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Part 2

November 12, 1998

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

November 12, 1998

RECENT DEVELOPMENTS

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

Domestic Nonfinancial Developments

Overview

The rise in real GDP in the third quarter evidently exceeded our expectations; but a slowing of employment growth in the past couple of months suggests that activity may be decelerating again in the current quarter. Meanwhile, indicators of wage and price inflation have been mixed of late.

Real GDP for 1998:Q3

On October 30, the BEA issued its initial estimates of the national income accounts for the third-quarter showing that real GDP increased at an annual rate of 3.3 percent. Since then, new data, on net, point to a small upward revision. The largest change on the plus side is a faster pace of inventory investment at merchant wholesalers; an upward revision to business fixed investment is also likely, based on September reports on construction put in place and manufacturers' shipments. We have anticipated some partial offsets in yet-to-be released data, primarily lower exports and higher imports in September than had been assumed by the BEA. On net, we anticipate that the new data will boost the GDP growth rate to 3.6 percent.

Real GDP and Selected Components

Component	1998:Q2	1998:Q3	
		BEA advance	Expected revision
Percent change, annual rate			
Real GDP	1.8	3.3	3.6
Final sales	4.6	2.3	2.2
Private domestic final purchases	7.4	3.4	3.6
Consumption	6.1	3.9	3.9
Business fixed investment	12.8	-1.0	-0.5
Residential investment	15.0	6.8	7.7
Federal government	7.3	-1.7	-1.6
State and local government	1.8	3.2	3.3
Level, billions of chained (1992) dollars			
Inventory investment	38.2	57.2	65.4
Net exports	-245.2	-262.5	-265.9

CHANGES IN EMPLOYMENT

(Thousands of employees; based on seasonally adjusted data)

	1996	1997	1998				
			H1	Q3	Aug.	Sept.	Oct.
	-Average monthly changes-						
Nonfarm payroll employment ¹	233	282	244	199	322	157	116
Private	224	263	222	156	226	137	92
Manufacturing	3	21	-2	-32	99	-10	-52
Nonmanufacturing	222	241	223	188	127	147	144
Construction	28	20	23	7	19	-21	19
Transportation and utilities	8	14	15	11	20	2	19
Trade	54	48	49	68	9	89	-9
Finance, insurance, real estate	14	17	23	17	2	13	25
Services	117	142	117	87	77	65	95
Total government	9	20	22	43	96	20	24
Private nonfarm production workers ¹	190	212	166	106	116	112	61
Manufacturing production workers	0	16	-10	-30	90	16	-37
Total employment ²	232	240	72	185	101	597	-88
Nonagricultural	226	243	79	127	14	607	-172
Memo:							
Aggregate hours of private production workers (percent change) ^{1,3}	3.2	3.4	2.6	1.4	0.1	-0.4	0.6
Average workweek (hours) ¹	34.4	34.6	34.7	34.5	34.6	34.4	34.6
Manufacturing (hours)	41.6	42.0	41.8	41.7	41.7	41.6	41.8

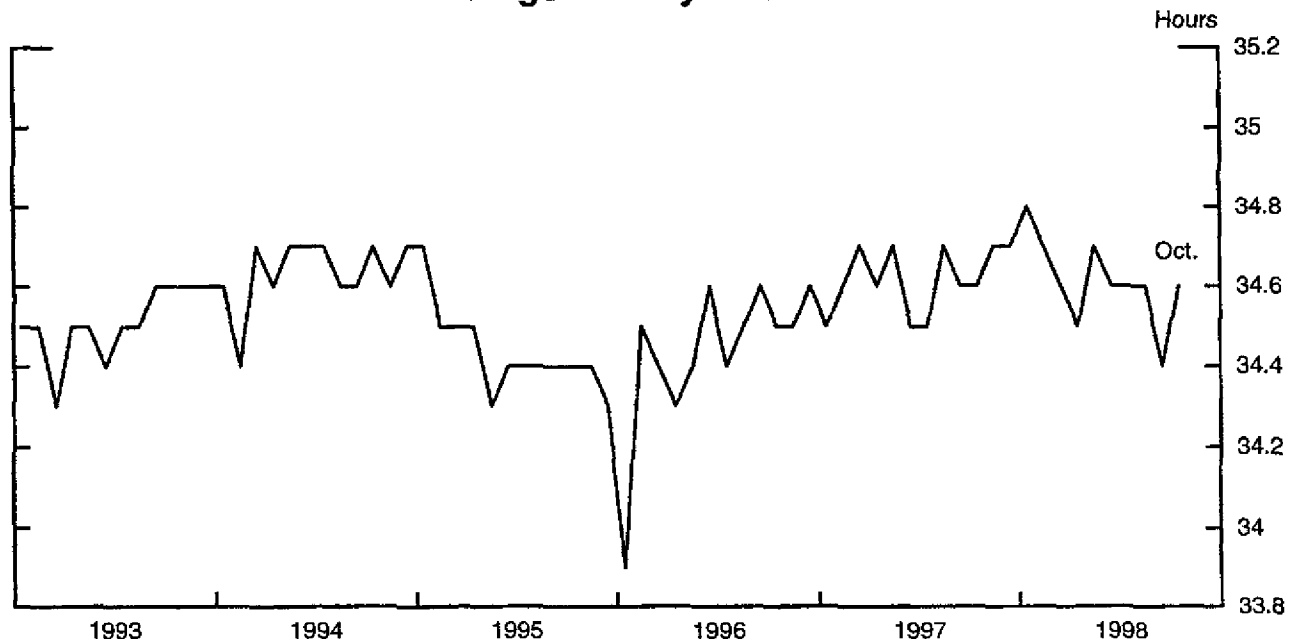
Note. Average change from final month of preceding period to final month of period indicated.

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



Labor Market Developments

Nonfarm payroll employment rose just 116,000 in October after having increased 157,000 in September. Despite an upward revision to the September figure, the two months of data mark a noticeable step-down in the pace of hiring--from 235,000 per month during the first eight months of the year. Aggregate hours of production or nonsupervisory workers rebounded 0.6 percent in October; they had dropped 0.4 percent in September, when seasonal adjustment difficulties appeared to depress the measured workweek. The unemployment rate was unchanged in October at its third-quarter level (4.6 percent) but was about 1/4 percentage point above the low reached last spring.

After having posted only a small decline in September (-10,000), manufacturing jobs dropped more than 50,000 in October. On average, these declines match the rate at which factory employment has been contracting since March. The cumulative job loss now totals 200,000--about 1.1 percent of the factory workforce. Much of the decline has been in the apparel, industrial machinery, and electrical equipment industries, which are particularly sensitive to conditions in Asia.

Construction employment zigzagged over the past two months, showing essentially no net change. The flattening out appears in large part to be the result of cutbacks in heavy construction that have been offset by ongoing hiring by residential builders and special trade contractors.

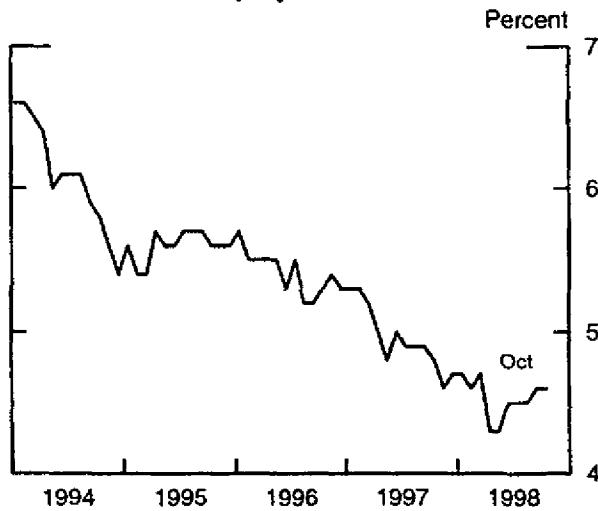
Hiring in services has also tapered off a bit recently. October's gain was depressed by unusually large monthly declines in employment in lodging and in amusement and recreation services. Jobs in business services bounced back in October, but, with sluggish activity in the help supply industry, the average rise in recent months has been well below the brisk pace earlier in the year. In October, the level of employment in the help supply industry--which has been volatile from month to month--was 40,000 below its peak in June. The weakness in the temporary help supply industry may be a result, in part, of cutbacks in manufacturing. At the beginning of 1997 (the last period of available data), about 30 percent of workers in the temporary help supply industry worked at manufacturing establishments.

One notable exception to the generally slower payroll gains has been the strong performance in the finance, insurance, and real estate sector. Jobs there rose almost 40,000 over the two months ending in October, with especially sharp gains among securities and commodity brokers and by mortgage bankers and brokers. However, with the recent announcements of staff cutbacks in the financial industry, this year's hiring surge may be coming to an end.

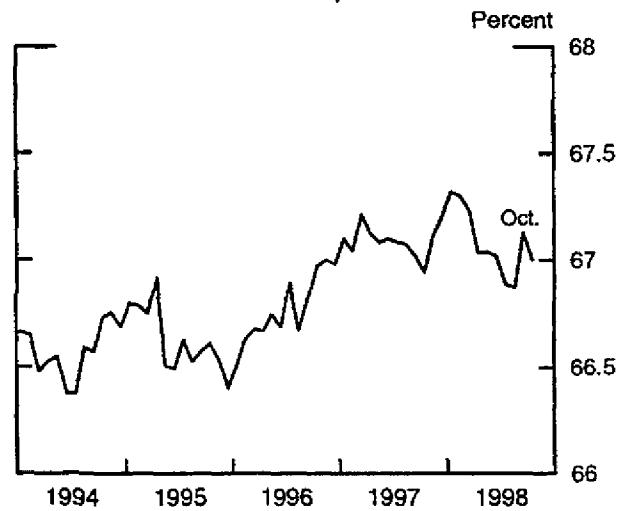
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
 (Percent; based on seasonally adjusted data, as published)

	1996	1997	1998			1998		
			Q1	Q2	Q3	Aug.	Sept.	Oct.
Civilian unemployment rate (16 years and older)	5.4	4.9	4.7	4.4	4.6	4.5	4.6	4.6
Teenagers	16.7	16.0	14.6	14.0	14.7	15.0	15.4	16.0
Men, 20 years and older	4.6	4.2	3.8	3.6	3.8	3.7	3.8	3.7
Women, 20 years and older	4.8	4.4	4.3	4.0	4.0	4.1	4.0	4.0
Labor force participation rate	66.8	67.1	67.3	67.0	67.0	66.9	67.1	67.0
Teenagers	52.3	51.6	53.3	52.4	52.7	52.3	53.8	52.9
Men, 20 years and older	76.8	76.9	76.9	76.8	76.7	76.5	76.7	76.6
Women, 20 years and older	59.9	60.5	60.6	60.4	60.3	60.4	60.4	60.4
Women maintaining families	65.3	67.4	67.9	67.5	68.7	68.1	69.4	68.2

