Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

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

November 8, 2000

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

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Domestic Nonfinancial Developments

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Overview

The growth of economic activity has cooled from the extraordinary pace of the first half of the year. Private employment has been increasing more slowly in recent months, and hours worked have changed little. The expansion in the manufacturing sector has decelerated sharply, reflecting slower production in the high-tech industries and small, but widespread, declines elsewhere. The moderation in demand has been most apparent in residential construction and in outlays for equipment and software, while the rise in consumer spending remains relatively solid. The inflation picture has not changed much since the last Greenbook: Increases in hourly compensation continue to move up, and although large productivity gains are still offsetting most of the rise in hourly pay, core inflation appears to be moving gradually higher.

Real GDP

According to the BEA's advance estimate, real GDP increased at an annual rate of 2.7 percent in the third quarter. More recent source data suggest that the BEA will nudge that figure down a touch, to 2.6 percent. Downward revisions

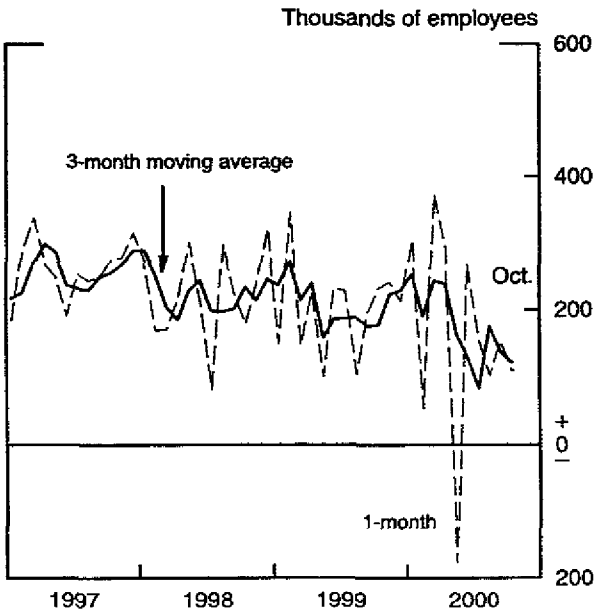
Real GDP and Selected Components

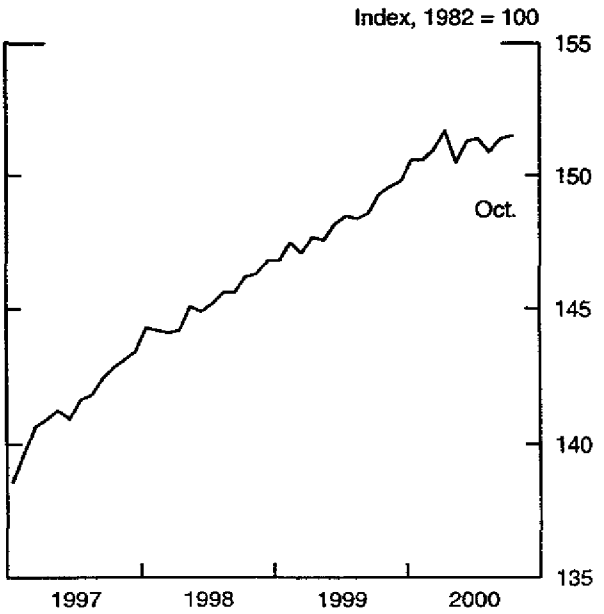
Component	2000:Q2	2000:Q3	
		BEA advance	Greenbook
	Percent change, annual rate		
Real GDP	**5.6**	**2.7**	**2.6**
Final sales	3.9	2.7	3.1
Private domestic final purchases	4.7	4.2	4.2
Consumption	3.1	4.5	4.5
Business fixed investment	14.6	6.9	7.4
Equipment and software	17.9	8.5	6.7
Nonresidential structures	4.4	1.7	9.5
Residential investment	1.3	-9.2	-9.7
Federal government	17.2	-10.1	-10.1
State and local government	-1.1	.0	2.5
	Level, billions of chained (1996) dollars		
Inventory investment	78.6	79.9	66.6
Net exports	-403.4	-410.8	-409.5

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

	1999	2000 H1	2000 Q3	2000 Sept.	2000 Oct.
	-Average monthly change-				
Nonfarm payroll employment[1]	229	268	25	195	137
Previous	*229*	*268*	*40*	*252*	
Private	202	186	134	230	117
Strike-adjusted Private	201	186	137	153	110
Mining	-3	2	0	2	4
Manufacturing	-18	2	-40	-59	-9
Construction	25	19	13	33	34
Transportation and utilities	15	12	16	6	23
Retail trade	36	31	16	-21	4
Wholesale trade	13	8	7	7	15
Finance, insurance, real estate	10	-4	10	9	20
Services	124	116	115	176	18
Total government	28	82	-109	-35	20
Census		78	-150	-11	-15
Total employment[2]	159	127	-6	249	261
Nonagricultural	155	120	-12	252	367
Memo:					
Aggregate hours of private production workers (percent change)[1,3]	2.1	2.2	0.2	0.3	0.1
Average workweek (hours)[1]	34.5	34.5	34.4	34.4	34.3
Manufacturing (hours)	41.7	41.7	41.4	41.2	41.3

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 changes from Q4 to Q4. Semi-annual data are percent changes from 1999:Q4 to 2000:Q2 at an annual rate. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.





to the estimates of business outlays for equipment and software and the change in business inventories slightly more than offset upward revisions to investment in nonresidential structures and to construction activity by state and local governments. The recent source data and their implications for real GDP are discussed in more detail later in the text.[1]

Labor Market Developments

Growth in labor demand has stepped down appreciably since midyear, but despite the slowdown, there has been no easing of the tightness in the labor market. The unemployment rate has fluctuated narrowly around 4 percent over the past year, with the last two monthly readings at 3.9 percent.

In October, strike-adjusted private nonfarm payrolls rose 110,000, following a downward-revised gain of 153,000 in September.[2] Since June, private nonfarm employment growth has averaged 130,000 per month, down from the first-half pace of 186,000.[3] The slowdown in employment growth has been concentrated in the manufacturing, retail trade, and help-supply services industries. Higher energy prices and a rising dollar have hit the manufacturing sector in recent months, and after posting a small increase in the first half, factory payrolls declined 33,000 per month on average between June and October. Help-supply services employment declined 6,000 per month, on average, between June and October after having risen 14,000 per month in the first half of the year. Hiring in retail trade has moderated to a rate of around 15,000 per month since midyear, about half the pace seen in the first half.

In contrast, employment in the services industries--excluding help-supply--has slowed little. And, because construction activity has remained at a high level into early autumn, when seasonal cutbacks typically occur, increases in construction jobs have been strong on a seasonally adjusted basis in recent months. Similarly, employment in the real estate industry has risen for three consecutive months, following a weak spring and early summer.

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1. Unless otherwise indicated, all references to third-quarter GDP and its components are based on staff estimates that take account of data received since the BEA's advance report.

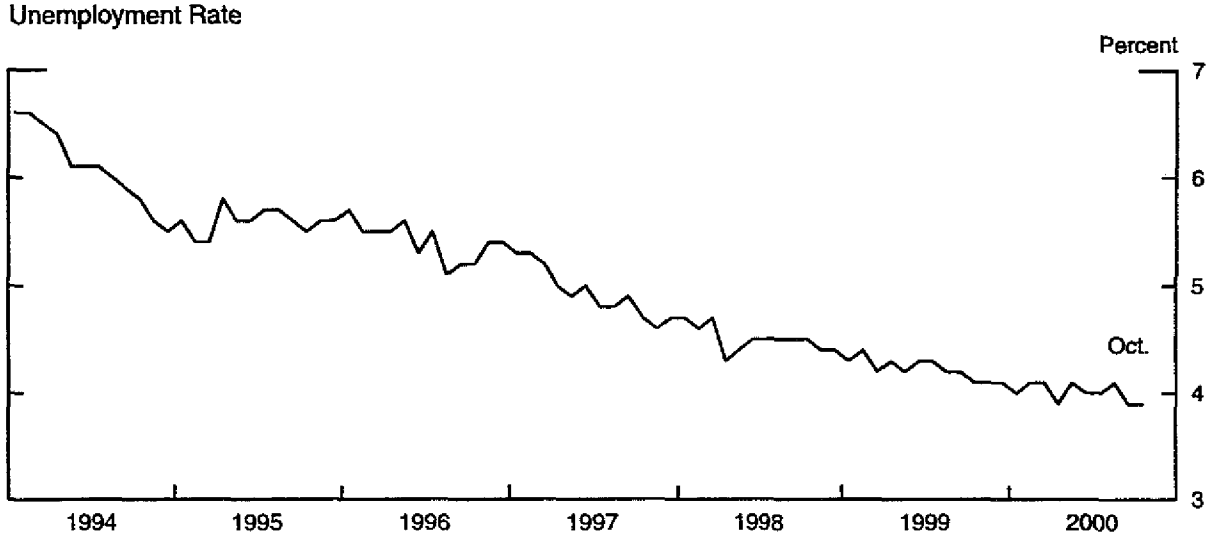
2. The strike at Verizon Communications lopped about 85,000 off of employment in August and boosted payroll growth in September by the same amount.

3. The BLS commissioner announced the preliminary estimate for the March 2000 benchmark revision. Based primarily on unemployment insurance records, which cover nearly all employers, the BLS estimates that the benchmark will raise the level of payroll employment by 392,000 in March 2000. The 0.3 percent anticipated revision is in line with the average absolute revision over the past decade. The BLS will fold in the results of the annual benchmarking to the payroll survey data with the June 2001 employment report by increasing employment growth about equally in each month from April 1999 to March 2000.

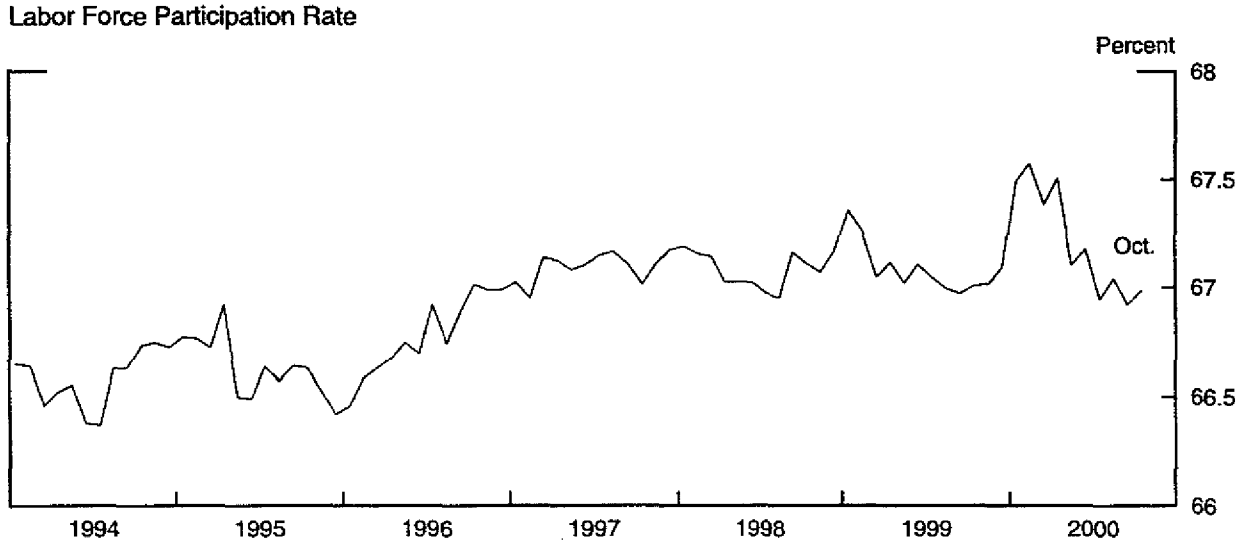
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

	1999	2000			
		H1	Q3	Sept.	Oct.
Civilian unemployment rate (16 years and older)	4.2	4.0	4.0	3.9	3.9
Teenagers	13.9	12.8	13.5	12.8	12.6
20-24 years old	7.5	7.6	6.5	6.4	6.8
Men, 25 years and older	3.0	2.8	2.8	2.8	2.9
Women, 25 years and older	3.3	3.2	3.3	3.2	3.0
Labor force participation rate	67.1	67.4	67.0	66.9	67.0
Teenagers	52.0	52.3	51.9	51.6	52.1
20-24 years old	77.6	78.2	77.4	78.1	78.7
Men, 25 years and older	76.1	76.1	75.9	75.8	75.7
Women, 25 years and older	59.5	60.0	59.4	59.3	59.3
Memo:					
Potential worker rate	7.1	6.7	6.7	6.6	6.7

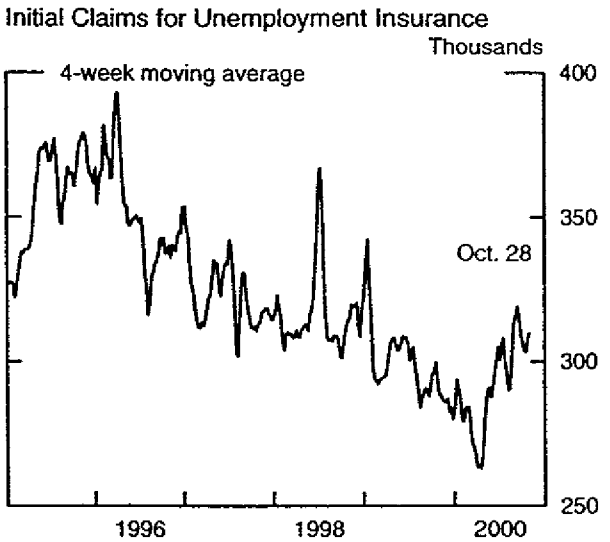
Unemployment Rate

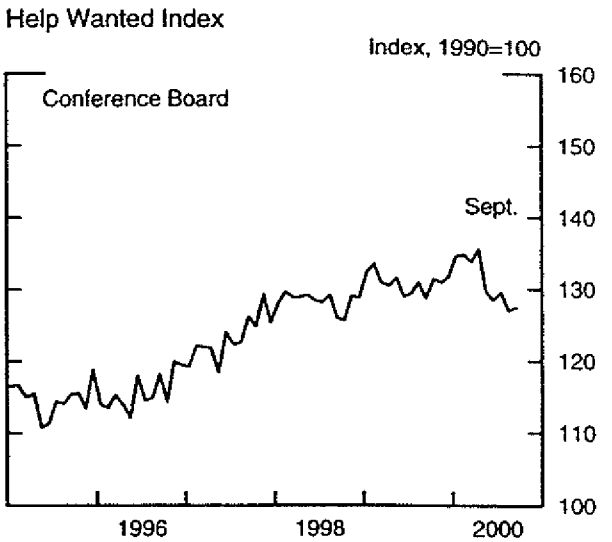


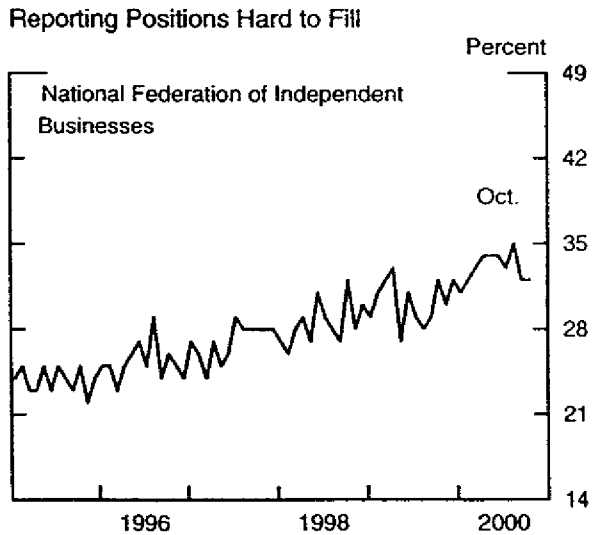
Labor Force Participation Rate

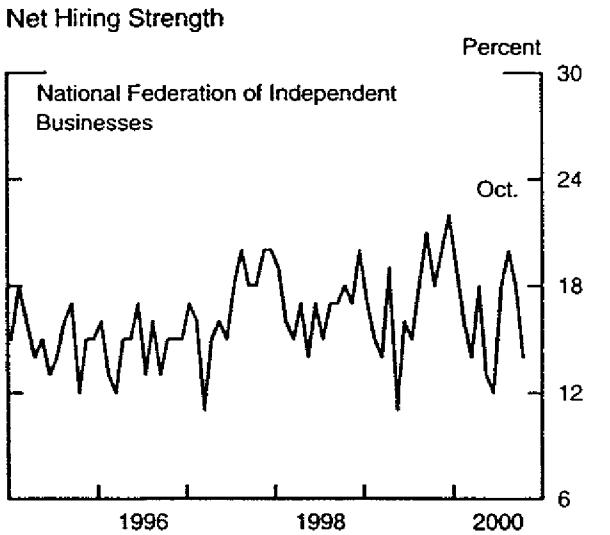


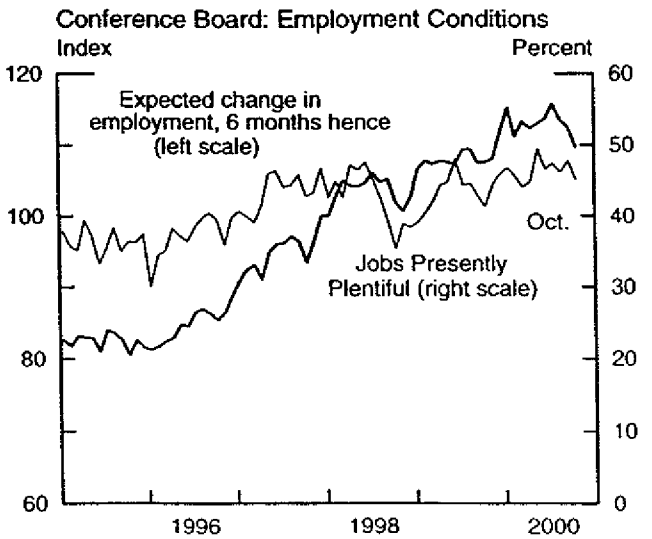
Labor Market Indicators

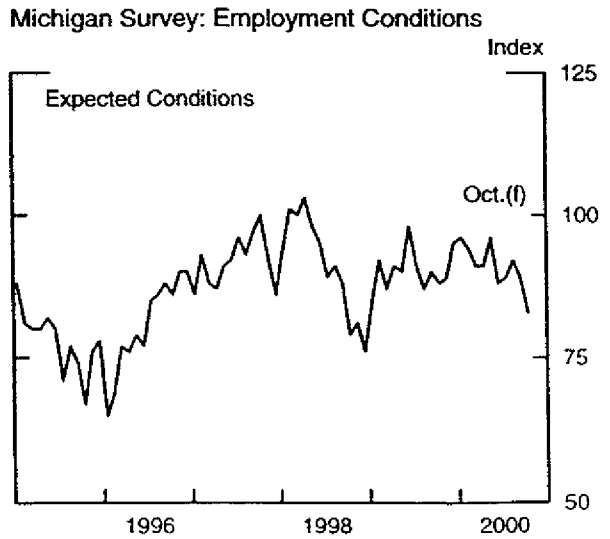












Note. Expected conditions index is the proportion of households expecting unemployment to fall, minus the proportion expecting unemployment to rise, plus 100.

Poor earnings results and reports of layoffs at dot.com firms have fueled concerns that labor demand in the high-technology sector of the economy is dropping off. However, there is as of yet no hard evidence of a slowdown in the employment figures for the high-technology sector more broadly defined. Unpublished BLS tabulations show employment growth in high-technology intensive industries picking up slightly in the second half.[4] Moreover, while the outplacement firm of Challenger, Gray, and Christmas reported that layoffs among dot.com firms topped 5,500 in October, laid-off workers are said to have had little difficulty in finding new jobs elsewhere in the sector.

The average workweek of production or nonsupervisory workers on private nonfarm payrolls has moved down on net in recent months to 34.3 hours in October. The shorter workweek coupled with the moderation in employment growth has kept aggregate hours essentially flat since the spring.

In the household survey, employment rose 261,000 in October following a similar-size increase in September, and the labor force participation rate held at 67.0 percent. Since midyear, household employment has grown at about the same rate as total nonfarm payroll employment. In aggregate, the unemployment rate remained at its thirty-year low, with significant changes in the rates among major demographic groups.

Most other indicators of labor market activity reinforce the picture of slower labor demand: Initial claims for unemployment insurance have continued to run at a higher level in recent weeks than we had seen in the first quarter; likewise, employers have been posting fewer vacancies in the past few months, pushing the help-wanted index well off its recent highs. In addition, the National Federation of Independent Businesses reported that the percentage of firms planning to expand employment declined from August to October. Respondents to the Michigan and Conference Board consumer surveys have been less optimistic about job prospects in the next six to twelve months.

Productivity remains on a strong upward trend. The advance estimate showed that output per hour of all persons in the nonfarm business sector rose at an annual rate of 3.8 percent in the third quarter after posting a 6.1 percent rate of

4. High-technology industries include computer and data processing services, research, development, and testing services, and the following manufacturing industries: industrial chemicals, drugs, computer and office equipment, communications equipment, electronic components and accessories, aerospace, search and navigation equipment, and measuring and controlling devices.

increase in the second quarter.[5] The incoming data on output and hours suggest that growth of output per hour will be revised down a bit to an annual rate of 3.7 percent. Over the four quarters ended in 2000:Q3, productivity increased about 5 percent, up from the 3 percent rise over the previous four quarters.

Labor Output per Hour
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Sector	1998[1]	1999[1]	1999	2000		
			Q4	Q1	Q2	Q3
Nonfarm business	2.9	4.1	8.0	1.9	6.1	3.7[2]
Nonfinancial corporations[3]	3.8	4.8	6.1	2.9	5.4	n.a.

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

Industrial Production

Industrial production increased at an annual rate of 2-3/4 percent in the third quarter, less than half the rate of expansion in the first half of this year. The factory operating rate edged down in September to 81.2 percent, still close to its long-term average; it has fallen almost half a percentage point since June.

The slowdown in the manufacturing sector has been widespread. The production of construction supplies, industrial materials, and general business supplies all fell sharply last quarter. A lower level of housing starts reduced demand for wood and masonry products, while rising energy costs and intensified import competition pressured the paper and steel industries. Inventory-sales ratios at manufacturers and wholesalers in these industries have moved up--most notably at steel service centers. Elsewhere, the production of consumer durable goods excluding motor vehicles, computers, and communications equipment fell faster in the third quarter than in the second, and

5. Our estimate of third-quarter productivity growth reflects a 2.9 percent increase in output and a 0.8 percent decrease in hours of all persons. According to more detailed unpublished data, hours of employees in the nonfarm business sector declined 0.3 percent last quarter--primarily reflecting the weakness in manufacturing--and hours of self-employed and unpaid family workers fell 5 percent.

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

	Proportion 1999	1999[1]	2000 H1[1]	2000 Q3	2000 July	2000 Aug.	2000 Sept.
			-Annual rate-		--Monthly rate---		
'otal	100.0	4.2	7.3	2.8	-.2	.4	.2
Manufacturing	88.5	4.8	7.4	3.2	.0	.2	.3
Ex. motor vehicles and parts	83.1	4.8	7.6	4.9	.6	-.2	.5
Mining	5.2	-.9	5.4	1.1	-.1	.0	-1.0
Utilities	6.3	.2	7.8	-.7	-3.7	3.6	.7
elected industries:							
High technology	9.5	37.4	65.2	48.4	3.9	2.3	2.5
Computers	3.1	51.1	44.5	38.1	2.7	2.7	2.7
Communication equipment	2.5	13.6	30.9	30.5	4.9	1.5	.9
Semiconductors[2]	4.0	44.3	108.4	67.0	4.3	2.5	3.5
Motor vehicles and parts	5.4	4.0	4.3	-20.1	-8.9	6.5	-2.3
Aircraft and parts	2.6	-16.6	-9.5	11.5	2.6	-1.5	-.7
Oil and gas extraction	3.5	.2	6.4	5.4	.6	.2	-1.0
arket groups, excluding selected industries and other energy:							
Consumer goods	22.7	1.5	.2	2.5	.6	-.6	.8
Durables	3.6	6.2	-.3	-6.3	.0	-2.9	2.0
Nondurables	19.1	.7	.3	4.1	.7	-.1	.6
Business equipment	8.6	-.3	6.6	1.9	.1	.2	-.1
Construction supplies	6.2	3.2	4.4	-4.8	.1	-1.1	.3
Materials	24.0	3.4	.7	-3.6	-.6	-.5	-.1
Durables	16.3	2.3	2.4	-1.4	.0	-.6	-.2
Nondurables	7.7	6.1	-2.9	-8.4	-2.0	-.2	.0

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

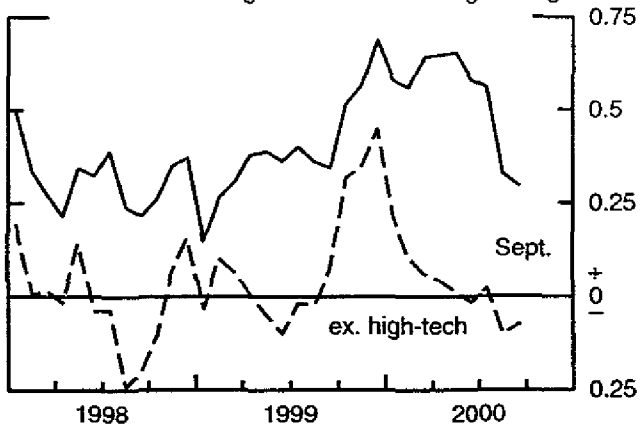
CAPACITY UTILIZATION
(Percent of capacity)

	1988-89 High	1959-99 Avg.	2000 H1	2000 Q3	2000 July	2000 Aug.	2000 Sept.
Manufacturing	85.7	81.6	81.1	81.3	81.3	81.3	81.2
Primary processing	88.9	82.9	83.6	82.1	82.4	81.9	81.9
Advanced processing	84.2	81.1	80.4	81.2	81.1	81.2	81.2

Industrial Output and Related Indicators

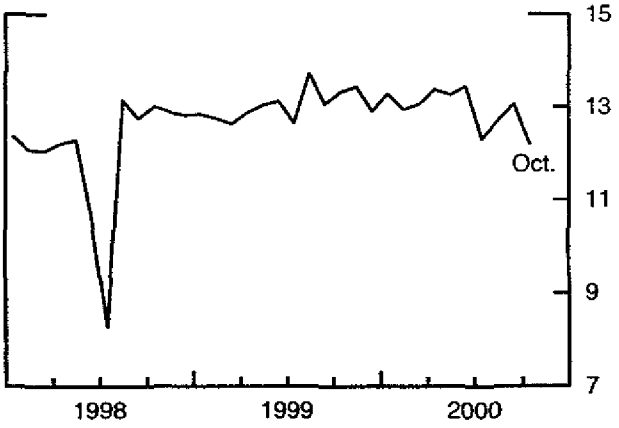
Manufacturing IP Ex. Motor Vehicles and Parts

Percent change of 3-month moving average



Motor Vehicle Assemblies

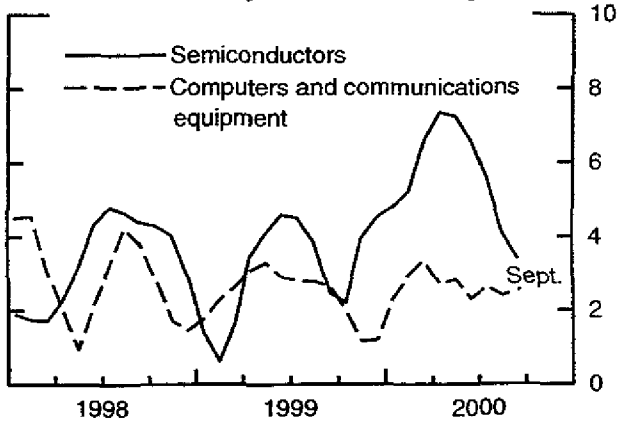
Millions of units



Note. Staff estimate for October.

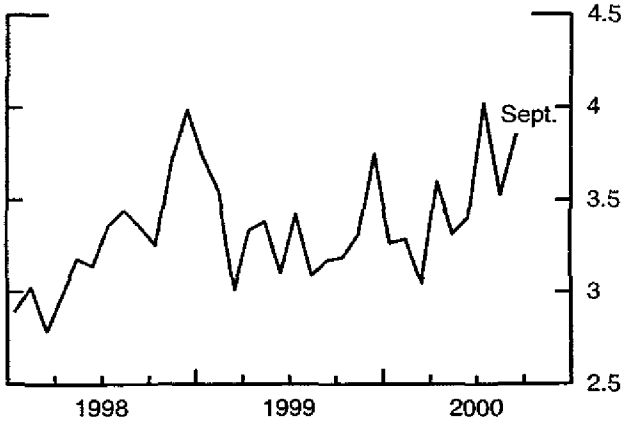
High-Tech Industries IP

Percent change of 3-month moving average



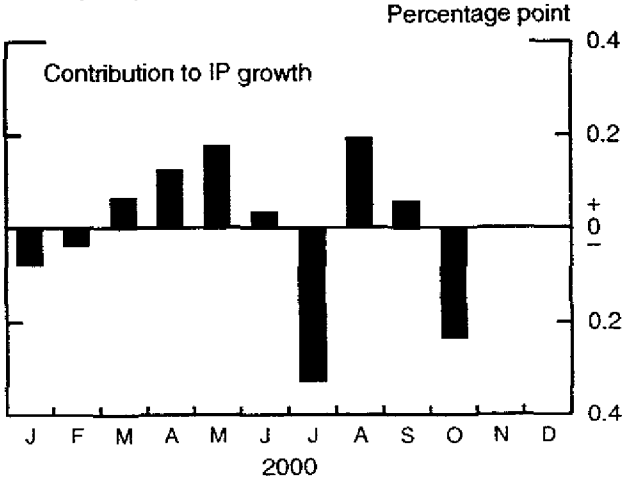
Inventories to Shipments at Steel Service Centers

Months



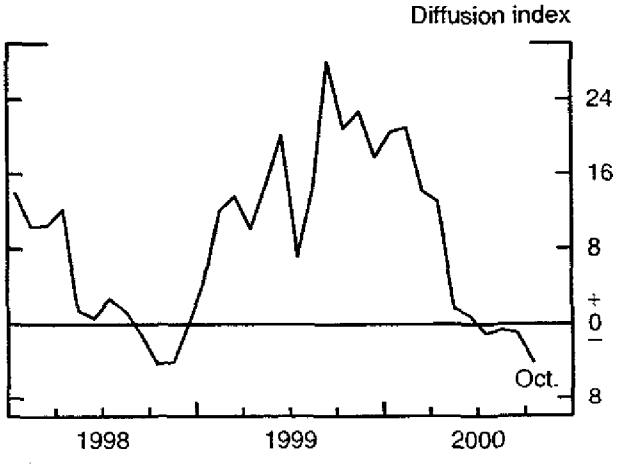
Weekly Physical Product Data Ex. Motor Vehicles

Percentage point



NAPM New Orders

Diffusion index

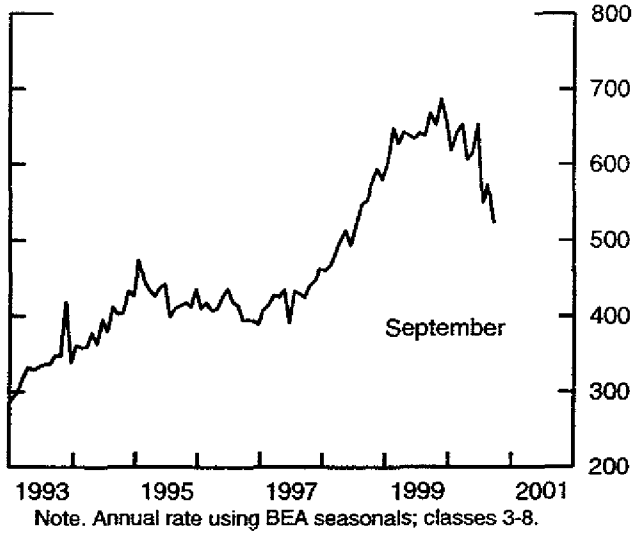


Medium and Heavy Trucks

(Seasonally adjusted)

Medium and Heavy Truck Sales

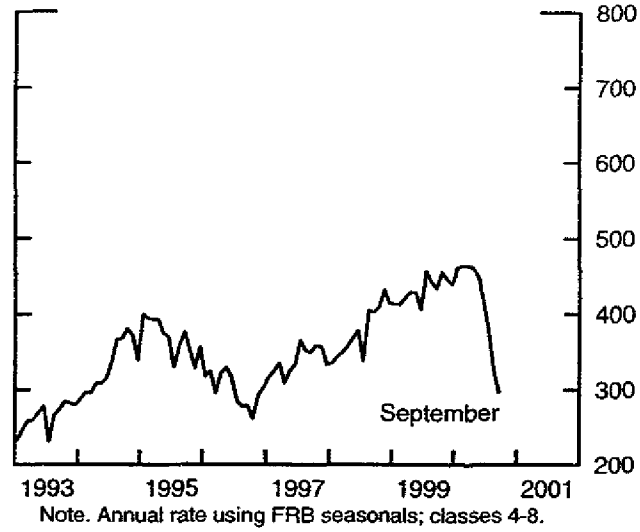
Thousands of units, annual rate



Note. Annual rate using BEA seasonals; classes 3-8.

Medium and Heavy Truck Production

Thousands of units, annual rate



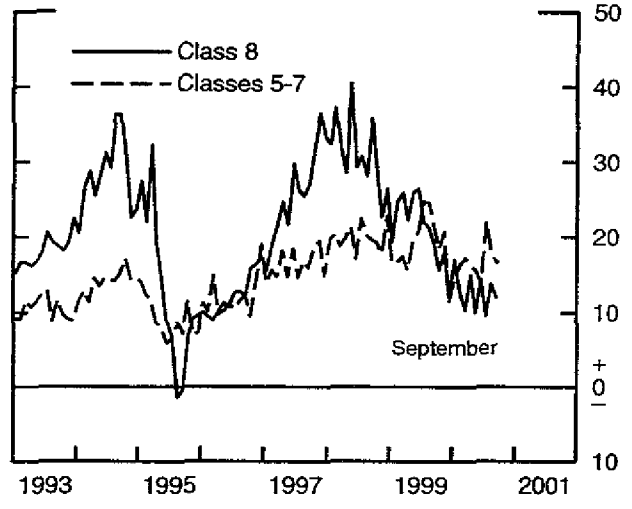
Note. Annual rate using FRB seasonals; classes 4-8.

Days' Supply of Medium and Heavy Trucks

Note. Classes 4-8.

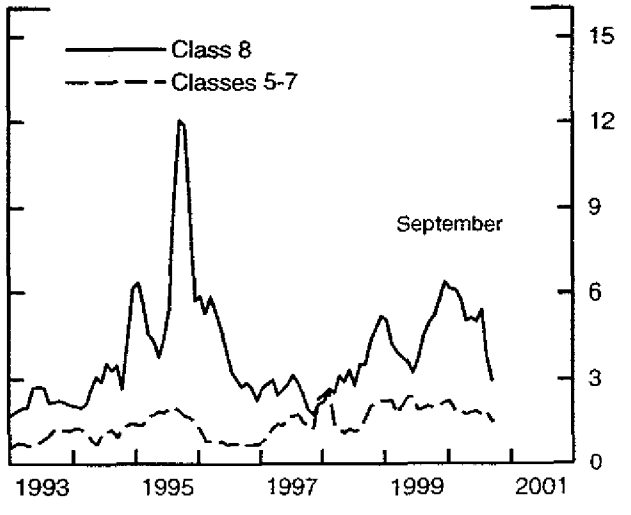
New Net Orders

Thousands of units



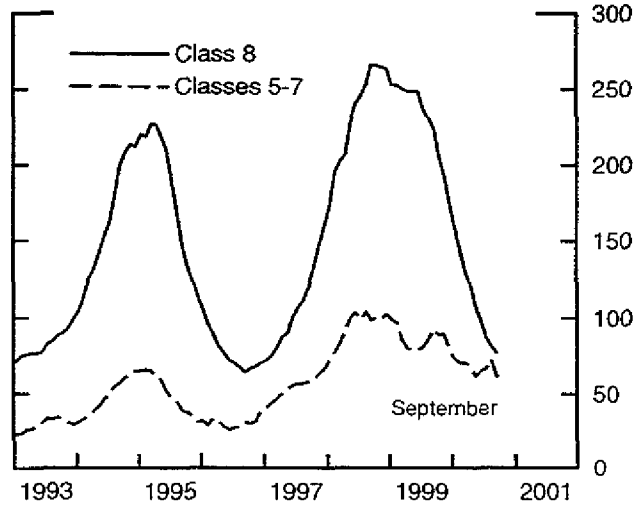
Cancellations

Thousands of units, 3-month moving average



Backlogs

Thousands of units



the output of business equipment excluding high-tech goods and motor vehicles and parts also decelerated.

