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## Current Economic Conditions and Selected Forecasts

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## **ABSTRACT**

This report begins with a comprehensive presentation of current economic conditions focusing on income growth, unemployment, and inflation. The posture of monetary and fiscal policy is surveyed as are the forecasts of economic activity. It concludes with data on the factors important for economic growth. This report is updated periodically.

# Current Economic Conditions and Selected Forecasts

## Summary

According to the National Bureau of Economic Research, the arbitrator of the U.S. business cycle, the U.S. economy is in an expansion that is soon be 7 years old, having gotten underway in March of 1991.

Gross Domestic Product (GDP), our basic measure of economic activity, grew at an annual rate of 4.8% during 1998:1 compared with 3.8% during 1997, 2.8% during 1996, 2.0% during 1995, 3.5% during 1994 and 2.3% during 1993. Over the past five quarters there has been some net increase in inventories as the growth rate of final sales has been closer to 3%.

The unemployment rate has continued to fall during 1997 and 1998, reaching an expansion low of 4.3% in April 1998. The monthly unemployment rates recorded during most of the past 2 years have been below the rates thought by many economists to characterize full employment. If these economists are correct, excess demand currently characterizes the economy. Excess demand leads to a rise in the inflation rate. This has yet to materialize, however. During the past 12 months, approximately 2.9 million jobs have been created, which means an average rate of job creation per month of 243,500. During the expansion, over 14 million jobs have been added to the economy.

The inflation rate has, on average, been low over most of the expansion. Except for 1996, the rate of inflation measured by the Consumer Price Index has declined in each year of the expansion. For the 12 months ending in April 1998, the CPI rose 1.4%, the lowest rate of increase since 1986. For the 3-months ending in April, it rose at an annual rate of 1.2%. A similar pattern shows up in the two GDP price indexes. Both indexes rose 1.8% during 1997 and at a rate of 1.4% for the 12 months ended in March. Labor costs, a possible indicator of future inflation, have shown some tendency to accelerate as labor markets have tightened.

Fiscal policy continued to tighten during 1996 and 1997. Monetary policy appears to be geared to promoting a real GDP growth rate of about 2.0% to 2.75% per year, a rate thought compatible with a stable rate of inflation.

Recent forecasts by private sector individuals and firms expect GDP to grow about 3.1% during 1998 and in the 1.7% to 2.3% range during 1999. Unemployment is expected to average about 4.7% this year and 5.0% for 1999 and inflation is expected to average in the 1.4% to 2.8% range for both years.



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# Current Economic Conditions and Selected Forecasts

## Current Economic Conditions

In March 1998, the American economy completed its 84th month of expansion according to the National Bureau of Economic Research, the nonprofit, nonpartisan organization that dates the phases of the business cycle for the United States. The length of the current expansion is above average. The nine completed expansions since the end of World War II have averaged 50 months. This average is dominated by two long expansions: one ran for 106 months and dominated the decade of the 1960s; the other dominated the decade of the 1980s and ran for 92 months. GDP growth during the early part of the current expansion was insufficient to keep the unemployment rate from rising.<sup>1</sup> Substantial growth began in 1992. The higher rate of growth reversed the rise in the unemployment rate which had reached 7.7% in June 1992. The fall in the unemployment rate was accomplished in an environment of low inflation.

Thus far, the rate of increase of most broad-based price and wage indexes have remained fairly low even as the economy moves toward over-full employment. Given the expected growth rates in the labor force and productivity, the determinants of a sustainable rate of growth, growth of GDP in the 2.0%–2.5% range would be compatible with a continued low rate of inflation. This is, no doubt, why the Federal Reserve hiked interest rates seven times beginning in February 1994 in an effort to reduce GDP growth to a more sustainable rate. During 1995, GDP growth was 2.0%, most of which took place in the third quarter. During 1996, however, GDP growth accelerated to 2.8% (with growth at a 4.3% annual rate during the fourth quarter). This prompted the Federal Reserve to raise interest rates on March 25, 1997. During 1997 GDP grew 3.8%. For the first quarter of 1998, GDP grew at an annual rate of 4.8%.

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<sup>1</sup>Gross Domestic Product rather than Gross National Product is now used as the principal measure of economic activity for the United States. The two measures differ in their treatment of foreign-owned productive resources in the United States and similar U.S.-owned resources abroad.

