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## **Part 2**

March 24, 1999

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

March 24, 1999

## **RECENT DEVELOPMENTS**

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# **DOMESTIC NONFINANCIAL DEVELOPMENTS**

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## **Domestic Nonfinancial Developments**

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### **Overview**

The economic expansion continues to exhibit almost startling momentum. Consumer spending soared in the first two months of 1999--boosted by a remarkable level of motor vehicle sales--and housing starts rose to still higher levels. The industrial sector continued to struggle, owing in large measure to problems in international trade, but job gains elsewhere in the economy were sizable and the unemployment rate remained low. To round out the good news, inflation remained subdued through February.

### **Labor Market Developments**

Strength in the demand for labor continued unabated in early 1999. The monthly increases in private nonfarm payroll employment averaged 216,000 in January and February, a shade above the pace of job growth in 1998.

The recent employment gains have been driven disproportionately by activity in the construction and retail trade industries. Boosted by the robust housing market, construction employment rose 43,000 per month on average. In the retail industry, payrolls were up a substantial 80,000 per month; especially notable, general merchandisers and miscellaneous retail establishments recorded less-than-seasonal layoffs, and stores selling furniture and building materials hired actively.

Elsewhere, the picture was mixed: Employment in business services rose briskly over the first two months of the year and, in February, health services posted the first large gain since last summer; however, some other industries in services saw declines. Employment gains in FIRE were robust in January but slowed in February.

In manufacturing, firms have shed almost 70,000 jobs so far in 1999. Accounting for half of this decline were the apparel, textile, machinery, and aircraft industries--all of them greatly exposed to foreign demand or competition.

With strong overall growth in payrolls and a pop-up in the average workweek, the index of aggregate hours of private production or nonsupervisory workers rose 0.6 percent in February after having held steady in January. The level of aggregate hours in February was 0.9 percent above that in the fourth quarter, pointing to another solid increase in hours in the first quarter.

Data from the household survey continue to indicate a very tight labor market. The unemployment rate was little changed, on net, over the first two months of the year. Since last spring, the unemployment rate has fluctuated

CHANGES IN EMPLOYMENT

(Thousands of employees; based on seasonally adjusted data)

	1998	1998		1999		
		Q3	Q4	Jan.-Feb.	Jan.	Feb.
--Average monthly changes--						
Nonfarm payroll employment <sup>1</sup>	236	204	252	246	217	275
Private	207	166	220	216	178	253
Manufacturing	-19	-29	-44	-34	-17	-50
Construction	29	12	57	43	14	72
Transportation and utilities	15	14	16	15	14	15
Retail trade	39	48	40	80	36	123
Finance, insurance, real estate	22	20	22	15	23	7
Services	113	91	127	94	101	87
Business services	39	16	50	38	36	40
Help supply services	6	-12	13	7	7	7
Total government	29	38	31	31	39	22
Private nonfarm production workers <sup>1</sup>	157	125	173	174	97	250
Total employment <sup>2</sup>	157	188	236	309	870	-252
Nonagricultural	171	153	319	257	793	-280
Memo:						
Aggregate hours of private production workers (percent change) <sup>1,3</sup>	2.0	1.6	2.3	2.9	0.0	0.6
Average workweek (hours) <sup>1</sup>	34.6	34.5	34.6	34.6	34.5	34.7
Manufacturing (hours)	41.8	41.7	41.7	41.6	41.6	41.6

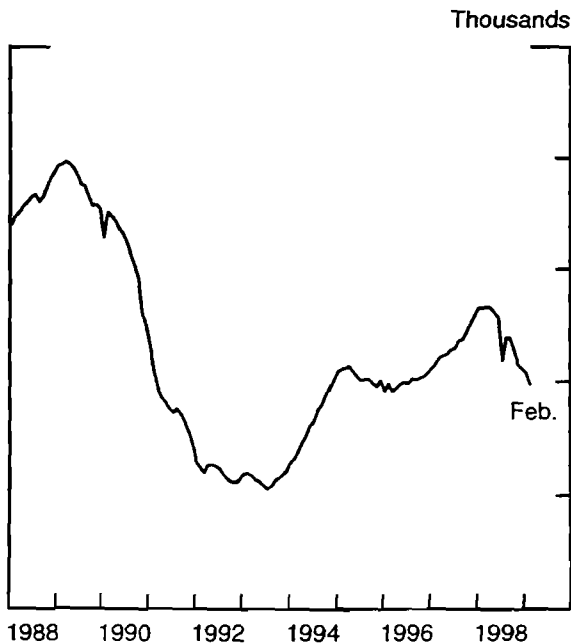
Note. Average change from final month of preceding period to final month of period indicated.

1. Survey of establishments.

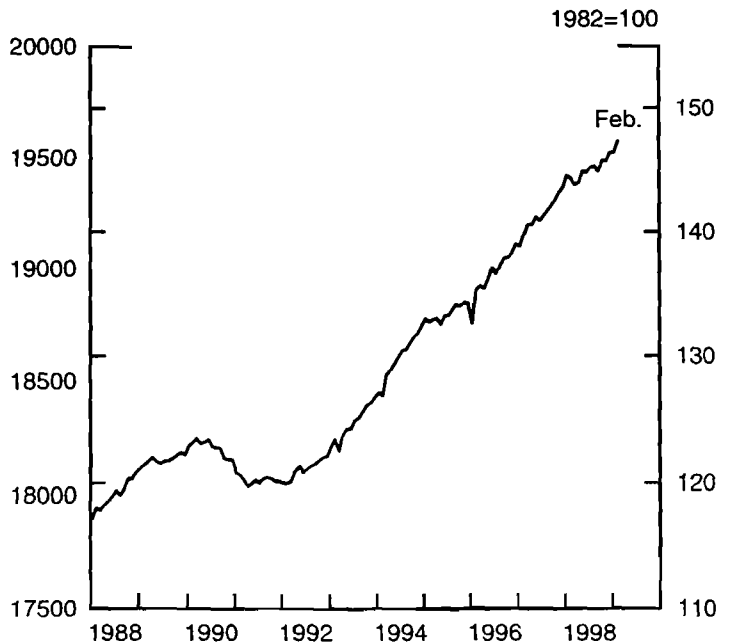
2. Survey of households.

3. Annual data are percent change from Q4 to Q4. Quarterly data and Jan.- Feb. average are percent change from preceding quarter at an annual rate. Monthly data are percent change from preceding month.

Manufacturing Employment



Aggregate Hours of Production or Nonsupervisory Workers



in a narrow 4-1/4 to 4-1/2 percent range.<sup>1</sup> In addition, the labor force participation rate only edged down a tenth last month from the record high of 67.4 percent reached in January. The ready availability of jobs appears to be raising participation over a broad spectrum of demographic groups and, not surprisingly, the percentage of the population aged 16 to 64 who want jobs but are not in the labor force continues to hold at very low levels.

Other indicators that have become available since the last Greenbook confirm the picture of strong labor demand and a limited supply of potential new workers. Initial claims for unemployment insurance moved down still further, and the vacancy rate, as proxied by the Conference Board's Help Wanted Index, climbed in January to near the all-time high reached last March. Firms' perceptions of hiring strength as measured by the National Federation of Independent Businesses' survey of small firms, the Manpower survey, and the BNA survey remain below levels reached last year but still indicate considerable strength. According to the Conference Board's survey, individuals currently perceive an abundance of jobs, and their expectations of future employment opportunities continue to be optimistic; the Michigan SRC and the Conference Board's measures of expected labor market conditions have moved up, on balance, since January, although they remain below the very high levels observed early last year.

In addition to the big gains in employment, the end of 1998 saw a surge in productivity. Output per hour in the nonfarm business sector is now reported to have jumped at an annual rate of 4.6 percent in the fourth quarter.<sup>2</sup> Over the four quarters ended in 1998:Q4, productivity in the nonfarm business sector rose 2.7 percent after solid increases in the prior two years. The resurgence in productivity growth in recent years has been impressive: On a consistently measured basis, average productivity rose 2.0 percent per year from 1995 to 1998, 1.2 percent from 1990 to 1995, and 1.3 percent from

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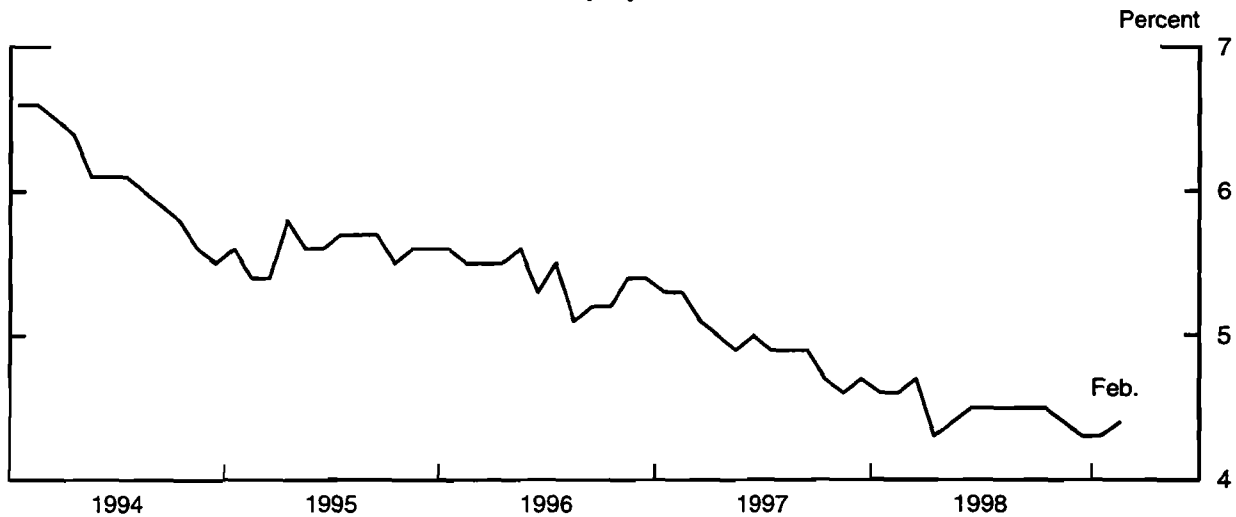
1. Some private analysts have suggested that the amount of upward wage pressure generated by the recently low unemployment rates is lessened by the relatively high median duration of unemployment spells. While plausible in principle, such an offset is likely to be small. The unemployment rate combines the incidence and duration of unemployment into a single summary measure. In practice, we have found that measures of unemployment duration do not add significant information about wage pressures beyond that provided by the unemployment rate. In addition, comparisons over time using the duration measure alone are complicated by the CPS redesign in 1994 that significantly increased average measured durations.

2. We are expecting a 1/4 percentage point (annual rate) downward revision to fourth-quarter productivity growth because of the upward revision to December aggregate production worker hours that was reported in the February employment report.

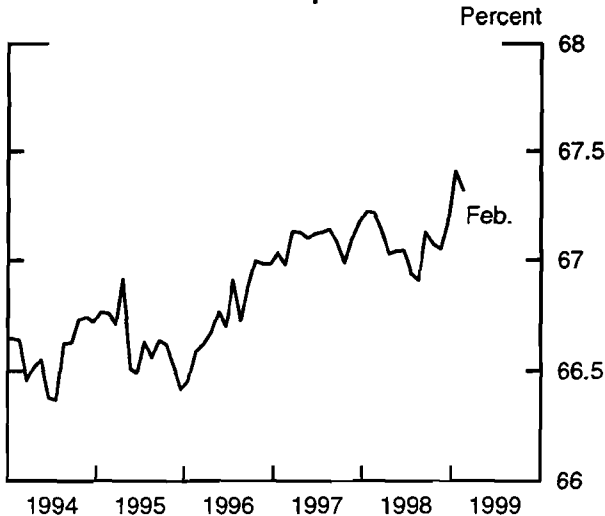
**SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES**  
 (Percent; based on seasonally adjusted data, as published)

	1997	1998	1998			1998	1999	
			Q2	Q3	Q4	Dec.	Jan.	Feb.
Civilian unemployment rate	4.9	4.5	4.4	4.5	4.4	4.3	4.3	4.4
Teenagers	16.0	14.6	14.2	14.7	14.9	14.0	15.5	14.1
Men, 20 years and older	4.2	3.7	3.6	3.8	3.6	3.6	3.4	3.7
Women, 20 years and older	4.4	4.1	4.0	4.0	4.0	3.9	3.7	3.8
Labor force participation rate	67.1	67.1	67.0	67.0	67.1	67.2	67.4	67.3
Teenagers	51.6	52.8	52.4	52.8	52.8	52.9	52.4	53.2
Men, 20 years and older	76.9	76.8	76.8	76.7	76.8	76.8	77.1	77.0
Women, 20 years and older	60.5	60.4	60.4	60.3	60.5	60.6	60.9	60.8
Women maintaining families	67.4	68.3	67.5	68.7	69.1	70.1	69.5	69.8

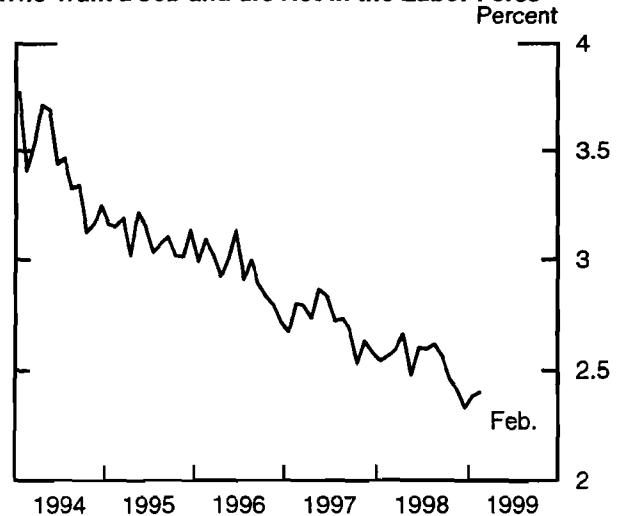
**Unemployment Rate**



**Labor Force Participation Rate**



**Share of the Population age 16 to 64  
Who Want a Job and are Not in the Labor Force**

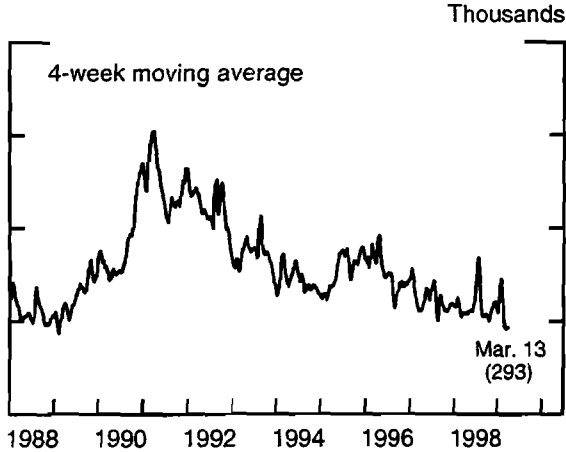


Note. Seasonally adjusted by FRB staff.



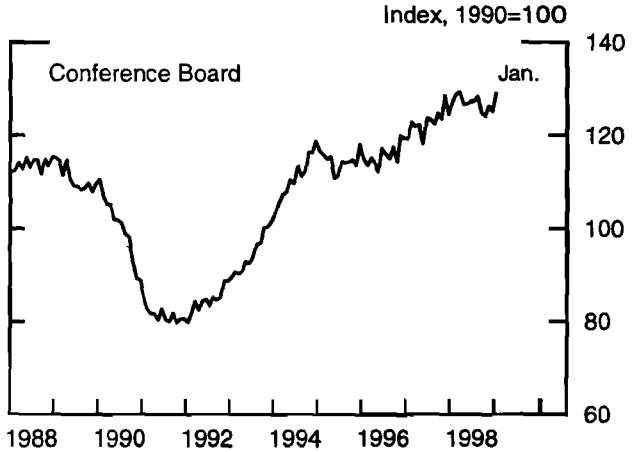
## Labor Market Indicators

Initial Claims for Unemployment Insurance



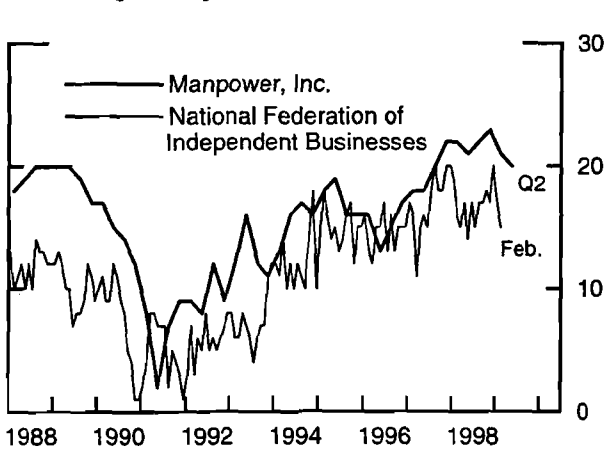
Note. State programs, includes EUC adjustment.

Help Wanted Index



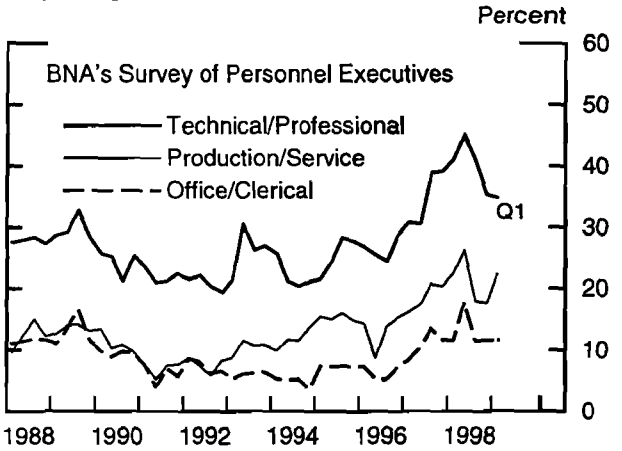
Note. Series adjusted for consolidation of newspaper industry and rise of hiring through personnel supply agencies.

Net Hiring Strength

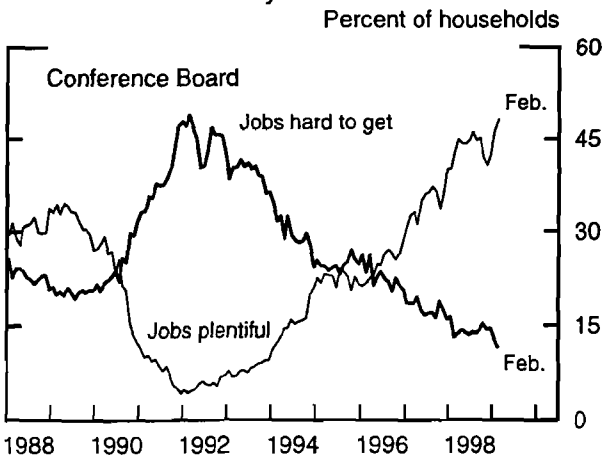


Note. Percent planning an increase in employment minus percent planning a reduction.

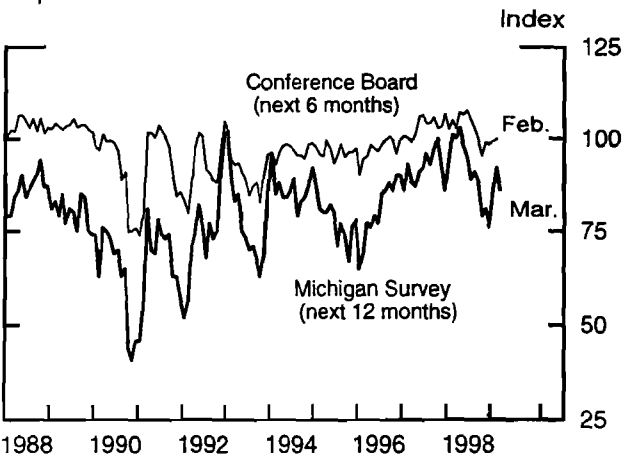
Reporting Positions Hard to Fill



Current Job Availability



Expected Labor Market Conditions



Note. Michigan index: the proportion of households expecting unemployment to fall, less the proportion expecting unemployment to rise, plus 100. Conference Board index: the proportion of respondents expecting more jobs, less the proportion expecting fewer jobs, plus 100.

**LABOR PRODUCTIVITY**  
(Percent change from preceding period at compound annual rate;  
based on seasonally adjusted data)

	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
<u>Output per hour</u>						
Total business	1.7	2.9	4.1	0.1	2.6	4.8
Nonfarm business	1.5	2.7	3.6	0.3	2.5	4.6
Manufacturing	5.6	3.8	1.6	3.9	4.7	5.2
Nonfinancial corporations <sup>2</sup>	2.5	n.a.	2.7	3.1	4.4	n.a.
<u>Compensation per hour</u>						
Total business	3.8	4.2	5.0	4.1	3.7	4.0
Nonfarm business	3.7	4.0	4.7	4.1	3.9	3.5
Manufacturing	5.4	3.3	4.0	2.6	3.2	3.3
Nonfinancial corporations <sup>2</sup>	3.8	n.a.	3.6	4.6	4.0	n.a.
<u>Unit labor costs</u>						
Total business	2.0	1.2	0.8	4.0	1.0	-0.8
Nonfarm business	2.1	1.3	1.1	3.7	1.4	-1.1
Manufacturing	-0.1	-0.6	2.4	-1.3	-1.5	-1.8
Nonfinancial corporations <sup>2</sup>	1.2	n.a.	0.9	1.5	-0.3	n.a.
Memo:						
ECI compensation per hour	3.4	3.5	2.7	3.6	4.4	2.9

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

2. Nonfinancial corporate sector includes all corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

**Average Growth of Nonfarm Business Productivity**  
(Percent, compound annual rate)

Series	1979-90	1990-95	1995-98
Published	1.0	1.0	2.0
Methodologically consistent	1.3	1.2	2.0

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1979 to 1990.<sup>3</sup> Of course, the recent surge in productivity has coincided with very robust (and likely partly unanticipated) output growth and probably reflects, in part, a lag in hiring in a tight labor market rather than permanent, structural improvements in operating efficiency--that is, a mix of "cycle" and improved "trend."

### **Industrial Production**

Industrial production has grown only slightly since December, with no change in January and a rise of just 0.2 percent in February. Mining activity in January was depressed by further weakness in gas and oil extraction, while the return of milder weather restrained output of utilities in February.<sup>4</sup> In manufacturing, production expanded modestly in both months, pushed up by gains in most high-tech industries (defined as computers, communications equipment, and semiconductors). In the transportation sector (motor vehicles and aircraft), output declined over January and February. In other sectors, production remained flat, on net, over the first two months of 1999.

Output of motor vehicles and parts has remained near the fourth-quarter's extremely elevated post-strike levels. First-quarter production of motor vehicles is expected to come in at around 12.7 million units (annual rate): Losses due to storm-related closings in the Midwest in January and to an explosion at Ford's Rouge facilities in February are being offset by what appears to be a substantial overbuild relative to schedules in March. The elevated production levels are likely to continue for a time because recent sales surprises have left inventories of some models too lean. Elsewhere in the transportation sector, the output of aircraft and parts declined again in February as Boeing continues to adjust production to the scheduled decline in aircraft completions.

The output of high-tech industries has increased substantially so far this year. Computer production remained robust through February, and the output of semiconductors and related electronic components grew sharply. Production of communications equipment was soft, on balance, in January and February, but with orders running above shipments, the weakness may only be temporary.

Manufacturing production outside the transportation and high-tech industries changed little, on net, in January and February with strength in business equipment, durable consumer goods, and construction supplies balanced by

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3. The consistently measured series corrects for the technical changes to the CPI that affect the chain price index for the nonfarm business sector.

4. Cooler-than-normal temperatures are expected to boost utilities generation significantly in March.

GROWTH IN SELECTED COMPONENTS OF INDUSTRIAL PRODUCTION  
(Percent change from preceding comparable period)

	Proportion 1998	1998 <sup>1</sup>	1998	1998	1999	
			Q4	Dec.	Jan.	Feb.
			-Annual- --rate--	--Monthly rate---		
Total index	100.0	1.9	2.2	.2	.0	.2
Mining	5.4	-4.6	-9.6	-1.0	-3.0	.4
Utilities	6.2	-.9	-19.8	1.7	1.9	-.6
Manufacturing	88.4	2.5	4.8	.1	.1	.2
Motor vehicles and parts	5.1	.7	37.5	-1.4	-.3	-.2
Aircraft and parts	3.1	8.6	-3.5	-1.6	-1.3	-1.5
High-tech	8.4	26.6	31.7	1.2	1.9	1.8
Other manufacturing	71.8	-.2	.4	.2	-.1	.1
Consumer goods	23.2	-1.1	-1.1	.0	-.2	-.1
Durables	3.6	1.7	-2.1	1.1	.0	1.3
Nondurables	19.6	-1.7	-1.0	-.2	-.3	-.3
Business equipment	9.0	.9	-.5	-.4	-.3	.8
Construction supplies	5.6	5.0	5.5	1.6	.4	.0
Materials	24.6	-1.4	.7	.3	.1	-.1
Durables	16.2	-.8	1.6	.3	.2	.0
Nondurables	8.2	-2.8	-3.3	.4	.1	-.3
Memo: High-tech industries						
Computer equipment	2.5	53.0	46.0	2.0	1.9	1.8
Communication equipment	2.1	5.4	-7.3	-.5	.6	-.5
Semiconductors <sup>2</sup>	3.9	25.5	50.9	1.6	2.6	3.0

1. From the final quarter of the previous period to the final quarter of the period indicated.

2. Includes related electronic components.

CAPACITY UTILIZATION  
(Percent of capacity; seasonally adjusted)

	1988-89	1959-98	1998		1998	1999	
	High	Avg.	Q3	Q4	Dec.	Jan.	Feb.
Manufacturing	85.7	81.6	80.2	80.1	79.9	79.6	79.5
Primary processing	88.9	82.8	82.9	82.5	82.8	83.0	82.6
Advanced processing	84.2	81.1	79.3	79.3	78.9	78.5	78.4

**Production of Domestic Autos and Trucks**  
(Millions of units at an annual rate; FRB seasonal basis)

Item	1998	1999				
	Q4	Jan.	Feb.	Mar. <sup>1</sup>	Q1 <sup>1</sup>	Q2 <sup>1</sup>
U.S. production	12.9	12.8	12.7	12.4	12.6	12.6
Autos	5.9	5.6	5.4	5.5	5.5	5.5
Trucks	7.0	7.2	7.3	6.8	7.1	7.1
Days' Supply <sup>2</sup>						
Autos	52.6	62.9	55.6	n.a.	n.a.	n.a.
Light trucks	57.7	62.3	59.2	n.a.	n.a.	n.a.

NOTE. Components may not sum to totals because of rounding.

1. Production rates are manufacturers' schedules.

2. Quarterly data are for last month of quarter.

n.a. Not available.

**New Orders for Durable Goods**  
(Percent change from preceding period except as noted; seasonally adjusted)

Component	Share, 1998:H2 (percent)	1998		1999		
		Q3	Q4	Jan.	Feb.	Jan-Feb/ 1998:Q4
Total durable goods	100	2.7	0.6	3.3	-5.0	3.0
Adjusted durable goods <sup>1</sup>	70	3.3	0.0	-0.7	-2.4	1.1
Computers	6	2.7	0.6	-4.6	0.3	-1.0
Nondefense capital goods excluding aircraft and computers	18	5.4	-2.4	-3.2	-1.1	2.2
Other	46	2.6	0.8	0.7	-3.2	1.0
MEMO						
Real adjusted orders <sup>2</sup>	...	4.9	0.9	0.0	-2.2	2.3

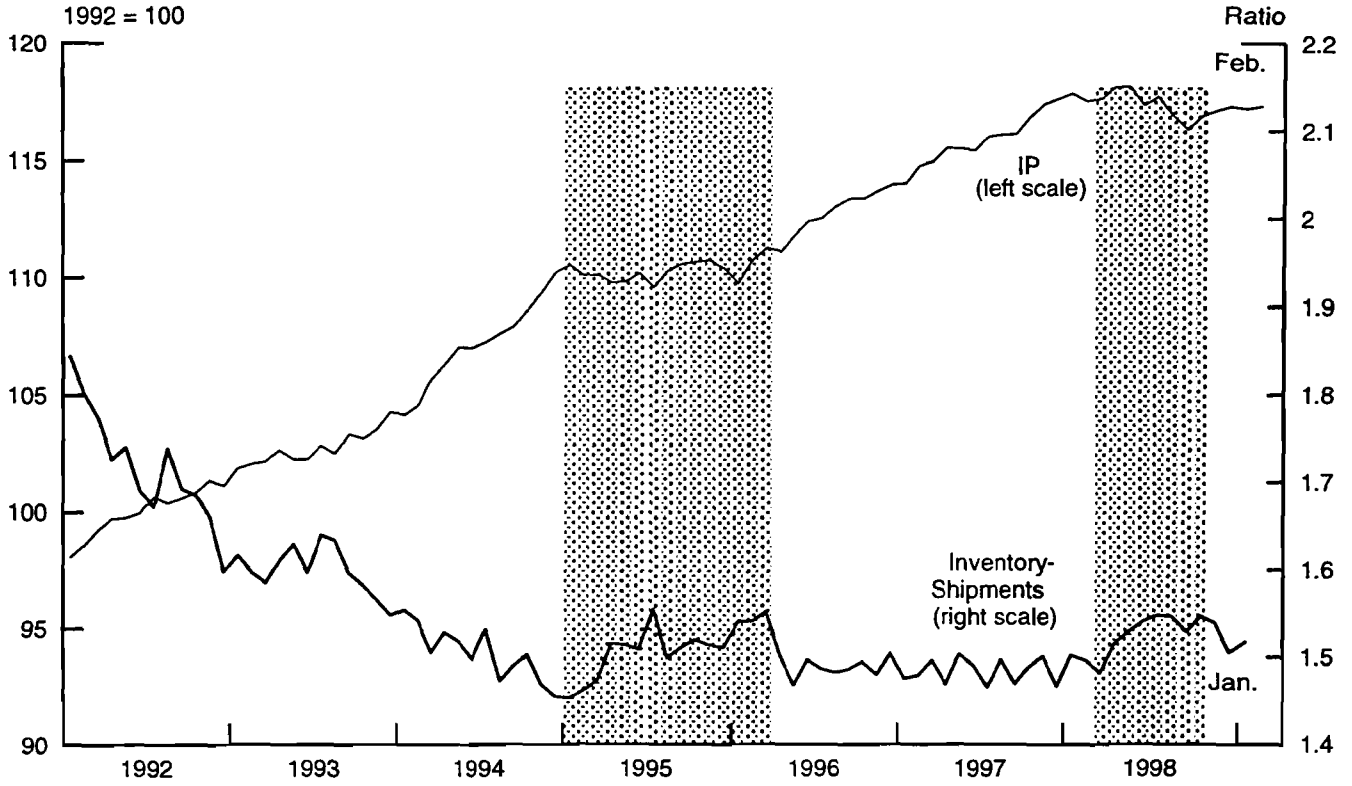
1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.

2. Nominal adjusted durable goods orders were split into three components: computers, electronic components, and all other. The components were deflated and then aggregated in a chain-weighted fashion.

... Not applicable.

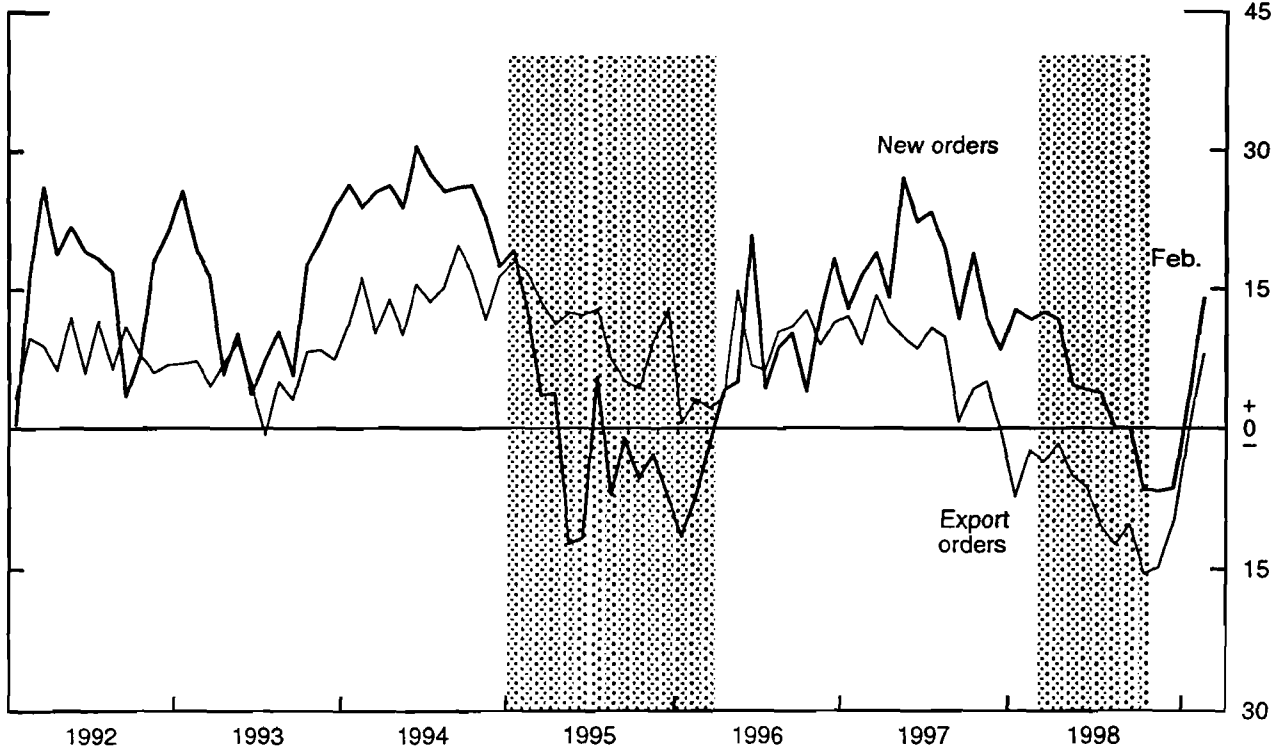
# Manufacturing IP and Inventory-Shipments Ratio <sup>1</sup>

(Ex. High Tech, Motor Vehicles and Parts, and Aircraft and Parts)



# Purchasing Managers <sup>1</sup>

Manufacturing <sup>2</sup>  
Percent



<sup>1</sup> Shaded regions highlight periods of increase in the inventory-shipments ratio.  
<sup>2</sup> Percent reporting increases minus percent reporting decreases.

weakness in nondurable consumer goods and nondurable materials. A large part of the strength in business equipment was due to a rebound in farm machinery and service industry machinery. Partially offsetting this was reduced demand for oil and gas field machinery related to the decline in extraction activity. And, the output of construction machinery has decreased significantly--though the level remains elevated.

Possibly reflecting spillovers from the housing sector, the output of durable consumer goods was boosted over the first two months of the year by large increases in the production of lawn and garden equipment and continuing strength in household appliances. In another housing-related industry, the production of manufactured construction supplies rose, on net, in January and February.

Elsewhere, inventory overhangs in a few sectors (notably petroleum, chemicals, textiles, metals, and industrial machinery) continued to hold down production. In some of these industries, demand from abroad deteriorated at the end of 1997, and unwanted inventories had accumulated by mid-1998. In the aggregate, however, the rise in the manufacturing inventory-shipments ratio has been small.

Looking ahead, most anecdotal evidence and statistical indicators suggest a firming of orders for manufacturing goods. The Beige Book reported that businesses in a number of districts are cautiously optimistic about 1999 and expect orders and output to increase in the next six months. Board staff contacts report stronger demand for steel, appliances, and several types of machinery, but producers of chemicals still complain of excess capacity, weak orders, and soft prices. Also, although the staff series of real adjusted durable goods orders--based on data from the Census Bureau--declined in February, the average over the first two months of the year was 2-1/4 percent above the fourth-quarter reading. In addition, the National Association of Purchasing Managers' survey reported a substantial upswing in the new orders index in January and February, at least in part owing to a strengthening in new export orders.

### **Consumer Spending and Personal Income**

Consumer spending surged in the early months of the year and is headed toward another hefty advance in this quarter. Disposable personal income increased rapidly, and higher equity prices boosted net worth further.

**Motor vehicles.** The average pace of motor vehicle sales in January and February was close to the lofty 16-1/4 million unit (annual rate) level of the fourth quarter. Industry sources indicate that sales this month have remained exceptionally strong.

**SALES OF AUTOMOBILES AND LIGHT TRUCKS**  
(Millions of units at an annual rate, FRB seasonals)

	1997	1998	1998		1998	1999	
			Q3	Q4	Dec.	Jan.	Feb.
<b>Total</b>	15.1	15.4	14.6	16.3	17.2	15.6	16.8
Adjusted <sup>1</sup>	15.0	15.5	14.7	16.3	17.2	15.6	16.8
<b>Autos</b>	8.3	8.1	7.8	8.5	9.1	7.9	8.7
<b>Light trucks</b>	6.8	7.3	6.8	7.7	8.1	7.6	8.1
<b>North American<sup>2</sup></b>	13.1	13.4	12.6	14.1	14.8	13.3	14.5
Autos	6.9	6.8	6.5	7.1	7.5	6.5	7.2
Light trucks	6.2	6.7	6.2	7.0	7.3	6.8	7.3
<b>Foreign Produced</b>	1.9	2.0	2.0	2.2	2.4	2.2	2.3
Autos	1.4	1.4	1.3	1.5	1.6	1.4	1.5
Light trucks	.6	.6	.7	.7	.8	.8	.8

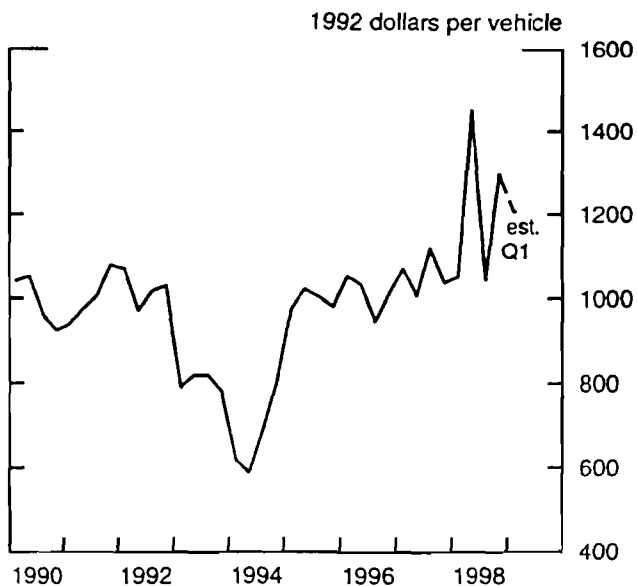
**Memo:**

Retail Sales	12.4	12.9	12.2	13.3	13.9	12.7	14.2
Fleet Sales	2.6	2.6	2.5	3.0	3.3	2.8	2.7

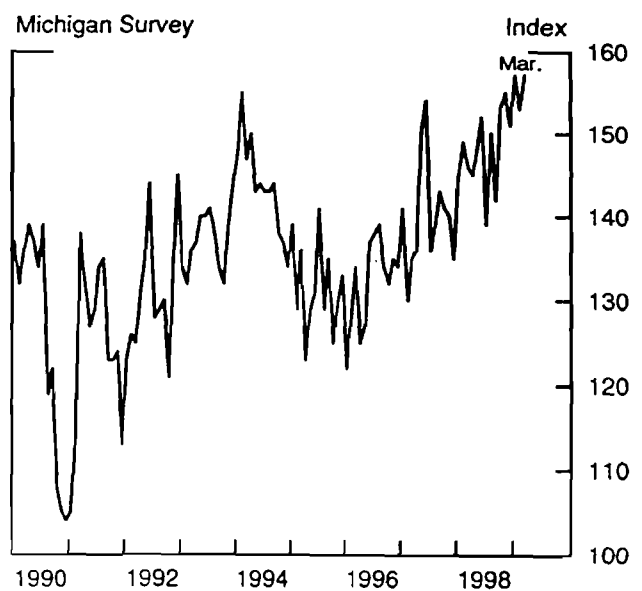
Note. Components may not add to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

**New Car and Light Truck Incentives**



**Buying Attitudes for New Vehicles**



Note: Data from J.D. Powers, deflated by CPI for new motor vehicles.



