Prefatory Note

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Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. 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 optimal 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.

Confidential (FR) Class III FOMC

Part 2

March 25, 1998

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

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RECENT DEVELOPMENTS

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Consumption, housing, and business equipment spending appear to have advanced briskly this quarter. Were it not for the likelihood that net exports and inventory investment have dropped off from their fourth-quarter rates, we would be anticipating real GDP growth at least as strong as that seen in 1997. Indeed, growth in production worker hours in January and February was more robust than over the four quarters of last year. The pressures on labor supplies have forced many employers to offer workers higher pay or other inducements. But, thanks in large measure to a glut of oil this winter, price inflation has been almost negligible of late.

Labor Market Developments

Payroll employment gains averaged more than 340,000 in the first two months of 1998. Construction jobs continued to rise rapidly--even faster than in the fourth quarter. In addition to the strong fundamentals in this sector, unseasonably warm weather in much of the country and the need to repair damage from ice storms and heavy rains appear to have provided some extra lift to employment. This should reduce the amount of additional hiring this spring, when the seasonal step-up in construction typically takes place. Service-producing industries continued to post major job gains in January and February. In manufacturing, however, employment increases averaged 20,000 per month, off from double that pace in the fourth quarter.

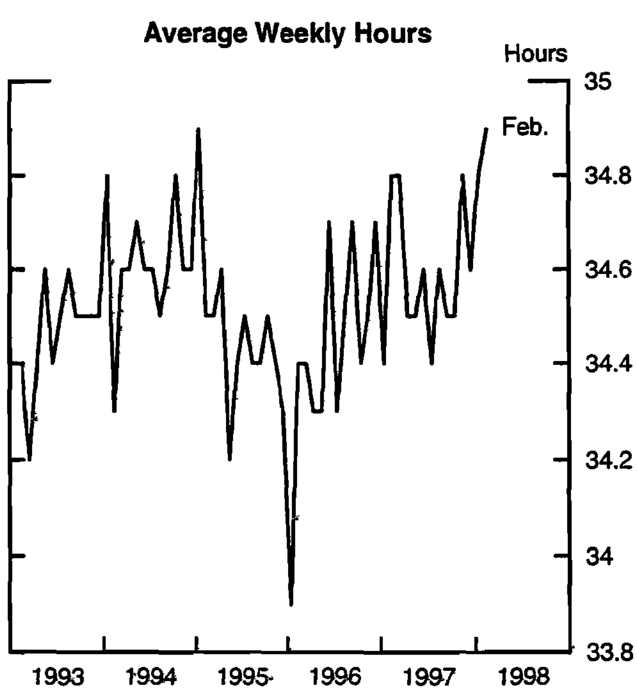
With two months of strong growth in payroll employment and further increases in the workweek, aggregate hours of production or nonsupervisory workers on private nonfarm payrolls in February were estimated by BLS to have been 1.6 percent (not at an annual rate) above their fourth-quarter average. Reporting problems associated with variations in the number of workdays in the month appear to have biased the published quarterly pattern of hours significantly.[1] Even adjusting for these problems, the February level of aggregate hours still would be 1.1 percent above its

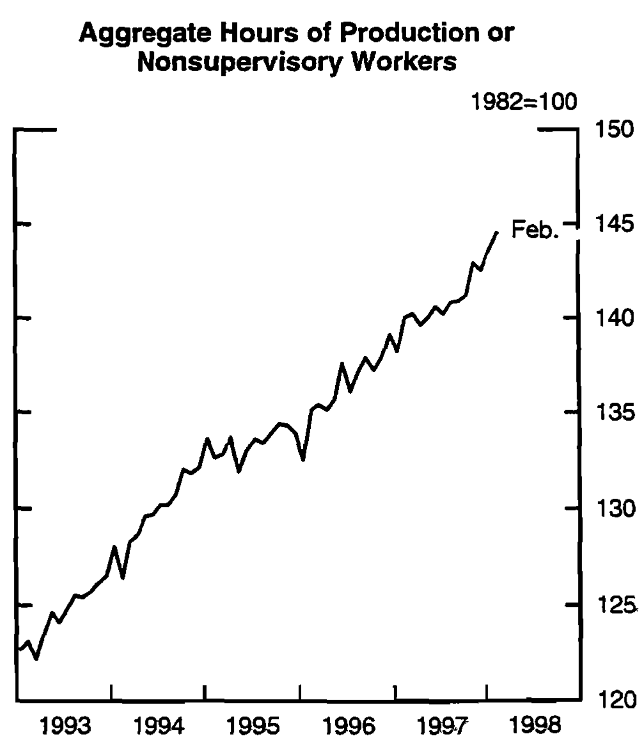
1. The BLS adjusts for monthly variations in the number of workdays in a pay period for employees paid on a monthly or semi-monthly basis. However, some firms have been reporting hours (and payrolls) for such employees as though each month were of a "typical" length. This reporting problem, which dates back to 1988, has led to an overstatement of hours in months with fewer workdays and an understatement in months with more workdays. In June, the BLS will correct these reporting problems and will revise the hours data back to 1988 accordingly.

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

	1996	1997	1997 Q2	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb
	---Average monthly changes---							
Nonfarm payroll employment [1]	212	267	237	245	358	354	375	310
Private	198	246	206	220	339	347	370	274
Goods Producing	19	38	15	19	75	107	137	37
Manufacturing	-5	19	10	12	40	40	45	-2
Construction	24	19	4	7	35	65	92	41
Service Producing	178	208	191	201	265	240	233	237
Transportation and utilities	9	16	10	13	2	-17	51	34
Trade	60	60	52	63	98	64	45	30
Finance, insurance, real estate	11	16	14	16	23	19	12	27
Services	98	116	115	109	142	174	125	146
Help supply services	13	10	-17	5	32	36	-7	52
Total government	14	21	31	25	19	7	5	36
Private nonfarm production workers [1]	168	198	163	161	273	279	181	303
Manufacturing production workers	-5	14	7	9	32	31	31	-4
Total employment [2]	232	240	119	123	339	202	306	80
Nonagricultural	226	243	118	112	351	201	372	65
Memo:								
Aggregate hours of private production workers (percent change)[1,3]	2.9	3.0	1.7	1.6	4.5	-0.3	0.8	0.6
Average workweek (hours) [1]	34.4	34.6	34.5	34.5	34.6	34.6	34.8	34.9
Manufacturing (hours)	41.5	42.0	42.0	41.8	42.1	42.2	42.1	42.0

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





fourth-quarter average, putting hours on track to grow at least as fast in the first quarter as they did in the fourth quarter (on an adjusted basis).[2]

The household survey also portrayed a robust labor market in early 1998. The unemployment rate dipped to 4.6 percent in February, and the participation rate rose to a record 67.3 percent in January and held at that level in February. Since the first quarter of 1997, the participation rate has risen 0.2 percentage point, with about half of the increase reflecting a further rise in participation among adult women who maintain families--an obvious group to be affected by strong labor markets and welfare reform.

With the January data, the BLS introduced new composite estimation procedures intended to reduce the variance in household employment. The new method has very little effect on estimates of the unemployment rate, but it results in somewhat lower estimates of employment, the civilian labor force, and the participation rate. Had these new procedures been in place in 1997, we estimate that the participation rate would have differed little from the published figures in the first half of the year but would have been nearly 1/4 percentage point lower in the second half. This correction does not affect the 0.2 percentage point rise in the participation rate over the past year.

Among other indicators, initial claims for unemployment insurance have remained in the very low range of 300,000 to 320,000. The Manpower Employment Outlook Survey index of expectations for net hiring in the second quarter of 1998 edged down from the first quarter but remained in the high range that has prevailed over the past year.[3] The various surveys of companies' hiring experiences are all reporting tightness in the labor market. In addition, the index of the expected change in unemployment in the preliminary Michigan SRC consumer survey for March remained at one of its most optimistic readings.

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2. The BLS will implement the annual benchmark revision to nonfarm payroll employment in early June with the release of the May employment data. The March 1997 level of employment will be revised up 431,000 (or 0.4 percent), with the increase wedged into the data beginning April 1996. The level of hours in the nonfarm business sector is likely to be revised up roughly 0.3 percent, and productivity, all else equal, can be expected to be revised downward by a similar amount.

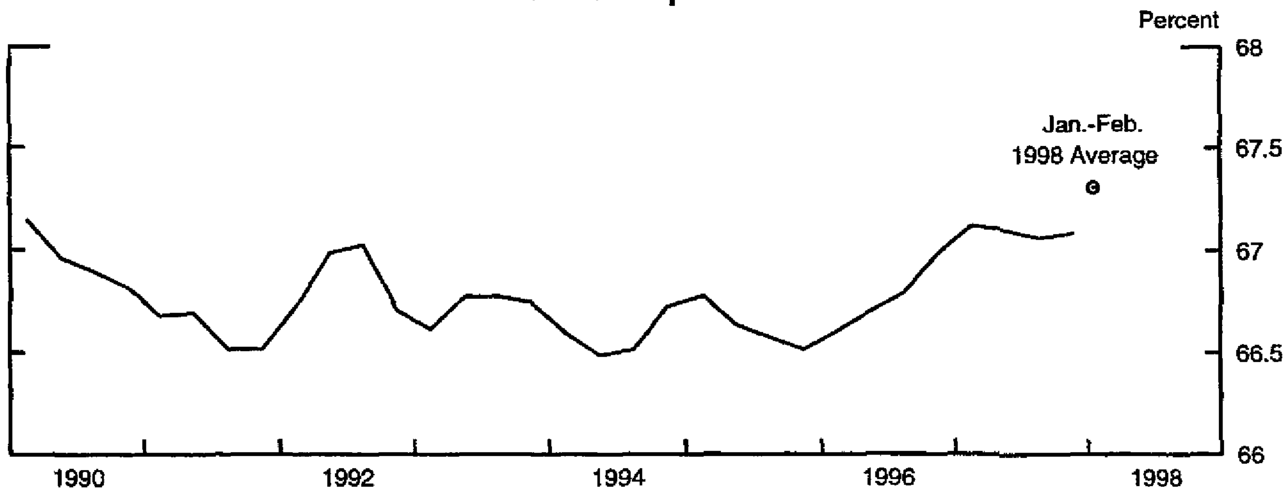
3. Although the survey refers to the second quarter, experience suggests that it is better interpreted as an indicator of employment growth in the current (first) quarter.

SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES [1]
(Percent; based on seasonally adjusted data, as published)

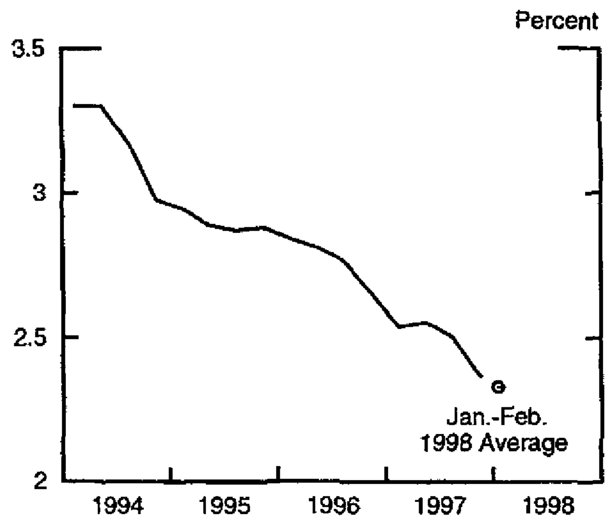
			1997			1997	1998	
	1996	1997	Q2	Q3	Q4	Dec.	Jan.	Feb.
Civilian unemployment rate (16 years and older)	5.4	4.9	4.9	4.9	4.7	4.7	4.7	4.6
Teenagers	16.7	16.0	15.9	16.3	15.0	14.3	14.1	14.7
Men, 20 years and older	4.6	4.2	4.1	4.1	4.0	4.1	3.8	3.8
Women, 20 years and older	4.8	4.4	4.4	4.3	4.0	4.0	4.4	4.3
Labor force participation rate	66.8	67.1	67.1	67.1	67.1	67.2	67.3	67.3
Teenagers	52.3	51.6	51.7	51.1	51.4	51.6	53.1	53.3
Men, 20 years and older	76.8	76.9	77.0	76.9	76.9	77.0	77.1	76.9
Women, 20 years and older	59.9	60.5	60.5	60.6	60.5	60.7	60.6	60.6
Women maintaining families	65.3	67.4	67.2	68.0	68.2	69.2	68.6	68.3

1. Data for 1998 are not comparable with earlier years because of a methodological change introduced by the BLS in January 1998.

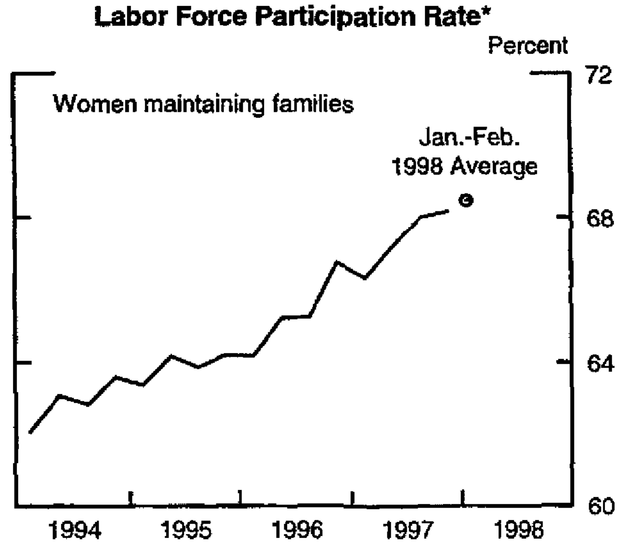
Labor Force Participation Rate*



Percent of Population Not in the Labor Force Who Want Jobs*



Labor Force Participation Rate*

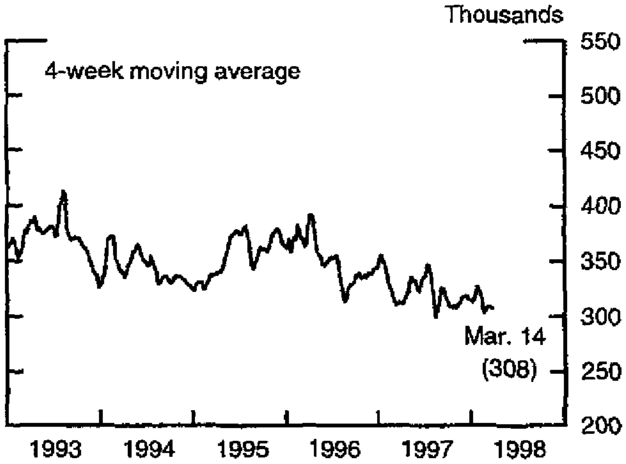


Note. Seasonally adjusted by FRB staff.

* Data are quarterly prior to 1998. Monthly data as of January 1998 are not comparable due to methodological changes introduced by the BLS.

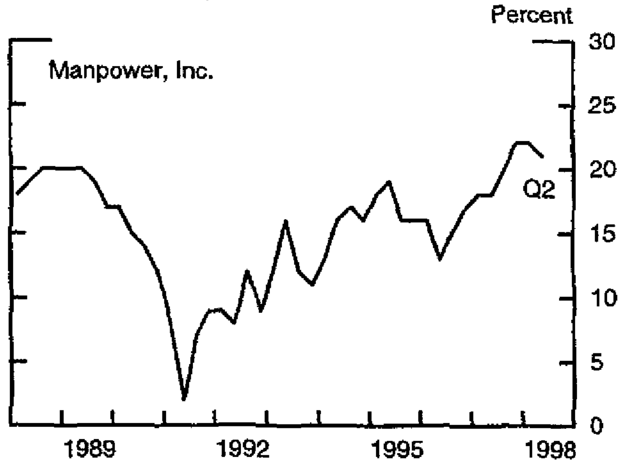
Labor Market Indicators

Initial Claims for Unemployment Insurance



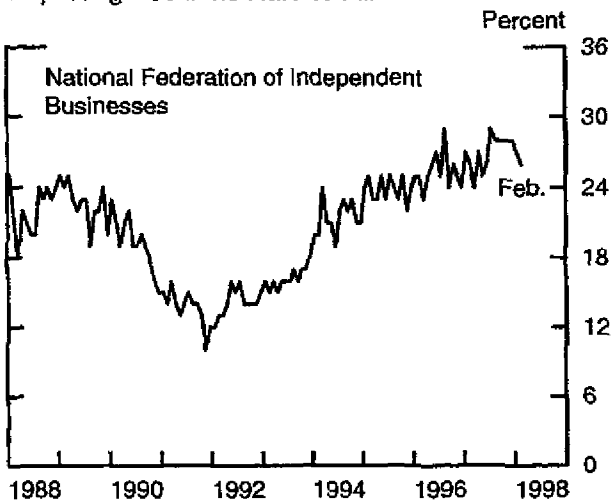
Note. State programs, includes EUC adjustment.

Net Hiring Strength

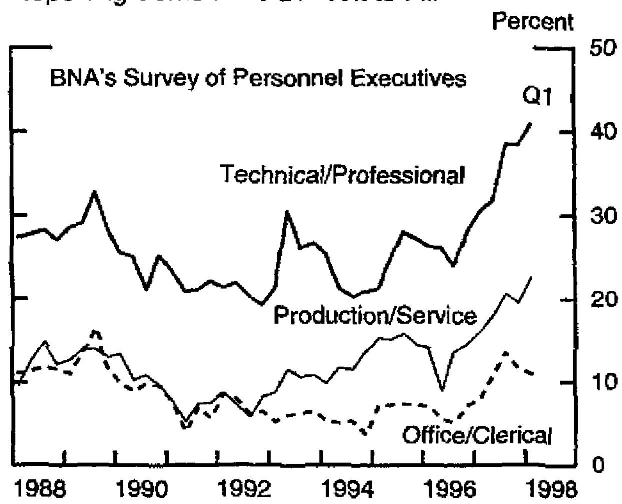


Note. Percent planning an increase in employment minus percent planning a reduction.

Reporting Positions Hard to Fill

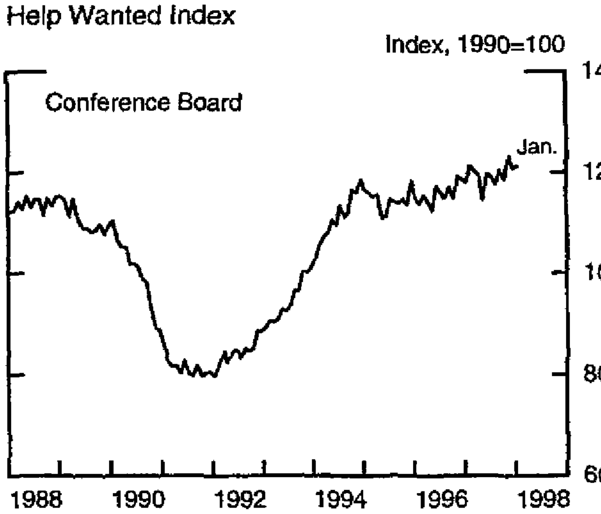


Reporting Some Jobs Difficult to Fill



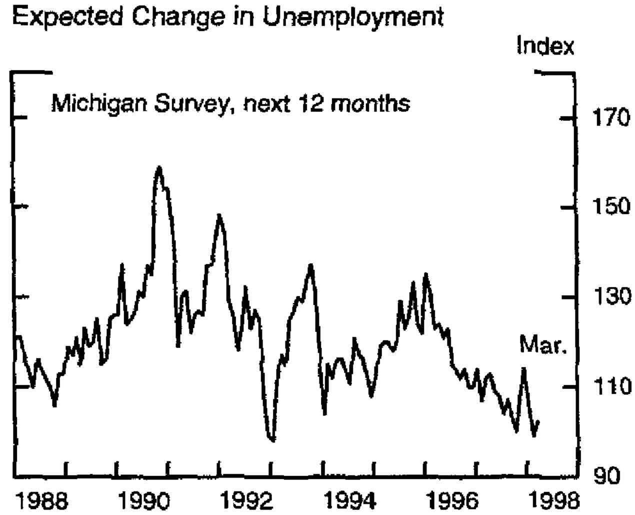
Note. Seasonally adjusted by FRB staff.

Help Wanted Index



Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Expected Change in Unemployment



Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

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

	Proportion 1997	1997[1]	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
			-Annual rate-		--Monthly rate---		
Total index	100.0	5.7	6.0	7.2	.3	.1	.0
Previous		5.7	6.0	7.1	.4	.0	
Manufacturing	86.2	6.3	6.1	8.0	.4	.3	.0
Durables	46.6	9.5	10.1	10.2	.5	.3	.1
Motor vehicles and parts	5.2	11.9	20.5	23.1	.5	-1.1	-2.2
Aircraft and parts	2.3	18.5	20.3	20.5	3.3	.3	-.1
Nondurables	39.6	2.7	1.5	5.5	.2	.4	-.1
Manufacturing excluding motor vehicles and parts	81.0	5.9	5.2	7.1	.4	.4	.1
Mining	6.2	2.1	1.8	-2.3	-.5	1.6	-.3
Utilities	7.6	2.6	8.3	6.2	-.4	-3.1	.9
IP by market group excluding motor vehicles and parts							
Consumer goods	26.3	2.4	1.7	5.4	-.2	.7	-.1
Durables	4.0	4.2	2.5	2.7	-.5	2.4	.2
Nondurables	22.3	2.1	1.6	5.8	-.2	.5	-.2
Business equipment	12.3	10.8	13.3	9.2	1.0	-.6	.1
Information processing	5.5	12.0	16.4	8.7	.3	-.3	.4
Computer and office eq.	1.8	35.7	50.2	26.0	1.6	3.0	1.8
Industrial	4.5	5.7	9.0	7.0	1.3	-1.0	-.3
Transit	1.1	27.3	28.7	29.6	4.8	.4	-.1
Other	1.3	9.4	3.4	1.4	-.9	-1.6	.6
Construction supplies	5.6	2.1	-2.0	3.8	-.6	.8	.4
Materials	38.5	6.9	7.4	6.9	.5	.1	.2
Durables	21.1	10.8	10.6	11.5	.3	.9	.3
Semiconductors	3.7	39.8	40.3	31.5	2.5	2.7	2.4
Basic metals	3.6	4.7	4.3	7.6	-1.9	1.2	-.4
Nondurables	9.0	3.4	2.8	5.0	1.2	-1.1	.3

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	1959-97 Avg.	1996 Q4	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
Manufacturing	85.7	81.7	81.4	81.6	82.2	82.3	82.2	81.8
Primary processing	88.9	82.8	85.9	85.8	86.0	86.1	86.0	85.6
Advanced processing	84.2	81.1	79.4	79.8	80.5	80.6	80.5	80.1

The strong gains in employment and the workweek in the fourth quarter of 1997 were accompanied by an increase in output per hour in the nonfarm business sector of 1.6 percent at an annual rate. The reporting problems in measuring the workweek mentioned above probably caused published productivity growth in the fourth quarter to be understated by between 1/2 and 1 percentage point, and we expect published productivity growth in the first quarter of 1998 to be understated by a similar amount. Over the four quarters of 1997, productivity rose 2.1 percent; this figure probably was not greatly affected by the workweek measurement problems.

Industrial Production

After growing at a torrid pace in the second half of last year, industrial production decelerated noticeably over the first two months of this quarter. In part, the slowdown reflected the effects of the unusually warm weather on utilities output. But signs of a tapering were also apparent in manufacturing, where output rose only 0.3 percent in January and was unchanged in February--trimming the factory operating rate to its long-term average of 81-3/4 percent.

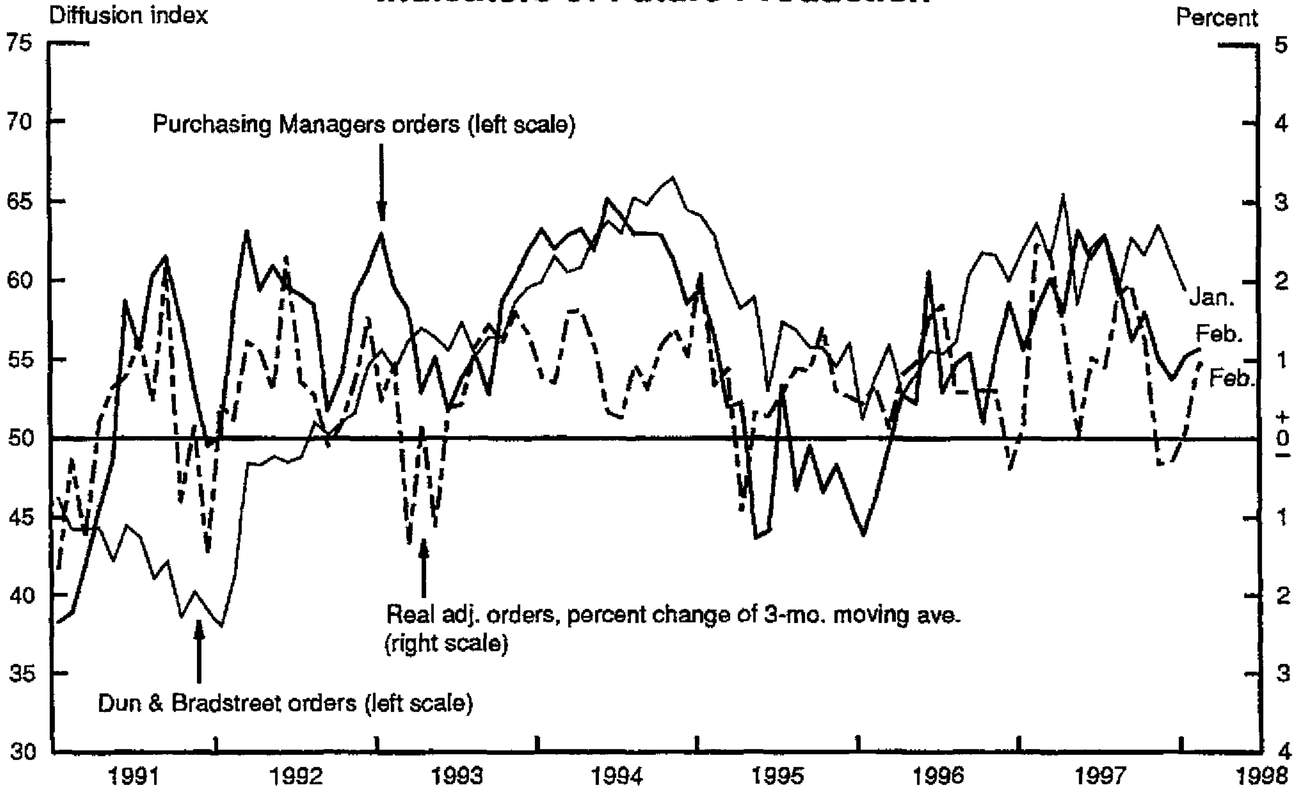
To some extent, the recent deceleration in manufacturing production reflects developments in the motor vehicle sector, where output had been boosted in late 1997 by the make-up of assembly shortfalls that occurred last spring and summer due to strikes and plant startup problems. With the adjustment apparently complete, assemblies fell back to a 12.4 million unit annual rate in January and to 12 million units in February, reducing industrial production growth 0.1 percentage point in each month. While inventories are

PRODUCTION OF DOMESTIC AUTOS AND TRUCKS
(Millions of units at an annual rate; FRB seasonal basis)

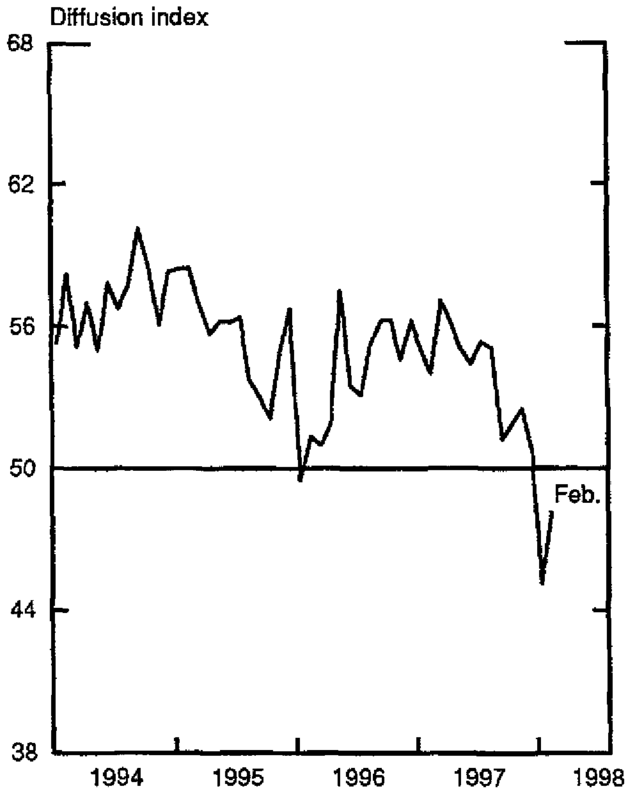
	1998			1997	1998	
	Jan.	Feb.	Mar.	Q4	Q1	Q2
			Sched.		Sched.	Sched.
U.S. production	12.4	12.0	11.8	12.7	12.0	12.2
Autos	5.9	5.4	5.4	5.9	5.6	5.5
Trucks	6.4	6.6	6.4	6.7	6.5	6.7
Days' supply						
Light vehicles	66.1	68.5	...	66.4	...	...
Autos	61.5	62.1	...	60.1	...	...
Light trucks	70.7	74.5	...	70.6	...	...

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

Indicators of Future Production

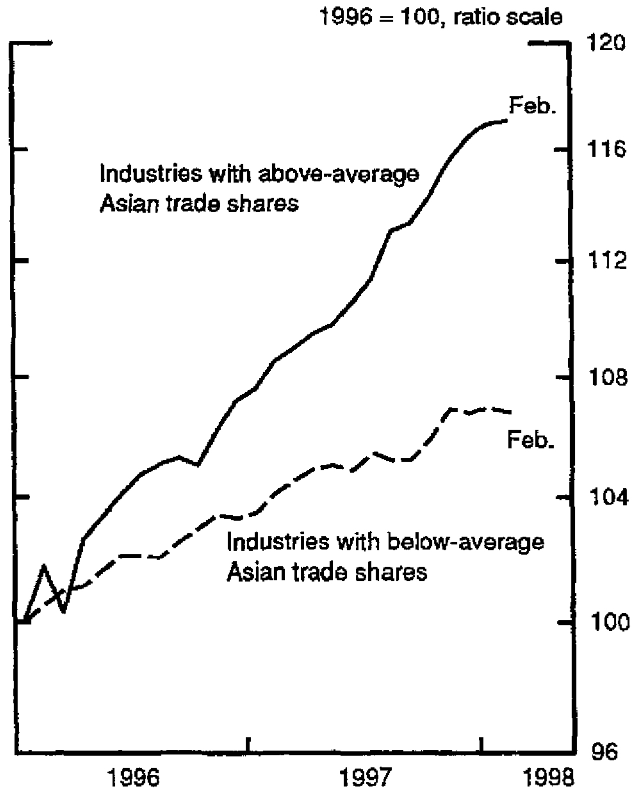


New Export Orders



Note. Data from survey of National Association of Purchasing Managers.

Manufacturing Output and Asian Trade Shares



Note. Asian trade shares are based on exports and imports relative to industry shipments.

high for a few models of light vehicles, days' supply, on balance, is well aligned with demand. Looking ahead, the scheduled assembly pace for March through June averages just a bit above 12 million units--consistent with light vehicle sales remaining in the vicinity of 15 million units, where they have been for several years now.

The output of business equipment excluding motor vehicles and parts has also slowed after having risen rapidly in 1997: It fell 0.6 percent in January and was little changed in February. Production of industrial, communications, and photographic equipment has been weak, and aircraft assemblies have flattened out as Boeing nears completion of its ramp-up.[4] As for other final products, the production of non-automotive consumer goods has slowed a bit recently after a fourth-quarter spurt, while the strength in the building sector has continued to lift output of construction supplies. The production of non-automotive materials edged up 0.2 percent in February after having increased just 0.1 percent in January--well off the pace set last year.

Leading indicators of industrial production point to growth over the next few months. On a three-month moving average basis, the staff's estimate of real adjusted durable goods orders advanced about 1 percent in February. The new orders index from the NAPM also has turned up in recent months, while the new orders index from the Dun and Bradstreet Manufacturing Survey remains at a high level.

While overall orders remain positive, reports from manufacturers indicate that export orders from Asia are declining. In addition, the diffusion index for export orders in the NAPM survey was modestly negative in both January and February--the first consecutive negative readings since the question was introduced in 1988. The role of the Asia crisis in explaining the slowing in industrial output over the past couple of months is unclear: Although production in industries that export an above-average share of their output to Asian countries has slowed recently, output in

4. However, shortages of parts and modifications demanded by U.S. and European safety regulators are forcing Boeing to postpone deliveries of aircraft that are largely completed.

RETAIL SALES
(Percent change; seasonally adjusted)

	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
Total sales	1.8	.1	.5	1.0	.5
Previous estimate		.0	.3	.1	
Building materials and supplies	-.7	.1	1.4	3.6	2.0
Automotive dealers	3.6	-.2	2.3	-.2	.1
Retail control[1]	1.4	.1	-.2	1.1	.6
Previous estimate		.1	-.2	.4	
Durable goods	1.6	1.7	.2	3.3	.9
Furniture and appliances	1.9	1.0	1.5	3.3	-.4
Other durable goods	1.4	2.2	-.9	3.2	2.1
Nondurable goods	1.4	-.2	-.3	.7	.5
Apparel	2.8	-1.1	-.1	2.1	1.3
Food	1.1	.3	-.5	-.5	.2
General merchandise	1.5	.4	.2	2.2	1.3
Gasoline stations	1.0	-.8	-1.7	-2.0	-1.1
Drug stores	1.8	1.2	-1.1	1.8	.4
Other nondurable goods	1.4	-.7	.0	1.2	.5

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

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

	1996	1997	1997 Q2	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
Total	15.1	15.1	14.5	15.3	15.3	16.1	14.5	15.0
Adjusted[1]	15.0	15.1	14.7	15.3	15.0	15.3	15.1	14.9
Autos	8.5	8.3	8.0	8.4	8.2	8.7	7.5	8.0
Light trucks	6.6	6.9	6.5	6.9	7.1	7.3	6.9	7.0
North American[2]	13.4	13.2	12.7	13.3	13.3	13.9	12.7	12.9
Autos	7.3	6.9	6.7	7.1	6.8	7.1	6.3	6.6
Big Three	5.3	4.9	4.8	5.1	4.8	5.0	4.4	4.7
Transplants	2.0	2.0	1.9	2.0	2.0	2.1	1.9	1.9
Light trucks	6.1	6.3	5.9	6.3	6.5	6.7	6.4	6.3
Foreign produced	1.7	1.9	1.8	2.0	2.0	2.2	1.8	2.1
Autos	1.3	1.4	1.3	1.4	1.4	1.6	1.3	1.4
Light trucks	.4	.6	.6	.6	.6	.6	.5	.6

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

industries that export less heavily to Asia also has decelerated (chart).[5]

Finally, we estimate that manufacturing capacity will grow 5.4 percent in 1998.[6] This preliminary estimate suggests that appreciable gains in industrial demand can be accommodated without straining productive facilities.

Personal Income and Consumption

Consumer spending surged in early 1998. The factors that fueled the robust increase in consumption last year have, if anything, become more positive in recent months: Growth in real disposable personal income has been very strong; households have continued to enjoy extraordinary gains in net worth; and consumer sentiment has reached new highs.

In February, nominal sales in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 0.6 percent following an upward-revised gain of more than 1 percent in January. (The gain in January had originally been reported as 0.4 percent.) Sales were especially strong at apparel and general merchandise stores and at stores selling "other durable goods," which include jewelry, books, and sporting goods. Based on the February retail sales and consumer price reports, we estimate that real personal consumption expenditures for goods other than motor vehicles rose 1.4 percent in January and 0.6 percent in February.

Adjusted for shifts in reporting periods, sales of light motor vehicles averaged 15 million units at an annual rate in January and February. This pace has been sustained in part by more attractive selling terms, including cut-rate finance charges and relatively generous price incentives. In recent weeks, General Motors has boosted its incentives to counter the richer packages offered by

5. Industries with above-average Asian trade shares are leather, electrical machinery, industrial machinery and computing equipment, miscellaneous manufacturing, instruments, apparel, chemicals, fabricated metals, and rubber. Industries with below-average Asian trade shares are lumber, primary metals, tobacco, paper, textiles, furniture, food, petroleum, printing and publishing, and stone, clay, and glass.

6. The 1998 capacity estimate is based on estimates of the growth of manufacturers' capital input and available measures of capacity in physical volume terms for selected industries, such as steel, aluminum, selected chemicals, and motor vehicles. Capital input is derived from the most recent information on manufacturers' capital spending plans from NAPM and from data on contracts and orders for industrial plant and equipment, which suggest that the level of manufacturing investment continues to be high.

REAL PCE SERVICES
(Percent change from the preceding period;
derived from billions of chained (1992) dollars)

	1996	1997	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.
	--- Q4/Q4 ---		-- Annual rate --		Monthly rate	
PCE Services	2.8	4.2	3.9	5.4	.6	.2
Energy	.7	1.5	-6.6	13.6	-.1	-6.1
Non-energy	2.9	4.4	4.4	5.1	.6	.4
Housing	1.7	2.0	2.0	2.0	.2	.2
Household operation	2.0	5.3	8.3	7.3	.4	.5
Transportation	4.2	4.9	6.1	5.5	1.3	-.2
Medical	2.5	3.4	3.1	3.6	.1	.1
Personal business	4.6	6.9	7.5	8.0	1.4	.6
Other	4.1	7.0	5.2	8.7	1.3	1.4

PERSONAL INCOME
(Average monthly percent change)

	1996	1997	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.
	-- Q4/Q4 --		Annual rate		Monthly rate	
Total personal income	5.8	6.0	4.6	6.4	.4	.6
Wages and salaries	6.4	7.1	5.8	8.9	.4	.7
Private	7.1	7.8	6.3	10.0	.5	.7
Other labor income	.7	3.0	2.5	3.6	.3	.3
Less: Personal tax and nontax payments	12.5	10.8	7.9	9.9	.5	-.6
Equals: Disposable personal income	4.8	5.2	4.1	5.8	.4	.8
Memo:						
Real disposable income[1]	2.0	3.7	2.6	4.5	.4	.7
Saving rate (percent)	4.3	3.8	3.5	3.8	3.9	4.2

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

Ford and Chrysler, and Toyota announced modest incentives on the Camry and Corolla models--two of its leading sellers.

Real expenditures on services rose only 0.2 percent in January as warmer-than-average temperatures reduced energy consumption sharply. In February, real outlays for electricity and natural gas likely rose: According to data from the National Weather Service, February also was warmer than average, but temperatures were closer to seasonal norms than they were in January. In March, temperatures thus far have been colder than average, suggesting another increase in energy outlays this month.

