May 31, 2005

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The Nature and Possible Solutions to the Current Energy Challenge

Energy prices have been exploding for well over one year...

The overall CPI increased by 2.7% for calendar year 2004, while energy increased by 10.9%. The CPI increase for 2004 (less energy) was 2.0%.
Many firms have been “eating” these costs, as competition in markets such as autos did not allow higher prices, the net result being lower profits.

Some of these costs will certainly leak through in the form of higher prices in areas that face less competition. The longer those higher energy prices persist, the more likely that other consumer prices will be affected.

The inability to pass through energy and other commodity prices has a negative affect on profits and hastens the necessity of restructuring, causing greater job insecurity – this certainly has been the case in the auto industry.

In order to understand the economic dilemma facing many firms concerning energy, we will distinguish the causes of inflation: those coming from the demand side and those coming from the supply side.
Most of the current inflationary pressures are coming from the energy sector. The price of imported oil has risen by 36% from April 2004 to March 2005.

The overall Imports increased by 7.1%, from April 2004 through March 2005, while energy increased by 36.1%. Without oil, import prices increased 2.9%.

This had helped drive up the prices of energy substitutes such as natural gas. The causes of energy prices soaring lies in both the demand side and the supply side of this industry.

The quantity demanded of oil, while negatively related to the price of oil, is positively related to the level of income and production of the nation/world. As the surge in world growth has been occurring, it causes the demand to increase significantly. Given a relatively constant supply of oil, it has resulted in a doubling in the price of crude oil from $25 to over $50 a barrel in the past few years.
Demand side of the energy picture...

In economic theory, we have what are called normal goods – energy is included in that category. A normal good is one in which as the world income rises (income effect), it increases the demand (not just the quantity demanded) for the good, energy in this case. The direct effect would be an increase in demand and hence the price of oil. Going back in time, the oil shocks in 1973 and 1978 resulted from a surge in world production and income. This time around, it is exacerbated by China getting on board in an effort to expand its economy more rapidly. In summary, as the world income has been growing more rapidly in recent years, it has caused the worldwide demand for oil to increase. This is but one of the reasons for such high current oil prices.
In the long run, there are both microeconomic and macroeconomic effects from the persistently high oil prices. In the microeconomic sense, as high oil prices continue, it will cause a significant increase in both conservation and the development of alternative energy sources, such as fuel cell technology, nuclear power and renewable sources such as wind and solar. It will also open debate with environmentalists concerning changes that have occurred in terms of efficiency and safety in nuclear power and with other sources of energy. In a macroeconomic sense, these high-energy prices act like a tax on the economy. Think of it this way: after-tax, after-energy cost disposable income is significantly lowered, thus reducing the demand for other goods such as autos. In other words, it has the affect of slowing down the rate of growth in the economy, which in turn begins to weaken the demand for energy (including oil) through the income effect previously mentioned – the income effect works both ways.

**Supply factors also play a role in energy price determination...**
Three major contributors to rising oil prices on the supply side are oil companies (including OPEC) holding firm their capacity and production in the face of increasing demand, with rising prices and resulting profits; environmental concerns that make it difficult to develop and exploit energy resources, including oil; and higher costs associated with extracting oil in geographically challenging locations.

We can see that in the case of the United States, for oil in particular, we not only have fewer firms, but their refining capacity has decreased from 17.6 million barrels per day in 1982 to 17.2 million barrels per day in 2002 – with no improvement since then. In fact, our consumption is outpacing our refining capacity by around three million barrels per day. Not only does this mean that we are importing more crude oil, we also importing more refined products (e.g., around 10% of our gasoline is imported). In addition, the industry has become more concentrated: the top three firms in 1982 had a 20% share of the market; in 2002, that amount grew to 30%.