The sustained high demand has mainly reflected favorable consumer fundamentals--robust income, wealth, and confidence. But these pluses have been reinforced by attractive pricing, including still-considerable incentives. In particular, GM sweetened general incentives in the middle of February and offered a special discount of \$1,000 to employees, their relatives, and retirees for purchases made during the last few days of the month.

The preliminary reading of the Michigan survey's index of car-buying conditions rebounded in March, matching the recent peak in January. The reasons for consumers' upbeat views were numerous, with particularly favorable readings regarding prices, finance rates, and the strength of the economy.

**Other consumption and personal income.** In February, nominal sales in the retail control category, which excludes sales at automotive dealers and building material and supply stores, increased 0.5 percent after an upward-revised gain of 1.1 percent in January.<sup>5</sup> Taking the two months together, gains in retail sales were widespread and were particularly strong at general merchandise and apparel stores. Based on the retail sales and consumer price data, we estimate that average real spending on goods excluding motor vehicles in January and February was 1.9 percent (not an annual rate) above the fourth-quarter level.

Published data on service expenditures are available only through January, when real PCE for services jumped 0.6 percent. Outlays were boosted by a pickup in energy services after the unseasonably warm weather in December. Among non-energy services in January, increases were reported in almost all major components. In particular, a surge in stock market volume at the turn of the year helped to push brokerage services up more than 11 percent in January (not at an annual rate), and outlays for recreational services jumped 1.5 percent.

In January, real disposable personal income increased 0.5 percent. The relatively large gain reflected not only strength in private wages and salaries but also the net effects of a number of special factors--including federal pay increases, COLAs for several federal transfer programs, and annual inflation

---

5. The increase in nominal retail control in January had been reported at 0.3 percent in the advance release. The revision to January retail control is the largest since the Census Bureau completed the switch to a new sampling procedure with the release of November 1997 data; indeed, the January revision was almost three times the standard deviation of revisions since the new sampling procedures were implemented. Nevertheless, the standard deviation of revisions under the new methodology remains about half of what it was under the previous survey design.

RETAIL SALES  
(Percent change from preceding period)

	1998		1998	1999	
	Q3	Q4	Dec.	Jan.	Feb.
Total sales	.0	2.3	1.1	1.0	.9
Previous estimate		2.3	1.0	.2	
Building materials and supplies	.4	3.5	2.2	1.6	1.2
Automotive dealers	-3.0	5.1	2.3	.7	1.8
Retail control <sup>1</sup>	1.0	1.3	.6	1.1	.5
Previous estimate		1.2	.5	.3	
GAF <sup>2</sup>	.6	1.5	.6	2.2	.7
Durable goods	1.9	1.4	1.1	.8	.0
Furniture and appliances	2.6	1.1	1.6	.2	1.0
Other durable goods	1.3	1.6	.7	1.4	-.9
Nondurable goods	.8	1.3	.5	1.1	.7
Apparel	-.6	.5	-.2	3.7	1.0
Food	1.1	1.1	.8	.0	.9
General merchandise	.1	2.1	.4	2.6	.5
Gasoline stations	.4	-1.1	.8	-.3	.8
Other nondurable goods	1.6	1.7	.4	.8	.4

1. Total retail sales less sales at building material and supply stores and automotive dealers, except auto and home supply stores.
2. General merchandise, apparel, furniture, and appliance stores.

REAL PCE SERVICES  
(Percent change from the preceding period)

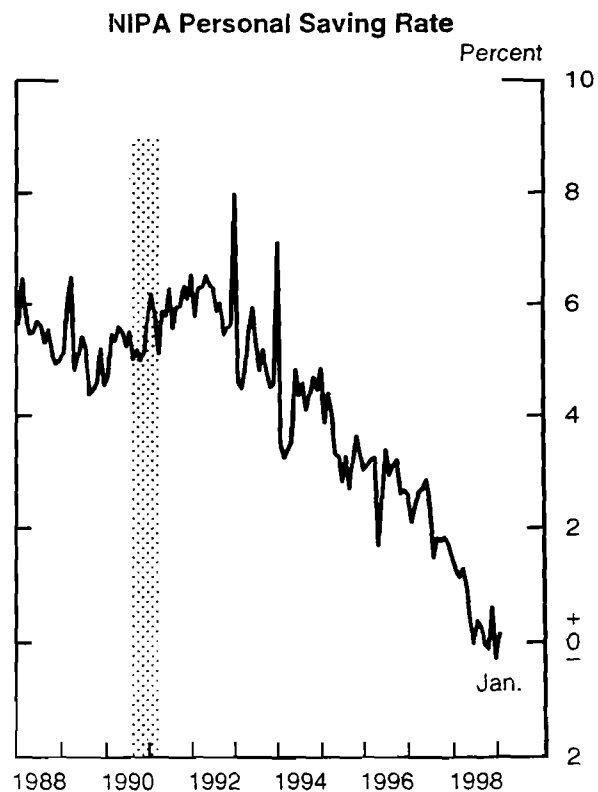
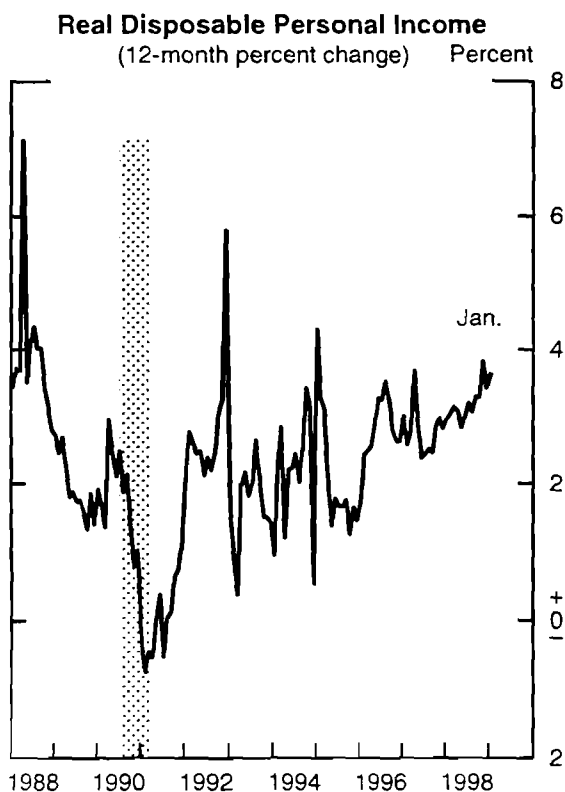
	1998	1998		1998		1999
		Q3	Q4	Nov.	Dec.	Jan.
	Q4/Q4	- Annual rate -		--- Monthly rate ---		
PCE Services	4.0	5.4	1.7	.0	.3	.6
Energy	-2.2	24.0	-23.5	-3.2	.8	3.7
Non-energy	4.3	4.7	2.9	.2	.2	.4
Housing	2.4	2.4	2.4	.1	.3	.2
Household operation	6.5	7.2	5.1	.3	.3	.6
Transportation	2.7	-1.7	2.3	.3	.8	.2
Medical	3.0	2.1	2.9	.2	.2	.2
Recreation	9.9	13.0	9.9	.9	.0	1.5
Personal business	5.5	5.3	3.3	-.2	.5	1.5
Brokerage services	17.0	23.1	11.2	-2.8	1.7	11.1
Other	6.8	15.7	-2.3	-.1	-.4	-.2

Note. Derived from billions of chained (1992) dollars.

PERSONAL INCOME  
(Percent change)

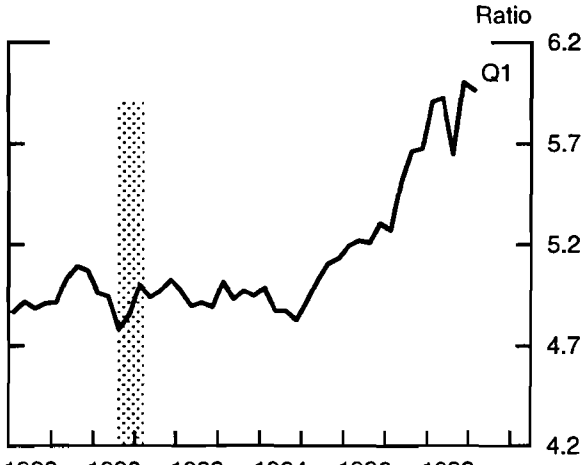
	1997	1998	1998			1998		1999
			Q2	Q3	Q4	Nov.	Dec.	Jan.
	-- Q4/Q4 --		-- Annual rate --			-- Monthly rate --		
Total personal income	5.4	5.1	4.5	4.5	5.3	.9	-.1	.6
Wages and salaries	7.2	6.2	5.6	5.9	6.0	.5	.4	.7
Private	7.9	6.6	6.0	6.3	6.4	.6	.5	.6
Other labor income	2.8	3.5	2.9	2.7	2.6	.2	.2	.3
Transfer payments	3.8	3.5	2.4	2.5	2.2	.1	.5	.9
Less: Personal tax and nontax payments	11.5	9.6	10.1	5.8	5.9	.6	.4	.0
Equals: Disposable personal income	4.4	4.3	3.5	4.3	5.2	.9	-.1	.7
Memo:								
Real disposable income <sup>1</sup>	2.9	3.5	2.6	3.2	4.2	.9	-.2	.5
Saving rate (percent)	2.1	.5	.4	.2	.1	.6	-.3	.1

1. Derived from billions of chained (1992) dollars.



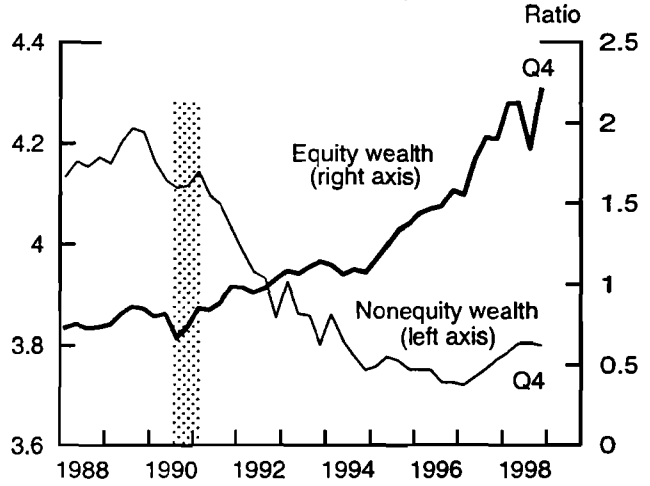
### Household Indicators

Ratio of Net Worth to DPI

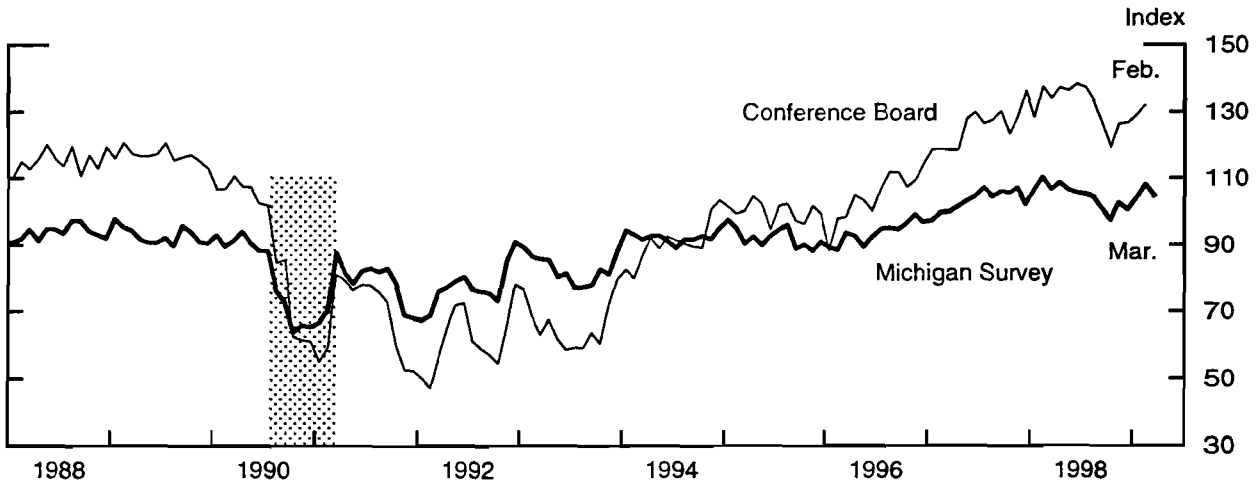


Note: The 1999:Q1 observation is a staff estimate.

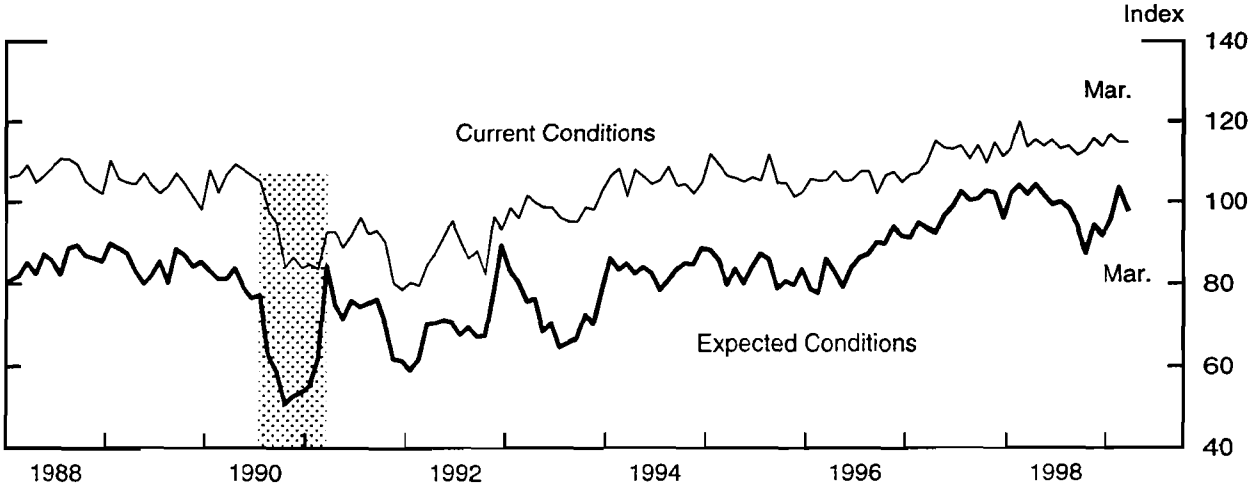
Ratio of Equity and Nonequity Wealth to DPI



Consumer Confidence



Michigan Survey



adjustments to tax withholding schedules and the EITC. These positive factors were partially offset by higher personal contributions for social insurance (subtracted from personal income), which owed to an increase in the taxable wage base for social security. The BEA does not seasonally adjust these items, leading to a discontinuity in seasonally adjusted income growth each January. In addition, personal tax payments were reduced by the child tax credit and the education expenditures tax credit, but their effects were roughly counterbalanced by other provisions of the Taxpayer Relief Act of 1997, including changes in safe harbor provisions for the payment of estimated taxes.

More generally, income has been on a solid uptrend. Over the twelve months ended January, real DPI increased 3.6 percent--about 1/2 percentage point faster than during the same period a year earlier. In February, an increase in production worker hours combined with a small uptick in wages suggests another significant gain in income.

In addition to the impetus to spending from strong income growth, demand has been boosted by the soaring wealth of households. In the fourth quarter, the resurgent stock market lifted the ratio of household net worth to income to a new high--more than reversing the third-quarter decline--and it appears to have held close to this level in the first quarter. With such sharp gains in household net worth, individuals have had little reason to boost their savings out of current income. In January, the saving rate was 0.1 percent, unchanged from the fourth-quarter average.

Consumer sentiment remains positive in general. Although the preliminary March reading on consumer sentiment from the Michigan survey ticked down, this index has moved up, on balance, since January; it remains in the high range that has prevailed over the past two years. Households were extremely upbeat about current conditions in early March, although their expectations regarding personal finances and the economic outlook softened a little.

### **Housing Markets**

Housing markets remained very robust in the first quarter, with total housing starts in January and February averaging 1.8 million units (annual rate). Single-family starts reached 1.41 million units (annual rate) in February, the highest level in twenty years. The recent strength in housing starts is largely attributable to the robust economy and favorable financial conditions. Moreover, good weather this winter likely provided an additional boost by making it easier for builders to address demand backlogs by extending the construction season in some regions.

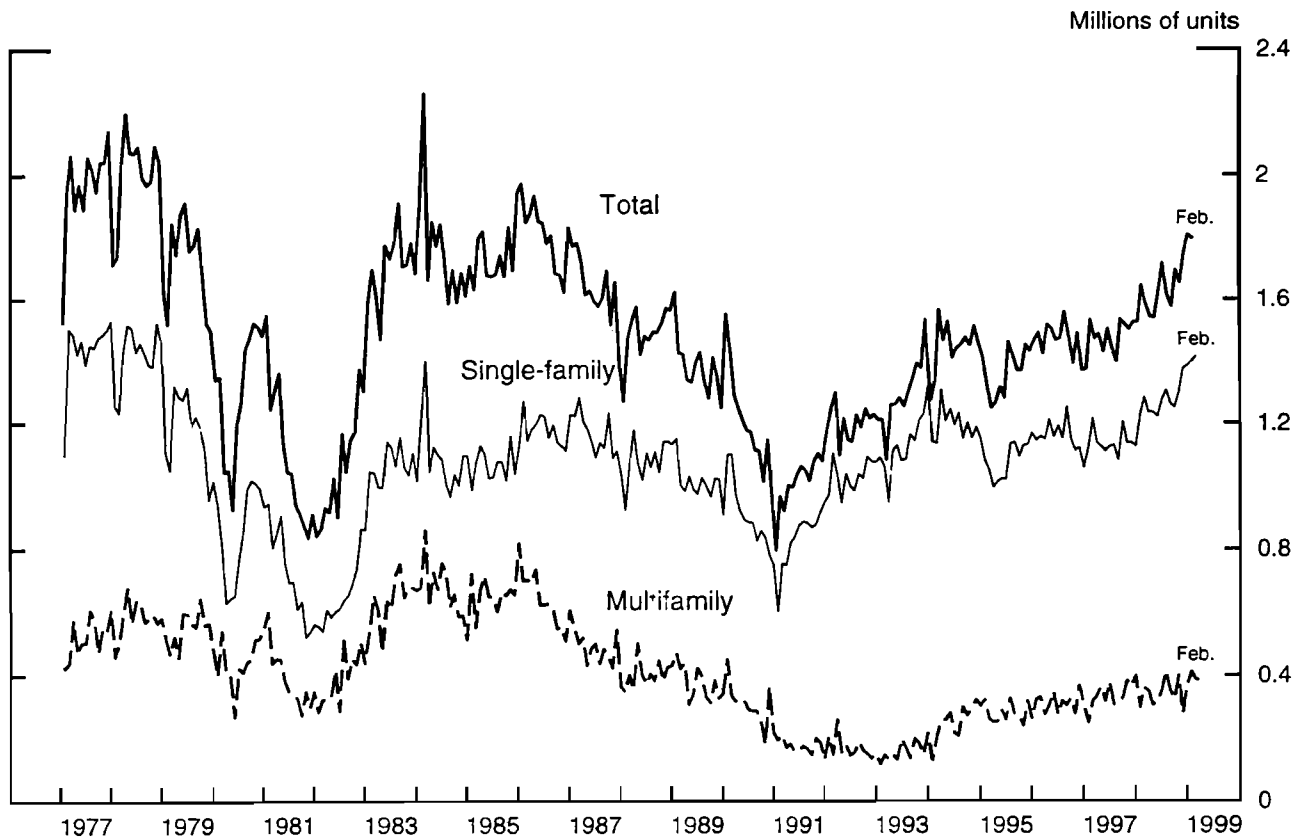
**Private Housing Activity**  
(Millions of units; seasonally adjusted annual rate)

	1998	1998				1999	
		Q2	Q3	Q4 <sup>r</sup>	Dec. <sup>r</sup>	Jan. <sup>r</sup>	Feb. <sup>P</sup>
<i>All units</i>							
Starts	1.62	1.57	1.64	1.70	1.75	1.81	1.80
Permits	1.60	1.53	1.58	1.69	1.73	1.78	1.75
<i>Single-family units</i>							
Starts	1.27	1.24	1.27	1.35	1.38	1.40	1.41
Permits	1.18	1.14	1.17	1.25	1.31	1.28	1.31
Adjusted permits <sup>1</sup>	1.22	1.18	1.21	1.29	1.35	1.32	1.35
New home sales	.89	.89	.86	.96	.97	.92	n.a.
Existing home sales	4.79	4.78	4.78	4.89	5.03	5.07	n.a.
<i>Multifamily units</i>							
Starts	.35	.33	.36	.35	.37	.41	.39
Permits	.42	.38	.41	.45	.42	.50	.44
<i>Mobile homes</i>							
Shipments	.37	.37	.37	.37	.38	.39	n.a.

Note. p Preliminary. r Revised. n.a. Not available.

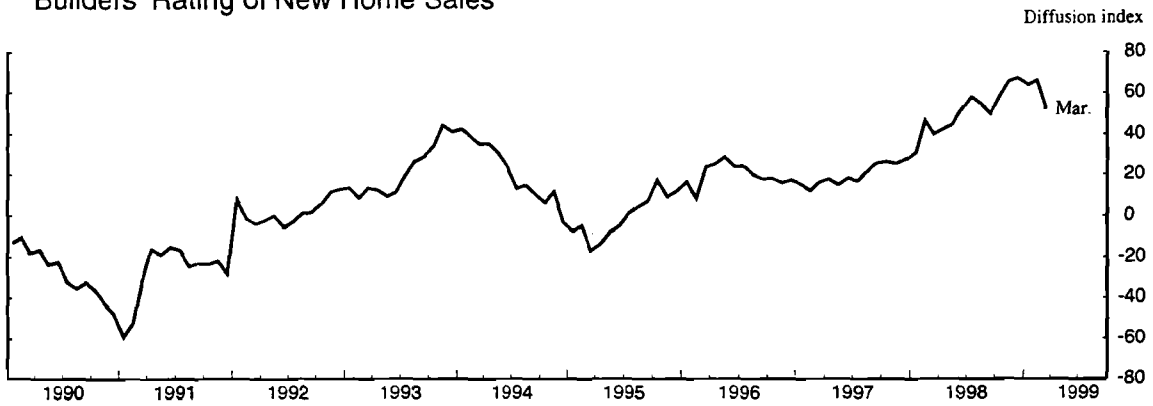
1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas, minus a correction for those starts in permit-issuing places that lack a permit.

**Private Housing Starts**  
(Seasonally adjusted annual rate)



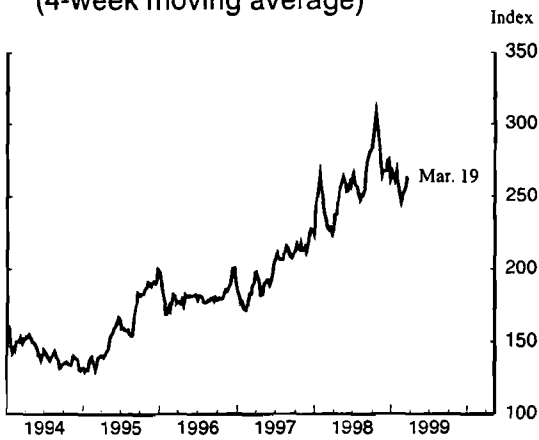
## Indicators of Housing Demand and Prices

Builders' Rating of New Home Sales

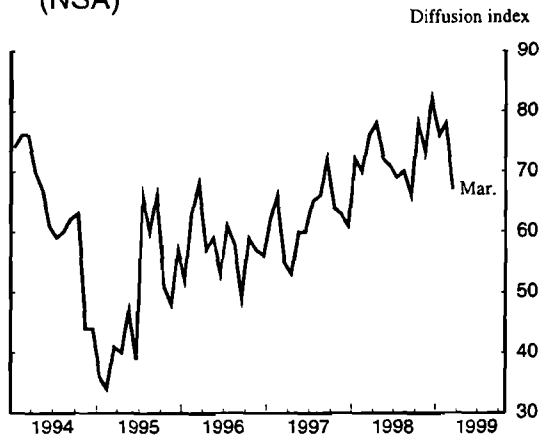


Note. Calculated from National Association of Homebuilders' data as the proportion of respondents rating current sales as good minus the proportion rating them as poor. Seasonally adjusted by staff.

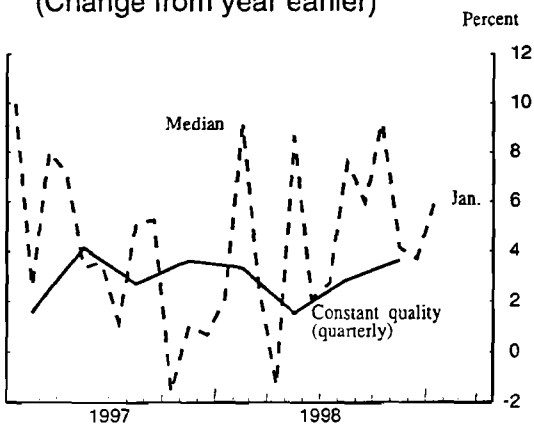
MBA Index of Purchase Applications (4-week moving average)



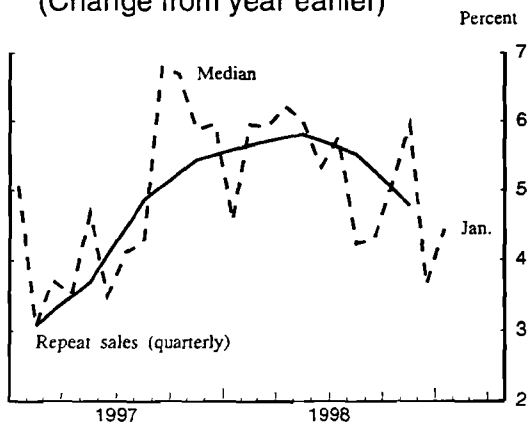
Consumer Home-Buying Attitudes (NSA)



Change in Prices of New Homes (Change from year earlier)



Change in Prices of Existing Homes (Change from year earlier)



BUSINESS CAPITAL SPENDING INDICATORS  
 (Percent change from preceding comparable period;  
 based on seasonally adjusted data, in current dollars)

	1998		1998	1999	
	Q3	Q4	Dec.	Jan.	Feb.
<u>Producers' durable equipment</u>					
Shipments of nondefense capital goods	1.6	4.0	-.2	-1.9	-.5
Excluding aircraft and parts	1.4	1.7	1.5	-2.0	-.1
Office and computing	2.0	.6	-.4	-.3	3.3
Communications equipment	2.1	5.3	1.8	6.0	-6.6
All other categories	1.0	1.2	2.2	-4.9	.4
Shipments of complete aircraft	5.3	26.0	-30.4	34.8	n.a.
Sales of heavy trucks	9.9	9.8	-1.1	.3	8.6
Orders for nondefense capital goods	4.3	-4.3	2.6	9.6	-7.1
Excluding aircraft and parts	4.7	-1.6	7.7	-3.5	-.8
Office and computing	2.7	.6	5.6	-4.6	.3
Communications equipment	-3.0	5.8	2.1	11.1	-1.7
All other categories	7.7	-4.4	10.1	-6.8	-1.0
<u>Nonresidential structures</u>					
Construction put in place, buildings	1.7	3.2	1.9	-1.1	n.a.
Office	1.4	10.9	3.0	1.1	n.a.
Other commercial	-.2	3.8	2.1	-2.2	n.a.
Institutional	-.6	.9	4.6	-5.4	n.a.
Industrial	.1	-2.3	-.8	-2.7	n.a.
Lodging and miscellaneous	11.8	-.3	.2	4.6	n.a.
Rotary drilling rigs in use <sup>1</sup>	-11.9	-14.7	-4.8	-3.2	-6.9
Memo (1992 Chained dollars):					
Business fixed investment	-.7	16.0	n.a.	n.a.	n.a.
Producers' durable equipment	-1.0	19.2	n.a.	n.a.	n.a.
Office and computing	50.0	49.2	n.a.	n.a.	n.a.
Communications equipment	12.4	14.5	n.a.	n.a.	n.a.
Other equipment <sup>2</sup>	2.5	.8	n.a.	n.a.	n.a.
Nonresidential structures	.2	7.4	n.a.	n.a.	n.a.

1. Percent change of number of rigs in use, seasonally adjusted.

2. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.

n.a. Not available.



Home sales also have been very strong--though there are hints of a peaking. Existing home sales reached a record high in January; because most of these transactions are recorded at closing, this measure tends to be a bit of a lagging indicator of demand. New home sales decreased in January for the second consecutive month--though the January figure still was the third highest observation in the 36-year history of the series.

Other indicators also provide some hints that demand is topping out. Judging from the decline registered by the National Association of Home Builders' monthly survey of builders, sales of new homes may have moderated in early March. In addition, the MBA index of applications for mortgages to finance home purchases has, on net, moved down considerably from the high reached last October. The Michigan survey series on perceived homebuying conditions, which set a record high last December, declined noticeably in early March, although it remains at a highly favorable level by historical standards.

Housing prices have continued to rise appreciably faster than overall inflation. The median price of new homes was up 6 percent in January from a year earlier, a rate that is in the middle of the range seen over the past year. However, the year-over-year change in the constant-quality price of new homes, which adjusts for changes in house size and other amenities as well as shifts in the geographic composition of sales, was up just 3.6 percent in the fourth quarter, about the same as a year ago. For existing homes, the median price rose 4-1/2 percent from a year earlier in January, at the lower end of the range seen in the past year. The repeat-sales index of existing home prices increased 4-3/4 percent over the four quarters of last year.

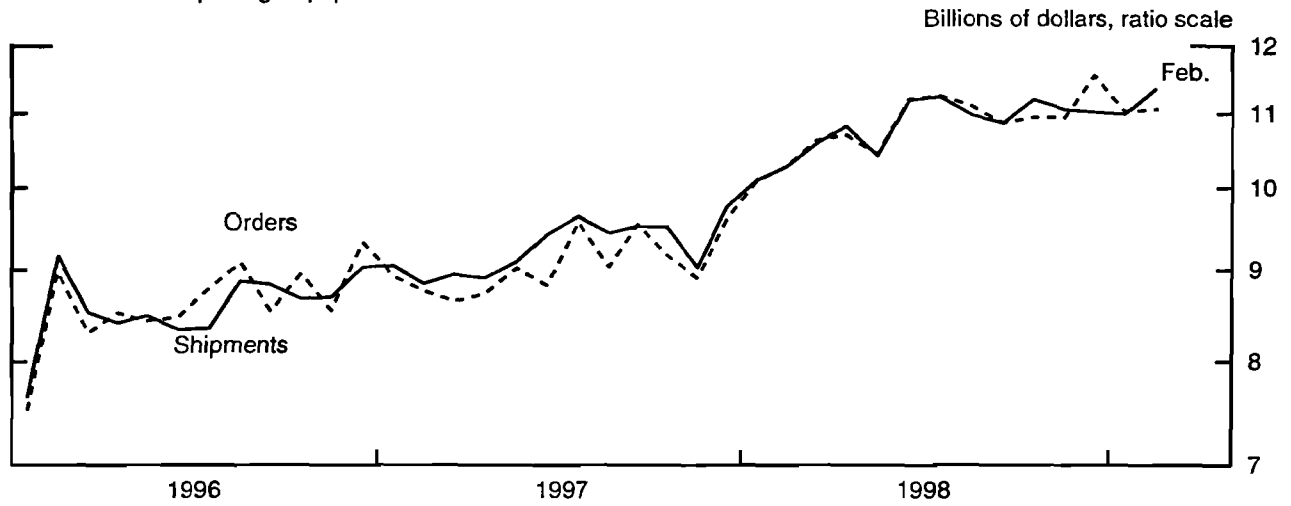
### **Business Fixed Investment**

After having soared in the fourth quarter, the pace of real business fixed investment appears to have decelerated to a more moderate rate of advance. In particular, the rate of increase of expenditures on durable equipment appears to be slowing after a strong fourth quarter, and spending on nonresidential structures shows signs of flattening.

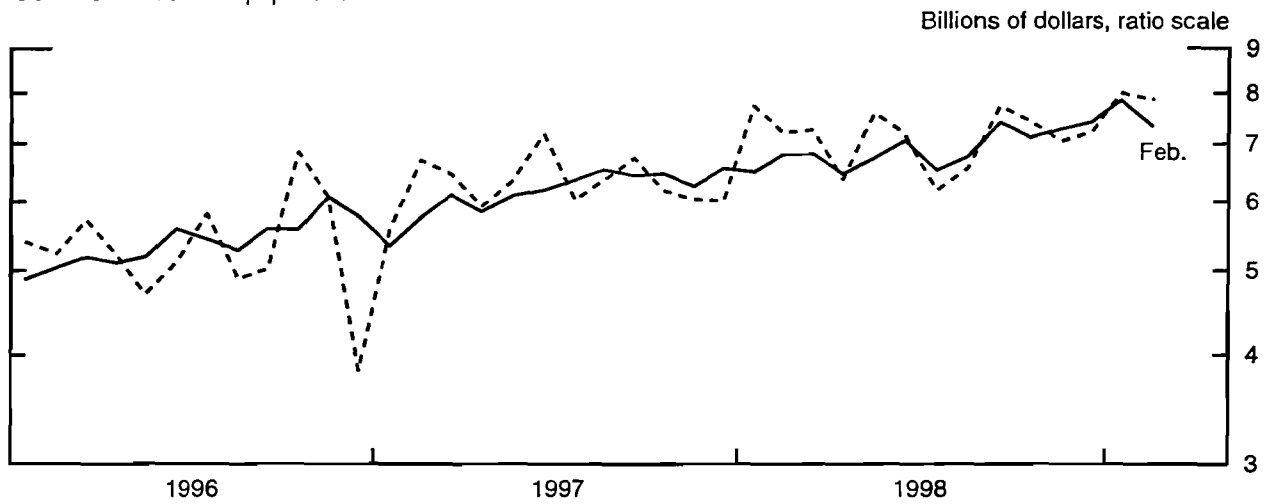
**Producers' durable equipment.** Producers' durable equipment appears to be advancing considerably this quarter, albeit at a slower pace than in the fourth quarter. Although the incoming data point to a sizable gain in real business outlays on computers, the increase looks to be smaller than last quarter. Also, Boeing's reported delivery schedule suggests that aircraft shipments to domestic carriers will decelerate, on balance, in the first quarter. Moreover, the growth of business spending on motor vehicles and communications equipment is apparently slowing from the substantial pace of the fourth quarter, and outlays for other equipment appear lackluster.

