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CLASS II - FOMC

March 27, 1998

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

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## SUPPLEMENTAL NOTES

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### THE DOMESTIC NONFINANCIAL ECONOMY

#### Real GDP and Corporate Profits: 1997:Q4

According to BEA's final estimate, real GDP increased 3.7 percent at an annual rate in the fourth quarter of 1997. As in the preliminary report, fourth-quarter GDP growth received a strong boost from inventory accumulation, while growth of final sales slowed to 2.3 percent at an annual rate. Consumer spending moderated last quarter, and business fixed investment edged down after a spectacular third-quarter rise.

The final estimate of real GDP growth in the fourth quarter was 0.2 percentage point less than the pace reported in BEA's preliminary release. Growth of consumer spending was revised down by 0.6 percentage point, reducing its contribution to GDP growth by 0.4 percentage point; the change reflected new information on utilities and hospital usage. Spending on producers' durable equipment was revised up, raising its contribution to GDP growth by 0.3 percentage point; new information on shipments of aircraft accounted for the change.

The GDP chain price index increased 1.4 percent at an annual rate in the fourth quarter. Over the four quarters of 1997, the GDP chain price index increased 1.8 percent. The chain price index for gross domestic purchases--which measures prices of items purchased, rather than produced, in the United States--increased 1.4 percent at an annual rate in the fourth quarter. Over the four quarters of 1997, this measure of prices increased 1.3 percent, the smallest four-quarter increase since the early 1960s.

The report included the first estimate of corporate profits for the fourth quarter. BEA estimates that corporate profits on an economic basis (including the inventory valuation adjustment and capital consumption adjustments) declined \$9 billion in the fourth quarter after having increased \$32 billion in the third quarter. As a share of GNP, corporate profits (excluding Federal Reserve Banks) were 9.7 percent in the fourth quarter, down from 9.9 percent in the third quarter. For 1997 as a whole, the profit share (excluding FR Banks) was also 9.7 percent, up from 9.4 percent in 1996, and marked the best profits performance since 1968.

### Personal Income and Consumption

Real personal consumption expenditures rose 0.3 percent in February following an upward revised gain of 0.6 percent in January. After having surged in January, real outlays for durable goods edged up 0.2 percent in February--held down by a sharp drop in spending for motor vehicles. Real expenditures for nondurable goods rose a robust 0.6 percent in February, while real service expenditures climbed 0.3 percent. The January-February data, along with the lower level of personal consumption expenditures reported for the fourth quarter, put spending on a slightly higher growth trajectory than shown in the Greenbook forecast.

Total nominal personal income increased 0.6 percent for a second month in February, buoyed by another strong gain in wages and salaries. Most other components of income registered modest gains. Nominal disposable income also rose 0.6 percent in February, and after factoring in a small increase in prices, real disposable income, which increased 0.8 percent in January, was up another 0.5 percent. With growth in personal income again outpacing that of outlays, the saving rate edged up to 4.3 percent in February.

The final report of the Michigan Survey Research Center was little changed from the preliminary report of two weeks ago. Sentiment fell back in March from the exceptionally high February reading but remained at a very favorable level. Compared with the February results, respondents had less favorable views of their current and expected personal finances, and their appraisals of buying conditions for large household appliances edged off a bit. However, responses on business conditions were mixed. Households were more optimistic about business conditions over the next twelve months but were less sanguine about conditions over the next five years.

Of those questions not in the overall index, the index of expected unemployment change, which had returned to a low level in February, edged up in March. Consumers' willingness to use savings to finance a major purchase rose in March to the highest reading of the current expansion, but their willingness to use credit fell back a bit after having risen sharply earlier in the year.

The mean of expected inflation over the next twelve months rose 0.3 percentage point to 2.9 percent in March, and the median edged up to 2.5 percent. Average expected inflation over the next five to ten years rose slightly to 3.3 percent but the median edged down to 2.8 percent.