What comes out of a barrel of crude oil?
http://www.energy.ca.gov/gasoline/whats_in_barrel_oil.html

From our previous newsletter on energy:
Worldwide Oil - production (million barrels/day)
Total Worldwide 75.3 (2001 estimate)
CIA World Factbook

- United States, 8.1
- Saudi Arabia, 8.7
- Russia, 7.3
- Norway, 3.4
- Mexico, 3.6
- United Arab Emirates, 2.6
- Venezuela, 3.1
- Iran, 3.8
- Canada, 2.7
- China, 3.3
- United States, 8.1
- Saudi Arabia, 8.7
- Russia, 7.3
- Norway, 3.4
- Mexico, 3.6
- United Arab Emirates, 2.6
- Venezuela, 3.1
- Iran, 3.8
- Canada, 2.7
- China, 3.3
There are two reasons for this: as the oil industry, both in OPEC and non-OPEC countries, has become more cartelized, higher profits are achieved when demand is increasing by holding the line on output and letting prices and profits increase.

**Recent US oil mergers**

1997 – Ashland Oil combines most assets with Marathon Oil
1998 – British Petroleum (BP) acquires Amoco
1998 – Pennzoil merges with Quaker State Oil
1999 – Exxon and Mobil join to form ExxonMobil
2000 – British Petroleum (BP) acquires ARCO (Atlantic Richfield)
2001 – Chevron acquires Texaco to form Chevron Texaco
2002 – Conoco merges with Phillips
2002 – Royal Dutch Shell acquires Pennzoil-Quaker State
This behavior is further exacerbated by the political influence of the environmental lobbies whose aim it is to restrict the use and growth of new capacity. This also holds true for alternative energy sources, other fossil fuels and nuclear power. This presents us with strange bedfellows: the energy producing companies and the environmental groups -- they both have been getting what they want over at least the past ten years --- no capacity increases in oil, nuclear power or other alternatives.

The unwillingness of the Federal Trade Commission to prevent many of these mergers from occurring is based on the Chicago School of thought. That school argues that there are alternatives to petroleum products as supported by cross-price elasticity studies that because of the substitutability of these products with petroleum, place them in the same market. Two examples of cross-price elasticity: the "light vehicle market" includes passenger cars, light trucks and sport utility vehicles, but not commercial size trucks (e.g., 5-ton dump truck); also, the Alcoa case from decades ago, where the defense argued convincingly that appropriate market was not aluminum foil, but the more general food wrap category. The studies showed that there were substitutes based on cross-price elasticity.

The flaw in this argument in the case of the petroleum market is the political power of the environmental movement precludes the use of substitutes for petroleum products, such as coal and natural gas in the fossil fuel group, and nuclear, solar and wind power in the alternative energy group.

What good is a substitute if you can’t use it?

More on the Recartelization of the American Oil Industry

From 1991 through 2000, there were over 2,600 mergers in the petroleum industry. The largest of these mergers included Mobil and Exxon, the two biggest domestic oil companies at the time. As noted previously, the top three firms went from having about 20% market share to 30% market share. To put this in perspective, in the U.S. auto industry, the Big Three had over 90% of the domestic market share after WWII. Today, that same three have between 50 and 60%.

As the New Paradigm argues, increasingly competitive markets are more indicative of reality in the U.S. economy today. The trend in the petroleum industry is one rare exception to this rule.
How did this happen?

According to the U.S. Government Accountability Office (GAO), the agencies involved with antitrust activities are the U.S. Department of Justice and the Federal Trade Commission. “FTC analyzes these mergers to determine if they would likely diminish competition in the relevant markets and result in harm, such as increased prices.” The GAO has proved beyond any shadow of a doubt that the petroleum industry has in fact recartelized and as a result of this increased market power, a heavy burden has been placed upon U.S. business and households.