Data on personal income are available through January, when total nominal income increased 0.6 percent. Disposable personal income rose faster than total income in January--up 0.8 percent in nominal terms and 0.7 percent in real terms. DPI growth was boosted in January by a federal pay increase for civilian workers, cost-of-living adjustments to several federal transfer programs, and the annual adjustment of tax withholding schedules for inflation.[7] Although such changes occur at the same time every year, the BEA does not seasonally adjust them, which distorts income growth each January. In addition, personal tax payments were reduced in January by the tax changes legislated last year (for example, the child tax credit). All told, these factors boosted DPI growth in January by about $20 billion, or 0.3 percentage point. According to the latest published data, the saving rate rose to 4.2 percent in January; however, these data do not reflect the huge upward revision to January consumer spending, which, all else equal, would push the saving rate 0.2 percentage point below the published number. Turning to February, income growth likely remained strong, reflecting the increases in production worker hours and wages reported in the February employment release.[8]

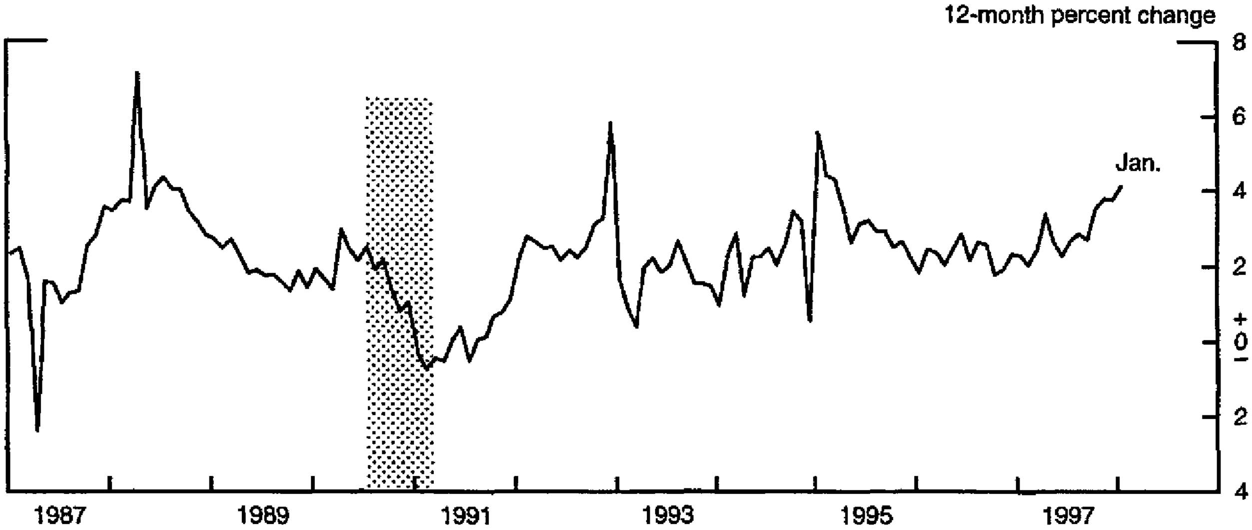
According to the preliminary report of the Michigan Survey Research Center, the index of consumer confidence fell back in early March after a surge in February. Nonetheless, consumer confidence,

7. These factors were offset somewhat by a boost to personal contributions for social insurance (an item subtracted from personal income) due to an increase in the taxable wage base for social security.

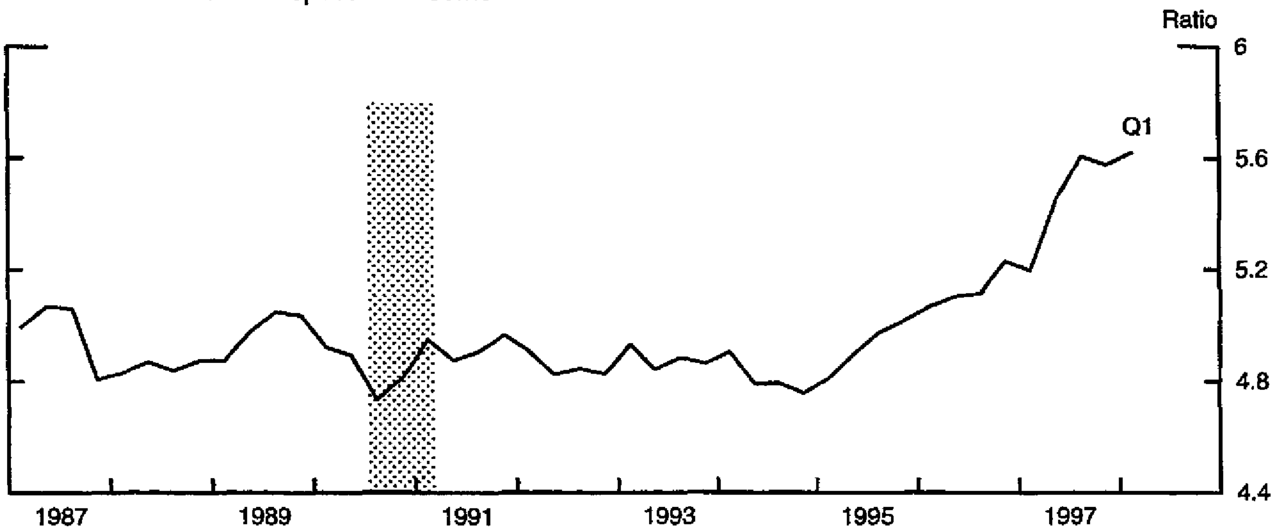
8. As discussed in the earlier section on labor markets, the increase in the workweek in February was biased upward. However, the bias in the workweek should not affect monthly estimates of wage and salary income generated by the BEA. Analysts at the BEA routinely adjust the BLS data to produce an estimate of the average workweek that they believe is more appropriate for the entire month.

Household Indicators

Real Disposable Personal Income

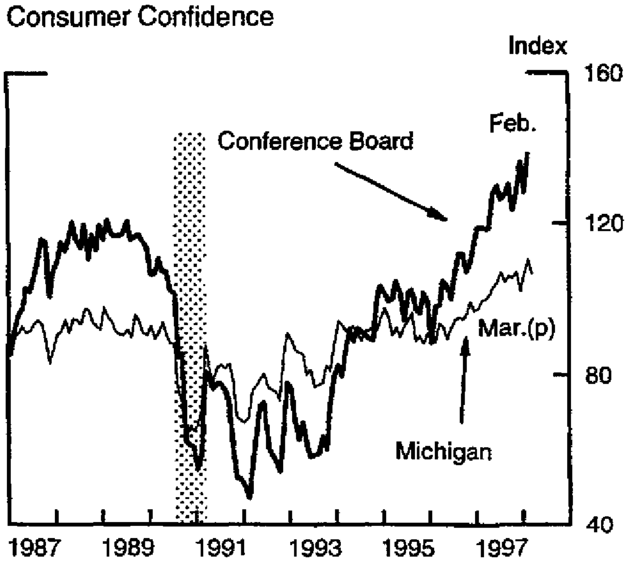


Ratio of Net Worth to Disposable Income

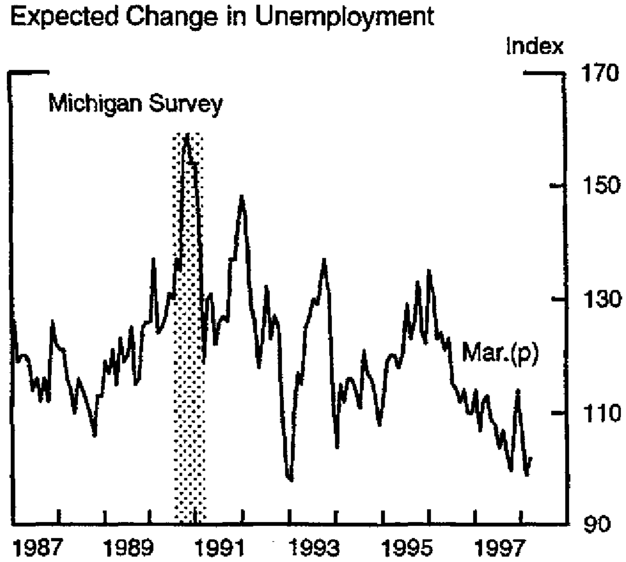


Note. Data for 1998:Q1 are staff estimates.

Consumer Confidence



Expected Change in Unemployment



Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

as measured by both the SRC and Conference Board, has remained at extremely favorable levels.

Housing Markets

Housing activity has strengthened in recent months, spurred by further gains in employment, income, and wealth as well as by the drop in fixed mortgage rates. Single-family housing starts were at an annual rate of 1.27 million units in February, up from January's 1.22 million unit pace; the average for these two months was more than 9 percent above the fourth-quarter average. Adjusted permits for single-family units, which we view as a better indicator of underlying activity, rose close to 1 percent in February and have been on a solid uptrend since last September.[9] Moreover, despite the strong readings on starts in recent months, the backlog of unused permits, which has some utility as a forward indicator for starts, has edged up since November.

The effects of unseasonable weather on starts can be quite pronounced during the winter months, and they are difficult to pin down this year. For the nation as a whole, temperatures were well above average in January and February--a clear plus for builders--but precipitation, which tends to slow construction, has been unusually heavy since November. Our best guess is that, on balance, starts were boosted to some extent by this winter's weather, but that much of the strength in the single-family sector so far this year is attributable to strong fundamentals.

Indeed, indicators that are less affected by weather than starts all point to a brisk pace of housing demand. The thirty-year, fixed-mortgage rate, which averaged 7.9 percent in the first half of 1997, fell sharply in the second half of last year and has averaged just a shade over 7 percent so far this year. Partly in response to the decline in long-term interest rates, mortgage applications--both for home purchase and refinancing--surged to record levels, and home sales responded accordingly. Sales of existing houses in February were at a record-setting 4.75 million unit annual rate, up sharply further from the strong January reading. New home sales in January came in just shy of 880,000 units, about equaling the record posted in 1986. More timely indicators have also shown continued strength. Builders' ratings of both current and expected new home sales, which have climbed

9. Adjusted permits equal permit issuance plus starts outside of permit-issuing places and a correction for units started within permit-issuing places for which permits were not issued.

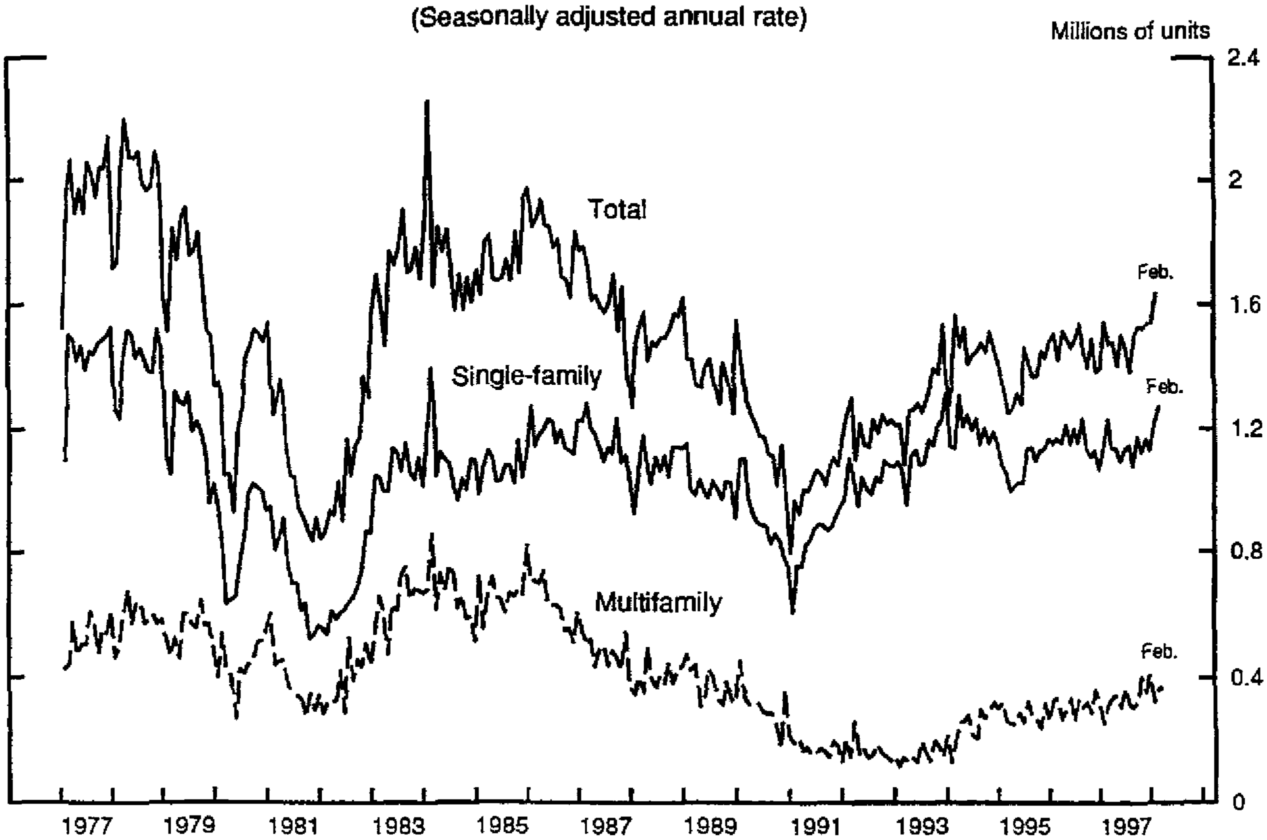
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		1997				1998	
	1997	Q2	Q3	Q4[r]	Dec.[r]	Jan.[r]	Feb.[p]
All units							
Starts	1.47	1.46	1.45	1.53	1.54	1.54	1.64
Permits	1.44	1.43	1.42	1.47	1.48	1.53	1.63
Single-family units							
Starts	1.13	1.12	1.13	1.14	1.13	1.22	1.27
Permits	1.06	1.05	1.04	1.07	1.07	1.13	1.16
Adjusted permits[1]	1.12	1.12	1.10	1.15	1.13	1.24	1.25
New home sales	.80	.78	.81	.83	.80	.88	n.a.
Existing home sales	4.22	4.12	4.25	4.38	4.37	4.37	4.75
Multifamily units							
Starts	.34	.34	.32	.39	.41	.33	.37
Permits	.39	.37	.38	.40	.41	.39	.46
Mobile homes							
Shipments	.35	.36	.35	.35	.35	.36	n.a.

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

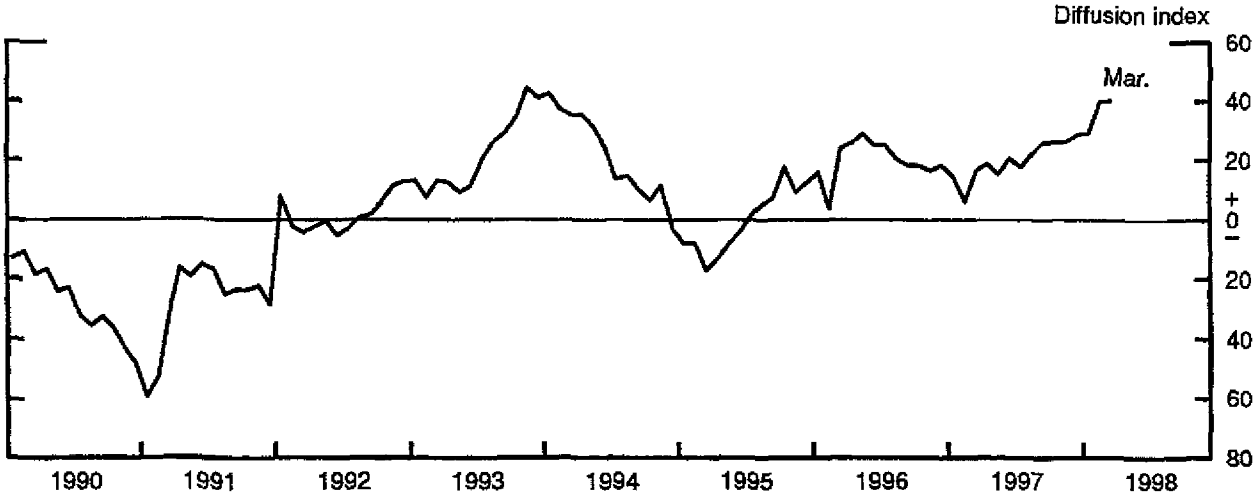
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas, and a correction for starts occurring in permit issuing places, but without a permit.

Private Housing Starts
(Seasonally adjusted annual rate)



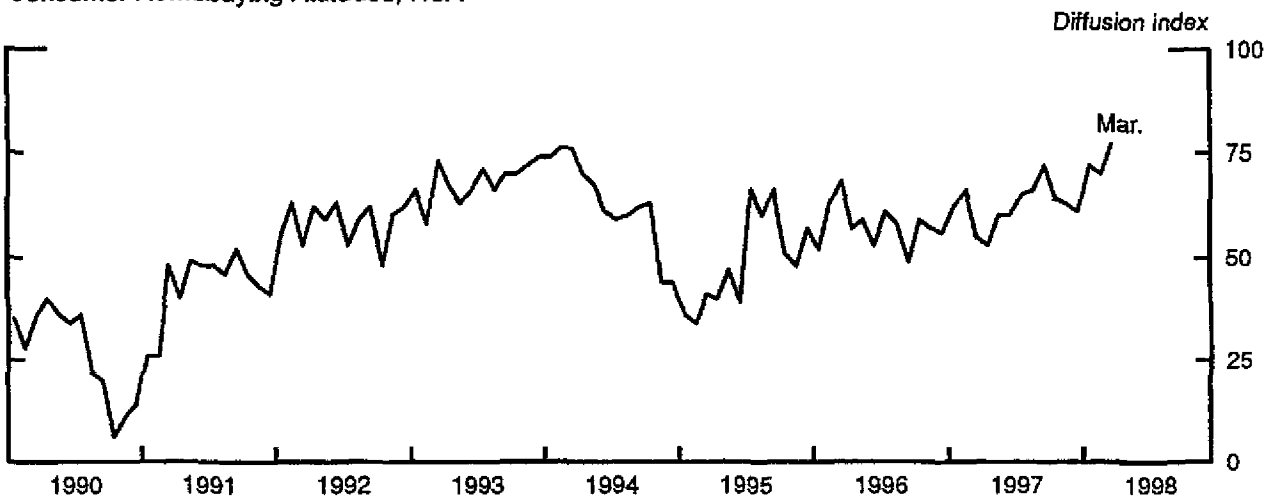
Indicators of Housing Demand

Builders' Rating of New Home Sales, SA



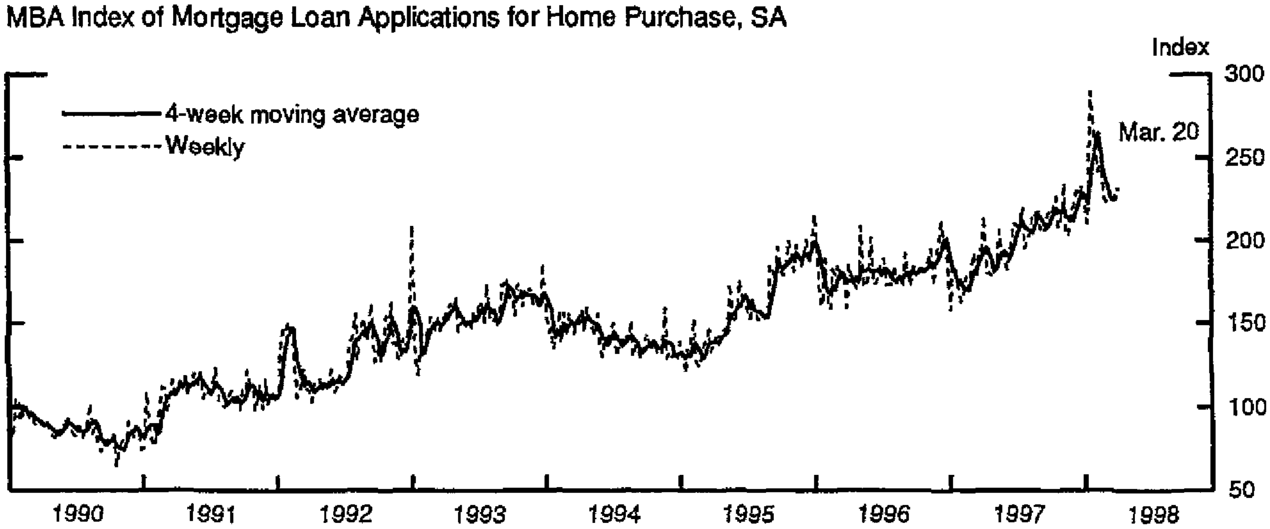
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

Consumer Homebuying Attitudes, NSA



Note. The homebuying attitudes index is calculated from Survey Research Center data as the proportion of respondents rating current conditions as good minus the proportion rating conditions as bad.

MBA Index of Mortgage Loan Applications for Home Purchase, SA



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

	1997		1997	1998	
	Q3	Q4	Dec.	Jan.	Feb.
Producers' durable equipment					
Shipments of nondefense capital goods	3.9	-.6	3.0	1.6	1.4
Excluding aircraft and parts	4.0	.3	3.1	.0	2.1
Office and computing	5.5	-2.2	9.1	1.8	3.1
Communications equipment	7.8	-1.3	3.9	-.3	4.3
All other categories	2.6	1.6	.8	-.7	1.2
Shipments of complete aircraft[1]	6.7	4.5	58.1	12.9	n.a.
Sales of heavy trucks	4.7	4.9	6.4	-3.0	2.5
Orders of nondefense capital goods	6.5	7.3	-21.8	13.1	-5.4
Excluding aircraft and parts	7.2	-1.2	1.6	2.7	1.3
Office and computing	7.8	-3.5	9.4	4.0	2.9
Communications equipment	-.6	-5.7	-1.5	30.7	-11.8
All other categories	9.1	.7	-.3	-4.2	4.7
Nonresidential structures					
Construction put in place, buildings	3.2	-1.2	.2	1.0	n.a.
Office	8.5	4.7	1.5	.8	n.a.
Other commercial	1.8	-2.4	.1	.5	n.a.
Institutional	.9	2.6	-.8	5.9	n.a.
Industrial	3.4	-6.0	-.4	.7	n.a.
Lodging and miscellaneous	2.1	-5.5	1.0	-4.0	n.a.
Rotary drilling rigs in use[2]	-.1	-2.6	3.7	6.4	.8
Memo:					
Business fixed investment	19.2	-3.5	n.a.	n.a.	n.a.
Producers' durable equipment	24.1	-3.3	n.a.	n.a.	n.a.
Office and computing	47.0	13.0	n.a.	n.a.	n.a.
Communications equipment	31.3	-5.4	n.a.	n.a.	n.a.
Other equipment[3]	9.9	.6	n.a.	n.a.	n.a.
Nonresidential structures	6.7	-4.3	n.a.	n.a.	n.a.

1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.
2. Percent change of number of rigs in use, seasonally adjusted.
3. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

steadily during the past year or so, edged up further in March. Consumers' assessments of homebuying conditions this month were upbeat. Finally, although mortgage applications for home purchase have receded in recent weeks, they are still at a very high level.

Multifamily starts were at a 366,000 unit annual rate in February. During the first two months of this year, these starts averaged 346,000 units, down noticeably from the 390,000 unit pace posted in the fourth quarter of last year and only a touch above their 1997 average. Although the fundamentals for this sector--such as rents and vacancy rates--have improved during the past year or two, they do not suggest that rental markets have tightened appreciably. As a result, the drop in construction of these units during the first two months of this year was not surprising.

Business Fixed Investment

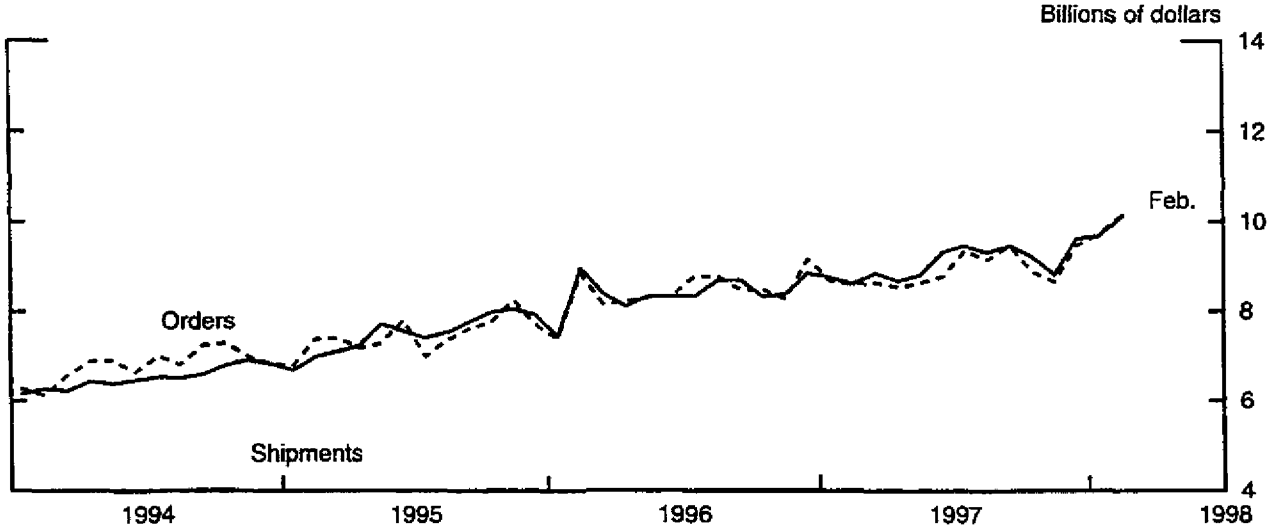
Available indicators suggest that real business fixed investment--which declined in the fourth quarter--will rise briskly in the current quarter. Although the spending indicators for nonresidential structures have been surprisingly lackluster, the combination of rebounding shipments and plummeting computer prices points to a sizable gain in real equipment outlays.

A huge increase in real outlays for office and computing equipment appears to be under way this quarter: Nominal shipments surged 9 percent in December and tacked on further increases of 2 and 3 percent in January and February respectively. Meanwhile, the producer price index for computing equipment fell nearly 10 percent over the first two months of 1998. In part, the plunge in prices reflects heightened competition at the low end of the microprocessor market, which has contributed to the boom of sales of low-end PCs. Also important, manufacturers are offering significant discounts to clear out inventories of a broad range of computers. In some cases, they are cutting prices to facilitate a shift to the build-to-order practices used by Dell, which holds inventories equal to only one week's sales. In addition, many producers of high-end servers and workstations apparently did not move quickly enough to match the steep cuts at the lower end of the market and are now slashing prices to clear out their distribution channels.

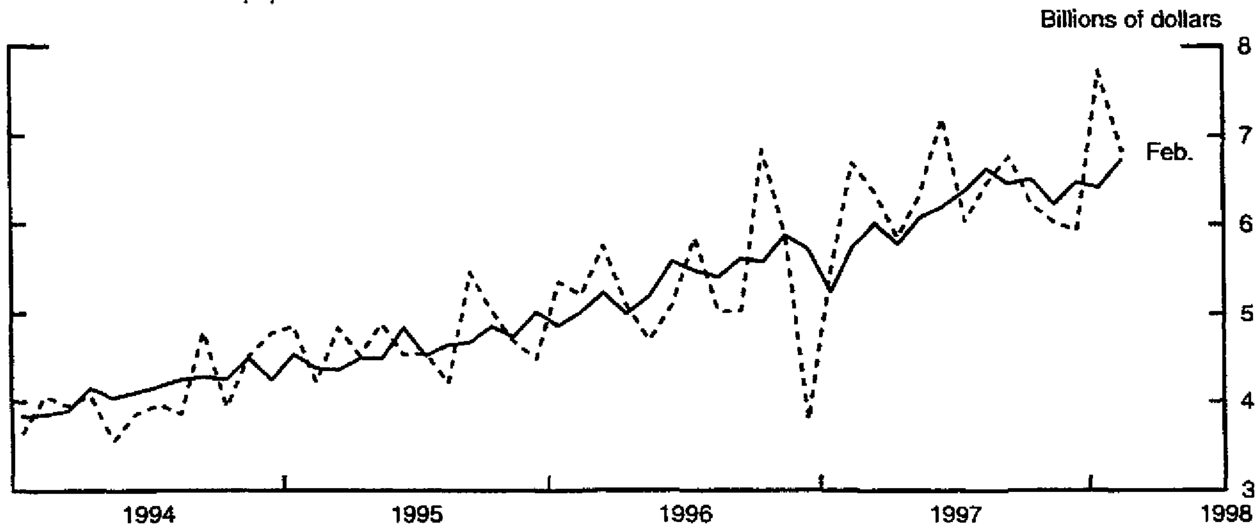
The outlook for communications equipment has also improved. After having declined in the fourth quarter, shipments and orders for communications equipment rose substantially, on average, in January and February. More generally, widening use of the Internet,

Orders and Shipments of Nondefense Capital Goods

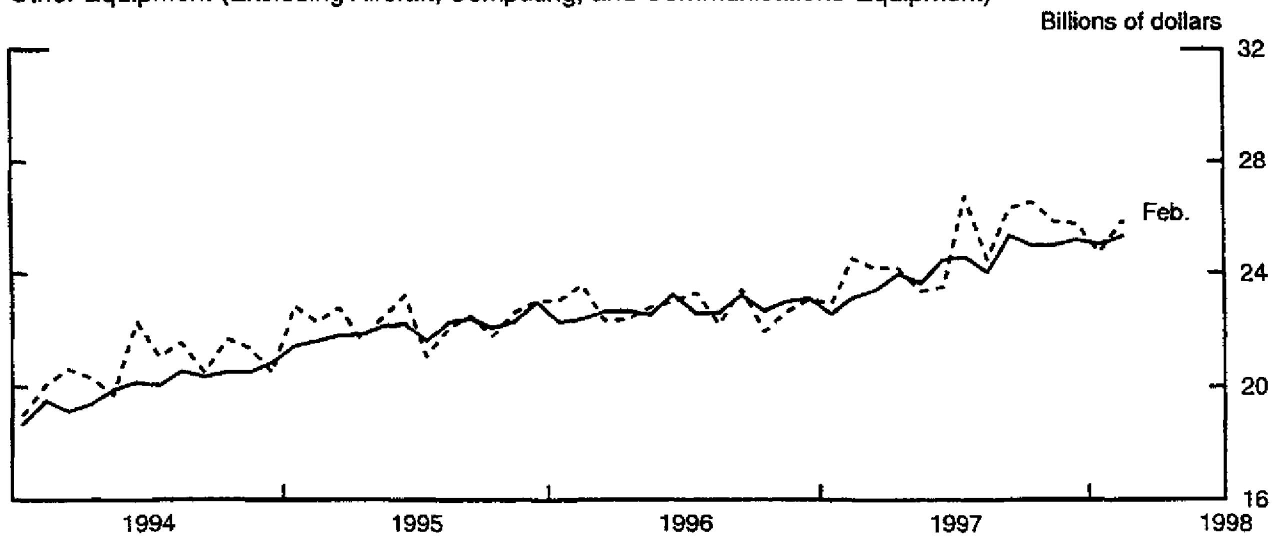
Office and Computing Equipment



Communications Equipment

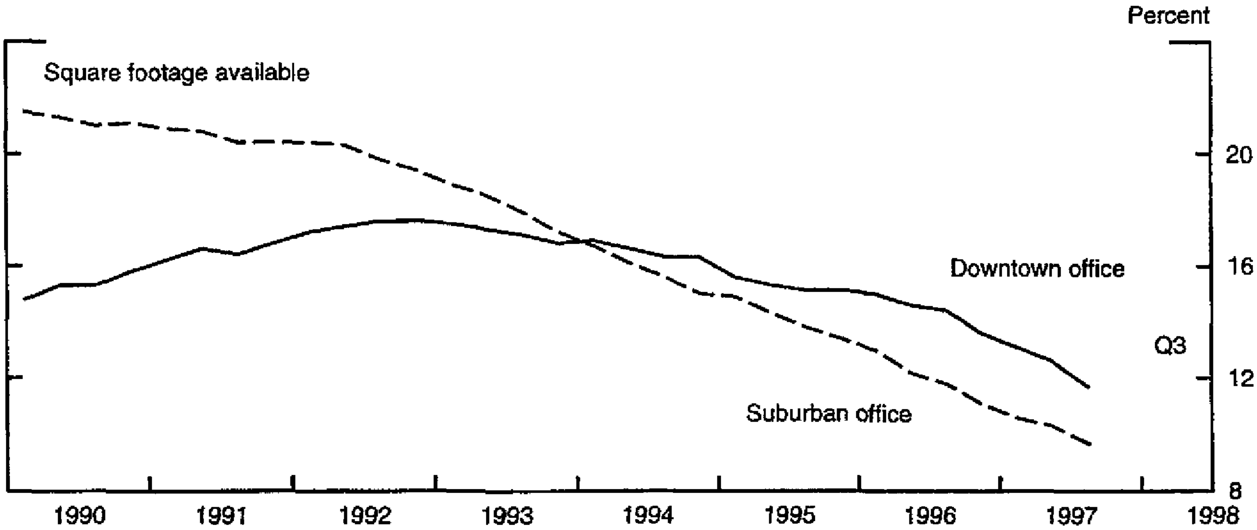


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



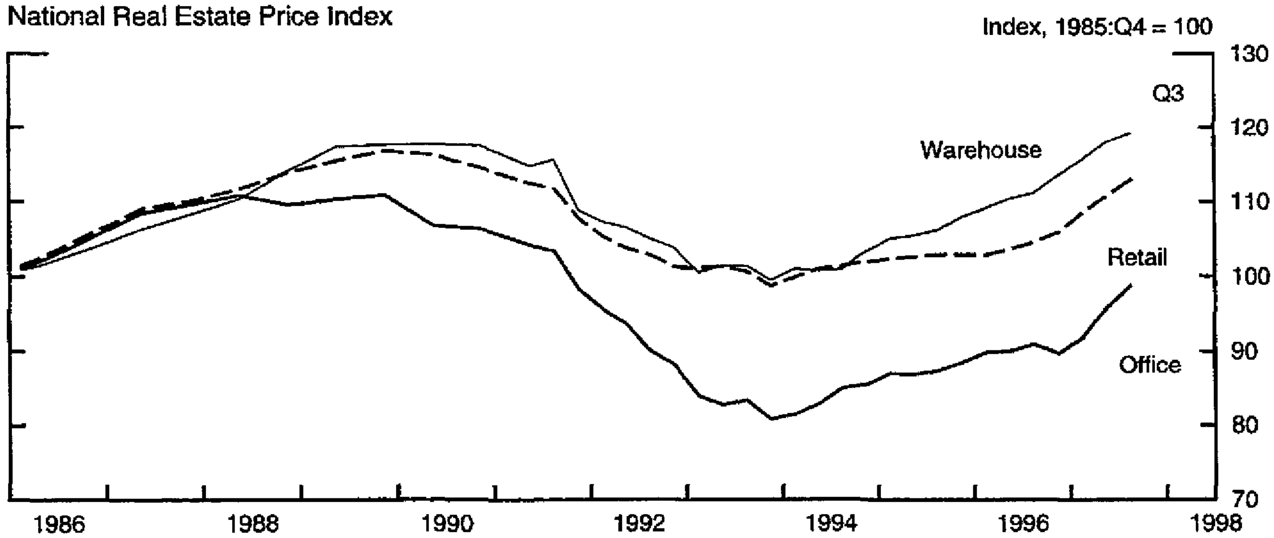
Nonresidential Construction Indicators

Vacancy Rates



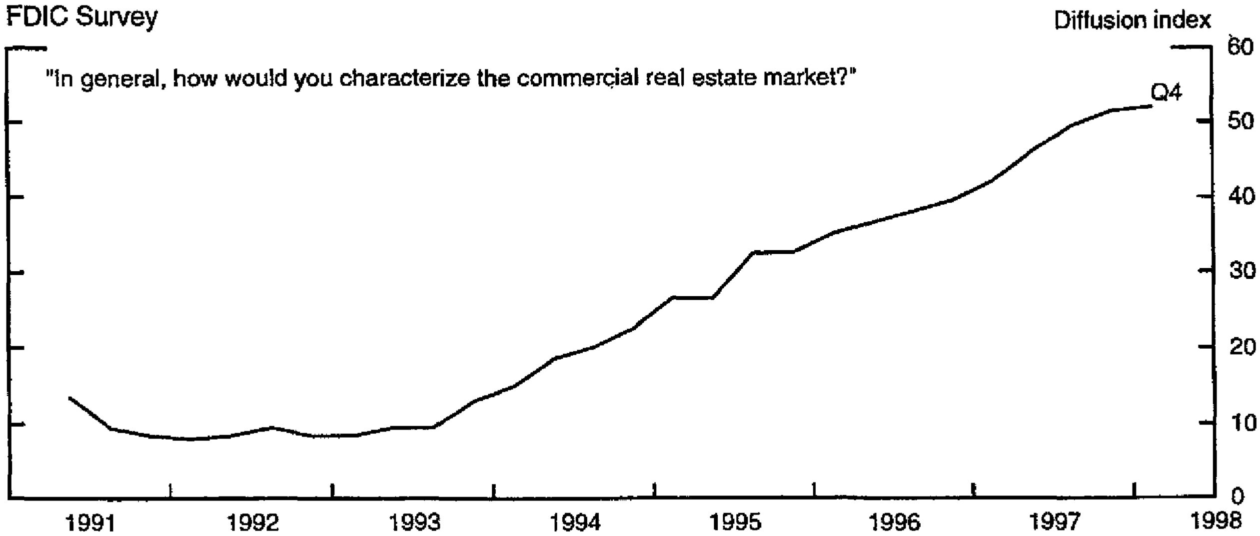
Source. CB Commercial Real Estate.

National Real Estate Price Index



Note. Data are semiannual from 1986 to 1991 and quarterly from 1992 forward.

