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EYES ONLY

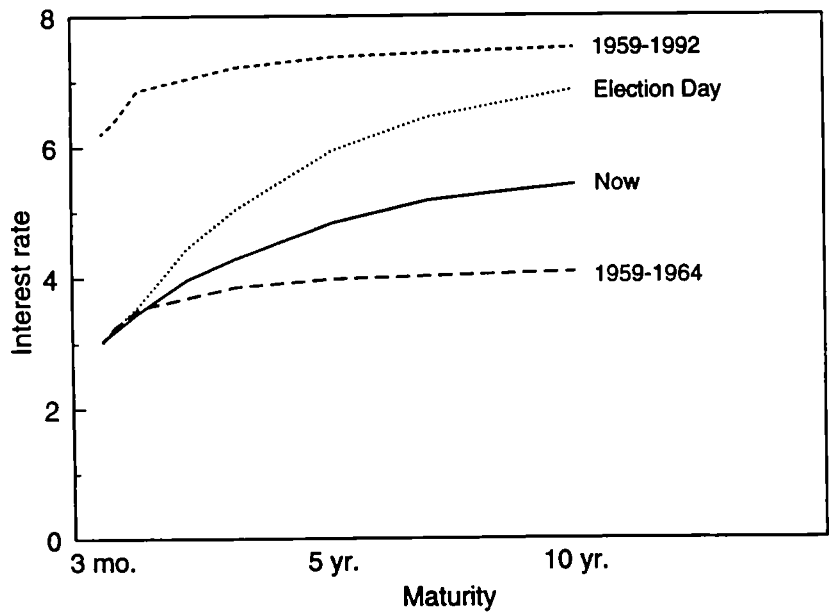
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 29, 1993

CHART OF THE WEEK

Interest Rate Yields by Maturity



Yields on long-term bonds have fallen substantially since Election Day, when 10-year Treasuries yielded 6.9 percent. They currently yield 5.4 percent. There has been no corresponding decline in short-term interest rates. Hence, the spread between 3-month bills and 10-year bonds has fallen from 3.9 percentage points to 2.4 percentage points. This spread is still large by historical standards. (From 1959 to 1992, the spread averaged 1.3 percentage points. From 1959 to 1964, the only period since 1959 with short rates as low as they are now, it averaged about 1 percentage point.) The spread tends to forecast future short rates. Short rates will probably rise somewhat as the spread returns to normal. The Administration's forecast has Treasury bill rates increasing to 3.6 percent in 1994 and 3.9 percent in 1995.

EYES ONLY

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QUOTATION OF THE WEEK

In most things we buy, necessity is the mother of invention. In the health care world, invention is the mother of necessity.

Robert Reischauer
New York Times, October 26

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard

Real GDP grew at an annual rate of 2.8 percent during the third quarter. The Administration's August forecast predicted growth at about a 3 percent annual rate for the second half of 1993. Our forecast is therefore on track. The following scorecard gives the growth of the major components during the third quarter and indicates factors affecting their recent performance or outlook.

Component	Growth*	Comments
Consumer expenditure on motor vehicles	-3.7	Automobile production was disappointing during the third quarter due to manufacturing problems at GM, constraining sales. Many sales came from inventories. Production should be much stronger in the fourth quarter.
Consumer expenditure excluding motor vehicles	4.6	Spending on other durables, nondurables, and services were all up strongly.
Producer's durable equipment	9.0	Interest-sensitive investment continues to be an important source of strength.
Housing	10.1	The response of housing to interest rates has been slow, but a recent increase in starts suggests that it is now underway.
Nonresidential structures	-0.8	Overhang of commercial structures from the 1980s makes this sector no better than neutral for growth.
Inventories (change, billions of 1987$)	$7.3	Low inventory investment has been a factor depressing growth throughout the year. During the third quarter, farm and automobile inventories were down because of the flood and production problems in autos. Inventory accumulation should be neutral or positive in the fourth quarter.
Federal purchases	-6.1	Defense cuts continue to be a ~~negative factor~~ for growth.
Exports	-1.1	Slow growth abroad and therefore low demand for our goods is a major drag on U.S. production.
Imports	1.9	As the recovery strengthens, demand for imports will grow.

*Percent real growth in third quarter at annual rate (except inventories). These preliminary figures are subject to substantial revision.

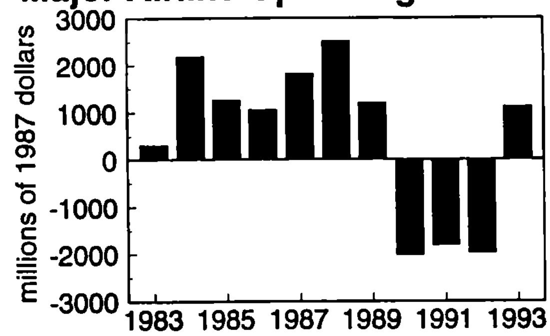
EYES ONLY

CURRENT DEVELOPMENT

Airline Profits Rebound

Most of the major U.S. carriers reported operating profits in the third quarter of 1993. American, Delta and United collectively earned $775 million, compared with a loss of $90 million during the same quarter 1 year ago. Northwest, which was considering bankruptcy reorganization last summer, showed an operating profit of $270 million. Most carriers also recorded profits during the second quarter of 1993.

Major Airline Operating Profits



1993 profits are estimates based on information supplied by Kidder, Peabody & Co.

Airline industry profits are sensitive to the business cycle. The major domestic carriers collectively reported $6.8 billion in operating losses between 1990 and 1992, but they earned significant profits in the boom years of the 1980s.

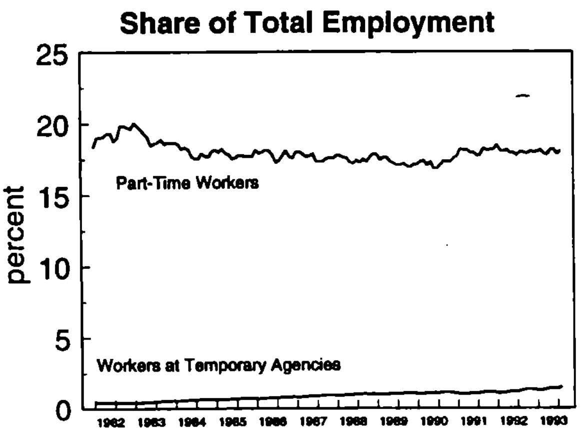
Analysis. Because airline profits are strongly cyclical, a healthy economy may largely solve the financial problems of the airline industry. This was not the conclusion of the National Commission to Ensure a Strong, Competitive Airline Industry, chaired by Governor Baliles. The Commission argued that improved macroeconomic performance would not be sufficient to aid carriers in financial distress and recommended significant tax relief for the airline industry.

The long-term financial health of the aircraft manufacturing industry is closely tied to that of the airlines. A sustained economic rebound in foreign and domestic air travel will be necessary for the airlines to generate substantial orders for new aircraft. Boeing's production rate has declined by more than one-third since the summer of 1992, and the company projects that by mid-1994 it will employ 23,000 fewer workers than at the start of 1993.

EYES ONLY

TREND

Temporary Jobs Grow, But Are Still Small Share of Employment



Although the number of workers in the temporary service industry nearly quadrupled during the last decade, it remains very small. Temporary workers were 0.4 percent of total employment in 1982 and have risen to 1.5 percent today. In addition to workers at temporary help agencies, some firms hire temporary workers on their own. Adding these workers to the agency workers raises the share of temporary workers in total employment to about 3 percent—still a small fraction.

Part-time workers are a much larger fraction of employment. There has been no discernible trend in the share of part-time workers in total employment during the last decade. Although there has been a slight increase in their share recently, it is nearly entirely the result of an increase in voluntary part-time work.

Analysis. Some analysts have raised concerns about decreasing benefit coverage and increasing employment instability resulting from an increase in temporary and part-time work. A subsequent Weekly Economic Briefing will evaluate these concerns.

EYES ONLY

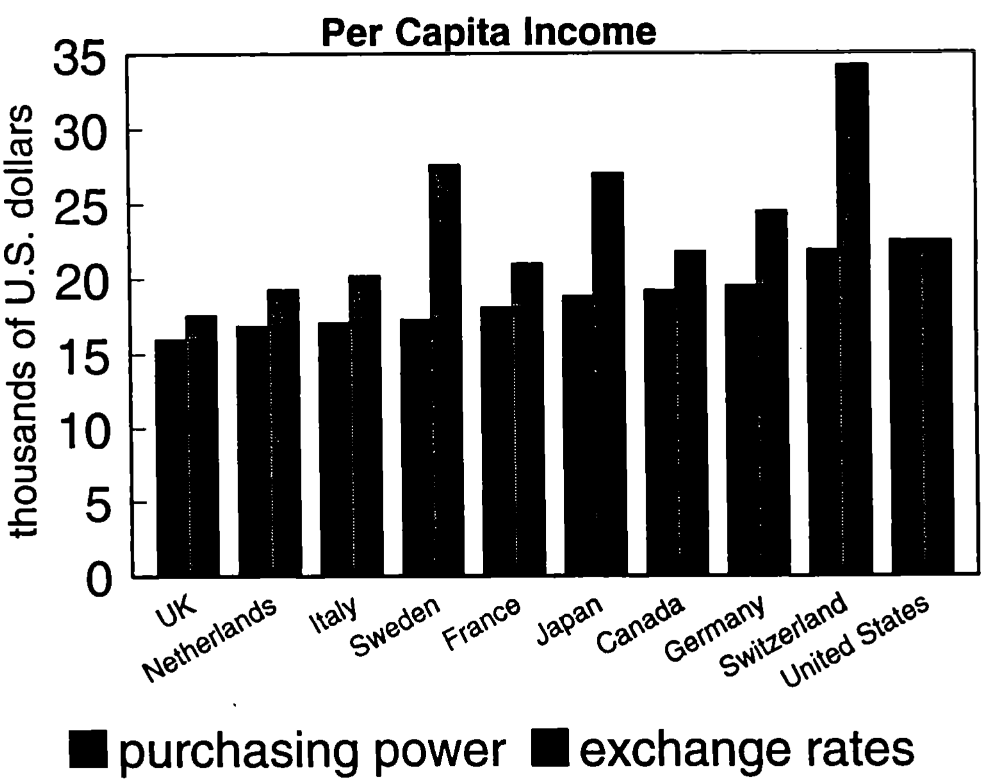
ARTICLE

Exchange Rate Movements Mask Preeminence of U.S. Living Standard

Income per capita in Switzerland was 49,000 Swiss francs in 1991, which corresponded to slightly more than $34,000 at then current exchange rates. Income per capita in the United States was approximately $22,500. Were living standards in Switzerland really 50 percent higher than in the United States?