First, Crude Oil Prices
According to the EIA (Energy Information Administration: US Dept. of Energy) as illustrated in the graph, Crude Oil Domestic Prices vs. Imported Crude Oil, note the following trends:

- From 1991 – 1997, the domestic crude oil prices were less than imported oil
- From 1997 – 2000, the gap closed...note that this was when recartelization was pretty much complete
- From 2000 – 2005, the domestic prices of crude oil rose well above imported oil; increasing even more rapidly in ’04 – ’05

This was a manifestation of the effects of the recartelizing and increasing market power of the U.S. petroleum industry. Notice that prices were more or less flat from 1991 – 1997; followed by an upward (if irregular) trend that continues into 2005. It is clear that the effects of recartelizing and increasing market power of U.S. petroleum firms are linked to the merger activity in the 1990s.
...and then Refining

Background

U.S. Government Accountability Office
Report: GAO-04-951T
Mergers and Other Factors that Affect U.S. Refining Industry
Released: July 15, 2004
Click here to download full report (a must read)

“Historically, the domestic petroleum market has been divided into five regions: the East Coast region (PADD I), the Midwest region (PADD II), the Gulf Coast region (PADD III), the Rocky Mountain region (PADD IV), and the West Coast region (PADD V). These regions are known as Petroleum Administration for Defense Districts (PADDs).”

(Page 6: GAO-04-951T)

Refining and Gasoline
“For example, the HHI (Herfindahl-Hirschman Index [http://www.usdoj.gov/atr/public/testimony/hhi.htm]) of the refining market in the East Coast region increased from a moderately concentrated level of 1136 in 1990 to a highly concentrated level of 1819 in 2000. In the Rocky Mountain and the West Coast regions, it increased from 1029 to 1124 and from 937 to 1267, respectively, in that same period. Thus, while each of these refining markets increased in concentration, the Rocky Mountain remained within the moderately concentrated range but the West Coast changed from unconcentrated in 1990 to moderately concentrated in 2000. The HHI of refining markets also increased from 699 to 980 in the Midwest and from 534 to 704 in the Gulf Coast during the same period, although these markets remained unconcentrated.

In both the refining and wholesale markets of the downstream segment, merger activity and market concentration were highly correlated for most regions of the country.” (Page 8: GAO-04-951T)

<table>
<thead>
<tr>
<th>Region</th>
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<tr>
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<td>1136</td>
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<tr>
<td>Midwest region (PADD II)</td>
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<td>Rocky Mountain region (PADD IV)</td>
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<tr>
<td>West Coast region (PADD V)</td>
<td>937</td>
<td>1267</td>
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</table>
Competition

On average, the U.S. refinery market concentration increased by nearly 40% from 1990 to 2000. This is in stark contrast to the auto industry where the market concentration declined by around 30%.

According to merger guidelines issued by Department of Justice and Federal Trade Commission, market concentration as measured by the Herfindahl-Hirschman Index (HHI) is ranked into three separate categories: a market with HHI under 1,000 is considered to be unconcentrated; if HHI is between 1,000 and 1,800 the market is considered moderately concentrated; and if HHI is above 1,800, the market is considered highly concentrated.

Gasoline...
Rising Mark ups from U.S. Oil Well to Gas Pump

Energy Information Agency (U.S. Dept of Energy)
April 2005 Monthly Energy Review From Table 9.1 (Crude Oil) and 9.4 (Gasoline)

From January 1991 through June 1997, the mark up on regular unleaded gasoline averaged $0.78 per gallon on domestic crude oil. Domestic crude averaged $0.37 per gallon and regular unleaded gasoline averaged $1.15 per gallon.

From July 1997 through June 2000, the mark up on regular unleaded gasoline averaged $0.82/gallon on domestic crude oil. Domestic crude averaged $0.37/gallon and regular unleaded gasoline averaged $1.19/gallon.

From July 2000 through January 2005, the mark up on regular unleaded gasoline averaged $0.92/gallon on domestic crude oil. Domestic crude averaged $0.65/gallon and regular unleaded gasoline averaged $1.57/gallon.
Retail and Summary

U.S. Government Accountability Office
Report: GAO-04-982T
Mergers and Other Factors that Affect U.S. Refining Industry
Released: July 15, 2004
Click here to download full report (a must read)

“We estimated a high and statistically significant degree of correlation between merger activity and the HHIs for refining in PADDs I, II, and V for 1991 through 2000. Specifically, the corresponding correlation numbers are 91 percent for PADD V (West Coast), 93 percent for PADD II (Midwest), and 80 percent for PADD I (East Coast). While mergers were positively correlated with refining HHIs in PADDs III and IV—the Gulf Coast and the Rocky Mountains—the estimated correlations were not statistically significant.

