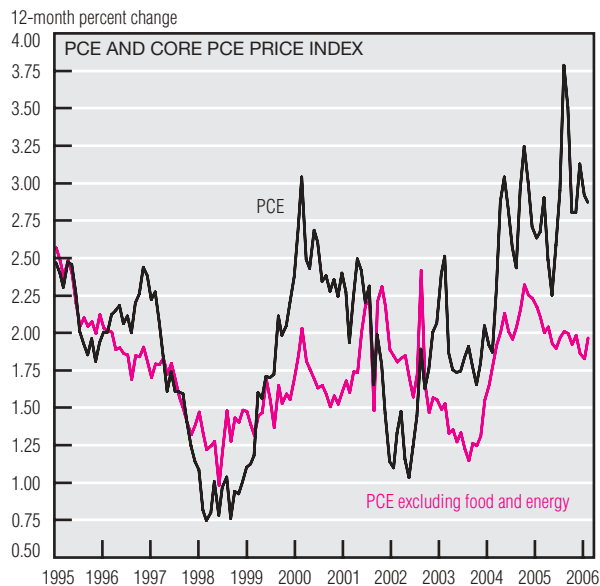
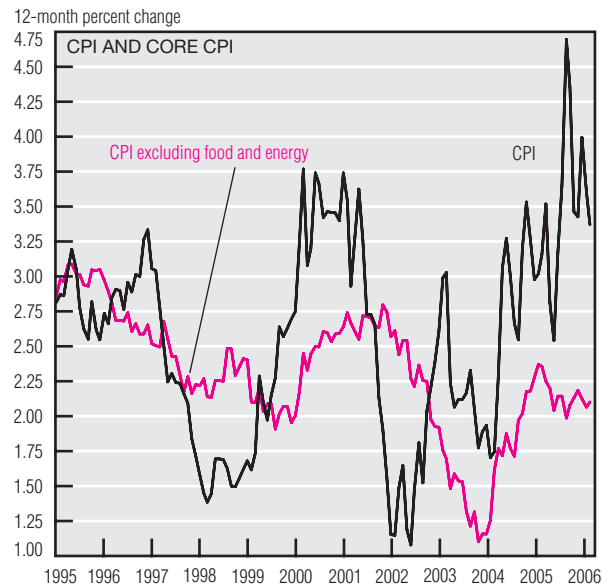
"That loser! He told Molly that he hadn't decided yet—he said he was going to be data dependent!"

"So what are you going to do?" I asked. "It's 2:15."

"I'm still not sure," Courtney said. "I know everyone expects me to be there. But you know what?" she grinned. "Just because I show up doesn't mean I have to stay long."

Inflation and Prices

	Percent change, last:				2005 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
March Price Statistics					
Consumer prices					
All items	4.3	4.3	3.4	2.5	3.6
Less food and energy	4.2	2.8	2.1	2.0	2.2
Median ^b	5.0	3.7	2.7	2.7	2.5
Producer prices					
Finished goods	6.2	-2.5	3.5	2.4	5.8
Less food and energy	1.5	3.1	1.7	1.2	1.7



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.

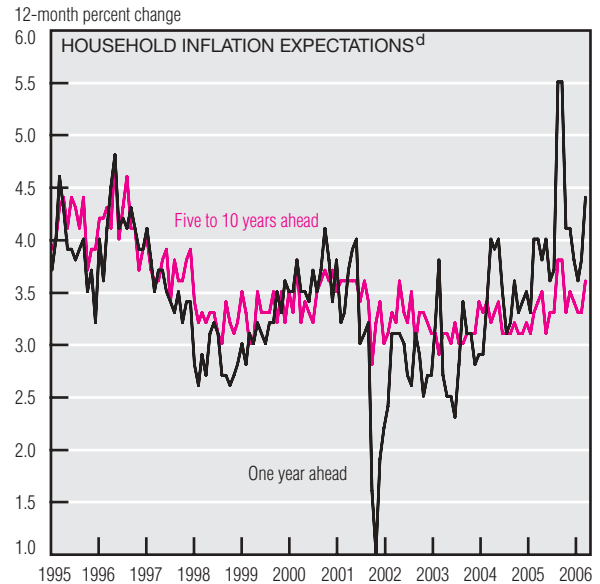
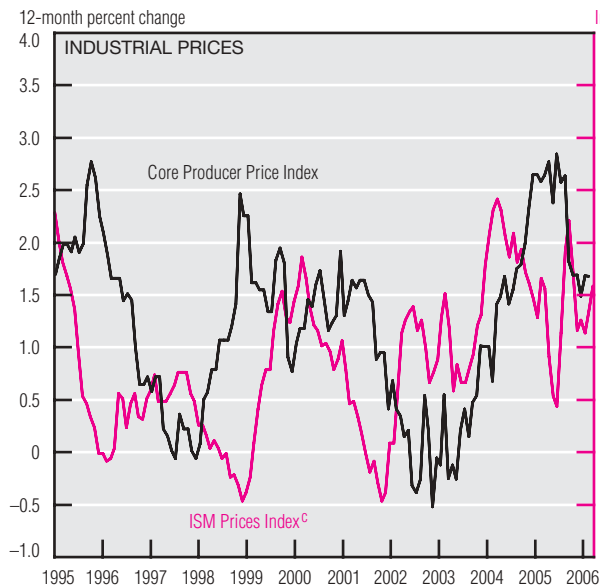
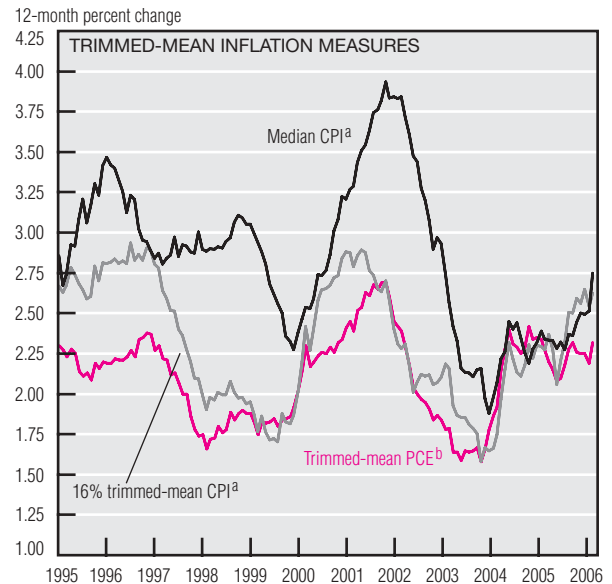
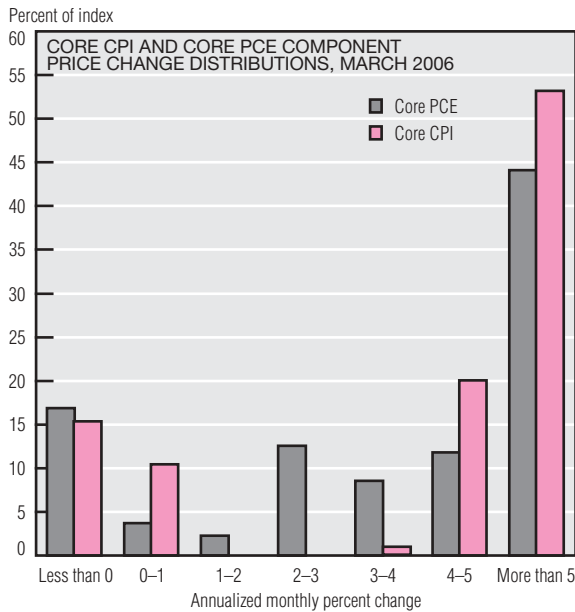
Inflation pressures intensified in March. The Consumer Price Index (CPI) rose at a 4.3% annualized rate, after holding steady in February. However, monthly growth in the core retail price measures was brisk: The CPI excluding food and energy rose 4.2% (annualized), the fastest monthly rate since November 2001. The Bureau of Labor Statistics attributed 70% of the core CPI's monthly rise to an acceleration in apparel and shelter prices. Meanwhile, the median CPI surged 5.0%—its fastest monthly growth rate since February 1994.

The 12-month trend in the CPI decelerated through the first quarter of 2006, while growth in the CPI excluding energy continued to fluctuate between 2% and 2¹/₄%, as it has since mid-2005. Likewise, the longer-term growth rate of the Personal Consumption Expenditure price index (PCE), which measures an alternative market basket of consumer goods, has also decelerated since January, while the PCE excluding food and energy continues to hover around 2.0%—a level that some consider the high end of the range associated with price stability. However, the prices of some items

in the PCE market basket are artificially derived because they cannot be observed directly in the marketplace (charitable donations, for example) or because they are benefits associated with other services provided by retailers (such as certain non-priced services provided by financial institutions). The market-based core PCE, which excludes such items, suggests that price growth has fluctuated around a much lower trend, between 1¹/₂% and 1³/₄%, since the beginning of 2005.

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Inflation and Prices (cont.)



a. Calculated by the Federal Reserve Bank of Cleveland.

b. Calculated by the Federal Reserve Bank of Dallas.

c. From the Manufacturing ISM Report on Business.

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

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; University of Michigan; Institute for Supply Management, Federal Reserve Bank of Dallas; and Federal Reserve Bank of Cleveland.

