

FIRST LADY'S OFFICE

Room 100 OEOB

MARGARET (MAGGIE) WILLIAMS

Diane Limbo

PRESIDENTIAL CORRESPONDENCE

TALKING POINTS

OVERVIEWS, BACKLOGS, AGENDAS

MZNOs

LOGS

HEALTH CARE

ISSUES

SUPPORT

CHILDREN

GREETINGS

HEALTH CARE

ISSUES

ENCLOSURES FILED OVERSIZE ATTACHMENTS

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NARA

CHILDREN'S SUPPORT

AGENCY LIAISON REPORT

10 FILES

MARGARET A. WILLIAMS (CORRESPONDENCE)

SUPPORT HEALTH CARE

THANK YOU

CHILDREN

FIRST LADY'S OFFICE -

NAFTA

SUPPORT

HEALTH CARE

CHILDREN

AGENCY LIAISON

HEALTH CARE

CHILDREN

SUGGESTIONS

SUPPORT

HEARTFELT

EDUCATION

LETTER WRITING CAMPAIGN

FOREIGN AFFAIRS

WOMEN'S ISSUES

CHILDREN'S ISSUES

HEALTH CARE

SUGGESTIONS / CRITICISMS

FLOTUS CORRESPONDENCE REPORTS

FLOTUS AGENCY LIAISON REPORTS

FLOTUS CORRESPONDENCE LOGS

FLOTUS CORRESPONDENCE OVERVIEWS,
BACKLOGS, AGENDAS

SAMPLE INCOMING CORRESPONDENCE

February 10, 1993

Dear Mr Rodham Clinton:

WE ARE JUST GETTING BY!

Recent media statements that consideration is being given to somehow dilute our Social Security benefits causes me to urge you not to jeopardize the well-being of the retired, who have a few more years to live and who need whatever resources have been earned over many long years of labor.

My husband worked in the printing industry for 46 years, while we raised and educated three children who are a credit to us and this country, paid off a modest home, invested in good health with wholesome sports activities, went to church on Sundays, served our community, and generally led a good and worthwhile life. When our children entered college, I took my first job outside of the home and endorsed my paychecks over to tuition payments. Thus, we were able to realize our dream of educating our children while always paying our way. We lived frugally and were fortunate enough to contribute to a small pension fund besides Social Security for our retirement years. We felt that it was worth sacrificing along the way to be able to retire with dignity.

BUT NOW WE ARE JUST GETTING BY! We are at the most vulnerable stage of our lives. Our health costs, at the age when every human being can expect to need more health care, are increasing. The younger people are being told that we are using up their contributions to the Social security fund. That is untrue! We paid our fair share -- this fund is not an entitlement or charity! It is very hurtful to us to hear younger workers thoughtlessly accuse us of eating up their contribution dollars. They do not have the foresight to imagine that they will be in our shoes not too many years from now, with the same needs we have. If our independence is taken away from us, we will either have to become a financial burden on the government, or we will become a burden to our married children who have family obligations of their own! Neither is a reasonable solution, so help us to continue to take care of ourselves as long as possible.

Canada is an example of helping elderly to lead independent lives. My aunt in Winnipeg who is 92 years old still lives in her older home in a suburb, with assistance from the government in the form of weekly housecleaning help and health checkups by a nurse, and substantial home maintenance in the form of new roof, exterior house painting, and removal of mature diseased trees, all paid for by the government. The total cost of these services plus her monthly Canada pension help this lady to remain in her own home, and total far less than if she had to be placed in a home full time at the expense of the taxpayer!

The retired citizens have done their fair share, and are still contributing. Many of my peers are helping adult children who have had to move back into their parents' homes for economic or emotional reasons. And many retired persons are caring for grandchildren whose parents insist they have to carry two jobs to pay for expensive homes and furnishings. Despite this, we are happy not to be financially dependent on our children. BUT, WE ARE JUST GETTING BY!

We want to continue to remain independent and to help our fellow man, as long as health and resources permit. We pay the full range of taxes working people pay, and would necessarily have to share any added consumer taxes.

The Social Security fund has been raided in the past to help pay for wars. But this annuity, this trust fund which we paid for over a life time of work, and on which we paid income tax originally, is still solvent, and should not be utilized for purposes other than those for which it was intended. We urge you not to postpone or eliminate cost-of-living increases in Social Security benefits, not to increase taxes on payments, nor raise the cost of Medicare Part B coverage. REMEMBER, WE ARE JUST GETTING BY!

Name Elfrida M. Rieger
Address 1238 Gulluck St.
Park Ridge Ill. 60068

P.S. No nest eggs here!

February 16, 1993

Mrs. Hillary R. Clinton
The White House
1600 Pennsylvania Ave. NW
Washington, D.C. 20500

Dear Mrs. Clinton:

California, as you know, is suffering through a prolonged and serious recession. Our unemployment rate is still too high and lay-offs are continuing. The area north of San Francisco and Sacramento has been hit especially hard with several years of drought. Poor fishing seasons for the coastal fishing fleet; depletion of private forest lands; and the outright moving of lumber mills and lumber processing plants to Mexico and Peru. We need to look at programs which will bring long term environmentally sound results and eventually stable jobs to our area.

Perhaps something that worked before will work again. During the 1930s the Federal government instituted a number of programs to put young people to work, and to reclaim the land simultaneously. It employed adults with forestry and environmental knowledge to organize and supervise young people to clean up streams, to plant trees, to renew fish breeding areas and to construct small bridges and trails for recreational and commercial use. The young people learned the discipline of hard work; an appreciation for the outdoors; and earned some money plus good food and safe, clean housing. The northwest still has remnants of hikers cabins, trails, bridges and small recreational dams that these young people built.

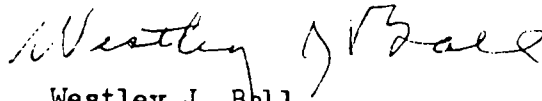
At present the State of California has a similar program that might serve as a model for a national or state-by-state program. Incidentally, the Federal government has a tree planting program in the North coast of California area, but believe it-or-not, the last time I saw the operation, it was being done by private contractors who employed Mexican nationals to do the work! I have the feeling that there are young people who, if recruited properly, would enjoy themselves and would mature through such a program.

Funding is a problem. No one can deny this fact. Perhaps a coalition of environmental groups; of professional fishing, hunting and recreational organizations; and fishing, timber, lumber and housing industries might bond together to take back the land.

I would appreciate your consideration of this proposal. You might wonder why I am interested enough in this bygone jobs program to write this letter to you. I worked in a program very much like this while going to college in the 30s and by father was one of the adults who helped supervise the young people in the forestry and environmental jobs program.

Once again, thank you for your consideration.

Sincerely

A handwritten signature in cursive script, reading "Westley J. Ball". The signature is written in dark ink and is positioned above the printed name.

Westley J. Ball
2355 Brommer #33
Santa Cruz, CA. 95062

February 21, 1993

Mrs. Hillary Rodham Clinton,
1600 Pennsylvania Ave.,
Washington, D. C.

Dear First Lady:

Unless a better way is worked out I plan to name the U. S. Treasury as contingent beneficiary on a Certificate of Deposit for \$16,000.00 (my share of the national debt). I write to you as the best hope for spreading this idea and preferably providing a better way for millions of patriotic citizens to "bequeath" their share.

A better way would be for the government to sell interest bearing certificates with no redemption value. Thus they would become void on the death of the subscriber. The interest payment checks could bear "Payable only if the payee is still living on the above date."

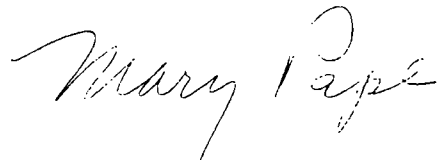
I live in a retirement community and have spoken to friends about this idea. Some are interested and others think I should be committed. One has said he would buy his \$16,000 share of such certificates if made available. He suggests calling the certificates "Patriotic Bequest Certificates".

We cannot know until this idea is tried how well it would catch on, but there is nothing to lose by trying. The idea might grow through the years.

I think most buyers would want secrecy until death possibly so as not to be targeted, but it could become fashionable for death notices to mention that the deceased had purchased a Patriotic Bequest Certificate.

If this idea is accepted please do not give me credit for it. I do not want my name in any publicity.

Respectfully yours,



(Mrs) Mary Pape
1203 Harkness Way
Sun City Center, FL. 33573

Age 86
Occupation: Part time employee
S.C.C. Library
S.C.C. Bridge Assn.

LOUIS ROBERTSON

PATENT SOLICITATION

February 21, 1993

1411 NASHUA CIRCLE - SUN CITY CENTER, FL 33670
TELEPHONE (813) 634-6105

Mrs. Hillary Rodham Clinton
1600 Pennsylvania Ave.
Washington, D. C.

Dear Madam;

I add my letter to Mary Pape's partly so that you can know from the start that there is already at least one person who agrees with her idea.

Also, I have been exposed to it long enough to be able to suggest some details or thoughts that might be helpful.

There could be more than one variety of Patriotic Bequest Bonds. One variety could be redeemable, while the subscriber lives. The other, with perhaps slightly higher interest payments, could be non-redeemable. The former might attract those whose financial position is not quite safe in case of catastrophic illness.

Direct purchase from the government with no commission deducted, and with no local handling appeals to me, more than buying CDs from a bank (where I might be thought crazy if I named the government as contingent beneficiary).

Announcement that Patriotic Bequest Bonds have been made available "by request" might remove some fear of proposing a "dud". The announcement should not assume that only the wealthy would buy. Anyone without children needing the whole inheritance may be enough moved by patriotism. In fact, Mary Pape's willingness to pay her share of the national debt is amazing, because her ability to do so is only because her needs are small and she is a good manager. Someone a bit wealthy, with equal patriotism might well buy double to makeup for one who can't. Remember that the government gets the money now, not at death. Wouldn't it be wonderful if the idea took hold so well that within a year or two a substantial part of the debt had been converted to bequest bonds? Unlikely, yes -- but impossible unless tried.

Hopefully yours,

Louis Robertson

WILLIAM L. PALMER
836 Via Lido Nord
Newport Beach, CA 92663

February 18, 1993

Ms. Hillary Rodham Clinton
The White House
Washington, D.C.

Dear Ms. Clinton:

The reason George Bush lost the election was because he was fundamentally a poor politician -- and he didn't control spending, even his own.

The reason Ronald Reagan's years produced record deficits was because Congress and the Administration could not bring itself to cut spending.

And if Bill Clinton, ambitious politician that he is, doesn't get this message, he too will be a one-term president. As an American and a moderate, I wish him well. However, as a realist, I have serious doubts that he will not continue his long record of obfuscating on the truth and fudging on promises used to get elected.

His latest and oft-repeated promise to cut the presidential staff by 25% is a perfect example. Most people think this means a 25% cut in spending. Oh no, he means a 25% cut in bodies, not dollars. The actual dollar savings (which is what really counts) is closer to 3%, and even this "savings" is questionable because of shifting accountability for personnel. Pure Washington shell game! And people wonder why the electorate is so cynical.

The bottom line is that if this tax increase goes the way of the two previous tax increases, and actual dollar spending cuts over the next four years fail to match tax increases, Republican zealots will have a field day and President Clinton and all his promises will be history! Not to mention your hopes for health care reform.

Sincerely,

A handwritten signature in dark ink, appearing to read 'WL Palmer', with a stylized flourish at the end.

William L. Palmer

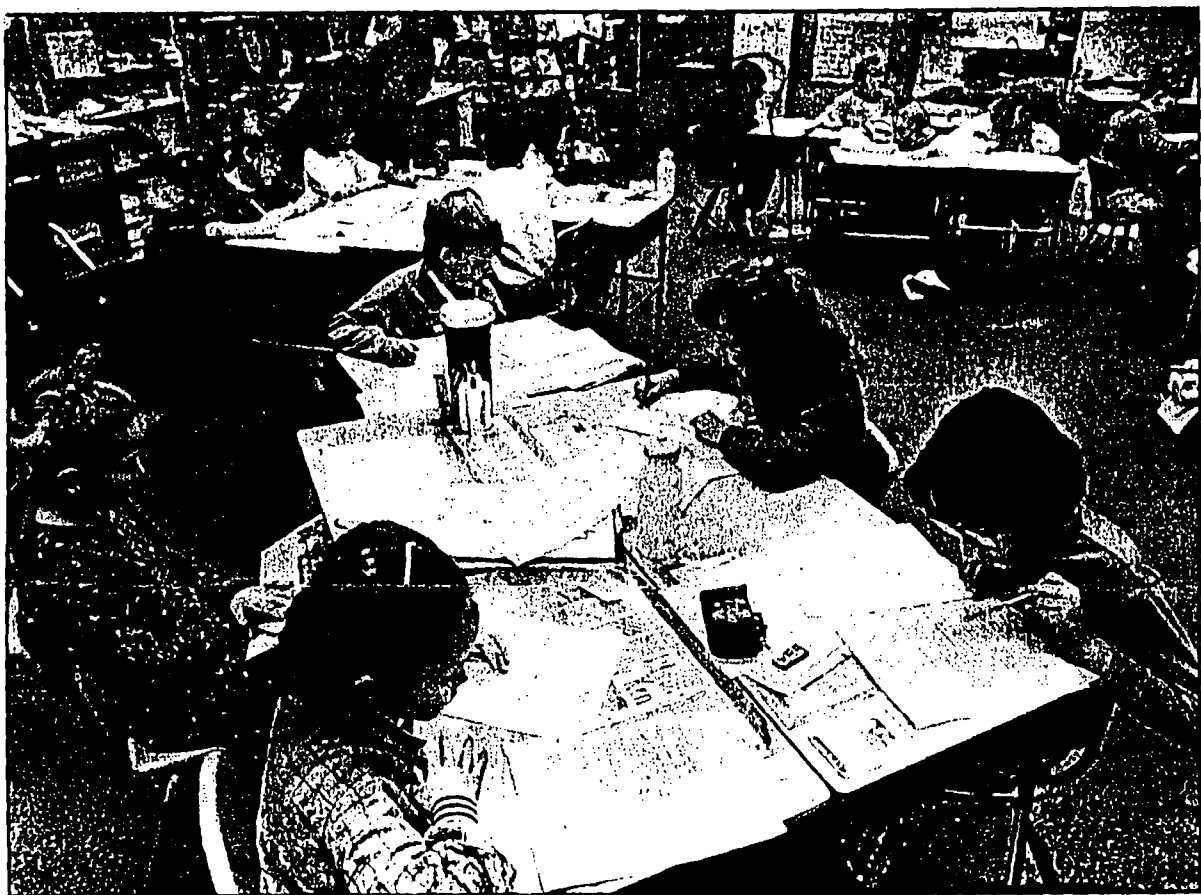
Deer Park Elementary
N. 428 Main Street
Deer Park, WA 99006
January 29, 1993

Mrs. Hillary Clinton
1601 Pennsylvania Avenue
Washington, DC 20500

Dear Mrs. Clinton,

I am a third grader. There is a boy in our class. His name is Ryan Elledge. He is going to have surgery in Pottsville, Pennsylvania. There is an auction. Can you send us a flag or anything you want for the auction. The surgery costs \$350,000 so please help this family. He is very very sick. This is what he needs replace: liver, pancreas, small intestine and stomach. He is nice, funny and a very good friend and awesome too. So please save him by helping him. Oh yeh, he is in my class at Deer Park Elementary. Can you come to the auction? If not it's okay. Bye bye. Thank you!

Sincerely,
Sarah Galbraith



Second-graders at Deer Park Elementary write letters to House Speaker Tom Foley and President and Mrs. Clinton, asking their support for the school's efforts to help classmate Ryan Elledge, below.

A little help for their friend

Schoolmates pitch in to help boy who needs surgery

In/Around: Deer Park

By Bonnie Harris
Staff writer

Ryan Elledge has had nine operations in his eight years of life.

One more finally could save him.

Surgeons already have removed Ryan's gall bladder and most of his intestine. Now the second-grader's liver, pancreas and stomach are failing — complications that could take his life within the year.

A four-organ transplant, however, could replace Ryan's dying organs with healthy ones.

Those odds were good enough for teachers and school supporters.

Fundraisers already have been planned to help pay for the operation, which would cost nearly \$400,000.

"The transplant could be the answer to our prayers," said Ryan's father, Kurt Elledge. "It could be what we've been waiting for."

Specialists plan to perform the operation at the Children's Hospital in Pittsburgh, where Ryan is on a waiting list. At any time, a matching donor could be found and Ryan and his parents would leave immediately, Elledge said.

While Ryan's rare AB-positive blood type makes finding a donor more difficult, it lessens the competition when one becomes available, he said.

"Ryan is tired of doctors and hospitals, and people poking around all the time," Elledge said. "But he's willing to go through it all again — one more time."

Last year, Ryan was diagnosed with short bowel syndrome, an infection in the small intestine that is not uncommon in newborns. Later complications required the removal of his gall bladder, and intravenous feedings began to deteriorate his stomach, liver and pancreas.

Usually such deteriorations take several years, but occurred quickly in Ryan's body, which is small for his age. The development took Elledge and his wife, Julie, off guard.

"We weren't ready for this yet," he said.

Elledge sold a barber shop he managed for eight years in Deer Park so he could stay home with Ryan. His wife, who receives Group Health medical coverage from her job as a medical bookkeeper, continued working.

Medical care costs up to \$20,000 a month while Ryan



is at home, and can top \$50,000 with each hospital stay, Elledge said.

Until now, Group Health has covered virtually all of those fees, but has not yet agreed to cover the four-organ transplant, considered experimental.

Chradia Sobczuk, a Deer Park Elementary reading specialist, said Ryan's school family wants to help.

An auction and spaghetti feed is planned for March, she said, and donations are needed to put on the block.

A trust account at Washington Trust Bank has been set up for donations.

Ryan's classmates last week wrote letters to Tom Foley and President and Mrs. Clinton, asking them to help support the school.

**PHOTOCOPY
PRESERVATION**

THE WHITE HOUSE

WASHINGTON

March 25, 1993

Mr. Ryan Elledge
Deer Park Elementary School
428 North Main Street
Deer Park, Washington 99006

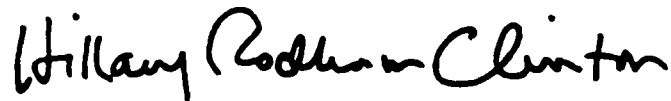
Dear Ryan:

Many of your classmates at Deer Park Elementary School have written to let me know about your illness. You are very lucky to have so many friends who care deeply about you.

I understand you hope to have surgery soon. Our thoughts and prayers are with you and your family. Enclosed is a signed photograph which I hope will remind you of our support and help keep your spirits up.

President Clinton joins me in sending you our best wishes. We hope that you get well soon.

Sincerely yours,

A handwritten signature in black ink that reads "Hillary Rodham Clinton". The signature is written in a cursive, flowing style.

Hillary Rodham Clinton

File

FRIDAY REPORT

EXPEDITE /___/

REGULAR HANDLING /___/

FYI /X/

MEMO TO: _____

DATE: 4/2/93

DIRECTOR

DEPUTY DIRECTOR

DEPUTY DIRECTOR FOR MANAGEMENT

EXECUTIVE ASSOCIATE DIRECTOR

JIM MURR

DIRECTOR'S OFFICE DISTRIBUTION (ALL OF THE ABOVE) /X/

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MAGGIE WILLIAMS - 2nd Floor, WW /X/

HOWARD PASTER - 2nd Floor, WW /X/

ROBERT RUBIN - WH, 2nd Floor, WW /X/

GENE SPERLING - WH, 2nd Floor, WW /X/

BOWMAN CUTTER - NEC, Room 231 /X/

GEORGE STEPHANOPOULOS - WH Communications, 1st Floor, WW /X/

DEE DEE MEYERS - WH Press Office, 1st Floor, WW /X/

LAURA TYSON - CEA, Chairman, Room 314 /X/

ALAN S. BLINDER - CEA, Room 314 /X/

JOSEPH STIGLITZ - CEA, Room 315 /X/

JOHN GIBBONS - OSTP, Room 424 /X/

ROY NEEL - VP's Office, Room 274 /X/

GREG SIMON - VP's Office, Room 280 /X/

Other: /___/

FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Friday Economic
and
Financial Report
yellow

April 2, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik *JJM*
SUBJECT: Friday Economic and Financial Report

SUMMARY

This Friday Report examines three aspects of the labor market.

- Labor market data, released this morning, suggest that economic growth came to a halt last month. The unemployment rate plateaued at February's 7.0 percent; there were fewer jobs in March than in February; and the number of industries reducing payrolls slightly exceeded the number increasing them.

On the basis of labor market and other indicators, real GDP probably rose at a 2-1/2 to 3 percent annual rate in the first quarter, down from 4.7 percent in the fourth quarter.

- New data from the Small Business Administration support the common wisdom that small businesses are the source of new jobs. Last year, as in 1990, industries dominated by small businesses increased their payrolls. In contrast, in each of the last three years, big business industries reduced employment.
- High unemployment afflicts most industrialized countries. An Organization for Economic Cooperation and Development (OECD) report suggests that, unlike many European countries, U.S. unemployment is cyclical in origin, rather than structural.

The United States can bring down unemployment by boosting short- and long-term economic growth prospects and by expanding active labor market policies. U.S. public spending on such programs is just one-fourth of one percent of GDP, about half the OECD average. The Administration has proposed three new policies in this area.

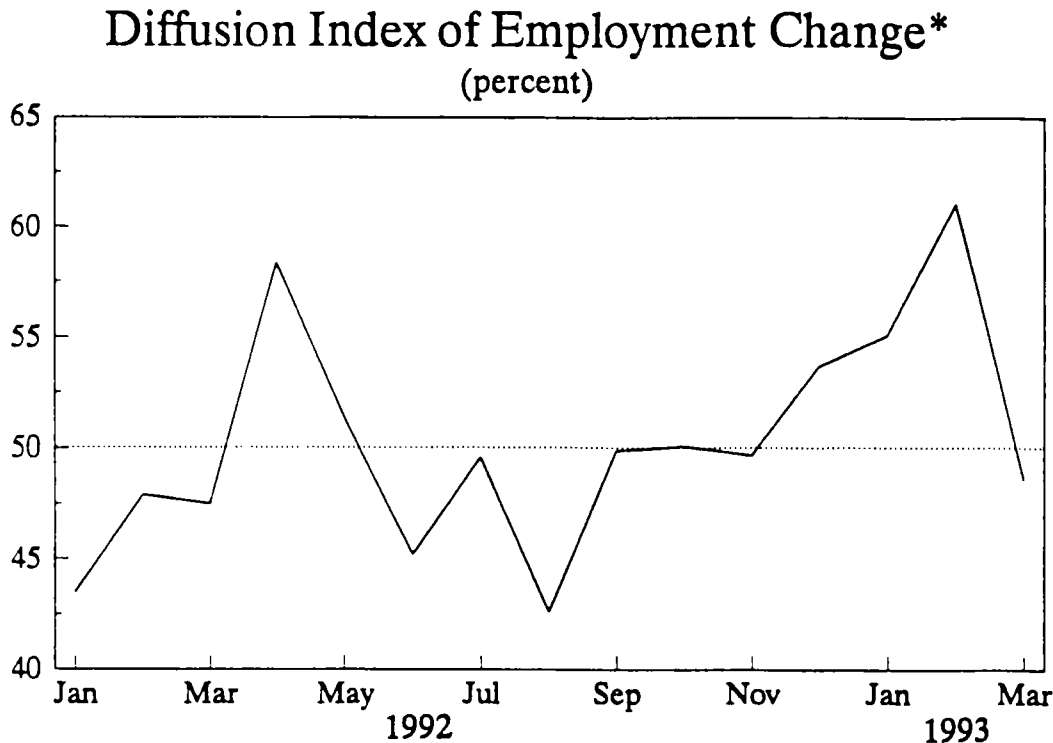
Weather or Not

The labor market data released this morning showed little, if any, advance in economic activity last month. Poor weather may have played a role, but probably a minor one. More fundamentally, the pace of job creation -- and therefore income -- slowed substantially from that during January-February. Judging by the available monthly labor market and other indicators, real GDP probably rose at a 2-1/2 to 3 percent annual rate in the first quarter. By comparison, fourth quarter growth was at a 4.7 percent pace. The recent slowdown should alleviate any concerns about accelerating inflation.

March Labor Market -- There was little change in employment or unemployment last month. The unemployment rate stayed at February's 7.0 percent. The number of unemployed held at 8.9 million, only 12,000 below the prior month's level.

LABOR MARKET INDICATORS						
	1992		1993			
	Q3	Q4	Q1	Jan	Feb	Mar
Civilian Unemployment Rate	7.6	7.3	7.0	7.1	7.0	7.0
Civilian Unemployment (millions)	9.7	9.3	9.0	9.0	8.9	8.9
Average Monthly Change (1000s)						
Civilian Employment	50	196	85	-240	380	114
Civilian Unemployment	-142	-90	-139	-267	-137	-12
Payroll Jobs	25	85	153	113	367	-22
Private	-13	73	156	134	345	-10
Manufacturing	-45	-13	14	30	20	-9
Mining	-5	-0	-4	-3	-12	3
Construction	-9	3	4	-23	93	-59
Services	45	84	143	130	244	55
Government	37	12	-4	-21	22	-12

The number of jobs edged down 22,000 in March, following average gains of 240,000 per month in January-February. Weakness in job creation was widespread last month, as shown by the diffusion index of employment change, which dipped below the 50 percent mark.



* Percent of 356 industries increasing payrolls.

Factory employment edged down (9,000), following gains in each of the four prior months. Although the factory workweek shrank as well, much of that may have been due to the severe winter storm that blanketed the East Coast in the middle of the month. It is likely that stepped-up production later in the month made up for most of the weather-related loss. In that case, March production probably was about unchanged from February, rather than down, as the raw employment and hours numbers would suggest. (Data to be released April 16.)

Where the Jobs Are

The common wisdom that small businesses are the source of new jobs is validated by new, unpublished statistics by the Small Business Administration. In each of the last three years, industries dominated by large businesses cut their work forces. In contrast, during 1990 and 1992, small-business-dominated industries added to their payrolls. Even in the weak year of 1991, job losses in small-firm industries were less than in large-business-dominated industries.

Employment Growth in Industry (December-to-December, % Change)				
Year	Small-Business- Denominated Industries*	Large-Business- Denominated Industries*	Indeterminate Industries	Total
1990	1.1	-0.6	-2.2	0.3
1991	-0.5	-1.4	-1.7	-1.0
1992	1.0	-0.5	0.8	0.4

*Small- (large-) business-dominated industries are those in which at least 60 percent of employment is in firms with fewer (more) than 500 employees. Indeterminate industries are the remainder.				

Unemployment Here and Abroad

Unacceptably high unemployment is a malady affecting not only the United States, but almost all the industrialized nations belonging to the Organization for Economic Cooperation and Development (OECD). Next week, representatives from all 24 member nations will meet in Paris to discuss their common affliction.

A working paper prepared by the OECD for that meeting, "High and Persistent Unemployment: Assessment of the Problem and its Causes," provides a hopeful message for the United States. According to the report, most of the rise in our unemployment in recent years is cyclical in origin, rather than structural. Therefore, a short-term stimulus package, combined with a longer-term program to keep interest rates low by cutting the Federal deficit, could significantly reduce unemployment. By contrast, labor market rigidities in Europe -- fostered by social institutions and legislation -- limit unemployment reductions, even when economic activity picks up.

The report demonstrates that:

- o In the United States, along with Canada and the United Kingdom, there is a relatively strong tendency for employment to fluctuate as output fluctuates. That flexibility has its downside during recessions, but its upside during recoveries.
- o Countries with highly cyclical unemployment also tended to have a pronounced increase in their trend unemployment in the 1980s. That is not the case in the United States, however; although unemployment is relatively cyclical, trend unemployment has hardly risen.

Whether unemployment stays high or comes down quickly after a negative shock to labor productivity depends, to a large extent, on how rapidly real wages adjust. Compared with many European countries, U.S. institutions and policies tend to foster a relatively rapid adjustment. In particular:

- o The United States and Canada have the **least centralized collective bargaining system** among the OECD countries.
- o The U.S. **unemployment benefit system is less generous** than that of the six other major industrialized countries. Consequently, there is more pressure on the unemployed here to find new jobs.
- o Apart from civil rights legislation, the United States has **comparatively few restrictions on firms' ability to hire and fire workers**. In contrast, employment protection legislation abroad tends to slow the adjustment of unemployment and real wages.
- o The U.S. **minimum wage is relatively low** in comparison with its average wage. As a result, youth employment is not as detrimentally affected as it is abroad.

A downside consequence of U.S. flexibility is that real wages are squeezed when labor productivity is adversely affected. The solution to this, however, is not to adopt European-style rigidities that keep wages high at the expense of jobs, but to boost productivity by shifting more private and public resources into high-return investments.

There is one area where the United States might fruitfully follow the lead of other OECD countries: devote a greater share of resources to active labor market policies that shorten job search time, such as training, counselling and employment services. U.S. public spending on such programs is just one-fourth of one percent of GDP, about half the OECD average. The Administration has proposed three new active labor market policies.

- o The **dislocated worker program** will provide reemployment services and training to workers who lose their jobs because of industry restructuring, defense cutbacks, environmental regulation or international competition (new spending totals \$4.6 billion, FY 1994-97).
- o The **one-stop career shopping program** will enable people to obtain access to Federal programs and services more easily (\$900 million, FY 1994-97).
- o The **youth apprenticeship program** will create a combined school and work transition track for high school students who do not plan to attend college (\$1.2 billion, FY 1994-97).