FDIC Survey

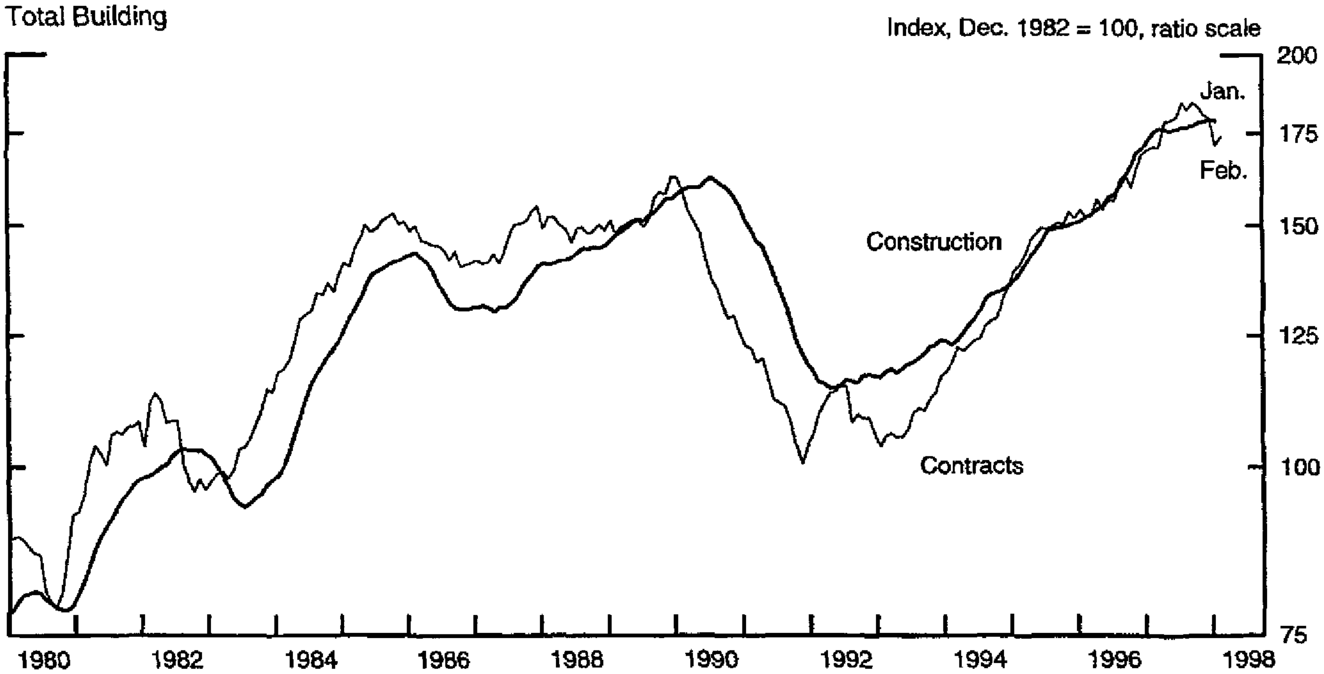


Note. Calculated as [(Percent reporting tight supply - Percent reporting excess supply)/2] + 50.

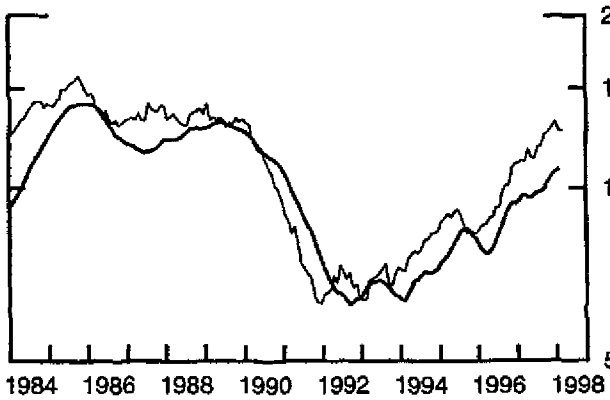
Nonresidential Construction and Contracts

(Six-month moving average)

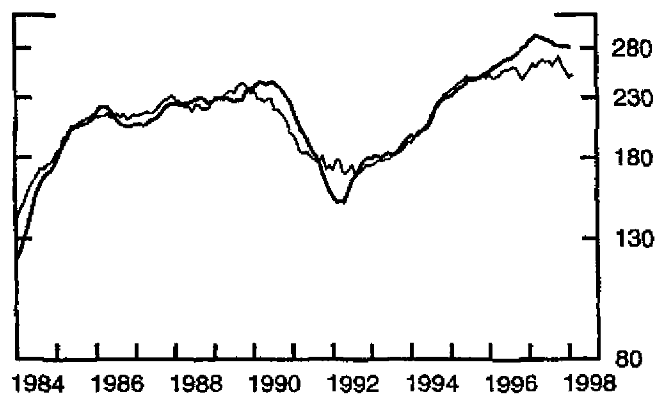
Total Building



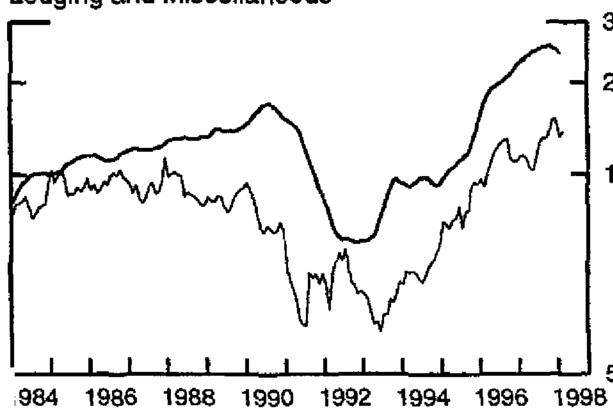
Office



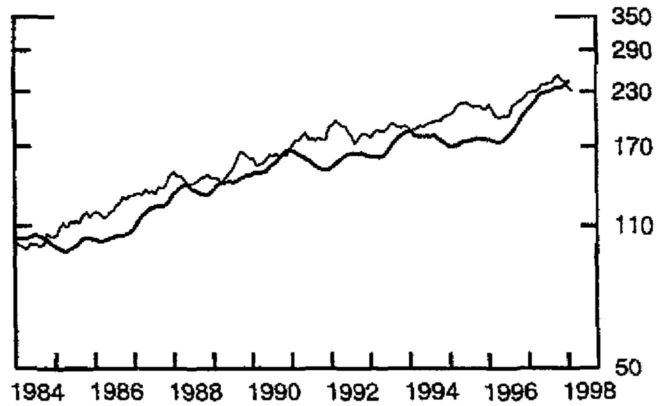
Other Commercial



Lodging and Miscellaneous



Institutional



Note. For contracts, total includes private only; individual sectors include public and private.

upgrading of cable systems, and long-distance telephone companies' plans for entering local phone markets suggest the potential for further healthy gains in expenditures in this category this year.

Transportation equipment expenditures are likely to hold down business investment in the first quarter. The drag comes mostly from the aircraft industry. As noted, production has flattened out, and our sources indicate that a very high percentage of this quarter's output will be exported, implying that domestic expenditures on aircraft are likely to fall.

Recent indicators for spending on equipment outside of the high-tech and transportation sectors have been mixed. Shipments have edged up, on balance, so far this year, but orders have bounced around and their three-month moving average has dropped back from the very high readings in the second half of 1997. Nonetheless, lagged accelerator effects should remain a plus for growth in expenditures over the coming months.

The evidence on nonresidential construction activity continues to be puzzling. The fundamentals in some key segments appear very strong, and anecdotal reports seem quite upbeat. Vacancy rates are continuing to decline, and real estate prices are accelerating: According to the National Real Estate Index, prices for both office and retail buildings rose 8 percent over the year ended in 1997:Q3 (the latest available data), up from a 4 percent rise for office buildings and a 1-1/2 percent increase for retail buildings over the year-earlier period. However, nominal private nonresidential building construction has not changed much, on balance, since last summer. Private construction contracts rose 21 percent in February, reversing their January plunge, but, on a six-month moving average basis, they remained almost 6 percent below last September's peak. Taken together, these data suggest limited potential for expansion in real outlays on nonresidential structures in the first quarter.[10]

The surprising lack of strength in nonresidential construction activity might be due to problems with the source data for the official estimates. When choosing a sample of construction projects on which to base its estimates of construction put-in-place, the

10. Another factor that will hold down measured growth in investment in nonresidential structures in the first quarter is the federal government's sale to the private sector of the Elk Hills energy facility, a one-time transaction that boosted real nonresidential structures (and depressed real federal expenditures) by $3 billion at an annual rate in the fourth quarter.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars at annual rates;
based on seasonally adjusted data)

	1997			1997		1998
	Q2	Q3	Q4	Nov.	Dec.	Jan.
Book value basis						
Total	51.5	43.7	41.6	38.3	49.4	9.8
Excluding wholesale and retail motor vehicles	48.9	36.7	42.8	51.1	39.6	18.3
Manufacturing	25.1	17.3	17.8	24.5	-7.1	16.7
Excluding aircraft	19.8	13.3	15.3	19.9	5.8	13.9
Wholesale	19.1	15.8	17.7	21.9	30.3	-15.6
Excluding motor vehicles	14.3	14.2	19.4	27.7	24.3	-18.1
Retail	7.4	10.5	6.2	-8.0	26.2	8.7
Auto dealers	-2.1	5.4	.6	-6.9	3.8	-11.0
Excluding auto dealers	9.6	5.1	5.6	-1.2	22.4	19.7

SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

	Cyclical reference points		Range over preceding 12 months		
	1990-91 high	1995-96 low	High	Low	January 1998
Manufacturing and trade	1.58	1.37	1.38	1.35	1.37
Less wholesale and retail motor vehicles	1.55	1.34	1.35	1.33	1.34
Manufacturing	1.75	1.36	1.37	1.34	1.36
Primary metals	2.08	1.49	1.65	1.59	1.63
Nonelectrical machinery	2.48	1.80	1.82	1.71	1.69
Electrical machinery	2.08	1.41	1.46	1.29	1.38
Transportation equipment	2.93	1.48	1.61	1.52	1.60
Motor vehicles	.97	.56	.62	.54	.58
Aircraft	5.84	4.15	4.76	4.09	4.03
Nondefense capital goods	3.09	2.31	2.39	2.21	2.20
Textiles	1.71	1.44	1.52	1.47	1.44
Chemicals	1.44	1.25	1.37	1.27	1.38
Petroleum	.94	.75	.85	.79	.85
Home goods & apparel	1.96	1.67	1.74	1.64	1.65
Merchant wholesalers	1.36	1.24	1.28	1.22	1.27
Less motor vehicles	1.31	1.21	1.26	1.20	1.24
Durable goods	1.83	1.53	1.56	1.50	1.54
Nondurable goods	.96	.93	.99	.92	.98
Retail trade	1.61	1.50	1.51	1.48	1.49
Less automotive dealers	1.48	1.43	1.44	1.41	1.42
Automotive dealers	2.21	1.68	1.77	1.68	1.68
General merchandise	2.43	2.20	2.16	2.08	2.06
Apparel	2.56	2.42	2.60	2.44	2.58
GAF	2.44	2.23	2.20	2.10	2.09

Census Bureau uses F.W. Dodge's data on construction contracts. Recently, Dodge altered its data collection methodology, moving toward electronic reporting, while Census changed its sample construction technique. These changes arouse suspicions, but they do not clearly point to a downward bias in the construction put-in-place data.

Business Inventories

In book-value terms, business inventories excluding motor vehicles rose at an $18 billion annual rate in January, after an accumulation of $43 billion in the fourth quarter of 1997. For most manufacturing and trade groupings, inventory-sales ratios in January were near the middle of their recent ranges. On the whole, business inventories appear to be at comfortable levels.

Manufacturers' stocks excluding aircraft and parts rose $14 billion in January, about the same as in the fourth quarter. Among sectors that export heavily to Asia, the pace of stockbuilding picked up a bit at producers of electrical machinery, but stocks rose only moderately at producers of instruments, and inventories in the nonelectrical machinery sector declined, reflecting a large drop in stocks held by office and computing manufacturers.

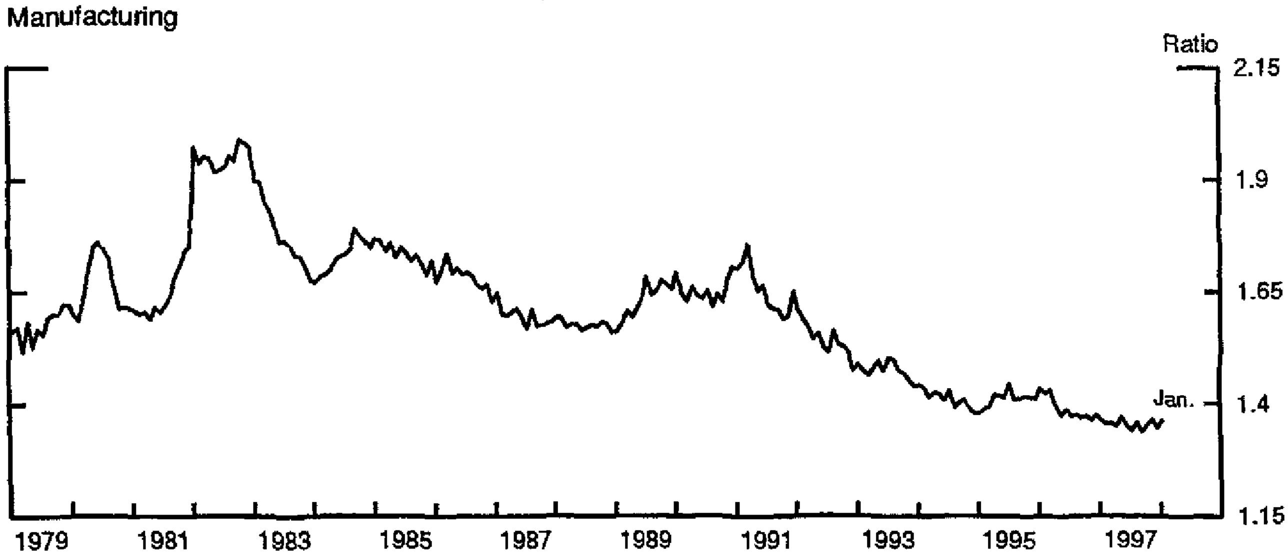
Refiners' inventories fell sharply further in January, probably reflecting the steep reduction in oil prices.[11] However, nominal shipments of petroleum declined even more, and the inventory-shipments ratio for this sector remained at the high end of the past year's range.

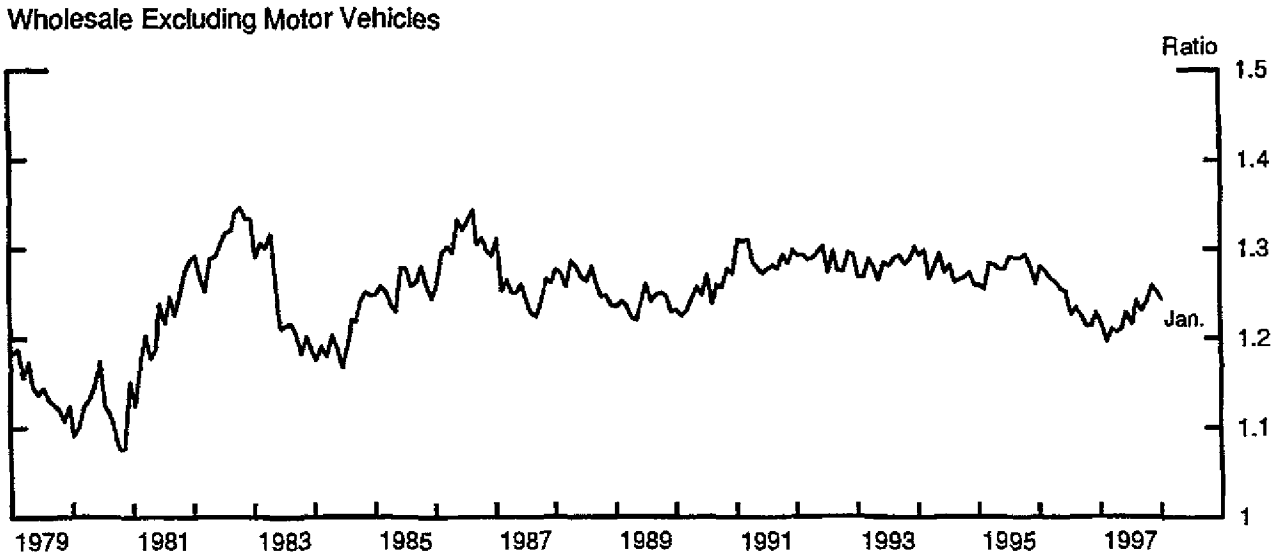
Wholesale inventories excluding motor vehicles fell $18 billion at an annual rate in January. The drop was in stocks of nondurable goods and largely reflected a return of farm products inventories to more normal levels and a sharp drop in tobacco stocks (on a not seasonally adjusted basis).

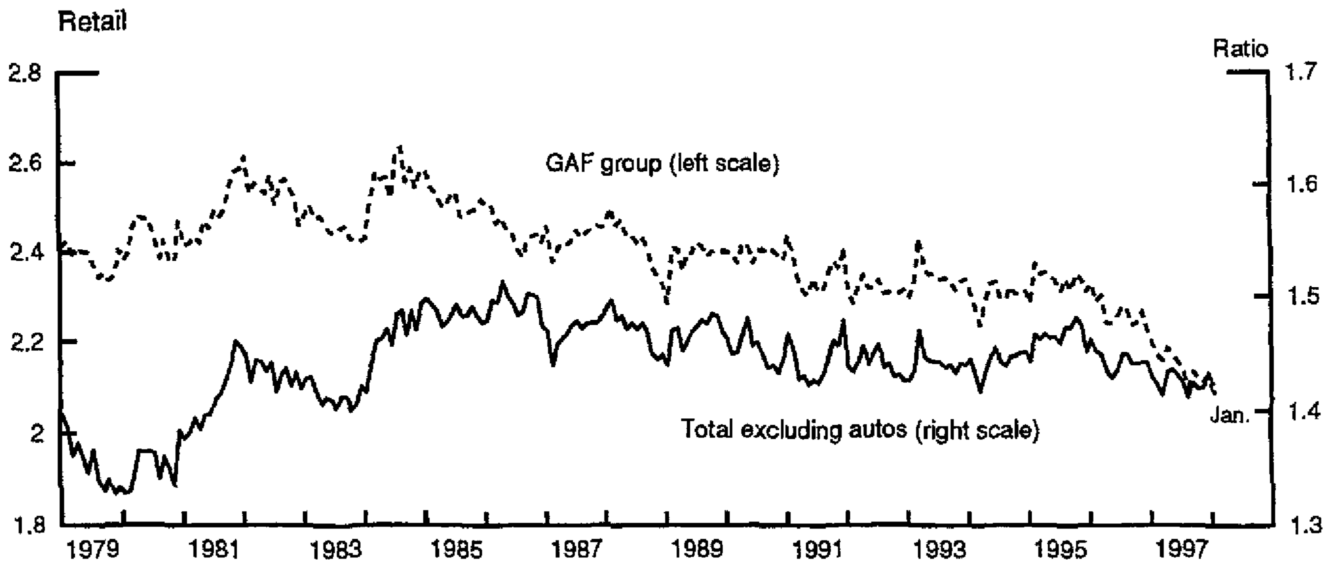
Inventories at non-auto retailers rose at nearly a $20 billion annual rate in January. This increase came on the heels of a similar-sized buildup in December, though the stockbuilding in January was more evenly spread across categories. Retail sales were also very strong in January, and the inventory-sales ratio edged down toward the lower end of the range that has prevailed over the past year.

11. Physical product data available from the Department of Energy suggest that real stocks at refiners rose in January. However, particularly because these data are not published on a seasonally adjusted basis, aligning them with the Census data can be difficult.

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







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

	January-February			12 months ending in Feb.		
	1997	1998	Percent change	1997	1998	Percent change
Outlays	271.7	276.9	1.9	1599.9	1627.1	1.7
Deposit insurance	-2.3	-0.5	n.a.	-12.4	-7.1	n.a.
Spectrum auction	0.0	-0.6	n.a.	-4.0	-8.1	n.a.
Other	273.9	278.1	1.5	1616.3	1642.2	1.6
Receipts	241.0	260.6	8.1	1483.2	1638.9	10.5
Deficit (+)	30.6	16.4	n.a.	116.6	-11.8	n.a.
	Adjusted for payment timing shifts[1] and excluding deposit insurance and spectrum auction					
Outlays	273.9	278.1	1.5	1608.6	1642.1	2.1
National defense	43.0	41.2	-4.2	270.5	269.2	-0.5
Net interest	40.5	40.5	0.0	243.1	245.3	0.9
Social security	60.3	62.5	3.6	356.4	371.2	4.2
Medicare	31.3	31.2	-0.2	181.7	192.8	6.1
Medicaid	15.6	16.2	3.5	95.1	98.0	3.1
Other health	4.3	4.7	9.8	28.2	28.3	0.4
Income security	46.0	48.3	5.1	231.6	232.5	0.4
Other	33.0	33.4	1.5	202.1	204.8	1.3
Receipts	241.0	260.6	8.1	1483.2	1638.9	10.5
Individual income and payroll taxes	210.1	229.4	9.2	1159.6	1285.5	10.9
Withheld + FICA	183.9	196.6	6.9	1009.4	1092.9	8.3
Nonwithheld + SECA	41.9	48.6	16.0	245.3	286.6	16.8
Refunds (-)	15.7	15.8	0.9	95.1	93.9	-1.2
Corporate	7.0	5.2	-25.7	172.3	189.5	10.0
Other	23.9	25.9	8.5	151.3	163.8	8.3
Deficit (+)	32.9	17.5	n.a.	125.4	3.2	n.a.
Memo:						
Refunds + EITC	24.1	27.3	13.3	116.4	118.7	2.0

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

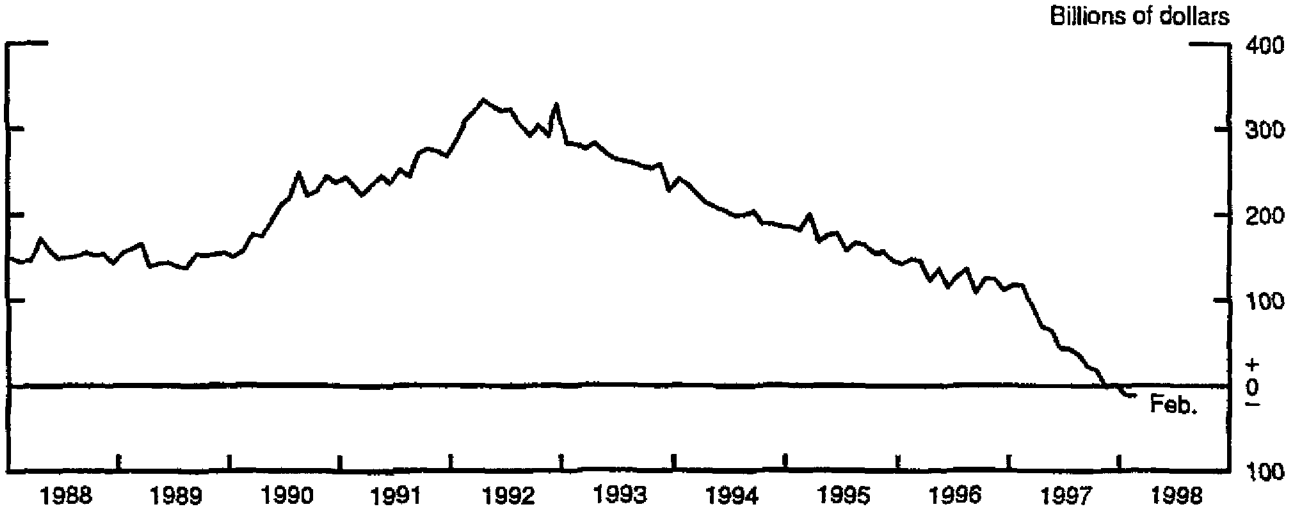
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. Outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.

n.a.--Not applicable

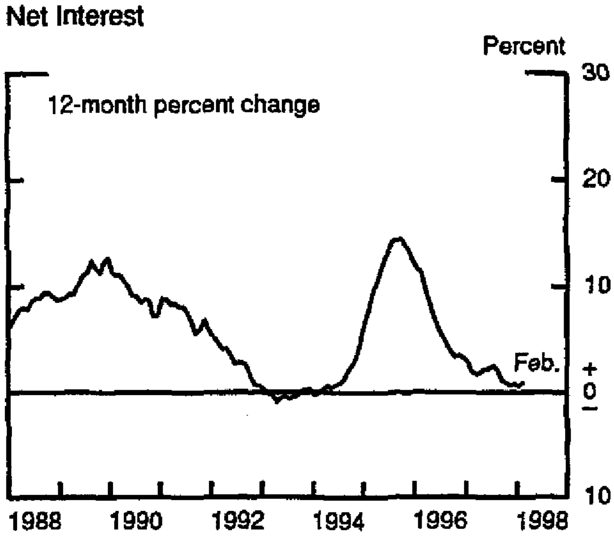
Federal Sector Developments

(12-Month Moving Sums)

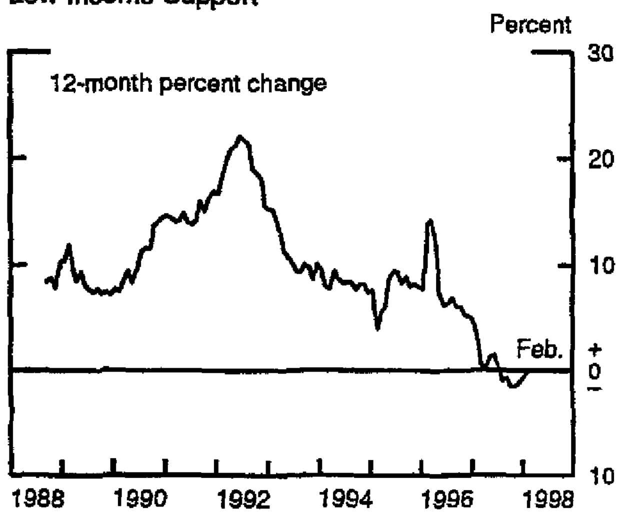
Deficit



Net Interest

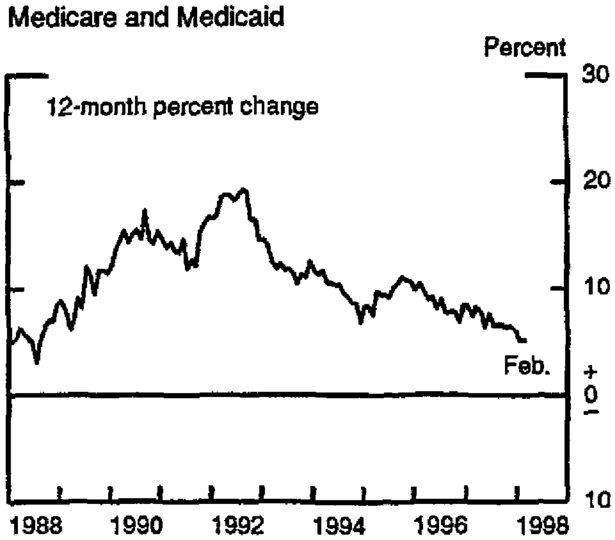


Low Income Support

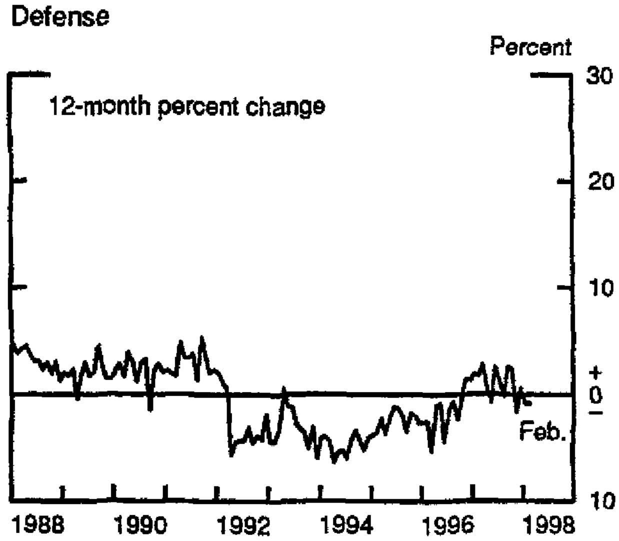


Note. Includes SSI, Food and Nutrition, EITC and AFDC/TANF.

Medicare and Medicaid



Defense



Note. Excludes the Defense Cooperation Account.

Federal Sector

The incoming news on the federal budget has remained very favorable. Bolstered by continued strong revenue growth, the budget showed a small surplus over the twelve months ending in February, and a surplus for fiscal 1998 is looking increasingly likely. Indeed, in early March, the Congressional Budget Office released updated estimates that showed a surplus of $8 billion for fiscal 1998; in January, the CBO had projected a deficit of $5 billion.[12]

According to the Monthly Treasury Statement, receipts in January and February were 8 percent above a year earlier. Individual income and payroll taxes rose 9 percent; by comparison, personal income rose 6 percent over the twelve months ended in January. Rising liabilities owing to bonuses, capital gains realizations, and real bracket creep appear to have more than offset the downward pressures on receipts from legislated tax reductions that are now kicking in. Personal income tax refunds--including the portion of the earned income tax credit that is scored as an outlay for income security--were 13 percent higher in January and February than in the same months of 1997. The surge in refunds largely reflects faster processing by the IRS owing to increased use of electronic filing. The amount of the average refund rose only 3 percent to about $1400.

Outlays grew slowly in January and February. Contributors included the effects of declining inflation on the social security COLA and many other transfer payments, slower growth of net federal debt and thus debt service payments, a decline in the use of low-income support programs, and the phase-in of cuts made to Medicare last year. In addition, nominal defense outlays, adjusted for payment timing shifts, fell about 4 percent in January and February from the same period last year. Taking a longer perspective, defense expenditures have been moving sideways over the past two years.

State and Local Governments

Recent indicators of spending by state and local governments have been mixed. Growth in employment averaged 25,000 in the first two months of the year, well ahead of the fourth-quarter pace but

12. The Administration's latest official estimate is for a $10 billion deficit in fiscal 1998. However, this estimate was released in early February and did not reflect the strength in revenues over the past few months. A discussion of the proposals in the President's budget for fiscal 1999 and the outlook for the budget over the next several years is provided in the appendix.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1997		1998	
	Feb. 1997	Feb. 1998	Q3	Q4	Jan.	Feb.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	3.0	1.4	2.0	2.3	.0	.1
Food (15.3)	3.8	1.9	3.0	2.1	.3	.0
Energy (7.0)	7.8	-8.8	1.6	1.2	-2.4	-2.2
CPI less food and energy (77.7)	2.5	2.3	1.7	2.1	.2	.3
Commodities (24.1)	1.0	.4	-.7	.6	.1	.2
New vehicles (5.1)	1.3	-.7	-.6	-1.5	.1	-.1
Used cars and trucks (1.9)	-2.0	-3.9	-11.2	-2.8	.1	.2
Apparel (4.9)	.5	.0	-1.2	.4	-.5	.2
Tobacco (0.9)	3.3	10.0	3.0	11.0	.7	2.9
Other Commodities (11.3)	1.2	.4	.1	.4	.2	.1
Services (53.6)	3.1	3.1	2.8	3.0	.2	.3
Shelter (29.4)	3.0	3.2	3.0	3.5	.2	.3
Medical care (4.4)	3.0	3.0	2.4	3.1	.1	.4
Other Services (19.8)	3.2	3.2	2.8	2.7	.3	.4
PPI						
Finished goods (100.0)[2]	2.2	-1.6	-.8	.7	-.7	-.1
Finished consumer foods (23.2)	2.4	-.1	-3.0	1.5	-.4	.4
Finished energy (13.6)	9.5	-11.0	-.2	.3	-3.7	-1.8
Finished goods less food and energy (63.3)	.6	.1	-.2	.7	-.1	.1
Consumer goods (38.0)	.7	.5	-.1	1.5	-.1	.1
Capital equipment (25.3)	.4	-.7	-.2	-.7	-.1	-.1
Intermediate materials (100.0)[3]	1.1	-1.7	-.5	.4	-.6	-.2
Intermediate materials less food and energy (81.8)	-.1	.0	.5	.2	-.1	-.1
Crude materials (100.0)[4]	4.5	-13.5	-4.0	18.7	-4.5	-2.5
Crude food materials (42.2)	-3.5	-5.3	-16.6	2.5	-3.3	-.7
Crude energy (36.2)	18.5	-26.2	9.8	58.7	-7.3	-6.5
Crude materials less food and energy (21.6)	-2.1	-5.0	1.8	-3.9	-2.2	.1

1. Relative importance weight for CPI, December 1997.
2. Relative importance weight for PPI, December 1997.
3. Relative importance weight for intermediate materials, December 1997.
4. Relative importance weight for crude materials, December 1997.

about matching the average rise during all of 1997. Real construction spending in January was about 1 percent below the fourth-quarter average.

Most states are currently in the process of preparing their fiscal 1999 budgets. With robust revenue growth, ending balances in state general funds are at their highest levels as a percentage of expenditures since 1980, and governors in almost half the states are proposing tax cuts. However, according to the National Conference of State Legislatures, this year's tax changes are unlikely to be much bigger than the small to medium-sized reductions seen in recent years. Once again, the emphasis is expected to be on cuts in personal income taxes. Some states are also considering facilitating reductions in property taxes, which are primarily local taxes, by increasing state grants to localities for K-12 school programs.[13]

Local governments also appear to be doing well. According to a 1997 survey by the National League of Cities, more than two-thirds of cities were better off financially in fiscal 1997 than in the previous year; that percentage has been rising for five years. Local governments whose revenues come in large part from income taxes and state grants seem to be better-off than those more dependent on property taxes.

Prices

The consumer price index was unchanged in January and edged up only 0.1 percent in February, as large declines in energy prices nearly offset increases elsewhere.[14] Over the twelve months ending in February, the CPI rose only 1.4 percent, the smallest twelve-month increase since December 1986. (The oil-induced low in CPI inflation that year was 1.1 percent.)

The CPI for energy has dropped considerably since late 1997, mainly reflecting the slump in crude oil prices. After averaging more than $21 per barrel in October, the spot price of West Texas intermediate fell substantially through mid-March before rebounding

13. In addition, some states (New York, Pennsylvania, Vermont, and Connecticut) are hoping to squirrel funds away for a rainy day or reduce outstanding debt (Rhode Island). And legislators in other states are proposing to use surpluses for infrastructure projects (Colorado and Minnesota) or other short-term spending programs.

14. In January, the BLS introduced major revisions to the CPI, which included updated expenditure weights (to the 1993-95 period), new geographic sample and population weights, new categories of goods sampled, and an improved quality-adjustment procedure for computer prices.

Daily Spot and Posted Prices of West Texas Intermediate

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

Monthly Average Prices of West Texas Intermediate

Month	Posted	Spot
April	18.52	19.72
May	19.55	20.83
June	17.96	19.17
July	18.15	19.63
August	18.51	19.93
September	18.14	19.79
October	19.80	21.26
November	18.83	20.17
December	16.97	18.32
January	15.33	16.71
February	14.78	16.06
March [1]	13.10	14.63

1. Through March 24, 1998.

somewhat in recent days. It now stands at around $15-1/2 per barrel. As a result of the decline in crude oil prices, gasoline and heating oil prices plunged in January and February, and private survey data suggest that, on a seasonally adjusted basis, the retail price of gasoline dropped further in March. The indexes for natural gas and electricity have declined as well, as warmer-than-usual weather weakened demand. Electricity prices were also depressed by legislated price cuts in January associated with the initial stages of deregulation in California and a rebate in February to California customers for the lower-than-expected fuel input costs by utilities in 1997.[15]

The CPI for food rose 0.3 percent in January but was unchanged in February. The price index for fruits and vegetables fell back somewhat last month after having risen sharply in January. Excluding fruits and vegetables, food prices were up 0.1 percent in the latest month, the same as in each of the previous two months. El Nino probably has played a role in the recent volatility of fresh produce prices, with flooding having temporarily disrupted field operations in both the West and the South. More generally, though, El Nino's effects are less clear, as the mild winter has spared agriculture from many of the normal adversities of the winter season. Livestock operations, for example, were less strained than usual by the winter this year, and production has thereby been increased--perhaps more so than producers might have wished, given the degree to which livestock prices were pushed down in the first two months of the year. Meanwhile, crop prices have not achieved their customary seasonal gains so far this year, partly because of concerns that the problems in Asia will limit exports. Reflecting these developments, the PPI for crude foods--an index that includes both crops and livestock--fell 4 percent over the first two months of 1997 to a level more than 5 percent below that of a year earlier. And, futures prices for farm commodities have weakened, on balance, since the January Greenbook.

For items other than food and energy, consumer prices rose 0.2 percent in January and 0.3 percent in February. On a twelve-month basis, core consumer prices rose 2.3 percent in February, down

15. On January 1, residential electricity rates in California were cut 10 percent. On March 31, users will have the option of buying electricity from alternative providers, which may lead to further price reductions over time. However, at least in the near term, additional savings will more likely be realized by industrial rather than residential consumers.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994	1995	1996	1997
Product prices				
GDP chain price index	2.5	2.4	2.3	1.8
Nonfarm business chain-type price index[1]	2.5	1.7	1.9	1.5
Expenditure prices				
Gross domestic purchases chain-type price index	2.5	2.3	2.3	1.4
Less food and energy	2.6	2.4	1.9	1.5
PCE chain-type price index	2.6	2.2	2.7	1.5
Less food and energy	2.8	2.4	2.3	1.6
CPI	2.7	2.6	3.2	1.9
Less food and energy	2.8	3.1	2.6	2.2
Median CPI	2.9	3.2	2.8	2.8
Trimmed mean CPI	2.6	2.7	2.8	2.1

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]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1996-Q1	2.7	3.9	2.8	4.1	3.0
Q2	2.8	4.5	3.0	4.3	3.0
Q3	2.9	4.2	3.1	4.3	3.0
Q4	3.2	4.0	3.0	4.2	3.0
1997-Q1	2.9	3.8	2.9	4.2	3.0
Q2	2.3	3.6	2.9	4.0	2.9
Q3	2.2	3.4	2.7	4.0	3.0
Q4	1.9	3.3	2.8	4.1	2.7
1998-Q1		2.8	2.4		2.6
Oct.	2.1	3.2	2.8	4.1	
Nov.	1.8	3.4	2.9	4.1	
Dec.	1.7	3.4	2.8	4.0	2.7
1998-Jan.	1.6	2.8	2.3	3.7	
Feb.	1.4	2.6	2.4	4.0	
Mar.		3.0	2.5		2.6

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. Compiled by the Federal Reserve Bank of Philadelphia.

slightly from the 2.5 percent pace recorded a year earlier but up a touch from the pace recorded in the previous couple of months. Core services prices advanced 3.1 percent over the past twelve months--about the same as over the preceding year. Falling import prices likely were a factor helping to hold the rate of change of core CPI commodities to 0.4 percent over the year ending in February. Prices of new vehicles, which have been restrained by the strong dollar and competition for market share, were unchanged on balance in the first two months of this year after having declined in 1997. And while used car and truck prices have moved up in the past three months, they remain 4 percent below their year-earlier level. Apparel prices, while volatile on a month-to-month basis, were down on balance in January and February and unchanged from a year ago after having risen somewhat in the previous twelve-month period. In contrast, tobacco prices have accelerated sharply; the index's 10 percent increase over the past year reflects three large wholesale price hikes and a number of hefty increases in state excise taxes.

Broad measures of prices in the NIPA decelerated last year. For example, the chain price indexes for GDP and for PCE excluding food and energy rose 1/2 and 3/4 percentage point less over the four quarters of 1997 than they did during 1996. As with the CPI, the chain price index for core PCE was held down in 1997 by a decline in durable goods prices and a deceleration in services other than energy and housing.

Prices of capital equipment in the PPI edged down 0.1 percent in both January and February, reflecting further declines for motor vehicles and a very large drop in computer prices. In contrast, reports of price pressures in trucking and rail transportation have begun to surface recently. The PPI for railroad transportation was up 1.1 percent in the twelve months ending in February, the largest increase since May 1994. The PPI for trucking and courier services also moved up in the first two months of this year, although the twelve-month change in the index--2.3 percent--was still 1/4 percentage point below the twelve-month change last February.