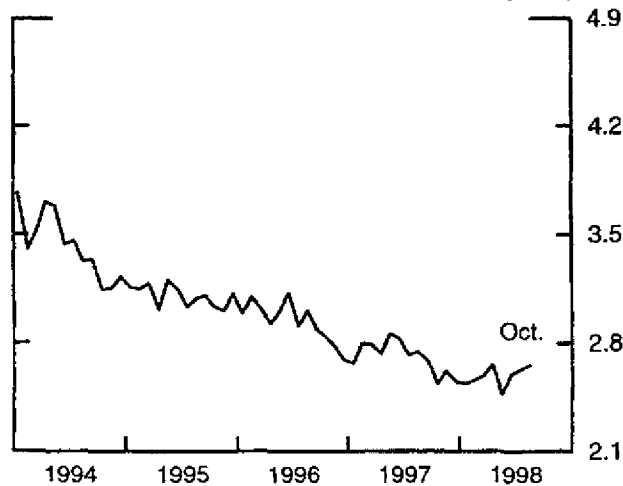
Unemployment Rate



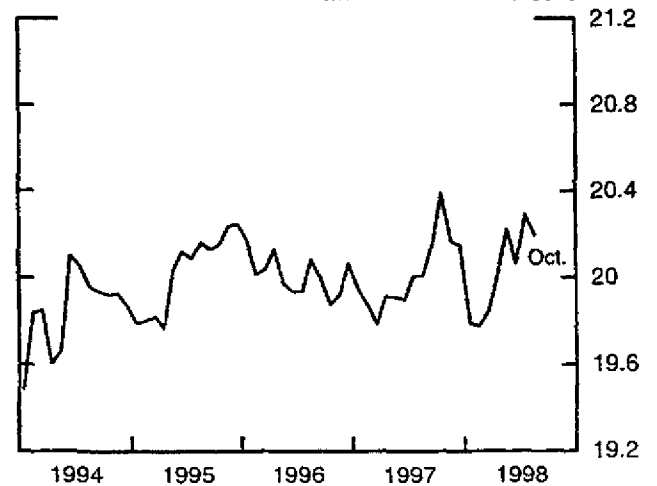
Labor Force Participation Rate



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



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



*Seasonally adjusted by FRB staff.

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

Sector	1996 ¹	1997		1998			1997: Q3 to 1998: Q3
		Year ¹	Q4	Q1	Q2	Q3	
Total business	2.4	1.9	.9	4.1	.1	2.4	1.8
Nonfarm business	2.1	1.7	.9	3.5	.3	2.3	1.7
Manufacturing	4.6	4.5	4.9	1.4	2.3	3.7	3.1
Nonfinancial corporations ²	2.4	2.6	1.0	2.6	3.1	n.a.	3.1 ³

1. From fourth quarter of preceding year to fourth quarter of year shown.

2. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies; accounts for about two-thirds of business employment.

3. 1997:Q2 to 1998:Q2.

n.a. Not available.

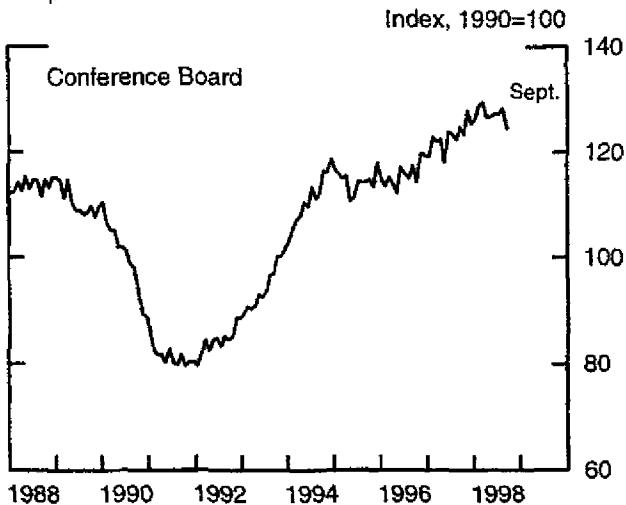
Output per hour in the nonfarm business sector is estimated by the BLS to have risen at an annual rate of 2.3 percent last quarter, well above the 0.3 percent rate in the second quarter. The third-quarter figure is a preliminary estimate, and the upward revision to real GDP that we are projecting would mean an upward revision to productivity growth--perhaps as much as 1/2 percentage point. Productivity in the manufacturing sector, at an annual rate of 3.7 percent for the third quarter, also posted a stronger gain than in the previous quarter. Over the four quarters ending in 1998:Q3, productivity in the nonfarm business sector (as currently published) rose 1.7 percent, and manufacturing productivity increased 3.1 percent.

Since June, the unemployment rate has been steady at just over 4-1/2 percent, and the labor force participation rate has fluctuated around the October reading of 67 percent. To date, layoffs do not appear to have played a major role in the slowdown in employment. The proportion of the unemployed who are job losers has been little changed since midyear, and initial claims for unemployment insurance have remained low.

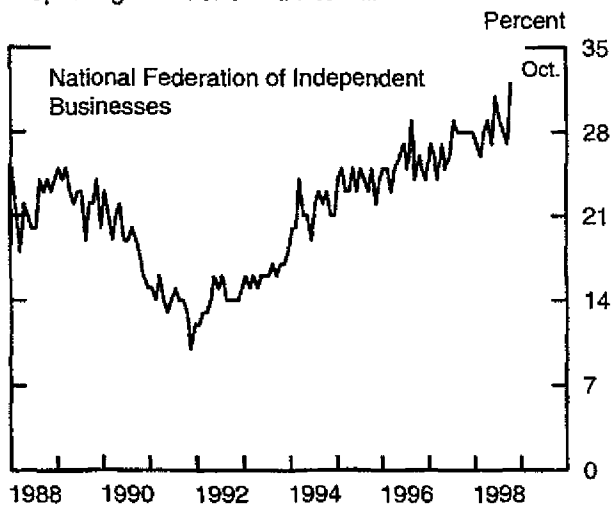
Most other labor market indicators are consistent with weaker hiring. The Conference Board's help wanted index declined sharply in September, and respondents to its October survey of households reported that current job availability had turned much less positive. Looking ahead, respondents to the Conference Board as well as the Michigan SRC survey were gloomier last month about future labor market

Labor Market Indicators

Help Wanted Index

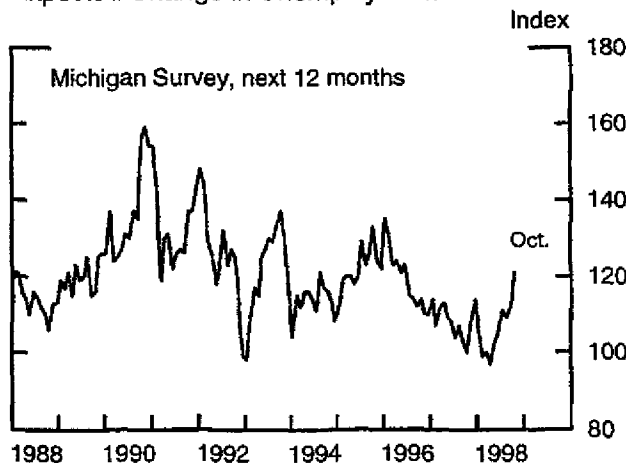


Reporting Positions Hard to Fill

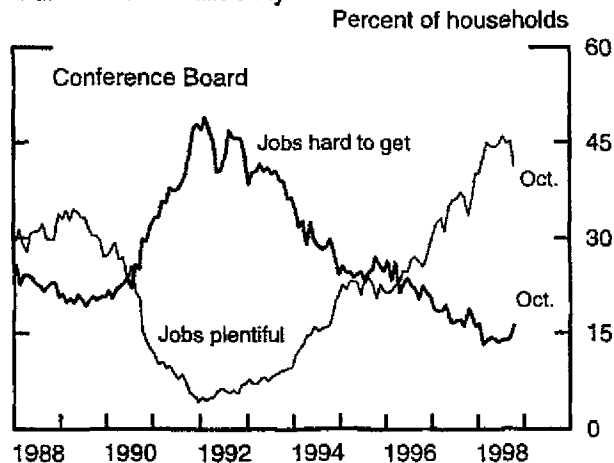


Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Expected Change in Unemployment

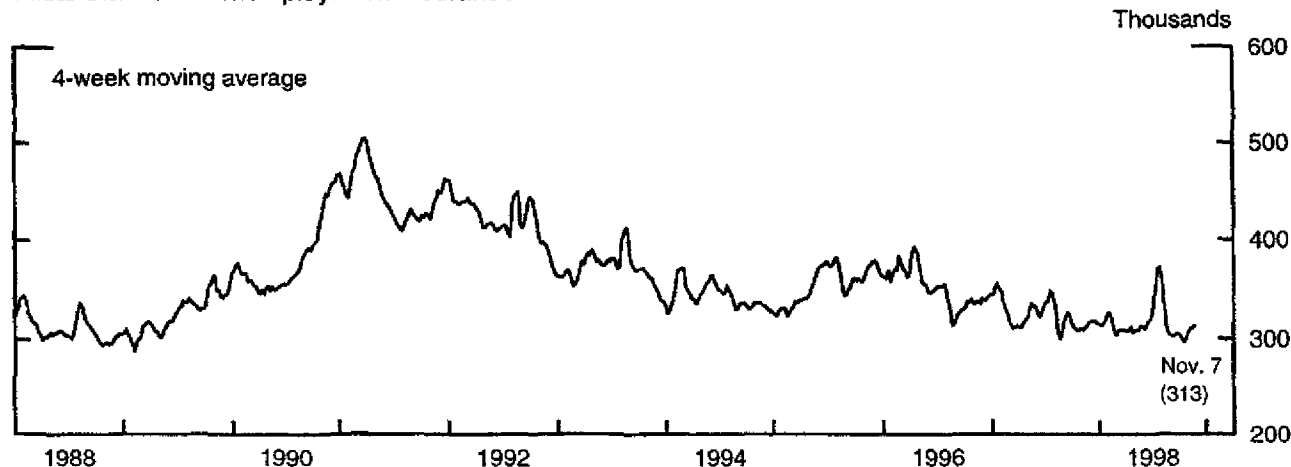


Current Job Availability



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

Initial Claims for Unemployment Insurance



Note. State programs, includes EUC adjustment.

conditions. In contrast, the number of firms in the National Federation of Independent Business' survey reporting jobs difficult to fill bounced back in October.

Industrial Production

Industrial activity has decelerated sharply since the end of last year largely because of the decline in net exports. The slowdown is evident in every major market grouping with the exception of construction supplies, where production has been boosted by rising residential building. In the third quarter, industrial production was flat as declines in manufacturing and mining output were offset by another surge in utilities.

Industrial production probably posted a small decline in October.¹ Total industrial output was pulled down by a sharp drop in utilities output from its high level and another fall in mining output. The decrease in the output of utilities can be explained by a return to more normal temperatures throughout the country. The recent downward trend in mining activity is the result of reduced oil and gas drilling in the wake of weak crude oil prices. Meanwhile, manufacturing output is estimated to have risen.

Within manufacturing, motor vehicle assemblies increased 1/4 million units in October, to 13.0 million units, a level higher than that before the GM strike.

