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

August 18, 1999

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

August 18, 1999

RECENT DEVELOPMENTS

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Domestic Nonfinancial Developments

Overview
Economic activity appears to be expanding at least moderately in the current quarter. Although some signs of a slackening in the pace of domestic final sales growth have crept into the picture, lean inventories at midyear and a possible boost to exports from improving growth abroad suggest a fairly solid trend in overall demand. Employment gains have been very large of late, keeping the labor market tight. But whether this has led in turn to increased cost pressures is unclear: Certainly, with the exception of the energy sector, price inflation has remained subdued and profit reports have been upbeat.

Real GDP
According to the BEA's advance estimate, real GDP rose at an annual rate of 2.3 percent in the second quarter. Subsequently, we have received additional source data that point to a downward revision, perhaps to a shade under the 2 percent mark; lower estimates for personal consumption expenditures and inventory accumulation account for the bulk of the expected revision. *Unless otherwise noted, the discussion of second-quarter activity in the remainder of this section of the Greenbook incorporates our expected revisions to the GDP data.*

Labor Market Developments
Gains in nonfarm payrolls averaged about 290,000 in June and July, up from an average of 195,000 over the first five months of the year. Still, with the household survey showing a much more modest net gain in employment, the jobless rate held in the neighborhood of about 4-1/4 percent, where it has been since the turn of the year.

Manufacturing employment rose 31,000 in July, after having declined 36,000 in June. The gain last month was the first in sixteen months, apart from the rebound at the end of the GM strike last summer. Of course, some caution is appropriate before concluding that a turning point has been reached, given the large seasonal movements in factory jobs that occur around this time of year and other statistical uncertainties. Still, some other indicators of manufacturing activity, such as the National Purchasing Managers' survey, do suggest that some firming may indeed have occurred since the spring.

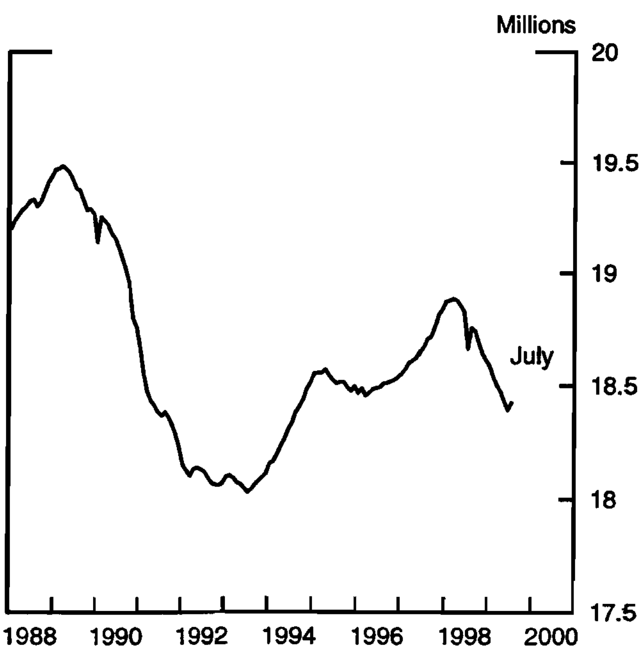
Construction payrolls increased about 20,000 in both June and July, in line with the average monthly increases over the previous twelve-month period. Hiring in the services-producing sector also was strong in June and July, with the gains exceeding the average of the past year.

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

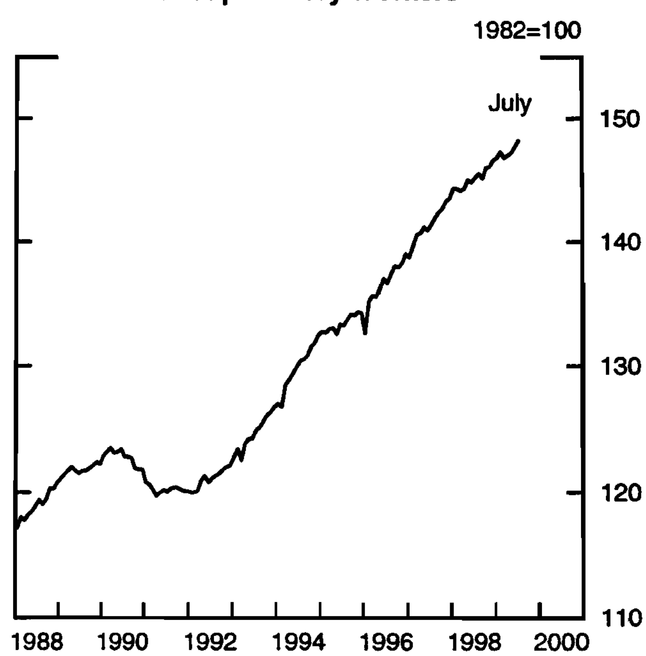
	1998	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
	-Average monthly changes-					
Nonfarm payroll employment[1]	244	209	207	28	273	310
Private	217	171	199	50	239	294
Goods producing	8	-23	-35	-89	-19	50
Mining	-3	-7	-8	-7	-4	-3
Manufacturing	-19	-36	-37	-44	-36	31
Construction	30	20	9	-38	21	22
Service producing	208	194	234	139	258	244
Transportation and utilities	18	16	15	8	20	14
Trade	46	44	74	36	56	107
Finance, insurance, real estate	26	18	15	10	18	13
Services	119	116	130	85	164	110
Total government	27	38	8	-22	34	16
Private nonfarm production workers[1]	167	156	135	70	146	256
Total employment[2]	157	169	133	155	208	-125
Nonagricultural	171	149	109	244	149	-63
Memo:						
Aggregate hours of private production workers (percent change)[1,3]	2.1	2.0	0.9	0.1	0.3	0.3
Average workweek (hours)[1]	34.6	34.6	34.4	34.4	34.5	34.5
Manufacturing (hours)	41.8	41.6	41.7	41.7	41.7	41.9

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Survey of households.
3. Annual data are percent change from Q4 to Q4. Quarterly data are percent change from preceding quarter at an annual rate. Monthly data are percent change from preceding month.

Manufacturing Employment



Aggregate Hours of Production or Nonsupervisory Workers



The average workweek of production or nonsupervisory workers on private nonfarm payrolls edged back up 0.1 hour to 34.5 hours in June and held at that level in July. Aggregate hours increased 0.3 percent in both June and July. The level of hours last month was 0.6 percent above the second-quarter average (not at an annual rate), suggesting that even with only modest growth in August and September, the overall gain in production worker hours in the third quarter could easily approach 3 percent at an annual rate.

The household survey and other labor market indicators continue to portray a robust, taut labor market. The unemployment rate, at 4.3 percent in June and July, has remained close to the 29-year low reached earlier this year. The labor force participation rate, which was 67.0 percent in July, also has changed little in recent months. The share of the population out of the labor force but wanting a job continued to bounce around in the low zone that has prevailed since the end of last year. In addition, the number of job leavers who were unemployed for less than five weeks (as a percentage of household employment) has been running higher of late, an indication, perhaps, that workers perceive plentiful job opportunities--which certainly is what the Conference Board consumer survey shows to be the case.

Among other indicators, initial claims for unemployment insurance since the July reference week have been very low--the lowest in this decade, on average. In the July National Federation of Independent Businesses' survey of small businesses, the fraction of firms reporting that positions are hard to fill and the net hiring strength index both remained high by historical standards.

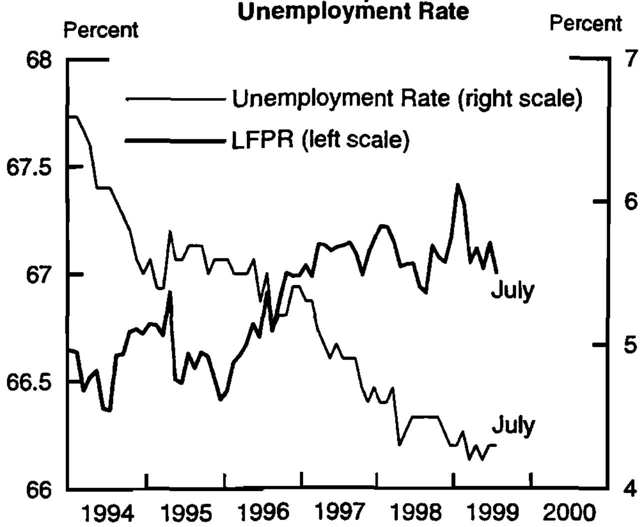
According to the BLS's preliminary estimate, labor productivity in the nonfarm business sector rose at an annual rate of 1.3 percent in the second quarter of 1999, a smaller gain than in recent quarters. Hours in the nonfarm business sector are estimated to have increased at an annual rate of 1.1 percent in the second quarter, while output moved up at a 2.4 percent rate.[1] This measure of output is calculated from the product side of the national accounts. We do not have an "official" measure of nonfarm business output for the second quarter from the income side of the accounts because NIPA profits have yet to be published. However, if second-quarter economic profits edged up from their first-quarter level--which appears roughly consistent with the book value profits reports for S&P 500 companies--the resulting income-side measures for the second-quarter increases in nonfarm business output and productivity would be on the order of 2-1/2 percentage points higher than the product-side figures. Under this scenario, an income-side-based measure of

1. This output figure is consistent with the BEA's advance estimate of growth in real GDP.

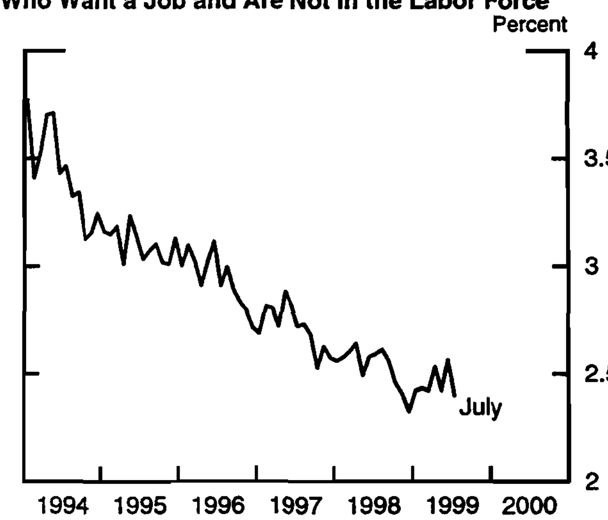
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

			1998	1999		1999		
	1997	1998	Q4	Q1	Q2	May	June	July
Civilian unemployment rate	4.9	4.5	4.4	4.3	4.3	4.2	4.3	4.3
Teenagers	16.0	14.6	14.9	14.6	13.4	12.6	13.5	12.7
Men, 20 years and older	4.2	3.7	3.6	3.4	3.5	3.6	3.6	3.5
Women, 20 years and older	4.4	4.1	4.0	3.8	3.9	3.6	3.9	4.0
Labor force participation rate	67.1	67.1	67.1	67.3	67.1	67.0	67.1	67.0
Teenagers	51.6	52.8	52.8	52.6	51.7	52.1	51.1	51.7
Men, 20 years and older	76.9	76.8	76.8	76.9	76.6	76.5	76.7	76.6
Women, 20 years and older	60.5	60.4	60.5	60.8	60.9	60.7	61.0	60.7
Women maintaining families	67.4	68.3	69.1	69.4	68.9	68.5	68.9	70.6

Labor Force Participation Rate and Unemployment Rate

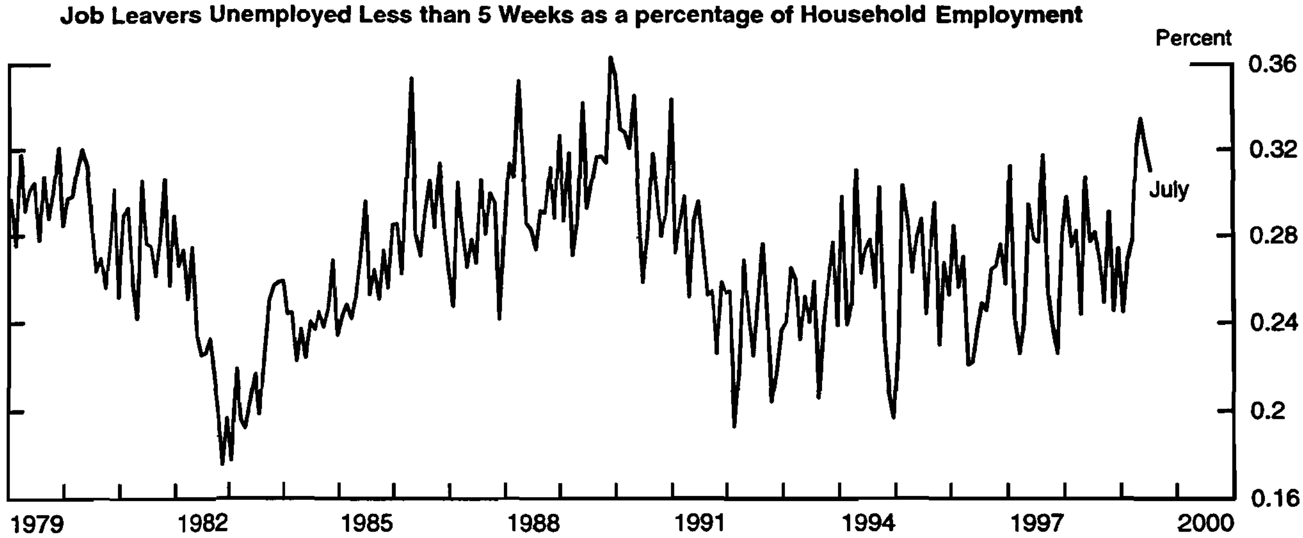


Share of the Population Age 16 to 64 Who Want a Job and Are Not in the Labor Force



Note. Seasonally adjusted by FRB staff.

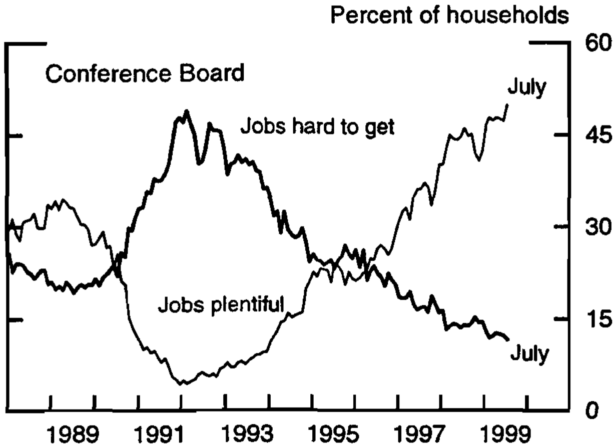
Job Leavers Unemployed Less than 5 Weeks as a percentage of Household Employment



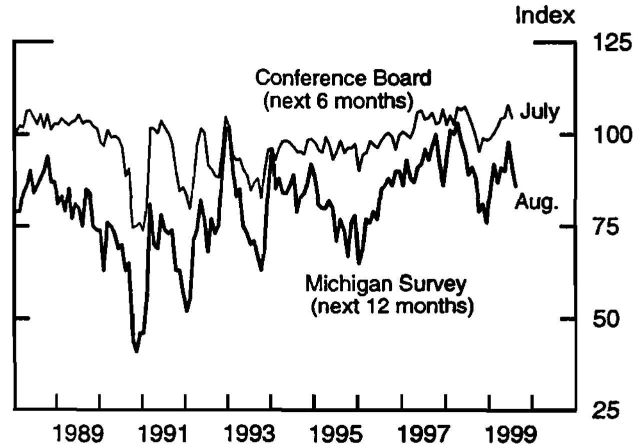
Note. Seasonally adjusted by FRB staff. Data prior to February 1997 are not strictly comparable because of CPS redesigns and BLS recompositing.

Labor Market Indicators

Current Job Availability

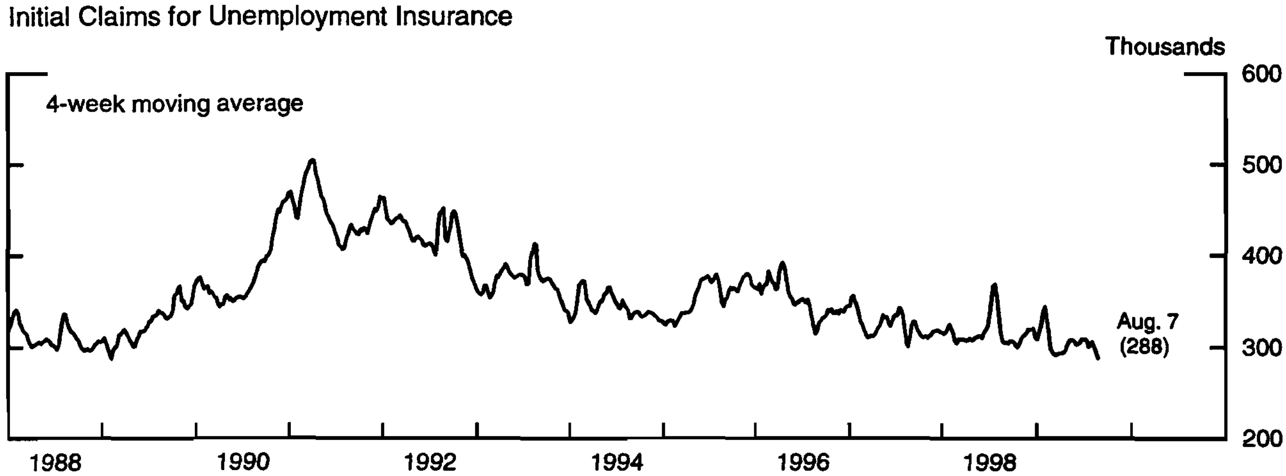


Expected Labor Market Conditions



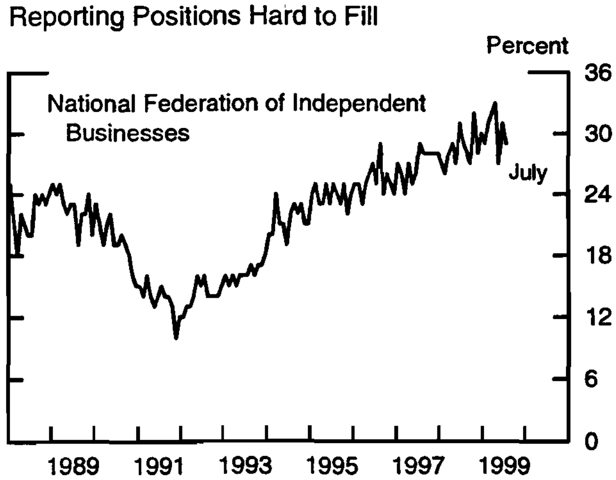
Note. Michigan index: the proportion of households expecting unemployment to fall, less the proportion expecting unemployment to rise, plus 100. Conference Board index: the proportion of respondents expecting more jobs, less the proportion expecting fewer jobs, plus 100.

Initial Claims for Unemployment Insurance

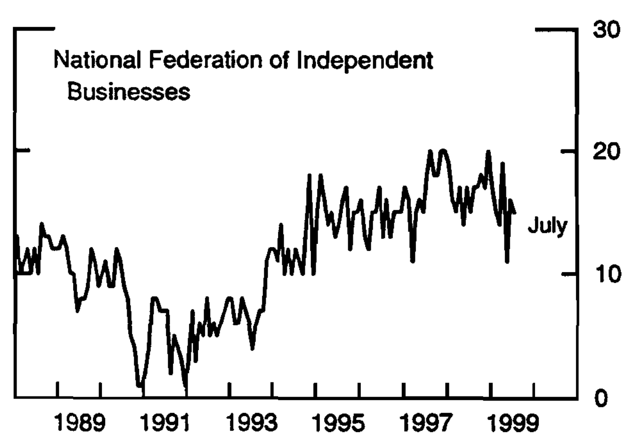


Note. State programs, includes EUC adjustment.

Reporting Positions Hard to Fill



Net Hiring Strength



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

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

	1997[1]	1998[1]	1998 Q3	1998 Q4	1999 Q1	1999 Q2
<u>Output per hour</u>						
Total business	1.8	2.8	3.1	4.3	3.9	1.6
Nonfarm business	1.6	2.6	2.7	4.1	3.6	1.3
Previous					3.5	
Manufacturing	5.3	3.8	4.8	5.3	6.3	4.9
Nonfinancial corporations[2]	2.6	3.3	4.6	3.1	5.0	n.a.
<u>Compensation per hour</u>						
Total business	3.8	4.2	4.1	4.2	5.1	5.4
Nonfarm business	3.7	4.1	4.1	3.8	4.4	5.1
Previous					4.2	
Manufacturing	5.2	3.2	3.1	3.5	5.2	6.0
Nonfinancial corporations[2]	3.8	4.1	4.3	4.0	4.9	n.a.
<u>Unit labor costs</u>						
Total business	2.0	1.4	1.0	-0.1	1.1	3.8
Nonfarm business	2.1	1.5	1.3	-0.4	0.8	3.8
Previous					0.7	
Manufacturing	-0.1	-0.6	-1.5	-1.8	-1.1	1.1
Nonfinancial corporations[2]	1.2	0.7	-0.3	0.8	-0.1	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. Nonfinancial corporate sector includes all corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.
n.a. Not available.

nonfarm productivity would have increased roughly 3-1/2 percent between the second quarter of 1998 and the second quarter of 1999, about ½ percentage point faster than the product-side measure. That said, whether this alternative measure is closer to "truth" is conjectural, and both the product- and income-side measures of output could be revised appreciably in this fall's comprehensive benchmark revisions to the NIPA.

Industrial Production

Industrial production rose just 0.1 percent in June and then jumped 0.7 percent in July. The outsized gain in July reflected in part a surge in the output of utilities as the heat wave in the eastern United States spurred electricity demand. However, manufacturing production also moved unevenly, edging up only 0.1 percent in June before surging 0.6 percent last month. To some extent, the monthly variations probably were exaggerated by the interaction in a few industries of capacity constraints and seasonal factors. The average growth pace for the two months better captures our sense of what has been occurring in the factory sector. The factory operating rate averaged 79.5 percent in June and July, a couple of percentage points below its long-term mean.

Within manufacturing, the output of motor vehicles and parts rose 2 percent in June but then retraced that advance in July. Although it was scheduled to remain at a high level last month, production at Ford was held back by parts shortages that stemmed from startup problems following seasonal plant shutdowns. Assembly schedules indicate that production likely will rise in coming months as automakers attempt to build stocks in the face of torrid demand. Production of high-technology items--computers, semiconductors, and communications equipment--continued to advance at a strong pace. Output of business equipment excluding motor vehicles and high-technology items declined, on balance, over the past two months, with notable weakness in farm and construction machinery. The output of iron and steel, which bottomed out late last year, has continued to recover. The production of construction supplies, which surged in the later part of 1998, has fluctuated around an elevated level since early this year. Recently, the seasonally adjusted data for the production of construction supplies have bounced around some, as high rates of capacity utilization muted the normal pattern of a large pickup in activity in June and a step down in July.

Production in a number of nondurable goods industries--notably textiles and chemicals--has picked up, on balance, over the past few months. The gains come on the heels of large declines in 1998 and essentially flat production earlier this year. In large part, this pattern mirrors developments in foreign demand; exports slowed or dropped significantly in these industries in early- to

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

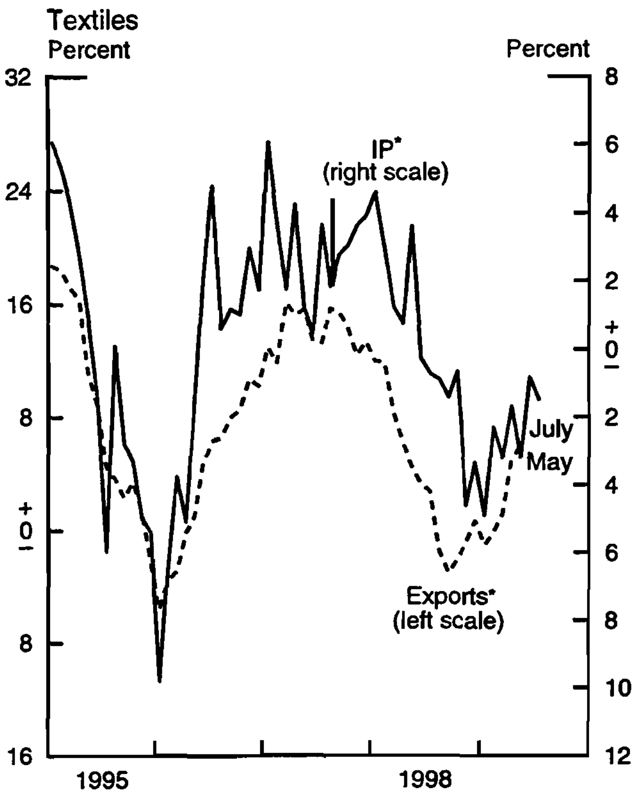
	Proportion 1998	1998[1]	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
			-Annual-rate-		--Monthly rate---		
Total index	100.0	1.9	1.3	3.8	.2	.1	.7
Mining	5.4	-4.9	-7.4	-1.8	.1	-.1	.8
Utilities	6.2	-1.1	4.8	5.0	-.4	.4	2.5
Manufacturing	88.4	2.5	1.5	4.1	.3	.1	.6
Motor vehicles and parts	5.1	.7	-2.9	10.5	.8	1.9	-2.0
Aircraft and parts	3.1	8.9	-11.6	-14.9	-1.8	-2.2	-.5
High-tech	8.4	26.7	17.2	42.0	3.2	2.3	2.8
Other manufacturing	71.8	-.2	.7	.4	-.1	-.2	.6
Consumer goods	23.2	-1.1	-.2	-.9	-.1	-.2	.4
Durables	3.6	1.7	9.7	6.3	.1	-.6	1.5
Nondurables	19.6	-1.6	-2.0	-2.2	-.2	-.1	.2
Business equipment	9.0	1.0	-3.4	-1.0	-.2	-1.3	.4
Construction supplies	5.6	5.0	7.6	-.1	.6	-.7	1.0
Materials	24.6	-1.3	1.4	1.4	.0	.3	.8
Durables	16.2	-.8	.6	1.2	-.1	.3	1.2
Nondurables	8.2	-2.8	2.4	1.1	.1	.4	-.1
Memo: High-tech industries							
Computer equipment	2.5	53.0	34.1	49.6	2.9	2.6	2.5
Communication equipment	2.1	5.6	.4	35.6	3.8	1.1	3.1
Semiconductors[2]	3.9	25.7	16.4	40.4	3.2	2.7	2.8

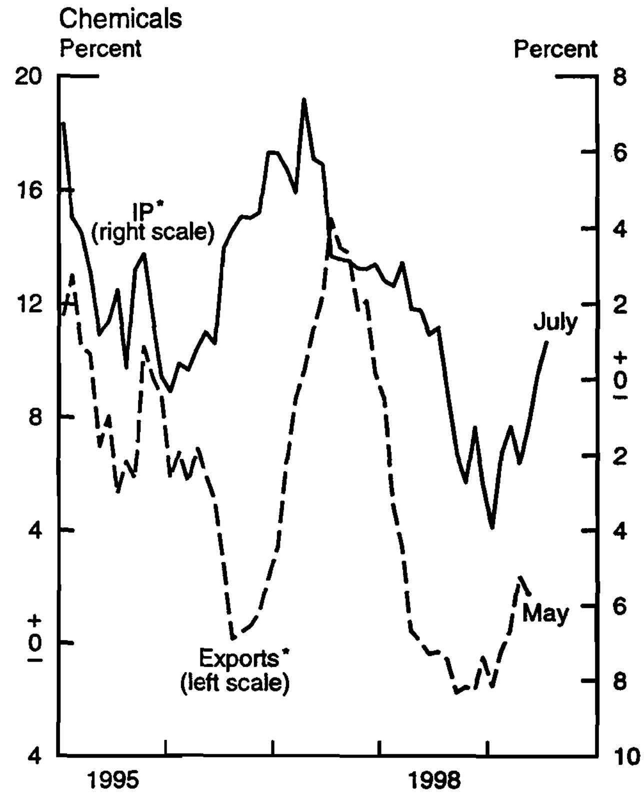
1. From the final quarter of the previous period to the final quarter of the period indicated.
2. Includes related electronic components.

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-98 Avg.	1998 Q4	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
Manufacturing	85.7	81.6	80.1	79.5	79.5	79.5	79.4	79.7
Primary processing	88.9	82.8	82.5	82.8	82.5	82.4	82.5	83.0
Advanced processing	84.2	81.1	79.3	78.3	78.5	78.6	78.4	78.6

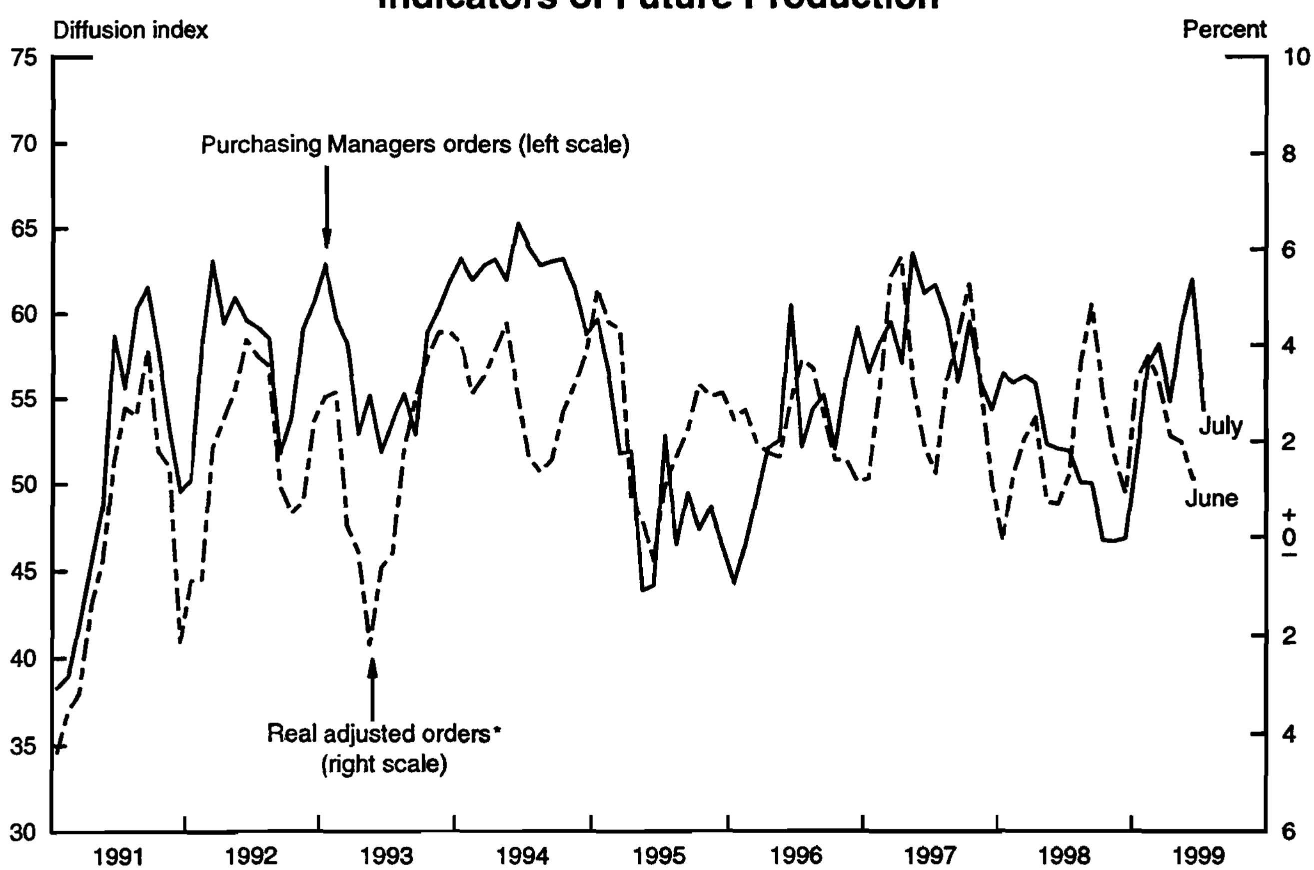
Foreign Demand and Production





*Percent change from year earlier. Exports are smoothed with a three-month moving average.

Indicators of Future Production



*Three-month percent change of three-month moving average.

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

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

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

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

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

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

mid-1998, but began to stabilize this year. Still, though production in these industries picked up recently, it remains near year-earlier levels.

Recent readings on orders for manufactures suggest that moderate advances in production will continue. The Beige Book reports improvement in manufacturing activity in most Districts and suggests that foreign demand for goods, while below year-earlier levels, has stabilized or improved slightly in recent months. The new orders index from the National Association of Purchasing Management also continues to indicate rising orders. However, the staff's series on real adjusted durable goods orders declined in May and June, although it increased 1.2 percent for the second quarter as a whole.

Motor Vehicles

Sales of light vehicles in July (adjusted for shifts in manufacturers' reporting periods), at 16.7 million units (annual rate), matched the robust pace of the second quarter. Industry analysts expect that sales will remain exceptionally strong, with forecasts ranging between 16-3/4 and 17 million units for the third quarter as a whole.

To this point, demand indicators remain decidedly positive. According to readings on perceived car-buying conditions in the Michigan SRC survey, consumers continue to view the market for new vehicles as exceptionally attractive because economic conditions are good and interest rates are relatively low. Furthermore, prices have remained subdued, and the CPI for new vehicles in July was 0.5 percent below its level of a year ago; prices have been restrained by sales incentives, which increased in the third quarter.

Business demand for light vehicles has also been impressive this year, with fleet sales through July running about 6 percent above the pace in 1998. Sales of medium and heavy duty trucks averaged an annual rate of about 615,000 units in June and July, only slightly below the 630,000 unit average of the first five months of the year. Net new orders for medium and heavy trucks averaged 480,000 units in June and July, up noticeably from the first five months of the year.

At the end of July, motor vehicle inventories were on the lean side, owing partly to the production problems at Ford. Production schedules for the remainder of the third quarter average about 13.3 million units.

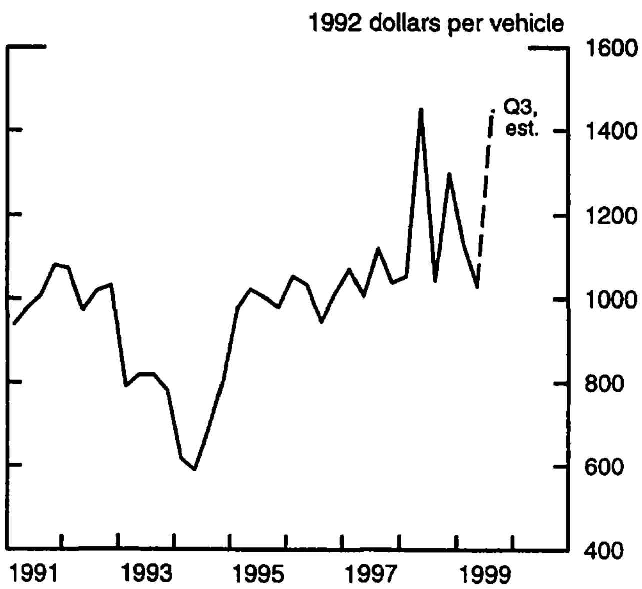
One source of uncertainty in the outlook for the auto market is the status of ongoing negotiations between the UAW, CAW, and the Big Three automakers. Industry analysts generally agree that neither workers nor management will risk derailing the current boom by failing to reach an

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

			1999		1999		
	1997	1998	Q1	Q2	May	June	July
Total	15.1	15.4	16.2	16.7	17.2	16.9	16.9
Adjusted[1]	15.0	15.5	16.2	16.7	16.9	17.1	16.6
Autos	8.3	8.1	8.4	8.7	8.9	8.7	8.8
Light trucks	6.8	7.3	7.9	8.0	8.3	8.1	8.1
North American[2]	13.1	13.4	13.9	14.3	14.7	14.5	14.4
Autos	6.9	6.8	6.8	7.0	7.1	7.0	7.0
Light trucks	6.2	6.7	7.1	7.3	7.5	7.4	7.3
Foreign Produced	1.9	2.0	2.3	2.4	2.5	2.4	2.5
Autos	1.4	1.4	1.5	1.7	1.8	1.7	1.7
Light trucks	.6	.6	.8	.7	.7	.7	.8
Memo:							
Retail Sales[3]	12.4	12.9	13.5	13.9	14.4	13.9	14.1
Fleet Sales[3]	2.6	2.6	2.7	2.8	2.8	3.0	2.8

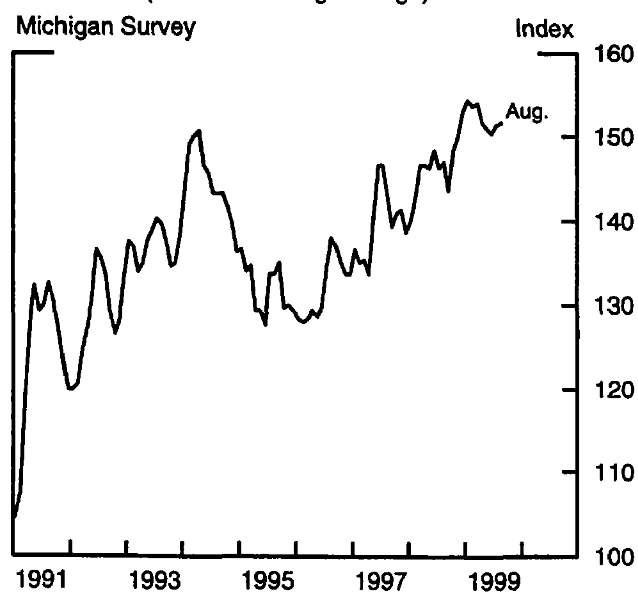
Note. Components may not add to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are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

Marketing Incentives for Light Vehicles
(FRB seasonals)



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

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



agreement before the contracts expire in mid- to late September. Even so, given the contentious relationship between the unions and the major producers, particularly GM, a major strike cannot be ruled out. In spite of recent back-pedaling by GM, tensions concerning GM's proposed modular assembly techniques and their implications for outsourcing remain high. Furthermore, Ford's relationship with the UAW has worsened recently, and the union announced that it intends to fight plans by Ford to spin off its Visteon parts subsidiary; however, press reports suggest that the likelihood of a strike over this issue is low.

Consumer Spending and Personal Income

Real consumer spending rose at an annual rate of about 3-3/4 percent in the second quarter--a solid gain, but well off the very strong pace of the first quarter--and the available data suggest there may be some further slippage in the current period.[2] The fundamental factors supporting spending are still favorable, however: Growth in real disposable income has been solid, households' wealth has increased substantially again so far this year, and consumer sentiment remains exceptionally positive.

According to the advance report, nominal outlays at stores in the retail control category increased 0.2 percent in July. General merchandise stores and outlets selling "other durable goods" posted strong gains. But these were partly offset by a drop in nominal purchases at apparel stores and at eating and drinking establishments. After factoring in the increase in consumer prices last month, we estimate that real outlays for goods other than motor vehicles edged down 0.1 percent in July. However, real consumer spending on motor vehicles likely rose last month, and we estimate that real personal consumption expenditures for all goods ticked up in July to a level 0.7 percent above the second-quarter average.[3]

Real outlays for services increased at an annual rate of 4-1/4 percent in the second quarter, with spending in all the major components posting solid gains. In the current quarter, extremely hot weather in July boosted outlays for energy services. Real outlays for brokerage services also may have been up a good deal in July as stock market trading volume rose last month for the first time since last April. However, so far in August, temperatures and stock market volume have averaged closer to seasonal norms.