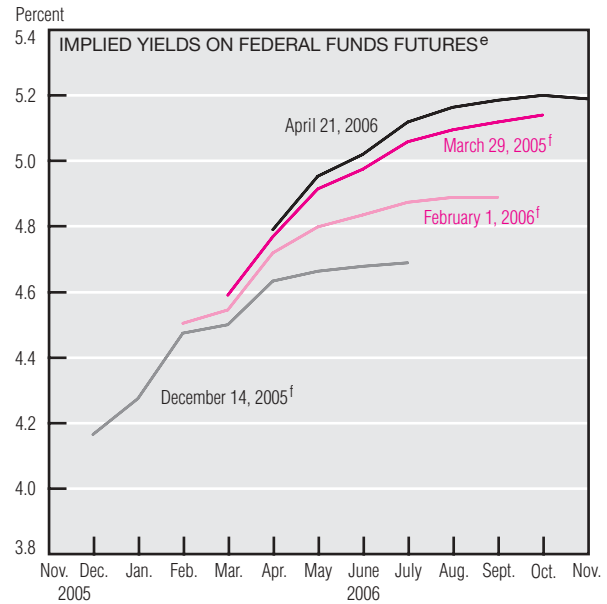
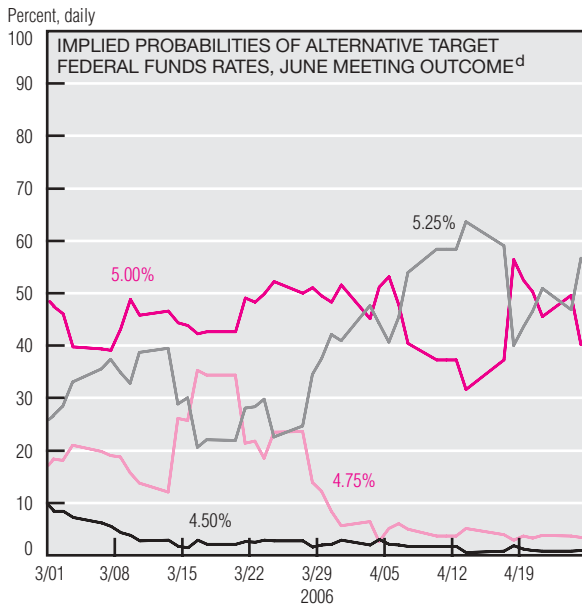
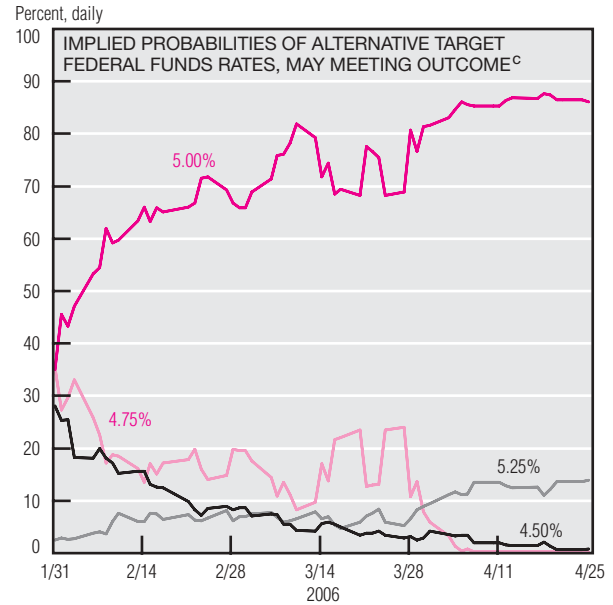
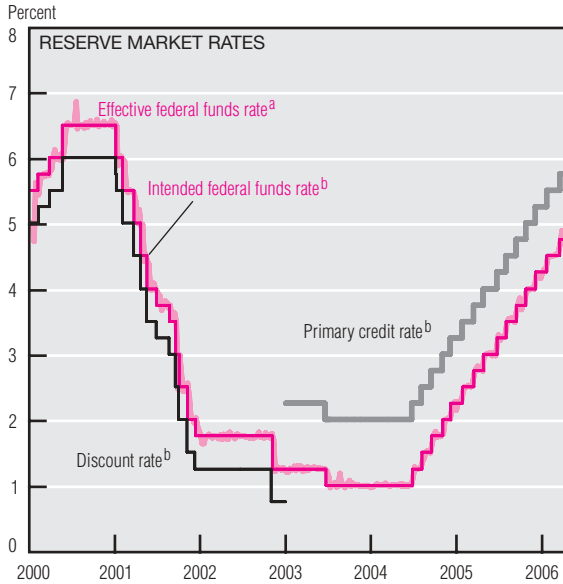
The latest retail price data suggest that acceleration in growth rates for the monthly CPI and PCE resulted from broad-based increases in the indexes' core component prices. The vast majority of CPI and PCE component prices grew at rates well above the indexes' overall longer-term trends. Indeed, the prices of nearly 45% of the core PCE components and nearly 55% of the core CPI components rose more than 5% during the month. However, monthly price data fluctuate widely and may ob-

scure an underlying, more stable inflation trend. Core inflation measures, like the median and 16% trimmed-mean CPI, as well as the trimmed-mean PCE, seek to characterize the inflation trend more accurately by systematically eliminating the more extreme—and presumably most transitory—price changes. The median and 16% trimmed-mean CPI measures suggest that inflation has accelerated since early 2004 and has risen about $\frac{1}{2}$ percentage point more since mid-2005. This may reflect a

pass-through of industrial prices into retail prices.

Meanwhile, household inflation expectations rose in April: Average short-term inflation expectations jumped to their highest level (4.4%) since the months that followed Hurricane Katrina, while average long-term expectations inched upward to reach their highest level (3.6%) since last fall. This is on the high end of the 3%–3 $\frac{1}{2}$ % range in which longer-term inflation expectations have generally fluctuated for nearly a decade.

Monetary Policy



a. Weekly average of daily figures.

b. Daily observations.

c. Probabilities are calculated using trading-day closing prices from options on May 2005 federal funds futures that trade on the Chicago Board of Trade.

d. Probabilities are calculated using trading-day closing prices from options on June 2005 federal funds futures that trade on the Chicago Board of Trade.

e. All yields are from constant-maturity series

f. One day after the FOMC meeting.

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.

Since the Federal Open Market Committee (FOMC) increased the intended federal funds rate to 4.75% on March 28, 2006, market participants' views on the expected course of policy have shifted markedly in response to incoming economic reports and Federal Reserve officials' speeches.

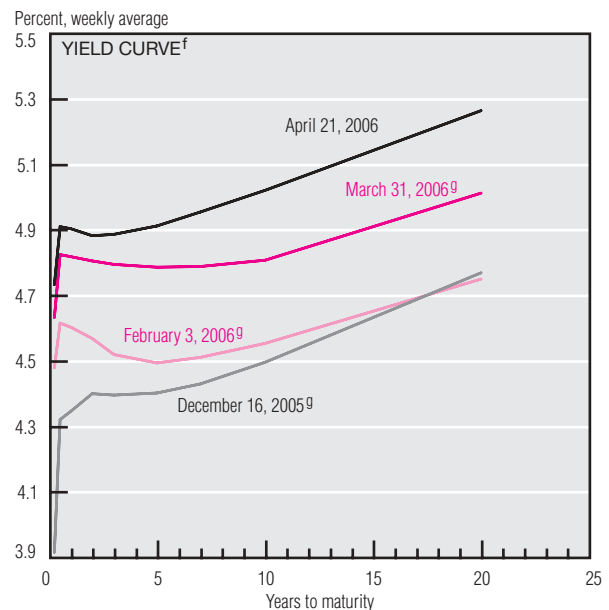
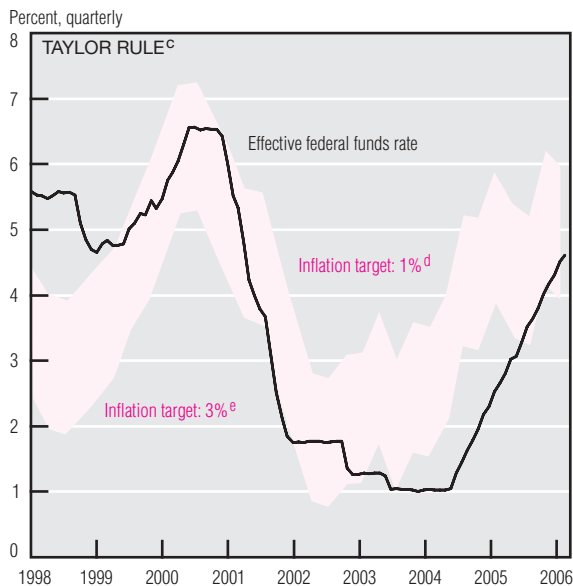
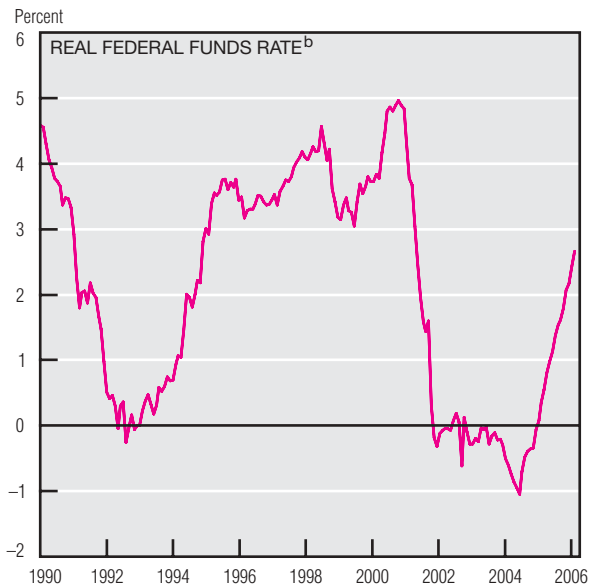
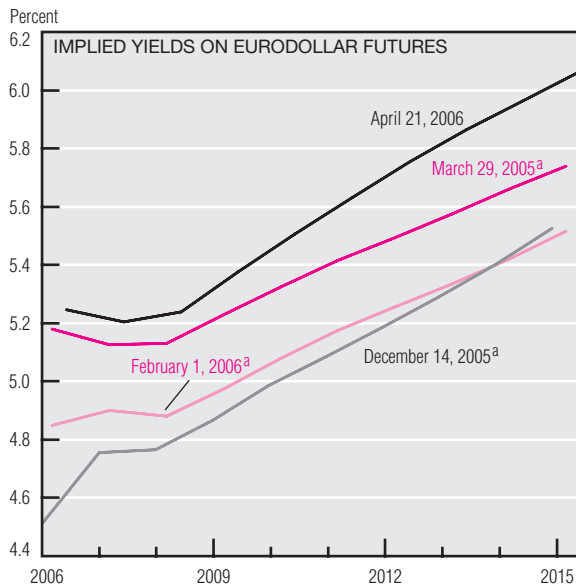
In the days before the March meeting, participants in the federal funds options market placed about a 25% probability on a pause in policy tightening at the May and June meetings. But they quickly changed those views

in response to the March press release, which stated that growth appears to have "rebounded strongly" in the first quarter of 2006; it also made a reference to "inflation pressures." The statement preceded a marked reduction in probabilities of tightening.

Since March 28, the probability associated with a further funds rate increase of 25 basis points (bp) at the May meeting has steadily risen and is currently near 90%. However, views on the likelihood of a pause at the June meeting have bounced around considerably.

On April 18, the release of the FOMC's March meeting minutes and a speech by Federal Reserve Bank of San Francisco president Janet Yellen preceded a dive in the probability of a further rate increase in June. Both the minutes and President Yellen's speech indicated that further rate hikes might not be necessary, depending on upcoming data. But the next day brought news of an increase in core CPI inflation, beginning a reversal of the previous day's impact on expectations.

Money and Financial Markets



a. One day after the FOMC meeting.

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

c. The formula for the Taylor rule is taken from "How Useful Are Taylor Rules for Monetary Policy?" by Sharon Kozicki, Federal Reserve Bank of Kansas City, *Economic Review*, 1999:1Q, vol. 84, no. 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%.

d. Assumes an interest rate of 2.5% and an inflation target of 1%.

e. Assumes an interest rate of 1.5% and an inflation target of 3%.

f. All yields are from the constant-maturity series.

g. The Friday after the FOMC meeting.

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; and Bloomberg Financial Information Services.

Market participants now place nearly even probabilities on a pause and a 25 bp funds rate hike in June. Federal funds futures foretell a further 50 bp increase in the funds rate by the end of October.

Implied yields on Eurodollar futures, which give a longer-run indication of the course of policy, tell a similar story—that the current round of policy tightening will end later in 2006

after a cumulative increase of 50 bp in the federal funds rate.