Prices at earlier stages of processing remain quiescent. The PPI for intermediate materials less food and energy edged down 0.1 percent in both January and February, and the index in February was unchanged from its level a year earlier. The PPI for core crude materials fell 2.2 percent in January but edged up in February, the

SPOT PRICES OF SELECTED COMMODITIES

	Current price ($)	Percent change[1]: 1996	1997	Dec. 30 to Jan. 27[2]	Jan. 27[2] to Mar. 24	Memo: Year earlier to date
Metals						
Copper (lb.)	.850	-21.3	-24.3	1.2	3.7	-30.3
Steel scrap (ton)	135.500	-13.1	23.2	1.4	-6.9	-.7
Aluminum, London (lb.)	.649	-8.5	-.6	.2	-5.0	-11.2
Precious metals						
Gold (oz.)	300.300	-4.8	-21.4	3.0	.5	-14.1
Silver (oz.)	6.370	-6.1	28.3	-1.8	5.9	24.3
Forest products						
Lumber (m. bdft.)	285.000	59.2	-29.6	-2.4	.0	-23.4
Plywood (m. sqft.)	280.000	-3.2	-4.8	-5.0	-1.8	-13.0
Petroleum						
Crude oil (barrel)	14.210	29.3	-31.7	-3.4	-9.0	-24.0
Gasoline (gal.)	.466	27.2	-25.8	-5.6	-1.5	-23.8
Fuel oil (gal.)	.442	18.3	-29.7	-5.2	-5.8	-22.2
Livestock						
Steers (cwt.)	61.000	-1.1	3.0	-5.9	-4.7	-10.3
Hogs (cwt.)	36.000	14.9	-36.4	5.0	-2.0	-30.1
Broilers (lb.)	.549	12.5	-21.2	4.0	6.9	4.4
U.S. farm crops						
Corn (bu.)	2.550	-24.4	.2	3.3	-3.4	-12.1
Wheat (bu.)	3.483	-12.8	-22.6	4.3	-5.1	-23.8
Soybeans (bu.)	6.455	-3.7	-1.8	-.1	-4.3	-21.6
Cotton (lb.)	.672	-8.7	-9.7	-3.3	8.8	-3.1
Other foodstuffs						
Coffee (lb.)	1.585	34.7	25.4	3.8	-10.5	-26.6
Memo:						
JOC Industrials	96.200	-4.1	-8.6	-1.6	-.3	-10.5
JOC Metals	87.900	-8.3	-5.0	.3	-1.3	-11.9
KR-CRB Futures	229.730	-.1	-3.2	1.2	-1.5	-6.4
KR-CRB Spot	304.070	.9	-8.4	-2.1	1.3	-10.4

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

first increase in six months. Since the mid-February pricing date for the PPI, the Journal of Commerce and KR-CRB industrial price indexes have ticked up, on balance, but remain below their levels at the end of last year.

After having dropped in 1997, short-term inflation expectations have fallen further this year. As measured by the Michigan SRC index, one-year-ahead inflation expectations--both the mean and the median--fell about 1/2 percentage point in the first quarter. Longer-term inflation expectations, measured by either the Philadelphia Fed's survey of professional forecasters or the Michigan survey, edged down in the first quarter.

Subdued price inflation and declining inflation expectations notwithstanding, the BLS's Productivity and Cost report shows that compensation per hour in the nonfarm business sector rose at a 5.2 percent annual rate in the fourth quarter of last year. Over the four quarters of 1997, compensation per hour grew 4.1 percent, up about a quarter point from the rate recorded in 1996. The Employment Cost Index for compensation--which controls for occupational and industry mix shifts but excludes some forms of remuneration such as stock options and sign-on bonuses--rose 3.4 percent last year, also about 1/4 percentage point faster than the increase recorded in 1996.

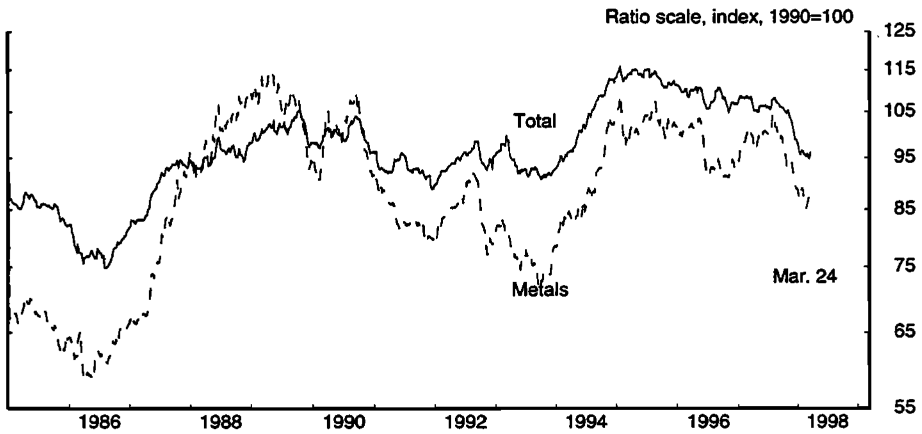
Despite the acceleration in compensation in 1997, the pickup in productivity growth last year limited the increase in unit labor costs to 1.9 percent. Even so, the rise in unit labor costs was about 1/2 percentage point greater than that in output prices, and the price markup over unit labor costs in the nonfarm business sector continued to edge down.

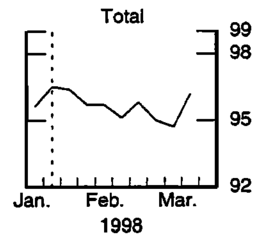
Readings of labor costs this quarter are primarily limited to the BLS monthly data on average hourly earnings of production or nonsupervisory workers. In January and February, hourly earnings rose 0.3 percent and 0.6 percent respectively. The published data, however, have been distorted by reporting problems with the workweek data.[16] After adjusting for this distortion, average hourly earnings would have increased 0.3 percent in January and 0.4 percent in February. The twelve-month change in average hourly earnings

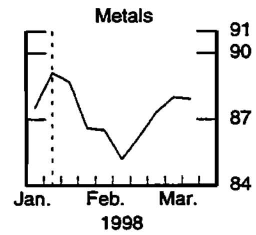
16. BLS reports that the level of average hourly earnings and the number of working days in the month are negatively correlated. In particular, reported earnings growth last month was overstated and will likely be understated in both March and April. The bias is mainly evident in sectors outside of manufacturing.

Commodity Price Measures

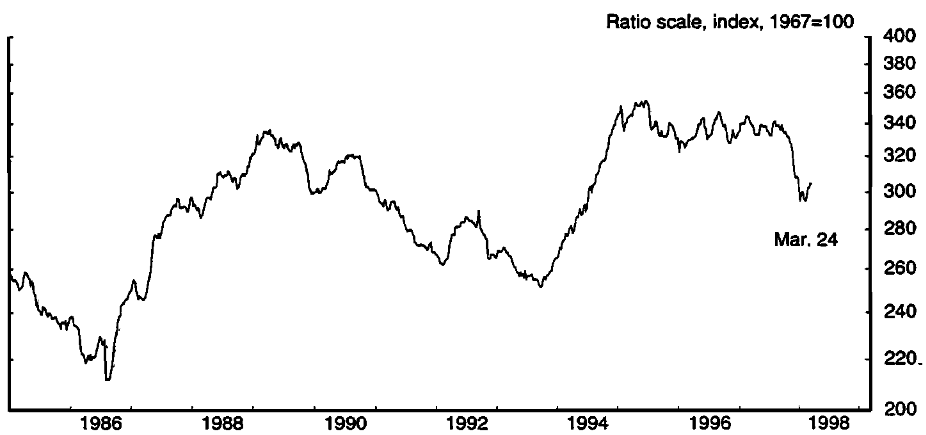
Journal of Commerce Index

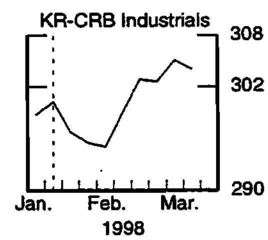




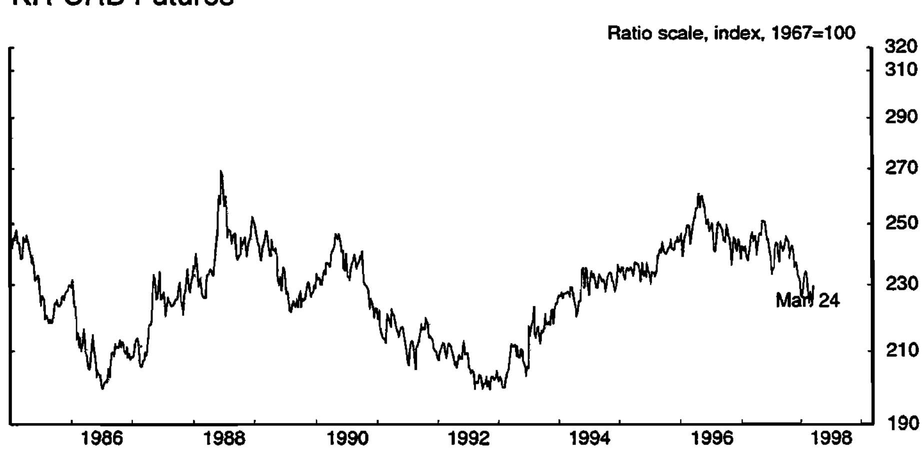


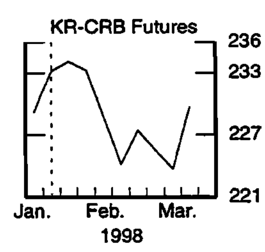
KR-CRB Spot Industrials





KR-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 KR-CRB spot price index consists entirely of industrial commodities, excluding energy. The KR-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.

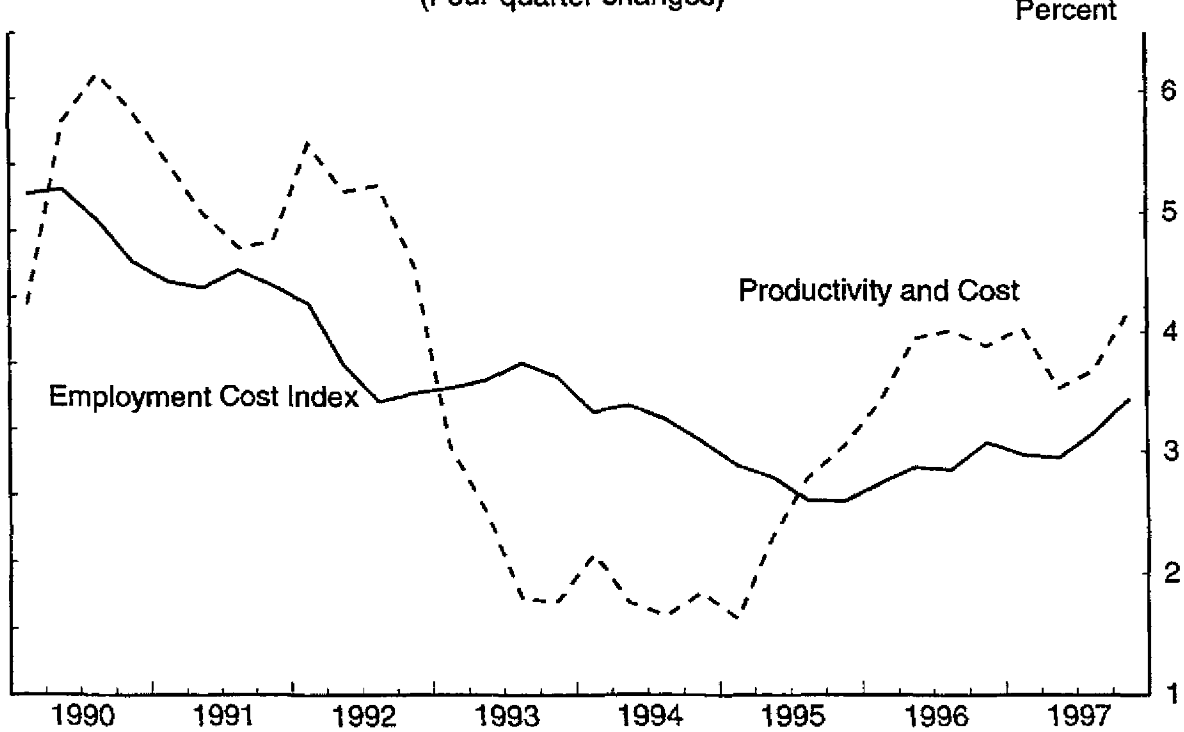
ending in February 1998, which was largely unaffected by this measurement problem, was 4.1 percent, roughly where it has been the past year or so. On an industry basis, reported hourly earnings growth has edged down or remained flat in most industries over the past year. Two notable exceptions are finance, insurance, and real estate, where commissions on mortgage transactions may have boosted earnings, and transportation.

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

	1996[1]	1997[1]	1997 Q1	Q2	Q3	Q4
Output per hour						
Total business	1.8	2.3	1.6	2.2	3.5	1.8
Nonfarm business	1.7	2.1	1.1	2.3	3.6	1.6
Manufacturing	4.4	4.8	3.3	3.8	8.0	4.3
Nonfinancial corporations[2]	2.8	3.1	1.7	2.4	6.3	n.a.
Compensation per hour						
Total business	4.0	4.2	4.1	3.1	4.2	5.5
Nonfarm business	3.9	4.1	4.3	3.2	3.8	5.2
Manufacturing	3.0	4.1	4.4	2.6	3.4	6.1
Nonfinancial corporations[2]	3.8	3.6	4.0	3.2	4.3	n.a.
Unit labor costs						
Total business	2.2	1.9	2.5	.9	.7	3.7
Nonfarm business	2.2	1.9	3.1	.9	.2	3.5
Manufacturing	-1.3	-.7	1.0	-1.1	-4.2	1.8
Nonfinancial corporations[2]	1.0	.5	2.3	.8	-1.9	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

Compensation per Hour
(Four-quarter changes)

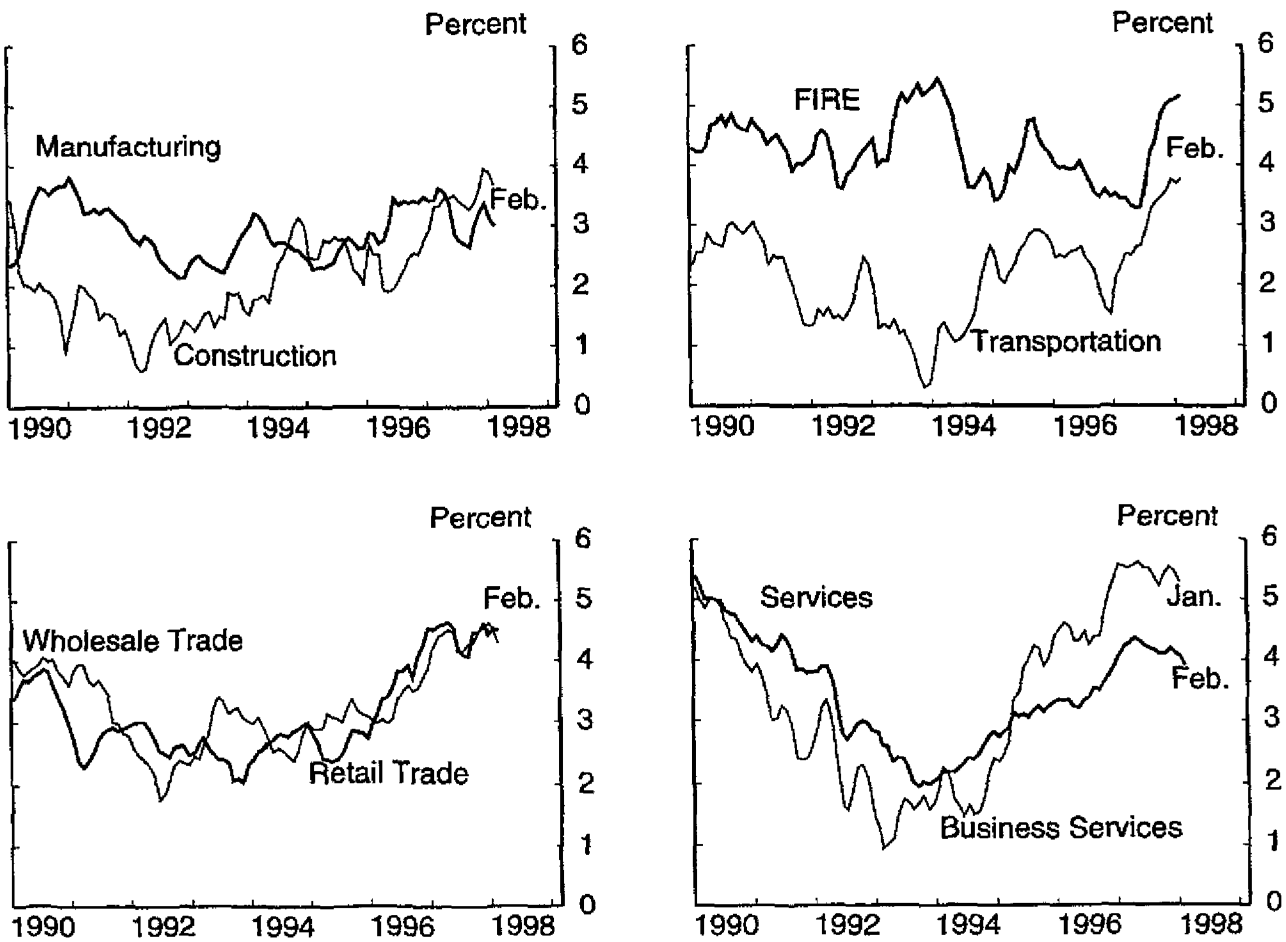


AVERAGE HOURLY EARNINGS
(Percentage change; based on seasonally adjusted data)

	Twelve-month percent change[1]			Percent change to Feb. 1998		1998	
	Feb. 1996	Feb. 1997	Feb. 1998	Aug. 1997	Nov. 1997	Jan.	Feb.
	-Annual rate-					-Monthly rate-	
Total private nonfarm	2.9	3.9	4.1	4.8	3.9	.3	.6
Manufacturing	2.5	3.6	3.1	3.5	1.8	-.1	.4
Durable	2.0	3.5	2.8	3.1	.6	-.4	.3
Nondurable	3.3	3.4	3.3	3.4	3.6	.2	.5
Construction	2.0	3.5	3.4	3.9	3.0	-.7	.6
Transportation and public utilities	2.6	2.2	4.1	3.4	5.7	1.3	-.1
Finance, insurance, and real estate	4.0	3.6	5.7	5.0	5.4	.3	1.4
Retail trade	3.1	4.7	4.6	5.6	4.3	.6	.4
Wholesale trade	3.0	4.6	4.5	4.2	2.6	-.1	1.0
Services	3.3	4.4	4.1	4.6	3.6	.3	.7

1. Uses not seasonally adjusted data.

Average Hourly Earnings
(Smoothed twelve-month changes*)



* Three-month moving average of twelve-month changes.

APPENDIX

THE FISCAL 1999 BUDGET

On February 2, President Clinton submitted his fiscal 1999 budget to the Congress. In early March, CBO released a preliminary analysis of the President's budgetary proposals, which also included an update of its January baseline budget estimates. The CBO analysis incorporated recent budget data, but the economic assumptions were unchanged from those published in January. The Administration's and the CBO's budget and economic outlooks are quite similar.

I. Baseline Budget Projections

The Administration estimates that the budget will record a $10 billion deficit this fiscal year and move into surplus next year--if the discretionary spending caps enacted in 1997 are adhered to and if no new tax or mandatory spending policies are enacted (table 1). The baseline surplus is projected to grow to $89 billion (3/4 percent of GDP) in fiscal 2003. This improvement in the budget balance occurs despite a fall in receipts as a share of GDP because the outlay share falls even faster. The Administration projects that the surplus will widen further to 2 percent of GDP by 2008 as outlays continue to shrink relative to GDP and the receipts share holds steady.

CBO has released new estimates that show an $8 billion surplus in fiscal 1998, mainly because of the continued strength in receipts. CBO's projections are essentially the same as OMB's through fiscal 2000. But CBO is less optimistic about the outlook for subsequent years, and their projected surplus grows to only 1 percent of GDP by 2008 (table 2). The chief difference between the OMB and CBO baseline projections is the expected pace of Medicare spending.

The key factor damping outlay growth in both OMB's and CBO's baseline projections is the restraint implied by the statutory caps on discretionary spending, which would cause discretionary outlays to fall from 7 percent of GDP in fiscal 1997 to around 5-1/2 percent of GDP in fiscal 2002 when the current caps expire. The projections hold discretionary spending constant in real terms after 2002, which lowers its share of GDP further.[1] Net interest outlays also are expected to decline as a share of GDP throughout the projection, mainly because of a decline in the debt-to-GDP ratio, while mandatory spending will continue to grow faster than GDP under current policies.

Meanwhile, OMB and CBO expect the receipts share of GDP to remain near 20 percent over the next couple of years, but to drift down to roughly 19-1/2 percent by 2001 and hold steady thereafter. The projected decline mainly reflects: (1) the 1997 tax changes, which boost revenues in fiscal 1999 but subsequently reduce them by

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1. OMB and CBO use different price indexes to calculate real discretionary spending and thus baseline spending after 2002. OMB uses the GDP deflator and CBO uses the CPI-U. The caps are no longer adjusted for differences between actual inflation and the inflation rate projected when the caps were instituted.

an amount equal to 0.3 percent of GDP; (2) an anticipated fall in the "high-tax income share" (the sum of corporate profits plus wages and salaries as a percent of GDP); and (3) an assumed gradual unwinding of some of the factors (including the extraordinary run-up in capital gains realizations) that have elevated receipts in recent years.

II. Economic Assumptions

The broad contours of OMB's and CBO's economic assumptions are about the same. OMB and CBO both finalized their economic assumptions in early December, and neither anticipated the continued strength in economic activity in late 1997 and early 1998 or the sharp declines in oil prices and domestic interest rates since late last year.

OMB expects real GDP growth to slow to a 2.0 percent rate in 1998 and to remain there until the unemployment rate moves back to the Administration's point estimate of the NAIRU, 5.4 percent, in 2001 (table 3). In subsequent years, real GDP is projected to rise 2.4 percent per year--matching the Administration's estimate of real potential GDP growth. The projected increase in real GDP reflects 1.1 percent annual gains in the labor force and 1.3 percent productivity growth. Inflation, as measured by the CPI, is projected to remain subdued. Although high resource utilization rates in the near term are expected to put upward pressures on prices, low import prices and technical changes to the CPI are expected to hold down measured inflation.[2]

CBO's projections are similar to those of OMB. The chief differences are the following:

- CBO projects real GDP growth to stay below potential longer, allowing the unemployment rate to rise a bit above its 5.8 percent NAIRU estimate.
- CBO expects inflation to pick up more than does OMB and assumes that the wedge between CPI inflation and the GDP deflator will be larger.[3] All else equal, a larger wedge implies a smaller budget surplus because the CPI is used to index spending programs and the GDP deflator is a component of income and thus tax growth.
- CBO assumes that the high-tax income share will fall more rapidly than does OMB.

III. Policy Proposals

The President outlined a number of initiatives for receipts and outlays. According to OMB, these changes would have small budgetary effects and be roughly deficit-neutral in the aggregate. However, the President wants to modify current budget guidelines by using increases in taxes to lift the caps on discretionary spending as

---

2. The Administration estimates that technical changes to the CPI in 1998 and 1999 would reduce measured CPI inflation by a total of 0.41 percentage point and boost measured real GDP by 0.14 percentage point.

3. CBO expects the wedge to be 0.3 percentage point, while OMB projects only a 0.1 percentage point difference. As CBO notes, the wedge has averaged 0.4 percentage point per year over the past twenty years. However, looking ahead, the technical changes to the CPI should reduce substantially the wedge.

well as to fund some additional mandatory spending.[4] CBO expects that the Administration's policies would reduce the surplus by $9 billion in fiscal 1999, relative to current services, and by $5 billion to $15 billion in each of the next four years. The difference between the two estimates stems from different views about the speed at which the proposed budget authority would translate into outlays.

Discretionary spending. Under last year's budget agreement, nominal discretionary spending was slated to rise 1-1/2 percent in fiscal 1999 and then remain essentially flat through 2002 when the caps expire (table 4). In real terms, defense spending was expected to fall in each of the next two fiscal years, while nondefense spending was expected to edge up in fiscal 1999 but shrink in fiscal 2000. According to OMB estimates, the Administration's proposals do not change the path of defense spending relative to last year's budget agreement. However, nondefense discretionary outlays would grow more in real terms in fiscal 1999 and fall more slowly than previously anticipated in subsequent years.

- OMB estimates that discretionary spending would be $5 billion higher than the existing caps in fiscal 1999 and $16 billion higher in fiscal 2002.[5]
- According to CBO calculations, the President's plans would boost spending even further above the existing caps owing to CBO's evaluation of how quickly new budget authority is converted into outlays, particularly for defense and subsidized housing. CBO's anticipated "spendout rates" raise outlays $4 billion to $7 billion per year above OMB's estimates.

Mandatory spending. On net, OMB estimates that the President's proposals would boost mandatory spending about $4 billion per year. Most of the increase would be for provisions expected to be authorized in the tobacco legislation--namely unrestricted grants to state governments and a variety of health initiatives. In addition, the President wants to raise spending on education programs, child care, and food stamps. The President's plan to extend Medicare to certain individuals under age 65 is expected to have little effect on the budget, at least in the near term; this plan would allow persons aged 62 to 64 to purchase Medicare on an actuarially fair basis (some of which may be paid after age 65 though increased premiums) and allow previously insured displaced workers over age 55 to buy into Medicare at set rates. Elsewhere, the Administration expects to save nearly $17 billion over five years by reversing a ruling concerning veterans' compensation for tobacco-related illnesses; last year they were ruled to be service-related disabilities. CBO estimates that the President's mandatory spending initiatives would be more costly than the OMB expects, reflecting

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4. Two budget control mechanisms are in place; discretionary spending caps and the PAYGO system which controls mandatory spending and taxes. In the past, there have been shifts in budget resources between discretionary and mandatory spending, but there have not yet been instances of interchanging resources between taxes and discretionary spending.

5. In prior years, discretionary spending caps have been adjusted to offset the budget effects of changes to mandatory spending programs that were included in the appropriations bills. The President proposes to raise the budget caps in a similar manner to reflect higher receipts from the tobacco settlement, restoration of Superfund excise and income taxes, and increased airport and airway user fees.

different judgments about the cost savings that would emanate from this change in veterans' compensation. CBO's estimates for the expansion of Medicare are similar to those of the Administration.

Receipts. Both OMB and CBO estimate that the President's proposals would add about $19 billion per year (0.2 percent of GDP) to receipts once the changes are fully phased in. Most of the increase would come from legislation that the Administration anticipates will arise out of last year's tobacco settlement. Other key proposals affecting receipts include the following:

- Tax cuts amounting to about $5 billion per year when fully phased in, including an expanded child care credit, personal and business tax credits to promote energy efficiency and school construction, an extension of the research and experimentation tax credit, and tariff reductions.
- Tax increases on businesses, including limits on the use of foreign tax credits, restrictions on rules for corporate-owned life insurance, and changes in the tax treatment of reserves set aside for annuity contracts. Restoration of the expired Superfund excise and income taxes and conversion of the airport and airway trust fund excise taxes to user fees, but at higher effective rates.

1. The Budget Outlook under the President's Proposals
(Billions of dollars; fiscal years)

Measure	1998	1999	2000	2001	2002	2003
Office of Management and Budget						
February baseline[1]	-10	6	5	28	90	89
PLUS: New proposals	0	4	4	0	-1	-6
EQUALS: February surplus (deficit, -)	-10	10	9	28	90	83
Congressional Budget Office						
January baseline[1]	-5	-2	-3	14	69	54
PLUS: Changes to baseline	13	11	4	-1	-2	-1
EQUALS: March baseline[1]	8	9	1	13	67	53
PLUS: New proposals	1	-5	-6	-5	-16	-11
EQUALS: Budget under President's proposals	8	4	-5	8	51	42

2. CBO Baseline Budget as a Percent of GDP
(Fiscal years)

Measure	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Receipts	19.9	19.6	19.4	19.4	19.3	19.3	19.3	19.3	19.3	19.3
Outlays	19.8	19.6	19.3	18.8	18.8	18.7	18.7	18.4	18.3	18.3
Surplus	.1	.0	.1	.7	.5	.7	.7	1.0	1.0	1.0
Debt	43	42	40	38	36	34	31	29	27	25
MEMO *OMB's budget under President's policies*										
Surplus	.1	.1	.3	.9	.8	1.0	1.2	1.4	1.7	2.0
Debt	44	42	40	38	35	33	30	28	25	22

3. Economic Assumptions
(Calendar years)

Measure	1998	1999	2000	2001	2002	2003
	Percentage change, Q4 to Q4					
Real GDP						
OMB	2.0	2.0	2.0	2.3	2.4	2.4
CBO	2.3	1.9	1.9	2.0	2.2	2.3
GDP price index						
OMB	2.0	2.1	2.2	2.2	2.2	2.2
CBO	2.1	2.2	2.4	2.5	2.4	2.5
Consumer price index						
OMB	2.2	2.2	2.3	2.3	2.3	2.3
CBO	2.4	2.5	2.7	2.8	2.8	2.8
	Annual average (percent)					
Unemployment rate						
OMB	4.9	5.1	5.3	5.4	5.4	5.4
CBO	4.8	5.1	5.4	5.6	5.8	5.9
3-month Treasury bill						
OMB	5.0	4.9	4.8	4.7	4.7	4.7
CBO	5.3	5.2	4.8	4.7	4.7	4.7
10-year Treasury note						
OMB	5.9	6.1	6.0	5.9	5.9	5.9
CBO	6.0	6.1	6.0	5.9	5.9	5.9

4. OMB Estimates of the President's Budget Proposals
(Billions of dollars; fiscal years)

Proposal	1998	1999	2000	2001	2002	2003	1998-2003
	Changes from baseline						
Receipts	-.1	12.9	14.7	16.7	18.5	18.7	81.5
Tobacco legislation	.0	9.8	11.8	13.3	14.5	16.1	65.5
Other	-.1	3.1	2.9	3.4	4.0	2.6	16.0
Tax relief	-.5	-3.2	-5.1	-5.5	-5.0	-5.4	-24.2
Tax increases	.4	6.3	8.0	8.8	9.0	8.0	40.2
Mandatory spending	.0	4.5	5.1	5.8	2.5	3.3	21.3
Tobacco legislation[1]	.0	3.4	3.9	4.6	5.0	5.4	22.3
Other	.0	1.1	1.2	1.2	-2.5	-2.1	1.0
Veterans compensation	.0	-.7	-1.3	-2.3	-6.3	-6.3	-17.0
Medicare buy-in	.0	.1	.4	.4	.3	.3	1.5
Other	.0	1.7	2.1	3.1	3.5	3.9	16.5
Discretionary spending[2]	.0	4.8	8.4	10.2	15.6	21.7	60.7
	Level of discretionary spending						
MEMO							
Current dollars							
Proposed	553	566	574	575	577	595	...
Capped baseline	553	561	565	565	561	574	...
1992 dollars							
Proposed	478	479	475	466	457	461	...
Capped baseline	478	474	468	458	445	444	...

1. Includes unrestricted grants to states and various health initiatives.
2. Excludes fiscal 1998 supplemental appropriations.
... Not applicable.
SOURCE. Budget of the United States Government.

DOMESTIC FINANCIAL DEVELOPMENTS

Selected Financial Market Quotations[1]
(Percent except as noted)

Instrument	1997 Sep. 30	1998 Jan. 2	1998 FOMC * Feb. 4	1998 Mar. 24	Change to Mar. 24, from: Sep. 30	Jan. 2	FOMC * Feb. 4
Short-term rates							
Federal funds							
intended rate [2]	5.50	5.50	5.50	5.50	.00	.00	.00
realized rate [3]	5.51	5.44	5.53	5.42	-.09	-.02	-.11
Treasury bills [4]							
3-month	4.93	5.18	5.12	5.03	.10	-.15	-.09
6-month	5.08	5.19	5.08	5.01	-.07	-.18	-.07
1-year	5.18	5.18	4.98	5.09	-.09	-.09	.11
Commercial paper							
1-month	5.51	5.56	5.48	5.53	.02	-.03	.05
3-month	5.48	5.54	5.40	5.47	-.01	-.07	.07
Large negotiable CDs [4]							
1-month	5.59	5.64	5.52	5.58	-.01	-.06	.06
3-month	5.67	5.69	5.52	5.58	-.09	-.11	.06
6-month	5.72	5.71	5.53	5.60	-.12	-.11	.07
Eurodollar deposits [5]							
1-month	5.56	5.59	5.50	5.56	.00	-.03	.06
3-month	5.63	5.69	5.53	5.56	-.07	-.13	.03
Bank prime rate	8.50	8.50	8.50	8.50	.00	.00	.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	5.88	5.62	5.36	5.52	-.36	-.10	.16
10-year	6.12	5.67	5.56	5.58	-.54	-.09	.02
30-year	6.41	5.86	5.86	5.88	-.53	.02	.02
U.S. Treasury 10-year indexed note	3.61	3.70	3.66	3.71	.10	.01	.05
Municipal revenue (Bond Buyer) [6]	5.63	5.41	5.33	5.36	-.27	-.05	.03
Corporate-A utility, recently offered	7.44	6.96	6.96	7.06	-.38	.10	.10
High-yield corporate [7]	9.02	9.04	8.88	8.83	-.19	-.21	-.05
Home mortgages [8]							
FHLMC 30-yr fixed rate	7.28	7.03	7.12	7.08	-.20	.05	-.04
FHLMC 1-yr adjustable rate	5.51	5.50	5.59	5.67	.16	.17	.08

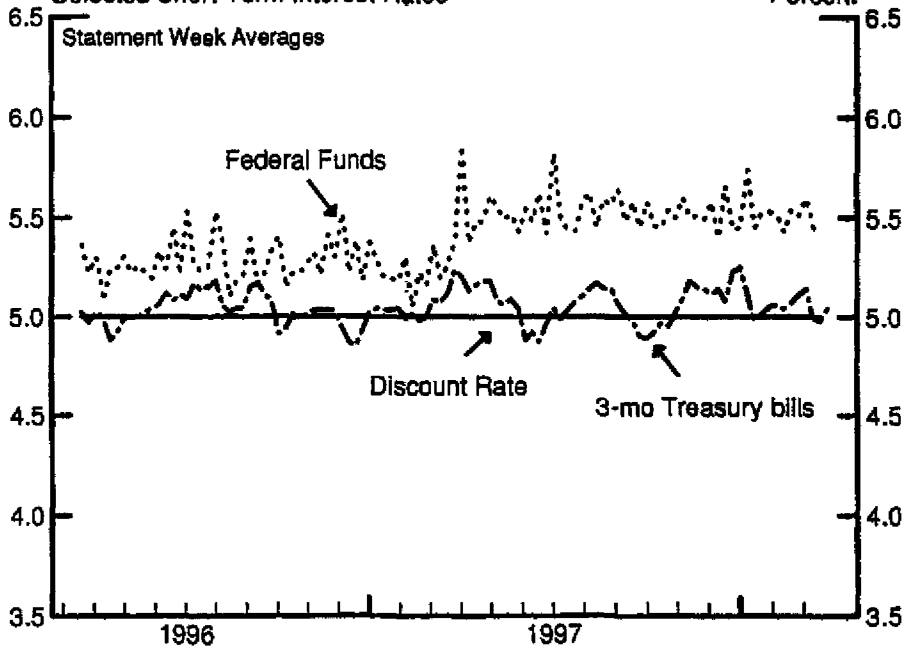
Stock exchange index	Record high Level	Record high Date	1998 Jan. 2	1998 FOMC * Feb. 4	1998 Mar. 24	Percentage change to Mar. 24, from: Record high	Jan. 2	FOMC * Feb. 4
Dow-Jones Industrial	8906.43	3/20/98	7965.04	8160.35	8904.44	-.02	11.79	9.12
S&P 500 Composite	1105.65	3/24/98	975.04	1006.00	1105.65	.00	13.40	9.91
NASDAQ (OTC)	1812.44	3/24/98	1581.53	1666.34	1812.44	.00	14.60	8.77
Russell 2000	476.26	3/24/98	436.52	437.80	476.26	.00	9.10	8.78
Wilshire	10507.21	3/24/98	9327.71	9565.62	10507.21	.00	12.65	9.84

1. One-day quotes except as noted.
2. FOMC's intended rate.
3. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
4. Secondary market.
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.

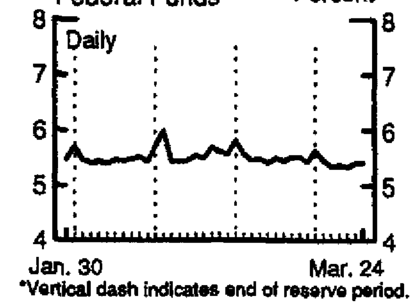
* Figures cited are as of the close on February 3, 1998.

