Prefatory Note

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Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 3/16/2011.

Confidential (FR) Class III FOMC

Part 2

September 29, 1999

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

September 29, 1999

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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DOMESTIC NONFINANCIAL DEVELOPMENTS

Domestic Nonfinancial Developments

Overview

Recent data have reaffirmed the strong uptrend in U.S. economic activity. Payrolls have risen rapidly, and the growth in aggregate hours worked has picked up. Although residential construction may have topped out, expenditures on producers' durable equipment and personal consumption expenditures continue to provide substantial impetus to growth in domestic spending. At the same time, although prices of oil and a variety of other industrial commodities have continued to post significant increases, "core" consumer inflation has remained modest.

Labor Market Developments

Private nonfarm payrolls rose an average of 182,000 a month in July and August, about in line with the average monthly gains during the first half of the year. Job gains in the private services-producing sector remained robust through August, but goods-producing payrolls were held down by a 63,000 drop in manufacturing employment that more than reversed July's surprising uptick. Averaging through the recent fluctuations, employment losses in manufacturing appear to have moderated of late, with sizable losses in the first half of the year giving way to declines averaging a more modest 6,000 per month in July and August. Employment in the construction sector seems to be decelerating; the number of construction jobs fell 29,000 in August after gains in June and July that were somewhat smaller than those recorded earlier this year.

Average weekly hours of production or nonsupervisory workers on private nonfarm payrolls edged up 0.1 hour in August to 34.6 hours. The index of hours of production or nonsupervisory workers rose 0.1 percent; cumulating this slight increase with some substantial gains in earlier months, this series stands 0.8 percent above the second-quarter average (not at an annual rate). And with hours worked by the self-employed also up sharply in August, hours in the nonfarm business sector as a whole appear to have risen faster this quarter than during the first half of this year.

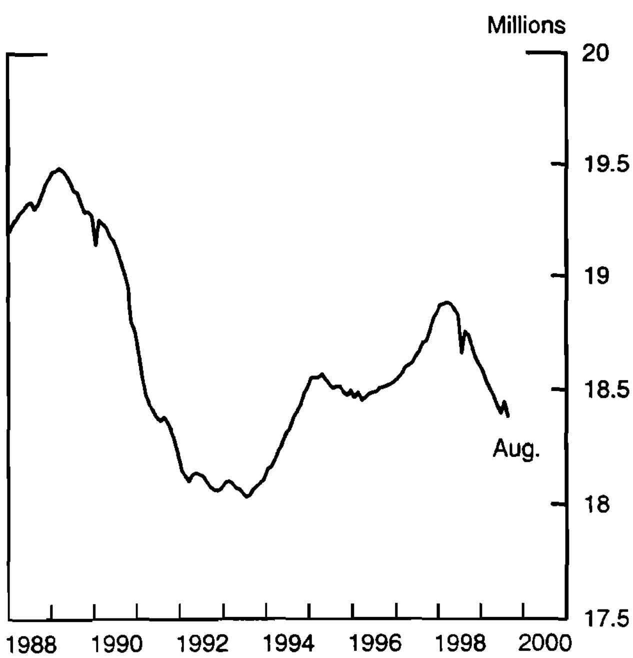
Data from the household survey continue to portray an exceptionally tight labor market. The unemployment rate edged back down to 4.2 percent in August, the low end of the range for this year. The share of the population out of the labor force but wanting a job fell further, returning this series to near its historical low, and the number of job leavers who were unemployed for less than five weeks (as a percentage of household employment) remained at a very high level despite a decline in August. Other labor market indicators support the same impression of tightness; for example, the four-week moving average of initial claims for unemployment insurance has been running near its twenty-five-year low.

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

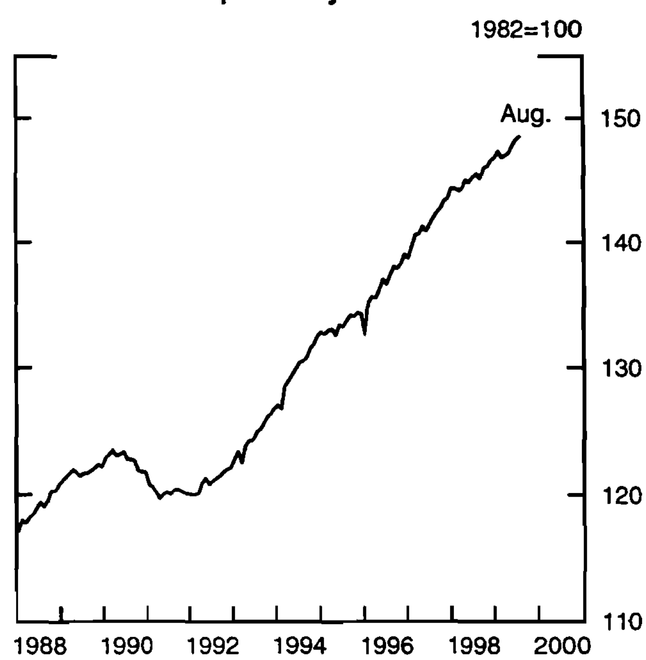
	1998	1999 Q1	1999 Q2	1999 June	1999 July	1999 Aug.
	-Average monthly changes-					
Nonfarm payroll employment[1]	244	209	210	281	338	124
Private	217	171	204	253	287	77
Goods producing	8	-23	-35	-19	68	-95
Mining	-3	-7	-8	-5	3	-3
Manufacturing	-19	-36	-36	-33	51	-63
Construction	30	20	9	19	14	-29
Service producing	208	194	239	272	219	172
Transportation and utilities	18	16	16	23	16	12
Trade	46	44	77	64	117	17
Finance, insurance, real estate	26	18	14	15	8	11
Services	119	116	132	170	78	132
Total government	27	38	6	28	51	47
Private nonfarm production workers[1]	167	156	148	185	249	17
Total employment[2]	157	169	133	208	-125	104
Nonagricultural	171	149	109	149	-63	177
Memo:						
Aggregate hours of private production workers (percent change)[1,3]	2.1	2.0	1.0	0.4	0.3	0.1
Average workweek (hours)[1]	34.6	34.6	34.4	34.5	34.5	34.6
Manufacturing (hours)	41.8	41.6	41.7	41.7	41.9	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.

Manufacturing Employment



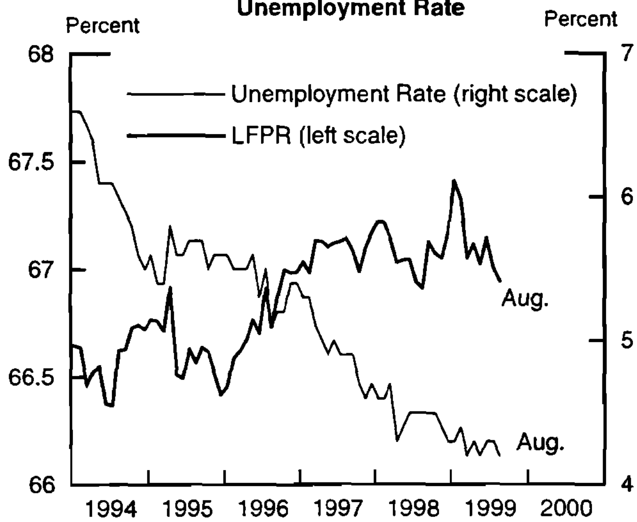
Aggregate Hours of Production or Nonsupervisory Workers



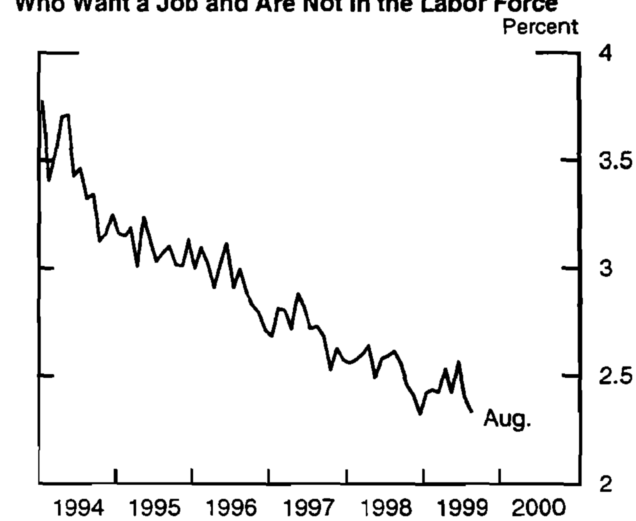
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

			1998	1999		1999		
	1997	1998	Q4	Q1	Q2	June	July	Aug.
Civilian unemployment rate (16 years and older)	4.9	4.5	4.4	4.3	4.3	4.3	4.3	4.2
Teenagers	16.0	14.6	14.9	14.6	13.4	13.5	12.7	13.5
20-24 years old	8.5	7.9	7.1	7.3	7.6	7.7	7.7	7.3
Men, 25 years and older	3.6	3.2	3.2	3.0	3.0	3.0	3.0	3.1
Women, 25 years and older	3.9	3.6	3.6	3.4	3.5	3.5	3.6	3.3
Labor force participation rate	67.1	67.1	67.1	67.3	67.1	67.1	67.0	66.9
Teenagers	51.6	52.8	52.8	52.6	51.7	51.1	51.7	50.9
20-24 years old	77.6	77.5	77.1	77.7	77.2	77.6	77.6	77.7
Men, 25 years and older	76.3	76.2	76.3	76.4	76.1	76.1	76.0	76.1
Women, 25 years and older	59.3	59.2	59.3	59.6	59.6	59.8	59.4	59.4

Labor Force Participation Rate and Unemployment Rate

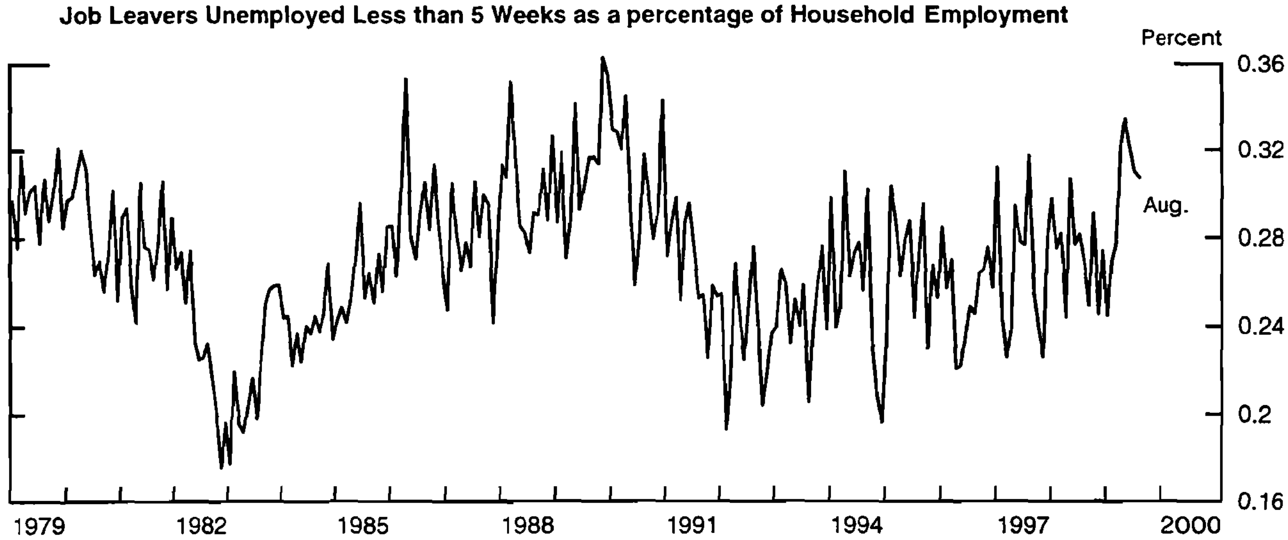


Share of the Population Age 16 to 64 Who Want a Job and Are Not in the Labor Force



Note. Seasonally adjusted by FRB staff.

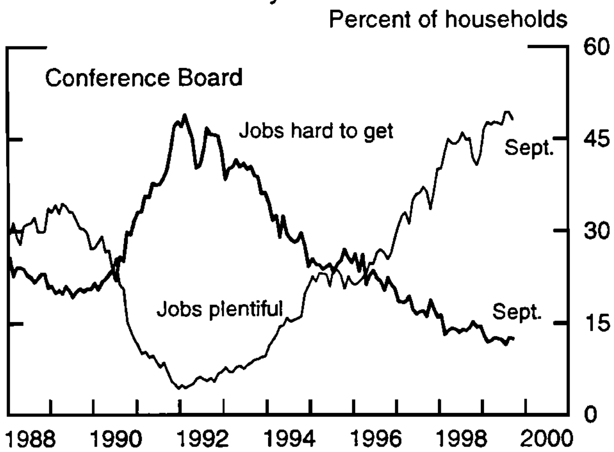
Job Leavers Unemployed Less than 5 Weeks as a percentage of Household Employment



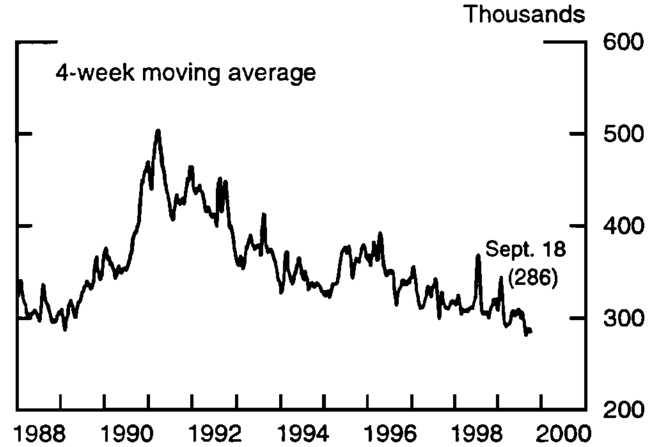
Note. Seasonally adjusted by FRB staff. Data prior to February 1997 are notstrictly comparable, because of CPS redisigns and BLS recompositing.

Labor Market Indicators

Current Job Availability

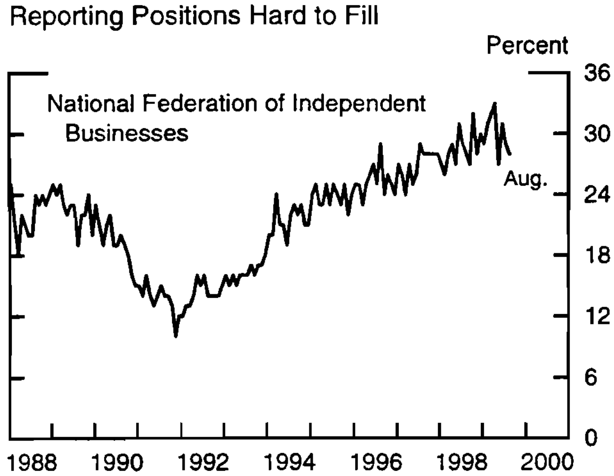


Initial Claims for Unemployment Insurance

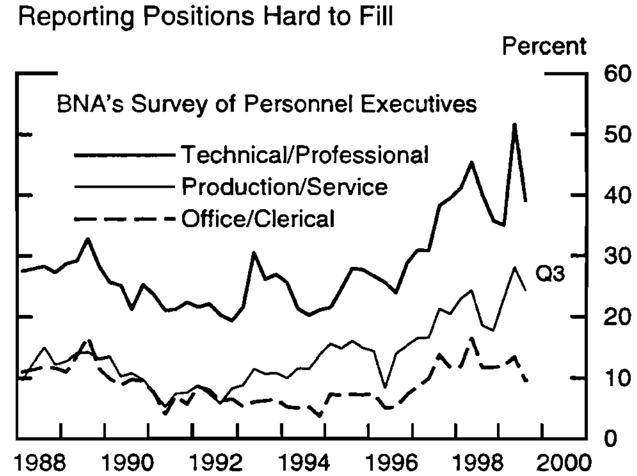


Note. State programs, includes EUC adjustment.

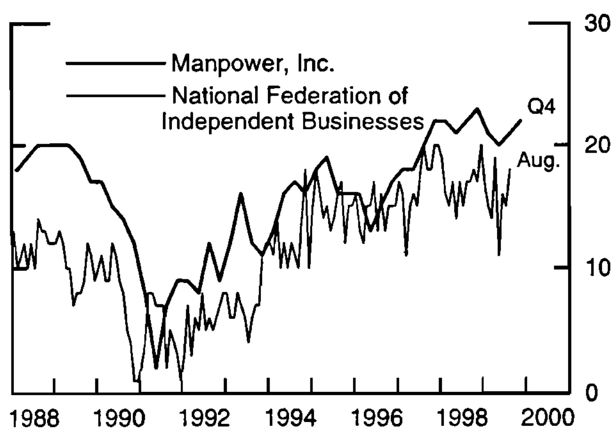
Reporting Positions Hard to Fill



Reporting Positions Hard to Fill

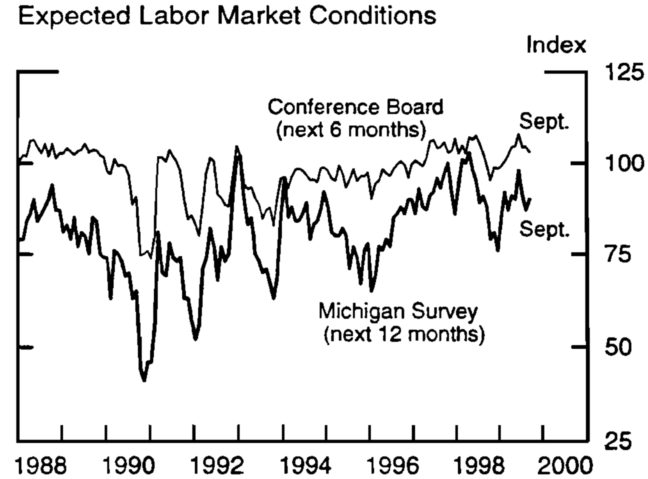


Net Hiring Strength



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

Expected Labor Market Conditions



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

The labor force participation rate edged down to 66.9 percent in August, a twelve-month low. However, the bulk of the drop came from a decline in the participation rate of teenagers, an erratic series that is particularly difficult to seasonally adjust. Other major demographic groups showed unchanged or increased participation rates. The overall participation rate has backed off from its peak of 67.3 percent recorded in the first quarter and currently stands at a level slightly below its average over the past year.

Among other labor market indicators, the Conference Board's consumer survey shows that workers continue to perceive job opportunities as very plentiful. Information on the views of firms leads to the same general conclusion: Recent surveys conducted by the National Federation of Independent Businesses and the Bureau of National Affairs show that although difficulties in filling open positions may have eased a bit recently, the proportion of firms reporting difficulties remains very high.

Industrial Production

Industrial production rose 0.3 percent in August after jumping 0.7 percent in July. With the August level now 1-1/4 percent (not at an annual rate) above the second-quarter average, production is poised to post a second consecutive quarter of solid growth.

The output of utilities declined 1.6 percent in August, reflecting a retreat from July's heat-related surge in demand, but the output of mines rose markedly for a second month, largely on the strength of increases in oil and gas drilling and coal production. In manufacturing, production grew 0.4 percent owing to continued advances in "high-tech" industry output and robust motor vehicle assemblies. The increase in manufacturing production in August raised the factory operating rate to 79.8 percent, but the rate remained well below its long-term average.

Within manufacturing, durable goods production advanced 0.7 percent in August. Output of motor vehicles and parts jumped with Ford's recovery from parts-shortage problems in July, adding to the impetus from the blockbuster pace of sales in August. Production schedules for the rest of the year call for assemblies to decrease a bit but to remain at very high levels. In light of current low levels of inventories and ongoing strength in sales, our industry contacts hint at the possibility that production plans for coming months may be increased. Excluding motor vehicles, production in the three major high-technology industries--computers, semiconductors, and communications equipment--has provided most of the gains in recent months. The output of nondurable industries has softened, on net, in recent months.

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

	Proportion 1998	1998[1]	1999 Q1	1999 Q2	1999 June	1999 July	1999 Aug.
			-Annual rate-		--Monthly rate---		
Total index	100.0	1.9	1.3	3.8	.2	.7	.3
Previous		1.9	1.3	3.8	.1	.7	
Manufacturing	88.4	2.5	1.5	4.0	.1	.6	.4
Durables	49.6	5.3	2.1	7.2	.4	1.2	.7
Motor vehicles and parts	5.1	.7	-2.9	10.2	1.6	-.1	4.4
Aircraft and parts	3.1	8.9	-11.6	-12.7	-2.0	-.7	-2.4
Nondurables	38.8	-.9	.7	-.1	-.4	-.1	.1
Manufacturing excluding motor vehicles and parts	83.3	2.6	1.8	3.6	.0	.7	.2
Mining	5.4	-4.9	-7.4	-3.3	-.2	.9	.6
Utilities	6.2	-1.1	4.8	7.1	2.0	2.3	-1.6
IP by market group							
Consumer goods	27.5	-.4	.9	1.6	.2	-.2	.8
Durables	6.0	4.9	7.6	12.0	.7	-1.0	3.2
Nondurables	21.5	-1.8	-.9	-1.4	.1	.1	.0
Business equipment	15.4	8.3	-.7	7.1	-.4	.9	.2
Information processing	6.1	14.4	7.1	27.9	.2	3.3	.7
Computer and office eq.	2.5	53.0	34.1	46.4	2.2	3.3	3.0
Industrial	4.8	1.5	-6.1	-2.8	-.3	.3	-.9
Transit	3.1	12.1	-8.4	-4.6	-.9	-1.3	-.2
Other	1.5	-1.4	3.3	-14.3	-2.6	-2.9	2.8
Construction supplies	6.0	5.1	8.3	-1.3	-.6	1.1	-.6
Materials	39.1	1.6	2.3	5.2	.6	1.5	.3
Durables	23.8	3.8	2.7	7.7	.9	2.2	.5
Semiconductors	3.9	25.7	16.4	38.3	3.2	5.2	3.2
Basic metals	3.6	-6.3	1.4	5.4	1.1	1.8	.2
Nondurables	8.4	-2.8	2.1	1.3	.5	-.2	.0

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-98 Avg.	1998 Q4	1999 Q1	1999 Q2	1999 June	1999 July	1999 Aug.
Manufacturing	85.7	81.6	80.1	79.5	79.5	79.4	79.6	79.8
Primary processing	88.9	82.8	82.5	82.8	82.5	82.4	82.8	82.7
Advanced processing	84.2	81.1	79.3	78.3	78.5	78.4	78.6	78.9

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

Item	1999					
	Q1	Q2	Q3[1]	June	July	Aug.[1]
U.S. production	12.7	13.1	13.1	13.4	12.6	13.5
Autos	5.6	5.6	5.7	5.6	5.4	5.9
Trucks	7.1	7.5	7.4	7.8	7.2	7.5
Days' supply						
Autos	58.7	57.0	n.a.	57.0	56.1	n.a.
Light trucks[2]	59.9	64.9	n.a.	64.9	63.1	n.a.

NOTE. Components may not sum to totals because of rounding.
1. Production rates are manufacturers' schedules.
2. Excludes medium and heavy trucks (classes 4-8).
n.a. Not available.

Turning to market groups, consumer goods production climbed 0.8 percent in August with continuing strength in the output of durable goods and, especially, the remarkable pace of production of automotive products. Materials production in August increased 0.3 percent; much of the strength in this category in recent months has been concentrated in semiconductors and steel. And while the output of construction supplies fell 0.6 percent in August, the level of production has remained high since early this year, with some erratic month-to-month changes recently.

Production of business equipment grew 0.2 percent last month after a 0.9 percent climb in July. Information processing equipment (including communications equipment)--which rose 0.7 percent in August and 17.6 percent over the past year--continues to be the dominant source of growth in business equipment production. Output in the other equipment categories has remained weak in recent months. In the aircraft sector--as shown in the accompanying figure--completions of commercial aircraft at Boeing rose strongly through late last year but have been dropping back more recently; Boeing expects further declines in completions through the end of next year. Production of capital goods excluding high-technology products and transportation equipment has been softening since early 1998. As of the second quarter, the exports of these goods still were below their levels of a year earlier, although the rate of decline had eased considerably on a year-to-year basis.

New orders for durable goods have been strong of late. The staff's estimate of real adjusted durable goods orders in July and August is 5-1/2 percent above the average for the second quarter (not at an annual rate). The new orders index

Recent Trends in Business Equipment Production

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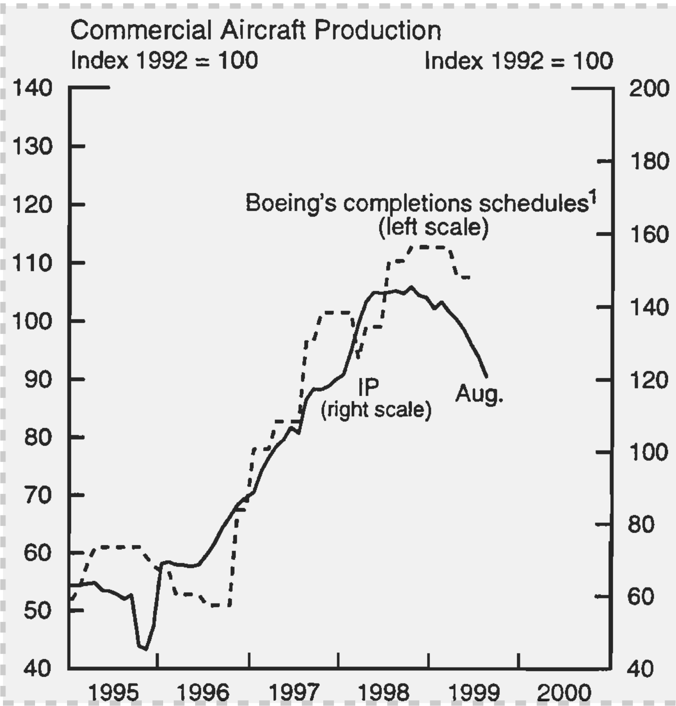
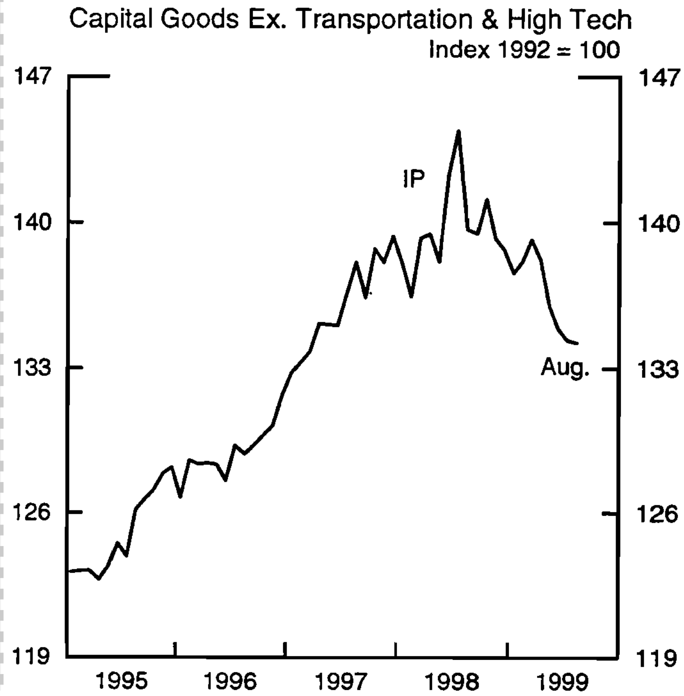
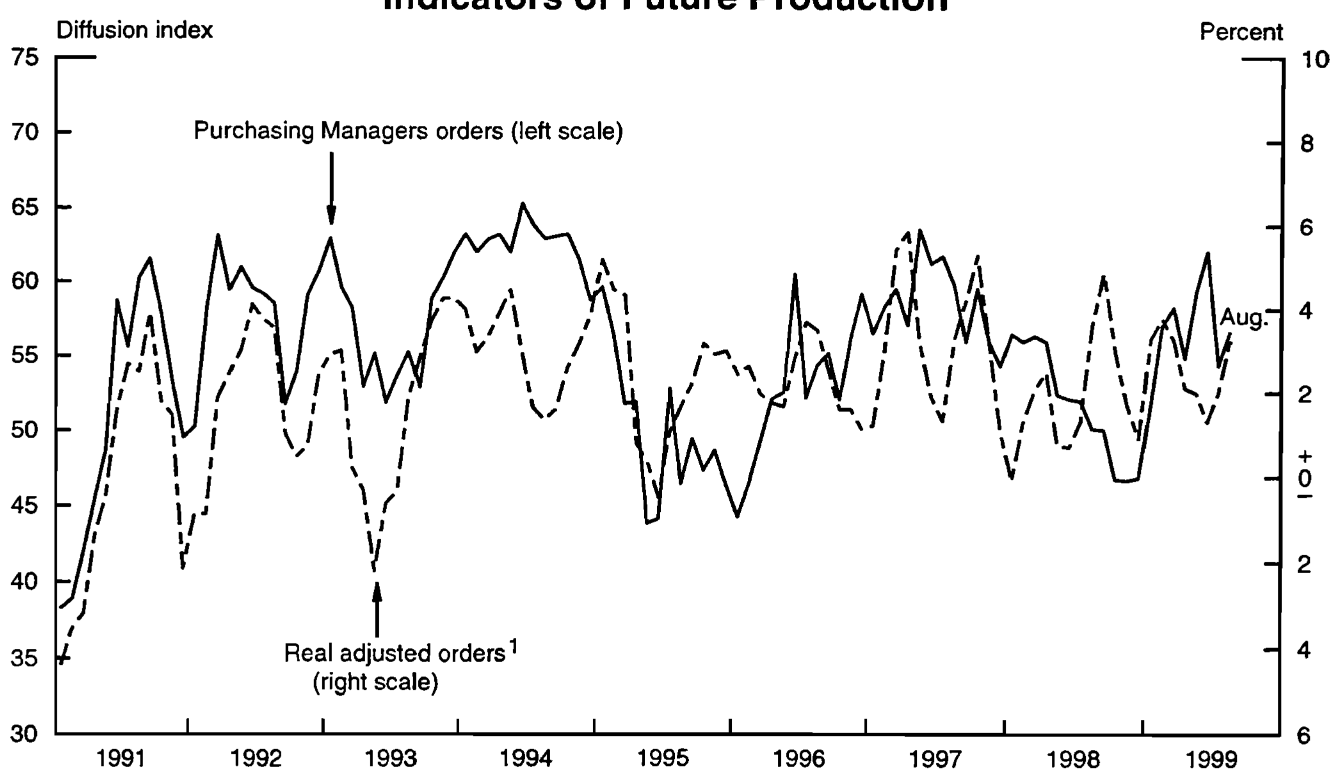




1. Boeing's completions schedules equals actual completions through August 1999 and scheduled completions thereafter.

Indicators of Future Production



1. Three-month percentage change of three-month moving average.

from the National Association of Purchasing Management rose slightly in August; that survey has been showing firmer export orders in recent months. The Beige Book noted increases in orders and production throughout the country, partly in response to the Asian recovery.

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

Component	Share, 1999:H1	1999				
		Q1	Q2	Apr.	May	June
Total durable goods	100.0	3.8	-1.1	-2.4	1.0	.4
Adjusted durable goods[1]	69.0	2.0	.4	.3	-1.3	-.7
Computers	6.0	-.5	2.9	1.8	.5	-4.7
Nondefense capital goods excluding aircraft and computers	18.0	4.4	-1.2	-.2	-4.0	-3.5
Other	46.0	1.5	.7	.2	-.4	.8
MEMO						
Real adjusted orders[2]	...	3.3	1.2	.6	-1.1	-.5

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Nominal adjusted durable goods orders were split into three components: computers, electronic components, and all other. The components were deflated and then aggregated in a chain-weighted fashion.
... Not applicable.

Motor Vehicles

Light vehicle sales, adjusted for shifts in automakers' reporting periods, soared to a 17.8 million unit annual rate in August, more than a million units above the already strong pace in July. A huge spike in fleet purchases, particularly from GM and Ford, more than accounted for the increase.[1] Retail sales of motor vehicles were little changed but remained extremely high. Our industry contacts report that they expect fleet sales to return to more normal levels in September; however, automakers are not expecting much cooling in the red-hot pace of consumer demand.

Buying conditions for motor vehicles have remained very favorable. Although the Michigan Survey Research Center's index of consumer perceptions of car-buying conditions has dropped a bit in recent months, the level is still quite high by historical standards. These positive assessments are likely based on the near-

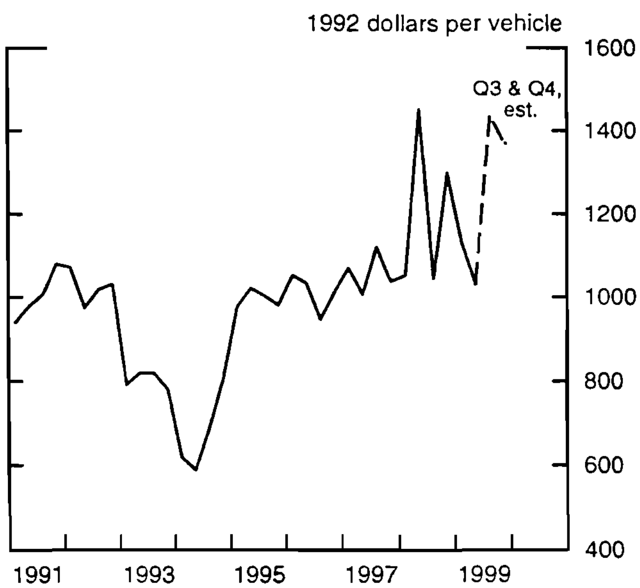
1. Data on fleet sales are confidential.

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

			1999		1999		
	1997	1998	Q1	Q2	June	July	Aug.
Total	15.1	15.4	16.2	16.7	16.9	16.9	17.6
Adjusted[1]	15.0	15.5	16.2	16.7	17.1	16.7	17.8
Autos	8.3	8.1	8.4	8.7	8.7	8.8	9.4
Light trucks	6.8	7.3	7.9	8.0	8.1	8.1	8.1
North American[2]	13.1	13.4	13.9	14.3	14.5	14.4	15.3
Autos	6.9	6.8	6.8	7.0	7.0	7.0	7.8
Light trucks	6.2	6.7	7.1	7.3	7.4	7.3	7.4
Foreign Produced	1.9	2.0	2.3	2.4	2.4	2.5	2.3
Autos	1.4	1.4	1.5	1.7	1.7	1.7	1.6
Light trucks	.6	.6	.8	.7	.7	.8	.7
Memo:							
Retail Sales[3]	12.4	12.9	13.5	13.9	13.9	14.1	13.9
Fleet Sales[3]	2.6	2.6	2.7	2.8	3.0	2.8	3.6

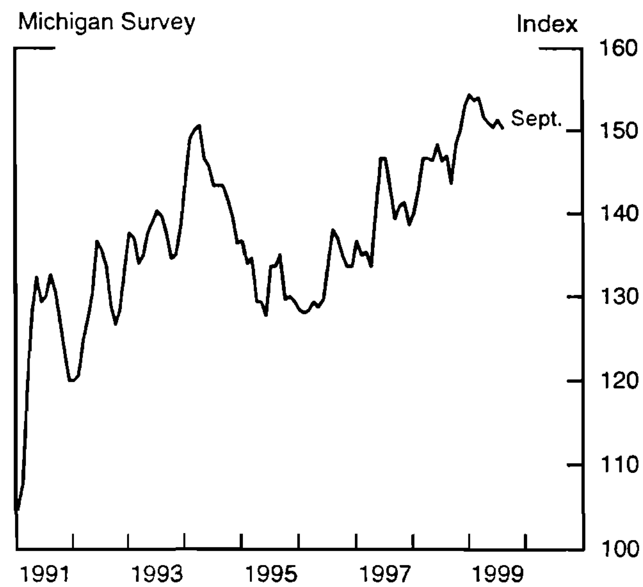
Note. Components may not add to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.
3. Confidential

Marketing Incentives for Light Vehicles
(FRB seasonals)



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

Buying Attitudes for New Vehicles
(3-month moving average)



absence of increases in new car sticker prices of late and the offer of sizable incentives by manufacturers. Indeed, the CPI for new vehicles edged down in August, owing to incentives and model-year close-out sales; over the past year, the new-vehicle CPI has fallen almost a percentage point. Through July, increases in interest rates had not had an appreciable effect on net auto financing rates--a sizable proportion of new-vehicle acquisitions are obtained under special finance or lease rates that have been subsidized by captive finance companies as part of incentive programs.