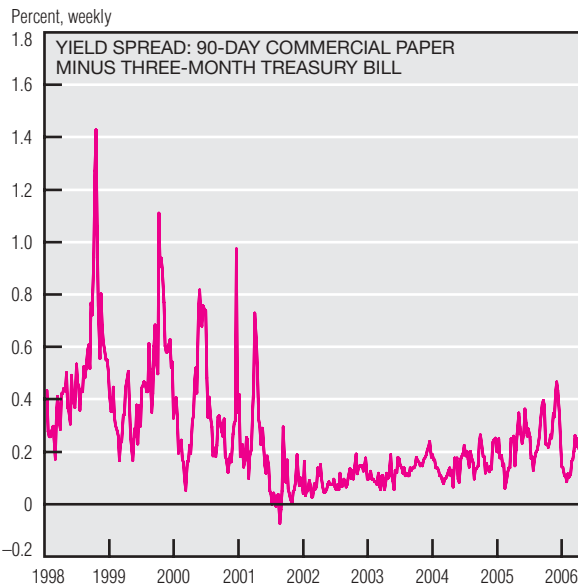
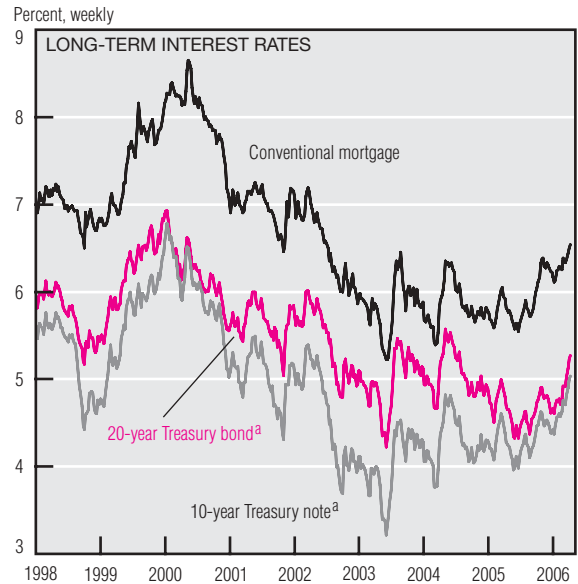
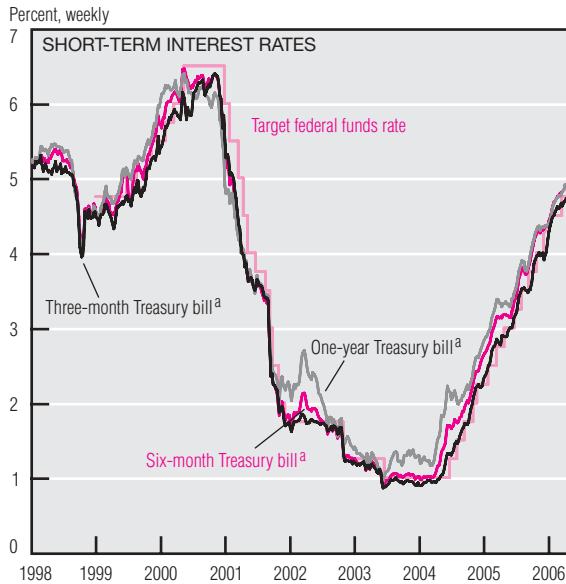
Since the current round of tightening began in June 2004, the real (inflation-adjusted) fed funds rate has increased more than 370 bp. The latest increase in the funds rate moves it toward the middle of the range suggested by the Taylor rule, which considers the rate a reaction to a weighted average of inflation, target inflation, and economic growth.

The minutes of the FOMC's March meeting indicate that many members view the rate as approaching the neutral level. However, as Federal Reserve Bank of Chicago president Moskowitz noted on March 7, being in the neutral range does not rule out future rate hikes.

The inversion of the yield curve observed earlier this year has nearly disappeared. The curve remains mildly

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Money and Financial Markets (cont.)



a. Yields from constant-maturity series

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

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

inverted only for maturities of six months through three years, with the three-year rate only 2 bp less than the six-month rate. In recent months, however, many Federal Reserve officials have noted that yield curve inversions do not necessarily portend a downturn in economic activity.

Short-term rates have moved in step with funds rate increases. Since the current round of policy tightening began in June 2004, Treasury rates have moved up more than 320 bp at the short end of the maturity

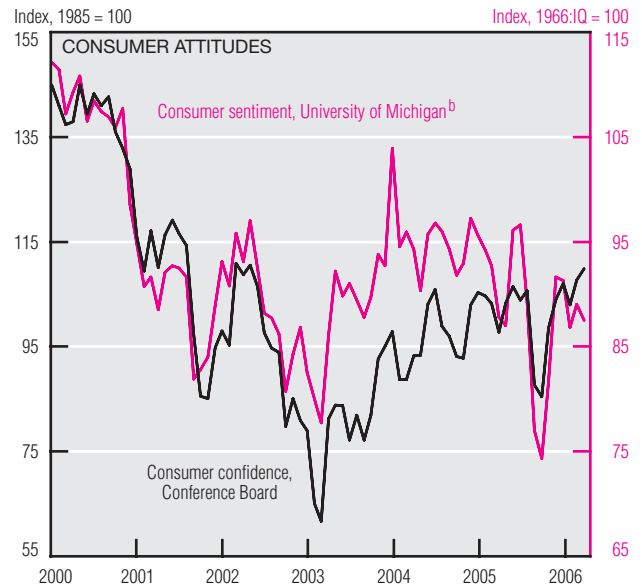
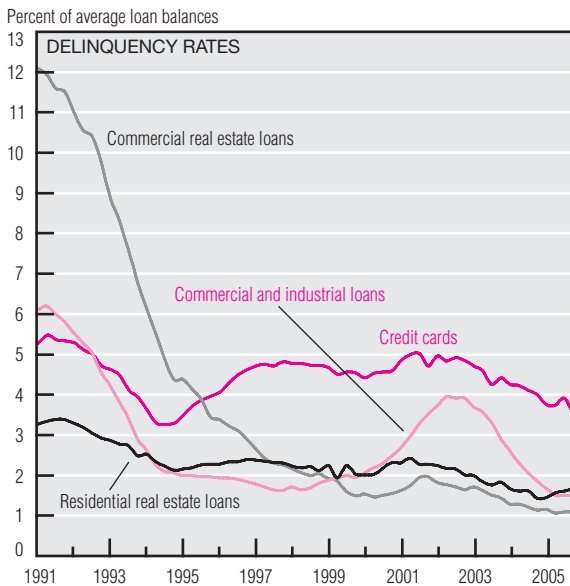
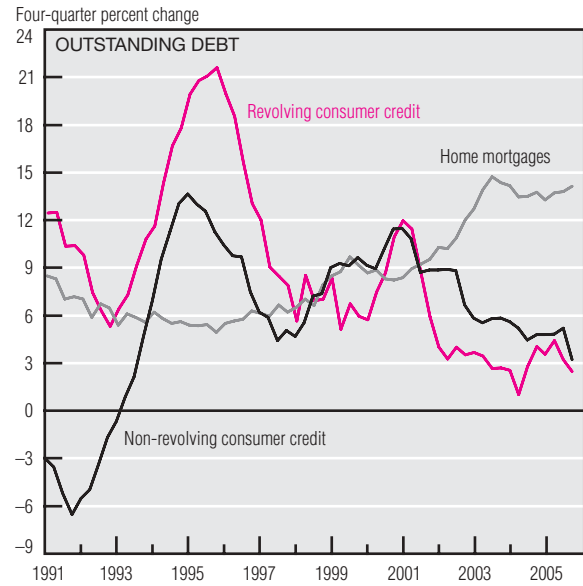
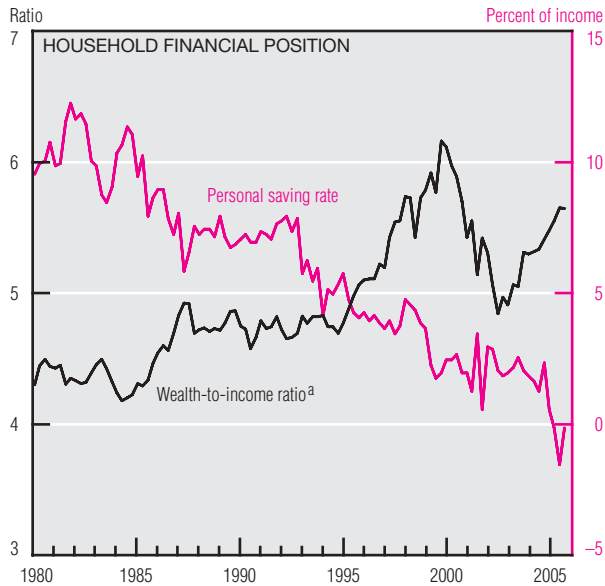
spectrum. Long-term Treasury yields rose more than 20 bp in April, causing a noticeable steepening of the yield curve at the long end. In fact, 10- and 20-year Treasury rates both rose above 5%, their highest level in more than 18 months.

Although long-term rates on conventional mortgages have trended upward, increasing more than 80 bp since September 2005, home mortgage debt growth remained robust in 2005:IVQ. However, mortgage applications and housing starts have slowed down during the last month.

The risk spreads on corporate bonds indicate investors' willingness to take on risk. To derive the spread, we compare the yield on corporate bonds with that on a safe asset (Treasury debt). After plummeting in late 2005 and early 2006, risk spreads on short-term corporate debt have risen modestly in recent months. The spread between 90-day commercial paper and three-month Treasury bills is more than 10 bp higher than at the beginning of February. Risk spreads on longer-term AA- and BBB-rated corporate debt have been flat so far

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Money and Financial Markets (cont.)



a. Wealth is defined as household net worth; income is defined as personal disposable income.

b. Data are not seasonally adjusted

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Flow of Funds Accounts of the United States," *Federal Reserve Statistical Releases*, Z.1; University of Michigan; and the Conference Board.

this year, whereas risk spreads for high-yield corporate debt have actually fallen.

For the third consecutive quarter, the saving rate was negative in 2005:IVQ. Monthly data indicate that it remained negative through February 2006. However, the wealth-to-income ratio continues the upward trend that began in late 2002.

