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CLASS II - FOMC

January 30, 1998

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

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SUPPLEMENTAL NOTES

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THE DOMESTIC NONFINANCIAL ECONOMY

Real Gross Domestic Product

Real GDP is estimated to have increased at a 4.3 percent annual rate in the fourth quarter of 1997, after having risen at a 3.1 percent annual pace in the third quarter. Final sales decelerated about a percentage point in the fourth quarter while the pace of inventory investment picked up. In particular, nonfarm inventory investment was reported to have been almost \$50 billion last quarter, up from about \$38 billion in the third quarter.

The domestic components of final sales more than accounted for the slowdown in spending last quarter. Real consumer spending decelerated in the fourth quarter, with purchases of durable goods registering a substantially smaller increase than in the prior quarter and with outlays for nondurables edging down.<sup>1</sup> Following extraordinary gains in the second and third quarters, spending for producers' durable equipment declined in the fourth quarter; outlays for nonresidential structures also contracted. Government purchases rose modestly in the fourth quarter; gains in defense and in state and local spending were partly offset by a further decline in the federal nondefense category.

In contrast to the domestic components, the external sector boosted growth of final sales last quarter. Real exports of goods and services are estimated to have risen at an annual rate of 11.3 percent in the fourth quarter, with the rate of increase picking up for both agricultural and nonagricultural goods. At the same time, import growth dropped back to just 1.3 percent last quarter, held down by a decline in oil imports and modest increases in other categories.

Elsewhere in the accounts, personal income growth was quite strong last quarter, and the personal saving rate moved up to 3.9 percent. Although corporate profits are not included in the advance report, the implicit profit share was 10.1 percent in the fourth quarter.<sup>2</sup>

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1. To estimate the motor vehicle numbers in the GDP report, BEA adjusted the December sales figures to mitigate the impact of automakers extending their reporting periods into early January.

2. This share is estimated on the assumption that the statistical discrepancy was the same in the fourth quarter as it was in the third quarter. Excluding Federal Reserve banks, the implicit profit share was 9.8 percent.

The chain-weighted price index for GDP rose at a 1.5 percent annual rate in the fourth quarter, about the same as the increase registered in the previous quarter. Over the four quarters of last year, this index was up just 1.8 percent, the smallest yearly increase since 1964.

#### Consumer Sentiment

According to the final report, the Michigan SRC index of consumer confidence rose in January--almost reversing its December decline and putting it back at the top of the extremely favorable range that has prevailed since early last year. The final level of the index in January was more than 2-1/2 percentage points above the preliminary reading of two weeks ago. Households' views of their current personal financial situation were little changed in January. However, they were decidedly more optimistic about their future personal finances, owing possibly to lower expected inflation. According to the SRC, the fewest number of respondents in thirty years expected inflation to erode their living standards. In addition, consumers were more optimistic about future business conditions. Appraisals of buying conditions for large household appliances also improved in January.

Among the questions not in the overall index, the index of expected unemployment change fell back in January following an unexpected surge in December. Consumers' willingness to use credit was higher in January, while their willingness to use savings was little changed.

The mean of expected inflation over the next twelve months dropped to a historical low of 2.8 percent in January, and the median declined to 2.3 percent. The mean of expected inflation over the next five to ten years fell 1/2 percentage point to 3.4 percent while the median declined 1/4 percentage point to 2.9 percent.

Consumer confidence as measured by the Conference Board and Michigan surveys moved in opposite directions in December and January. The Conference Board survey showed that consumer confidence rose sharply in December and then fell back in January. In January, views on expected business and employment conditions as well as future income gains were decidedly more pessimistic--the opposite of the Michigan results. Nevertheless, despite the differences between the two indexes over the past two months, both surveys indicate that consumer confidence remains at the highly favorable level that prevailed in the second half of last year.

Erratum

On page 3 of Part 1, the characterization of our projected federal budget was incorrect. Our economic projection leads us to expect that the federal budget will be about in balance in fiscal years 1998 and 1999.

