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

June 24, 1998

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

June 24, 1998

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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DOMESTIC NONFINANCIAL DEVELOPMENTS

Domestic Nonfinancial Developments

Overview

The information now available suggests that real GDP growth slowed sharply in the second quarter, after an advance in the first quarter that may be revised upward to almost 5-1/2 percent. The crisis in Asia and the associated appreciation of the dollar continued to exert a significant drag on U.S. economic activity, and there are hints in the underlying source data that growth in private domestic final demand moderated a bit as well. The first readings on inventory investment indicate a ratcheting down of stockbuilding early in the second quarter from the breakneck pace of the first quarter, and the strike at General Motors clearly has caused stocks of motor vehicles to run off this month. In the labor market, payrolls continued to expand rapidly, and the unemployment rate held at 4.3 percent in May--the lowest level since 1970. The most recent news on producer and consumer prices has been a bit less favorable than earlier in the year.

Labor Market Developments

The labor market showed continued strength in May. At 296,000, growth in payroll employment almost matched its rapid April pace; average weekly hours of production and nonsupervisory workers increased 0.2 hour, to 34.7 hours; and the unemployment rate held at 4.3 percent.[1]

The private service-producing sector once again dominated hiring in May, accounting for virtually all of the total net increase in nonfarm jobs. In the goods-producing sector, mining, construction, and manufacturing all lost jobs. Manufacturing employment declined in May and has registered a net increase of only 9,000 so far this year, a pattern that is generally consistent with the slowing growth of manufacturing production.[2] Construction employment fell in May, but this followed

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1. With the latest release, the payroll employment data were benchmarked to more comprehensive counts of employment, derived primarily from unemployment insurance tax records for March 1997. As previously announced, the level of payroll employment in March 1997 was revised up 431,000, or 0.4 percent (not seasonally adjusted). In addition, the seasonal adjustment factors were revised back to 1993. The most notable effect of the revision to the seasonal factors was to shift about 100,000 jobs in 1998 from January and February to March, pushing March's previously reported negative employment growth well into positive territory.

2. Strikes by 3,400 workers at the General Motors Metal Stamping plant on June 5 and by 5,800 workers at the Delphi Automotive Systems plant on June 11 (both in Flint, Michigan) have, so far, led General Motors to furlough about 92,000 workers at other plants in the United States as a result of parts shortages. All of the furloughed workers apparently worked during at least part of the June reference

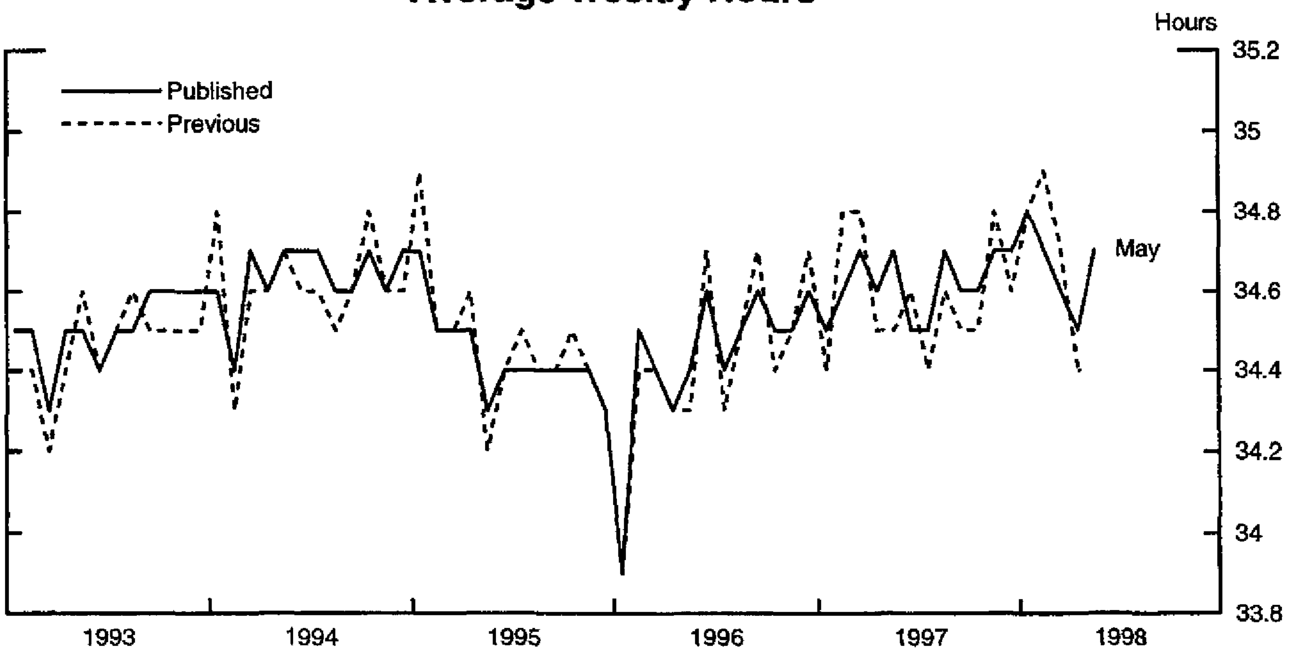
(continued...)

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

	1996	1997	1997 Q3	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
	---Average monthly changes---							
Nonfarm payroll employment [1]	233	282	249	336	208	82	302	296
Private	224	263	227	312	192	74	266	255
Previous	198	246	220	339	197	-26	243	n.a.
Goods Producing	31	42	30	67	28	-38	58	-36
Manufacturing	3	21	15	35	13	7	-3	-26
Construction	28	20	15	32	17	-42	66	-9
Service Producing	193	220	197	245	165	112	208	291
Transportation and utilities	8	14	10	5	18	10	8	22
Trade	54	48	46	73	22	-10	83	98
Finance, insurance, real estate	14	17	18	23	21	26	28	20
Services	117	142	124	144	104	86	89	151
Help supply services	19	26	11	32	12	-1	-17	26
Total government	9	20	21	24	16	8	36	41
Private nonfarm production workers [1]	190	212	170	246	136	40	142	248
Manufacturing production workers	0	16	9	29	4	-11	-12	-19
Total employment [2]	232	240	123	339	72	-169	389	70
Nonagricultural	226	243	112	351	157	33	171	85
Memo:								
Aggregate hours of private production workers (percent change)[1,3]	3.2	3.4	2.3	4.1	3.2	-0.4	0.1	0.7
Previous[1,3]	2.9	3.0	1.6	4.5	4.8	-0.7	-0.4	n.a.
Average workweek (hours) [1]	34.4	34.6	34.6	34.7	34.7	34.6	34.5	34.7
Previous [1]	34.4	34.6	34.5	34.6	34.8	34.7	34.4	n.a.
Manufacturing (hours)	41.6	42.0	41.9	42.1	42.0	41.8	41.4	41.7

n.a. Not available.
Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Survey of households.
3. Annual data are percent change from Q4 to Q4. Quarterly data are percent change from preceding period at an annual rate. Monthly data are percent change from preceding month.

Average Weekly Hours

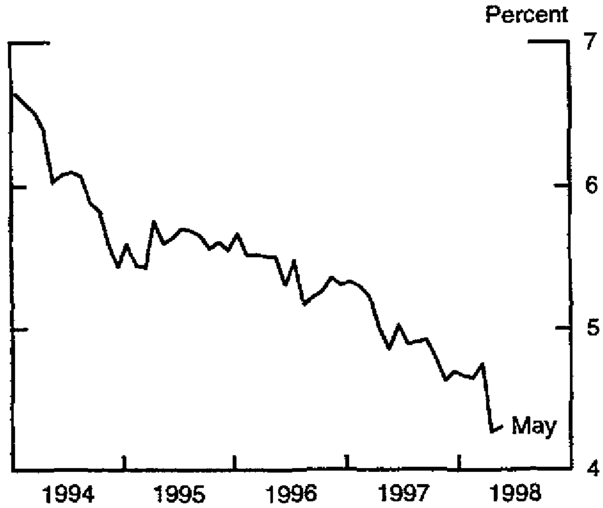


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES [1]
(Percent; based on seasonally adjusted data, as published)

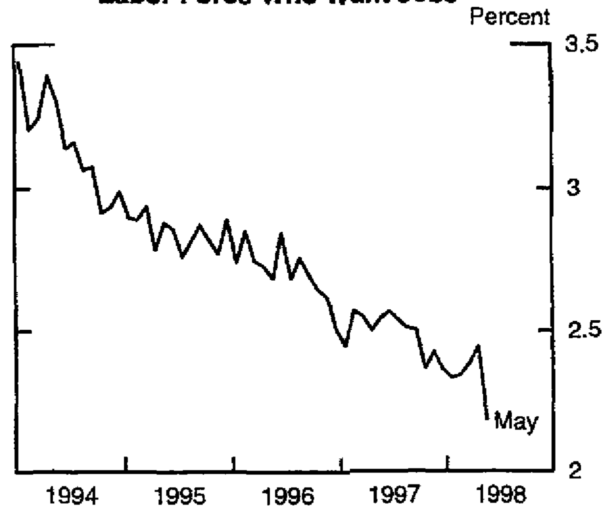
	1996	1997	1997 Q3	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
Civilian unemployment rate (16 years and older)	5.4	4.9	4.9	4.7	4.7	4.7	4.3	4.3
Teenagers	16.7	16.0	16.3	15.0	14.6	15.0	13.1	14.2
Men, 20 years and older	4.6	4.2	4.1	4.0	3.8	3.9	3.4	3.5
Women, 20 years and older	4.8	4.4	4.3	4.0	4.3	4.3	4.1	3.9
Labor force participation rate	66.8	67.1	67.1	67.1	67.3	67.2	67.0	67.0
Teenagers	52.3	51.6	51.1	51.4	53.3	53.5	51.8	52.3
Men, 20 years and older	76.8	76.9	76.9	76.9	76.9	76.7	76.9	76.8
Women, 20 years and older	59.9	60.5	60.6	60.5	60.6	60.7	60.3	60.4
Women maintaining families	65.3	67.4	68.0	68.2	67.9	66.8	67.3	67.9

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

Unemployment Rate*

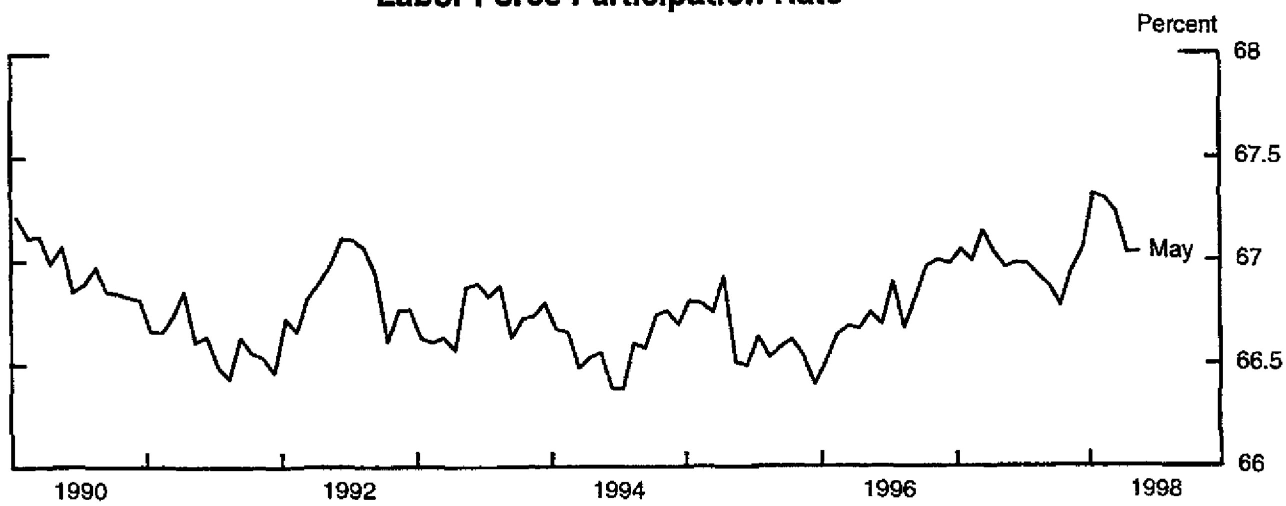


Percent of Population Not in the Labor Force Who Want Jobs*



Note. Seasonally adjusted by FRB staff.

Labor Force Participation Rate*



* Data after January 1998 are not strictly comparable to data before January 1998 due to methodological changes introduced by the BLS.

substantial gains earlier in the year: On balance, the industry has added an average of 21,000 jobs per month thus far this year.

Despite the robust growth in payrolls in April and May, growth in hours worked by all employees for the second quarter is likely to slow significantly from the rapid first-quarter pace. After declining, on balance, over March and April, aggregate hours of production workers increased 0.7 percent in May. However, hours of nonproduction/supervisory workers and the self-employed posted sizable gains in recent months, and the change in production-worker hours probably overstates the underlying slowdown in labor demand.

In the May household report, the civilian unemployment rate held steady after plummeting to 4.3 percent in April. After the April report, we discounted this drop somewhat. Now, with another month in hand and no rebound evident, we see no grounds for questioning the level, particularly as the decline in the unemployment rate between March and May was spread across all major demographic groups.

Over the first five months of this year, the average labor force participation rate edged above the previous cyclical high posted in late 1989 and early 1990, continuing a mild uptrend evident since 1996.[3] The recent increase in participation appears to be associated with the considerable tightening of labor markets over the past two years. For example, among adult women (aged 25 to 64), the gradual uptrend of the early 1990s steepened noticeably in 1996 and 1997, and rates among younger women aged 20 to 24 also turned up. Among adult men, the gradual downtrend for those aged 25 to 54 has halted, and rates for those aged 55 to 64--the early retirement group--have firmed. Two groups that have not responded to the tight labor markets are younger men (aged 20 to 24), whose rates have been little changed, on balance, and teenagers, whose participation continues to sag.

Other indicators of labor market activity have continued to come in strong. The latest employment survey from the Bureau of National Affairs indicated a sharp increase in the number of firms reporting that jobs were difficult to fill; Manpower, Inc.'s Employment Outlook Survey for the third quarter of 1998 remains very

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2. (...continued)
week for the payroll survey and so should still show up as employed in the June employment report. The shortened workweeks of the 19,000 or so workers who were furloughed during the June reference week will, in principle, depress the measured average weekly hours that will be published in the report, but their number was not large enough to make a noticeable difference on the overall average workweek.

3. The labor force data discussed here and shown in the text table have been adjusted by the staff, to the extent possible, for the CPS redesign in 1994 and for subsequent reweighting, population controls, and recompositing.

Labor Force Participation Rates
(Percent; seasonally adjusted)

Age group (years)	1989	1994	1996	1997	1998: Jan.-May
Total, 16 and older	67.0	66.6	66.8	67.0	67.2
16-19	56.2	52.7	52.3	51.3	52.8
Men					
20-24	84.0	83.1	82.5	82.4	82.8
25-54	93.2	91.7	91.7	91.8	91.9
55-64	67.1	65.5	67.0	67.5	67.9
65 and older	17.9	16.8	16.8	16.7	16.2
Women					
20-24	72.5	71.1	71.3	72.5	73.3
25-54	74.3	75.3	76.1	76.6	76.6
55-64	47.0	48.9	49.6	50.8	51.5
65 and older	9.2	9.2	8.6	8.4	8.6

optimistic (though it probably tells us more about the second quarter than the third); the National Federation of Independent Businesses survey indicated that the percentage of small businesses reporting vacancies "hard to fill" remained high in May at 27 percent; and the Conference Board's help-wanted index held close to its recent high. Initial claims for unemployment insurance remained low into mid-June, despite the onset of increased layoffs associated with the GM strike.

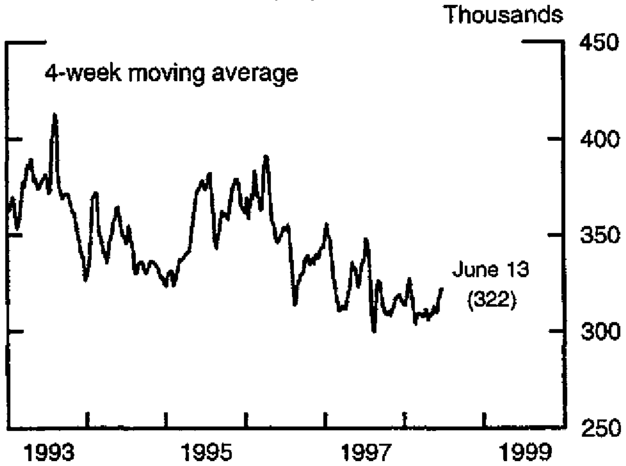
Updated figures for first-quarter productivity will not be available until August, at which time they will incorporate the recent revisions to the employee hours data, including the adjustment for the length-of-pay-period problem. Using the BLS's published revision to employee hours as a guide and the current staff estimate of first-quarter output growth, we calculate that on a corrected basis, productivity rose 3.4 percent at an annual rate in the first quarter. On a similar basis, we estimate that productivity rose 2.3 percent over the four quarters ended in 1998:Q1, compared with a 1.2 percent increase over the previous four-quarter period.

Industrial Production

Industrial activity has picked up in recent months, after having slowed earlier this year, but appears to be on only a slow upward trend--owing in significant part to the weakness in U.S. net exports. Moreover, the shutdown of production at GM will take a considerable chunk out of IP in June.

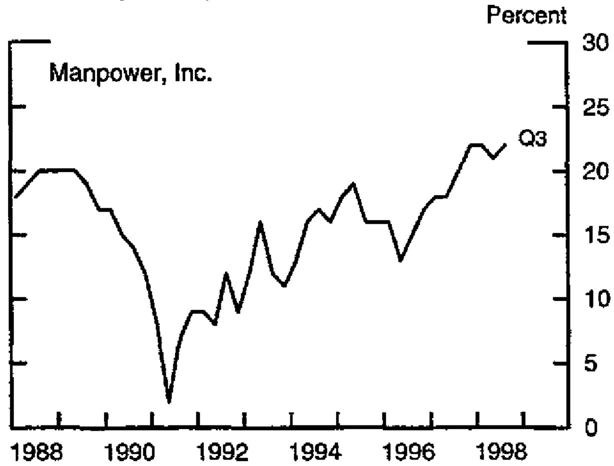
Labor Market Indicators

Initial Claims for Unemployment Insurance



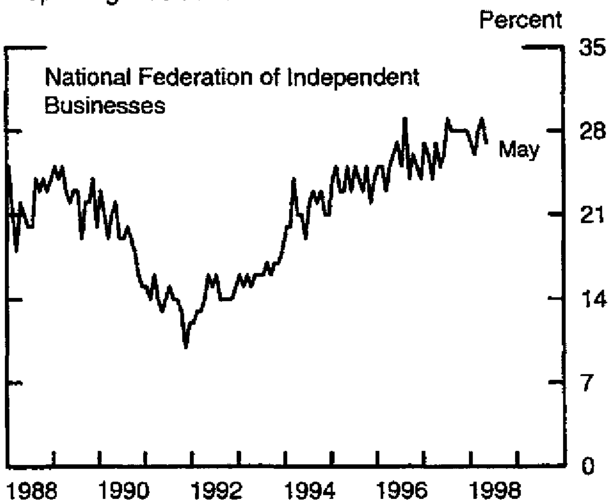
Note. State programs, includes EUC adjustment.

Net Hiring Strength

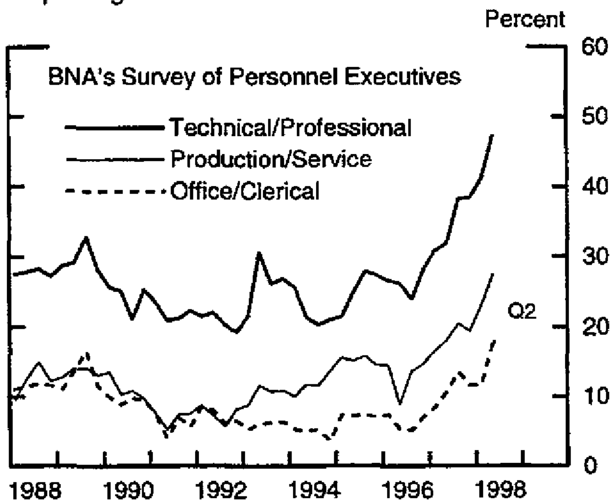


Note. Percent planning an increase in employment minus percent planning a reduction.

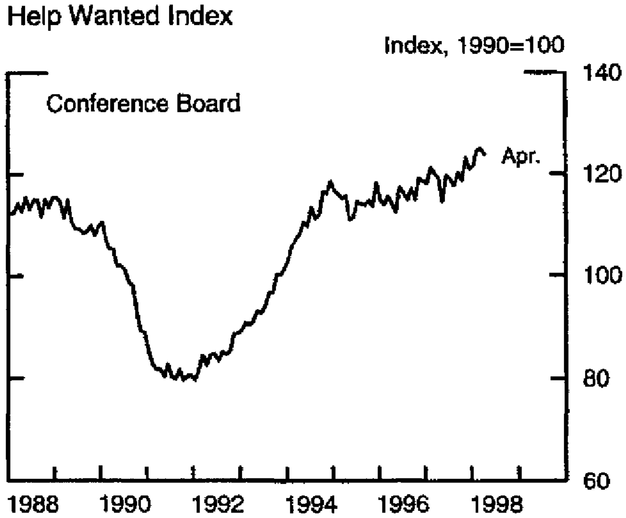
Reporting Positions Hard to Fill



Reporting Some Jobs Difficult to Fill

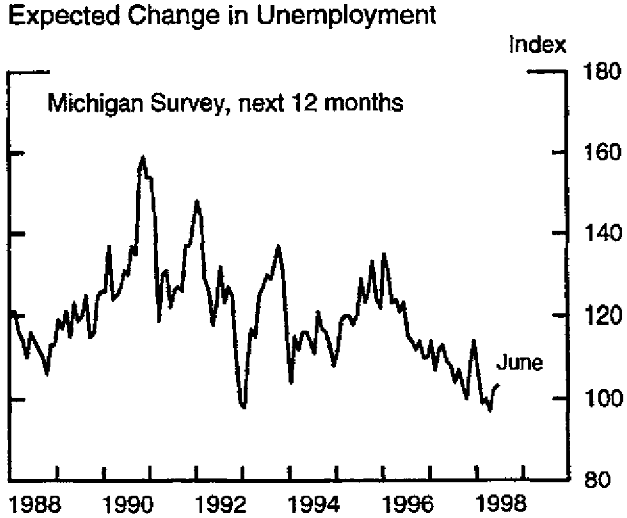


Help Wanted Index



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

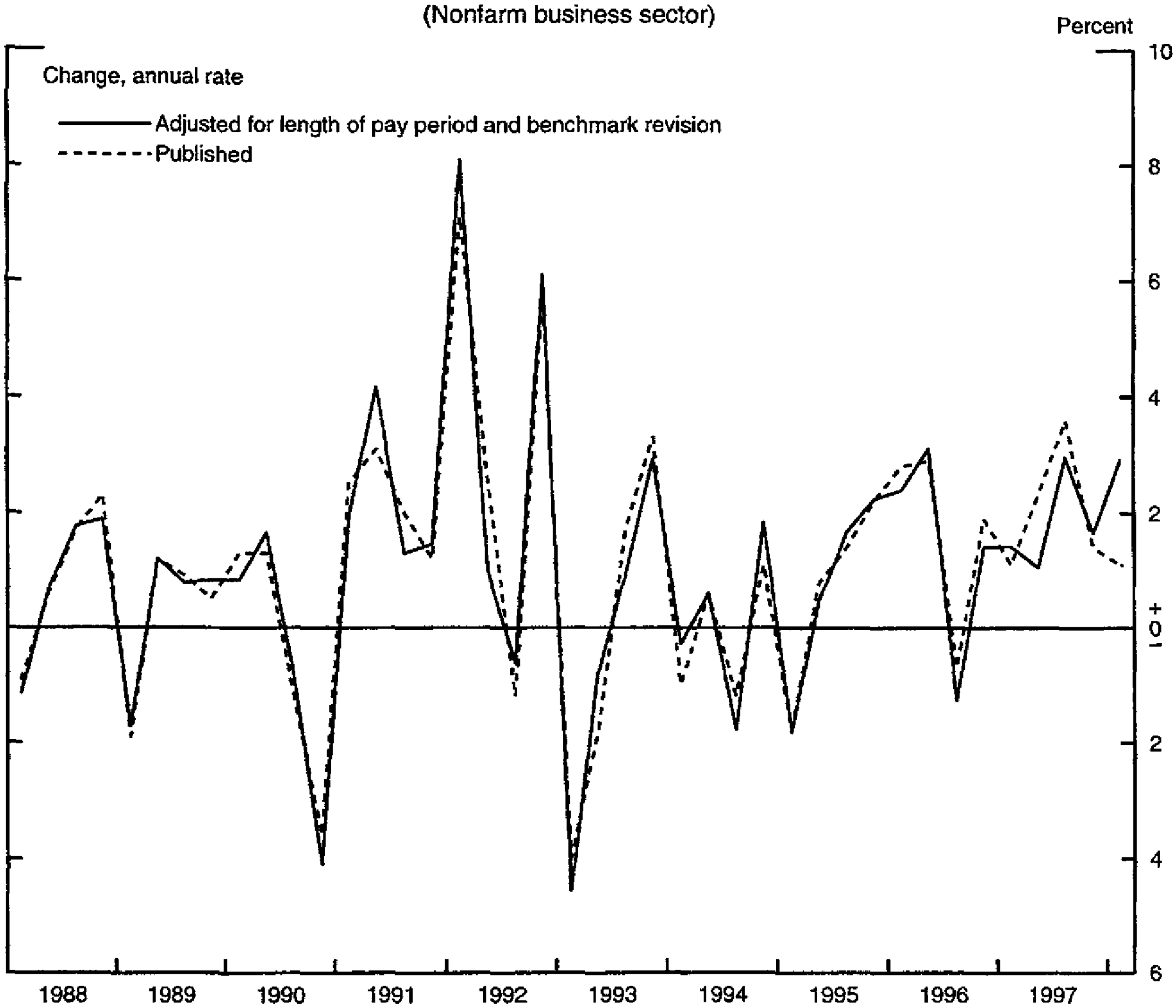
Expected Change in Unemployment

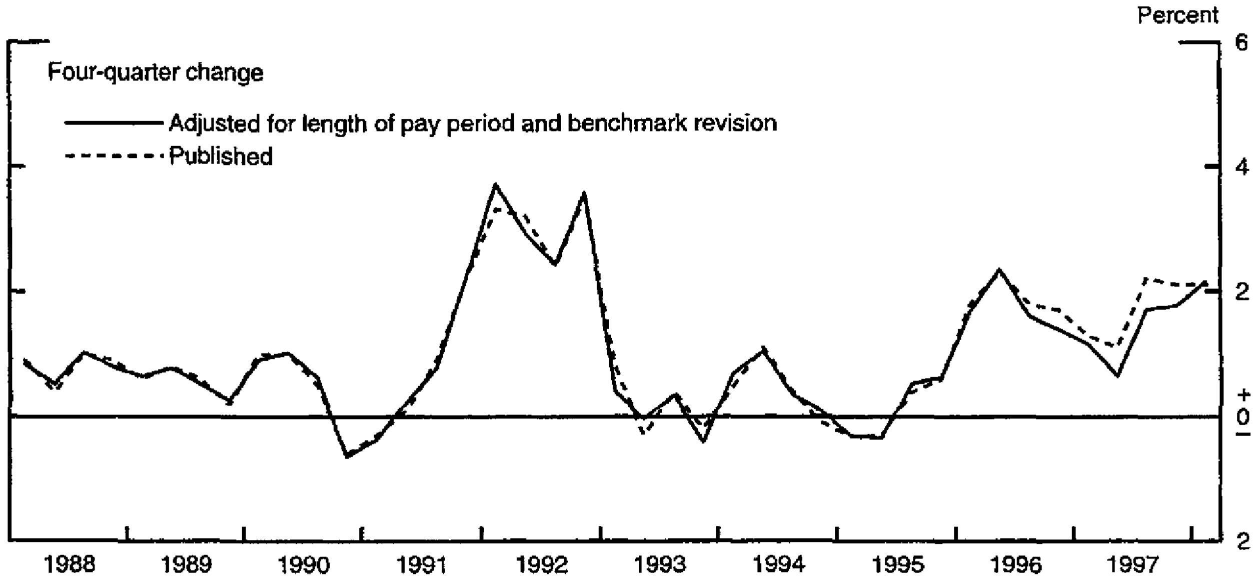


Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

Productivity Growth

(Nonfarm business sector)





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

	Proportion 1997	1997[1]	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
			-Annual rate-		--Monthly rate---		
Total index	100.0	5.8	7.2	1.0	.4	.3	.5
Previous		5.8	7.2	1.0	.3	.1	
Manufacturing	86.2	6.3	8.1	2.0	.0	.5	.2
Durables	46.6	9.5	10.3	2.2	.2	.6	.5
Motor vehicles and parts	5.2	11.9	23.1	-18.7	-1.1	2.5	.6
Aircraft and parts	2.3	18.5	20.5	10.3	-.2	-.6	.5
Nondurables	39.6	2.6	5.5	1.8	-.3	.5	-.1
Manufacturing excluding motor vehicles and parts	81.0	6.0	7.2	3.5	.1	.4	.2
Mining	6.2	2.1	-2.1	9.6	-.9	-.2	1.2
Utilities	7.6	2.4	5.5	-15.8	6.3	-2.2	2.8
IP by market group, exluding motor vehicles and parts and energy							
Consumer goods	22.9	2.4	4.7	3.3	-.1	.6	.2
Durables	4.0	4.2	2.6	10.5	.5	.2	1.2
Nondurables	19.0	2.0	5.1	1.9	-.2	.7	.0
Business equipment	12.3	10.8	9.4	2.3	1.0	.9	.2
Information processing	5.5	12.2	9.4	6.0	.8	2.2	.5
Computer and office eq.	1.8	36.3	28.3	56.6	5.0	3.4	2.7
Industrial	4.5	5.6	6.8	-2.9	1.7	-.3	-.4
Transit	1.1	27.3	29.6	18.5	-1.2	-.6	1.6
Other	1.3	9.5	1.5	-9.4	1.4	1.4	-.6
Construction supplies	5.6	2.2	4.1	9.4	-1.0	-.2	.5
Materials	30.1	8.7	9.8	3.8	-.1	.1	.1
Durables	21.1	10.8	11.6	5.7	.3	.2	.1
Semiconductors	3.7	39.8	31.5	29.8	-.3	.9	1.5
Basic metals	3.3	4.7	5.6	3.6	-2.2	-1.0	.1
Nondurables	9.0	3.5	5.3	-.8	-1.1	-.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 High	1959-97 Avg.	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
Manufacturing	85.7	81.7	82.2	81.5	81.0	81.1	80.9
Primary processing	88.9	82.8	86.0	85.6	85.0	84.9	84.6
Advanced processing	84.2	81.1	80.4	79.7	79.2	79.4	79.2

Large swings in utility output continued to buffet industrial production through May, with output rising almost 3 percent last month after posting a sizable decline in April. In manufacturing, after slipping on net over the preceding few months, production increased 0.5 percent in April and 0.2 percent in May. However, capacity is estimated to be expanding at a faster rate than output; the factory operating rate declined to 80.9 percent in May, the lowest level in more than two years.

Manufacturing output had been boosted in recent months by rising production of motor vehicles. Assemblies reached 12.4 million units at an annual rate in May, as the Big Three aimed to satisfy the added demand that resulted from a ratcheting up of incentives. But strikes by the United Auto Workers at GM parts facilities in Flint, Michigan have led to shortages of key parts and have now halted GM's production in North America. Currently, little progress has been reported in negotiations to end the strikes, and we expect that motor vehicle assemblies in June will be held down nearly 2 million units at an annual rate as a result. The fall in assemblies resulting from the strikes will likely trim industrial production in June about 1 percentage point and decrease second-quarter GDP about 1/2 percentage point at an annual rate.

Outside of motor vehicles, the production of consumer goods edged up in May, led by an increase in durables. Likewise, the production of business equipment rose modestly, buoyed by another sizable increase in computer production. Although Boeing continues to have difficulty finishing planes, production activity remains at levels close to those earlier this year.[4] Within the materials group, growth in semiconductor production has slackened noticeably this year, and it is lagging far behind growth in the production of computers because of a worldwide oversupply that has led to a glut of chip inventories.

The Asian crisis clearly has contributed to this year's overall stepdown in the growth of manufacturing output. The June Beige Book and other anecdotal reports have again indicated reduced Asian exports and increased import competition for a variety of industries. Materials producers (metals, chemicals, lumber) as well as equipment producers (industrial, construction, and high-technology equipment, such as semiconductor manufacturing equipment) expressed concerns about dwindling orders

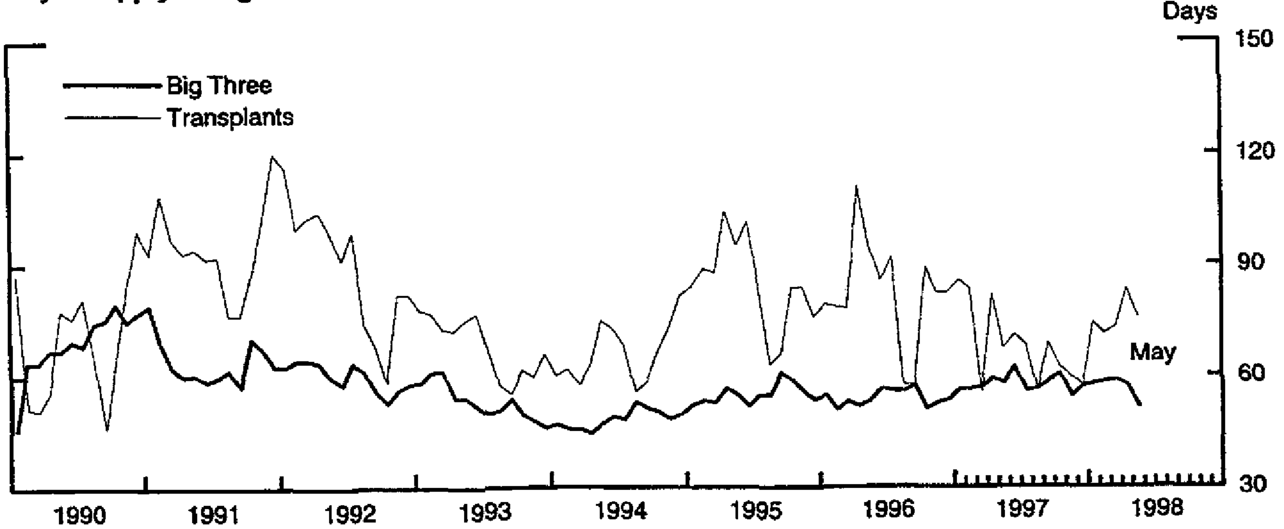
4. Based on news reports and conversations with Boeing sources, it appears that the company had difficulty completing new generation 737s because of parts shortages, minor redesigns, and inexperienced employees. Company representatives claim that they will be able to surmount most of their production problems shortly. Boeing also recently announced changes that will affect production next year. First, it will begin production of the 717, the smallest plane in its line-up. Second, Boeing will reduce the production rate of 747s from 5 aircraft per month to an average of 3.5 aircraft in response to reduced demand from Asian customers.

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

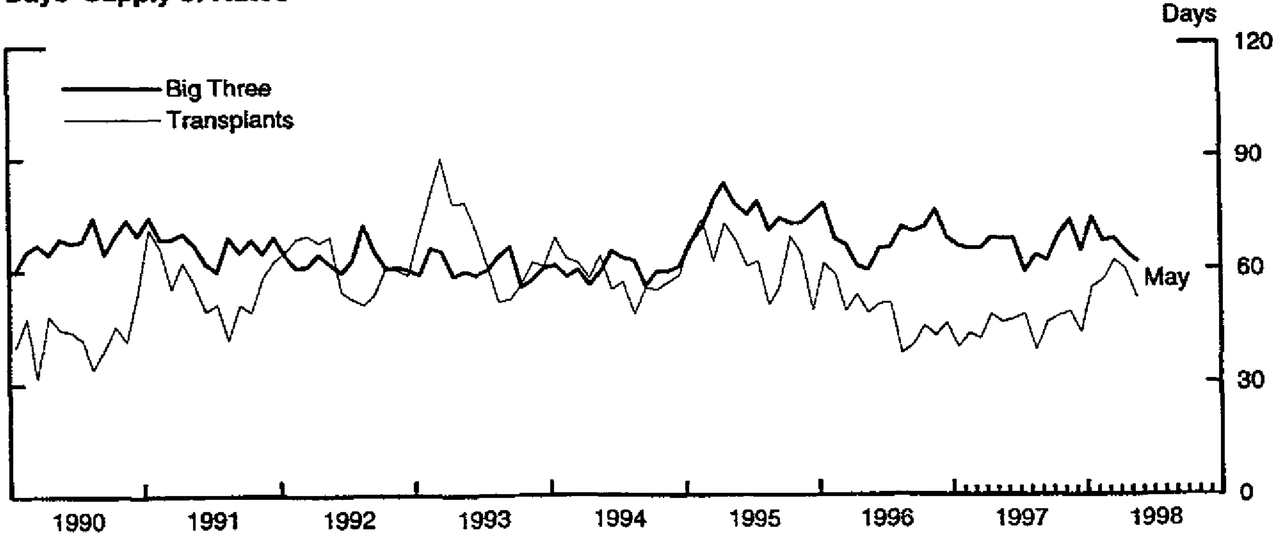
Item	1998			1998		
	April	May	June[1]	Q1	Q2[1]	Q3[1]
U.S. production	12.2	12.4	12.8	12.1	12.5	12.6
Autos	5.5	5.6	5.9	5.5	5.7	6.2
Trucks	6.7	6.9	6.9	6.5	6.8	6.4
Days' supply						
Autos	60.4	56.3	-	64.5	-	-
Light trucks	74.3	66.6	-	74.9	-	-

NOTE. Components may not sum to totals because of rounding.
1. Scheduled.

