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EYES ONLY

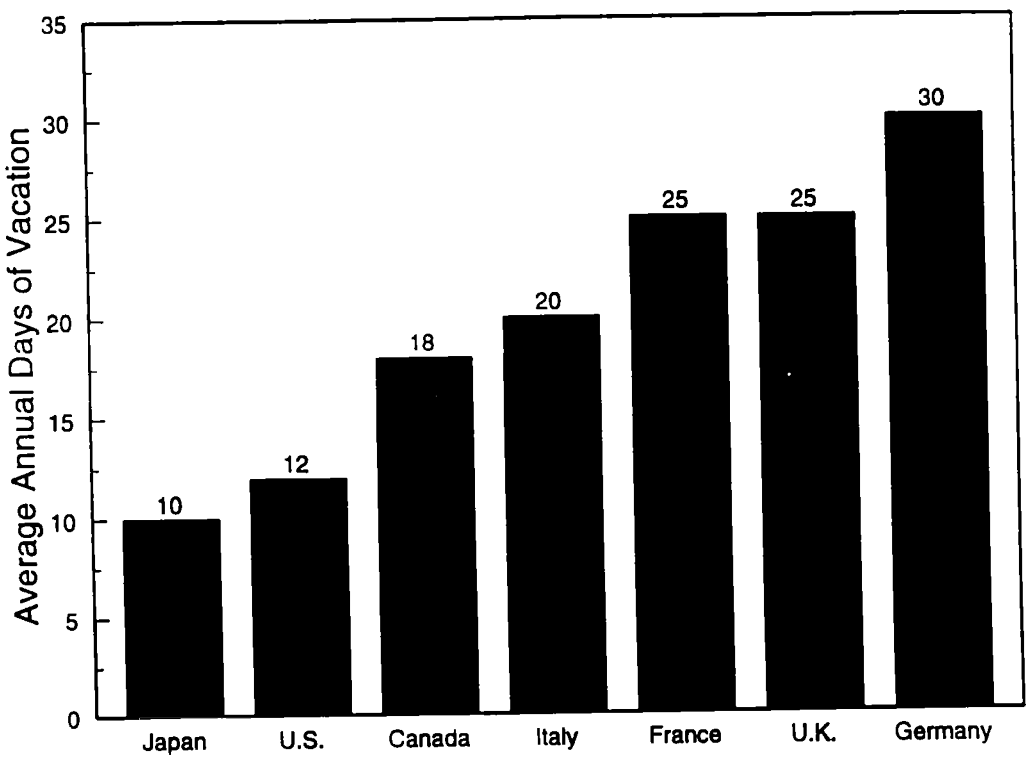
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 25, 1994

CHART OF THE WEEK

Vacation Days Vary by Country



U.S. manufacturing workers take less than half the vacation time taken by their European counterparts. Among G-7 countries, only Japanese workers take less vacation than U.S. workers.

EYES ONLY

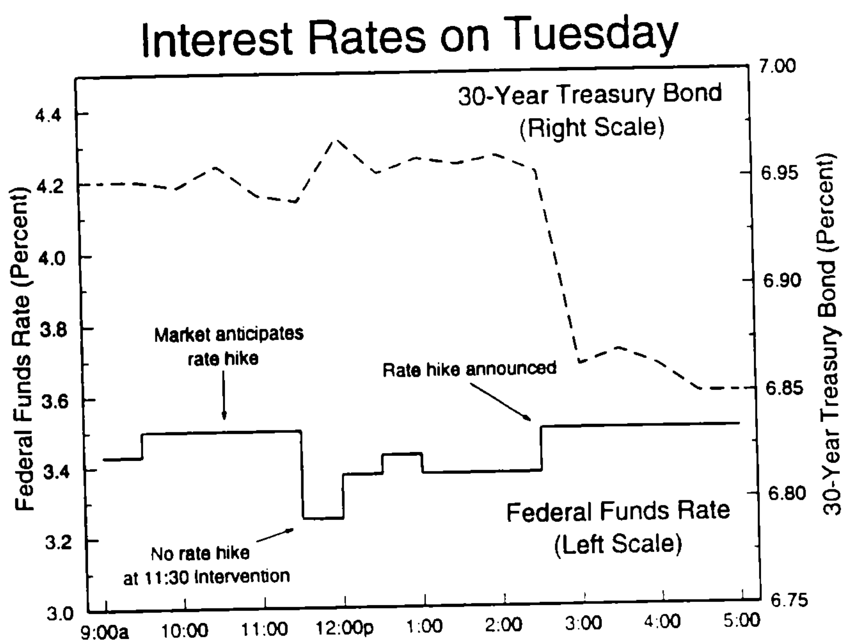
CONTENTS

EYES ONLY

CURRENT DEVELOPMENT

FOMC Raises Short-Term Interest Rates

The Federal Open Market Committee (FOMC) announced Tuesday afternoon it would raise short-term interest rates. Although the FOMC announcement did not specify the size of the increase, it appears to be 25 basis points. The chart shows interest rates on Tuesday. The Federal funds rate had reached 3.5 percent in mid-morning as the market anticipated the FOMC action. It fell back to 3.25 percent when the Fed's daily 11:30 a.m. intervention reflected no policy change. In the afternoon, when the FOMC made its announcement, the Federal funds rate jumped back to 3.5 percent and long-term interest rates fell sharply (see chart).



Analysis. Often, when a change in the short-term interest rate is announced by the FOMC, the long-term interest rate initially moves in the same direction. For example, on February 4, when the FOMC announced its previous decision to increase the short-term rate, the long-term rate rose 6 basis points the same day and a further 50 basis points in subsequent weeks.

Why did the long-term interest rate fall immediately after Tuesday's announcement of the FOMC decision to raise short-term interest rates?

- Most likely, the initial decline in the long-term rate reflected an initial decline in inflationary expectations. Early in the week it was widely reported that such expectations had risen as a result of bond market fears that the FOMC had lost its resolve to fight inflation—perhaps under the mistaken impression that the Administration had tried to "jawbone" the Fed last week. When the FOMC acted, it may have dispelled these fears, and market participants may have revised their projection of future inflation downward.

- Alternatively, bond market participants might have been expecting the FOMC to announce a larger increase in short-term rates on Tuesday. Under this scenario, an increase of only 25 basis points would have been unexpected good news that drove down the long-term real rate of interest.

In either case, the initial decline in the long-term rate was not large enough to return it to its February 4 level. Nor did the initial decline persist. By the end of Thursday, the long-term rate had risen 13 basis points from its Tuesday close.

EYES ONLY

CURRENT DEVELOPMENT

Ethanol Initiatives Could Raise Farm Program Spending

Last fall, the EPA proposed a rule effectively requiring that 30 percent of all gasoline sold in designated areas be made with ethanol or one of its derivatives. Since virtually all of the additional ethanol will be made from corn, this mandate could increase the price of corn and increase the income of corn farmers.

Direct budgetary impact. Gasohol—a blend of 10 percent ethanol and 90 percent gasoline—is exempt from 5.4 cents per gallon of the Federal gasoline tax. This translates into a 54 cent subsidy for each gallon of ethanol. (By comparison, wholesale gasoline prices are only about 65 cents per gallon.) Increased ethanol use resulting from the EPA's new rule will cost the Federal Highway Trust Fund about $270 million per year.

Impact on farm program spending. USDA argues that a higher market price for corn could reduce farm support payments by $580 million in 1998, in which case the ethanol mandate will have a positive overall budgetary impact. But related USDA policies will largely determine whether overall farm subsidies rise or fall. In the past, USDA has frequently relaxed its restrictions on planted acreage for commodities whose prices have risen sharply. Yet USDA's analysis of the ethanol rule's budgetary impact assumes that there will be no change in its acreage limitations for corn. If planted acreage for corn is allowed to rise, as corn prices rise in response to the ethanol mandate, farm support payments could actually increase from current levels, possibly by about $70 million per year according to our analysis.

Deficiency Payments

The Federal Government supports farm income by setting a target price and providing farmers with "deficiency payments" that fill the gap between the market price and the target price. Farmers participating in the program must idle a fraction of their land each year. That fraction generally rises when market prices are low and falls when market prices are high.

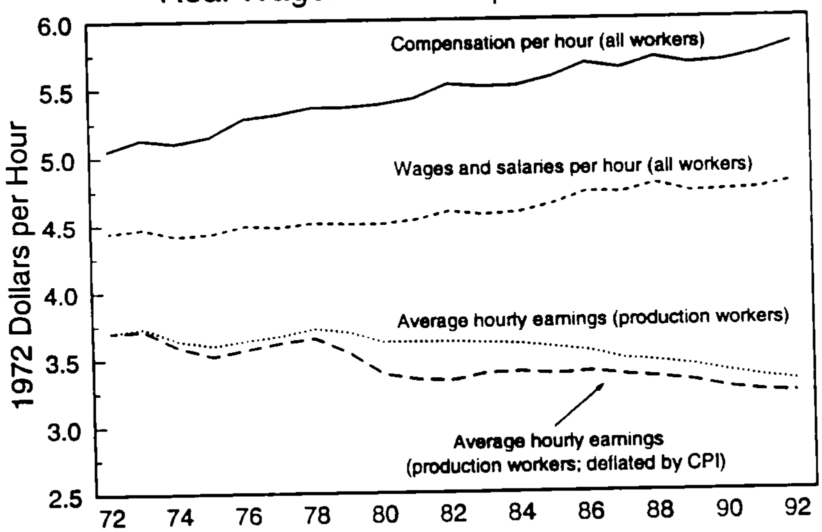
EYES ONLY

ARTICLE

Average Hourly Earnings Understates Growth in Compensation

It is often stated—somewhat misleadingly—that real wages have been falling in the United States. This assertion is based on the BLS's series on real average hourly earnings (AHE), which fell 13 percent from 1972 to 1992 (see bottom line on chart).

Real Wages and Compensation



Note: Series are converted to real dollars with the implicit price deflator for personal consumption expenditures, except where noted.

<u>The real AHE series is misleading for the following reasons:</u>

- Real AHE is deflated by the consumer price index. Due to a problem in the homeownership component that was remedied in the mid-1980s, the CPI overstated inflation during the late 1970s and early 1980s. Consequently, real wage growth was <u>understated</u>. When average hourly earnings are deflated instead by the deflator for personal consumption expenditures, the real wage series (second line from the bottom in the chart) declined by 10 percent from 1972 to 1992.

- The AHE series includes only production workers (about three-quarters of workers). Nonproduction workers (managers, executives, professionals, etc.) are paid more on average and got larger raises in the 1980s than production workers. Total real <u>wages and salaries</u> per hour (second line from the top) grew 8 percent.

EYES ONLY

- Fringe benefits have accounted for an increasing share of labor compensation. Real total compensation per hour (top line) grew 15 percent between 1972 and 1992—almost twice as much as wages and salaries per hour.

Analysis. Although real compensation has been growing substantially faster than hourly earnings, its growth in the last 20 years has been disappointing compared to the early postwar period. Real compensation per hour grew 2.9 percent per year from 1948 to 1972, but only 0.7 percent per year since then. The slow growth in compensation since the early 1970s is the direct consequence of the slow growth in productivity.

Family Income versus Hourly Wages and Compensation

Real median family income is another oft-cited measure of economic well-being. It has barely increased over the last two decades. Family income is not, however, directly comparable to the measures of hourly labor income shown in the chart for three reasons:

1. Family income includes non-labor income (interest and dividends, for example), government transfer payments (social security and AFDC, for example), and pension payments.
2. Family income can change because of changes in the number of workers in a family or changes in their hours of work.
3. Since high incomes have grown faster than low incomes, average incomes or wages increased faster than median. The measures of wages and compensation in the chart are all average measures.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

South Leads Job Growth Outlook. A private forecasting firm predicts that the South—led by Florida—will have the strongest employment growth through the end of 1995. California will restrain total employment growth in the West; but Arizona, Nevada, and Utah should be among the strongest creators of new jobs. The Northeast will continue to lag the rest of the nation.

Manufacturing Firms Both Create and Destroy Jobs. According to a new study, job creation and job destruction require nearly 12 percent of manufacturing workers to change jobs or job status each year. Job destruction rises sharply in recessions, but continues at around 5 percent of manufacturing employment even in economic expansions. Even when overall employment is rising, some firms will be shrinking and some plants will be closing. Focusing only on job destruction can therefore give a misleading picture of employment trends.

Potential Price War for Cholesterol-Lowering Drugs. Sandoz Ltd. announced that it would sell its new cholesterol-reducing drug, Lescol, for nearly 50 percent less than similar drugs now available. Sandoz hopes to capture 10 percent of the $5 billion world market for these widely used prescription drugs. Analysts believe prices for these drugs will be forced down as drug companies compete for large customers, especially the managed health care plans. Managed care organizations generally look for the lowest priced drug in a given therapeutic class.

Banks Raise Prime Rate. Commercial banks raised their prime lending rate from 6.0 percent to 6.25 percent following Tuesday's FOMC meeting. This increase is not surprising given the recent rise in interest rates. Over time, fewer and fewer loans are being made at the prime rate, although lines of credit of small firms and individuals are often tied to it.

EYES ONLY

RELEASES THIS WEEK

Trade Deficit

The trade deficit for goods and services rose to $6.3 billion in January from $4.1 billion in December.

Durable Goods

New orders for durable goods fell 2.5 percent in February, according to the advance report.

MAJOR RELEASES NEXT WEEK

GDP revision (Thursday)
Employment (Friday)
Personal income (Friday)

Owing to the vacations at the Sidwell Friends and National Cathedral schools, there will be no Weekly Economic Briefing next week.

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993	1993:3	1993:4
Percent growth (annual rate)					
Real GDP	2.5	3.9	3.2	2.9	7.5
GDP deflator	5.7	2.8	2.2	1.6	1.3
Productivity					
Nonfarm business	1.2	3.6	1.9	4.0	6.1
Manufacturing (1978-92)	2.1	4.8	5.2	3.0	7.2
Real compensation per hour	0.7	2.1	0.1	1.8	–0.1
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.5	11.6	11.9
Residential investment	4.8	4.0	4.2	4.1	4.3
Exports	7.9	11.6	11.6	11.5	11.9
Imports	9.0	12.3	13.1	13.2	13.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	3.0	2.8	3.0
Federal surplus	–2.8	–4.6	N.A.	–3.3	N.A.

	1970–1992	1992	1993	Jan. 1994	Feb. 1994
Unemployment Rate	6.7*	7.4*	6.8*	6.7	6.5

*Figures beginning 1994 are not comparable with earlier data. The 1993 unemployment rate is estimated to have been 7.4 percent on a basis comparable to the 1994 data.

	1970–1992	1992	1993	Jan. 1994	Feb. 1994
Payroll employment (thousands)					
increase per month			168	-2	217
increase since Jan. 1993					2090
Inflation (percent per period)					
CPI	5.9	2.9	2.7	0.0	0.3
PPI-Finished goods	5.2	1.6	0.2	0.2	0.5

No new data this week.

