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WEB Feb. 1995

EYES ONLY

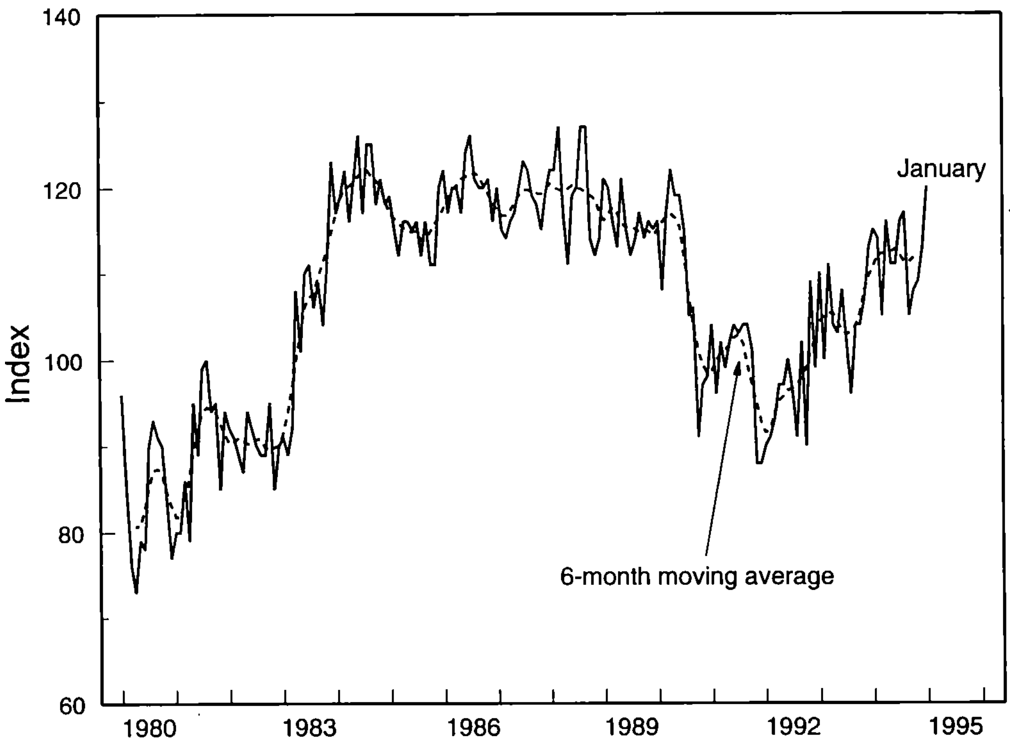
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

February 21, 1995

CHART OF THE WEEK

Index of Current Personal Financial Situations



Respondents in the University of Michigan's January survey of consumers were very upbeat in their assessments of their own financial situations. Separate data show delinquency rates on mortgages and other consumer debt trending to 20-year lows. Both pieces of evidence suggest that household spending—while slowing—probably retains forward momentum.

EYES ONLY

CONTENTS

"This is a second opinion. At first, I thought you had something else."

EYES ONLY

CURRENT DEVELOPMENT

Is the Economy Settling into Cruising Speed?

The U.S. economy was expanding at a rapid clip last year, with very little sign of slowing until just recently. Nonfarm employment increased about 300,000 per month on average in the fourth quarter of 1994 and, according to current estimates, real GDP increased 4.5 percent at an annual rate led by a 20 percent (annual rate) increase in equipment investment.

Several recent indicators suggest that growth may now be in the process of slowing to a more sustainable pace. Retail sales increased at an average monthly rate of 0.2 percent in December and January, down from about 0.8 percent from mid-year through November. Nonfarm employment increased only 130,000 in January and housing starts dropped 10 percent.

Financial markets have taken note of the moderation in the pace of activity. The rate on 30-year Treasury bonds has declined about 60 basis points from its peak in November, to 7.6 percent. And rates on 30-year mortgages have declined about 45 basis points over the same period.

Analysis. The decline in long-term bond rates suggests that financial market participants now view the outlook for price pressures as less threatening, and hence anticipate that the recent tightening move by the Federal Reserve is nearing completion. Prices in the market for federal funds futures now are consistent with market participants placing only 50-50 odds on a further Fed tightening of 50 basis points by May of this year.

EYES ONLY

SPECIAL ANALYSIS

Pensions In America: A Short Primer

Broadly speaking, employer-sponsored pension plans in the United States are of two main types:

- Under a defined benefit plan, an employer promises to pay a retirement benefit to vested employees (those with sufficiently long service with the firm) based on a predetermined formula. For example, an employer might promise to pay a monthly retirement benefit equal to 1-1/2 percent of each vested employee's final monthly salary for each year of service with the firm. Under this plan, an employee with 30 years of service would receive a monthly benefit equal to 45 percent of his/her final monthly salary.
- Under a defined contribution plan, an employer sets aside retirement monies on an ongoing basis. These contributions are specifically earmarked for individual employees, and the retirement nest egg available to each employee upon separation from the firm is simply the accumulated value of these contributions, including investment earnings.

The following box contrasts key characteristics of defined benefit and defined contribution plans.

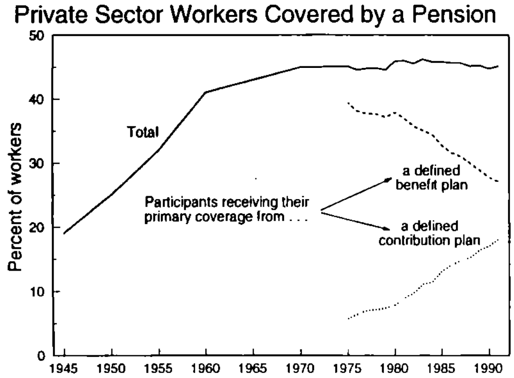
Key Characteristics of Defined Benefit and Defined Contribution Plans

Defined Benefit Plans	Defined Contribution Plans
• Benefits depend on years of service and salary, and thus are relatively easy to predict. Employers bear the investment risk associated with funding the benefits.	• Benefits depend on investment outcomes, and thus are relatively difficult to predict. Employees bear all investment risk.
• Benefits are insured by the Pension Benefit Guaranty Corporation against the possibility that the sponsor may go bankrupt, leaving a plan that is less than fully funded.	• There is no role for the PBGC to play in insuring defined contribution plans. Each employee's assets are held separately from the employer's assets.
• Defined benefit plans discourage job switching. An employee who stays with the same employer during her entire career generally will have more retirement income than one who earns the same salary with the same benefits package, but switches employers during her career.	• Benefits are at least partially portable across employers. Vested workers generally can change jobs without adverse impact on their retirement income.