Living standards depend both on income earned by consumers and on the cost of goods and services available to them. For example, the price of a Big Mac in the United States is $2.28 while the cost of a Big Mac in Switzerland is $3.99. Since Swiss prices are higher, a higher income level in Switzerland does not necessarily mean a higher standard of living.

International differences in prices make it essential to adjust incomes for differences in purchasing power when making international comparisons. The chart shows the levels of income per capita for various countries. The light bars convert the foreign income into dollars using the exchange rate—without making any correction for cost of living. The dark bars correct for differences in purchasing power across countries. The corrections are made using OECD data on prices in different countries.



Adjusted for purchasing power, the United States has the highest per capita income among industrial countries. Switzerland, Sweden, and Japan all have lower income than the United States once the very high prices in those countries are taken into account.

Several industrial countries appear to have enjoyed much more rapid increases in income during the 1985-91 period than the United States. Exchange rate changes account for much of these increases. Looking only at changes in the dollar value of income ignores changes in the dollar value of the cost of living. At the beginning of this period, the dollar was grossly overvalued. Its return to a more normal level since then makes it appear that incomes have been rising more rapidly elsewhere. The table shows how the appreciation of currencies relative to the dollar in the second half of the 1980s overstated income gains in many countries relative to ours.

Real U.S. Dollar Change in Per Capita Income, 1985-91

	Exchange rates	Purchasing power
Japan	13,900	5,200
Switzerland	12,500	800
Germany	10,700	2,600
Netherlands	9,200	3,500
France	7,700	1,700
Sweden	6,300	-1,800
Italy	6,000	-400
United Kingdom	4,400	-300
Canada	3,500	400
United States	1,100	1,100

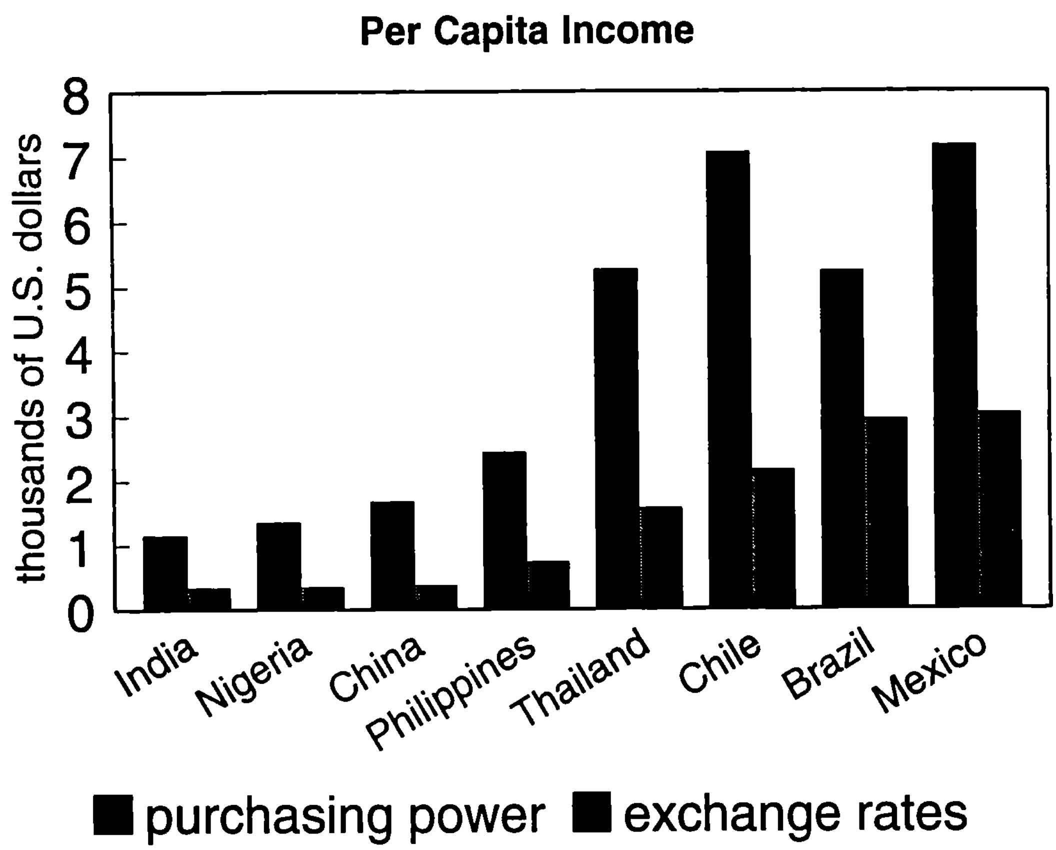
Note: Figures are changes in per capita income in 1985 U.S. dollars, converted using exchange rates or purchasing power.

The movements in the exchange rate substantially overstate changes in real income. Japan and Germany saw huge increases when income is converted to dollars using the exchange rate, but enjoyed much smaller increases once purchasing power is taken into account. Sweden, Italy, and the United Kingdom, which had increases when income is converted to dollars using the exchange rate, actually registered decreases in income measured in purchasing power.

Continued . . .

EYES ONLY

Mexico's income per capita was 9,150 pesos in 1991, which, converted using the exchange rate, corresponded to only $3,000. In developing countries, low wages lead to low prices for services and other non-traded goods. As a result, low-income countries have price levels that are systematically lower than high-income countries. Consequently, comparing income levels using market exchange rates understates the standard of living of developing countries. Adjusted for purchasing power, Mexico enjoyed a per capita income of about $7,000 in 1991, over twice what is implied by converting the peso income to dollars with the exchange rate.



Income Comparisons Do Not Tell the Whole Story

Purchasing-power corrected income shows differences in the real buying power for marketed goods and services, but is an incomplete measure of the standard of living. Factors such as crime, pollution, congestion, and the quality of health and education affect well-being, but are not captured by income.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

GM and UAW Tentatively Agree to Contract. Under the terms of the new 3-year contract, hourly workers will receive a 3 percent wage increase initially and an additional 3 percent at the beginning of the second year. The agreement gives GM a modest increase in flexibility to restructure its operations. It grants no concessions in health benefits and increases pension benefits. The agreement still must be approved by GM's board and the union's rank and file.

Automakers Report Improved Third Quarter Results. Chrysler and Ford reported positive profits this quarter and GM's loss narrowed sharply. Chrysler earned $423 million versus $202 million the previous year. Ford had a profit of $463 million, up from a $272 million loss last year. GM reduced its loss from $1.1 billion to $113 million. The improved results can largely be attributed to reduced costs and an improving domestic economy.

Cosmetics Sales Boom in China. Cosmetics companies in the United States, Japan, and France are all eyeing the growing market in China. The Chinese government estimates that the market for cosmetics, fragrance, hair and skin care products was 6 billion yuan ($1 billion) in 1992, up from 100 million yuan in 1980. Currently, imports account for only 2 percent of sales, but the number might improve if the growing number of international retail stores in China are successful. Most major U.S. cosmetic and toiletry firms are pursuing opportunities in China.

Fifth TV Network Announced for January 1995. Paramount Communications and Chris-Craft Industries plan to launch a fifth television network. The proposed network will combine stations owned by the two companies and add affiliate stations from the ranks of independent broadcasters. The decision to start the network was prompted in part by Paramount's desire to develop a new distribution system for its programming because the major networks are increasingly producing their own programming. Similarly, Time-Warner in conjunction with Tribune Company is expected to announce plans to form a television network.

SEC Filings Going On Line. The National Science Foundation has funded a 2-year grant to make Securities and Exchange Commission filings available through the Internet computer network. The SEC's Electronic Data Gathering and Retrieval system should be available by January. The NSF grant will fund access to the SEC data for a number of small institutions that could not afford to purchase this information from private sources.

EYES ONLY

RELEASES THIS WEEK

GDP

Real GDP grew at a 2.8 percent annual rate in the third quarter. The implicit price deflator rose 1.6 percent.

Budget Deficit

The fiscal year 1993 budget deficit was $254.9 billion.

Auto Sales

Sales of domestically produced automobiles were 7.8 million units at annual rate during the second 10 days in October, the highest number for a 10-day period since January.

Durable Goods

New orders for durable goods were up 0.7 percent in September.

Consumer Confidence

The Conference Board reported that its index of consumer confidence fell during October. In contrast, the University of Michigan's consumer sentiment index rose. Both indexes are preliminary.

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)

Employment (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	3.7	–1.8	–1.3	
Manufacturing (begins 1977)	2.0	5.2	4.9	5.2	
Real compensation per hour	0.6	2.2	–1.0	–1.5	
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	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	–41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	0.0
PPI-Finished goods	5.3	1.6	–0.2	–0.6	0.2

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

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 28, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	*3688 record high*
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.04
10-year T-bond	7.01	5.81	5.68	5.36	5.41
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.86
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 28, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.673	+0.4	+8.2
Yen-Dollar	108.0	−0.2	−12.0
Multilateral (Mar. 1973=100)	94.49	+0.3	+7.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.7 (Sep)	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)

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EYES ONLY

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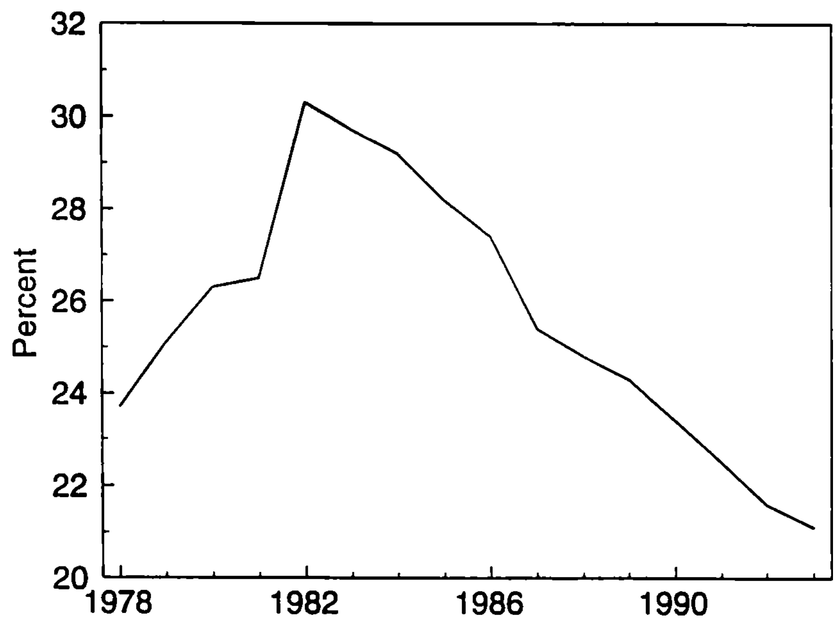
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 22, 1993

CHART OF THE WEEK

Bank Loans as a Fraction of Business Borrowing
(Commercial and Industrial)



Over the last decade, U.S. corporations have reduced their reliance on bank lending as a source of funds. Some of this is a consequence of the shift from bank lending to marketed instruments—corporate bonds and commercial paper.