Selected Interest Rates

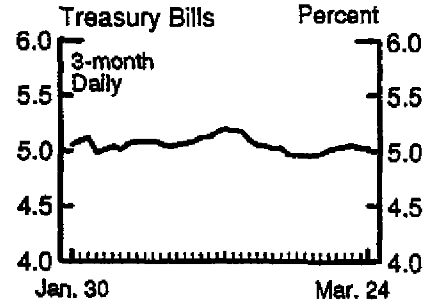
Selected Short-Term Interest Rates



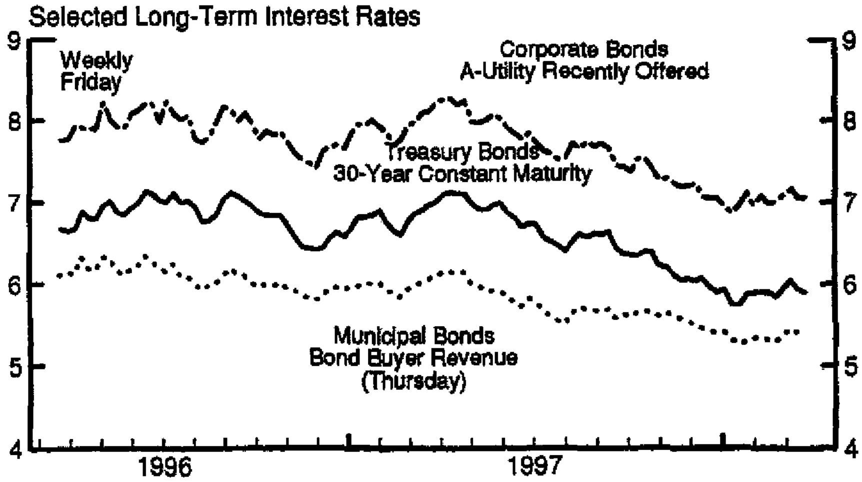
Federal Funds*

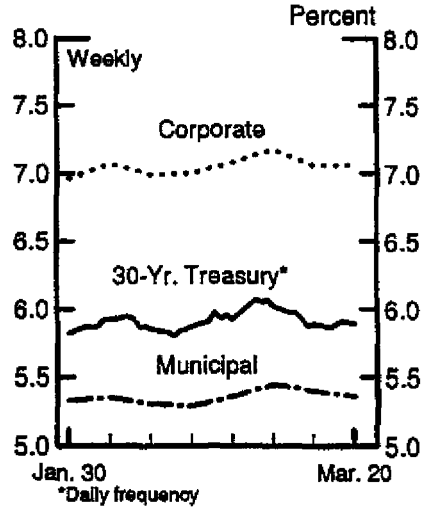


Treasury Bills

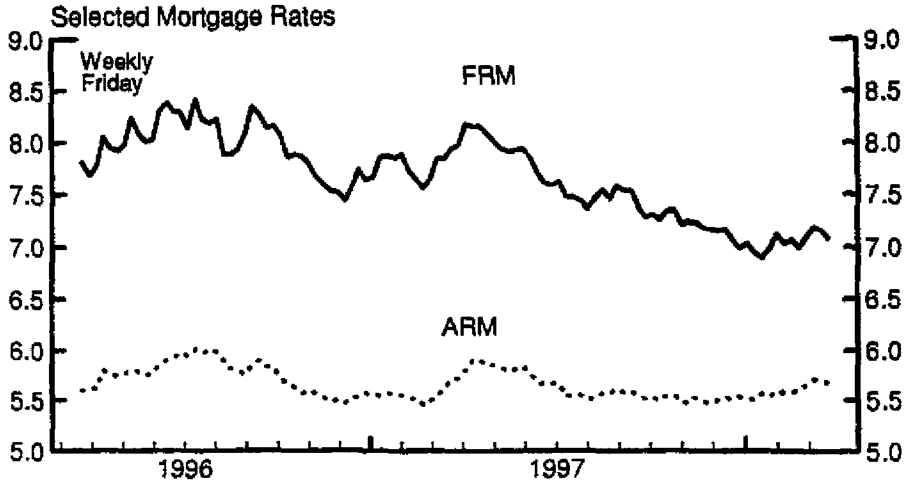


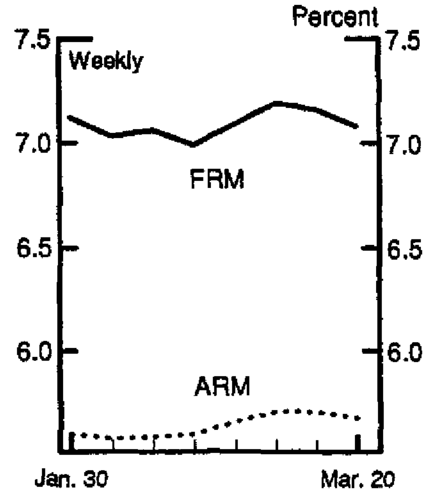
Selected Long-Term Interest Rates





Selected Mortgage Rates





Most interest rates are unchanged or a little higher, on balance, since the last FOMC meeting. Market participants generally interpreted Chairman Greenspan's Humphrey-Hawkins testimony as signaling that Fed policymakers were less inclined toward easing than had been thought. With incoming data on the strong side, rates rose in late February but retraced a good bit of that advance in early March. Although some economic reports this month came in stronger than anticipated, others showed inflation to be low, and declining oil prices may have reinforced expectations that inflation would remain in check. Federal funds futures rates are flat through the summer, suggesting (after allowance for a small term premium) low odds of a policy easing later in the year (chart). Despite some evidence of slipping corporate credit ratings and weaker profit prospects, quality spreads have held steady and equity prices have advanced sharply.

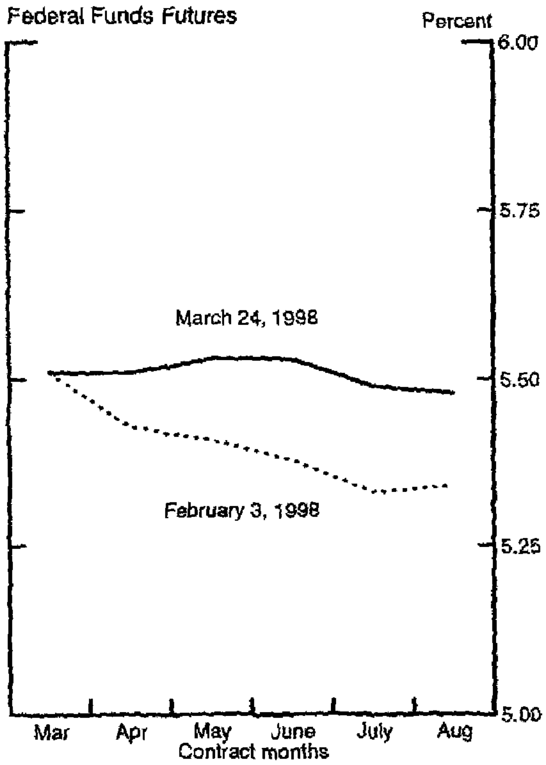
Borrowing, except by the federal government, has been substantial of late. With long-term interest rates at relatively low levels, businesses have issued a considerable amount of bonds, but they have also tapped the commercial paper market and banks in volume. Low interest rates have spurred mortgage debt growth, which rose toward year-end and seems to have remained strong this quarter. Some of this mortgage borrowing has probably replaced consumer loans, damping growth in consumer credit. State and local governments have taken advantage of improved budget positions and a favorable rate environment to finance long-needed investment projects and to refinance more costly debt. The continued improvement of the fiscal position of the federal government has held down Treasury borrowing.

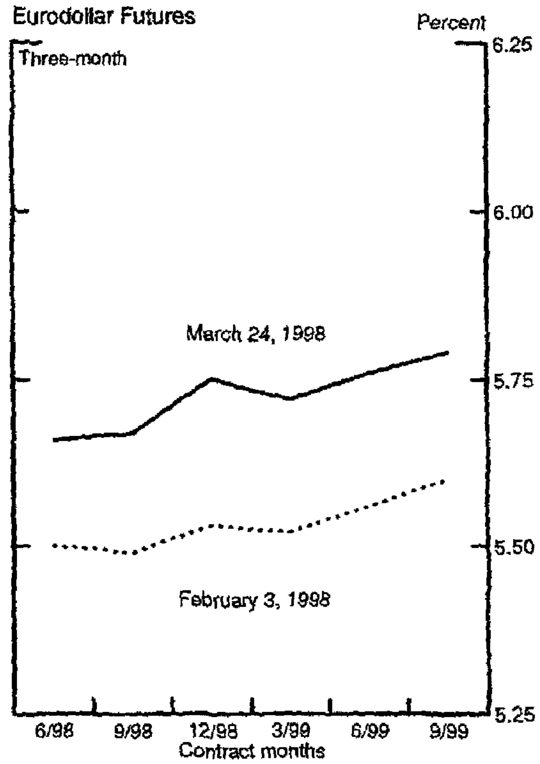
The rapid growth in the monetary aggregates in the final quarter of last year has extended into the early months of this year. M2 is growing rapidly relative to estimates of nominal income, even though its opportunity cost has not changed much. Growth of M3 has been boosted by funding needs arising from the rapid expansion of bank assets, reflecting the overall strong demand for credit.

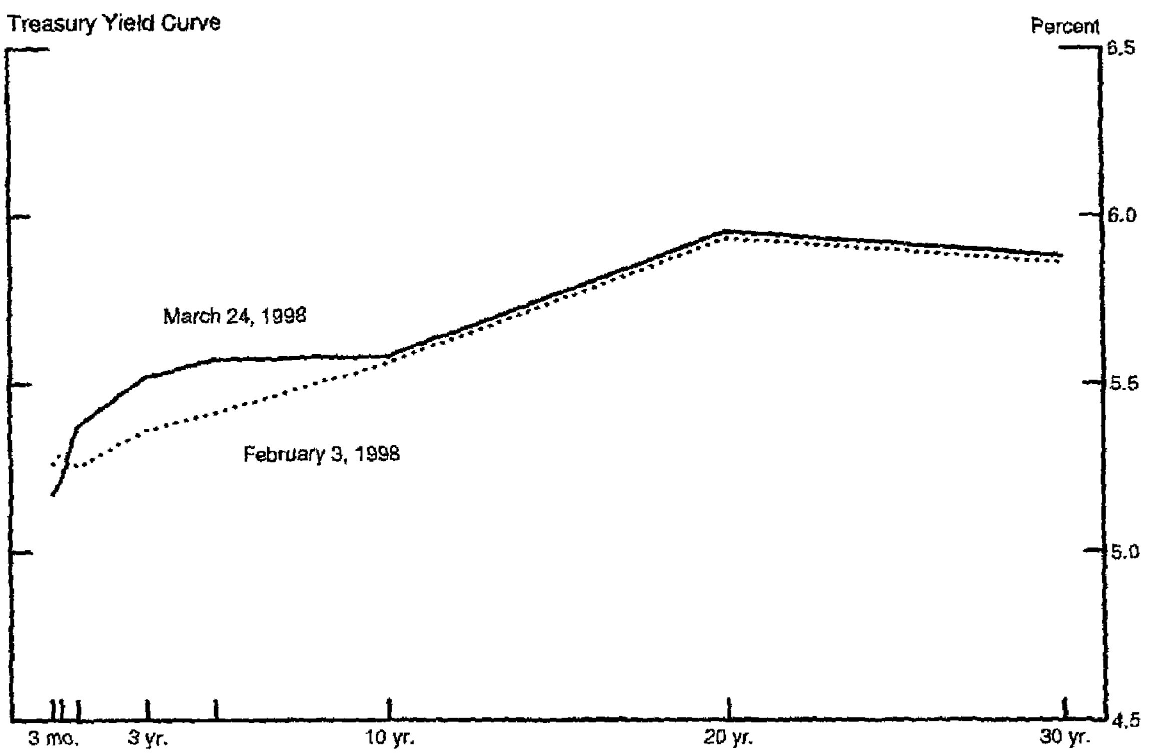
Business Finance

Business borrowing has been robust in all sectors of the credit markets, bolstered in part by brisk merger activity. Gross issuance

Selected Financial Market Quotes







of investment-grade bonds by nonfinancial corporations was a strong $9 billion in February (table), after extremely heavy issuance in January, and partial data suggest continued brisk issuance this month. Speculative-grade bond offerings were strong in both January and February and only slightly less so in early March. Proceeds were used partly to finance investment in the capital-intensive telecommunication sector. Net issuance of nonfinancial commercial paper was heavy in February, though below the torrid January pace; data for the first part of this month show some cooling off. Borrowing from banks by nonfinancial corporations continued at a double-digit pace last month but has probably slowed a bit in March.

Recent indicators hint at a slight deterioration in corporate credit quality. Over January and February, Moody's downgraded $53 billion more of nonfinancial corporate debt than it upgraded, at an annual rate (chart). Looking forward, Moody's has $20 billion more nonfinancial debt under review for a possible downgrade than it has under review for a possible upgrade. In addition, the percentage of total business liabilities accounted for by failed businesses moved up in January and February mainly because of the bankruptcy filings of two large retailers (chart).

Still, overall credit quality remains good, and debt markets have absorbed all this borrowing by businesses with little effect on rate spreads. After moving up late last year, spreads between investment-grade bonds and thirty-year Treasuries have held fairly steady so far this year. The junk-bond spread over Treasuries has come down after rising in January and is just above historic lows. Spreads on bank business loans have been little changed recently.

Market reports on the outlook for corporate profits have been mixed over the intermeeting period. The Institutional Brokers Estimate System (I/B/E/S) "bottom-up" forecast of year-ahead earnings for the S&P 500--an aggregation of projections from individual company analysts--was revised down sharply in February (chart). This owed mainly to analysts' expectations of the negative impact of lower oil prices on energy companies, the looming effects of the Asian crisis, and greater competitive pricing pressures on prominent technology companies. Preliminary data for March indicate substantial further downward revisions. Even after these revisions, the "bottom-up" outlook has 1998 profit growth at an optimistic 9 to 10 percent. In contrast, I/B/E/S's "top-down" forecast of year-ahead S&P 500 profit growth--an average of the macro projections of

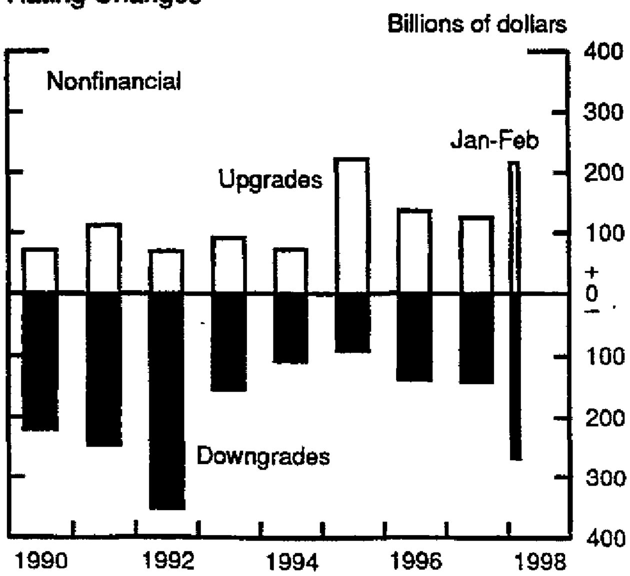
GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS
(Billions of dollars; monthly rates, not seasonally adjusted)

			1997			1998	
Type of security	1996	1997	Q3	Q4	Dec.	Jan.	Feb.
All U.S. corporations	58.4	69.7	76.7	72.0	69.9	74.7	72.0
Stocks[1]	10.2	9.8	8.7	11.6	8.4	7.5	8.8
Bonds	48.2	59.9	68.0	60.4	61.6	67.2	63.2
Nonfinancial corporations							
Stocks[1]	6.7	5.0	5.2	5.6	3.0	1.7	5.2
Initial public offerings	2.9	1.8	1.8	2.5	.9	.4	1.6
Seasoned offerings	3.8	3.2	3.3	3.1	2.0	1.3	3.4
Bonds	12.5	17.3	21.5	16.9	12.9	29.5	21.9
By rating, sold in U.S.[2]							
Investment grade	6.3	7.4	9.9	6.8	5.8	17.8	9.0
Speculative grade	4.8	7.9	9.1	7.7	6.4	9.9	10.8
Public	2.3	1.5	1.0	.8	.7	1.6	.6
Rule 144A	2.5	6.5	8.1	6.9	5.7	8.3	10.2
Financial corporations							
Stocks[1]	3.5	4.8	3.5	6.0	5.5	5.9	3.8
Bonds	35.8	42.6	46.5	43.5	48.6	37.7	41.3
Memo:							
Net issuance of commercial paper, nonfinancial corporations[3]	-.1	1.1	.8	1.1	-4.9	8.3	5.9
Change in C&I loans at commercial banks[3]	5.3	6.7	8.0	7.1	10.0	4.3	12.1

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.

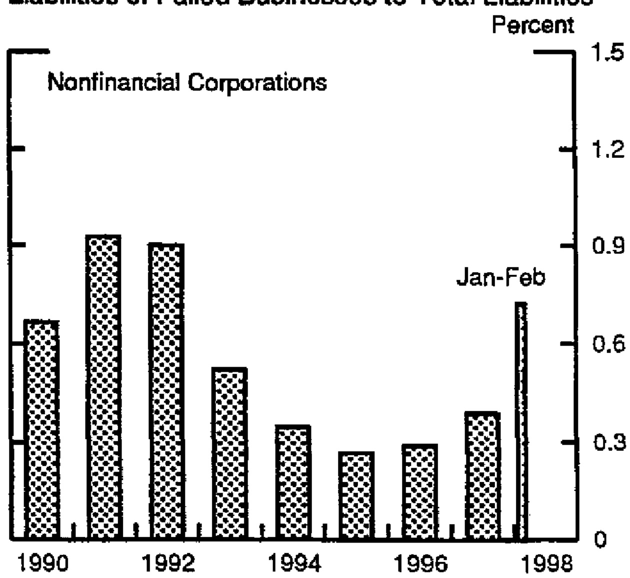
Credit Quality

Rating Changes



Source. Moody's. Jan-Feb observation at an annual rate.

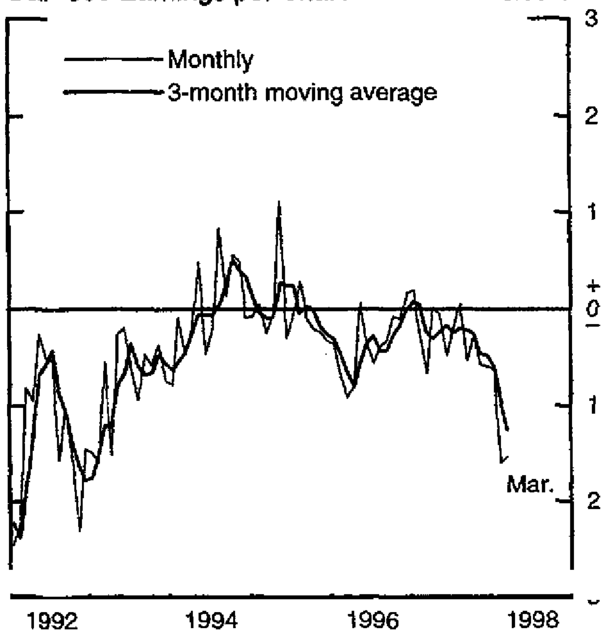
Liabilities of Failed Businesses to Total Liabilities



Source. Dun and Bradstreet. Jan-Feb observation is based on preliminary data, at an annual rate.

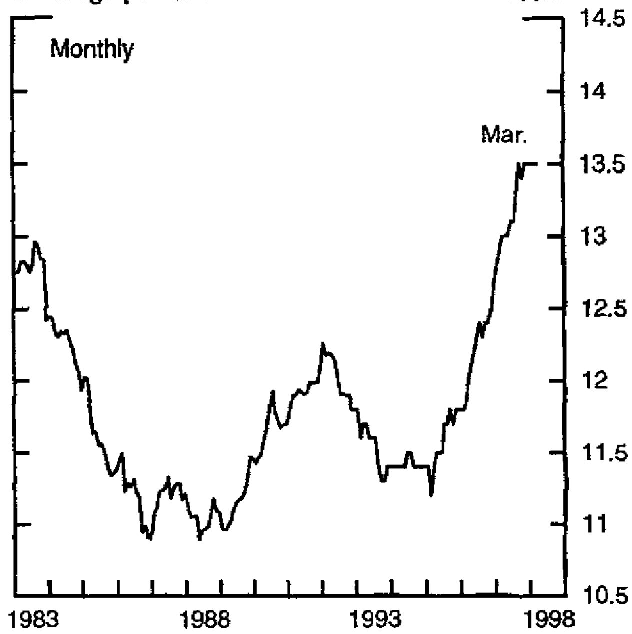
Corporate Earnings and Stock Prices

Revisions to Year-Ahead Projections of S&P 500 Earnings per Share



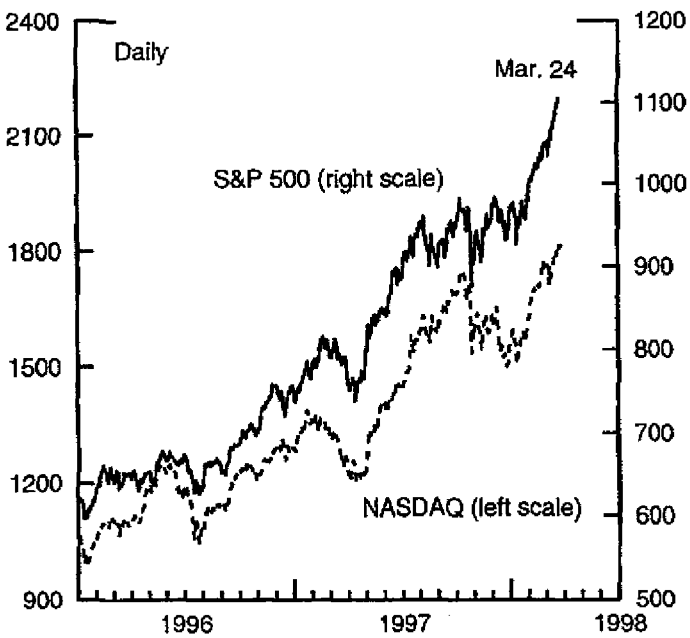
Source. I/B/E/S. Projections are from individual company analysts.

Expected Long-Term Growth of S&P 500 Earnings per Share

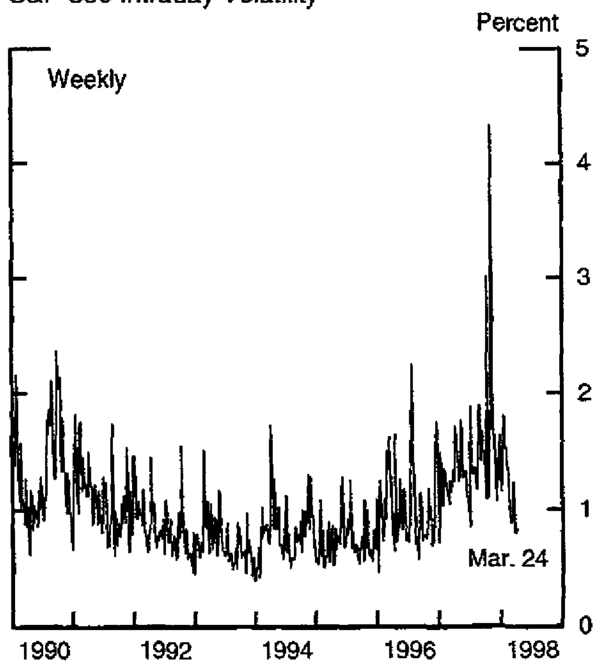


Source. I/B/E/S. Projections are from individual company analysts.

Selected Indexes

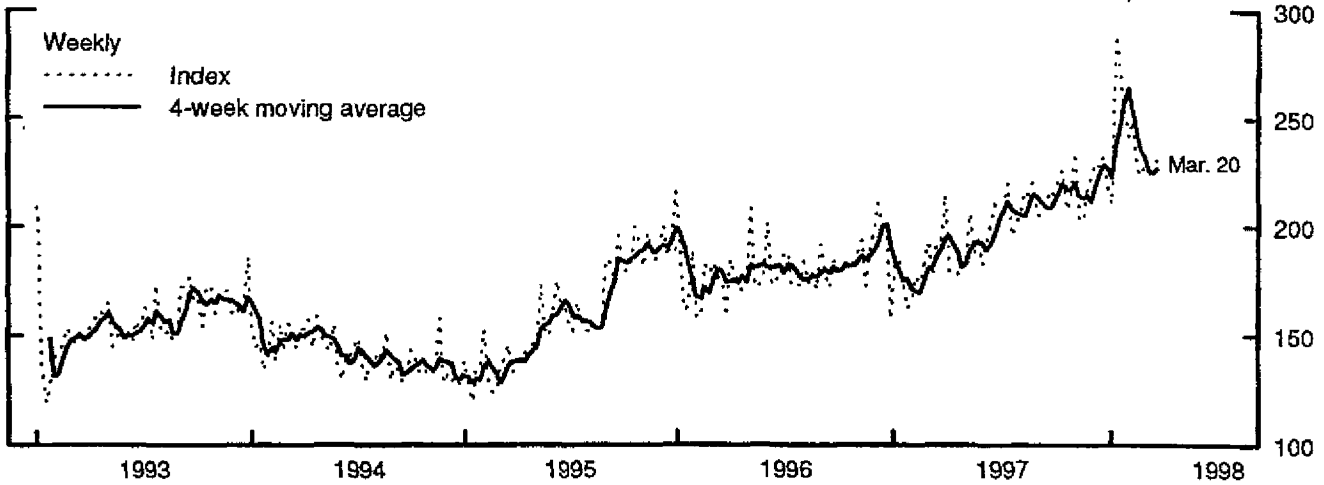


S&P 500 Intraday Volatility

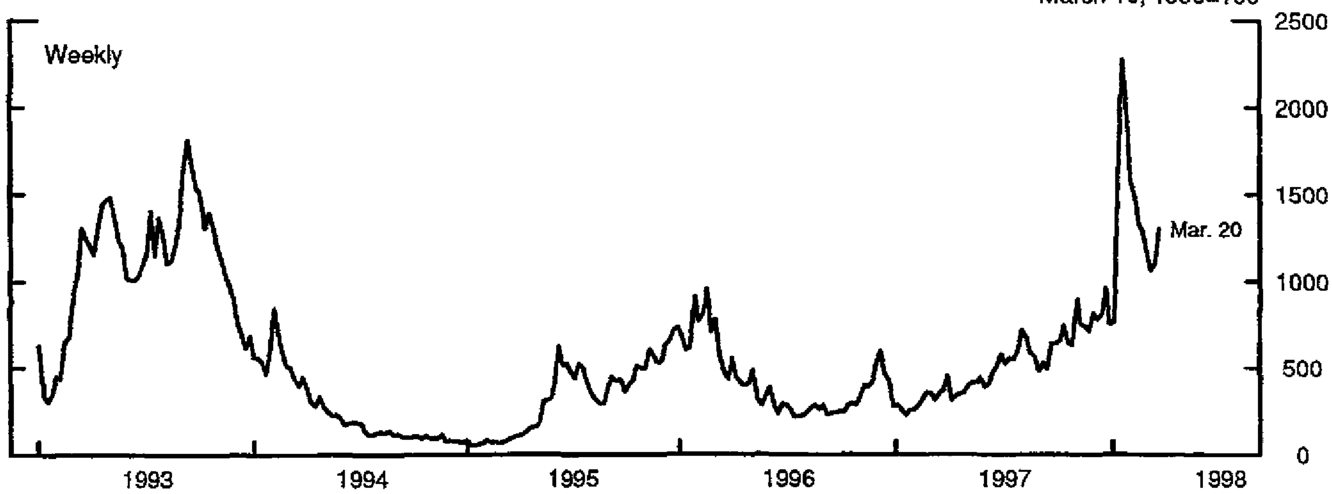


Note. Intraday volatility is the weekly average of the daily S&P 500 high minus low as a percentage of the low.

MBA Mortgage Purchase Application Index
(Seasonally adjusted by Board staff)



MBA Mortgage Refinancing Application Index
(Seasonally adjusted by Board staff)



CONSUMER CREDIT OUTSTANDING
(Percent change, seasonally adjusted annual rate)

			1997					1998
	1996	1997	Q2	Q3	Q4	Nov.	Dec.	Jan. p
Total	7.8	4.6	4.8	4.2	3.3	-4.8	4.7	2.8
Auto	7.7	5.9	7.3	6.4	9.0	-5.2	19.6	6.8
Revolving	12.7	6.3	5.3	7.9	3.4	-2.1	2.3	6.1
Other	0.5	0.0	0.8	-5.3	-4.7	-9.2	-12.0	-9.2

p Preliminary.

strategists--has been revised down only slightly. This outlook has been well below the "bottom-up" forecast, and it continues to project 1998 profit growth of about 6 to 7 percent. At the same time, long-run corporate profit expectations have not been revised down at all. I/B/E/S's "bottom-up" forecast of five-year earnings growth remained at its record level in March (chart).

Perhaps reflecting the still-optimistic long-run forecasts of earnings, the stock market as a whole has been largely impervious to short-run profit concerns (chart). Indeed, major indexes have risen 8-3/4 to 10 percent in the intermeeting period, leaving price-earnings ratios at or near all-time highs. Meanwhile, volatility of equity prices has subsided in recent weeks from the very high levels reached at the onset of the Asian crisis (chart).

Gross equity issuance increased in February, to $5-1/4 billion, swollen by issues to finance mergers and acquisitions and a step-up of initial public offerings, as pricing conditions for new shares improved. Partial data for March suggest that gross issuance has remained healthy. Net equity issuance, however, continued to be negative, as mergers and acquisitions retired nearly $18 billion of equity over the first two months of the year. This amount was a bit above the strong average monthly pace of last year. Share repurchases also likely remained brisk, as announcements have totaled $22 billion so far this year.

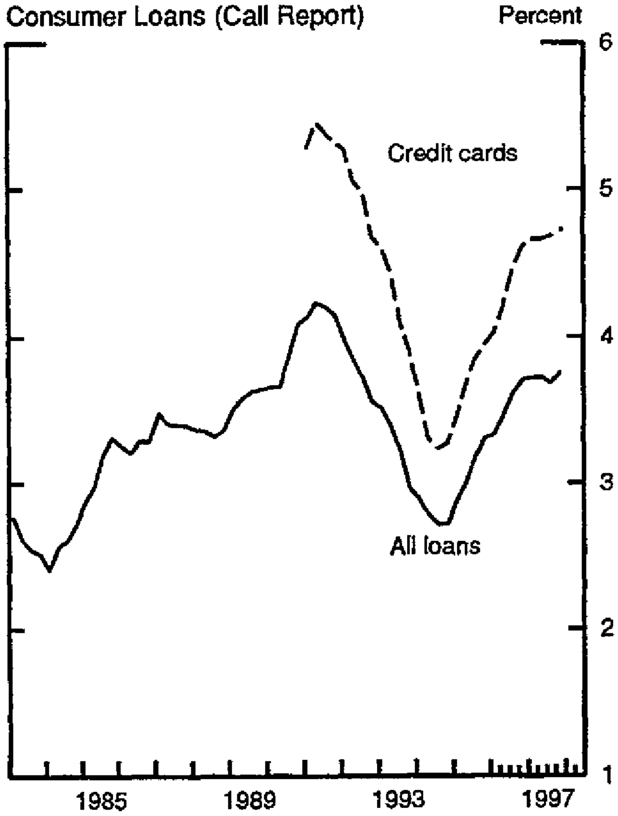
Household Finance

Current indicators point to solid growth in household debt this quarter, near the brisk pace of late last year. According to our flow of funds estimates, growth in home mortgage debt climbed to an 8-1/4 percent annual rate in the fourth quarter of 1997, and information on the first quarter suggests little slackening: Real estate loan growth at banks and information on mortgage pools, coupled with increases in reported home sales and high readings on the application indexes of the Mortgage Bankers Association (MBA), all point to continued strength. Though off its peak early in the year, the MBA purchase-money index has remained in historically high territory throughout the first quarter (chart). The MBA refinancing index also remains high, although below its peak in early January (chart).[1]

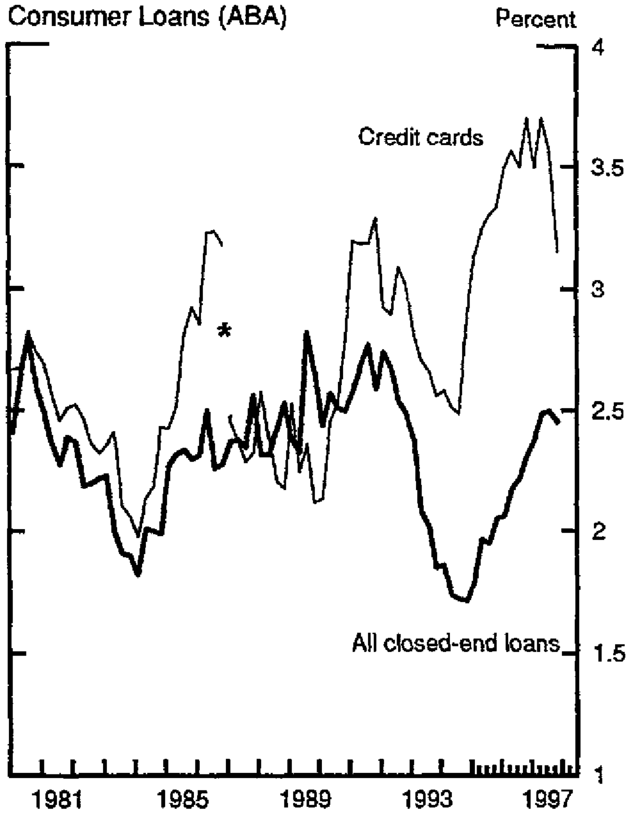
1. The sharp spike in the refinancing index in January likely reflects some bunching of applications that were delayed or postponed for the Christmas holidays and hence may overstate the strength of underlying activity.

Delinquency Rates on Household Debt
(Seasonally adjusted, quarterly)

Consumer Loans (Call Report)

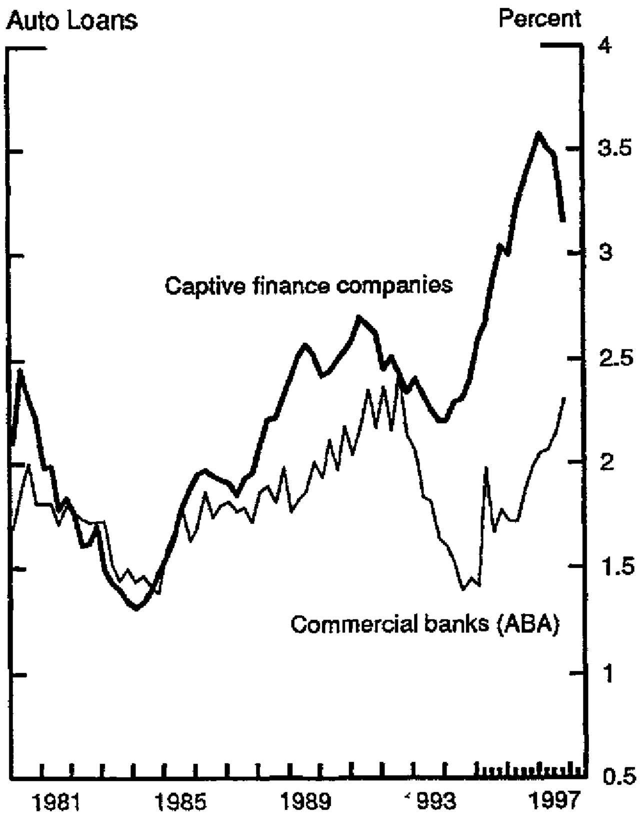


Consumer Loans (ABA)

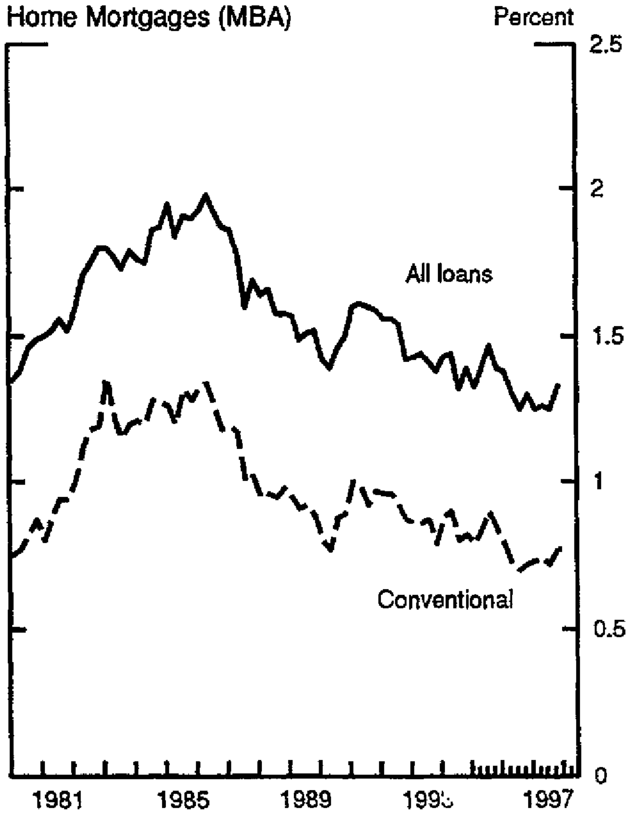


* Break in series between 1986 and 1987.

Auto Loans



Home Mortgages (MBA)



Note. Loans past due 60 days or more.

Consumer credit expanded about 2-3/4 percent at an annual rate in January (table), extending the gradual slowing trend that began in 1995. Some slowdown is fairly typical for consumer credit in the more advanced stages of an economic expansion.[2] Last year's deceleration, however, was amplified by households stepping up their use of home equity debt (included in the mortgage debt statistics) as an alternative to consumer loans. The staff estimates that this substitution shaved roughly 3 percentage points from consumer debt growth and added 1 percentage point to mortgage debt growth in 1997. This year, cash-out refinancings of home mortgages may be substituting for both consumer and home equity credit.

Recent trends in household debt quality generally have been encouraging. Call Report data for all domestically chartered banks, which leveled out last year, showed only a small rise in delinquency rates on all consumer loans and on credit card loans in the fourth quarter (chart). Data from the American Bankers Association (ABA) showed a slight drop in the delinquency rate for all closed-end consumer loans and a steep drop for credit card accounts in the fourth quarter (chart), but these results are considered less reliable than Call Report data.[3]

Other performance measures were mixed. After reaching record highs in the first part of 1997, delinquency rates at the captive auto finance companies dropped sharply at year-end. In contrast, the ABA series on auto loan delinquencies rose noticeably in the fourth quarter (chart). The MBA reported small increases in mortgage delinquency rates in the fourth quarter, but these rates had been hovering near their lowest levels in twenty years (chart). Meanwhile, the rating agencies reported declining charge-offs in January and February on credit card receivables backing asset-backed securities. Finally, the steep rise in personal bankruptcies that

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2. In the early stages of an expansion, net increases in consumer debt tend to be large because an upturn in spending for consumer durables boosts loan originations while debt repayments remain low. As the expansion progresses, however, debt expands and repayments--a function of past originations--begin to rise more rapidly, providing more of an offset to new originations and resulting in smaller net additions to the stock of debt.

3. The ABA series measure the number of delinquent loans as a percentage of the total number outstanding and are based on a sample of banks. Call Report data measure the dollar amount of delinquent loans as a percentage of the dollar amount outstanding and are for all banks. The ABA also has a delinquency rate series based on dollar amounts, but it is not seasonally adjusted. This series showed a moderate drop in credit card delinquencies in the fourth quarter of 1997.

TREASURY FINANCING
(Billions of dollars)

Item	1997 Q2	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
Total surplus / deficit(-)	100.1	-10.9	-39.7	13.6	25.4	-41.7
Means of financing deficit						
Net borrowing	-69.2	10.6	33.7	-1.8	-24.8	30.6
Nonmarketable	1.9	4.1	15.8	5.2	2.2	5.0
Marketable	-71.1	6.5	17.9	-7.0	-27.0	25.5
Bills	-81.4	-2.2	14.4	-3.4	-26.7	16.3
Coupons	10.3	8.7	3.5	-3.6	-0.2	9.2
Decrease in cash balance	-17.8	7.6	11.7	-12.1	-8.4	24.0
Other[1]	-13.1	-7.4	-5.7	0.2	7.9	-12.8
Memo:						
Cash balance, end of period	51.3	43.6	31.9	31.9	40.3	16.3

Note. Details may not sum to totals because of rounding.
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

NET CASH BORROWING OF GOVERNMENT-SPONSORED ENTERPRISES
(Billions of dollars)

Agency	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
FHLBs	5.2	18.7	5.2	-2.5	0.6
FHLMC	-1.9	9.2	-5.7	12.7	n.a.
FNMA	12.5	11.8	8.2	0.8	3.1
Farm Credit Banks	-0.5	1.9	2.4	-2.2	-0.1
SLMA	-4.3	-2.8	-2.6	n.a.	n.a.

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

began in mid-1995 slowed considerably in the second half of last year.