## Orders and Shipments of Nondefense Capital Goods

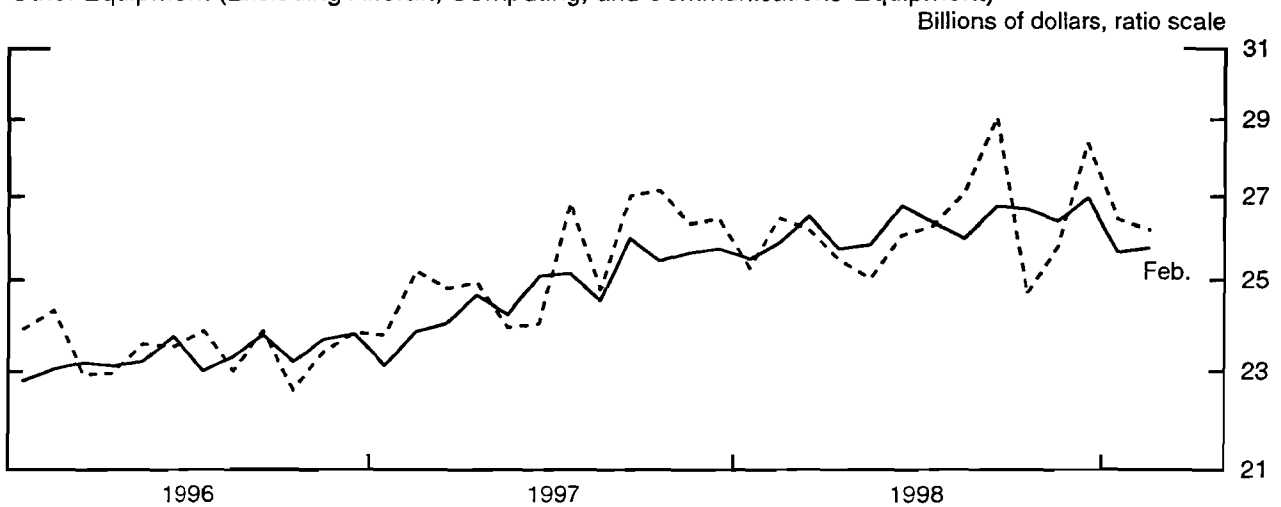
Office and Computing Equipment



Communications Equipment



Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



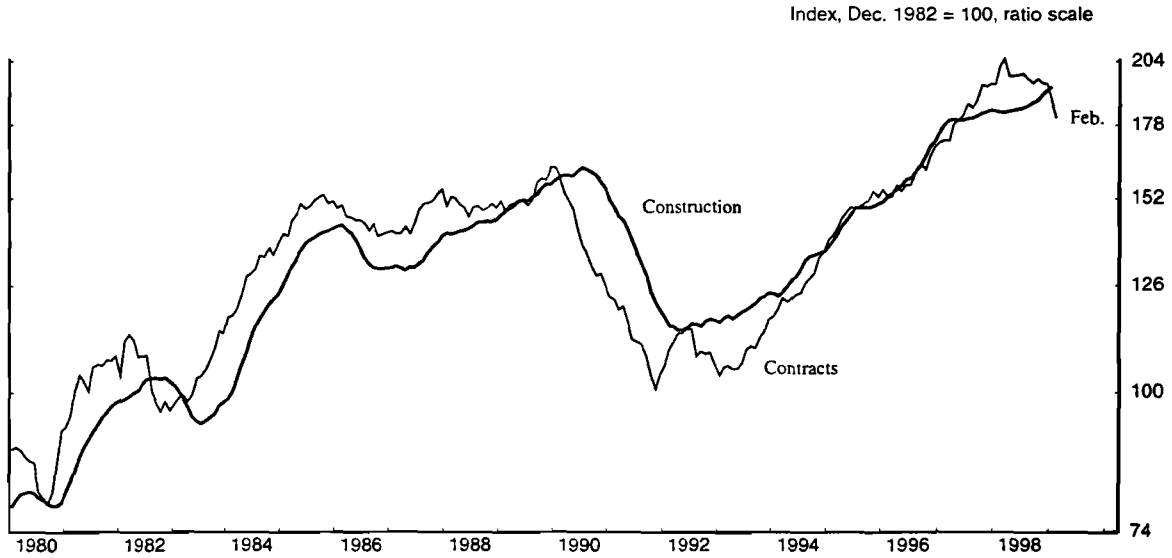
Business outlays for motor vehicles likely will rise much less this quarter than last. Fleet sales of autos and trucks dropped back in January and February to more normal levels from the post-strike pace of the fourth quarter. In addition, leases to consumers, which also rebounded sharply last quarter, are expected to show a smaller increase in the current quarter. However, sales of medium and heavy trucks moved further into uncharted territory in February as sales surged to about 660,000 units at an annual rate--40 percent higher than a year ago. Although up in February, net new orders for trucks have eased, on balance, since the middle of last year. However much of this near-term weakness has been in demand from Mexico and, to a lesser extent, Canada, while domestic demand has remained quite strong. Even with the recent softening in orders, backlogs remain extraordinarily high, and the near-term outlook for sales is still favorable.

Gains in real expenditures on office and computing equipment appear to be running below the sizable increase registered last quarter. Nominal shipments of computers rose 3-1/4 percent in February, despite reports of soft demand for personal computers. Earlier in the year, PC makers slashed prices at the first sign of weakness to avoid a repeat of last year's costly inventory problems. Moreover, the introduction at the very end of February of computers using Pentium III microprocessors has led to further price reductions on models with older chips.

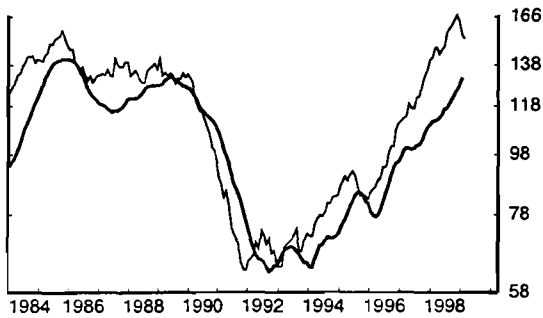
A moderate increase in real outlays for communications equipment seems to be under way this quarter. Although nominal shipments in February stood only 1 percent above their fourth-quarter level, the level of orders last month was up considerably from the fourth-quarter average, suggesting continued strength going forward. Two strong forces have affected (and will continue to affect) the domestic market for communications equipment. In late January, the Supreme Court ruled that the FCC's interpretation of the Telecommunications Act of 1996 is valid and that local telephone companies must begin leasing their equipment, or "elements," to would-be market entrants at competitive prices. The resolution of the appeals process in favor of increased competition should spur further spending on communications equipment going forward. In addition, most large telecommunications companies are moving toward communications networks that are packet-switched (that is, transmitted using the same technology as that of the Internet) rather than circuit-switched (for example, most current voice networks). The need for a smooth transition has contributed to the rash of mergers of traditional telephone companies (which account for 90 percent of telecom revenue) with smaller, more technologically advanced companies. These newly formed entities have easy access to financial resources and are positioned to continue to spend quite lavishly on their emerging networks.

## Nonresidential Construction and Contracts (Six-month moving average)

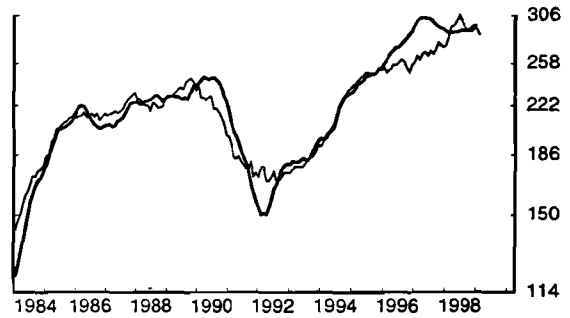
### Total Private Building



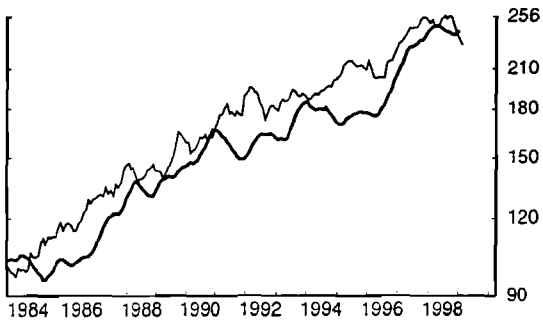
### Office



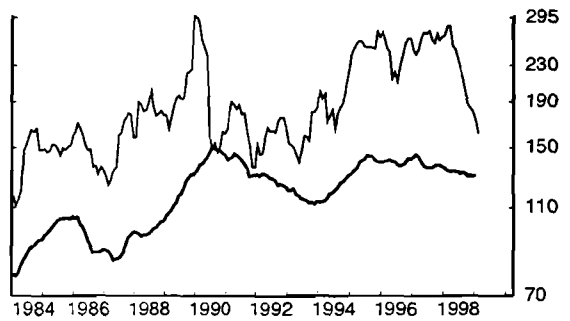
### Other Commercial



### Institutional



### Industrial



Note. Individual sectors include both public and private building.

Outside of the high-tech and transportation sectors, nominal shipments rose 1/2 percent in February but remained below the fourth-quarter average due to the 5 percent drop in January. Across the two months, the weakness in shipments is fairly widespread and is particularly noticeable within the industrial machinery category.

**Nonresidential structures.** Spending on nonresidential construction got off to a slow start in January, with nominal outlays for private nonresidential buildings declining 1.1 percent. Industrial construction continued to fall, consistent with the relatively low rate of capacity utilization in manufacturing industries. Non-office commercial building turned down after having risen at an annual rate of 3-3/4 percent last quarter, and institutional construction also declined. However, the uptrend in the construction of office buildings--where outlays rose considerably in 1998--continued into January, and the building of lodging facilities increased. Contracts for private nonresidential construction, a precursor of construction spending, declined 21 percent over the first two months of the year, owing to continued weakness in industrial building and a decline in contracts for construction of stores and warehouses. Overall, contracts have been trending down for more than a year, depressed by the weakness in industrial buildings.

### **Business Inventories**

The book-value of business inventories excluding motor vehicles was little changed in January, down from the \$6.3 billion pace posted in the fourth quarter of 1998. Although readings across industries are mixed, business inventories in the aggregate appear to be at comfortable levels.

Manufacturers' inventories dropped in January as producers of aircraft and parts reduced stocks for the third consecutive month. Excluding aircraft, inventories fell \$1.8 billion in January. Inventories accumulated at producers of food and chemicals. Also, stocks of industrial machinery rose slightly, despite a decline in inventories held by manufacturers of computers and peripheral parts. Producers of electronic and other electrical equipment, especially communication equipment, drew down stocks.

Wholesale inventories excluding motor vehicles were essentially unchanged in January. Large declines occurred at distributors of apparel, farm products, and professional and commercial equipment, a grouping which includes office and computing equipment. In contrast, machinery wholesalers found themselves with sharply higher holdings, raising an already high inventory-sales ratio. And in the aggregate, wholesale inventory-sales ratios (excluding motor vehicles) have been elevated since last summer.

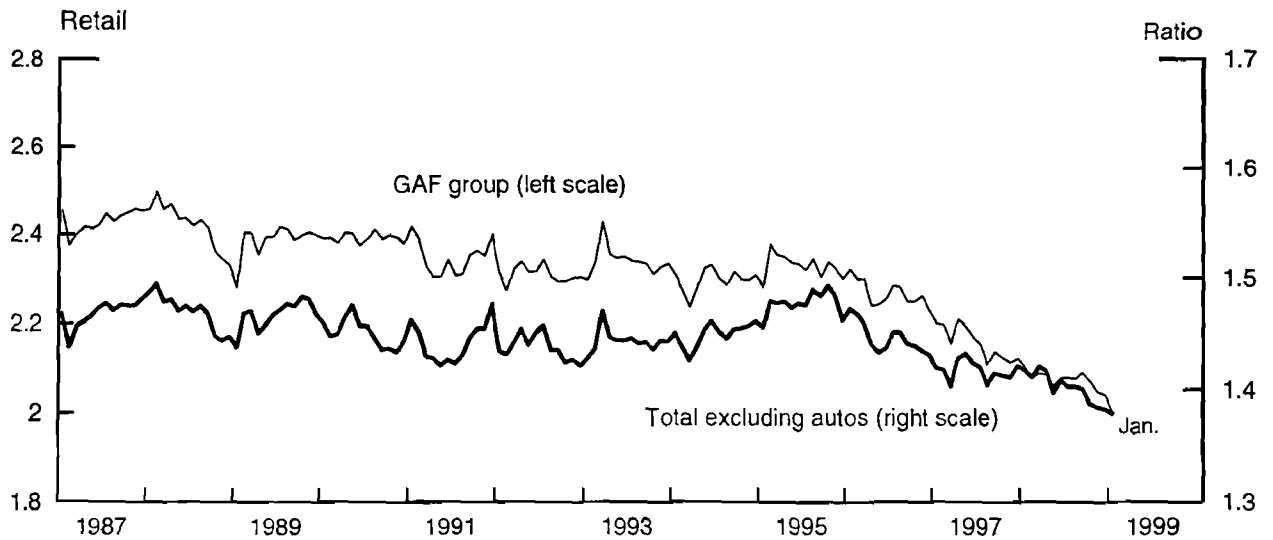
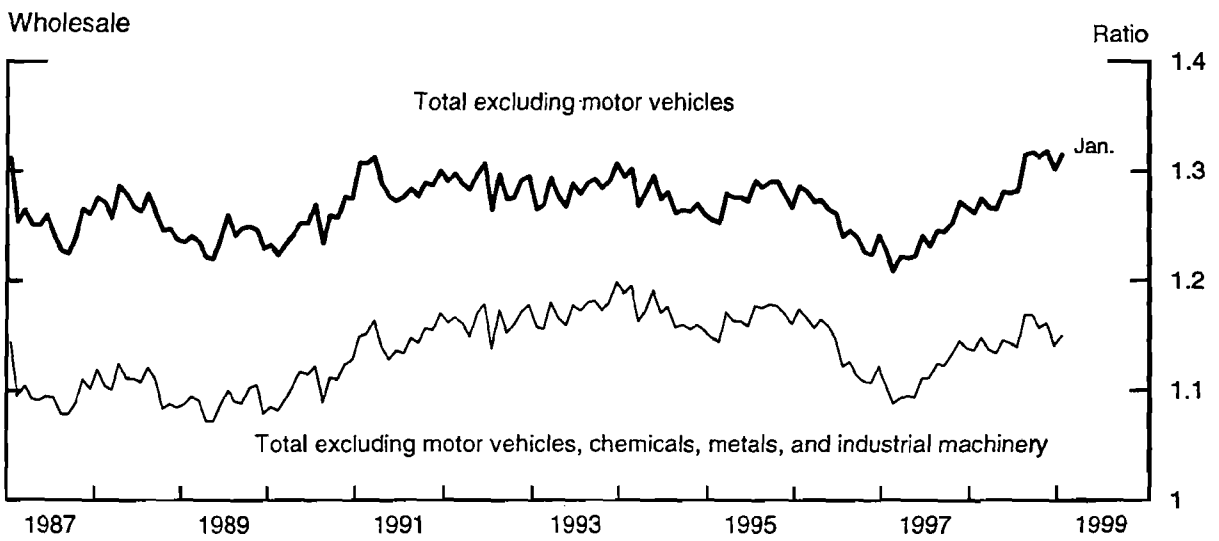
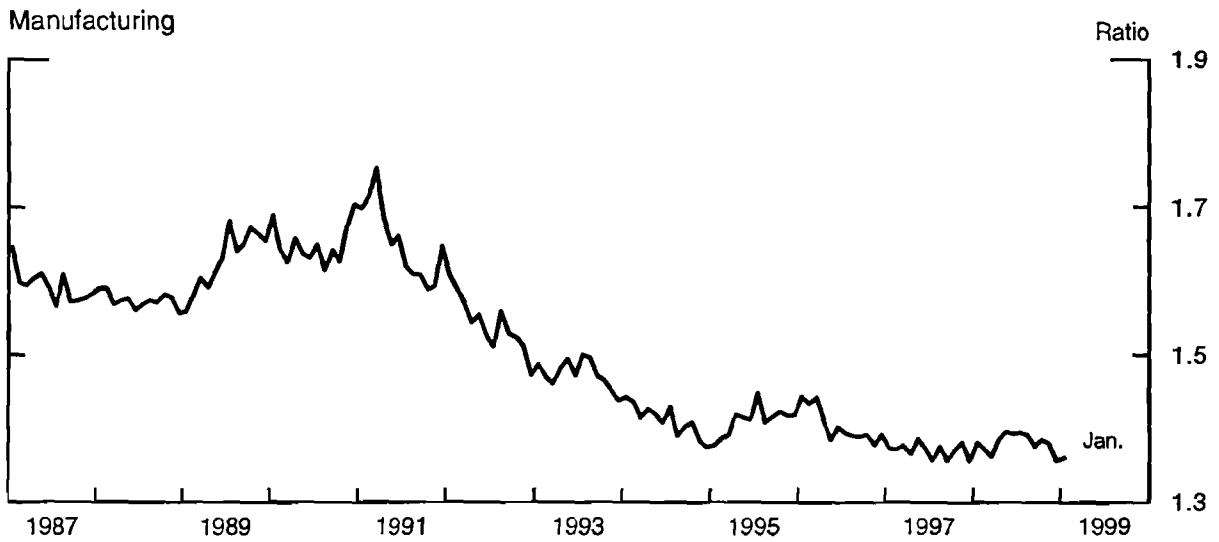
CHANGES IN MANUFACTURING AND TRADE INVENTORIES  
(Billions of dollars; annual rate except as noted;  
based on seasonally adjusted Census book value)

Category	1998			1998		1999
	Q2	Q3	Q4	Nov.	Dec.	Jan.
Manufacturing and trade	7.0	41.4	26.2	55.2	-6.6	1.3
Less wholesale and retail motor vehicles	35.0	33.8	6.3	37.7	-31.2	.5
Manufacturing	19.0	7.4	-7.0	-.4	-50.4	-22.0
Less aircraft	6.9	1.3	-3.9	11.7	-39.3	-1.8
Merchant wholesalers	-.4	26.4	11.3	23.3	15.0	-8.4
Less motor vehicles	10.9	24.5	6.3	25.7	2.5	-1.4
Retail trade	-11.5	7.6	21.9	32.3	28.8	31.7
Automotive dealers	-16.6	5.7	14.9	20.0	12.1	7.8
Less automotive dealers	5.0	1.8	6.9	12.4	16.8	23.8

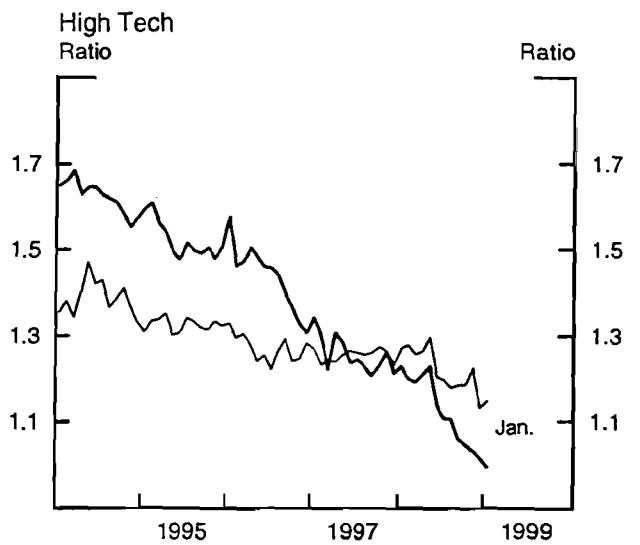
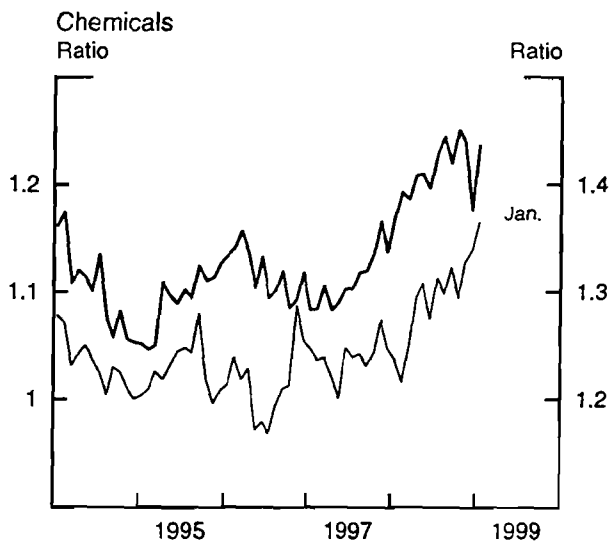
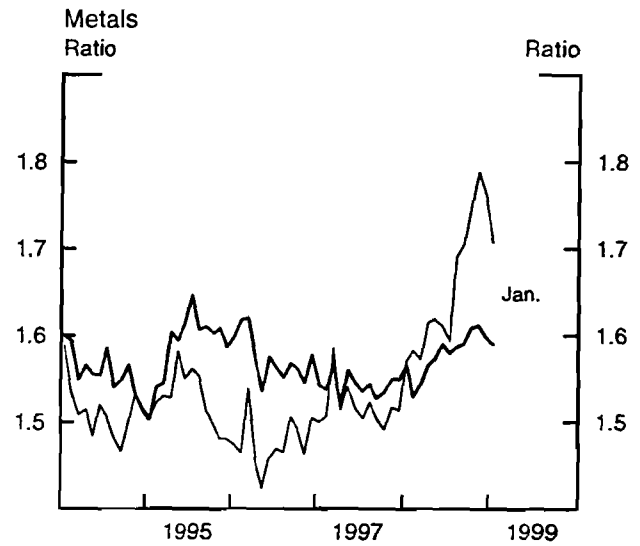
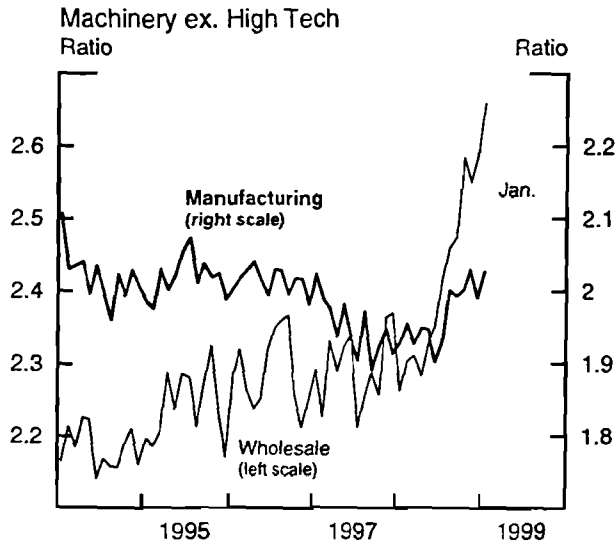
SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE  
(Months' supply, based on seasonally adjusted Census book value)

Category	Cyclical reference points		Range over preceding 12 months		January 1999
	1990-91	1995-96	High	Low	
	high	low			
Manufacturing and trade	1.58	1.38	1.39	1.37	1.37
Less wholesale and retail motor vehicles	1.55	1.35	1.37	1.35	1.35
Manufacturing	1.75	1.38	1.40	1.36	1.36
Primary metals	2.08	1.49	1.74	1.54	1.71
Steel	2.56	1.69	2.25	1.81	2.21
Nonelectrical machinery	2.48	1.77	1.69	1.61	1.66
Electrical machinery	2.08	1.41	1.39	1.21	1.20
Transportation equipment	2.93	1.51	1.85	1.57	1.56
Motor vehicles	.97	.56	.64	.53	.54
Aircraft	5.84	4.44	4.97	4.05	4.16
Nondefense capital goods	3.09	2.27	2.21	2.04	2.07
Textiles	1.71	1.42	1.59	1.40	1.53
Paper	1.32	1.06	1.23	1.16	1.20
Chemicals	1.44	1.25	1.45	1.37	1.44
Petroleum	.94	.80	.99	.87	.94
Home goods & apparel	1.96	1.63	1.75	1.61	1.61
Merchant wholesalers	1.36	1.26	1.33	1.29	1.33
Less motor vehicles	1.31	1.22	1.32	1.26	1.31
Durable goods	1.83	1.55	1.66	1.59	1.65
Nondurable goods	.95	.91	.99	.94	.97
Retail trade	1.61	1.50	1.49	1.44	1.44
Less automotive dealers	1.48	1.43	1.42	1.38	1.38
Automotive dealers	2.22	1.69	1.70	1.56	1.60
General merchandise	2.42	2.20	2.09	1.98	1.92
Apparel	2.53	2.27	2.54	2.35	2.38
GAF	2.42	2.23	2.11	2.04	2.00

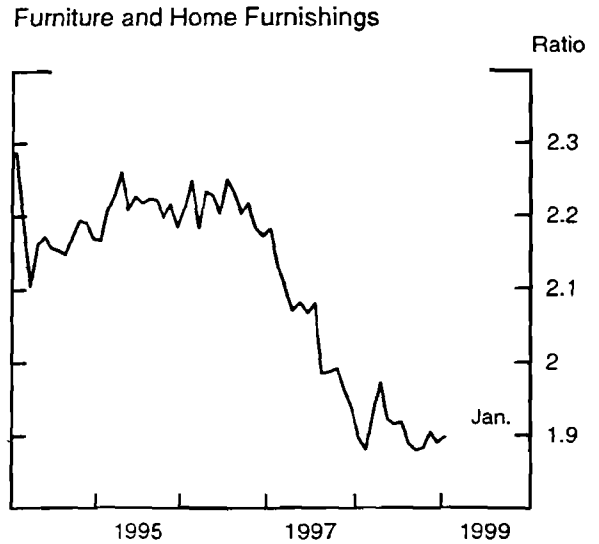
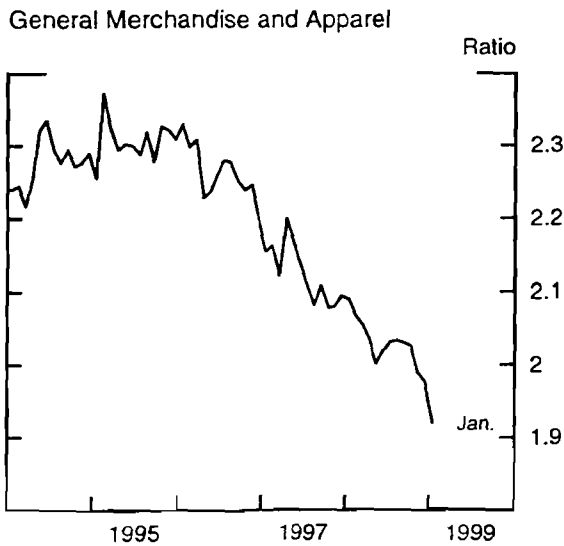
### Inventory-Sales Ratios, by Major Sector (Book value)



### Inventory-Sales Ratios Manufacturing and Wholesale



### Retail Trade





In both the manufacturing and wholesale sectors, inventory-sales ratios have run up in the machinery (excluding high tech), metals, and chemicals components. Although production has declined sharply in these sectors, the reductions have not kept pace with falling shipments; some of the weakness undoubtedly reflects sluggish demand from abroad. Compared with manufacturing, the overhangs are more pronounced in the wholesale trade sector--where a flood of imports most likely has contributed to stockbuilding--and thus show through more dramatically in the aggregate wholesale inventory-sales ratio. Indeed, excluding motor vehicles, machinery, metals, and chemicals, wholesale inventory-sales ratios have retraced much of last summer's rise.

Notable developments also have occurred in high-tech categories, where inventory-sales ratios have fallen appreciably since early 1998.<sup>6</sup> The decline in inventories relative to sales at high-tech businesses may reflect the large incentives to increase turnover in industries characterized by rapidly changing technology and falling prices. To this end, PC computer makers have moved increasingly toward building to order and selling directly to households and businesses.

In retail trade, which is less affected by weak demand from the external sector, inventories seem in good shape. Stocks at non-auto retailers rose at an annual rate of \$24 billion in January, reflecting increases in nearly every major category. However, this high level of stockbuilding took place against the backdrop of a huge increase in retail sales. Spending was particularly strong at general merchandisers and apparel outlets, and inventory-sales ratios in these two categories fell sharply further. The stock-to-sales ratio also remained low in the furniture and home furnishings sector, which includes consumer electronic and computer stores among many other types of establishments. Overall, the inventory-sales ratio at non-auto retailers in January remained at 1.38 for the third consecutive month, the lowest ratio of this expansion.

### **Government Sector**

According to Monthly Treasury Statements, the federal budget surplus over the twelve months ended February, adjusted for payment timing shifts and excluding deposit insurance and spectrum auction proceeds, was \$76 billion. This figure compares with a \$5 billion deficit in the comparable year-earlier period. As expected, refunds in January and February were substantially

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6. In manufacturing, the high-technology sector depicted on the chart includes computer and office equipment, communications equipment, and electronic components (semiconductors); the high-tech wholesalers are the distributors of professional and commercial equipment.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS  
(Unified basis; billions of dollars)

	January-February			12 months ending in Feb.		
	1998	1999	Percent change	1998	1999	Percent change
<b>Outlays</b>	276.9	243.7	-12.0	1627.1	1659.6	2.0
Deposit insurance	-0.5	-0.3	n.a.	-7.1	-5.3	n.a.
Spectrum auction	-0.6	0.0	n.a.	-8.1	-2.2	n.a.
Sale of major assets	0.0	0.0	n.a.	0.0	-3.2	n.a.
Other	278.1	244.0	-12.2	1642.3	1670.4	1.7
<b>Receipts</b>	260.6	271.1	4.1	1638.9	1758.3	7.3
<b>Surplus</b>	-16.4	27.5	n.a.	11.8	98.6	n.a.
Outlays excluding deposit insurance and spectrum auction are adjusted for payment timing shifts <sup>1</sup>						
<b>Outlays</b>	278.1	282.8	1.7	1643.9	1682.2	2.3
National defense	41.4	42.5	2.6	271.5	270.6	-0.3
Net interest	40.5	38.0	-6.1	245.3	236.8	-3.5
Social security	62.5	64.7	3.4	371.2	384.5	3.6
Medicare	31.2	29.9	-4.3	194.6	192.1	-1.3
Medicaid	16.2	17.4	7.8	98.0	103.3	5.3
Other health	4.7	4.7	-1.4	28.3	30.8	9.0
Income security	48.3	49.5	2.4	232.6	236.0	1.5
Other	33.2	36.2	9.1	202.4	228.1	12.7
<b>Receipts</b>	260.6	271.1	4.1	1638.9	1758.3	7.3
Individual income and payroll taxes	229.4	239.3	4.3	1285.5	1394.5	8.5
Withheld + FICA	196.6	208.5	6.1	1092.8	1180.8	8.0
Nonwithheld + SECA	48.6	51.0	4.9	286.6	318.1	11.0
Refunds (-)	15.8	20.2	27.8	93.9	104.4	11.2
Corporate	5.2	6.3	20.4	189.5	186.1	-1.8
Gross	10.5	10.8	3.2	211.3	213.9	1.2
Refunds (-)	5.3	4.5	-13.9	21.8	27.7	27.4
Other	25.9	25.5	-1.5	163.8	177.6	8.4
<b>Surplus</b>	-17.5	-11.7	n.a.	-5.0	76.1	n.a.

Note. Components may not sum to totals because of rounding.

1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first three days of a month are nonworking days. Outlays for defense, social security, Medicare, income security, and "other" have been adjusted to account for these shifts.

n.a.--Not applicable

## Administration Budget Projections and Economic Assumptions

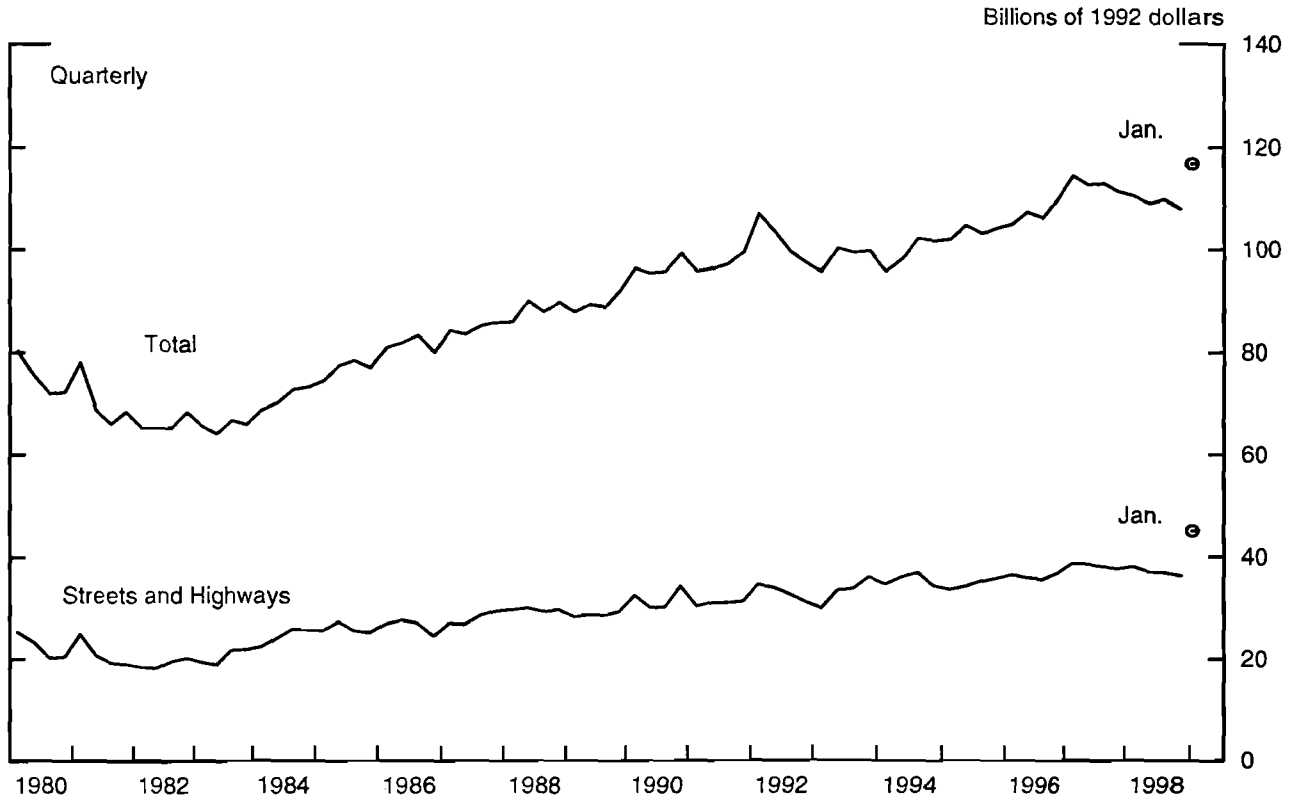
Measure	1999	2000	2001	2002	2003	2004	Total, 2000-04
<b>BUDGET PROJECTIONS (FISCAL YEARS)</b>	Billions of dollars						
<i>Baseline</i> <sup>1</sup>							
Receipts	1,807	1,872	1,925	1,998	2,066	2,157	10,018
Outlays	1,727	1,755	1,791	1,811	1,884	1,950	9,191
Surplus	80	117	134	187	182	208	828
<i>Policy proposals</i>							
Universal savings account	0	-14	-16	-22	-21	-24	-96
Defense and other priorities	0	0	-26	-41	-37	-34	-138
Debt service	0	0	-2	-4	-8	-11	-24
Surplus	79	103	90	120	117	139	569
<b>MEMO</b>							
CBO baseline surplus <sup>1</sup>	111	133	156	212	213	239	952
<b>ECONOMIC ASSUMPTIONS (CALENDAR YEARS)</b>	Percent change, Q4 to Q4						
Nominal GDP	4.0	4.2	4.1	4.5	4.5	4.5	...
Real GDP	2.0	2.0	2.0	2.4	2.4	2.4	...
CPI-U	2.3	2.3	2.3	2.3	2.3	2.3	...
	Percent, annual average						
Unemployment	4.8	5.0	5.3	5.3	5.3	5.3	...
Yield on selected Treasuries							
3-month	4.2	4.3	4.3	4.4	4.4	4.4	...
10-year	4.9	5.0	5.2	5.3	5.4	5.4	...

1. Assumes that (1) discretionary spending will be held at the caps through fiscal 2002 and rise with inflation thereafter and (2) taxes and mandatory spending will evolve according to current law.

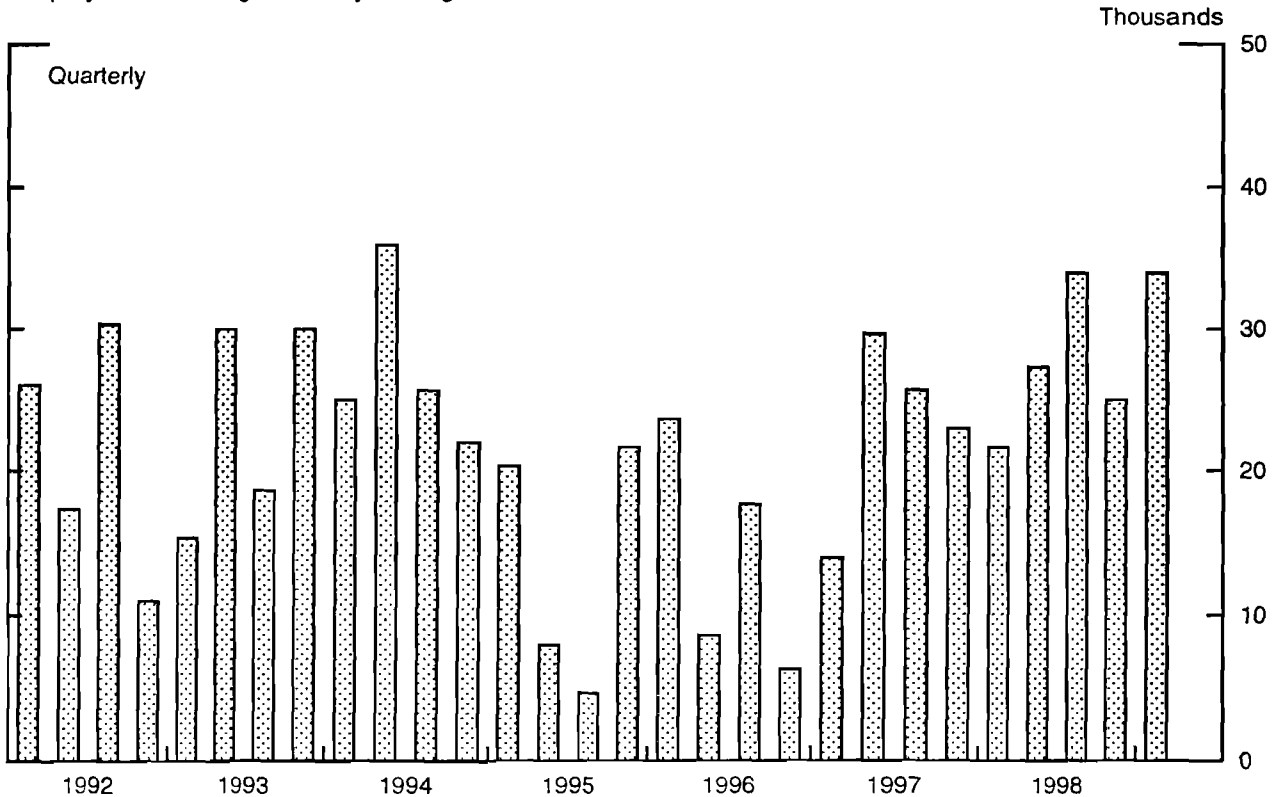
... Not applicable.

## Indicators of State and Local Spending

Real Construction Put in Place



Employment: Average Monthly Change



Note: 1999 Q1 is the average of January and February.

higher than over the same period last year, reflecting the effects of the child tax credit enacted in 1997 and the ongoing shift toward earlier filing. Even excluding refund payments, the increase in tax revenues appears to be moderating from the spectacular pace of the past few years. At the same time, outlays are still increasing slowly. Defense spending over the year ended February was about the same in nominal terms as over the previous year, and Medicare expenditures have remained subdued. In addition, net interest expenditures continued to fall over the past twelve months.

Based in part on the data in the Monthly Treasury Statements, it appears likely that real federal consumption and investment expenditures will decline somewhat in the first quarter. The decrease likely will be concentrated in the defense area.

On February 1, President Clinton submitted his fiscal 2000 budget to the Congress. According to the Administration, if current policies were to remain in place, the unified budget would show a surplus of \$117 billion in fiscal 2000 and a cumulative total of \$828 billion between fiscal 2000 and 2004. The Administration's projections also suggest that, as a percent of GDP, the baseline surplus would rise from a bit less than 1 percent this year to 3-1/2 percent in fiscal 2014.

The President's plan contains a number of spending and revenue initiatives and a sizable transfer of monies from the on-budget accounts to the social security trust fund. Over the 2000-04 period, the Administration's proposals would reduce the cumulative surplus by \$259 billion.