EYES ONLY

ARTICLE

Trends in Pension Coverage



Between 1945 and 1970, the fraction of private-sector workers covered by a pension rose from less than 20 percent to about 45 percent (see chart). Since 1970, however, there has been no net increase in the coverage rate. As we have noted earlier (Chart of the Week, Weekly Economic Briefing, September 19, 1994), the share of workers deriving their primary pension coverage from defined contribution plans has been rising since at least the mid-1970s, while the share deriving their primary coverage from defined benefit plans has been falling.

In part, the failure of the overall coverage ratio to increase since the early 1970s reflects the changing structure of the labor market. For example, the fraction of the full-time labor force employed in the high-coverage manufacturing sector declined from 34 percent in 1972 to 28 percent in 1988; at the same time, the fraction of full-time employment in the low-coverage service sector increased. In a related development, the share of workers employed in the high-coverage unionized sector declined (e.g., from 27 percent in 1979 to 17 percent in 1988).

Coverage rates by size of business. Small firms are much less likely to offer pension coverage to their workers than are large firms. For example, in 1988 (latest data available) only 17 percent of firms with fewer than 25 employees offered pensions to their workers, whereas 84 percent of firms with more than 500 employees offered such coverage. Therefore, the pension coverage problem appears to be mainly a small-firm problem.

To some extent, the lesser availability of pensions at small firms reflects the fact that workers employed at these firms are less likely to be covered by a union contract and more likely to be part-time, have lower wages, and change jobs more frequently.

Historically, administrative costs may also have been an important factor inhibiting small businesses from offering pensions to their employees. However, increased competition—especially from mutual fund companies—has helped bring administrative costs down. Today, annual administrative fees even for very small firms run as low as $50 per employee for a bare-bones defined contribution plan, and $200 per employee for a defined contribution plan that is comparable to one that a Fortune 500 company might offer. At this level, administrative costs should present less of a barrier to availability than in the past.

Pros and cons of the shift toward defined contribution plans. Defined contribution plans have some advantages relative to defined benefit plans, including greater portability of benefits across employers and the absence of risk to the PBGC. In addition, defined contribution plans often offer greater flexibility to employees, allowing them to decide whether they should participate in the program at all (some employees may prefer to maximize their current compensation at the expense of retirement income), how their accumulating retirement monies should be invested (some may prefer low-risk, low-return bonds while others are comfortable with higher-risk, higher-return stocks), and whether they should tap into the assets accumulated in these plans for non-retirement purposes.

For some workers, this increased flexibility no doubt is a plus. At the same time, however, it does increase the opportunity for short-sighted or ill-informed decisionmaking on the part of participants. For example, some analysts have expressed concern that individuals may be too cautious in their investment decisions and thus may end up with too small a nest egg upon retirement. Even at the Federal Reserve Board, where the work force is probably more financially literate than in the country as a whole, only about 12 percent of the assets of the Thrift Savings Plan are invested in equities. (Historically, investments in stocks have paid much higher rates of return over the long term than have investments in fixed income securities.) In addition, a decision either to opt out of a retirement plan altogether or to tap retirement funds for non-retirement purposes may reflect an inadequate appreciation of retirement income needs.

For these reasons among others, some observers have worried that current generations of workers may not be providing adequately for their retirement. (See Weekly Economic Briefing, October 3, 1994, "Are Baby Boomers Saving Enough?")

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

For Many Employers, Health-Care Burden Lightened in 1994. The cost to employers of providing health insurance for their employees fell slightly last year, thanks to a continuing shift toward managed-care plans. According to an annual survey of 2,100 firms with ten or more employees, average health-care expenditures per insured employee fell 1.1 percent in 1994, marking the first time in the survey's nine-year history that costs grew more slowly than inflation. The consulting firm Foster Higgins & Co., which conducts the survey, attributed the cost reduction to the growing popularity of HMOs, preferred-provider organizations, and point-of-service plans. Such plans now cover 63 percent of insured employees, up from 52 percent in 1993. But not all is well: Firms with fewer than 500 employees saw costs rise 6.5 percent, even though well over half of their employees are now covered by managed-care plans.

U.S. Foothold in Japanese PC Market Grows. Having launched a price war in the Japanese market back in 1992, U.S. manufacturers of personal computers are now being rewarded with gains in market share. Three major U.S. PC makers—Apple, IBM, and Compaq—saw their collective share increase sharply, from 22 percent in 1993 to over 29 percent in 1994. Apple and IBM solidified their positions as the market's second- and third-leading sellers, while Compaq climbed into a sixth-place tie with Toshiba. Japanese computer giant NEC, although still by far the leader with more than 40 percent of the market, lost a whopping 6 percentage points in market share in just one year. To what do the U.S. manufacturers owe their latest inroads? In part, to their global savoir-faire: Unlike NEC's leading model, PCs made by U.S. manufacturers are compatible with international standards.

Mice Develop Alzheimer's, Opening Way to New Research. A six-year effort to induce Alzheimer's disease in mice has paid off, moving science a big step closer to finding a cure for the disease. Scientists at Athena Neurosciences and Eli Lilly & Co. announced this week that they had succeeded in causing Alzheimer's-like brain symptoms, such as damage to nerve endings and thinning of synapses, by introducing disease-causing genes into mice embryos. According to press accounts, numerous academic laboratories and pharmaceutical companies have been racing to produce the first "animal model" for the human disease. Athena and Lilly reportedly hope to begin methodical screening of candidate drugs in a few months, after they've bred more of the mice, with clinical trials of potential treatments to start within two years.

EYES ONLY

RELEASES LAST WEEK

U.S. International Trade in Goods and Services
****Embargoed until Friday, February 17, 1995 at 8:30 a.m.****

The goods and services trade deficit fell to $7.3 billion in December from $10.0 billion in November. For the year 1994, the goods and services trade deficit was $108.1 billion compared with a deficit of $75.7 billion in 1993.