## Recent Macroeconomic Developments

The growth rate of GDP both before and after the 1990–1991 recession is shown in **Table 1**.<sup>2</sup> The relatively shallow recession was followed by a recovery/expansion of modest proportions. Only in 1992 did GDP growth become relatively rapid. This continued into 1994. As the economy approached full employment, the Federal Reserve began to tighten monetary policy to sustain the expansion. As this happened, inventories began to accumulate during 1994. During 1995 and the first quarter of 1996, inventories were reduced to bring them into line with the slower rate of growth of sales. This slowed GDP growth during 1995. For 1996 as a whole, however, inventories did not increase as Final Sales rose 2.8%. This was not the case during 1997 and the first quarter of 1998 as GDP growth substantially outstripped the growth rate of final sales indicating the buildup of inventories.

**Table 1. The Growth Rate of Real GDP vs. Final Sales**  
(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998*
GDP									
Year Over Year	1.2	-0.9	2.7	2.3	3.5	2.0	2.8	3.8	4.8
4thQ Over 4thQ	-0.2	0.4	3.7	2.2	3.3	1.6	3.3	3.7	3.7
Final Sales									
Year Over Year	1.6	-0.7	2.5	2.1	2.9	2.5	2.8	3.1	3.4
4thQ Over 4thQ	0.6	-0.4	3.9	2.1	2.6	2.2	3.1	3.1	3.2

\*Annualized rate for the first quarter.

Source: U.S. Department of Commerce.

The unemployment rate, a near constant 5.3% for 2 years, began rising in July 1990. It rose sharply over the ensuing 10 months, reaching 6.7% in March 1991, the official trough of the recession. However, initially, even as the economy recovered, the unemployment rate continued to rise, reaching a high of 7.7% in June 1992. Since that time, the rate has fallen slowly, reaching an expansion low of 4.3% in April 1998, a rate not seen since the 1960s. Since August 1994, the rate has fluctuated within a range of from 4.3% to 6.0%. This range is thought by many economists to be consistent with full employment. However, a rate of 4.3% is below all estimates of the lower bound of the range. Since the expansion began in March 1991, civilian employment has risen by about 14.0 million.

<sup>2</sup>The annual rate of growth of GDP and other economic variables can be computed in two ways. One is to take the annual average of GDP for 1996, for example, and compare it to the annual average for 1995. When this method is used, the calculated growth rate is actually GDP's growth from the mid point of 1995 to the mid point of 1996. An alternative method is to compute its growth from the fourth quarter of 1995 to the fourth quarter of 1996 (or where monthly data are available, from December to December). This method has the advantage of computing growth over the past 12 months in question. The GDP growth rates used in the text of this report are those on a year over year basis.



The unemployment data recorded since January 1994 are computed on the basis of substantial changes in the questionnaire used in the survey of households from which the labor market data are obtained, and thus, are not comparable with the pre-1994 data shown on **Table 2**.

**Table 2. Civilian Unemployment Rate**  
(in percentages)

	J	F	M	A	M	J	J	A	S	O	N	D
1992	7.1	7.3	7.3	7.3	7.4	7.7	7.6	7.6	7.5	7.4	7.3	7.3
1993	7.1	7.0	7.0	7.0	6.9	6.9	6.8	6.7	6.7	6.7	6.5	6.4
1994	6.7	6.6	6.5	6.4	6.1	6.1	6.1	6.0	5.8	5.7	5.6	5.4
1995	5.7	5.4	5.5	5.8	5.7	5.6	5.7	5.6	5.6	5.5	5.6	5.6
1996	5.7	5.5	5.5	5.5	5.6	5.3	5.4	5.2	5.2	5.2	5.3	5.3
1997	5.3	5.3	5.2	5.0	4.8	5.0	4.9	4.9	4.9	4.8	4.6	4.7
1998	4.7	4.6	4.7	4.3	4.3							

**Source:** U.S. Department of Labor.

As the economic expansion has taken hold and the unemployment rate has fallen, fears of a renewed burst of inflation have arisen. Thus far, there is little evidence in the broad based price and wage indexes that inflationary pressures are building.<sup>3</sup>

As shown in **Table 3**, the CPI rose 1.7% during 1997. For the 12 months ended in April 1998, it rose 1.4% and for the 3 month period ending in April, the CPI rose at an annual rate of 1.2%. The rate of inflation shown by the two price indexes derived from the GDPs accounts recorded in **Table 4**, has shown a continued tendency to fall. During 1994, both the implicit price deflator and the chain weight deflator rose 2.5%. During 1995, they both rose 2.4%. During 1996, the chain weighted index rose 2.3% while the implicit deflator rose 2.2%.<sup>4</sup> Both indexes rose 1.4% for the four quarters ended in March 1998.

Labor costs, regarded by some as an indication of future inflation, as shown in **Table 5**, have turned in an encouraging performance. Per unit labor costs, which are heavily influenced by productivity, rose slowly during the recovery because recorded productivity was high.<sup>5</sup> This is characteristic of the initial stages of an economic upturn. The rise in the Employment Cost Index for private industry has shown some tendency to accelerate since its 1995 low. This may be the early sign of future price rises.