The CBO's preliminary analysis of the President's budget, which was released on March 3, shows unified surpluses (excluding proposals contingent on social security reform) through fiscal 2004 that are slightly higher than the OMB's. The CBO's more favorable outlook for the budget under current policies more than accounts for the difference.<sup>7</sup> The CBO has edged up its own projection for the baseline surplus since January, mainly because of incoming data reporting low outlays for Medicare. The CBO's baseline projection now shows baseline surpluses of \$111 billion in fiscal 1999 and \$133 billion in fiscal 2000.

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7. The CBO's analysis includes its own estimates of the budgetary effects of the President's "basic" policy proposals--that is, those that are *not* contingent on social security reform. Because the Administration provided little detail on the proposals that are contingent on social security reform (including additional discretionary spending and funding for Universal Savings Accounts), the CBO simply assumes the amounts specified in the budget.

CPI AND PPI INFLATION RATES  
(Percent change)

	From twelve months earlier		1998		1999	
	Feb. 1998	Feb. 1999	Q3	Q4	Jan.	Feb.
			-Annual rate-		-Monthly rate-	
<u>CPI</u>						
All items (100.0) <sup>1</sup>	1.4	1.6	1.7	2.0	.1	.1
Food (15.4)	1.9	2.4	2.7	2.9	.5	.1
Energy (6.3)	-8.8	-5.7	-6.4	-6.2	-.2	.0
CPI less food and energy (78.3)	2.3	2.1	2.3	2.3	.1	.1
Commodities (24.0)	.4	.7	1.1	1.0	.0	-.4
New vehicles (5.0)	-.7	-.4	1.4	-.9	.1	-.3
Used cars and trucks (1.9)	-3.9	-.1	4.7	5.2	-1.6	-1.5
Apparel (4.8)	.0	-1.7	1.2	-1.3	-1.1	-.2
Tobacco (1.2)	10.0	33.5	17.3	34.3	6.6	-1.4
Other Commodities (11.1)	.4	-.3	-.9	-.4	.1	-.3
Services (54.3)	3.1	2.8	2.7	2.8	.2	.2
Shelter (29.9)	3.2	3.0	3.2	3.8	.0	.1
Medical care (4.5)	3.0	3.4	3.6	2.8	.4	.3
Other Services (19.9)	3.2	2.3	1.7	1.4	.3	.3
<u>PPI</u>						
Finished goods (100.0) <sup>2</sup>	-1.5	.5	-.1	1.1	.5	-.4
Finished consumer foods (23.3)	-.1	.2	.7	.6	1.6	-1.4
Finished energy (11.9)	-10.9	-7.0	-7.4	-6.5	1.8	-1.0
Finished goods less food and energy (64.8)	.1	2.2	1.1	2.7	-.1	.0
Consumer goods (39.6)	.6	3.8	2.0	4.1	-.1	-.1
Capital equipment (25.2)	-.7	.0	-.2	.9	-.1	.1
Intermediate materials (100.0) <sup>3</sup>	-1.8	-2.7	-2.2	-3.2	.1	-.5
Intermediate materials less food and energy (83.2)	.0	-1.7	-1.5	-2.7	-.2	-.2
Crude materials (100.0) <sup>4</sup>	-13.8	-12.2	-19.4	-8.1	2.6	-3.4
Crude food materials (42.2)	-5.3	-6.0	-17.3	1.7	5.1	-2.8
Crude energy (31.9)	-26.8	-19.4	-25.0	-9.0	.6	-7.4
Crude materials less food and energy (25.9)	-5.2	-13.3	-14.8	-24.2	.2	1.1

1. Relative importance weight for CPI, December 1998.

2. Relative importance weight for PPI, December 1998.

3. Relative importance weight for intermediate materials, December 1998.

4. Relative importance weight for crude materials, December 1998.

Spending by state and local governments appears to have accelerated in early 1999. In particular, real construction outlays--which are volatile on a monthly basis--surged in January to a level about 8 percent above the average for the fourth quarter. The increase in construction outlays was concentrated in the highway and bridges category. More generally, hiring by state and local governments also appears to have picked up of late: On average, employment rose 34,000 per month between December and February, compared with an increase of 27,000 per month, on average, over 1998 as a whole.

### **Prices**

The good news continues on the inflation front: Both the overall and core indexes increased just 0.1 percent per month in January and February. Over the past twelve months, the overall index was up just 1.6 percent. Excluding food and energy, the CPI increased 2.1 percent over the year ended in February, down 0.2 percentage point from the previous twelve months. However, measured on a consistent basis, there was no deceleration in core CPI.<sup>8</sup> Of course, the late-year surge in tobacco prices pushed up the core index; excluding those increases as well, core prices would have decelerated more last year on a published basis, and they would also have decelerated on a consistently measured basis.

With the release of the January CPI data, the BLS implemented a number of additional technical changes. A geometric-mean weighting formula was introduced to aggregate individual price quotes at the finest level of published data. BLS estimates that, going forward, the adoption of geometric weighting in categories that make up about 60 percent of the index will reduce the annual increase in the CPI for all of 1999 about 0.2 percentage point. Other changes include a new housing sample; a new estimation method for owners' equivalent rent; hedonic adjustment of television prices; and the treatment of costs associated with mandated pollution control measures as price increases rather than quality improvements.

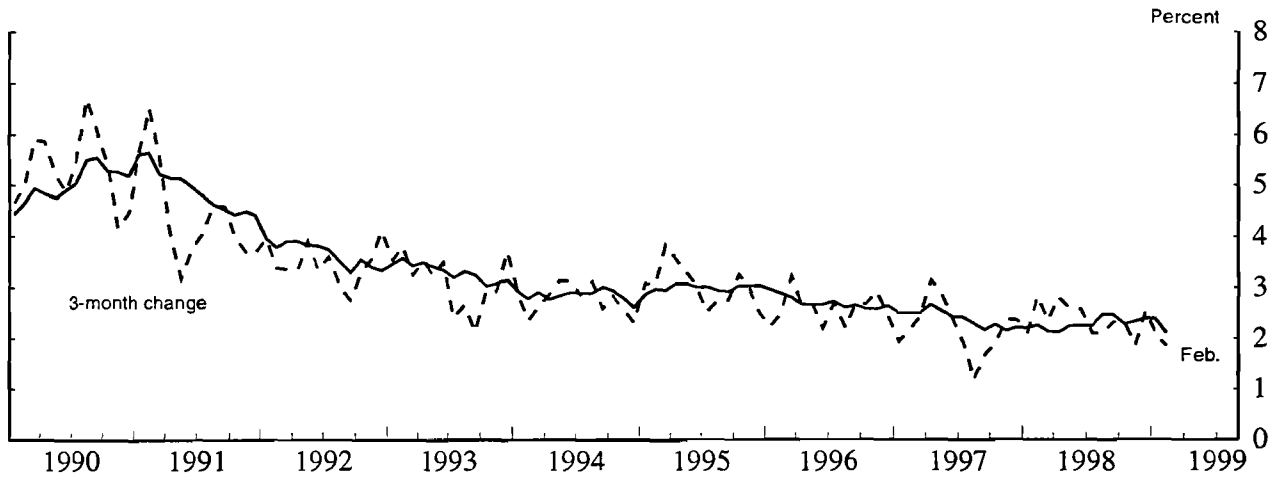
Turning to the details, the CPI for food edged up 0.1 percent in February following January's 0.5 percent increase. Over the twelve months ended in February, retail food prices increased 2.4 percent, up 1/2 percentage point from the previous twelve months. The acceleration in retail grocery prices this past year seems to largely reflect a swing in prices received by farmers for livestock products; these prices fell about 4 percent over the twelve

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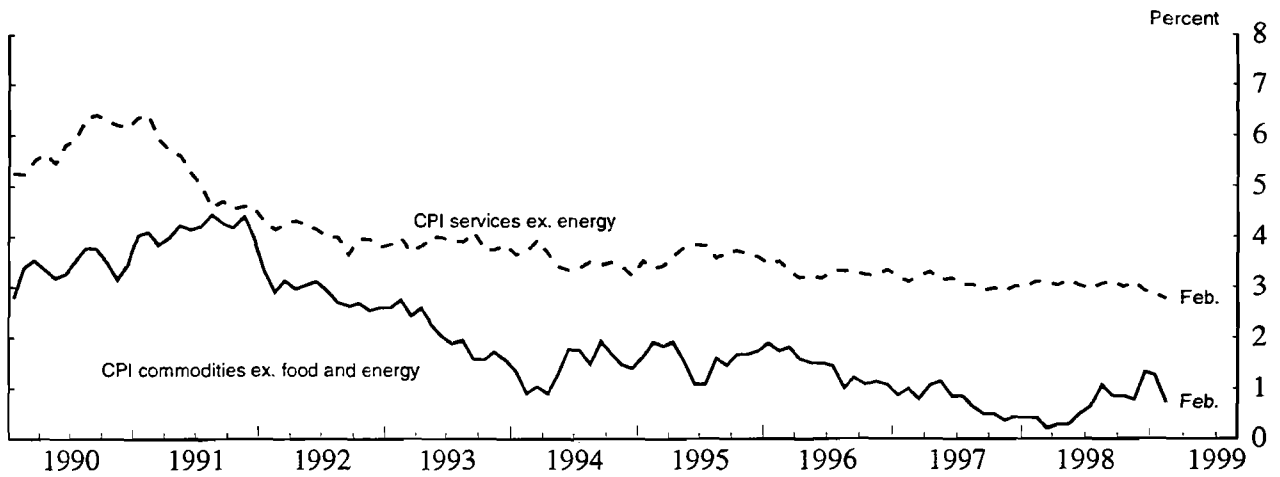
8. The technical changes introduced in January 1998--updating the base period and adding hedonics for computer prices--and those introduced in January of this year held down the change in the core CPI over the twelve months ended February of this year by about 1/4 percentage point compared with the increase over the twelve months ended in February 1998.

## Measures of Core Consumer Price Inflation (Twelve-month change except as noted)

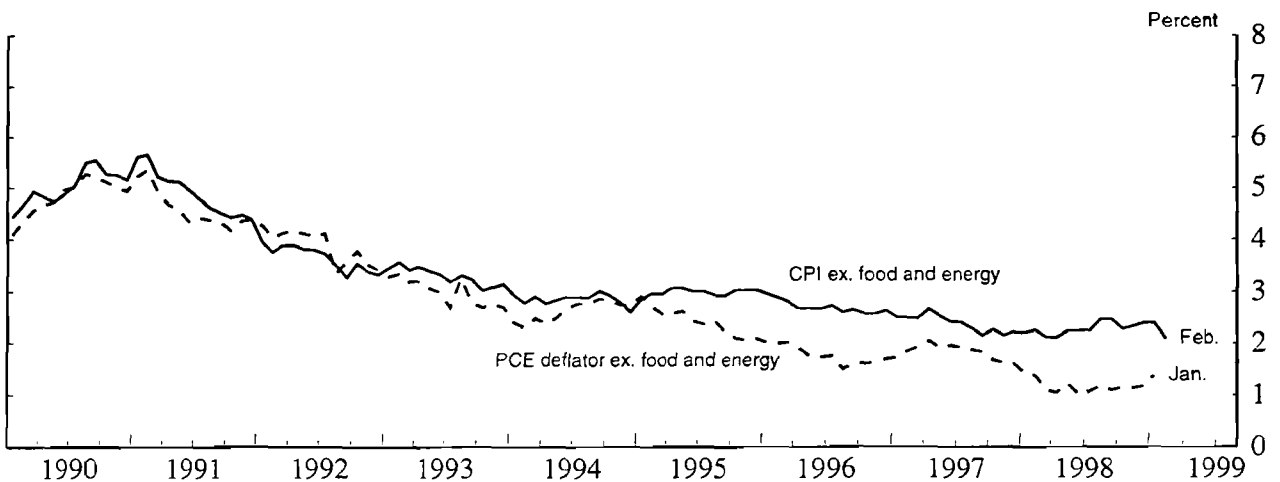
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE





months ended in February 1998 but have risen about 1 percent this past year, mainly because of higher dairy prices. That turnabout for livestock prices resulted in a slower rate of decline this past year in the farm portion of total value added for domestically produced foods--even though crop prices fell much faster than in the previous year. Meanwhile, the farm-to-retail margin, which now accounts for almost 80 percent of total value added in the food industry, continued to expand this past year, at a pace that easily offset the further decline in the overall farm contribution to retail grocery prices.

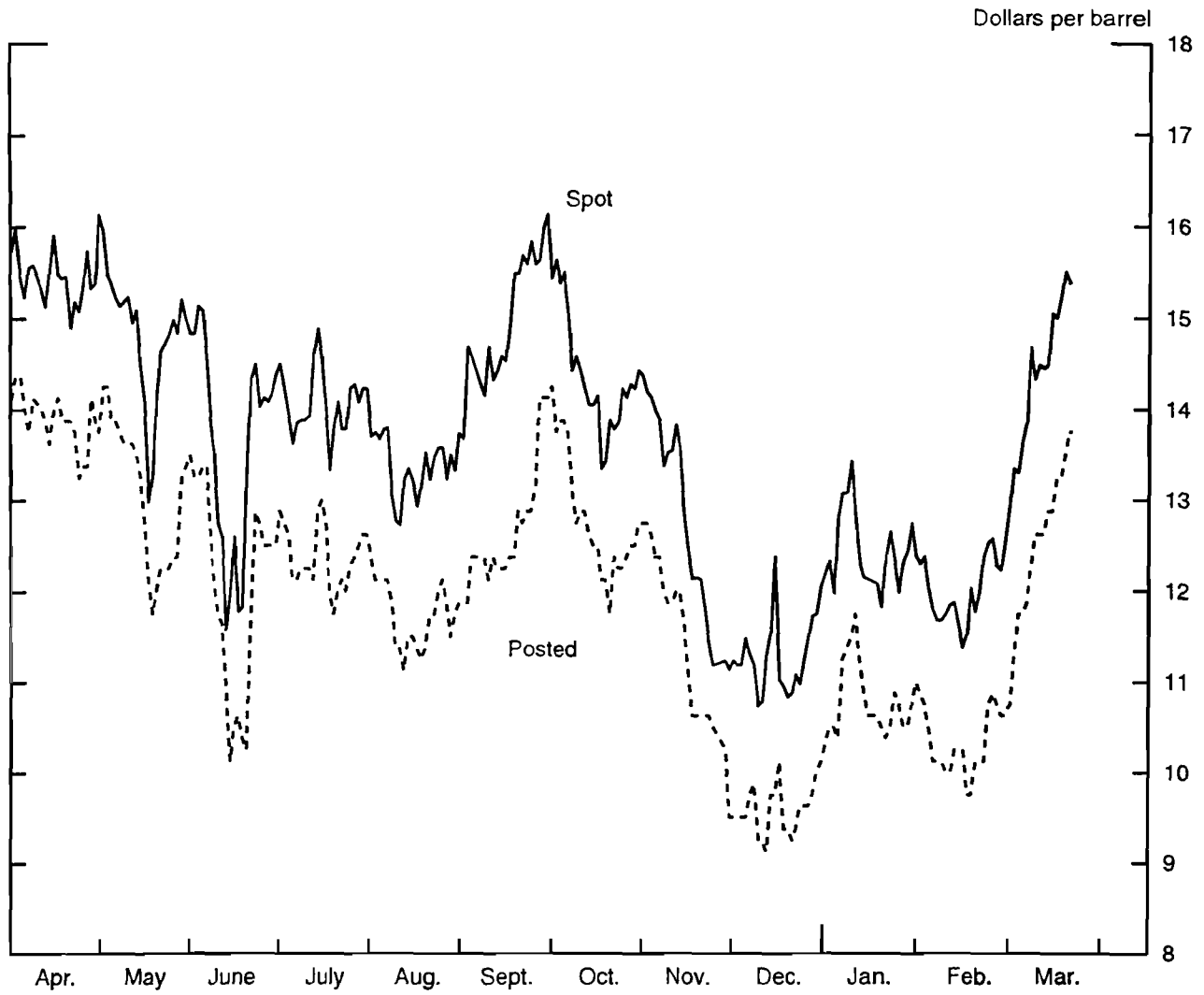
Energy prices were flat in February after having edged down 0.2 percent in January. An increase in electricity prices in February offset further declines in gasoline and heating oil prices. Looking ahead, recent data from the Lundberg survey suggest that retail prices of gasoline have moved up from February's bargain basement levels. Higher crude costs likely will continue putting upward pressure on gasoline prices. (See the International Developments section for an update on recent developments in oil markets.)

The CPI for commodities other than food and energy dropped sharply in February after having been flat in January. Prices of both durable and nondurable goods fell last month. Over the twelve months ended February, commodity prices excluding food and energy rose 0.7 percent, up from the 0.4 percent rate in the previous twelve months. The 26 percent surge in the index for tobacco from November to January more than explains this recent acceleration: Excluding tobacco (as well as food and energy), commodity prices in the CPI dropped 0.6 percent in the last year.

Over the twelve months ended in February, prices of services other than energy rose 2.8 percent, down from the 3.1 percent increase in the comparable period ended February 1998. The index for non-energy services rose 0.2 percent in February for the third consecutive month. Following the unusually small rise of 0.1 percent in January, the index for owners' equivalent rent moved up 0.3 percent in February; last month's increase was just about in line with the average monthly increases in each of the previous two years.

The latest data on capital equipment prices suggest continued softness: The producer price index for capital equipment rose 0.1 percent in February following a 0.1 percent decrease in January. Over the twelve months ended in February, capital equipment prices were about unchanged after having fallen 0.7 percent in the previous twelve-month period. In the first two months of this quarter, the PPI for computers fell at an annual rate of 27 percent, somewhat faster than the 22 percent pace posted in the fourth quarter.

## Daily Spot and Posted Prices of West Texas Intermediate



Note. Posted prices are evaluated as the mean of the range listed in the Wall Street Journal.

### Monthly Average Prices of West Texas Intermediate

Month	Posted	Spot
April	13.90	15.44
May	13.13	14.86
June	12.09	13.66
July	12.36	14.08
August	11.73	13.36
September	12.65	14.95
October	12.81	14.39
November	11.54	12.94
December	9.59	11.28
January	10.81	12.47
February	10.33	12.01
March <sup>1</sup>	12.25	14.14

1. Through March 23, 1999.

## SPOT PRICES OF SELECTED COMMODITIES

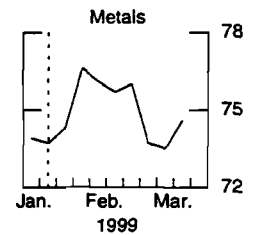
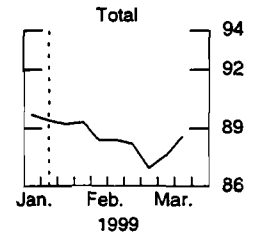
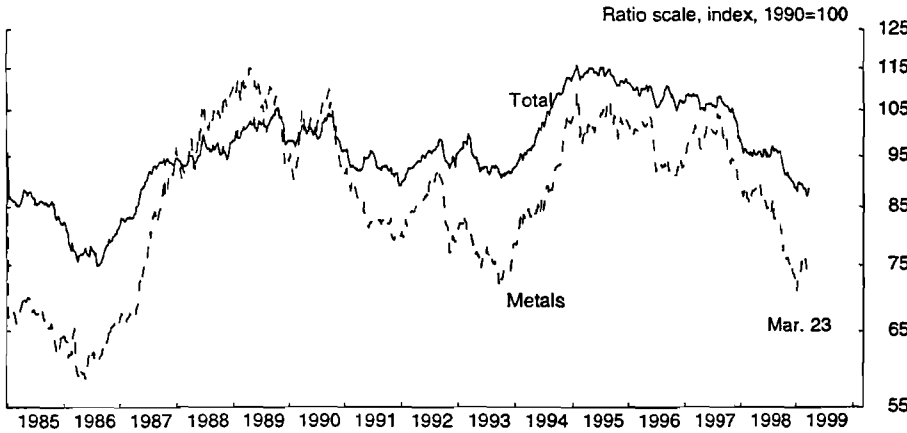
	Current price (\$)	-----Percent change <sup>1</sup> -----				Memo: Year earlier to date
		1997	1998	Dec. 29 to Jan. 26 <sup>2</sup>	Jan. 26 <sup>2</sup> to Mar. 23	
<b>Metals</b>						
Copper (lb.)	.680	-21.5	-14.8	.0	-1.4	-20.0
Steel scrap (ton)	84.500	19.3	-47.5	17.2	-.8	-32.6
Aluminum, London (lb.)	.570	-1.9	-17.6	-1.6	3.2	-12.2
<b>Precious metals</b>						
Gold (oz.)	284.100	-20.7	-1.1	.1	-1.0	-5.4
Silver (oz.)	5.070	27.2	-18.0	2.6	-1.6	-20.4
<b>Forest products</b>						
Lumber (m. bdft.)	319.000	-26.6	2.7	10.0	-3.3	11.9
Plywood (m. sqft.)	365.000	-1.7	3.3	8.1	9.0	30.4
<b>Petroleum</b>						
Crude oil (barrel)	13.290	-27.4	-36.1	4.6	22.9	-6.5
Gasoline (gal.)	.452	-23.5	-33.5	-3.7	40.6	-3.1
Fuel oil (gal.)	.416	-29.6	-33.6	-3.7	31.7	-5.8
<b>Livestock</b>						
Steers (cwt.)	66.000	4.2	-13.2	5.1	6.5	8.2
Hogs (cwt.)	28.250	-30.8	-55.7	83.9	-.9	-21.5
Broilers (lb.)	.537	-24.4	15.0	3.3	-8.4	-2.2
<b>U.S. farm crops</b>						
Corn (bu.)	2.115	-3.8	-19.4	.7	1.9	-17.1
Wheat (bu.)	2.910	-24.1	-5.7	-6.0	-6.7	-16.4
Soybeans (bu.)	4.720	-3.2	-21.1	-5.5	-6.3	-26.9
Cotton (lb.)	.591	-10.9	-10.2	-4.0	7.3	-12.0
<b>Other foodstuffs</b>						
Coffee (lb.)	1.000	26.1	-31.4	-10.7	-4.3	-36.9
<b>Memo:</b>						
JOC Industrials	88.600	-7.3	-9.8	1.0	-.9	-7.9
JOC Metals	74.600	-4.7	-18.5	1.8	1.2	-15.1
CRB Futures	189.870	-4.9	-17.2	-1.7	1.2	-17.4
CRB Spot	256.480	-7.6	-14.1	-.3	-2.4	-15.7

1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.

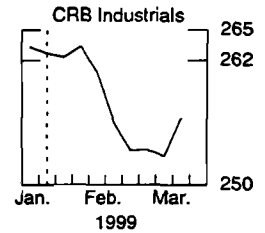
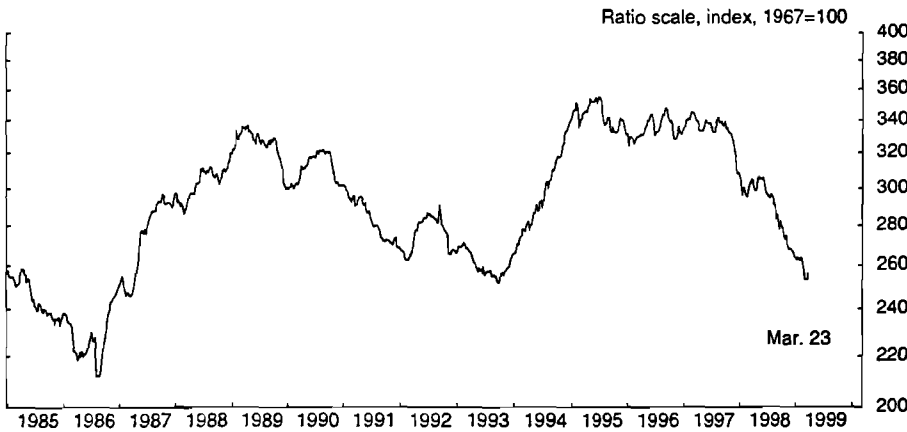
2. Week of the January Greenbook.

## Commodity Price Measures

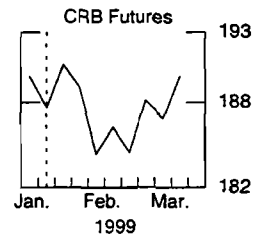
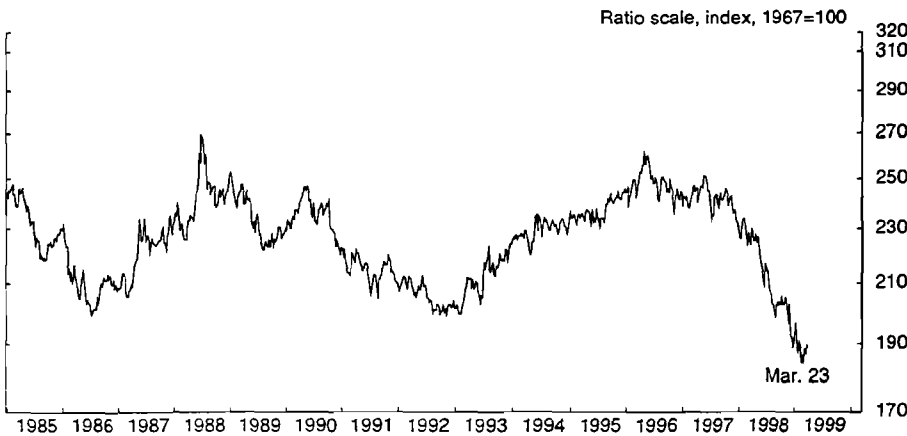
Journal of Commerce Index



CRB Spot Industrials



CRB Futures



Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the CRB spot price index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

The PPI for intermediate materials other than food and energy declined 0.2 percent in February, about the same as the monthly declines since November. In contrast, the PPI for crude materials other than food and energy rose 1.1 percent in February, the first sizable monthly increase in about a year and a half. However, prices of many raw materials have turned down, on balance, since price data for the PPI were collected in mid-February. The CRB index of spot industrial prices has dropped about 2-1/2 percent since mid-February. On the other hand, the price of crude oil--which is not included in the CRB spot index--has moved up sharply in recent weeks.

After having edged lower in the second half of last year, the median measure of one-year-ahead-inflation expectations in the Michigan Survey has moved back up to 2.6 percent in the first quarter, following readings of 2.4 percent in each of the previous two quarters. The survey respondents' views on longer-term inflation expectations have been more stable recently, with the median Michigan five- to ten-year expectations unchanged in the first quarter at 2.8 percent. Also, the ten-year expectations of the Professional Forecasters dropped to 2.3 percent.

### **Labor Costs**

Average hourly earnings of private production or nonsupervisory workers rose 0.1 percent in February after having increased 0.4 percent in January. Over the twelve months ended in February, average hourly earnings increased 3.6 percent, off noticeably from the mid-1998 peak in this series of 4.4 percent. Outside of the services industry, the recent deceleration in average hourly earnings has been widespread.

Looking back to the fourth quarter, compensation per hour in the nonfarm business sector increased at an annual rate of 3.5 percent in the fourth quarter and 4.0 percent for the year as a whole. The ECI increased somewhat less during 1998, which is not surprising given the greater cyclical sensitivity of compensation per hour. Unit labor costs in the nonfarm business sector dropped 1.1 percent in the fourth quarter--reflecting the surge in productivity--and decelerated considerably over the past year.

BROAD MEASURES OF INFLATION  
(Four-quarter percent change)

	1995 Q4	1996 Q4	1997 Q4	1998 Q4
<u>Product prices</u>				
GDP chain price index	2.1	1.8	1.7	0.9
Nonfarm business chain-type price index <sup>1</sup>	1.4	1.6	1.7	0.3
<u>Expenditure prices</u>				
Gross domestic purchases chain-type price index	2.0	1.8	1.3	0.4
Less food and energy	2.2	1.3	1.4	0.8
PCE chain-type price index	1.9	2.2	1.5	0.7
Less food and energy	2.1	1.6	1.6	1.2
CPI	2.7	3.1	1.9	1.5
Less food and energy	3.1	2.6	2.2	2.4
Median CPI	3.3	2.9	2.9	3.0
Trimmed mean CPI	2.8	2.9	2.2	1.9

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS  
(Percent)

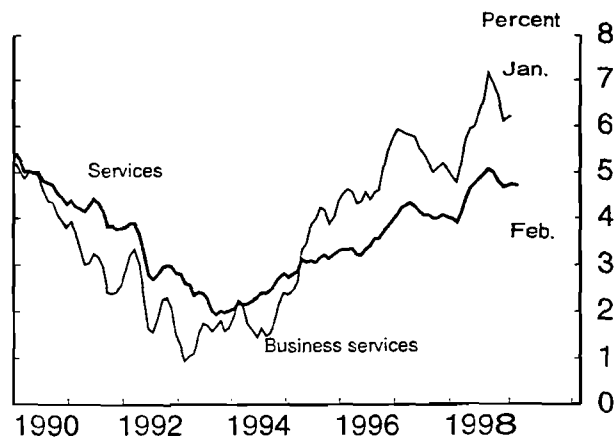
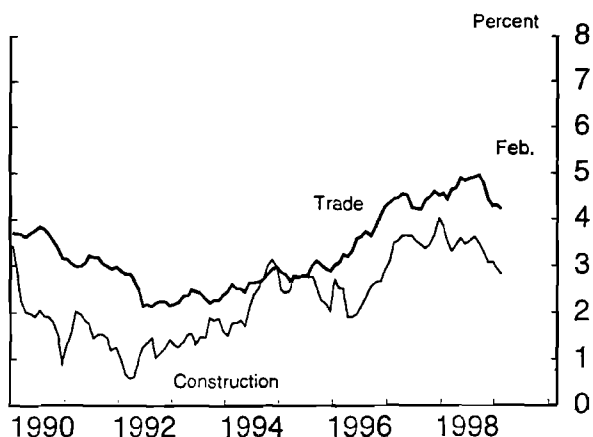
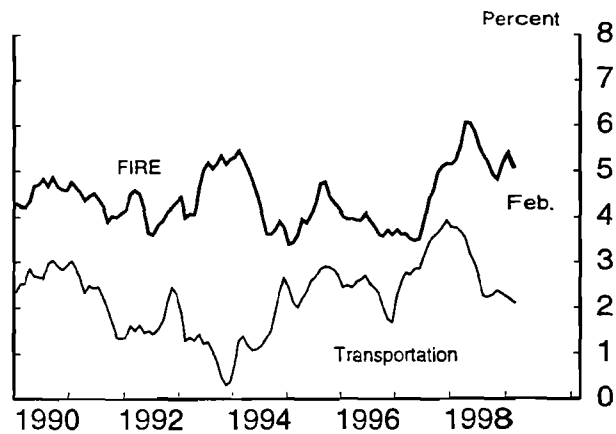
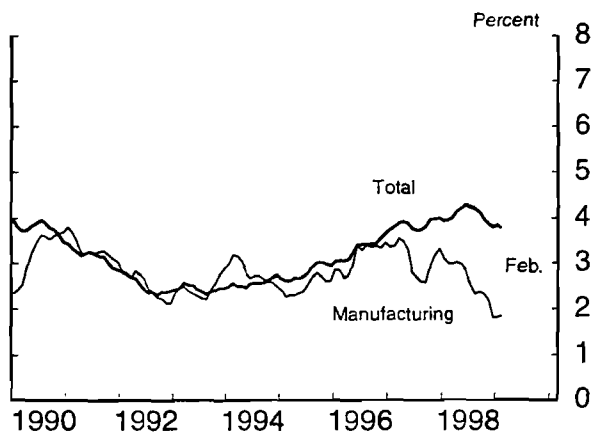
	Actual inflation <sup>1</sup>	University of Michigan (1-year) Mean <sup>2</sup>	Median <sup>3</sup>	University of Michigan (5- to -10-year) Mean <sup>4</sup>	Median <sup>5</sup>	Professional forecasters (10-year) <sup>6</sup>
1997-Q1	2.9	3.8	2.9	3.8	3.1	3.0
Q2	2.3	3.6	2.9	3.8	3.0	2.9
Q3	2.2	3.4	2.7	3.6	3.0	3.0
Q4	1.9	3.3	2.8	3.8	3.1	2.7
1998-Q1	1.5	2.8	2.4	3.3	2.9	2.6
Q2	1.6	3.0	2.6	3.3	2.8	2.5
Q3	1.6	2.8	2.4	3.2	2.8	2.5
Q4	1.5	2.7	2.4	3.2	2.8	2.5
1999-Q1		3.0	2.6	3.3	2.8	2.3
Oct.	1.5	2.6	2.5	3.2	2.8	
Nov.	1.5	2.7	2.3	3.1	2.8	
Dec.	1.6	2.8	2.5	3.2	2.9	2.5
1999-Jan.	1.7	3.0	2.7	3.5	3.0	
Feb.	1.6	2.8	2.5	3.3	2.8	
Mar.		3.1	2.7	3.0	2.7	2.3

1. CPI; percent change from the same period in the preceding year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Average increase for responses to the question: By about what percent per year do you expect prices (CPI) to go up, on the average, during the next 5 to 10 years?
5. Median increase for responses to question above.
6. Compiled by the Federal Reserve Bank of Philadelphia.