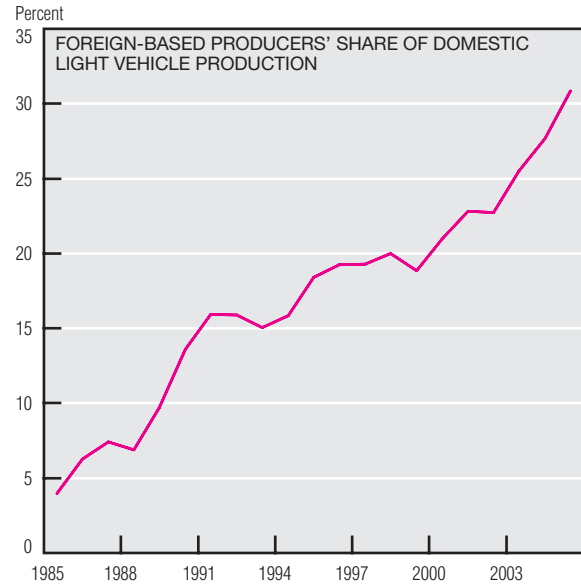
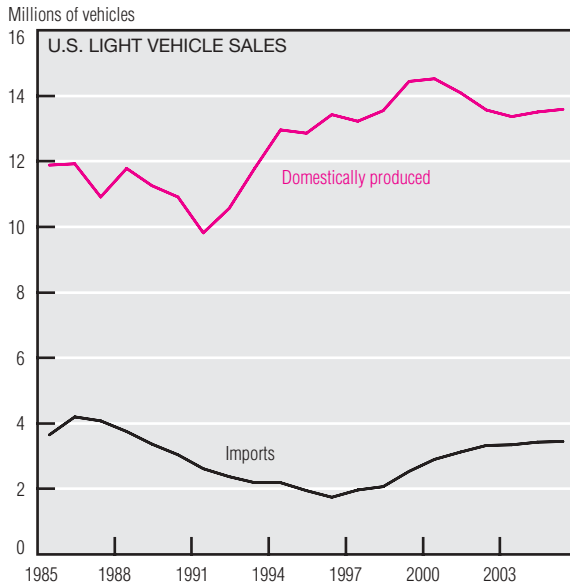
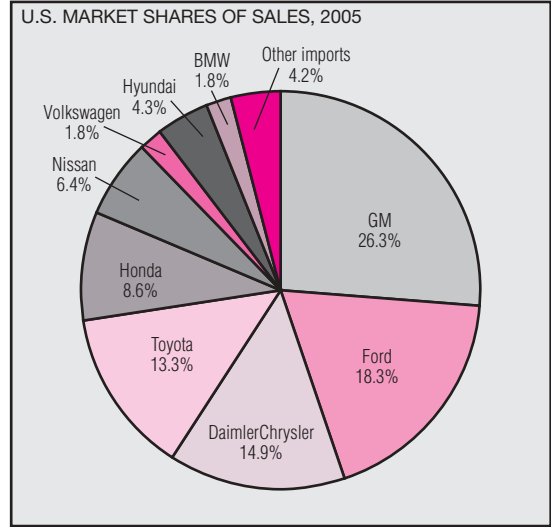
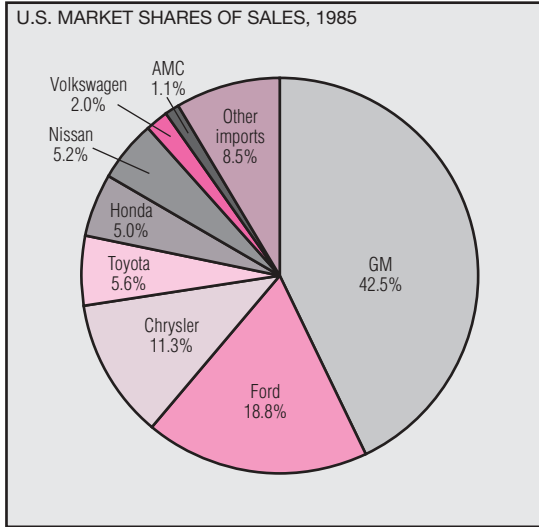
Outstanding home mortgage debt continued to grow at double-digit annual rates in 2005:IVQ. Since the first quarter of 2002, mortgage debt has increased at annual rates above 10%.

Consumer credit growth, both revolving and non-revolving, declined substantially in the last quarter of 2005. Auto sales slowed markedly in the first part of the year, dampening growth in non-revolving consumer credit. For February 2006, overall consumer credit growth was 2.55% year over year, its lowest growth rate since 1993.

Despite high and rising levels of consumer debt, delinquency rates on consumer loans remained low. However, delinquency rates for residential real estate loans ticked up slightly in 2005:IVQ.

In April, the Conference Board's Index of Consumer Confidence unexpectedly rose 2.1 points to 109.6, its highest level since May 2002. Most of the increase resulted from a rise in the present conditions component of the index, although the future expectations component also rose. However, consumers' buying plans fell off: Fewer intended to buy major appliances or homes over the next few months. The University of Michigan Consumer Sentiment Index declined in April because of a drop in the index's expectations component.

The American Auto Industry



SOURCE: Ward's Automotive Reports.

In the past 20 years, American automakers have lost market share to their foreign-based rivals. In 1985, American-brand vehicles accounted for about 74% of U.S. passenger-vehicle purchases. By 2005, this figure had fallen to less than 60% (including the German-American firm, DaimlerChrysler, formed from the 1998 merger of Germany's Daimler-Benz and America's Chrysler). Much of the loss in American automakers' market share can be traced to General Motors, whose share fell from 42.5% in 1985 to 26.3% in 2005.

Given these declines, and the associated market share gains by foreign-based producers, one might expect imported vehicles to have become a larger fraction of U.S. auto sales over the past 20 years. In fact, imports account for a slightly smaller fraction of domestic auto sales today than in 1985, when roughly 4 million vehicles made their way to the American auto market from abroad. Thereafter, vehicle imports declined throughout the late 1980s and early 1990s. They have risen recently, but as of 2005, they remained less than 4 million. In

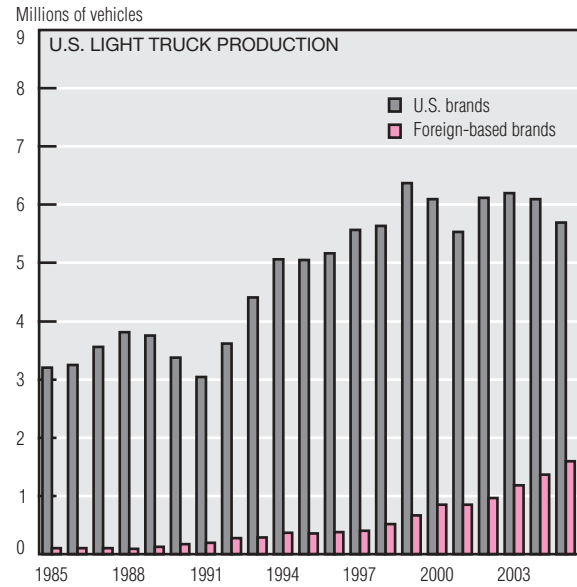
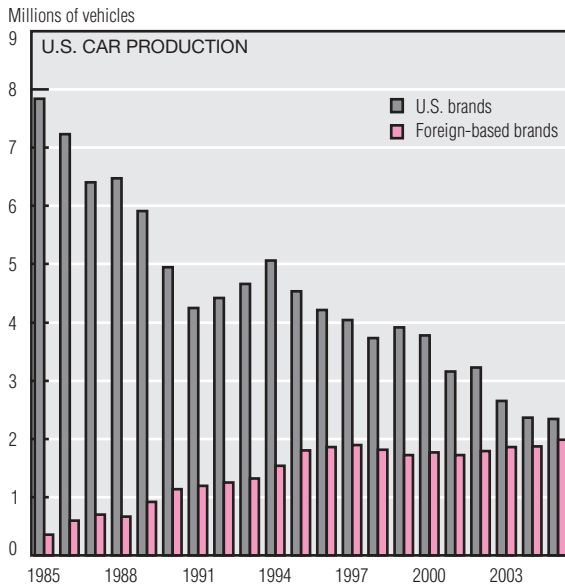
contrast, domestic production increased throughout the 1985–2005 period.

How did foreign-based producers increase their share of the American auto market, even as the number of imported vehicles remained below 1985 levels? The answer lies in foreign firms' share of domestic production, which rose from less than 5% in 1985 to more than 30% in 2005.

Much of this gain has come from changes in the composition of car (as opposed to light truck) production,

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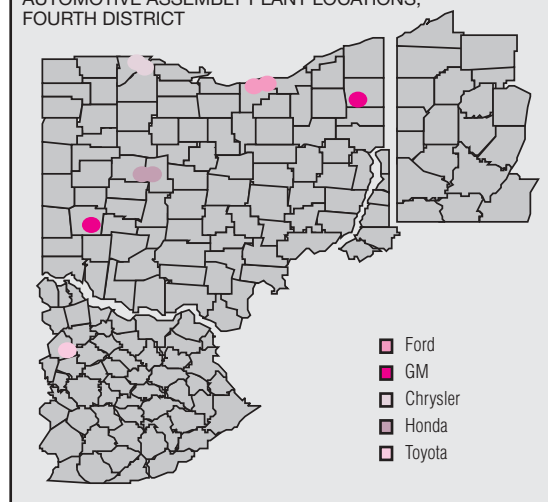
The American Auto Industry (cont.)



Fourth District Light Vehicle Production, 2005

	Cars	Trucks	Total
Domestic	301,159	846,251	1,147,410
Ford	—	230,132	230,132
GM	301,159	299,020	600,179
Chrysler	—	317,099	317,099
Percent of U.S. production	7.0	11.6	9.9
Foreign-based brands	1,090,190	66,166	1,156,306
Honda	581,063	66,166	647,179
Toyota	509,127	—	509,127
Percent of U.S. production	25.2	0.9	10.0
District production	1,391,349	912,367	2,303,716
District percent of U.S. production	32.2	12.5	19.8

AUTOMOTIVE ASSEMBLY PLANT LOCATIONS, FOURTH DISTRICT



SOURCE: Ward's Automotive Reports.

which today is split about evenly between the Big Three automakers and foreign-based brands. Over the past 20 years, American automakers have scaled back production sharply. In 1985, they made about 8 million cars; by 2005, that figure had fallen to about 2 million. In contrast, foreign-based manufacturers made less than half a million cars in 1985; by 2005, their total production nearly equaled their American counterparts'.

The decline in American automakers' car production partly reflects

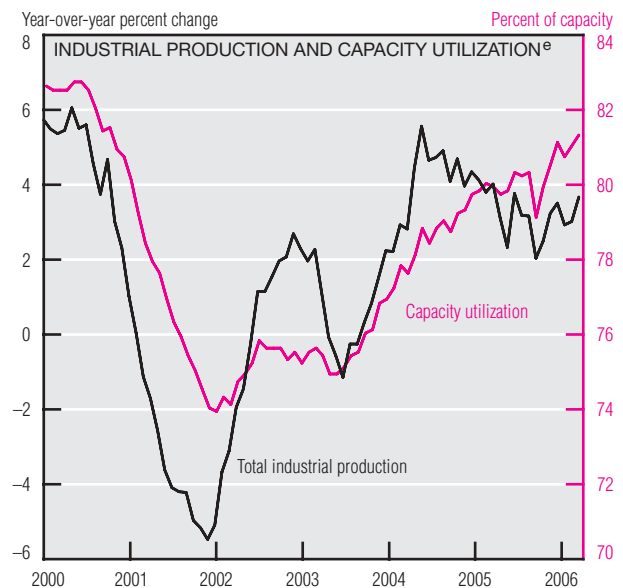
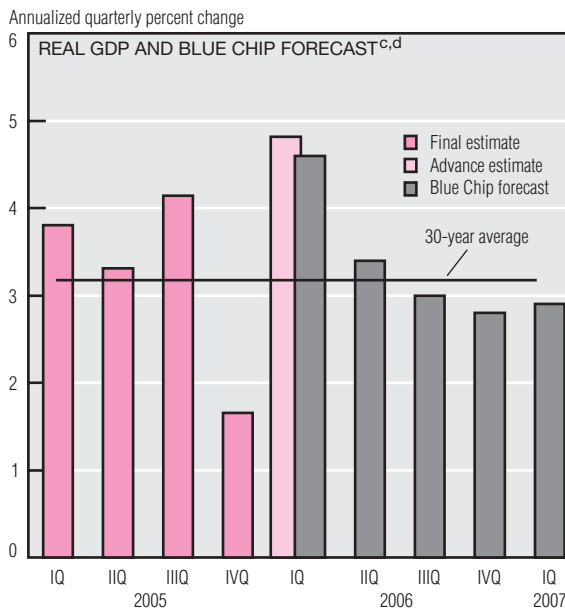
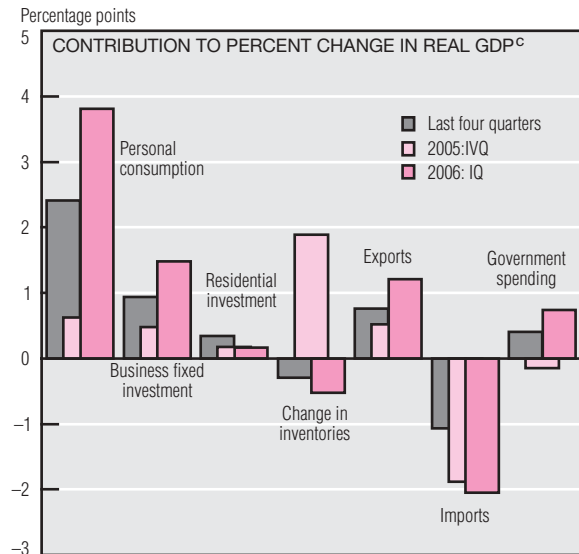
their strategic shift into more profitable sport utility vehicles (SUVs), which are classified as light trucks rather than as cars. From 1985 to 2005, American companies roughly doubled their light truck output as a result of surging SUV production. Only recently have foreign-based automakers ramped up their light truck production, and they now account for about one-fourth of domestic output.