EYES ONLY

FINANCIAL STATISTICS

	1992	1993	Jan. 1994	Feb. 1994	Mar. 24, 1994
Dow-Jones Industrial Average	3284	3522	3868	3906	3821
Interest Rates					
3-month T-bill	3.43	3.00	2.98	3.25	3.45
10-year T-bond	7.01	5.87	5.75	5.97	6.58
Mortgage rate, 30-year fixed	8.40	7.33	7.06	7.15	7.80
Prime rate	6.25	6.00	6.00	6.00	6.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Mar. 24, 1994**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.669	−1.1	+2.2
Yen-Dollar	104.9	−0.9	−10.6
Multilateral (Mar. 1973=100)	93.70	−0.6	+0.5

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+3.2 (Q4)	6.5 (Feb)	2.5 (Feb)
Canada	+3.0 (Q4)	11.4 (Jan)	1.2 (Jan)
Japan	0.0 (Q4)	2.8 (Nov)	1.0 (Dec)
France	−0.1 (Q4)	11.7 (Dec)	2.1 (Dec)
Germany	−0.8 (Q4)	6.5 (Dec)	3.4 (Jan)
Italy	−0.5 (Q3)	10.6 (Jul)	4.2 (Jan)
United Kingdom	+2.6 (Q4)	10.0 (Jan)	2.5 (Jan)

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EYES ONLY

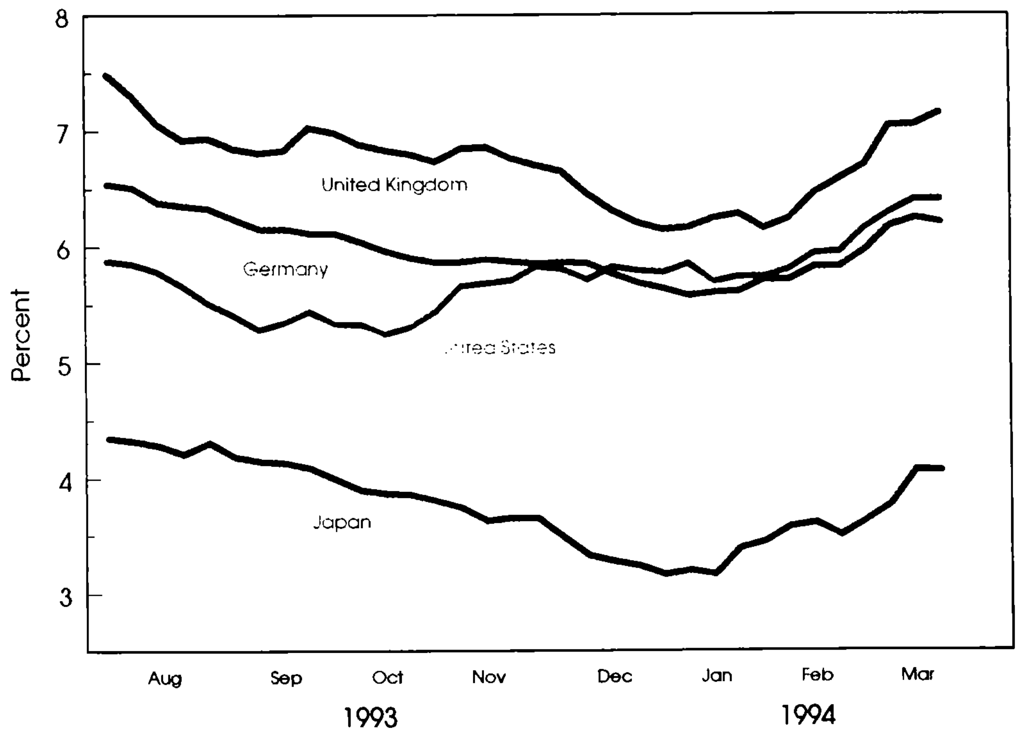
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 18, 1994

CHART OF THE WEEK

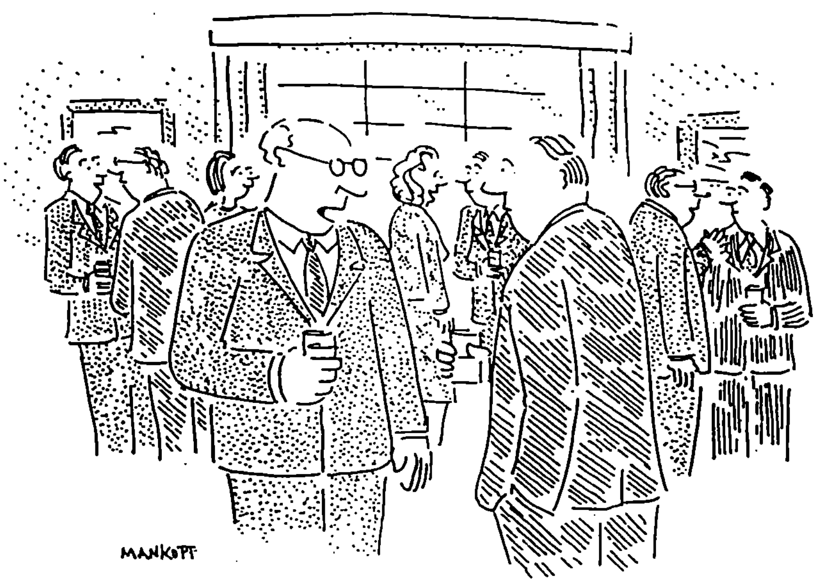
Long-term Interest Rates



Long-term interest rates have increased significantly around the world since the beginning of the year (see Article, page 4).

EYES ONLY

CONTENTS



"Oh, I think Whoopi is a good choice, but I would have preferred Greenspan."

EYES ONLY

CURRENT DEVELOPMENT

Five Myths About Inflation

Inflation concerns have been cited as one reason for the recent runup in U.S. interest rates. But there are few signs of change in underlying inflation fundamentals. Perhaps the markets are reacting more to inflation myths than to inflation realities.

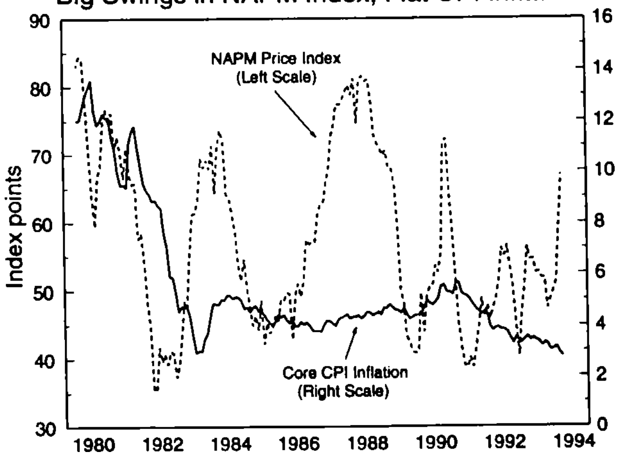
Myth 1: Wage Inflation Will Accelerate

Fact: Wages show no evidence of acceleration. Indeed, because of strong productivity growth, unit labor costs have been falling over the past half year. Nor is it very likely that wage inflation will pick up noticeably until the unemployment rate falls below 5.5 percent (perhaps 6.1 percent on the new basis).

Myth 2: Rising Gold Prices Signal Inflation

Fact: Over the past decade, there has been an inverse relationship between gold prices and inflation.

Big Swings in NAPM Index, Flat CPI Inflation



Myth 3: NAPM Input Prices Predict Inflation

Fact: Higher industrial input prices have been a poor predictor of core inflation over the past decade (see chart of the NAPM price survey index).

Myth 4: Higher Import Prices Will Fuel Inflation

Fact: Although prices of imports from Japan have risen 7 percent over the past year, the dollar is stronger overall and import prices are flat.

Myth 5: Inflation Rates Jump Upward Quickly

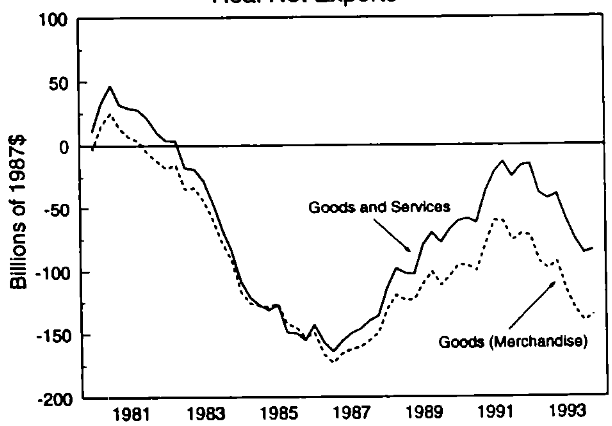
Fact: Other than oil shocks and episodes during the Vietnam War, there has been only one year since 1957 when core inflation increased by more than one percentage point.

CURRENT DEVELOPMENT

New Foreign Trade Statistics Will Include Services

The January trade statistics, to be released March 22, will include monthly imports and exports of services for the first time. The United States has generally run a trade surplus in services since the mid-1970s, and this surplus has grown sharply since 1986. The monthly trade deficit will therefore be reduced noticeably once services are included.

Real Net Exports



In 1993, the average monthly merchandise trade deficit was $9.7 billion. Including services, the average deficit was only $6.4 billion. Similarly, our average monthly merchandise deficit with Japan was $4.9 billion in 1993, but only $3.9 billion with services included.

Analysis. There are several good reasons for including services in our monthly trade numbers.

- Services represent growing shares of world trade and output. Service exports currently represent 30 percent of total U.S. exports, up from 19 percent in 1960. Excluding such a large component of our trade makes present monthly statistics less reliable indicators of our overall trade pattern.

- Other G-7 countries already report trade in both goods and services each month. Until now, the United States has reported services trade only on a quarterly and annual basis.

- For years, private-sector users have requested that services trade data be made available on a monthly basis.

Critics may claim that the Administration has decided to include services in an attempt to make the monthly trade deficit look better. These claims are meritless.

EYES ONLY

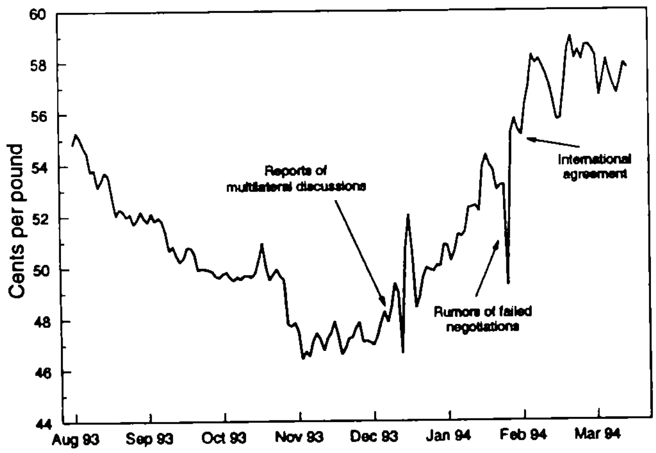
CURRENT DEVELOPMENT

International Agreement Raises Aluminum Prices

Between 1988 and late 1993, a world-wide cyclical downturn in demand and increased exports from the former Soviet Union drove aluminum prices from over $1 per pound to under 50 cents per pound. Prices started to rise last December when international negotiations began over an agreement to curtail production (see chart). That agreement, which places explicit limits on Russian production and implicit limits on Western production, was signed at the end of January. Since then, several Russian and Western firms have announced production cutbacks. Prices have continued on their upward trend, and are now about 15 percent above their levels at the beginning of the year.

The higher prices have had a particularly adverse impact on the Japanese, who are the world's biggest net importers of aluminum—and who were not represented at the negotiations. Since the United States is also a net importer of aluminum, it has also suffered from the price increases.

Aluminum Prices Rise



100 7%

Bonds 7%

95

EYES ONLY

ARTICLE

Long-Term Interest Rates Rise Worldwide

The rise in long-term interest rates over the past month has not been limited to the United States (see Chart of the Week). Even by the standards of the past few years, during which long-term rates tended to move together worldwide, the recent coincidence of interest rate increases around the world has been striking. Analysts have offered a number of explanations for these increases. Some explanations are more plausible than others.

- **A tight money scare.** The Fed's recent decision to raise short-term interest rates has fueled fears of further increases in the near future, and such fears have caused an even greater increase in long-term rates. Ten-year Treasury rates have now returned to their February 1993 levels. At the same time, investors have been disappointed by the recent pace of interest rate cuts in Germany and France, leading to fears that monetary policy in those countries will be tighter than previously believed.
- **A growth scare.** Interest rates generally rise as economies strengthen since businesses borrow more to finance increased investment. The growing strength of the U.S. economy is commonly cited as a cause of rising U.S. long-term rates. There are also signs that the continental European and Japanese economies may be starting to recover, but forecasts are for slow growth in the near term.
- **An inflation scare.** Inflation fears have allegedly increased in U.S. bond markets since the Fed's February 4th decision. These fears seem exaggerated (see Current Development, p. 1). Concerns about inflation have apparently contributed to rising long-term rates in Britain as well (see box). These concerns should be less important in continental Europe and Japan, where economies remain slack and inflation is falling.
- **A trade war scare.** Increases in long-term rates in Japan and the United States have been attributed to fears of a trade war. This cannot, however, explain a rise in both U.S. and Japanese interest rates. If investors expected the yen to rise relative to the dollar, they would dump dollar bonds and buy yen bonds. If they expected to yen to fall, they would dump yen bonds and buy dollar bonds. In either case, long-term interest rates in Japan and the United States should move in opposite directions. ?
- **Technical factors.** Highly leveraged institutional investors have reportedly sold large amounts of long-term bonds in markets around the world. Market participants say that institutions that were borrowing short-term funds to finance their holdings of long-term

bonds have sold off these holdings because the cost of short-term borrowing has risen. Others report that institutions have sold long-term bonds to offset losses from other investments.

Recent experience confirms once again that speculative markets generally overreact—moving more in one direction or the other than seems to be warranted by changes in "fundamentals."

Index Bonds Help Measure Expected Inflation

The British Government issues bonds—called index bonds—that pay a stated real interest rate and bonds that pay a stated nominal interest rate. By comparing the yields on these two bond~~s, we can determine~~ the market's inflation forecast. ~~This~~ comparison indicates that about half of the increase in British bond yields since the beginning of the year is due to higher expected inflation. If the United States Government also issued index bonds, as Fed Chairman Greenspan has advocated, a market-based measure of inflationary expectations would be available to policymakers.

EYES ONLY

ARTICLE

The Long-Run Social Security Solvency Problem

Over the next few decades, the government will probably be forced either to raise taxes or to cut government benefits to retirees and others. Although there is no immediate problem, the Social Security trust fund is projected to become insolvent in about forty years. This issue appears likely to frame debates on Social Security for the next generation.

Intergenerational Transfers in Social Security. Today's Social Security system favors older workers and retirees at the expense of younger and future workers. Because the rapid increases in real benefits that occurred in the late 1960s and early 1970s were not coupled with commensurate increases in payroll taxes, an average worker retiring today can expect to receive benefits that significantly exceed payroll taxes paid. In contrast, a new entrant in the labor force can expect to pay more in payroll taxes than will be received as future benefits (see box).