RECENT ECONOMIC INDICATORS AS OF APRIL 2, 1993
(S.A. OR AS INDICATED)

	Feb-92	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93
GDP (Quarterly Series, % A.R.)														
Nominal GDP		6.2			4.3			5.3			7.1			
Real GDP		2.9			1.5			3.4			4.7			
Implicit Price Deflator		3.1			2.7			2.0			2.3			
Fixed-Weight Price Index		3.7			3.0			2.0			3.3			
CYCLICAL INDICATORS														
Leading Index, Percent	0.7	0.4	0.3	0.6	-0.3	0.1	-0.2	0.1	0.5	0.5	1.7	0.0	0.5	NA
Coincident Index, Percent	0.5	0.0	0.0	0.0	-0.1	0.4	-0.5	0.1	0.5	0.2	1.0	-0.2	0.2	NA
Purchasing Managers' Diffusion Index	53.4	54.8	52.2	55.7	52.3	53.0	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4
Percent	9.4	2.6	-4.7	6.7	-6.1	1.3	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3
Industrial Production	107.2	107.6	108.1	108.9	108.5	109.4	109.1	108.9	109.7	110.4	110.8	111.3	111.8	NA
Percent	0.56	0.37	0.46	0.74	-0.37	0.83	-0.27	-0.18	0.73	0.64	0.36	0.45	0.45	NA
Capacity Utilization, Manufacturing	77.4	77.5	77.7	78.2	77.8	78.1	77.9	77.5	77.9	78.3	78.4	78.8	78.9	NA
EMPLOYMENT INDICATORS														
Civilian Employment, Million	117.0	117.3	117.5	117.6	117.5	117.7	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6
Nonfarm Payroll Employment, Million	108.1	108.2	108.4	108.5	108.4	108.6	108.5	108.5	108.6	108.6	108.8	108.9	109.2	109.2
Civilian Unemployment Rate, Percent	7.3	7.3	7.3	7.4	7.7	7.6	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0
Employment/Population Ratio	61.3	61.4	61.5	61.5	61.4	61.4	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4
Average Weekly Hours, Manufacturing	41.1	41.1	41.1	41.3	41.0	41.0	41.0	40.9	41.1	41.2	41.2	41.4	41.5	41.2
CONSUMER SECTOR														
Retail Sales, Billion \$	161.2	159.6	160.2	161.3	161.1	162.3	163.2	164.2	167.6	167.3	169.2	169.4	169.8	NA
Percent	1.4	-1.0	0.4	0.7	-0.1	0.7	0.6	0.6	2.1	-0.2	1.1	0.0	0.3	0.3
Total Auto Sales, Million Units, A.R.	8.5	8.3	8.2	8.4	8.9	8.3	7.9	8.3	8.3	8.2	8.7	8.6	8.0	NA
Domestic Auto Sales, Million Units, A.R.	6.2	6.0	6.0	6.3	6.7	6.4	6.0	6.3	6.3	6.2	6.7	6.6	6.0	NA
Personal Income, Billion \$, A.R.	4988.7	5009.6	5015.4	5032.7	5038.5	5048.7	5056.4	5080.9	5145.0	5143.7	5194.0	5219.2	5229.1	NA
Percent	0.9	0.4	0.1	0.3	0.1	0.2	0.2	0.5	1.3	-0.0	1.0	0.5	0.2	NA
Disposable Personal Income, Billion \$, A.R.	4360.8	4400.6	4400.7	4415.1	4419.5	4424.6	4426.3	4448.7	4505.9	4500.4	4545.4	4562.4	4571.9	NA
Savings Rate, Percent	4.9	5.3	5.5	5.3	5	4.8	4.6	4.6	4.4	4.4	4.4	4.3	NA	NA
Real Personal Income, Billion \$7\$, A.R.	4079.1	4076.2	4070.9	4078.4	4076.5	4078.1	4094.3	4090.9	4125.9	4118.3	4155.2	4162	4156.7	NA
Percent	0.5	-0.1	-0.1	0.2	-0.0	0.0	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.1	NA
Real Disposable Personal Income, Billion \$7\$, A.R.	3565.9	3581.9	3573.3	3578.6	3576.1	3574.4	3585.5	3581.7	3613.4	3604	3637.1	3638.2	3634.8	NA
Percent	0.5	0.4	-0.2	0.1	-0.1	-0.0	0.3	-0.1	0.9	-0.3	0.9	0.0	-0.1	NA
Consumer Sentiment Index, U of Michigan	68.8	76.0	77.2	79.2	80.4	76.6	76.1	75.6	73.3	85.3	91.0	89.3	86.6	84.3
Percent	1.9	10.5	1.6	2.6	1.5	-4.7	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-2.7
HOUSING SECTOR														
Housing Starts, Thousand Units, A.R.	1285	1318	1095	1197	1141	1106	1229	1218	1226	1226	1286	1178	1208	NA
Single-Family Starts	1137	1050	939	1019	994	961	1038	1045	1079	1089	1133	1061	1052	NA

	Feb-92	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93
BUSINESS SECTOR														
Nondefense Capital Goods Orders, Billion \$	29.5	32.2	29.9	30.5	31.0	29.3	28.2	30.6	31.7	28.6	34.0	30.4	34.7	NA
Percent	-2.1	9.2	-7.0	1.9	1.6	-5.4	-3.9	8.6	3.6	-9.7	19.0	-10.8	14.4	NA
Nonresidential Construction Put in Place, Billion \$	125.0	128.5	127.2	124.1	127.6	124.7	117.8	122.5	123.5	122.7	121.7	119.9	NA	NA
Inventory Change Book Value, Billion \$, A.R.	14.3	18.6	29.8	-6.9	48.0	402	22.1	-19.4	21.1	12.3	28.7	2.8	NA	NA
Inventory/Sales Ratio, Total Business	1.52	1.52	1.52	1.52	1.50	1.49	1.52	1.50	1.49	1.49	1.46	1.46	NA	NA
INFLATION INDICATORS														
CPI, Percent	0.2	0.4	0.3	0.1	0.2	0.3	0.2	0.1	0.4	0.2	0.1	0.5	0.3	NA
CPI Less Food and Energy, Percent	0.3	0.3	0.3	0.3	0.1	0.3	0.2	0.1	0.5	0.3	0.2	0.5	0.5	NA
PPI Finished Goods, Percent	0.2	0.2	0.2	0.3	0.2	0.0	0.1	0.2	0.0	-0.2	0.1	0.2	0.4	NA
PPI Less Food and Energy, Percent	0.1	0.3	0.3	0.4	-0.2	0.1	0.0	0.1	-0.1	0.1	0.2	0.4	0.3	NA
Gold, \$ per ounce	353.8	343.8	338.2	337.3	341.3	353.2	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3
W. Texas Spot Oil Price, \$/bbl	19.0	18.9	20.2	20.9	22.4	21.8	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3
MERCHANDISE TRADE														
Exports, Billion \$, A.R.	451.9	445.0	436.9	428.6	458.0	453.7	429.6	454.6	468.9	458.2	476.1	444.1	NA	NA
Imports, Billion \$, A.R.	492.9	513.7	521.9	514.8	539.5	542.0	539.7	558.6	555.9	546.4	558.7	531.7	NA	NA
Deficit, Billion \$, A.R.	-41.1	-68.7	-85.1	-86.2	-81.5	-88.4	-110.1	-104.0	-87.0	-88.2	-82.7	-87.6	NA	NA
U.S. EXCHANGE RATE														
Multilateral	88.0	90.4	89.8	88.3	85.9	82.6	81.0	82.0	85.0	90.0	90.5	92.4	93.8	NA
Percent	2.3	2.7	-0.7	-1.7	-2.7	-3.9	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	NA
Yen/\$	127.7	132.9	133.5	130.8	126.8	125.9	126.2	122.6	121.2	123.9	124.0	125.0	120.8	NA
DM/\$	1.62	1.66	1.65	1.62	1.57	1.49	1.45	1.45	1.49	1.59	1.58	1.61	1.64	NA
\$/Pound	1.78	1.72	1.76	1.81	1.86	1.92	1.94	1.85	1.65	1.53	1.55	1.53	1.44	NA
MONEY AND CREDIT														
M2, Billion \$	3467.7	3467.8	3464.8	3467.4	3461.9	3463.5	3472.3	3480.2	3491.5	3498.1	3497.3	3487.8	3475.3	NA
Percent	6.0	0.0	-1.0	0.9	-1.9	0.6	3.1	2.8	4.0	2.3	-0.3	-3.2	-4.2	NA
M3, Billion \$	4189.0	4184.9	4177.9	4179.6	4169.9	4168.8	4178.6	4182.8	4179.8	4178.5	4167.1	4142.1	4133.9	NA
Percent	4.9	-1.2	-2.0	0.5	-2.7	-0.3	2.9	1.2	-0.9	-0.4	-3.2	-7.0	-2.3	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	994.9	1000.0	996.8	1000.0	996.8	991.5	986.8	982.1	988.2	991.6	996.9	NA	NA	NA
Percent, A.R.	8.2	6.3	-3.8	3.9	-3.8	-6.2	-5.6	-5.5	7.7	4.2	6.6	NA	NA	NA
C&I Loans, Billion \$	455.5	454.3	452.3	454.3	452.3	448.0	443.6	440.1	440.3	439.9	441.0	NA	NA	NA
Commercial Paper, Billion \$	539.4	545.7	544.5	545.7	544.5	543.5	543.2	542.0	547.9	551.7	555.9	NA	NA	NA
INTEREST RATES														
Federal Funds Rate	4.1	4.0	3.7	3.8	3.8	3.3	3.3	3.2	3.1	3.1	2.9	3.0	3.0	NA
T-Bill, 3 Month	3.8	4.0	3.8	3.6	3.7	3.2	3.1	2.9	2.9	3.1	3.2	3.0	2.9	NA
T-Bond, 30 Year	7.9	8.0	8.0	7.9	7.8	7.6	7.4	7.3	7.5	7.6	7.4	7.3	7.1	NA
Corporate AAA Bonds	8.3	8.4	8.3	8.3	8.2	8.1	8.0	7.9	8.0	8.1	8.0	7.9	7.7	NA
Mortgage Commitment Rate	8.8	8.9	8.9	8.7	8.5	8.1	8.0	7.9	8.1	8.3	8.2	8.0	7.7	NA
STOCK MARKET														
Dow Jones 30 Industrials	3257.3	3247.4	3294.1	3376.8	3337.8	3329.4	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7
Standard & Poor's 500	412.6	407.4	407.4	414.8	408.3	415.1	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2

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FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

April 16, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik *JJM*
SUBJECT: Friday Economic and Financial Report

SUMMARY

Research and development (R&D) comprises a small share of GDP, but has an enormous impact on economic growth because of its very high rates of return. The direct rates of return to industry-financed R&D range from 20 to 50 percent. The total return to society may be twice as large because much of the benefit of new knowledge accrues to firms that did not make the initial investment.

Taking into account the direct and indirect returns, R&D may have contributed about 0.4 percentage point per year to GDP growth in the 1980s. About half of the contribution came from the industry engaging in the R&D, about half through indirect channels.

Since the mid-1980s, public and private R&D spending after adjustment for inflation has grown very slowly. That does not necessarily mean that the contribution of R&D to growth will fall off in the coming years. Much of the weakness is in the highly specialized defense sector, which has only a limited impact on productivity growth. In addition, the Administration is focusing its outlays and tax policy on productivity-enhancing R&D.

- Federal R&D is being reoriented toward civilian uses. By FY 1998, civilian R&D is projected to reach 50 percent of all Federal R&D spending, up from 41 percent in FY 1993.
- The Administration has proposed restoring the research and experimentation tax credit. Although it is estimated to cost \$2.2 billion in lost revenues by FY 1998, it still represents a sound Federal policy. Because of the high social returns to R&D, reinstating the tax credit would generate total returns considerably higher than most other Federal investments and tax expenditures.

Stimulating Innovation and Economic Growth

Introduction

Economic growth is not simply the result of combining one part capital to two parts of labor. Rather, it is a complex process that depends on the generation of knowledge. As Charles Schultze put it in his recent book, *Memos to the President*, "In the long run, the advance in scientific knowledge, and its translation into new and improved products and methods of production, is the most important force contributing to economic growth." Rapidly growing firms -- and nations -- are those at the forefront of discovery and innovation.

New knowledge comes about in many places: shop floors, academia, and national labs. It is spurred by broad challenges, like strengthening our national defense or conserving energy, and by narrower ones, like building a better mouse trap -- or mouse.

Organized research and development, whether performed in the private or public sector, lies behind most advances in knowledge. Last year, R&D spending totaled just under \$160 billion. Industry-financed R&D was only \$80 billion -- a small drop in a \$6 trillion GDP economic bucket. That drop, however, holds the promise of creating streams of growth in the future.

Return to R&D

Private Industry: The direct rate of return on industry-financed R&D is estimated to be very high, averaging between 20 to 50 percent. This is well above typical estimates of an 8 percent return on corporate plant and equipment and a 10-12 percent return on investment in education.

- o The high rate of return has resulted in R&D investment providing a significant boost to productivity growth despite its relatively small size. Industry-financed R&D probably directly accounted for about 0.2 percentage point of the almost 1 percent per year rise in productivity during the 1980s.

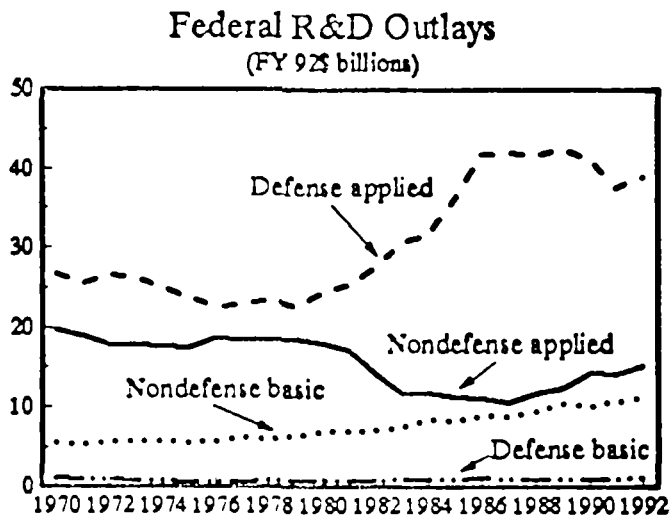
The total return to society from industry R&D has been well above the direct rates of return captured by firms making the investment.

- o The benefits from the new knowledge acquired by one firm "spill-over" to other firms that imitate or improve upon the initial innovation.
- o Productivity benefits accrue to users of the initial innovation as well. Over 40 percent of the R&D used by a typical manufacturing industry was developed by another industry. Outside of manufacturing little R&D is done, so the importation share is even larger.

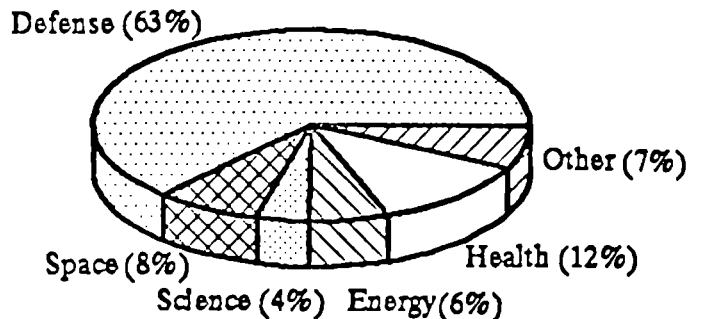
This indirect contribution is hard to measure, but might have accounted for another 0.2 percent of the productivity growth in the 1980s.

Federal: Federal Government R&D investment has also contributed to productivity growth, but to a much lesser extent than industry spending. In the past, the Federal Government has devoted much of its R&D to mission-oriented defense and space technology and to basic research. Relatively little has gone to direct output-increasing applications.

- o While defense R&D has had significant spill-overs into civilian applications, it is difficult to estimate the rate of return of investments focused on enhancing military objectives. The spill-overs include improvements in civilian aviation, lasers, micro-electronics, acute trauma care and communications satellites.



Federal R&D Spending by Budget Function
(FY 1980-92, percent of total)



- o It is also hard to estimate the rate of return on basic research, which accounted for almost 20 percent of Federal R&D spending since 1980. By definition, basic research is not intended to produce a commercial product, even though commercial payoffs often result from its intellectual foundation. For example, federally supported basic research contributed to the development of recombinant DNA, solar collectors, computer time-sharing, fiber optics, and disease-resistant crops.

R&D Trends

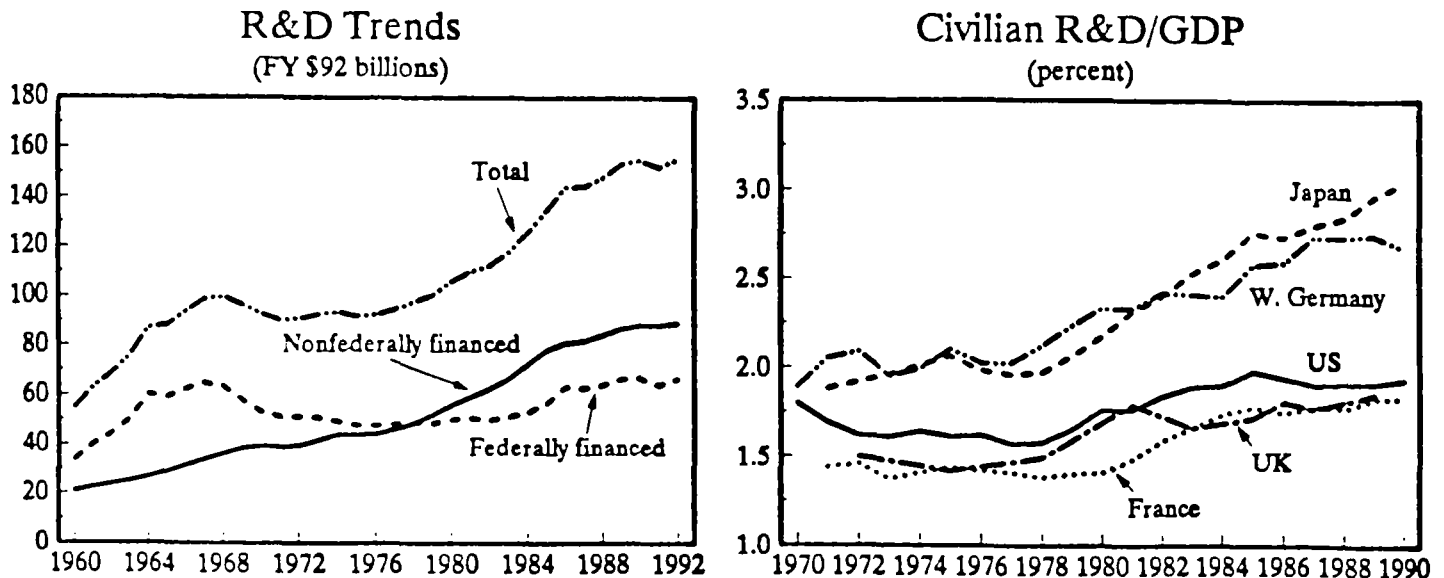
Last year, public and private R&D spending totaled \$157 billion, a gain of only 1.2 percent over 1991 after adjustment for inflation. The advance this year is likely to be small as well.

- o The Federal budget calls for little change in total R&D spending after adjustment for inflation in both FY 1993 and 1994. Industry R&D in 1993 is likely to increase less than 1 percent in real terms, according to a forecast produced by Battelle at the end of 1992. R&D spending is expected to be strong in communications, electronics, chemicals, materials, and energy-efficient products and process, but weak elsewhere, especially defense.

This lack of significant increases in overall R&D funding continues a trend that began in the mid-1980s. In contrast, during the decade 1975-85, real R&D investment rose a strong 5 percent per year on average.

- o During 1975-80, the two oil price shocks forced the Federal Government and industry to boost energy-related R&D. About half of the increase in total R&D was energy-related in that period.
- o During 1982-85, Federal defense R&D rose 8 percent per year, inducing a resurgence of R&D financed by defense-related industries.

The U.S. has had about the same overall R&D/GDP share as most other major industrial nations (about 2-1/2 percent). More importantly for economic growth, however, is the civilian share. By this standard, the U.S. has been investing relatively less of its resources in R&D than have Japan and Germany.



Administration R&D Policy

The Administration has embarked on a two-pronged strategy to raise the impact of R&D on economic growth: reorient Federal spending toward civilian applications and stimulate private R&D through enhanced tax advantages.

Outlays: The budget places a high priority on projects that facilitate the commercialization and use of new technologies, and a lower priority on purely military R&D and basic civilian research.

- o The FY 1994 budget calls for a 5 percent increase in nominal civilian R&D compared with only 1 percent for defense. After adjustment for inflation, civilian outlays will be

up slightly; defense outlays will be down. Even within defense R&D, a greater emphasis is placed on technologies with dual commercial and military applications relative to those with solely military uses.

- The reorientation will raise the civilian share in Federal R&D from FY 1993 (41 percent) to FY 1994 (42 percent). By FY 1998, the Administration expects the civilian share of Federal R&D to reach 50 percent.

Federal R&D Budget Authority					
	\$ billions			Percent change	
	FY 92	FY 93	FY 94	FY 93	FY 94
Total	68.1	70.3	72.1	3.3	2.5
Defense	40.1	41.6	42.0	3.8	0.9
Basic	1.1	1.4	1.3	21.7	-10.3
Applied	38.9	40.2	40.7	3.3	1.3
Civilian	28.0	28.7	30.1	3.8	4.9
Basic	11.8	12.3	12.7	4.0	3.1
Applied	16.1	16.4	17.4	1.6	6.3

- o The budget proposes a relatively large 6 percent nominal increase for applied civilian research and development. There is an emphasis on cost-shared joint activities with industry (e.g., consortia and cooperative R&D agreements). Civilian basic research increases 3 percent in nominal terms next fiscal year.

Tax Policy: The Administration proposes to enhance further the already favorable tax treatment of industry outlays for R&D by reinstating the "research and experimentation" tax credit that expired last June.

Currently, the tax code encourages private R&D in two ways.

- o First, equipment used in research is assumed to have a five-year life. This provides the benefits of accelerated depreciation to most R&D equipment.

- o Second, firms can deduct qualified research and experimentation expenses (principally, wages and supplies) as they are incurred, i.e., "expensing" them, rather than capitalizing and depreciating them over time like other investments. The expensing provision for R&E has a revenue cost of about \$2 billion in FY 1994.
 - Because of expensing, the marginal effective tax rate on research and experimentation investment is zero; if firms require a 6 percent after-tax real return, they would be willing to invest in research having a pretax return of 6 percent. In contrast, the pretax return would have to be higher (8 or 9 percent) for most other investments so that firms can cover their taxes.

The Administration has proposed enlarging the tax preferences for R&D by reinstating permanently the 20 percent tax credit for all qualified research and experimentation expenses above a historically determined base amount.¹ Because the social rate of return to R&D is much greater than the private return, this is an appropriate tax expenditure on economic grounds.

- o The Administration estimates that reinstating the tax credit would entail revenue losses of \$1.2 billion in FY 1994, rising to \$2.2 billion by 1998.
- o Two recent studies by respected researchers estimate that an earlier version of the tax credit may have created \$2 of new research for every \$1 of revenue lost. GAO, however, estimated that the credit was much less effective, generating only 15 to 36 cents of research for every dollar of lost revenue.
- o If the proposed measure generates additional private R&D in each year equal to the lost revenues, an estimate in the middle of the range found by researchers, then annual industry R&D would be boosted by about 1 to 2 percent. While not a large benefit, this still makes the tax credit a sound Federal policy. Based on the social payoffs to R&D, reinstating the tax credit would generate total returns considerably higher than most other Federal investments and tax expenditures.

The tax credit has the advantage that individual projects are chosen by industry. This helps to insure that the R&D funds are allocated to the most valuable projects.

¹Each firm's base is determined by calculating research expenses in 1984-88 as a percentage of the firm's sales during those years. This percentage is then multiplied by the average of sales during the most recent four years. For example, if research spending in 1984-88 was 10 percent of a firm's sales and sales in 1989-92 averaged \$100 million, then the base would be \$10 million. If research totaled \$15 million in 1992, the tax credit would be \$1 million (20 percent times the \$15 million of new research minus the \$10 million base).

Conclusion

Despite the slow growth of overall R&D investment in recent years, there is reason to be cautiously optimistic about its future contribution to growth.

- o The Federal Government is shifting its funding toward areas with higher productivity impacts. Its and industry's curtailment of specialized defense R&D outlays may have little negative effect on productivity growth.
- o For the private sector, passage of the Administration's permanent research and experimentation tax credit will provide a boost to spending. Lower interest rates and less reliance on corporate debt financing can be expected to tilt investment decisions toward those with longer-term payouts, such as R&D.

More importantly, a resumption of sustained economic growth will create the strong cash flow firms need to commit resources to R&D, and will provide healthy markets for the commercial products and processes that result from this new knowledge.

RECENT ECONOMIC INDICATORS AS OF APRIL 16, 1993
(S.A. OR AS INDICATED)

	Feb-92	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93
GDP (Quarterly Series, % A.R.)														
Nominal GDP		6.2			4.3			5.3			7.1			
Real GDP		2.9			1.5			3.4			4.7			
Implicit Price Deflator		3.1			2.7			2.0			2.3			
Fixed-Weight Price Index		3.7			3.0			2.0			3.3			
CYCLICAL INDICATORS														
Leading Index, Percent	0.7	0.4	0.3	0.6	-0.3	0.1	-0.2	0.1	0.5	0.5	1.7	0.0	0.5	NA
Coincident Index, Percent	0.5	0.0	0.0	0.0	-0.1	0.4	-0.5	0.1	0.5	0.2	1.0	-0.2	0.2	NA
Purchasing Managers' Diffusion Index	53.4	54.8	52.2	55.7	52.3	53.0	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4
Percent	9.4	2.6	-4.7	6.7	-6.1	1.3	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3
Industrial Production	107.2	107.6	108.1	108.9	108.5	109.4	109.1	108.9	109.7	110.4	111.0	111.4	112.0	112.0
Percent	0.56	0.37	0.46	0.74	-0.37	0.83	-0.27	-0.18	0.73	0.64	0.54	0.36	0.54	0.00
Capacity Utilization, Manufacturing	77.4	77.5	77.7	78.2	77.8	78.1	77.9	77.5	77.9	78.3	78.5	79.0	79.2	79.1
EMPLOYMENT INDICATORS														
Civilian Employment, Million	117.0	117.3	117.5	117.6	117.5	117.7	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6
Nonfarm Payroll Employment, Million	108.1	108.2	108.4	108.5	108.4	108.6	108.5	108.5	108.6	108.6	108.8	108.9	109.2	109.2
Civilian Unemployment Rate, Percent	7.3	7.3	7.3	7.4	7.7	7.6	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0
Employment/Population Ratio	61.3	61.4	61.5	61.5	61.4	61.4	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4
Average Weekly Hours, Manufacturing	41.1	41.1	41.1	41.3	41.0	41.0	41.0	40.9	41.1	41.2	41.2	41.4	41.5	41.2
CONSUMER SECTOR														
Retail Sales, Billion \$	161.1	159.9	160.2	161.3	161.1	162.3	163.2	164.2	167.6	167.3	169.2	169.2	168.7	166.9
Percent	1.3	-0.7	0.2	0.7	-0.1	0.7	0.6	0.6	2.1	-0.2	1.1	0.0	-0.3	-1.0
Total Auto Sales, Million Units, A.R.	8.5	8.3	8.2	8.4	8.9	8.3	7.9	8.3	8.3	8.2	8.7	8.6	8.0	8.3
Domestic Auto Sales, Million Units, A.R.	6.2	6.0	6.0	6.3	6.7	6.4	6.0	6.3	6.3	6.2	6.7	6.6	6.0	6.3
Personal Income, Billion \$, A.R.	4988.7	5009.6	5015.4	5032.7	5038.5	5048.7	5056.4	5080.9	5145.0	5143.7	5194.0	5219.2	5229.1	NA
Percent	0.9	0.4	0.1	0.3	0.1	0.2	0.2	0.5	1.3	-0.0	1.0	0.5	0.2	NA
Disposable Personal Income, Billion \$, A.R.	4360.8	4400.6	4400.7	4415.1	4419.5	4424.6	4426.3	4448.7	4505.9	4500.4	4545.4	4562.4	4571.9	NA
Savings Rate, Percent	4.9	5.3	5.5	5.3	5	4.8	4.6	4.6	4.4	4.4	4.4	4.3	NA	NA
Real Personal Income, Billion \$75, A.R.	4079.1	4076.2	4070.9	4078.4	4076.5	4078.1	4094.3	4090.9	4125.9	4118.3	4155.2	4162	4156.7	NA
Percent	0.5	-0.1	-0.1	0.2	-0.0	0.0	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.1	NA
Real Disposable Personal Income, Billion \$75, A.R.	3565.9	3581.9	3573.3	3578.6	3576.1	3574.4	3585.5	3581.7	3613.4	3604	3637.1	3638.2	3634.8	NA
Percent	0.5	0.4	-0.2	0.1	-0.1	-0.0	0.3	-0.1	0.9	-0.3	0.9	0.0	-0.1	NA
Consumer Sentiment Index, U of Michigan	68.8	76.0	77.2	79.2	80.4	76.6	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9
Percent	1.9	10.5	1.6	2.6	1.5	-4.7	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8
HOUSING SECTOR														
Housing Starts, Thousand Units, A.R.	1285	1318	1095	1197	1141	1106	1229	1218	1226	1226	1286	1178	1208	NA
Single-Family Starts	1137	1050	939	1019	994	961	1038	1045	1079	1089	1133	1061	1052	NA

	Feb-92	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93
BUSINESS SECTOR														
Nondefense Capital Goods Orders, Billion \$	29.5	32.2	29.9	30.5	31.0	29.3	28.2	30.6	31.7	28.6	34.0	30.4	34.7	NA
Percent	-2.1	9.2	-7.0	1.9	1.6	-5.4	-3.9	8.6	3.6	-9.7	19.0	-10.8	14.4	NA
Nonresidential Construction Put in Place, Billion \$	125.0	128.5	127.2	124.1	127.6	124.7	117.8	122.5	123.3	122.7	122.2	123.2	123.5	NA
Inventory/Change Book Value, Billion \$, A.R.	8.7	29.3	32.4	-4.4	55.4	40.6	27.0	-11.5	11.4	14.9	26.6	26.6	36.3	NA
Inventory/Sales Ratio, Total Business	1.51	1.51	1.51	1.51	1.50	1.50	1.52	1.50	1.49	1.49	1.46	1.46	1.46	NA
INFLATION INDICATORS														
CPI, Percent	0.2	0.4	0.3	0.1	0.2	0.3	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1
CPI Less Food and Energy, Percent	0.3	0.3	0.3	0.3	0.1	0.3	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1
PPI Finished Goods, Percent	0.2	0.2	0.2	0.3	0.2	0.0	0.1	0.2	0.1	-0.2	0.0	0.2	0.4	0.4
PPI Less Food and Energy, Percent	0.1	0.3	0.3	0.4	-0.2	0.1	0.0	0.1	-0.1	0.2	0.1	0.4	0.3	0.1
Gold, \$ per ounce	353.8	343.8	338.2	337.3	341.3	353.2	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3
W. Texas Spot Oil Price, \$/bbl	19.0	18.9	20.2	20.9	22.4	21.8	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3
MERCHANDISE TRADE														
Exports, Billion \$, A.R.	451.9	445.0	436.9	428.6	458.0	453.7	429.6	454.6	468.9	458.2	476.1	445.8	446.2	NA
Imports, Billion \$, A.R.	492.9	513.7	521.9	514.8	539.5	542.0	539.7	558.6	555.9	546.4	558.7	531.7	532.5	NA
Deficit, Billion \$, A.R.	-41.1	-68.7	-85.1	-86.2	-81.5	-88.4	-110.1	-104.0	-87.0	-88.2	-82.7	-85.9	-86.4	NA
U.S. EXCHANGE RATE														
Multilateral	88.0	90.4	89.8	88.3	85.9	82.6	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7
Percent	2.3	2.7	-0.7	-1.7	-2.7	-3.9	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2
Yen/\$	127.7	132.9	133.5	130.8	126.8	125.9	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0
DM/\$	1.62	1.66	1.65	1.62	1.57	1.49	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65
\$/Pound	1.78	1.72	1.76	1.81	1.86	1.92	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46
MONEY AND CREDIT														
M2, Billion \$	3467.7	3467.8	3464.8	3467.5	3462.1	3463.6	3472.4	3480.2	3491.4	3498.0	3496.9	3486.9	3474.0	3471.8
Percent	6.0	0.0	-1.0	0.9	-1.9	0.5	3.1	2.7	3.9	2.3	-0.4	-3.4	-4.4	-0.8
M3, Billion \$	4189.0	4184.9	4177.9	4179.8	4170.1	4169.0	4178.7	4182.9	4179.8	4178.4	4166.4	4140.6	4132.7	4128.0
Percent	4.9	-1.2	-2.0	0.5	-2.7	-0.3	2.8	1.2	-0.9	-0.4	-3.4	-7.2	-2.3	-1.4
C&I Loans & Commercial Paper, Billion \$, N.S.A.	994.9	1000.0	996.8	1000.0	996.8	991.5	986.8	982.1	988.2	991.6	996.9	NA	NA	NA
Percent, A.R.	8.2	6.3	-3.8	3.9	-3.8	-6.2	-5.6	-5.5	7.7	4.2	6.6	NA	NA	NA
C&I Loans, Billion \$	455.5	454.3	452.3	454.3	452.3	448.0	443.6	440.1	440.3	439.9	441.0	NA	NA	NA
Commercial Paper, Billion \$	539.4	545.7	544.5	545.7	544.5	543.5	543.2	542.0	547.9	551.7	555.9	NA	NA	NA
INTEREST RATES														
Federal Funds Rate	4.1	4.0	3.7	3.8	3.8	3.3	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1
T-Bill, 3 Month	3.8	4.0	3.8	3.6	3.7	3.2	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0
T-Bond, 30 Year	7.9	8.0	8.0	7.9	7.8	7.6	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8
Corporate AAA Bonds	8.3	8.4	8.3	8.3	8.2	8.1	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6
Mortgage Commitment Rate	8.8	8.9	8.9	8.7	8.5	8.1	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5
STOCK MARKET														
Dow Jones 30 Industrials	3257.3	3247.4	3294.1	3376.8	3337.8	3329.4	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7
Standard & Poor's 500	412.6	407.4	407.4	414.8	408.3	415.1	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2

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FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

August 20, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

SUMMARY

This Friday Report examines the view that a "credit crunch" prevented firms and consumers from gaining access to credit, and thereby worsened the 1990 recession and weakened the subsequent economic recovery. Credit normally contracts during an economic slowdown. The current credit contraction, however, has been far more pronounced and protracted than normal. This Report attributes the severity of the current downturn to two factors that go well beyond the normal functioning of the credit cycle:

- **Bank Capital Crunch** -- The collapse of the real estate market in the late 1980s led to falling bank equity values in New England and other regions. The imposition of stricter (albeit long-overdue) capital standards coincided with this reduction in equity and forced banks to constrain lending until bank capital ratios satisfied the new Basle standards.
- **Deleveraging of Corporate and Personal Indebtedness** -- Increased debt finance during the 1980s left both businesses and consumers extremely vulnerable to reductions in cash flow. As a result, the collapse of real estate values and the onset of the recession led to a self-reinforcing deterioration in borrower creditworthiness and a need for balance sheet restructuring.