<sup>3</sup>For a more extensive discussion of inflation and other alternative measures of the inflation rate, see Library of Congress. Congressional Research Service. *Inflation: Causes, Costs and Current Status*. CRS Report 96-914 E, by Gail Makinen.

<sup>4</sup>On a year over year basis, the rise in the Implicit Price Deflator between 1990 and 1996 was respectively, 4.3% 4.0%, 2.8%, 2.6%, 2.4%, 2.5%, and 2.3%. The corresponding rise in the chain type deflator was identical.

<sup>5</sup>On a year over year basis, the rise in per unit labor costs for 1990 through 1996 was respectively, 5.0%, 4.2%, 1.9%, 2.1%, 1.6%, 2.2%, and 1.8%.

**Table 3. Rate of Change in the Consumer Price Index**  
(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998*
Dec. Over Dec.	6.1	3.1	2.9	2.7	2.7	2.5	3.3	1.7	1.4
Year Over Year	5.4	4.2	3.0	3.0	2.6	2.8	2.9	2.3	0.5

\*Based on first quarter data.

Source: U.S. Department of Labor.

**Table 4. Rate of Change in the GDP Deflators**  
(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998*
Implicit Price Deflator	4.6	3.4	2.6	2.5	2.5	2.4	2.2	1.8	1.4
Chain Type Deflator	4.6	3.4	2.6	2.5	2.5	2.4	2.3	1.8	1.4

\*Based on first quarter data.

Source: U.S. Department of Commerce.

**Table 5. Rate of Change in Labor Costs**  
(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998*
Unit Labor Costs	6.4	2.5	1.0	2.2	2.1	2.3	2.2	1.9	2.2
Employment Cost Index	4.6	4.4	3.5	3.6	3.1	2.6	3.1	3.5	3.6

\* The employment cost index is for private industry and for the 12 months ending in December except for 1998, which is the 12 months ending in March. Unit labor costs are from 1997:1 to 1998:1.

Source: U.S. Department of Labor.

**Table 6. U.S. Foreign Trade Deficit**  
(as a percent of GDP)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998*
Trade Deficit	2.8	2.0	1.4	1.0	0.4	0.5	1.1	1.6	1.5	1.7	2.0	2.9

\*Based on first quarter data.

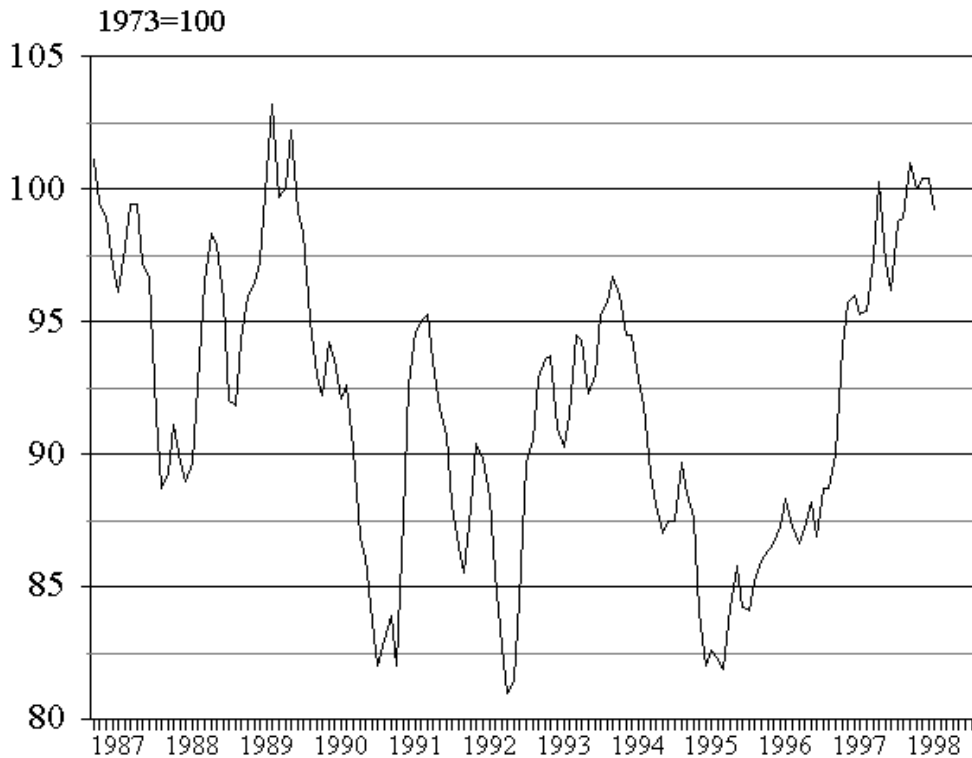
Source: U.S. Department of Commerce.