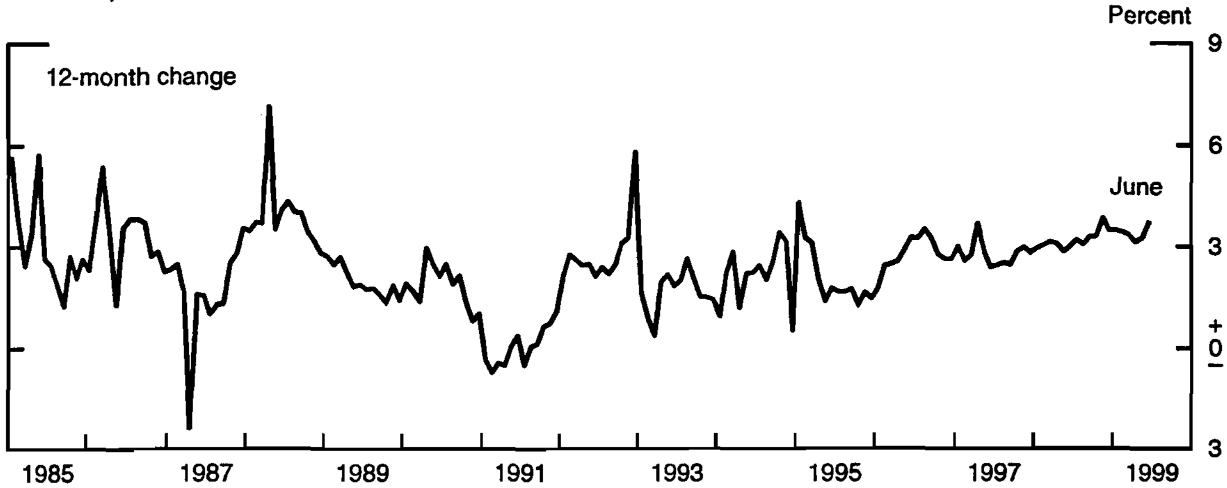
---

2. This second-quarter figure is about 1/4 percentage point below the BEA's advance estimate, owing to revised retail sales data.

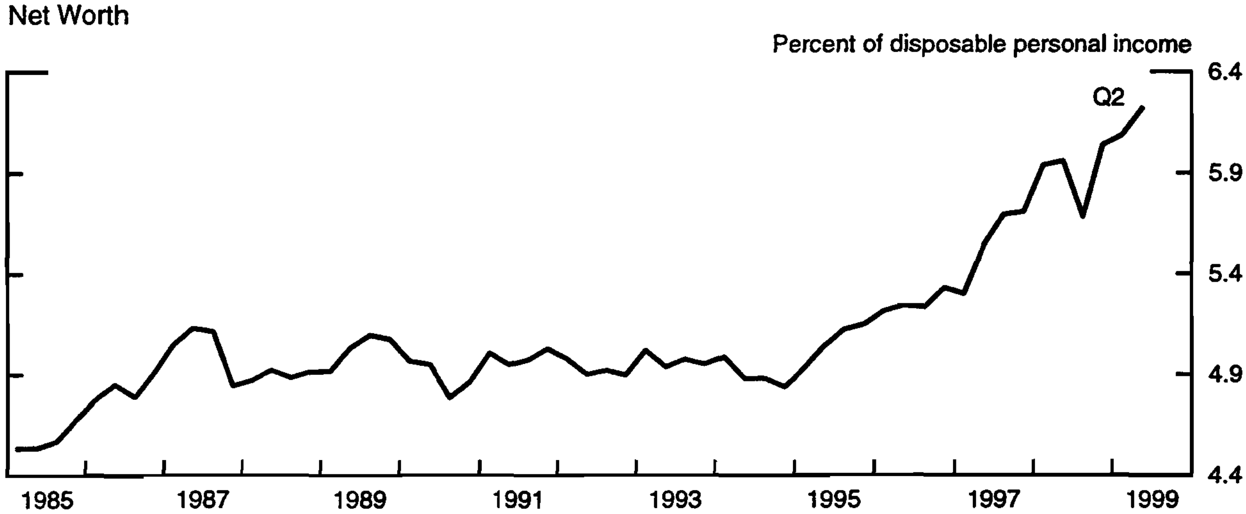
3. Overall unit sales of light vehicles declined in July, but this reflected a drop in fleet sales to businesses rather than a decline in purchases by individuals. The data allocating sales between fleet and retail customers are confidential.

Household Indicators

Real Disposable Personal Income

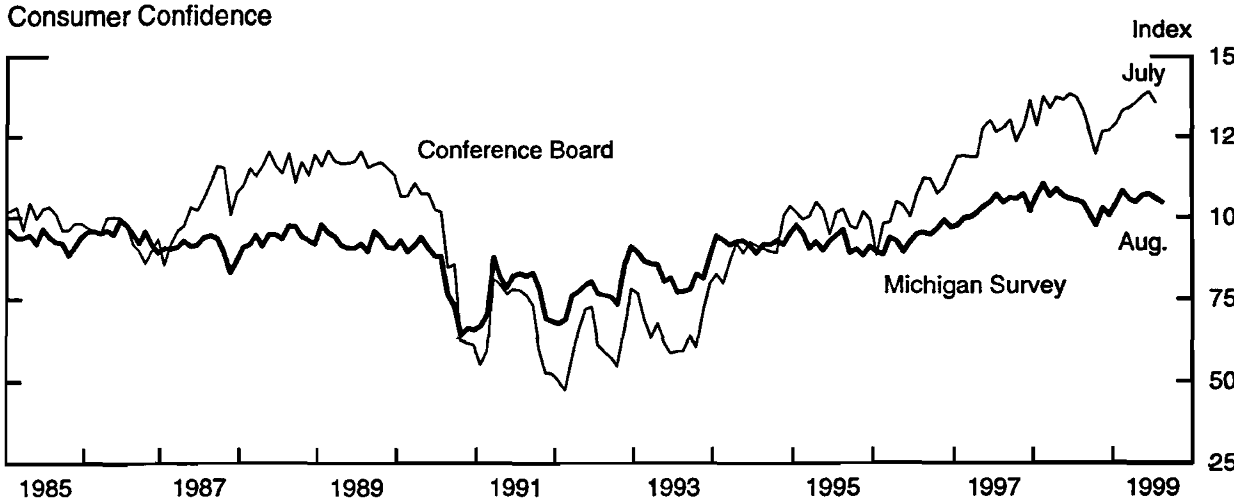


Net Worth



Note. Figure for 1999:Q2 is a staff estimate.

Consumer Confidence



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

	1998	1999 Q1	1999 Q2	1999 Apr.	1999 May	1999 June
	Q4/Q4	- Annual rate -		--- Monthly rate ---		
PCE	5.3	6.7	4.0	-.1	.6	.4
Durables	13.2	12.9	5.6	-1.6	2.5	.3
Motor vehicles	15.1	-.6	2.0	-2.5	4.5	-.9
Other durable goods	11.9	23.3	8.0	-1.0	1.2	1.2
Nondurables	4.7	9.5	3.0	-.6	.6	.5
Gas and oil	2.9	-.3	1.7	1.2	1.5	-.8
Clothing and shoes	6.9	29.1	2.5	-.9	.8	.7
Other nondurables	4.4	6.2	3.2	-.7	.5	.6
Services	4.0	4.1	4.2	.4	.1	.3
Energy	-4.6	14.9	9.9	-.5	-2.0	1.3
Non-energy	4.4	3.7	3.9	.5	.2	.2
Housing	2.4	2.9	2.2	.1	.2	.2
Household operation	6.5	6.8	8.5	1.0	.6	.5
Transportation	2.7	3.3	2.5	.2	-.1	.4
Medical	3.0	2.0	3.0	.2	.3	.2
Recreation	9.9	12.4	13.0	1.5	-.1	1.1
Personal business	6.0	5.4	5.7	1.6	-.2	-.6
Brokerage services	17.1	35.3	32.4	10.9	-2.8	-5.1
Other	6.8	1.0	1.1	-.5	.3	.6

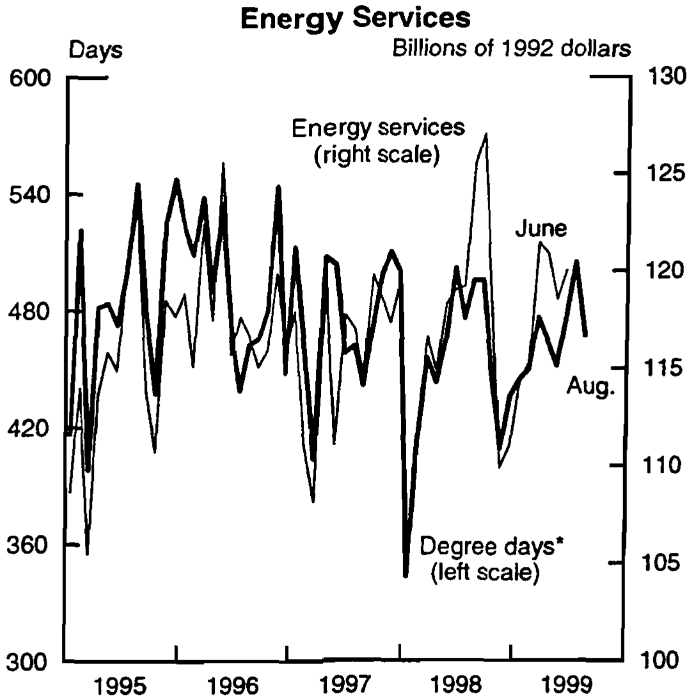
Note. Derived from billions of chained (1992) dollars.

RETAIL SALES
(Percent change from preceding period)

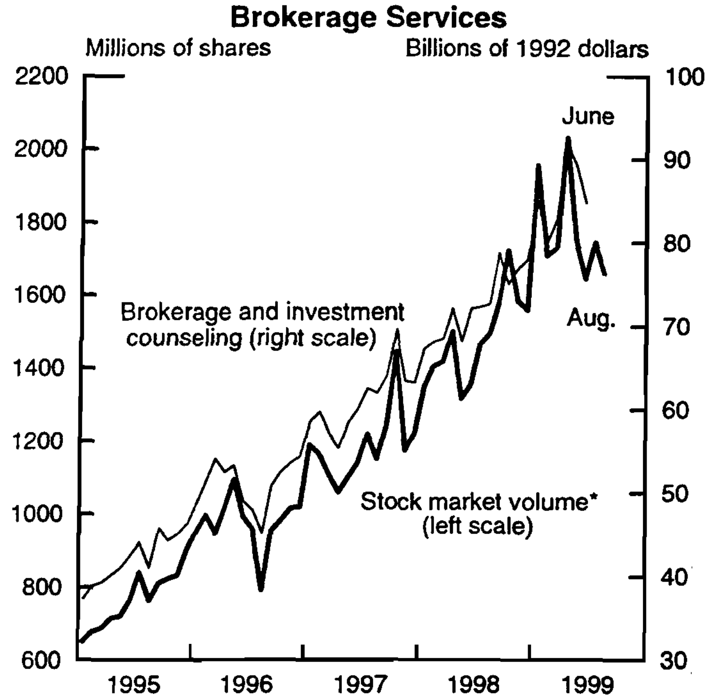
	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
Total sales	3.3	1.7	1.0	-.2	.7
Previous estimate[1]		1.8	1.1	.1	
Retail control[2]	2.7	1.9	.4	.2	.2
Previous estimate[1]		2.0	.4	.4	
Durable goods	2.6	.5	.5	-1.0	.1
Furniture and appliances	2.4	1.4	.5	.6	-.0
Other durable goods	2.8	-.2	.6	-2.2	.2
Nondurable goods	2.7	2.2	.3	.4	.2
Apparel	4.6	2.4	.6	-.4	-.4
Food	1.6	1.1	1.1	-.1	.1
General merchandise	3.9	.7	.2	.6	1.0
Gasoline stations	-4.0	6.3	-.8	-.5	1.2
Other nondurable goods	4.6	2.9	.1	1.2	-.5

1. Revised data released on July 30.
2. Total retail sales less sales at building material and supply stores and automotive dealers, except auto and home supply stores.

Consumer Service Expenditures and Income



*Note. Sum of seasonally adjusted heating and cooling degree days. The August value is based on data through August 14.



*Note. The August value is an average based on data through August 17.

PERSONAL INCOME
(Percent change)

	1997	1998	1998 Q4	1999 Q1	1999 Q2	1999 Apr.	1999 May	1999 June
	-- Q4/Q4 --		-- Annual rate --			-- Monthly rate --		
Total personal income	5.4	5.1	5.5	5.1	5.2	.5	.3	.7
Wages and salaries	7.2	6.3	6.4	7.2	5.7	.6	.5	.5
Private	7.9	6.8	7.0	7.2	6.3	.6	.5	.6
Other labor income	2.8	3.5	2.6	3.6	4.8	.4	.4	.4
Transfer payments	3.8	3.4	1.9	6.0	2.4	.0	.1	.3
Less: Personal tax and nontax payments	11.5	9.7	6.1	7.0	6.5	.6	.8	.8
Equals: Disposable personal income	4.4	4.3	5.4	4.8	4.9	.4	.2	.7
Memo:								
Real disposable income[1]	2.9	3.5	4.3	3.5	2.4	-.2	.2	.7
Saving rate (percent)	2.1	.5	.0	-.7	-1.1	-1.0	-1.4	-1.0

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

At the end of July, the Census Bureau released revised estimates of retail sales back to 1990.[4] The revisions reflected information from the 1997 Census of Retail Trade. (These censuses are conducted every five years.) The BEA will incorporate the revisions into its estimates of the increase in the second-quarter PCE with this month's preliminary GDP release. However, revisions to earlier PCE data will not be published until the comprehensive benchmark revisions to the NIPA in late October. Overall, the revised data suggest scarcely any change in growth rates of real PCE in 1998 or the first half of 1999. However, revisions to earlier periods were more substantial, pointing to an upward adjustment to the growth in total real PCE of nearly 0.2 percentage point per year from 1993 through 1997. The cumulative effect of these revisions, other things equal, will be to raise the level of real PCE in 1998 $46 billion, or 2-1/4 percent, from the previous estimate.

Revisions to Annual Growth and Levels of Total Real Personal Consumption Expenditures Implied by Revisions to Retail Sales

Period	Annual growth (percentage points)	Level	
		Billions of chained 1992 dollars	Percent
1993	.16	6.8	.4
1994	.19	15.3	.9
1995	.18	23.9	1.3
1996	.18	33.0	1.8
1997	.17	42.3	2.2
1998	.04	46.1	2.2
1999:H1	.0	48.1	2.2

NOTE: The calculations are from annual averages.

Of course, after the BEA incorporates additional information from other source data, the revisions to total PCE that eventually are published in the benchmark revisions may differ substantially from those shown above. In addition, when considering the implications for the personal saving rate, revisions to personal income could also be a factor. On that score, state

4. Not seasonally adjusted data were revised from January 1993 through June 1999; seasonal factors and seasonally adjusted data were revised back to January 1990. For its upcoming benchmark revision to the NIPA, the BEA will revise seasonal factors from 1988 onward.

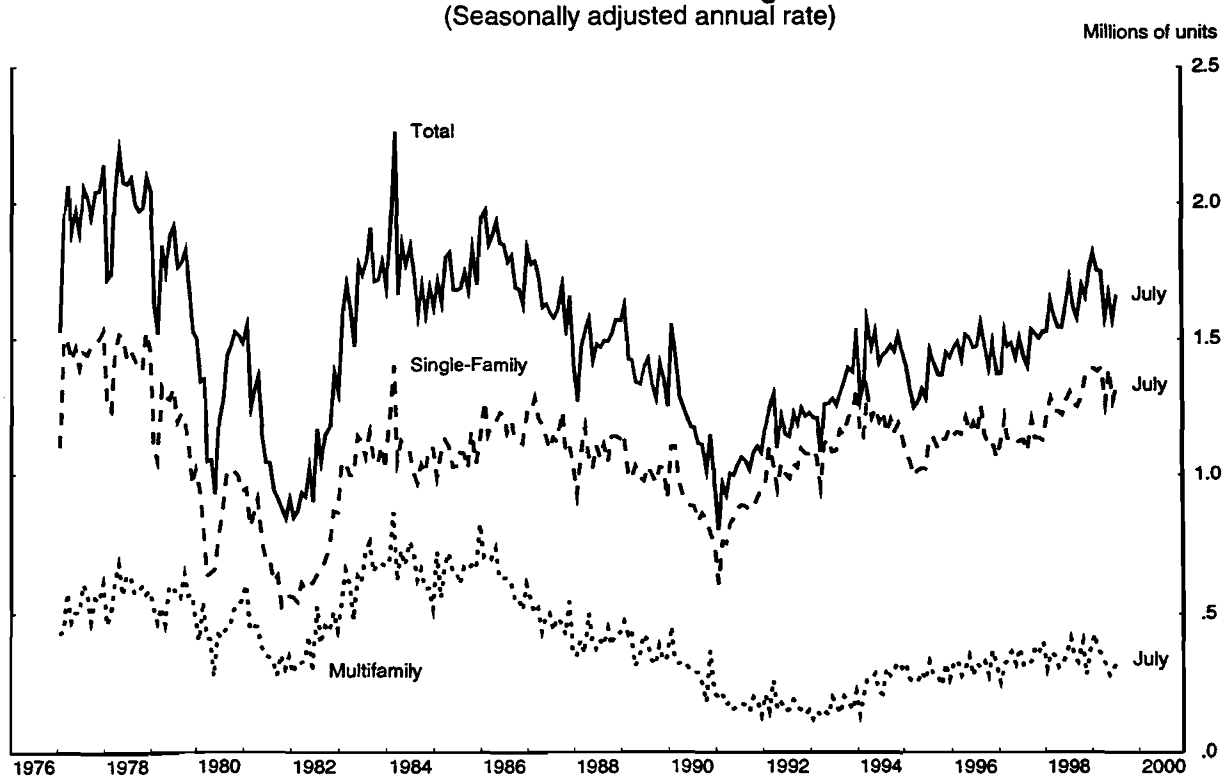
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		1998	1999				
	1998	Q4	Q1	Q2r	May r	June r	July p
All units							
Starts	1.62	1.70	1.77	1.61	1.67	1.57	1.66
Permits	1.60	1.71	1.72	1.60	1.59	1.64	1.63
Single-family units							
Starts	1.27	1.35	1.39	1.31	1.39	1.27	1.33
Permits	1.18	1.25	1.28	1.23	1.24	1.24	1.24
Adjusted permits[1]	1.28	1.34	1.37	1.32	1.34	1.33	1.33
New home sales	.89	.95	.90	.92	.90	.93	n.a.
Existing home sales	4.97	5.10	5.21	5.26	5.00	5.53	n.a.
Multifamily units							
Starts	.35	.35	.38	.30	.28	.30	.33
Permits	.42	.45	.45	.37	.35	.40	.39
Mobile homes							
Shipments	.37	.37	.38	.36	.37	.36	n.a.

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

1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas, minus a correction for those starts in permit-issuing places that lack a permit.

Total Private Building
(Seasonally adjusted annual rate)



unemployment insurance data suggest a substantial upward revision--on the order of $40 billion--to the level of wage and salary income in 1998.[5]

With regard to more recent income data, real disposable personal income rose 3-3/4 percent over the twelve months ended in June--up from the 3 percent increase recorded over the same period a year ago. Part of the strengthening in income growth over the past year reflected payments to farmers under a bill signed last autumn. But, even if these special payments are excluded from personal income, real DPI still rose 3-1/4 percent over the past year. In July, wage and salary income appears poised to post a substantial gain, based on the readings on production-worker hours and average hourly earnings.

Consumer confidence has edged lower in recent months but has changed relatively little on balance so far this year. The Michigan SRC index of consumer sentiment was pulled down in early August by somewhat less favorable appraisals of buying conditions for large household goods and opinions concerning business conditions over the next year. However, views on current and expected personal financial situations improved, as did expectations of longer-term business conditions over the next five years. The Conference Board index of consumer sentiment declined in July, but it too remained at a high level.

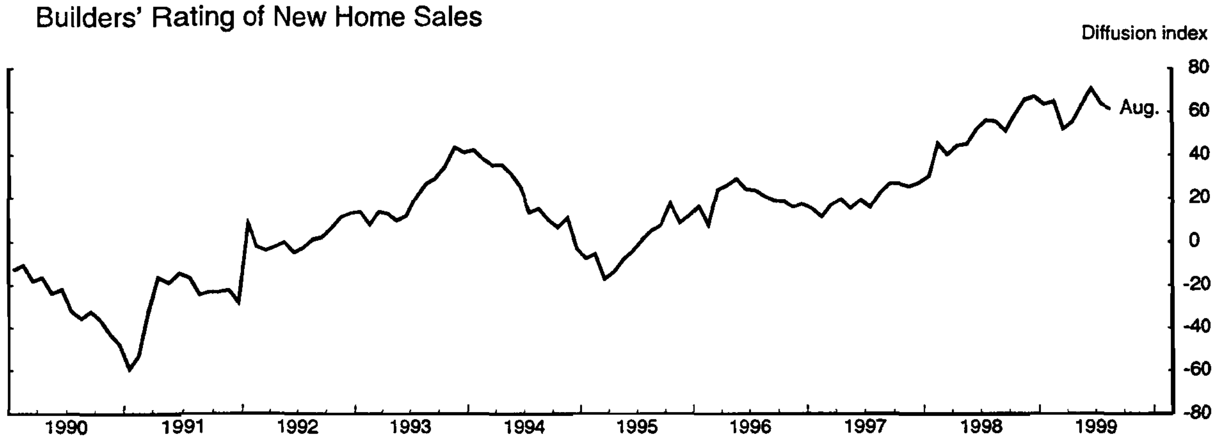
Housing Markets

Activity in the housing sector has remained strong so far this summer. Starts of single-family houses were at a 1.33 million unit annual rate in July, up from June's 1.27 million unit rate and only a little short of the average pace during the first half of this year. The seasonal peak of single-family starts normally is in June. However, owing to large backlogs--that reflect, in part, production constraints related to shortages of labor and some key materials--builders did not pare construction as much as they usually do in July. Indeed, on a not seasonally adjusted basis, single-family starts declined 4 percent in July as compared with the typical 9 percent decline built into the seasonal factors. Multifamily starts were at a 333,000 unit pace in July, similar to their average during the first half of this year.

5. Other notable revisions to the household sector that will occur in October include the following: a boost to real (but not nominal) PCE due to the incorporation of the geometric means CPI data the following for 1978-1994; and moving the pension plan contributions of local, state, and federal governments out of the government sector and into the household sector, which will raise personal income. (We estimate that, by itself, this latter change will boost the current *level* of the saving rate approximately 1-3/4 percentage points, but that it will not substantially alter the downward trend in the saving rate over the past few years.)

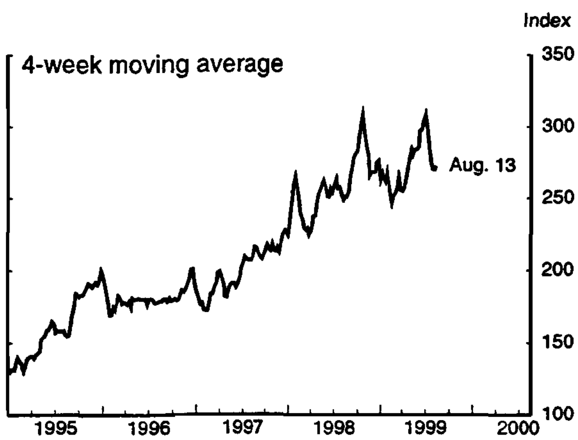
Indicators of Housing Demand and Prices

Builders' Rating of New Home Sales

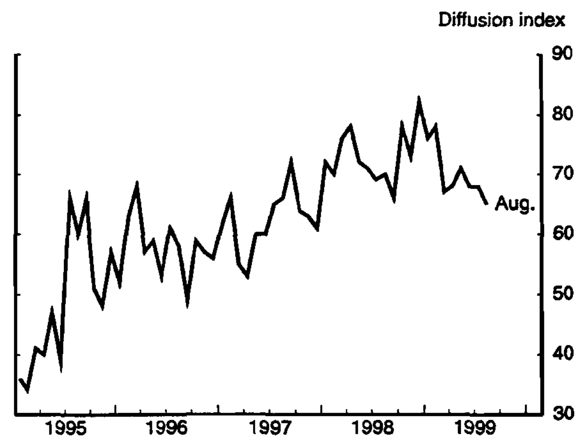


Note. Calculated from National Association of Homebuilders' data as the proportion of respondents rating current sales as good minus the proportion rating them as poor. Seasonally adjusted by Board staff.

MBA Index of Purchase Applications

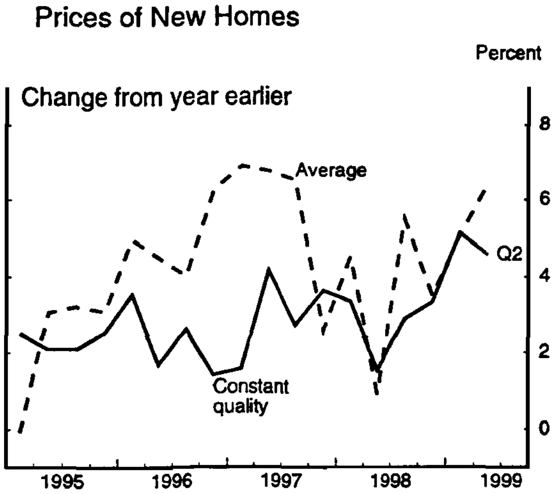


Consumer Home-Buying Attitudes

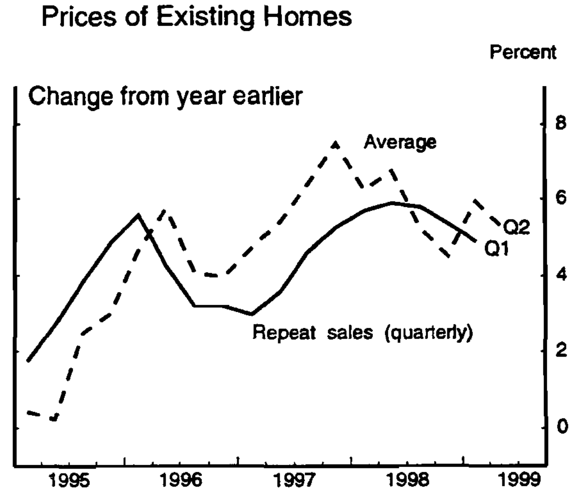


Source. Michigan Survey, not seasonally adjusted

Prices of New Homes



Prices of Existing Homes



Home sales continued at elevated levels through June. Sales of new homes rose to an annual rate of 929,000 in that month, 2-1/4 percent above the average earlier this year. Existing home sales were at a 5.53 million unit rate in June, nearly 7 percent higher than their average from January to May. (New home sales are the more current indicator of demand, for they generally are reported at the time a contract is signed rather than at the closing, as is more common for existing home sales.)

Interest rates on fixed-rate mortgages have increased more than a percentage point this year, but the effect of that rise on housing demand has been blunted to some extent by shifting into adjustable-rate loans. The rate on one-year adjustable rate mortgages has risen only half as much as the fixed mortgage rate. As a result, the ARM share of purchase loans, which bottomed out at 8 percent last fall when the yield curve was relatively flat, has been trending up and stood at 22 percent in June.[6]

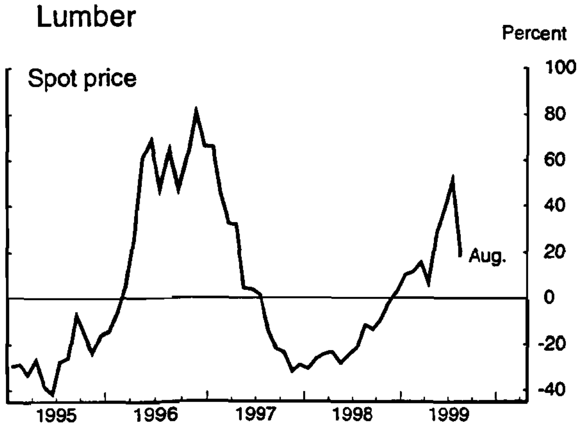
Applications for mortgages to purchase homes have receded somewhat, on net, since June, but nevertheless are at a high level. In addition, builders' ratings of new home sales, which soared in June to the highest level on record, eased a bit in July and August, but remained comfortably above the levels of last summer. However, recent data from the Michigan SRC survey indicated that the backup in mortgage rates has contributed substantially to a notable retreat in consumers' assessments of homebuying conditions.

Demand and cost pressures appear to have translated into an acceleration in new home prices this year. The average price of new homes in the second quarter was up 6.4 percent from a year earlier. The constant-quality price index for new homes--which controls for a number of attributes and is thus a better measure of house price inflation--rose at an annual rate of about 4-3/4 percent in the first half of this year, compared with a 3 percent pace in both 1997 and 1998. The year-over-year change in prices of existing homes averaged about 5-1/2 percent during the first half of this year, similar to the 1998 pace. These contrasting figures for house price inflation possibly reflect in part the different regional composition of new and existing home sales. Moreover, some of the acceleration in new house prices may be attributable to

6. Adjustable-rate loans include not only one-year ARMs, but also loans that switch to a fixed rate after a set period of time.

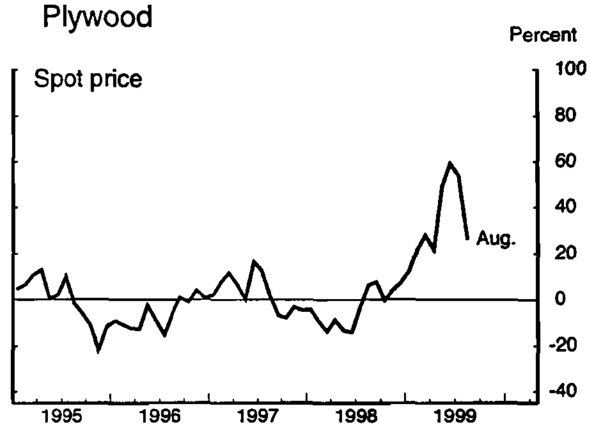
Indicators of Input Costs for the Construction Sector
(Change from year earlier)

Lumber



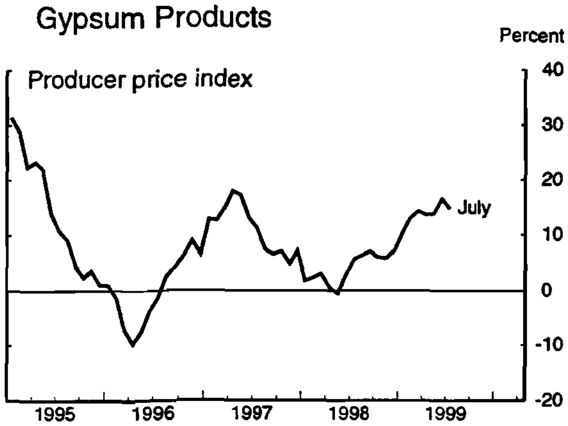
Note. The Aug. reading is an average of weekly data through Aug. 13.

Plywood

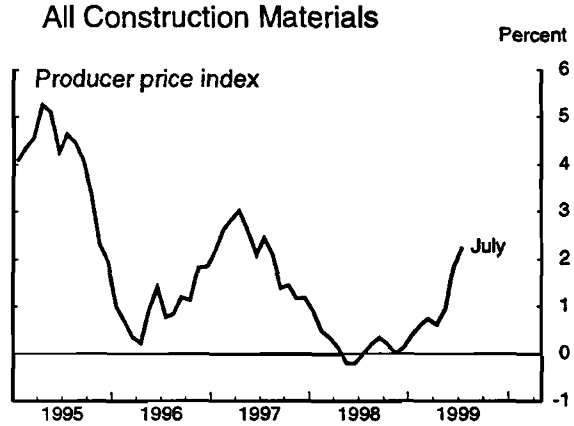


Note. The Aug. reading is an average of weekly data through Aug. 13.

Gypsum Products

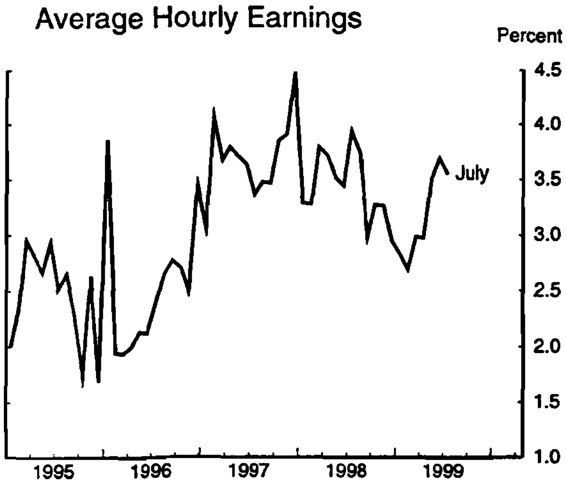


All Construction Materials



Note. PPI intermediate materials and components for construction.

Average Hourly Earnings



Employment Cost Index

Note. ECI for total compensation.

an increase in certain amenities that are not captured by the quality adjustment procedure.[7]

Although the most recent data suggest an easing of some cost pressures, on balance, the prices of lumber, plywood, and gypsum products have risen substantially over the past year. The producer price index for components and materials for construction--which measures the cost of inputs for all types of construction (not just residential)--rose 2-1/4 percent over the twelve months ended in July; this index was essentially unchanged in the year-earlier period. The increase in the PPI for construction materials has been held back by lower prices for asphalt roofing materials and some metals used in construction.[8] With regard to labor costs, the average hourly earnings of construction workers in July were up 3-1/2 percent from a year earlier. The year-over-year increase in this series had trended down in 1997 and 1998 but has accelerated about 1 percentage point since the turn of this year. The employment cost index for workers in the construction industry--which includes both wages and benefits but holds constant the mix of jobs and overtime--was up 3.1 percent in the second quarter from a year earlier.

Business Fixed Investment

Producers' durable equipment. Real outlays on producers' durable equipment increased at an annual rate of 15 percent in the second quarter, with growth again fueled by strong demand for high-tech equipment and motor vehicles. The little information that is available concerning spending in the current quarter points toward a moderate deceleration.

Real expenditures on office and computing equipment posted increases of about 40 percent (annual rate) in each of the first two quarters of this year. Though well below the 64 percent advance recorded in 1998, the recent pace of spending is still large enough to result in a rapid expansion of the stock of computing equipment. Concerning the recent data, nominal shipments of office and computing equipment rose 3.3 percent for the second quarter as a whole, but they backed down noticeably in May and June from the high reached in April. Even taking into account the anecdotal evidence that the pace of Y2K-related upgrades has slowed and that some businesses are planning to postpone further system upgrades until after the turn of the year,

7. The attributes controlled for by the constant-quality price index include the size of homes, the number of bathrooms, the type of parking facility, the type of foundation, and the number of bedrooms. The index does not, however, control for the use of higher-quality building materials and components or for the addition of numerous luxury features.

8. Metal components are primarily used in nonresidential construction, although some residential builders have begun using metal structural components.

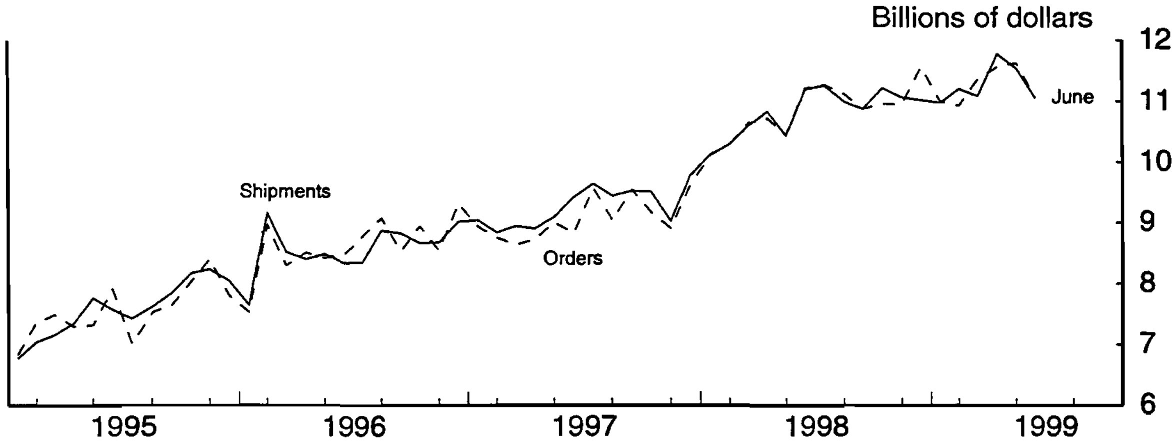
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	1999		1999		
	Q1	Q2	Apr.	May	June
Producers' durable equipment					
Shipments of nondefense capital goods	-1.4	3.0	.9	1.5	-1.9
Excluding aircraft and parts	-.6	3.4	.8	.8	.1
Office and computing	-.1	3.3	6.2	-2.0	-4.2
Communications equipment	5.7	6.6	2.3	1.6	3.9
All other categories	-2.5	2.4	-1.9	1.8	.8
Shipments of complete aircraft	-21.2	-15.7	15.7	10.5	-31.4
Medium & heavy truck sales (units)	5.9	-.8	-3.4	2.8	-4.7
Orders for nondefense capital goods	6.9	-4.3	-1.5	1.0	-4.3
Excluding aircraft and parts	3.1	-.2	.3	-2.9	-3.8
Office and computing	-.5	2.9	1.8	.5	-4.7
Communications equipment	11.6	3.1	-2.3	1.0	6.8
All other categories	2.4	-2.5	.5	-5.4	-6.6
Nonresidential structures					
Construction put in place, buildings	.5	-2.4	-2.4	-1.2	.7
Office	5.0	2.3	-.9	2.7	3.0
Other commercial	.7	-1.5	-2.2	-2.1	-1.7
Institutional	-4.7	-.8	1.5	-4.7	2.8
Industrial	-4.5	-11.8	-9.5	-3.2	1.4
Lodging and miscellaneous	4.3	-3.5	-2.3	-.2	-1.7
Rotary drilling rigs in use[1]	-13.9	-6.4	-5.0	2.9	5.5
Memo (1992 Chained dollars):					
Business fixed investment	8.5	10.8	n.a.	n.a.	n.a.
Producers' durable equipment	9.5	15.3	n.a.	n.a.	n.a.
Office and computing	37.9	38.1	n.a.	n.a.	n.a.
Communications equipment	31.8	48.4	n.a.	n.a.	n.a.
Motor Vehicles	11.1	20.8	n.a.	n.a.	n.a.
Aircraft	-41.1	10.5	n.a.	n.a.	n.a.
Other equipment[2]	1.3	-.4	n.a.	n.a.	n.a.
Nonresidential structures	5.7	-1.2	n.a.	n.a.	n.a.