While the capital constraints on banks have been largely satisfied thanks to record bank profits, on-going balance sheet restructurings are likely to continue to retard credit expansion and economic growth over the coming year.

Reassessing the "Credit Crunch"

Recovery from the 1990 recession has been sluggish relative to previous cyclical upturns. This may have been partly due to the post-1989 weakness in bank lending, popularly known as the "credit crunch." This Friday Report examines the history of the credit cycle and compares the current lending "crunch" with previous contractionary episodes. It argues that the severity and length of the recent decline in bank lending are due to factors that go well beyond a typical credit contraction. These factors include the deleveraging of corporate and personal balance sheet indebtedness and the stricter capital requirements imposed on banks following the S&L fiasco of the 1980s.

Credit Cycles and the Importance of Bank Lending

A "credit crunch" refers to a reduction in the supply of bank loans offered at any given interest rate or a worsening of loan terms for any given borrower. During a credit crunch, fewer new loans are extended and fewer existing loans are rolled over. Because the reduction in loans is typically supply-driven, an excess demand for funds develops, and previous bank borrowers are forced to look to alternate sources of borrowing or forgo planned investment projects.

Traditional macroeconomic analysis assumes that firms can always find alternate sources of credit and have little or no trouble financing profitable investment projects. An alternative "credit" view, however, challenges this assumption, asserting that the cost of finding alternate finance is often significant. The credit view attributes these costs to one of two factors that give bank loans a "special" role in the allocation of financial resources.

- Bank loans and other forms of credit are not perfect substitutes. Firms cannot costlessly switch between bank and nonbank suppliers of credit.
- Given the problems of moral hazard and adverse selection, banks often maximize their expected return by rationing the volume of credit at a preset interest rate instead of allowing the credit market to clear by setting a higher rate. If banks allowed their interest rate to rise to market-clearing levels, their expected return would fall; creditworthy applicants would borrow elsewhere, leaving the bank with a riskier pool of potential borrowers who plan more speculative investments.

According to the credit view, changes in bank lending can have a real impact on the overall economy through the "credit channel." A reduction in bank lending, possibly in response to tighter monetary policy, leads to a rise in the cost of funds (or reduced access to credit in the case of rationing) for firms that cannot obtain alternate sources of credit at comparable terms. As real resources fall with the increase in firms' cost of funds or increased rationing, businesses may have to cut back on investment plans, placing a drag on economic growth.

The Credit Cycle -- Over the past 40 years, credit cycles have tended to follow a boom-bust pattern, with monetary policy usually initiating the bust in the cycle.

- A typical credit cycle starts with a jump in investment. As asset prices rise, firms begin pledging previously leveraged collateral to obtain borrowing for additional investments. Expectations of continued asset price inflation provide both borrowers and lenders with a false sense of security, leading to an easing of bank credit terms and more speculative or leveraged financial transactions.
- At some point, however, usually when the Federal Reserve moves to stem inflationary pressure with tighter monetary policy, there is a downward shift in firms' expectations of revenue or profit, driving expected asset earnings below required debt service payments for weaker firms. Firm balance sheets deteriorate and lenders become more cautious in the face of rising credit risks. Yield spreads between risky assets and safe assets start to rise -- reflecting the increase in market risk.
- As actual returns from new and existing capital assets fall below expectations, asset prices start to decline. This reduction in the market value of assets can accelerate if receipts fall short of interest payments on outstanding debt, forcing borrowers to sell assets, especially commercial real estate, to raise funds to pay off troubled loans.
- Finally, banks, which are by nature highly leveraged, suffer capital losses from loan write-offs and begin to restrict access to credit. It is at this point, when banks start to restrict the issuance of credit, that the credit channel becomes blocked. This chokes a wide range of businesses and restricts overall economic growth. Small business, which is often the first place banks ration credit, is especially hard hit because small firms do not share the same access to alternate financial resources as their larger brethren.

The 1990 Credit Crunch

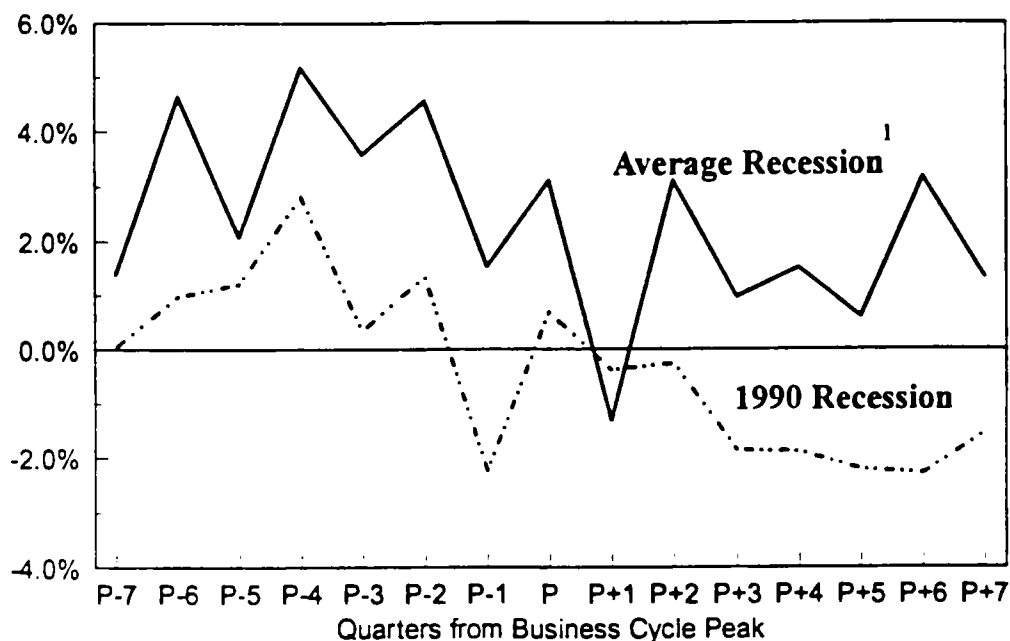
The latest credit contraction is unique in its severity and duration. Since the end of 1989, business lending by commercial banks has fallen by more than 14 percent (\$92 billion), with sharper contractions in the Northeast (16.8 percent), the Southwest (14.8 percent), and the West (16.1 percent). As shown in the chart below, this contraction in bank business lending has been far more pronounced than in previous credit cycles.

What Explains the Current Tightness in Credit?

The most recent credit crunch is not the result of tight monetary policy, the normal cause of increases in the cost of credit and reduced bank lending.

- Interest rates on three-month Treasury bills fell to a 30-year low of 2.86 percent last October and have remained below 3.0 percent through the first half of 1993.
- Bank reserves and the monetary base have ballooned over the past two years. Total reserves have grown at an annual rate of 16 percent and the monetary base at 10 percent.

New Commercial Bank Lending
(Percent Change, Annual Rate)



(1) Average over last 6 recessions, excluding 1981.

In addition, unlike many previous cycles, disintermediation was not a factor in the recent contraction. As shown in Table 1, new lending was depressed across all financial sectors and loan types and not just limited to commercial banks. The issuance of nonfinancial commercial paper, the primary alternative to bank lending, actually fell 4 percent over the past three years.

New Lending by Financial Institution and Loan Type

Percent Change 1989:Q4-1993:Q1

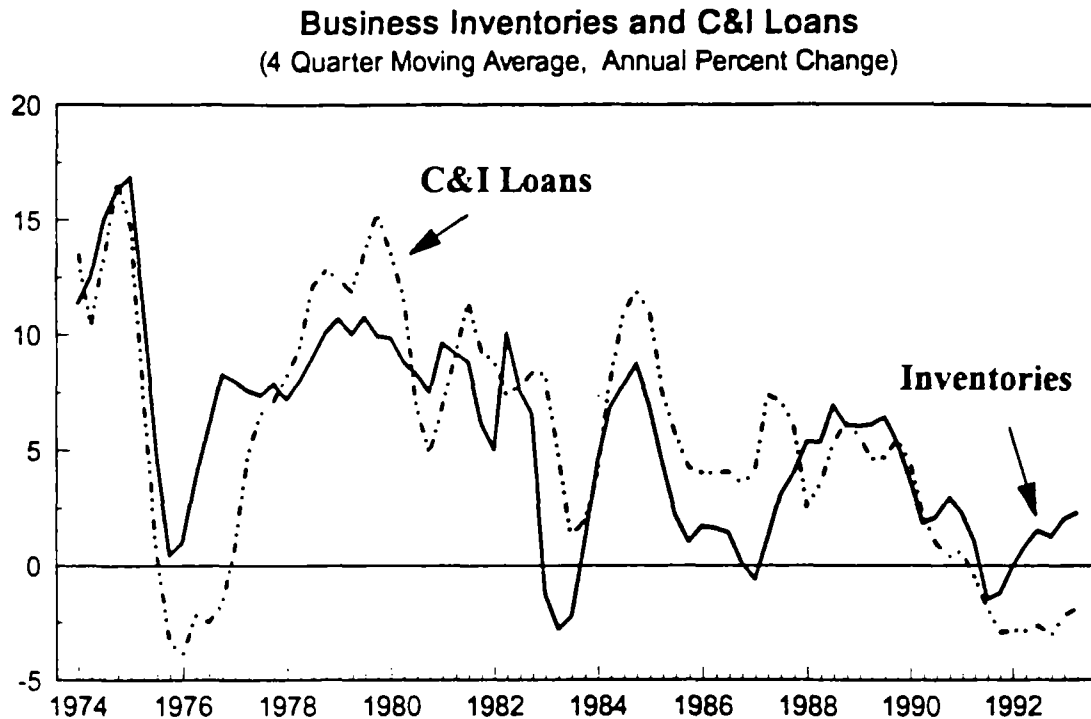
	Business	Mortgages	Consumers
U.S. Commercial Banks	-14.1	15.1	-6.2
Thriffs	-88.3	-38.2	-7.1
Finance Companies	8.7	21.1	-19.8
Insurance Companies	30.1	-1.7	NA
Securitized Credit Obligations	669.8	NA	142.0

\$ Billions 1989:Q4-1993:Q1

	Business	Mortgages	Consumers
U.S. Commercial Banks	-92.3	110.9	-23.7
Thriffs	-25.6	-264.7	-10.1
Finance Companies	23.5	42.8	-28.6
Insurance Companies	17.3	-4.1	NA
Securitized Credit Obligations	13.5	NA	69.2
Net Change	-63.6	-115.1	6.8

Like its predecessors, however, the current cycle shares the feature of being at least partially supply constrained.

- The close relationship between business inventories and banks' commercial and industrial (C&I) lending has diverged since the start of the recession, indicating a supply constraint or structural shift in the source of inventory finance. In the past, large firms have used C&I loans to finance a build-up of inventories at the start of an economic recovery. During the current cycle, however, C&I lending has remained flat and the build-up in inventories has largely been financed with internal funds or nonbank credit.



- The spreads between the Federal funds rate and rates on corporate and consumer loans remain at historically high levels, despite large drops in the spreads on nonbank credit.
- The mixed signals provided by current monetary indicators are characteristic of a blockage in the credit channel. While the extremely slow growth in M2 signals a less accommodating monetary policy, historically low interest rates and rapid growth in bank reserves indicate otherwise.

The severe and protracted decline in post-1989 lending can be attributed to two factors.

- Bank capital crunch: Falling equity values, as loan delinquencies and defaults soared, and long-overdue but poorly timed stricter capital standards forced banks to constrain lending until bank capital ratios satisfied the new Basle standards.
- Balance-sheet deleveraging: Highly leveraged corporate and consumer balance sheets led to a self-reinforcing deterioration in borrower creditworthiness.

The Capital Crunch: New England Experience -- Evidence of a bank "capital" crunch originates mostly from the recent experience in New England, where the collapse of the commercial real estate market and the phase-in of stricter loan oversight and bank capital standards played a significant role in the decline in bank lending.¹ The New England episode was due largely to the puncture of a large speculative bubble in the regional real estate market. The bubble was set off by the passage of favorable real estate tax provisions in 1981 that were largely eliminated by the 1986 Tax Reform Act. The collapse of regional real estate values in the late 1980s increased bank loan write-offs and critically depleted bank capital. Banks, in transitioning to the stricter (albeit long-overdue) capital standards established in the international Basle accord, were forced to raise capital by selling assets and constraining loan growth -- leading to a "capital" crunch during the 1989-1990 period. The same pattern of contracting bank balance sheets later emerged in the Mid-Atlantic region and, more recently, in the West.

Given this serious asset squeeze and the new risk-weighted capital standards, banks also found it much more profitable to invest their surplus funds in government securities rather than in private loans. The steepness in the Treasury yield curve made this shift in asset portfolios especially attractive to banks. The high rates of return on basically risk-free Treasury notes and bonds simply represented a better investment when compared with the less attractive rates on more risky real estate loans that carry an 8 percent risk-based capital requirement.

The steep yield curve is widely expected to narrow in the coming years as the economic expansion gathers momentum and the Federal budget deficit is reduced. When this occurs, the structure of interest rates should resume a more typical historical pattern and banks should begin to shift assets back toward commercial loans and other risky assets. Already, the Administration's deficit reduction package has prompted long-term Treasury bond rates to fall to 6.2 percent, down by almost 125 basis points since the end of 1992.

The Unwinding of the Leverage Boom -- Unlike past credit cycles, the latest credit squeeze was precipitated by a leverage boom, not an investment boom. Almost \$600 billion of the \$1 trillion in net new borrowing by nonfinancial corporations during the 1984-1989 period went into acquisitions, buyouts, stock repurchases, and other highly leveraged transactions.² Total business-sector debt rose from just 52 percent of GDP in 1980 to a peak of almost 67 percent in 1989. Meanwhile, household debt rose from just under 50 percent of GDP to over 68 percent in 1991. Total government debt rose from 37 percent to just over 66 percent of GDP by the end of last year.

Many causes of the mid-1980s leverage boom have been cited, including overly optimistic projections of firm earnings, tax advantages, banking deregulation, and the increasing

¹Syron, Richard F., "Are We Experiencing a Credit Crunch?" New England Economic Review, Federal Reserve Bank of Boston, July/August 1991.

²Friedman, Benjamin, "The Minsky Cycle in Action: But Why?" Quarterly Review, Federal Reserve Bank of New York, Spring 1993.

popularity of debt finance.³ Regardless of the motivation, the impact of the increased corporate propensity for debt finance was to increase the sensitivity of corporate profits to changes in cash flows. The protracted decline in real estate values and the onset of the 1990 recession forced highly leveraged firms facing falling cash flows to shed workers and scrap investment plans faster than less-leveraged firms. Meanwhile, deteriorating balance sheets impaired leveraged firms' ability to raise external funds. In a feedback process, this cutback in firm spending spilled over into the performance of financial intermediaries and the economy more broadly.

Thus, the highly leveraged position of corporate balance sheets exacerbated the decline in business lending as borrower creditworthiness plummeted with earnings, in what Bernanke and Gertler referred to as a type of "financial accelerator" in the contraction of credit.⁴ The perseverance of the current contraction in bank lending through 1992 and into early 1993 has been largely driven by this firm deleveraging -- most borrowers were either not creditworthy enough to borrow or were more interested in reducing debt burdens than in taking on new debt. A similar pattern emerged in the consumer sector.

Credit for the Future?

While the precipitating cause of the credit crunch will remain the subject of debate, the principal factors that led to the sustained decline in lending over the 1990-1993 period are becoming better understood. Looking forward, commercial banks appear to be in a strong position to resume lending. Banks are flush with cash and capital, thanks to record profits last quarter; and the Administration's commitment to deficit reduction has helped lower the premium on long-term Treasury securities, increasing the attractiveness of commercial loans. In the end, however, it will be the demand-side factors that continue to dominate the pace of recovery. Credit growth will remain weak over the next several quarters until both consumers and businesses complete their balance sheet restructuring, laying the foundation for the next investment cycle.

³The popularity of corporate leveraging followed the widespread acceptance of Jensen's "free cash flow" theory which claimed that long-term corporate savings can be generated through leveraged streamlining of corporate operations. Jensen, Michael, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers." American Economic Review, May 1986, pp. 323-29.

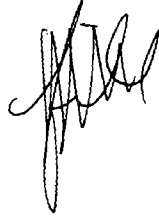
⁴Bernanke, Ben and Mark Gertler, "Financial Fragility and Economic Performance." The Quarterly Journal of Economics, vol 105, February 1990, pp. 87-114.

RECENT ECONOMIC INDICATORS AS OF AUGUST 20, 1993
(S.A. OR AS INDICATED)

	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP			5.3			7.1			4.3			4.0	
Real GDP			3.4			4.7			0.7			1.6	
Implicit Price Deflator			2.0			2.3			3.3			2.6	
Fixed-Weight Price Index			2.3			3.3			4.3			2.6	
CYCLICAL INDICATORS													
Leading Index, Percent	0.1	-0.2	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.3	-0.4	0.1	NA
Coincident Index, Percent	0.4	-0.5	0.1	0.5	0.2	1.0	0.0	0.2	0.0	-0.2	0.3	-0.3	NA
Purchasing Managers' Diffusion Index	53.0	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5
Percent	1.3	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5
Industrial Production	106.8	106.6	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.2	110.6
Percent	0.75	-0.19	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.00	0.36
Capacity Utilization, Manufacturing	78.9	78.7	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.6	80.4	80.4
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.7	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3
Nonfarm Payroll Employment, Million	108.6	108.6	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3
Civilian Unemployment Rate, Percent	7.6	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8
Employment/Population Ratio	61.4	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6
Average Weekly Hours, Manufacturing	41.1	41.1	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4
CONSUMER SECTOR													
Retail Sales, Billion \$	162.4	163.2	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.1	172.3
Percent	0.7	0.5	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.2	0.1
Total Auto Sales, Million Units, A.R.	8.3	7.9	8.3	8.3	8.2	8.7	8.6	8.0	8.3	8.9	9.1	9.1	8.7
Domestic Auto Sales, Million Units, A.R.	6.4	6.0	6.3	6.3	6.2	6.7	6.6	6.0	6.3	6.8	6.9	7.1	6.7
Personal Income, Billion \$, A.R.	5048.7	5056.4	5080.9	5145.0	5143.7	5194.0	5223.1	5229.0	5260.8	5271.0	5298.7	5296.2	NA
Percent	0.2	0.2	0.5	1.3	-0.0	1.0	0.6	0.1	0.6	0.2	0.5	-0.0	NA
Disposable Personal Income, Billion \$, A.R.	4424.6	4426.3	4448.7	4505.9	4500.4	4545.4	4566.3	4573.2	4605.4	4611.8	4632.4	4629.3	NA
Savings Rate, Percent	4.8	4.6	4.6	4.4	4.4	4.4	4.5	4.9	4.8	4.8	4.3	NA	NA
Real Personal Income, Billion \$75, A.R.	4078.1	4094.3	4090.9	4125.9	4118.3	4155.2	4161.8	4156.6	4171.9	4166.8	4185.4	4183.4	NA
Percent	0.0	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.1	0.4	-0.1	0.4	-0.0	NA
Real Disposable Personal Income, Billion \$75, A.R.	3574.4	3585.5	3581.7	3613.4	3604	3637.1	3639.9	3634.3	3652.6	3646.7	3658.7	3655.6	NA
Percent	-0.0	0.3	-0.1	0.9	-0.3	0.9	0.1	-0.2	0.5	-0.2	0.3	-0.1	NA
Consumer Sentiment Index, U of Michigan	76.6	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0
Percent	-4.7	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1106	1229	1218	1226	1226	1286	1171	1180	1124	1206	1248	1246	1212
Single-Family Starts	961	1038	1045	1079	1089	1133	1051	1036	987	1059	1107	1078	1060

	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	28.7	27.5	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.4	NA
Percent	-4.8	-4.3	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	11.5	NA
Nonresidential Construction Put in Place, Billion \$	129.4	125.0	128.2	130.3	128.9	128.9	128.3	129.1	131.5	131.2	134.5	133.9	NA
Inventory Change Book Value, Billion \$, A.R.	36.5	23.5	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	16.9	NA
Inventory/Sales Ratio, Total Business	1.50	1.52	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.47	NA
INFLATION INDICATORS													
CPI, Percent	0.3	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1
CPI Less Food and Energy, Percent	0.3	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1
PPI Finished Goods, Percent	0.0	0.1	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.5	0.0	-0.3	-0.2
PPI Less Food and Energy, Percent	0.1	0.0	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.2	0.2	-0.1	0.1
Gold, \$ per ounce	353.2	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1
W. Texas Spot Oil Price, \$/bbl	21.8	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	449.2	436.4	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.8	NA
Imports, Billion \$, A.R.	539.3	540.6	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.5	NA
Deficit, Billion \$, A.R.	-90.1	-104.2	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	NA
U.S. EXCHANGE RATE													
Multilateral	82.6	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6
Percent	-3.9	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0
Yen/\$	125.9	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7
DM/\$	1.49	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72
\$/Pound	1.92	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50
MONEY AND CREDIT													
M2, Billion \$	3463.6	3472.4	3480.2	3491.4	3498.0	3496.9	3486.9	3475.4	3472.8	3474.4	3504.9	3511.0	3515.1
Percent	0.5	3.1	2.7	3.9	2.3	-0.4	-3.4	-3.9	-0.9	0.6	11.1	2.1	1.4
M3, Billion \$	4169.0	4178.7	4183.0	4180.0	4178.5	4166.4	4141.0	4135.4	4131.0	4141.9	4171.2	4166.7	4158.9
Percent	-0.3	2.8	1.2	-0.9	-0.4	-3.4	-7.1	-1.6	-1.3	3.2	8.8	-1.3	-2.2
C&I Loans & Commercial Paper, Billion \$, N.S.A.	966.0	981.4	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA
Percent, A.R.	-26.3	20.9	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA
C&I Loans, Billion \$	422.8	439.3	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA
Commercial Paper, Billion \$	543.2	542.0	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA
INTEREST RATES													
Federal Funds Rate	3.3	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1
T-Bill, 3 Month	3.2	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0
T-Bond, 30 Year	7.6	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6
Corporate AAA Bonds	8.1	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2
Mortgage Commitment Rate	8.1	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2
STOCK MARKET													
Dow Jones 30 Industrials	3329.4	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4
Standard & Poor's 500	415.1	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3

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FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D.C. 20503

September 3, 1993

MEMORANDUM FOR THE DIRECTOR

FROM:

Ahmad for
Joseph J. Minarik

SUBJECT:

Friday Economic and Financial Report

SUMMARY

Despite the small decline in August payroll employment, the economy continues to grow at a modest pace.

- Labor input gains during July and August are consistent with the Mid-Session Review growth in the third quarter.
- Since December, employment has increased 1.2-1.4 million, and the unemployment rate at 6.7 percent is a full percentage point below a year ago.
- However, industrial jobs declined again, partly offset by an increase in hours worked to peak levels, and construction employment also declined.
- The labor report helped send Treasury bond yields below 6 percent.

The GDP revisions for 1990 through 1993 contained good news on economic growth and productivity.

- Real GDP growth was marked up slightly in the second quarter of 1993, as upward revisions in inventories and government spending offset a sharp decline in net exports.
- The 1991 recession was milder and the subsequent recovery was stronger than estimated previously. Since the recession trough, GDP growth has averaged 2.4 percent, 0.4 percentage points faster than prior estimates. That is still a lackluster pace compared with the average 4.8 rate during a typical postwar recovery.

HAPPY LABOR DAY

Labor markets continued to improve in August, albeit at a slow pace. Aggregate hours worked in July and August were up 2.8% at an annual rate over the second quarter level -- a good start toward third quarter GDP growth even before September employment and productivity growth for the quarter are factored in.

The two measures of employment changed in opposite directions this month. Households reported a large increase of 409,000 -- but that followed two months of little or no increase in this series. Business establishments, in contrast, reported a 39,000 decline in payrolls, following a large 211,000 increase in July. Averaging out these wiggles, however, it is clear that employment has been improving at a modest pace. Since December 1992, employment is up 1.4 million by the household measure, and nearly 1.2 million measured by payrolls.

This progress is finally improving the unemployment rate. It was 6.7 percent in August, down 0.3 percentage point from June and a full percentage point from a year ago.

LABOR MARKET INDICATORS							
	1993						
	Q1	Q2	Apr	May	Jun	Jul	Aug
Unemployment Rate	7.0	7.0	7.0	6.9	7.0	6.8	6.7
Unemployment (millions)	8.9	8.9	8.9	8.9	8.9	8.8	8.7
Average Monthly Change (1000s)							
Employment	114	202	-149	857	-54	82	409
Unemployment	-134	-7	61	-67	50	-139	-108
Payroll Jobs	172	182	255	238	43	211	-39
Private	163	167	243	219	39	191	-28
Manufacturing	9	-40	-72	-36	-56	-14	-42
Mining	-4	-2	0	2	-6	-1	-4
Construction	7	24	36	60	-3	22	-8
Services	151	186	279	193	104	184	26
Government	9	15	12	19	4	20	-11

However, the industrial sector is still sluggish.

- o The number of **manufacturing** jobs declined 42,000 in August, continuing the trend of the past several months. Weakness in the factory sector is also evident in the National Association of Purchasing managers' Index, which edged down to 49.3 percent in August. Combining the decline in manufacturing employment and the gains in factory workweek and overtime hours, industrial production was probably flat in August (data to be released September 16).
- o Elsewhere, additions to payroll were subdued. **Services** added 34,000 jobs in August, only about a third of the average monthly increase of the past year and a half. **Retail trade** was flat last month, although it had experienced a steady improvement since early 1992. Finally, there was little or no growth in **construction** employment over the summer months, following fairly strong gains earlier in the year.

The modest pace of labor market gains helped to spur a further rally in the bond market. The long-term Treasury bond yield fell to 5.95 percent, the lowest rate in over 25 years. Since the election, bond yields have declined a cumulative 1-3/4 percentage points.

REVISED GDP ESTIMATES

The latest revisions of the National Income and Product Accounts show that growth during 1990-1992 was stronger than previously estimated. There was a slight upward revision in growth for this year.

Real GDP growth in the second quarter was better than most analysts had expected. It was marked up from an annual rate of 1.6 to 1.8 percent, whereas expectations had been for a downward revision because of the wider merchandise trade deficit in June. Growth in the first half of this year, however, averaged only 1.3 percent, well below the revised 4.5 percent annual rate during the second half of 1992.

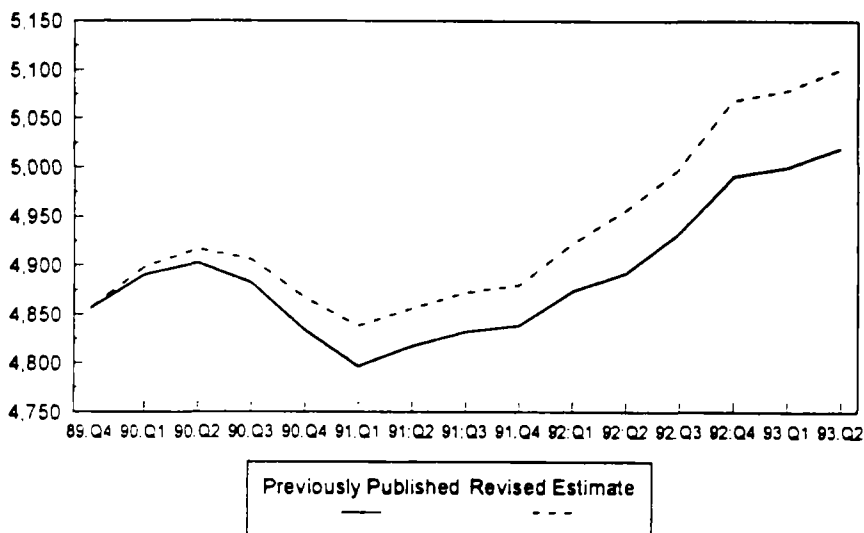
- o Net exports, previously estimated as little changed in the second quarter, showed a sharp drop, subtracting nearly 1 percentage point from overall GDP growth.
- o The downward revision in trade was, however, more than offset by a smaller decline in the rate of inventory accumulation, an upward revision in government purchases (particularly state and local), and slightly stronger numbers for most other GDP components [see Attachment for details].

The 1990-91 recession was milder and the subsequent economic recovery was stronger than estimated previously.

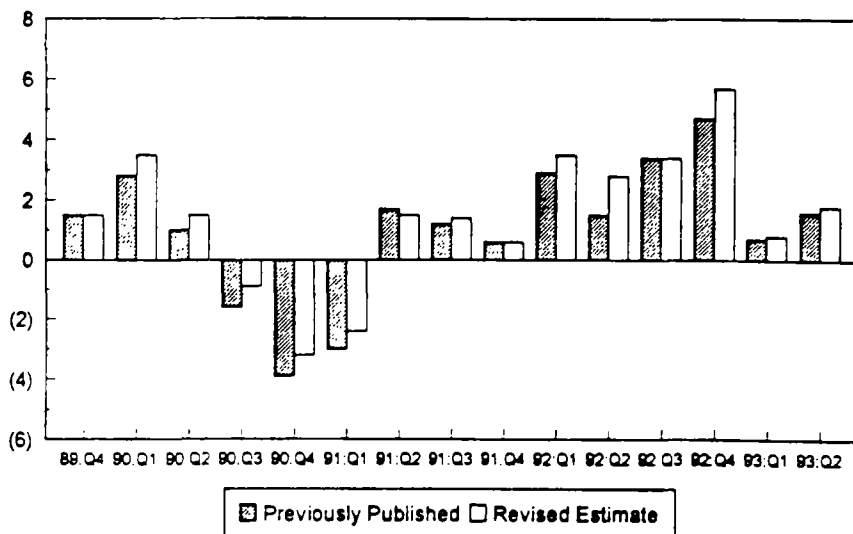
- o Real GDP declined 2.1 percent (annual rate) from the cyclical peak in Q2/1990 to the trough of the recession in Q1/1991. In the previously published estimates, it had declined 2.9 percent.
- o During the expansion since Q1/1991, real GDP has grown at an annual rate of 2.4 percent, or 0.4 percentage point faster than previously estimated. That is still a lackluster performance when compared with the average 4.8 percent rate of growth in a typical postwar recovery.

Real GDP

(Billions of 1987 Dollars)



(Percent Change, Annual Rate)



- o As shown in the above charts, the economy was stronger for the past several years than previously estimated. By Q4/1992, the level of real GDP was 1.6 percent higher.
 - Stronger consumer spending, business equipment investment, and state and local purchases accounted for most of the better-than-expected economic performance.
 - There were also stronger gains in personal income, corporate profits and personal saving. The personal saving rate averaged 5.3 percent in 1992, compared with 4.8 percent prior to the revision.

The Federal deficit on a National Income Accounts basis (which excludes the RTC and other financial transactions) averaged \$251 billion in the initial three quarters of FY 1993, or \$20 billion less than the FY 1992 deficit of \$271 billion.

- o There has been substantial improvement in recent quarters, with the NIA Federal budget deficit as percent of GDP declining to 3.6 percent in Q2/1993 from 4.8 percent in Q3/1992.

SECOND QUARTER GDP

Real GDP was revised upward to a 1.8 percent annual rate from 1.6 percent in the advance estimate. Final sales, which exclude inventory accumulation, accelerated to a 3.1 percent rate.