Although growth in production of high-tech equipment and parts remains quite strong, the gains last quarter were not as large as those earlier in the year. This moderation accounted for almost half of the quarterly deceleration in total IP. Growth in semiconductor output, which had soared at an annual rate of 109 percent in the first half of the year, slowed to 67 percent in the third quarter. We continue to believe that the first-half burst in production was a response to a temporary surge in demand for chips. During that time, equipment production took off with the lifting of Y2K-related lockdowns, and some manufacturers sought to stockpile chips in response to lengthening order lead-times and shortages. Media reports indicate that fears of shortages have since eased and that some equipment makers are now working off their stocks. Consistent with these reports, spot prices for DRAM chips fell faster in October than some analysts had expected.

Motor vehicle output, which increased at an annual rate of 4-1/2 percent in the first half of this year, fell 20 percent in the third quarter (annual rate). Although production slowed in all major segments of the industry, the decline in assemblies of medium and heavy trucks was particularly striking. The demand for new trucks has weakened precipitously, and third-quarter sales were down about 17 percent from the peak in the fourth quarter of 1999. Moreover, orders backlogs for heavy trucks have plunged in recent months. Industry contacts attribute the slump in demand to several factors, including higher operating costs (especially fuel costs), declines in truck freight, and an excess supply of late-model used trucks.

Looking ahead to the fourth quarter, available source data suggest that IP was little changed in October. Weekly data indicate that motor vehicle assemblies dropped 900,000 units (annual rate) last month, directly shaving 0.2 percentage point from the change in total IP. Other industries for which we have weekly physical product data also contracted in October, reducing IP another 0.2 percentage point; significant decreases occurred in electricity generation and steel and appliance production. Offsetting those declines, industries for which we have no weekly physical product data appear to have contributed about a half percentage point increase to the production index; the production estimate for these industries is based on flat October production worker hours and our assumptions about productivity trends.

Fourth-quarter auto and truck assembly schedules are at 12.6 million units (annual rate), which implies a noticeable pickup from the October level. But the days' supply of light trucks is high, and the companies are putting off the highest production to December, raising suspicions that actual production may fall below schedules. Moreover, both GM and Chrysler announced one-week

shutdowns at several plants in late October and November in order to reduce inventories. It does not appear that the latest schedules reflect the effects of these closings, which are expected to cut this month's assemblies nearly 0.3 million units at an annual rate.

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

Item	2000						
	Q2	Q3	Q4[1]	Sept	Oct[1]	Nov[1]	Dec[1]
U.S. production	13.4	12.7	12.6	13.1	12.2	12.4	13.1
Autos	5.8	5.7	5.3	5.8	5.2	5.2	5.5
Trucks	7.6	7.0	7.2	7.2	7.0	7.2	7.6
Days' supply[2]							
Autos	53.1	55.8	n.a.	55.8	58.2[4]	n.a.	n.a.
Light trucks[3]	76.4	74.9	n.a.	72.2	78.7[4]	n.a.	n.a.

Note. Components may not sum to totals because of rounding.
1. Production rates reflect actual September data, staff estimates based on weekly data for October, and manufacturers' schedules for November and December.
2. Quarterly average calculated using end-of-period stocks and average reported sales.
3. Excludes medium and heavy (classes 3-8) trucks.
4. Staff estimate.
n.a. Not available.

Other indicators of activity in the industrial sector are showing some weakness. Real adjusted new orders for durable goods (Census M3 data) rose in both August and September, but not enough to offset a large July decline. Outside of high-tech equipment and electronic components, real adjusted new orders have declined, on balance, for the last two quarters, and they posted a significant decrease in September. Purchasing managers indicated that new orders fell again in October and that new export orders fell for the first time since January 1999. Other components of the purchasing managers' index also have deteriorated from earlier in the year.

Consumer Spending and Income

Real consumer spending increased at an annual rate of 4-1/2 percent in the third quarter after having risen at a 3 percent pace in the second quarter. Expenditures picked up for the major components of goods, though the largest single contribution came from a bounceback in the pace of motor vehicle purchases, which had fallen off significantly in the second quarter from the very high pace of early this year. Outlays on services rose at an annual rate

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

Component	Share, 2000:H1	2000				
		H1[1]	Q3	July	Aug.	Sept.
Total orders	**100.0**	**3.5**	**-3.2**	**-13.2**	**2.9**	**3.0**
Adjusted orders[2]	70.0	3.3	-1.1	-4.9	1.6	2.0
Computers	6.0	7.8	5.7	8.8	4.7	-10.7
Communication equipment	5.0	4.6	-5.6	-23.1	-2.4	23.2
Other capital goods	14.0	5.0	-.1	-.9	-3.9	1.1
Other[3]	45.0	2.2	-1.9	-5.6	3.2	2.1
Memo:						
Real adjusted orders	. . .	4.0	-.3	-4.7	2.0	2.0
Excluding high tech	. . .	1.4	.0	.0	.0	-1.3

1. Quarterly rate.
2. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
3. Includes primary metals, most fabricated metals, most stone, clay, and glass products, electronic components, household appliances, scientific instruments, and miscellaneous durable goods.
. . . Not applicable.

of 3-3/4 percent in the third quarter, down from a 4-1/2 percent rise in the second quarter; a sharp deceleration in energy expenditures accounted for the slowing.

In October, light vehicle sales fell to an annual rate of 16.7 million units, down 400,000 units (2 percent) from the second-quarter average. Owing to an extra boost to marketing incentives, GM was one of the few automakers to post higher sales; most firms, including Ford, Chrysler, and the major Japanese firms, saw moderate sales declines. Based on confidential data on fleet and retail sales, we estimate that lower retail sales accounted for about two-thirds of the total decline in October light vehicle sales. Fourth-quarter incentives remain generous by historical standards, albeit less so than in the third quarter; automakers expect that sales in the last two months of the year will hold close to October's pace.

Current-quarter indicators for personal consumption expenditures outside of motor vehicles are limited. The Bank of Tokyo-Mitsubishi's chain store sales index--which we have found to have some predictive content for the Census Bureau's data on retail sales--dropped 2-1/2 percent last month. In addition, recent weather conditions seem to point to a small decrease in outlays on electricity and natural gas in October. By contrast, physical product data from the Department of Energy indicate a sizable increase in real purchases of gasoline in October. In addition, the volatility of equity prices last month

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

	1999	2000 Q1	2000 Q2	2000 Q3	2000 July	2000 Aug.	2000 Sept.
	Q4/Q4	----- Annual rate -----			---- Monthly rate ----		
PCE	5.6	7.6	3.1	4.5	.4	.5	.4
Durables	11.1	23.6	-5.0	7.5	.8	.9	1.5
Motor Vehicles	6.4	27.7	-16.9	6.4	1.2	.6	2.6
Nondurables	5.9	6.0	3.6	4.9	.6	.5	-.1
Services	4.2	5.2	4.6	3.7	.2	.4	.5
Energy	1.5	7.2	21.4	-2.7	-.8	2.6	.4
Housing	2.7	2.4	2.7	2.2	.2	.2	.2
Transportation	4.2	4.2	3.9	1.5	-.2	.2	.2
Recreation	5.7	9.6	9.0	8.1	1.5	-.3	.7
Other	4.9	6.0	4.1	4.7	.2	.4	.5

Note. Derived from billions of chained (1996) dollars.

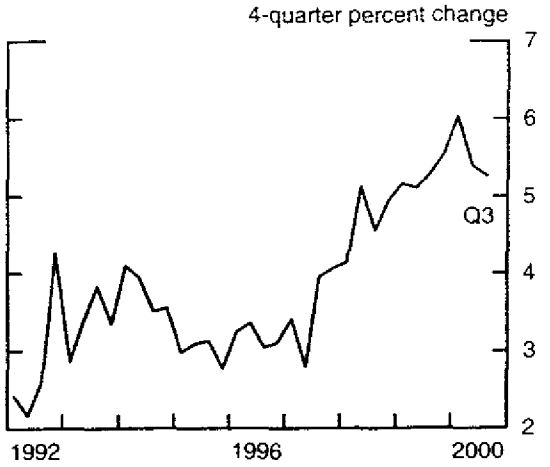
PERSONAL INCOME
(Percent change from the preceding period)

	1999	2000 Q1	2000 Q2	2000 Q3	2000 July	2000 Aug.	2000 Sept.
	Q4/Q4	-- Annual rate --			--- Monthly rate ---		
Total personal income	5.6	6.9	6.9	5.5	.3	.4	1.1
Wages and salaries	6.5	7.4	7.0	5.6	.5	.2	.6
Private	6.9	7.1	7.3	6.2	.5	.2	.6
Less: Personal tax and nontax payments	8.1	14.8	12.8	10.1	.4	1.2	1.0
Equals: Disposable personal income	5.2	5.5	5.9	4.7	.2	.2	1.1
Memo:							
Real disposable income[1]	3.1	1.9	3.7	2.5	.0	.2	.7
Saving rate (percent)	2.2	.2	.3	-.2	-.1	-.4	-.1

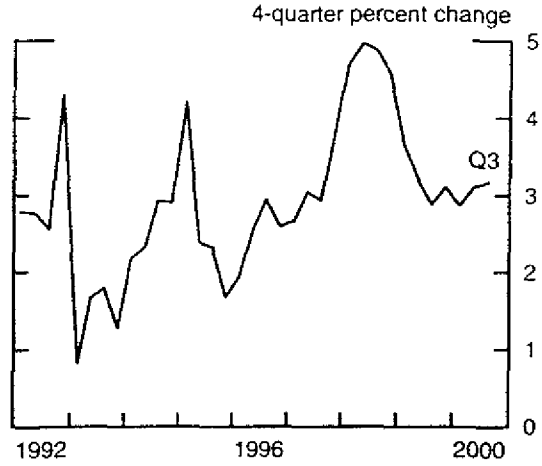
1. Derived from billions of chained (1996) dollars.

Personal Consumption Expenditures

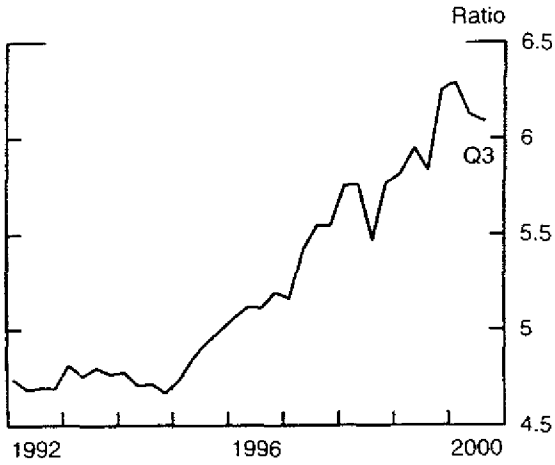
Real Total PCE



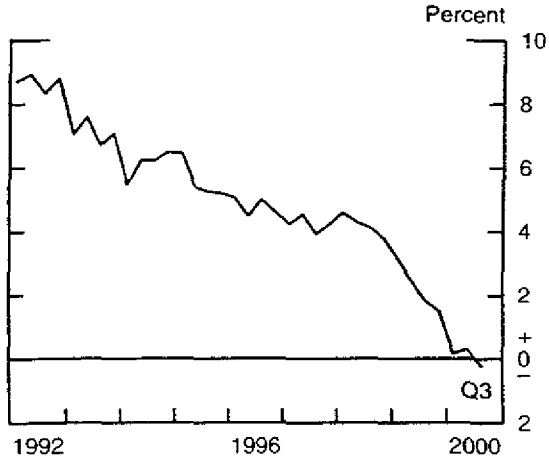
Real Disposable Income



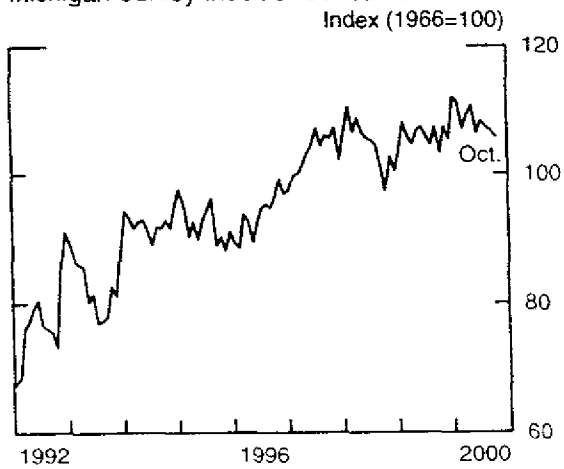
Ratio of Household Net Worth to DPI



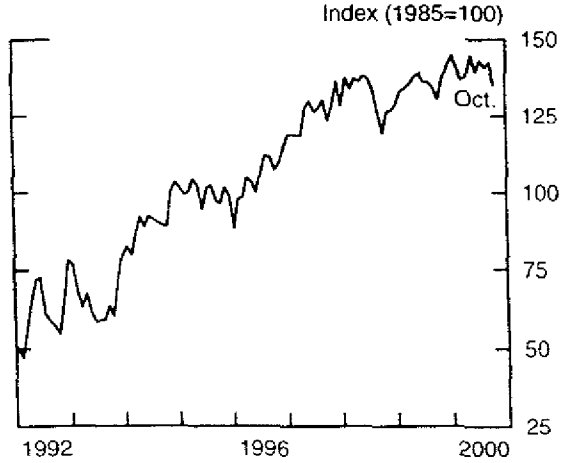
Personal Saving Rate



Michigan Survey Index of Consumer Sentiment



Conference Board Index of Consumer Confidence



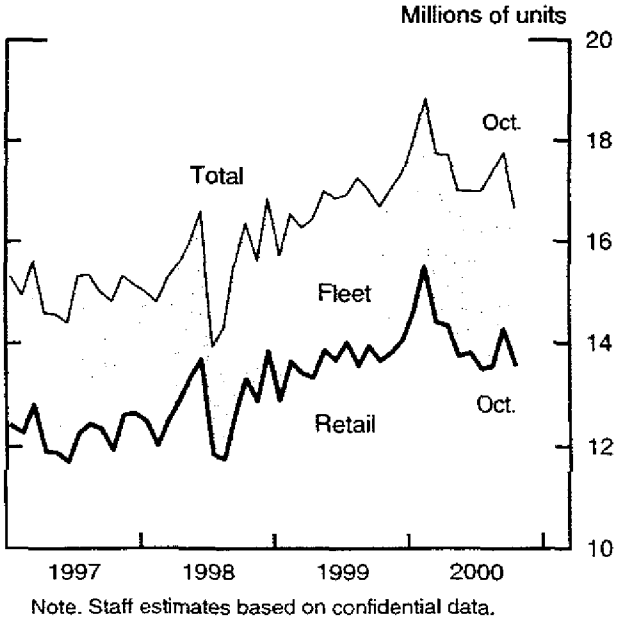
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

			2000			2000		
	1998	1999	Q1	Q2	Q3	Aug.	Sept.	Oct.
Total[1]	15.5	16.8	18.1	17.2	17.4	17.4	17.8	16.7
Autos	8.2	8.7	9.3	8.9	8.8	8.7	8.9	8.6
Light trucks	7.3	8.1	8.8	8.3	8.6	8.6	8.9	8.1
North American[2]	13.4	14.3	15.3	14.4	14.5	14.6	14.8	13.9
Autos	6.8	7.0	7.3	6.9	6.8	6.8	6.8	6.6
Big Three	4.7	4.9	5.2	4.8	4.5	4.5	4.5	4.4
Transplants	2.1	2.1	2.1	2.1	2.3	2.3	2.3	2.1
Light trucks	6.7	7.3	8.0	7.4	7.7	7.8	8.0	7.4
Foreign Produced	2.0	2.5	2.9	2.9	2.8	2.7	2.9	2.7
Autos	1.4	1.7	2.0	2.0	2.0	1.9	2.1	2.0
Light trucks	.7	.8	.8	.9	.8	.8	.8	.7
Memo:								
Total, as reported	15.4	16.8	18.2	17.2	17.4	17.4	17.8	16.7

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.

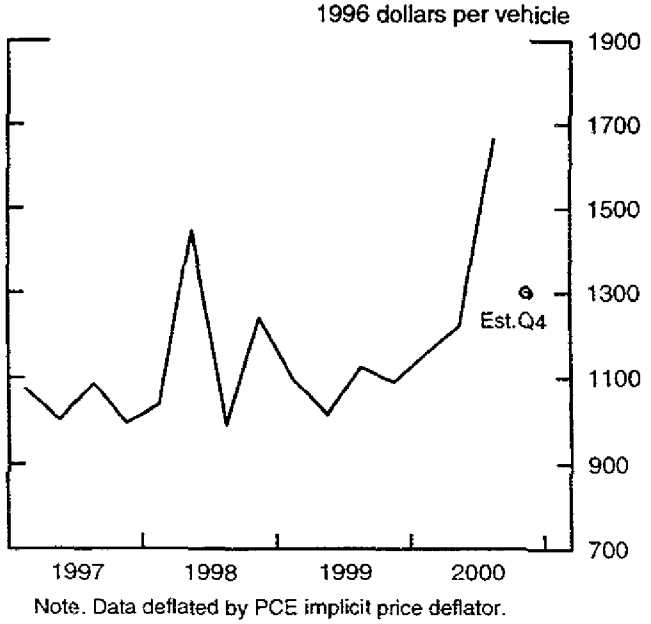
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Fleet and Retail Sales of Light Vehicles
(Annual rate; FRB seasonals)



Note. Staff estimates based on confidential data.

Marketing Incentives for Light Vehicles



Note. Data deflated by PCE implicit price deflator.

coincided with a rather heavy volume of transactions, suggesting that real service expenditures might have received a noticeable boost from brokerage fees and trading commissions.

Recent data on income, wealth, and consumer confidence seem consistent with moderate consumption growth. Real disposable personal income rose at an annual rate of 2-1/2 percent in the third quarter, leaving the four-quarter change at 3-1/4 percent--about in line with the slower pace of income growth that has prevailed since early last year.[6] Given the flatness of the stock market over the summer, we estimate that the ratio of household net worth to disposable income slipped last quarter for the second quarter in a row. And both the Michigan Survey Research Center and the Conference Board indexes of consumer sentiment indicate some slight softening in confidence recently. Nonetheless, both indexes remain elevated by historical standards and thus do not suggest major concerns on the part of households.

Housing Markets

Single-family housing starts fell 2.9 percent in the third quarter to a 1.23 million unit annual rate, the lowest level since the first quarter of 1998. Permit issuance for single-family construction decreased about in line with starts. Within the quarter, however, there was a slight uptick in starts in August and September, likely in response to a drop in rates on fixed-rate mortgages, which were down about 70 basis points from their peak in May. Initial rates on adjustable-rate contracts continued to edge up over the summer but have turned down recently.

The Census Bureau estimates that new home sales increased 6-1/4 percent in the third quarter, to an annual rate of 910,000 units. Both the figure for the third quarter and the sales pace for the year to date are about in line with the average for 1999. Although the Census estimate is frequently subject to substantial revision, we suspect that the decline in mortgage rates provided some lift to demand. Sales of existing homes were little changed in the third quarter; through September, sales for this year averaged nearly 4 percent below the rate in 1999.

The most recent indicators of homebuying conditions are mixed. The buying conditions index from the Michigan survey receded in October after having rebounded somewhat last summer: Respondents took less favorable views of housing prices and interest rates last month. However, builders' rating of new home sales continued to rise slowly in October. But from a longer-term perspective, these attitude indexes seem to be telling a more consistent

6. In September, real disposable personal income was boosted substantially (0.7 percentage point) by specially authorized federal farm subsidy payments. Without this boost, real disposable income would have grown at an annual rate of just 1-1/2 percent in the third quarter.

Private Housing Activity

(Millions of units; seasonally adjusted annual rate)

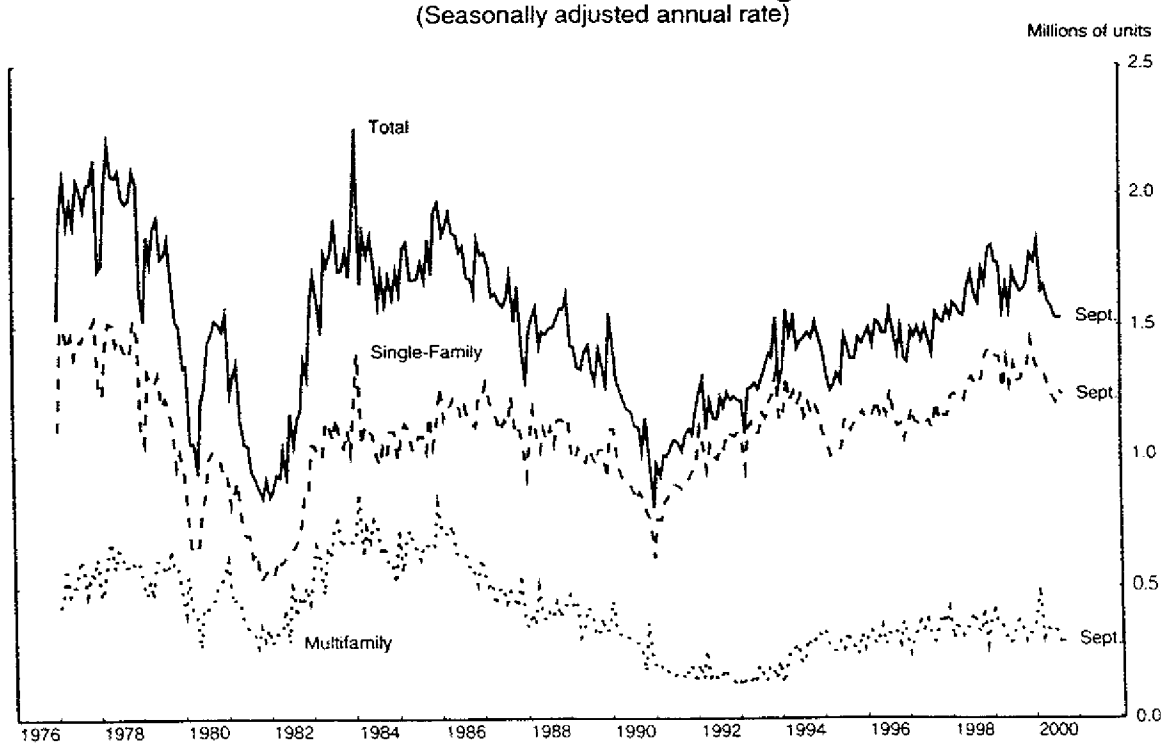
	1999	2000					
		Q1	Q2	Q3[p]	July[r]	Aug.[r]	Sept.[p]
All units							
Starts	1.67	1.73	1.61	1.53	1.53	1.53	1.53
Permits	1.66	1.67	1.53	1.50	1.51	1.49	1.51
Single-family units							
Starts	1.33	1.34	1.27	1.23	1.20	1.25	1.23
Permits	1.25	1.26	1.15	1.13	1.12	1.14	1.15
Adjusted permits[1]	1.34	1.34	1.24	1.21	1.20	1.21	1.23
New home sales	0.91	0.93	0.86	0.91	0.92	0.87	0.95
Existing home sales	5.20	4.80	5.09	5.08	4.82	5.28	5.14
Multifamily units							
Starts	0.33	0.40	0.34	0.30	0.33	0.28	0.30
Permits	0.42	0.41	0.39	0.37	0.39	0.35	0.36
Mobile homes							
Shipments	0.35	0.30	0.27	n.a.	0.25	0.25	n.a.

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

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

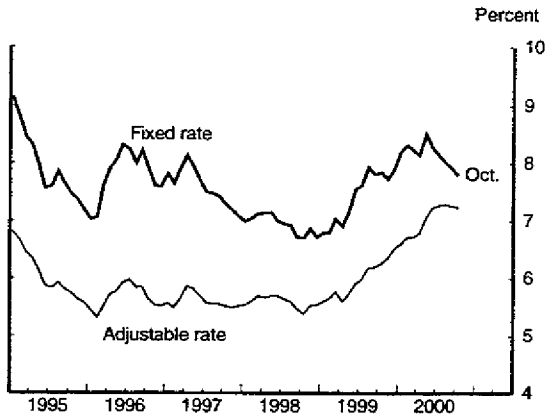
Total Private Building

(Seasonally adjusted annual rate)



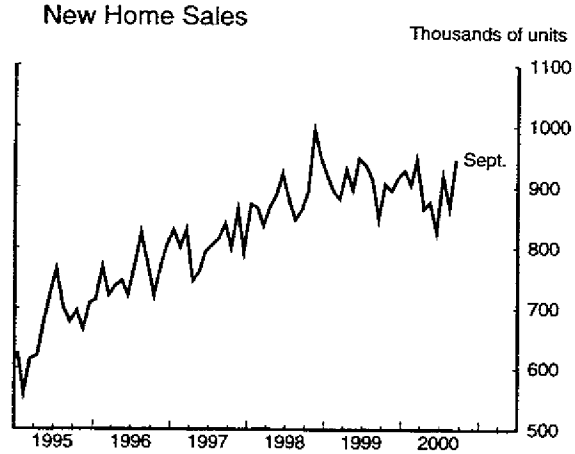
Indicators of Single-Family Housing

Mortgage Rates



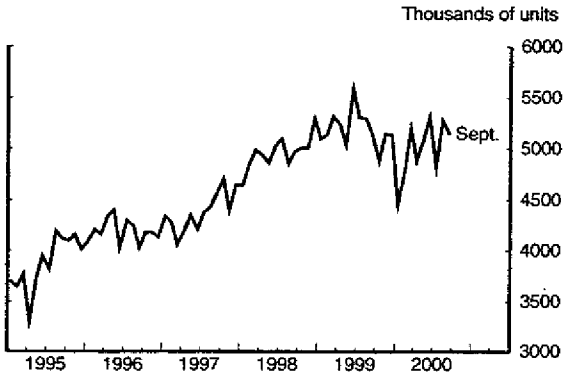
Source. Freddie Mac.

New Home Sales



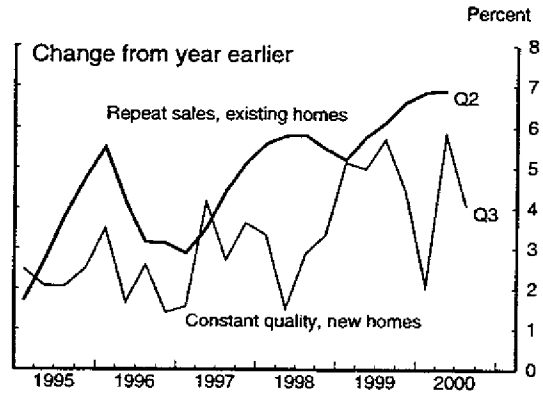
Source. Census Bureau.

Existing Home Sales



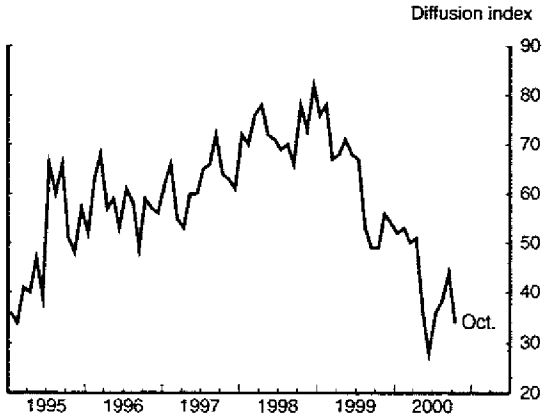
Source. National Association of Realtors.

House Prices



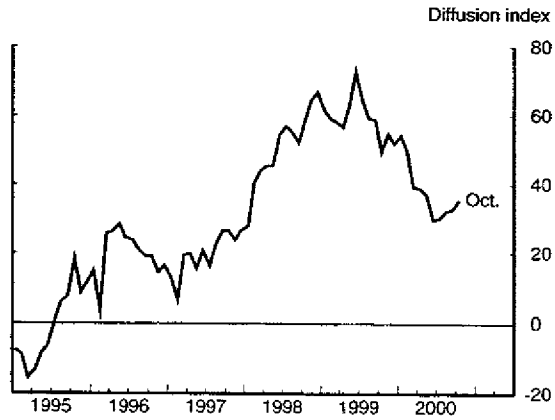
Source. Census Bureau (new); Fannie Mae and Freddie Mac (existing).

Perceived Homebuying Conditions



Source. Michigan Survey, not seasonally adjusted.

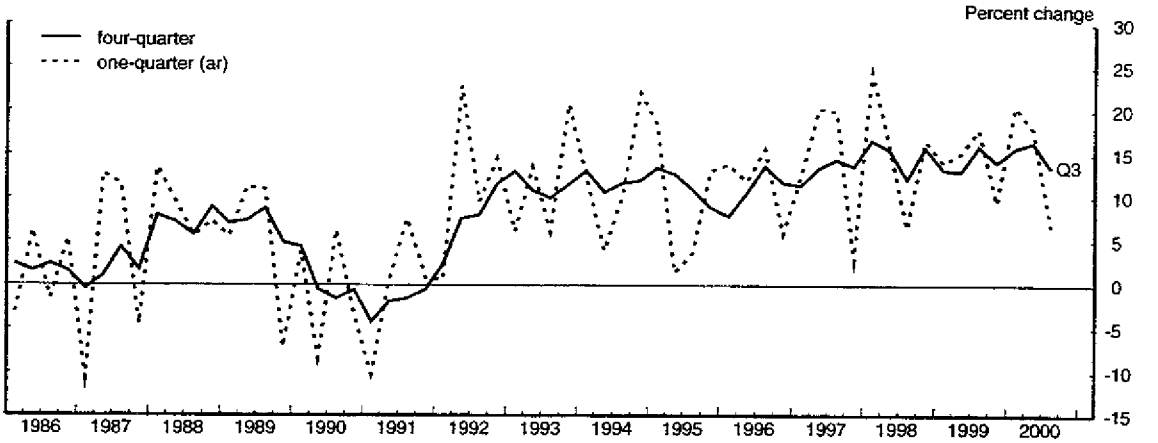
Builders' Rating of New Home Sales



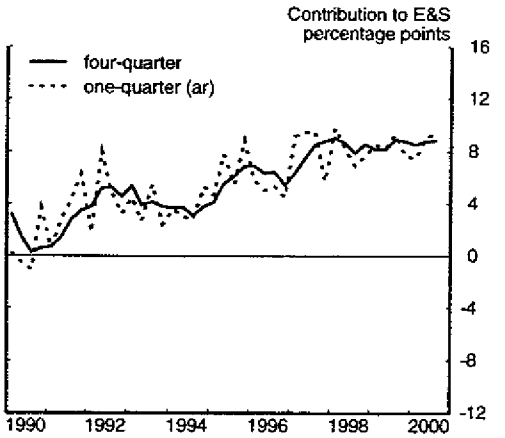
Source. National Association of Home Builders.

Equipment and Software

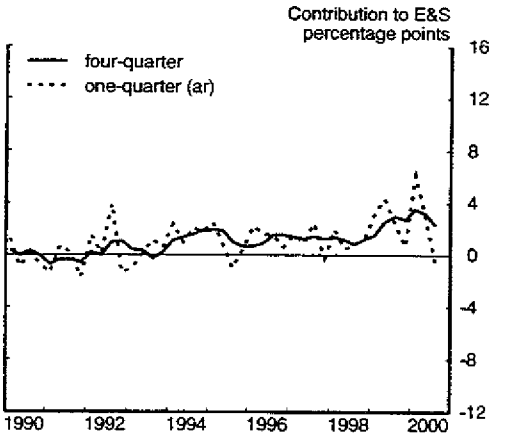
Total Equipment and Software



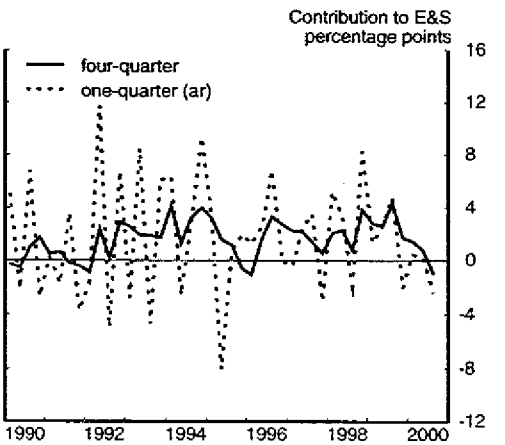
Computers and Software



Communications Equipment

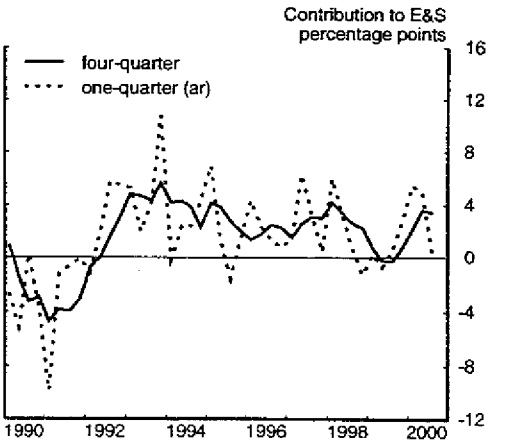


Transportation Equipment



Note. Motor vehicles and aircraft.

Other Equipment



Note. Excludes computers, software, communications, and transportation.

story--both remain substantially below the extremely elevated ranges observed in the latter half of 1998 and the first half of 1999.

House prices continue to rise more quickly than overall inflation, but recent increases have not been as large as those reported earlier this year. In the third quarter, the constant-quality price of new homes sold was up 4 percent from a year earlier; the second-quarter rise had been 5-3/4 percent on a year-to-year basis.

In the multifamily sector, starts fell 12 percent in the third quarter, to an annual rate of 299,000 units. However, the data for this sector are highly variable, and the recent weakness follows a strong first half. Moreover, the market conditions underlying the multifamily sector appear favorable. Although the vacancy rate for multifamily rental units edged up in the third quarter, it remains in the low end of the range of the past two years. Faster increases in rents--the year-to-year rise in the CPI rent index in September was the largest in nearly a decade--are also providing incentive for construction.[7]

Business Fixed Investment

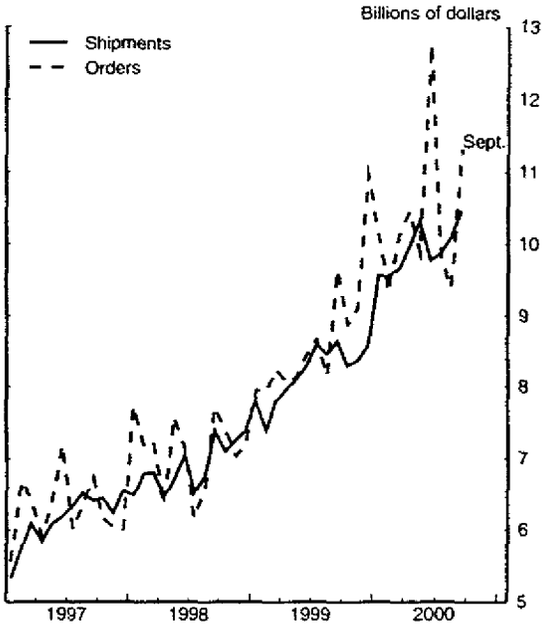
Equipment and software. Real expenditures on equipment and software decelerated sharply in the third quarter; according to the advance estimate of GDP, real E&S spending rose at an annual rate of 8-1/2 percent last quarter after having risen at nearly a 20 percent pace in the first half of the year. Moreover, recent incoming data that were not incorporated in the GDP figures suggest that the increase in real E&S spending in the third quarter was probably closer to 6-3/4 percent (annual rate).

