

## **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,<sup>1</sup> and then making the scanned versions text-searchable.<sup>2</sup> 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.

---

<sup>1</sup> 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).

<sup>2</sup> 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 II - FOMC

May 15, 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

## TABLE TO CONTENTS

	Page
<b>THE DOMESTIC NONFINANCIAL ECONOMY</b>	
Industrial production .....	1
Consumer sentiment .....	2
<u>Tables</u>	
Growth in selected components of industrial production .....	3
Capacity utilization .....	3
University of Michigan Survey Research Center: Survey of Consumer Attitudes .....	5
<u>Chart</u>	
Industrial production and goods GDP .....	4
<b>THE FINANCIAL ECONOMY</b>	
<u>Tables</u>	
Selected financial market quotations .....	6
Commercial bank credit .....	7

## SUPPLEMENTAL NOTES

---

### THE DOMESTIC NONFINANCIAL ECONOMY

#### Industrial Production

Industrial production rose 0.1 percent in April after a revised 0.3 percent increase in March and declines earlier in the year. Utilities output, which has been volatile in recent months owing to the unseasonable weather, retreated 1.9 percent in April after having surged 6.0 percent in March. In manufacturing, production advanced 0.3 percent after two months of declines. The factory operating rate, which edged down to 80.8 percent in April, is 1-1/2 percentage points lower than the rate at the end of last year.

The sharp deceleration in industrial activity in the first quarter followed a rapid pace of growth in the second half of last year. By contrast, the staff estimates that the goods and structures component of GDP grew about 9 percent in the first quarter. Last quarter's large IP-goods GDP discrepancy follows three consecutive quarters in which IP growth exceeded growth in goods and structures GDP. Over the last four quarters, goods and structures GDP and IP have grown at about the same pace (chart).

The output of consumer goods remained flat in April; a 0.9 percent rise in the production of durable goods was offset by a decline in the output of consumer energy products. However, production of business equipment, which weakened early this year, grew sharply for a second month in April. The output of computers, which increased at a 53 percent annual rate in the first quarter, rose another 3 percent. Production of communications equipment also grew at a healthy rate last month. In addition, the production of medium and heavy trucks has grown strongly in the last two months, coinciding with sales rates that are the highest since 1978. In contrast, civilian aircraft assemblies changed little last month; Boeing has largely completed its ramp-up in final assemblies to 43 planes per month, compared with 26.5 planes per month at the beginning of 1997.<sup>1</sup>

The production of construction supplies declined for a second month in April, although its level remained above that at the end of last year. Non-energy materials edged up in April, held down by a decline in steel output. Semiconductor production, which boosted durable

---

1. Boeing is likely to step up production again next year as it starts producing the 717, the smallest model in its product line.

materials growth last year, continued to expand in April, but growth has slowed recently. According to the Semiconductor Industry Association, worldwide consumption of semiconductors slackened early this year. Also, semiconductor demand has reportedly been softened by a reduction in semiconductor inventories held by downstream firms. Within nondurable materials, chemical production slowed for the third consecutive month, and the inventory-to-sales ratio has risen to the highest level since 1991. Part of this slowdown is thought to be attributable to the Asian crisis; domestic manufacturers report that they are facing intense competitive pressure from Asian producers for certain products.

### Consumer Sentiment

According to the preliminary report from the Michigan Survey Research Center, consumer sentiment fell back somewhat in early May but remained at a highly favorable level.<sup>2</sup> All the major components in the aggregate index moved lower; if these readings were not to change in the final report, the overall index would be back to the level that prevailed, on average, in the fourth quarter of last year.

Among those questions not in the overall measure, the index of expected unemployment change jumped 9 percentage points in early May as the share of respondents expecting more unemployment over the coming year climbed from 16 to 22 percent of the sample. Nevertheless, the increase in the index in early May only returned it to about the same level that prevailed in the fourth quarter.

Consumers' appraisals of buying conditions for cars edged higher in early May, while their views on buying conditions for homes fell back. Although a larger share of respondents believed that now was a good time to buy a home because "times are good" and "prices low," this was offset, in part, by a decline in the share that viewed interest rates as low.

The mean of expected inflation over the next twelve months rose 0.4 percentage point to 3.1 percent in early May--the median was up 0.3 percentage point to 2.7 percent. In contrast, the mean of expected inflation over the next five to ten years edged down 0.2 percentage point to 3 percent in early May; the median edged up 0.1 percentage point to 2.8 percent.