Despite the compositional changes, however, total U.S. vehicle production has remained relatively stable

over the past 20 years. And although the geography of the American auto industry has changed throughout this period—notably by expanding southward beyond the Midwest—the Fourth Federal Reserve District remains an important area for auto production, accounting for roughly 20% of national output. The District's production is split about evenly between American and foreign-based brands, with trucks produced primarily at American automakers' plants and cars primarily at foreign-based facilities.

Economic Activity

	Change, billions of 2000 \$	Annualized percent change	
		Current quarter	Four quarters
Real GDP	133.1	4.8	3.5
Personal consumption	106.6	5.5	3.4
Durables	53.5	20.6	4.4
Nondurables	31.1	5.4	4.4
Services	31.4	2.8	2.8
Business fixed investment	44.9	14.3	9.0
Equipment	41.8	16.4	10.7
Structures	5.4	8.7	4.1
Residential investment	4.0	2.6	5.8
Government spending	19.1	3.9	2.1
National defense	12.2	10.3	3.5
Net exports	-23.0	—	—
Exports	35.2	12.1	7.5
Imports	58.1	13.0	6.6
Change in business inventories	-16.0	—	—



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.

e. Seasonally adjusted.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and *Blue Chip Economic Indicators*, April 10, 2006.

Real GDP increased at an annual rate of 4.8% in 2006:IQ, according to the Commerce Department's advance estimate; this was 3.1 percentage points (pp) higher than the final estimate of 1.7% for growth in 2005:IVQ. The acceleration in 2006:IQ resulted primarily from faster growth in personal consumption and exports, and an increase in government spending. These gains were partly offset by a downturn in private inventory investment.

Almost all components made significantly higher contributions to the change in real GDP in 2006:IQ

than in the previous quarter. The two exceptions were changes in private inventories and imports, which subtract from GDP. After adding only 0.6 pp to real GDP in 2005:IVQ, personal consumption added 3.8 pp this quarter, its largest contribution since 2003:IIIQ.

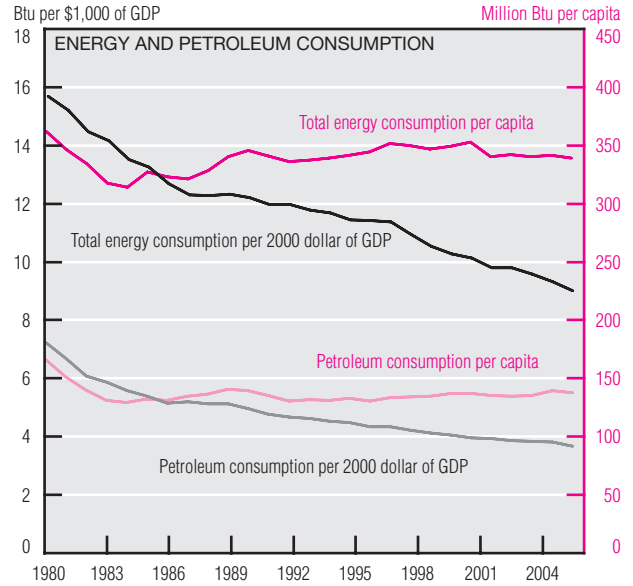
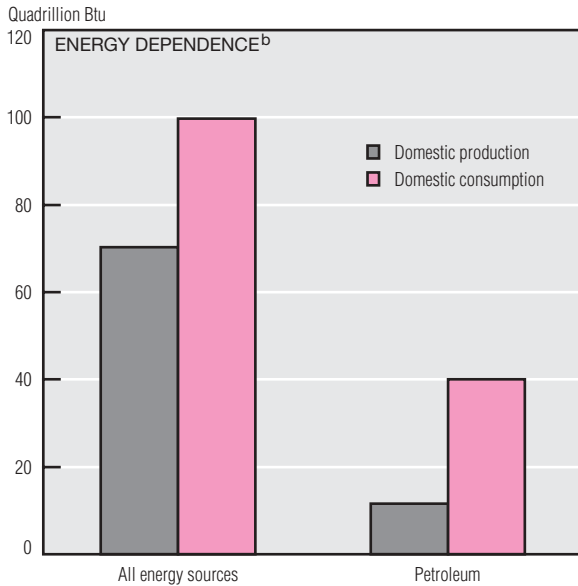
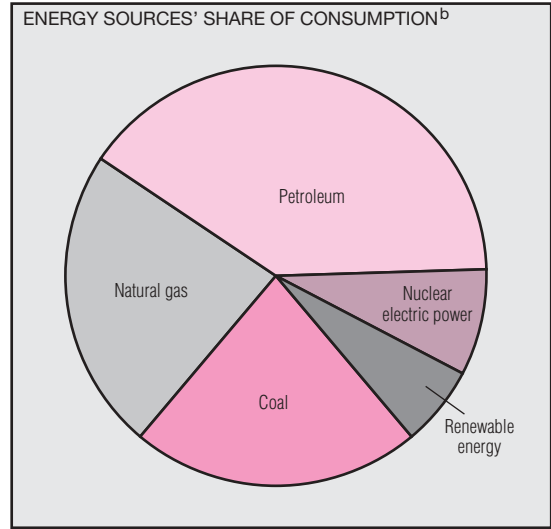
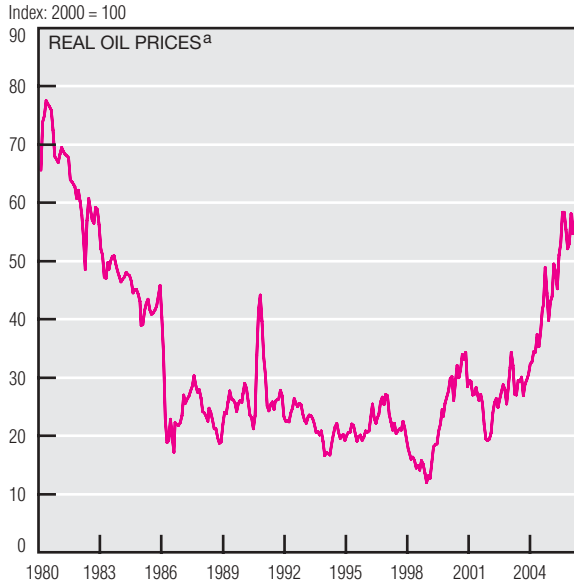
This was only the sixth time since the beginning of 2000 that GDP growth has topped 4.0%. Blue Chip forecasters were off by only 0.2 pp, after predicting 4.6% growth in their April 10 report. They expect growth in the remaining three quarters of

2006 to slow to 3.4%, 3.0%, and 2.8%. In the past 30 years, GDP growth has averaged 3.2%.

Total industrial production was up 3.6% from March 2005. Its annual growth has averaged 3.0% over the past 12 months. Over the same period, average growth was 3.8% in manufacturing, -3.0% in mining, and 2.3% in utilities. Capacity utilization has been increasing fairly steadily since June 2003, and now exceeds 81% of capacity, which is still below the average for the late 1990s.

(continued on next page)

Economic Activity (cont.)



a. Deflated using personal consumption expenditures.
 b. 2004 figures.
 SOURCE: U.S. Department of Energy, Energy Information Administration.

With oil prices topping \$70 per barrel, energy policy is once again commanding the attention of decision-makers and the public. Although oil prices are still below the 1980 historic high of nearly \$78 in real terms, they show little sign of abating before the end of the summer driving season.

Higher oil prices will cause consumers to conserve and switch to other fuels but, short-run alternatives are limited. The U.S. obtains over 40% of its energy from petroleum. Coal and natural gas each account for about 22%, with nuclear at 8% and renewable energy (hydroelectric,

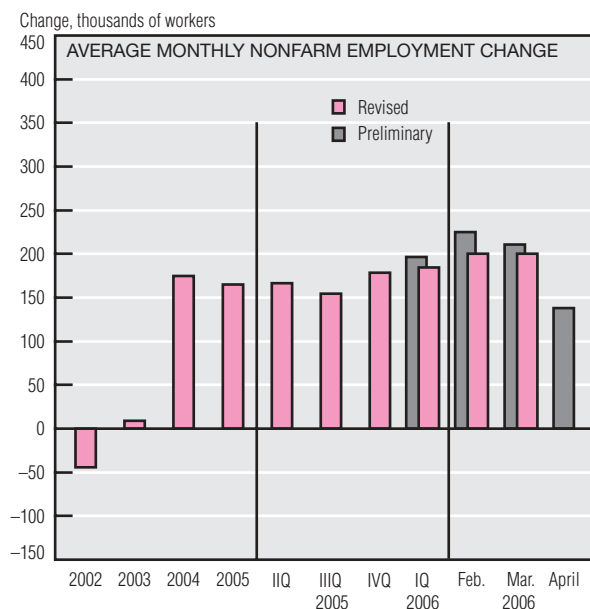
geothermal, biomass, solar, and wind) at 6%.

Energy policy issues arise because various energy sources have different impacts on the environment and only 70% of U.S. energy consumption is supplied by domestic production. Nearly all the shortfall comes from petroleum: Domestic production supplies only 28% of U.S. consumption. This is problematic because much of the world's oil is located in politically unstable regions, and thus is at a higher risk for disruptions.