## Real Gross Domestic Product and Related Items

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

	1996:Q4 to 1997:Q4	1997:Q3 Final	1997:Q4 Preliminary	1997:Q4 Final
1. Gross domestic product	3.7	3.1	3.9	3.7
2. Final sales	3.1	4.7	2.5	2.3
3. Consumer spending	3.6	5.6	3.1	2.5
4. Durables	6.8	18.4	1.7	1.9
5. Nondurables	1.4	4.3	-1.0	-1.2
6. Services	4.0	3.9	5.4	4.4
7. Business fixed investment	9.0	19.2	-3.5	-8
8. Producers' durable equipment	12.9	24.1	-3.3	-3
9. Nonresidential structures	-7	6.7	-4.3	-2.3
10. Residential investment	5.6	2.7	9.7	9.1
11. Federal government consumption expenditures and investment	-7	-1.1	-2.1	-2.3
12. Defense	-8	1.2	1.3	1.0
13. Nondefense	-6	-5.7	-8.6	-8.6
14. State and local government consumption expenditures and investment	2.0	2.3	1.8	1.8
15. Exports of goods and services	10.2	4.4	10.0	8.3
16. Imports of goods and services	14.4	14.6	6.4	5.3
<b>ADDENDA:</b>				
17. Nonfarm inventory investment <sup>1</sup>	57.8 <sup>2</sup>	38.3	64.4	64.5
18. Motor vehicles <sup>1</sup>	3.3 <sup>2</sup>	.3	7.2	8.6 <sup>4</sup>
19. Excl. motor vehicles <sup>1</sup>	54.5 <sup>2</sup>	38.0	57.2	55.9 <sup>4</sup>
20. Farm inventory investment <sup>1</sup>	8.0 <sup>2</sup>	9.5	9.8	9.8
21. Net exports of goods and services <sup>1</sup>	-146.5 <sup>2</sup>	-164.1	-158.5	-159.1
22. Nominal GDP	5.6	4.6	5.4	5.2
23. GDP price index	1.8	1.4	1.4	1.4
24. Profit share <sup>3</sup>	10.0 <sup>2</sup>	10.2	n.a.	10.0
25. (Excluding FR banks)	9.7 <sup>2</sup>	9.9	n.a.	9.7
26. Real disposable personal income	3.7	2.6	4.5	4.5
27. Personal saving rate (percent)	3.9 <sup>2</sup>	3.5	3.8	3.9

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

PERSONAL INCOME  
(Average monthly change at an annual rate; billions of dollars)

	1996	1997	1997			1998	
			Q2	Q3	Q4	Jan.	Feb.
Total personal income	32.5	32.2	25.1	24.0	38.3	40.9	43.7
Wages and salaries	21.2	21.2	15.4	16.2	30.6	30.4	34.6
Private	19.6	19.0	14.3	13.9	28.8	26.1	32.1
Other labor income	.5	.9	.6	1.1	1.2	1.3	1.2
Proprietors' income	2.2	2.0	3.1	.7	1.7	1.4	1.3
Farm	.8	-.2	.9	-1.7	-.3	-2.1	-2.5
Rent	.7	-.3	-.5	.1	-1.1	-.9	-.5
Dividend	2.8	3.0	2.0	2.1	2.1	2.1	1.9
Interest	2.2	2.4	2.8	1.8	2.1	2.0	1.8
Transfer payments	4.2	4.5	2.6	3.1	3.7	8.8	5.5
Less: Personal contributions for social insurance	1.4	1.5	1.0	1.0	2.0	4.2	2.2
Less: Personal tax and nontax payments	9.2	7.7	7.3	4.9	8.7	-6.1	9.6
Equals: Disposable personal income	23.3	24.4	17.8	19.2	29.6	46.9	34.1
Memo: Real disposable income <sup>1</sup>	9.6	16.1	12.3	9.8	22.8	40.4	26.2

