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Confidential (FR) Class III FOMC

Part 2

August 16, 2000

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

Prepared for the Federal Open Market Committee
by the staff of the Board of Governors of the Federal Reserve System

Confidential (FR) Class III FOMC

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Domestic Nonfinancial Developments

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Overview

On balance, economic activity appears to be expanding at a more moderate pace than observed earlier in the year. Growth of employment and hours worked has shifted down noticeably in recent months, and sales of new homes and motor vehicles are well off their earlier highs. By contrast, business spending for equipment and software continues to surge. Labor markets remain extremely tight. Some measures of hourly labor compensation have accelerated significantly of late, and nearly all are rising considerably more rapidly than a few years ago. But with productivity growth also having increased, most measures of core prices have accelerated only modestly.

Real GDP

According to the advance estimate prepared by the Bureau of Economic Analysis, real GDP increased at an annual rate of 5.2 percent in the second quarter. Data received since the advance release suggest that real GDP growth will be marked down to about a 4.9 percent rate, as downward revisions to expenditures on nonresidential structures, residential investment, and state and local government spending more than offset an upward revision to inventories.[1] *Unless otherwise indicated, the discussion of second-quarter activity in this section of the Greenbook incorporates our expected revisions to GDP.*

Real GDP and Selected Components
(Percent change, annual rate, except as noted)

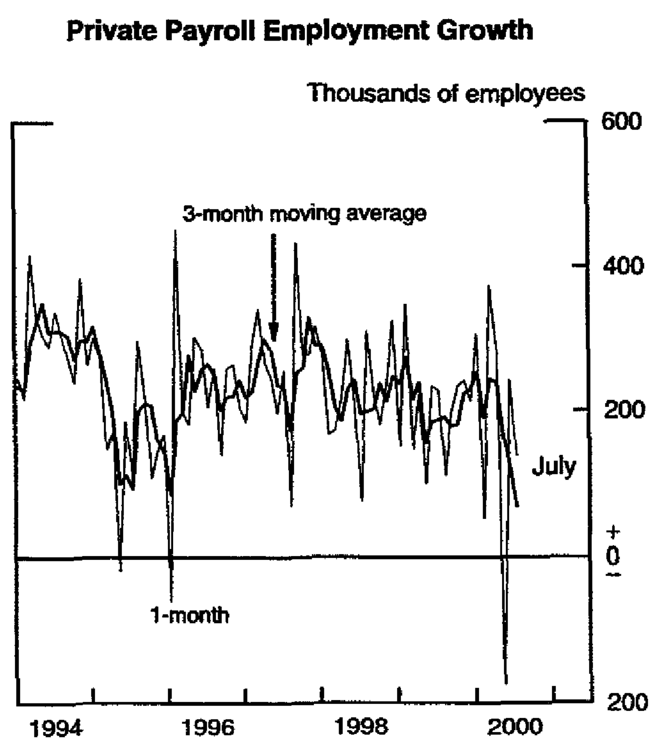
	2000:Q1	2000:Q2	
		BEA advance	Staff estimate
Real GDP	**4.8**	**5.2**	**4.9**
Final sales	6.7	4.2	3.4
Private domestic final purchases	9.3	5.2	4.7
Consumption	7.6	3.0	2.9
Business fixed investment	21.0	19.1	15.1
Residential investment	3.2	3.9	1.1
Government	-1.1	6.0	5.4
Inventory investment *(level, billions of chained 1996 dollars)*	36.6	60.3	76.6

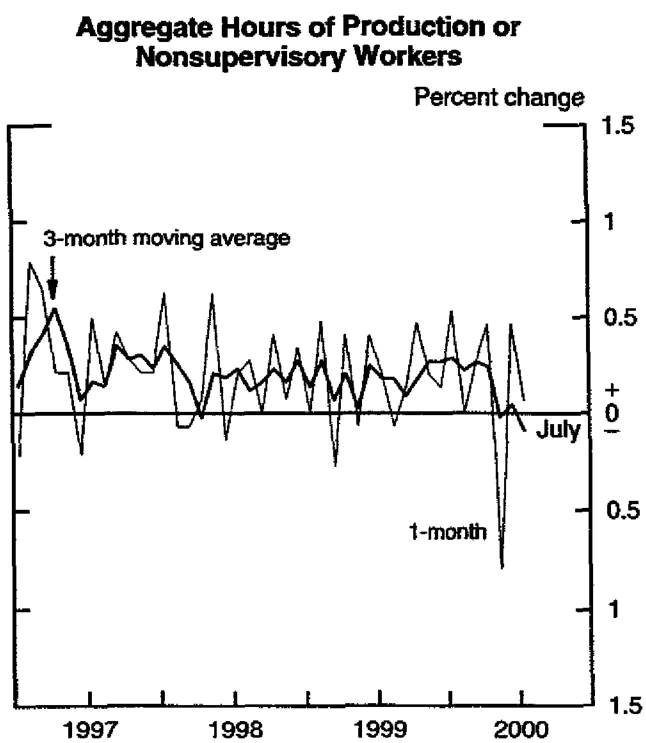
1. The June report on international trade in goods and services--the only major piece of source data for the second quarter still outstanding--will be released on Friday, August 18.

CHANGES IN EMPLOYMENT
(Thousands of employees; based on seasonally adjusted data)

	1998	1999	2000 Q1	2000 Q2	2000 May	2000 June	2000 July
	----Average monthly change----						
Nonfarm payroll employment[1]	251	229	324	204	171	30	-108
Previous				*197*	*171*	*11*	
Private	224	202	244	119	-174	242	138
Mining	-3	-3	2	1	0	0	1
Manufacturing	-12	-18	-1	5	-13	13	46
Construction	37	25	58	-19	-28	2	6
Transportation and utilities	20	16	14	11	-8	23	20
Retail trade	30	36	30	28	-133	48	49
Wholesale trade	10	13	5	11	-7	2	10
Finance, insurance, real estate	22	10	3	-11	-10	-11	7
Services	120	124	128	98	25	165	-1
Total government	28	28	80	84	345	-212	-246
Census			58	98	356	-136	-292
Total employment[2]	156	159	246	7	-991	464	-430
Nonagricultural	169	155	220	19	-934	441	-408
Memo:							
Aggregate hours of private production workers (percent change)[1,3]	2.3	2.1	3.2	1.1	-0.8	0.5	0.1
Average workweek (hours)[1]	34.6	34.5	34.5	34.5	34.4	34.5	34.4
Manufacturing (hours)	41.8	41.7	41.7	41.7	41.4	41.6	41.7

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 are percent change from preceding quarter at an annual rate. Monthly data are percent change from preceding month.





Labor Market Developments
The data for July reinforce the impression that private-sector hiring has slowed since the first quarter of this year. However, the labor market remains quite tight, and employers continue to report difficulties in finding and retaining workers.

Private nonfarm payrolls rose 138,000 in July following an average monthly increase of about 120,000 in the second quarter. This pace was down from 240,000 per month in the first quarter of the year and 200,000 per month over all of 1999. A portion of the deceleration can be attributed to industries--such as construction--in which the interaction of tight labor markets, heavy demand, and unusual weather may have distorted usual seasonal employment patterns. Despite an increase in July, employment in finance, insurance, and real estate has fallen appreciably since February, and payroll gains have been less robust in services--perhaps reflecting the difficulty in finding workers.[2] In addition, almost all of the rise in retail trade employment in July reflected hiring at eating and drinking places, a category that has been quite volatile in the past several months. Manufacturing employment posted a strong gain last month, although the BLS cautions that changes in the timing of regular summer vacations and related factory downtimes may have shifted some employment from August into July on a seasonally adjusted basis (as appears to have been the case last year).

As a result of the smaller employment gains, aggregate hours of production or nonsupervisory workers on private nonfarm payrolls rose at an annual rate of 1.1 percent in the second quarter, compared with a 3.2 percent annual rate in the first quarter and a 2.1 percent increase over the whole of 1999. July's increase of 0.1 percent (not at an annual rate) left the level of hours just a bit above the second-quarter average.

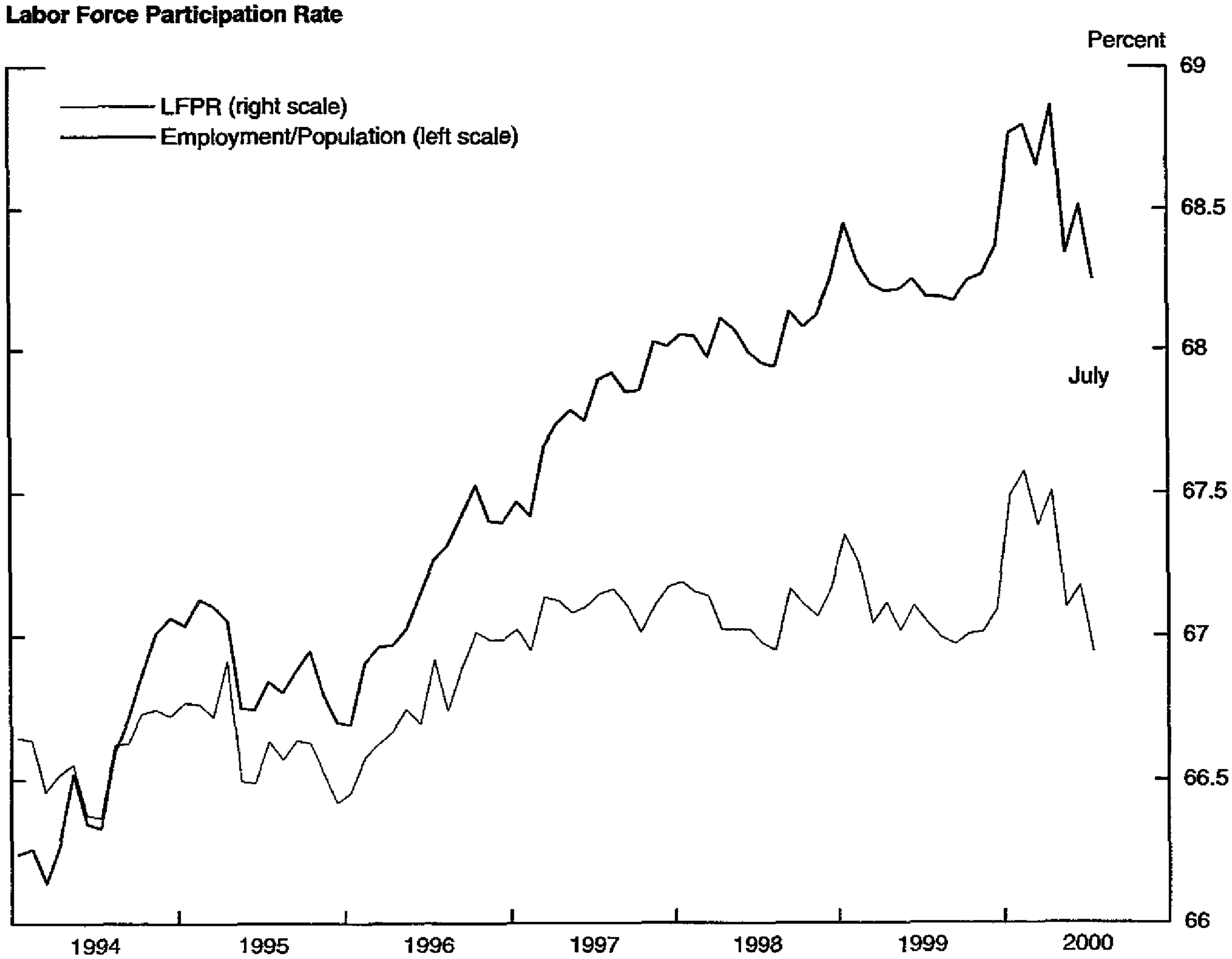
One outstanding question is the extent to which private employment gains have been affected by the hiring patterns associated with the decennial Census. While there are no data that would allow us to answer this question conclusively, an examination of worker flows using Current Population Survey (CPS) microdata indicates that an unusually large number of workers moved from private employment to federal employment between April and May, which was when Census added the bulk of its intermittent workers. The CPS data do not indicate a large net flow of workers from the federal government to the private sector between May and June, when the Census began to release

2. The change in employment in services was held down about 30,000 in July as a result of the implementation of the Workforce Investment Act, which replaced the federally funded summer jobs program for youth with a year-round program. Nevertheless, employment gains elsewhere in services were small last month.

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

	1998	1999	2000 Q1	2000 Q2	2000 May	2000 June	2000 July
vilian unemployment rate (16 years and older)	4.5	4.2	4.1	4.0	4.1	4.0	4.0
Teenagers	14.6	13.9	13.4	12.3	12.5	11.6	13.4
20-24 years old	7.9	7.5	7.5	7.6	8.2	7.5	6.8
Men, 25 years and older	3.2	3.0	2.9	2.8	2.8	2.8	2.8
Women, 25 years and older	3.6	3.3	3.2	3.2	3.3	3.2	3.3
bor force participation rate	67.1	67.1	67.5	67.3	67.1	67.2	66.9
Teenagers	52.8	52.0	52.1	52.5	51.6	52.9	51.3
20-24 years old	77.5	77.6	78.6	77.7	77.2	77.6	76.8
Men, 25 years and older	76.2	76.1	76.3	75.8	75.8	75.8	75.8
Women, 25 years and older	59.2	59.5	60.0	60.0	59.9	59.7	59.6
mo:							
Potential worker rate	7.6	7.1	6.8	6.7	6.8	6.6	6.8

Labor Force Participation Rate



intermittent workers in large numbers, but the movement may show up in the July data, which we have not yet received.[3]

In the household survey, the labor force participation rate, which had surged to more than 67-1/2 percent earlier in the year, averaged just 67.1 percent over the past three months. We had ascribed a portion of the first-quarter increase in the participation rate to a somewhat delayed reaction to strong real wage growth and abundant employment opportunities. Although we expect that July's reading of 66.9 percent--the lowest since August 1998--overshot on the down side, it now appears that the participation rate probably has remained roughly trendless since 1997. Employment growth in the household survey has generally followed the pattern of labor force growth, and thus the unemployment rate--which stood at 4.0 percent in July--has fluctuated in a narrow range since last September.

As with the unemployment rate, other indicators suggest that the labor market remains tight. Smoothing through the weekly ups and downs, the level of initial claims for unemployment insurance has been running about 300,000 per week over the past two months; although claims are up from a few months ago, they remain quite low by historical standards. Likewise, the level of insured unemployment has risen since mid-May, but only to levels that are similar to those posted at the beginning of the year. Households responding to both the Conference Board and Michigan consumer surveys remained optimistic about job prospects. On the employers' side, the National Federation of Independent Businesses's (NFIB's) measure of "positions hard to fill" ticked down in July but remained near the record high posted in each of the previous three months.

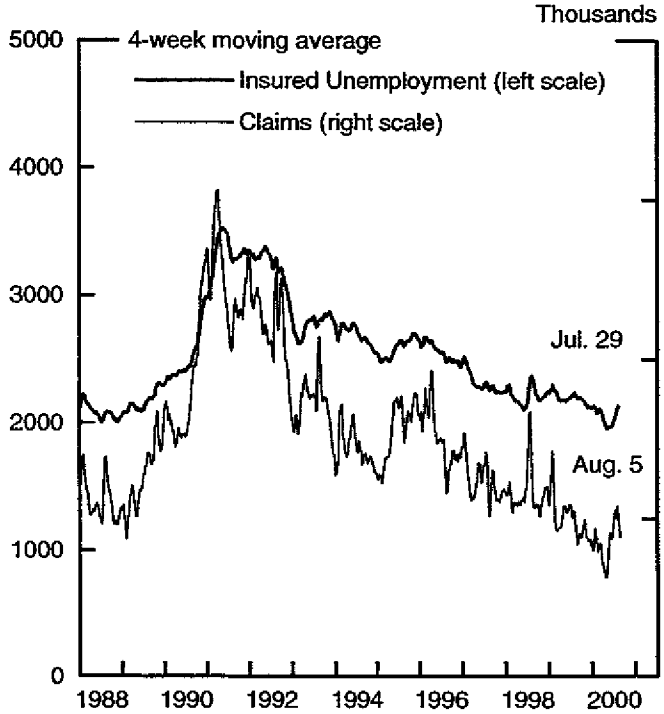
The latest estimates from the Bureau of Labor Statistics indicate that output per hour in the nonfarm business sector rose at an annual rate of 5.3 percent in the second quarter.[4] This leaves nonfarm business productivity up 5.1 percent over

3. The number of temporary Census employees fell 292,000 in July after having declined 136,000 in June. About 190,000 additional workers will leave the Census payroll by the end of the year.

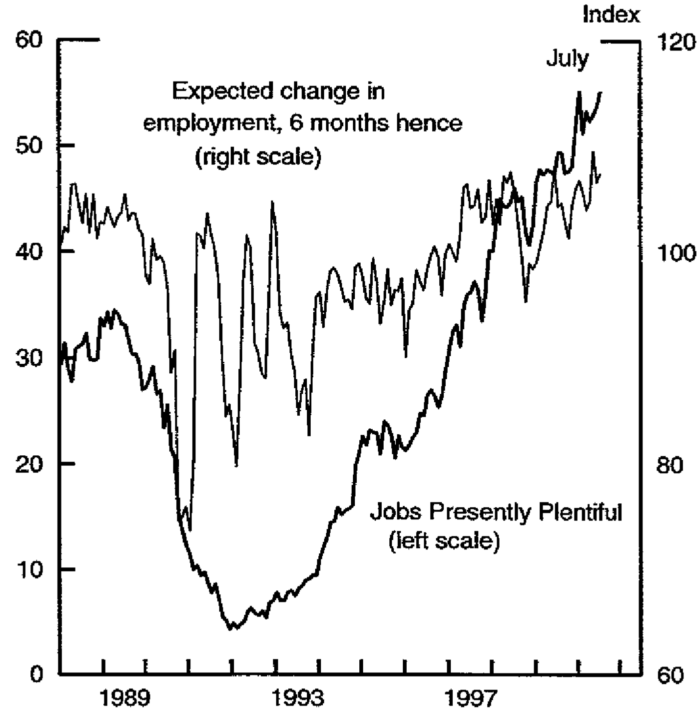
4. We currently do not expect this figure to be revised, as our predicted changes to output and the revisions to hours that are implied by the July employment report offset each other. (The BLS did not incorporate the hours data from the July employment report--which was released on August 4--into the second-quarter productivity data that were released on August 8.)

Labor Market Indicators

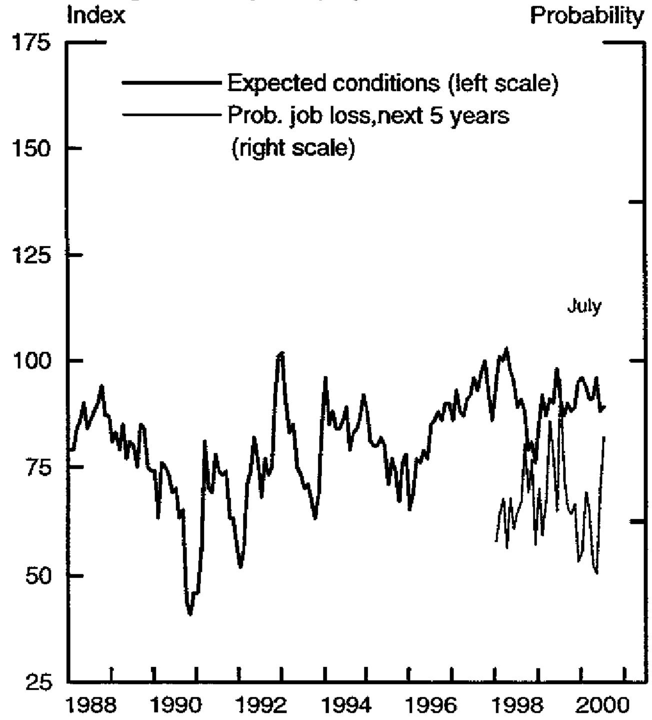
Initial Claims for Unemployment Insurance



Conference Board: Employment Conditions

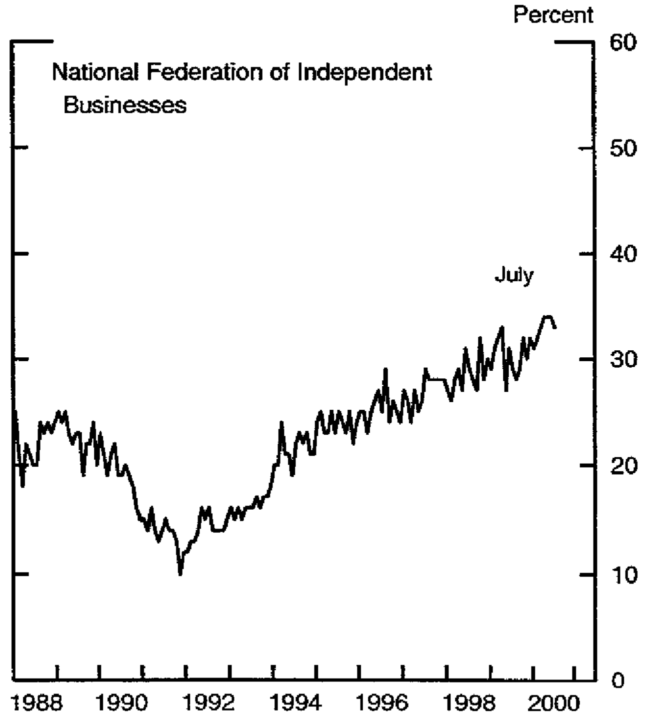


Michigan Survey: Employment Conditions



Note. Expected conditions index is the proportion of households expecting unemployment to fall, less the proportion expecting unemployment to rise, plus 100.

Reporting Positions Hard to Fill



the four quarters ending in 2000:Q2.[5] This rate of increase is more than twice as fast as the year-earlier change and represents the largest four-quarter gain since 1983, when the economy was recovering from a deep recession. In the nonfinancial corporate sector, output per hour rose 4.5 percent over the year ending in 2000:Q1 (latest available data); with the exception of the 4.8 percent increase posted over 1999, this was the largest four-quarter change since 1976.

Labor Output per Hour

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

Sector	1998[1]	1999[1]	1999		2000	
			Q3	Q4	Q1	Q2[e]
Nonfarm business	2.9	4.1	5.2	8.0	1.9	5.3
Ex. defense spending anomaly	2.9	4.0	5.2	7.4	3.1	4.7
Nonfinancial corporations[2]	3.8	4.8	5.1	6.1	2.9	n.a.

1. 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, and finance and insurance companies; the sector accounts for about two-thirds of business employment.
e. Staff estimate.

Industrial Production

Industrial production rose 0.4 percent in July following a more moderate gain in June. A surge in oil and natural gas drilling in the wake of higher energy prices pushed up mining production last month, while cooler-than-normal temperatures depressed utilities output. Manufacturing production rose about 1/2 percent for the fourth consecutive month. July's increase in output reflected advances across a variety of industries and market groups.

Activity in the high-tech sector (that is, computers, semiconductors, and communications equipment) continues to be strong. Although recent rates of output growth have been somewhat lower than ones posted earlier this year, we

5. The patterns of nonfarm business output and productivity growth have been distorted over the past three quarters because the BEA attributed to the last quarter of 1999 payments to defense contractors for goods and services that were delivered in the first quarter of 2000. The staff estimates that this shift boosted fourth-quarter output and productivity growth rates by about 0.6 percentage point, held down the first-quarter growth rates by about 1.2 percentage points, and raised second-quarter growth rates by 0.6 percentage point. (The change in productivity over the four quarters ending in 2000:Q2 is unaffected by the shift.)

The anomaly probably did not distort the nonfinancial corporate figures, which are measured using the income-side data from the national accounts; in their own accounts, corporations most likely applied the early federal payments to the first quarter.

INDUSTRIAL PRODUCTION
(Percent change from preceding period)

	2000	1999	2000		2000		
	July	Q4	Q1	Q2	May	June	July
	--Proportion--	--Annual rate--			--Monthly rate--		
TOTAL INDEX	100.0	5.3	6.5	7.3	.6	.2	.4
MANUFACTURING	88.2	7.1	7.0	7.4	.5	.4	.5
Durables	50.0	7.0	11.9	14.3	1.2	.7	.6
Nondurables	38.1	7.2	.8	-1.3	-.3	.0	.5
MINING	5.9	5.2	3.6	4.3	-.1	.9	1.7
UTILITIES	5.9	-16.6	1.3	8.2	2.5	-2.5	-3.3
Selected industries							
High technology	10.3	31.2	59.8	68.9	4.2	3.3	3.6
Motor vehicles and parts	5.1	3.7	1.2	7.1	2.1	-1.0	-5.5
Aircraft and parts	2.3	-22.7	-13.2	-9.6	-1.4	-.2	2.0
Market groups excluding selected industries							
Business equipment and parts	12.0	5.0	6.5	4.8	.3	.0	1.1
Energy	12.3	-6.2	2.3	6.2	1.2	-1.0	-.8
Defense equipment and parts	1.7	-6.1	-16.7	4.0	.4	2.1	2.2
Other	56.3	6.1	1.8	-.7	-.2	.0	.4
Consumer goods and parts	24.4	5.7	1.4	-.6	-.2	.3	.4
Manufactured homes	.2	-22.0	-22.5	-26.3	-1.1	-1.7	-1.9
Construction supplies	6.2	4.5	8.4	.4	-1.3	-.5	.3
General business supplies	7.2	5.0	1.7	-.9	-.2	-.4	.5
Materials	18.3	8.1	.6	-.9	.1	-.2	.2

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89	1959-99	1999	2000		2000		
	High	Avg.	Q4	Q1	Q2	May	June	July
Manufacturing	85.7	81.6	80.3	80.8	81.4	81.4	81.4	81.6
Primary processing	88.9	82.9	83.7	83.8	83.3	83.3	83.0	83.2
Advanced processing	84.2	81.1	79.1	79.9	80.8	80.9	81.0	81.2

suspect that the earlier gains were temporarily boosted by the lifting of Y2K-related lockdowns. Indeed, the 3-1/2 percent average monthly pace of increase in high-tech output in June and July is still very high by historical standards. Although we see little evidence of significant strains on supply in the high-tech sector as a whole, the narrowly defined semiconductor industry--where factory operating rates are in excess of 100 percent--presents a notable exception. The industry is facing a torrid pace of demand, and some downstream producers are encountering price hikes for--and spot shortages of--certain types of chips. The rate of capacity expansion in semiconductors has increased significantly and will likely continue to be rapid; last month the Semiconductor Industry Association revised up its forecast for growth of nominal capital spending in 2000 by North American semiconductor producers by roughly 50 percentage points.

New Orders for Durable Goods
(Percent change from preceding period; seasonally adjusted)

Component	Share, 2000:H1	2000				
		Q1	Q2	Apr.	May	June
Total orders	**100.0**	**2.9**	**4.3**	**-5.8**	**7.2**	**9.7**
Adjusted orders[1]	70.0	4.3	2.5	-5.4	7.6	0.3
Computers	6.0	6.1	10.4	10.1	1.0	-1.5
Communication equipment	5.0	-2.4	11.0	3.1	-4.1	26.7
Other capital goods	14.0	10.0	0.1	-0.8	-1.7	5.5
Other[2]	45.0	3.3	1.3	-9.6	12.9	-3.5
MEMO						
Real adjusted orders[3]	...	5.0	3.2	-5.3	7.9	0.6
Excluding high tech	...	3.6	-0.6	-2.3	0.8	0.6

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Includes primary metals, most fabricated metals, most stone, clay, and glass products, electronic components, household appliances, scientific instruments, miscellaneous durable goods.
3. 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.

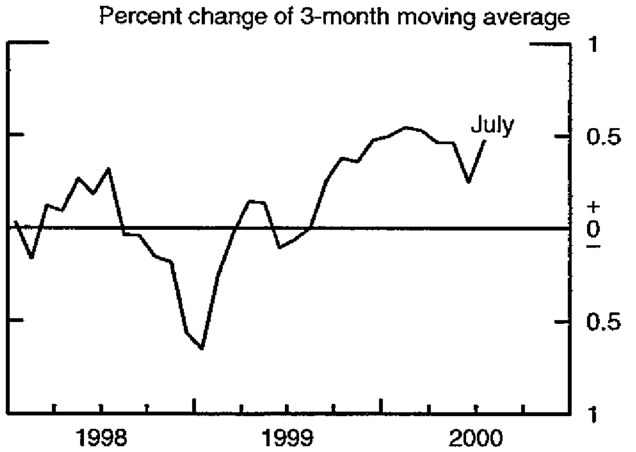
In the transportation sector, production of motor vehicles and parts dropped 5-1/2 percent in July after a smaller decline in June. Assemblies of light motor vehicles in July came in well below the schedules that were announced at the beginning of the month; according to industry contacts, the reduction reflected automakers' efforts to correct inventory imbalances and was not the result of

Industrial Production, Unfilled Orders, and Inventories

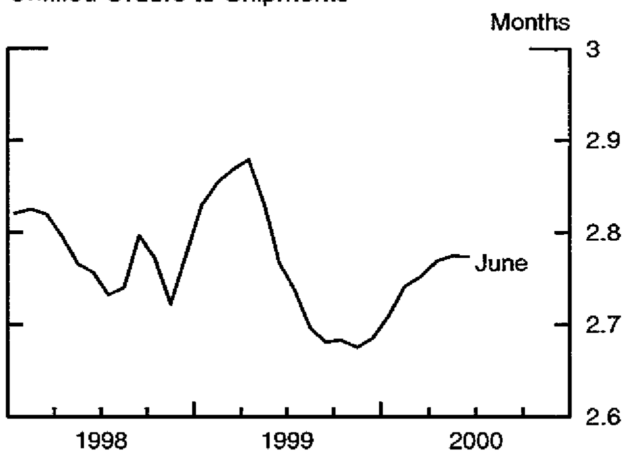
Selected Market Groups Excluding Motor Vehicles, Aircraft, High-Tech Goods and Energy Goods

Business Equipment and Parts

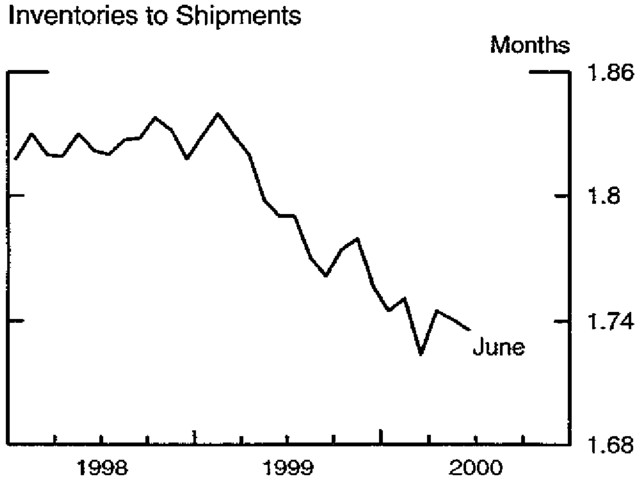
Industrial Production



Unfilled Orders to Shipments

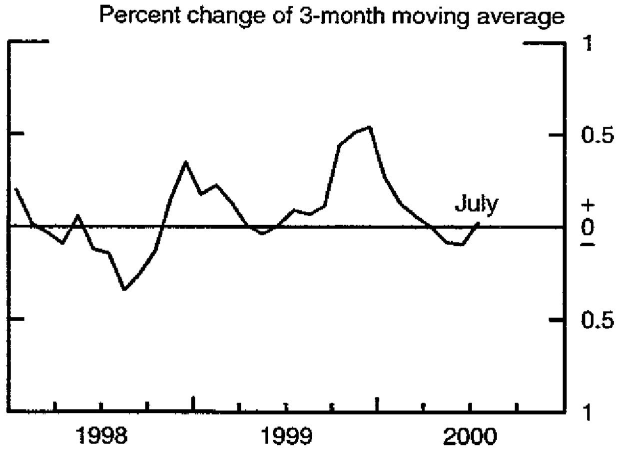


Inventories to Shipments

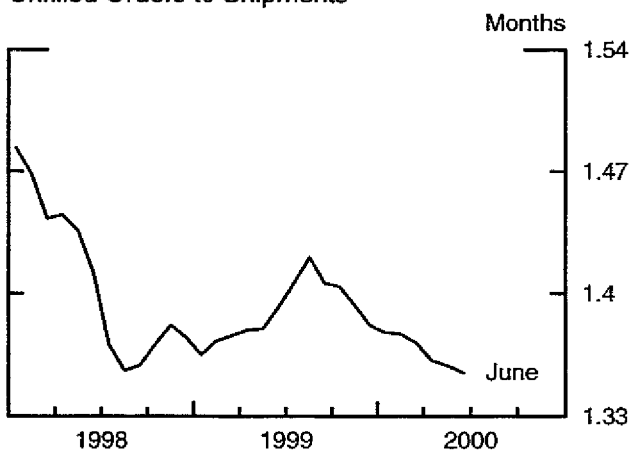


Other Market Groups

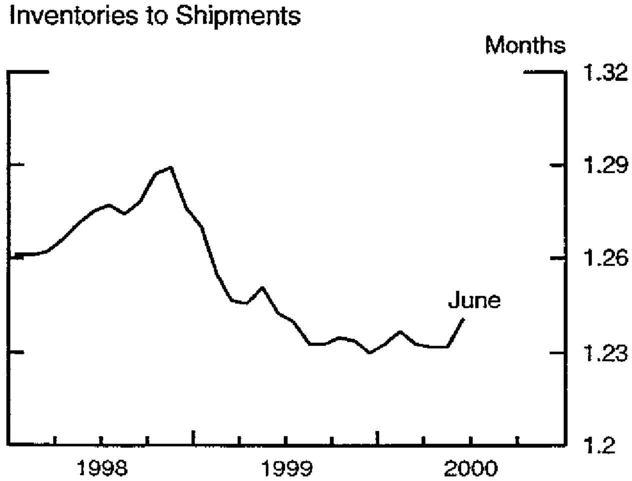
Industrial Production



Unfilled Orders to Shipments



Inventories to Shipments



problems related to model changeovers.[5] Current schedules show a bounceback in production that would leave assemblies at a 13.2 million unit annual rate for the third quarter as a whole, down only 1/4 million units from the second-quarter pace. Nonetheless, the third-quarter rate is off 1/2 million units from the schedules initially announced in May. Medium and heavy truck production tumbled in June, and recovered only a fraction of its loss in July. Elsewhere in the transportation sector, production of aircraft and parts turned up moderately in July after falling at an annual rate of 9-1/2 percent in the second quarter.[6]

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

Item	2000						
	Q1	Q2	Q3[1]	June	July	Aug.[1]	Sept.[1]
U.S. production	13.1	13.4	13.2	13.4	12.4	13.4	13.9
Autos	5.6	5.8	5.8	5.7	5.5	5.8	5.9
Trucks	7.5	7.6	7.5	7.7	6.9	7.5	8.0
Days' supply							
Autos	51.6	55.0	n.a.	55.0	55.6	n.a.	n.a.
Light trucks[2]	64.7	78.1	n.a.	78.1	78.7	n.a.	n.a.

NOTE. Components may not sum to totals because of rounding.
1. Production rates reflect actual July data and manufacturers' schedules for August and September.
2. Excludes medium and heavy (classes 3-8) trucks.
n.a. Not available.

Production of other types of non-high-tech business equipment and parts was robust in the first half of the year and rose 1.1 percent in July. Conditions appear ripe for further expansion. Led by a surge in bookings for engines and turbines, new orders jumped 5-1/2 percent in June; even excluding these items, which tend to have long lead times ahead of shipments, orders were up 1-1/4 percent. Moreover, orders backlogs for this aggregate have moved up from lows posted at the end of last year, and the inventory-shipments ratio for the category has been dropping rapidly since the beginning of 1999.

Output in most remaining categories of non-energy industrial production (largely consumer goods, business and construction supplies, and materials) rose

5. However, according to **confidential** conversations with industry contacts, a minor production problem with one new model has surfaced in August.

6. Boeing's recently announced increase in the production of 737s is not expected to materially affect output until the fourth quarter of this year.

RETAIL SALES
(Percent change; seasonally adjusted)

	2000 Q1	2000 Q2	2000 May	2000 June	2000 July
Total sales	3.2	.5	.1	.4	.7
Retail control[1]	2.8	1.5	.4	.4	.6
Previous estimate		1.5	.4	.3	
Furniture and appliances	3.6	.7	-.3	-.9	1.3
Other durable goods	2.9	-1.4	-.4	-.9	1.1
Apparel	3.2	.6	.5	-1.1	-.1
Food	-.1	2.7	-.3	.7	.1
General merchandise[2]	2.4	1.4	.9	.0	1.6
Gasoline stations	7.7	1.8	.1	2.7	-.1
Eating & drinking establishments	2.5	.8	-.1	.3	.8
Other nondurable goods[3]	4.5	2.7	1.7	1.3	-.2
Memo: Sales of autos[4]	9.4	8.9	8.8	8.8	8.8
Sales of light trucks[4]	8.8	8.3	8.2	8.2	8.2

1. Total retail sales less sales at building material and supply stores and automotive dealers, except auto and home supply stores.
2. Excludes mail-order houses.
3. Includes sales at liquor stores, mail-order houses, and drug and proprietary stores.
4. Sales to both households and businesses. Millions of units, annual rate.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

	1999	2000 Q1	2000 Q2	2000 May	2000 June
	Q4/Q4	- Annual rate -		Monthly rate	
tal real PCE	5.6	7.6	3.0	.3	.2
Durable goods	11.1	23.6	-3.9	-.8	.9
Motor vehicles and parts	6.4	27.7	-15.3	-3.5	1.8
Furniture and household equipment	15.6	19.1	7.7	.3	.8
Computers	37.8	41.1	20.9	.1	5.2
Other durable goods	13.1	24.1	1.0	2.8	-.7
Nondurable goods	5.9	6.0	3.5	.6	-.1
Services	4.2	5.2	4.2	.3	.2
Household operations	4.5	6.1	6.4	.9	-.8
Electricity and natural gas	1.5	7.2	10.9	2.1	-2.7
Transportation	4.2	4.2	3.2	.6	-.0
Medical	3.2	2.1	3.0	.3	.2
Personal business	9.0	11.3	2.5	-.5	.8
Brokerage services	34.7	79.0	-9.6	-7.1	2.9
Recreation	5.7	9.6	8.5	1.0	-.0
Other	2.5	4.0	4.8	.4	.4

Note. Derived from billions of chained (1996) dollars.

0.4 percent in July, with widespread increases posted across its components. This gain followed weak growth in output in the first quarter and a decline in the second. Indeed, the July production figures appear strong relative to other indicators of demand for many items in this category. The Census data on manufacturers' new orders for these goods have weakened after having moved up in the first quarter, and the level of unfilled orders relative to shipments has turned down after rising in the first half of 1999. The NAPM's diffusion index for new orders has fallen considerably, and more purchasing managers are now reporting declines in new orders than are reporting increases.[7]

With July's increase in overall output, the factory operating rate rose 1/4 percentage point to 81.6 percent. This is about equal to its long-term average. Only a few industries--specifically, semiconductors, petroleum products, nonferrous primary metals, and noncomputer industrial machinery--are operating at rates near or above their last cyclical peak. Other indicators also point to little tightness in the manufacturing sector--the index of vendor performance in the NAPM survey has edged down (although it still indicates that delivery times are lengthening), and purchasing managers listed only electronic components as being in short supply.

Consumer Spending and Income

The limited data in hand suggest that consumer spending headed into the third quarter at a somewhat faster pace than the 3 percent annual rate posted in the second quarter. Nevertheless, we are not expecting to see a replay of the first quarter, when purchases surged at an annual rate of more than 7-1/2 percent: Although recent readings of consumer sentiment have held near historical highs, real income growth has been moderate in recent quarters, and the stock market has changed little on balance so far this year, suggesting that the impetus to spending from wealth gains may have begun to wane.

Nominal retail sales in the control category of stores, which excludes automotive dealers and building material and supply stores, increased 0.6 percent in July. Noticeable gains were recorded last month in sales at general merchandisers, furniture and appliance stores, and eating and drinking establishments. However, estimated retail purchases of motor vehicles

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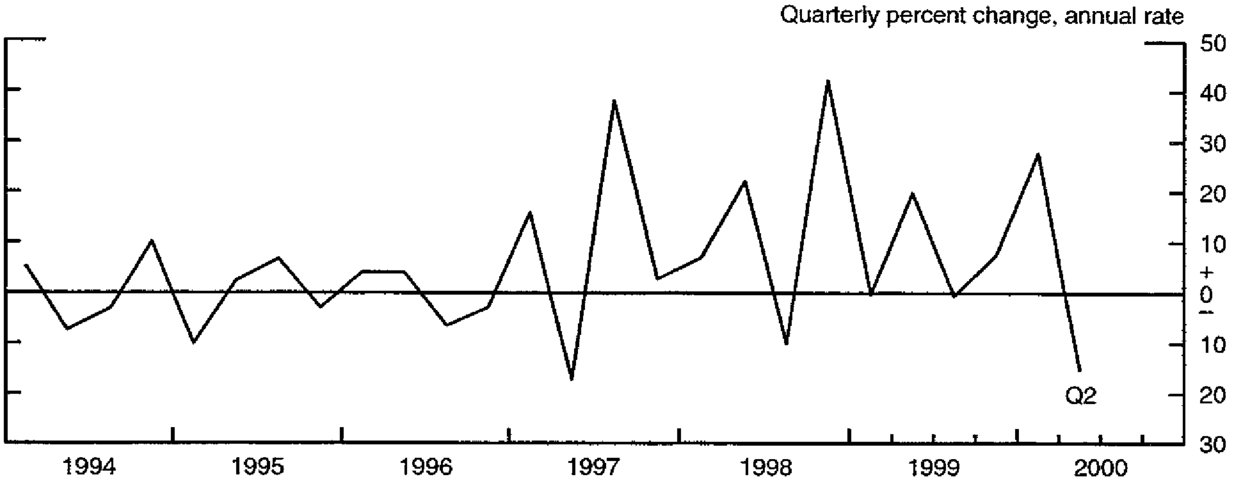
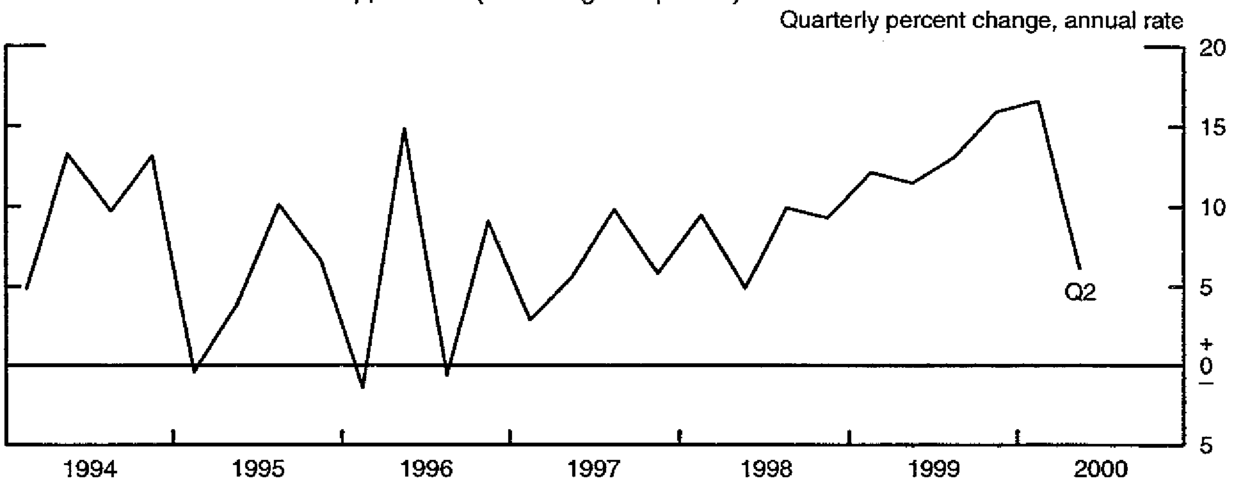
7. We cannot identify orders for specific industries in the NAPM survey. Currently, the NAPM measure implies that orders are a very small drag on the growth in manufacturing production (excluding motor vehicles). The real adjusted durable goods orders series derived from the Census M3 data implies that orders are a small impetus to output, but this largely reflects developments in the high-tech sector. Excluding high-tech items, both the NAPM- and M3-based measures imply that orders currently are restraining production growth slightly. (In regression models of manufacturing-sector output excluding motor vehicles and parts, the NAPM's diffusion index for new orders and the M3-derived measure have about equal explanatory power.)