Retail Sales

Advance estimates show that retail sales increased 0.2 percent in January following a similar increase in December. Excluding sales in the automotive group, retail sales rose 0.4 percent.

Consumer Price Index

The consumer price index increased 0.3 percent in January. Excluding food and energy, consumer prices rose 0.4 percent.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.4 percent in January following a 0.9 percent increase in December. Capacity utilization rose 0.1 percentage point to 85.5 percent.

Housing Starts

Housing starts fell 9.8 percent in January to a seasonally adjusted annual rate of 1.38 million units.

MAJOR RELEASES THIS WEEK

Advance Durable Orders (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.0	4.1	4.0	4.5
GDP deflator	5.5	2.3	2.9	1.9	1.6
Productivity					
Nonfarm business	1.2	1.4	−2.1	3.2	1.8
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	2.8
Real compensation per hour	0.6	0.7	−2.0	−0.4	1.4
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.1
Residential investment	4.7	4.3	4.4	4.3	4.2
Exports	8.0	12.3	12.1	12.4	12.7
Imports	9.2	14.4	14.2	14.6	15.0
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	−2.8	N.A.	−2.2	−2.3	N.A.

	1970-1993	1994	Nov. 1994	Dec. 1994	Jan. 1995
Unemployment Rate	6.7*	6.1*	5.6	5.4	5.7

*Figures beginning 1994 are not comparable with earlier data.

	1970-1993	1994	Nov. 1994	Dec. 1994	Jan. 1995
Payroll employment (thousands)					
increase per month			534	210	134
increase since Jan. 1993					5578
Inflation (percent per period)					
CPI	5.8	2.7	**0.1**	0.2	**0.3**
PPI-Finished goods	5.0	1.7	0.6	0.4	0.3

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Dec. 1994	Jan. 1995	Feb. 16, 1995
Dow-Jones Industrial Average	3522	3794	3770	3872	3988
Interest Rates					
3-month T-bill	3.00	4.25	5.60	5.71	5.69
10-year T-bond	5.87	7.09	7.81	7.78	7.40
Mortgage rate, 30-year fixed	7.33	8.36	9.19	9.15	8.84
Prime rate	6.00	7.15	8.50	8.50	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Feb. 16, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.490	–2.6	–13.6
Yen-Dollar	97.41	–1.5	–6.1
Multilateral (Mar. 1973=100)	86.70	–1.7	–9.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q4)	5.7 (Jan)	2.8 (Jan)
Canada	4.8 (Q3)	9.6 (Dec)	0.3 (Dec)
Japan	1.1 (Q3)	2.9 (Nov)	0.7 (Dec)
France	2.9 (Q3)	12.4 (Nov)	1.7 (Dec)
Germany	2.5 (Q3)	6.4 (Nov)	2.8 (Dec)
Italy	3.7 (Q3)	12.0 (Oct)	4.1 (Dec)
United Kingdom	4.0 (Q4)	8.8 (Dec)	2.9 (Dec)

EYES ONLY

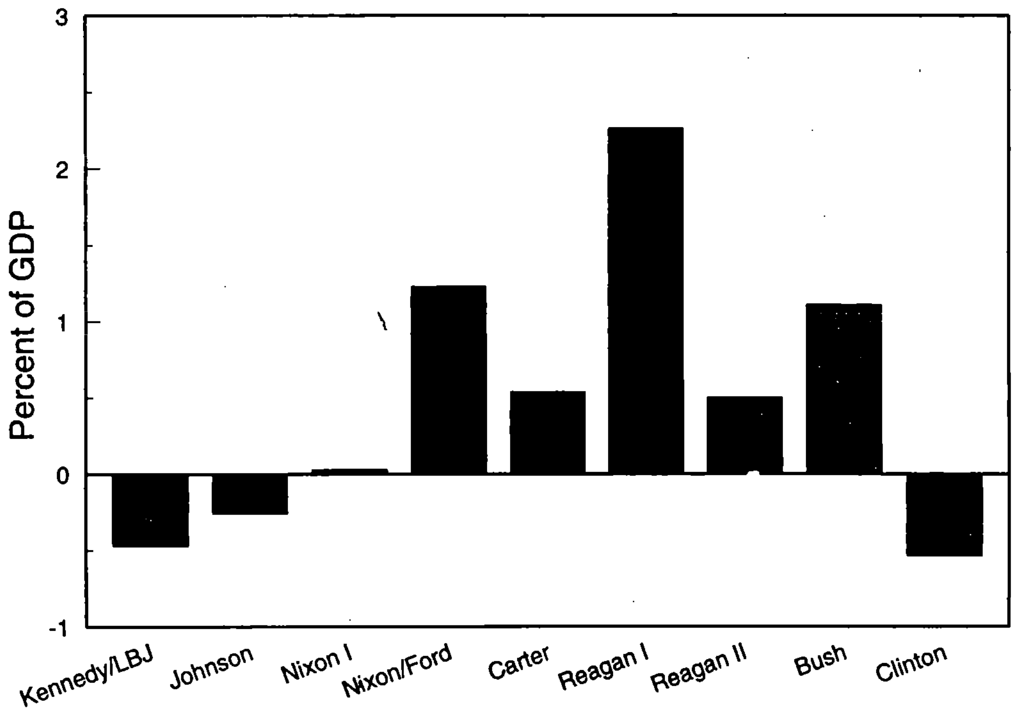
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

February 10, 1995

CHART OF THE WEEK

Average Annual Non-Interest Deficits by Administration



Note: Data for 1995-97 are '96 Budget estimates.

In FY1994—the first year in which the Federal government operated under a Clinton budget—revenues were nearly sufficient to cover spending for all purposes other than interest on past government borrowing. According to current projections, revenues will exceed non-interest spending in each of fiscal years 1995, 1996, and 1997. If these projections are borne out, this Administration will be the first since President Johnson's to run a non-interest surplus over a complete cycle of four fiscal years.

EYES ONLY

CONTENTS

"Must you tell us what our daily share of the national debt is every time we sit down to dinner?"