In wholesale gasoline markets, market concentration increased broadly throughout the United States between 1994 and 2002. Specifically, we
found that 46 states and the District of Columbia had moderately or highly concentrated markets by 2002, compared to 27 in 1994.

Evidence from various sources indicates that, in addition to increasing market concentration, mergers also contributed to changes in other aspects of market structure in the U.S. petroleum industry that affect competition—specifically, vertical integration and barriers to entry.” (Page 14: GAO-04-98T Refining Industry)

There are a wide variety of ways in which the energy challenge can be met...

On the demand side...

• We could alleviate price pressures through subsidies and taxes leading to greater conservation of current resources

• Implement technological changes in the production of buildings and vehicles, requiring lower energy usage

On the supply side...

• We could legally reverse the mergers of major oil companies that have occurred over the past fifteen years

• We could release federally owned lands for the exploitation and production of various forms of fossil fuels

• We could overhaul the environmental restrictions on nuclear power, fossil fuels and other alternatives by recognizing significant technological changes that have occurred reducing environmental risks of energy production (Safer designs in nuclear power plants, e.g., France; double hull oil tankers; and bird-safe windmills)

Last thoughts...

The benefits from increased production of energy, especially in the form of electric power, are very clear. Society has fallen behind in acknowledging those declining costs: both in terms of direct costs –
increasingly efficient extraction methods; and environmental costs – safer delivery of energy to society.

and now for something completely different...

THE LEGACY OF ARTHUR LAFFER
“VILIFIED OR VINDICATED”

On numerous occasions, the editor of this Newsletter has spoken about the fiscal drag. During the administrations of Eisenhower and Kennedy, that topic often came up in the context of stagnation. Taxes usually rise at a faster than do government expenditures. When those rates of increase are stable, if federal deficits are occurring, it is inevitable that a surplus will emerge and grow ever larger unless there is a cut in tax rates or an increase in expenditure rates or some exogenous increase in either. This topic is part of a much larger area of discussion, supply side economics.

The implications of the fiscal drag have much to tell us of budget behavior in recent times. When the so-called Bush tax cuts occurred a few years ago, wild predictions were made about uncontrollable federal budget deficits. The emotions generated by such statements were exploited in order to eliminate much of the tax cuts. Now data is coming from various agencies such as Congressional Budget Office ($49 billion reduction in deficit 2004 - 2005) indicating that the deficits are less than had been forecasted by the more alarmist end of the economic analysis community.

Economists’ Statement Opposing the Bush Tax Cuts
Open Letter to Bush from Economists in Opposition to the Tax Cuts

It should be recalled, that from 1992 to 2000, tax rates were raised or applied for the first time on most sources, including the first taxation of social security. The taxes paid on social security benefits do not go back to the Social Security Fund but rather go to the general account of the Federal government thus exacerbating the Social security crisis and causing much hand wringing. Why not eliminate that tax or at least return that portion collected back to the Social Security Trust Fund.

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Between the rise in the tax base and the increase in tax rates, tax revenues swelled and surpassed federal government spending so that by 1998 a budgetary surplus emerged and rapidly rose to over $200 billion in 2000. This along with the swelling trade deficit and a turn to monetary constraint gave us the collapse in real GDP from a plus 7.3 percent to a negative 0.5 percent in the third quarter of 2000.

In recent years, there has been a reluctance to use the term fiscal drag, but as Gertrude Stein once said, a rose by any other name is still a rose. Economic expansion still causes an increasing flow of tax revenues at roughly the tax rates already mandated by Congress. A tax still depresses by taking from the taxpayer some of the income earned by participating in the production process out of which a society gets its goods and services. This means that the public participating in the production process cannot buy the goods and services to the extent they pay taxes. This frees up resources to produce public or social goods such as highways, education, defense, etc. It also enables government to pay transfer payments to those who did not currently earn such receipts since they did not earn the transfer payments as income as they did not participate in the production process.
To understand the issue of federal budgetary behavior more clearly, and to be able to better appraise the contribution of Arthur Laffer, let us examine the following graphics.