Getting as much as is economically feasible out of each BTU is one way

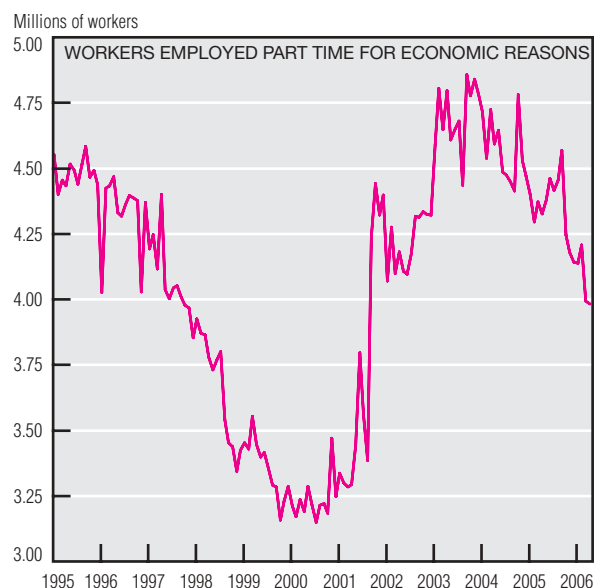
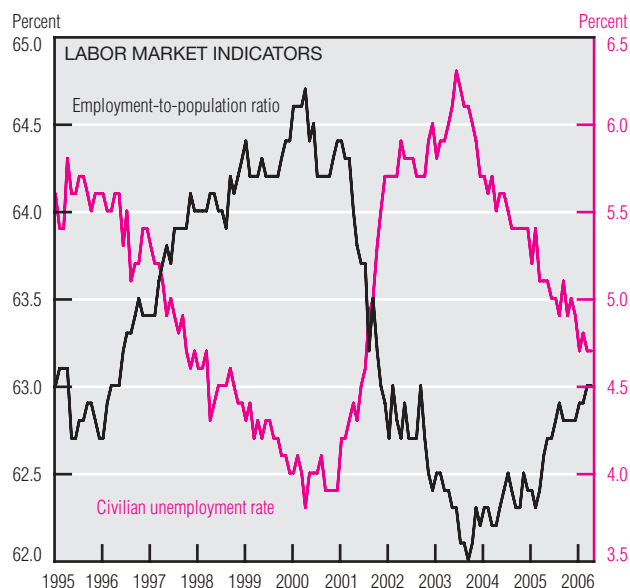
to address energy policy issues. Since 1980, the U.S. has become much more efficient in its overall energy consumption, with the amount of energy used per dollar of real GDP declining 40%. Petroleum consumed per dollar of GDP has fallen even more, about 45%. As impressive as these declines are, measured as consumption per capita, far less progress has been made. Overall energy use per capita has been flat since 1980. Per capita petroleum use has fallen about 10% since 1980, but has been relatively flat since the mid-1980s.

Labor Markets



Labor Market Conditions

	Average monthly change (thousands of employees, NAICS)				
	2002	2003	2004	2005	Apr. 2006
Payroll employment	-45	9	175	165	138
Goods producing	-76	-42	28	22	37
Construction	-8	10	26	25	10
Manufacturing	-67	-51	0	-6	19
Durable goods	-48	-32	9	1	24
Nondurable goods	-19	-19	-9	-7	-5
Service providing	32	51	147	143	101
Retail trade	-9	-4	17	13	-36
Financial activities ^a	6	7	8	12	26
PBS ^b	-17	23	40	41	28
Temporary help svcs.	2	12	13	14	-1
Education & health svcs.	40	30	33	31	35
Leisure and hospitality	12	19	26	21	20
Government	21	-4	13	14	7
	Average for period (percent)				
Civilian unemployment rate	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.

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

Nonfarm payroll growth was slightly less vigorous in April than earlier this year: Employment increased by 138,000 jobs, less than the expected 200,000 and below the average monthly gain of 171,000 jobs over the previous 12 months. Employment gains for February and March were revised down a combined 36,000 jobs.

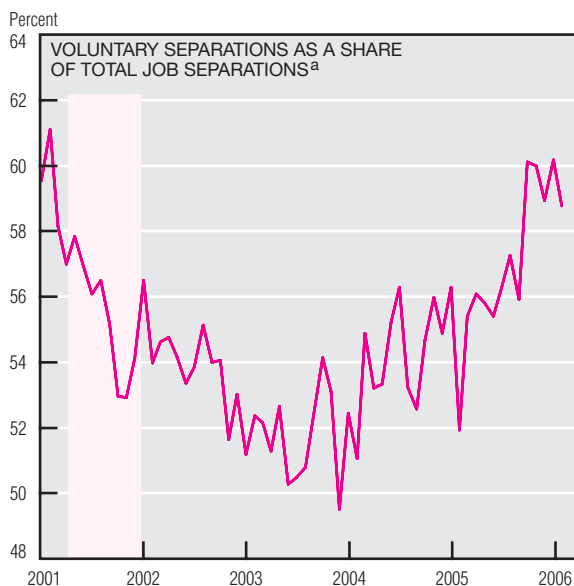
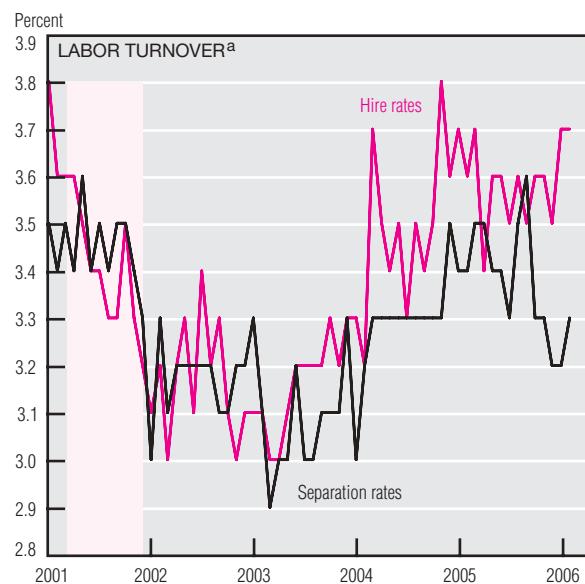
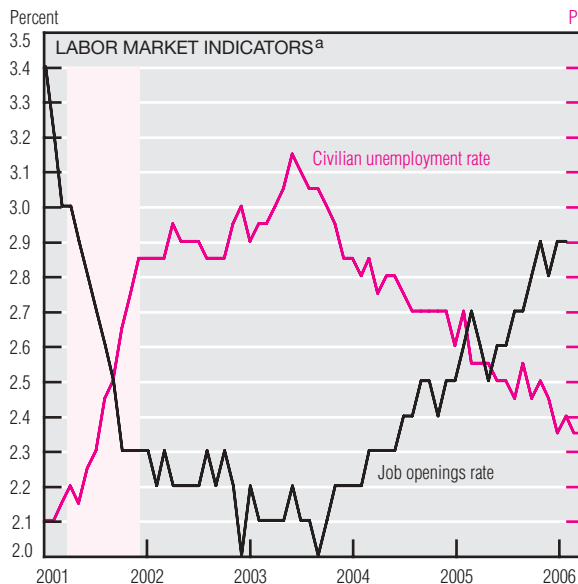
The service-providing sector, which generally accounts for about four-fifths of monthly employment gains, added 101,000 jobs in April, down from its average increase of 174,000 jobs in the preceding two months. Gains were solid in the education and

health services industry (35,000) and robust in the financial activities industry (26,000). Although job growth in business services and in leisure and hospitality has decelerated since March, these industries still added 28,000 and 20,000 jobs, respectively, in April. On the other hand, retail employment decreased by about 36,000 jobs, more than offsetting the 23,000 job gain in March. Meanwhile, the goods-producing sector posted a net increase of 37,000 jobs in April, more than the average monthly increase of 26,000 jobs over the previous 12 months. Manufacturing added

19,000 jobs net, its highest monthly gain in nearly two years, primarily because of a 13,900 gain in the transportation sector.

The unemployment rate, which has fallen nearly $\frac{1}{2}$ percentage point over the past year, remained steady in April at 4.7%, and the employment-to-population ratio stayed at 63.0. Meanwhile, the number of people working part time for economic reasons fell to its lowest level (3.98 million workers) since August 2001. This could be a sign that labor markets are improving as more part-time workers find full-time jobs.

Job Openings and Labor Turnover



Hire and Separation Rates, 2001 and 2005

Industry	Percent			
	2001		2005	
	Hire rate	Separation rate	Hire rate	Separation rate
Total private	3.8	3.9	4.0	3.8
Construction	5.5	5.9	5.8	5.5
Manufacturing	2.1	3.1	2.4	2.6
Trade, transportation, and utilities	3.8	4.0	4.0	3.9
Professional and business services	4.3	4.0	5.2	4.8
Education and health services	2.9	2.6	2.7	2.4
Leisure and hospitality	7.2	6.9	6.5	6.3

a. Shaded bar represents a recession.

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

Since the beginning of 2004, employment growth has been solid: Average monthly payroll gains have reached 170,000 jobs, while the unemployment rate has gone down to 4.7%—the lowest level in nearly four years. The Labor Department's Job Openings and Labor Turnover Survey supplements its monthly payroll data with indicators of the unmet demand for labor and the extent of labor shortages. The job openings rate, which considers the number of unfilled jobs and measures labor market tightness, rose to its highest level since the current economic expansion began.

Today's relatively high rate could reflect difficulties in finding qualified workers or could simply indicate firms' willingness to add new jobs. However, hiring rates have risen as well, suggesting that the higher openings rate reflects firms' stronger demand for workers.

Separation rates, which include voluntary separations, layoffs and discharges, and other separations (including retirement), have inched down recently, after trending up since late 2003. However, the rate of voluntary separations, which can indicate workers' ability to change jobs or their

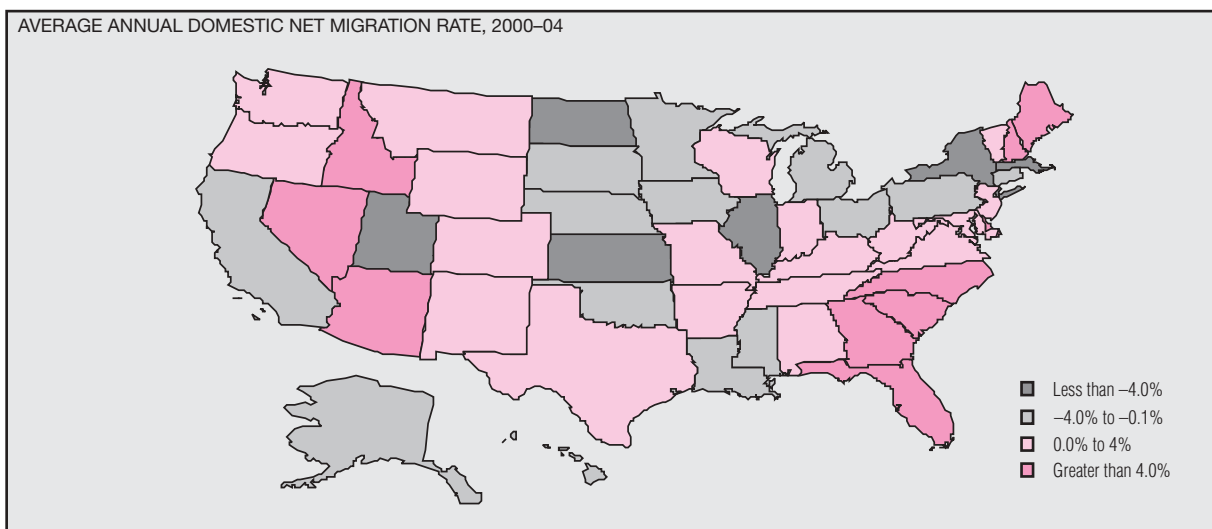
readiness to retire, has risen steadily from about 50% of all separations in December 2003 to nearly 60% in recent months.

From 2001 to 2005, hire rates rose in all major industries except education and health services, and leisure and hospitality. During the same period, total separation rates fell in all major industries except professional and business services, where employment at temporary help service firms is more volatile than in other industries. In 2005, jobs increased in every major private industry except manufacturing.