1. Billions of chained (1992) dollars.

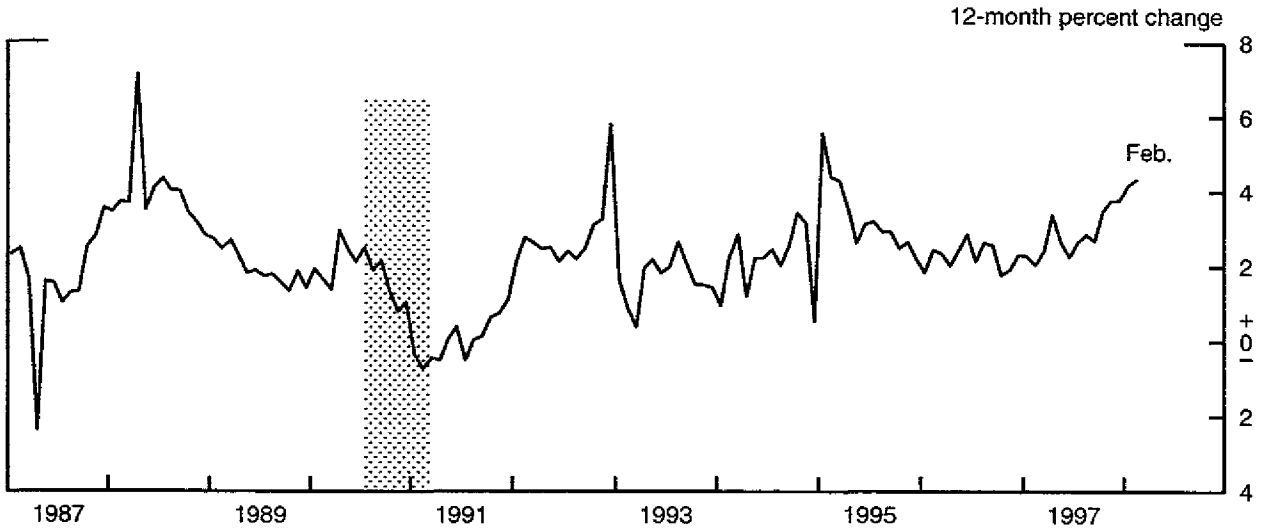
REAL PERSONAL CONSUMPTION EXPENDITURES  
(Percent change from the preceding period)

	1997	1997			1998	
		Q2	Q3	Q4	Jan.	Feb.
		- - - Annual rate - - -			Monthly rate	
Personal consumption expenditures	3.6	.9	5.6	2.5	.6	.3
Durable goods	6.8	-5.4	18.4	1.9	2.2	.2
Excluding motor vehicles	8.4	1.6	11.8	4.5	3.7	1.1
Nondurable goods	1.4	-2.1	4.3	-1.2	.8	.6
Excluding gasoline	1.3	-2.7	4.7	-1.6	.6	.7
Services	4.0	3.9	3.9	4.4	.3	.3
Excluding energy	4.2	3.4	4.4	4.4	.6	.3
Memo:						
Personal saving rate (percent)	3.9	4.2	3.5	3.9	4.2	4.3
Real disposable income <sup>1</sup>	3.7	3.1	2.6	4.5	.8	.5

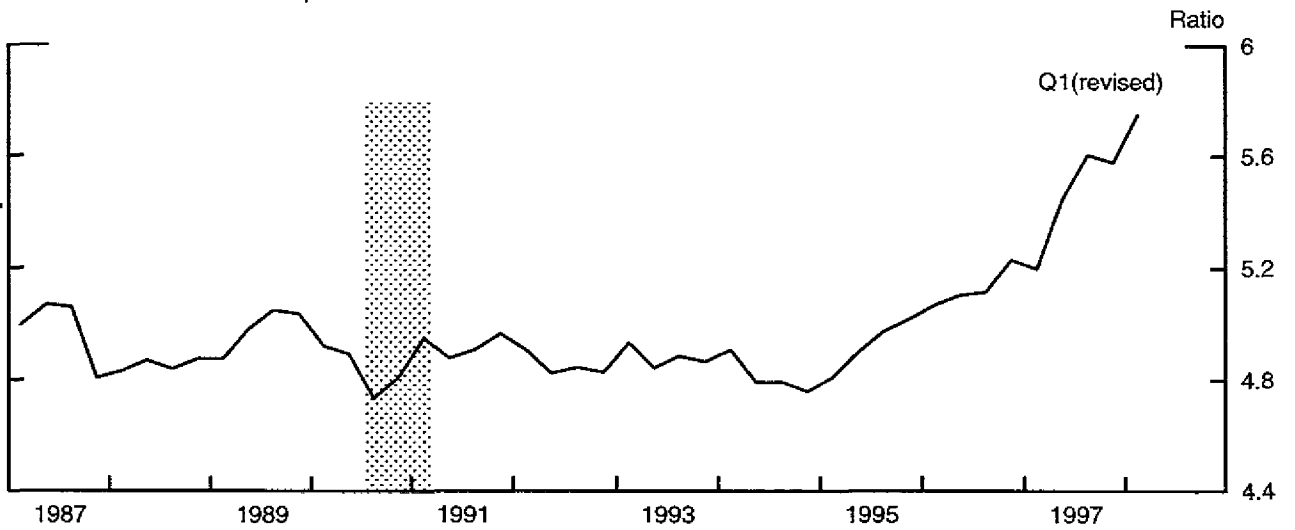
1. Percent changes derived from billions of chained (1992) dollars.