**AVERAGE HOURLY EARNINGS**  
(Percentage change; based on seasonally adjusted data)

	Twelve-month percent change			Percent change to Feb. 1999		1999	
	Feb. 1997	Feb. 1998	Feb. 1999	Aug. 1998	Nov. 1998	Jan.	Feb.
	- - - - -Annual rate- - - - -					-Monthly rate-	
Total private nonfarm	4.0	4.0	3.6	3.0	3.1	.4	.1
Manufacturing	3.5	3.1	1.8	2.1	2.4	.4	.1
Construction	3.9	3.2	2.7	1.3	.7	-.5	.3
Transportation and public utilities	2.3	4.0	1.8	2.4	2.1	-.1	.1
Finance, insurance, and real estate	3.2	6.0	4.6	4.4	3.4	.3	.0
Retail trade	4.5	4.8	4.3	3.0	5.1	.6	.0
Wholesale trade	4.5	4.4	3.5	2.0	2.0	.6	-.3
Services	4.1	4.1	4.9	4.2	5.0	.7	.3

**Average Hourly Earnings**  
(3-month moving average of twelve-month change)



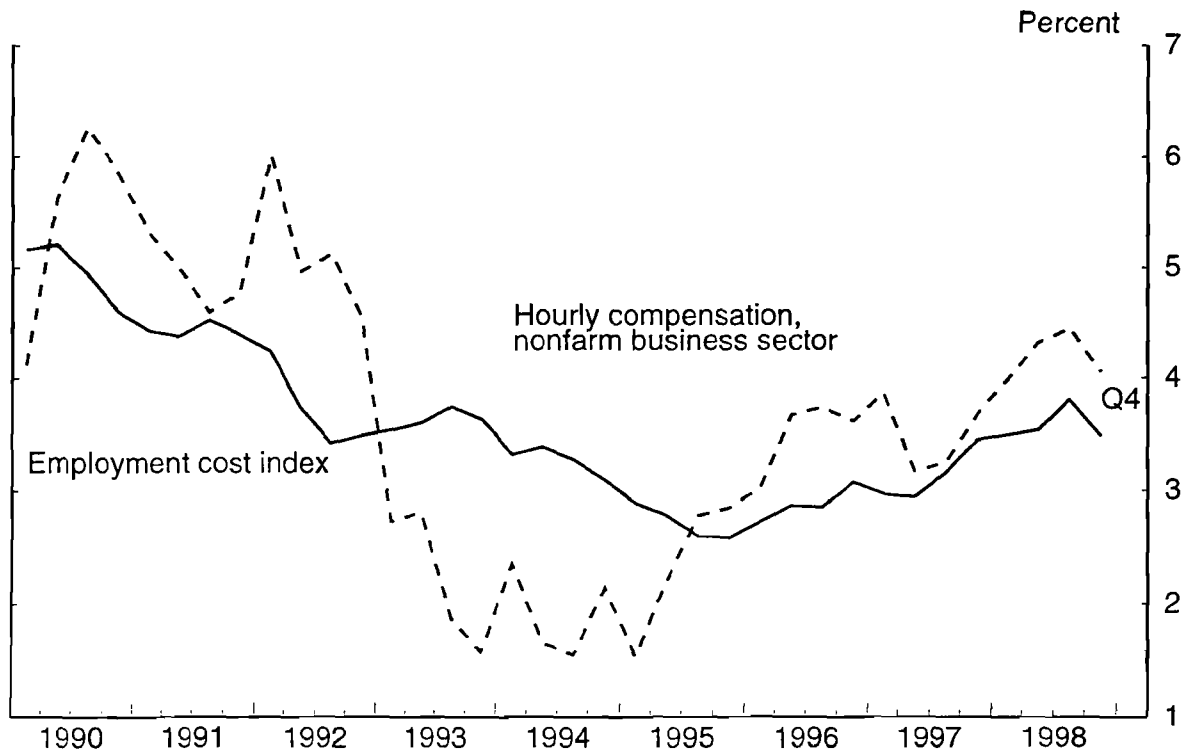
LABOR PRODUCTIVITY AND COSTS<sup>1</sup>  
 (Percent change; annual rate; based on seasonally adjusted data)

	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
<u>Output per hour</u>						
Total business	1.7	2.9	4.1	.1	2.6	4.8
Nonfarm business	1.5	2.7	3.6	.3	2.5	4.6
Manufacturing	5.6	3.8	1.6	3.9	4.7	5.2
Nonfinancial corporations <sup>2</sup>	2.5	n.a.	2.7	3.1	4.4	n.a.
<u>Compensation per hour</u>						
Total business	3.8	4.2	5.0	4.1	3.7	4.0
Nonfarm business	3.7	4.0	4.7	4.1	3.9	3.5
Manufacturing	5.4	3.3	4.0	2.6	3.2	3.3
Nonfinancial corporations <sup>2</sup>	3.8	n.a.	3.6	4.6	4.0	n.a.
<u>Unit labor costs</u>						
Total business	2.0	1.2	.8	4.0	1.0	-.8
Nonfarm business	2.1	1.3	1.1	3.7	1.4	-1.1
Manufacturing	-.1	-.6	2.4	-1.3	-1.5	-1.8
Nonfinancial corporations <sup>2</sup>	1.2	n.a.	.9	1.5	-.3	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

Measures of Compensation per Hour  
 (Four-quarter change)





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**DOMESTIC FINANCIAL  
DEVELOPMENTS**

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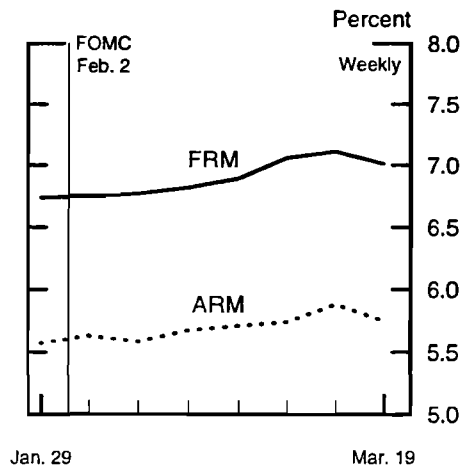
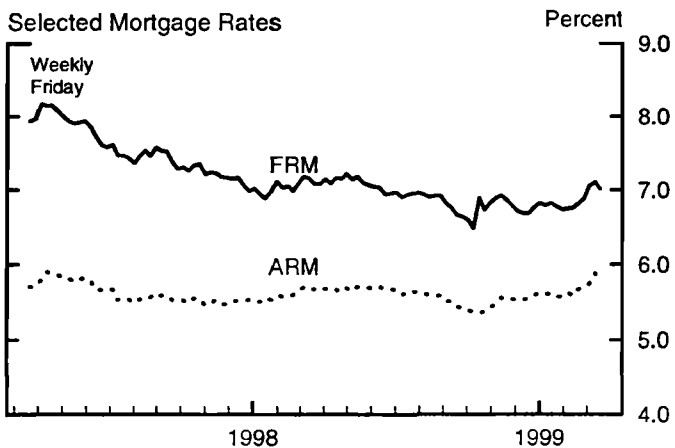
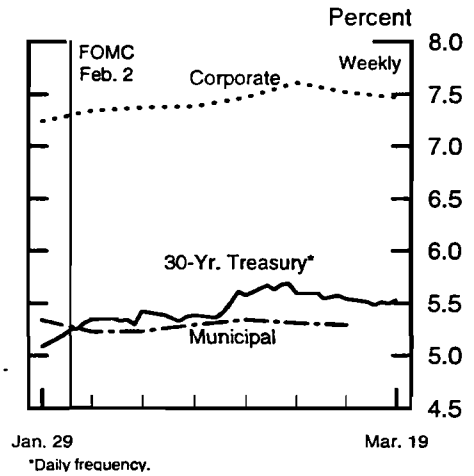
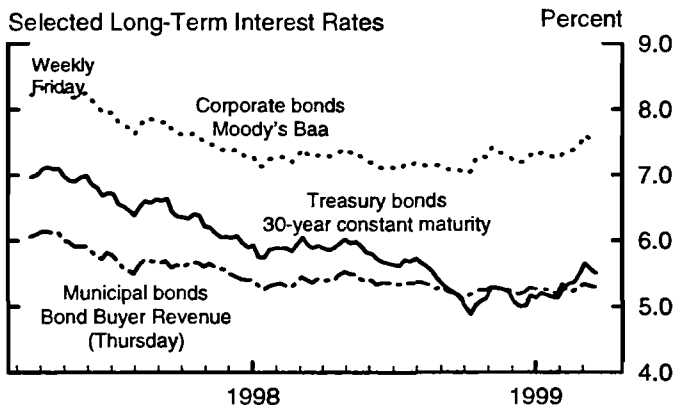
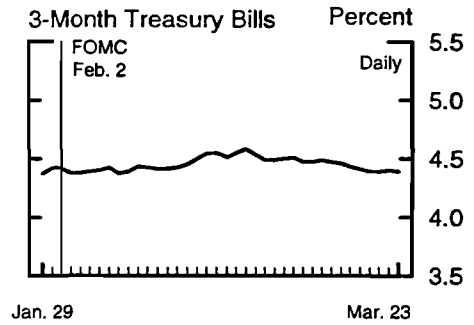
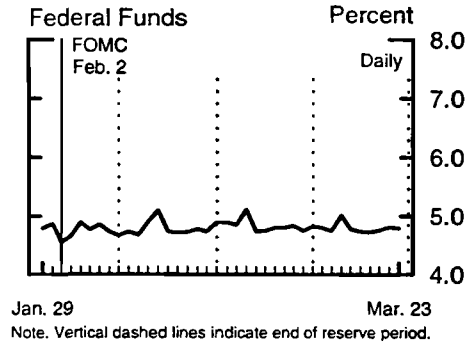
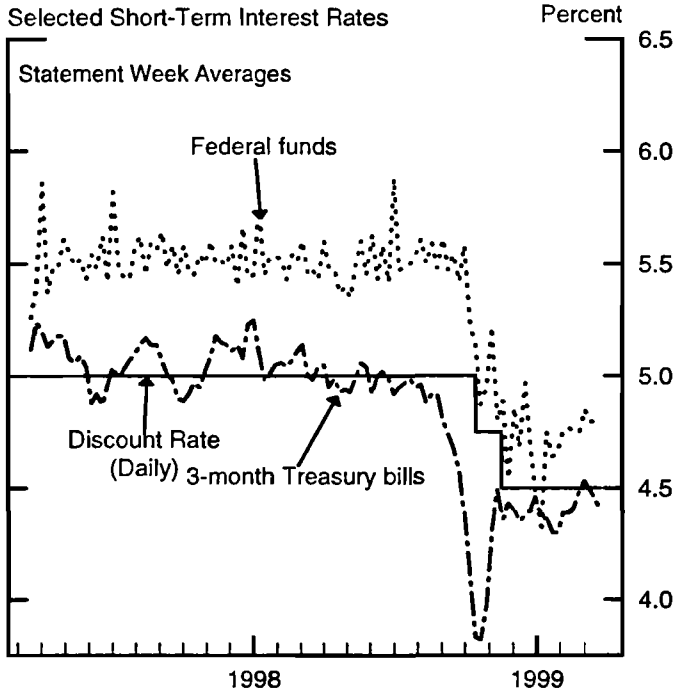
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**Selected Financial Market Quotations**  
(One-day quotes in percent except as noted)

Instrument	1998		1999		Change to Mar. 23 from selected dates (percentage points)		
	Oct. 15	Dec. 31	FOMC* Feb. 3	Mar. 23	Oct. 15	Dec. 31	FOMC* Feb. 3
<i>Short-term</i>							
<i>Federal funds</i>							
FOMC intended rate	5.00	4.75	4.75	4.75	-.25	.00	.00
Realized rate <sup>1</sup>	5.40	4.58	4.65	4.78	-.62	.20	.13
<i>Treasury bills <sup>2</sup></i>							
3-month	4.05	4.37	4.42	4.39	.34	.02	-.03
6-month	4.12	4.39	4.41	4.42	.30	.03	.01
1-year	4.06	4.33	4.38	4.49	.43	.16	.11
<i>Commercial paper</i>							
1-month	5.27	4.90	4.79	4.82	-.45	-.08	.03
3-month	5.13	4.84	4.76	4.81	-.32	-.03	.05
<i>Large negotiable CDs <sup>2</sup></i>							
1-month	5.35	5.01	4.87	4.87	-.48	-.14	.00
3-month	5.31	4.97	4.88	4.91	-.40	-.06	.03
6-month	5.10	4.97	4.90	4.99	-.11	.02	.09
<i>Eurodollar deposits <sup>3</sup></i>							
1-month	5.34	4.94	4.81	4.81	-.53	-.13	.00
3-month	5.28	4.94	4.81	4.88	-.40	-.06	.07
<i>Bank prime rate</i>							
	8.25	7.75	7.75	7.75	-.50	.00	.00
<i>Intermediate- and long-term</i>							
<i>U.S. Treasury (constant maturity)</i>							
2-year	4.13	4.54	4.70	5.03	.90	.49	.33
10-year	4.58	4.65	4.79	5.20	.62	.55	.41
30-year	5.02	5.09	5.24	5.57	.55	.48	.33
U.S. Treasury 10-year indexed note	3.69	3.88	3.76	3.90	.21	.02	.14
Municipal revenue (Bond Buyer) <sup>4</sup>	5.21	5.26	5.17	5.29	.08	.03	.12
Corporate bonds, Moody's seasoned Baa	7.26	7.23	7.32	7.53	.27	.30	.21
High-yield corporate <sup>5</sup>	11.29	10.52	10.49	10.66	-.63	.14	.17
<i>Home mortgages (FHLMC survey rate) <sup>6</sup></i>							
30-year fixed	6.49	6.77	6.74	7.01	.52	.24	.27
1-year adjustable	5.36	5.58	5.57	5.75	.39	.17	.18

Stock exchange index	Record high		1998	1999		Change to Mar. 23 from selected dates (percent)		
	Level	Date	Dec. 31	FOMC* Feb. 3	Mar. 23	Record high	Dec. 31	FOMC* Feb. 3
Dow-Jones Industrial	9,997.62	3-18-99	9,181.43	9,274.12	9,671.83	-3.26	5.34	4.29
S&P 500 Composite	1,316.55	3-18-99	1,229.23	1,261.99	1,262.14	-4.13	2.68	.01
NASDAQ (OTC)	2,510.09	2-1-99	2,192.69	2,463.42	2,322.84	-7.46	5.94	-5.71
Russell 2000	491.41	4-21-98	421.96	421.73	383.37	-21.99	-9.15	-9.10
Wilshire 5000	11,932.09	3-18-99	11,317.59	11,588.71	11,449.19	-4.05	1.16	-1.20

1. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
  2. Secondary market.
  3. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
  4. Most recent Thursday quote.
  5. Merrill Lynch Master II high-yield bond index composite.
  6. For week ending Friday previous to date shown.
- \* Data are as of the close on February 2, 1999.

# Selected Interest Rates



## Domestic Financial Developments

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### Overview

Longer-term Treasury rates backed up significantly in the first weeks of the intermeeting period, with economic data running on the strong side of market expectations and Chairman Greenspan's Humphrey-Hawkins testimony suggesting to many that, in the circumstances, monetary policymakers might be modestly inclined toward tightening. Rates have retraced some of that rise this month, as data releases have conveyed favorable inflation news and subsequent statements by Fed officials gave the impression that they saw risks as more balanced. On net, Treasury coupon yields have risen 30 to 40 basis points from the February FOMC meeting. With yields on Treasury indexed debt up about 15 basis points, real rates apparently made up a good bit of the nominal rate rise.

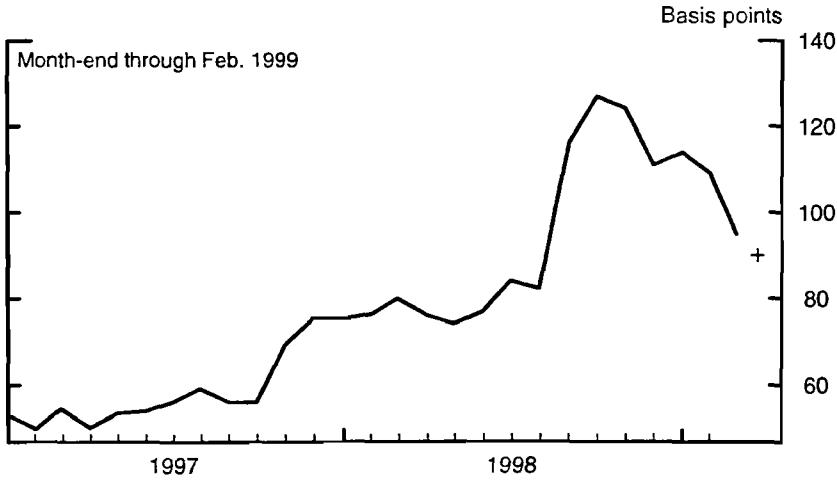
Some of the backup in nominal Treasury rates likely reflects a further unwinding of last fall's safety and liquidity concerns. Evidence of this recovery is apparent in the fact that yields on private debt securities have risen generally less than those on comparable Treasuries. Spreads of commercial paper yields over comparable-maturity Treasury repo rates for both high-tier and lower-tier issuers have returned to levels observed before the market disruptions last fall, and spreads over Treasuries on relatively illiquid asset-backed securities and municipal bonds have retraced a good portion of their rise as well. Still, spreads on lower-rated corporate bonds and commercial mortgage-backed securities, while down significantly from their October peaks, remain substantially above mid-1998 levels. Some spreads for on-the-run/off-the-run Treasury securities have also stayed wide.

In equity markets, many large cap stock indexes hit record highs in the period following the last FOMC meeting. Good news on the pace of economic activity and corporate profits more than offset the effects on share valuations of rising bond yields. After the Dow touched 10,000 last week, however, the market focus seemed to shift to the negatives and uncertainties in the picture, and prices slipped back, leaving all major indexes (except the DJIA) at or below their February 2 levels. Gross issuance of new shares has been strong, including some IPOs, but retirements through mergers and buybacks continue to dominate.

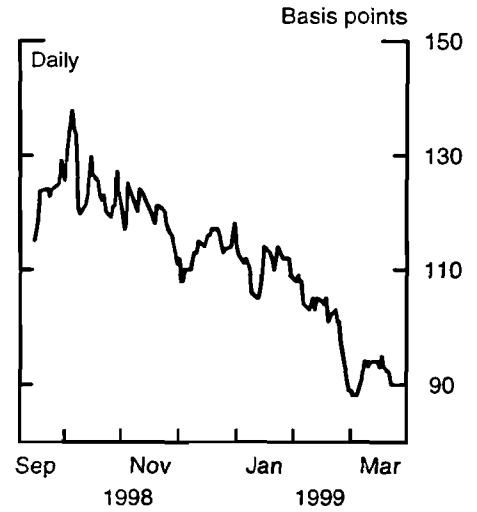
Business and household borrowing has continued at a hefty pace overall. Corporate bond issuance was brisk in February and March, and commercial paper outstanding rebounded sharply from its fourth-quarter decline. Some of the commercial paper proceeds evidently were used to repay bank loans, which have declined since the beginning of the year. Consumer credit surged at a double-digit rate in January, while mortgage debt growth for the quarter as a whole seems likely to ease off its robust 11 percent pace in the fourth quarter. With regard to government financing, municipal bond issuance has

## Spreads on Corporate Securities

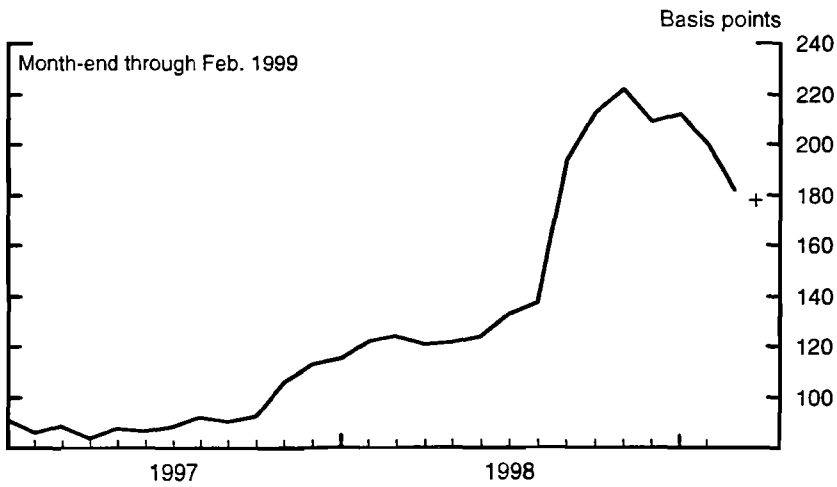
AA Corporate Bond Yield Less Ten-Year Treasury



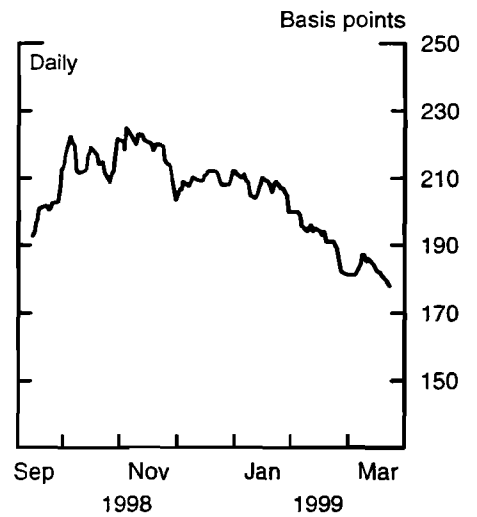
Note. + indicates the latest observation (Mar. 21).  
Source. Merrill Lynch.



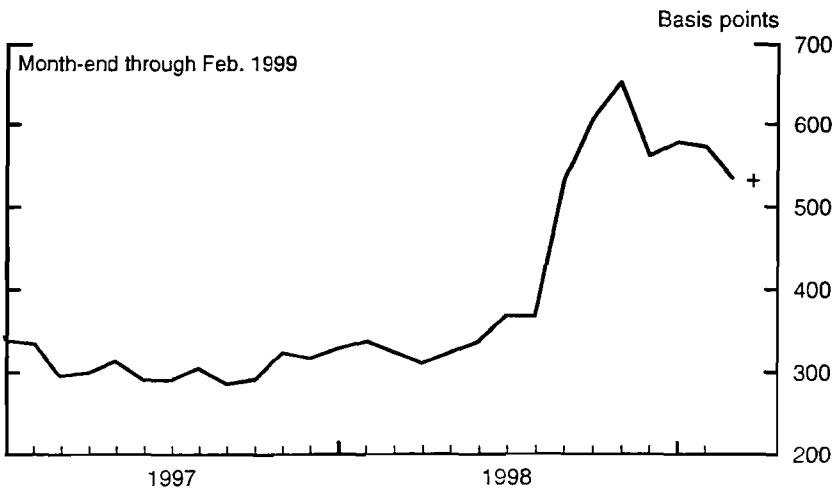
BBB Corporate Bond Yield Less Ten-Year Treasury



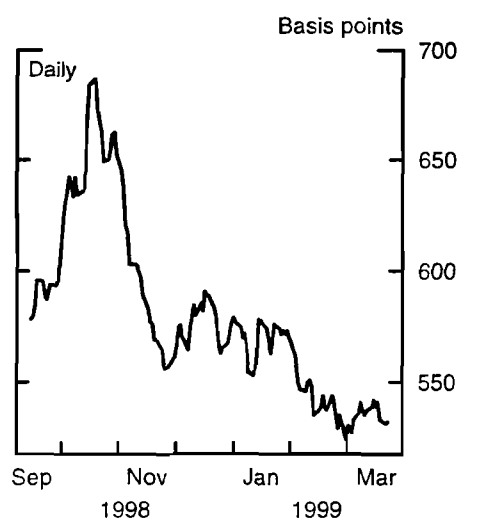
Note. + indicates the latest observation (Mar. 21).  
Source. Merrill Lynch.



High-Yield Bond Yield Less Seven-Year Treasury



Note. + indicates the latest daily observation (Mar. 21).  
Source. Merrill Lynch Master II.



moderated somewhat from last year's near-record rate, and continued improvements in budget prospects have led the Treasury to trim several bill and note auction sizes this quarter.

Growth of the broad monetary aggregates apparently has slowed sharply this month, perhaps owing in part to reduced demands for safe and liquid instruments as well as lessened overall funding needs by banks. But the robust rate of recent months implies that through February, M2 has risen at a 7-1/2 percent annual rate and M3 at a 9 percent rate, from their respective fourth-quarter levels. Bank credit ran off in both January and February after its fourth-quarter bulge, and partial data suggest that it was weak again in March.

### **Business Finance**

Although spreads remain elevated for all but the top-rated firms, interest rate levels have been attractive enough to encourage heavy issuance of corporate bonds this quarter. More than half of the funds raised in recent weeks have been earmarked for paying down debt. The speculative-grade side of the market demonstrated some breadth in February, with offerings spread among a number of small issues. However, in March large telecom firms once again dominated the market, as Charter Communications placed a \$3 billion offering, the third largest junk-rated issue in history. On the whole, the speculative-grade market still appears somewhat wary of offerings from smaller and lesser-known firms.

Outstanding commercial paper grew quite rapidly in the intermeeting period, boosted in March by AT&T's \$8 billion paper issuance to complete its acquisition of the cable television firm TCI. This paper is expected to be paid down soon with proceeds from a record \$8 billion bond offering by AT&T in late March.

Merger activity has continued at a hefty pace. While the largest deals have been among firms in the telecommunications sector, megamergers have been completed in many industries. Most of the deals have been friendly and structured as pure stock swaps, with few requiring cash financing from domestic sources; consequently, despite the high dollar-value of deals completed so far this year, the cash needs of U.S. acquirers have been well below those of last year. Looking ahead, the list of deals pending completion suggests that merger-related borrowing demands by domestic companies likely will remain moderate.

Notwithstanding the continued robust pace of economic expansion, there appears to have been some slippage in corporate credit quality since year-end. Most notably, the default rate on junk bonds has moved up in recent months,

**GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS**  
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
<b>All U.S. corporations</b>	75.2	92.2	80.6	90.9	80.5	80.0	85.5
Stocks <sup>1</sup>	9.8	10.6	6.0	8.7	8.7	6.7	9.7
Bonds	65.4	81.7	74.6	82.1	71.9	73.2	75.8
<b><u>Nonfinancial corporations</u></b>							
Stocks <sup>1</sup>	5.0	6.2	3.7	6.5	7.6	3.3	8.5
Initial public offerings	1.8	2.2	1.0	3.7	3.6	.9	3.4
Seasoned offerings	3.2	4.0	2.8	2.8	4.0	2.4	5.1
Bonds	19.3	24.7	16.7	23.9	25.0	20.2	20.9
By rating, sold in U.S. <sup>2</sup>							
Investment grade	9.4	13.8	11.0	16.6	14.6	9.9	12.4
Speculative grade	8.0	9.4	4.2	6.7	9.0	9.0	7.8
Public	1.5	1.8	1.4	.6	1.0	.7	1.9
Rule 144A	6.5	7.6	2.8	6.1	8.0	8.3	5.9
Other (Sold Abroad/Unrated)	1.9	1.4	1.4	.6	1.5	1.3	.7
<b><u>Financial corporations</u></b>							
Stocks <sup>1</sup>	4.8	4.4	2.3	2.2	1.1	3.4	1.2
Bonds	46.1	57.0	57.9	58.2	46.8	53.1	54.9
<b><u>Memo:</u></b>							
Net issuance of commercial paper, nonfinancial corporations <sup>3</sup>	1.1	2.3	7.4	-3.3	-5.2	6.5	9.0
Change in C&I loans at commercial banks <sup>3</sup>	6.4	6.7	9.1	5.3	-8.6	3.9	1.3

Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.

2. Bonds categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.

3. End-of-period basis. Seasonally adjusted.

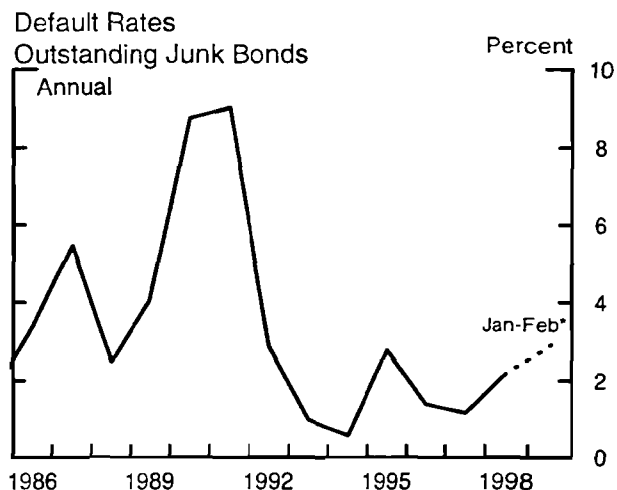
### Corporate Finance and Stock Prices

Mergers and Acquisitions  
Nonfinancial Firms

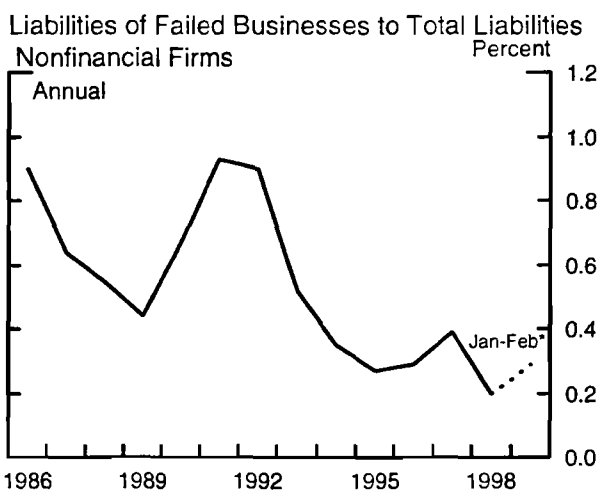
Billions of dollars

	Cash paid by domestic corps.	Total deal value
Completed		
1997	95.2	323.9
1998	135.0	510.7
1999*	92.6	675.8

\* Completed to date plus pending.

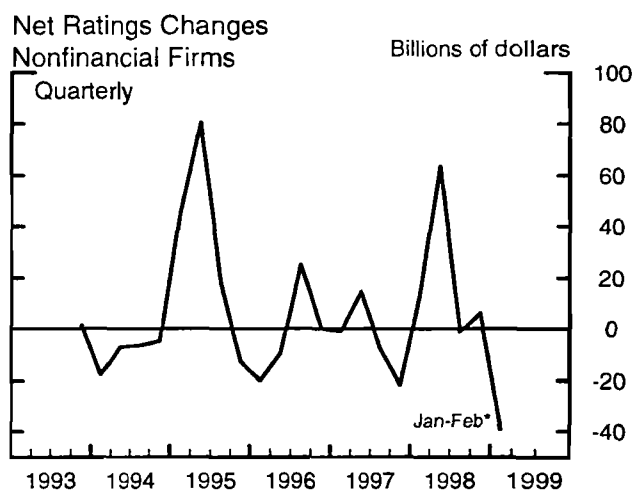


\* Annual rate.



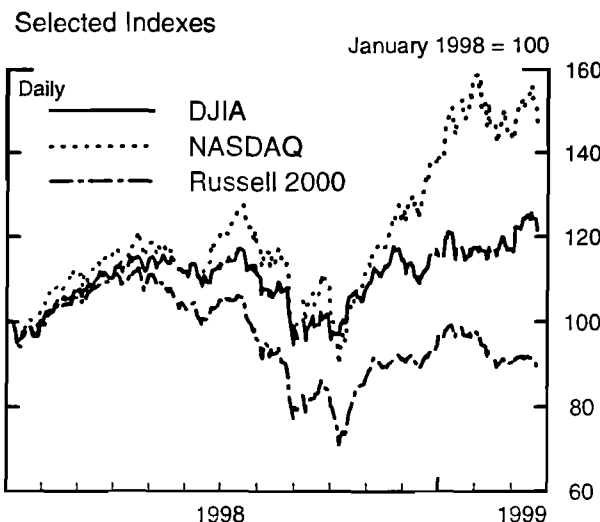
\* Annual rate.

Source: Dun and Bradstreet.

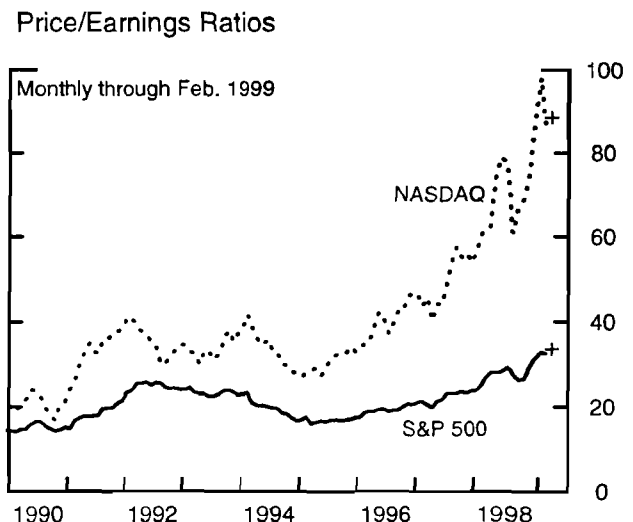


\* Quarterly rate.

Source: Moody's. Upgrades minus downgrades.



Note. Last observation is for March 23.



Note. + indicates the latest daily observation (Mar. 23).



as has the business failure rate--a measure of financial distress that covers the entire business sector. That junk bond spreads remain quite elevated likely reflects, at least in part, market perceptions of higher credit risk. Indeed, a simple forecasting model predicts that rising debt-to-asset ratios and higher asset volatility will be mirrored in a further increase in the junk bond default rate in coming months.<sup>1</sup> In addition, the number of Moody's downgrades of nonfinancial firms exceeded upgrades in January and February by more than two to one, leading to a net downgrade of \$39 billion. However, several of the firms downgraded are oil producers, and if the recent rebound in oil prices persists, these lower ratings may be short lived. On the financial side, Moody's upgraded \$35 billion of debt outstanding at Chrysler's financial subsidiary after its parent merged with Daimler. Debt placed on watch for future rating actions suggests a rough balance between upgrades and downgrades.

The Dow and the S&P 500 indexes both hit new highs in mid-March, boosted by favorable economic data and improved earnings expectations in several sectors; financial shares were notably strong. However, both indexes have since retreated 3 to 4 percent from their highs on renewed concerns that earnings may not be buoyant enough to support the lofty valuations. These concerns have centered on computer-related firms, contributing to the 6 percent decline in the Nasdaq over the intermeeting period. The Russell 2000 fell another 10 percent, placing it more than 20 percent below its record high set almost a year ago. Despite the recent setback in the market, both the S&P 500 and Nasdaq P/E ratios remain close to record levels.

The \$8-1/2 billion of gross equity offerings in February was the highest monthly total since the market plunge last summer. Seasoned issuance was dominated by telecommunications firms. IPOs by Internet-related companies have met with exceptionally strong demand, but investors have been less receptive to other IPOs. Overall, the rise in the pace of registration statements since January points to a steady stream of IPO offerings in the next few months.

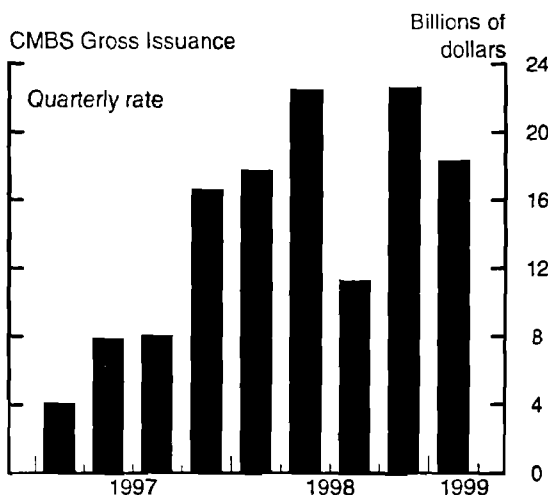
### **Commercial Real Estate Finance**

Gross issuance of commercial mortgage-backed securities remained strong in the first quarter. Most of the overhang of loans originated before the onset of market turmoil last summer appears to have been eliminated this quarter, and conduit lenders have reportedly returned to originating mortgages in volume.

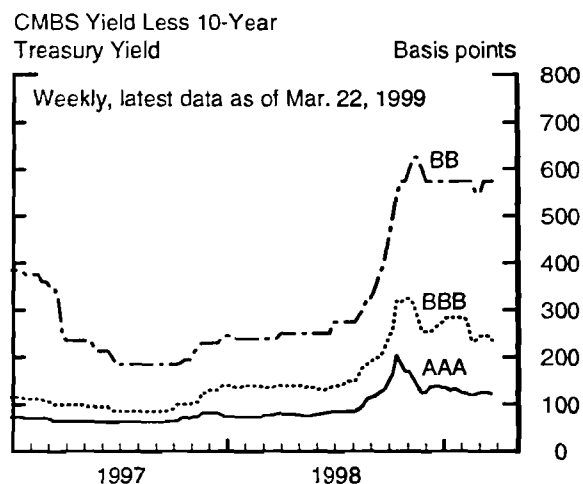
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<sup>1</sup> Inputs to the model are the rating distribution of outstanding bonds, the percentage of banks tightening low underwriting standards, and aggregate default rate predictions from a private firm model which forecasts firms' default probabilities based on their outstanding debt and asset values and asset volatility.

### Commercial Real Estate



Source. Commercial Mortgage Alert.

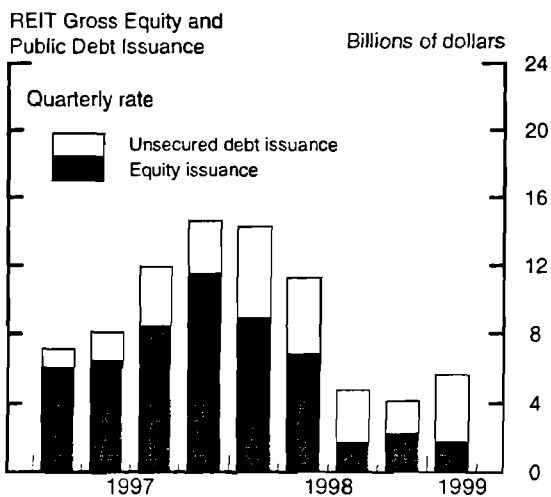


Source. Morgan Stanley.

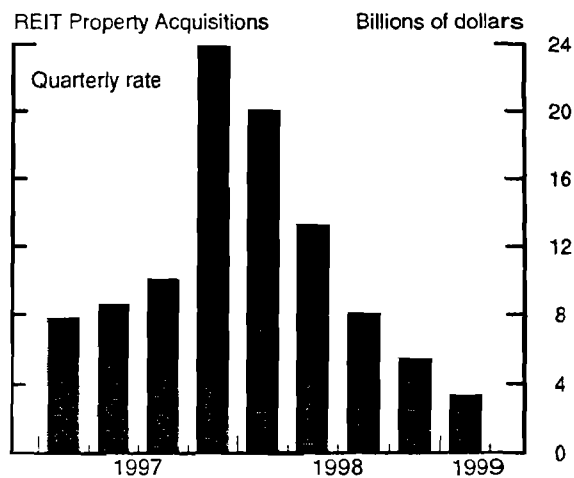
#### Net Lending for Multifamily and Commercial Mortgages (Billions of dollars, quarterly rates, seasonally adjusted)

Lender	1997	1998	1998			
			Q1	Q2	Q3	Q4
Commercial banks	8.5	10.5	7.8	4.9	13.6	15.9
Federally related mortgage pools	1.3	2.6	1.2	1.4	4.2	3.7
Life insurance companies	-0.5	1.2	-0.3	1.2	-0.4	4.2
<b>Total</b>	<b>9.3</b>	<b>14.3</b>	<b>8.7</b>	<b>7.5</b>	<b>17.4</b>	<b>23.8</b>

Source. Flow of Funds.

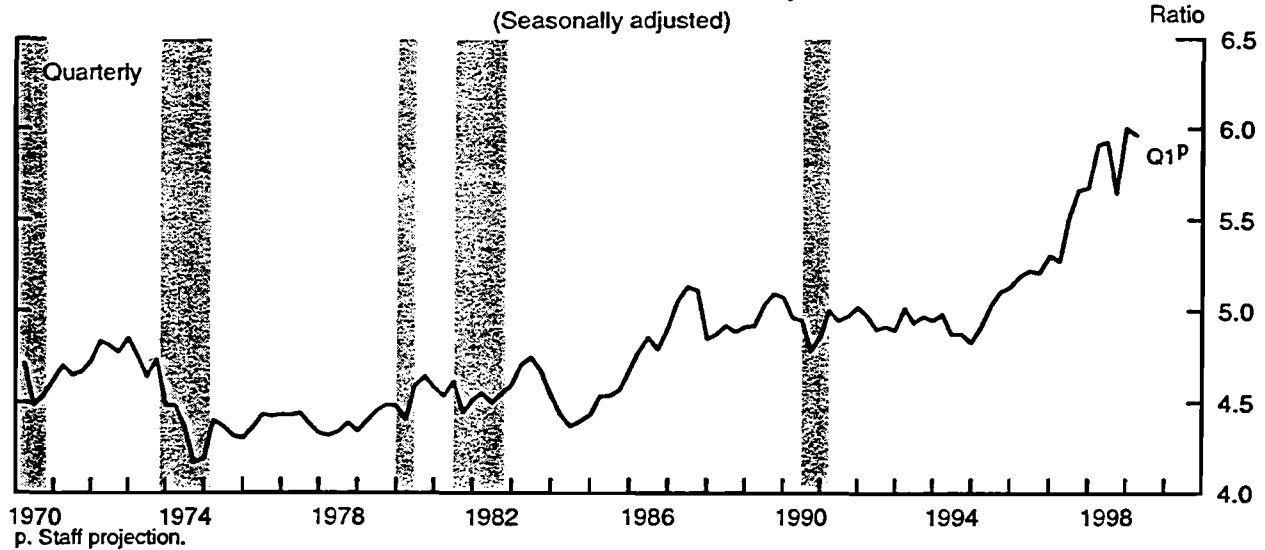


Note. 1999:Q1 is staff estimate.  
Source. National Association of Real Estate Investment Trusts.



Note. 1999:Q1 is staff estimate.  
Source. National Association of Real Estate Investment Trusts.

### Household Net Worth Relative to Disposable Income



### Net Flows of Mutual Funds

(Excluding reinvested dividends; billions of dollars; monthly rates; not seasonally adjusted)

	1997	1998					1999	
		H1	Q3	Oct.	Nov.	Dec.	Jan.	Feb. <sup>e</sup>
<b>Total long-term funds</b>	22.7	29.3	10.5	7.6	22.9	6.4	24.8	12.1
<b>Equity funds</b>	19.0	21.1	4.7	2.5	12.8	3.2	15.7	6.7
Domestic	15.8	18.6	5.9	3.1	13.9	5.9	14.8	9.6
International	3.1	2.5	-1.2	-0.6	-1.2	-2.7	0.9	-2.9
<b>Hybrid funds</b>	1.4	1.7	-0.1	-0.2	1.5	-0.1	0.7	-0.2
<b>Bond funds</b>	2.4	6.5	6.0	5.4	8.7	3.3	8.4	5.6
International	-0.1	0.0	-0.3	-0.3	0.1	-0.3	-0.0	-0.1
High-yield	1.4	1.8	-0.4	0.4	4.7	-1.0	1.5	0.6
Other taxable	1.0	3.5	5.3	4.7	1.8	3.4	5.0	3.5
Municipals	0.1	1.2	1.4	0.6	2.2	1.2	2.0	1.6

Source. Investment Company Institute (ICI).

<sup>e</sup> Staff estimates based on ICI weekly data.

### 401(k) Plan Contributions and Transfers

(Percent of total)

	Contributions <sup>1</sup>					Transfers <sup>2</sup>				
	H1	1998 Q3	Q4	1999 Jan.	Feb.	H1	1998 Q3	Q4	1999 Jan.	Feb.
<b>Company stock</b>	17	19	23	26	17	-35	-18	-30	-40	-3
<b>Equity funds</b>	47	49	45	42	33	19	-44	-16	51	2
Domestic	41	44	40	36	30	22	-50	-13	40	31
International	6	5	4	5	3	-3	7	-3	11	-29
<b>Hybrid funds</b>	13	11	10	8	35	14	-18	6	15	-15
<b>Fixed income<sup>3</sup></b>	23	21	22	25	16	2	80	40	-28	16

1. Allocation of new contributions to 401(k) plans; percentages sum to 100.

2. Allocation of transfers among existing assets within 401(k) plans; percentages sum to zero.

3. Includes bond and money funds and GIC/stable value investments.

Source. Hewitt Associates.