Real Expenditures on Durable Consumption Goods

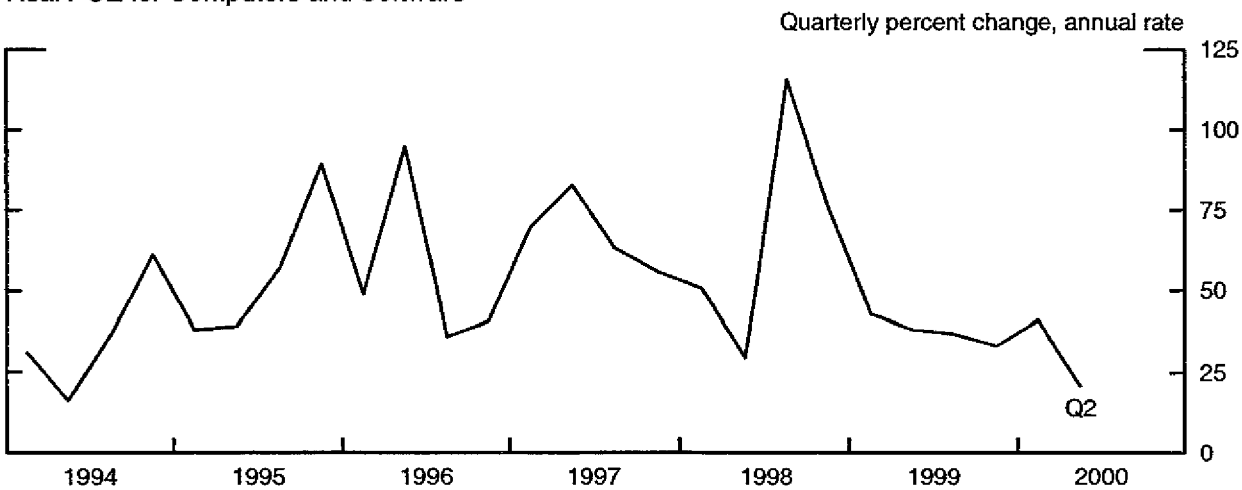
Real PCE for Motor Vehicles



Real PCE for Furniture and Appliances (excluding computers)



Real PCE for Computers and Software



(**confidential**) fell at an annual rate of nearly 250,000 units in July, leaving them at their lowest level since April 1999. Combining these data with July's increase in consumer prices, we estimate that real personal consumption expenditures for all goods rose 0.5 percent last month.

As is often the case, much of the recent variation in PCE growth reflects developments in the durable goods categories. We estimate that real purchases of durable goods rose nearly 1 percent in July. This gain, however, followed a dramatic second-quarter step-down in the pace of durable goods purchases from the huge increases recorded in the preceding quarter: After having risen almost 24 percent at an annual rate in the first quarter, real outlays for durable goods fell about 4 percent in the second quarter. The deceleration in spending was led by a decline in motor vehicle purchases, but expenditures for furniture and appliances and household purchases of computers and software also grew at lower rates last quarter.

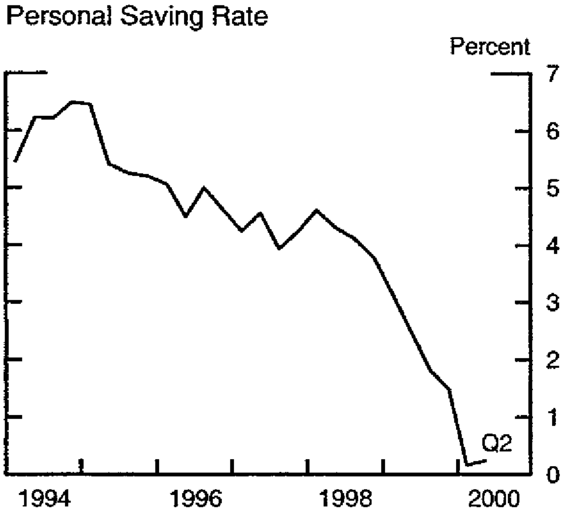
The rise in services expenditures also moderated in the second quarter. But excluding brokerage services (which fell nearly 10 percent at an annual rate after having surged almost 80 percent in the first quarter), real spending on services actually accelerated a touch--from 4 percent to 4-1/4 percent--between the first and second quarters. More recently, real energy expenditures--which rose briskly over the first half of the year--probably fell sharply in July as temperatures for the country as a whole dropped below seasonal norms. And last month's financial-market transaction volumes do not point to much strength in brokerage services.

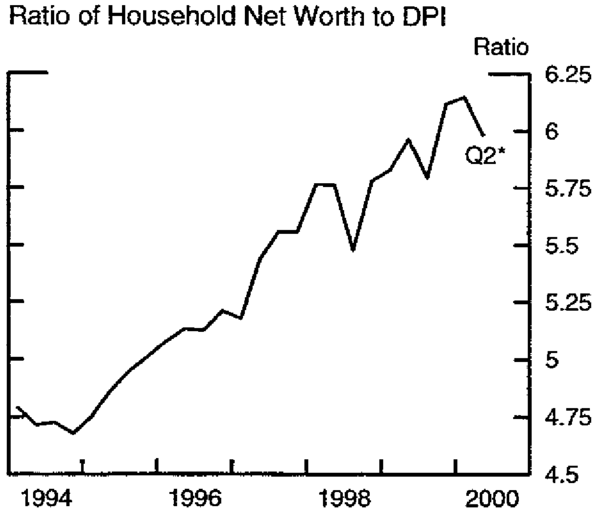
The moderation in the pace of real consumer spending appears to be consistent with underlying fundamentals. Last quarter's lackluster stock market pulled the ratio of net worth to disposable income down to a level a bit below that of the fourth quarter of 1999. In addition, growth of real disposable personal income has been relatively subdued in recent quarters: Over the first half of the year, real DPI increased at an annual rate of 2-3/4 percent, down only a bit from the 3 percent pace of 1999, but well below the more than 4-1/2 percent gains of 1998.[8] Data in the employment report for July point to another moderate increase in wage and salary disbursements last month.

In line with these two influences, there is some evidence that households' expectations of future income gains may be ebbing: According to the Michigan

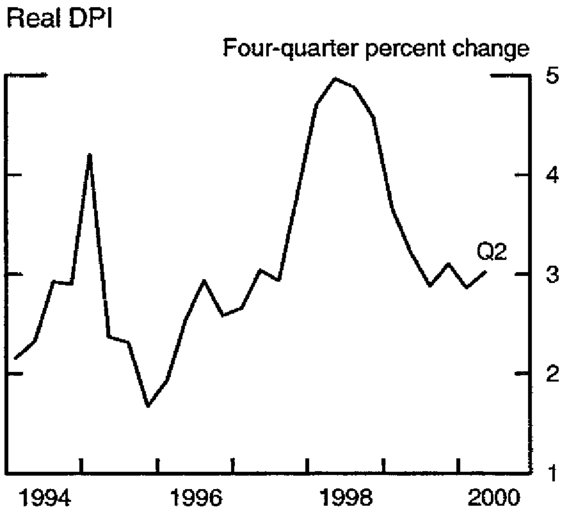
8. The shortfall of real DPI growth relative to GDP in 1999 and the first half of 2000 reflects a variety of factors. First, consumption prices--which are used to deflate nominal DPI--increased faster than overall GDP prices in 1999, reflecting, in part, developments in the energy sector. Second, in the first half of 2000, wages and salaries did not accelerate, while nominal GDP did. Third, effective tax rates have risen. Finally, growth in a number of smaller categories of personal income has been relatively lackluster.

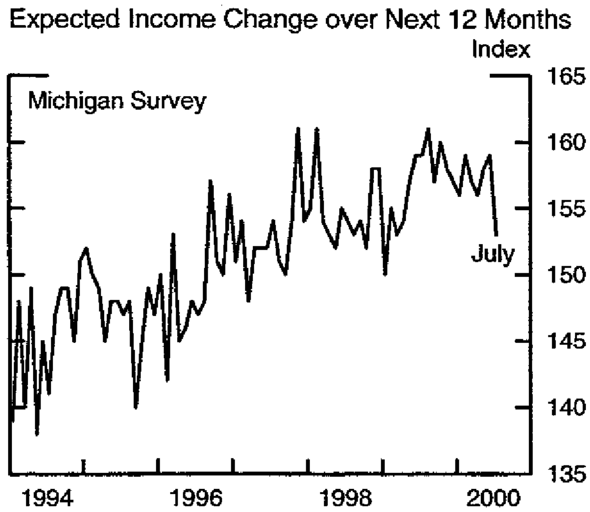
Household Indicators



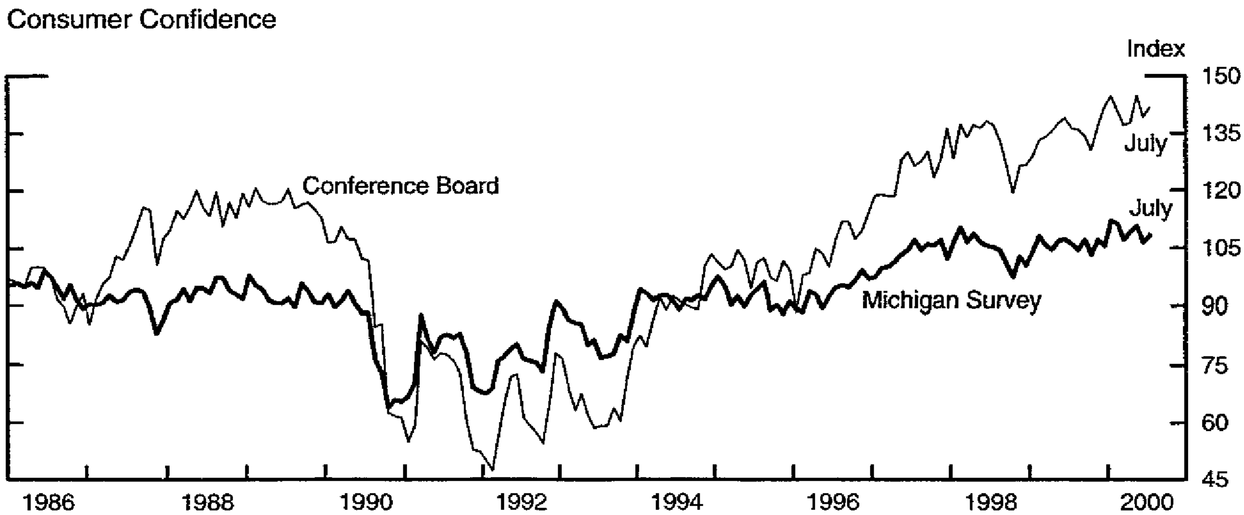


*Value for 2000:Q2 is a staff estimate.





Note. Share expecting income to rise less share expecting income to fall plus 100.



Survey Research Center (SRC), the index of expected income change over the next twelve months has moved lower recently. Despite the deterioration in income prospects, overall consumer sentiment--as measured by both the Michigan SRC and Conference Board surveys--rose in July, suggesting that households remain generally upbeat about current and future economic conditions.

Housing Markets

Most of the principal housing-market indicators show weaker activity in the single-family sector. On balance, mortgage rates have been running well above last year's level, and the recent trends in stock-market wealth and employment growth have likely damped demand this spring and summer. A small portion of the decline in construction in recent months probably also reflects a return to more normal weather.[9]

Single-family housing starts decreased 2 percent in July, to an annual rate of 1.2 million units. Starts have trended down steeply this year, and in July were 13 percent below the high level recorded in the fourth quarter of last year. Over this period, adjusted permits for single-family construction have declined about in line with starts.

Sales of new homes fell in June to an annual rate of 829,000 units. This drop left the pace of sales for the second quarter down nearly 8 percent from the first quarter and 6 percent below the 1999 average. In contrast, sales of existing homes rose 5-1/2 percent in the second quarter. The increase, however, merely reversed a portion of earlier declines, and the pace of sales remains below last year's average. Moreover, because of the usual lags in timing, we would be particularly reluctant to read the recent rise in existing home sales as a response to the drop in mortgage rates that has occurred since late May.[10]

Other housing indicators have also been soft, on balance. Builders' ratings of new home sales ticked up in August but remained well off the high levels recorded in mid-1999. The Michigan survey's measure of households' perception of homebuying conditions also were up a bit in July--largely in

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9. Based on quarterly averages of metropolitan statistical area precipitation and temperature weighted by the amount of construction activity in each area, overall weather in the fourth quarter of 1999 and the first quarter of this year was unusually mild, but averaged much closer to normal in the second quarter of this year. On net, we estimate that weather pulled forward a small amount of activity from the first two quarters of 2000 into the fourth quarter of 1999, reducing the level of single-family starts by perhaps 10,000 units (annual rate) in the first quarter and 15,000 units in the second quarter.

10. New home sales are recorded when sales contracts are signed, while existing home sales are typically recorded when the sales are closed. We would therefore expect the response of existing home sales to changing market conditions to lag behind the response of new home sales, although the data do not always line up very well with this supposition.

Private Housing Activity

(Millions of units; seasonally adjusted annual rate)

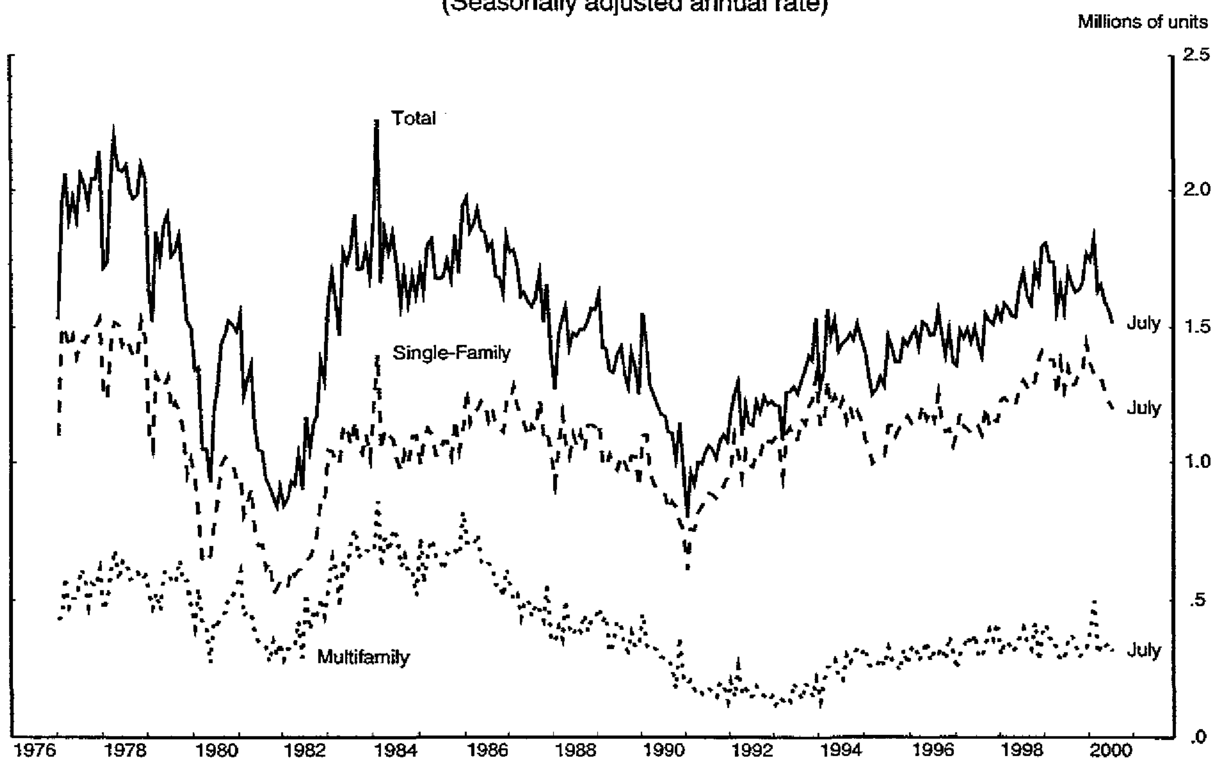
		1999	2000				
	1999	Q4	Q1	Q2[r]	May[r]	June[r]	July[p]
All units							
Starts	1.67	1.69	1.73	1.60	1.59	1.56	1.51
Permits	1.66	1.67	1.67	1.53	1.51	1.53	1.50
Single-family units							
Starts	1.33	1.38	1.34	1.26	1.26	1.22	1.20
Permits	1.25	1.24	1.26	1.15	1.15	1.13	1.11
Adjusted permits[1]	1.34	1.33	1.34	1.24	1.24	1.20	1.19
New home sales	.91	.91	.93	.85	.86	.83	n.a.
Existing home sales	5.20	5.06	4.80	5.07	5.09	5.23	n.a.
Multifamily units							
Starts	.33	.31	.40	.34	.33	.34	.32
Permits	.42	.43	.41	.39	.36	.40	.39
Mobile homes							
Shipments	.35	.31	.30	.27	.27	.26	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.

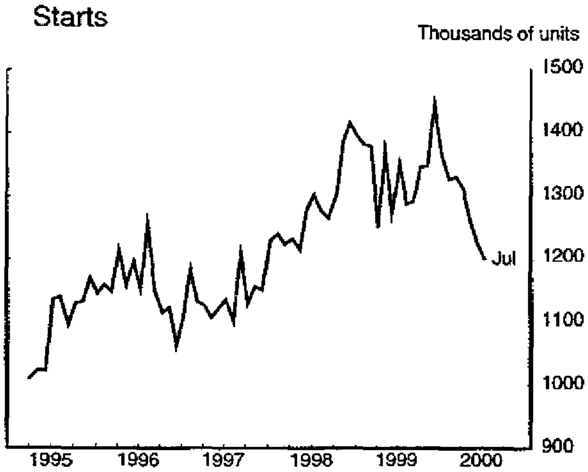
Total Private Building

(Seasonally adjusted annual rate)



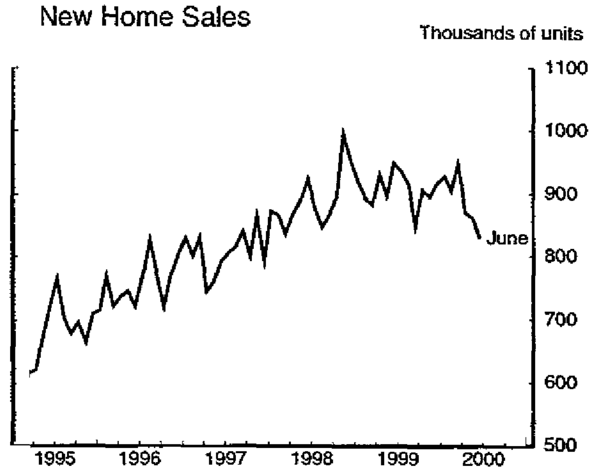
Indicators of Single-Family Housing

Starts



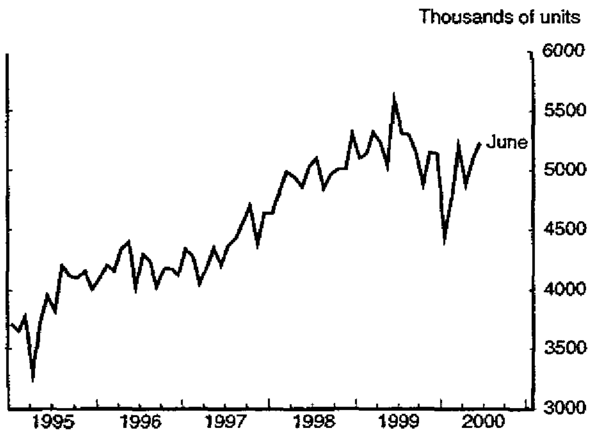
Source. Census Bureau.

New Home Sales



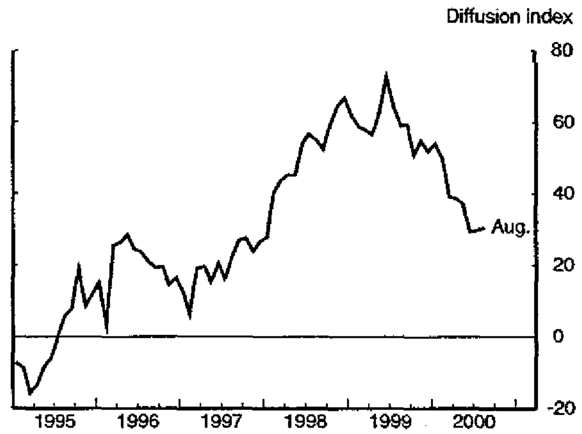
Source. Census Bureau

Existing Home Sales



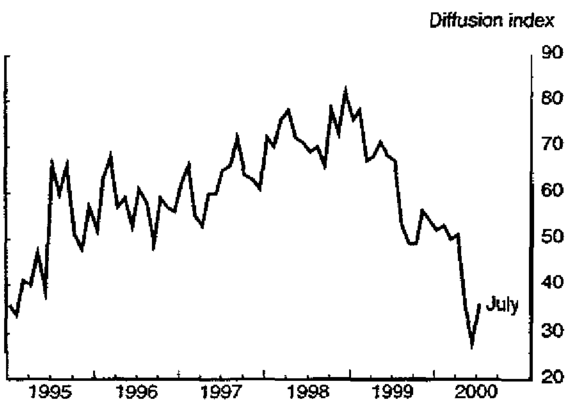
Source. National Association of Realtors

Builders' Rating of New Home Sales



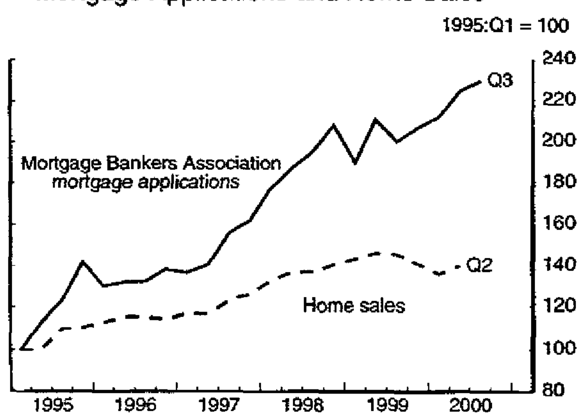
Source. National Association of Home Builders

Perceived Homebuying Conditions



Source. Michigan Survey, not seasonally adjusted.

Mortgage Applications and Home Sales

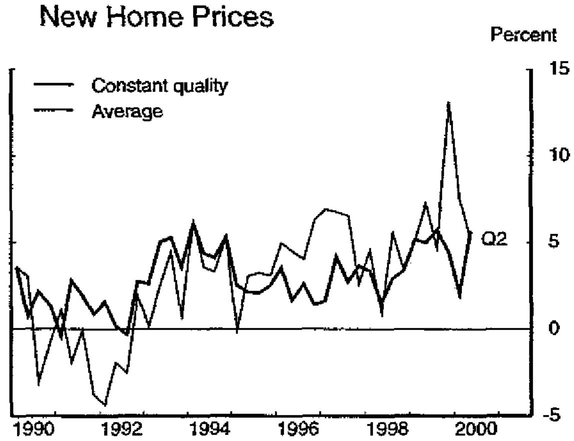


Note. Sales include new and existing home sales, including condos and coops. The Q3 reading for mortgage applications is the average of weekly data through Aug. 11.

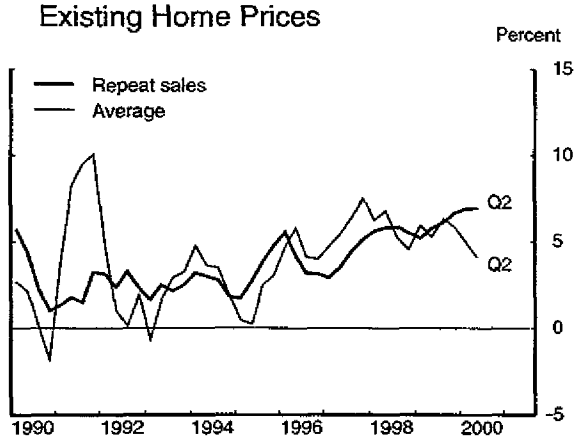
House Prices and Construction Costs

(Change from year earlier, except where noted)

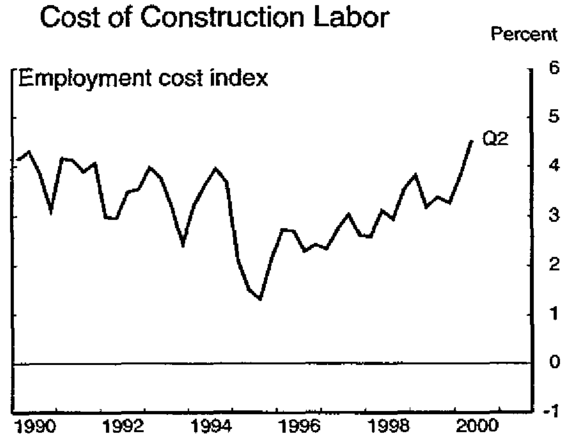
New Home Prices



Existing Home Prices

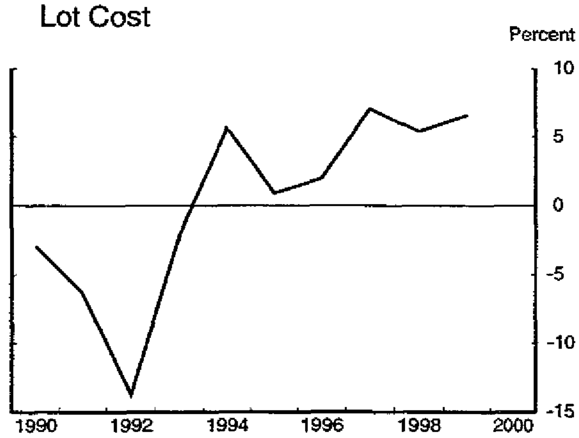


Cost of Construction Labor



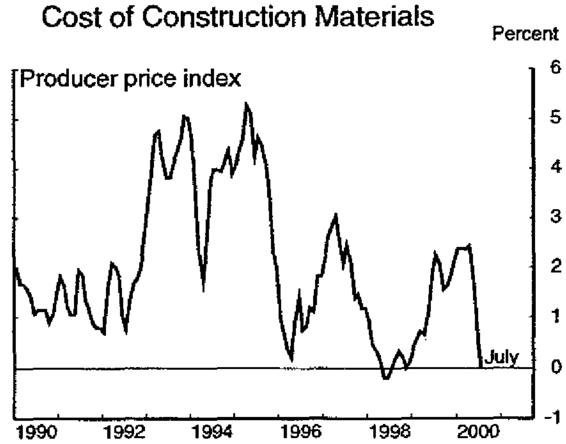
Note. ECI for total compensation.

Lot Cost



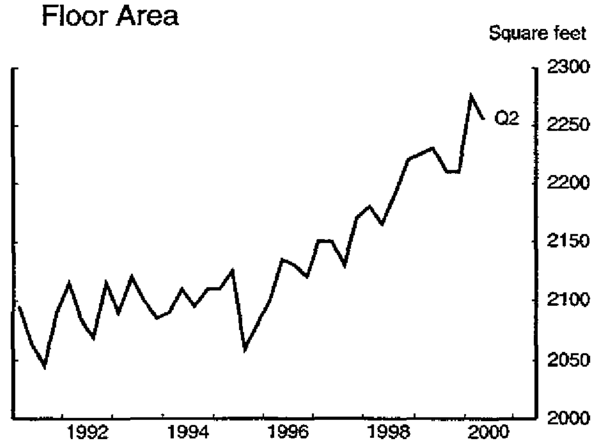
Note. Computed by staff from Census data.

Cost of Construction Materials



Note. PPI intermediate materials and components for construction.

Floor Area



Note. Level. Computed by staff from Census data for new homes completed for sale.

response to declining mortgage rates--but still remained near a five-and-a-half-year low. In contrast, the Mortgage Bankers' Association index of purchase applications for home mortgages remained near the top of its range through early August. The MBA series has continued to rise even as total sales of single-family housing units have leveled off. However, as we noted in the June Greenbook, this index likely has been boosted by expansion in the market share of the large companies that are included in the MBA sample, as well as an increasing incidence of multiple applications for mortgages; these developments imply that the trends in the index likely do not reflect the underlying level of housing demand. Finally, data from the Senior Loan Officers Opinion Survey for August indicate that the demand for mortgages at commercial banks has weakened moderately, on net, since May.

House prices appear to be rising briskly. The constant-quality new-home price index, which controls for differences over time in house size, geography, and several other important structural characteristics, rose at a year-over-year rate of 5-3/4 percent in the second quarter.[11] The repeat-sales price index for existing homes, which is also relatively unaffected by compositional changes, has been accelerating, on net, since early 1995, and rose at a year-over-year rate of 6.9 percent in both the first and second quarters of this year. On net, overall construction costs also appear to have picked up: The employment cost index for construction has been accelerating--it rose 4-1/2 percent over the twelve months ending in June--and the cost of land for homebuilding has increased in recent years at an even faster rate.[12] However, as measured by the PPI, the cost of materials for construction has decelerated noticeably and was unchanged in July from a year earlier.

In the multifamily sector, starts fell 7-1/2 percent to 315,000 units (annual rate) in July. Starts averaged a 339,000 unit pace in the second quarter, which is 14 percent below the strong first-quarter reading but still a bit higher than the average over all of last year. The vacancy rate for multifamily rental units was about unchanged in the second quarter from its year-ago level, and remained in the much lower range that it has declined to over the past several years.

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11. The year-over-year change in the average price of new homes moderated further in the second quarter, but the rate of increase remained fairly elevated at about 5 percent. The average price is influenced by shifts in the structural characteristics and geographic composition of new homes sold. The fact that over the past several years the average price has tended to rise faster than the constant-quality index is consistent with observed increases in the average size of completed new homes.

12. Data for lot costs in 2000 are not yet available, but reports from builders suggest that the rate of increase probably has not moderated.

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

	2000		2000		
	Q1	Q2	Apr.	May.	June
Equipment and software					
Shipments of nondefense capital goods	3.9	6.1	3.2	3.5	-.3
Excluding aircraft and parts	6.0	4.3	1.2	.9	1.6
Office and computing equipment	7.4	10.2	9.0	.4	.3
Communications equipment	13.9	4.5	3.4	3.3	-5.3
All other categories	3.1	1.5	-2.9	.3	4.7
Shipments of complete aircraft	-24.4	26.8	106.6	49.9	-41.1
Medium & heavy truck sales (units)	-3.0	-3.0	-7.8	-.7	8.0
Orders for nondefense capital goods	4.7	6.5	1.9	-1.1	16.5
Excluding aircraft and parts	6.4	4.8	2.6	-1.5	7.7
Office and computing equipment	6.1	10.4	10.1	1.0	-1.5
Communications equipment	2.1	11.2	3.4	-5.6	27.1
All other categories	8.0	.2	-.9	-1.2	5.8
Nonresidential structures					
Construction put in place, buildings	8.1	1.7	-1.6	1.2	-1.1
Office	6.9	5.4	2.1	-3.4	1.9
Other commercial	6.4	-2.8	-3.4	-.2	.3
Institutional	5.9	3.1	-1.5	3.8	-2.5
Industrial	15.1	6.0	-1.1	6.1	-5.5
Lodging and miscellaneous	8.0	-2.6	-5.1	3.0	-1.4
Rotary drilling rigs in use[1]	6.2	8.7	5.1	4.3	-.8

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

Business Fixed Investment

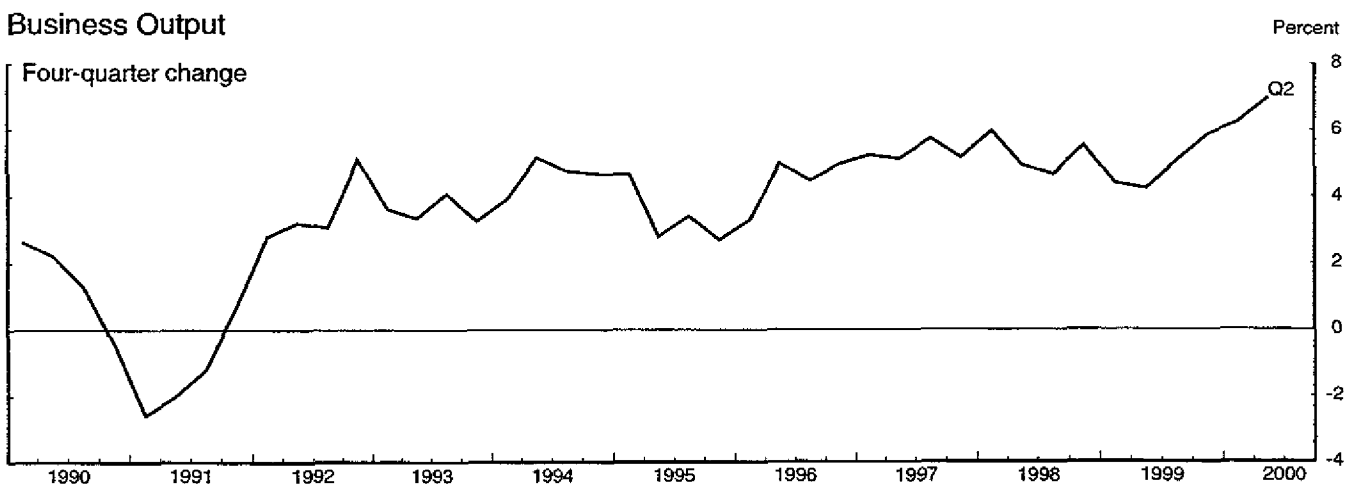
Equipment and software. Business spending on equipment and software has continued to advance at a rapid clip: Real outlays increased at an annual rate of 21 percent in the second quarter, about the same pace as in the first quarter. Real spending on high-tech equipment has accelerated this year, and investment in industrial machinery has also been very strong. These developments reflect the supportive environment for capital investment; notably, business output growth has been brisk and corporate cash flow ample. While we have no direct evidence on investment in the current quarter, the recent data on orders and shipments of capital goods point toward another sizable gain in spending on communications equipment, as well as solid increases in outlays for non-high-tech equipment (outside of transportation equipment)--albeit at a more moderate rate than in the first and second quarters.

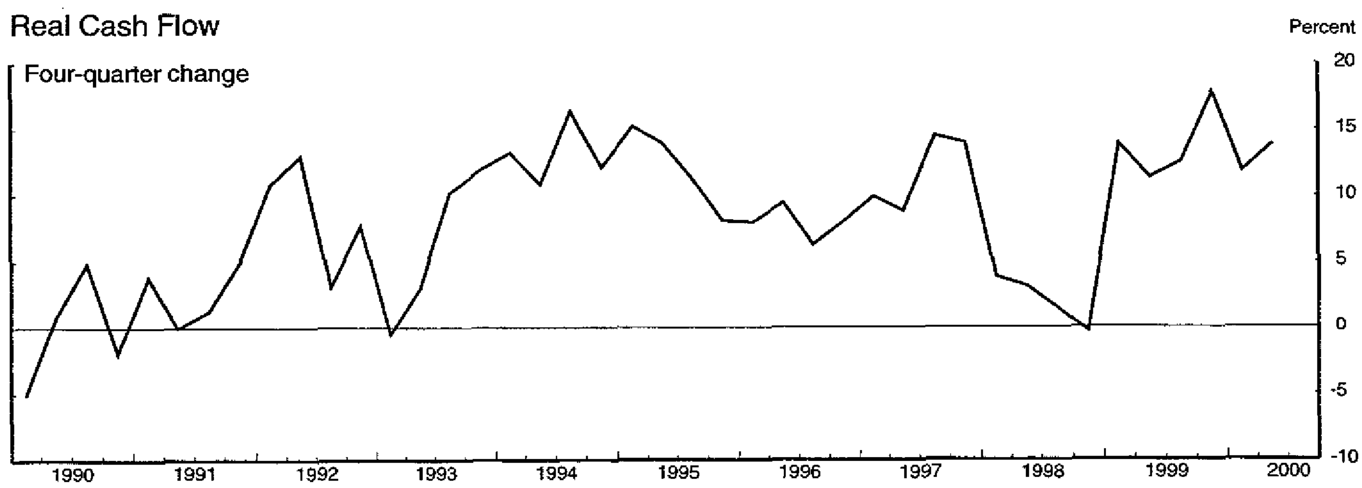
Real expenditures on computing equipment advanced at an annual rate of 63 percent in the second quarter, the fastest quarterly growth rate since early 1998. This hefty increase was remarkable considering that the boost to real spending from falling computer prices was weaker than it has been, on average, in recent years; indeed, the 44 percent (annual rate) increase in nominal computer spending last quarter was the fastest pace recorded since 1995. (The smaller price declines apparently reflect the combination of high rates of capacity utilization at many chip manufacturers and heavy demand.)

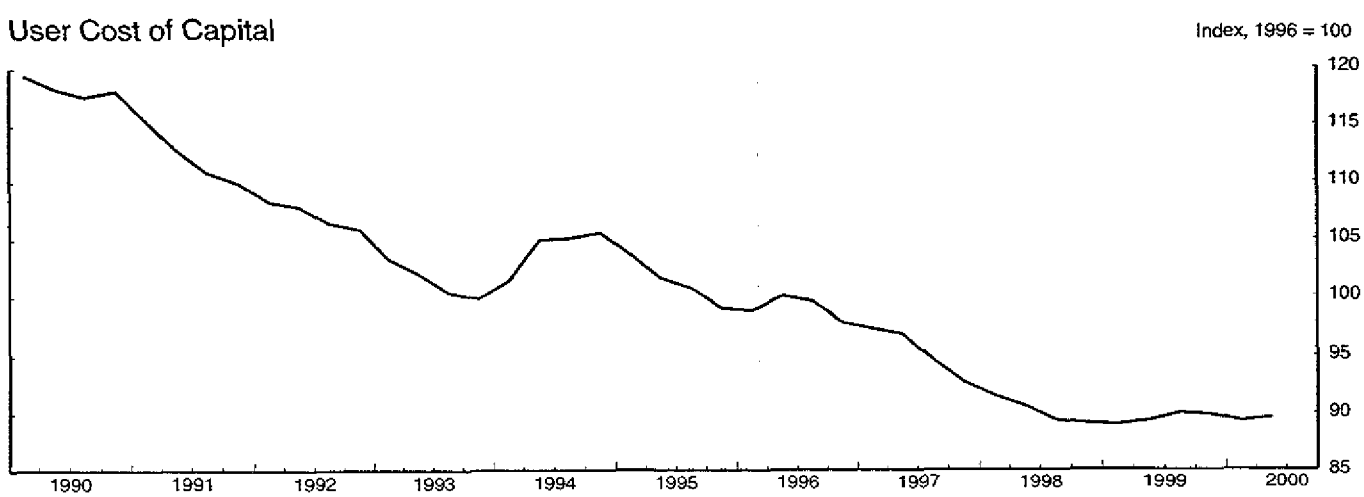
On the software side, the trend in business purchases have been stronger than we had previously thought. After having incorporated new source data on the software industry, the BEA now estimates that real business outlays on software over the past three years increased at an average rate of 25 percent per year--about 10 percentage points faster, on average, than was previously indicated. When annual source data are unavailable, the BEA uses judgmental trends in constructing its estimates of nominal software expenditures. These trends are based on the recent performance of spending; accordingly, the software revisions imply that the published series for equipment and software spending will likely continue to increase at a faster pace in coming quarters.

Demand for communications equipment has also been exceptionally strong of late. Real spending in this category decelerated, as a blistering 68 percent first-quarter rise gave way to "only" a 26 percent increase in the second quarter. Outlays for communications equipment appear to be poised for another substantial increase. Bookings have been very strong in recent months--they surged 27 percent in June, for example--adding to a substantial backlog of unfilled orders. Indeed, some major manufacturers of communications gear, such as Lucent, are reported to be having difficulties in raising production fast enough to meet the exploding demand for cutting-edge fiber-optic technologies.