	1992		1993	
	Q3	Q4	Q1	Q2
	(percent change, annual rate)			
Real GDP	3.4	5.7	0.8	1.8
Real Final Sales	3.7	5.8	-0.8	3.1
GDP Implicit Price Deflator	1.0	3.3	3.6	2.3

Consumer spending, especially on durable goods, and nonresidential investment grew rapidly. Residential investment declined. Government spending rebounded following a first quarter decline.

	(percent change, annual rate)			
Consumer Spending	4.2	5.6	0.8	3.2
Consumer Durables	10.7	13.2	-1.3	10.8
Nonresidential Fixed Investment	3.8	7.6	14.4	14.4
Residential Investment	1.2	32.8	1.5	-8.4
Government Spending	4.1	-1.4	-6.4	4.3
Federal	8.7	-3.5	-16.2	3.1
State & local	1.2	0.0	0.3	5.0

A slowdown in the rate of inventory accumulation from the first to the second quarter restrained GDP growth. Net exports also fell sharply, knocking nearly one percentage point off GDP growth.

	(billions 1987 dollars)			
Inventory Change	9.6	8.7	29.3	13.9
Net Exports	-42.5	-38.8	-59.9	-73.1
Exports	579.3	591.6	588.0	595.0
Imports	621.8	630.3	647.9	668.1

Disposable personal income rose at an 5.9 percent rate following a first quarter decline. The saving rate rose slightly. Corporate profits from production rose at a 10.8 percent annual rate in the second quarter. The gyrations in prior quarters' profit rates reflect the write-offs relative to Hurricane Andrew in Q3.

	(percent change, annual rate)			
Saving Rate	4.9	6.0	3.9	4.5
Real Disposable Pers. Income	1.9	10.6	-7.8	5.9
Corporate Profits	-36.5	104.6	-6.6	10.8

RECENT ECONOMIC INDICATORS AS OF SEPTEMBER 3, 1993
(S.A. OR AS INDICATED)

	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP		4.6			9.2			4.4			4.2		
Real GDP		3.4			5.7			0.8			1.8		
Implicit Price Deflator		1.0			3.3			3.6			2.3		
Fixed-Weight Price Index		2.3			3.3			4.3			2.6		
CYCLICAL INDICATORS													
Leading Index, Percent	-0.2	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.3	-0.4	0.1	-0.1	NA
Coincident Index, Percent	-0.5	0.1	0.5	0.2	1.0	0.0	0.4	0.1	0.6	0.2	-0.1	-0.2	NA
Purchasing Managers' Diffusion Index	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5	49.3
Percent	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5	-0.4
Industrial Production	106.6	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.2	110.6	NA
Percent	-0.19	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.00	0.36	NA
Capacity Utilization, Manufacturing	78.7	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.6	80.4	80.4	NA
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3	119.7
Nonfarm Payroll Employment, Million	108.6	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3	110.3
Civilian Unemployment Rate, Percent	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8	6.7
Employment/Population Ratio	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6	61.8
Average Weekly Hours, Manufacturing	41.1	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4	41.5
CONSUMER SECTOR													
Retail Sales, Billion \$	163.2	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.1	172.3	NA
Percent	0.5	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.2	0.1	NA
Total Auto Sales, Million Units, A.R.	8.1	8.3	8.3	8.3	8.7	8.7	8.0	8.4	9.0	9.1	8.8	8.6	NA
Domestic Auto Sales, Million Units, A.R.	6.1	6.3	6.3	6.3	6.7	6.7	6.0	6.4	6.9	6.9	6.9	6.6	NA
Personal Income, Billion \$, A.R.	5118.4	5172.4	5239.1	5238.5	5507.3	5225.7	5249.1	5289.2	5366.0	5383.2	5377.9	5368.2	NA
Percent	-0.2	1.1	1.3	-0.0	5.1	-5.1	0.4	0.8	1.5	0.3	-0.1	-0.2	NA
Disposable Personal Income, Billion \$, A.R.	4474.2	4526.9	4587.9	4582.8	4802.2	4570.6	4591.9	4630.1	4688.1	4698.7	4693.5	4679.3	NA
Savings Rate, Percent	4.9	4.9	4.8	6	5.5	5	3.9	4.4	4.8	4.5	4	NA	NA
Real Personal Income, Billion \$73, A.R.	4094.3	4090.9	4125.9	4118.3	4155.2	4161.8	4156.6	4171.9	4166.8	4185.4	4183.4	NA	NA
Percent	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.1	0.4	-0.1	0.4	-0.0	NA	NA
Real Disposable Personal Income, Billion \$73, A.R.	3628.4	3632.8	3666.8	3656.9	3829.1	3630.7	3636.5	3660.4	3694.8	3698.9	3693.2	3680	NA
Percent	0.4	0.1	0.9	-0.3	4.7	-5.2	0.2	0.7	0.9	0.1	-0.2	-0.4	NA
Consumer Sentiment Index, U of Michigan	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0	NA
Percent	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5	NA
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1229.0	1218.0	1226.0	1226.0	1286.0	1171.0	1180.0	1124.0	1206.0	1248.0	1246.0	1212.0	NA
Single-Family Starts	1038.0	1045.0	1079.0	1089.0	1133.0	1051.0	1036.0	987.0	1059.0	1107.0	1078.0	1060.0	NA

	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	27.5	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.9	30.2	NA
Percent	-4.3	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	13.1	-10.8	NA
Nonresidential Construction Put in Place, Billion \$	125.0	128.2	130.3	128.9	128.9	128.3	129.1	131.5	131.2	134.5	133.9	NA	NA
Inventory Change Book Value, Billion \$, A.R.	23.5	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	16.4	NA	NA
Inventory/Sales Ratio, Total Business	1.52	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.47	NA	NA
INFLATION INDICATORS													
CPI, Percent	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1	NA
CPI Less Food and Energy, Percent	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1	NA
PPI Finished Goods, Percent	0.1	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.5	0.0	-0.3	-0.2	NA
PPI Less Food and Energy, Percent	0.0	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.2	0.2	-0.1	0.1	NA
Gold, \$ per ounce	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1	380.2
W. Texas Spot Oil Price, \$/bbl	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9	18.0
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	436.4	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.8	NA	NA
Imports, Billion \$, A.R.	540.6	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.5	NA	NA
Deficit, Billion \$, A.R.	-104.2	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	NA	NA
U.S. EXCHANGE RATE													
Multilateral	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6	NA
Percent	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0	NA
Yen/\$	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7	NA
DM/\$	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72	NA
\$/Pound	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50	NA
MONEY AND CREDIT													
M2, Billion \$	3472.7	3480.7	3492.1	3498.7	3497.8	3488.3	3477.5	3474.9	3476.7	3507.1	3514.7	3520.4	NA
Percent	3.2	2.8	4.0	2.3	-0.3	-3.2	-3.7	-0.9	0.6	11.0	2.6	2.0	NA
M3, Billion \$	4179.1	4183.5	4180.6	4179.3	4167.2	4142.2	4137.4	4133.0	4144.6	4175.2	4173.0	4166.9	NA
Percent	2.9	1.3	-0.8	-0.4	-3.4	-7.0	-1.4	-1.3	3.4	9.2	-0.6	-1.7	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	981.4	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA	NA
Percent, A.R.	20.9	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA	NA
C&I Loans, Billion \$	439.3	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA	NA
Commercial Paper, Billion \$	542.0	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA	NA
INTEREST RATES													
Federal Funds Rate	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1	3.0
T-Bill, 3 Month	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0	3.0
T-Bond, 30 Year	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6	6.3
Corporate AAA Bonds	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2	6.9
Mortgage Commitment Rate	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2	7.1
STOCK MARKET													
Dow Jones 30 Industrials	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4	3597.0
Standard & Poor's 500	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3	454.1

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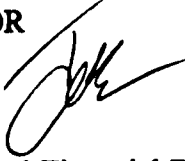
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FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503
July 23, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

SUMMARY

The first story analyzes Fed Chairman Greenspan's testimony this week. He indicated that the Federal Reserve will raise the Federal funds rate if there are renewed signs of inflation. The Fed has all but abandoned the money targets as an instrument of policy.

* * * * *

The second story examines the evidence on medical cost-shifting. Cost-shifting occurs when health care providers are not fully reimbursed for their services to some of their patients, but then finance those services through higher charges on other patients. The uninsured are the main group whose unpaid medical care may lead to cost-shifting, but Medicare and Medicaid can cause similar problems to the extent their reimbursement rates fail to cover the cost of care.

Solid evidence is available only for hospitals. In 1991, it is estimated that hospitals had a net loss of \$11 billion on uncompensated care while charging private payers about 30 percent more than the cost of their care. Medicaid payments were equal to only 82 percent of costs and Medicare payments to 88 percent of their costs.

The fact that hospitals provide unreimbursed services does not prove that cost-shifting is occurring. Hospitals could be absorbing the costs rather than passing them on. On balance, while there is some evidence that unreimbursed hospital costs are shifted to other payers, there is little support for the claim that this occurs fully or automatically.

Econometric analysis of cost-shifting, based on a sample of Illinois hospitals from the mid-1980s, found that these hospitals raised their prices to private patients by enough to compensate for about half the loss in revenue from cutbacks in Medicaid. State data also point to some cost-shifting. States with a significant level of uncompensated care, such as Arkansas and Mississippi, tend to have higher private payment to cost ratios.

Fed Chief Says Monetary Easing Has Ended

Fed Chairman Greenspan testified before two Congressional committees this week and presented the Federal Open Market Committee's (FOMC) semi-annual report to Congress. Financial markets didn't like what they heard and read. The bond market rally of the last few weeks stalled, with long-bond rates edging up to 6.67 percent from last week's 22-year low of 6.52 percent.

Interest Rates

The FOMC report indicated that the Fed was tilting toward raising interest rates in the future, although there are no immediate plans to raise the Federal funds rate from its current level of 3 percent. The Chairman emphasized that the current level of short-term interest rates is about zero after adjusting for inflation. Since long-term real interest rates are considerably higher, "market participants anticipate that short-term real rates will have to rise if substantial inflationary imbalances are to be avoided."

The prospect, therefore, is that the Fed will maintain stable rates until we get another round of disappointing inflation indicators. At that time, the Fed is likely to raise the Federal funds rate, even if it means slowing the economy. The Fed will not ease monetary policy unless it fears economic growth will be so meager that there will be a sharp upturn in unemployment.

Monetary Targets

The FOMC lowered its M2 target range for 1993 by a full percentage point to a range of 1 to 5 percent. The M3 target range was lowered by one-half percentage point to a range of 0 to 4 percent. Preliminary 1994 targets were set equal to the revised 1993 targets. Money growth for the first half of 1993 has been close to zero for both aggregates.

Chairman Greenspan's testimony and the FOMC report explicitly state that the monetary targets are of limited use in guiding policy. The relationship between money and the economy has broken down since 1986 for a variety of reasons. Recently, there has been a large shift of assets by investors out of CDs and money market mutual funds (both part of M2 and M3) into stock and bond mutual funds (which are not included in either measure). The FOMC attributes flat money growth to these portfolio shifts rather than weakness in the overall economy.

Although lowering the targets makes it more likely that they will be met, the Fed stated that it does not intend to use money growth as a signal for policy changes in the foreseeable future. Instead, the Fed's policy will be geared almost solely to signs of inflation and real economic activity. This continues the disengagement from the targets that has occurred over the past several years.

The President's Economic Package

The Chairman's testimony provides strong implicit support for the President's program. He made it clear that the short-term contractionary effect of cuts in spending and higher taxes would be more than offset in the long run by lower interest rates, higher investment, and gains in productivity. In his words before the House Banking Committee:

"It seems that the prospective cuts in the deficit are having a variety of substantial economic effects, well in advance of any actual change in taxes or projected outlays. . . To be sure, the conventional wisdom is that budget deficit reduction restrains economic growth for a time, and I suspect that this is correct. However, over the long run, such wisdom points in the opposite direction. In fact, one can infer that recent declines in long-term interest rates are bringing forward some of these anticipated long-term gains. . . A credible and effective fiscal package would promise an improved outlook for sustained lower long-term interest rates and a better environment for private sector investment. All told, the productive capacity of the economy will doubtless be higher, and its resilience greater."

Summary

Unless economic activity slows sharply and unemployment increases, the decline in short-term rates has ended. Rates may remain at current levels if inflation remains in check. In this environment, the financial markets will place increasing emphasis on monthly inflation indicators, and oil and other commodity prices as signals of the Fed's policy stance.

Medical Cost-Shifting

Health care providers have traditionally supplied some care to patients who are unable to pay for it. The cost of such uncompensated care has either been absorbed by providers or shifted to other paying patients. That practice continues today for the approximately 37 million Americans without health insurance. These people generally do receive medical treatment when they fall seriously ill, but because of a lack of insurance, they are often unable to pay the full cost of their care, and health care providers are forced to absorb the costs or pass them on. Cost shifting is said to occur when the costs are passed on to private health care payers.

Cost-shifting may also occur when the Government does not fully reimburse providers for health benefits paid for through government programs. Medicaid reimbursement rates have not fully covered hospital costs, as measured by the American Hospital Association (AHA), for over a decade. In recent years, Medicare payments have also fallen short of AHA estimated costs.

For the Nation's hospitals alone, the total loss on below-cost care has been estimated at \$26 billion for 1991.¹ This includes \$11 billion in uncompensated care and \$15 billion in Medicare and Medicaid shortfalls. One of the potential benefits of health reform is a reduction in this cost-shifting and potential savings for other payers.²

A discrepancy between what it costs to care for one group of patients and what they pay for that care does not, however, necessarily affect the charges to other patients. Cost-shifting is not the only option for health care providers forced to confront such a discrepancy. Providers could absorb some or all of the shortfall. Economic analysis implies that the extent to which cost-shifting occurs depends on the medical marketplace, the degree of competition among hospitals, and the extent to which health care providers are motivated by profit maximization. On balance, the evidence suggests that cost-shifting does occur, but that it is not as automatic or as complete as some simple assertions would suggest.

Measuring the Extent of Cost-Shifting

Solid evidence on cost-shifting is only available for hospitals, not for physicians, but there is reason to believe that cost-shifting is more prevalent among hospitals. It is more difficult for hospitals to turn away nonpaying patients than it is for individual physicians, so they have more costs to shift. There also may be more opportunity for hospitals to cost-shift because they generally have more market power than individual physicians.

Hospital Losses and Gains -- The table below compares hospital net gains and losses in 1991 for different groups of payers, along with the ratio of their payments to the cost of the services provided to each group. It shows that total unreimbursed care, including uncompensated care to the uninsured and Medicaid and Medicare shortfalls, amounted to \$26 billion in 1991:

- o There was a net loss of about \$11 billion on uncompensated care. This figure reflects the subsidies that hospitals receive from State and local governments to help pay for this care, but those subsidies amount to less than 20 percent of the cost of care.
- o Medicaid payments were equal to only 82 percent of the estimated cost of treating Medicaid patients. This is an increase over 1989, however, when the ratio was 77 percent. Preliminary evidence for 1992 points to another increase.

¹The Prospective Payment Assessment Commission (ProPAC), Medicare and the American Health Care System, Report to the Congress, June 1993, page 31. ProPAC was set up by Congress to supervise the operation of Medicare's Prospective Payment System. Its cost data has some shortcomings conceptually, but it is the best available for analyzing cost-shifting.

²Health reform will extend health insurance coverage to everyone, but even with universal coverage, health care providers would still experience losses from patients who failed to pay any required copayments or deductibles.

- o Medicare's payment to cost ratio is higher than Medicaid's, but short of full reimbursement. In 1991, Medicare paid 88 percent of hospital costs, down from 93 percent in 1989.
- o Meanwhile, private payers were charged about 30 percent more than the cost of their care.

Hospital Gains and Losses by Payer Group, 1991		
Payment Source	Net Gain or Loss (billions)	Payment to Cost Ratio (percent)
Below Cost:		
Uncompensated Care	-\$10.8	19.6
Medicaid	-5.1	81.6
Medicare	-10.0	88.4
Above Cost:		
Other Government	0.0	100.1
Private Payers	26.1	129.7

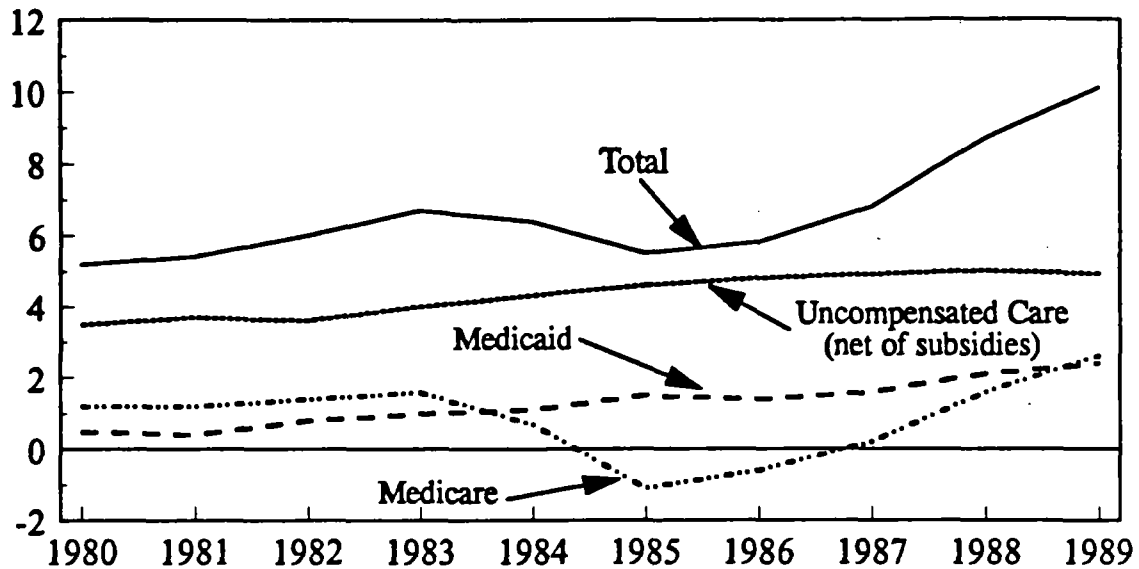
Source: ProPAC, Medicare and the American Health Care System: Report to the Congress, June 1993.		

Changes over Time in Hospitals' Unreimbursed Costs -- The first chart below shows how the ratio of unreimbursed care to total hospital costs changed over the past decade. Except for a two-year period in the middle of the decade, unreimbursed costs rose steadily in the 1980s. Changes in Medicare payments account for the temporary fluctuation. Prior to the establishment of the Prospective Payment System (PPS) in 1984, Medicare did not fully cover hospital costs. PPS reversed this practice initially. The new rates established under PPS boosted hospital Medicare margins significantly but, since 1987, Medicare has returned to its earlier practice and not provided full reimbursement to hospitals.

Hospital Margins -- Hospitals' margins -- the difference between total revenues and total expenses -- have fluctuated over the past 12 years without any clear-cut trend, despite the increase in unreimbursed care at the end of the 1980s (see chart). The stability of hospitals' overall margins in the face of rising losses on unreimbursed care may indicate cost-shifting, or it may indicate that hospitals were able to lower costs in response to changing payment practices by Medicare and Medicaid. The expectation of such reductions was one of the main reasons for adopting PPS in Medicare.

Hospitals' Unreimbursed Costs*

(as a percentage of hospitals' total costs)

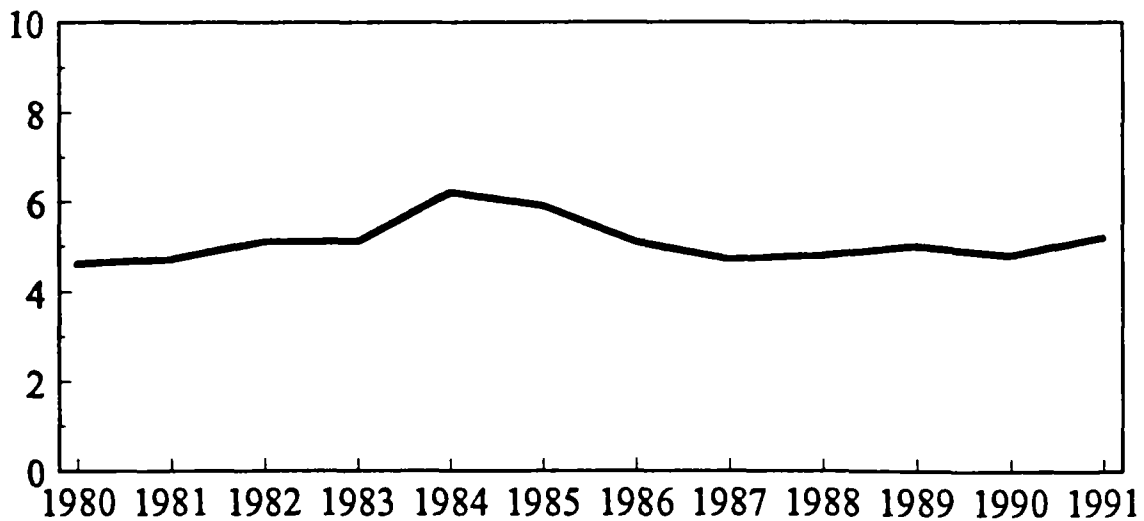


*Unreimbursed care includes uncompensated care plus the shortfalls in Medicare and Medicaid.

Source: Congressional Budget Office, Responses to Uncompensated Care and Public-Program Controls on Spending: Do Hospitals "Cost Shift?" May 1993.

Hospital Margins*

(in percent)



*Margins are defined as the difference between hospitals' total revenues and total costs, expressed as a percentage of total revenues.

Source: Congressional Budget Office, Trends in Health Spending: An Update, June 1993.

State-by-State Variations -- The table at the end of the paper shows the ratio of hospital payments to costs by payer on a State-by-State basis. Most States have a higher payment ratio for Medicare than Medicaid, with both ratios nearly always under 100 percent; in all States, private payers are charged more than the cost of the services they receive.

Hospitals' billed charges can be thought of as the upper limit on payments for hospital services, or "list prices." Although some insurers continue to pay billed charges, many receive discounts. Managed care organizations such as HMOs and PPOs have been especially successful in negotiating discounted prices. ProPAC estimates that while about 60 percent of conventional private insurers continue to pay billed charges, only about 15 percent of all HMOs and 21 percent of all PPOs do so. Some States where managed care is widespread, such as Minnesota and Massachusetts, have below-average ratios of payments to costs for private payers, but California, where HMOs are also widespread, is only about average.

Three of the four States with the lowest ratios of payments to costs -- New Jersey, New York and Maryland -- experimented with hospital rate regulation in the 1980s. While rate regulation appears to be somewhat successful in leveling out payments from different providers, its ability to restrain the overall growth of health care costs is not proven. Past experience with global price controls, as in 1971-1974, strongly argues against the view that regulation alone can control the upward trend in hospital costs.

Interpreting the Evidence

The fact that hospitals provide unreimbursed services does not establish that cost-shifting is occurring. Even though privately insured patients pay more for hospital care than do uninsured patients or Medicaid and Medicare beneficiaries, this does not necessarily mean that the private patients would pay less if the other payers paid more. Whether or not that would happen depends on the nature of the markets for hospital care and the motivations of hospital administrators and physicians.

Imperfect Competition and Cost-Shifting -- Hospitals are different from conventional business firms, but economic analysis can help clarify the choices hospital administrators face. If hospital services were sold in perfectly competitive markets, excess profits and losses would be competed away, forcing revenues to correspond to costs in the long run. Individual hospitals would be unable to vary their charges independently since prices would be set by the market. If Government forced competitive hospitals to accept patients who were unable to cover the full cost of their care, hospital margins would be reduced at first until the weaker hospitals were driven out of business. Eventually, a reduced supply of hospital services to paying customers would lead to a rise in price that would allow the remaining hospitals to cover the cost of unreimbursed care.

This kind of cost-shifting, however, does not appear to be typical of the hospital sector. Most hospitals instead seem to operate in imperfectly competitive markets in which prices exceed costs for sustained periods, and in which distinct groups of customers are charged different prices for

similar services. However, even though a hospital may be able to raise its charges to private payers when there is a decline in payments by Medicare or Medicaid or an increase in the number of uninsured among its patients, it might not be in its interest to do so.³

If a hospital were a profit maximizing firm, it would already be charging its privately paying patients prices that maximized its profit, and there would be no advantage in trying to raise its charges to them. If Government mandates were to force it to accept underpaying patients, it would not raise its other charges, not because of altruism, but because the hospital would already be exploiting its market power to the fullest extent. Indeed, raising its other charges would only reduce its revenues by choking off demand from privately paying patients.

Health economists have concluded that in imperfectly competitive markets, profit-maximizing hospitals would not find it in their interest to cost-shift.⁴ But, obviously, hospitals do not all behave like profit-maximizing firms. Therefore, it is useful to examine the actual behavior of hospitals who may depart from the theoretical model.

The Need to Cost-Shift – A number of studies have attempted to define a variable that would measure the "need" for hospitals to cost-shift. Typically, these include the sum of three terms: the cost of uncompensated care; the excess cost of treating Medicaid, Medicare and Blue Cross patients; and the difference between nonpatient revenues and costs. If hospitals charged private insurers more to cover each of these three terms, their charges would go up in step with the "need to cost-shift" variable. Studies from the early 1980s using this technique found that hospitals with a larger need to cost-shift raised their mark-ups less from 1980 to 1982 than did hospitals with a lesser need.⁵

More recently, however, ProPAC found evidence of cost-shifting, using this approach. The 1992 ProPAC study divided hospitals according to both their ability and need to cost-shift. Holding ability to cost-shift constant, it found that hospitals with a larger need to cost-shift have

³A profit-maximizing hospital with monopoly power would serve more patients up to the point where the extra revenue from serving another patient equaled the added cost of doing so. A hospital that followed these pricing rules in the markets it served would not find it in its interest to raise prices to private patients if Medicare or Medicaid reimbursement rates fell or if uncompensated care rose.

⁴See, for example, J. W. Hay, "The Impact of Public Health Care Financing Policies on Private-Sector Hospital Costs," Journal of Health Politics, Policy and Law, 7(4):945-952, 1983; and R. W. Foster, "Cost-Shifting under Cost Reimbursement and Prospective Payment," Journal of Health Economics, 4(3):262-271, 1985.

⁵See, for example, J. Hadley and J. Feder, "Hospital Cost-Shifting and Care for the Uninsured," Health Affairs, 4:67-80, 1985; and S. Zuckerman and J. Holahan, "PPS Waivers: Implications for Medicare, Medicaid, and Commercial Insurers," Journal of Health Politics, Policy, and Law, 13(4):663-681, 1988. Blue Cross patients are included in the need to cost-shift measure because of the potential ability of Blue Cross to obtain lower hospital rates than smaller private payers.

somewhat higher ratios of payments to costs for private insurers. It is worth noting, however, that when the establishment of PPS temporarily reduced the need to cost-shift nationally, private payers did not see any significant reduction in premiums in the aggregate.

Cost-Shifting and Nonprofit Hospitals -- Hospitals differ from the typical business firm in the motivations of their administrators and physicians. The assumption of profit maximization does not adequately describe these institutions. No single model has emerged in economics to analyze the behavior of nonprofit organizations, but modifications to the standard profit-maximizing model have been tried with varying degrees of success. One such model has been used to analyze the cost-shifting issue.⁶

This model assumes that, other things remaining constant, hospitals would prefer to increase their total service output to the community. They are also assumed to value an increase in their margins. Hospitals that were motivated by an altruistic desire to serve the community or by less admirable prestige motives might equally well be characterized by such a functional relationship.

Using this model, some evidence of cost-shifting was found in a sample of Illinois hospitals from the mid-1980s. These hospitals were estimated to have raised their prices to private patients by enough to compensate for about half the loss in revenue from cutbacks in the Medicaid program.

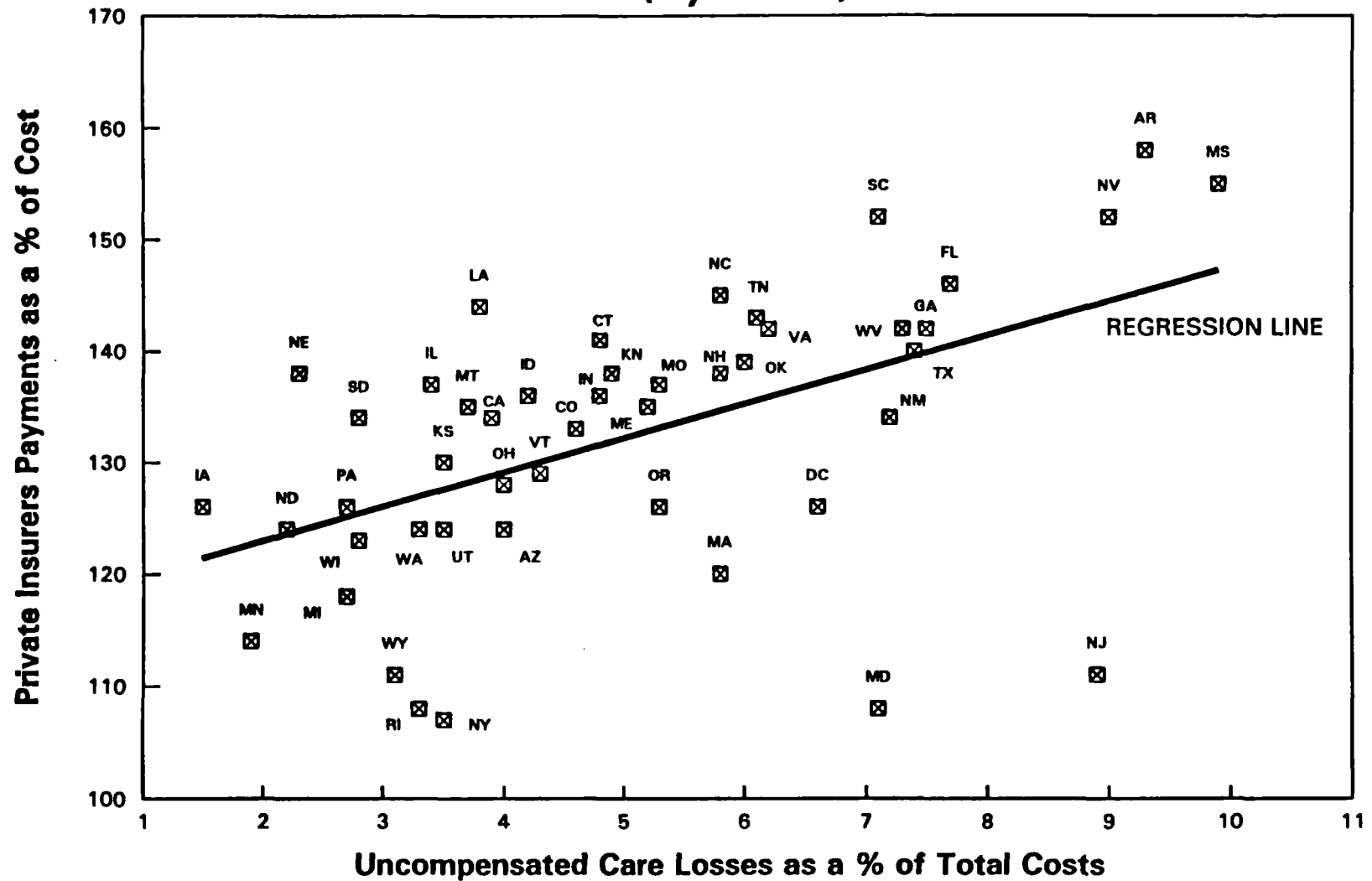
Cross-State Comparisons of Cost-Shifting -- ProPAC's cross-state data can also be used to look for evidence of cost-shifting. The chart at the end of the paper shows that there is a clear correlation between the ratio of uncompensated care to total hospital costs and the private payment to cost ratio. States like Arkansas and Mississippi with a significant level of uncompensated care also tend to have higher private payment to cost ratios. This is consistent with the findings mentioned above that at least partial cost-shifting occurred in Illinois in response to differences in Medicaid rates.