Federal Government Finance

The Treasury ran down its cash balance last quarter and is doing so again this quarter, thereby limiting its borrowing from the public. Nonetheless, to bridge seasonal needs for social security payments and early tax refunds, the Treasury auctioned two short-term cash management bills, which settled in mid-February and early March. The Treasury has chosen to absorb most of the effects of surprisingly strong tax inflows and increased issuance of indexed debt in the bill sector, leading to redemptions that have shrunk the stock of regular (three-month, six-month, one-year) bills by more than $100 billion since the beginning of last year. At the midquarter refunding in February the Treasury sold $35 billion of three-year, ten-year, and thirty-year securities, the same total amount as in November's refunding.

To contribute further to the development of the market for indexed debt, the Treasury announced plans to sell a thirty-year indexed bond in April 1998 but did not announce a planned auction size. About $41 billion of indexed debt, amounting to 1 percent of all marketable Treasury debt, is outstanding.

Shortly after the onset of the Asian currency crises, the prospect of sizable liquidity needs in the region sparked fears of massive sales of Treasury securities. There was a moderate amount of selling among Asian holders just after the crisis began in the fall of last year, and in December 1997 public and private Asian holders (mainly Japanese) were big net sellers, liquidating about $15 billion of Treasury securities. Treasury data for January 1998, however, show that net sales slowed to about half that amount.

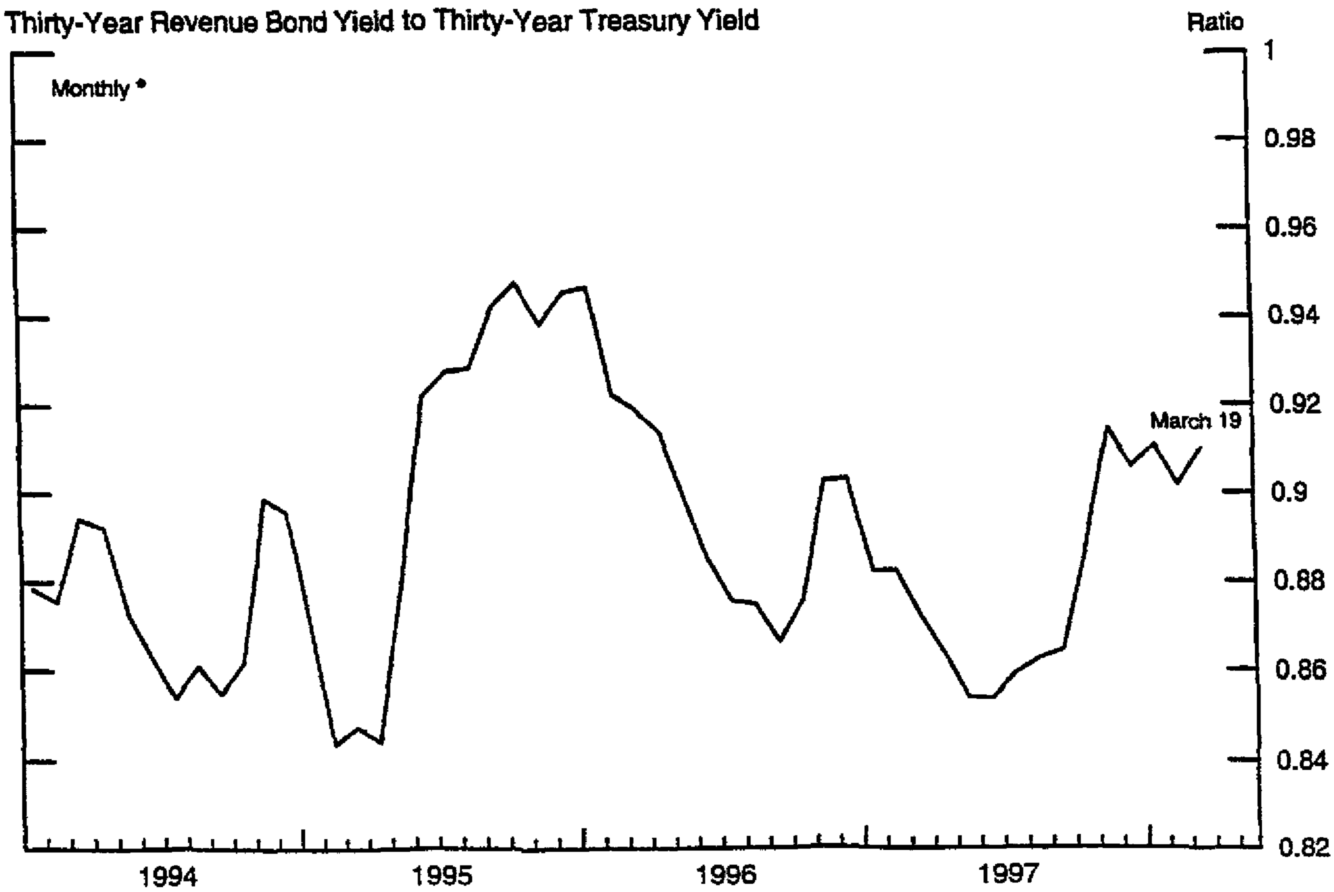
Spreads between rates on noncallable federal agency securities and Treasuries remained steady over the intermeeting period, even as government-sponsored enterprises (GSEs) continued to issue lots of debt. In global issues alone, GSEs marketed bonds worth nearly $18 billion, with the bulk of that denominated in U.S. dollars. A further spur to GSE offerings has been reduced issuance by the Treasury. Fannie Mae and, more recently, Freddie Mac have seen this as an opportunity to lower their borrowing costs by providing bonds that can compete--via their size, liquidity, and maturity--with Treasuries as benchmark instruments. The housing agencies are well

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

	1995	1996	1997	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb.
Total tax-exempt	15.4	17.9	21.5	24.7	24.0	22.5	18.7	22.1
Long-term	12.1	14.3	17.9	18.9	21.1	21.3	16.8	21.3
Refundings[1]	3.6	4.9	6.6	8.9	8.0	7.9	7.1	8.8
New capital	8.5	9.4	11.3	10.0	13.1	13.5	9.7	12.5
Short-term	3.3	3.6	3.6	5.8	2.9	1.2	1.9	0.8
Total taxable	0.7	0.8	1.1	0.9	0.9	0.8	1.0	0.7

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

Tax-Exempt to Taxable Yield Ratio



*Average of weekly data. Last value is average of weeks to date.

placed to expand their balance sheets to take advantage of this opportunity.

State and Local Government Finance

Though somewhat off last quarter's rapid pace, gross issuance of long-term municipal debt was strong in January and February (table). A generally favorable interest rate environment kept refundings moving along at a good clip. Strong economic growth has improved the fiscal position of state and local governments and has made governments more comfortable about taking on additional debt. Authorities have, therefore, responded to relatively low rates by raising a substantial amount of new capital in February, especially to finance outlays for transportation, education, and health care. Even though the sector as a whole experienced larger operating surpluses, most state and local governments have been contemplating cutting taxes or saving for a rainy day, rather than reducing debt, as the best uses of the higher surpluses.

On balance over the intermeeting period, municipal bonds underperformed Treasuries, with the tax-exempt to taxable yield ratio rising to 0.91, near the high end of its range over the past two years (chart). This ratio has moved up since mid-1997, as interest rates have fallen and investors have priced into outstanding municipal securities the increased likelihood of calls or advance refundings.

Credit quality in the municipal market has continued to improve. Ratings changes by Standard & Poor's since the beginning of 1998 show upgrades exceeding downgrades by a large margin. The net upgrade has been widespread across sectors--health, housing, infrastructure, and power--and across geographic regions.

Money and Financial Intermediaries

The broad monetary aggregates grew rapidly in February. M3 expanded at an 8-1/2 percent annual rate, despite sharp declines in RPs and Eurodollars. M2 accelerated to a 9-1/4 percent annual rate. Only part of the pickup can be attributed to a more rapid pace of mortgage refinancing and somewhat elevated tax refunds, both of which can initially add to liquid deposits.

The rapid growth of M2 so far this year follows strong expansion in the second half of 1997. Over this period, nominal GDP was strong; however, M2 outpaced GDP, and its velocity fell, even as its measured opportunity cost (the three-month Treasury bill rate less the own rate on M2) was essentially unchanged. The

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1997	1997 Q3	1997 Q4	1997 Dec.	1998 Jan.	1998 Feb. (p)	1997:Q4 to Feb. 98 (p)	Level (bil. $) Feb. 98 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-1.2	.3	.8	7.6	-3.0	2.8	2.5	1075.8
2. M2[2]	5.6	5.4	6.8	6.8	7.2	9.3	7.9	4096.0
3. M3	8.7	8.1	9.9	11.2	10.7	8.5	10.3	5462.2
Selected Components								
4. Currency	7.5	7.0	8.7	10.2	5.6	9.8	8.6	431.0
5. Demand deposits	-2.0	.0	-3.7	7.9	-13.3	-2.8	-1.9	391.8
6. Other checkable deposits	-12.2	-10.1	-4.7	2.5	-1.0	.0	-.5	244.9
7. M2 minus M1[3]	8.2	7.3	9.0	6.5	10.9	11.6	9.8	3020.1
8. Savings deposits	9.9	7.1	12.2	11.3	12.2	13.2	12.0	1427.2
9. Small time deposits	1.9	2.6	.7	.6	1.5	-1.0	.3	965.6
10. Retail money market funds	15.8	16.1	15.6	4.8	22.9	28.0	19.9	627.4
11. M3 minus M2[4]	19.7	16.9	19.6	24.9	21.2	6.3	17.7	1366.2
12. Large time deposits, net[5]	18.1	16.1	12.7	18.9	11.6	26.0	19.3	599.4
13. Institution-only money market mutual funds	21.0	19.6	22.0	34.5	14.7	12.3	17.7	384.7
14. RPs	17.0	13.5	38.3	9.3	52.6	-25.9	19.0	239.8
15. Eurodollars	27.2	19.3	12.4	51.5	25.1	-34.4	8.6	142.2
Memo								
16. Sweep-adjusted M1[6]	6.2	6.1	7.1	9.7	2.5	6.1	6.1	1337.7
17. Monetary base	6.0	6.3	8.1	9.9	5.8	3.5	6.5	484.3
18. Household M2[7]	6.4	6.3	7.4	5.7	9.6	12.3	9.3	3705.3
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
19. Large time deposits, gross	11.2	12.0	8.4	7.7	2.5	13.1	...	698.1
20. Net due to related foreign institutions	-3.4	-4.0	-5.4	9.9	15.8	-9.8	...	209.6
21. U.S. government deposits at commercial banks	.2	-2.3	.8	-.1	1.4	-6.3	...	15.5

1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
2. Sum of seasonally adjusted M1, retail money market funds, savings deposits, and small time deposits.
3. Sum of retail money funds, savings deposits, and small time deposits, each seasonally adjusted separately.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees, each seasonally adjusted separately.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government, and foreign banks and official institutions.
6. 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.
7. M2 less demand deposits.
8. For the years shown, "average monthly change" is the fourth quarter-to-fourth quarter dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.

p--Preliminary.

surprisingly strong M2 growth may have owed partly to a continued rebalancing of household portfolios away from directly held instruments and toward M2 but was apparently not a reflow out of stock and bond mutual funds.

Preliminary data indicate strong net sales for both stock and bond mutual funds in February (table). Household interest in stock funds recovered from the reduced December-January pace, with domestic funds leading the way and international funds remaining out of favor. Disaggregated data provided by the Investment Company Institute indicate that stock funds specializing in Asian markets have seen very small positive net sales since the beginning of this year, in contrast to the net outflows experienced by these funds over the second half of last year. Although net inflows to bond funds dipped from January's high reading, they remained well above the monthly average of the past year. Press accounts have ascribed some of the strength in mutual fund sales to the popularity of the new Roth IRAs. This effect cannot be ruled out, but with IRAs accounting for only 5 percent of total fund sales in recent years, the current surge in Roth IRAs may not be responsible for much of the recent strength. Moreover, the flow of assets into Roth IRAs may owe more to a reallocation of household portfolios than to increases in household saving.

The rapid growth of stock funds and the sharp gains in the stock market over the past several years generated huge capital gains distributions by mutual funds last year, mainly in December, the month in which most distributions for the year are made (chart). Although some of these distributions were posted to tax-favored accounts, such as IRAs and 401(k) plans, a large portion is likely to be taxable, further swelling the Treasury's coffers this spring. Higher final income tax payments from this source, however, are unlikely to reduce consumer spending very much, either because the distributions and accompaning tax liabilities had been expected or because those receiving them have above-average income and assets with which to buffer any tax surprises.

Commercial banks maintained credit growth at around a 10 percent annual rate in January and February (table), and partial data suggest rapid growth again in March. Securities holdings, which were a major factor in asset expansion late last year, have increased less rapidly this year. Total loans, on the other hand, have accelerated, with the notable exception of consumer loans,

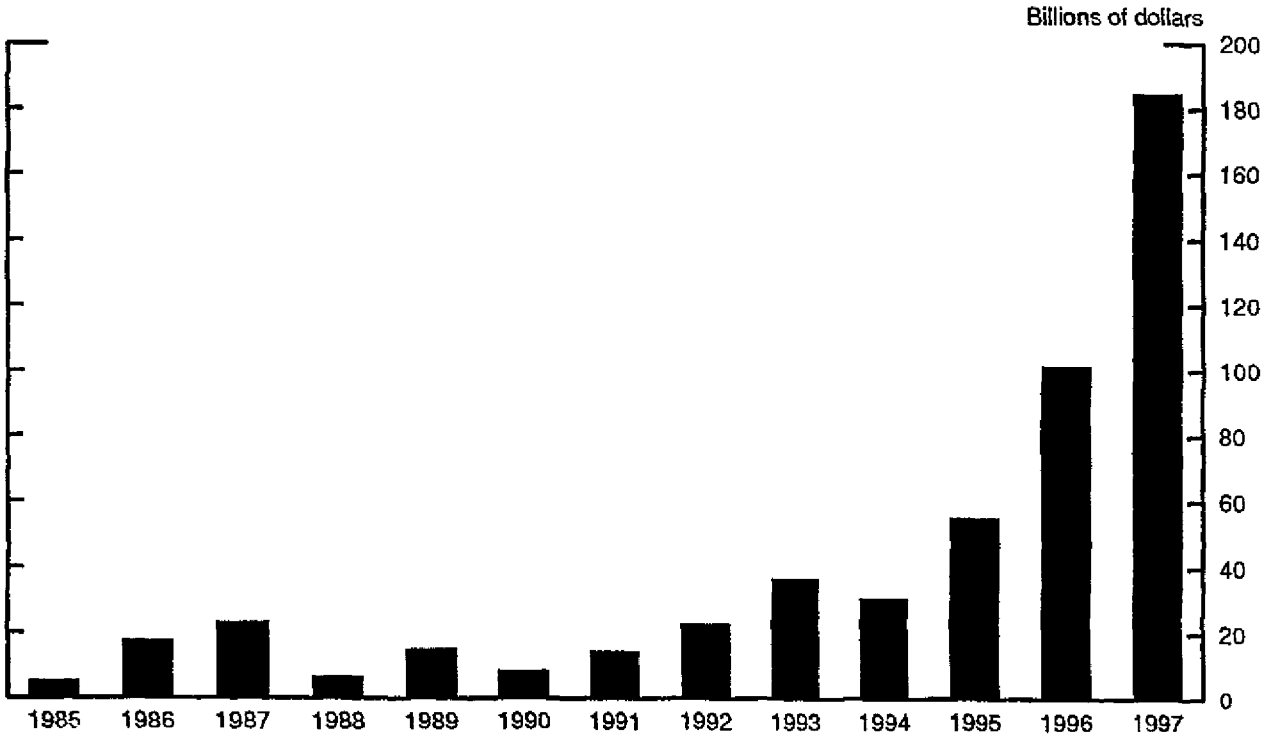
Net Sales of Stock and Bond Mutual Funds

(Excluding Reinvested Distributions)
(Billions of dollars; quarterly and annual data at monthly rate)

			1997			1998		Memo:
	1996	1997	Q3	Q4	Dec.	Jan.	Feb.e	Jan. Assets
Stock funds	**18.5**	**19.4**	**22.2**	**17.4**	**15.4**	**14.6**	**19.5**	**2,425**
Domestic equity[1]	14.7	16.4	18.7	18.0	16.6	15.6	18.9	2,074
Aggressive growth	4.7	3.1	4.8	3.1	2.2	0.0	1.3	370
Growth	3.9	4.8	5.9	6.3	6.1	5.8	6.5	685
Growth and income	6.2	8.5	7.9	8.7	8.3	9.7	11.2	1,016
International	3.9	3.0	3.5	-0.6	-1.2	-1.0	0.6	351
Bond funds	**1.3**	**4.0**	**5.1**	**6.6**	**5.5**	**11.3**	**8.5**	**1,055**
High-yield	1.0	1.5	1.6	1.7	2.2	3.0	1.1	109
Balanced	0.9	1.8	1.8	1.9	2.1	3.1	2.4	324
Other	-0.7	0.7	1.7	3.0	1.2	5.2	5.0	621

Source. Investment Company Institute (ICI).
1. Includes precious metals funds not shown elsewhere.
e ICI and staff estimates.

Capital Gains Distributions to Mutual Fund Shareholders



Source: ICI

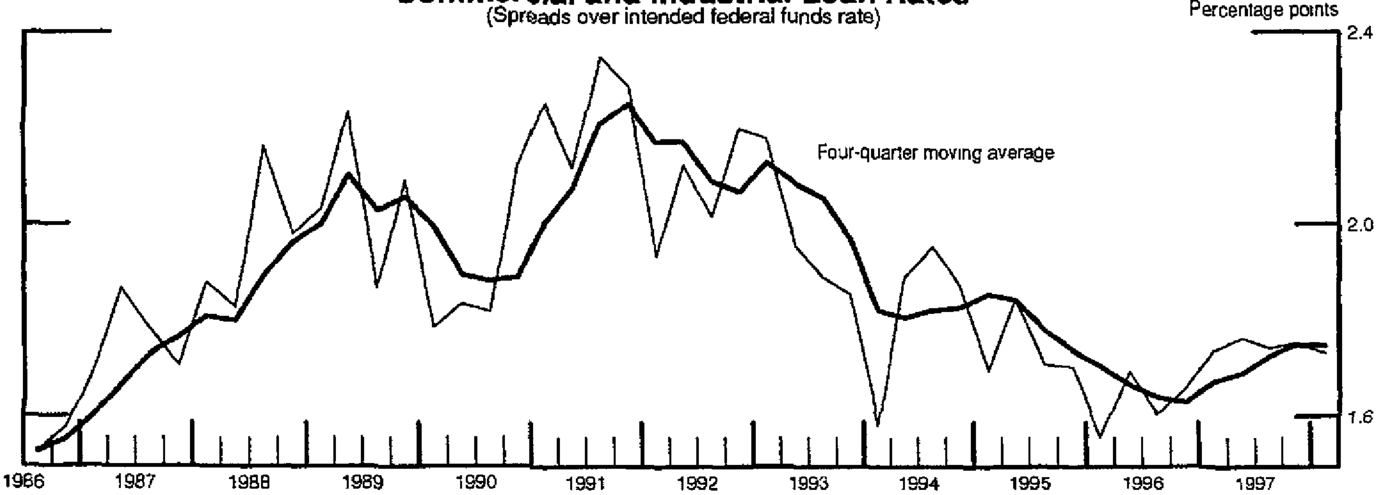
Commercial Bank Credit
(Percent change; seasonally adjusted annual rate)

Type of credit	1997	1997 Q3	1997 Q4	1997 Dec.	1998 Jan	1998 Feb.	Level, Feb 1998 (billions of $)
1. Bank credit: Reported	8.8	6.9	9.9	10.2	13.9	8.3	4,188.4
2. Adjusted[1]	8.4	6.0	10.1	10.6	10.8	9.9	4,088.7
3. Securities: Reported	9.9	4.1	18.3	22.7	18.2	1.6	1,120.1
4. Adjusted[1]	8.3	0.3	19.8	25.6	6.5	7.0	1,020.4
5. U.S. government	5.6	-0.4	11.9	10.0	16.1	9.1	768.2
6. Other[2]	20.8	15.3	33.7	51.5	22.3	-14.1	352.0
7. Loans[3]	8.4	7.9	7.0	5.6	12.3	10.8	3,068.3
8. Business	9.5	9.0	10.9	14.0	12.2	11.4	873.9
9. Real estate	9.1	9.2	6.3	0.0	2.7	13.9	1,244.6
10. Home equity	16.1	16.8	12.7	11.1	6.1	4.9	99.1
11. Other	8.6	8.6	5.8	-1.1	2.6	14.7	1,145.5
12. Consumer: Reported	-2.1	0.6	-6.3	-1.6	-7.6	-7.8	502.1
13. Adjusted[4]	3.6	3.3	6.0	5.2	2.9	0.8	716.6
14. Other[5]	19.8	11.4	18.3	14.0	65.1	22.1	447.6

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.

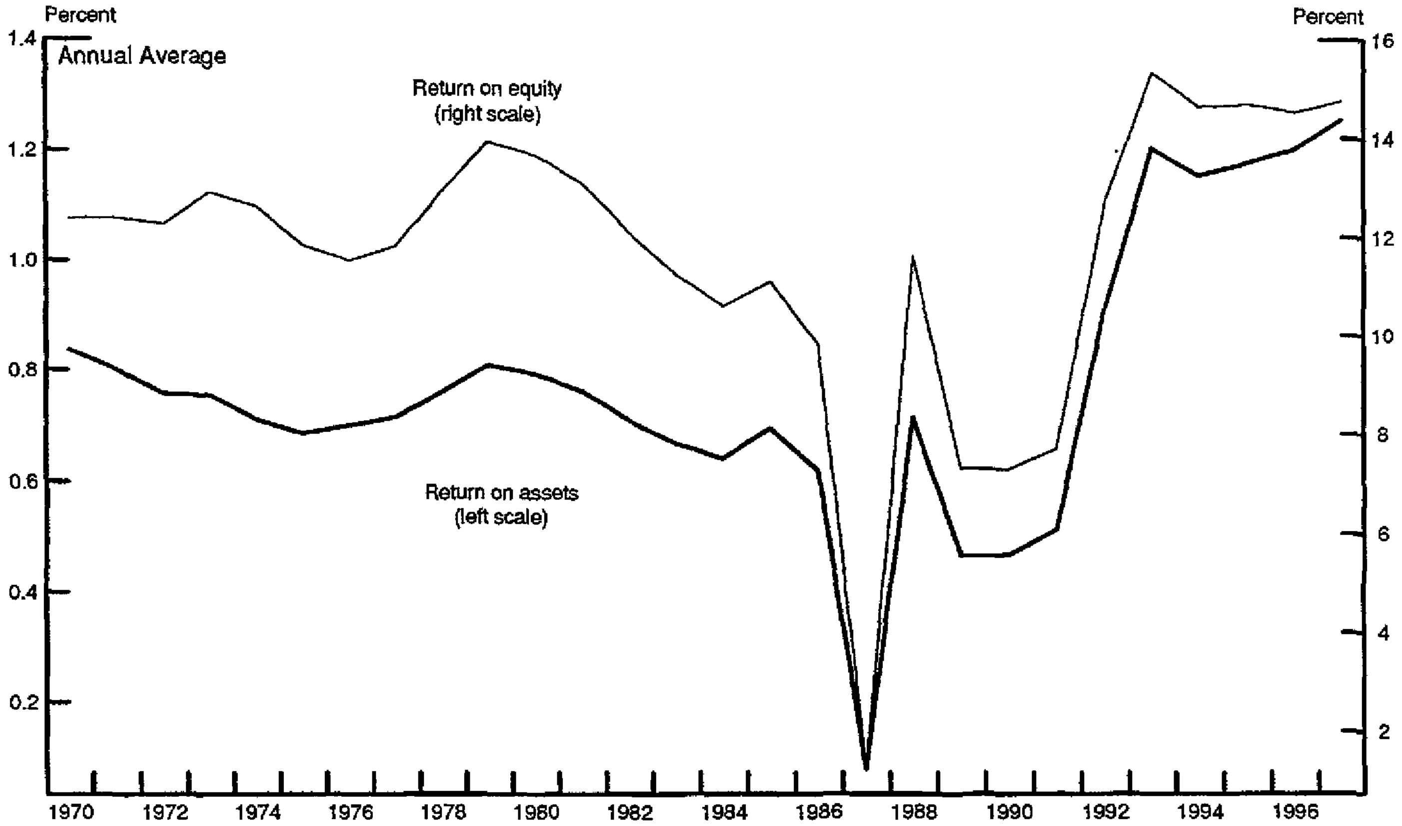
1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FASB 115).
2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not U.S. government securities.
3. Excludes interbank loans.
4. Includes an estimate 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.

Commercial and Industrial Loan Rates
(Spreads over intended federal funds rate)

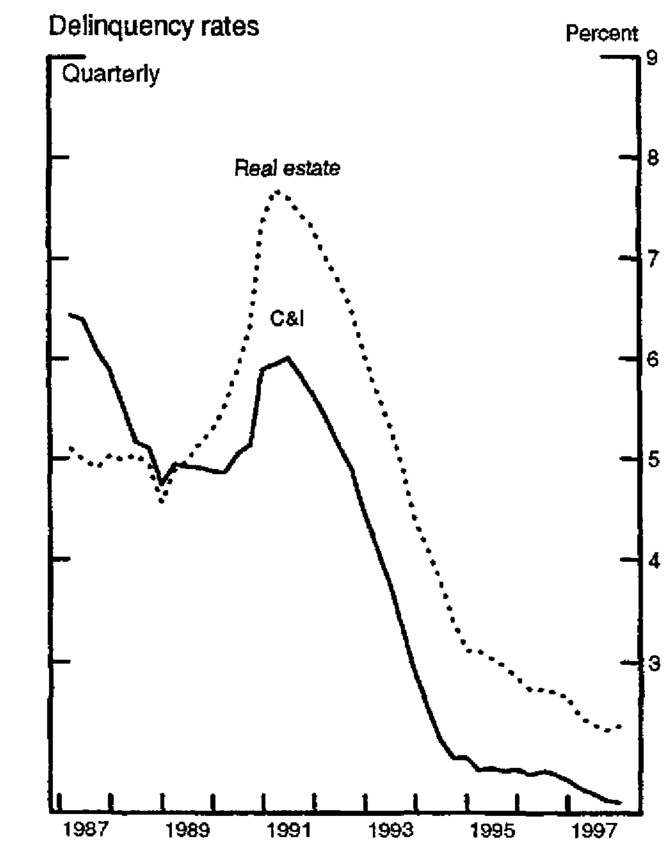


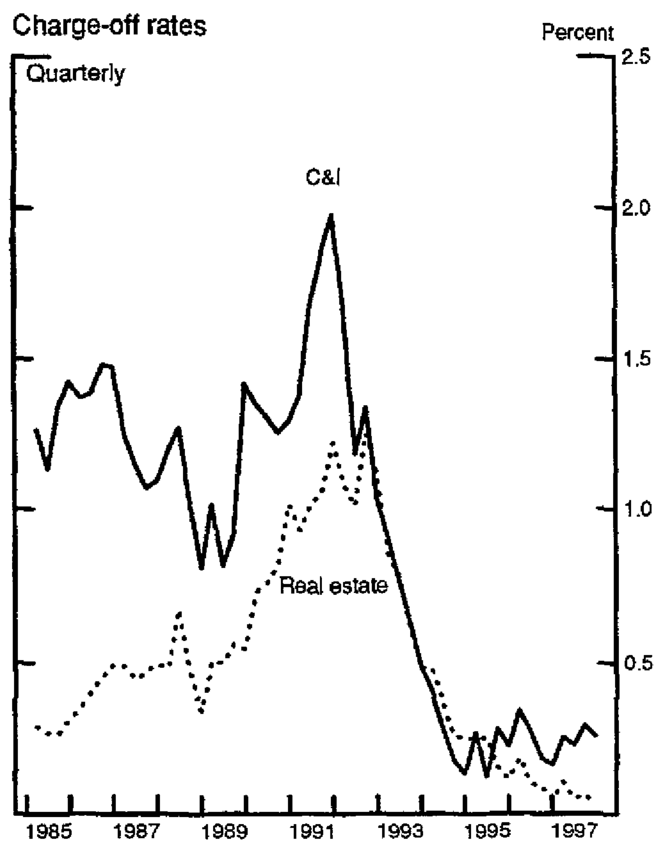
Source. Survey of Terms of Business Lending.

Measures of Commercial Bank Profitablity



Loan Performance at Commercial Banks





which have been weak thus far in 1998 even after adjusting for securitization. Unlike last year, there is little evidence that home equity loans have substituted for consumer loans. Cash-out refinancings, however, may have damped growth in both consumer and home equity loans. Real estate loans surged in February, with commercial mortgages reviving after two months of little change and residential loans responding to a strong housing market and perhaps being boosted by mortgage refinancings.[4]

Business loans continued strong in the first two months of the year, in part boosted by mergers and acquisitions, but this growth was achieved with little effect on loan pricing as recorded in the February Survey of Terms of Business Lending (STBL). The average rate on commercial and industrial loans was about the same as in the November survey, and the spread of the average rate above the intended federal funds rate remained at about the level for most of last year, following a widening in 1996 and early 1997 (chart).[5]

Call report data (chart) show another highly profitable year for banks, notwithstanding some fourth-quarter losses at large banks resulting from events in Asia. Narrower net interest margins were offset by lower noninterest expense and higher noninterest income. Provisions for loan and lease losses as a fraction of assets edged up last year but remained in check, reflecting low overall charge-off rates. For categories other than consumer loans, delinquency and charge-off rates turned in another excellent performance in the fourth quarter (chart).

4. Cash-out refinancings result in new mortgages with larger balances than the old ones. Refinancing mortgages that have been securitized results in the extinguishing of a loan <u>off</u> banks' books and the warehousing (until packaging and sale are arranged) of a new loan <u>on</u> banks' books.

5. Data from the Loan Pricing Corporation and anecdotal information tend to confirm the STBL result that loan spreads have stabilized in recent quarters. The Senior Loan Officer Opinion Survey, however, is somewhat at odds with this, as respondents have suggested that spreads have continued to narrow in recent quarters.

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In January, the U.S. trade deficit in goods and services widened to $12 billion as exports declined more than imports. The deficit was the largest since the monthly series for goods and services was first published in January 1992. Trade data for February will be released on April 17.

NET TRADE IN GOODS & SERVICES
(Billions of dollars, seasonally adjusted)

	1997	Annual rates 1997 Q2	Q3	Q4	Monthly rates 1997 Nov	Dec	1998 Jan
Real NIPA 1/							
Net exports of G&S	-146.4	-136.6	-164.1	-158.5	...	...	...
Nominal BOP							
Net exports of G&S	-113.7	-102.7	-119.6	-115.1	-8.9	-10.9	-12.0
Goods, net	-199.0	-188.8	-208.0	-199.8	-15.7	-17.7	-18.8
Services, net	85.3	86.1	88.4	84.6	6.8	6.8	6.8

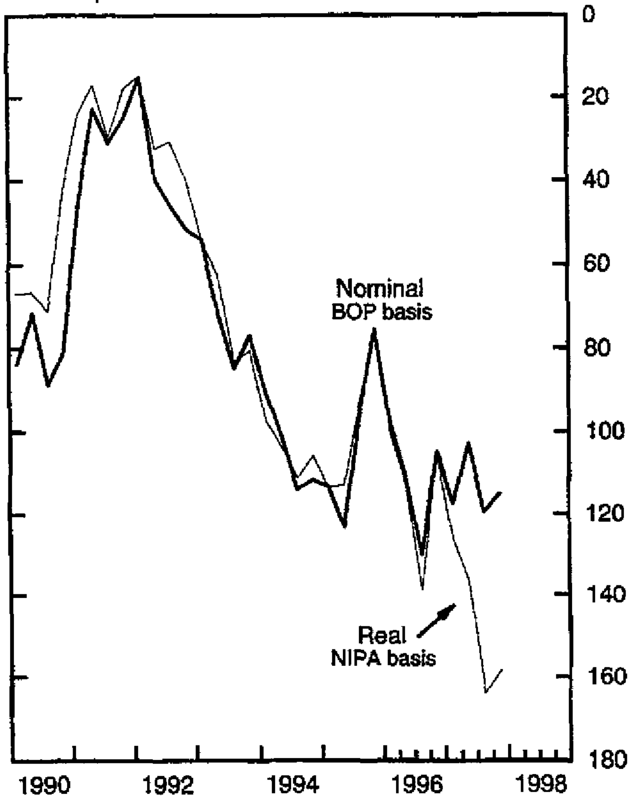
1. In billions of chained (1992) dollars.
Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

Exports were 2-1/2 percent lower in January than in December. Most of the decrease was in civilian aircraft (reversing much of the sharp increase recorded in December) and other capital goods. Declines were recorded in total goods exports to Korea, Hong Kong, Singapore, and Taiwan. The level of exports in January was 2-1/2 percent lower than the average for the fourth quarter of 1997. Real exports grew at a 8-1/2 percent annual rate in the fourth quarter, with the largest increases in aircraft, machinery-other-than-computers-and-semiconductors, and automotive and agricultural products. By area most of the increase in the fourth quarter was to Western Europe, Canada, and Latin America; there were also increased exports to countries in Asia part of which were increased deliveries of aircraft.

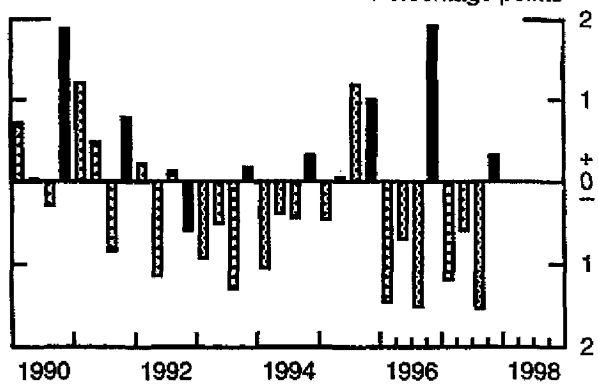
The decrease in imports in January was in oil (there was a small decline in quantity, and the price dropped to about $15 per barrel from an average of nearly $17.50 per barrel in the fourth quarter), as well as in capital goods and automotive imports from Canada. The level of imports in January was about the same as the average for the fourth quarter. Real imports grew at a 5-3/4

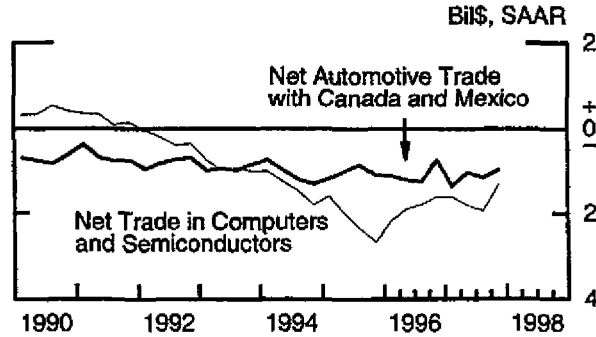
U.S. International Trade in Goods and Services

Net Exports

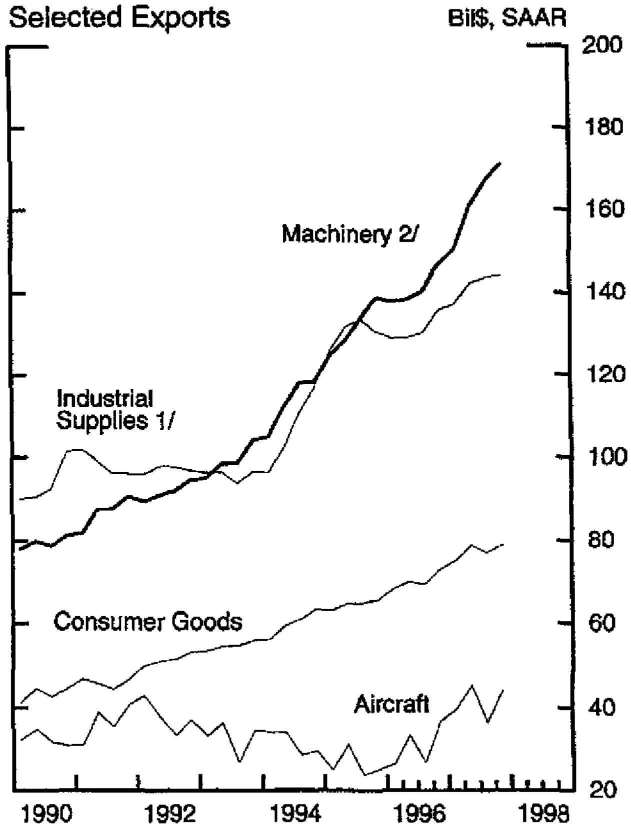


Contribution of Net Exports to Real GDP Growth



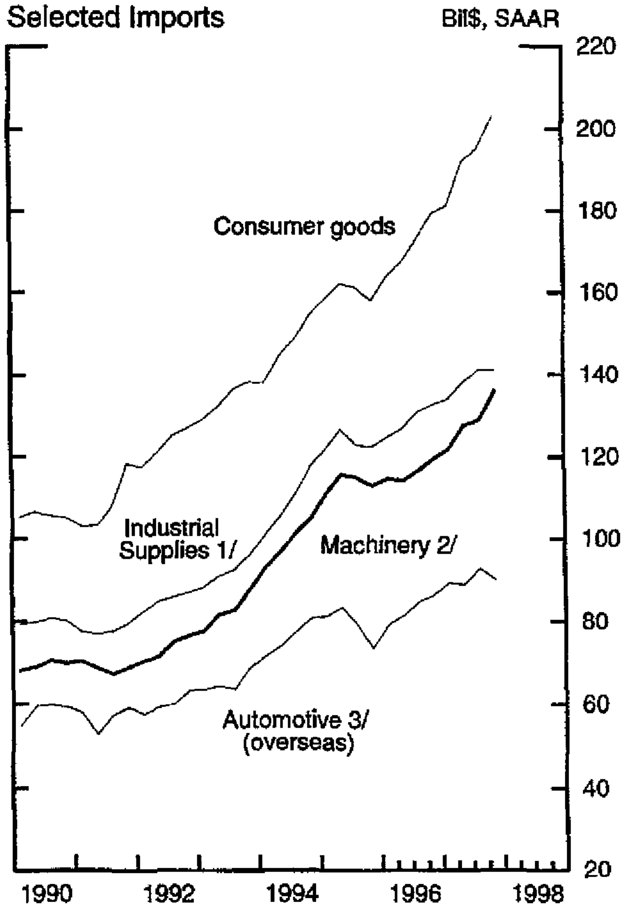


Selected Exports



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

Selected Imports



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

U.S. EXPORTS AND IMPORTS OF GOODS AND SERVICES
(Billions of dollars, SAAR, BOP basis)

	Levels				Amount Change 1/			
	1997		1997	1998	1997		1997	1998
	Q3	Q4	Dec	Jan	Q3	Q4	Dec	Jan
Exports of G&S	938.6	952.3	952.2	927.4	0.4	13.7	8.3	-24.8
Goods exports	681.0	697.3	701.0	675.6	-3.9	16.3	10.7	-25.4
Agricultural	58.2	61.5	59.3	56.0	1.7	3.3	-2.3	-3.3
Gold	3.4	3.4	4.0	7.1	-5.8	-0.0	1.2	3.1
Other goods	619.3	632.4	637.6	612.4	0.3	13.1	11.8	-25.2
Aircraft & pts	36.3	44.3	63.0	42.5	-9.2	8.0	27.2	-20.4
Computers	52.4	48.6	45.6	45.4	2.5	-3.8	-2.8	-0.2
Semiconductors	40.3	38.9	39.5	38.7	2.0	-1.4	3.1	-0.9
Other cap gds	169.0	174.0	172.3	164.0	6.2	5.0	-0.1	-8.4
Automotive	72.9	76.8	70.5	77.5	-0.3	3.9	-12.0	6.9
to Canada	38.6	40.8	39.6	37.5	0.3	2.2	-2.3	-2.2
to Mexico	11.3	13.3	10.6	11.5	-0.0	2.0	-4.4	1.0
to ROW	22.9	22.6	20.3	28.5	-0.6	-0.3	-5.2	8.1
Ind supplies	143.3	143.9	142.7	139.3	1.3	0.6	-2.0	-3.4
Consumer goods	76.9	78.9	76.9	79.6	-1.9	2.0	-1.8	2.6
All other	28.3	27.2	27.1	25.6	-0.3	-1.2	-1.8	-1.6
Services exports	257.6	255.0	251.3	251.8	4.2	-2.6	-2.4	0.6
Imports of G&S	1058.2	1067.4	1083.0	1071.9	17.3	9.2	32.2	-11.1
Goods imports	889.0	897.1	913.4	901.1	15.4	8.0	34.2	-12.3
Petroleum	70.3	69.1	63.2	58.9	-0.6	-1.2	-4.6	-4.4
Gold	3.0	3.8	5.4	7.8	-8.0	0.8	2.0	2.4
Other goods	815.7	824.2	844.7	834.5	24.0	8.4	36.8	-10.3
Aircraft & pts	19.0	18.6	21.4	16.4	3.5	-0.4	5.9	-5.0
Computers	73.7	71.0	71.3	72.4	3.1	-2.7	2.6	1.1
Semiconductors	39.0	37.8	36.9	35.1	2.9	-1.1	-0.1	-1.8
Other cap gds	130.9	138.1	141.5	138.8	1.3	7.2	5.9	-2.7
Automotive	143.1	140.7	146.8	143.1	5.4	-2.3	5.7	-3.7
from Canada	50.3	50.5	57.0	52.5	1.7	0.2	8.7	-4.4
from Mexico	25.6	27.7	24.5	24.9	-0.4	2.1	-3.4	0.4
from ROW	67.2	62.5	65.3	65.7	4.1	-4.7	0.4	0.3
Ind supplies	141.1	141.2	143.1	144.7	3.0	0.1	4.2	1.6
Consumer goods	195.1	203.1	208.4	207.3	3.0	7.9	7.4	-1.1
Foods	40.6	40.2	42.2	40.5	0.6	-0.4	3.6	-1.7
All other	33.3	33.5	33.1	36.0	1.2	0.3	1.5	2.9
Services imports	169.2	170.4	169.6	170.8	1.9	1.2	-2.0	1.2
Memo:								
Oil qty (mb/d)	10.96	10.69	10.32	10.68	0.16	-0.26	-0.03	0.36
Oil price ($/bbl)	17.56	17.67	16.78	15.09	-0.44	0.11	-1.18	-1.69

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

percent rate in the fourth quarter, with most of the increase in consumer goods and machinery other than computers and semi-conductors.