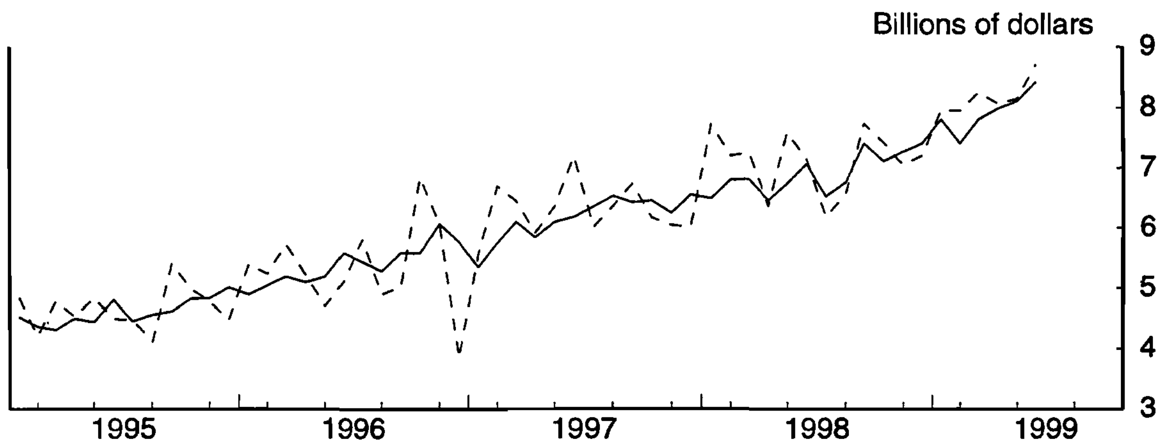
1. Percent change of number of rigs in use, seasonally adjusted.
2. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

Recent Data on Orders and Shipments

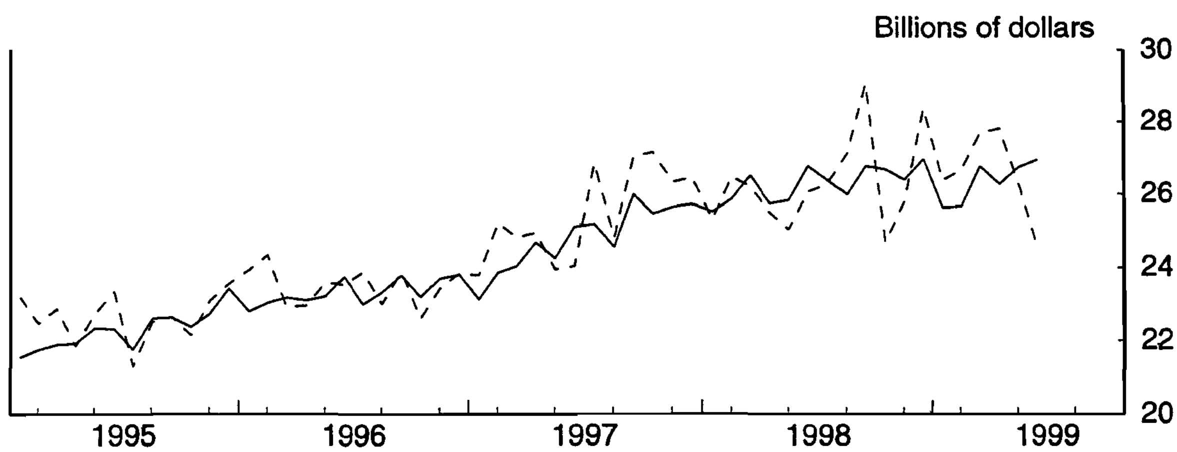
Office and Computing Equipment



Communications Equipment



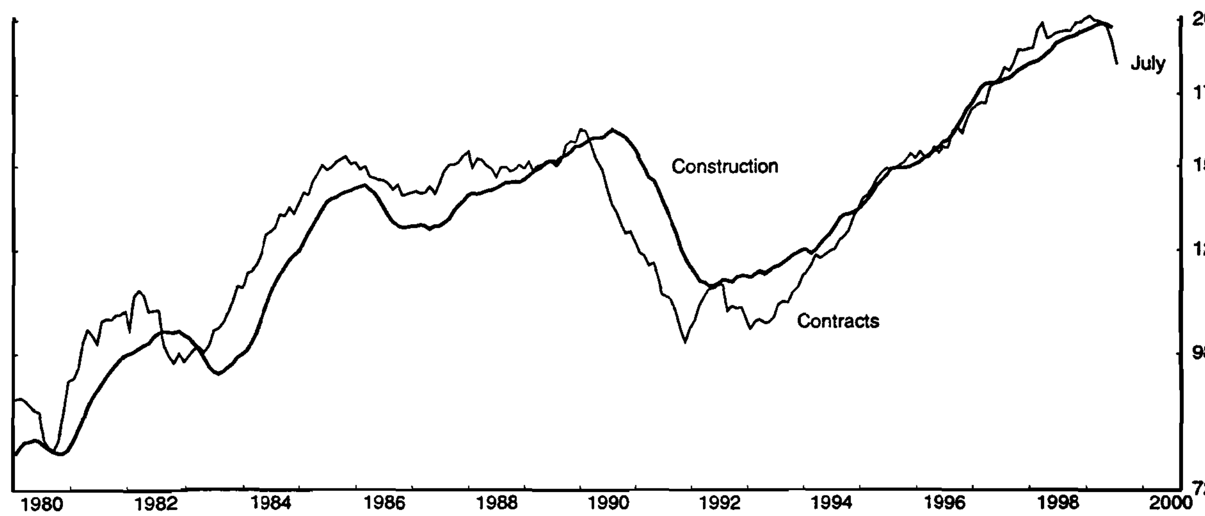
Other Equipment (Total Excluding Aircraft, Computers, Communications)



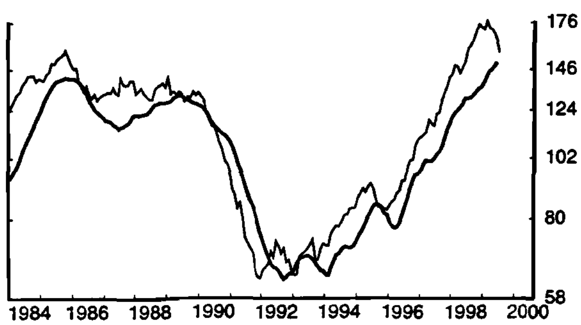
Nonresidential Construction and Contracts
(Six-month moving average)

Total Private Building

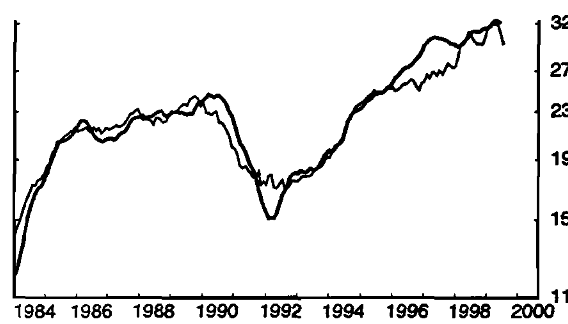
Dec. 1982 = 100, ratio scale



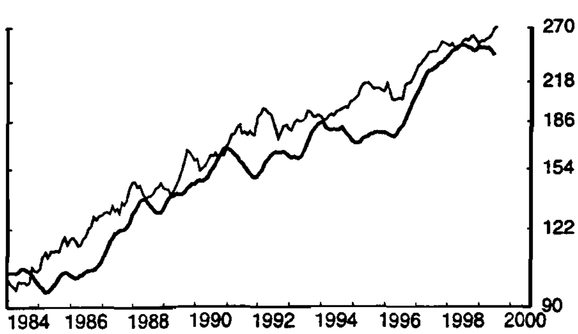
Office



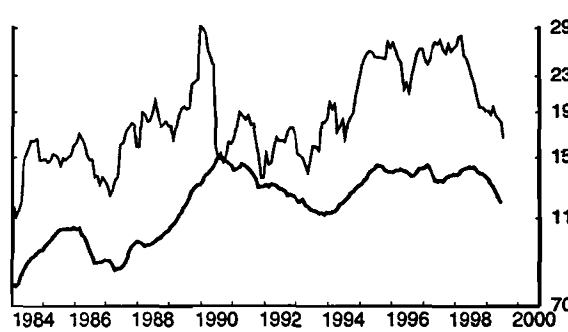
Other Commercial



Institutional



Industrial



Note. Individual sectors include both public and private building.

underlying demand for computers seems strong and this recent weakness in shipments likely is transitory. Elsewhere in the high-tech sector, real outlays on communications equipment have soared this year, rising at an annual rate of nearly 50 percent in the second quarter. With nominal orders up 3 percent last quarter, the near-term outlook for spending remains very positive.

Spending on transportation equipment appears set to be a drag on PDE growth in the current quarter. After having posted hefty increases over the first half of this year, indications are that business spending on motor vehicles may be falling off. Outlays by domestic carriers for commercial aircraft are not likely to post much of a gain this quarter. Imports from Airbus should be up some; Boeing's delivery schedules suggest that its total shipments should be about flat this quarter, though information on the destination of these shipments, and thus on the split between domestic outlays and exports, is still sketchy.

Expenditures on equipment outside the high-tech and transportation categories have been flat over the past few quarters. Real investment on industrial equipment declined ½ percent over the four quarters ended in the second quarter of 1999; spending on this category has probably been held back by weak demand from the manufacturing sector, which accounts for about 65 percent of outlays for industrial equipment.[9] Other weak categories over the past year have been agricultural machinery (down 14 percent) and construction machinery (down 9 percent). The near-term indicators for outlays outside the high-tech and transportation categories are mixed. Orders were very weak in the second quarter, falling 2-1/2 percent. Although much of the decline reflected a falloff in orders for engines and turbines--where lead times are long and orders previously had been extremely strong--bookings for other items also were fairly soft. On the plus side, manufacturing activity has been firmer of late, suggesting that weakness in this sector is likely to be less of a restraint in the coming months than it has been over the past several quarters.

Nonresidential Structures. After having posted solid gains late last year and early this year, real outlays for nonresidential structures edged down in the second quarter, in part because of continued weakness in industrial buildings and declines in outlays for institutional structures and hotels and motels. In addition, real outlays for office buildings, which rose at an annual rate of 22 percent in the first quarter, flattened out in the second quarter.

9. About half of the remainder of industrial equipment is purchased by the utility and mining sectors and about half by a variety of other industries.

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

Category	1998 Q4	1999 Q1	1999 Q2	1999 Apr.	1999 May	1999 June
Manufacturing and trade	22.8	34.3	36.4	24.4	39.0	45.8
Less wholesale and retail motor vehicles	5.8	10.2	13.4	7.3	16.0	16.8
Manufacturing	-7.0	-12.9	-1.0	-4.6	6.6	-5.1
Less aircraft	-3.9	-3.0	7.9	4.0	16.3	3.3
Merchant wholesalers	10.6	7.5	6.5	3.3	7.0	9.1
Less motor vehicles	5.6	6.5	4.8	3.5	2.4	8.6
Retail trade	19.2	39.7	31.0	25.7	25.4	41.8
Automotive dealers	12.0	23.1	21.4	17.3	18.4	28.5
Less automotive dealers	7.2	16.6	9.6	8.4	7.0	13.3

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

Category	Cyclical reference points: 1990-91 high	Cyclical reference points: 1991-98 low	Range over preceding 12 months: High	Range over preceding 12 months: Low	June 1999
Manufacturing and trade	1.58	1.37	1.40	1.35	1.34
Less wholesale and retail motor vehicles	1.55	1.34	1.38	1.32	1.31
Manufacturing	1.75	1.36	1.39	1.32	1.31
Primary metals	2.08	1.46	1.74	1.64	1.61
Steel	2.56	1.59	2.25	1.99	2.04
Nonelectrical machinery	2.48	1.61	1.66	1.61	1.62
Electrical machinery	2.08	1.21	1.32	1.20	1.20
Transportation equipment	2.93	1.51	1.85	1.47	1.42
Motor vehicles	.97	.53	.64	.52	.50
Aircraft	5.84	4.05	4.97	3.82	4.22
Nondefense capital goods	3.09	2.04	2.21	1.96	1.98
Textiles	1.71	1.38	1.59	1.48	1.58
Paper	1.32	1.06	1.23	1.18	1.20
Chemicals	1.44	1.25	1.45	1.37	1.36
Petroleum	.94	.80	.99	.82	.80
Home goods & apparel	1.96	1.59	1.75	1.53	1.60
Merchant wholesalers	1.36	1.24	1.35	1.30	1.28
Less motor vehicles	1.31	1.22	1.34	1.28	1.26
Durable goods	1.83	1.54	1.66	1.58	1.57
Nondurable goods	.95	.90	1.02	.97	.94
Retail trade	1.61	1.44	1.47	1.42	1.45
Less automotive dealers	1.48	1.38	1.40	1.35	1.35
Automotive dealers	2.22	1.59	1.73	1.59	1.75
General merchandise	2.42	2.00	2.06	1.94	1.93
Apparel	2.53	2.28	2.50	2.27	2.29
GAF	2.41	2.06	2.11	2.00	1.99

Contracts for new private construction fell sharply in July, following a large decline in the second quarter. In the office sector, contracts bounced back up last month but were still well off the recent peaks. Elsewhere, contracts for industrial structures continued to plunge. Contracts for other commercial buildings dipped in July.

Business Inventories

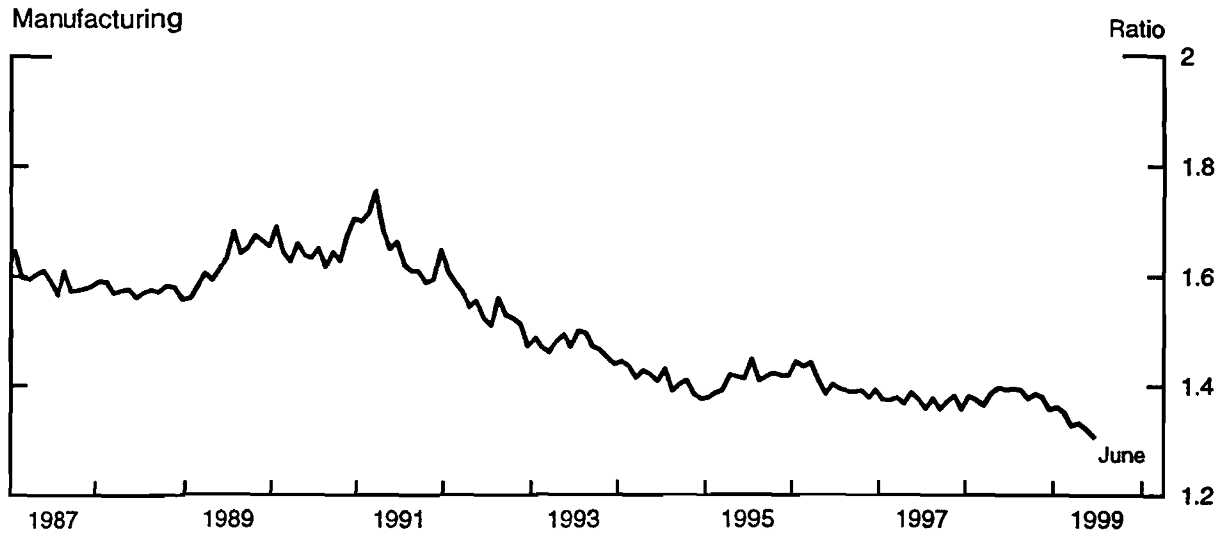
Real nonfarm inventory investment slowed in the second quarter, and, by historical standards, stocks appear lean in many industries. We estimate that real total nonfarm inventories increased at an annual rate of $11-1/2 billion last quarter, down from a $35 billion pace in the first quarter of the year.[10] The motor vehicle sector accounted for about $5 billion of the decline in the pace of inventory investment. Outside of motor vehicles, the step-down in stockbuilding in real terms contrasts with a pickup in book value inventory investment last quarter. The rise in petroleum prices largely accounted for this difference: Although refiners and petroleum wholesalers drew down stocks in real terms last quarter, the rising prices of crude oil and refined products increased the value of the inventories held on their books.

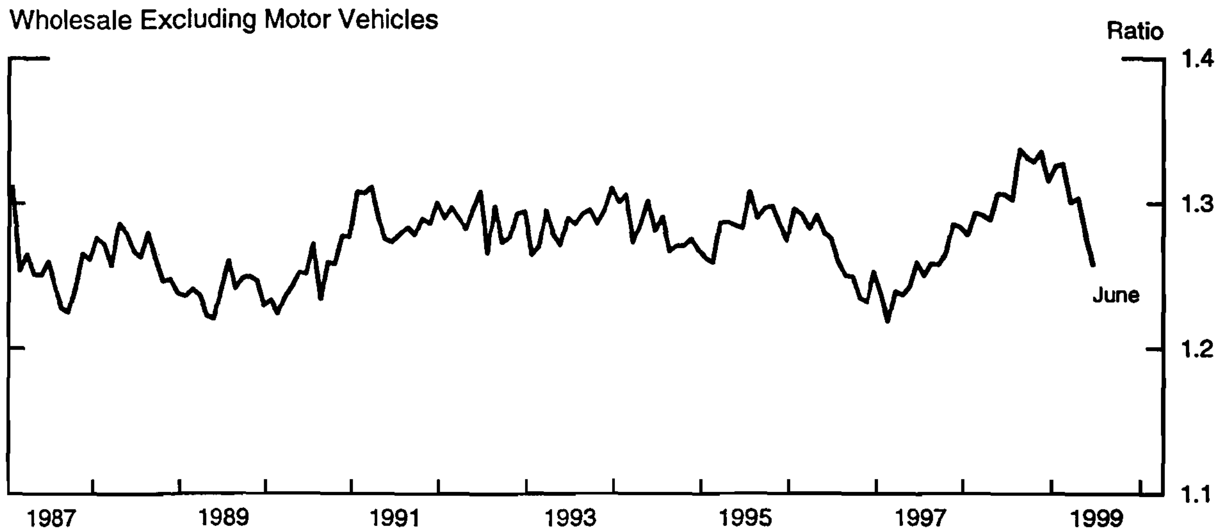
Despite the rise in petroleum prices, the book value of manufacturing inventories for the sector as a whole declined in the second quarter for the third quarter in a row. The drop reflects shrinking stocks of aircraft and parts that have accompanied the slower production at Boeing. However, even excluding the aircraft and petroleum industries, stockbuilding by manufacturers has been modest and inventory-shipments ratios have declined across a wide range of industries. Most notably, inventory-shipments ratios in the metals and chemicals industries, which had been relatively high last year, have dropped significantly in recent quarters.

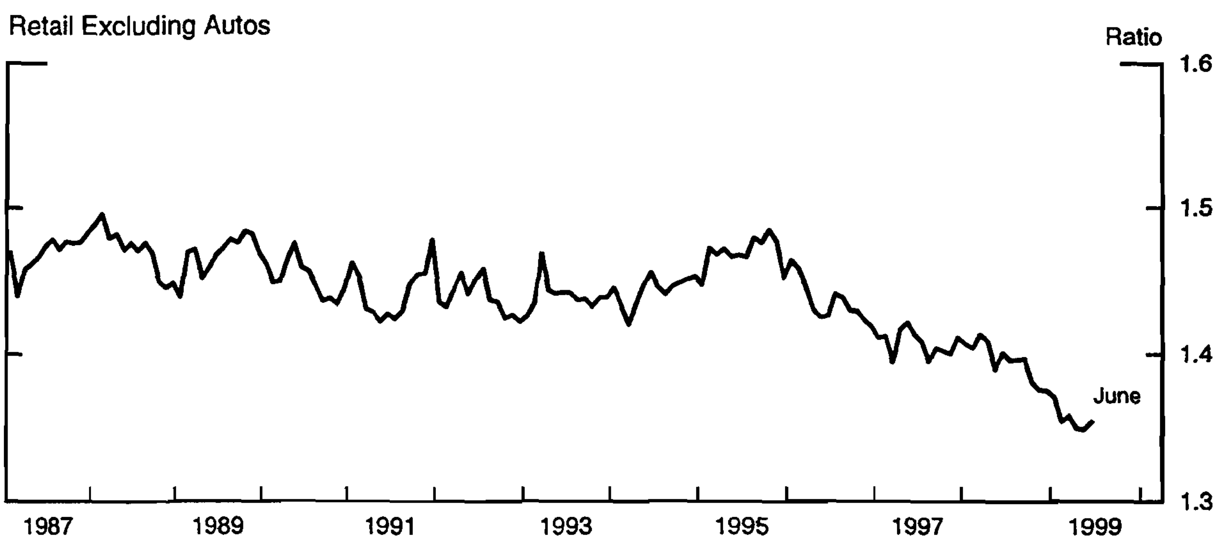
The book value of wholesale inventories excluding motor vehicles rose at an annual rate of $5 billion in the second quarter, about the same modest pace as recorded in the previous two quarters. Sales in the wholesale sector have been robust, on balance, in recent months. These developments brought the inventory-sales ratio for nonvehicle wholesalers, which had reached a 12-year high of 1.34 months in August 1998, down to 1.26 months in June, about in line with the average level for this ratio over the past few years. Only a few signs of inventory imbalances remain in the wholesale sector--namely, at distributors of machinery, where stocks remain stubbornly high, and at jobbers

10. This figure is about $4 billion below the advance GDP estimate; on balance, the book value inventory data that have become available since the advance release have been weaker than the BEA had assumed.

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







of metals and minerals, although their inventory-sales ratios have backed off some from recent peaks.

In the retail trade sector, the book value of non-auto stocks rose at an annual rate of $9.6 billion in the second quarter, down from a $16.6 billion pace in the first quarter. Inventories for this category have moved in line with sales in recent months. The inventory-sales ratio for non-auto retailers was 1.35 months in June, a very lean level by historical comparison. However, this ratio has remained in a relatively narrow range since February, suggesting that retailers might be fairly comfortable with the current level of stocks.

Federal Government

The federal budget surplus over the twelve months ending in June was $97 billion, up $40 billion from the corresponding year-earlier period. After adjustment for payment timing shifts, deposit insurance, spectrum auction proceeds, and sales of major assets, the improvement was about $45 billion.

The continued favorable surplus trends were reflected in recent mid-session budget reviews by the OMB and the CBO. The OMB now projects unified budget surpluses of $99 billion for fiscal 1999 and $142 billion for fiscal 2000.[11] The OMB projects that the surplus will increase steadily thereafter, rising to $254 billion by 2004 and to $473 billion by 2009. The CBO's new baseline projection is somewhat more positive than the OMB's in the near term; it shows surpluses under current laws and policies of $120 billion in fiscal 1999 and $161 billion in fiscal 2000. The CBO's surplus projection remains slightly higher than the OMB's through fiscal 2004 and then falls below it, ending in fiscal 2009 at $413 billion.[12]

The OMB's surplus projections for fiscal 1999 and 2000 are up $20 billion and $25 billion, respectively, from its forecasts made in February. The CBO's projections were revised up $9 billion in 1999 and $28 billion in 2000. These revisions largely were the result of more positive economic assumptions--unlike the past few years, neither agency was greatly surprised by this year's tax

11. The OMB projections reported here include some minor policy changes but exclude the effects of Administration social security and Medicare reform proposals, and the adoption of initiatives (notably, Universal Savings Accounts and some additional discretionary spending) that were proposed contingent on the enactment of those reforms.

12. The OMB's on-budget projections--that is, excluding Social Security and the Postal Service--are for a deficit of $25 billion in fiscal 1999 and a surplus of $5 billion in fiscal 2000. The on-budget surplus is projected to rise to $79 billion in 2004 and $240 billion in fiscal 2009. CBO's on-budget projections are for a deficit of $4 billion in fiscal 1999, and surpluses of $14 billion in fiscal 2000, $85 billion in 2004, and $178 billion in 2009.

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

	June			12 months ending in Jun.		
	1998	1999	Percent change	1998	1999	Percent change
Outlays	136.8	145.9	6.7	1640.3	1694.2	3.3
Deposit insurance	-0.3	-0.4	28.0	-4.5	-5.7	26.3
Spectrum auction	0.0	0.0	0.0	-1.5	-2.8	80.3
Sale of major assets	0.0	0.0	0.0	-3.2	0.0	-100.0
Other	137.0	146.3	6.7	1649.5	1702.7	3.2
Receipts	187.9	199.5	6.2	1696.4	1790.7	5.6
Surplus	51.1	53.6	4.8	56.2	96.5	71.7
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	137.0	146.3	6.7	1654.7	1703.8	3.0
National defense	22.3	24.1	8.0	270.3	274.6	1.6
Net interest	19.4	18.5	-4.6	245.0	233.6	-4.6
Social security	35.4	36.3	2.4	375.8	388.1	3.3
Medicare	16.1	16.7	3.5	195.1	190.9	-2.2
Medicaid	9.0	9.4	4.4	100.0	105.3	5.3
Other health	2.6	2.9	11.7	28.6	31.9	11.4
Income security	14.6	14.6	0.1	231.7	235.7	1.7
Other	17.6	23.8	35.2	208.1	243.7	17.1
Receipts	187.9	199.5	6.2	1696.4	1790.7	5.6
Individual income and payroll taxes	135.9	147.1	8.2	1338.2	1431.7	7.0
Withheld + FICA	97.7	106.6	9.2	1127.5	1216.3	7.9
Nonwithheld + SECA	40.3	42.8	6.3	309.6	337.3	9.0
Refunds (-)	2.1	2.4	18.3	98.9	121.9	23.3
Corporate	39.8	39.3	-1.3	189.7	179.7	-5.3
Gross	41.1	40.6	-1.2	214.0	211.0	-1.4
Refunds (-)	1.3	1.3	2.5	24.4	31.3	28.7
Other	12.1	13.2	8.5	168.5	179.3	6.4
Surplus	50.8	53.2	4.7	41.7	86.9	108.3

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

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

n.a.--Not applicable

Revisions to Budget Projections
(Billions of dollars, fiscal years)

Item	1999	2000	2001	2002	2003	2004
	Office of Management and Budget					
February surplus	79	117	134	187	182	208
PLUS: Changes						
Policy	-4	-4	-2	-1	-1	-1
Economic	18	21	20	19	24	31
Technical	6	9	16	15	18	16
Total	20	26	34	33	41	46
EQUALS: June surplus	99	143	168	220	223	254
	Congressional Budget Office					
March-April baseline surplus	111	133	156	212	213	239
PLUS: Changes						
Policy	-4	-8	-4	-2	-3	-3
Economic	15	33	37	37	33	26
Technical	-1	3	4	0	5	5
Total	10	28	37	34	35	28
EQUALS: July baseline surplus	120	161	193	246	247	266

NOTE. The OMB surplus is the projection pending social security and Medicare reform. The CBO baseline assumes that discretionary spending will be held at the caps through fiscal 2002 and rise with inflation thereafter; and that taxes and mandatory spending will evolve according to current laws.

OMB and CBO Economic Projections
(Calendar years)

Measure and agency	1999	2000	2001	2002	2003	2004	2004-2009
	Year-over-year percent change, annual rate						
Nominal GDP							
OMB	5.2	4.2	4.2	4.4	4.8	4.8	4.8
CBO	5.3	4.3	4.3	4.2	4.2	4.2	4.4
Real GDP							
OMB	3.9	2.4	2.1	2.2	2.5	2.5	2.5
CBO	4.0	2.4	2.4	2.3	2.3	2.3	2.5
GDP price index							
OMB	1.3	1.8	2.1	2.2	2.2	2.2	2.2
CBO	1.3	1.8	1.8	1.8	1.8	1.8	1.9
Consumer price index							
OMB	2.2	2.4	2.4	2.5	2.5	2.5	2.5
CBO	2.2	2.5	2.5	2.5	2.5	2.5	2.5
	Percent, annual average[1]						
Civilian unemployment rate							
OMB	4.3	4.5	4.9	5.2	5.2	5.2	5.2
CBO	4.2	4.3	4.6	4.9	5.1	5.3	5.5
Three-month Treasury bill							
OMB	4.5	4.5	4.5	4.5	4.6	4.6	4.6
CBO	4.6	5.0	4.6	4.5	4.5	4.5	4.5
Ten-year Treasury note							
OMB	5.4	5.5	5.5	5.6	5.6	5.6	5.6
CBO	5.6	5.9	5.5	5.4	5.4	5.4	5.4

Note. OMB economic assumptions for 2005-09 are confidential.
1. Values in 2004-09 are for 2009.

collections. Both agencies also revised up their surplus projections over the longer run, reflecting more favorable assumptions for economic growth and unemployment.

With regard to budget legislation for fiscal 2000, the House has passed 11 and the Senate has passed 9 of the 13 regular appropriations bills that fund discretionary spending. Emergency and regular spending included in these bills exceeds allocations that were designed to meet the fiscal 2000 discretionary spending caps by about $30 billion. (The caps mandated substantial cuts in real spending, while the appropriation bills hold real spending at about the 1999 level.) In addition, the Congress has passed a tax cut bill that would reduce fiscal 2000 revenues $5 billion. Although the President has promised to veto this tax cut, he also has proposed spending that is not included in the current versions of the appropriation bills and indicated a willingness to accept a small future tax cut. This leaves open the possibility of a compromise between the Congress and the Administration that would involve both tax cuts and additional spending. These circumstances create substantial risk that the currently projected on-budget surpluses for fiscal 2000 will not materialize.

State and Local Government

Real purchases of goods and services by state and local governments edged down in the second quarter, as increases in expenditures for consumption and equipment were outweighed by a retracing of the surge in real construction spending in the first quarter.[13] Most of this gyration in construction results from an atypical pattern for highway construction, which rose sharply on a seasonally adjusted basis early in the year when relatively warm weather muted the usual winter slowdown in activity. In recent months, adjusted highway spending has moved back down, and by June it was at the low end of the range seen in recent years.

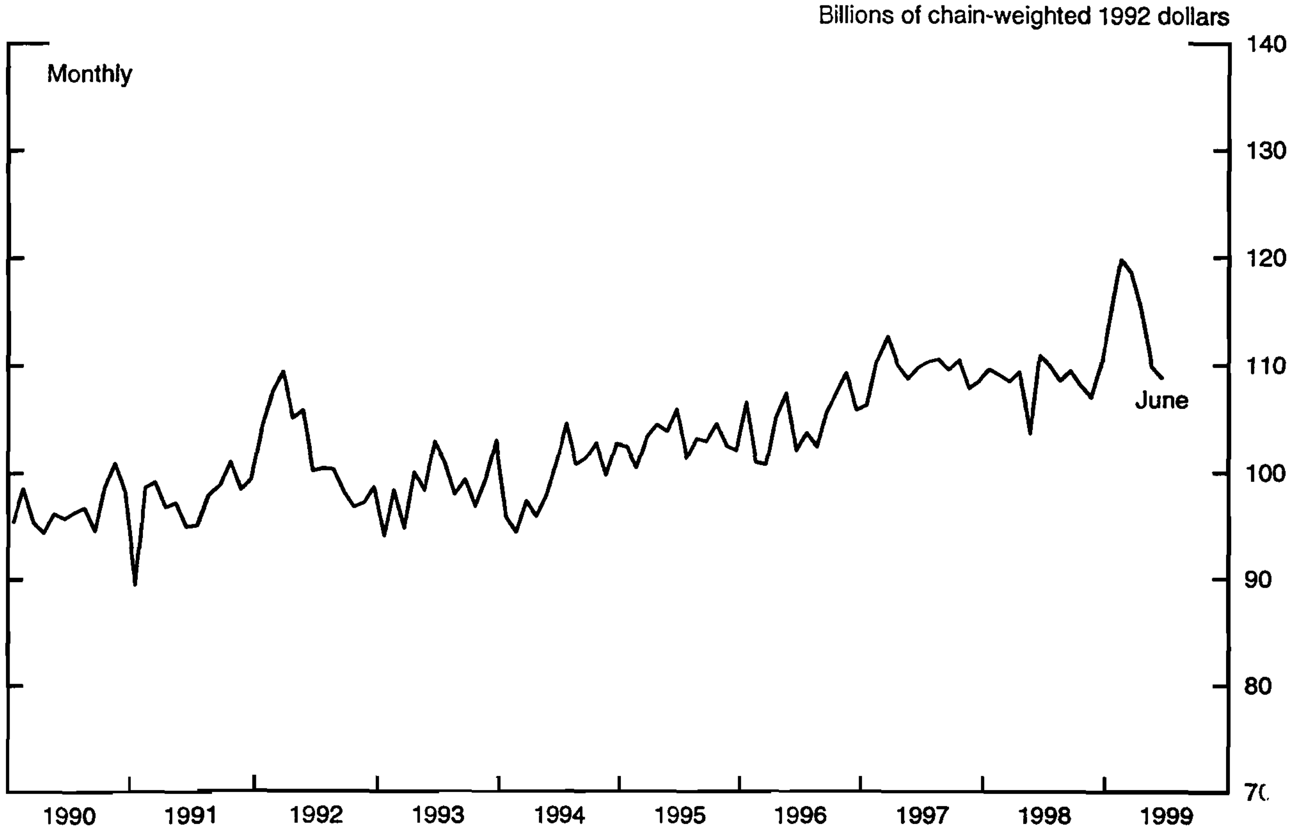
The fiscal condition of state governments has continued to improve. According to a preliminary survey, fiscal 1999 marked the sixth consecutive year of improving budgetary conditions.[14] Indeed, as a percent of general fund expenditures, year-end general fund balances stood at their highest level since 1978, when the data were first collected. During the past year, as in other recent years, strong revenue growth has allowed many states to make

13. New information on construction spending in June and revisions to data for earlier months suggest that the BEA's advance estimate of a 0.2 percent annual rate decline in real state and local government purchases in the second quarter will be revised to show a decline of about 1 percent.

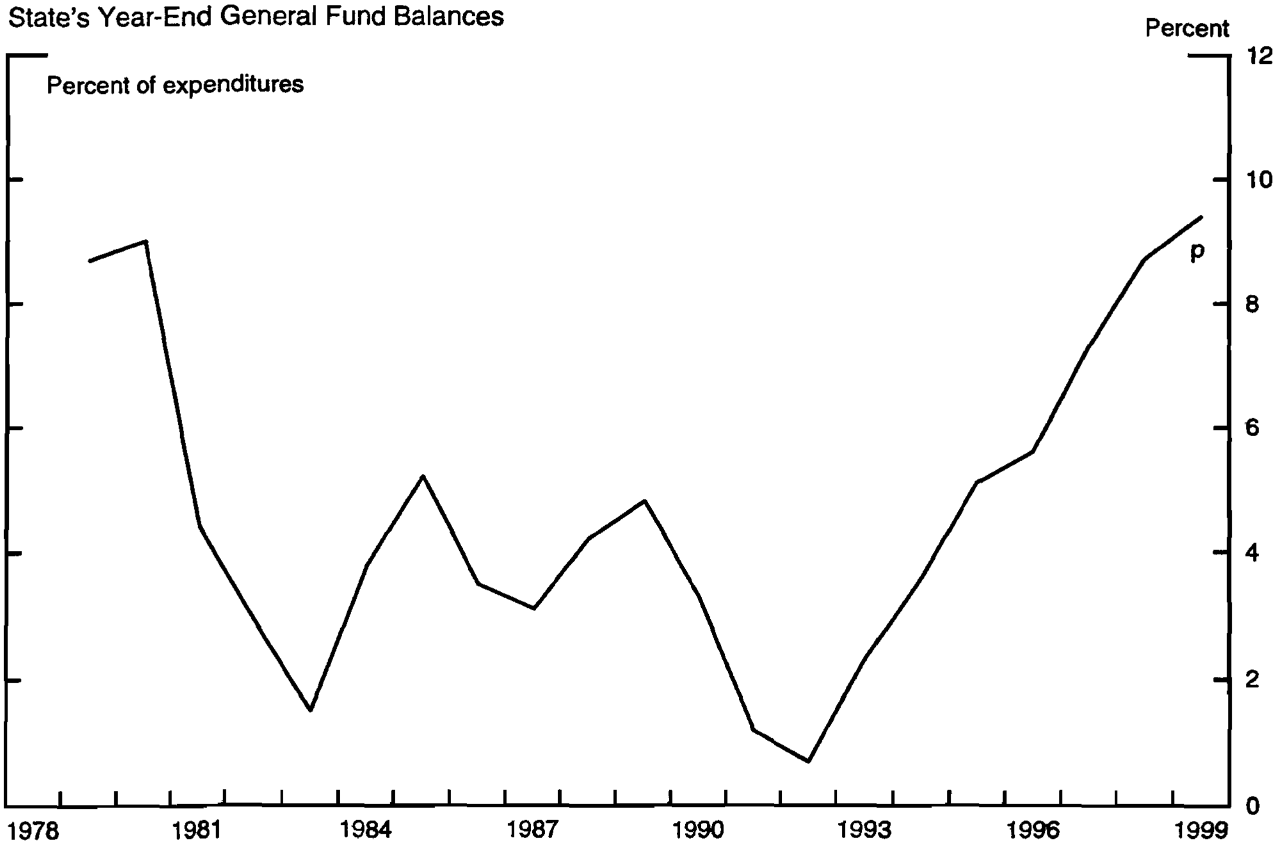
14. Forty-four states reported in the National Conference of State Legislature's survey; final and complete figures will probably not be available until December.

State and Local Governments

Total State and Local Construction Put in Place



State's Year-End General Fund Balances



p - Preliminary
Source. National Conference of State Legislatures.

deposits into their rainy-day funds and/or to cut taxes. Many states have also been able to expand construction projects and expenditures for operational programs. Among general fund spending, the largest increases in appropriation for fiscal 2000 are for education.

Prices and Wages

Prices. Inflation remained subdued through the middle of the summer. The overall CPI, which was flat in May and June, increased 0.3 percent in July. Excluding food and energy prices, the core CPI increased 0.2 percent in July, after rising 0.1 percent in June. On a twelve-month change basis, core consumer prices were up 2.1 percent as of July 1999, essentially unchanged from the 2.2 percent increase in the previous twelve-month period.[15] Reflecting the rebound in energy prices, the rate of increase of the overall CPI stepped up from 1.7 percent over the twelve months ended July 1998 to 2.1 percent in the most recent twelve-month period.

Consumer food prices increased 0.2 percent in July following no change in June. Over the past twelve months, food prices rose 2.1 percent--little changed from the previous twelve months and the same rate as core inflation.

The CPI for energy rose 2.1 percent in July, following declines of 1-1/4 percent in both May and June. Gasoline prices turned up sharply again in July; prices had moved down in May and June after having soared 15 percent in April. Recent survey data suggest that gasoline prices continued to rise rapidly through early August.

Outside of food and energy, the prices of consumer commodities edged up 0.1 percent in July and were just 0.6 percent higher than a year earlier. New vehicle prices were little changed last month, but used car prices continued to rebound. The volatile apparel price index dropped sharply in July and is down 1-3/4 percent over the past year. But tobacco prices jumped 3.3 percent in July, continuing the zig-zag pattern that has prevailed since early this year.

Prices of non-energy services rose 0.3 percent in July, following an increase of 0.1 percent in June. Owners' equivalent rent rose 0.1 percent in July for the second consecutive month. So far this year, owners' equivalent rent has increased at an annual rate of 2.2 percent, well below the pace in recent

15. The staff's consistent methodology series for core CPI showed no deceleration, increasing 2.0 percent over both twelve-month periods.