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## Real Gross Domestic Product and Related Items

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

	1996:Q4 to 1997:Q4	1997:Q2 Final	1997:Q3 Final	1997:Q4 Advance
1. Gross domestic product	3.9	3.3	3.1	4.3
2. Final sales	3.5	2.5	4.7	3.6
3. Consumer spending	3.8	.9	5.6	3.2
4. Durables	7.0	-5.4	18.4	2.6
5. Nondurables	1.6	-2.1	4.3	-.4
6. Services	4.2	3.9	3.9	5.1
7. Business fixed investment	8.2	14.6	19.2	-3.6
8. Producers' durable equipment	11.8	23.0	24.1	-3.9
9. Nonresidential structures	-.8	-4.7	6.7	-2.7
10. Residential investment	5.9	7.4	2.7	10.4
11. Federal government consumption expenditures and investment	.0	6.6	-1.1	.7
12. Defense	-.3	7.5	1.2	2.9
13. Nondefense	.7	4.9	-5.7	-3.8
14. State and local government consumption expenditures and investment	2.1	1.2	2.3	2.1
15. Exports of goods and services	10.9	18.4	4.4	11.3
16. Imports of goods and services	13.3	20.5	14.6	1.3

### ADDENDA:

17. Nonfarm inventory investment <sup>1</sup>	54.1 <sup>2</sup>	70.1	38.3	49.7
18. Motor vehicles <sup>1</sup>	2.4 <sup>2</sup>	2.6	.3	5.0
19. Excl. motor vehicles <sup>1</sup>	51.7 <sup>2</sup>	67.5	38.0	44.7
20. Farm inventory investment <sup>1</sup>	8.2 <sup>2</sup>	7.5	9.5	10.5
21. Net exports of goods and services <sup>1</sup>	-142.1 <sup>2</sup>	-136.6	-164.1	-141.4
22. Nominal GDP	5.8	5.2	4.6	5.9
23. GDP price index	1.8	1.8	1.4	1.5
24. Profit share <sup>3</sup>	n.a.	9.9	10.2	n.a.
25. (Excluding FR banks)	n.a.	9.6	9.9	n.a.
26. Real disposable personal income	3.7	3.1	2.6	4.7
27. Personal saving rate (percent)	3.8 <sup>2</sup>	4.2	3.5	3.9

1. Level, billions of chained (1992) dollars.
2. Annual average.
3. Economic profits as a share of nominal GNP.

January 30, 1998

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

	1997 May	1997 Jun	1997 Jul	1997 Aug	1997 Sep	1997 Oct	1997 Nov	1997 Dec	1998 Jan (f)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	103.2	104.5	107.1	104.4	106.0	105.6	107.2	102.1	106.6
Current conditions	113.5	113.2	114.0	110.7	114.1	109.8	114.9	111.4	113.5
Expected conditions	96.6	98.9	102.6	100.3	100.7	102.8	102.3	96.1	102.2
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Personal financial situation									
Now compared with 12 months ago*	122	126	130	121	127	124	130	123	124
Expected in 12 months*	138	131	133	138	138	136	138	136	141
Expected business conditions									
Next 12 months*	142	147	151	150	149	154	151	142	148
Next 5 years*	109	121	130	116	119	125	123	109	123
Appraisal of buying conditions									
Cars	150	154	136	139	143	141	140	135	145
Large household appliances*	173	168	166	167	170	161	169	166	171
Houses	160	160	165	166	172	164	163	161	172
Willingness to use credit									
Willingness to use savings	49	43	49	48	50	37	46	39	55
Willingness to use savings									
Willingness to use savings	71	73	68	70	57	69	69	75	74
Expected unemployment change - next 12 months									
Expected unemployment change - next 12 months	109	108	104	107	103	100	108	114	106
Expected inflation - next 12 months									
Mean	3.7	3.5	3.4	3.3	3.5	3.2	3.4	3.4	2.8
Median	2.9	2.8	2.7	2.7	2.8	2.8	2.9	2.8	2.3
Expected inflation - next 5 to 10 years									
Mean	3.8	3.9	3.4	3.8	3.6	3.6	3.8	3.9	3.4
Median	3.0	3.1	2.9	3.0	3.1	3.0	3.1	3.1	2.9

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

(p) -- Preliminary

(f) -- Final

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

THE FINANCIAL ECONOMY

Mutual Funds

The top panel of the attached exhibit updates our information on net sales of mutual funds, to include the final December totals released Friday by the Investment Company Institute. As shown, December net sales of bond funds slowed substantially from the extremely high levels of November, but remain at a solid pace relative to previous months and quarters. Net sales of equity funds declined more modestly during December, with small net outflows continuing among international funds.

As shown in the bottom panel, liquidity ratios for both equity and bond funds remained near their recent levels.

