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CLASSROOM EDITION

Realists vs. Optimists: Indicators reflect cycles in business and the economy

Some economists and corporate executives believe the business cycle has been tamed. They don't see any reason to anticipate a recession and think the current economic expansion could last until at least the turn of the century.

Do you think they are realistic or overly optimistic?

Analysts examine many economic indicators to determine the future course of the economy; the charts below show how five of these indicators have performed during the past 37 years.

But economists differ in their interpretation of these and other data. And unforeseen events, such as the Gulf War that began after Iraq invaded Kuwait on Aug. 2, 1990, can destroy even the best analyst's forecasts.

Read the descriptions of the indicators charted here and look at their historical patterns. What do you think will happen to the U.S. economy between now and the turn of the century?

Dow Jones Industrial Average

The Dow Jones Industrial Average consists of the stocks of 30 large U.S. manufacturing and service companies.

Typically, when investors feel good about the future prospects for corporate sales and profits, they buy stocks, boosting share prices. When investors are concerned about the future, they sell shares, driving stock prices down.

Falling stock prices reduce investors' wealth, causing them to cut back on spending. Falling prices also reduce the incentive for companies to issue new stock to raise money for investment.

Real Gross Domestic Product

Real gross domestic product is the total market value of all final goods and services produced in a year. It is adjusted for inflation and is the measure that determines periods of expansion and contraction in the business cycle.

An expanding economy is registered by a rise in GDP. When economic activity reaches a peak, the economy begins to contract and GDP falls. Many people take it as a sign of recession when GDP falls for two consecutive quarters. When the recession reaches a trough and the economy begins to expand again, GDP rises.

Consumer Price Index

This index is a measure of inflation. It reflects changes in the prices of a fixed "market basket" of goods and services bought by urban consumers.

The index is weighted based on the proportion of income spent for different types of products. Prices are compared with a base period (1982-1984).

Changes in the consumer price index affect people's purchasing power. Fluctuations influence our understanding of whether living standards are rising or falling, and spur the Federal Reserve to boost or cut interest rates.

Unemployment Rate

The U.S. unemployment rate reflects the percentage of people in the labor force who are willing and able to work but who can't find jobs.

When companies cut production, unemployment often rises. Rising unemployment means reduced consumer purchasing power in the future, which hurts economic growth.

Some people call the unemployment rate plus the inflation rate the "misery index," to describe the impact of high unemployment and high prices.

Federal Funds Rate

The Federal Reserve uses monetary policy to allow the economy to grow as fast as it can without causing inflation.

One way the Federal Reserve does this is by influencing the direction of the federal funds rate. This is the interest rate banks charge each other for overnight loans. The Fed also influences the growth of the money supply in the U.S.

The Fed constantly tracks a wide variety of economic and financial data to determine what course of action to take regarding the economy.

How to Read these Charts

The charts below illustrate data from 1960 to 1996 for five economic indicators. The title boxes on the right side of the charts label and briefly explain each indicator.

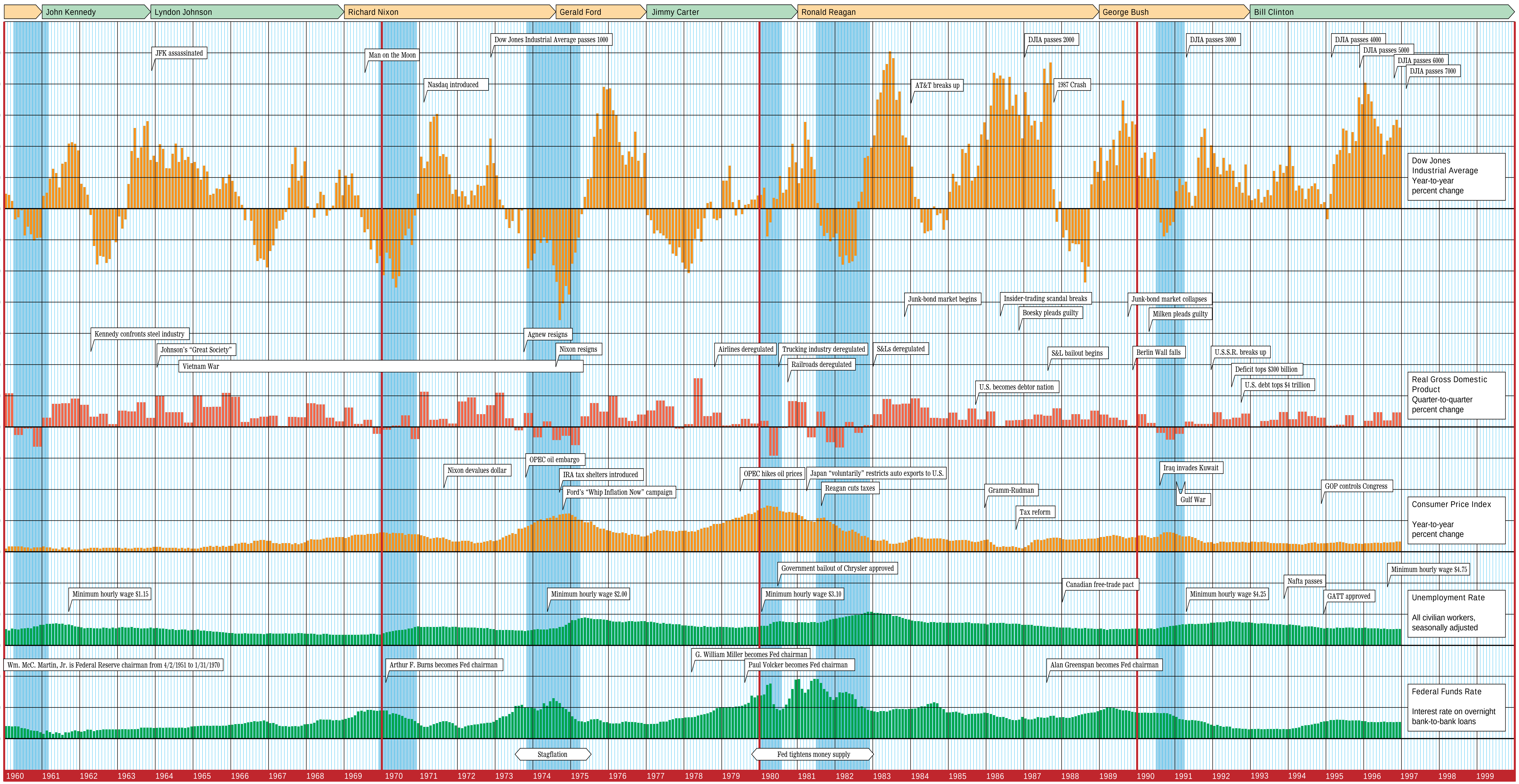
These boxes are located above the baseline (zero) for each chart.

To read these charts, start at the base line and count up or down. The scale for each chart is in percent, in increments of 10. Percentages above the baseline are positive; percentages below are negative.

The colors of the charts indicate the type of data they illustrate. Indicators shown as year-to-year percent changes are orange. Indicators shown as a rate are green. Real gross domestic product, shown as a quarter-to-quarter percent change, is red. Real GDP is a good place to start when analyzing the business cycle because it determines periods of recession and recovery.

The light-blue shaded areas represent recessions. The flags identify economic and historical events.

At the top are the presidents. Republicans are in light orange; Democrats are in light green.



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