The U.S. foreign trade deficit (net imports), as shown in **Table 6**, recorded a continued and dramatic fall from 1986 through 1991. In each of these years the trade deficit declined as export growth exceeded import growth. During 1992 the trade deficit began to grow as a fraction of GDP and is now running at a rate comparable to 1987.

The increase in the U.S. foreign trade deficit during 1992–1996 reminds us that the United States still receives a substantial inflow of capital from abroad.

Figure 1 records the movement in the foreign exchange value of the dollar. Since early 1994 the dollar has been under heavy selling pressure. It probably would have continued to fall in price (depreciate) during 1995, 1996, and 1997 had it not been for substantial foreign central bank intervention. Net official inflows of capital, a measure of central bank intervention, accounted for about 75% of the net capital inflow in 1995, about 60% during 1996, and about 50% during the first quarter of 1997.

**Figure 1.** U.S. Dollar Exchange Rate, 1987-1998



Source: Board of Governors of the Federal Reserve System.

## Posture of Monetary and Fiscal Policy

The course of GNP growth can respond significantly to changes in fiscal and monetary policy. The posture of fiscal policy depends on how it is measured. A generally accepted method is to examine the ratio of the structural or full employment budget deficit to full employment GDP. When that is done, as shown in **Table 7**, fiscal policy during 1997 was contractionary as the full employment deficit fell from 1.6% to 1.0% of potential GNP. An alternative, although inferior measure, is the ratio of the actual budget deficit to actual GDP. When this ratio is examined, fiscal policy in 1997 was also contractionary as the actual deficit fell from 1.4% to 0.3% of actual GDP.

**Table 7. Alternative Measures of Fiscal Policy**  
(\$ in billions)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Standardized Budget Deficit	\$138	\$151	\$154	\$182	\$203	\$235	\$240	\$194	\$190	\$123	\$80
Full Employment GDP	4,642	4,935	5,280	5,635	6,005	6,300	6,588	6,877	7,203	7,534	7,872
Ratio	0.029	0.031	0.029	0.032	0.034	0.037	0.036	0.028	0.026	0.016	0.010
Actual Budget Deficit	\$150	\$155	\$152	\$221	\$269	\$290	\$255	\$203	\$164	\$107	\$22
Actual GDP	4,609	4,957	5,356	5,683	5,862	6,149	6,478	6,849	7,194	7,533	7,972
Ratio	0.033	0.031	0.028	0.039	0.046	0.047	0.039	0.030	0.023	0.014	0.003

**Source:** Congressional Budget Office (January 1998).

Traditionally, the posture of monetary policy has been judged either by the growth of the monetary aggregates or by movements in interest rates.<sup>6</sup> In fact, neither is an unambiguous indicator. The monetary aggregates, for example, give a confused picture. Although M1 can explain how the economic expansion got underway, it cannot explain the expansions continuation. The opposite is true for both M2 and M3.

Although the contraction of reserves could indicate monetary tightening, it is, in fact, compatible with monetary expansion. This occurs because over much of this expansion, demand deposits have been declining and it is against these deposits that banks are legally obligated to hold reserves. Each dollar of decline frees up about 10 cents in reserves that banks can lend. Thus, even though reserves have fallen, they have declined by less than the reserves set free by the contraction of demand deposits. This has increased the net lending powers of banks.

Some of the dollars that were in checking accounts have found their way into passbook savings and CDs. These shifts can explain why M1 falls without a commensurate fall in M2 and M3. For the latter to grow, however, funds must be added to passbook savings and CDs that were not originally in checking accounts.

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<sup>6</sup>For a more comprehensive discussion of monetary policy, see U.S. Library of Congress. Congressional Research Service. *Monetary Policy: Current Policy of Conditions*. CRS Report 96-983 E, by Gail Makinen.