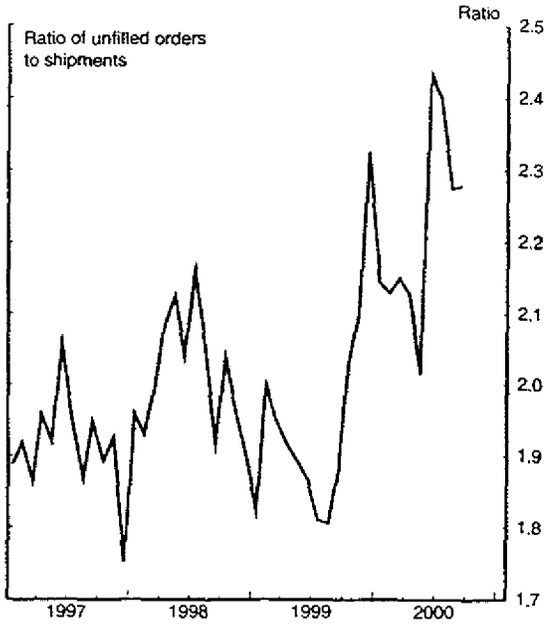
In the high-tech area last quarter, real expenditures both on computers and peripherals and on software continued to advance at the robust rates seen earlier in the year. Indeed, the strong gains in real outlays for computers and software have continued this year despite smaller declines in computer prices and an acceleration in software prices. By contrast, we estimate that real expenditures on communications equipment fell at an annual rate of 4.8 percent in the third quarter following increases at more than a 40 percent rate during the first half of the year. This decline in spending, slumping stock prices of several large producers and users of communications equipment, and increasing risk premiums on the debt of telecommunications firms all raise the question of whether a downshift in activity is under way in this sector. However, the latest data on orders of communications equipment are more favorable. Although

7. The CPI rent series includes single-family as well as multifamily units.

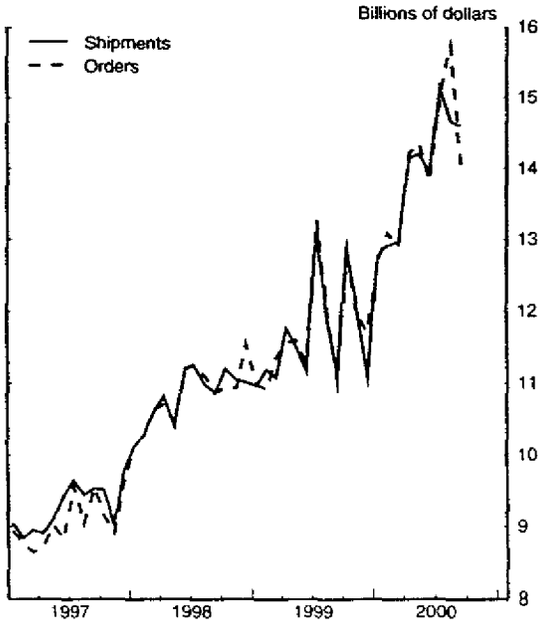
Recent Data on Orders and Shipments

Communications Equipment

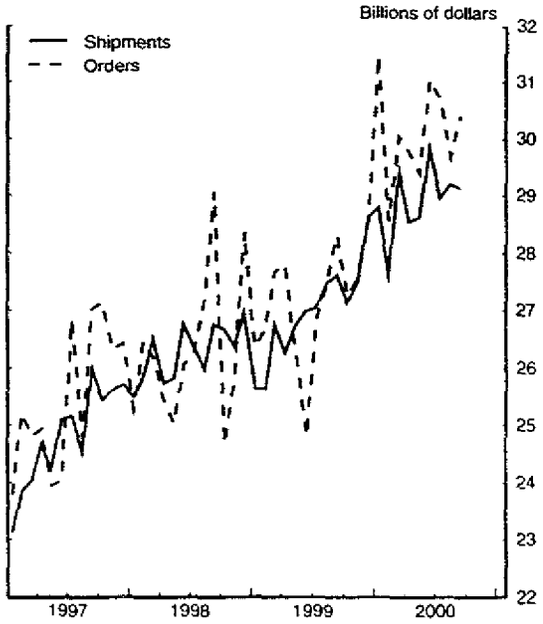




Office and Computing Equipment



Other Equipment



Note. Excluding aircraft, computers, and communications equipment.

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

	2000		2000		
	Q2	Q3	July	Aug.	Sept.
Equipment and software					
Shipments of nondefense capital goods	5.8	.8	-1.9	3.4	.0
Excluding aircraft and parts	4.0	1.7	.8	.0	.5
Office and computing equipment	9.4	5.0	8.6	-3.2	-.3
Communications equipment	4.6	1.2	1.0	2.4	3.6
All other categories	1.4	.3	-2.9	.8	-.2
Shipments of complete aircraft	59.4	-12.3	4.7	13.7	-29.2
Medium & heavy truck sales (units)	-3.0	-11.4	-14.3	1.8	-7.9
Orders for nondefense capital goods	6.5	1.4	-12.2	4.4	5.8
Excluding aircraft and parts	4.7	.2	-3.7	-1.3	1.8
Office and computing equipment	9.6	5.7	8.8	4.7	-10.7
Communications equipment	11.9	-7.9	-23.4	-4.0	20.6
All other categories	.2	.6	-1.1	-3.3	2.4
Nonresidential structures					
Construction put in place, buildings	1.2	3.6	1.3	2.5	3.4
Office	5.1	3.2	1.3	1.5	6.1
Other commercial	-3.1	.2	-2.2	4.6	-.1
Institutional	1.4	5.3	4.2	1.6	2.5
Industrial	6.2	9.8	5.5	1.3	5.7
Lodging and miscellaneous	-2.8	.9	-1.1	2.6	3.7
Rotary drilling rigs in use[1]	8.7	10.3	7.1	3.0	.4

1. Percent change of number of rigs in use, seasonally adjusted.

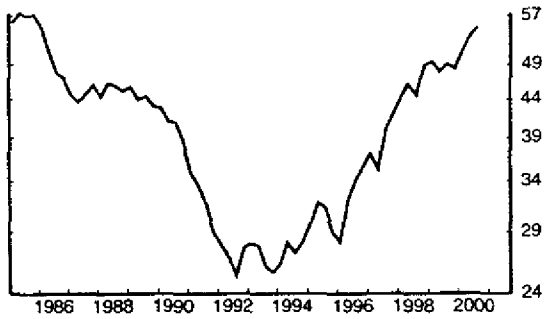
Real Investment in Nonresidential Structures

(Billions of 1996 dollars, chain weighted)

Buildings

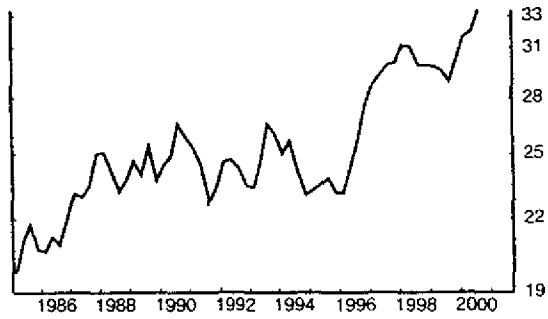
Note. In addition to buildings, the nonresidential structures category includes outlays for drilling and mining, expenditures by utilities, and investment in miscellaneous private facilities such as streets, sewers, and parks.

Office

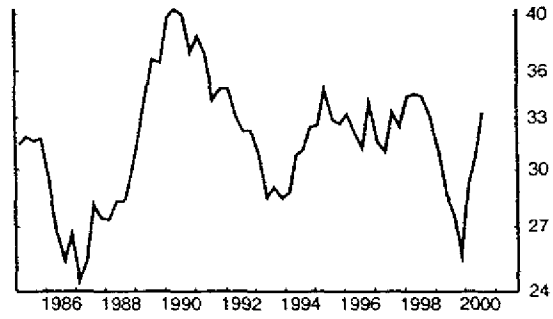


Other Commercial

Institutional



Industrial



Note. Estimates for 2000:Q3 are staff estimates based on the latest data for construction put in place.

orders fell sharply over the summer, they soared in September, and the backlog of unfilled orders, already at an elevated level, edged up further.

Outside of the high-tech area, real equipment expenditures declined in the third quarter, reflecting declines in spending on trucks and autos and on aircraft. Expenditures on other types of equipment were little changed, on net, following substantial gains in the first half of the year: Growth in outlays for industrial and agricultural equipment slowed, and spending on construction and mining equipment turned down. New orders for nondefense capital goods excluding aircraft and high-tech equipment rose in September and have edged up, on balance, over the past two quarters. Moreover, orders consistently have been running above shipments so far this year, resulting in a rising orders backlog that should provide some support for shipments in coming months.

Nonresidential structures. Recent data on construction put in place (CPIP) indicate that nonresidential investment in the third quarter was much stronger than the BEA had assumed in its advance release. Our estimate is that real investment in structures rose at an annual rate of 9-1/2 percent in the quarter, up from a 4-1/2 percent pace in the second quarter.[8]

Taking account of the CPIP data, we estimate that construction of office buildings increased at an annual rate of about 11 percent in the third quarter, after having risen at an annual rate of 23 percent in the first half of this year. Expenditures for office construction are up 12 percent over the past four quarters. The fundamentals in this sector remain very favorable to further growth: Vacancy rates in both downtown and suburban locations remain at extremely low levels, and rent increases are still reported to be strong.

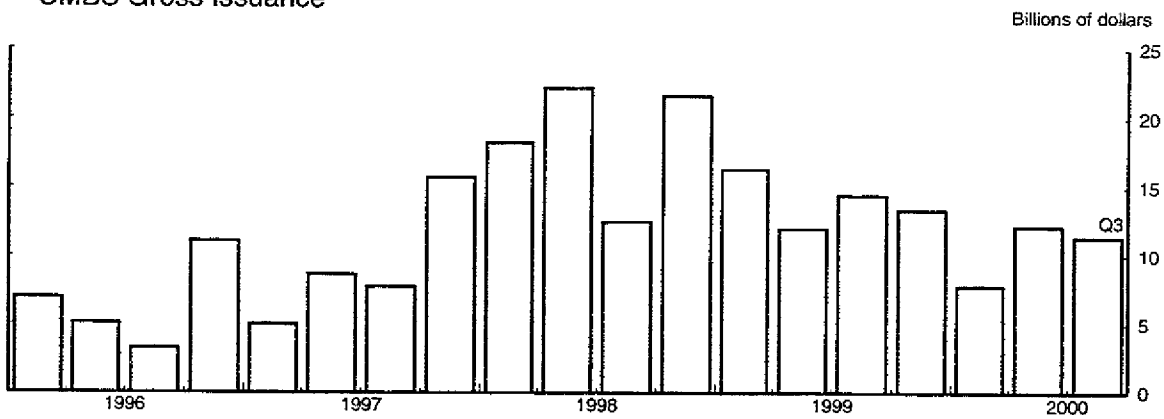
Construction of other commercial structures, which include retail space and warehouses, declined at an annual rate of 3 percent in the third quarter, but the level of expenditures is up 6-3/4 percent from a year earlier. Industry observers report that investments in warehouse facilities built to handle modern inventory and distribution systems continue to be viewed favorably. By contrast, construction of new retail space is hampered by substantial investment already in place in regional malls and "big-box" stores, as well as with continuing uncertainty about the long-term effect of inroads by e-commerce on the demand for retail space.

Our contacts suggest that financing for commercial and office construction appears to be generally available; close scrutiny of projects by investors, rating

8. Nonresidential construction put in place rose 3.4 percent in September, and the August gain was revised up sharply to 2.5 percent. Our estimate for third-quarter real NRS growth is 7-3/4 percentage points higher than the BEA's advance estimate.

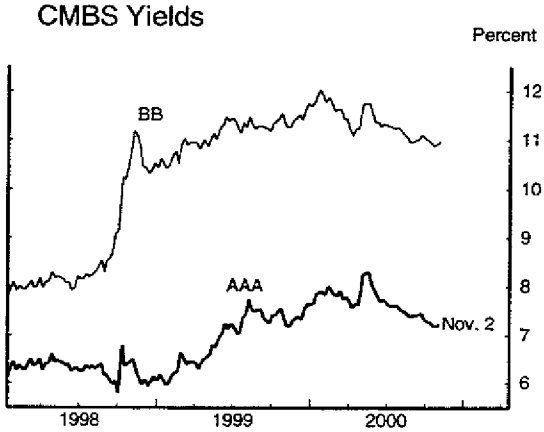
Commercial Mortgage Markets

CMBS Gross Issuance



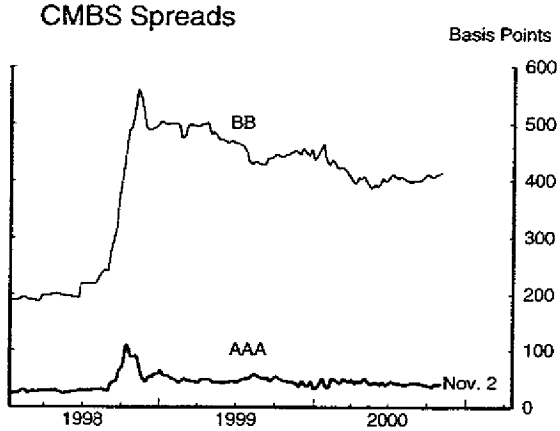
Note. Excludes all CMBS backed by mortgages on foreign properties, and Fannie Mae and Freddie Mac securities.
Source. Commercial Mortgage Alert.

CMBS Yields



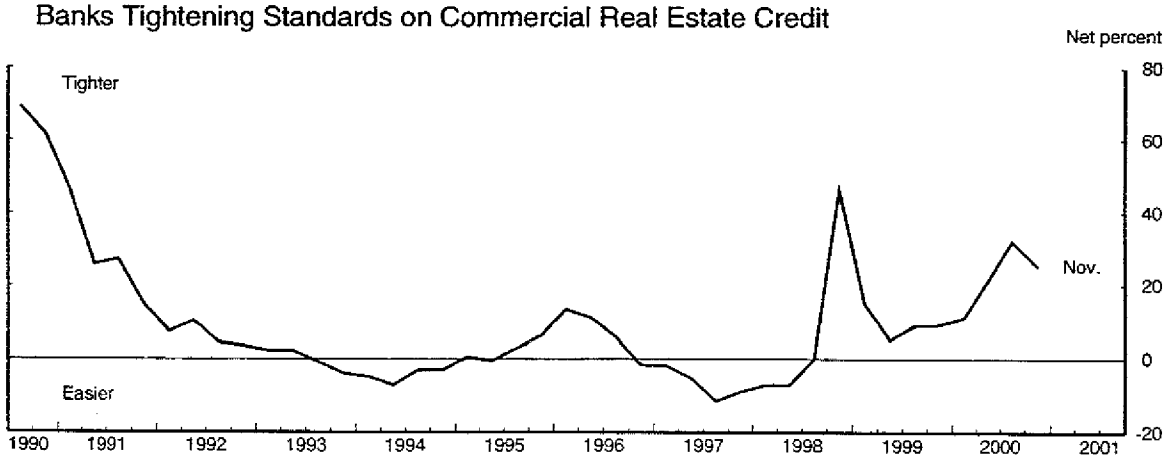
Source. Morgan Stanley.

CMBS Spreads



Note. Rate on CMBS minus 10-year swap rate.
Source. Morgan Stanley.

Banks Tightening Standards on Commercial Real Estate Credit



Source. Senior Loan Officer Opinion Survey.

agencies, regulatory authorities, and investment analysts is said to have limited speculative ventures and helped preclude general overbuilding in the office and commercial real estate markets. The data from financial markets generally support these perceptions. Issuance of commercial mortgage-backed securities (CMBS) has been well maintained. Furthermore, in recent months, yields on AAA-rated CMBS have fallen to the lowest level in a year, and their spreads relative to the ten-year swap rate have remained low. Yields for below-investment-grade (BB rated) CMBS also have fallen, and spreads on these issues declined through midyear and have risen only a little since then. Delinquency rates on CMBS remained low through September, and delinquencies on mortgages held by commercial banks and life insurance companies stayed low through the second quarter (latest data). However, commercial banks have apparently continued to view the risk associated with commercial real estate lending with some concern: In the two most recent Senior Loan Officer Opinion Surveys, one-fourth or more of the respondents reported having tightened their credit standards for commercial mortgage loans.

Real outlays for industrial structures rebounded this year in response to falling vacancy rates and the rise in manufacturing capacity utilization through the second quarter. Expenditures increased 39 percent (annual rate) in the third quarter and were up 20-1/2 percent from the year-earlier level. However, the flattening of utilization rates since the spring will likely curb new construction in the manufacturing sector to some degree.

Outside of the buildings category, investment in drilling and mining has continued at a rapid pace, rising at an annual rate of 18 percent in the third quarter. These expenditures were up 39 percent over the past year and accounted for nearly one-third of the growth in total nonresidential structures investment in that period.

Business Inventories

According to the advance GDP report, the real stock of nonfarm inventories increased at an annual rate of about 5-1/2 percent in the third quarter. Information that has become available since the advance report was released would trim that figure to an annual rate of about 4-3/4 percent. Thus, for a second consecutive quarter, inventories rose faster than real final sales, and many aggregate inventory-sales ratios have moved up in recent months. Although businesses on the whole do not appear to be uncomfortable with their current levels of stocks, overhangs are apparent in some industries and have no doubt contributed to the softening of production discussed earlier.

In manufacturing, current-cost inventories increased at an annual rate of only $9.7 billion in September, well below the assumption that the BEA had incorporated into its advance GDP estimate. Durable goods stocks changed little in September, both at the aggregate level and in the industry detail. The

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

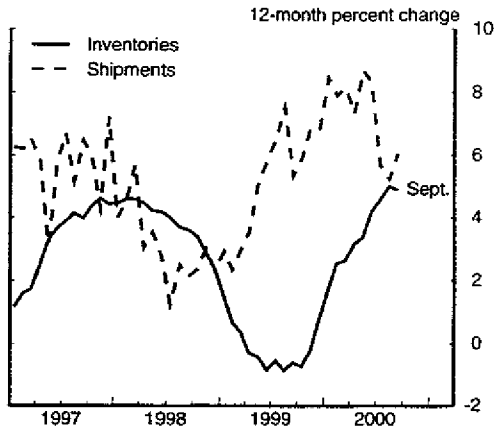
Category	2000			2000		
	Q1	Q2	Q3	July	Aug.	Sept.
Manufacturing and trade	60.8	105.9	n.a.	58.7	105.2	n.a.
Less wholesale and retail motor vehicles	50.9	72.3	n.a.	64.9	68.2	n.a.
Manufacturing	22.0	24.6	25.7	51.1	16.1	9.7
Less aircraft	18.6	30.0	27.8	54.8	18.8	9.8
Merchant wholesalers	25.1	36.2	13.9	12.7	22.6	6.4
Less motor vehicles	21.6	33.1	17.2	16.7	25.7	9.1
Retail trade	13.6	45.1	n.a.	-5.2	66.5	n.a.
Automotive dealers	6.4	30.5	n.a.	-2.3	40.1	n.a.
Less automotive dealers	7.2	14.6	n.a.	-2.9	26.4	n.a.

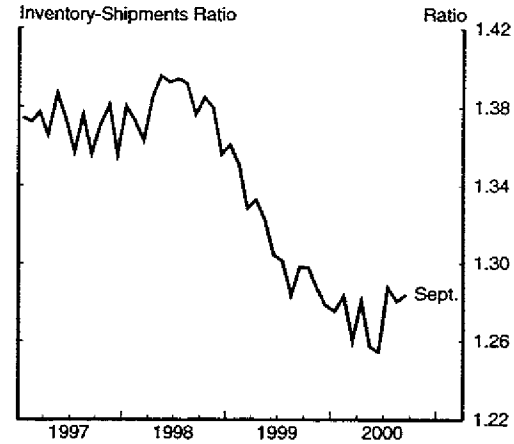
SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE
(Months' supply, based on seasonally adjusted Census book value)

Category	Cyclical reference points		Range over preceding 12 months		September 2000
	1990-91 high	1991-98 low	High	Low	
Manufacturing and trade	1.58	1.37	1.34	1.31	n.a.
Less wholesale and retail motor vehicles	1.55	1.34	1.30	1.27	n.a.
Manufacturing	1.75	1.36	1.30	1.25	1.28
Primary metals	2.08	1.46	1.59	1.53	1.59
Steel	2.56	1.59	2.07	1.87	2.15
Nonelectrical machinery	2.48	1.61	1.59	1.40	1.45
Electrical machinery	2.08	1.21	1.21	1.09	1.11
Transportation equipment	2.93	1.51	1.50	1.32	1.42
Motor vehicles	.97	.53	.59	.51	.58
Aircraft	5.84	4.05	4.53	3.51	3.68
Nondefense capital goods	3.09	2.04	1.96	1.70	1.71
Textiles	1.71	1.38	1.64	1.52	1.68
Paper	1.32	1.06	1.20	1.12	1.21
Chemicals	1.44	1.25	1.38	1.30	1.39
Petroleum	.94	.80	.77	.66	.70
Home goods & apparel	1.96	1.59	1.60	1.49	1.66
Merchant wholesalers	1.36	1.24	1.30	1.27	1.30
Less motor vehicles	1.31	1.22	1.28	1.25	1.28
Durable goods	1.83	1.53	1.62	1.55	1.61
Nondurable goods	.96	.90	.96	.94	.95
Retail trade	1.61	1.45	1.45	1.40	n.a.
Less automotive dealers	1.48	1.38	1.35	1.32	n.a.
Automotive dealers	2.23	1.58	1.80	1.60	n.a.
General merchandise	2.68	2.01	1.95	1.85	n.a.
Apparel	2.54	2.29	2.29	2.18	n.a.
Food	.83	.79	.82	.78	n.a.

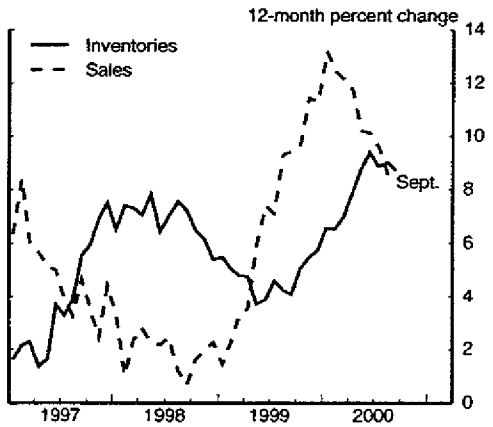
Inventories and Sales

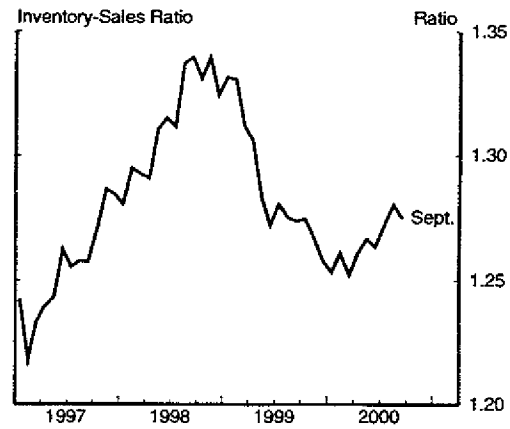
Manufacturing



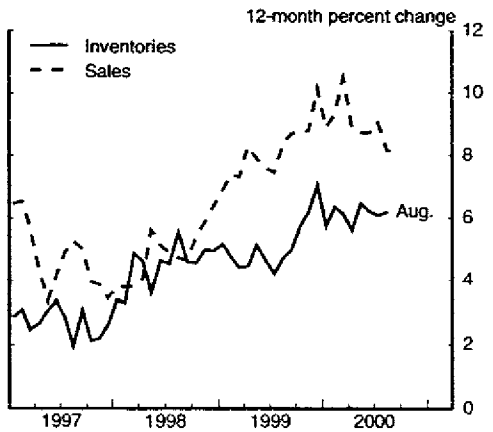


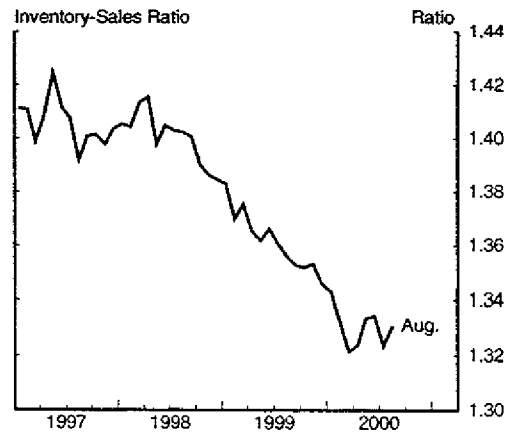
Wholesale Trade Excluding Motor Vehicles





Retail Trade Excluding Motor Vehicles





Note. Inventories are book value.

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

	September			12 months ending in Sep.		
	1999	2000	Percent change	1999	2000	Percent change
Outlays	142.4	153.6	7.9	1702.9	1788.0	5.0
Deposit insurance	-0.5	-0.2	...	-5.3	-3.1	...
Spectrum auction	-0.8	0.0	...	-1.8	-0.2	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	143.6	153.8	7.1	1710.0	1791.3	4.8
Receipts	200.4	219.5	9.5	1827.3	2025.0	10.8
Surplus	58.0	65.8	...	124.4	237.0	90.6
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	143.6	147.2	2.5	1710.7	1784.4	4.3
National defense	24.3	25.8	6.1	276.3	292.1	5.7
Net interest	15.3	12.6	-17.5	230.3	223.4	-3.0
Social security	32.6	34.8	6.9	390.6	409.4	4.8
Medicare	16.1	15.5	-3.4	191.0	196.9	3.1
Medicaid	10.1	10.5	3.8	108.0	117.9	9.1
Other health	2.9	3.1	5.0	32.8	36.3	10.8
Income security	16.9	17.7	4.6	237.2	245.0	3.3
Agriculture	1.2	6.8	495.0	24.3	38.5	58.2
Other	24.3	20.4	-16.2	220.3	224.8	2.1
Receipts	200.4	219.5	9.5	1827.3	2025.0	10.8
Individual income and payroll taxes	143.7	159.7	11.2	1455.8	1620.1	11.3
Withheld + FICA	98.1	109.3	11.4	1238.1	1361.5	10.0
Nonwithheld + SECA	48.6	54.0	11.1	340.4	392.7	15.4
Refunds (-)	3.1	3.6	17.0	122.7	134.0	9.2
Corporate	40.2	43.4	8.0	184.7	207.3	12.2
Gross	42.6	46.2	8.5	216.3	235.7	8.9
Refunds (-)	2.3	2.7	17.6	31.6	28.4	-10.4
Other	16.5	16.3	-1.0	186.8	197.6	5.8
Surplus	56.8	72.3	...	116.6	240.7	106.4

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.
... Not applicable.

accumulation of nondurables in September was led by another sizable increment to the stocks of chemical producers. The inventory-shipments ratio for all of manufacturing is up only a little from its low of a few months ago, although that is a departure from the downward trend of the past few years. Inventory-shipments ratios for metals, construction materials, chemicals, textiles, and rubber and plastics are at their highest levels in a year or more.

The book value of non-auto wholesale inventories rose at an annual rate of $17.2 billion in the third quarter, about $5 billion below the level implicit in the advance GDP estimate. Inventory accumulation in the third quarter was well below the $33.1 billion pace recorded in the second quarter; growth of sales slowed, and the ratio of inventories to sales edged up. As in manufacturing, inventory-sales ratios are elevated in some wholesale sectors, notably for metals and minerals, paper and paper products, and construction supplies.

The book value of non-auto retail inventories rose about $12 billion on average in the July-August period, just below the pace in the second quarter. With sales rising at about the same rate as the stock of inventories, the inventory-sales ratio has shown very little net movement over the past few months. Within the retail sector, inventories are high relative to sales at building material and hardware stores and at motor vehicle dealers, but are low at general merchandise and food stores. Elsewhere, on balance, the inventory-sales ratio has been relatively flat.

Government Expenditures

Federal sector. The federal government's unified budget surplus soared to $237 billion in fiscal 2000, an increase of $113 billion from a year earlier. The on-budget surplus, which excludes social security and the postal service, was $87 billion, compared with $1 billion a year earlier.

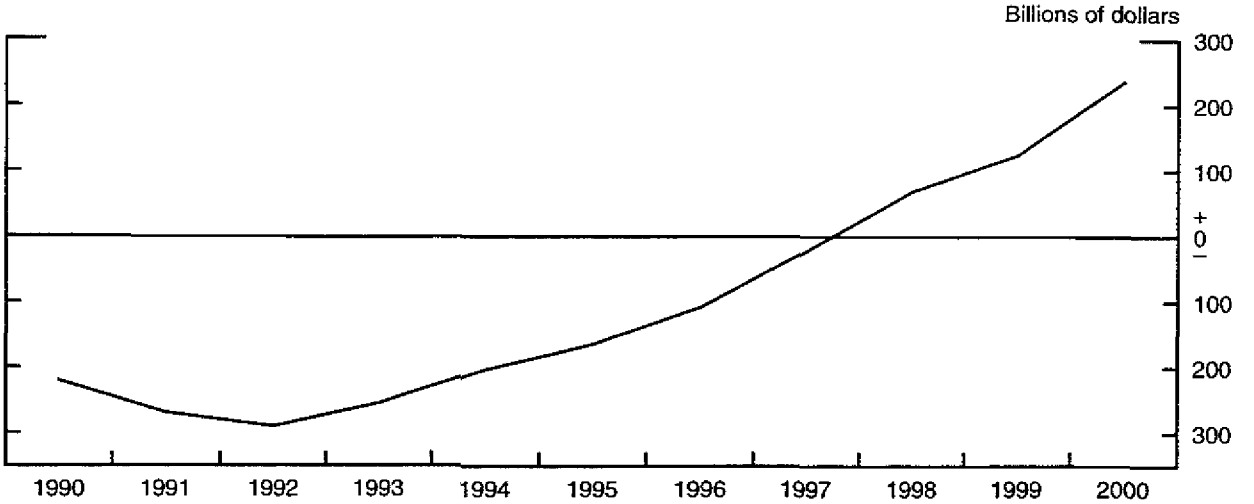
For the fiscal year, receipts rose nearly 11 percent, the highest rate in more than a decade, propelled by another huge increase in personal income taxes. Outlays also rose more rapidly than they had in recent years, reflecting, in part, the high level of discretionary appropriations enacted last fall, legislative initiatives that raised social security payments and agriculture spending, and a pickup in Medicaid grants. The latter reflects the effects of the child health insurance program passed in 1997 as well as new efforts by states to boost the federal government's share of Medicaid expenses.

In September, receipts rose 9-1/2 percent relative to a year earlier, with sizable increases in nonwithheld income tax and social insurance contributions and in corporate income tax payments. September outlays were 8 percent higher than those of a year earlier; much of the increase was attributable to timing shifts,

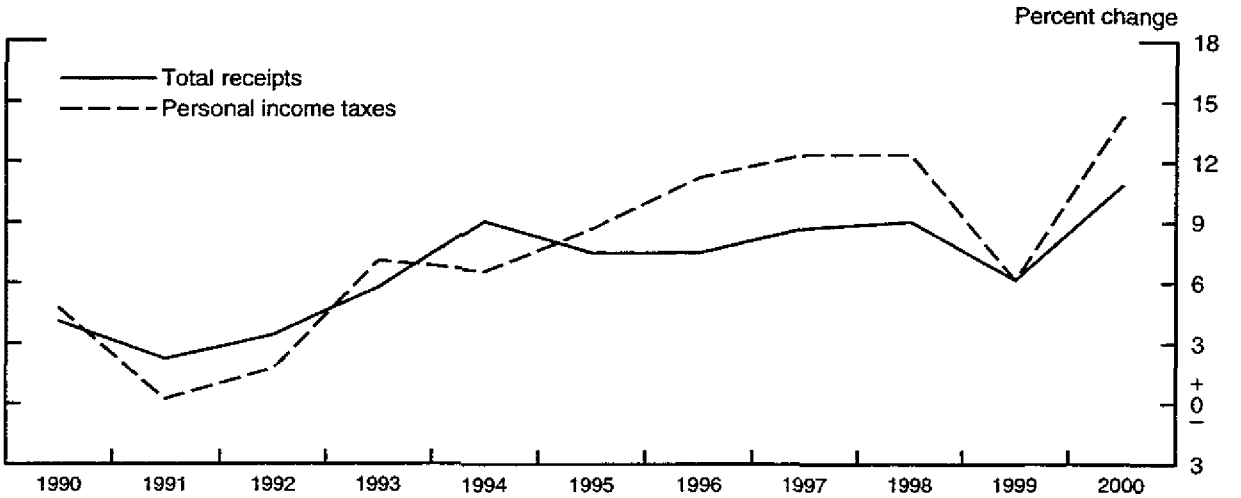
Federal Sector Developments

(Fiscal years)

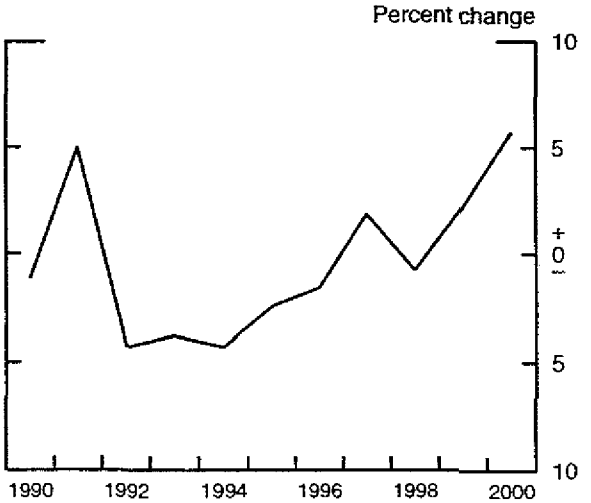
Unified Surplus



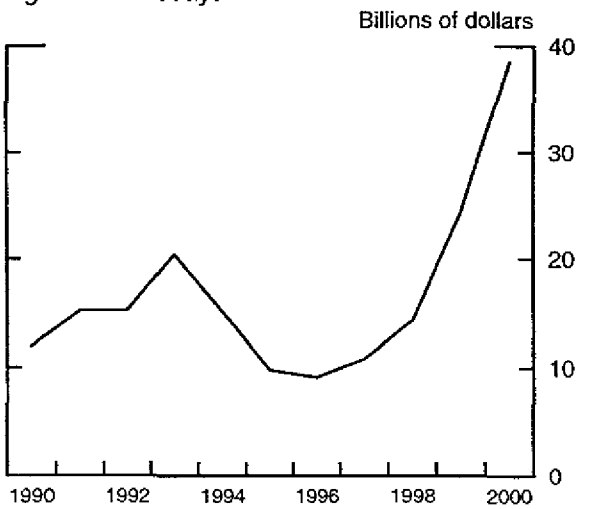
Unified Receipts



Defense Outlays



Agriculture Outlays



but agriculture spending surged as the emergency payments to farmers included in last spring's legislation were disbursed.

Congress passed a continuing resolution to temporarily fund the government and then adjourned until after the election. After the recess, action is required on five appropriations bills that have yet to be enacted. In addition, the agenda is expected to include legislation to provide tax relief, larger payments to Medicare providers, and a boost to the minimum wage.

State and local sector. According to the BEA's advance estimate, total real spending by state and local governments on consumption and investment was unchanged in the third quarter. But the September report on construction put in place suggests a substantial upward revision, to an annual rate of increase of about 2.5 percent. The BEA had estimated a 10 percent drop in investment spending (annual rate); however, the CPIP data indicate that actual investment by state and local governments edged up at an annual rate of 1.3 percent. Consumption expenditures rose at a 2-3/4 percent annual rate--near the low end of the range seen in recent years.

In October, state and local employment rebounded from the small decline posted in the previous month; the gain of 20,000 was spread fairly evenly among categories. Non-education employment growth was held down by striking Los Angeles transit workers.

Looking forward, a recent survey of fiscal 2001 budgets submitted by governors indicates that education tops the list of priorities, with most states focusing on student performance standards and the hiring and retention of qualified K-12 teachers.[9] Other education goals include school construction (with special concern about technology for K-12 classrooms), school safety, and early childhood development programs. Outside of education, states' policies are aimed at tax cuts, technology-related initiatives, environmental programs, and highway and other transportation-related infrastructure.

Around a third of the states had significant tax initiatives and legislative referenda on the November ballot.[10] Generally, most of the smaller measures cutting taxes passed: Among the smaller reductions, roughly seven states restricted property taxes in some way, and two states repealed their inheritance taxes. Measures in Colorado and Oregon that would have had a significantly negative impact on revenues failed. Very few measures on the ballot would

---

9. Revenues from states pay for about half of all K-12 expenditures nationwide.

10. An initiative is a measure placed on the ballot through the citizen petition process; only 24 states permit initiatives. Legislative referenda are measures that have been passed by the legislature but require popular approval before they can become law. Legislative referenda include constitutional amendments and bond questions.