Equipment Investment Fundamentals

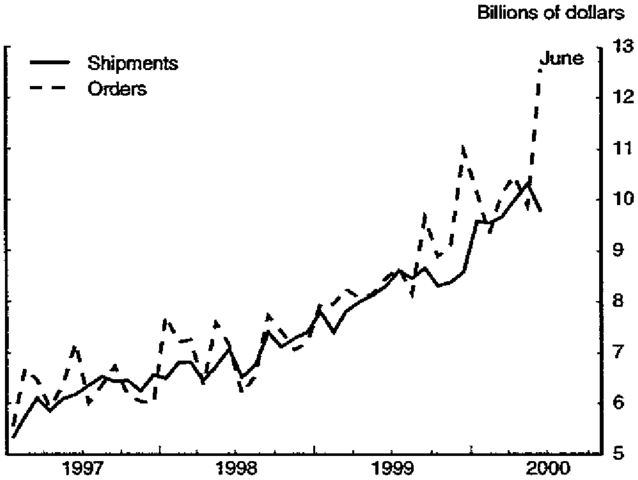


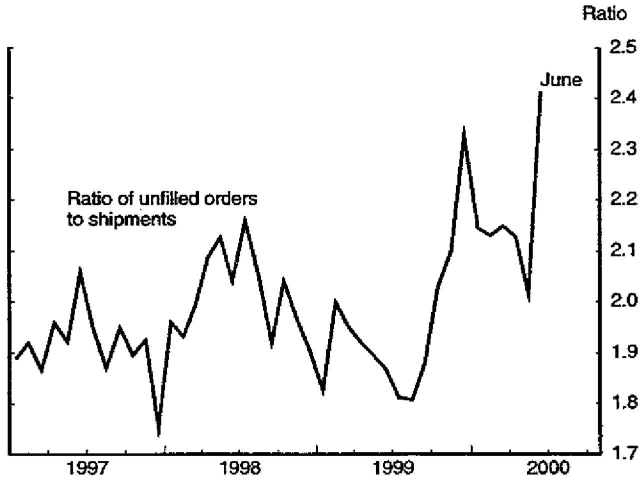




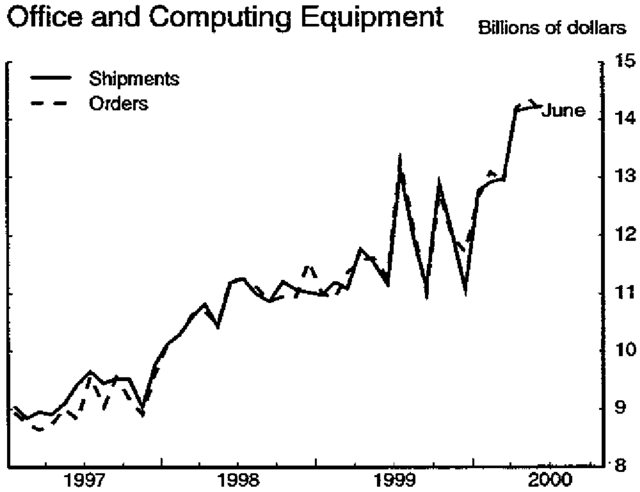
Recent Data on Orders and Shipments

Communications Equipment

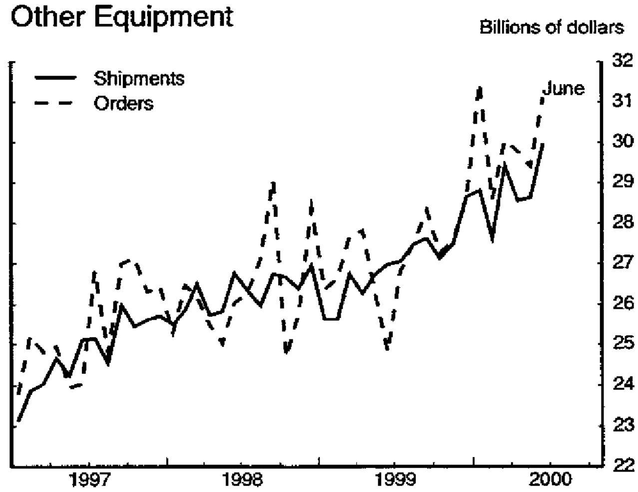




Office and Computing Equipment

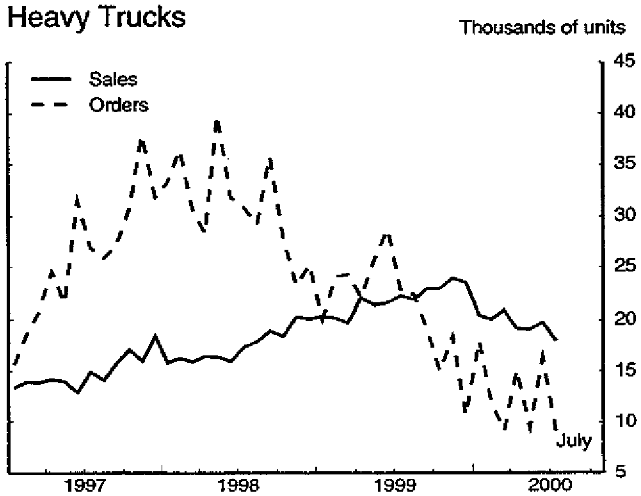


Other Equipment

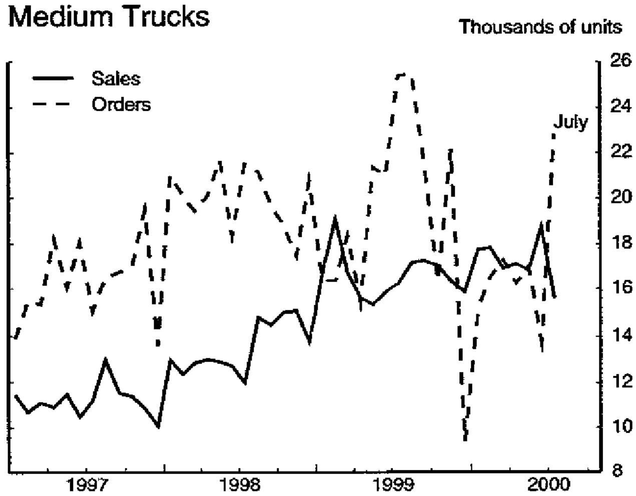


Note. Excluding aircraft, computers, and communications equipment.

Heavy Trucks



Medium Trucks

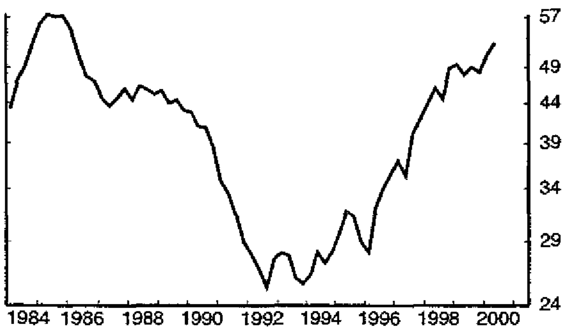


Real Investment in Nonresidential Structures
(Billions of 1996 dollars, chain weighted)

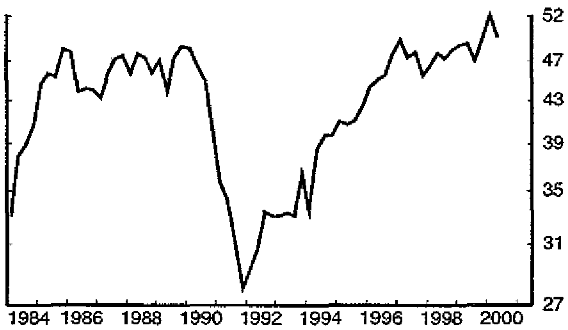
Buildings

Note. In addition to buildings, the nonresidential structures category includes outlays for drilling and mining, expenditures by utilities, and investment in miscellaneous private facilities such as streets, sewers, and parks.

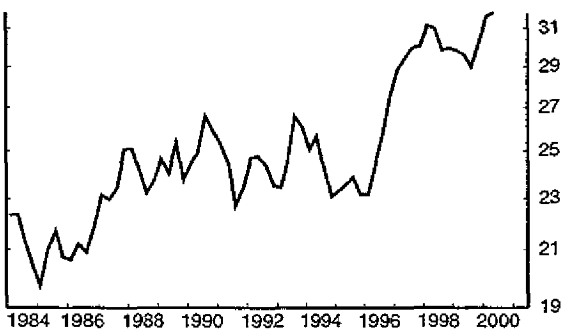
Office



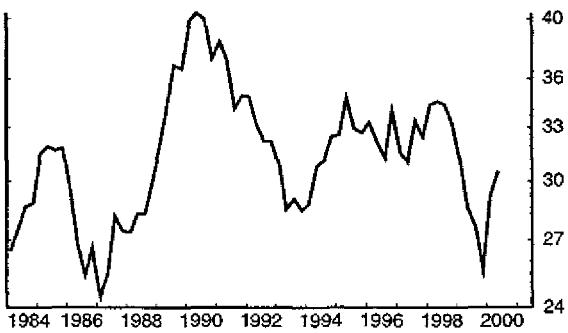
Other Commercial



Institutional



Industrial



Note. Estimates for 2000:Q2 are staff estimates based on the June data for construction put in place.

Nonetheless, while the increasing order backlog could reflect some bottleneck problems, capacity utilization rates for domestic communications equipment producers as a whole are only slightly above historical norms.

The volatile transportation sector provided a moderate boost to overall business spending in the second quarter, as a large increase in domestic aircraft expenditures offset a drop in motor vehicle outlays. We do not yet have much hard information on current-quarter domestic spending on aircraft, and the incoming data on business demand for motor vehicles have been mixed. Sales of light vehicles to fleets (**confidential**) were up noticeably in July, after holding steady in the second quarter. By contrast, sales of medium and heavy trucks dropped sharply in July to their lowest level since September 1998. Industry contacts continue to report poor profitability due to higher fuel prices, interest rates, wages, and insurance costs, and the stock of heavy trucks (both new and used) remains large. Net orders for heavy trucks have remained soft over the past several months, and backlogs fell in June to below 100,000 units for the first time in three years. Although net new orders for medium trucks rose in July to their highest level of the year, they still are below 1998's record level.

Real spending on equipment outside of the high-tech and transportation categories increased at an annual rate of 16 percent in the second quarter, following a 15 percent advance in the first quarter. This strength reflected higher outlays in a wide range of categories, including industrial machinery, construction machinery, business furniture, and engines and turbines. The increase in spending on engines and turbines so far this year likely reflects the large number of orders placed for gas turbines in 1998; delivery lags for these items are a couple of years long. Orders for engines and turbines have also been running at high levels in recent months; these goods accounted for most of June's increase in non-high-tech, non-transportation orders as well as for all of the recent increase in unfilled orders for this subcategory of equipment. With the exception of turbines, orders in this aggregate have been edging down of late.

Nonresidential structures. Real investment in nonresidential structures is estimated to have declined at an annual rate of 2-1/2 percent in the second quarter following a 22 percent surge in the first quarter.[13] The latest construction put-in-place data--which cover June--were weak. But given their volatility and tendency toward large revisions, these data provide little reliable

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13. The second-quarter figures are staff estimates of what BEA will publish when it revises its advance NIPA numbers to reflect the latest construction-put-in-place data. The nonresidential construction-put-in-place data for June were well below the assumption BEA made in estimating second-quarter GDP, and the data for April and May were revised down as well. These differences imply a downward revision of about $10 billion to BEA's estimate of second-quarter real spending on nonresidential structures.

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

Category	1999 Q4	2000 Q1	2000 Q2	2000 Apr.	2000 May	2000 June
Manufacturing and trade	81.0	60.8	106.6	74.6	122.4	122.7
Less wholesale and retail motor vehicles	70.3	50.9	73.3	52.2	87.8	79.9
Manufacturing	18.8	22.0	23.5	23.8	17.9	28.8
Less aircraft	27.2	18.6	29.0	30.9	29.8	26.4
Merchant wholesalers	25.7	25.1	37.0	35.5	36.3	39.1
Less motor vehicles	22.8	21.6	33.4	31.9	34.7	33.5
Retail trade	36.5	13.6	46.1	15.4	68.1	54.7
Automotive dealers	7.7	6.4	29.6	18.8	33.0	37.2
Less automotive dealers	28.8	7.2	16.4	-3.4	35.2	17.6

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

Category	Cyclical reference point 1990-91 high	Cyclical reference point 1991-98 low	Range over preceding 12 months High	Range over preceding 12 months Low	2000 March	2000 June
Manufacturing and trade	1.58	1.37	1.34	1.31	1.31	1.32
Less wholesale and retail motor vehicles	1.55	1.34	1.31	1.27	1.27	1.28
Manufacturing	1.75	1.36	1.30	1.26	1.26	1.25
Primary metals	2.08	1.46	1.61	1.53	1.54	1.55
Steel	2.56	1.59	2.04	1.87	1.87	1.99
Nonelectrical machinery	2.48	1.61	1.60	1.41	1.46	1.45
Electrical machinery	2.08	1.21	1.21	1.11	1.13	1.09
Transportation equipment	2.93	1.51	1.50	1.38	1.44	1.31
Motor vehicles	.97	.53	.57	.51	.52	.52
Aircraft	5.84	4.05	4.53	3.51	4.53	3.60
Nondefense capital goods	3.09	2.04	1.98	1.70	1.83	1.70
Textiles	1.71	1.38	1.60	1.52	1.55	1.57
Paper	1.32	1.06	1.19	1.12	1.13	1.18
Chemicals	1.44	1.25	1.36	1.30	1.32	1.35
Petroleum	.94	.80	.79	.66	.66	.69
Home goods & apparel	1.96	1.59	1.60	1.49	1.49	1.55
Merchant wholesalers	1.36	1.24	1.30	1.27	1.28	1.29
Less motor vehicles	1.31	1.22	1.28	1.25	1.25	1.26
Durable goods	1.83	1.53	1.59	1.55	1.58	1.60
Nondurable goods	.96	.90	.97	.94	.94	.94
Retail trade	1.61	1.45	1.45	1.40	1.40	1.44
Less automotive dealers	1.48	1.38	1.37	1.32	1.32	1.34
Automotive dealers	2.23	1.58	1.73	1.60	1.64	1.76
General merchandise	2.68	2.01	1.95	1.88	1.90	1.89
Apparel	2.54	2.29	2.30	2.18	2.18	2.26
Food	.83	.79	.82	.79	.81	.78

information regarding underlying trends, and, on balance, the fundamentals in this sector appear consistent with moderate gains in activity.

The construction of office buildings remains an area of strength. Real expenditures for office construction increased at an annual rate of 14-1/2 percent in the second quarter, leaving spending 10 percent above its year-earlier level. Construction of other commercial structures (which include retail space and warehouses) has been fairly flat, on balance, since the mid 1990s. Recently, investment in buildings of this type has been volatile, falling at an annual rate of 18 percent in the second quarter after having risen at a 21 percent pace in the first quarter. Real outlays for industrial construction plummeted last year but have rebounded sharply of late, rising at an annual rate of 19 percent in the second quarter. Nevertheless, the pace of construction in this sector remains well below the rates seen in the mid-1990s.

Business Inventories

We estimate that the real stock of nonfarm inventories increased at an annual rate of $70 billion last quarter, up from a $33 billion pace in the first quarter of the year.[14] About $14 billion of the second quarter's accumulation occurred in the motor vehicle sector, where stocks are now running at uncomfortably high levels. Elsewhere, despite a faster pace of stockbuilding, only a few instances of inventory overhangs are apparent.

The book value of manufacturers' inventories increased at an annual rate of $28.8 billion in June. For the second quarter as a whole, manufacturing stocks rose at a $23.5 billion rate, a touch faster than the $22.0 billion pace recorded in the first quarter. Excluding aircraft--and thus the swings in inventories associated with the Boeing strike--second-quarter inventory investment was $29 billion, up from $19 billion in the first quarter. However, with non-aircraft manufacturing shipments increasing 1.4 percent, the inventory-shipments ratio was left unchanged at 1.17 months, and stocks appear to be at comfortable levels in most industries. An exception is the construction materials and supplies grouping, for which demand has slowed in recent months and the inventory-shipments ratio has reached a four-year high.

The book value of non-auto wholesale inventories rose at an annual rate of $33-1/2 billion in the second quarter, up from a $21-1/2 billion pace in the first quarter. The inventory-sales ratio for this sector has edged up a touch in recent months, but evidence of unwanted accumulation is limited despite slower growth in sales, which fell from a first-quarter pace of a little over 12 percent

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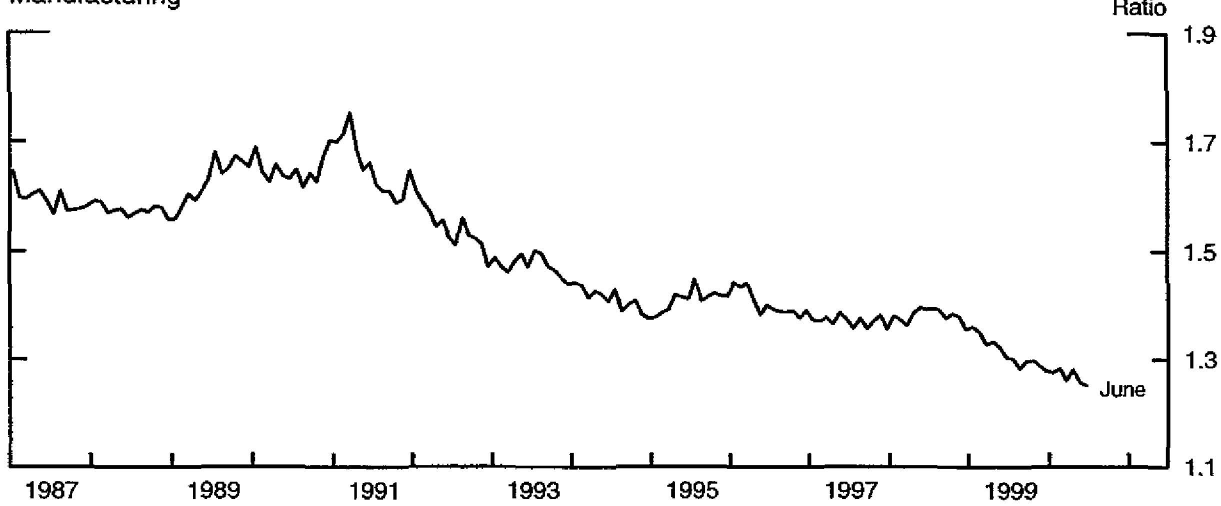
14. This figure is about $15 billion stronger than BEA had assumed when preparing the advance estimate of second-quarter GDP.

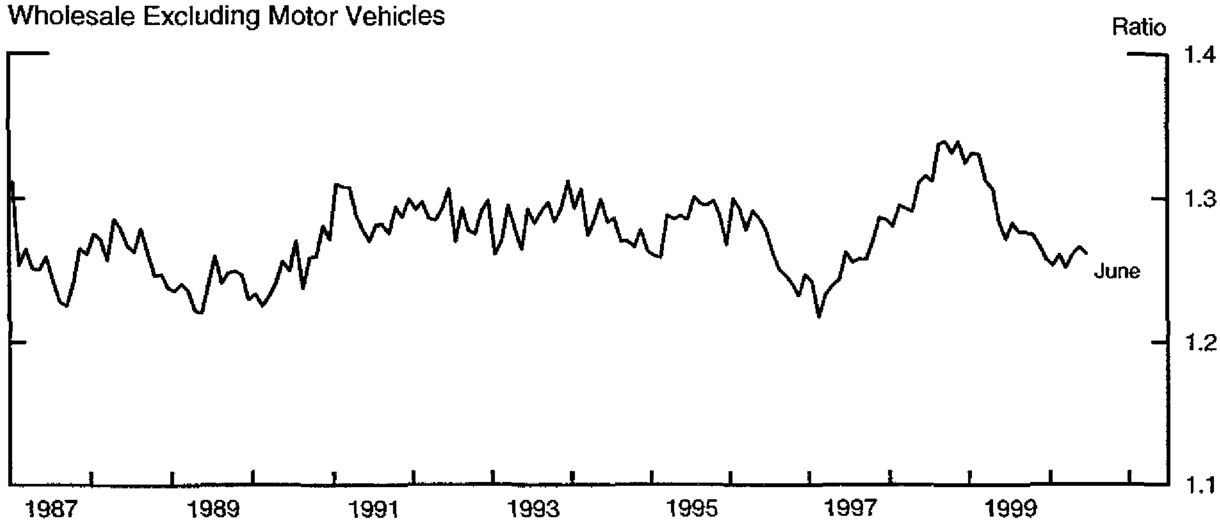
Inventory-Sales Ratios, by Major Sector

(Book value)

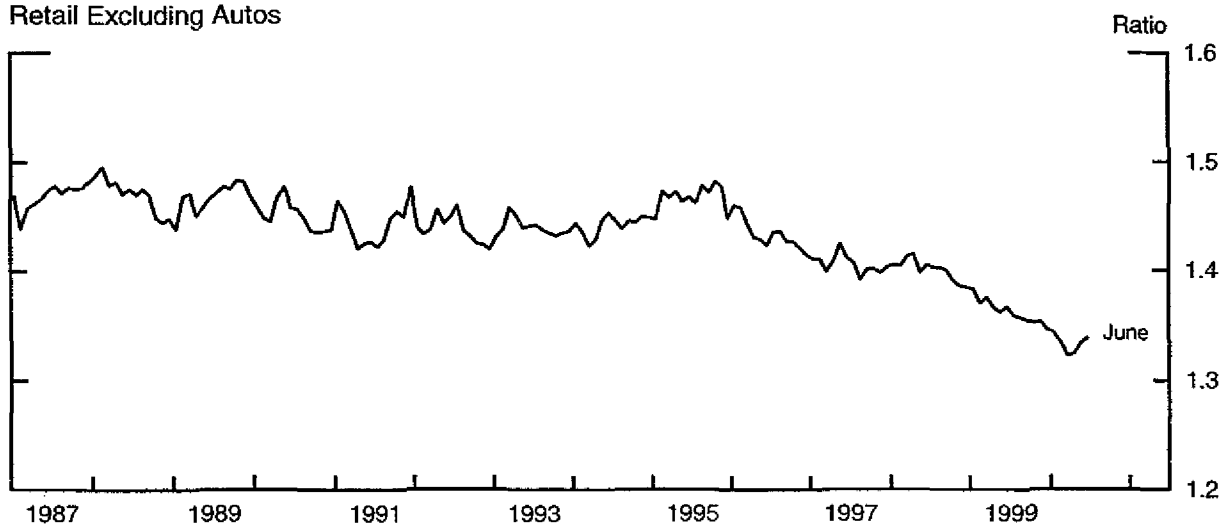
Manufacturing



Wholesale Excluding Motor Vehicles



Retail Excluding Autos



(annual rate) to a 7-3/4 percent rate in the second quarter. One exception is steel service centers, where reports of inventory overhangs continue.

Non-auto retail inventories rose $18 billion in book-value terms in June, and the inventory-sales ratio for this grouping--which had fallen rapidly over the early part of this year--edged up to 1.34 months, the same level as recorded in January. The increases in inventory-sales ratios in the second quarter were largely concentrated among retailers that saw a sharp slowdown in sales, most notably building materials stores, but also apparel outlets, furniture dealers, and stores selling "other durable goods" such as sports products, toys, and jewelry. Nonetheless, despite these increases in inventory-sales ratios, retail stocks are still very lean by historical standards, and the June ratio appears about consistent with the downward trend seen since early 1998.

Government Expenditures

Federal government. Federal budget prospects continue to look bright. According to the latest Monthly Treasury Statement, the budget surplus over the twelve months ending in June totaled $207 billion--about $110 billion larger than the surplus posted over the same period a year ago--as robust increases in tax receipts far exceeded the pace of outlays. Moreover, new budget projections by the Administration and the Congressional Budget Office call for significantly higher surpluses under current services than were forecast last winter.

After taking account of legislation enacted through mid-June, OMB estimated that the fiscal year 2000 surplus would reach $224 billion, and CBO estimated a surplus of $232 billion; a surplus of $119 billion was realized in fiscal 1999. Looking further ahead, both OMB and CBO project that the total unified surplus would rise from about 2-1/2 percent of GDP this year to above 4 percent of GDP over the next ten years if discretionary spending were held constant in real terms and if receipts and mandatory spending were to evolve according to current law. The on-budget surplus, which excludes social security and the Postal Service, is projected to rise from roughly 1 percent of GDP in fiscal 2001 to 2-1/2 percent of GDP by 2010. The current projections for this fiscal year are roughly $50 billion higher than those made last winter, and by 2010, the upward revisions increase to about $200 billion. New economic assumptions are responsible for the lion's share of the revisions; in addition, effective tax rates were raised, consistent with this spring's surprisingly strong tax collections.

With regard to recent budget legislation, a supplemental appropriations bill for fiscal year 2000 was enacted in early July. The bill is projected to boost spending by $3 billion in fiscal 2000 and by $4 billion in fiscal 2001; the increase will mainly fund military operations in Kosovo. In addition, the bill

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

	June			12 months ending in June		
	1999	2000	Percent change	1999	2000	Percent change
Outlays	145.9	158.6	8.7	1694.6	1775.4	4.8
Deposit insurance	-0.4	-0.1	...	-5.7	-3.7	...
Spectrum auction	0.0	0.0	...	-2.8	-0.8	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	146.3	158.7	8.4	1703.1	1779.9	4.5
Receipts	199.5	214.9	7.7	1791.1	1982.0	10.7
Surplus	53.6	56.3	...	96.5	206.7	114.3
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	146.3	147.9	1.1	1703.7	1770.2	3.9
National defense	24.1	27.2	12.7	274.1	290.9	6.1
Net interest	18.5	17.5	-5.5	233.6	228.0	-2.4
Social security	36.3	38.2	5.3	388.1	403.3	3.9
Medicare	16.7	15.8	-5.2	190.5	195.0	2.4
Medicaid	9.4	10.4	11.2	105.3	115.0	9.3
Other health	2.9	3.0	2.9	31.9	35.3	10.8
Income security	14.6	16.6	13.8	236.1	245.3	3.9
Agriculture	2.6	1.7	-36.1	26.6	32.1	20.7
Other	21.2	17.4	-17.7	217.5	225.3	3.6
Receipts	199.5	214.9	7.7	1791.1	1982.0	10.7
Individual income and payroll taxes	147.1	160.1	8.9	1432.1	1584.6	10.6
Withheld + FICA	106.6	113.8	6.7	1216.3	1334.7	9.7
Nonwithheld + SECA	42.8	49.6	15.7	337.3	384.2	13.9
Refunds (-)	2.4	3.2	33.9	121.5	134.3	10.6
Corporate	39.3	40.5	3.2	179.7	201.5	12.1
Gross	40.6	41.9	3.2	211.0	229.3	8.6
Refunds (-)	1.3	1.4	1.5	31.3	27.8	-11.4
Other	13.2	14.2	7.8	179.4	196.0	9.3
Surplus	53.2	67.0	...	87.4	211.8	142.3

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.

... Not applicable.

ADMINISTRATION BUDGET AND ECONOMIC PROJECTIONS

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Budget projections (Fiscal years)											
	Billions of dollars										
Current services surplus	224	239	279	295	324	360	422	479	532	595	670
On-budget[1]	76	79	104	104	120	134	184	223	260	307	364
Off-budget	148	160	175	191	204	226	238	256	272	288	306
Surplus under proposed budget[2]	211	248	249	261	281	295	335	379	415	449	501
	Percent of GDP										
Current services surplus	2.3	2.3	2.6	2.6	2.7	2.9	3.2	3.5	3.7	3.9	4.2
On-budget[1]	0.8	0.8	1.0	1.0	1.1	1.2	1.5	1.7	2.0	2.2	2.5
Off-budget	1.5	1.6	1.6	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Economic assumptions (Calendar years)											
	Percent change, Q4 to Q4										
Nominal GDP	6.0	5.3	5.1	4.9	5.0	4.9	5.0	5.0	4.9	4.9	4.8
Real GDP	3.9	3.2	3.1	2.9	2.9	2.8	2.9	2.9	2.8	2.8	2.8
CPI-U	3.2	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
	Percent, annual average										
Unemployment rate	4.1	4.1	4.3	4.5	4.7	4.8	5.0	5.1	5.1	5.1	5.1
Treasury yields											
Three-month	5.8	6.2	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Ten-year	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3

Note. The on-budget surplus excludes the social security surplus and the Postal Service (which are off-budget). The current services baseline assumes that budget authority for discretionary spending grows at the rate of inflation after 2000.

1. Includes Medicare Hospital Insurance trust fund which the Administration proposes to move off-budget.
2. Includes Reserve for America.

Source. Office of Management and Budget, Mid-Session Review of the 2001 Budget, June 2000.

CBO BUDGET AND ECONOMIC PROJECTIONS

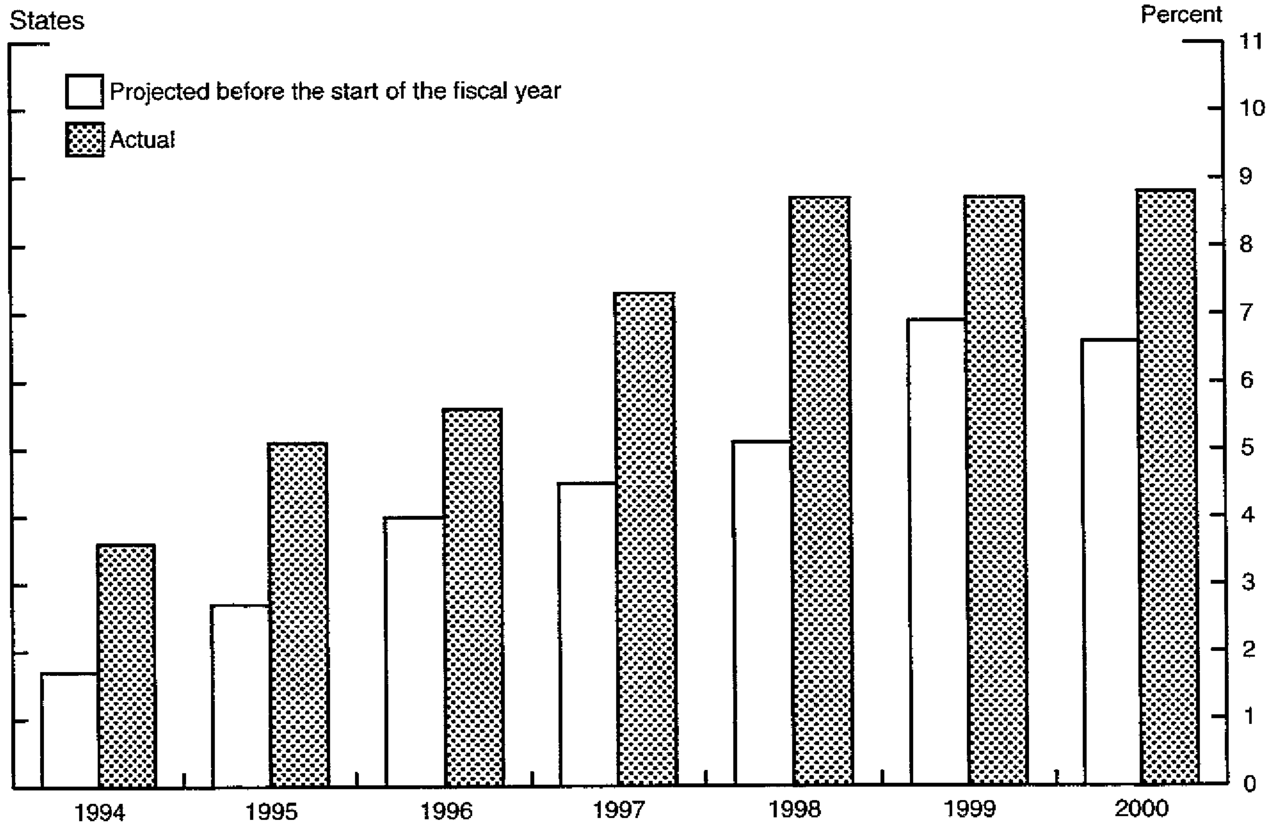
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Budget projections assuming constant real discretionary spending (Fiscal years)											
	Billions of dollars										
Total surplus	232	268	312	345	369	402	469	523	565	625	685
On-budget	84	102	126	143	154	169	222	260	288	332	377
Off-budget	149	165	186	202	215	232	247	263	278	293	307
	Percent of GDP										
Total surplus	2.4	2.6	2.9	3.0	3.1	3.2	3.6	3.9	4.0	4.2	4.4
On-budget	0.9	1.0	1.2	1.3	1.3	1.4	1.7	1.9	2.0	2.2	2.4
Off-budget	1.5	1.6	1.7	1.8	1.8	1.9	1.9	1.9	2.0	2.0	2.0
Economic assumptions (Calendar years)											
	Percent change, year over year										
Nominal GDP	7.0	5.3	4.9	4.6	4.5	4.5	4.6	4.6	4.6	4.7	4.7
Real GDP	4.9	3.1	2.7	2.6	2.6	2.7	2.7	2.7	2.7	2.8	2.9
CPI-U	3.1	2.7	2.9	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5
	Percent, annual average										
Unemployment rate	3.9	3.8	4.1	4.4	4.7	4.9	5.0	5.1	5.2	5.2	5.2
Treasury yields											
Three-month	5.9	6.7	5.5	4.9	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Ten-year	6.5	6.8	6.3	5.8	5.7	5.7	5.7	5.7	5.7	5.7	5.7

Note. The on-budget surplus excludes the social security surplus and the Postal Service (which are off-budget). The constant real discretionary baseline assumes that budget authority for discretionary spending grows at the rate of inflation after 2000.

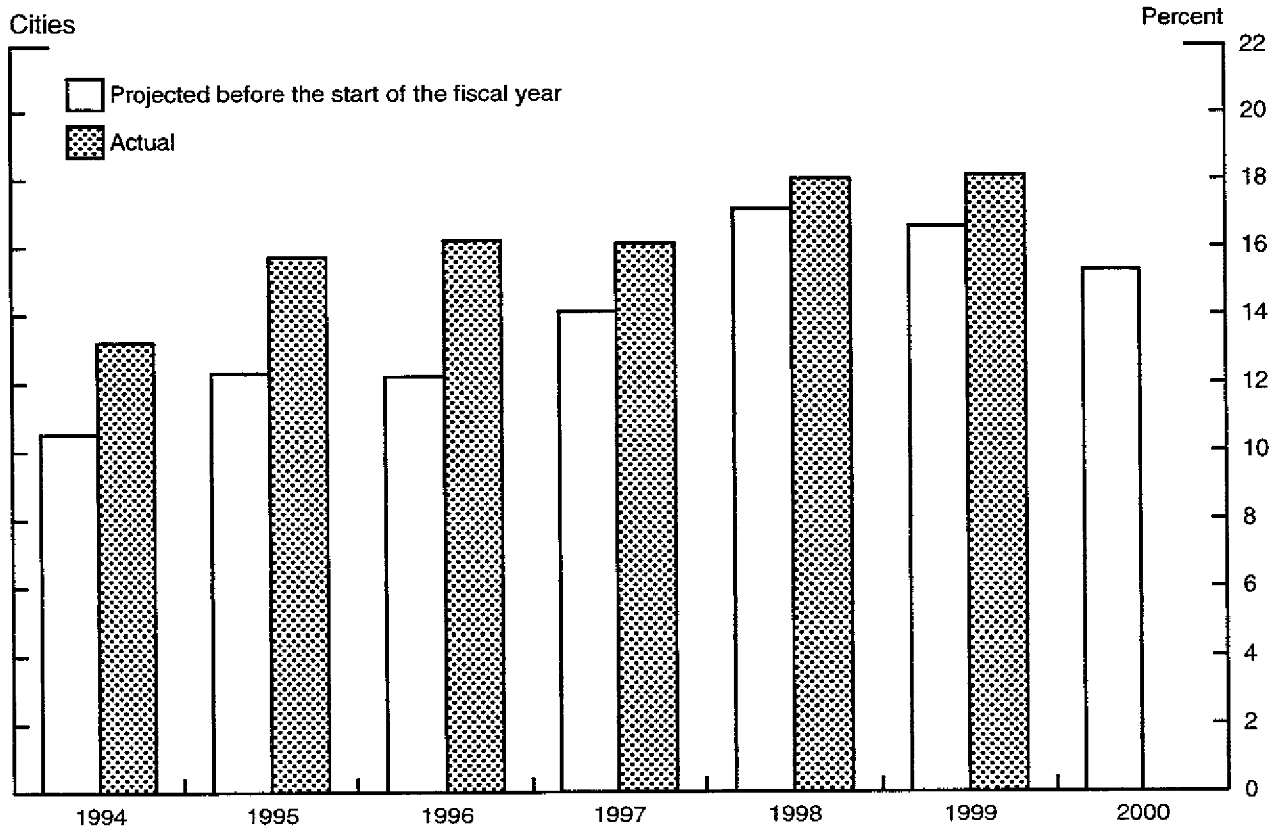
Source. Congressional Budget Office, The Economic and Budget Outlook: An Update July 2000.

State and City General Fund Balances

(As a percent of expenditures, fiscal years)



Source. National Conference of State Legislatures.



Source. National League of Cities.

Note: Most states end their fiscal years in June. The timing of cities' fiscal years varies greatly, and the actual values for their budgets in FY 2000 are not available.

CPI AND PPI INFLATION RATES
(Percent)

	From 12 months earlier		2000		2000	
	July 1999	July 2000	Q1	Q2	June	July
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.1	3.5	4.1	3.6	.6	.2
Food (15.3)	2.1	2.6	1.5	2.6	.1	.5
Energy (7.0)	3.3	19.3	31.5	13.8	5.6	.1
CPI less food and energy (77.7)	2.1	2.4	2.3	2.8	.2	.2
Commodities (23.4)	.6	.4	-.9	1.3	-.2	.0
New vehicles (4.8)	-.5	.4	-1.4	1.8	-.1	.2
Used cars and trucks (1.9)	.7	2.0	-6.3	4.6	.2	-.3
Apparel (4.7)	-1.8	-2.2	-4.2	-2.2	-.6	-1.0
Tobacco (1.3)	30.3	12.6	12.5	15.1	-1.3	3.1
Other Commodities (10.7)	-.5	-.1	.2	.5	.0	-.0
Services (54.3)	2.7	3.3	3.6	3.5	.3	.2
Shelter (29.9)	2.9	3.1	3.5	3.5	.3	.2
Medical care (4.5)	3.3	4.4	4.6	5.1	.5	.4
Other Services (20.0)	2.3	3.3	3.4	3.2	.3	.2
PPI						
Finished goods (100.0)[2]	1.5	4.1	4.8	3.7	.6	.0
Finished consumer foods (22.9)	-.1	2.1	2.2	4.0	-.3	.0
Finished energy (13.8)	4.9	19.2	30.8	11.9	5.1	-.7
Finished goods less food and energy (63.3)	1.3	1.5	.3	1.8	-.1	.1
Consumer goods (38.9)	2.4	1.7	.2	1.8	-.1	.1
Capital equipment (24.4)	-.1	1.2	1.0	1.5	.0	.1
Intermediate materials (100.0)[3]	.3	5.0	6.9	4.4	.9	.2
Intermediate materials less food and energy (81.7)	-.1	2.8	3.4	3.3	.2	.2
Crude materials (100.0)[4]	-.2	23.4	18.1	19.9	5.8	-1.1
Crude food materials (39.0)	-7.2	3.3	5.3	8.3	-2.6	-2.7
Crude energy (39.0)	13.4	53.5	30.9	47.9	16.2	.4
Crude materials less food and energy (22.0)	-6.7	7.5	19.6	-7.4	-1.3	-1.8

1. Relative importance weight for CPI, December 1999.
2. Relative importance weight for PPI, December 1999.
3. Relative importance weight for intermediate materials, December 1999.
4. Relative importance weight for crude materials, December 1999.

shifted $10 billion of spending from fiscal 2001 into fiscal 2000. Congress also passed two tax cuts: a phased-in repeal of the estate and gift tax, and a bill that would mitigate the so-called marriage penalty. The President has vetoed the marriage tax relief bill and has promised to veto the estate tax bill. Elsewhere, legislation to boost the minimum wage and to cut business taxes has passed the House and awaits Senate action.

State and local governments. Real purchases by state and local governments were little changed in the second quarter after having posted unusually rapid increases during the fall and winter. The source of the slowdown can be traced to construction spending and appears to owe in large part to the unusually dry and mild weather that facilitated work--especially on highways--during the late fall and winter. State and local employment, which provides the first piece of third-quarter data for this sector, rose 39,000 in July; this was well above the average monthly increase seen during the first half of the year.

According to two recent surveys, both city and state governments continue to enjoy very sound fiscal conditions. Measured as a share of expenditures, general-fund ending balances of both states and cities remain elevated.[15] Moreover, since 1994, ending balances have been coming in well above what states and cities had projected at the beginning of their fiscal years. In response to their improved fiscal positions, state governments have saved money in their reserve accounts and have enacted a record amount of tax cuts. The rate of spending by city governments has trended up since the mid-1990s, and while many cities have added new fees and charges, they have done so at a much-reduced pace relative to that seen earlier in the decade.

Prices

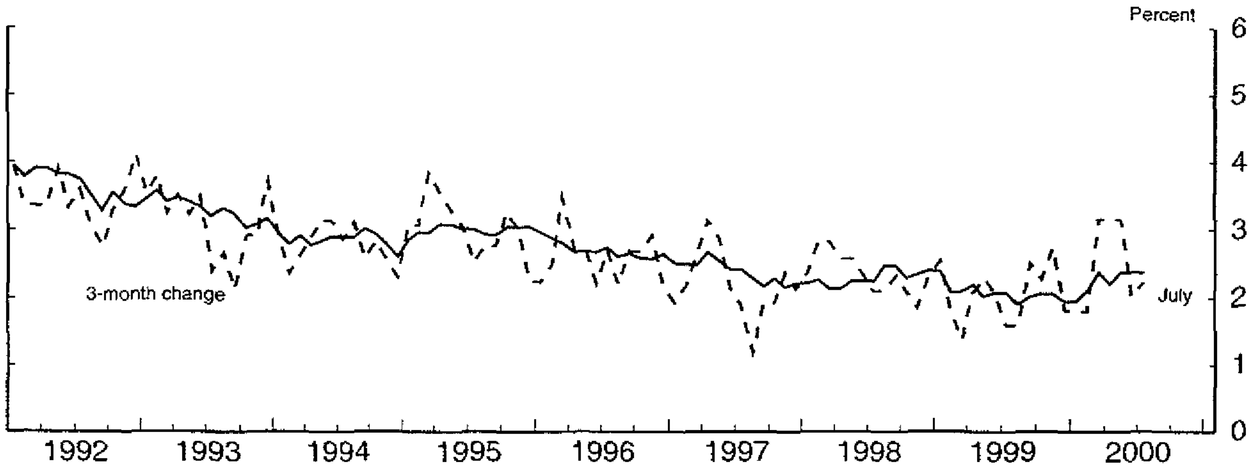
The data received since the June Greenbook are broadly consistent with an acceleration in prices. The consumer price index rose 0.2 percent in July following an increase of 0.6 percent in June. The June figure was pushed up by a surge in energy prices, while in July the index for energy was about flat. Food prices were about unchanged in June but jumped in July. Over the past twelve months, the headline CPI rose 3.5 percent, considerably faster than the 2.1 percent pace that prevailed a year earlier; an acceleration in energy prices contributed importantly to the pickup. Outside of food and energy, prices increased 0.2 percent in both June and July and were up 2.4 percent over the past year. The core CPI has accelerated nearly 0.5 percentage point in the past

15. The state report includes all states except Massachusetts, while the city survey is based on a sample of 1,060 large and medium-sized cities (of which a third responded). The general funds are the largest funds of state and city governments; they do not include capital spending and account for roughly 50 percent of total outlays. Ending balances are the resources left in the general fund at the end of the year.