Demand for trucks has also been exceptionally robust. In August, medium and heavy truck sales reached 640,000 units at an annual rate, above even the already-high 628,000 average rate posted in the first half of the year. So far this year, sales of medium and heavy trucks have been 27 percent higher than in the comparable period of 1998. Data for August on new orders for medium and heavy trucks, combined with the already high levels of backlogs, suggest that sales will remain strong in the near term.

Consumer Spending and Personal Income

Consumer spending continues to be a major source of economic strength despite some deceleration from the torrid pace posted in the first half of the year. In the retail sales report for August, nominal expenditures for goods in the retail control category increased 0.6 percent after a gain of 0.4 percent in July. Sales increases were spread across all major components. Apparel outlays jumped 1-1/4 percent in August, a gain consistent with anecdotal reports of strong demand for back-to-school clothing. Nominal purchases at gasoline stations rose about 2 percent, and although a good deal of this increase undoubtedly reflects a steep rise in gasoline prices, physical product data from the Department of Energy indicate that real gasoline consumption also rose in August. Real PCE for motor vehicles also is likely to have increased in August. In sum, we estimate that spending on all goods grew 0.4 percent in real terms during the month, a gain that puts the average level of real goods expenditures in July and August about 1 percent above the second-quarter average.

Real expenditures on services rose 0.4 percent in July, the most recent month for which data are available. This increase reflects, in part, a jump in electricity outlays due to unseasonably warm weather; based on subsequent weather data, demand for electricity likely fell back in August and was little changed in September. Spending on recreational services posted a robust gain in July, and outlays for medical, personal care, and personal business services also rose.

Real disposable personal income edged down 0.1 percent in July, owing to a decline in federal disaster aid to farmers that had boosted income growth in June. However, wage and salary disbursements were up substantially in July,

RETAIL SALES
(Percent change from preceding period)

	1999		1999		
	Q1	Q2	June	July	Aug.
Total sales	3.3	1.7	-.1	1.0	1.2
Previous estimate		1.7	-.2	.7	
Retail control[1]	2.7	1.9	.2	.4	.6
Previous estimate		1.9	.2	.2	
Durable goods	2.6	.5	-.8	-.2	.5
Furniture and appliances	2.4	1.5	.7	-.3	.7
Other durable goods	2.8	-.2	-2.1	-.2	.4
Nondurable goods	2.7	2.2	.4	.5	.7
Apparel	4.6	2.3	-.7	-.9	1.3
Food	1.6	1.0	-.3	.4	.3
General merchandise	3.9	.8	.7	.5	.3
Gasoline stations	-4.0	6.4	-.1	4.0	2.1
Other nondurable goods	4.6	2.9	1.2	-.2	.6

1. Total retail sales less sales at building material and supply stores and automotive dealers, except auto and home supply stores.

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

		1999		1999		
	1998	Q1	Q2	May	June	July
	Q4/Q4	- Annual rate -		--- Monthly rate ---		
PCE	5.3	6.7	4.6	.5	.3	.2
Durables	13.2	12.9	9.5	2.2	.4	.2
Motor vehicles	15.1	-.6	8.1	3.4	.3	-.3
Other durable goods	11.8	23.4	10.5	1.4	.6	.6
Nondurables	4.7	9.5	2.9	.5	.4	-.2
Gas and oil	2.9	-.4	.9	.4	1.1	-1.2
Clothing and shoes	6.9	29.2	3.9	.7	.5	1.1
Other nondurables	4.4	6.2	2.9	.5	.3	-.4
Services	4.0	4.1	4.3	.2	.3	.4
Energy	-4.6	14.9	11.7	-1.6	1.6	1.8
Non-energy	4.4	3.7	4.0	.2	.2	.3
Housing	2.4	2.9	2.3	.2	.2	.2
Household operation	6.5	6.9	8.8	.6	.4	.5
Transportation	2.7	3.2	2.9	-.1	.7	-.1
Medical	3.0	2.0	3.0	.3	.2	.3
Recreation	9.9	12.4	12.8	.0	1.1	.9
Personal business	6.0	5.4	5.7	-.2	-.6	.2
Brokerage services	17.1	35.3	31.2	-2.8	-5.7	-.3
Other	6.8	1.0	1.6	.7	.3	.7

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

and, in light of the increases in production worker hours and wages last month, they appear poised to post a moderate gain in August.

The personal saving rate was -1.4 percent in July, little changed from the second-quarter average, but about 1-3/4 percentage points below the rate of a year ago. With the broadest indexes of stock prices reaching new highs in July, consumers overall apparently saw little reason to save out of current income. The more recent retreat in stock market valuation has reduced household wealth and pushed the ratio of wealth to income down somewhat.

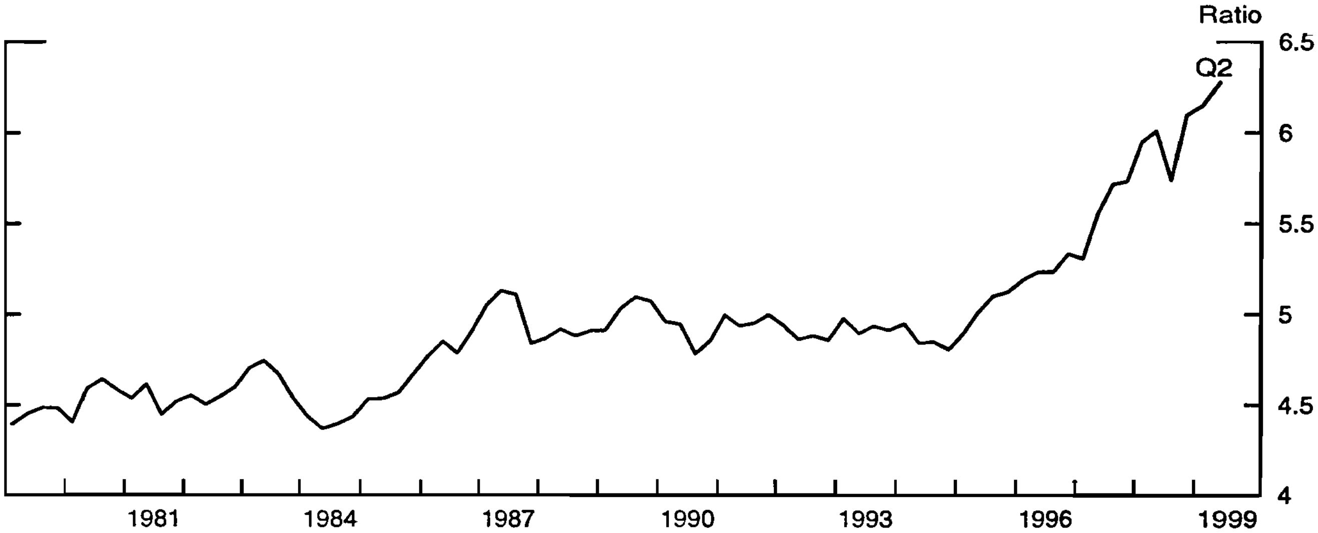
Consumer sentiment in September as measured by the preliminary Michigan survey was up a little from August and at the top of the high range that has prevailed since the spring of 1997. Respondents were particularly upbeat about future business conditions, and assessments of buying conditions for large household appliances also improved. The Conference Board index edged down for a third consecutive month in September, but its level also remained high. Views of the respondents to the Conference Board's questions on present conditions were little changed. However, assessments of future business conditions, job prospects, and income gains all softened. Cut-off dates for both the preliminary Michigan survey and the Conference Board survey were around the middle of September; therefore, neither survey could have picked up any shift in sentiment in response to the more recent decline in stock prices.

A large proportion of respondents in the most recent Michigan survey--and a considerably larger share than was the case six months ago--reported that they expect interest rates to increase over the next year. Their appraisals of buying conditions for homes (which are not a component of the overall index) were the most pessimistic in more than four years, reflecting the recent run-up in mortgage rates. Similarly, in the Conference Board survey the proportion of households expecting increases in interest rates has been running at an appreciably higher level in recent months.

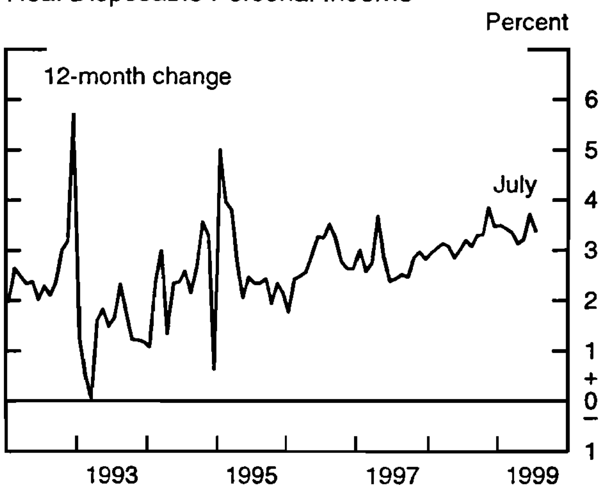
The current high levels of the two indexes of consumer sentiment do not suggest that households harbor much anxiety about the millennium change, although neither the regular Michigan survey nor the Conference Board survey specifically tracks consumers' views regarding anticipated Y2K problems. Opinion polls that have been directed to this topic have yielded decidedly mixed results. For example, in December 1998, more than a third of respondents to a poll conducted by Gallup in partnership with the National Science Foundation and *USA Today* felt that the millennium bug would cause "major problems," but by August of this year, this share had dropped to 11 percent. About half of the respondents to the August survey had no plans to take any precautionary steps. At the same time, however, 36 percent of Gallup respondents said that they

Household Indicators

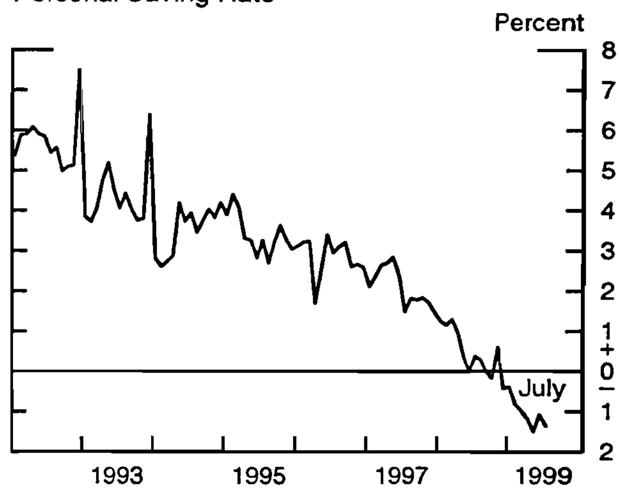
Ratio of Net Worth to DPI



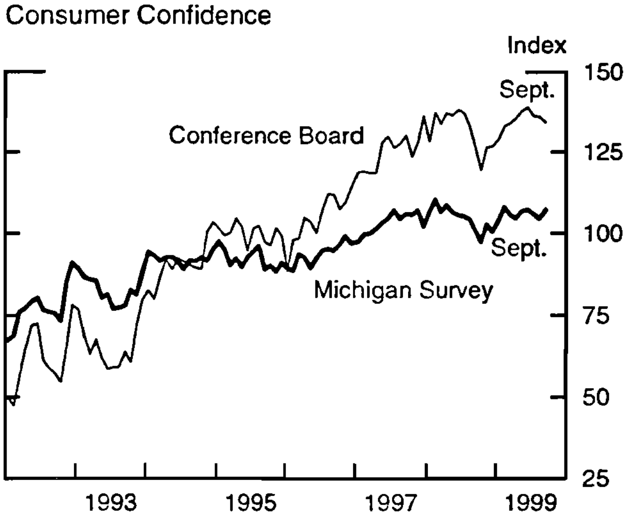
Real Disposable Personal Income



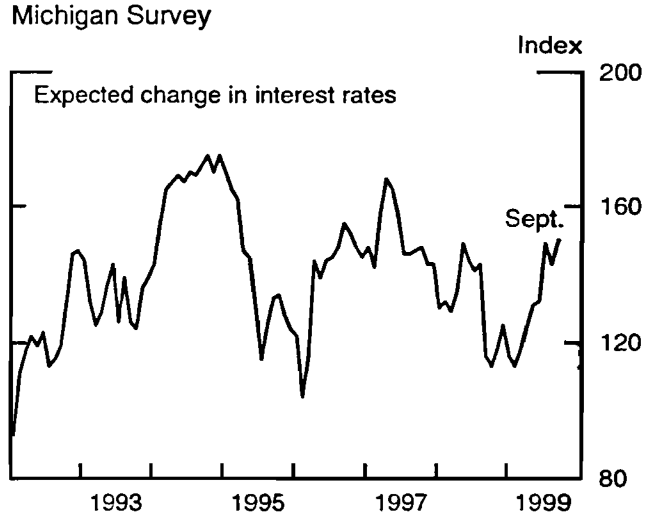
Personal Saving Rate



Consumer Confidence



Michigan Survey



Note: Share expecting rates to rise over the next year less share expecting rates to fall plus 100.

would stockpile food and water in advance of the new year, up from 26 percent in December.

Housing Markets

Housing construction remained strong, on balance, into late summer but with some indications of deceleration. Single-family starts declined in August but only slightly, and the level--1.30 million units at an annual rate--remained high. Adjusted single-family permits fell a bit more than starts, leaving the ratio of starts to permits slightly above its long-run average. A high ratio of starts to permits is often a harbinger of some slippage in starts going forward; however, the number of single-family permits previously issued but still unused was at a nine-year high in August. In addition, the inventory of unsold homes remains quite low. These indicators suggest continuing support for high levels of single-family construction in the near future.

Recent data provide conflicting signals about whether higher mortgage rates have affected sales of single-family houses. On the one hand, new home sales edged up to 980,000 units at an annual rate in July, the second-highest level on record; on the other hand, existing home sales for August slid 2-3/4 percent, to 5.25 million units at an annual rate. While existing home sales are now nearly 7 percent below their record high posted in June, the August level still ranks as the fifth highest ever.[2] Rising mortgage rates appear to be leaving a clearer imprint on survey data and mortgage applications. As noted above, consumer attitudes toward homebuying turned much less positive in both August and September, and higher mortgage rates were specifically reported as the main factor underlying this shift. Also, the MBA index of purchase applications for home mortgages has declined noticeably since late June.

Homebuilders continue to complain of severe shortages of labor and materials. According to a survey conducted earlier this month by the National Association of Home Builders, shortages of wallboard, insulation materials, brick, and labor have remained severe and in some cases have worsened (see table). Recent price data have provided mixed support for builders' views: The PPI for gypsum wallboard posted another large gain in August, raising it to a level about 20 percent above that of a year earlier. Lumber and plywood prices, however, have dropped back significantly from the stratospheric levels of a couple of months ago, although they remain high by historical standards.

2. This pattern of improvement in July new home sales and deterioration in August of existing home sales is somewhat unusual in that the former usually respond to changing economic circumstances more rapidly than the latter: New home sales are recorded when a contract is signed or a deposit is accepted, whereas most existing home sales are tallied as of the closing date of the sale.

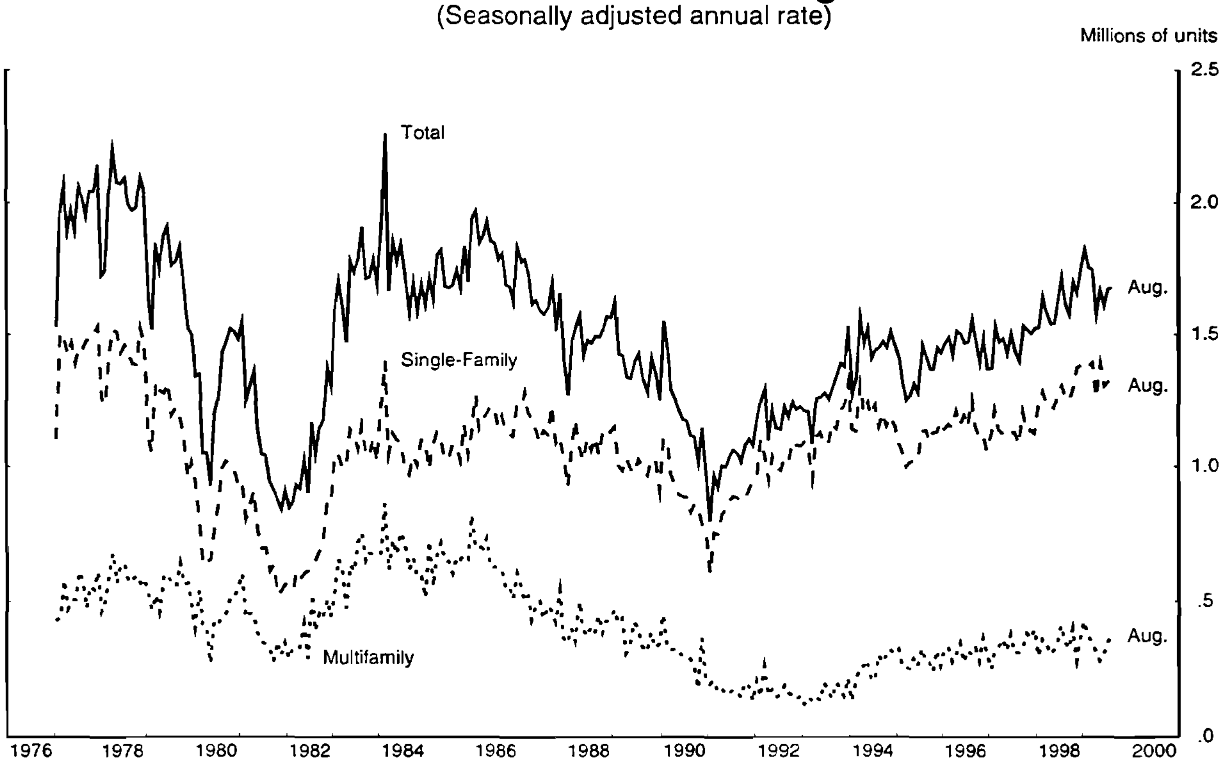
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		1998	1999				
	1998	Q4	Q1	Q2[r]	June[r]	July[r]	Aug.[p]
All units							
Starts	1.62	1.70	1.77	1.62	1.61	1.67	1.68
Permits	1.60	1.71	1.72	1.60	1.64	1.64	1.61
Single-family units							
Starts	1.27	1.35	1.39	1.32	1.31	1.32	1.30
Permits	1.18	1.25	1.27	1.23	1.24	1.25	1.20
Adjusted permits[1]	1.28	1.34	1.37	1.32	1.33	1.34	1.27
New home sales	.89	.95	.90	.95	.98	.98	n.a.
Existing home sales	4.97	5.10	5.21	5.29	5.63	5.40	5.25
Multifamily units							
Starts	.35	.35	.38	.30	.30	.35	.37
Permits	.42	.45	.45	.37	.40	.39	.41
Mobile homes							
Shipments	.37	.37	.38	.36	.36	.34	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.

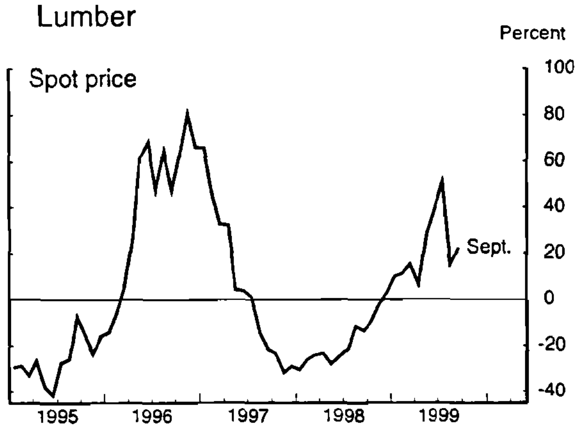
Total Private Building
(Seasonally adjusted annual rate)



Indicators of Input Costs for the Construction Sector

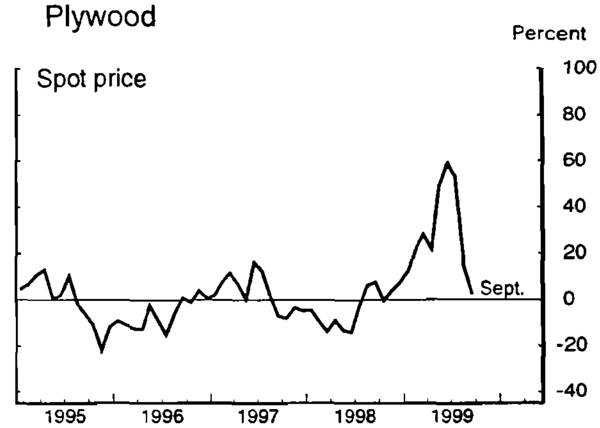
(Change from year earlier)

Lumber



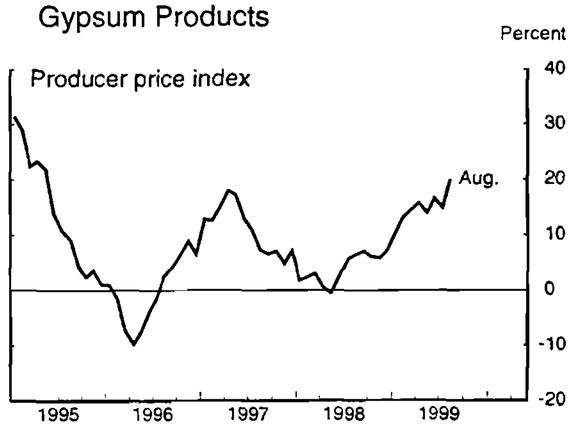
Note. The Sept. reading is an average of weekly data through Sept. 24.

Plywood

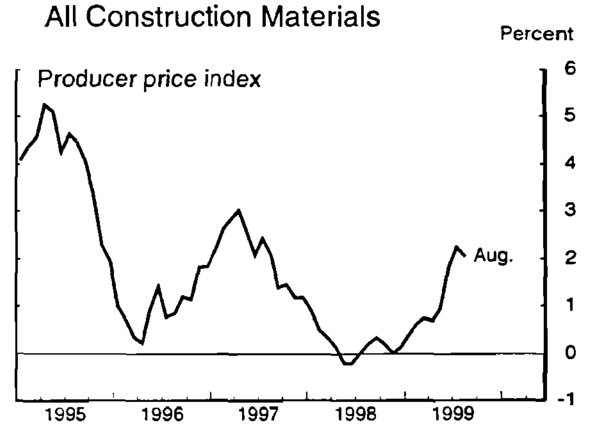


Note. The Sept. reading is an average of weekly data through Sept. 24.

Gypsum Products

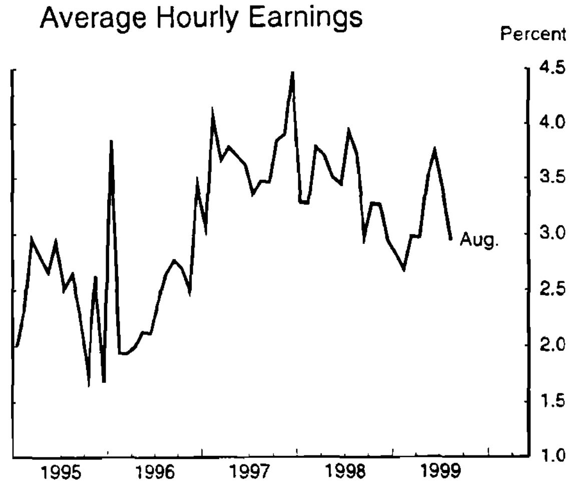


All Construction Materials



Note. PPI intermediate materials and components for construction.

Average Hourly Earnings



Employment Cost Index

Note. ECI for total compensation.

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

	1999		1999		
	Q1	Q2	June	July	Aug.
Producers' durable equipment					
Shipments of nondefense capital goods	-1.4	3.0	-1.9	3.0	2.6
Excluding aircraft and parts	-.6	3.4	.2	5.0	-.8
Office and computing	-.1	3.7	-3.2	17.6	-6.1
Communications equipment	5.7	6.0	2.4	3.6	-1.0
All other categories	-2.5	2.5	1.0	.2	1.8
Shipments of complete aircraft	-22.3	-15.4	-20.9	22.3	n.a.
Medium & heavy truck sales (units)	5.9	-.8	-4.7	.5	4.1
Orders for nondefense capital goods	6.9	-4.2	-3.9	8.0	3.6
Excluding aircraft and parts	3.1	-.1	-3.3	9.5	-.8
Office and computing	-.5	3.6	-2.9	17.7	-6.6
Communications equipment	11.6	2.1	3.8	2.6	-4.7
All other categories	2.4	-2.2	-5.6	8.1	3.2
Nonresidential structures					
Construction put in place, buildings	.5	-2.0	-.7	.1	n.a.
Office	5.0	1.5	2.2	1.6	n.a.
Other commercial	.7	1.5	-.9	-.7	n.a.
Institutional	-4.7	-.6	.3	.2	n.a.
Industrial	-4.5	-12.7	1.1	-3.2	n.a.
Lodging and miscellaneous	4.3	-5.2	-7.9	2.4	n.a.
Rotary drilling rigs in use[1]	-13.9	-6.4	5.5	5.1	5.7
Memo (1992 Chained dollars):					
Business fixed investment	8.5	11.2	n.a.	n.a.	n.a.
Producers' durable equipment	9.5	15.9	n.a.	n.a.	n.a.
Office and computing	37.9	44.2	n.a.	n.a.	n.a.
Communications equipment	31.8	49.0	n.a.	n.a.	n.a.
Motor Vehicles	10.8	14.1	n.a.	n.a.	n.a.
Aircraft	-41.1	10.5	n.a.	n.a.	n.a.
Other equipment[2]	1.2	1.6	n.a.	n.a.	n.a.
Nonresidential structures	5.7	-1.2	n.a.	n.a.	n.a.

1. Percent change of number of rigs in use, seasonally adjusted.
2. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

Home Builders Reporting Shortages of Materials and Labor
(Percent)

Item	1998	1999		
	June	March	June	September
Materials				
Wallboard	16	60	86	72
Insulation	12	42	20	33
Brick	13	23	22	47
Labor	n.a.	n.a.	75	82

n.a. Not available.
SOURCE. National Association of Home Builders.

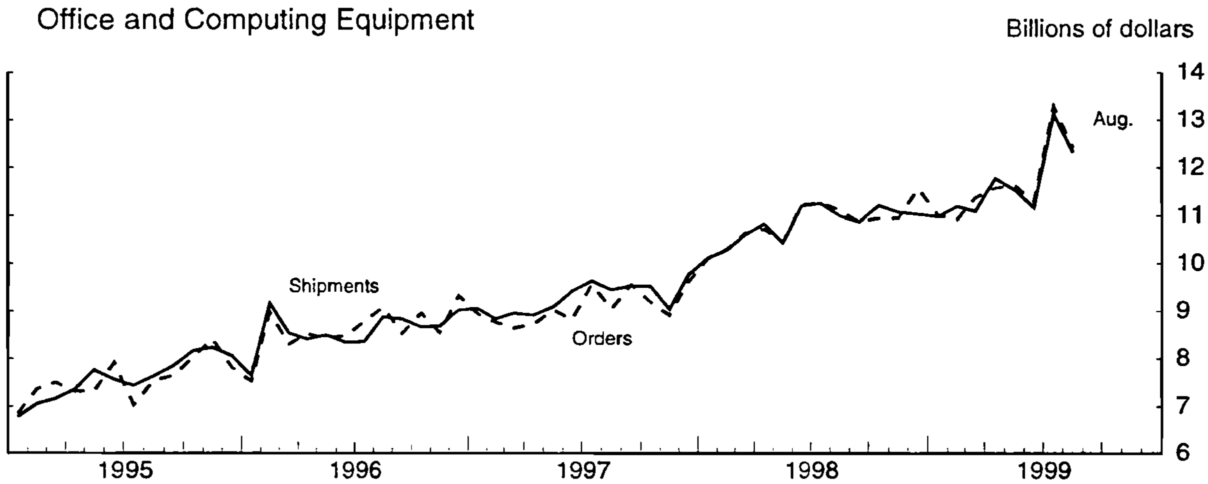
Broader measures of construction costs show only modest price pressures. For example, the PPI for intermediate materials and components rose just 2 percent over the twelve months ended in August after holding flat over the previous twelve-month period, and the average hourly earnings of construction workers have risen only moderately over the past twelve months--a touch less than 3 percent. The last ECI showed hourly compensation of construction workers up slightly more than 3 percent over the twelve months ended in June. However, coverage of these series extends across all types of construction, not just homebuilding, and therefore may underestimate the cost increases that homebuilders have been experiencing.

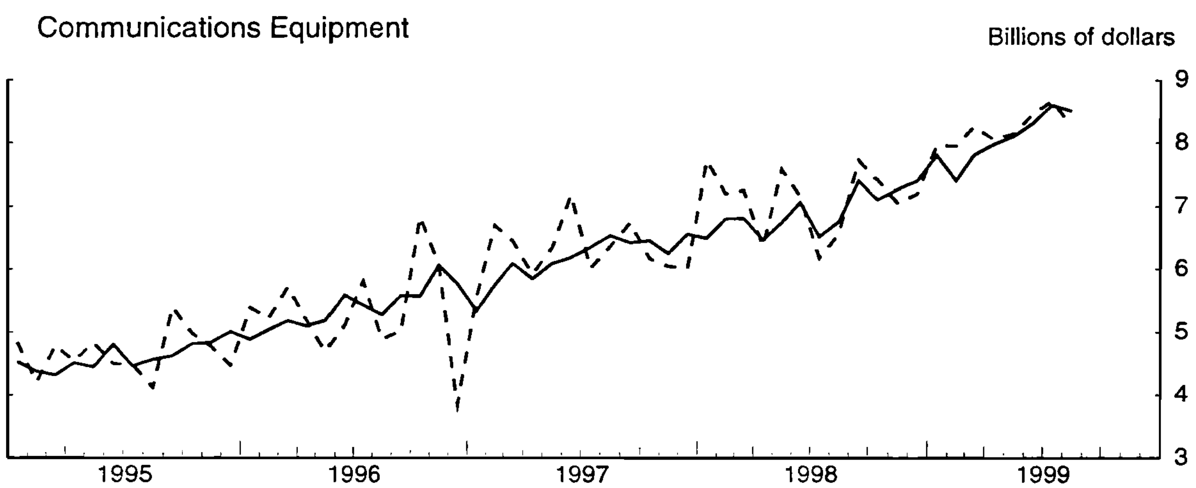
In view of the strength of sales, builders might be expected to find it relatively easy to pass on cost increases to homebuyers in the form of higher prices. In the second quarter, quality-adjusted prices of new homes were up 4.6 percent from the level of a year earlier, a deceleration from the year-to-year rise reported in the first quarter but otherwise the fastest in several years.

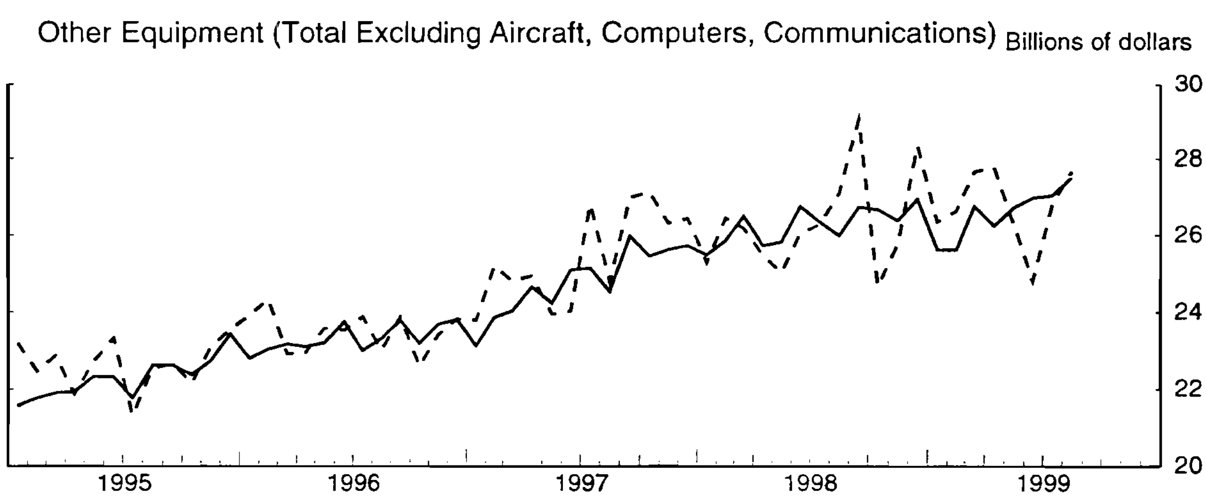
Business Fixed Investment

Producers' durable equipment. Real expenditures on producers' durable equipment appear to have posted another impressive gain in the third quarter, bolstered by outlays for high-tech machinery and transportation equipment. Nominal shipments of office and computing equipment surged in July and dropped back only a little in August (the industry detail on orders and shipments is confidential), and the prices of computing equipment have maintained a steep downward trend. These developments suggest that the third-quarter gain in real computer outlays could be very large indeed. Last-minute attempts of some firms to get new systems in place before the end of the year might explain some of the jump in shipments. But declining prices and a widening range of

Recent Data on Orders and Shipments







applications for computers are continuing to provide strong motivation for businesses to invest. A notable example of recent price attractiveness is Sun Microsystems's offer of generous discounts to customers who are willing to trade in non-Sun equipment before the new millennium.[3]

The factors underlying the recent strength in domestic communications equipment spending--falling prices, a rising importance of networking equipment, and ongoing telecommunications deregulation--have not abated, and this sector will likely post another sizable gain in the third quarter. Still, growth in real outlays on communications equipment is unlikely to repeat last quarter's advance of nearly 50 percent at an annual rate. Nominal shipments of communications equipment by domestic producers have remained on a strong uptrend this quarter, but imports of communications equipment fell 4-1/2 percent in July after an unusually large second-quarter gain.