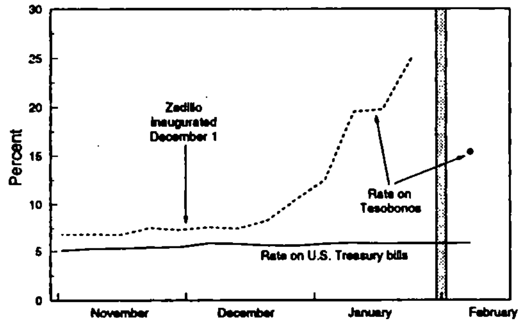
EYES ONLY

CURRENT DEVELOPMENT

Tesobono Spread Drops Following Presidential Announcement

Tesobonos are short-term bonds issued by the Mexican government. Effectively, these bonds promise a rate of return that is fixed in U.S. dollar terms. Until the peso crisis erupted, the yield on 3-month Tesobonos was roughly 2 percentage points higher than the yield on comparable-maturity U.S. Treasury bills (see chart). As the situation came unglued, however, the yield on 3-month Tesobonos climbed to 25 percent. On January 31, auctions of Tesobonos were suspended; later that morning, President Clinton announced the Exchange Stabilization Fund support package. <u>On February 7, when 3-month Tesobonos next were offered at auction, the yield dropped to about 15 percent</u>.

Interest Rates on 3-Month Securities



Note: The shaded region marks January 31, when Tesobono auctions were suspended and President Clinton announced the ESF package.

Analysis. Tesobonos are risky. By contrast, U.S. Treasury securities are essentially risk-free. The differential between the rates paid on these securities reflects investor assessments of the likelihood that the Mexican government will partially or completely default on Tesobonos (perhaps by breaking the linkage to U.S. dollars) and of the loss to investors in the event of such a default.

The increase in the spread between the rates paid on Mexican and U.S. securities in December and January suggests that investors were becoming more pessimistic either about the probability of default, or about the extent of their loss in the event of default, or both. The drop in 3-month Tesobono rates in this week's auction indicates that the Administration's announcement reduced investor anxieties somewhat. Nonetheless, the size of the remaining spread suggests that investors are still very nervous that they may not be fully repaid. Moreover, the rate on 1-year Tesobonos edged down only slightly in the most recent auction, suggesting that concerns over the longer-term outlook were not assuaged.

SPECIAL ANALYSIS

Discrimination in Hiring Persists

Affirmative action is under attack from several quarters. House Republicans reportedly are planning to hold hearings on the topic in the next few months. The Supreme Court will rule on a related case by mid-year. And conservatives in California are pushing for a ballot initiative that would eliminate all state affirmative action requirements.

The charge from many opponents is that affirmative action often leads to reverse discrimination against white males. Evidence based on "testing" indicates that conventional discrimination in the markets tested remains much more prevalent than reverse discrimination. (See box for a discussion of testing.) Results from one recent survey of the literature indicate that in order to have the same probability of obtaining a job offer, blacks and Hispanics have to submit approximately three times as many job applications as do non-minority job candidates.

These results are based mainly on tests of employers in the retail sector. It remains to be seen whether similar results are obtained from other employers, including those who are subject to Federal affirmative action requirements.

Testing as a Method for Diagnosing Discrimination

In a typical testing-based study of hiring practices, minority and non-minority "candidates" with matched fictitious backgrounds (e.g., similar education and experience) are sent to apply for the same jobs. Differences in job offer rates for minority and non-minority candidates are useful in measuring the pervasiveness of discrimination in the job market at large. In general, however, testing is not a powerful means of detecting discrimination by any but the largest employers, because only one or a few pairs of matched candidates can plausibly be sent to apply for a given job.

In a few cases, though, the treatment of black and white "candidates" has been so different as to strongly suggest discrimination by an individual employer. For example, in some cases, a non-minority candidate was interviewed after the minority candidate had been denied an interview and told that the position had been filled.

EYES ONLY

ARTICLE

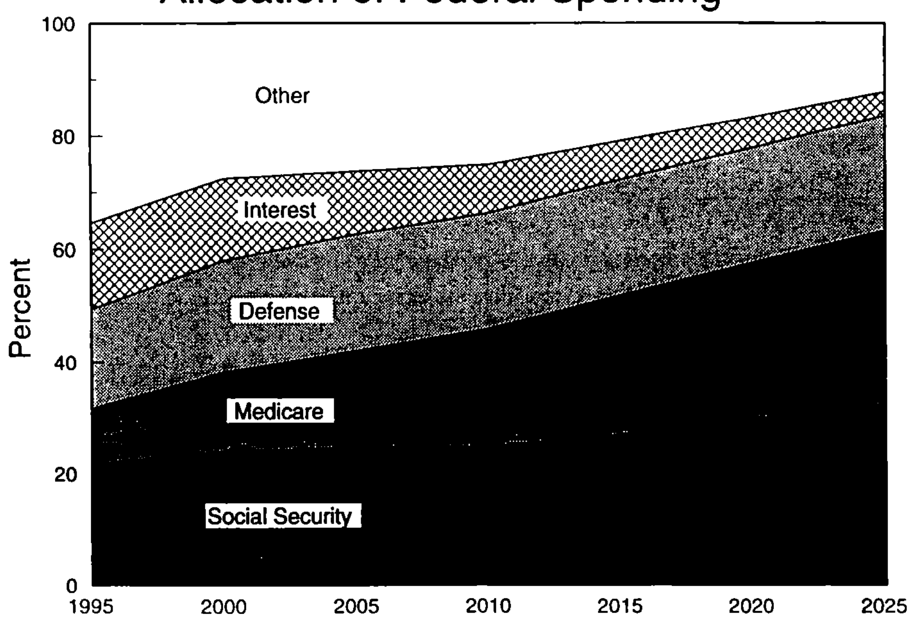
The Incredible Shrinking Federal Government

Thus far, the debate over the proposed balanced budget amendment has failed to focus on the implications of the amendment for the composition of Federal outlays in the long term. Various proponents have, however, specified broad categories of spending that they would refuse to cut. Social Security, defense spending, and interest payments have figured prominently in such pledges. In addition, proponents have pledged not to raise taxes.