EYES ONLY

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QUOTATION OF THE WEEK

"Well, it looks like we don't have a consensus...yet."

Chairman Henry Gonzalez, at a House Banking Committee hearing on Tuesday where Chairman Greenspan and 15 other senior Federal Reserve officials voiced objection to proposals to change Federal Reserve procedures. (See Article, p. 4.)

EYES ONLY

CURRENT DEVELOPMENT

New Cable Rate Regulations a Limited Success

A Federal Communications Commission (FCC) survey found that cable television rate regulation has lowered the bill for 68 percent of cable customers. Equipment charges generally declined significantly, but the average programming charge likely fell by no more than a few percent. The FCC's regulations, which implement 1992 legislation, took effect September 1.

Analysis. The rules seek to lower programming rates to long-run average cost by reducing each cable system's rate to a "competitive benchmark." Yet many systems are likely continue to charge a rate in excess of cost. The rules have several loopholes.

- The FCC's rules do not reduce rates to the benchmark. Rather, the initial rate reduction is limited to 10 percent, and regulated rates can increase with inflation. Hence, the many cable firms currently charging more than 10 percent above the competitive benchmark can permanently keep rates above cost, unless new competition from telephone companies lowers prices.

- The "competitive benchmark" may be set above long-run average cost. The benchmark is based in part on the rates of systems with less than 30 percent market penetration. Such systems may have low penetration precisely because they are charging high prices.

- The "competitive benchmark" can be evaded because it is defined on a "per channel" basis. Cable systems can lower average per channel rates without cutting the charge for existing programming by adding low-priced programming, or by shifting high-priced programming to unregulated "pay-per-channel" status.

EYES ONLY

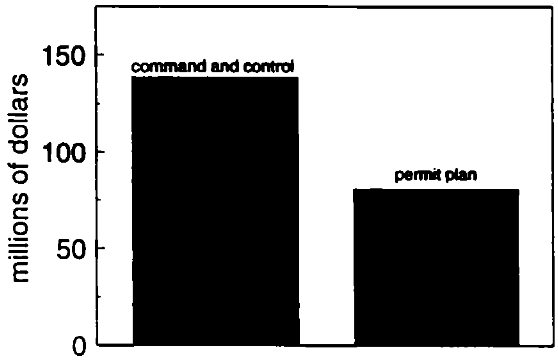
CURRENT DEVELOPMENT

Southern California Approves Smog Market Plan

Last week, Southern California's South Coast Air Quality Management District approved a plan to allow companies to buy and sell permits to pollute. The plan affects 390 of the region's largest polluters including petrochemical plants, glass factories, mining operations, and electric generating stations. These businesses each emit substantial quantities of either nitrogen oxides or sulfur oxides, the main ingredients of Southern California's brown haze.

The new program would require each company to reduce pollutants by a set percentage based on its past emissions. A company that lowers its emissions by more than the required amount will receive credits that it can sell to other companies that cannot meet their targets as cheaply.

Average Annual Costs of Emission Reduction Plans



Analysis. The ability to market pollution permits encourages companies that can reduce pollution cheaply to do so by more than the mandated percentage. Therefore, this plan will produce region-wide emission reductions faster and at lower cost than the current approach of regulating pollution at each source. The Air Quality Management District estimates that marketable permits will reduce the cost of pollution reduction by 42 percent (see chart).

A second trading program in the same District covering pollutants from organic compounds could come next year. EPA has a similar pollution trading program on a national scale to reduce acid rain by promoting reductions in sulfur dioxide emissions from power plants.

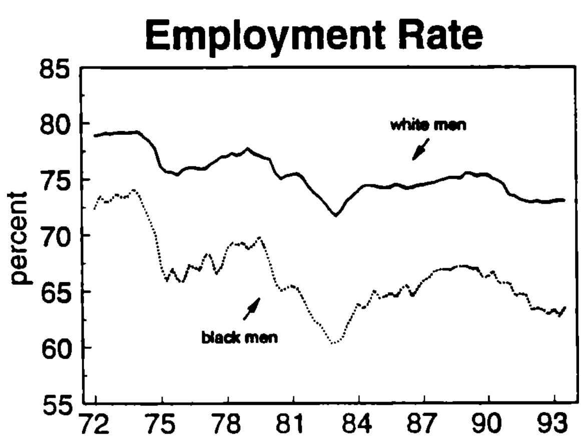
EYES ONLY

CURRENT DEVELOPMENT

Black Employment in Recent Recession Suffered a *Normal* Cyclical Decline

A recent article in the Wall Street Journal stated incorrectly that blacks were the only racial group that suffered declines in employment during the last recession. The Wall Street Journal's figures implied that total employment increased during the recession, which would have come as a surprise to the American people.

The fact is that both blacks and whites suffered employment losses during the last cyclical downturn, with much of the loss by blacks coming before the official beginning of the recession. Blacks did lose jobs at a greater rate than whites, but this pattern is typical of recessions.



Analysis. The employment rate of black men has fallen over 10 percentage points since the early 1970s. The white male employment rate has also fallen, but only half as much. This disturbing trend in black male employment is a much more important story than the normal cyclical fluctuations. Black males work disproportionately in low-wage occupations. Part of the overall decline in labor force participation of black males is a response to declining wages for the lowest-paid workers.

Falling employment of black men has adversely affected the incomes of black families. Moreover, black women have had a high labor force participation rate for decades. Since they were already working, there was little room within the black family for increased income of women to replace the stagnating income of men.

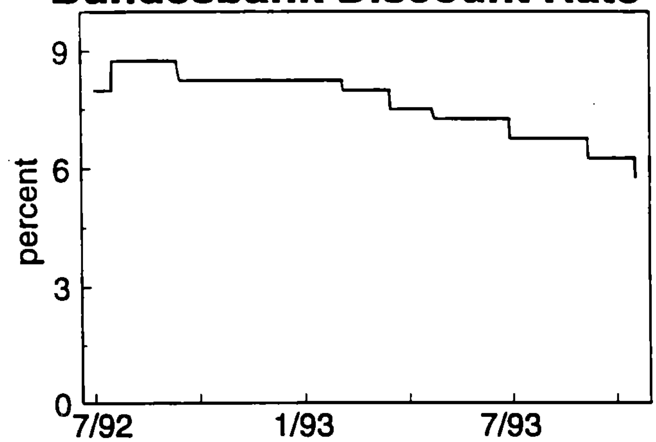
EYES ONLY

CURRENT DEVELOPMENT

Bundesbank Cuts Discount Rate, Other European Countries Follow

The Bundesbank lowered its key interest rates by 50 basis points on Thursday. The discount rate, the effective floor for money market interest rates, was set at 5.75 percent, and the Lombard rate, the effective ceiling, was set at 6.75 percent. These cuts represent the sixth time this year that the Bundesbank has reduced the discount rate.

Bundesbank Discount Rate



Interest rate cuts followed in several European countries: Austria, Belgium, Italy, the Netherlands, Switzerland, and Sweden. As of 7 p.m. Thursday, France has conspicuously failed to follow suit.

Analysis. The Bundesbank for the past year has been following a policy of slowly cutting interest rates in small increments. Consumer prices have been rising at a 2.4 percent annual rate over the past 3 months while wholesale prices have been flat. Thus, short-term real interest rates remain high. That fact, plus the weak German economy, suggest that there is additional room for interest rate cuts by the Bundesbank.

EYES ONLY

ARTICLE

Federal Reserve Independence Debated

The House Banking Committee recently held hearings on proposals to make the Fed more accountable in its conduct of monetary policy. The proposals—all opposed by the Fed—include the following:

- Closer alignment of the term of the Federal Reserve Board's Chairman with that of the President. The Chairman's term would begin 1 year into a new administration and would last 4 years.

- Direct Presidential appointment of the Fed's twelve regional bank presidents. Five regional presidents join the seven Fed Governors on the Federal Open Market Committee (FOMC), the body that determines monetary policy. These presidents are currently selected by the regional banks, with approval from the Board of Governors.

- Closer and more formalized communication between the Fed and the executive branch, and greater Congressional oversight of the Fed through broader General Accounting Office (GAO) audits.

- More timely disclosure of Federal Open Market Committee minutes. Presently, FOMC policy decisions are released in summary form 6 weeks after a meeting. One proposal calls for immediate disclosure of the FOMC's decisions. Another calls for release of more detail, even a videotape.

Merits. The various proposals have some merit.

- Although the Fed argues otherwise, the suggestion for faster dissemination of FOMC decisions may remove some of the uncertainty financial markets face in trying to divine Fed policy. FOMC decisions are often leaked. Some recent research shows that these leaks do not affect financial market volatility. Thus, fears of routine release of the decisions are perhaps overstated. The related proposal to provide a fuller record of FOMC meetings would, however, probably reduce debate at FOMC meetings.

- That the Reserve Bank presidents are chosen by their boards of directors, which are composed mainly of business people and bankers, does mean that they have less political legitimacy than they might. An argument for Presidential appointment can indeed be made.

Pitfalls. In a recent letter to Chairman Gonzalez, you said you are presently "disinclined" to support the proposal for Presidential appointment of Reserve Bank presidents, although you understand his concerns. The following considerations provide reasons for not tampering with the current system.

- There is a substantial risk that bond market participants would interpret any change in the rules under which monetary policy is formulated as a sign that the Fed would be subjected to political pressure to overstimulate the economy. Such beliefs would cause interest rates to rise.

- There is some evidence that less independent central banks typically yield higher inflation with few or no offsetting benefits. Countries with tighter political control of their central bank experience high inflation, yet do not enjoy smoother or higher rates of GDP growth, lower interest rates, or more jobs. It could be that countries with independent central banks merely have other sound policies or institutions. Thus, many economists believe that exerting greater political control over the central bank is dangerous.

- Chairman Greenspan and the Fed are adamantly opposed to any change.

None of the proposals under consideration by the House Banking Committee would radically challenge the Fed's independence. Nonetheless, tampering with the present system right now would have few or no benefits and potentially serious and adverse consequences.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Survey Shows Human Side of Recession. The University of Chicago's National Opinion Research Center's General Social Survey reveals the consequences for families of the 1990-1991 recession. One fourth of all households reported experiencing pay cuts for the husband, wife, or both sometime during 1990 or 1991. Over 28 percent reported a major worsening of their finances, and over 10 percent were forced to pawn goods. The survey shows that financial problems hit blacks, women, households with many children, and separated and divorced individuals especially hard.

Two Major Banks Cut Their Prime Lending Rates. Morgan Guaranty Trust and Harris Trust reduced their prime rate to 0.5 percent on October 18. As of Thursday, no other major banks have followed.