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

Item	1998					
	Aug.	Sept.	Oct. ¹	Q2	Q3	Q4 ²
U.S. production	13.2	12.7	13.0	11.6	11.4	12.8
Autos	6.3	6.5	6.1	5.3	5.6	5.9
Trucks	6.9	6.2	6.9	6.4	5.8	6.9
Domestic stocks ³						
Autos	1.2	1.2	n.a.	1.1	1.2	n.a.
Light trucks	1.3	1.3	n.a.	1.4	1.3	n.a.

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

1. Production rates are latest estimates from Ward's Automotive Communications.

2. Production rates are manufacturers' schedules.

3. Quarterly data are for last month of quarter.

n.a. Not available.

1. The annual revision to industrial production and capacity utilization will be published later this month. The revisions to capacity utilization will incorporate information from the 1997 Survey of Plant Capacity.

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

	Proportion 1997	1997 ¹	1998		1998		
			Q2	Q3	July	Aug.	Sept.
			-Annual rate-		--Monthly rate---		
Total index	100.0	5.8	1.7	.0	-.4	1.6	-.3
Previous		5.8	1.7		-.4	1.7	
Manufacturing	86.2	6.3	.8	-.6	-.4	1.8	-.4
Durables	46.6	9.5	2.5	1.9	-.9	4.0	-.7
Motor vehicles and parts	5.2	11.9	-11.9	1.7	-12.9	43.4	-3.1
Aircraft and parts	2.3	18.5	.0	6.2	1.2	.8	-.3
Nondurables	39.6	2.6	-1.3	-3.5	.2	-.6	-.2
Manufacturing excluding motor vehicles and parts	81.0	6.0	1.6	-.8	.3	-.1	-.3
Mining	6.2	2.1	-3.9	-6.1	.2	-.8	-.5
Utilities	7.6	2.4	18.8	12.5	-.8	.6	1.6
IP by market group, excluding motor vehicles and parts and energy							
Consumer goods	22.9	2.4	-.5	-3.4	.2	-.5	-.2
Durables	4.0	4.2	4.8	-1.4	.1	.1	-.3
Nondurables	19.0	2.0	-1.6	-3.8	.2	-.7	-.1
Business equipment	12.3	10.8	9.5	5.1	.6	-.2	-.4
Information processing	5.5	12.2	15.1	4.7	-.1	1.1	-.1
Computer and office eq.	1.8	36.3	56.9	39.7	2.5	3.4	2.6
Industrial	4.5	5.6	6.2	6.8	.7	.2	-2.2
Transit	1.1	27.3	4.1	13.0	1.6	1.4	.1
Other	1.3	9.5	5.8	-4.5	2.5	-8.1	4.4
Construction supplies	5.6	2.2	2.5	6.3	.9	.7	-.7
Materials	30.1	8.7	.9	-.9	.2	.1	-.1
Durables	21.1	10.8	2.4	-1.1	-.1	.6	.0
Semiconductors	3.7	39.8	10.6	11.7	.9	1.3	1.7
Basic metals	3.3	4.7	-10.0	-6.5	-.4	1.6	-2.2
Nondurables	9.0	3.5	-3.1	-.6	1.0	-1.0	-.3

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89	1959-97	1998	1998			1998	
	High	Avg.	Q1	Q2	Q3	July	Aug.	Sept.
Manufacturing	85.7	81.7	81.6	80.7	79.7	79.1	80.3	79.6
Primary processing	88.9	82.8	85.6	84.8	83.9	84.3	84.1	83.3
Advanced processing	84.2	81.1	79.8	79.0	77.9	76.9	78.7	78.0

Automakers expect to keep assemblies at a high level through the fourth quarter. They are anticipating strong sales, and GM needs to restock strike-depleted inventories. Nonetheless, if their sales objectives are realized, inventories will likely remain quite lean at the end of the fourth quarter.

The production of aircraft and parts is estimated to have increased further in October after having reached a very high level in the third quarter. Boeing officials claim that most of the production snags that have plagued the effort to ramp up assemblies since the end of 1995 are behind them. The company has significantly reduced overtime, parts shortages, design changes, and the number of jobs behind schedule--all key measurements of production problems. However, for Boeing to meet its 1998 delivery schedule of 550 aircraft, production lines will have to run smoothly and without the usual late-December shutdown.²

The production of computers and semiconductors evidently increased substantially again in October. Although semiconductor output decelerated earlier this year, production has picked up in recent months. According to a growing consensus among market analysts, the chip industry is about to pull out of its recent slump. Nevertheless, the extent of its recovery is still a matter of debate: Forecasts for the increase in nominal worldwide chip sales in 1999 range between 7 percent and 16 percent.³

Looking beyond October, most indicators point to continuing weakness in other areas of manufacturing. The National Association of Purchasing Management reported a sharp decline in its new orders index in October, to the lowest level since early 1996; the Dun and Bradstreet index also plunged in September. Anecdotal evidence in the Beige Book and from the Board staff's own industry contacts suggest that the weakness is widespread within manufacturing. The slowdown in the demand for manufactured goods will likely provoke a reduction in manufacturers' capital spending plans and, consequently, a slowing of capacity growth.

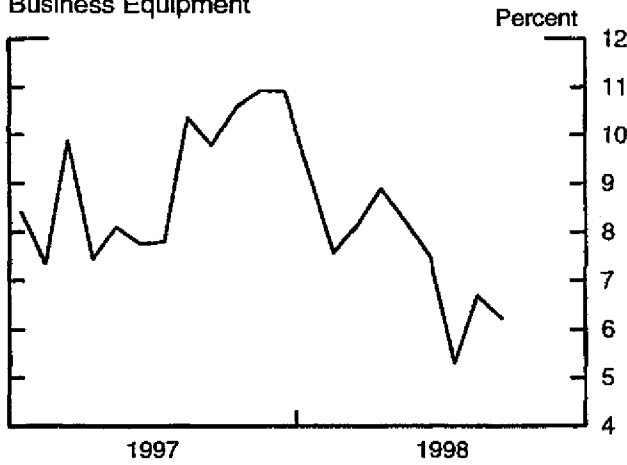
On the positive side, the Commerce Department reported that orders for durable goods increased substantially in the third quarter after having decreased, on average, in the first half of the year. The staff's estimate for real adjusted durable goods orders advanced almost 5 percent in the third quarter. However, a good part of

2. Through the first three quarters of 1998, Boeing delivered 370 commercial airplanes; another 180 are scheduled this quarter. The company plans to deliver a record 620 commercial jets in 1999; its previous record, set in 1991, was 605 deliveries.

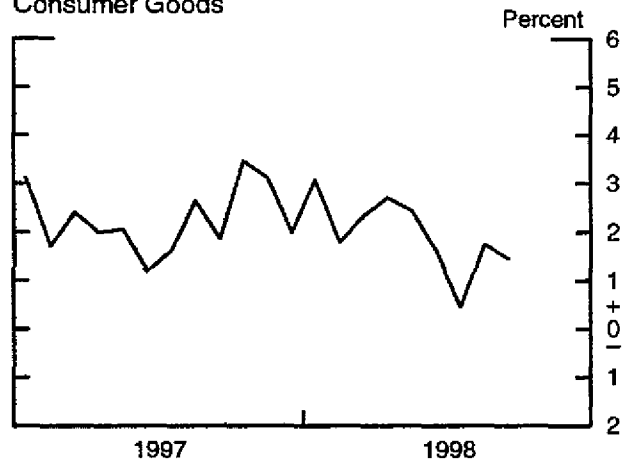
3. According to the Semiconductor Industry Association, nominal worldwide chip sales are expected to decline 10.9 percent this year.

Industrial Production (12-month change, through September)

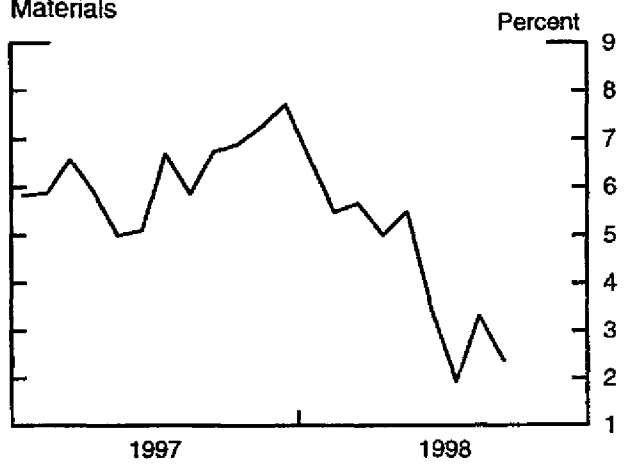
Business Equipment



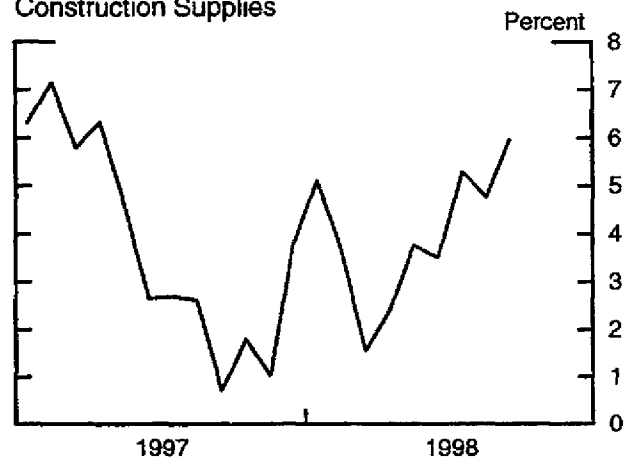
Consumer Goods



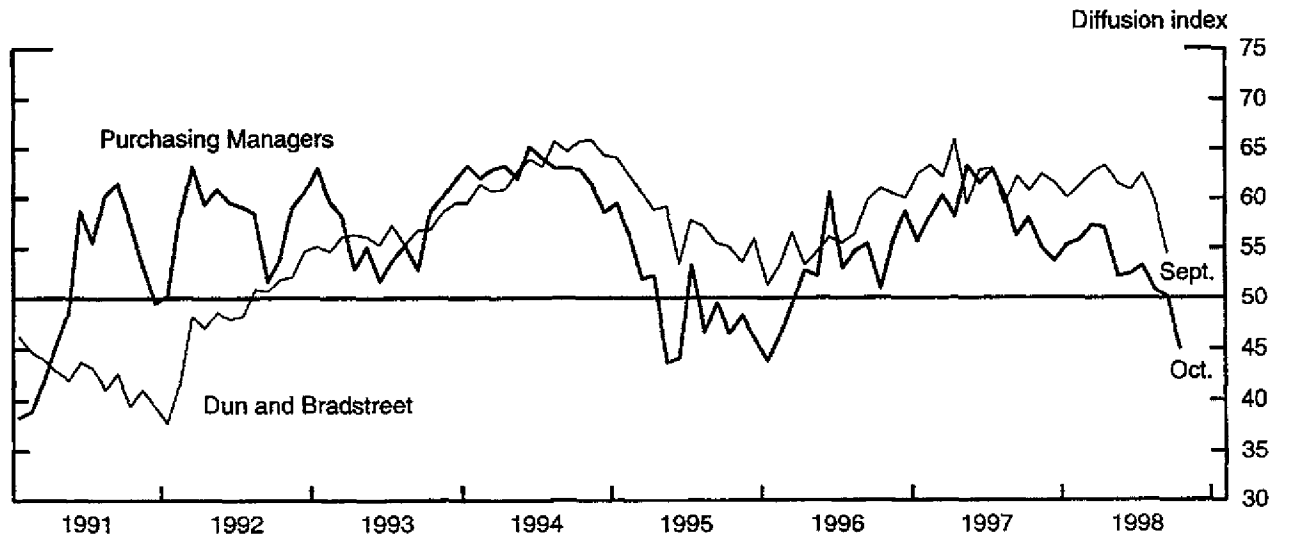
Materials



Construction Supplies



Indicators of Future Production: New Orders Indexes



the strength in this series was in categories with long production cycles.⁴ Therefore, we expect that the strength in these orders will have just a minor positive effect on industrial production in the next few months.