Days' Supply of Light Trucks



Days' Supply of Autos

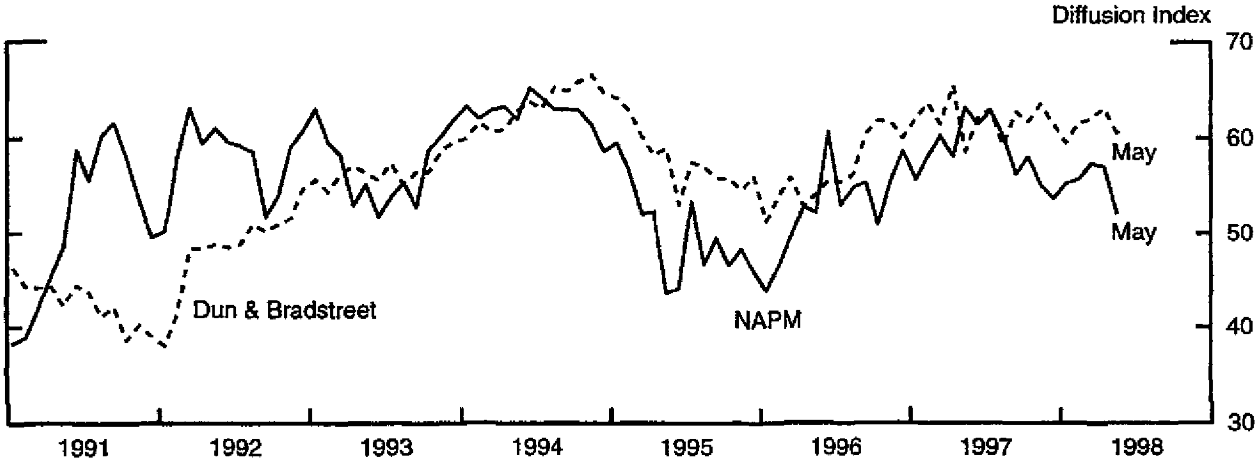


New Orders for Durable Goods
(Percent change from preceding period; seasonally adjusted)

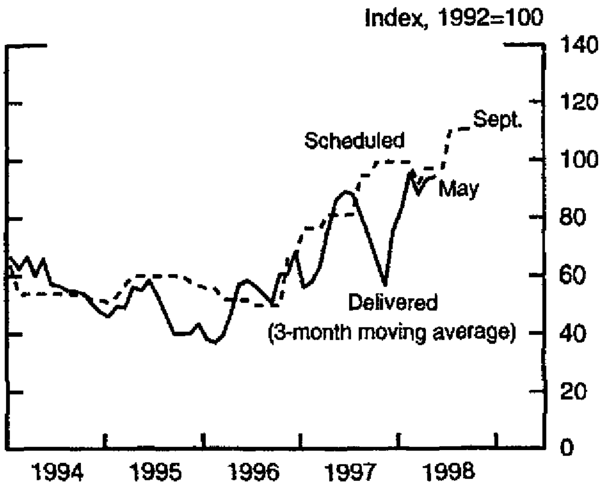
Component	Share, 1997:H2	1997	1998			
		Q4	Q1	March	April	May
Total durable goods	100	2.0	-1.0	.3	1.6	-2.6
Adjusted durable goods[1]	69	-.1	.8	.0	-.3	-2.1
Computers	5	-3.5	13.5	4.5	-1.2	-2.3
Nondefense capital goods excluding aircraft and computers	17	-.6	2.3	-1.1	-4.5	1.9
Other	47	.4	-1.1	-.1	1.3	-3.6
Memo: Real adjusted orders[2]	...	.7	2.0	.6	.1	-1.7

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Deflation and chain-weight aggregation of the computer, electronic components, and "all other" categories of nominal adjusted durable goods.
... Not applicable.

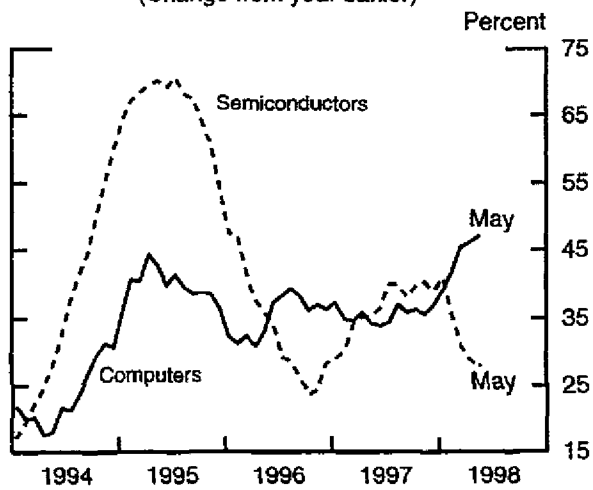
New Orders Indexes



Boeing Production
Civilian Aircraft



Computer and Semiconductor Production
(Change from year earlier)

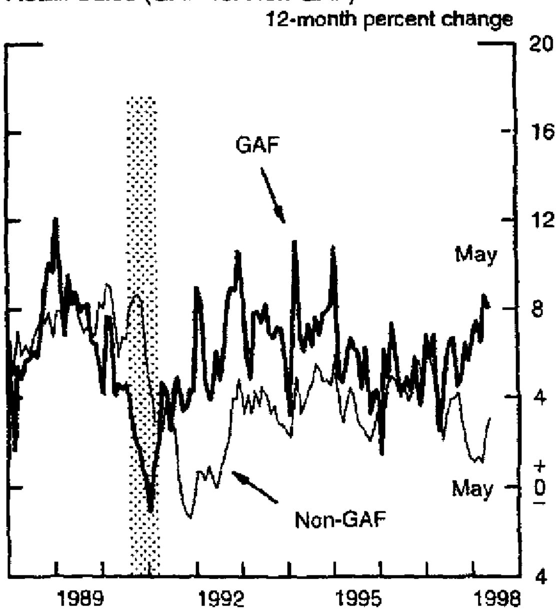


RETAIL SALES
(Percent change; seasonally adjusted)

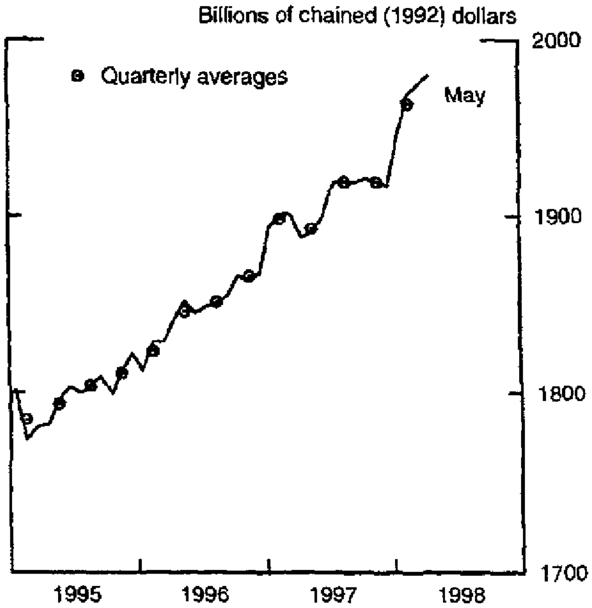
	1997	1998	1998		
	Q4	Q1	Mar.	Apr.	May
Total sales	.2	2.0	.1	.7	.9
Previous estimate		2.0	.0	.5	
Building materials and supplies	1.3	5.8	.6	1.9	-.1
Automotive dealers	-.2	2.3	.2	1.2	2.4
Retail control[1]	.2	1.6	.0	.4	.5
Previous estimate		1.6	.0	.4	
GAF[2]	.8	3.6	.0	.4	.7
Durable goods	2.0	3.8	-1.3	-.8	1.2
Furniture and appliances	1.7	4.7	-.8	-1.4	1.5
Other durable goods	2.1	3.0	-1.7	-.3	.9
Nondurable goods	-.2	1.1	.3	.6	.4
Apparel	-.8	4.1	.3	1.3	-.0
Food	.3	.2	.7	.6	.2
General merchandise	.9	2.9	.3	.9	.6
Gasoline stations	-.7	-4.7	-.5	.3	.7
Drug stores	.7	2.4	-.1	1.5	-.3
Eating and drinking	-.4	2.3	-.2	-.1	-.1
Other nondurable goods	-3.6	.6	1.2	.3	1.3

1. Total retail sales less sales at building material supply stores and automotive dealers, except auto and home supply stores.
2. General merchandise, apparel, furniture, and appliance stores.

Retail Sales (GAF vs. Non-GAF)



PCE Goods Excl. Motor Vehicles



Note. Data for first quarter, April and May are staff estimates.

and excess stocks. The separate question on export orders in the National Association of Purchasing Management (NAPM) survey in May indicated that the percentage of respondents reporting decreases in foreign demand continued to outweigh the percentage reporting increases.

Several leading indicators of industrial production have weakened recently. The NAPM survey reported that a noticeably smaller percentage of manufacturers booked increases in orders in May than in previous months, and the staff's estimate of real adjusted durable orders declined 1 percent over the past three months. In contrast, the May new orders index from Dun & Bradstreet remained at a high level.

Consumption and Personal Income

Strong fundamentals have continued to boost consumer demand. Rapid job growth and sizable gains in real wages have generated hefty increases in labor income. In addition, households have enjoyed a further large increase in net worth this year, and consumer sentiment remains very upbeat.

Nominal sales at the "control" category of stores, which excludes automotive dealers and building material and supply stores, rose 0.5 percent in May. Sales were particularly strong at general merchandise, apparel, and furniture and appliance (GAF) stores, where sales jumped 0.7 percent. Sales in this grouping--which are more cyclically sensitive than other outlays--have been accelerating since around the middle of last year. In contrast, sales growth at non-GAF stores has changed little on balance.

In May, sales of light vehicles exceeded 16 million units for the first time since 1989. The recent pickup in sales probably reflects at least in part the sharp increase in incentives offered by the Big Three this quarter. Most likely, the temporary nature of these incentives pulled forward sales from later in the year.[5] In addition, in coming weeks, sales may be crimped by short supplies of popular models--particularly of sport-utility and pickup trucks--as a result of strike-related shutdowns.

Growth in real outlays for services has also remained brisk. In April (the last month for which we have data), a small decline in energy services held down growth in overall service expenditures, but outlays for non-energy services rose a solid 0.4 percent with all major components recording strong gains. Given the May retail

5. Adjusting for changes in manufacturers' reporting periods, light vehicle sales were about 300,000 units lower at an annual rate than reported. Assuming they do not adjust for the change in reporting periods, BEA's second-quarter estimates of GDP are likely to overstate expenditures on motor vehicles (in both PCE and PDE) and understate motor vehicle inventories.

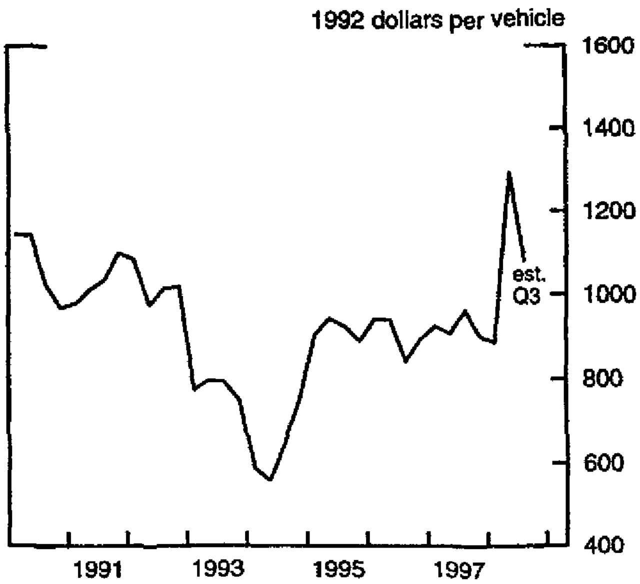
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

	1996	1997	1997 Q3	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
Total	15.1	15.1	15.3	15.3	14.8	15.0	15.4	16.2
Adjusted[1]	15.0	15.1	15.3	15.0	15.1	15.2	15.4	15.9
Autos	8.5	8.3	8.4	8.2	7.8	8.0	8.2	8.4
Light trucks	6.6	6.8	6.9	7.1	7.0	7.1	7.2	7.8
North American[2]	13.4	13.2	13.3	13.3	12.9	13.2	13.4	14.2
Autos	7.3	6.9	7.1	6.8	6.5	6.6	6.8	7.1
Big Three	5.3	4.9	5.1	4.8	4.6	4.7	4.9	4.9
Transplants	2.0	2.0	2.0	2.0	1.9	1.9	1.9	2.1
Light trucks	6.1	6.3	6.3	6.5	6.4	6.5	6.6	7.1
Foreign produced	1.7	1.9	2.0	2.0	1.9	1.9	2.0	2.0
Autos	1.3	1.4	1.4	1.4	1.3	1.3	1.4	1.4
Light trucks	.4	.6	.6	.6	.6	.6	.6	.6

Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary.

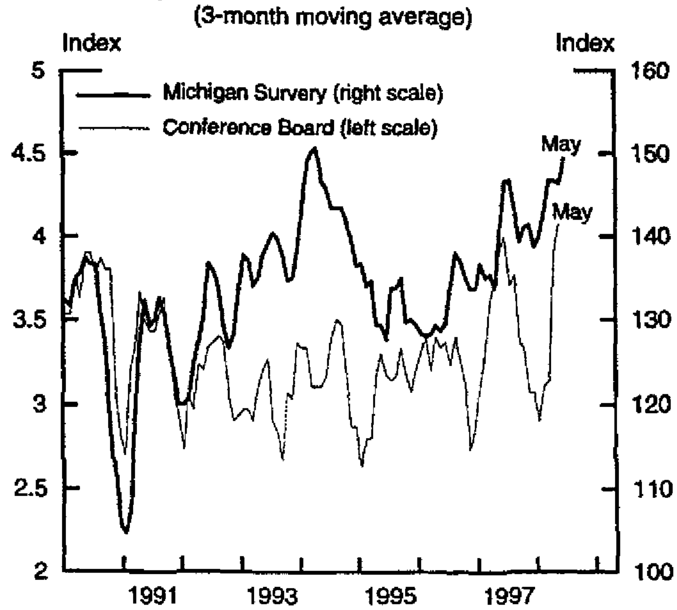
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that the industry classifies as imports

New Car and Light Truck Incentives



Note. Incentive data from J.D. Power, deflated by CPI for all items, except motor vehicles.

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



REAL PCE SERVICES
(Percent change from the preceding period)

	1997	1998 Q1	1998 Feb.	1998 Mar.	1998 Apr.
	Q4/Q4	Annual rate	--- Monthly rate		---
PCE Services	4.0	4.0	.0	.8	.3
Energy	-.6	-17.4	.0	11.3	-3.0
Non-energy	4.2	4.9	.0	.4	.4
Housing	2.1	2.3	.1	.1	.2
Household operation	5.2	5.0	.4	.4	.4
Transportation	5.0	5.0	.0	.3	.6
Medical	2.8	2.9	.1	.0	.3
Recreation	7.8	12.6	-1.1	.8	.4
Personal business	6.8	7.9	.1	.6	.5
Other	6.3	7.7	-.1	1.7	1.2

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

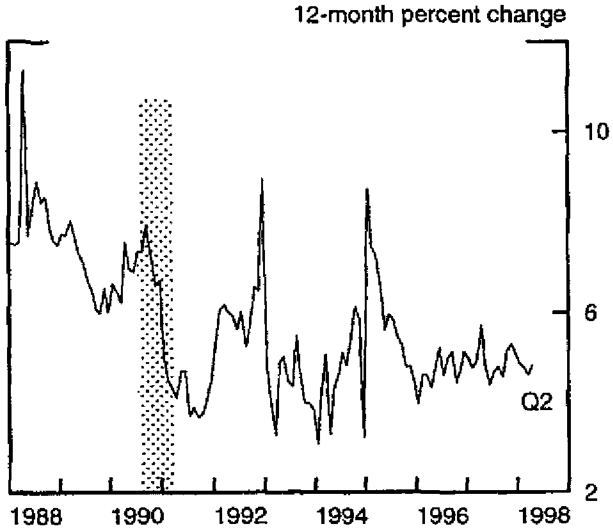
PERSONAL INCOME
(Average monthly percent change)

	1997	1998 Q1	1998 Feb.	1998 Mar.	1998 Apr.
	Q4/Q4	Annual rate	--- Monthly rate		---
Total personal income	6.0	6.6	.6	.3	.4
Wages and salaries	7.1	8.8	.9	.2	.4
Private	7.8	9.5	1.0	.2	.5
Other labor income	3.0	3.6	.3	.3	.3
Less: Personal tax and nontax payments	10.8	15.5	1.2	.3	.6
Equals: Disposable personal income	5.2	5.1	.5	.3	.4
Memo:					
Real disposable income[1]	3.7	4.7	.4	.3	.2
Saving rate (percent)	3.9	3.7	3.8	3.6	3.5
Previous		4.2	4.4	4.2	

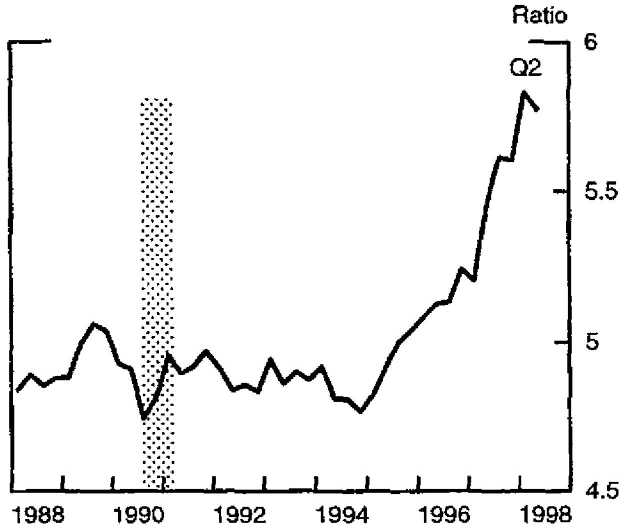
1. Derived from billions of chained (1992) dollars.

Household Spending Indicators

Real Disposable Personal Income

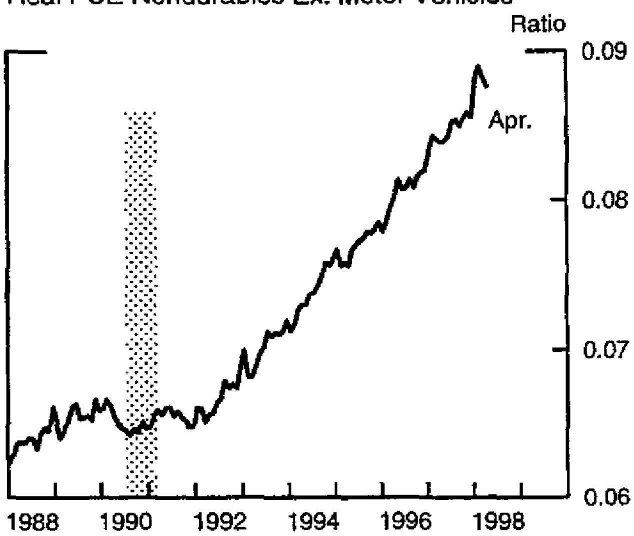


Ratio of Net Worth to Disposable Personal Income



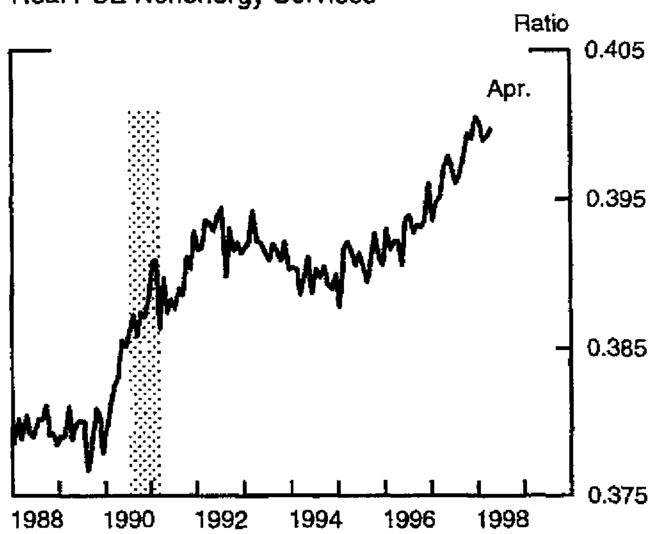
Note. Q2 is a staff estimate.

Real PCE Nondurables Ex. Motor Vehicles



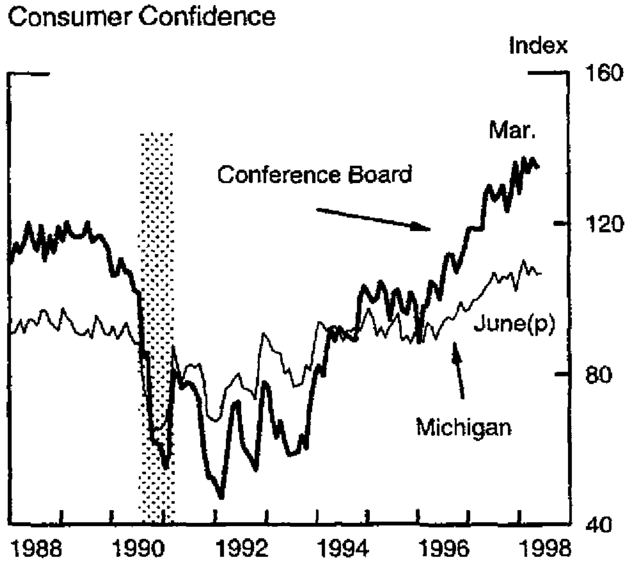
Note. Share of total real PCE.

Real PCE Nonenergy Services

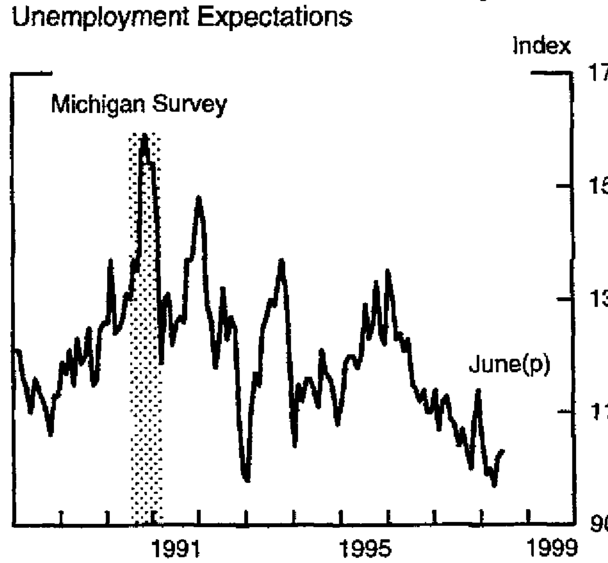


Note. Share of total real PCE, excludes housing services.

Consumer Confidence



Unemployment Expectations



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

sales report, motor vehicle sales, information on consumer prices, and limited indicators for service outlays, real personal consumption expenditures (PCE) are estimated to have increased 0.6 percent in May, following a gain of 0.5 percent in April.

Real disposable personal income (DPI) rose 0.2 percent in April--the ninth consecutive monthly increase. The NIPA personal saving rate fell 0.1 percentage point to 3.5 percent. In addition, the saving rate in the first quarter was revised down 1/2 percentage point, largely reflecting an upward revision to personal tax payments.[6] Over the past year, the saving rate has dropped more than 1/2 percentage point. Personal income likely posted another substantial gain in May, as two key series used to estimate income--employee hours and average hourly earnings--posted strong increases.

Consumer confidence remains extraordinarily high. In early June, the preliminary reading of the Michigan Survey Research Center index of consumer sentiment was little changed, remaining in the middle of the historically high range that has prevailed since the turn of the year. Although assessments of expected business and labor market conditions slipped a bit in June, both series remain close to their first-quarter average, which suggests little overall change in households' views on the economic outlook.

Housing Markets

The brisk expansion in the market for single-family housing has continued into the second quarter. Strong income growth and low nominal mortgage rates have kept the cash-flow burden of purchasing a new home low, and increases in financial wealth likely have given added impetus to demand.

Sales of new homes moved up in May to an 888,000 unit annual rate in a record for the series.[7] Existing home sales declined slightly in May but remain very high relative to the stock of housing units. The National Association of Home Builders' survey of its members indicated that new home sales reached a new high in June for the second month in succession, and applications for mortgages to finance home purchases have been only slightly below their record highs. Consumers'

---

6. Treasury data received this spring pointed to personal tax payments in April that were substantially higher than had been anticipated earlier in the year by the BEA. Following their usual practice, the BEA incorporated the higher level of tax payments by spreading the increase over the entire year, generating a $24.5 billion upward revision to personal tax and nontax payments in January.

7. Data for new home sales begin in January 1963. The existing home sales series extends back to January 1968.

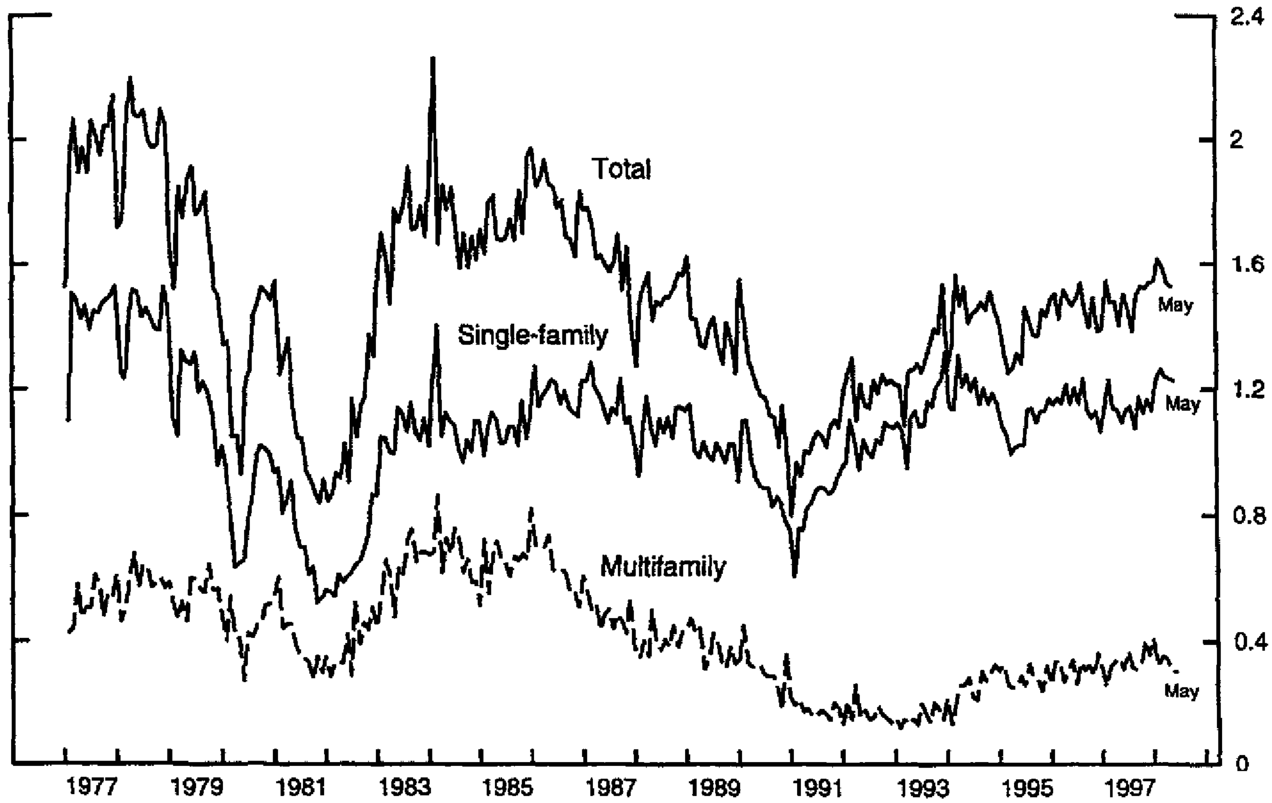
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

	1997	1997 Q3	1997 Q4	1998 Q1[r]	1998 Mar.[r]	1998 Apr.[r]	1998 May [p]
All units							
Starts	1.47	1.45	1.53	1.58	1.59	1.54	1.53
Permits	1.44	1.45	1.48	1.59	1.57	1.52	1.55
Single-family units							
Starts	1.13	1.13	1.14	1.24	1.24	1.23	1.23
Permits	1.06	1.07	1.10	1.15	1.14	1.15	1.15
Adjusted permits[1]	1.14	1.12	1.18	1.24	1.21	1.24	1.23
New home sales	.80	.81	.83	.86	.84	.89	n.a.
Existing home sales	4.22	4.25	4.38	4.68	4.89	4.77	n.a.
Multifamily units							
Starts	.34	.32	.39	.34	.35	.31	.30
Permits	.39	.39	.38	.44	.43	.37	.40
Mobile homes							
Shipments	.35	.35	.35	.37	.37	.37	n.a.

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

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

Private Housing Starts
(Seasonally adjusted annual rate)



assessments of homebuying conditions also remain near the all-time high reached in March.

Starts of single-family homes were little changed in May at a level only a shade below the elevated first-quarter pace. But while starts have been high of late, they have been rather low relative to sales. As a result, the inventory of new homes for sale in April equaled 3.9 months of sales at the current rate, the second lowest monthly ratio on record. Part of the explanation for the weakness of starts relative to sales may be that shortages of skilled construction workers have constrained building activity.[8] In April and May the unemployment rate for construction workers was the lowest in the twenty-year history of the series. There also have been a number of anecdotal reports that labor shortages have been restraining construction. Surveys by the NAHB in September of 1996 and 1997 showed that as many as three-fourths of builders perceived some degree of shortage in particular construction trades. In March of this year a shortage of skilled labor was reported by 85 percent of builders, suggesting that the supply of workers became more strained over the preceding six months. [9]

Reflecting the tight supply of labor, rising construction wages are putting some upward pressure on building costs. Average hourly earnings of employees of residential contractors have accelerated noticeably over the past year. Wages paid to employees in special trades, such as plumbers and electricians, have not accelerated, rising at a pace close to 3-1/2 percent since early 1997.[10]

The upward cost pressure arising from wage increases has been moderated by leveling or falling prices for some important building materials. Lumber prices have fallen 25 percent from their level of a year ago, partially as a result of reduced Asian demand, and plywood prices are off 15 percent. Smaller declines have occurred in insulation and roofing materials, and the price of gypsum products has been essentially unchanged over the past year, albeit at a high level. In fact, according to an index of

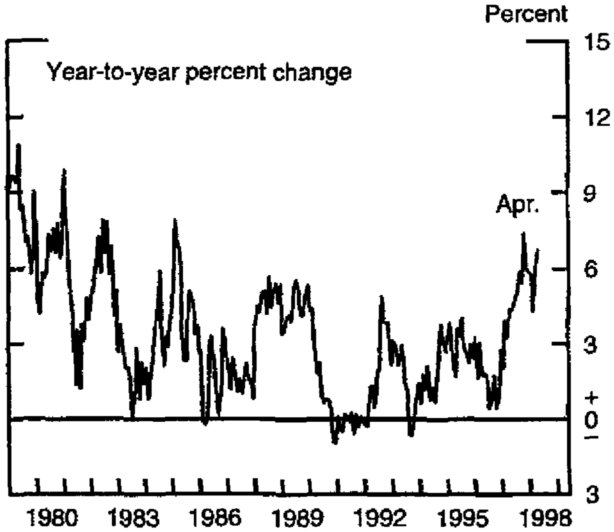
8. The high level of construction in the first quarter probably was unconstrained by the supply of workers because on a not-seasonally-adjusted basis, the level of construction employment was still relatively low.

9. This inference is tentative because the questions were asked differently in the various surveys. In the March 1998 survey, builders were asked whether there was a shortage of skilled labor, in general. The September 1996 and 1997 surveys asked builders to rate the availability of workers in nine specific trades. In both of the earlier surveys, the responses ranged from 35 percent that indicated a dearth of excavators to 75 percent that cited a shortage of carpenters, leaving open the possibility that the share of builders that experienced some type of skilled labor shortage exceeded 75 percent.

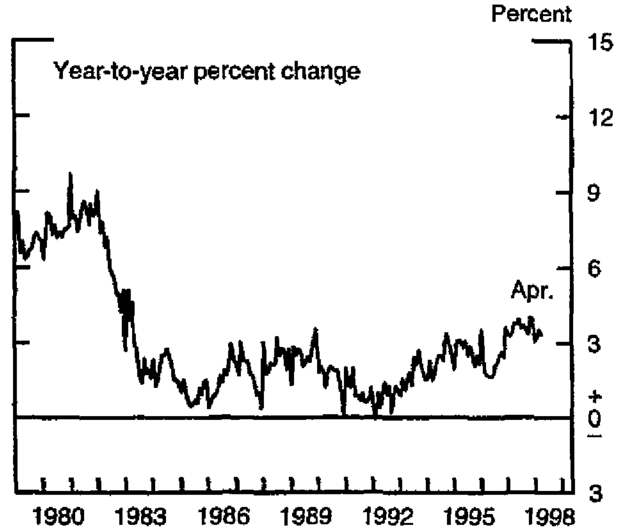
10. Wage data for specific types of construction workers lag the data for total construction wages by one month. Employees in special trades work in other types of construction besides residential building.

Construction Costs and House Prices

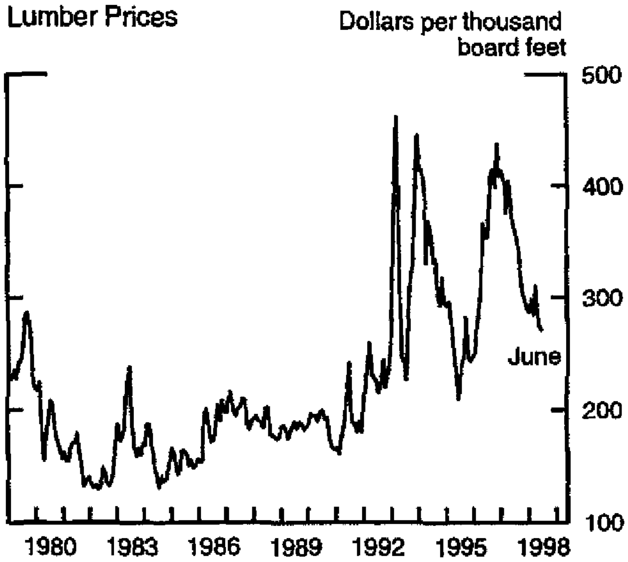
Wages at Residential Contractors



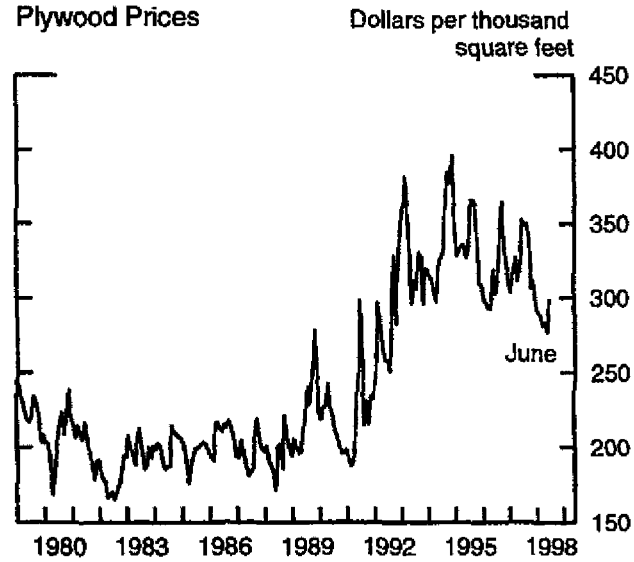
Wages for Special Trades



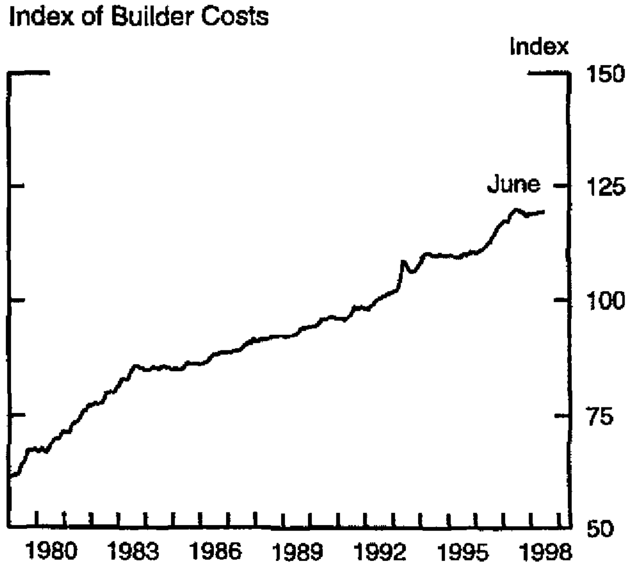
Lumber Prices



Plywood Prices

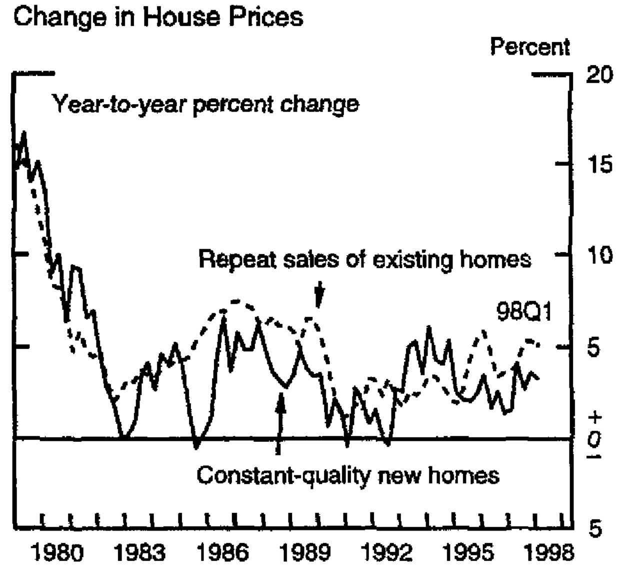


Index of Builder Costs



Source. Engineering News Record
Note. Includes labor and materials

Change in House Prices



overall building costs published by the *Engineering News-Record*, a construction trade publication, rising labor costs and declining costs for some materials have been roughly offsetting. This index has shown only a slight upward drift so far this year.[11] Nonetheless, house prices have been responding to strong demand, posting significant gains relative to the general price level. The constant-quality price of new homes rose 3.3 percent in the first quarter, year-over-year, matching the increase in 1997. The repeat-sales index for existing homes has risen at about a 5.2 percent rate since mid-1997.

