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January 28, 2000

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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## Supplemental Notes

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### The Domestic Nonfinancial Economy

#### Gross Domestic Product (1999:Q4, advance estimate)

According to BEA's advance release, real GDP rose at an annual rate of 5.8 percent in the fourth quarter of 1999 after having increased at a 5.7 percent rate in the third quarter. Final sales rose at an annual rate of 4.6 percent in the fourth quarter--also similar to the pace in the preceding quarter. The change in private inventories contributed more than 1 percentage point to the change in real GDP for the second consecutive quarter; the fourth-quarter figure is based on BEA's assumption that manufacturing and trade inventory investment in December ran close to the substantial average pace of accumulation currently shown in the Census Bureau's data for October and November.

Among the components of final sales, real PCE posted a further sizable gain in the fourth quarter, rising at an annual rate of 5.3 percent, and the personal saving rate moved down 0.2 percentage point to 1.9 percent. Real federal government purchases accelerated sharply, to a 16 percent rate, because of a surge in defense outlays.<sup>1</sup> In contrast, business spending on equipment and software slowed to an annual rate of about a 5 percent, with decelerations in all of its major components. Spending on structures--both residential and nonresidential--slipped further in the fourth quarter. Finally, real exports and imports both decelerated in the fourth quarter; on balance, net exports held down the rise in real GDP roughly 3/4 percentage point--about the same as in the third quarter.

The chain-weighted price index for GDP rose at an annual rate of 2 percent last quarter after an increase of 1.1 percent in the third quarter. The pickup in GDP price inflation reflected larger increases in the price indexes for most of the major categories of private final sales.

The figure reported today for fourth-quarter GDP growth was about 1/2 percentage point above the January Greenbook projection. The BEA's estimates for inventory investment and federal government spending both were a good deal higher than the Greenbook projections. As noted above, the disparity in the inventory numbers involves some important assumptions regarding missing data. In the case of federal purchases, the BEA simply translated the jump in vendor payments into purchases, without making any judgment about the degree to which that jump might have reflected financial transactions

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1. The jump in the BEA's estimate of defense spending appears to be based in part on the sharp increase in payments to defense vendors during December that may have been related to Y2K concerns. Vendor payments dropped below trend in early January--a pattern consistent with an acceleration of payments before year-end.

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## Real Gross Domestic Product and Related Items

(Percent change from previous period at compound annual rates;  
based on seasonally adjusted data, chain-type indexes)

	1999:Q2	1999:Q3	1999:Q4
	Final	Final	Advance
1. Gross domestic product	1.9	5.7	5.8
2. Final sales	3.4	4.5	4.6
3. Consumer spending	5.1	4.9	5.3
4. Durables	9.1	7.7	11.8
5. Nondurables	3.3	3.6	6.1
6. Services	5.2	5.0	3.5
7. Business fixed investment	7.0	10.9	2.5
8. Equipment and software	11.2	15.7	4.9
9. Nonresidential structures	-5.3	-3.8	-5.3
10. Residential investment	5.5	-3.8	-1.2
11. Federal government consumption expenditures and investment	2.1	4.1	16.0
12. State and Local government consumption expenditures and investment	.9	4.8	4.4
13. Exports of goods and services	4.0	11.5	6.9
14. Imports of goods and services	14.4	14.9	10.6
<hr/>			
<i>ADDENDA:</i>			
15. Nonfarm inventory investment <sup>1</sup>	13.1	41.2	71.4
16. Motor vehicles <sup>1</sup>	1.3	12.7	15.6
17. Excl. motor vehicles <sup>1</sup>	11.8	28.5	55.8
18. Net exports of goods and services <sup>1</sup>	-319.0	-338.2	-356.1
19. Nominal GDP	3.3	6.8	7.9
20. GDP price index	1.3	1.1	2.0
21. Profit share <sup>2</sup>	9.6	9.5	n.a.
22. (Excluding FR banks)	9.3	9.2	n.a.
23. Real disposable personal income	3.2	2.9	4.6
24. Personal saving rate (percent)	2.5	2.1	1.9

1 Level, billions of chained (1996) dollars.

2 Economic profits as a share of nominal GNP.

BROAD MEASURES OF INFLATION  
(Four-quarter percent change)