Conclusion

There is ample evidence that hospitals charge different prices for similar services. Private payers generally pay a higher proportion of costs than does the Government for Medicaid and Medicare. Economists who have studied the cost-shifting issue, however, have usually remained skeptical of claims that changes in hospital costs for Medicaid, Medicare or uncompensated care are shifted fully to private payers. There is evidence that for hospitals some degree of cost-shifting occurs. Extending insured coverage to the currently uninsured may lead to some reduction in private insurance payments, but the amount of the savings is uncertain.

⁶D. Dranove, "Pricing by Nonprofit Institutions: The Case of Hospital Cost-Shifting," Journal of Health Economics, 7(1): 47-57, 1988.

PRIVATE MARK-UPS AND UNCOMPENSATED CARE (by State)



HOSPITAL PAYMENTS BY SOURCE, STATE AVERAGES, 1991 (In Percent)*

State	Payments as a percentage of Costs			Uncompensated Care Losses as a Percentage of Total Costs
	Private Insurers	Medicare	Medicaid	
New York	107	95	89	3.5
Maryland	108	108	107	7.1
Rhode Island	108	99	91	3.3
New Jersey	111	98	119	8.9
Wyoming	111	86	94	3.1
Minnesota	114	92	84	1.9
Michigan	118	90	85	2.7
Massachusetts	120	94	89	5.8
Wisconsin	123	94	77	2.8
Arizona	124	94	80	4.0
Utah	124	87	88	3.5
North Dakota	124	88	96	2.2
Washington	124	100	82	3.3
Pennsylvania	126	90	74	2.7
Iowa	126	88	92	1.5
Oregon	126	96	65	5.3
District of Columbia	126	89	80	6.6
Ohio	128	87	90	4.0
Vermont	129	90	86	4.3
Kansas	130	88	82	3.5
Colorado	133	89	78	4.6
New Mexico	134	93	86	7.2
South Dakota	134	88	86	2.8
California	134	88	67	3.9
Montana	135	91	87	3.7
Maine	135	82	87	5.2
Indiana	136	85	99	4.8
Idaho	136	91	77	4.2
Missouri	137	87	77	5.3
Illinois	137	86	56	3.4
Nebraska	138	83	73	2.3
New Hampshire	138	83	90	5.8
Kentucky	138	90	99	4.9
Oklahoma	139	87	92	6.0
Texas	140	87	76	7.4
Connecticut	141	83	65	4.8
Virginia	142	90	73	6.2
Alabama	142	94	76	7.5
Georgia	142	87	88	7.5
West Virginia	142	90	85	7.3
Tennessee	143	87	82	6.1
Louisiana	144	87	87	3.8
North Carolina	145	89	85	5.8
Florida	146	84	82	7.7
Nevada	152	86	60	9.0
South Carolina	152	84	103	7.1
Mississippi	155	94	108	9.9
Arkansas	158	94	63	9.3
U.S. Average	130	88	82	4.8

* Alaska, Hawaii, and Delaware omitted for lack of data

RECENT ECONOMIC INDICATORS AS OF JULY 23, 1993
(S.A. OR AS INDICATED)

	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP	4.3			5.3			7.1			4.3			
Real GDP	1.5			3.4			4.7			0.7			
Implicit Price Deflator	2.7			2.0			2.3			3.3			
Fixed-Weight Price Index	3.0			2.3			3.3			4.3			
CYCLICAL INDICATORS													
Leading Index, Percent	-0.3	0.1	-0.2	0.1	0.5	0.7	1.7	-0.3	0.4	-1.0	0.2	-0.3	NA
Coincident Index, Percent	-0.1	0.4	-0.5	0.1	0.5	0.2	1.0	0.0	0.2	0.0	-0.3	0.4	NA
Purchasing Managers' Diffusion Index	52.3	53.0	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3
Percent	-6.1	1.3	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5
Industrial Production	106.0	106.8	106.6	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.3	110.1
Percent	-0.66	0.75	-0.19	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.09	-0.18
Capacity Utilization, Manufacturing	78.6	78.9	78.7	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.7	80.3
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.5	117.7	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2
Nonfarm Payroll Employment, Million	108.5	108.6	108.6	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.0	110.0
Civilian Unemployment Rate, Percent	7.7	7.6	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0
Employment/Population Ratio	61.4	61.4	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6
Average Weekly Hours, Manufacturing	41.1	41.1	41.1	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.3
CONSUMER SECTOR													
Retail Sales, Billion \$	161.1	162.3	163.2	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.2	171.9
Percent	0.0	0.7	0.6	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.4	0.4
Total Auto Sales, Million Units, A.R.	8.9	8.3	7.9	8.3	8.3	8.2	8.7	8.6	8.0	8.3	8.9	9.1	9.1
Domestic Auto Sales, Million Units, A.R.	6.7	6.4	6.0	6.3	6.3	6.2	6.7	6.6	6.0	6.3	6.8	6.9	7.1
Personal Income, Billion \$, A.R.	5038.5	5048.7	5056.4	5080.9	5145.0	5143.7	5194.0	5223.1	5229.0	5260.8	5266.3	5296.6	NA
Percent	0.1	0.2	0.2	0.5	1.3	-0.0	1.0	0.6	0.1	0.6	0.1	0.6	NA
Disposable Personal Income, Billion \$, A.R.	4419.5	4424.6	4426.3	4448.7	4505.9	4500.4	4545.4	4566.3	4573.2	4605.4	4608.7	4633.6	NA
Savings Rate, Percent	5	4.8	4.6	4.6	4.4	4.4	4.4	4.5	4.9	4.8	4.9	NA	NA
Real Personal Income, Billion 87\$, A.R.	4076.5	4078.1	4094.3	4090.9	4125.9	4118.3	4155.2	4161.8	4156.6	4171.9	4163.1	4183.7	NA
Percent	-0.0	0.0	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.1	0.4	-0.2	0.5	NA
Real Disposable Personal Income, Billion 87\$, A.R.	3576.1	3574.4	3585.5	3581.7	3613.4	3604	3637.1	3639.9	3634.3	3652.6	3644.5	3660.2	NA
Percent	-0.1	-0.0	0.3	-0.1	0.9	-0.3	0.9	0.1	-0.2	0.5	-0.2	0.4	NA
Consumer Sentiment Index, U of Michigan	80.4	76.6	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5
Percent	1.5	-4.7	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1141	1106	1229	1218	1226	1226	1286	1171	1180	1124	1206	1254	1254
Single-Family Starts	994	961	1038	1045	1079	1089	1133	1051	1036	987	1059	1110	1079

07/23/93

	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	30.2	28.7	27.5	29.8	31.0	27.7	33.2	29.3	33.4	29.8	30.9	30.5	NA
Percent	1.3	-4.8	-4.3	8.4	4.1	-10.7	19.7	-11.6	14.0	-10.9	3.7	-1.1	NA
Nonresidential Construction Put in Place, Billion \$	132.6	129.4	125.0	128.2	130.3	128.9	128.9	128.3	129.1	131.5	130.8	134.0	NA
Inventory Change Book Value, Billion \$, A.R.	49.1	38.4	23.5	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	21.5	NA
Inventory/Sales Ratio, Total Business	1.50	1.50	1.52	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	NA
INFLATION INDICATORS													
CPI, Percent	0.2	0.3	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0
CPI Less Food and Energy, Percent	0.1	0.3	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1
PPI Finished Goods, Percent	0.2	0.0	0.1	0.2	0.1	-0.2	0.0	0.3	0.4	0.2	0.6	0.0	-0.3
PPI Less Food and Energy, Percent	-0.2	0.1	0.0	0.1	-0.1	0.2	0.1	0.4	0.2	0.1	0.4	0.2	-0.1
Gold, \$ per ounce	341.3	353.2	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4
W. Texas Spot Oil Price, \$/bbl	22.4	21.8	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	456.5	449.2	436.4	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.4	NA
Imports, Billion \$, A.R.	538.7	539.3	540.6	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.8	NA
Deficit, Billion \$, A.R.	-82.2	-90.1	-104.2	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.4	NA
U.S. EXCHANGE RATE													
Multilateral	85.9	82.6	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8
Percent	-2.7	-3.9	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7
Yen/\$	126.8	125.9	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4
DM/\$	1.57	1.49	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65
\$/Pound	1.86	1.92	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51
MONEY AND CREDIT													
M2, Billion \$	3462.1	3463.6	3472.4	3480.2	3491.4	3498.0	3496.9	3486.9	3475.4	3472.9	3474.6	3505.7	3512.1
Percent	-1.9	0.5	3.1	2.7	3.9	2.3	-0.4	-3.4	-3.9	-0.9	0.6	11.3	2.2
M3, Billion \$	4170.1	4169.0	4178.7	4183.0	4180.0	4178.5	4166.4	4141.0	4135.4	4131.0	4142.1	4171.6	4167.1
Percent	-2.7	-0.3	2.8	1.2	-0.9	-0.4	-3.4	-7.1	-1.6	-1.3	3.3	8.9	-1.3
C&I Loans & Commercial Paper, Billion \$, N.S.A.	990.9	966.0	981.4	987.1	991.1	996.9	989.8	986.1	978.4	979.9	NA	NA	0
Percent, A.R.	-10.4	-26.3	20.9	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	NA	NA	NA
C&I Loans, Billion \$	447.3	422.8	439.3	439.3	439.5	441.0	438.3	436.3	437.4	438.4	NA	NA	0
Commercial Paper, Billion \$	543.5	543.2	542.0	547.9	551.7	555.9	551.5	549.9	541.1	541.4	NA	NA	0
INTEREST RATES													
Federal Funds Rate	3.8	3.3	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0
T-Bill, 3 Month	3.7	3.2	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1
T-Bond, 30 Year	7.8	7.6	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8
Corporate AAA Bonds	8.2	8.1	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3
Mortgage Commitment Rate	8.5	8.1	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4
STOCK MARKET													
Dow Jones 30 Industrials	3337.8	3329.4	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8
Standard & Poor's 500	408.3	415.1	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1

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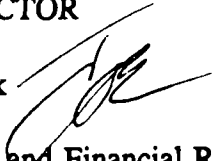
FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 21, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

SUMMARY

Millions of families now face the cost of long-term care for the disabled; given the age profile of the population, many millions more will face that issue in the future. This Friday Report combines disability rates by age with the middle path Social Security population projection to estimate the number of severely disabled and the costs of long-term care through the year 2050 .

The risk of disability rises sharply with age. Almost 25 percent of the population over 65 has one or more disabilities, about 5 percent require institutional care.

Beginning in 2030, when the first wave of baby-boomers will turn 85, and continuing through 2050, the ranks of the high-disability over-85 age group will swell. Consequently, long after financial pressure on the Social Security trust fund has attained its peak, the numbers of people with severe disabilities will mount -- as will the costs of long-term care to the Nation.

- By 2050, there might be 13 million people with severe disabilities. In 1990, by contrast, there were 5 million.
- By 2050, assuming no change in policies, the combined public and private costs of long-term care might be about \$700 billion in 1993 dollars (4-1/2 percent of GDP) compared with \$108 billion in 1993 (1-3/4 percent of GDP). About one-half of the increase is estimated to be due to demographic factors, and about one-half to an assumption that the annual average growth of long-term care costs would exceed the growth of the Consumer Price Index by about 1-1/2 percentage points per year.

If private or public insurance policies are significantly expanded, long-term care costs would be higher. In return, however, the disabled would receive badly needed services that many families cannot now afford.

The Need for and Cost of Long-Term Care*

We all hope that our children, our parents and we ourselves will go from cradle to grave without the burden of chronic mental illness or severe physical impairment. Unfortunately, for millions of people, that wish is not fulfilled. Moreover, the demographic profile of the Nation suggests that when the baby-boom generation born between 1946 and 1964 grows old and grey, the number of Americans with disabilities will increase substantially.

This Friday Report combines disability rates and population forecasts to project the disabled population through 2050. By 2050, there may be 13 million people with severe disabilities residing in the community or in institutions. By contrast, the comparable figure for 1990 is 5 million and for 2020, 8 million. In light of these trends in the number of disabled, the cost of long-term care can be expected to increase much more rapidly after 2020.

The Nation's total spending on long-term care through 2050 will be driven by demographic trends, the price of long-term care relative to overall inflation, and any reforms of public policies that might enhance the availability of third-party payments, be they new government programs or more favorable tax benefits for private insurance. Assuming that the current policies are not changed, then long-term care spending might rise from its current \$110 billion (1-3/4 percent of GDP) to \$250 billion (2-1/2 percent) by 2020, and then to \$700 billion (4-1/2 percent) by 2050 in 1993 dollars. About one-half of the increase in total cost is attributable to demographic factors, and about one-half is due to an assumption that long-term care costs are likely to rise 1-1/2 percentage points per year faster than the Consumer Price Index.

If policies are instituted that lower the out-of-pocket costs of using nursing homes or home care services, then future costs would be even higher. For example, although there is considerable uncertainty, one estimate suggests that instituting a new social insurance program that covered 80 percent of the cost of home care services to the severely disabled might double the use of such services among the eligible population, and might increase by 50-60 percent total spending of home care services above those in the baseline estimate. On the benefits side, such a program would provide the disabled with services that many families cannot now afford, or which force families to exhaust their lifetime savings.

Risk of Disability in the Community

Although disability occurs at all ages, the odds rise sharply with age.

- o Only 3 percent of 18-64 year olds have a physical or mental disability that requires the assistance of others; only 0.4 percent are severely disabled.

*The Friday Report relies extensively on materials developed by the Health Care Reform Long-Term Care Working Group. The estimates of current and future costs are for INTERNAL USE ONLY.

- o At the other end of the age spectrum, however, about 40 percent of those over 85 need the help of others to perform at least one of the five essential activities of living (ADLs), or one of the five activities required for independent living (IADLs).¹

Moreover, about 20 percent of those over 85 are severely disabled: without assistance from others, they are physically unable to perform three or more of the five essential ADLs or they have an equivalent cognitive impairment.

Prevalence of Disability in the Community (Percent of age group population)				
Age Group	Any Disability*	Severely Disabled**		
		Functional	Cognitive	Functional or Cognitive
Under 18	0.4	NA	NA	0.2
18-64	3.2	0.3	0.2	0.4
65-74	} 16.5	2.0	1.3	3.3
75-84		3.9	5.4	9.4
85 and Over	40.7	8.5	12.2	20.7
Source: 1989 National Health Interview Survey, 1987 National Medical Expenditure Survey, 1990 Survey of Income and Program Participation, 1989 National Long-Term Care Survey.				
*Disability defined as needing help from others to perform an activity of daily living (ADL) or an instrumental activity of daily living (IADL).				
**Severely disabled defined as a person needing help to perform three or more ADLs or a similar level of cognitive impairment.				

Number of Disabled in the Community and Institutions

Despite the sharp rise in the prevalence of disability with age, it is misleading to think of the disabled in the community as almost entirely comprised of the elderly. Because the population under 65 is seven times larger than that over 65, these younger people with disabilities comprise

¹The five essential activities of daily living (ADLs) are bathing, dressing, using the toilet, getting in or out of bed, continence and eating. The instrumental activities of daily living (IADLs) that need to be performed for an individual to live independently include preparing meals, managing money, making telephone calls, going shopping and doing light housework.

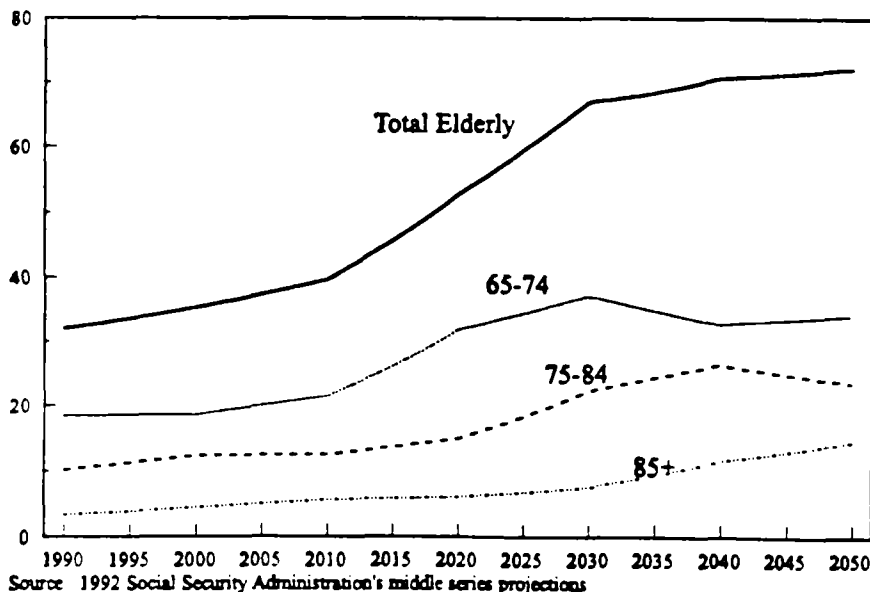
45 percent of all noninstitutionalized disabled (4.7 million out of a total of 10.3 million). Even among those disabled living in institutions, nearly 30 percent are under 65 years old (600,000 out of 2.3 million).

Number of Persons with Any Disability in the Community and Institutions: 1990 (in thousands; % of cohort in parentheses)				
	Under Age 18	Age 18-64	Age 65+	Total
Community	402 (0.6%)	4,271 (2.7%)	5,661 (17.7%)	10,334 (4.0%)
Institutions	88 (0.1%)	550 (0.3%)	1,638 (5.1%)	2,276 (0.9%)
Total	490 (0.7%)	4,821 (3.0%)	7,299 (22.9%)	12,610 (4.9%)
Source: 1990 Survey of Income and Program Participation, 1990 Census, Unpublished data from National Institute of Mental Health, and University of Minnesota.				

Aging Baby-Boomers

While the number of people requiring long-term care is large now, it will be much greater still when the baby-boom generation grows old in the next century. After 2010, the first of the baby-boomers reach young old-age, 65 to 74, which will boost the number of Medicare and Social Security beneficiaries and begin to increase the severely disabled elderly population. After 2030, however, the first wave of baby-boomers will be 85, a high-disability age group that will continue to swell for the next two decades. During the three decades from 2020 to 2050, the number of people over 85 will surge from 6 million to 14-1/2 million, according to the latest Social Security middle series projection. Consequently, long after the financial pressure on the Social Security trust fund has attained its peak, the costs of long-term care will continue to mount.

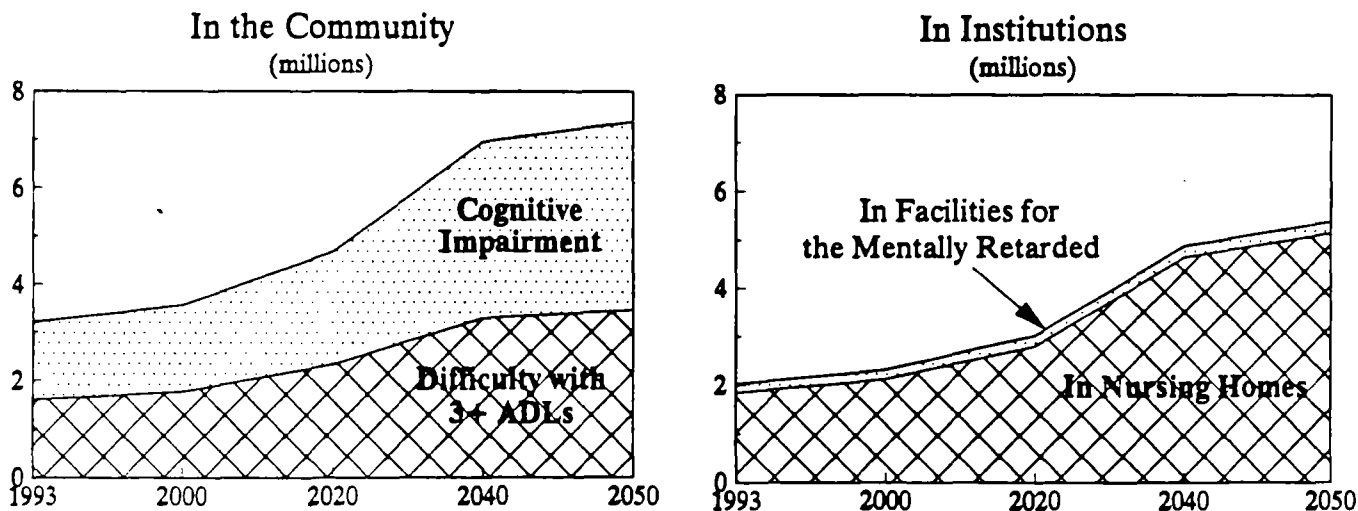
Elderly Population
(millions)



Even these projections may be on the low side. The latest Census middle range projection for 2050 envisages nearly 3-1/2 million more people between 65 and 84 than does the Social Security projection, and 3 million more people over 85. Some private demographers expect an even larger elderly population in the middle of the next century than the Census estimates.

Combining current disability rates and rates of utilization of institutions with the Social Security population projection results in a moderate increase in the number of disabled and severely disabled people between now and 2020, and a sharp rise thereafter. By 2050, there might be 13 million people with severe disabilities. According to these calculations, there might be 7-1/2 million severely disabled living in the community and another 5-1/2 million in institutions. Changes in utilization of institutions in the future would change the split between community and institutions, but not affect the total number of severely disabled. Using the Census instead of the Social Security population projection boosts the total number of severely disabled by 2050 to 14-1/2 million. By contrast, in 1990, there were 5 million severely disabled (3 million living in the community and 2 million in institutions).

Number of People with Severe Disabilities



Source: Estimated using 1992 Social Security middle path population projections; current disability rates in the community; and current institutional utilization rates.

What About Better Health?

The prevalence of disability in each age group during the next half century may be higher or lower than that of the current population. Universal health insurance, an emphasis on disease prevention, healthier lifestyles, and advances in medicine may reduce disability -- or may enable more people to live to an older age and incur more disabilities.

- o Eliminating Alzheimer's disease among the elderly, for example, would directly reduce the number of severely disabled living in the community by 3-1/2 million by 2050, and would

cut the nursing home population due to this illness by almost 40 percent.² The elimination would indirectly increase the number of severely disabled due to other illnesses, but to a much lesser extent.

- o Curing cancer would cause only a small reduction in the prevalence of severe disability due to that disease. It would, however, extend by an average of 15 years the life span of the 21 percent of the population that would otherwise have died from cancer. By enabling these people to live to a much older age -- 85 instead of 70 on average -- a cure for cancer would likely increase the number of people with severe disabilities.³

The range of plausible estimates for the population needing long-term care in the future is very wide.

- o Simulations of a high-disability prevalence scenario for the year 2020 with the Brookings-ICF long-term care model found almost one-third more disabled elderly than in a low disability scenario using the same model.⁴
- o Another simulation model of long-term care that includes the relationship between higher income and better health also shows the sensitivity of estimates of the future number of elderly and disabled elderly population. According to these simulations, raising the future income of the elderly raises longevity significantly, adding 4-1/2 million to the number of people over 65 by 2040, compared with a baseline projection. The number of seriously disabled elderly, however, is projected to be 8 percent lower in the higher income scenario than in the baseline projection, despite the higher population.⁵

²Kenneth Manton, Larry Corder and Robert Clark, "Estimates and Projections of Dementia Related Service Expenditures," in Forecasting the Health of Elderly Populations, edited by K. Manton, R. Suzman and B. Singer.

³The effects of curing cancer are from Kenneth Manton and Eric Stallard, "The Projected Demand for Cancer Care, the Supply of Facilities and the Personnel Needed to Meet It," draft paper, 1992; and Public Health Service, U.S. Decennial Life Tables for 1979-1981, Vol. 1 No. 2.

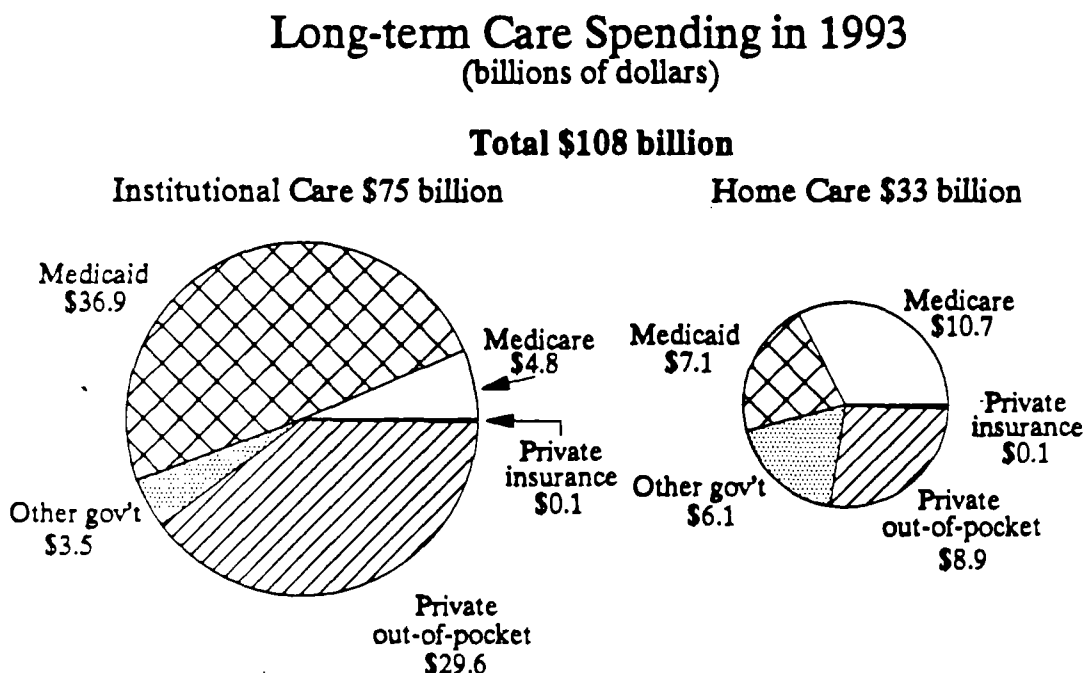
⁴A. Rivlin and J. Wiener, Caring for the Disabled Elderly.

⁵Kenneth Manton, Eric Stallard and Korbin Liu, "Effects of Income on Functional Disability and Health Care Expenditures in the U.S. Elderly Population 1990 to 2040," draft paper, 1993. In the higher-income, lower-disability simulation, all current and future cohorts of elders are assumed to have the same income as the current cohort of 65-69 year olds, which is higher than that for all current elderly. This leads the model to predict a longer average life span at age 65 (because higher incomes are associated with increased life expectancy) and to predict fewer disabled people (because higher income in the model reduces the prevalence of severe disability).

Costs of Long-Term Care

This year, long-term care may cost about \$108 billion, most of which is for people living in institutions. These figures do not, however, include the value of the time spent by family and friends caring for the disabled living in the community. Assuming a \$10 per hour wage, the total value of "free" care may be about twice the \$33 billion in paid home care.⁶

The public sector, mostly through Medicaid and Medicare, is likely to pay about \$70 billion for long-term care this year, primarily for the disabled living in institutions. Almost all of the private sector long-term costs are out-of-pocket payments by individuals; unlike acute care, private insurance payments are negligible.



Source: Long Term Care working group estimate; for INTERNAL use only.

Even assuming current public policies are not changed, the projected disability trends discussed earlier suggest that long-term care costs will increase dramatically after 2020, when the baby-boom generation enters its high disability years. By 2020, total long-term care costs may rise to \$250 billion in constant 1993 dollars. By 2050, however, inflation-adjusted costs may reach \$700 billion. The growth of costs is likely to outstrip the Social Security projection for the growth in real Gross Domestic Product. As a result, the share of long-term care spending in GDP is likely to rise sharply in the next century, reaching 4-1/2 percent of GDP by 2050. In 1993, the share is expected to be about 1-3/4 percent.

⁶Kenneth Manton and Eric Stallard, "The Projected Demand for Cancer Care..."

Total Long-Term Care Spending Projections (billions of 1993 dollars; percent of real GDP in parentheses)				
	1993	2000	2020	2050
Home Care	33 (0.5%)	44 (0.6%)	74 (0.7%)	205 (1.3%)
Institutional	75 (1.2%)	95 (1.3%)	174 (1.7%)	500 (3.2%)
Total	108 (1.7%)	139 (1.9%)	248 (2.4%)	705 (4.5%)
<i>Source: Long-Term Care Working Group estimates; for INTERNAL USE only.</i>				

If policies are modified so that the out-of-pocket costs of long-term care services to the disabled are reduced, then it is likely that use of, and therefore, spending on long-term services, would be greater than shown in the table. At the same time, however, long-term care services provided to the disabled would be expanded, thereby providing badly needed benefits to the disabled and their families.

- o The amount of "induced demand" because of lower out-of-pocket spending may not be very large for nursing home use because most people try to stay out of institutionalized residences as long as possible.
- o Induced demand, however, could be substantial for home care services.
 - According to one estimate, a nonmeans-tested public program that paid 80 percent of the costs of home care services to the severely disabled (i.e., reduced costs to an eligible individual from 100 percent of the bill to 20 percent) might result in 50-60 percent higher total spending for long-term home care than shown in the table above. Considerable uncertainty surrounds this estimate of the costs of induced demand, as well as the costs associated with other expanded programs, because there is not much previous experience that can provide guidance.
 - Induced demand would also occur if private long-term care insurance became much more prevalent. Public policies that would achieve this include better regulation of the industry to enhance consumers' confidence in the quality of the insurance products purchased; tax incentives to promote the purchase of insurance; and policy changes that enable purchasers of insurance to keep more of their assets and still be able to qualify for Medicaid nursing home coverage. Unlike a public program, the costs of induced use would be paid for by the insurance premiums paid by covered individuals.

Conclusion

As worrisome and costly as long-term care is now, it will become even more so 30 to 60 years from now when the elderly and very elderly comprise a much larger share of the population. Assuming that current policies are not changed, by 2050 long-term care expenditures may comprise 4-1/2 percent of Gross Domestic Product. If private or public insurance policies are significantly expanded, the share of GDP in the next century would be even larger, but the services provided to those needing long-term care would be considerably enhanced.