Business Fixed Investment

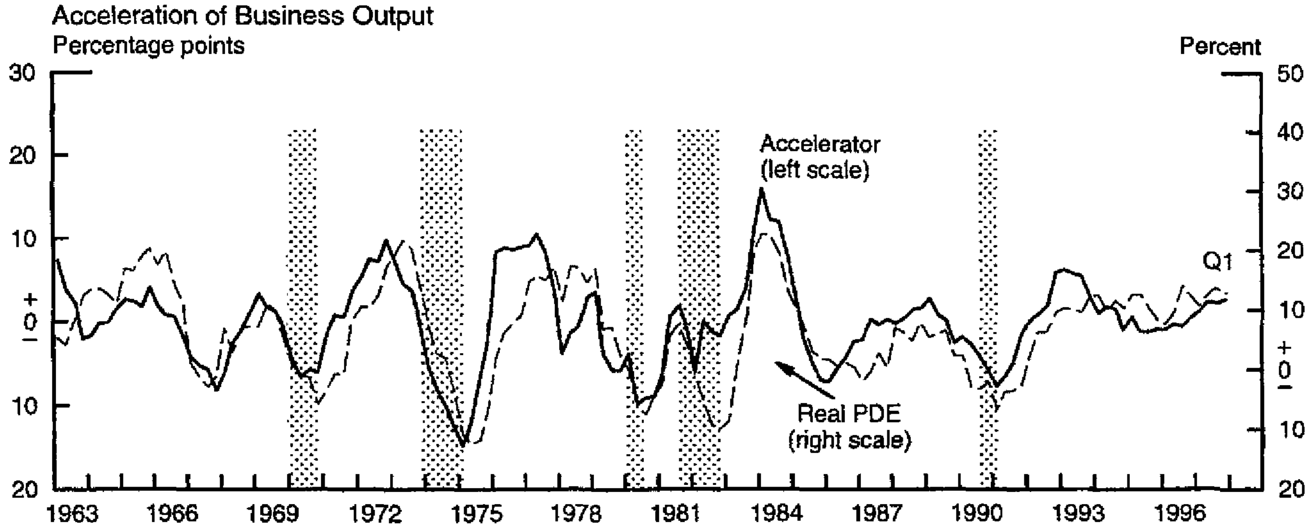
Real business fixed investment appears to be decelerating in the second quarter from its heady first-quarter pace, as a slowing in growth of producers' durable equipment expenditures seems to be more than offsetting a pickup in spending on nonresidential structures. Nonetheless, growth in the second quarter should remain substantial--not surprising, given that business output has accelerated over the past couple of years and the user cost of capital has edged down in recent quarters as a consequence of declining long-term interest rates and falling equipment prices.

Real expenditures on office and computing equipment are expected to register another large gain in this quarter, albeit a fraction of the stunning 100 percent annual rate figure now estimated for the first quarter. After increasing a cumulative 21 percent over the previous five months, nominal shipments of computer equipment fell 2-1/4 percent in May. However, the average level of nominal shipments in April and May was still 3-1/2 percent above the first-quarter level, and, combined with sizable price declines, this points to continuing strength in real spending. Several factors suggest that spending will continue to be boosted by rapid price cutting in coming months. Competition is intensifying in the market for microprocessors, some PC makers have not completely worked off their excess inventories, and competition from Asian producers is placing downward pressure on the prices of components, especially memory and storage devices.

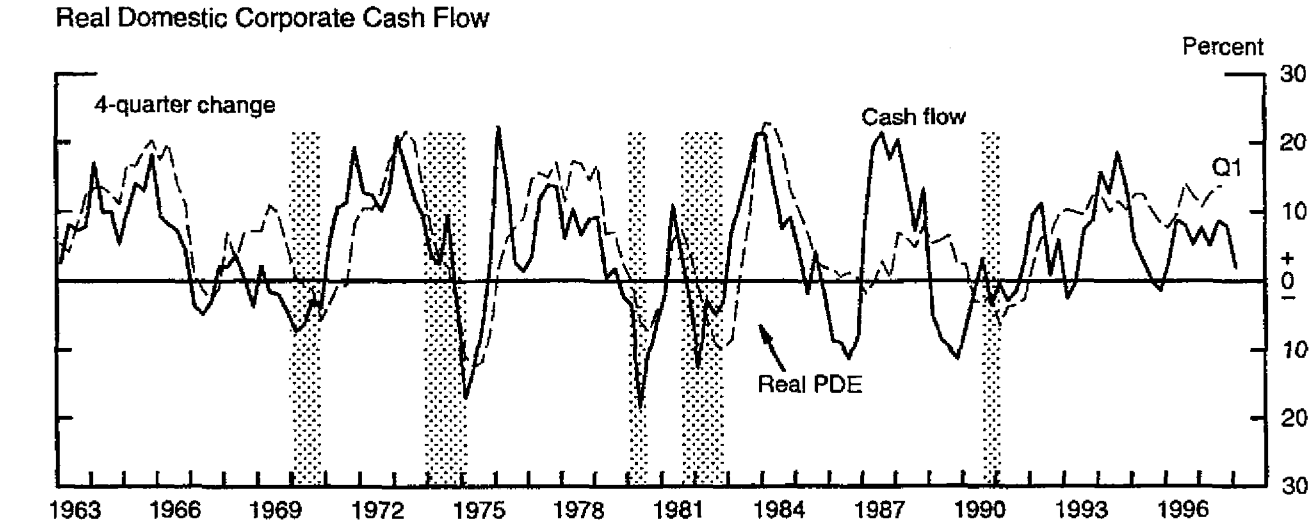
Shipments of communications equipment have weakened, on balance, so far this spring, following rapid growth in spending during the first quarter. The slowdown is expected to be temporary, however, as Internet usage continues to expand and telephone companies revamp their networks. Communications companies have for

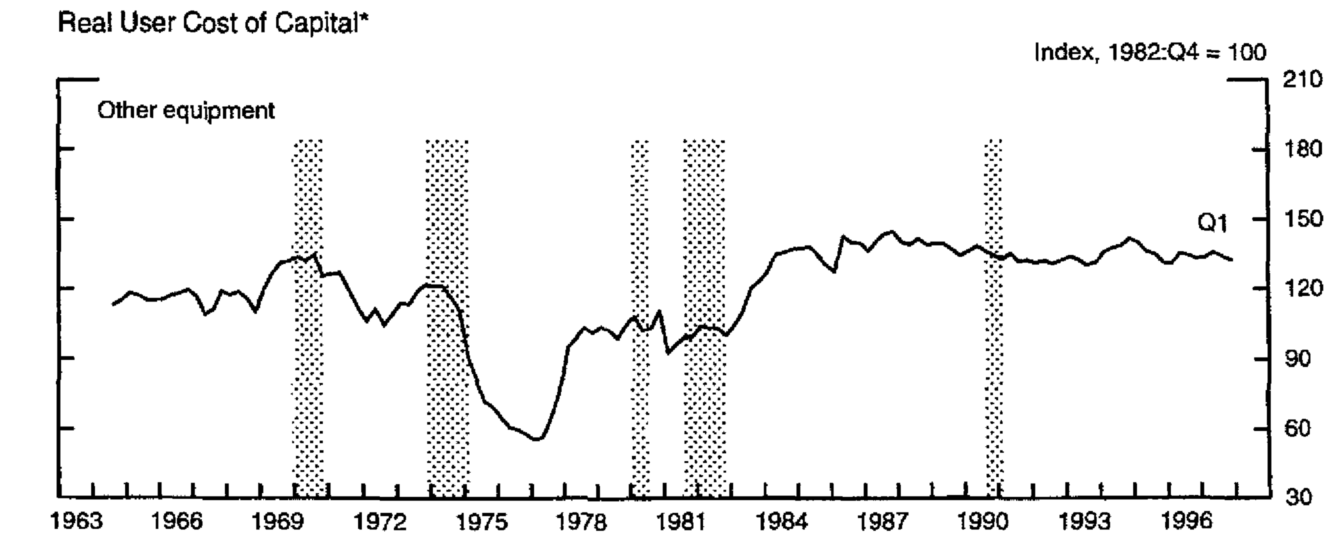
11. This index is not limited to residential construction. Also, it does not include the cost of land, which reportedly has been rising rapidly in some urban areas where usable land is in short supply.

Determinants of Equipment Spending



Note. The accelerator is the 8-quarter percent change in business output less the year-earlier 8-quarter percent change. Real PDE is the percent change over the most recent four quarters.





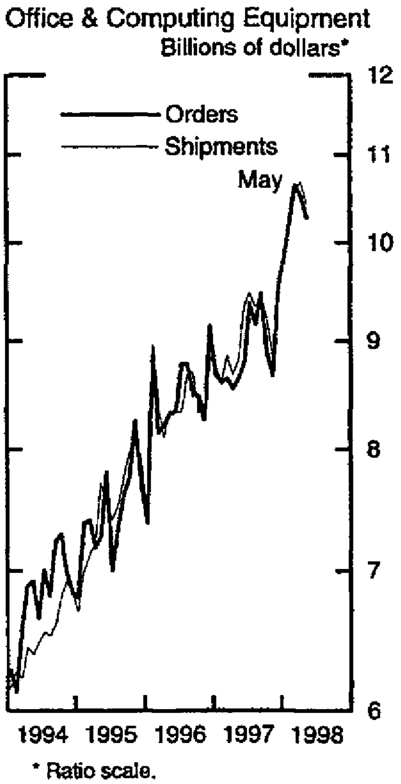
* Staff estimate.

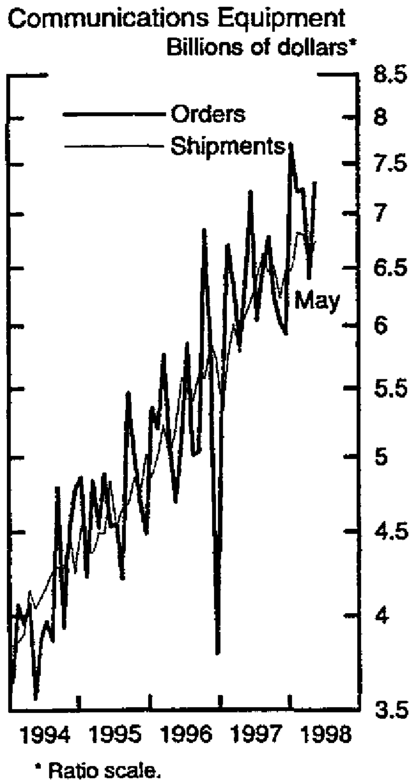
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period; based on seasonally adjusted data, in current dollars)

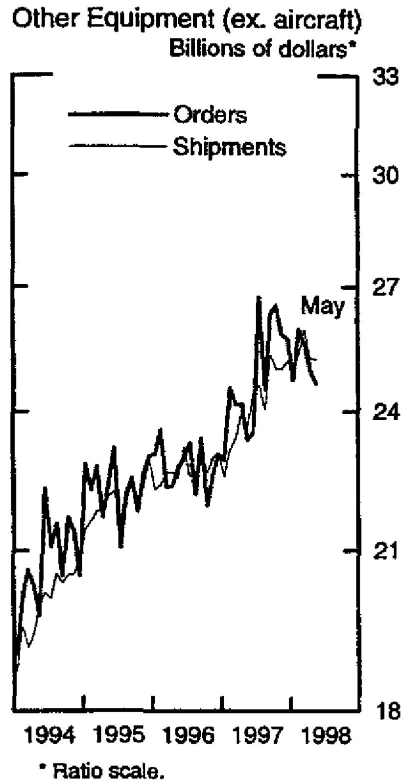
	1997			1998	1998		
	Q2	Q3	Q4	Q1	Mar.	Apr.	May
Producers' durable equipment							
Shipments of nondefense capital goods	5.5	3.9	-.6	5.3	2.2	-1.9	.3
Excluding aircraft and parts	4.1	4.0	.3	4.0	2.3	-2.0	-.1
Office and computing	2.3	5.5	-2.2	10.5	4.1	.9	-2.3
Communications equipment	6.2	7.8	-1.3	4.5	-.3	-4.4	3.7
All other categories	4.3	2.6	1.6	1.5	2.3	-2.6	-.1
Shipments of complete aircraft[1]	23.3	6.7	4.5	35.2	-33.6	18.3	n.a.
Sales of heavy trucks	-1.8	4.7	4.9	3.3	4.8	4.6	-1.2
Orders of nondefense capital goods	-.5	6.5	7.3	-1.8	-.1	1.9	-1.6
Excluding aircraft and parts	.3	7.2	-1.2	4.7	.2	-3.7	.9
Office and computing	.2	7.8	-3.5	13.5	4.5	-1.2	-2.3
Communications equipment	4.6	-.6	-5.7	21.9	.3	-11.5	14.0
All other categories	-.7	9.1	.7	-2.3	-1.4	-2.5	-1.2
Nonresidential structures							
Construction put in place, buildings	-2.0	3.2	-1.1	1.0	.6	2.3	n.a.
Office	-3.3	8.5	4.6	.0	2.5	2.0	n.a.
Other commercial	-5.8	1.8	-2.6	.8	-.3	4.2	n.a.
Institutional	4.6	.9	2.8	2.5	-.8	2.0	n.a.
Industrial	-3.9	3.4	-5.2	3.4	1.8	-2.0	n.a.
Lodging and miscellaneous	3.5	2.1	-5.3	-2.1	-.2	5.0	n.a.
Rotary drilling rigs in use[2]	7.6	-.1	-2.6	8.1	-2.6	-6.8	-4.6
Memo (1992 Chained dollars):							
Business fixed investment	14.6	19.2	-.8	17.2	n.a.	n.a.	n.a.
Producers' durable equipment	23.0	24.1	-.3	27.5	n.a.	n.a.	n.a.
Office and computing	46.2	47.0	14.4	98.3	n.a.	n.a.	n.a.
Communications equipment	7.9	31.3	-3.8	30.9	n.a.	n.a.	n.a.
Other equipment[3]	19.7	9.9	1.0	13.1	n.a.	n.a.	n.a.
Nonresidential structures	-4.7	6.7	-2.3	-7.4	n.a.	n.a.	n.a.

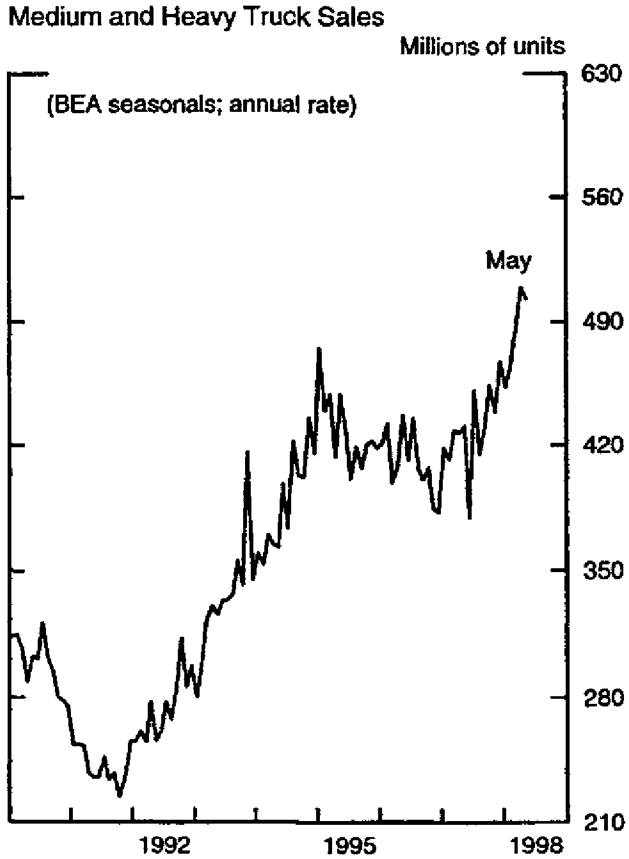
1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.
2. Percent change of number of rigs in use, seasonally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

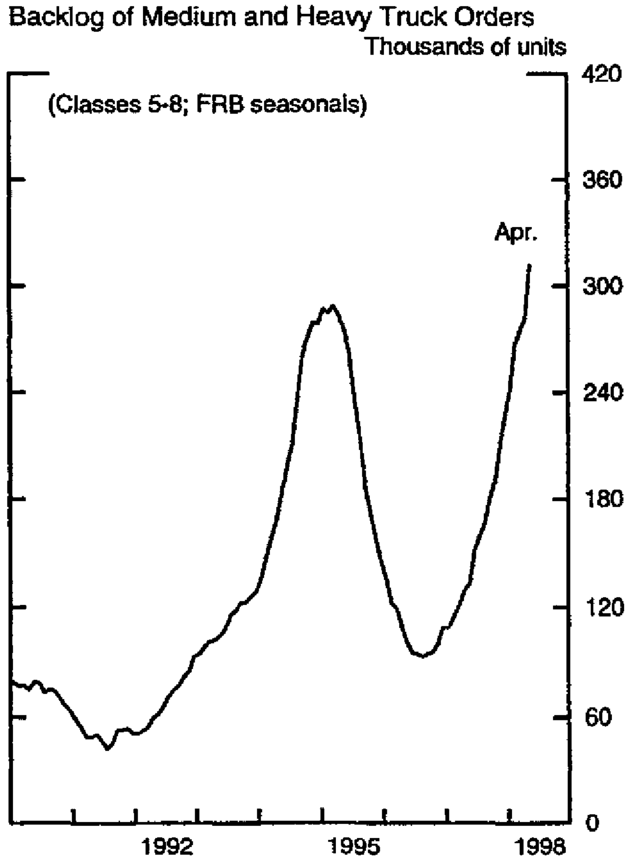
Indicators of Producers' Durable Equipment Spending











some time been implementing cable upgrades and integrated services digital networks (ISDNs) to speed connections to the Web, and now other new technologies for improved data transmission are set to roll out this summer, providing an additional boost to spending.[12]

In the transportation sector, business spending on motor vehicles continues to be very strong. Most notably, sales of medium and heavy trucks have trended up over the past year, reaching a twenty-five-year high in April. Unfilled orders for medium and heavy trucks have been rising, suggesting that sales may remain high in coming months, even if new orders slip. Concerning aircraft, we expect that despite production difficulties, Boeing's domestic deliveries should be relatively flat in the second quarter.

Outside high-tech and transportation equipment, there has been a noticeable slowing in recent months, following a sizable increase in the first quarter. Nominal shipments for this category were flat in May, remaining 1 percent below their first-quarter average. Orders have declined in recent months and have now fallen behind shipments.

In contrast to the deceleration in growth in equipment spending, the available indicators of outlays on nonresidential structures suggest that real spending has turned up in the second quarter after registering declines in the past two quarters. Indeed, for the first time in months, the spending data appear consistent with reports of declining vacancy rates, accelerating real estate prices, and the generally positive assessments of conditions by commercial real estate market participants. The latest data on construction put-in-place show that spending on private nonresidential buildings advanced 2.3 percent in April; in addition, the figures for both February and March were revised up noticeably. However, the data on construction contracts continue to look weak, leaving open some question about future activity levels.

Business Inventories

Available information for the current quarter suggests that inventory investment has slowed from its rapid first-quarter pace. After expanding at a $54 billion annual rate in the first quarter, book-value inventories for all manufacturing and trade excluding

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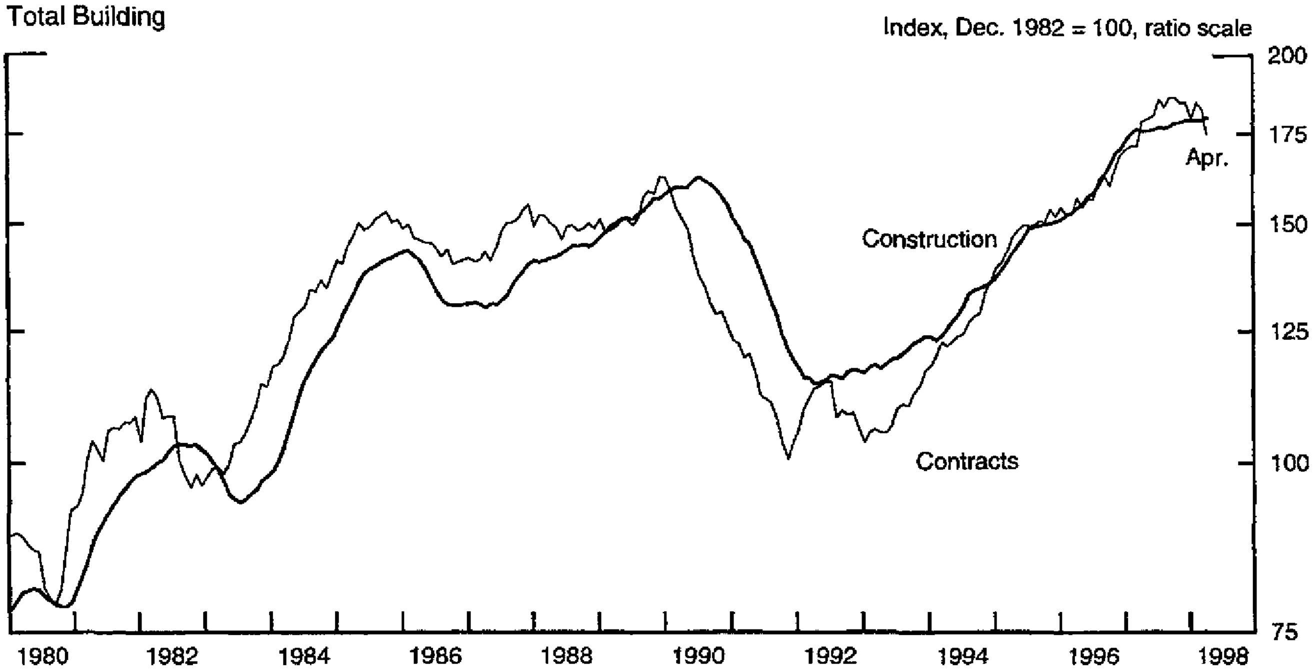
12. Two of these technologies are asymmetric digital subscriber lines (ADSL) and asynchronous transfer mode (ATM). Many of the regional Bell operating companies are planning to offer ADSL, which enables standard copper wires to carry digital data as well as (analog) voice transmissions. Other communications companies, led by Sprint, are adopting ATM, which expands the bandwidth of the phone line to allow simultaneous transmission of voice, video, and data.

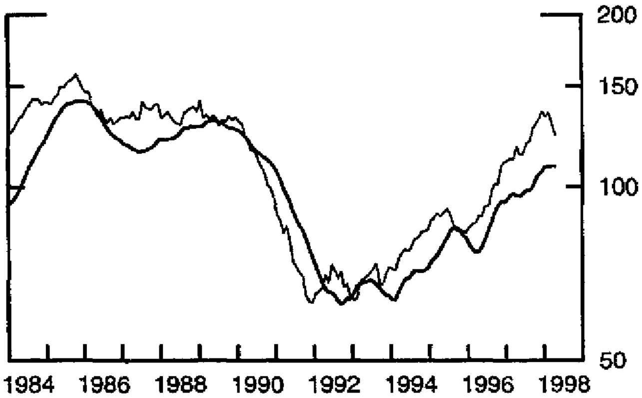
Nonresidential Construction and Contracts

(Six-month moving average)

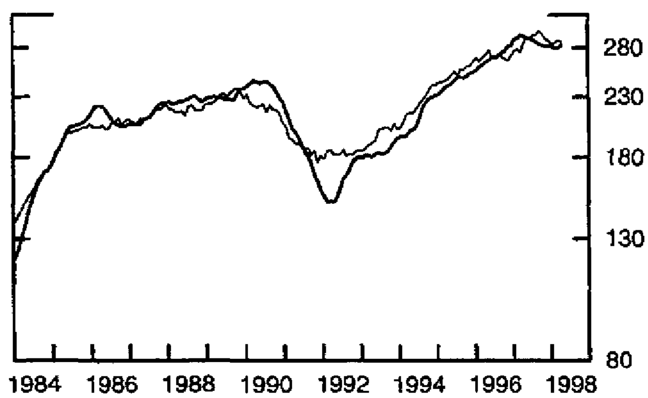
Total Building



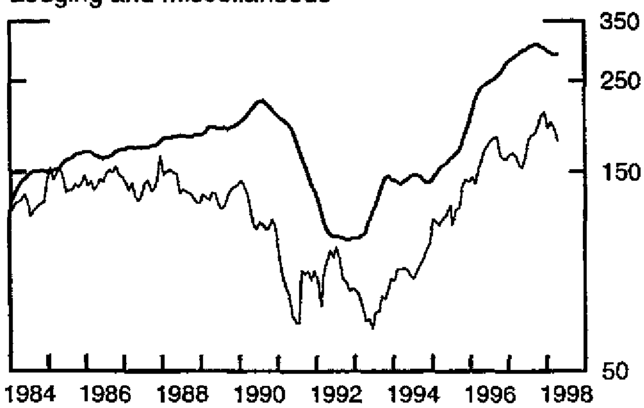
Office



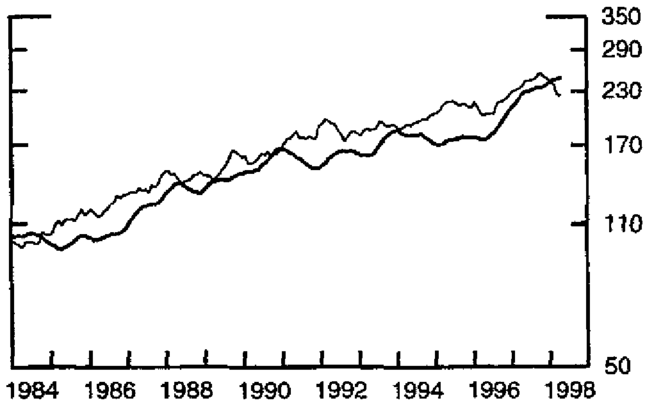
Other Commercial



Lodging and Miscellaneous



Institutional



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

motor vehicles increased at a $35 billion pace in April. Moreover, the first quarter's book-value increase translated into a huge increase in real stocks, largely as a result of falling prices--most notably for petroleum--and combining evidence on producer prices with the latest book-value data suggests that the increase in real stocks also slowed markedly in April.

Manufacturers' inventories increased in book-value terms at a swift $28 billion annual rate in April. However, most of this accumulation was due to a buildup in work-in-process inventories of civilian aircraft, a development connected to production problems at Boeing and financing difficulties for some of its Asian customers. It appears that the parts shortage should ease in the coming months; the time-horizon for the resolution of the Asian financing problems is more uncertain. [The information above from Boeing is CONFIDENTIAL.]

The increase in non-auto trade inventories slowed significantly in April as stocks built up at a $5.6 billion annual rate in book-value terms, compared with a $32 billion pace in the first quarter. Wholesale stocks excluding motor vehicles declined slightly in April as the result of significant runoffs in stocks of farm products and of goods in the "other nondurable" category, which apparently reflected primarily a liquidation of farm supply products. However, prices of some farm products have been moving lower, so real stocks may not have declined much.[13] Inventories held by non-auto retailers increased at a $10 billion annual rate in April, down from a $21 billion rate of increase in the first quarter. Inventory-sales ratios for both wholesalers and retailers were unchanged in April: The wholesale ratio has been flat so far this year, after a noticeable run-up last year, and the retail inventory-sales ratio has remained essentially flat over the past year.

After a substantial buildup in the first quarter due to unseasonably mild winter weather, petroleum stocks appear to have climbed somewhat further in the current quarter according to physical product data from the Department of Energy. [14] Inventories are currently extremely high--indeed, in some instances, straining storage capacity.

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13. The detail for the other nondurable category is from unpublished, not seasonally adjusted data provided to us by the Census Bureau.

14. These data, however, are not always a precise indicator of BEA's figures on real petroleum stocks.

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

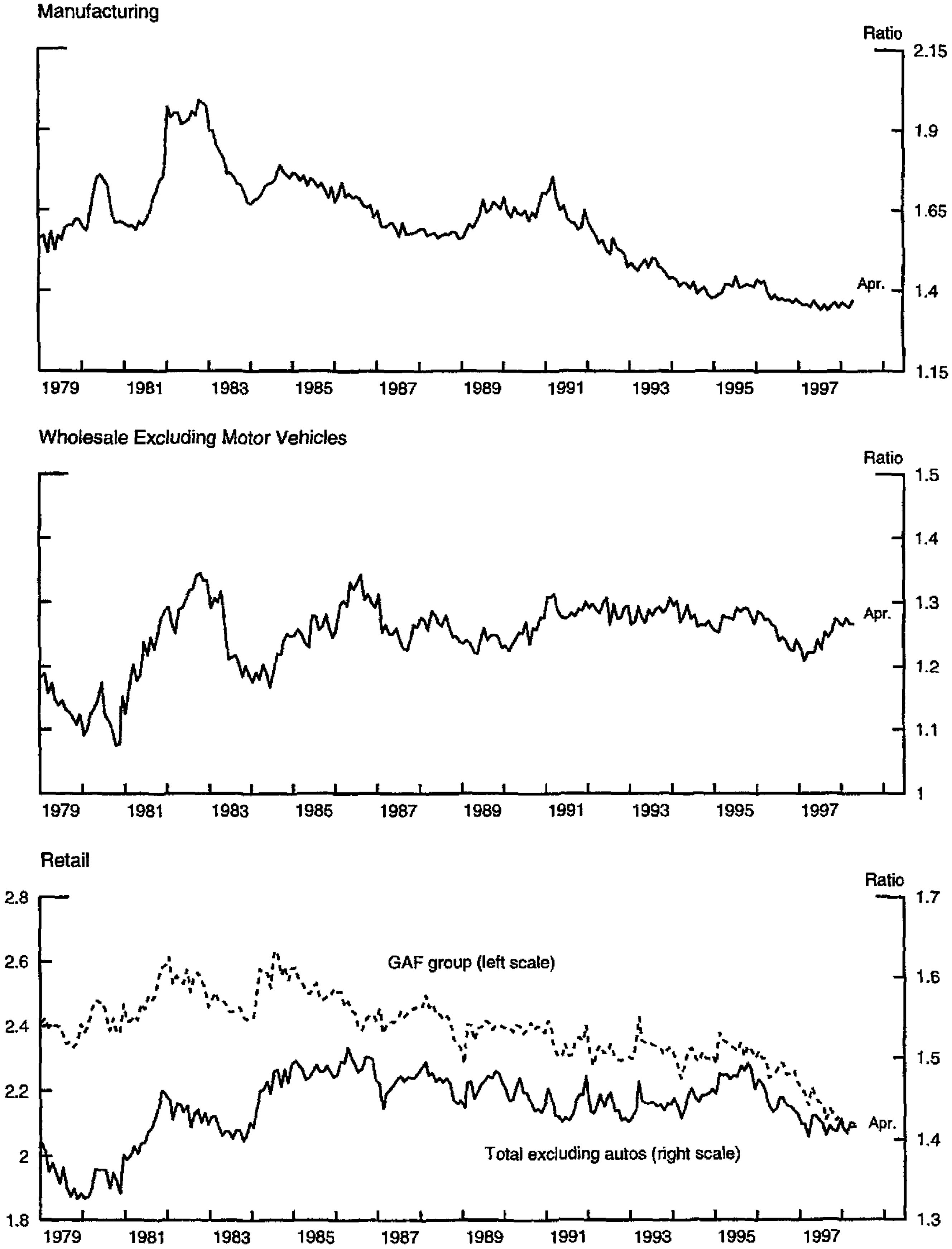
	1997		1998	1998		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Book value basis						
Total	41.5	41.9	61.4	88.6	78.7	22.9
Excluding wholesale and retail motor vehicles	35.4	42.3	54.0	85.5	50.7	33.9
Manufacturing	17.3	17.8	22.0	35.2	12.4	28.3
Excluding aircraft	13.3	15.3	19.0	28.1	13.7	10.6
Wholesale	14.5	18.1	17.3	43.4	22.5	-21.5
Excluding motor vehicles	12.9	19.5	11.5	38.1	10.7	-4.4
Retail	9.7	6.0	22.1	9.9	43.8	16.2
Auto dealers	4.5	.9	1.6	-2.3	16.2	6.1
Excluding auto dealers	5.2	5.1	20.5	12.2	27.6	10.0

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

	Cyclical reference points		Range over preceding 12 months		
	1990-91 high	1995-96 low	High	Low	April 1998
Manufacturing and trade	1.58	1.38	1.38	1.36	1.38
Less wholesale and retail motor vehicles	1.55	1.34	1.35	1.33	1.35
Manufacturing	1.75	1.36	1.37	1.34	1.37
Primary metals	2.08	1.49	1.65	1.59	1.63
Nonelectrical machinery	2.48	1.80	1.80	1.67	1.68
Electrical machinery	2.08	1.41	1.39	1.29	1.37
Transportation equipment	2.93	1.48	1.61	1.51	1.58
Motor vehicles	.97	.56	.62	.54	.55
Aircraft	5.84	4.15	4.76	4.04	4.29
Nondefense capital goods	3.09	2.31	2.34	2.13	2.20
Textiles	1.71	1.44	1.53	1.45	1.55
Chemicals	1.44	1.25	1.41	1.27	1.43
Petroleum	.94	.75	.86	.79	.84
Home goods & apparel	1.96	1.67	1.74	1.64	1.67
Merchant wholesalers	1.36	1.26	1.30	1.25	1.29
Less motor vehicles	1.31	1.22	1.27	1.22	1.27
Durable goods	1.83	1.55	1.61	1.55	1.59
Nondurable goods	.95	.91	.96	.89	.94
Retail trade	1.61	1.50	1.51	1.47	1.48
Less automotive dealers	1.48	1.43	1.43	1.41	1.42
Automotive dealers	2.22	1.69	1.78	1.68	1.69
General merchandise	2.42	2.20	2.20	2.06	2.04
Apparel	2.53	2.27	2.45	2.32	2.37
GAF	2.42	2.23	2.21	2.07	2.09

Inventory-Sales Ratios, by Major Sector

(Book value)



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

	April-May			12 months ending in May.		
	1997	1998	Percent change	1997	1998	Percent change
Outlays	277.6	270.5	-2.6	1596.5	1622.2	1.6
Deposit insurance	-2.4	-0.8	n.a.	-14.2	-4.5	n.a.
Spectrum auction	-1.4	-0.1	n.a.	-5.2	-6.8	n.a.
Other	281.5	271.3	-3.6	1616.0	1633.5	1.1
Receipts	323.1	356.3	10.3	1531.7	1681.9	9.8
Deficit (+)	-45.4	-85.8	n.a.	64.8	-59.7	n.a.
	Adjusted for payment timing shifts[1] and excluding deposit insurance and spectrum auction					
Outlays	273.8	271.3	-0.9	1615.7	1641.1	1.6
National defense	46.4	45.3	-2.4	270.9	270.8	-0.0
Net interest	42.2	41.8	-1.0	244.7	245.1	0.2
Social security	60.7	62.8	3.5	360.0	374.5	4.0
Medicare	33.2	32.4	-2.5	185.3	192.8	4.0
Medicaid	16.1	16.8	4.1	94.5	99.0	4.8
Other health	4.7	4.9	4.2	28.1	28.6	1.7
Income security	40.9	39.5	-3.4	231.7	230.4	-0.5
Other	29.6	27.9	-5.9	200.7	200.0	-0.3
Receipts	323.1	356.3	10.3	1531.7	1681.9	9.8
Individual income and payroll taxes	255.0	286.6	12.4	1199.5	1324.2	10.4
Withheld + FICA	170.2	186.0	9.3	1025.2	1117.7	9.0
Nonwithheld + SECA	130.3	147.7	13.4	267.2	305.1	14.2
Refunds (-)	45.5	47.1	3.7	92.8	98.6	6.3
Corporate	31.7	30.6	-3.3	179.7	189.2	5.3
Other	36.4	39.1	7.2	152.5	168.5	10.5
Deficit (+)	-49.2	-85.0	n.a.	84.0	-40.8	n.a.