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	1996 Q4	1997 Q4	1998 Q4	1999 Q4
<hr/>				
<u>Product prices</u>				
GDP chain price index	1.7	1.6	1.1	1.6
Nonfarm business chain price index <sup>1</sup>	1.5	1.5	0.4	1.4
 <u>Expenditure prices</u>				
Gross domestic purchases chain price index	1.7	1.1	0.7	1.9
Less food and energy	1.3	1.3	1.1	1.5
PCE chain price index	2.2	1.3	1.0	2.0
Less food and energy	1.6	1.4	1.4	1.5
CPI	3.1	1.9	1.5	2.6
Less food and energy	2.6	2.2	2.4	2.1
Median CPI	2.9	2.9	3.0	2.2
Trimmed mean CPI	2.9	2.2	1.9	1.9

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1. Excluding housing.

(accelerated payments) rather than actual deliveries. The differences in the estimates of inventory change and defense spending were offset to some extent by lower-than-anticipated figures for business fixed investment, residential investment, and net exports. The increase in the GDP price index was almost 1/2 percentage point above our projection; the difference is largely attributable to lower-than-expected prices for imports and higher-than-expected prices for computers and software. The data in the advance release for fourth-quarter GDP also imply that productivity in the nonfarm business sector rose at an annual rate of about 4-3/4 percent last quarter--and 3-1/4 percent over the four quarters of 1999.

### **Employment Cost Index**

The Employment cost index for hourly compensation of private industry workers increased at an annual rate of 4.3 percent in the three months ending in December, up from the 3.4 percent increase posted in the preceding quarter. The wage and salary component of compensation rose at an annual rate of 4.0 percent, while benefit costs were up at a 5.5 percent rate. Over the twelve months of 1999, hourly compensation increased 3.4 percent, about the same as during 1998. (Excluding sales occupations, ECI compensation rose 3.7 percent over the twelve months ending in December, compared with a 3.1 percent increase over the preceding year.) At 3.4 percent, ECI wage inflation was 0.4 percentage point lower in 1999 than in 1998, but benefit costs accelerated 1 percentage point, rising at the same pace as wages in 1999.

Benefit detail--other than that for health insurance--is unpublished and is provided to us by the BLS on a confidential basis. Health insurance costs rose 5.8 percent over 1999, up from a 2.5 percent increase over the preceding twelve-month period. Employer costs for workers compensation fell 0.7 percent over 1999, but this rate of decline was much slower than that seen in 1998, when these costs dropped 5.3 percent. Elsewhere, nonproduction bonuses provided a rare exception to the general pattern of benefit cost acceleration: After having risen 6.2 percent during 1998, nonproduction bonuses declined 7.6 percent during 1999.<sup>2</sup>

Compensation in manufacturing, retail trade, and services (particularly for health-service workers) accelerated in 1999, but this was offset by a deceleration in finance, insurance, and real estate (FIRE) and in transportation and public utilities. By occupation, a sharp deceleration in the compensation of sales workers over the course of 1999 offset more rapid increases in compensation for

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2. In this release, BLS announced that the definition of nonproduction bonuses will be expanded beginning in June of this year to include hiring and referral bonuses.

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION  
FOR PRIVATE INDUSTRY WORKERS