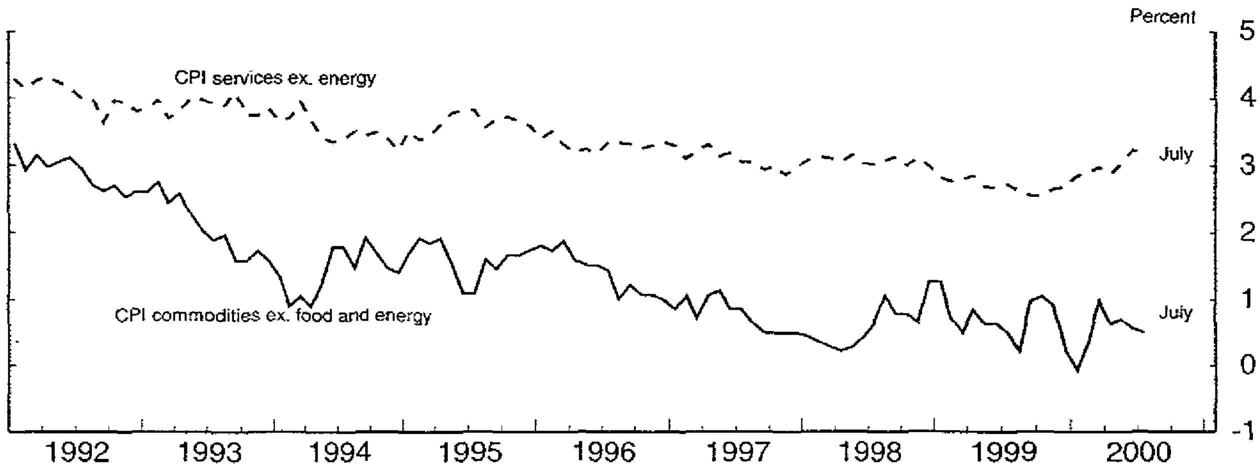
Measures of Core Consumer Price Inflation

(12-month change except as noted)

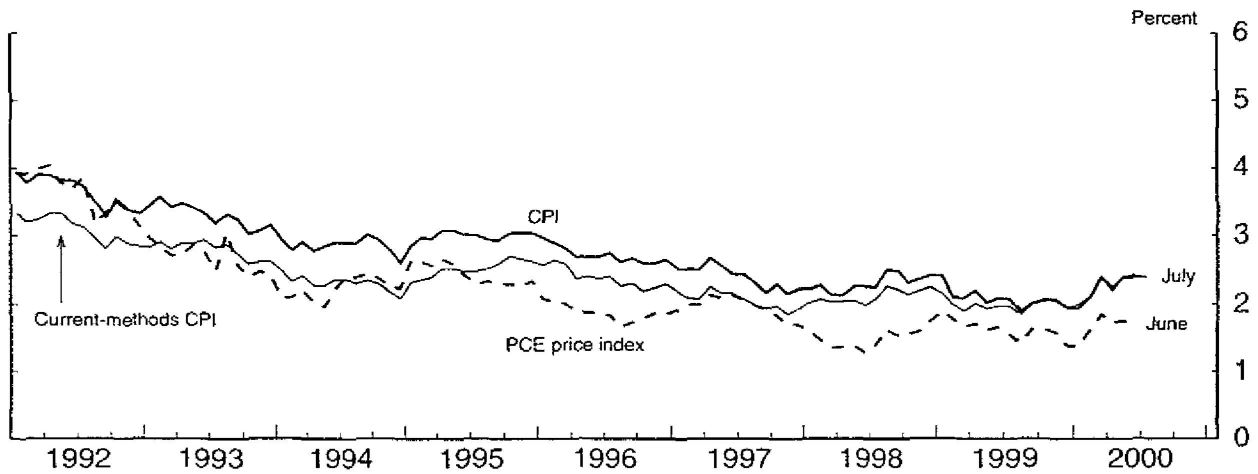
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE Excluding Food and Energy



year (current-methods basis); excluding tobacco, the acceleration was 2/3 percentage point.

Core commodity prices edged down a touch, on balance over the past two months and were up 0.4 percent over the past year--a little less than the pace of a year ago. However, absent tobacco prices--which decelerated sharply over the past twelve months after surging in late 1998--the pickup in core commodity inflation over the past year was almost 1/2 percentage point.[16] Over the past two months, prices of new vehicles changed little and were up just 0.4 percent from a year ago, as the Big Three have kept incentives elevated in an attempt to mitigate inventory imbalances and secure higher market shares. Although this pace of increase was modest, it represented a 1 percentage point pickup from the year-earlier period.

The CPI for non-energy services increased 0.2 percent in July after an increase of 0.3 percent in June. Over the past year, these prices were up 3.3 percent, 0.6 percentage point more than in the year-earlier period. The acceleration owed to faster price increases for many service items, including medical care and airfares. The acceleration in airfares owed in part to the rise in fuel costs.

Over the four quarters ended in 2000:Q2, the core CPI rose 2.3 percent--0.6 percentage point faster than the increase in core PCE prices.[17] With regard to recent quarterly movements, core PCE prices rose about 1 percentage point less than the core CPI in the second quarter, following a first-quarter increase that was similar to the CPI's. The narrowing of the gap in the first quarter occurred mainly because the prices of items that are included in PCE but not in the CPI rose more rapidly than is typical, pushing up core PCE inflation relative to core CPI inflation.[18] In the second quarter, prices for these "out-of-scope" items increased a little more slowly than is typical. One item that was particularly important was imputed charges for commercial bank services (which account for about 2-1/2 percent of total personal consumption); the price for this component of PCE jumped 17-1/2 percent at an annual rate in the first quarter but then increased at a much slower 4 percent pace in the second quarter.

In addition to giving different readings on the level of inflation, the core PCE price index and the CPI present somewhat different pictures of the pattern of inflation over time. In particular, during the four quarters through 2000:Q2,

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16. The major tobacco companies hiked the wholesale price of cigarettes by 6 cents per pack at the very end of July, which should show up in the August CPI.

17. In 1998 and 1999, the gap between core CPI inflation (measured on a current-methods basis) and core PCE inflation averaged a bit below 0.6 percentage point. Prior to the annual NIPA revision, the gap was a little larger.

18. Many of these items do not have market prices, and the BEA relies on a variety of sources and techniques to estimate their price.

BROAD MEASURES OF INFLATION
(4-quarter percent change)

	1997 Q2	1998 Q2	1999 Q2	2000 Q2
Product prices				
GDP chain price index	2.1	1.2	1.5	2.1
Less food and energy	2.2	1.3	1.6	2.0
Nonfarm business chain price index[1]	2.2	0.8	1.3	1.7
Expenditure prices				
Gross domestic purchases chain price index	1.8	0.8	1.5	2.4
Less food and energy	1.8	1.0	1.5	1.8
PCE chain price index	2.0	1.0	1.7	2.5
Less food and energy	2.1	1.3	1.6	1.7
CPI	2.3	1.6	2.1	3.2
Less food and energy	2.5	2.2	2.1	2.3
Current-methods CPI	2.0	1.4	2.0	3.2
Less food and energy	2.2	2.1	1.9	2.3
Median CPI	2.9	2.9	2.6	2.5
Trimmed mean CPI	2.5	2.0	1.8	2.4

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year		University of Michigan: 5 to 10 years		Professional forecasters (10-year)[4]
		Mean[2]	Median[2]	Mean[3]	Median[3]	
1998-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	1.7	3.0	2.6	3.3	2.8	2.3
Q2	2.1	3.1	2.7	3.3	2.8	2.5
Q3	2.3	3.1	2.7	3.4	2.9	2.5
Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.2	3.5	3.0	3.3	2.8	2.5
2000-Jan.	2.7	3.5	3.0	3.5	3.0	
Feb.	3.2	3.5	2.9	3.3	2.9	
Mar.	3.7	3.8	3.2	3.8	3.1	2.5
Apr.	3.0	3.5	3.2	3.2	2.8	
May	3.1	3.5	3.0	3.4	2.9	
June	3.7	3.4	2.9	3.3	2.8	2.5
July	3.5	3.7	3.0	3.2	2.8	

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

core PCE prices accelerated 0.3 percentage point less than the core CPI (on a current-methods basis), while in the prior four quarters the pattern was reversed, with core PCE prices accelerating noticeably more than the core CPI. Swings of this magnitude in the relative patterns of acceleration are not unusual and often owe to movements in the prices of out-of-scope items, as mentioned above. Recently, however, the divergence largely stems from differences in the prices used for some individual items in each measure. For example, the BEA uses PPIs for physician services and for-profit hospitals instead of CPIs in constructing the PCE price index. In combination, these PPIs did not accelerate over the past year--contributing to the relatively flat pattern of core PCE inflation--while the corresponding CPIs accelerated considerably.

Outside of the consumer sector, capital goods prices have shown clear signs of accelerating. Although the PPI for capital equipment was essentially unchanged in June and July, this index has risen 1.2 percent over the past twelve months, up more than 1 percentage point from its year-earlier pace. Prices have accelerated for motor vehicles, aircraft, and a range of other capital goods. In addition, a small part of this overall acceleration is the result of a slower rate of decline in computer prices; these prices fell 16 percent during the past year, compared with an average decline of nearly 24 percent over the preceding two years.

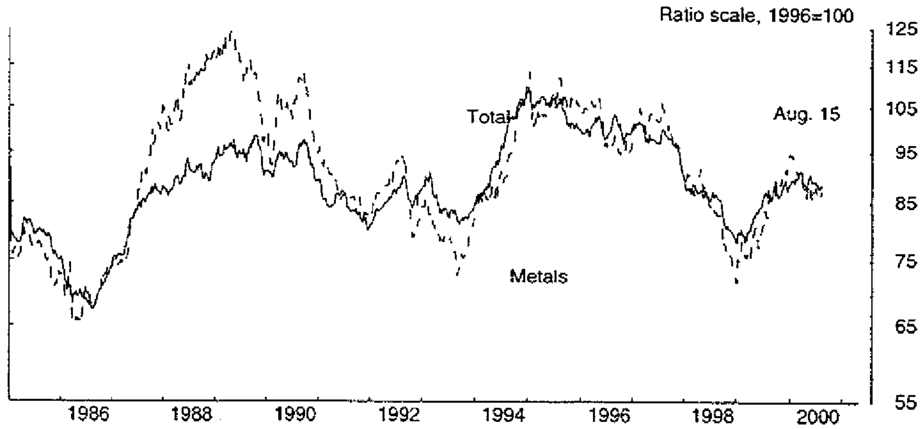
This firming of investment prices has contributed to an acceleration in the broader price indexes. The chain price index for gross domestic purchases excluding food and energy rose 1.8 percent over the four quarters ended in the second quarter of 2000, up 0.3 percentage point from a year earlier.

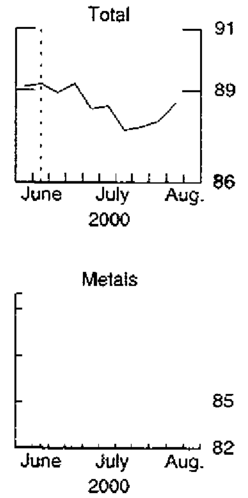
Inflation has been mixed at earlier stages of processing. The PPI for intermediate materials excluding food and energy rose 0.2 percent further in July, extending a long string of increases in this series. Over the past twelve months, this index has risen 2.8 percent, up considerably from the year-earlier period, when these prices were flat. In contrast, the PPI for core crude goods fell 1.8 percent in July after having dropped 1.3 percent in June; despite recent declines, these prices are up 7-1/2 percent over the past year. Since the mid-July pricing date for the PPI, the Journal of Commerce index of industrial commodities has changed little, on balance, as declines in prices of plywood and some metals--including steel scrap--were offset by increases elsewhere. Although not included in the Journal of Commerce index, prices of crops and livestock have moved lower, as well, since mid-July.

As for inflation expectations, the median response to the University of Michigan survey of one-year ahead inflation expectations was 3.0 percent in July, the same as the average over the first half of the year. These expectations are up about 1/4 percentage point from a year ago. The five-to-ten-year median

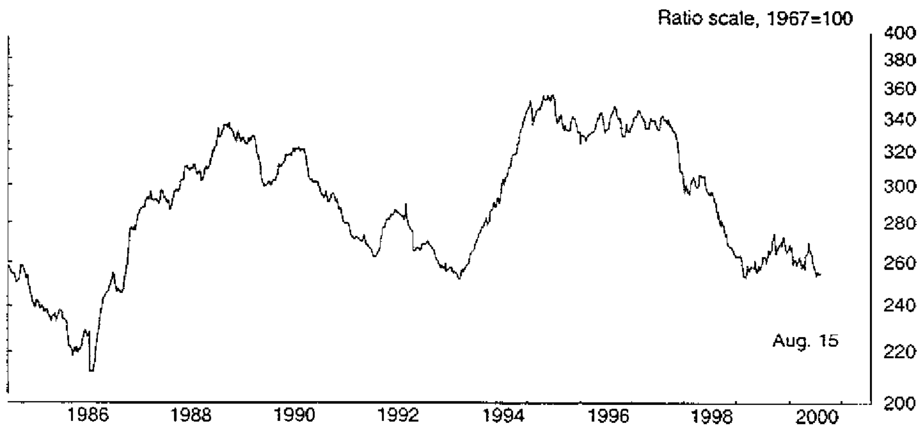
Commodity Price Measures

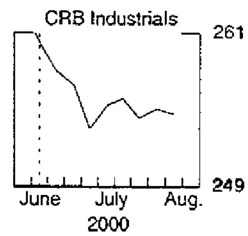
Journal of Commerce Index



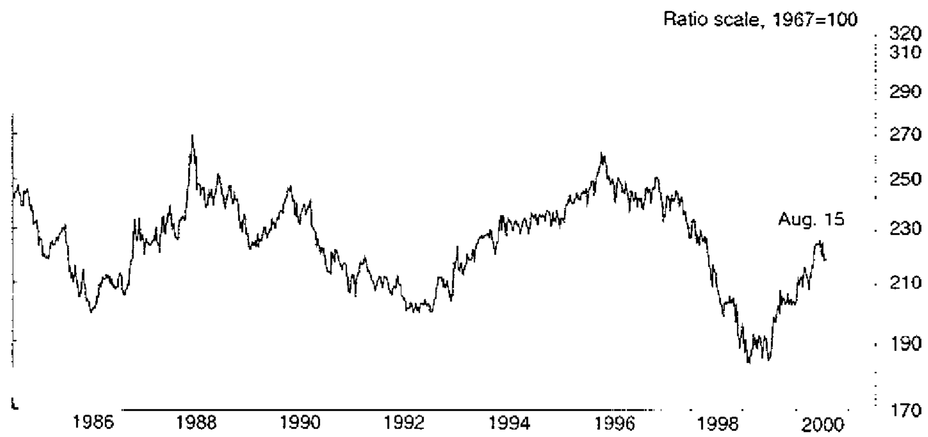


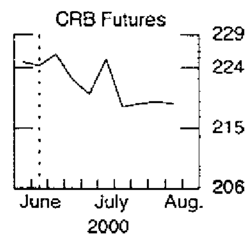
CRB Spot Industrials





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.

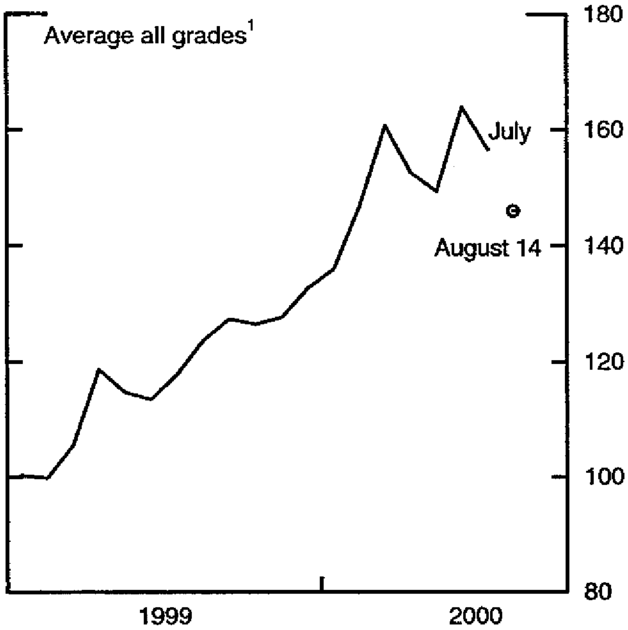
SPOT PRICES OF SELECTED COMMODITIES

	Current price (dollars)	Percent change[1] 1998	1999	Dec. 28 to June 20[2]	June 20[2] to Aug. 15	Memo: Year earlier to date
Metals						
Copper (lb.)	.900	-18	27.5	-1.1	3.4	11.1
Steel scrap (ton)	92.000	-47	61.5	-17	-5.8	-7.7
Aluminum, London (lb.)	.695	-18	26.8	-2.4	-.1	6.2
Precious metals						
Gold (oz.)	274.15	-1.8	1.3	-1.5	-4.2	5.6
Silver (oz.)	4.900	-20	4.3	-3.7	-2.9	-7.1
Forest products[3]						
Lumber (m. bdft.)	220.00	2.7	8.3	-18	-17	-37.1
Plywood (m. sqft.)	287.00	6.8	-1.6	-1.6	-4.3	-33.3
Petroleum						
Crude oil (barrel)	29.850	-43	147.2	11.8	4.6	44.9
Gasoline (gal.)	.855	-43	109.2	34.9	-9.1	34.0
Fuel oil (gal.)	.869	-39	115.2	7.6	14.3	54.7
Livestock						
Steers (cwt.)	64.500	-13	15.3	3.3	-8.2	-1.1
Hogs (cwt.)	43.000	-65	127.4	44.7	-16	25.5
Broilers (lb.)	.494	27.6	1.4	-.9	-13	-15.3
U.S. farm crops						
Corn (bu.)	1.470	-19	-8.5	-5.3	-18	-21.0
Wheat (bu.)	2.763	-11	-20.3	11.2	-6.0	3.2
Soybeans (bu.)	4.475	-20	-16.8	9.0	-7.4	.3
Cotton (lb.)	.589	-9.3	-19.4	19.7	6.4	14.1
Other foodstuffs						
Coffee (lb.)	.783	-30	2.1	-26	-11	-15.2
Memo:						
JOC Industrials	88.600	-14	12.2	1.2	-.7	1.9
JOC Metals	87.300	-20	28.0	-6.1	.0	1.4
CRB Futures	218.69	-18	6.9	9.9	-2.5	10.9
CRB Spot	254.69	-14	1.0	-2.2	-2.1	-4.3

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 June Greenbook.
3. Reflects prices on the Friday before the date indicated.

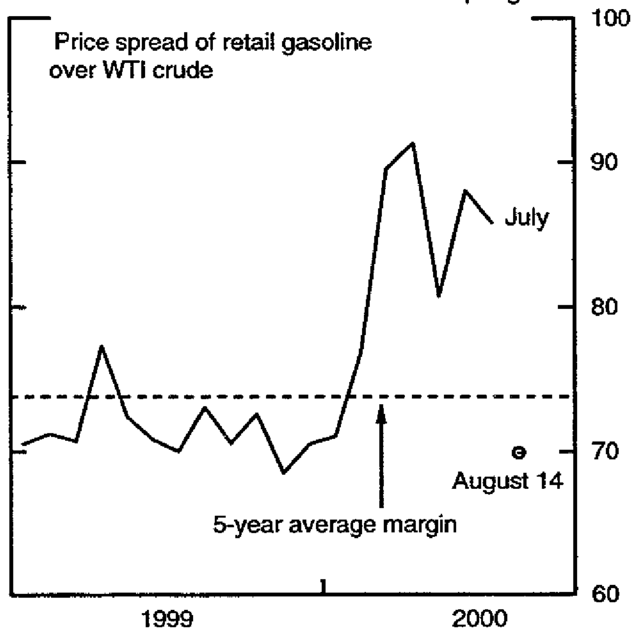
Gasoline and Heating Oil Developments

Retail Gasoline Prices

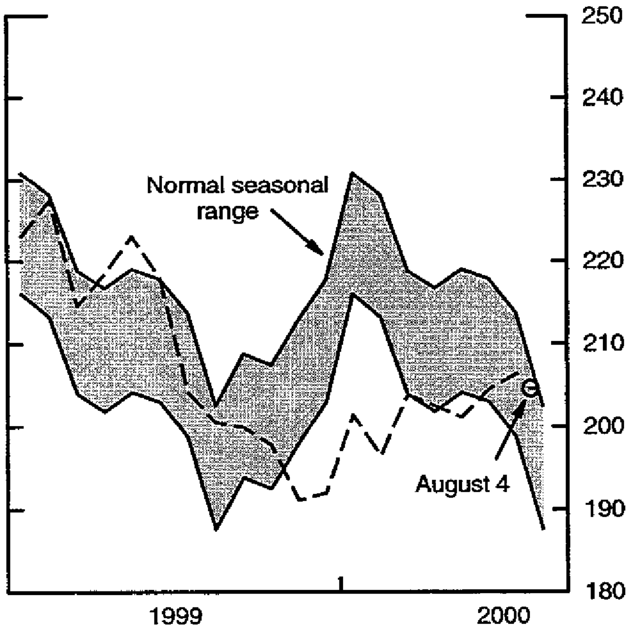


1. Prices adjusted using CPI seasonal factors.

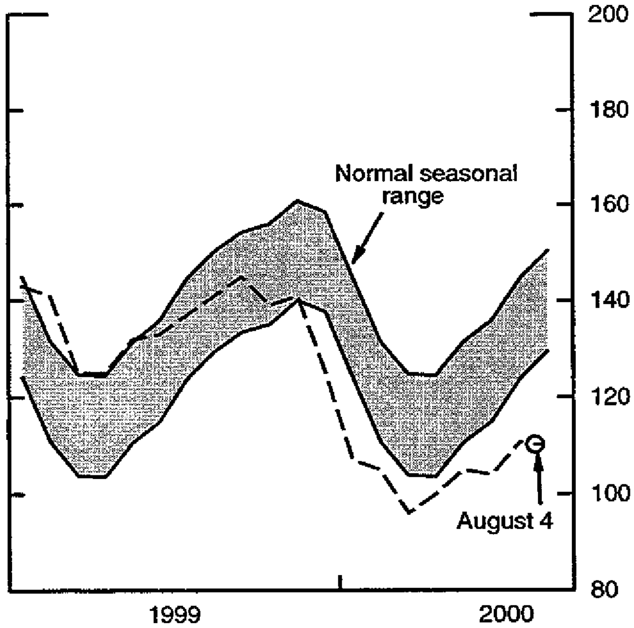
Gasoline Price Margins



Gasoline Inventories



Heating Oil Inventories



Source. U.S. Department of Energy.

expectation came in at 2.8 percent in July; longer-run expectations have remained quite stable over the past couple of years.

Energy price developments. Energy prices have played a key role in the acceleration of the CPI since the start of the year. Increases in gasoline prices have been particularly large, driven by low inventories and supply disruptions. In early June, the Midwest was hit by gasoline pipeline breakdowns, and refiners ran into major difficulties in blending ethanol into gasoline to meet environmental standards for the Chicago and Milwaukee areas. As a result, refiners' profit margins for gasoline rose to exceptionally high levels in the region. Since June, however, supplies of oxygenated gasoline have poured into the Midwest, and gasoline prices in that area have plunged at both the wholesale and retail levels. As of early August, the spread between retail gasoline prices and crude oil costs had returned to a more normal level for the country as a whole.

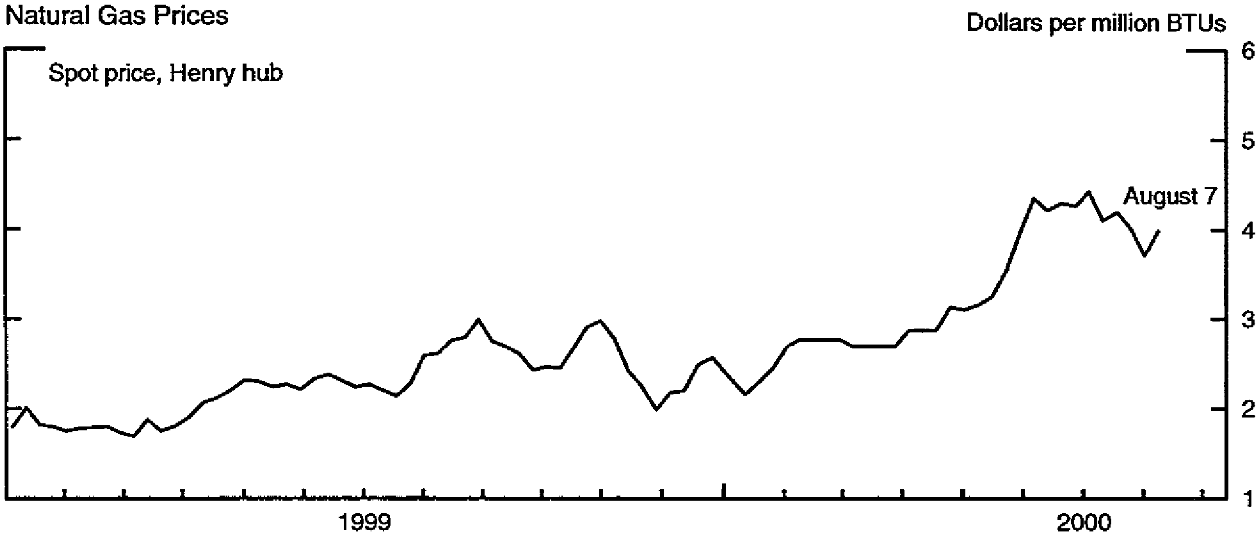
Production difficulties have been less severe for heating oil, although inventories have been lean for quite some time. As of the end of July, distillate inventories constituted about 28 days of wintertime supply, below the July norm of about 33 days. This suggests that even typical weather this coming winter could strain supplies and boost prices. However, heating oil is a relatively small fraction of total oil demand, even in the winter, and a moderate boost in refinery output could put inventories back in line with demand rather promptly--indeed, futures quotes show little indication that a heating-oil shortfall is anticipated.

Tight supplies and rising prices have also characterized the market for natural gas over the past year. Growth in gas supplies has been disappointing, and levels of natural gas in storage are below the norm for this time of year. That said, at current rates of accumulation, storage levels at the start of the winter heating season will be closer to normal than was the case last November. If the winter turns out to be no colder than usual, this level of inventory should be enough to avoid any significant supply disruptions. Nonetheless, futures prices for this winter remain in the same high range seen at the time of the June Greenbook.

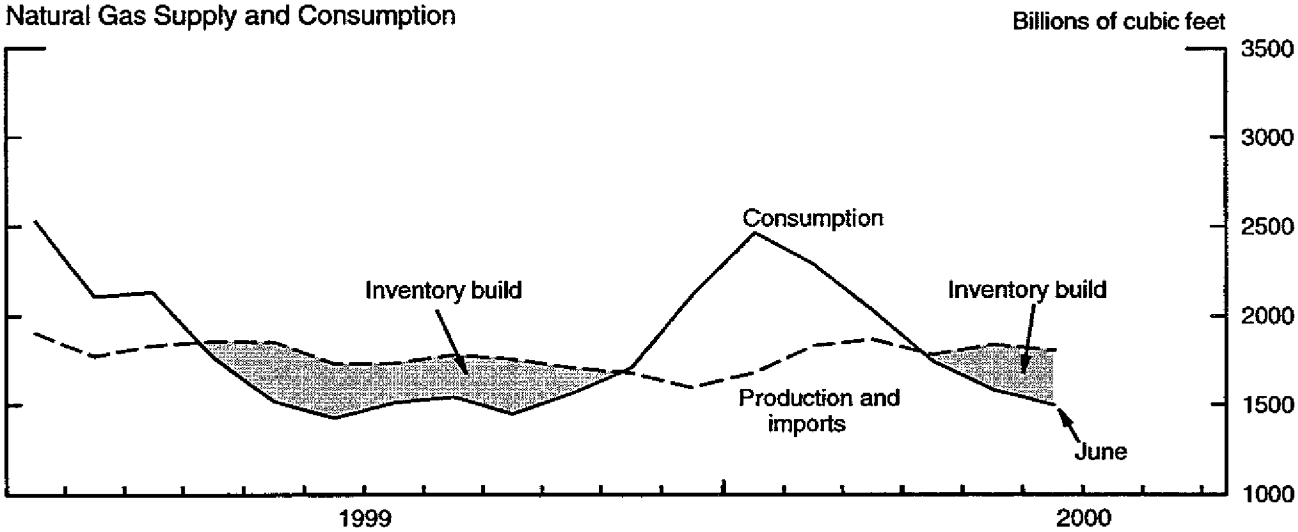
Electricity demand has soared over the past year along with rapid economic growth. The power generation and transmission system has not expanded to keep pace, especially in the West. As a result, spells of hot weather this summer have driven California spot prices to unusually high levels. Residential prices remain partially regulated in most of California and the rest of the country, limiting the response of residential electric rates to spot-price increases. Given the usual drop in air-conditioning demand for electricity at summer's end, capacity should be more than adequate for the fourth quarter; in addition, substantial new generating capacity is due to come on line in 2001. Still,

Natural Gas Developments

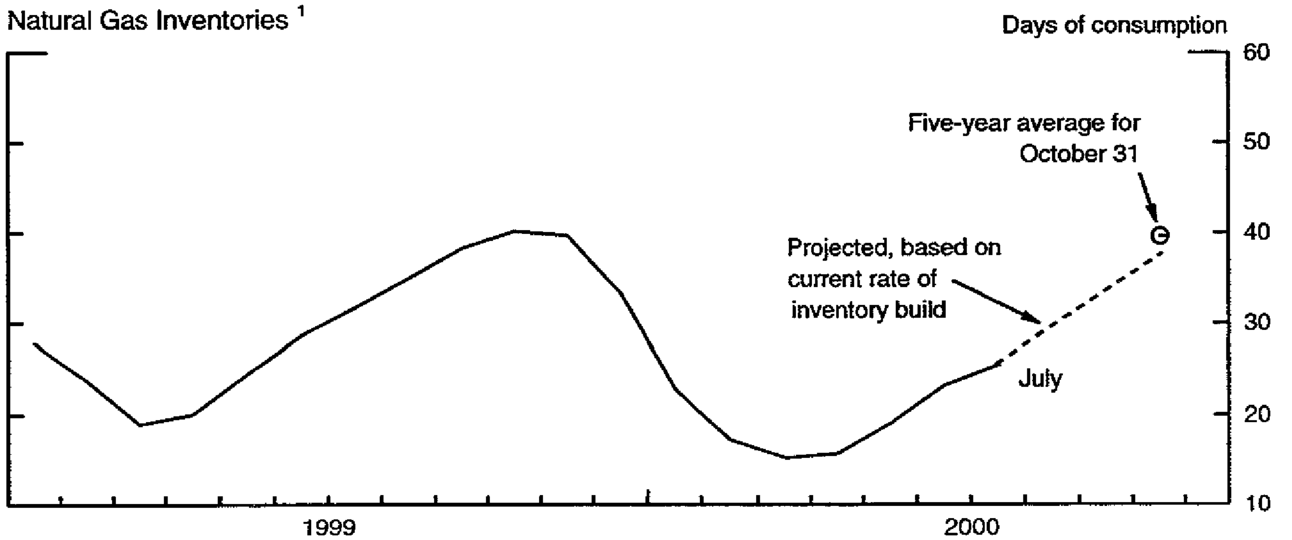
Natural Gas Prices



Natural Gas Supply and Consumption



Natural Gas Inventories [1]



1. Working gas in storage divided by U.S. D.O.E. projection of 2000/2001 average daily winter consumption. July data preliminary.

Source. U.S. Department of Energy.

whether electrical generation and transmission capacity will be sufficient to avoid further spot-price spikes next summer is an open question.

Labor Costs

Recent data indicate that both the ECI and productivity and cost (P&C) measures of hourly compensation increased more than 4-1/2 percent over the past year. Although the specific pattern of acceleration differs across the two series, both show a net pickup in labor costs over the past five or so years.

The ECI rose especially sharply over the first half of this year, leaving the twelve-month change 1-1/4 percentage points above its pace of a year ago. This acceleration in the ECI has been widespread across industries and occupations. Although the ECI for wages and salaries has accelerated about 1/2 percentage point, the bigger jump has occurred in benefit costs inflation, which rose 5-3/4 percent over the past year--more than 3 percentage points faster than over the year-earlier period. Health insurance costs have been a noticeable source of the acceleration in benefit costs, but increases in the other major categories have picked up as well.[19]

The jump in the ECI brings its rate of increase into line with the P&C measure of hourly compensation, which is now reported to have risen at around 4-3/4 percent over the past four quarters and in the year-earlier period. The P&C data incorporate information from the annual NIPA revision. Two aspects of this revision warrant further comment. First, with little change to the 1998 rate of increase and an upward revision in 1999, this measure is now reported to show less deceleration between 1998 and 1999 than was reported prior to the NIPA revision. Even so, increases in P&C hourly compensation still show a surge in 1998 that is difficult to explain fully. Second, even though the rate of increase in compensation per hour was revised up in 1999, productivity growth was also marked up, implying little revision to the growth rate of unit labor costs last year.

The July employment report provided the first look at wage developments in the third quarter. Average hourly earnings of production or nonsupervisory workers increased 0.4 percent in July. Over the past twelve months, this series increased 3.7 percent, about the same pace as in the year-earlier period. Over long spans of time, movements in average hourly earnings are similar to those in the corresponding ECI series for wages and salaries of workers in production and

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19. In June, BLS expanded the definition of benefits in the ECI to include hiring and referral bonuses. Because BLS merely added these new components to the June level of compensation, their inclusion induces a small discontinuity in the ECI. A rough calculation performed by the BLS suggests that adding these new components of bonuses could have boosted the level of total civilian compensation by "at most" a penny per hour. A one-cent increase in hourly compensation translates to 0.2 percentage point on the quarterly change (at an annual rate).

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION FOR PRIVATE INDUSTRY WORKERS

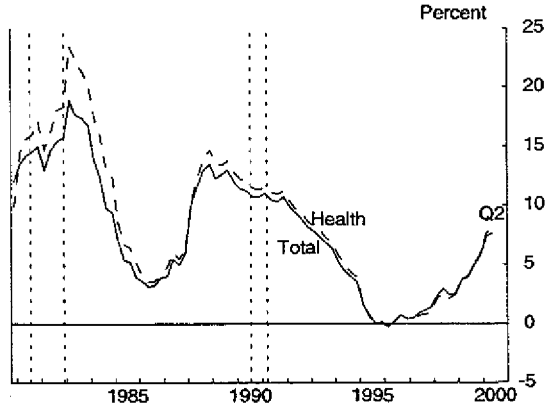
	1999			2000	
	June	Sept.	Dec.	Mar.	June
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	4.3	3.7	4.0	5.9	4.4
Wages and salaries	4.7	3.5	3.7	4.9	4.2
Benefit costs	3.9	3.9	4.7	9.7	5.0
By industry					
Construction	2.7	2.7	4.1	5.9	5.5
Manufacturing	2.9	3.5	4.6	6.6	4.2
Trans., comm., and public utilities	4.1	2.0	2.0	4.0	5.7
Wholesale trade	4.8	5.1	6.4	4.1	4.3
Retail trade	5.7	2.0	4.4	6.7	3.4
FIRE	12.7	5.0	1.9	10.4	2.9
Services	3.4	3.6	4.2	5.3	5.2
By occupation					
White collar	5.2	3.7	3.9	6.7	5.2
Blue collar	3.3	3.5	3.8	6.1	3.7
Service occupations	3.2	1.1	4.6	3.4	4.5
Memo:					
State and local governments	3.5	3.1	4.3	3.4	3.1
	-----Twelve-month percent change----				
Total hourly compensation	3.3	3.1	3.4	4.6	4.6
Excluding sales workers	3.2	3.2	3.7	4.3	4.4
Wages and salaries	3.6	3.2	3.5	4.2	4.1
Excluding sales workers	3.6	3.3	3.7	3.8	3.9
Benefit costs	2.5	2.8	3.4	5.5	5.7
By industry					
Construction	3.2	3.4	3.3	3.8	4.6
Manufacturing	2.7	2.8	3.4	4.4	4.7
Trans., comm., and public utilities	2.8	2.4	2.2	3.0	3.4
Wholesale trade	4.3	3.9	4.0	5.1	5.0
Retail trade	3.5	3.0	3.8	4.7	4.1
FIRE	5.3	4.7	4.1	7.4	5.0
Services	3.1	3.0	3.4	4.1	4.6
By occupation					
White collar	3.4	3.2	3.5	4.8	4.9
Sales	3.9	2.6	1.9	6.7	5.4
Nonsales	3.3	3.3	3.8	4.5	4.7
Blue collar	2.9	3.1	3.4	4.2	4.3
Service occupations	3.4	2.7	3.3	3.2	3.4
Memo:					
State and local governments	3.0	2.9	3.4	3.6	3.5

1. Seasonally adjusted by the BLS.

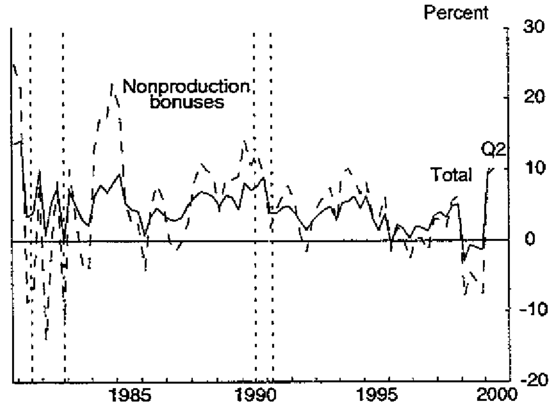
Components of ECI Benefits Costs (CONFIDENTIAL)

(Private industry workers; 12-month change)

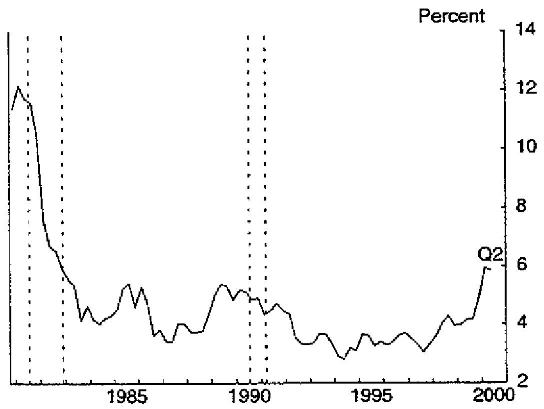
Insurance Costs



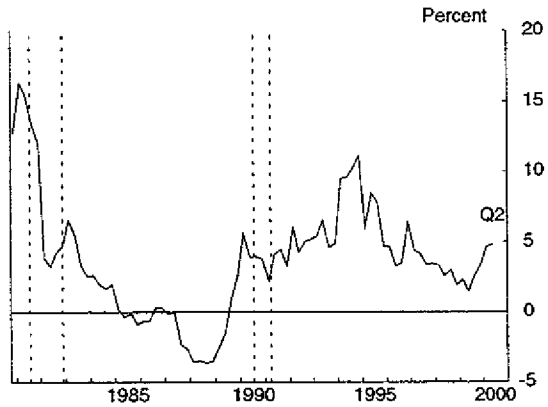
Supplemental Pay



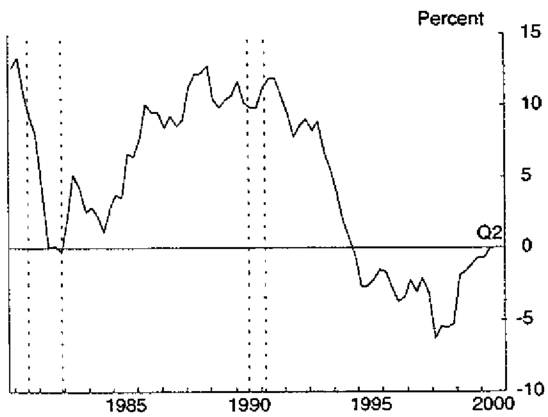
Paid Leave



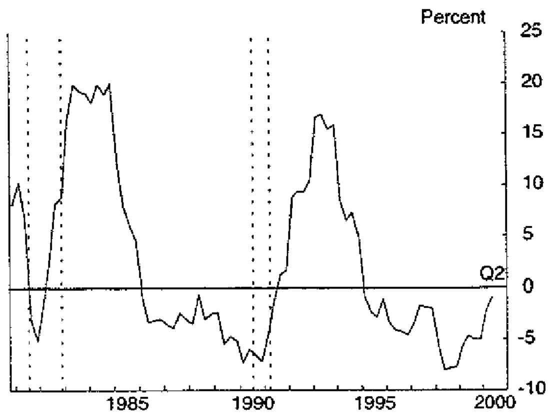
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



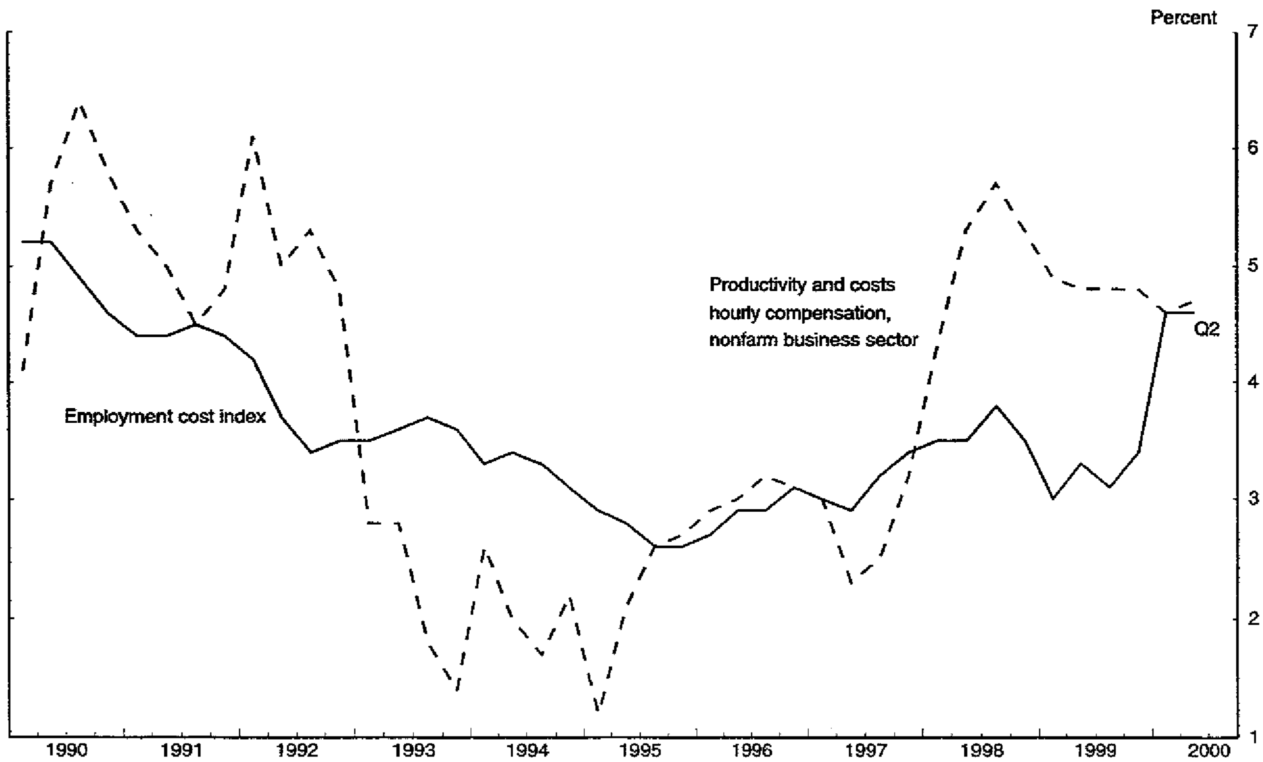
Note. Unpublished and confidential ECI benefits detail.

LABOR COSTS
(Percent change; annual rate; based on seasonally adjusted data)

	1998[1]	1999[1]	1999 Q3	1999 Q4	2000 Q1	2000 Q2	1999:Q2 to 2000:Q2
Compensation per hour							
Total business	5.3	4.8	5.3	3.8	3.5	6.3	4.7
Nonfarm business	5.3	4.8	5.5	4.2	3.9	5.3	4.7
Nonfinancial corporations[2]	4.9	5.0	5.4	4.1	2.7	n.a.	n.a.
Unit labor costs							
Total business	2.3	.7	.4	-3.6	1.9	.1	-.3
Nonfarm business	2.3	.7	.3	-3.5	1.9	-.1	-.4
Nonfinancial corporations[2]	1.1	.1	.3	-1.8	-.2	n.a.	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.