Note. Components may not sum to totals because of rounding.
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. Outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.
n.a.--Not applicable

Federal Government

The budget recorded a $60 billion surplus over the twelve months ending in May. Receipts in April and May were 10 percent higher than a year earlier, led by a 12 percent increase in nonwithheld personal income taxes and social insurance collections, reflecting robust April payments. Withheld income and payroll taxes were 9 percent higher, growing faster than wages and salaries in part because of real bracket creep. Receipts growth was restrained by net corporate income taxes, which fell in April and May relative to a year ago. Since the beginning of the calendar year, corporate income tax collections have been roughly the same as a year earlier, reflecting some leveling off in corporate profits. Outlays in April and May, adjusting for payment timing shifts, were 1 percent below those of a year earlier. Defense spending, adjusted for payment timing shifts, was down 2-1/2 percent from a year earlier, although 6 percent above the first-quarter average.

The Office of Management and Budget released its mid-session review of the budget in late May. It projects surpluses of $39 billion in fiscal year 1998 and $54 billion in fiscal year 1999; some $49 billion and $44 billion higher, respectively, than in its January projection. Revised economic assumptions accounted for about one-third of the improvement in the deficit outlook, while stronger-than-expected tax payments accounted for most of the rest. The economic assumptions underpinning these projections incorporated recent data but left most longer-term assumptions unchanged. The relative strength seen in tax collections this year is expected to persist into the coming year. Thus, receipts are projected to rise as a share of GDP next year, despite the anticipated reduction in tax payments owing to last year's tax law changes.[15]

Congress is still finalizing its fiscal policy blueprint. Both the Senate and the House versions of the fiscal 1999 budget resolution call for equally sized tax and spending cuts. However, the Senate's version calls for $30 billion in tax and spending reductions over five years--excluding any tobacco legislation--while the House-passed version calls for $100 billion in tax and spending cuts. In contrast, the President's budget proposes a $15 billion increase in taxes and spending over five years, excluding proposals related to the tobacco legislation. A six-year reauthorization of transportation programs that allows increased spending on highways and mass transit

15. The personal income tax cuts included in OBRA 1997 reduce tax liability about $20 billion, 0.3 percent of GDP, beginning in 1998, but much of the effect on payments is projected to occur in 1999.

Administration Economic and Budget Projections

Measure	1998	1999	2000	2001	2002	2003
ECONOMIC ASSUMPTIONS (CALENDAR YEARS)	Percent change, Q4 to Q4					
Real GDP						
May	2.4	2.0	2.0	2.2	2.4	2.4
January	2.0	2.0	2.0	2.3	2.4	2.4
CPI-U						
May	1.6	2.1	2.3	2.3	2.3	2.3
January	2.1	2.2	2.3	2.3	2.3	2.3
	Percent, annual average					
Unemployment						
May	4.8	5.0	5.2	5.4	5.4	5.4
January	5.0	5.2	5.4	5.4	5.4	5.4
91-day Treasury bill						
May	5.0	4.9	4.8	4.7	4.7	4.7
January	5.0	4.9	4.8	4.7	4.7	4.7
10-year Treasury note						
May	5.6	5.6	5.6	5.6	5.6	5.6
January	5.6	5.6	5.6	5.6	5.6	5.6
BUDGET PROJECTIONS (FISCAL YEARS)[1]	Billions of dollars					
Surplus						
May estimate	39	54	61	83	148	150
January estimate	-10	10	9	28	90	83
Change in estimates	49	44	52	55	58	67
Economic[2]	12	22	22	24	24	27
Other	37	22	30	31	34	40
	Percent of GDP					
Receipts	20.4	20.5	20.2	20.1	20.1	20.0
Outlays	19.9	19.9	19.6	19.2	18.6	18.6
Surplus	.5	.6	.7	.9	1.5	1.4

1. Assumes implementation of the Administration's budget.
2. Change resulting from new economic assumptions.
SOURCE. Office of Management and Budget, *Mid-Session Review: Budget of the United States Government* (May 26, 1998).

was enacted.[16] It also "reduces" veterans' programs to keep overall spending levels unchanged.[17]

State and Local Government Sector

Real spending by state and local governments appears to be picking up in the second quarter. Employment growth over the first two months of the quarter averaged 38,000, considerably above the 22,000 average rise during the first quarter. In addition, real construction spending rose 1.4 percent at a monthly rate in April, the largest advance since October.

State and local construction spending has been on a downtrend since February 1997. Most categories have followed this pattern, although considerable weakness was concentrated in the miscellaneous non-building category that includes such items as amusement and recreational facilities and power generating facilities. Highway construction has remained fairly strong so far this year despite concern about a temporary lapse in federal highway funding when new obligations were halted on May 2. In fact, the actual flow of funding was never disrupted, and the President signed the new legislation, the Transportation Equity Act for the 21st Century, on June 9. Underlying demand for infrastructure coupled with strong fiscal positions of most governments suggest that fundamentals are in place for further strength in state and local construction.

A recent survey from the National Association of State Budget Officers confirms earlier reports on the continuing strong fiscal positions of the states. As in recent years, the good health springs largely from strong revenues: For fiscal 1998, which ends on June 30 for most states, tax collections appear to be coming in nearly 2 percent higher than the estimates states used in adopting their budgets. As in recent years, states likely will enact numerous small tax cuts this year, which are expected to total 1/2 to 1 percent of revenues. Meanwhile, expenditure policy has remained

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16. The act boosts nominal spending authority about 40 percent from 1998 to 2003. It also includes provisions that limit the ability to shift spending from transportation to other programs. Thus, although annual appropriations bills could be used to limit transportation spending below the amount authorized by this act--as has typically been the case--the new procedural limits make it more likely that much of the new spending authority will be used.

17. In January, baseline outlays for veterans' compensation were boosted to reflect an administrative decision that increased eligibility for veterans' compensation. The new act reverses that administrative decision and thus reduces veterans' benefits relative to the January baseline. Under the budget rules, changes in outlays or taxes owing to administrative decisions are not subject to the PAYGO restrictions and do not need to be offset elsewhere, but legislated changes are subject to the PAYGO restrictions.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1997	1998	1998	
	May 1997	May 1998	Q4	Q1	Apr.	May
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.2	1.7	2.3	.5	.2	.3
Food (15.3)	3.0	2.4	2.1	1.4	.1	.6
Energy (7.0)	-2.7	-5.6	1.2	-19.9	-.1	.3
CPI less food and energy (77.7)	2.5	2.2	2.1	2.4	.3	.2
Commodities (24.1)	1.1	.2	.6	.8	.1	.1
New vehicles (5.1)	.8	-.9	-1.5	-.3	.0	-.3
Used cars and trucks (1.9)	-2.3	-2.5	-2.8	.4	.6	1.2
Apparel (4.9)	1.2	.0	.4	-1.5	-.1	.4
Tobacco (0.9)	4.6	10.7	11.0	9.6	3.8	1.7
Other Commodities (11.3)	1.2	.2	.4	1.6	-.1	-.0
Services (53.6)	3.2	3.1	3.0	3.1	.4	.3
Shelter (29.4)	3.1	3.4	3.5	3.1	.3	.4
Medical care (4.4)	3.0	3.1	3.1	3.1	.4	.2
Other Services (19.8)	3.6	2.8	2.7	3.2	.4	.0
PPI						
Finished goods (100.0)[2]	.4	-.9	.6	-3.8	.2	.2
Finished consumer foods (23.2)	2.8	-1.3	1.8	-1.8	.4	-.3
Finished energy (13.6)	-2.8	-7.2	.3	-21.9	-.1	.8
Finished goods less food and energy (63.3)	.2	.6	.5	-.1	.2	.2
Consumer goods (38.0)	.4	1.4	1.4	.0	.3	.5
Capital equipment (25.3)	-.1	-.6	-1.0	-.8	.1	-.2
Intermediate materials (100.0)[3]	-.6	-1.6	.3	-4.2	.0	-.1
Intermediate materials less food and energy (81.8)	.1	-.1	.1	-.8	.0	-.1
Crude materials (100.0)[4]	-4.7	-9.2	20.6	-35.3	1.0	-.3
Crude food materials (42.2)	-8.1	-9.5	2.9	-14.1	.3	-1.4
Crude energy (36.2)	-3.0	-10.9	64.8	-61.2	3.5	.6
Crude materials less food and energy (21.6)	-.2	-6.5	-3.8	-14.3	-.9	.5

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

conservative. Regarding welfare reform, according to the survey, all states met or exceeded their statutory maintenance-of-effort requirement for fiscal year 1998.[18] As caseloads have fallen in recent years, spending per family has risen, particularly in the first half of the current federal fiscal year. Within welfare payments, states appear to be spending less than in the past on direct cash assistance and more on supportive services, especially child care.

Prices and Labor Costs

The CPI increased 0.3 percent in May, as energy prices turned up and food prices posted their largest increase in more than a year. Consumer prices excluding food and energy increased 0.2 percent and have accelerated to a 2.6 percent annual rate over the past three months, reflecting, in part, a pickup in tobacco prices and shelter costs. A similar pattern is evident in core PCE prices. Nonetheless, viewed over a longer time period, the CPI excluding food and energy rose 2.2 percent over the past twelve months, down from a 2.5 percent increase in the year-earlier period, while core PCE price inflation fell 1 percentage point to 1.3 percent in the year ended in April.[19] The overall CPI was up only 1.7 percent over the past twelve months because of the sharp decline in energy prices, while total PCE prices increased just 1 percent.

The CPI for food rose 0.6 percent in May, reflecting a sharp jump in the extremely volatile price index for fruits and vegetables. However, that rise should be reversed before long, as wholesale prices of fresh produce appear to have dropped sharply in recent weeks. Other than fruits and vegetables, food prices have remained quiet, on balance.[20] In farm markets, futures prices for livestock commodities have

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18. The recent reforms require states to maintain their own welfare expenditures at 75 percent or more of their fiscal 1994 expenditure. Included in the tally are state outlays for AFDC benefits and administration, emergency assistance, JOBS, AFDC-related child care, and at-risk child care. States that do not move the required number of welfare recipients into work activities must spend at least 80 percent of their 1994 welfare expenditure. In addition, states lose $1 of federal aid for every $1 they fall short of the maintenance-of-effort requirement.

19. These estimates of core PCE inflation are unpublished staff estimates.

20. Although considerable media focus has been directed this week to a recent surge in the price of butter, the implications of that price surge for food prices overall do not seem likely to be very great. Butter and margarine (which, since January, have been grouped together in the fats and oils category of the CPI) have a combined weight of about 0.6 percent in the CPI for food and a weight of about 0.1 percent in the total CPI. A rise in butter prices of 14 percent over the twelve months ended in May added less than 0.1 percentage point to food prices overall. The impact on the total CPI rounded, easily, to zero. At least through May, the prices of other milk products did not seem to have gained much momentum. The CPI for dairy products (excluding butter) was down slightly in May and up less than 2 percent over the most recent twelve-month period. In the PPI, the price index for dairy products ticked up in May after two months of sharp declines; the farm price of milk plunged 6.5 percent in the May

(continued...)

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1995 Q1	1996 Q1	1997 Q1	1998 Q1
Product prices				
GDP chain price index	2.7	2.3	2.2	1.4
Nonfarm business chain-type price index[1]	2.8	1.5	2.0	1.0
Expenditure prices				
Gross domestic purchases chain-type price index	2.8	2.2	2.1	0.9
Less food and energy	2.8	2.2	1.8	1.2
PCE chain-type price index	2.9	2.1	2.6	1.0
Less food and energy	3.0	2.1	2.3	1.4
CPI	2.8	2.8	2.9	1.5
Less food and energy	2.9	2.9	2.5	2.3
Median CPI	2.8	3.4	2.8	2.9
Trimmed mean CPI	2.7	2.8	2.7	2.0

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan (1-year) Mean[2]	University of Michigan (1-year) Median[3]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1996-Q1	2.7	3.9	2.8	4.1	3.0
Q2	2.8	4.5	3.0	4.3	3.0
Q3	2.9	4.2	3.1	4.3	3.0
Q4	3.2	4.0	3.0	4.2	3.0
1997-Q1	2.9	3.8	2.9	4.2	3.0
Q2	2.3	3.6	2.9	4.0	2.9
Q3	2.2	3.4	2.7	4.0	3.0
Q4	1.9	3.3	2.8	4.1	2.7
1998-Q1	1.5	2.8	2.4	3.8	2.6
Q2		3.0	2.5		2.5
1998-Jan.	1.6	2.8	2.3	3.7	
Feb.	1.4	2.6	2.4	4.0	
Mar.	1.4	2.9	2.5	3.8	2.6
Apr.	1.4	2.7	2.4	4.0	
May	1.7	3.1	2.6	4.0	
Jun		3.1	2.6		2.5

1. CPI; percent change from the same period in the preceding year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Compiled by the Federal Reserve Bank of Philadelphia.

declined sharply, on balance, since the week of the May Greenbook. However, futures prices for crops have moved up, on net, as a price surge over the past few days has more than reversed the sharp declines that took place from mid-May to mid-June. Options prices have recently been signaling a heightened degree of uncertainty in regard to the outlook.

The May upturn in consumer energy prices was 0.3 percent and reflected a rise in motor fuel prices of 0.9 percent, the first increase since last September. However, survey results from early June point to small declines in gasoline prices so far this month.

Prices for commodities other than food and energy rose 0.1 percent in May and have decelerated almost 1 percentage point over the past year. The largest increases in May were for tobacco products and for used cars and trucks. In contrast, consumer prices of new motor vehicles moved down 0.3 percent in May--a decline that was surprisingly small given the Big Three coupon incentives that went into effect in late April. (The PPI for new vehicles dropped more than 1-1/2 percent in May.) Prices for other consumer goods were stable in May, likely restrained by intense competition from imports.

The prices of nonenergy services increased 0.3 percent in May and 3.1 percent over the past twelve months. The stability of the rate of increase of service prices over the past year reflects offsetting movements in several key components. The twelve-month change in the CPI for shelter has moved up 1/4 percentage point to 3.4 percent. The cost of medical services has continued to rise at about a 3 percent pace, while the pace of "other services" has slowed 3/4 percentage point to 2-3/4 percent.

Core PCE prices have continued to rise considerably less rapidly than has the core CPI. Indeed, over the past few years the core CPI has increased about 3/4 percentage point more rapidly than have core PCE prices, a gap that is wider than the average of earlier periods. Although CPIs are the primary inputs into PCE prices, the two price measures can differ for a variety of reasons. First, they use different aggregation formulas: PCE prices are chain weighted, whereas the CPI is a Laspeyres index, and the CPI should rise more rapidly than PCE prices for this reason. Second, many items in PCE are simply "out of scope" for the CPI, which measures only out-of-pocket expenditures of households. Expenditures by religious and welfare

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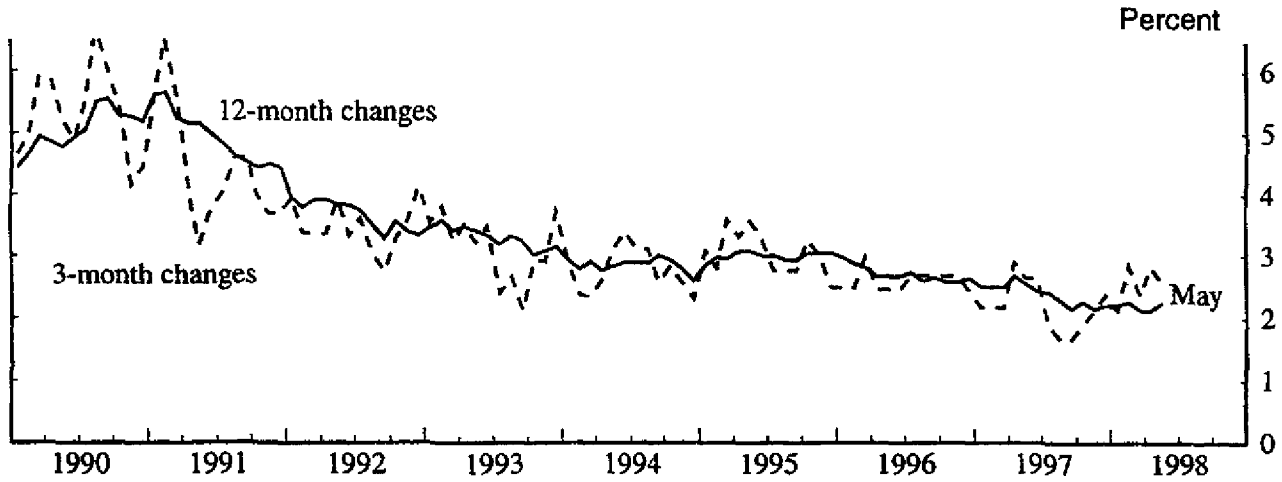
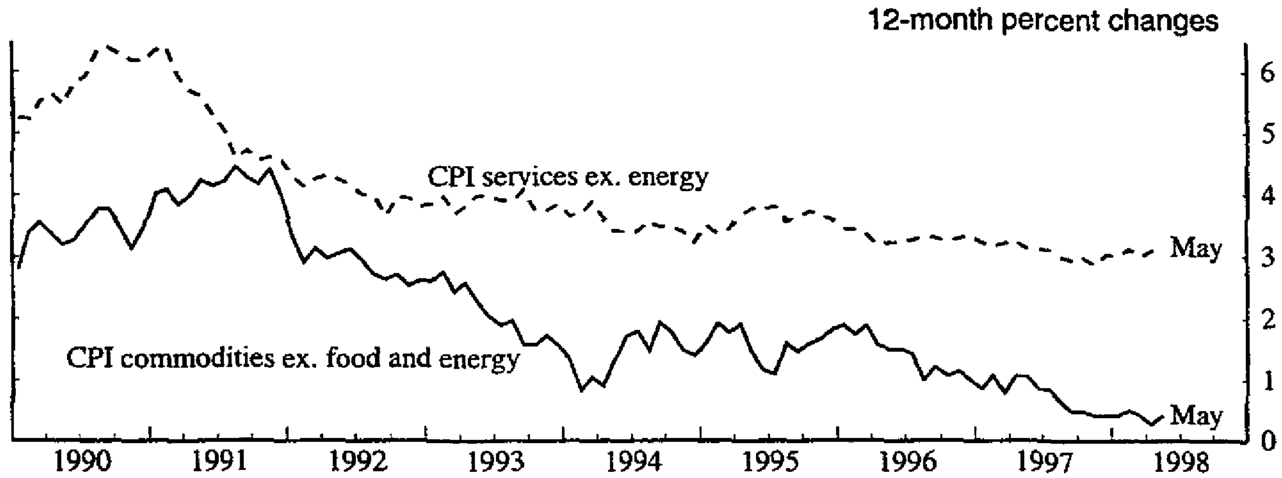
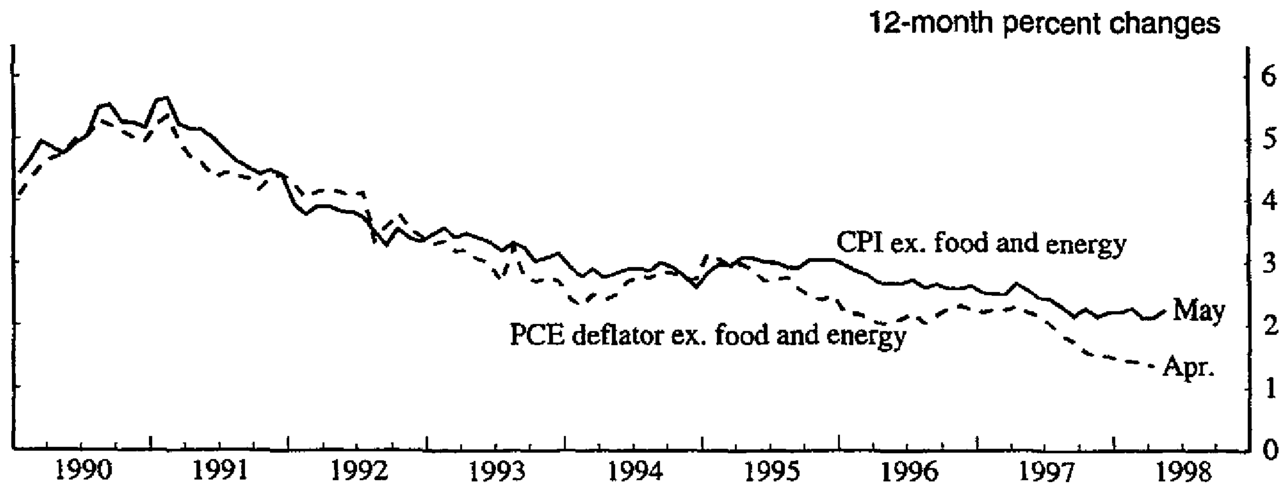
20. (...continued)
PPI after small declines in both March and April. Year-to-year increases in milk production have been picking up of late; in the states for which monthly data are collected, production in May was up 2.1 percent from the level of a year earlier. (Butter production has dropped sharply, however.)

Measures of Core Consumer Price Inflation

CPI ex. food and energy







organizations, imputed brokerage fees, and bank service charges are all items included in the PCE deflator but are not covered in the CPI.[21] Third, items that are not out of scope of one index or the other have different weights in the two indexes. For example, medical services have a much larger weight in PCE, and housing and energy have larger weights in the CPI. Finally, for some items in PCE, BEA chooses not to use the CPI as the price measure even though the CPI is available. Medical services, airfares, and computers are examples. Analysts at the BLS have concluded that the relatively large gap between increases in the CPI and in PCE prices in recent years has owed to a combination of these factors, with no single "smoking gun."

Capital goods prices have shown no sign of bottoming out. The PPI for capital equipment fell 0.6 percent over the past twelve months after having been about unchanged over the preceding twelve-month period. The drop in motor vehicle prices has contributed to this decline, as have declines in computer prices that have been larger than usual of late. Competition from falling import prices certainly has contributed to the softness in these areas. Indeed, the import share of capital equipment spending is about 40 percent, more than double that of consumer commodities other than food and energy.

There are few signs of inflationary pressures coming from earlier stages of processing. The PPI for intermediate materials other than food and energy edged down in May and was about unchanged over the past twelve months. The PPI for core crude materials moved up in May, following several months of negative readings, and this index stood well below its year-earlier level. Since the middle of May, most industrial commodity prices have moved downward. Nevertheless, the Journal of Commerce industrial price index is essentially unchanged since that time, reflecting sharp increases in cotton prices.

Short-term inflation expectations also remain pretty well in check, although they have backed up a little bit so far this quarter after having dropped notably in the first few months of the year. According to the Michigan survey, median one-year-ahead inflation expectations edged back up to 2.6 percent in May and early June after having dropped below 2-1/2 percent earlier in the year. Still, these expectations remain below the 2-3/4 percent average in the second half of 1997. Longer-term inflation expectations have remained low this quarter, with both the Michigan survey's median five- to ten-year ahead inflation expectations and the Philadelphia Fed's survey of professional forecasters ten-year expectations remaining below 3 percent.

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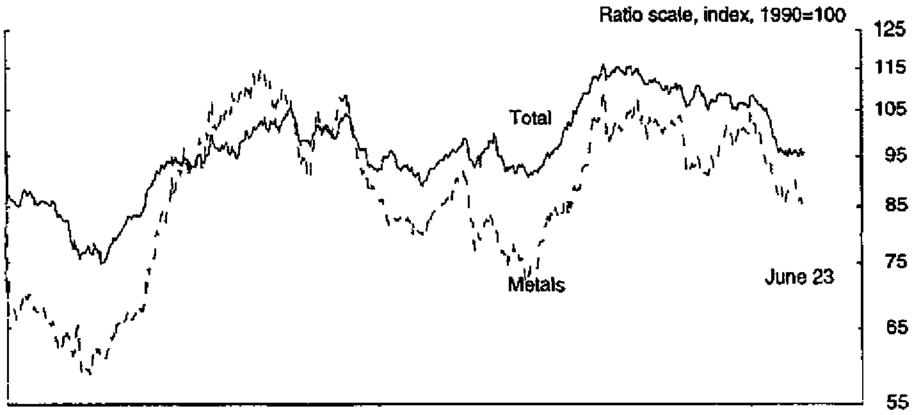
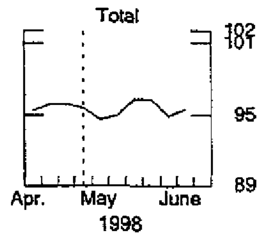
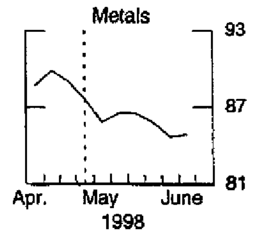
21. Going the other way, used cars are in the CPI but are out of scope of PCE.

Commodity Price Measures

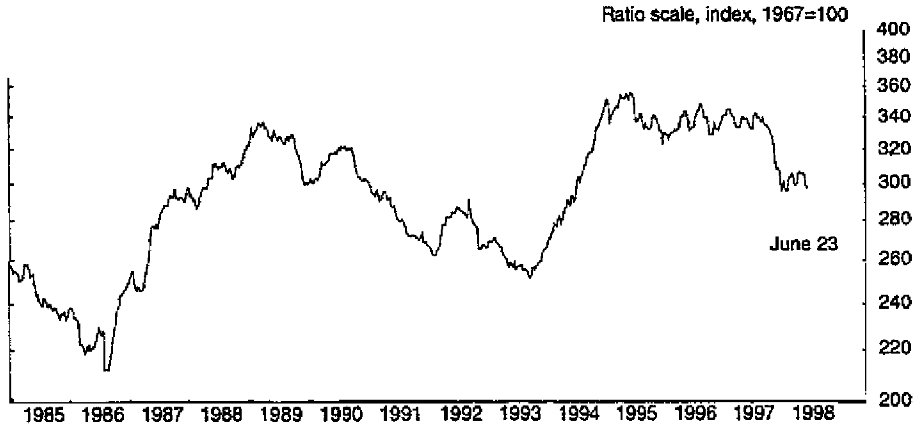
Journal of Commerce Index

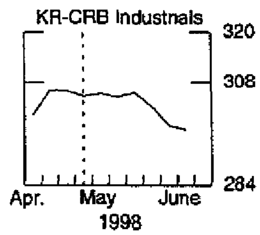




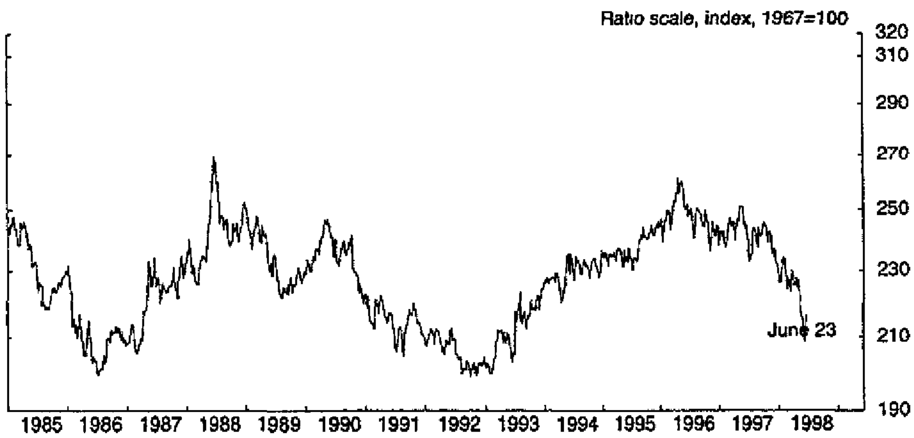


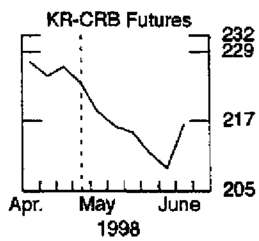
KR-CRB Spot Industrials





KR-CRB Futures





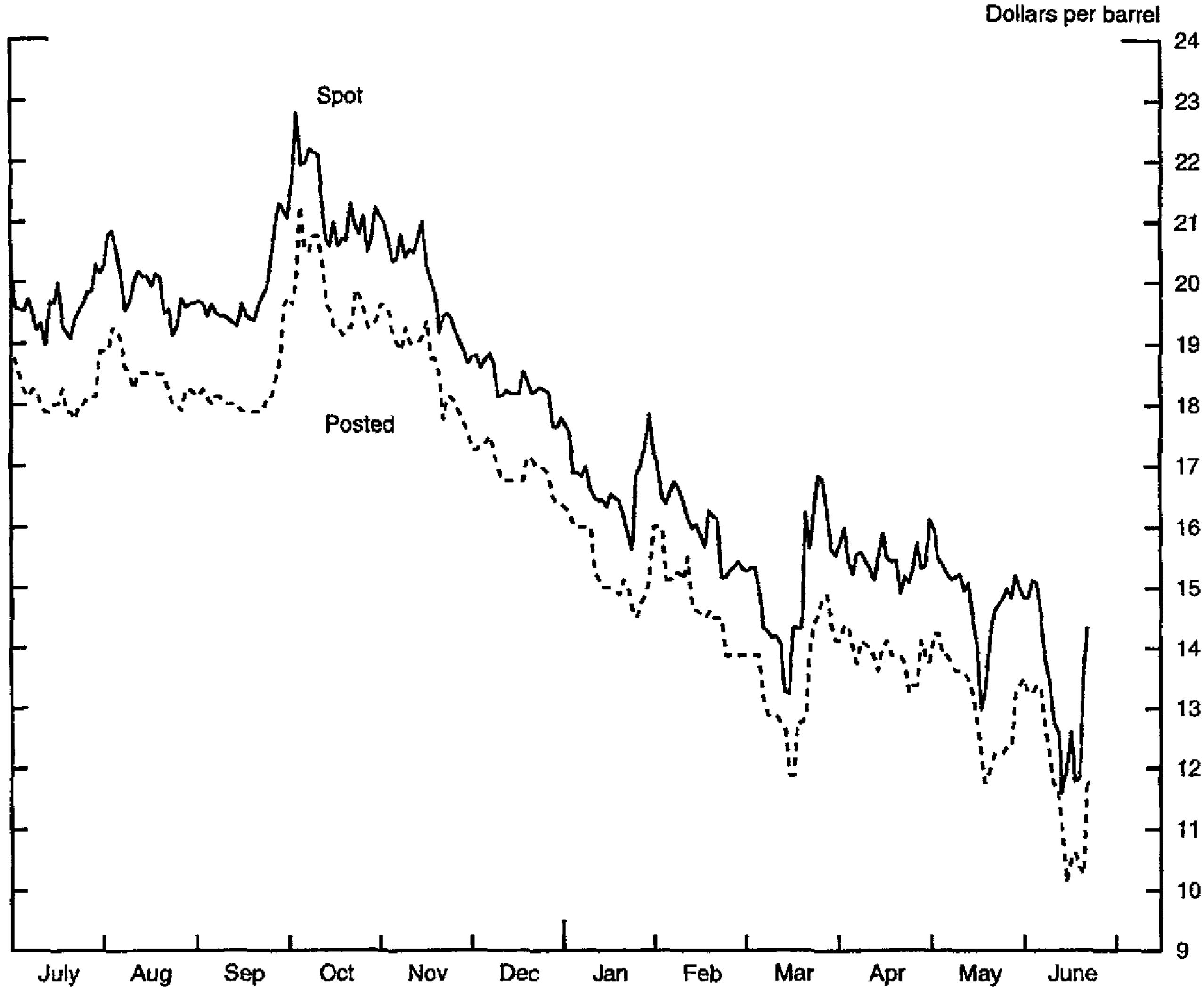
Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the KR-CRB spot price index consists entirely of industrial commodities,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

SPOT PRICES OF SELECTED COMMODITIES

	Current price ($)	Percent change[1]: 1996	1997	Dec. 30 to May 12[2]	May 12[2] to June 23	Memo: Year earlier to date
Metals						
Copper (lb.)	.800	-21.3	-24.3	1.2	-2.4	-35.0
Steel scrap (ton)	135.500	-13.1	23.2	-5.6	.0	-2.2
Aluminum, London (lb.)	.596	-8.5	-.6	-9.4	-3.4	-15.7
Precious metals						
Gold (oz.)	294.450	-4.8	-21.4	3.2	-1.6	-13.0
Silver (oz.)	5.350	-6.1	28.3	-6.5	-6.6	12.2
Forest products						
Lumber (m. bdft.)	280.000	59.2	-29.6	-4.1	.0	-24.7
Plywood (m. sqft.)	310.000	-3.2	-4.8	-6.7	10.7	-12.7
Petroleum						
Crude oil (barrel)	12.310	29.3	-31.7	-10.5	-14.9	-30.9
Gasoline (gal.)	.447	27.2	-25.8	-1.0	-10.0	-15.5
Fuel oil (gal.)	.396	18.3	-29.7	-14.9	-5.8	-22.7
Livestock						
Steers (cwt.)	63.000	-1.1	3.0	-1.5	-6.0	.0
Hogs (cwt.)	41.500	14.9	-36.4	18.6	.0	-32.5
Broilers (lb.)	.667	12.5	-21.2	24.6	8.6	9.0
U.S. farm crops						
Corn (bu.)	2.385	-24.4	.2	-8.4	1.9	-4.6
Wheat (bu.)	3.160	-12.8	-22.6	-7.3	-3.1	-9.5
Soybeans (bu.)	6.560	-3.7	-1.8	-5.4	2.7	-20.0
Cotton (lb.)	.752	-8.7	-9.7	1.5	15.9	4.1
Other foodstuffs						
Coffee (lb.)	1.210	34.7	25.4	-16.7	-14.8	-46.5
Memo:						
JOC Industrials	95.500	-4.1	-8.6	-2.5	-.1	-9.8
JOC Metals	84.900	-8.3	-5.0	-1.4	-3.1	-15.3
KR-CRB Futures	216.470	-.1	-3.2	-3.1	-3.1	-10.3
KR-CRB Spot	296.840	.9	-8.4	-.7	-2.6	-11.5

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

Daily Spot and Posted Prices of West Texas Intermediate



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

Monthly Average Prices of West Texas Intermediate

Month	Posted	Spot
July	18.15	19.63
August	18.51	19.93
September	18.14	19.79
October	19.80	21.26
November	18.83	20.17
December	16.97	18.32
January	15.33	16.71
February	14.78	16.06
March	13.44	15.02
April	13.90	15.44
May	13.13	14.86
June [1]	11.93	13.51

1. Through June 23, 1998.

Information on labor costs this quarter are mostly limited to the BLS monthly data on average hourly earnings of production or nonsupervisory workers.[22] Average hourly earnings were reported to have increased 0.3 percent in May, after having risen 0.5 percent in April; the average monthly increase in the first quarter was 0.3 percent. Over the twelve months ended in May, average hourly earnings rose 4.3 percent, up from 3.9 percent over the previous twelve-month period and from 3.3 percent over the twelve months before that.

This acceleration has been widespread across industries. The largest increases have been in finance, insurance, and real estate, and in business services (which includes temporary help firms), both of which are posting rates of increase near 6 percent or higher. Average hourly earnings in wholesale and retail trade also have continued to accelerate markedly. The one notable exception is manufacturing, where average hourly earnings were up a little less than 3 percent over the past year, about the same as the increases over the preceding two years.

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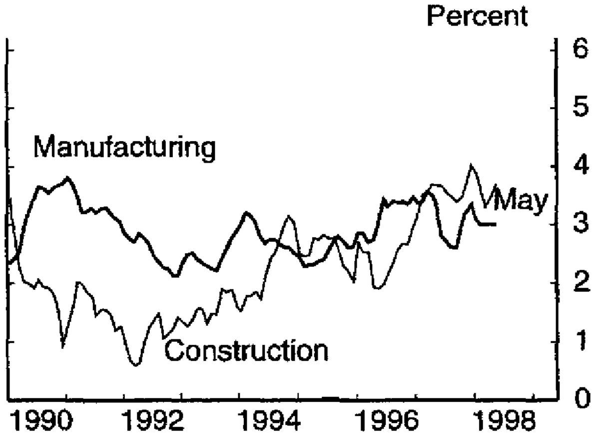
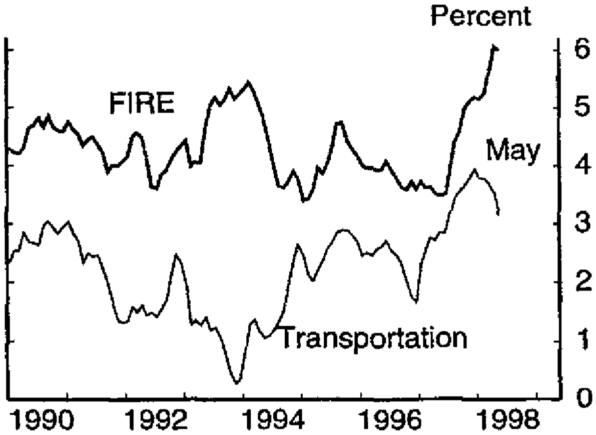
22. These series now have been corrected for the length-of-pay-period problems that had been plaguing them. Concerning compensation per hour, as described in the May Greenbook, we are not sure of the extent to which this series was affected by the length-of-pay-period problem. The corrected growth rate could range from the published 4.2 percent to as much as 1-1/2 percentage point percent higher, based on our current estimates. Unfortunately, this uncertainty will not be resolved until the August revision to the Productivity and Costs data.