RECENT ECONOMIC INDICATORS AS OF MAY 21, 1993
(S.A. OR AS INDICATED)

	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93
GDP (Quarterly Series, % A.R.)														
Nominal GDP	62			4.3			5.3			7.1			5.2	
Real GDP	2.9			1.5			3.4			4.7			1.8	
Implicit Price Deflator	3.1			2.7			2.0			2.3			3.3	
Fixed-Weight Price Index	3.4			3.0			2.3			3.3			4.0	
CYCLICAL INDICATORS														
Leading Index, Percent	0.4	0.3	0.6	-0.3	0.1	-0.2	0.1	0.5	0.7	1.7	-0.1	0.5	-1.0	NA
Coincident Index, Percent	0.0	0.0	0.0	-0.1	0.4	-0.5	0.1	0.5	0.2	1.0	0.0	0.2	0.1	NA
Purchasing Managers' Diffusion Index	54.8	52.2	55.7	52.3	53.0	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7
Percent	2.6	-4.7	6.7	-6.1	1.3	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9
Industrial Production	105.6	106.3	106.7	106.0	106.8	106.6	106.2	107.5	108.4	108.9	109.3	109.9	109.9	110.0
Percent	0.28	0.66	0.38	-0.66	0.75	-0.19	-0.38	1.22	0.84	0.46	0.37	0.55	0.00	0.09
Capacity Utilization, Manufacturing	78.6	78.8	79.1	78.6	78.9	78.7	78.4	79.2	79.7	79.8	80.3	80.5	80.5	80.7
EMPLOYMENT INDICATORS														
Civilian Employment, Million	117.3	117.5	117.6	117.5	117.7	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4
Nonfarm Payroll Employment, Million	108.2	108.4	108.5	108.4	108.6	108.5	108.5	108.6	108.6	108.8	108.9	109.2	109.2	109.3
Civilian Unemployment Rate, Percent	7.3	7.3	7.4	7.7	7.6	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0
Employment/Population Ratio	61.4	61.5	61.5	61.4	61.4	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3
Average Weekly Hours, Manufacturing	41.1	41.1	41.3	41.0	41.0	41.0	40.9	41.1	41.2	41.2	41.4	41.5	41.2	41.5
CONSUMER SECTOR														
Retail Sales, Billion \$	160.0	160.2	161.3	161.1	162.3	163.2	164.2	167.6	167.3	169.2	169.2	169.1	167.7	169.7
Percent	-0.6	0.1	0.7	-0.1	0.7	0.6	0.6	2.1	-0.2	1.1	0.0	-0.1	-0.8	1.2
Total Auto Sales, Million Units, A.R.	8.3	8.2	8.4	8.9	8.3	7.9	8.3	8.3	8.2	8.7	8.6	8.0	8.3	8.9
Domestic Auto Sales, Million Units, A.R.	6.0	6.0	6.3	6.7	6.4	6.0	6.3	6.3	6.2	6.7	6.6	6.0	6.3	6.8
Personal Income, Billion \$, A.R.	5009.6	5015.4	5032.7	5038.5	5048.7	5056.4	5080.9	5145.0	5143.7	5194.0	5221.9	5227.8	5260.3	NA
Percent	0.4	0.1	0.3	0.1	0.2	0.2	0.5	1.3	-0.0	1.0	0.5	0.1	0.6	NA
Disposable Personal Income, Billion \$, A.R.	4400.6	4400.7	4415.1	4419.5	4424.6	4426.3	4448.7	4505.9	4500.4	4545.4	4565	4571.8	4603.9	NA
Savings Rate, Percent	5.3	5.5	5.3	5	4.8	4.6	4.6	4.4	4.4	4.4	4.5	4.8	NA	NA
Real Personal Income, Billion \$75, A.R.	4076.2	4070.9	4078.4	4076.5	4078.1	4094.3	4090.9	4125.9	4118.3	4155.2	4164.2	4155.6	4174.8	NA
Percent	-0.1	-0.1	0.2	-0.0	0.0	0.4	-0.1	0.9	-0.2	0.9	0.2	-0.2	0.5	NA
Real Disposable Personal Income, Billion \$75, A.R.	3581.9	3573.3	3578.6	3576.1	3574.4	3585.5	3581.7	3613.4	3604	3637.1	3640.5	3634.1	3653.3	NA
Percent	0.4	-0.2	0.1	-0.1	-0.0	0.3	-0.1	0.9	-0.3	0.9	0.1	-0.2	0.5	NA
Consumer Sentiment Index, U of Michigan	76.0	77.2	79.2	80.4	76.6	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6
Percent	10.5	1.6	2.6	1.5	-4.7	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3
HOUSING SECTOR														
Housing Starts, Thousand Units, A.R.	1318	1095	1197	1141	1106	1229	1218	1226	1226	1286	1171	1180	1137	1213
Single-Family Starts	1050	939	1019	994	961	1038	1045	1079	1089	1133	1051	1036	1000	1063

	Mar-92	Apr-92	May-92	Jun-92	Jul-92	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93
BUSINESS SECTOR														
Nondefense Capital Goods Orders, Billion \$	32.2	29.9	30.5	31.0	29.3	28.2	30.6	31.7	28.6	34.0	30.4	34.6	31.0	NA
Percent	9.2	-7.0	1.9	1.6	-5.4	-3.9	8.6	3.6	-9.7	19.0	-10.8	13.9	-10.4	NA
Nonresidential Construction Put in Place, Billion \$	128.5	127.2	124.1	127.6	124.7	117.8	122.5	123.3	122.7	122.2	123.0	126.5	123.2	NA
Inventory Change Book Value, Billion \$, A.R.	20.4	41.3	-4.4	55.4	40.6	27.0	-11.5	11.4	14.9	26.6	26.6	42.5	78.8	NA
Inventory/Sales Ratio, Total Business	1.51	1.51	1.51	1.50	1.50	1.52	1.50	1.49	1.49	1.46	1.46	1.46	1.47	NA
INFLATION INDICATORS														
CPI, Percent	0.4	0.3	0.1	0.2	0.3	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4
CPI Less Food and Energy, Percent	0.3	0.3	0.3	0.1	0.3	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4
PPI Finished Goods, Percent	0.2	0.2	0.3	0.2	0.0	0.1	0.2	0.1	-0.2	0.0	0.2	0.4	0.4	0.6
PPI Less Food and Energy, Percent	0.3	0.3	0.4	-0.2	0.1	0.0	0.1	-0.1	0.2	0.1	0.3	0.3	0.1	0.4
Gold, \$ per ounce	343.8	338.2	337.3	341.3	353.2	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6
W. Texas Spot Oil Price, \$/bbl	18.9	20.2	20.9	22.4	21.8	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3
MERCHANDISE TRADE														
Exports, Billion \$, A.R.	446.1	436.6	431.7	456.5	449.2	436.4	451.9	466.6	453.6	470.1	450.1	443.1	468.0	NA
Imports, Billion \$, A.R.	512.7	520.7	523.7	538.7	539.3	540.6	551.6	553.4	547.6	553.7	542.1	538.0	590.4	NA
Deficit, Billion \$, A.R.	-66.6	-84.1	-92.1	-82.2	-90.1	-104.2	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-122.5	NA
U.S. EXCHANGE RATE														
Multilateral	90.4	89.8	88.3	85.9	82.6	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6
Percent	2.7	-0.7	-1.7	-2.7	-3.9	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2
Yen/\$	132.9	133.5	130.8	126.8	125.9	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4
DM/\$	1.66	1.65	1.62	1.57	1.49	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60
\$/Pound	1.72	1.76	1.81	1.86	1.92	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54
MONEY AND CREDIT														
M2, Billion \$	3467.8	3464.8	3467.5	3462.1	3463.6	3472.4	3480.2	3491.4	3498.0	3497.0	3487.0	3475.2	3472.2	3472.5
Percent	0.0	-1.0	0.9	-1.9	0.5	3.1	2.7	3.9	2.3	-0.3	-3.4	-4.0	-1.0	0.1
M3, Billion \$	4184.9	4177.9	4179.8	4170.1	4169.0	4178.7	4183.0	4180.0	4178.5	4166.5	4140.9	4134.4	4128.5	4135.0
Percent	-1.2	-2.0	0.5	-2.7	-0.3	2.8	1.2	-0.9	-0.4	-3.4	-7.1	-1.9	-1.7	1.9
C&I Loans & Commercial Paper, Billion \$, N.S.A.	1000.0	996.8	1000.0	990.9	966.0	981.4	987.1	991.1	996.9	989.8	986.1	978.4	979.9	NA
Percent, A.R.	6.3	-3.8	3.9	-10.4	-26.3	20.9	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	NA
C&I Loans, Billion \$	454.3	452.3	454.3	447.3	422.8	439.3	439.3	439.5	441.0	438.3	436.3	437.4	438.4	NA
Commercial Paper, Billion \$	545.7	544.5	545.7	543.5	543.2	542.0	547.9	551.7	555.9	551.5	549.9	541.1	541.4	NA
INTEREST RATES														
Federal Funds Rate	4.0	3.7	3.8	3.8	3.3	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0
T-Bill, 3 Month	4.0	3.8	3.6	3.7	3.2	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9
T-Bond, 30 Year	8.0	8.0	7.9	7.8	7.6	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9
Corporate AAA Bonds	8.4	8.3	8.3	8.2	8.1	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5
Mortgage Commitment Rate	8.9	8.9	8.7	8.5	8.1	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5
STOCK MARKET														
Dow Jones 30 Industrials	3247.4	3294.1	3376.8	3337.8	3329.4	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6
Standard & Poor's 500	407.4	407.4	414.8	408.3	415.1	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1

file

FRIDAY REPORT

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DATE: 9/17/93

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FROM: JOSEPH J. MINARIK, Ext. 5873

*FRI. Economic
& Financial Report
(Insurance
Companies)*



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503
September 18, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

SUMMARY

In 1991, 24 multistate insurance companies, with assets totalling \$44 billion, were taken over by state insurance commissioners. The two biggest failures, Executive Life of California and Mutual Benefit Life of New Jersey, each had about \$14 billion in assets, around 400,000 individual policyholders, and were major writers of investment contracts to pension plans and municipalities.

This month, courts have approved rehabilitation plans for both companies. This Friday Report describes the likely resolution of Executive Life and Mutual Benefit, focusing on where the resources will come from to meet policyholder liabilities and the extent of policy value that will be recovered.

- Mutual Benefit policyholders who keep their policies in force with the successor company will be fully covered as a result of agreements worked out with guaranty associations in 48 states and a consortium of insurance companies, including Metropolitan and Prudential.
- Many Executive Life policyholders will also receive full coverage. On average, individual-type policies with the successor company will receive between 94 and 99 percent of their policy value. Municipalities and pension funds that had multi-million dollar investment contracts will recover around 87 percent on average.

The resources to cover these policies will come from the assets remaining in the insolvent companies, multiyear assessments of insurance companies by the industry-financed guaranty system totalling about \$2-1/4 billion, and guaranties by the consortium of insurance companies.

The private-sector policyholder insurance system was put to the test by these two failures. If their policyholders were not adequately protected, then it would be difficult to retain and attract policyholders at other companies. The absence of policyholder runs recently reflects, in no small part, the industry's success in minimizing the losses of Executive Life and Mutual Benefit policyholders.

Life after Death in the Life Insurance Industry

1991 was a disastrous year for the life insurance industry. Twenty-four firms that operated in two or more states were taken over by regulators. The book value of their assets as of their last annual statement totalled \$44 billion. In contrast, the worst previous year since the Great Depression was 1986, when firms with \$4 billion in assets failed -- most of which was concentrated in Baldwin United.

The two largest failures in 1991 were Executive Life of California and Mutual Benefit Life in New Jersey. Resolving these insolvencies was the greatest challenge ever to the industry's long-standing policy to "bury its own." Failure to make good on the bulk of these companies' promises to policyholders would shake, if not destroy, the trust on which the industry depends. This did not come to pass. The sharp reduction in the number and size of firms taken over by regulators since 1991 and the absence of policyholder runs attest to the fact that a healthier insurance industry has restored policyholders' faith.

Multistate Life Insurance Failures		
	<u>Number</u>	<u>Assets*</u> \$ Millions
1986	6	3,999
1987	9	88
1988	6	51
1989	27	1,367
1990	18	1,005
1991	24	44,401
1992	15	1,629
Jan-June 1993	9	1,640
----- *Book value reported on last annual statement.		

This Friday Report describes the likely resolution of Executive Life and Mutual Benefit. As a result of court rulings in California and New Jersey this month, it is now possible to determine which entity will assume the insolvent company's policyholder liabilities; where the resources will come from to meet that obligation; and, finally, the extent of policyholders' losses. As described in the Appendix comparing Federal deposit insurance with the insurance industry's policyholder insurance, it often takes considerable time and effort to resolve a large, multistate insurance company failure.

Why Executive Life and Mutual Benefit Failed

In terms of size, Executive Life and Mutual Benefit had a lot in common. Executive Life had \$13 billion in assets on its books, 340,000 individual policyholders, and operations in 46 states. Mutual Benefit, a 150-year old company, had \$14 billion in book value of assets, 400,000 individual policyholders, and operations in all states. Both companies were major writers of investment contracts with pension plans, known as Pension Guaranteed Income Contracts (GICs), and Executive Life wrote similar contracts to back municipal bonds (Muni GICs).¹ Through sales of these to pension plan sponsors, bond trustees and other intermediaries, each company indirectly affected several hundred thousand participants in addition to its individual policyholders.

Executive Life and Mutual Benefit had a common fatal flaw: each shunned the typical insurance company practice of diversifying assets. Executive Life put 90 percent of its \$10 billion bond portfolio into high-yielding junk bonds; the average insurance company had only 10 percent. Mutual Benefit had 63 percent of its assets in real estate; the average company in 1991 had 3 percent. When the junk bond and real estate markets collapsed at the end of the 1980s, policyholder runs at both firms triggered regulator takeovers. Though the junk bond market has recovered and real estate market values are beginning to come back, Executive Life and Mutual Benefit had neither the luxury of time nor the diversity of portfolio to wait out the slump. If regulators had liquidated their assets when the companies were taken over, Executive Life and Mutual Benefit would have had approximately 55 cents per dollar of policyholder liabilities.

The Successors

Although it has taken two years of difficult negotiation and legal wrangling, this month the courts approved the insurance commissioners' plans to transfer the assets and liabilities of Executive Life and Mutual Benefit to successor companies.

- o Executive Life's policies will be assumed by a brand new company, Aurora, that will be capitalized with the proceeds from the 1992 sale of Executive Life's portfolio of junk bonds, payments by guaranty associations, and capital put up by the new company's owners.
- Guaranty associations in 43 states will contribute a total of \$2.1 billion, payable over six years. These assessments are backloaded, with annual payments during 1993-1996 of \$142 million per year, followed by a balloon payment in 1997 of \$1.5 billion. The backloading arrangement worked out with the California insurance commissioner provides insurance companies the time needed to build up

¹Guaranteed Income Contracts are a contract between an insurance company and a corporate, profit-sharing pension plan or municipality that guarantees a specific rate of return on invested capital over the life of the contract. In this transaction, the insurance company accepts all of the market, credit and interest-rate risk.

reserves for this extraordinary expense. In most states, firms can deduct the assessment from their annual premium taxes paid to state coffers, usually over five years. Thus, ultimately, taxpayers in these states will probably "pay" up to 80 percent of the assessment in the form of lower tax receipts. In these states as well as those without a premium offset, policyholders in the future will pay the additional costs of the assessment in the form of higher premiums.

- o Mutual Benefit policies will be assumed by a subsidiary of Mutual Benefit. That transfer is needed to cut off the claims of general creditors of Mutual Benefit. The subsidiary will receive an infusion of funds from guaranty payments totalling \$160 to \$200 million over the next seven years. That amount is estimated to be sufficient to meet liquidity needs of the subsidiary through the year 2000. If, by 2000, the real estate market has not recovered sufficiently to put the subsidiary on a sound financial footing, 48 guaranty associations and a consortium of insurance companies, including Metropolitan and Prudential, have agreed to make good on the entirety of the \$8.1 billion in estimated policy value.

-- The guaranty associations have committed to guarantee all of the \$5.9 billion in policy values written to individuals. A consortium of the life insurance companies that are the major issuers of GICs have voluntarily agreed to guarantee all of the \$2.2 billion in Mutual Benefit GICs.

Who Loses What?

Policyholders of the insolvent companies are to recover part or all of their policy value. How much they receive will depend upon whether the policy was with Executive Life or Mutual Benefit, whether the policyholder stays with the successor company, the amount of assets that remain in the estate of the insolvent company relative to its policy liabilities, and the extent of guaranties provided by guaranty associations and the industry.

- o In both cases, however, some policy values have been reduced because the rehabilitation plans of both insolvent companies incorporate a write-down of interest income for the remaining life of the contract. In the case of Executive Life policyholders, they will receive rates tied to Treasuries instead of the much higher rates of return generated by junk bonds. Mutual Benefit policyholders are guaranteed an annual interest rate of only 3.5 to 5.0 percent over the seven-year rehabilitation period.

The plans are structured to provide financial incentives for policyholders to keep their policies in force with the successor companies. Policyholders who "opt out" do not receive any guaranty association insurance coverage and will recover less than those who "opt in."

In the case of Mutual Benefit:

- o Those who opt out are to receive only 55 percent of their policy value. They may not be able to recover any part of the 45 percent shortfall from their guaranty association; it is the associations' position that guaranty coverage is limited only to those who opt in.

- o Those policyholders who opt in and keep their policies in force for seven years, however, are promised full coverage. That is the case even if guaranty association law had a lower coverage limit or even excluded coverage. The full coverage is provided by 48 guaranty associations and a consortium of insurance companies.

In the case of Executive Life:

- o The plan calls for those who opt out to ultimately receive only 81 percent of their policy value, their proportionate share of Executive Life assets, and funds from guaranty associations and the successor company. As in the case of Mutual Benefit, guaranty associations maintain that they do not have to pay for any shortfall of policyholders who opt out.
- o Those who opt in and keep their policies for five years are to receive 100 percent of policy value up to the limit provided by their state's guaranty association law and 86 percent on policy values in excess of that limit.
 - For example, someone with an annuity valued at \$100,000 residing in a state where the guaranty association insured \$100,000 on an annuity would receive only \$81,000 if they opt out. If they opt in, however, the full value of the policy would be maintained. If someone had an annuity valued at \$200,000 and opted in, the plan calls for them to get \$186,000 ultimately (100 percent of the first \$100,000 and 86 percent of the next \$100,000.)

If all policyholders opt in, they will recover an average of 93.7 percent of their policy value, \$8.71 billion out of \$9.3 billion of policy value (see table below). The biggest losses in absolute terms (\$270 million) and as a percent of policy value (14 percent) will be incurred by Muni GICs, which do not have any guaranty association coverage in any state. Individual policyholders will recover between 94 and 99 percent of policy value. Structured settlements are at the low end of this range because limits on guaranty association coverage result in associations protecting only 54 percent of the total value of such policies. (Structured settlements involve tort cases, such as workers compensation and medical malpractice.)

Executive Life Policyholder Recoveries				
	Policy Value	Ultimate Recovery	Ultimate Loss	Percent Recovered
	------(billions)-----			
Annual Premium Whole Life	1.86	1.80	0.06	96.8
Single Premium Whole Life	0.57	0.55	0.02	96.8
Single Premium Deferred Annuity	1.34	1.32	0.02	98.3
Pension Plan Annuities	1.30	1.28	0.02	98.5
Structured Settlements	1.16	1.09	0.07	93.6
Pension GICs	1.12	0.99	0.13	88.8
Muni GICs	1.96	1.69	0.27	86.2
Total	9.30	8.71	0.59	93.7

Pension Plan Annuitants

While Mutual Benefit had few, if any, annuitants formerly covered by a pension plan, Executive Life had slightly over 100,000 such policies totalling \$1.3 billion (\$1.03 billion involved terminated pension plan annuities and \$260 million were policies for retirees from on-going pension plans). Had these pension promises remained in the pension plan rather than being annuitized with an insurance company, the Pension Benefit Guarantee Corporation (PBGC) would have guaranteed most and, in many cases, all of the value of these pensions. Since the PBGC does not insure these annuities, there is no PBGC guarantee underpinning the pension annuitants of Executive Life.

Nonetheless, these pension annuitants will recover 98.5 percent of their policy value. Losses will be just under \$20 million out of the nearly \$1.3 billion in total pension annuities. The shortfall in recovery occurs because of the absence of insurance industry guaranty associations in three jurisdictions at the time of insolvency, the exclusion of guaranty association coverage for policyholders residing abroad, and limits on coverage in jurisdictions with systems already in place.

As a consequence of the 1991 insurance industry failures, guaranty associations were established in Colorado, Louisiana and the District of Columbia. Had these associations existed at the time of Executive Life's failure, the number of annuitants without any guaranty association coverage would have been reduced from 3,646 to only 913 and the percent of policy value recovered would have increased to 99 percent.

Conclusion

The rehabilitation plans for Executive Life and Mutual Benefit are likely to result in relatively small losses to those policyholders who keep their policies intact with the successor insurance companies. Executive Life's policyholders are likely to recover nearly 94 percent of their policy value. About half of the \$590 million lost will be incurred by multimillion dollar investment contracts (GICs) sold to pension plans and municipalities. Individual policyholders, including pension plan annuitants, will receive nearly complete coverage. Mutual Benefit policyholders who opt into the rehabilitation plan are likely to receive full policy value thanks to guarantees by 48 guaranty associations and a consortium of insurance companies. The private sector guaranty system that covers policyholders faced a serious challenge in the failure of Executive Life and Mutual Benefit -- and demonstrated that it could fulfill its promises.

APPENDIX

Federal Deposit Insurance versus Insurance Industry Policyholder Insurance

There are two fundamental differences between deposit insurance and policyholder insurance: the former is national in scope and backed by the Federal Government; the latter varies across states and is backed by the insurance industry. As a result of these fundamental differences:

- o The funds to make good on promised coverage of depository institutions are available through an insurance fund financed by industry-paid annual premiums or, if this is inadequate, the Treasury. In the past, this has created a moral hazard that increases system risk: depositors can seek out the highest paying depository institution because their deposits are Federally insured; this gives depositories an incentive to take on additional risk, especially if regulators follow a policy of "too big to fail." In the insurance industry, moral hazard is diminished because policyholders are directly at risk. Even if they are covered by the industry guaranty, the uncertainty and delays in the recovery process provide a powerful incentive for policyholders to balance risk with return.

The resources to make good on the policyholder guaranty limits come from post-insolvency assessments levied against the solvent insurance companies operating in each state in which the insolvent company was licensed. There is no preexisting fund, nor is there any state government backing. The word "state" in the guaranty system refers to geography rather than level of government.

- o Federal deposit insurance provides immediate and full access to insured funds. Policyholders of insolvent insurance companies have to rely on more cumbersome and drawn out processes, especially when the failure involves a large multistate insurance company. The insurance commissioner in charge of the failed company often has to sew together a patchwork quilt comprised of the remaining assets of the insolvent company, payments from various state insurance guaranty associations, and ad hoc arrangements negotiated with the groups of policyholders and other insurance companies. While the details are being worked out and even beyond, policyholders may face cutbacks in their usual benefits, write-downs in their policy values, and moratoriums or substantial penalties on policy loan withdrawals and surrenders.
- o National standards for Federal deposit insurance provide clear, uniform coverage. Insurance industry coverage standards vary substantially across states, especially for GICs. Consequently, when a multistate insurer goes under, it takes some time and considerable effort to determine which guaranty association covers which policyholders and to what extent.
- o Deposit insurance is provided to all depositors, regardless of their place of residence. Guaranty association coverage, however, generally applies only to residents of the state

in which the insolvent firm was licensed to do business; policyholders residing abroad are not covered. Moreover, at the time of the Executive Life and Mutual Benefit takeovers by regulators, Colorado, Louisiana and the District of Columbia did not have guaranty associations. Therefore, resident policyholders had no guaranty policyholder coverage. Executive Life policyholders will recover their proportionate share of Executive Life assets (estimated to be 86 percent of their policy value); Mutual Benefit policyholders will receive 100 percent from an ad hoc arrangement worked out with guaranty associations and an industry consortium. In the wake of the 1991 insolvencies, all three jurisdictions without guaranty associations established them.

RECENT ECONOMIC INDICATORS AS OF SEPTEMBER 17, 1993
(S.A. OR AS INDICATED)

	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP		4.6			9.2			4.4			4.2		
Real GDP		3.4			5.7			0.8			1.8		
Implicit Price Deflator		1.0			3.3			3.6			2.3		
Fixed-Weight Price Index		2.3			3.3			4.3			2.6		
CYCLICAL INDICATORS													
Leading Index, Percent	-0.2	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.3	-0.4	0.1	-0.1	NA
Coincident Index, Percent	-0.5	0.1	0.5	0.2	1.0	0.0	0.4	0.1	0.6	0.2	-0.1	-0.2	NA
Purchasing Managers' Diffusion Index	52.2	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5	49.3
Percent	-1.5	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5	-0.4
Industrial Production	106.6	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.4	110.9	111.1
Percent	-0.19	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.18	0.45	0.18
Capacity Utilization, Manufacturing	78.7	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.7	80.6	80.7	80.8
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.8	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3	119.7
Nonfarm Payroll Employment, Million	108.6	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3	110.3
Civilian Unemployment Rate, Percent	7.6	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8	6.7
Employment/Population Ratio	61.4	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6	61.8
Average Weekly Hours, Manufacturing	41.1	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4	41.5
CONSUMER SECTOR													
Retail Sales, Billion \$	163.2	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.6	173.1	173.5
Percent	0.7	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.5	0.3	0.2
Total Auto Sales, Million Units, A.R.	8.1	8.3	8.3	8.3	8.7	8.7	8.0	8.4	9.0	9.1	8.8	8.6	8.6
Domestic Auto Sales, Million Units, A.R.	6.1	6.3	6.3	6.3	6.7	6.7	6.0	6.4	6.9	6.9	6.9	6.6	6.7
Personal Income, Billion \$, A.R.	5118.4	5172.4	5239.1	5238.5	5507.3	5225.7	5249.1	5289.2	5366.0	5383.2	5377.9	5368.2	NA
Percent	-0.2	1.1	1.3	-0.0	5.1	-5.1	0.4	0.8	1.5	0.3	-0.1	-0.2	NA
Disposable Personal Income, Billion \$, A.R.	4474.2	4526.9	4587.9	4582.8	4802.2	4570.6	4591.9	4630.1	4688.1	4698.7	4693.5	4679.3	NA
Savings Rate, Percent	4.9	4.9	4.8	6	5.5	5	3.9	4.4	4.8	4.5	4	NA	NA
Real Personal Income, Billion \$75, A.R.	4151.2	4151.2	4187.9	4180.8	4391.8	4150.7	4156.1	4181.2	4228.5	4238.7	4231.2	4220.3	NA
Percent	0.6	0.0	0.9	-0.2	5.0	-5.5	0.1	0.6	1.1	0.2	-0.2	-0.3	NA
Real Disposable Personal Income, Billion \$75, A.R.	3628.4	3632.8	3666.8	3656.9	3829.1	3630.7	3636.5	3660.4	3694.8	3698.9	3693.2	3680	NA
Percent	0.4	0.1	0.9	-0.3	4.7	-5.2	0.2	0.7	0.9	0.1	-0.2	-0.4	NA
Consumer Sentiment Index, U of Michigan	76.1	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0	NA
Percent	-0.7	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5	NA
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1229	1218	1226	1226	1286	1171	1180	1124	1206	1248	1246	1212	NA
Single-Family Starts	1038	1045	1079	1089	1133	1051	1036	987	1059	1107	1078	1060	NA

	Aug-92	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	27.5	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.9	30.2	NA
Percent	-4.3	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	13.1	-10.8	NA
Nonresidential Construction Put in Place, Billion \$	125.0	128.2	130.3	128.9	128.9	128.3	129.1	131.5	131.2	134.4	135.9	130.5	NA
Inventory Change Book Value, Billion \$, A.R.	18.3	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	0.3	-46.7	NA
Inventory/Sales Ratio, Total Business	1.52	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.46	1.47	NA
INFLATION INDICATORS													
CPI, Percent	0.2	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1	0.3
CPI Less Food and Energy, Percent	0.2	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1	0.3
PPI Finished Goods, Percent	0.1	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.6	-0.1	-0.3	-0.2	-0.6
PPI Less Food and Energy, Percent	0.0	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.4	0.1	-0.1	0.1	-1.0
Gold, \$ per ounce	344.6	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1	380.2
W. Texas Spot Oil Price, \$/bbl	21.4	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9	18.0
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	436.4	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.7	445.0	NA
Imports, Billion \$, A.R.	540.6	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.4	569.1	NA
Deficit, Billion \$, A.R.	-104.2	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	-124.1	NA
U.S. EXCHANGE RATE													
Multilateral	81.0	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6	94.3
Percent	-1.9	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0	-0.3
Yen/\$	126.2	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7	103.8
DM/\$	1.45	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72	1.69
\$/Pound	1.94	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50	1.49
MONEY AND CREDIT													
M2, Billion \$	3472.7	3480.7	3492.1	3498.7	3497.8	3488.3	3477.5	3474.9	3476.7	3507.1	3514.8	3520.9	NA
Percent	3.2	2.8	4.0	2.3	-0.3	-3.2	-3.7	-0.9	0.6	11.0	2.7	2.1	NA
M3, Billion \$	4179.1	4183.5	4180.6	4179.3	4167.3	4142.2	4137.4	4133.0	4144.6	4175.2	4173.3	4167.3	NA
Percent	2.9	1.3	-0.8	-0.4	-3.4	-7.0	-1.4	-1.3	3.4	9.2	-0.5	-1.7	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	981.4	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA	NA
Percent, A.R.	20.9	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA	NA
C&I Loans, Billion \$	439.3	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA	NA
Commercial Paper, Billion \$	542.0	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA	NA
INTEREST RATES													
Federal Funds Rate	3.3	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1	3.0
T-Bill, 3 Month	3.1	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0	3.0
T-Bond, 30 Year	7.4	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6	6.3
Corporate AAA Bonds	8.0	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2	6.9
Mortgage Commitment Rate	8.0	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2	7.1
STOCK MARKET													
Dow Jones 30 Industrials	3307.5	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4	3597.0
Standard & Poor's 500	417.9	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3	454.1

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& Financial Rpt."*

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

DATE: 10/4/93

TO: The Director

FROM: ASSOCIATE DIRECTOR
FOR ECONOMIC POLICY

The attached Friday Report replaces the version distributed last week, which transposed two rows of figures in the table on page 2. We apologize for the inconvenience.

Attachment

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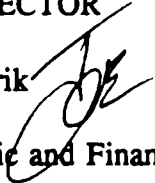
FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 4, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

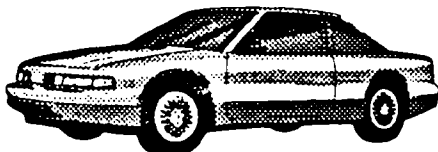
SUMMARY

This Friday Report assesses the recent improved performance of the U.S. auto sector and shows that while the outlook for continued profits looks promising, the road to recovery remains bumpy.

- In the first half of this year, strong sales and declining production costs helped propel General Motors, Ford and Chrysler into the black -- reporting earnings of \$889 million, \$775 million, and \$685 million, respectively.

Ultimately, the viability of U.S. auto makers depends on their success in restructuring and downsizing.

- U.S. automakers face higher costs than their Japanese competitors, in part because of rising health care costs and unfunded pension benefit liabilities.
- World excess capacity, rising environmental quality standards, and increasing competition from Japanese transplant factories, especially in the light truck and utility vehicle markets, will put further pressure on Big Three profit margins.



PROFITS RETURN FOR THE AUTOMOBILE INDUSTRY

The automobile industry has turned the corner in 1993, with all three major domestic auto producers now making profits, following substantial losses in the prior three years. This changed fortune reflects declining production costs resulting from industry downsizing, as well as strong domestic light truck sales where competition from Japanese producers is less stiff. This Friday Report assesses the recent improved performance of the U.S. auto sector and shows that while the outlook for continued profits looks promising, the road to recovery remains bumpy.

Profits Take a U-Turn

After several years of sluggish growth, sales of domestic automobiles gained strength during the first part of 1993. Total domestic vehicle sales rose about 7 percent during the first eight months of 1993 to an annual rate of over 14 million units.

- Most of the recent gains have been in the light truck and utility vehicle segment of the market where sales have surged by over 15 percent this year, following a similar increase in 1992. Automobile sales, however, remain weak, rising only 2 percent so far this year, after remaining flat in 1991 and 1992.
- The recent strength in light truck sales has directly improved the profitability of U.S. auto makers because they account for about 85 percent of the light truck market. In the second quarter, reported profits were \$889 million for GM, \$775 million for Ford, and \$685 million for Chrysler.

The discussion below assesses how the U.S. domestic auto industry has responded to changed market conditions; the recent cost-cutting measures for improving international competitiveness; and some of the major impediments that pose a threat to the industry's viability.