Telecommunications Companies to Offer Powerful Transmission System. Motorola Inc. and US West Inc. announced plans to sell switches (computers that relay phone calls and data) that will use new asynchronous transfer mode (ATM) technology. ATM allows transmission at speeds up to 622 million bits per second, making the simultaneous transmission of voice, data, and video applications over the same wire feasible. Motorola's product will more than triple the speed of existing telephone lines, and so facilitate the provision of multimedia telecommunications services by telephone companies (see Weekly Economic Briefing, October 1, 1993).

Multimedia Product Launched for Christmas. Yes! Entertainment Corp. has developed a new technology that enables TV signals to control other electronic devices in the home. The technology's first application will be TV Teddy, a Teddy Ruxpin doll that will speak and sing in conjunction with a television program. The information to tell TV Teddy what to say will be embedded in a portion of the signal not displayed on the television. A decoder will translate and transmit the data to the teddy bear. This new technology raises yet another issue of standardization: Will Barbie be able to talk to Barney?

EYES ONLY

RELEASES THIS WEEK

Housing Starts

Housing starts increased 2.8 percent from August to September, to an annual level of 1.35 million units.

Consumer Sentiment ** NOT FOR PUBLIC RELEASE **

In the preliminary report for October, the University of Michigan survey showed that consumer sentiment rebounded sharply.

MAJOR RELEASES NEXT WEEK

Fiscal Year 1993 Deficit (Tuesday)

Durable Goods Shipments and Orders (Wednesday)

GDP (Thursday)

Personal Income (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	–1.8	–1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	–1.0	–1.5
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Federal surplus	–2.8	–4.6	–4.3	–4.2	–3.5

	1970–1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	–41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	0.0
PPI-Finished goods	5.3	1.6	–0.2	–0.6	0.2

No new data this week.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 21, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3636
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.05
10-year T-bond	7.01	5.81	5.68	5.36	5.35
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.74
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 21, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.665	+3.3	+10.1
Yen-Dollar	108.3	+0.9	−11.3
Multilateral (1973=100)	94.21	+1.9	+9.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.3 (Jul)	1.7 (Aug)
Germany	−2.4 (Q2)	6.1 (Aug)	4.2 (Aug)
Italy	−0.9 (Q1)	10.6 (Jul)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.5 (Aug)	1.7 (Aug)

EYES ONLY
f: WEB.

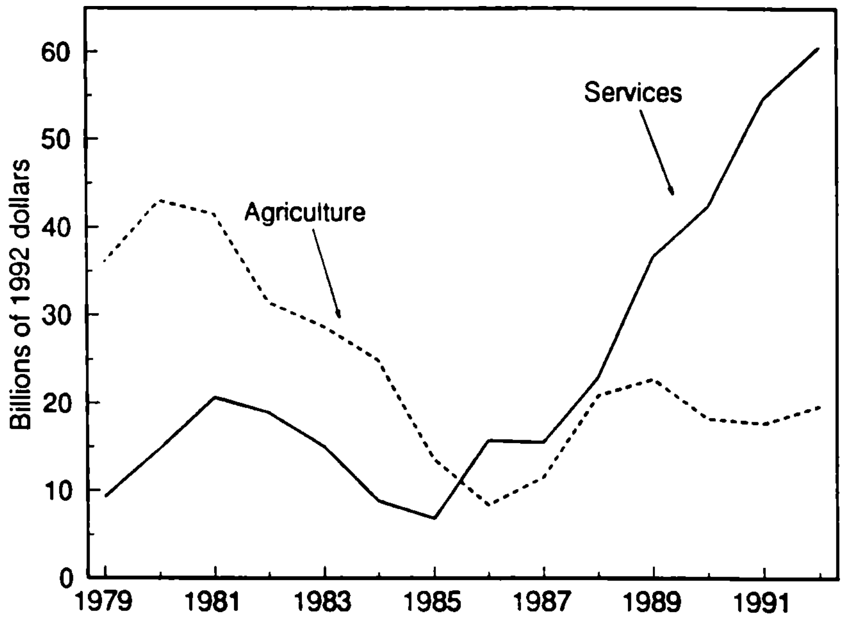
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 15, 1993

CHART OF THE WEEK

Trade Surpluses:
Services and Agricultural Products



The trade surplus in agricultural products—historically a major export sector for the United States—has stagnated, while the trade surplus in services is now substantial and rising. In 1992, the surplus in services offset more than half of the deficit in merchandise. [See Current Development, page 1.]

EYES ONLY

CONTENTS

QUOTATION OF THE WEEK

October. This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August, and February.

—Mark Twain, Pudd'nhead Wilson.

EYES ONLY

CURRENT DEVELOPMENT

Service Exports Boom

Manufactured and agricultural products have traditionally been the main exports of the United States. Nowadays, however, high productivity makes U.S. firms strong competitors in world markets for services. Service exports have grown an astounding 75 percent in real terms since 1986 and currently account for 29 percent of U.S. exports. Agricultural goods account for only 7 percent while manufacturing accounts for most of the rest.

This rapid growth in exports has led to the large trade surplus in services (see Chart of the Week), which partly offsets the substantial and persistent deficit in manufactured goods. An inflation-adjusted surplus in services of $16 billion in 1986 has mushroomed to a surplus of $61 billion in 1992. The United States currently runs a service sector surplus with virtually all trading partners, including Japan ($13 billion) and Western Europe ($20 billion). The strong growth in the service sector trade surplus contrasts sharply with a fairly stagnant surplus in agricultural trade.

Analysis. Service sector jobs are often thought of as low skilled and low wage. Many of them are, but many export-oriented service jobs are high skilled and high wage. Wages in service jobs overall are 15 percent below the national average, but wages in export-oriented service jobs are 20 percent above the average. Workers in export-oriented service industries are typically not flipping hamburgers or sweeping floors, they are working as airline pilots, engineers, accountants, and professors.

The U.S. exports ...

more equipment installation and repair services than inorganic chemicals,

more than two-thirds as many airline services as commercial aircraft, and

more educational and financial services than corn and wheat.

EYES ONLY

CURRENT DEVELOPMENT

Solution to Michigan School Funding Impasse Debated

Reliance on property taxes to fund public schools has led to substantial inequities in per-pupil expenditures in Michigan, as it has in many states. Following years of failed attempts at school-funding reform, Michigan recently eliminated the local property taxes that funded schools, effective in fall 1994. Absent some action to raise revenue, there will be no money for schools to reopen next year.

The state legislature is now debating Governor Engler's proposal to increase the sales tax from 4 to 6 percent, increase the cigarette tax by 50 cents per pack, increase the single business tax rate, impose a statewide property tax on businesses and second homes, tax home sales, and reduce homeowner tax benefits. The Michigan legislature has until the end of the year to authorize a public referendum on the sales tax increase, which requires a constitutional amendment.

The plan also allows for school choice among public schools.

Analysis. It is estimated that the Governor's proposed tax package will nearly offset the revenue loss from the property tax repeal. The proposal guarantees per- pupil spending of $4,500, but would give larger grants to schools that currently have higher costs. Hence, the proposal perpetuates some differences in per-pupil expenditures, but does guarantee a substantial minimum level of spending for each student in the state.

Michigan Proposal Would Increase Federal Revenues

The Michigan proposal would replace the property tax, which is tax deductible, with a sales tax, which is not. This change would increase Michigan citizens' Federal tax payments by about $400 million per year.

EYES ONLY

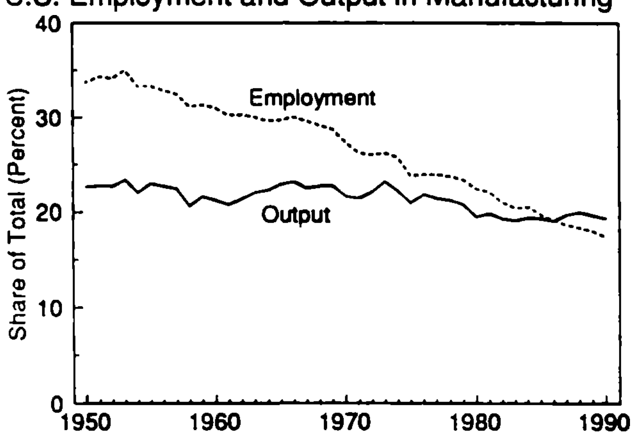
TRENDS

Manufacturing Output Share Stable While Employment Share Falls

Is U.S. manufacturing industry shrinking? That depends on whether you look at manufacturing's share of output or employment. Manufacturing industries accounted for 23 percent of output in 1950. Today they account for 19 percent. Hence, the long-term trend is small. There is a strong cyclical component, however, so the share should increase slightly as the recovery continues.

In contrast to manufacturing's nearly constant share of output, its share of employment has declined steadily and dramatically since 1950. In 1950, it was 34 percent; now it is 17 percent.

U.S. Employment and Output in Manufacturing



Analysis. Much faster productivity growth in manufacturing than in the rest of the economy has allowed manufacturing's share of output to remain fairly stable while its share of labor input has fallen markedly. Manufacturing productivity growth has been particularly strong from 1980 growing at a 2.8 percent annual rate.

EYES ONLY

ARTICLE

Is the Stock Market Ripe for a Crash?

Some say that October is the cruelest month for the stock market. The two most spectacular crashes of the stock market this century occurred in October. On October 28 and 29, 1929, the stock market lost 13 and 12 percent of its value; on October 19, 1987, it lost 23 percent. These two salient events, combined with the perception that stock prices are currently too high, have led to speculation in the press about another crash this October.

While a large stock market correction, or even a crash, is always possible, there is no particular reason to expect a large move in stock prices this month—or in any specific month, for that matter.

POTUS: discuss

- In general, changes in the stock market cannot be predicted. If a crash were widely anticipated, it would occur almost immediately as investors tried to dump their stock.
- That the two crashes took place in October is an unhappy coincidence. On average, there is nothing special about stock market performance in October.
- Despite recent talk of a stock market bubble, there are no major signs that the current market rally is driven by speculative excess.

Two pieces of "evidence" have been used to argue that the risk of a crash this October is unusually high.