Oil Imports and Prices

The quantity of oil imported declined 2-1/2 percent during the fourth quarter of last year to a rate of 10.7 mb/d. Oil imports remained flat at that rate in January. This decline followed two consecutive quarters of strong imports, driven by extremely robust consumption in the second and third quarters. Preliminary Department of Energy statistics indicate that oil imports declined in February due to a fall in consumption that is most likely weather related.

The price of imported oil declined significantly in February for the fourth consecutive month. For January-February combined (shown in the table that follows), prices of oil imports exhibited their greatest decline since the first quarter of 1991.

Declines in prices since November followed increases in the previous three months. The run-up in prices from late summer through early fall reflected production disruptions in Colombia and the lagged effect of Iraq not exporting for two months. Spot WTI prices have declined sharply since November as the market reacted to increased production from Saudi Arabia, Kuwait, and the UAE, weak demand in Asia, relatively warm weather in the northern hemisphere, and the resumption of oil production for export by Iraq. By February prices were more than 15 percent below yearend levels. After dropping below $13 per barrel earlier this month, when it appeared that OPEC would have difficulty restraining production in order to accommodate increased shipments from Iraq, prices have risen by about $3.50 per barrel to around $16.00 per barrel on the news of an agreement among major oil producers to restrain production by more than 1.0 mbd.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports decreased slightly in February for the fifth consecutive month. This decline was attributable to decreases in all major trade categories, with the exception of

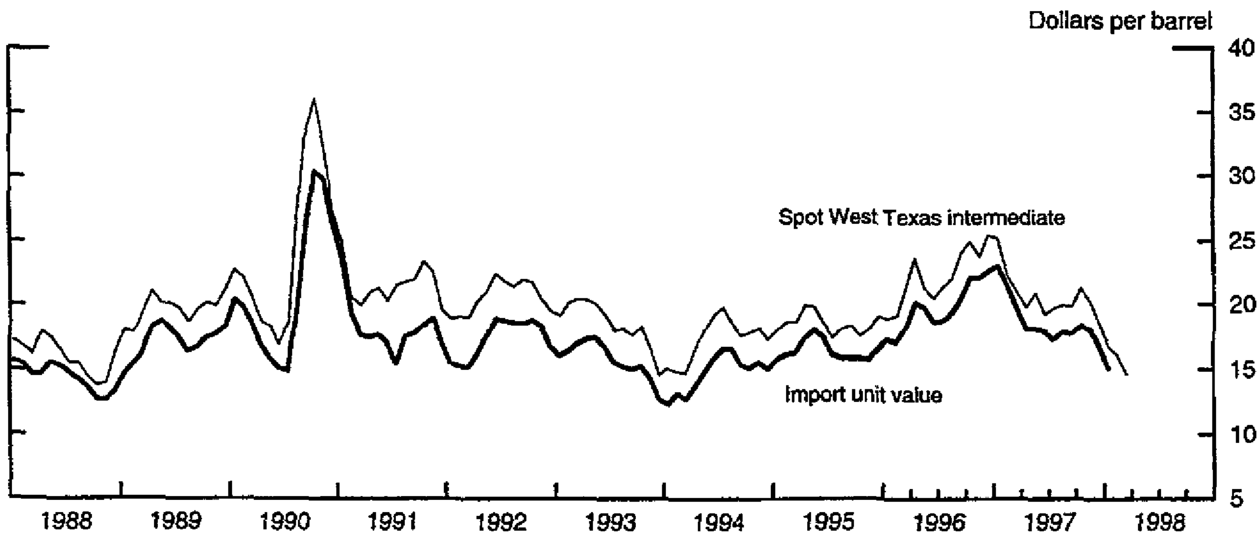
PRICES OF U.S. IMPORTS AND EXPORTS
(Percentage change from previous period)

	Annual rates			Monthly rates		
	1997		1998	1997	1998	
	Q3	Q4	Q1e/	Dec	Jan	Feb
	-----------BLS prices (1995=100)-----------					
Merchandise imports	-1.5	-2.0	-9.5	-1.0	-1.2	-0.8
Oil	-2.8	7.2	-53.3	-6.7	-9.0	-7.4
Non-oil	-1.5	-2.7	-4.4	-0.4	-0.6	-0.3
Foods, feeds, bev.	-5.3	-4.5	-4.1	0.2	-0.5	-0.7
Ind supp ex oil	1.6	-1.4	-10.2	-1.4	-1.6	-0.5
Computers	-14.5	-17.7	-14.9	-0.5	-2.6	-1.7
Semiconductors	-5.3	-15.4	-14.1	-2.5	-0.7	-1.1
Cap. goods ex comp & semi	-1.1	-2.1	-2.9	-0.2	-0.4	-0.3
Automotive products	1.9	1.3	0.5	-0.1	0.0	0.4
Consumer goods	-0.8	-0.8	-0.4	0.1	-0.2	0.2
Merchandise exports	-1.1	-2.9	-4.3	-0.4	-0.7	-0.2
Agricultural	-10.8	-6.4	-14.2	-0.8	-2.7	-1.5
Nonagricultural	-0.1	-2.4	-2.8	-0.4	-0.4	0.0
Ind supp ex ag	0.7	-5.2	-6.9	-0.8	-1.1	-0.1
Computers	-7.9	-7.6	-9.0	-1.4	-1.0	-0.5
Semiconductors	-8.7	-14.0	-3.6	-1.2	0.0	-0.1
Cap. goods ex comp & semi	0.5	-0.5	0.4	0.1	0.0	0.1
Automotive products	0.4	0.1	0.1	0.0	0.0	0.0
Consumer goods	1.7	1.2	-0.5	0.1	-0.2	0.0
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	-3.0	-2.2	n.a	...	...	...
Non-oil merchandise	-2.3	-3.4	n.a	...	...	...
Exports of gds & serv.	-2.0	-2.1	n.a	...	...	...
Nonag merchandise	-2.3	-3.2	n.a	...	...	...

e. Average of two months.

3-25-98

Oil Prices



consumer goods, and automotive products. For January-February combined, the decline in prices of non-oil imports was 4.4 percent at an annual rate, somewhat larger than in the fourth quarter of 1997; the larger decline was attributable primarily to a substantial drop in prices of non-oil industrial supplies.

Prices of exports declined slightly in February for the third consecutive month. The decline was due to lower prices for agricultural products. Prices of nonagricultural products remained unchanged on average. For January-February combined, the decline in prices of exports resulted from lower prices for agricultural products, nonagricultural industrial supplies, computers, semiconductors, and consumer goods.

U.S Current Account--1997-Q4 and Year

The U.S. current account deficit widened $10 billion SAAR in the fourth quarter. A narrowing of the deficit on goods and

U.S. CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	Goods & services balance	Investment income, net	Transfers, net	Current acct balance
Years				
1996	-111.0	2.8	-40.0	-148.2
1997	-113.6	-14.3	-38.5	-166.4
Quarters				
1995-1	-113.2	8.2	-33.8	-138.8
2	-123.2	12.9	-32.5	-142.8
3	-95.5	-1.6	-35.4	-132.5
4	-75.5	7.8	-34.5	-102.2
1996-1	-98.2	8.2	-41.6	-131.5
2	-111.1	3.5	-34.8	-142.3
3	-130.1	-5.5	-35.8	-171.3
4	-104.8	5.0	-47.7	-147.5
1997-1	-117.3	-8.1	-34.3	-159.7
2	-102.7	-13.1	-35.4	-151.2
3	-119.6	-16.5	-36.3	-172.5
4	-115.0	-19.4	-48.1	-182.5
Memo:				
$ Change				
1997:				
Q1-Q4	-12.5	-13.1	13.4	-12.2
Q2-Q1	14.6	-5.0	-1.1	8.5
Q3-Q2	-16.9	-3.5	-0.9	-21.3
Q4-Q3	4.7	-2.9	-11.8	-10.0

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

services (exports rose more than imports) was more than offset by an increase in the deficit on investment income and increased net unilateral transfers. For investment income, there were small declines in income from both net direct investment and net portfolio investment. The increase in net unilateral transfers was more than accounted for by U.S. government grants to Israel which normally occur in the fourth quarter of each year.

For the full year 1997, the U.S. current account deficit increased to $166 billion, $18 billion larger than in 1996. Almost all of the greater deficit came from a shift from a surplus to a deficit on investment income and largely reflected growing net income payments as a result of growing U.S. international indebtedness. There were only small changes in net trade and unilateral transfers.

U.S. International Financial Transactions

Net purchases of U.S. securities by private foreigners were a record $346 billion in 1997, up $59 billion or 20 percent over 1996 (Summary of U.S. International Transactions table, line 4). Net private purchases of Treasury securities and corporate and other bonds remained strong, but the increase was more than accounted for by the record net purchases of corporate stocks totaling $67.8 billion in 1997 (line 4c). U.S. stocks attracted investors from Japan and financial centers in Europe and the Caribbean, probably as a result of the booming U.S. economy and increased uncertainty abroad. Net purchases of U.S. stocks continued at a robust pace in January.

Net purchases of corporate and other bonds by private foreigners were up in December and January (line 4b). New Eurobond issues by U.S. corporations and government agencies were strong in January and showed continuing strength in February. About one-third of the bonds purchased by private foreigners were bonds of U.S. government agencies.

In January, there was little net change in private foreigners' holdings of U.S. Treasuries, following a sharp decline in December (line 4a). Sizable net purchases of Treasury bonds and notes in January were countered by net sales of U.S. Treasury bills. Japanese holders recorded large net sales in December and January, probably as a consequence of the large premium that Japanese banks

SUMMARY OF U.S. INTERNATIONAL TRANSACTIONS
(Billions of dollars, not seasonally adjusted except as noted)

	1996	1997	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1997 Dec	1998 Jan
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	127.7	18.2	27.5	-4.9	22.4	-26.8	-14.8	2.5
a. G-10 countries	36.6	1.8	7.7	4.6	2.0	-12.5	-11.0	-3.0
b. OPEC countries	15.4	11.8	7.0	2.6	3.5	-1.3	-1.1	-3.2
c. All other countries	75.7	4.6	12.8	-12.1	16.8	-13.0	-2.7	8.8
2. Change in U.S. official reserve assets (decrease, +)	6.7	-1.0	4.5	-.2	-.7	-4.5	-3.7	-0.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-50.1	29.4	-26.1	15.5	-3.9	43.9	44.7	-11.1
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	287.2	346.1	79.0	97.8	97.3	72.7	4.0	20.8
a. Treasury securities[3]	155.6	148.1	33.1	43.1	36.5	35.5	-10.2	1.8
b. Corporate and other bonds[4]	118.9	130.7	33.7	33.2	37.1	26.8	9.5	11.7
c. Corporate stocks	12.7	67.8	12.2	21.5	23.7	10.4	4.8	7.3
5. U.S. net purchases (-) of foreign securities	-110.6	-84.8	-17.0	-22.3	-39.7	-5.8	-1.2	-3.6
a. Bonds	-51.4	-46.1	-5.2	-8.7	-24.2	-8.1	-3.1	-3.7
b. Stocks	-59.3	-38.7	-11.8	-13.6	-15.6	2.3	1.9	.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-87.8	-119.4	-26.8	-37.0	-22.8	-32.9	n.a	n.a
7. Foreign direct investment in U.S.	77.0	107.9	30.7	26.7	25.9	24.6	n.a	n.a
8. Foreign holdings of U.S. currency	17.3	24.8	3.5	4.8	6.6	9.9	n.a	n.a
9. Other (inflow, +)[5]	-72.3	-57.7	-38.3	-28.6	-12.5	4.1	n.a	n.a
U.S. current account balance (s.a.)	-148.2	-166.4	-39.9	-37.8	-43.1	-45.6	n.a	n.a
Statistical discrepancy (s.a.)	-46.9	-97.1	-14.1	-14.0	-29.5	-39.6	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 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. goverment agency bonds.

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

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

were forced to pay in the interbank market to obtain funds. In the rest of Asia, there were small net private sales in December and January.

U.S. purchases of foreign securities were down in 1997 primarily because of net sales of foreign stocks in the fourth quarter (line 5). Net sales of stocks in Japan of $4.2 billion and in Mexico of $1.2 billion accounted for the bulk of the fourth quarter sell-off. In Asia, the picture was mixed. Investors took advantage of sharply depressed stock prices in dollars to purchase stocks in some Asian markets but continued selling in others. In January, net sales of foreign stocks were near zero, in part owing to net purchases in Japan, which reversed the fourth quarter trend.

Foreign official assets held in the United States increased in January by $2.5 billion, following an outflow of $14.8 billion in December (line 1). Spain, China, and Singapore more than accounted for the increase in January. Japan was responsible for much of the outflow in December.

There were large net inflows into banks at the end of 1997, after large net outflows earlier in the year (line 3). By the end of January, these inflows were partially reversed. Monthly average data on net claims of U.S. banking offices on own foreign offices and IBFs suggest that there were outflows in February (International Banking Data Table, line 1).

U.S. direct investment abroad and foreign direct investment in the United States reached record levels in 1997. Direct investment outflows were up 36 percent from 1996 (Summary of U.S. International Transactions table, line 6), and direct investment inflows were up 40 percent (line 7). The strong growth in direct investment resulted from the continuing boom in cross-border mergers and acquisitions over the year. The fourth-quarter flows reflected transactions such as Merrill Lynch's purchase of Mercury assets and ING's purchase of Equitable of Iowa.

The large negative statistical discrepancy in 1997 implies that net payments in the current account or net outflows in the capital account have gone unrecorded. Large negative discrepancies have become common in 1990s for reasons that are not well understood.

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

	1994 Dec.	1995 Dec.	1996 Dec.	1997 Jun.	1997 Sep.	1997 Dec.	1998 Jan.	1998 Feb.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-231.2	-225.7	-211.6	-195.8	-230.5	-222.6
a. U.S.-chartered banks	-70.1	-86.1	-66.4	-79.9	-77.9	-69.8	-83.7	-78.6
b. Foreign-chartered banks	-153.9	-173.9	-164.8	-146.0	-133.7	-126.0	-146.8	-144.0
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	31.9	33.4	34.0	34.4	35.4	36.5
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	79.4	74.8	84.7	90.1	n.a	n.a
3. Eurodollar holdings of U.S. nonbank residents								
a. At all U.S.-chartered banks and foreign- chartered banks in Canada and the United Kingdom	86.3	94.6	119.5	134.0	142.6	153.4	159.1	154.2
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	122.2	130.6	130.3	115.0	n.a	n.a
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	178.1	212.8	239.0	251.1	271.8	287.2	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	242.0	275.8	336.7	401.4	417.7	415.2	n.a.	n.a.

1. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts.
Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR2951.
Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s.
Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994.
Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. They include some foreign-currency denominated deposits and loans. Source: SCB

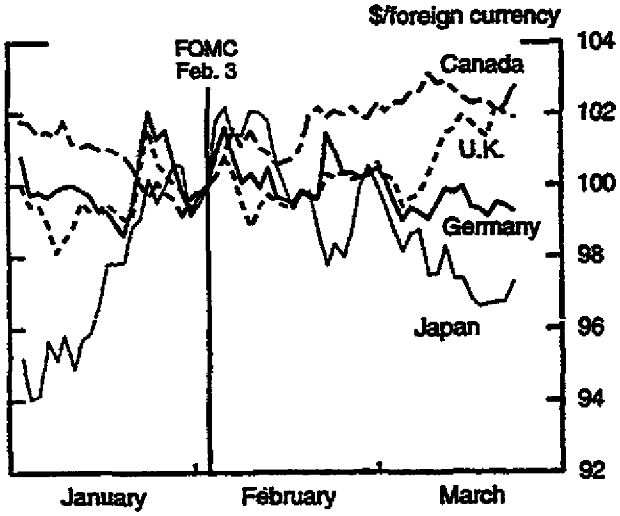
Foreign Exchange and International Asset Markets

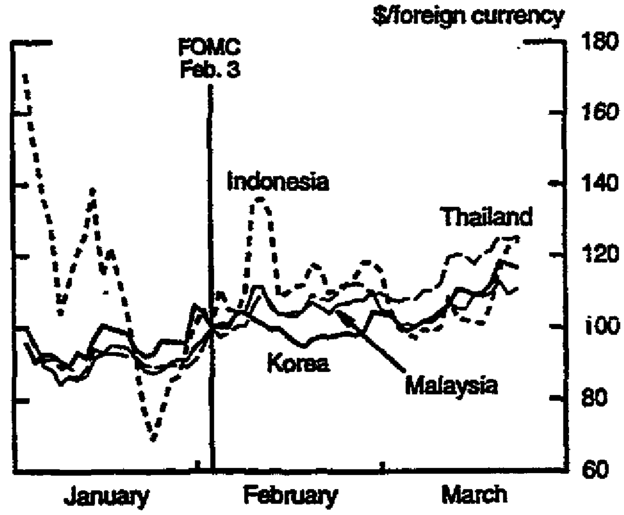
Since the February FOMC meeting, the dollar has strengthened 3 percent against the yen. The yen's depreciation vis-à-vis the dollar is generally attributed to reports of continued weak economic activity in Japan together with a growing market sentiment that Japanese authorities would either delay further or put off completely a sizable fiscal stimulus package. The Japanese long-term bellwether bond yield fell 30 basis points during the intermeeting period, and the major Japanese stock market indices declined 2 percent on balance. Yields on short-term debt instruments also fell, as the Bank of Japan provided substantial liquidity in advance of the end of the Japanese fiscal year.

The exchange value of the dollar has moved in relatively narrow ranges against the mark and sterling since the February FOMC meeting, appreciating 3/4 percent against the mark and depreciating 2 percent against sterling. The appreciation of sterling against the mark was supported by a modest widening, of 4 to 6 basis points, in the short-term and long-term interest rate differentials in favor of sterling. While official interest rate hikes in Germany are perceived to have become less likely in view of falling German inflation, signs of continued robust growth in the United Kingdom have kept markets guessing about the possibility of another rate increase by the Bank of England.

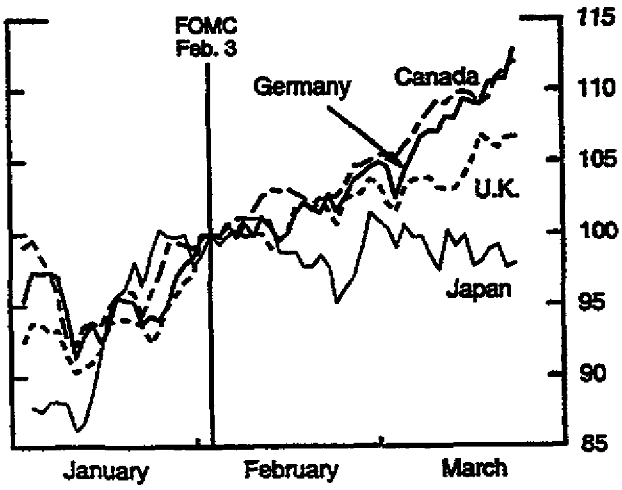
The release in late February of official 1997 government budget figures for the EU member countries, which showed that all countries except Greece satisfied the key Maastricht reference value of a budget deficit of no more than 3 percent of GDP, strengthened expectations that 11 countries will participate in launching the euro in January 1999. The EMU convergence reports of the European Commission and the European Monetary Institute published on March 25 validated these expectations. Spreads between the long-term interest rates of the prospective euro member countries have narrowed further, with the Italian and Spanish rates falling 12 basis points more than those of Germany and France. Italian three-month rates fell about 90 basis points over the period, while equivalent German and French short-term rates were little changed. European equity market indices have risen between 7 and 13 percent, to record highs, since the February FOMC meeting.

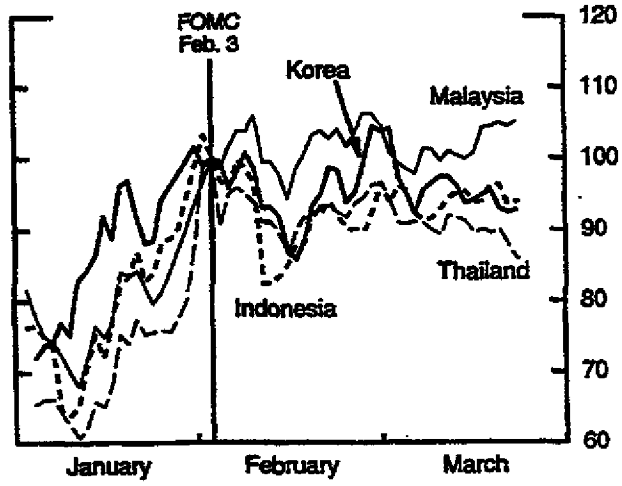
Exchange Rates
(Daily Indices, Feb. 3, 1998 = 100)





Stock Market Indices
(Daily Indices, Feb. 3, 1998 = 100)





Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Feb. 3	Mar. 25	Change	Feb. 3	Mar. 25	Change
Germany	3.47	3.44	-0.03	5.08	4.83	-0.25
Japan	0.85	0.70	-0.15	1.85	1.55	-0.30
United Kingdom	7.47	7.50	0.03	6.08	5.87	-0.21
Canada	5.04	4.86	-0.18	5.41	5.34	-0.07
France	3.46	3.46	0.00	5.11	4.87	-0.24
Italy	6.19	5.31	-0.88	5.40	5.02	-0.38
Belgium	3.45	3.65	0.20	5.21	4.95	-0.26
Netherlands	3.36	3.38	0.02	5.07	4.85	-0.22
Switzerland	1.19	1.13	-0.06	2.86	2.75	-0.11
Sweden	4.48	4.57	0.09	5.62	5.25	-0.37
Weighted-average foreign	3.91	3.81	-0.10	4.76	4.52	-0.24
United States	5.52	5.57[p]	0.05	5.56	5.57[p]	0.01

Note. Change is in percentage points. [p] Preliminary.

On March 15, it was announced that Greece would devalue the drachma and enter the ERM, in preparation for possible future membership in the monetary union. On the same day, the Irish punt's central parity within the ERM was revalued 3 percent, reflecting the ongoing strength of the currency relative to that of the other ERM members and making it more likely that the punt will be converted to the euro at its established central parity.

The dollar depreciated 2-2/3 percent against the Canadian dollar over the period, reversing earlier appreciations. The Canadian long-term bond yield was little changed.

The dollar has depreciated between 15 and 20 percent since the February FOMC meeting against the currencies of Korea and Thailand, as markets perceived that the governments of the two countries were coming to grips with their financial sector problems. Malaysia's currency appreciated about 10 percent against the dollar. The exchange value of Indonesia's currency underwent several gyrations as talk about introducing a currency board system appeared to lift the rupiah temporarily. Subsequent criticism of the currency board plan, together with a perception that Indonesia possesses neither sufficient foreign exchange reserves nor the macroeconomic policy resolve to implement such a system credibly (at proposed exchange rates considerably appreciated from current levels), led to depreciations of the rupiah. On balance, the dollar depreciated 19 percent against the rupiah over the intermeeting period. Share prices in the Southeast Asian economies turned in mixed performances; increases were recorded in Singapore, Hong Kong, Malaysia and the Philippines, while decreases occurred in Thailand, Korea, and Indonesia.

The price of gold has fluctuated between $290 and $302 per fine ounce since the February FOMC meeting. Gold prices briefly came under pressure on March 18 when it was revealed that the Belgian central bank had sold 300 metric tons -- the equivalent of about $2.9 billion -- of its monetary gold reserves during January and February. On March 23, the price of gold jumped $7 per fine ounce on technical market factors; it fell back slightly over the following two days.

The Desk did not intervene.

Developments in Foreign Industrial Countries

Partial data for the first quarter suggest that the pace of economic expansion has picked up in the European countries and remains strong on balance in Canada, while the Japanese economy continues to be weak. Although there are signs that the southeast Asian crises have begun to show up in monthly trade data, particularly for Japan, the full impact on the foreign industrial economies remains to be seen. Fourth-quarter GDP data are now available for all the major foreign industrial countries. Growth continued at a healthy pace in France, moderated somewhat in the United Kingdom and Canada, and proceeded at only a modest pace in Germany and Italy. In Japan, economic activity contracted slightly in the fourth quarter, leaving the level of activity little changed from one year ago.

Recent declines in oil prices have helped reduce CPI inflation in all the foreign G-7 countries. Inflation is around one percent in France, Germany, and Canada and is under two percent in Italy. After netting out the effects of tax increases, inflation remains near zero in Japan. In the United Kingdom, however, consumer price inflation remains slightly above the government's target of 2-1/2 percent.

On March 25, the European Union Commission released its convergence report, stating that each of the eleven countries that is striving to enter monetary union when it starts in 1999 has satisfied requirements for first-round entry. The European Monetary Institute also released its convergence report on March 25. The EMI noted that major improvements in terms of convergence have been made by the EU nations, although a permanent resolution to the problems of high public debt and deficits needs to remain a priority for several countries. The EMI also stated that although the Italian lira has been participating in the Exchange Rate Mechanism for only 15 months, the currency has been broadly stable over the two-year reference period.

Individual country notes. In **Japan**, GDP contracted slightly during the fourth quarter, with a 3 percent (SAAR) decline in domestic demand partially offset by a 2.3 percentage point contribution from net exports. Consumption fell 3.6 percent, while plant and equipment investment grew 2.3 percent. Residential investment fell to its lowest level since 1987, registering its fourth consecutive quarter of double-digit decline. The public sector made a slight negative contribution to growth, as a reduction in public investment more than offset an increase government consumption.

JAPANESE REAL GDP
(Percent change from previous period, SAAR) [1]

	1996	1997	1997			
			Q1	Q2	Q3	Q4
GDP	3.4	-0.2	8.3	-10.6	3.2	-0.7
Total Domestic Demand	3.3	-1.9	7.8	-14.3	3.5	-3.0
Consumption	2.4	-0.8	16.8	-19.5	7.0	-3.6
Investment	6.0	-5.1	-4.2	-10.1	-2.9	-2.9
Government Consumption	1.8	0.2	-3.7	-3.7	2.8	5.6
Inventories (contribution)	-0.2	0.2	-0.1	1.1	0.1	-0.5
Exports	8.0	8.9	5.7	25.1	-5.8	12.9
Imports	7.0	-4.2	1.8	-8.7	-4.3	-5.2
Net Exports (contribution)	0.2	1.6	0.5	3.8	-0.3	2.3

1. Annual changes are Q4/Q4.

Economic indicators for the first quarter suggest that the economy remains weak. Industrial production and household expenditure have recovered only slightly from significant declines in the fourth quarter, while auto registrations have continued to decline. Housing starts have remained near ten-year lows, and labor market conditions show signs of further deterioration. Consumer price inflation, net of the effects of fiscal measures, remains near zero.

Japan's trade surplus during January and February averaged $8.8 billion, slightly above the fourth-quarter average. Effects of the Asian crises are now clearly visible. Exports to Korea and Thailand plunged 40 percent from a year earlier, while exports to other Asian countries declined almost 5 percent. By contrast, Japanese exports to the United States and the EU were up by about 15 percent from the first two months of 1997. Japanese import prices in February were down 8.4 percent from a year earlier, led by 25 percent declines in the price of oil products and lumber.

JAPANESE ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997					1998	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	-0.1	-0.3	-2.3	-5.0	1.1	2.9	n.a.
Housing Starts	-5.0	-10.5	0.2	-4.4	1.3	1.1	n.a.
Machinery Orders	6.0	1.3	-12.9	-4.9	-0.1	-0.8	n.a.
New Car Registrations	-18.5	2.9	-0.0	-8.8	18.0	-13.9	-1.6
Unemployment Rate (%)	3.4	3.4	3.5	3.5	3.5	3.5	n.a.
Job Offers Ratio[1]	0.73	0.73	0.69	0.69	0.67	0.64	n.a.
Business Sentiment[2]	7	3	-11	...	...	...	...
CPI (Tokyo area)[3]	1.5	1.7	2.1	2.0	1.8	2.0	2.1
Wholesale Prices[3]	2.6	2.0	1.6	1.5	1.6	0.7	-1.0

1. Level of indicator.
2. Percent of large manufacturing firms having a favorable view of business conditions less those with an unfavorable view (Tankan survey).
3. Percent change from previous year, NSA.

The government has recently gained legislative approval for several of its policy initiatives. The FY 1997-98 supplementary budget, which includes a temporary tax cut plus new spending on public works and disaster relief, was approved by the Diet on February 4. On February 16, the Diet approved the government's plan to provide ¥30 trillion to help stabilize the banking system. The FY 1998-99 budget was approved by the Diet's lower house on March 20 and is now being reviewed by the upper house. (The budget becomes law thirty days following lower-house approval, if it has not yet been approved by the upper house.)

In mid-March, prosecutors arrested a senior Bank of Japan employee on charges that he had provided confidential data regarding BOJ money market operations to several large commercial banks in exchange for lavish entertainment. The arrest led to the resignation of BOJ Governor Matsushita, as Matsushita took responsibility for the scandal. The government has appointed Masaru Hayami, a former BOJ Executive Director and financial sector executive, to head the central bank.

Real GDP growth in **Germany** slowed in the fourth quarter of last year to 1.1 percent at an annual rate, bringing growth over 1997 (Q4/Q4) to 2.3 percent. The slowdown in fourth-quarter growth reflected a sizable drop in net exports, as export growth dropped back from its double-digit pace. Machinery and equipment spending continued to post healthy gains in the fourth quarter, although total investment continued to be held back by troubles in the construction sector. Inventories made a sizable contribution to fourth-quarter growth, but they are a residual in the national accounts and are subject to significant revision.

GERMAN REAL GDP
(Percent change from previous period, SAAR) [1]

	1996	1997	1997			
			Q1	Q2	Q3	Q4
GDP	2.1	2.3	1.5	3.8	2.9	1.1
Total Domestic Demand	1.2	1.3	2.3	1.0	-0.9	2.7
Consumption	1.0	0.6	0.3	3.6	-3.2	1.7
Investment	2.4	-0.8	-7.8	2.2	2.4	0.2
Government Consumption	0.7	-1.8	2.1	2.9	-5.5	-6.1
Inventories (contribution)	0.0	1.5	3.4	-2.1	1.6	2.8
Exports	8.3	11.7	5.7	15.5	21.1	5.5
Imports	4.8	8.0	8.5	5.1	7.3	11.3
Net Exports (contribution)	0.9	1.1	-0.7	2.8	3.7	-1.5

1. Annual changes are Q4/Q4.

Indicators for the first quarter suggest a pick-up in growth from its lackluster pace in the fourth quarter. In January, industrial production jumped 2.5 percent and manufacturing orders surged 3.3 percent, led by strong increases in domestic orders. Business confidence has remained at its recent high. Conditions in the labor market have improved marginally so far this year, with the all-German unemployment rate edging down from 11.8 percent in

December to 11.5 percent in February. Consumer price inflation is currently near one percent, benefiting from lower prices of food and energy.

GERMAN ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997				1998		
	Q3	Q4	Nov	Dec	Jan	Feb	Mar
Industrial Production	1.8	0.4	-0.3	0.2	2.5	n.a.	n.a.
Orders	2.6	-0.9	-0.6	-0.4	3.3	n.a.	n.a.
Unemployment Rate (%)	11.6	11.8	11.8	11.8	11.6	11.5	n.a.
Western Germany	9.9	9.9	9.9	9.9	9.7	9.6	n.a.
Eastern Germany	18.8	19.6	19.6	19.8	19.2	19.2	n.a.
Capacity Utilization[1]	86.0	87.2	...	...	...	...	...
Business Climate[1,2]	16.0	17.3	16.0	19.0	19.0	n.a.	n.a.
Consumer Prices[3]							
All-Germany	1.9	1.8	1.9	1.8	1.3	1.1	n.a.
Western Germany	1.9	1.7	1.8	1.7	1.1	1.1	1.0

1. Western Germany.
2. Percent of firms (in manufacturing, construction, wholesale, and retail) citing an improvement in business conditions (current and expected over the next six months) less those citing a deterioration in conditions.
3. Percent change from previous year.

In **France**, fourth-quarter real GDP increased 3.1 percent (SAAR), the third consecutive quarter of strong growth. Domestic demand underpinned continued economic expansion for the second straight quarter. Although export growth slowed sharply, net exports made a small positive contribution.

Data for the first quarter suggest that on balance the growth in French domestic demand remains robust. In January, consumption of manufactured products increased 2.6 percent; the broad-based rise reflected strong seasonal purchases associated with post-holiday discounts and continued strength in durable goods purchases. Industrial production declined in January, but recent business surveys suggest that business confidence remains high. The surveys also provide further confirmation that the impetus to growth has shifted from foreign to domestic demand as a modest decline in

FRENCH REAL GDP
(Percent change from previous period, SAAR) [1]

	1996	1997	1997 Q1	Q2	Q3	Q4
GDP	2.3	3.2	1.3	4.7	3.7	3.1
Total Domestic Demand	1.5	1.7	-1.7	2.2	3.9	2.3
Consumption	1.8	2.2	1.5	0.2	4.1	3.0
Investment	0.2	0.1	-5.7	1.7	5.4	-0.5
Government Consumption	2.0	1.4	1.6	1.4	1.1	1.3
Inventories (contribution)	-0.1	0.0	-1.8	1.4	0.1	0.4
Exports	8.5	12.1	9.6	24.1	12.4	3.2
Imports	5.7	7.3	-0.4	15.9	13.8	0.9
Net Exports (contribution)	0.8	1.5	3.0	2.5	-0.1	0.8

1. Annual changes are Q4/Q4.

export orders has been offset by higher domestic orders. The rate of unemployment declined to 12.1 in January reflecting cyclical improvement and the increased use of temporary contracts. Inflation is near a 40-year low; in February, consumer prices were 0.7 percent above their year-earlier level.

FRENCH ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997 Q2	Q3	Q4	Nov	Dec	1998 Jan	Feb
Consumption of Manufactured Products	-0.2	2.5	1.0	0.4	-0.4	2.6	n.a.
Industrial Production	2.9	1.8	1.7	-1.5	2.3	-0.9	n.a.
Capacity Utilization	83.8	84.9	84.6	...	...	...	...
Unemployment Rate (%)	12.5	12.5	12.4	12.4	12.2	12.1	n.a.
Business Confidence[1]	8.3	14.5	15.3	16.0	17.0	14.0	19.0
Consumer Prices[2]	0.9	1.3	1.2	1.3	1.1	0.5	0.7

1. Percent balance of manufacturing firms citing an improvement in the outlook versus those citing a worsening; no August survey conducted.
2. Percent change from previous year.

The expansion of economic activity in the **United Kingdom** eased in the fourth quarter, as real GDP growth dipped to 2.5 percent (SAAR). However, the growth of domestic demand remained strong, led by robust consumption growth and renewed strength in fixed investment, while net exports subtracted 2.7 percentage points from total GDP growth.

UNITED KINGDOM REAL GDP
(Percent change from previous period, SAAR)[1]

	1996	1997	1997			
			Q1	Q2	Q3	Q4
GDP	2.9	2.9	2.1	3.5	3.6	2.5
Total Domestic Demand	2.8	3.8	3.2	5.4	2.5	4.0
Consumption	4.3	5.1	4.1	7.6	2.8	5.9
Investment	2.6	5.9	6.8	10.7	2.1	4.2
Government Consumption	1.4	-0.8	-1.6	-7.0	5.0	0.9
Inventories (contribution)	-0.6	-0.3	-0.1	0.3	-0.6	-0.6
Exports	7.1	6.5	7.7	13.4	5.7	-0.2
Imports	8.0	10.0	8.0	20.4	3.9	8.3
Net Exports (contribution)	-0.3	-1.1	-0.1	-2.1	0.5	-2.7
Non-oil GDP	2.8	3.0	2.6	3.7	2.9	2.9

1. Annual changes are Q4/Q4.

Indicators for the current quarter are mixed, but on balance point to moderate growth. Industrial production declined in January, as manufacturing output was unchanged and mild temperatures again led to lower output of utilities industries. However, recent survey data suggest somewhat more strength in the manufacturing sector. Business sentiment has remained positive, as the outlook for domestic orders continues to offset weakness in export orders resulting primarily from the strength of sterling. Consumer spending remains strong on balance. The average volume of retail sales in January and February was up 1.1 percent from the fourth quarter, as the surge in post-holiday sales in January was only partially reversed in February. Conditions in the labor market remain tight. The official claims-based unemployment rate fell below 5 percent in February for the first time since 1980, and survey evidence points to continued shortages of skilled workers. Retail prices excluding mortgage interest payments rose 2.6 percent over the year to February, after meeting the government's inflation target of 2-1/2 percent for underlying inflation in January for the first time since last May.