A simple simulation. To illustrate the long-term effects of the proposed amendment, the CEA ran a simple simulation based on the following assumptions: The deficit is eliminated in equal-sized steps between 1995 and 2002, and it remains at zero thereafter; tax receipts, Social Security, and Medicare continue to grow as projected under current law; and defense spending remains fixed relative to the size of the economy. The chart below and the table on the next page summarize the simulation results.

In 1995, Social Security, Medicare, defense, and interest together constitute about 65 percent of overall Federal expenditures. All other programs (both mandatory and discretionary) compose the remaining 35 percent. By 2002, when the deficit is supposed to have been eliminated, Social Security, Medicare, defense, and interest make up three-fourths of overall Federal expenditures. By 2025, nearly 90 percent of total Federal spending is made up of the four specified items. Social Security and Medicare each constitute almost one-third of Federal spending, while interest payments have declined to only 4 percent of spending.

Allocation of Federal Spending



The 12 percent of spending on all other programs is not even enough to support projected outlays for Medicaid and Federal pensions. All other expenditures are squeezed out of the Federal budget under this simulation.

Analysis. A Constitutional amendment by itself does not make any of the hard choices that would have to be made in order to achieve budgetary balance. If Social Security, Medicare, defense, and interest payments are held harmless and taxes are not raised, the Federal government will consist of nothing other than Medicaid and Federal pensions by the year 2025. Under the constraints of a balanced-budget amendment, there are only three ways to prevent this from occurring: increase revenues, cut the largest entitlement programs or cut defense spending.

Allocation of Federal Outlays
(percent)

	FY1995	FY2002	FY2025
Interest	15	13	4
Social Security	22	25	32
Medicare	10	16	31
Defense	18	21	20
Other	35	26	12

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

How Not to End Welfare. In 1991, the state of Michigan abruptly terminated its General Assistance (GA) program that had been providing a maximum of $160 per month to 80,000 poor working-age jobless adults with no dependent children. A new study by two University of Michigan researchers finds that few of the former welfare recipients have made a smooth transition into the labor market. Nearly two years after GA ended, only about 20 percent were in regular jobs. (Those who had found jobs were earning an average gross pay of $650 per month.) Of the remaining 80 percent—all of whom were categorized as "able-bodied" in 1991—almost one-fifth suffered from such poor health that they had qualified for disability assistance, and many others also suffered from chronic health problems. Their inability to land a job probably also reflected both a lack of skills (half were high-school dropouts) and a lack of employment opportunities (more than half lived in job-poor inner cities). How did they scrape by? By getting help from family and friends, taking odd jobs, and relying on food stamps, homeless shelters, and soup kitchens.

G-7 Outlook Is Strongest in a Generation, Says British Forecast. With its felicitous combination of steady growth and low inflation, the outlook for the advanced economies is healthier than it has been in 30 years, according to a forecast released this week by the London Business School. The forecast predicts that the output of the G-7 nations will grow by 3 percent in both 1995 and 1996, with average inflation remaining below 2-1/2 percent in each year. As for the U.S. economy, the forecast expects a "soft landing," with growth averaging 2.6 percent in 1995 and 1996 and inflation remaining below 3 percent.

Another Tragic AIDS Milestone. AIDS has surpassed accidents as the number-one killer of Americans aged 25 to 44, according to new data from the Centers for Disease Control. Men have been hit the hardest: In 1993 (the latest year for which data are available), the disease was the leading killer of men aged 25 to 44 in 79 cities. The death rates were highest in San Francisco, Newark, Fort Lauderdale, Atlanta, and Miami, but many smaller cities also made the list—for example, Tulsa, Omaha, Raleigh, and two Springfields (Missouri and Massachusetts). And for young women, AIDS was the leading killer in 15 cities.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index ****Embargoed until 8:30 a.m., Friday****

The producer price index for finished goods rose 0.3 percent in January. Excluding food and energy, producer prices increased 0.2 percent.

Productivity

Nonfarm business productivity increased 1.8 percent at an annual rate in the fourth quarter. Manufacturing productivity increased 2.8 percent.

Auto Sales

Domestic autos were sold at an annual rate of 7.0 million units in January.

MAJOR RELEASES NEXT WEEK

Retail Sales (Tuesday)
Consumer Prices (Wednesday)
Industrial Production (Wednesday)
Housing Starts (Thursday)
U.S. International Trade in Goods and Services (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	**4.0**	4.1	4.0	**4.5**
GDP deflator	5.5	**2.3**	2.9	1.9	**1.6**
Productivity					
Nonfarm business	1.2	**1.4**	–2.1	**3.2**	**1.8**
Manufacturing (1978-93)	2.1	**4.6**	5.6	**3.5**	**2.8**
Real compensation per hour	0.6	**0.7**	–2.0	**–0.4**	**1.4**
Shares of Real GDP (percent)					
Business fixed investment	11.0	**12.6**	12.4	12.7	**13.1**
Residential investment	4.7	**4.3**	4.4	4.3	**4.2**
Exports	8.0	**12.3**	12.1	12.4	**12.7**
Imports	9.2	**14.4**	14.2	14.6	**15.0**
Shares of Nominal GDP (percent)					
Personal saving	4.9	**3.0**	3.0	3.0	**3.4**
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.

			Nov. 1994	Dec. 1994	Jan. 1995
Unemployment Rate	6.7*	6.1*	5.6	5.4	**5.7**

*Figures beginning 1994 are not comparable with earlier data.