Domestic Migration

U.S. Domestic Net Migration		
Region/division	Average annual rate	
	1990–2000	2000–04
Northeast	-6.1	-4.6
New England	-3.7	-2.0
Middle Atlantic	-7.0	-5.5
Midwest	-1.2	-2.5
East North Central	-1.9	-2.9
West North Central	0.6	-1.4
South	4.1	3.4
South Atlantic	5.4	5.8
East South Central	3.9	1.1
West South Central	2.2	0.6
West	0.1	0.8
Mountain	11.6	6.9
Pacific	-4.1	-1.6

Fourth District States, Domestic Net Migration		
Region/division	Average annual rate	
	1990–2000	2000–04
Ohio	-1.8	-2.8
Pennsylvania	-2.4	-0.3
Kentucky	2.7	1.3
West Virginia	0.1	1.1



NOTE: Rates per 1,000 midpoint population.
SOURCE: U.S. Department of Commerce, Bureau of the Census.

Population change has two sources: natural increase (births and deaths) and migration, domestic and international. Because the rate of natural increase is about the same throughout the nation, and international migration is small, domestic migration plays a large role in determining population growth across areas. How does the Fourth District's domestic migration compare with the rest of the nation?

The Northeast census region, of which Pennsylvania is a part, had a

higher rate of population loss than any of the nation's other three regions: On net, the Northeast lost 6.1 people per thousand residents in the 1990s and 4.6 per thousand since 2000. The Midwest, of which Ohio is a part, also posted net losses in the 1990s (-1.2) and since 2000 (-2.5). Kentucky and West Virginia belong to the South, which was the fastest-growing region in both periods.

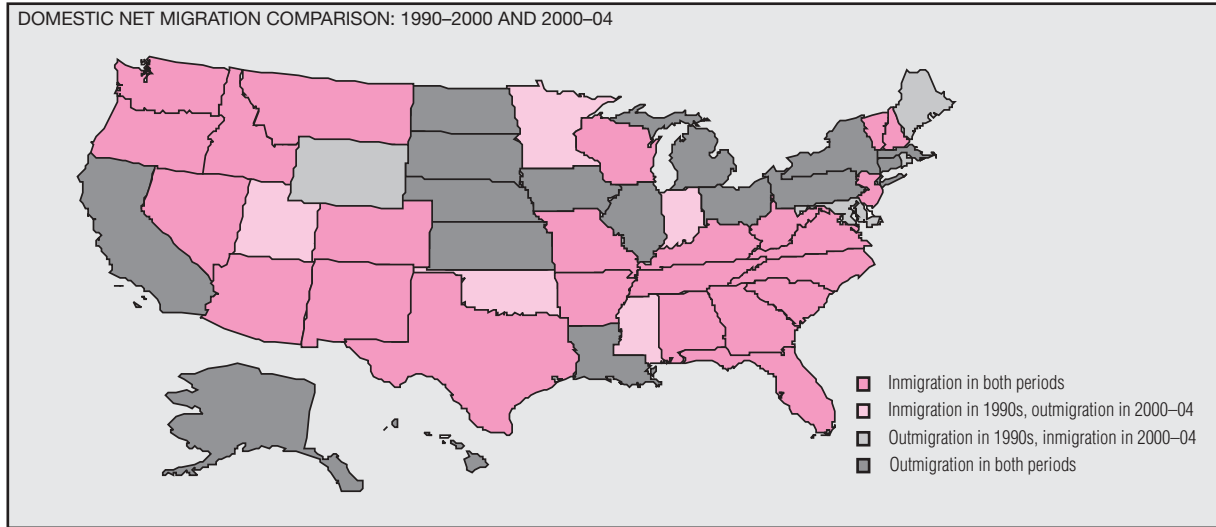
At the state level, Pennsylvania lost residents in both periods, although its net migration rate in 2000–04

improved on its 1990s rate. Ohio, like Pennsylvania, lost residents in both periods, but its rate of loss was higher in 2000–04. On the other hand, Kentucky and West Virginia have been attracting residents from other states since 1990, like the rest of the South.

Looking at the entire nation, we find that Kentucky and West Virginia show some of the better population gains from other states. Of all the states' annual domestic net migration rates for 2000–04, Kentucky ranked

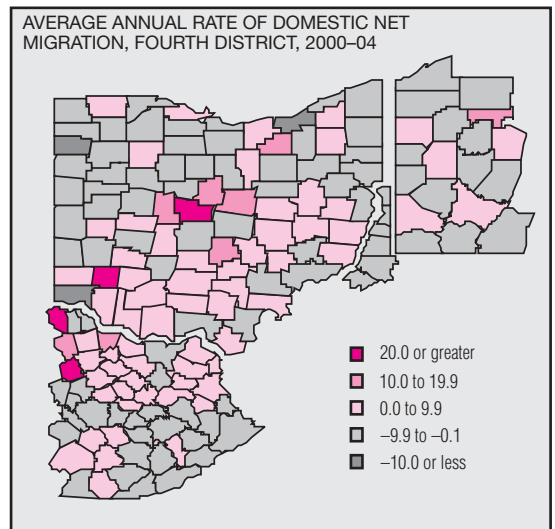
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Domestic Migration (cont.)



Domestic Net Migration by Metropolitan Statistical Area

MSA	Average annual number		Average annual rate	
	1990-2000	2000-04	1990-2000	2000-04
Cleveland	-11,643	-12,306	-5.5	-5.7
Pittsburgh	-8,840	-5,720	-3.6	-2.4
Cincinnati	2,586	-2,239	1.3	-1.1



NOTE: Rates per 1,000 midpoint population.
 SOURCE: U.S. Department of Commerce, Bureau of the Census.

twentieth and West Virginia came in twenty-third. In fact, at a time when California and New York were losing residents to other states, Kentucky and West Virginia were gaining them.

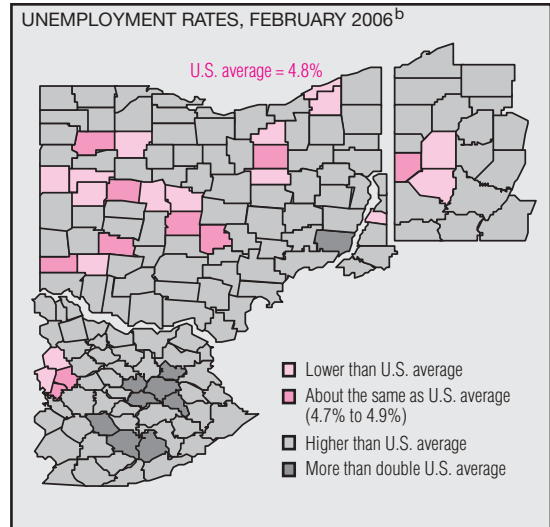
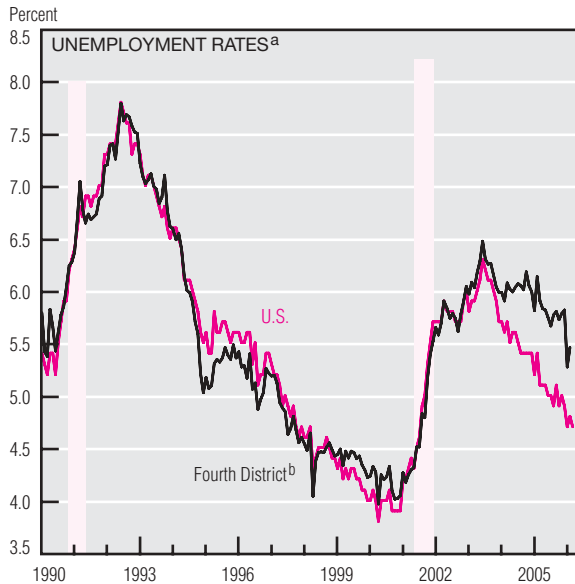
The direction of migration flows for all four District states was the same in 2000-04 as in the 1990s. Wyoming, Maine, Rhode Island, and Maryland lost residents to other states in the 1990s, then gained residents from them in 2000-04. Utah, Mississippi, Oklahoma, Indiana, and Minnesota

did just the opposite, gaining residents from other states in the 1990s but losing them in the years that followed.

The District's three largest metropolitan areas all lost population, on net, to other areas in the post-2000 period. Cleveland had the lowest average annual domestic net migration rate, losing about 12,300 people per year since 2000. Pittsburgh's net annual loss during the period averaged 5,700 residents, and Cincinnati's loss averaged 2,200.

However, a breakdown of domestic migration rates by county shows that the suburbs around major cities are growing fast. For example, average annual domestic migration rates have been 10% or better since 2000 in Delaware, Union, Monroe, Knox, and Fairfield counties near Columbus, Warren and Boone counties near Cincinnati, Medina County near Cleveland, and Scott County near Lexington.

Fourth District Employment



	12-month percent change, March 2006							
	Cleveland	Columbus	Cincinnati	Dayton	Toledo	Pittsburgh	Lexington	U.S.
Total nonfarm	-0.1	0.9	1.2	-0.1	0.7	1.2	1.7	1.6
Goods-producing	-0.7	0.9	0.5	-0.3	-0.6	1.0	1.5	1.4
Manufacturing	-0.1	-0.6	0.0	-0.3	-1.0	-1.1	0.6	-0.4
Natural resources, mining, and construction	-3.4	4.1	1.8	0.0	0.7	5.2	4.2	4.7
Service-providing	0.0	0.9	1.3	-0.1	1.1	1.2	1.8	1.6
Trade, transportation, and utilities	-1.4	0.2	-0.3	-1.7	0.2	0.8	4.0	1.1
Information	-2.6	0.5	-3.1	-0.9	-2.5	-4.3	2.2	0.3
Financial activities	-0.5	-0.1	2.0	-1.6	3.0	0.6	0.0	2.3
Professional and business services	1.4	2.1	3.0	1.9	1.5	0.4	2.7	2.8
Education and health services	1.1	1.4	2.6	0.5	2.9	2.1	1.0	2.3
Leisure and hospitality	2.0	1.8	2.9	1.9	1.9	6.5	2.1	2.3
Other services	-0.9	1.6	0.2	0.0	0.0	-0.2	0.0	0.2
Government	-1.0	0.1	0.2	-1.2	-0.2	-0.8	0.0	0.7
February unemployment rate (percent)	5.1	4.9	5.2	5.5	6.3	4.9	5.0	4.8

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 in February was 5.5%, up from 5.3% a month earlier. This reflects a 3.6% rise in unemployment, a 0.2% fall in the number employed, and virtually no change in the size of the labor force. Nationally, the unemployment rate was 4.8% in February, falling to 4.7% in March.