CPI AND PPI INFLATION RATES
(Percent)

	From 12 months earlier		2000		2000	
	Sept. 1999	Sept. 2000	Q2	Q3	Aug.	Sept.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.6	3.5	3.6	3.1	-.1	.5
Food (15.3)	2.2	2.6	2.6	4.0	.2	.2
Energy (7.0)	10.2	15.4	13.8	9.8	-2.9	3.8
CPI less food and energy (77.7)	2.0	2.6	2.9	2.5	.2	.3
Commodities (23.4)	1.0	.3	1.3	-.1	-.1	.5
New vehicles (4.8)	-.5	-.1	1.8	-.1	-.2	-.2
Used cars and trucks (1.9)	2.5	.3	4.6	1.4	-.1	.6
Apparel (4.7)	-1.3	-1.1	-2.2	-3.5	.2	1.6
Tobacco (1.3)	31.9	9.1	15.1	5.6	-1.6	3.5
Other Commodities (10.7)	-.4	.1	.5	.4	.1	-.1
Services (54.3)	2.5	3.5	3.5	3.4	.3	.1
Shelter (29.9)	2.7	3.3	3.5	3.2	.2	.2
Medical care (4.5)	3.3	4.7	5.1	5.1	.4	.4
Other Services (20.0)	2.1	3.5	3.2	3.4	.4	-.1
PPI						
Finished goods (100.0)[2]	3.1	3.3	3.2	2.6	-.2	.9
Finished consumer foods (22.9)	1.0	.3	4.4	-2.9	-.7	.4
Finished energy (13.8)	13.8	17.2	9.5	17.3	-.2	3.7
Finished goods less food and energy (63.3)	1.8	1.2	1.6	1.4	.1	.3
Consumer goods (38.9)	2.9	1.3	1.4	1.5	.1	.4
Capital equipment (24.4)	.0	1.2	1.2	1.4	.0	.2
Intermediate materials (100.0)[3]	2.0	4.5	4.4	3.5	-.2	.7
Intermediate materials less food and energy (81.7)	.6	2.3	3.6	1.0	-.1	.0
Crude materials (100.0)[4]	16.5	16.3	21.6	17.5	-1.5	5.3
Crude food materials (39.0)	-1.2	-2.5	8.6	-24.4	-4.5	3.9
Crude energy (39.0)	53.4	40.8	52.1	85.4	.6	8.1
Crude materials less food and energy (22.0)	.9	2.5	-7.0	-13.7	-1.3	.3

1. Relative importance weight for CPI, December 1999.
2. Relative importance weight for PPI, December 1999.
3. Relative importance weight for intermediate materials, December 1999.
4. Relative importance weight for crude materials, December 1999.

have raised taxes. Among these, voters in Arizona approved a 0.6 percent increase in the sales tax rate, with the proceeds earmarked for school improvements.

Prices

The consumer price index rose 0.5 percent in September and was up 3.5 percent over the past twelve months, about 1 percentage point more than over the year-earlier period. Higher energy prices, along with a pickup in core inflation, contributed about equally to the faster pace of overall CPI inflation over the past year. Excluding food and energy, the CPI rose 0.3 percent in September and was up 2.6 percent over the past twelve months. On a current-methods basis, the twelve-month change in the core CPI has moved up 0.5 percentage point over the past year; excluding tobacco as well as food and energy, the acceleration over the past year was 0.8 percentage point.[11]

Core PCE prices have accelerated noticeably less over the past year than the core CPI; the twelve-month change in core PCE prices in September was 1.7 percent, compared with an increase of 1.6 percent in the year-earlier period. As we have discussed previously, the coverage and methodology of PCE prices and the CPI differ in important ways, and movements in these indexes have deviated from one another noticeably in the past. In particular, PCE includes some items that are not in the CPI, and several of these "out-of-scope" items--such as imputed charges for commercial bank services--do not have market prices. The BEA imputes these nonmarket core PCE prices using a variety of methods. Over the past year, an index of the nonmarket prices (constructed by the staff) has decelerated considerably. In contrast, an index of the market-based core PCE prices accelerated 0.3 percentage point over the past twelve months, closer to the acceleration in core CPI.[12] Furthermore, relative to their lows over the past two years, both the current-methods CPI and the core PCE have accelerated about 1/2 percentage point.

The CPI for energy rose substantially in September and was up more than 15 percent from a year earlier, reflecting the passthrough of higher crude oil prices. We believe that the effects of higher crude oil prices had been fully reflected in retail prices of gasoline and heating oil by September. Crude oil

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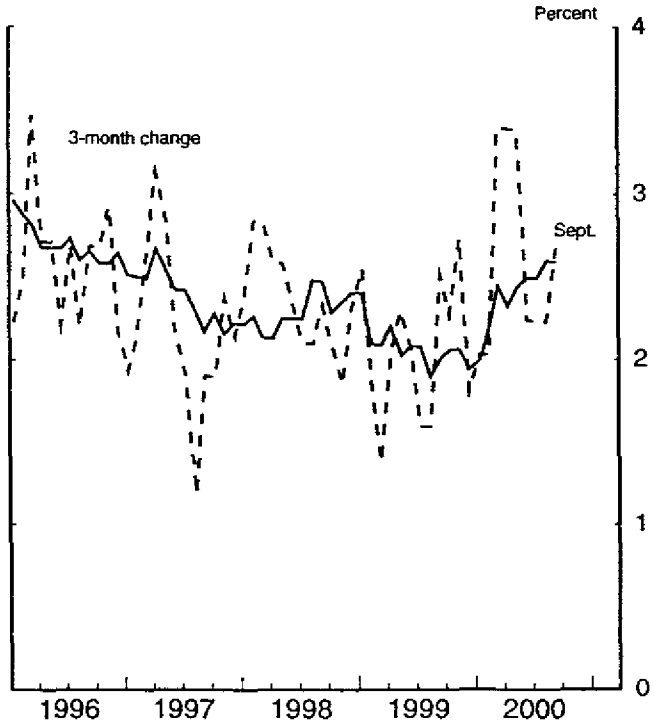
11. After the September Greenbook was published, the BLS revised up slightly CPI figures for this year to correct a programming error that affected the indexes for residential rent and owners' equivalent rent. Although the errors affected data back to January 1999, the BLS only revised data for this calender year. Because the BLS set the levels of this year's indexes at their proper values, but did not change the indexes for 1999, there is now a discontinuity in the published series between December 1999 and January 2000. The staff's current-methods index includes an adjustment to the 1999 data that removes this discontinuity.

12. The components with market-based prices made up nearly 80 percent of core PCE in the third quarter of this year.

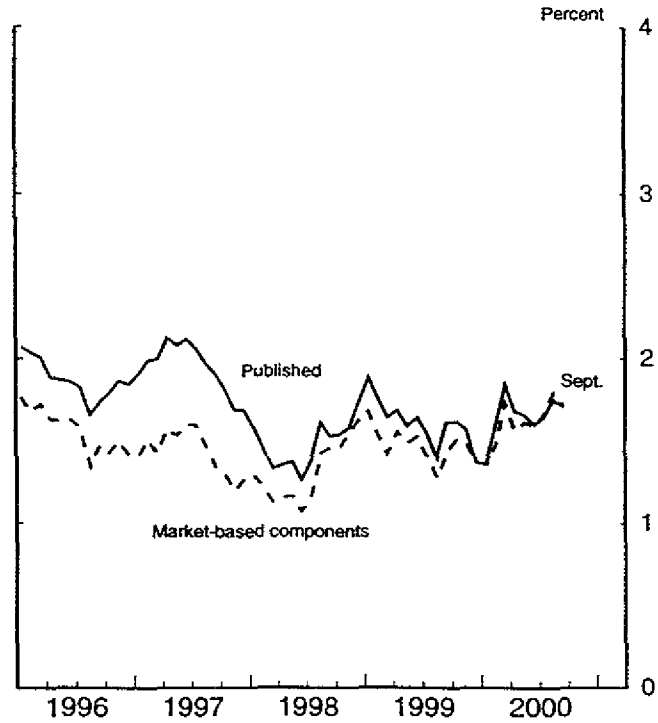
Measures of Core Consumer Price Inflation

(12-month change except as noted)

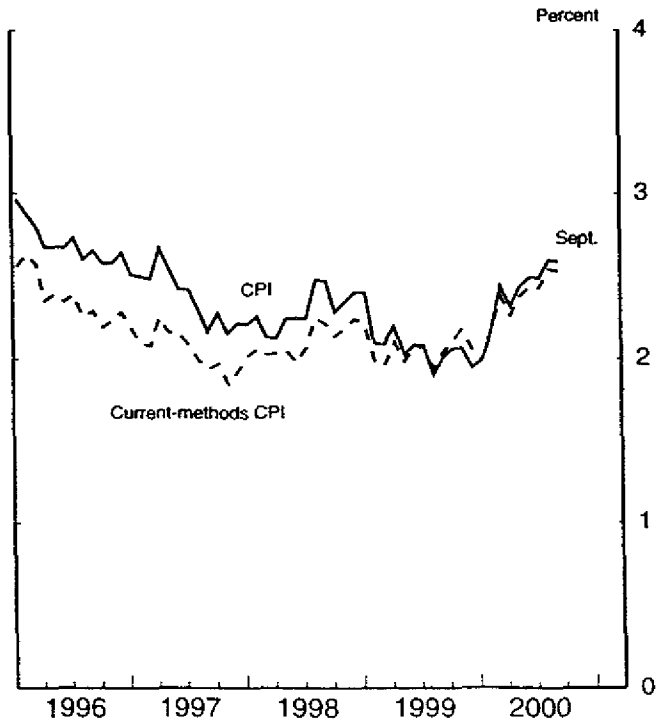
CPI Excluding Food and Energy



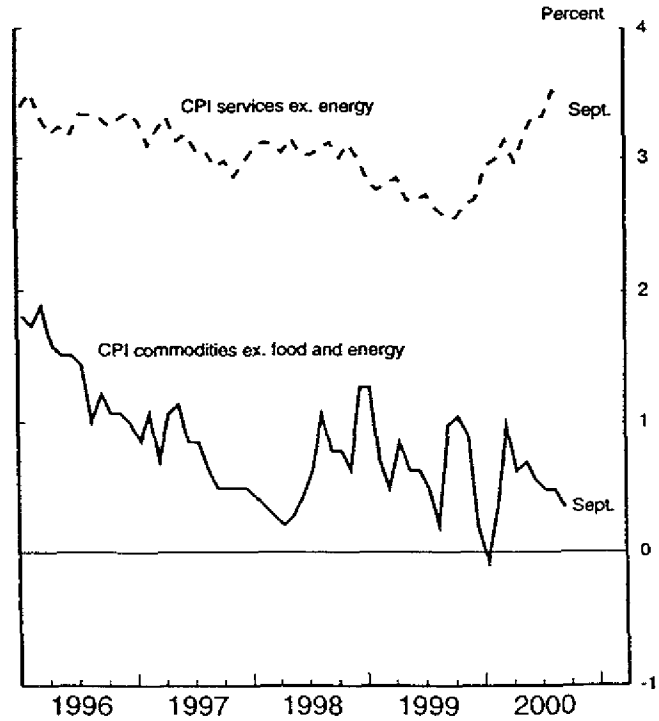
PCE Excluding Food and Energy



CPI Excluding Food and Energy



CPI Services and Commodities



prices eased slightly in October, and survey data for the month suggest declines in retail prices of gasoline and heating oil. Natural gas prices rose substantially further in September, and spot prices point to another increase in October. Consumer electricity prices changed little in September for the second consecutive month, following large increases during the summer.

The CPI for food rose 0.2 percent in September, the same rate of increase as in August. The twelve-month change stood at 2.6 percent in September--the same as the core index--and the amount of acceleration in food prices over the past year was just a shade less than that registered by core inflation. The crop that is being harvested this fall, though down from estimates made earlier, is still expected to be ample.[13] The path of futures prices through late 2001 has changed relatively little in recent weeks and continues to suggest that farm prices will contribute little to food price inflation in coming months.

Although core commodity prices in the CPI have decelerated over the past year, this pattern reflects a sharp deceleration in tobacco prices, which had surged in late 1998. Excluding tobacco, core commodity prices accelerated about 1/4 percentage point over the past year. This pattern of acceleration reflects modest pickups in rates of inflation for many commodities, including new light vehicles, and a slower rate of decline in computer prices.

The CPI for non-energy services rose just 0.1 percent in September--held down by a decline in airfares. Nonetheless, these prices are up 3.5 percent over the past year, a considerably faster rate of increase than in the prior twelve months.[14] Many items have contributed to this pickup. Airfares--despite the decline in September--have accelerated sharply as jet fuel prices have risen. In addition, the rate of increase in medical services has stepped up in the past year, and rents have increased more rapidly in the past twelve months than in the previous year.

Capital goods prices have shown clear signs of acceleration over the past year. With an increase of 0.2 percent in the PPI for capital goods in September, the twelve-month change in the index was 1.2 percent, up more than 1 percentage point from its year-earlier pace. PPIs have accelerated for a wide range of capital goods, including civilian aircraft, oil and gas field equipment, machine

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13. Planting of the winter wheat crop that will be harvested next year got off to a late start this fall because of extremely dry weather in some growing areas. Progress of the planting was still lagging somewhat as of the first week in November. The condition of the crop in early November was similar to that of a year ago and suggests that yields could still turn out to be relatively high if the weather cooperates from this point on.

14. Because of a discontinuity in the CPI introduced with the BLS' correction of the aforementioned programming error, the amount of acceleration in non-energy service prices is overstated in the published figures by a bit more than 0.1 percentage point.

BROAD MEASURES OF INFLATION
(4-quarter percent change)

	1997 Q3	1998 Q3	1999 Q3	2000 Q3
Product prices				
GDP chain price index	1.9	1.3	1.4	2.3
Less food and energy	2.0	1.4	1.5	2.2
Nonfarm business chain price index[1]	2.1	0.8	1.2	2.0
Expenditure prices				
Gross domestic purchases chain price index	1.6	0.8	1.7	2.6
Less food and energy	1.6	1.1	1.4	2.0
PCE chain price index	1.9	1.1	1.8	2.5
Less food and energy	2.0	1.5	1.5	1.7
PCE chain price index - market-based components	1.5	0.9	1.8	2.6
Less food and energy	1.5	1.3	1.4	1.7
CPI	2.2	1.6	2.3	3.5
Less food and energy	2.3	2.4	2.0	2.5
Current-methods CPI	1.9	1.4	2.3	3.4
Less food and energy	2.0	2.2	2.0	2.5
Median CPI	2.9	2.9	2.3	2.9
Trimmed mean CPI	2.4	2.0	1.8	2.6

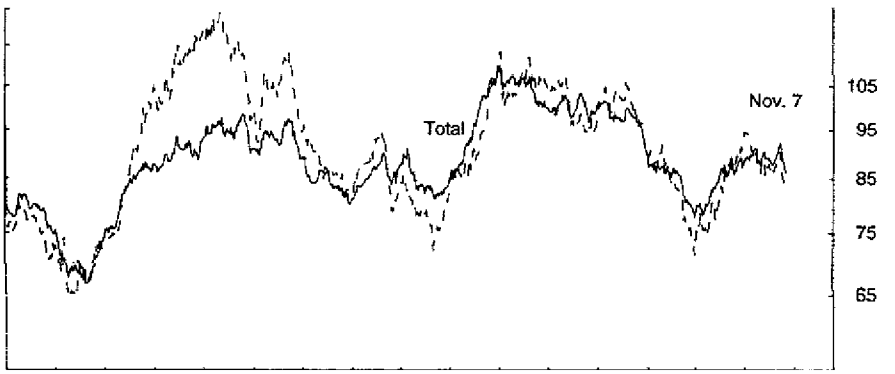
1. Excluding housing.

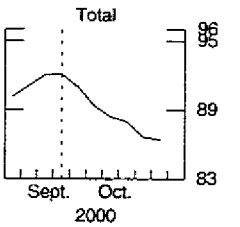
SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

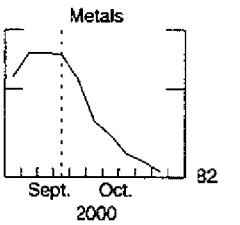
	Actual inflation[1]	University of Michigan				Professional forecasters (10-year)[4]
		1 year		5 to 10 years		
		Mean[2]	Median[2]	Mean[3]	Median[3]	
1998-Q4	1.5	2.7	2.4	3.2	2.8	2.5
1999-Q1	1.7	3.0	2.6	3.3	2.8	2.3
Q2	2.1	3.1	2.7	3.3	2.8	2.5
Q3	2.3	3.1	2.7	3.4	2.9	2.5
Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3	3.5	3.6	2.9	3.4	2.9	2.5
July	3.7	3.7	3.0	3.2	2.8	
Aug.	3.4	3.5	2.7	3.5	2.9	
Sept.	3.5	3.7	2.9	3.6	3.0	2.5
Oct.		4.1	3.2	3.7	3.0	

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

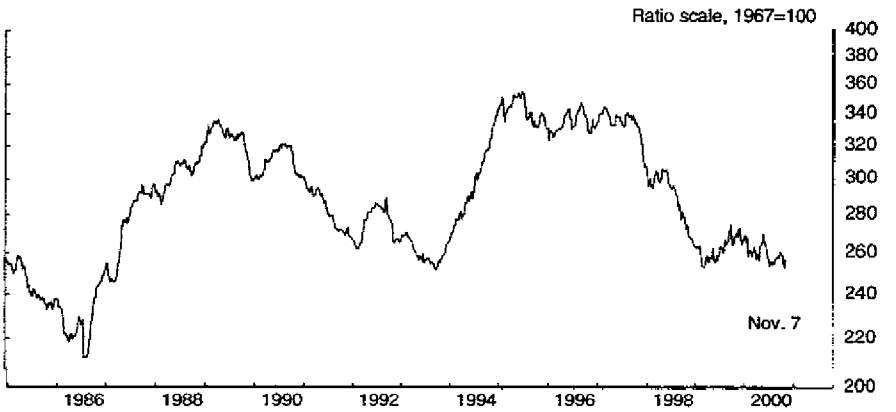
Commodity Price Measures

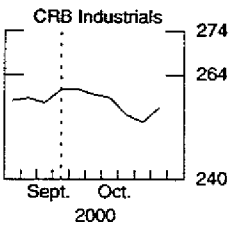




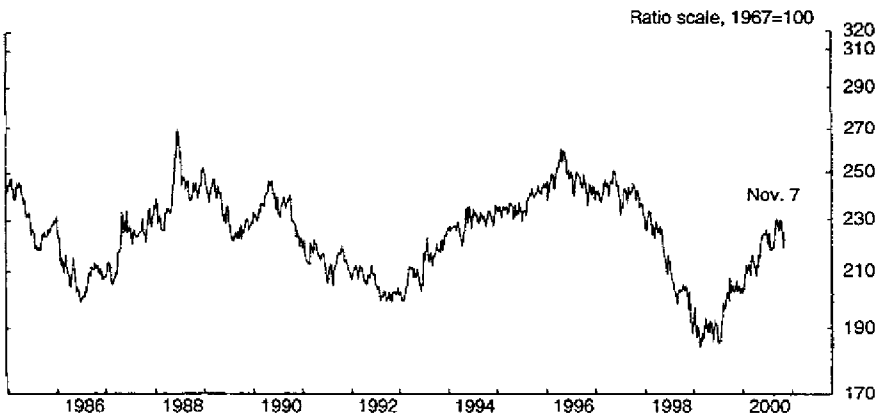


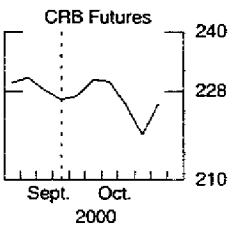
CRB Spot Industrials





CRB Futures





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

SPOT PRICES OF SELECTED COMMODITIES

	Current price (dollars)	Percent change[1] 1998	1999	Dec. 28 to Sept. 26[2]	Sept. 26[2] to Nov. 07	Memo: Year earlier to date
Metals						
Copper (lb.)	0.870	-18	27.5	10.2	-10.3	3.6
Steel scrap (ton)	74.333	-47	61.5	-21.6	-19.2	-30.3
Aluminum, London (lb.)	0.668	-18	26.8	2.4	-8.5	1.3
Precious metals						
Gold (oz.)	265.50	-1.8	1.3	-5.5	-3.4	-8.7
Silver (oz.)	4.750	-20	4.3	-5.2	-4.4	-7.3
Forest products[3]						
Lumber (m. bdft.)	190.00	2.7	8.3	-29	-17	-39.7
Plywood (m. sqft.)	285.00	6.8	-1.6	8.2	-14	-12.3
Petroleum						
Crude oil (barrel)	31.490	-43	147.2	14.9	7.3	30.1
Gasoline (gal.)	0.957	-43	109.2	32.8	3.3	41.7
Fuel oil (gal.)	0.955	-39	115.2	31.4	2.9	52.8
Livestock						
Steers (cwt.)	71.000	-13	15.3	-2.9	7.6	2.5
Hogs (cwt.)	36.750	-65	127.4	23.4	-16	17.6
Broilers (lb.)	0.569	27.6	1.4	-6.9	6.1	-6.9
U.S. farm crops						
Corn (bu.)	1.980	-19	-8.5	-16	24.5	7.6
Wheat (bu.)	3.420	-11	-20.3	17.1	10.5	25.0
Soybeans (bu.)	4.635	-20	-16.8	5.0	-0.4	2.1
Cotton (lb.)	0.629	-9.3	-19.4	31.7	3.3	30.6
Other foodstuffs						
Coffee (lb.)	0.750	-30	2.1	-29	-12	-33.6
Memo:						
JOC Industrials	86.400	-14	12.2	4.5	-6.2	-1.2
JOC Metals	82.400	-20	28.0	-2.9	-8.7	-8.2
CRB Futures	225.51	-18	6.9	10.9	-0.4	10.3
CRB Spot	256.55	-14	1.0	-2.1	-1.5	-5.0

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

tools, and communications equipment. In addition, a small portion of the overall acceleration owes to a slower rate of decline in computer prices; these prices fell about 15 percent over the past twelve months, compared with a year-earlier rate of decline in excess of 20 percent. Although not included in the PPI for capital goods, software prices in the NIPAs have also accelerated considerably in the past year.

The firming of investment prices has contributed to an acceleration in the broader price indexes in the national accounts. Over the four quarters ended in the third quarter of 2000, the chain-weighted price index for gross domestic purchases increased 2.6 percent, almost 1 percentage point faster than in the prior year.

At earlier stages of processing, prices for industrial materials other than food and energy have been on the soft side recently. The PPI for core intermediate materials was unchanged in September after rising 2.3 percent over the past year. Although this pace of increase is faster than that of a year earlier, changes in core intermediate prices have eased in recent months. The PPI for core crude materials increased 0.3 percent in September after having declined in each of the preceding six months. Although these prices moved up 2.5 percent over the past year, this rate of rise is well below the double-digit increases that the twelve-month change was registering earlier this year. Moreover, since the mid-September pricing date of the PPI, the Journal of Commerce index of industrial commodities has declined 5.2 percent, with lower prices for metals--including steel scrap--forest products, and textiles.

Near-term inflation expectations picked up in October. The median response to the University of Michigan survey of one-year-ahead inflation expectations was 3.2 percent in October, up from the 3 percent pace that prevailed through the first three quarters of the year.[15] In contrast to the pickup in near-term expectations, longer-term expectations remained relatively steady last month, with the five-to-ten-year median expectation at 3.0 percent.

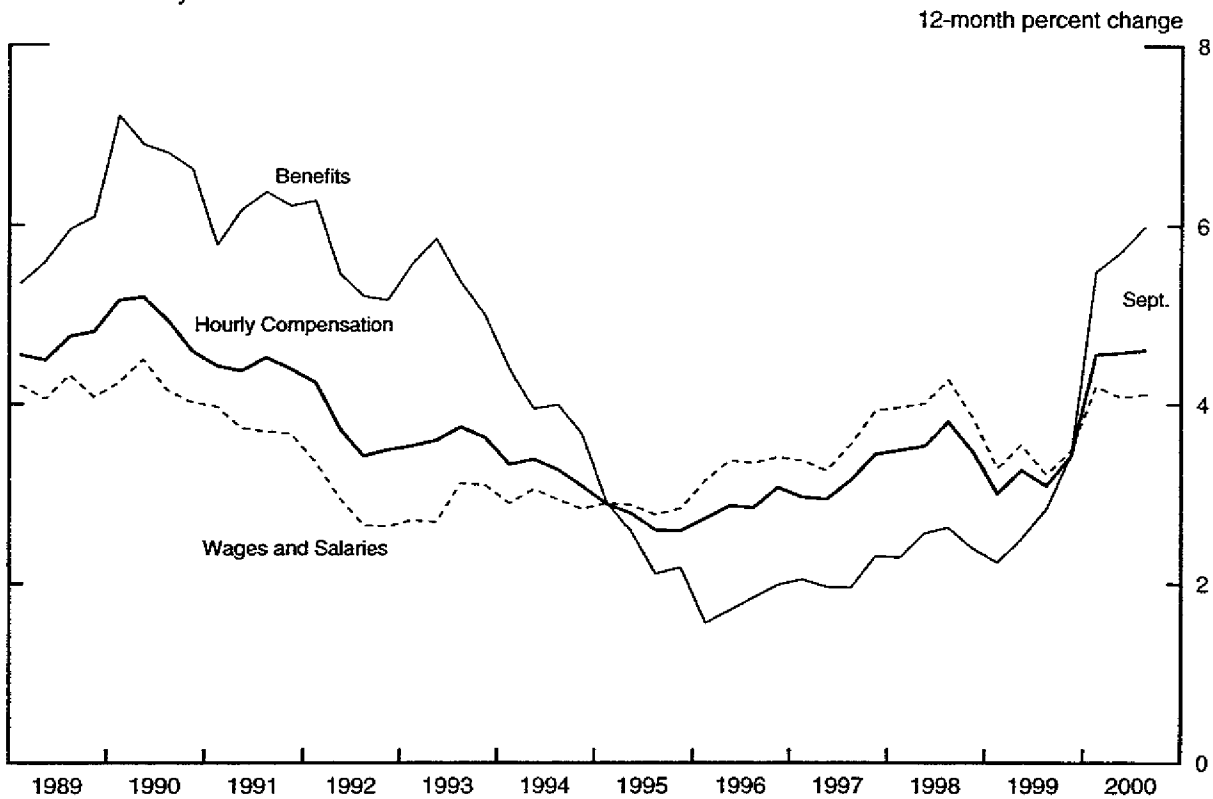
Labor Costs

The third-quarter gain in the ECI was less than the elevated rates of increase registered in the prior two quarters; however, over the past twelve months, ECI compensation per hour rose 4.6 percent, up considerably from the 3.1 percent pace during the prior year. Faster increases in benefits costs--which accelerated more than 3 percentage points over the past year--contributed importantly to this pickup. Health insurance costs and nonproduction bonuses were a noticeable

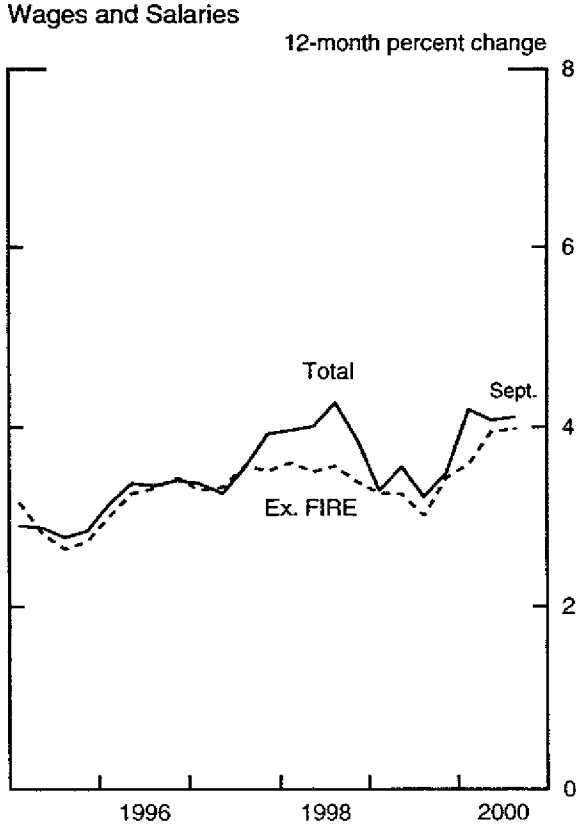
15. The mean response jumped by more--from about 3.6 percent in the first three quarters of the year to 4.1 percent in October; however, we tend to prefer the median response because the mean measure can be strongly affected by a few extreme readings.

Employment Cost Index

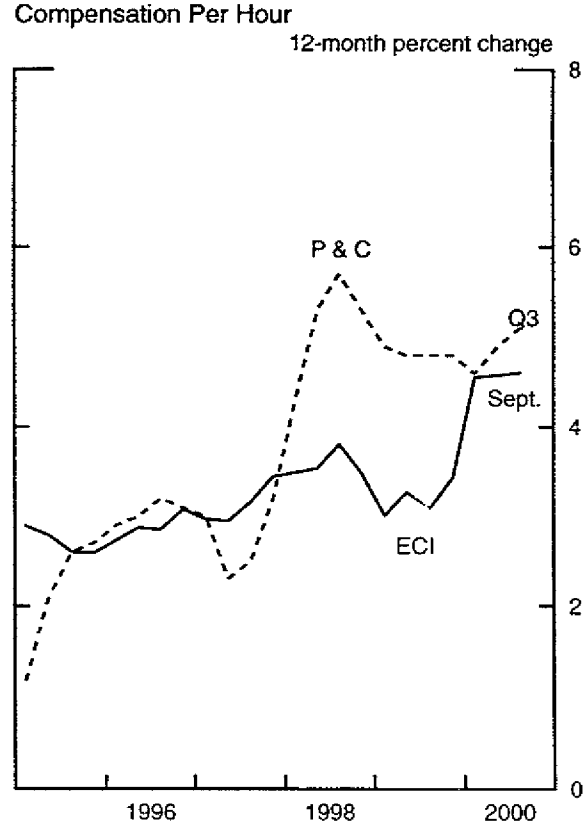
Private Industry Workers



Wages and Salaries



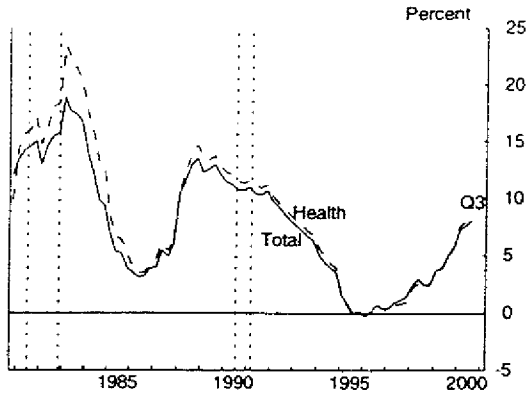
Compensation Per Hour



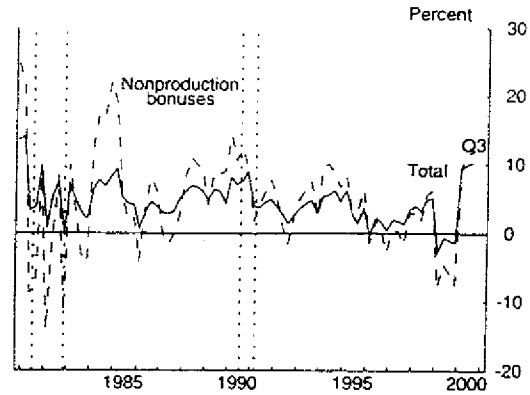
Components of ECI Benefits Costs (CONFIDENTIAL)

(Private industry workers; 12-month change)

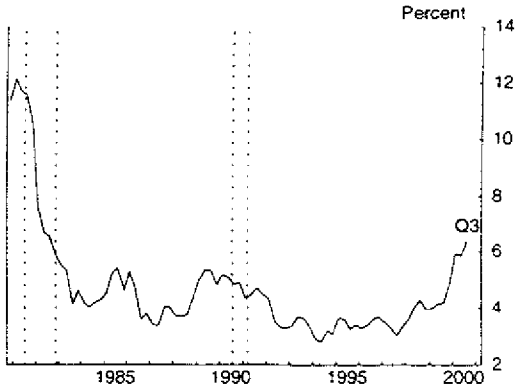
Insurance Costs



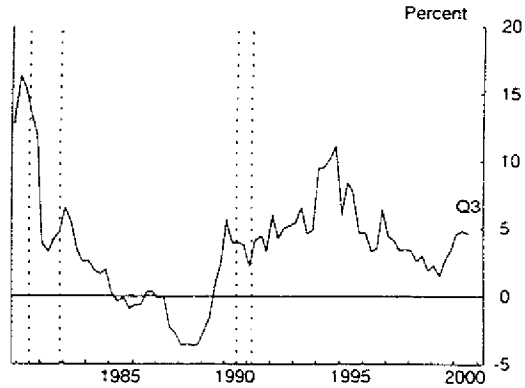
Supplemental Pay



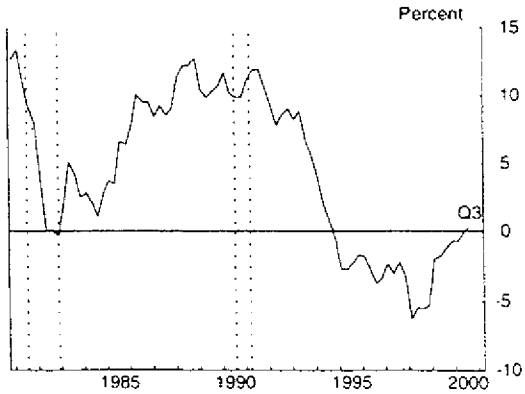
Paid Leave



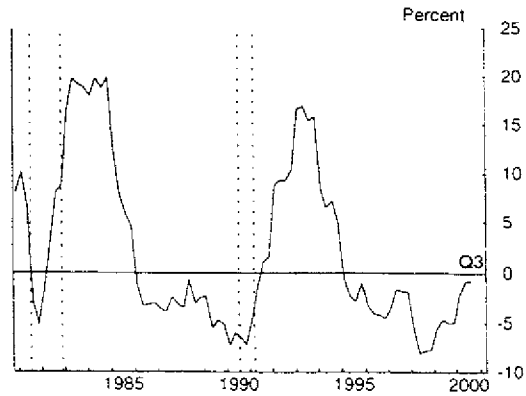
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



Note. Unpublished and confidential ECI benefits detail.

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

	1998[1]	1999[1]	1999 Q4	2000 Q1	2000 Q2	2000 Q3	1999:Q3 to 2000:Q3
Compensation per hour							
Total business	5.3	4.8	3.8	3.5	7.0	5.8	5.0
Nonfarm business	5.3	4.8	4.2	3.9	5.9	6.4	5.1
Nonfinancial corporations[2]	4.9	5.0	4.1	2.7	6.1	n.a.	n.a.
Unit labor costs							
Total business	2.3	.7	-3.6	1.9	.0	2.5	.2
Nonfarm business	2.3	.7	-3.5	1.9	-.2	2.5	.1
Nonfinancial corporations[2]	1.1	.1	-1.8	-.2	.6	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.

source of this acceleration in benefits, but rates of increase in the other major benefit categories have moved up as well.

The ECI for wages and salaries also has moved up considerably over the past year, following a sharp deceleration in 1999; at 4.1 percent, it is still below its most recent peak, registered in the third quarter of 1998. This pattern mainly reflects sharp swings in wage changes in the finance, insurance, and real estate industry (FIRE), which surged in 1998 during the mortgage refinancing wave and then subsided in 1999. Excluding FIRE, a persistent upward trend in rates of increase is more evident than in the overall wage and salary figures.

The productivity and cost measure of compensation per hour is estimated to have increased sharply in the third quarter, bringing the four-quarter change to 5.1 percent. Setting aside the difficult-to-explain surge in 1998 and subsequent deceleration in 1999, P&C hourly compensation has accelerated considerably since 1995. Both the ECI and the P&C measure show a similar amount of acceleration over the 1995-2000 period, reflecting a combination of rising productivity growth, tight labor markets, and--in recent years--higher price inflation.