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

Component	Share, 1998:H1	1998				
		Q2	Q3	July	Aug.	Sept.
Total durable goods	100.0	.8	2.5	2.0	2.0	.8
Adjusted durable goods ¹	70.0	.6	3.2	2.6	-1.7	2.5
Computers	6.0	4.3	2.8	.4	-1.3	-1.9
Nondefense capital goods excluding aircraft and computers	18.0	-2.5	5.4	-2.3	3.8	9.3
Other	46.0	.5	2.4	4.8	-3.7	.4
MEMO						
Real adjusted orders ²	...	.7	4.7	3.1	-1.1	2.9

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.

2. Nominal adjusted durable goods orders were split into three components: computers, electronic components, and all other. The components were deflated and then aggregated in a chain-weighted fashion.

... Not applicable.

Consumption and Personal Income

Real personal consumption expenditures increased almost 4 percent in the third quarter, but this was down from the still more breathtaking pace over the first half of the year. Household net worth posted a noticeable decline during the summer slump in the stock market, but previous increases in wealth undoubtedly provided some ongoing impetus to spending last quarter; with the subsequent snapback in share prices recently, wealth effects are likely to provide a continuing lift to demand for a while longer. Several measures of consumer confidence have dropped sharply in recent months from record highs, although they remain at relatively positive levels.

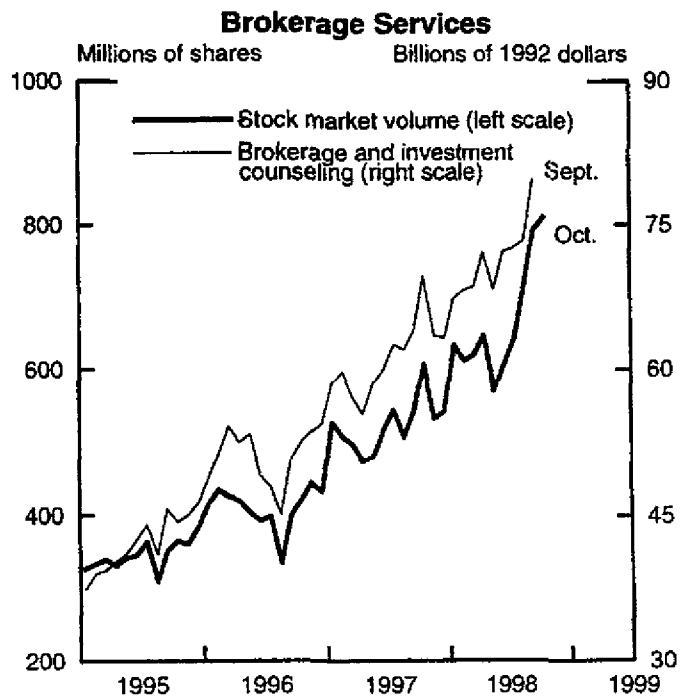
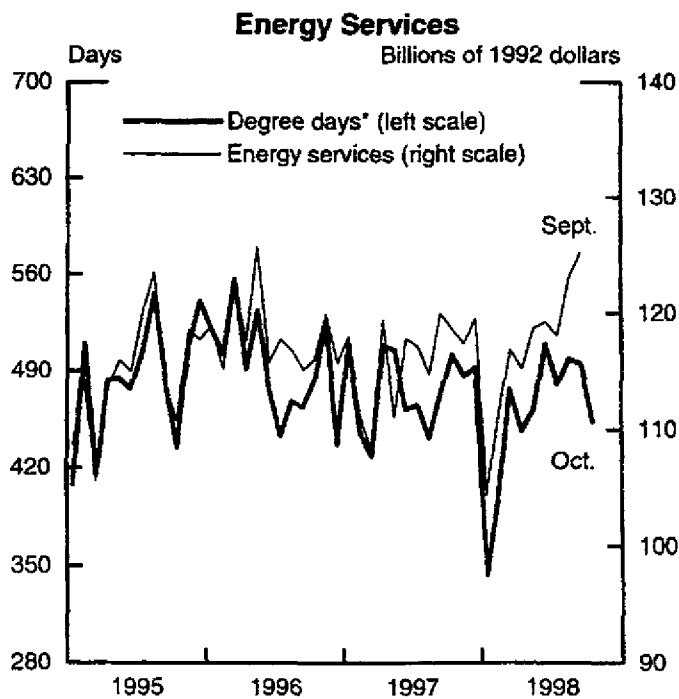
Total real PCE rose 0.6 percent in September after having increased 0.3 percent in August. Real spending on durable goods was strong in September, led by a 4.3 percent jump in motor vehicle outlays. In addition, real expenditures increased for

4. For instance, orders for gas turbines skyrocketed in the third quarter because of strong demand from electric utilities. Many utilities, most notably in the Midwest, experienced severe strains on capacity this summer and are now ordering equipment to avoid these problems in the future.

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

	1997	1998			1998		
		Q1	Q2	Q3	July	Aug.	Sept.
	Q4/Q4	----- Annual rate -----			--- Monthly rate ---		
PCE	3.7	6.1	6.1	3.9	-.2	.3	.6
Durables	7.4	15.8	11.2	.0	-4.4	1.4	2.4
Motor vehicles	4.0	8.6	19.1	-15.3	-12.5	3.9	4.3
Computers	71.9	66.2	32.1	121.7	11.3	5.3	-1.4
Other durable goods	6.7	18.2	4.8	6.5	.6	-.4	1.5
Nondurables	2.0	7.4	5.3	2.3	.4	-.2	.2
Gas and oil	1.0	1.4	-.3	10.9	1.2	1.7	-.0
Clothing and shoes	4.3	22.2	5.3	.7	1.9	-2.3	.7
Other nondurables	1.6	4.8	5.8	1.9	.0	.1	.1
Services	3.8	3.5	5.4	5.5	.5	.4	.4
Energy	1.1	-24.2	27.4	15.4	-1.0	4.1	1.7
Non-energy	3.9	4.9	4.6	5.1	.6	.2	.3
Housing	2.4	2.7	2.2	2.4	.2	.1	.2
Household operation	8.7	6.5	7.1	5.8	.4	.3	.3
Transportation	5.1	3.7	6.7	.2	-.1	-.8	.2
Medical	2.3	3.1	3.9	2.1	.2	.1	.2
Personal business	4.7	6.5	6.9	5.0	.3	.3	1.0
Other	6.0	9.2	6.2	17.0	2.3	.9	.2
Memo:							
PCE excluding motor vehicles	3.7	6.0	5.4	5.0	.5	.2	.4

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



*Note. Sum of seasonally adjusted heating and cooling degree days.

furniture, household goods, and electronic equipment (excluding computers); spending on these items may be receiving a boost from the high level of activity in the housing market. Real outlays for computers edged down; however, press reports of strong consumer demand for PCs suggest that this is most likely a temporary lull. Real expenditures for nondurable goods posted a solid gain, in part because of strong purchases of apparel.

Real expenditures for services increased 0.4 percent in September. Overall spending for energy services rose as above-average temperatures boosted outlays for electricity (some air conditioners had to keep running). The weather pattern in October would suggest that spending for energy services likely declined. Heavy activity in the stock market boosted real outlays for brokerage services \$6 billion in September, and a further increase in stock market volume in October likely lifted brokerage services. A rise in spending for airline travel contributed to a gain in transportation services in September, but spending on recreational services dropped, largely because of a decline in motion picture admissions.

Partial indicators of spending, such as various chain store indexes, indicate that spending on goods in the GAF category of retail sales (general merchandise, apparel, furniture, and appliance stores) increased modestly in October; trade commentary suggests that warm weather delayed purchases of fall merchandise. However, the surge in sales of motor vehicles undoubtedly provided a strong boost to overall PCE. Retailers appear to be anticipating solid increases in sales through the holiday shopping season.

Real disposable personal income rose 2.6 percent at an annual rate in the third quarter, and the personal saving rate fell to 0.1 percent. In September, the saving rate dipped to -0.2 percent--the lowest reading in the history of the monthly series, which goes back to 1959. Although a rare occurrence, a negative saving rate does not seem at odds with historical patterns of household behavior once the enormous gains in household net worth over the past three years are taken into consideration. Labor income growth probably recorded another solid gain in October, judging by the aggregate hours and wages of production workers reported for the month.

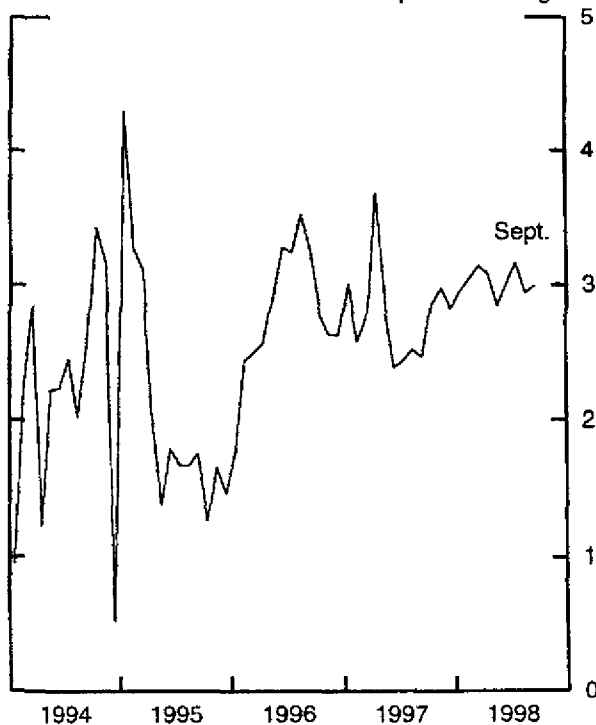
Consumer confidence continued to retreat in October, according to standard surveys. In October, the Michigan SRC sentiment index was nearly 12 percent below its most recent peak in February, while the Conference Board confidence index was about 15 percent below its peak in June; nonetheless, both remain at relatively high levels by pre-1997-98 standards. In the Conference Board survey, households' assessments of both current and expected conditions have deteriorated in recent months. In the Michigan survey, assessments of expected business conditions have

PERSONAL INCOME
(Average monthly percent change)