---

2. The preliminary report was based on about 60 percent of the full sample.

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

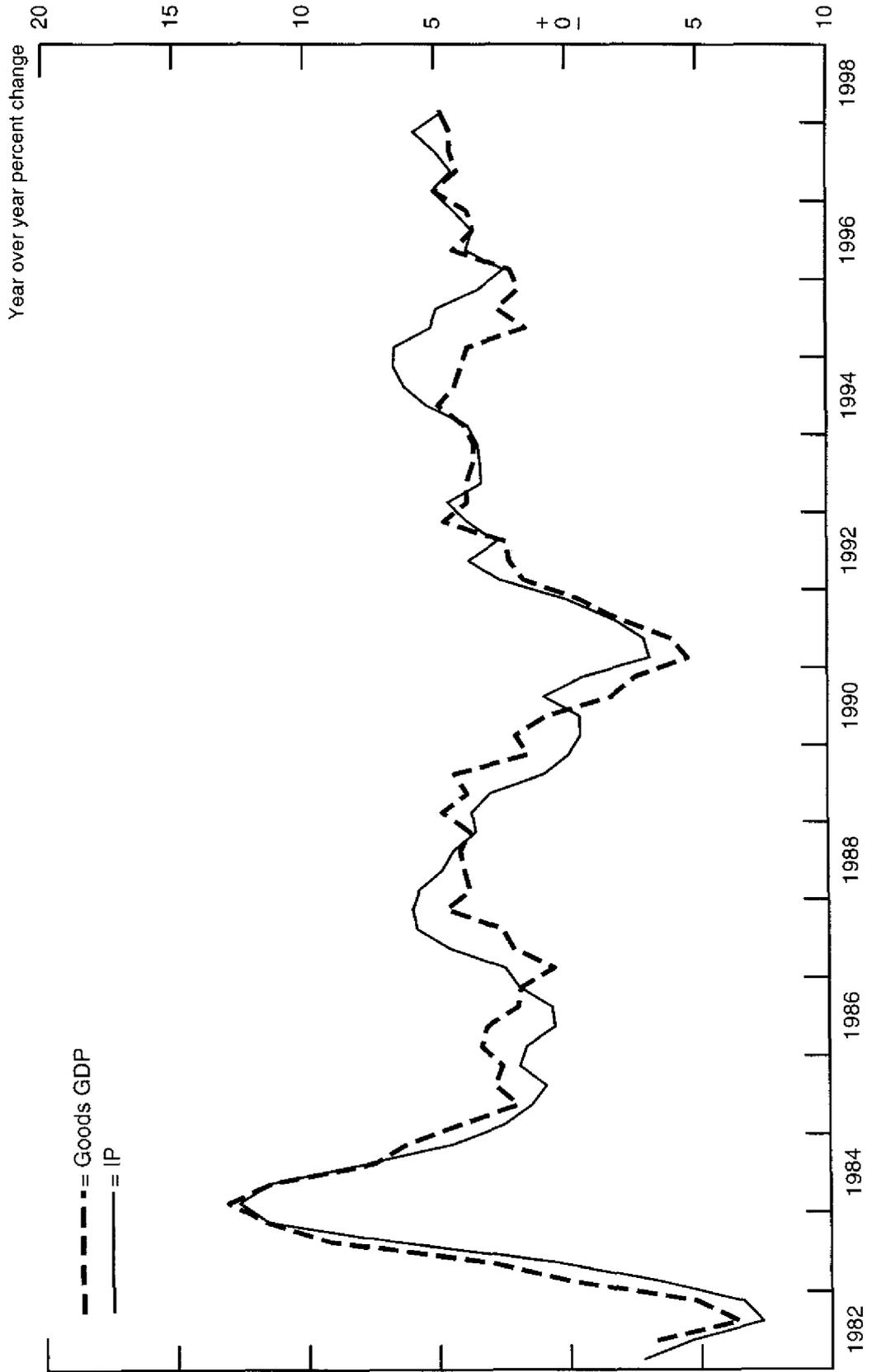
	Proportion 1997	1997 <sup>1</sup>	1997	1998	1998		
			Q4	Q1	Feb.	Mar.	Apr.
		-Annual rate-		--Monthly rate--			
Total index	100.0	5.8	7.2	1.0	-.3	.3	.1
Previous		5.8	7.2	.9	-.2	.2	
Manufacturing	86.2	6.3	8.1	2.0	-.4	-.2	.3
Durables	46.6	9.5	10.3	2.2	-.3	.2	.4
Motor vehicles and parts	5.2	11.9	23.1	-17.5	-1.1	.0	1.5
Aircraft and parts	2.3	18.5	20.5	12.6	-.2	-.6	-.3
Nondurables	39.6	2.6	5.5	1.8	-.4	-.6	.2
Manufacturing excluding motor vehicles and parts	81.0	6.0	7.2	3.4	-.3	-.2	.2
Mining	6.2	2.1	-2.1	7.8	-.5	-.4	-.2
Utilities	7.6	2.4	5.5	-15.4	-.2	6.0	-1.9
IP by market group							
Consumer goods	28.3	2.8	6.6	-1.3	-1.2	.2	.0
Durables	6.0	6.0	11.1	1.6	-.9	.0	.9
Nondurables	22.3	2.0	5.4	-2.1	-1.3	.3	-.2
Business equipment	13.7	10.8	10.7	.1	-.4	.8	1.0
Information processing	5.5	12.2	9.4	4.4	1.1	.3	2.0
Computer and office eq.	1.8	36.3	28.3	52.8	3.5	4.6	3.0
Industrial	4.5	5.6	6.8	-3.6	-1.5	.9	-.7
Transit	2.4	17.6	25.8	3.5	-1.5	1.3	1.4
Other	1.3	9.5	1.5	-10.0	-.8	1.0	1.4
Construction supplies	5.6	2.2	4.1	9.2	.6	-.7	-.1
Materials	40.3	7.3	7.6	1.6	.0	.2	.0
Durables	22.9	11.2	12.1	2.5	-.3	.1	.1
Semiconductors	3.7	39.8	31.5	30.5	1.0	.3	.9
Basic metals	3.6	4.8	7.9	.0	-.3	-1.7	-.3
Nondurables	9.0	3.5	5.3	.6	.9	-1.2	-.2