The October employment report provided the first look at wage developments in the fourth quarter. Average hourly earnings of production or nonsupervisory workers increased 0.4 percent that month, bringing the twelve-month change in the wage measure to 3.8 percent. On balance, however, the rate of increase in average hourly earnings has changed relatively little since the beginning of 1999. This stands in contrast to the acceleration over that period in the ECI for wages and salaries of production or nonsupervisory workers--the ECI's closest counterpart to the average hourly earnings measure. There are, of course, many differences in the construction of these two wage series, and they have often diverged for significant periods of time. For one thing, average hourly earnings includes the effect of swings in overtime hours, while the ECI does not. In addition, the ECI uses fixed weights to aggregate industries and occupations, while average hourly earnings is a current-weighted measure. Our sense from looking more carefully at the recent divergence in these measures is that both swings in overtime hours and changes in industrial composition have contributed to the more sanguine view of wage pressures suggested by the average hourly earnings data.[16]

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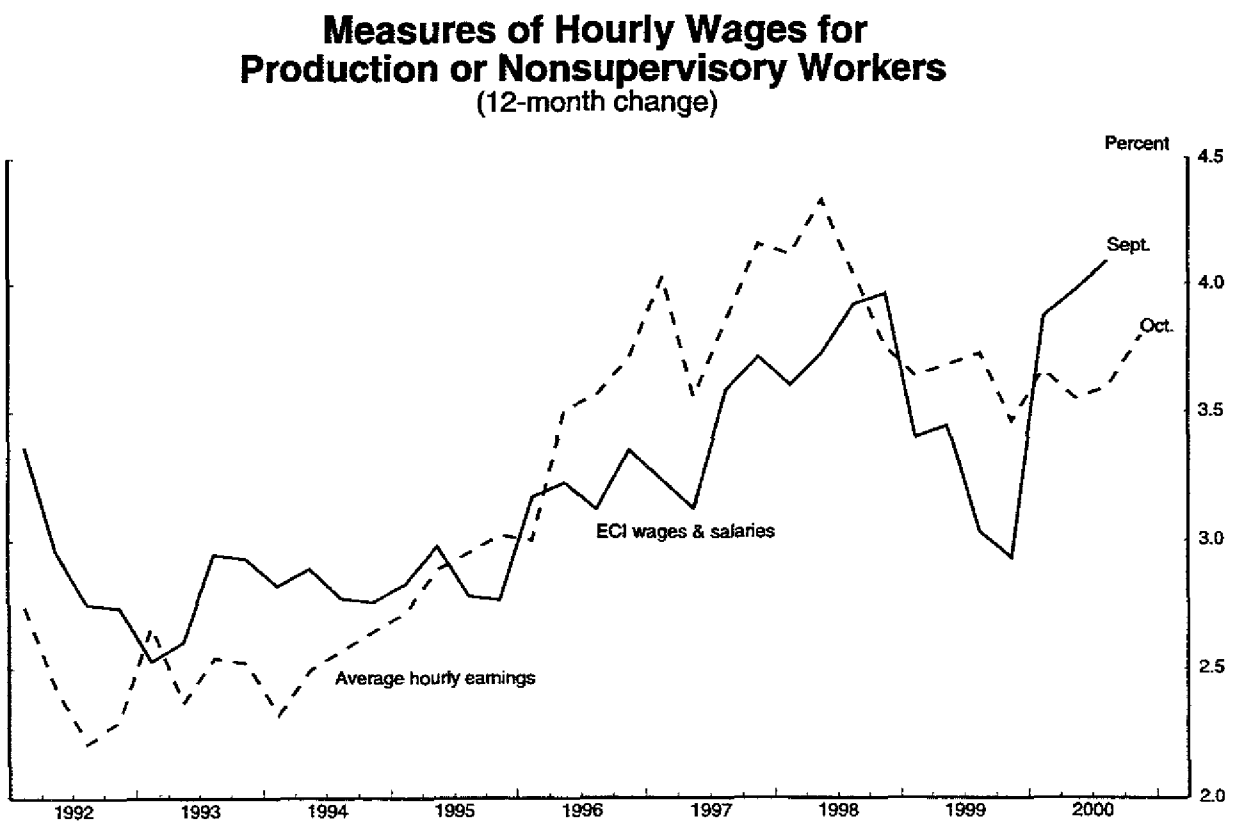
16. A very rough gauge of these effects can be calculated by comparing average hourly earnings for the manufacturing sector with and without overtime hours and by comparing overall average hourly earnings with a measure adjusted (approximately) for changes in industrial composition. Although the results are sensitive to the particular time period chosen for the calculation, these estimates suggest that a small decline in manufacturing overtime and changes in industrial composition held down the acceleration in average hourly earnings over the last year and a half by something in the neighborhood of 1/4 percentage point relative to the corresponding ECI measure.

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

	12-month percent change			Percent change to Oct. 2000 from month indicated		2000	
	Oct. 1998	Oct. 1999	Oct. 2000	Apr. 2000	July 2000	Sept.	Oct.
	- - - - - - - -Annual rate- - - - - - - - -					-Monthly rate-	
Total private nonfarm	3.9	3.6	3.8	3.7	4.1	.2	.4
Manufacturing	2.0	3.7	3.3	3.5	3.9	-.1	.8
Construction	3.4	3.5	3.9	2.6	2.5	.3	.2
Transportation and public utilities	2.2	2.5	3.7	3.3	5.3	.2	.5
Finance, insurance, and real estate	4.8	3.4	3.1	2.8	4.3	.4	.1
Retail trade	4.5	4.0	3.9	3.2	3.9	.4	.1
Wholesale trade	4.7	3.5	4.3	4.7	4.3	.7	.2
Services	4.7	3.9	3.9	4.4	4.4	.2	.5



Domestic Financial Developments

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	1999	2000			Change to Nov. 7 from selected dates (percentage points)		
	June 29	May 15	FOMC* Oct. 3	Nov. 7	1999 June 29	2000 May 15	FOMC* Oct. 3
Short-term							
FOMC intended federal funds rate	4.75	6.00	6.50	6.50	1.75	.50	.00
Treasury bills [1]							
3-month	4.70	5.94	6.03	6.23	1.53	.29	.20
6-month	4.92	6.24	6.01	6.10	1.18	-.14	.09
1-year	4.89	6.05	5.75	5.90	1.01	-.15	.15
Commercial paper							
1-month	5.18	6.47	6.50	6.47	1.29	.00	-.03
3-month	5.12	6.59	6.51	6.50	1.38	-.09	-.01
Large negotiable CDs [1]							
1-month	5.21	6.55	6.57	6.55	1.34	.00	-.02
3-month	5.32	6.74	6.70	6.66	1.34	-.08	-.04
6-month	5.43	6.97	6.67	6.65	1.22	-.32	-.02
Eurodollar deposits [2]							
1-month	5.13	6.53	6.54	6.53	1.40	.00	-.01
3-month	5.25	6.72	6.71	6.68	1.43	-.04	-.03
Bank prime rate	7.75	9.00	9.50	9.50	1.75	.50	.00
Intermediate- and long-term							
U.S. Treasury (constant maturity)							
2-year	5.68	6.88	5.98	5.99	.31	-.89	.01
10-year	5.93	6.47	5.83	5.87	-.06	-.60	.04
30-year	6.07	6.17	5.93	5.90	-.17	-.27	-.03
U.S. Treasury 10-year indexed note	4.01	4.21	3.97	3.89	-.12	-.32	-.08
Municipal revenue (Bond Buyer) [3]	5.62	6.23	5.85	5.73	.11	-.50	-.12
Private instruments							
10-year swap	6.81	7.82	6.93	6.95	.14	-.87	.02
10-year FNMA	6.59	7.70	6.76	6.74	.15	-.96	-.02
Merrill Lynch BBB	7.60	8.86	8.15	8.46	.86	-.40	.31
High yield[4]	10.53	11.94	11.92	12.85	2.32	.91	.93
Home mortgages (FHLMC survey rate) [5]							
30-year fixed	7.63	8.52	7.88	7.73	.10	-.79	-.15
1-year adjustable	5.93	6.96	7.21	7.12	1.19	.16	-.09

Stock exchange index	Record high		2000			Change to Nov. 7 from selected dates (percent)		
	Level	Date	May 15	FOMC* Oct. 3	Nov. 7	Record high	May 15	FOMC* Oct. 3
Dow-Jones Industrial	11,723	1-14-00	10,808	10,700	10,952	-6.58	1.34	2.36
S&P 500 Composite	1,527	3-24-00	1,452	1,436	1,432	-6.26	-1.41	-.30
Nasdaq (OTC)	5,049	3-10-00	3,608	3,569	3,416	-32.34	-5.32	-4.29
Russell 2000	606	3-9-00	498	512	506	-16.52	1.65	-1.11
Wilshire 5000	14,752	3-24-00	13,438	13,522	13,403	-9.14	-.26	-.88

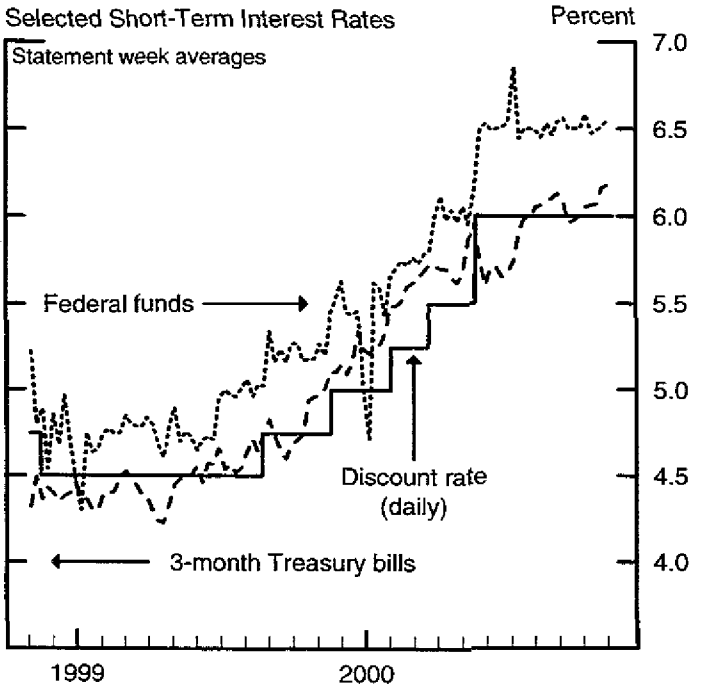
1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Most recent Thursday quote.
4. Merrill Lynch 175 high-yield bond index composite.
5. For week ending Friday previous to date shown.

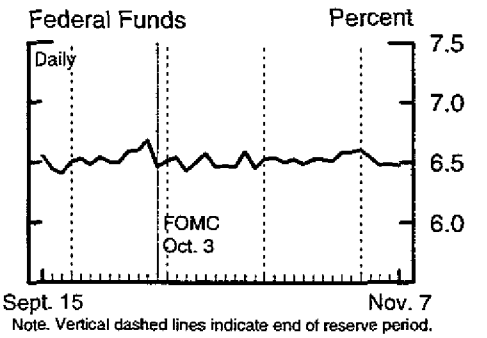
* Data are as of the close on October 2, 2000.

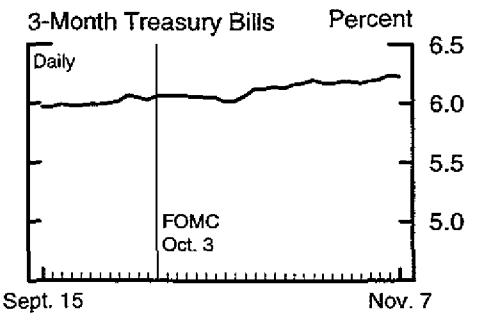
NOTE. June 29, 1999 is the day before the beginning of the most recent sequence of policy tightenings.
NOTE. May 15, 2000 is the day before the most recent tightening.

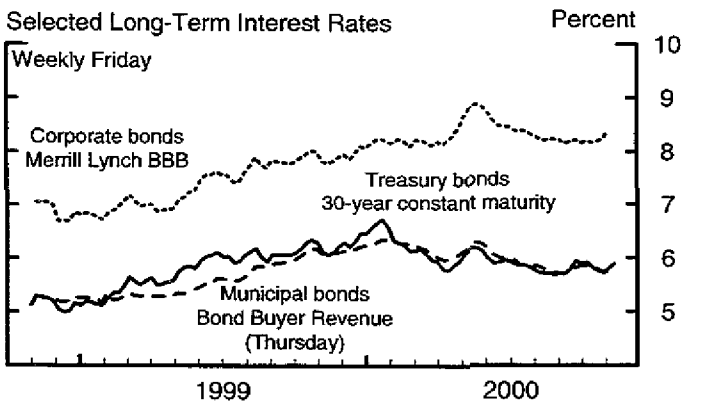
BA:DAM

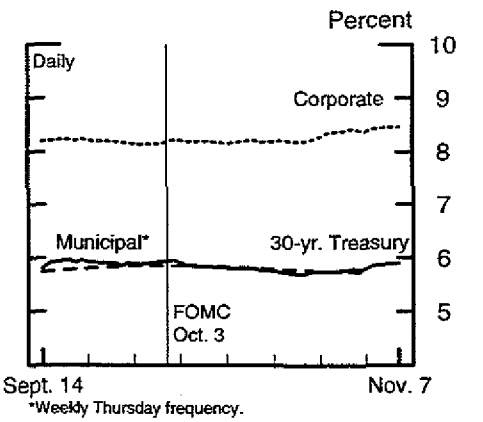
Selected Interest Rates

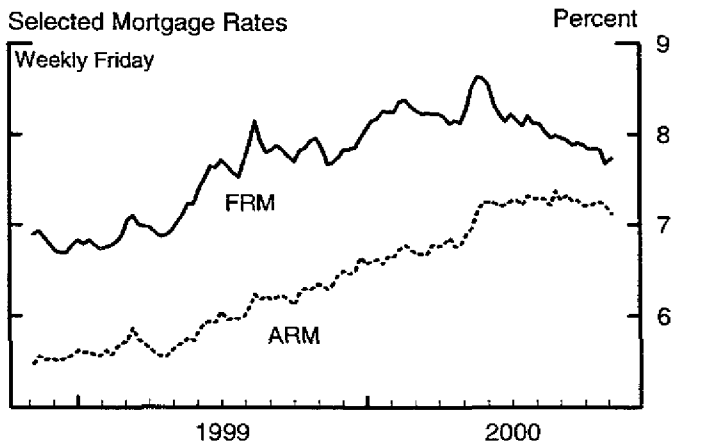


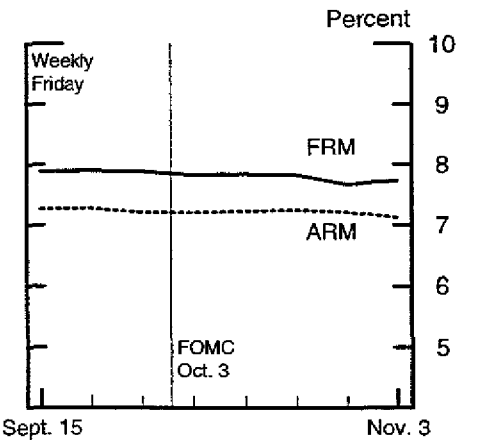












Domestic Financial Developments

Overview

Concerns about decelerating corporate earnings and revenues, particularly in the telecom and internet sectors, led to considerable volatility in the equity market over the intermeeting period. On net, however, broad equity indexes were off only slightly. Yields on Treasury securities and most higher-grade private debt instruments were also about unchanged. But the increased volatility, together with the perception that economic growth has settled into a slower pace, made market participants more wary about credit risk, causing yield spreads on lower-grade bonds to widen sharply.

The pace of financing slackened over the intermeeting period. Corporate bond issuance dropped off until very recently and remained concentrated in larger issues, while equity issuance continued to be well below the pace earlier this year. Nonfinancial commercial paper and business loans at banks were both quite sluggish in October, and the Senior Loan Officer Opinion Survey confirmed that many banks have tightened terms and standards for C&I lending in recent months. Little, if any, tightening was reported for consumer and mortgage loans, which have continued to expand briskly.

Interest Rates and Stock Prices

Treasury yields increased several basis points in response to the statement released after the October FOMC meeting, which market participants saw as reflecting more concern about inflation than had been anticipated. Yields dropped back over subsequent weeks, though, as tensions in the Middle East and the choppy decline in equity prices led to heightened expectations of Federal Reserve easing next year and to safe-haven flows into Treasury securities. More recently, Treasury yields backed up as equity prices rebounded and employment data showed a continued tight labor market.

On net over the intermeeting period, nominal Treasury coupon yields were about flat.[1] Yields on inflation-indexed Treasury securities fell about 15 basis points at the five-year maturity, and the wider spread below nominal Treasuries suggests some increased concern about near-term inflation pressures. Nonetheless, federal funds and eurodollar futures rates on contracts expiring next year were little changed, on balance, over the intermeeting period, and continue to suggest that the market is pricing in some chance of policy easing next year.

In equity markets, a number of earnings warnings by well-known firms and a paring back of analysts' earnings forecasts caused sharp declines in some stock prices, but left broad indexes only slightly lower on balance. The tech-heavy

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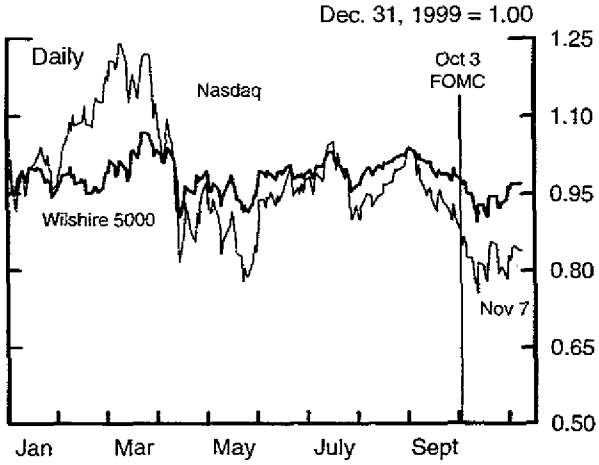
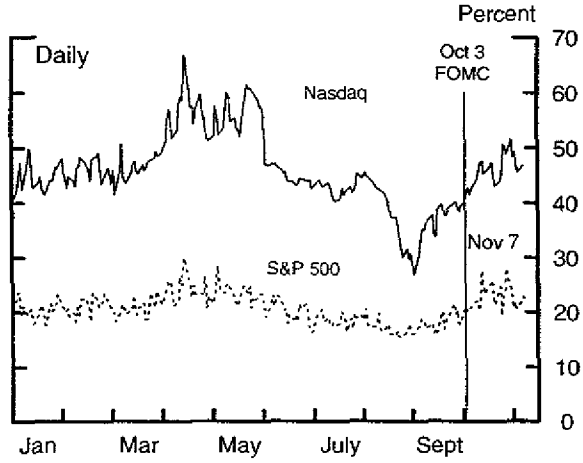
1. While private short-term rates were about unchanged, Treasury bill rates rose 10 to 20 basis points, likely reflecting supply pressures.

Corporate Finance

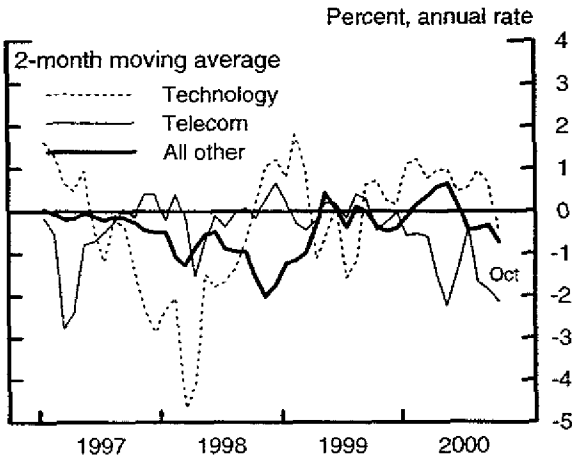
Selected Stock Indexes



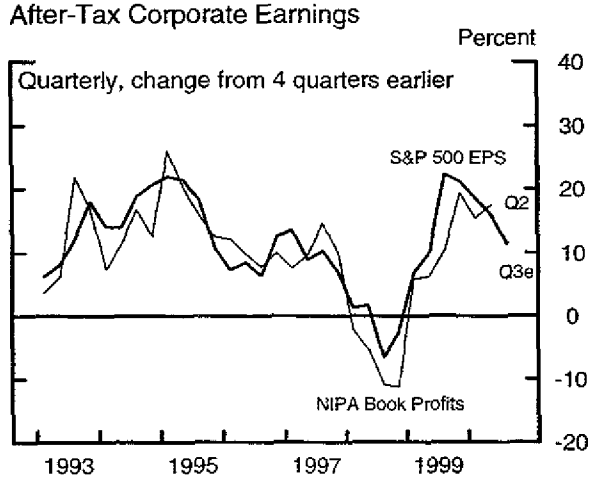
Implied Volatility for Selected Stock Indexes



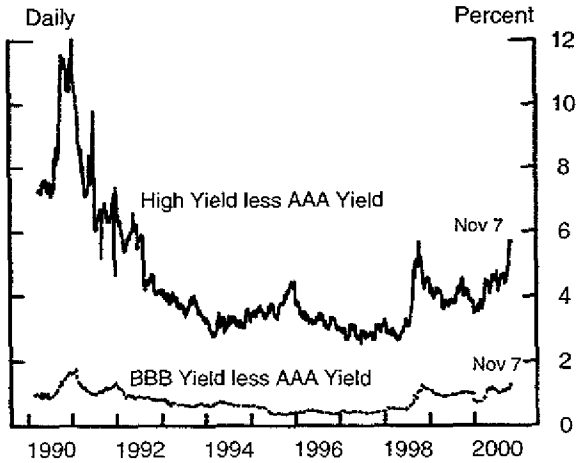
Revisions to Year-ahead Earnings



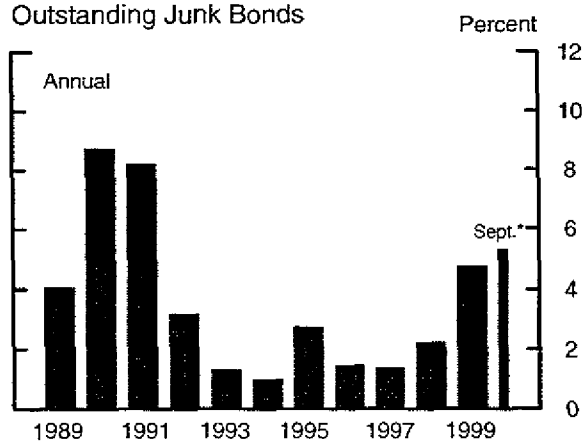
After-Tax Corporate Earnings



Corporate Bond Spreads



Default Rates
Outstanding Junk Bonds



* Year-to-date (Sept. 2000) at an annual rate.

Nasdaq dropped nearly 15 percent in the first two weeks of October, but has recovered much of that loss. Movements in the Wilshire 5000 and the S&P 500 were more muted and, on net, are about unchanged over the intermeeting period. Option prices indicate that volatility is expected to remain high.

The perception that the economy is slowing led investors to become more concerned about the credit quality of lower-rated corporate borrowers, causing yield on the bonds of such issuers to jump. In contrast, agency spreads over Treasuries receded some, helped in part by the announcement that Freddie Mac and Fannie Mae were adopting a number of measures to increase the transparency of their balance sheets and strengthen their capital base and liquidity.

Business Finance

Responding to warnings about third- and fourth-quarter earnings--especially from such high-profile companies as Apple, Xerox, Dell, Lucent, and Home Depot--equity analysts pared back forecasts of S&P 500 companies' earnings in the twelve months ahead by more than 1 percent between mid-September and mid-October. This was the largest monthly cut in almost two years. While the revisions for most sectors were small in comparison to those that followed the unfolding of the Asian crisis or the Russian default, the telecom sector has been singled out for a more significant reassessment. This month likely will show more of the same, given last week's announcements from WorldCom and Sprint that their growth in 2001 will be well under that implied by analysts' projections.

Projections for some computer-related technology firms were also trimmed in the most recent month, but, overall, average forecasts in this sector showed very little decline. For the remainder of the S&P 500, the modest forecast reductions observed of late were consistent with the recent deceleration in economic activity.

With nearly 450 third-quarter earnings reports now in, four-quarter growth in S&P 500 earnings per share appears to have slowed to 11-1/2 percent, from 16 percent in the second quarter. Seasonally adjusted, their earnings are estimated to have risen about 2 percent from their second-quarter level (at a quarterly rate), a touch stronger than anticipated in the previous Greenbook.

As revisions to corporate earnings forecasts triggered price revaluations in equity markets, gross public equity issuance was subdued. Telecom offerings, which had accounted for more than 30 percent of the total proceeds this year, fell in October. Several issuers withdrew or postponed offerings, including Verizon Wireless, which put off an anticipated $5 billion IPO. In other sectors--including biotech and energy--issuance has continued, albeit at a less robust pace than in recent quarters. Together, initial public and seasoned offerings

Gross Issuance of Securities by U.S. Corporations

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

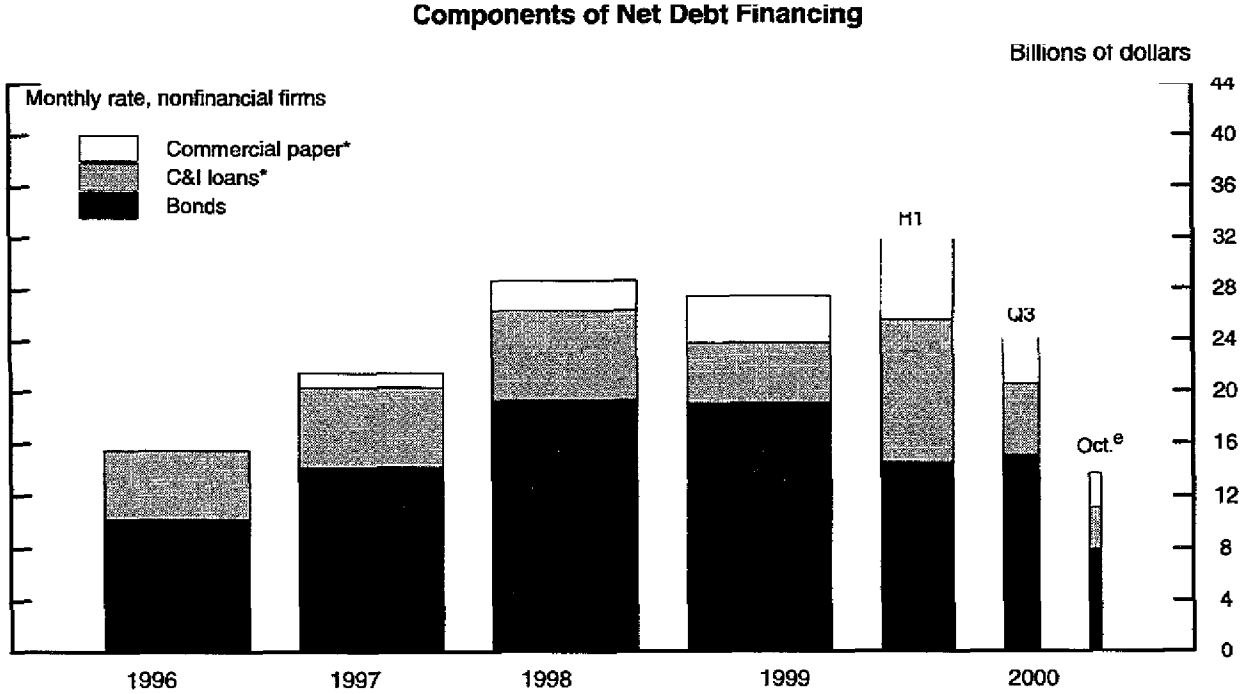
Type of security	1998	1999	H1	Q3	2000 Aug.	Sept.	Oct.[e]
All U.S. corporations	94.0	89.4	80.0	80.8	82.8	94.1	57.2
Stocks[1]	10.6	11.0	14.1	9.1	12.9	6.3	6.8
Bonds	83.5	78.4	65.9	71.7	69.9	87.8	50.9
Nonfinancial corporations							
Stocks[1]	6.2	9.2	12.4	7.5	8.6	5.1	5.2
Initial public offerings	2.2	4.2	5.7	4.5	5.5	3.9	2.8
Seasoned offerings	4.0	5.0	6.7	3.0	3.2	2.2	3.4
Bonds[2]	25.7	24.5	21.3	19.4	17.9	24.5	12.6
Investment grade[3]	14.1	13.9	11.5	11.0	11.5	13.6	6.5
Speculative grade[3]	10.2	7.5	5.4	4.9	4.0	7.0	3.0
Other (Sold abroad/unrated)	1.3	3.1	4.4	3.5	2.5	3.9	3.1
Financial corporations							
Stocks[1]	4.4	1.8	1.6	1.6	4.2	.2	.6
Bonds	57.8	53.9	44.7	52.3	51.9	63.4	37.8
Memo							
Net issuance of commercial paper, nonfinancial corporations[4]	2.3	3.6	6.4	5.2	4.8	-4.2	2.5
Change in C&I loans at commercial banks[4]	7.0	4.7	10.9	5.6	5.6	.3	3.2

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. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard Poor's if unrated by Moody's.
4. End-of-period basis, seasonally adjusted.

e Staff estimate.

Components of Net Debt Financing



* Seasonally adjusted.
e Staff estimate.

totaled just over $6 billion last month, a bit below the average pace of the past few years.

New data show venture capital investments down only slightly in the third quarter from their gigantic first-half pace, and exceeding public market issuance. As in the public market, it appears that Internet commerce continued to fall out of favor, while the share going to biotech picked up. Industry participants anticipate continued sizable investments as venture capitalists put recently raised funds to work.

Announcements of share repurchases in the third quarter were sluggish, but total share repurchases for this year are likely to be robust in light of earlier announcements. And while merger announcements in the third quarter and in October were mostly stock-financed deals, the pending list of cash-financed mergers remains sizable, suggesting that net equity retirements will likely remain substantial over the coming quarters.

In the bond market, risk spreads continued to climb in October, particularly in the speculative-grade segment. By mid-month, the yield spread of junk bonds over AAA-rated issues rose to a level last observed during the market disruption in the fall of 1998. Current spreads are now broadly consistent with the staff model of credit risk and do not seem excessive in light of the heightened risks faced by high-yield investors. Moreover, while liquidity conditions in the junk bond market reportedly have deteriorated, there is no evidence of the kind of breakdown seen a couple years ago, and even some very low-quality offerings have been marketed.

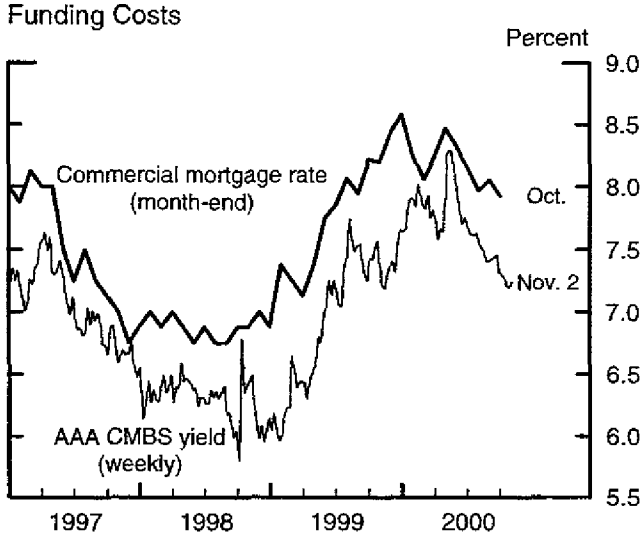
With both yields and spreads up, October recorded the lowest level of gross bond issuance since April--$12-1/2 billion by nonfinancial issuers. Both investment- and speculative-grade offerings fell to roughly half their year-average pace. However, in early November, the market appears to have strengthened, drawing a number of larger issuers off the sidelines.

Firms did not turn from bond markets to shorter-term sources in October. Outstandings of nonfinancial commercial paper rose less than $3 billion in October, only partially reversing the run-off in September. The October weakness was partly attributable to the exit by Xerox from the CP market--which paid down nearly $5 billion of outstandings--after a very unfavorable third-quarter report suggested a faster-than-expected deterioration in Xerox's competitive position.

Business credit at banks was also sluggish in October, apparently owing to both softer demand and perhaps to the tighter standards that banks have been reporting. On net, more than 40 percent of domestic banks in the November Business Loan Practices Survey reported a tightening of standards on C&I loans

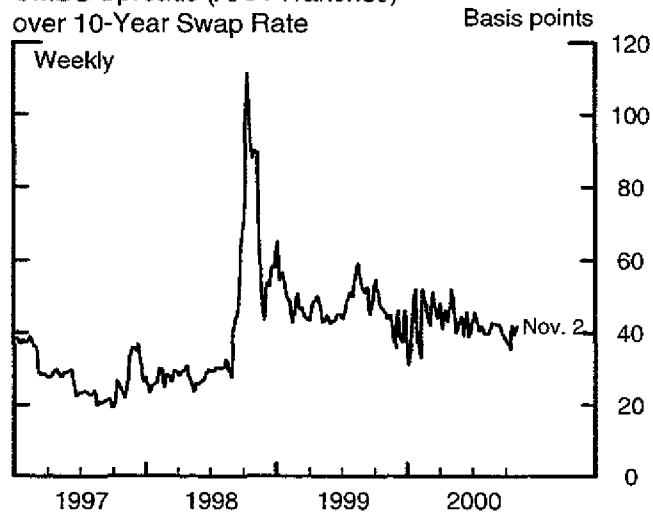
Commercial Real Estate

Funding Costs



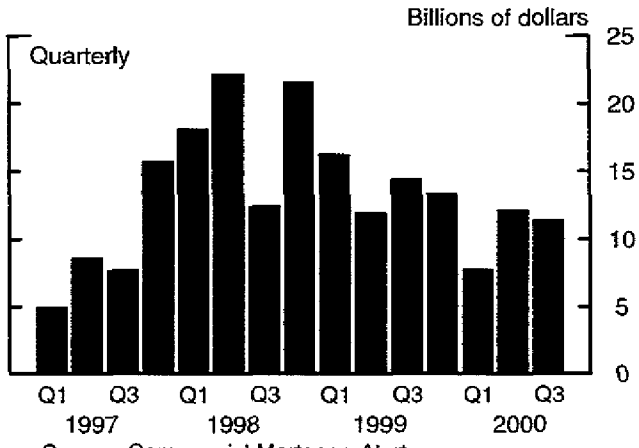
Source. Barron's/Levy National Mortgage Survey; Morgan Stanley.

CMBS Spreads (AAA Tranches) over 10-Year Swap Rate



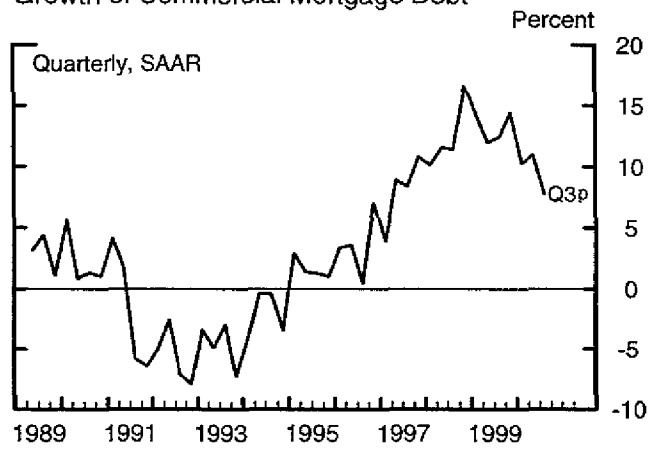
Source. Morgan Stanley.

Total CMBS Gross Issuance



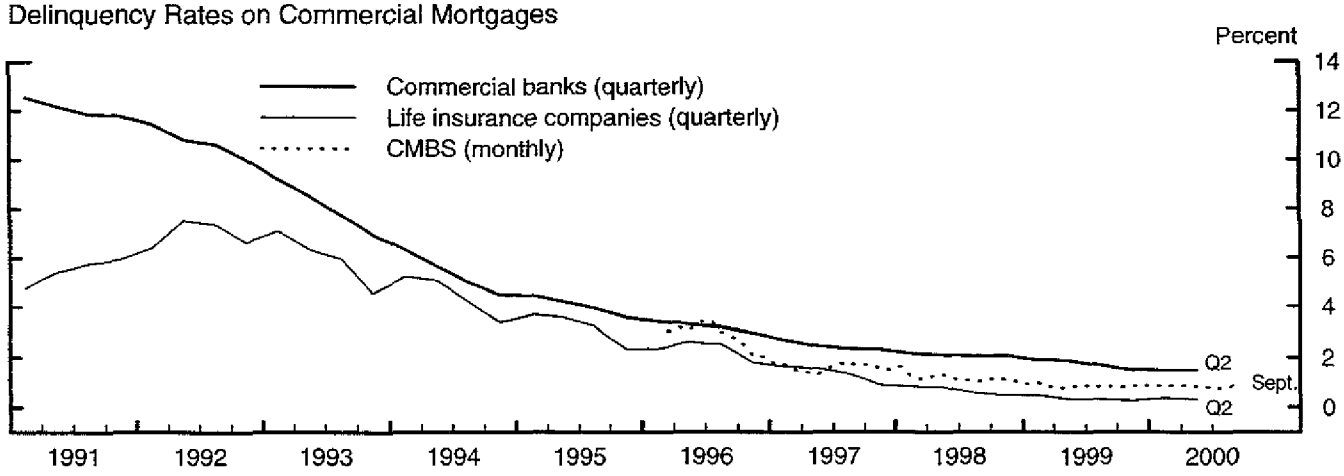
Source. Commercial Mortgage Alert.

Growth of Commercial Mortgage Debt



p. Staff projection.