			Nov. 1994	Dec. 1994	Jan. 1995
Payroll employment (thousands)					
increase per month			**534**	**210**	**134**
increase since Jan. 1993					**5578**
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.2	N.A.
PPI-Finished goods	5.0	1.7	**0.6**	**0.4**	**0.3**

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, February 10, 1995**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Dec. 1994	Jan. 1995	Feb. 9, 1995
Dow-Jones Industrial Average	3522	3794	3770	3872	3933
Interest Rates					
3-month T-bill	3.00	4.25	5.60	5.71	5.78
10-year T-bond	5.87	7.09	7.81	7.78	7.58
Mortgage rate, 30-year fixed	7.33	8.36	9.19	9.15	8.80
Prime rate	6.00	7.15	8.50	8.50	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Feb. 9, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.5287	0.6	–13.1
Yen-Dollar	98.94	–0.5	–8.6
Multilateral (Mar. 1973=100)	88.21	0.5	–8.9

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q4)	5.7 (Jan)	2.7 (Dec)
Canada	4.8 (Q3)	9.6 (Dec)	0.3 (Dec)
Japan	1.1 (Q3)	2.9 (Nov)	0.7 (Dec)
France	2.9 (Q3)	12.4 (Nov)	1.7 (Dec)
Germany	2.5 (Q3)	6.4 (Nov)	2.8 (Dec)
Italy	3.7 (Q3)	12.0 (Oct)	4.1 (Dec)
United Kingdom	4.0 (Q4)	8.8 (Dec)	2.9 (Dec)

WEB Jan. 1995

EYES ONLY

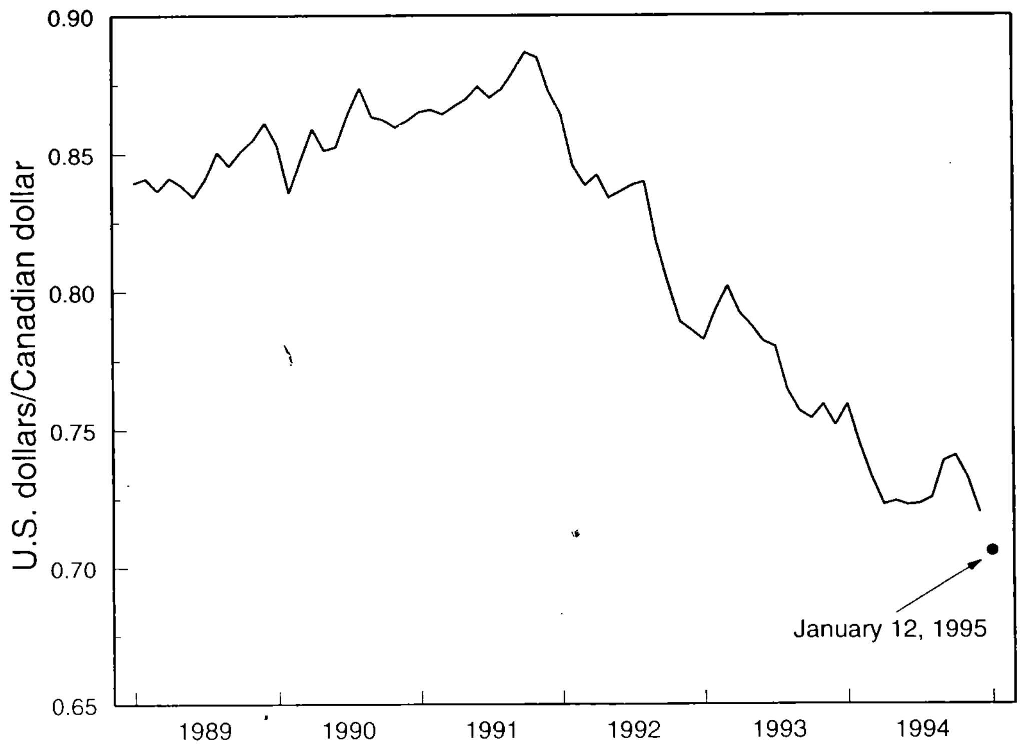
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

January 16, 1995

CHART OF THE WEEK

The Exchange Rate Between U.S. and Canadian Dollars



The Canadian dollar has been on a slide in recent years, losing 18 percent of its value relative to the U.S. dollar since mid-1991. Canada—like some countries in Europe—has been plagued by rising government debt and political uncertainty. The ratio of net government debt to GDP hit 65 percent last year (up from less than 40 percent in 1989), and the Quebec separatist movement has gained widespread attention. If the peso crisis in Mexico continues to affect markets outside of Latin America, the Canadian dollar may weaken further. Since the beginning of the peso crisis in late December, the Canadian dollar has declined 1.6 percent relative to the U.S dollar.

EYES ONLY

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"I've reluctantly devalued the frank."

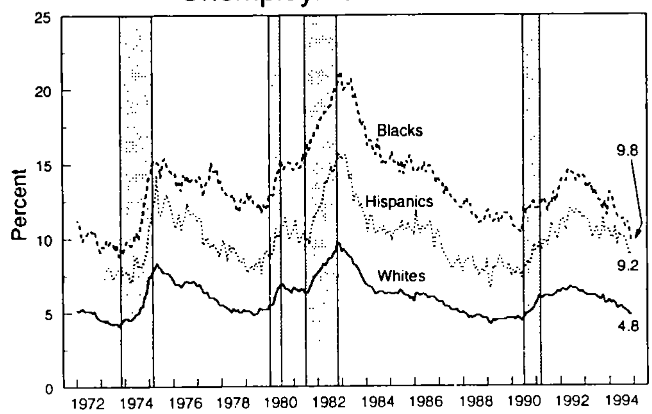
EYES ONLY

TREND

Unemployment Rate Drops Sharply for Blacks, Less So for Hispanics

In December, the unemployment rate for blacks dipped below 10 percent for the first time since 1974 (see chart).

Unemployment Rates



Note: Shaded regions indicate recessions. The observations for 1994 come from the redesigned Current Population Survey.

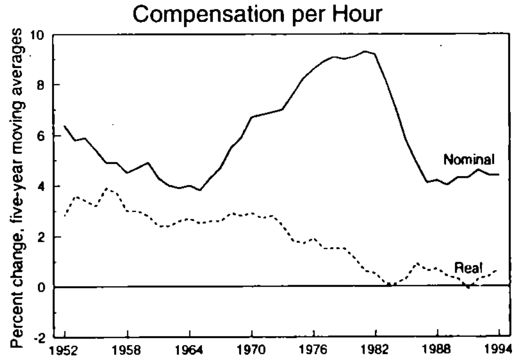
In relative terms, the reduction in measured unemployment during the last few years has been somewhat greater for blacks than for whites and hispanics. From its peak in mid-1992, the unemployment rate among blacks has dropped by nearly one-third. In contrast, the rate among whites has declined 28 percent, while among Hispanics it has declined only 23 percent.