Demographics Affect Solvency. Moreover, demographic trends imply that payroll taxes must rise over the next few decades simply to maintain current benefit levels. Today, there are 3.2 workers for every Social Security beneficiary. This ratio is anticipated to fall to 2.0 workers per retiree by 2035 as the "baby boom" generation ages. As a result, unless payroll tax rates are raised, Social

Social Security Benefits and Taxes

Year of Retirement	Ratio of Benefits to Taxes
1975	3.27
1994	1.44
2015	0.97
2035	0.87

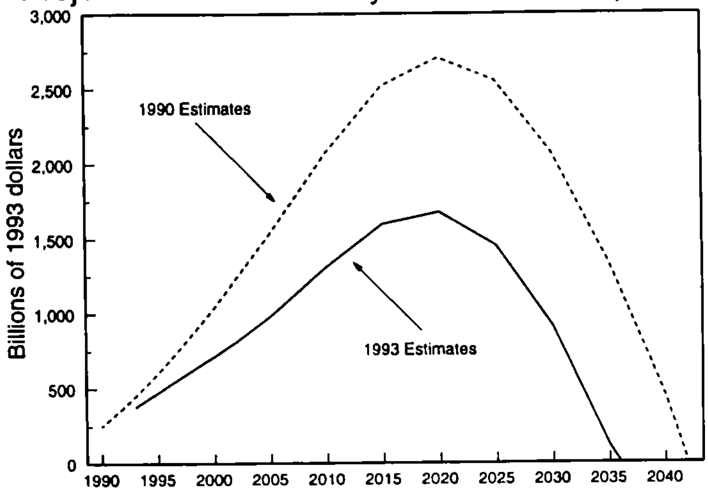
These estimates are for workers earning an average wage during their lifetime.

Security payments will dramatically exceed payroll tax collections, and the Social Security trust fund will become insolvent by the middle of the next century. These demographic changes imply that the young and future generations will bear the burden of putting the Social Security trust fund on solid financial ground, unless payroll tax rates are increased or benefit levels (as a percentage of lifetime wages) are reduced.

EYES ONLY

Recent actuarial forecasts are more pessimistic about the long-run solvency of the Social Security trust fund than were earlier forecasts (see chart). This pessimism partly reflects lower expectations for real wage growth.

Projected Social Security Trust Fund Surplus



EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Competition Heats Up in "Chip Wars." Intel, which controls about three-quarters of the $9 billion microprocessor market, is facing a three-pronged attack on its dominance. First, Apple Computer has introduced PCs based on the new PowerPC microprocessor—a chip jointly developed with IBM and Motorola —that is more powerful, more efficient, and less costly to manufacture than Intel chips now on the market. Second, Advanced Micro Devices won a copyright challenge allowing it to continue to clone Intel's most successful products. Third, NexGen Microproducts has introduced a clone of Intel's most advanced microprocessors.

Manufacturers Expect Continued Strong Growth. The Dun & Bradstreet Industrial Sentiment Index of expected conditions for the coming three months rose in February for the third consecutive month and was at its highest level since January 1990. Three of the index's five components—production, new orders, and unfilled orders—showed marked improvements; finished goods inventories and export expectations showed little change from January. The D&B Employment Expectations Index also jumped, suggesting increased hiring in the next three months. Moreover, the Selling Price Index fell, suggesting diminished price pressures overall.

Innovative Cleanup at Gas Plant Site. A New Jersey utility is using an innovative combination of technologies to clean up the site of a former gas manufacturing plant. An experimental cryogenic barrier prevents flooding and runoff to a nearby river and construction of temporary tents prevents release of noxious air emissions into the urban neighborhood. On-site heating of the contaminated soil to 1,800 degrees Fahrenheit vaporizes even the most viscous contaminants and has the additional advantages of producing reusable byproducts and avoiding transport of hazardous materials. Nearly 2,000 similar sites across the country could use this technology, but at a cost of more than $1500 per cubic yard treated, the technique is very costly. The cost will most likely be absorbed by the utilities' shareholders and customers.

Rising Sam? U.S. Firms Regain Patent Lead. In 1993, for the first time since 1985, a U.S. firm—IBM—headed a list of companies ~~that were awarded the~~ most U.S. patents. Three of the top five companies were American, but six of the top ten were Japanese. In 1992, Japanese companies held four of the top five spots, with GE ranked fourth and IBM sixth.

EYES ONLY

RELEASES THIS WEEK

Consumer Prices

The consumer price index rose 0.3 percent in February. Over the past 12 months, it has increased 2.5 percent.

Producer Prices

The producer price index for finished goods increased by 0.5 percent in February. Over the past 12 months, it has risen only 0.2 percent.

Industrial Production and Capacity Utilitization

The Federal Reserve's index of industrial production increased 0.4 percent in Feburary.

Housing Starts

Housing starts rebounded modestly in February from their depressed level in January.

MAJOR RELEASES NEXT WEEK

Exports and imports of goods and services (Tuesday)
Durable goods (Wednesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1993	1993:3	1993:4
Percent growth (annual rate)					
Real GDP	2.5	3.9	3.2	2.9	7.5
GDP deflator	5.7	2.8	2.2	1.6	1.3
Productivity					
Nonfarm business	1.2	3.6	1.9	4.0	6.1
Manufacturing (1978-92)	2.1	4.8	5.2	3.0	7.2
Real compensation per hour	0.7	2.1	0.1	1.8	−0.1
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.5	11.6	11.9
Residential investment	4.8	4.0	4.2	4.1	4.3
Exports	7.9	11.6	11.6	11.5	11.9
Imports	9.0	12.3	13.1	13.2	13.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	3.0	2.8	3.0
Federal surplus	−2.8	−4.6	N.A.	−3.3	N.A.

	1970-1992	1992	1993	Jan. 1994	Feb. 1994
Unemployment Rate	6.7*	7.4*	6.8*	6.7	6.5

*Figures beginning 1994 are not comparable with earlier data. The 1993 unemployment rate is estimated to have been 7.4 percent on a basis comparable to the 1994 data.

	1970-1992	1992	1993	Jan. 1994	Feb. 1994
Payroll employment (thousands)					
increase per month			168	-2	217
increase since Jan. 1993					2090
Inflation (percent per period)					
CPI	5.9	2.9	2.7	0.0	**0.3**
PPI-Finished goods	5.2	1.6	0.2	0.2	**0.5**

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1992	1993	Jan. 1994	Feb. 1994	Mar. 17, 1994
Dow-Jones Industrial Average	3284	3522	3868	3906	3865
Interest Rates					
3-month T-bill	3.43	3.00	2.98	3.25	3.47
10-year T-bond	7.01	5.87	5.75	5.97	6.40
Mortgage rate, 30-year fixed	8.40	7.33	7.06	7.15	7.76
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Mar. 17, 1994**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.688	+0.3	+1.5
Yen-Dollar	105.8	+0.3	–9.8
Multilateral (Mar. 1973=100)	94.31	+0.3	–0.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+3.2 (Q4)	6.5 (Feb)	2.5 (Feb)
Canada	+3.0 (Q4)	11.4 (Jan)	1.2 (Jan)
Japan	+0.5 (Q3)	2.8 (Nov)	1.0 (Dec)
France	–0.1 (Q4)	11.7 (Dec)	2.1 (Dec)
Germany	–0.8 (Q4)	6.5 (Dec)	3.4 (Jan)
Italy	–0.5 (Q3)	10.6 (Jul)	4.2 (Jan)
United Kingdom	+2.6 (Q4)	10.0 (Jan)	2.5 (Jan)

BR|BO|65|SM

EYES ONLY

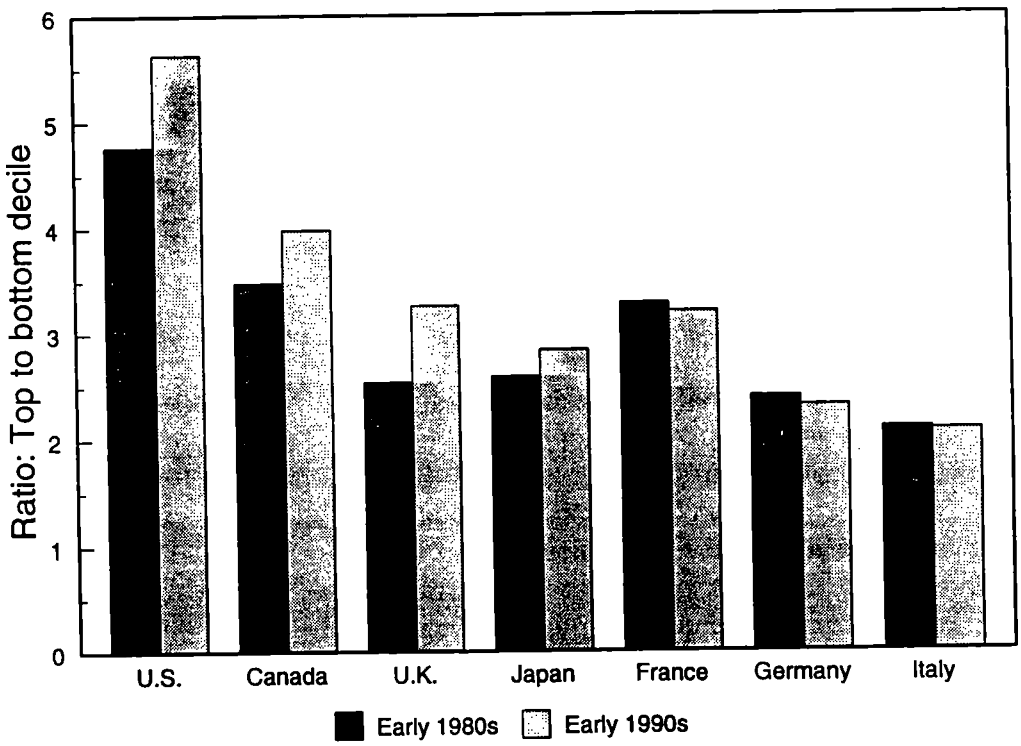
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 11, 1994

CHART OF THE WEEK

Earnings Inequality for Men in G-7 Countries



The chart shows the ratio of wages and salaries of high earners (ninetieth percentile) to those of low earners (tenth percentile). Among G-7 countries, the gap between high and low earnings is the biggest in the United States. The gap increased during the 1980s in the English-speaking countries and Japan. (The pattern across countries is similar for women.)

EYES ONLY

CONTENTS

EYES ONLY

CURRENT DEVELOPMENT

OECD Predicts Slow Growth in Europe and Japan

The OECD predicts that recovery will take hold in the industrial economies in 1994, but that growth will be sluggish in the continental European countries and in Japan (see first table). Robust growth is predicted for the United States and Canada.

GDP Growth Forecasts by OECD

	1993	1994	1995
United States	3.0%	3.7%	3.0%
Japan	-0.3	0.4	2.9
Germany	-1.3	0.8	2.3
France	-0.7	1.1	2.5
United Kingdom	2.0	2.8	3.2
Canada	2.5	3.9	4.3

Note: Growth rates are year over year.

Analysis. Forecasted output growth in Europe and Japan is insufficient to reduce unemployment rates through 1994. For the unemployment rate to fall in an individual country, output must grow fast enough to absorb both increases in labor productivity and increases in the size of the workforce. Only in the United States, Canada, and Britain is output growing this fast. In continental Europe, slow output growth will lead to continued high and probably rising unemployment.

GDP Growth Required to Reduce Unemployment Rate

United States	2.4%
Japan	2.7
Germany	1.7
France	2.5
United Kingdom	2.0
Canada	2.5

Note: The figures are the sum of projected labor force growth and productivity growth in each country.

EYES ONLY

CURRENT DEVELOPMENT

Accounting Rules for Stock Options Create Controversy

The Financial Accounting Standards Board (FASB) held public hearings this week on a proposal to require that firms record the value of stock options granted to employees as an expense against earnings. Currently, neither the granting nor the exercising of a stock option is an expense reported to shareholders. Because high-tech firms are heavy users of stock options as compensation, their reported earnings would be disproportionately affected by the rule change.

Analysis. For the stock market to function efficiently, stockholders must have complete and accurate information about managers' compensation. The FASB proposal would require that companies provide more information. Some opponents of this proposal argue that it will reduce reported earnings and thereby depress stock prices, making it more difficult for companies to raise equity capital. But this argument is true only if the current accounting rules obscure managerial compensation and therefore disguise the true profitability of the firm from stock market participants.

Opponents of FASB's proposal also argue that there is no way to measure accurately the value of the options. The realized value of a stock option cannot be known until it is exercised. Yet, there are methods to estimate the value of an option when it is granted. The debate is over whether it misleads shareholders more to report a zero value of a stock option than to report an estimate of its value.

Firm Uses Options to Reduce Taxes and Increase Reported Earnings

Under the current system, firms get a tax deduction when the options are exercised. Since a tax deduction increases after-tax profits and the firm does not report a corresponding expense to its shareholders, the exercise of an option increases reported profits. The proposed change in the FASB rules would not change the tax-treatment of options unless there were a change in the tax law.

Last month, Conseco, an Indiana-based insurance company, induced its top executives to exercise about $200 million worth of stock options. This generated a tax deduction, thereby increasing earnings reported to shareholders by approximately $70 million. To compensate its employees for exercising their options early, the company granted them additional options worth more than $20 million. Neither the value of the exercised options nor the value of the new options will be reported to shareholders as an expense on the income statement. Moreover, Federal tax revenues are essentially unaffected: The firm's reduced tax liability is approximately offset by the tax the executives owe from exercising the options.

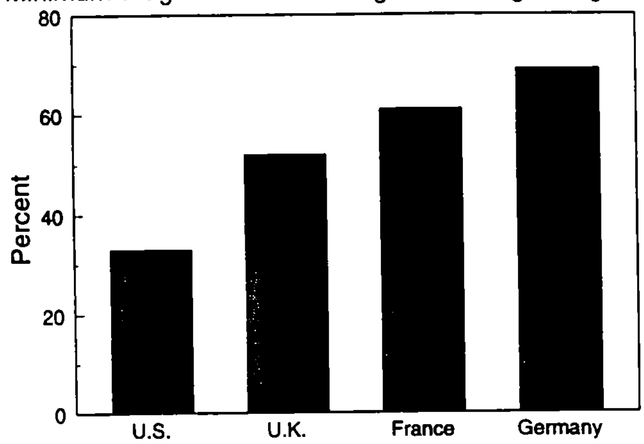
EYES ONLY

TREND

Minimum Wages are Higher in Europe

Minimum wages are considerably higher relative to average wages in Europe than in the United States.

Minimum Wages as a Percentage of Average Wages



High minimum wages raise the income of some less-skilled workers, but price others out of the market.

Effect on young workers. Many analysts contend that high minimum wages contribute to youth unemployment: Young workers typically have low work experience and skills and therefore are more likely to have productivity below the minimum wage. This seems to be true in France where youth unemployment is over 20 percent. In contrast, Germany has a much less severe youth unemployment problem, perhaps in part because of Germany's extensive training and apprenticeship programs.

EYES ONLY

ARTICLE

"Corporatization" Effort Targets Air Traffic Control for Restructuring

The Department of Transportation (DOT) is now developing a detailed plan to restructure the Nation's air traffic control system, as promised by the Administration's Civil Aviation Initiative. Both the National Performance Review (NPR) and the National Commission to Ensure a Strong Competitive Airline Industry proposed that the air traffic control system be run by a public corporation that would replace the Federal Aviation Administration (FAA).

Current organization is inefficient. The NPR argued that existing budgeting, personnel, and procurement rules impede the FAA's ability to adopt cutting-edge technology quickly and cheaply. One dramatic example makes the case: Much of its equipment is so old that <u>the FAA is the world's largest buyer of vacuum tubes</u>. The NPR's concern is magnified by the impending transition to satellite-based air navigation and air traffic control, a new technology that promises to reduce costly air traffic delays by permitting more direct routing of flights.

The benefits of corporatization may apply to other government functions, but the air traffic control system is an excellent place to start.

- Upgrading the air traffic control system will require large capital expenditures.
- The cost of operating the system is largely covered by a ticket and cargo waybill tax that resembles a user fee.
- The airlines provide a group of "clients" that would monitor the performance of the corporation and exert pressure on it to be efficient.