## Net Sales of Long-Term Mutual Funds

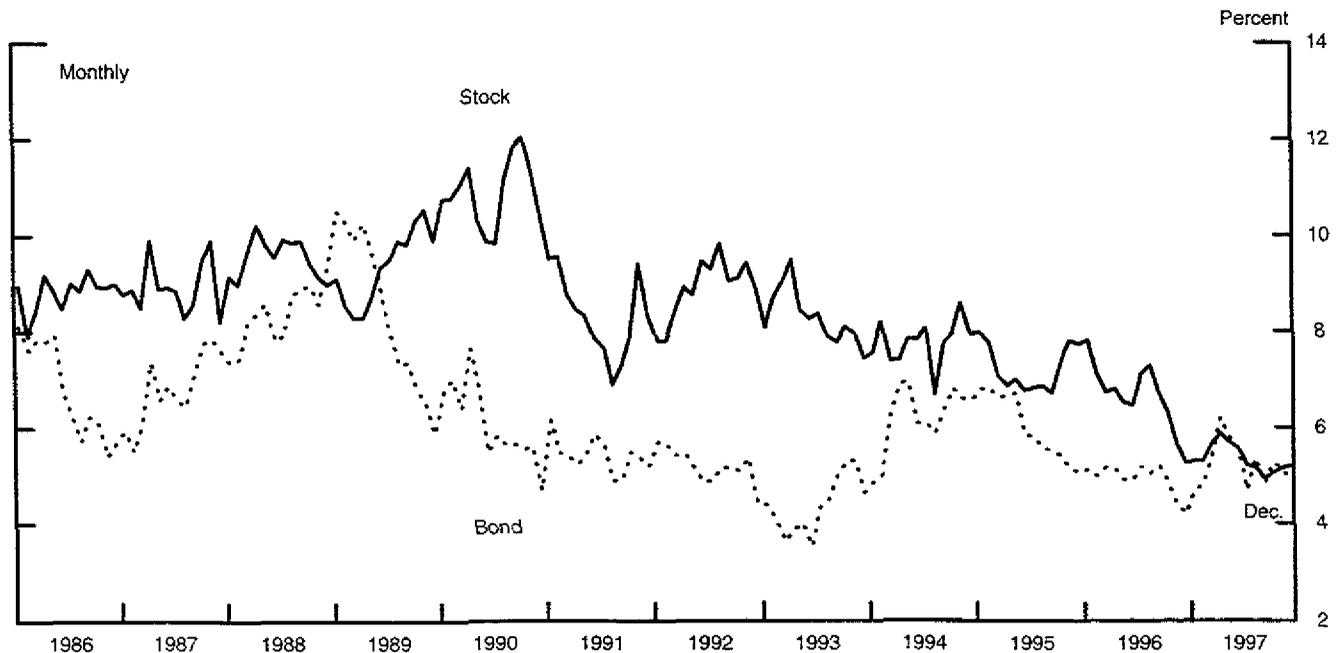
(Billions of dollars excluding reinvested distributions; quarterly and annual data at a monthly rate)

	1995	1996	1997				Memo: Dec. assets	
			Q2	Q3	Oct.	Nov.		Dec.
<b>Stock funds</b>	<b>10.7</b>	<b>18.5</b>	<b>18.7</b>	<b>22.2</b>	<b>18.5</b>	<b>18.2</b>	<b>16.8</b>	<b>2400</b>
Domestic equity <sup>1</sup>	9.7	14.7	13.9	18.7	18.5	18.9	17.5	2053
Aggressive Growth	3.1	4.7	2.4	4.8	4.0	3.0	2.3	370
Growth	3.1	3.9	3.2	5.9	5.8	7.0	6.3	677
Growth & income	3.7	6.2	8.3	7.9	8.9	8.9	8.8	1003
International	1.0	3.9	4.8	3.5	0.1	-0.7	-0.7	347
<b>Bond funds</b>	<b>-0.4</b>	<b>1.3</b>	<b>3.0</b>	<b>5.1</b>	<b>3.7</b>	<b>11.4</b>	<b>5.6</b>	<b>1031</b>
High-yield	0.7	1.0	1.7	1.6	0.9	2.1	2.2	104
Balanced	0.5	0.9	1.8	1.8	1.2	4.0	2.3	316
Other	-1.6	-0.7	-0.5	1.7	1.6	5.3	1.1	611

1. Includes precious metals funds not shown elsewhere.

Source. Investment Company Institute (ICI)

## Liquidity Ratios for Domestic Long-Term Mutual Funds



Note. Liquidity ratio is cash and short-term securities as a percent of total assets.