These newer mortgages are expected to be securitized in the next few months, and issuance in the second quarter is anticipated to be nearly \$16 billion, well above market analysts' predictions just a few months ago, but a little below the estimated current-quarter pace.

Although financing for commercial real estate transactions appears to be readily available, risk spreads remain elevated compared with a year ago. Relative to ten-year Treasury yields, spreads on AAA-rated securities, which account for nearly three-quarters of the CMBS market, were about unchanged over the intermeeting period and are still more than 40 basis points above their level a year ago. Spreads on other investment-grade CMBS narrowed slightly over the intermeeting period, while below-investment-grade spreads changed little on balance and are quite wide relative to early last year.

Newly available data for the fourth quarter confirm that institutional lenders and banks jumped into the commercial mortgage loan market when conduit lending shut down last fall. Lending by commercial banks and originators of loans for federally related mortgage pools (mainly Fannie Mae and Freddie Mac) remained elevated in the fourth quarter, after a pickup in the third quarter. Life insurance companies also stepped up their lending in the fourth quarter following several years of virtually no increase in holdings of such loans. Information from Fannie Mae, Freddie Mac, and large commercial banks indicates that they have continued to be active in the commercial mortgage market so far this year.

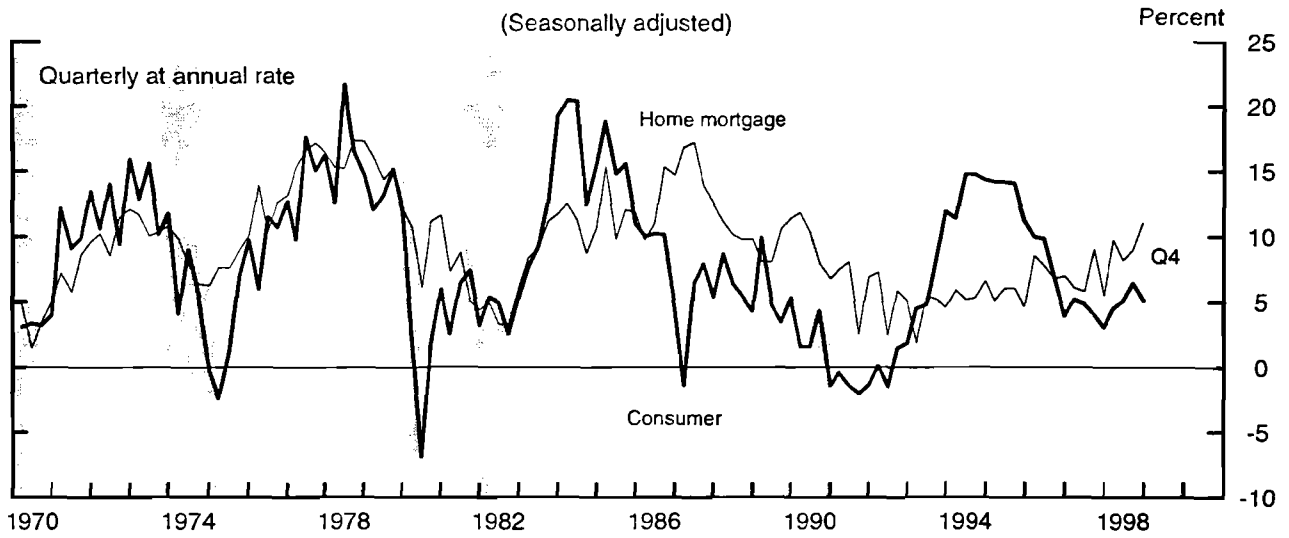
REIT stock prices continue to languish, holding down the pace of REIT equity issuance and property acquisition. However, several large REITs have marketed unsecured debt in the past two months and used the proceeds to pay down bank lines that were drawn in 1998. The issues were heavily oversubscribed; as an industry, REITs have issued over \$3 billion in unsecured debt in the first two and a half months of 1999, a little more than over the final five months of 1998.

### **Household Finance**

The ratio of households' net worth to disposable income hit a record in the fourth quarter and was on track to be higher still in the first quarter, before the last several days' stock market declines. Mutual fund shareholders have displayed some queasiness in their appetite for new equity fund shares, with inflows to domestic equity funds still running below the pace of early last year, although some renewed strength was evident in the first half of March. International equity funds recorded an outflow of almost \$3 billion in February, more than reversing the small inflow in January and continuing the trend of outflows from international funds that started in August of last year. Likewise, sample data suggest that 401(k) plan holders have made efforts to

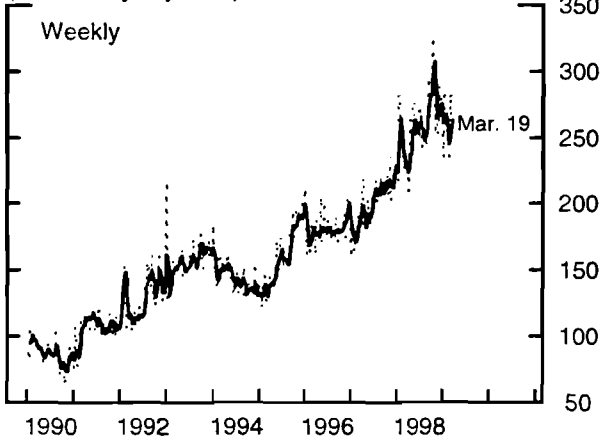
### Household Debt Growth

(Seasonally adjusted)



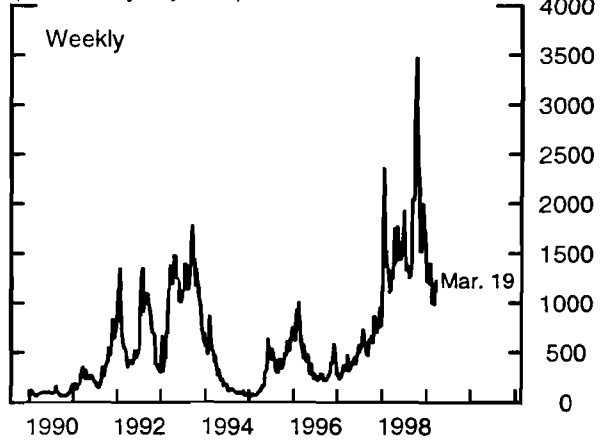
MBA Purchase Index  
(Seasonally adjusted)

March 16, 1990 = 100



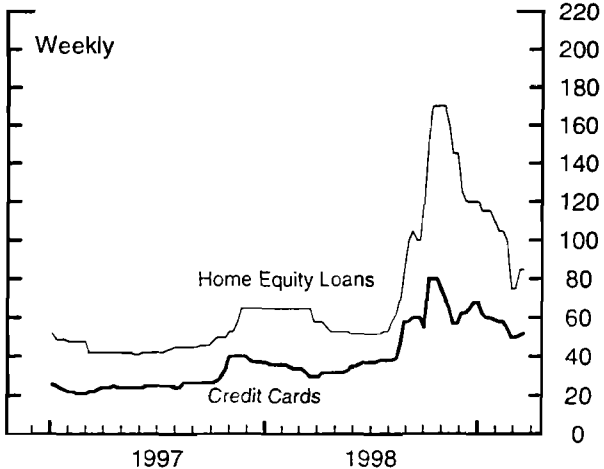
MBA Refinancing Index  
(Seasonally adjusted)

March 16, 1990 = 100



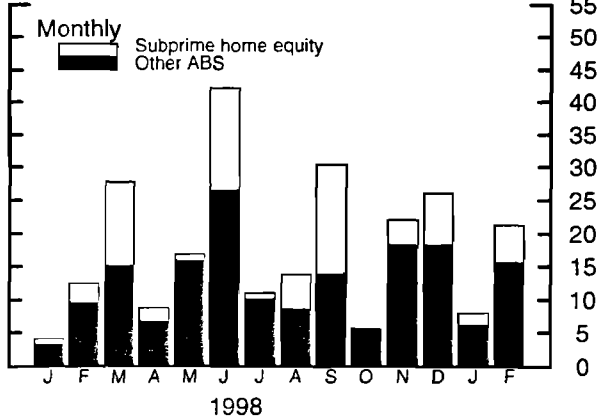
ABS Yield Spreads

Basis points



Asset-Backed Security Issuance

Billions of dollars



Note. Latest observation is for March 19.  
Source. Salomon Smith Barney.

Note. Excludes securities backed by commercial mortgages and by first mortgages on residential properties.  
Source. Inside MBS & ABS.

limit their rising exposure to equities. The share of new 401(k) contributions to company stock and equity funds dropped in February to about one-half of total contributions, from an average pace of about two-thirds over the last year. Transfers among existing assets, which involved only about 1 percent of account balances in February, were primarily from international to domestic equity funds.

Household debt appears to be continuing its brisk growth in the first quarter. After increasing at a surprisingly sluggish 3 percent rate in December, consumer credit surged at a 13-1/2 percent pace in January, despite little growth in consumer loans at banks. Home mortgage debt probably will moderate somewhat this quarter from the 11 percent pace recorded in the fourth; the MBA purchase and refinance indexes have subsided since last fall, and that tendency may continue in coming weeks as a consequence of the recent rise in mortgage rates.

The latest readings on household credit quality have either been roughly stable or tilted toward the positive side. ABA data show that delinquencies on consumer closed-end loans and credit cards edged up slightly in the fourth quarter, but stayed within the relatively elevated range observed over the last year and a half. Moody's reported that, in January, the delinquency rate on securitized credit card receivables remained near its lowest level in two and a half years, and the Mortgage Bankers Association reported that sixty-day-and-over delinquencies on home mortgage loans declined in the fourth quarter, continuing the downtrend established last year.

Further evidence on the unwinding of market stresses appears in investors' renewed enthusiasm for asset-backed securities, where spreads declined dramatically in January and February. Issuance of asset-backed securities during these months has been strong--February's \$21 billion was the highest ever recorded for that month--with a large share backed by home-equity and auto loans.

### **Federal Government and Agency Finance**

The federal budget is actually expected to show a small surplus in the first quarter, in advance of spring tax season, and Treasury borrowing, on net, has been light. Weekly bill auctions were pared from \$15 billion to \$14 billion in mid-March, and the February quarterly refunding package of notes and bonds was lowered \$3 billion from the \$38 billion total in November. The Treasury also announced that it plans a modest reduction in the offering size of ten- and thirty-year inflation-protected securities and is considering reducing the frequency of new issues of the nominal thirty-year bond and two-year note. However, the mid-March two-year note auction took place with no changes. The Treasury also issued a large volume of cash management bills over the

## Treasury and Agency Finance

### Treasury Financing (Billions of dollars)

Item	1998		1999			
	Q3	Q4	Q1 <sup>e</sup>	Jan	Feb	Mar <sup>e</sup>
<b>Total surplus, deficit (-)</b>	<b>3.0</b>	<b>-55.0</b>	<b>2.3</b>	<b>70.3</b>	<b>-42.9</b>	<b>-25.2</b>
Means of financing deficit						
Net borrowing	28.8	32.3	8.1	-31.2	1.7	37.6
Nonmarketable	10.1	8.2	1.1	-0.8	0.8	1.1
Marketable	-38.9	24.1	7.0	-30.4	0.9	36.6
Bills	-3.5	53.3	38.9	-28.4	4.3	63.0
Coupons	-35.3	-29.2	-31.9	-2.0	-3.5	-26.4
Decrease in cash balance	33.4	21.4	-1.7	-39.6	52.4	-14.6
Other <sup>1</sup>	-7.6	1.3	-8.6	0.5	-11.3	2.1
MEMO						
Cash balance, end of period	38.9	17.5	19.2	57.1	4.6	19.2

e = estimate

NOTE. Components may not sum to totals because of rounding.

1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

### Net Cash Borrowing of Government-Sponsored Enterprises (Billions of dollars)

Agency	1998				1999	
	Q2	Q3	Q4	Dec	Jan	Feb
FHLBs	10.5	14.7	38.9	8.4	1.4	n.a.
FHLMC	7.0	32.7	54.4	19.5	13.5	n.a.
FNMA	25.1	24.2	29.7	13.9	0.9	10.1
Farm Credit Banks	2.4	-0.4	-0.8	-2.6	-2.2	5.3
SLMA	-3.1	0.5	1.6	1.5	n.a.	n.a.

NOTE. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

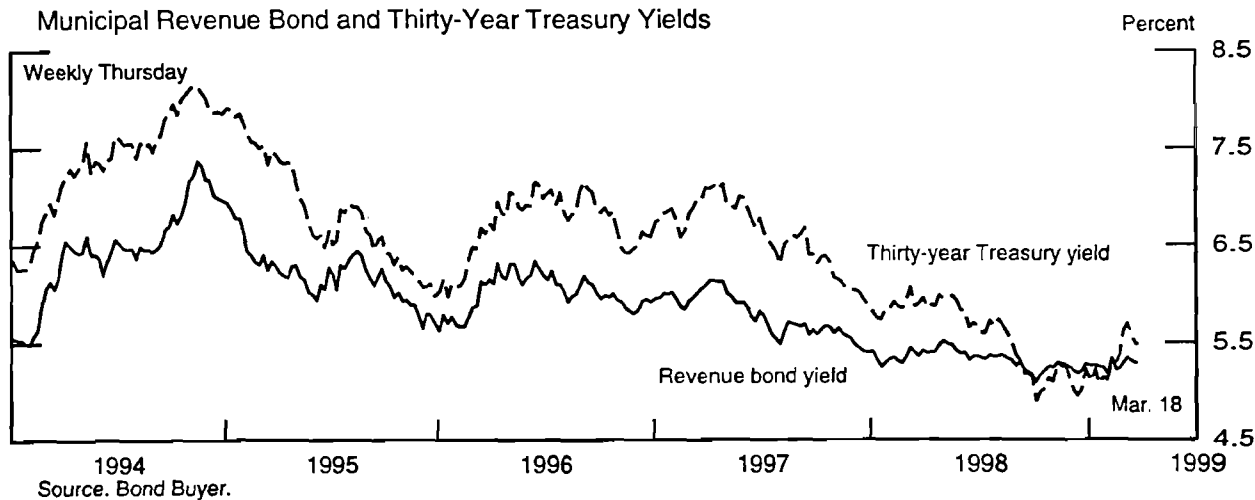
## State and Local Finance

**GROSS OFFERINGS OF MUNICIPAL SECURITIES**  
(Billions of dollars; monthly rates, not seasonally adjusted)

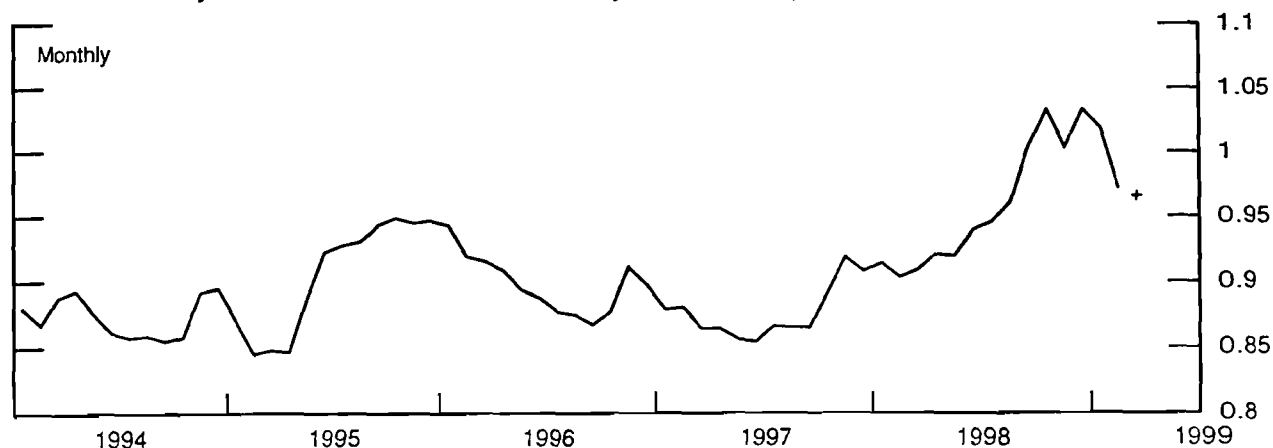
	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
<b>Total tax-exempt</b>	21.5	24.3	23.1	23.4	27.4	18.6	17.4
Long-term	17.9	21.9	20.2	21.0	24.3	16.9	16.2
Refundings <sup>1</sup>	6.6	8.5	8.1	7.8	9.8	5.0	5.6
New capital	11.3	13.4	12.1	13.2	14.5	11.9	10.7
Short-term	3.6	2.4	2.9	2.3	3.1	1.7	1.2
<b>Total taxable</b>	1.1	1.1	1.3	0.8	1.1	2.4	0.7

Note. Includes issues for public and private purposes.  
1. All issues that include any refunding bonds.

Municipal Revenue Bond and Thirty-Year Treasury Yields



Ratio of Thirty-Year Revenue Bond Yield to Thirty-Year Treasury Yield



Note. Average of weekly data. + indicates latest observation (Mar 18).



intermeeting period, scheduled to mature with the bulge of April tax receipts, in order to maintain its cash balance and allow substantial paydowns of coupon debt.

Government-sponsored enterprises have continued to tap global markets, and to structure issues in ways that capture some of the liquidity benefits that the Treasury is losing as its issue sizes decline. Freddie Mac and Fannie Mae recently issued \$7 billion and \$9 billion of global reference and benchmark notes, respectively, while the Federal Home Loan Bank placed \$10 billion of global long-term debt. Moreover, Fannie Mae has offered to exchange about \$15 billion of outstanding debt for five-year benchmark notes and reopened its February five-year note for an additional \$2 billion in mid-March. Fannie and Freddie have used proceeds from these issues to expand the volume of mortgages that they retain on their books. Spreads between benchmark and reference notes and comparable Treasuries showed mixed, modest changes over the intermeeting period. While off their October peaks, these spreads have remained about twice their year-ago levels, held up in part by the large issuance.

### **Municipal Finance**

Gross long-term municipal bond issuance totaled about \$16 billion in February, close to the January pace but down from the elevated fourth-quarter rate. New capital financing remains strong, supported in particular by borrowing for education projects. Advanced refundings were appreciably below the fourth-quarter rate, as the pool of bonds for which early refunding is both possible and profitable diminished significantly with the heavy refunding volume of 1998.

Municipal bond yields rose only about half as much as long-term Treasury yields over the intermeeting period, bringing yield ratios down near levels observed before last summer's market turmoil. The revenue-to-Treasury bond ratio now stands at 0.97, down from 1.02 as of the last FOMC meeting. Credit quality has been stable over the intermeeting period, with a roughly equal number of upgrades and downgrades.

### **Money and Bank Credit**

Growth of the broad monetary aggregates continued to moderate over the intermeeting period. After the rapid 11 percent growth rate in the fourth quarter, M2 decelerated to roughly a 6 percent pace in January and February. Preliminary data for early March suggest that M2 expansion slowed further. The deceleration this year may reflect some shifting by households toward longer-term assets not in M2, whose yields have risen while rates on components of M2 remain historically low. The deceleration in the liquid

MONETARY AGGREGATES  
(Based on seasonally adjusted data)

Aggregate or component	1998	1998		1998	1999		1998:Q4	Level
		Q3	Q4	Dec.	Jan.	Feb. (p)	to Feb. 99 (p)	(bil. \$) Feb. 99 (p)
Aggregate								
Percentage change (annual rate) <sup>1</sup>								
1. M1	1.8	-2.0	5.0	4.7	-3.0	1.5	1.6	1092.0
2. M2 <sup>2</sup>	8.5	6.9	11.0	10.1	6.5	5.6	7.5	4446.5
3. M3	10.9	8.6	12.9	12.0	4.1	10.4	9.0	6072.1
Selected Components								
4. Currency	8.3	8.2	9.6	7.4	8.9	13.0	9.9	467.6
5. Demand deposits	-4.2	-11.4	.2	1.6	-20.3	2.3	-4.9	371.8
6. Other checkable deposits	.4	-6.1	4.8	5.3	2.4	-20.7	-3.1	244.9
7. M2 minus M1 <sup>3</sup>	10.9	9.9	13.0	11.8	9.6	7.0	9.4	3354.5
8. Savings deposits	14.0	14.0	15.6	17.0	13.0	7.4	12.3	1632.4
9. Small time deposits	-1.4	-2.5	-2.1	-4.8	-6.8	-7.2	-6.0	940.9
10. Retail money market funds	23.7	19.0	28.4	22.3	23.2	23.7	23.2	781.2
11. M3 minus M2 <sup>4</sup>	18.2	13.4	18.4	17.3	-2.6	23.5	13.2	1625.5
12. Large time deposits, net <sup>5</sup>	9.8	3.1	4.7	9.0	16.2	-9.2	5.2	633.8
13. Institution-only money market mutual funds	34.7	26.6	41.8	29.5	-2.8	34.7	22.1	529.9
14. RPs	17.3	11.7	16.4	34.0	-25.0	68.7	24.8	308.2
15. Eurodollars	9.8	21.9	7.6	-20.0	-35.2	37.0	-4.1	153.7
Memo								
16. Liquid Deposits <sup>6</sup>	8.8	7.0	11.7	13.0	6.1	3.5	7.7	2249.1
17. Sweep-adjusted M1 <sup>7</sup>	6.0	4.1	7.2	7.1	-.5	4.9	4.0	1410.7
18. Monetary base	7.1	6.8	8.9	8.3	8.4	9.4	8.8	520.7
19. Household M2 <sup>8</sup>	10.1	8.7	12.4	11.2	9.3	11.2	10.7	4100.9
Average monthly change (billions of dollars) <sup>9</sup>								
Memo								
Selected managed liabilities at commercial banks:								
20. Large time deposits, gross	5.1	0	8.1	4.8	9.1	1.9	...	756.0
21. Net due to related foreign institutions	2.6	7.7	7.5	-1.2	-3.6	12.6	...	226.3
22. U.S. government Deposits at commercial banks	.6	-.4	.5	-1.4	1.3	-18.3	...	11.0

1. For the years shown, Q4-to-Q4 percent change. For the quarters shown, based on quarterly averages.

2. Sum of M1, retail money market funds, savings deposits, and small time deposits.

3. Sum of retail money funds, savings deposits, and small time deposits.

4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.

5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.

6. Sum of demand deposits, other checkable deposits, and savings deposits.

7. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.

8. M2 less demand deposits.

9. For the years shown, "average monthly change" is the Q4-to-Q4 dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.

p--Preliminary.

**Commercial Bank Credit**  
(Percent change; seasonally adjusted annual rate)

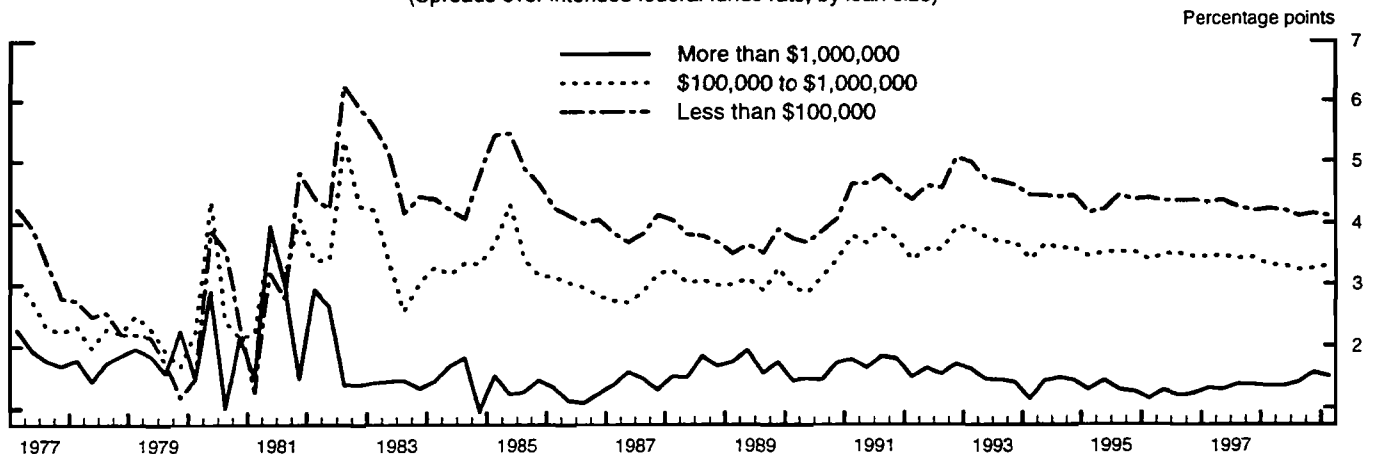
Type of credit	1998	1998		1999			Level, Feb 1999 (billions of \$)
		Q4	Q1 p	Dec	Jan	Feb	
1. Bank credit: Reported	11.2	16.7	-1.4	5.2	-6.7	-4.1	4,508.0
2.           Adjusted <sup>1</sup>	10.4	15.3	0.5	3.9	-5.3	-2.8	4,394.2
3. Securities: Reported	15.0	25.1	-7.0	8.0	-17.8	-10.1	1,207.3
4.           Adjusted <sup>1</sup>	12.3	20.1	0.0	2.8	-13.5	-5.4	1,093.5
5.   U.S. government	6.2	10.3	4.1	3.2	3.3	-1.8	794.0
6.   Other <sup>2</sup>	35.1	54.3	-26.9	16.8	-55.6	-25.6	413.3
7. Loans <sup>3</sup>	9.8	13.7	0.7	4.2	-2.5	-1.9	3,300.7
8.   Business	11.3	15.6	-0.1	-2.9	-3.7	-0.5	942.1
9.   Real estate	6.7	8.7	7.7	12.6	4.4	3.1	1,331.5
10.   Home equity	0.1	-3.3	-1.7	-1.2	-5.0	-1.2	96.4
11.   Other	7.2	9.6	8.4	13.9	5.2	3.4	1,235.1
12. Consumer: Reported	-1.5	2.6	3.4	7.0	5.3	0.5	504.2
13.           Adjusted <sup>4</sup>	6.0	6.3	3.4	9.3	1.6	0.0	757.8
14.   Other <sup>5</sup>	29.9	34.1	-17.3	-6.2	-24.3	-19.4	522.9

Note. Adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.

- 1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FASB 115).
  - 2. Includes securities of corporations, state and local governments, and for foreign governments and any trading account assets that are not U.S. government securities.
  - 3. Excludes interbank loans.
  - 4. Includes an estimate of outstanding loans securitized by commercial banks.
  - 5. Includes security loans, loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
- p Preliminary.

**Commercial and Industrial Loan Rates at Domestic Banks**

(Spreads over intended federal funds rate, by loan size)



deposit and retail money fund components of M2 is also consistent with a further unwinding of risk and liquidity concerns.

M3 expanded at a 10-1/2 percent annual rate in February, up from 4 percent in January but still below the 13 percent rate in the fourth quarter of 1998. However, a substantial portion of the February strength in M3 came from an unusually large volume of RP funding by a single bank for Treasury auction purchases, which boosted the M3 growth rate by 2-1/4 percentage points. The strength in February was also attributable, in part, to a shift in the mix of bank liabilities toward those included in the M3 aggregate. Bank repurchase agreements generally increased sharply, along with Eurodollar deposits, while federal government deposits, which are not included in M3, declined. Institution-only money market mutual fund growth slowed somewhat from the torrid pace in the fourth quarter of 1998, but it has remained robust as corporations apparently have continued to out-source their cash management. Weekly data through early March suggest a pronounced slowdown in M3 this month.

Bank credit (adjusted for mark-to-market accounting rules) unwound from its fourth-quarter bulge in both January and February, showing weakness in securities holdings and across all loan categories. Real estate loans decelerated, as the pace of home sales and mortgage refinancing has cooled a bit in recent months. In addition, banks reportedly have securitized the raft of refinancing loans that closed last fall. Business loans, which grew rapidly last year when capital market disruptions prompted firms to draw heavily on outstanding lines of credit at banks, were about flat on balance in February and early March. Banks have also reduced their holdings of securities after building up portfolios late last year, when private and agency risk spreads widened. Preliminary data for March suggest another weak month for total bank credit.

The February survey of terms of business lending shows the spread between rates on newly originated C&I loans and the intended federal funds rate to have narrowed slightly from the previous survey in November. The most significant move was in rates on large loans (those greater than \$1 million), which reversed 6 basis points of their 16 basis point increase over the three months ending in November. Reports suggest that pricing has also eased moderately in the syndicated loan market since January.

Fourth-quarter call reports reveal that the return on equity at commercial banks slipped further last quarter to its lowest level in six years, although bank profits remained historically strong. So far, gains in nondeposit fee income have partially offset higher merger-related expenses and narrower interest margins. The call reports also show that delinquency rates on

mortgage loans and business loans remained quite subdued in the fourth quarter, while consumer loan delinquencies held at an elevated level. The behavior of net charge-off rates has been broadly similar to that of delinquency rates, except that the rate on C&I loans has shown an upward trend over the past two years and rose further in the fourth quarter.

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## **INTERNATIONAL DEVELOPMENTS**

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## International Developments

### U.S. International Transactions

#### Trade in Goods and Services

In January, the nominal U.S. trade deficit in goods and services was \$17.0 billion, substantially larger than deficits in any of the preceding four months, and slightly higher than the previous peak level recorded last August. The value of exports declined to the lowest level since last August and the value of imports rose.

#### Net Trade in Goods & Services (Billions of dollars, seasonally adjusted)

	1998	Annual rate 1998			Monthly rate 1998 1999		
		Q2	Q3	Q4	Nov.	Dec.	Jan.
<i>Real NIPA<sup>1</sup></i>							
Net exports of G&S	-238.3	-245.2	-259.0	-250.5	...	...	...
<i>Nominal BOP</i>							
Net exports of G&S	-169.3	-176.9	-186.0	-172.7	-15.2	-14.1	-17.0
Goods, net	-248.2	-259.1	-259.6	-249.8	-21.7	-20.5	-23.4
Services, net	78.9	82.2	73.6	77.1	6.5	6.4	6.4

1. Billions of chained (1992) dollars.

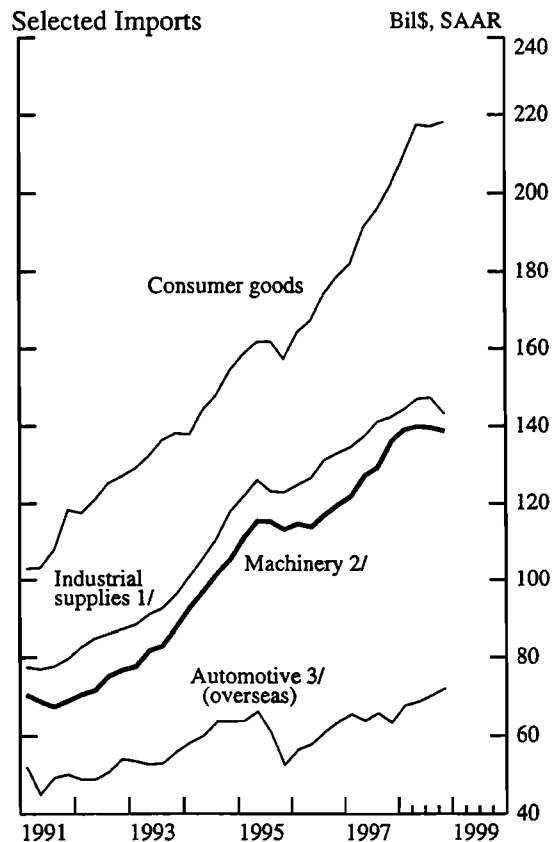
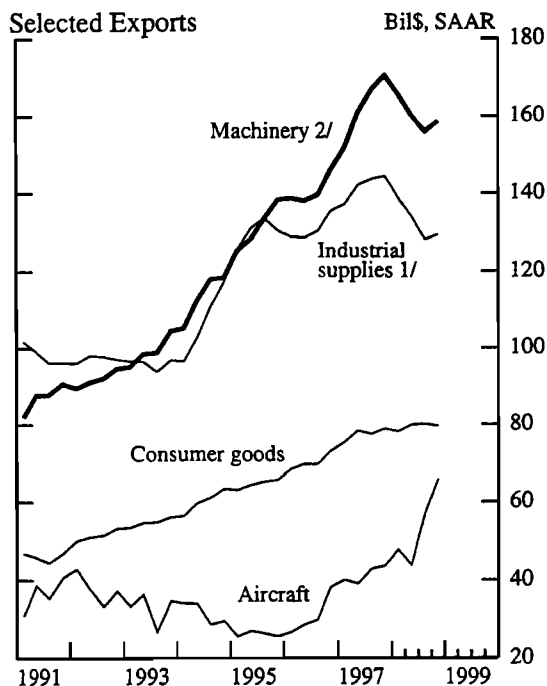
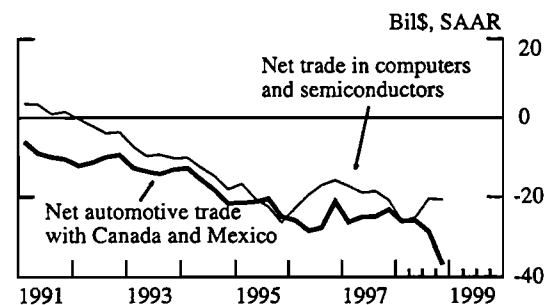
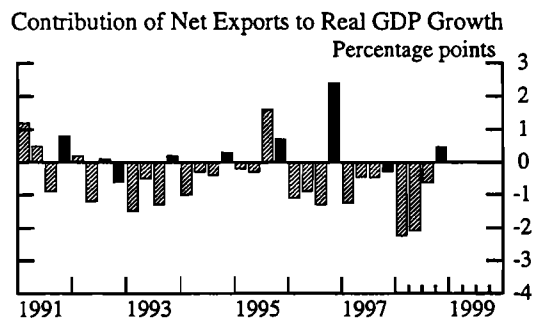
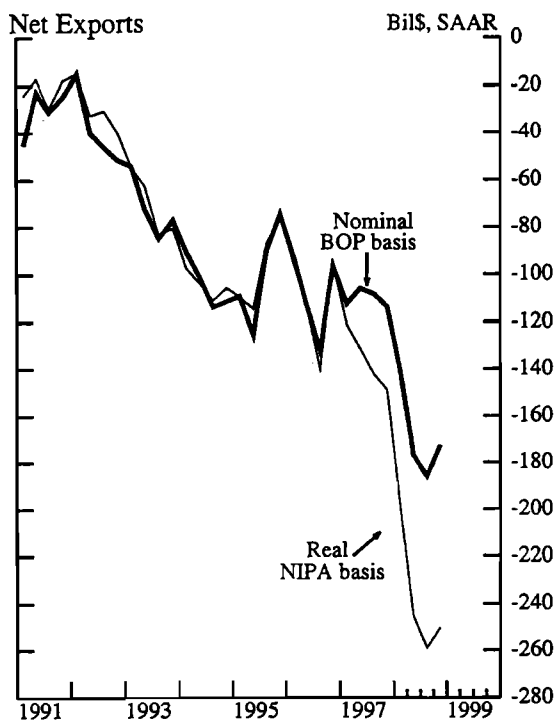
Source. U.S. Department of Commerce, Bureau of Economic Analysis and Census.

n.a. Not available. ... Not applicable.

The value of exports fell 1.4 percent in January, the third consecutive month of decline. Half of the decrease in January was in agricultural products, especially corn, soybeans and cotton. The remaining decline was largely in exported automotive parts to countries other than Canada and Mexico and in the value of chemicals. Exported machinery (other than computers and semiconductors) decreased in January for the third consecutive month. Exports to countries in Asia generally turned down in January from peak levels in December that had been boosted by record deliveries of aircraft. The level of total exports in January was 3 percent less than the fourth-quarter average.

The value of imports rose 2 percent in January, nearly reversing the decline in December. About one-fourth of the increase was in imported consumer goods. In addition, strong increases were recorded for automotive vehicles from Canada and computers, which reversed the declines for both categories of trade recorded in December. The value of imported oil was about the same in January as in December as a small decline in price was about offset by an increase in quantity. The level of total imports in January was 3 percent above the fourth-quarter average.

## U.S. International Trade in Goods and Services



1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.

1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.



**U.S. Exports and Imports of Goods and Services**  
(Billions of dollars, SAAR, BOP basis)

	Levels				Amount Change <sup>1</sup>			
	1998		1998	1999	1998		1998	1999
	Q3	Q4	Dec.	Jan.	Q3	Q4	Dec.	Jan.
<b>Exports of G&amp;S</b>	909.4	948.9	934.5	921.3	-11.5	39.5	-12.8	-13.2
Goods exports	653.7	686.0	673.6	658.0	-4.5	32.3	-11.7	-15.6
Agricultural	49.2	54.1	55.2	48.3	-3.1	4.9	1.9	-6.9
Gold	5.2	6.9	3.0	2.7	1.0	1.7	-5.0	-0.3
Other goods	599.2	624.9	615.4	607.0	-2.5	25.7	-8.6	-8.5
Aircraft & pts	56.9	65.8	63.8	63.1	13.3	8.9	-0.9	-0.7
Computers	45.0	45.9	45.3	45.4	0.3	0.9	-0.4	0.2
Semiconductors	37.3	40.1	42.2	41.7	1.9	2.8	3.5	-0.5
Other cap gds	158.5	161.7	159.2	157.8	-4.1	3.2	-1.3	-1.3
Automotive	65.7	74.3	73.8	71.3	-6.9	8.6	-3.1	-2.6
to Canada	34.3	43.2	42.9	43.4	-5.2	8.9	-1.9	0.5
to Mexico	10.5	11.9	10.9	10.4	-1.9	1.5	-1.7	-0.4
to ROW	21.0	19.2	20.0	17.4	0.2	-1.7	0.5	-2.6
Ind supplies	128.3	129.5	126.9	123.9	-5.8	1.3	-3.7	-3.0
Consumer goods	80.1	79.5	77.6	77.6	0.3	-0.6	-1.8	-0.0
All other	27.4	28.0	26.6	26.2	-1.4	0.6	-5.2	-0.4
Services exports	255.8	263.0	260.9	263.3	-7.0	7.2	-1.1	2.4
<b>Imports of G&amp;S</b>	1095.4	1121.7	1103.1	1125.2	-2.5	26.2	-26.1	22.0
Goods imports	913.3	935.7	919.6	939.0	-4.0	22.5	-25.8	19.4
Petroleum	49.2	46.6	39.7	40.0	-4.7	-2.6	-7.9	0.3
Gold	7.3	6.6	4.4	3.6	1.9	-0.7	-2.9	-0.8
Other goods	856.8	882.6	875.5	895.5	-1.2	25.8	-15.0	19.9
Aircraft & pts	21.9	24.1	22.3	21.9	-0.5	2.2	-1.5	-0.3
Computers	71.2	74.7	72.1	76.7	-0.5	3.6	-5.4	4.5
Semiconductors	31.5	32.0	32.3	33.8	-2.0	0.5	-0.9	1.6
Other cap gds	142.4	144.3	142.3	144.6	-0.5	1.9	-4.0	2.3
Automotive	143.8	164.0	165.9	167.4	-2.5	20.2	0.4	1.5
from Canada	47.7	61.3	58.7	64.7	-1.6	13.6	-5.3	6.0
from Mexico	25.8	30.6	28.9	27.9	-2.7	4.8	-1.2	-1.1
from ROW	70.3	72.1	78.3	74.9	1.8	1.8	6.9	-3.4
Ind supplies	147.5	143.2	139.1	140.5	0.2	-4.4	-5.1	1.4
Consumer goods	217.1	218.2	217.7	223.7	-0.3	1.1	-0.9	6.0
Foods	40.4	41.0	42.6	43.7	-1.3	0.6	2.2	1.1
All other	41.0	41.0	41.1	43.1	6.2	0.0	0.4	1.9
Services imports	182.2	185.9	183.6	186.2	1.5	3.7	-0.4	2.6
<i>Memo:</i>								
Oil qty (mb/d)	11.62	11.22	10.75	11.07	-0.17	-0.41	-0.57	0.32
Oil price (\$/bbl)	11.59	11.38	10.10	9.88	-0.91	-0.25	-1.41	-0.22

1. Change from previous quarter or month.

Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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**Quantity and price of imported oil.** The quantity of imported oil rose in January from a low level in December. Preliminary Department of Energy statistics indicate higher imports in February. The increases in January and February largely reflect declines in domestic production and the onset of colder weather.