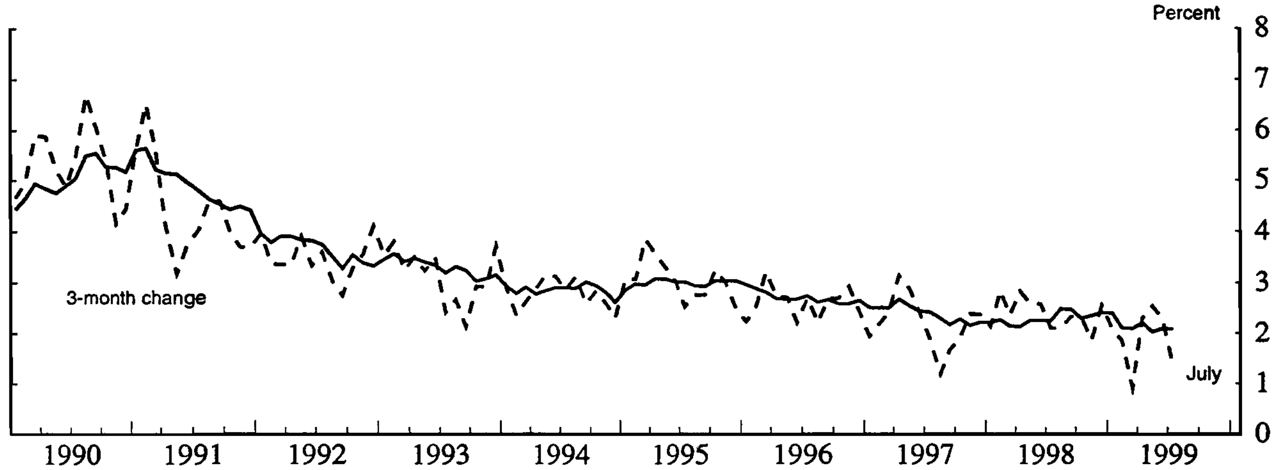
CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1999		1999	
	July 1998	July 1999	Q1	Q2	June	July
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	1.7	2.1	1.5	3.5	.0	.3
Food (15.4)	2.2	2.1	2.4	.9	.0	.2
Energy (6.3)	-5.6	3.3	-2.0	25.5	-1.2	2.1
CPI less food and energy (78.3)	2.2	2.1	1.6	2.4	.1	.2
Commodities (24.0)	.6	.6	.0	.6	.0	.1
New vehicles (5.0)	-.7	-.5	-.7	-1.0	-.1	.1
Used cars and trucks (1.9)	.9	.7	-11.5	2.3	.9	.9
Apparel (4.8)	-.5	-1.8	-6.8	3.9	-.4	-.9
Tobacco (1.2)	12.9	30.3	81.5	-.7	.2	3.3
Other Commodities (11.1)	.3	-.5	-.6	-.3	.0	-.0
Services (54.3)	3.0	2.7	2.4	3.1	.1	.3
Shelter (29.9)	3.3	2.9	1.7	3.4	.3	.1
Medical care (4.5)	3.4	3.3	3.7	3.3	.4	.2
Other Services (19.9)	2.6	2.3	3.1	2.7	-.2	.5
PPI						
Finished goods (100.0)[2]	-.2	1.5	1.3	2.7	-.1	.2
Finished consumer foods (23.3)	.5	-.3	2.5	-2.4	.4	-.9
Finished energy (12.0)	-7.5	4.9	-4.0	26.4	-.3	3.4
Finished goods less food and energy (64.7)	1.1	1.3	2.1	.4	-.2	.0
Consumer goods (39.5)	2.1	2.3	3.6	.5	-.1	.1
Capital equipment (25.2)	-.5	-.1	-.4	.2	-.3	-.1
Intermediate materials (100.0)[3]	-1.6	.1	-2.5	4.1	.4	.6
Intermediate materials less food and energy (83.2)	-.4	-.1	-1.7	1.7	.5	.4
Crude materials (100.0)[4]	-8.4	-.7	-12.7	23.6	1.4	-.2
Crude food materials (45.0)	-7.4	-7.5	-2.5	-9.4	.4	-4.8
Crude energy (31.7)	-10.4	12.1	-29.4	112.2	3.1	3.7
Crude materials less food and energy (23.3)	-7.6	-6.6	-5.1	1.4	.5	2.3

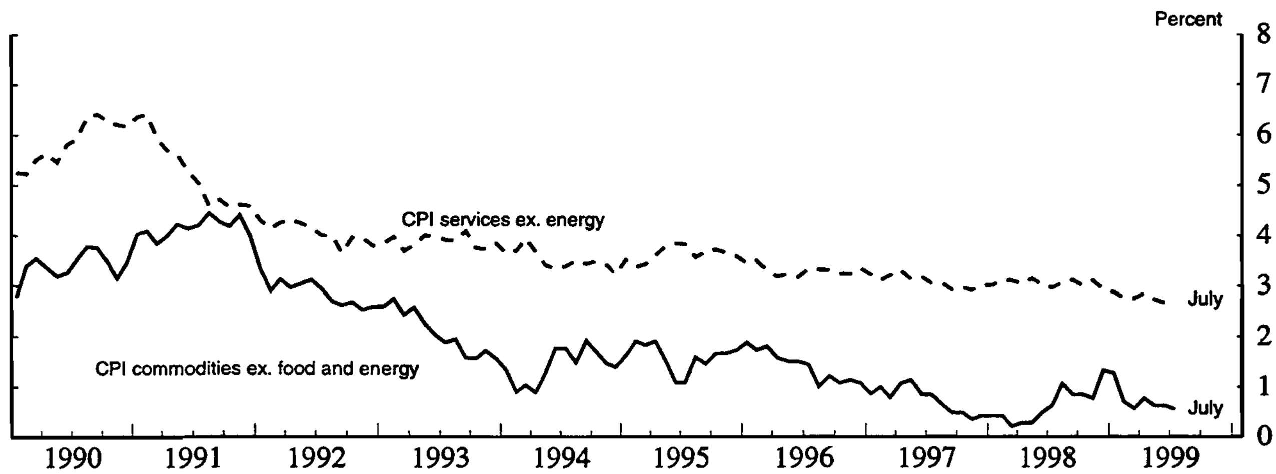
1. Relative importance weight for CPI, December 1998.
2. Relative importance weight for PPI, December 1998.
3. Relative importance weight for intermediate materials, December 1998.
4. Relative importance weight for crude materials, December 1998.

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

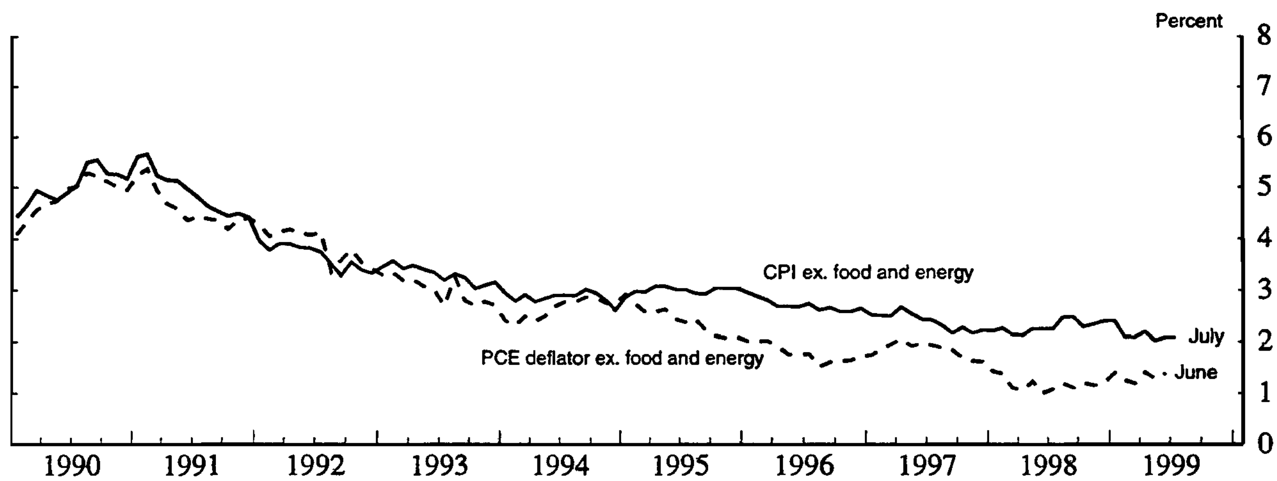
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE



BROAD MEASURES OF INFLATION
(Four-quarter percent change)

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

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year Mean[2]	University of Michigan: 1 year Median[3]	University of Michigan: 5 to 10 years Mean[4]	University of Michigan: 5 to 10 years Median[5]	Professional forecasters (10-year)[6]
1997-Q1	2.9	3.8	2.9	3.8	3.1	3.0
Q2	2.3	3.6	2.9	3.8	3.0	2.9
Q3	2.2	3.4	2.7	3.6	3.0	3.0
Q4	1.9	3.3	2.8	3.8	3.1	2.7
1998-Q1	1.5	2.8	2.4	3.3	2.9	2.6
Q2	1.6	3.0	2.6	3.3	2.8	2.5
Q3	1.6	2.8	2.4	3.2	2.8	2.5
Q4	1.5	2.7	2.4	3.2	2.8	2.5
1999-Q1	1.7	3.0	2.6	3.3	2.8	2.3
Q2	2.1	3.1	2.7	3.3	2.8	2.5
Q3						2.5
1999-Jan.	1.7	3.0	2.7	3.5	3.0	
Feb.	1.6	2.8	2.5	3.3	2.8	
Mar.	1.7	3.1	2.7	3.0	2.7	
Apr.	2.3	3.0	2.7	3.0	2.8	
May	2.1	3.2	2.8	3.5	2.9	
June	2.0	3.1	2.5	3.3	2.8	
July	2.1	3.0	2.7	3.3	2.9	
Aug.		3.3	2.9	3.3	2.7	

1. CPI; percent change from the same period in the preceding year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Average increase for responses to the question: By about what percent per year do you expect prices (CPI) to go up, on the average, during the next 5 to 10 years?
5. Median increase for responses to question above.
6. Compiled by the Federal Reserve Bank of Philadelphia. The figure for 1999:Q3 is CONFIDENTIAL until 10:00AM August 23rd.

years.[16] Elsewhere, prices of medical care services rose 0.2 percent in July on top of a 0.4 percent increase in June. At 3.3 percent, the year-over-year change in these prices continued to run ahead of general price inflation. And the turbulence in airfares continued, as July's 6.5 percent jump followed June's decline of nearly 5 percent.

Other broad measures of inflation have moved up recently, partly reflecting the pickup in energy prices. The GDP chain price index rose 1.3 percent from the second quarter of 1998 to the second quarter of 1999, a bit ahead of the 1.0 percent increase in the previous four-quarter period. The chain price indexes for gross domestic purchases and for personal consumption expenditures both accelerated more than GDP prices, owing largely to their greater energy shares; excluding food and energy, both indexes accelerated about 1/4 percentage point over the past four quarters.

In the PPI, capital goods prices edged lower in July, following a 0.3 percent decline in June. Prices of light vehicles moved down again in July, after having posted sizable declines in June. On the other hand, computer prices have dropped at an average rate of about 1-1/4 percent in the past two months, considerably slower than their earlier rate of decline. Over the twelve months ending in July, capital goods prices are down 0.1 percent, compared with a 0.5 percent decrease in the previous twelve-month period.

At earlier stages of processing, some notable firming has occurred in the prices for materials excluding food and energy. Some of these prices have been boosted by the passthrough of higher crude oil costs. More generally, the pickup in materials prices probably reflects a turnaround in demand--especially from Asia--and heightened prospects for further increases in worldwide growth.

Specifically, the PPI for intermediate materials other than food and energy rose 0.4 percent in July; this sizable gain followed June's 0.5 percentage point increase, and the recent run-up is the largest since the 1994-95 burst, which occurred at a time of much higher U.S. capacity utilization and poorer vendor performance. Prices of materials used in construction increased 3/4 percent in each of the past two months, and prices of some metal and plastic products moved higher in July. Analysis by the Board staff suggests that increases in core intermediate prices are passed through to the core CPI relatively quickly, within about one to two quarters. Nonetheless, the magnitude to date of the

16. Although the procedures for housing in the CPI changed in January, the BLS maintains that this change has not affected the magnitude of increases in owners' equivalent rent this year.

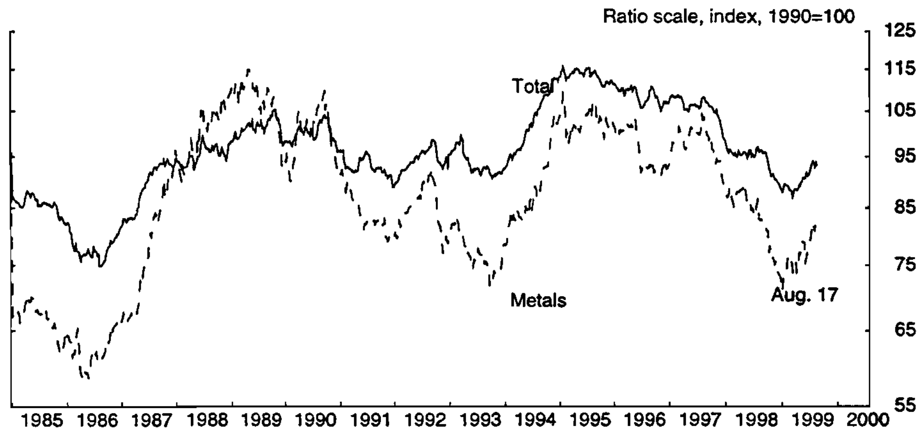
SPOT PRICES OF SELECTED COMMODITIES

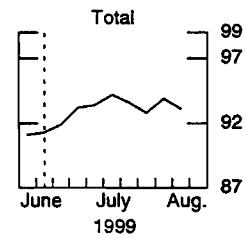
	Current price ($)	Percent change[1]: 1997	1998	Dec. 29 to June 22[2]	June 22[2] to Aug. 17	Memo: Year earlier to date
Metals						
Copper (lb.)	.810	-21.5	-14.8	-2.9	20.9	5.2
Steel scrap (ton)	99.667	19.3	-47.5	29.4	6.0	-7.9
Aluminum, London (lb.)	.655	-1.9	-17.6	8.4	7.6	10.1
Precious metals						
Gold (oz.)	259.650	-20.7	-1.1	-9.9	.4	-8.7
Silver (oz.)	5.275	27.2	-18.0	1.1	3.8	3.8
Forest products[3]						
Lumber (m. bdft.)	350.000	-26.6	2.7	31.3	-11.2	11.1
Plywood (m. sqft.)	430.000	-1.7	3.3	59.7	-13.1	16.2
Petroleum						
Crude oil (barrel)	20.600	-27.4	-36.1	50.6	32.4	73.1
Gasoline (gal.)	.638	-23.5	-33.5	44.0	32.9	57.0
Fuel oil (gal.)	.561	-29.6	-33.6	30.8	30.9	66.9
Livestock						
Steers (cwt.)	65.250	4.2	-13.2	13.6	-2.6	10.6
Hogs (cwt.)	34.250	-30.8	-55.7	135.5	-6.2	-2.1
Broilers (lb.)	.583	-24.4	15.0	6.1	-3.1	-22.6
U.S. farm crops						
Corn (bu.)	1.860	-3.8	-19.4	-4.1	-5.8	-2.1
Wheat (bu.)	2.678	-24.1	-5.7	-17.8	-1.8	-.8
Soybeans (bu.)	4.460	-3.2	-21.1	-16.1	-.2	-16.6
Cotton (lb.)	.516	-10.9	-10.2	-7.1	-3.2	-29.2
Other foodstuffs						
Coffee (lb.)	.923	26.1	-31.4	-8.1	-14.2	-23.1
Memo:						
JOC Industrials	93.100	-7.3	-9.8	3.2	2.0	-3.4
JOC Metals	84.200	-4.7	-18.5	7.9	7.8	1.4
CRB Futures	197.230	-4.9	-17.2	.3	3.0	-2.7
CRB Spot	266.200	-7.6	-14.1	-2.6	3.7	-8.5

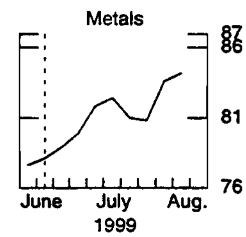
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the June Greenbook.
3. Reflects prices on the Friday before the date indicated.

Commodity Price Measures

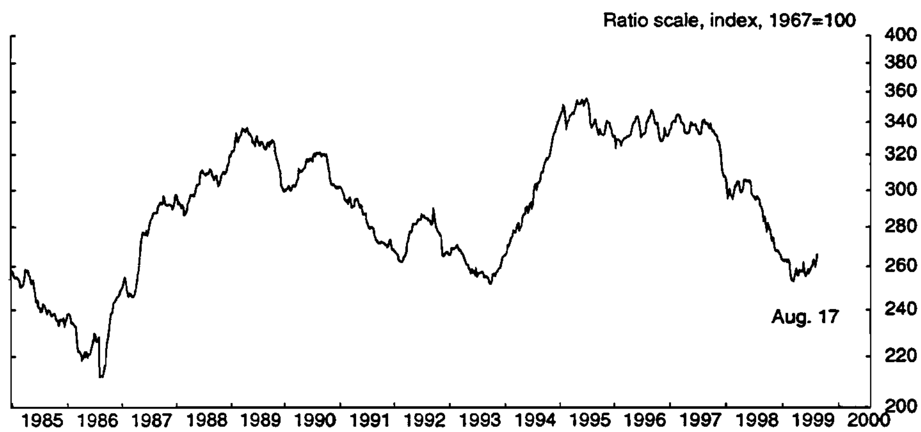
Journal of Commerce Index

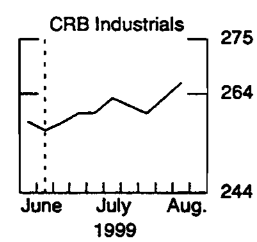




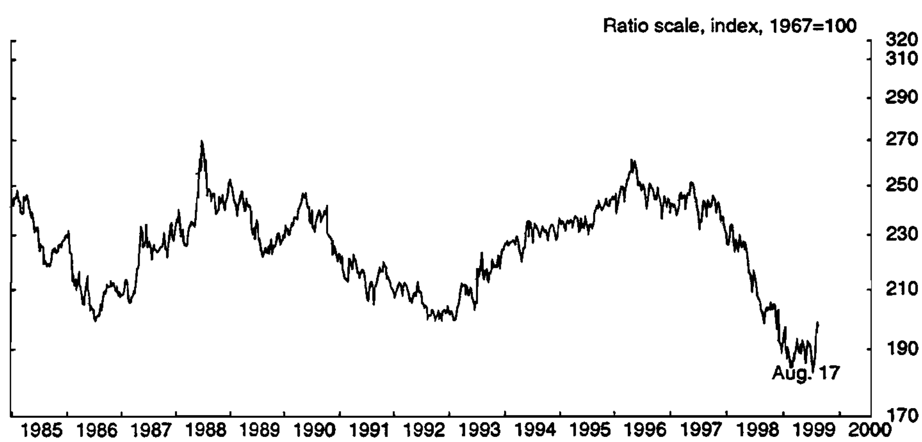


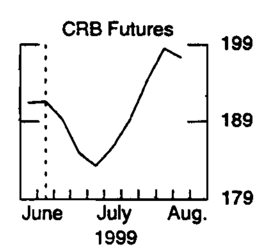
CRB Spot Industrials





CRB Futures





Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the CRB spot price index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1998			1999	
	June	Sept.	Dec.	Mar.	June
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	3.6	4.1	2.9	1.4	4.6
Wages and salaries	3.9	4.8	3.0	1.8	5.0
Benefit costs	2.8	2.5	2.8	0.8	3.9
By industry					
Construction	5.0	1.5	4.9	3.9	2.1
Manufacturing	2.4	2.9	2.3	2.6	2.6
Trans., comm., and public utilities	4.8	3.8	2.9	0.0	4.4
Wholesale trade	2.3	7.1	6.7	-1.4	5.1
Retail trade	3.3	3.9	0.9	3.0	6.3
FIRE	5.1	7.7	4.3	-2.8	12.7
Services	3.2	3.8	3.1	2.0	3.4
By occupation					
White collar	4.1	4.7	3.7	0.0	5.2
Blue collar	3.0	2.7	3.0	2.7	3.3
Service occupations	2.7	3.3	2.1	4.4	3.8
Memo:					
State and local governments	3.0	2.9	2.9	2.6	3.2
	-----Twelve-month percent change----				
Total hourly compensation	3.5	3.8	3.5	3.0	3.3
Excluding sales workers	3.4	3.5	3.1	3.0	3.2
Wages and salaries	4.0	4.3	3.9	3.3	3.6
Excluding sales workers	3.8	3.9	3.4	3.4	3.6
Benefit costs	2.6	2.6	2.4	2.2	2.5
By industry					
Construction	3.1	2.9	3.5	3.8	3.2
Manufacturing	2.5	2.7	2.7	2.6	2.7
Trans., comm., and public utilities	4.1	4.2	3.8	2.9	2.8
Wholesale trade	3.6	4.6	5.7	3.6	4.3
Retail trade	3.6	3.7	3.0	2.8	3.5
FIRE	7.0	8.0	5.9	3.5	5.3
Services	3.4	3.5	3.0	3.0	3.1
By occupation					
White collar	4.0	4.4	3.9	3.1	3.4
Sales	5.0	6.2	6.8	3.2	3.9
Nonsales	3.8	4.0	3.3	3.0	3.3
Blue collar	2.7	2.7	2.7	2.9	2.9
Service occupations	3.9	3.2	2.9	3.1	3.4
Memo:					
State and local governments	2.7	3.0	3.0	2.9	3.0

1. Seasonally adjusted by the BLS.

pickup in the PPI for core materials implies only a small boost to core consumer prices.[17]

Looking farther back in the production process, the core crude PPI was up 2-1/4 percent in July, following a rise of 0.5 percent in June. The *Journal of Commerce* index of commodity prices rose 2.5 percent between mid-June and mid-July, but has since changed little, on net.

Although the monthly numbers are erratic, the preliminary read on short-term inflation expectations from the Michigan SRC survey rose in early August. Median expectations of inflation over the next year came in at 2.9 percent in August, up from the second quarter average; the mean one-year inflation expectation moved up to 3.3 percent. However, consumers evidently view the bulge as transitory: Median expectations of inflation over the next five to ten years from the Michigan survey inched down to 2.7 percent, from 2.8 percent in the second quarter.

Labor Costs. We have seen a series of higher readings for increases in wages and salaries and total compensation per hour in the recent quarterly and monthly statistical releases. Even with these gains, however, the compensation data still show some deceleration over the past year.

The employment cost index for hourly compensation of private industry workers jumped at an annual rate of 4.6 percent in the three months ended in June after having risen at an unusually slow 1.4 percent rate in the first quarter. Still, on a twelve-month basis, hourly compensation in the ECI decelerated slightly, from 3.5 percent during the twelve months ended in June 1998 to 3.3 percent during the twelve months ended in June 1999.

The ECI for private wages and salaries rose at an annual rate of 5.0 percent in the second quarter following a 1.8 percent rate increase in the previous quarter. The second-quarter bounceback reflected a surge in finance, insurance, and real estate as well as a pickup in some other industries following unusually weak first-quarter numbers. Nevertheless, on a twelve-month-change basis, hourly wages and salaries decelerated from a 4.0 percent

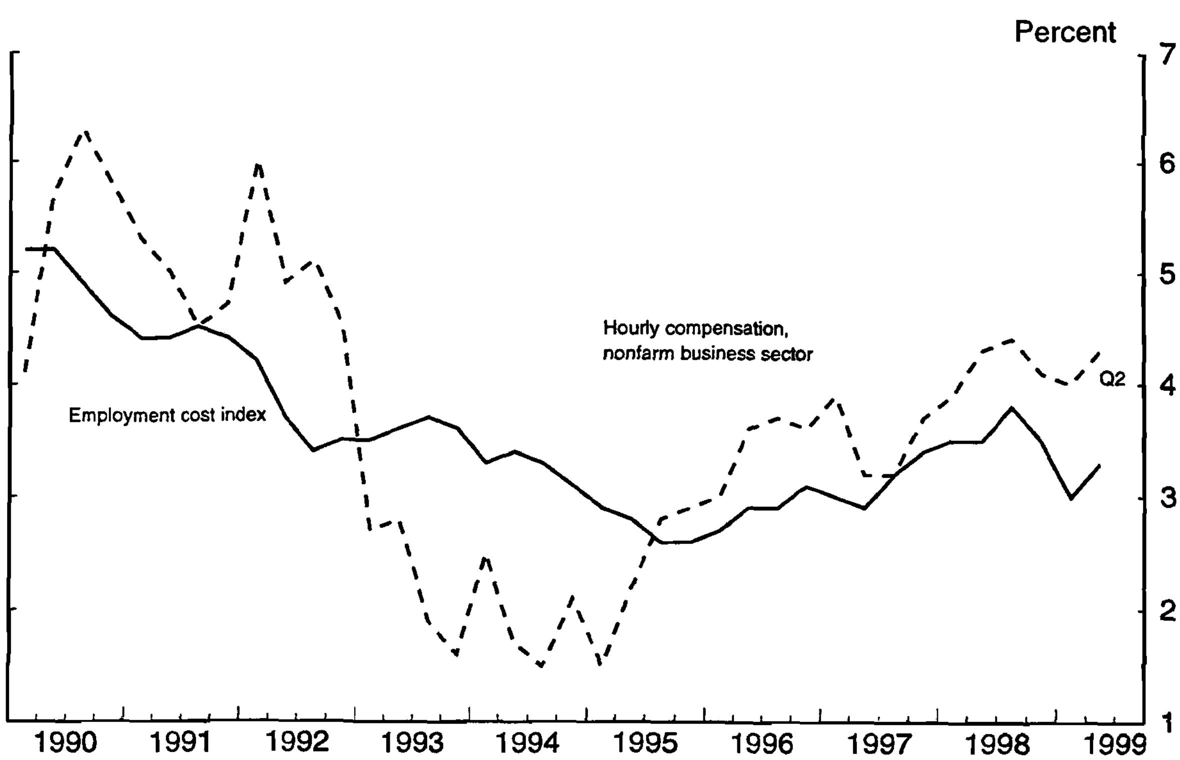
17. Our research also suggests that the impact of core intermediate materials prices on the core CPI tends to be larger during periods of high resource utilization, proxied by either the unemployment rate or capacity utilization. (This may be because competitive pressures are greater when the economy is weak, making it harder for firms to pass along cost increases.) Of course, these indicators currently are giving conflicting readings of slack, but even based on the unemployment rate, the influence of the recent runup in core intermediate materials prices on the CPI ought to be small.

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

	1997[1]	1998[1]	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1998:Q2 to 1999:Q2
Compensation per hour							
Total business	3.8	4.2	4.1	4.2	5.1	5.4	4.7
Nonfarm business	3.7	4.1	4.1	3.8	4.4	5.1	4.3
Manufacturing	5.2	3.2	3.1	3.5	5.2	6.0	4.4
Nonfinancial corporations[2]	3.8	4.1	4.3	4.0	4.9	n.a.	n.a.
Unit labor costs							
Total business	2.0	1.4	1.0	-.1	1.1	3.8	1.4
Nonfarm business	2.1	1.5	1.3	-.4	.8	3.8	1.4
Manufacturing	-.1	-.6	-1.5	-1.8	-1.1	1.1	-.8
Nonfinancial corporations[2]	1.2	.7	-.3	.8	-.1	n.a.	n.a.

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

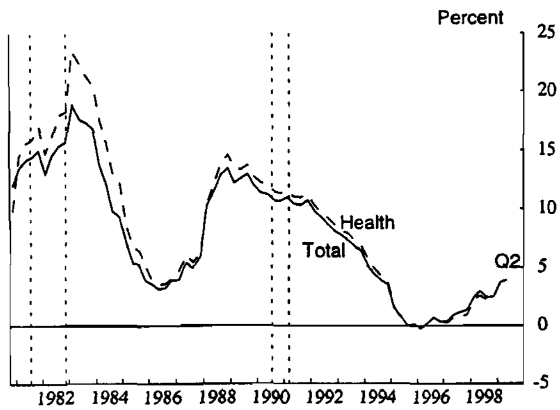
Measures of Compensation per Hour
(Four-quarter change)



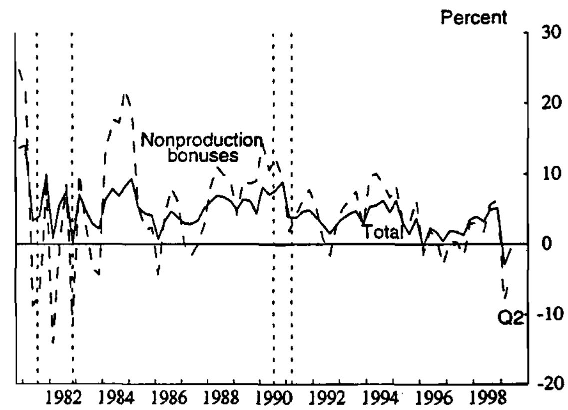
Components of ECI Benefits Costs (CONFIDENTIAL)

(Private industry workers; twelve-month change)

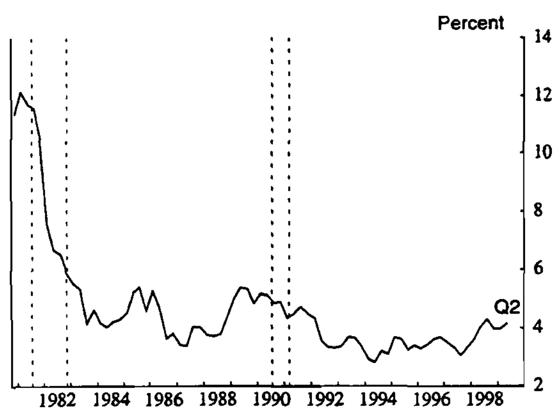
Insurance Costs



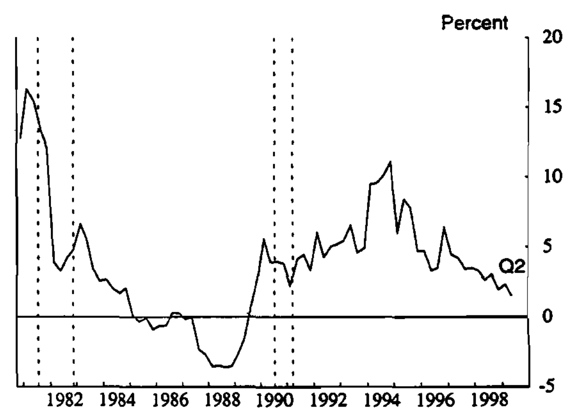
Supplemental Pay



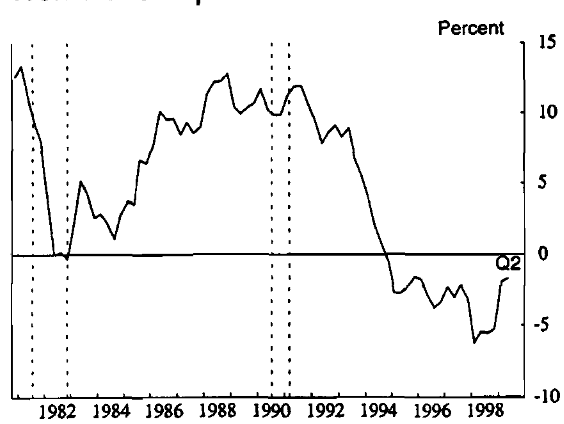
Paid Leave



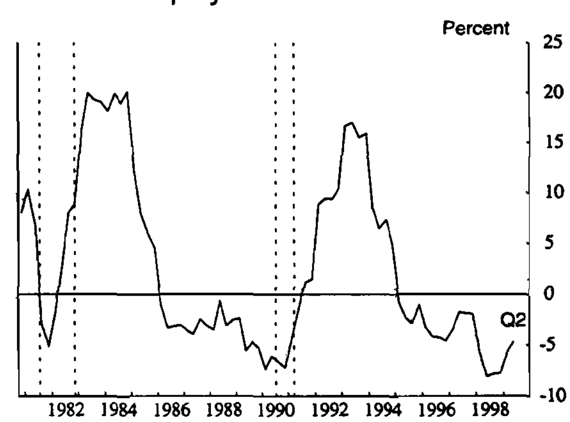
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance

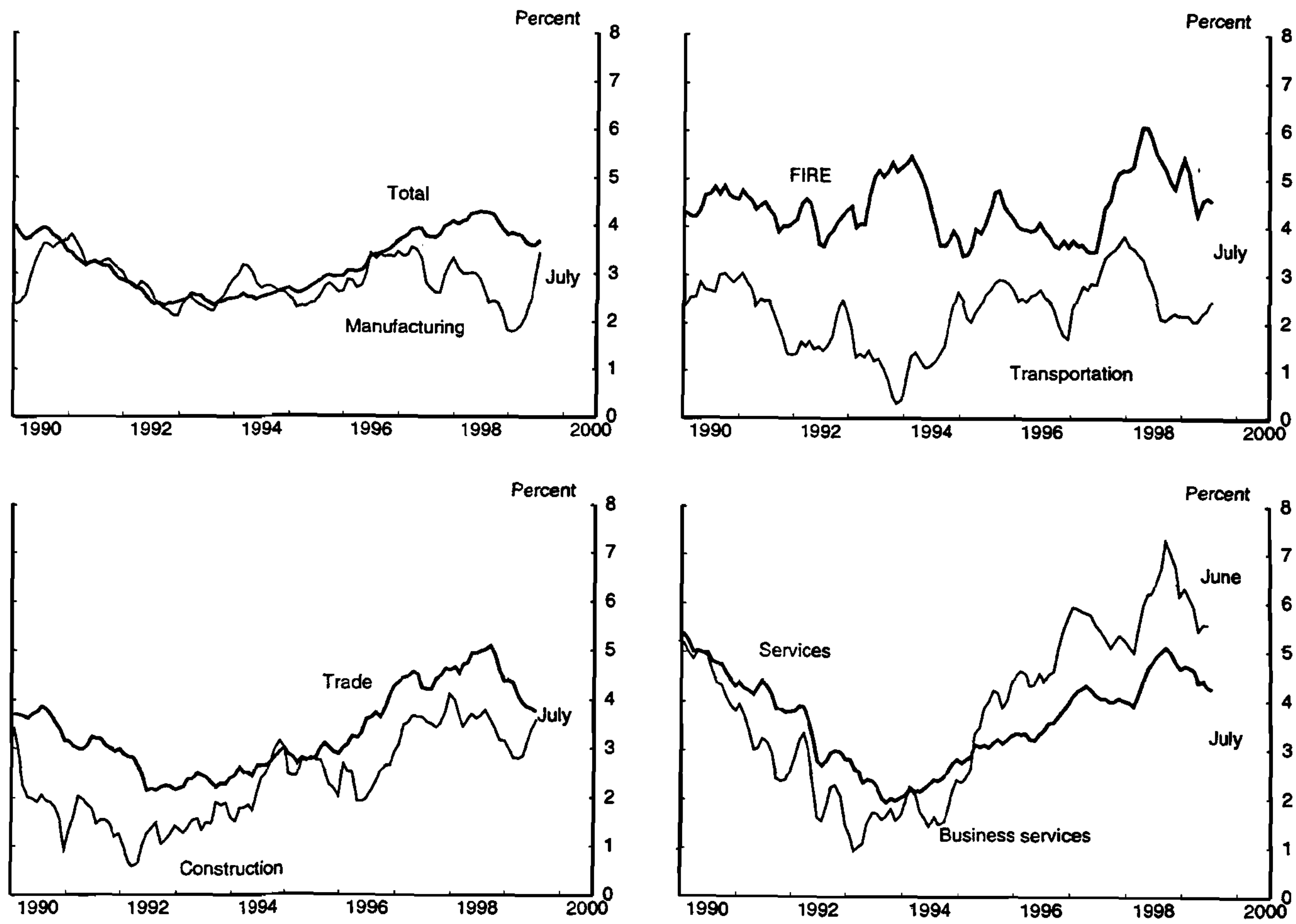


Note. Unpublished and confidential ECI benefits detail.

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

	Twelve-month percent change			Percent change to Jul. 1999		1999	
	July 1997	July 1998	July 1999	Jan. 1999	Apr. 1999	June	July
	- - - - - - -	-Annual rate-	- - - - - - -			-Monthly rate-	
Total private nonfarm	3.7	4.3	3.8	3.9	4.6	.4	.5
Manufacturing	2.6	2.4	4.3	6.0	7.5	.6	.7
Construction	3.4	3.9	3.5	5.1	6.0	.4	.4
Transportation and public utilities	3.7	2.3	2.7	3.0	3.1	-.2	.6
Finance, insurance, and real estate	4.1	5.5	4.3	3.2	3.1	.2	.4
Retail trade	4.3	5.2	3.9	3.8	3.1	.2	.4
Wholesale trade	4.5	4.8	3.6	3.4	4.5	.5	.3
Services	4.0	5.1	4.2	4.0	4.6	.3	.4

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



increase in June 1998 to a 3.6 percent gain in June 1999. The deceleration was most prominent in the FIRE category.

Benefit costs in the ECI increased at an annual rate of 3.9 percent in the second quarter, following a rise of 0.8 percent in the first quarter. Much of this volatility was a result of swings in non-production bonuses. Overall, benefit costs were up 2.5 percent during the twelve-months ended in June, little changed from the 2.6 percent rate of increase in the previous twelve-month period. Health insurance costs and legally required benefits accelerated over this period, but these pickups were offset by smaller increases in supplemental pay and in retirement and savings benefits. (Please note: With the exception of the health insurance numbers, these data on benefit components are confidential and not for release to the public.)

According to the BLS's productivity and cost measure, hourly compensation in the nonfarm business sector increased at an annual rate of 5.1 percent in the second quarter, up from a 4.4 percent rise in the first quarter. Over the past four quarters, hourly compensation increased 4.3 percent, the same as the increase over the previous four-quarter period. However, this fall we are anticipating a considerable upward revision to the rate of increase in compensation per hour during 1998--one that could, all else equal, boost the four-quarter changes through the second quarters of 1998 and 1999 to about 5.0 percent and 4-3/4 percent respectively.[18]

The recent monthly readings for average hourly earnings of production or nonsupervisory workers have been on the high side; earnings were up 0.5 percent in July following a 0.4 percent increase in June. Nonetheless, like the other measures of hourly compensation, this reading of wages has decelerated over the past year: On a twelve-month change basis, average hourly earnings were up 3.8 percent in the period ended in July, down from a 4.3 rate of rise in the previous twelve months. Much of this deceleration occurred in the second half of last year, and in part reflected the warning boost from the earlier minimum wage hike.

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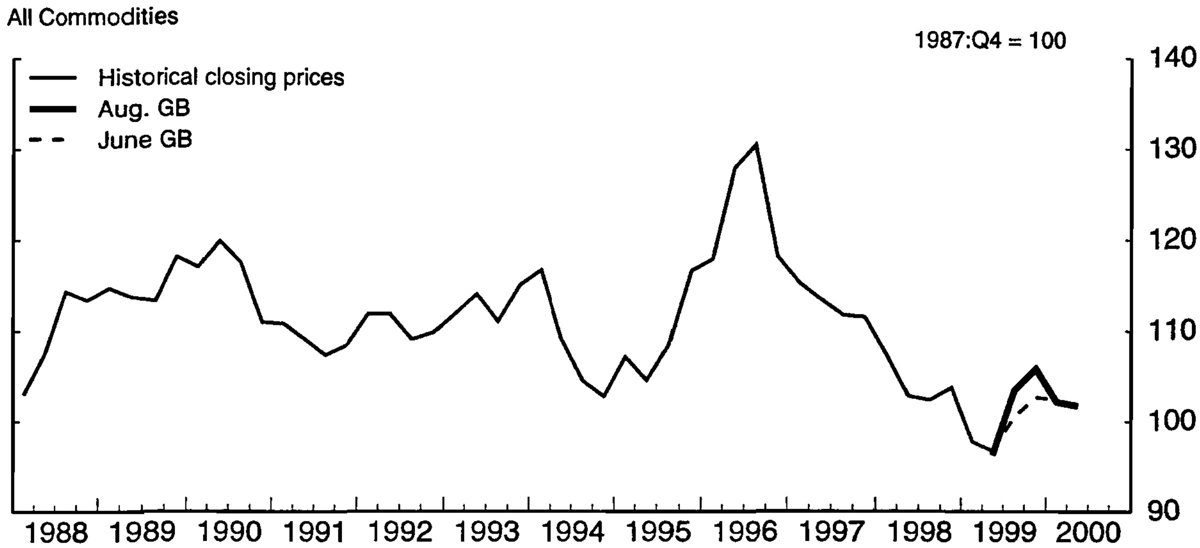
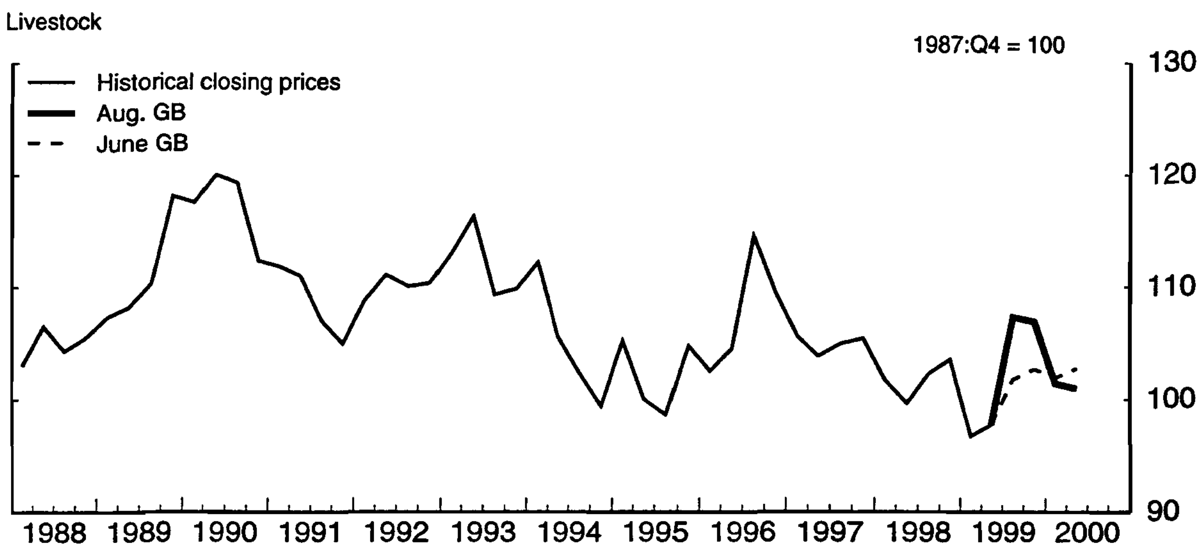
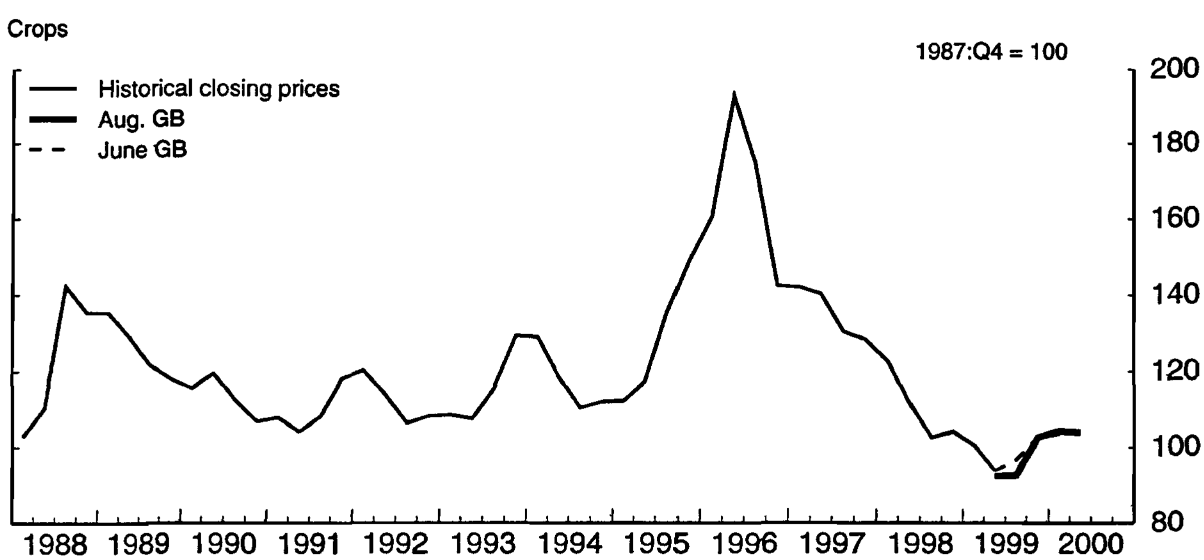
18. The BLS constructs its measure of hourly compensation using information on total compensation in the nonfarm business sector published by the BEA in the NIPA and data on hours from its own household and payroll employment surveys. The BEA's analysis of the unemployment insurance tax records for 1998 point to a large upward revision to wages and salaries in that year. (The revision to compensation per hour will likely be most pronounced in the first half of the year.) These--and a host of other data that could affect compensation per hour--will be incorporated in the NIPA in this October's comprehensive benchmark revisions and in the productivity and cost data that are released in November.