Indicators of transportation equipment spending for the third quarter are also upbeat. After increasing moderately in the second quarter, business expenditures on aircraft are poised to record a substantial gain in the third quarter. Boeing reports strong shipments in August, despite cutbacks in production, and deliveries to domestic carriers are likely to be further bolstered this quarter by stepped-up purchases from Airbus. In the other major transportation categories the news is equally rosy. As noted above, a disproportionate share of August's motor vehicle sales ended up in fleet sales to businesses, and demand for medium and heavy trucks continued at high levels over the summer.

Excluding the high-tech and transportation sectors, real expenditures for equipment appear to have picked up a little in the third quarter after posting relatively sluggish gains in the first half of the year. Nominal shipments in this category in August were 3-1/4 percent above the second-quarter average. Moreover, new orders for these goods, after having fallen 12-1/2 percent over the first half of the year, bounced back in July and August and no longer trail shipments.

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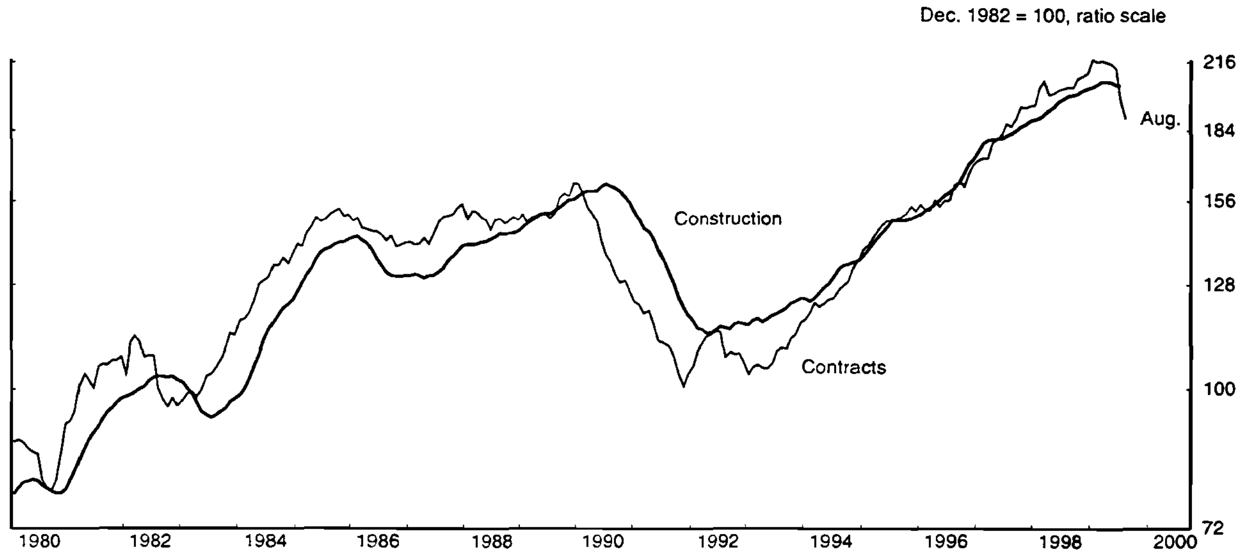
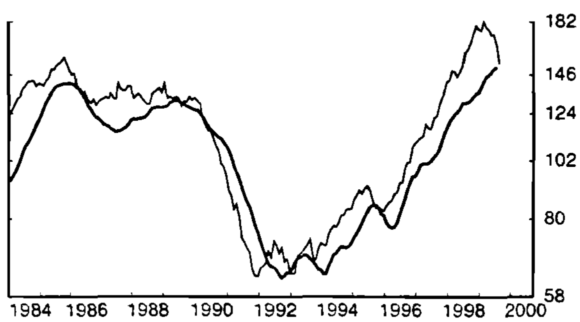
3. We cannot rule out the possibility that a disproportionately large share of computer shipments has ended up in the hands of consumers this quarter. Compuserve has announced sharply higher membership rates owing to the success of its offer of $400 rebates to personal computer purchasers who agree to three years of Internet service. In addition, reports in the Beige Book and elsewhere suggest that back-to-school sales of computers have been good. The BEA, however, will not diverge from the normal allocation between PDE and PCE that they apply to computer sales unless evidence to the contrary is overwhelming. Whatever the allocation, the surge in shipments of computers should show up as increased real GDP.

Nonresidential Construction and Contracts
(Six-month moving average)

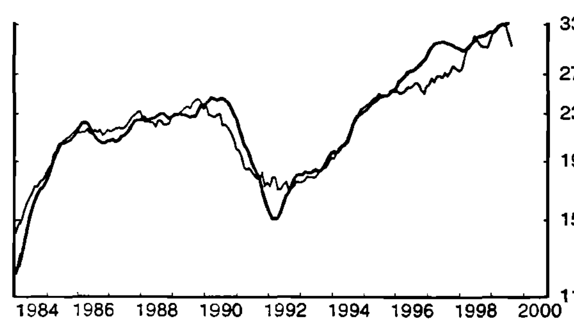
Total Private Building



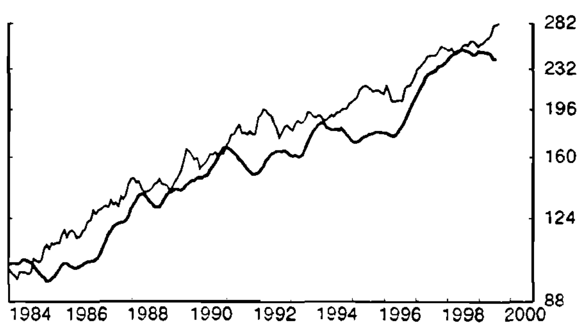
Office



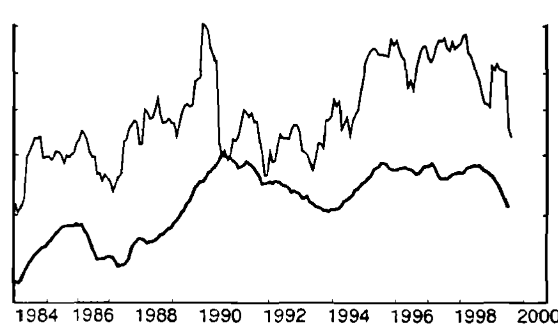
Other Commercial



Institutional



Industrial



Note. Individual sectors include both public and private building.

Nonresidential structures. Real investment in nonresidential construction declined at an annual rate of 1.2 percent in the second quarter, and the available third-quarter indicators point to persistent sluggishness. Nominal expenditures on buildings put in place changed little in July and were 0.4 percent below the average for the second quarter. The recent pattern of steep declines in the construction of industrial facilities resumed in July, and expenditures for other commercial structures--which include retail properties and warehouses--fell moderately. On the positive side, office construction posted a respectable gain in July, and investment in hotel and motel properties turned up. Construction of institutional structures--which include religious and educational buildings and hospitals--was about unchanged.

Overall, contracts for nonresidential construction continued to decline in August. Construction contracts for industrial buildings rose noticeably, but in light of ample manufacturing capacity, this development probably is just a temporary blip in statistically noisy data. Contracts for office buildings and for other commercial structures also declined in August, continuing established downtrends in both series. Although vacancy rates for offices in downtown locations remained quite low at midyear, they no longer are trending down, and vacancy rates for suburban offices have risen a bit. Furthermore, increases in office property values have moderated noticeably so far this year. In other sectors, the rate of increase in property values for warehouses has changed little, on balance, over the past two years, while the value of retail properties has decelerated substantially over this period.

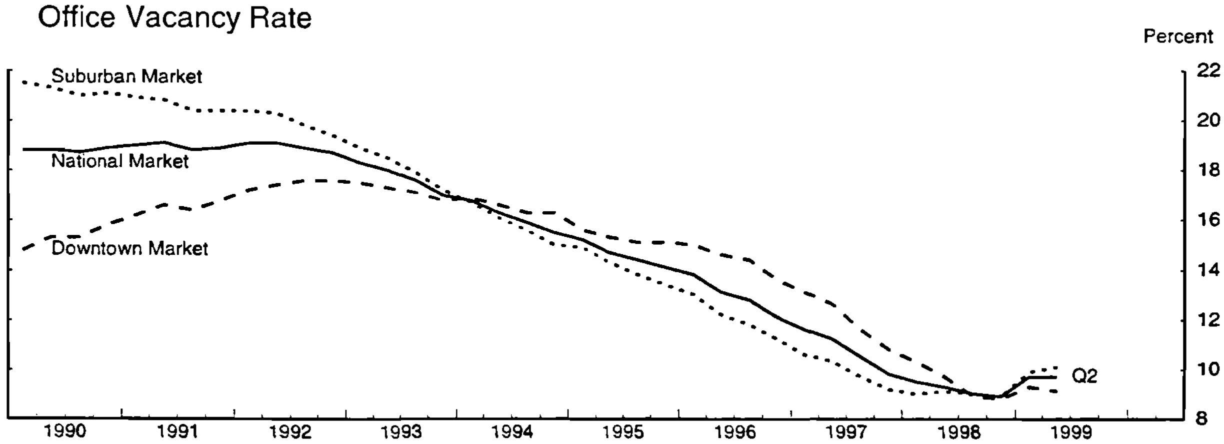
Business Inventories

After posting only a small gain in the second quarter, investment in business inventories rose sharply in July. For manufacturing and trade excluding motor vehicles, the book value of inventories increased at a $46 billion annual rate, up from a $13 billion pace in the second quarter. Following liquidations in each of the previous three quarters, the book value of manufacturers' inventories accumulated at a $26 billion annual pace in July; part of the step-up likely reflected rising petroleum prices. Stockbuilding at wholesalers (excluding motor vehicle distributors) also picked up in July, registering a $27 billion (annual rate) increase. In contrast, retailers (excluding auto dealerships) reduced stocks at a $7 billion pace. Inventories are low relative to sales in the manufacturing and retail sectors, and much of last year's run-up in the ratio for the wholesale trade sector has been reversed.

Inventory-to-sales ratios, outside of motor vehicles, have come down markedly in a large number of sectors since the turn of the year. In many sectors, the falling ratios appear to reflect ongoing efforts to streamline inventory systems. For example, the stock-to-sales ratios of manufacturers of machinery,

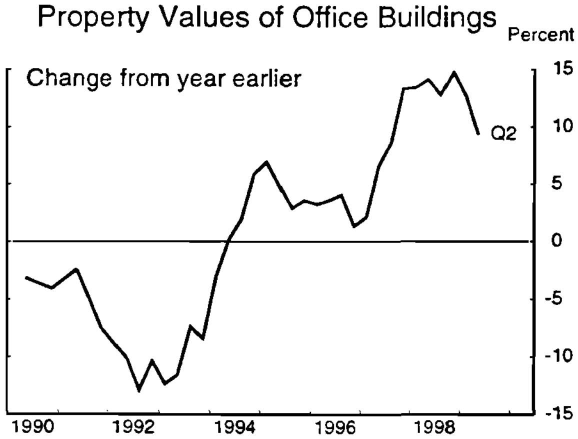
Indicators of Market Conditions for Nonresidential Structures and Apartments

Office Vacancy Rate



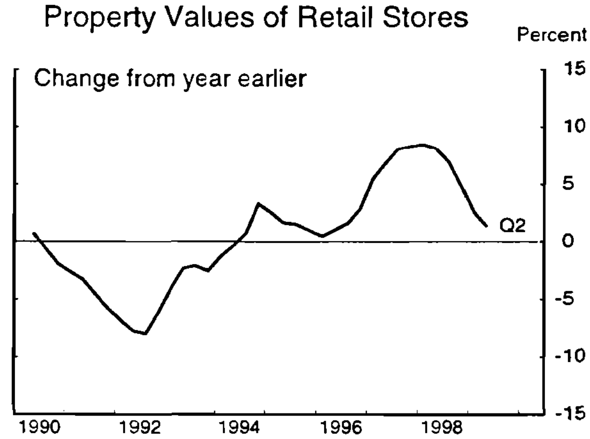
Source. CB Richard Ellis

Property Values of Office Buildings



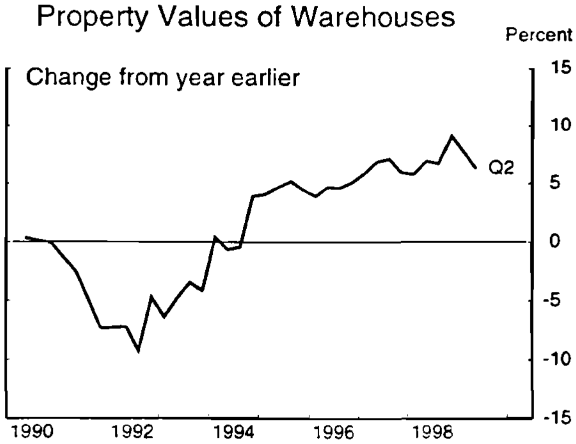
Source. National Real Estate Index

Property Values of Retail Stores



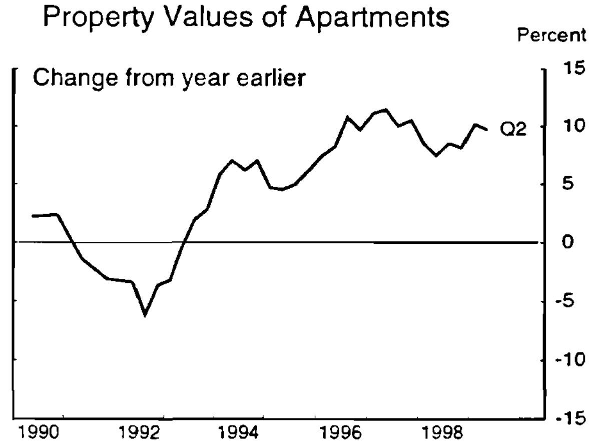
Source. National Real Estate Index

Property Values of Warehouses



Source. National Real Estate Index

Property Values of Apartments



Source. National Real Estate Index

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

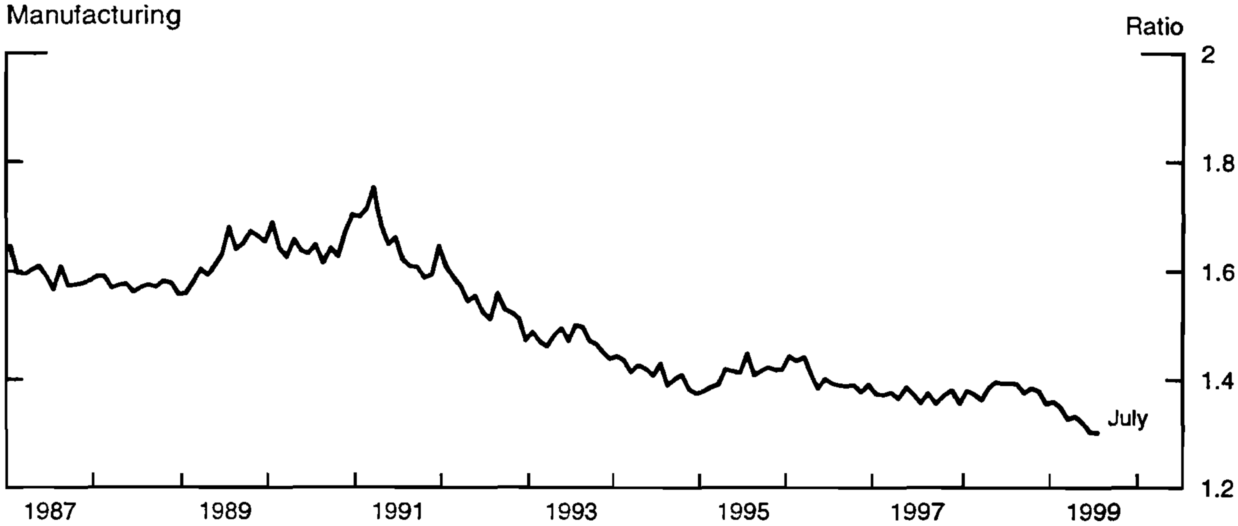
Category	1998 Q4	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
Manufacturing and trade	22.8	34.3	34.8	39.0	40.9	43.6
Less wholesale and retail motor vehicles	5.8	10.2	12.9	16.0	15.3	47.4
Manufacturing	-7.0	-12.9	-3.6	6.6	-12.6	27.3
Less aircraft	-3.9	-3.0	5.1	16.3	-5.2	20.3
Merchant wholesalers	10.6	7.5	8.0	7.0	13.8	30.8
Less motor vehicles	5.6	6.5	6.2	2.4	12.8	27.3
Retail trade	19.2	39.7	30.3	25.4	39.7	-14.5
Automotive dealers	12.0	23.1	20.1	18.4	24.6	-7.3
Less automotive dealers	7.2	16.6	10.2	7.0	15.2	-7.1

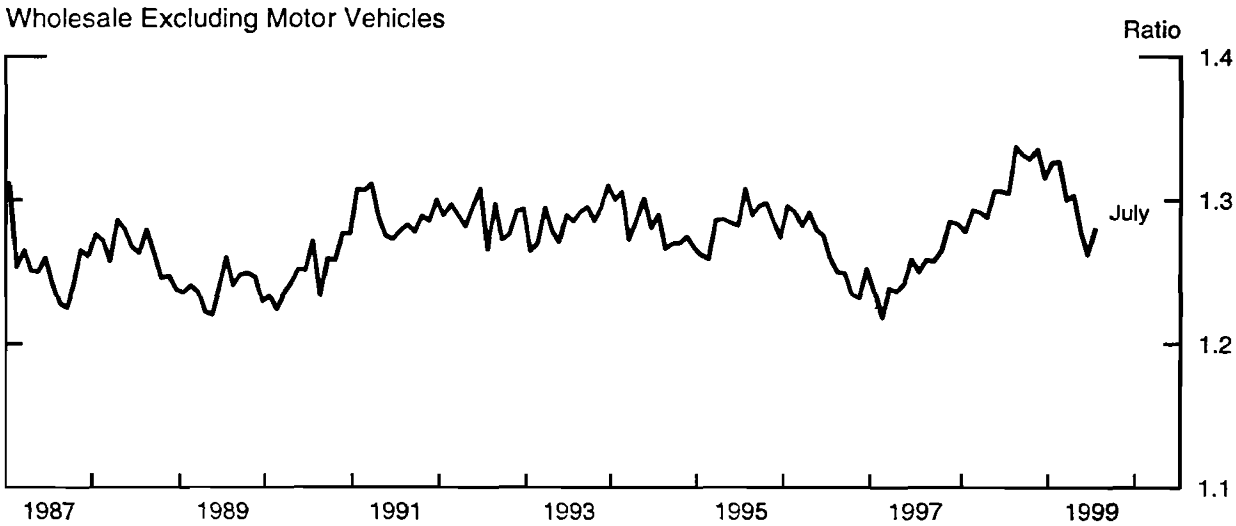
SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE
(Months' supply, based on seasonally adjusted Census book value)

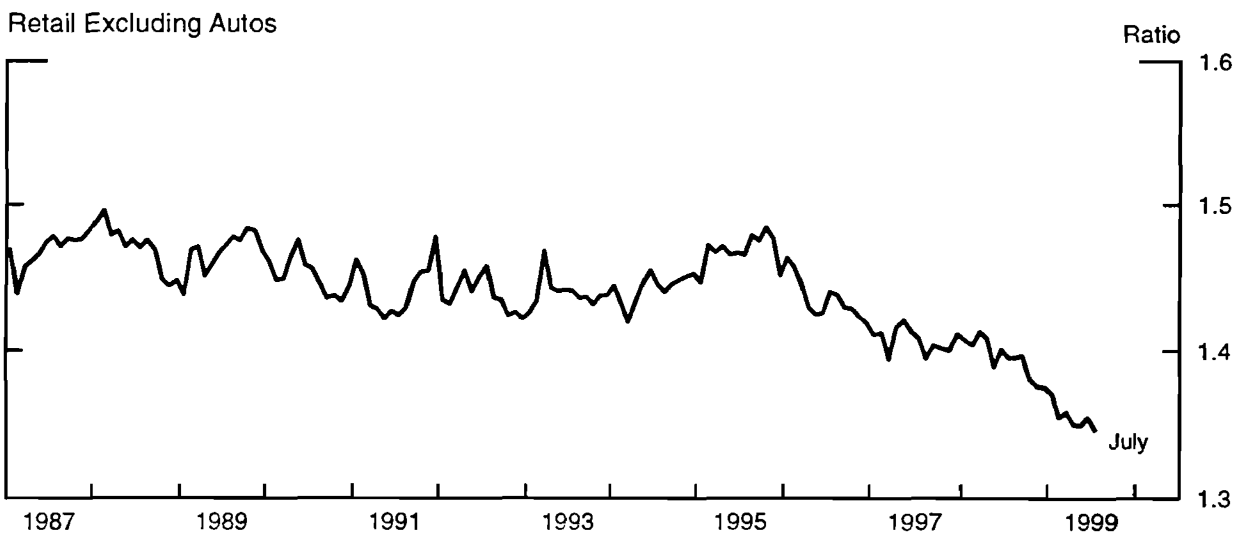
Category	Cyclical reference points: 1990-91 high	Cyclical reference points: 1991-98 low	Range over preceding 12 months: High	Range over preceding 12 months: Low	July 1999
Manufacturing and trade	1.58	1.37	1.40	1.34	1.34
Less wholesale and retail motor vehicles	1.55	1.34	1.38	1.31	1.31
Manufacturing	1.75	1.36	1.39	1.30	1.30
Primary metals	2.08	1.46	1.74	1.61	1.60
Steel	2.56	1.59	2.25	2.04	2.01
Nonelectrical machinery	2.48	1.61	1.66	1.60	1.51
Electrical machinery	2.08	1.21	1.30	1.20	1.17
Transportation equipment	2.93	1.51	1.85	1.44	1.49
Motor vehicles	.97	.53	.62	.51	.51
Aircraft	5.84	4.05	4.97	3.82	4.47
Nondefense capital goods	3.09	2.04	2.21	1.96	1.93
Textiles	1.71	1.38	1.59	1.48	1.54
Paper	1.32	1.06	1.23	1.18	1.18
Chemicals	1.44	1.25	1.45	1.35	1.36
Petroleum	.94	.80	.99	.79	.76
Home goods & apparel	1.96	1.59	1.75	1.53	1.58
Merchant wholesalers	1.36	1.24	1.35	1.28	1.29
Less motor vehicles	1.31	1.22	1.34	1.26	1.28
Durable goods	1.83	1.54	1.66	1.57	1.58
Nondurable goods	.95	.90	1.02	.95	.96
Retail trade	1.61	1.44	1.47	1.42	1.43
Less automotive dealers	1.48	1.38	1.40	1.35	1.35
Automotive dealers	2.22	1.59	1.74	1.61	1.68
General merchandise	2.42	2.00	2.05	1.93	1.91
Apparel	2.53	2.28	2.50	2.27	2.29
GAF	2.41	2.06	2.11	1.99	1.98

Inventory-Sales Ratios, by Major Sector

(Book value)







instruments, tobacco, fabricated metals, transportation equipment, and stone, clay, and glass products, as well as general merchandisers and furniture retailers, have exhibited steady downtrends for most of the decade. So far this year, the decrease in inventories relative to sales in these industries--which account for about 30 percent of the total sales for the manufacturing and trade sector (excluding automotive products)--has been in line with their long-term downward trends.

In some other industries, this year's falling inventory-sales ratios followed a marked run-up in the ratios that coincided with the weakening demand from abroad and heightened competition from imports that occurred during late 1997 and 1998. Among these industries, which collectively represent about 20 percent of the sales in the broader aggregate, manufacturers and distributors of chemicals and of metals and minerals, producers of paper and of leather, wholesalers of electrical equipment and of hardware, professional and commercial equipment jobbers, and apparel retailers all have managed to bring their stock-to-sales ratios down from last year's elevated levels. Still, in some cases--namely in the chemicals, metals, and wholesale machinery sectors--further reductions appear to be necessary to bring inventory-sales ratios back in line with the levels that generally prevailed a couple of years ago.

Among the remaining industries, the overall ratio of inventories to sales moved up slightly in 1997 and 1998 and down slightly in 1999. Much of this decline owed to a sharp drop in stock-to-sales ratios at petroleum refiners and distributors, where the run-up in crude oil prices and the deteriorating margins have made it more costly to hold inventories. Inventory-to-sales ratios in the remaining industries, representing about half of the sales of the sector, have been flat over the past two years: The current level of inventories does not look out of line with shipments and sales, and stockbuilding has proceeded at a steady, modest pace.

Government Expenditures

Federal. The federal government posted a unified deficit of $28 billion during July and August, down about $8 billion from the same period a year earlier. Adjusted federal outlays for July and August were up just 3 percent from last year's level. This modest growth owes primarily to declines in net interest and Medicare expenditures and continued very slow growth in the cyclically sensitive income security category. Spending restraint in these areas partially offset the increases in Medicaid, other health programs, defense, and the "other" category--primarily nondefense discretionary spending.

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

	July-August			Fiscal year to date		
	1998	1999	Percent change	1998	1999	Percent change
Outlays	266.7	275.9	3.4	1508.7	1559.9	3.4
Deposit insurance (DI)	-1.0	-0.6	-44.1	-4.0	-4.9	21.2
Spectrum auction	-0.4	-0.1	-84.5	-1.2	-1.0	-15.5
Sale of major assets	0.0	0.0	0.0	-3.2	0.0	-100.0
Other	268.1	276.5	3.1	1517.0	1565.7	3.2
Receipts	231.5	248.2	7.2	1540.5	1626.5	5.6
Surplus	-35.3	-27.7	-21.5	31.8	66.6	109.3
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	269.2	277.0	2.9	1522.0	1566.5	2.9
National defense	44.3	47.0	6.1	245.6	252.5	2.8
Net interest	42.2	39.5	-6.2	227.4	215.0	-5.4
Social security	63.1	64.8	2.7	347.4	358.0	3.0
Medicare	32.8	32.4	-1.2	178.3	174.4	-2.2
Medicaid	16.6	18.0	8.4	92.5	97.9	5.9
Other health	5.1	5.7	10.1	27.2	29.8	9.6
Income security	35.8	37.0	3.5	215.8	219.9	1.9
Other	29.2	32.6	11.5	187.7	218.9	16.6
Receipts	231.5	248.2	7.2	1540.5	1626.5	5.6
Individual income and payroll taxes	196.5	209.2	6.5	1231.2	1311.7	6.5
Withheld + FICA	190.5	204.1	7.1	1059.3	1140.0	7.6
Nonwithheld + SECA	10.0	10.0	0.4	268.7	291.8	8.6
Refunds (-)	4.0	4.9	22.1	96.7	120.1	24.1
Corporate	5.5	7.1	28.2	151.9	144.4	-4.9
Gross	8.8	10.4	18.9	174.3	173.8	-0.3
Refunds (-)	3.2	3.3	3.0	22.5	29.3	30.5
Other	29.4	31.9	8.5	157.4	170.3	8.2
Surplus	-37.7	-28.8	-23.6	18.5	59.9	224.1

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.

Receipts in July and August were about 7 percent higher than last year's level. This rise reflects the robust growth of withheld income and payroll taxes that is related primarily to the growth of nominal wages and salaries. September is important for receipts because individuals and corporations are required to make their quarterly estimated tax payments by the fifteenth day of the month. Preliminary data reported in the Daily Treasury Statement indicate that Treasury fared well on the fifteenth and that receipts for the month likely will be up about 10 percent compared to September of 1998. This gain places the federal government on track for a sizable surplus in September and a total surplus in the $118 billion to $128 billion range for fiscal 1999.

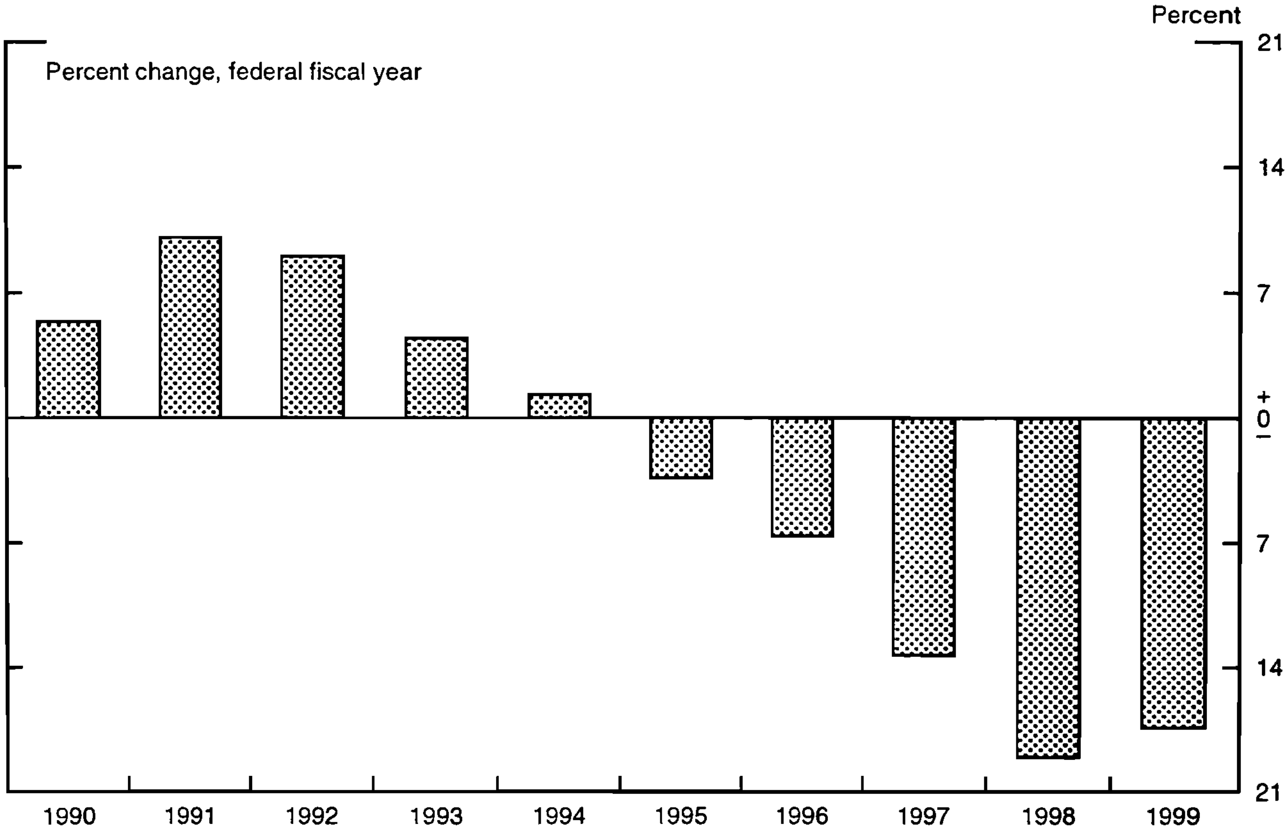
The congressional appropriations process that will fund discretionary spending programs in fiscal 2000 remains far from complete. As of September 28, Congress had sent the President four of the thirteen regular appropriations bills, and the President has signed one of these and vetoed one. Congressional versions of most other bills are nearing completion, but several of these face presidential veto threats.[4] Therefore, Congress has enacted a three-week continuing resolution that provides temporary funding to programs whose regular appropriation has not been enacted. In this time period, Congress and the Administration will have to reconcile significant differences in spending priorities, and also reconcile the appropriations bills with the discretionary spending caps and promises to not spend any of the social security surplus. This likely will be a formidable task because the CBO and the Democratic staff of the House Budget Committee claim that congressional action to date would reduce the CBO baseline surplus projection about $40 billion (this would cut the projected social security surplus about $25 billion).

State and local. Employment gains in the state and local government sector averaged almost 52,000 in July and August, nearly double the 28,000 average over the first half of the year. However, much of the strength this quarter stems from increases in local education and may reflect difficulties with seasonal adjustment during the volatile summer months. Meanwhile, real state-and-local expenditures on construction edged down in July, with a large drop in the education component. Real outlays on highway construction, which had surged in the first quarter and fallen back in the spring, jumped 2 percent in July to a level comparable to the fourth-quarter average.

Some of the fiscal good news among the states reflects the steady decline of welfare caseloads from their peak in 1994 (see chart). By March 1999--the last

4. The House and Senate have passed different versions of eight other bills; the differences are being reconciled in conference.

Welfare Caseloads



Note. The observation for 1999 is the percent change for the first six months compared with the same period in the prior year.

month for which data are available--caseloads stood at their lowest level in thirty years. Indeed, states have not needed to use all of their federal grants: Temporary Assistance to Needy Families for the period from federal fiscal year 1997 through the first quarter of 1999 were $4.2 billion, about 12 percent of the total federal TANF funds awarded so far. Current law states that these funds will remain available for obligation until drawn on by the states.

Prices and Labor Costs

Prices. Outside of the energy sector, inflation has remained subdued. The overall CPI rose 0.3 percent in August but only 0.1 percent excluding food and energy. Over the most recent twelve months, the headline CPI has accelerated to 2.3 percent from 1.6 percent in the previous twelve-month period owing to the sharp rebound in energy prices; the core CPI has risen just 1.9 percent, down from the 2.5 percent increase of a year earlier.[5]

The jump in CPI energy prices in August was the second in a row and reflected the pass-through of higher crude petroleum costs into motor fuel and home heating oil. Since the end of last year, gasoline prices have climbed about 23 percent (not at an annual rate) after having fallen more than 15 percent in 1998. The latest survey data suggest that retail prices for gasoline rose further in September. In August, natural gas prices posted a large increase for the third consecutive month. Food prices, on the other hand, have remained more or less in check, rising 0.2 percent in each of the past two months. Since August of last year, food prices have increased 2.0 percent, about in line with the core CPI. Prices of some farm commodities moved up a little following the damage wrought by hurricane Floyd; overall, however, agricultural futures prices are lower than they were at the time the August Greenbook was published.