## Household Indicators

Real Disposable Personal Income

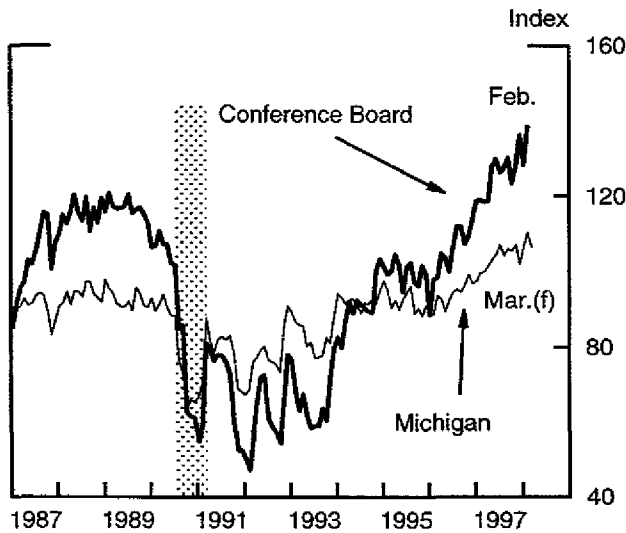


Ratio of Net Worth to Disposable Income

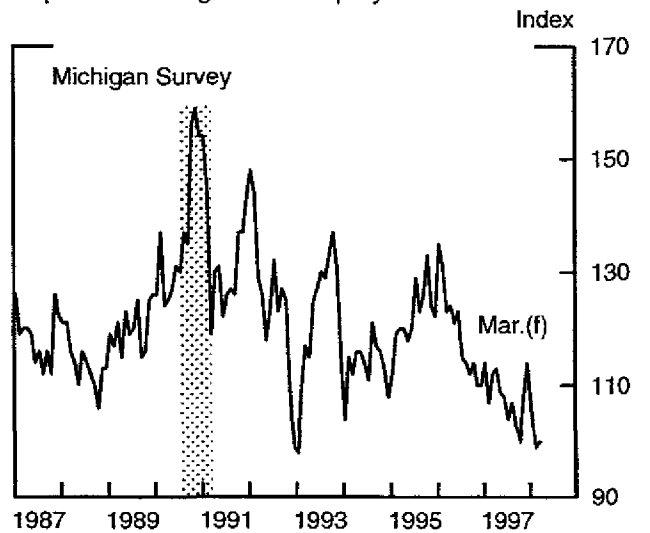


Note. Data for 1998:Q1 are staff estimates.