After decreasing 8 percent at an annual rate in the fourth quarter of 1998, the price of imported oil fell further in January. This decline in price was driven by lower consumption, unseasonably warm weather, high exports from Iraq, and high crude oil inventories. The average spot price of West Texas Intermediate (WTI) fell to \$12.01 per barrel in February from \$12.47 in January. This decline was driven largely by unexpectedly high production from Iran and Iraq; together they increased output by 400,000 barrels per day from January levels. During the first three weeks of March, the spot price for WTI increased \$3 per barrel in anticipation of supply cuts from OPEC producers. On March 23, OPEC signed an agreement to reduce oil supply by nearly 2 million barrels per day.

**Prices of non-oil imports and exports.** Prices of non-oil goods imports declined slightly in February after rising in January. Prices of “core” goods imports (which exclude oil, computers, and semiconductors) moved similarly. For January-February combined, prices of “core” goods rose slightly with increases in capital goods, automotive products, and consumer goods largely offset by declines in prices of imported foods and industrial supplies. Prices of imported computers fell only slightly and prices of imported semiconductors rose.

Prices of goods exports declined marginally in February after being unchanged in January. For January-February combined, prices decreased only 0.2 percent at an annual rate. Prices of both agricultural (largely soybeans) and nonagricultural products fell. Prices of exported “core” goods (which exclude agricultural products, computers, and semiconductors) rose 0.1 percent at an annual rate. Increases in prices of exported capital equipment and automotive products slightly outweighed declines in prices of exported industrial supplies and consumer goods.

**Prices of U.S. Imports and Exports**  
(Percentage change from previous period)

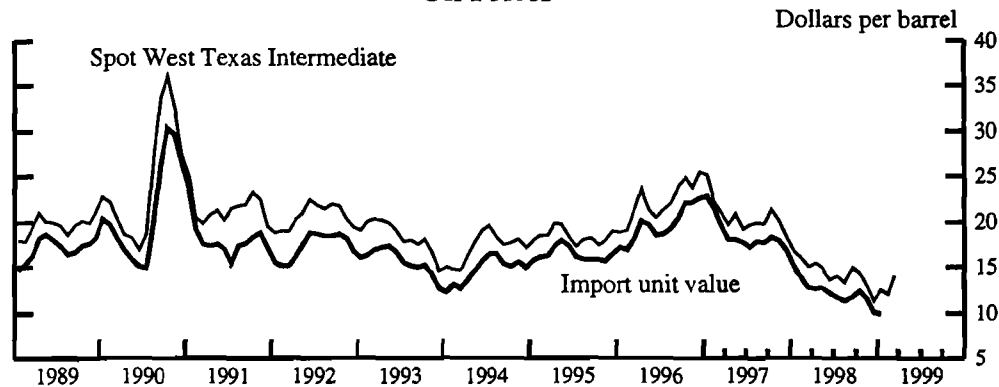
	Annual rates			Monthly rates		
	1998		1999	1998		1999
	Q3	Q4	Q1 <sup>e</sup>	Dec.	Jan.	Feb.
	----- BLS prices (1995=100) -----					
<b>Merchandise imports</b>	-6.0	-1.7	-2.0	-0.9	0.3	-0.1
Oil	-23.3	-17.9	-35.0	-13.4	3.5	-1.5
Non-oil	-4.5	-0.7	0.2	-0.2	0.2	-0.1
Core goods*	-3.6	0.3	0.3	-0.1	0.2	-0.2
Foods, feeds, beverages.	-7.0	1.3	-3.4	0.0	0.9	-2.7
Industrial supplies ex oil	-8.4	-4.6	-0.6	-0.4	0.1	0.0
Computers	-10.4	-16.6	-3.4	0.3	-0.3	-0.7
Semiconductors	-12.1	2.6	2.7	0.6	0.1	0.7
Cap. goods ex comp & semi	-3.7	2.9	1.2	-0.1	0.0	0.3
Automotive products	-1.6	1.5	1.8	0.1	0.1	0.3
Consumer goods	-1.3	0.7	0.2	-0.4	0.2	0.1
<b>Merchandise exports</b>	-4.5	-2.1	-0.2	-0.1	0.0	-0.1
Agricultural	-11.5	-7.3	-0.7	0.7	0.0	-2.4
Nonagricultural	-3.7	-1.2	-0.5	-0.1	-0.1	0.1
Core goods*	-2.5	-1.1	0.1	-0.2	0.1	0.1
Industrial supplies ex ag	-9.1	-5.6	-1.8	-0.3	-0.2	0.0
Computers	-14.0	-4.9	-1.5	-0.1	-0.3	0.0
Semiconductors	-10.2	-1.1	-6.1	0.0	-1.4	0.1
Cap. goods ex comp & semi	-0.6	0.1	1.2	0.1	0.2	0.1
Automotive products	0.4	1.7	0.6	-0.1	0.1	0.2
Consumer goods	-0.8	0.4	-0.7	-0.2	-0.1	0.1
	----- Prices in the NIPA accounts (1992=100) -----					
<b>Chain-weight</b>						
Imports of goods & services	-4.8	-0.2	n.a.	...	...	...
Non-oil merchandise	-4.4	-1.0	n.a.	...	...	...
Core goods*	-3.3	0.4	n.a.	...	...	...
Exports of goods & services	-2.8	-0.9	n.a.	...	...	...
Nonag merchandise	-3.4	-1.7	n.a.	...	...	...
Core goods*	-2.4	-1.1	n.a.	...	...	...

\*/ Excludes computers and semiconductors.

e/ Average of two months.

n.a. Not available. ... Not applicable.

### Oil Prices



**U.S. Current Account**

The U.S. current account deficit narrowed slightly in the fourth quarter to \$255 billion at a seasonally adjusted annual rate. The decrease resulted from smaller deficits for goods and services and for investment income; net unilateral transfers rose, mostly due to an increase in U.S. government grants to Israel. The smaller deficit for goods and services reflected both an improved trade balance (as exports increased faster than imports) and a larger surplus on services (as receipts increased more than payments). The smaller deficit on investment income was entirely due to a larger surplus on net direct investment income, with receipts increasing more than payments.

**U.S. Current Account**

(Billions of dollars, seasonally adjusted annual rate)

Period	Goods and services balance	Net investment income	Net transfers	Current account balance
<i>Annual</i>				
1997	-110.2	-5.3	-39.7	-155.2
1998	-169.1	-22.5	-41.9	-233.4
<i>Quarterly</i>				
1997:Q1	-112.5	.1	-35.5	-148.0
Q2	-106.1	1.8	-36.1	-140.4
Q3	-108.4	-6.2	-37.8	-152.4
Q4	-113.8	-17.0	-49.3	-180.2
1998:Q1	-141.5	-8.9	-37.7	-188.1
Q2	-176.9	-13.4	-37.6	-227.9
Q3	-186.0	-36.7	-40.1	-262.8
Q4	-172.0	-31.0	-52.0	-255.1
<i>Change</i>				
Q2-Q1	-35.5	-4.5	.2	-39.8
Q3-Q2	-9.0	-23.3	-2.6	-34.9
Q4-Q3	13.9	5.6	-11.9	7.7

Source. U.S. Department of Commerce, Bureau of Economic Analysis.

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The U.S. current account deficit for the year 1998 increased to a record \$233 billion or 2.7 percent of GDP. Larger deficits on goods and services and on investment income accounted for most of the increase, although net unilateral transfers also grew.

### **U.S. International Financial Transactions**

In 1998, foreign official assets held in the United States declined, mainly as a result of large third-quarter outflows (line 1 of the U.S. International Transactions table). Brazil and Greater China, facing pressure to devalue, accounted for a large share of the third-quarter depletion. Inflows resumed in the fourth quarter and continued into the new year. In January 1999, Saudi Arabia and Japan increased their reserves, while Argentina and Brazil drew on their reserves as pressure on their currencies escalated. Partial data through early March, from the Federal Reserve Bank of New York, suggest that Brazilian and Argentinean official reserves have stabilized (at least temporarily). Singapore also drew on their reserves in January, which may be associated with a reported move into euro reserves.

Net purchases of U.S. securities by private foreigners rebounded in the fourth quarter of 1998, returning to levels recorded at the beginning of the year (line 4). However, in January 1999, foreign net purchases of U.S. securities were again small, with net purchases of U.S. Treasuries especially weak (line 4a). Residents of Japan bought Treasury bills, and financial centers in the Caribbean sold Treasury bonds and notes. Foreign purchases of other U.S. securities remained positive, but fell from their fourth quarter highs (line 4b and 4c). The United Kingdom and Germany more than accounted for the recorded net purchases of U.S. stocks in January; net selling was concentrated in Singapore and in financial centers in the Caribbean. As in 1998, foreign purchases of corporate and other bonds were responsible for the largest share of the total net securities inflow in January. Agency purchases accounted for nearly all of the January gain.

U.S. investors sold foreign bonds and stocks on net in the late summer and early fall of 1998 (line 5), probably reflecting the Russian default and the collapse of Long Term Capital Management. Toward the end of the year, U.S. residents bought foreign securities on net as uncertainty in foreign markets subsided. In January, most likely as a result of the Brazilian devaluation, investors in the United States again retreated from foreign securities. Sales were concentrated in Brazil and in financial centers in Europe and the Caribbean.

**Summary of U.S. International Transactions**  
(Billions of dollars, not seasonally adjusted except as noted)

	1997	1998	1998					
			Q1	Q2	Q3	Q4	Dec.	Jan.
<b>Official capital</b>								
1. Change in foreign official assets in U.S. (increase, +)	20.0	-18.6	12.4	-9.8	-46.1	25.5	6.5	3.9
a. G-10 countries	1.8	6.5	4.0	-10.0	*	12.4	2.8	3.6
b. OPEC countries	12.9	-9.0	-4	.1	-11.6	2.8	1.2	3.5
c. All other countries	5.2	-16.0	8.8	.1	-34.6	9.6	2.5	-3.2
2. Change in U.S. official reserve assets (decrease, +)	-1.0	-6.8	-4	-1.9	-2.0	-2.4	-1.8	-4
<b>Private capital</b>								
<b>Banks</b>								
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	34.7	57.2	-5.8	5.4	43.1	14.4	22.2	5.0
<b>Securities<sup>2</sup></b>								
4. Foreign net purchases of U.S. securities (+)	346.7	275.6	75.4	98.9	20.1	81.1	25.8	8.6
a. Treasury securities <sup>3</sup>	147.2	46.9	-2.4	26.0	-1.2	24.5	5.3	-2.4
b. Corporate and other bonds <sup>4</sup>	128.1	170.9	46.6	57.7	25.6	41.0	15.8	7.9
c. Corporate stocks	71.3	57.8	31.1	15.3	-4.2	15.7	4.7	3.0
5. U.S. net purchases (-) of foreign securities	-89.1	-10.4	-12.4	-30.2	15.6	16.6	-3.8	2.3
a. Bonds	-48.2	-18.9	-9.6	-27.2	7.5	10.4	-4.6	-9
b. Stocks	-40.9	8.5	-2.8	-3.0	8.1	6.2	.8	3.2
<b>Other flows (quarterly data, s.a.)</b>								
6. U.S. direct investment (-) abroad	-121.8	-131.9	-34.7	-41.0	-23.3	-33.0	n.a.	n.a.
7. Foreign direct investment in U.S.	93.4	196.2	26.0	19.2	30.3	120.6	n.a.	n.a.
8. Foreign holdings of U.S. currency	24.8	16.6	.7	2.3	7.3	6.3	n.a.	n.a.
9. Other (inflow, + ) <sup>5</sup>	-52.8	-140.8	-11.6	11.9	-6.6	-134.7	n.a.	n.a.
<b>U.S. current account balance (s.a.)</b>	<b>-155.2</b>	<b>-233.4</b>	<b>-47.0</b>	<b>-57.0</b>	<b>-65.7</b>	<b>-63.8</b>	<b>n.a.</b>	<b>n.a.</b>
<b>Statistical discrepancy (s.a.)</b>	<b>-99.7</b>	<b>-3.6</b>	<b>-2.6</b>	<b>2.2</b>	<b>27.3</b>	<b>-30.6</b>	<b>n.a.</b>	<b>n.a.</b>

NOTE. The sum of official capital, private capital, the current account balance, and the statistical discrepancy is zero. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes Treasury bills.

4. Includes U.S. government agency bonds.

5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

n.a. Not available. \* Less than \$50 million.

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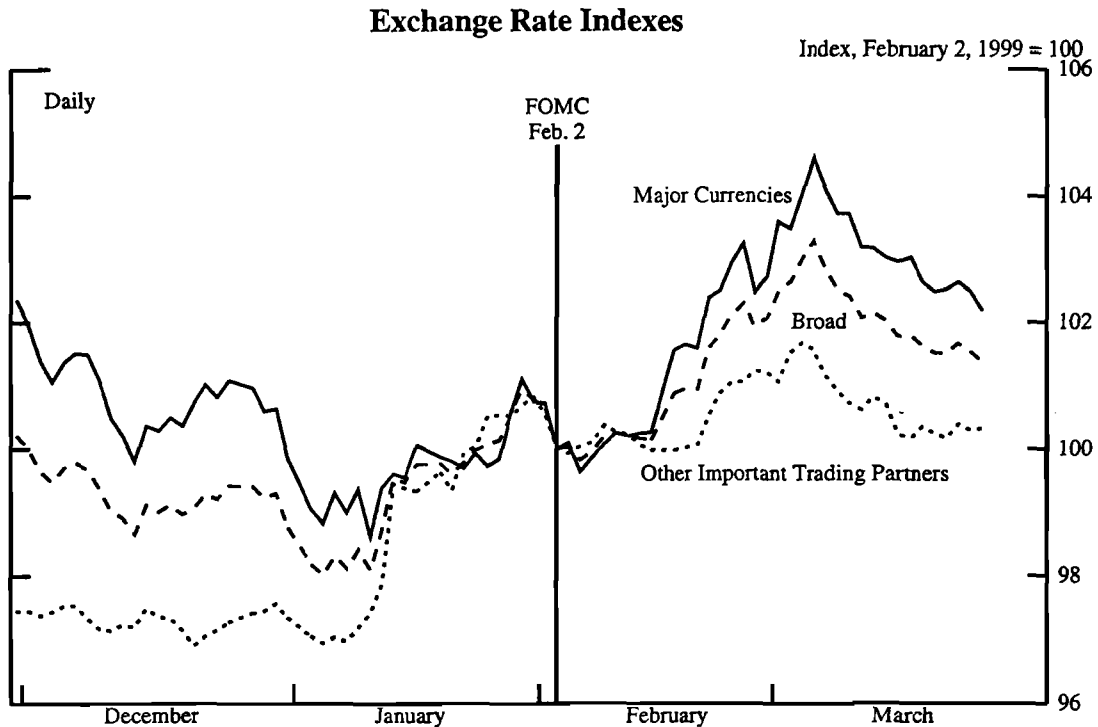
Moderate inflows through banking offices in the United States continued in 1998 (line 3). Foreign chartered banks accounted for most of the large December inflow, offsetting a November outflow of similar magnitude. In January 1999, a modest bank inflow was reported. Partial data for February show large inflows by foreign offices of U.S. banks.

Foreign direct investment in the United States soared in 1998 (line 7), largely as a result of two mega-mergers (BP-Amoco and Daimler-Chrysler) that were completed in the fourth quarter. The two mergers were associated with an increase in U.S. holdings of foreign securities that is not incorporated into U.S. net purchases of foreign securities (line 5). To reconcile this in the balance of payments accounts, other flows (line 9) show a large net outflow in the fourth quarter. U.S. direct investment abroad remained robust throughout 1998 (line 6).

The statistical discrepancy in the U.S. international accounts narrowed significantly in 1998 (last line), as compared with 1997. In the third quarter, the statistical discrepancy was revised up from negative \$3.5 billion to positive \$27.3 billion. In the fourth quarter, the statistical discrepancy was negative \$30.6 billion, indicating some combination of over-recorded net capital inflows or under-recorded net exports.

## Foreign Exchange Markets

In the period following the February FOMC meeting, the foreign exchange value of the dollar rose 2.2 percent on a weighted average basis against the other major currencies, led by an appreciation of 4.6 percent against the yen and 3.5 percent in terms of the euro.



Movements of the yen have been strongly correlated with the yield of the 10-year Japanese government bond (JGB), which declined more than 50 basis points. At the beginning of this period, the JGB yield reached an 18-month high of 2.36 percent, as projections that the Japanese government would greatly increase future issuance of bonds to fund larger-than-expected stimulus measures came on the back of statements from the Ministry of Finance (MoF) that it would be reducing its purchases of these bonds. At the same time, the yen hovered near the rate of 112 yen/dollar. Given JGB yields, market forces might have caused the yen to strengthen to under 112 yen/dollar; however, the Japanese intervention to weaken the yen in early January seemed to remain a factor for traders. Furthermore, policymakers in Japan appeared to be in agreement that yen appreciation to a level stronger than 110 yen/dollar would be detrimental to the economy. In addition, Japanese government officials began to express concern over the rise in long-term interest rates, and some officials called on the Bank of Japan (BOJ) to increase JGB purchases. While the BOJ rejected calls to underwrite JGBs either directly or indirectly, on February 12 the



BOJ Policy Board lowered its target on the overnight call rate 10 basis points to a level of 15 basis points and announced it intended to try to move the call rate even lower in the future. In fact, within a few days the call rate fell nearly to zero. Shortly afterwards, the MoF announced that the monthly 10-year JGB issue size would be reduced for the remainder of the fiscal year and that purchases by the Trust Fund Bureau would be resumed.

### Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities <sup>1</sup>
	Mar. 24	Change	Mar. 24	Change	Change
Canada	5.02	-0.11	5.16	0.15	-2.77
Japan	0.08	-0.45	1.76	-0.50	8.12
Germany	--	--	3.99	0.29	-5.99
United Kingdom	5.25	-0.50	4.57	0.34	1.47
France	--	--	4.10	0.30	-3.52
Italy	--	--	4.24	0.30	5.40
Switzerland	1.08	-0.09	2.60	-0.02	-2.30
Australia	4.79	0.06	5.43	0.26	2.02
United States	4.90	0.02	5.16	0.37	0.32
Memo: Weighted-average foreign	3.00	-0.21	3.85	0.04	n.a.

NOTE. Change is in percentage points from February 2 to March 24.

n.a. Not available.

<sup>1</sup> Equity prices.

Throughout February, the dollar appreciated against the euro, gaining 3 percent. The dollar's appreciation against the euro was driven by a series of data releases showing the U.S. economy maintaining surprisingly strong momentum. Also, data showing growth in Germany and Italy at rates below earlier market projections fueled expectations that the ECB Governing Council might ease in the near term. On balance, the dollar has moved up slightly against the euro so far in March; a 2-1/2 percent jump in the value of the euro immediately following the resignation of German Finance Minister Lafontaine on March 11 was quickly reversed.

During the intermeeting period, the U.S. dollar fell 1/2 percent against the Canadian dollar and was, on balance, unchanged against the Australian dollar, amid a rebound in commodity prices, especially oil. The dollar also remained unchanged against sterling, even as the Bank of England lowered its official repo rate 50 basis points, more than had been expected, in response to continuing signs of weak economic activity in the United Kingdom. Nonetheless, yields on 10-year gilts rose 40 basis points.

Yields on 10-year government securities rose about 30 basis points in the euro area and 40 basis points in the United States, while rising only 15 basis points in Canada. Earlier in March, the yield on the U.S. 10-year Treasury rose above the yield on the Canadian 10-year bond for the first time in eight months. Throughout the rest of March, the bond yields have remained within a few basis points of each other.

The dollar was little changed versus the currencies of our other important trading partners, with a 2 percent appreciation versus the Brazilian *real* offset by a 4 percent depreciation against the Mexican peso. Financial markets in Brazil have shaken off the turmoil that was triggered in early January when the state of Minas Gerais declared a moratorium on debt payments to the central government. There has been a sequence of positive market reactions approving the appointment, in early February, of Arminio Fraga as Brazil's central bank president. The agreement reached with the IMF that paves the way for payment of a second tranche of financial aid added further support to the *real*, Brazilian Brady bonds, and equities. The Mexican peso has also benefitted from the swing toward optimism in emerging markets. In addition, the strong growth in the U.S. economy coupled with the recent sharp rise in oil prices and lower-than-expected inflation in Mexico have contributed to a rise in the Mexican peso as well as the prices of equities and Mexican Brady bonds.

The fall in the yen *vis-à-vis* the dollar contributed to a weakening of the currencies of the emerging Asian economies. The Korean won, the Taiwan dollar, the Indonesian rupiah, and Thai baht depreciated between 2 and 4-1/2 percent against the dollar. In local currency terms, share prices rose between 5 and 20 percent in these countries, with the exception of Indonesia, which saw a 3 percent decline as domestic turmoil continued. Share prices of Indonesian financial institutions fell amid the release of the specifics of the program to shut down a large number of insolvent Indonesian banks.

The price of gold rose 2 percent towards the beginning of March. However, following proposals by Presidents Clinton and Chirac that the International Monetary Fund sell some of its gold reserves to finance part of a debt relief initiative for highly indebted poor countries, gold prices subsequently fell over 3 percent, and on net are 1 percent lower in the period following the February FOMC.

. The Desk did not intervene during the period for the accounts of the System or the Treasury.

#### Financial Indicators in Latin America, Asia, and Russia

Country	Currency/ US dollar		Short-term Interest Rates		Dollar-denominated bond spread <sup>1</sup>		Equity prices
	Mar. 24	Change	Mar.23/24	Change	Mar.23/24	Change	Change
Mexico	9.70	-3.93	22.75	-8.00	7.23	-1.61	15.46
Brazil	1.85	1.93	37.10	-5.90	12.88	-2.22	20.10
Argentina	1.00	0.00	6.00	-4.00	7.91	-0.60	1.47
Chile	490.20	-0.43	n.a.	n.a.	n.a.	n.a.	11.70
China	8.28	0.03	n.a.	n.a.	1.86	-0.62	3.78
Korea	1222.00	4.36	5.20	-1.00	2.49	-0.52	7.79
Taiwan	33.07	2.26	4.70	-0.65	n.a.	n.a.	19.82
Singapore	1.72	2.33	1.69	0.44	n.a.	n.a.	6.72
Hong Kong	7.75	-0.02	5.30	-0.24	n.a.	n.a.	12.72
Malaysia	3.80	-0.01	5.80	-0.30	3.20	-1.47	-14.66
Thailand	37.50	2.04	5.25	-0.50	2.31	-0.44	3.78
Indonesia	8820.00	1.67	38.89	-0.21	9.80	-1.32	-3.41
Philippines	38.55	0.39	n.a.	n.a.	3.75	-0.26	15.08
Russia	25.52	10.24	--	--	67.89	5.74	38.03

NOTE: Change is in percentage points from February 2 to March 23/24.

1. Mexico, Brazil, Argentina, Venezuela, and Russia: Stripped Brady bond yield spread over U.S. Treasuries. China and Korea: Global bond yield spread. Malaysia and Philippines: Eurobond yield spread. Thailand and Indonesia: Yankee bond yield spread.

n.a. Not available.

## **Developments in Foreign Industrial Countries**

Economic activity in most of the major industrial countries has shown signs of weakness in recent months. During the fourth quarter, Japanese GDP registered its fifth consecutive quarterly decline, and recent data provide little evidence of an impending recovery, although some indications of stability may be emerging. In the euro zone, fourth-quarter GDP growth slowed sharply, with outright contractions in Germany and Italy but continued strength in France. In the United Kingdom, following a year of lackluster growth, economic activity remains subdued. In all of the aforementioned countries, external demand made a significantly negative contribution to growth during the fourth quarter, mainly reflecting sharp declines in exports. In Canada, by contrast, growth rebounded during the fourth quarter, and exports surged.

Inflationary pressures in these economies have remained nonexistent, with evidence of incipient deflation in Japan and 12-month increases in consumer prices of less than 1 percent in the euro area and Canada.

In **Japan**, real GDP declined 3.2 percent (SAAR) during the fourth quarter. Residential and business investment plunged 25 percent and 21 percent, respectively, and private consumption weakened slightly. All told, private domestic demand declined 6.3 percent, the poorest performance since 1997Q2 when an increase in the consumption tax triggered a steep drop in expenditure. External demand also made a negative contribution to growth, subtracting 1.3 percentage points, as exports fell 13 percent. Imports registered their seventh consecutive quarterly decline, falling 6 percent. The weakness in private expenditure and net exports was only partially offset by a 50 percent surge in public investment, due largely to the effects of the April 1998 stimulus package.

Recent economic indicators are mixed, with some suggesting that the economy has stopped contracting and others pointing to further declines. Notably, industrial production appears to have stabilized in recent months, and industrial firms have made some progress in paring inventory levels. In addition, consumption indicators such as household expenditure and retail sales have been stable. On the other hand, machinery orders during January were down 1.5

<b>Japanese Real GDP</b>						
(Percent change from previous period, SAAR)						
Component	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
GDP	-0.8	-3.0	-4.8	-2.9	-1.2	-3.2
Total domestic demand	-2.2	-3.2	-3.9	-4.5	-2.2	-2.0
Consumption	-1.1	.0	1.4	-.6	-.6	-.3
Private Investment	-4.9	-16.1	-16.0	-13.5	-12.7	-21.8
Public Investment	-4.5	8.6	-9.4	-11.3	15.6	49.9
Government consumption	-1.0	1.1	2.8	.6	3.1	-2.2
Inventories (contribution)	.0	-.3	-.3	-.3	-.5	-.1
Exports	7.6	-6.3	-10.6	-7.6	7.4	-13.0
Imports	-3.3	-8.4	-4.4	-21.4	-.5	-5.9
Net exports (contribution)	1.4	.1	-1.0	1.6	1.0	-1.3

1. Q4/Q4.

percent (not annualized) from an already weak fourth-quarter average and down 15.8 percent from a year earlier. Similarly, new public works contracts during the fourth quarter fell 4 percent (not annualized) from the third-quarter average and declined further during January. Labor market conditions also remain severe, with unemployment at a record high of 4.4 percent for three consecutive months and the offers-to-applicants ratio near an all-time low.

There is mounting evidence of deflation in the Japanese economy. In February, both the CPI and the "core" CPI registered twelve-month declines, while the wholesale price index was down a sizable 3.8 percent from a year earlier. The decline in wholesale prices largely reflects the yen's sharp appreciation during the second half of 1998 and weakness in the prices of energy and other commodities. Total employee earnings in January were down 2 percent from a year earlier, following a 4 percent drop in December, with bonus payments showing particularly sharp declines.

Japan's current account surplus during 1998 rose to \$122 billion, up sharply from the \$94 billion surplus recorded in 1997. The current account remained on a rising trend during January, reaching \$12.2 billion (or \$146.8 billion at an annual rate).

**Japanese Economic Indicators**  
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Industrial production	-5.1	.0	-.4	-2.1	1.3	.4	n.a.
Housing starts	-5.8	-6.7	-1.8	-5.2	5.6	.7	n.a.
Machinery orders	-6.5	-4.6	-3.3	0.3	2.3	-3.1	n.a.
New car registrations	-.8	.7	-11.9	-4.4	2.4	6.8	-5.2
Unemployment rate <sup>1</sup>	4.1	4.3	4.4	4.4	4.4	4.4	n.a.
Job offers ratio <sup>2</sup>	.53	.50	.48	.47	.48	.49	n.a.
Business sentiment <sup>3</sup>	-38	-51	-56	...	...	...	...
CPI (Tokyo area) <sup>4</sup>	.6	-.1	.7	1.0	.8	.1	-.2
Wholesale prices <sup>4</sup>	-1.6	-.7	-3.6	-3.5	-4.4	-4.9	-3.8

1. Percent.

2. Level of indicator.

3. Tankan survey, diffusion index.

4. Percent change from previous year, NSA.

n.a. Not available. ... Not applicable.

On February 12, the Bank of Japan's Policy Board cut its target for the overnight call-money rate from 25 basis points to 15 basis points and promised further declines if there was no "disturbance in the market." The BOJ also indicated that it would "encourage the expansion" of the monetary aggregates in an effort to offset deflationary pressures. Following the meeting, the BOJ aggressively injected liquidity into the interbank market, pushing the overnight call-money rate below 5 basis points during most of March.

Preliminary statistics for the eleven countries in the **euro zone** confirm a significant slowing in the growth of real GDP during the fourth quarter. The slowing owed primarily to a contraction in real activity in Germany and Italy, while the French economy expanded at a healthy pace. (Taken together, Germany, France, and Italy account for almost 75 percent of real output in the euro area). In Germany, domestic demand growth weakened, despite robust private consumption spending. In France, while consumption was also strong, the strength in domestic demand was broadly based and included a sharp rise in business fixed investment. In all three countries, export growth turned sharply negative in the fourth quarter. Although imports in all three countries contracted as well, on net the external balance subtracted from growth during the fourth quarter.

<b>Euro-11 Real GDP</b>						
(Percent change from previous period, SAAR)						
Component	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
Euro-11 GDP	3.2	2.3	3.1	2.4	2.7	.9
<i>Germany:</i>						
GDP	2.3	1.8	5.3	-.1	3.6	-1.5
Domestic demand	1.5	2.8	7.8	-.1	3.1	.7
Net exports <sup>2</sup>	.9	-1.0	-2.3	.0	.5	-2.1
<i>France:</i>						
GDP	3.0	2.8	3.2	3.6	1.5	2.9
Domestic demand	1.8	3.5	5.1	4.5	.6	3.9
Net exports <sup>2</sup>	1.3	-.7	-1.8	-.8	.9	-1.0
<i>Italy:</i>						
GDP	2.9	.9	-.8	3.3	2.2	-1.1
Domestic demand	4.2	1.5	3.5	3.3	-1.3	.4
Net exports <sup>2</sup>	-1.1	-.6	-4.1	.0	3.5	-1.5

1. Q4/Q4.

2. Contribution to GDP growth.

Only limited information is available on economic developments during the first quarter. Based on surveys of the eleven countries in the euro area conducted by the European Commission, consumer confidence rose in January from its level at the end of 1998. Although business confidence in the construction sector has improved somewhat this year, confidence in the manufacturing sector dropped further in February. Both domestic and export orders weakened considerably in euro-zone countries; this weakening has been particularly striking for Germany, France, and Italy. The drop-off in orders was accompanied by a rise in the percentage of firms reporting that stocks of finished goods are too high.

**Euro-11 Forward-looking Indicators**  
(Percent balance measure, SA)

Indicator	1998					1999	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Consumer confidence <sup>1</sup>	-5.3	-4.7	-2.0	-2.0	-1.0	.0	.0
Construction confidence <sup>2</sup>	-22.0	-13.0	-15.0	-14.0	-14.0	-9.0	-9.0
Industrial confidence <sup>3</sup>	2.0	-.7	-7.3	-8.0	-9.0	-9.0	-11.0
<i>Of which:</i>							
Total orders	-13.0	-4.0	-13.0	-14.0	-15.0	-16.0	-20.0
Export orders	-3.0	-5.0	-17.3	-18.0	-21.0	-20.0	-25.0
Stocks	7.0	8.0	11.3	11.0	13.0	14.0	15.0

NOTE: Diffusion indices based on European Commission surveys in individual countries.

1. Averages response to questions on financial situation, general economic situation, and purchasing attitudes.

2. Averages response to questions on output trend and orders.

3. Averages response to questions on production expectations, orders, and stocks.

In France, industrial production posted a significant rise in January, while consumption of manufactured products (not shown on the table) surged. The unemployment rate for the euro zone edged down slightly in January to 10.6 percent. Consumer price inflation remains at historically low levels in the euro area, with Germany and France teetering on the brink of deflation.

Based on national statistics for each of the eleven countries in the euro area, the weighted-average general government deficit narrowed further in 1998 to 2.1 percent of GDP from 2.5 percent in 1997. In six of the countries, the fiscal situation appears to give no cause for immediate concern, as the balance shows a surplus or small deficit. In three other countries (including Germany), the government registered a deficit near 2 percent of GDP, suggesting that as growth slows, automatic stabilizers could push the deficit up toward the Stability and Growth Pact (SGP) limit of 3 percent of GDP. In France and Italy, the situation is even more problematic. Neither country posted any significant improvement in its fiscal deficit last year, with both very close to the SGP limit.



<b>Euro-11 Current Indicators</b>							
(Percent change from previous period except as noted, SA)							
Indicator	1998					1999	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
<i>Industrial production</i>							
Euro-11 <sup>1</sup>	.8	.8	-.3	-.2	-2.6	n.a.	n.a.
Germany	-.2	1.6	-2.3	-1.9	.6	n.a.	n.a.
France	1.3	.3	.1	.1	-1.2	.6	n.a.
<i>Unemployment rate</i>							
Euro-11 <sup>2</sup>	11.0	10.9	10.7	10.7	10.7	10.6	n.a.
Germany	11.2	10.9	10.7	10.7	10.7	10.6	10.5
France	11.9	11.8	11.5	11.5	11.5	11.4	n.a.
<i>Consumer prices<sup>3</sup></i>							
Euro-11 <sup>4</sup>	1.4	1.2	.9	.8	.8	.8	n.a.
Germany	1.4	.7	.4	.5	.4	.2	.2
France	1.0	.6	.3	.2	.3	.2	.2
Italy	1.8	1.8	1.6	1.5	1.5	n.a.	n.a.

1. Index excludes construction. Includes Eurostat estimates for Luxembourg and Portugal.

2. Standardized to ILO definition. Includes Eurostat estimates in some cases.

3. Percent change from previous year.

4. Eurostat harmonized definition.

In a highly unexpected move, German Finance Minister Lafontaine announced his resignation in early March from the cabinet and as leader of the Social Democratic Party. Chancellor Schroeder has appointed Hans Eichel, Minister-President of Hesse to replace Lafontaine at the Finance Ministry. Schroeder is slated to be confirmed as party leader at a caucus in early April.

In early February, former Italian Prime Minister Prodi formed a new political group, further splintering the unity of the center-left bloc that currently heads the government. The new group, Democrats for the Olive Tree, will focus over the short term on the upcoming elections for the European Parliament in June. Prodi is reportedly a top candidate to succeed Jacques Santer as head of the European Commission; Santer resigned from his post, together with other Commissioners, in mid-March following publication of report indicating widespread fraud and mismanagement. One of the first responsibilities of the new European Parliament will be to select Santer's successor.

<b>U.K. Real GDP</b>						
(Percent change from previous period, SAAR)						
Component	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
GDP	4.0	1.0	1.4	1.3	1.0	0.4
Total domestic demand	5.2	2.7	1.8	2.8	2.2	3.9
Consumption	4.2	1.9	2.7	1.6	0.9	2.4
Investment	10.6	7.2	7.3	.0	10.0	12.1
Government consumption	0.2	1.7	1.7	1.7	2.2	1.3
Inventories (contribution)	.7	-1	-1.5	1.5	-.4	.0
Exports	7.3	.2	-1.5	6.0	2.0	-5.4
Imports	11.3	6.1	2.2	9.6	5.5	7.1
Net exports (contribution)	-1.3	-2.0	-1.2	-1.3	-1.2	-4.1

1. Q4/Q4.

In the **United Kingdom**, real GDP growth slowed markedly last year, with fourth-quarter growth falling to 0.4 percent (SAAR). While consumer expenditure picked up during the fourth quarter and investment spending continued at a healthy pace, net exports made a large negative contribution to growth, as exports fell sharply and imports remained quite strong.

Indicators for the current quarter point to subdued activity. Industrial production declined in January, in large part reflecting lower output of utilities industries during a warmer-than-normal January. Manufacturing output registered a slight increase, following six consecutive monthly declines. Business surveys for February indicate further contraction of the manufacturing sector in the near term, but suggest that manufacturers are somewhat less pessimistic about future prospects for output and orders. Retail sales rebounded in January, as consumers apparently took advantage of sales; for January and February on average, sales were up 0.7 percent from the fourth-quarter average. The official claims-based unemployment rate remained 4.6 percent in February.

In early March, average earnings data were released; the series had been suspended since November, pending a methodological review. The newly revised series indicates that although earnings growth picked up in the first half of last year, it has since slowed. Producer input prices continued to decline in

<b>U.K. Economic Indicators</b>							
(Percent change from previous period except as noted, SA)							
Indicator	1998					1999	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Industrial production	1.2	.4	-.9	.0	-.8	-.5	n.a.
Retail sales	.2	.5	-.1	1.0	-1.0	1.3	-.4
Unemployment rate <sup>1</sup>	4.8	4.6	4.6	4.6	4.6	4.6	4.6
Business confidence <sup>2</sup>	-.7	-11.7	-23.0	-27.0	-13.0	-13.0	-10.0
Retail prices <sup>3</sup>	3.0	2.6	2.6	2.5	2.6	2.6	2.4
Producer input prices <sup>4</sup>	-7.9	-9.2	-9.2	-8.6	-9.0	-7.0	-6.4
Average earnings <sup>4</sup>	5.6	5.1	4.5	4.6	4.2	4.1	n.a.

1. Percent.

2. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.