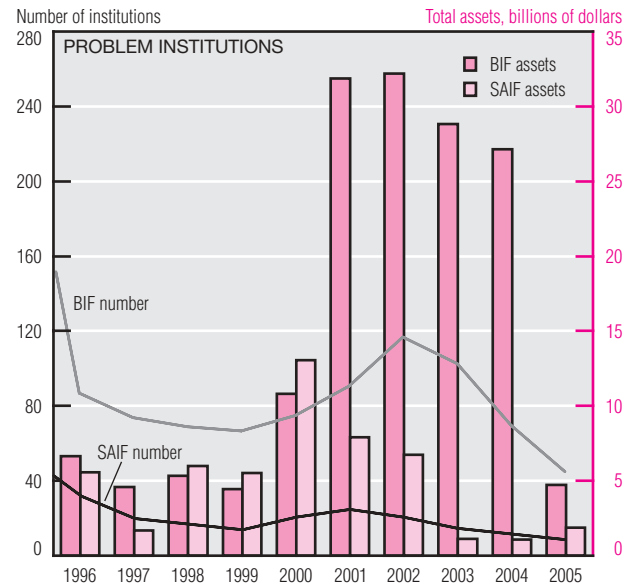
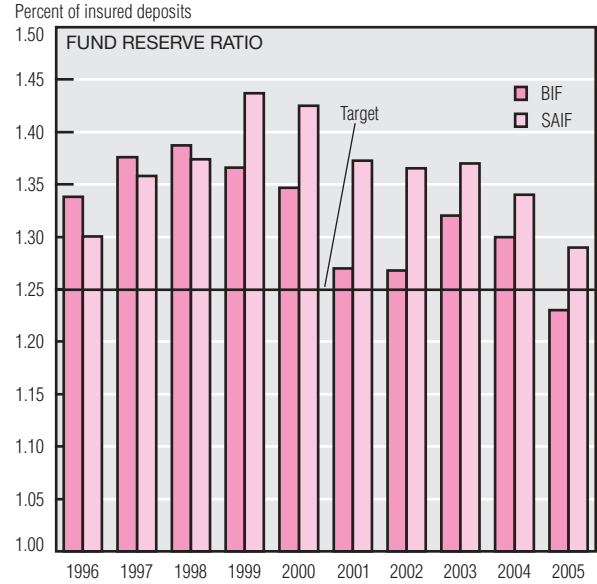
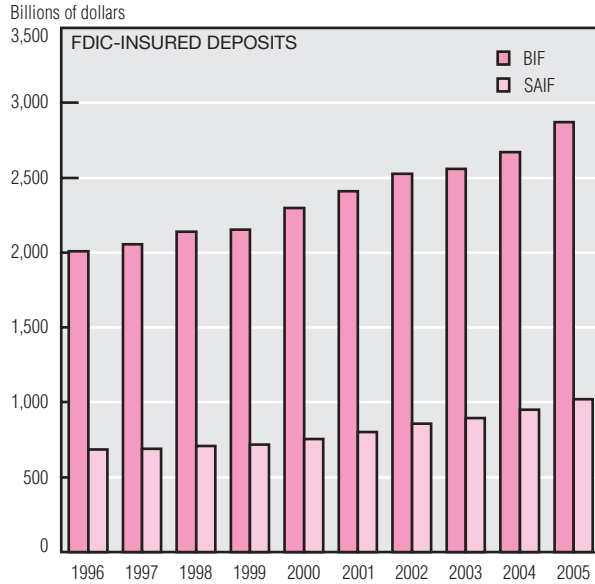
Unemployment rates among the District's counties generally exceeded the U.S. average in February. Kentucky's rates were particularly high: Eight of the state's 56 District counties

posted rates that were more than double the national average, but only four counties had rates that were close to this average or lower. Among the District's major metropolitan areas, Toledo experienced the highest unemployment rate (6.3%), but this was an improvement on the previous few months. Rates in most of the District's major metropolitan areas were close to the national average, but none were below it.

Employment growth has varied significantly among the District's metropolitan areas: Whereas Cleveland and

Dayton lost employment in the 12 months ending in March, growth in Pittsburgh, Cincinnati, and Lexington was similar to the nation's. In fact, none of Lexington's industries posted job losses for the year. Cleveland, on the other hand, saw its goods producers continuing to struggle during the year, losing jobs in the natural resources, mining, and construction sector—which meanwhile was growing rapidly in the District's other metropolitan areas—and in manufacturing.

FDIC Funds



SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

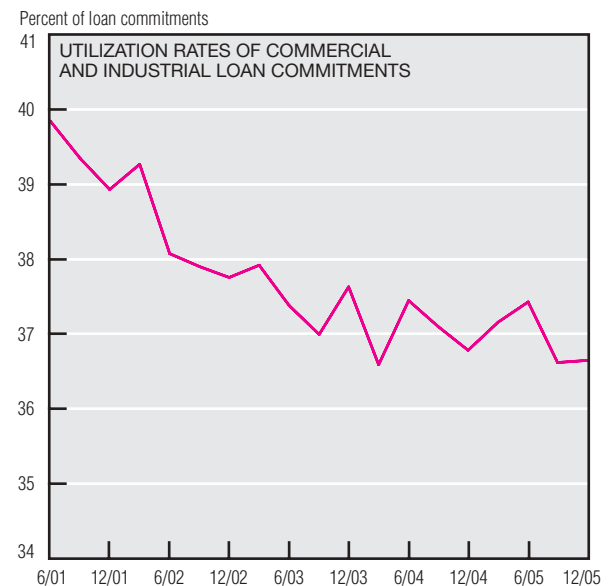
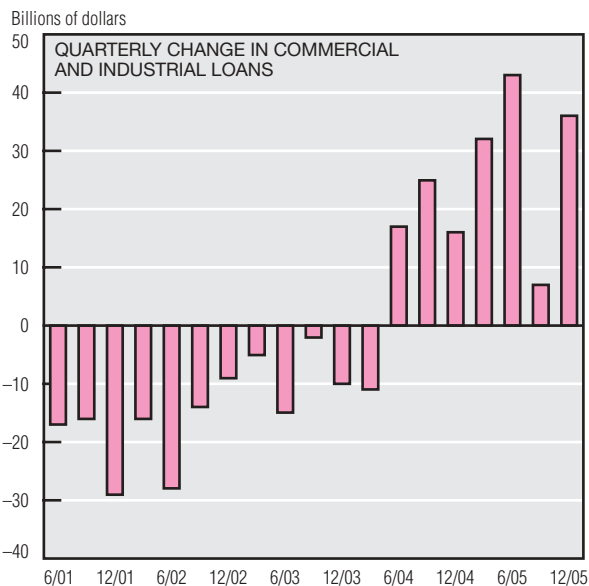
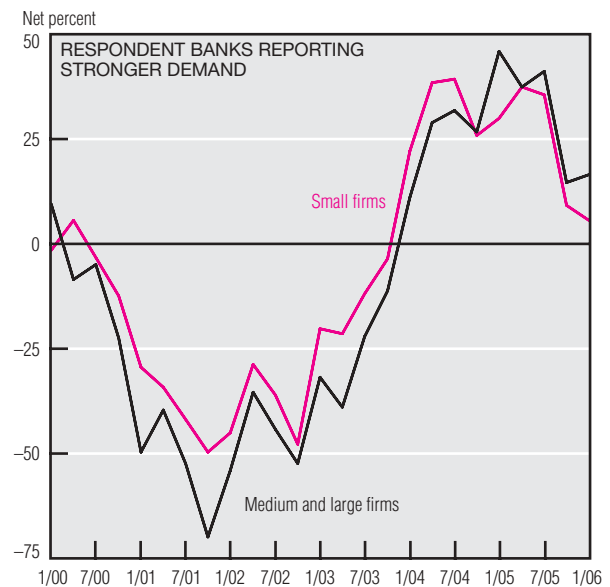
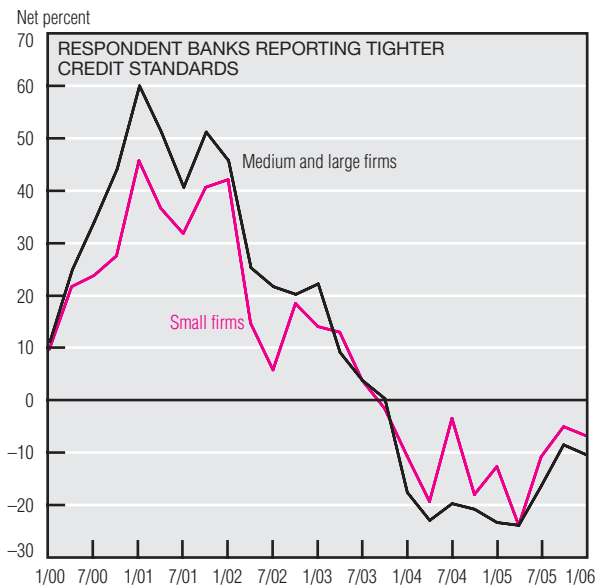
In 2005, deposits insured by the FDIC's Bank Insurance Fund (BIF) grew at a 7.51% annual rate, and those insured by the Savings Association Insurance Fund (SAIF) at 7.36%. As of December 31, 2005, the FDIC insured about \$2.9 trillion of BIF members' deposits and over \$1 trillion of SAIF members'. Growth in insured deposits outstripped BIF and SAIF reserves. As a result, BIF reserves fell from 1.30% of insured deposits at the end of 2004 to 1.23% at the end of 2005, slightly below the mandated 1.25% target ratio of reserves to insured deposits. Over this period, the SAIF ratio of reserves

to insured deposits fell from 1.34% to 1.29%. The solid position of both funds reflects the stability of the banking and thrift industries.

Bank failures since 1995 have been miniscule in terms of failed institutions' numbers and total assets. No insured institution failed in 2005:IV, the sixth consecutive quarter and the longest period without failures since the FDIC's inception; 2005 was the first full calendar year with no failures. (The three BIF members that failed in 2004 were small institutions with total assets of \$151 million; the sole SAIF member that failed had only \$15 million.)

At the end of 2005, the total number of problem institutions (those with substandard examination ratings) dropped to 52, the lowest number in 36 years. From the end of 2004 to the end of 2005, the number fell from 69 to 44 for the BIF and from 11 to 8 for the SAIF; the total assets of problem institutions plunged from \$28.25 billion to \$6.61 billion. For the BIF, the decrease in the number of problem institutions accompanied a decrease in their assets from \$27.16 to \$4.74 billion. The SAIF's assets increased from \$1.09 to \$1.87 billion.

Business Loan Markets



SOURCES: Board of Governors of the Federal Reserve System, *Senior Loan Officer Survey*, January 2006; and Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

Credit availability for businesses continued to improve in 2005 and early 2006, according to the Federal Reserve's *Senior Loan Officer Survey*. In the January 2006 survey (covering November, December, and January), respondent banks reported further easing of lending standards for commercial and industrial (C&I) loans. Respondents had narrowed their lending spreads, reduced collateral requirements, and increased the size of credit lines. This relaxation was due partly to stronger competition from other banks and other sources of business credit and partly to greater tolerance

for risk and increased liquidity in the secondary market for C&I loans.

Demand for commercial and industrial loans by businesses of all sizes continues to be strong, but 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 a record high of 45.5% in the January 2005 survey to 16.1% in January 2006 (up from 14.3% in October 2005). Demand for small-business loans likewise declined, with the share of respondents who reported stronger demand falling from

29.6% in January 2005 to 5.3% in January 2006 (down from 8.9% in October 2005). Relaxed lending standards continued to translate into more commercial and industrial loans. Banks' and thrifts' holdings of such loans increased \$36 billion in 2005: IVQ, the seventh consecutive quarter of expanding business loan portfolios. This increase coincided with only a slight change in the utilization rate of business loan commitments (credit lines extended by banks to commercial and industrial borrowers), further evidence that business credit is in ample supply.