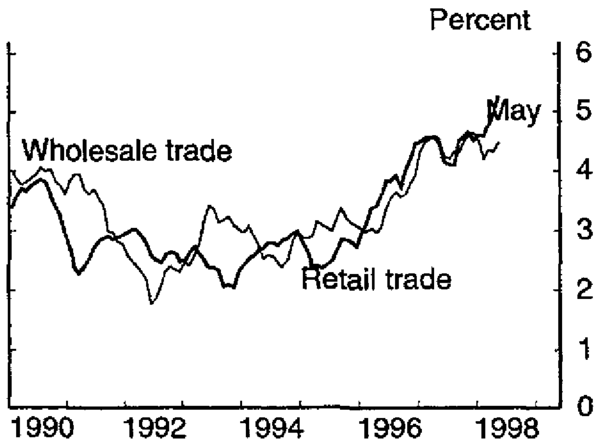
AVERAGE HOURLY EARNINGS
(Percentage change; based on seasonally adjusted data)

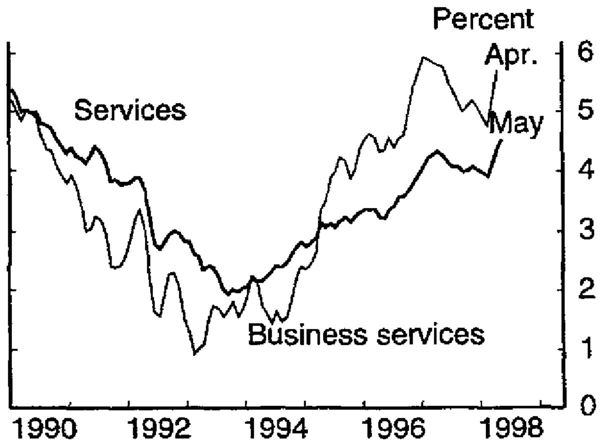
	Twelve-month percent change			Percent change to May. 1998		1998	
	May 1996	May 1997	May 1998	Nov. 1997	Feb. 1998	Apr.	May
	-Annual rate-					-Monthly rate-	
Total private nonfarm	3.3	3.9	4.3	4.2	4.5	.5	.3
Manufacturing	3.5	3.0	2.8	2.0	1.5	-.1	.2
Construction	2.1	3.7	3.5	3.1	3.7	.4	.2
Transportation and public utilities	2.6	2.8	3.2	2.7	1.3	.3	-.1
Finance, insurance, and real estate	4.2	3.7	5.7	5.3	5.3	1.1	.1
Retail trade	3.7	4.4	5.6	6.0	7.2	.8	.3
Wholesale trade	3.2	4.5	4.8	4.3	5.9	.4	.8
Services	3.2	4.3	4.7	5.0	6.2	.7	.4

Average Hourly Earnings
(Smoothed twelve-month changes*)









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

DOMESTIC FINANCIAL DEVELOPMENTS

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

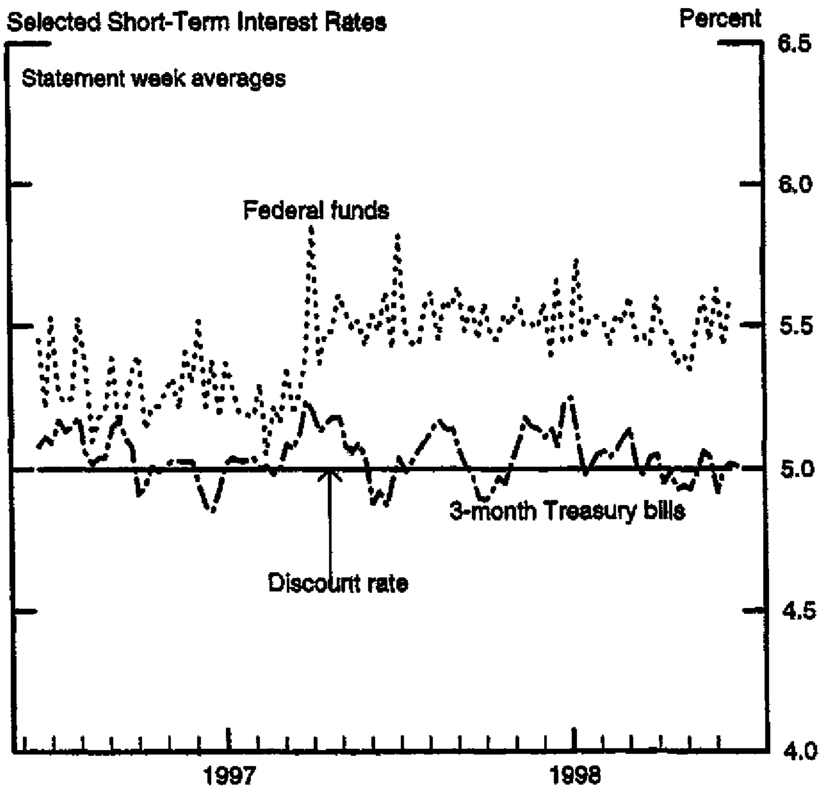
Instrument	1997 Sep. 30	1998 Jan. 2	1998 FOMC * May 19	1998 June 23	Change to June 23, from: Sep. 30	Change to June 23, from: Jan. 23	Change to June 23, from: FOMC * May 19
Short-term rates							
Federal funds							
intended rate [2]	5.50	5.50	5.50	5.50	.00	.00	.00
realized rate [3]	5.51	5.44	5.56	5.54	.03	.10	-.02
Treasury bills [4]							
3-month	4.93	5.18	5.05	4.97	.00	-.21	-.08
6-month	5.08	5.19	5.17	5.13	.05	-.06	-.04
1-year	5.18	5.18	5.17	5.13	-.05	-.05	-.04
Commercial paper							
1-month	5.51	5.56	5.50	5.53	.02	-.03	.03
3-month	5.48	5.54	5.50	5.48	.00	-.06	-.02
Large negotiable CDs [4]							
1-month	5.59	5.64	5.56	5.58	-.01	-.06	.02
3-month	5.67	5.69	5.60	5.60	-.07	-.09	.00
6-month	5.72	5.71	5.68	5.65	-.07	-.06	-.03
Eurodollar deposits [5]							
1-month	5.56	5.59	5.53	5.53	.00	-.06	.00
3-month	5.63	5.69	5.59	5.56	-.07	-.13	-.03
Bank prime rate	8.50	8.50	8.50	8.50	.00	.00	.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	5.88	5.62	5.59	5.51	-.37	-.11	-.08
10-year	6.12	5.67	5.64	5.45	-.67	-.22	-.19
30-year	6.41	5.86	5.92	5.64	-.77	-.22	-.28
U.S. Treasury 10-year indexed note	3.61	3.70	3.76	3.71	.10	.01	-.05
Municipal revenue (Bond Buyer) [6]	5.63	5.41	5.48	5.36	-.27	-.05	-.12
Corporate-A utility, recently offered	7.44	6.96	7.13	6.93	-.51	-.03	-.20
High-yield corporate [7]	9.02	9.04	9.02	9.19	.17	.15	.17
Home mortgages [8]							
FHLMC 30-yr fixed rate	7.28	7.03	7.19	6.94	-.34	-.90	-.25
FHLMC 1-yr adjustable rate	5.51	5.50	5.71	5.68	.17	.18	-.03

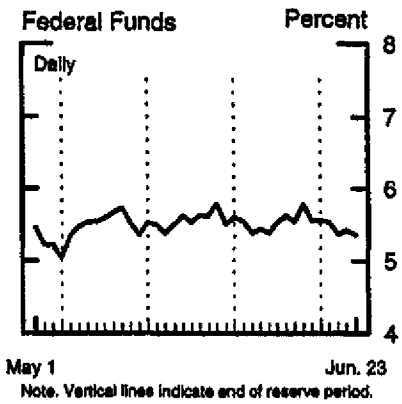
Stock exchange index	Record high Level	Record high Date	1998 Jan. 2	1998 FOMC * May 19	1998 June 23	Percentage change to June 23, from: Record high	Percentage change to June 23, from: Jan. 2	Percentage change to June 23, from: FOMC * May 19
Dow-Jones Industrial	9211.84	5/13/98	7965.04	9050.91	8828.41	-4.16	10.84	-2.46
S&P 500 Composite	1130.54	4/22/98	975.04	1105.82	1119.49	-.98	14.81	1.24
NASDAQ (OTC)	1917.61	4/22/98	1581.53	1831.62	1844.57	-3.81	16.63	.71
Russell 2000	491.41	4/21/98	436.52	467.61	447.42	-8.95	2.50	-4.32
Wilshire	10782.75	4/22/98	9327.71	10485.71	10502.79	-2.60	12.60	.16

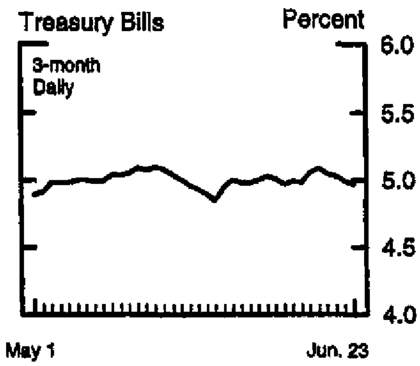
1. One-day quotes except as noted.
2. FOMC's intended rate.
3. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
4. Secondary market.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. 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.

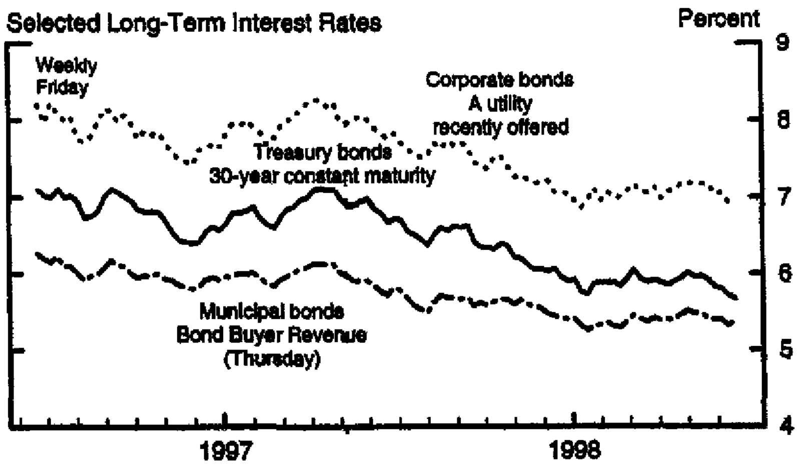
* Figures cited are as of the close on May 18,1998.

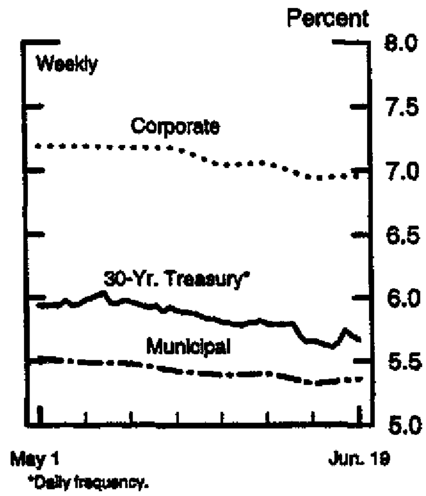
Selected Interest Rates

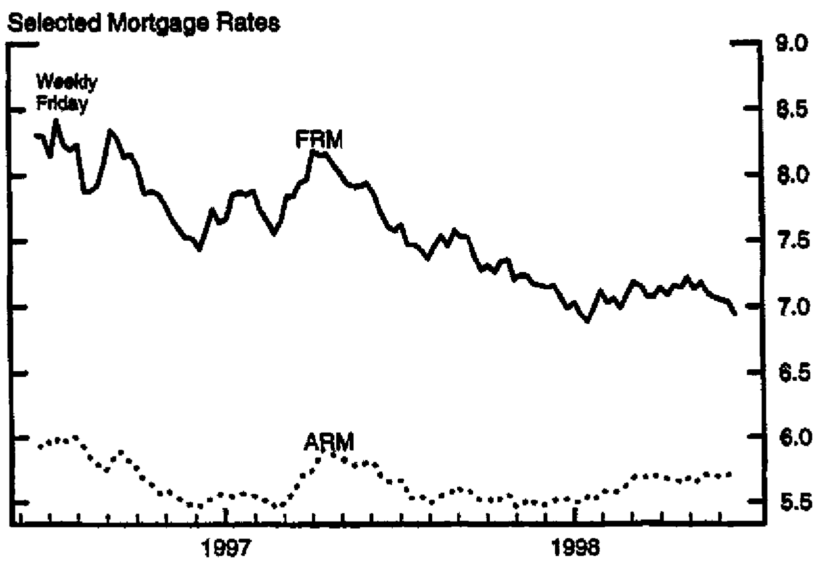


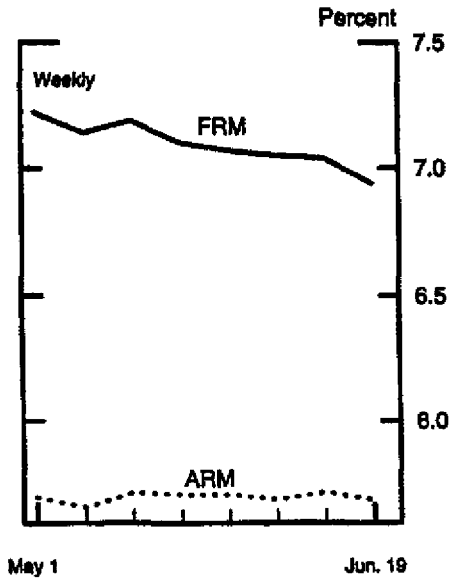












Domestic Financial Developments

Overview

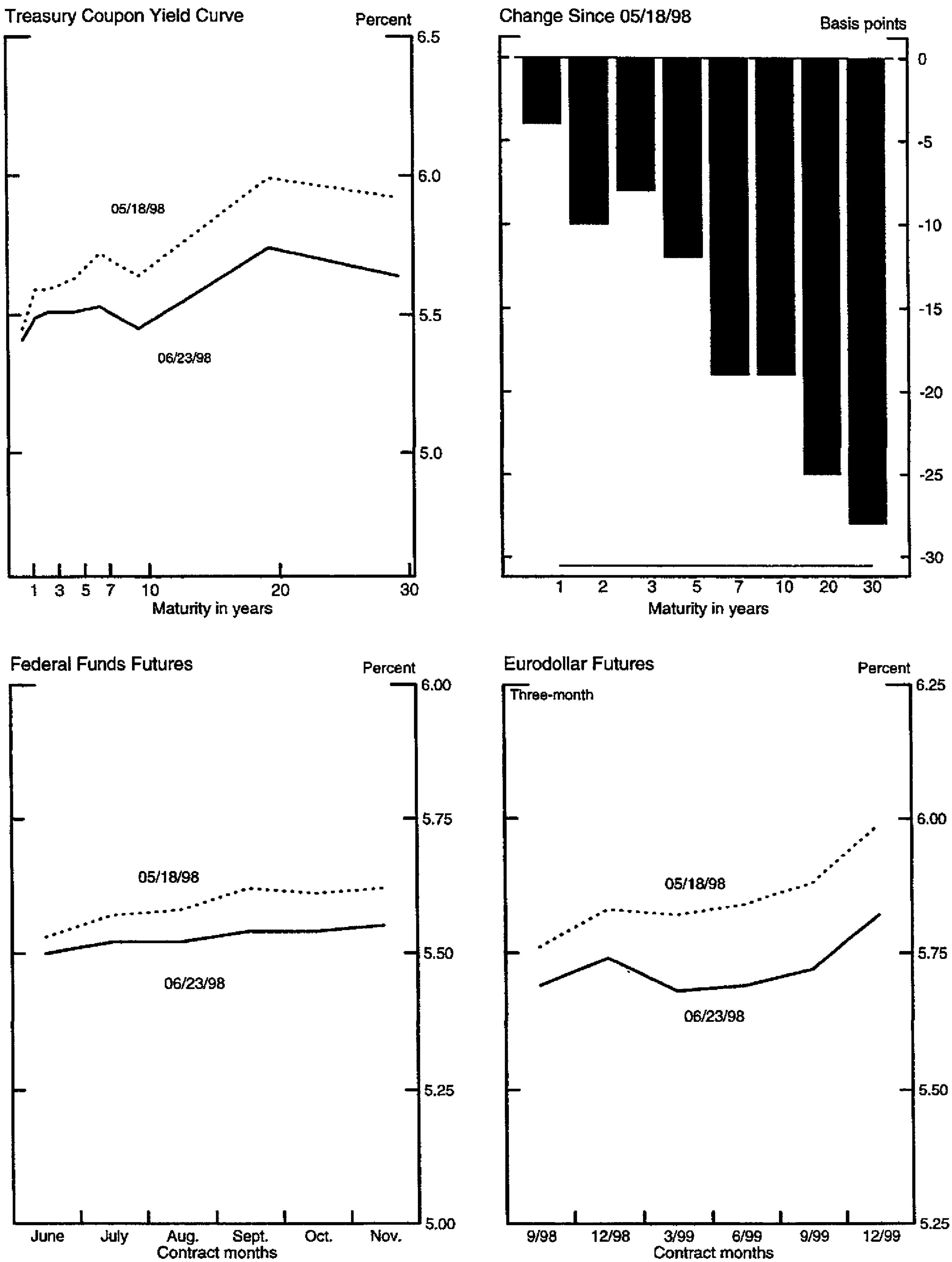
Domestic bond markets rallied over the intermeeting period amid further turbulence in Asian and Russian financial markets. High-quality dollar-denominated assets once again benefited from perceptions that they provided a refuge from troubles in that hemisphere, and traders found comfort in the Chairman's testimony before the Joint Economic Committee, which was widely interpreted as indicating that monetary policy would be on hold at least through next week's FOMC meeting. On June 15, the yield on the thirty-year Treasury bond hit 5.61 percent, its lowest level since the bond was added to the regular Treasury issuance calendar in 1978 and more than a quarter percentage point below the level at the May meeting. After coordinated intervention by U.S. and Japanese monetary authorities to support the Japanese yen, yields backed up somewhat; however, the yen has weakened again in the past couple of days, and--aided by a weak durable goods report--the long bond yield has slipped back close to its low.

The flight to safety focused on Treasury securities especially, given their great liquidity, and spreads of highly rated corporate bonds over Treasuries widened slightly. But spreads on junk bonds have moved up 36 basis points over the intermeeting period reflecting both the decline in Treasuries and an increase in junk bond interest rates. The difference between the high-yield bond rate and the comparable Treasury rate now stands at 366 basis points, the widest since March 1996--though still low by historical standards.

Share prices have been mixed, with the Dow Jones index down slightly, on balance, and broader indexes unchanged to up a bit. Daily price movements have often been sizable: At times, investor sentiment seemed to be swayed by the negative implications for profits of the Asian economic slump and an appreciating dollar. Almost as often, however, when there was no negative news, "bargain" hunting and the continuing influx of mutual fund money appeared to buoy the markets.

Net borrowing by the private nonfinancial sector has shown only slight hints of slowing. Gross issuance of bonds eased a bit in May and June from April's record pace but remained heavy, and commercial and industrial loans at banks have maintained strong growth. In the household sector, indicators suggest that home mortgage debt has continued to rise briskly in recent months, and consumer credit accelerated somewhat over the first four months of the year after having slowed late in 1997. Growth of state and local government debt, which was rapid in the first quarter,

Treasury Yield Curve and Selected Short-Term Futures Rates



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moved down in April and May but remains strong. The federal government, in contrast, has partially offset the strength in borrowing in other sectors, as the Treasury continued to pay down debt in recent months further restricting the supply of short-term bills.

Banks continue to provide a substantial proportion of total credit. Bank credit growth picked up in May after having contracted in April. Growth of the broad monetary aggregates slowed markedly in May, partly reflecting the rundown of balances built up in April to meet outsized tax liabilities. Averaging through April and May, money growth slowed from the first quarter pace but remains fairly rapid.

Business Finance

Credit market borrowing of nonfinancial businesses has remained robust of late. In May, gross bond issuance by investment-grade corporations totaled $8 billion (table)--down from the frantic $12-1/2 billion per month rate in March and April but still above the average pace of 1997. Speculative grade bond offerings were exceptionally heavy in April and May, with a large share of issues carrying ratings in the lower ranges. Net issuance of nonfinancial commercial paper turned positive in May after two months of contraction.

In addition to financing expenditures, corporations have continued to use bond proceeds to repay shorter-term obligations and to retire higher-rate bonds. Indeed, in May, more than half of the proceeds from speculative grade issues were designated to refinance existing debt, which in some cases had been used to fund previous mergers. Investment-grade firms stated that they planned to use more than a third of their bond proceeds in May to pay down bank debt and to retire commercial paper.

Partial data for June indicate that gross issuance of investment-grade bonds will likely exceed May's pace, although the pace of offerings has slacked off considerably after an initial flurry early in the month. In contrast, speculative-grade issuance slowed in June. Investors, concerned about earnings prospects of domestic firms after the latest flare-up in Asian markets, forced several companies to postpone low-rated offerings and others to reduce the size of their issues or to make concessions in the form of shorter maturities or higher coupons. Still, the resulting increase in junk-bond spreads was moderate.

Overall, measures of credit quality of nonfinancial corporations remained favorable at the start of the summer. Data through May indicated liabilities of failed businesses were running at about half the rate of 1997 (chart); and in April, high-yield bond defaults were at a $3 billion annual rate, about the same rate as in 1997 and

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

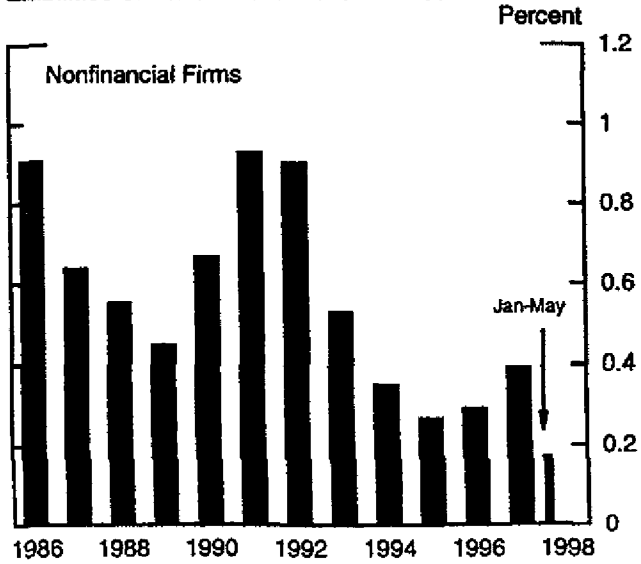
Type of security	1996	1997	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May
All U.S. corporations	58.4	69.7	72.0	92.8	117.4	88.3	80.4
Stocks[1]	10.2	9.8	11.6	12.7	19.3	12.4	13.6
Bonds	48.2	59.9	60.4	80.1	98.1	75.9	66.7
Nonfinancial corporations							
Stocks[1]	6.7	5.0	5.6	6.1	10.8	5.5	8.7
Initial public offerings	2.9	1.8	2.5	1.2	1.6	1.9	2.8
Seasoned offerings	3.8	3.2	3.1	4.8	9.2	3.6	5.9
Bonds	12.5	17.3	17.0	25.4	24.4	32.6	24.2
By rating, sold in U.S.[2]							
Investment grade	6.3	7.4	6.8	13.1	12.6	12.6	8.1
Speculative grade	4.8	8.0	7.8	10.7	10.3	17.7	13.8
Public	2.3	1.5	.9	2.1	3.2	2.1	2.5
Rule 144A	2.5	6.5	6.9	8.6	7.1	15.6	11.3
Financial corporations							
Stocks[1]	3.5	4.8	6.0	6.6	8.5	6.9	5.0
Bonds	35.8	42.6	43.4	54.7	73.7	43.3	42.6
Memo:							
Net issuance of commercial paper, nonfinancial corporations[3]	-.1	1.1	1.1	4.5	-.7	-8.2	2.3
Change in C&I loans at commercial banks[3]	5.4	6.0	5.4	3.2	-10.0	8.1	8.0

Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Bonds categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
3. End-of-period basis. Seasonally adjusted.

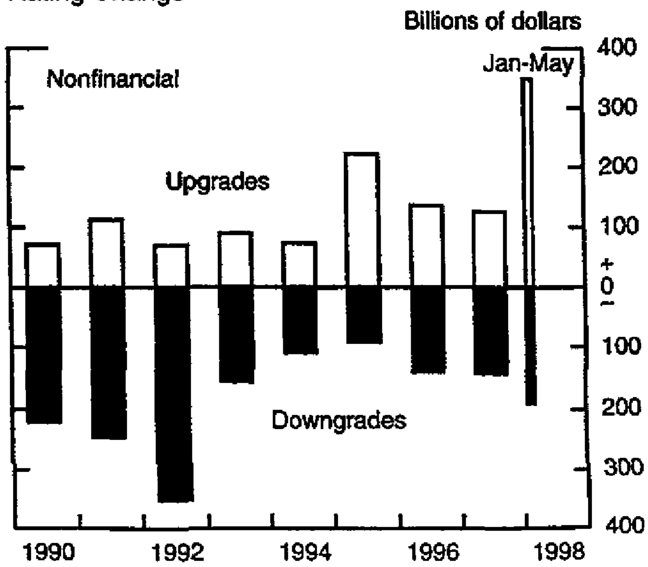
Credit Quality

Liabilities of Failed Businesses to Total Liabilities



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

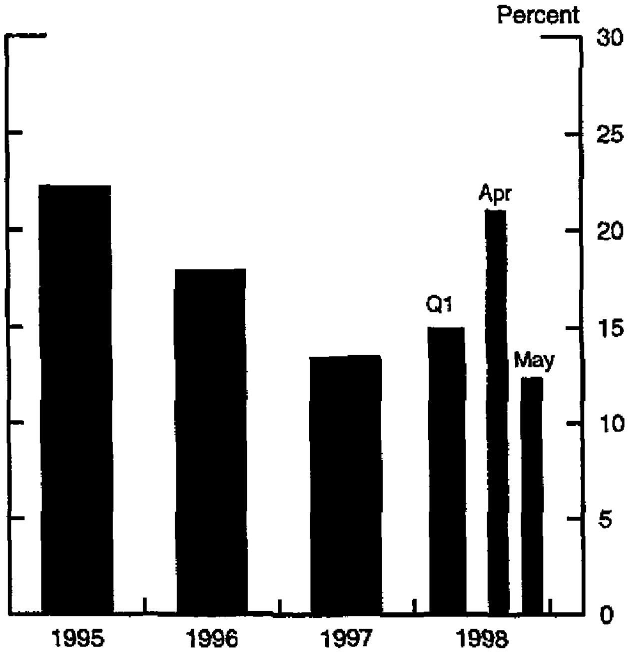
Rating Changes



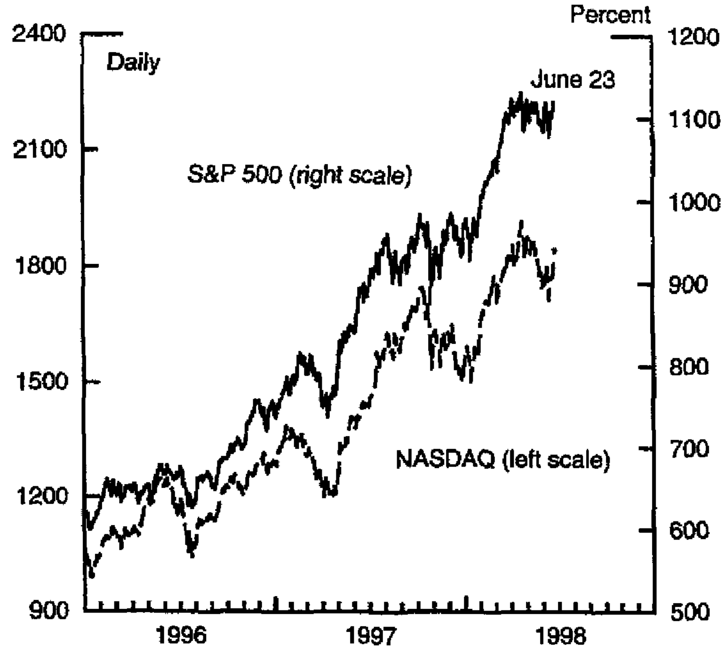
Source. Moody's. Jan-May observation at an annual rate.

Corporate Earnings and Stock Market Prices

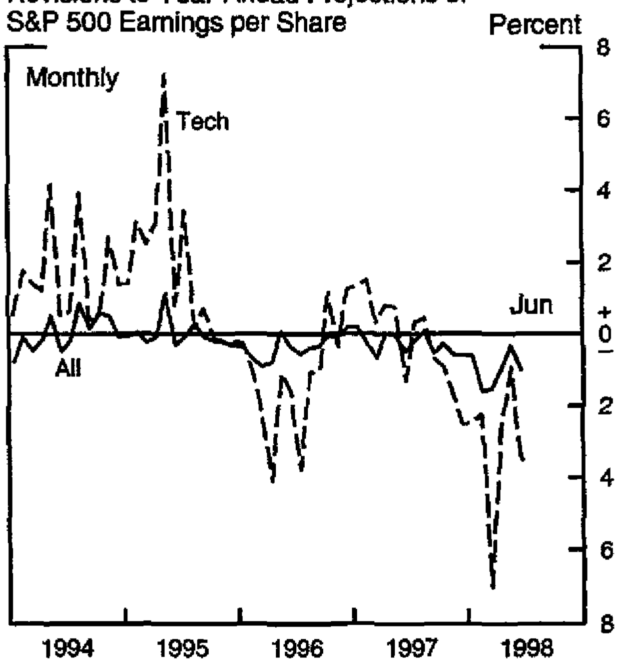
IPOs: Average First-Day Price Changes



Selected Indexes

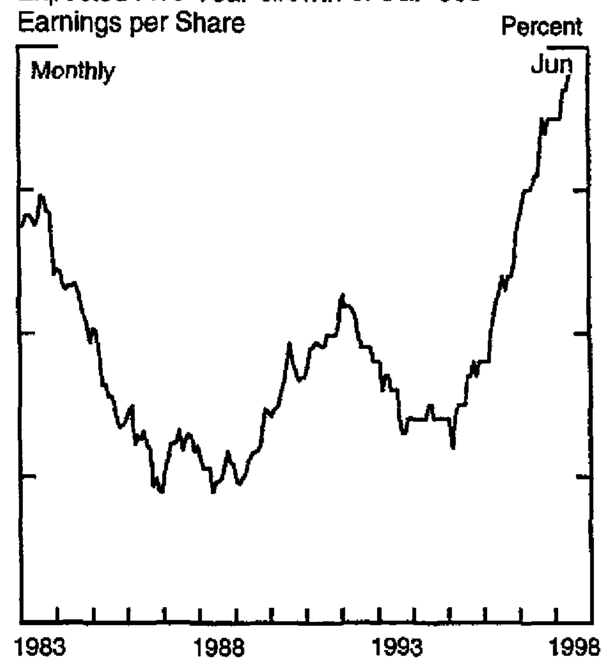


Revisions to Year-Ahead Projections of S&P 500 Earnings per Share



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

Expected Five-Year Growth of S&P 500 Earnings per Share



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

down from the $8 billion annual rate in the first quarter. Also, in May, upgrades of nonfinancial corporate debt by Moody's again exceeded downgrades, bringing the year-to-date net change favoring upgrades to about $159 billion at an annual rate (chart), a significant reversal from each of the previous two years when debt had been downgraded slightly, on net. However, net upgrades may decline in the near future: At the end of May, Moody's had $13 billion more in nonfinancial debt under review for possible downgrade than they did for upgrade.

Gross equity issuance increased in May to $8-3/4 billion. In large part, the rise in equity issuance reflected a step-up in issues by firms paying down debt that had been used to fund previous acquisitions (table). Initial public offerings also increased markedly in May after a run-up in first-day returns in April (chart). However, investors' appetite for these new issues waned, and first-day returns in May dropped below the average of the first four months of 1998. On net, equity retirements by nonfinancial firms continued to outstrip issuance by a wide margin, reflecting the high pace of business mergers and corporate share repurchase programs. Year-to-date announcements of the latter are off a bit from the pace in 1997, but they still indicate that the volume of repurchases will remain high for some time to come.

Stock prices have been volatile over the intermeeting period. The changes in prices appear mainly to reflect investors' shifting concerns about corporate earnings in light of a more pessimistic outlook for a near-term recovery in East Asia and adverse currency translations of foreign earnings. Basic materials, oil, and semiconductor stocks have been hit hard over recent weeks. Nonetheless, the technology-laden NASDAQ index is little changed, on balance, while the broader-based S&P 500 is up 1-1/4 percent (chart).

Company announcements since late May warning that second-quarter profits could be weaker than anticipated have prompted equity analysts to aggressively cut projections for near-term earnings. As was the case late in the first quarter, projections of profits in the technology sector took a disproportionate hit in June (chart). Not surprisingly, earnings projections for the oil and basic materials sectors were also marked down further by large amounts. Analysts have yet to cut estimates of earnings for GM; over the next four weeks, adjustments to reflect the effects of the strike are expected to drag down projections for aggregate earnings significantly. Nonetheless, as of mid-June, the I/B/E/S "bottom-up" forecast of year-ahead earnings for the S&P 500--an aggregation of security analysts' projections for individual companies--still has 1998 profit growth at 7-1/4 percent, implying strong earnings growth in the second half of the year; expectations for corporate profits over the next five years hit another record high in June (chart).

Household Sector Finance

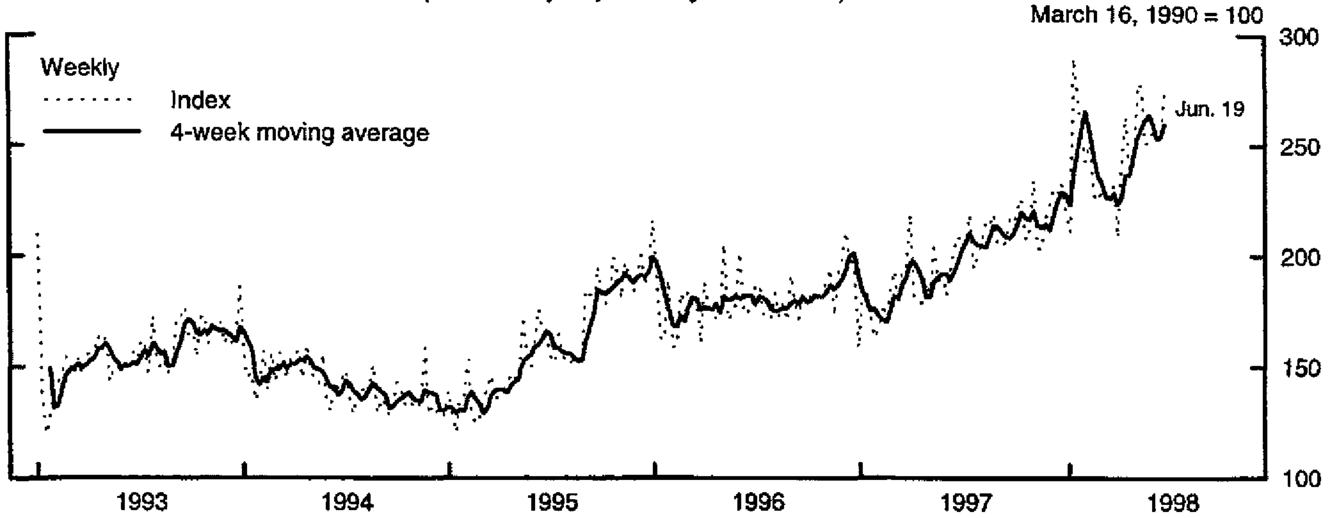
Household debt grew at a 7-3/4 percent annual rate in the first quarter, at least in part reflecting the robust increases in personal consumption outlays and the high rate of home sales. Home mortgage debt continued to expand at an 8-1/4 percent pace, and consumer credit growth rebounded to a 4-1/2 percent annual growth rate after slowing to only a 2-1/4 percent annual rate in the fourth quarter of last year.

Data for the second quarter indicate that growth of household debt has remained strong. Consumer credit grew at a 5-1/4 percent annual rate in April, and available data for the second quarter suggest that the low level of home mortgage interest rates is spurring another sizable increase in mortgage debt. Through mid-June, the MBA mortgage purchase application index remained near the record highs reached earlier in the year (chart); and the mortgage refinancing application index was in the elevated range recorded during the refinancing boom in 1993 (chart).

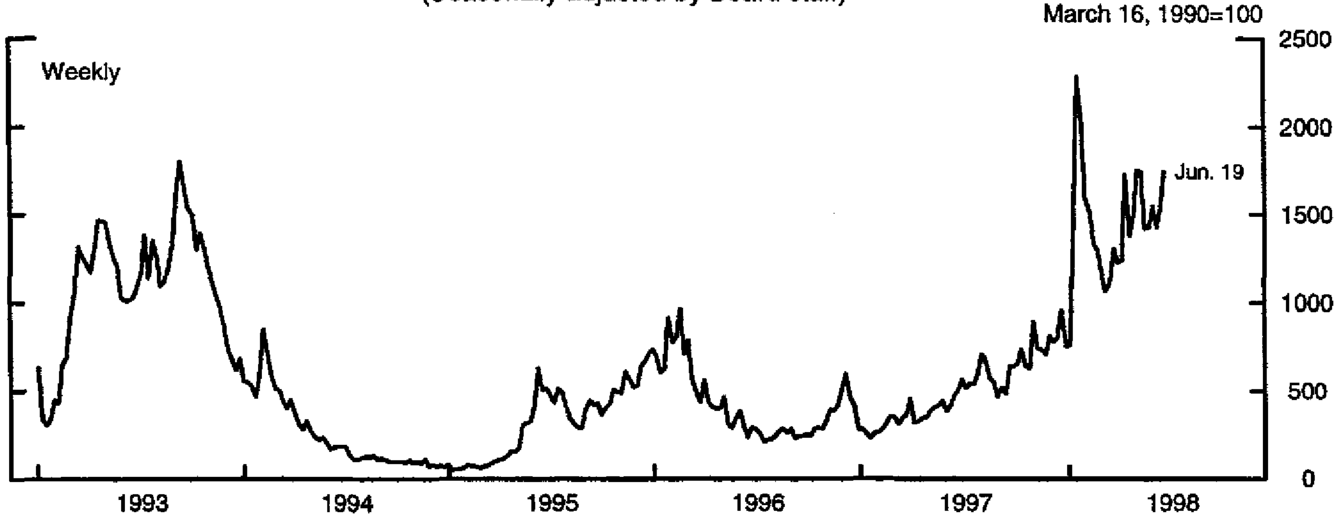
Most measures of household credit quality have stabilized over the past year and recent trends are favorable. Consumer loan delinquencies reported by banks on the Call Report edged down in the first quarter (chart), as did those at banks surveyed by the American Bankers Association (not shown). Delinquency rates at the captive auto finance companies and on credit card receivables that back securities continued to decline in April (not shown). The rate of nonbusiness bankruptcy filings increased only slightly in the first quarter and has changed little over the past year (chart).