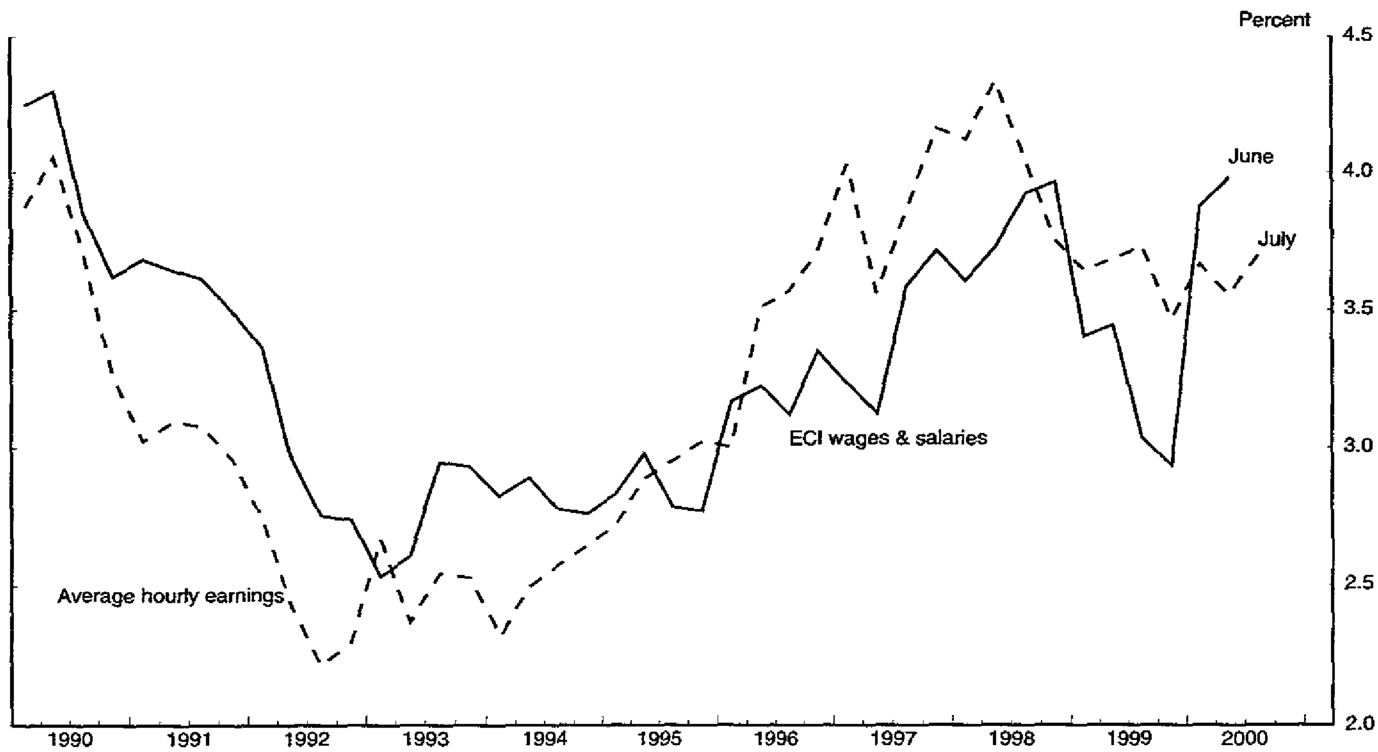
Measures of Compensation per Hour
(4-quarter change)



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

	12-month percent change			Percent change to Jul. 2000 from month indicated		2000	
	July 1998	July 1999	July 2000	Jan. 2000	Apr. 2000	June	July
	-Annual rate-					-Monthly rate-	
Total private nonfarm	4.2	3.8	3.7	4.0	3.6	.3	.4
Manufacturing	2.4	4.0	2.8	3.1	2.5	.6	.1
Construction	3.8	3.6	4.3	5.1	3.6	.1	1.0
Transportation and public utilities	2.3	2.7	2.9	3.3	1.5	.4	-.6
Finance, insurance, and real estate	5.5	4.3	2.8	3.1	3.0	.3	.2
Retail trade	5.2	3.9	3.8	4.1	2.6	.3	.3
Wholesale trade	5.0	3.5	4.3	4.6	5.7	.9	.5
Services	5.1	4.0	3.7	4.2	4.4	.3	.4

Measures of Hourly Wages for Production or Nonsupervisory Workers
(12-month change)



nonsupervisory occupations. However, rates of increase in these series can deviate noticeably, and significant differences have occurred in the past couple of years.

Agricultural Developments

Although drought has afflicted some farming areas this season, total harvests are once again likely to be sizable. Indeed, the first estimates of this year's harvest based on field surveys by the USDA suggest that corn production may be about 3 percent higher and soybean production about 9 percent higher than previous peaks. As a result, stocks of these commodities are expected to rise further.

Given these projected harvests, grain prices have fallen almost to last summer's depressed levels; the cumulative decline over the past couple of months has reduced the price of corn by roughly one-third and the price of soybeans by roughly one-fifth. Moreover, because of a glut of cattle that have been fattened for slaughter, prices for these animals fell sharply over the first part of August. Finally, prices for chickens are near the low end of the range seen over the past decade, and supplies are ample. Politicians have reacted to the low crop prices by providing additional income subsidies of more than $5 billion, while drought-stricken farmers in some areas in the western Great Plains and along parts of the Gulf Coast have also been given access to emergency funds for drought relief.

Appendix

The Annual Revision to the National Income and Product Accounts

On July 29, the BEA published its regular annual revision to the national income and product accounts. The revision, which extended back to 1997, incorporated more comprehensive source data, including the 1997 Economic Census, the 1997 Census of Governments, annual business surveys from the Census, new information from the OMB and the USDA, unemployment insurance records, updated international transactions accounts, and tabulations of tax returns. In addition, the BEA began using new source data for employer-provided health insurance.

Revisions to GDP and its Components
From the fourth quarter of 1996 to the first quarter of this year, the average annual rate of growth in real GDP was revised up 0.1 percentage point. On a fourth-quarter to fourth-quarter basis, growth was revised up 0.2 percentage point in 1997, down 0.1 percentage point in 1998, and up 0.4 percentage point in 1999. With regard to the quarterly pattern, the most notable revisions were a 1 percentage point boost to growth in the fourth quarter of 1999--to 8.3 percent at an annual rate--and a 3/4 percentage point downward revision to the first quarter of 2000--to a 4.8 percent annual rate.

Real growth in business fixed investment is now 1.4 percentage points per year higher, on average, than before, with most of the revision reflecting stronger software spending. The new data on software incorporated by the BEA--the 1997 Economic Census, the 1998 Service Annual Survey, and BLS wage and hours-worked data for computer programmers and systems analysts--all pointed to larger increases in nominal software expenditures than in the earlier estimates. The growth rate of residential investment spending was revised down an average of 0.9 percentage point per year over the revision period, reflecting updated construction data. Revisions to the other components of GDP were small.

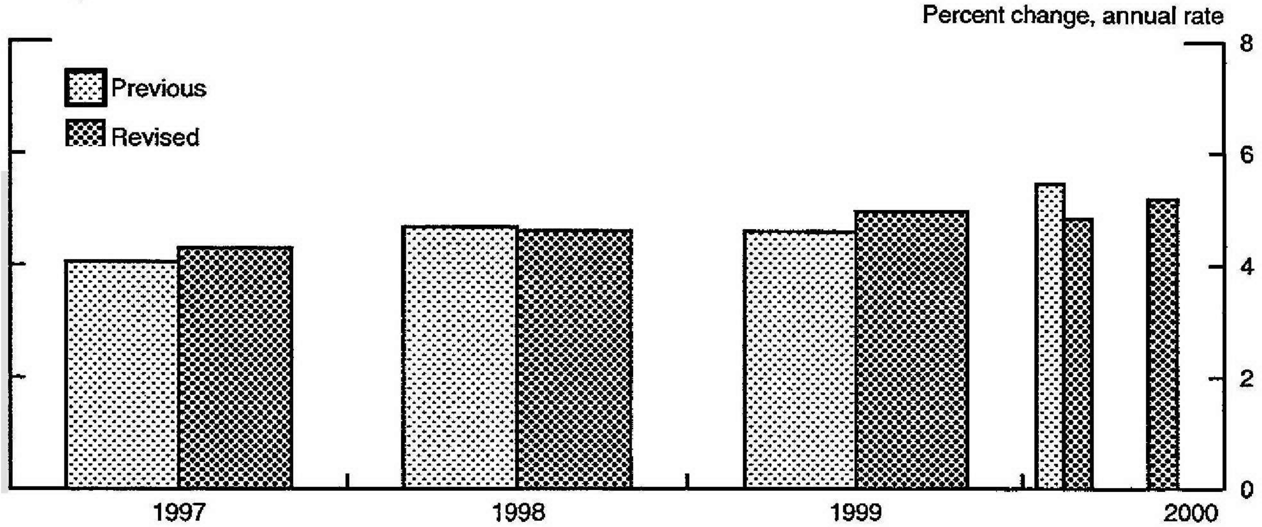
Income-Side Developments
On the whole, real gross domestic income was little modified over the revision period. Sizable downward revisions to corporate profits and compensation were about offset by large upward revisions to net interest income and the consumption of fixed capital. With GDP revised up and GDI little changed, the large gap between them (the statistical discrepancy) was reduced somewhat in this revision.

The ratio of profits to gross national product was revised down throughout the revision period. Much of the downward revision to profits was in the financial sector, where tax records showed lower profits at investment companies. Among nonfinancial firms, profits were revised down most in the transportation and public utilities industry. The personal saving rate was unchanged on balance over the revision period.

Compensation and Prices
Growth in nonfarm business compensation per hour revised down, on net, over the revision period. Four-quarter changes in compensation per hour were revised down about 1 percentage point in 1997, left essentially unrevised in 1998, and revised up about 1/2 percentage point in 1999. The large downward revision in 1997 mainly reflected the incorporation of source data from a new survey--the Medical Expenditure

Annual Revision to National Income and Product Accounts

Change in Real GDP*

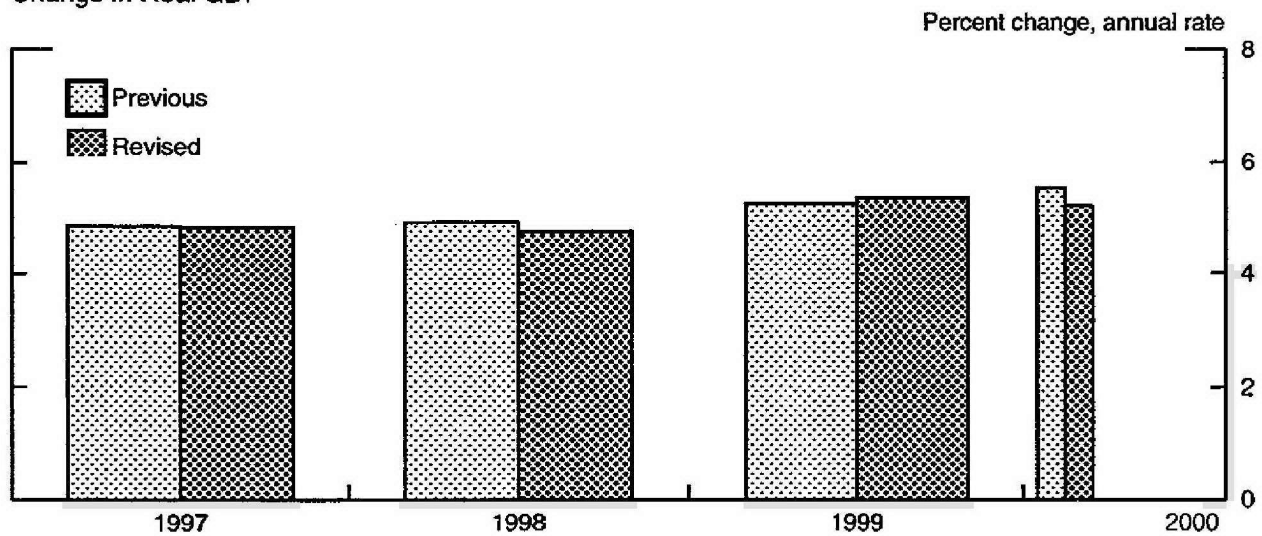


* Annual changes are Q4 to Q4.

Real GDP and Related Items
(Annualized percent change from 1996:Q4 to 2000:Q1)

	Previous Estimate	Revised Estimate
1. Gross domestic product	4.5	4.6
2. Final sales	4.5	4.6
4. PCE	5.1	5.1
5. Business fixed investment	10.9	12.3
6. Residential investment	6.2	5.3
7. Federal spending	.5	.5
8. State and local spending	4.1	4.1
Memo:		
9. Nonfarm business output (less housing)	5.3	5.4

Change in Real GDI*



* Annual changes are Q4 to Q4.

Panel Survey from the Department of Health and Human Services--to estimate employer-provided health insurance.[1] The data from the survey point to a lower *level* of the "other labor income" component of compensation, which the BEA folded directly into its estimates of the level of total compensation beginning in 1997. However, because the data for 1996 were unrevised, the growth rate of compensation per hour in 1997 was held artificially low; a rough calculation by the staff suggests that if the new data had been incorporated in 1996 as well, the growth rate in 1997 would have been revised down only 1/3 percentage point.

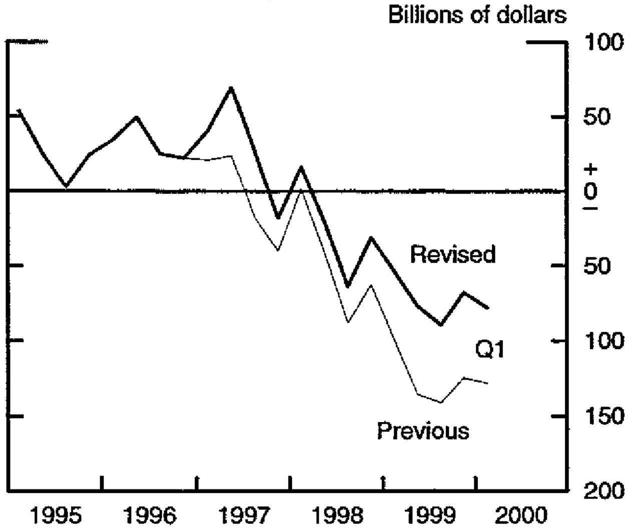
Four-quarter changes in core PCE prices were little revised in 1997, revised up about 0.3 percentage point in 1998, and essentially unrevised, on balance, in 1999.[2] For 1998, the upward revisions were concentrated in the prices of an assortment of service items, including brokerage services, imputed charges for bank services, and the religion and welfare category.

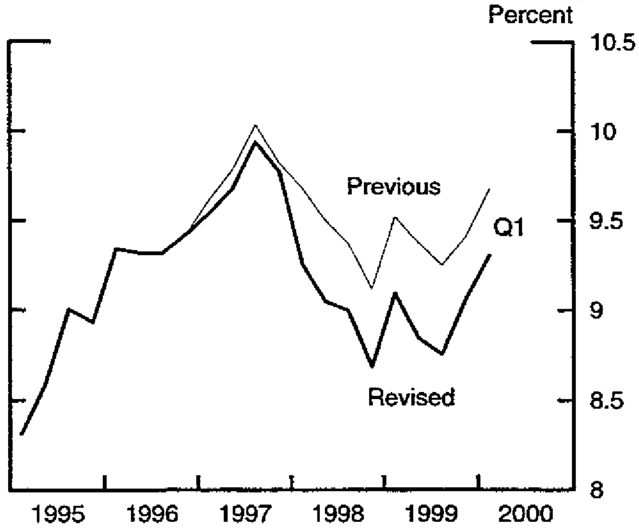
BLS's Annual Revisions to Productivity
On August 8, the BLS released updated estimates of productivity, which incorporate the new GDP data as well as the annual revision to the payroll employment survey released in June. The new figures show that output per hour in the nonfarm business sector rose at an annual rate of 2.9 percent between the fourth quarter of 1996 and the first quarter of this year, the same pace as was estimated prior to the revision. However, the pattern within that period was altered: Productivity growth was revised up a bit in 1997, down in 1998 and early 1999, and up again over the past several quarters.

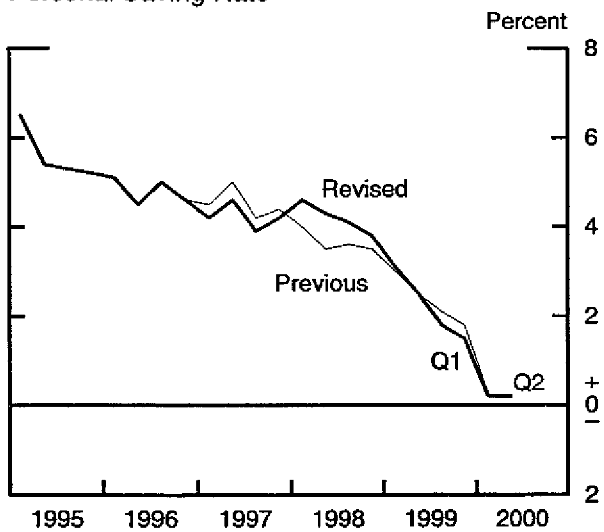
1. This survey was first taken in 1996.

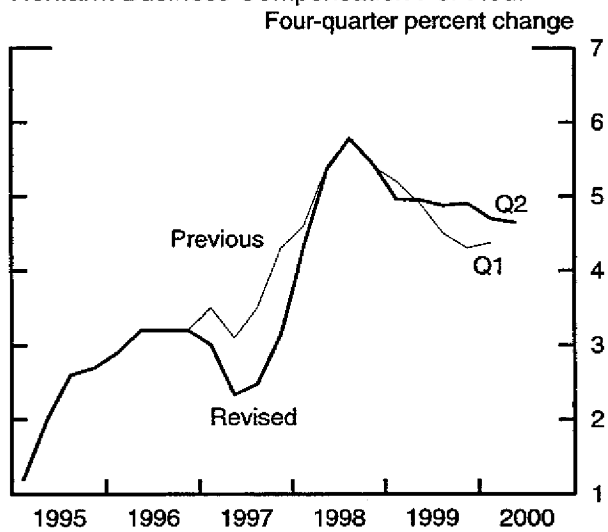
2. Quarterly changes (at annual rates) in core PCE prices were revised up between 0.2 and 0.4 percentage point from 1997:Q4 through 1999:Q1. In 1999:Q4, the quarterly rate of change was revised down about 0.3 percentage point.

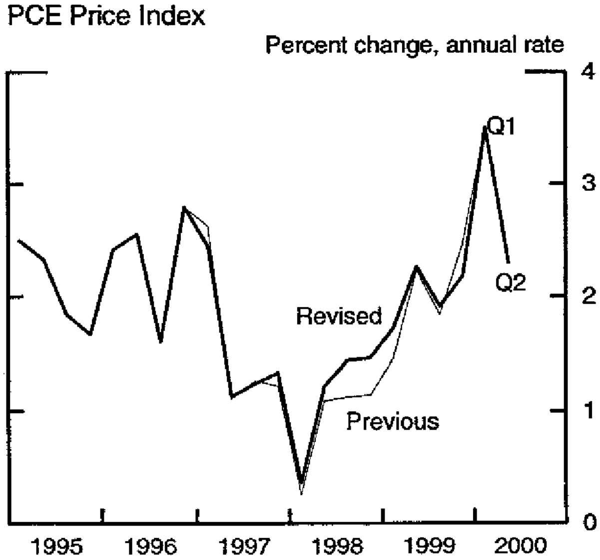
Annual Revision to National Income and Product Accounts
(Continued)

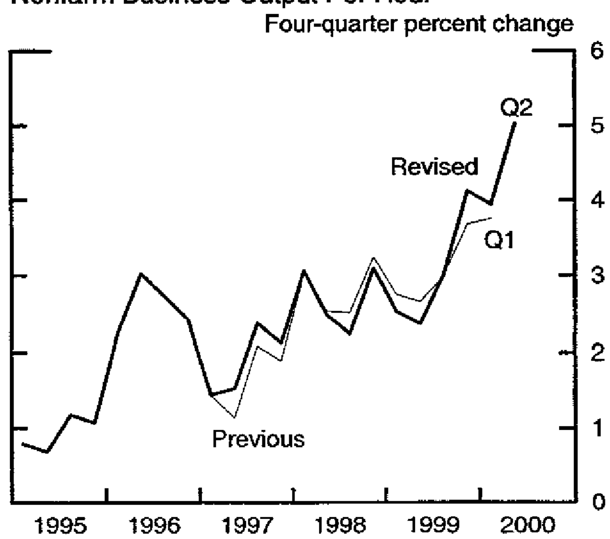
Statistical Discrepancy


Profits as a Share of GNP (Excluding FR Banks)


Personal Saving Rate


Nonfarm Business Compensation Per Hour


PCE Price Index


Nonfarm Business Output Per Hour


Domestic Financial Developments

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	1999 FOMC* June 30	2000 FOMC** May 16	2000 FOMC*** June 28	2000 Aug. 15	Change to Aug. 15 from selected dates (percentage points) FOMC* June 30	FOMC** May 16	FOMC*** June 28
Short-term							
FOMC intended federal funds rate	4.75	6.00	6.50	6.50	1.75	.50	.00
Treasury bills [1]							
3-month	4.70	5.94	5.67	6.10	1.40	.16	.43
6-month	4.92	6.24	5.96	6.09	1.17	-.15	.13
1-year	4.89	6.05	5.82	5.90	1.01	-.15	.08
Commercial paper							
1-month	5.18	6.47	6.56	6.49	1.31	.02	-.07
3-month	5.12	6.59	6.58	6.48	1.36	-.11	-.10
Large negotiable CDs [1]							
1-month	5.21	6.55	6.66	6.55	1.34	.00	-.11
3-month	5.32	6.74	6.74	6.61	1.29	-.13	-.13
6-month	5.43	6.97	6.89	6.75	1.32	-.22	-.14
Eurodollar deposits [2]							
1-month	5.13	6.53	6.66	6.53	1.40	.00	-.13
3-month	5.25	6.72	6.72	6.59	1.34	-.13	-.13
Bank prime rate	7.75	9.00	9.50	9.50	1.75	.50	.00
Intermediate- and long-term							
U.S. Treasury (constant maturity)							
2-year	5.68	6.88	6.50	6.28	.60	-.60	-.22
10-year	5.93	6.47	6.10	5.81	-.12	-.66	-.29
30-year	6.07	6.17	5.95	5.72	-.35	-.45	-.23
U.S. Treasury 10-year indexed note	4.01	4.21	4.08	4.01	.00	-.20	-.07
Municipal revenue (Bond Buyer) [3]	5.62	6.23	5.99	5.82	.20	-.41	-.17
Private instruments							
10-year swap	6.81	7.82	7.33	7.06	.25	-.76	-.27
10-year FNMA	6.59	7.70	7.15	6.89	.30	-.81	-.26
Merrill Lynch BBB	7.60	8.86	8.49	8.23	.63	-.63	-.26
High yield[4]	10.53	11.94	11.98	11.82	1.29	-.12	-.16
Home mortgages (FHLMC survey rate) [5]							
30-year fixed	7.63	8.52	8.14	8.04	.41	-.48	-.10
1-year adjustable	5.93	6.96	7.22	7.28	1.35	.32	.06

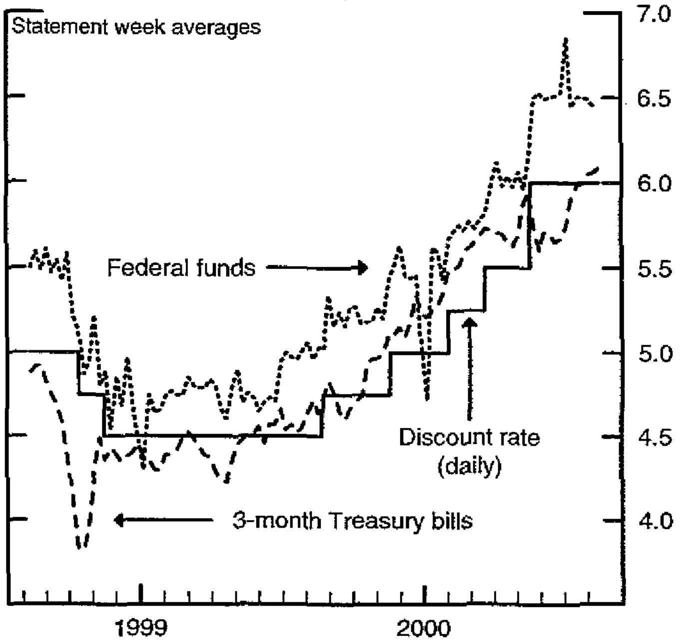
Stock exchange index	Record high Level	Record high Date	2000 FOMC** May 16	2000 FOMC*** June 28	2000 Aug. 15	Change to Aug. 15 from selected dates (percent) Record high	FOMC** May 16	FOMC*** June 28
Dow-Jones Industrial	11,723	1-14-00	10,808	10,504	11,067	-5.60	1.23	5.36
S&P 500 Composite	1,527	3-24-00	1,452	1,451	1,484	-2.82	1.27	2.34
Nasdaq (OTC)	5,049	3-10-00	3,608	3,859	3,852	-23.71	3.72	-.19
Russell 2000	606	3-9-00	498	508	510	-15.87	.79	.36
Wilshire 5000	14,752	3-24-00	13,438	13,537	13,810	-6.39	1.55	2.02

1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Most recent Thursday quote.
4. Merrill Lynch 175 high-yield bond index composite.
5. For week ending Friday previous to date shown.

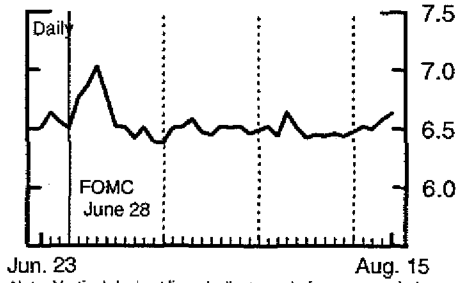
* Data are as of the close on June 29, 1999.
** Data are as of the close on May 15, 2000.
*** Data are as of the close on June 27, 2000.

Selected Interest Rates

Selected Short-Term Interest Rates

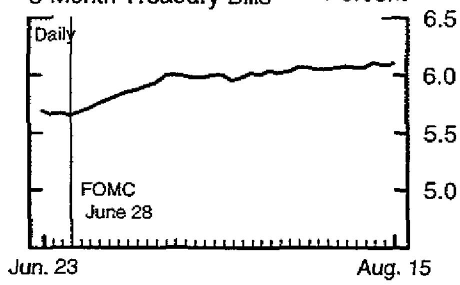


Federal Funds

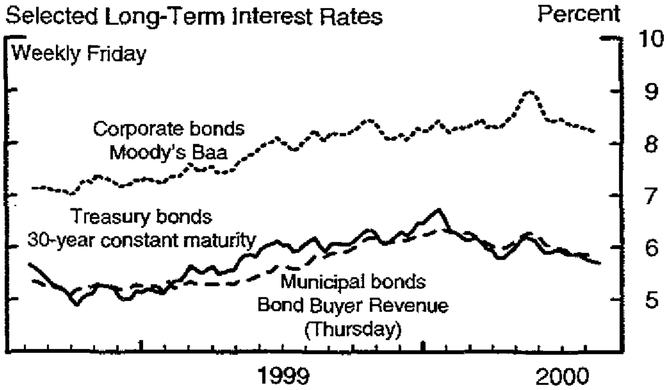


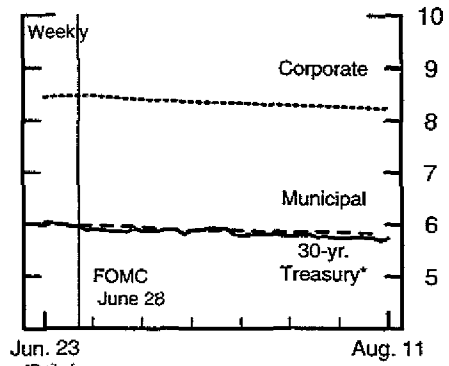
Note. Vertical dashed lines indicate end of reserve period.

3-Month Treasury Bills



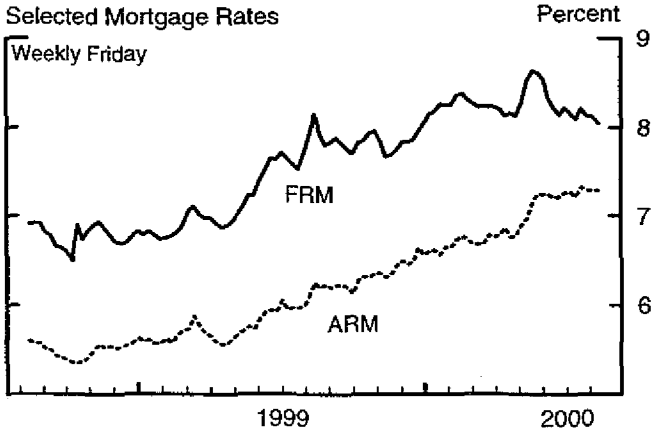
Selected Long-Term Interest Rates

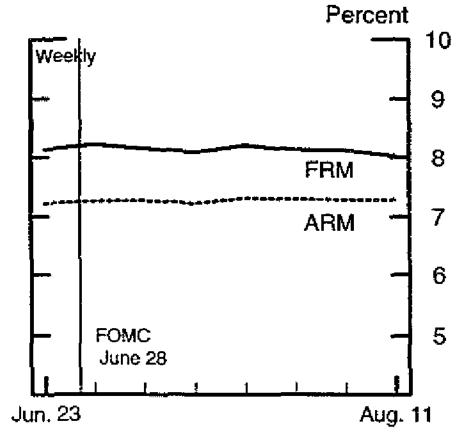




*Daily frequency.

Selected Mortgage Rates





Domestic Financial Developments

Overview

Most nominal interest rates have declined moderately since the June FOMC meeting, with incoming news on the economy seen as indicating that growth is slowing to a more sustainable pace and that inflation remains contained. As a consequence, the term structure of interest rates does not appear to incorporate any further tightening in the stance of monetary policy. Stock prices have risen a little on net over the intermeeting period, as the boost from lower interest rates has been tempered by corporate announcements pointing to a less buoyant outlook for profits.

Business borrowing has remained robust, and the pace of equity offerings has picked up of late to meet large and growing external financing needs. Households, too, have continued to borrow at a strong pace, with both consumer and mortgage debt expanding briskly. By contrast, the burgeoning federal surplus has allowed the Treasury to pay down debt at a rapid clip, and net borrowing by state and local governments has remained subdued. With borrowing strong at banks, bank credit and M3 have continued to advance rapidly. However, previous increases in market interest rates have damped the recent growth of M2 relative to its pace earlier this year.

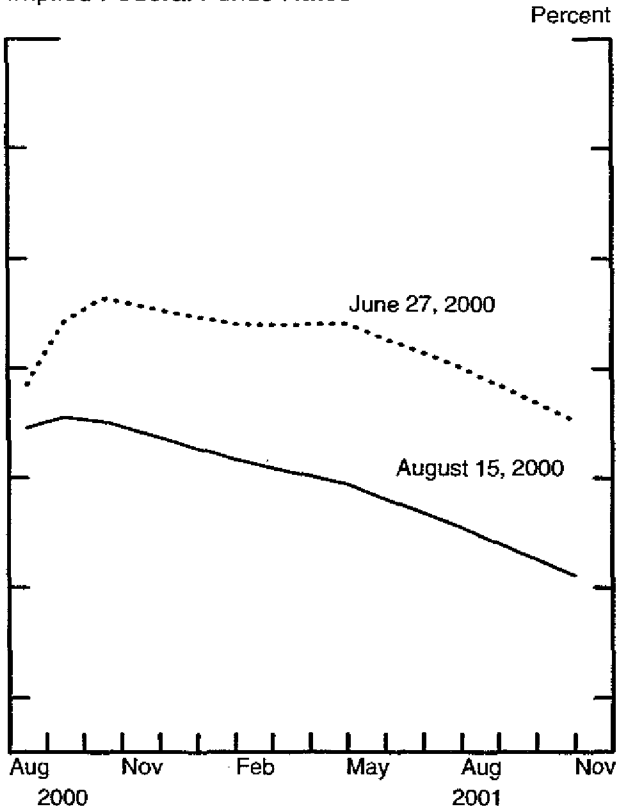
Interest Rates and Stock Prices

Market participants had largely anticipated the FOMC's decisions at its June meeting to leave the intended federal funds rate unchanged and to reiterate that risks remained weighted toward heightened inflation pressures. Nonetheless, interest rates fell a bit following the announcement, as some market participants reportedly read the accompanying statement as suggesting a reduced likelihood of additional tightening. The expected path of the federal funds rate has shifted down further over the intermeeting period; incoming data and the Chairman's semiannual monetary policy testimony on July 20 apparently reinforced the notion that the economic expansion was slowing to a more sustainable pace. Federal funds and eurodollar futures rates have declined about 10 to 30 basis points since the June meeting, and the September federal funds futures rate suggests that market participants see virtually no chance of a policy tightening at next week's meeting. Moreover, futures quotes further out the curve indicate that investors believe no further tightening is in train.

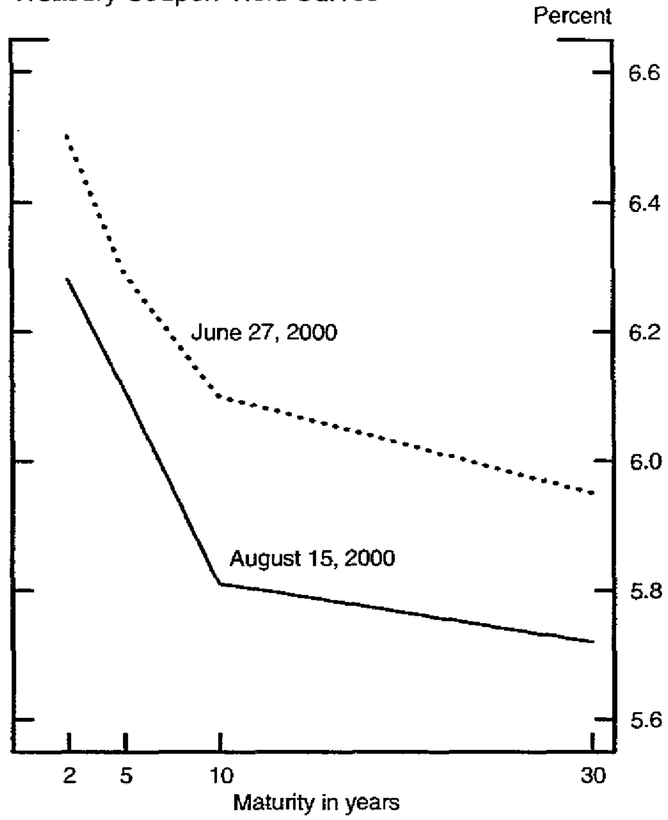
Reflecting this revision to the outlook for policy, yields on nominal Treasury coupon securities and longer-term private obligations have declined as much as

Financial Developments

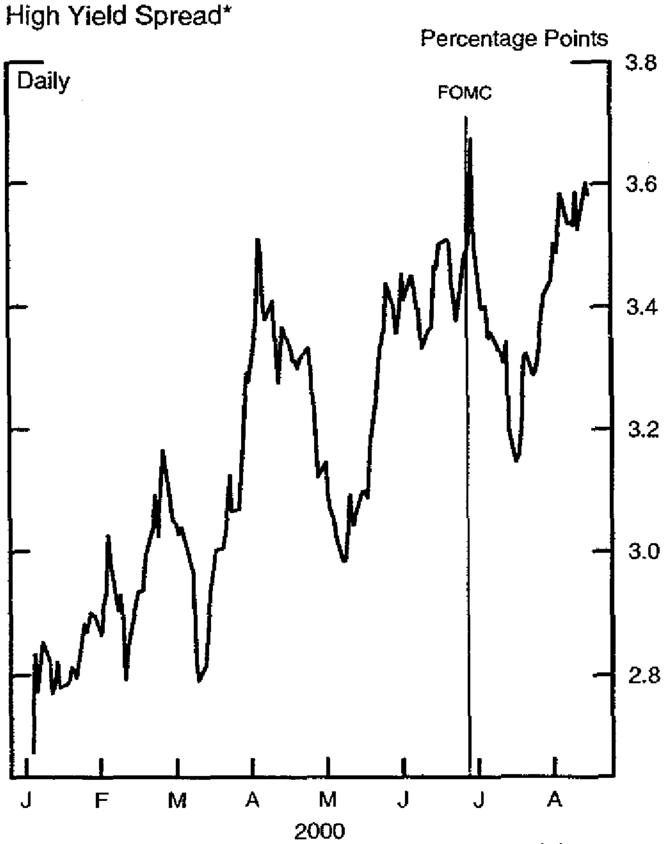
Implied Federal Funds Rates



Treasury Coupon Yield Curves

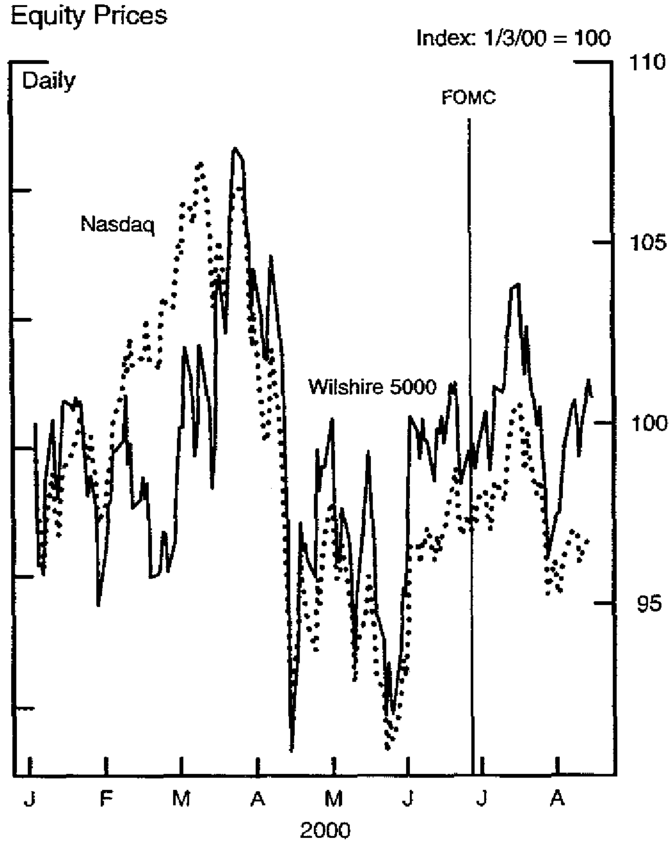


High Yield Spread*



*The spread between the Merrill Lynch 175 yield and the Merrill Lynch BBB yield.

Equity Prices



30 basis points over the intermeeting period.[1] Yields on ten-year swaps, agency benchmark securities, and investment-grade corporate bonds fell about as much as those on comparable Treasury securities, on net, over the intermeeting period. However, junk bond yields fell less, on balance, reflecting continued concerns about potential problems of riskier firms in a slowing economy.

Stock prices surged over the first half of the intermeeting period as expectations of additional policy restraint unwound. However, those gains were largely reversed when a number of prominent firms, primarily in the telecommunications portion of the technology sector, warned that their earnings over the second half of the year were not likely to meet analysts' expectations. The Nasdaq ended the intermeeting period about where it began, with prices of telecommunications stocks down substantially. Broader indexes are up about 2 percent on balance over the intermeeting period.

Business Finance

With nearly all firms having reported, profit growth for the S&P 500 in the second quarter appears to have been strong, although below the pace of the previous two quarters. Earnings per share in the second quarter rose about 15 percent from a year earlier, down from the 20 percent gains reported for the two previous quarters. While profits of nonfinancial businesses, especially those in the technology sector, continued to grow at a brisk pace, those in the financial sector slowed significantly, largely owing to sluggish bank profits.[2]

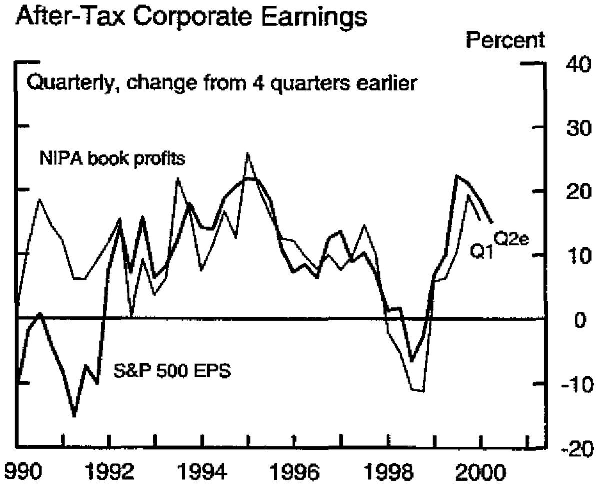
The latest information on credit quality revealed little deterioration for most firms but reinforced existing concerns about lower-rated nonfinancial firms. While junk bond defaults eased in June and July from the record level in May, the annual default rate measured on a year-to-date basis through July remained higher than any other annual level since 1991. Default rates are expected to continue to rise over the next year because of the seasoning of the slug of junk bonds issued before the market turmoil in late 1998 and because of the higher asset volatility of a number of issuers. The ratio of liabilities of failed businesses to total business liabilities remained high through July. However, ratings changes suggest a small improvement in overall credit quality, as Moody's upgraded $50 billion of corporate debt on net in June and July. The

1. In contrast to most other yields, Treasury bill rates have trended higher since the June FOMC meeting. However, these increases appear to reflect primarily a reversal of the unexpected and difficult-to-explain declines posted in relatively illiquid markets over the previous intermeeting period.

2. Net income of the forty-four large bank holding companies that reported earnings in July fell 30 percent relative to a year earlier. The drop reflected a combined $3.5 billion net loss at First Union and Bank One, with a one-time restructuring charge by First Union accounting for most of this loss. Net income at the remaining forty-two bank holding companies rose 5-1/2 percent over the second quarter of 1999, still a significant slowdown in profitability that largely reflected an increase in noninterest expense.

Corporate Finance

After-Tax Corporate Earnings

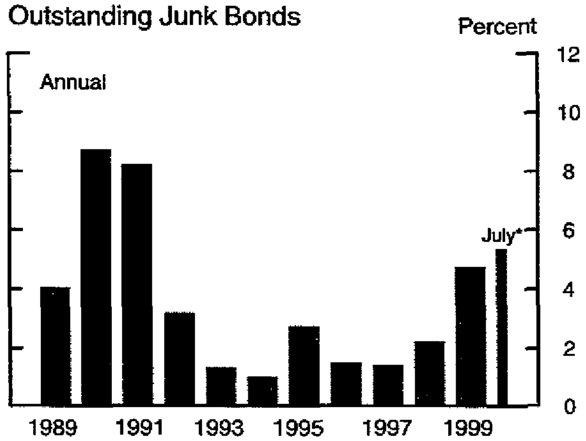


e. Staff estimate.

Details of Q2 S&P 500 Earnings

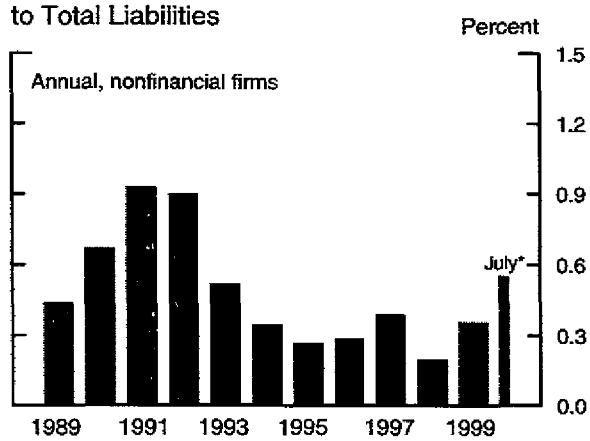
- Continued rapid growth in nonfinancial sector profits, particularly technology
- Slowdown in growth of financial sector profits, particularly banks
- Warnings for Q3 earnings in telecom and internet sectors

Default Rates Outstanding Junk Bonds



* Year-to-date (July 2000) at an annual rate.