UNITED KINGDOM ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997					1998	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	0.5	1.0	-0.9	-0.5	0.1	-0.5	n.a.
Retail Sales	1.9	1.0	1.4	-0.5	0.1	1.8	-1.2
Unemployment Rate (%)	5.8	5.3	5.1	5.1	5.0	5.0	4.9
Business Confidence[1]	17.7	18.0	13.0	9.0	10.0	9.0	11.0
Consumer Prices[2]	2.6	2.8	2.8	2.8	2.7	2.5	2.6
Producer Input Prices[3]	-9.6	-8.5	-8.9	-8.3	-9.2	-10.1	-9.5
Average Earnings[3]	4.3	4.4	4.6	4.8	4.5	4.5	n.a.

1. Percent of firms expecting output to increase in the next four months minus those expecting output to decrease.
2. Retail prices excluding mortgage interest payments. Percent change from previous year.
3. Percent change from previous year.

In its February *Inflation Report*, the Bank of England noted that while growth is expected to slow sharply over the coming year and the strength of sterling has depressed retail price inflation, domestically-generated inflation is "significantly above the target level" and concluded that "the balance of risks in the projection implies that it is more likely than not that a modest further rise in interest rates will be necessary at some point to meet the inflation target looking two years or so ahead."

Chancellor of the Exchequer Gordon Brown released the Labour government's second budget on March 17. The budget introduces some new initiatives for addressing long-term unemployment as part of the "Welfare to Work" reform and provides tax relief for low-income working families, but the overall impact is neutral. The general government fiscal deficit, on a Maastricht basis, is projected to decline to £1.3 billion in FY 1998-99, or 0.1 percent of GDP, and to be in balance in the following year.

In **Italy**, GDP rose only 0.7 percent (SAAR) in the fourth quarter. Both household consumption and business fixed investment declined, and net exports contributed negatively. A large increase in inventory accumulation more than accounted for fourth-quarter GDP growth. The data indicate that the positive effects on household consumption of the government's tax-incentive program on new auto purchases have started to subside.

ITALIAN REAL GDP
(Percent change from previous period, SAAR) [1]

	1996	1997	1997			
			Q1	Q2	Q3	Q4
GDP	-0.2	2.8	0.1	7.8	2.6	0.7
Total Domestic Demand	-1.1	3.7	1.8	10.6	-0.9	3.7
Consumption	1.0	1.9	4.8	2.8	0.9	-1.0
Investment	-2.7	2.1	0.8	5.1	3.2	-0.5
Government Consumption	-0.3	-0.2	-1.8	0.5	0.6	0.1
Inventories (contribution)	-1.1	2.1	-1.0	7.4	-2.1	4.2
Exports	4.3	9.1	-21.3	43.8	30.2	-3.8
Imports	1.0	14.3	-18.3	67.0	16.3	7.7
Net Exports (contribution)	0.8	-0.8	-1.6	-2.3	3.4	-2.8

1. Annual changes are Q4/Q4.

First-quarter indicators are limited but point to a pickup in growth. In January, business sentiment soared, and industrial production rose 1.0 percent. In January and February, consumer confidence exceeded the fourth-quarter average.

Italian inflation has ticked up recently but remains low. In March, preliminary data from eleven Italian cities, which carry a cumulative 76 percent weight in the national index, increased 1.8 percent over the year earlier. The slight pickup in CPI inflation in recent months in part reflects the passthrough effects of the VAT hike in October.

ITALIAN ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997				1998		
	Q3	Q4	Nov	Dec	Jan	Feb	Mar
Industrial Production	0.5	1.3	0.6	-0.4	1.0	n.a.	n.a.
Cap. Utilization (%)	77.7	79.0	...	...	...	...	...
Unemployment Rate (%)	12.1	n.a.	...	...	...	...	...
Consumer Confidence[1]	117.2	115.3	116.7	113.2	120.8	118.7	n.a.
Bus. Sentiment[2] (%)	18.0	17.0	13.0	26.0	35.0	n.a.	n.a.
Consumer Prices[3]	1.5	1.6	1.6	1.5	1.6	1.8	1.8
Wholesale Prices[3]	0.4	0.4	0.6	0.6	n.a.	n.a.	n.a.

1. Level of index, NSA.
2. Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.
3. Percent change from previous year.

Canadian real GDP grew a moderate 3.0 percent (SAAR) in the fourth quarter, slowing down from an average pace of about 4-1/2 percent over the first three quarters. Final domestic demand edged up only 1.2 percent, but GDP growth was supported by an improvement in net exports. Consumer spending grew 2.3 percent, less than half its third quarter pace, as personal income growth suffered from strikes by postal workers and Ontario teachers. Business fixed investment was little changed in the fourth quarter, following seven quarters of robust growth.

The Canadian unemployment rate fell back to 8.6 percent in February, the same level as in December, retracing the upward blip in January caused by the ice storm in Quebec and eastern Ontario that stalled employment growth. For January and February on average, employment growth was fully as strong as that in the last two months of 1997. Lower energy prices have helped keep consumer price inflation near one percent, the bottom of the Bank of Canada's target range.

The Bank of Canada raised its key Bank Rate 50 basis points to 5 percent on January 30. The move was aimed at defending the Canadian dollar, which had fallen 2 percent in the previous two weeks to a new record low of just above 68 U.S. cents. The Bank indicated that the easing of monetary conditions associated with the depreciation was not appropriate.

CANADIAN REAL GDP
(Percent change from previous period, SAAR) [1]

	1996	1997	1997 Q1	1997 Q2	1997 Q3	1997 Q4
GDP	2.0	4.2	4.7	5.2	3.9	3.0
Total Domestic Demand	4.1	3.9	0.9	7.2	6.6	1.2
Consumption	3.0	4.1	3.9	4.6	5.5	2.3
Investment	13.8	6.6	8.8	5.3	12.5	0.3
Government Consumption	-0.8	0.5	-0.2	0.2	2.0	-0.1
Inventories (contribution)	0.1	0.2	-3.0	3.3	0.6	-0.2
Exports	2.6	11.9	24.8	3.3	12.2	8.3
Imports	7.8	13.1	17.3	6.4	23.8	6.0
Net Exports (contribution)	-1.6	-0.3	2.5	-1.0	-3.5	0.8

1. Annual changes are Q4/Q4.

The Canadian government announced on February 24 its forecasts of a balanced budget for the current fiscal year ending March 31 as well as for the next two fiscal years. This would mark the first balanced budget since FY 1969-70 and the first time in almost 50 years that the budget would be balanced for three years in a row, the culmination of four years of fiscal restraint aided by recent strong economic growth and taxes paid on capital gains in the stock market. In the current fiscal year, the C$5 billion surplus over the first nine months has been allocated largely to a number of new spending plans, with the largest share going to improve access to post-secondary education. In the next two fiscal years, the projected budget is kept from going into surplus by a C$3 billion contingency fund and conservative assumptions for economic growth and interest rates. Given the projected budget balances, the government forecasts that economic growth will lower the debt/GDP ratio to 63 percent in 1999-2000 from 72 percent in 1995-96.

CANADIAN ECONOMIC INDICATORS
(Percent change from previous period except where noted, SA)

	1997					1998	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
GDP at Factor Cost	1.1	1.2	0.7	-0.2	1.0	n.a.	n.a.
Industrial Production	1.4	1.7	0.7	-0.2	0.9	n.a.	n.a.
Manufacturing Survey:							
Shipments	0.9	2.5	0.8	-0.0	2.0	-3.8	n.a.
New Orders	1.4	2.0	1.6	-1.0	-1.7	-0.8	n.a.
Retail Sales	1.7	1.7	1.3	-0.9	3.3	-1.9	n.a.
Housing Starts	-4.3	2.2	0.1	0.0	0.3	-4.7	11.0
Employment	0.9	0.8	0.4	0.3	0.3	-0.0	0.6
Unemployment Rate (%)	9.3	9.0	8.9	9.0	8.6	8.9	8.6
Consumer Prices[1]	1.6	1.7	1.0	0.9	0.7	1.1	1.0
Consumer Attitudes[2]	116.0	119.9	116.8	...	...	...	...
Business Confidence[3]	165.0	164.9	159.2	...	...	...	...

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

At the time of the budget announcement, the Bank of Canada and the Government of Canada released a joint statement extending current inflation-control targets until the end of 2001. The target range will remain from 1 to 3 percent, defined in terms of 12-month CPI inflation, and the operational guide for policy will continue to be the CPI excluding food and energy and adjusted for the effects of indirect tax changes.

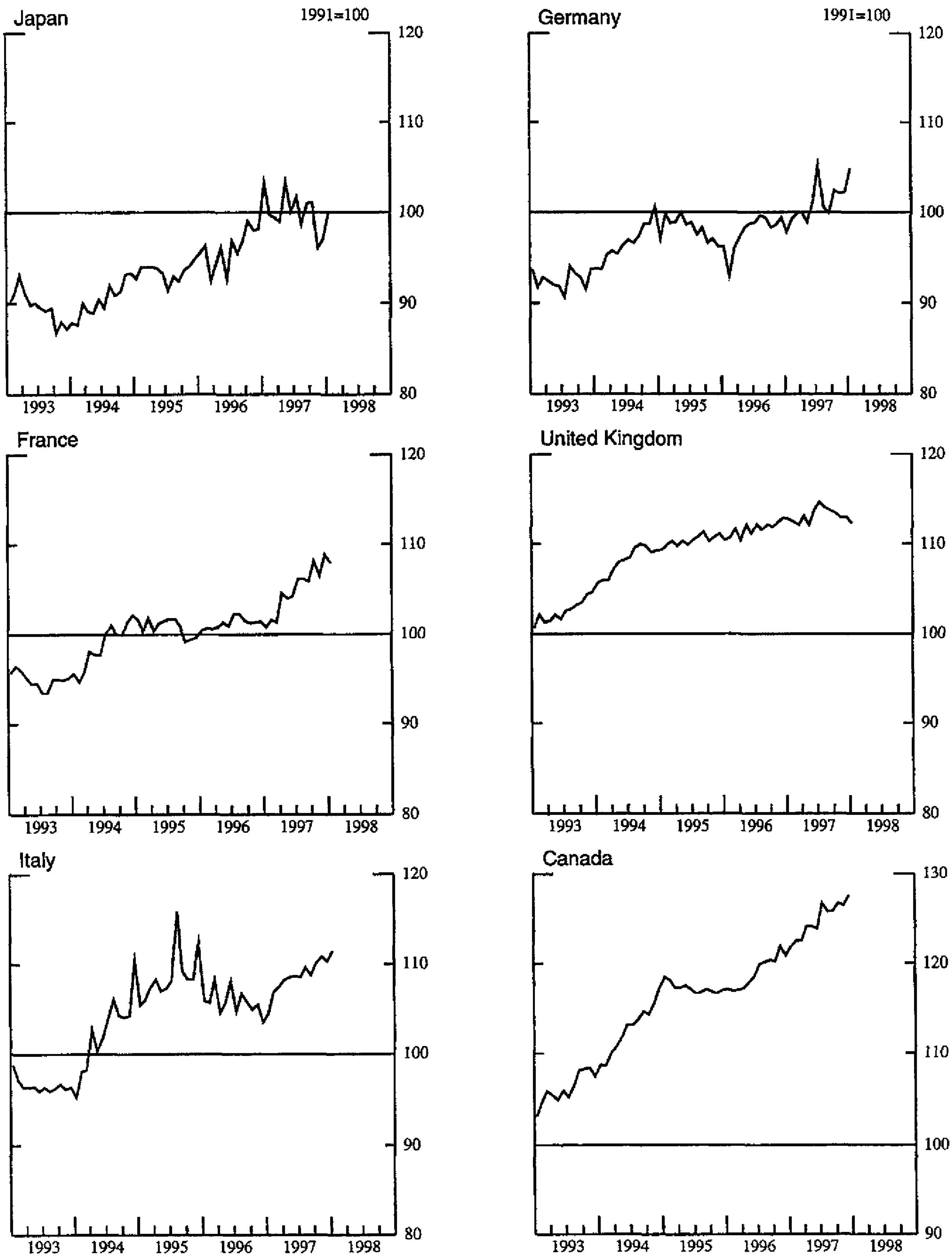
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1997	1997					1998	
		Q2	Q3	Q4	Nov	Dec	Jan	Feb
Japan: trade	83.0	22.6	22.2	24.7	8.5	6.2	8.3	9.2
current account	96.0	26.4	24.4	29.8	10.2	8.5	8.1	n.a.
Germany: trade[1]	69.9	17.8	19.0	19.9	7.0	6.9	3.5	n.a.
current account[1]	-1.4	2.8	-2.2	4.3	0.8	6.1	-6.9	n.a.
France: trade	29.3	8.5	8.1	7.3	1.8	2.3	n.a.	n.a.
current account	39.9	11.5	8.5	11.0	2.3	3.1	n.a.	n.a.
U.K.: trade	-21.3	-5.1	-4.6	-7.0.	-2.7	-2.2	n.a.	n.a.
current account	7.3	2.8	2.2	0.2	...	...	...	...
Italy: trade	30.4	8.1	7.1	6.4	2.3	1.5	n.a.	n.a.
current account[1]	35.8	7.1	11.5	8.4	2.7	1.9	n.a.	n.a.
Canada: trade	16.9	4.5	3.4	2.9	0.9	1.4	1.2	n.a.
current account	-12.2	-2.3	-4.8	-4.4	...	...	...	...

1. Not seasonally adjusted.
... Data not available on a monthly basis.

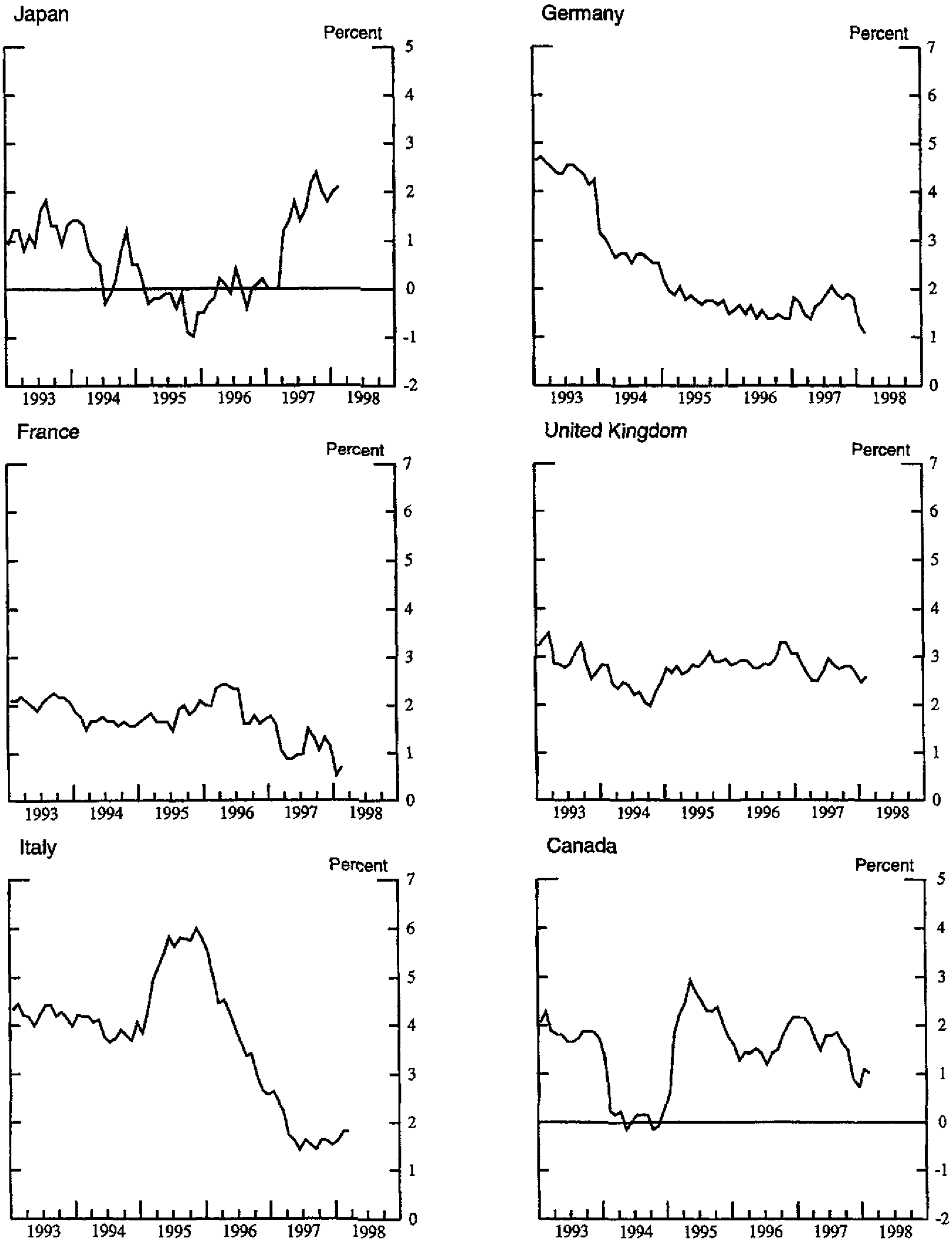
MARCH 25, 1998

Industrial Production in Selected Industrial Countries



MARCH 25, 1998

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



Economic Situation in Other Countries

Korea and Thailand continued their resolute steps toward implementing reforms under their respective IMF programs, despite pronounced slowdowns in economic activity. The course of reforms in Indonesia remains highly uncertain, and the economic and financial situation continues to deteriorate. Economic activity showed signs of slowing in Malaysia, the Philippines, and Singapore, putting further pressure on policymakers in those countries to intensify their reform efforts. Inflation picked up considerably in the ASEAN region--particularly Indonesia--and in Korea.

The impact of the slowdown in Korea and the ASEAN region on economic activity in other emerging-market countries was not very pronounced. Exports slowed substantially in Taiwan but remained strong in China. Among Latin American countries, growth remained strong, except in Brazil.

Individual country notes. In **Korea**, financial markets appear to have stabilized since the beginning of this year, with the won appreciating and the stock market showing a substantial rebound (albeit from very depressed levels). However, there is evidence that the financial crisis has generated a sharp downturn in activity. Although Korea does not publish seasonally-adjusted GDP estimates, we estimate that real GDP contracted 1.7 percent (SAAR) during the fourth quarter. Moreover, the unemployment rate jumped to 4.1 percent in January 1998 from 2.1 percent in October, reflecting both corporate restructuring efforts and a surge in bankruptcies.

Korea's current account moved dramatically into surplus, following two years of sizeable deficits. During January-February, the current account showed a surplus of nearly $7 billion (not an annual rate), compared with a deficit of $5-1/2 billion a year earlier. Most of this swing reflected a sharp contraction of imports, due to very tight credit conditions and a high degree of economic uncertainty. Imports fell 35 percent in the first two months of this year from their year-earlier level. Exports rose 9.5 percent, but most of the growth was attributable to a temporary surge in gold exports.

KOREAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	6.8	5.5	6.3	3.9	...	...
Industrial Production	8.4	8.1	8.9	7.0	n.a.	n.a.
Consumer Prices	4.9	4.5	4.0	5.1	8.4	9.5
Trade Balance[1]	-15.3	-2.7	0.0	3.3	2.0	3.8
Current Account[1]	-23.7	-9.0	-2.3	3.5	3.1	3.9

1. Billions of U.S. dollars, NSA

The recent stabilization of Korea's financial markets has reflected in part the success of a rollover arrangement in which Korea's foreign bank creditors agreed to extend their maturing claims on Korean banks. In late January, the Korean authorities proposed a longer-term restructuring of the external liabilities of Korean banks. This "Exchange Offer" allowed creditor banks to exchange most of their short-term claims on Korean banks for restructured notes that carried a sovereign guarantee. The restructured notes have maturities ranging from 1 to 3 years, and interest rates between 2.25 and 2.75 percent above LIBOR. Creditor banks have agreed to exchange $21.7 billion of $22.35 billion in claims that were eligible to be tendered. The formal debt exchange will occur on April 8.

The reserve position of the Bank of Korea has improved markedly since the beginning of this year, with the BOK's useable foreign exchange reserves rising from under $6 billion on December 31 to $20.3 billion on March 16. In addition to disbursements from the multilaterals (which totaled $5 billion over the period), the increase in reserves has reflected repayments to the BOK's support window by Korean banks, and a gold campaign that has contributed over $1.5 billion to the BOK's reserves.

Korea has continued to implement financial sector restructuring measures called for in its IMF program. In early February, Korea closed 10 of the 14 merchant banks it had suspended in early December. Two additional merchant banks were closed at the end of last month. Korea allowed foreign investors to purchase securities issued by Korean corporations without restriction as of February 16 and it has announced that it will lift remaining restrictions on the purchase of money market instruments issued by Korean financial institutions by the end of this year.

Significant progress has been made in labor reform. The Korean National Assembly passed legislation in February that will ease the ability of employers to lay off workers. The legislation included provisions to increase substantially the funding of Korea's nascent unemployment compensation scheme.

In the **ASEAN** region, the substantial increases in interest rates since the onset of the crisis, along with the effects of the currency depreciations and associated declines in investor confidence, have slowed domestic demand growth considerably. In Indonesia, real GDP growth in 1997 slowed to under 5 percent, compared with nearly 8 percent in 1996. In Malaysia, industrial production in January was less than 3 percent above its year-earlier level. In the Philippines and Singapore, there was a marked slowdown in real GDP growth in the fourth quarter of 1997. Thailand continued to show the strongest effects to date from the crisis: industrial production in the fourth quarter was nearly 13 percent below its year-earlier level.

ASEAN ECONOMIC INDICATORS: GROWTH

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP, SAAR						
Indonesia	7.8	4.7	...	...	...	...
Malaysia	8.6	n.a.	3.9	n.a.	...	...
Philippines	5.7	5.1	1.9	1.1	...	...
Singapore	6.7	7.5	6.3	2.2	...	...
Thailand	6.4	-0.4	...	...	...	...
Industrial Production[1]						
Malaysia	11.0	10.8	9.8	10.2	2.8	n.a.
Thailand	7.2	-0.9	-2.6	-12.7	n.a.	n.a.

1. Year-over-Year

Inflation has been rising in most economies in the region, driven in large part by the sharp depreciation of their currencies. In Indonesia, consumer prices in February were 32 percent higher than the year-earlier level; a long drought has exacerbated the inflationary pressure. The inflation rate picked up noticeably in February in both the Philippines and Malaysia and showed a further uptick in Thailand.

ASEAN ECONOMIC INDICATORS: INFLATION
(Percent change from year earlier)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Consumer Prices						
Indonesia	8.0	6.5	6.0	10.0	18.1	31.7
Malaysia	3.5	2.7	2.3	2.7	3.4	4.4
Philippines	8.4	5.1	4.9	6.1	6.4	7.4
Singapore	1.4	2.0	2.3	2.3	1.2	n.a.
Thailand	5.8	5.6	6.2	7.5	8.6	8.9

Trade balances continued to improve in most economies in the region as a result of the real depreciation of their currencies, the slowdown in their growth, and strong industrial country growth (outside of Japan).

ASEAN ECONOMIC INDICATORS: TRADE BALANCE

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Trade Balance[1]						
Indonesia	6.9	11.8	1.5	3.1	n.a.	n.a.
Malaysia	-0.2	-0.2	0.5	0.4	0.6	n.a.
Philippines	-11.4	-10.7	-2.8	-2.3	n.a.	n.a.
Singapore[2]	2.3	-5.8	-2.2	-0.8	0.5	n.a.
Thailand	-9.5	-4.6	-0.7	2.5	0.9	n.a.

1. Billions of U.S. dollars
2. Non-oil trade balance

Implementation of economic reforms varied quite a bit across the ASEAN region. The IMF approved the release of the third tranche of $270 million for Thailand and commended the Thai authorities "for resolutely implementing the economic program in very difficult circumstances." In contrast, the IMF delayed a scheduled review of Indonesia's current program, thereby holding up the release of the next tranche of IMF funds. However, newly-reelected President Suharto and his economic team are negotiating with IMF staff on a revised program. Amidst signs of increasing stress in their financial sectors, there was some acceleration in reforms in Malaysia and the Philippines. In Malaysia, Deputy Prime Minister and Finance Minister Anwar announced a package of reforms on March 24-25. While complete details are not available as yet, the measures appear to have fallen short of expectations, particularly since Anwar did not outline concrete steps towards a previously announced expansion of stock ownership rights for ethnic-Chinese Malays and foreign individuals. The Philippines agreed to further banking sector reforms in a letter of intent submitted for the IMF Board's review. If approved, the two-year stand-by agreement will give the country access to $1.6 billion in credit from the IMF, and additional funding from the World Bank and the ADB.

In **Hong Kong**, pressure on the currency has abated considerably, and the stock market has recovered substantially from its early January lows. The yield spread between Hong Kong government debt and U.S. Treasuries at a 10-year maturity fell from 550 basis points in mid-January to around 210 basis points on March 24. Over this same period, Hong Kong's stock market rose more than 40 percent. Hong Kong authorities, as well as Chinese officials, continue to stress Hong Kong's commitment to the fixed peg against the dollar. Foreign exchange reserves were $98 billion at the end of January, up about $5 billion from December.

In **China**, export growth continued to be strong and inflation quiescent in the first two months of 1998. China's trade surplus of $7.1 billion in the first two months of 1998 compares with a surplus of $3.8 billion in the year-earlier period. Exports rose 16 percent, while imports were virtually unchanged. (Because of the Chinese New Year--which fell in January this year but February last year--it is useful to combine data for the first two months of the year). This sizable surplus suggests that China's net exports have not yet been significantly affected by the Asian crisis; Chinese authorities did report, without providing details, that exports to Asia declined, while exports to Europe and the United States grew rapidly. China's exchange rate has continued to appreciate slowly against the U.S. dollar over the past year, despite the substantial depreciation of other Asian currencies since the middle of 1997. In 1998, Chinese leaders have consistently pledged not to allow its currency to depreciate. Foreign-exchange reserves remained stable in the first two months of 1998 at $140 billion.

At the annual National People's Congress in March, authorities announced several major reforms. China will substantially reduce its government bureaucracy, eliminating 11 out of its 40 ministry-

CHINESE ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	9.7	8.8	8.0	8.2	...	...
Industrial Production	15.6	13.1	12.1	13.0	n.a.	n.a.
Consumer Prices[1]	7.0	0.4	1.8	0.4	0.3	-0.1
Trade Balance[2]	12.2	40.3	12.8	9.7	4.0	3.1

1. End of period
2. Billions of U.S. dollars, NSA

level bodies. China will issue about $33 billion in bonds to increase the capital of the four major banks. China is also considering a large infrastructure spending program in order to try to prevent the economy from slowing sharply as a result of the Asian crisis. Although the Asian crisis has had only a minimal direct effect on China so far, authorities have repeatedly stressed that they expect their trade surplus and capital inflows to be adversely affected.

On March 24, China cut interest rates, with lending rates falling by an average of 60 basis points, and deposit rates falling by an average of 16 basis points. The Chinese government continues to set the interest rates that banks and other financial institutions can charge, and the rate cut appears to reflect concerns about China's slowing economy. In a related move, the People's Bank of China (PBOC)--China's central bank--also cut reserve requirements on deposits from 13 percent to 8 percent; the PBOC pays interest on these reserves, but it reduced the interest rate by 230 basis points, reducing the incentive for depository institutions to hold excess reserves with the central bank rather than making loans.

Taiwan's exports have slowed substantially, while industrial production remains robust and inflation remains low. Taiwan ran a rare trade deficit of $610 million in February, following a small trade surplus in January. The deficit in February was the largest monthly deficit since the 1970s. In January and February together, exports fell 10 percent from the year-earlier period, while imports were unchanged. The sharp fall in exports suggests that the Asian crisis may be having an adverse effect on Taiwan, whose exchange rate has depreciated by less than that of most other developing

Asian economies. As of March 24, the Taiwan dollar had appreciated about 5 percent against the U.S. dollar since its lows in early January; the stock market had risen about 8 percent from the beginning of the year. International reserves were $84 billion at the end of February, up about $1 billion since the beginning of the year.

TAIWAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted, NSA)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	5.7	6.8	6.9	7.1	...	...
Industrial Production	1.6	7.0	7.4	8.2	-6.8	19.9
Consumer Prices[1]	2.5	0.2	0.6	0.2	1.9	0.3
Trade Balance[2]	14.3	7.7	2.0	2.2	-0.2	-0.6
Current Account[2]	10.5	7.4	2.3	2.2	...	...

1. End of period
2. Billions of U.S. dollars, NSA

In **Brazil**, real GDP growth slowed to 2 percent (SAAR) in the fourth quarter and industrial output declined. Unemployment rose from 4.8 percent in December to 7.3 percent in January, the highest level in 13 years. The slowdown in economic activity has contributed to a narrowing of the trade deficit in recent months. The trade deficit for the January-February period stood at $0.8 billion, about half the deficit over the same period a year earlier. In early March, the central bank reduced the overnight rate from 34.5 percent to 28 percent, partly in response to the slowdown in economic activity in recent months.

The decline in domestic interest rates may also reflect perceptions of reduced risk of a devaluation in the near term. In recent weeks, stock prices have risen and as of March 24 the Bovespa had nearly regained its level in late-October 1997. Since the beginning of the year, the spread between stripped yields on Brazilian Brady bonds and U.S. Treasuries has dropped by about 140 basis points, to about 440 basis points on March 23. International reserves (liquidity concept) have risen in recent weeks to $59 billion at the end of February, putting them nearly back to their level in late-October 1997.

BRAZILIAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP, SAAR[1]	2.8	3.0	4.3	2.0	...	...
Industrial Production (SA)	5.4	2.0	1.0	-2.4	1.6	n.a.
Open Unemployment Rate (%)	5.4	5.6	5.9	5.3	7.3	n.a.
Consumer Prices[2]	9.4	4.3	0.4	1.1	0.9	0.5
Trade Balance[3]	-5.5	-8.4	-2.2	-2.9	-0.7	-0.1
Current Account[3]	-24.3	-33.8	-7.9	-11.2	-2.1	-1.7

1. Percent-change from previous period.
2. INPC, Percentage change from previous period. Annual data are Dec/Dec.
3. Billions of U.S. dollars, NSA

In **Mexico**, the economy continues to be strong but there are some signs that the pace of economic activity has slowed somewhat. Industrial production grew by 7.6 percent in January from its year-earlier level, compared with a 9.2 percent rise in December. The unemployment rate rose to 3.6 percent in January and remained near that level in February.

The Mexican current account deficit was $7.3 billion in 1997, up from $1.9 billion in 1996, and it widened throughout the year. The trade balance continued was in deficit in January, at a slightly higher rate than in the second half of 1997; the growth of both imports and exports slowed sharply.

MEXICAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	5.1	7.0	8.1	6.7	...	...
Industrial Production	10.4	9.2	10.2	8.9	7.6	n.a.
Unemployment Rate (%)	5.5	3.7	3.7	3.1	3.6	3.5
Consumer Prices[1]	27.7	15.7	3.0	3.4	2.2	1.7
Trade Balance[2]	6.3	0.6	-0.3	-1.3	-0.6	n.a.
Imports[2]	89.6	109.8	28.5	31.0	9.3	n.a.
Exports[2]	95.9	110.4	28.2	29.7	8.7	n.a.
Current Account[2]	-1.9	-7.3	-2.5	-3.1	...	...

1. Percentage change from previous period.
2. Billions of U.S. dollars, NSA

The rise in consumer prices accelerated in January and February due the depreciation of the peso, adjustments to the basic wage rate, and increases in prices of basic foodstuff. In early March, the Bank of Mexico tightened monetary policy, hoping to keep inflation under control and to prevent the rapid depreciation of the exchange rate. In addition to more restrictive monetary policy, it is expected that fiscal policy may have to be tighter as oil prices continue to decline, reducing dramatically the revenue of the Mexican government.

Mexican financial markets continue to be affected modestly by the Asian crisis and declining oil prices. The peso value of the dollar, which opened the year at 8.1 has fallen to 8.5, and has remained volatile. At the most recent Treasury auction on March 24, 28-day interest rates were 19.85 percent, above their end-January level reflecting tighter monetary policy.

In **Argentina**, economic growth continues to be robust. Real GDP grew 8.2 percent in 1997 (Q4/Q4). In February, industrial production (SA) was up 7.5 percent over a year ago. Consumer price inflation picked up significantly in January-February. However, this rise was partly accounted for by seasonal factors and partly by an increase in public transport fares approved by the government; the 12-month inflation rate for February was around half a percent.

The accumulated 12-month trade deficit in January was about $3.5 billion, compared with a trade surplus of around $1.4 billion in the previous twelve months. This outcome took the trade deficit beyond the limit agreed upon with the IMF for any 12-month period. This limit was set under the terms of a $2.8 billion three-year Extended Fund Facility that was officially approved earlier this year. The widening of external balances is a reflection of strong imports of capital goods, a fall in commodity prices, and a slowdown in exports to Brazil.

At present, there are not many direct indications that spillovers from Asia have slowed down the Argentine economy. While the stock market is still roughly 20 percent below where it was at the onset of the Asian crisis, interest rates on peso and dollar deposits and the spread between them are now below their pre-crisis levels. International reserves (excluding gold) stood at over $21 billion at end-February, up over 10 percent from their level at end of September last year, before the Asian crisis erupted.

ARGENTINE ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	4.3	8.4	8.6	8.2	...	...
Industrial Production (SA)	3.1	8.6	9.2	9.2	6.4	7.5
Unemployment Rate (%)[2]	17.2	14.9	...	13.7	...	...
Consumer Prices[1]	0.1	0.3	0.3	-0.2	0.6	0.4
Trade Balance[3]	1.6	-3.1	-1.1	-1.6	-0.7	n.a.
Current Account[3]	-4.0	n.a.	-2.7	n.a.	...	...

1. Percentage change from previous period; annual and quarterly numbers use end-of-period figures.
2. Unemployment figures available only in May and October of each year. The annual figure is the average of the two surveys.
3. Billions of U.S. dollars, NSA

In **Venezuela**, preliminary real GDP data confirm that economic recovery took hold in 1997 as real GDP grew 5.1 percent in 1997, with the oil sector growing 8.8 percent and the non-oil sector 3.3 percent. Consumer prices rose 2.2 percent in February, roughly in line with market expectations. The recovery has widened external balances; the non-oil trade deficit moved from about $4.8 billion in 1996 to about $6.1 billion in 1997.

The recent slump in oil prices spells trouble for the Venezuelan economy in the near future. So far this year, the price of the Venezuelan oil basket has averaged over $4 per barrel less than last year. The oil sector currently accounts for about a third of total output and over half of government revenues; each dollar decline in the oil price translates into about $1 billion loss of revenues to the government. The effects of the oil prices are also reflected in the stock market and international reserves. The Caracas stock exchange has fallen by over 15 percent since the start of this year and international reserves (excluding gold) were just over $13 billion in mid-March, roughly 8 percent lower than at the end of last year.

In other developments, the Central bank has allowed the depreciation rate of the bolivar to increase somewhat since the

VENEZUELAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	-0.4	5.1	...	...	...	...
Unemployment Rate (NSA, %)	11.8	11.8	11.5	11.1	...	...
Consumer Prices[1]	103.3	37.6	9.7	9.4	2.1	2.2
Non-oil Trade Balance[2]	-4.8	-6.1	-2.2	-2.0	n.a.	n.a.
Trade Balance[2]	13.8	12.3	2.6	2.3	n.a.	n.a.
Current Account[2]	8.8	n.a.	...	...	...	...

1. Percentage change from previous period, NSA; annual and quarterly numbers are end-of-period figures.
2. Billions of U.S. dollars, NSA.

start of this year, and the Venezuelan government has reached an informal agreement with the IMF on a monitoring program which would involve technical assistance but no actual disbursements.

In **Russia**, recent data indicate a possible slowing in the pace of activity. In February, real GDP was flat on a year-over-year basis after recording small gains in January and late last year. The twelve-month inflation rate in January eased further to just over 10 percent.

The exchange market pressure on the ruble which developed in January, mainly as a result of spillover from the Asian financial crises, intensified in early February but has since receded. The ruble strengthened after monetary authorities reaffirmed their commitment to support the currency and expressed a willingness to raise interest rates to achieve this end, even at the cost of weaker economic growth. The central bank raised its key refinancing rate to a peak on 42 percent in early February, but subsequently has been able to reduce this rate in three stages to 30 percent as pressure on the ruble has subsided. Foreign exchange reserves, which declined $2 billion in January to $16 billion, have shown no further net reduction since then. The March 11 announcement by Moody's of a downgrading of its ratings of Russian debt (citing rising short-term debt, diminished export earnings and excessive budget deficits) has had little apparent negative impact on the ruble exchange rate. In early March, Russia returned to the international debt market for the first time since last October, with a $150 million eurobond issue by the Moscow city telephone network. The three-year issue was placed at 690 basis points over Treasury securities.

RUSSIAN ECONOMIC INDICATORS
(Percent change from year earlier except where noted)

	1996	1997	1997		1998	
			Q3	Q4	Jan	Feb
Real GDP	-6.3	0.4	1.1	0.9	1.3	0.0
Industrial Production	-5.2	1.9	2.2	3.4	1.5	1.4
Consumer Prices	52.8	14.8	14.5	11.8	10.1	n.a.
Ruble Depreciation	12.5	12.7	10.3	7.8	7.2	7.0
Trade Balance[1]	16.4	n.a.	n.a.	n.a.	...	...
Current Account[1]	2.2	n.a.	n.a.	n.a.	...	...

1. Billions of U.S. dollars.

On March 11, the opposition-controlled State Duma (parliament) finally passed a 1998 budget, nearly six months after the government submitted a budget proposal. The new budget represents a significant improvement over budgets of recent years in that its estimates of revenues and expenditures are relatively realistic. The projected fiscal deficit is about 5 percent of GDP (compared with an actual deficit of about 7 percent last year).

On March 23, Russian President Boris Yeltsin dismissed Prime Minister Viktor Chernomyrdin and his entire cabinet. In explaining the move, President Yeltsin stated that it is ". . . an effort to make economic reforms more energetic and effective, to give them a political push, a new impulse." As interim Prime Minister, President Yeltsin named outgoing Fuel and Energy Minister Sergei Kiriyenko, a young technocrat generally seen as supportive of economic reform. Russian financial markets initially reacted negatively to the announcement of the government's dismissal, but soon recovered.