The CPI for commodities other than food and energy edged down 0.1 percent in August and has risen only 0.2 percent over the past twelve months. Computer prices fell 3.8 percent--the largest monthly decline since January. New and used car prices continued to move in opposite directions: After ticking down in August, prices for new motor vehicles are now down 0.6 percent since the beginning of the year; in contrast, used car prices posted their fifth consecutive sizable increase in August. Tobacco prices fell

5. Changes in methodology introduced in January have held down the increase in the CPI, thus exaggerating the deceleration in the core CPI. On a consistently measured basis using current methodology, the core CPI increased 1.9 percent in the most recent twelve months, down from the 2.2 percent increase in the twelve months ended in August 1998.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1999		1999	
	Aug. 1998	Aug. 1999	Q1	Q2	July	Aug.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	1.6	2.3	1.5	3.4	.3	.3
Food (15.4)	2.2	2.0	2.4	.9	.2	.2
Energy (6.3)	-7.7	7.2	-2.0	25.5	2.1	2.7
CPI less food and energy (78.3)	2.5	1.9	1.6	2.5	.2	.1
Commodities (24.0)	1.1	.2	.0	.6	.1	-.1
New vehicles (5.0)	-.1	-1.0	-.7	-1.0	.1	-.1
Used cars and trucks (1.9)	1.8	1.8	-11.5	2.3	.9	1.0
Apparel (4.8)	1.2	-3.1	-6.8	3.9	-.9	-.3
Tobacco (1.2)	12.4	27.9	81.5	-.7	3.3	-1.3
Other Commodities (11.1)	.2	-.5	-.6	-.3	.0	-.2
Services (54.3)	3.1	2.6	2.4	3.1	.3	.2
Shelter (29.9)	3.3	2.8	1.7	3.4	.1	.2
Medical care (4.5)	3.5	3.2	3.7	3.3	.2	.3
Other Services (19.9)	2.7	2.2	3.1	2.7	.5	.0
PPI						
Finished goods (100.0)[2]	-.8	2.3	1.3	2.7	.2	.5
Finished consumer foods (23.3)	.2	.4	2.5	-2.1	-.9	.4
Finished energy (12.0)	-10.5	10.9	-4.0	26.6	3.4	3.7
Finished goods less food and energy (64.7)	1.1	1.3	2.1	.3	.0	-.1
Consumer goods (39.5)	2.1	2.0	3.6	.4	.1	-.1
Capital equipment (25.2)	-.7	.1	-.4	.3	-.1	.0
Intermediate materials (100.0)[3]	-2.1	1.2	-2.5	4.1	.6	.8
Intermediate materials less food and energy (83.2)	-.6	.2	-1.7	1.7	.4	.2
Crude materials (100.0)[4]	-12.3	8.3	-12.7	24.6	-.2	4.6
Crude food materials (45.0)	-7.4	-3.1	-2.5	-9.9	-4.8	3.8
Crude energy (31.7)	-19.1	32.1	-29.4	118.5	3.7	7.2
Crude materials less food and energy (23.3)	-11.2	-2.1	-5.1	1.7	2.3	1.8

1. Relative importance weight for CPI, December 1998.
2. Relative importance weight for PPI, December 1998.
3. Relative importance weight for intermediate materials, December 1998.
4. Relative importance weight for crude materials, December 1998.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1996 Q2	1997 Q2	1998 Q2	1999 Q2
Product prices				
GDP chain price index	1.9	2.0	1.0	1.2
Nonfarm business chain-type price index[1]	1.3	2.0	0.7	0.9
Expenditure prices				
Gross domestic purchases chain-type price index	1.7	1.7	0.6	1.2
Less food and energy	1.5	1.7	0.8	1.1
PCE chain-type price index	2.0	1.9	0.8	1.4
Less food and energy	1.8	2.0	1.1	1.3
CPI	2.9	2.3	1.6	2.1
Less food and energy	2.7	2.5	2.2	2.1
Median CPI	3.2	2.9	2.9	2.6
Trimmed mean CPI	2.8	2.5	2.0	1.8

1. Excluding housing.

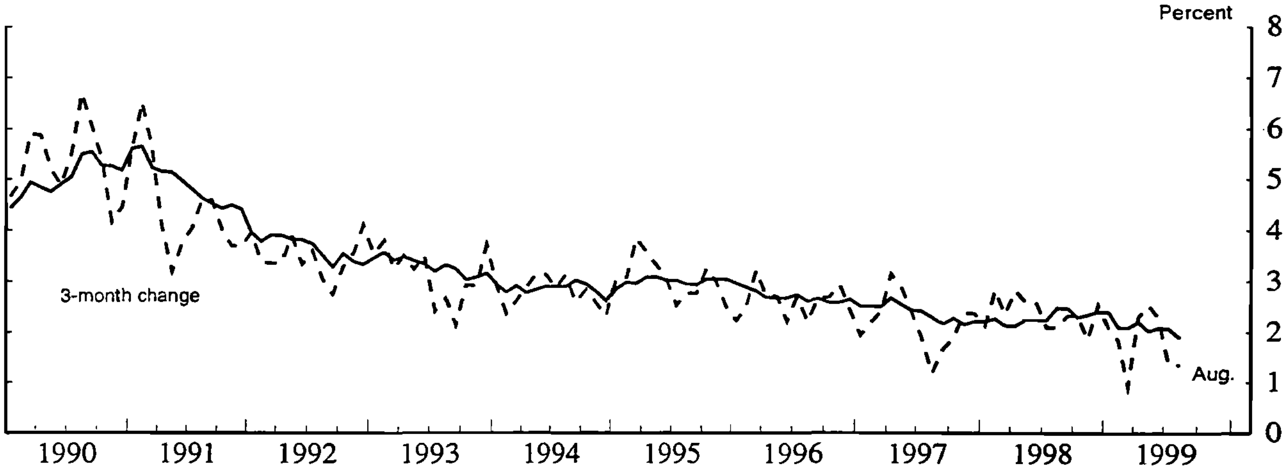
SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year Mean[2]	University of Michigan: 1 year Median[3]	University of Michigan: 5 to 10 years Mean[4]	University of Michigan: 5 to 10 years Median[5]	Professional forecasters (10-year)[6]
1998-Q1	1.5	2.8	2.4	3.3	2.9	2.6
Q2	1.6	3.0	2.6	3.3	2.8	2.5
Q3	1.6	2.8	2.4	3.2	2.8	2.5
Q4	1.5	2.7	2.4	3.2	2.8	2.5
1999-Q1	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		3.2	2.7	3.3	2.9	2.5
Apr.	2.3	3.0	2.7	3.0	2.8	
May	2.1	3.2	2.8	3.5	2.9	
June	2.0	3.1	2.5	3.3	2.8	2.5
July	2.1	3.0	2.7	3.3	2.9	
Aug.	2.3	3.2	2.8	3.3	2.8	
Sept.		3.3	2.7	3.4	3.0	2.5

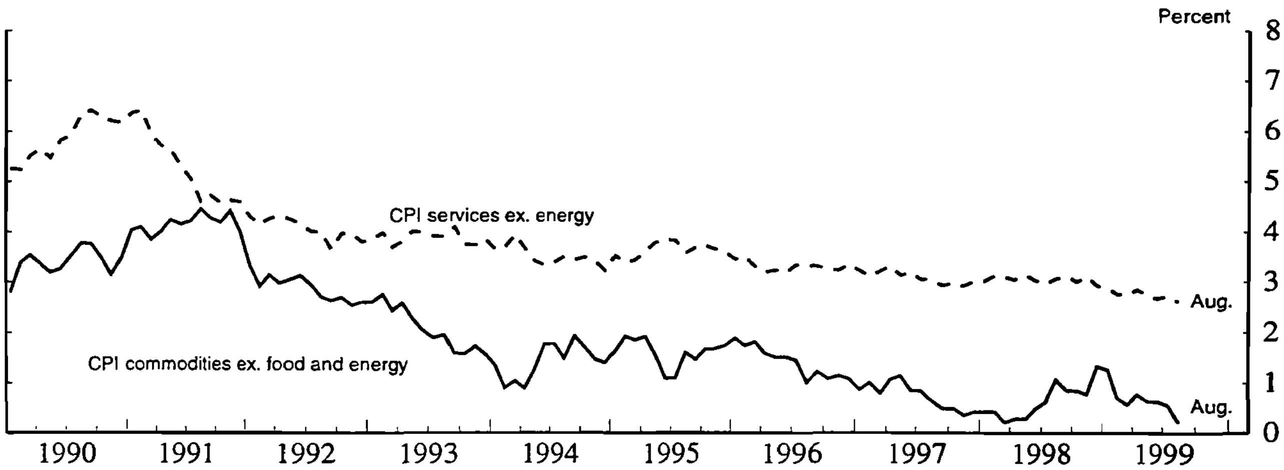
1. CPI; percent change from the same period in the preceding year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Average increase for responses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

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

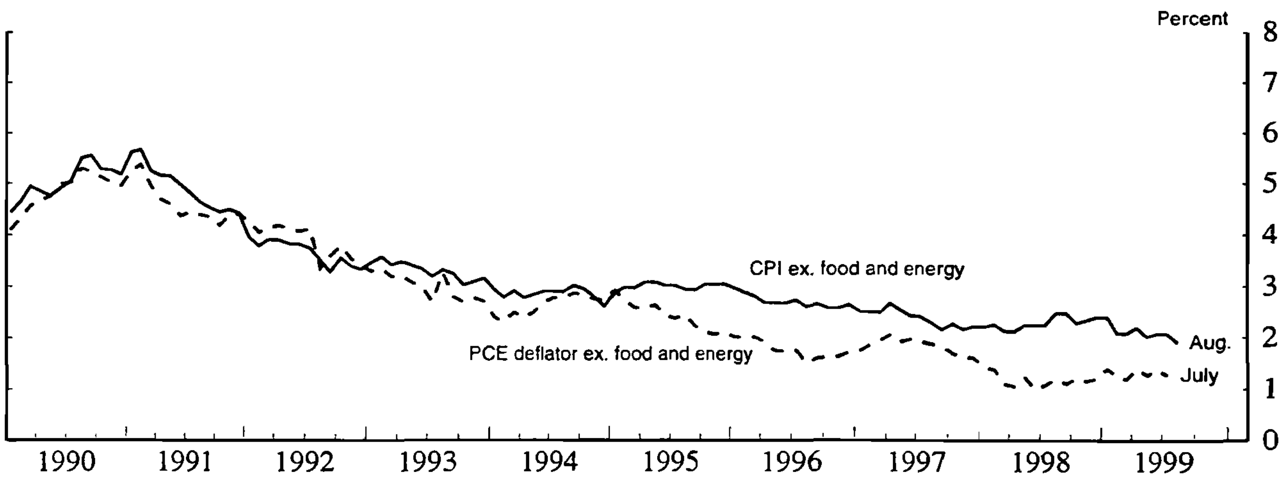
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE



1.3 percent in August, reversing some of the July increase. We expect to see the first effects of the recent hike in wholesale cigarette prices in the September CPI report.[6] However, some reports have suggested that the tobacco companies might temper the initial impact of these price increases on consumers by offering coupons and other forms of discounting, implying that the adjustment could be spread across several months. On net, we would expect these tobacco price increases to boost both the core and total CPI indexes by about a tenth.

Prices of services excluding energy moved up 0.2 percent in August after having increased 0.3 percent in July. Owners' equivalent rent rose 0.2 percent last month, continuing the string of small increases seen so far this year. Through the first eight months of the year, owners' equivalent rent has increased 2.2 percent at an annual rate, down from the 3.2 percent rate of rise posted for all of 1998.[7] Among other key components, airfares fell 2.7 percent last month, following July's 6.5 percent increase; even with only a small weight, the month-to-month swing in this component accounted for the tick down in the broader services (excluding energy) category. For the twelve months ended in August, prices of non-energy services rose 2.6 percent, down from 3.1 percent in the previous twelve-month period; about half of this deceleration can be accounted for by the slowdown in owners' equivalent rent.

For capital goods, the PPI was unchanged in August after two months of declines. Producer prices of computers plunged 3-1/4 percent last month after having dropped only 1-1/4 percent per month, on average, in June and July. In the year to date, computer prices have fallen 24 percent at an annual rate, just a little less rapidly than the average in 1998. Finally, the producer price indexes for new cars and light trucks were both down again in August, and prices of communications equipment held about steady for the two months following June's sharp decrease.

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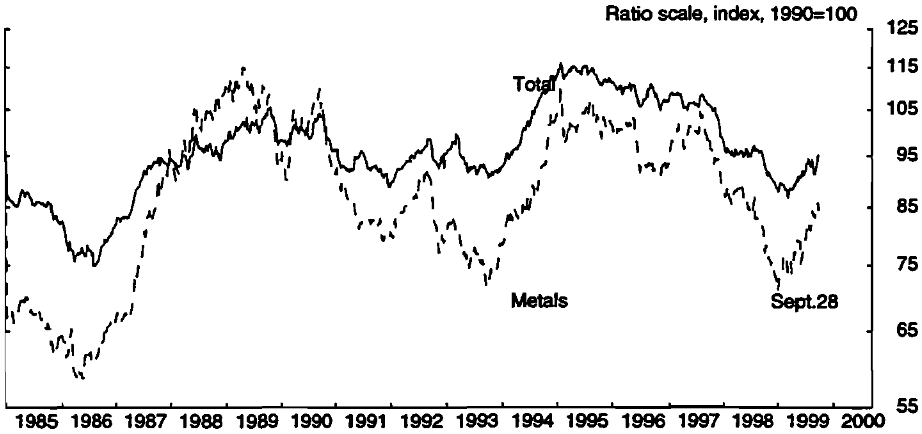
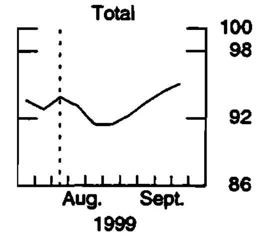
6. Major tobacco companies raised wholesale cigarette prices 18 cents per pack as of September 1. As reported by the *Wall Street Journal*, 10 cents per pack can be attributed to the rise in federal excise taxes scheduled for January 1, 2000, and 4 cents covers additional costs related to the tobacco settlement. The remaining 4 cents, according to the *Journal* article, is a reflection of the normal uptrend in prices. The increase was supposedly timed to prevent wholesalers from stocking up ahead of the increase in the excise taxes.

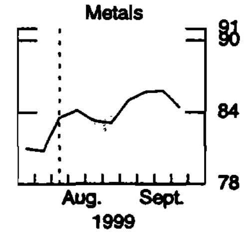
7. The small increases in owners' equivalent rent stand in contrast to the increases in house prices. BLS analysts say that there is no obvious reason why the new sample of households and weighting change, introduced in January of this year should have held down the published price increases. The index for rent of primary residence--which was also affected by the change in the sample of households but not by the change in weighting--has also decelerated. In any case, the relationship between owners' equivalent rent and house prices has never been a particularly tight one.

Commodity Price Measures

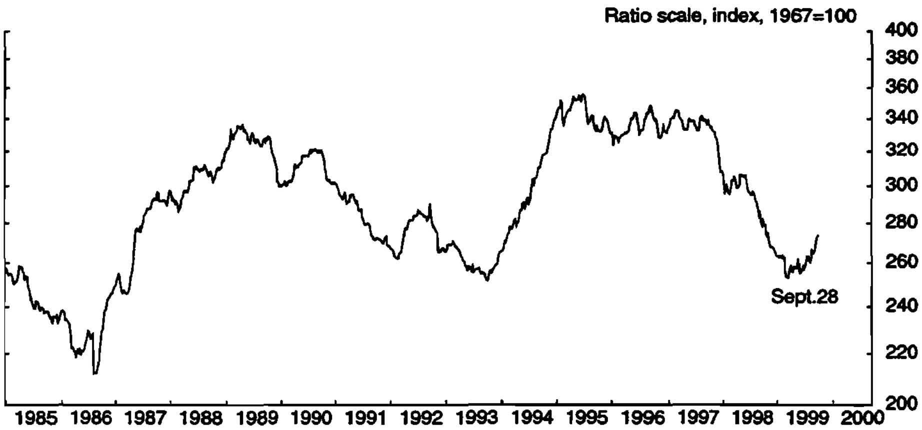
Journal of Commerce Index

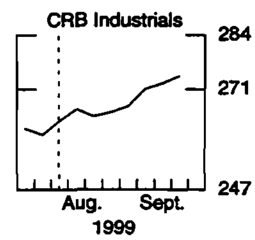




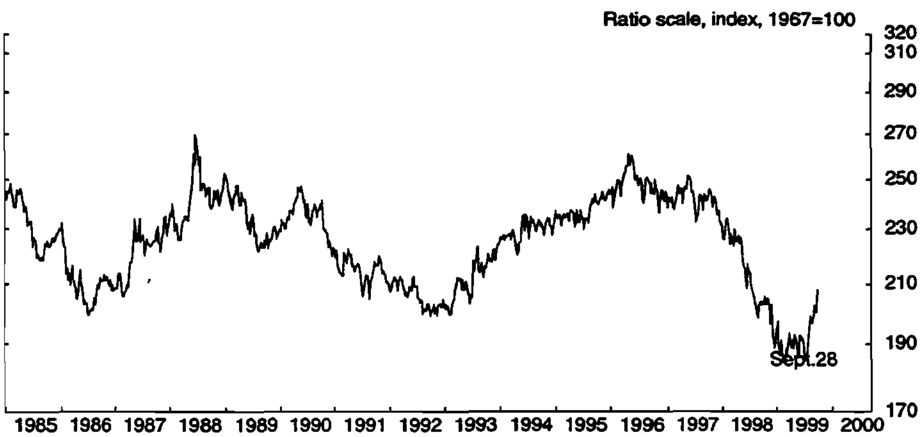


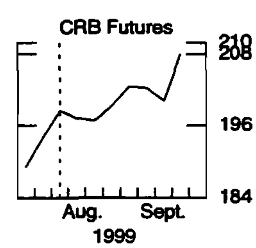
CRB Spot Industrials





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

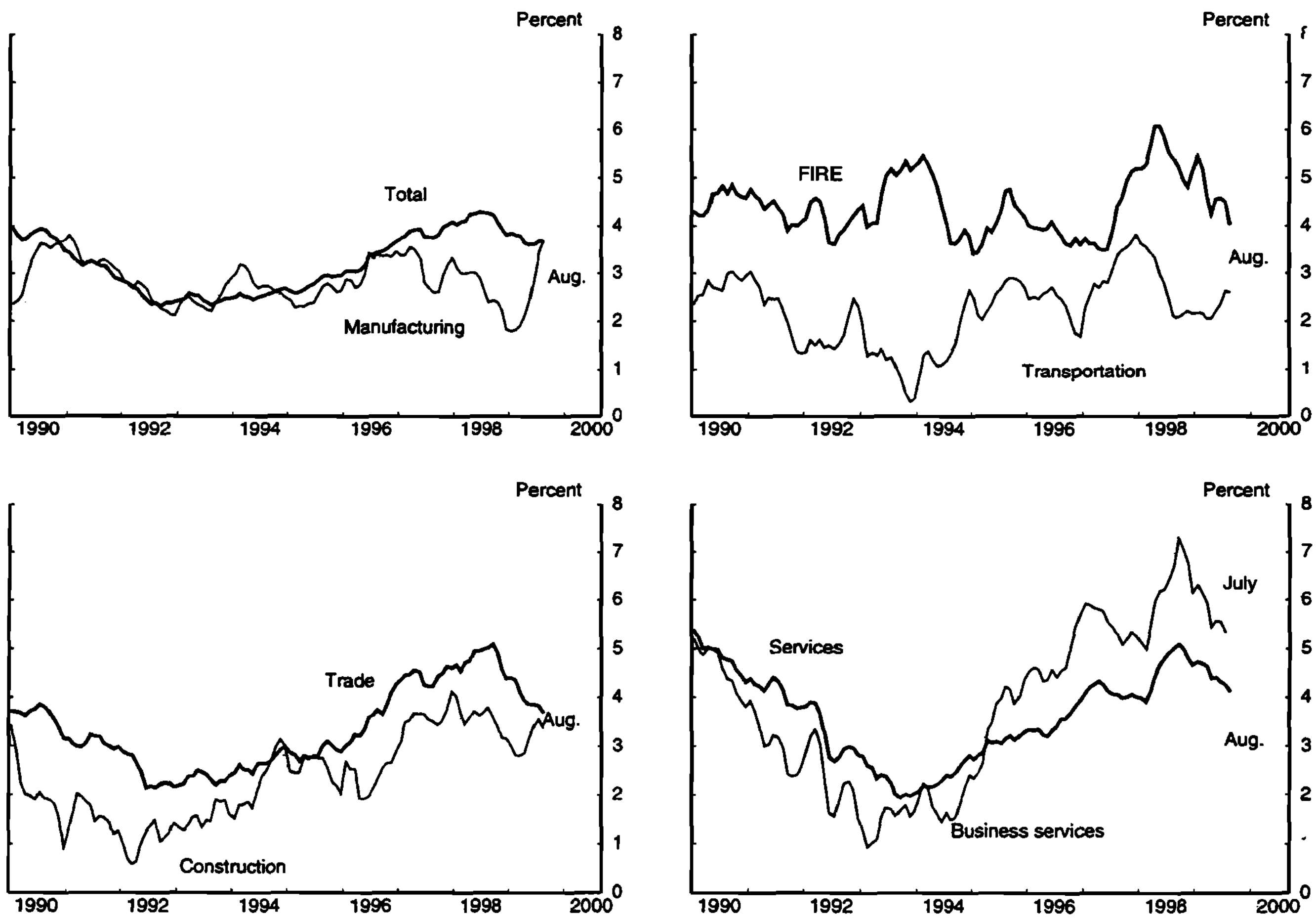
	Current price ($)	Percent change[1]: 1997	1998	Dec. 29 to Aug. 17[2]	Aug. 17[2] to Sept. 28	Memo: Year earlier to date
Metals						
Copper (lb.)	.830	-21.5	-14.8	17.4	2.5	5.1
Steel scrap (ton)	99.667	19.3	-47.5	37.2	.0	1.9
Aluminum, London (lb.)	.670	-1.9	-17.6	16.6	2.3	12.5
Precious metals						
Gold (oz.)	322.610	-20.7	-1.1	-9.5	24.2	9.0
Silver (oz.)	5.765	27.2	-18.0	5.0	9.3	7.4
Forest products[3]						
Lumber (m. bdft.)	330.000	-26.6	2.7	16.7	-5.7	20.0
Plywood (m. sqft.)	355.000	-1.7	3.3	38.7	-17.4	2.9
Petroleum						
Crude oil (barrel)	23.280	-27.4	-36.1	99.4	13.0	62.5
Gasoline (gal.)	.726	-23.5	-33.5	91.4	13.8	57.2
Fuel oil (gal.)	.614	-29.6	-33.6	71.1	9.4	47.5
Livestock						
Steers (cwt.)	65.250	4.2	-13.2	10.6	.0	12.5
Hogs (cwt.)	36.630	-30.8	-55.7	121.0	6.9	16.3
Broilers (lb.)	.546	-24.4	15.0	2.8	-6.4	-17.7
U.S. farm crops						
Corn (bu.)	1.825	-3.8	-19.4	-9.7	-1.9	-.5
Wheat (bu.)	2.843	-24.1	-5.7	-19.3	6.2	-2.9
Soybeans (bu.)	4.595	-3.2	-21.1	-16.3	3.0	-9.4
Cotton (lb.)	.492	-10.9	-10.2	-10.1	-4.6	-29.2
Other foodstuffs						
Coffee (lb.)	.838	26.1	-31.4	-21.2	-9.2	-24.5
Memo:						
JOC Industrials	95.100	-7.3	-9.8	5.2	2.1	.8
JOC Metals	84.400	-4.7	-18.5	16.3	.2	4.3
CRB Futures	207.970	-4.9	-17.2	3.3	5.4	2.1
CRB Spot	273.960	-7.6	-14.1	1.0	2.9	-2.8

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

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

	Twelve-month percent change			Percent change to Aug. 1999		1999	
	Aug. 1997	Aug. 1998	Aug. 1999	Feb. 1999	May 1999	July	Aug.
	-Annual rate-					-Monthly rate-	
Total private nonfarm	3.9	4.2	3.5	3.7	3.7	.3	.2
Manufacturing	2.8	2.5	3.5	5.0	4.7	.5	-.1
Construction	3.5	3.7	2.9	4.0	1.9	.2	-.2
Transportation and public utilities	3.7	2.1	2.3	2.3	1.0	.8	-.5
Finance, insurance, and real estate	5.1	4.7	3.8	2.6	2.2	.4	.0
Retail trade	4.2	5.3	3.6	3.8	3.6	.4	.2
Wholesale trade	5.0	4.6	3.2	3.7	3.9	.3	.1
Services	4.1	4.9	4.1	3.8	4.3	.3	.4

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



The quiescence of prices at the final goods level contrasts with a less favorable trend in prices at earlier stages of processing. Prices of PPI core intermediate materials moved up again in August, albeit at a more moderate pace than in the previous two months; over the past six months, these prices have increased at a 3 percent annual rate after having dropped 1.7 percent in the prior twelve months. Some of the recent rise reflects increases in the prices of some chemicals and plastics--both of which use petroleum heavily in their production. Still further back in the production chain, core materials prices at the crude level were up substantially again in August and have climbed 9-1/2 percent at an annual rate since the beginning of the year after having dropped 16 percent in 1998.

In the SRC survey of households, median expectations of inflation over the next twelve months came in at 2.7 percent for the third quarter, about unchanged from the average for the second quarter. Over the longer term, respondents expect a bit higher inflation: The average of third-quarter readings on median expectations for the next five to ten years was 2.9 percent, up about a tenth from the second quarter.

Labor costs. We have received only a few bits of information on labor costs since the last Greenbook, and they have provided mixed signals. Average hourly earnings of production or nonsupervisory workers on nonfarm payrolls rose 0.2 percent in August, as wage gains in services and wholesale and retail trade were partially offset by declines in most other major sectors. Average hourly earnings advanced 3.5 percent over the year ended August 1999, down from the 4.2 percent gain for the previous twelve months.

In contrast to the overall AHE data, wage increases from union settlements have shown some acceleration in 1999. The Bureau of National Affairs reported that first-year wage increases for all union settlements averaged 3.4 percent during the first thirty-eight weeks of 1999, up from 2.9 percent during the same period last year. Although these data do include the settlement reached between Boeing and its union, they do not include the recent generous settlements in the auto industry. Boeing and the International Association of Machinists and Aerospace Workers agreed to wage increases of 4 percent in each of the first two years of their contract and 3 percent in the third. This was in addition to a $4,400 average lump-sum payment, an increase in the hourly shift differential, and cost-of-living wage adjustments. On September 16, DaimlerChrysler and the UAW reached a tentative agreement that extends for four years instead of the traditional three years. The contract includes annual wage increases of 3 percent--on top of cost-of-living adjustments that will provide almost full indexation to the CPI-W--plus a signing bonus of $1,350. General Motors and the UAW reached tentative agreement on September 28 on a settlement that reportedly is quite similar to the DaimlerChrysler contract. Negotiations involving Ford are expected to be stickier because of the company's announced intention to spin off parts plants outside of existing bargaining units.

On the benefits side, we have no new information on the private sector. However, the Office of Personnel Management recently announced that premiums for participants in the Federal Employee Health Benefit Plan will increase 10 percent in 2000, on average, assuming no change in enrollments, and 9.3 percent taking account of anticipated changes in enrollment patterns. This will be the third consecutive large increase in FEHBP health costs. OPM cites rapidly rising costs for prescription drugs as one factor driving the substantial increases. For much of the 1990s, FEHBP increases were broadly similar to those indicated by the health insurance component of the ECI for private-sector workers. In the past couple of years, however, premiums have risen considerably faster than the ECI health component. The OPM announcement, together with the sizable increases in health insurance costs for the year 2000 announced by CALPERS last May, may be seen as pointing toward rising health insurance costs in the private sector.

DOMESTIC FINANCIAL DEVELOPMENTS

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

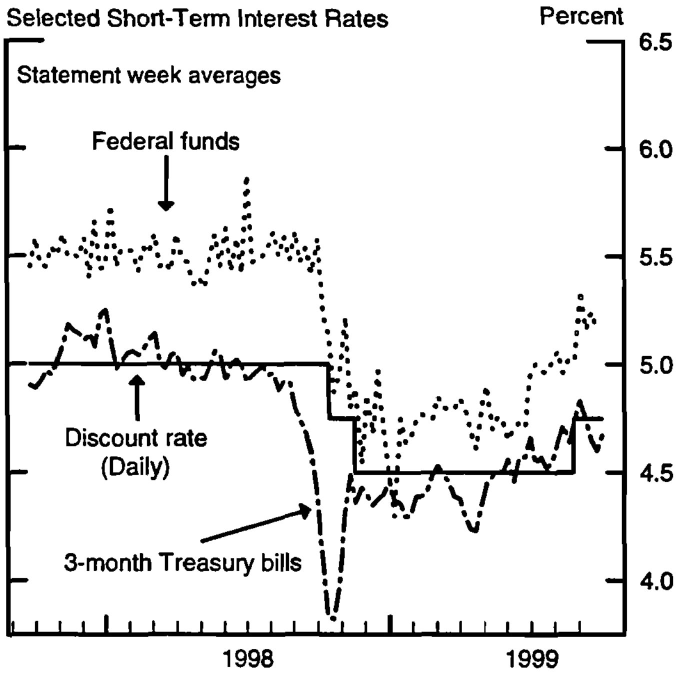
Instrument	1998 Oct. 15	1998 Dec. 31	1999 FOMC* Aug. 24	1999 Sept. 28	Change to Sept. 28 from selected dates (percentage points) Oct. 15	Dec. 31	FOMC* Aug. 24
Short-term							
FOMC intended federal funds rate	5.00	4.75	5.00	5.25	.25	.50	.25
Treasury bills [1]							
3-month	4.05	4.37	4.78	4.71	.66	.34	-.07
6-month	4.12	4.39	4.94	4.77	.65	.38	-.17
1-year	4.06	4.33	4.93	4.91	.85	.58	-.02
Commercial paper							
1-month	5.27	4.90	5.20	5.29	.02	.39	.09
3-month	5.13	4.84	5.30	5.32	.19	.48	.02
Large negotiable CDs [1]							
1-month	5.35	5.01	5.31	5.35	.00	.34	.04
3-month	5.31	4.97	5.43	5.45	.14	.48	.02
6-month	5.10	4.97	5.86	5.88	.78	.91	.02
Eurodollar deposits [2]							
1-month	5.34	4.94	5.25	5.31	-.03	.37	.06
3-month	5.28	4.94	5.38	5.44	.16	.50	.06
Bank prime rate	8.25	7.75	8.00	8.25	.00	.50	.25
Intermediate- and long-term							
U.S. Treasury (constant maturity)							
2-year	4.13	4.54	5.66	5.65	1.52	1.11	-.01
10-year	4.58	4.65	5.89	5.89	1.31	1.24	.00
30-year	5.02	5.09	5.98	6.07	1.05	.98	.09
U.S. Treasury 10-year indexed note	3.69	3.88	4.02	4.08	.39	.20	.06
Municipal revenue (Bond Buyer) [3]	5.21	5.26	5.86	5.93	.72	.67	.07
Corporate bonds, Moody's seasoned Baa	7.26	7.23	8.10	8.24	.98	1.01	.14
High-yield corporate [4]	11.28	10.17	10.91	11.22	-.06	1.05	.31
Home mortgages (FHLMC survey rate) [5]							
30-year fixed	6.49	6.77	7.93	7.76	1.27	.99	-.17
1-year adjustable	5.36	5.58	6.18	6.19	.83	.61	.01

Stock exchange index	Record high Level	Record high Date	1998 Dec. 31	1999 FOMC* Aug. 24	1999 Sept. 28	Change to Sept. 28 from selected dates (percent) Record high	Dec. 31	FOMC* Aug. 24
Dow-Jones Industrial	11,326.04	8-25-99	9,181.43	11,299.76	10,275.53	-9.28	11.92	-9.06
S&P 500 Composite	1,418.78	7-16-99	1,229.23	1,360.22	1,282.20	-9.63	4.31	-5.74
Nasdaq (OTC)	2,887.06	9-10-99	2,192.69	2,719.57	2,756.25	-4.53	25.70	1.35
Russell 2000	491.41	4-21-98	421.96	437.25	418.49	-14.84	-.82	-4.29
Wilshire 5000	12,976.99	7-16-99	11,317.59	12,367.22	11,697.48	-9.86	3.36	-5.42

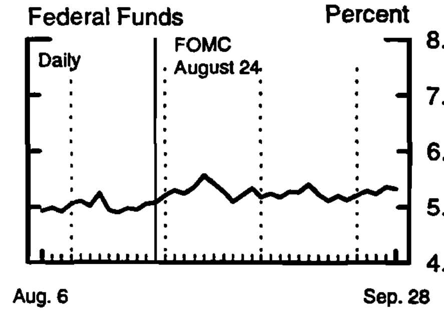
1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Most recent Thursday quote.
4. Merrill Lynch 175 high-yield bond index composite.
5. For week ending Friday previous to date shown.
* Data are as of the close on August 23, 1999.

Selected Interest Rates

Selected Short-Term Interest Rates

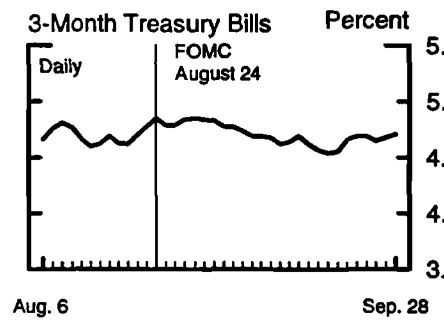


Federal Funds

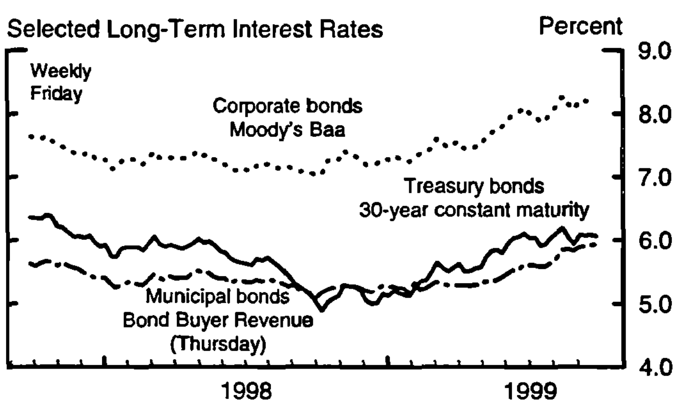


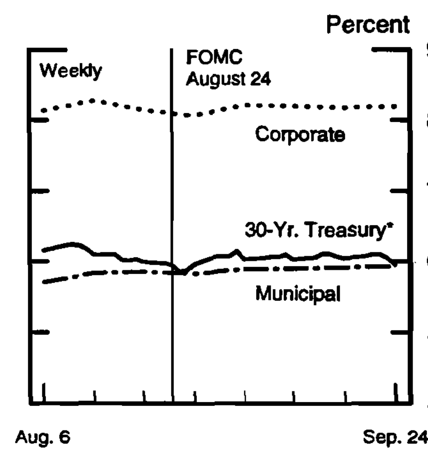
Note. Vertical dashed lines indicate end of reserve period.

3-Month Treasury Bills



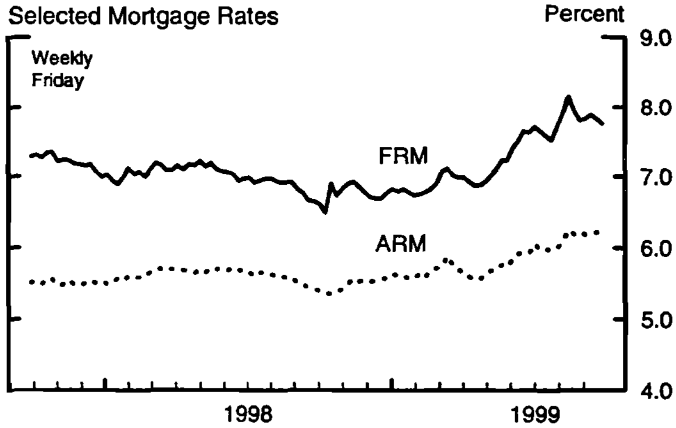
Selected Long-Term Interest Rates

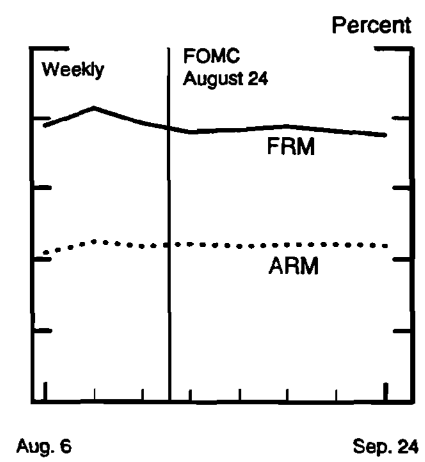




*Daily frequency.