On balance, aggregate household balance sheet measures indicate additional strengthening. In the first quarter, the increase in household debt was more than offset by a further rise in assets owing to the increase in stock market prices and home values, and the ratio of household net worth to disposable personal income is estimated to have reached a new high (chart). Recent developments suggest that the ratio of net worth to income leveled off in the second quarter. The aggregate debt service burden of the household sector is estimated to have edged down in the first half of the year (chart). Lower interest rates and a shift in the composition of debt from consumer credit to longer maturity mortgage loans have more than offset the brisk pace of debt growth.

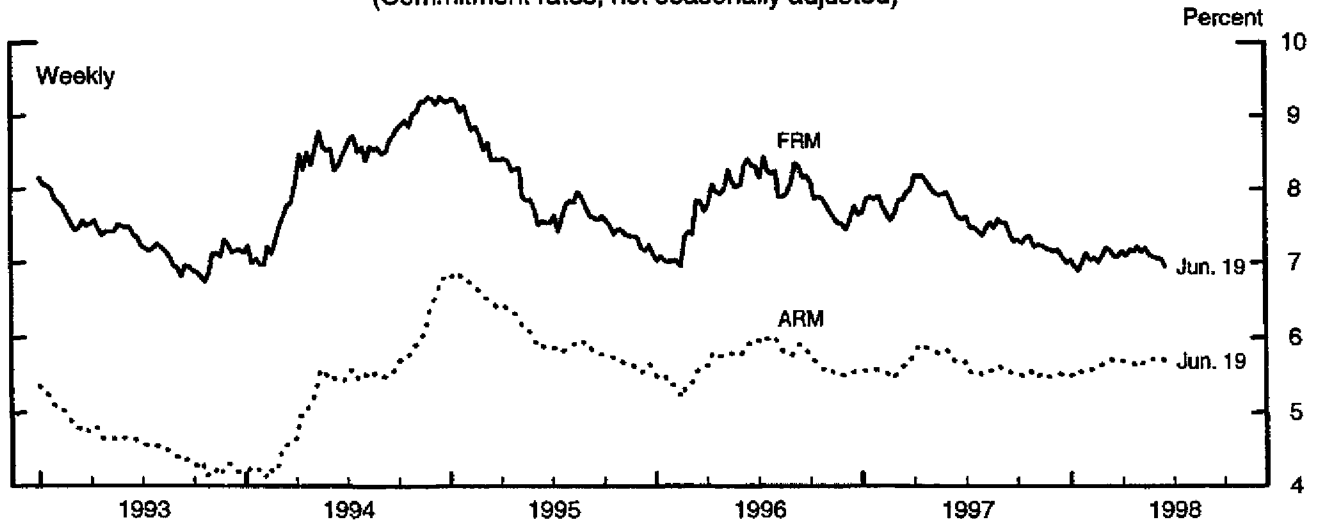
MBA Mortgage Purchase Application Index
(Seasonally adjusted by Board staff)



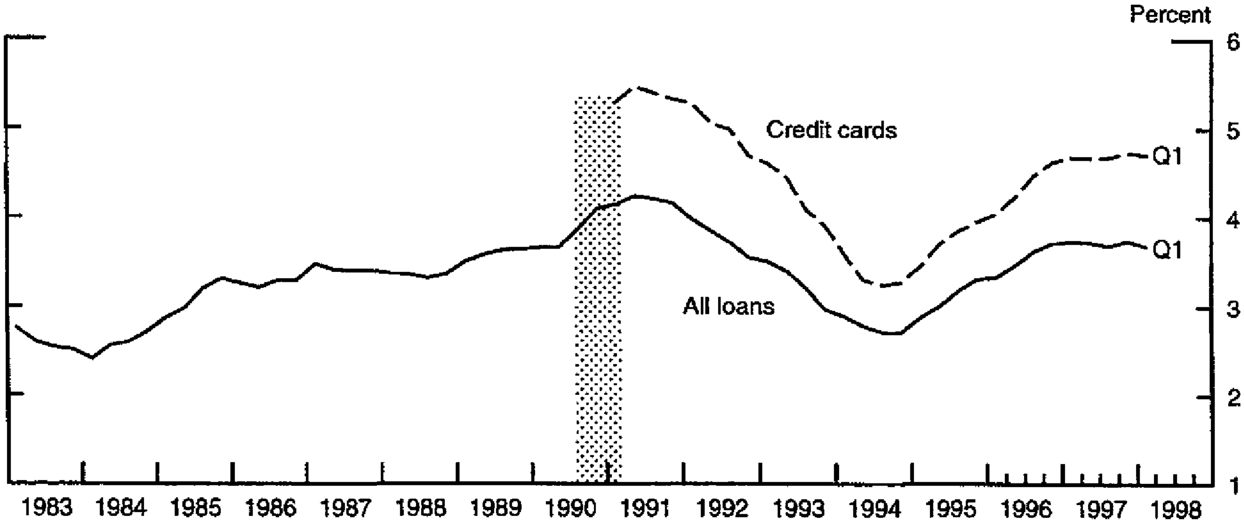
MBA Mortgage Refinancing Application Index
(Seasonally adjusted by Board staff)



Freddie Mac FRM and ARM Rates
(Commitment rates, not seasonally adjusted)

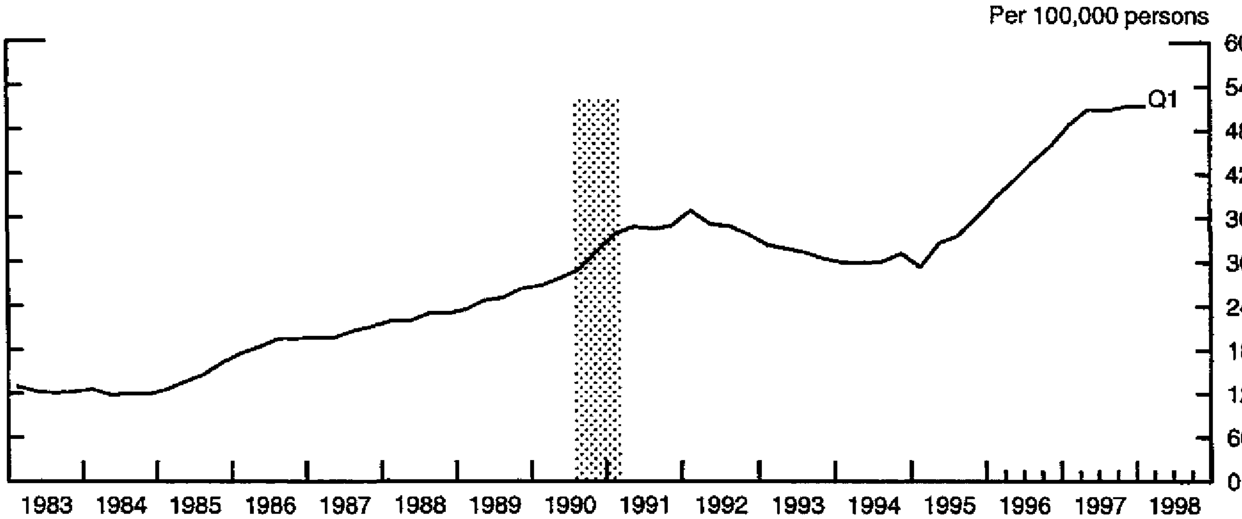


Consumer Loan Delinquency Rates at Banks
(Seasonally adjusted, quarterly averages)



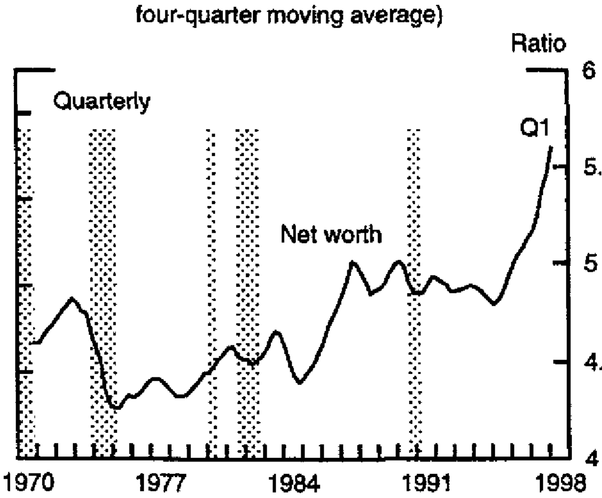
Source. Call Report.

Nonbusiness Bankruptcy Filings
(Seasonally adjusted)



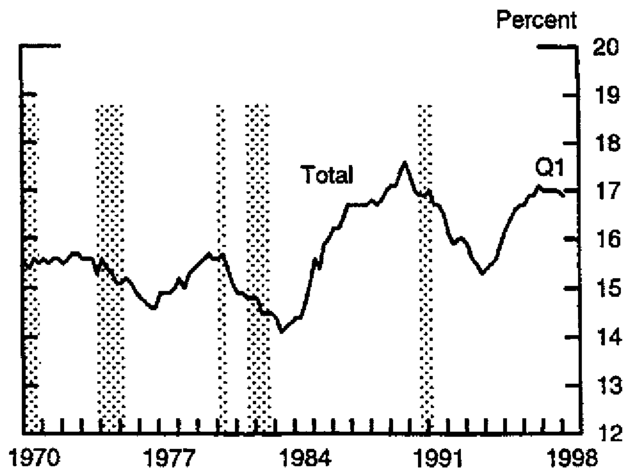
Source. Administrative Office of the U.S. Courts; seasonally adjusted at the Federal Reserve Board.

Household Net Worth
(Ratio to disposable personal income, four-quarter moving average)



Source. Flow of Funds Accounts.

Ratio of Household Debt Service to Disposable Personal Income



Note. Debt service is a staff estimate of scheduled payments of principal and interest on mortgage and consumer debt.

Treasury Financing
(Billions of dollars)

Item	1997 Q4	1998 Q1	1998 Q2[p]	1998 April	1998 May	1998 June[p]
Total surplus, deficit (-)	**-39.7**	**-30.2**	**137.6**	**124.6**	**-38.8**	**51.8**
Means of financing deficit						
Net borrowing	33.7	25.9	-83.7	-60.6	-8.6	-14.6
Nonmarketable	15.8	17.3	15.1	7.2	4.3	3.6
Marketable	17.9	8.6	-98.8	-67.8	-12.9	-18.2
Bills	14.4	4.1	-80.2	-62.0	-10.1	-8.1
Coupons	3.5	4.6	-18.6	-5.7	-2.7	-10.1
Decrease in cash balance	11.7	4.3	-48.2	-60.4	51.9	-39.7
Other[1]	-5.7	0.0	-5.7	-3.6	-4.5	2.4
MEMO						
Cash balance, end of period	31.9	27.6	75.8	88.0	36.1	75.8

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

p Projected.

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

Agency	1997 Q4	1998 Q1	1998 Feb.	1998 March	1998 April
FHLBs	18.7	4.0	0.6	5.9	5.2
FHLMC	9.2	24.1	2.2	9.2	7.5
FNMA	11.8	11.3	3.1	7.5	14.9
Farm Credit Banks	1.9	-1.2	-0.1	1.1	0.5
SLMA	-2.8	-1.4	0.2	-3.3	n.a.

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

Federal Government Finance

The strong inflows of income tax receipts led the Treasury to reduce the size of the weekly bill auctions $1-1/2 billion during the second quarter. Even so, the Treasury cash balance ballooned, and it is expected to reach about $76 billion at the end of June (table).

The Treasury's new auction schedule, announced in May for implementation in July, will shift the supply of securities toward shorter maturities. Gross issuance of three- to five-year securities is expected to be reduced $27 billion in the third quarter; bills and two-year note offerings will rise a comparable amount. The new mix of securities is expected to stabilize the average maturity of the public debt at about forty-four months, up two months from a year earlier.

The latest round in the Asian turmoil resulted in a decline of foreign official holdings of U.S. Treasury securities as central banks sold Treasury securities in connection with attempts to defend the parities of their domestic currencies. Since the end of March, foreign official holdings of U.S. Treasury securities in custody at the New York Fed have fallen about $15 billion.

Spreads between non-callable federal agency securities and Treasury securities have held steady over the intermeeting period, ranging from 18 to 35 basis points depending on the issuer. As the supply of Treasury debt has contracted, the agencies have moved to satisfy the demand for highly liquid, low-risk debt instruments by issuing non-callable notes.[1] The funds raised have been used to increase the agencies' portfolio holdings of mortgage assets.

The Congress and the Administration have reached a temporary agreement on federally backed student loans that would extend the program through the summer, allowing students to line up financing for the fall semester. This financing had been threatened by a disagreement over the extent of federal government subsidy. The compromise lowers the rate on student loans for three months. The lender's rate will be set at the three-month bill rate plus 280 basis points; the borrower's rate would be half a percentage point lower, with the federal government funding the difference.

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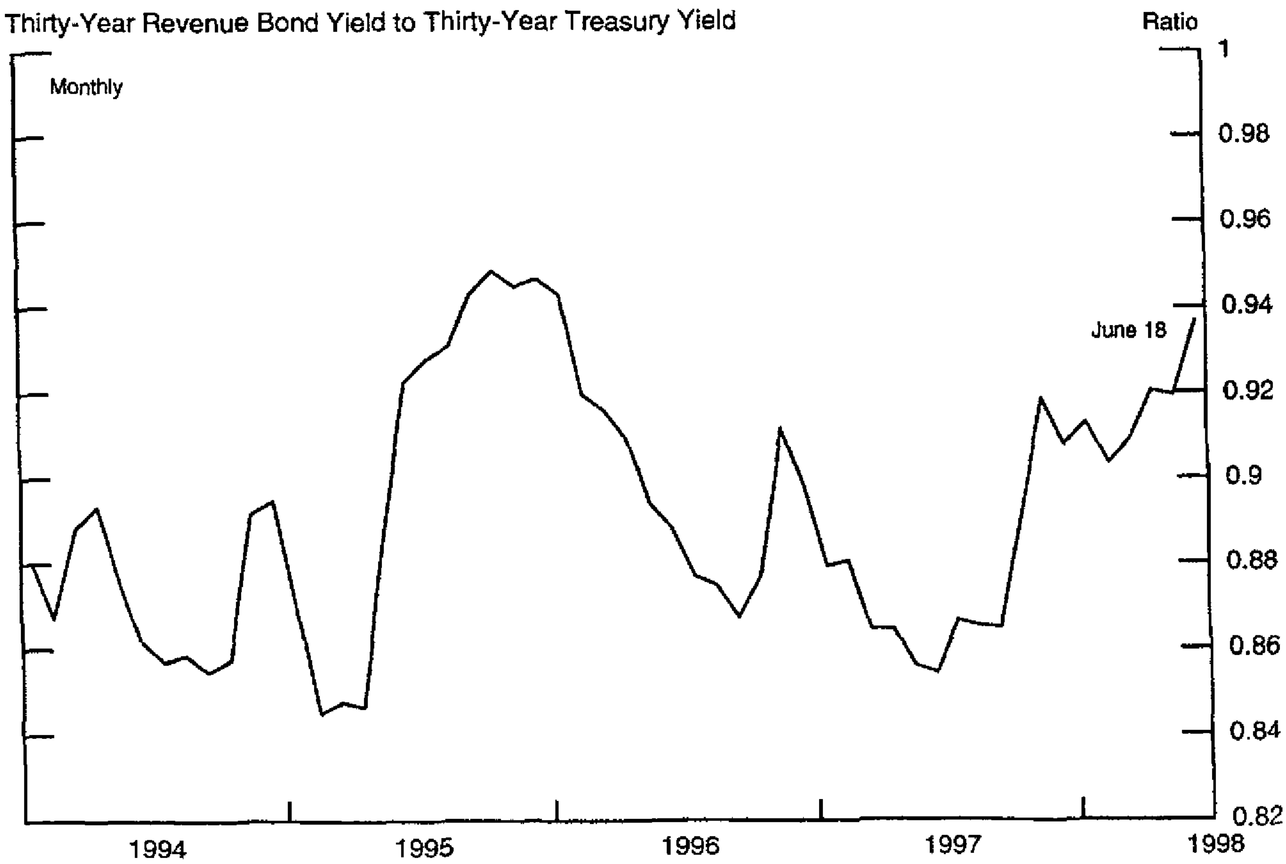
1. For example, Fannie Mae expanded the offerings of its Benchmark Notes on June 3 when it issued $3-1/2 billion in seven-year notes, a new maturity for the program and the first time they have issued at a maturity at which the Treasury does not borrow. (The U.S. Treasury discontinued selling seven-year notes in 1992.) Since January, FNMA has issued $20 billion of three-, five-, and ten-year notes. In April, Freddie Mac held the first quarterly auction of its Reference Notes, issuing $5 billion of ten-year notes.

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

	1995	1996	1997	1997	1998			
				Q4	Q1	Mar.	Apr.	May
Total tax-exempt	15.4	17.9	21.5	24.0	23.3	28.9	21.5	23.6
Long-term	12.1	14.3	17.9	21.1	22.0	27.9	20.3	22.9
Refundings[1]	3.6	4.9	6.6	8.0	9.5	12.7	7.7	7.6
New capital	8.5	9.4	11.3	13.1	12.5	15.1	12.6	15.3
Short-term	3.3	3.6	3.6	2.9	1.3	1.1	1.3	0.8
Total taxable	0.7	0.8	1.1	0.9	1.3	2.2	0.8	0.9

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

Tax-Exempt to Taxable Yield Ratio



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

Municipal Finance

Long-term municipal bond rates fell 12 basis points during the intermeeting period, somewhat less than yields of comparable Treasuries, pushing the municipal-over-Treasury-bond ratio to a two-year high (chart). The increase in the ratio represents a continuation of a trend that began in mid-1997 when Treasury yields began falling. As interest rates have fallen, investors have priced into outstanding municipal securities the increased likelihood of calls or advanced refundings. The recent increase of the ratio can also be attributed to the market's difficulty in absorbing a large volume of new issues. Indeed, gross long-term municipal issuance increased to $23 billion in May, up from the already robust $20 billion in April (table). Issuance continued at a strong pace in the first two weeks of June.

Offerings representing financing for new expenditures remained strong in May. Funding needs for education facilities by universities and local school districts and for the acquisition of health facilities by nonprofit organizations continued to buoy issuance; in May, such funding represented $4 billion of the total amount raised. In addition, last month's issuance included a $3.4 billion offering by the Long Island Power Authority (LIPA), a municipal authority created to take over the privately owned Long Island Lighting Company (LILCO). By reducing the interest payments on the LILCOs' outstanding debt, a large part of which was acquired to finance its now defunct nuclear power plants, LIPA will be able to reduce the utility rates paid in the region.

Municipal debt refundings dropped off in April and May from the strong pace earlier in the year. However, with interest rates down further in early June, refunding issuance has begun to pick up again.

Credit quality of municipal debt continues to improve, reflecting the stronger fiscal positions of many state and local governments. Upgrades by Moody's have been outpacing downgrades by approximately six to one, a ratio that has persisted since early 1997.

Money, Mutual Funds and Bank Credit

The broad monetary aggregates slowed significantly in May. M2 grew at just a 2-1/4 percent pace (table), down from the 8-1/2 percent annual rate posted over the first four months of the year. The recent pattern of M2 growth reflects unusual flows associated with tax payments: Households built up larger-than-seasonal balances in April to meet sizable nonwithheld obligations, and these balances then ran off in May

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1997	1997 Q4	1998 Q1	1998 Mar.	1998 Apr.	1998 May (p)	1997:Q4 to May 98 (p)	Level (bil. $) May 98 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-1.2	.9	3.0	5.1	-1.6	-1.7	1.7	1078.2
2. M2[2]	5.7	7.1	8.0	8.3	9.1	2.3	7.4	4171.3
3. M3	8.8	10.0	11.2	14.8	10.5	6.0	10.7	5608.2
Selected Components								
4. Currency	7.5	8.7	8.0	3.9	3.6	5.3	6.5	435.6
5. Demand deposits	-2.0	-3.7	-1.7	-2.1	-11.7	2.2	-2.8	388.1
6. Other checkable deposits	-12.2	-4.7	2.4	19.6	4.8	-18.7	1.1	246.6
7. M2 minus M1[3]	8.4	9.4	9.8	9.4	12.9	3.8	9.5	3093.1
8. Savings deposits	9.9	12.2	12.0	11.9	21.8	2.5	12.3	1471.0
9. Small time deposits	2.3	1.6	.6	-2.1	-3.7	-5.1	-1.4	961.5
10. Retail money market funds	16.0	16.0	19.6	21.6	18.0	19.8	20.7	660.6
11. M3 minus M2[4]	19.5	19.2	21.1	34.5	14.7	16.9	20.8	1436.9
12. Large time deposits, net[5]	17.1	9.1	19.0	38.1	-3.5	3.7	15.7	611.4
13. Institution-only money market mutual funds	21.0	22.0	18.9	22.5	51.7	38.7	29.1	422.0
14. RPs	17.0	38.3	32.7	88.5	-2.8	6.5	25.8	258.4
15. Eurodollars	31.2	24.4	16.9	-36.8	22.4	28.8	10.9	145.1
Memo								
16. Sweep-adjusted M1[6]	6.1	7.1	6.5	7.8	5.1	1.8	5.7	1355.5
17. Monetary base	5.9	7.9	6.9	4.1	3.4	4.8	5.5	489.2
18. Household M2[7]	6.6	7.7	9.3	10.0	9.3	3.7	8.8	3784.1
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
19. Large time deposits, gross	11.2	8.4	8.5	17.5	-4.5	2.9	. . .	714.2
20. Net due to related foreign institutions	-3.4	-3.8	7.1	-21.9	-27.0	-6.0	. . .	168.1
21. U.S. government deposits at commercial banks	.2	.8	-.4	6.4	4.8	14.2	. . .	40.9

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

p--Preliminary.

Net Sales of Selected Long-Term Mutual Funds
(Excluding Reinvested Distributions)
(Billions of dollars; quarterly and annual data at monthly rate)

			1997		1998			Memo:
	1996	1997	Q3	Q4	Q1	Apr.	May.[e]	Apr. Assets
Total Long-Term Funds	**19.3**	**22.7**	**26.9**	**24.1**	**30.1**	**31.9**	**30.0**	**3,910**
Equity Funds	**18.0**	**19.0**	**21.8**	**17.8**	**20.5**	**26.6**	**18.9**	**2,795**
Domestic	14.1	15.8	18.3	17.9	18.8	22.0	15.5	2,384
Growth	8.3	7.9	10.6	9.8	8.7	12.0	8.0	1,274
Income	5.8	7.9	7.7	8.0	10.2	9.9	7.6	1,110
International	4.0	3.1	3.5	-0.1	1.6	4.6	3.4	411
Hybrid Funds	**1.0**	**1.4**	**1.5**	**1.3**	**2.3**	**1.0**	**1.3**	**352**
Bond Funds	**0.2**	**2.4**	**3.7**	**5.1**	**7.3**	**4.4**	**9.7**	**763**
Taxable	0.7	2.3	3.0	4.3	6.2	3.8	6.5	488
Global	-0.2	-0.1	-0.1	-0.1	0.0	0.1	-0.1	26
High-yield	1.0	1.4	1.6	1.7	2.5	0.9	1.6	119
Government	-1.1	-0.8	-0.8	0.2	0.4	-0.3	0.4	132
Other	1.0	1.8	2.3	2.5	3.3	3.1	4.6	210
Municipals	-0.5	0.1	0.7	0.8	1.2	0.5	3.2	276

Source. Investment Company Institute (ICI).
e Staff estimates.

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

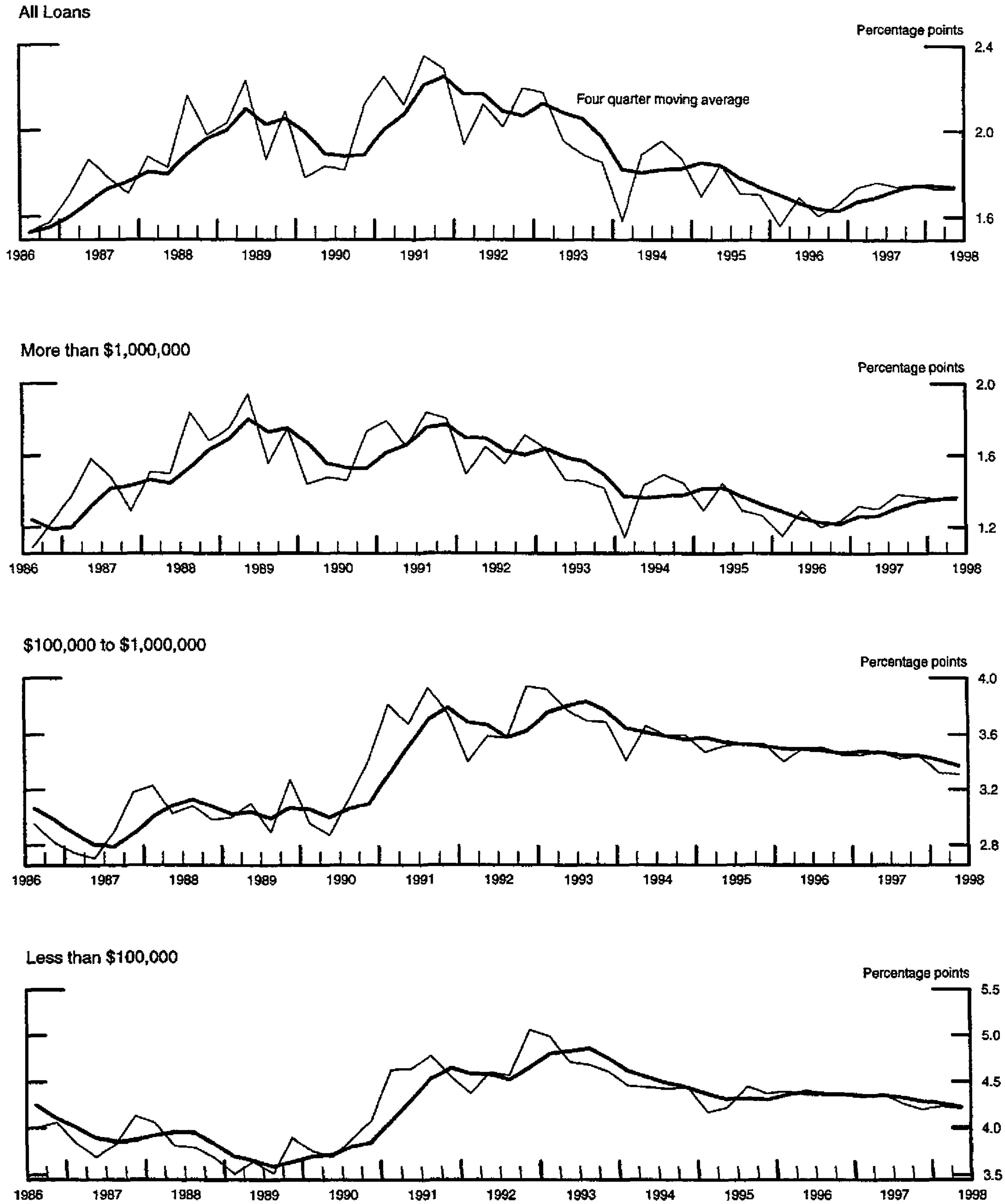
Type of credit	1997	1997 Q4	1998 Q1	1998 Mar	1998 Apr	1998 May	Level, May 1998 (billions of $)
1. Bank credit: Reported	8.9	8.1	11.8	10.9	-4.0	8.9	4,234.3
2. Adjusted[1]	8.4	8.6	11.3	12.0	-2.8	8.5	4,141.9
3. Securities: Reported	10.2	13.3	17.1	19.9	-21.6	16.8	1,122.2
4. Adjusted[1]	8.5	16.1	15.8	25.5	-18.4	16.1	1,029.8
5. U.S. government	6.2	11.6	15.8	18.1	-26.8	11.5	769.3
6. Other[2]	20.4	17.2	20.1	23.9	-10.0	28.5	352.9
7. Loans[3]	8.4	6.3	9.9	7.6	2.4	6.0	3,112.1
8. Business	8.8	8.4	10.1	2.2	-2.3	10.9	876.7
9. Real estate	9.1	6.3	7.4	10.9	8.1	1.3	1,269.1
10. Home equity	15.4	10.6	4.9	1.2	3.7	-6.1	98.1
11. Other	8.5	5.9	7.5	11.6	8.6	2.0	1,171.0
12. Consumer: Reported	-1.4	-7.0	-3.4	-2.1	-13.1	0.0	496.6
13. Adjusted[4]	4.2	5.3	3.9	1.0	4.4	10.0	725.7
14. Other[5]	19.8	19.0	32.7	19.4	12.8	16.1	469.7

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

Commercial and Industrial Loan Rates at Domestic Banks

(Spreads over intended federal funds rate, by loan size)



Source. Survey of Terms of Business Lending. The most recent quarterly survey occurred May 4-8, 1998.

when tax checks cleared. Smoothing through the monthly fluctuations, M2 slowed to an average annual growth rate of about 5-3/4 percent in April and May, putting the year-to-date annual growth rate at 7-1/2 percent. Data for the first two weeks of June suggest that M2 is continuing to decelerate somewhat.

M3 growth moderated from the double-digit levels it registered over the first four months of this year, to 6 percent in May. The slowdown in M3 was entirely due to components in M2, as the non-M2 part of M3 accelerated to a 17 percent growth rate. The institution-only money market mutual fund and Eurodollar components recorded particularly large advances of nearly 40 percent and 30 percent at annual rates, respectively. M3 is up 10-3/4 percent (annual rate) in May from the fourth quarter of 1997, also well above the upper limit of its annual range.

The staff estimates that net sales of long-term mutual funds in May continued near the $30 billion monthly pace of the first four months of this year (table). However, the composition of flows shifted more toward bond funds; both taxable and tax-exempt bond funds picked up.[2] Sales of equity funds--most notably domestic growth funds--slowed. Growth of international funds also dropped off, in part reflecting continued outflows from Asian and Latin American funds.

Bank credit expanded at an 8-1/2 percent annual rate in May, adjusted for mark-to-market accounting effects (table). The rise in May more than reversed a moderate decline in April but was still shy of the 11-1/4 percent rate of increase posted in the first quarter. Increases in securities holdings resumed in May, and total loan growth strengthened.

Business loan growth, which had been weak in March and April as banks issued collateralized loan obligations and nonfinancial firms repaid loans from the proceeds of stock and bond sales, moved up at an 11 percent annual pace in May. Bank competition for business loans remains intense. The May Survey of Terms of Business Lending at banks indicated that, for large loans in recent quarters, spreads over the intended funds rate have widened, but on net, they remain low relative to the past ten years. Spreads on small and medium-sized loans have yet to return to the low levels recorded in the late 1980s, but they have narrowed gradually since 1993 (chart).

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2. Inflows to municipal bond funds and to domestic equity funds were boosted in May by the conversion of about $8 billion of assets directly held in bank trust funds to mutual funds. Such transactions tend to be lumpy, but on average they have added about $2 billion to monthly mutual fund flows over the past year or two.

Real estate loans at banks expanded at a 1-1/4 percent annual rate in May, likely held down by securitizations of refinanced home mortgage loans booked in previous months. Consumer loans were about unchanged in May after dropping 13 percent in April; after adjusting for securitizations, however, consumer loans were up at a strong 10 percent annual rate.

INTERNATIONAL DEVELOPMENTS

International Developments

U.S. International Trade in Goods and Services

In the first quarter, the U.S. nominal trade deficit in goods and services was substantially larger than in any quarter of 1997, as exports fell and imports rose. NIPA real net exports fell sharply, yielding a negative contribution to real GDP growth of an estimated 2-1/4 percentage points. For April, the nominal deficit widened to $14.5 billion as exports declined more than imports.

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

		Annual rates			Monthly rates		
	1997	1997		1998	1998		
		Q3	Q4	Q1	Feb	Mar	Apr
Real NIPA 1/							
Net exports of G&S	-146.5	-164.1	-159.1	-214.7	...	...	...
Nominal BOP							
Net exports of G&S	-113.7	-108.4	-113.8	-139.5	-11.7	-13.2	-14.5
Goods, net	-199.0	-197.2	-199.4	-222.8	-18.1	-20.5	-21.5
Services, net	85.3	88.8	85.5	83.3	6.4	7.3	7.0

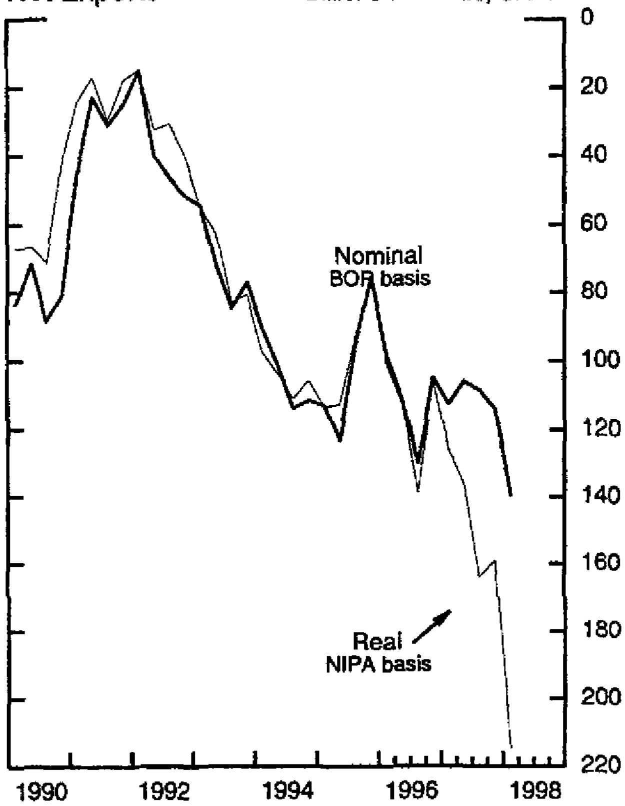
1. In billions of chained (1992) dollars.
Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

In the first quarter, the value of exports was 1-1/4 percent less than in the fourth quarter. The largest decreases were in machinery, industrial supplies, and agricultural products. Much of the decline in goods exports was to countries in Asia, particularly Korea. Exports in April were 2-1/2 percent less than in March. The largest decline was in exports of aircraft from relatively high levels in the previous month; there were smaller decreases recorded for exports of industrial supplies.

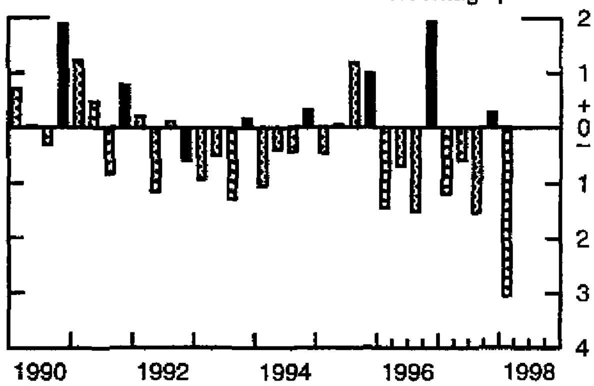
In the first quarter, the value of imports was 1-1/4 percent higher than in the fourth quarter. Increases were recorded across most major trade categories. The value of oil imports dropped sharply in the first quarter because of declining prices; the quantity of oil imported rose slightly. The value of imports in April was 1 percent less than in March. Most of the decline was in imports of capital goods and automotive products that was only partly offset by an increase in imported oil (entirely due to a rise in quantity).