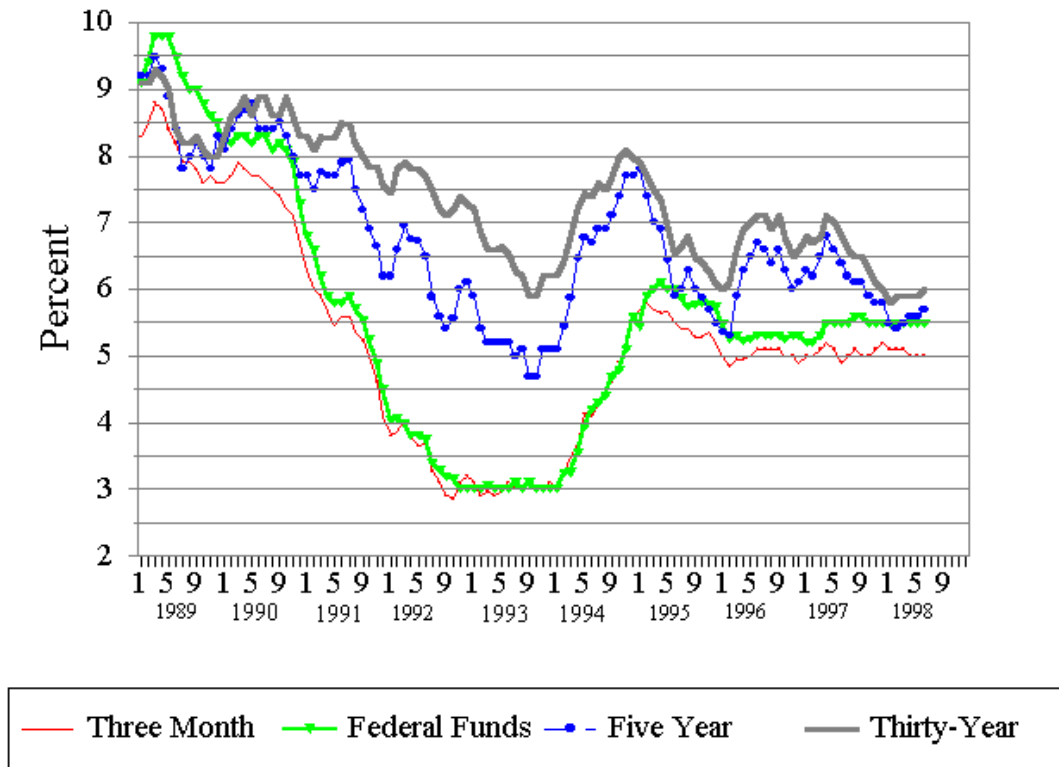
**Table 8. The Growth Rates of the Monetary Aggregates**  
(annualized rates of change)

Time Period	Aggregate Reserves	Monetary Base	M1	M2	M3
88:12-89:12	0.3%	4.1%	0.9%	5.1%	3.7%
89:12-90:12	2.9	9.3	4.0	3.5	1.4
90:12-91:12	9.5	5.8	8.6	3.1	1.3
91:12-92:12	19.5	10.6	14.2	1.7	0.1
92:12-93:12	11.4	10.0	10.1	1.5	0.9
93:12-94:12	-2.1	8.4	1.7	0.9	1.4
94:12-95:12	-5.1	3.9	-2.2	4.6	6.1
95:12-96:12	-11.0	4.2	-4.3	4.9	7.4
96:12-97:12	-5.7	6.3	-1.2	5.2	8.4
97:10-98:04	-0.2	6.4	3.3	8.5	12.0
98:01-98:04	-5.0	3.4	2.2	9.5	11.6

**Source:** Board of Governors of the Federal Reserve System.

The growth in the reserves of depository institutions results to a large degree from decisions to move the key federal funds' interest rate (shown in figure 2). The rate was forced down beginning in October 1990. From April through July 1991, the rate was held at a fairly steady 5.75%. In August it was moved toward 5.50%, in September to 5.25%, in November to 4.75%, in January 1992 to about 4.0%, in April toward 3.75%, in July toward 3.25%, and in September toward 3.0%, where it was maintained for nearly 16 months. Beginning in February 1994, the Board of Governors, in a series of seven steps culminating in February 1995, raised the federal funds rate to 6.0%. (The increase in the federal funds rate was achieved by reducing the level of aggregate reserves available to depository institutions.) Early in July, as a pronounced slowdown in economic activity became apparent, the federal funds rate was reduced to 5.75%. In mid-December it was reduced to 5.5% and on January 31, 1996, it was reduced to 5.25%. However, as GDP growth rose in 1996 to a rate believed to be unsustainable, the Federal Reserve reversed course and hiked the rate to 5.5% on March 25, 1997.

As shown in figure 2, movements in short term interest rates mimic closely movements in the federal funds rate. This is not as true for longer term rates. Their rise and fall as well as the magnitude of their shifts is often different from the timing and magnitude of shifts in the federal funds rate. This is due in part to the fact that they respond to the longer run outlook for inflation and the financing requirements necessitated by the budget deficit, both current and prospective.

**Figure 2.** Yield on Selected U.S. Treasury Securities and Federal Funds

Source: Board of Governors of the Federal Reserve System.