Selected Mortgage Rates





Domestic Financial Developments

Overview
Market reaction to the System's 25 basis point tightening and the symmetric directive in August was limited since these actions were largely expected. For much of the intermeeting period, longer-term Treasury yields fluctuated in a narrow range, as incoming data pointing to unexpected strength in the U.S. economy and indicating a pickup abroad were counterbalanced by signs that retail price inflation was under control. In late September, however, yields swung more widely, partly in response to shifting sentiment on the equity market. Since the August meeting, Treasury yields have changed little, on net, at intermediate maturities and have risen about 10 basis points at the long end. Futures markets, which had never assigned much probability to a tightening at the October FOMC meeting, also foresee very low odds of a rate hike in November.

Yield spreads on investment-grade corporate debt have edged higher, but junk bond spreads have risen more substantially, reflecting concerns about prospective defaults. Most of the broad indexes of equity prices have posted sizable declines over the intermeeting period, with the Wilshire 5000 down more than 5 percent; at times the price declines seemed linked to concerns about a reallocation of portfolios away from the U.S. market.

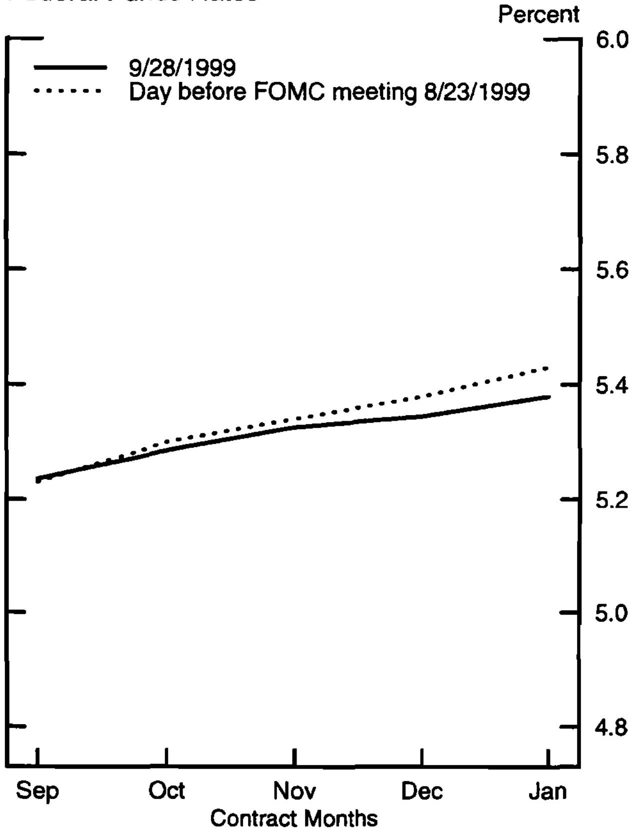
Since the August FOMC meeting, concerns about liquidity in financial markets at year-end and supply congestion in advance of the century date change have eased slightly, but many gauges of Y2K pressures on financial markets remain elevated. Special measures announced by the Desk and speeches by Federal Reserve System officials reassured market participants that the central bank stood ready to manage the century date change smoothly. Substantial uncertainty about the year-end remains, however, particularly about whether trading activity will slow and liquidity will dry up because of a reluctance to take on risk.

Available data for the third quarter indicate that private nonfinancial sectors have been adding debt at about the same fairly brisk rate as last quarter. Overall corporate debt growth has remained strong, with some firms that encountered tepid demand in the bond market borrowing instead from banks. Growth in home mortgage debt also has remained solid despite the sharp decline in refinancing activity, and growth in consumer credit has strengthened. Municipal debt has grown moderately, while the federal government has continued to pay down debt.

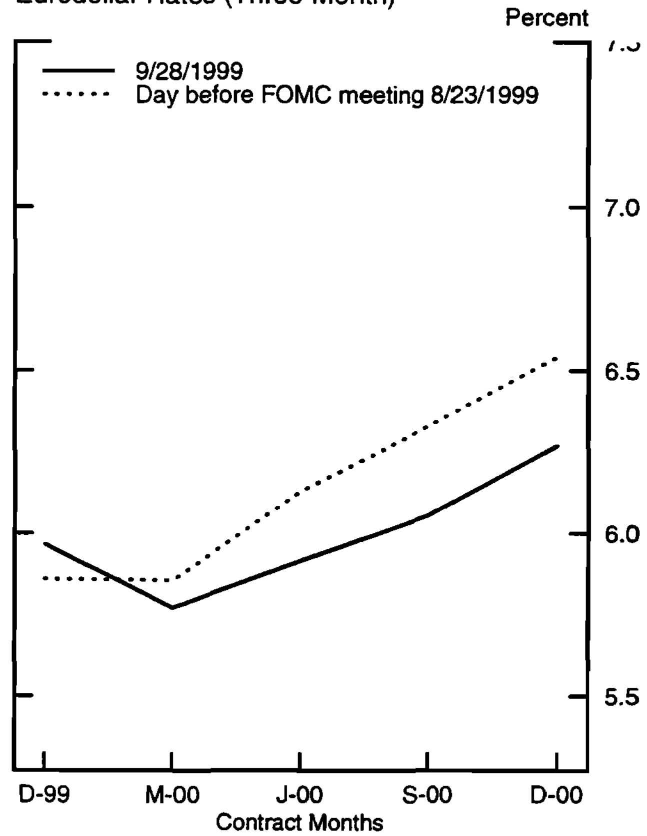
Liquidity and Year-End Concerns
Interest rate spreads over Treasuries have narrowed in many--but certainly not all--markets during the intermeeting period. However, even in those markets

Selected Short-Term Futures Rates

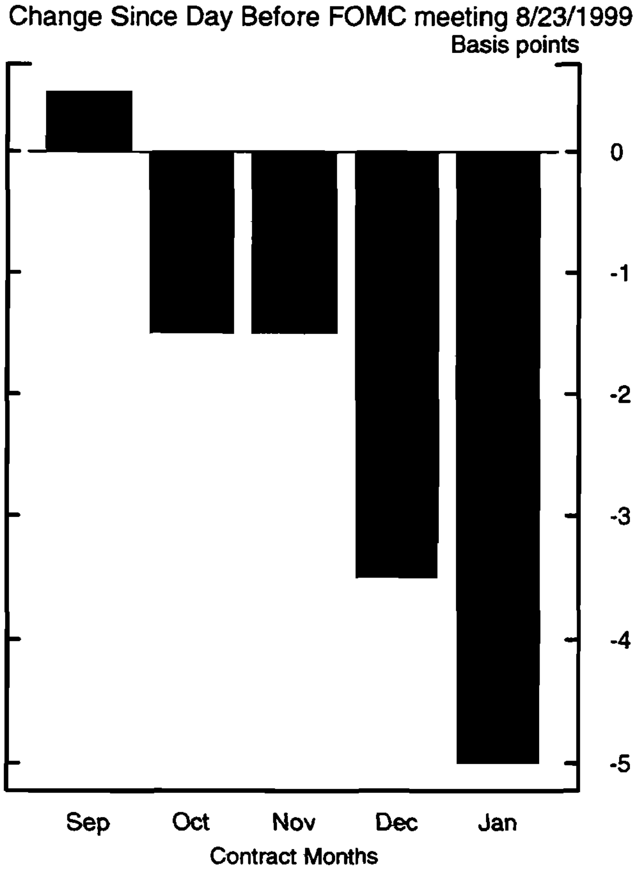
Federal Funds Rates



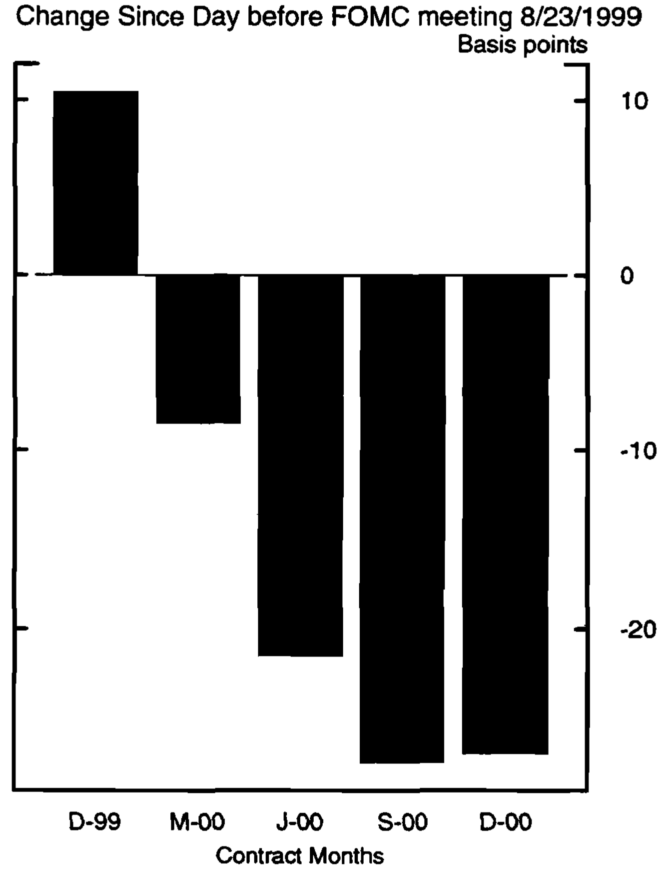
Eurodollar Rates (Three-Month)



Change Since Day Before FOMC meeting 8/23/1999



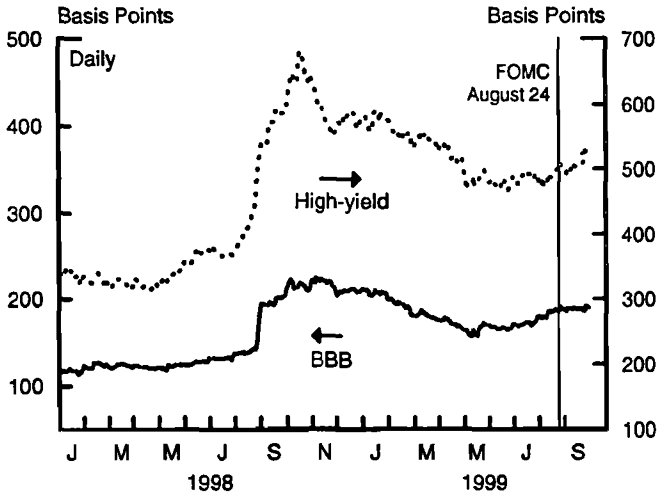
Change Since Day before FOMC meeting 8/23/1999



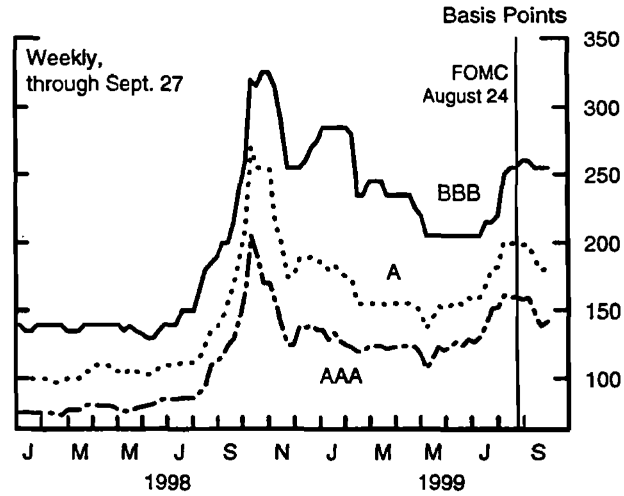
Yield Spreads over Comparable Treasuries

(Last observation is Sept. 28 except as noted)

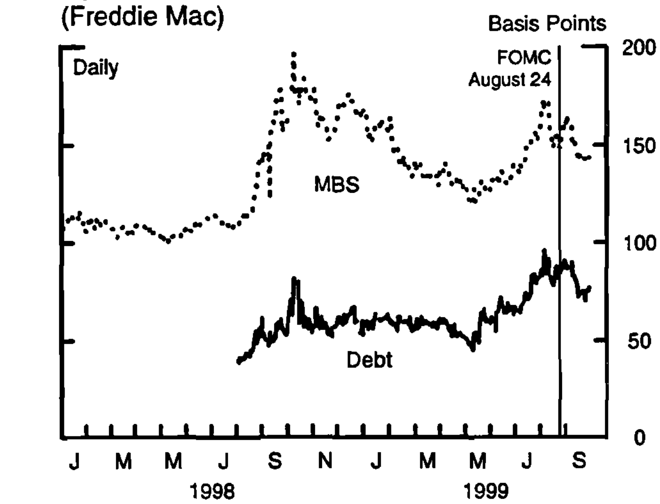
Corporate bonds



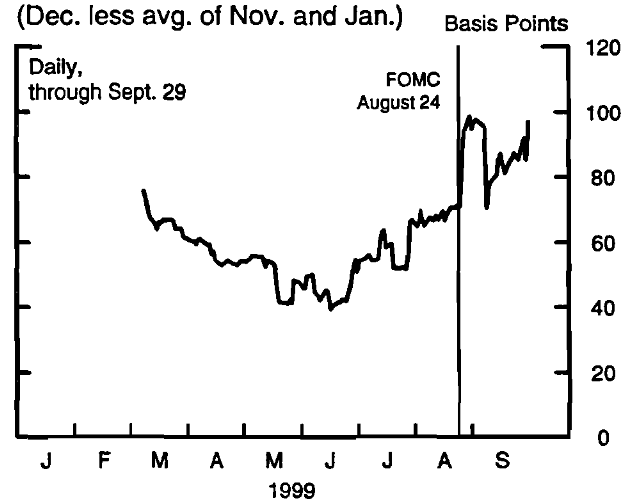
Commercial mortgage-backed securities



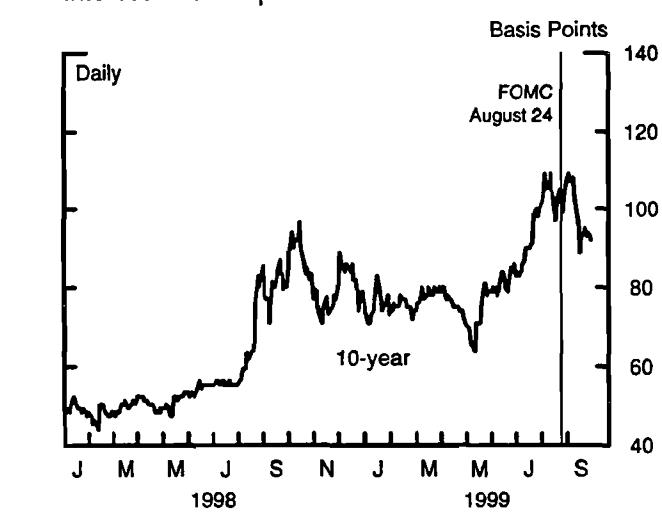
Agency debt and mortgage-backed securites
(Freddie Mac)



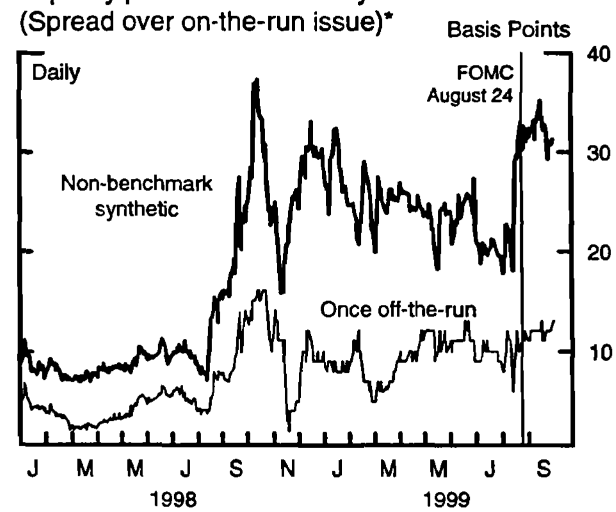
Y2K butterfly spread for LIBOR futures
(Dec. less avg. of Nov. and Jan.)



Interest rate swaps



Liquidity premium in Treasury market
(Spread over on-the-run issue)*



* Thirty-year bond

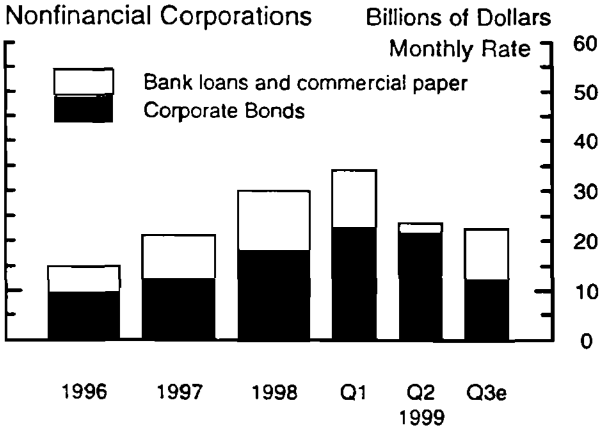
GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1997	1998	1999 H1	1999 Q3[e]	1999 Aug.	1999 Sept.[e]
All U.S. corporations	77.4	94.0	102.7	82.4	74.0	76.0
Stocks[1]	9.8	10.6	10.1	9.3	7.5	8.0
Bonds	67.6	83.5	92.6	73.1	66.5	69.0
Nonfinancial corporations						
Stocks[1]	5.0	6.2	7.6	7.9	6.1	6.5
Initial public offerings	1.8	2.2	2.8	3.4	2.6	3.2
Seasoned offerings	3.2	4.0	4.8	4.5	3.5	3.3
Bonds	18.6	25.7	28.7	24.7	21.9	24.0
By rating, sold in U.S.[2]						
Investment grade	8.4	14.1	16.1	16.4	16.8	17.0
Speculative grade	8.2	10.2	9.2	4.7	3.1	4.5
Public	1.5	1.8	1.4	1.0	.3	1.5
Rule 144A	6.7	8.4	7.8	3.7	2.7	3.0
Other (Sold Abroad/Unrated)	1.9	1.3	3.4	2.8	1.9	2.5
Financial corporations						
Stocks[1]	4.8	4.4	2.4	1.4	1.4	1.5
Bonds	49.1	57.8	63.9	49.1	44.6	45.0
Memo:						
Net issuance of commercial paper, nonfinancial corporations[3]	1.1	2.3	2.8	2.5	6.2	-4.0
Change in C&I loans at commercial banks[3]	6.1	7.3	2.4	6.6	13.4	.5

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

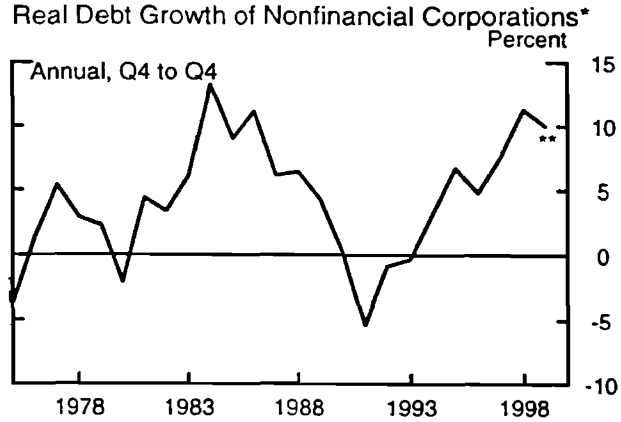
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Bonds categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
3. End-of-period basis. Seasonally adjusted.
e Staff estimate.

Major Components of Net Borrowing by Nonfinancial Corporations



Calculated on a per[illegible] end basis. Bank loans include CLOs.

Real Debt Growth of Nonfinancial Corporations*



*Nominal debt growth less growth in GDP chain-weight price index.
**Through Q3 estimate, at annual rate.

where spreads have come down, they have not fully retraced the rise during the summer and remain well above their levels before the disruptions of last fall.

On September 8, the Federal Reserve Bank of New York announced several measures to address year-end pressures: The temporary expansion of acceptable RP collateral to include mortgage-backed securities, authorization to enter into RPs with maturities up to ninety days, and a temporary Stand-by Financing Facility under which options on RP transactions would be auctioned. After the announcement, the one-month December libor futures rate dropped about 25 basis points. However, nearly all of that decline has since been retraced. Similarly, the butterfly spread on libor futures--which compares the rate on the December contract with the average of rates on the surrounding contracts--has reversed the entire decline that followed the September 8 announcement. Moreover, the premium in the commercial paper market for funding over year-end continues to be elevated, about matching year-end premiums seen during the financial market disruptions last October. All of this suggests that lenders are still quite wary of committing unsecured funds at year-end.

Despite the continued concern about potential year-end difficulties, spreads on interest rate swaps have narrowed since the August FOMC meeting. These spreads have fallen, in part, because market participants have revised down their expectation for the volume of near-term bond issuance, which has tempered the demand for swaps as a hedge against the risk of a rise in bond yields. In addition, on the supply side, counterparties willing to receive fixed-rate payments have come back into the swaps market, which has improved liquidity and narrowed spreads.

Swap contracts typically entail very little credit risk, and the spreads on most other highly-rated instruments--including agency, mortgage-backed, and asset-backed securities--have moved down with swaps. However, spreads for lower-rated securities have not declined. Indeed, as noted above, junk bond spreads actually have widened a fair bit since the August FOMC meeting.

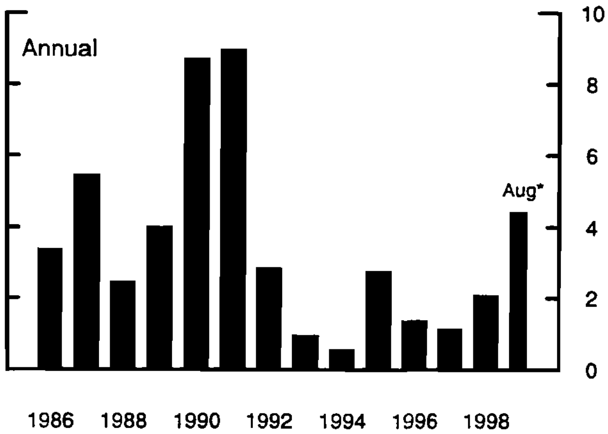
Business Finance

Net borrowing by nonfinancial businesses in the third quarter has been similar to the second-quarter pace, but higher interest rates, especially on lower-rated corporate bonds, have shifted funding away from bonds and toward bank loans. Gross issuance of bonds by nonfinancial corporations in August and September came in somewhat below the pace in the first half of this year, falling well short of market expectations. Investment-grade bond offerings were buoyed by a number of multibillion dollar deals, but investors remain reluctant to purchase smaller, less liquid issues. Speculative-grade issuance dropped sharply, as yields on these bonds widened on investor anxiety about potential defaults; reflecting

Corporate Finance and Stock Prices

Default Rates
Outstanding Junk Bonds

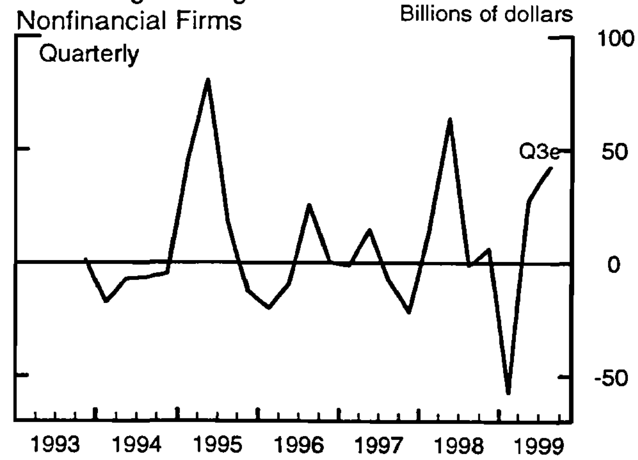
Percent



*Previous 12 months.

Net Ratings Changes
Nonfinancial Firms

Billions of dollars



Source. Moody's. Upgrades minus downgrades.

Mergers and Acquisitions
Nonfinancial Firms

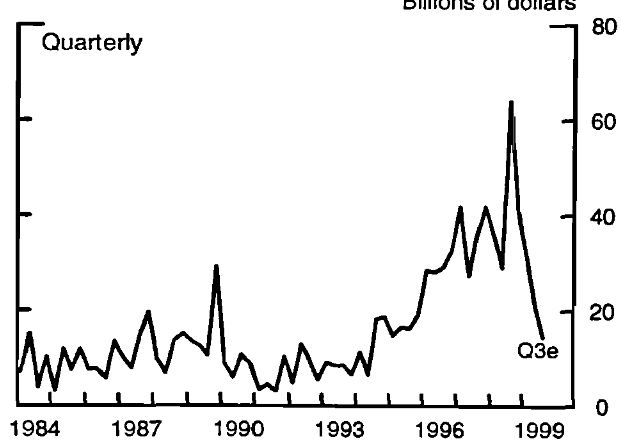
Billions of dollars

Quarterly rate

	Cash paid by domestic corps.	Total deal value
1997	21.5	82.9
1998	32.6	129.4
1999 Q1	23.5	145.0
Q2	24.0	218.0
Q3e	36.0	110.0

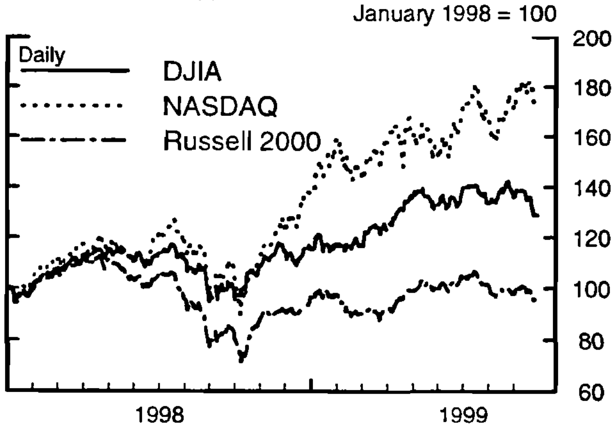
Announced Share Repurchases

Billions of dollars



Selected Indexes

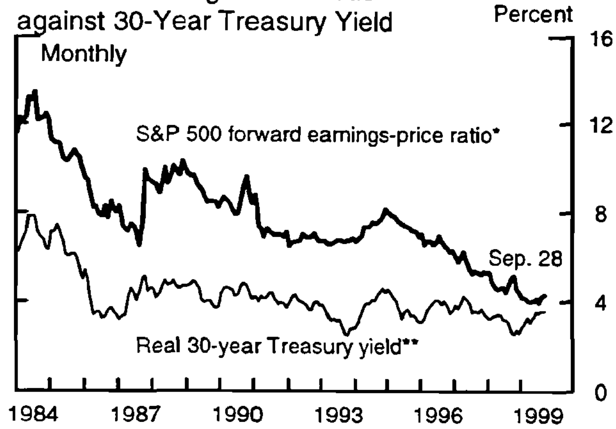
January 1998 = 100



Note. Last observation is for Sep. 28.

Forward Earnings-Price Ratio
against 30-Year Treasury Yield

Percent



* Based on I/B/E/S operating earnings over coming 12 months.

** Nominal yield less Philadelphia Fed 10-year inflation expectations.

these concerns, junk-bond mutual funds experienced net outflows in August and the first half of September. At least part of the expected surge in issuance may only have been postponed, however, because a growing issuance calendar points to heavy offerings in the weeks ahead as firms act to complete their funding ahead of year-end.

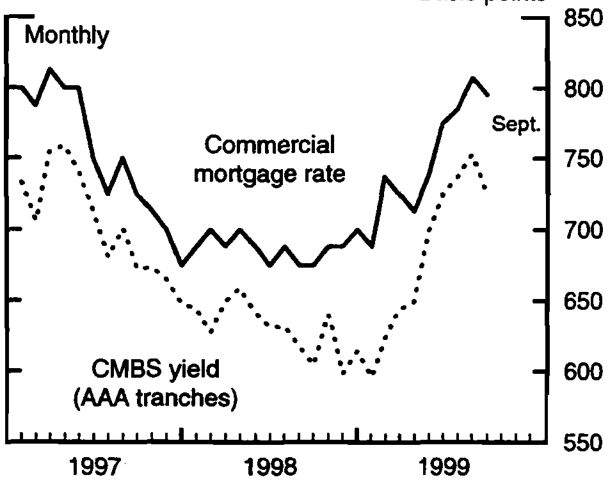
Short- and intermediate-term business credit strengthened in the third quarter. Nonfinancial commercial paper outstanding rose steadily until mid-September, when some issuers used the proceeds of bond issues to pay down their paper. Business loan growth was robust in August and September. Many borrowers found banks to be a more attractive source of credit than the bond market and tapped their committed lines of credit even in the face of a continued firming of loan pricing and other terms. According to the August Survey of Terms of Business Lending, the proportion of loans made under commitment rose sharply, nearly reaching its recent peak when bond market financing almost shut down in the fourth quarter of 1998. The survey also showed that the average spread over the intended federal funds rate for loans made at domestic banks rose 7 basis points between the May and August surveys, bringing the cumulative rise so far this year to about 1/4 percentage point. The proportion of loans backed by collateral increased for the third consecutive quarter.

Indicators of business credit quality have been mixed. Junk bond defaults for the twelve months ended in August were higher than for any other year since 1991, and a further rise is likely in part because of the aging of bonds issued over the past two years. Business failures have continued to run above the pace of recent years, although they have slowed a bit lately. On the plus side, bonds of nonfinancial firms have been upgraded, on net, in the third quarter, and the dollar volume of debt on review for upgrades exceeds that for downgrades.

Gross equity issuance slowed in August from the torrid July rate, to about the average pace of last year. The cooler market reception in August and early September for new shares, particularly for Internet-related firms, was short-lived, however, as issuance rebounded late in the month. Meanwhile, equity at nonfinancial firms continued to be retired at a rapid pace, as merger and acquisition activity showed little sign of slowing. An estimated $110 billion of deals closed in the third quarter, and almost a third of that amount was financed with cash. Announcements of share repurchases, however, dropped to an estimated $15 billion in the third quarter, about half the pace of recent years. The rise in corporate bond yields this year has increased the cost of borrowing to fund capital expenditures, which may have induced firms to earmark more of their profits for investment rather than returning them to shareholders via repurchases.

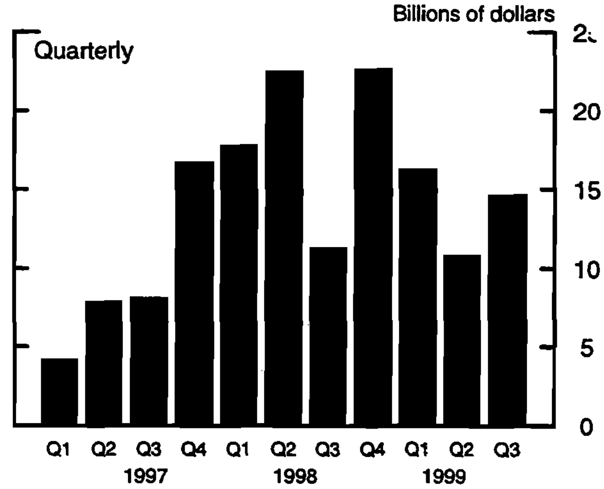
Commercial Real Estate

Funding Costs



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

CMBS Gross Issuance



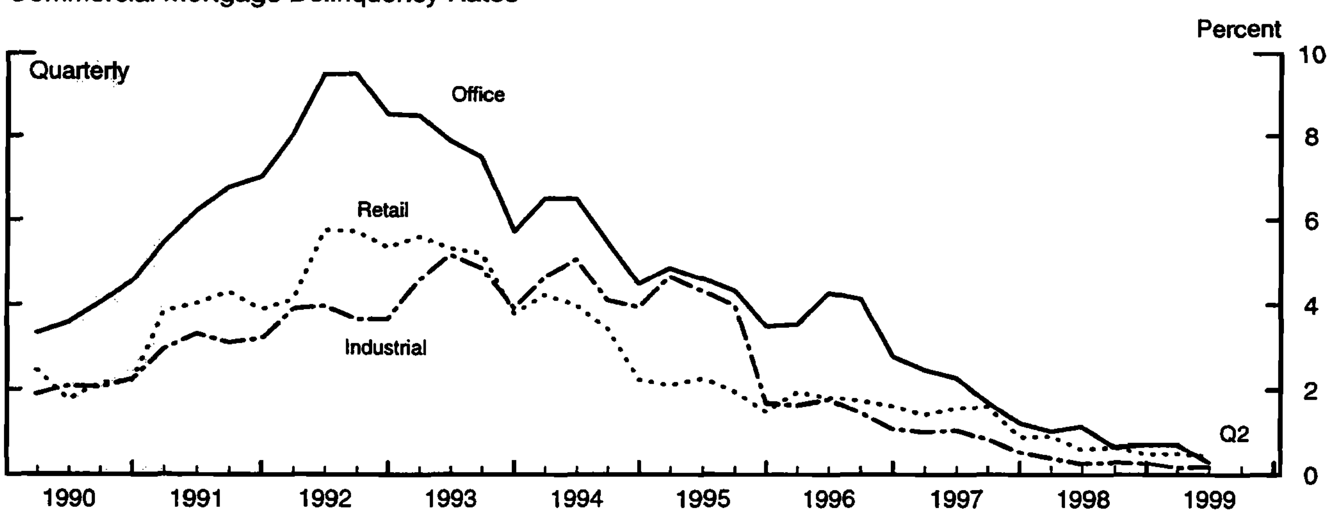
Note. 1999:Q3 Staff estimate.
Source. Commercial Mortgage Alert.

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

Lenders	1997	1998 H1	1998 H2	1999 Q1	1999 Q2
Commercial banks and thrifts	6.6	5.1	13.9	15.2	15.7
Fannie Mae and Freddie Mac*	0.6	1.3	5.0	3.2	3.4
Life insurance companies	-0.5	0.4	2.7	3.4	5.0
Total	6.7	6.8	21.6	21.8	24.1

*Includes multifamily mortgage portfolio holdings and MBS collateral.
Source. Flow of Funds, Financial Institutions.

Commercial Mortgage Delinquency Rates



Source. ACLI.

The DJIA and S&P 500 have fallen about 9 percent and 6 percent, respectively, since the last FOMC meeting, partly on concerns about a reallocation of investor portfolios away from U.S. and toward foreign markets. The Nasdaq hit a new high during the intermeeting period but then retreated with the broader market, including a large, one-day drop in late September on comments by Microsoft's president that technology stocks were overvalued. On balance, the Nasdaq has edged up since the last FOMC meeting. Equity valuations continue to look rich, as the gap between the forward earnings-yield and the real ten-year Treasury yield has remained extremely narrow.

Third-quarter earnings reports will begin to come out in a few weeks. So far, the number of warnings about third-quarter earnings has been fairly typical, after two quarters of relatively few warnings, which suggests that positive earnings surprises this quarter will not be outsized.