1. From the final quarter of the previous period to the final quarter of the period indicated.

CAPACITY UTILIZATION  
(Percent of capacity; seasonally adjusted)

	1988-89	1959-97	1997	1998	1998		
	High	Avg.	Q4	Q1	Feb.	Mar.	Apr.
Manufacturing	85.7	81.7	82.2	81.5	81.5	81.0	80.8
Primary processing	88.9	82.8	86.0	85.6	85.6	85.1	84.8
Advanced processing	84.2	81.1	80.4	79.7	79.6	79.1	79.1

# Industrial Production and Goods GDP (Index, 1992=100)



May 15, 1998

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

	1997 Sep	1997 Oct	1997 Nov	1997 Dec	1998 Jan	1998 Feb	1998 Mar	1998 Apr	1998 May (p)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	106.0	105.6	107.2	102.1	106.6	110.4	106.5	108.7	105.2
Current conditions	114.1	109.8	114.9	111.4	113.5	120.0	113.7	115.5	111.5
Expected conditions	100.7	102.8	102.3	96.1	102.2	104.2	101.9	104.3	101.1
-----									
Personal financial situation									
Now compared with 12 months ago*									
Expected in 12 months*	127	124	130	123	124	142	128	131	124
Expected in 12 months*	138	136	138	136	141	145	134	138	132
Expected business conditions									
Next 12 months*	149	154	151	142	148	155	158	162	157
Next 5 years*	119	125	123	109	123	121	119	121	118
Appraisal of buying conditions									
Cars	143	141	140	135	145	149	146	145	146
Large household appliances*	170	161	169	166	171	170	167	169	165
Houses	172	164	163	161	172	170	176	178	173
Willingness to use credit	50	37	46	39	55	56	49	51	54
Willingness to use savings	57	69	69	75	74	78	82	70	77
Expected unemployment change - next 12 months	103	100	108	114	106	99	100	97	106
Expected inflation - next 12 months									
Mean	3.5	3.2	3.4	3.4	2.8	2.6	2.9	2.7	3.1
Median	2.8	2.8	2.9	2.8	2.3	2.4	2.5	2.4	2.7
Expected inflation - next 5 to 10 years									
Mean	3.6	3.6	3.8	3.9	3.4	3.2	3.3	3.2	3.0
Median	3.1	3.0	3.1	3.1	2.9	2.9	2.8	2.7	2.8