## Summary of Current Developments

The NBER decided that the U.S. recession that began in July 1990 ended in March 1991. By 1992:1 GDP recovered the ground lost in the three quarters during which output contracted. The growth rate of GDP during the recovery was, however, low when compared with the average of past expansions. The unemployment rate began to rise in July 1990. It rose rapidly, reaching 6.8% in May 1991. For the first 6 months of 1992 it slowly crept upward, reaching a high of 7.7% in June. Since then it has fallen. Over the past 24 months, it has ranged between 4.3 and 5.6%, a range consistent with most measures of full employment, if not overfull employment. During the expansion more than 14.0 million jobs have been added to the U.S. economy. All three price indexes show that the inflation rate during the expansion has remained low. Monetary policy, responsible for the recovery, was adjusted to slow the growth of aggregate demand. This has involved seven upward adjustments to the federal funds rates between February 1994 and February 1995. The rate was adjusted downward by 0.25% in early July and mid-December of 1995, and on January 31, 1996. Although this led to a rise in the growth rate of GDP, the rate achieved was thought to be too high. Consequently, on March 25, 1997, the Federal Reserve hiked the rate by 0.25%.

## Sources of GDP Growth

**Table 9** records the sources of growth in GDP over the current expansion. These data record two interesting developments. First, investment spending has played an important role in this expansion. And among the categories of investment, outlays for personal computers have been important. This bodes well for the longer run growth in productivity. Second, except for 1996, purchases by all levels of government have played virtually no role in the expansion.

**Table 9. Sources of GDP Growth: 1990 through 1998:1**

	1990	1991	1992	1993	1994	1995	1996	1997	1998:1
Real GDP Growth*	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Consumption	84.2	-44.9	69.0	86.0	59.8	79.3	68.6	65.0	91.0
Investment	-55.5	-135.4	31.9	46.6	55.7	22.0	28.6	50.7	90.1
Govt. Purchases	45.5	12.9	3.5	-2.0	0.0	0.0	6.4	4.8	-12.0
Federal	(13.0)	(4.3)	(-6.9)	(-13.5)	(-8.7)	(-12.8)	(-3.2)	(-1.3)	(-14.4)
State & Local	(32.4)	(-17.2)	(10.3)	(11.5)	(8.7)	(12.8)	(9.5)	(6.1)	(2.4)
Net Exports	25.9	67.3	-4.4	-30.5	-15.1	-1.4	-3.6	-20.5	-68.9

\* Computed using real GDP at 1992 chained dollars.

Source: Department of Commerce.

## Economic Forecasts, 1998

All of the forecasts summarized in **Table 10** expect the expansion now in progress to continue through 1998. If these forecasts come to pass, the economy is expected to maintain a soft landing in the sense that GDP growth at about 2.0% to 2.5% will be sufficient to keep the unemployment rate about 5.0%. The inflation rate is expected to remain in the 2.0% to 3.0% range. Similarly, the modest nature of the expansion is expected to keep both short-term and long-term interest rates from rising much above their 1997 levels.

The *Wall Street Journal* published the results of its survey of 55 economic forecasters in its January 2, 1998 edition. These forecasters, on average, expect real GDP to grow at an annual rate of 2.6% during the first half 1998 and at an annual rate of 2.1% during the second half of the year and the CPI is expected to rise 2.3% for the year ended in December. The 3-month Treasury bill rate and 30-year bond rate are expected to be 5.18% and 6.02% on June 30 and 5.15% and 6.60% on December 31, 1998.

The Chairman of the Board of Governors of the Federal Reserve presented the economic projections of the Federal Reserve for 1998 in testimony before the Subcommittee on Domestic and International Monetary Policy of the House Banking Committee on February 24, 1998. The Federal Reserve projects that over the four quarters of 1998 real GDP will grow between 2.0% and 2.75% and that the CPI will increase from 1.75% to 2.25%. The civilian unemployment rate is projected to average about 4.75% during the fourth quarter of the year.