Corporate structure could enhance efficiency. Corporatization would permit budgeting, procurement and personnel decisions to be made in a business-like manner. In addition, it is likely that top management would enjoy longer tenure, contributing to efficient internal operation. Moreover, the aviation industry could be given a greater role in oversight.

Reorganizing an agency into a public corporation will require the development of new mechanisms to ensure cooperation with other government agencies. For example, a new air traffic control corporation would need to coordinate with both the DOT (which would continue to regulate safety) and the Pentagon. Similar problems have been overcome successfully in other countries which have corporatized their air traffic control systems, including Australia, Germany, the United Kingdom, and New Zealand.

Government organizations are often slow to make productive investments. The recommendation for "corporatizing" the Nation's air traffic control system also seeks in part to correct the tendency to stint on public investment when budgets are tight. One way to address this problem is to move an agency making large capital expenditures off-budget, by making it a corporation with authority to borrow against future revenues. The corporations's off-budget status reduces public oversight over its activities, but the corporation's incentive to waste funds will be minimized because those who pay for the capital expenditures (that is, the airlines) also receive the benefits, and because the users have the ability to monitor corporate expenditures.

Borrowing Rates

The interest rate at which an air traffic control corporation could borrow would depend on whether the government guaranteed its bonds. Guaranteed bonds would yield about the Treasury bond rate. Interest rates paid by Government Sponsored Enterprises (GSEs), which do not carry an explicit guarantee, are somewhat higher. A fully private air traffic control corporation would borrow at the higher rates paid by corporations.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Fed Reports on Regional Economic Conditions, Los Angeles Economy Remains Weak. The Federal Reserve survey of regional economic conditions reported that overall economic activity continued to expand moderately in January and February. Weakness continued, however, in the Los Angeles area, reflecting the area's dependence on aerospace and defense. Durable goods were selling well in all districts, despite the unusually cold and snowy weather in two-thirds of the country. In contrast, nondurable sales were sluggish in several eastern districts. The districts report that prices of manufactured products and consumer goods were generally stable, but several report that prices are up for an increasing number of commodities—building materials, selected metals, and some chemicals.

Gender Pay Gap Narrows. A study of hourly earnings by gender in 10 industrialized countries finds that during the 1980s women's wages rose relative to men's in most of the countries. Japan is the biggest exception to this trend. The authors attribute the improvement—which was sharpest in the United States —in part to an increase in the level of women's experience in the labor market. Nonetheless, the gap in the United States remains substantial.

Chrysler Plans Large Employment Increase. Chrysler intends to add about 6,000 jobs. The company plans to retool an idle St. Louis plant, will add a third work shift at a Detroit plant, and will expand production in Mexico. GM and Ford have announced plans that will add about 3,500 jobs, mostly in Michigan.

Industrial Vacancy Rates Fall. The U.S. vacancy rate for large industrial space was 8.3 percent at the end of 1993, down from 9 percent in mid-1992. In the mid-1980s the vacancy rate was about 5 percent. Westchester, Cleveland, Dallas, and Los Angeles metropolitan areas had the highest end-of-year vacancy rates; Seattle, Columbus, Portland, Charlotte, and Nashville had the lowest.

EYES ONLY

RELEASES THIS WEEK

Productivity

Productivity in the nonfarm business sector increased 1.9 percent during 1993.

Retail Sales ** FOR RELEASE FRIDAY 8:30 A.M. **

According to the advance estimate, retail sales rose 1.5 from January to February and have increased 7.6 percent from February 1993.

MAJOR RELEASES NEXT WEEK

Producer Prices (Tuesday)
Industrial Production (Tuesday)
Consumer Prices (Wednesday)
Housing Starts (Wednesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993	1993:3	1993:4
Percent growth (annual rate)					
Real GDP	2.5	3.9	3.2	2.9	7.5
GDP deflator	5.7	2.8	2.2	1.6	1.3
Productivity					
Nonfarm business	1.2	3.6	**1.9**	**4.0**	**6.1**
Manufacturing (1978-92)	**2.1**	**4.8**	**5.2**	**3.0**	**7.2**
Real compensation per hour	0.7	2.1	0.1	**1.8**	**–0.1**
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.5	11.6	11.9
Residential investment	4.8	4.0	4.2	4.1	4.3
Exports	7.9	11.6	11.6	11.5	11.9
Imports	9.0	12.3	13.1	13.2	13.5
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	3.0	2.8	3.0
Federal surplus	–2.8	–4.6	N.A.	–3.3	N.A.

	1970–1992	1992	1993	Jan. 1994	Feb. 1994
Unemployment Rate	6.7*	7.4*	6.8*	6.7	6.5

*Figures beginning 1994 are not comparable with earlier data. The 1993 unemployment rate is estimated to have been 7.4 percent on a basis comparable to the 1994 data.

	1970–1992	1992	1993	Jan. 1994	Feb. 1994
Payroll employment (thousands)					
increase per month			168	-2	217
increase since Jan. 1993					2090
Inflation (percent per period)					
CPI	5.9	2.9	2.7	0.0	N.A.
PPI-Finished goods	5.2	1.6	0.2	0.2	N.A.

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1992	1993	Jan. 1994	Feb. 1994	Mar. 10, 1994
Dow-Jones Industrial Average	3284	3522	3868	3906	3831
Interest Rates					
3-month T-bill	3.43	3.00	2.98	3.25	3.49
10-year T-bond	7.01	5.87	5.75	5.97	6.48
Mortgage rate, 30-year fixed	8.40	7.33	7.06	7.15	7.63
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Mar. 10, 1994**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.683	−1.5	+1.1
Yen-Dollar	105.5	+1.9	−10.6
Multilateral (Mar. 1973=100)	94.01	−0.6	−0.5

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+3.2 (Q4)	6.5 (Feb)	2.5 (Jan)
Canada	+3.0 (Q4)	11.4 (Jan)	1.2 (Jan)
Japan	+0.5 (Q3)	2.8 (Nov)	1.0 (Dec)
France	−0.1 (Q4)	11.7 (Dec)	2.1 (Dec)
Germany	−0.8 (Q4)	6.5 (Dec)	3.4 (Jan)
Italy	−0.5 (Q3)	10.6 (Jul)	4.2 (Jan)
United Kingdom	+2.6 (Q4)	10.0 (Jan)	2.5 (Jan)

BR/Bo/GS/SM

EYES ONLY

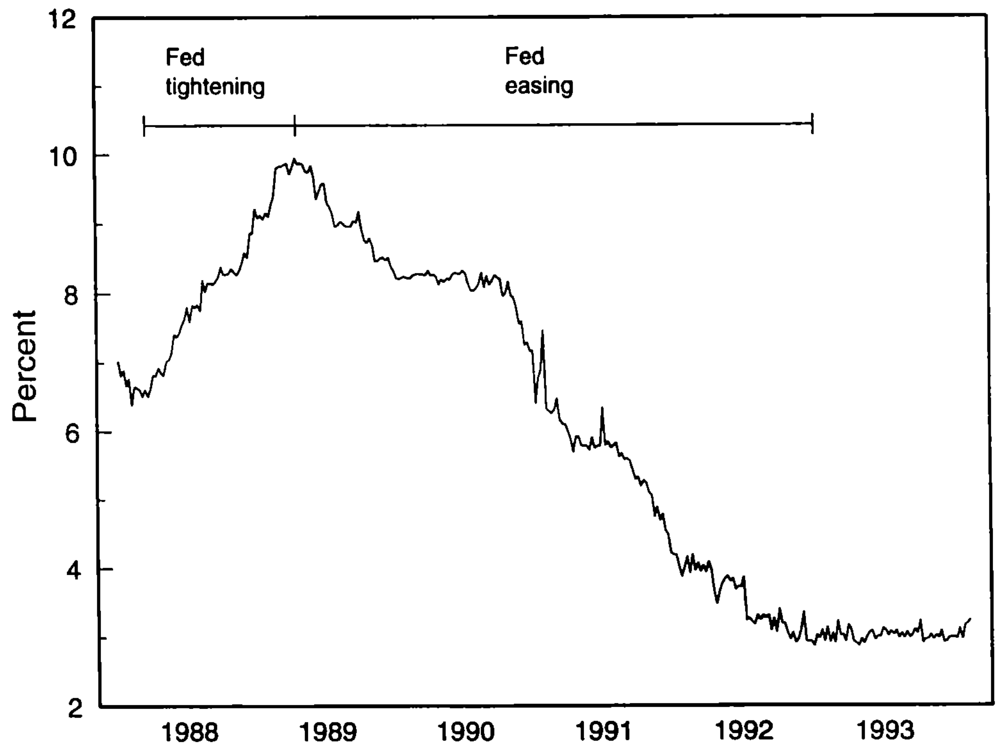
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

February 25, 1994

CHART OF THE WEEK

Federal Funds Rate



The federal funds rate—the overnight loan rate which the Federal Reserve uses to control interest rates—has been about 3 percent for over 18 months. The Federal Reserve's decision on February 4 to raise it 25 basis points is hardly noticeable in the graph. But the Federal Reserve's move may have raised fears of a series of increases such as those seen in 1988 (see Current Development, p. 1).

EYES ONLY

CONTENTS

QUOTATION OF THE WEEK

"I think the market has overreacted [to the Fed's tightening] and that before long the market will realize that and reverse itself."

—Dallas Federal Reserve Bank President Robert McTeer (February 24, 1994)

(Alas, yields on 30-year bonds increased 10 basis points on February 24.)

EYES ONLY

CURRENT DEVELOPMENT

Long-term Interest Rates Rise

The yield on long-term bonds has increased by nearly one-half of a percentage point since the Federal Reserve's announcement on February 4 that it was raising short-term interest rates by 25 basis points (see chart).

Analysis. Financial markets are extremely volatile. Since they are forward-looking and respond to the perceptions of market participants, it is usually hard to explain any particular market fluctuation—even after the fact. For example, apart from the Fed's policy action, it is hard to find any change in economic fundamentals that could explain the recent increase in long-term interest rates.

Why might a 25 basis point increase in short-term rates raise long-term rates by almost twice as much? Concerns about future Fed tightening are the most likely explanation. Market participants may be worried that the increase in short rates on February 4 is the first installment in a series of rate increases—mirroring the staircase pattern of increases the Fed undertook in 1988 when rates rose over 300 basis points in 12 months (see Chart of the Week and box on page 2).

The long-term outlook for inflation, real growth, and budget deficits should be more important than current Fed policy for long-term bond rates. None of these factors has changed much recently. Yet, perceptions of them could affect the bond market.

- The drumbeat of good economic news is sinking in, and the market is now digesting the fact that real GDP growth may have been around 7 percent in the fourth quarter of 1993 and may exceed 3 percent this quarter. Why a 6-month growth spurt

EYES ONLY

should move 30-year bond rates is a good question. But the one thing we know about speculative markets is that they overreact to everything.

- It is also possible that the Fed's "preemptive strike" against inflation had the ironic effect of focussing the market's attention on inflation. ("What does the Fed know that we don't?") For example, an obscure regional survey of manufacturing prices by the Philadelphia Fed received great attention.

- Finally, an increase in expected future budget deficits could raise real long-term rates. But recent news about the deficit has been better than expected and private analysts have not pointed to concerns over the deficit as a reason for the recent increase in rates.

If these factors prove to be will-o'-the-wisps, the recent increase in long-term rates might well be reversed. But if the increase in long-term rates persists, it would tend to slow the economy—with a lag of about 3 quarters. We estimate that each 10 basis point increase in long-term rates is roughly equivalent to a $6 billion fiscal contraction. Thus, the recent increase in rates, if sustained, corresponds to a $25-$30 billion spending cut.

Reprinted from Weekly Economic Briefing, January 21, 1994

Federal Reserve Policy. The Federal Reserve is likely to increase interest rates to combat what it sees as incipient inflation. The Fed has wide discretion over the timing and magnitude of the interest rate changes. Even if it decides to raise rates, it can do so in ways that minimize the risk to stable growth.

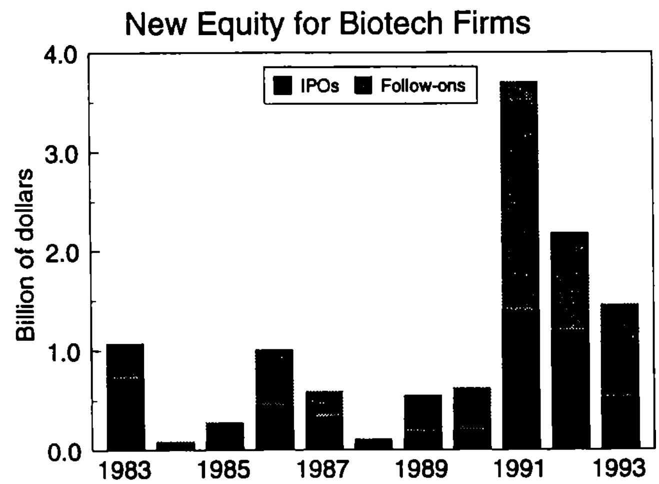
A modest increase in short-term rates would not harm the expansion, but a significant increase in long-term rates would. If the Fed raises short-term interest rates in a way that makes market participants think more rate hikes are coming, long-term rates could rise substantially. On the other hand, if bond traders believe that the rise in short rates is a one-shot event (at least for a while), long rates would probably increase much less. The point is that the Fed can influence—though not totally control—market expectations by when and how it changes interest rates and what, if anything, it says.

EYES ONLY

CURRENT DEVELOPMENT

Why are Biotechnology IPOs Slumping?

Biotechnology firms are raising equity at a much lower rate today than two years ago. Between 1991 and 1993, the total volume of initial public offerings (IPOs) and follow-on offerings by biotech firms declined over 60 percent (see chart). (A large portion of the decline in public offerings from 1992 to 1993 has been made up by private placements, however.) Over the same period, IPOs in other industries have risen strongly. From an historical perspective the recent pattern is not terribly unusual. Twice in the past decade, the rate of new equity capital infusions into the biotech industry dropped off steeply.



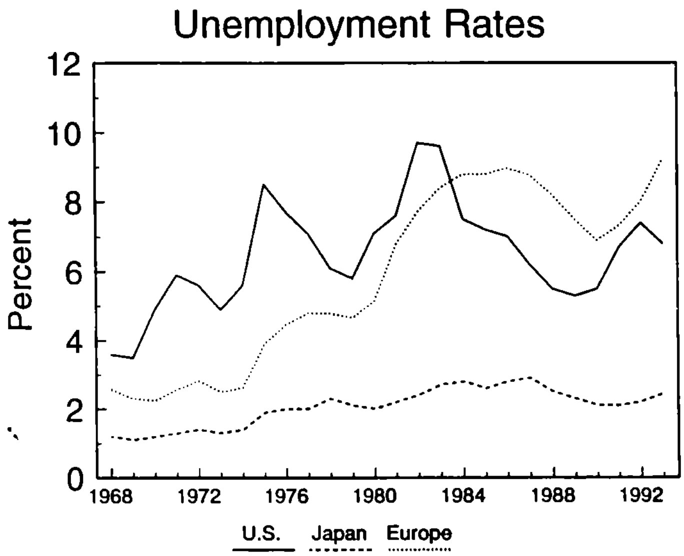
Analysis. Some industry participants attribute these developments to investor concern about the potential regulation of drug prices under health reform. No one can say for sure whether this is true or not. Stock markets are one place where views on such matters are registered. Biotech stock prices did plunge more that 35 percent from November 1992 to February 1993, but they have since recovered some of those losses.