In the first graph, the typical behavior of Federal tax revenues and federal spending is portrayed as they relate to Gross Domestic Product.

GDP is a very good proxy for the tax base. Most federal tax revenues are positively related to economic activity although not necessarily in a strictly proportional way. For the sake of simplicity, we will assume that tax revenues rise at the rate of 40% of GDP’s growth. For a similar reason, assume that Federal Government expenditures rise at a rate of 35% of the growth of GDP. Some expenditure patterns are more complicated and fall as GDP rises. These have traditionally been referred to as *built-in stabilizers*. Such types of spending increase the strength of the fiscal drag argument since falling expenditures have similar impacts as do rising tax revenues.
Note that if we begin at a GDP of 10 trillion dollars, the Federal budget is in deficit as expenditures exceed taxes. As GDP rises beyond this level, tax revenues rise at a faster rate than government expenditures (even more when built-in stabilizers are considered). At a GDP level of 12 trillion dollars, the federal budget is in balance and further rises in GDP will result in a surplus (with stable rates of growth in tax revenues and federal expenditures – no exogenous shifts in either).

This automatic growing out of a deficit phenomenon was even stronger when inflation was rampant in the 1970s and taxes such as the Federal Income Tax had many more brackets, and were more narrowly spaced – a term arose called the bracket creep. Since the taxes referred to nominal not real income, effective real tax rates were increasing at each level of real income. This increased the pressure to index the brackets and make them wider.

Arthur Laffer suggested that if the tax rates were reduced, it would stimulate the tax base, GDP, and eventually increase tax revenues, which is the product of rate multiplied by base. In economics, this relationship is usually referred to as an elasticity measure, in this case, the income, or GDP elasticity of taxes. What led to some criticism of Laffer’s proposal is that elasticity depends upon a response and such responses often increase with time. Given enough time, all else equal, it is nearly a truism. The dire predictions of the so called Bush tax cuts is partly due to the ignoring of this fiscal drag relationship, partly due to the elasticity estimates and partly due to the time period involved.

Estimates now coming out show a much less bleak picture for the Federal budgetary deficit (2004 deficit was $412 billion and is projected to come in at around $365 billion in 2005)

Congressional Budget Office
http://www.cbo.gov/showdoc.cfm?index=1944&sequence=0

The Fiscal Drag and the New Paradigm

Estimates of when a balanced budget will occur from a fiscal mix can go awry if GDP moves in an unpredictable manner. A recession, especially a severe one, will impact revenue and expenditure estimates (due to the endogenous relationship between GDP and both tax revenues and government expenditures).

In Graph A, just below, tax revenues and government expenditures are related to time. As GDP rises with time, tax revenues and government expenditures rise as time passes. Conversely, when a recession occurs, tax revenues collapse as the tax base (GDP) collapses. The expenditure line also falls, but less so, due to expenditures considered as built-in stabilizers.
Note that the period of time in which the budget would be balanced is pushed farther out to a later date. As long as the relationships to GDP do not change, a balance will come – but at a later date.

Graph A  Impact of Fiscal Policy Stimulus on the Federal Budget

[Graph showing the impact of fiscal policy stimulus on the federal budget. The graph illustrates the relationship between tax revenue and government expenditures over different levels of GDP. The graph indicates that tax revenue line I (tax rate x base) intersects the government expenditures line, leading to a new balance at a later date.]
In the Graph B, similar to Graph A, if policy makers reduce tax rates, the tax revenue line will drop at each level of GDP, providing it is a more or less lump sum tax cut. The slope of the tax revenue line will flatten if the rates (bracket rates in the case of the income tax) are reduced. Again, as long as the resulting tax rates are greater with respect to GDP than the expenditure rates (also related to GDP), deficits will shrink, as GDP rises and a federal budgetary balance/surplus will occur – further out in time. To the economic advisors of Eisenhower and Kennedy, what appeared to be a resulting slowdown in spending, was a warning flag that stagnation was in the imminent. Tax cuts or spending increases seemed a necessary policy response.