Futures Price Index for Food Commodities







On an industry basis, manufacturing wages have posted sharp gains recently, a somewhat surprising development in light of the weakness observed in this sector more generally. Since January, average hourly earnings in manufacturing have risen 6 percent at an annual rate. Some of the rapid increase in wages reflects the growing use of overtime hours; excluding overtime, straight-time wages increased at an annual rate of 5.3 percent over the past six months. By contrast, the ECI paints a relatively benign picture for the sector, with its measure of wages and salaries of manufacturing workers increasing at annual rates of 3-1/4 percent in both the first and second quarters. (Unlike average hourly earnings, the ECI is not affected by changes in overtime hours or by occupational or industry mix shifts within manufacturing.)[19] Outside of manufacturing, average hourly earnings for construction and transportation workers also have picked up.

Agricultural Developments

Dry weather has been hurting crops in some parts of the country in recent weeks, but the damage overall does not appear to have been great enough to significantly alter the farm outlook. The USDA's latest production forecasts for the major farm crops, based on conditions as of August 1, showed only small downward revisions from last month's estimates and were slightly stronger, on balance, than the estimates available at the time the June Greenbook was completed. Crop prices, which had moved up sharply from mid-July to early August in response to concerns about the weather, fell back sharply after the August crop report was released.

Whether the current production estimates will hold up through coming revisions remains to be seen. The USDA's weekly reports on crop conditions suggest, for example, that weather may have taken a further toll on the crops in the first half of August. Still, the crops are rapidly approaching a point of maturity such that a catastrophic outcome--for the nation as a whole--seems quite unlikely. Even allowing for further markdowns from the August estimates, supplies are likely to remain ample, if not excessive.

Meanwhile, livestock output continues to advance. The USDA is predicting increases of about 1-1/2 percent for both beef and pork this year; 1999 production forecasts for both those crops have been revised up over the past couple of months. Output of poultry, which had posted a subpar gain of only 1 percent in 1998, appears to be headed for a more typical increase--about

19. In addition, the ECI sample includes supervisory workers, who are excluded from the calculation of average hourly earnings.

5 percent--in 1999. Production of milk is expected to rise 3 percent this year, a relatively large advance by historical standards.

Futures prices of agricultural products displayed considerable volatility over the period from late June to mid-August, initially plunging in response to indications of favorable crop progress, then turning up sharply as concerns about the drought intensified, only to fall back again, as noted above, in reaction to the USDA's August crop report. On net, the index of futures prices that the staff maintains firmed somewhat between late June and mid-August. Crop prices ended up little changed over the period, but dairy prices staged another big run-up, similar to the price surge that developed in 1998. Market sources indicate that strength of demand for dairy products is more than offsetting the impressive gain in milk production this year. Futures prices, overall, continue to point to only a moderate rebound in farm prices over the coming year.

In the absence of a significant price rally, government subsidies to agriculture seem likely to remain substantial. The Freedom to Farm bill provided fixed annual payments of about $5 billion to farmers over the seven-year period starting in 1996. A safety net feature of that bill provided for added payments during times of unusually low prices, and the USDA is predicting that those payments will exceed $2-1/2 billion in fiscal 1999. Still more subsidies (about $5 billion) were appropriated for fiscal 1999 to offset the effects of soft export markets and crop and livestock losses that occurred in some regions last year. This year again, a sizable emergency allocation to agriculture is working its way through Congress. The Senate approved additional farm aid of $7-1/2 billion before recessing, and final details of an aid package will be worked out with House conferees when the Congress reconvenes.

DOMESTIC FINANCIAL DEVELOPMENTS

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	1998 Oct. 15	1998 Dec. 31	1999 FOMC* June 30	1999 Aug. 17	Change to Aug. 17 from selected dates (percentage points) Oct. 15	Dec. 31	FOMC* June 30
Short-term							
Federal funds							
FOMC intended rate	5.00	4.75	4.75	5.00	.00	.25	.25
Realized rate [1]	5.40	4.58	4.72	5.05	-.35	.47	.33
Treasury bills [2]							
3-month	4.05	4.37	4.70	4.61	.56	.24	-.09
6-month	4.12	4.39	4.92	4.92	.80	.53	.00
1-year	4.06	4.33	4.89	4.92	.86	.59	.03
Commercial paper							
1-month	5.27	4.90	5.18	5.18	-.09	.28	.00
3-month	5.13	4.84	5.12	5.30	.17	.46	.18
Large negotiable CDs [2]							
1-month	5.35	5.01	5.21	5.28	-.07	.27	.07
3-month	5.31	4.97	5.32	5.44	.13	.47	.12
6-month	5.10	4.97	5.43	5.86	.76	.89	.43
Eurodollar deposits [3]							
1-month	5.34	4.94	5.13	5.19	-.15	.25	.06
3-month	5.28	4.94	5.25	5.38	.10	.44	.13
Bank prime rate	8.25	7.75	7.75	8.00	-.25	.25	.25
Intermediate- and long-term							
U.S. Treasury (constant maturity)							
2-year	4.13	4.54	5.68	5.68	1.55	1.14	.00
10-year	4.58	4.65	5.93	5.89	1.31	1.24	-.04
30-year	5.02	5.09	6.07	6.02	1.00	.93	-.05
U.S. Treasury 10-year indexed note	3.69	3.88	4.01	4.02	.33	.14	.01
Municipal revenue (Bond Buyer) [4]	5.21	5.26	5.62	5.84	.63	.58	.22
Corporate bonds, Moody's seasoned Baa	7.26	7.23	8.05	8.13	.87	.90	.08
High-yield corporate [5]	11.28	10.17	10.53	10.86	-.42	.69	.33
Home mortgages (FHLMC survey rate) [6]							
30-year fixed	6.49	6.77	7.63	8.15	1.66	1.38	.52
1-year adjustable	5.36	5.58	5.93	6.24	.88	.66	.31

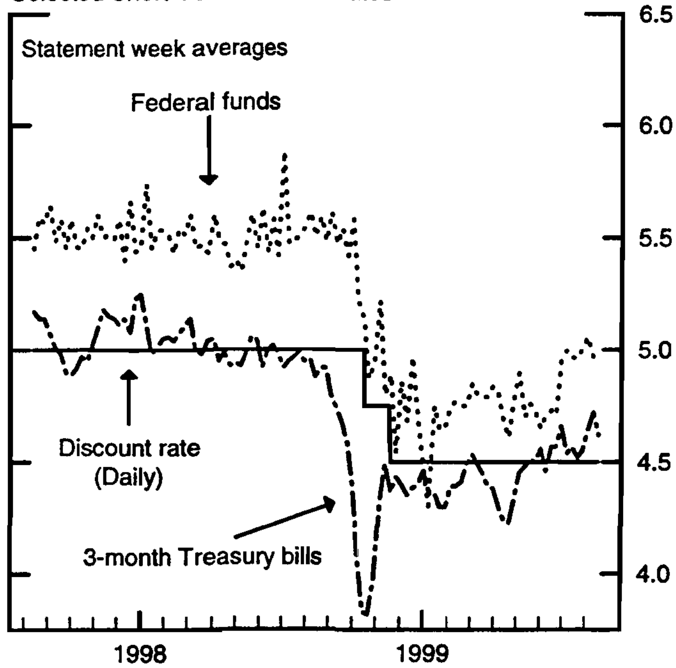
Stock exchange index	Record high Level	Record high Date	1998 Dec. 31	1999 FOMC* June 30	1999 Aug. 17	Change to Aug. 17 from selected dates (percent) Record high	Dec. 31	FOMC* June 30
Dow-Jones Industrial	11,209.84	7-16-99	9,181.43	10,815.35	11,117.08	-.83	21.08	2.79
S&P 500 Composite	1,418.78	7-16-99	1,229.23	1,351.45	1,344.16	-5.26	9.35	-.54
Nasdaq (OTC)	2,864.48	7-16-99	2,192.69	2,642.11	2,671.22	-6.75	21.82	1.10
Russell 2000	491.41	4-21-98	421.96	454.08	436.00	-11.28	3.33	-3.98
Wilshire 5000	12,976.99	7-16-99	11,317.59	12,377.95	12,227.77	-5.77	8.04	-1.21

1. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
2. Secondary market.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
4. Most recent Thursday quote.
5. Merrill Lynch 175 high-yield bond index composite.
6. For week ending Friday previous to date shown.

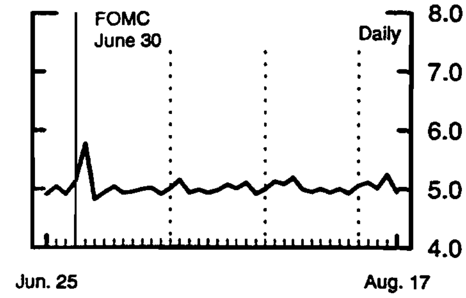
* Data are as of the close on June 29, 1999.

Selected Interest Rates

Selected Short-Term Interest Rates — Percent

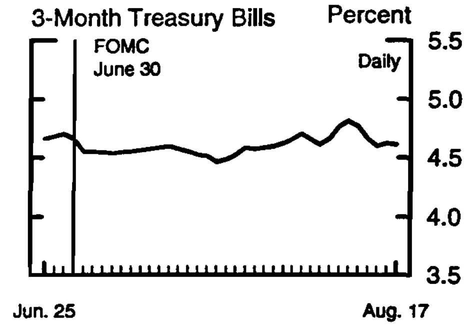


Federal Funds — Percent

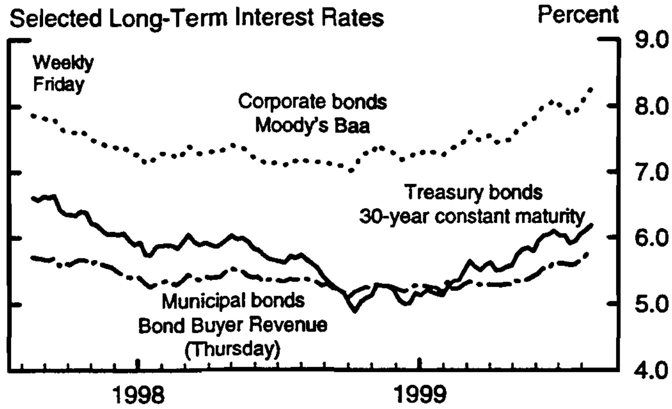


Note. Vertical dashed lines indicate end of reserve period.

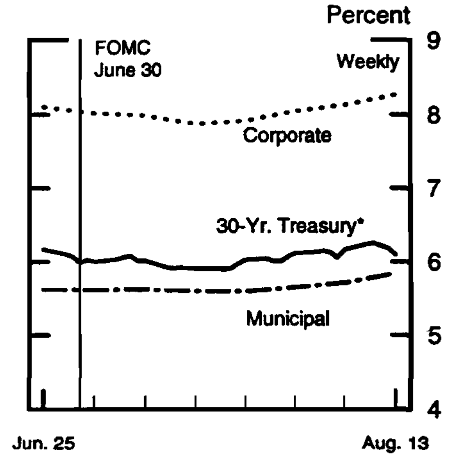
3-Month Treasury Bills — Percent



Selected Long-Term Interest Rates — Percent

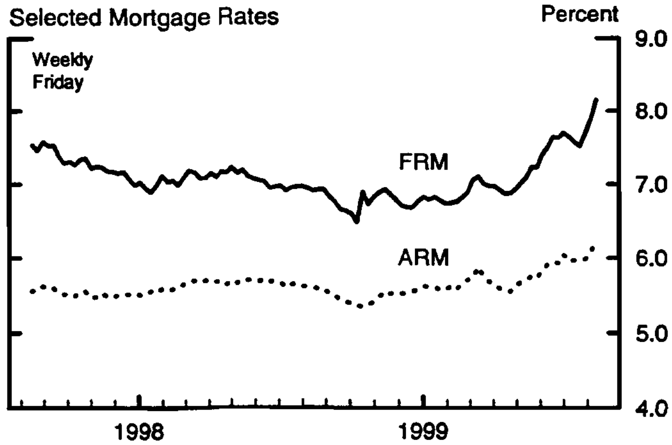


Percent

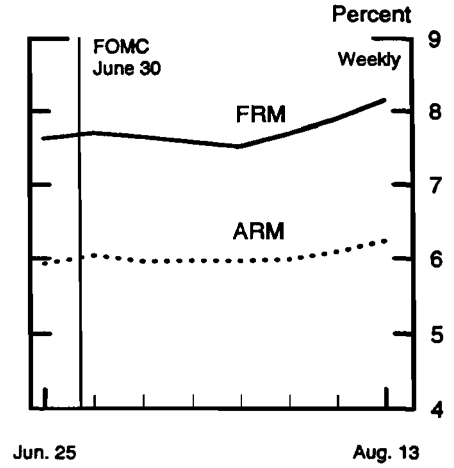


*Daily frequency.

Selected Mortgage Rates — Percent



Percent



Domestic Financial Developments

Overview
Financial markets have been on edge recently, uncertain about the inflation outlook and Federal Reserve policy and anxious about possible Y2K-related problems. Liquidity has been at a premium, likely compounded by still-vivid memories of last fall's turmoil, and a wide range of price spreads have reflected the strains.

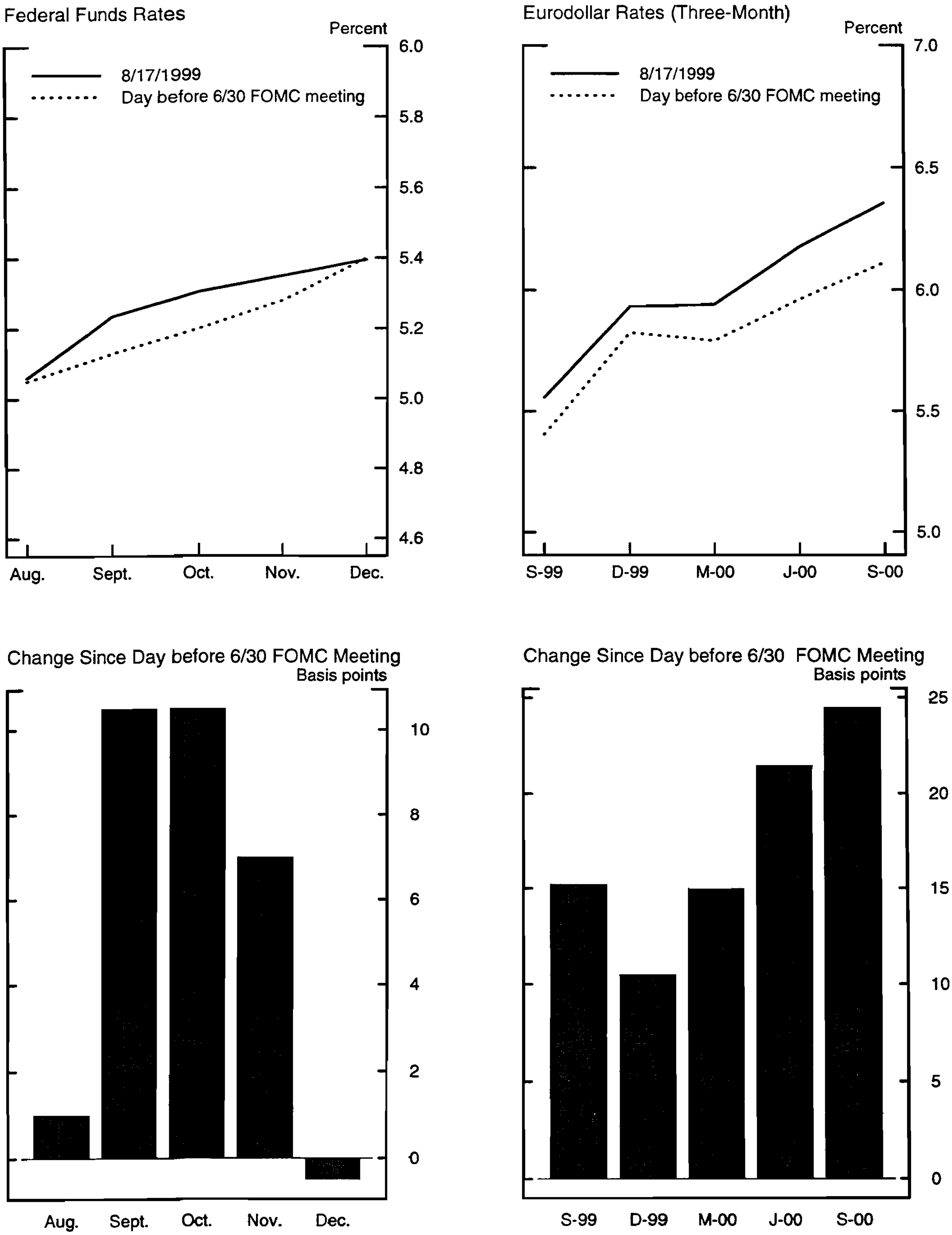
Treasury yields generally fell early in the intermeeting period, despite the tightening of monetary policy announced in June. The announcement also included news that the Committee, though still highly attentive to inflation risks, had shifted to a neutral bias in its directive. This shift led some market participants to trim their expectations of additional policy tightening going forward. Subsequently, however, Treasury yields retraced most of this decline. First, the Chairman's Humphrey-Hawkins testimony on July 22 was interpreted by most market participants as suggesting greater odds of a tighter monetary stance in the near term than they had read from the June announcement. The markets' assessment of those odds was raised further in light of subsequent data indicating some emerging pressures on labor costs. Increasing signs of an incipient recovery in Europe also likely pushed Treasury yields higher by reducing the relative attractiveness of dollar assets. On net, yields on intermediate- and long-term Treasury securities are little changed or slightly down since the last FOMC meeting. Market participants evidently now believe that a 25 basis point increase in the federal funds rate at the August meeting is highly likely; indeed, they appear to be giving nontrivial odds on a further policy tightening move by year-end.

Anticipating higher rates and possible disruptions to liquidity in credit markets near the end of the year, corporations and other issuers of fixed-income securities have accelerated their long-term borrowing. Gross offerings of investment-grade corporate bonds were heavy in July and the first half of August, and issuance of agency debt, commercial-mortgage-backed securities, and asset-backed securities also has been robust. Partly as a result of these supply pressures, credit spreads have widened--and worries that they might push out further have led to intensified hedging activity by prospective issuers, driving spreads on interest rate swaps above their highs of last year.[1]

---

1. Swaps have become an increasingly favored hedging instrument since last fall's financial market turmoil: Many dealers and underwriters who had been relying on short Treasury positions as a primary hedging tool reportedly suffered sizable losses when credit spreads widened sharply last year. Swaps are less vulnerable to basis risk occurring when private rates rise in relation to those on Treasuries.

Selected Short-Term Futures Rates



The latest data on consumer credit show a sharp deceleration in the second quarter, but mortgage debt continued to rise at a rapid clip. Municipal bond issuance has remained strong into the third quarter, although it has slowed from its remarkable June pace. The federal government expects to pay down debt in the third quarter and has announced several steps to maintain the liquidity of the market for its securities in the face of its shrinking debt. The Treasury has also indicated that it was targeting an unexpectedly large cash balance of $80 billion at year-end as a precaution against Y2K problems, which will boost bill issuance in the remainder of the year.

Equity prices rose substantially in the first half of the intermeeting period, buoyed by lower interest rates and earnings reports that were generally better than anticipated. However, those gains were largely reversed with the backup in rates since mid-July. Over the intermeeting period, the Wilshire 5000 dropped about 1 percent, while other major indexes were little changed or up 1 to 3 percent. The prices of Internet stocks have declined on net and are now 18 percent below their April peak, but still up 38 percent so far in 1999.[2]

Growth of the broad monetary aggregates remained moderate in July. Bank credit was about flat last month; an increase in security holdings roughly offset a decline in loans. However, early data for August suggest some rebound in bank credit growth.

Yield Spreads and Financial Market Liquidity

Financial market participants' concerns about shifting credit demands and market liquidity in advance of the century date change evidently have increased in recent weeks. Rates on six-month Eurodollar deposits jumped about 20 basis points as their maturity crossed year-end, and the yield on Treasury bills maturing early in 2000 fell by a like amount. In addition, the already-substantial premiums on commercial paper issues that extend into next year increased further, and the millennium butterfly spread in the Eurodollar futures market rose about 10 basis points at the end of June, as did the butterfly spread in the Euribor futures market.[3]

2. The references to Internet stock prices are based on the Inter@ctive Week Internet Index, which is a value-weighted index of 50 companies whose business is tied to the Internet, including Internet retailers, providers of content and services, and producers of computer hardware and communications equipment.

3. These butterfly spreads are the difference between the rate on the December contract and the average of the rates on the September and March contracts. Because the rate on the December contract is for a deposit from mid-December to mid-March, it should capture the expected effects of the century date change on funding costs.

Selected Financial Market Spreads

BBB Corporate Bond Yield Less Ten-Year Treasury

Source. Merrill Lynch.

High-Yield Bond Yield Less Seven-Year Treasury

Source. Merrill Lynch 175 Index.

Ten-Year Interest Rate Swap Spread

Concerns about Y2K-related disruptions to market activity apparently were not limited to the money markets. The desire to secure financing before a possible reduction in market liquidity as the year-end approaches reportedly has led some issuers in the fixed-income markets to advance part of their financing into the current quarter. The anticipated stepped-up issuance in the near term and perhaps some lingering memories of last fall's difficulties have apparently contributed to a widening of yield spreads over Treasuries in the corporate debt, commercial-mortgage-backed securities, and asset-backed securities markets, but most spread levels remain below their highs of last year. Nonetheless, to hedge against the risk of further widening of credit spreads, many market participants that have immediate plans to issue or underwrite securities have entered interest rate swaps as fixed-rate payers, helping push the ten-year swap spread to record highs during the intermeeting period.[4] Increased uncertainty about the path of short-term interest rates, as evidenced by a rise in implied volatility from options on Eurodollar futures contracts, may also have driven swap spreads wider by increasing the demand for fixed-rate payer positions. In contrast to the level of swap spreads, Eurodollar implied volatility remains well below levels reached last year.

Greater hedging activity probably is also behind the intensified specialness in RP markets of some on-the-run Treasury issues and has thus contributed to a deterioration of some measures of market performance. The overnight and term repo rates for the on-the-run ten-year Treasury note are well below other short-term market rates, and some off-the-run/on-the-run Treasury spreads have widened of late. Still, although the latest readings on conditions in the Treasury securities market suggest that most bid-asked spreads are still a bit wider than the "typical" levels that prevailed prior to last fall, recent movements in these spreads do not appear to be signaling any significant pressure in overall Treasury market liquidity.

Business Finance

Gross issuance of bonds by nonfinancial corporations rose to a hefty $25-1/2 billion in July after having slowed somewhat in June. Flows thus far in August suggest another strong month. Corporate bond prices rallied following the monetary policy announcement on June 30, and a number of investment-grade companies returned to the market in July and during the first two weeks of August--in some instances with jumbo-sized offerings, taking advantage of

4. The widening of swap spreads can also be attributed to a reduction in perceived prepayment risks on mortgages as market interest rates have risen. Some holders of mortgages and mortgage-backed securities, finding that their portfolios now have durations longer than they desire, reportedly have decided to enter swaps as fixed-rate payers, effectively shortening durations by converting part of their fixed-rate assets into floating ones and, in the process, adding to the upward pressures on swap spreads.

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

Type of security	1997	1998	1999 Q1	1999 Q2	1999 June	1999 July
All U.S. corporations	77.4	94.0	107.7	97.0	94.7	93.7
Stocks[1]	9.8	10.6	9.0	11.0	8.0	11.1
Bonds	67.6	83.5	98.6	86.1	86.7	82.7
Nonfinancial corporations						
Stocks[1]	5.0	6.2	7.0	8.1	6.3	10.0
Initial public offerings	1.8	2.2	2.7	2.9	2.9	4.3
Seasoned offerings	3.2	4.0	4.3	5.3	3.4	5.7
Bonds	18.6	25.7	28.0	28.8	22.9	25.6
By rating, sold in U.S.[2]						
Investment grade	8.4	14.1	15.7	16.0	12.9	15.0
Speculative grade	8.2	10.2	9.2	9.2	7.5	6.5
Public	1.5	1.8	1.3	1.6	1.7	1.1
Rule 144A	6.7	8.4	7.9	7.6	5.8	5.3
Other (Sold Abroad/Unrated)	1.9	1.3	3.1	3.6	2.6	4.2
Financial corporations						
Stocks[1]	4.8	4.4	2.0	2.8	1.7	1.1
Bonds	49.1	57.8	70.6	57.2	63.8	57.0
Memo:						
Net issuance of commercial paper, nonfinancial corporations[3]	1.1	2.3	5.4	.3	-7.0	5.3
Change in C&I loans at commercial banks[3]	6.1	7.3	2.4	2.1	1.8	4.8

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.

investors' preferences for liquid, high-grade bonds. Issuance by speculative-grade firms in July and early August fell short of June's pace, as some deals were postponed or canceled because of weak investor interest.

Short- and intermediate-term business credit turned up in July, in part as some speculative-grade firms tapped bank lines instead of a less receptive bond market. Results from the August Senior Loan Officer Survey show a modestly more restrictive posture toward business lending mostly taking the form of wider credit spreads. Nonfinancial commercial paper outstanding was down substantially in June, erasing strong growth in April and May, but turned up briskly in July and early August.

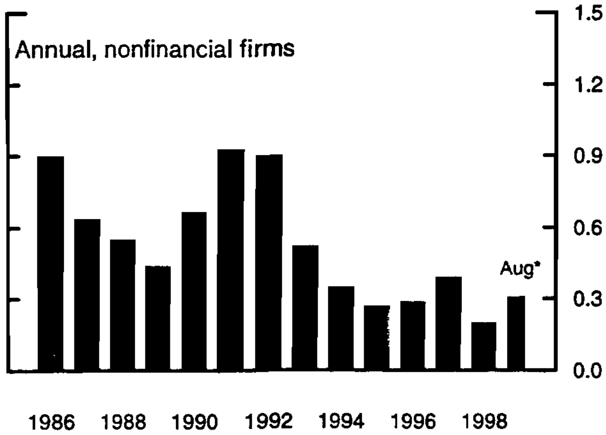
The credit performance of U.S. businesses has remained fairly strong, but some indicators have deteriorated a bit. The delinquency rate on C&I loans at banks continued to edge up in the second quarter. The ratio of failed-business liabilities to total liabilities for all nonfinancial businesses picked up through June and July, though it remained low by historical standards. In addition, the junk bond default rate jumped in July, and the twelve-month trailing-average rate is the highest level since 1992. In contrast, Moody's rating changes have resulted in modest net upgrades, mainly reflecting merger-related synergies, and the list of nonfinancial firms on the Watchlist suggests further small net improvements.

Gross equity issuance by nonfinancial corporations totaled a hefty $10 billion in July, reflecting some bounceback from early June when firms postponed their offerings as prices stagnated. Thus far in August, gross equity issuance has roughly matched the July pace. Seasoned offerings have been particularly strong, bolstered by the large financing needs of telecommunications companies. IPOs continued at a frenetic pace, and despite the pounding taken by Internet stocks over the past two months, "dot-com" issues continued to account for more than half of IPO volume. Average first-day returns were still well above 50 percent in July, but that was off sharply from 100 percent and more earlier this year. Moreover, in late July and early August, a few well-publicized IPOs encountered quite poor first-day returns, suggesting that investor enthusiasm may have finally started to flag. Even so, the list of registered offerings is long, and new filings have continued at a rapid clip.

M&A activity continues to sizzle. In the second quarter, equity retirements associated with cash-financed mergers totaled about $24 billion, in line with the brisk first-quarter pace. In addition, U.S. equity retirements were boosted by a number of large acquisitions by foreigners. New deals continue to be announced at a record pace. As a result, the pending list is bulging with deals slated to close later this year or next year, indicating that cash needs will remain high in the

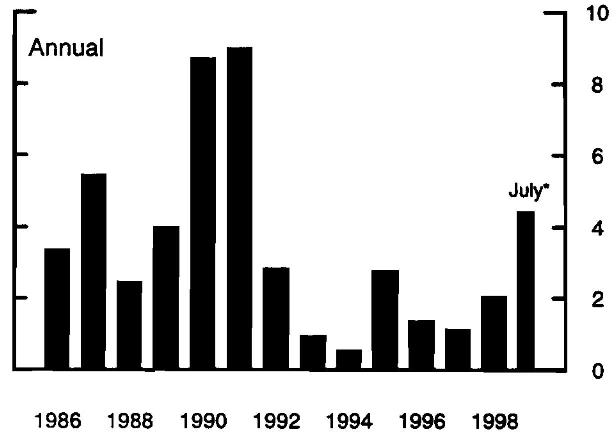
Corporate Finance and Stock Prices

Liabilities of Failed Businesses
to Total Liabilities



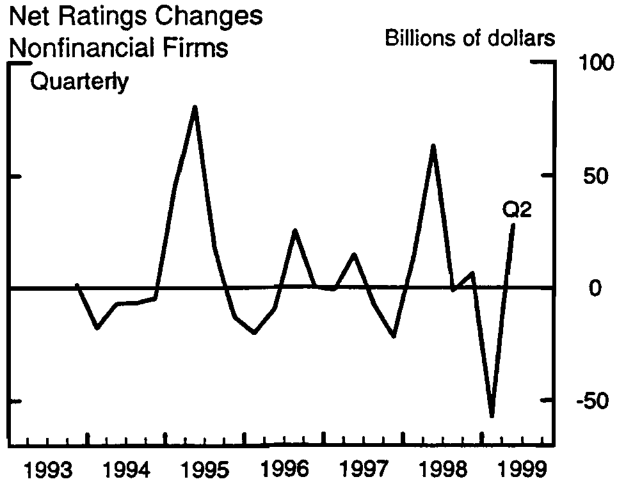
*Previous 12 months through Aug. 13.
Source. Dun & Bradstreet.

Default Rates
Outstanding Junk Bonds



*Previous 12 months.

Net Ratings Changes
Nonfinancial Firms



Source. Moody's. Upgrades minus downgrades.

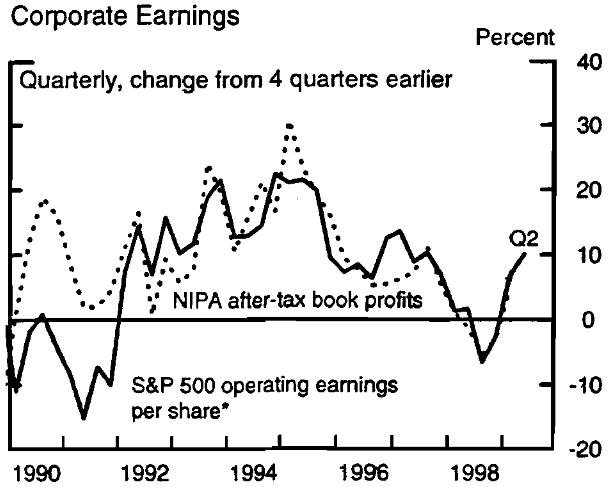
Mergers and Acquisitions
Nonfinancial Firms

Billions of dollars

Quarterly rate

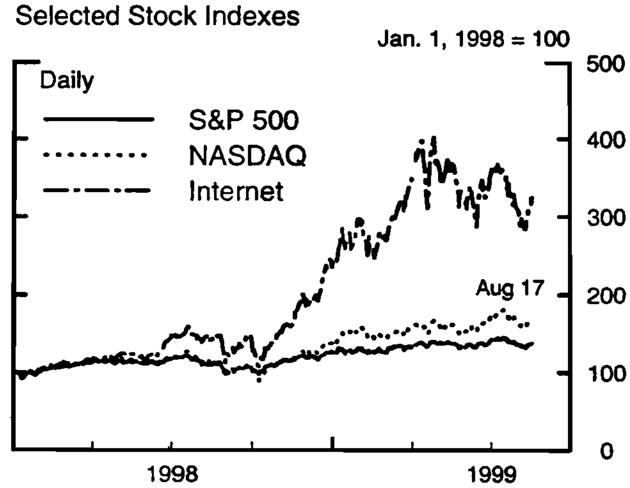
	Cash paid by domestic corps.	Total deal value
1997	21.5	82.9
1998	32.6	129.4
1999 Q1	23.5	145.0
Q2	24.0	218.0

Corporate Earnings



*Source. Goldman Sachs, I/B/E/S.

Selected Stock Indexes



near term. In contrast, announcements of share repurchases slowed for the second consecutive quarter, suggesting a moderate step-down from the extraordinary pace of last year.

S&P 500 earnings per share in the second quarter are estimated to have risen a robust 10 percent from four quarters earlier. Earnings of nonfinancial firms accelerated from the already strong gain of the first quarter. The computer-technology sector logged about a 40 percent gain, accounting for a disproportionate amount of nonfinancial sector growth, but the earnings of other nonfinancial industries also rose. Part of the pickup owes to a lessening of the drag on overall book profits associated with soft commodity prices; also, more than 1 percentage point of the pickup can be attributed to GM's large profit increase from strike-depressed levels of a year earlier. Smaller firms continued to underperform their larger counterparts in the second quarter.

Commercial Real Estate Finance

Reports suggest that commercial mortgage rates have increased around 50 basis points over the past two months and are at levels not seen since early 1997. Institutions that supply loans for commercial-mortgage-backed securities have indicated that the back-up in rates has slowed commercial mortgage lending considerably.

Spreads on investment-grade CMBS have increased 30 to 50 basis points since the June FOMC. The widening reflects the liquidity and rate uncertainty concerns noted above. Gross issuance of CMBS is expected to total close to $16 billion in the third quarter, up from $11 billion in the second quarter.

After a brief rally early in the second quarter, REIT equity values are down 10 percent from their early May peaks and are down 5 percent since the start of the year. REIT equity and debt issuance has remained weak, and the few issues brought to market have been poorly received. Property acquisitions have remained well below the pace of the first half of 1998.

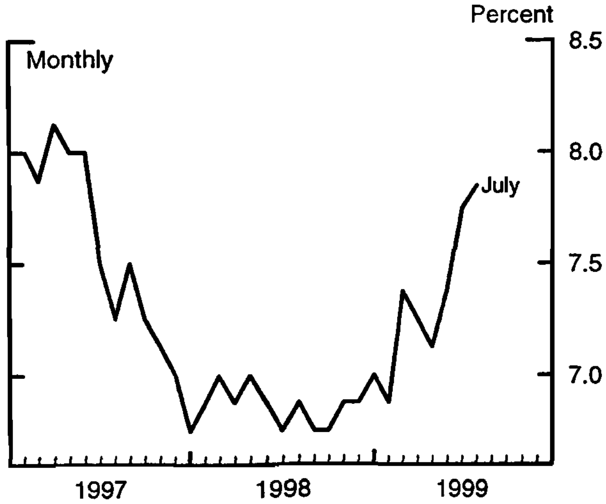
Household Finance

With broad measures of equity prices little changed on net since the June FOMC meeting, the ratio of household net worth to disposable income has remained not far from the record reached at midyear. Participating in the post-FOMC meeting enthusiasm for shares, households allocated $15 billion to domestic equity mutual funds in July.[5] In contrast to recent strength in equity funds, inflows to bond funds in July recorded only small inflows. However, the weakness in

5. Investors with 401(k) accounts allocated more than two-thirds of new contributions to company stock and equity funds in the second quarter--a healthy rise from the first quarter.

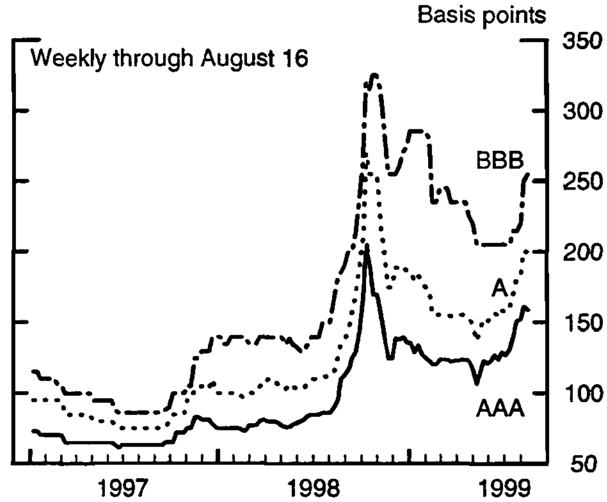
Commercial Real Estate

Ten-Year Commercial Mortgage Rate



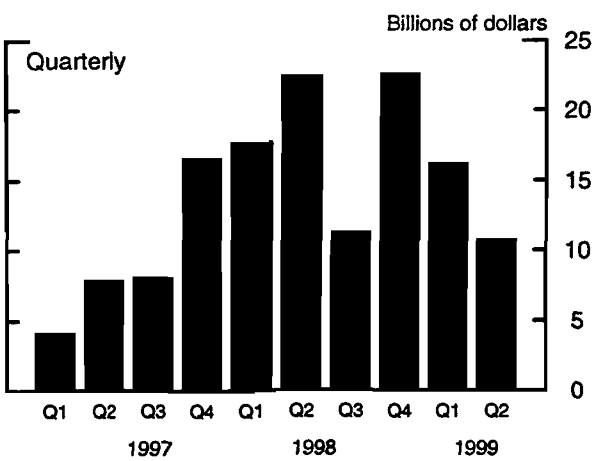
Source. Barron's/Levy National Mortgage Survey.