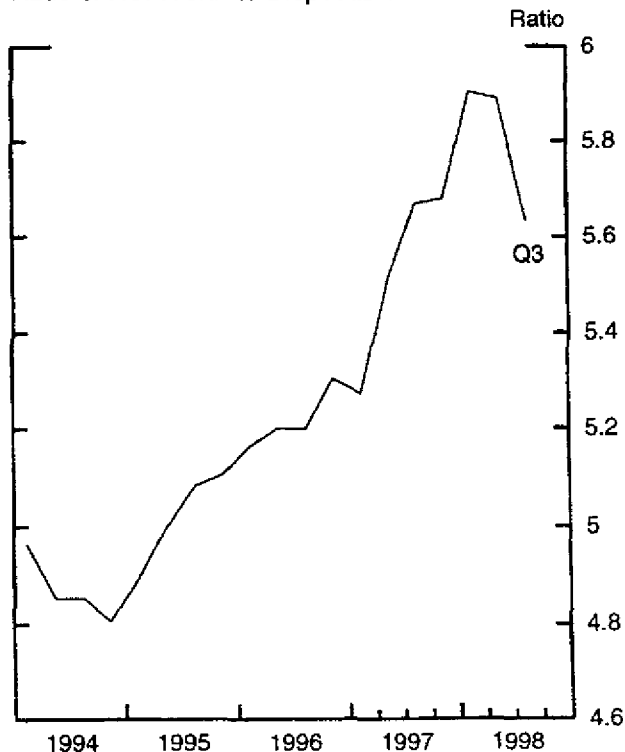
	1997	1998			1998		
		Q1	Q2	Q3	July	Aug.	Sept.
	Q4/Q4	--- Annual rate ---			--- Monthly rate ---		
Total personal income	5.4	5.9	4.5	4.2	.4	.4	.2
Wages and salaries	7.2	7.4	5.6	5.7	.5	.7	.1
Private	7.9	7.9	6.0	6.1	.6	.8	.1
Less: Personal tax and nontax payments	11.5	17.1	10.1	7.6	.4	1.0	.2
Equals: Disposable personal income	4.4	4.0	3.5	3.6	.4	.3	.2
Memo:							
Real disposable income ¹	2.9	4.0	2.6	2.6	.2	.2	.2
Saving rate (percent)	2.1	1.2	.4	.1	.3	.2	-.2

Note. Derived from BEA's advance estimates.
1. Derived from billions of chained (1992) dollars.

Real Disposable Personal Income
12-month percent change



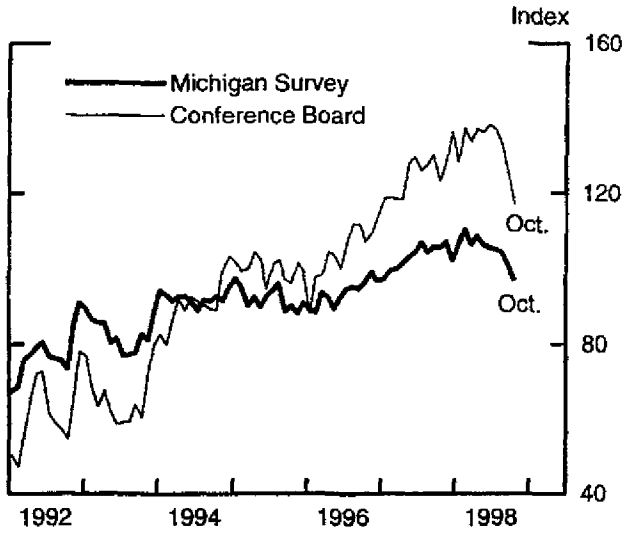
Ratio of Net Worth to Disposable Income



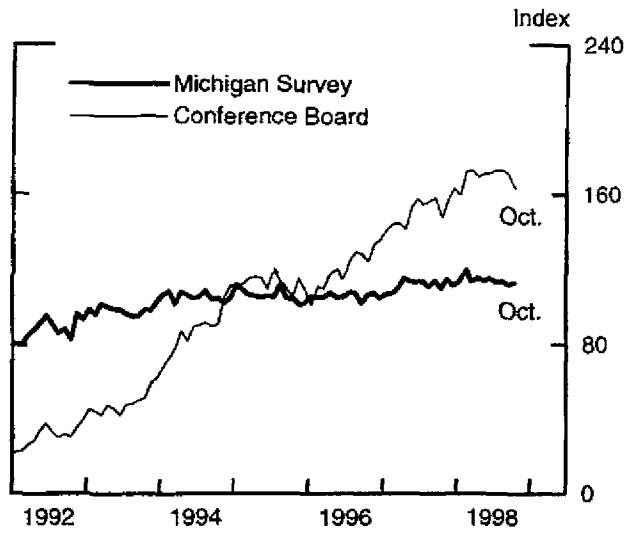
Note. Q3 is a staff estimate.

Consumer Surveys

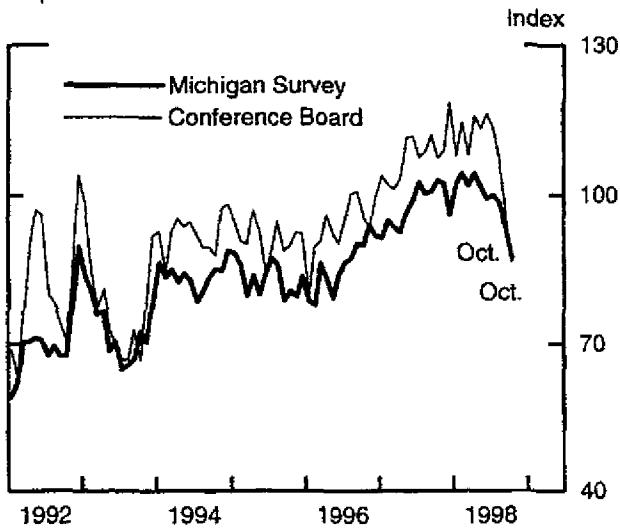
Consumer Confidence



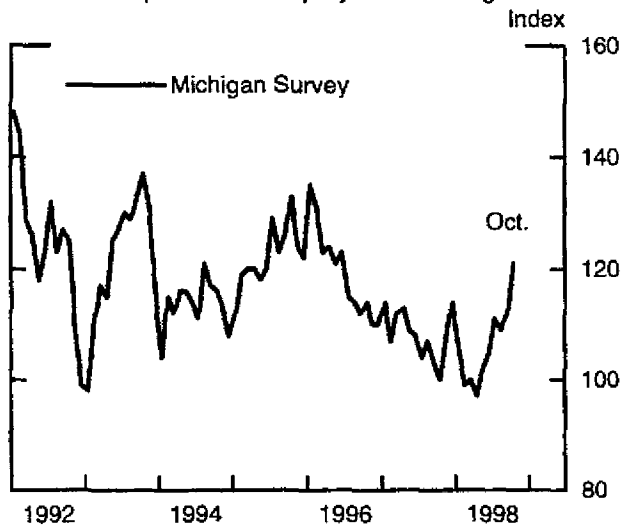
Present and Current Conditions



Expected Conditions



Index of Expected Unemployment Change



PROBABILITY OF JOB LOSS
(Michigan Survey; among respondent aged 64 and under)

		1998									
		Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.
Mean ¹		19.4	20.2	20.7	19.2	20.7	19.8	20.3	20.6	22.4	20.9

1. Probability that household will experience a job loss over the next 5 years.

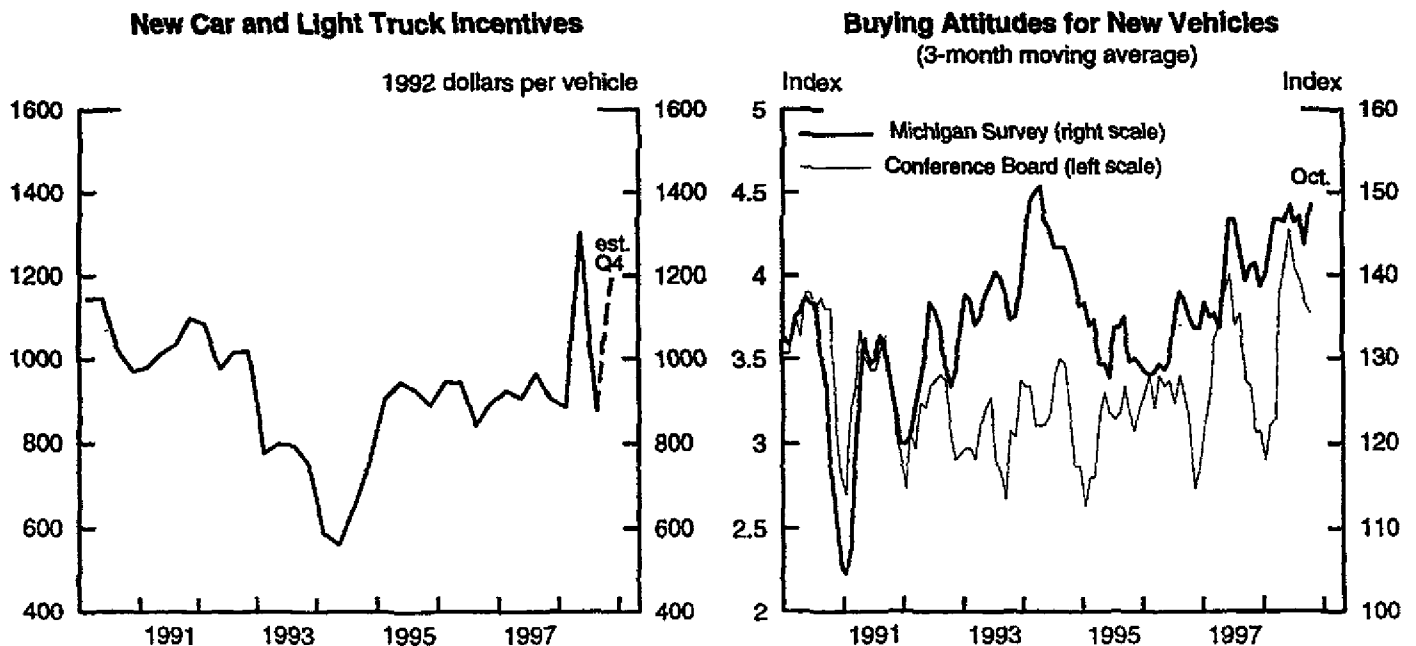
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

	1996	1997	1998			1998		
			Q1	Q2	Q3	Aug.	Sept.	Oct.
Total	15.04	15.07	15.07	16.08	14.56	14.41	15.46	16.48
Adjusted ¹	15.05	15.02	15.32	16.03	14.56	14.61	15.46	16.38
Autos	8.53	8.27	8.03	8.44	7.71	7.80	8.17	8.70
Light trucks	6.52	6.80	7.04	7.64	6.84	6.61	7.29	7.78
North American ²	13.34	13.14	13.12	14.09	12.55	12.38	13.54	14.37
Autos	7.25	6.92	6.65	7.06	6.38	6.41	6.94	7.34
Big Three	5.28	4.95	4.70	5.01	4.17	4.07	4.92	5.12
Transplants	1.97	1.97	1.92	2.05	2.21	2.36	2.03	2.23
Light trucks	6.09	6.23	6.48	7.03	6.17	5.97	6.60	7.03
Foreign Produced	1.70	1.93	1.95	1.99	2.01	2.03	1.92	2.12
Autos	1.27	1.36	1.38	1.37	1.34	1.39	1.22	1.37
Light trucks	.43	.57	.57	.62	.67	.64	.69	.75

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

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

November 5, 1998



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

weakened noticeably; by contrast, respondents' views on current and expected personal finances improved somewhat in October. The index of expected unemployment, which is not included in the overall Michigan index, deteriorated sharply in October, reaching its least favorable level since June 1996. However, this change in sentiment for the labor market overall did not yet appear to alter individuals' assessments of the possibility that someone in their household would experience a job loss: On average in October, households assigned a 21 percent probability that their household might suffer a job loss over the next five years; that figure remained within the narrow range recorded since the SRC added the question to its survey in January.