Commercial Real Estate Finance

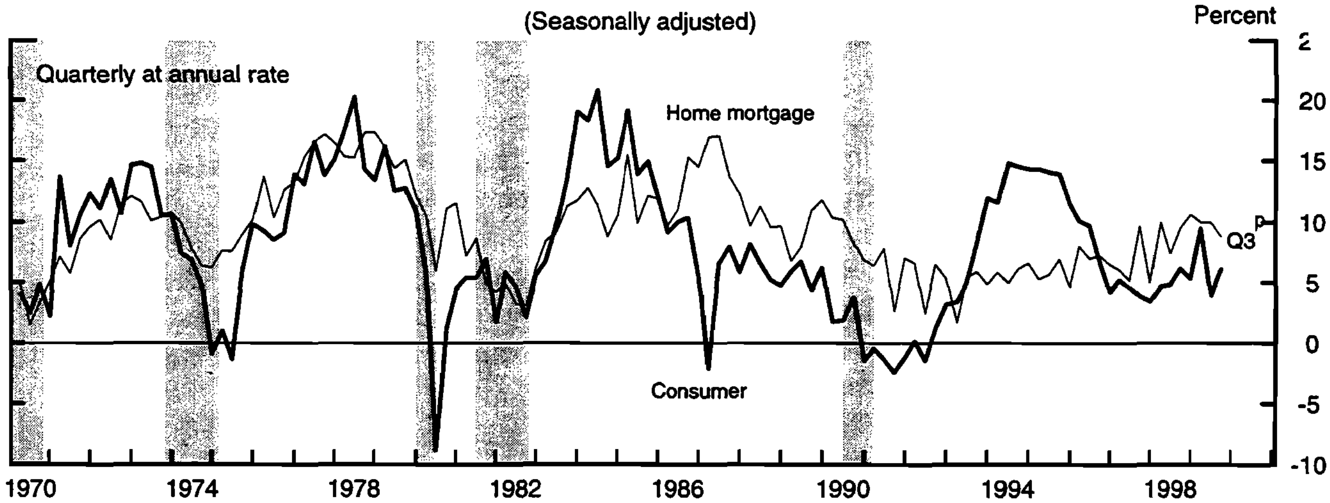
Commercial mortgage interest rates continued to rise in August, and despite the downturn in September, they remain more than 100 basis points above the level at the end of last year. Yields on commercial mortgage-backed securities (CMBS) have displayed similar movements.

CMBS issuance is expected to total around $15 billion for the third quarter, slightly below previous expectations, as a few deals were postponed when yields rose in late August. Although issuance is up from the second quarter, it remains well below the pace of 1998. Since early this year, institutions that supply loans for CMBS have indicated that their originations have been well below expectations. Anecdotal reports suggest that the rise in interest rates over this period has hurt demand for refinancing. In addition, after the events of last fall, conduit lenders have been less aggressive in their mortgage pricing. Newly available data for the second quarter indicate that other lenders--depository institutions, life insurance companies, and federal agencies--have picked up market share, partly because of the less favorable pricing of conduits. On the whole, originations for new development have remained strong.

Conditions in commercial real estate markets continued to be solid, with low vacancy rates, moderately rising prices, and few markets reporting imbalances. These conditions have translated into the lowest delinquency rates for commercial mortgage loans held by insurance companies in the thirty-four year history of that series; similarly, Call Report data on commercial real estate loans at banks show very low delinquency rates through the second quarter.

Household Debt Growth

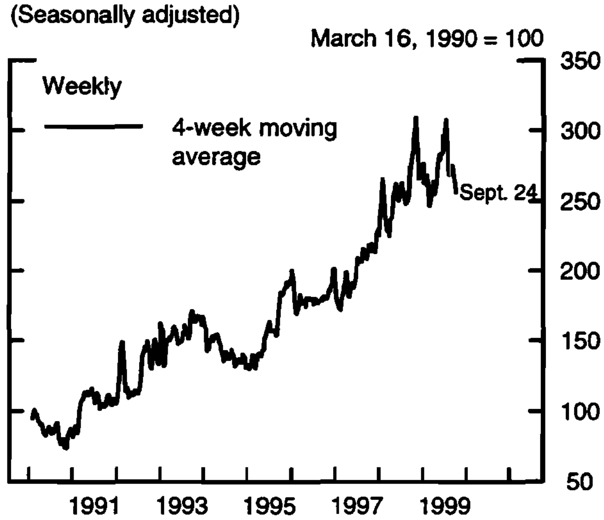
(Seasonally adjusted)



p. Staff projection.

MBA Purchase Index

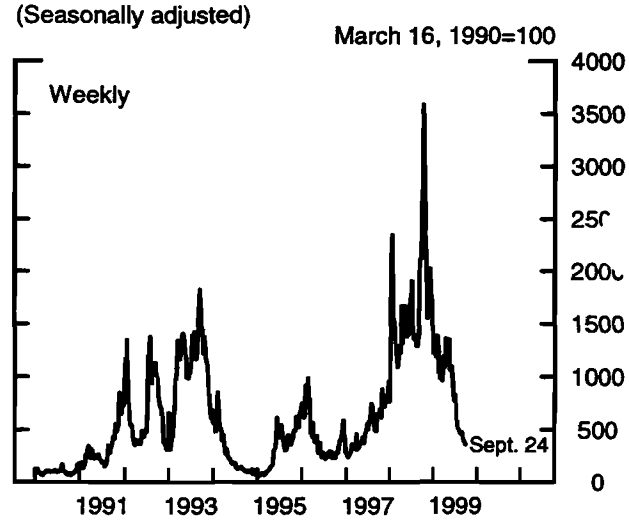
(Seasonally adjusted)



Source. Mortgage Bankers Association.

MBA Refinancing Index

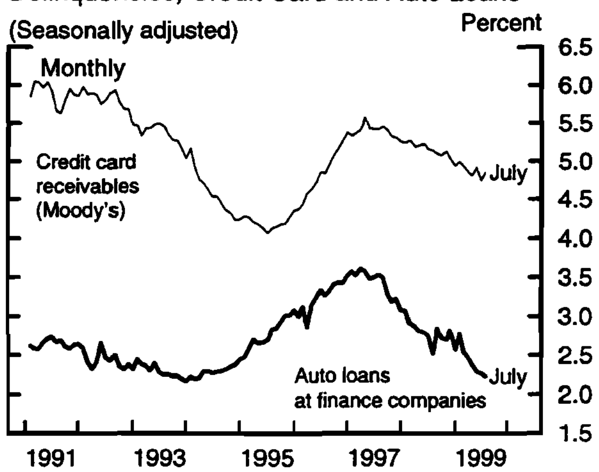
(Seasonally adjusted)



Source. Mortgage Bankers Association.

Delinquencies, Credit Card and Auto Loans*

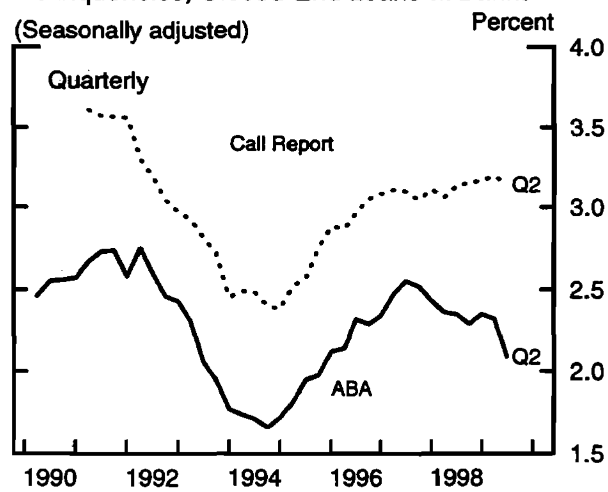
(Seasonally adjusted)



*30 days or more past due. Credit card series based on dollar amount of delinquencies; auto loan series based on number of accounts delinquent.

Delinquencies, Closed-End Loans at Banks*

(Seasonally adjusted)



*30 days or more past due. Call Report series based on dollar amount of delinquencies; ABA series based on number of accounts delinquent.

Household Finance
Household borrowing appears to have remained fairly rapid in the third quarter. The growth of consumer credit picked up in July, as revolving debt continued strong and nonrevolving debt turned around from its weak June showing. Commercial bank data (adjusted for securitization) show an acceleration of consumer loans in August and September. The limited evidence available on mortgage debt growth also suggests strength, consistent with indicators of a still-buoyant housing market. Residential real estate loans at commercial banks, which grew moderately in July, surged in August. The Mortgage Bankers Association home purchase index is still at a high level, though it has dropped back from its recent peak. In contrast, refinancing activity has stayed in the doldrums.

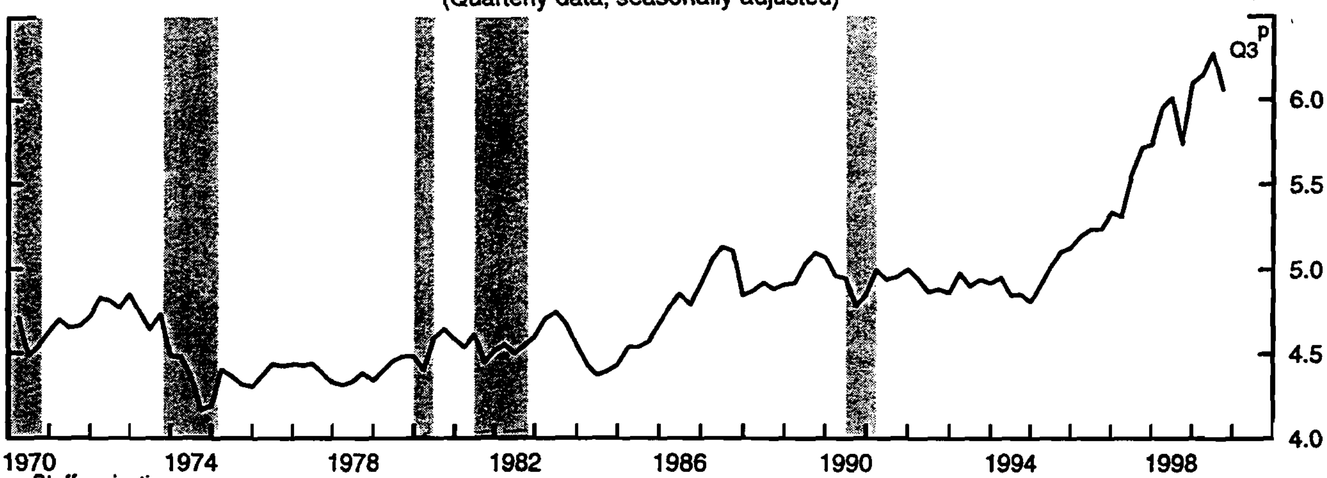
Indicators of household credit quality remain favorable. The delinquency rate for auto loans at finance companies fell to its lowest level in the past five years, and delinquencies for securitized credit card receivables remained on a downward trend. In addition, the delinquency series from the American Bankers Association on closed-end consumer loans showed a marked drop in the second quarter. A more comprehensive series from bank Call Reports, which has diverged from the ABA series in recent years, also turned down, but only slightly.

The ratio of household net worth to income likely fell in the third quarter in large part because of declines in equity prices. Responding to these price declines, mutual fund shareholders added only about $10 billion to their equity fund holdings in August, the lowest amount in the past six months. Weekly data (not shown) indicate a similar pace of inflows into equity funds during September. Bond funds experienced modest outflows in August, and are on track for a considerably larger outflow in September. Data on 401(k) pension plans give a more mixed picture of household allocations between equities and bonds through August, as contributions to, and transfers of, plan assets were funneled into both equity and fixed income funds.

Government Finance
Treasury. In early August, the Treasury announced that it was aiming for an $80 billion year-end cash balance, which would be much larger than usual. To raise this much cash, the Treasury planned to increase bill auction sizes moderately and to issue a substantial amount of cash management bills, perhaps starting as early as September. Since these cash management bills were likely to mature in January, the prospect of additional supply pushed up yields on existing bills maturing after the turn of the year. Following that announcement, however, bill auction sizes were *reduced* by $1 billion in late August and again in early

Household Net Worth Relative to Disposable Income

(Quarterly data; seasonally adjusted)



p. Staff projection.

Net Flows of Mutual Funds

(Excluding reinvested dividends; billions of dollars at monthly rates)

	1996	1997	1998 H1	1998 H2	1999 Q1	1999 Q2	1999 July	1999 Aug.[e]	Assets July
Total long-term funds	**19.3**	**22.7**	**29.3**	**11.4**	**16.4**	**20.1**	**12.3**	**8.9**	**4,584**
Equity funds	**18.0**	**19.0**	**21.1**	**5.4**	**10.5**	**19.9**	**12.3**	**9.7**	**3,367**
Domestic	14.1	15.8	18.6	6.7	12.6	18.7	16.2	8.9	2,927
International	4.0	3.1	2.5	-1.3	-2.1	1.2	-4.0	0.8	441
Hybrid funds	**1.0**	**1.4**	**1.7**	**0.1**	**-0.5**	**-0.3**	**-0.2**	**-0.5**	**378**
Bond funds	**0.2**	**2.4**	**6.5**	**5.9**	**6.4**	**0.5**	**0.2**	**-0.3**	**839**
International	-0.2	-0.1	0.0	-0.2	-0.1	-0.1	-0.3	-0.3	23
High-yield	1.0	1.4	1.8	0.5	1.0	-0.4	0.2	-0.8	123
Other taxable	-0.1	1.0	3.5	4.3	3.9	1.2	1.2	1.6	397
Municipals	-0.5	0.1	1.2	1.3	1.6	-0.2	-0.9	-0.8	296

e Staff estimates based on ICI weekly data.

Source. Investment Company Institute (ICI).

401(k) Plan Contributions and Transfers

(Percent of total)

	Contributions[1] 1998	Contributions 1999 Q1	Contributions 1999 Q2	Contributions 1999 Jul.	Contributions 1999 Aug.	Transfers[2] 1998	Transfers 1999 Q1	Transfers 1999 Q2	Transfers 1999 Jul.	Transfers 1999 Aug.
Company stock	**19**	**19**	**21**	**19**	**21**	**-84**	**-53**	**-70**	**68**	**-73**
Equity funds	**47**	**43**	**47**	**48**	**46**	**-16**	**-4**	**100**	**32**	**21**
Domestic	42	38	43	44	42	-14	27	34	102	0
International	5	5	4	4	4	-2	-32	66	-70	20
Hybrid funds	**12**	**17**	**10**	**12**	**12**	**11**	**-44**	**-18**	**-16**	**-27**
Fixed income[3]	**22**	**21**	**22**	**21**	**21**	**89**	**99**	**-13**	**-84**	**79**

1. Allocation of new contributions to 401(k) plans; percentages sum to 100.
2. Allocation of transfers among existing assets within 401(k) plans; percentages sum to zero.
3. Includes bond and money funds and GIC/stable value investments.

Source. Hewitt Associates.

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	1999					
	Q1	Q2	Q3	July	Aug	Sept[e]
Total surplus, deficit (-)	**5.8**	**143.1**	**n.a.**	**-25.2**	**-2.5**	**n.a.**
Means of financing deficit						
Net borrowing	7.5	-108.0	n.a.	1.2	26.5	n.a.
Nonmarketable	2.2	6.3	n.a.	-2.7	-1.0	n.a.
Marketable	5.2	-114.3	-19.4	3.8	27.5	-50.5
Bills	34.0	-78.0	4.4	6.9	35.0	-37.3
Coupons	-28.7	-36.3	-23.8	-3.0	-7.5	-13.2
Decrease in cash balance	-4.1	-31.5	n.a.	13.6	3.2	n.a
Other[1]	-9.1	-3.6	n.a.	10.4	-27.1	n.a.
MEMO						
Cash balance, end of period	21.6	53.1	n.a.	39.6	36.4	n.a.

NOTE. Components may not sum to totals because of rounding.
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
e Estimated.

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

Agency	1998	1999				
	Q4	Q1	Q2	June	July	Aug
FHLBs	38.9	20.2	34.7	15.5	7.7	13.5
Freddie Mac	54.4	11.8	15.2	-3.1	20.2	n.a.
Fannie Mae	29.7	15.1	24.5	7.0	2.8	14.5
Farm Credit Banks	-.8	3.0	1.2	1.1	-.8	0.3
Sallie Mae	1.6	1.4	1.2	-.2	n.a.	n.a.
MEMO: Outstanding						
Fannie Mae benchmark notes	42.2	61.5	82.7	82.7	87.6	95.1
Freddie Mac reference notes	20.0	30.0	45.5	45.5	50.8	57.8

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

State and Local Finance

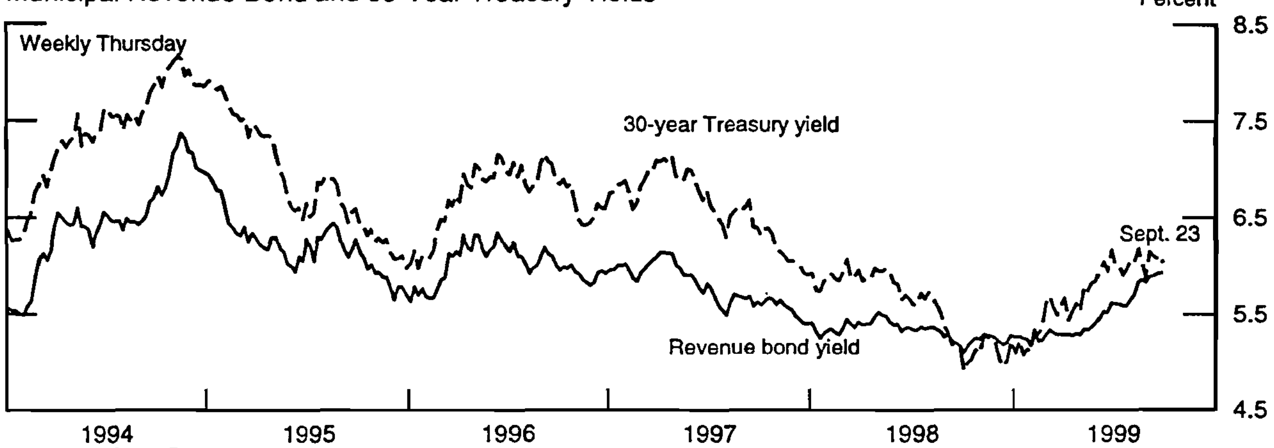
Gross Offerings of Municipal Securities

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

	1997	1998	1999 H1	1999 Q3 [2]	1999 July	1999 Aug.	1999 Sept.[2]
Long-term	17.9	21.9	18.8	16.2	18.7	15.7	14.1
Refundings [1]	6.6	8.5	5.2	3.5	6.5	3.2	0.8
New capital	11.3	13.4	13.6	12.7	12.2	12.5	13.3
Short-term	3.6	2.4	2.3	4.0	2.5	6.2	3.3
Total tax-exempt	21.5	24.3	21.1	20.2	21.1	22.0	17.4
Total taxable	1.1	1.1	1.2	0.8	0.7	0.6	1.2

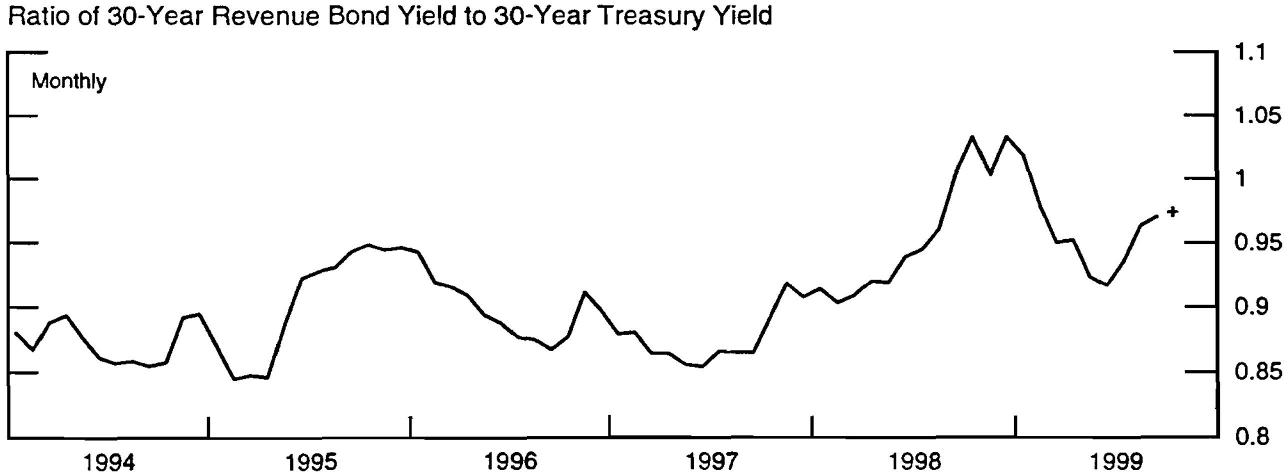
Note. Includes issues for public and private purposes.
1. All issues that include any refunding bonds.
2. Projections based on data through Sept. 23.

Municipal Revenue Bond and 30-Year Treasury Yields



Source. Bond Buyer.

Ratio of 30-Year Revenue Bond Yield to 30-Year Treasury Yield



Note. Average of weekly data. + indicates latest observation (Sept. 23).

September. These cutbacks depressed yields on bills maturing in December, including the current three-month bill. Strong quarterly tax payments in September have validated these cuts to some extent and have delayed the likely issuance of cash management bills until later this year. With such bills still likely to mature in January, this prospective supply has kept elevated the yields on existing bills maturing then.

Federal agency. Debt issuance by government-sponsored enterprises remained brisk over the intermeeting period, with Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System all issuing substantial amounts. As the agencies have maneuvered for benchmark status in light of the projected secular decline in Treasury issuance, they have had a generally favorable reception from investors. The FHLB "Tap" program (described in the August Greenbook) has gotten off to a good start, and Freddie Mac's ten-year Reference Note was increased from $4 billion to $6 billion in response to strong investor demand. Under Freddie Mac's new financing calendar, five-year Reference Notes will be issued in January and July and ten-year Reference Notes in March and September. Freddie Mac also announced the recent ten-year Reference Note two weeks before issuance, instead of the usual two days, in an effort to develop the when-issued market.

As noted above in the section on liquidity and year-end concerns, agency spreads--which are linked to swap spreads because the agencies make heavy use of swaps for hedging and arbitrage--have narrowed somewhat since the last FOMC in tandem with swap spreads. The agencies' recent efforts to enhance the liquidity of their benchmark issues may have also altered market perceptions and contributed to the narrowing.

State and local. Gross issuance of long-term debt in August and September, which averaged about $15 billion per month, was down from the July pace because of a decline in refunding activity. Refunding has been held down by the rise in interest rates this year, although improvements in the credit quality of individual issuers have encouraged some refunding deals to come to market despite rising rates. New capital issuance remained strong in August and September, reflecting hefty outlays for educational facilities and transportation projects.

Yields on long-term municipal bonds rose over the intermeeting period, lifting slightly the ratio of the thirty-year revenue bond yield to the thirty-year Treasury yield. Strong supply of municipal bonds relative to Treasuries and some weakening of demand, as evidenced by outflows from tax-exempt mutual funds, contributed to the underperformance of municipal bonds.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1998	1999 Q1	1999 Q2	1999 June	1999 July	1999 Aug. (p)	1998:Q4 to Aug. 99 (p)	Level (bil. $) Aug. 99 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	1.8	2.8	3.5	-3.9	-1.7	2.9	1.8	1102.2
2. M2[2]	8.5	7.2	5.6	4.2	5.4	5.5	6.1	4561.9
3. M3	10.9	7.6	5.4	5.6	4.8	4.9	6.1	6206.1
Selected Components								
4. Currency	8.3	9.7	11.2	8.0	7.9	8.9	10.1	490.9
5. Demand deposits	-4.2	-4.4	-3.8	-21.1	-1.0	1.7	-4.7	363.1
6. Other checkable deposits	.4	1.3	-.3	-2.9	-23.9	-6.5	-3.9	239.7
7. M2 minus M1[3]	10.9	8.7	6.3	6.8	7.6	6.3	7.5	3459.7
8. Savings deposits	14.0	11.9	11.0	13.6	15.2	6.6	11.9	1725.1
9. Small time deposits	-1.4	-5.8	-4.9	-6.2	-.9	2.6	-4.0	926.7
10. Retail money market funds	23.6	20.5	10.2	7.8	1.5	9.9	12.8	807.9
11. M3 minus M2[4]	18.1	8.6	4.7	9.5	3.2	3.4	6.2	1644.3
12. Large time deposits, net[5]	9.8	.8	-3.7	-6.6	19.6	-6.9	-.2	624.6
13. Institution-only money market mutual funds	34.7	17.9	14.5	7.7	-4.6	22.9	14.4	556.4
14. RPs	17.6	14.1	-2.7	53.2	-.4	6.2	9.3	310.2
15. Eurodollars	8.5	-.8	20.4	-1.5	-26.9	-28.3	-.4	153.1
Memo								
16. Liquid Deposits[6]	8.8	7.9	7.3	6.2	8.4	4.6	7.3	2327.9
17. Sweep-adjusted M1[7]	6.2	5.7	6.9	1.3	3.9	6.9	5.7	1462.2
18. Monetary base	7.1	9.1	10.1	6.2	8.0	7.0	9.2	544.4
19. Household M2[8]	9.8	8.3	6.5	6.4	5.9	5.9	7.1	4198.8
	Average monthly change (billions of dollars)[9]							
Memo								
Selected managed liabilities at commercial banks:								
20. Large time deposits, gross	5.1	4.8	-2.5	-5.9	8.5	0	...	748.1
21. Net due to related foreign institutions	1.6	-1.3	-.8	12.5	-.3	5.9	...	222.2
22. U.S. government deposits at commercial banks	.6	-3.0	.2	1.6	3.5	-8.2	...	16.1

1. For the years shown, Q4-to-Q4 percent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, savings deposits, and small time deposits.
3. Sum of retail money funds, savings deposits, and small time deposits.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.
6. Sum of demand deposits, other checkable deposits, and savings deposits.
7. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
8. M2 less demand deposits.
9. For the years shown, "average monthly change" is the Q4-to-Q4 dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.
p--Preliminary.

The credit quality of municipal issuers has shown further improvement in recent months. As has been the case for several years, Standard and Poor's upgraded more issues (both in number and dollar volume) than they downgraded. The exception remained health care issuers, some of which have reported increased costs for bond insurance and letters of credit.

Money and Bank Credit

M2 continued to grow in August at about the average 5-1/2 percent pace of the preceding several months, despite a further rise in opportunity costs. Liquid deposits in M2 grew moderately, and retail money market mutual funds picked up, as households slowed their contributions to equity and bond mutual funds. The currency component continued its rapid advance in August, perhaps reflecting robust retail sales; preliminary data for September show a noticeable acceleration, but it is not yet clear whether the additional strength is related to a precautionary buildup of liquidity by households in advance of year-end. Thus far in September, M2 is growing somewhat faster than in August because of strength in liquid deposits and currency.

M3 also continued to expand at a moderate rate in August and into the first half of September. Institution-only money market mutual funds accounted for most of the non-M2 expansion in M3, as their yields caught up to previous increases in short-term market rates. In contrast, large time deposits ran off last month because banks used nondeposit funds to finance the sizable acceleration of bank credit.

The pickup in bank credit in August owed entirely to loans. Business loans surged, even as loan pricing appeared to firm, because companies found conditions in the junk bond market unreceptive. Solid business loan growth seems to have continued through mid-September. Real estate loans grew rapidly in August, with both residential and commercial components showing strength, and growth has continued at a brisk rate in September.

Commercial Bank Credit

(Percent change; seasonally adjusted annual rate)

Type of credit	1998	1999 Q2	1999 Q3 p	1999 Jul	1999 Aug	1999 Sep p	Level, Sep 1999 p (billions of $)
1. Bank credit: Reported	11.0	0.3	5.2	-0.6	9.5	8	4,609
2. Adjusted[1]	10.2	2.2	5.6	1.0	9.2	5	4,521
3. Securities: Reported	14.0	-2.9	14.6	17.1	15.7	12	1,251
4. Adjusted[1]	11.1	4.6	17.0	24.8	14.8	3	1,163
5. U.S. government	5.9	4.3	6.4	2.8	8.3	-6	816
6. Other[2]	32.4	-16.9	31.5	46.6	30.5	46	436
7. Loans[3]	9.9	1.5	1.9	-7.0	7.3	6	3,358
8. Business	11.8	2.6	4.9	1.7	10.1	9	979
9. Real estate	6.5	3.6	5.7	1.2	10.7	8	1,389
10. Home equity	0.0	6.7	-19.7	-67.1	8.6	9	99
11. Other	7.1	3.3	7.8	6.8	10.9	8	1,290
12. Consumer: Reported	-1.5	-2.9	-9.3	-19.5	-0.7	6	486
13. Adjusted[4]	6.0	1.3	5.3	4.6	8.0	13	774
14. Other[5]	30.0	-2.0	-3.5	-32.7	-0.2	-6	504

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

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

p Preliminary.

INTERNATIONAL DEVELOPMENTS

International Developments

U.S. International Transactions

Trade in Goods and Services

The nominal U.S. trade deficit in goods and services rose to $25.2 billion in July, the third consecutive monthly increase. For the second quarter, the deficit was $259 billion at a seasonally adjusted annual rate, $43 billion larger than in the first quarter.

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

	1998	Annual rate 1998 Q4	Annual rate 1999 Q1	Annual rate 1999 Q2	Monthly rate 1999 May	Monthly rate 1999 June	Monthly rate 1999 July
Real NIPA[1]							
Net exports of G&S	-238.2	-250.0	-303.6	-337.4	...	...	...
Nominal BOP							
Net exports of G&S	-164.3	-173.0	-215.9	-259.1	-21.4	-24.6	-25.2
Goods, net	-246.9	-254.3	-296.8	-337.6	-27.9	-31.2	-31.7
Services, net	82.6	81.3	80.9	78.5	6.5	6.6	6.5

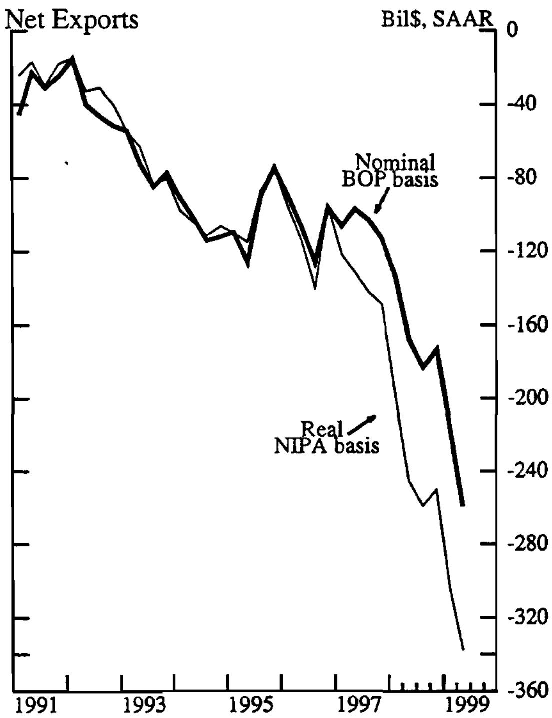
1. Billions of chained (1992) dollars.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

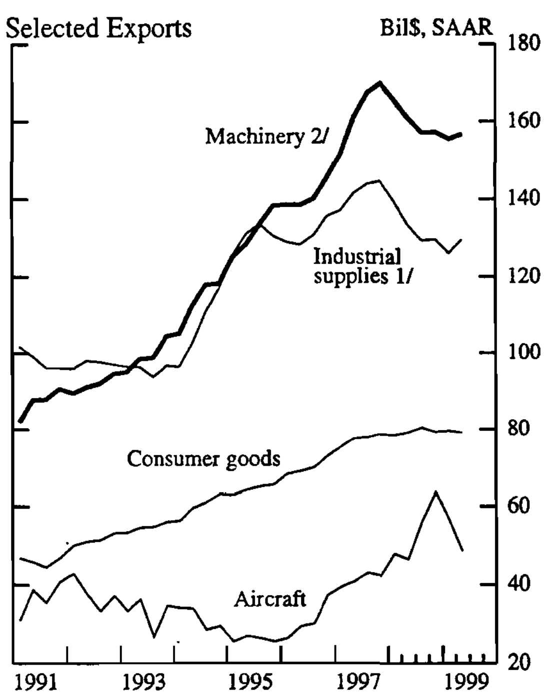
In July, the value of exports rose 1/2 percent to a level that was 1 percent higher than the second-quarter average. The increase resulted primarily from a jump in exports of industrial machinery and semiconductors. Aircraft exports increased slightly as a gain in exported engines and parts more than offset a drop in completed aircraft. Exports of automotive products and industrial supplies, which had increased in the second quarter, declined somewhat in July. Exports of consumer goods increased.

The value of imports rose 1 percent in July following increases of 3 to 4 percent in each of the prior two months in response to the strength of U.S. domestic demand. The increase in July was spread among aircraft, consumer goods, industrial supplies, and oil. Imports of automotive products rose slightly as lower imports from Canada and Mexico offset higher imports from the rest of the world. The level of goods and services imports in July was 4 percent higher than the average for the second quarter.

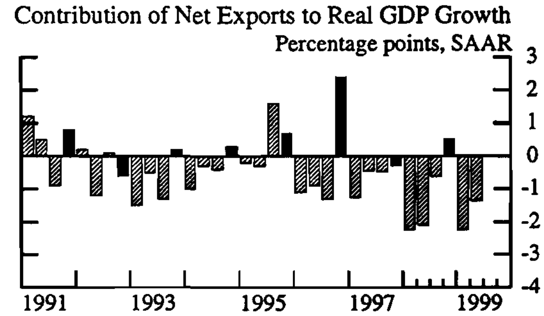
Quantity and price of imported oil. The value of imported oil increased in July as the pickup in prices outstripped a slight decline in quantity. The average price of imported oil rose from $13.65 per barrel in April to $16.80 per barrel in July. A cutback in supplies, primarily from OPEC, and strengthening world demand drove the rise in oil prices.

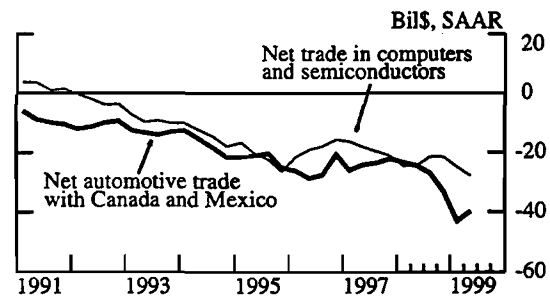
U.S. International Trade in Goods and Services

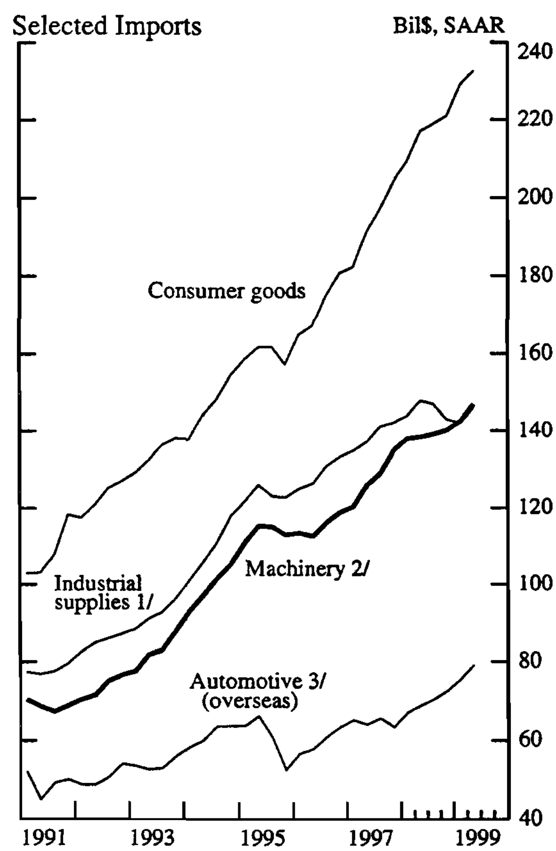




1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.