In current times, this should be a warning to all analysts that tax cuts still stimulate and raise the tax base even if the slope of the tax revenue line is flattened. Raising taxes do something similar, but in the opposite direction. This relationship was apparently ignored in the period from 1992 to 2000 as taxes rose by nearly 17% (from 17.7% of the GDP in 1992, to 20.7% of the GDP in 2000). Increasing tax rates and new taxes such as social security
taxes, along with a rising rate of growth in GDP coupled with a rising trade deficit gave us the collapse in 2000: from a quarterly real growth of 7.3% in quarter four of 1999 to a negative 0.5% in the 3rd quarter of 2000.

A belated, hats off to Mr. Laffer...imagine what he could have done with a pad of paper in place of a napkin.

As we put this newsletter to bed, the Fed is less than a week away from another FOMC meeting and fully prepared to continue its errant policy of influencing short-term rates upward (Fed funds rate). You can see that the effect on the long-term rates that the Fed has achieved the opposite of what they wanted. As we have consistently said in previous newsletters, were it not for the federal deficit, we would be living through another period similar to that we experienced in collapse that occurred in 2000.

The Fed continues to obsess on inflation that haunts their memories of the 1970s. In this issue, as well as others, most of the current inflation is a result of a single source – that of energy. As the April 2005 CPI data points out, absent energy prices, the core rate shows virtually no inflation.

Why this obsession by the Fed?

Conundrum crisis – day 335

On June 30, 2004, the Fed began its drive to force up short-term interest rates; the longer-term rates (10-year) have fallen ever since.
In upcoming issues, we will analyze some of the literature concerning the Fed’s policy and what they perceive as the puzzling behavior of long-term securities.
Current Statistics (5-31-2005)

The Employment Picture

**Unemployment Rate**

{(5.4% Feb)…(5.2% Mar)}…{5.2% Apr}

Total Nonfarm payroll employment increased by 274,000 over the month April. Employment rose in April, and the unemployment rate was unchanged at 5.2 percent, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Job growth was widespread, with gains in construction, mining, and several service-providing industries.

**Industry Payroll Employment (Establishment Survey Data)**

Total nonfarm payroll employment rose by 274,000, seasonally adjusted, to 133.3 million in April. This followed gains of 300,000 in February and 146,000 in March (as revised). In April, notable increases occurred in several industries, including construction, mining, food services, and health care.

**Unemployment (Household Survey Data)**

Total employment grew by 598,000 in April to 141.1 million, and the employment-population ratio—the proportion of the population age 16 and over with jobs—edged up to 62.6 percent. The civilian labor force increased by 605,000 in April to 148.8 million; the labor force participation rate, at 66.0 percent, also was up over the month.

News Release - [http://bls.gov/news.release/empsit.nr0.htm](http://bls.gov/news.release/empsit.nr0.htm)

**Jobless Claims**

(4-wk rolling average: 324,250 May-7, to 330,000 May-14, to 330,500 May-21)

In the week ending May 21, the advance figure for seasonally adjusted initial claims was 323,000, an increase of 1,000 from the previous week’s revised figure of 322,000. The 4-week moving average was 330,500, an increase of 500 from the previous week’s revised average of 330,000.

For 2001, the average weekly initial jobless claims were running around 405,000; thus far, in 2005, the average has been in the 330,000 range.

GDP (1st Quarter 2005 Real GDP: 3.5%) Revised upward from

Real gross domestic product -- the output of goods and services produced by labor and property located in the United States -- increased at an annual rate of 3.5 percent in the first quarter of 2005, according to preliminary estimates released by the Bureau of Economic Analysis. In the fourth quarter, real GDP increased 3.8 percent. It marked the 14th consecutive quarter of economic expansion.

The GDP estimates released today are based on more complete source data than were available for the advance estimates issued last month. In the advance estimates, the increase in real GDP was 3.1 percent.