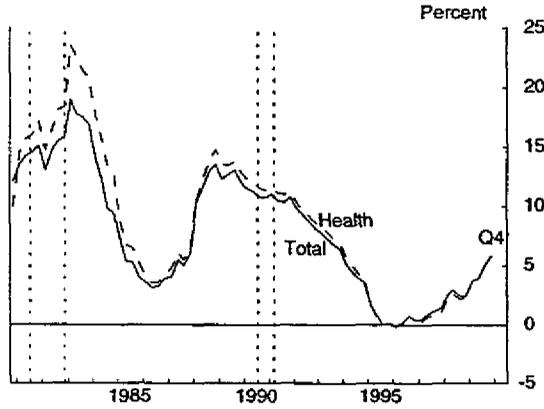
	1998	1999			
	Dec.	Mar.	June	Sept.	Dec.
-----Quarterly percent change----- (Compound annual rate)					
Total hourly compensation <sup>1</sup>	2.9	1.4	4.6	3.4	4.3
Wages and salaries	3.0	1.8	5.0	3.2	4.0
Benefit costs	2.8	0.8	3.9	3.6	5.5
By industry					
Construction	4.9	3.9	2.1	2.7	4.4
Manufacturing	2.3	2.6	2.6	3.7	4.6
Trans., comm., and public utilities	2.9	0.0	4.4	2.3	2.0
Wholesale trade	6.7	-1.4	5.1	5.4	7.0
Retail trade	0.9	3.0	6.3	1.7	4.1
FIRE	4.3	-2.8	12.7	5.0	1.9
Services	3.1	2.0	3.4	3.6	4.7
By occupation					
White collar	3.7	0.0	5.2	3.9	4.8
Blue collar	3.0	2.7	3.3	3.5	4.1
Service occupations	2.1	4.4	3.8	0.3	4.6
Memo:					
State and local governments	2.9	2.6	3.2	3.1	4.6
-----Twelve-month percent change-----					
Total hourly compensation	3.5	3.0	3.3	3.1	3.4
Excluding sales workers	3.1	3.0	3.2	3.2	3.7
Wages and salaries	3.9	3.3	3.6	3.2	3.5
Excluding sales workers	3.4	3.4	3.6	3.3	3.7
Benefit costs	2.4	2.2	2.5	2.8	3.4
By industry					
Construction	3.5	3.8	3.2	3.4	3.3
Manufacturing	2.7	2.6	2.7	2.8	3.4
Trans., comm., and public utilities	3.8	2.9	2.8	2.4	2.2
Wholesale trade	5.7	3.6	4.3	3.9	4.0
Retail trade	3.0	2.8	3.5	3.0	3.8
FIRE	5.9	3.5	5.3	4.7	4.1
Services	3.0	3.0	3.1	3.0	3.4
By occupation					
White collar	3.9	3.1	3.4	3.2	3.5
Sales	6.8	3.2	3.9	2.6	1.9
Nonsales	3.3	3.0	3.3	3.3	3.8
Blue collar	2.7	2.9	2.9	3.1	3.4
Service occupations	2.9	3.1	3.4	2.7	3.3
Memo:					
State and local governments	3.0	2.9	3.0	2.9	3.4

1. Seasonally adjusted by the BLS.

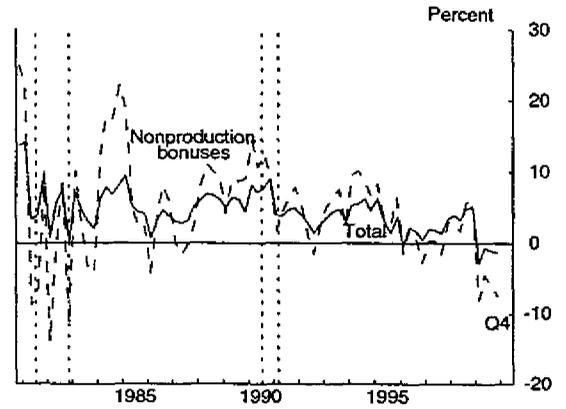
# Components of ECI Benefits Costs (CONFIDENTIAL)

(Private industry workers; twelve-month change)