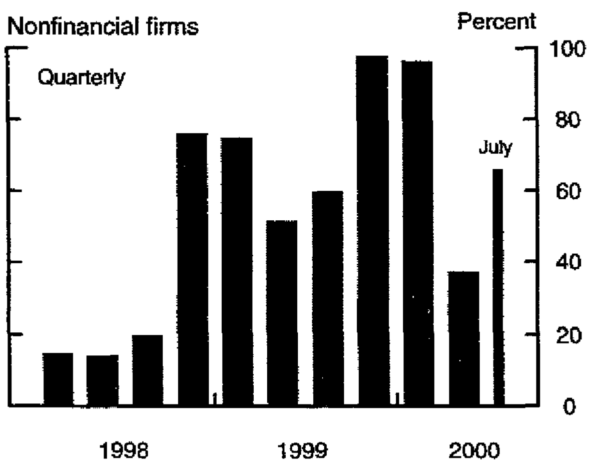
Liabilities of Failed Businesses to Total Liabilities



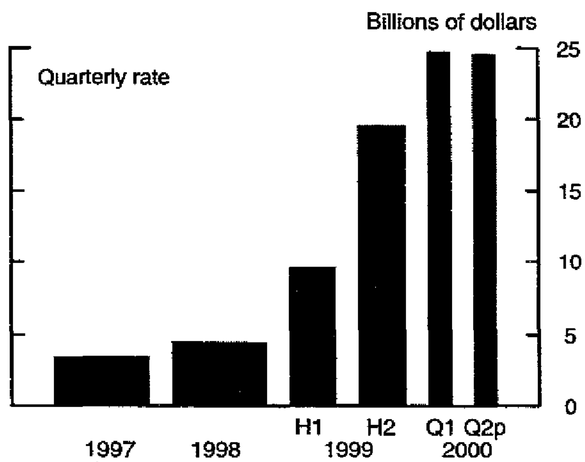
* Year-to-date (July 2000) at an annual rate.
Source. Dun & Bradstreet.

Average First-Day Returns on IPOs

Nonfinancial firms



Venture Capital Investments



p. Preliminary.
Source. Venture Economics.

amount of debt on the watchlist is evenly split between upgrades and downgrades.

Conditions in the corporate bond market have continued to improve over the intermeeting period. Investors welcomed large issues by investment-grade firms, including enormous offerings under the benchmark debt programs of Ford and Fannie Mae. In addition, buyers reportedly have been more willing to buy debt with longer-dated maturities; several large issuers sold thirty-year bonds, a segment of the market that had been nearly dormant since April. Issuance by investment-grade firms eased in July from the rapid pace set in June, but issuance to date in August suggests a return to more robust activity. Proceeds from a number of recent bond issues have been used to fund merger and acquisition activity. The recovery in the junk sector of the bond market has also been notable, with a rebound in issuance in June and July. Looking ahead, junk bond offerings are expected to be buoyed in coming quarters by strong needs to fund high-technology infrastructure.

Firms also raised substantial sums in the commercial paper market in both June and July, largely to provide short-term financing to complete mergers. In contrast, firms' reliance on business loans from banks slowed noticeably over that period, perhaps because they found the capital markets more receptive. Meanwhile, a significant fraction of banks in the latest Senior Loan Officer Opinion Survey reported continued tightening of both standards and terms on business loans over the past three months, and most said that tightening was due to a less favorable or more uncertain economic outlook. On balance, overall borrowing by businesses was relatively large again in July, about matching the second-quarter rate.

Gross equity issuance picked up in June and July as stock price volatility retreated. Offerings of seasoned issues rose somewhat, while IPOs increased considerably. Indeed, while offer prices on most IPOs in the second quarter had to be reduced to be sold, two-thirds of firms in July were able to price their offerings above their filing ranges. The average first-day return on new issues also shot up. Optical telecommunications equipment has been the hottest IPO sector; biotechnology and Internet software companies have also generally been well received by investors. The upcoming calendar for IPOs remains packed, as firms have been waiting to take advantage of an improvement in market tone. In addition, despite heightened market volatility early in the second quarter, venture capitalists appear to have continued to finance startups at a near-record pace, with most of the funds going to Internet-related firms. Venture capital investments surpassed funds raised by initial public offerings in the first half of the year.

Merger activity has remained strong, especially in the telecommunications sector. Merger-related equity retirements were substantial in the second quarter

Gross Issuance of Securities by U.S. Corporations

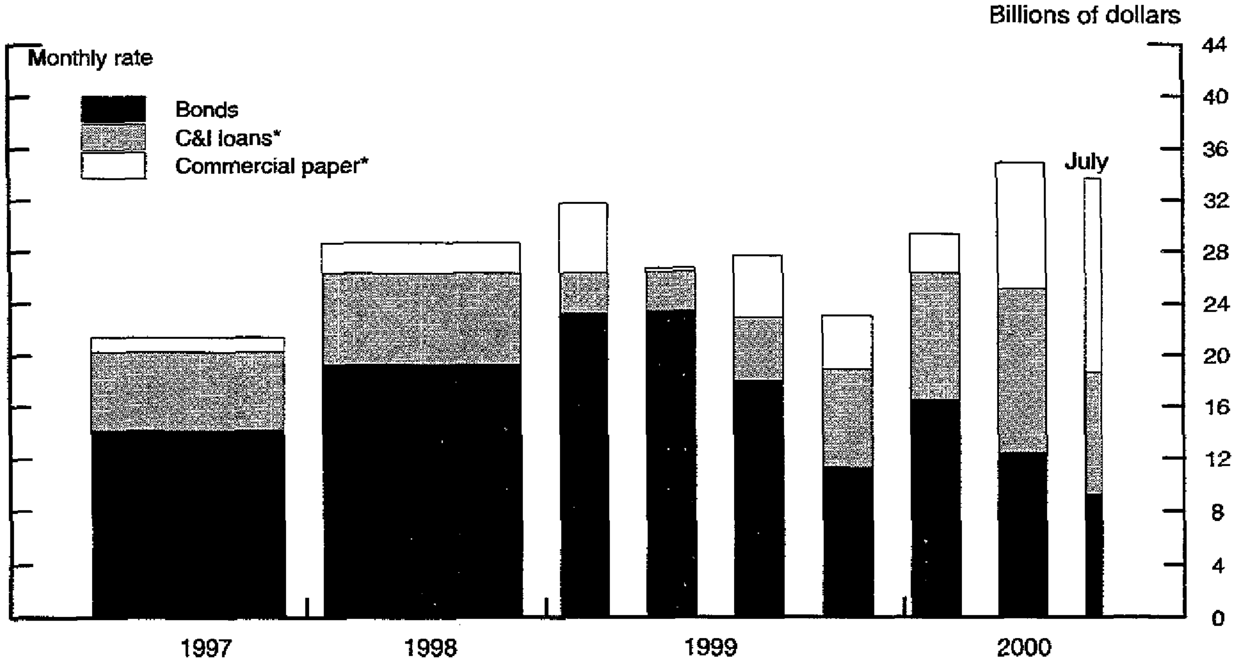
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1998	1999	2000 Q1	2000 Q2	2000 May	2000 June	2000 July
All U.S. corporations	94.0	89.4	84.8	75.9	62.9	102.9	64.4
Stocks [1]	10.6	11.0	16.9	11.2	4.7	7.8	9.5
Bonds	83.5	78.4	67.9	64.7	58.2	95.1	54.9
Nonfinancial corporations							
Stocks [1]	6.2	9.2	15.6	9.2	4.5	6.5	9.3
Initial public offerings	2.2	4.2	4.8	6.6	2.1	4.3	6.1
Seasoned offerings	4.0	5.0	10.8	2.6	2.4	2.2	3.2
Bonds [2]	25.7	24.5	23.1	19.4	20.8	29.3	15.7
Investment grade [3]	14.1	13.9	11.6	11.4	13.5	15.0	7.8
Speculative grade [3]	10.2	7.5	7.5	3.2	1.9	6.2	3.8
Other (Sold abroad/unrated)	1.3	3.1	4.0	4.8	5.4	8.1	4.1
Financial corporations							
Stocks [1]	4.4	1.8	1.3	1.9	.2	1.4	.3
Bonds	57.8	53.9	44.8	45.3	37.4	65.7	39.2
Memo							
Net issuance of commercial paper, nonfinancial corporations [4]	2.3	3.6	3.0	9.7	-1.8	15.8	15.0
Change in C&I loans at commercial banks [4]	7.0	4.6	10.0	12.8	19.3	3.9	9.4

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. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard Poor's if unrated by Moody's.
4. End-of-period basis, seasonally adjusted.

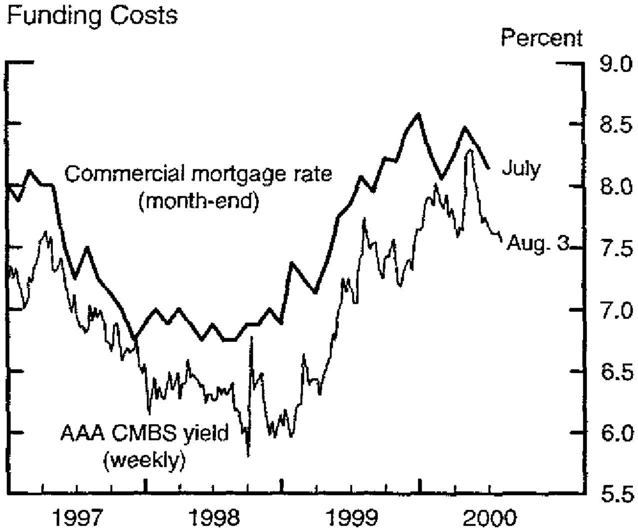
Components of Net Debt Financing



* Seasonally adjusted.

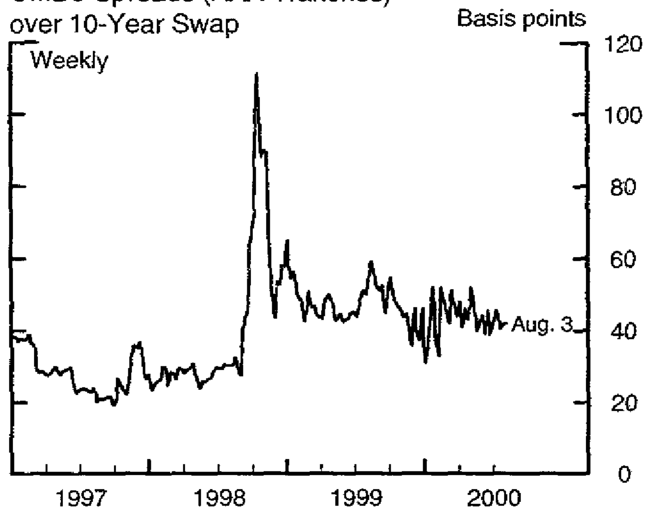
Commercial Real Estate

Funding Costs



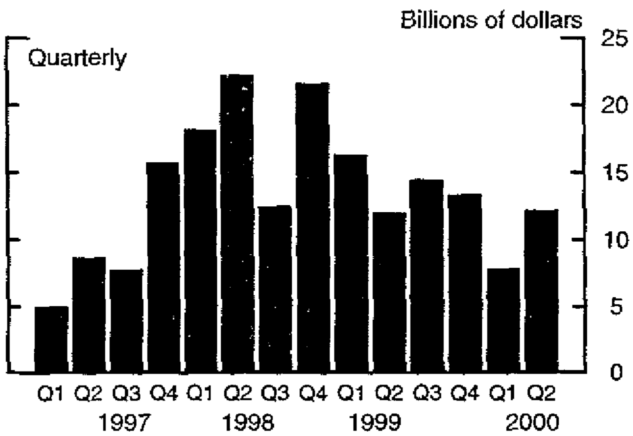
Source. Barron's/Levy National Mortgage Survey; Morgan Stanley

CMBS Spreads (AAA Tranches) over 10-Year Swap



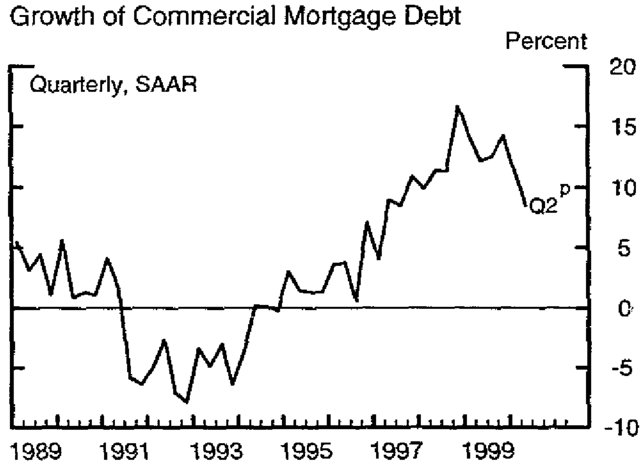
Source. Morgan Stanley.

Total CMBS Gross Issuance



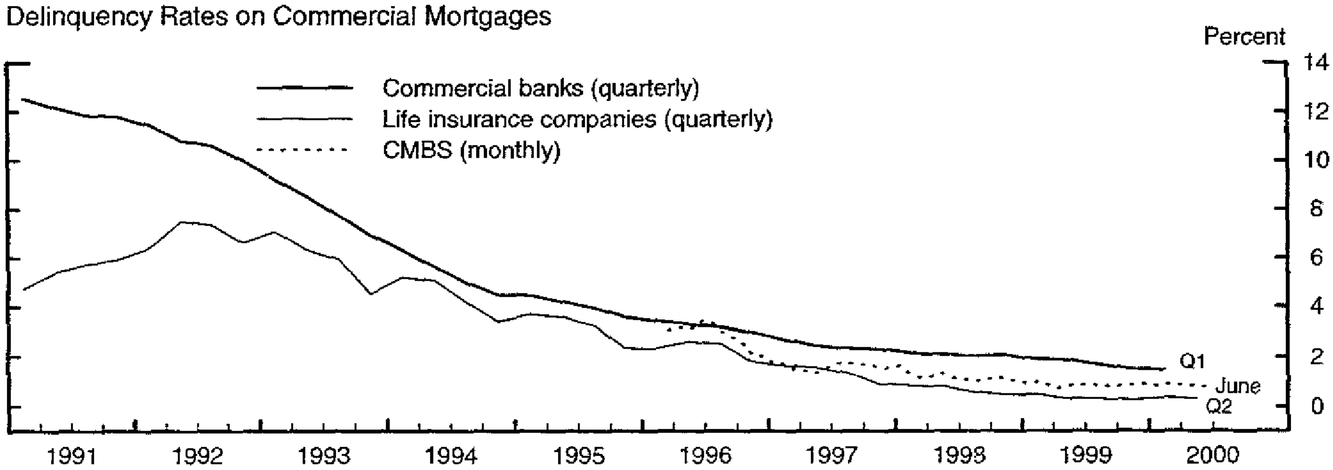
Note. 2000:Q2 figure is preliminary.
Source. Commercial Mortgage Alert.

Growth of Commercial Mortgage Debt



p. Staff projection.

Delinquency Rates on Commercial Mortgages



Source. ACLI, Morgan Stanley, Call Reports.

and will likely continue at a brisk pace in the months ahead. About half of the deals announced in the second quarter will be financed with cash, up from 10 percent to 20 percent on average over the past two years, a shift reflecting a decline in the share of deals involving high-technology companies and an increase in the share involving the "old economy" firms. In addition, the announced acquisitions of U.S. companies by foreign firms will lead to sizable merger-related retirements of U.S. equity. Equity retirements related to stock buyback programs should continue to be near the elevated pace observed over the past year as the record level of announced repurchases in the first quarter by "old economy" firms is completed.

Commercial Real Estate Finance

Interest rates on loans and securities used to finance commercial real estate have moved down with other long-term rates. Interest rates on commercial mortgage loans dropped about 30 basis points over June and July, while yields on AAA-rated commercial-mortgage-backed securities (CMBS) have fallen about 50 basis points over those months, leaving the spread relative to swap rates about unchanged.

CMBS issuance was heavy in June, pushing the second-quarter volume above $12 billion, compared with about $8 billion in the first quarter. Issuance in the third quarter is expected to be near the second-quarter pace. The rapid issuance reflects securitization of a large stockpile of loans that accumulated earlier in the year when market conditions deteriorated. Commercial mortgage debt from all sources apparently expanded at about an 8-1/2 percent annual rate in the second quarter, down from 10 percent in the first quarter. A slowdown in commercial bank lending in July suggests that a further deceleration may be in train for the third quarter.

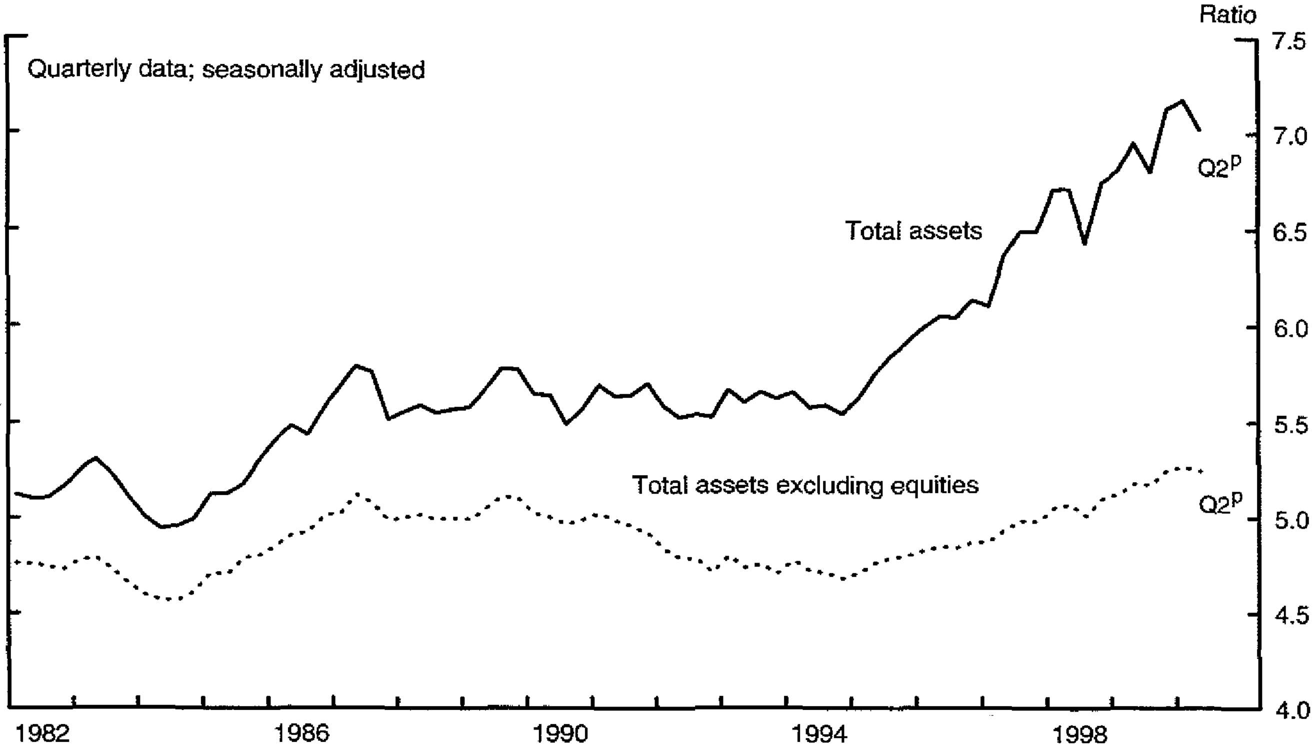
Delinquency rates for commercial mortgages in securitized pools remained near their historic lows through June. Data for insurance companies indicate that delinquencies on their loan portfolios held at very low levels in the second quarter. Nonetheless, senior loan officers reported in the August survey that they had firmed credit conditions further.

Household Finance

Judging from mutual fund flows, households continued to direct a substantial portion of saving into equity investments in recent months, despite the less ebullient stock market. Investors continued to favor capital appreciation funds (whose assets tend to be relatively concentrated in technology stocks) over less risky total return funds. Bond funds experienced small inflows in June and July, their first of the year.

Consumer loan rates have registered mixed changes since the June FOMC meeting. Rates on new auto loans at banks have risen about 10 basis points, and

Household Assets Relative to Disposable Income



p. Staff projection.

Net Flows into Long-Term Mutual Funds

(Excluding reinvested dividends; billions of dollars, monthly rates.)

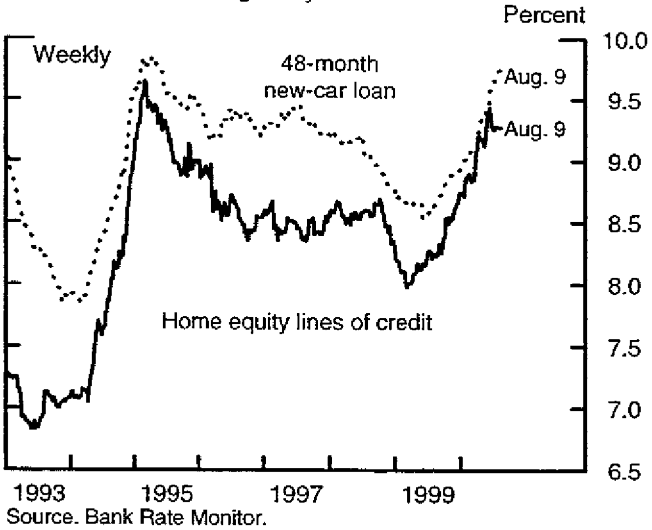
	1997	1998	1999	2000 Q1	2000 Q2	2000 June	2000 July[e]	Assets June
Total long-term funds	**22.7**	**20.2**	**14.2**	**29.2**	**18.6**	**20.6**	**15.2**	**5,463**
Equity funds	**19.0**	**13.2**	**15.7**	**44.5**	**24.4**	**22.4**	**15.8**	**4,321**
Domestic	15.8	12.6	14.8	32.3	21.1	20.7	14.1	3,697
Capital appreciation	7.9	7.1	13.5	46.5	22.2	23.3	18.5	2,410
Total return	7.9	5.5	1.4	-14.2	-1.1	-2.5	-4.3	1,288
International	3.1	0.6	0.9	12.1	3.3	1.6	1.7	624
Hybrid funds	**1.4**	**0.9**	**-1.0**	**-5.9**	**-2.0**	**-2.2**	**-1.7**	**351**
Bond funds	**2.4**	**6.2**	**-0.5**	**-9.4**	**-3.8**	**0.5**	**1.1**	**791**
International	-0.1	-0.1	-0.2	-0.2	-0.2	0.0	0.1	22
High-yield	1.4	1.1	-0.2	-1.7	-0.5	1.4	-0.5	106
Other taxable	1.0	3.9	1.0	-4.5	-1.2	0.2	0.3	399
Municipals	0.1	1.3	-1.0	-3.0	-1.9	-1.1	1.2	264

e. Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute (ICI).

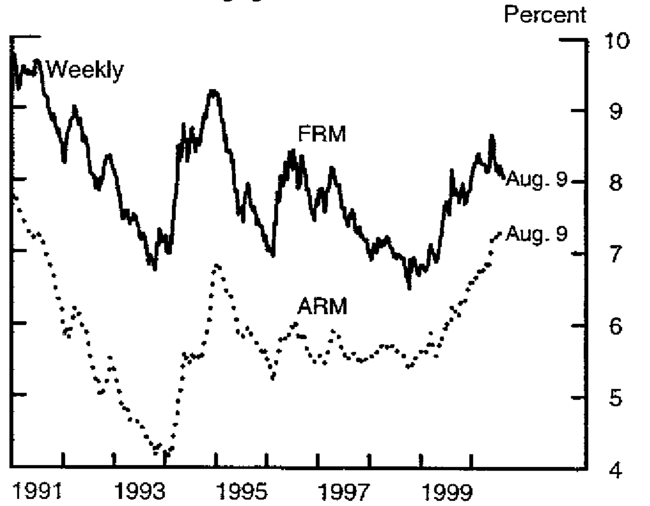
Household Liabilities

Interest Rates Charged by Banks

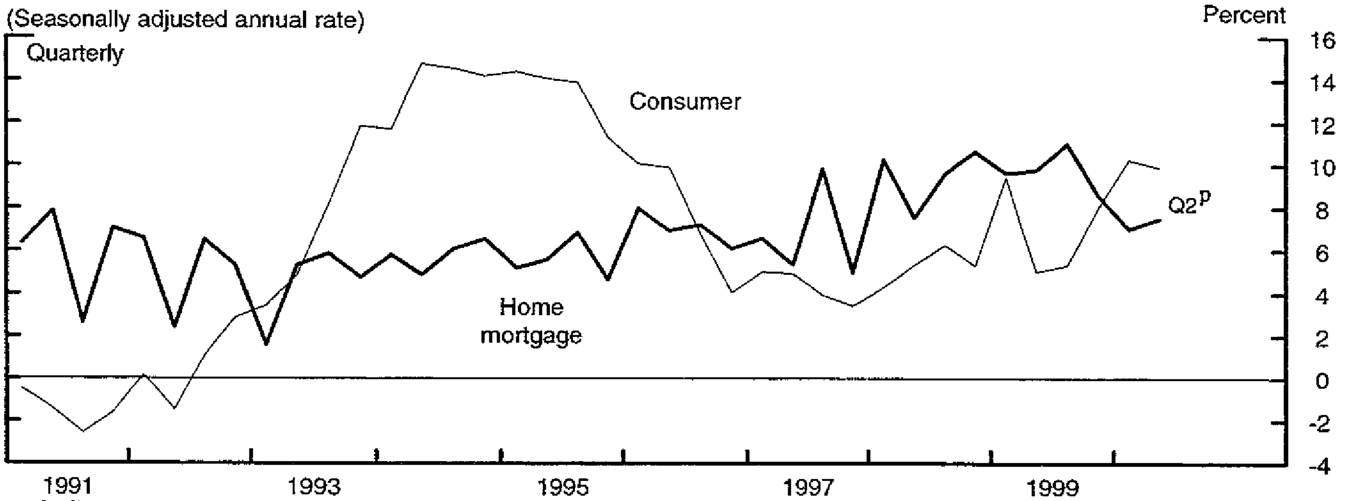


Source. Bank Rate Monitor.

Freddie Mac Mortgage Rates

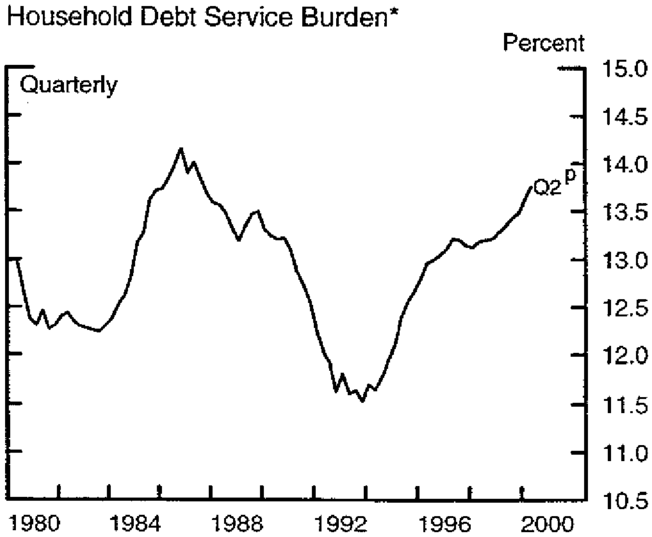


Household Debt Growth
(Seasonally adjusted annual rate)



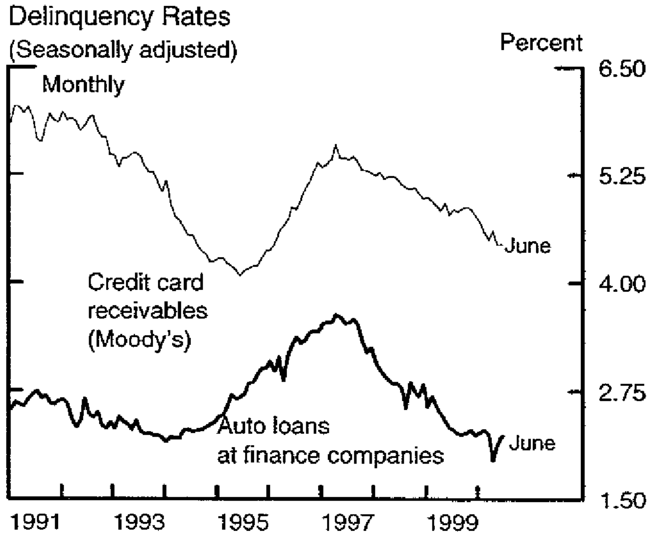
p. Staff projection.

Household Debt Service Burden*



p. Staff projection.
*Required debt payments relative to disposable personal income.

Delinquency Rates
(Seasonally adjusted)



rates on new car loans at the captive auto finance companies--though still substantially lower than bank rates--have also edged up in recent months. Rates on adjustable-rate mortgages have changed little, while those on fixed-rate mortgages have fallen with bond yields.

Growth of household debt in the second quarter appears to have been in line with its rapid pace of the past two quarters. Consumer credit continued to expand at a robust 10 percent annual rate in the second quarter, while mortgage debt growth is estimated to have edged up slightly from its first quarter pace of 7 percent.

The household debt-service burden has trended upward with interest rates and rapid debt growth, and is currently at its highest point since its mid-1980s peak. However, current measures of household credit quality have yet to show signs of deterioration. Delinquency rates on new-car loans at captive finance companies remained low in June. The Moody's index of delinquencies on credit card loans in securitized pools continued to be at a low level through June.[3] Meanwhile, in the latest Senior Loan Officer Survey, banks reported that standards and terms on all types of consumer and mortgage loans were essentially unchanged.

Treasury and Agency Finance

The Treasury's mid-quarter refunding announcement on August 2 included no changes to the planned auction schedule. The lack of change surprised some market participants, who had expected an announcement of a future termination of the thirty-year bond auctions, and that security's yield rose in response. The Treasury again noted that it was considering eliminating the one-year bill. To that end, it is working with the Congress to revise a number of statutory provisions that reference the one-year yield for the purpose of setting interest rates on various contracts, such as student loans.

The Treasury announced that it will continue its twice-monthly buyback operations. It confirmed that it will repurchase up to $30 billion this year, and said it would include callable securities in the program. In June and July, the Treasury bought back $7 billion of securities, bringing the total repurchased since the start of the buyback program in March to $17.5 billion. These operations have proceeded smoothly. In addition, the Treasury paid down about $40 billion of maturing obligations in June and July, and is on track to pay down around $225 billion this fiscal year.

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3. The decline of 17 basis points from April to May appears to be mostly caused by a change in reporting methods by a few large issuers. The time after which loans are charged off was changed in May from 180 days to 150 days on pools issued by Bank One, First USA, and First Chicago. As a result, delinquencies were pushed down and charge-offs were pushed up as more loans were affected by the new limit.

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	1999	2000				
	Q4	Q1	Q2	May	June	July
Total surplus, deficit (-)	**-20.6**	**-15.0**	**212.2**	**-3.6**	**56.3**	**n.a.**
Means of financing deficit						
Net borrowing	47.6	-27.1	-189.6	-53.8	-23.1	-32.3
Nonmarketable	1.0	-6.4	2.2	1.5	-1.4	-7.6
Marketable	46.6	-20.7	-191.7	-55.3	-21.7	-24.7
Bills	83.6	16.0	-123.7	-14.8	-6.7	-9.5
Coupons[1]	-37.0	-34.7	-57.1	-33.5	-13.1	-10.6
Debt buybacks	.0	-2.0	-11.0	-7.0	-2.0	-4.5
Decrease in cash balance	-26.9	38.6	-12.7	69.5	-34.4	27.2
Other[2]	-.2	3.5	-9.9	-12.1	1.2	n.a.
MEMO						
Cash balance, end of period	83.3	44.8	57.4	23.1	57.4	30.2

NOTE. Components may not sum to totals because of rounding.
1. Does not include Treasury debt buybacks.
2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
e. Estimated.
n.a. Not available.

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

Agency	1999	2000				
	Q4	Q1	Q2	May	June	July
FHLBs	47.4	6.3	33.2	15.8	10.9	n.a.
Freddie Mac	19.6	17.3	6.3	4.3	-8.3	n.a.
Fannie Mae	22.7	9.9	21.0	10.1	6.7	n.a.
Farm Credit Banks	0.9	-1.7	2.4	1.0	-0.5	n.a.
Sallie Mae	0.1	-3.9	-0.8	3.0	-5.9	n.a.
MEMO						
Outstanding noncallable notes and bonds						
Fannie Mae benchmark	106.4	128.1	142.1	139.1	142.1	147.6
Freddie Mac reference	69.5	85.5	96.5	93.5	96.5	100.5

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.
n.a. Not available.

In part to offset actual and expected redemptions of bills by the System Open Market Account, the Treasury increased the sizes of the weekly three- and six-month bill auctions by $2 billion in July and said it expects further increases over the balance of the year.[4] In early August, the Treasury auctioned $25 billion in the mid-quarter refunding--including new ten-year notes and reopenings of the five-year note and the thirty-year bond--all of which were well received. It also plans to issue two cash management bills in August to bridge seasonal lows in its cash position until the mid-September tax date.

Liquidity in the markets for Treasury securities was little changed over the intermeeting period. Market participants continued to turn away from the thirty-year Treasury bond as a benchmark for pricing and hedging, relying increasingly on the ten-year note and on interest rate swaps and GSE securities. Reflecting this change, open interest on the CBOT Treasury bond futures contract in July was 40 percent below its year-earlier level.

The tone in the market for GSE securities was relatively upbeat over the intermeeting period. Market participants generally do not expect congressional action this year that would materially change the relationship between the GSEs and the government. Fannie Mae's issuance of $11-1/2 billion of securities in early August--the largest bond sale in U.S. history outside of Treasuries--was well received.

State and Local Government Finance

Gross issuance of long-term municipal bonds in July remained well below the robust pace of the past two years. Refunding offerings continued to be relatively sparse, as the net rise in interest rates over the past year has made it unprofitable to refund older debt. In addition, swollen tax revenues have continued to hold down the need to raise new funds even as capital spending has been brisk; the result has been a smaller-than-usual seasonal bounce in new capital issuance in June, followed by a decline in July. With a large offset from debt retirement associated with prior advance refundings, net issuance has been meager.

Credit quality remains strong in the municipal market, with the exception of the health care sector. With their revenues under pressure from government and managed-care reimbursement policies, not-for-profit health care providers account for a large share of downgrades. Yields on municipal bonds moved slightly more than taxable yields over the intermeeting period, leaving the ratios of municipal yields to Treasuries and to Aaa corporate bonds down slightly on balance.

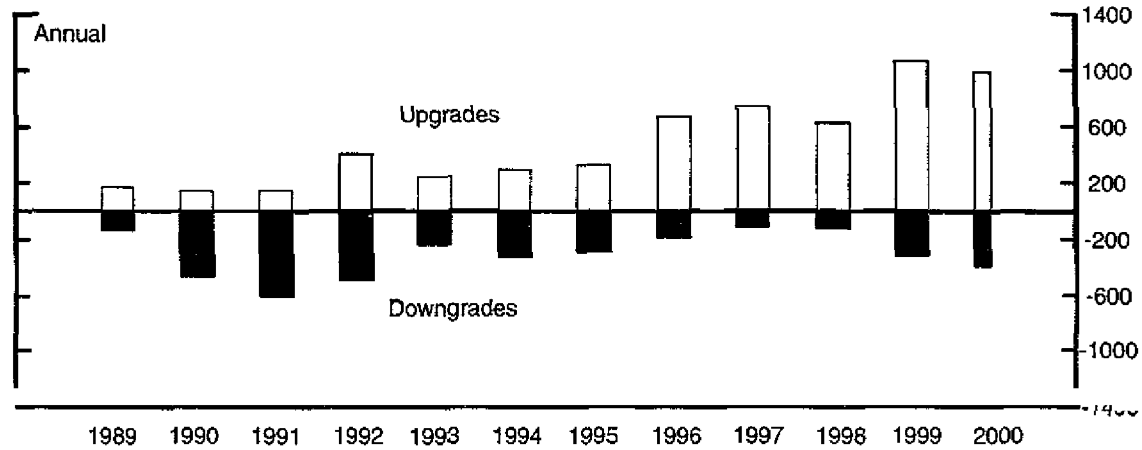
4. These redemptions relate to recently announced limits on the percentage of outstanding individual Treasury bill and coupon issues held by the System Open Market Account.

State and Local Finance

Gross Offerings of Municipal Securities
(Billions of dollars; monthly rates, not seasonally adjusted)

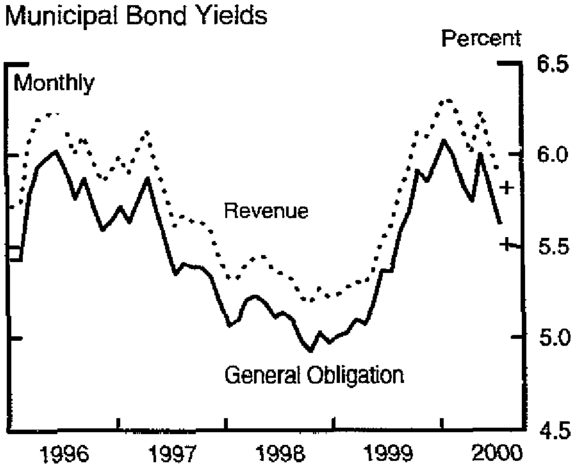
	1998	1999	2000 Q1	2000 Q2	2000 May	2000 June	2000 July
Long-term	21.9	18.0	12.2	16.2	14.1	20.2	12.8
Refundings[1]	8.5	4.5	1.9	2.4	1.7	3.2	1.5
New capital	13.4	13.5	10.3	13.8	12.5	17.0	11.3
Short-term	2.4	2.7	1.6	3.6	1.4	8.4	2.6
Total tax-exempt	24.3	20.6	13.8	19.8	15.5	28.6	15.4
Total taxable	1.1	1.1	0.6	0.6	0.5	0.7	0.7

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



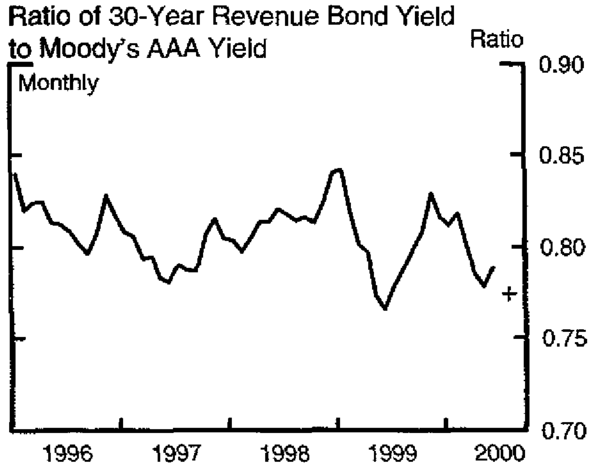
* Data through Aug. 3, 2000, at an annual rate.

Municipal Bond Yields



Note. Average of weekly data.
+ indicates latest observation (Aug. 10).

Ratio of 30-Year Revenue Bond Yield to Moody's AAA Yield



Note. Average of weekly data.
+ indicates latest observation (Aug. 10).

Money and Bank Credit

M2 grew moderately in July; its 3-1/4 percent rate of expansion was only about half the pace registered on average over the first two quarters of the year. Flows into small time deposits remained brisk, reflecting their relatively attractive rates, but their growth has likely been at the expense of other M2 components. M2 expansion has been held down by sluggish currency growth--which seems due at least in part to relatively weak foreign demand--as well as by weakness in retail money market mutual funds. Despite a widening in their opportunity cost, growth of liquid deposits rebounded somewhat in July after posting essentially no gain in June.[5] Available data for August suggest that these patterns are continuing.

In contrast to M2, M3 has accelerated in recent months, advancing at an 9 percent annual rate in July, about 1 percentage point faster than in the second quarter. July's pickup was driven by the interest-sensitive institutional money fund component and likely arose from a transitory narrowing of the spread between yields available on direct holdings of money market instruments and yields on the money funds themselves, which occurred early in July. Large time deposits continued to expand rapidly in June and July.

Adjusted for mark-to-market accounting rules, growth of bank credit remained robust, expanding at an 8 percent annual rate in July, following a 9 percent rate in June.[6] Nonetheless, the recent pace of growth is down significantly from that in the second quarter, when the unsettled conditions in the high-yield bond market in April and May forced many firms to turn to banks in order to obtain funds.

Major loan categories registered moderate gains in July, and generally slowed from the brisk pace set earlier in the year. Supported by continued strength in capital equipment spending, business loans advanced at a 7 percent annual rate. Real estate lending appears to have cooled slightly in July, as both home equity and other residential loans expanded less rapidly than in the first and second quarters. Consumer loans adjusted for securitization also weakened in July relative to the first half of the year.

5. The retail money fund and liquid deposit components of M2 (but not overall M2) have been affected by Merrill Lynch's decision, effective June 5, to restructure its Cash Management Accounts, and the discussion above abstracts from these effects. The restructuring shifts customers' funds from retail money funds into FDIC-insured money market deposit accounts (which are included in liquid deposits) at two of Merrill Lynch's affiliated depository institutions. Through the end of July, roughly $13-1/2 billion had been transferred. The new arrangement allows each customer a maximum of $200,000 of deposit insurance--$100,000 at each depository institution--and reportedly has provided the two depository institutions with a relatively inexpensive and stable source of funds.

6. Expansion at the two Merrill Lynch-affiliated depository institutions accounted for as much as 3/4 percentage point of the growth in total bank credit in each month.

Monetary Aggregates

(Based on seasonally adjusted data)

;gregate or component	1999	2000 Q1	2000 Q2	2000 May	2000 June	2000 July (p)	1999:Q4 to July 00 (p)	Level (bil. $) July 00 (p)
gregate	Percent change (annual rate)[1]							
M2[2]	6.1	6.0	6.1	-0.8	3.2	3.3	5.3	4791.9
M3	7.5	10.5	7.8	3.6	6.7	9.1	8.9	6766.9
lected components								
Currency	10.9	10.9	0.2	3.9	4.2	3.0	5.1	523.5
Liquid deposits[3]	5.9	-0.4	4.0	-6.0	0.4	4.4	1.7	2362.0
Small time deposits	-0.7	8.2	11.1	11.8	16.8	11.4	10.8	1017.3
Retail money market funds	12.8	18.7	9.7	-3.9	-5.8	-9.3	8.9	879.7
M3 minus M2[4]	11.3	22.4	11.9	14.7	15.3	23.4	18.4	1975.0
Large time deposits, net[5]	8.7	22.0	17.6	5.8	19.3	18.7	19.8	769.5
Institution-only money market mutual funds	17.1	23.5	13.8	17.3	15.5	51.8	23.7	686.0
. RPs	9.8	17.6	4.5	24.0	23.2	2.8	11.8	348.6
. Eurodollars	5.9	29.2	-3.2	24.9	-17.0	-23.4	6.1	170.9
:mo								
. M1	1.8	0.5	-1.4	-11.8	-2.9	0.9	-1.0	1103.8
. Sweep-adjusted M1[6]	5.1	2.5	2.3	-5.8	0.3	3.6	2.0	1497.4
. Demand deposits	-6.2	-14.9	-6.6	-25.3	-13.3	3.3	-9.6	332.0
. Other checkable deposits	-2.7	1.5	1.6	-27.1	-6.9	-9.0	-1.7	239.1
. Savings deposits	10.2	2.3	6.3	0.7	3.9	6.5	4.5	1791.0
. Monetary base	12.4	4.3	-3.3	2.7	2.8	3.3	1.1	577.0
	Average monthly change (billions of dollars)[7]							
lected managed liabilities at commercial banks								
. Large time deposits, gross	7.5	16.9	4.5	0.7	11.7	8.0	.	908.2
. Net due to related foreign institutions	0.5	3.5	4.0	25.6	9.8	0.0	...	259.3
. U.S. government deposits at commercial banks	0.2	1.7	1.1	0.1	-9.5	-1.5	...	30.4

1. For the years shown, Q4 to Q4 precent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, saving deposits, and small time deposits.
3. Sum of demand deposits, other checkable deposits, and saving deposits.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. ıressees.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official .titutions.
6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into VIDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
7. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is : quarter-to-quarter dollar change, divided by 3.
- Preliminary.