Motor Vehicles

Adjusted for shifts in reporting periods, sales of new light vehicles surged in October to an annual rate of about 16-1/2 million units, an increase of about 1 million units from the already strong pace in September. The strength in sales partly reflects a renewal of aggressive incentives by the Big Three. As a result, the gains in sales were a bit more concentrated in the domestic makes.

The favorable pricing environment is helping to maintain quite upbeat consumer perceptions of buying conditions for new vehicles. The Michigan SRC index of car-buying conditions jumped in October to its highest reading of the year; consumers' more-favorable views regarding motor vehicle prices more than offset concerns about current and future economic conditions. The Conference Board index of buying intentions rose in October, but the three-month moving average is down from the exceptionally high levels posted this spring, when the "coupon" incentive programs were in place.

The outlook for sales in the near term remains solid, bolstered primarily by the continuing incentives and modest-to-nonexistent sticker price increases on 1999 models. However, reports from industry contacts that the biggest incentives have been on 1998 models, for which supplies are now nearly exhausted, suggest that sales in November may decline substantially from the exceptionally strong October reading.

Housing Markets

Activity in the single-family housing market showed signs of peaking this summer, but the decline of mortgage rates this fall has produced an upturn in several indicators of demand.

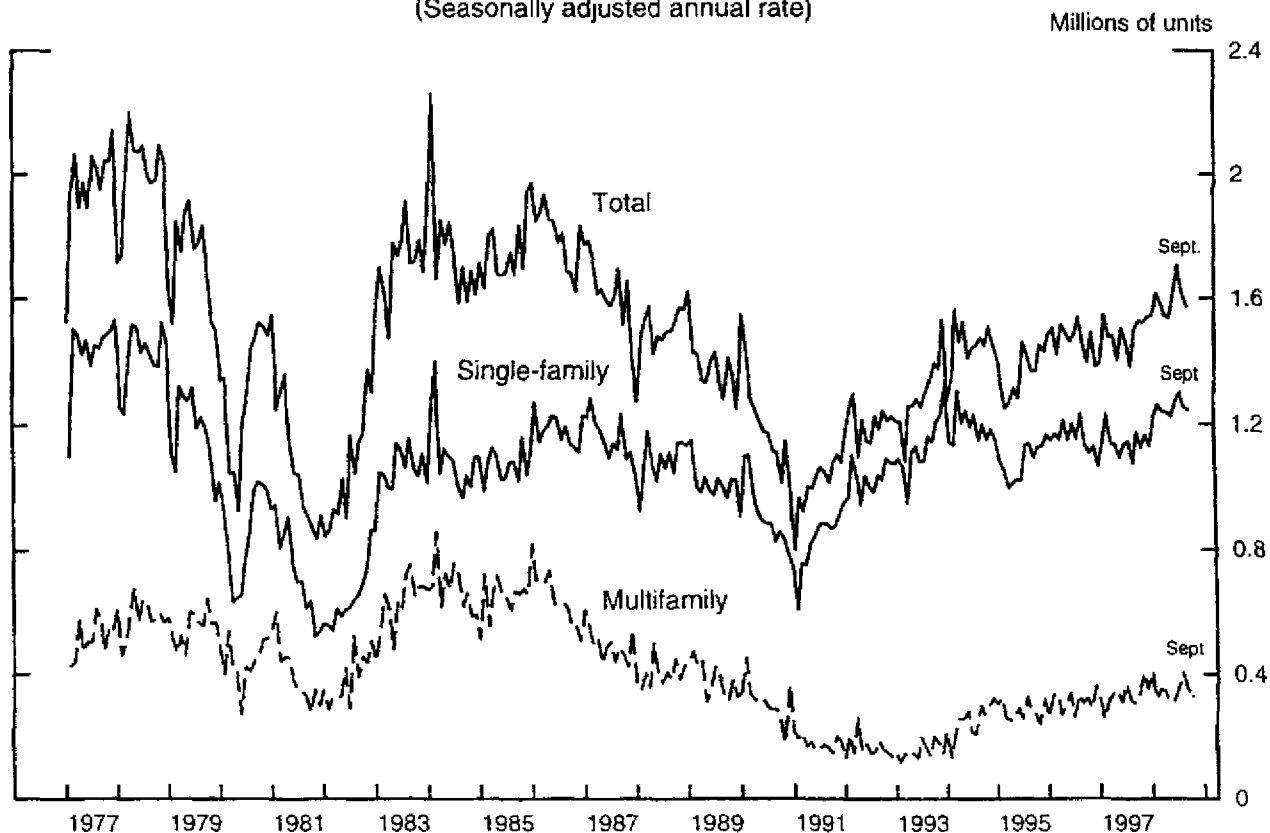
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

	1997	1998					
		Q1	Q2	Q3P	July ^f	Aug. ^f	Sept. ^P
<i>All units</i>							
Starts	1.47	1.58	1.57	1.63	1.70	1.62	1.58
Permits	1.44	1.59	1.53	1.58	1.58	1.62	1.55
<i>Single-family units</i>							
Starts	1.13	1.24	1.24	1.27	1.30	1.25	1.25
Permits	1.06	1.15	1.14	1.17	1.17	1.18	1.16
Adjusted permits ¹	1.14	1.24	1.23	1.26	1.26	1.27	1.26
New home sales	.80	.86	.90	.84	.87	.83	.82
Existing home sales	4.22	4.68	4.78	4.77	4.91	4.73	4.68
<i>Multifamily units</i>							
Starts	.34	.34	.33	.37	.40	.36	.33
Permits	.39	.44	.38	.41	.41	.44	.38
<i>Mobile homes</i>							
Shipments	.35	.37	.37	n.a.	.38	.37	n.a.

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

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

Private Housing Starts
(Seasonally adjusted annual rate)



Starts of single-family homes retreated some in August and September.⁵ Still, the highest quarterly reading in 19 years was the third quarter's 1.27 million unit annual rate for starts. Similarly, new single-family home sales have receded from their record-setting pace in June, but the third-quarter average was the third highest in the past 20 years, exceeded only by the preceding two quarters of this year. Existing home sales set a record in July and declined only slightly in August and September.⁶

According to the monthly NAHB survey, sales of new homes strengthened further in October. Applications for mortgages to finance home purchases also increased. With a sharp increase in the share of households mentioning that mortgage rates are attractively low, the Michigan SRC index of homebuying conditions rebounded to one of the highest levels on record.

Prices of new homes rose moderately in the third quarter. The nominal constant-quality price of new homes was up just 2.8 percent from a year earlier. Price increases for existing homes--as measured by the Freddie Mac and Fannie Mae repeat-sales price index and by the NAR's average and median sales prices--have been running somewhat higher, in the range of 4 to 7 percent above a year earlier.

Multifamily housing starts jumped 12-1/2 percent in the third quarter. However, current market conditions in this sector are difficult to read. Although vacancy rates for multifamily rental units have been about unchanged in recent years, the CPI for residential rent has risen in real terms.

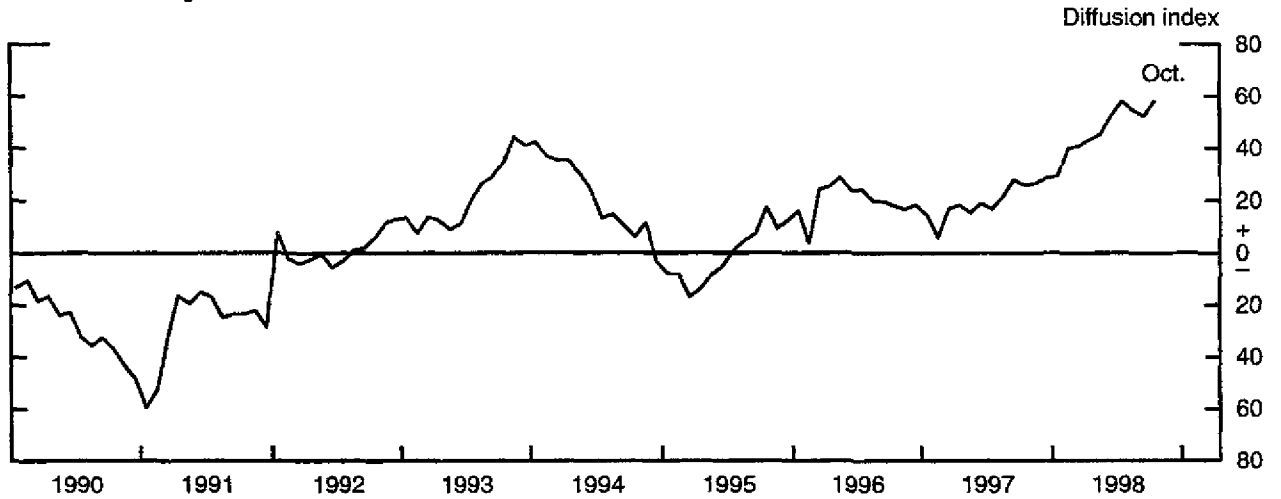
Although underwriting standards have been tightened in recent months, industry observers report that most apartment developers have not had significant problems in financing multifamily projects. However, large-scale projects are said to be encountering greater difficulty in obtaining funds because they rely more heavily on the market for commercial mortgage-backed securities, where flows have constricted and interest rates have risen sharply. Nevertheless, funding is available from traditional sources, such as pension funds and insurance companies, and Fannie Mae and Freddie Mac continue to purchase and securitize multifamily mortgages.

5. The September decrease was more heavily concentrated in the South, where activity had been relatively high earlier in the summer. Hurricane Georges played at most, a small part in this decline; the hurricane did not make landfall until September 28, and few large cities were affected.

6. Data on new home sales are based either on the signing of a contract or on payment of a deposit, but a substantial portion of existing home sales are not recorded until the sale is closed.