The major contributors to the increase in real GDP in the first quarter were:

Personal Consumption Expenditures (PCE) 2.54%
(Durable Goods 0.15% (Motor Vehicles and parts -0.34%; Nondurable Goods 1.09%; Services 1.30% change from 4th Quarter)

Gross private domestic investment: 1.65%
(Fixed Investment 0.87%; Change in Private Inventories 0.78%)

Net Exports (Exports – Imports): -0.67%
Exports contributed 0.71% while Imports negatively impacted the total by -1.38%

Government Spending (Government consumption expenditures and gross investment): -0.03%
Federal increasing 0.03% and State and Local down -0.06%

Leading Indicators

According to figures released by the Conference Board on Thursday, May 19, 2005, the leading index fell again in April, which is now the fourth consecutive decline because February’s small increase was revised down to a small decrease. The leading index has declined at a 1.0 percent annual rate over the last six months, and there have been more weaknesses than strengths among the components in recent months.

Next release – Monday, June 20 at 10:00 AM ET


Construction (put in place)  (March 0.5% above February)

The U.S. Census Bureau of the Department of Commerce announced today (May 2, 2005) that construction spending during March 2005 was estimated at a seasonally adjusted annual rate of $1,051.8 billion, 0.5 percent (±1.6%) above the revised February estimate of $1,046.9 billion.

The March figure is 8.0 percent (±2.2%) above the March 2004 estimate of $973.9 billion.

What Recession?  The ongoing debate as to when/if there indeed was a recession at all

(Webster's Dictionary)  RECESSION : A period during which economic activity, as measured by gross domestic product, declines for at least two quarters in a row in a specific country. If the decline is severe and long, such as greater than ten percent, it

Bureau of Economic Analysis (BEA)
Table 1.1.1. Percent Change From Preceding Period in Real Gross Domestic Product
[Percent] Seasonally adjusted at annual rates
Today is: 5/27/05 Last Revised on May 26, 2005  Next Release Date June 29, 2005

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During the first 3 months of this year, construction spending amounted to $222.4 billion, 9.3 percent (±2.1%) above the $203.5 billion for the same period in 2004.

Next release – April 2005 data will be released on June 1, 2005 at 10:00 A.M. EDT.


**New Housing Starts  (April 11.0% above March)**

Privately-owned housing starts in April were at a seasonally adjusted annual rate of 2,038,000. This is 11.0 percent (±9.7%) above the revised March estimate of 1,836,000 and is 3.6 percent (±7.2%)* above the revised April 2004 rate of 1,968,000.

Single-family housing starts in April 2005 were at a rate of 1,635,000; this is 6.3 percent (±8.9%)* above the revised March figure of 1,538,000. The April rate for units in buildings with five units or more was 351,000.

Next release (for May) – June 16, 2005 at 8:30 A.M. EDT.


**New Residential Sales  (April 0.2% above March)**

Sales of new one-family houses in April 2005 were at a seasonally adjusted annual rate of 1,316,000, according to estimates released jointly today by the U.S. Census Bureau and the Department of Housing and Urban Development. This is 0.2 percent (±8.8%)* above the revised March rate of 1,313,000 and is 13.3 percent (±13.8%)* above the revised April 2004 estimate of 1,162,000.

The median sales price of new houses sold in April 2005 was $230,800; the average sales price was $283,500. The seasonally adjusted estimate of new houses for sale at the end of April was 440,000. This represents a supply of 4.1 months at the current sales rate.

Next release (for May) – June 24, 2005 at 10:00 A.M. EDT.

Durable Goods

New orders for manufactured durable goods in April increased $3.7 billion or 1.9 percent to $200.3 billion, the U.S. Census Bureau announced today. This followed a 1.6 percent March decrease.

Shipments of manufactured durable goods in April, up six of the last seven months, increased $3.3 billion or 1.6 percent to $207.9 billion. This followed a 0.2 percent March increase.

Unfilled orders for manufactured durable goods in April, down three of the last four months, decreased slightly to $553.7 billion. This followed a 0.2 percent March decrease.

Meanwhile, Inventories of manufactured durable goods in April, up seventeen consecutive months, increased $0.3 billion or 0.1 percent to $291.8 billion. This followed a 0.5 percent March increase.