Despite the improvements of the past three years, the unemployment rate for blacks remains more than twice as high as the rate for whites, and slightly higher than the rate for Hispanics. And for teenagers, the racial discrepancy is even greater. The teen unemployment rate averaged about 14-1/4 percent for whites during the fourth quarter of 1994, compared with 35 percent for blacks.

EYES ONLY

TREND

Memo to Workers: Don't Be Fooled by the Nominal Growth in Your Earnings



Note: Observations for 1994 are CEA estimates.

A key determinant of the improvement over time in workers' well-being is the rate of growth of real compensation per hour. In turn, a key determinant of the trend in real compensation is the trend in labor productivity. For example, growth in real compensation per hour began to slow in the mid-1970s (see chart), about the time when trend productivity growth declined.

By contrast, trend growth in real compensation historically has been essentially unrelated to trend growth in nominal compensation.

- During the early 1960s, real compensation per hour increased more than 2 percent per year despite slow growth of nominal compensation per hour (see chart).
- Between the mid-1960s and the early 1980s, the growth of real compensation per hour slowed, even as the growth of nominal compensation per hour was rising—in part reflecting and in part contributing to higher inflation rates during the period.
- During the early 1980s, the growth in nominal compensation per hour slowed sharply—as the inflation rate moved down—with no discernible corresponding move in real compensation per hour.

Sustainable improvement in the growth of real compensation can result only from improvements in trend growth of productivity, while nominal compensation tends to move with the inflation rate.

EYES ONLY

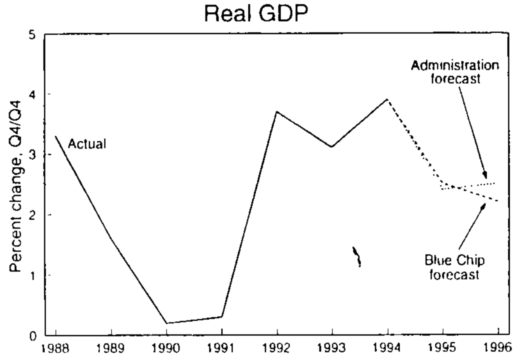
ARTICLE

The Macroeconomic Outlook for 1995 and 1996

The momentum of the economic expansion during the second half of 1994 is likely to carry into the first half of 1995. The current strength of both consumer and business spending reflects continued optimism about job prospects and overall business conditions. However, most economists believe that the pace of the expansion during 1994 (nearly 4 percent growth in real GDP at an annual rate) cannot be sustained indefinitely without fueling inflation. A critical question is whether the Federal Reserve can bring the pace of activity back down to a level that it views as sustainable without inducing a recession. Financial market participants are betting on another hike in short-term interest rates, possibly when the FOMC meets at the end of this month.

Key elements of the outlook. In general, private-sector forecasters anticipate continued real growth in the economy during the next two years (albeit at a more subdued pace), and slight upticks in unemployment and inflation. These expectations are broadly consistent with the Administration forecast that will be published early next month along with the budget.

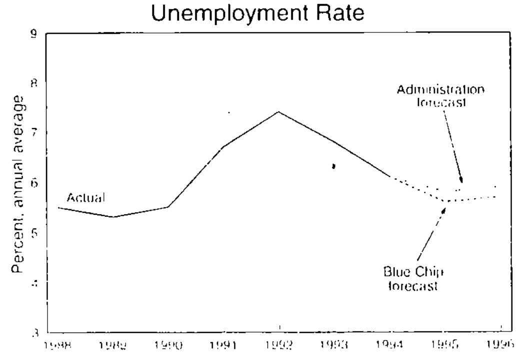
Real GDP



Note: Observation for 1994 is a CEA estimate.

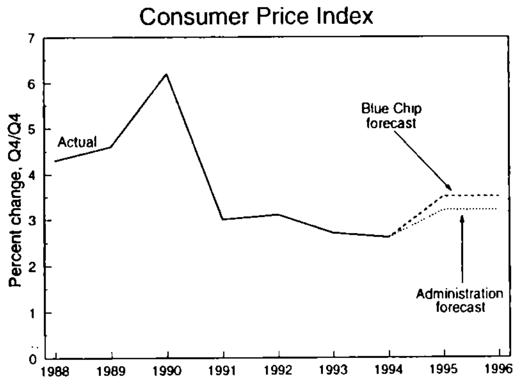
Real GDP. According to the Blue Chip consensus forecasts released this week, growth will moderate to about 2.5 percent in 1995 and 2.2 percent in 1996. As 1995 progresses, the interest rate increases implemented during 1994 should begin to restrain new home construction and spending on consumer durables. The Administra-tion's current forecast for GDP is very similar to the Blue Chip consensus.

Unemployment Rate



Note: Data reflect revised CPS after 1993

Unemployment and Employment. The Blue Chip consensus sees the jobless rate edging up less than 1/2 percentage point over the next two years from its current level. (This uptick is obscured in the annual-average data used in the chart.) The Administration's official forecast allows for slightly more unemployment, partly because it was finalized before December's surprising drop was known. The Administration expects a total of more than 4 million additional jobs to be created during 1995 and 1996. (Blue Chip does not publish a forecast for job growth.)



Inflation. The Blue Chip consensus sees a noticeable uptick in inflation over the next two years, from 2.6 percent over the four quarters of 1994 to 3.5 percent in 1996. In part, this expectation reflects a belief on the part of many forecasters that the economy currently is operating above its "potential" level. The Administration's official projection is slightly more optimistic, based partly on the belief that the recent favorable trends in inflation (which have surprised many analysts) will continue.

Risks to the forecast. None of the more than 50 forecasters participating in the Blue Chip process is projecting that the economy will slide into recession during the next two years. Nonetheless, there are risks, and at this point the risks may be tilted toward the downside.

Bust could follow boom. Given the uncertainty surrounding the timing and magnitude of the impacts of changes in interest rates, the current level of interest rates could prove insufficient to slow the pace of the expansion. If so, and activity continues to rise at a vigorous rate, the Federal Reserve could step on the brakes more firmly in order to wring out inflationary pressures at an early stage. In that event, real activity could drop off precipitously and unemployment could rise sharply as we head into 1996 before an easing of monetary policy brings about a return to a sustainable output path.