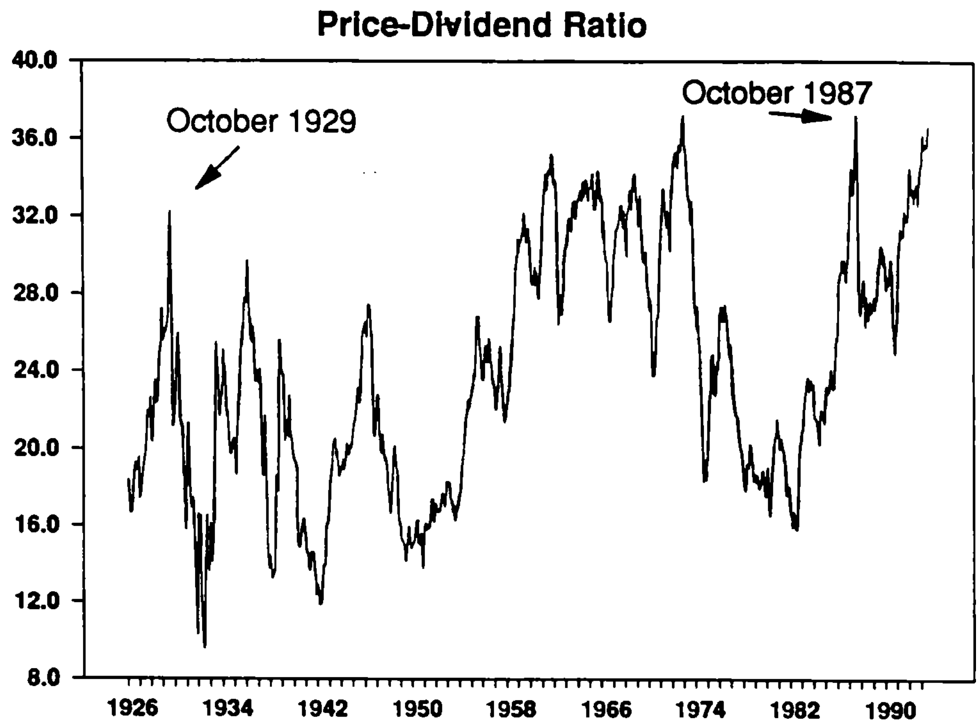
The Price-Dividend Ratio is High. The chart shows the ratio of stock prices to dividends. It does confirm the widespread perception that the stock market is currently high. The two fundamental factors determining the price-dividend ratio are the interest rate and dividend growth.

- Low interest rates are certainly one factor contributing to the current strength of the stock market. Investors seeking higher yields than those offered by bonds and bank deposits are bidding up the price of stocks.
- Dividends have been almost flat since 1990. As the recovery continues to consolidate, they should resume more normal growth.

Hence, the current "high" stock prices are broadly consistent with the fundamentals of low interest rates and sustained economic growth.

The price-dividend ratio is almost as high today as it was prior to the October 1987 crash. But the real interest rate is much lower today than it was then. In

September 1987, the 30-year Treasury bond rate was 9.6 percent and the core inflation rate was about 3.5 percent, implying a 6.1 percent real rate. This September, the long bond rate was 6.0 percent and core inflation was about 3 percent, implying a 3 percent real rate. This decline of about 3 percentage points in the real interest rate makes the current high price-dividend ratio much more consistent with market fundamentals than an equally high ratio in October 1987.



Risk to the Market from Inexperienced Investors? Many investors, accustomed to the high nominal interest rates of the 1980s, are moving funds into the stock market in search of higher yields. Historically, stocks have earned higher returns than bonds, but holding stocks entails greater risk. Some people fear that if stock prices retreat, these less experienced investors might decide to dump their holdings, leading to a crash. Although it is possible that a flight of inexperienced investors from the stock market could increase the size of a stock market movement, this effect is more likely to cause a reversal of recent gains than a crash. Small share holders hold only a small fraction of the market. If they sell irrationally, institutional investors can pick up their stock. Crashes occur when major players in the market lose confidence and try to sell at once.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Baby Bell to Acquire Cable TV Giant. Bell Atlantic announced plans to acquire Tele-Communications Inc. (TCI), the Nation's largest operator of cable television systems. The deal is valued at over $20 billion. This proposed merger, which will be reviewed by government regulators, is one of several deals linking phone and cable companies. US West, Southwestern Bell, and Bell South have recently made significant investments in cable operations. As discussed in the Weekly Economic Briefing of October 1, 1993, regulatory and technological developments are undermining the distinction between cable television and local telephone service.

House Banking Committee Holds Hearing on Restructuring the Federal Reserve. The House Banking Committee heard testimony from Fed Chairman Greenspan on several proposals aimed at increasing the accountability of the Federal Reserve. The Committee is considering proposals that would (1) increase oversight of the Fed, (2) change the voting membership of the monetary-policy-setting Federal Open Market Committee, (3) align the term of the Fed chairman more closely with the President's, (4) change how the Federal Reserve district bank presidents are appointed, and (5) provide for earlier release of the FOMC minutes. Chairman Greenspan opposed all of these measures.

On October 19, the Committee will hear testimony from all twelve presidents of the Federal Reserve district banks. An upcoming Weekly Economic Briefing will examine the issue of the Federal Reserve's independence.

Utility Will Convert Vehicles to Natural Gas. Southern California Gas Co. will convert conventional vehicles to burn natural gas. The utility expects to convert 17,000 vans and trucks by 1996 at a cost of $2,500 to $7,500 per vehicle. During the same time period, the company will increase fivefold the number of natural gas refueling stations in Southern California. This expansion of the refueling infrastructure is meant to encourage other fleets to switch to this cleaner-burning fuel.

German Court Clears Way For Maastricht Treaty. The German Federal Constitutional Court ruled that the Maastricht treaty is compatible with the German Constitution, rejecting arguments that the treaty stripped Germany of its basic sovereign rights.

Corn, Soybean Production Down. The October USDA forecast of the U.S. corn crop is 6.96 billion bushels, down 4 percent from the September forecast and about 9 percent below the typical 1980-1992 harvest. Wet weather in the Midwest and drought in the South have led the USDA to revise its soybean production forecast to 1.89 billion bushels, down 1 percent from last month. If the forecast is correct, this year's crop will be about 2 percent below the 1980-1992 average. Because stocks are high, these substandard harvests should have only a small impact on prices.

Drug Industry Consolidation Continues. Two acquisitions in the drug industry were announced this week. Cardinal Distribution purchased Whitmire Distribution for $303 million to create the third largest drug wholesaler in the country. Hoechst Celanese Corporation offered $546 million for a controlling stake of Copley Pharmaceutical, a manufacturer of generic drugs. Drug companies are under increasing pressure from managed-care organizations to cut prices. The acquisitions are part of the industry's ongoing response to these competitive pressures.

U.S. Economic Historians win Nobel Prize. Robert W. Fogel of the University of Chicago and Douglass C. North of Washington University won the 1993 Nobel Memorial Prize in Economic Science. They were honored for "applying economic theory and quantitative methods" to historical issues. Professor Fogel studied the role of railroads in the economic development of the United States. Professor North's research stresses how institutions, especially legal systems, promote economic growth.

EYES ONLY

RELEASES THIS WEEK

Retail Sales

Total retail sales increased 0.1 percent in September; but the increases for both July and August were revised upward to 0.5 percent.

Producer Prices

The producer price index for finished goods rose a modest 0.2 percent in September following declines in the three previous months.

Consumer Prices ** FOR RELEASE 8:30 FRIDAY MORNING **

The consumer price index was unchanged in September.

Industrial Production ** FOR RELEASE 9:15 FRIDAY MORNING **

Industrial production rose 0.2 percent in September. Since September 1992, it has risen 4.6 percent.

Merchandise Trade ** FOR RELEASE 8:30 FRIDAY MORNING **

The merchandise trade deficit was $9.7 billion in August, down from $10.4 million in July.

New Car Sales

Sales of domestically produced cars were 6.8 million units at annual rate during the first 10 days in October, up from an average of 6.6 million units during September.

MAJOR RELEASES NEXT WEEK

Housing Starts (Tuesday)

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	-1.8	-1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	-1.0	-1.5
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Federal surplus	-2.8	-4.6	-4.3	-4.2	-3.5

	1970-1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	-41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	**0.0***
PPI-Finished goods	5.3	1.6	-0.2	-0.6	**0.2**

* New CPI and PPI releases in **boldface**. CPI for release 8:30 Friday morning.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 14, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3622
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.01
10-year T-bond	7.01	5.81	5.68	5.36	5.23
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.81
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 14, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.613	−0.6	+10.4
Yen-Dollar	107.3	+2.2	−11.3
Multilateral (1973=100)	92.49	+0.1	+10.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.3 (Jul)	1.7 (Aug)
Germany	−2.4 (Q2)	6.1 (Aug)	4.2 (Aug)
Italy	−0.9 (Q1)	10.6 (Jul)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.5 (Aug)	1.7 (Aug)

f: WEB

EYES ONLY

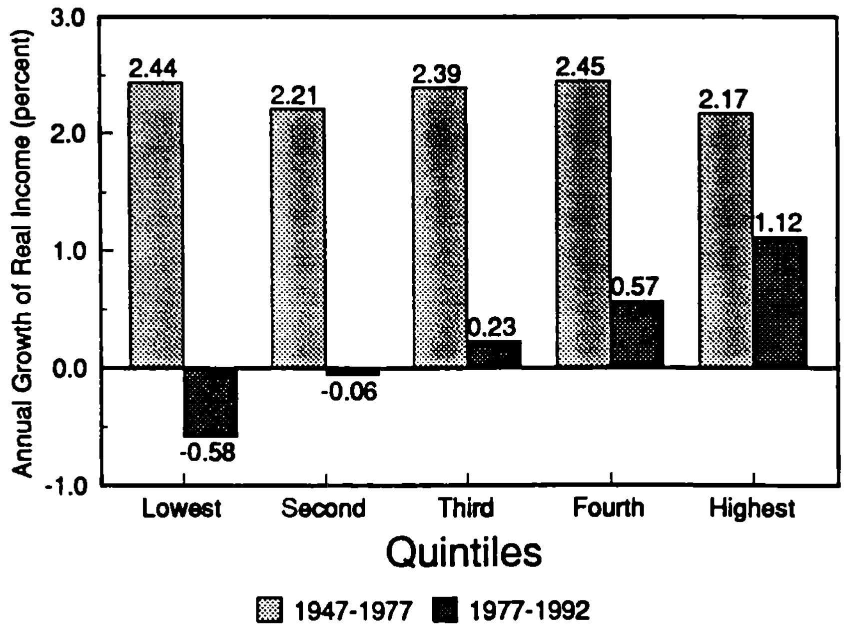
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 8, 1993

CHART OF THE WEEK

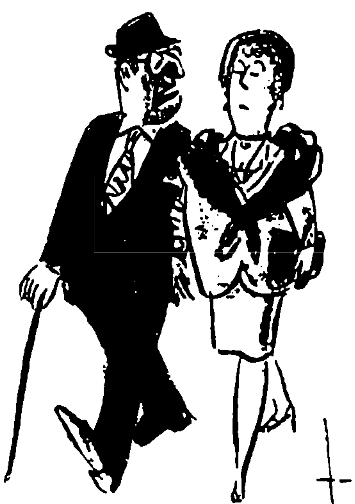
Widening Income Disparities



For about three decades, real incomes of rich and poor American families grew at roughly equal rates (the light-shaded bars). In the last 15 years, however, this pattern changed dramatically (dark-shaded bars). Real incomes of middle-income families have stagnated while low-income families have experienced real income declines.

EYES ONLY

CONTENTS



"There is a perfect example of what is wrong with this country today."