EYES ONLY

ARTICLE

Unemployment in G-7 Countries

Unemployment in the G-7 countries has increased markedly since the late 1960s. Although unemployment has increased throughout the G-7 countries, the differences across countries are more pronounced than the similarities (see graph).



- **Europe.** With the exception of the late 1980s "Euro-boom," unemployment in Europe has trended upward since the early 1970s. It has risen in periods of recession (1974-75 and 1980-82), but in contrast to the United States, the unemployment rate in Europe has remained well above pre-recession levels during recoveries.

- **United States.** The United States had higher unemployment rates than the European G-7 countries during the 1960s and 1970s. In contrast to Europe, however, our unemployment rate has no upward trend. In consequence, unemployment here has been lower than in Europe since the mid-1980s.

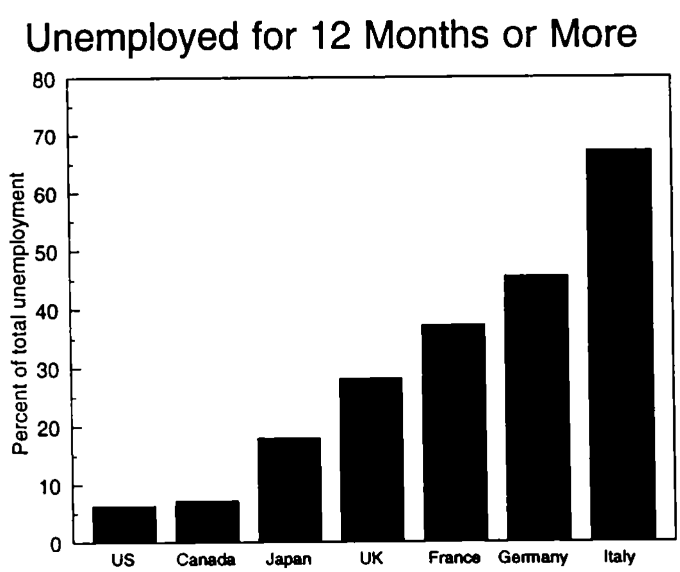
- **Japan.** Japan is unique among the G-7 in having maintained low unemployment rates throughout the last three decades. The low rate in Japan is due in part to "corporate paternalism," whereby firms substantially insulate workers from cyclical fluctuations.

The recent business cycle. Unemployment rates in Europe have risen sharply during the past 3 years (see table below). The importance of macroeconomic factors should not be underestimated, as the Europeans are prone to do: Over the last 3 years, unemployment appears to have increased primarily because of the global recession.

EYES ONLY

Civilian Unemployment Rates in G-7 Nations			
	1990	**1993**	**change**
United States	6.0	6.5	0.5
Canada	9.2	11.1	1.9
United Kingdom	7.2	10.1	2.9
France	9.2	11.5	2.3
Western Germany	4.7	6.1	1.4
Italy	8.3	10.6	2.3
Japan	2.1	2.6	0.5

Long-term unemployment. The overall unemployment rates of the United States and Europe hide dramatic differences in the amount of long-term unemployment. The United States has very little long-term unemployment compared to European G-7 countries. U.S. unemployment results mainly from short spells that can facilitate the matching of jobs and workers. In Europe, nearly half the unemployed have been unemployed for over a year (see chart).



Why is long-term unemployment so much higher in Europe? In part, generous social welfare benefits cushion the impact of unemployment and therefore reduce incentives to take a job. In addition, high labor costs—stemming from powerful unions and the combination of high minimum wages and payroll taxes —discourage firms from employing workers whose skills are not highly valued.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Corporate Profits and Earnings Rise. Combined net income for a sample of 674 major corporations surged 61 percent in the fourth quarter of 1993 from a year earlier, and after-tax profits from continuing operations jumped 38 percent. Wall Street analysts generally expect continued strong earnings growth in 1994, but at a more modest pace than last year.

Information System Investment Has High Payoff. A recent academic study has found that investment in information systems (IS)—computer hardware, software, and related worker training—yields a significantly higher return than other types of investment. Earlier studies using similar models had failed to confirm a significant payoff from IS investment. The analysts attribute their findings to the use of more recent and detailed firm-level data than were available previously.

Production of Energy-Efficient Environmentally-Friendly Refrigerator Begins. Whirlpool has begun producing CFC-free refrigerators that exceed the 1993 Federal energy standards by more than 25 percent. The company won a super-efficient refrigerator program contest sponsored by utilities that will pay Whirlpool $100 for each such refrigerator delivered in a sponsor's service area. The utilities expect the cost savings from reduced power generation to more than pay for the contest.

FCC Reduces Cable TV Rates. The FCC's new cable-TV rate regulations seek to close loopholes in last year's rules. Last year's 10 percent rate reduction order actually allowed rates to rise for nearly a third of cable subscribers. The FCC staff estimates that cable monopolies charge rates 17 percent above competitive levels on average. The FCC expects that its revised rules will lower average rates by 7 percent for about 90 percent of the nation's cable companies. Cable companies argue that the new rules will inhibit the investment needed to create the information superhighway. And Bell Atlantic and TCI blamed the cancellation of their planned merger on the new regulations—but analysts point out that the two firms had never agreed on terms.

Small Businesses Optimistic About Economy, But Grumpy About Policy. The NFIB's quarterly small business optimism index jumped in January. Small business, however, still does not give credit to sound economic policies. Although the NFIB did rate Administration economic policies slightly higher in January than in the second half of 1993, only 7 percent of those surveyed considered them "excellent" or "good" and 44 percent characterized them as "poor." Only 1 percent rated Congress's economic policies as high as "good" and 48 percent rated them as "poor."

EYES ONLY

RELEASES THIS WEEK

Durable goods

New orders for durable goods rose 3.7 percent in January.

Consumer confidence

The Conference Board's index of consumer confidence fell slightly in February, but it remains substantially higher than it was all last year.

MAJOR RELEASES NEXT WEEK

GDP (Tuesday)
Employment (Friday)
Leading Indicators (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993	1993:3	1993:4
Percent growth (annual rate)					
Real GDP	2.5	3.9	2.8	2.9	5.9
GDP deflator	5.7	2.8	2.2	1.6	1.3
Productivity					
Nonfarm business	1.2	3.6	1.5	4.0	4.2
Manufacturing (1978-92)	2.2	4.9	5.5	3.1	7.8
Real compensation per hour	0.7	2.1	0.1	2.4	0.0
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.5	11.6	12.0
Residential investment	4.8	4.0	4.2	4.1	4.4
Exports	7.9	11.6	11.6	11.5	11.8
Imports	9.0	12.3	13.2	13.2	13.6
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	3.0	2.8	3.0
Federal surplus	–2.8	–4.6	N.A	–3.3	N.A.

	1970–1992	1992	1993	Dec. 1993	Jan. 1994
Unemployment Rate					
old basis	6.7	7.4	6.8	6.4	6.3
new basis			7.4	7.0	6.7

Note: New basis is official as of Jan. 1994. Shaded figures are estimates for comparison on a consistent basis.

	1970–1992	1992	1993	Dec. 1993	Jan. 1994
Payroll employment (thousands)					
increase per month			164	190	62
increase since Jan. 1993					1843
Inflation (percent per period)					
CPI	5.9	2.9	2.7	0.2	0.0
PPI-Finished goods	5.2	1.6	0.2	–0.1	0.2

EYES ONLY

FINANCIAL STATISTICS

	1992	1993	Dec. 1993	Jan. 1994	Feb. 24, 1994
Dow-Jones Industrial Average	3284	3522	3744	3868	3840
Interest Rates					
3-month T-bill	3.43	3.00	3.06	2.98	3.36
10-year T-bond	7.01	5.87	5.77	5.75	6.22
Mortgage rate, 30-year fixed	8.40	7.33	7.17	7.06	7.32
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Feb. 24, 1994**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.719	−0.3	+5.9
Yen-Dollar	105.2	+0.8	−10.3
Multilateral (Mar. 1973=100)	95.06	−0.1	+1.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q4)	6.7 (Jan)	2.5 (Jan)
Canada	+3.0 (Q3)	11.2 (Dec)	1.2 (Jan)
Japan	+0.5 (Q3)	2.8 (Nov)	1.0 (Dec)
France	−0.6 (Q3)	11.7 (Nov)	2.1 (Dec)
Germany	−1.4 (Q3)	6.5 (Nov)	3.4 (Jan)
Italy	−0.5 (Q3)	10.6 (Jul)	4.2 (Jan)
United Kingdom	+2.6 (Q4)	9.9 (Dec)	2.5 (Jan)

GS Copy

EYES ONLY

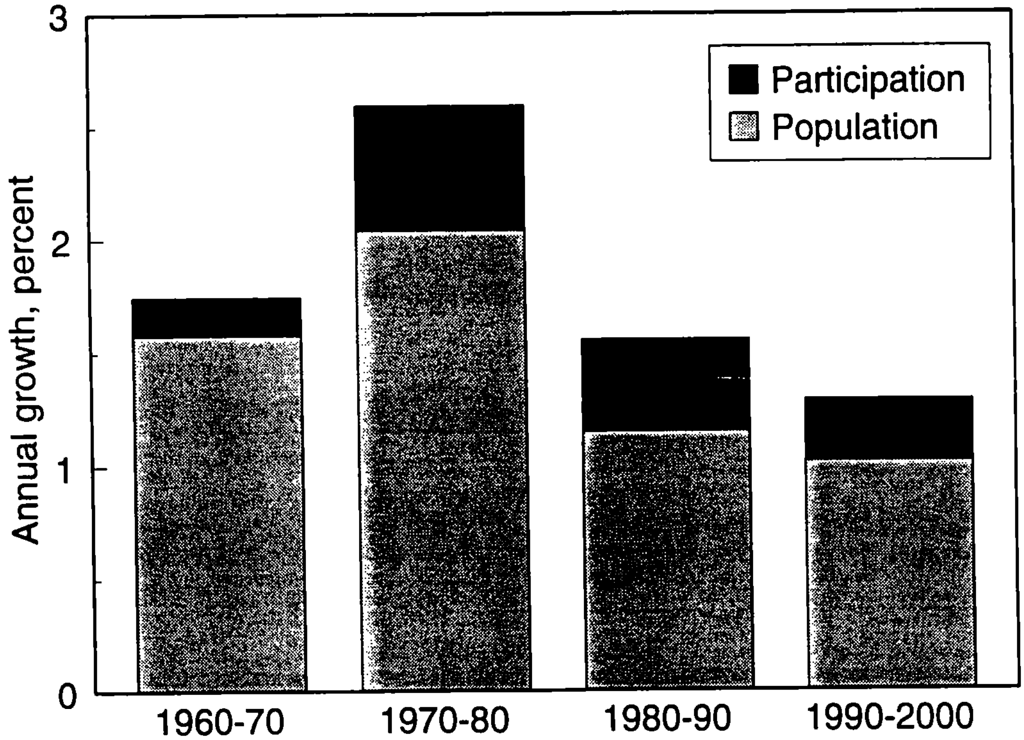
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

January 28, 1994

CHART OF THE WEEK

Labor Force Growth: Population plus Participation



Working age population and the labor force participation rate jointly determine the size of the labor force. The 1970s saw large increases in the labor force as the baby-boom generation reached working age and women's participation in the labor force rose. In the 1980s, both population and participation growth slowed substantially. In the 1990s, they are projected to slow even more. Job growth will be slower in the 1990s than in the 1970s and 1980s simply because the labor force is not growing as fast.

EYES ONLY

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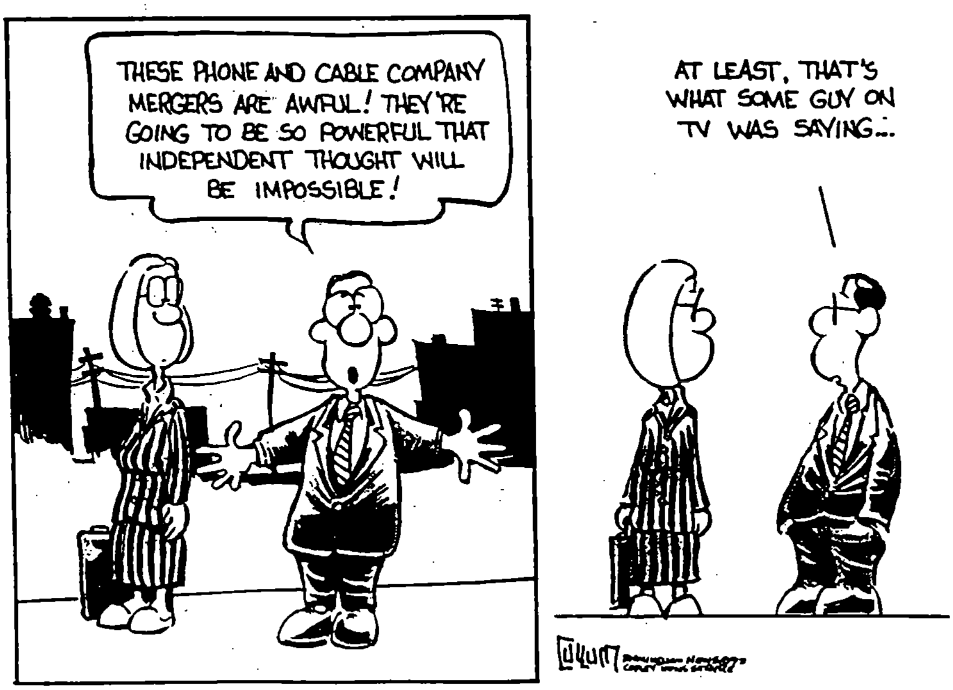


EYES ONLY

SPECIAL ANALYSIS

New Unemployment Rate to be Higher

Starting with the February 4 release, the unemployment rate will be based on the BLS's new household survey and new population benchmarks from the 1990 Census. (The Weekly Economic Briefing, November 19, 1993, described the new survey.) The new survey produces a higher measured unemployment rate than the old survey.

What the BLS will report. When it releases the official unemployment rate based on the new survey next Friday, the BLS will also provide the following additional estimates to help interpret the new measure:

1. The BLS will estimate what the unemployment rate would have been in the past (from September 1992 to December 1993) had the new methodology been used. For this period, the rate calculated with the new method is about 0.6 percentage point higher on average than the old method.
2. The BLS will report its estimate of what the January 1994 unemployment rate would have been if it had been calculated using the old methodology. This estimate will be based on the historical relationship between the old unemployment measure, payroll employment, and unemployment insurance claims. The BLS plans to follow the same procedure in several subsequent monthly reports. During the next several months, the BLS does not plan to report estimates of the unemployment rate based on results of a scaled down version of the old unemployment survey which it will continue to administer.

For January 1994 and beyond, the difference between the official rate and what the BLS estimates the rate would have been under the old methodology may be substantially more or less than the 0.6 percentage point "guesstimate." Both the new official survey and the estimate of the difference between the old and new methods are subject to statistical variability.

How the Administration's economic assumptions reflect the new data. The Administration's economic forecast is based on the old measure, the one for which we have models and experience. In the Economic Report of the President and Budget tables, we will include a line translating the old rate into a range for the new rate. For example, for 1994 we forecast an unemployment rate of 6.5 percent on the old basis and give a range of 6.8 to 7.4 percent on the new basis.

EYES ONLY

CURRENT DEVELOPMENT

Recently Proposed Large Mergers are Concentrated in Two Industries

Many proposed large mergers made the headlines late last year. Seven of the 15 largest mergers pending on December 31 were in the telecommunications and information services sector. These include Bell Atlantic-TCI (telephone-cable) and AT&T-McCaw Cellular. Three more were in health care, including Merck-Medco (drugs) and Columbia Healthcare-HCA (hospitals).