Foreign economies could sputter. As domestic demand cools off later this year in response to higher interest rates, foreign demand should fill some of the void. In particular, export demand from Japan and Europe should pick up markedly, in line with the gathering momentum of their recoveries. If, however, those recoveries stall, growth in exports will slow, possibly by enough to knock an additional 1/4 percentage point off the growth of real output in 1995.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Honda Announces Ultra-Low-Emissions Engine. Honda Motor Co. announced this week that it has developed the first gasoline engine clean enough to meet the Ultra Low Emissions Vehicle (ULEV) standard. Honda's new prototype Accord engine has passed the California air-quality board's 100,000-mile driving test, but still must undergo further tests. (Full certification is anticipated within the next two years or so.) Honda expects the new engine will be roughly as powerful and fuel-efficient as its current Accord engine, at an additional cost to consumers of no more than $300. Honda vehicles using the new engine should be available by late 1997. Prior to Honda's announcement, the only vehicle satisfying the ULEV standard was a natural-gas-powered Chrysler minivan.

In Terms of Buying Power, Americans Are Second to One. The World Bank's annual rankings of economies by income per capita are out, and they show that the United States has solidified its position as one of the world's most affluent nations. In current-dollar terms, U.S. income ranks seventh on the world list, up one notch from last year's ranking. But in terms of real buying power (a better measure of per-capita income, since dollar prices of goods vary substantially from country to country), the United States ranks second only to Luxembourg. (No comparison with last year on this scale is possible, as last year's rankings did not include a buying-power measure of income.) The rest of the top ten in buying power, in descending order: Switzerland, United Arab Emirates, Qatar, Hong Kong, Japan, Germany, Singapore, and Canada.

Dunlop Commission Makes its Recommendations. After nearly two years of study, the Dunlop Commission has come out with its report on the future of labor-management relations. Among the Commission's many proposals, some are aimed at equalizing the balance of power between companies and nascent unions. For example, the Commission recommends that NLRB union representation elections be held within two weeks of request (to prevent employers from delaying elections while forcing out pro-union workers). On workplace safety, the Commission advocates a stick-and-carrot approach: require all but the smallest workplaces to establish formal safety programs (to include regular safety training and investigation of all serious accidents), but then give more regulatory latitude to firms with strong safety records. Finally, the Commission recommends revising the National Labor Relations Act to permit employee involvement groups, while maintaining the ban on company-dominated unions.

EYES ONLY

RELEASES LAST WEEK

Retail Sales

****Embargoed until Friday, January 13, 1995 at 8:30 a.m.****

Advance estimates show that retail sales decreased 0.1 percent in December following an increase of 0.2 percent in November. Excluding sales in the automotive group, retail sales were unchanged in December.

Consumer Price Index

The consumer price index increased 0.2 percent in December. Excluding food and energy, consumer prices were up 0.1 percent. For the 12-month period ending in December, the consumer price index was 2.7 percent higher than a year ago. Excluding food and energy, the index was 2.6 percent higher than a year ago.

Producer Price Index

The producer price index for all finished goods increased 0.2 percent in December. Excluding food and energy, producer prices also increased 0.2 percent.

MAJOR RELEASES THIS WEEK

Industrial Production and Capacity Utilization (Tuesday)
U.S. International Trade in Goods and Services (Thursday)
Housing Starts (Friday)

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U.S. ECONOMIC STATISTICS

	1970–1993	1993	1994:1	1994:2	1994:3
Percent growth (annual rate)					
Real GDP	2.5	3.1	3.3	4.1	**4.0**
GDP deflator	5.5	1.8	2.9	2.9	1.9
Productivity					
Nonfarm business	1.2	1.8	2.9	–2.1	2.9
Manufacturing (1978-93)	2.1	3.8	6.4	5.6	3.6
Real compensation per hour	0.6	–0.3	3.9	–2.0	–0.6
Shares of Real GDP (percent)					
Business fixed investment	11.0	11.5	12.2	12.4	12.7
Residential investment	4.7	4.1	4.4	4.4	4.3
Exports	8.0	11.7	11.8	12.1	12.4
Imports	9.2	13.2	13.8	14.2	14.6
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	2.7	3.0	**3.0**
Federal surplus	–2.8	–3.8	–2.7	–2.2	–2.3

		1994	Oct. 1994	Nov. 1994	Dec. 1994
Unemployment Rate	6.7*	**6.1***	**5.7**	**5.6**	**5.4**

*Figures beginning 1994 are not comparable with earlier data.

		1994	Oct. 1994	Nov. 1994	Dec. 1994
Payroll employment (thousands)					
increase per month			**162**	**488**	**256**
increase since Jan. 1993					**5602**
Inflation (percent per period)					
CPI	5.8	**2.7**	0.1	0.3	**0.2**
PPI-Finished goods	5.0	**1.7**	–0.5	0.5	**0.2**

New or revised data in **boldface.**

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FINANCIAL STATISTICS

	1993	1994	Nov. 1994	Dec. 1994	Jan. 12, 1995
Dow-Jones Industrial Average	3522	3794	3792	3770	3859
Interest Rates					
3-month T-bill	3.00	4.25	5.29	5.60	5.62
10-year T-bond	5.87	7.09	7.96	7.81	7.80
Mortgage rate, 30-year fixed	7.33	8.36	9.18	9.19	9.19
Prime rate	6.00	7.15	8.15	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Jan. 12, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.529	−1.5	−11.8
Yen-Dollar	98.85	−2.1	−12.0
Multilateral (Mar. 1973=100)	88.26	−0.9	−8.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.4 (Q3)	5.4 (Dec)	2.7 (Dec)
Canada	4.8 (Q3)	9.6 (Nov)	−0.1 (Nov)
Japan	1.1 (Q3)	2.9 (Nov)	0.7 (Oct)
France	2.8 (Q3)	12.4 (Oct)	1.6 (Nov)
Germany	2.5 (Q3)	6.4 (Nov)	2.6 (Nov)
Italy	2.3 (Q2)	11.4 (Jul)	3.7 (Nov)
United Kingdom	4.1 (Q3)	9.1 (Nov)	2.6 (Nov)