Consumer Confidence



Expected Change in Unemployment



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



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

Instrument	1997		1998			Change to Mar. 26, from:		
	Sep. 30	Jan. 2	FOMC *		Sep. 30	Jan. 2	FOMC *	
			Feb. 4	Mar. 26				Feb. 4
<b>Short-term rates</b>								
Federal funds								
intended rate <sup>2</sup>	5.50	5.50	5.50	5.50	0.00	0.00	0.00	
realized rate <sup>3</sup>	5.51	5.44	5.53	5.55	0.04	0.11	0.02	
Treasury bills <sup>4</sup>								
3-month	4.93	5.18	5.12	5.08	0.15	-0.10	-0.04	
6-month	5.08	5.19	5.08	5.00	-0.08	-0.19	-0.08	
1-year	5.18	5.18	4.98	5.14	-0.04	-0.04	0.16	
Commercial paper								
1-month	5.51	5.56	5.48	5.51	0.00	-0.05	0.03	
3-month	5.48	5.54	5.40	5.45	-0.03	-0.09	0.05	
Large negotiable CDs <sup>4</sup>								
1-month	5.59	5.64	5.52	5.59	0.00	-0.05	0.07	
3-month	5.67	5.69	5.52	5.59	-0.08	-0.10	0.07	
6-month	5.72	5.71	5.53	5.62	-0.10	-0.09	0.09	
Eurodollar deposits <sup>5</sup>								
1-month	5.56	5.59	5.50	5.56	0.00	-0.03	0.06	
3-month	5.63	5.69	5.53	5.56	-0.07	-0.13	0.03	
Bank prime rate								
	8.50	8.50	8.50	8.50	0.00	0.00	0.00	
<b>Intermediate- and long-term rates</b>								
U.S. Treasury (constant maturity)								
3-year	5.88	5.62	5.36	5.65	-0.23	0.03	0.29	
10-year	6.12	5.67	5.56	5.68	-0.44	0.01	0.12	
30-year	6.41	5.86	5.86	5.96	-0.45	0.10	0.10	
U.S. Treasury 10-year indexed note	3.61	3.70	3.66	3.76	0.15	0.06	0.10	
Municipal revenue (Bond Buyer) <sup>6</sup>	5.63	5.41	5.33	5.42	-0.21	0.01	0.09	
Corporate-A utility, recently offered	7.44	6.96	6.96	7.06	-0.38	0.10	0.10	
High-yield corporate <sup>7</sup>	9.02	9.04	8.88	8.85	-0.17	-0.19	-0.03	
Home mortgages <sup>8</sup>								
FHLMC 30-yr fixed rate	7.28	7.03	7.12	7.08	-0.20	-0.76	-0.04	
FHLMC 1-yr adjustable rate	5.51	5.50	5.59	5.67	0.16	0.17	0.08	
<b>Stock exchange index</b>								
	Record high		1998			Percentage change to Mar. 26, from:		
	Level	Date	Jan. 2	FOMC * Feb. 4	Mar. 26	Record high	Jan. 2	FOMC * Feb. 4
Dow-Jones Industrial	8906.43	3/20/98	7965.04	8160.35	8846.89	-0.67	11.07	8.41
S&P 500 Composite	1105.65	3/24/98	975.04	1006.00	1100.80	-0.44	12.90	9.42
NASDAQ (OTC)	1828.54	3/26/98	1581.53	1666.34	1828.54	0.00	15.62	9.73
Russell 2000	477.81	3/26/98	436.52	437.80	477.81	0.00	9.46	9.14
Wilshire	10507.21	3/24/98	9327.71	9565.62	10482.20	-0.24	12.38	9.58

1. One-day quotes except as noted.
  2. FOMC's intended rate.
  3. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
  4. Secondary market.
  5. Bid rates for Eurodollar deposits at 11 a.m. London time.
  6. Most recent observation based on one-day Thursday quote and futures market index changes.
  7. Merrill Lynch Master II high-yield bond index composite.
  8. Quotes for week ending Friday previous to date shown.
- \* Figures cited are as of the close on February 3, 1998.

## THE INTERNATIONAL ECONOMY

In **Japan**, the Liberal Democratic Party on March 26 announced the outline of a ¥16 trillion (3.2 percent of GDP) fiscal stimulus package. This preliminary package was heavily weighted towards public investment, with particular emphasis on the environment, education, energy, and disaster-relief measures. The LDP, however, also called for swift consideration of sizable cuts in personal income and corporate tax rates. The package included some proposals for further structural reforms. Notably, it urged policymakers to develop a global strategy for disposing of the banking system's collateral-backed bad loans and for revitalizing the real estate market. The LDP also suggested that public funds--in addition to the recently approved ¥30 trillion--should be made available to buy securitized debt from financial companies.

The March 26 announcement was too incomplete to determine what share of the ¥16 trillion headline figure will translate into actual fiscal stimulus. In recent years, the actual stimulus in such packages has been roughly 40 to 50 percent as large as the headline figure. This suggests new effective stimulus of ¥6-8 trillion, somewhat larger than what was assumed in the March Greenbook. The LDP will hammer out the details of its proposals during the next month. After these details are announced, the proposals must be adopted by the government and approved by the Diet.

On March 27, the **German** cabinet approved the launch of European Monetary Union in 1999 with 11 members. The decision came immediately following the Bundesbank's convergence report that--in much stronger language than in the EMI and EC reports released on March 25--expressed "serious concerns" as to whether Italy and Belgium had achieved fiscal sustainability. The report noted that Italy and Belgium had exceeded the 60 percent debt-to-GDP ratio "particularly strongly" and stated that they needed to make binding commitments to cut debt before entering EMU. The Bundesbank also noted that Italy and Finland had been participating in the ERM for less than two years and therefore had not fully met the exchange rate criteria.

Erratum

Central banks of major foreign industrial countries reported about \$500 million in net *purchases* of dollars over the intermeeting period. Part 1 of the Greenbook incorrectly reported \$500 million in net *sales* of dollars.