**Table 10. Economic Forecasts, 1998**

	1997				1998				1997*	1998	1999
	1*	2*	3*	4*	1*	2	3	4			
<b>Nominal GDP<sup>a</sup></b>											
OMB	7.4	5.2	4.6	5.2	5.8	NA	NA	NA	5.8	4.3	4.1
CBO	7.4	5.2	4.6	5.2	5.8	NA	NA	NA	5.8	4.7	4.2
DRI	7.4	5.2	4.6	5.2	5.8	3.8	4.1	3.3	5.8	4.6	3.9
WEFA	7.4	5.2	4.6	5.2	5.8	3.7	4.7	4.8	5.8	4.7	5.3
BC	7.4	5.2	4.6	5.2	5.8	4.0	4.2	4.3	5.8	4.7	4.4
<b>Real GDP<sup>a</sup></b>											
OMB	4.9	3.3	3.1	3.7	4.8	NA	NA	NA	3.8	2.4	2.0
CBO	4.9	3.3	3.1	3.7	4.8	NA	NA	NA	3.8	2.7	2.0
DRI	4.9	3.3	3.1	3.7	4.8	2.0	2.1	1.4	3.8	3.1	1.8
WEFA	4.9	3.3	3.1	3.7	4.8	2.3	1.9	2.2	3.8	3.1	2.7
BC	4.9	3.3	3.1	3.7	4.8	2.4	2.3	2.3	3.8	3.1	2.3
<b>Unemployment<sup>b</sup></b>											
OMB	5.3	4.9	4.9	4.7	4.7	NA	NA	NA	4.9	4.9	5.1
CBO	5.3	4.9	4.9	4.7	4.7	NA	NA	NA	4.9	4.8	5.1
DRI	5.3	4.9	4.9	4.7	4.7	4.6	4.6	4.7	4.9	4.7	5.0
WEFA	5.3	4.9	4.9	4.7	4.7	4.5	4.6	4.7	4.9	4.6	5.0
BC	5.3	4.9	4.9	4.7	4.7	4.7	4.7	4.7	4.9	4.7	4.9
<b>GDP Deflator<sup>a</sup> (chain weights)</b>											
OMB	2.4	1.8	1.4	1.4	1.0	NA	NA	NA	2.0	1.9	2.0
CBO	2.4	1.8	1.4	1.4	1.0	NA	NA	NA	2.0	2.2	2.3
DRI	2.4	1.8	1.4	1.4	1.0	1.7	1.9	2.8	2.0	1.4	2.0
WEFA	2.4	1.8	1.4	1.4	1.0	1.4	2.7	2.6	2.0	1.6	2.5
BC	2.4	1.8	1.4	1.4	1.0	1.6	1.9	2.0	2.0	1.6	2.1
<b>CPI-U<sup>a</sup></b>											
OMB	2.3	1.0	2.0	2.1	0.5	NA	NA	NA	2.3	2.1	2.2
CBO	2.3	1.0	2.0	2.1	0.5	NA	NA	NA	2.3	2.2	2.5
DRI	2.3	1.0	2.0	2.1	0.5	2.0	2.6	2.7	2.3	1.7	2.6
WEFA	2.3	1.0	2.0	2.1	0.5	1.7	2.6	2.9	2.3	1.7	2.8
BC	2.3	1.0	2.0	2.1	0.5	1.8	2.2	2.3	2.3	1.7	2.4
<b>T-BILL Rate<sup>b</sup></b>											
OMB	5.1	5.1	5.1	5.1	5.1	NA	NA	NA	5.1	5.0	4.9
CBO	5.1	5.1	5.1	5.1	5.1	NA	NA	NA	5.1	5.3	5.2
DRI	5.1	5.1	5.1	5.1	5.1	5.0	5.0	5.0	5.1	5.0	4.6
WEFA	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.5
BC	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.2
<b>10-Year Rate<sup>b</sup></b>											
OMB	6.6	6.7	6.3	5.9	5.7	NA	NA	NA	6.4	5.9	5.8
CBO	6.6	6.7	6.3	5.9	5.7	NA	NA	NA	6.4	6.0	6.1
DRI	6.6	6.7	6.3	5.9	5.7	5.8	5.7	5.7	6.4	5.7	5.5
WEFA	6.6	6.7	6.3	5.9	5.7	5.7	5.8	5.9	6.4	5.7	6.1
BC	6.6	6.7	6.3	5.9	5.7	5.7	5.7	5.8	6.4	5.7	5.9



**Sources:** Data Resources, Inc., *U.S. Forecast Summary*, May 1998; Wharton Econometric Forecasting Associates Group. *U.S. Economic Outlook*, May 1998; *Blue Chip Economic Indicators*, May 10, 1998. Congressional Budget Office, January 7 1998; and, the Office of Management and Budget, February 1998. \* Actual data, subject to revisions. The annual data for nominal GDP, real GDP, the GDP deflator and the CPI are on a year over year basis; and the unemployment and interest rate data are either quarterly or annual averages.

- a. Annualized quarterly rates of change.
- b. Quarterly averages.

## **Promotion of Economic Growth**

Over the longer run, the economic well-being of a nation depends on the growth of potential output or GDP per capita. Crucial to this growth is the fraction of a nation's resources devoted to capital formation. The ability to add to the capital stock through investment depends on a nation's saving rate.