CMBS Yield Less Ten-Year Treasury



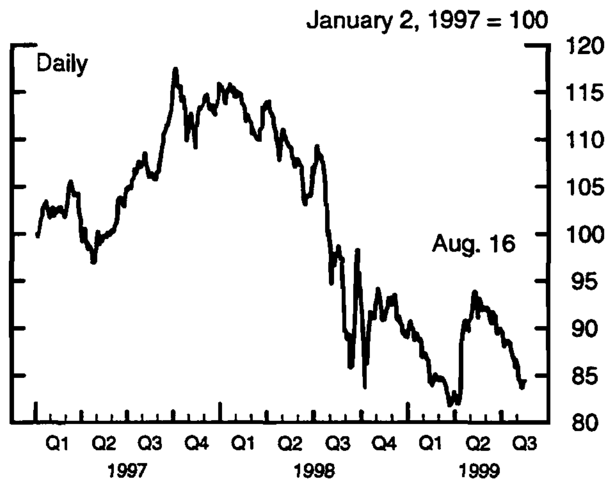
Source. Morgan Stanley.

CMBS Gross Issuance



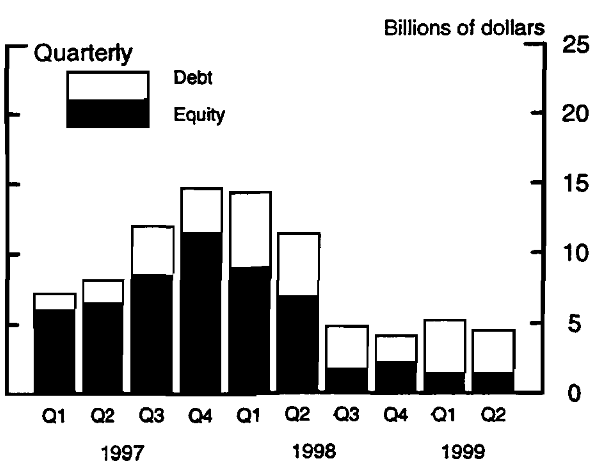
Source. Commercial Mortgage Alert.

REIT Price Index



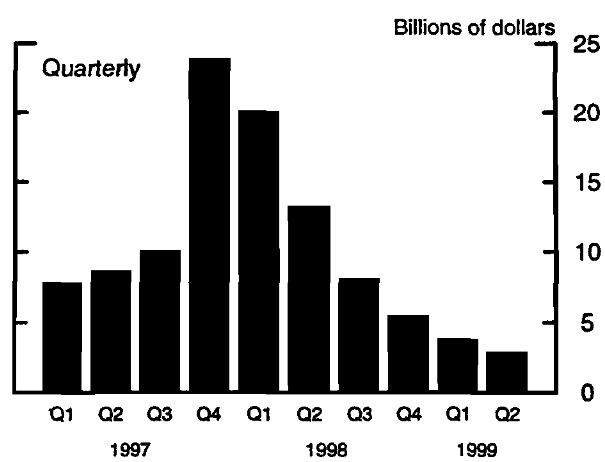
Source. National Association of Real Estate Investment Trusts.

REIT Unsecured Debt and Equity Issuance



Source. National Association of Real Estate Investment Trusts.

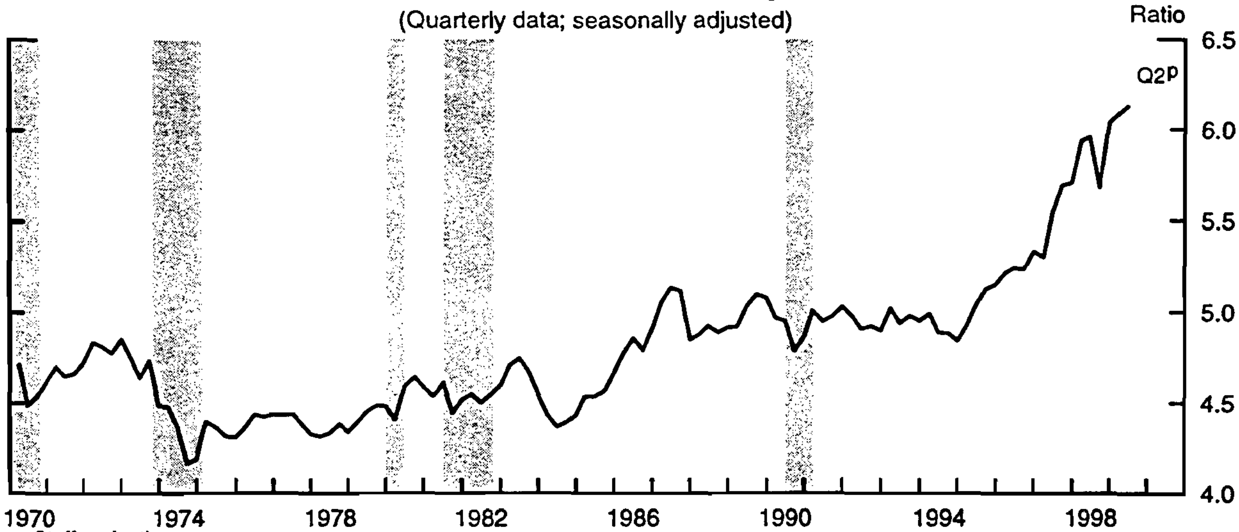
REIT Property Acquisition



Source. National Association of Real Estate Investment Trusts.

Household Net Worth Relative to Disposable Income

(Quarterly data; seasonally adjusted)



p. Staff projection.

Net Flows of Mutual Funds

(Excluding reinvested dividends; billions of dollars; monthly rates; not seasonally adjusted)

	1996	1997	1998 H1	1998 H2	1999 Q1	1999 Q2	1999 July[e]	Assets June
Total long-term funds	**19.3**	**22.7**	**29.3**	**11.4**	**16.4**	**20.1**	**16.0**	**4,650**
Equity funds	**18.0**	**19.0**	**21.1**	**5.4**	**10.5**	**19.9**	**14.9**	**3,424**
Domestic	14.1	15.8	18.6	6.7	12.6	18.7	16.2	2,988
International	4.0	3.1	2.5	-1.3	-2.1	1.2	-1.2	436
Hybrid funds	**1.0**	**1.4**	**1.7**	**0.1**	**-0.5**	**-0.3**	**-0.3**	**385**
Bond funds	**0.2**	**2.4**	**6.5**	**5.9**	**6.4**	**0.5**	**1.3**	**842**
International	-0.2	-0.1	0.0	-0.2	-0.1	-0.1	-0.3	25
High-yield	1.0	1.4	1.8	0.5	1.0	-0.4	0.8	123
Other taxable	-0.1	1.0	3.5	4.3	3.9	1.2	0.8	398
Municipals	-0.5	0.1	1.2	1.3	1.6	-0.2	-0.1	297

e Staff estimates based on ICI weekly data.

Source. Investment Company Institute (ICI).

401(k) Plan Contributions and Transfers

(Percent of total)

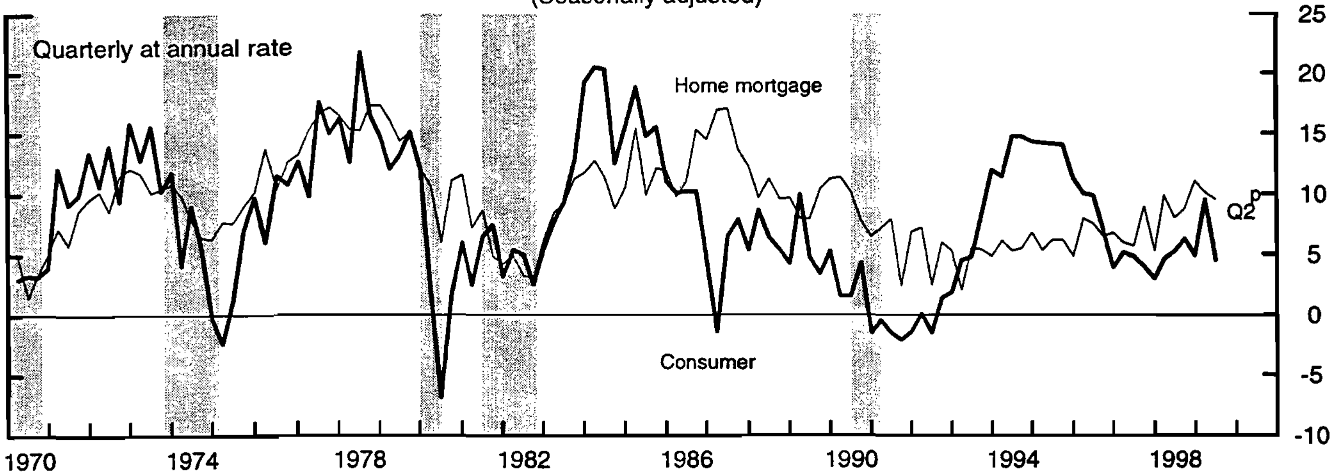
	Contributions[1] 1998	Contributions[1] 1999 Q1	Contributions[1] 1999 Q2	Contributions[1] 1999 July	Transfers[2] 1998	Transfers[2] 1999 Q1	Transfers[2] 1999 Q2	Transfers[2] 1999 July
Company stock	**19**	**19**	**21**	**19**	**-84**	**-53**	**-70**	**68**
Equity funds	**47**	**43**	**47**	**48**	**-16**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

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

Source. Hewitt Associates.

Household Debt Growth

(Seasonally adjusted)

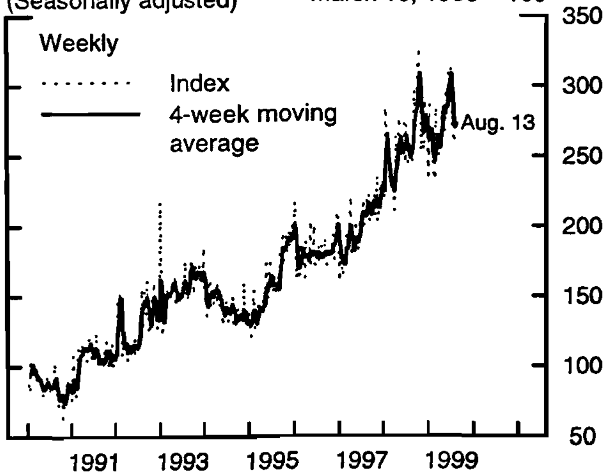


p. Staff projection.

MBA Purchase Index

(Seasonally adjusted)

March 16, 1990 = 100

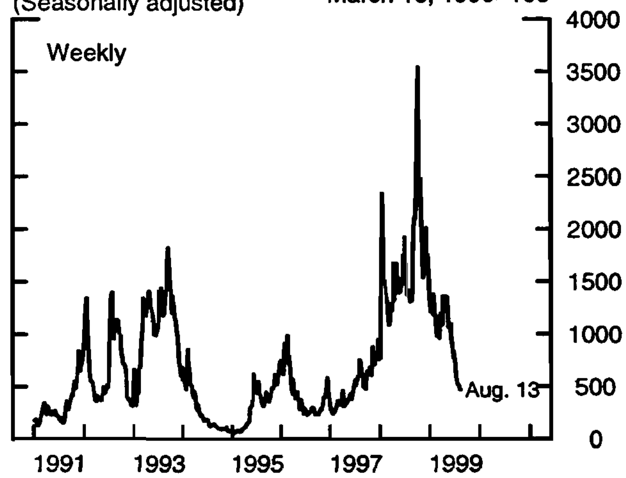


Source. Mortgage Bankers Association.

Refinancing Index

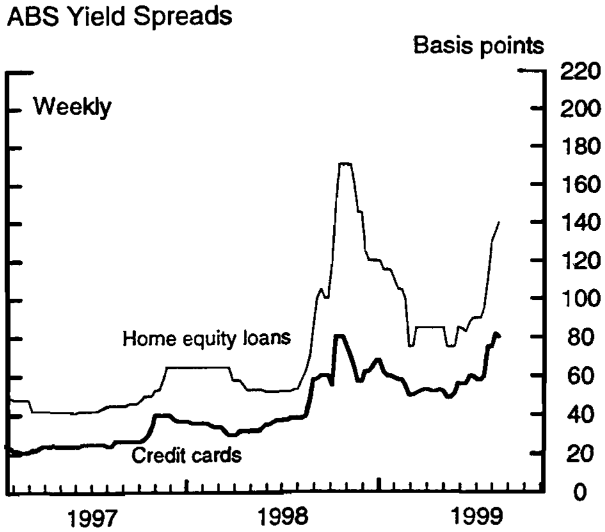
(Seasonally adjusted)

March 16, 1990=100



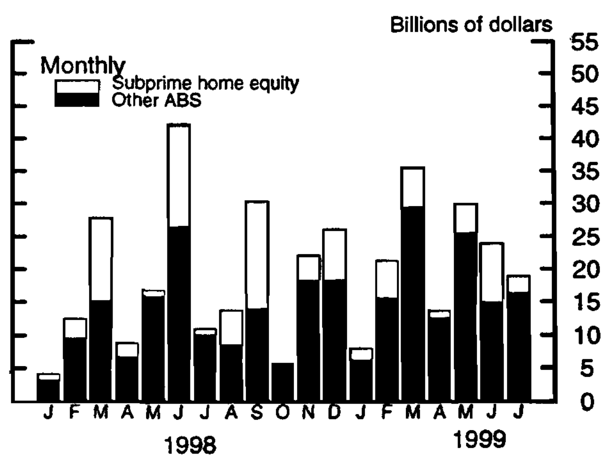
Source. Mortgage Bankers Association.

ABS Yield Spreads



Note. Latest observation is for August 13.
Source. Salomon Smith Barney.

Asset-Backed Security Issuance



Note. Excludes securities backed by commercial mortgages and by first mortgages on residential properties.
Source. Inside MBS & ABS.

equity prices and rise in bond yields in late July and early August has apparently dampened enthusiasm for shares, and equity funds have experienced net outflows.

Consumer credit decelerated sharply in the second quarter, to an estimated 4-1/2 percent annual pace, but mortgage debt continued to grow at a robust rate. Bank loan officers reported little change in consumer lending practices over the past three months. Turning to the current quarter, the rise in mortgage rates evidently has cut a bit from the volume of applications for home purchase loans, while refinancings have virtually dried up. Mortgage bankers have started to trim their work forces, but industry sources express some concern that desperate efforts to maintain volume will lead to excessively aggressive pricing.

Measures of household credit quality remain strong. Per capita personal bankruptcy filings fell at an 18 percent annual rate in the second quarter, reaching their lowest level in nearly three years. Call Report data indicate that delinquencies on closed-end consumer loans and on credit cards at commercial banks fell in the second quarter, while delinquencies on mortgage debt were about unchanged. The Moody's index of delinquency rates on credit card receivables reached a three-year low in June, while delinquencies at the captive auto finance companies dropped to a five-year low.

As in other fixed-income markets, a combination of anticipated heavy issuance and uncertainty about future interest rates drove up spreads on asset-backed securities. Credit card and home equity loan ABS spreads have reached levels only slightly below those reached during the market turmoil of last year. Issuance has remained strong, however, in July and into August, despite the fact that ABS sales are typically weak in the early part of each quarter. Indeed, compared to July 1998, last month's ABS issuance was quite high.

Government Securities Markets

The federal government estimates that in the current quarter it will pay down $11 billion of marketable securities, assuming a $45 billion cash balance by quarter-end. The Treasury's midquarter financing auctions last week were well received and raised $37 billion in notes and bonds. The Treasury has stated that it plans to build up its cash balance to $80 billion by year-end, from about $40 billion at the end of July and $17-1/2 billion at the end of last year. The extra cash over the century date change will be used to back up the Federal Financing Bank's $20 billion line to credit unions and will also serve as a safeguard against any Y2K-related disruptions to receipts or securities offerings. The additional funding will be done through modestly increasing weekly bill offerings and through cash management bills. The weekly bill auction increased $1 billion at the beginning of August. Further increases in the weekly bill

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	1998	1999				
	Q4	Q1	Q2	May	June	July[e]
Total surplus, deficit (-)	**-54.5**	**5.8**	**143.1**	**-24.0**	**53.6**	**n.a.**
Means of financing deficit						
Net borrowing	32.3	7.5	-110.2	-.6	-24.5	.9
Nonmarketable	8.2	2.2	4.0	.9	-.7	-3.0
Marketable	24.1	5.2	-114.3	-1.5	-23.8	3.8
Bills	53.3	34.0	-78.0	-1.7	-.8	6.9
Coupons	-29.2	-28.7	-36.3	.2	-23.0	-3.0
Decrease in cash balance	21.4	-4.1	-31.5	32.5	-27.5	13.6
Other[1]	.9	-9.1	-1.3	-8.0	-1.6	n.a.
MEMO						
Cash balance, end of period	17.5	21.6	53.1	25.6	53.1	39.6

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

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

Agency	1998	1999				
	Q4	Q1	Q2	May	June	July
FHLBs	38.9	20.2	34.7	6.1	15.5	n.a.
Freddie Mac	54.4	11.8	15.2	7.1	-3.1	n.a.
Fannie Mae	29.7	15.1	24.5	13.9	7.0	2.8
Farm Credit Banks	-.8	3.0	1.2	-.9	1.1	-.8
Sallie Mae	1.6	1.4	1.2	.5	-.2	n.a.
MEMO: Outstanding						
Fannie Mae benchmark notes	42.2	61.5	82.7	76.9	82.7	87.6
Freddie Mac reference notes	20.0	30.0	45.5	40.0	45.5	50.8

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

auction size probably will be limited to an additional $1 billion; consequently, for the Treasury to achieve its targeted increase in cash balances will require outsized offerings of cash management bills toward the end of the year.

The Treasury also announced several steps to maintain the liquidity of the market for its securities in the face of dwindling public debt. Most significantly, it released for public comment a plan to repurchase off-the-run securities, with a possible initiation of the program as early as January. Doing so would allow it to maintain larger issuance sizes, trim the maturity of the outstanding debt, and absorb seasonal excesses in cash. In addition, the Treasury announced that it would no longer issue thirty-year bonds in November but would limit its bond offerings to February and August. The Treasury is also considering reducing the frequency of its issuance of one-year bills and two-year notes.

Agency debt issuance has remained strong during the intermeeting period, with offerings from Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System totaling nearly $25 billion. Fannie Mae's issues included an estimated $2-1/2 billion increase in its on-the-run ten-year benchmark note, which was exchanged for outstanding securities having about seven to eight years to maturity. This is the second debt exchange for Fannie Mae so far this year.

The entire amount of global bonds issued by the Federal Home Loan Bank System during the intermeeting period came through a new Tap Issue Program. Under this program, noncallable debt securities with two- to ten-year maturities will be sold and then reopened regularly over a three-month period through competitive auctions to reach potential outstanding issue size of $1 billion to $3 billion. The new program should combine the flexibility of daily issuance and the liquidity of large outstanding size (comparable to those of its jumbo global bonds). The Federal Home Loan Bank System also launched callable jumbo bonds, which will have two years or more to maturity. The minimum issue size is $1 billion for new issues and $100 million for reopenings.

Municipal Finance

After surging in June, gross issuance of long-term municipal bonds slowed in July, though it remained strong at nearly $19 billion; weekly data for August point to another robust month. New capital issuance in July and thus far in August has maintained its relatively high pace of the past few years, boosted particularly by spending on education. Refunding activity, which has generally remained subdued this year, was boosted somewhat in July by two large deals, at

State and Local Finance

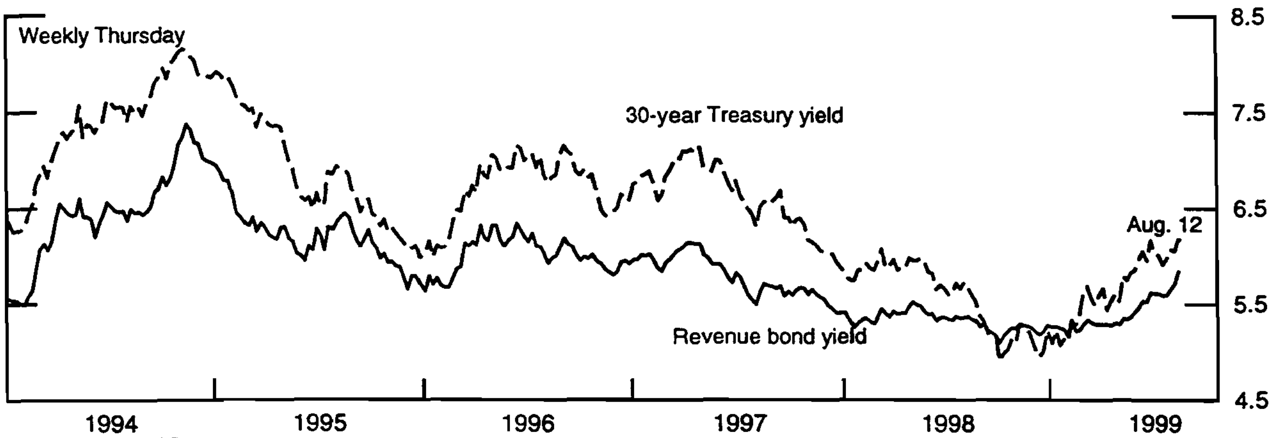
Gross Offerings of Municipal Securities

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

	1997	1998	1999 Q1	1999 Q2	1999 May	1999 June	1999 July
Long-term	17.9	21.9	19.2	18.5	16.2	23.4	18.7
Refundings [1]	6.6	8.5	6.2	4.2	4.1	3.2	6.5
New capital	11.3	13.4	12.9	14.3	12.1	20.2	12.2
Short-term	3.6	2.4	1.4	3.1	0.7	7.7	2.5
Total tax-exempt	21.5	24.3	20.6	21.6	17.0	31.1	21.1
Total taxable	1.1	1.1	1.4	0.9	0.9	1.2	0.7

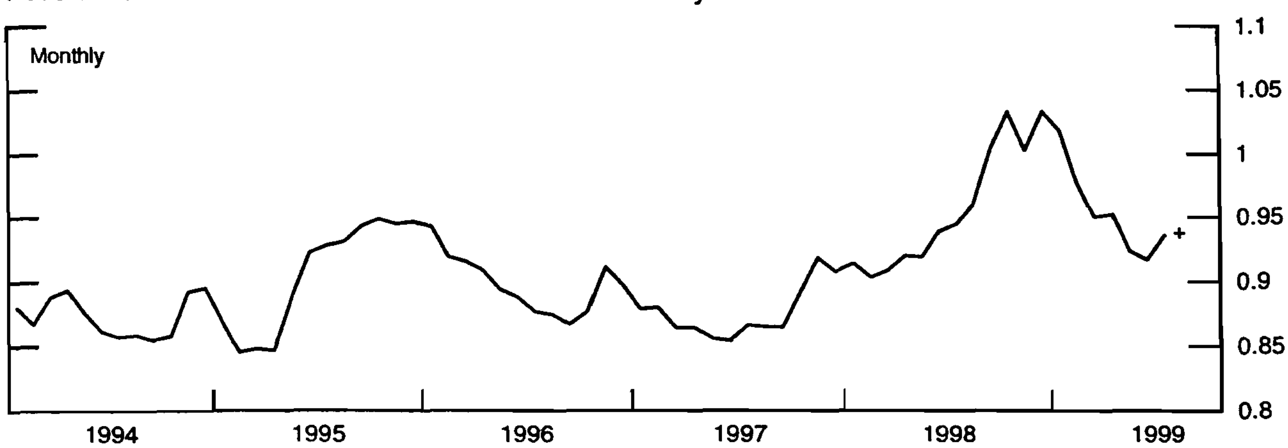
Note. Includes issues for public and private purposes.
1. All issues that include any refunding bonds.

Municipal Revenue Bond and 30-Year Treasury Yields



Source. Bond Buyer.

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



Note. Average of weekly data. + indicates latest observation (Aug. 12).

least one of which was made profitable when the issuer's credit rating was raised.[6]

Yields on long-term municipal bonds have risen about in line with Treasuries since the June FOMC meeting, and yield ratios have been relatively stable. Although investors' demand for municipal bonds has generally remained solid, heavy supply has kept yield ratios high by historical standards.

The credit quality of municipal issuers remained strong and generally showed improvement. Over the past few years, Standard and Poor's has consistently issued more upgrades than downgrades, in terms of both number of ratings actions and the par value of bonds rated. The exception continued to be the health care industry, where government regulation and managed care penetration have been taking a toll on earnings.

Money and Bank Credit

The broad monetary aggregates posted moderate growth in July for a third consecutive month. M2 grew at a 5 percent rate, restrained to a small degree by the rise in opportunity costs associated with the policy tightening of late June and the general rise in market interest rates of late. M2 growth for the second quarter, at 5-3/4 percent, still exceeded GDP growth, and the velocity of this aggregate decreased at a 1-3/4 percent pace, somewhat faster than in the first quarter. Since the fourth quarter of 1998, M2 has expanded at a 6 percent rate, 1 percentage point above the FOMC's long-run range but 2-1/2 percentage points less than in 1998.

M3 grew at a 4-3/4 percent rate in July, continuing its slower growth of recent months. Institutional money funds--whose yields typically lag increases in market rates--suffered outflows because some large investors shifted to direct investments in market instruments. From the fourth quarter of last year through July, M3 grew at a 6 percent pace, at the upper end of the FOMC's long-run range.

Restraining M3 growth in recent months also has been the modest needs of depositories to increase funding, given the tepid growth of their assets. Indeed, bank credit was about flat in July, weakening further from the sluggish average pace over the first two quarters of the year. Very large securitizations of consumer and home equity loans by banks that elected to hold the resulting securities caused a substantial boost to the growth of the securities component of bank credit in July and a corresponding weakening of loan growth. Even

6. The two refundings were a $1.5 billion refunding by the Foothill/Eastern Transportation Corridor Agency in California and a $900 million deal by the District of Columbia.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1998	1999 Q1	1999 Q2	1999 May	1999 June	1999 July (p)	1998:Q4 to July 99 (p)	Level (bil. $) July 99 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	1.8	2.8	3.5	-4.0	-4.0	-3.4	1.4	1097.9
2. M2[2]	8.5	7.2	5.7	4.7	4.3	5.0	6.1	4542.3
3. M3	10.8	7.5	5.2	4.7	5.4	4.8	6.1	6176.9
Selected Components								
4. Currency	8.3	9.7	11.2	11.1	7.7	7.9	10.2	487.2
5. Demand deposits	-4.2	-4.4	-3.8	-14.8	-21.1	-6.0	-6.1	361.1
6. Other checkable deposits	.4	1.3	-.3	-17.3	-2.9	-23.9	-3.6	241.0
7. M2 minus M1[3]	10.9	8.7	6.5	7.5	6.9	7.7	7.7	3444.4
8. Savings deposits	14.0	11.9	11.0	13.0	13.6	15.2	12.5	1715.5
9. Small time deposits	-1.4	-5.7	-4.6	-3.7	-5.8	-.5	-4.6	926.2
10. Retail money market funds	23.7	20.5	10.3	9.1	7.8	1.5	13.1	802.7
11. M3 minus M2[4]	18.0	8.2	3.9	5.1	8.5	4.3	6.1	1634.6
12. Large time deposits, net[5]	9.8	1.0	-4.2	-4.8	-6.8	21.6	.7	628.5
13. Institution-only money market mutual funds	34.7	17.9	14.5	13.8	7.7	-4.6	13.1	546.0
14. RPs	17.1	11.7	-6.8	17.6	48.3	2.4	6.8	302.7
15. Eurodollars	8.5	-.8	21.7	-8.9	-.7	-27.6	3.7	157.4
Memo								
16. Liquid Deposits[6]	8.8	7.9	7.3	5.2	6.2	7.7	7.5	2317.6
17. Sweep-adjusted M1[7]	6.2	5.7	6.9	4.2	1.0	2.7	5.4	1450.6
18. Monetary base	7.1	9.1	10.1	13.9	6.1	7.6	9.4	541.0
19. Household M2[8]	9.9	8.3	6.6	6.4	6.6	5.9	7.3	4181.2
	Average monthly change (billions of dollars)[9]							
Memo								
Selected managed liabilities at commercial banks:								
20. Large time deposits, gross	5.1	4.8	-2.5	-2.9	-5.9	8.6	...	748.2
21. Net due to related foreign institutions	1.6	-.1	-1.9	-6.5	12.6	.9	...	217.5
22. U.S. government deposits at commercial banks	.6	-3.0	.2	1.1	1.6	3.8	...	24.6

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

p--Preliminary.

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

Type of credit	1998	1999 Q1	1999 Q2	1999 May	1999 Jun	1999 Jul	Level, Jul 1999 (billions of $)
1. Bank credit: Reported	11.0	-0.3	-0.3	1.7	8.3	-1.0	4,535
2. Adjusted[1]	10.2	1.9	1.8	2.0	11.0	0.3	4,463
3. Securities: Reported	14.0	-6.2	-3.4	-0.1	15.0	15.6	1,219
4. Adjusted[1]	11.2	2.0	4.7	1.0	26.5	21.5	1,147
5. U.S. government	5.9	4.1	4.3	-2.6	20.9	5.6	816
6. Other[2]	32.3	-24.7	-18.4	4.9	3.4	35.6	403
7. Loans[3]	9.9	1.8	0.9	2.3	5.9	-6.9	3,316
8. Business	11.9	1.3	2.4	-6.3	7.3	1.4	959
9. Real estate	6.6	7.8	3.0	6.5	3.9	0.9	1,355
10. Home equity	0.1	-2.4	4.9	12.1	-8.4	-66.2	94
11. Other	7.1	8.6	2.9	6.1	4.9	6.2	1,260
12. Consumer: Reported	-1.5	2.9	-3.5	-10.3	-11.3	-18.2	486
13. Adjusted[4]	6.0	3.4	0.7	-5.5	3.6	3.2	762
14. Other[5]	30.0	-12.6	-3.3	19.7	24.9	-31.5	516

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.

abstracting from these transactions, however, loan growth in July was quite weak and securities growth strong. Loan growth was held down by a slowdown in business loans and a sharp runoff of security loans.

Preliminary Call Report data indicate that commercial banks' returns on assets and equity in the second quarter reversed some of the improvement in the first quarter but remained high. Capital ratios were little changed, and the vast majority of banks continue to be well-capitalized.

Appendix

August Senior Loan Officer Opinion Survey on Bank Lending Practices

The August 1999 Senior Loan Officer Opinion Survey on Bank Lending Practices focused primarily on changes over the past three months in the supply of and demand for bank loans to businesses and households. Additional questions addressed Year 2000 (Y2K) issues and loan quality. Loan officers from fifty-six large domestic banks and twenty-two U.S. branches and agencies of foreign banks participated in the survey. The responses suggest that banks became somewhat more cautious lenders over the past quarter but show no widespread reduction in credit availability.

The results indicate a continued slight firming of business lending practices. For domestic banks, this has taken the form more of a tightening of terms on C&I loans, particularly risk premiums and loan rate spreads, as only a few reported that they had strengthened underwriting standards. In contrast, large proportions of the branches and agencies tightened both standards and terms on C&I loans. Similarly, for commercial real estate loans, a small fraction of domestic banks and a larger fraction of branches and agencies raised standards.

The survey found little evidence of any changes in standards and terms on loans to households. A small net fraction indicated greater willingness to make consumer installment loans, and virtually no banks indicated any change in standards for or terms on credit card and other consumer loans. Demand for consumer loans was also reported to be about unchanged, but many banks said that demand for home mortgages had decreased.

To a large extent, the respondents said they were willing to extend special contingency lines of credit over year-end, at least to existing customers, but most had not received requests for such lines. The banks were not, in general, tightening terms and standards on renewals of existing lines over year-end. Those banks limiting credit lines over year-end were chiefly concerned about Y2K effects on borrowers' repayment prospects, although several were also worried about the effect of borrowing on capital ratios, and about possible difficulties they might encounter in funding draws on credit lines over year-end. A large majority of the respondents appeared willing to use the Federal Reserve's recently announced Special Liquidity Facility. Those expressing reluctance to use the facility cited as reasons difficulties with collateral procedures and stigma associated with borrowing at the discount window.

The respondents indicated that over the past year the performance of their business loan portfolios had become more sensitive to a period of economic weakness, primarily because of a weaker financial condition of borrowers, but also because of eased lending standards and terms. Banks assessed the sensitivity of their household loan portfolio to an economic slowdown to have changed little over the past year.

Lending to Businesses

About 5 percent of the domestic bank respondents said that over the past three months, they had tightened *standards* on C&I loans to large and middle-market borrowers (down from 10 percent in May), and 25 percent of the branch and agency respondents said that they had tightened (about the same as in May). The survey found no change, on net, in standards on loans to small businesses. On net, about a fourth of the domestic banks and more than half of the branches and agencies reported tightening *terms* on C&I loans, particularly risk premiums, spreads of loan rates over the banks' cost of funds, and costs of credit lines. The net percentages tightening terms increased a bit relative to those recorded on the May survey. However, in the case of both standards and terms, the net percentages tightening are significantly lower than those reported last fall. The loan officers most commonly cited a worsening of industry-specific problems, a less favorable or more uncertain economic outlook, and a reduced tolerance for risk as the reasons for having tightened.

On net, no domestic bank respondents said that demand for C&I loans had changed over the preceding three months (neither from large and middle-market firms nor from small businesses). The branch and agency responses also showed virtually no change in demand. Those respondents reporting a change in demand generally attributed it to variation in their customers' merger and acquisition and plant and equipment financing needs.

As in May, less than 10 percent of domestic bank respondents, on net, reported tighter standards on commercial real estate loans. By contrast, nearly 40 percent of branch and agency respondents tightened standards on these loans, a larger percentage than in May. About 10 percent, on net, of the domestic bank respondents said that demand for commercial mortgages had increased over the past three months; branch and agency respondents also reported little change in demand. Only about half of the foreign bank respondents answered the questions on commercial real estate loans, likely reflecting the departure of many of the branches and agencies from this line of business.

Lending to Households

As in recent quarters, banks appear not to have made any significant adjustments to their consumer lending policies following the pronounced tightening that began in the mid-1990s. About 10 percent of the respondents, on net, said their willingness to make consumer installment loans had gone up over the preceding three months. Only two banks tightened standards on credit cards; and three, on net, tightened standards on other consumer loans. Terms on these loans were also reported as little changed. About 10 percent of the banks, on net, reported stronger demand for consumer loans.

The survey also found little evidence of changed standards for home mortgages, with one bank, on net, easing. A large net percentage--35 percent--said that demand for home mortgages had decreased, whereas in May respondents had reported increased demand. Even though the question specifically asks about demand for mortgages to purchase homes as opposed to refinancing existing mortgages, the reported decrease in demand still likely reflects, in part, a decline in refinancing activity.

Year 2000

The respondents reported continued progress toward mitigating the Year 2000 risks posed by their customers. More than 90 percent of the domestic banks, up from 70 percent in May, had evaluated the Y2K preparedness of at least 90 percent of their material business customers. About 80 percent of branch and agencies had evaluated 90 percent of their customers, up only a little from May. About 95 percent of the banks surveyed stated that less than 5 percent of their customers that had been evaluated were not making satisfactory progress toward achieving Y2K preparedness.

The survey results indicate that requests for Year 2000 contingency lines of credit have been limited to date. Relatively small percentages of the domestic bank respondents had received requests for such lines from nonfinancial and financial firms--10 percent and 20 percent respectively. These percentages, however, are about twice as large as found in May. Branch and agency respondents were less likely to have received requests for such lines. The requests that banks had received for contingency lines were from many different types of financial firms, with the largest number having received requests from domestic commercial banks, followed by finance companies, mutual funds, and savings and loans. Some of the loan officers noted that although they have received relatively few requests to date for contingency lines, the requests they had received were, in some cases, substantial, and they thought that more requests may be forthcoming.

All the domestic bank respondents were willing to extend Y2K contingency lines, but nearly two-thirds--a larger fraction than in May--would do so only for existing customers. About a third of branches and agencies were unwilling to extend contingency lines; the remainder were willing to extend such lines only to existing customers. A fourth of the domestic banks, up from about 15 percent in May, had tightened standards or terms on renewals of existing lines that extended into next year but were not specifically meant to meet year-end funding needs. Those banks that were adjusting policies on renewals were tightening standards, raising spreads or fees, requiring a rate premium for advances around year-end, or pricing lines off of their own cost of funds rather than off independent indexes (such as LIBOR). By contrast, two-thirds of the branches and agencies were adjusting policies on renewals, including limiting the usage of lines over year-end. Those respondents (domestic and foreign) that were unwilling to extend Year 2000 contingency lines of credit, were limiting such lines to existing customers, or had tightened standards or terms on renewals of existing lines gave a variety of reasons for their reluctance. Most commonly, the respondents were concerned about Y2K effects on borrowers' repayment prospects, difficulty funding draws on credit lines over year-end, and the effect of borrowing on capital ratios, but also about credit quality generally.

Several questions addressed the willingness of respondents to use the Century Date Change Special Liquidity Facility (SLF), which will make discount window credit readily available to depository institutions in sound financial condition at a 150 basis point premium over the FOMC's target federal funds rate between October 1, 1999, and April 7, 2000. Nearly 70 percent of the domestic and foreign respondents said they would not be likely to borrow overnight funds in the market at a rate greater than that charged by the SLF. Of the institutions that would pay more for funds to avoid borrowing from the SLF, a third thought it likely they would pay more than 50 basis points in excess of the SLF rate to do so. Those that would be willing to pay a premium to avoid borrowing at the SLF cited as the reasons difficulties with collateral procedures and limitations on the amount of collateral the institution has available to pledge, resistance by senior management to borrowing at the discount window, and concern that use of the facility would be viewed negatively either by bank regulators or by market participants.[1] Over 80 percent of the respondents said that the existence of the SLF had not changed their willingness to extend Year 2000 contingency lines of credit.

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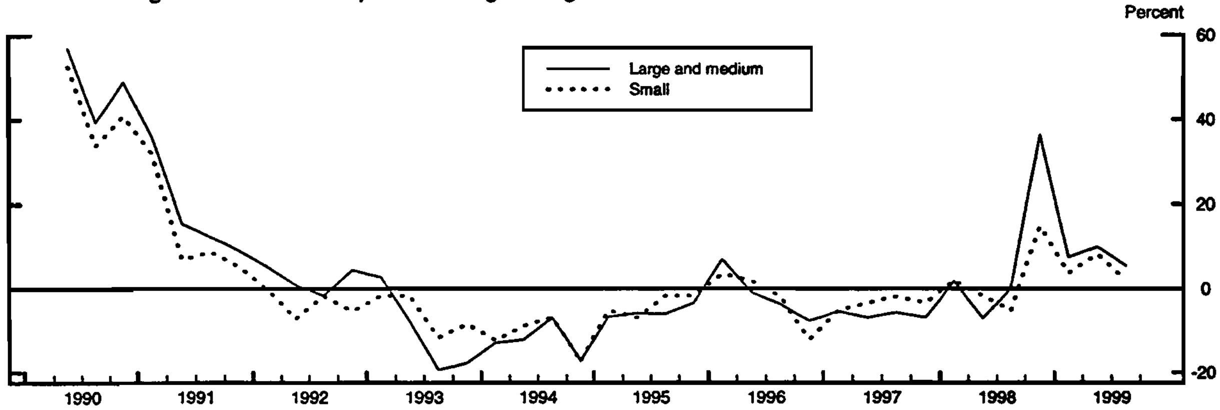
1. As noted in the questionnaire, absent signs of financial trouble, use of the Special Liquidity Facility will not be taken as an indication of underlying problems and will not trigger intensified oversight by supervisory authorities. As also noted, the Federal Reserve treats information on individual bank borrowing at the discount window as confidential.