Analysis. Both the telecommunications and health care industries are undergoing dramatic regulatory changes.

- Congress and the Administration are moving to enact wide-ranging telecommunications legislation this year. The regulatory reforms will likely allow competition in local telephone service and permit phone and cable companies to enter new businesses. Firms are presumably merging to take advantage of the new opportunities created by regulatory changes and advances in technology.
- In the health care and pharmaceutical industries, many firms are believed to be merging in anticipation of health reform. They may see acquisitions as ways to lower costs or to increase their bargaining power with suppliers, health insurers, or regulators under the new regulatory regime.

Many current headline mergers may be prompted by changes in regulation and technology. In contrast, many economists believe that the merger wave of the 1980s was encouraged by the tax code, Wall Street's discovery of leverage, and the breakup of the conglomerates created in earlier merger waves in the 1950s and 1960s.

EYES ONLY

SPECIAL ANALYSIS

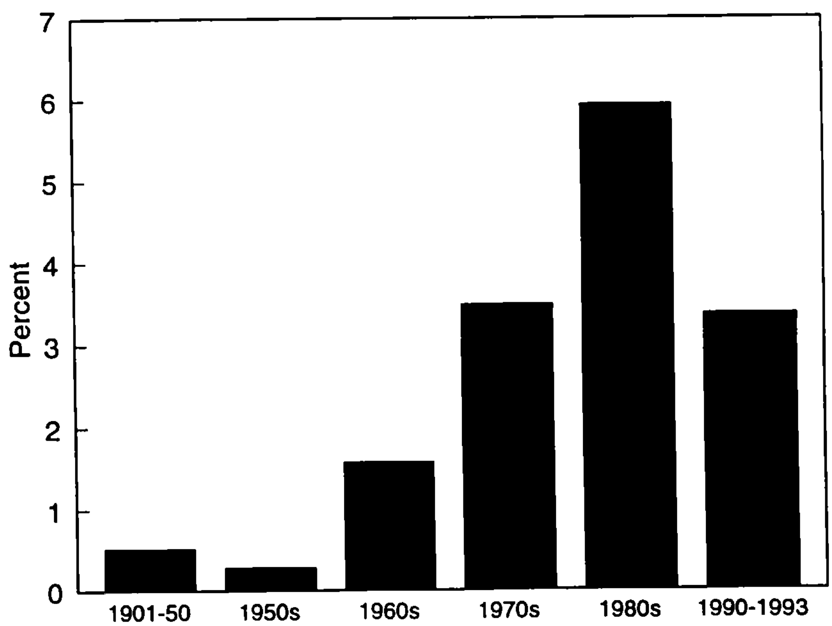
Can Long-term Interest Rates Stay So Low?

Long-term Treasury bonds now yield about 6 percent. These nominal interest rates are very low by the standards of the two last decades. Some analysts, apparently relying on the theory that whatever goes down must go up, suggest that long-term rates cannot remain this low. We do not agree with their logic or their conclusion. The Administration forecasts that long-term interest rates will remain about where they are for the foreseeable future. Many private forecasters agree.

Long-term Rates and Expected Inflation. The nominal interest rate has two parts: the real rate and the expected inflation over the term of the bond. In the Administration's forecast, expected inflation is between 3 and 3-1/2 percent over the next 10 years. The Blue Chip consensus has the same forecast. Expected inflation of 3 to 3-1/2 percent and a nominal interest rate of 6 percent implies a real interest rate of 2-1/2 to 3 percent.

The chart shows the history of real yields on long-term Treasuries. Although the current real long rate of about 2-1/2 percent is substantially below the level of the 1980s, it is high compared to historical averages based on longer time periods.

Real Long-term Interest Rates



During the 1980s, the real long-term interest rate averaged almost 6 percent. This unusually high rate presumably reflected excessive borrowing by the Federal Government. With the deficit now under control, it seems likely that the real rate will revert toward its historical norm. For the first 6 decades of the century, real long-term rates were below 1 percent. In the 1960s, they averaged about 2 percent and in the 1970s between 3 and 4 percent.

Therefore, a 2-1/2 percent real long-term rate is somewhat above the historical average, suggesting that there is still room for long-term rates to fall further. (However, we do not expect this to happen anytime soon.)

For the nominal rate to stay low, inflation must also stay under control. That is what we forecast. But adverse shocks (such as a reversal of the recent decline in oil prices), faster than anticipated expansion, or inappropriate monetary policy, could make that forecast wrong.

Relationship of Long-Term and Short-Term Rates. Last week we noted that short-term interest rates are likely to rise. This does not contradict the claim that long-term rates can stay low.

The historical yield spread between 10-year and 3-month Treasuries is about 1-1/4 percentage points. The spread is now about 3 percentage points. Therefore, there is room for short rates to rise with no increase in long-term rates as the spread between them falls back toward its historical range.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Consumer Sentiment Up Sharply. The University of Michigan's monthly consumer survey for early January showed that the strong rebound in consumer confidence is continuing. Following a 7.0-point rise in December, the overall index jumped 7.6 points in January to 95.8—its highest level in 5 years. Consumers expect inflation to remain low in the near and longer terms and are increasingly optimistic about employment growth for the coming year. Attitudes about major durable purchases improved to their highest level since the last cyclical peak as consumers viewed their financial positions more positively than any time since 1990.

The current surge in consumer confidence, which began in the fall, is based primarily on consumers' perceptions of a strengthening economy. A similar survey by the Conference Board supports the Michigan survey's results.

Net Worth of Median Household Falls. The Census Bureau reports that median household net worth dropped 12 percent between 1988 and 1991, mainly because of lower home values. In 1991, white households had median net worth of $44,400, while African-American households had median net worth of just $4,600. The median net worth of married-couple households was $60,000, more than four times greater than that of female-headed households.

Toyota Creates Non-Lifetime Employment Category. Toyota, trying to change its rigid organizational structure, announced it will begin to hire temporary professional workers. Major companies in Japan have had a longstanding practice of offering salaried workers permanent employment with pay based on seniority and company performance. Toyota will offer these new workers annual contracts instead of the usual lifetime commitment. Moreover, Toyota said it will pay these professionals salaries based on individual merit.

New Technology Promises Big Operating Savings for Railroads. Burlington Northern Railroad and CSX Transportation became the first two North American carriers to commit to buying diesel electric locomotives based on a new AC-traction motor technology. AC-traction motors generate pulling power more efficiently, use less fuel, and should require less maintenance than conventional DC-traction motors. Three of the new locomotives, for example, can replace up to five older units.

EYES ONLY

RELEASES THIS WEEK

GDP

Real GDP grew at a 5.9 percent annual rate in the fourth quarter. The GDP price deflator increased at a 1.3 percent annual rate.

Durable Goods

Orders for new durable goods rose 2.2 percent in December.

Employment Cost

The employment cost index rose 3.6 percent during 1993.

Collective Bargaining Agreements

For major collective bargaining agreements settled in the fourth quarter of 1993, wages will increase 2.9 percent in the first year of the contract and 2.0 percent per year over the life of the contract.

MAJOR RELEASES NEXT WEEK

Personal Income (Monday)

Leading Indicators (Tuesday)

Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993	1993:3	1993:4
Percent growth (annual rate)					
Real GDP	2.5	3.9	2.8	2.9	**5.9**
GDP deflator	5.8	2.8	2.2	1.6	**1.3**
Productivity					
Nonfarm business	1.1	3.6	N.A.	4.3	N.A.
Manufacturing (begins 1977)	2.0	4.9	N.A.	3.1	N.A.
Real compensation per hour	0.6	2.1	N.A.	2.5	N.A.
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.5	11.6	**12.0**
Residential investment	4.8	4.0	4.2	4.1	**4.4**
Exports	7.9	11.6	11.6	11.5	**11.8**
Imports	9.0	12.3	13.2	13.2	**13.6**
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	3.0	2.8	**3.0**
Federal surplus	–2.8	–4.6	N.A	–3.3	N.A.

	1970–1992	1992	1993	Nov. 1993	Dec. 1993
Unemployment Rate	6.7	7.4	6.8	6.5	6.4
Payroll employment (thousands)					
increase per month			162	202	183
increase since Jan. 1993			1,947	1,631	1,814
Inflation (percent per period)					
CPI	6.0	2.9	2.7	0.2	0.2
PPI-Finished goods	5.3	1.6	0.2	0.0	–0.1

GDP data (components and deflator) **embargoed until 8:30 a.m. Friday, January 28th.**

EYES ONLY

FINANCIAL STATISTICS

	1992	1993	Nov. 1993	Dec. 1993	Jan. 27, 1994
Dow-Jones Industrial Average	3284	3522	3675	3744	3926

Dow Jones Industrial Average at **record high**.

Interest Rates					
3-month T-bill	3.43	3.00	3.10	3.06	2.92
10-year T-bond	7.01	5.87	5.72	5.77	5.73
Mortgage rate, 30-year fixed	8.40	7.33	7.16	7.17	6.97
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Jan. 27, 1994**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.738	0.0	+9.6
Yen-Dollar	108.9	−2.3	−12.3
Multilateral (Mar. 1973=100)	95.95	−0.4	+5.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	**+2.8** (Q4)	6.4 (Dec)	2.7 (Dec)
Canada	+3.0 (Q3)	11.0 (Nov)	1.8 (Nov)
Japan	+0.5 (Q3)	2.7 (Oct)	1.4 (Oct)
France	−0.7 (Q3)	11.5 (Oct)	2.2 (Oct)
Germany	−1.4 (Q3)	6.5 (Nov)	3.7 (Nov)
Italy	−0.6 (Q2)	10.6 (Jul)	4.1 (Nov)
United Kingdom	+2.1 (Q3)	10.1 (Nov)	1.4 (Nov)

GDP data **embargoed until 8:30 a.m. Friday, January 28th.**

EYES ONLY

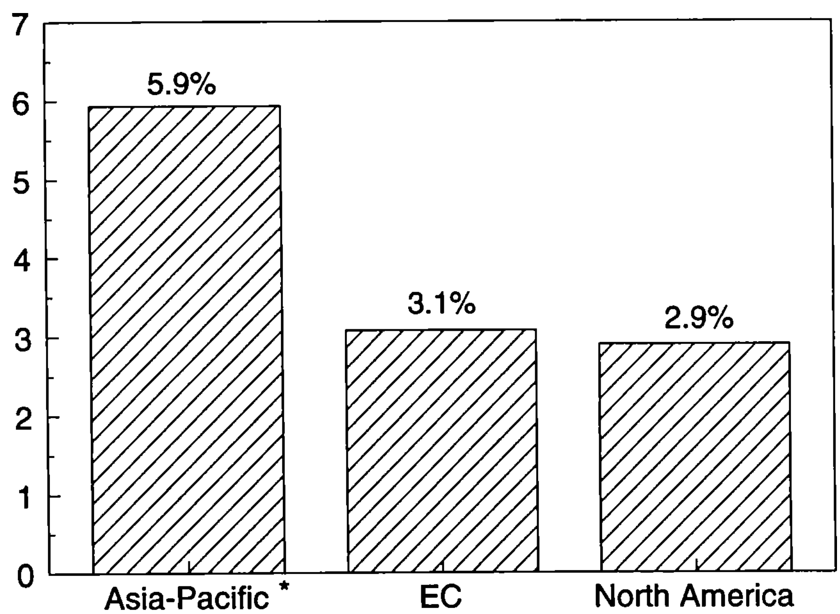
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

November 12, 1993

CHART OF THE WEEK

GDP Growth Rates
(1965 to 1990)



Asia-Pacific countries grew about twice as fast as Europe and North America over the last quarter century. This growth has made them become more important markets and more independent players in world trade.

*The Asia-Pacific countries include Australia, China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, and Thailand. APEC members Hong Kong and Taiwan are excluded because of data problems.

EYES ONLY

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QUOTATION OF THE WEEK

What protection teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war.

Henry George
Protection or Free Trade, 1886

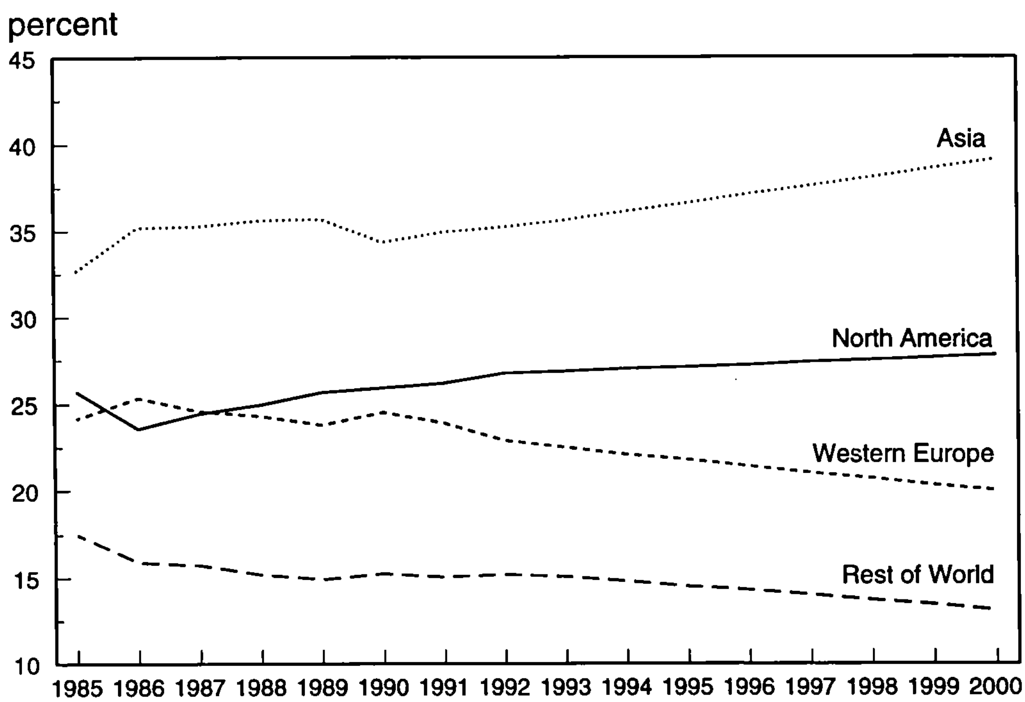
SPECIAL ANALYSIS: APEC

Asia-Pacific Countries Becoming Largest Economic Bloc

The Asia-Pacific countries have achieved the world's most rapid rates of economic growth in the past quarter century. (See the Chart of the Week.) Consequently, these countries, the members of APEC other than the United States and Canada, have increased their share of world output dramatically. Since they are likely to continue to grow more rapidly than other countries, the Asia-Pacific countries will probably continue to increase in importance in world trade. Their share of world output is projected to rise from 24 percent in 1991 to about 30 percent by the year 2000, surpassing both North America and Europe and becoming the world's largest economic zone.

The United States' Asia-Pacific partners currently account for about 35 percent of all U.S. trade, versus 23 percent for the EC. By the end of the century, U.S. trade with Asia is expected to rise to almost 40 percent of all U.S. trade. Asia-Pacific markets will be increasingly important not only for the United States but also for other Asia-Pacific countries. Trade within the region will grow, thereby reducing the weight of the United States in their trade baskets. In short, Asia-Pacific countries will become more important in our trade while we will become less important in theirs.