Delinquency Rates on Commercial Mortgages



Source. ACLI; Morgan Stanley; Call Reports.

to large and middle-market firms over the past three months, the highest proportion since November 1990. Tightening was even more prominent among branches and agencies of foreign banks. Moreover, a large percentage of both domestic and foreign banks also reported tightening loan terms and charging higher premiums on riskier loans. Finally, more than half the respondents reported that they expected standards and terms on C&I loans to tighten somewhat further over the next year, even if the economy expands at a sustainable rate.

Overall credit quality of U.S. businesses has deteriorated noticeably this year, though measures suggest conditions stabilized somewhat in the third quarter. Moody's rating changes resulted in an overall net downgrade of about $112 billion last quarter, the fourth consecutive quarter of net downgrades. The aggregate liabilities of firms filing for bankruptcy fell off in the third quarter; on balance, the ratio of failed to total liabilities is not running much above its 1999 level and remains near the middle of its range over the past decade. Although it eased a bit in the third quarter, the default rate on outstanding junk bonds for the year to date stood at an elevated 5.3 percent in September, and defaults have been sprinkled fairly widely across sectors.

Commercial Real Estate

Since the last FOMC meeting, yields on AAA-rated commercial-mortgage-backed securities (CMBS) have declined along with the rate on comparable ten-year swaps. CMBS issuance in the third quarter was little changed from its second-quarter level, but commercial mortgage debt from all sources is estimated to have moderated to a 6-1/2 percent rate in the third quarter, well below the pace seen over the past couple of years. Delinquency rates on commercial mortgages remain at historically low levels. Nonetheless, about a quarter of the respondents to the November senior loan officer survey reported that they had tightened standards on commercial real estate loans.

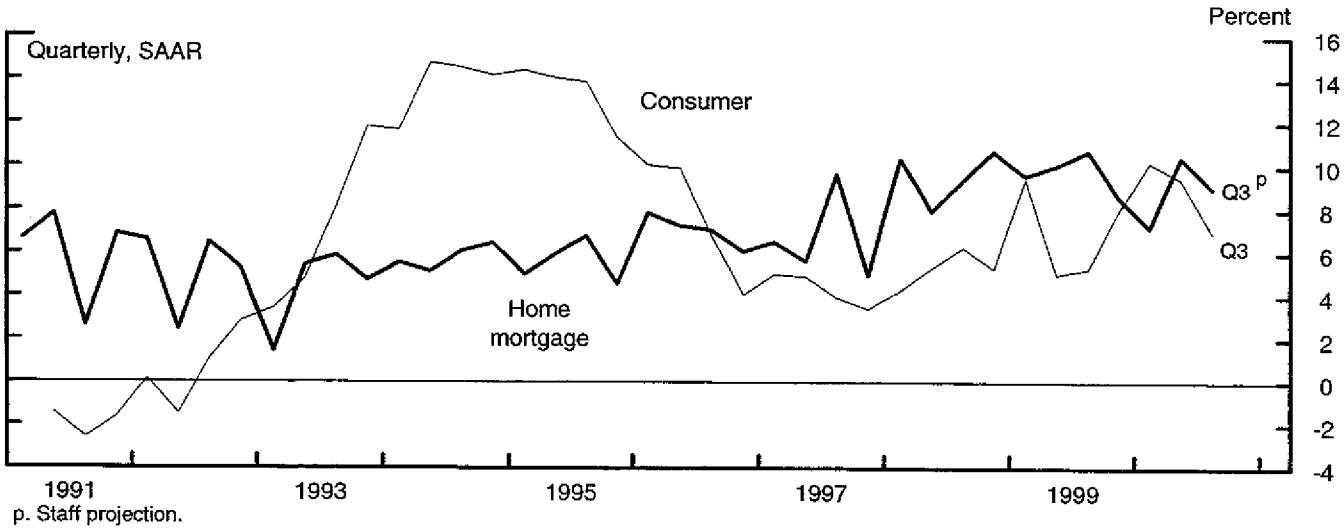
Household Finance

Available data for the third quarter suggest that household net borrowing in consumer and mortgage markets cooled a bit from the first-half pace. The robust growth seen in household debt through the third quarter helped push up the household debt-service burden close to its peak in the mid-1980s. Nonetheless, the latest measures of debt-repayment performance have shown few signs of a deterioration in consumer credit quality. Moreover, households hold lofty levels of assets relative to disposable income.

Credit conditions for households have not changed appreciably. Interest rates charged by banks on new-car loans and on home equity lines of credit are essentially unchanged since the last meeting. Also, interest rates on adjustable-rate mortgages have changed little, while rates on fixed-rate mortgages have declined roughly in line with those on ten-year Treasury notes. Little, if any,

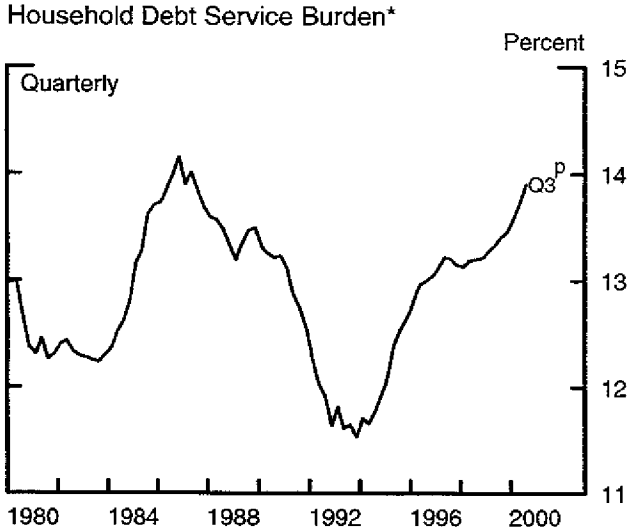
Household Liabilities

Household Debt Growth



p. Staff projection.

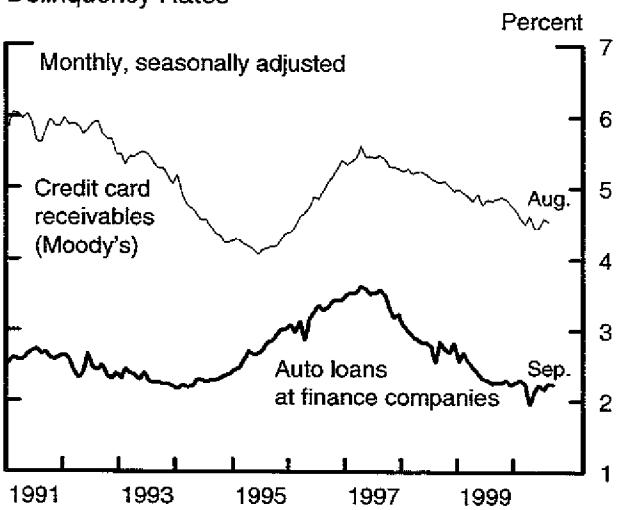
Household Debt Service Burden*



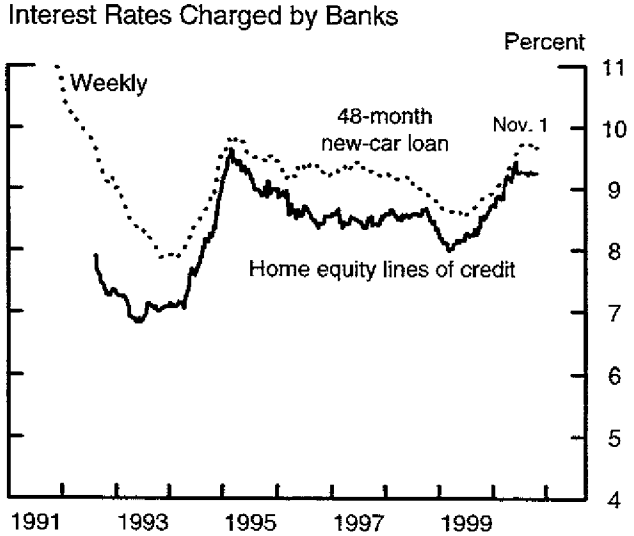
p. Staff projection.

*Required debt payments relative to disposable personal income.

Delinquency Rates

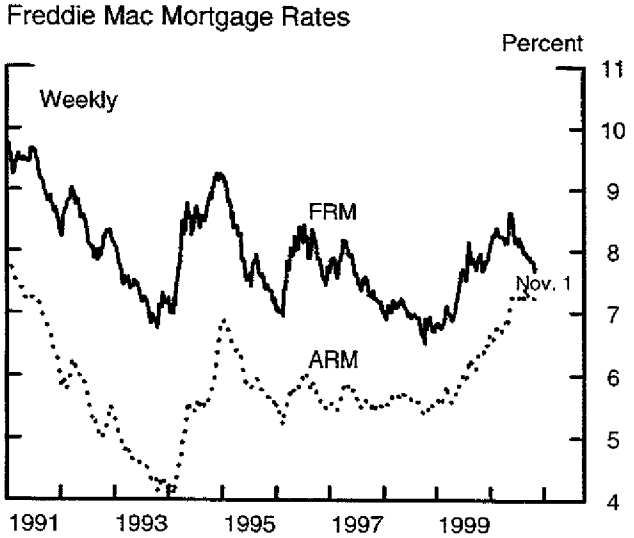


Interest Rates Charged by Banks



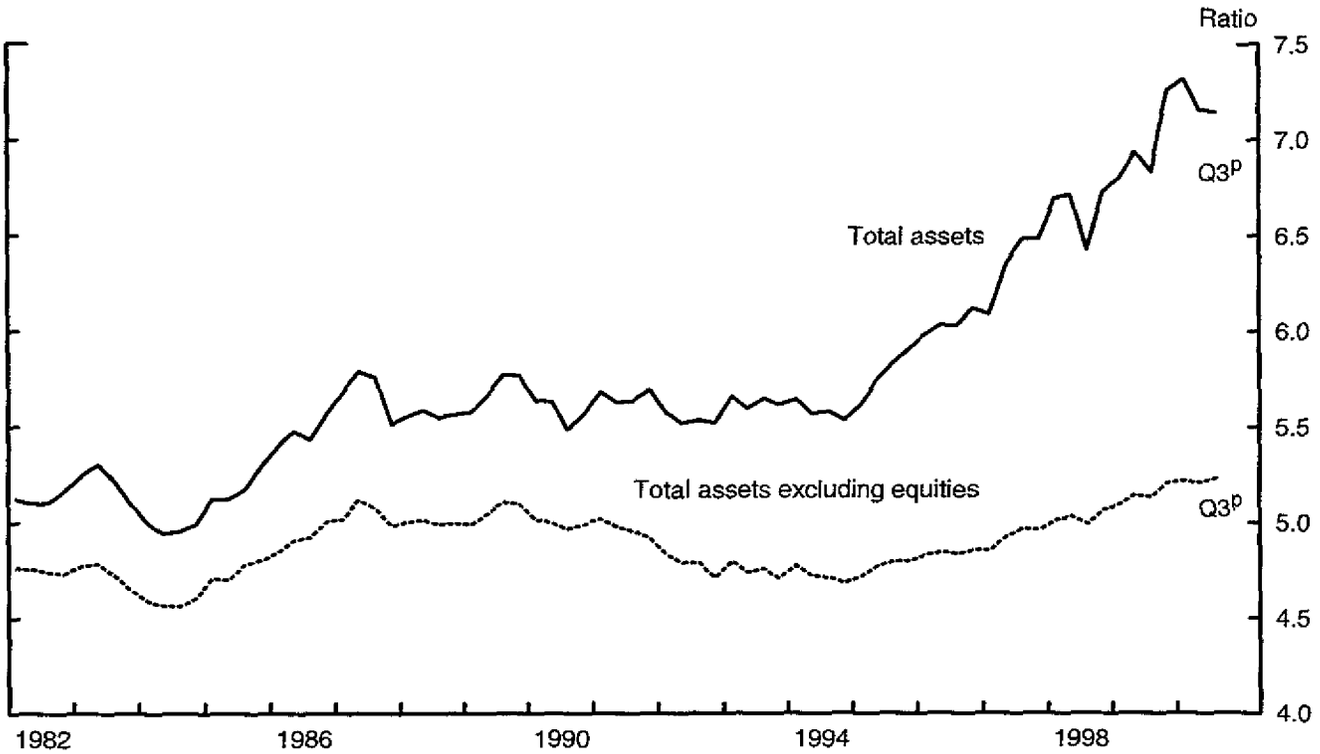
Source. Bank Rate Monitor.

Freddie Mac Mortgage Rates



Household Assets Relative to Disposable Income

(Quarterly data; seasonally adjusted)



p. Staff projection.

Net Flows into Long-Term Mutual Funds

(Excluding reinvested dividends; billions of dollars, monthly rates.)

	1997	1998	1999	2000 H1	2000 Q3	2000 Sept.	2000 Oct. [e]	Assets Sept.
Total long-term funds	**22.7**	**20.2**	**14.2**	**23.8**	**16.1**	**12.1**	**13.2**	**5,551**
Equity funds	**19.0**	**13.2**	**15.7**	**34.4**	**19.6**	**17.3**	**15.2**	**4,398**
Domestic	15.8	12.6	14.8	26.7	17.3	15.7	13.7	3,801
Capital appreciation	7.9	7.1	13.5	34.4	20.0	16.6	14.5	2,493
Total return	7.9	5.5	1.4	-7.6	-2.7	-0.9	-0.8	1,308
International	3.1	0.6	0.9	7.7	2.2	1.5	1.5	597
Hybrid funds	**1.4**	**0.9**	**-1.0**	**-4.0**	**-1.6**	**-2.1**	**-1.6**	**355**
Bond funds	**2.4**	**6.2**	**-0.5**	**-6.6**	**-1.9**	**-3.1**	**-0.4**	**799**
International	-0.1	-0.1	-0.2	-0.2	-0.1	-0.2	-0.2	21
High-yield	1.4	1.1	-0.2	-1.1	-0.7	-0.7	-1.3	102
Other taxable	1.0	3.9	1.0	-2.8	-0.7	-0.8	0.4	408
Municipals	0.1	1.3	-1.0	-2.5	-0.3	-1.4	0.7	267

e. Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute (ICI).

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	2000					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Total surplus, deficit (−)	**-15.0**	**211.8**	**60.5**	**-10.4**	**65.8**	**n.a.**
Means of financing deficit						
Net borrowing	-27.1	-189.6	-53.6	10.0	-32.3	-29.6
Nonmarketable	-6.4	2.2	-5.5	0.3	0.4	1.0
Marketable	-20.7	-191.7	-48.1	9.7	-32.7	-30.6
Bills	16.0	-123.7	-14.1	26.6	-31.2	2.3
Coupons[1]	-34.7	-57.1	-25.7	-14.7	0.0	-28.9
Debt buybacks	-2.0	-11.0	-8.2	-2.2	-1.5	-4.0
Decrease in cash balance	38.6	-12.7	4.8	20.9	-39.5	n.a.
Other[2]	3.5	-9.6	-11.6	-20.4	6.0	n.a.
MEMO						
Cash balance, end of period	44.8	57.4	52.7	13.2	52.7	n.a.

NOTE. Components may not sum to totals because of rounding.
1. Does not include Treasury debt buybacks.
2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
e. Estimated.
n.a. Not available.

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

Agency	2000					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
FHLBs	6.3	33.2	12.1	7.8	7.7	n.a.
Freddie Mac	17.3	6.3	n.a.	13.3	n.a.	n.a.
Fannie Mae	9.9	21.0	28.5	15.7	11.9	n.a.
Farm Credit Banks	-1.7	2.4	1.5	0.4	0.9	n.a.
Sallie Mae	-3.9	-0.8	5.2	-0.1	-1.7	n.a.
MEMO						
Outstanding noncallable notes and bonds						
Fannie Mae benchmark	128.1	142.1	163.6	159.1	163.6	172.6
Freddie Mac reference	85.5	96.5	110.6	104.5	110.5	117.6

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

tightening was reported for consumer and mortgage loans in the November survey of loan officers.

Inflows to equity mutual funds decelerated in September and October yet remained substantial in the face of declining equity prices and increased market volatility. Those inflows continued to be steered disproportionately into riskier domestic capital appreciation funds. In a break from recent trends, some bond fund categories began showing positive net inflows in October.

Treasury Finance

The Treasury's surplus over the third quarter came in at about $60 billion, allowing a paydown of about $54 billion in debt held by the public. Coupon retirements accounted for more than half of this total--$26 billion through redemptions and $8 billion through debt buybacks. On November 1, the Treasury announced that it expects to pay down $23 billion in marketable debt over the fourth quarter, a bit more than previously estimated. The Treasury conducted two more buyback operations in October for a total of $3 billion. Total debt buybacks for the year, at about $24 billion, are on track to meet Treasury's $30 billion target.

At the midquarter refunding announcement, the Treasury indicated that it will buy back $9 billion of securities in the first quarter of 2001. In response, the yield on thirty-year bonds increased several basis points after the announcement, as market participants were apparently expecting first-quarter buybacks to be a bit bigger. In the refunding operation, the Treasury auctioned $12 billion of new five-year notes and $8 billion of ten-year notes as a reopening of the new securities issued in August.

Recent market volatility has been accompanied by only a small deterioration in measures of Treasury market liquidity. The volume of primary dealer transactions in government securities edged down over the intermeeting period, while bid-ask spreads widened a little. Unlike some past episodes of market turbulence, however, the spread between on-the-run and off-the-run securities has not moved much lately.

Agency Finance

Issuance of agency debt continued at a strong pace during the intermeeting period, with Fannie Mae and Freddie Mac selling a combined $23 billion of Benchmark and Reference notes and bonds. In total, about $297 billion of these securities are outstanding. Issuance of Benchmark and Reference bills has also remained robust.

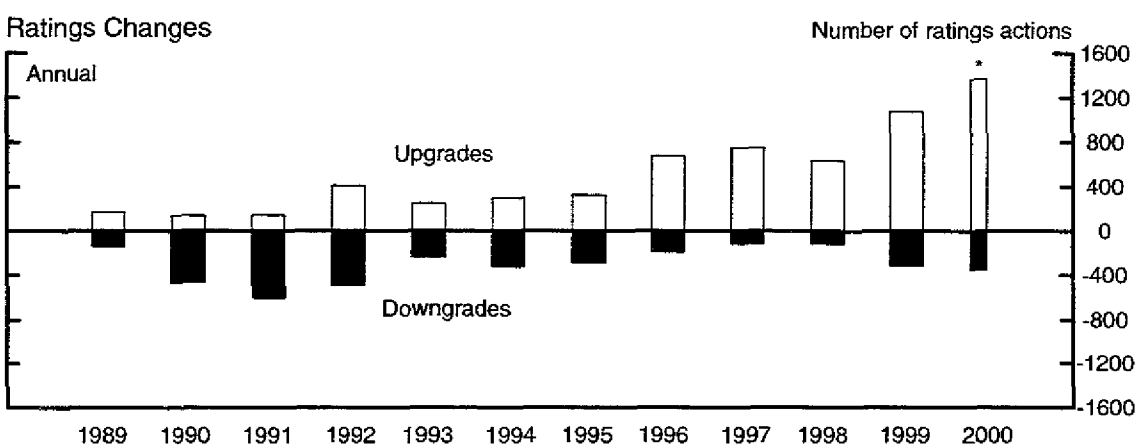
Agency spreads over Treasury yields are down a bit since the last FOMC meeting. Spreads had widened early in the intermeeting period, along with other corporate spreads, but narrowed appreciably on the October 20

State and Local Finance

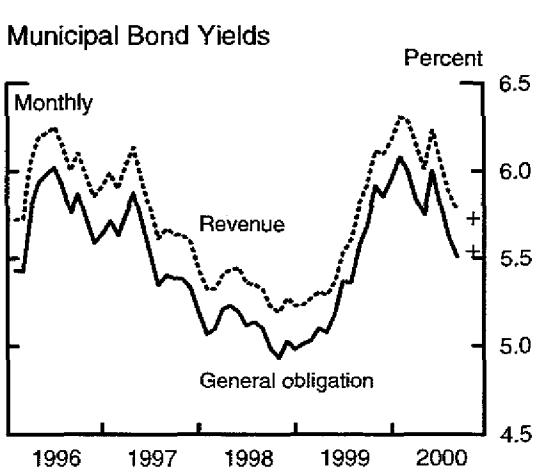
Gross Offerings of Municipal Securities
(Billions of dollars; monthly rates, not seasonally adjusted)

	1998	1999	2000 H1	2000 Q3	2000 Aug.	2000 Sept.	2000 Oct.
Long-term [1]	21.9	18.0	14.2	14.6	15.3	15.6	18.0
Refundings [2]	8.5	4.5	2.1	2.0	2.9	1.6	1.6
New capital	13.4	13.5	12.1	12.6	12.4	14.0	16.4
Short-term	2.4	2.7	2.6	3.6	6.2	1.9	2.2
Total tax-exempt	24.3	20.6	16.8	18.1	21.5	17.5	20.3
Total taxable	1.1	1.1	0.6	0.8	1.1	0.5	0.4

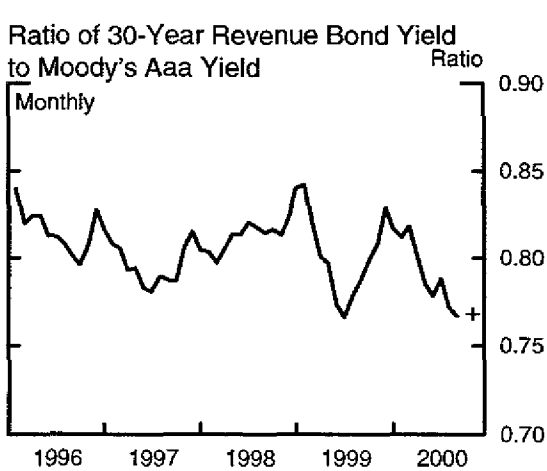
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.



* Data through Oct. 19, 2000, at an annual rate.



Note. Average of weekly data.
+ indicates latest observation (Nov. 3).



Note. Average of weekly data.
+ indicates latest observation (Nov. 3).

announcement by Fannie Mae and Freddie Mac of measures designed to strengthen their capital base and enhance disclosure and market discipline. Specifics included plans to issue subordinated debt to increase total capital relative to assets by roughly one-third and the implementation of risk-based capital stress tests. Fannie and Freddie also pledged to continue to maintain at least 5 percent of on-balance-sheet assets in a liquid portfolio of nonmortgage securities and to disclose, on a monthly basis, their sensitivity to interest rate risk and, on a quarterly basis, their exposure to credit risk. A portion of this decline in spreads reportedly was attributable to investor perceptions that this agreement reduced the risk that Congress would take steps to loosen the GSE's remaining ties to the government.

State and Local Government Finance

Gross issuance of long-term bonds by state and local governments picked up in October, despite a further slackening in refunding activity. The increase was driven by stronger issuance for new capital projects, which may have been spurred by the easing of long-term yields and yields spreads since late summer.

Credit quality has improved further in the state and local sector this year, with upgrades outpacing downgrades for the fifth straight year. The not-for-profit health care sector remains the only notable exception to the rule of improving credit quality.

Money and Bank Credit

Bank credit contracted 6-1/4 percent at an annual rate during October. Securities holdings plunged 20 percent, reflecting runoffs at large domestic and foreign banks. The drop was especially dramatic in trading accounts, but investment accounts also shrank. Loans declined about 2 percent, as portfolios of large domestic and foreign institutions contracted, and loan growth at small banks slowed to 5-1/4 percent, roughly half the pace of recent months.

Commercial and industrial loans were about flat in October (on a month-average basis), following anemic growth in September, reflecting both tighter lending standards for businesses as well as weaker loan demand, according to the November survey of loan officers. Commercial real estate loans contracted a bit in October after slowing in the third quarter from the double-digit pace of expansion earlier this year. Consumer loans are estimated to have risen about 3-3/4 percent in October, after adjusting for securitization and related activities. Overall lending was also held down in October by security loans, which dropped at large domestic banks after having expanded rapidly in the previous quarter.

With reduced financing needs, banks ran off their managed liabilities, including those in M3. M3 growth slowed appreciably--to a 4 percent pace--about half its

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	1999	2000 Q2	2000 Q3	2000 Aug.	2000 Sept.	2000 Oct. (pe)	Level (bil. $) Oct. 00 (pe)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	6.2	6.4	4.7	7.5	8.7	4.2	4871.4
2. M3	7.7	8.6	8.3	10.0	8.3	4.0	6910.7
Selected components							
3. Currency	10.9	-0.2	3.5	2.1	2.1	4.6	524.1
4. Liquid deposits[3]	5.9	4.3	4.3	7.6	10.1	1.8	2402.1
5. Small time deposits	-0.7	10.3	10.8	11.5	5.7	4.1	1027.7
6. Retail money market funds	13.5	11.6	-0.6	6.3	12.8	10.7	908.6
7. M3 minus M2[4]	11.7	13.9	17.1	15.8	7.2	3.6	2039.3
8. Large time deposits, net[5]	8.6	15.3	11.3	20.2	-15.5	-2.0	762.0
9. Institution-only money market mutual funds	17.2	13.7	33.3	28.2	32.7	6.6	724.1
10. RPs	12.1	10.8	7.9	-16.9	-1.3	0.7	362.9
11. Eurodollars	5.1	15.4	1.5	16.3	21.8	20.2	190.3
Memo							
12. M1	1.8	-1.3	-2.7	-3.5	-6.4	4.8	1095.3
13. Sweep-adjusted M1[6]	5.1	2.4	1.4	1.7	-1.1	6.5	1502.2
14. Demand deposits	-6.2	-6.1	-9.6	-16.9	-15.0	0.7	324.1
15. Other checkable deposits	-2.7	2.8	-7.7	3.5	-11.5	12.1	238.3
16. Savings deposits	10.2	6.5	8.5	12.6	17.5	0.7	1839.7
17. Monetary base	12.4	-3.2	2.6	0.6	3.0	5.3	579.2
	Average monthly change (billions of dollars)[7]						
Selected managed liabilities at commercial banks							
18. Large time deposits, gross	7.5	4.6	8.1	16.3	-9.9	-2.0	915.3
19. Net due to related foreign institutions	0.6	5.0	6.4	8.5	-1.0	-17.4	268.9
20. U.S. government deposits at commercial banks	0.2	1.1	-5.2	-12.0	0.8	-3.4	19.2

1. For the years shown, Q4 to Q4 precent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, saving deposits, and small time deposits.
3. Sum of demand deposits, other checkable deposits, and saving 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. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
7. 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.

Commercial Bank Credit

(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	1999	Q2 2000	Q3 2000	Aug. 2000	Sept. 2000	Oct.p 2000	Level, Oct. 2000p ($ billions)
Total							
1. Adjusted[1]	**5.5**	**12.5**	**9.7**	**9.5**	**8.3**	**-6.3**	**5,034**
2. Reported	4.1	12.3	10.0	10.4	11.8	-6.4	5,134
Securities							
3. Adjusted[1]	8.3	10.0	2.8	-.6	-4.4	-20.1	1,204
4. Reported	3.1	9.4	4.5	3.5	9.9	-19.5	1,304
5. U.S. government	2.8	.5	-1.3	-9.7	-7.8	-21.7	793
6. Other[2]	3.8	25.1	14.5	25.6	38.4	-16.2	512
Loans[3]							
7. Total	4.5	13.4	11.9	12.8	12.4	-1.9	3,830
8. Business	4.9	13.6	9.4	10.2	1.0	-.6	1,081
9. Real estate	9.4	15.9	10.7	6.6	8.1	-2.5	1,625
10. Home equity	-3.3	29.2	13.6	13.3	17.2	21.0	122
11. Other	10.4	14.9	10.4	6.1	7.4	-4.4	1,503
12. Consumer	-2.3	9.4	12.9	21.0	8.4	-2.0	533
13. Adjusted[4]	4.4	7.9	11.5	12.7	5.3	-5.9	837
14. Other[5]	-1.8	9.5	19.6	27.9	50.3	-2.6	590

Note. All data are 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 are percentage changes in consecutive levels, annualized but not compounded. These data have been benchmarked to the December 1999 Call Report.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FIN 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 and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

p Preliminary.

September advance. Growth of M2 also moderated to near a 4 percent annual rate in October from its rapid pace in August and September. The slowing was concentrated in liquid deposits and appears consistent with the less rapid pace of expansion in nominal spending and the lingering effects of widening M2 opportunity costs last spring.

At twenty-four large bank holding companies that have reported their third-quarter earnings, net income fell 3 percent relative to a year earlier. In general, the largest banks with nationwide operations fared better than the smaller regional bank holding companies, as revenue from investment banking and investment management activities turned in better results than more traditional lines of business. Net interest income rose only 1 percent, as net interest margins fell about 50 basis points from a year earlier. With the notable exception of four of the very largest banks, most institutions reported a deterioration in the quality of their business loan portfolios and increased their loan-loss provisions markedly. Several banks also took substantial charges in their automobile leasing operations, in which realized residual values continued to be much weaker than anticipated.

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The November 2000 Senior Loan Officer Opinion Survey on Bank Lending Practices focused on changes in the supply of and demand for bank loans to businesses and households over the past three months. Supplementary questions addressed the extent to which tighter credit standards have affected different customer groups, the degree to which the increase in delinquency rates on commercial and industrial loans has been anticipated, and banks' expectations about changes in credit policies over the next year. Loan officers from fifty-seven large domestic banks and twenty-four U.S. branches and agencies of foreign banks participated in the survey.

Over the past three months, the number of foreign and domestic banking institutions that reported tightening standards and terms on C&I loans to large and medium sized firms--44 percent and 80 percent respectively--exceeded the number that tightened lending conditions following the financial crisis in the fall of 1998. About a quarter of domestic and foreign banks also tightened standards for commercial real estate loans. On net, demand for C&I and commercial real estate loans was reported to have weakened somewhat over the past three months.

Over the past year, domestic banks applied tighter standards and terms most aggressively on C&I loans intended to finance mergers and acquisitions (M&As) as well as to new customers seeking lines of commitment. Foreign banks applied tighter lending policies more evenly but most often targeted customers in selected industries. Looking ahead, more than half of all banks indicated that they anticipate a further tightening of standards and terms on C&I loans before the end of 2001. Substantial net fractions of both domestic and foreign respondents also reported that the increase in C&I loan delinquency rates over the past two years was somewhat greater than expected.

Although a large fraction of domestic banks tightened lending policies in the business sector, credit standards for all types of household lending were relatively unchanged over the past three months. Almost all domestic banks reported very little change in standards for residential mortgage loans, while only a handful banks had tightened standards and terms for all types of consumer loans. Demand for both residential mortgages and consumer loans reportedly weakened over the past three months.

Lending to Businesses

On net, more than 40 percent of domestic banks reported a tightening of standards on C&I loans to large and middle-market firms over the past three months. About a quarter of domestic respondents, on net, indicated that they had tightened standards to small firms over the same period. A full 80 percent of branches and agencies of foreign banks reported somewhat tighter standards on C&I loans. The net percentage of domestic and foreign respondents that tightened standards during the last quarter was higher than the percentage of banks that had tightened in the aftermath of the Russian debt crisis in the fall of 1998; in fact, the net percentage of domestic banks that tightened standards on C&I loans is the highest it has been since November 1990. Even if the economy expands at a sustainable rate over the next year, more than half of the

domestic banks and two-thirds of foreign respondents indicated that they expect a further tightening of standards and terms on C&I loans over that period.

At least a third of domestic and foreign banks, on net, reported tightening each of the loan terms listed in the survey for large and middle-market firms. Two-thirds of domestic respondents and three-quarters of foreign branches and agencies charged higher premiums on riskier loans, with no bank reporting an easing in this category. On net, about half of both domestic and foreign institutions indicated a general increase in spreads of loan rates over their cost of funds on loans to large businesses. The overall tightening of terms on C&I loans to small firms was somewhat less. Among both domestic and foreign institutions that had tightened standards or terms on C&I loans the reasons most often cited for changing their lending policies were a less favorable or more uncertain economic outlook, a worsening of industry-specific problems, and a reduced tolerance for risk. A significant fraction of foreign respondents also mentioned an increase in defaults by below-investment-grade borrowers as a reason for tightening standards and terms on C&I loans over the past three months.

The November survey included a special question to determine which customer groups had been most affected by the switch to tighter standards and terms on C&I loans over the past year. Loans to finance mergers and acquisitions were most frequently mentioned as affected by tighter underwriting standards, and banks also claimed to be clamping down somewhat more on applications from new customers seeking loan commitments. Branches and agencies of foreign banks appear to have tightened somewhat more evenly across all customer groups listed, though they were most likely to apply more stringent standards and terms to firms in selected industries and customers seeking M&A financing. Among all the respondents, numerous institutions noted that they had been especially cautious when lending to industries such as healthcare, movie theaters, and communications, and at least two banks singled out the textile, retail, trucking, and asbestos removal industries.

On net, 22 percent of domestic banks reported moderately weaker demand for C&I loans from large and middle-market firms, while almost 40 percent of foreign branches and agencies saw weaker demand over the past three months. A smaller net fraction of domestic banks reported decreased demand from small firms over the same period. Consistent with the slowdown in the pace of business investment during the third quarter, domestic banks that reported weaker loan demand most often cited a decrease in customer demand for credit to finance capital expenditures, followed by a reduced demand for M&A financing. A decrease in customers' need for M&A financing was the most common response among foreign respondents that experienced weaker loan demand.

A special question addressed the extent to which the gradual and sustained increase in delinquency rates on C&I loans over the past two years had been expected. Delinquency rates at small domestic banks (banks with less than $20 billion in assets) rose about in line with expectations, on balance. However, on net, more than 60 percent of large domestic banks and 55 percent of branches and agencies of foreign banks reported that they were somewhat surprised by the deterioration in the quality of their C&I loan portfolios over the past two years. Moreover, 10 percent of all domestic

banks indicated that the increase in C&I loan delinquency rates over the past two years had been much greater than initially anticipated.

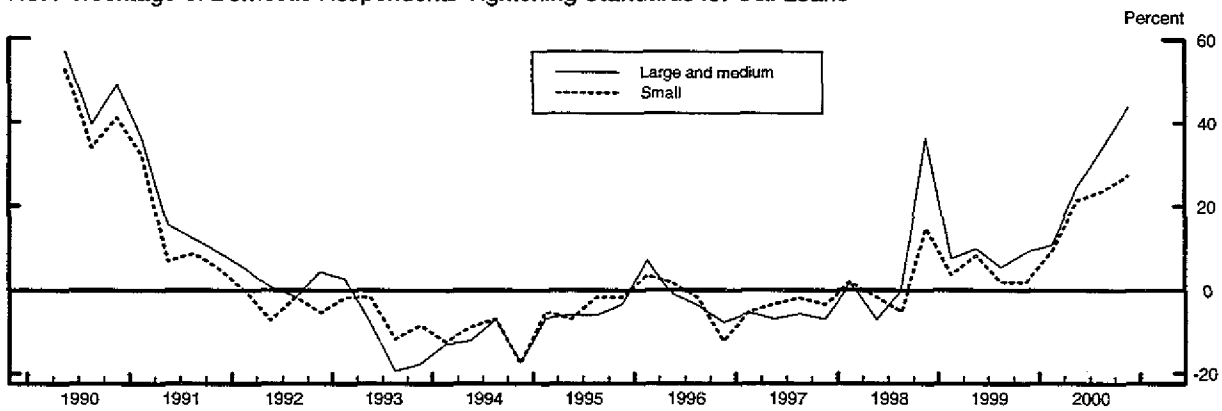
Lending to Households

Over the past three months, banks' credit standards for approving residential mortgage loans were largely unchanged. The deterioration in the demand for home mortgage loans at banks slowed over the past three months: On net, 33 percent of respondents reported somewhat weaker demand in the current survey, compared with 40 percent in the August survey.

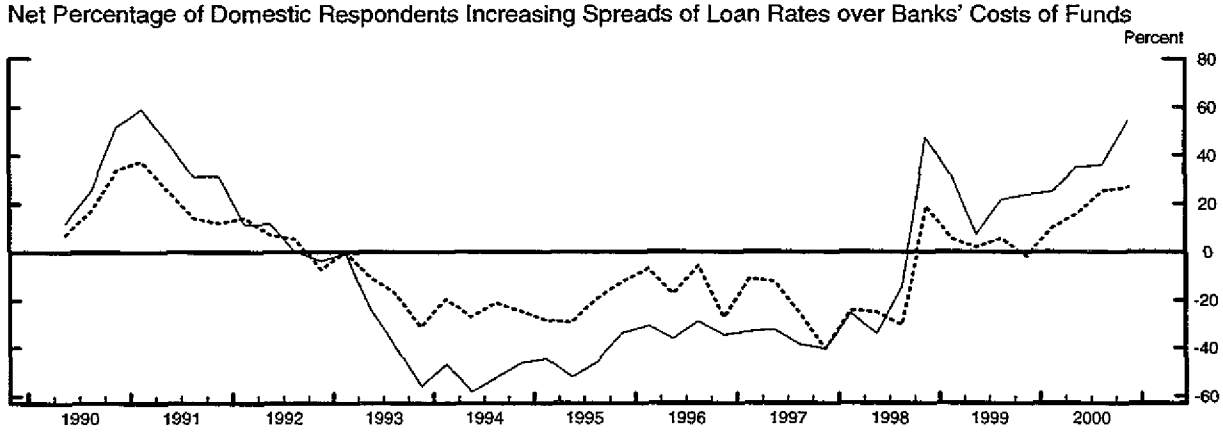
Nearly all banks also indicated that their willingness to make consumer installment loans was unchanged from three months ago. However, a few banks, on net, tightened credit standards for both credit card and other consumer loans, and more than 10 percent of banks reported charging higher spreads of loan rates over the cost of funds on these loans as well. On net, 13 percent of domestic banks observed moderately weaker demand for all types of consumer loans over the past three months.