Saving comes from several sources. In the private sector individuals (households) and businesses are responsible for saving. The former save when all of their after tax income is not used for consumption. Businesses save through retained earnings and capital consumption allowances.

The public sector can also be a source of national saving and this occurs when government revenues are larger than expenditures. Budget surpluses, then, can be viewed as a source of national saving.

In **Table 11** the sources of saving for the United States during the past 35 years are shown. There are several things to note about these data. First, the gross private sector savings rate has averaged a remarkably stable 16%-17% of GDP, with most of the saving being done by businesses. More significantly, however, the private sector saving rate net of depreciation, representing saving available for additions to capital, declined considerably in the 1980s. Thus, even without a federal budget deficit, the United States would have had a "saving problem."

Second, over this 35-year period, the saving done by the public sector, as a whole, has declined. There is, however, diversity as to the contribution made by the level of government. The large negative contribution made by the federal government during the 1980s reflects the widely publicized budget deficit. Even though state and local governments have been running sizable budget surpluses, they have not been large enough to offset the federal deficits.

Third, the data show that for 20 of these 35 years, the United States exported a small fraction of its savings to the rest of the world (i.e., was a net exporter of capital). This changed during the 1980s when the United States started to import the savings of the rest of the world.

Should efforts to correct the international trade deficit prove fruitful, the net inflow of foreign saving will cease. Should this occur without a significant improvement in either the private sector saving rate or the negative saving rate of the public sector, the

rate of new investment will fall to a very low level in the United States and with it the means for improving the well-being of future generations of Americans.

**Table 11. U.S. Saving By Sector**  
(as a percent of GDP)

Year	Private Sector				Public Sector				Net Private & Pub. <sup>a</sup>	Net <sup>b</sup> Foreign
	Pers.	Bus.	Total	Net of Deprec.	Fed.	State & Local	Total	Net of Deprec.		
1960-9	5.2	11.2	16.4	8.8	2.1	2.8	5.0	2.4	11.2	-0.6
1970-9	5.8	11.3	17.2	8.7	-0.5	3.1	2.6	0.2	8.8	-0.2
1980-9	5.2	11.9	17.1	7.3	-2.0	2.9	0.8	-1.3	6.0	1.6
1990-7	3.6	11.4	15.0	5.9	-1.6	2.4	0.8	-1.3	4.6	1.3
1984	6.3	12.6	18.9	9.2	-2.9	3.2	0.3	-1.8	7.4	2.3
1985	5.2	12.3	17.5	7.9	-2.8	3.2	0.4	-1.7	6.2	2.8
1986	4.7	11.3	16.0	6.4	-2.9	3.1	0.2	-1.9	4.5	3.2
1987	3.8	11.7	15.5	5.9	-1.6	2.8	1.2	-1.0	4.9	3.3
1988	4.0	12.0	16.0	6.5	-1.3	2.7	1.4	-0.7	5.8	2.3
1989	3.7	11.3	15.0	5.5	-1.0	2.7	1.7	-0.3	5.2	1.7
1990	3.9	11.1	15.0	5.7	-1.6	2.4	1.2	-1.3	4.4	1.4
1991	4.4	11.3	15.7	6.3	-2.2	2.3	0.1	-2.0	4.3	-0.1
1992	4.6	10.9	15.5	6.4	-3.4	2.4	-1.0	-3.1	3.3	0.8
1993	3.8	11.1	14.9	5.8	-2.8	2.5	-0.3	-2.5	3.3	1.3
1994	3.0	11.8	14.8	5.4	-1.7	2.4	0.7	-1.3	4.1	2.0
1995	3.5	11.5	15.0	5.9	-1.4	2.4	1.0	-1.0	4.9	1.6
1996	3.1	11.6	14.7	5.8	-0.5	2.4	1.9	-0.1	5.7	1.7
1997	2.8	11.6	14.4	5.5	0.5	2.3	2.8	1.0	6.5	2.0

**Source:** U.S. Department of Commerce.

a. Equal to the sum of private sector saving net of depreciation and total public sector saving net of depreciation.

b. Negative sign indicates the export of saving from the United States. Positive sign indicates the import of saving from abroad.

A sudden increase in the national saving rate is, however, not without some possible adverse consequences. In the short run, a sudden increase in the saving rate means decreased consumption and/or lower public sector net spending. In either case, the demand for some types of output would fall to be replaced by an increased demand for other types of output. As a result, some industries and firms would have to contract while others expand. Resources would have to transit from declining to growing industries. These short-run dislocations should be borne in mind if a higher national saving rate becomes the object of public policy.