Shares of U.S. Trade, by Region



EYES ONLY

Analysis. As our Asian partners' reliance on the U.S. market declines, our ability to use unilateral trade measures or threats of domestic market closure to win greater openness of Asian markets will diminish. This suggests that the United States will have to act in concert with other countries to achieve our economic and political goals in the APEC region. Consequently, there are long-term advantages for the United States from the establishment of an institutional infrastructure for cooperation in the Asia-Pacific region. The APEC forum is the leading candidate for such cooperation.

The outcomes of NAFTA and the Uruguay Round will affect the evolution of the APEC agenda. Enactment of NAFTA will encourage the APEC countries to pursue greater integration with the United States. If the Uruguay Round is successfully completed, APEC will likely focus on issues traditionally not covered in the GATT, such as investment, competition policy, environmental policies, and macroeconomic coordination. If the Uruguay Round fails, however, APEC would likely focus on the reductions of more traditional trade barriers.

APEC includes a diverse range of countries:

Industrialized countries: United States, Japan, Canada, Australia, and New Zealand,

The "Four Tigers:" South Korea, Singapore, Taiwan, and Hong Kong,

Developing countries: Indonesia, Malaysia, Thailand, China, and the Philippines.

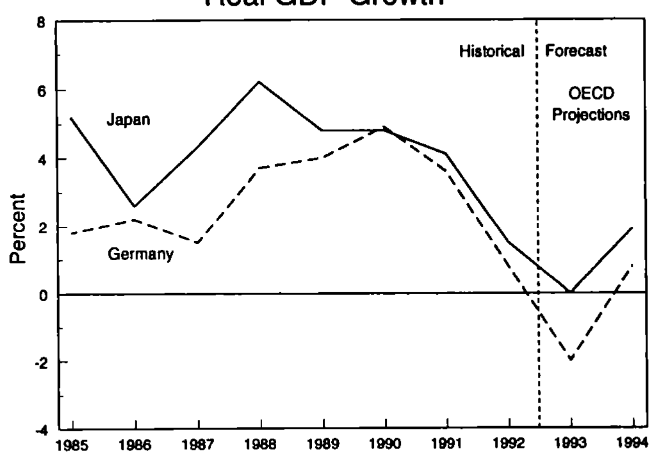
EYES ONLY

CURRENT DEVELOPMENT

Japanese and German Economies Still Weakening

OECD analysts continue to mark down their economic growth forecasts for Japan and Germany. Moreover, the latest data, such as industrial production indexes, are still declining in both countries.

Real GDP Growth



The OECD now forecasts that Japan will post no growth this year and a paltry 1.9 percent growth rate in 1994. The OECD's Japan experts, however, note that the most recent data indicate that further downward revisions to the 1994 forecast may be necessary, possibly to around 1 percent. Investment spending is still contracting, and the strong yen is crimping exports.

The OECD now expects that real GDP in Germany will decline in both the third and fourth quarters of 1993 and will fall by 2 percent for the year. For 1994, the OECD expects GDP growth of just 0.8 percent in Germany. With the world's highest labor costs, (at current exchange rates), German firms may not receive a boost from exports.

Analysis. At the OECD Economic Policy Committee meeting—chaired this week by CEA Chair Tyson—Japan indicated that additional fiscal stimulus was possible and Germany indicated that a further decline in short-term rates could occur this year. Neither country would commit to the timing or size of such expansionary steps.

EYES ONLY

CURRENT DEVELOPMENT

Partial Settlement Accepted in Airline Price-Fixing Case

A Federal district judge approved a settlement between the Justice Department and two of the eight major airlines charged with price-fixing. The government contends that the leading domestic carriers negotiated more than 50 agreements to raise fares since 1988, potentially leading to billions of dollars in consumer overpayments for air travel. USAir and United will no longer engage in practices they allegedly used to negotiate fare agreements. The two airlines agreed not to tell each other the dates that proposed fares would take effect, nor the non-advertised dates that existing fares will end.

The nonsettling defendants include Alaska Air, American, Continental, Delta, Northwest, TWA, and ATP, a joint venture of the major airlines that operates a computer database for collecting and disseminating fare information. The government and the non-settling defendants will go to trial next fall.

Analysis. The magnitude of the consumer injury and the size of the firms involved may make this case the largest price-fixing conspiracy uncovered since General Electric and Westinghouse were found guilty of fixing electrical equipment prices during the 1950s. The lawsuit also shows how computerized data dissemination systems can create new methods for price fixing.

Private Damages Suit Settles First

A private class action lawsuit seeking damages from the major carriers was filed in 1990, when the press first reported a Justice Department investigation of airline price-fixing, and was settled last year. Most affected passengers were awarded either minor discounts for future travel or less than $100 cash. The plaintiffs' lawyers earned $14.4 million in fees. Tom O'Donnell, the CEA's Chief of Staff, was a named class representative.

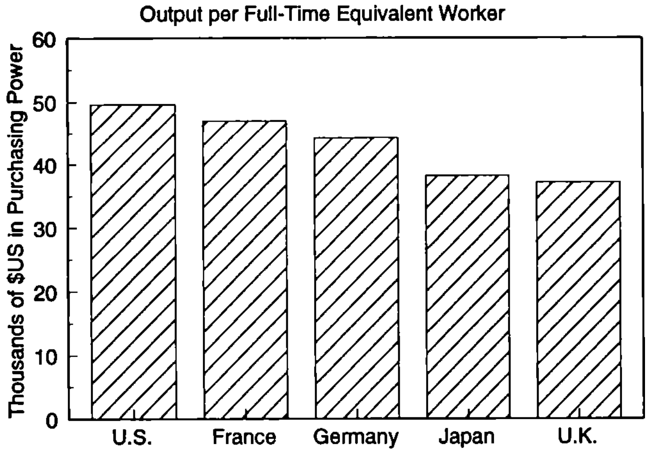
EYES ONLY

ARTICLE

U.S. Leads World in Productivity But Lags in Some Industries

The United States enjoys the highest income per capita in the world. (See Weekly Economic Briefing, October 29). The U.S. economy employs a larger fraction of its population and provides a longer average work week than any high-income country other than Japan. These two factors, however, explain only part of our higher per capita income. The most important source of our success is that U.S. workers produce more output per hour worked than workers of any other Nation. Higher labor productivity in the U.S. leads directly to higher American living standards.

Labor Productivity
Output per Full-Time Equivalent Worker



Although productivity is higher in the United States—both overall and within manufacturing—large differences exist across industries. U.S. firms lead in some industries, but lag in others. Case studies by McKinsey & Co. of nine industries in 1990—comprising about 20 percent of the manufacturing sector—found that U.S. productivity exceeded German productivity in seven of the nine and matched German productivity in the remaining two. U.S. productivity fell short of Japanese productivity in five of the nine—including autos, auto parts, steel, and consumer electronics—but exceeded Japanese productivity in the remaining four and on average across all industries.

According to McKinsey, differences in productivity stem primarily from differences ~~in the technology~~ used (processed foods, beer, steel, and metalworking), the design of products for ease of manufacturing (autos, auto parts, consumer electronics, steel, and metalworking), and the organization of functions and tasks (steel, metalworking, autos, auto parts, and consumer electronics).

In some industries, firms have acquired best practices from competitors abroad and productivity differences are small or have narrowed. In other industries, large productivity differences persist. What explains the differences? The case studies suggest that direct competition with leading-edge firms is one important common feature in narrowing productivity differences. Foreign direct investment and "transplants" also figure prominently in the case studies as a ~~means to transfer technology and management practices. For example~~, the U.S. auto assembly

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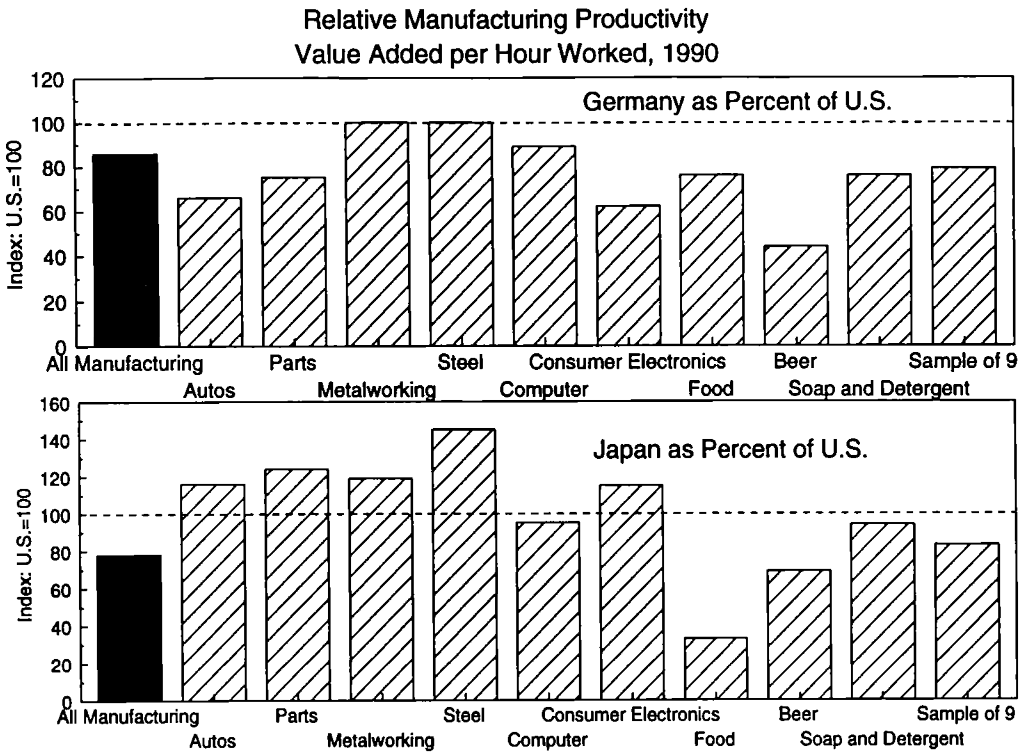

industry has greatly improved its productivity by learning from Japanese competitors and especially from transplants. U.S. productivity in auto assembly is now comparable to that of Japanese assemblers except for Toyota, which has 40 percent higher productivity than its competitors. In contrast, the German beer industry and the Japanese food industry are sheltered from domestic and foreign competition and lag far behind leading-edge firms.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Deregulation Boosts U.S. GDP. Econometric studies compiled by Clifford Winston of the Brookings Institution suggest that the deregulation of seven U.S. industries—airlines, railways, trucking, telecommunications, cable television, stockbrokerage services, and natural gas—in the 1980s was beneficial to both consumers and producers. Consumers gained between $33 billion and $43 billion a year in 1990 prices in lower prices and better services. Quantification of quality improvements would add even more. Producers gained an estimated $3 billion a year. The total gain amounts to an improvement of 7-9 percent in output of the deregulated industries.

Gore-Perot Debate Rallies Peso, Mexican Stocks. On Wednesday, the day after the Vice President's debate, the peso more than regained its losses from Tuesday's speculative run. The peso has been under pressure from speculators betting against passage of NAFTA. The Mexican stock market rallied along with the peso, gaining 4.2 percent to close at a record high, with gainers out numbering losers almost ten to one.

Japan's Banks Lose Patience with Real Estate. Rather than follow their usual policy of propping up failing companies with additional loans, several large Japanese banks chose to allow a construction company to fail. It was probably Japan's biggest bankruptcy since World War II. The tougher attitude reflects new tax incentives for banks to write off loans, strong bank profits that make it easier for banks to book bad loans, and the creation of a special cooperative institution set up by Japan's banks to clear bad debts.

Corn and Soybean Production Forecasts Fall. The USDA revised its forecasts of corn and soybean production down sharply this month. The forecast of corn production fell 7 percent and soybean production fell 3 percent from last month. Pressure on supply should not be large, however, because stocks are relatively high and export demand is weaker than last year. Thus, little if any additional inflation from this source is expected.

Higher-Income Families Shop More at Discount Warehouses. Roper Starch Worldwide reports that 30 percent of households earning more than $50,000 a year and 26 percent of those earning between $30,000 and $50,000 shopped at a discount warehouse store in the last month. In contrast, only 14 percent of households earning between $15,000 and $30,000 and only 9 percent of those earning under $15,000 a year reported such shopping.

EYES ONLY

RELEASES THIS WEEK

Blue Chip Forecast

The Blue Chip consensus forecasts for economic growth in both calendar year 1993 and 1994 are now 2.8 percent, both up 0.1 percentage point from last month.

Producer Prices

The producer price index for finished goods fell 0.2 percent in October. This was the third decline in the past 4 months.

Consumer Prices

The consumer price index increased 0.4 percent in October and 2.8 percent over the past 12 months.

Retail Sales

The advance report on retail sales for October showed an increase of 1.5 percent.

MAJOR RELEASES NEXT WEEK

Industrial Production (Monday)

Housing Starts (Wednesday)

Merchandise Trade (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.8
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	3.9
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	2.4
Real compensation per hour	0.6	2.1	–0.9	–1.0	2.3
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.5
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	–2.8	–4.6	–4.2	–3.5	

	1970–1992	1992	Aug. 1993	Sept. 1993	Oct. 1993
Unemployment Rate	6.7	7.4	6.7	6.7	6.8
Payroll employment (thousands)					
increase per month			–33	162	177
increase since Jan. 1993			1070	1232	1409
Inflation (percent per period)					
CPI	6.0	2.9	0.3	0.0	**0.4***
PPI-Finished goods	5.3	1.6	–0.6	0.2	**–0.2**

*New releases this week in **bold**.

EYES ONLY

FINANCIAL STATISTICS

	1992	Aug. 1993	Sept. 1993	Oct. 1993	Nov. 11, 1993
Dow-Jones Industrial Average	3284	3597	3592	3626	3662
Interest Rates					
3-month T-bill	3.43	3.02	2.95	3.02	3.12
10-year T-bond	7.01	5.68	5.36	5.33	5.72
Mortgage rate, 30-year fixed	8.40	7.11	6.91	6.82	7.12
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Nov. 10, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.692	−0.3	+5.5
Yen-Dollar	107.1	−0.5	−14.0
Multilateral (Mar. 1973=100)	95.02	−0.2	+5.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.8 (Oct)	**2.8 (Oct)**
Canada	+2.4 (Q2)	11.2 (Sep)	1.9 (Sep)
Japan	−0.5 (Q2)	2.6 (Aug)	2.0 (Aug)
France	−1.0 (Q2)	11.3 (Aug)	2.3 (Sep)
Germany	−2.4 (Q2)	6.2 (Sep)	4.0 (Sep)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

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EYES ONLY

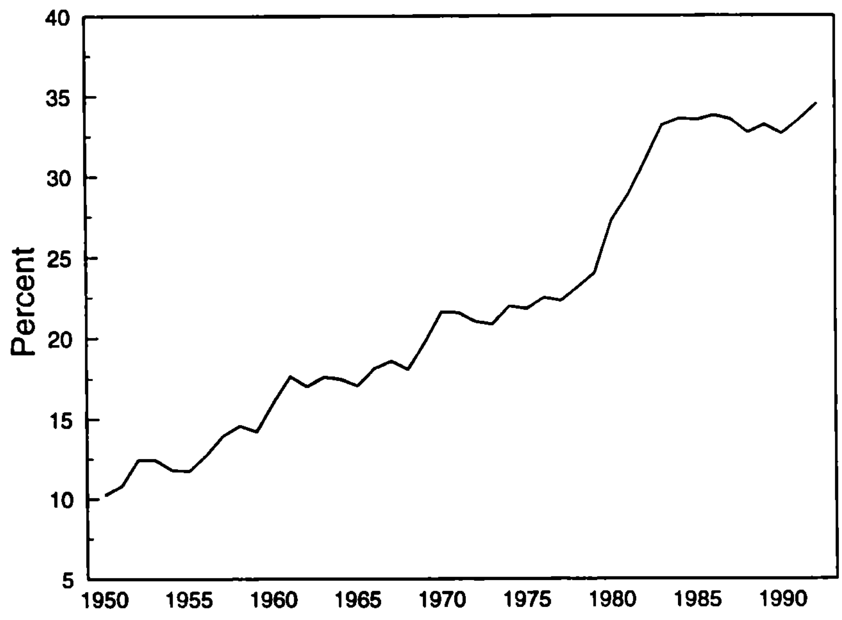
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

November 5, 1993

CHART OF THE WEEK

Information Processing Equipment:
An Increasing Share of Equipment Investment



As a share of investment in all producers' durables, investment in information processing equipment—computers, telephones, and photocopiers—has increased dramatically over the last 40 years. Today, these items account for 35 out of every 100 dollars invested in equipment. The dollar share has stabilized in recent years because declines in computer prices have made purchasing computer power even cheaper. In real terms, information processing equipment purchases have grown at an 8 percent rate since 1980; other producer investment has grown at just a 1 percent rate.