"There is a perfect example of what is wrong with this country today."

EYES ONLY

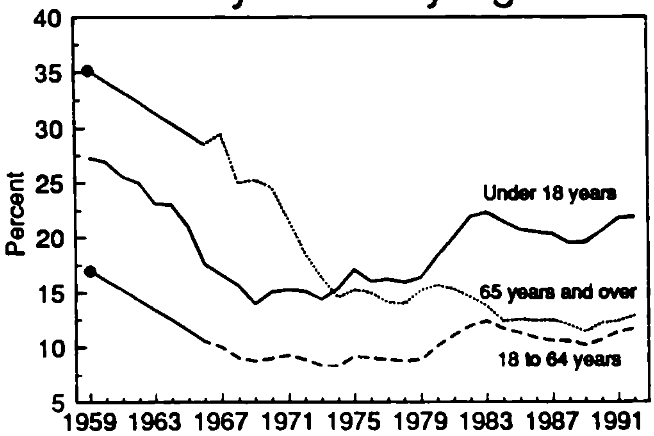
CURRENT DEVELOPMENT

Poverty Rate Increases to 14.5 Percent

During 1992, 14.5 percent of Americans lived in poverty, up from 14.2 percent in 1991. Real median household income fell 0.8 percent. The chart shows how the poverty rate for children has increased substantially since the early 1970s, while the rate for the elderly has fallen since the 1960s. The poverty rate for female-headed families was 34.9 percent in 1992; the rate for black female-headed families was 49.8 percent.

Analysis. The poverty rate both moves with the business cycle and has long-term trends.

Poverty Rates by Age



- During recessions poverty increases. The chart shows small upticks in poverty at or following troughs of the recessions in 1970, 1975, 1982, and 1991. The poverty rate should fall somewhat during the current recovery, but not by enough to reverse the upward shift since the late 1970s.

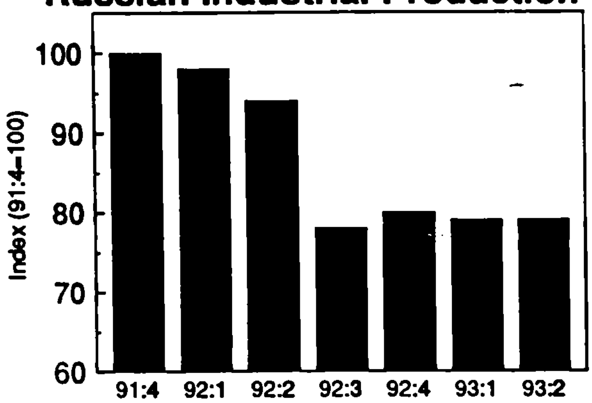
- The decline in wages of the lowest paid workers over the last decade is the largest factor contributing to increased poverty and decreased income of the poor (see "Chart of the Week"). Increased supply and decreased demand for low-skilled workers are the main reasons for the decline of wages of low-income workers.

- The decreased poverty rate for the elderly is accounted for by improving Social Security and Medicare benefits. The increased poverty rate of children arises from both the declining wages of parents and the increase in households headed by single individuals.

CURRENT DEVELOPMENT

Subsidies in Russia Stabilize Output but Cause Inflation

Russian Industrial Production

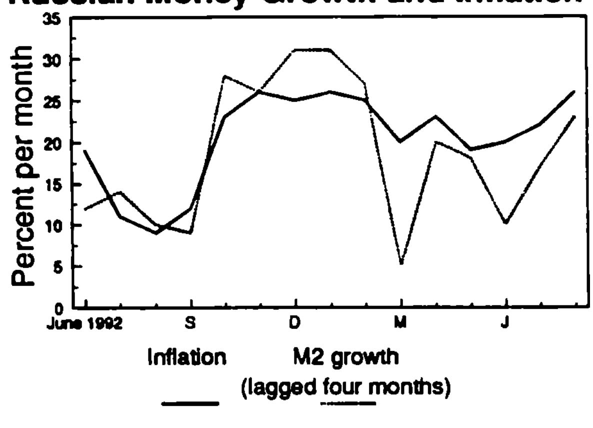


Industrial production in Russia fell 8 percent in 1991 and 19 percent in 1992. Since September 1992, however, output has remained stable. The output decline in Russia has been less dramatic than in many other reforming socialist countries. In Poland, for example, industrial production fell by more than 35 percent in the 2 years following the introduction of reform measures.

At the same time, inflation in Russia is much higher than in most other reforming economies. Since October 1992, prices in Russia have been rising at about 25 percent per month. At a similar point in the reform process, inflation in Poland was well under 5 percent per month.

Analysis. <u>The relatively small decline in production in Russia may reflect the fact that reform has been delayed</u>. Massive subsidies have helped maintain production and employment in the industrial and agricultural sectors, which employ half the Russian workforce. These subsidies, amounting to 26 percent of GDP in 1992, have been financed largely by printing rubles. As the chart shows, using the printing press to finance government spending has led to a high rate of inflation.

Russian Money Growth and Inflation



Restricting the subsidies will be a crucial part of any stabilization process in Russia. Unless Russia undertakes significant reform, it will face a continued tradeoff between maintaining employment and subsidy-driven inflation.

EYES ONLY

TREND

No Trend in Share of Jobs in Small Businesses

Small businesses account for about the same proportion of jobs today as they have over the last 20 years. It is true that small businesses create jobs at a higher rate than large businesses. But small businesses also destroy them at a higher rate. Small firms are more likely to lay off workers or go out of business than large firms.

Share of Employment by Establishment Size

	Workers per Establishment				
	<20	20-99	100-499	500-999	1000+
1975	27.1	26.9	22.7	8.1	15.4
1980	26.0	28.3	23.8	7.6	14.3
1985	26.9	29.0	23.9	7.0	13.1
1990	26.1	29.3	24.5	7.0	13.1

Source: Department of Commerce, County Business Patterns.

As the table shows, there have been only small changes in the share of employment in small firms. The smallest and largest firms have had modest employment losses offset by gains within firms of intermediate size.

Analysis. Small firms are a very heterogeneous group. They include mom and pop stores, insurance agencies, and high-tech startups. Today's successful startups will become tomorrow's big firms, but many startups will fail. Policies that address concerns of some small businesses may not be appropriate for others.

Large firms provide, on average, more attractive jobs than small firms. Large firms are much more likely to provide fringe benefits (including health insurance, pensions, and paid vacation) as well as more training. Moreover, the greater volatility of employment in small firms means that these jobs are relatively less secure.

ARTICLE

Bush Fiscal Gimmicks Shifted GDP from 1993 to 1992

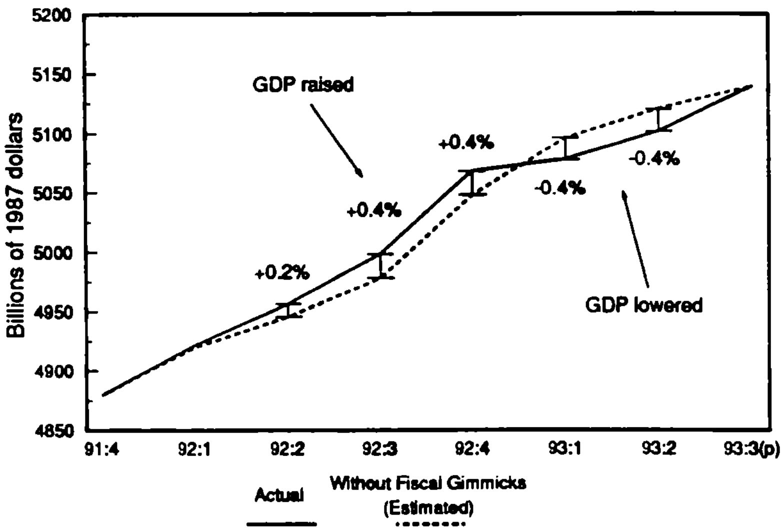
During 1992, President Bush acted to stimulate economic growth. Two fiscal measures gave a short-run boost to the economy in 1992, but led to slower growth in 1993. There were two principal measures:

1) The change in income tax withholding that President Bush announced in his January 1992 State of the Union address.

2) The temporary burst in defense purchases in the second half of 1992.

The CEA estimates that these two measures added 0.2 percent to the level of GDP in the second quarter of 1992 and 0.4 percent in the third and fourth quarters. But as the chart shows, these gains were temporary. The CEA estimates GDP was 0.4 percent lower during the first two quarters of 1993 than it would have been without the fiscal gimmickry.

Real GDP with and without Gimmicks



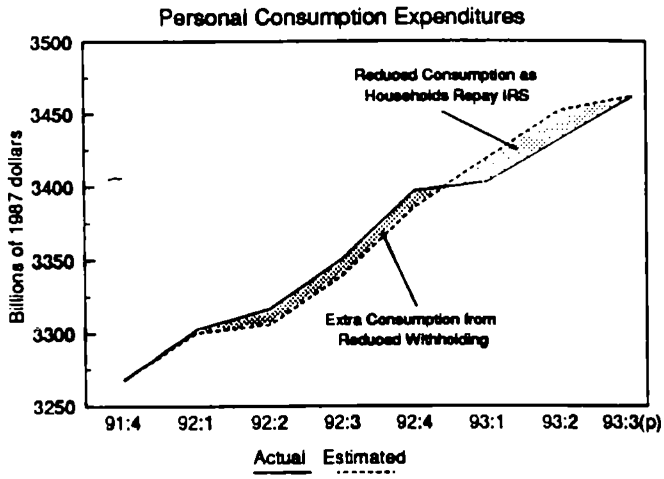
Government has at its disposal powerful tools for affecting the timing of demand and production.

- The Bush Administration intended the two fiscal measures to have only temporary benefits. They borrowed some of 1993's GDP for 1992.

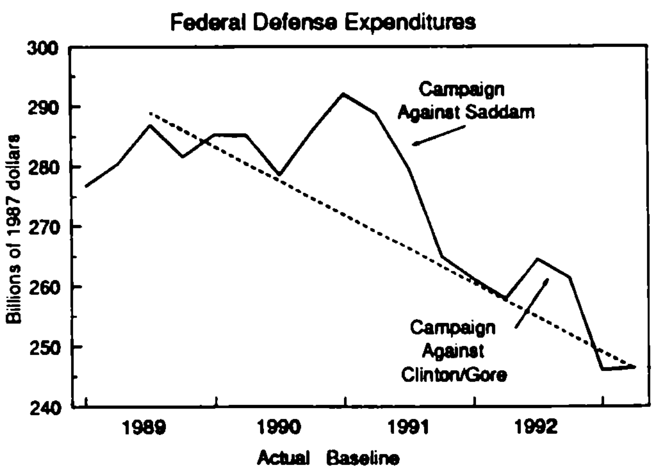
- These measures partly account for the slow growth in the first two quarters of 1993.