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

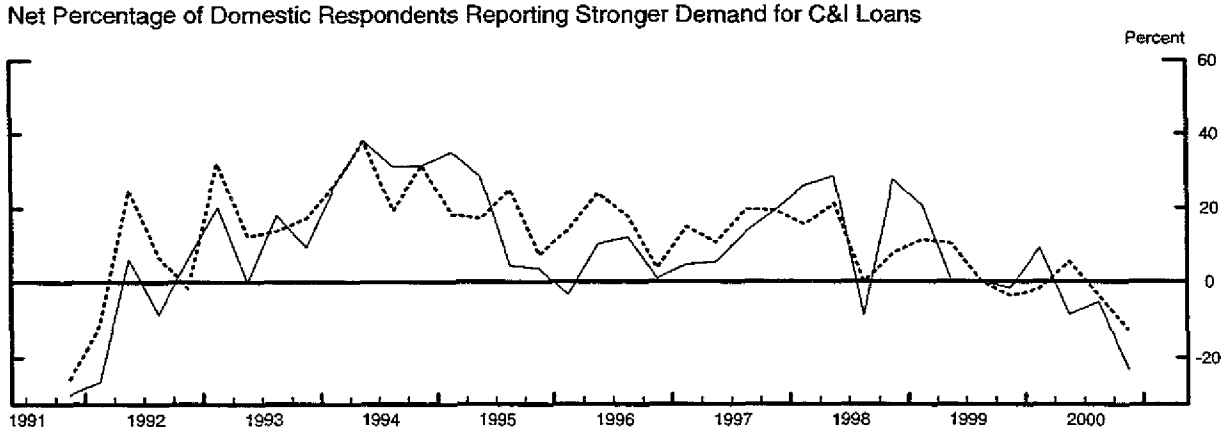
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

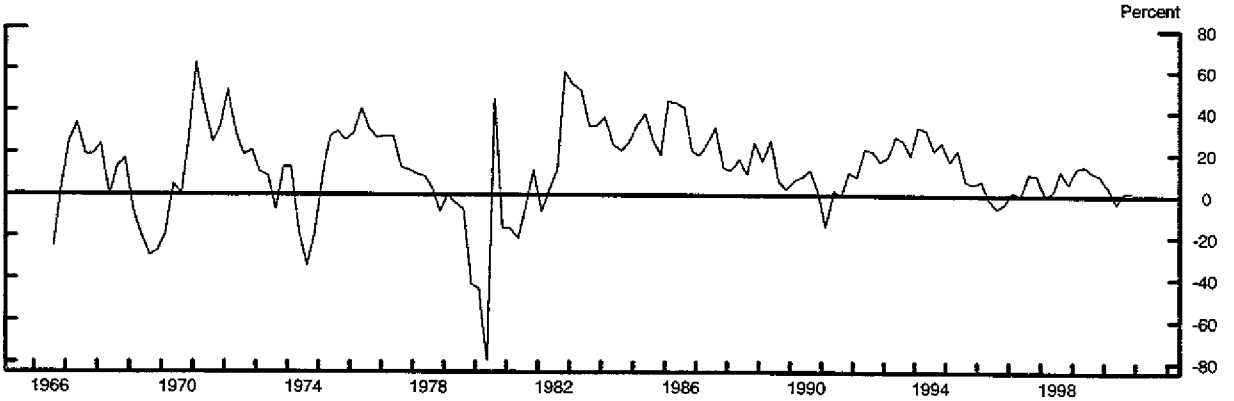


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

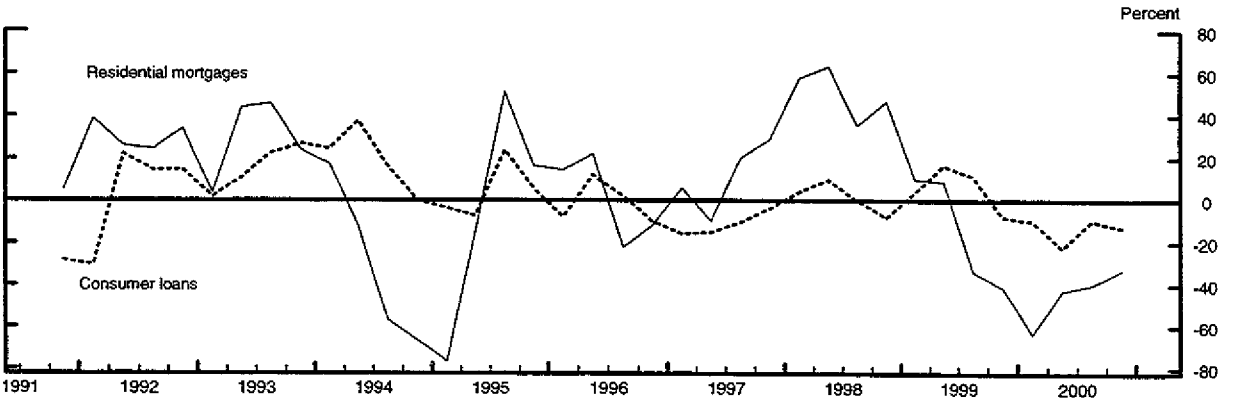


Measures of Supply and Demand for Loans to Households

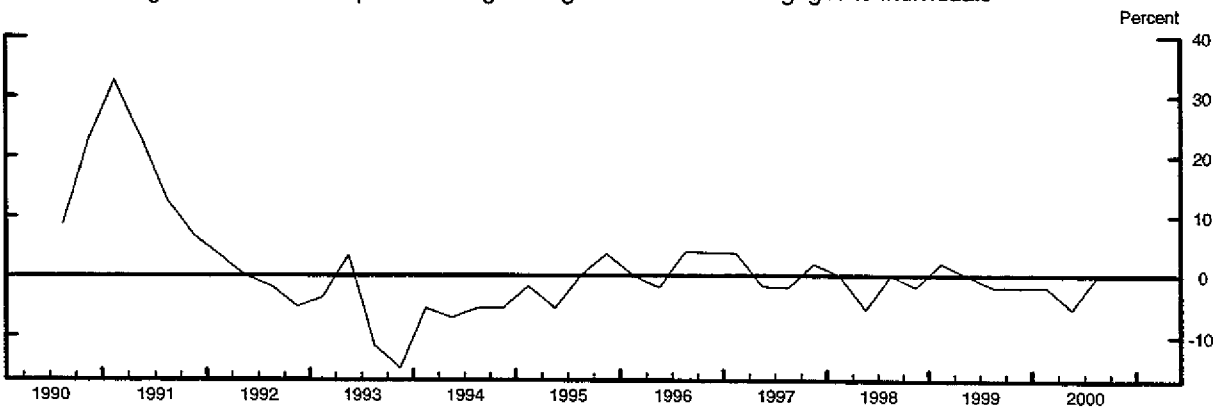
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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 August, the U.S. trade deficit in goods and services was $29.4 billion. This compares with a deficit of $31.7 billion in July. For July and August combined, the deficit was $367 billion at an annual rate, $10 billion (annual rate) larger than in the second quarter.

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

	1999	Annual rate 2000			Monthly rate 2000		
		Q1	Q2	Q3[e]	June	July	Aug.
Real NIPA[1]							
Net exports of G&S	-322.4	-376.8	-403.4	-410.8	...	...	...
Nominal BOP							
Net exports of G&S	-265.0	-340.5	-357.1	-366.8	-29.8	-31.7	-29.4
Goods, net	-345.6	-423.4	-440.9	-449.6	-36.9	-38.5	-36.4
Services, net	80.6	82.9	83.8	82.8	7.0	6.8	7.0

1. Billions of chained (1996) 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.

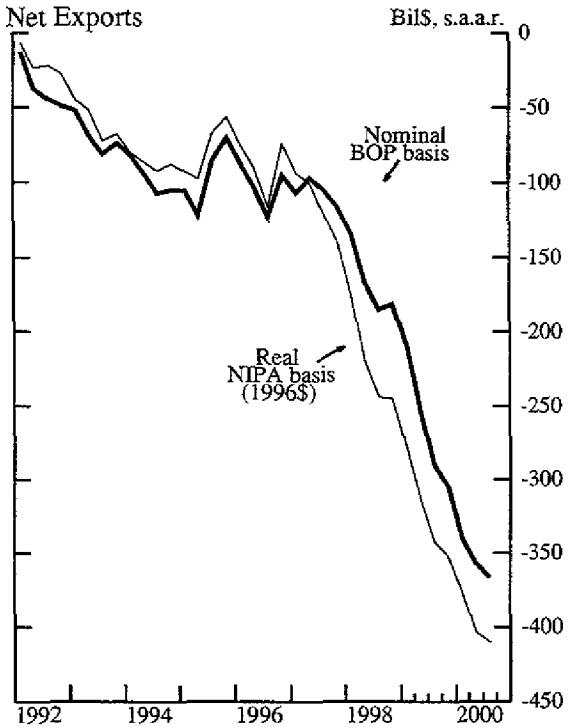
The value of exports of goods and services in August jumped 3.6 percent, with increases recorded in all major trade categories. For July and August combined, the value of exports rose at about the same strong pace recorded in the second quarter (close to 14 percent at an annual rate), led by increases in exported machinery (a broad range of products) and industrial supplies (particularly fuels and chemicals). There were smaller increases in exported agricultural, consumer, and automotive products and in service receipts.

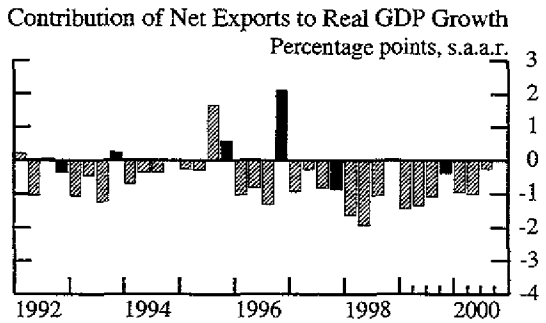
The value of imports of goods and services rose 0.8 percent in August as increases in some categories of trade (particularly capital goods) were partly offset by declines in the value of imported oil (all from price movements), automotive products and industrial supplies. For July and August combined, the value of imports rose strongly, but at a slower pace than in the second quarter. Increases were recorded in all major categories of trade.

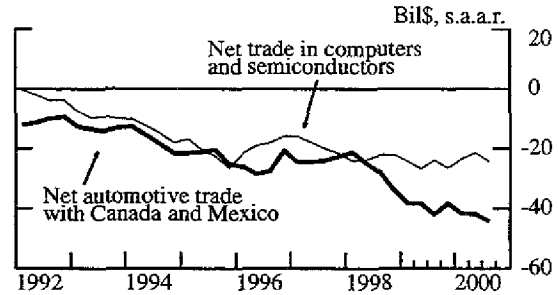
Prices of Internationally Traded Goods

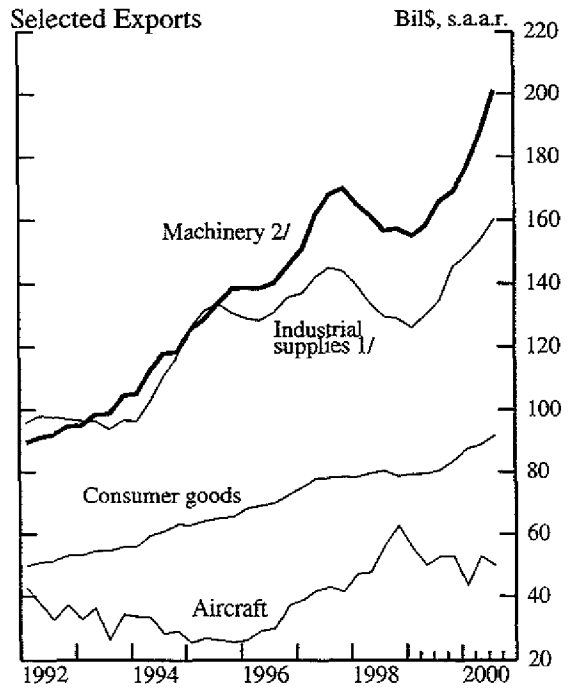
Oil. Following two months of small changes, the price of imported oil (BLS) jumped 14.1 percent in September, driven by strong global demand, concerns

U.S. International Trade in Goods and Services

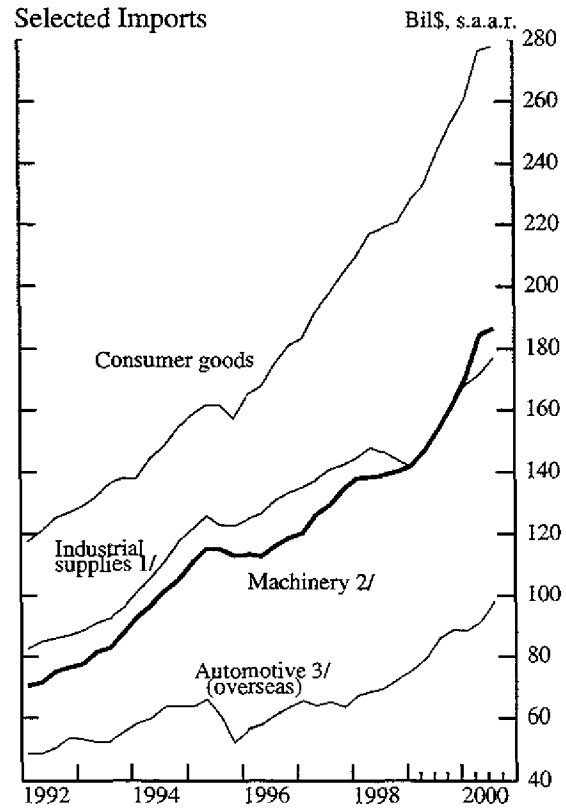








1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.



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

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

	Levels				Amount Change[1]			
	2000		2000		2000		2000	
	Q2	Q3[e]	July	Aug.	Q2	Q3[e]	July	Aug.
Exports of G&S	**1060.4**	**1096.9**	**1077.6**	**1116.3**	**36.5**	**36.5**	**-14.3**	**38.7**
Goods exports	767.1	798.4	781.2	815.6	32.2	31.2	-16.5	34.4
Agricultural	52.8	55.8	54.3	57.3	0.3	3.0	0.8	2.9
Gold	3.7	3.4	2.7	4.1	-5.9	-0.3	-2.4	1.4
Other goods	710.6	739.2	724.1	754.2	37.9	28.5	-14.8	30.1
Aircraft & pts	52.9	50.0	49.5	50.5	9.2	-2.9	-6.0	1.0
Computers	55.4	58.8	57.1	60.5	4.2	3.4	-0.2	3.4
Semiconductors	59.6	63.5	62.6	64.4	7.1	3.9	-2.4	1.8
Other cap gds	189.1	203.1	198.8	207.4	10.1	14.0	3.1	8.6
Automotive	80.1	81.5	77.5	85.5	-0.3	1.4	-6.9	8.0
to Canada	45.0	44.8	42.7	46.8	-2.5	-0.3	-4.2	4.1
to Mexico	17.3	15.5	13.7	17.3	1.4	-1.8	-4.8	3.6
to ROW	17.7	21.3	21.1	21.4	0.8	3.5	2.1	0.3
Ind supplies	153.6	160.2	156.1	164.4	4.8	6.6	-0.8	8.3
Consumer goods	88.5	91.6	90.7	92.6	1.2	3.1	-2.4	1.9
All other	31.5	30.5	31.9	29.1	1.4	-0.9	-0.3	-2.8
Services exports	293.3	298.6	296.4	300.7	4.3	5.3	2.2	4.3
Imports of G&S	**1417.5**	**1463.7**	**1457.9**	**1469.5**	**53.1**	**46.2**	**7.9**	**11.6**
Goods imports	1208.1	1247.9	1243.4	1252.5	49.8	39.9	3.5	9.0
Petroleum	117.1	126.1	127.8	124.3	9.0	9.0	-0.6	-3.5
Gold	3.0	2.9	2.4	3.3	-6.6	-0.1	-1.7	0.9
Other goods	1088.0	1119.0	1113.2	1124.8	47.4	31.0	5.8	11.6
Aircraft & pts	24.9	25.7	25.4	26.0	1.7	0.9	0.4	0.6
Computers	89.9	95.5	93.0	98.0	6.1	5.5	1.6	5.0
Semiconductors	46.4	51.1	49.9	52.3	3.1	4.7	-0.3	2.4
Other cap gds	187.3	189.3	186.3	192.2	13.4	1.9	-2.7	5.9
Automotive	195.4	202.4	204.0	200.9	2.1	7.0	3.1	-3.1
from Canada	63.3	65.4	66.1	64.6	-2.8	2.1	-0.0	-1.6
from Mexico	40.8	39.0	36.0	42.0	1.9	-1.8	-6.5	6.0
from ROW	91.4	98.1	101.9	94.3	3.1	6.7	9.7	-7.6
Ind supplies	171.6	177.1	179.4	174.7	3.2	5.5	4.9	-4.6
Consumer goods	276.4	277.9	276.8	278.9	15.9	1.5	-0.7	2.1
Foods	45.6	47.3	47.2	47.5	1.1	1.7	1.1	0.3
All other	50.5	52.7	51.2	54.2	0.9	2.2	-1.4	3.0
Services imports	209.5	215.8	214.5	217.1	3.4	6.3	4.4	2.6
Memo:								
Oil quantity (mb/d)	12.26	12.30	12.26	12.34	0.90	0.05	-0.46	0.08
Oil import price ($/bbl)	26.11	28.06	28.53	27.59	0.13	1.94	0.90	-0.94

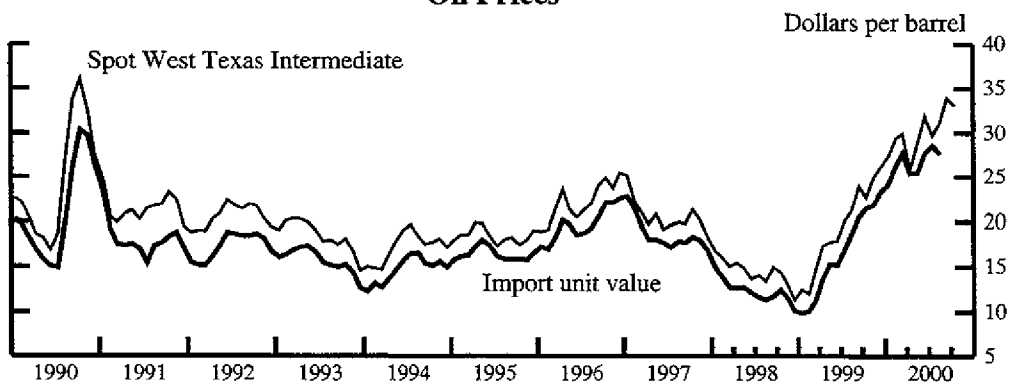
1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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

	Annual rates 2000			Monthly rates 2000		
	Q1	Q2	Q3	July	Aug.	Sept.
	---------- BLS prices (1995 weights)----------					
Merchandise imports	10.5	0.1	6.8	0.0	0.2	1.5
Oil	105.1	-6.3	55.7	-1.6	0.1	14.1
Non-oil	1.7	1.0	1.1	0.3	0.1	-0.3
Core goods*	1.9	1.6	1.8	0.4	0.1	-0.3
Foods, feeds, beverages	0.0	-4.4	-4.0	0.0	0.4	-0.7
Industrial supplies ex oil	11.0	9.8	8.6	1.0	0.9	-0.8
Computers	-1.4	-9.1	-3.4	-0.2	-0.2	-0.4
Semiconductors	-3.9	0.0	-4.9	-0.9	0.2	0.2
Cap. goods ex comp & semi	-1.7	0.3	-1.7	0.1	-0.1	-0.3
Automotive products	0.7	1.4	0.7	0.2	-0.2	-0.2
Consumer goods	-0.8	-1.9	-0.4	0.3	0.0	-0.1
Merchandise exports	2.7	2.0	-0.1	0.0	-0.3	0.5
Agricultural	0.5	5.7	-12.1	-2.1	-2.1	3.2
Nonagricultural	2.9	1.5	1.1	0.2	-0.1	0.3
Core goods*	4.2	2.1	1.8	0.3	-0.1	0.4
Industrial supples ex ag	12.2	5.9	3.4	0.5	-0.5	1.3
Computers	-7.1	-4.5	-2.6	-0.2	-0.5	-0.2
Semiconductors	-5.0	-4.1	-5.7	-0.1	-0.1	-0.3
Cap. goods ex comp & semi	0.9	1.2	1.0	0.1	0.1	0.0
Automotive products	0.3	0.8	0.9	0.3	0.0	0.0
Consumer goods	0.5	-0.1	-0.3	0.1	0.0	-0.3
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	5.6	0.2	3.9	...	...	...
Non-oil merchandise	0.9	0.8	0.7	...	...	...
Core goods*	1.5	1.8	1.5	...	...	...
Exports of goods & services	1.9	1.9	0.9	...	...	...
Nonag merchandise	1.4	1.3	0.9	...	...	...
Core goods*	3.2	2.4	1.3	...	...	...

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

Oil Prices



over low inventories, and uncertainty over OPEC production. In late September, following the Clinton administration's decision to release 30 million barrels of oil from the Strategic Petroleum Reserve, the spot price of West Texas Intermediate fell from its post Gulf War high of $37.20 per barrel to near $30 per barrel. During October, however, oil prices moved higher as the deteriorating situation in the Middle East, the terrorist attack on the USS Cole, and Iraqi threats to suspend exports raised the possibility that oil supplies from the region could be disrupted. An increase in OPEC's production targets of 500,000 b/d had little effect on oil prices as most OPEC countries appear to be producing at capacity. Spot WTI remained between $33 and $35 per barrel during the latter half of October, and is currently trading around $33 per barrel.

Non-oil imports. In September, prices of imported non-oil goods declined for the first time since May, and only the second time since July 1999. The largest decreases were in industrial supplies (led by a drop in prices of unfinished metals) and foods. There were small price declines in all other major trade categories with the exception of imported semiconductors whose prices rose for the second consecutive month. The price of imported core goods (which excludes oil, computers, and semiconductors) declined 0.3 percent, also the first decrease since May. In the third quarter, the price of core goods imports rose 1.5 percent at an annual rate, similar to rates recorded in the past two quarters. The increase was attributable to industrial supplies and, to a much lesser extent, to automotive products. The price indexes of imported machinery, consumer goods, and foods all declined in the third quarter.

Exports. Prices of total goods exports rose moderately in September led by higher prices for agricultural products (following two months of substantial declines) and industrial supplies (primarily rising prices for exported fuels). In the third quarter, prices of total goods exports were about unchanged. Prices of agricultural exports dropped 12 percent at an annual rate (largely grains and oilseeds, the prices of which, however, turned up in September). Once again, prices of exported computers and semiconductors declined. The price of core goods exports (which excludes computers, semiconductors, and agricultural products) rose 1.3 percent at an annual rate in Q3, a somewhat smaller rise than in Q2, with increases recorded in prices of industrial supplies, machinery, and automotive products.

Note: BLS prices for imports and exports in October were released on November 8 and will be included in the Greenbook supplement.

U.S. International Financial Transactions

Private foreign net purchases of U.S. securities were very strong in the third quarter (line 4 of the Summary of U.S. International Transactions table). Net purchases of agency bonds (line 4b), corporate bonds (line 4c), and corporate stocks (line 4d) each proceeded at a record annual pace. Corporate bond purchases by private foreigners in the third quarter were concentrated in international financial centers in the United Kingdom, the Caribbean, and Japan; net purchases of agency bonds were distributed more widely, with large net purchases in the United Kingdom and Japan. Net purchases of U.S. stocks were very strong in Europe, but also significant in most other areas of the world. Holdings of Treasury securities continued their moderate fall (line 4a).

Net acquisitions of foreign securities by U.S. investors were just under $11 billion for the quarter, two-thirds of that accounted for by stock swaps (lines 5 and 5c). After large net purchases of foreign stocks in July, U.S. investors liquidated a monthly record $10.7 billion in September (line 5b). Both the purchases and sales of foreign stocks were primarily through Europe.

Foreign official assets held in the United States continued their moderate rise in the third quarter (line 1). Increases and decreases for individual countries were all in the moderate range. Russian reserves rose throughout the quarter, continuing a year-long string of monthly increases that have added a total of $13 billion to its reserves held in the United States. However, there is little or no evidence of other oil exporters adding significantly to their reserve holdings in the United States over the past year. Moderate reserve decreases were registered for the quarter by Japan, Korea, France, and a few other countries. Mirroring private foreign investors, official institutions made sizable net purchases of agency bonds in the third quarter ($14 billion), while reducing their holdings of U.S. Treasury securities. Partial data from FRBNY indicate that in October foreign official reserves held in the United States decreased by $19 billion.

Consistent with the slowing in the rate of expansion of domestic bank credit, there was a moderate capital outflow through banks in September (line 3).

Summary of U.S. International Transactions

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

	1998	1999	1999	2000				
			Q4	Q1	Q2	Q3	Aug.	Sept.
Official financial flows	**-23.4**	**55.0**	**29.0**	**22.1**	**9.1**	**11.9**	**3.7**	**-2.4**
1. Change in foreign official assets in U.S. (increase, +)	-16.6	46.4	27.4	22.7	7.1	12.2	2.7	-1.1
a. G-10 countries	6.9	49.7	10.2	11.1	5.6	-4.2	-1.4	-4.4
b. OPEC countries	-9.0	2.0	-1.7	5.7	1.2	3.2	2.2	-.1
c. All other countries	-14.4	-5.3	19.0	5.9	.4	13.2	1.9	3.4
2. Change in U.S. official reserve assets (decrease, +)	-6.8	8.6	1.6	-.6	2.0	-.3	1.0	-1.3
Private financial flows	**170.6**	**268.4**	**40.7**	**35.4**	**139.9**	**n.a.**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	57.3	-9.8	-16.6	-31.0	50.8	-13.0	1.6	-31.8
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	275.2	319.0	74.1	122.4	67.1	101.3	54.9	23.8
a. Treasury securities	49.3	-20.0	-17.1	-9.1	-20.5	-12.5	-2.0	-3.9
b. Agency bonds	50.5	71.9	15.6	26.0	19.0	24.4	11.4	7.7
c. Corporate and municipal bonds	121.7	158.8	40.6	43.5	41.6	41.9	21.5	11.1
d. Corporate stocks	53.7	108.2	35.0	62.1	27.0	47.5	23.9	8.9
5. U.S. net acquisitions (-) of foreign securities	-107.3	-113.0	-17.3	-24.8	-19.9	-10.9	-3.5	10.2
a. Bonds	-17.4	-5.7	2.0	-8.9	10.8	-.3	-2.5	-.5
b. Stock purchases	6.2	15.6	-5.9	-15.9	6.9	-3.2	1.0	10.7
c. Stock swaps[3]	-96.1	-122.9	-13.4	.0	-37.6	-7.4	-2.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-146.1	-150.9	-33.3	-43.0	-37.5	n.a.	...	...
7. Foreign direct investment in U.S.	186.3	275.5	49.4	49.0	80.0	n.a.	...	...
8. Foreign holdings of U.S. currency	16.6	22.4	12.2	-6.8	1.0	n.a.	...	...
9. Other (inflow, +)[4]	-111.4	-74.8	-27.8	-30.4	-1.6	n.a.	...	...
U.S. current account balance (s.a.)	**-217.1**	**-331.5**	**-96.2**	**-101.5**	**-106.1**	**n.a.**	**...**	**...**
Capital account balance (s.a.)[5]	**.2**	**-3.5**	**-4.0**	**.2**	**.2**	**n.a.**	**...**	**...**
Statistical discrepancy (s.a.)	**69.7**	**11.6**	**30.5**	**43.8**	**-43.1**	**n.a.**	**...**	**...**

NOTE. The sum of official and private financial flows, the current account balance, the capital 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 adjustments BEA makes to account for incomplete coverage; therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. U.S. acquisitions of foreign equities associated with foreign takeovers of U.S. firms.

4. 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

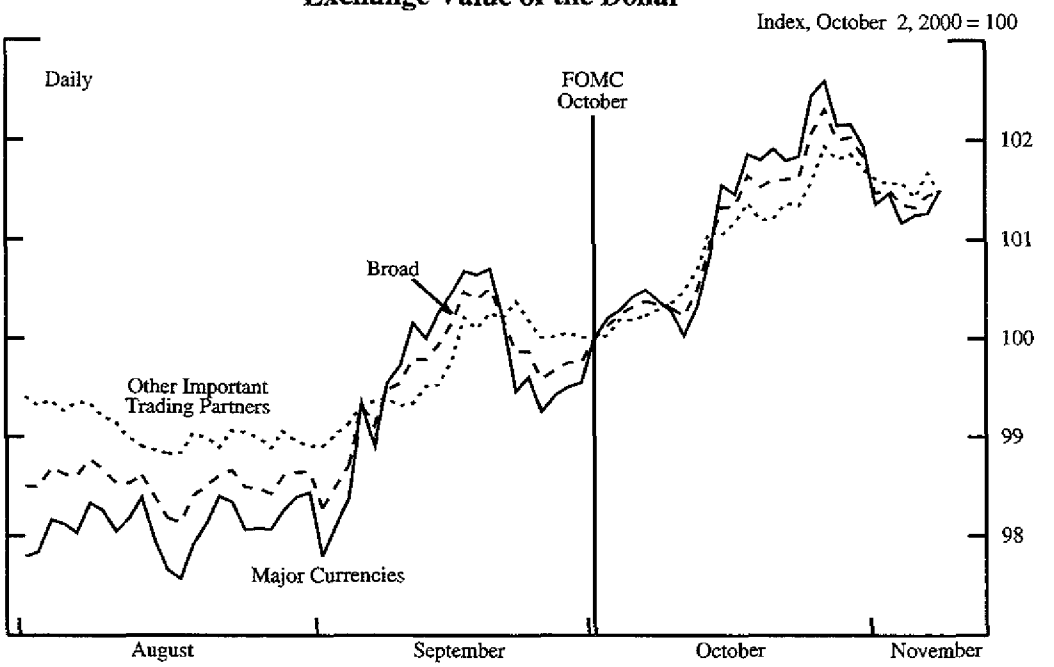
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

The exchange value of the dollar against a weighted average of other major currencies has risen 1½ percent on balance since the FOMC meeting on October 3; the dollar appreciated against European currencies and the Canadian and Australian dollars, but depreciated slightly against the yen.

Exchange Value of the Dollar



Buoyed by the market's focus on the continuing positive differential in growth rates between the United States and the euro area, the dollar appreciated to record highs against the euro in the second half of October, surpassing levels reached prior to the September 22 joint foreign exchange intervention operation by the G-7. The October 5 decision of the European Central Bank to raise its refinancing rate 25 basis points to 4¾ percent did not give any support to the common currency. However, the release of weaker-than-expected U.S. GDP growth data on October 27 was viewed by many in the market as marking a shift in the exchange rate trend, and the dollar lost a sizable share of its intermeeting gains versus the euro in the two weeks preceding the publication of this Greenbook.

. The British pound and the Swiss franc generally followed the movements of the euro during the period. On net, during the intermeeting period, the dollar appreciated about 2½ percent against the euro and the Swiss franc, and 3 percent versus sterling. The dollar also appreciated 1¾ percent against the Canadian dollar amid uncertainty about the upcoming Canadian parliamentary elections.

The dollar depreciated 1 percent against the yen over the intermeeting period despite disquieting signals about the fragility of Japan's economic recovery, including the bankruptcy of two life insurance companies and a substantial decline in industrial production in September. The dollar appreciated 3 percent against the Australian dollar, reflecting concerns about the economic situation in Japan, Australia's largest export market, and the size of Australia's current account deficit.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Nov. 8 (Percent)	Percentage Point Change	Nov. 8 (Percent)	Percentage Point Change	Percent Change
Canada	5.90	.00	5.87	.11	-8.29
Japan	.50	.10	1.82	-.01	-3.16
Euro area	5.12	.13	5.26	.03	1.77
United Kingdom	6.02	-.01	5.20	-.01	3.21
Switzerland	3.44	-.01	3.93	-.05	2.78
Australia	6.39	-.25	6.15	.05	1.54
United States	6.66	-.04	5.89	.06	-.28
Memo: Weighted-average foreign	4.15	.06	5.00	.03	n.a.

NOTE. Change is from October 2 to November 8.
n.a. Not available.

Net changes in short-term and long-term market interest rates of industrial countries were relatively small during the period. The spread between U.S. and euro-area ten-year yields increased 3 basis points. The spread between three-month rates, however, narrowed 17 basis points, reflecting in part the ECB's surprise tightening move of October 5. Headline equity indexes in the euro area and the United Kingdom rose slightly on net over the period amid a high level of stock price volatility, particularly for technology-sector shares. The 8 percent decline in Canadian share prices was in large part the result of the drop in the share price of one telecommunications company, but the 3 percent decline in Japanese share prices was more broad-based.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Nov. 8	Percent Change	Nov.7/8 (Percent)	Percentage Point Change	Nov.7/8 (Percent)	Percentage Point Change	Percent Change
Mexico	9.58	1.83	17.26	2.00	3.72	.67	3.75
Brazil	1.95	5.41	16.60	.25	9.70	1.19	-2.39
Argentina	1.00	.00	13.50	4.80	11.62	3.04	-9.03
Chile	573.90	2.30	11.62	1.58	2.16	.40	1.74
China	8.28	-.02	n.a.	n.a.	1.41	.05	5.38
Korea	1133.50	1.37	6.00	.10	2.06	.17	-5.28
Taiwan	32.10	2.59	5.57	.57	...	...	.73
Singapore	1.74	-.33	2.69	.19	...	...	1.70
Hong Kong	7.80	.01	5.60	-.71	...	...	.03
Malaysia	3.80	-.01	2.95	-.02	1.95	.09	7.71
Thailand	43.57	3.00	3.00	-.25	1.15	.10	8.20
Indonesia	9175.00	4.74	13.81	.29	6.83	.04	-1.43
Philippines	50.00	8.25	16.00	5.00	5.36	.97	3.74
Russia	27.80	.16	n.a.	n.a.	8.97	.17	-9.41

NOTE. Change is from October 2 to November 7/8.

1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.

2. Spread over similar maturity U.S. Treasury bond yield. Mexico, Brazil, Argentina and Venezuela: Stripped Brady bond yield. Chile, China, and Korea: Global bond yield. Malaysia, Philippines and Russia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

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

Renewed concerns over Argentina's external financing situation and its recent economic and fiscal performance left their imprints on Latin American financial markets. The sharp increase in the yield spread over Treasuries of Argentine debt was most notable, but bond prices in Brazil and Mexico were also affected. Pressure on the Argentine peso, which is pegged to the dollar, was evident in the sharp movements in non-deliverable forward exchange rates (not shown), with one-year instruments implying a depreciation risk premium of more than 7 percent. Among unpegged currencies, the dollar appreciated 5½ percent against the Brazilian *real*, but only about 2 percent versus the Mexican peso. Equity prices declined in Argentina and Brazil; Mexican share prices, by contrast, rose.

Asset prices in several Asian countries also declined during the intermeeting period, suggesting a possible decrease in the appetite of international investors for exposure to emerging markets. A set of country-specific factors, however, also contributed to the movements in asset prices in the region. For example, political turmoil continued to weigh on the exchange values of the currencies of the Philippines, Indonesia and Taiwan, and sharp declines in the price of computer chips were seen as a major cause of the decline of equity prices in Korea.

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

Developments in Foreign Industrial Countries

Data released since the September Greenbook suggest that economic growth in the foreign industrial countries slowed in the third quarter from the strong pace recorded in the first half of the year. In Japan, economic activity appears to have expanded at a much slower rate in the third quarter, reinforcing concerns about the durability of the Japanese recovery. Available indicators suggest that growth in the euro area also slowed somewhat in the third quarter. Activity in Canada continued to expand strongly in the third quarter, although at a slower pace than was recorded in the first half of the year. Third quarter growth in the United Kingdom was 2.8 percent (s.a.a.r.), about the same as the first half of the year.