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

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

	Levels				Amount Change[1]			
	1999		1999		1999		1999	
	Q1	Q2	June	July	Q1	Q2	June	July
Exports of G&S	927.6	938.9	943.5	948.4	-20.0	11.2	7.7	5.0
Goods exports	657.2	663.4	665.7	669.9	-23.3	6.3	4.2	4.3
Agricultural	47.3	49.0	49.7	49.6	-7.0	1.7	0.5	-0.1
Gold	2.9	3.3	3.9	1.8	-4.2	0.5	1.9	-2.1
Other goods	607.0	611.1	612.0	618.5	-12.1	4.1	1.8	6.5
Aircraft & pts	56.6	48.7	46.4	47.0	-7.0	-7.9	-1.8	0.6
Computers	44.1	46.5	47.1	48.1	-1.4	2.3	0.4	1.0
Semiconductors	42.1	45.2	45.3	49.8	2.5	3.1	0.2	4.5
Other cap gds	158.8	159.2	159.3	165.3	-1.6	0.3	-0.1	6.0
Automotive	71.4	75.0	78.0	73.3	-3.3	3.6	5.0	-4.7
to Canada	42.7	44.6	46.8	44.8	-1.0	1.9	2.4	-2.0
to Mexico	10.3	11.4	11.4	10.3	-1.7	1.2	-0.3	-1.1
to ROW	18.4	19.0	19.9	18.2	-0.7	0.6	2.9	-1.7
Ind supplies	126.1	129.5	129.5	128.2	-3.6	3.4	-1.4	-1.3
Consumer goods	79.6	79.1	78.5	80.6	0.4	-0.5	0.5	2.1
All other	28.2	27.9	27.9	26.2	1.9	-0.3	-3.2	-1.7
Services exports	270.4	275.4	277.8	278.5	3.3	5.0	3.5	0.7
Imports of G&S	1143.5	1198.0	1238.7	1250.6	22.8	54.5	46.3	11.9
Goods imports	954.0	1001.1	1039.8	1050.3	19.1	47.1	43.6	10.5
Petroleum	42.4	63.7	67.2	69.8	-3.4	21.3	-0.7	2.6
Gold	3.2	3.2	3.3	2.7	-3.3	-0.1	0.3	-0.6
Other goods	908.4	934.3	969.3	977.8	25.9	25.9	44.0	8.5
Aircraft & pts	22.2	22.6	23.3	27.8	-2.1	0.4	0.5	4.5
Computers	77.6	82.0	85.9	86.0	2.9	4.5	5.1	0.1
Semiconductors	33.4	37.3	38.2	38.8	1.5	3.9	0.2	0.6
Other cap gds	145.9	149.8	158.2	154.3	2.6	3.9	9.4	-3.9
Automotive	171.6	175.1	185.7	186.3	10.4	3.4	10.6	0.7
from Canada	65.1	62.6	64.5	63.1	7.0	-2.5	1.1	-1.4
from Mexico	30.9	33.2	34.4	31.6	0.3	2.3	0.1	-2.7
from ROW	75.6	79.3	86.9	91.6	3.1	3.7	9.4	4.7
Ind supplies	142.2	146.2	148.7	151.1	-0.9	3.9	3.9	2.4
Consumer goods	229.1	232.7	239.0	243.6	8.2	3.6	12.1	4.6
Foods	41.7	43.8	45.1	44.2	0.1	2.1	1.5	-0.9
All other	44.6	44.8	45.3	45.7	3.2	0.2	0.7	0.4
Services imports	189.5	196.9	198.9	200.4	3.7	7.4	2.7	1.4
Memo:								
Oil qty (mb/d)	11.21	11.86	12.17	11.38	0.20	0.65	0.01	-0.79
Oil price ($/bbl)	10.39	14.69	15.12	16.78	-0.99	4.30	-0.16	1.66

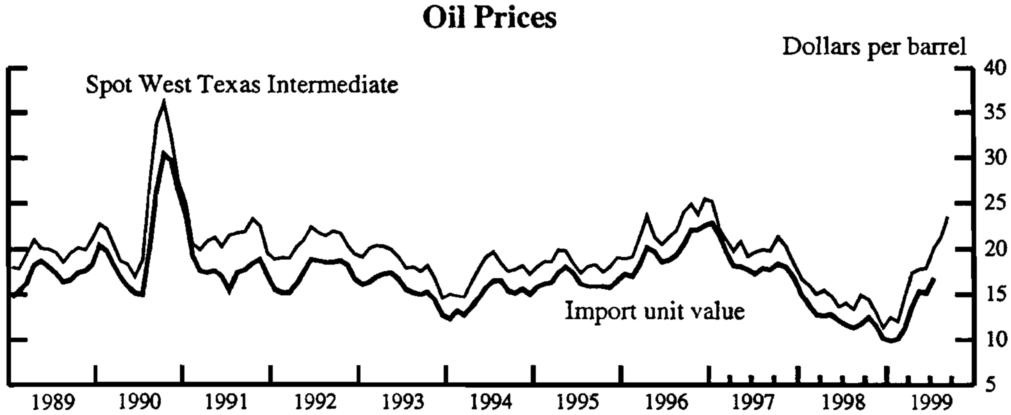
1. Change from previous quarter or month.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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

	Annual rates 1999 Q1	Annual rates 1999 Q2	Annual rates 1999 Q3e	Monthly rates 1999 June	Monthly rates 1999 July	Monthly rates 1999 Aug.
	BLS prices (1995=100)					
Merchandise imports	-1.6	6.6	5.7	-0.1	0.8	1.0
Oil	-18.4	256.1	108.1	0.3	10.9	11.3
Non-oil	-0.7	-2.0	-0.3	-0.2	0.0	0.0
Core goods*	-0.1	-1.1	0.7	-0.2	0.2	0.0
Foods, feeds, beverages.	-6.0	0.4	-5.3	-1.2	-0.9	0.0
Industrial supplies ex oil	-1.7	1.5	6.6	0.3	1.0	0.2
Computers	-9.0	-17.3	-8.8	-0.9	-1.4	-0.4
Semiconductors	2.0	-3.3	-9.1	-0.6	-1.8	0.0
Cap. goods ex comp & semi	0.7	-3.4	-2.5	-0.3	-0.3	0.0
Automotive products	1.3	0.9	0.7	-0.1	0.1	0.1
Consumer goods	0.3	-2.3	-0.8	-0.1	-0.1	0.0
Merchandise exports	-1.1	-0.3	-0.3	0.0	-0.3	0.4
Agricultural	-6.0	-8.5	-5.2	-0.2	-2.2	1.9
Nonagricultural	-0.6	0.6	0.3	0.1	-0.1	0.2
Core goods*	0.3	1.8	1.3	0.1	0.0	0.3
Industrial supples ex ag	-2.0	3.1	5.2	0.6	0.2	1.0
Computers	-6.5	-7.2	-7.5	-1.0	-1.0	0.0
Semiconductors	-7.7	-5.9	-9.4	-1.2	-0.9	-0.5
Cap. goods ex comp & semi	1.4	0.3	-0.3	0.0	0.0	0.0
Automotive products	0.6	0.1	0.8	0.2	0.1	-0.1
Consumer goods	-0.5	-0.1	0.3	0.1	0.0	0.0
Chain-weight	Prices in the NIPA accounts (1992=100)					
Imports of goods & services	-3.3	4.6	n.a.	...	...	...
Non-oil merchandise	-1.7	-3.9	n.a.	...	...	...
Core goods*	-0.1	-0.9	n.a.	...	...	...
Exports of goods & services	-0.6	-0.1	n.a.	...	...	...
Nonag merchandise	-1.4	-0.9	n.a.	...	...	...
Core goods*	-0.2	1.1	n.a.	...	...	...

*/ Excludes computers and semiconductors.
e/ Average of two months.
n.a. Not available. ... Not applicable.

Oil Prices



More recently, oil prices have risen further as OPEC continues to curtail production. The members of OPEC, at their September 22 ministerial meeting, reaffirmed their intentions to hold back production through March 2000. The monthly average spot price of West Texas Intermediate (WTI) increased from $20 per barrel in July to $21.25 in August. Spot WTI is currently trading near $25 per barrel.

Prices of non-oil imports and exports. In August, prices of imported non-oil goods were unchanged for the second consecutive month. Prices of "core" goods imports (which exclude oil, computers, and semiconductors) were flat with little change in all major categories. For July-August combined, the price for "core" goods imports rose 3/4 percent at an annual rate from the second-quarter average, compared with declines in the first two quarters of the year. Strong increases in the prices of imported non-oil industrial supplies (particularly lumber) in July-August and a small rise in the prices of imported automotive products more than offset declines recorded for prices of imported machinery (other than computers and semiconductors), foods (especially coffee), and consumer goods. Prices of imported computers and semiconductors fell at about a 9 percent annual rate.

Prices of exported goods rose slightly in August reflecting higher prices for both agricultural products (reversing a drop in July) and industrial supplies (the fifth consecutive month of increase). For July-August combined, prices of agricultural exports declined 5 percent at an annual rate from the second quarter average; prices of "core" goods exports (which exclude agricultural products, computers, and semiconductors) rose 1-1/4 percent at an annual rate, nearly the same rate of increase as in the second quarter. Prices of exported industrial supplies rose modestly, while automotive products and consumer goods registered small increases. Prices of exported computers and semiconductors fell at an 8 to 9 percent annual rate.

U.S. Current Account

In the second quarter, the U.S. current account deficit increased to $322 billion at a seasonally adjusted annual rate, $47 billion larger than in the first quarter. The higher deficit on goods and services trade resulted from a substantial increase in imports that surpassed a small increase in exports. The balances on net investment income and other net income and transfers also weakened, partly reversing the previous quarter's improvement. The negative balance on net investment income grew slightly as declines in direct investment receipts more than offset an increase in portfolio income. The larger deficit in other income and transfers was mainly driven by increased U.S. government grant disbursements.

U.S. Current Account
(Billions of dollars, seasonally adjusted annual rate)

Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
Annual				
1997	-104.7	8.2	-46.9	-143.5
1998	-164.3	-7.0	-49.3	-220.6
Quarterly				
1998:Q1	-133.4	6.1	-44.8	-172.1
Q2	-167.8	2.9	-44.7	-209.6
Q3	-182.9	-22.5	-48.5	-253.9
Q4	-173.1	-14.3	-59.3	-246.7
1999:Q1	-215.9	-11.8	-46.9	-274.6
Q2	-259.1	-12.0	-50.6	-321.8
Change				
Q3-Q2	-15.1	-25.4	-3.8	-44.3
Q4-Q3	9.8	8.2	-10.8	7.2
Q1-Q4	-42.8	2.5	12.4	-27.9
Q2-Q1	-43.2	-0.2	-3.7	-47.2

Source: U.S. Department of Commerce, Bureau of Economic Analysis.
Note: The data for 1999:Q2 include revised trade figures for June that became available with the release of the July trade data.

U.S. International Financial Transactions
In July, for the first time this year, U.S. residents' purchases of foreign securities exceeded their sales (line 5 of the Summary of U.S. International Transactions table). Although the $5 billion in net purchases was not particularly large, it does represent a return to the pattern seen prior to the recent financial turmoil. The most pronounced change between the first half of this year and July was in U.S. transactions in European equities. During the first half, U.S. residents recorded average monthly net sales of almost $7 billion. In July, net sales of European equities were only $1 billion. Since February, U.S. residents have been acquiring Japanese equities at a pace of nearly $3.5 billion per month. These purchases picked up further in July.

Private foreign purchases of U.S. securities accelerated further in July, as a huge increase in purchases of corporate and agency bonds more than outweighed a slowing in foreign purchases of U.S. equities and an increase in foreign sales of Treasuries (lines 4a-c). Of the $27 billion in net purchases of corporate and agency bonds, roughly $7 billion was of agencies, continuing the shift toward agencies.

Foreign official inflows to the United States were almost $8 billion in July (line 1), primarily reflecting an increase in Japanese official reserve assets in the United States following their foreign exchange market intervention. Partial data from the FRBNY show that between end-July and mid-September foreign official reserves in the United States rose another $7 billion, again reflecting Japanese intervention purchases.

Banking enterprises recorded net capital outflows of almost $20 billion in July (line 3), nearly reversing a similar inflow in June. However, monthly banking flows have become even more volatile in the wake of recent large cross-border merger and acquisition activity, and staff attach little importance to large monthly swings.

Recently released balance of payments data for 1999:Q2 show very large inflows through foreign direct investment into the United States (line 7), again associated with merger and acquisition activity. Of the $118 billion inflow, the foreign acquisition of AirTouch alone accounts for over $60 billion. U.S. direct investment abroad also remained strong in the second quarter (line 6) and was only slightly lower than the record pace set in 1999:Q1. Many of the large acquisitions in recent years have included a sizable equity component whereby shares in the acquired firm are swapped for shares in the acquiring firm. These swaps are not picked up in the Treasury International Capital (TIC) reporting system and thus are not included in line 5.b. These swaps are, however, included in "Other" flows, line 9, and account for most of the large outflows in recent quarters.

The statistical discrepancy in the international accounts was a negative $36 billion in the second quarter, indicating reported net capital inflows greatly exceeded the recorded current account deficit. While there are undoubtedly errors in the reporting of both current transactions and those on the capital account, the size and complexity of recent merger activity has strained the statistical reporting system for financial flows. As a result, most of the recent discrepancy probably owes to overstated net capital inflows rather than an understated current account deficit.

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

	1997	1998	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 June	1999 July
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	20.0	-17.1	-46.4	26.7	6.3	*	5.3	7.8
a. G-10 countries	1.8	6.9	*	12.8	12.7	7.6	13.0	7.8
b. OPEC countries	12.9	-9.0	-11.6	2.8	2.2	2.5	.4	.7
c. All other countries	5.2	-14.9	-34.8	11.0	-8.6	-10.2	-8.1	-.7
2. Change in U.S. official reserve assets (decrease, +)	-1.0	-6.8	-2.0	-2.4	3.9	1.2	.1	.4
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	33.9	57.0	53.1	12.3	6.2	11.3	20.7	-19.7
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	346.7	275.2	22.7	80.6	54.3	82.7	24.7	30.4
a. Treasury securities[3]	147.2	49.3	1.1	24.6	-8.6	-5.2	-1.7	-4.9
b. Corporate and other bonds[4]	128.1	172.2	27.7	40.9	52.8	50.2	14.7	27.1
c. Corporate stocks	71.3	53.7	-6.1	15.2	10.1	37.7	11.8	8.2
5. U.S. net purchases (-) of foreign securities	-89.1	-11.1	14.7	16.5	7.4	17.6	15.2	-4.8
a. Bonds	-48.2	-17.4	7.8	10.4	-.8	3.3	9.0	-2.6
b. Stocks [6]	-40.9	6.2	7.0	6.2	8.2	14.3	6.2	-2.2
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-110.0	-132.8	-21.6	-30.8	-41.4	-35.0	n.a	n.a
7. Foreign direct investment in U.S.	109.3	193.4	24.9	120.6	22.9	118.6	n.a	n.a
8. Foreign holdings of U.S. currency	24.8	16.6	7.3	6.3	2.4	3.1	n.a	n.a
9. Other (inflow, +)[5,6]	-47.9	-163.9	-21.1	-130.4	11.9	-82.4	n.a	n.a
U.S. current account balance (s.a.)	-143.5	-220.6	-63.5	-61.7	-68.7	-80.7	n.a	n.a
Statistical discrepancy (s.a.)	-143.2	10.1	31.9	-37.7	-5.2	-36.4	n.a	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. Includes U.S. government agency bonds.

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

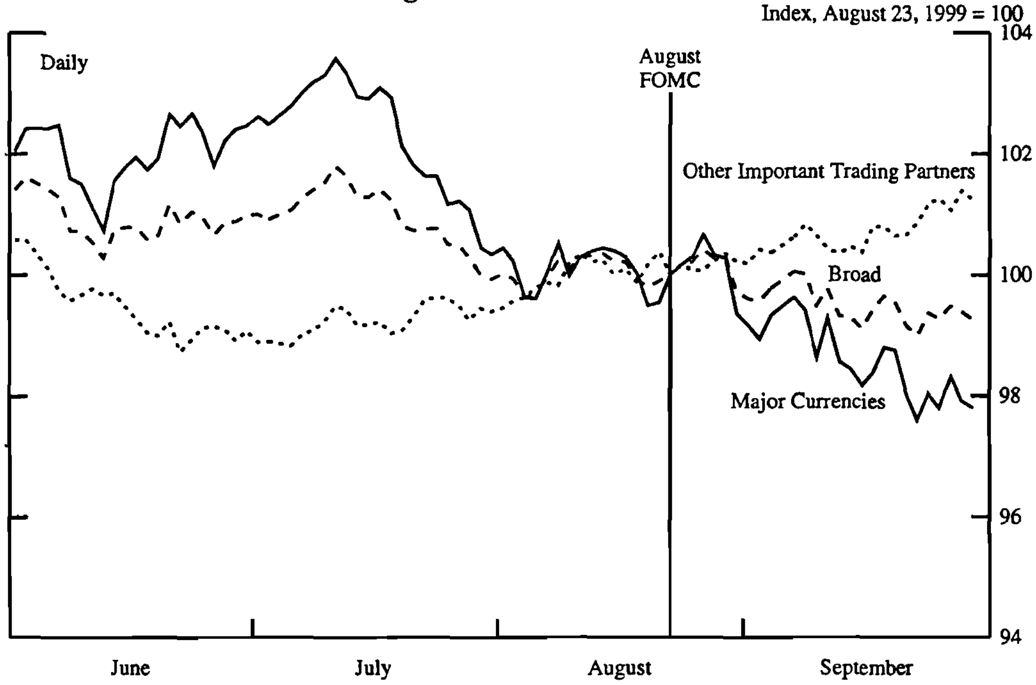
6. Quarterly balance of payments data include large U.S. acquisitions of foreign equities associated with foreign takeovers of U.S. firms. These are not included in line 5.b but are included in line 9.

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

Foreign Exchange Markets

Since the August FOMC meeting, the dollar has weakened 3/4 percent against the broad index of foreign currencies. During the period, the dollar depreciated nearly 2-1/4 percent in terms of the major currencies index but appreciated about 1-1/4 percent in terms of the currencies of our other important trading partners. Most of the dollar's decline against the major currencies index is due to its 4-1/2 percent depreciation against the yen. The dollar also lost 2 percent against the Canadian dollar, 2-1/4 percent against sterling, and 2-3/4 percent against the Australian dollar.

Exchange Value of the Dollar



The dollar's latest bout of weakness against the yen began on September 8, when the release of Japanese national accounts data revealed that economic activity expanded in the second quarter, a touch better than the market consensus expectation that GDP would fall. The dollar dropped 3 percent against the yen within 24 hours. In response, Japanese monetary authorities intervened to buy dollars on September 10, which temporarily halted the yen's rise. However, the yen resumed its strengthening course in short order. Another round of intervention on September 14 had little apparent effect; the dollar depreciated further against the yen, touching a low of about ¥103.50. The downward trend was interrupted by rumors both that the Bank of Japan might adopt more stimulative measures, such as unsterilized intervention or other methods of injecting additional liquidity into the Japanese economy, and that the United States and other countries were considering joining Japanese authorities in coordinated intervention to weaken the yen. However, following its meeting on September 21, the Bank of Japan's Policy Board released a statement that reaffirmed its policy of maintaining the overnight call rate near zero and rejected both unsterilized intervention and other methods of further expanding liquidity. The unwillingness of the Bank of Japan to ease monetary policy in order to weaken the yen led market participants to view coordinated intervention as even less likely than before and the value of the yen crept up. However, the yen gave up some of its earlier gains against the dollar following the meetings of G-7 officials that began on September 25. The G-7 communique expressed concern about the yen's appreciation and Bank of Japan Governor Hayami and other officials indicated that there might be some room for Japanese monetary policy to respond to foreign exchange developments. Since the G-7 meetings, the dollar has been supported by market speculation that G-7 officials may have reached a substantive agreement involving additional monetary easing by the Bank of Japan and possible coordinated intervention.

Japanese ten-year government bond yields declined 25 basis points on balance over the period, as implied yields on Euroyen contracts fell by as much as 50 basis points. The Nikkei index fell 5-1/4 percent on balance, led by export-sector and technology shares. Other Asian equity indexes fell as well during

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Sep. 29 (Percent)	Percentage Point Change	Sep. 29 (Percent)	Percentage Point Change	Percent Change
Canada	4.91	-0.08	5.74	0.02	-4.14
Japan	0.20	0.17	1.68	-0.25	-5.22
Euro area	3.08	0.40	5.11	0.33	-1.83
United Kingdom	5.35	0.29	5.71	0.54	-8.55
Switzerland	1.84	0.85	3.40	0.27	-2.97
Australia	4.99	-0.01	6.25	-0.07	-5.43
United States	6.00	0.57	5.91	0.02	-6.70
Memo: Weighted-average foreign	3.03	0.19	4.89	0.10	

NOTE. Change is from August 23 to September 29.

the intermeeting period. Equity prices slid 5-1/2 percent in Hong Kong, 10 percent in Indonesia, 11-1/2 percent in Malaysia, and almost 13 percent in Thailand. The Indonesian rupiah lost nearly 10 percent against the dollar amid the political and social turmoil that ensued following the vote for independence in East Timor. The Thai baht depreciated 7-3/4 percent owing to disappointing data on the pace of recent economic growth, concerns about non-performing loans, and worries about upcoming debt payments.

In the euro area, ten-year government bond yields rose 33 basis points over the intermeeting period, narrowing the spread to comparable U.S. Treasuries by about 30 basis points. Share prices declined moderately in most of the countries in the euro area, but were up slightly in France and Italy.

The Bank of England's Monetary Policy Committee (MPC) surprised markets on September 8 by raising its official repo rate 25 basis points, to 5.25 percent. The MPC stated that while near-term inflation was expected to remain below target, preemptive policy action was necessary to forestall future inflationary pressures. British stock prices have fallen 8-1/2 percent, and ten-year gilt yields have risen 54 basis points since the time of the August FOMC meeting.

The price of gold was unusually volatile during the intermeeting period, soaring well above $300 per ounce near the end of the period, mostly in response to official actions. Gold prices were boosted by a better-than-expected response to an auction of gold conducted by the Bank of England on September 21, and the IMF's announcement on September 23 that it would revalue, but not sell, its stock of gold. The rally intensified following the announcement on September 26 that the ECB and 14 national European central banks had reached an agreement to limit their sales of gold to 400 metric tons a year for the next five years. The central banks also agreed not to expand their gold leasing activities.

Latin American financial markets were relatively quiet during much of the period, although some countries experienced heightened financial stress. The Colombian peso and Chilean peso depreciated against the dollar by 5 percent and 3 percent, respectively, as authorities abandoned their crawling-peg exchange rate regimes. Ecuador announced that it would cover only part of the interest payments due September 28 on its Brady bonds, paying only the interest due on uncollateralized bonds. Despite these developments, the EMBI spread declined about 120 basis points, on balance. The Brazilian *real* depreciated 3-1/4 percent, but the Mexican peso was little changed on balance, supported in part by rising crude oil prices. Equity prices rose 9-1/2 percent in Argentina, 12 percent in Brazil, and nearly 24 percent in Venezuela, but fell 2-1/2 percent in Mexico.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest Rates		Dollar-denominated bond spread[1]		Equity prices
Country	Sep. 29	Percent Change	Sep.28/29 (Percent)	Percentage Point Change	Sep.28/29 (Percent)	Percentage Point Change	Percent Change
Mexico	9.35	0.06	19.50	-0.80	7.00	-1.44	-2.37
Brazil	1.92	3.22	19.30	-1.10	12.03	-2.58	12.15
Argentina	1.00	-0.00	9.50	2.00	8.56	-1.96	9.47
Chile	529.60	3.06	n.a.	n.a.	n.a.	n.a.	1.24
China	8.28	0.00	n.a.	n.a.	1.33	-0.19	-3.65
Korea	1217.00	1.59	5.14	-0.11	2.14	-0.05	-5.31
Taiwan	31.65	-1.03	4.80	0.00	n.a.	n.a.	-6.21
Singapore	1.71	1.44	2.19	0.31	n.a.	n.a.	-4.45
Hong Kong	7.77	0.05	5.59	-0.73	n.a.	n.a.	-5.44
Malaysia	3.80	0.00	2.78	-0.16	2.68	-0.42	-11.50
Thailand	41.28	7.70	3.50	0.00	1.14	-0.02	-12.74
Indonesia	8340.00	9.88	13.41	0.09	7.35	0.05	-9.97
Philippines	40.85	3.34	n.a.	n.a.	3.15	-0.19	-6.28
Russia	25.13	1.33	n.a.	n.a.	69.33	9.90	-27.01

NOTE. Change is from August 23 to September 28/29.

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

n.a. Not available.

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

Developments in Foreign Industrial Countries

Incoming data for the foreign industrial countries suggest that on balance economic activity has improved since earlier this year. In Japan, second-quarter GDP posted a slight gain, although available third quarter indicators are mixed. Real GDP in the second quarter expanded only modestly in the euro zone, with activity in Germany especially weak, but available third-quarter data and forward-looking confidence indicators suggest improvement in the second half of the year. In the United Kingdom, growth picked up in the second quarter and indicators point to further acceleration, while economic activity in Canada appears to be continuing at a robust pace.

Inflationary pressures remain subdued in these countries, although higher oil prices have contributed to an uptick in headline measures. Japanese core consumer prices were unchanged in the twelve months to August. Euro-zone inflation has edged up recently, but twelve-month inflation remains close to 1 percent. Canadian core inflation remains below the midpoint of the Bank of Canada's 1 to 3 percent target band, and U.K. inflation has edged down to close to 2 percent.

In **Japan**, real GDP posted a 0.9 percent (SAAR) increase during the second quarter, bringing growth during the first half of the year to 4.5 percent (SAAR). The twin engines of growth were private consumption and residential investment, which registered an outsized 82 percent gain, stimulated by tax incentives. By contrast, business fixed investment declined 14.9 percent, the fifth double-digit decline in the past six quarters, and public demand contracted 8.9 percent as impetus from the stimulus packages announced during 1998 waned. External demand contributed only slightly to growth.

Available economic indicators for the third quarter are mixed. Industrial production during August rebounded sharply, rising to its highest level since the first quarter of 1998, but July housing starts were down sharply from levels during the first half of the year. The household expenditure series during July was up slightly from the second-quarter average, but retail sales for July and August on average were down 0.6 percent from the second quarter average. Production and shipments of investment goods in July registered a sharp rebound from the very weak second-quarter average, but private machinery orders were down slightly. July unemployment remained at 4.9 percent, a record high, and the offers to applicants ratio remained at 0.46, a record low. The Tokyo "core" CPI in August was unchanged from a year earlier.

Japanese Real GDP
(Percent change from previous period, SAAR)

Component	1997[1]	1998[1]	1998 Q3	1998 Q4	1999 Q1	1999 Q2
GDP	-.8	-3.0	-1.2	-3.3	8.1	.9
Total domestic demand	-2.2	-3.2	-2.2	-1.9	9.7	.8
Consumption	-1.1	-.1	-.6	-.6	5.1	3.4
Private Investment	-4.9	-15.9	-12.7	-21.1	11.3	- .9
Public Investment	-4.5	8.6	15.6	49.8	47.9	-15.1
Government consumption	-1.0	1.1	3.1	-2.2	3.1	-1.8
Inventories (contribution)	.0	-.3	-.5	-.1	.1	.7
Exports	7.6	-6.0	7.4	-12.1	.1	3.6
Imports	-3.3	-7.7	-.5	-3.1	11.6	3.0
Net exports (contribution)	1.4	.0	1.0	-1.4	-1.2	.2

1. Q4/Q4.

Japan's merchandise trade surplus during the first eight months of 1999 was $110 billion at an annual rate, essentially unchanged from the $108 billion surplus during all of 1998. Denominated in dollars, imports during the first eight months of the year were up 4.3 percent from their 1998 average, while exports were up 3.6 percent. In recent months, Japanese exports to developing Asia have surged, as recovery in these countries has taken hold, but exports to Europe have declined significantly from 1998 levels.

In mid-August, Industrial Bank of Japan, Fuji Bank and Dai-Ichi Kangyo Bank announced the formation of a business alliance. They expect to form a joint holding company by the fall of 2000 and to integrate their businesses in early 2002. The resulting bank would have assets of over ¥140 trillion (about $1.3 trillion), making it the largest bank in the world.

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

Indicator	1998	1999					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production	-.7	.6	-1.0	-1.0	3.2	-.6	4.6
Housing starts	-1.8	7.8	3.7	-2.2	6.5	-11.7	n.a.
Machinery orders	-2.7	1.9	-3.7	7.9	-7.1	-2.6	n.a.
New car registrations	.8	1.5	-.0	5.5	.2	-7.8	n.a.
Unemployment rate[1]	4.4	4.6	4.8	4.6	4.9	4.9	n.a.
Job offers ratio[2]	.47	.49	.47	.46	.46	.46	n.a.
Business sentiment[3]	-49	-44	-37	...	...	...	...
CPI (Tokyo area)[4]	.7	-.2	-.4	-.6	-.4	-.1	.3
Wholesale prices[4]	-3.6	-4.0	-3.6	-3.4	-4.0	-3.8	-4.4

1. Percent.
2. Level of indicator.
3. Tankan survey, diffusion index.
4. Percent change from year earlier, NSA.
n.a. Not available. ... Not applicable.

Real GDP in the **euro zone** is estimated to have expanded a modest 1.3 percent (SAAR) in the second quarter. French and Italian GDP showed moderate increases, while German GDP was up only slightly.

Limited data on production, as well as recent readings on sentiment and new orders, suggest a pickup in activity in the third quarter. In Germany, production was up sharply in July, and new orders for manufactured goods–especially foreign goods–have been on a rising trend for several months. In Italy, too, industrial production rose in July, following the decline in the second quarter. Optimism in most of the euro-zone countries has been building in recent months, with improvement in the industrial, consumer, and construction components of the euro-11 confidence index.

The harmonized unemployment rate for the euro area edged down to 10.2 percent in July, about ¾ percentage point below its year-ago level and 1½ percent below its recent peak in 1997. (In constructing the harmonized unemployment series, Eurostat standardizes national statistics to International Labor Organization definitions.) The German unemployment rate remained unchanged in both July and August, while the French unemployment rate fell slightly in July.

Euro-11 Real GDP
(Percent change from previous period, SAAR)

Component	1997[1]	1998[1]	1998		1999	
			Q3	Q4	Q1	Q2
Euro-11 GDP	2.9	1.9	2.2	.6	1.8	1.3
Germany:						
GDP	1.4	1.2	1.6	-1.1	1.8	.2
Domestic demand	.7	2.5	2.4	2.5	1.9	.1
Net exports (contribution)	.7	-1.3	- .7	-3.5	- .1	.1
France:						
GDP	3.0	2.9	1.9	2.4	1.6	2.4
Domestic demand	2.2	3.8	1.0	4.8	1.6	2.1
Net exports (contribution)	.9	-.8	.9	-2.2	.0	.4
Italy:						
GDP	2.9	.2	2.4	-1.8	.7	1.7
Domestic demand	4.2	1.5	1.5	1.8	3.7	1.7
Net exports (contribution)	-1.2	-1.3	.9	-3.5	-2.9	.0

1. Q4/Q4.

The euro-area harmonized CPI rose 1.1 percent in the twelve months to August, extending the upward trend since June, but twelve-month inflation is still below the European Central Bank (ECB)'s target rate of 2 percent. Noticeable differences persist among individual countries, with inflation rates in Germany, Austria, Belgium, and France below 1 percent, while rates in the Netherlands, Spain, Portugal, and Ireland are a touch above 2 percent.

Euro-11 Current Indicators
(Percent change from previous period except as noted, SA)

Indicator	1999						
	Q1	Q2	Q3	May	June	July	Aug.
Industrial production[1]							
Euro-11	-.0	.1	n.a.	.6	.5	-.1	n.a.
Germany	-.1	-.4	n.a.	.2	.3	1.3	n.a.
France	-.7	.6	n.a.	.5	.8	n.a.	n.a.
Italy	-.0	-.7	n.a.	-.4	1.5	.5	n.a.
Unemployment rate							
Euro-11[2]	10.4	10.3	n.a.	10.3	10.3	10.2	n.a.
Germany	10.6	10.5	n.a.	10.5	10.5	10.5	10.5
France	11.4	11.3	n.a.	11.4	11.3	11.2	n.a.
Italy	11.8	11.5	11.5	...	...	...	...
Consumer prices[3]							
Euro-11[4]	.5	.7	n.a.	.8	.9	1.1	1.1
Germany	.3	.5	n.a.	.4	.4	.7	.7
France	.3	.4	n.a.	.4	.3	.4	.5
Italy	1.4	1.5	n.a.	1.5	1.4	1.7	1.7

1. Indexes exclude construction.
2. Standardized to ILO definition. Includes Eurostat estimates in some cases.
3. Percent change from year earlier.
4. Eurostat harmonized definition.
n.a. Not available. ... Not applicable.

At its meeting on September 9, the Governing Council of the ECB left official interest rates unchanged. In a press conference following the September 9 meeting, ECB President Wim Duisenberg said that price pressures should remain contained and that harmonized inflation is expected to remain below the 2 percent ceiling for the foreseeable future. However, President Duisenberg also indicated that the Council remains concerned by recent M3 growth, which increased to 5.6 percent for the 12 months ending in August from a revised 5.5 percent for the twelve month period ending in July. The ECB's reference value is for annual M3 growth of 4.5 percent.

Euro-11 Forward-Looking Indicators
(Percent balance, SA)

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
Consumer confidence[1]	-2	0	-4	-3	-4	-5	-3
Construction confidence[2]	-15	-9	-7	-7	-8	-6	-5
Industrial confidence[3]	-7	-10	-10	-11	-11	-9	-8
Of which:							
Production expectations	3	1	3	2	3	5	7
Total orders	-13	-19	-21	-20	-22	-22	-19
Stocks	11	14	13	14	13	11	11

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.

The pace of economic activity in the **United Kingdom** picked up markedly in the second quarter, with real GDP expanding 2.6 percent (SAAR), the strongest increase in nearly two years. Consumption expenditures increased a robust 4.4 percent, while the increase in fixed investment spending was more modest. Strength in residential construction was offset by a decline in government fixed investment. Total domestic demand was held back by a sizable inventory drawdown that subtracted 3.1 percentage points from growth. Net exports contributed positively to growth for the first time in nearly two years, as export growth resumed and imports increased only moderately.