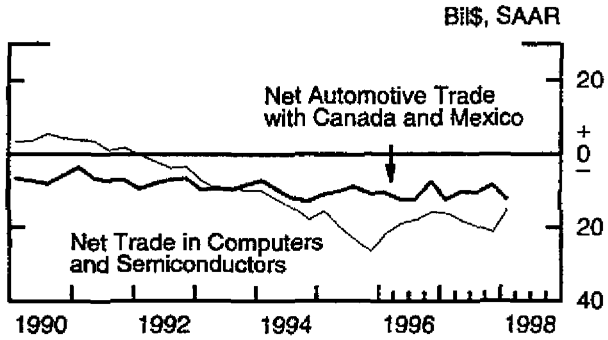
U.S. International Trade in Goods and Services

Net Exports

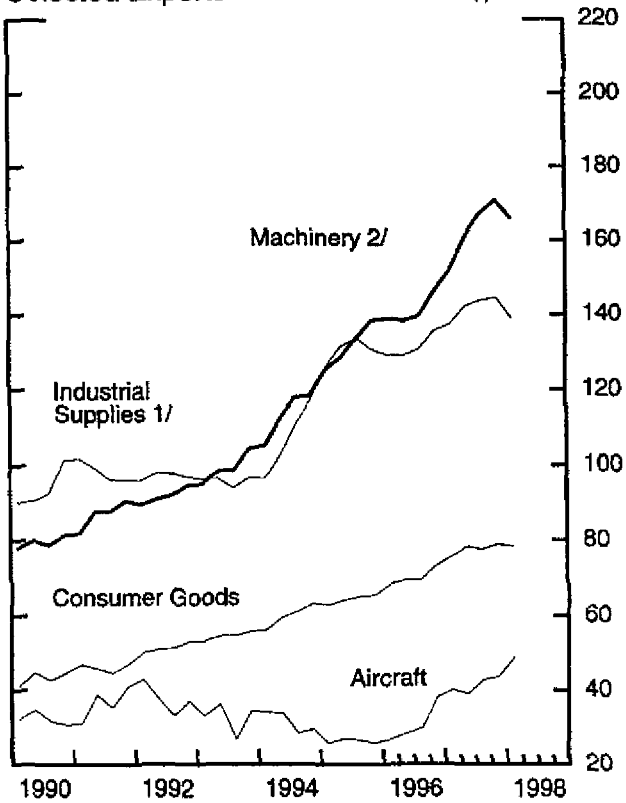


Contribution of Net Exports to Real GDP Growth



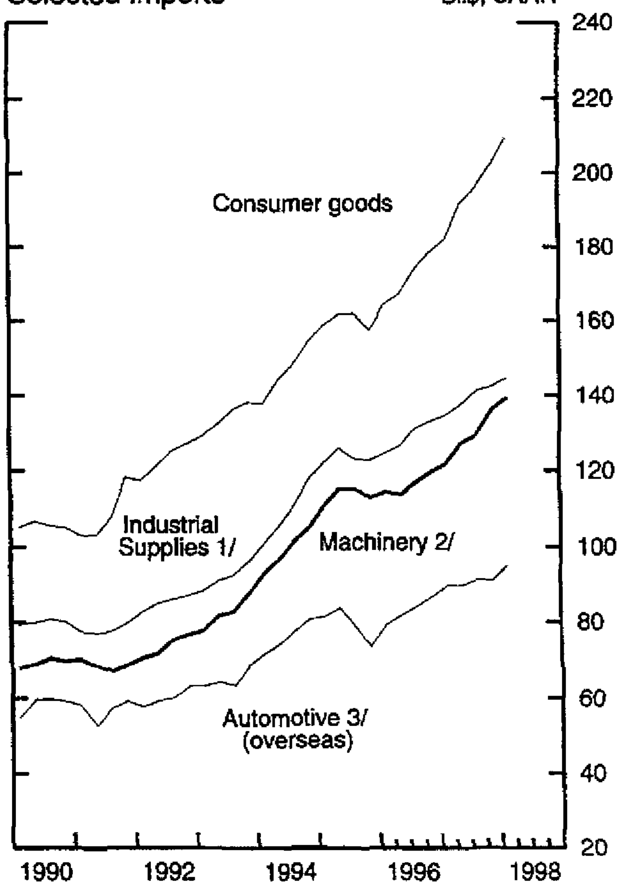


Selected Exports



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

Selected Imports



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

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

	Levels				Amount Change 1/			
	1997	1998	1998		1997	1998	1998	
	Q4	Q1	Mar	Apr	Q4	Q1	Mar	Apr
Exports of G&S	957.8	945.6	949.8	925.3	6.1	-12.2	17.6	-24.4
Goods exports	697.1	685.9	686.6	663.4	7.9	-11.3	10.4	-23.2
Agricultural	60.5	56.4	55.0	53.3	3.2	-4.1	-2.0	-1.7
Gold	3.4	5.3	4.9	3.5	-0.0	1.9	1.1	-1.4
Other goods	633.2	624.2	626.7	606.6	4.7	-9.0	11.3	-20.1
Aircraft & pts	43.6	48.8	50.0	39.0	0.8	5.3	4.8	-11.0
Computers	49.1	45.5	43.4	44.4	-2.8	-3.6	-2.8	1.0
Semiconductors	38.7	37.8	36.2	36.3	-1.5	-1.0	-2.3	0.1
Other cap gds	173.6	168.5	169.0	166.2	4.4	-5.1	1.2	-2.8
Automotive	76.6	77.7	78.9	77.9	1.8	1.1	2.7	-1.0
to Canada	41.3	40.8	42.6	42.0	1.7	-0.5	1.2	-0.6
to Mexico	13.3	13.2	14.0	14.8	2.0	-0.1	0.0	0.8
to ROW	22.0	23.7	22.3	21.1	-1.9	1.8	1.5	-1.2
Ind supplies	144.5	138.8	139.4	135.8	0.8	-5.7	2.0	-3.6
Consumer goods	78.8	78.3	78.6	79.5	1.3	-0.4	1.5	0.9
All other	28.3	28.8	31.2	27.6	-0.1	0.4	6.7	-3.6
Services exports	260.7	259.7	263.2	262.0	-1.8	-1.0	7.2	-1.2
Imports of G&S	1071.7	1085.1	1108.3	1098.8	11.5	13.4	35.4	-9.4
Goods imports	896.5	908.7	932.6	921.1	10.1	12.2	39.0	-11.6
Petroleum	68.6	54.9	51.2	57.8	-1.7	-13.7	-3.1	6.6
Gold	3.8	6.7	7.9	5.0	0.8	2.9	3.4	-2.9
Other goods	824.1	847.1	873.5	858.3	10.9	23.0	38.7	-15.2
Aircraft & pts	18.1	17.9	21.5	19.7	-0.9	-0.2	5.3	-1.8
Computers	70.9	72.4	74.3	70.7	-1.9	1.5	2.5	-3.5
Semiconductors	37.7	36.9	35.3	34.7	-0.0	-0.9	-3.0	-0.6
Other cap gds	138.1	141.8	145.9	142.5	6.7	3.7	5.5	-3.4
Automotive	141.0	148.0	155.7	146.0	-0.7	6.9	9.4	-9.7
from Canada	49.9	53.1	55.1	53.8	-0.4	3.1	2.7	-1.3
from Mexico	27.9	27.2	32.3	28.7	2.3	-0.7	7.8	-3.6
from ROW	63.2	67.7	68.3	63.5	-2.5	4.5	-1.0	-4.8
Ind supplies	142.3	144.5	145.1	147.2	1.1	2.2	1.6	2.1
Consumer goods	202.1	209.1	218.6	219.7	6.2	7.1	16.1	1.1
Foods	40.2	41.7	42.6	40.8	-0.3	1.5	0.4	-1.7
All other	33.6	34.8	34.5	37.0	0.7	1.2	0.9	2.5
Services imports	175.2	176.4	175.6	177.8	1.4	1.2	-3.6	2.1
Memo:								
Oil qty (mb/d)	10.69	10.83	11.01	12.58	-0.26	0.13	0.35	1.56
Oil price ($/bbl)	17.67	13.90	12.73	12.58	0.11	-3.77	-1.23	-0.15

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

Oil imports and prices. The quantity of imported oil rose to a rate of 10.83 mb/d in the first quarter of 1998 . Oil imports rose sharply in April, primarily due to an acceleration in stockbuilding; surprisingly strong consumption also contributed to the sharp increase. Preliminary Department of Energy statistics indicate that oil imports remained strong again in May, due to a large accumulation of stocks; oil consumption returned closer to its April rate.

For the first quarter, the price of imported oil dropped by about 21 percent, the largest decrease since the first quarter of 1991. Prices began declining sharply in November in response to increased production from Saudi Arabia, Kuwait, and the United Arab Emirates, to weak demand in Asia, to relatively warm weather in the northern hemisphere, and to the resumption of oil production for export by Iraq. The price of imported oil then rose slightly in April and May, following cuts in production by OPEC and non-OPEC countries. After trading in a range of $14.75 to $16.50 per barrel during April and May, the spot price for WTI plunged during June--WTI traded briefly below $12/b--following reports of surprisingly high levels of oil stocks and a sharp downward revision in estimates of Asian oil consumption during the first quarter of 1998Q1. The spot price has rebounded on news of further cuts in production by major oil producers. Currently, WTI is trading at just under $15/b.

Prices of non-oil imports and exports. Prices of U.S. non-oil imports decreased 0.3 percent in May, the same amount as in April. This decline was attributable to decreases in all major trade categories with the exception of consumer goods and industrial supplies, which remained unchanged from their April levels. For April-May combined, import prices declined 3-1/4 percent (AR) relative to their first-quarter levels.

Prices of total exports rose 0.1 percent in May, after falling for five consecutive months. This increase was mainly attributable to an increase in prices of agricultural exports. Prices for most other major trade categories decreased; the exceptions were prices of automotive products and capital goods other than computers and semiconductors, which remained unchanged. For April-May combined, export prices declined 2-1/2 percent (AR) relative to their first-quarter levels.

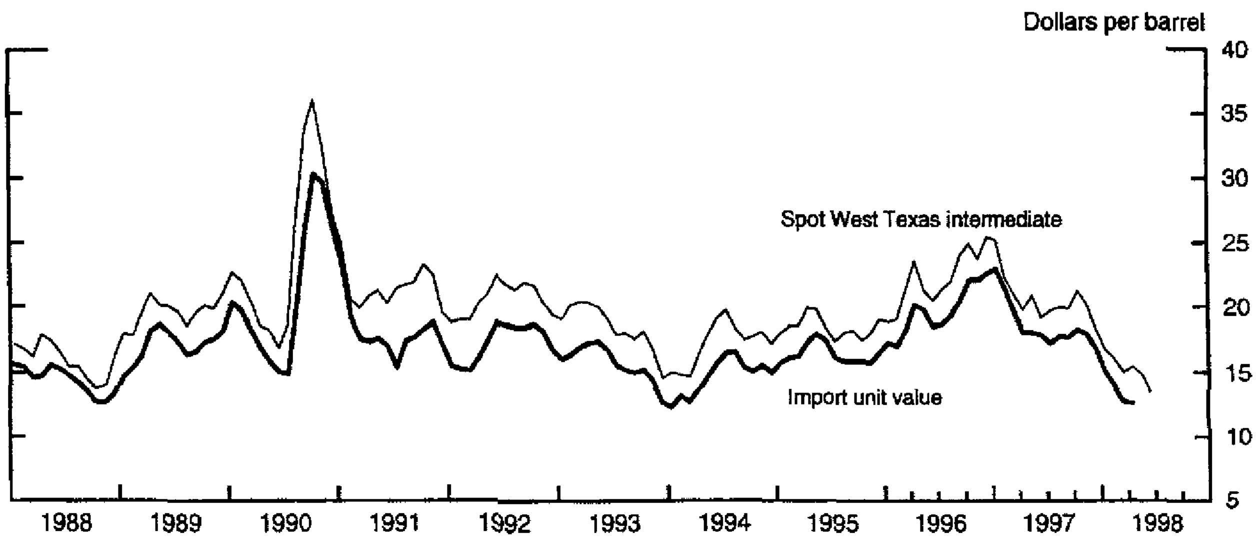
PRICES OF U.S. IMPORTS AND EXPORTS
(Percentage change from previous period)

	Annual rates			Monthly rates		
	1997	1998		1998		
	Q4	Q1	Q2e/	Mar	Apr	May
	-----------BLS prices (1995=100)-----------					
Merchandise imports	-2.0	-11.6	-4.9	-0.8	-0.3	-0.1
Oil	7.1	-61.6	-24.3	-9.1	1.2	1.4
Non-oil	-2.7	-5.3	-3.3	-0.3	-0.3	-0.3
Core goods	-0.8	-3.8	-2.1	-0.2	-0.2	-0.2
Foods, feeds, bev.	-4.5	-5.1	-0.2	-0.1	0.8	-0.9
Ind supp ex oil	-1.4	-11.1	-2.9	-0.2	-0.3	0.0
Computers	-17.7	-17.3	-18.1	-1.9	-2.0	-2.1
Semiconductors	-15.3	-16.7	-5.4	0.1	-0.7	0.1
Cap. goods ex comp & semi	-2.1	-3.2	-2.3	-0.1	-0.3	-0.2
Automotive products	1.3	-0.1	-0.3	0.1	-0.1	-0.1
Consumer goods	-0.8	-1.1	-2.9	-0.6	-0.4	0.0
Merchandise exports	-2.9	-5.0	-2.6	-0.3	-0.4	0.1
Agricultural	-6.4	-15.7	-6.5	-0.6	-1.2	0.9
Nonagricultural	-2.4	-3.7	-2.1	-0.3	-0.2	-0.1
Core goods	-1.0	-3.5	-1.7	-0.2	-0.1	-0.1
Ind supp ex ag	-5.2	-9.0	-4.4	-0.9	-0.3	-0.2
Computers	-7.6	-10.7	-8.6	-1.2	-1.2	-0.3
Semiconductors	-14.4	-6.6	-6.3	-1.4	-0.5	-0.2
Cap. goods ex comp & semi	-0.3	0.0	-0.0	0.1	-0.1	0.0
Automotive products	0.1	-0.1	0.3	0.0	0.1	0.0
Consumer goods	1.2	-0.5	-0.8	0.0	-0.3	0.2
	--Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	-2.1	-11.3	n.a	...	...	...
Non-oil merchandise	-3.4	-6.8	n.a	...	...	...
Core goods	-0.6	-3.5	n.a	...	...	...
Exports of gds & serv.	-2.1	-4.9	n.a	...	...	...
Nonag merchandise	-3.2	-5.5	n.a	...	...	...
Core goods	-0.8	-2.4	n.a	...	...	...

/ Excludes computers and semiconductors.
e. Average of two months.

June 23, 1998

Oil Prices



U.S. Current Account

The U.S. current account deficit increased $8.6 billion (SAAR) in the first quarter of 1998. A substantial increase in the deficit on trade in goods and services more than offset an increase in net investment income and an increase in net unilateral transfers. The jump in the trade deficit reflected both a drop in exports and an increase in imports. The rise in net investment income was primarily due to larger receipts from U.S. assets held abroad, while payments on foreign assets in the United States were virtually unchanged. The increase in net unilateral transfers in the first quarter reflected lower U.S. government grant disbursements, which were boosted in the fourth quarter by the annual payment of grants to Israel.

As is customary each June, estimates of U.S. international transactions were revised to incorporate updated source data and improved methodologies. These revisions lowered the deficit $10 to $14 billion in 1994 through 1997 and had much smaller effects on the deficit in 1986 through 1993. The revisions to annual data affected mostly estimates of capital flows, as well as income payments and receipts. In addition, the quarterly pattern of trade was revised substantially, as seasonal factors were revised. The largest adjustment was to exports of civilian aircraft, which are are now seasonally adjusted. The effects of the revised seasonals was to largely eliminate the amount of "residual" seasonality in total goods exports.

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

	Goods & services balance	Investment income, net	Transfers, net	Current acct balance
Years				
1996	-108.6	14.2	-40.6	-134.9
1997	-110.2	-5.3	-39.7	-155.2
Quarters				
1997-1	-112.5	0.1	-35.5	-148.0
2	-106.1	1.8	-36.1	-140.4
3	-108.4	-6.2	-37.8	-152.4
4	-113.8	-17.0	-49.3	-180.2
1998-1	-139.4	-12.5	-36.9	-188.8
Memo:				
$ Change				
Q3-Q2	-2.4	-8.0	-1.6	-12.0
Q4-Q3	-5.4	-10.8	-11.6	-27.8
Q1-Q4	-25.6	4.5	12.5	-8.7

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

U.S. International Financial Transactions

Led by almost $25 billion in net purchases of U.S. corporate and other bonds, foreign net purchases of U.S. securities were very strong in April (lines 4 and 4b of the Summary of U.S. International Transactions table). By contrast, net purchases of Treasuries and corporate stocks were modest (lines 4a and 4c). A contributing factor to April's surge in bond purchases by foreigners was probably the very high level of new offerings of Eurobonds by U.S. corporations; offerings were much lower in May. About half the net bond purchases were made in the United Kingdom; Japanese residents increased their holdings by almost $3 billion.

Although net foreign purchases of both Treasuries and corporate stocks were low in April, holdings by residents of various countries changed markedly. Japanese residents reversed their net sales of the first quarter and picked up over $7 billion in U.S. Treasury obligations. On the other hand, residents of the Netherlands Antilles, the British West Indies, and Bermuda (presumably hedge funds) sold almost $10 billion in Treasuries (mostly bonds and notes). The modest net foreign purchases of U.S. stocks reflected purchases of over $7 billion by investors in Europe and Japan and sales of more than $3 billion in the Netherlands Antilles and Bermuda.

Almost all of the U.S. net purchases of foreign securities in April were in the form of bonds (lines 5 and 5a). $4.5 billion of this total was in Korean bonds, the probable result of the flotation of several new issues by the Korean government.

Foreign official reserve assets held in the United States changed little on net in April (line 1); however, G-10 reserves fell substantially, primarily because of Japanese intervention operations (line 1a). Brazilian and Korean reserves increased significantly. Preliminary information from FRBNY shows little change in custody holdings for foreign official institutions in May.

Recently released (preliminary) BOP data for the first quarter show a continuation of robust direct investment capital outflows and inflows (lines 6 and 7). Both are down somewhat from the (revised) figures for the fourth quarter of 1997, but are close to the 1997 average. The statistical discrepancy in the first quarter is virtually zero; the revised figure for 1997 showed nearly $100 billion in unrecorded capital outflows, with half of that total coming in the fourth quarter.

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

	1996	1997	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Mar	1998 Apr
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	127.7	18.4	-4.9	22.4	-26.7	11.9	10.1	-2.0
a. G-10 countries	36.6	1.8	4.6	2.1	-12.6	4.0	3.5	-13.4
b. OPEC countries	15.4	11.8	2.6	3.5	-1.3	-.6	2.4	-.5
c. All other countries	75.7	4.7	-12.1	16.8	-12.8	8.6	4.2	11.9
2. Change in U.S. official reserve assets (decrease, +)	6.7	-1.0	-.2	-.7	-4.5	-.4	-.1	-.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-50.1	34.5	15.5	-1.0	46.1	-5.1	-11.9	8.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	287.2	346.1	97.4	96.4	72.9	76.1	17.9	29.8
a. Treasury securities[3]	155.6	147.3	42.8	35.6	35.4	-1.5	-14.1	2.1
b. Corporate and other bonds[4]	118.9	131.0	33.2	37.1	27.0	47.4	19.2	24.6
c. Corporate stocks	12.7	67.8	21.5	23.7	10.4	30.1	12.8	3.1
5. U.S. net purchases (-) of foreign securities	-110.6	-87.5	-22.8	-40.3	-7.5	-6.3	1.2	-9.6
a. Bonds	-51.4	-47.2	-9.2	-24.6	-8.3	-3.6	2.8	-9.5
b. Stocks	-59.3	-40.2	-13.6	-15.8	.8	-2.7	-1.6	-.2
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-81.1	-121.8	-26.4	-27.5	-35.5	-30.9	n.a	n.a
7. Foreign direct investment in U.S.	77.6	93.4	20.1	19.0	28.5	25.0	n.a	n.a
8. Foreign holdings of U.S. currency	17.4	24.8	4.8	6.6	9.9	.7	n.a	n.a
9. Other (inflow, +)[5]	-80.3	-52.0	-20.3	-16.8	13.8	-24.9	n.a	n.a
U.S. current account balance (s.a.)	-134.9	-155.2	-35.1	-38.1	-45.0	-47.2	n.a	n.a
Statistical discrepancy (s.a.)	-59.6	-99.7	-28.1	-20.0	-52.0	1.1	n.a	n.a

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

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.
2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce
3. Includes Treasury bills.
4. Includes U.S. government agency bonds.
5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

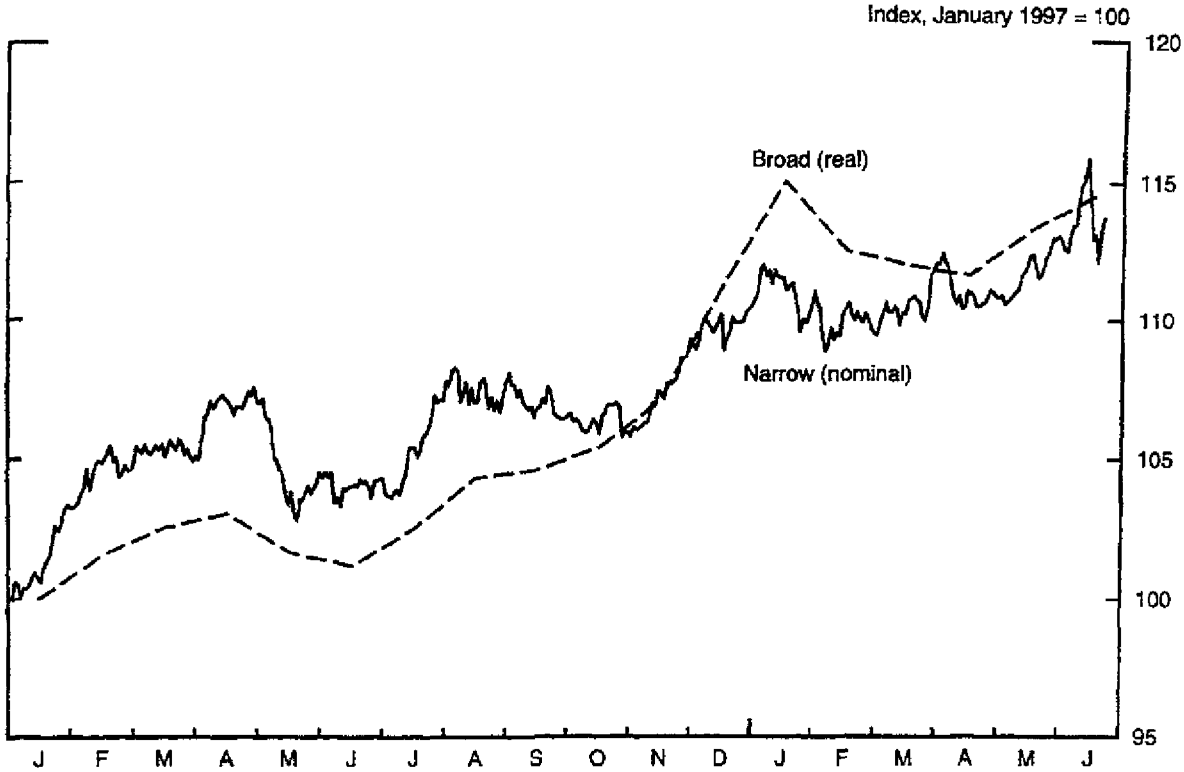
Foreign Exchange Markets

The dollar continued to move up against most major currencies following the May FOMC meeting, but its climb was interrupted on Wednesday June 17, when the Desk conducted joint intervention operations in the foreign exchange market for the United States and Japan. Between the May FOMC meeting and mid-June, the dollar had risen more than 2 percent on a weighted average basis against the major currencies (narrow index). Immediately following the intervention operation, the dollar gave up those gains and more but has since drifted back up to end the period more than 1-1/4 percent higher on balance.

The dollar's overall rise prior to the intervention operations was led by an appreciation of more than 6 percent against the yen. The dollar was boosted against the yen by signs of further deterioration in economic activity in Japan and concerns about the impact of Japan's slide on other Asian economies and the rest of the world. The pace of the dollar's climb picked up following remarks from Treasury Secretary Rubin on June 11, which were interpreted by market participants as an indication that the United States did not intend to assist Japan in dealing with its problems, although the Secretary did state that intervention support had not been taken off the table. Six days later the Desk sold $833 million for the accounts of the Treasury and the System . This was the first operation for U.S. accounts since August 15, 1995. The action, combined with news that high-level U.S. monetary officials were traveling to Japan to discuss its economic problems with Japanese authorities, was seen as signaling that the United States had secured or expected to secure from Japan a commitment to undertake some further significant policy measures to address Japan's flagging activity and weak financial system. As a consequence, the dollar reversed course sharply against the yen. In the days following the operation, however, optimism about prospects for concrete policy developments began to erode, and the dollar ended the period up more than 3 percent on balance against the yen.

The bellwether government bond yield in Japan declined to a record low of 1.19 percent in early June, as prospects for recovery dimmed and the Bank of Japan appeared to be considering the possibility of reducing its official discount rate from the already low level of ½ percent. The yield rebounded, however, with the reversal of the yen, ending the period down only 6 basis points on balance at 1.26 percent. Short-term interest rates in Japan were little changed, and equity prices declined about 1-3/4 percent on net.

Dollar Exchange Rate Indexes



Financial Indicators in Major Industrial Countries

	Three-month rates		Ten-year yields		Equity prices
	June 24	Change	June 24	Change	Change
Canada	5.13	-0.03	5.33	-0.11	-6.38
Japan	0.56	0.01	1.27	-0.06	-1.70
Germany	3.47	-0.07	4.75	-0.25	4.00
United Kingdom	7.69	0.31	5.81	-0.14	-0.89
France	3.45	-0.05	4.82	-0.25	3.95
Italy	5.00	0.00	5.06	-0.20	-3.68
Switzerland	1.81	0.25	3.03	-0.01	3.06
Australia	5.49	0.50	5.61	-0.12	-5.12
Weighted-average foreign	3.64	0.02	4.08	-0.13	
United States	5.60	0.00	5.45[P]	-0.19	-0.08

Note. Change is in percentage points from May 18 to June 24. [P] Preliminary.

The Canadian dollar declined to a record level of C$1.4754 per U.S. dollar near the end of the period. On balance, the Canadian dollar moved down more than 1-1/4 percent against the U.S. dollar, as the weakness in Japan and elsewhere in Asia, along with an associated decline in commodity prices, weighed on the Canadian currency. The Australian dollar also suffered under those influences, reaching a twelve-year low of US$0.5859. While the Australian dollar recovered some with the yen, it still ended the period down 1-1/2 percent against the U.S. dollar.

Sterling rose 2-3/4 percent on balance against the dollar during the intermeeting period, buoyed by a surprise increase on June 4 of 1/4 percentage point in the official RP rate of the Bank of England to 7-1/2 percent and later data releases that fostered expectations of at least one more increase in the near term. The three-month interbank interest rate in the United Kingdom rose 31 basis points during the period. The yield on the ten-year gilt declined 10 basis points, somewhat less than the 20 to 30 basis point declines in yields of comparable securities in the United States and Europe.

The dollar moved only slightly on balance against the continental European currencies, as long-term interest rates in Germany and the United States declined apace. European share prices showed mixed changes, with prices down in the United Kingdom and Italy but up in Germany and France.

Against other important currencies, the dollar firmed about 2 percent on a trade-weighted basis. The most notable change among Asian emerging market currencies was in the value of the Indonesian rupiah, which depreciated more than 20 percent against the dollar during the period. Despite an early firming of the rupiah following the relatively orderly passage of power from President Suharto to his vice-president and the debt exchange agreement reached between Indonesia and creditor banks, the rupiah subsequently moved down sharply with the yen and rising concern about the economic problems of Japan. An easing of short-term interest rates by Bank Indonesia may also have contributed to the decline in the rupiah. By comparison, the declines in other Asian currencies were small at 5 percent or less, and the Korean won firmed 4 percent during the period. The Mexican peso depreciated more than 4 percent against the U.S. dollar, in part in reaction to declining oil prices.

Emerging market equity prices generally continued on their downtrend during the period. Declines on the order of 23 percent occurred in Thailand and Russia, as monetary authorities in the two countries raised interest rates to combat downward pressures on their currencies. Short-term interest rates increased 2 and 4-1/2 percentage points, respectively, in Thailand and Russia, and credit spreads on dollar-denominated debt in the

Financial Indicators in Latin America, Asia, and Russia

	Currency/US dollar		Short-term interest rates		Dollar-denominated bond spread		Equities
	June 23	Change	June 23	Change	June 23	Change	Change
Mexico	8.9100	4.38	19.25	1.87	5.51[b]	0.65	-5.6
Brazil	1.1547	0.64	22.50	-3.20	6.72[b]	0.65	-2.6
Argentina	.9998	0.00	6.45	-0.43	5.99[b]	0.45	-11.7
Chile	454.9	0.20					-6.9
China	8.3100	0.00					2.2
Korea	1386	-4.28	16.10	-1.90	4.98[g]	0.79	-15.5
Taiwan	34.45	1.95	6.90	-0.15			-6.2
Singapore	1.6520	-0.06	6.75	-1.75			-12.3
Hong Kong	7.7438	-0.08	9.05	1.88			-12.7
Malaysia	3.9550	2.86	11.00	0.10	4.07[e]	1.12	-16.9
Thailand	41.25	4.56	24.00	2.00	4.44[y]	1.45	-23.3
Indonesia	14600	24.79	58.45	-1.74	7.57[y]	-0.58	8.8
Philippines	41.00	4.33			3.71[e]	0.34	-20.2
Russia	6.2190	0.63	28.49	4.53	9.33[b]	1.26	-24.2

Note. Change is in percentage points from May 18 to June 23. [b] Stripped Brady bond yield spread over U.S. Treasuries. [g] Global bond yield spread. [e] Eurobond yield spread. [y] Yankee bond yield spread.

two countries rose more than 125 basis points during the period. Double-digit equity price declines also occurred in the Philippines, Malaysia, Hong Kong, Singapore, Korea, and Argentina; smaller declines took place in Mexico, Brazil, and Taiwan during the intermeeting period. In contrast, share prices rose more than 8 percent in Indonesia, supported at least in part by the easier monetary policy stance there.

The Desk sales of $833 million against yen were split evenly between the System and Treasury accounts.

Developments in Foreign Industrial Countries

The Japanese economy appears to have fallen into recession, with economic activity contracting sharply during the first quarter and monthly indicators suggesting a further decline during the second quarter. In contrast, domestic demand in the major European economies expanded strongly during the first quarter, with particular strength in investment.

The Asian crisis, coupled with the intensifying recession in Japan, has significantly weakened the external performance of the foreign industrial countries. Export growth in all of these countries has slowed in recent quarters, while imports have generally remained strong. During the first quarter, external demand made a negative contribution to growth in all countries except Canada. In the major European economies, net exports subtracted 2-3 percentage points from growth.

Inflation in most of these countries remains quiescent. However, in the United Kingdom, consumer prices were up 3.2 percent in May from a year earlier, well above the government's 2-1/2 percent target.

Individual country notes. In **Japan,** first-quarter GDP fell 5.3 percent (SAAR), led by an 18.8 percent plunge in private nonresidential investment. This weakness in investment seems to reflect the high level of uncertainty in the economy and the fact that banks have become more conservative in their lending practices. Private consumption, however, was up slightly from the previous quarter, supported by a temporary tax cut implemented in February. Public demand subtracted almost 1 percentage point from growth, as both government consumption and public investment declined. Imports fell 5.3 percent, but exports dropped 14.2 percent; accordingly, external demand subtracted 1.4 percentage points from growth. The government also revised 1997Q4 GDP growth downward from -0.7 percent to -1.5 percent.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	3.4	-0.4	-10.6	3.2	-1.5	-5.3
Total Domestic Demand	3.3	-2.0	-14.3	3.5	-3.7	-3.9
Consumption	2.4	-0.9	-19.5	7.0	-4.0	0.4
Investment	6.0	-5.4	-10.1	-2.9	-4.3	-12.6
Government Consumption	1.8	0.2	-3.7	2.8	5.6	-2.2
Inventories (contribution)	-0.2	0.2	1.1	0.1	-0.5	0.0
Exports	8.0	8.5	25.1	-5.8	11.3	-14.2
Imports	7.0	-4.5	-8.7	-4.3	-6.5	-5.3
Net Exports (contribution)	0.2	1.6	3.8	-0.3	2.2	-1.4

1. Annual changes are Q4/Q4.

Economic indicators for the second quarter suggest continued weakness in economic activity. Industrial production in April registered its third consecutive month of sharp decline, and labor market conditions deteriorated further. The unemployment rate increased to a post-war high of 4.1 percent, and the offers-to-applicants ratio declined to 0.55, its lowest level since 1978. Wages and total employment were both down slightly from year-earlier levels. Labor market uncertainty appears to be weighing heavily on the household sector, where expenditures fell sharply in April, fully reversing a March rebound. Auto registrations in April and May were down 4 percent (not annualized) from their first-quarter average. Consumer price inflation, net of the effect of fiscal measures, remains near zero.

Japan's trade surplus during the first five months of the year was $109 billion at an annual rate, well above the $83 billion surplus registered in all of 1997. Exports during the first five months (valued in dollar terms) were 7 percent below their 1997 average, but imports dropped a sizable 16 percent. The weakness in exports primarily reflects the impact of the Asian crisis. Exports to Korea, Thailand and Indonesia were all down sharply from a year earlier, while exports to the United States and (particularly) the European Union continued to register strong gains. The weakness in imports is due largely to the ongoing contraction in Japanese private domestic demand.

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

	1997		1998				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Industrial Production	-0.3	-2.3	-1.5	-3.9	-2.3	-1.6	n.a.
Housing Starts	-10.5	0.2	1.1	1.8	-1.3	-5.7	n.a.
Machinery Orders	-0.2	-10.2	-4.2	-4.9	7.5	-9.8	n.a.
New Car Registrations	2.9	-0.0	-7.5	-1.6	1.5	-8.5	8.7
Unemployment Rate (%)	3.4	3.5	3.6	3.6	3.9	4.1	n.a.
Job Offers Ratio[1]	0.73	0.69	0.61	0.61	0.58	0.55	n.a.
Business Sentiment[2]	3	-11	-31	...	...	...	...
CPI (Tokyo area)[3]	1.7	2.1	2.1	2.0	2.2	0.7	0.8
Wholesale Prices[3]	1.7	1.4	-0.4	-1.0	-1.1	-2.7	-1.7

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

In the **Euro area** (the eleven countries scheduled to enter monetary union), domestic demand showed significant strength during the first quarter, but the Asian crisis is beginning to affect economic performance. Net exports subtracted 2-3 percentage points from first-quarter growth in the major European economies, and business confidence slipped in May, owing largely to lower export orders. Area-wide consumer confidence, however, has continued to rise.

Real GDP in **Germany** rose 3.9 percent (SAAR) in the first quarter owing to a 6.3 percent surge in domestic demand, confirming indications in recent quarters that domestic demand has been picking up. The growth of domestic demand was led by significant increases in private consumption and investment spending. Exports continued to expand, although at a less robust pace than in recent years, and the rate of import growth picked up, so that the external sector made a negative contribution to growth.

Indicators for the second quarter suggest that growth may have slowed a bit from the robust pace in the first quarter. Industrial output and business confidence fell in April, while manufacturing orders rose. Conditions in the labor market have continued to improve; the all-German unemployment rate declined further in May to 11.2 percent. Consumer price inflation has remained very low despite the 1 percentage point increase in the value-added tax implemented in April.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	2.1	2.3	3.9	2.9	1.2	3.9
Total Domestic Demand	1.2	1.3	1.4	-0.7	3.1	6.3
Consumption	1.1	0.6	3.8	-3.0	1.8	4.6
Investment	2.4	-0.8	3.0	2.7	0.7	11.0
Government Consumption	0.7	-1.8	3.7	-5.3	-5.9	7.3
Inventories (contribution)	-0.1	1.5	-2.2	1.5	3.0	-0.1
Exports	8.2	11.7	14.6	20.9	5.2	5.1
Imports	4.9	8.1	5.3	7.7	12.1	13.5
Net Exports (contribution)	0.9	1.0	2.5	3.6	-1.8	-2.3

1. Annual changes are Q4/Q4

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

	1997	1998					
	Q4	Q1	Q2	Mar	Apr	May	June
Industrial Production	0.5	2.4	n.a.	0.8	-0.6	n.a.	n.a.
Orders	-0.6	3.5	n.a.	-0.5	0.6	n.a.	n.a.
Unemployment Rate (%)	11.8	11.5	n.a.	11.5	11.3	11.2	n.a.
Western Germany	9.9	9.6	n.a.	9.6	9.5	9.4	n.a.
Eastern Germany	19.6	19.2	n.a.	19.3	19.1	18.7	n.a.
Capacity Utilization[1]	87.0	87.4	n.a.	...	...	...	...
Business Climate[1,2]	17.3	18.3	n.a.	19.0	15.0	n.a.	n.a.
Consumer Prices[3]							
All-Germany	1.8	1.2	n.a.	1.1	1.4	1.3	n.a.
Western Germany	1.7	1.1	1.3	1.0	1.4	1.3	1.2

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

In **France**, real GDP increased 2.2 percent (SAAR) in the first quarter, with domestic demand expanding 4.8 percent. Although private consumption decelerated from the rapid pace of the fourth quarter, it still recorded growth of 2.4 percent, and business investment increased 4.4 percent. Net exports subtracted 2.5 percentage points from growth in the first quarter, as imports surged more than 11 percent and export growth weakened. The major surprise in the release was a 2.2 percentage point contribution from inventories, as inventory levels rebounded from recent lows.

Second-quarter data are limited but suggest that domestic demand has remained firm. Although auto sales in April were down slightly, retail sales at large stores were strong, and consumption of manufactured products rose again in May (up 2.8 percent in the first five months of 1998). INSEE's consumer survey showed that consumer confidence gained momentum in May. Consumer price inflation remains near 40-year lows.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	2.3	3.1	4.7	3.7	3.2	2.2
Total Domestic Demand	1.2	1.7	2.3	3.6	1.9	4.8
Consumption	1.8	2.6	1.2	4.8	3.8	2.4
Investment	-0.2	0.9	5.2	2.6	-0.6	4.4
Government Consumption	2.7	0.7	0.7	0.8	0.9	1.0
Inventories (contribution)	-0.4	-0.1	0.4	0.1	-0.4	2.2
Exports	10.3	13.2	26.1	14.4	7.9	2.9
Imports	6.3	9.0	18.4	15.0	4.1	11.2
Net Exports (contribution)	1.1	1.4	2.4	0.1	1.3	-2.5

1. Annual changes are Q4/Q4.

On May 19, the National Assembly approved the first stage of controversial legislation aimed at reducing the legal work week from 39 to 35 hours beginning in the year 2000. On June 10, the Constitutional Council declared that a challenge to the workweek bill from the opposition was unfounded. The government hopes that a reduced work week will help create new jobs by increasing employment opportunities.