Loan Quality

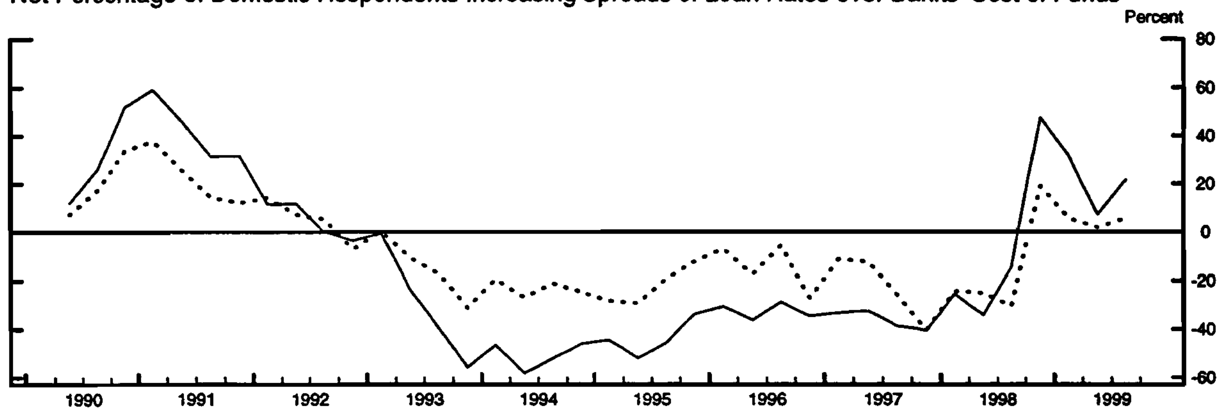
Two special questions addressed changes in loan quality over the past year. On net, the domestic respondents said that the delinquency and charge-off rates of their credit card and other consumer loans had not become more sensitive to a period of economic weakness over the past year, although a few said their residential real estate loans had become more sensitive. A small net percentage of the domestic and foreign respondents, about 15 percent, judged their commercial real estate loans to have become more sensitive to a downturn. However, about a third of the domestic and foreign respondents, on net, said their C&I loan portfolios had become more sensitive. Domestic banks most commonly attributed the heightened sensitivity of their C&I loan portfolios to borrowers' greater financial leverage and banks' eased lending standards and terms and also noted borrowers' narrower profit margins and reduced cash-flow projections. Branches and agencies also stressed a shift in the composition of borrowers toward riskier credits.

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

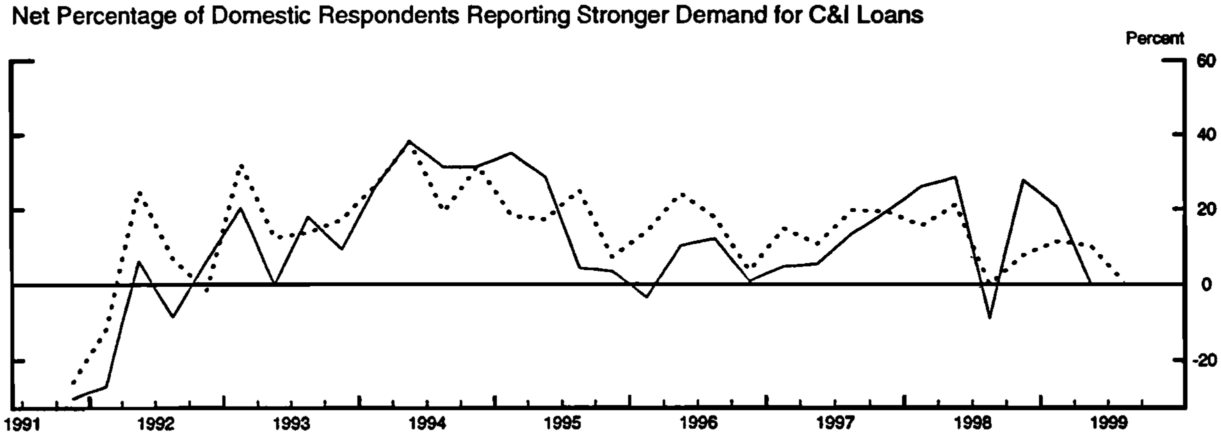
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

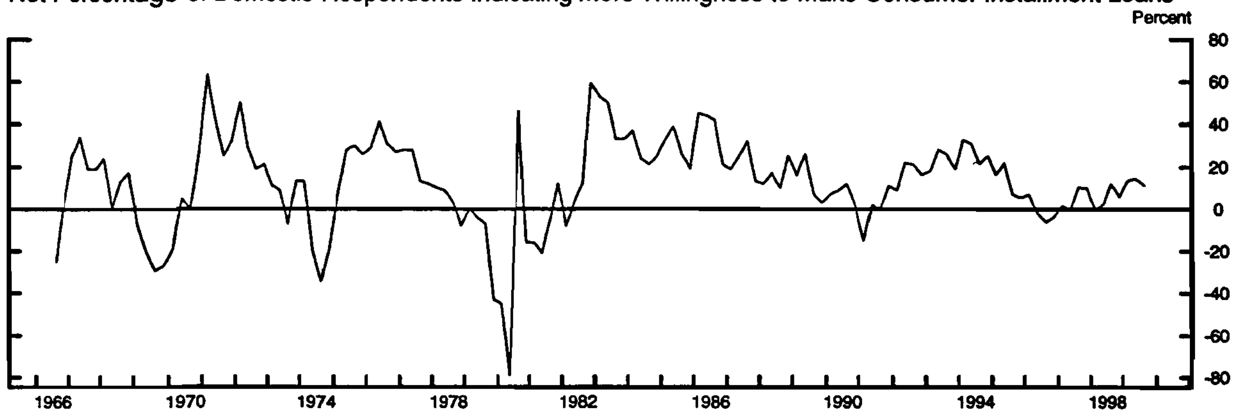


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

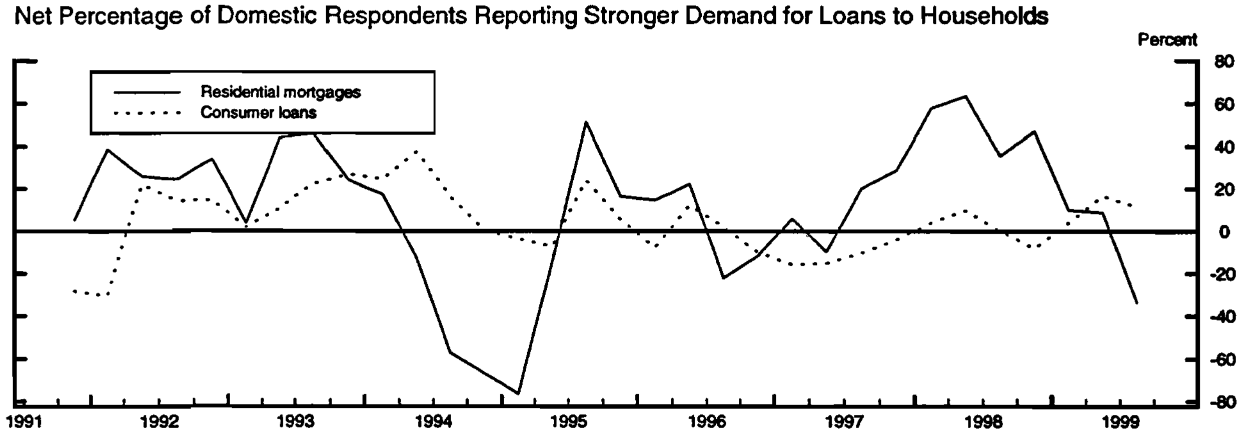


Measures of Supply and Demand for Loans to Households

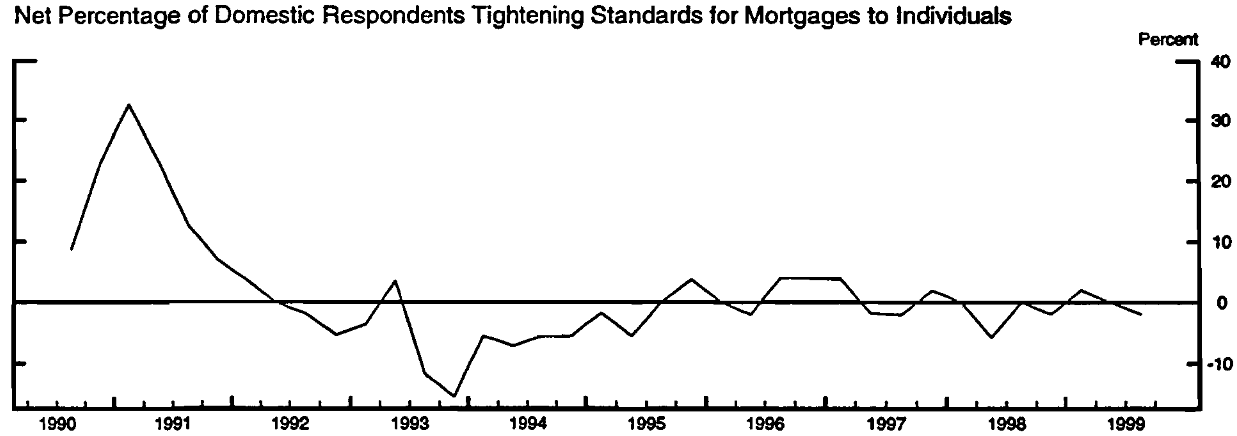
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



INTERNATIONAL DEVELOPMENTS

International Developments

U.S. International Transactions

Trade in Goods and Services

In May, the nominal U.S. trade deficit in goods and services was $21.3 billion. The deficit increased $2.7 billion from April, revised, as the value of exports declined slightly and the value of imports rose. For April-May combined, the nominal U.S. trade deficit in goods and services increased to $240 billion at a seasonally adjusted annual rate. Data for June will be released on August 19 and will be reviewed in the Greenbook Supplement.

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

	1998	Annual rate 1998	1999		Monthly rate 1999		
		Q4	Q1	Q2[e]	Mar.	Apr.	May
Real NIPA[1]							
Net exports of G&S	-238.2	-250.0	-303.6	-323.0	...	...	...
Nominal BOP							
Net exports of G&S	-164.3	-173.0	-215.0	-239.6	-18.9	-18.6	-21.3
Goods, net	-246.9	-254.3	-296.8	-321.3	-25.7	-25.3	-28.2
Services, net	82.6	81.3	81.8	81.7	6.7	6.7	6.9

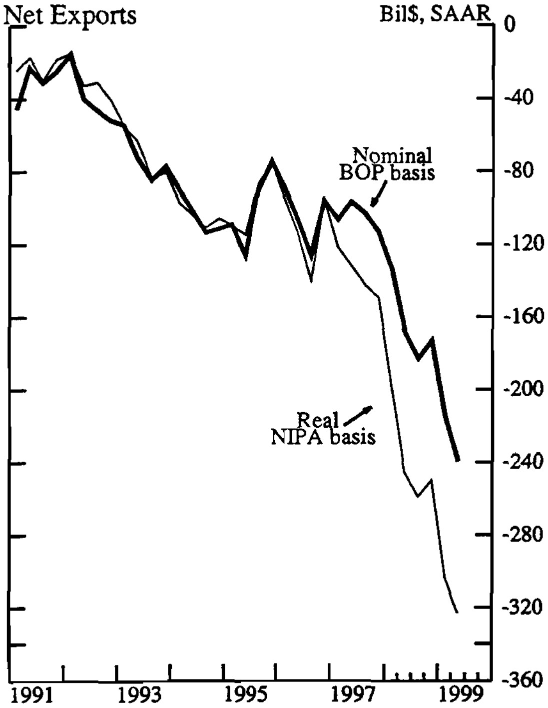
1. Billions of chained (1992) dollars.
e. BOP data are two months at an annual rate.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports fell 3/4 percent in May, following a 1-1/2 percent increase in April. The declines were primarily in aircraft, consumer goods, automotive products, and gold. Increased exports of automotive products to Canada and Mexico only partly offset declines to other destinations. Exports of industrial supplies increased for the second consecutive month, largely due to fuels. For April-May combined, the value of exports rose 3/4 percent over the first quarter level, with increases spread over most major trade categories, except for a sharp drop in aircraft exports.

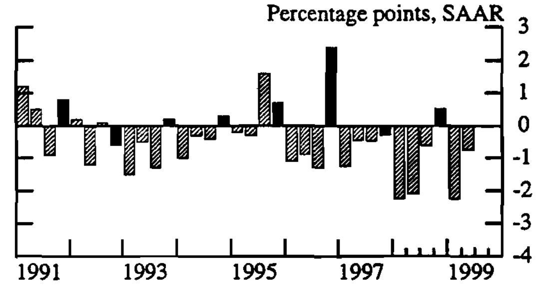
The value of imports rose 2 percent in May, increasing for the fifth consecutive month. The largest increases were in imports of oil, automotive products, and all the major categories of capital goods. Imports of consumer goods declined, following an upturn in April. For April-May combined, the value of imports rose 2-3/4 percent over the first quarter level, with much of the increase due to a higher value of oil imports.

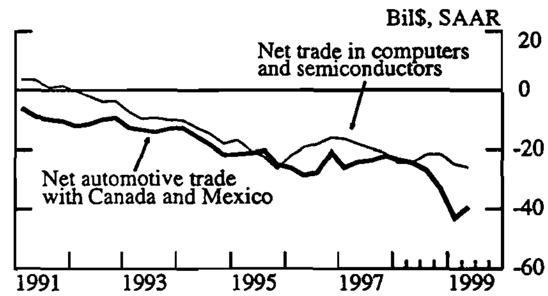
U.S. International Trade in Goods and Services

Net Exports

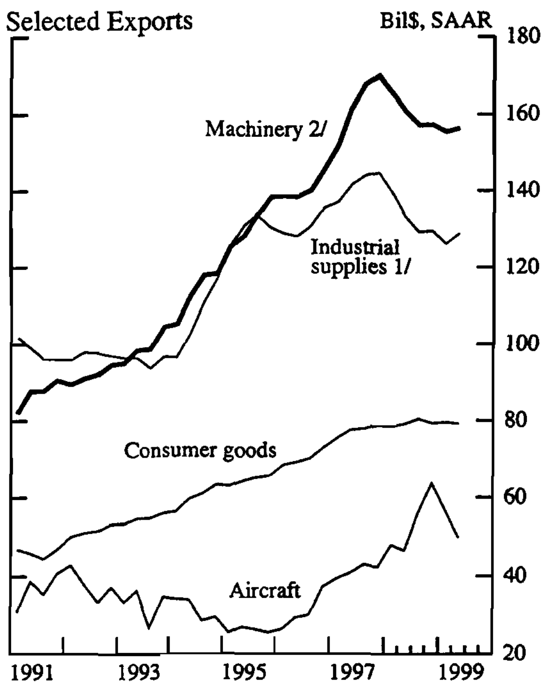


Contribution of Net Exports to Real GDP Growth



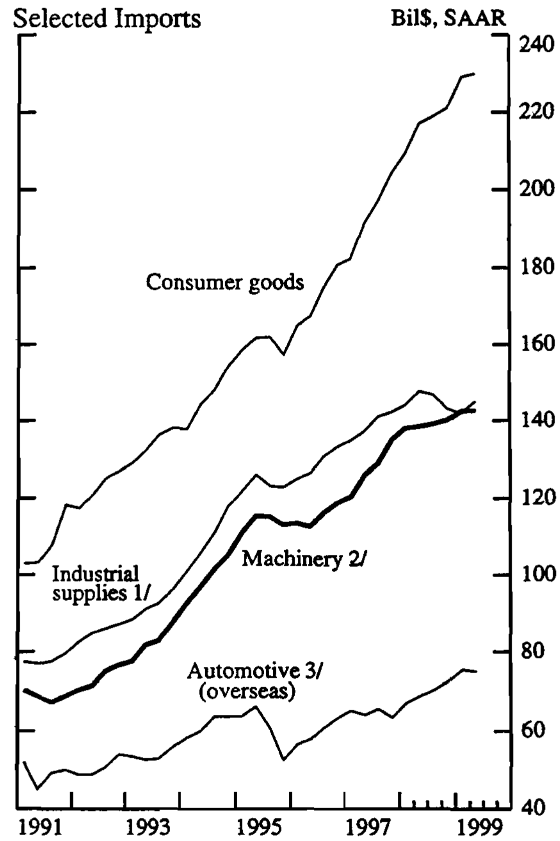


Selected Exports



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]			
	1999		1999		1999		1999	
	Q1	Q2[e]	Apr.	May	Q1	Q2[e]	Apr.	May
Exports of G&S	928.4	935.0	938.7	931.3	-19.2	6.6	14.0	-7.4
Goods exports	657.2	659.4	663.2	655.5	-23.3	2.2	11.3	-7.7
Agricultural	47.3	48.4	48.1	48.8	-7.0	1.1	1.7	0.6
Gold	2.9	3.1	4.0	2.2	-4.2	0.2	1.2	-1.9
Other goods	607.0	607.8	611.1	604.6	-12.1	0.9	8.5	-6.5
Aircraft & pts	56.6	49.8	51.6	48.0	-7.0	-6.8	0.5	-3.5
Computers	44.1	46.1	45.6	46.5	-1.4	1.9	2.3	1.0
Semiconductors	42.1	45.1	45.0	45.2	2.5	3.0	2.2	0.1
Other cap gds	158.8	158.7	158.8	158.5	-1.6	-0.2	-2.8	-0.3
Automotive	71.4	73.3	74.1	72.5	-3.3	1.9	4.0	-1.5
to Canada	42.7	43.5	42.7	44.4	-1.0	0.8	-0.0	1.7
to Mexico	10.3	11.4	11.3	11.5	-1.7	1.1	1.1	0.2
to ROW	18.4	18.4	20.1	16.7	-0.7	-0.0	2.9	-3.5
Ind supplies	126.1	129.0	128.2	129.8	-3.6	2.8	1.5	1.6
Consumer goods	79.6	79.2	80.8	77.5	0.4	-0.4	2.6	-3.4
All other	28.2	26.8	27.0	26.6	1.9	-1.4	-0.8	-0.4
Services exports	271.2	275.6	275.5	275.7	4.1	4.4	2.7	0.3
Imports of G&S	1143.4	1174.5	1161.8	1187.3	22.8	31.1	9.8	25.5
Goods imports	954.0	980.7	967.2	994.1	19.1	26.7	7.2	26.8
Petroleum	42.4	60.6	55.9	65.2	-3.4	18.2	11.6	9.3
Gold	3.2	3.1	3.2	3.0	-3.3	-0.2	-0.2	-0.2
Other goods	908.4	917.0	908.1	925.9	25.9	8.7	-4.2	17.8
Aircraft & pts	22.2	22.3	21.7	22.9	-2.1	0.1	-0.4	1.1
Computers	77.6	80.1	79.5	80.8	2.9	2.6	4.3	1.4
Semiconductors	33.4	36.9	35.6	38.2	1.5	3.5	2.5	2.5
Other cap gds	145.9	145.5	142.5	148.5	2.6	-0.4	-3.5	6.0
Automotive	171.6	169.4	164.5	174.3	10.4	-2.3	-10.9	9.8
from Canada	65.1	61.6	59.9	63.4	7.0	-3.5	-6.2	3.5
from Mexico	30.9	32.7	31.1	34.3	0.3	1.8	-3.2	3.2
from ROW	75.6	75.0	73.5	76.5	3.1	-0.5	-1.5	3.0
Ind supplies	142.2	145.1	145.0	145.2	-0.9	2.9	0.3	0.2
Consumer goods	229.1	230.0	232.2	227.8	8.2	0.9	5.1	-4.4
Foods	41.7	43.1	42.6	43.6	0.1	1.4	2.0	1.0
All other	44.6	44.6	44.5	44.7	3.2	0.0	-3.6	0.2
Services imports	189.4	193.9	194.5	193.2	3.6	4.4	2.6	-1.3
Memo:								
Oil qty (mb/d)	11.21	11.46	11.22	11.69	0.20	0.26	0.38	0.47
Oil price ($/bbl)	10.39	14.45	13.64	15.26	-0.99	4.07	2.44	1.62

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

Quantity and price of imported oil. The value of imported oil increased substantially in May as a modest rise in quantity augmented the effects of sharply higher prices. For April-May combined, the price of imported oil, at $14.50 per barrel, was 40 percent above the first quarter level. Reduced supplies, primarily from OPEC, fueled the rise in oil prices.

More recently, oil prices have increased further as OPEC continues to adhere to its production restraint agreements. The monthly average spot price of West Texas Intermediate (WTI) has increased from $17.75 in May to over $20 per barrel in July. Supply disruptions in Nigeria, strengthening world demand, and lower inventories have also contributed to higher prices. Spot WTI is currently trading above $21 per barrel.

Prices of non-oil imports and exports. In July, prices of non-oil imports fell slightly as declines in the prices of computers and semiconductors offset a small increase in the price of "core" imports. Among core goods, higher prices of imported industrial supplies and a marginal increase for automotive products were partly offset by declines in the prices for foods, machinery, and consumer goods. For the second quarter of 1999, prices of non-oil imports decreased 2 percent at an annual rate, a somewhat larger rate of decline than in the previous two quarters. Prices of core imports declined 1 percent at an annual rate following two quarters of virtually no price change. The decline in core prices reflected a swing from increases to decreases in the prices of machinery and consumer goods that was only partly offset by increases in the prices of imported industrial supplies, foods, and automotive products.

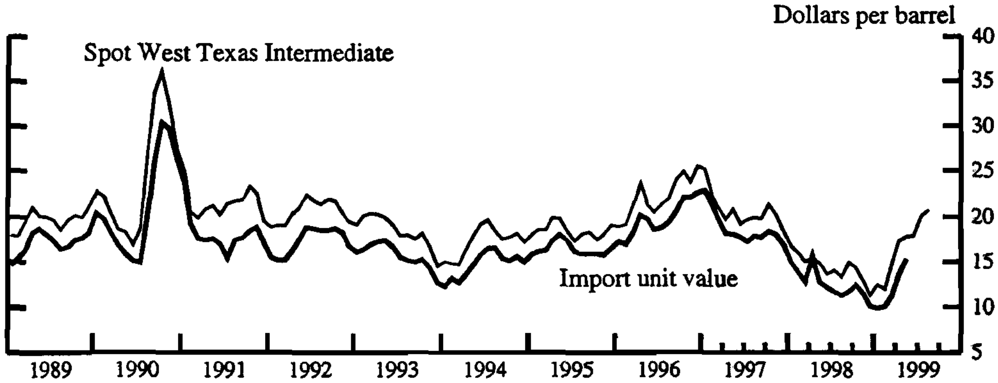
Prices of total exports fell slightly in July, the first decrease since March, due to declines in the prices of agricultural products, computers, and semiconductors. Prices of core exports did not change as higher prices for exported industrial supplies, machinery, and automotive products were offset by lower prices of consumer goods. In the second quarter, prices of total exports declined slightly, primarily due to lower prices of agricultural exports and continued declines in the prices of computers and semiconductors. Prices of core exports rose about 1-1/2 percent at an annual rate, led by increases in industrial supplies. This increase followed little change in core export prices in the first quarter.

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

	Annual rates			Monthly rates		
	1998	1999		1999		
	Q4	Q1	Q2	May	Jun.	Jul.
	--------------- BLS prices (1995=100)---------------					
Merchandise imports	-1.9	-1.6	6.5	0.7	-0.2	0.9
Oil	-17.7	-18.4	254.0	7.3	-0.1	11.0
Non-oil	-0.7	-0.7	-2.0	0.2	-0.2	-0.1
Core goods*	0.3	-0.1	-1.1	0.3	-0.2	0.1
Foods, feeds, beverages.	1.3	-6.0	0.7	1.0	-1.2	-1.0
Industrial supplies ex oil	-4.7	-1.7	1.6	1.0	0.2	1.1
Computers	-16.6	-9.0	-17.5	-0.3	-1.0	-1.4
Semiconductors	2.6	2.0	-3.9	-0.4	-1.1	-1.8
Cap. goods ex comp & semi	2.9	0.7	-3.4	-0.3	-0.3	-0.3
Automotive products	1.5	1.3	0.9	0.3	-0.1	0.1
Consumer goods	0.7	0.3	-2.3	-0.1	-0.1	-0.1
Merchandise exports	-2.1	-1.1	-0.3	0.1	0.0	-0.2
Agricultural	-7.3	-6.0	-8.5	0.4	-0.2	-2.0
Nonagricultural	-1.4	-0.6	0.6	0.0	0.1	-0.1
Core goods*	-1.1	0.3	1.8	0.3	0.1	0.0
Industrial supples ex ag	-5.6	-2.0	3.3	0.5	0.3	0.2
Computers	-5.0	-6.5	-7.2	-0.7	-1.0	-0.9
Semiconductors	-1.6	-7.7	-5.9	-1.6	-0.9	-0.9
Cap. goods ex comp & semi	0.1	1.4	0.3	-0.2	0.0	0.1
Automotive products	1.7	0.6	0.1	0.1	0.2	0.1
Consumer goods	0.3	-0.5	-0.1	0.0	0.1	-0.1
Chain-weight	-----Prices in the NIPA accounts (1992=100)-----					
Imports of goods & services	-0.1	-3.3	4.0	...	...	...
Non-oil merchandise	-1.1	-1.7	-3.8	...	...	...
Core goods*	0.3	-0.1	-0.8	...	...	...
Exports of goods & services	-0.9	-0.6	-0.2	...	...	...
Nonag merchandise	-1.8	-1.4	-0.8	...	...	...
Core goods*	-1.1	-0.2	1.2	...	...	...

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

Oil Prices



U.S. International Financial Transactions
In the second quarter of 1999 foreign official assets held in the United States remained largely unchanged (line 1 of the Summary of U.S. International Transactions table). A sizeable reduction in European reserves was mostly offset by an increase in Japanese reserves. Venezuela and Saudi Arabia also registered increases in their reserves in the second quarter in concert with the rebound in oil prices. Corresponding to reported intervention this summer, Japanese reserves increased sharply in June and partial data from the FRBNY indicate that Japanese reserves jumped again in July. Although Brazilian reserves were up significantly and Chilean reserves remained unchanged for the quarter, both countries decreased their reserves markedly in June.

Net purchases of U.S. securities by private foreigners remained strong in the second quarter of 1999 (line 4). They were concentrated in corporate securities (lines 4b and 4c), while holdings of Treasury securities (line 4a) declined modestly. The move out of Treasuries was more than offset by foreign net purchases of agency bonds, which made up about one-third of net purchases of U.S. corporate bonds in both June and the second quarter. Transactions through financial centers in Europe and the Caribbean accounted for most of the large net purchases of stocks and bonds in June.

U.S. investors continued selling foreign bonds and stocks on net in the late spring and early summer (line 5). Second quarter sales of foreign securities were concentrated in the United Kingdom, with an especially large sell-off in June. The U.K. net sales were partially offset by large net purchases of Japanese stocks in the second quarter. U.S. holdings of Latin American securities also increased in the second quarter as a result of sizeable global bond issues in April by Argentina, Brazil, and Mexico; however, U.S. residents sold securities on net from these three countries in June.

Moderate inflows through banking offices in the United States continued in the second quarter (line 3), with inflows in May and June more than offsetting April outflows. U.S.-chartered banks were largely responsible for the net inflow.

Summary of U.S. International Transactions

(Billions of dollars, not seasonally adjusted except as noted)

	1997	1998	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 May	1999 June
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	20.0	-17.1	-46.4	26.7	6.3	-.2	-6.1	5.0
a. G-10 countries	1.8	6.9	*	12.8	12.7	7.6	2.0	13.0
b. OPEC countries	12.9	-9.0	-11.6	2.8	2.2	2.3	1.6	.2
c. All other countries	5.2	-14.9	-34.8	11.0	-8.6	-10.2	-9.6	-8.3
2. Change in U.S. official reserve assets (decrease, +)	-1.0	-6.8	-2.0	-2.4	3.9	1.2	1.1	.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	34.0	57.0	53.1	12.3	6.2	10.1	16.1	19.4
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	346.7	275.2	22.7	80.6	54.3	81.0	23.9	24.5
a. Treasury securities[3]	147.2	49.3	1.1	24.6	-8.6	-5.3	1.2	-1.9
b. Corporate and other bonds[4]	128.1	172.2	27.7	41.0	52.8	48.6	14.3	14.6
c. Corporate stocks	71.3	53.7	-6.1	15.2	10.1	37.7	8.4	11.7
5. U.S. net purchases (-) of foreign securities	-89.1	-11.0	14.7	16.5	7.4	18.7	3.1	15.2
a. Bonds	-48.2	-17.4	7.8	10.4	-.8	4.4	.6	9.0
b. Stocks [6]	-40.9	6.4	7.0	6.2	8.2	14.3	2.5	6.2
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-110.0	-132.8	-21.6	-30.8	-38.3	n.a.	n.a.	n.a.
7. Foreign direct investment in U.S.	109.3	193.4	24.9	120.6	19.1	n.a.	n.a.	n.a.
8. Foreign holdings of U.S. currency	24.8	16.6	7.3	6.3	2.4	n.a.	n.a.	n.a.
9. Other (inflow, +)[5,6]	-48.5	-164.0	-21.1	-130.4	23.0	n.a.	n.a.	n.a.
U.S. current account balance (s.a.)	-143.5	-220.6	-63.5	-61.7	-68.6	n.a.	n.a.	n.a.
Statistical discrepancy (s.a.)	-143.2	10.1	31.9	-37.7	-15.7	n.a.	n.a.	n.a.

NOTE. The sum of official capital, private capital, the current account balance, and the statistical discrepancy is zero. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

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

3. Includes Treasury bills.

4. Includes U.S. government agency bonds.

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

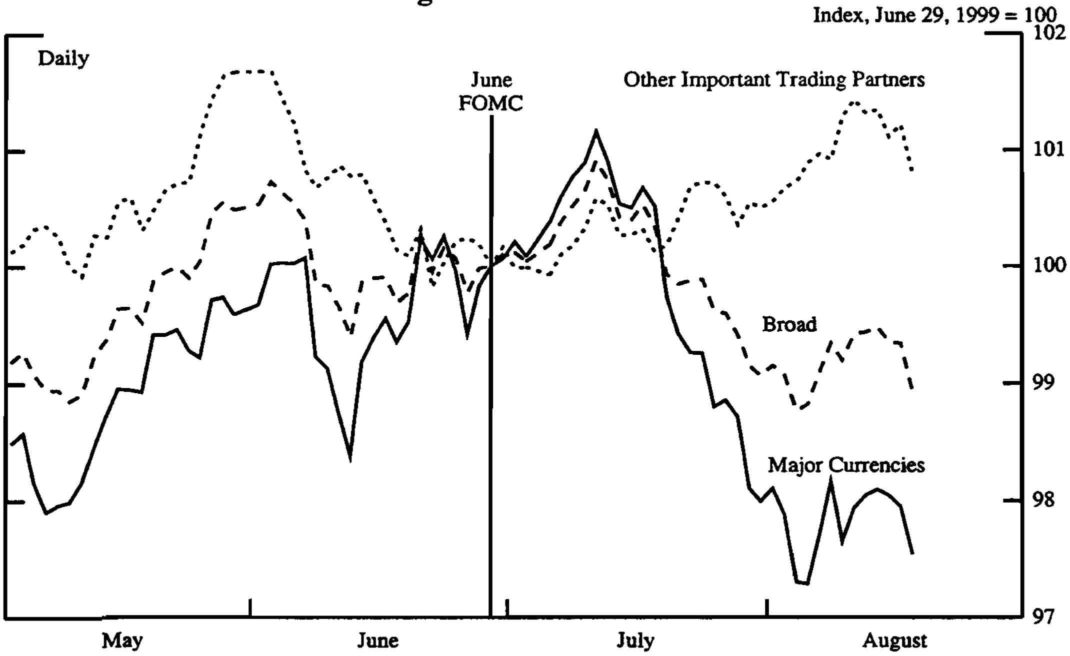
6. Quarterly balance of payments data include large U.S. acquisitions of foreign equities associated with foreign takeovers of U.S. firms. These are not included in line 5.b but are included in line 9.

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

Foreign Exchange Markets

Since the June FOMC meeting, the dollar has depreciated 2-1/2 percent in terms of the major currencies index, but has appreciated about 1 percent in terms of the currencies of our other important trading partners. The dollar depreciated 7 percent versus the yen, 2 percent against the euro, and 1-1/2 percent in terms of sterling. The bulk of the dollar's decline against the major currencies began in mid-July amid data releases suggesting a pickup in activity in Europe and possibly Japan, and despite increasing market expectations of monetary tightening in the United States.

Exchange Value of the Dollar



The yen's movement against the dollar occurred in two major episodes, with much of the movement coming very late in the intermeeting period. The yen's strength appeared to reflect an ongoing reassessment among market participants of the prospects for Japanese financial assets and the underlying economy. The Bank of Japan maintained its policy stance with the overnight call rate at only a few basis points, and benchmark government bond yields increased slightly over the period. Despite the reports of improved market sentiment towards Japan, the Nikkei index was little changed on balance, reportedly due in part to concerns that the strengthening yen may affect the profitability of exporting firms and threaten Japan's budding recovery. The same concerns led Japanese monetary authorities to intervene three times in July to weaken the yen,

. Since the latest operation on July 21, the yen has appreciated another 5 percent.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Aug. 18	Change	Aug. 18	Change	Change
Canada	5.02	0.07	5.73	0.13	1.35
Japan	0.03	-0.01	1.91	0.11	0.62
Euro area	2.68	0.01	4.85	0.33	-1.09
United Kingdom	5.03	-0.09	5.26	0.14	0.72
Switzerland	1.01	-0.06	3.16	0.15	0.08
Australia	4.98	-0.03	6.33	0.06	1.16
United States	5.41	0.09	5.91	-0.02	-2.18
Memo: Weighted-average foreign	2.84	0.01	4.81	0.20	

NOTE. Change is in percentage points from June 29 to August 18.

The euro came within one cent of parity with the dollar in the middle of July, but rose quickly afterwards as signs of economic recovery in France and Germany became more abundant. Ten-year government bond yields rose more than 30 basis points in the euro area over the intermeeting period, while the yields on comparable U.S. Treasuries were little changed. Expectations that the European Central Bank would raise interest rates 50 basis points or more during the year 2000 became more prevalent; these interest rate expectations were seen as a factor behind the slight decline in share prices in Germany and France.

During the period, as data pointing to recovery in the United Kingdom were released, market participants also came to believe that the next interest rate move by the Bank of England would be up, rather than down, which had been the prevailing opinion in late June. These beliefs were tempered by projections that inflation would remain below the Monetary Policy Committee's target for the next two years. British assets generally outperformed euro-area assets, with ten-year gilt yields increasing only about 15 basis points, and share prices in London up slightly on balance.

A measure of anxiousness returned to the financial markets of emerging economies during the intermeeting period, both in Asia and in Latin America. In Asia, the renewed tensions between China and Taiwan, as well as the increasingly open discussion within China of the possible devaluation of the renminbi, were reflected in falling equity prices in much of the region. The dollar appreciated about 4 percent versus the Thai baht, the Korean won, and the Philippine peso. The dollar appreciated 10 percent against the Indonesian rupiah amid continued political unrest and increasing doubts about the reform of Indonesia's financial sector.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest Rates		Dollar-denominated bond spread[1]		Equity prices
Country	Aug. 18	Change	Aug.17/18	Change	Aug.17/18	Change	Change
Mexico	9.29	-1.35	19.50	-0.70	8.64	0.64	-6.47
Brazil	1.88	6.27	20.05	-1.65	14.04	2.26	-12.80
Argentina	1.00	-0.00	7.25	-1.25	10.61	0.90	-8.37
Chile	511.10	-1.27	n.a.	n.a.	n.a.	n.a.	-1.45
China	8.28	-0.02	n.a.	n.a.	1.72	0.24	-9.04
Korea	1202.00	3.84	5.11	0.01	2.36	0.42	-3.18
Taiwan	31.83	-1.49	4.85	0.05	n.a.	n.a.	-6.11
Singapore	1.67	-1.71	2.13	0.75	n.a.	n.a.	-8.91
Hong Kong	7.76	0.07	6.11	0.31	n.a.	n.a.	-5.61
Malaysia	3.80	-0.00	2.95	-0.05	3.10	0.49	-8.31
Thailand	38.38	4.07	3.50	-0.50	1.14	0.03	-20.84
Indonesia	7325.00	9.90	13.36	-6.64	7.28	0.05	-17.51
Philippines	39.55	4.46	n.a.	n.a.	3.31	0.20	-15.27
Russia	24.57	1.36	n.a.	n.a.	63.08	16.67	-14.82

NOTE. Change is in percentage points from June 29 to August 17/18.

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

n.a. Not available.

In Latin America, financial markets appeared particularly sensitive to prospects for rising interest rates in the United States. The Brazilian *real* depreciated 6-1/4 percent, but the Mexican peso appreciated slightly, supported in part by rising crude oil prices. Concerns over the viability of Argentina's currency board did not abate, as the recession appeared to deepen and political uncertainty increased ahead of this fall's presidential election. Equity prices fell close to 13 percent in Brazil, 8 percent in Argentina, and 6 percent in Mexico. Brady yield spreads over Treasuries widened appreciably during the intermeeting period, with the Emerging Market Bond Index spread increasing 100 basis points on balance.

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

Developments in Foreign Industrial Countries

Recent data suggest that economic activity in the foreign industrial countries generally has continued to firm. While the most recent production data for the euro zone are lackluster, forward-looking indicators suggest continuing economic recovery. Euro-zone consumer and business confidence improved in July, and German manufacturing orders rose sharply in the second quarter. U.K. real GDP rose 2 percent in the second quarter after two quarters of little growth, with industrial production registering the first quarterly increase in a year. Canadian economic growth has remained strong, and recent increases in manufacturing orders and manufacturing employment indicate momentum in the industrial sector. In contrast, Japanese data on industrial production, employment, and orders suggest that growth in the second quarter has stalled following the surprising surge in GDP in the first quarter.

Inflationary pressures have remained subdued in these countries. Japanese consumer prices were unchanged over the 12 months to July. Twelve-month euro-area inflation has stayed around 1 percent. Inflation in the United Kingdom remains below the 2.5 percent target rate, while Canadian inflation has picked up a bit recently to just below the mid-point of its 1 to 3 percent target range.

In **Japan**, economic indicators provide little evidence of sustained recovery. Industrial production during the second quarter was down 3.8 percent (SAAR) from the first-quarter average, and MITI's index of service sector activity during April and May was down 0.8 percent from the first quarter. Unemployment in June reached a postwar high of 4.9 percent, and the offers-to-applicants ratio remained at a record low. Second-quarter data on machinery orders and capital goods shipments also suggest profound weakness. By contrast, the real household expenditure series surged 8 percent during the second quarter, but the marked divergence between this series and NIA private consumption during the first quarter raises questions about how these data should be interpreted. Housing starts continued to rise during the second quarter, supported by government incentives. The Tokyo-area CPI in July was unchanged from a year earlier.

The BOJ's June Tankan survey showed an improvement in business confidence, although the level of confidence remained low. The diffusion index for aggregate business sentiment (across all sizes of firms and all industries) increased from -44 in March to -37 in June, with sentiment among large manufacturers rising from -47 to -37. Firms expect conditions to show further improvement over the next three months.

Japan's merchandise trade surplus during the first half of 1999 was $109 billion at an annual rate, essentially unchanged from the $108 billion surplus during all of 1998. Measured in dollars, imports and exports during the first half were both up about 2 percent from their 1998 averages.