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

(p) -- Preliminary

(f) -- Final

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

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

Instrument	1997	1998			Change to May 14, from:			
	Sep. 30	Jan. 2	FOMC * Mar. 31	May 14	Sep. 30	Jan. 2	FOMC * Mar. 31	
<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	5.52	5.51	0.00	0.07	-0.01	
Treasury bills <sup>4</sup>								
3-month	4.93	5.18	5.09	5.04	0.11	-0.14	-0.05	
6-month	5.08	5.19	5.04	5.17	0.09	-0.02	0.13	
1-year	5.18	5.18	5.16	5.19	0.01	0.01	0.03	
Commercial paper								
1-month	5.51	5.56	5.54	5.50	-0.01	-0.06	-0.04	
3-month	5.48	5.54	5.44	5.49	0.01	-0.05	0.05	
Large negotiable CDs <sup>4</sup>								
1-month	5.59	5.64	5.59	5.56	-0.03	-0.08	-0.03	
3-month	5.67	5.69	5.60	5.59	-0.08	-0.10	-0.01	
6-month	5.72	5.71	5.64	5.67	-0.05	-0.04	0.03	
Eurodollar deposits <sup>5</sup>								
1-month	5.56	5.59	5.56	5.50	-0.06	-0.09	-0.06	
3-month	5.63	5.69	5.56	5.56	-0.07	-0.13	0.00	
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	5.69	5.64	-0.24	0.02	-0.05	
10-year	6.12	5.67	5.72	5.67	-0.45	0.00	-0.05	
30-year	6.41	5.86	5.98	5.98	-0.43	0.12	0.00	
U.S. Treasury 10-year indexed note	3.61	3.70	3.75	3.76	0.15	0.06	0.01	
Municipal revenue (Bond Buyer) <sup>6</sup>	5.63	5.41	5.42	5.48	-0.15	0.07	0.06	
Corporate-A utility, recently offered	7.44	6.96	7.17	7.17	-0.27	0.21	0.00	
High-yield corporate <sup>7</sup>	9.02	9.04	8.86	9.01	-0.01	-0.03	0.15	
Home mortgages <sup>8</sup>								
FHLMC 30-yr fixed rate	7.28	7.03	7.08	7.19	-0.09	-0.65	0.11	
FHLMC 1-yr adjustable rate	5.51	5.50	5.70	5.71	0.20	0.21	0.01	
<b>Stock exchange index</b>								
	Record high		1998			Percentage change to May 14, from:		
	Level	Date	Jan. 2	FOMC * Mar. 31	May 14	Record high	Jan. 2	FOMC * Mar. 31
Dow-Jones Industrial	9211.84	5/13/98	7965.04	8782.12	9172.23	-0.43	15.16	4.44
S&P 500 Composite	1130.54	4/22/98	975.04	1093.55	1117.37	-1.16	14.60	2.18
NASDAQ (OTC)	1917.61	4/22/98	1581.53	1818.70	1865.36	-2.72	17.95	2.57
Russell 2000	491.41	4/21/98	436.52	476.23	475.55	-3.23	8.94	-0.14
Wilshire	10782.75	4/22/98	9327.71	10423.24	10617.25	-1.53	13.82	1.86

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 March 30, 1998.

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

Type of credit	1997		1998				Level, Apr 1998 (billions of \$)
	1997	Q4	Q1	Feb	Mar	Apr	
1. Bank credit: Reported	8.8	8.0	11.8	8.8	12.1	-4.0	4,205.0
2.           Adjusted <sup>1</sup>	8.4	8.5	11.2	9.7	13.1	-2.8	4,112.2
3. Securities: Reported	10.3	13.4	17.1	4.7	20.0	-22.2	1,106.6
4.           Adjusted <sup>1</sup>	8.5	16.1	15.2	7.7	24.8	-19.2	1,013.8
5.   U.S. government	6.2	11.6	15.6	12.0	18.6	-26.6	761.9
6.   Other <sup>2</sup>	20.6	17.6	20.6	-11.1	23.2	-12.4	344.7
7. Loans <sup>3</sup>	8.3	6.1	9.9	10.3	9.3	2.6	3,098.4
8.   Business	8.9	8.4	9.9	10.0	1.2	-0.7	869.5
9.   Real estate	9.0	6.2	7.3	13.3	12.4	6.9	1,266.6
10.   Home equity	16.2	11.8	6.6	6.1	-3.6	1.2	99.1
11.   Other	8.5	5.8	7.3	14.0	13.8	7.3	1,167.5
12. Consumer: Reported	-1.5	-7.1	-3.4	-3.3	-2.1	-12.7	496.6
13.           Adjusted <sup>4</sup>	4.2	5.3	3.8	1.5	1.0	-2.3	715.6
14.   Other <sup>5</sup>	19.4	18.1	33.9	18.4	28.8	14.1	465.7

Note. Adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FASB 115).

2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not U.S. government securities.

3. Excludes interbank loans.

4. Includes an estimate of outstanding loans securitized by commercial banks.

5. Includes security loans, loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.