Source. Investment Company Institute.

**Selected Financial Market Quotations<sup>1</sup>**  
(Percent except as noted)

Instrument	1997			1998	Change to Jan. 29, from:			
	Jan. 2	Sep. 30	FOMC * Dec. 16	Jan. 29	Jan. 2	Sep. 30	FOMC * Dec. 16	
<b>Short-term rates</b>								
Federal funds <sup>2</sup>	5.79	5.57	5.50	5.63	-0.16	0.06	0.13	
Treasury bills <sup>3</sup>								
3-month	5.05	4.93	5.10	5.06	0.01	0.13	-0.04	
6-month	5.14	5.08	5.18	5.03	-0.11	-0.05	-0.15	
1-year	5.28	5.18	5.18	4.99	-0.29	-0.19	-0.19	
Commercial paper <sup>4</sup>								
1-month	5.48	5.51	5.79	5.47	-0.01	-0.04	-0.32	
3-month	5.47	5.48	5.70	5.40	-0.07	-0.08	-0.30	
Large negotiable CDs <sup>3</sup>								
1-month	5.39	5.59	5.87	5.53	0.14	-0.06	-0.34	
3-month	5.42	5.67	5.79	5.53	0.11	-0.14	-0.26	
6-month	5.50	5.72	5.79	5.54	0.04	-0.18	-0.25	
Eurodollar deposits <sup>5</sup>								
1-month	5.38	5.56	5.81	5.50	0.12	-0.06	-0.31	
3-month	5.44	5.63	5.75	5.53	0.09	-0.10	-0.22	
Bank prime rate	8.25	8.50	8.50	8.50	0.25	0.00	0.00	
<b>Intermediate- and long-term rates</b>								
U.S. Treasury (constant maturity)								
3-year	6.13	5.88	5.70	5.39	-0.74	-0.49	-0.31	
10-year	6.54	6.12	5.78	5.58	-0.96	-0.54	-0.20	
30-year	6.75	6.41	5.97	5.85	-0.90	-0.56	-0.12	
U.S. Treasury 10-year indexed note	n.a.	3.61	3.57	3.64	n.a.	0.03	0.07	
Municipal revenue (Bond Buyer) <sup>6</sup>	5.96	5.63	5.45	5.33	-0.63	-0.30	-0.12	
Corporate-A utility, recently offered	7.64	7.44	7.30	7.09	-0.55	-0.35	-0.21	
High-yield corporate <sup>7</sup>	9.72	9.02	9.04	8.90	-0.82	-0.12	-0.14	
Home mortgages <sup>8</sup>								
FHLMC 30-yr fixed rate	7.64	7.28	7.17	7.12	-0.52	-0.16	-0.05	
FHLMC 1-yr adjustable rate	5.57	5.51	5.53	5.53	-0.04	0.02	0.00	
<b>Stock exchange index</b>	Record high		1997		1998	Percentage change to Jan. 29, from:		
	Level	Date	Jan. 2	FOMC * Dec. 16	Jan. 29	Record high	Jan. 2	FOMC * Dec. 16
Dow-Jones Industrial	8259.31	8/6/97	6441.49	7922.59	7973.02	-3.47	23.78	0.64
S&P 500 Composite	983.79	12/5/97	736.01	963.39	985.49	0.17	33.90	2.29
NASDAQ (OTC)	1745.85	10/9/97	1279.70	1536.56	1619.49	-7.24	26.55	5.40
Russell 2000	465.21	10/13/97	357.96	420.76	431.99	-7.14	20.68	2.67
Wilshire	9486.69	10/7/97	7146.80	9162.76	9372.50	-1.20	31.14	2.29

1. One-day quotes except as noted.

2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average for maintenance period ending January 28, 1998.

3. Secondary market.

4. As of September 2, 1997, commercial paper rates are those collected by the Depository Trust Company; prior rates are averages of offering rates at several large dealers.

5. Bid rates for Eurodollar deposits at 11 a.m. London time.

6. Most recent observation based on one-day Thursday quote and futures market index changes.

7. Merrill Lynch Master II high-yield bond index composite.

8. Quotes for week ending Friday previous to date shown.

\* Figures cited are as of the close on December 15, 1997.