U.K. Real GDP
(Percent change from previous period, SAAR)

Component	1997[1]	1998[1]	1998 Q3	1998 Q4	1999 Q1	1999 Q2
GDP	3.4	1.6	2.2	.2	.9	2.6
Total domestic demand	4.6	3.4	3.5	3.3	5.1	.5
Consumption	4.3	2.8	.9	4.3	6.4	4.4
Investment	10.9	9.2	17.0	8.0	1.8	1.2
Government consumption	-1.8	2.0	1.6	3.1	6.8	2.6
Inventories (contribution)	.4	-.3	-.2	-1.5	-.5	-3.1
Exports	7.4	-.7	2.4	-6.4	-5.3	8.8
Imports	11.2	6.0	7.9	3.2	6.5	1.9
Net exports (contribution)	-1.2	-2.2	-1.9	-3.2	-3.9	2.0

1. Q4/Q4.

Incoming data indicate that activity continued to strengthen in the third quarter. Industrial production picked up further in July, and manufacturing surveys suggest continued expansion in August. Retail sales have remained strong, with the volume of sales for July and August on average increasing 1.2 percent from the second-quarter average. Business confidence has improved markedly since late last year, with output expectations rising from a percent balance of -27 last November to +17 in both August and September.

Labor market conditions have continued to improve. The official claims-based unemployment rate was 4.2 percent in August, the lowest rate in nearly 20 years, and the Labor Force Survey measure of the unemployment rate edged down to 5.9 percent for the May-July period. Wage growth has remained moderate; "headline" annual average earnings growth was 4.2 percent for the three months centered in July, slightly lower than average growth recorded in the first half of the year.

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

Indicator	1998	1999					
	Q4	Q1	Q2	June	July	Aug.	Sept.
Industrial production	-.8	-.6	.6	.3	.3	n.a.	n.a.
Retail sales	.0	1.0	1.0	.2	.3	.8	n.a.
Unemployment rate[1]	4.6	4.5	4.5	4.4	4.3	4.2	n.a.
Business confidence[2]	-23.0	-10.3	8.0	10.0	-4.0	17.0	17.0
Retail prices[3]	2.6	2.6	2.3	2.2	2.2	2.1	n.a.
Producer input prices[4]	-9.2	-5.8	-1.6	-1.0	2.9	3.8	n.a.
Average earnings[4]	4.6	4.6	4.4	4.4	4.2	n.a.	n.a.

1. Percent.
2. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
3. Excluding mortgage interest payments. Percent change from year earlier.
4. Percent change from year earlier.
n.a. Not available.

Inflationary pressures remain contained, with the twelve-month rate of retail price inflation (excluding mortgage interest rates) comfortably below the official target of 2.5 percent. Producer input prices for materials and fuel have edged up since April, primarily reflecting higher oil prices.

Canadian real GDP rose 3.3 percent (SAAR) in the second quarter, led by a surge in capital spending. Strong demand for computers, reportedly fueled in part by Y2K preparations, was the primary contributor to the surge in capital spending, but investment in other types of machinery and equipment also posted sizable gains. The pace of government spending picked up due to increased health care spending, while consumer spending grew a more moderate 3 percent after a sharp rise in the first quarter. Net exports made a large negative contribution to growth, as much of the runup in investment spending was on imports. Export growth slowed partly due to a decline in automotive exports and foreign travel expenditures.

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

Component	1997[1]	1998[1]	1998		1999	
			Q3	Q4	Q1	Q2
GDP	4.4	2.8	2.6	4.8	4.2	3.3
Total domestic demand	5.1	1.0	-4.4	5.0	3.0	9.7
Consumption	4.1	2.0	.9	.0	4.2	3.0
Investment	12.7	1.3	-1.3	5.0	12.1	22.4
Government consumption	.3	2.1	-.1	2.4	.9	2.3
Inventories (contribution)	.4	-.8	-4.6	3.4	-1.8	3.1
Exports	11.9	9.0	11.2	14.2	9.5	1.5
Imports	14.9	4.2	-6.2	15.9	4.5	18.2
Net exports (contribution)	-.8	1.9	6.5	-.2	2.0	-5.7

1. Q4/Q4.

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

Indicator	1998	1999					
	Q4	Q1	Q2	May	June	July	Aug.
GDP at factor cost	1.1	1.0	.9	.3	.3	n.a.	n.a.
Industrial production	1.4	1.1	.6	.2	.5	n.a.	n.a.
New manufacturing orders	4.5	.6	.6	2.7	.2	1.1	n.a.
Retail sales	-.1	2.5	.9	.5	.4	1.3	n.a.
Employment	1.3	.9	-.1	-.1	.0	.3	.0
Unemployment rate[1]	8.0	7.8	8.0	8.1	7.6	7.7	7.8
Consumer prices[2]	1.1	.8	1.6	1.6	1.6	1.8	2.1
Consumer attitudes[3]	109.8	117.1	116.6	...	...	...	...
Business confidence[4]	132.3	150.1	150.7	...	...	...	...

1. Percent.
2. Percent change from year earlier.
3. Level of index, 1991 = 100.
4. Level of index, 1977 = 100.
n.a. Not available. ... Not applicable.

Limited third-quarter indicators suggest that activity remains vigorous. New manufacturing orders surged in July, and job growth resumed after a decline in employment in the second quarter. Retail sales rose sharply in July, after posting moderate gains in May and June.

After rising sharply in the second quarter, increases in core consumer prices (which exclude food and energy prices) were extremely modest in both July and August. As a result, twelve-month core inflation remained 1.6 percent in August, well within the Bank of Canada's 1 to 3 percent target range. Higher gasoline prices, however, pushed the twelve-month inflation rate for the overall index in August to 2.1 percent, its highest level in almost three years.

Nominal wages have risen sharply this year. Average hourly wages for permanent workers were up 2.9 percent in August from a year ago, almost double the pace recorded at the end of last year.

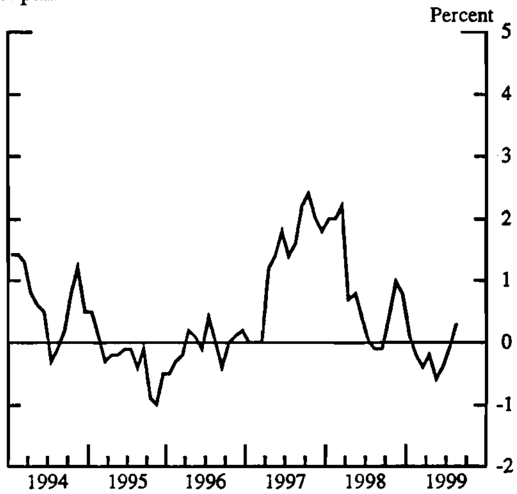
External Balances
(Billions of U.S. dollars, SAAR)

Country and balance	1998		1999			
	Q3	Q4	Q1	Q2	July	Aug.
Japan						
Trade	107.3	113.0	113.1	104.7	124.0	99.8
Current account	118.5	133.0	116.0	113.7	120.8	n.a.
Euro-11						
Trade[1]	105.8	98.1	42.7	65.6	n.a.	n.a.
Current account[1]	86.3	84.3	41.3	n.a.	...	...
Germany						
Trade	72.3	70.5	76.2	64.7	80.8	n.a.
Current account	7.1	-17.2	-9.9	n.a.	...	...
France						
Trade	28.9	25.4	19.6	16.4	40.5	n.a.
Current account	42.7	48.3	34.5	29.4	n.a.	n.a.
Italy						
Trade	28.5	25.0	20.9	14.4	n.a.	n.a.
Current account[1]	20.0	5.9	1.9	6.8	32.7	n.a.
United Kingdom						
Trade	-35.1	-41.1	-48.4	-43.4.	-41.9	n.a.
Current account	8.5	-8.3	-23.3	-24.0	...	...
Canada						
Trade	15.0	12.9	19.7	19.8	25.6	n.a.
Current account	-10.1	-10.7	-2.7	-3.6	...	...

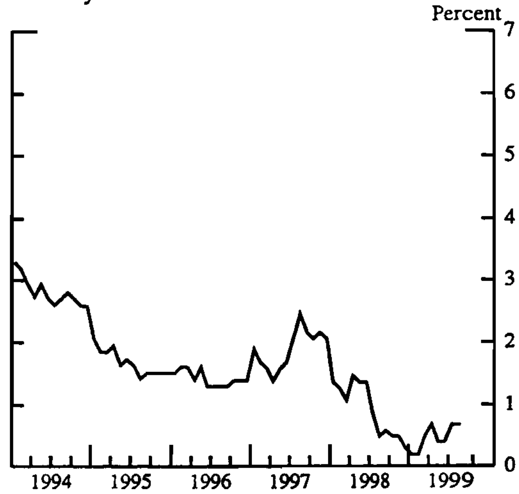
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

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

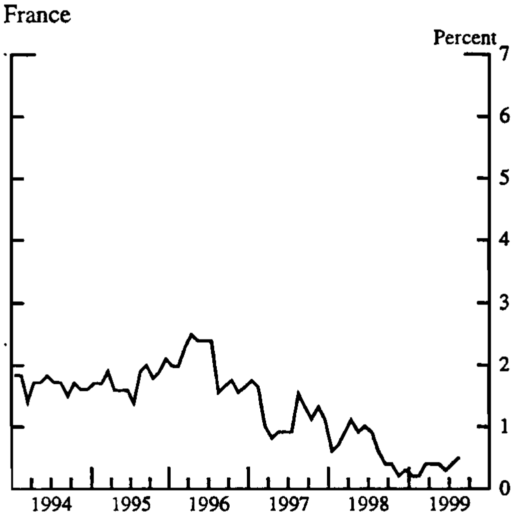
Japan



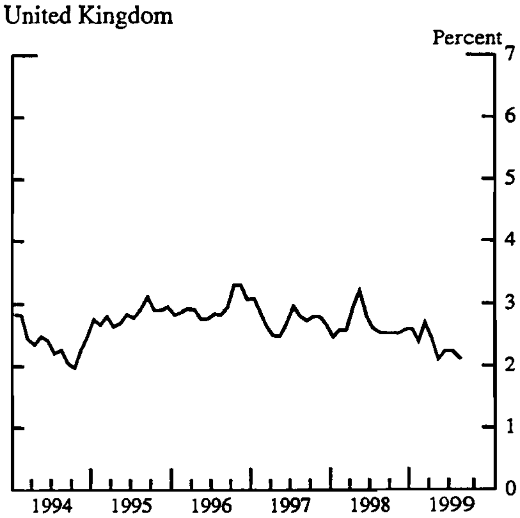
Germany



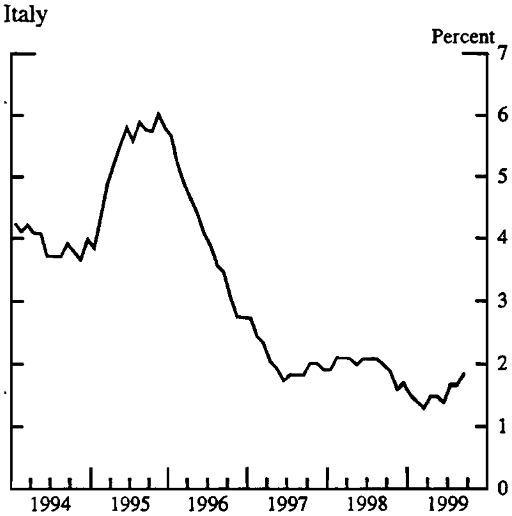
France



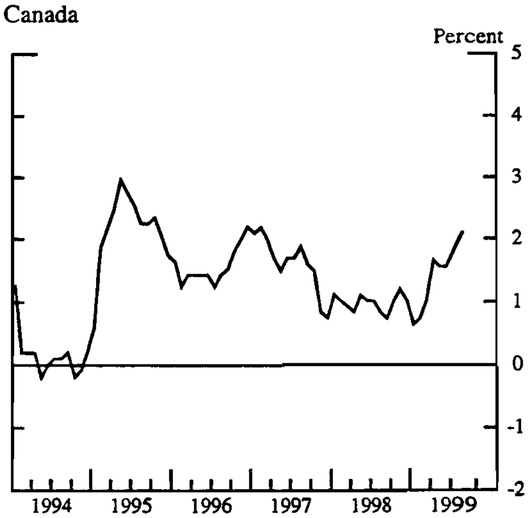
United Kingdom



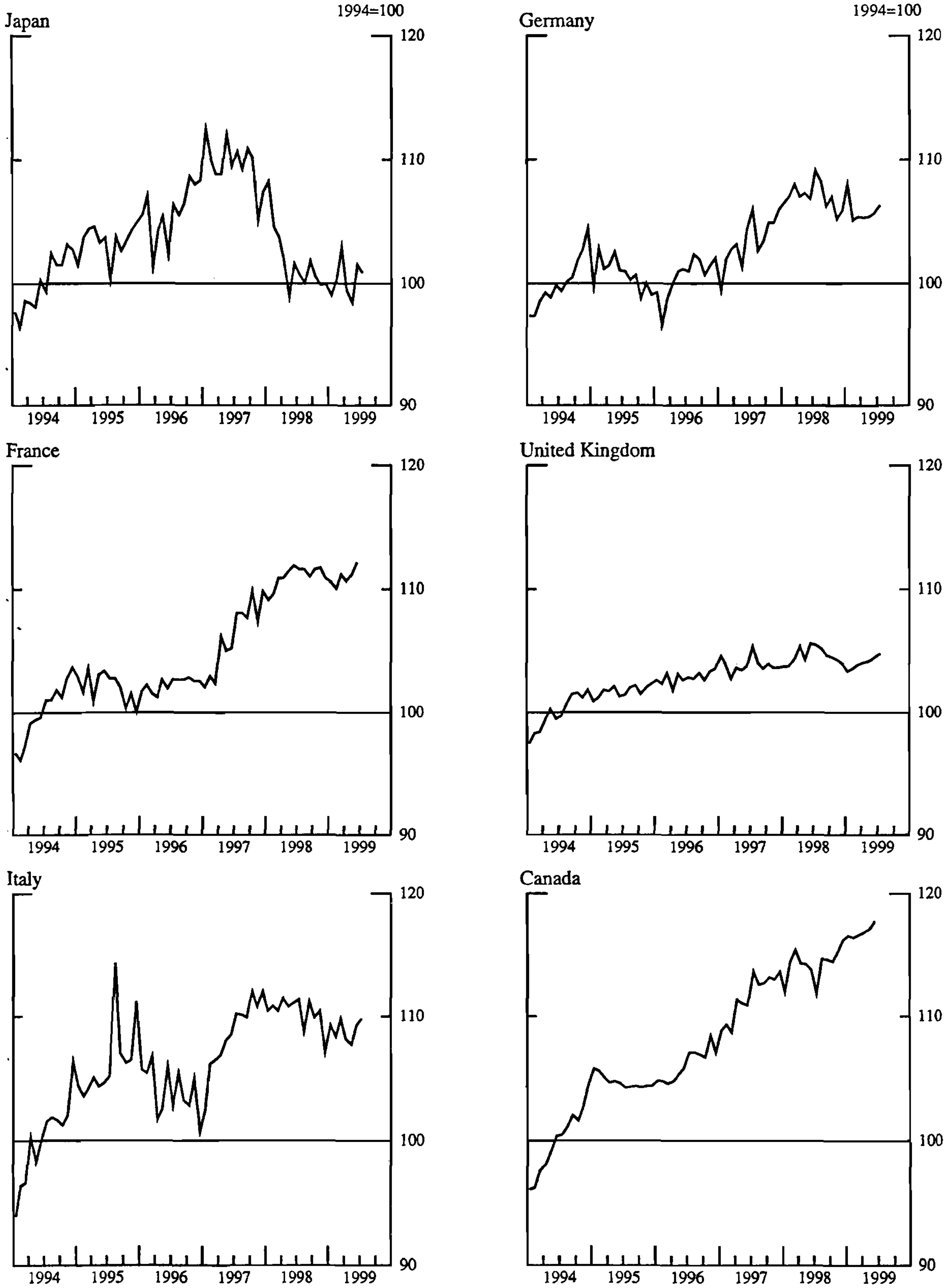
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Economies in most of developing Asia continue to recover, with the exception of Indonesia, which remains plagued by domestic problems. ASEAN growth has helped pull Hong Kong out of its recession, while in China there are indications that economic activity may have picked up. In Latin America, in contrast, activity remains weak, with the major exception of Mexico. Argentina continued to experience deflationary pressures. In Brazil, there is no conclusive evidence that the recovery seen in the first half of the year has continued. In Russia, economic activity has weakened, and the outlook there continues to be clouded by political problems. The relatively weak level of domestic demand in the major developing economies has dampened inflationary pressures. Ecuador's failure to honor fully its Brady bonds seems to have had limited effects on other developing country financial markets.

In developing Asia, the economic rebound narrowed trade surpluses in general over the first half of the year. However, several economies recorded a jump in exports in July (and August in China). In Latin America, trade performance has been mixed. Brazilian and Argentine exports have been depressed by low commodity prices, weak demand in major trading partners, and, in Argentina's case, the real appreciation of its currency. Mexico's trade deficit narrowed on balance over the July-August period owing to continued rapid export growth.

In **Brazil**, there were mixed signals concerning whether the economy was continuing to recover from the recession registered during the second half of 1998. Industrial output increased on balance over the second quarter, but registered a 1.3 percent decline in June (SA) and a small decline in July. The unemployment rate has remained high. The still weak economy helped keep inflationary pressures at bay, offsetting to some extent the 15 percent depreciation of the *real* against the dollar between mid-May and end-August. Consumer price inflation (as measured by the IPC-A) declined from 1.2 percent in July to 0.3 percent in August (SA), suggesting that the effects of the government's increases in utilities prices in June and July have receded. Brazil continued to see less trade adjustment than had been expected after the collapse of the *real* early this year; exports have been depressed by weak demand in Latin American trading partners (especially Argentina) and by low world commodity prices.

On September 22, the central bank's monetary policy council, the COPOM, reduced the overnight lending rate (the Selic) from 19.5 to 19 percent. The decline had been expected, due to lower-than-anticipated inflation recently and the weak economy. The Selic rate had not been changed since late July, but the central bank had reduced Brazil's very high reserve requirements somewhat in early September to boost liquidity.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	2.2	-1.6	-6.9	3.1	3.8	...	...
Industrial production	3.9	-2.1	-3.4	.4	1.4	-.6	n.a.
Unemployment rate[2]	5.7	7.6	7.7	7.5	7.5	7.5	7.5
Consumer prices[3]	5.2	1.7	1.8	2.3	3.3	4.6	5.7
Trade balance[4]	-8.4	-6.4	-5.2	-1.4	-2.1	-1.1	-5.5
Current account[5]	-33.8	-34.9	-46.8	-20.8	-28.4	-16.7	-23.1

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, NSA, annual rate.
n.a. Not available. ... Not applicable.

Since late August, yields on dollar-denominated and *real*-denominated Brazilian instruments have declined roughly 100-300 basis points. These declines most likely reflected three events that signaled the government's commitment to fiscal and monetary discipline. First, in late August, the government unveiled its year 2000 fiscal budget for the central government, which was well received. The budget projects a primary surplus of 2.7 percent of GDP, putting it within reach of the IMF program target of a surplus of 3-1/4 percent of GDP for the entire public sector. Second, in early September, President Cardoso sacked the development minister, who had been advocating more expansionary policies and who had criticized Finance Minister Pedro Malan. Third, the government quashed initiatives from the strong rural bloc in congress to provide a generous bailout package to farmers. Cardoso's popularity ratings, however, have remained in the doldrums, and analysts remain concerned about the slow pace of fiscal and other reforms.

In **Mexico**, the economic recovery continues, although there are some indications that the very strong pace of growth seen in the second quarter will not be sustained. Seasonally adjusted industrial production rose 1 percent in July, about equal to its growth in June, but representing some deceleration compared with May. The reported unemployment rate rose in August. Inflation has been trending down in recent months; the twelve-month inflation rate in August was 16-1/2 percent, down from 18-1/2 percent at end-1998. The seasonally adjusted trade deficit for July-August narrowed to about $1.5 billion

(AR) from over $6 billion (AR) in the second quarter, as export growth outpaced import growth.

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

Indicator	1997	1998	1998 Q4	1999 Q1	1999 Q2	1999 July	1999 Aug
Real GDP[1]	7.2	2.9	.1	1.3	7.7	...	...
Industrial production	9.3	6.6	-.4	1.2	1.4	1.0	n.a.
Unemployment rate[2]	3.7	3.2	3.0	2.7	2.6	2.1	2.5
Consumer prices[3]	15.7	18.6	17.6	18.6	17.9	17.0	16.6
Trade balance[4]	.6	-7.7	-7.3	-6.2	-6.2	1.7	-4.8
Imports[4]	109.8	125.2	128.2	129.3	138.5	131.1	151.2
Exports[4]	110.4	117.5	120.8	123.1	132.3	132.8	146.5
Current account[5]	-7.4	-15.8	-18.6	-11.7	-11.3	...	...

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.
5. Billions of U.S. dollars, NSA, annual rate.
n.a. Not available. ... Not applicable.

In August, Moody's upgraded Mexico's sovereign ceiling from Ba2 to Ba1, and in September Standard and Poor's raised its rating's outlook for Mexico from stable to positive. However, S&P identified a number of factors preventing an upgrade of Mexico's long-term foreign-currency debt rating, currently BB, including the fragility of its banking sector. On September 21, the Mexican government unveiled a new plan designed to bring its bank capitalization rules more in line with international standards.

On the political front, on-going negotiations have not yet resulted in an agreement between the major opposition parties that would put up a joint presidential candidate to oppose the ruling party's candidate. So far, neither of the two major opposition parties' candidates, Vincente Fox of the right-wing PAN or Cuauhtemoc Cardenas of the left-wing PRD, have indicated any willingness to step down. For the first time, the ruling party, the PRI, will select its presidential nominee through a primary (to be held on November 7); in the past, the party had automatically chosen as its presidential candidate the person nominated by the outgoing president.

In **Argentina**, data released since the last Greenbook point to continued weak economic performance on balance. Second quarter GDP has fallen almost 5 percent from the same quarter last year, and all indications suggest that the drop in output for 1999 as a whole will be worse than the Tequila Crisis in 1995. Industrial production jumped in August, but was down 7.1 percent from its year earlier level. While the IP number may hint of a turnaround, other indicators have pointed to continued weakness in economic activity, including a nearly 2 percent decline in consumer prices over the 12 months ending in August. Argentina registered a trade deficit in July, as the Brazilian devaluation early this year and low world prices of commodities continue to depress exports.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	7.8	-.6	-8.9	-5.8	-1.2	...	...
Industrial production	10.4	1.4	-6.1	-2.2	-1.5	-1.2	5.6
Unemployment rate[2]	14.9	12.9	12.4	n.a.	14.5	...	...
Consumer prices[3]	.4	.7	.8	-.1	-1.1	-1.4	-1.9
Trade balance[4]	-2.1	-3.2	-1.2	-1.1	1.6	-1.3	n.a.
Current account[5]	-12.0	-14.7	-14.8	n.a.	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, NSA. Q4 and Q2 figures are from surveys released in October and May, 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, NSA, annual rate.
n.a. Not available. ... Not applicable.

Argentina is now in the final month of its presidential campaign; elections will be held on October 24. After unsettling comments by presidential hopefuls shook international markets earlier this summer, concerted efforts to calm the markets by financial advisors of the main candidates have had limited success. The stock market index has returned to its level of early July, but was 15 percent below its recent peak in early May. Interest rates have remained elevated. The IMF has been working with the current government as well as the candidates on a financing package. In late September, the IMF indicated that funds would be made available to Argentina in return for fiscal adjustments and labor market reforms.

In **Venezuela**, the weak economy continued to take a back seat to politics. Real GDP in the first half of the year was 9-1/2 percent below its level last year, reflecting declines in domestic demand. The fall in output helped mute inflationary pressures; consumer price inflation rose 22-1/2 percent over the 12 months ended August, down from 36-1/2 percent over the same period a year earlier.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	5.5	-8.2	-19.8	4.9	-6.3	...	...
Unemployment rate[2]	11.7	11.2	11.0	14.0	16.3	n.a.	n.a.
Consumer prices[3]	37.6	29.9	31.2	29.1	23.9	23.2	22.5
Non-oil trade balance[4]	-7.5	-8.6	-7.9	-7.4	n.a.	n.a.	n.a.
Trade balance[4]	10.6	3.4	3.1	2.1	n.a.	n.a.	n.a.
Current account[5]	4.7	-1.7	-.9	n.a.	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. NSA. Q1 figure is for March. Q2 figure is May-June average.
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, NSA, annual rate.
n.a. Not available. ... Not applicable.

Since July, when a Chavez-dominated assembly was elected to rewrite the constitution, this assembly has, in addition to debating Chavez's proposed constitution, acted to disband the Supreme Court and take on many of the governing responsibilities of the Congress. In consequence, uncertainty surrounding the political situation continues to depress Venezuelan asset prices and investor confidence in prospects for the Venezuelan economy more generally.

In **Korea**, recent data provide further evidence of a robust recovery. Real GDP in the second quarter increased at about a 15 percent annual rate, matching the very rapid growth in the first quarter. Second quarter growth was boosted by strong increases in consumption and fixed investment. A slowing in the rate of inventory decumulation also made a significant positive contribution to growth, while net exports made a slight negative contribution. Industrial production declined slightly in August after posting another substantial increase in July. The unemployment rate decreased to 5.7 percent in August, nearly 2 percentage points below its level of a year earlier. Despite this rapid growth, inflation has remained low, with year-over-year consumer price increases running below 1 percent.

With recovery apparently well established, the government's recently released budget for next year calls for slower growth of spending and a reduced deficit. Total expenditures are projected to increase by only 5 percent–the lowest rate of increase in nearly a decade–while the deficit as a percent of GDP is expected to be 3-1/2 percent, down from an estimated 4 percent this year.

On September 17, the Financial Supervisory Commission announced that final agreement had been reached on the sale of a controlling interest in Korea First Bank to Newbridge Capital, a U.S.-based investment fund. A tentative agreement had been reached last December, but this was followed by months of contentious negotiations over the terms of the sale as Korean economic prospects brightened. Last month, the government abandoned an attempt to sell Seoulbank to Hong Kong Shanghai Bank when final terms could not be agreed upon. The government had promised to sell both of these troubled banks as part of its agreement with the IMF.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	3.7	-5.3	6.0	14.7	15.4	...	...
Industrial production	5.3	-7.3	10.0	1.9	6.4	2.3	-.9
Consumer prices[2]	6.6	4.0	6.0	.7	.6	.3	.9
Trade balance[3]	-3.2	41.2	36.0	31.7	28.0	34.9	29.3
Current account[4]	-8.2	40.6	34.8	28.7	25.8	33.5	17.0

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

The **ASEAN** region shows clear signs of continued recovery, with the exception of Indonesia, which continues to be plagued by internal problems. Malaysian GDP growth in the second quarter was remarkably strong, fueled largely by a rebound in the global electronics market. Philippine second-quarter GDP growth continued to indicate a robust recovery from its mild recession of 1998. Announced Thai GDP growth for the second quarter was significantly slower than anticipated and inconsistent with monthly indicators, which suggested significant strength in the second quarter. July's industrial production for Singapore and Malaysia indicated a slowing in the torrid pace of second-quarter growth as electronic components demand slackened, but Thai industrial production continued to grow. Remaining excess capacity continues to dampen inflation across the region.

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

Indicator and country	1997	1998	1999				
			Q1	Q2	June	July	Aug
Real GDP[1]							
Indonesia	1.1	-17.7	20.0	-2.2	...	...	...
Malaysia	5.7	-10.3	12.4	22.6	...	...	...
Philippines	5.0	-1.8	5.5	4.8	...	...	...
Singapore	8.1	-1.1	5.0	22.7	...	...	...
Thailand	-4.7	-6.0	3.6	1.7	...	...	...
Industrial production							
Indonesia	13.2	-12.8	5.9	-1.5	...	...	...
Malaysia	10.7	-7.2	1.8	5.2	4.9	-2.5	n.a.
Philippines	5.1	-11.5	8.3	.1	-3.8	-4.3	n.a.
Singapore	4.7	-.4	6.2	6.4	5.4	-4.9	-1.3
Thailand	-.6	-10.0	2.0	5.8	3.6	.9	n.a.

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

Apart from an extraordinary July surge in exports from Malaysia, Thailand and Singapore, trade surpluses throughout the region have begun to narrow since late last year, as import growth has outpaced export gains.

ASEAN financial markets have been depressed by a series of largely unrelated events across the region. The Indonesian rupiah has fallen 20 percent since mid-July in response to broadening banking scandals and unrest in East Timor following its August independence referendum. The banking scandal, involving possible malfeasance by members of the ruling Golkar party, has also stalled further disbursements of funds from the IMF and World Bank. The currencies of the Philippines and Thailand have depreciated since July on market anticipation of a devaluation of the renminbi next year, troubles in Indonesia, and domestic developments.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars, SAAR)

Country	1997	1998	1998	1999				
			Q4	Q1	Q2	June	July	Aug
Indonesia	11.9	21.5	15.5	19.6	23.1	21.6	24.1	n.a.
Malaysia	-.2	15.0	19.3	19.4	18.8	16.2	20.1	n.a.
Philippines	-10.5	-.1	2.7	2.6	1.2	1.7	1.2	n.a.
Singapore	-7.4	8.3	9.5	6.7	2.7	4.0	-1.5	-4.9
Thailand	-4.6	12.2	11.3	11.1	11.5	7.2	12.0	n.a.

n.a. Not available.

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

Country	1997[1]	1998[1]	1998	1999				
			Q4	Q1	Q2	June	July	Aug
Indonesia	10.3	77.6	78.4	56.0	30.9	24.5	13.5	5.8
Malaysia	2.9	5.3	5.4	4.0	2.7	2.2	2.5	2.3
Philippines	6.6	10.4	10.6	10.1	6.8	5.7	5.7	5.5
Singapore	2.0	-1.5	-1.6	-.6	.1	.6	.6	.9
Thailand	7.6	4.3	5.0	2.7	-.4	-1.2	-1.1	-1.1

1. December/December.

Thailand announced that it plans to make no further drawings on its $17.2 billion IMF package, after having drawn a total of $13.5 billion. Thailand will retain its IMF program and the rights to draw from its line of credit in the future, but further drawings seem unlikely, given the rebuilding of Thai reserves and a continued current account surplus. As part of its IMF agreement, the Thai government sold a majority stake in one of five nationalized banks to a foreign financial institution.

Less than $1 billion in foreign funds were repatriated from Malaysia following the expiration of the one-year holding period mandated by the imposition of capital controls on September 1, 1998. This sum was less than had been anticipated. In late September, Malaysia unexpectedly changed its two-tier exit tax scheme, removing the higher levy for funds invested for less than one year.

Hong Kong has finally emerged from recession, with economic activity rebounding strongly in the second quarter, partly reflecting a sharp increase in regional trade, which greatly benefits Hong Kong's entrepot economy. Consumer prices continue to fall sharply, contributing to high real interest rates. The Hong Kong Monetary Authority raised base interest rates 25 basis points to 6.75 percent in late August; shortly afterwards Hong Kong banks raised their deposit rates a similar amount, to 3.75 percent. Preliminary data indicate that the unemployment rate edged up to 6.1 percent in the June-August period from 6 percent in the May-July period. Spreads between one-year Hong Kong government debt and U.S. Treasuries were around 70 basis points on September 28, down sharply from their levels of nearly 280 basis points in January.

Hong Kong Economic Indicators
(Percent change from previous period, SA, except as noted)

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	2.8	-5.7	-1.4	-2.2	12.6	...	...
Consumer prices[2]	5.2	-1.6	-.8	-1.8	-4.0	-5.5	-6.0
Trade balance[3]	-20.6	-10.6	-4.5	-2.5	-4.6	-10.6	-3.5

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

In **China**, there are some signs that economic activity may be picking up after slowing sharply earlier in the year. Industrial production grew strongly in July, while soaring exports in July and August caused the trade surplus, which had narrowed sharply in the first half of the year, to widen significantly. Deflation continues, however, reflecting weak private domestic demand. In August, the government unveiled a series of new stimulus measures including a large increase in spending on infrastructure, a 30 percent increase in social security payments to laid-off workers, and an increase in salaries of civil servants and the pensions of retired state workers.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	8.2	9.5	13.8	2.2	1.1	...	...
Industrial production[2]	11.7	7.8	9.5	12.4	8.5	10.7	n.a.
Consumer prices[2]	.4	-1.0	-1.1	-1.4	-2.2	-1.4	-1.3
Trade balance[3]	40.4	43.6	35.1	19.4	13.1	36.0	39.6

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 **Taiwan**, second quarter GDP growth was remarkably strong, boosted by soaring exports of electronic products. The unemployment rate was 2.8 percent in August (SA), the lowest rate in six months. Inflation remains low. In late September, an earthquake disrupted industrial production and caused some damage to infrastructure. However, the key electronics sector is expected to recuperate quickly. Taiwan's trade and current account surpluses continued to shrink, albeit from elevated levels, as soaring imports outpaced rapidly growing exports. Taiwan's foreign exchange reserves rose to a record $100 billion at the end of August. Stock prices in Taiwan have mostly recovered from the sharp drop in July, although political tensions between China and Taiwan remain heightened.

In **Russia,** after staging a recovery over the first half of 1999, industrial output declined in July and August. Unemployment appears to have peaked at just over 14 percent. Monthly consumer price inflation reached a low for the year of 1.2 percent in August. The trade surplus widened, boosted by the improvement in Russia's international competitiveness following the 1998 collapse of the ruble and the rise in oil prices. Negotiations for restructuring Russia's heavy external debt obligations are underway. However, investigations into alleged illegal financial activities are expected to delay the next disbursement of the $4.5 billion IMF program that was approved last July.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	7.1	3.7	6.0	6.3	10.9	...	...
Industrial production	7.4	3.7	-.3	1.6	5.0	-.6	.4
Consumer prices[2]	.3	2.1	2.9	.7	-.1	-.8	1.1
Trade balance[3]	14.4	10.4	1.9	15.6	15.7	6.3	4.7
Current account[4]	7.7	3.4	2.0	8.4	6.7	...	...

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

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	July	Aug
Real GDP[1]	2.6	-9.0	-.9	5.7	n.a.	...	...
Industrial production	1.7	-5.1	2.9	10.4	4.2	-2.9	-.6
Unemployment rate[2]	10.8	11.5	11.7	13.0	14.1	14.2	n.a.
Consumer prices[3]	11.0	84.4	70.0	102.8	116.8	126.6	100.2
Ruble depreciation[4]	6.8	71.3	23.9	16.2	-2.8	.0	.0
Trade balance[5]	14.7	15.4	34.2	27.3	27.5	32.4	n.a.
Current account[6]	4.0	2.4	26.6	20.3	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. End of period, NSA.
5. Billions of U.S. dollars, annual rate.
6. Billions of U.S. dollars, NSA, annual rate.
n.a. Not available. ... Not applicable.