Details of the timing of these fiscal measures are given on the next page.

Withholding tax change. The change in the withholding tax gave most wage earners an extra $25 a month in take-home pay beginning in March 1992. In April 1993, these people therefore owed the IRS an extra $250. Many households simply let the extra pay accumulate in their bank accounts and used this accumulation to make the extra $250 payment to the IRS in April. But other households—estimated to be about 40 percent—spent the extra cash. They then had to reduce spending when they settled with the IRS. This led to the shifting of consumption from 1993 to 1992 shown in the chart.



Defense spending. During the second half of 1992, defense spending increased well above the post-Cold-War trend. This burst in spending does not reflect President Bush's much-criticized authorization of exports of future production of F-15s, F-16s, and M-1A2s. Rather, the increases were mainly in the miscellaneous "other services" category, where executive discretion could increase purchases quickly.



Are 1993 Tax Liabilities a Threat to 1994 Growth? High-income households will have large tax liabilities in April 1994 due to the retroactive increase in income tax rates in 1993. There is reason to expect, however, that these extra payments by high-income individuals to the IRS in 1994 will have a smaller effect on GDP than the extra payments to the IRS in 1993 made by taxpayers affected by the 1992 change in withholding. High-income taxpayers are more likely to make the payments out of savings. Moreover, under provisions of OBRA, they can spread the payments over 3 years. And many high-income taxpayers acted to minimize their added tax liability by shifting income from 1993 to December 1992.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Trade Liberalization Increases World Income. A joint World Bank-OECD study released last week finds that a successful conclusion of the Uruguay Round multilateral trade reforms would yield $190 billion per year in increased income in the world economy by the year 2002 (in 1992 dollars). All regions gain, but the developed countries gain the most. The study finds that trade liberalization would increase real income in the United States by 0.7 percent in 2002. These estimates represent a lower bound, since the model includes only the gains from reductions in manufacturing and agricultural tariffs. It does not incorporate reductions in trade barriers in services, which would greatly benefit the United States.

Alabama To Get Mercedes-Benz Plant. Tuscaloosa won the bidding for the first Mercedes assembly plant in the United States. To attract the project the State and several local governments agreed to a tax break package valued at more than the $300 million cost of the plant. The plant will employ 1,200 workers, but local officials claim it will generate another 10,000-13,000 jobs in the State.

Two Largest Hospital Firms Plan Merger. Columbia Healthcare Corporation announced it will acquire HCA-Hospital Corporation. Columbia has 94 acute-care and specialty hospitals and HCA has 96 hospitals. The merged firm will operate in 26 States and plans to add not-for-profit hospitals, outpatient surgery centers, and home health-care networks within local markets. The two firms project that they will save $130 million annually through combined purchasing and centralized management within markets.

EC Wants Movie Protection. EC Trade Commissioner Leon Brittan argued at a recent meeting of EC foreign ministers that the EC film industry should be protected by a "cultural specificity" clause. The Europeans claim that subsidies are necessary to allow them to compete against big-budget Hollywood productions tailored for the huge U.S. market. The French believe that only a total GATT exemption will ensure sufficient European-produced programs on EC television stations.

Highway Accidents and Homicides Are Leading Causes of Workplace Fatalities. The Labor Department's first national Census of Fatal Occupational Injuries found that vehicle accidents accounted for 18 percent of deaths in 1992; homicides accounted for 17 percent of deaths. Women accounted for only 7 percent of on-the-job deaths, but 40 percent of those deaths were homicides.

Supreme Court Agrees to Review Retroactive Tax Change. The Supreme Court will review the ruling of the U.S. Court of Appeals for the 9th Circuit that the Federal estate tax changes enacted in December 1987, but retroactive to October 1986, are unconstitutional. Since the 1930s, the courts have rejected all constitutional challenges to retroactive tax provisions.

Telephone Competition from Wireless Phone Now Possible. Motorola is backing a small Illinois company that has patented equipment that allows regular phone users to bypass the local phone company through a wireless network. The cost of cellular phone service must still fall sharply before the technology will be widely used, but it is already being installed as a backup system at hospitals and businesses.

EYES ONLY

RELEASES THIS WEEK

Employment **FOR RELEASE FRIDAY, 8:30 a.m.**

The unemployment rate in September was 6.7 percent, unchanged from August.

Automobile Sales

Sales of domestically produced automobiles were 6.6 million units at annual rate during the third quarter, down from 6.9 million in the second quarter.

MAJOR RELEASES NEXT WEEK

Retail Sales (Thursday)

Producer Prices (Thursday)

Consumer Prices (Friday)

Industrial Production (Friday)

Merchandise Trade (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	−1.8	−1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	−1.0	−1.5
Shares of GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Federal surplus	−2.8	−4.6	−4.3	−4.2	−3.5

	1970-1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	**6.7***
Payroll employment (thousands)					
increase per month			**237**	**−41**	**156***
increase since Jan. 1993			**1103**	**1062**	**1218**
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	--
PPI-Finished goods	5.3	1.6	−0.2	−0.6	--

***Unemployment and employment for release FRIDAY 8:30 a.m.**

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 7, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3584
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	2.98
10-year T-bond	7.01	5.81	5.68	5.36	5.33
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.87
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 7, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.622	−0.7	+12.1
Yen-Dollar	105.0	−1.1	−12.7
Multilateral (1973=100)	92.38	−0.6	+10.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.8 (Aug)
Canada	+2.4 (Q2)	11.6 (Jul)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.2 (Jun)	1.7 (Aug)
Germany	−2.4 (Q2)	6.0 (Jul)	4.2 (Aug)
Italy	−0.9 (Q1)	10.8 (Apr)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.4 (Jun)	1.7 (Aug)

EYES ONLY

P. WEB

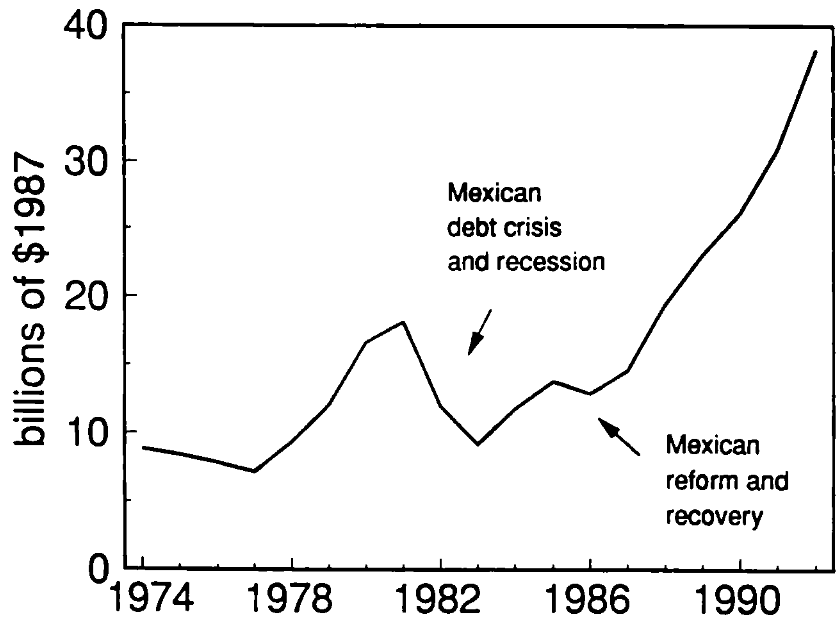
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 1, 1993

CHART OF THE WEEK

U.S. Merchandise Exports to Mexico



The decline in U.S. exports to Mexico in the early 1980s was caused by the recession and debt crisis in Mexico. Beginning in 1986, Mexico underwent substantial reforms. It joined the GATT, devalued and stabilized its currency, and unilaterally reduced tariffs and nontariff barriers. The reforms, together with recovery from recession, led to significant increases in Mexico's demand for U.S. goods. Mexico's share of total U.S. exports rose from 4.8 percent in 1974 to 9.0 percent in 1992.

EYES ONLY

CONTENTS

"Won't all these new rules impact adversely on the viability of small businesses with fewer than fifty employees?"

EYES ONLY

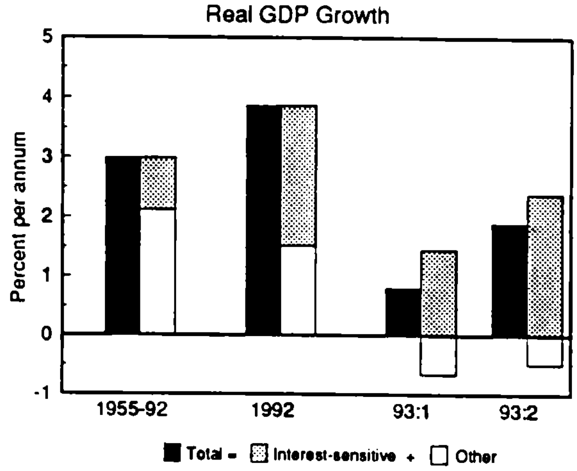
CURRENT DEVELOPMENT

Interest-Sensitive Components Lead GDP Growth

Business fixed investment, housing, and consumer durables—the three most interest-sensitive components of GDP—accounted for more than 100 percent of real growth in the first half of 1993. During the first two quarters of 1993, they grew at an annual rate of 7.8 percent, while the other components of GDP—largely the rest of consumption and government—fell at a rate of 0.7 percent. In 1992, these interest-sensitive components grew 9.9 percent, while the others grew 2.1 percent.

The chart shows growth in GDP and the contributions to growth of the interest-sensitive and other components. The interest-sensitive components account for about 30 percent of GDP growth on average (see bars for 1955-1992). During recoveries, interest-sensitive components typically contribute about one-half of GDP growth. In the current recovery, they have been even more important than usual, contributing almost two-thirds of growth.

Real GDP Growth



Analysis. Low interest rates and the strengthening of the financial system have played a major role in sustaining the recovery. Without the extra boost from interest-sensitive components, growth in the first half of 1993 would have been even more disappointing.

EYES ONLY

CURRENT DEVELOPMENT

IMF Cuts Growth Forecasts, Urges Action

The IMF reduced its forecast of industrial country growth for 1993 and 1994. Managing Director Camdessus characterized growth as "anemic at best" and called for interest rate cuts to spur growth in Europe. -He described unemployment levels as "intolerable." This urging of economic stimulus is in sharp contrast to the IMF's usual calls for restraint.

GDP Growth Rates

	1992	1993	1994
Industrial Countries	1.7	1.1	2.2
United States	2.6	2.7	2.6
Japan	1.3	-0.1	2.0
European Community	1.1	-0.2	1.6
Canada	0.7	2.6	3.8
Developing Countries	5.8	6.1	5.5
Asia	7.8	8.7	7.1
Western Hemisphere	2.5	3.4	3.5

Note: Growth rates are calendar year over calendar year. 1992 are actual. 1993 and 1994 are IMF projections.