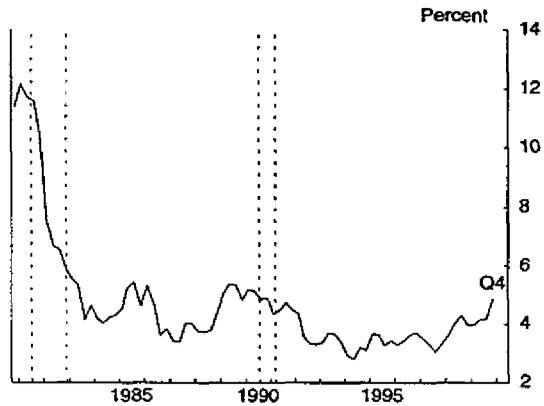
### Insurance Costs



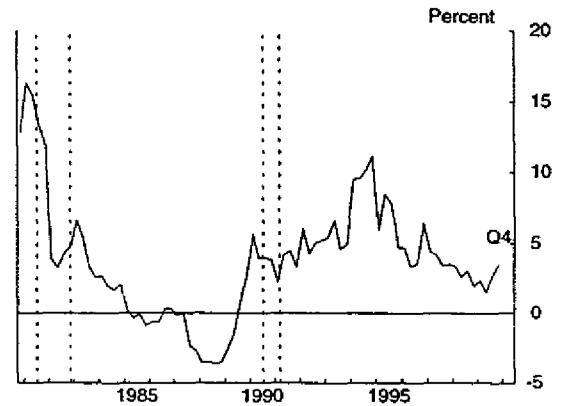
### Supplemental Pay



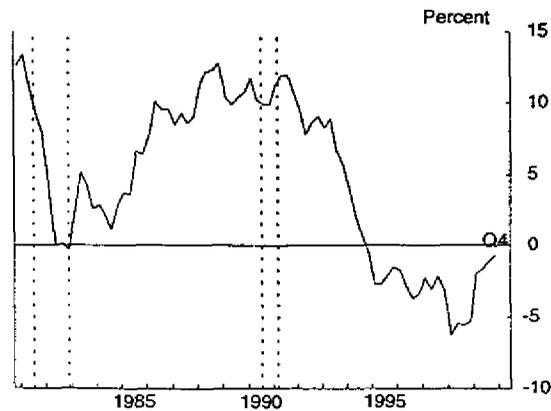
### Paid Leave



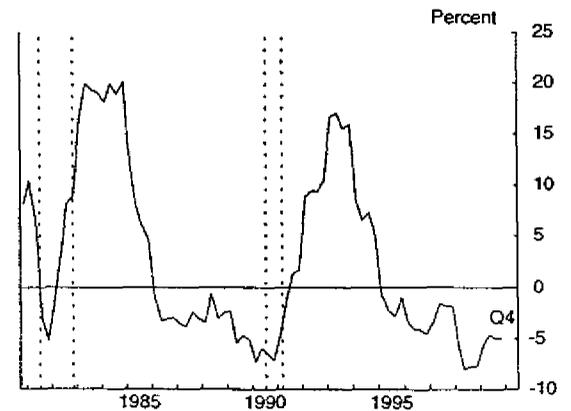
### Retirement and Savings



### Workers' Compensation Insurance



### State Unemployment Insurance



Note. Unpublished and confidential ECI benefits detail.

other white-collar workers and for blue-collar and service workers. For white-collar occupations, the acceleration in the compensation of non-sales workers was concentrated in executive, administrative, and managerial occupations; among blue-collar and service occupations, the pickup was more broad-based.

### **Consumer Sentiment**

According to the final report, the Michigan Survey Research Center index of consumer sentiment shot up 6-1/2 points in January to a record level. Looking at prospects for the coming year, consumers in January were even more optimistic about their own personal financial situations and about general business conditions than they were during 1999. In addition, survey respondents have never before expressed such favorable expectations for business conditions over the next five years. Appraisals of buying conditions for large household appliances also bounced back in January, and assessments of current financial situations moved slightly above last month's favorable level.

Most of the questions not included in the overall index recorded modest changes in January. Appraisals of buying conditions for cars rose a little this month, while appraisals of home buying conditions slipped a bit. Views on buying conditions for both of these big-ticket items, although still reasonably positive, were in the lower end of the ranges posted over the past two years. The index of expected unemployment change ticked down in January, indicating that respondents continue to hold a very favorable outlook for labor market conditions. One area in which responses from households changed noticeably in January was in their willingness to use savings to finance a major purchase: This index surged to the highest level recorded since mid-summer and to the second highest reading in the 16 years that the question has been included in the survey.

The mean of expected inflation over the next year ticked down 0.1 percentage point to 3.5 percent in January, and the median of expected inflation was unchanged at 3.0 percent. Looking five years ahead, the mean of expected inflation increased 0.3 percentage point to 3.5 percent, while the median rose 0.1 percentage point to 3.0 percent.

UNIVERSITY OF MICHIGAN SURVEY RESEARCH CENTER: SURVEY OF CONSUMER ATTITUDES  
(Not seasonally adjusted)