3. Excluding mortgage interest payments. Percent change from previous year.

4. Percent change from previous year.

n.a. Not available. ... Not applicable.

February. The twelve-month rate of retail price inflation (excluding mortgage interest payments) was 2.4 percent in February, slightly below the inflation target. On an EU-harmonized basis, U.K. consumer price inflation is somewhat lower, registering 1.5 percent in February.

At its March meeting, the Monetary Policy Committee (MPC) of the Bank of England left the official repo rate unchanged at 5.5 percent, following five consecutive monthly reductions totaling 200 basis points. The minutes of the meeting indicate that, on balance, the news since the publication of the February *Inflation Report* pointed to slightly lower inflation. Accordingly, the MPC maintained an easing bias, stating that "the direction of interest rates was still more likely than not to be down."

Chancellor of the Exchequer Gordon Brown presented the Government's fiscal year 1999/00 budget on March 9. The budget is moderately stimulative, with most of the proposals addressing about £4 billion in tax cuts geared largely towards middle- and lower-income working families; nonetheless, the Government projects that the budget will remain in slight surplus over the next several years. The economic forecasts underlying the budget are unchanged from last November's pre-budget report, and call for somewhat stronger growth this year than most private sector forecasts.

In **Canada**, fourth-quarter GDP growth rebounded sharply from the lackluster pace recorded earlier in 1998. Despite meager consumer spending growth during the fourth quarter, domestic demand rose 4.8 percent (SAAR). This mainly reflected a sizable recovery in inventory investment, as firms rebuilt inventories depleted by strikes last summer and fall. In addition, growth in business fixed investment resumed in the fourth quarter, led by strong demand for computers and office equipment. Net exports made a small positive contribution to growth, as both exports and imports, particularly for automotive products, surged during the fourth quarter.

**Canadian Real GDP**  
(Percent change from previous period, SAAR)

Component	1997 <sup>1</sup>	1998 <sup>1</sup>	1998			
			Q1	Q2	Q3	Q4
GDP	4.4	2.8	3.2	1.5	1.7	4.6
Total domestic demand	4.7	1.1	-.4	4.3	-4.1	4.8
Consumption	4.1	2.1	.2	6.0	1.5	.8
Investment	7.3	3.2	.6	9.8	-.8	3.6
Government consumption	.4	.9	-.1	1.7	.7	1.1
Inventories (contribution)	.7	-.9	-.6	-1.4	-5.0	3.3
Exports	11.0	9.1	11.0	2.2	7.7	16.2
Imports	13.5	4.3	.6	9.8	-7.0	15.5
Net exports (contribution)	-.7	1.8	3.8	-2.6	5.6	.6

1. Q4/Q4.

Recent economic indicators suggest that the fourth-quarter upswing in activity has continued. Employment growth remained brisk in January and February, and retail sales in January rose sharply.

In recent months, inflation has moved lower. The twelve-month change in consumer price inflation fell from 1.2 percent in December to 0.7 percent in February. Four-quarter hourly wage inflation in the manufacturing sector was only 1 percent in the fourth quarter, compared to 2.7 percent in the third quarter. The producer price index in January was down 0.3 percent from a year earlier.

<b>Canadian Economic Indicators</b>							
(Percent change from previous period except as noted, SA)							
Indicator	1998						
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
GDP at factor cost	.4	.3	1.0	.4	.4	n.a.	n.a.
Industrial production	.4	-.3	1.4	.9	.8	n.a.	n.a.
New manufacturing orders	-.6	1.9	4.2	-3.4	.0	.8	n.a.
Retail sales	1.6	.7	-.3	1.3	-.3	1.7	n.a.
Employment	.6	.5	1.3	.6	.2	.6	.1
Unemployment rate <sup>1</sup>	8.4	8.3	8.0	8.0	8.0	7.8	7.8
Consumer prices <sup>2</sup>	1.0	.9	1.1	1.2	1.0	.6	.7
Consumer attitudes <sup>3</sup>	114.9	103.2	109.8	...	...	...	...
Business confidence <sup>4</sup>	148.9	128.6	132.3	...	...	...	...

1. Percent.

2. Percent change from year earlier.

n.a. Not available. ... Not applicable.

3. Level of index, 1991 = 100.

4. Level of index, 1977 = 100.

In February, the government announced the federal budget for fiscal years 1999/00 and 2000/01. Although the federal budget is expected to run surpluses over the next two years, fiscal policy is expected to be somewhat more expansionary. The government announced C\$5.4 billion in immediate new spending, as well as modest tax reductions. These tax cuts are expected to reduce federal revenues by C\$1.5 billion in 1999/00 and C\$2.8 billion in 2000/01.

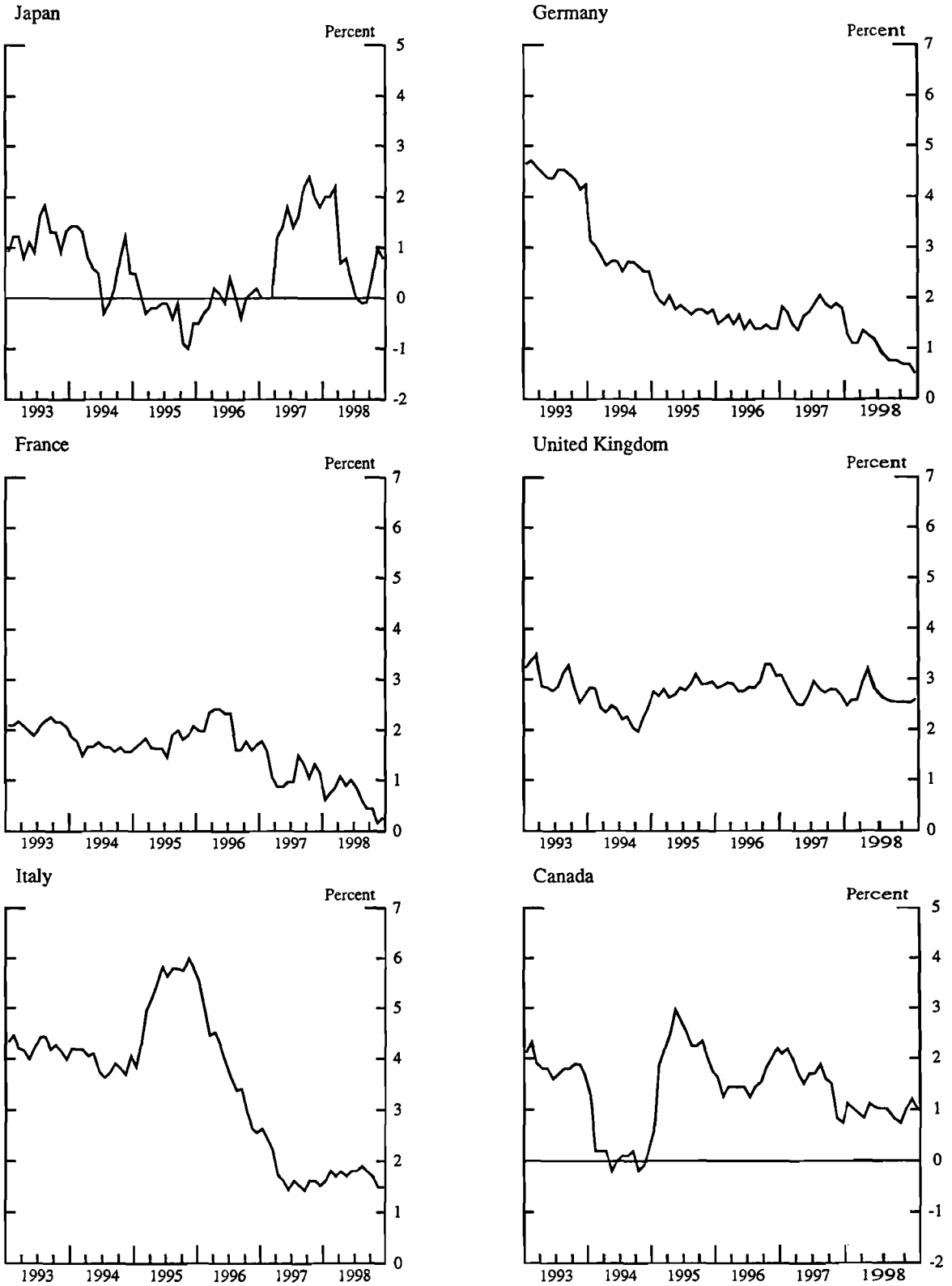
**External Balances**  
(Billions of U.S. dollars, SAAR)

Country and balance	1998					
	Q2	Q3	Q4	Dec.	Jan.	Feb.
<i>Japan</i>						
Trade	112.2	107.5	109.3	110.6	140.3	88.0
Current account	106.8	131.4	134.5	128.5	146.8	n.a.
<i>EU-11</i>						
Trade <sup>1</sup>	89.3	87.4	69.0	70.6	n.a.	n.a.
Current account <sup>1</sup>	108.7	94.7	n.a.	...	...	...
<i>Germany</i>						
Trade <sup>1</sup>	78.1	74.1	79.1	40.2	62.6	n.a.
Current account <sup>1</sup>	11.7	-19.2	-9.1	-6.6	-12.4	n.a.
<i>France</i>						
Trade	26.4	30.6	30.5	36.8	n.a.	n.a.
Current account	36.9	41.7	47.2	40.4	n.a.	n.a.
<i>Italy</i>						
Trade	29.5	28.7	25.9	27.9	n.a.	n.a.
Current account <sup>1</sup>	31.0	43.2	20.4	20.1	n.a.	n.a.
<i>United Kingdom</i>						
Trade	-31.0	-34.7	12.9	-45.0	-56.1	n.a.
Current account	-7.9	15.8	-13.5	...	...	...
<i>Canada</i>						
Trade	10.8	13.6	12.9	12.1	21.6	n.a.
Current account	-13.9	-11.5	-13.5	...	...	...

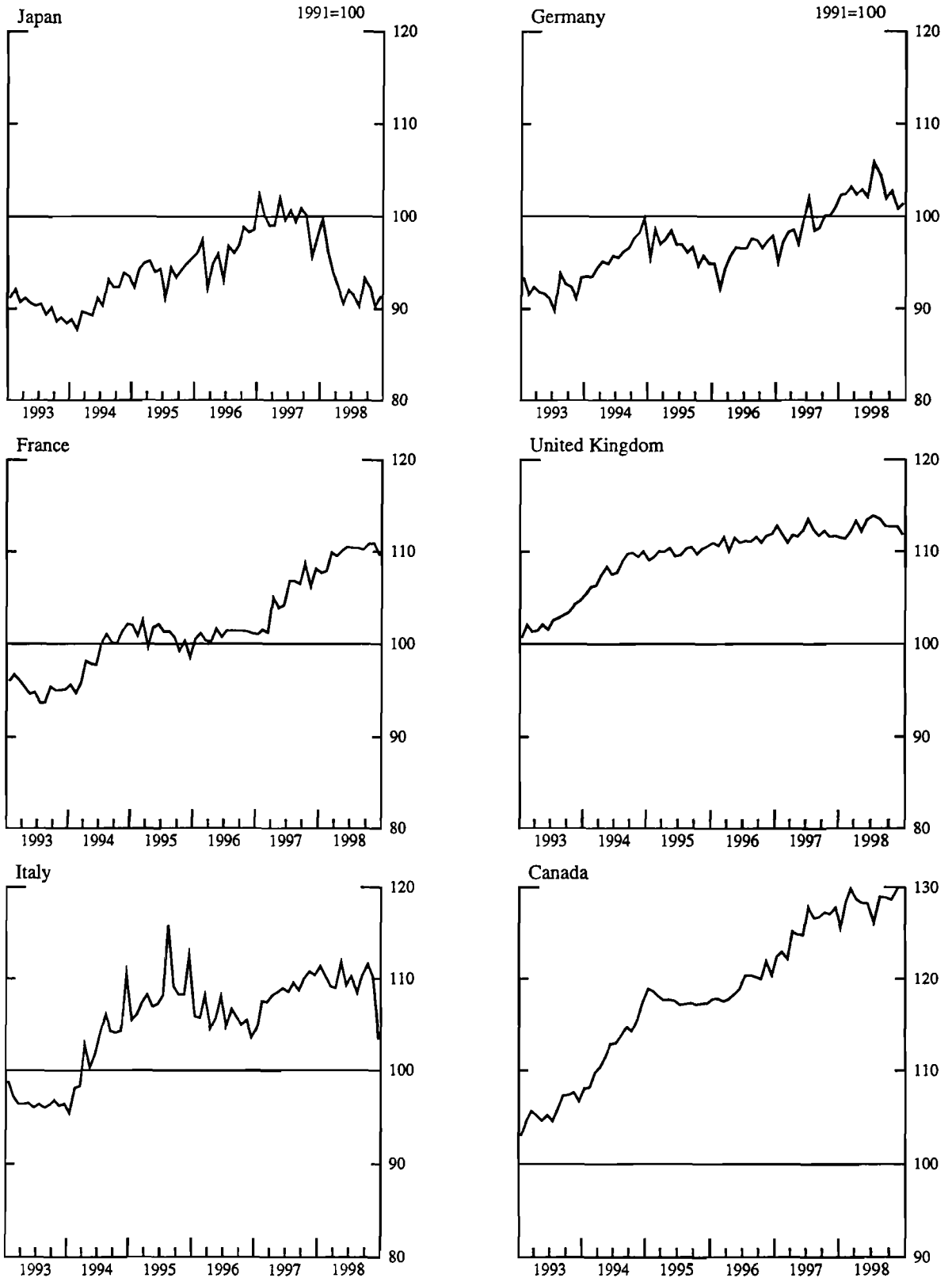
1. Not seasonally adjusted.

n.a. Not available. ... Not applicable.

**Consumer Price Inflation in Selected Industrial Countries**  
(12-month change)



**Industrial Production in Selected Industrial Countries**





### **Economic Situation in Other Countries**

In the aftermath of the collapse in mid-January of the Brazilian *real's* peg to the U.S. dollar, the Brazilian currency fell by about 35 percent, and considerable uncertainties about the economy's prospects remain. Brazilian real GDP fell sharply late last year, and inflationary pressures have surfaced. Elsewhere in Latin America, economic activity also continued to decline due to high interest rates and recent disruptions to capital flows. Although contagion from Brazil to date has been more limited than expected, recent data indicate that sluggishness in economic activity has continued into this year. Despite declining economic activity, trade adjustment in the region has not generally been as strong as might be expected, reflecting weakness in exports. Inflation remained virtually non-existent in Argentina, moderate in Mexico, and quite high in Venezuela. Ecuador has encountered financial woes, but its problems are primarily home-grown in origin and are not expected to spill over into other countries.

In the Asian developing economies, there are signs that recovery has begun in Korea and that economic activity in the ASEAN countries may be close to bottoming out, although in Taiwan growth has slowed. Korea and all of the ASEAN countries are running trade surpluses as a result of weakness in imports. However, this has contributed to a narrowing of the trade surpluses of China and Taiwan, as the demand for their exports from the other Asian economies has declined. Inflation rates in the developing Asia region have generally remained stable.

The economic situation in Russia continues to deteriorate. Russia has made some progress in restructuring its domestic public debt, but remains locked in a dispute with the IMF over appropriate fiscal policy.

In **Brazil**, uncertainty about whether the government has the determination to implement needed fiscal and monetary policies has dominated financial developments in recent weeks. Late January witnessed the removal of central bank President Francisco Lopes, who had been on the job for only two weeks, and the appointment of Arminio Fraga, a former employee of George Soros, to the post. The move appears to have been prompted by President Cardoso's dissatisfaction concerning Lopes' handling of the government's decision to allow the *real* to float. Senate confirmation of Fraga's appointment was delayed until early March, as a consequence of both the carnival holiday and charges that the Soros Fund had profited from advance notice of Fraga's appointment. (Fraga denied the charges.) Within 24 hours of Fraga's senate confirmation on March 3, the central bank monetary policy committee met and raised the overnight interest rate from 39 to 45 percent.

As a consequence of the depreciation of the *real*, consumer price inflation, which had been either negative or negligible in December, depending on the index, rose to about 13 percent per annum in January and to about 20 percent per annum in February. The most recent weekly data suggest a downturn in inflation, perhaps reflecting the central bank's rate hike in early March, as well as the weak economy. Real GDP fell over 6 percent SAAR in the fourth quarter of the year, the second consecutive quarterly decline. However, concerns about future inflation have been raised by pressures to reintroduce indexation of wage contracts, a practice that has been legally banned since 1995.

### Brazilian Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	3.5	.1	-6.1	-6.4	...	...	...
Industrial production <sup>2</sup>	3.9	-2.2	-1.5	-4.1	-2.3	1.8	n.a.
Unemployment rate <sup>3</sup>	5.7	7.6	7.8	6.9	6.3	7.7	n.a.
Consumer prices <sup>4</sup>	4.3	2.5	3.6	2.7	2.5	2.3	3.0
Trade balance <sup>5</sup>	-8.4	-6.4	-7.4	-10.5	-7.1	-9.0	2.6
Current account <sup>5</sup>	-33.8	-34.9	-37.1	-46.8	-47.8	-30.4	n.a.

1. Percent change from previous period, SAAR.

2. Percent change from previous period, SA.

3. Percent. "Open" unemployment rate.

4. Percent change from year earlier.

5. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

On March 8, Brazil and the IMF announced that they had concluded negotiations on the revision of Brazil's \$18 billion IMF program agreed to in December 1998. The revision of the program was necessary because the collapse of the *real* in mid-January undermined the assumptions underlying the program. The program is scheduled to be considered by the IMF Executive Board on March 30; its approval would pave the way for a second disbursement of about \$8.6 billion from IMF resources and bilateral donors. Under the program, Brazil commits to raising the primary balance from zero in 1998 to a surplus of 3.1 percent of GDP in 1999. The program provides for setting of monetary targets, but these may be adjusted if there are signs that money demand has deviated significantly from its projected path. Limited interventions in foreign exchange markets are allowed, in part to finance the external deficit in the early months of this year, and in fact there have been some moderate intervention operations in

recent weeks. International reserves have fallen from about \$36 billion in late January to about \$34 billion recently.

The **Mexican** economy experienced a sharp slowdown in the fourth quarter of 1998. In response to high interest rates and capital outflows after the Russian crisis, real gross domestic product was nearly flat in the fourth quarter (SAAR). Recent monthly data indicate that the economy is still sluggish. The trade deficit shrank in January and February, primarily due to a fall-off in merchandise imports. Prices rose only 1.3 percent in February over the previous month, following increases of 2.4 and 2.5 percent in December and January, respectively.

#### Mexican Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	6.8	4.8	3.8	.1	...	...	...
Industrial production <sup>2</sup>	9.1	6.3	6.3	3.9	3.9	1.4	n.a.
Unemployment rate <sup>3</sup>	3.7	3.2	3.2	2.8	2.6	3.0	3.2
Consumer prices <sup>2</sup>	15.7	18.6	15.6	17.6	18.6	19.0	18.5
Trade balance <sup>4</sup>	.6	-7.7	-9.2	-10.1	-10.6	-6.5	-4.3
Imports <sup>4</sup>	109.8	125.2	123.4	133.4	134.2	111.3	120.2
Exports <sup>4</sup>	110.4	117.5	114.2	123.3	123.5	104.7	115.9
Current account <sup>4</sup>	-7.4	-16.1	-18.7	-18.6	...	...	...

1. Percent change from previous period; SAAR estimated by staff.

2. Percent change from year earlier.

3. Percent.

4. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

In recent weeks, financial markets in Mexico have rallied to levels not seen since before last August's Russian crisis. Improved prospects for Brazil, higher oil prices, as well as a booming U.S. equity market and strong import demand, have provided a hefty boost to Mexico's equity and fixed-income markets. On March 23, Mexico's stock market was up more than 40 percent since Brazil's devaluation on January 13. Over the same period, the peso appreciated 8.6 percent, while interest rates on the benchmark 28 day Mexican treasury bills (cetes) fell nearly 11 percentage points to about 22 percent.

In **Argentina**, the recession resulting from uncertainties associated with the global financial turmoil continued. Real GDP in the fourth quarter of last year declined for the second consecutive quarter. Monthly industrial production data indicate that sluggishness in economic activity has continued into this year. Despite the slowdown in growth in 1998, external balances deteriorated; this reflects the fact that while growth of imports has slowed, export growth has slowed by much more (particularly exports to Brazil), with exports declining about 2 percent in 1998. With the currency peg holding, inflation remains virtually non-existent.

### Argentine Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	8.6	4.1	-5.9	-5.7	...	...	...
Industrial production <sup>2</sup>	8.6	.4	.0	-9.4	-12.2	-8.6	-11.7
Unemployment rate <sup>3</sup>	14.9	12.9	13.2	12.4	...	...	...
Consumer prices <sup>2</sup>	.3	.7	1.1	.7	.7	.5	.0
Trade balance <sup>4</sup>	-2.2	-3.7	-5.6	-4.8	-3.5	-5.1	n.a.
Current account <sup>4</sup>	-9.3	n.a.	n.a.	n.a.	...	...	...

1. Percent change from previous period; SAAR.

2. Percent change from year earlier; quarterly and annual consumer price changes use end of period data.

3. Percent. The third and fourth quarter figures are from surveys conducted in August and October, respectively.

4. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

The negative reaction of financial markets to the Brazilian devaluation in mid-January proved to be more subdued than the reaction to the Russian devaluation and debt moratorium last year. Domestic interest rates are now below their pre-Brazilian crisis values. Brady spreads have also returned to the values prevailing just before mid-January, but remain substantially higher than their pre-Asian crisis values.

Shortly after the Brazilian currency collapse, the Argentine government announced that it was considering a dollarization of its economy, which would involve replacing its domestic currency with U.S. dollars. The objective is to raise confidence in the economy and bring down Argentine interest rates by eliminating the premium associated with devaluation risk. Several options are being considered by the Argentine government, including a bilateral treaty with

the United States that would allow for some sharing with the Argentine government of seigniorage revenues that would accrue to the United States.

The **Venezuelan** economy continues to be plagued by the effects of the earlier slump in world oil prices, a ballooning government budget deficit, and uncertainties associated with the domestic political situation and global financial conditions. In consequence, real GDP plummeted in the fourth quarter of last year, making year-over-year growth in 1998 negative. Inflation continues to be quite high, and, with the government not letting the domestic currency depreciate at anywhere close to the inflation rate, the problem of exchange rate overvaluation continues. The decline in oil prices and the overvaluation of the currency contributed to turn the current account from a sizeable surplus in 1997 to a deficit in 1998.

#### Venezuelan Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	5.9	-5	-15.3	-19.8	...	...	...
Unemployment rate <sup>2</sup>	11.7	11.2	11.0	11.0	...	...	...
Consumer prices <sup>3</sup>	37.6	30.1	36.2	31.2	30.1	30.3	29.7
Non-oil trade balance <sup>4</sup>	-7.5	-8.6	-9.0	-6.8	-6.4	n.a.	n.a.
Trade balance <sup>4</sup>	10.5	3.4	3.0	4.5	4.0	n.a.	n.a.
Current account <sup>4</sup>	4.7	-1.7	-1.6	-9	...	...	...

1. Percent change from previous period, SAAR.

2. Percent. NSA.

3. Percent change from year earlier, end of period.

4. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

The fall in oil revenues turned the central government's fiscal balance from a surplus of 1.6 percent of GDP in 1997 into a deficit of 4.3 percent of GDP in 1998. The government has announced an economic program that includes some tax reform. However, the program is viewed as highly inadequate and conservative estimates predict at least a doubling of the central government deficit for this year.

Since the Central Bank of **Ecuador** let the national currency, the *sucre*, float on February 12, it has lost over 50 percent of its value. On March 9, fearing further large runs on commercial bank deposits precipitated by the *sucre's* fall, the authorities declared a national banking holiday for the entire week. One day

later, President Jamil Mahaud declared a national state of emergency. Although Ecuador's economy has suffered from declining commodity prices (especially oil) and *El Niño*-induced flooding, its current problems are largely a consequence of prolonged large fiscal deficits and a history of economic mismanagement. A recently approved fiscal package should generate revenue of about 2.6 percent of GDP and will help reduce a current fiscal deficit of about 6 percent of GDP. The Mahaud administration also hopes that its passage will release financial assistance from the IMF, World Bank, and others. However, since the package was announced, Ecuador's second-largest bank has failed and the *sucre* has fallen further.

In **Korea**, recent data provide further evidence that the steep drop in activity bottomed out late last year and that recovery is underway. Real GDP grew strongly in the fourth quarter of last year. Industrial production in January showed a large gain from one year earlier, but declined 3.3 percent from the previous month on a seasonally adjusted basis, depressed in part by a strike at a large semiconductor plant. Combined retail and wholesale sales, a widely watched indicator of demand, showed a 2.8 percent 12-month rise in January, the first such increase in 15 months, boosted by stronger consumer spending on autos and other consumer durable goods. The unemployment rate rose to a record high 8.7 percent in February. With promised corporate restructuring likely to involve further layoffs, a weak labor market may hold down the recovery in consumer spending. Rising unemployment and low capacity utilization rates have continued to put downward pressure on prices, with consumer prices showing almost no increase from their year-earlier level in February.

The current account showed a positive swing of nearly \$50 billion from 1997 to 1998. This movement was entirely accounted for by a drop in imports; the dollar value of imports fell 35 percent in 1998 whereas export revenues were about flat, although export volumes are believed to have risen.

In February, the government announced that Seoulbank, nationalized shortly after the 1997 currency crisis, was being sold to a foreign bank, HSBC Holdings of the United Kingdom. This sale follows the sale late last year of nationalized Korea First Bank to U.S. interests and represents an important step in the process of financial market restructuring.

### Korean Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	5.5	-5.8	1.6	5.3	...	...	...
Industrial production <sup>2</sup>	6.7	-7.2	-8.3	-.5	5.1	15.0	n.a.
Consumer prices <sup>2</sup>	6.6	4.0	7.0	6.0	4.0	1.5	.2
Trade balance <sup>3</sup>	-3.2	41.2	41.4	39.2	40.3	22.4	n.a.
Current account <sup>3</sup>	-8.2	40.0	38.5	34.7	37.1	22.9	n.a.

1. Percent change from previous period; SAAR estimated by staff.

2. Percent change from year earlier.

3. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

Recent indicators for the ASEAN countries suggest that economic activity in the region may be close to bottoming out. Fourth-quarter real GDP growth for both the Philippines and Singapore was better than expected. Industrial production numbers indicate that Thailand has bottomed out, and other ASEAN economies may not be far behind.

All the ASEAN countries are running trade surpluses, with balances up sharply across the region relative to last year. The improvement has resulted mainly from a reduction in imports rather than increases in export revenues. However, in recent months imports across the region appear to have stabilized, and trade surpluses have begun to shrink.

ASEAN financial markets were generally flat as market participants await the outcomes of anticipated reforms. Inflation appears to have stabilized across the region, mainly reflecting weak domestic demand. Twelve-month inflation in each of the ASEAN countries declined somewhat in January and February, while prices in Singapore continue to fall.

Financial sector restructuring and reform have advanced in Indonesia and Thailand recently. Indonesia closed 38 banks, nationalized seven others, and recapitalized another nine. Thailand's parliament recently passed crucial amendments to the country's bankruptcy and foreclosure laws to streamline the legal process and improve creditors' power to seize collateral. Malaysia relaxed some of its exchange controls by introducing an "exit tax" on repatriation of foreign portfolio capital to replace measures implemented last September that prohibited repatriation of investment principal until September 1999.

### ASEAN Economic Indicators: Growth

Indicator and country	1997	1998	1998				1999	
			Q3	Q4	Nov.	Dec.	Jan.	
<i>Real GDP<sup>1</sup></i>								
Indonesia	4.9	-13.6	-25.0	-0	...	...	...	
Malaysia	7.8	n.a.	-2.3	n.a.	...	...	...	
Philippines	5.2	-5	1.8	-1.6	...	...	...	
Singapore	8.0	1.5	-6	-6	...	...	...	
Thailand	-1.3	n.a.	n.a.	n.a.	...	...	...	
<i>Industrial production<sup>2</sup></i>								
Indonesia	6.4	-12.9	-18.4	-19.5	...	...	...	
Malaysia	10.7	-7.2	-10.5	-10.9	-12.3	-9.6	-11.1	
Philippines	8.9	-2.0	-3.1	-11.7	-17.8	-8.7	-2.5	
Singapore	4.7	-5	-4.3	-2.6	-3.5	-3.1	10.0	
Thailand	-6	-12.0	-11.1	-3.6	-5.3	-2.6	-1.0	

1. Percent change from previous period; SAAR estimated by staff.

2. Percent change from year earlier.

n.a. Not available. ... Not applicable.

### ASEAN Economic Indicators: Trade Balance (Billions of U.S. dollars; annual rate; not seasonally adjusted)

Country	1997	1998	1998				1999	
			Q3	Q4	Nov.	Dec.	Jan.	Feb.
Indonesia	11.9	21.4	23.3	17.6	19.3	16.8	n.a.	n.a.
Malaysia	-.2	15.0	16.5	20.8	20.5	21.2	13.6	n.a.
Philippines	-10.5	-.2	2.0	3.2	2.5	5.5	2.2	n.a.
Singapore <sup>1</sup>	-5.8	8.3	10.9	8.9	10.3	3.8	.8	3.4
Thailand	-4.6	12.2	12.6	13.4	12.5	14.8	9.8	n.a.

1. Non-oil trade balance.

n.a. Not available. ... Not applicable.



### ASEAN Economic Indicators: CPI Inflation

(Percent change from year earlier)

Country	1997	1998	1998				1999	
			Q3	Q4	Nov.	Dec.	Jan.	Feb.
Indonesia	10.3	77.6	76.3	78.4	78.2	77.6	71.1	53.7
Malaysia	2.9	5.3	5.7	5.4	5.6	5.3	5.2	3.8
Philippines	6.6	10.4	10.4	10.6	11.2	10.4	11.5	9.9
Singapore	2.1	-1.5	-8	-1.6	-1.6	-1.5	-5	-6
Thailand	7.6	4.3	8.2	5.0	4.7	4.3	3.5	2.9

n.a. Not available. ... Not applicable.

In **Hong Kong**, real GDP fell about 5.1 percent in 1998 from a year earlier, according to preliminary data. Hong Kong's unemployment rate was 6 percent during the December-February period, up from 5.5 percent during the September-November period. In February 1999, consumer prices were below their year-earlier level. Hong Kong's merchandise trade deficit continued to narrow in recent months, reflecting continued weakening of imports. Foreign exchange reserves were \$90 billion at the end of February, up about \$2 billion from their recent low in September.

Authorities announced that the budget deficit in fiscal 1998/99 was about \$4 billion (about 2-1/2 percent of GDP) and that they expect a comparable budget deficit in fiscal 1999/2000. The government plans to sell about two thirds of its \$19 billion equity portfolio, most of which was acquired in its

### Hong Kong Economic Indicators

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	5.3	-5.1	-4.6	-1.2	...	...	...
Consumer prices <sup>2</sup>	5.2	-1.6	2.5	-1.6	-1.6	-1.1	-1.7
Trade balance <sup>3</sup>	-20.6	-10.6	-9.7	-4.4	-10.5	-1.0	n.a.

1. Percent change from previous period; SAAR estimated by staff.

2. Percent change from year earlier.

3. Billions of U.S. dollars, AR, NSA. Imports are c.i.f.

n.a. Not available. ... Not applicable.

controversial August 1998 intervention. Spreads between one-year Hong Kong government debt and U.S. Treasuries fell to around 170 basis points from about 230 basis points in late January.

In **China**, the trade surplus continued to narrow in recent months, largely reflecting weakening exports. The value of exports in the first two months of 1999 fell 10 percent from its year-earlier level, while the value of imports rose 5 percent. Moderate deflation continues.

Chinese leaders met for the annual two-week National People's Congress (NPC) in early March. Premier Zhu Rongji warned that it would be difficult to achieve the government's 7 percent growth target for 1999, given weak domestic demand, the "grim" external environment, and "lax" financial discipline. Nevertheless, he asserted that the target would be achieved through a sizeable increase in the fiscal deficit. Zhu claimed that China would continue with difficult reforms of state-owned enterprises and the state banking system; many analysts have argued that the slowdown in economic growth has slowed the pace of reform. The NPC also passed a constitutional amendment recognizing private enterprises as an "important component" of the national economy, and central bank governor Dai Xianglong pledged to boost lending to private industry.

Following China's decision in January to put the Guangdong Investment and Trust Corporation into bankruptcy, several rating agencies have downgraded ratings for other Chinese financial institutions, including the major state commercial banks. For example, S&P now rates the Bank of China, considered the strongest of the major state banks, two notches below China's sovereign rating for foreign currency counter party risk; a year ago, the Bank of China had the same rating as the central government. Given the substantial bad debt problems of the banks as well as their weak internal controls, the key question is how much support these institutions will receive from the government in case of financial difficulties. It remains likely that the government will continue to guarantee deposits by Chinese savers at the banks. However, it is less clear that the government will guarantee external liabilities.

In March, authorities confirmed press reports that China plans to establish institutions modeled after the U.S. Resolution Trust Corporation to take some of the bad loans off the books of the major commercial banks. China plans to establish a separate institution for each of the four major banks, although the timetable and procedures remain unclear.

**Chinese Economic Indicators**  
(Percent change from year earlier except as noted)

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	8.8	7.8	10.8	12.4	...	...	...
Industrial production	13.1	10.4	10.5	11.3	7.5	8.0	13.2
Consumer prices	.4	-1.0	-1.4	-1.1	-1.0	-1.2	-1.3
Trade balance <sup>2</sup>	40.7	43.3	51.2	32.7	27.6	17.9	27.4

1. Percentage change from previous period; SAAR estimated by staff.

2. Billions of U.S. dollars, AR, NSA, imports are c.i.f.

n.a. Not available. ... Not applicable.

In **Taiwan**, real GDP growth slowed considerably in the fourth quarter. For all of 1998, GDP rose 4.8 percent from a year earlier, the lowest growth rate since 1982. Unemployment was 2.7 percent in February, down from 2.8 percent in January. Inflation was unchanged from its level at end-1998.

Taiwan's current account surplus in 1998 was the smallest surplus since 1983, reflecting a sharp decline in exports, which in turn is a consequence of reduced demand by other Asian economies. Taiwan's trade balance remained in surplus in the first two months of 1999, with the value of exports rising 7 percent from a year-earlier and the value of imports falling 6 percent. Foreign exchange reserves rose to \$93 billion in February, up about \$2 billion from December and the highest level since July 1997. Taiwan's stock market remained relatively stable in early 1999, but this stability appears to reflect continuing intervention by the government's stock stabilization fund.

Amid growing concern about slowing growth and weak bank health, Taiwan's authorities in February announced several proposals aimed at improving the operations of Taiwan's capital markets and stimulating the economy. The proposals would make it easier for listed firms to buy back their own shares, "to better ensure price stability." Other changes include reducing bank reserve requirements for a range of deposits; cutting bank business taxes from five to two percent; and raising the limit on foreign stock ownership from 30 percent to 50 percent of total market value.

**Taiwan Economic Indicators**

Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb
Real GDP <sup>1</sup>	6.8	4.8	5.9	2.9	...	...	...
Industrial production <sup>2</sup>	6.8	3.8	5.0	1.6	-.6	15.0	-6.3
Consumer prices <sup>2</sup>	.2	2.1	.6	2.9	2.1	.4	2.1
Trade balance <sup>3</sup>	7.7	6.0	14.0	5.0	-3.5	6.3	12.8
Current account <sup>3</sup>	7.7	3.6	8.3	2.1	...	...	...

1. Percent change from previous period; SAAR estimated by staff.

2. Percent change from year earlier.

3. Billions of U.S. dollars, AR, NSA, imports are c.i.f.

n.a. Not available. ... Not applicable.

The **Russian** economy remains in turmoil. Real GDP fell sharply in 1998. Industrial output was down 5.2 percent for the year, although the rate of decline has slowed since last September, as import substitution and the weak ruble cushioned producers from the full fallout of the crisis. The ruble has depreciated by about 11 percent in nominal terms against the dollar so far this year, and is down roughly 75 percent since the onset of the August 1998 crisis. The sharp increase in the cost of imports caused inflation to soar to over 100 percent in February (twelve-month basis).

The government remains in a standoff with the IMF over fiscal policy. The IMF has made known that it would like to see a primary (excluding interest payments) surplus of 3-4 percent of GDP next year, and sees stronger revenue performance as the key to accomplishing this task. Russia's 1999 budget aims to trim the overall deficit from 5-1/2 percent of GDP in 1998 to 2-1/2 percent this year, with a primary surplus of 1-3/4 percent. Several assumptions underlying the budget seem overly optimistic, including an annual inflation rate of 30 percent and an exchange rate of 21.5 rubles per dollar. Furthermore, the budget assumes the resumption of IMF and World Bank lending as well as the successful "re-rescheduling" of about \$7 billion in Soviet-era debt.

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**Russian Economic Indicators**


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Indicator	1997	1998	1998			1999	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	.8	-4.6	-19.7	-.9	n.a.	n.a.	n.a.
Industrial production <sup>2</sup>	1.8	-5.2	-11.8	-8.9	-6.6	-4.9	-3.7
Unemployment rate <sup>3</sup>	10.8	11.5	11.5	11.7	11.8	12.4	12.4
Consumer prices <sup>2</sup>	11.0	84.4	26.2	70.0	84.4	97.1	103.4
Ruble depreciation <sup>2</sup>	17.0	71.3	63.1	71.3	73.8	73.6	73.6
Trade balance <sup>4</sup>	17.0	13.8	15.1	37.0	42.0	22.8	n.a.
Current account <sup>4</sup>	3.5	n.a.	.9	n.a.	...	...	...

1. Percent change from previous period, AR.

2. Percent change from year earlier.

3. Percent.

4. Billions of U.S. dollars, AR, NSA.

n.a. Not available. ... Not applicable.

The government continues to negotiate with foreign creditors on rescheduling its Soviet-era external debt, while maintaining that it will meet in full all obligations of the Russian Federation issued since 1991. Russia is due to make several large payments on its debt this summer, an all the more pressing reason to reach an agreement with the IMF as soon as possible. Several banks have accepted the government's terms for restructuring short-term domestic debt, leading to speculation that others may soon follow suit. The government plans to permit foreigners to invest a portion of the restructured debt in the stock market, a fact that has led the RTS index to rise almost 50 percent since the end of January. Negotiations on restructuring Russia's \$40 billion debt to the Paris Club will not begin until after the government's economic plan wins approval from the IMF.

The Central Bank has come under fire following the revelation that it entrusted several billion dollars worth of foreign exchange reserves to FIMACO, a small off-shore finance company in the Caribbean. The scandal has raised doubts about the integrity of the Central Bank and bolstered efforts to limit its independence.