**Total Vehicle Sales in the U.S.
(Millions, Annual Rate)**

	1990	1991	1992	1993*
Cars:				
Domestic	6.9	6.1	6.3	6.6
Foreign	2.6	2.2	2.1	2.0
Total Cars	9.5	8.4	8.4	8.6
Light Trucks:				
Domestic	4.0	3.6	4.2	4.9
Foreign	0.4	0.3	0.2	0.2
Total Light Trucks	4.4	3.9	4.4	5.1
Heavy Trucks	0.3	0.2	0.3	0.3
Total Vehicles	14.2	12.5	13.1	14.0

* Through August

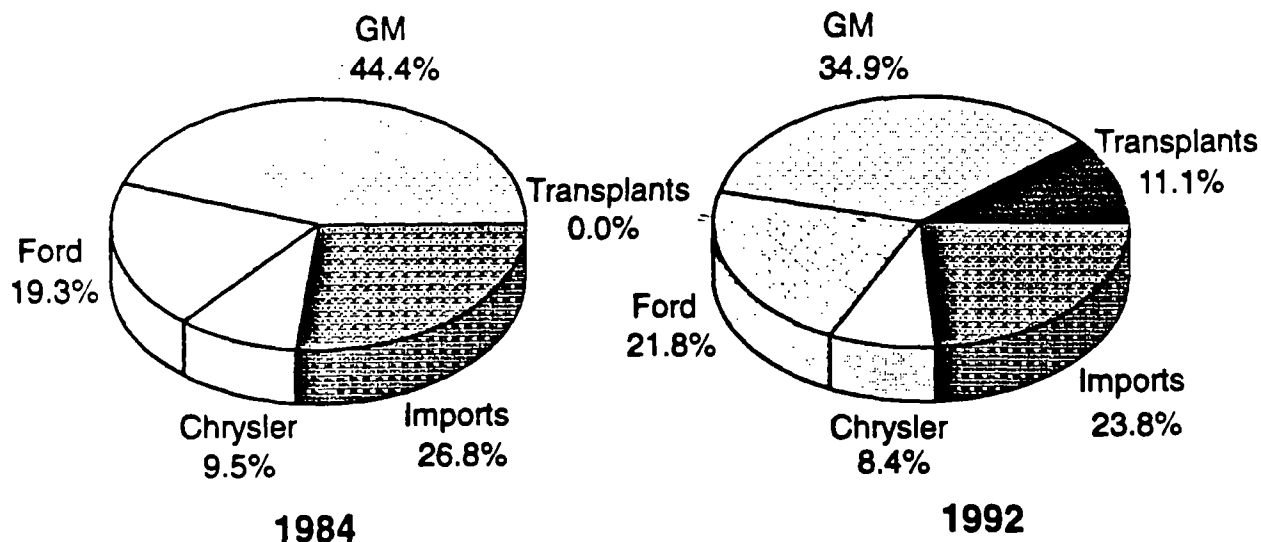
Eroding Market Shares in the 1980s

American auto producers were much less successful than their Japanese counterparts in adapting to changed market conditions during the 1980s. As a result, from 1984 to 1991 the market share of the Big Three fell from 73.2 percent to 64.2 percent, despite a surge in total vehicle sales to over 15 million units a year during most of this period.

- Japanese producers, aided by the overvalued dollar in the early eighties, registered a corresponding gain, increasing their market share to over 30 percent.
- In the wake of this decline in market share, U.S. auto makers actually increased production and turned to high-volume, low-margin fleet sales to their own captive rental agencies to generate book profits. This strategy not only failed to address the structural problems in industry, but actually backfired by leading to a deluge of high-quality used cars on the market -- further reducing new car demand.

It was only in recent years that the domestic auto producers began to face the challenges of intense competition, sharply rising costs, and production overcapacity. The 1990 recession and subsequent weak economic recovery helped expose the need for restructuring while the appreciation in the value of the yen provided a reprieve that should help the industry accomplish its restructuring goals.

Market Share of US New Car Sales



Industry Restructuring and Prospects for Growth

In restructuring, each of the Big Three has faced overwhelming bureaucracies, industry overcapacity, and high production and compensation costs. They have had varying degrees of success in achieving their desired objectives.

Chrysler -- After barely escaping bankruptcy, Chrysler was forced to downsize and trim production costs during the late 1980s. In the process, Chrysler scaled back production capacity, outsourced over 70 percent of material input production, and switched to a new design-production-marketing method called the platform technique: a production strategy, similar to the Saturn program, that puts together workers from all three fields and gives them responsibility for the product.

- Chrysler developed the LH series using this platform technique for a total program cost of \$1.6 billion, much lower than the development costs of Ford's new Mondeo line (\$6 billion) and GM's 1987 GM-10 line (\$7 billion).
- As a result, Chrysler's profits and market share shot up in the first half of this year as the newly introduced LH series, Grand Cherokee and Chrysler minivans recorded strong sales.

While profits may be restrained over the next two quarters by the costs associated with introducing its two newest product lines, analysts are expecting Chrysler's profits to surge again in the beginning of 1994. The main obstacle faced by Chrysler in the long term is actually undercapacity. As the economic recovery gains momentum and automobile sales accelerate, Chrysler may not have the production capacity to expand with consumer demand. Because Chrysler also appears reluctant to build additional production facilities, it was looking to win concessions from the United Auto Workers (UAW) in the current round of labor negotiations to relax restrictions on third shifts and overtime. Based on the sketchy details of the labor agreement concluded last night, it is too early to know if Chrysler was successful in obtaining these concessions.

Ford -- Over the past ten years, Ford has exhibited a better track record of productivity gains and responsiveness to consumer demand than either GM or Chrysler and, as a result, has been able to make steady gains in market share.

- The Taurus line has been highly successful in competing with Japanese models and rates high in customer satisfaction.
- Ford has restructured a large portion of its operations and has improved assembly productivity in all of its plants, often to levels comparable with the Japanese.

Ford, however, continues to be strapped by high health care costs, organizational inefficiencies, and losses on European operations from the ill-fated purchase of Jaguar. Ford is also suffering cost overruns on the development of the new "world car," the Mondeo, which will be made in and for both European and American markets. Ford hopes that its on-going restructuring will further increase production efficiency and reduce these costs. Like Chrysler, however, Ford is

also running at or above 100 percent of full production capacity and would benefit from UAW concessions on overtime and third shifts.

General Motors -- Unlike Chrysler and Ford, General Motors is only beginning its restructuring effort. Last year, GM announced plans to reduce its future work force by 50,000, closing at least six assembly plants and 15 parts and components facilities. Just last week, GM was reported to plan to raise the number of total job cuts to 100,000 over the next five years. While the number of jobs that will actually be cut remains uncertain, GM appears committed to downsizing. High labor costs, production overcapacity, and an expensive vertical integration structure are currently crippling the company's domestic markets.

- GM spends nearly \$795 more per car on labor than Chrysler or Ford. Its plan to cut 100,000 employees is directly targeted at reducing this labor-cost gap.
- GM buys 70 percent of its parts from internal components operations that are uncompetitive in both price and quality.

While there has been progress at GM, as manifested by the success of the new Saturn model, GM's market share has not rebounded. Nonetheless, GM is on track to reach its goal of breaking even (before taxes and interest) on its North American operations in 1993. This would complement its European operations which, unlike Ford, have been strong enough to remain profitable over the past several years.

While GM faces the costs associated with excess capacity, it also benefits from the flexibility to expand production in response to rising sales. Thus, if Chrysler and Ford have not obtained concessions on overtime or third-shift restrictions from the UAW, GM will be in a better position to expand production and recoup market share as consumer demand increases.

Industry Obstacles to Growth

For GM, Ford and Chrysler, the need for increased production efficiency through corporate restructuring is heightened by several industry trends that may serve as a further drag on industry profits.

The Rising Costs of Health Care -- Health care costs remain one of the largest production expenditures of domestic automobile manufacturers. In 1991, the health care costs for the Big Three averaged out to approximately \$1,100 per car, a \$600 disadvantage per car compared to the Japanese. Health care benefits have been at the top of the UAW's demands, both in the current round of labor contract negotiations and in lobbying for a National health care policy.

- GM, with its heavy vertical integration structure, suffers the most from health care costs, paying an average of \$1,500 per car.
- Chrysler and Ford have lower costs, paying \$700 and \$750 in health care costs per car respectively. In terms of sheer dollar volume, however, the health-care industry is Ford's largest single vendor.

- The recently adopted Financial Accounting Standard 106, which requires firms to fund their post-retirement obligations such as health care benefits, will cost the Big Three auto makers an estimated \$35 billion in 1993, and then \$2.5 billion a year. If enacted, the Administration's National health care proposal would defray a large portion of these costs.

Funding Pension Benefit Promises -- In 1991, GM and Chrysler¹ once again topped the list of companies with the largest unfunded pension liabilities, with \$19 billion and \$3 billion respectively -- approximately 53 percent of the total unfunded liabilities in plans insured by the Pension Benefit Guaranty Corporation. Not only does this pension underfunding expose the Federal government to large contingent liabilities, it damages the auto makers' credit ratings.

Chrysler has taken a substantial step towards funding its outstanding pension promises, contributing an extra \$1 billion in 1992; and GM has promised to fund its current benefits completely by the year 2000. A new Administration pension reform bill being submitted to Congress on October 4th will force GM and Chrysler to stand behind these public commitments to fund these benefits. While a transition rule will soften the initial impact of these stricter funding rules, the more stringent funding rules incorporated in the Administration's bill will force GM and Chrysler to use a large portion of their cash earnings over the next few years to reduce the magnitude of their unfunded benefit promises.

Rising Environmental Standards -- Stricter Federal environmental standards, passed in the Clean Air Act of 1990, and state initiatives like the California Air Resources Board (CARB) standards have raised car development and production costs for vehicles sold in the United States. While auto makers are well into their research efforts to comply with these standards, the Clean Air Act requirement that all centrally fueled fleets must cut hydrocarbon and toxic chemical emissions by 75 percent by 1998 effectively mandates the use of alternate fuels. This presents both a technical and an economic challenge for the auto industry.

- Several joint research ventures of the Big Three have analyzed the technical feasibility of using ethanol, methanol, propane, natural gas or electricity as an alternate automotive fuel, with little success.
- Even if technical obstacles were overcome, the cheaper gasoline prices make alternative fuels a less attractive alternative for consumers.

The Administration's announcement this week of a joint Federal government-U.S. auto maker research venture into alternate automotive fuels represents a bold step in assisting the auto industry in meeting this regulatory requirement.

Overcapacity and Foreign Competition -- The largest obstacle to future growth, however, remains overcapacity. Ford estimated that aggregate world motor vehicle production capacity exceeds world demand by almost 8 million units. Most of this excess capacity can be attributed

¹Ford currently has fully funded its pension liability.

to increases in the production capacity of the Japanese and the failure of GM to reduce plant capacity in line with market share.

- Japanese transplant facilities in the United States alone have the capacity to produce over two million vehicles; and capacity is expected to increase to three million by 1995.
- At the beginning of 1992, GM had a world production capacity of 6.7 million units, well above the 4.5 million vehicles it sold in 1991. GM expects to reduce this capacity to 6.1 million by 1995.
- Ford and Chrysler, which are currently at or near capacity, are producing around 3.5 million and 2 million units per year, respectively.

Another immediate concern for the Big Three is the future value of the Japanese yen and its effects on Japanese competition. The nearly 18 percent yen appreciation against the dollar so far this year has made Japanese cars relatively more expensive than domestic automobiles, giving the Big Three a much-needed reprieve from Japanese competition. The problem is whether this reprieve will be long enough for the Big Three to achieve efficiency gains from their restructuring.

- In the past, the Japanese have used similar periods to pare back operations and obtain efficiency gains of their own.
- Many Japanese companies are already implementing plans to increase transplant production of light trucks in the United States, bypassing the 25 percent tariff on light truck imports and tapping into the fastest growing segment of the U.S. market.

Conclusions

Vehicles sales in 1993 are projected to be 13.6 million, well below "normal" vehicle demand estimated at 15.4 million. Given this, U.S. auto makers are looking for a resurgence in consumer confidence and consumer spending to boost profits further as the recovery continues. Ultimately, however, the competitiveness of the U.S. automobile industry depends on the success of on-going restructuring efforts. With the industry healthier than it has been in some time, it must complete this process and set the stage for sustained long-term profitability.

RECENT ECONOMIC INDICATORS AS OF OCTOBER 1, 1993
(S.A. OR AS INDICATED)

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP	4.6			9.2			4.4			4.3			
Real GDP	3.4			5.7			0.8			1.9			
Implicit Price Deflator	1.0			3.3			3.6			2.3			
Fixed-Weight Price Index	2.3			3.3			4.3			2.6			
CYCLICAL INDICATORS													
Leading Index, Percent	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.2	-0.3	0.1	0.1	1.0	NA
Coincident Index, Percent	0.1	0.5	0.2	1.0	0.0	0.4	0.1	0.6	0.2	-0.2	-0.4	0.7	NA
Purchasing Managers' Diffusion Index	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5	49.3	NA
Percent	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5	-0.4	NA
Industrial Production	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.4	110.9	111.1	NA
Percent	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.18	0.45	0.18	NA
Capacity Utilization, Manufacturing	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.7	80.6	80.7	80.8	NA
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3	119.7	NA
Nonfarm Payroll Employment, Million	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3	110.3	NA
Civilian Unemployment Rate, Percent	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8	6.7	NA
Employment/Population Ratio	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6	61.8	NA
Average Weekly Hours, Manufacturing	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4	41.5	NA
CONSUMER SECTOR													
Retail Sales, Billion \$	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.6	173.1	173.5	NA
Percent	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.5	0.3	0.2	NA
Total Auto Sales, Million Units, A.R.	8.3	8.3	8.3	8.7	8.7	8.0	8.4	9.0	9.1	8.8	8.6	8.6	NA
Domestic Auto Sales, Million Units, A.R.	6.3	6.3	6.3	6.7	6.7	6.0	6.4	6.9	6.9	6.9	6.6	6.7	NA
Personal Income, Billion \$, A.R.	5172.4	5239.1	5238.5	5507.3	5225.7	5249.1	5289.2	5365.6	5380.4	5373.6	5357.8	5428.1	NA
Percent	1.1	1.3	-0.0	5.1	-5.1	0.4	0.8	1.4	0.3	-0.1	-0.3	1.3	NA
Disposable Personal Income, Billion \$, A.R.	4526.9	4587.9	4582.8	4802.2	4570.6	4591.9	4630.1	4687.8	4697.3	4691.6	4673.1	4738.7	NA
Savings Rate, Percent	4.9	4.8	6	5.5	5	3.9	4.4	4.7	4.4	3.9	3.7	NA	NA
Real Personal Income, Billion 87\$, A.R.	4151.2	4187.9	4180.8	4391.8	4150.7	4156.1	4181.2	4228.5	4238.7	4231.2	4220.3	NA	NA
Percent	0.0	0.9	-0.2	5.0	-5.5	0.1	0.6	1.1	0.2	-0.2	-0.3	NA	NA
Real Disposable Personal Income, Billion 87\$, A.R.	3632.8	3666.8	3656.9	3829.1	3630.7	3636.5	3660.4	3694.2	3697.7	3691.2	3673.6	3717.7	NA
Percent	0.1	0.9	-0.3	4.7	-5.2	0.2	0.7	0.9	0.1	-0.2	-0.5	1.2	NA
Consumer Sentiment Index, U of Michigan	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0	NA	NA
Percent	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5	NA	NA
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1218	1226	1226	1286	1171	1180	1124	1206	1248	1248	1227	1323	NA
Single-Family Starts	1045	1079	1089	1133	1051	1036	987	1059	1107	1079	1063	1180	NA

10/01/93

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.9	30.1	32.0	NA
Percent	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	13.1	-11.0	6.3	NA
Nonresidential Construction Put in Place, Billion \$	128.2	130.3	128.9	128.9	128.3	129.1	131.5	131.2	134.4	135.9	130.5	NA	NA
Inventory Change Book Value, Billion \$, A.R.	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	0.3	-46.7	NA	NA
Inventory/Sales Ratio, Total Business	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.46	1.47	NA	NA
INFLATION INDICATORS													
CPI, Percent	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1	0.3	NA
CPI Less Food and Energy, Percent	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1	0.3	NA
PPI Finished Goods, Percent	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.6	-0.1	-0.3	-0.2	-0.6	NA
PPI Less Food and Energy, Percent	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.4	0.1	-0.1	0.1	-1.0	NA
Gold, \$ per ounce	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1	380.2	NA
W. Texas Spot Oil Price, \$/bbl	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9	18.0	NA
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.7	445.0	NA	NA
Imports, Billion \$, A.R.	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.4	569.1	NA	NA
Deficit, Billion \$, A.R.	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	-124.1	NA	NA
U.S. EXCHANGE RATE													
Multilateral	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6	94.3	NA
Percent	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0	-0.3	NA
Yen/\$	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7	103.8	NA
DM/\$	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72	1.69	NA
\$/Pound	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50	1.49	NA
MONEY AND CREDIT													
M2, Billion \$	3480.7	3492.1	3498.7	3497.8	3488.8	3477.2	3474.6	3477.3	3507.7	3514.9	3521.3	3526.8	NA
Percent	2.8	4.0	2.3	-0.3	-3.0	-3.9	-0.9	0.9	11.0	2.5	2.2	1.9	NA
M3, Billion \$	4183.5	4180.6	4179.3	4167.3	4142.7	4137.0	4132.6	4144.7	4174.3	4174.4	4172.6	4175.7	NA
Percent	1.3	-0.8	-0.4	-3.4	-6.9	-1.6	-1.3	3.6	8.9	0.0	-0.5	0.9	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA	NA	NA
Percent, A.R.	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA	NA	NA
C&I Loans, Billion \$	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA	NA	NA
Commercial Paper, Billion \$	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA	NA	NA
INTEREST RATES													
Federal Funds Rate	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1	3.0	NA
T-Bill, 3 Month	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0	3.0	NA
T-Bond, 30 Year	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6	6.3	NA
Corporate AAA Bonds	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2	6.9	NA
Mortgage Commitment Rate	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2	7.1	NA
STOCK MARKET													
Dow Jones 30 Industrials	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4	3597.0	NA
Standard & Poor's 500	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3	454.1	NA



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

DATE: 10/4/93

TO: The Director

FROM: ASSOCIATE DIRECTOR
FOR ECONOMIC POLICY

The attached Friday Report replaces the version distributed last week, which transposed two rows of figures in the table on page 2. We apologize for the inconvenience.

Attachment

FRIDAY REPORT

EXPEDITE /___/

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MEMO TO: _____

DATE: 10/4/93

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FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 4, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

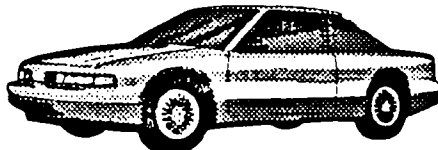
SUMMARY

This Friday Report assesses the recent improved performance of the U.S. auto sector and shows that while the outlook for continued profits looks promising, the road to recovery remains bumpy.

- In the first half of this year, strong sales and declining production costs helped propel General Motors, Ford and Chrysler into the black -- reporting earnings of \$889 million, \$775 million, and \$685 million, respectively.

Ultimately, the viability of U.S. auto makers depends on their success in restructuring and downsizing.

- U.S. automakers face higher costs than their Japanese competitors, in part because of rising health care costs and unfunded pension benefit liabilities.
- World excess capacity, rising environmental quality standards, and increasing competition from Japanese transplant factories, especially in the light truck and utility vehicle markets, will put further pressure on Big Three profit margins.



PROFITS RETURN FOR THE AUTOMOBILE INDUSTRY

The automobile industry has turned the corner in 1993, with all three major domestic auto producers now making profits, following substantial losses in the prior three years. This changed fortune reflects declining production costs resulting from industry downsizing, as well as strong domestic light truck sales where competition from Japanese producers is less stiff. This Friday Report assesses the recent improved performance of the U.S. auto sector and shows that while the outlook for continued profits looks promising, the road to recovery remains bumpy.

Profits Take a U-Turn

After several years of sluggish growth, sales of domestic automobiles gained strength during the first part of 1993. Total domestic vehicle sales rose about 7 percent during the first eight months of 1993 to an annual rate of over 14 million units.

- Most of the recent gains have been in the light truck and utility vehicle segment of the market where sales have surged by over 15 percent this year, following a similar increase in 1992. Automobile sales, however, remain weak, rising only 2 percent so far this year, after remaining flat in 1991 and 1992.
- The recent strength in light truck sales has directly improved the profitability of U.S. auto makers because they account for about 85 percent of the light truck market. In the second quarter, reported profits were \$889 million for GM, \$775 million for Ford, and \$685 million for Chrysler.

The discussion below assesses how the U.S. domestic auto industry has responded to changed market conditions; the recent cost-cutting measures for improving international competitiveness; and some of the major impediments that pose a threat to the industry's viability.

Total Vehicle Sales in the U.S. (Millions, Annual Rate)				
	1990	1991	1992	1993*
Cars:				
Domestic	6.9	6.1	6.3	6.6
Foreign	2.6	2.2	2.1	2.0
Total Cars	9.5	8.4	8.4	8.6
Light Trucks:				
Domestic	4.0	3.6	4.2	4.9
Foreign	0.4	0.3	0.2	0.2
Total Light Trucks	4.4	3.9	4.4	5.1
Heavy Trucks	0.3	0.2	0.3	0.3
Total Vehicles	14.2	12.5	13.1	14.0
* Through August				

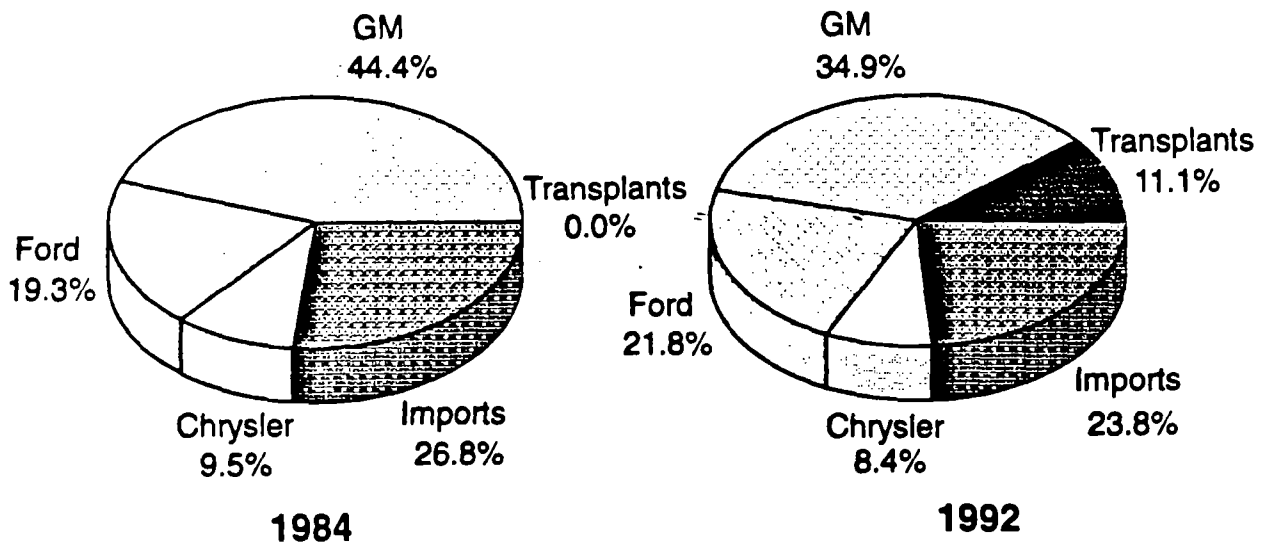
Eroding Market Shares in the 1980s

American auto producers were much less successful than their Japanese counterparts in adapting to changed market conditions during the 1980s. As a result, from 1984 to 1991 the market share of the Big Three fell from 73.2 percent to 64.2 percent, despite a surge in total vehicle sales to over 15 million units a year during most of this period.

- Japanese producers, aided by the overvalued dollar in the early eighties, registered a corresponding gain, increasing their market share to over 30 percent.
- In the wake of this decline in market share, U.S. auto makers actually increased production and turned to high-volume, low-margin fleet sales to their own captive rental agencies to generate book profits. This strategy not only failed to address the structural problems in industry, but actually backfired by leading to a deluge of high-quality used cars on the market -- further reducing new car demand.

It was only in recent years that the domestic auto producers began to face the challenges of intense competition, sharply rising costs, and production overcapacity. The 1990 recession and subsequent weak economic recovery helped expose the need for restructuring while the appreciation in the value of the yen provided a reprieve that should help the industry accomplish its restructuring goals.

Market Share of US New Car Sales



Industry Restructuring and Prospects for Growth

In restructuring, each of the Big Three has faced overwhelming bureaucracies, industry overcapacity, and high production and compensation costs. They have had varying degrees of success in achieving their desired objectives.

Chrysler -- After barely escaping bankruptcy, Chrysler was forced to downsize and trim production costs during the late 1980s. In the process, Chrysler scaled back production capacity, outsourced over 70 percent of material input production, and switched to a new design-production-marketing method called the platform technique: a production strategy, similar to the Saturn program, that puts together workers from all three fields and gives them responsibility for the product.

- Chrysler developed the LH series using this platform technique for a total program cost of \$1.6 billion, much lower than the development costs of Ford's new Mondeo line (\$6 billion) and GM's 1987 GM-10 line (\$7 billion).
- As a result, Chrysler's profits and market share shot up in the first half of this year as the newly introduced LH series, Grand Cherokee and Chrysler minivans recorded strong sales.

While profits may be restrained over the next two quarters by the costs associated with introducing its two newest product lines, analysts are expecting Chrysler's profits to surge again in the beginning of 1994. The main obstacle faced by Chrysler in the long term is actually undercapacity. As the economic recovery gains momentum and automobile sales accelerate, Chrysler may not have the production capacity to expand with consumer demand. Because Chrysler also appears reluctant to build additional production facilities, it was looking to win concessions from the United Auto Workers (UAW) in the current round of labor negotiations to relax restrictions on third shifts and overtime. Based on the sketchy details of the labor agreement concluded last night, it is too early to know if Chrysler was successful in obtaining these concessions.

Ford -- Over the past ten years, Ford has exhibited a better track record of productivity gains and responsiveness to consumer demand than either GM or Chrysler and, as a result, has been able to make steady gains in market share.

- The Taurus line has been highly successful in competing with Japanese models and rates high in customer satisfaction.
- Ford has restructured a large portion of its operations and has improved assembly productivity in all of its plants, often to levels comparable with the Japanese.

Ford, however, continues to be strapped by high health care costs, organizational inefficiencies, and losses on European operations from the ill-fated purchase of Jaguar. Ford is also suffering cost overruns on the development of the new "world car," the Mondeo, which will be made in and for both European and American markets. Ford hopes that its on-going restructuring will further increase production efficiency and reduce these costs. Like Chrysler, however, Ford is

also running at or above 100 percent of full production capacity and would benefit from UAW concessions on overtime and third shifts.

General Motors -- Unlike Chrysler and Ford, General Motors is only beginning its restructuring effort. Last year, GM announced plans to reduce its future work force by 50,000, closing at least six assembly plants and 15 parts and components facilities. Just last week, GM was reported to plan to raise the number of total job cuts to 100,000 over the next five years. While the number of jobs that will actually be cut remains uncertain, GM appears committed to downsizing. High labor costs, production overcapacity, and an expensive vertical integration structure are currently crippling the company's domestic markets.

- GM spends nearly \$795 more per car on labor than Chrysler or Ford. Its plan to cut 100,000 employees is directly targeted at reducing this labor-cost gap.
- GM buys 70 percent of its parts from internal components operations that are uncompetitive in both price and quality.

While there has been progress at GM, as manifested by the success of the new Saturn model, GM's market share has not rebounded. Nonetheless, GM is on track to reach its goal of breaking even (before taxes and interest) on its North American operations in 1993. This would complement its European operations which, unlike Ford, have been strong enough to remain profitable over the past several years.

While GM faces the costs associated with excess capacity, it also benefits from the flexibility to expand production in response to rising sales. Thus, if Chrysler and Ford have not obtained concessions on overtime or third-shift restrictions from the UAW, GM will be in a better position to expand production and recoup market share as consumer demand increases.

Industry Obstacles to Growth

For GM, Ford and Chrysler, the need for increased production efficiency through corporate restructuring is heightened by several industry trends that may serve as a further drag on industry profits.

The Rising Costs of Health Care -- Health care costs remain one of the largest production expenditures of domestic automobile manufacturers. In 1991, the health care costs for the Big Three averaged out to approximately \$1,100 per car, a \$600 disadvantage per car compared to the Japanese. Health care benefits have been at the top of the UAW's demands, both in the current round of labor contract negotiations and in lobbying for a National health care policy.

- GM, with its heavy vertical integration structure, suffers the most from health care costs, paying an average of \$1,500 per car.
- Chrysler and Ford have lower costs, paying \$700 and \$750 in health care costs per car respectively. In terms of sheer dollar volume, however, the health-care industry is Ford's largest single vendor.

- The recently adopted Financial Accounting Standard 106, which requires firms to fund their post-retirement obligations such as health care benefits, will cost the Big Three auto makers an estimated \$35 billion in 1993, and then \$2.5 billion a year. If enacted, the Administration's National health care proposal would defray a large portion of these costs.

Funding Pension Benefit Promises -- In 1991, GM and Chrysler¹ once again topped the list of companies with the largest unfunded pension liabilities, with \$19 billion and \$3 billion respectively -- approximately 53 percent of the total unfunded liabilities in plans insured by the Pension Benefit Guaranty Corporation. Not only does this pension underfunding expose the Federal government to large contingent liabilities, it damages the auto makers' credit ratings.

Chrysler has taken a substantial step towards funding its outstanding pension promises, contributing an extra \$1 billion in 1992; and GM has promised to fund its current benefits completely by the year 2000. A new Administration pension reform bill being submitted to Congress on October 4th will force GM and Chrysler to stand behind these public commitments to fund these benefits. While a transition rule will soften the initial impact of these stricter funding rules, the more stringent funding rules incorporated in the Administration's bill will force GM and Chrysler to use a large portion of their cash earnings over the next few years to reduce the magnitude of their unfunded benefit promises.

Rising Environmental Standards -- Stricter Federal environmental standards, passed in the Clean Air Act of 1990, and state initiatives like the California Air Resources Board (CARB) standards have raised car development and production costs for vehicles sold in the United States. While auto makers are well into their research efforts to comply with these standards, the Clean Air Act requirement that all centrally fueled fleets must cut hydrocarbon and toxic chemical emissions by 75 percent by 1998 effectively mandates the use of alternate fuels. This presents both a technical and an economic challenge for the auto industry.

- Several joint research ventures of the Big Three have analyzed the technical feasibility of using ethanol, methanol, propane, natural gas or electricity as an alternate automotive fuel, with little success.
- Even if technical obstacles were overcome, the cheaper gasoline prices make alternative fuels a less attractive alternative for consumers.

The Administration's announcement this week of a joint Federal government-U.S. auto maker research venture into alternate automotive fuels represents a bold step in assisting the auto industry in meeting this regulatory requirement.

Overcapacity and Foreign Competition -- The largest obstacle to future growth, however, remains overcapacity. Ford estimated that aggregate world motor vehicle production capacity exceeds world demand by almost 8 million units. Most of this excess capacity can be attributed

¹Ford currently has fully funded its pension liability.

to increases in the production capacity of the Japanese and the failure of GM to reduce plant capacity in line with market share.

- Japanese transplant facilities in the United States alone have the capacity to produce over two million vehicles; and capacity is expected to increase to three million by 1995.
- At the beginning of 1992, GM had a world production capacity of 6.7 million units, well above the 4.5 million vehicles it sold in 1991. GM expects to reduce this capacity to 6.1 million by 1995.
- Ford and Chrysler, which are currently at or near capacity, are producing around 3.5 million and 2 million units per year, respectively.

Another immediate concern for the Big Three is the future value of the Japanese yen and its effects on Japanese competition. The nearly 18 percent yen appreciation against the dollar so far this year has made Japanese cars relatively more expensive than domestic automobiles, giving the Big Three a much-needed reprieve from Japanese competition. The problem is whether this reprieve will be long enough for the Big Three to achieve efficiency gains from their restructuring.

- In the past, the Japanese have used similar periods to pare back operations and obtain efficiency gains of their own.
- Many Japanese companies are already implementing plans to increase transplant production of light trucks in the United States, bypassing the 25 percent tariff on light truck imports and tapping into the fastest growing segment of the U.S. market.

Conclusions

Vehicles sales in 1993 are projected to be 13.6 million, well below "normal" vehicle demand estimated at 15.4 million. Given this, U.S. auto makers are looking for a resurgence in consumer confidence and consumer spending to boost profits further as the recovery continues. Ultimately, however, the competitiveness of the U.S. automobile industry depends on the success of on-going restructuring efforts. With the industry healthier than it has been in some time, it must complete this process and set the stage for sustained long-term profitability.