Capital Goods Industries (April):

Nondefense new orders for capital goods in April increased $2.6 billion or 3.8 percent to $70.3 billion.

Defense new orders for capital goods in April decreased $1.1 billion or 14.5 percent to $6.7 billion.

Next release (for May) – June 24, 2005 at 8:30 A.M. EDT.


Current Account Balance (Trade Balance)

The Current Account Balance consists of the Trade Balance (Net Exports (Exports less Imports) of Goods and Services), the Income Balance (Income Receipts and Income Payments), and net Unilateral Current Transfers. The Department of Commerce publishes the Current Account Balance data on quarterly basis.
The U.S. Current Account Balance 2003 – $530.7 billion
The U.S. Current Account Balance 2004 – $665.9 billion

The U.S. Trade Balance 2003 – $496.5 billion
The U.S. Trade Balance 2004 – $617.1 billion

The U.S. Census Bureau and the U.S. Bureau of Economic Analysis, through the Department of Commerce, announced today that total March exports of $102.2 billion and imports of $157.2 billion resulted in a goods and services deficit of $55.0 billion, $5.6 billion less than the $60.6 billion in February, revised. March exports were $1.5 billion more than February exports of $100.7 billion. March imports were $4.1 billion less than February imports of $161.2 billion.

In March, the goods deficit decreased $5.2 billion from February to $59.4 billion, and the services surplus increased $0.4 billion to $4.4 billion. Exports of goods increased $1.0 billion to $72.1 billion, and imports of goods decreased $4.2 billion to $131.5 billion. Exports of services increased $0.5 billion to $30.1 billion, and imports of services increased $0.1 billion to $25.7 billion.

In March, the goods and services deficit was up $7.9 billion from March 2004. Exports were up $6.8 billion, or 7.1 percent, and imports were up $14.7 billion, or 10.3 percent.

Next release (for April) – June 10, 2005 at 8:30 A.M. EDT

The Good (Exports Apr 2004 - May 2005)
Extracted from Department of Commerce
May 11, 2005 (February revised)
The Bad (Imports Apr 2004 - Mar 2005)
Extracted from Department of Commerce
May 11, 2005 (February revised)
CPI – The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.7 percent in April, before seasonal adjustment, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. The April level of 194.6 (1982-84=100) was 3.5 percent higher than in April 2004.

Energy costs advanced sharply for the third consecutive month--up 4.5 percent in April. Within energy, the index for petroleum-based energy increased 6.3 percent and the index for energy services increased 2.3 percent.

Most notably, the index for all items less food and energy, which increased 0.4 percent in March, was virtually unchanged in April.

Next release (for May) – June 15, 2005, at 8:30 A.M. (EDT)

**PPI** – The Producer Price Index for Finished Goods advanced 0.6 percent in April, seasonally adjusted, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. This increase followed a 0.7-percent rise in March and a 0.4-percent gain in February.

Among finished goods, much of April's increase was due to a 2.1-percent advance in the energy goods index. Excluding prices for energy goods, the finished goods index inched up 0.1 percent.

Next release (for May) – Jun 11, 2005 at 8:30 A.M. EDT


**Productivity, Unit Labor Cost and Compensation (Seasonally Adjusted)**

The Bureau of Labor Statistics of the U.S. Department of Labor today reported preliminary productivity data— as measured by output per hour of all persons—for the first quarter of 2005. The seasonally adjusted annual rates of productivity change in the first quarter were:

- 2.1 percent in the business sector and
- 2.6 percent in the nonfarm business sector

Productivity in the business sector grew more slowly than in the fourth quarter of 2004, when it increased 3.7 percent. In the nonfarm business sector, however, productivity increased more in the first quarter than it had in the previous quarter.

**10-year U.S. Government Bond Rate**
The 10-year Maturity U.S. Government Security continues to remain trading at a relatively low rate.

10-Year Treasury Constant Maturity Rate
Not Seasonally Adjusted Monthly Numbers
Board of Governor’s Federal Reserve System

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