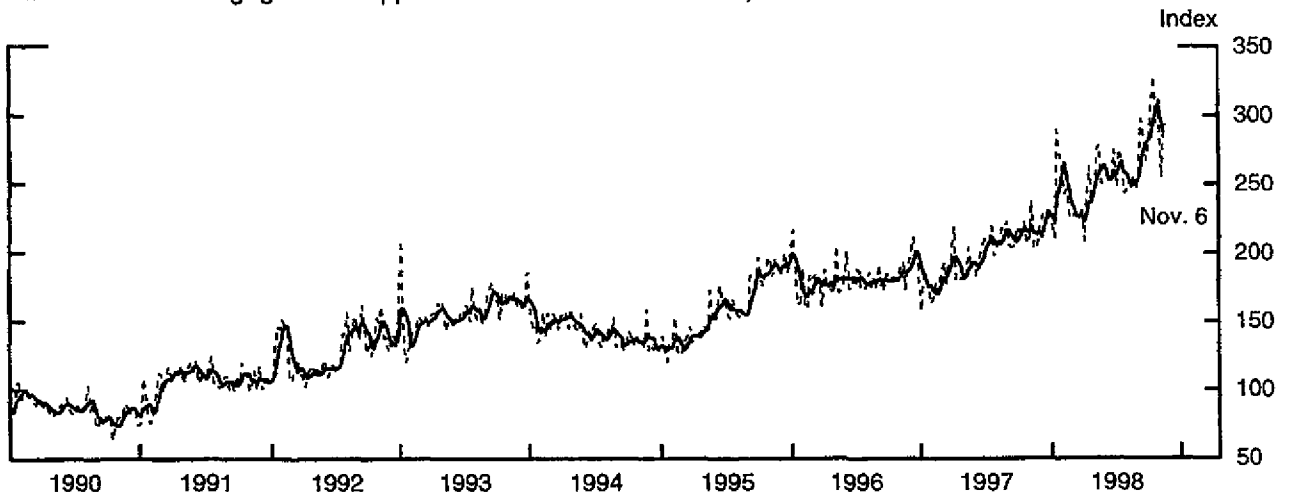
Indicators of Housing Demand

Builders' Rating of New Home Sales, SA

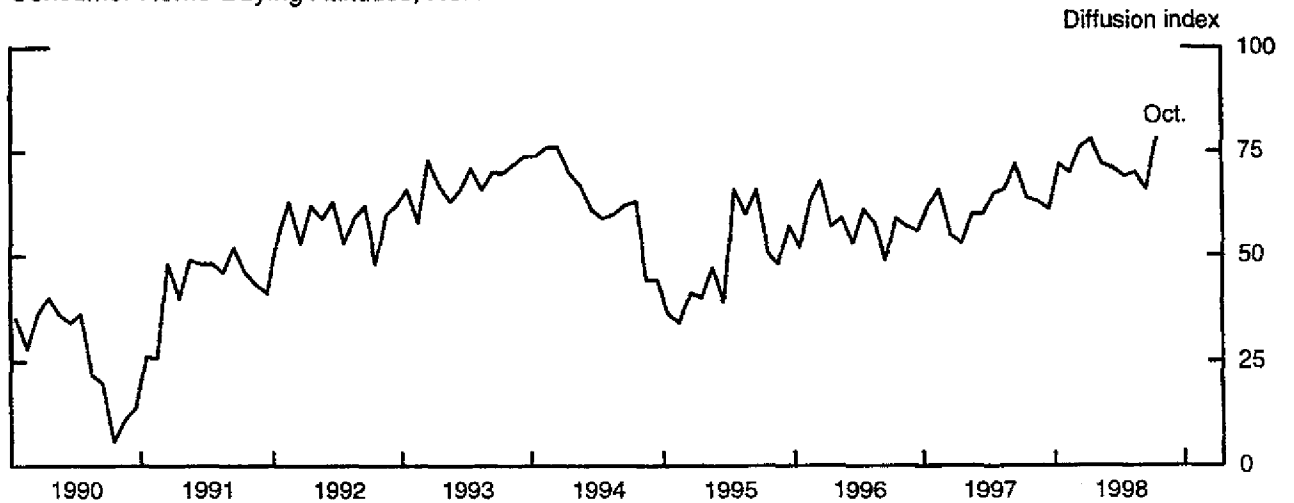


Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

MBA Index of Mortgage Loan Applications for Home Purchase, SA



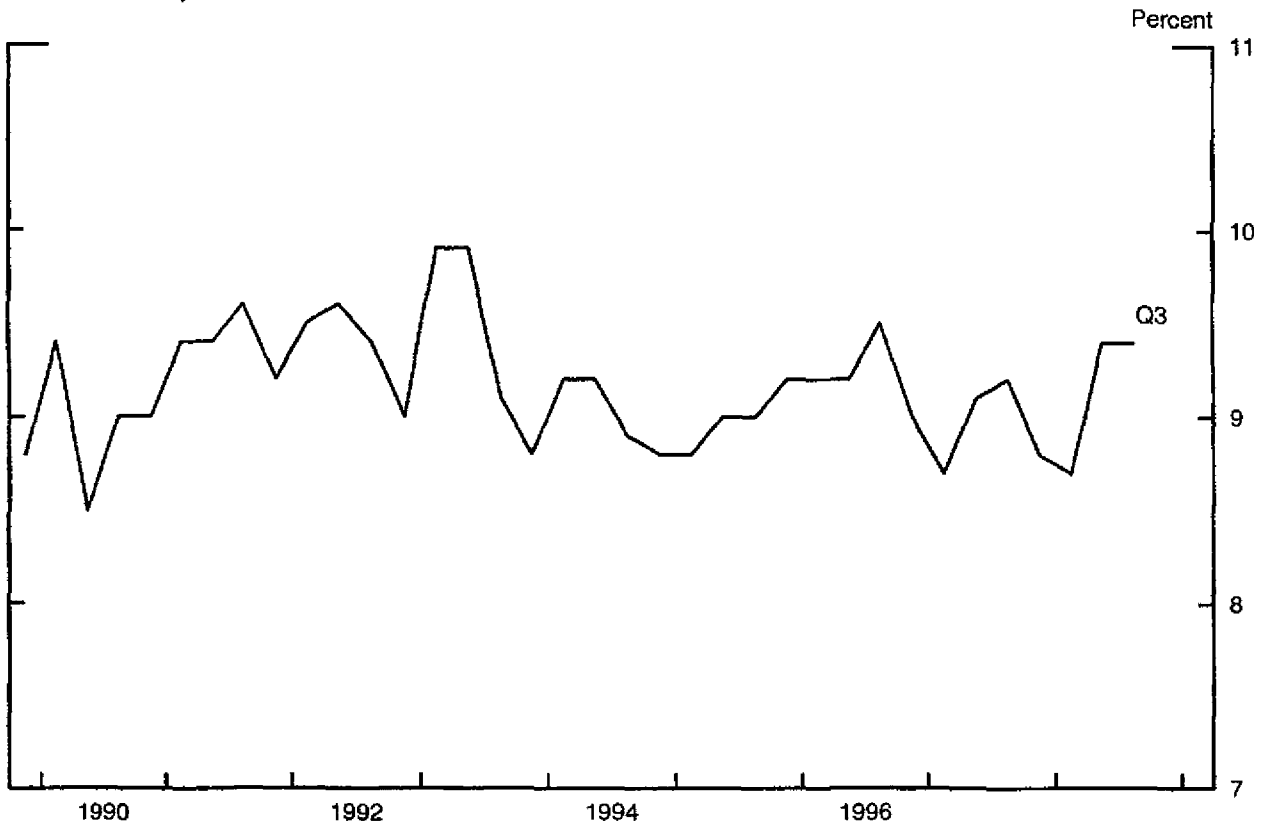
Consumer Home-Buying Attitudes, NSA



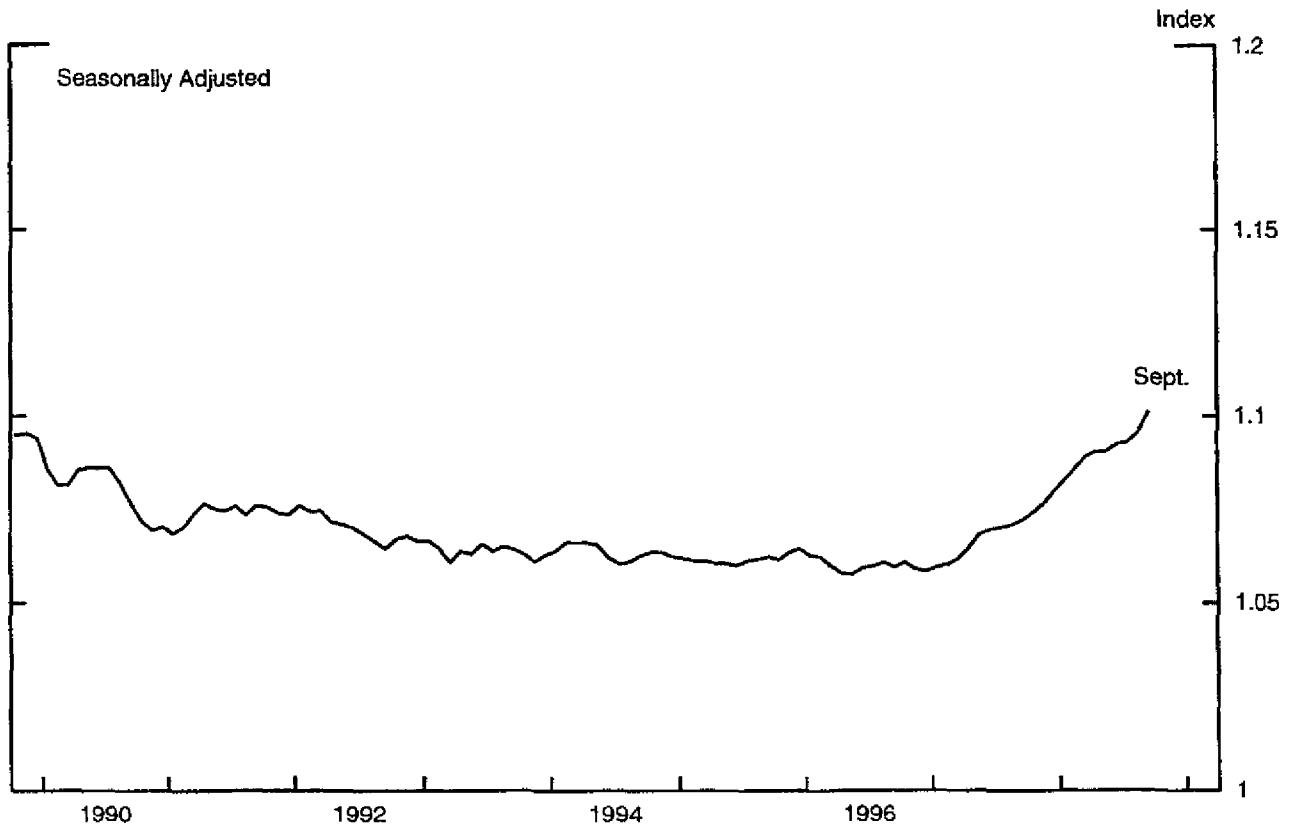
Note. The homebuying attitudes index is calculated from Survey Research Center data as the proportion of respondents rating current conditions as good minus the proportion rating conditions as bad.