Commercial Bank Credit

(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	1999	Q1 2000	Q2 2000	May 2000	June 2000	July 2000	Level, July 2000 ($ billions)
Total							
1. Adjusted[1]	**5.3**	**11.6**	**11.9**	**13.8**	**8.9**	**8.1**	**4,966**
2. Reported	4.0	11.6	11.8	16.0	6.4	8.1	5,045
Securities							
3. Adjusted[1]	8.0	5.6	7.9	8.1	3.7	5.6	1,225
4. Reported	2.8	5.8	7.7	16.7	-5.4	5.8	1,303
5. U.S. government	2.4	3.6	-.2	1.8	2.1	3.1	816
6. Other[2]	3.5	9.7	21.8	42.3	-17.9	10.4	487
Loans[3]							
7. Total	4.5	13.7	13.2	15.7	10.6	8.9	3,742
8. Business	4.8	11.5	13.5	23.0	9.5	6.9	1,074
9. Real estate	9.2	17.9	15.8	17.6	11.3	10.7	1,598
10. Home equity	-3.0	21.4	29.3	26.7	6.3	12.5	117
11. Other	10.3	17.7	14.7	16.9	11.8	10.5	1,481
12. Consumer	-2.4	12.0	9.0	7.8	13.4	.5	515
13. Adjusted[4]	4.4	7.0	6.8	4.9	8.2	-5.5	810
14. Other[5]	-1.6	7.3	9.5	3.8	7.7	16.0	555

Note. All data are 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 are percentage changes in consecutive levels, annualized but not compounded. These data have been benchmarked to the December 1999 Call Report.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FIN 115).
2. Includes securities of corporations, state and local governments, and 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 and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The August 2000 Senior Loan Officer Opinion Survey on Bank Lending Practices focused on changes in the supply of and demand for bank loans to businesses and households over the past three months. Supplementary questions addressed banks' policies regarding business loans that are secured by collateral and their activities in the market for syndicated loans. Loan officers from fifty-six large domestic banks and twenty-one U.S. branches and agencies of foreign banks participated in the survey.

The results of the August survey indicate continued firming of business lending practices by a significant fraction of both domestic and foreign banks. Compared to the May survey, a larger fraction of domestic respondents reported tightening standards on commercial and industrial (C&I) loans. As in May, more than half of domestic banks and branches and agencies of foreign banks increased the premiums charged on riskier loans from three months earlier. The fraction of domestic banks that reported tightening lending standards in the market for commercial real estate loans also rose relative to the previous survey.

Banks, on net, reported moderately weaker demand for C&I loans in August relative to three months ago. A large fraction of foreign respondents noted a decrease in demand for commercial real estate loans, while only a few domestic respondents, on net, reported weaker demand for this type of loan.

Responses indicate that domestic banks typically require significant collateral for C&I loans, especially when lending to small firms. In particular, a significant majority of domestic banks reported that more than three quarters of their small business loan outstandings are secured by collateral. Compared to domestic banks, however, foreign branches and agencies generally reported lower levels of collateralization in their business loan portfolio.

The survey also indicated that syndicated loans tend to be concentrated at the largest domestic banks and at foreign branches and agencies. Most banks that participate in this market noted that highly leveraged syndicated loans accounted for a relatively small share of their total loan portfolio. Moreover, most banks said that the delinquency rate on their syndicated loan portfolio was comparable to the delinquency rate on their traditional C&I loans.

Standards and terms on both residential mortgage loans and other loans to households were essentially unchanged in August relative to three months ago. Demand for residential mortgage loans weakened, on net, for the fifth consecutive quarter. On net, domestic banks also reported weaker demand for consumer loans over the past three months.

Lending to Businesses

About 34 percent of domestic banks reported that they had tightened standards somewhat over the past three months on C&I loans to large and middle-market firms, and 24 percent tightened standards on loans to small firms over the same period. The percentage of domestic banks that tightened standards on business loans increased 9 percentage points in August relative to the May survey, and for the second consecutive quarter, the tightening of standards was particularly notable at the largest banks. On net, almost a quarter of branches and agencies of foreign banks tightened standards on C&I loans.

Significant fractions of both domestic and foreign banks also reported tightening terms on C&I loans. Most strikingly, more than half of the domestic respondents indicated that they had increased premiums charged on riskier loans to large and middle-market firms. Moreover, about a third of domestic banks noted charging higher spreads over their bank's cost of funds and increasing the costs associated with credit lines. The same fraction of domestic banks increased premiums charged on riskier loans to small firms. Among branches and agencies, 57 percent increased the premiums charged on riskier loans, 43 percent increased the costs associated with credit lines, and 33 percent charged higher spreads over their bank's cost of funds.

A sizable majority of both domestic and foreign respondents pointed to a less favorable or more uncertain economic outlook as an important reason for tightening standards and terms on C&I loans. In addition, more than half of foreign banks noted a worsening of industry-specific problems, while a fair number of domestic banks cited a reduced tolerance for risk as well as a worsening of industry-specific problems as reasons for firming lending conditions in the business sector. Some of the largest domestic banks and foreign branches and agencies also identified an increase in defaults by below-investment-grade borrowers in the public debt markets as a reason for tightening standards and terms on C&I loans.

Over the past three months, about 25 percent of domestic banks reported weaker demand for business loans from large and middle-market firms, while 20 percent saw stronger demand. Demand from small firms was similarly mixed, leaving overall demand for C&I loans at domestic banks somewhat weaker, on net, over the period. Relative to the last survey, in which almost half of the foreign branches and agencies saw weaker demand, only 9 percent, on net, reported somewhat weaker demand for C&I loans over the past three months.

An increase (decrease) in customers' needs for merger and acquisition financing was most often identified as the reason for increased (decreased) demand for C&I loans at both domestic and foreign banks over the past three months. Domestic banks that experienced an increase in business loan demand also cited a shift in customer borrowing from other less attractive sources. On the other hand, domestic banks that reported a decrease in demand pointed to reduced capital expenditures by their customers.

The fraction of domestic respondents that indicated that they had tightened standards on commercial real estate loans over the past three months increased to 32 percent in

August, up from 22 percent in the May survey. In contrast, most branches and agencies of foreign banks reported no change in standards on commercial real estate loans. On net, a small fraction of domestic banks noted moderately weaker demand for commercial real estate loans in the August survey; however, 36 percent of foreign respondents reported weaker demand over the past three months.

C&I Loans Secured by Collateral

The survey included two special questions about C&I loans secured by collateral. More than 70 percent of domestic banks indicated that the majority of the dollar volume of outstanding C&I loans to large and middle-market firms is collateralized. Almost all banks reported that at least half of their business loan outstandings to small firms were collateralized, and nearly 80 percent of banks reported that more than three-quarters of their small business loans were secured by collateral. In contrast, half of the foreign banks said that less than a quarter of their outstanding dollar volume of business loans was collateralized.

At domestic banks, the vast majority of collateralized loans to both small and large firms are secured by accounts receivable, inventories, and capital equipment. At branches and agencies of foreign banks, equity of a subsidiary of the company receiving the loan is the most common form of collateral, followed by accounts receivable and inventories.

Lending to Households

Over the past three months, 51 out of 53 domestic banks reported no change in standards on residential mortgage loans. On net, 40 percent of respondents reported somewhat weaker demand for mortgages to purchase homes relative to three months ago. This marks the fifth consecutive quarter that banks have reported weaker demand for home mortgages.

Banks indicated almost no change in their willingness to make consumer installment loans over the past three months. Standards and terms on all types of consumer lending were also largely unchanged in August relative to three months ago. However, for the first time since 1996, the survey indicates that domestic banks, on net, have stopped tightening standards on applications for credit card loans. On net, about 10 percent of domestic respondents reported somewhat weaker demand for consumer loans over the same period.

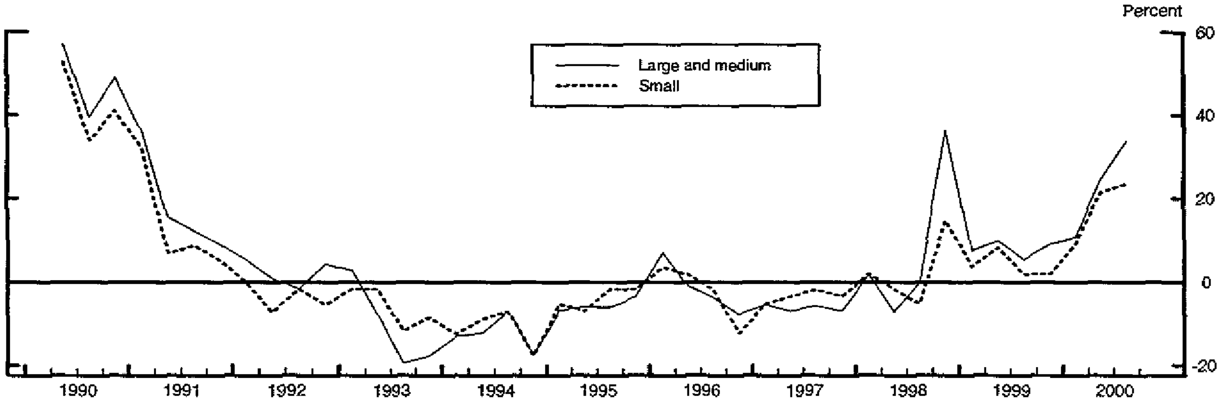
Syndicated Loans

In recent years, the market for syndicated loans has increased substantially. The August survey included three special questions about banks' activities in the market for syndicated loans. About 40 percent of the largest domestic banks reported that syndicated loans made up less than 20 percent of their outstanding C&I loan volume. However, about a quarter of the largest domestic banks and more than three-quarters of foreign branches and agencies reported that syndicated loans accounted for at least half of their business loan portfolio. The survey responses indicate that the smaller domestic banks on the panel engage in relatively little syndicated lending.

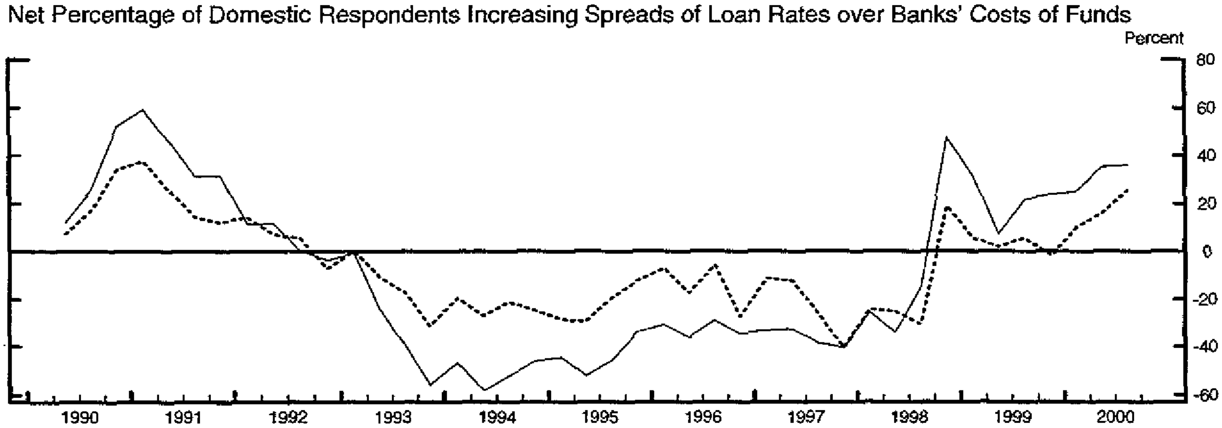
Between 55 and 60 percent of both large domestic and foreign banks reported that no more than 15 percent of the syndicated loans on their books are considered highly leveraged (made to below-investment-grade borrowers at more than 250 basis points over LIBOR). Only one large domestic bank and two foreign banks noted that highly leveraged syndicated loans account for more than half of their syndicated loan portfolio. Consistent with the relatively small share of highly leveraged syndicated loans on their books, banks indicated, on net, that the delinquency rate on outstanding syndicated loans is comparable to the delinquency rate on other C&I loans.

Measures of Supply and Demand for C&I Loans, by Size of Firm Seeking Loan

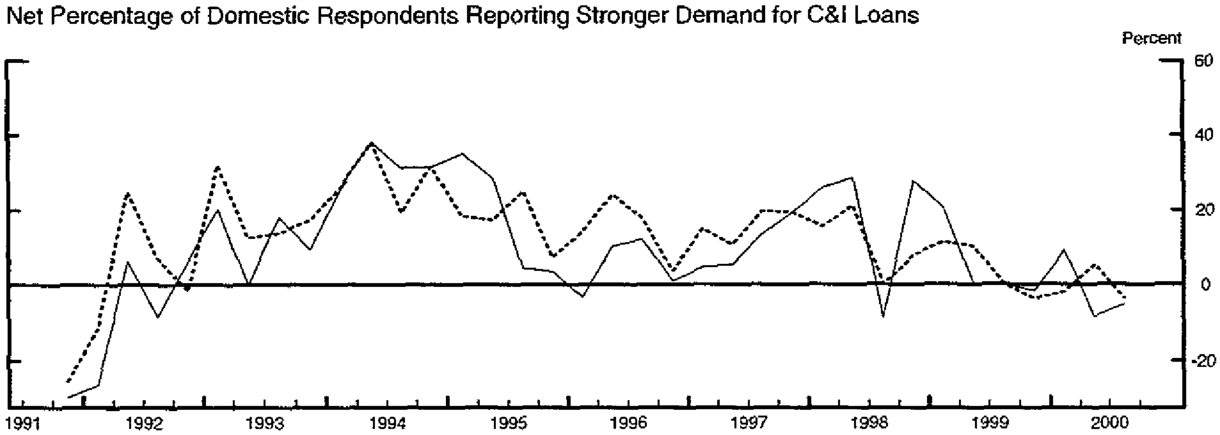
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



Net Percentage of Domestic Respondents Increasing Spreads of Loan Rates over Banks' Costs of Funds

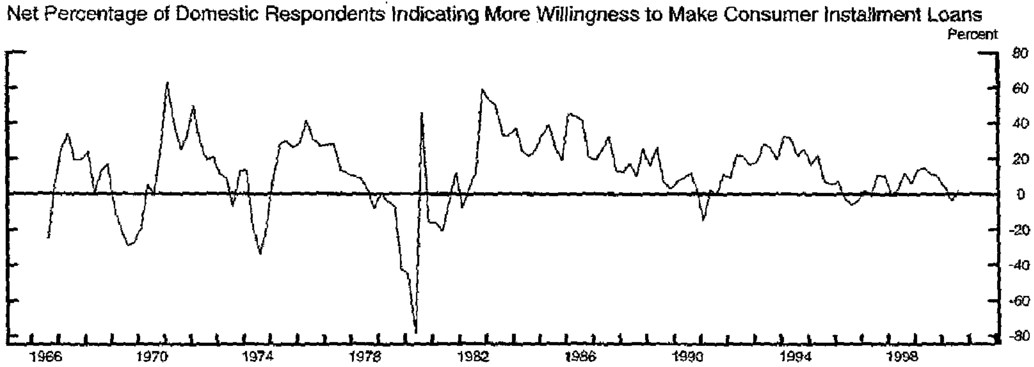


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

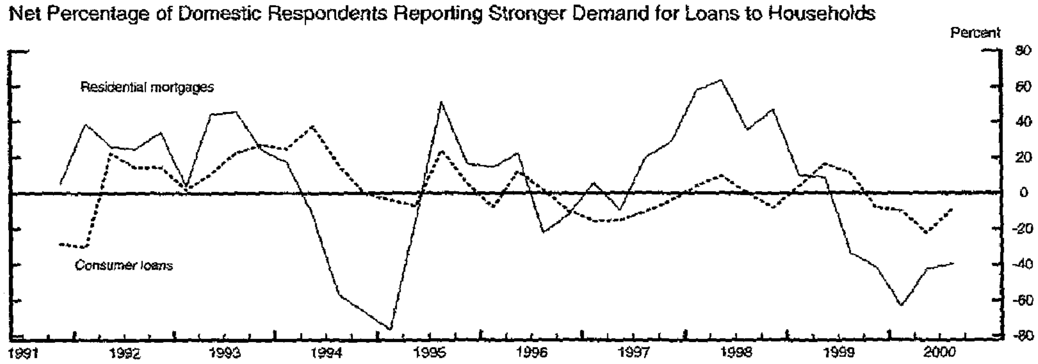


Measures of Supply and Demand for Loans to Households

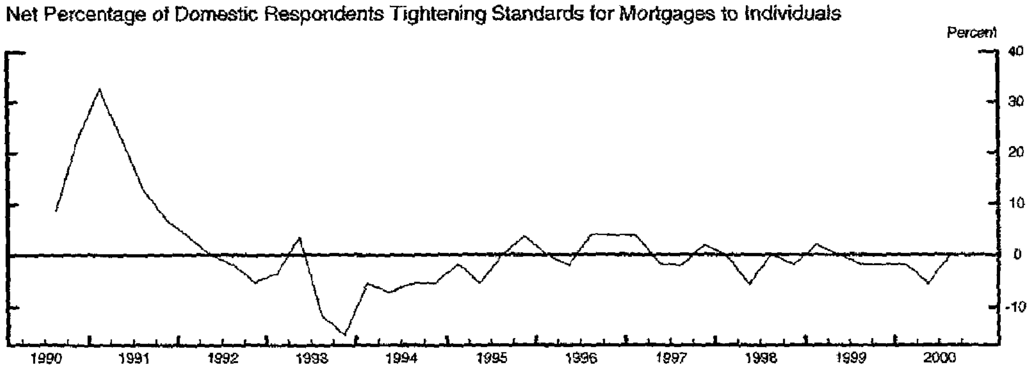
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



Net Percentage of Domestic Respondents Reporting Stronger Demand for Loans to Households



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

For April-May combined, the U.S. trade deficit in goods and services was $369 billion at an annual rate, $25 billion larger than in the first quarter. The monthly deficit in May was $31.0 billion, $0.5 billion larger than in April (revised). Data for June will be released on Friday, August 18, and will be included in the Greenbook Supplement.

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

	1999	Annual rate 1999	2000		Monthly rate 2000		
		Q4	Q1	Q2[e]	Mar.	Apr.	May
Real NIPA[1]							
Net exports of G&S	-322.4	-352.5	-376.8	-416.1	...	...	...
Nominal BOP							
Net exports of G&S	-265.0	-305.1	-344.7	-369.2	-30.6	-30.5	-31.0
Goods, net	-345.6	-384.9	-423.4	-444.4	-37.1	-36.9	-37.2
Services, net	80.6	79.8	78.7	75.1	6.5	6.4	6.1

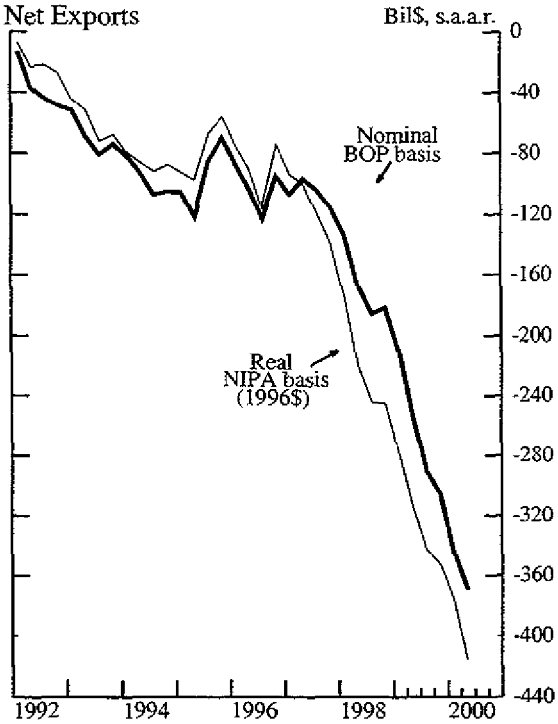
1. Billions of chained (1996) dollars.
e. BOP data are two months at an annual rate.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports of goods and services for April-May on average was 1.4 percent higher than in the first quarter. Almost all of the increase was in capital goods–especially high-tech products (computers, semiconductors, and telecommunications equipment)–and aircraft. Exports of high-tech products rose at about the same strong pace as recorded in the first quarter, and exports of aircraft rebounded from strike-depressed first quarter levels. Exports of other machinery grew moderately, held down by an unusual drop in shipments in May. Automotive products shipped to Canada (primarily parts used in vehicles sent to the United States) turned down in April-May as U.S. vehicle sales eased back from the torrid pace recorded earlier in the year. By region, most of the increase in goods exports in April-May was in shipments to developing countries, particularly Mexico, Korea, Taiwan, and China.

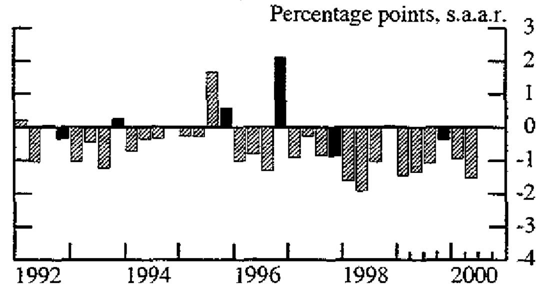
The value of imports of goods and services for April-May on average was 2.8 percent above the first-quarter level, with increases recorded in most major trade categories. The largest increases were in capital goods, consumer goods, and service payments (largely expenditures on travel). Automotive imports fell

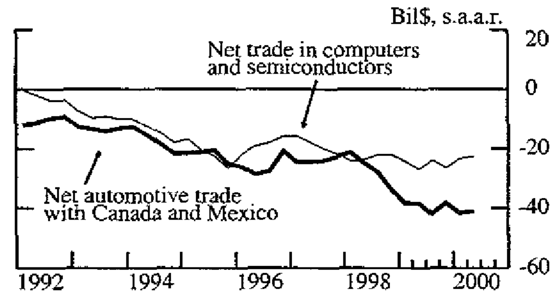
U.S. International Trade in Goods and Services

Net Exports

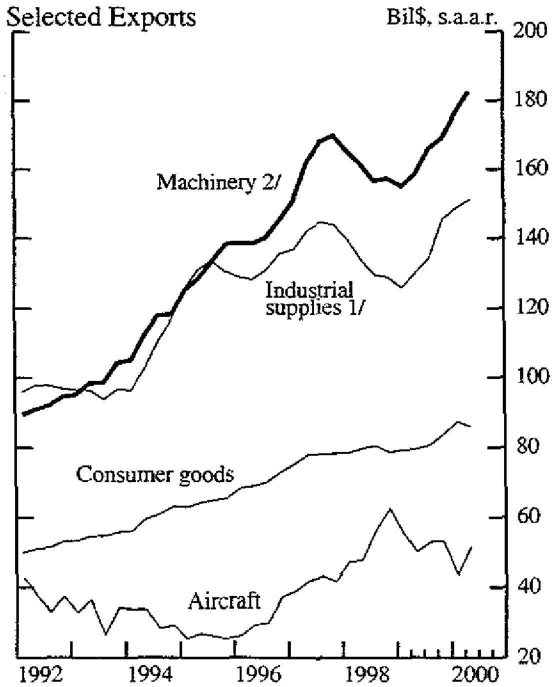


Contribution of Net Exports to Real GDP Growth



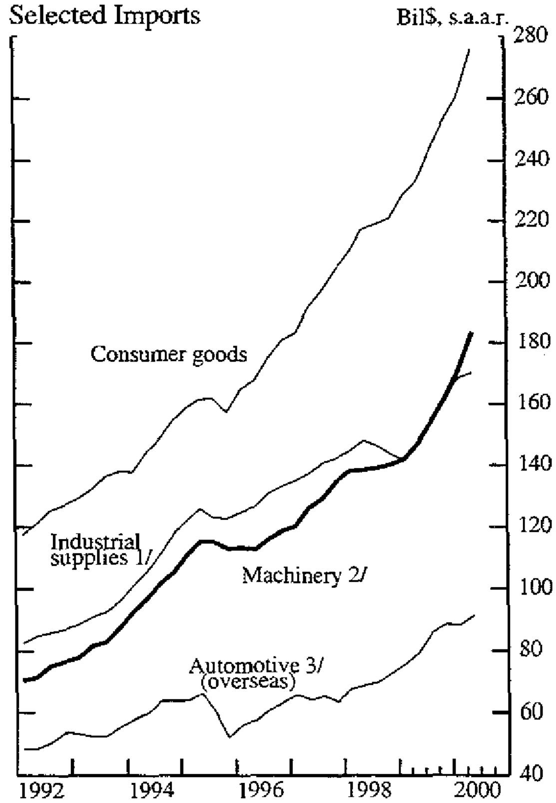


Selected Exports



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

Selected Imports



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, s.a.a.r., BOP basis)

	Levels				Amount Change[1]			
	2000		2000		2000		2000	
	Q1	Q2^e	Apr.	May	Q1	Q2^e	Apr.	May
Exports of G&S	**1020.1**	**1034.0**	**1039.0**	**1029.0**	**21.5**	**13.8**	**-1.7**	**-10.0**
Goods exports	734.9	747.2	750.8	743.6	14.6	12.3	0.6	-7.2
Agricultural	52.5	52.2	51.0	53.4	2.5	-0.3	-2.6	2.4
Gold	9.6	2.9	3.3	2.6	0.9	-6.7	-5.7	-0.7
Other goods	672.8	692.1	696.5	687.7	11.2	19.3	8.9	-8.8
Aircraft & pts	43.6	51.6	46.7	56.4	-9.4	7.9	12.1	9.7
Computers	51.2	54.2	56.5	52.0	3.4	3.1	3.0	-4.5
Semiconductors	52.5	56.7	55.9	57.5	1.2	4.2	1.2	1.6
Other cap gds	179.0	184.7	189.6	179.9	7.2	5.8	6.3	-9.7
Automotive	80.3	77.7	77.0	78.3	2.8	-2.7	-5.8	1.3
to Canada	47.5	44.1	43.7	44.5	0.2	-3.4	-4.3	0.8
to Mexico	15.9	16.7	16.4	17.1	2.2	0.8	-1.8	0.7
to ROW	17.0	16.9	17.0	16.8	0.4	-0.1	0.3	-0.2
Ind supplies	148.8	151.2	152.0	150.4	3.3	2.4	-4.9	-1.6
Consumer goods	87.3	85.8	86.6	85.0	3.7	-1.5	-2.5	-1.6
All other	30.0	30.2	32.3	28.1	-1.1	0.1	-5.8	-4.2
Services exports	285.2	286.8	288.2	285.3	7.0	1.5	-2.3	-2.9
Imports of G&S	**1364.8**	**1403.2**	**1405.0**	**1401.4**	**61.1**	**38.4**	**-3.0**	**-3.6**
Goods imports	1158.3	1191.6	1193.5	1189.6	53.0	33.3	-2.4	-3.9
Petroleum	108.0	110.8	109.1	112.5	22.3	2.7	-7.4	3.4
Gold	9.6	2.4	2.4	2.3	0.3	-7.2	-7.6	-0.0
Other goods	1040.6	1078.4	1082.1	1074.8	30.4	37.8	12.6	-7.3
Aircraft & pts	23.2	24.9	25.1	24.8	-0.9	1.7	-1.5	-0.3
Computers	83.8	89.1	90.4	87.9	0.1	5.3	7.5	-2.5
Semiconductors	43.2	44.5	43.0	45.9	1.5	1.2	-1.6	2.9
Other cap gds	173.9	186.3	185.6	187.0	8.8	12.3	6.6	1.5
Automotive	193.3	193.1	198.0	188.3	5.3	-0.2	1.6	-9.7
from Canada	66.1	61.9	63.0	60.7	0.8	-4.3	-5.2	-2.3
from Mexico	38.9	39.9	40.5	39.2	5.0	1.0	-2.0	-1.3
from ROW	88.3	91.4	94.4	88.3	-0.5	3.1	8.8	-6.1
Ind supplies	168.4	170.0	169.2	170.9	6.3	1.6	-4.2	1.8
Consumer goods	260.5	275.7	275.2	276.1	7.6	15.2	4.8	0.8
Foods	44.6	45.4	45.2	45.6	0.0	0.8	-0.7	0.4
All other	49.6	49.4	50.4	48.4	1.6	-0.2	0.1	-2.1
Services imports	206.6	211.6	211.5	211.8	8.1	5.0	-0.5	0.3
Memo:								
Oil quantity (mb/d)	11.35	11.95	11.79	12.11	0.75	0.59	0.24	0.32
Oil import price ($/bbl)	25.98	25.39	25.33	25.44	3.83	-0.61	-2.29	0.11

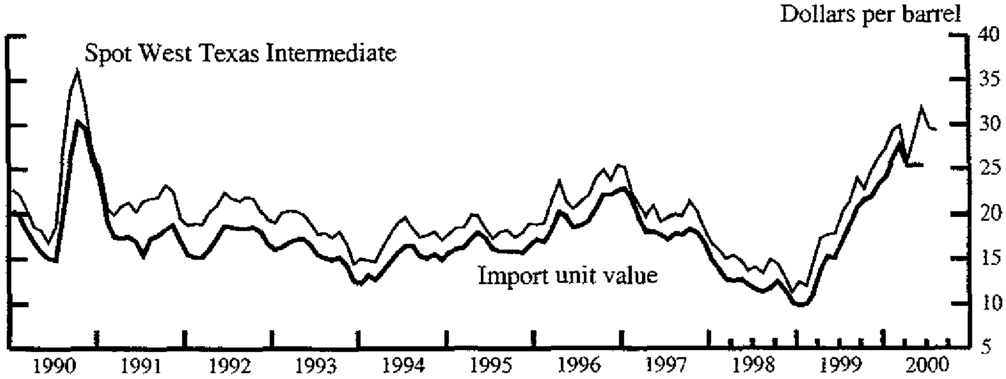
1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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

	Annual rates			Monthly rates		
	1999	2000		2000		
	Q4	Q1	Q2	May	June	July
	------------ BLS prices (1995 weights)------------					
Merchandise imports	8.2	10.5	0.0	0.4	1.2	0.0
Oil	83.5	105.1	-7.4	4.3	10.0	-2.4
Non-oil	1.9	1.7	1.0	-0.2	0.1	0.3
Core goods*	2.5	1.9	1.6	-0.2	0.2	0.4
Foods, feeds, beverages	2.6	0.0	-4.1	-1.5	-0.7	-0.2
Industrial supplies ex oil	9.9	11.0	10.1	-0.5	1.4	1.2
Computers	-1.0	-1.4	-8.9	-0.6	-0.2	-0.2
Semiconductors	-1.6	-3.9	0.0	-0.8	-0.3	-0.8
Cap. goods ex comp & semi	0.3	-1.7	0.3	0.0	-0.5	0.1
Automotive products	0.5	0.7	1.4	0.3	0.1	0.2
Consumer goods	0.1	-0.8	-2.2	-0.2	-0.5	0.3
Merchandise exports	2.4	2.7	2.1	0.3	-0.2	0.0
Agricultural	-1.7	0.5	5.7	0.6	-1.4	-2.1
Nonagricultural	3.0	2.9	1.5	0.3	-0.1	0.2
Core goods*	4.1	4.2	2.1	0.3	0.0	0.3
Industrial supples ex ag	10.6	12.2	6.2	0.7	0.0	0.4
Computers	-2.0	-7.1	-4.5	0.2	-0.3	0.2
Semiconductors	-3.6	-5.0	-4.1	-0.4	-1.5	-0.1
Cap. goods ex comp & semi	0.5	0.9	1.2	0.1	0.1	0.1
Automotive products	2.6	0.3	0.8	0.0	-0.1	0.3
Consumer goods	1.3	0.5	-0.3	0.0	-0.2	0.2
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	5.3	5.6	-0.2	...	...	...
Non-oil merchandise	1.0	0.9	0.7	...	...	...
Core goods*	1.4	1.5	1.6	...	...	...
Exports of goods & services	2.7	1.9	1.8	...	...	...
Nonag merchandise	2.5	1.4	1.3	...	...	...
Core goods*	2.9	3.2	2.3	...	...	...

*/ Excludes computers and semiconductors.
n.a. Not available. ... Not applicable.

Oil Prices



(particularly those from Canada), reflecting the recent easing of U.S. vehicle sales. The value of imported oil rose only moderately in April-May as an increase in quantity was nearly offset by a decline in prices.

Prices of Internationally Traded Goods.
Oil. In July, the price of imported oil (BLS) declined somewhat, following two months of increases. Oil prices generally eased during July following Saudi Arabia's announcement that it would increase oil production beyond its OPEC production target–despite objections from other OPEC producers. In early August, however, the spot price of West Texas Intermediate (WTI) crude moved higher amid concerns of falling crude oil inventories in the United States, supply disruptions in Colombia, and heightened uncertainty over Saudi production levels. Spot WTI is currently trading around $32 per barrel.

Non-oil imports. Prices of imported non-oil goods increased moderately in July, led by rising prices for industrial supplies (primarily natural gas and unfinished metals), with smaller increases in prices of imported automotive products and consumer goods. Prices of computers and semiconductors declined. The price index for other imported capital goods was up slightly from June but was below the average for the second quarter. The increase in prices of imported consumer goods in July followed declines in the previous two months. Overall, prices of imported core goods (which exclude oil, computers, and semiconductors) rose 0.4 percent in July, the largest monthly increase since February.

Exports. Prices of total goods exports were unchanged in July as declines in prices of agricultural products was offset by moderate increases in prices of a wide range of other exported goods, particularly industrial supplies and automotive products. The prices of exported computers rose slightly following declines in the previous month, and prices of semiconductors declined for the third consecutive month. The price index for other exported capital goods rose 0.1 percent in July, the same rate as recorded every month this year. Overall, prices of exported core goods (which exclude computers, semiconductors, and agricultural products) rose 0.3 percent in July, a rate that is in line with average increases recorded in the past three quarters.

U.S. International Financial Transactions
Foreign official assets held in the United States increased almost $7 billion in the second quarter (line 1 of the Summary of U.S. International Transactions table). Reserve inflows from Japan–associated with April foreign exchange intervention–resulted in the largest net inflow ($12 billion). Russia also increased its official holdings significantly in the quarter ($4.5 billion), as the country's massive current account surplus supported rapid reserve accumulation. Large decreases were recorded for Brazil, Switzerland, and Taiwan. Foreign officials favored agency bonds over Treasury debt in the quarter, as $10 billion

in official purchases of agencies more than offset $4 billion in official sales of Treasuries. Net sales of Treasuries would have been greater had it not been for Japan's large purchases in conjunction with its foreign exchange intervention. Partial data from the FRBNY indicate a slight decline in foreign official assets for July.

Private foreign purchases of U.S. securities slowed again in May, but resumed a strong pace in June (line 4). In all, in the second quarter private foreigners bought net $67 billion of U.S. securities, an amount far below the blistering pace of the first quarter. Weighing down total net purchases were $21 billion in net sales of Treasury securities, an amount that exceeds total net sales from last year. The sales of Treasuries more than offset purchases of agency bonds, which slowed markedly in June, reflecting a light issuing calendar. After a slowdown earlier in the quarter, foreign net purchases of corporate bonds and stocks picked up sharply in June. For the quarter, purchases of corporate bonds maintained the recent quarterly pace of over $40 billion. Net foreign purchases of U.S. stocks totaled $27 billion, down considerably from the extraordinary amount in the first quarter, but in line with last year's record pace. Of the nearly $70 billion in net purchases of U.S. corporate securities in the quarter, $62 billion was through Europe.

The data on U.S. purchases of foreign securities are once again confounded by stock swaps that result in acquisitions of foreign stocks by U.S. residents as payments for foreign takeovers of U.S. firms. According to the transactions data, U.S. investors sold $18 billion in foreign securities in the second quarter (line 5). However, once approximately $29 billion in foreign stocks acquired net through stock swaps is added to the transactions data, it is clear that U.S. investors in fact acquired about $11 billion in foreign securities in the quarter. Including the stock swaps, U.S. investors acquired about $22 billion in foreign stocks, most of which was through the United Kingdom. The recent trend of selling German stocks continued; net sales totaled $4 billion in the quarter and $7 billion over the past four months. U.S. investors sold $11 billion in foreign bonds, mostly through the Caribbean, but also through Asia.

A large net inflow of $52 billion was recorded for the banking sector in the second quarter (line 3). This net inflow was concentrated in May and is largely attributable to an increase in bank flows into U.S. branches of foreign banks from affiliated offices in the Caribbean. This large inflow is consistent with the large increase in business lending in May by foreign banks in the United States.

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

	1998	1999	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 May	2000 June
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	-16.6	46.4	13.0	27.4	22.7	6.7	-8.1	9.3
a. G-10 countries	6.9	49.7	19.2	10.2	11.1	5.6	.9	-.2
b. OPEC countries	-9.0	2.0	-1.3	-1.7	5.7	1.2	-1.1	2.7
c. All other countries	-14.4	-5.3	-5.0	19.0	5.9	-.1	-7.9	6.9
2. Change in U.S. official reserve assets (decrease, +)	-6.8	8.6	1.9	1.6	-.6	2.0	-.2	.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	57.3	-9.8	-18.3	-16.0	-32.4	52.3	52.8	-8.4
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	275.2	321.2	105.7	76.1	124.0	66.7	16.9	29.3
a. Treasury securities[3]	49.3	-19.8	9.8	-17.0	-9.1	-20.5	-6.7	-18.2
b. Agency bonds	50.5	73.8	21.2	17.5	26.6	18.4	9.9	3.9
c. Corporate and municipal bonds	121.7	159.0	49.5	40.8	44.5	41.8	7.6	25.8
d. Corporate stocks	53.7	108.2	25.2	35.0	62.1	27.0	6.0	17.8
5. U.S. net purchases (-) of foreign securities	-11.1	10.0	-10.8	-3.9	-24.9	18.0	12.8	3.7
a. Bonds	-17.4	-5.7	-10.1	2.0	-8.9	10.8	4.3	5.8
b. Stocks[4]	6.2	15.6	-.8	-5.9	-16.0	7.2	8.5	-2.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-146.1	-150.9	-43.6	-33.3	-34.8	n.a.	...	...
7. Foreign direct investment in U.S.	186.3	275.5	55.6	49.4	42.3	n.a.	...	...
8. Foreign holdings of U.S. currency	16.6	22.4	4.7	12.2	-6.8	n.a.	...	...
9. Other (inflow, +)[4,5]	-207.4	-203.5	-36.8	-47.8	-17.6	n.a.	...	...
U.S. current account balance (s.a.)	-217.1	-331.5	-89.6	-96.2	-102.3	n.a.	...	...
Statistical discrepancy (s.a.)	69.7	11.6	18.2	30.5	30.4	n.a.	...	...

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 excludes securities acquired through exchange of equities; therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes Treasury bills.

4. Quarterly balance of payments data include large U.S. acquisitions of foreign equities associated with foreign takeovers of U.S. firms. These are not included in line 5.b but are included in line 9.

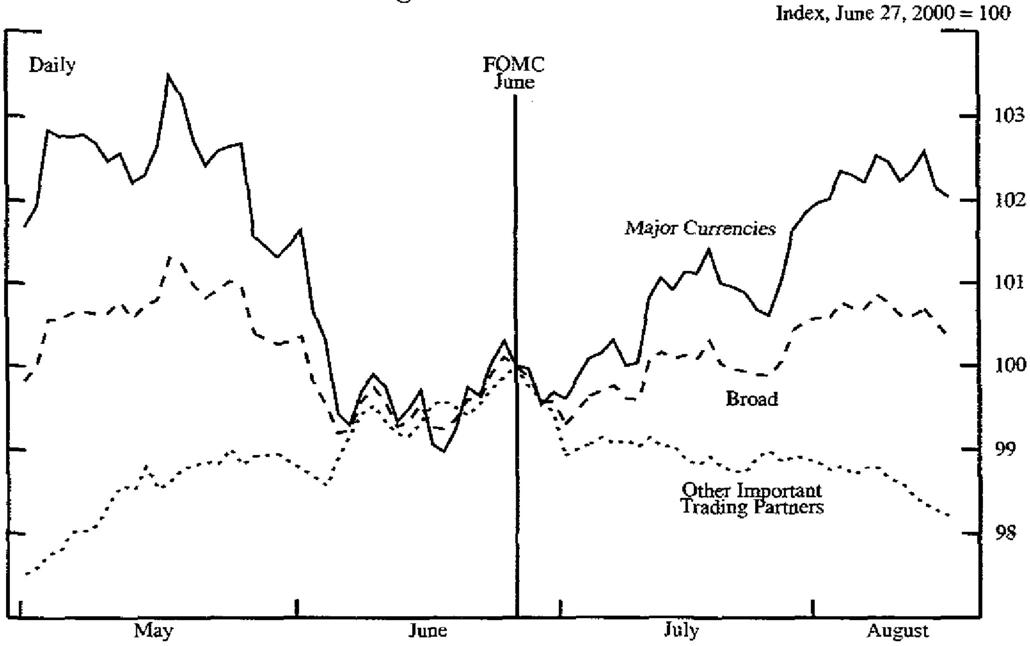
5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

Foreign Exchange Markets

Since the June FOMC meeting, the nominal exchange value of the dollar against a group of major currencies has risen 2 percent. The dollar appreciated 3¾ percent on balance vis-à-vis the euro and 2¾ percent against the yen, and was little changed against the Canadian dollar and the pound sterling. After trading in a narrow range during the first half of the intermeeting period, the dollar appreciated rapidly against the euro in late July and early August. This change appeared to be brought on by heightened market perceptions that growth in the United States, though possibly moderating slightly from its recent elevated level, could remain well above that in most European countries. The pronounced narrowing of yield differentials between dollar- and euro-denominated instruments–40 basis points for three-month money and 23 basis points for 10-year government bonds–occurred mainly during the last two weeks of the intermeeting period and might have helped check further appreciation of the dollar against the euro. The European Central Bank and the Bank of England did not adjust their policy rates during the period.