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

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production	-.7	.6	-1.0	-3.4	-1.0	3.2	n.a.
Housing starts	-1.8	7.8	3.7	-3.5	-2.2	6.5	n.a.
Machinery orders	-2.7	2.0	-3.7	-10.9	7.9	-7.1	n.a.
New car registrations	.8	1.5	-.0	-.8	5.5	.2	n.a.
Unemployment rate[1]	4.4	4.6	4.8	4.8	4.6	4.9	n.a.
Job offers ratio[2]	.47	.49	.47	.48	.46	.46	n.a.
Business sentiment[3]	-49	-44	-37	...	...	...	...
CPI (Tokyo area)[4]	.7	-.2	-.4	-.2	-.6	-.4	.0
Wholesale prices[4]	-3.6	-4.0	-3.6	-3.5	-3.4	-4.0	-3.8

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

Recent indicators for the European Union countries in the **euro zone** suggest that the economic recovery is getting back on track, with forward-looking indicators showing considerable improvement in the last few months. However the upturn remains fragile and uneven across countries, with growth rates in some of the smaller countries (notably Ireland, Spain, and Portugal) continuing to outpace performance in Germany, France, and Italy.

Industrial production for the euro zone as a whole turned up in May, but the April-May average was a little below the first-quarter level. Unemployment rates remain at high levels in most euro-zone countries.

Price pressures continue to be mild, although CPI data for July for Germany, Italy and, to a lesser extent, France showed an uptick in twelve-month inflation that has been linked primarily to higher energy prices. For the euro-area as a whole, harmonized twelve-month consumer price inflation dipped back below

1.0 percent in June, considerably below the ECB's target ceiling of 2 percent. Sizable differences still exist among individual countries, however, with inflation rates in Germany, Austria, Belgium, and France all below 1 percent, while rates in the Netherlands, Spain, Portugal, and Ireland are still a little above 2 percent.

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

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production							
Euro-11[1]	-.3	-.2	n.a.	-.7	.3	n.a.	n.a.
Germany	-2.0	.3	-.9	0.0	0.1	0.0	n.a.
France	-.2	-.3	n.a.	-.9	.8	n.a.	n.a.
Italy[1]	-1.2	.0	-.8	-1.5	-.4	1.1	n.a.
Unemployment rate							
Euro-11[2]	10.7	10.4	10.3	10.3	10.3	10.3	n.a.
Germany	10.7	10.6	10.5	10.6	10.5	10.5	10.5
France	11.6	11.4	11.3	11.3	11.4	11.3	n.a.
Italy	12.4	12.2	11.9	--	--	--	--
Consumer prices[3]							
Euro-11[4]	.8	.9	1.0	1.1	1.0	.9	n.a.
Germany	.4	.3	.5	.7	.4	.4	.7
France	.3	.3	.4	.5	.4	.3	.4
Italy	1.8	1.4	1.5	1.5	1.5	1.4	1.7

1. Index excludes construction.
2. Standardized to ILO definition. Includes Eurostat estimates in some cases.
3. Percent change from year earlier.
4. Eurostat harmonized definition.

In contrast to the lackluster production data, forward-looking indicators have turned quite positive. German manufacturing orders were up sharply in the second quarter, and the euro-zone indicator of economic sentiment rose in June, with increases in all three components of the index–industrial, consumer, and construction. The increase was also widespread across the major countries, with gains posted in Germany, France, Italy, and Spain.

Elections to the European parliament were held in June, and a conservative majority was voted into power. This likely will increase the pressure on most governments to proceed with market-oriented economic reforms but may also lead to greater economic policy divergence among the major European countries.

In Germany, the election results suggested a weakening of the ruling social-democratic party and were interpreted as a negative verdict on the Schroeder government's economic policy record. The government responded with a renewed promise to cut corporate tax rates to 25 percent by 2001 and make other pro-business tax changes. By contrast, in France the election result supported Jospin's left-wing coalition and is likely to reinforce France's determination to stick to its present economic policy course.

Euro-11 Forward-looking Indicators
(Percent balance measure, SA)

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
Consumer confidence[1]	-2.0	-.3	-4.0	-3.0	-4.0	-5.0	-3.0
Construction confidence[2]	-15.0	-9.0	-7.0	-7.0	-8.0	-6.0	-5.0
Industrial confidence[3]	-7.3	-10.3	-10.3	-11.0	-11.0	-9.0	-8.0
Of which:							
Production expectations	3.0	1.0	3.0	2.0	3.0	5.0	7.0
Total orders	-13.0	-19.0	-21.0	-20.0	-22.0	-22.0	-19.0
Stocks	11.0	14.0	13.0	14.0	13.0	11.0	11.0

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

Recent indicators point to recovery in the pace of economic activity in the **United Kingdom.** After registering little growth in the previous two quarters, real GDP expanded 2 percent (SAAR) in the second quarter. Industrial production rose 0.6 percent, with the manufacturing sector registering the first quarterly increase in over a year. Retail sales remained strong, with the average volume of sales increasing 0.9 percent over the quarter and somewhat further in July. Business and consumer confidence have slipped somewhat since May but remain well above lows reached late last year.

Conditions in the labor market remain healthy. The official unemployment rate edged down to 4.3 percent in July, and the Labor Force Survey unemployment rate improved to 6.0 percent for the April-June period.

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

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
Real GDP (SAAR)	.2	.5	2.0	n.a.	n.a.	n.a.	n.a.
Industrial production	-.8	-.7	.6	.2	.2	.1	n.a.
Retail sales	-.1	1.0	.9	-.2	1.1	.1	.2
Unemployment rate[1]	4.6	4.5	4.5	4.5	4.5	4.4	4.3
Business confidence[2]	-23.0	-10.3	8.0	-1.0	15.0	10.0	-4.0
Retail prices[3]	2.6	2.6	2.3	2.4	2.1	2.2	2.2
Producer input prices[4]	-9.2	-5.8	-1.6	-1.1	-2.7	-.9	2.9
Average earnings[4]	4.6	4.6	4.4	4.6	4.3	4.4	n.a.

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

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

In its August *Inflation Report*, the Monetary Policy Committee of the Bank of England said that it had raised its near-term outlook for real GDP growth, reflecting improved prospects for both domestic demand and net exports. However, its near-term inflation forecast was somewhat weaker, as recent data on wages and prices had been weaker than anticipated.

Economic growth in **Canada** has continued to expand at a brisk pace. Real GDP at factor cost rose sharply in both April and May, led by sharp increases in demand for telecommunication products, computers, and business services. This was offset to some extent by a slowdown in manufacturing from the sharp increase in activity earlier this year. However, a large increase in new manufacturing orders in May and a surge in manufacturing employment in July suggest that industrial production has already regained momentum and begun to post healthy gains. Furthermore, a rise in overall business confidence in the second quarter and recent surveys of capital spending intentions by firms suggest that overall investment spending should remain strong in the near term.

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

Indicator	1998	1999					
	Q4	Q1	Q2	Apr.	May	June	July
GDP at factor cost	1.0	.9	n.a.	.3	.3	n.a.	n.a.
Industrial production	1.3	.9	n.a.	.3	.2	n.a.	n.a.
New manufacturing orders	4.5	.6	.5	-1.3	3.0	-.1	n.a.
Retail sales	-.1	2.5	n.a.	-.2	.4	n.a.	n.a.
Employment	1.3	.9	-.1	.1	-.1	0	.3
Unemployment rate[1]	8.0	7.8	8.0	8.3	8.1	7.6	7.7
Consumer prices[2]	1.1	.8	1.6	1.7	1.6	1.6	1.8
Consumer attitudes[3]	109.8	117.1	116.6	...	...	...	...
Business confidence[4]	132.3	150.1	150.7	...	...	...	...

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

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

Despite these indications of robust investment spending, employment failed to expand during the second quarter. This weakness in employment to some extent offsets large increases in jobs in latter part of 1998, and employment in July rose sharply, confirming some of the strength in investment demand. The unemployment rate also continued to move lower, after spiking up in April.

After surging in the first quarter, gains in consumer spending have fallen back to more sustainable increases. Retail sales in April/May were up only 0.6 from the first quarter, compared to a 2.5 percent rise in the first quarter. Similarly, housing starts were up only 1.2 percent in the second quarter, compared to a hefty 5.8 percent increase in the first quarter.

The period of very low inflation experienced at the end of 1998 and early 1999 appears to have ended. CPI inflation rose sharply in April and May, partly due to higher energy prices, and has remained above 1.5 percent in more recent months, rising to 1.8 percent in July. Inflation expectations, as measured by yields on Canadian index-linked bonds, have also continued to move higher in recent months. And, the effective twelve-month average increase in wages in new collective bargaining agreements was 2.3 percent in April and May, after averaging only 1.5 percent in the first quarter.

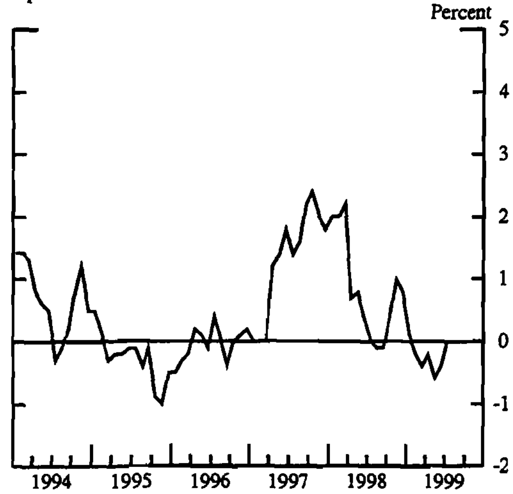
External Balances
(Billions of U.S. dollars, SAAR)

Country and balance	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 May	1999 June
Japan						
Trade	107.3	113.0	113.1	104.7	103.8	104.8
Current account	118.5	133.0	116.0	113.7	127.6	130.6
EU-11						
Trade[1]	106.1	97.5	44.7	n.a.	33.8	n.a.
Current account[1]	86.3	84.3	41.3	n.a.	...	...
Germany						
Trade	73.2	69.0	76.2	n.a.	44.4	n.a.
Current account	7.1	-17.2	-10.0	n.a.	...	...
France						
Trade	29.1	26.0	17.6	n.a.	11.9	n.a.
Current account	42.7	48.3	34.5	n.a.	25.5	n.a.
Italy						
Trade	28.8	26.7	44.8	n.a.	10.0	n.a.
Current account[1]	42.6	20.5	16.8	n.a.	n.a.	n.a.
United Kingdom						
Trade	-45.6	-51.4	-56.9	n.a.	-33.9	n.a.
Current account	8.5	-8.3	-16.6	n.a.	...	...
Canada						
Trade	15.0	12.9	19.6	n.a.	20.1	n.a.
Current account	-10.1	-10.7	-3.6	n.a.	...	...

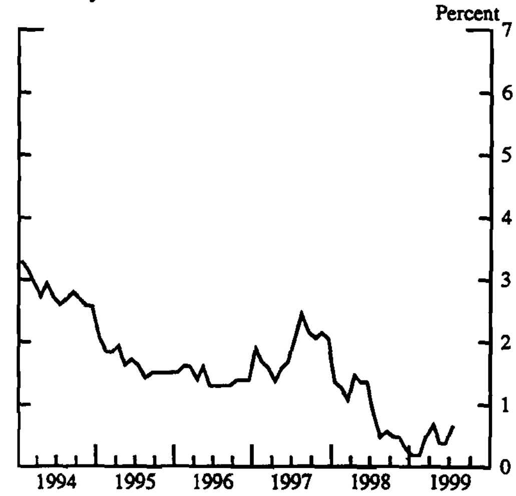
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

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

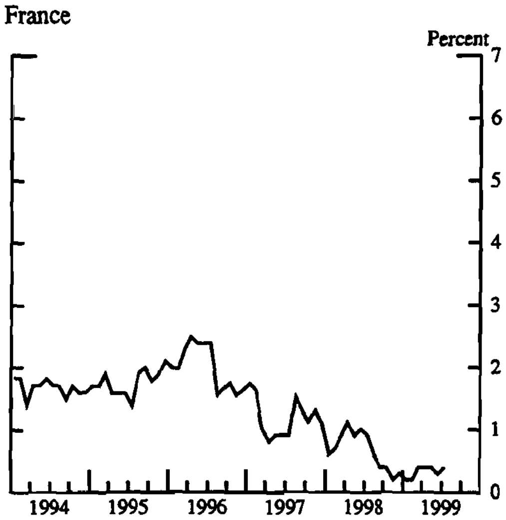
Japan



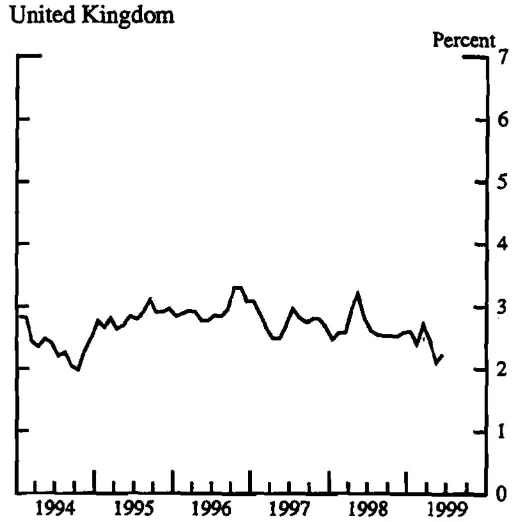
Germany



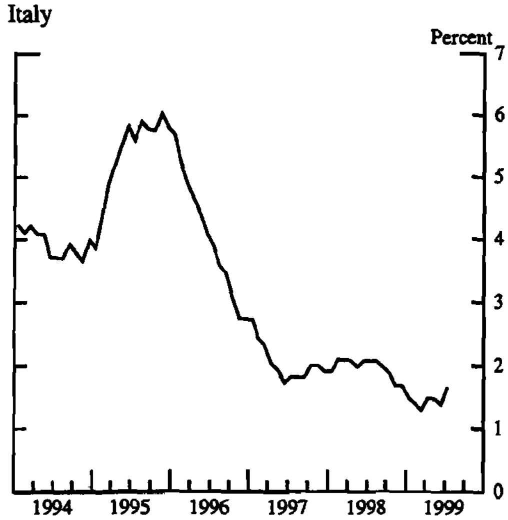
France



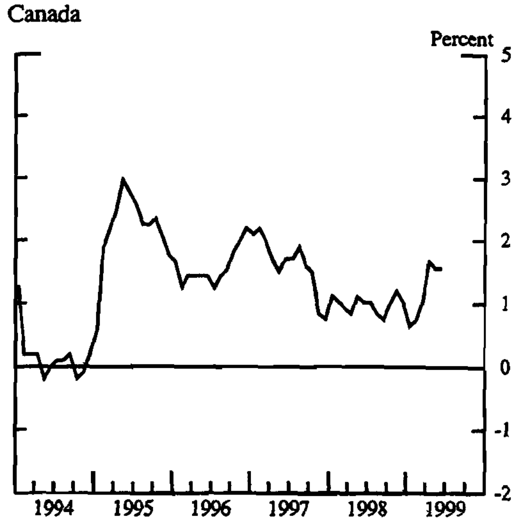
United Kingdom



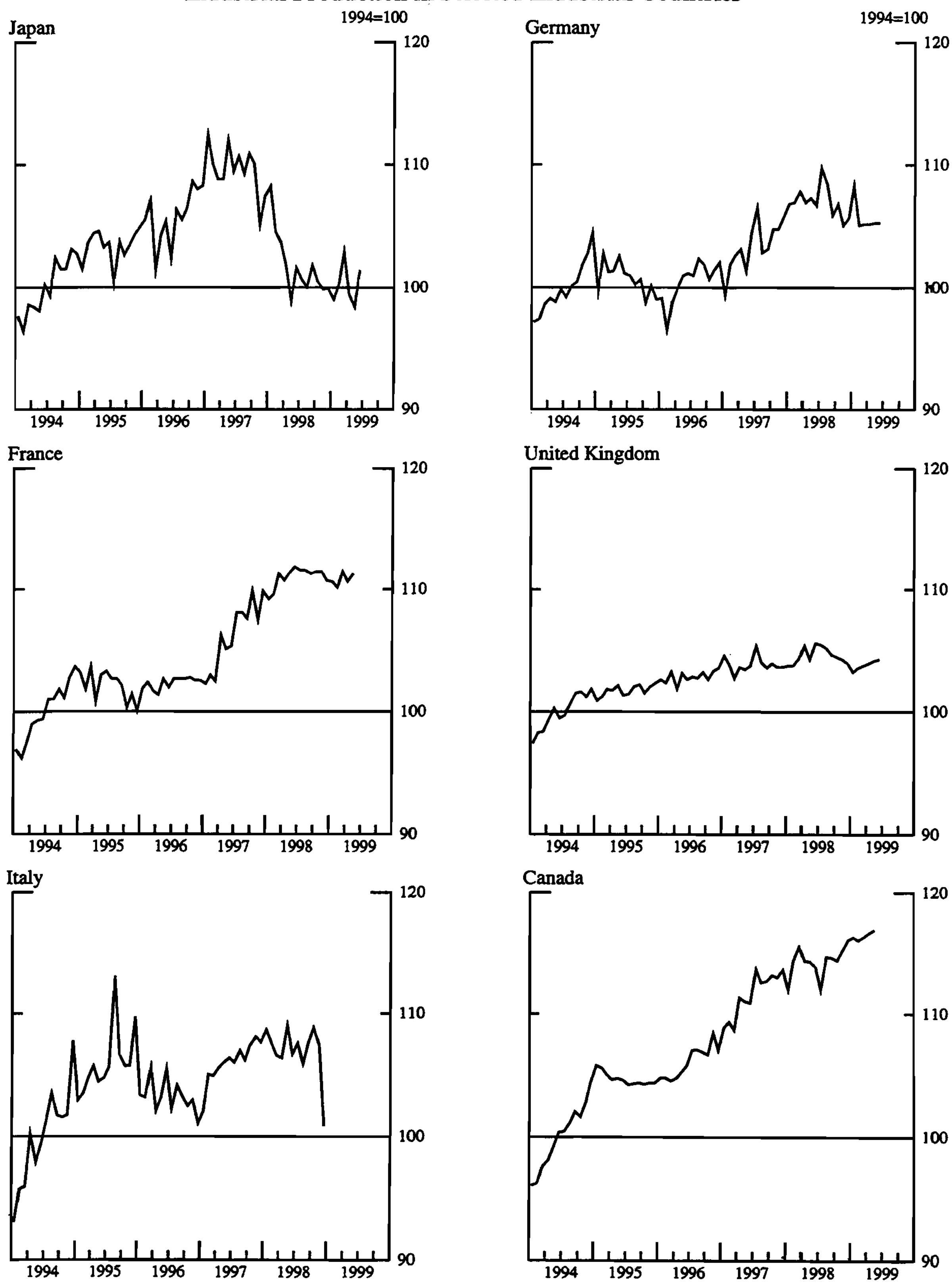
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In developing Asia the economic recovery appears to be gathering momentum, with China being the notable exception. Indications from Latin America are somewhat mixed. Economic growth accelerated in Mexico and continued to recover in Brazil. However, in Argentina the deep recession continues, and, despite the turnaround in oil prices, the Venezuelan economy continues to falter amid political uncertainty. There is also not much evidence of an increase in inflationary pressures in the region; inflation continued to be negative in Argentina and was roughly constant in Mexico and Venezuela, although Brazil experienced a slight increase. Recessionary pressures have turned the Argentine trade deficit into a surplus and narrowed Venezuela's non-oil trade deficit. The Brazilian trade deficit has also narrowed, but that of Mexico widened slightly in June after the narrowing that resulted from strong export growth in recent months.

In developing Asia, Korea and the ASEAN countries continued to display robust growth, although Indonesian GDP growth retreated in the second quarter from its very rapid first quarter pace. Growth was also strong in Taiwan, but the Hong Kong economy remains weak, and the pace of growth slowed sharply in China, amid renewed fears of a possible devaluation. Consistent with strong growth, the trade surpluses of the ASEAN countries as well as those of Korea and Taiwan have narrowed. In China exports continue to improve, reflecting in large part an improvement in other Asian economies. Inflation throughout developing Asia has continued to range from negative to moderate.

In Russia economic activity appears to be recovering, but the political landscape has changed again with yet another reshuffling of the cabinet.

In **Brazil**, economic growth has been surprisingly high in the first half of the year; second-quarter real GDP grew by 3.8 percent (SAAR), following a rise of 4.1 percent in the first quarter. However, unemployment in June rose to 7.6 percent from 7.2 percent (SA) in May. Moreover, industrial output declined in June, although for the second quarter as a whole it rose 1.6 percent. Inflation has also risen recently; the consumer price index rose approximately 0.3 percent (SA) in July, largely due to hikes in administered fuel prices, after showing deflation (reflecting mainly declines in food prices) over the second quarter. The trade deficit for the first seven months of the year has narrowed relative to its level over the same period last year, but not by as much as hoped, reflecting mainly declines in export prices and weak demand from Argentina and other Latin American trading partners.

A turbulent political situation is fueling skepticism about the political determination to tackle Brazil's fiscal problems. Stories of infighting within the coalition of political parties supporting President Cardoso prompted him in late July to reorganize executive level appointments, a move that observers regard as positive. Nonetheless, court challenges to several taxes and a social security reform that are crucial to the fiscal reform effort are still pending; the supreme court is expected to rule on the constitutionality of these changes soon. A recent "anti-poverty" proposal that seems to involve a tax on the rich has gained political momentum, raising some concerns that congress will be distracted from more pressing fiscal problems.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	2.0	-1.9	-6.6	4.1	3.8	...	...
Industrial production	3.9	-2.1	-3.7	.4	1.6	-1.3	n.a.
Unemployment rate[2]	5.7	7.6	7.6	7.5	7.5	7.6	n.a.
Consumer prices[3]	5.2	1.7	1.8	2.3	3.3	3.3	4.6
Trade balance[4]	-8.4	-6.4	-5.2	-1.4	-2.1	-3.5	-1.1
Current account[5]	-33.8	-34.9	-46.8	-20.8	-28.4	-35.3	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Annual figures are December-over-December. Quarterly figures are the quarterly average relative to the same quarter a year earlier. Monthly figures are the level in the month relative to a year earlier. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, NSA, annual rate.
n.a. Not available. ... Not applicable.

In late June, the central bank unveiled its inflation targeting system, an effort that is aimed at strengthening its anti-inflation credibility. The target is 8 percent in 1999, 6 percent in 2000, and 4 percent in 2001 (December-over-December basis). A 2 percentage point cushion on either side of the target is specified, and the central bank will issue explanations should inflation surpass the target. Since the last FOMC meeting, the Brazilian central bank has continued to reduce interest rates, albeit much more slowly than it had earlier this year. The overnight Selic rate, which declined from 45 percent in early March to 21 percent in late June, was lowered to 19.5 percent in late July. The downward "bias" to interest rates was also eliminated, meaning that interest rates will not be changed until the central bank open market committee meets again in September. Senior central bank officials have nonetheless stressed that interest rates could continue to decline over the rest of 1999.

In late July, the IMF Executive Board approved Brazil's third disbursement of $2.3 billion from its $18 billion stand-by. Notably, Brazil met its fiscal performance criterion for the first half of the year, with available data indicating that the primary surplus surpassed the target of 3 percent of GDP. However, about one percentage point of that surplus reflected non-recurring revenues, and continued passage and implementation of reforms are still needed to achieve lasting fiscal stability.

In **Mexico**, the pace of economic growth appears to be accelerating; seasonally-adjusted real GDP grew at a healthy annual rate of 7.7 percent in the second quarter, and industrial production also continued to grow in June. The seasonally-adjusted trade deficit, which had narrowed in recent months due to strong exports, widened again in June to $7.4 billion (AR). The recovery in real activity has not pushed up inflation and the 12-month inflation rate remained at around 17 percent in July.

The new Bank Deposit Insurance Institute (IPAB), created recently to rescue the bank bailout fund, Fobaproa, is up and running. A schedule has been announced for collecting quotas from banks and for the gradual reduction of limits on deposit insurance to $100,000 per account. The audit report resulting from an independent probe into Fobaproa also released its report in late July. It found the cost of the bailout to be higher than previously estimated, and identified $72.7 billion pesos (about $7.7 billion) in loans linked to the bailout as "questionable," but was not prepared to say whether they were illegal or not. The results of the audit were much less detrimental and embarrassing to the ruling party than some observers and opposition leaders had been predicting.

In July, the IMF Executive Board approved a new standby agreement for Mexico. Under the agreement, Mexico will receive $4.1 billion from the IMF, essentially offsetting payments on Mexico's 1995 IMF loan until 2001. In addition, loans of $5.2 billion from the World Bank and $3.5 billion from the Inter-American Development Bank for social programs and infrastructure developments will allow Mexico to ease pressures on public sector funding. These loans, in addition to the $4 billion credit line from the U.S. Export-Import Bank, will cover nearly 80 percent of the public sector's expected external debt service in 2000 and provide about 35 percent of total debt service.

Recently some financial market pressures returned amid general regional concerns about Latin America and market expectations of a U.S. interest rate increase, although they abated somewhat last week. On balance, over the past two months the Mexican stock market has declined about 8 percent, the benchmark 28-day treasury bill (cete) rate has risen by 80 basis points to 20.2 percent, and the Mexican peso is roughly unchanged.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	7.2	2.9	.1	1.3	7.7	...	...
Industrial production	9.3	6.6	- .4	1.2	1.4	0.9	n.a.
Unemployment rate[2]	3.7	3.2	3.0	2.7	2.6	2.6	n.a.
Consumer prices[3]	15.7	18.6	17.6	18.6	17.9	17.4	17.0
Trade balance[4]	.6	-7.7	-7.3	-6.2	-6.2	-7.4	n.a.
Imports[4]	109.8	125.2	128.2	129.3	138.5	141.3	n.a.
Exports[4]	110.4	117.5	120.8	123.1	132.3	134.0	n.a.
Current account[5]	-7.4	-15.8	-18.6	-11.7	n.a.	...	...

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

In **Argentina**, recent economic data indicates that the current recession is deeper than previously believed, and uncertainty surrounding the political elections in October continues to unsettle financial markets. Industrial production was down in July on a seasonally adjusted basis and has declined 12.5 percent over the past twelve months, and the unemployment rate reached 14.5 percent in May. Weakness in exports has been more than matched by a drop off in imports, and Argentina ran a trade surplus in the second quarter–the first surplus since 1997. Falling output and rising unemployment have contributed to a 1.5 percent drop in consumer prices over the 12 months ended July.

The presidential election is two months away, and uncertainty about the economic policies of the candidates is translating into market volatility. In particular, comments by presidential hopeful Eduardo Duhalde pushing for debt relief were largely behind the almost 9 percent drop in the Argentine stock market on July 12. Although recovering slightly upon a retraction by Duhalde, the stock market is down over about 9 percent since the beginning of July; both interest rates and currency futures rates suggest that investors' expected probability of a peso devaluation has increased significantly since early June. Rates are unlikely to come down until the economic stance of the new president becomes clear following the election.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	7.8	-.6	-8.9	-5.8	n.a.	...	...
Industrial production	10.4	1.4	-6.1	-2.2	-1.5	-1.8	-1.7
Unemployment rate[2]	14.9	12.9	12.4	n.a.	14.5	...	...
Consumer prices[3]	.3	.7	.8	-.0	-1.0	-1.3	-1.5
Trade balance[4]	-2.1	-3.2	-1.2	-1.1	1.6	1.4	n.a.
Current account[5]	-12.0	-14.7	-14.8	n.a.	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, NSA. Q4 and Q2 figures are from surveys released in October and May, respectively.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, NSA, annual rate.
n.a. Not available. ... Not applicable.

In **Venezuela**, a weak economy has taken a back seat to politics with the election in July of members to a popular assembly charged with rewriting the constitution by the end of the year. While GDP data on the first quarter may not be released until the end of the year, the Venezuelan Finance department stated that they projected real GDP to fall between 3 and 5 percent in 1999 (annual average change)--well below their earlier forecasts of a 2 to 3 percent decline. Imports and non-oil exports continued to contract sharply as the recession held down imports and the overvalued bolivar cut into exports. The unemployment rate has been steadily rising and hit 16.7 percent in June after averaging 11.2 percent in 1998. On a positive note, the recession is containing inflation--consumer prices rose 23.2 percent over the 12-months ended July after increasing close to 40 percent over the same period a year ago.

On the political front, President Hugo Chavez won a major victory when his supporters captured 90 percent of the seats of the Constitutional assembly. In mid-August, the assembly declared Venezuela in a state of emergency, giving it the power to take action in virtually all areas of public life. So far, the changes outlined in Chavez's proposals for the new constitution have been relatively conservative on the economic front. However, political uncertainty may dampen investor enthusiasm and delay the economic recovery.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	5.5	-8.2	-19.8	n.a.	n.a.	...	...
Unemployment rate[2]	11.7	11.2	11.0	14.0	16.3	16.7	n.a.
Consumer prices[3]	37.6	29.9	31.2	29.1	24.0	23.8	23.2
Non-oil trade balance[4]	-7.5	-8.6	-7.9	-7.4	n.a.	n.a.	n.a.
Trade balance[4]	10.6	3.4	3.1	2.1	n.a.	n.a.	n.a.
Current account[5]	4.7	-1.7	-.9	n.a.	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. NSA. Q1 figure is for March. Q2 figure is May-June average.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, NSA, annual rate.
n.a. Not available. ... Not applicable.

In **Korea**, the pace of the recovery has remained robust. Industrial production increased strongly in both May and June following a dip in April, and, for the second quarter as a whole, rose at a 6 percent annual rate. The capacity utilization rate, which had reached a low of 66 percent last year, moved up further to 80 percent in June, about the level prevailing before the late 1997 financial crisis. The unemployment rate eased further to 6.4 percent in June. Notwithstanding the speed of the recovery, inflation has remained very low, with consumer prices continuing to register a 12-month increase of less than 1 percent in July. With activity recovering strongly, the trade and current account surpluses have continued to shrink. Through the first half of the year, the current surplus was down nearly 40 percent compared with the first half of last year.

Daewoo, Korea's second largest conglomerate (chaebol), experienced a financial crisis in late July that triggered a 10 percent drop in stock prices--a reminder that the process of corporate and financial restructuring remains incomplete, and that the economic recovery could still be derailed by faltering in this regard. A government-arranged rescue package, involving new short-term loans from Daewoo's domestic creditors, defused the immediate threat that Daewoo would default on its commercial paper and bonds. In return for this support, Daewoo promised to implement a restructuring program that would force the conglomerate to sell off all but six auto-related units by end-1999.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	3.7	-5.3	6.0	14.7	n.a.	...	...
Industrial production	5.3	-7.3	10.0	6.8	1.5	5.0	n.a.
Consumer prices[2]	6.6	4.0	6.0	.7	.6	.6	.3
Trade balance[3]	-3.2	41.2	35.8	33.0	27.7	28.8	n.a.
Current account[4]	-8.2	40.0	34.7	27.1	25.8	29.5	n.a.

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

Recent developments in the ASEAN countries indicate that economic activity in the region has bottomed out, and a recovery in output has begun. Indonesian GDP retreated slightly in the second quarter, possibly as a result of disruptions caused by the June parliamentary elections, after very rapid growth in the first quarter. In Singapore, second-quarter GDP growth was remarkably strong. A rebound in the global electronics market fueled rapid growth in industrial production in Malaysia, Singapore and Thailand, while industrial production ceased its decline and began to grow moderately in the Philippines.

Notwithstanding increasing export values across the region, trade surpluses have begun to narrow since late last year as import growth has resumed. Malaysia and Thailand recorded double-digit seasonally adjusted, month-on-month increases in June imports. Indonesian exports and imports fell in June, but this may have been due to uncertainty associated with that month's elections.

ASEAN financial markets have retreated partially from the surge earlier this year for a variety of reasons. In Malaysia, some of the sell-off may be related to preparation by foreign investors to repatriate funds on September 1 as the one-year holding period mandated by last year's imposition of capital controls comes to an end. The currencies of the Philippines and Thailand have weakened recently on fears of a devaluation of the renminbi early next year. The Indonesian rupiah has plunged more than ten percent since end-June, hurt in part by negative market sentiment regarding possible malfeasance on the part of the

Indonesian Bank Restructuring Agency in its handling of the assets of Bank Bali, a nationalized bank due to be sold to Standard Chartered Bank of the United Kingdom. Soft domestic demand continues to dampen inflation across the region.

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

Indicator and country	1997	1998	1998	1999			
			Q4	Q1	Q2	May	June
Real GDP[1]							
Indonesia	2.3	-19.6	-.0	25.2	-2.2	...	...
Malaysia	5.7	-10.3	.8	12.3	n.a.	...	...
Philippines	5.0	-1.8	-1.6	3.9	n.a.	...	...
Singapore	8.1	-1.1	1.8	5.0	22.7	...	...
Thailand	-4.9	-5.4	14.0	6.7	n.a.	...	...
Industrial production							
Indonesia	13.2	-12.8	5.6	5.9	-1.5	...	...
Malaysia	10.7	-7.2	2.5	1.8	4.9	-1.5	4.0
Philippines	5.1	-11.3	-3.5	6.3	n.a.	1.0	n.a.
Singapore	4.7	-.4	2.5	6.0	6.0	6.9	5.5
Thailand	-.5	-10.0	2.8	2.0	3.5	-.6	1.4

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

The government of Malaysia announced that it expects the country's 21 domestic banks, 25 finance companies and 12 merchant banks to merge into six financial groups by end-September 1999. Finance Minister Daim insisted that the health of the banking sector is the sole reason for this enforced consolidation, but many observers note that all financial firms associated with the deposed Finance Minister Anwar Ibrahim are expected to disappear under this scheme, and banks headed by persons close to Prime Minister Mahathir Mohamad will act as the consolidators. The Thailand cabinet approved a new investment stimulus program that includes funds to aid businesses in investment and debt restructuring, subsidized mortgages for middle-to-low income households, tax breaks for businesses and tariffs reductions on imports of materials and capital goods. In Indonesia, parliamentary election results were finally ratified. Megawati Sukarnoputri's reformist PDI-P won 34 percent of the popular vote and B. J. Habbibi's ruling Golkar party received 20 percent of the vote. The allocation of seats is still to be decided, and the election of a new president by a supplemented parliament is scheduled to take place in November.

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

Country	1997	1998	1998	1999			
			Q4	Q1	Q2	May	June
Indonesia	11.9	21.5	15.5	18.3	22.8	24.9	21.6
Malaysia	-.1	14.9	19.3	19.4	18.7	19.7	16.2
Philippines	-10.5	-.2	2.7	2.6	n.a.	3.4	n.a.
Singapore	-7.4	8.3	9.5	6.7	2.8	1.9	4.0
Thailand	-4.6	12.2	11.3	11.1	11.1	13.1	6.0

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

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

Country	1997[1]	1998[1]	1998	1999				
			Q4	Q1	Q2	May	June	July
Indonesia	10.3	77.6	78.4	56.0	30.9	30.7	24.5	13.5
Malaysia	2.9	5.3	5.4	4.0	2.6	2.9	2.1	2.5
Philippines	6.6	10.4	10.6	10.1	6.8	6.7	5.8	5.7
Singapore	2.0	-1.5	-1.6	-.6	.1	.1	.5	n.a.
Thailand	7.6	4.3	5.0	2.7	-.4	-.5	-1.2	-1.1

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

Hong Kong's economy remains weak with consumer prices continuing to fall sharply, although some signs of a pickup in economic activity have recently emerged. The unemployment rate fell to 6 percent in the May-July period, down from a peak of 6.3 percent in the March-May period. The merchandise trade deficit widened in June from May, largely due to a rebound in imports which outpaced improving exports. Spreads between one-year Hong Kong government debt and U.S. Treasuries were around 73 basis points on August 18, roughly unchanged since mid-May, but nevertheless down sharply from their levels of nearly 280 basis points in January.

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

Indicator	1997	1998	1998 Q4	1999 Q1	1999 Q2	1999 May	1999 June
Real GDP[1]	2.8	-5.7	-1.4	-2.8	n.a.	...	...
Consumer prices[2]	5.2	-1.6	-.8	-1.8	-4.0	-4.0	-4.1
Trade balance[3]	-20.6	-10.6	-4.5	-2.5	-4.6	-3.6	-6.5

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

In **China**, rumors of a possible devaluation of the renminbi have resurfaced as recent data confirm that economic activity is slowing sharply. In the second quarter, seasonally adjusted real GDP was almost flat. Moderate deflation continues, reflecting weak private demand. Despite growing exports, China's trade surplus narrowed sharply in the first half of 1999, although it widened again in July. The growth in exports reflects an improvement in other Asian economies and the impact of government measures to expand exports. Imports, which had soared earlier in the year largely as a result of a successful anti-smuggling campaign, appear to have stabilized.

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

Indicator	1997	1998	1998 Q4	1999 Q1	1999 Q2	1999 June	1999 July
Real GDP[1]	8.2	9.5	13.8	2.2	1.1	...	...
Industrial production[2]	11.7	7.8	9.6	12.5	8.5	8.7	n.a.
Consumer prices[2]	.4	-1.0	-1.1	-1.4	-2.2	-2.1	-1.4
Trade balance[3]	40.4	43.6	35.1	19.4	13.1	5.6	36.0

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

Standard & Poor lowered the long-term foreign currency sovereign and senior unsecured ratings for China to BBB from BBB-plus and the short-term foreign currency credit rating to A-3 from A-2. The agency said that the downgrade reflected "lower trend growth prospects and rising fiscal costs of economic reform."

In **Taiwan**, the economy continues to strengthen with industrial production growing strongly in the second quarter. The unemployment rate was 2.9 percent in June, roughly unchanged from the beginning of the year. Deflation resumed in June with consumer prices falling from their year-earlier level, after a slight rise in prices in May. Taiwan's trade surplus narrowed sharply in June and July, albeit from elevated levels, as soaring imports managed to outpace rapidly growing exports. Taiwan's foreign exchange reserves rose to US$99 billion at the end of July, the highest level since July 1995. Stock prices in Taiwan have fallen sharply since mid-July, reflecting heightened political tensions between China and Taiwan.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	7.1	3.7	3.9	4.5	n.a.	...	...
Industrial production	7.4	3.7	-.3	1.6	5.0	4.0	n.a.
Consumer prices[2]	.3	2.1	2.9	.7	-.1	-.8	n.a.
Trade balance[3]	7.5	5.8	.7	14.2	18.3	13.1	6.1
Current account[4]	7.7	3.4	2.0	8.4	n.a.	...	...

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

Russia is far from being in good economic shape by any international standard, but the recent agreement on a modified IMF program and above-average second-quarter economic performance provide some grounds for limited optimism.

Second-quarter economic activity outperformed all expectations: industrial production rose above pre-crisis levels, higher tax revenues and rising world oil prices pushed the primary budget balance into surplus, the labor market has stabilized, and consumer price index inflation declined to a low of 1.9 percent (month-on-month) in June.

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

Indicator	1997	1998	1998	1999			
			Q4	Q1	Q2	June	July
Real GDP[1]	2.6	-9.0	-.9	5.7	n.a.	...	...
Industrial production	1.7	-5.1	2.9	10.4	4.2	1.8	n.a.
Unemployment rate[2]	10.8	11.5	11.7	13.0	14.1	14.1	n.a.
Consumer prices[3]	11.0	84.4	70.0	102.8	116.8	120.6	126.6
Ruble depreciation[4]	6.8	71.3	23.9	16.2	-2.8	-1.8	.0
Trade balance[5]	14.7	14.2	34.2	27.3	n.a.	n.a.	n.a.
Current account[6]	4.0	2.4	26.6	n.a.	n.a.	n.a.	n.a.

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

On July 28, the IMF approved the release of $4.5 billion to Russia to be disbursed in seven $640 million loan installments. The approved funds are to be used exclusively for financing repayments of previous IMF loans, thereby keeping Russia current with the IMF and avoiding a further deterioration of its international financial relations. Immediately after the approval, Paris Club country creditors agreed to reschedule $8 billion in Soviet-era bilateral debt due this year and next, to be repaid over the next 15-20 years.

President Yelstin fired yet another cabinet on August 9, replacing Prime Minister Sergei Stepashin with Vladimir Putin, the head of the Federal Security Agency. Since it is highly probable that current Finance Minister Mikhail Kasyanov and his financial team will be retained, the economic consequences of the cabinet shuffle are unlikely to be serious. Potential financial repercussions include possible delays in negotiations with London Club commercial creditors and delays in future World Bank loans as required legislative reforms in the Duma are further sidetracked by the process of confirming Putin as Prime Minister.