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

	1997		1998				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Consumption of Manufactured Products	2.6	1.4	1.4	-2.8	0.4	1.3	0.4
Industrial Production	1.8	1.7	1.1	0.8	1.9	-0.5	n.a.
Capacity Utilization	84.9	81.2	82.5	...	...	...	...
Unemployment Rate (%)	12.5	12.4	12.2	12.1	12.3	11.9	n.a.
Business Confidence[1]	14.7	17.7	19.7	19.0	23.0	19.0	20.0
Consumer Prices[2]	1.3	1.2	0.7	0.7	0.8	1.0	1.0

1. Percent balance of manufacturing firms citing an improvement in the outlook versus those citing a worsening.
2. Percent change from previous year.

Following negotiations lasting more than a year, the French Finance Ministry recently announced preliminary agreement with the European Commission regarding terms of a bailout of Credit Lyonnaise by the French government. According to the agreement, the ailing bank will sell more than $100 billion of its assets, and the bank will be privatized by October 1999. The Ministry indicated that privatization will be open and non-discriminatory, dispelling concerns that the government would attempt to keep the bank in French hands.

In **Italy**, real GDP declined 0.4 percent (SAAR) in the first quarter, after 0.8 percent growth in the fourth quarter. Domestic demand during the first quarter expanded at a healthy pace as a result of strength in business fixed investment. Net exports contracted due to weaker Asian demand for Italian exports. The first-quarter decline also reflected the fading impact on auto sales of soon-to-expire tax incentives and fewer working days than in the last quarter of 1997.

Second-quarter monthly indicators are mixed. Although industrial production declined further in April, consumer confidence in May soared to its highest level in eight years, while business sentiment and expected future production levels remained high. Inflation remains below 2 percent.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	-0.2	2.6	8.0	1.9	0.8	-0.4
Total Domestic Demand	-1.1	3.7	10.6	-1.5	3.9	2.9
Consumption	0.9	2.0	3.1	1.5	-0.9	0.2
Investment	-2.8	3.3	4.7	3.0	5.7	5.5
Government Consumption	-0.3	-0.1	0.5	0.6	0.5	1.8
Inventories (contribution)	-1.1	1.7	7.3	-3.1	3.2	1.5
Exports	4.0	8.9	39.3	29.7	-4.8	-6.4
Imports	0.5	14.5	60.3	15.9	7.5	6.4
Net Exports (contribution)	0.9	-0.9	-2.2	3.4	-3.1	-3.3

1. Annual changes are Q4/Q4.

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

	1997		1998				
	Q3	Q4	Q1	Mar	Apr	May	June
Industrial Production	0.5	1.3	-0.1	-0.9	-0.2	n.a.	n.a.
Cap. Utilization (%)	77.7	79.0	78.2	...	...	...	...
Unemployment Rate (%)	12.1	12.1	12.1	...	...	...	...
Consumer Confidence[1]	117.2	115.3	118.6	116.3	120.5	124.5	n.a.
Bus. Sentiment[2] (%)	18.0	17.0	32.0	27.0	21.0	n.a.	n.a.
Consumer Prices[3]	1.5	1.6	1.7	1.7	1.8	1.7	1.8

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

In the **United Kingdom**, growth of economic activity slowed further during the first quarter, as a decline in external demand partly offset continued strength in domestic demand. Net exports subtracted nearly 2 percentage points from GDP growth as exports fell sharply. Investment surged 16.3 percent, and consumer expenditure moderated somewhat from the fourth quarter's rapid pace.

Indicators for the second quarter suggest significant variation in growth rates across sectors. In manufacturing, business confidence has fallen sharply in recent months, reflecting concerns about both domestic and export demand. Industrial production picked up in April, owing to an increase in utilities production as temperatures returned to normal following a mild winter, but manufacturing output was essentially unchanged. Survey data, however, suggest that service industries continued to grow strongly in April, and retail sales surged in May. The average volume of retail sales in April and May was 0.5 percent above the first-quarter average.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	2.9	2.9	3.5	3.6	2.5	2.0
Total Domestic Demand	2.8	4.3	5.4	3.4	5.1	5.4
Consumption	4.3	5.1	7.6	2.8	5.9	3.5
Investment	2.6	6.5	10.7	4.4	4.3	16.3
Government Consumption	1.4	0.2	-7.0	10.4	-0.3	-1.8
Inventories (contribution)	-0.5	-0.0	0.2	-0.9	0.6	0.6
Exports	7.1	6.5	13.4	5.7	-0.2	-9.3
Imports	8.0	10.0	20.4	3.9	8.3	-2.2
Net Exports (contribution)	-0.2	-0.9	-1.7	0.4	-2.2	-1.9
Non-oil GDP	2.8	3.0	3.7	2.9	2.9	2.5

1. Annual changes are Q4/Q4.

Conditions in the labor market have tightened further, putting pressure on wages. The official claimant unemployment rate remained 4.8 percent in May, its lowest rate since 1980. Surveys continue to point to skills shortages, and average annual earnings growth accelerated to 5.2 percent in March. The twelve-month rate of British retail price inflation (excluding mortgage interest payments) rose to 3.2 percent in May, well above the 2-1/2 percent target; much of the increase from March's 2.6 percent rise reflects higher food prices and the timing of tax measures imposed in the last budget.

On June 18, the U.K. Government announced that it will set a national minimum wage at £3.60 effective April 1999. A lower "youth" minimum wage, for those aged 18 to 21, will be initially established at £3.00 and scheduled to rise to £3.20 in 2000. The minimum wage is expected to cover about 9 percent of the workforce and to add about 0.5 percentage point to annual earnings growth.

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

	1997		1998				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Industrial Production	1.0	-0.9	-0.2	-0.3	0.6	1.1	n.a.
Retail Sales	1.0	1.4	0.9	-1.2	0.3	-0.1	1.7
Unemployment Rate (%)	5.3	5.1	4.9	4.9	4.9	4.8	4.8
Business Confidence[1]	18.0	13.0	10.7	11.0	12.0	3.0	-2.0
Consumer Prices[2]	2.8	2.8	2.5	2.6	2.6	3.0	3.2
Producer Input Prices[3]	-8.5	-8.9	-10.0	-9.8	-10.1	-9.0	-8.9
Average Earnings[3]	4.3	4.5	4.9	4.9	5.2	n.a.	n.a.

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

In **Canada,** real GDP rose 3.7 percent (SAAR) in the first quarter of 1998. The Canadian economy shook off the negative effects of the January ice storm to maintain the robust average pace of growth recorded over the previous six quarters. Domestic demand edged up only 0.6 percent, as consumer spending grew at a 2.6 percent pace, but fixed investment declined 0.6 percent. Net exports, however, contributed 2.5 percentage points to growth, with exports expanding at a 6 percent rate and imports declining slightly. The strong contribution from the external sector during the first quarter can largely be attributed to rapid U.S. economic growth and the effects of Canadian dollar depreciation.

Monthly indicators point to an acceleration in domestic demand growth and a weakening in net exports in the current quarter. Consumption is supported by strong growth in jobs and income, with employment for the April/May period up 3.1 percent (SAAR) from the first quarter average. With capacity utilization at its highest level since

1988, investment is likely to rebound from weakness in the past two quarters. Building permits indicate strength in construction spending; the decline in housing starts in May partly reflected labor strikes that have since been resolved.

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

	1996	1997	1997			1998
			Q2	Q3	Q4	Q1
GDP	2.0	4.0	4.2	4.3	2.8	3.7
Total Domestic Demand	4.1	4.5	7.0	6.7	3.0	0.6
Consumption	3.0	4.3	4.4	5.0	2.7	2.6
Investment	13.8	6.6	5.3	12.5	0.3	-0.6
Government Consumption	-0.8	0.4	0.9	2.1	-0.7	-0.9
Inventories (contribution)	0.1	0.6	3.1	0.9	1.5	-0.6
Exports	2.6	11.1	0.2	13.6	7.3	5.9
Imports	7.8	13.5	3.1	23.6	9.2	-0.8
Net Exports (contribution)	-1.6	-0.7	-1.0	-3.0	-0.6	2.5

1. Annual changes are Q4/Q4.

Canada's trade surplus narrowed sharply in April. The deteriorating trade balance owed to fallout from the turmoil in Asia, which has weakened exports, as well as to a strengthening of Canadian domestic demand, which has spurred imports. Most notably, Canadian exports to Japan declined 43 percent in April versus the same month a year ago, while imports from Japan increased 20 percent. Canadian exports to the United States and Europe have risen relative to a year ago but by less than the rise in Canadian imports from those countries.

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

	1997		1998				
	Q3	Q4	Q1	Feb	Mar	Apr	May
GDP at Factor Cost	1.2	0.7	0.8	1.0	0.4	n.a.	n.a.
Industrial Production	1.7	0.9	-0.1	2.6	1.3	n.a.	n.a.
Manufacturing Survey:							
Shipments	2.5	0.9	-0.3	3.0	1.0	-0.6	n.a.
New Orders	2.0	1.6	-1.3	0.9	1.0	-0.3	n.a.
Retail Sales	1.7	1.2	0.8	0.9	0.2	n.a.	n.a.
Housing Starts	2.2	0.1	1.8	9.0	4.1	-8.3	n.a.
Employment	0.8	0.4	0.7	0.6	0.1	0.5	-0.0
Unemployment Rate (%)	9.0	8.9	8.7	8.6	8.5	8.4	8.4
Consumer Prices[1]	1.7	1.0	1.0	1.0	0.9	0.8	1.1
Consumer Attitudes[2]	119.5	116.7	118.5	...	...	...	...
Business Confidence[3]	164.9	159.2	155.0	...	...	...	...

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

EXTERNAL BALANCES
(Billions of U.S. dollars, SAAR)

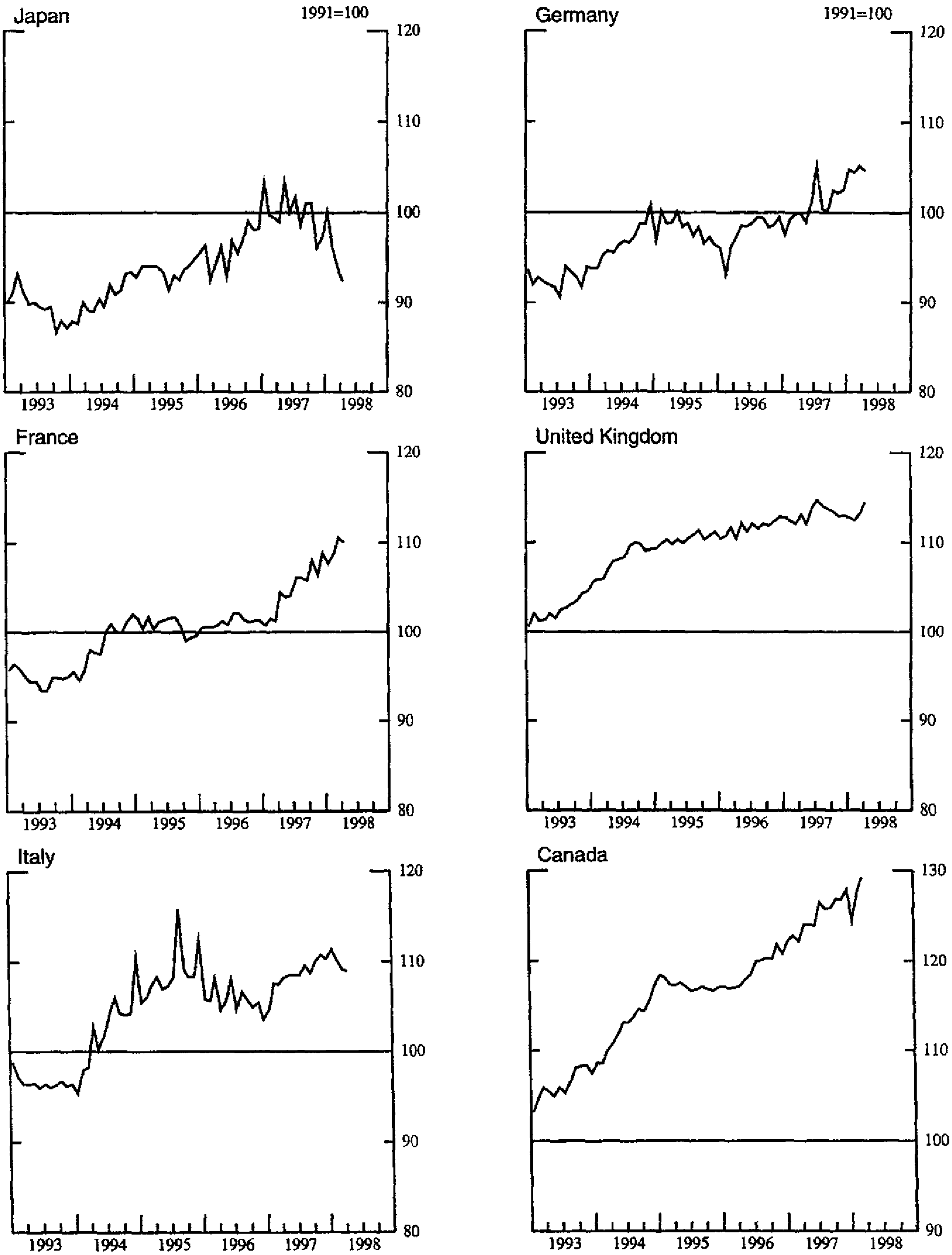
	1997		1998			
	Q3	Q4	Q1	Mar	Apr	May
Japan: trade	88.7	98.8	98.0	83.7	111.8	140.2
current account	99.6	119.2	116.6	103.8	76.5	n.a.
Germany: trade[1]	76.1	79.4	67.5	83.7	75.4	n.a.
current account[1]	-8.9	17.0	-14.0	50.5	15.8	n.a.
France: trade	29.9	31.9	28.1	26.3	n.a.	n.a.
current account	34.0	43.9	35.7	26.0	n.a.	n.a.
U.K.: trade	-18.4	-28.1	-31.5	-30.7	n.a.	n.a.
current account	8.9	0.3	-21.2	...	...	...
Italy: trade	28.6	25.5	n.a.	n.a.	n.a.	n.a.
current account[1]	45.4	37.6	n.a.	n.a.	n.a.	n.a.
Canada: trade	15.0	11.2	13.6	15.3	10.1	n.a.
current account	-19.1	-13.2	-10.8	...	...	...

1. The current account includes goods, services, and private and official transfers.

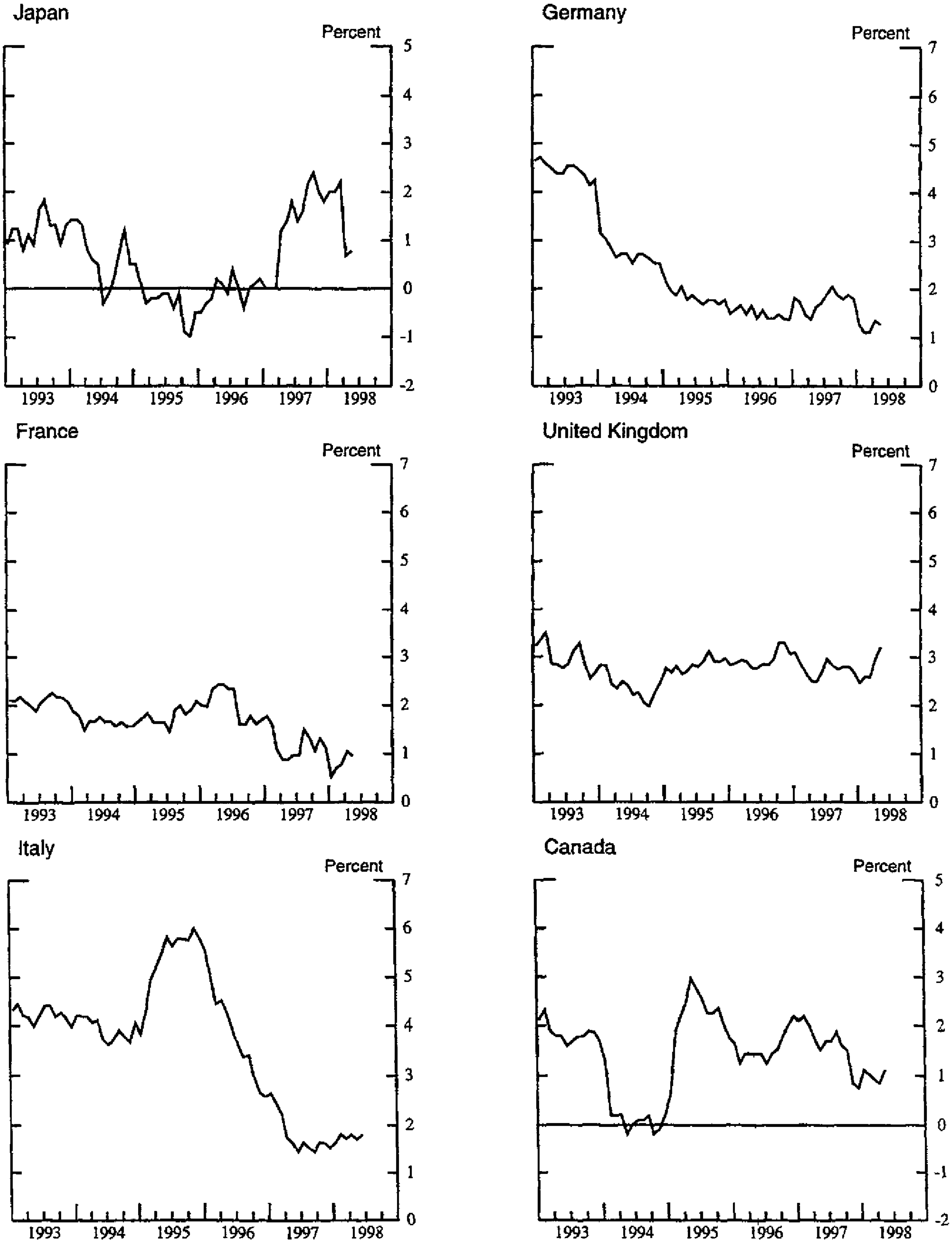
n.a. Not seasonally adjusted.

... Data not available on a monthly basis.

Industrial Production in Selected Industrial Countries



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



Economic Situation in Other Countries

In Korea and the ASEAN region, economic activity has declined sharply, mainly due to a marked contraction in domestic demand. Growth has slowed in China and Taiwan, while contracting sharply in Hong Kong. In Latin America, growth was strong in Argentina and Mexico, but weak in Brazil and Venezuela. Inflation has generally been stable to moderate, although it has been moving up in most of the affected Asian economies and has accelerated sharply in Indonesia.

The general adjustment toward surplus in external balances in Asia continued, with the exception of Taiwan. In Latin America, external balances continued to deteriorate except in Brazil, where the trade deficit narrowed further.

Implementation of reforms continued in Korea, Thailand, and the Philippines under their respective IMF programs. In May, Indonesia experienced a wave of anti-government demonstrations that toppled President Suharto; consequently the IMF postponed the $1 billion disbursement scheduled in early June. Elsewhere, Malaysia established the Asset Management Corporation to buy nonperforming loans from banks, and Singapore announced a five-step program to strengthen its banking system.

Individual country notes. Korea's financial crisis has generated a sharp decline in economic activity. Real GDP contracted 3.8 percent in 1998-Q1 on a four quarter-change basis. We estimate that on a seasonally-adjusted basis, real GDP contracted almost 23 percent (annual rate) from its level in 1997-Q4. Korea's output contraction reflects a collapse of domestic demand, particularly of fixed investment and inventories. The domestic demand contraction has been driven by a severe credit crunch, a high degree of economic uncertainty, and balance sheet adjustments by households and over-leveraged corporations.

Consumer price inflation rose to 8.2 percent in May on a 12 month-change basis, compared with an average rate of about 4 percent in the recent pre-crisis period. The relatively modest rise in consumer price inflation, despite a depreciation of the won of about 45 percent against the dollar since mid-October, appears attributable to the restraining effect of the downturn in aggregate demand on the prices of domestically-produced goods and services.

Korea has achieved a large and rapid improvement in its trade balance. During the January-April 1998 period, Korea's trade balance improved $70 billion (annual rate) from the same four months a year earlier, rising from a deficit of $26 billion to a surplus of $43 billion. Most of the improvement in the nominal trade balance has reflected a fall in imports. Export growth in dollar terms has remained modest, but dollar prices have fallen sharply and the volume of exports has increased markedly, partly offsetting the effects of reduced domestic demand on output.

Korea's usable international reserves rose to almost $37 billion on June 23 from $24 billion at end-March, and the won has remained roughly stable in the range of 1400 won/dollar. However, the stock market has performed poorly, closing on June 24 roughly 15 percent below its December 1997 trough. Labor unrest has contributed to the poor performance of Korea's stock market. The Korean Confederation of Trade Unions (KCTU), Korea's second largest trade union, with a reputation for being highly confrontational, staged a two day strike on May 27-28. Labor tensions have eased since early June, due in part to a lack of public support for strikes.

The Korean authorities have taken steps in recent weeks that suggest a willingness to accelerate financial sector cleanup and restructuring. This shift follows the strong performance of President Kim Dae Jung's coalition parties in Korea's local elections (held June 4), which were viewed as a referendum on President Kim's reform policies. The steps taken by the authorities include allocating an additional 50 trillion won (11 percent of GDP) to help finance the financial sector cleanup and restructuring, and a plan that requires banks to cut off credit to firms that the banks have assessed as insolvent.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	6.8	5.5	3.9	-3.8	...	...
Industrial Production	8.4	8.1	7.0	-7.9	n.a.	n.a.
Consumer Prices	4.9	4.4	5.0	8.9	8.8	8.2
Trade Balance[1]	-15.3	-3.9	10.8	38.4	45.6	n.a.
Current Account[1]	-23.7	-8.6	13.2	42.8	45.6	n.a.

1. Billions of U.S. dollars, AR, NSA.

In the **ASEAN** region, weakening domestic demand, tight credit conditions, and Japan's worsening economy continued to dampen economic activity. In Indonesia, real GDP fell by 6.2 percent (year-over-year SAAR) in the first quarter of 1998, while Malaysian GDP dropped 22.8 percent at a seasonally-adjusted annual rate. Industrial production declined sharply in Thailand in the first quarter.

ASEAN ECONOMIC INDICATORS: GROWTH

	1996	1997	1997 Q4	1998 Q1	1998 Apr
Real GDP, SAAR					
Indonesia[1]	8.0	4.6	1.4	-6.2	n.a.
Malaysia	8.6	7.8	7.9	-22.8	n.a.
Philippines	5.8	5.2	0.3	-1.1	n.a.
Singapore	6.9	7.7	0.8	0.5	n.a.
Thailand	6.4	-0.4	n.a.	n.a.	n.a.
Industrial Production[1]					
Indonesia	6.6	n.a.	1.6	n.a.	n.a.
Malaysia	11.0	10.7	10.1	-0.7	-3.4
Philippines	4.3	3.8	12.3	n.a.	n.a.
Singapore	3.3	4.6	8.8	5.9	1.3
Thailand	7.2	-0.4	-11.5	-16.8	n.a.

1. Year-over-Year.

Consumer prices continued to accelerate in Indonesia as distribution systems were slow to recover from the disruptions caused by the riots in early May and the weakening currency boosted the prices of imports. The Philippines also experienced a surge in inflation due in part to severe drought conditions. Elsewhere, weakening demand, as economies slowed, moderated inflationary pressures from depreciating currencies.

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

	1996	1997	1997 Q4	1998 Q1	1998 Apr	1998 May
Consumer Prices						
Indonesia	8.0	6.5	10.0	29.7	44.9	52.2
Malaysia	3.5	2.7	2.7	4.3	5.6	5.4
Philippines	8.4	5.1	6.1	7.1	7.9	9.2
Singapore	1.4	2.0	2.3	1.0	0.7	n.a.
Thailand	5.8	5.6	7.5	9.0	10.1	10.2

Trade surpluses widened further in most of the ASEAN countries in the first quarter, reflecting the effects of currency depreciation and sharp declines in growth of domestic demand. Malaysia and Thailand also reported a decline in exports in the first quarter of 1998, partly the result of difficulties in obtaining trade credit.

ASEAN ECONOMIC INDICATORS: TRADE BALANCE[1]

	1996	1997	1997	1998	1998		
			Q4	Q1	Feb	Mar	Apr
Indonesia	6.9	11.8	12.5	20.9	20.4	23.6	n.a.
Malaysia	-0.1	-0.2	1.7	9.0	7.9	12.0	11.5
Philippines	-11.4	-10.7	-8.9	-4.9	-4.3	-1.7	-2.1
Singapore[2]	-5.9	-5.8	-3.3	4.0	0.5	6.1	8.1
Thailand	-16.1	-4.6	10.0	12.5	13.7	13.5	7.1

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

Implementation of economic reforms varied across the ASEAN region. In the second week in May, Indonesia experienced a wave of anti-government demonstrations that sparked violence and toppled President Suharto. Although the transition of power to Vice President Habibie was relatively smooth, worsening economic conditions prompted the government to reinstate some subsidies and delay various reforms. The IMF Executive Board postponed the $1 billion disbursement scheduled in early June and has sent a mission to reevaluate the situation. Indonesia did, however, reach an agreement with its foreign bank creditors on a framework to restructure interbank, trade, and corporate debt.

Elsewhere, Malaysia has established the Asset Management Corporation to buy nonperforming loans from banks and plans to raise $6.6 billion to fund it by reallocating some government revenues, mandating contributions from financial institutions, and borrowing from local and foreign investors. Newly elected Philippine President Estrada has promised to continue implementing the IMF program and picked a strong economic team. Singapore announced a five-step program to strengthen its banking system that includes bringing disclosure norms up to international standards. The Thai Cabinet approved a fourth IMF letter of intent that cleared the way for disbursement of $133 million in early June.

In **Hong Kong**, economic activity has continued to weaken. According to preliminary estimates, GDP fell an estimated 9-1/2 percent in the first quarter (SAAR). In the March-May period, the unemployment rate rose to 4.2 percent, compared with a rate of only 2.4 percent in the fourth quarter of 1997. Interest rates rose sharply in mid-June as weakness of the yen contributed to speculative pressure on Hong Kong's exchange rate. On June 23, the yield spread between Hong Kong government securities and comparable U.S. Treasuries was around 475 basis points at maturities of 1-10 years, up about 175 basis points from the beginning of the month.

In **China**, industrial production has slowed, while imports, exports and consumer prices have fallen from year-earlier levels in recent months. China's trade surplus remains high. Compared with year-earlier levels the dollar value of exports was up 9 percent in the first five months of this year, but fell nearly 2 percent in May. While the dollar value of imports rose 2 percent in the first five months, they fell nearly 4 percent in May. Inflows of foreign direct investment fell nearly 2 percent in the first five months of the year from a year earlier, with declines particularly sharp in April and May.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	9.7	8.8	8.2	7.2	...	...
Industrial Production	15.6	13.1	13.0	10.3	8.6	n.a.
Consumer Prices[1]	7.0	0.4	0.4	0.7	-0.3	-1.0
Trade Balance[2]	12.2	40.3	38.8	42.4	51.1	45.6

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

Taiwan's GDP rose 5.9 percent in the first quarter from a year earlier. We estimate that growth slowed from about 8 percent (SAAR) in the second half of 1997 to about 2 percent in the first quarter. Export growth slowed substantially. Exports to Asia fell sharply from year-ago levels, while exports to the United States and Europe rose slightly; imports fell 3 percent. A very small trade surplus in the first four months of 1998 compares with a surplus of $4.8 billion (AR) in the year-earlier period. Consumer price inflation has risen to about 2 percent (year-over-year) thus far in 1998.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	5.7	6.8	7.1	5.9	...	...
Industrial Production	1.6	7.0	8.2	4.6	6.3	...
Consumer Prices[1]	2.5	0.2	0.2	2.6	2.1	1.7
Trade Balance[2]	14.3	7.7	2.2	-2.4	3.2	8.4
Current Account[2]	10.5	7.4	8.8	0.8	...	...

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

In **Mexico**, economic activity remains strong with GDP increasing 6.6 percent in 1998-Q1 on a four quarter-change basis. Industrial production growth dropped precipitously in April to 2.2 percent, due in part to the shorter number of work days in April stemming from the timing of Holy Week. Otherwise, there is little evidence of an economic slowdown. despite the decline in oil prices and the effects of the Asian crisis. The unemployment rate was 3.2 percent in May, compared with 3.7 percent in 1997. The trade deficit narrowed somewhat in May to $4.3 billion, while inflation slowed to 10 percent (monthly change at an annual rate).

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	5.1	7.0	6.7	6.6	...	...
Industrial Production	10.4	9.2	8.9	9.8	2.2	n.a.
Unemployment Rate (%)	5.5	3.7	3.1	3.5	3.1	3.2
Consumer Prices[1]	27.7	15.7	14.1	22.4	11.9	10.0
Trade Balance[2]	6.5	0.6	-5.2	-7.2	-4.8	-4.3
Imports[2]	89.5	109.8	124.0	120.0	122.4	121.8
Exports[2]	96.0	110.4	118.8	112.8	117.6	117.5
Current Account[2]	-1.9	-7.3	-14.4	-13.6	...	...

1. End of period; percentage change from previous period, AR, NSA.
2. Billions of U.S. dollars, AR, NSA.

Events in Asia and declining oil prices continue to influence the Mexican financial markets. Since the beginning of May the peso has declined almost 5 percent, the stock market has fallen 13 percent and spreads on Mexican Brady bonds, adjusted for collateral, have risen 125 basis points. In addition, the 28-day Cetes rate, which stood below 18 percent for the most of May, has surged, rising over 200 basis points.

In **Brazil**, there are few indications that economic activity has recovered in recent weeks, despite the reduction in the central bank's benchmark interest rate. Industrial production declined over 11 percent in April (SAAR.). Consumer durables production led the decline, plunging nearly 17 percent. While the April results may reflect some residual seasonality due to the Easter holiday (which fell in April this year), industrial production is well below its level in October 1997, when the central bank nearly doubled the overnight borrowing rate to over 40 percent to defend the *real* from downward pressures. The overnight rate has been gradually reduced since then, and currently stands at 21.75 percent. Unemployment dipped to below 8 percent in April, but the slight decline reflected the exit of workers from the labor force (mainly women and students). Consumer price inflation rose to 4.8 percent in May over the previous year; surging food prices owing to a severe drought in the northeast accounts for much of the rise.

Stock prices have fallen roughly 25 percent since mid-April, reflecting in part repercussions from problems in Asia and Russia. The decline also reflected electoral poll results indicating that President Cardoso's re-election next October is no longer certain. Lula, the leftist candidate making his third presidential bid, has gained considerably in recent weeks, aided by widespread concerns over high unemployment.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP[1]	2.9	3.0	0.8	-4.3	...	...
Industrial Production[1]	5.4	2.0	-10.0	-6.6	-11.2	n.a.
Open Unemployment Rate (%)	5.4	5.6	5.3	7.6	7.9	n.a.
Consumer Prices[2]	9.4	4.3	4.5	7.4	5.5	9.4
Trade Balance[3]	-5.5	-8.4	-11.6	-6.4	-3.6	-4.0
Current Account[3]	-24.3	-33.8	-44.8	-24.0	-38.0	-24.0

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

Brazil's overall fiscal deficit has been disappointingly high in recent months at 6.5 percent of GDP, in part reflecting a large increase in the government's cost of servicing its debt as a result of high interest rates. Although the trade deficit has continued to narrow, the improvement in the trade balance has been offset somewhat by higher interest payments on external debt, so the current account deficit has narrowed only slightly in recent months and stands at about 3.5 percent of GDP. In late May, one-year interest rates rose from about 22 percent to about 30 percent and have remained at that level since then.

In **Argentina**, the pace of economic growth remains strong but has slowed slightly, with real GDP in the first quarter growing at nearly 7 percent. Industrial production grew 4.8 percent in May (SAAR), a noticeable slowing from the high growth rates seen in the previous two quarters. Inflation is low, with 12-month consumer price inflation in May remaining at slightly over 1 percent. Although import growth slowed in April, external imbalances remain a cause for concern; over the first four months of this year the trade balance posted a deficit over $5 billion (AR), compared with about $1.5 billion (AR) over the same period a year ago. This widening deficit has led to some loss of international reserves, which, excluding gold, fell by about 4 percent in May.

Events in Asia continue to influence Argentine financial markets. Since the beginning of May, the blue-chip Merval stock index has fallen over 20 percent. Although deposit interest rates have not risen recently, Brady spreads have generally been increasing, rising by more than 120 basis points since the end of April.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	4.3	8.4	8.2	6.9	...	...
Industrial Production (SA)	3.1	8.6	9.2	6.8	4.8	4.8
Unemployment Rate (%)[2]	17.2	14.9	13.7	...	...	...
Consumer Prices[1]	0.1	0.3	-0.8	3.6	0.0	-0.1
Trade Balance[3]	1.6	-3.2	-7.2	-5.8	-2.6	n.a.
Current Account[3]	-4.0	-10.2	-15.2	n.a.	...	...

1. End of period: percentage change from previous period, AR, NSA.
2. Unemployment figures available only in May and October of each year. The annual figure is the average of the two surveys.
3. Billions of U.S. dollars, AR, NSA.

In **Venezuela,** the recent slump in oil prices continues to hurt the economy. Unemployment is rising and despite about $3.5 billion cuts in government expenditures, the considerably larger loss of oil revenue means that the fiscal position is deteriorating. With the currency already generally regarded as overvalued, fears of devaluation have risen. The government has been forced to boost interest rates to protect the bolivar; since the end of April, the loan rate has gone up about 10 percentage points to over 45 percent. Inflation is also running high; consumer prices rose about 46 percent (AR) in May. Although, the figures for the overall trade surplus are not yet available for 1998, indications are that falling oil prices are fast eroding Venezuela's considerable trade surplus.

Combined with oil prices, political uncertainty in the run-up to the December presidential elections and the popularity in the polls of former coup leader presidential candidate Hugo Chavez, is rattling investors; the Caracas stock index has fallen more than 10 percent since the beginning of May. In May 1998, the IMF approved a monitoring program for Venezuela, which involves technical assistance, but no disbursements.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	-0.4	5.1	...	...	...	...
Unemployment Rate (NSA, %)	11.8	11.8	10.6	11.6	...	...
Consumer Prices[1]	103.3	37.6	43.2	32.1	49.4	45.9
Non-oil Trade Balance[2]	-4.8	-6.6	-7.3	-6.1	n.a.	n.a.
Trade Balance[2]	13.6	11.1	10.9	n.a.	n.a.	n.a.
Current Account[2]	8.8	5.5	...	...	...	...

1. End of period; percentage change from previous period, AR, NSA.
2. Billions of U.S. dollars, AR, NSA.

In **Russia**, financial markets came under severe pressure in late May, and there was widespread speculation that the monetary authorities might be forced to allow the ruble to depreciate sharply. In part this pressure reflected renewed spillover from Asian financial market problems, but there were also a number of negative economic developments in Russia, including the failure of an IMF mission to reach an agreement with the government that would allow a quarterly disbursement of Fund resources, reports that tax revenues were running substantially below target, the apparent collapse of the nineteenth largest Russian commercial bank, the failure of an attempt to privatize Rosneft, a major oil company, and disruption of rail traffic by coal miners protesting late wage payments. The central bank moved to defend the ruble by temporarily raising its key money market intervention rate to 150 percent on May 27. After this move succeeded in easing pressure on the ruble somewhat, the central bank lowered this rate to 60 percent in early June. Since then, financial markets have remained unsettled, experiencing occasional bouts of--so far less intense--pressure.

On June 18, the IMF Board announced that it was delaying a vote on release of a quarterly payment of $670 million under Russia's existing EFF program. The Fund and the government have been trying to reach agreement on measures to improve the government's fiscal performance, focusing especially on tightened revenue collection. Earlier this month, the government had indicated that it intended to reduce 1998 spending by about 30 percent from previously planned levels and appointed, Boris Fedorov new head of the State Tax Service, with a mandate to combat tax avoidance.

There has been much speculation over that past month that additional funds--over and above the existing EFF arrangement--might be made available to the government, either from the IMF or through the G-7. Russian officials have recently indicated that they were seeking at least $10 billion in additional resources. However, so far no concrete new measures have been announced. Indicating a willingness to increase its use of the private market as a source of foreign currency resources, the government on June 3 floated a $1.25 billion five-year dollar-denominated Eurobond issue and, on June 18, issued an additional $2.5 billion of Eurobonds.

There is growing evidence that the high interest rates and reduced business confidence associated with the financial market pressures of recent months are starting to have a negative impact on the pace of economic activity, with both real GDP and industrial production registering 12-month declines in May.

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

	1996	1997	1997	1998	1998	
			Q4	Q1	Apr	May
Real GDP	-6.3	0.4	0.8	0.0	0.2	-1.2
Industrial Production	-5.2	1.9	3.4	1.4	0.8	-2.1
Consumer Prices	52.8	14.8	11.8	9.3	7.9	7.5
Ruble Depreciation	12.5	12.7	7.8	6.1	6.7	6.8
Trade Balance[1]	16.4	n.a.	n.a.	n.a.	...	...
Current Account[1]	2.2	-1.4	n.a.	n.a.	...	...

1. Billions of U.S. dollars.