The depth of the slowdown in the world economy has proven difficult to forecast. Just a year ago, the IMF predicted industrial country growth of 2.8 percent in 1993. Currently, they are forecasting growth of only 1.1 percent in 1993. Diminished prospects in Japan and, to a lesser extent, in Europe largely explain the revisions.

The IMF forecast of U.S. growth was also revised downward, but barely differs from the Administration forecast of 2.4 percent in 1993 and 3.0 percent in 1994. Over the last 12 months, the United States has grown more rapidly than all other major, industrialized economies (see International Statistics on page 10).

Developing countries in Asia and Latin America remain the bright spots in the world economy.

EYES ONLY

CURRENT DEVELOPMENT

New York Schools Reopening After Asbestos Crisis

Most of New York City's public schools reopened after an 11-day delay. Mayor Dinkins, after discovering previous asbestos inspections were faulty, ordered reinspection of all schools before classes could begin.

Prolonged exposure to concentrations of asbestos fibers in the air can be hazardous. But in schools most asbestos is sealed in walls. Recent water leaks and crumbling walls—a legacy of budget cuts in the 1970s—raised concern. Still, the estimated risk from asbestos in schools is only slightly higher than the same risk for outdoor exposure. Furthermore, students left out of school face other risks including staggeringly high homicide rates and the lost value of the education.

Analysis. New York City's sensitivity to the public perception of the hazards of asbestos demonstrates the complexity of policymaking where health and safety are concerned. Governments do not always have the flexibility to weigh relative risks, but where possible they should take them into account when allocating scarce resources.

Selected Lifetime Fatality Risks

Hazard		Deaths per million
Person on ground struck by crashing airplane		4
Asbestos outdoors:	Average exposure	4
	High exposure	40
Asbestos in schools:	Average exposure	6
	High exposure	60
Pedestrian struck by motor vehicle		2,000
Homicide, inner-city males, ages 15-24		10,000

EYES ONLY

ARTICLE

Regulatory, Technological Developments Reshape Telephone and Cable Television Markets

Developments in the regulation of local telephone service and cable television create the prospect of competition in both markets. Wireless communications, the technology of the future, is another source of potential competition.

- o Phone companies will be allowed to carry cable television signals.

  - -- In late August, a Federal district court allowed local telephone companies to own cable television programming. If upheld on appeal, this decision will remove the final regulatory impediment limiting the ability of local telephone companies to offer cable television services over phone lines.

  - -- Last year, the Federal Communications Commission (FCC) permitted all local phone companies to provide a "video dial tone" allowing them to offer television service.

  - -- In 1991, the Federal district court supervising the AT&T breakup permitted the "Baby Bell" companies to own and provide cable television to the extent allowed by other regulators.

- o Conversely, cable companies will be allowed to carry voice communications.

  - -- Some state regulators recently authorized cable television firms to provide local telephone service.

- o Wireless technologies might supplant both telephone and cable wiring.

  - -- Last week, the FCC announced rules for auctioning a part of the radio spectrum recently reallocated legislatively to providers of personal communications services (PCS). PCS will initially operate much like cellular telephone, but over time may become capable of sending video as well.

Technological and Regulatory Background. Similar technologies, involving lines connected to computerized central office switches, provide cable television and local telephone services. Almost all households have telephones, and most already have cable or could readily be connected.

Traditionally, economists have believed that the local provision of these services is a "natural monopoly"—meaning that only one firm would survive in a competitive market. For this reason, State price regulation rather than competition has long been relied upon to protect consumers from high telephone prices. In keeping with this tradition, local governments will be allowed to regulate some cable rates beginning next week. When cable television was developed, regulators chose to prohibit telephone companies from offering the new service, in part because cable could not be carried over the existing telephone wires.

Although the consequences of competition between local telephone and cable television providers are uncertain, the three most likely possibilities are:

- **Competition**. Fierce competition for the natural monopoly may lead firms to charge very low prices at first. Then the eventual exit of either the phone company or the cable company would reestablish monopoly in a local market. Throughout the country, cable television companies and local telephone companies appear to be positioning themselves for such competition, with phone companies upgrading to fiber optic lines and cable firms considering investment in more sophisticated central office switches.

- **Coexistence**. Regulators may prevent cable and telephone companies from offering new customers prices below those they charge existing customers, out of a concern for fairness to consumers. If so, the firms may be deterred from aggressive efforts to take business from their rivals. They may coexist while charging high prices, competing instead on service.

- **A Wireless Future?** If local telephone and cable services can be provided inexpensively through the radio spectrum rather than wire, the existing natural monopoly would be undermined. Competition that includes wireless providers would keep prices low by allowing many firms to serve each market. Wireless competition for local telephone service has been facilitated by the growth of cellular telephones, the recent allocation of radio spectrum to personal communications services, and digital signal compression. However, wireless competition for cable may be decades away.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

California's Job Losses Concentrated in Southern California. Payroll employment continues to fall throughout California, even as it has been increasing in most of the rest of the country. Most of the job losses in California are concentrated in the greater Los Angeles area. Four greater Los Angeles area Metropolitan Statistical Areas (MSAs)—Los Angeles/Long Beach, Riverside/San Bernadino, Ventura/Oxnard, and Anaheim/Santa Ana—collectively suffered a loss of about 1 percent of all nonfarm jobs from the end of 1992 until July 1993. In contrast, the other 12 MSAs in the state (for which establishment data are available and which together have roughly the same total employment as the greater Los Angeles area) collectively lost only 0.2 percent of nonfarm jobs over the same period. That is, the greater Los Angeles area has been losing jobs at about 5 times the rate of the rest of the state since the end of last year.

Corporate Downsizing to Continue. An American Management Association poll of 870 employers shows that 22 percent plan to reduce employment during the year ending in June 1994. Last year, 25 percent of the respondents expected to reduce employment, with 66 percent anticipating an economic downturn, in contrast to 40 percent this year. According to the new poll, 37 percent of large firms (over 10,000 employees), but only 15 percent of small firms (fewer than 100 employees) expect to reduce employment.

Business Confidence Weakens. The Conference Board's measure of business confidence—based on a survey of U.S. corporate executives—fell 7 points to 50 in the third quarter. The index is thus now showing an even balance between positive and negative responses and is at its lowest level in 2-1/2 years. Manufacturers are generally less optimistic, but firms in finance, insurance, and the trades are more optimistic than last quarter. Nearly 30 percent of the surveyed firms revised their capital budgets downward in the third quarter, in contrast to 22 percent last year.

Surveys by A.T. Kearney Inc. (82 CFOs) and Cahners Economics (400 executives) are consistent with The Conference Board data, but somewhat less pessimistic. The Kearney Survey reported expected fourth quarter operating profit growth of 13 percent from a year earlier, with sales growth of only 4 percent. The Purchasing Managers Survey (about 300 firms), however, reported essentially no change in business conditions for September. These surveys provide useful information for gauging the mood of business, but economists are skeptical of their predictive value.

EYES ONLY

Young Adults More Pessimistic. Only 21 percent of 18- to 29-year olds believe they have a "very good" chance of achieving the "good life" in contrast to 41 percent in 1978, according to a Roper Organization report. The report states that the 20 percentage point drop is "a huge shift in 15 years." Seventeen percent believe their chances for the good life are "not very good" or "not good at all," roughly double the level of any previous survey.

Japan To Import Rice. Japan will import 200,000 tons of rice to meet shortfalls in domestic production caused by severe weather conditions. The imports will come primarily from the United States, Thailand, and Australia. Japanese officials expect this year's rice crop will be only 80 percent of normal production and reserves have been depleted by past weak harvests. The Minister of Agriculture, Eijiro Hata, noted that the combination of excessive rainfall, low temperatures, and lack of sunshine resulted in a once-in-100 years emergency. Nonetheless, Hata said the government was considering easing restrictions on the amount of land used for rice production. The Japanese government has maintained self-sufficiency in rice by creating a rice marketing monopoly that has held prices at 5 to 6 times the world level for comparable quality rice.

Japanese Banks Lower Prime Rate. In response to last week's discount rate cut, a number of Japanese banks, including all three long-term credit banks, have cut their prime lending rates. The cuts are the third in 3 weeks and bring the prime rate to 4.5 percent, a record low.

Washington State Timber Revenue Up, Volume Down. The value of timber sold by the State of Washington for the year ending June 30 was the third largest ever, even though sales by volume were less than 60 percent of the 1979 peak. Timber prices rose rapidly throughout 1992 and early 1993, but have fallen 10 percent since their peak in May.

EYES ONLY

RELEASES THIS WEEK

GDP

Real GDP growth in the second quarter was revised up from an annual rate of 1.8 percent to 1.9 percent.

Personal Income

Personal income rose 1.3 percent in August. The July level was depressed by crop and flood damage. Absent these special factors, the growth in August was 0.7 percent.

Leading Indicators **FOR RELEASE FRIDAY, 8:30 a.m.**

The index of leading indicators rose 1.0 in August. For the first time since December 1986, there were increases in 10 of the 11 components of the index.

MAJOR RELEASES NEXT WEEK

Blue Chip Forecast (Thursday)

Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	**1.9***
GDP deflator	5.8	2.8	3.3	3.6	**2.3**
Productivity					
Nonfarm business	1.1	3.7	4.1	-1.8	-1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	-1.0	-1.5
Shares of GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	**3.3**
Business fixed investment	10.9	10.6	10.7	11.1	**11.5**
Residential investment	4.8	4.0	4.2	4.2	**4.0**
Exports	7.9	11.6	11.7	11.6	**11.6**
Imports	9.0	12.3	12.4	12.8	**13.1**
Federal surplus	-2.8	-4.6	-4.3	-4.2	**-3.5**

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08
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	1970-1992	1992	June 1993	July 1993	Aug. 1993
Unemployment Rate	6.7	7.4	7.0	6.8	6.7
Payroll employment (thousands)					
increase per month			43	211	-39
increase since Jan. 1993			866	1077	1038
Inflation (percent per period)					
CPI	6.0	2.9	0.0	0.1	0.3
PPI-Finished goods	5.3	1.6	-0.3	-0.2	-0.6

*Data revised this week in **bold**.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Sept. 30, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3555
Interest Rates					
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10-year T-bond	7.01	5.81	5.68	5.36	5.40
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.89
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Sept. 30, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.633	−0.6	+15.2
Yen-Dollar	106.1	+0.1	−11.6
Multilateral (1973=100)	92.91	0.0	+13.9

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
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Canada	+2.4 (Q2)	11.6 (Jul)	1.7 (Aug)
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France	−1.0 (Q2)	11.2 (Jun)	1.7 (Aug)
Germany	−2.4 (Q2)	6.0 (Jul)	4.2 (Aug)
Italy	−0.9 (Q1)	10.8 (Apr)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.4 (Jun)	1.7 (Aug)