Exchange Value of the Dollar



The dollar's appreciation against the yen, which occurred early in the intermeeting period, appeared to be influenced by an unwinding of market expectations that the Bank of Japan would end its zero interest rate policy at its mid-July meeting. In the event, the Bank of Japan explained that while the overall economic situation was indeed improving in Japan, the Bank was refraining from raising rates at that time in part because the bankruptcy of Sogo, a large Japanese department store chain, had temporarily heightened uncertainty in asset markets. A part of the dollar's July appreciation against the yen was unwound in early August after U.S. data releases showed accelerating productivity and subsiding labor cost pressures. Also, speculation began to mount that the Bank of Japan would tighten its monetary policy stance at the August 11 meeting of the Policy Board. The Policy Board did raise its target for the overnight interbank interest rate to 25 basis points at that meeting; domestic financial markets in Japan and the yen/dollar exchange rate showed little immediate reaction. Yields on three-month instruments rose 20 basis points, on balance, during the intermeeting period, yields on long-term yen debt obligations changed little, and the Topix index of Japanese share prices declined 5 percent.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Aug. 16 (Percent)	Percentage Point Change	Aug. 16 (Percent)	Percentage Point Change	Percent Change
Canada	5.92	.01	5.80	-.13	8.53
Japan	.28	.20	1.76	.03	-5.34
Euro area	4.82	.27	5.21	-.03	.81
United Kingdom	6.06	-.02	5.27	.02	.94
Switzerland	3.32	.00	4.01	-.11	8.72
Australia	6.49	.20	6.24	.00	4.77
United States	6.61	-.13	5.84	-.26	4.00
Memo: Weighted-average foreign	4.01	.14	4.97	-.04	n.a.

NOTE. Change is from June 27 to August 16.
n.a. Not available.

The dollar's exchange value against a group of currencies of other important U.S. trading partners declined almost 2 percent during the intermeeting period. This drop owed mainly to a 9 percent depreciation against the Mexican peso in late June and early July, which followed Mexican presidential elections that were peaceful and produced a clear victor, Vicente Fox of the opposition PAN party. Fluctuations in the dollar's exchange rate against the currencies of other Latin American countries and of developing Asian countries were generally limited. The yield spread of the EMBI+ index over U.S. Treasuries fell from 717 basis points to around 660 basis points, its lowest level since before the

Russian crisis of August 1998. Some of the decline was due to a successful exchange by Brazil of a portion of its high-yield Brady debt for a newly issued, lower-yield global bond.

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

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Aug. 16	Percent Change	Aug.15/16 (Percent)	Percentage Point Change	Aug.15/16 (Percent)	Percentage Point Change	Percent Change
Mexico	9.19	-8.88	14.80	-.30	3.98	-1.01	-3.64
Brazil	1.81	-.99	16.20	-2.00	8.63	-.22	7.21
Argentina	1.00	.00	7.45	-.30	8.48	-.46	.64
Chile	544.10	1.28	6.55	-1.15	1.82	-.18	1.37
China	8.28	.03	n.a.	n.a.	1.28	-.09	7.24
Korea	1115.10	-.29	5.90	-.10	1.86	-.13	-7.25
Taiwan	31.01	.62	4.86	-.19	...	...	-4.99
Singapore	1.72	-1.06	2.56	.06	...	...	6.35
Hong Kong	7.80	.06	5.77	-.37	...	...	9.77
Malaysia	3.80	-.01	2.98	.30	1.86	.04	-.85
Thailand	40.71	3.93	3.25	-.25	.99	-.23	-2.01
Indonesia	8285.00	-4.44	13.33	1.50	6.70	.37	-1.13
Philippines	44.87	4.59	9.44	.63	4.23	.06	-3.68
Russia	27.74	-1.28	n.a.	n.a.	8.11	-.62	32.52

NOTE. Change is from June 27 to August 15/16.

1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.

2. Spread over similar maturity U.S. Treasury bond yield. Mexico, Brazil, Argentina and Venezuela: Stripped Brady bond yield. Chile, China, and Korea: Global bond yield. Malaysia, Philippines and Russia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

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

Developments in Foreign Industrial Countries

Data released since the June Greenbook suggest that economic activity in the foreign industrial countries was strong in the second quarter, but the limited forward-looking indicators now available suggest some moderation in the pace of growth in the current quarter. On balance, incoming data for Japan have been positive, although some concerns have been raised about the durability of the Japanese recovery. In the United Kingdom, recent indicators suggest that although growth picked up in the second quarter, it is likely to slow somewhat in the near term, and incoming data for Canada suggest that growth has moderated from its recent rapid pace. In contrast, economic activity in the euro area appears to be expanding robustly.

Headline consumer price inflation moved higher in June in the euro area and in Canada, reflecting the recent surge in oil prices. However, core consumer price data show little evidence of inflationary pressures in most of the foreign industrial countries. In the euro area, the twelve-month rate of headline inflation jumped to 2.4 percent, well above the 2 percent target ceiling, while core inflation edged up to 1.3 percent. Headline Canadian inflation was 2.9 percent, near the top of its target band, but core inflation was only 1.4 percent. U.K. consumer price inflation remains below its target rate, and in Japan twelve-month consumer price inflation remains negative.

In **Japan,** recent economic indicators have generally been positive, although last month's bankruptcy of large-scale retailer Sogo has raised concerns about the durability of the fledgling recovery. Industrial production continued to rise in the second quarter, with an especially sharp gain in June, bringing the index to its highest level since late 1997. Continued strong growth in demand for equipment appears to have contributed to another solid gain in business investment. Consumer spending may finally be improving; in the second quarter, household expenditure posted its first quarterly gain since early last year. However, both nonresidential and residential construction dropped back in the second quarter after increasing earlier in the year.

The unemployment rate edged back up to 4.7 percent in June, a little below the peak level of 4.9 percent reached earlier this year, although the job-offers-to-applicants ratio continued to rise. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were down 0.7 percent in July from a year earlier. The wholesale price index for domestic goods was up 0.3 percent year-over-year in July, but this increase largely reflects higher energy prices. The Japan Real Estate Institute's urban land price index was down 3 percent at the end of March compared with six months earlier and was 33 percent below its September 1991 peak.

The latest Tankan survey showed another increase in business confidence in July, led by large manufacturers, who are benefitting from increased IT investment and strong foreign demand. However, the level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries remains low, at -18 in June versus -23 in March. Firms in all categories reported that they expect conditions to continue improving over the next three months. Survey expectations of profits, sales, and capital spending in FY2000 are optimistic. Profits are expected to increase 13 percent, following an estimated 24 percent increase in FY1999. Sales are expected to increase 2.4 percent this year, reversing a decline in FY1999 of about the same magnitude. Capital expenditures across all firms are projected to be flat in FY2000, after falling 9 percent in FY1999, but it is typical for capital spending projections to be revised up over the year as plans become firmer.

Japanese Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	1999	2000		2000			
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]	1.2	.7	1.5	-.5	.2	1.7	n.a.
Housing starts	-5.2	8.6	-2.5	-.4	-2.3	4.9	n.a.
Machinery orders[2]	8.7	4.9	3.1	-1.1	4.5	14.4	n.a.
Machinery shipments	3.0	2.4	4.6	.8	.7	3.5	n.a.
New car registrations	-4.7	9.2	1.0	.8	5.4	3.1	n.a.
Unemployment rate[3]	4.6	4.8	4.7	4.8	4.6	4.7	n.a.
Job offers ratio [4]	.49	.52	.57	.56	.56	.59	n.a.
Business sentiment[5]	-26	-23	-18	...	...	...	...
CPI (Core, Tokyo area)[6]	-.3	-.4	-.6	-.5	-.4	-.9	-.7
Wholesale prices[6]	-.7	-.1	.4	.5	.3	.3	.3

1. Adjusted for working days.
2. Private, excluding ships and electric power.
3. Percent.
4. Level of indicator.
5. Tankan survey, diffusion index.
6. Percent change from year earlier, n.s.a.
n.a. Not available. ... Not applicable.

Japan's merchandise trade surplus for the first six months of 2000 was $116 billion (s.a.a.r.), up from $109 billion in the same period last year. Denominated in dollars, exports were up 21 percent from year-ago levels, largely because of a continuing surge in exports to developing Asian economies. Imports were up 26 percent, partly reflecting a jump in the value of oil imports.

Citing signs of recovery and a reduction in downward price pressures, the Bank of Japan decided on August 11 to lift the zero interest rate policy, raising its target for the overnight call rate to 25 basis points. The decision was characterized as a small adjustment to the degree of monetary easing in line with the improvement of the economy.

Incoming data for the **euro area** suggest that economic activity grew robustly in the second quarter. For April and May on average, the volume of euro-area retail sales rose 1.2 percent above the first-quarter average, and euro-area industrial production increased 1.9 percent from the first quarter. Although German and Italian industrial production declined in June, output for the second quarter as a whole registered strong gains in both countries. Limited available forward-looking indicators suggest on balance that the pace of activity remains strong in the current quarter. The volume of German industrial orders rose 5.5 percent in the second quarter, reflecting strength in both domestic and foreign orders. Euro-area economic sentiment remained at high levels through July. However, surveys of euro-area purchasing managers suggest that manufacturing activity eased a bit in July.

The harmonized unemployment rate for the euro area edged down to 9.1 percent in June, its lowest rate since July 1992. (In constructing the harmonized unemployment series, Eurostat standardizes national statistics to International Labor Organization definitions.) In France, Germany, and Italy, unemployment rates remain above the euro-area average, although they have declined noticeably over the past year. In July, the German unemployment rate edged down to 9.5 percent, after remaining flat at 9.6 percent for three months.

Euro-area consumer prices rose 2.4 percent in the twelve months to June, well above the European Central Bank's 2 percent target ceiling, but the increase primarily reflected higher energy prices. Excluding energy prices, the twelve-month inflation rate edged up to 1.3 percent. July consumer price data show that twelve-month headline inflation remained high in Germany and Italy relative to last year, and increased in France.

Euro-Area Current Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	1999	2000		2000			
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]							
Euro-area	1.5	1.2	n.a.	.6	.8	n.a.	n.a.
Germany	.8	.9	2.6	.9	2.5	-2.9	n.a.
France	1.5	.5	n.a.	-.3	.7	n.a.	n.a.
Italy	1.6	.6	1.5	-.6	2.3	-.7	n.a.
Unemployment rate[2]							
Euro-area	9.6	9.5	9.2	9.3	9.2.	9.1	n.a.
Germany	10.4	10.1	9.6	9.6	9.6	9.6	9.5
France	10.8	10.2	9.8	9.9	9.8	9.6	n.a.
Italy	11.1	11.1	10.7	...	...	...	...
Consumer prices[3]							
Euro-area[4]	1.6	2.1	2.1	1.9	1.9	2.4	n.a.
Germany	1.0	1.8	1.6	1.5	1.4	1.9	1.9
France	1.0	1.5	1.4	1.2	1.4	1.6	1.8
Italy	2.1	2.3	2.4	2.3	2.4	2.7	2.6

1. Indexes exclude construction.
2. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases. Country figures are based on national definitions.
3. Percent change from year earlier.
4. Eurostat harmonized definition.
n.a. Not available. ... Not applicable.

Euro-Area Forward-Looking Indicators
(Percent balance, s.a.)

Indicator	1999	2000		2000			
	Q4	Q1	Q2	Apr.	May	June	July
Consumer confidence[1]	-1.3	-.3	.0	0	1	-1	0
Construction confidence[2]	-3.3	.0	2.0	2	1	3	2
Industrial confidence[3]	-1.3	2.7	6.0	5	5	8	7
of which:							
Production expectations	13.7	14.7	17.0	15	16	20	19
Total orders	-8.7	-1.7	5.0	3	4	8	5
Stocks	8.3	5.0	3.3	3	4	3	4

NOTE: Diffusion indexes based on European Commission surveys in individual countries.
1. Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.
2. Averages of responses to questions on output trend and orders.
3. Averages of responses to questions on production expectations, orders, and stocks.

In the **United Kingdom**, real GDP rose a preliminary 3.6 percent (s.a.a.r) in the second quarter of 2000. Despite this apparent rebound from a modest pace of growth in the first quarter, more forward-looking indicators suggest that growth is slowing toward a rate near trend. Although business confidence picked up somewhat in July, it remains considerably below levels recorded earlier this year. In July, the outlook for new orders fell further, primarily reflecting a weaker outlook for export orders. Consumer confidence has also fallen since early this year.

The official claims-based unemployment rate fell to a 25-year low of 3.7 percent in July, and the labor force survey measure of the unemployment rate fell to 5.5 percent for the three months centered in May, a record low. However, twelve-month growth in average earnings has moderated in recent months, to 3.8 percent in June. This rate is now below the 4.5 percent rate that the Bank of England has suggested is compatible with its inflation target.

Producer input prices have risen sharply in recent months, in part reflecting higher oil prices. The twelve-month rate of retail price inflation (excluding mortgage interest rates) remains below the 2½ percent target, in large part reflecting the continued strength of sterling relative to the euro.

The Bank of England's Monetary Policy Committee (MPC) left the repo rate unchanged at 6.0 percent for the sixth month in a row in August. In its August *Inflation Report*, the MPC released its latest GDP and inflation forecasts. Under the assumption that official interest rates remain unchanged at 6 percent, GDP growth is expected to slow to around 2½ percent, near trend, for the remainder of this year and 2001, then rise towards 2¾ percent in early 2002. Inflation is projected to rise gradually from its current rate below the 2½ percent target to just above target by the end of the forecast.

U.K. Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	1999	2000		2000			
	Q4	Q1	Q2	Apr.	May	June	July
Real GDP (s.a.a.r.)	2.8	2.0	3.6	...	...	...	...
Industrial production	.1	-.8	1.4	.9	.3	.1	n.a
Retail sales	1.4	1.4	.3	.0	.3	.7	n.a
Unemployment rate[1]							
Claims-based	4.1	4.0	3.8	3.8	3.8	3.8	3.7
Labor force survey[2]	5.9	5.8	n.a	5.6	5.5	n.a	n.a
Business confidence[3]	10.7	12.7	-4.0	1.0	-6.0	-7.0	3.0
Retail prices[4]	2.2	2.1	2.1	1.9	2.0	2.2	2.2
Producer input prices[5]	9.7	12.7	11.4	7.4	12.4	14.4	11.3
Average earnings[5]	5.5	5.7	4.2	4.6	4.0	3.8	n.a

1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.
n.a. Not available. ... Not applicable.

In **Canada**, indicators suggest that growth slowed somewhat in the second quarter from the strong gains of the previous two quarters. Real GDP in April and May, on average, was up 0.7 percent from the first quarter, after rising 1.1 percent in both the first quarter and the fourth quarter of last year. Consumer spending appears to have plateaued in the second quarter, as retail activity for the April-May period was scarcely above that of the first quarter. However, surveys of consumer confidence rebounded in the second quarter, and some of the sluggishness in spending was attributed to temporary factors such as abnormally cool spring weather.

Labor market indicators are also consistent with slowing growth. Employment fell by 0.1 percent in both June and July, the first monthly declines since January 1998. As a result, the July unemployment rate rose to 6.8 percent, the first monthly increase in nearly a year. Employment growth since March has averaged only 4,000 jobs per month, down from average monthly growth of 44,000 in the preceding six months.

The twelve-month rate of consumer price inflation jumped to 2.9 percent in June from 2.4 percent in May, largely on account of higher oil prices. However, the twelve-month rate of core inflation (which excludes food and energy prices) was only 1.4 percent in June, well within the Bank of Canada's 1 percent to 3 percent target range. Wage inflation, measured by average hourly earnings, has moderated in recent months, helping to keep core price inflation steady.

Canadian Economic Indicators

(Percent change from previous period except as noted, s.a.)

Indicator	1999	2000		2000			
	Q4	Q1	Q2	Apr.	May	June	July
GDP at factor cost	1.1	1.1	n.a.	.0	.6	n.a.	n.a.
Industrial production	1.1	1.3	n.a.	.1	1.5	n.a.	n.a.
New manufacturing orders	1.7	1.0	2.0	-2.7	1.7	3.0	n.a.
Retail sales	.4	1.9	n.a.	-1.1	.4	n.a.	n.a.
Employment	.9	.9	.4	.0	.3	-.1	-.1
Unemployment rate[1]	6.9	6.8	6.7	6.8	6.6	6.6	6.8
Consumer prices[2]	2.4	2.7	2.4	2.1	2.4	2.9	n.a.
Consumer attitudes[3]	119.9	113.8	117.0	...	...	...	...
Business confidence[4]	164.9	161.9	154.3	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Level of index, 1991 = 100.
4. Level of index, 1977 = 100.

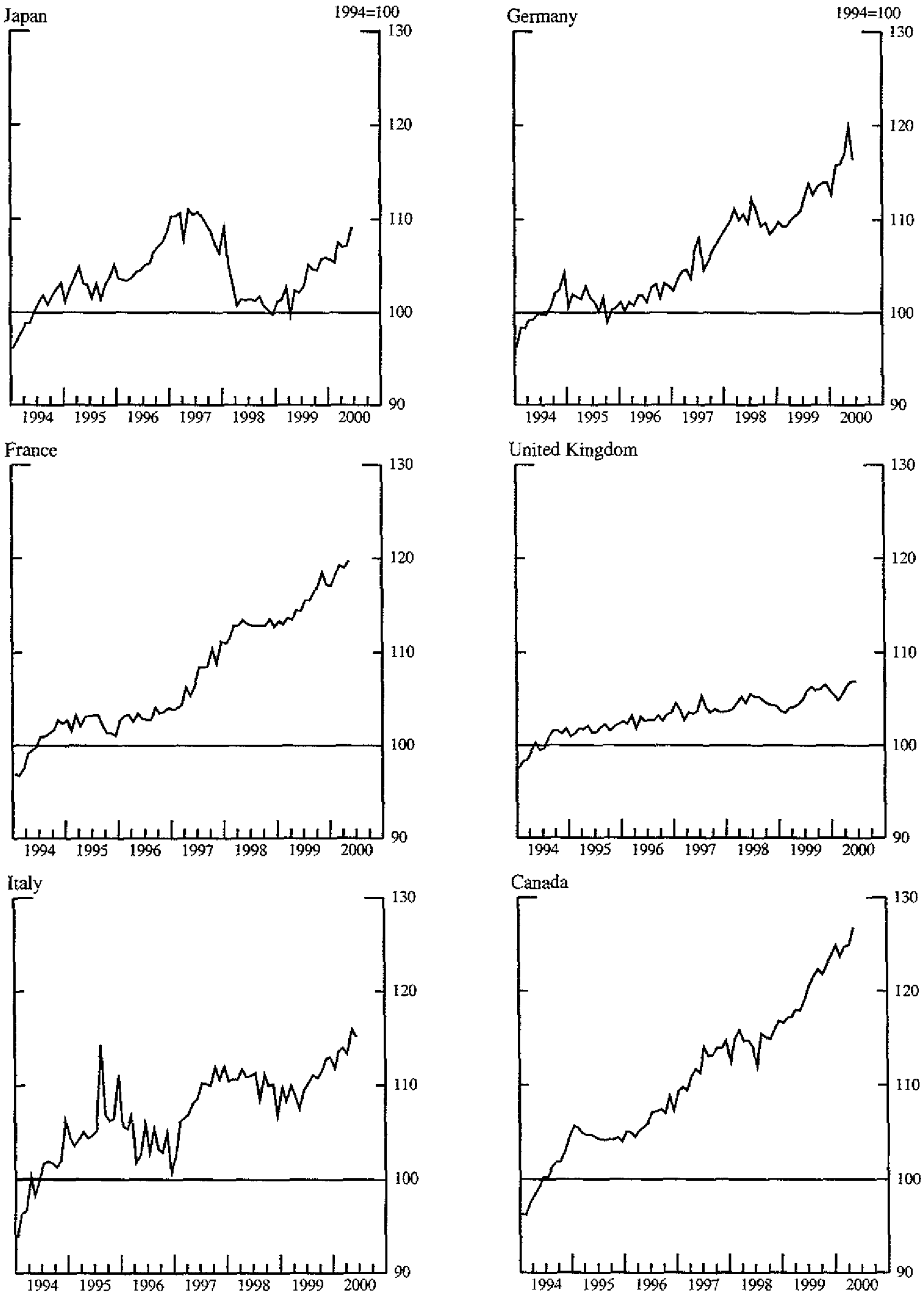
n.a. Not available. ... Not applicable.

External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	1999	2000		2000		
	Q4	Q1	Q2	Apr.	May	June
Japan						
Trade	98.1	120.1	112.5	129.0	83.2	125.3
Current account	103.5	135.4	130.4	144.9	123.7	122.6
Euro-Area						
Trade[1]	58.6	-4.7	n.a.	1.1	1.1	n.a.
Current account[1]	14.0	-32.3	n.a.	-36.4	-7.6	n.a.
Germany						
Trade	70.4	62.6	56.1	52.1	46.7	69.6
Current account	-31.6	-11.5	n.a.	...	...	...
France						
Trade	12.4	8.2	n.a.	2.7	20.5	n.a.
Current account	5.8	4.4	n.a.	2.6	6.4	n.a.
Italy						
Trade	9.5	9.4	n.a.	6.8	-10.8	n.a.
Current account[1]	-3.8	-9.0	n.a.	-7.1	-12.5	n.a.
United Kingdom						
Trade	-47.0	-42.2	n.a.	-50.0	-46.0	n.a.
Current account	-10.1	-25.7	n.a.	...	...	...
Canada						
Trade	23.7	33.5	n.a.	24.2	30.1	n.a.
Current account	-.9	13.3	n.a.	...	...	...

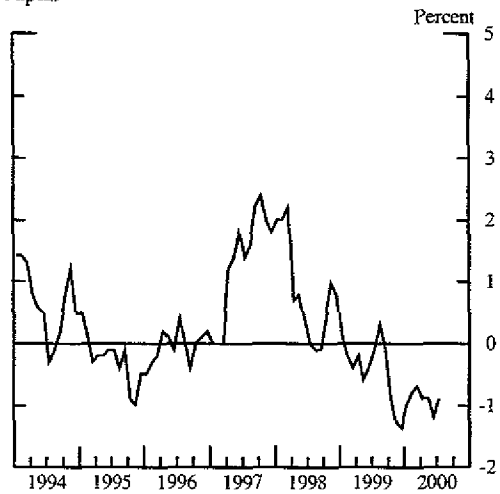
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

Industrial Production in Selected Industrial Countries

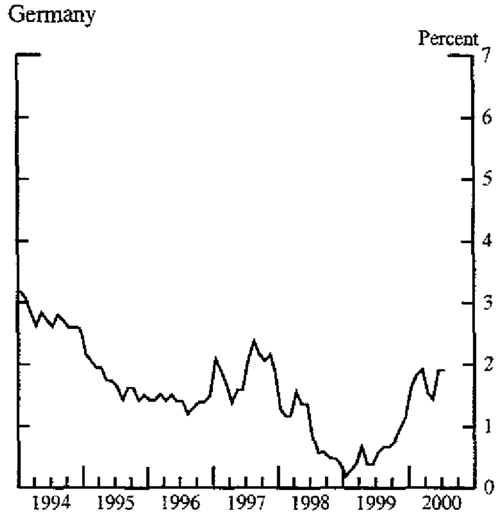


Consumer Price Inflation in Selected Industrial Countries
(12-month change)

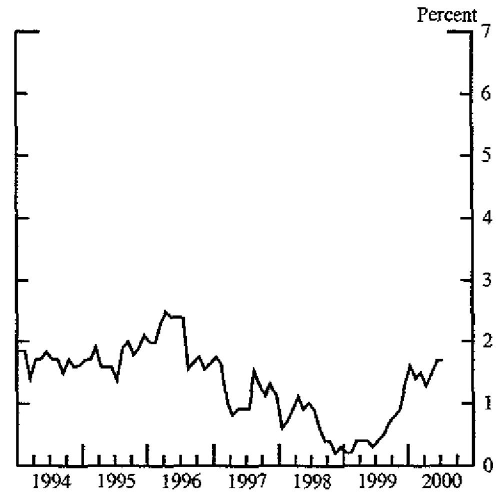
Japan



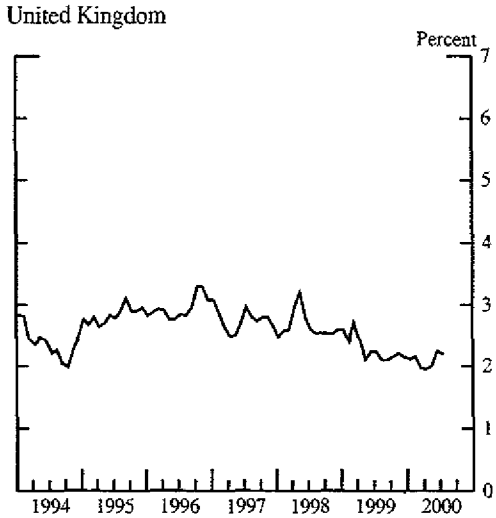
Germany



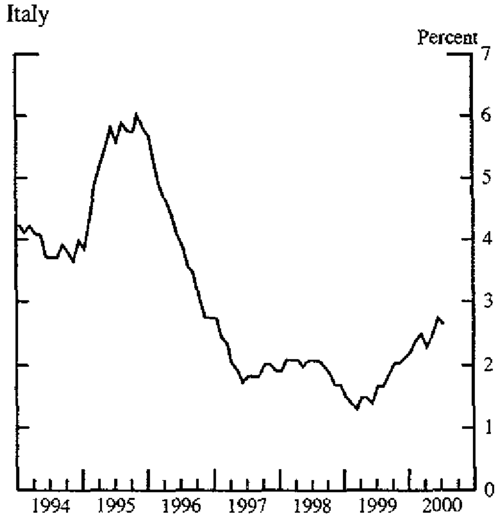
France



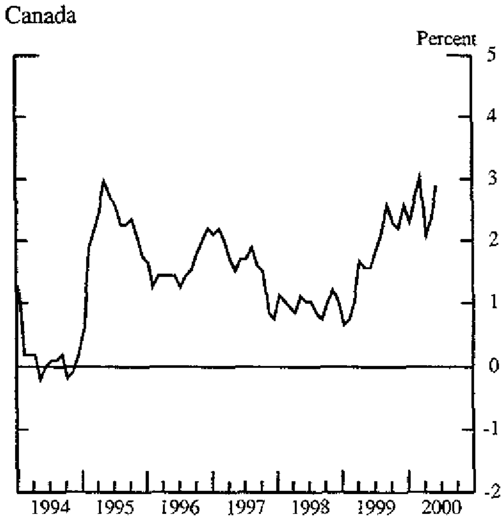
United Kingdom



Italy



Canada



Economic Situation in Other Countries

Economic conditions in the major developing countries remained generally favorable. In Mexico, growth in the second quarter slowed only a touch from the previous quarter's sizzling pace, and recent growth in Korea–although down somewhat from the double-digit rate recorded last year–has remained strong. In China, Hong Kong and Taiwan, data have indicated some payback in the second quarter for booming first-quarter growth, but the most recent monthly data suggest somewhat stronger growth going forward. Output growth in most ASEAN countries has also been strong. The leading exception to this favorable picture was Argentina, where unemployment rose and industrial production recorded a sizable decline in the second quarter.

Inflationary pressures in the developing countries were generally well contained. Inflation edged up in several countries, including Korea, in recent months, but Mexican inflation registered further declines (notwithstanding the buoyant pace of activity). Argentina and Hong Kong continued to experience deflation, while China's deflationary episode now appears to be over.

In **Mexico**, recent economic growth nearly matched the very rapid pace registered in the first quarter. GDP rose 8.7 percent (s.a.a.r.) in the second quarter, following a 11.3 percent jump in the previous quarter. Export growth has remained robust, driven largely by a booming U.S. economy, but imports have accelerated, resulting in a widening of the trade deficit in the second quarter. Notwithstanding the strong growth in demand, consumer price inflation continued to trend down.

In early July, opposition candidate Vicente Fox of the right-of-center National Action Party (PAN) achieved a landmark victory in the Mexican presidential election, ending the 71-year reign of the Institutional Revolutionary Party (PRI). The result was unexpectedly definitive and PRI officials quickly conceded defeat. The post-election situation has been orderly so far, although there are some indications of emerging dissension within the PRI. In the congressional elections, the PAN gained a large number of seats but did not win a majority in either house, raising the possibility of political wrangling during the transition in early December and the upcoming negotiations over the 2001 budget.

Mexican financial markets reacted favorably to the election results, with short-term interest rates dropping over 300 basis points in the immediate aftermath of the election. However, since late July this decline has reversed, as the Bank of Mexico has tightened monetary policy, arguing that the strength of the economy threatens to undermine its goals of holding inflation under 10 percent this year and below 8 percent next year. This is the fourth time this year that the Bank has moved to tighten monetary conditions.

Mexican Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	2.7	5.3	3.3	11.3	8.7	...	...
Industrial production	6.1	3.9	.9	2.5	2.2	2.2	n.a.
Unemployment rate[2]	3.2	2.5	2.3	2.2	2.2	2.2	n.a.
Consumer prices[3]	18.6	12.3	13.7	10.5	9.5	9.4	9.1
Trade balance[4]	-7.9	-5.4	-5.6	-6.8	-10.0	-8.2	n.a.
Imports[4]	125.4	142.1	152.2	160.8	170.9	171.8	n.a.
Exports[4]	117.5	136.7	146.6	154.0	160.8	163.6	n.a.
Current account[5]	-15.7	-14.0	-17.7	-16.8	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent; counts as unemployed those working one hour a week or less.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In July, the Mexican Finance Ministry unveiled a "financial strengthening" program for 2000-01. An important component of this program was the renewal and extension of credit lines with official and multilateral financial institutions amounting to $19.7 billion. In addition, the North American Framework Agreement, with its associated credit lines, was extended until December 2001. Among the arrangements mentioned in the package was the Federal Reserve's $3 billion swap line with the Bank of Mexico, which in May the FOMC had extended until December 2001. Other elements of the program included efforts to reduce public external debt and debt-servicing costs over the next three years and the decision to treat the current stand-by arrangement with the IMF as only a "precautionary arrangement."

In **Brazil,** data released since the June Greenbook indicate a slowing in the pace of growth, particularly in the industrial sector. Real GDP growth fell below 1 percent (s.a.a.r.) in the second quarter from 5 percent in the first quarter. Monthly consumer price inflation rose to 1.6 percent in July from very low rates in recent months, pushed up, in part, by drought and rising fuel prices. External performance has continued to be disappointing, with small trade deficits since March, after surpluses earlier this year. Export growth has been rapid–exports were up 20 percent in July relative to July 1999–but this expansion has been more than offset by import growth.

In mid-July, the Brazilian central bank reduced its overnight interest rate 100 basis points in two steps to 16.5 percent. These moves were motivated by prior signs of falling inflation and slowing output growth in recent months. In mid-August, the Brazilian government issued over $5 billion in 40-year global bonds (callable in 15 years) that were exchanged for a similar amount of Brady bonds. With this swap, Brazil retired about one-sixth of its Brady debt.

Brazilian Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	-2.0	3.8	9.4	5.0	.9	...	...
Industrial production	-2.0	-.7	4.0	1.2	.1	1.9	n.a.
Unemployment rate[2]	7.6	7.6	8.0	7.6	7.2	6.9	n.a.
Consumer prices[3]	1.7	8.9	8.4	7.9	6.6	6.5	7.0
Trade balance[4]	-6.6	-1.2	2.6	1.9	-.9	-1.2	-1.0
Current account[5]	-33.8	-24.4	-30.3	-16.2	-28.2	-35.1	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

The Brazilian government continues to record sizable primary (non-interest) surpluses, achieving a primary surplus of 4.7 percent of GDP over the January-May period. This result is well above the fiscal target in Brazil's IMF program. In early August, the Brazilian government announced that it would lower its target for the primary surplus in 2001 by ½ percentage point to 3 percent of GDP, and set a primary surplus target of 2.7 percent of GDP for 2002.

In **Argentina**, data continue to point to an anemic recovery at best. GDP grew 2½ percent (s.a.a.r.), on average, during the fourth quarter of 1999 and the first quarter of 2000, but indicators for the second quarter looked weak. Industrial production fell almost 5 percent, consumer prices dropped more than 1 percent below their year-earlier level, and the unemployment rate for May jumped to 14.5 percent. One hopeful sign has been the trade balance, which was positive in the second quarter, as export growth remained strong. The scant information for the third quarter has not been favorable–tax receipts were lackluster in July and there was little change in the rate of deflation. Financial market conditions have been unsettled, reflecting investor concerns over the slow recovery. Brady and EMBI+ spreads have edged up slightly since the last Greenbook, domestic short-term rates have edged down, and the stock market is basically unchanged.

Argentine Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	-.6	-.3	6.6	-1.5	n.a.	...	...
Industrial production	1.5	-6.9	4.9	1.2	-4.8	-5.8	n.a.
Unemployment rate[2]	12.9	13.8	13.8	...	14.5	...	...
Consumer prices[3]	.7	-1.8	-1.7	-1.3	-1.1	-1.2	-1.0
Trade balance[4]	-3.1	-.8	-.2	1.3	.8	.7	n.a.
Current account[5]	-14.3	-12.2	-13.3	n.a.	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May, August, and October, only. Figures for Q1 and Q4 reflect data for May and October, respectively.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

Recent data hint that recovery in **Venezuela** is taking hold. The government reported a 10 percent increase in manufacturing output over the year ending in May, and retail sales for May also grew notably from a year earlier. Inflation continues to fall. Going forward, however, inflationary pressures may be mounting as government spending is now soaring and the Central Bank is keeping interest rates relatively low. On the political front, elections for president and most national offices were held at the end of July. President Chavez won reelection with 60 percent of the vote, ensuring him another six years in office. Chavez's political control was enhanced further as his supporters won a majority of the seats in Congress. Spreads on external debt obligations have fallen somewhat since the elections, but uncertainty about Chavez's economic policies continues to unsettle investors. Despite the inflow of oil revenues, foreign currency reserves have risen only slightly this year, indicating sizable capital flight.

Venezuelan Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	-4.9	-4.5	1.5	4.4	n.a.	...	...
Unemployment rate[2]	11.2	15.2	14.5	15.3	n.a.	n.a.	n.a.
Consumer prices[3]	29.9	20.0	20.1	18.2	16.9	16.5	15.8
Non-oil trade balance[4]	-9.4	-7.5	-7 1	-8.7	n.a.	n.a.	n.a.
Trade balance[4]	2.7	9.2	12.9	19.9	n.a.	n.a.	n.a.
Current account[5]	-2.6	5.4	12.0	14.0	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Korea**, recent data suggest continued growth, but at a rate below the torrid pace of last year. Industrial production recorded its second consecutive strong increase in June, but this gain followed three months of declines. For the second quarter as a whole, industrial production increased only 1 percent. The unemployment rate edged down again in June. The inflation rate moved up further, to nearly 3 percent in July. Bank of Korea Governor Chon has indicated that preventing a build-up in inflation will be the Bank's top priority for the remainder of this year.

Earlier this month, President Kim Dae-jung announced a major reshuffling of his cabinet that involved replacing the finance and budget ministers and the head of the Financial Supervisory Commission. The president indicated that he wants to use the second half of his term to intensify the push for economic restructuring and financial reform. The cabinet changes appear consistent with this pledge, especially as the new appointments are technocrats rather than politicians.

Korean Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	-4.6	14.0	11.7	7.3	n.a.	...	...
Industrial production	-6.5	24.2	7.0	2.3	1.0	2.5	n.a.
Unemployment rate[2]	6.8	6.3	4.8	4.4	3.9	3.8	n.a.
Consumer prices[3]	4.0	1.4	1.3	1.5	1.4	2.2	2.9
Trade balance[4]	41.9	28.5	23.7	16.3	13.5	20.8	n.a.
Current account[5]	40.6	24.5	22.7	6.7	10.9	17.6	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year earlier, except annual changes, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

Economic conditions remain favorable across the **ASEAN** region. Second-quarter GDP rose over 10 percent (s.a.a.r.) in both Indonesia and Singapore, and Malaysia registered a healthy increase in second-quarter industrial production. Available data also show some signs of a pickup in the Philippines, following weak performance in the first quarter. Although strong exports remain the engine behind much of the growth in the region, consumption indicators point to continued recovery in domestic demand. Likewise, second quarter trade surpluses declined in much of the region, as growth in imports began to outpace growth in exports.

Indonesia saw a jump in inflation during the June-July period, as the rupiah weakened, but prices increased much more moderately in the rest of the ASEAN region.

The economic outlook in Thailand appears somewhat weaker than in the rest of the region. Recent industrial production, export, and import figures all have registered slight declines, and consumer confidence indices have also fallen in recent months. At the same time, political risks have heightened as parliamentary elections approach.

In contrast, the political outlook in Indonesia has improved, as fears that the president might be removed at the annual meeting of the People's Consultative Assembly (August 7-18) have subsided. In response to criticisms regarding the lack of leadership among the current economic policy team, President Wahid announced a series of changes. He has accepted the resignation of the current economics minister; he plans to hand over some of the day-to-day operations of the government to his vice president; and he intends to reshuffle the cabinet. The government also signed a new letter of intent with the IMF, paving the way for the release of the third $400 million disbursement under its three-year, $5 billion program.

ASEAN Economic Indicators: Growth
(Percent change from previous period, s.a., except as noted)

Indicator and country	1998	1999	1999	2000			
			Q4	Q1	Q2	May	June
Real GDP[1]							
Indonesia	-17.5	5.1	.7	15.1	10.7	...	...
Malaysia	-10.8	10.8	9.2	19.8	n.a.	...	...
Philippines	-2.0	5.1	3.1	.2	n.a.	...	...
Singapore	-1.2	7.0	4.7	15.3	11.1	...	...
Thailand	-7.1	6.8	4.4	6.0	n.a.	...	...
Industrial production							
Indonesia	-13.3	24.5	3.9	n.a.	n.a.	...	...
Malaysia	-7.2	9.1	3.5	7.0	3.8	3.0	2.0
Philippines	-11.6	3.4	-.7	3.7	n.a.	12.4	n.a.
Singapore	-.3	13.9	1.5	3.9	5.9	16.0	-4.4
Thailand	-10.0	12.5	3.0	-4.2	-.7	-.1	-.3

1 Annual rate. Annual figures are Q4/Q4.
n.a. Not available. ... Not applicable.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars, s.a.a.r.)

Country	1998	1999	1999	2000			
			Q4	Q1	Q2	May	June
Indonesia	21.5	24.7	29.0	32.8	31.3	28.9	32.3
Malaysia	15.0	18.9	20.2	18.7	13.9	13.7	14.9
Philippines	-.2	4.3	6.7	3.4	6.9	6.8	10.4
Singapore	8.3	3.6	5.6	5.9	-1.6	6.7	-7.3
Thailand	12.2	9.3	6.3	6.5	7.2	6.0	4.8

ASEAN Economic Indicators: CPI Inflation
(Percent change from year earlier, except as noted)

Country	1998[1]	1999[1]	1999	2000			
			Q4	Q1	Q2	June	July
Indonesia	77.5	2.0	1.7	-.5	1.2	2.1	4.6
Malaysia	5.3	2.5	2.1	1.5	1.4	1.3	1.4
Philippines	10.3	4.3	4.5	3.0	3.9	3.9	4.2
Singapore	-1.5	.9	.8	1.1	.8	.8	n.a.
Thailand	4.3	.7	.1	.8	1.6	2.0	2.0

1. December/December.
n.a. Not available.

In **China**, real GDP rose 1.9 percent (s.a.a.r.) in the second quarter, far slower than the near double-digit pace of the first quarter, but in line with staff expectations. This decline in growth largely appears to reflect temporary factors, including distortions caused by statistical inadequacies in accounting for the leap year and unusually long holiday celebrations. The waning effect of the fiscal package introduced late last year, as well as flat exports following the remarkable surge in the first quarter, also contributed to the more modest pace of expansion. Retail sales figures, however, suggest that consumer demand continued to recover, especially in urban areas. Consumer prices continued to edge up on a twelve-month basis, in part due to higher oil prices. The monthly trade surplus narrowed slightly in June and July, as imports rose and exports were roughly flat.

Chinese Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	9.5	6.2	10.6	9.6	1.9	...	...
Industrial production[2]	7.8	9.6	8.8	14.2	14.5	15.3	n.a.
Consumer prices[2]	-1.0	-1.0	-.8	.1	.1	.5	.5
Trade balance[3]	43.5	29.2	43.7	13.8	30.3	25.4	21.2

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual figures are Q4/Q4.
2. Percent change from year earlier.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In July, China's minister of finance confirmed that the government will boost public spending in the second half of this year to shore up domestic demand. The bulk of the extra spending has been earmarked for public investment projects, especially in the underdeveloped western provinces, and technological upgrades for state enterprises. Also in July, Central Bank Governor Dai announced a three-year plan for liberalizing interest rates. Beginning later this year, controls on foreign-exchange lending and deposit rates will be phased out, followed by the easing of controls on local currency lending rates. Lastly, local-currency deposit rates will become market-determined.

In **Hong Kong**, recent data suggested that economic growth in the second quarter slowed from the extraordinarily strong rate in the first quarter. Retail sales volume fell slightly (s.a.) in both April and May, depressed in part by higher interest rates and negative wealth effects associated with weakness in Hong Kong's stock market. Exports declined about 1 percent (s.a.) in the second quarter, largely reflecting reduced trade flows with mainland China. Nonetheless, strong employment gains pushed the unemployment rate down to 5 percent (s.a.) in the May-July period from 5.5 percent earlier in the year. The property market remained weak, with real estate prices and the number of transactions continuing to decline, despite the government's recent announcement that it would reduce the supply of subsidized apartments for sale. With falling property prices continuing to weigh on the rents and housing component of the CPI, the index edged down further in May and June on a seasonally adjusted basis.

Hong Kong Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	-5.8	9.1	16.1	23.4	n.a.	...	...
Unemployment rate[2]	4.4	6.1	6.0	5.5	5.0	5.0	5.0
Consumer prices[3]	-1.6	-4.0	-4.1	-5.1	-4.5	-4.5	n.a.
Trade balance[4]	-10.6	-5.6	-8.2	-7.7	-8.9	-10.4	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Monthly numbers are averages of the current and previous two months.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In **Taiwan**, real GDP rose 2.8 percent (s.a.a.r.) in the second quarter, far below the rapid first-quarter pace. The slower rate of growth in the second quarter was widely expected, given the sharp drop in industrial output in April, following several months of rapid expansion. In June, however, industrial output rebounded strongly, rising a seasonally adjusted 3.4 percent. Robust demand, especially from the United States, for electronics and information technology products in June and July boosted exports to record levels, although rapidly rising imports caused the trade surplus to narrow sharply. Despite higher oil prices, the 12-month rate of inflation remained very low, partly reflecting a steep fall in food prices. In late June, Taiwan's central bank raised its rediscount rate to 4.75 percent from 4.625 percent, the second such increase in recent months. In announcing the rise, the central bank noted widening spreads between interest rates in Taiwan and those in the United States and Europe, and indicated that the decision was taken to "prevent inflation from happening and maintain financial stability."

Taiwan Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	1999	2000			
			Q4	Q1	Q2	June	July
Real GDP[1]	3.3	6.4	10.6	11.8	2.8	...	...
Unemployment rate[2]	2.7	2.9	2.9	2.9	2.9	2.9	n.a.
Industrial production	2.6	7.7	4.3	3.1	1.9	3.4	n.a.
Consumer prices[3]	2.1	.1	-.1	.9	1.4	1.4	1.5
Trade balance[4]	5.9	10.9	8.6	8.8	6.1	12.2	1.2
Current account[5]	3.4	5.8	5.7	1.9	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.