RECENT ECONOMIC INDICATORS AS OF OCTOBER 1, 1993
(S.A. OR AS INDICATED)

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP	4.6			9.2			4.4			4.3			
Real GDP	3.4			5.7			0.8			1.9			
Implicit Price Deflator	1.0			3.3			3.6			2.3			
Fixed-Weight Price Index	2.3			3.3			4.3			2.6			
CYCLICAL INDICATORS													
Leading Index, Percent	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.2	-0.3	0.1	0.1	1.0	NA
Coincident Index, Percent	0.1	0.5	0.2	1.0	0.0	0.4	0.1	0.6	0.2	-0.2	-0.4	0.7	NA
Purchasing Managers' Diffusion Index	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5	49.3	NA
Percent	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5	-0.4	NA
Industrial Production	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.4	110.9	111.1	NA
Percent	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.18	0.45	0.18	NA
Capacity Utilization, Manufacturing	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.7	80.6	80.7	80.8	NA
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3	119.7	NA
Nonfarm Payroll Employment, Million	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3	110.3	NA
Civilian Unemployment Rate, Percent	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8	6.7	NA
Employment/Population Ratio	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6	61.8	NA
Average Weekly Hours, Manufacturing	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4	41.5	NA
CONSUMER SECTOR													
Retail Sales, Billion \$	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.6	173.1	173.5	NA
Percent	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.5	0.3	0.2	NA
Total Auto Sales, Million Units, A.R.	8.3	8.3	8.3	8.7	8.7	8.0	8.4	9.0	9.1	8.8	8.6	8.6	NA
Domestic Auto Sales, Million Units, A.R.	6.3	6.3	6.3	6.7	6.7	6.0	6.4	6.9	6.9	6.9	6.6	6.7	NA
Personal Income, Billion \$, A.R.	5172.4	5239.1	5238.5	5507.3	5225.7	5249.1	5289.2	5365.6	5380.4	5373.6	5357.8	5428.1	NA
Percent	1.1	1.3	-0.0	5.1	-5.1	0.4	0.8	1.4	0.3	-0.1	-0.3	1.3	NA
Disposable Personal Income, Billion \$, A.R.	4526.9	4587.9	4582.8	4802.2	4570.6	4591.9	4630.1	4687.8	4697.3	4691.6	4673.1	4738.7	NA
Savings Rate, Percent	4.9	4.8	6	5.5	5	3.9	4.4	4.7	4.4	3.9	3.7	NA	NA
Real Personal Income, Billion 87\$, A.R.	4151.2	4187.9	4180.8	4391.8	4150.7	4156.1	4181.2	4228.5	4238.7	4231.2	4220.3	NA	NA
Percent	0.0	0.9	-0.2	5.0	-5.5	0.1	0.6	1.1	0.2	-0.2	-0.3	NA	NA
Real Disposable Personal Income, Billion 87\$, A.R.	3632.8	3666.8	3656.9	3829.1	3630.7	3636.5	3660.4	3694.2	3697.7	3691.2	3673.6	3717.7	NA
Percent	0.1	0.9	-0.3	4.7	-5.2	0.2	0.7	0.9	0.1	-0.2	-0.5	1.2	NA
Consumer Sentiment Index, U of Michigan	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0	NA	NA
Percent	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5	NA	NA
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1218	1226	1226	1286	1171	1180	1124	1206	1248	1248	1227	1323	NA
Single-Family Starts	1045	1079	1089	1133	1051	1036	987	1059	1107	1079	1063	1180	NA

10/01/93

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.9	30.1	32.0	NA
Percent	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	13.1	-11.0	6.3	NA
Nonresidential Construction Put in Place, Billion \$	128.2	130.3	128.9	128.9	128.3	129.1	131.5	131.2	134.4	135.9	130.5	NA	NA
Inventory Change Book Value, Billion \$, A.R.	-11.1	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	0.3	-46.7	NA	NA
Inventory/Sales Ratio, Total Business	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.46	1.47	NA	NA
INFLATION INDICATORS													
CPI, Percent	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1	0.3	NA
CPI Less Food and Energy, Percent	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1	0.3	NA
PPI Finished Goods, Percent	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.6	-0.1	-0.3	-0.2	-0.6	NA
PPI Less Food and Energy, Percent	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.4	0.1	-0.1	0.1	-1.0	NA
Gold, \$ per ounce	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1	380.2	NA
W. Texas Spot Oil Price, \$/bbl	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9	18.0	NA
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.7	445.0	NA	NA
Imports, Billion \$, A.R.	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.4	569.1	NA	NA
Deficit, Billion \$, A.R.	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	-124.1	NA	NA
U.S. EXCHANGE RATE													
Multilateral	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6	94.3	NA
Percent	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0	-0.3	NA
Yen/\$	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7	103.8	NA
DM/\$	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72	1.69	NA
\$/Pound	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50	1.49	NA
MONEY AND CREDIT													
M2, Billion \$	3480.7	3492.1	3498.7	3497.8	3488.8	3477.2	3474.6	3477.3	3507.7	3514.9	3521.3	3526.8	NA
Percent	2.8	4.0	2.3	-0.3	-3.0	-3.9	-0.9	0.9	11.0	2.5	2.2	1.9	NA
M3, Billion \$	4183.5	4180.6	4179.3	4167.3	4142.7	4137.0	4132.6	4144.7	4174.3	4174.4	4172.6	4175.7	NA
Percent	1.3	-0.8	-0.4	-3.4	-6.9	-1.6	-1.3	3.6	8.9	0.0	-0.5	0.9	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA	NA	NA
Percent, A.R.	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA	NA	NA
C&I Loans, Billion \$	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA	NA	NA
Commercial Paper, Billion \$	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA	NA	NA
INTEREST RATES													
Federal Funds Rate	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1	3.0	NA
T-Bill, 3 Month	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0	3.0	NA
T-Bond, 30 Year	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6	6.3	NA
Corporate AAA Bonds	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2	6.9	NA
Mortgage Commitment Rate	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2	7.1	NA
STOCK MARKET													
Dow Jones 30 Industrials	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4	3597.0	NA
Standard & Poor's 500	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3	454.1	NA

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MEMO TO: _____

DATE: October 8, 1993

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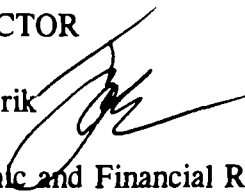
FROM: JOSEPH J. MINARIK, Ext. 5873



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 8, 1993

MEMORANDUM FOR THE DIRECTOR

FROM: Joseph J. Minarik 
SUBJECT: Friday Economic and Financial Report

SUMMARY

The first story assesses the near-term economic outlook. It is likely that real GDP grew at about a 2-1/2 percent annual rate in the third quarter, up from 1.9 percent in the second. Fourth quarter growth is likely to be at least 3.0 percent. These estimates are close to the Mid-Session Review (MSR) forecast of 2.9 percent and 3.0 percent in the third and fourth quarters, respectively.

- According to Labor Department figures released this morning, payroll jobs increased by 156,000 in September and the unemployment rate held at 6.7 percent. The labor market developments in the third quarter are consistent with a 2-1/2 percent GDP growth.
- Third quarter growth was restrained by the floods in the Midwest and a drop in auto production. Fourth quarter growth will be boosted by a bounce back in farm inventories and auto production as well as continued advances in consumer spending, equipment investment and housing construction.

In brief, the recovery is expected to gather strength in the closing months of 1993.

* * * * *

The second story looks at the trend in income distribution, drawing on the 1992 income numbers released earlier this week. From 1976 to 1986, the income distribution became increasingly skewed in favor of the rich. During the following five years, there was little change. Last year, however, the upward drift in the income distribution resumed.

- The richest 20 percent of households received 46.9 percent of the \$3.8 trillion in total household income last year, up from 46.5 percent in 1991.

Virtually all of the enlarged income shares of the top 20 percent may be due to high earners shifting their bonus payments normally received in early 1993 into late 1992 in order to avoid the higher tax rates of 1993 income. If this shift had not occurred, the 1992 income distribution would have been similar to that of 1991.

Real Growth on Track

The first official reading on third quarter growth will not be released until the end of this month, but based on the data at hand, it is likely that real GDP grew at about a 2-1/2 percent annual rate. That is very close to the Administration's Mid-Session Review forecast of 2.9 percent. Fourth quarter growth might well exceed the MSR forecast of 3.0 percent, which would more than offset any shortfall in the quarter just ended.

- o The MSR forecast is right in line with the current thinking of private sector forecasters. The October Blue Chip consensus, an average of 50 private forecasts, calls for 2.6 percent growth in Q3 and 3.0 in Q4.
- o According to Labor Department figures released this morning, payroll jobs increased by 156,000 in September and the unemployment rate held at 6.7 percent. Total labor hours worked in the economy rose at a 1.5 percent annual rate in the third quarter, which is consistent with a 2-1/2 percent GDP growth when productivity growth is factored in.
 - The factory payrolls shrank again last month, but the 18,000 decrease was much less than the 40,000 monthly average of the prior six months.
 - About 55 percent of all industries added to their payrolls last month, up from 43 percent in August. The biggest job gainers were the private service sector and local governments.

LABOR MARKET INDICATORS

	1993						
	Q2	Q3	May	Jun	Jul	Aug	Sep
Unemployment Rate	7.0	6.7	6.9	7.0	6.8	6.7	6.7
	Average monthly change (thousands)						
Payroll Jobs	179	117	238	43	237	-41	156
Private	167	90	219	39	219	-35	85
Manufacturing	-55	-26	-36	-56	-11	-48	-18
Mining	-1	0	2	-6	-1	-3	5
Construction	31	7	60	-3	19	-2	5
Services	192	108	193	104	212	18	93
Government	12	28	19	4	18	-6	71

Q3 Restraints Will Boost Q4 Growth

Third quarter growth was restrained by the floods in the Midwest (trimming 1/2 percent off the growth rate) and a 12 percent drop in auto production (-3/4 percent off of growth) which reduced auto inventories. Farm inventories and auto production are both likely to bounce back sharply in the fourth quarter adding a combined total of 1-3/4 percentage points to GDP growth.

Components of Q/3 Growth

Aside from the temporary weakness in inventories, GDP components were buoyant on balance in the third quarter due to the strength in consumer spending, equipment investment and housing construction. There is sufficient forward momentum to spending, income and employment that Q4 could be quite strong.

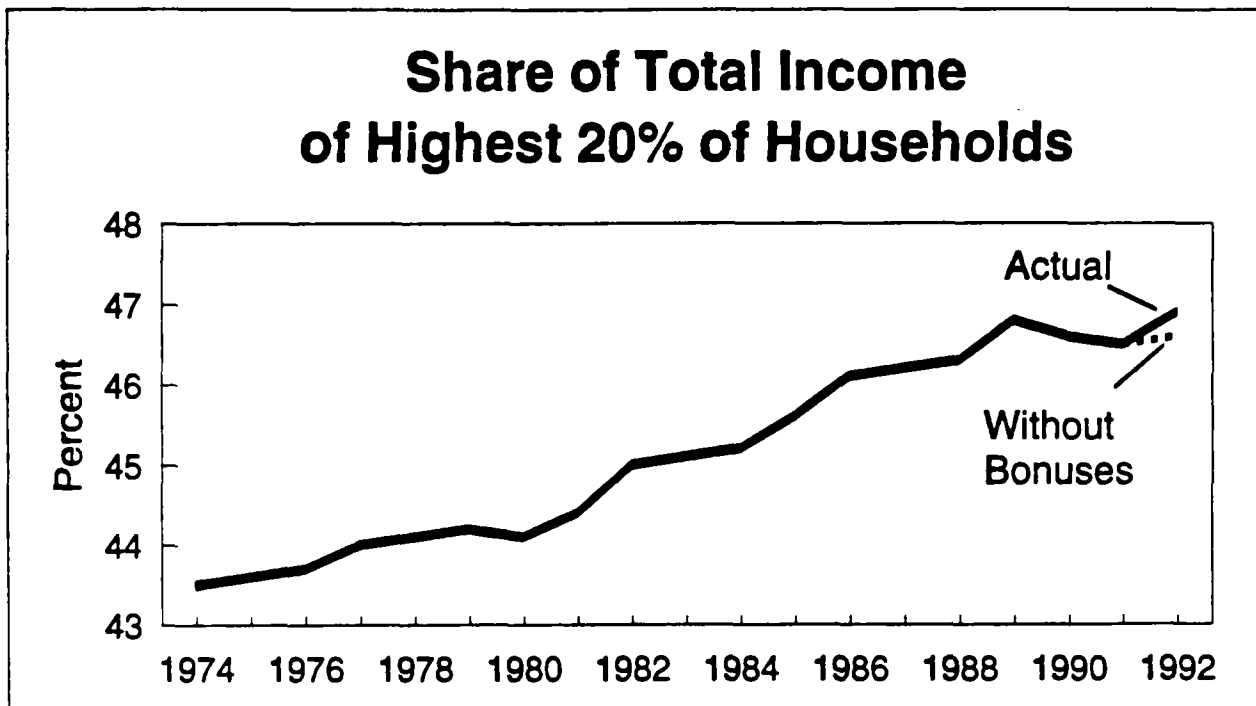
- o **Personal consumption** is estimated to have increased at a 4 percent annual rate, boosted in part by spending on durables other than autos.
- o **Producers' durable equipment (PDE) investment** probably grew at a rapid 10 percent rate on the strength of spending on computers. There was probably little if any growth in investment in **nonresidential structures** despite a sizable increase in oil and gas drilling.
- o **Residential investment** probably grew at about a 5 percent rate due to a pick up in housing starts and spending on home improvements.
- o **Net exports** continued to be a drag on the economy, although less so than during the first half of the year. Our exports have been restrained by recessions in Europe and Japan.
- o **Growth in state and local governments' purchases**, primarily on construction, probably offset lower Federal purchases.

Conclusion

With inflation in check, interest rates low and moderate growth ahead, the Fed is unlikely to raise interest rates in the near future. The recovery should, therefore, continue to gather strength this quarter and into 1994.

Did the Rich Get Richer in 1992?

From 1976 to 1986, the income distribution became increasingly skewed in favor of the rich. The share of total income going to the top 20 percent of households gained 2.4 percentage points, rising from 43.7 percent of total income to 46.1 percent. The concentration of income stabilized from 1986 to 1991, but seemed to have resumed its earlier upward trend in 1992 according to figures published by the Census Bureau earlier this week. The highest quintile of households (the top 20 percent) received 46.9 percent of the \$3.8 trillion in total household income last year, up from 46.5 percent in 1991.



Virtually all of the enlarged 1992 income shares of the top 20 percent and the top 5 percent, however, may be accounted for by high earners shifting their bonus payments normally received in early 1993 into late 1992 in order to avoid the higher tax rates on 1993 income. The Bureau of Economic Analysis has estimated that 1992 wages and salaries were boosted by \$20 billion because of bonus timing shifts.

If this shift had not occurred, the top quintile probably would have received about 46.6 percent of total income, not much different from the 46.5 percent of 1991. It is likely that most, if not all, of the advancement of bonuses was by the richest 5 percent of households. Adjusting the published numbers for the shift, their share of aggregate income would be reduced by 0.4 percentage point to 46.2 percent, close to the 46.1 percent of 1991.

This year's income and income share of the richest households will be restrained because of the bonus shifting. As a result, the 1993 numbers are likely to show a reduction in income inequality. Only after averaging 1992 and 1993 income data will it be possible to know whether the income distribution has really resumed its trend toward increased inequality.

Distribution of Household Income by Quintile (percent of aggregate income)						
	Lowest	Second	Third	Fourth	Highest	Top 5%
1992-As published	3.8	9.4	15.8	24.2	46.9	18.6
Without shifted bonuses	3.8	9.4	15.9	24.3	46.6	18.2
1991-As published	3.8	9.6	15.9	24.2	46.5	18.1

RECENT ECONOMIC INDICATORS AS OF OCTOBER 8, 1993
(S.A. OR AS INDICATED)

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
GDP (Quarterly Series, % A.R.)													
Nominal GDP	4.6			9.2			4.4			4.3			
Real GDP	3.4			5.7			0.8			1.9			
Implicit Price Deflator	1.0			3.3			3.6			2.3			
Fixed-Weight Price Index	2.3			3.3			4.3			2.6			
CYCLICAL INDICATORS													
Leading Index, Percent	0.1	0.5	0.7	1.7	-0.4	0.5	-1.0	0.2	-0.3	0.1	0.1	1.0	NA
Coincident Index, Percent	0.1	0.5	0.2	1.0	0.0	0.4	0.1	0.6	0.2	-0.2	-0.4	0.7	NA
Purchasing Managers' Diffusion Index	48.7	50.7	54.7	55.4	58.0	55.8	53.4	49.7	51.1	48.3	49.5	49.3	49.7
Percent	-6.7	4.1	7.9	1.3	4.7	-3.8	-4.3	-6.9	2.8	-5.5	2.5	-0.4	0.8
Industrial Production	106.2	107.5	108.4	108.9	109.3	109.9	110.1	110.4	110.2	110.4	110.9	111.1	NA
Percent	-0.38	1.22	0.84	0.46	0.37	0.55	0.18	0.27	-0.18	0.18	0.45	0.18	NA
Capacity Utilization, Manufacturing	78.4	79.2	79.7	79.8	80.3	80.5	80.6	80.9	80.7	80.6	80.7	80.8	NA
EMPLOYMENT INDICATORS													
Civilian Employment, Million	117.7	117.7	118.1	118.3	118.1	118.5	118.6	118.4	119.3	119.2	119.3	119.7	119.5
Nonfarm Payroll Employment, Million	108.7	108.8	108.9	109.1	109.2	109.5	109.6	109.8	110.1	110.1	110.3	110.3	110.5
Civilian Unemployment Rate, Percent	7.5	7.4	7.3	7.3	7.1	7.0	7.0	7.0	6.9	7.0	6.8	6.7	6.7
Employment/Population Ratio	61.3	61.3	61.4	61.5	61.3	61.4	61.4	61.3	61.7	61.6	61.6	61.8	61.6
Average Weekly Hours, Manufacturing	41.0	41.1	41.2	41.2	41.4	41.4	41.2	41.5	41.4	41.2	41.4	41.4	41.4
CONSUMER SECTOR													
Retail Sales, Billion \$	164.2	167.6	167.3	169.2	169.2	169.1	167.4	170.5	171.7	172.6	173.1	173.5	NA
Percent	0.6	2.1	-0.2	1.1	0.0	-0.1	-1.0	1.9	0.7	0.5	0.3	0.2	NA
Total Auto Sales, Million Units, A.R.	8.3	8.3	8.3	8.7	8.7	8.0	8.4	9.0	9.1	8.8	8.6	8.6	8.5
Domestic Auto Sales, Million Units, A.R.	6.3	6.3	6.3	6.7	6.7	6.0	6.4	6.9	6.9	6.9	6.6	6.7	6.6
Personal Income, Billion \$, A.R.	5172.4	5239.1	5238.5	5507.3	5225.7	5249.1	5289.2	5365.6	5380.4	5373.6	5357.8	5428.1	NA
Percent	1.1	1.3	-0.0	5.1	-5.1	0.4	0.8	1.4	0.3	-0.1	-0.3	1.3	NA
Disposable Personal Income, Billion \$, A.R.	4526.9	4587.9	4582.8	4802.2	4570.6	4591.9	4630.1	4687.8	4697.3	4691.6	4673.1	4738.7	NA
Savings Rate, Percent	4.9	4.8	6	5.5	5	3.9	4.4	4.7	4.4	3.9	3.7	NA	NA
Real Personal Income, Billion 87\$, A.R.	4151.2	4187.9	4180.8	4391.8	4150.7	4156.1	4181.2	4228.2	4236.5	4227.9	4212.1	4257.3	NA
Percent	0.0	0.9	-0.2	5.0	-5.5	0.1	0.6	1.1	0.2	-0.2	-0.4	1.1	NA
Real Disposable Personal Income, Billion 87\$, A.R.	3632.8	3666.8	3656.9	3829.1	3630.7	3636.5	3660.4	3694.2	3697.7	3691.2	3673.6	3717.7	NA
Percent	0.1	0.9	-0.3	4.7	-5.2	0.2	0.7	0.9	0.1	-0.2	-0.5	1.2	NA
Consumer Sentiment Index, U of Michigan	75.6	73.3	85.3	91.0	89.3	86.6	85.9	85.6	80.3	81.5	77.0	77.3	77.9
Percent	-0.7	-3.0	16.4	6.7	-1.9	-3.0	-0.8	-0.3	-6.2	1.5	-5.5	0.4	0.8
HOUSING SECTOR													
Housing Starts, Thousand Units, A.R.	1218	1226	1226	1286	1171	1180	1124	1206	1248	1248	1227	1323	NA
Single-Family Starts	1045	1079	1089	1133	1051	1036	987	1059	1107	1079	1063	1180	NA

10/08/93

	Sep-92	Oct-92	Nov-92	Dec-92	Jan-93	Feb-93	Mar-93	Apr-93	May-93	Jun-93	Jul-93	Aug-93	Sep-93
BUSINESS SECTOR													
Nondefense Capital Goods Orders, Billion \$	29.8	30.1	26.8	32.3	28.6	32.7	29.1	30.5	29.9	33.9	30.1	31.9	NA
Percent	8.4	1.1	-11.0	20.4	-11.2	14.3	-11.1	4.6	-1.7	13.1	-11.1	5.9	NA
Nonresidential Construction Put in Place, Billion \$	128.2	130.3	128.9	128.9	128.3	129.1	131.5	130.8	133.9	134.5	132.3	129.8	NA
Inventory Change Book Value, Billion \$, A.R.	-8.6	8.6	19.8	32.9	24.9	42.3	52.5	40.6	20.6	0.3	-26.1	NA	NA
Inventory/Sales Ratio, Total Business	1.50	1.49	1.49	1.46	1.46	1.46	1.47	1.47	1.47	1.46	1.47	NA	NA
INFLATION INDICATORS													
CPI, Percent	0.1	0.4	0.2	0.1	0.5	0.3	0.1	0.4	0.1	0.0	0.1	0.3	NA
CPI Less Food and Energy, Percent	0.1	0.5	0.3	0.2	0.5	0.5	0.1	0.4	0.2	0.1	0.1	0.3	NA
PPI Finished Goods, Percent	0.2	0.1	-0.2	0.0	0.3	0.4	0.3	0.6	-0.1	-0.3	-0.2	-0.6	NA
PPI Less Food and Energy, Percent	0.1	-0.1	0.2	0.1	0.4	0.2	0.2	0.4	0.1	-0.1	0.1	-1.0	NA
Gold, \$ per ounce	345.3	344.0	334.4	334.0	329.4	329.2	330.3	341.6	364.2	372.4	392.1	380.2	352.3
W. Texas Spot Oil Price, \$/bbl	21.9	21.7	20.3	19.4	19.1	20.1	20.3	20.3	19.9	19.1	17.9	18.0	17.5
MERCHANDISE TRADE													
Exports, Billion \$, A.R.	451.9	466.6	453.6	470.1	450.1	443.1	466.7	461.7	467.2	451.7	445.0	NA	NA
Imports, Billion \$, A.R.	551.6	553.4	547.6	553.7	542.1	538.0	592.2	583.9	567.7	596.4	569.1	NA	NA
Deficit, Billion \$, A.R.	-99.7	-86.8	-94.0	-83.6	-92.1	-94.8	-125.4	-122.2	-100.5	-144.7	-124.1	NA	NA
U.S. EXCHANGE RATE													
Multilateral	82.0	85.0	90.0	90.5	92.4	93.8	93.7	90.6	90.2	91.8	94.6	94.3	92.1
Percent	1.2	3.7	5.9	0.5	2.1	1.6	-0.2	-3.2	-0.4	1.7	3.0	-0.3	-2.4
Yen/\$	122.6	121.2	123.9	124.0	125.0	120.8	117.0	112.4	110.3	107.4	107.7	103.8	105.6
DM/\$	1.45	1.49	1.59	1.58	1.61	1.64	1.65	1.60	1.61	1.65	1.72	1.69	1.62
\$/Pound	1.85	1.65	1.53	1.55	1.53	1.44	1.46	1.54	1.55	1.51	1.50	1.49	1.52
MONEY AND CREDIT													
M2, Billion \$	3479.1	3490.0	3496.3	3494.9	3485.7	3474.1	3471.6	3473.4	3503.7	3511.0	3517.1	3522.1	NA
Percent	2.7	3.8	2.2	-0.5	-3.1	-3.9	-0.9	0.6	11.0	2.5	2.1	1.7	NA
M3, Billion \$	4181.8	4178.1	4175.7	4162.5	4137.4	4131.7	4127.2	4138.1	4167.6	4167.6	4165.4	4168.1	NA
Percent	1.2	-1.1	-0.7	-3.7	-7.0	-1.6	-1.3	3.2	8.9	0.0	-0.6	0.8	NA
C&I Loans & Commercial Paper, Billion \$, N.S.A.	987.1	991.1	996.9	989.8	986.1	978.4	979.9	984.8	986.4	987.6	NA	NA	NA
Percent, A.R.	7.3	5.0	7.2	-8.2	-4.4	-9.0	1.8	6.2	2.0	1.4	NA	NA	NA
C&I Loans, Billion \$	439.3	439.5	441.0	438.3	436.3	437.4	438.4	438.9	440.1	439.2	NA	NA	NA
Commercial Paper, Billion \$	547.9	551.7	555.9	551.5	549.9	541.1	541.4	545.8	546.3	548.5	NA	NA	NA
INTEREST RATES													
Federal Funds Rate	3.2	3.1	3.1	2.9	3.0	3.0	3.1	3.0	3.0	3.0	3.1	3.0	3.1
T-Bill, 3 Month	2.9	2.9	3.1	3.2	3.0	2.9	3.0	2.9	3.0	3.1	3.0	3.0	3.0
T-Bond, 30 Year	7.3	7.5	7.6	7.4	7.3	7.1	6.8	6.9	6.9	6.8	6.6	6.3	6.0
Corporate AAA Bonds	7.9	8.0	8.1	8.0	7.9	7.7	7.6	7.5	7.4	7.3	7.2	6.9	6.7
Mortgage Commitment Rate	7.9	8.1	8.3	8.2	8.0	7.7	7.5	7.5	7.5	7.4	7.2	7.1	6.9
STOCK MARKET													
Dow Jones 30 Industrials	3293.9	3198.7	3238.5	3303.2	3277.7	3367.3	3440.7	3423.6	3478.2	3513.8	3529.4	3597.0	3592.3
Standard & Poor's 500	418.5	412.5	422.8	435.6	435.2	441.7	450.2	443.1	445.3	448.1	447.3	454.1	459.2

Diane Lino

THE WHITE HOUSE

February 25, 1993

Ms. Deborah Roderick Stark
137 C Street, SE
Washington, D C 20003

Dear Deborah:

This adventure of the past several months has brought me in contact with many Wellesley alumna whom I had not had the privilege of knowing before, and I was especially pleased to meet you in January and add you to that growing list of new acquaintances.

Thank you for sending me the copy of your contribution to the report of the National Commission on Children. I appreciated the opportunity to read it and will be sharing it with members of my husband's staff as these issues are addressed and solutions sought. Having been a strong advocate for children and families all of my adult life, I am committed to search for ways to improve the quality of life for those less fortunate and to focus on helping children achieve their greatest potential.

Again, my special thanks for sharing your writing with me.

Sincerely yours,

Hillary
Hillary Rodham Clinton

cc: Carol Rasco
Shirley Sagawa

[Handwritten signature]
file
McC corr.

*File
I must
write
this woman
make
me.*

THE WHITE HOUSE
WASHINGTON

February 8, 1993

MEMORANDUM FOR THE FIRST LADY

From: Howard Paster *HP*

Subject: Attached letter from wife of Representative Stark

When Ira and I went to see Representative Stark to discuss the Health Policy Task Force, the Congressman asked me to share the attached with you. Deborah Roderick Stark is currently seeking a position at HHS. (I recommend you respond to her attached letter and enclosure without reference to her career ambitions.) As you may recall Mr. and Mrs. Stark were married in the past year, and were subjected to much comment because of their age difference (more than 30 years.)

The important thing in this transmittal is that Representative Stark wanted me to assure him that you would personally see his wife's letter, and I gave him that assurance.

137 C Street, SE
Washington, DC 20003
202/225-8626

January 27, 1993

Hillary Rodham Clinton
The White House
1600 Pennsylvania Avenue, NW,
Washington, DC 20500.

Dear Ms. Rodham Clinton,

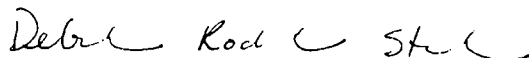
I was so excited to meet you at the Presidential-Congressional luncheon in Statuary Hall on January 20. I am proud that a Wellesley alumnae has such a prominent role in leading our democracy.

After graduating from Wellesley College, I had the great fortune to work with Marian Wright Edelman and Senator Rockefeller as a policy analyst for the National Commission on Children. In this capacity, I prepared briefing material for the 36 member bi-partisan Presidential-Congressional commission (on which President Clinton served) and organized field hearings and town meetings across the country. I became the staff expert in child welfare policy and education reform. As such, I authored two chapters in the Commission's final report, Beyond Rhetoric (1991). I am especially proud of the chapter I wrote on child welfare reform. I have enclosed this chapter -- Protecting Vulnerable Children and their Families -- for your review as the framework for reforming child welfare services can be applied to all social programs serving children and their families.

It is my sincere hope that when child welfare reform is at the top of your agenda, you will consider the recommendations outlined in the enclosed chapter. I strongly believe that we must provide a basic level of service for all families. Without this, children will continue to enter the child welfare system and their chances for successful reunification will be diminished. In the past decade, our government policies have limited services at the front end; those services that are necessary if we are to address the root of potential difficulties. We must now focus on prevention, enhancing the ability of families to thrive.

As a Wellesley alumnae, children's advocate, and spouse of a politician, I feel we have much in common. I look forward to working with you to help forge policies for our nation's children and their families.

Fondly,



Deborah Roderick Stark

DEBORAH RODERICK STARK

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CAREER OBJECTIVE

I hope to use my first-hand exposure to the needs of children and families, my knowledge of social services systems, and my understanding of the political process to help develop and implement social programs that will enhance the health and well-being of children and their families.

My principal areas of expertise are: (1) family support; (2) child welfare; (3) education.

EDUCATION

- 1991 - 1992 **U.C. BERKELEY, SCHOOL OF SOCIAL WELFARE** **BERKELEY, CA**

 M.S.W. On leave from Doctoral Program. Management and Planning student with emphasis on children and families, efficiency in social welfare administration, and designing culturally appropriate programs for hard-to-reach populations.
- 1985 - 1989 **WELLESLEY COLLEGE** **WELLESLEY, MA**

 B.A. *Cum Laude* in Political Science. 1987 Harry S. Truman Scholar from CA.

WORK EXPERIENCE

- Summer 1992 **PARENT-CHILD DEVELOPMENT CENTERS, INC.** **OAKLAND, CA**

 Infant and Toddler Center Coordinator. Responsible for designing a new infant and toddler center. Developed enrollment, staffing, and curriculum procedures. Researched and selected developmentally appropriate educational and recreational equipment. Designed a consumer oriented brochure and a fact sheet for businesses. Developed a public relations plan. Wrote a parent handbook. Organized fundraising and outreach to foundations and local employers.
- 1991 - 1992 **ALAMEDA COUNTY HEALTH CARE SERVICES AGENCY** **OAKLAND, CA**

 M.S.W. Intern. Participated in community-wide planning for implementation of the federal Healthy Start grant to reduce infant mortality in high-risk areas by 50 percent in five years. Researched goals, principles, and components of family support programs. Designed a plan to focus the discussion and action of the Healthy Start Task Forces. Assisted in the development of a questionnaire to provide baseline information about the Healthy Start project area.
- 1989 - 1991 **NATIONAL COMMISSION ON CHILDREN** **WASHINGTON, DC**

 Policy Analyst. Researched the development of children from the prenatal period to age 18 for a 36-member joint Presidential-Congressional Commission. Wrote reference and briefing material on various issues (e.g., education reform, school dropout, foster care, homeless and runaway children, alcohol and other drug use, juvenile delinquency, special needs of rural youth, and employer responses to work and family conflicts). Organized Commission field hearings nationwide. Coordinated with other children's organizations and policy research groups.
- The Commission's final report, Beyond Rhetoric: A New American Agenda for Children and Families, was released in July 1991. Principal author of two chapters: Increasing Educational Achievement, and Protecting Vulnerable Children and Their Families.
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WASHINGTON, DC

SPECIAL INTERESTS

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