	1999 May	1999 June	1999 July	1999 Aug.	1999 Sept.	1999 Oct.	1999 Nov.	1999 Dec.	2000 Jan. (f)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	106.8	107.3	106.0	104.5	107.2	103.2	107.2	105.4	112.0
Current conditions	121.1	118.9	116.5	114.1	115.9	112.7	116.8	112.2	117.3
Expected conditions	97.6	99.8	99.2	98.4	101.5	97.1	101.0	101.1	108.6
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Personal financial situation									
Now compared with 12 months ago*	133	133	132	132	132	127	138	133	135
Expected in 12 months*	135	133	135	139	135	133	138	132	141
Expected business conditions									
Next 12 months*	144	147	147	140	150	140	146	150	165
Next 5 years*	114	122	118	118	124	118	123	125	133
Appraisal of buying conditions									
Cars	151	150	153	148	145	146	148	141	144
Large household appliances*	182	176	171	165	169	166	166	158	169
Houses	171	168	167	153	149	149	156	154	152
Willingness to use credit	52	53	49	50	47	48	50	50	51
Willingness to use savings	75	88	73	65	62	59	68	70	85
Expected unemployment change - next 12 months	110	102	109	113	110	112	111	105	104
Prob. household will lose a job - next 5 years	22	20	24	21	20	20	21	19	18
Expected inflation - next 12 months									
Mean	3.2	3.1	3.0	3.2	3.2	3.5	3.3	3.6	3.5
Median	2.8	2.5	2.7	2.8	2.7	2.9	2.9	3.0	3.0
Expected inflation - next 5 to 10 years									
Mean	3.5	3.3	3.3	3.3	3.5	3.2	3.5	3.2	3.5
Median	2.9	2.8	2.9	2.8	2.9	2.8	2.9	2.9	3.0

\* -- Indicates the question is one of the five equally-weighted components of the index of sentiment.

(p) -- Preliminary

(f) -- Final

Note: Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

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

Instrument	1999			2000	Change to Jan. 27 from selected dates (percentage points)		
	June 29	Dec. 31	FOMC* Dec. 21	Jan. 27	1999 June 29	1999 Dec. 31	FOMC* Dec. 21
<i>Short-term</i>							
FOMC intended federal funds rate	4.75	5.50	5.50	5.50	.75	.00	.00
<i>Treasury bills</i> <sup>1</sup>							
3-month	4.70	5.17	5.39	5.42	.72	.25	.03
6-month	4.92	5.49	5.60	5.54	.62	.05	-.06
1-year	4.89	5.63	5.64	5.79	.90	.16	.15
<i>Commercial paper</i>							
1-month	5.18	5.13	6.30	5.64	.46	.51	-.66
3-month	5.12	5.75	5.93	5.82	.70	.07	-.11
<i>Large negotiable CDs</i> <sup>1</sup>							
1-month	5.21	5.72	6.47	5.80	.59	.08	-.67
3-month	5.32	5.90	6.17	5.94	.62	.04	-.23
6-month	5.43	6.08	6.15	6.14	.71	.06	-.01
<i>Eurodollar deposits</i> <sup>2</sup>							
1-month	5.13	5.69	6.38	5.69	.56	.00	-.69
3-month	5.25	5.88	6.13	5.94	.69	.06	-.19
Bank prime rate	7.75	8.50	8.50	8.50	.75	.00	.00
<i>Intermediate- and long-term</i>							
<i>U.S. Treasury (constant maturity)</i>							
2-year	5.68	6.24	6.21	6.51	.83	.27	.30
10-year	5.93	6.45	6.36	6.68	.75	.23	.32
30-year	6.07	6.48	6.44	6.53	.46	.05	.09
U.S. Treasury 10-year indexed note	4.01	4.33	4.31	4.32	.31	-.01	.01
Municipal revenue (Bond Buyer) <sup>3</sup>	5.62	6.23	6.17	6.34	.72	.11	.17
Corporate bonds, Moody's seasoned Baa	8.05	8.18	8.27	8.23	.18	.05	-.04
High-yield corporate <sup>4</sup>	10.53	10.94	10.95	11.09	.56	.15	.14
<i>Home mortgages (FHLMC survey rate)<sup>5</sup></i>							
30-year fixed	7.63	8.06	7.86	8.26	.63	.20	.40
1-year adjustable	5.93	6.56	6.49	6.56	.63	.00	.07

Stock exchange index	Record high		1999		2000	Change to Jan. 27 from selected dates (percent)		
	Level	Date	Dec. 31	FOMC* Dec. 21	Jan. 27	Record high	Dec. 31	FOMC* Dec. 21
Dow-Jones Industrial	11,723	1-14-00	11,497	11,144	11,028	-5.93	-4.08	-1.04
S&P 500 Composite	1,469	12-31-99	1,469	1,418	1,399	-4.81	-4.81	-1.38
Nasdaq (OTC)	4,235	1-21-00	4,069	3,784	4,040	-4.62	-.73	6.76
Russell 2000	534	1-21-00	505	467	517	-3.17	2.43	10.67
Wilshire 5000	13,813	12-31-99	13,813	13,249	13,396	-3.02	-3.02	1.11

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 December 20, 1999.