EYES ONLY

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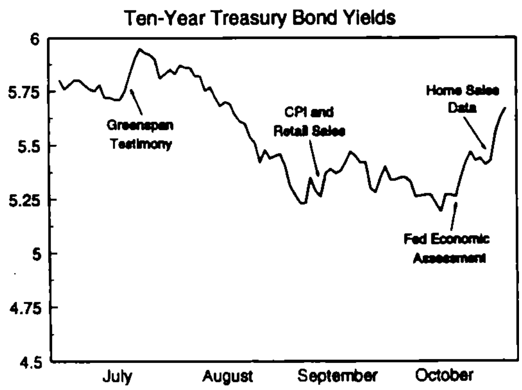
"Remember, this is a one-shot, not an entitlement."

EYES ONLY

CURRENT DEVELOPMENT

Bond Yields Rise—Yet Again



The decline in long-term yields brought about by the Administration's deficit reduction plan has not been entirely steady. This week's increase in bond yields is a case in point, with two additional episodes occurring since July. On Thursday, yields on 10-year Treasuries closed at 5.67 percent, up from 5.26 percent on October 21.

News that the economy is improving is taken as bad news in the bond market because it raises fears of increased inflation or of monetary restraint. This week's increase in yields was triggered by surprisingly strong home sales in September, the latest in a series of good releases. The increase in yields began 2 weeks ago, allegedly triggered by a positive assessment of business conditions by regional Federal Reserve Banks and Fed Chairman Greenspan.

There have been two other blips in the bond market since July.

- In September, yields increased 21 basis points following the CPI and retail sales announcements. The releases, though hardly dramatic themselves, were interpreted as news of economic strengthening, or maybe less weakness than expected.

- In July, rates increased 24 basis points following Greenspan's statement that interest rates might go up some day.

Analysis. Bond markets are highly speculative. Yields fell back again after the July and September blips up. It remains to be seen whether the current increase is another short-term blip or is longer lasting.

EYES ONLY

CURRENT DEVELOPMENT

Europe Takes Step Toward Monetary Union, Frankfurt Gets New Central Bank

European Monetary Institute = EMI = Frankfurt

Despite the August collapse of the exchange rate mechanism (ERM), EC leaders selected Frankfurt for the home of the new European Monetary Institute. The Maastricht Treaty calls for the creation of the EMI as the second of three steps leading to European Economic and Monetary Union (EMU) and a common currency. The Institute is the forerunner of the European Central Bank.

During the transition, each country will retain control over its monetary policy. The EMI will help coordinate monetary policies, oversee the European Monetary System, and monitor progress toward union. EMU is scheduled to begin no later than January 1, 1999 and requires participating countries to meet four convergence criteria (see box).

Analysis. Most observers view the timetable for monetary union as unrealistic. During the first stage, which ends January 1, 1994, all EC countries were to join the ERM and maintain exchange rates within narrow bands. But the ERM collapsed. In addition, no country currently satisfies all four convergence criteria, and only three satisfy three of the four. Since agreement was reached at Maastricht, the EC countries have diverged from the treaty's conditions for Economic and Monetary Union.

Convergence Criteria

Inflation	Within 1.5 percentage points of benchmark*
Long-term Interest Rates	Within 2 percentage points of benchmark
Government Debt	No more than 60 percent of GDP
Budget Deficit	No more than 3 percent of GDP

*Benchmarks are the average of the three lowest inflation countries.

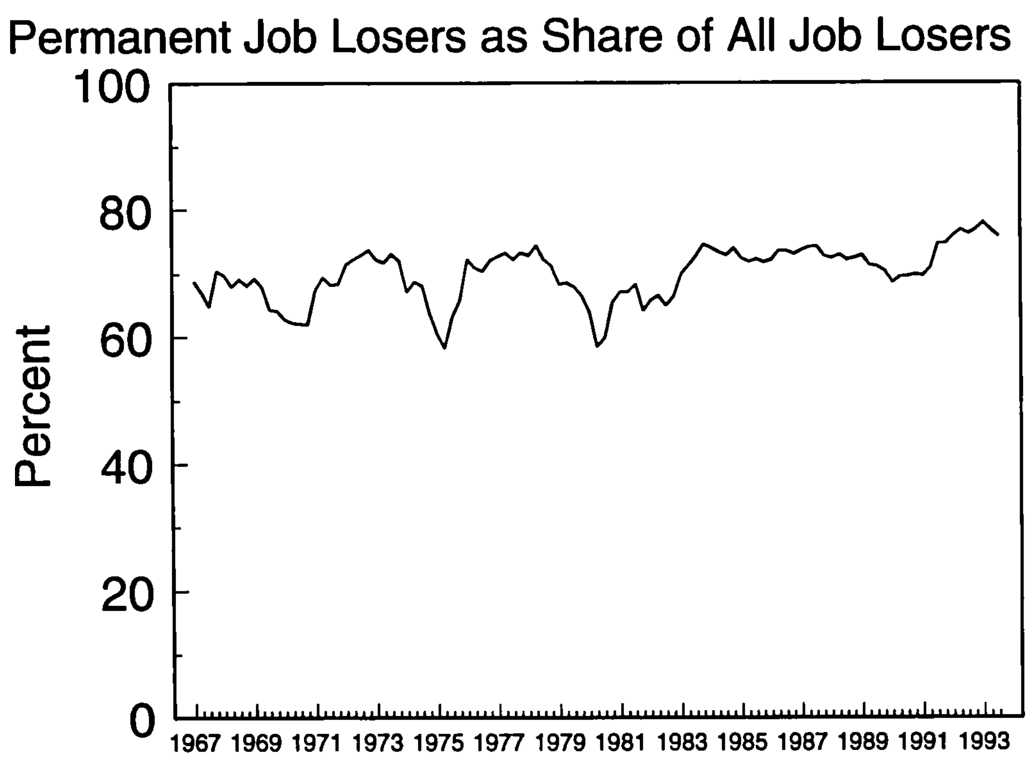
EYES ONLY

ARTICLE

Are Jobs Becoming Less Secure?

There have been numerous reports of large layoffs by employers who were previously thought to provide almost permanent employment. Has employment suddenly become less secure?

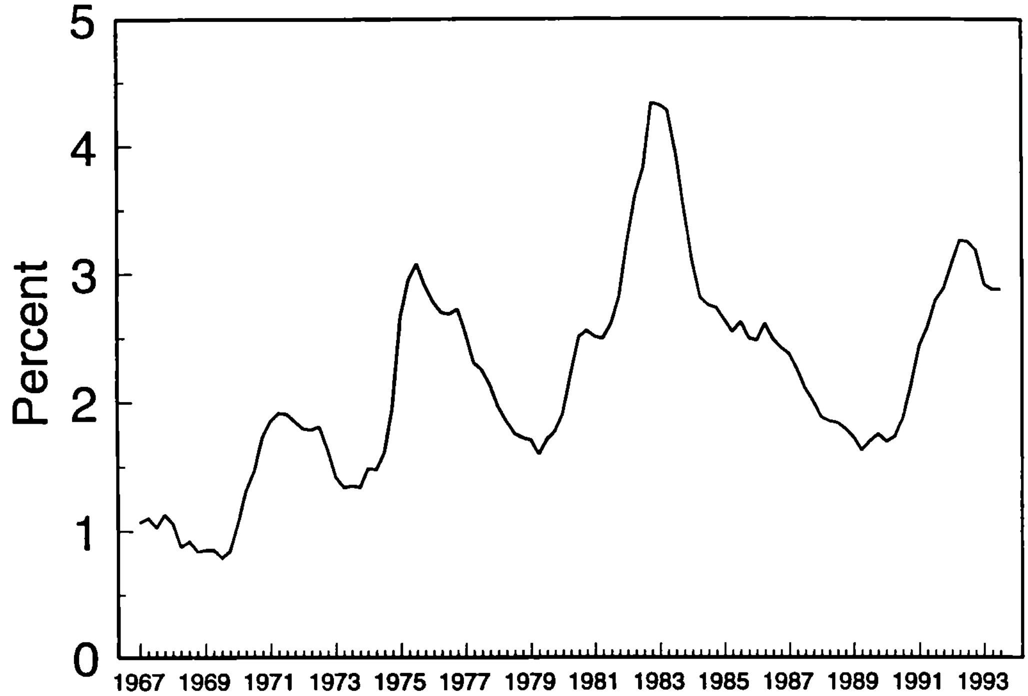
People can be unemployed because they have just entered the labor market, because they have recently re-entered the labor market, or because they have lost a job or been laid off. The chart shows the percentage of people in the last group who have lost jobs permanently. The recent peak of 78 percent in the first quarter of 1993, however, does not represent a radical change from its previous peak of 75 percent in the fourth quarter of 1983.



Similarly, the chart on the next page shows the fraction of the labor force (those working plus those looking for work) who are permanent job losers. This fraction trended upward in the 1970s, but shows large fluctuations with no trend since then. Controlling for business cycle conditions, the last few years are unexceptional. If we add in those on temporary layoff, the combined fraction of all job losers in the labor force is actually lower now than in either of the previous two recessions.

EYES ONLY

Permanent Job Losers as Share of Labor Force



Duration of Jobs. Another approach to the question of job security is to ask how long jobs last. In the U.S. job market, there is a lot of turnover among younger workers as they gain labor-market experience. But once they find the right job, they remain in it for a long period—often a whole career. In 1987, 31 percent of employees had been with their current employer for 8 or more years, up 1 percentage point from 1979. Hence, there has been little change in the fraction of employees in long-term employment relationships.

Conclusion. Unemployment has been high now for an extended period. Measures of distress in the labor market—permanent layoffs and long-term unemployment—are correspondingly high. ~~Therefore, the perception of hard times is understandable.~~ But these problems are not unusual and should abate as the recovery continues.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Higher Taxes Expected. A Business Week/Harris poll found that 87 percent of 1,252 adult respondents expect higher taxes over the next few years. Although a majority of respondents believe their taxes are too high and that past tax increases were not used efficiently, 73 percent expressed some willingness to accept higher taxes if they were used effectively. Spending for job creation and education were given the highest priority and defense and welfare the lowest.

New Technology Bolsters Renewable Energy. Over the next 5 years, 68 utilities across the country will buy $500 million of solar power panels to generate electricity. Utilities in Maine, Texas, and Vermont have agreed to test new, more efficient wind turbines. And an industry-financed group is refocusing exclusively on finding clean ways to burn biomass—wood and other plant materials.

Emerging Debt Markets Boom. Prices of sovereign debt have risen dramatically as the economies of the heavily indebted countries strengthened. A large and vital market in this debt has developed. Trading volume has increased more than tenfold in the past 3 years and could reach $1.2 trillion this year.

Software Counterfeiter Jailed. A computer software counterfeiter was sentenced to 1 year in Federal prison and a year's probation after pleading guilty. He is believed to be the first person sentenced for software counterfeiting in the United States.

[illegible]

Federal Reserve District Banks Report Slow to Moderate Growth. The Federal Reserve's October regional summary of business activity reported continued slow to moderate growth in most Federal Reserve districts. Consumer spending, particularly for autos and other durables, manufacturing, and residential real estate markets generally showed improvement. The San Francisco Bank reported general improvement across the district, but continued sluggishness in California and relatively weak conditions in western Washington and Hawaii's tourist industry. Separately, the president of the San Francisco Bank said he sees evidence that the worst of this cycle is past for California.

Xerox Introduces "Green" Graphic Film. Xerox introduced a silverless graphic-arts film it claims is cheaper to use and less harmful to the environment than current film. The new selenium-based film forms images when exposed to heat and light, avoiding the chemical processing necessary for traditional silver-halide films. Graphic-arts film is used in printing plates for high-volume printing, including newspapers, magazines, and catalogs.

EYES ONLY

RELEASES THIS WEEK

Employment ** FOR RELEASE 8:30 A.M. FRIDAY **

The unemployment rate was 6.8 percent in October. During October, payroll employment increased by 177,000 workers.

Leading Indicators

The index of leading indicators rose 0.5 percent in September.

Productivity

Productivity in nonfarm business rose at an annual rate of 3.9 percent in the third quarter.

Automobile Sales

Sales of domestically-produced automobiles were 7.1 million units at annual rate in October, up from 6.6 million units in September.

Home Sales

New homes sold at an annual rate of 762,000 in September, a large increase from August. (This series is exceptionally volatile.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Tuesday)

Consumer Prices (Wednesday)

Advance Retail Sales (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.8
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	−1.8	−0.4	**3.9***
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	**2.4**
Real compensation per hour	0.6	2.1	−0.9	−1.0	**2.3**
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.5
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	−2.8	−4.6	−4.2	−3.5	

	1970–1992	1992	Aug. 1993	Sept. 1993	Oct. 1993
Unemployment Rate	6.7	7.4	6.7	6.7	**6.8***
Payroll employment (thousands)					
increase per month			−33	162	**177**
increase since Jan. 1993			1070	1232	**1409**
Inflation (percent per period)					
CPI	6.0	2.9	0.3	0.0	
PPI-Finished goods	5.3	1.6	−0.6	0.2	

*New releases this week in **bold**. **Employment and unemployment for release 8:30 A.M. Friday.**

EYES ONLY

FINANCIAL STATISTICS

	1992	Aug. 1993	Sept. 1993	Oct. 1993	Nov. 4, 1993
Dow-Jones Industrial Average	3284	3597	3592	3626	3625
Interest Rates					
3-month T-bill	3.43	3.02	2.95	3.02	3.08
10-year T-bond	7.01	5.68	5.36	5.33	5.67
Mortgage rate, 30-year fixed	8.40	7.11	6.91	6.82	7.11
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Nov. 4, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.697	+1.5	+7.9
Yen-Dollar	108.3	+0.3	−12.0
Multilateral (Mar. 1973=100)	95.29	+0.8	+7.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	**6.8*** **(Oct)**	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.9 (Sep)
Japan	−0.5 (Q2)	2.6 (Jul)	2.0 (Aug)
France	−1.0 (Q2)	11.3 (Jul)	2.3 (Sep)
Germany	−2.4 (Q2)	6.1 (Aug)	4.0 (Sep)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

***Unemployment for release 8:30 A.M. Friday.**