Although rising oil prices drove broad measures of inflation higher in September for many of the foreign industrialized countries, core consumer price data show little evidence of inflation pressures. Twelve-month consumer price inflation in the euro area rose to 2.8 percent, well above the European Central Bank's 2 percent target ceiling, but core inflation (excluding food and energy prices) rose only modestly to 1.4 percent. Canadian consumer price inflation approached the ceiling of the Bank of Canada's 1 percent to 3 percent inflation target band, but core inflation declined to only 1.3 percent. In the United Kingdom, retail price inflation remained below the 2.5 percent target rate, while in Japan consumer price deflation intensified despite rising oil prices.

In **Japan,** economic activity appears to have slowed sharply in the third quarter after expanding rapidly in the first half of the year. Although industrial production has continued to advance, growth in the services sector has slowed and activity in construction has declined a bit. The all-industry index, which includes these components as well as a measure of public sector activity, was up about ½ percent on average in July and August relative to the second quarter level, following a gain of nearly 2 percent in the second quarter. The dichotomy between the weak household sector and the improving business sector remains. Household expenditures and car registrations fell in the third quarter, and housing starts were down as well. However, both orders and shipments of machinery rose.

The unemployment rate edged back up to 4.7 percent in September, reflecting increases in both layoffs and the number of people looking for work. The job-offers-to-applicants ratio remained steady at 0.62. Deflation in core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) has intensified despite the increase in energy prices, with prices down 1 percent in October from a year earlier. Twelve-month inflation in wholesale prices for domestic goods remains slightly positive, largely reflecting the impact of higher energy prices, but has dropped a bit since earlier this year.

Japan's merchandise trade surplus for the first nine months of 2000 was $112 billion (s.a.a.r.), roughly unchanged from the same period last year, as both exports and imports have increased sharply. The developing Asian countries continue to account for most of the export gain, while higher oil prices have contributed significantly to the increase in dollar-denominated imports.

Japanese Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2000			2000			
	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
Industrial production	.7	1.5	1.8	-.5	3.3	-3.5	n.a.
All-industry index	.4	1.7	n.a.	-1.1	1.4	n.a.	n.a.
Housing starts	8.6	-2.5	-2.8	-8.0	4.7	.1	n.a.
Machinery orders[1]	4.9	3.1	n.a.	-11.7	26.6	n.a.	n.a.
Machinery shipments	2.4	4.6	1.0	-3.2	6.0	-6.5	n.a.
New car registrations	9.2	1.0	-3.8	-13.6	16.6	-9.6	n.a.
Unemployment rate[2]	4.8	4.7	4.7	4.7	4.6	4.7	n.a.
Job offers ratio [3]	.52	.57	.61	.60	.62	.62	n.a.
Business sentiment[4]	-23	-18	-15	...	...	...	...
CPI (Core, Tokyo area)[5]	-.4	-.6	-.8	-.7	-.8	-1.0	-1.0
Wholesale prices[5]	-.1	.4	.2	.3	.2	.1	n.a.

1. Private, excluding ships and electric power.
2. Percent.
3. Level of indicator.
4. Tankan survey, diffusion index.
5. Percent change from year earlier, n.s.a.
n.a. Not available. ... Not applicable.

The Bank of Japan's September Tankan survey showed another overall improvement in business confidence in Japan, once again led by large manufacturers. The level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries crept up a little further, to -15 from -18 in June. Firms in all categories reported that they expect conditions to continue improving over the next three months. Profits are expected to increase 13 percent along with a 3 percent increase in sales, suggesting that further cost-cutting is occurring. Capital expenditures across all firms are projected to rise 1.5 percent in FY2000, after falling 9 percent in FY1999.

On October 19 the Japanese Cabinet approved an economic stimulus package of 11 trillion yen; the "real-water" component is estimated to be about 4 trillion yen, about 0.8 percent of GDP. The funds will be spent on projects related to information technology, environmental protection, urban infrastructure and disaster prevention as well as loan programs for small and midsize firms.

Recent data for the **euro area** suggest that the pace of economic expansion slowed somewhat in the third quarter. The average volume of retail sales for July and August was up only 0.4 percent from the second quarter average, after rising 1.1 percent in the second quarter. Growth in industrial production has also moderated in most euro-area countries including Germany and Italy. Exceptions to the slowing growth rate of industrial output include Finland and Spain, where production has accelerated in recent months.

Forward-looking indicators are also consistent with a more moderate pace of growth. Consumer confidence in the euro area declined in September and was unchanged in October, likely in reaction to the recent rise in oil prices and associated protests in a number of euro-area countries. The German Ifo Business Climate index fell in September for the fourth consecutive month and is now down 3 percent from a nine-year high reached in May of this year. However, the sentiment of euro-area industrial managers edged up in October to a level only a bit below the record high recorded in June.

The harmonized unemployment rate for the euro area was 9 percent in September, down nearly a full percentage point from September 1999, largely due to improved employment growth this year. The national unemployment rate in France continued to decline in September, while the Italian unemployment rate reached a seven-year low in the third quarter. In Germany, the unemployment rate edged down in September and was unchanged in October.

Euro-area consumer prices rose 0.5 percent (s.a.) in September from August, bringing the twelve-month rate of inflation to 2.8 percent, well above the 2 percent target ceiling of the European Central Bank. September's large increase in consumer prices mainly reflected higher energy prices; excluding food and energy, consumer prices rose a more modest 0.2 percent (s.a.) and were up only 1.4 percent from September 1999. In Germany, the 12-month rate of consumer price inflation declined from 2.5 percent in September to 2.3 percent in October, as energy costs fell from September's high level.

On October 5, the European Central Bank raised policy rates 25 basis points, bringing the minimum bid rate for its refinancing operations to 4.75 percent. In a press conference, European Central Bank President Wim Duisenberg stated that the actions were intended to ensure that "upward pressures on consumer prices stemming from oil prices and the foreign exchange value of the euro do not translate into more permanent inflationary tendencies."

Euro-Area Current Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2000						
	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
Industrial production[1]							
Euro-area	1.1	1.6	n.a.	.4	.2	n.a.	n.a.
Germany	1.2	2.9	1.8	3.0	.6	-1.3	n.a.
France	.7	.1	n.a.	(*) 1.6	...	n.a.	n.a.
Italy	.6	1.4	n.a.	-.9	1.3	n.a.	n.a.
Unemployment rate[2]							
Euro-area	9.5	9.2	9.0	9.0	9.1	9.0	n.a.
Germany	10.1	9.6	9.5	9.5	9.5	9.4	9.4
France	10.2	9.8	9.6	9.7	9.6	9.5	n.a.
Italy	11.1	10.7	10.5	...	...	...	...
Consumer prices[3]							
Euro-area[4]	2.1	2.1	2.5	2.4	2.3	2.8	n.a.
Germany	1.8	1.6	2.1	1.9	1.8	2.5	2.3
France	1.5	1.4	1.9	1.8	1.8	2.2	n.a.
Italy	2.3	2.4	2.4	2.6	2.3	2.3	2.2

1. Indexes exclude construction.
2. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases. Country figures are based on national definitions.
3. Percent change from year earlier.
4. Eurostat harmonized definition.
(*) July data reflect a July/August average; official French statistics report only one number for the two-month period.
n.a. Not available. ... Not applicable.

Euro-Area Forward-Looking Indicators
(Percent balance, s.a.)

Indicator	2000						
	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
Consumer confidence[1]	-.3	.0	-.7	0	1	-3	-3
Construction confidence[2]	.0	2.0	2.0	2	5	-1	2
Industrial confidence[3]	2.7	6.0	6.3	7	6	6	7
of which:							
Production expectations	14.7	17.0	18.3	19	18	18	19
Total orders	-1.7	5.0	4.7	5	4	5	5
Stocks	5.0	3.3	3.7	3	4	4	4

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

In the **United Kingdom**, the preliminary estimate of real GDP at factor cost showed growth of 2.8 percent (s.a.a.r.) in the third quarter. This suggests a minimal effect from the fuel blockades in September, consistent with the September and third-quarter retail sales numbers.

Current indicators suggest that growth is continuing, but at a moderate pace. Industrial production fell 1 percent in September, reflecting weak oil and gas output due to maintenance stoppages and low energy output due to warm weather. Over the past twelve months, however, industrial production is up 0.9 percent. Business confidence picked up somewhat in September, but remains below levels recorded earlier this year. New orders fell again in September, primarily due to weaker prospects for export orders. Consumer confidence has also fallen since early this year.

The official claims-based unemployment rate remained at a 25-year low of 3.6 percent in September, and the labor force survey measure of the unemployment rate remained at 5.3 percent for the three months centered in July, a record low. Nonetheless, twelve-month growth in average earnings has moderated in recent months, to 4.1 percent in August. This rate is now below the 4.5 percent rate that the Bank of England has suggested as compatible with its inflation target.

Producer input prices have risen sharply in recent months, in part reflecting higher oil prices. The twelve-month rate of retail price inflation (excluding mortgage interest rates) remains below the 2½ percent target.

Chancellor of the Exchequer Gordon Brown released the Pre-Budget Report on November 8, 2000. The fiscal stance is approximately the same as was forecasted in the March budget, with the fiscal year 2000-2001 budget surplus estimated at £16.6 billion (nearly 2 percent of 1999 GDP). Responding to widespread protests against the high price of fuel, excise duties on fuel and diesel were frozen until April 2002. There will also be a consolidation in vehicle excise rates which will specifically benefit the hauling industry.

U.K. Economic Indicators

(Percent change from previous period except as noted, s.a.)

Indicator	2000			2000			
	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
Real GDP (s.a.a.r.)	2.1	3.8	2.8*	...	...	...	...
Industrial production	-.8	1.4	.6	.5	.4	-1.0	n.a.
Retail sales	1.4	.3	1.3	.2	.6	.6	n.a.
Unemployment rate[1]							
Claims-based	4.0	3.8	3.6	3.7	3.6	3.6	n.a.
Labor force survey[2]	5.8	5.5	n.a.	5.3	n.a.	n.a.	n.a.
Business confidence[3]	12.7	-4.0	3.3	3.0	2.0	5.0	3.0
Retail prices[4]	2.1	2.1	2.1	2.2	1.9	2.2	n.a.
Producer input prices[5]	12.7	11.4	12.3	10.8	11.6	14.5	n.a.
Average earnings[5]	5.7	4.1	n.a.	3.9	4.1	n.a.	n.a.

1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.

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

* preliminary.

In **Canada,** indicators suggest economic activity continued to grow at a rapid pace in the third quarter, although weaker external demand has slowed that pace somewhat from the first half of the year. Real GDP in July and August, on average, rose 0.9 percent from the second quarter, a little lower than the pace recorded over the previous four quarters. Manufacturing production, particularly in the high-technology and transportation equipment sectors, continued its impressive growth. Strong retail activity and rising consumer confidence in the third quarter suggest that consumer spending also retains considerable strength. However, external demand seems to have softened in the third quarter, as export activity in the July-August period was scarcely above second-quarter levels.

Canadian Economic Indicators

(Percent change from previous period except as noted, s.a.)

Indicator	2000			2000			
	Q1	Q2	Q3	July	Aug.	Sept.	Oct.
GDP at factor cost	1.2	1.0	n.a.	.3	.4	n.a.	n.a.
Industrial production	1.6	1.6	n.a.	.1	.7	n.a.	n.a.
New manufacturing orders	1.0	1.7	n.a.	3.9	-3.6	n.a.	n.a.
Retail sales	1.9	1.1	n.a.	1.6	.1	n.a.	n.a.
Employment	.9	.4	.2	-.1	.2	.4	.1
Unemployment rate[1]	6.8	6.7	6.9	6.8	7.1	6.8	6.9
Consumer prices[2]	2.7	2.4	2.7	3.0	2.5	2.7	n.a
Consumer attitudes[3]	113.8	117.0	119.8	...	...	...	...
Business confidence[4]	161.9	154.3	149.4	...	...	...	...

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

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

Labor market indicators are also consistent with a high, but moderately slowing, pace of economic growth. Employment rose by 0.2 percent in the third quarter, after rising 0.9 and 0.4 percent in the first and second quarters. Employment growth has continued in the current quarter, with October employment rising 0.1 percent from September. However, the unemployment rate has not fallen this year, as labor force participation rates have risen alongside employment.

Higher energy prices pushed the twelve-month rate of consumer price inflation to 2.7 percent in September, near the ceiling of the Bank of Canada's 1 percent to 3 percent target range. However, the twelve-month core rate of inflation

(which excludes food and energy prices) was up only 1.3 percent in September, down from 1.5 percent in August. Wage increases have accelerated recently, with average hourly earnings rising 3.7 percent in the 12 months ending in October, up from growth of close to 3 percent in the first half of the year.

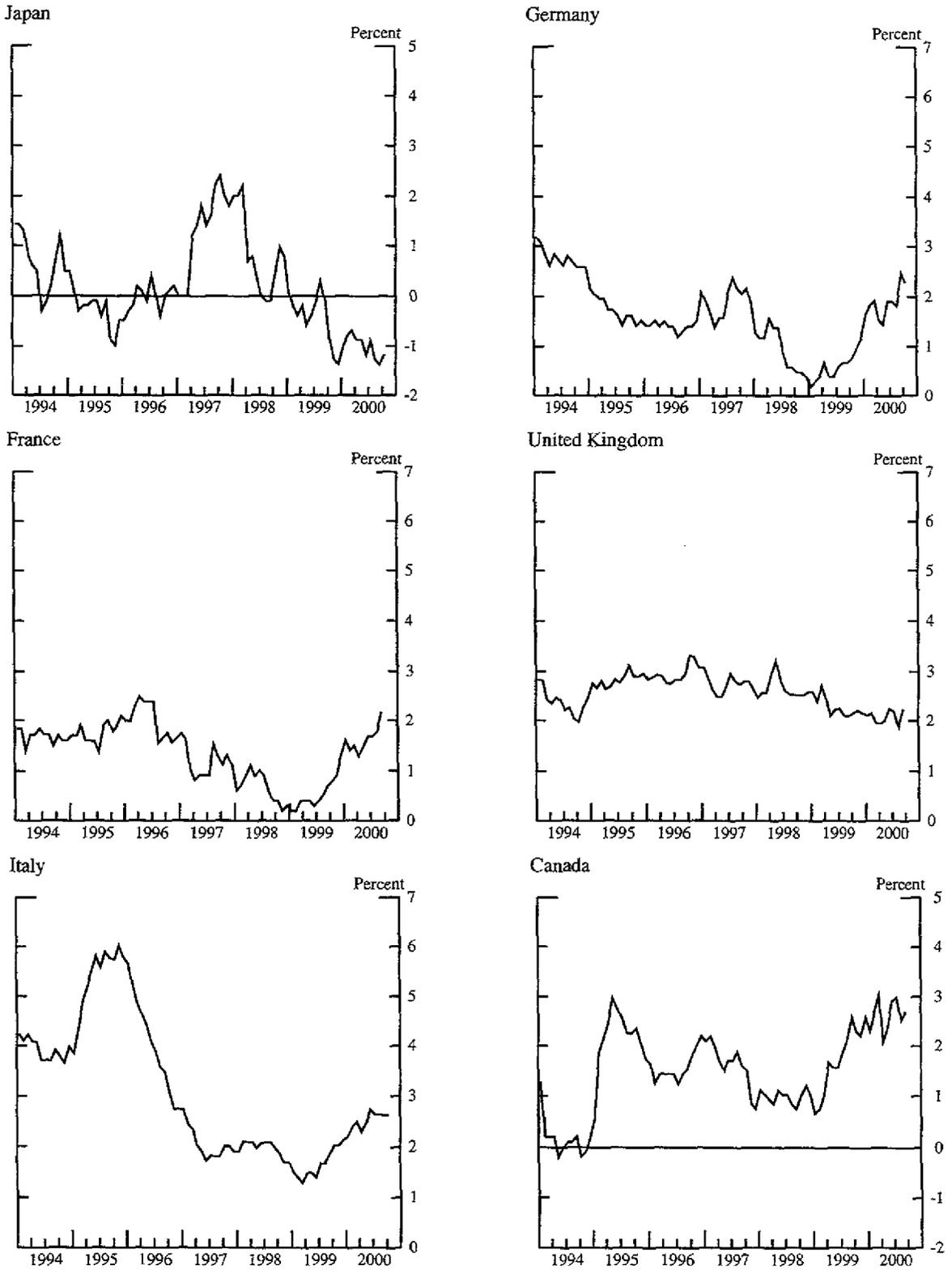
In his mid-year "Economic and Fiscal Update", Finance Minister Paul Martin detailed plans to increase the amount of tax cuts to C$100 billion (11 percent of 1999 GDP) over five years from the C$58 billion announced in the February budget. The new tax cuts include a further increase in the amount of capital gains excluded from taxation and additional reductions in personal and corporate income tax rates. Finance Minister Martin also announced plans for C$50 billion (6 percent of 1999 GDP) in new spending over five years, up from C$28 billion in the February budget. The plan also budgets an additional C$10 billion in debt reduction (1 percent of 1999 GDP) for the current fiscal year which, when combined with existing debt reduction plans, is projected to lower the debt to GDP ratio from 59 percent to 40 percent by 2005.

External Balances
(Billions of U.S. dollars, s.a.a.r.)

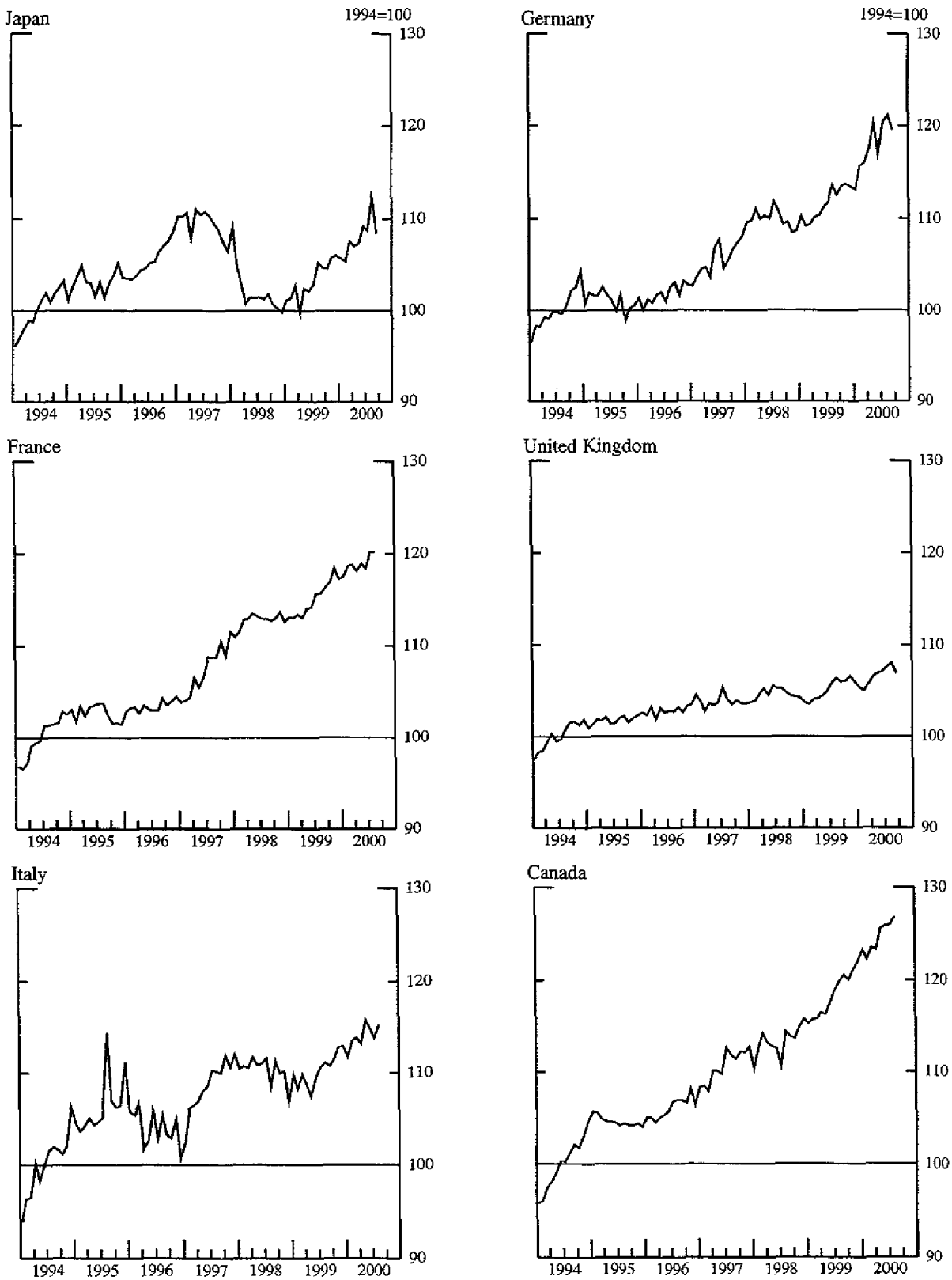
Country and balance	2000			2000		
	Q1	Q2	Q3	July	Aug.	Sept.
Japan						
Trade	120.1	112.5	104.6	102.8	99.6	111.3
Current account	136.4	128.3	n.a.	111.9	123.0	n.a.
Euro-Area						
Trade[1]	-6.2	15.2	n.a.	58.0	-10.8	n.a.
Current account[1]	-31.9	-25.0	n.a.	-24.8	-23.9	n.a.
Germany						
Trade	63.1	51.6	n.a.	48.4	43.4	n.a.
Current account	-10.3	-31.4	n.a.	...	...	...
France						
Trade	9.2	9.2	n.a.	-10.5	-2.7	n.a.
Current account	4.2	5.3	n.a.	3.5	n.a.	n.a.
Italy						
Trade	9.4	-2.6	n.a.	-8.8	-9.7	n.a.
Current account[1]	-7.4	-13.9	n.a.	33.0	8.6	n.a.
United Kingdom						
Trade	-44.7	-46.1	n.a.	-54.3	-40.6	n.a.
Current account	-21.4	-19.9	n.a.	...	...	...
Canada						
Trade	33.5	34.5	n.a.	31.6	32.2	n.a.
Current account	13.4	9.7	n.a.	...	...	...

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

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



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Economic activity in the major developing countries generally slowed during the third quarter from the very rapid rates that prevailed earlier this year. Growth slowed in Mexico and appears to have slowed in Brazil. Argentina took center stage in October, as the languishing economy and political stresses fueled concerns about the country's ability to service its debts. There were also signs that the pace of expansion moderated in Korea, Hong Kong, and Taiwan. Political instability in several ASEAN countries continue to be a cause for concern about the outlook for that region, notwithstanding indications that these economies continue to expand. China, in contrast, posted strong growth in the third quarter, with activity being boosted by government spending.

Inflationary pressures have grown in several countries, but generally, inflation has been remarkably subdued in the face of high fuel prices. Inflation has fallen in Mexico and Brazil, and deflationary pressures persist in Argentina.

With respect to external performance, the Mexican trade deficit narrowed as exports strengthened due to high oil prices and the strong U.S. economy. High oil prices also helped boost Argentina's trade balance. Export growth continued to be strong in Greater China and the ASEAN countries.

In **Argentina**, conditions have worsened since the last Greenbook. After an uptick in July, industrial production fell in August and September, leading to the second consecutive quarterly decline. Monthly inflation turned positive in October, but consumer prices are still ½ percent below their level of a year ago. Other recent indicators have been mixed, and consumer confidence remains low. Export growth continues to be the one consistently positive economic factor, driven partially by strong oil exports, resulting in another trade surplus in August.

Political uncertainty has also increased recently, as the resignation of Argentina's vice president in protest over a reshuffling of the cabinet in early October led to questions about the stability of the Alliance government. While the Alliance government appears to be holding together for now, many are concerned about the ability of the government to pass key pieces of legislation, including the 2001 budget now being debated in the Argentine congress. These concerns, together with the weak economy, have increased investors' skepticism about the ability of Argentina to finance its large external debt and fiscal deficit. The EMBI+ Argentina spread over U.S. Treasuries has soared about 250 basis points to over 900 basis points since late September, domestic 30-day deposit rates in pesos have risen 500 basis points to 13.5 percent, and the 1-day interbank rate has touched levels not seen in 7 years.

Argentine Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Sept.	Oct.
Real GDP[1]	-.6	-.3	-3.2	.5	n.a.	...	...
Industrial production	2.3	-6.0	2.2	-4.6	-2.9	-.1	n.a.
Unemployment rate[2]	12.9	13.8	...	15.4	...	...	...
Consumer prices[3]	.7	-1.8	-1.3	-1.1	-.9	-.8	-.5
Trade balance[4]	-3.1	-.8	1.8	.8	n.a.	n.a.	n.a.
Current account[5]	-14.3	-12.3	-12.9	-5.7	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May and October only. Figures for Q2 reflect data for May.
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, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Mexico**, growth appears to be moderating to a more sustainable rate. Consistent with the slowing in the pace of activity, average industrial production for July and August (s.a.) was only a touch above the second-quarter level. The unemployment rate also rose slightly to 2.3 percent (s.a.) in the third quarter. The continued generally favorable external environment, including high oil prices and a robust U.S. economy, led to export growth outpacing import growth, resulting in a narrowing of the trade deficit from $10 billion (a.r.) in the second quarter to $8 billion in the third quarter.

Inflation continued to decline, with consumer prices rising by less than 9 percent in September on a twelve-month basis, making it very likely that the government's target of 10 percent for year-end inflation will be achieved. The Bank of Mexico (BOM) announced ambitious targets for inflation for the coming years, with the goal of reducing inflation to 6.5 percent next year, 4.5 percent in 2002, and 3 percent in 2003. In order to bring inflationary expectations for 2001 closer in line to its target, the BOM undertook another round of monetary policy tightening in mid-October by increasing its "corto." Subsequently, interest rates have risen about 2 percentage points.

Mexican Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Aug.	Sept.
Real GDP[1]	2.7	5.3	12.0	5.4	n.a.	...	...
Industrial production	6.1	3.9	2.5	2.4	n.a.	-0.1	n.a.
Unemployment rate[2]	3.2	2.5	2.2	2.2	2.3	2.6	2.4
Consumer prices[3]	18.6	12.3	10.5	9.5	9.0	9.1	8.8
Trade balance[4]	-7.9	-5.4	-6.8	-10.0	-8.0	-8.4	-8.3
Imports[4]	125.4	142.1	160.8	170.9	182.2	182.9	181.4
Exports[4]	117.5	136.7	154.0	160.8	174.2	174.5	173.1
Current account[5]	-15.7	-14.0	-16.8	-14.6	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent; counts as unemployed those working one hour a week or less.
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, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Brazil,** data releases since the last Greenbook suggest a slowing in economic activity over the third quarter. Industrial production declined in August and September. High oil prices and a slowdown in export growth led to a continuation of monthly trade deficits. Inflation declined sharply in September and October, after having been driven up in July and August by increases in domestic energy prices and other government-controlled prices.

Despite the slowdown in inflation, the central bank's monetary policy committee held the overnight rate steady at 16.5 percent at its October meeting, citing its concern that high fuel prices will increase inflationary pressures. Wage pressures have been on the rise in recent weeks, seen, in part, in a 12 percent pay increase awarded to judiciary workers in October. Left wing parties posted gains in local elections, although commentators are divided as to whether these gains signal a fall in support for the reform process. Fiscal performance continued to be good, with Brazil meeting its IMF program fiscal target in September by a wide margin.

The *real* and other Brazilian asset prices have come under some downward pressures since mid-October, fueled by concerns about developments in Argentina. In response to the weakening of the *real*, Brazilian authorities have been rolling over all of the maturing dollar-indexed debt. This marks a

departure from the practice in recent months of allowing the stock to decline slightly in dollar terms. The authorities sold only two-thirds of the five-year dollar-indexed debt that it offered at two auctions in late October. This result prompted the central bank to reduce maturities at subsequent auctions of dollar-indexed debt to two years.

Brazilian Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Sept.	Oct.
Real GDP[1]	-2.0	3.8	5.0	.9	n.a.	...	...
Industrial production	-2.0	-.7	1.2	.2	1.1	-0.2	n.a.
Unemployment rate[2]	7.6	7.6	7.6	7.2	7.0	7.0	n.a.
Consumer prices[3]	1.7	8.9	7.9	6.6	7.6	7.6	n.a.
Trade balance[4]	-6.6	-1.2	1.9	-.9	-1.8	-3.8	-0.9
Current account[5]	-33.8	-25.1	-16.2	-28.2	-18.0	-19.0	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

Few economic data have filtered out of **Venezuela** since the last Greenbook. Trade figures for the second quarter reflect the sustained strength in oil exports, which contributed to a $12.6 billion (s.a.) current account balance. Much of this revenue is being channeled into government spending. Twelve-month inflation fell in October to 15 percent, marking a continuation of the downward trend in inflation in recent years.

In early November, the National Assembly approved the "Enabling Law," which gives President Chavez decree power for a year to enact laws affecting a broad range of areas from the oil sector to banks. Enabling laws are not unusual for Venezuela, but the powers granted in this law are viewed as unprecedented.

Venezuelan Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Sept.	Oct.
Real GDP[1]	-4.9	-4.5	4.4	8.7	n.a.	...	...
Unemployment rate[2]	11.2	15.2	15.3	n.a.	n.a.	n.a.	n.a.
Consumer prices[3]	29.9	20.0	18.2	17.1	15.5	15.9	15.0
Non-oil trade balance[4]	-9.4	-8.9	-9.1	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	2.7	7.7	19.7	18.6	n.a.	n.a.	n.a.
Current account[5]	-2.6	3.9	14.0	12.6	n.a.	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a.
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, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Korea**, recent activity data have been mixed. The monthly pattern of industrial production has been distorted because the Thanksgiving holiday fell at the beginning of September this year. For the third quarter as a whole, industrial production recorded a substantial increase. However, measures of consumer and business sentiment have deteriorated in recent months. The unemployment rate has recorded little change since the second quarter, after declining substantially last year and earlier this year. The consumer price inflation rate moved up sharply in September. This result prompted the Bank of Korea in early October to raise its key money market intervention rate by 25 basis points to 5.25 percent, the first such increase since February.

The government has recently indicated that it will ask the legislature for an additional 40 trillion won (8 percent of GDP) to complete financial sector restructuring. However, financial sector restructuring is being held up by uncertainties arising from continuing delays in corporate restructuring. Officials have promised that the (now largely government owned or controlled) banking sector will cut off funds by the end of November to nonviable companies currently under bank workout agreements. Market participants are viewing this promised action as a key test of the government's resolve to carry through on the restructuring process.

Korean Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Sept.	Oct.
Real GDP[1]	-4.6	14.0	7.2	4.6	n.a.	...	...
Industrial production	-6.5	24.2	2.3	1.0	8.1	-4.3	n.a.
Unemployment rate[2]	6.8	6.3	4.4	3.9	3.9	4.0	n.a.
Consumer prices[3]	4.0	1.4	1.5	1.4	3.2	4.0	2.8
Trade balance[4]	41.6	28.7	16.4	13.3	25.8	30.5	n.a.
Current account[5]	40.4	24.5	6.0	10.6	14.3	21.9	n.a.

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

The economic expansion appears to have continued in most of the **ASEAN** region during the third quarter. Export growth continued to be the driving force, although private consumption also picked up in Singapore and Malaysia. High oil prices and the depreciation of regional currencies have led to a rise in consumer price inflation.

The biggest concern for the region is the political turmoil that has embroiled several countries. Philippine President Estrada is facing calls for his resignation due to his alleged involvement in a gambling scandal, and Indonesian President Wahid is under investigation for alleged involvement in two scandals. In Thailand, the upcoming national elections in January have investors uncertain about the future course of the economic recovery and reform efforts, as a populist party is posing a strong challenge to the ruling party.

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

Indicator and country	1998	1999	2000				
			Q1	Q2	Q3	Aug.	Sept.
Real GDP[1]							
Indonesia	-17.5	5.1	15.1	10.7	n.a.	...	...
Malaysia	-11.1	11.0	19.8	4.1	n.a.	...	...
Philippines	-2.0	5.0	1.2	8.5	n.a.	...	...
Singapore	-1.2	7.0	15.3	11.1	n.a.	...	...
Thailand	-7.2	6.8	5.8	2.9	n.a.	...	...
Industrial production							
Indonesia[2]	-13.4	-1.0	4.3	6.5	n.a.	.9	n.a.
Malaysia	-7.2	9.1	7.0	4.2	2.5	.7	2.8
Philippines	-11.6	3.5	3.8	4.0	n.a.	-.6	n.a.
Singapore	-.3	13.9	3.7	5.4	4.2	9.5	-4.6
Thailand	-10.0	12.5	-4.0	-.5	1.0	.5	5.7

1. Annual rate. Annual figures are Q4/Q4.
2. Staff estimate of production.
n.a. Not available. ... Not applicable.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars, s.a.a.r.)

Country	1998	1999	2000				
			Q1	Q2	Q3	Aug.	Sept.
Indonesia	21.5	24.7	32.7	31.4	30.5	26.6	31.6
Malaysia	15.0	18.9	18.7	14.0	13.6	9.7	15.1
Philippines	-.2	4.3	3.9	7.0	n.a.	9.3	n.a.
Singapore	8.3	3.6	5.9	-1.6	4.4	11.0	-4.7
Thailand	12.2	9.3	6.5	7.1	6.1	5.7	5.4

n.a. Not available.

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

Country	1998[1]	1999[1]	2000				
			Q1	Q2	Q3	Sept.	Oct.
Indonesia	77.5	2.0	-.5	1.2	5.8	6.8	8.0
Malaysia	5.3	2.5	1.5	1.4	1.5	1.5	n.a.
Philippines	10.4	4.3	3.0	3.9	4.5	4.6	4.9
Singapore	-1.5	.9	1.1	.8	1.4	1.7	n.a.
Thailand	4.3	.7	.8	1.6	2.2	2.4	1.7

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

In **China**, economic activity picked up significantly, with real GDP rising 11 percent in the third quarter, boosted by an increase in state-sector investment and some strengthening in private consumption (especially in urban areas). Despite the pickup in activity, inflation remained very low; consumer prices were flat in September compared with the same month a year ago. Exports continued to register strong growth, although the rate of expansion of exports has slowed relative to earlier in the year. Imports fell slightly (s.a.) in September, but were up sharply on average in the third quarter due to stronger domestic demand and rising oil prices. In late September, President Clinton signed into law a bill granting China Permanent Normal Trading Relations status. However, disputes over a number of technical details have arisen during the final stages of multilateral talks and threaten to delay China's entry into the WTO until next year.

In **Hong Kong**, data releases since the last Greenbook have painted a mixed picture, but on balance suggest some sluggishness in economic activity in the third quarter. Retail sales volume was down roughly 5 percent (s.a.) over the July-August period, relative to the second quarter. The unemployment rate continued to ease only slowly, edging down to 4.8 percent (s.a.) in the July-September period. Deflationary pressures remain, with the twelve-month rate of decline in consumer prices moderating only a touch in September. On a more positive note, exports jumped about 5 percent (s.a.) in the third quarter. Imports, however, rose even faster, resulting in a sharp increase in the trade deficit.

Chinese Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Aug.	Sept.
Real GDP[1]	9.5	6.2	9.5	1.9	11.0	...	...
Industrial production[2]	9.2	8.0	10.8	11.7	12.5	12.8	12.0
Consumer prices[2]	-1.0	-1.0	.1	.1	.3	.3	.0
Trade balance[3]	43.5	29.2	13.8	30.4	10.0	-.9	9.6

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

Hong Kong Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	1998	1999	2000				
			Q1	Q2	Q3	Aug.	Sept.
Real GDP[1]	-5.8	9.3	22.9	-3.2	n.a.	...	...
Unemployment rate[2]	4.4	6.1	5.6	5.0	4.8	4.9	4.8
Consumer prices[3]	-1.6	-4.0	-5.1	-4.5	-2.8	-2.7	-2.6
Trade balance[4]	-10.6	-5.6	-7.7	-8.9	-14.1	-14.0	-15.1

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Monthly numbers are averages of the current and previous two months.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In **Taiwan**, there are signs that economic activity may be slowing amid heightened political uncertainties. Growth in industrial production moderated to 1.5 percent (s.a.) in the third quarter, as robust expansion in the information technology and electronics sectors was partly offset by a slowdown in some traditional industries. Exports rose to record levels in October, although the pace of expansion has slowed since earlier in the year. Inflation remained low; consumer prices in October were only 1 percent above their year-earlier level. Premier Tang Fei resigned unexpectedly in early October, worsening a crisis of confidence in Taiwan's new government.