Multifamily Housing

Rental Vacancy Rate

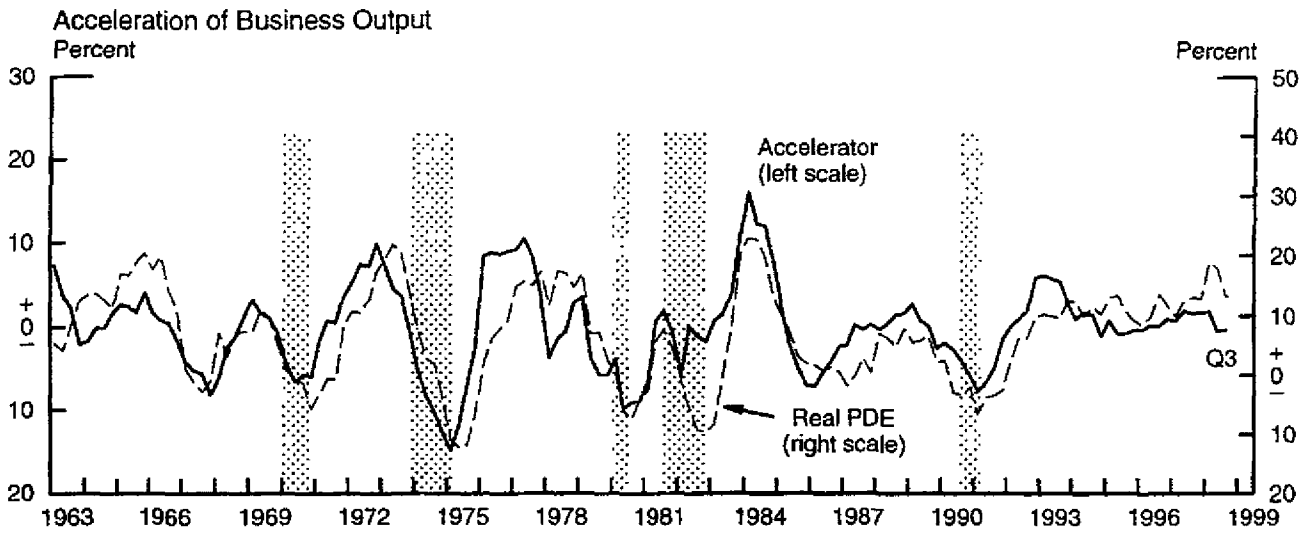


Real Residential Rent



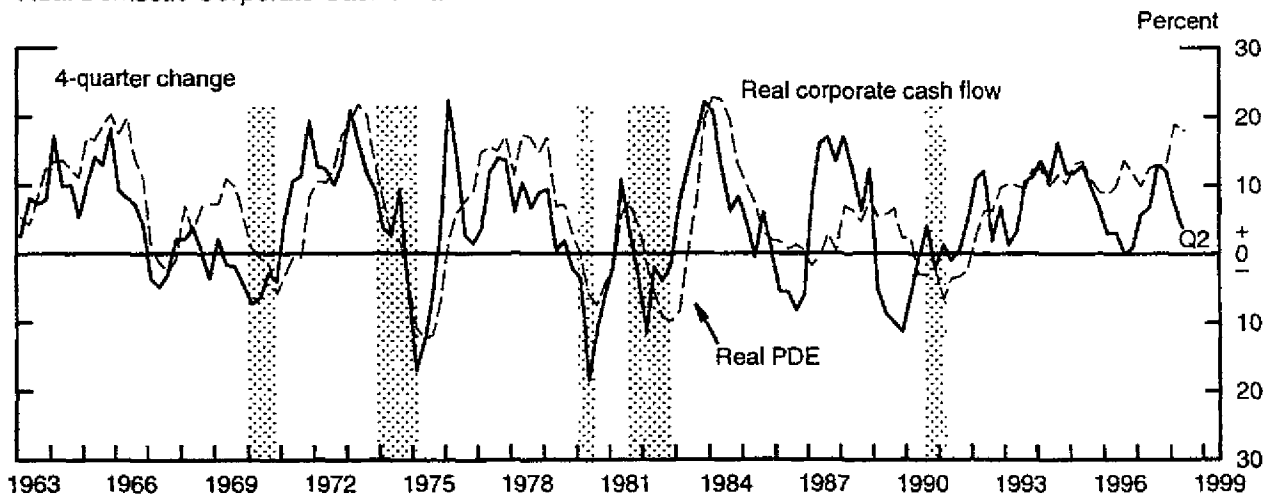
Note. Ratio of CPI rent to the CPI ex. housing for all rental units, including single-family.

Determinants of Equipment Spending



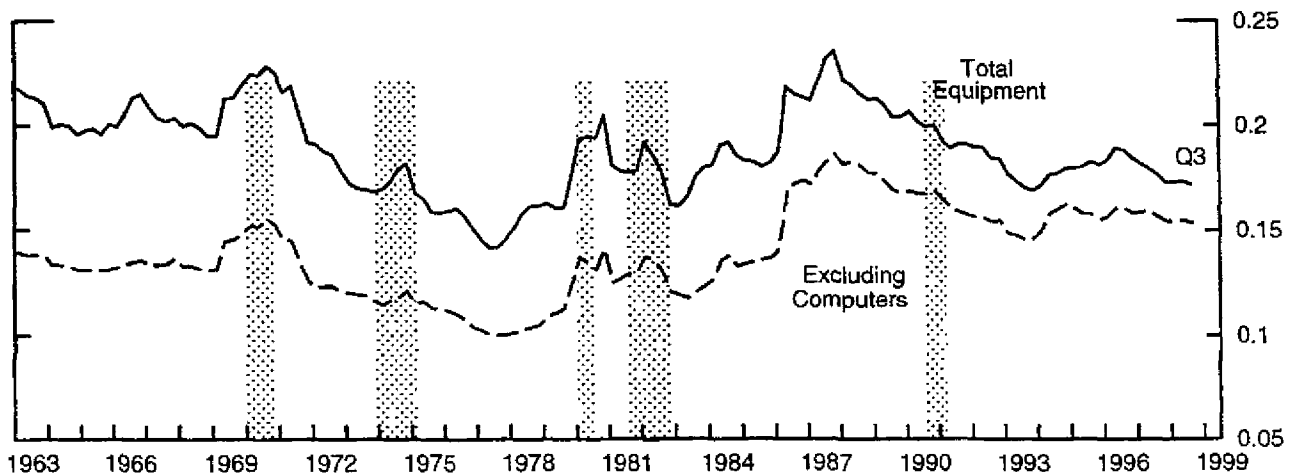
Note. The accelerator is the 8-quarter percent change in business output less the year-earlier 8-quarter percent change. Real PDE is the percent change over the most recent four quarters.

Real Domestic Corporate Cash Flow



Note. Real corporate cash flow is defined as nominal corporate cash flow divided by the deflator for total PDE.

Real User Cost of Capital*



* Staff estimate.

Business Fixed Investment

We now estimate that real business fixed investment, which had a blistering first half, was about unchanged in the third quarter.⁷ Spending was held down last quarter by a strike-related falloff in sales of new motor vehicles to fleets, which we expect to be largely reversed in the current quarter, and by a decline in aircraft deliveries to domestic firms.⁸ Outlays for nonresidential construction continued to slip last quarter.

Producers' durable equipment. Equipment spending outside of transportation appears to have increased somewhat more slowly in the third quarter than earlier in the year, although we estimate that it expanded at an annual rate of 12-1/4 percent. Recent developments in financial markets and a weak outlook for the manufacturing sector may have damped future capital spending plans, but through September new orders for capital equipment had not yet waned.

We now estimate that, following even more phenomenal increases of 101 percent in the first quarter and 60 percent in the second, real outlays on office and computing equipment increased at an annual rate of 46 percent in the third quarter. Real expenditures continue to be boosted by price declines that have run at an annual rate of almost 30 percent in each quarter this year, a faster drop than last year's pace. Various anecdotes suggest that some firms are dealing with the Year 2000 problem by upgrading to the latest information technology, a trend we expect to see extended for some months. The near-term outlook for spending on communications equipment also continues to appear positive: After having declined during the early summer, orders for this equipment rebounded in August and September, and a substantial backlog of orders remained.

Business demand for heavy trucks continues to be extraordinarily robust. Sales for heavy trucks in the third quarter averaged a record 542,000 units (annual rate). Net new orders of heavy trucks are off only slightly from the high levels seen earlier this year. Nonetheless, a record backlog suggests that spending on heavy trucks should remain strong in the near term. Excluding high-tech and transportation equipment, growth in equipment spending slowed from a 10 percent annual rate over the first half of the year to a 3 percent rate in the third quarter.

Despite numerous indications that firms have trimmed spending plans, orders received by U.S. equipment makers were still solid through September. New orders

7. Our current estimate of third-quarter real BFI growth is slightly higher than the 1 percentage point decline (annual rate) shown in BEA's advance release. The upward revision is a result of September data on construction put in place that were stronger than BEA had assumed when preparing the advance estimate and upward-revised figures for shipments of computers in September.

8. The decline was more than offset by an increase in exports of aircraft.

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

	1998		1998		
	Q2	Q3	July	Aug.	Sept.
<u>Producers' durable equipment</u>					
Shipments of nondefense capital goods	1.4	1.3	-2.1	-.2	3.6
Excluding aircraft and parts	1.6	1.2	-2.0	-.9	2.4
Office and computing	4.7	1.9	.5	-2.4	-1.4
Communications equipment	.8	1.7	-7.7	3.7	8.3
All other categories	.6	.8	-1.5	-1.5	2.5
Shipments of complete aircraft	-12.6	5.7	23.4	-20.0	-2.1
Sales of heavy trucks	4.7	9.9	9.2	5.7	3.6
Orders for nondefense capital goods	-.1	4.2	-.6	9.1	-3.4
Excluding aircraft and parts	-.9	4.8	-1.6	2.5	6.5
Office and computing	4.3	2.8	.4	-1.3	-1.9
Communications equipment	-4.9	-2.3	-13.6	6.2	20.1
All other categories	-1.8	7.5	.9	3.2	6.7
<u>Nonresidential structures</u>					
Construction put in place, buildings	1.1	-.2	-.3	.1	-1.9
Office	5.7	1.2	-2.3	-.1	2.7
Other commercial	.6	-2.6	.8	-4.7	-3.7
Institutional	-2.3	-1.8	-.4	1.2	1.6
Industrial	-2.5	-3.8	-4.9	8.5	-9.4
Lodging and miscellaneous	4.3	9.6	6.6	-1.1	.4
Rotary drilling rigs in use ¹	-11.9	-13.4	-5.1	-5.7	-4.7
Memo (1992 Chained dollars):					
Business fixed investment	12.8	-1.0	n.a.	n.a.	n.a.
Producers' durable equipment	18.8	1.1	n.a.	n.a.	n.a.
Office and computing	59.7	38.6	n.a.	n.a.	n.a.
Communications equipment	10.2	13.4	n.a.	n.a.	n.a.
Other equipment ²	8.8	3.2	n.a.	n.a.	n.a.
Nonresidential structures	-2.3	-6.5	n.a.	n.a.	n.a.

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

2. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.

n.a. Not available.

for capital equipment excluding high-tech and aircraft rose 7-1/2 percent in the third quarter. Much of this increase reflects a surge in orders evidently from electric utilities for gas turbines. In other categories new orders, on net, rose modestly, but assuming that the weakness in exports persists, the pace is consistent with rising real domestic demand, at least over the next few months.

Nonresidential construction. Nonresidential building activity continued to decline in the third quarter. On the basis of data through September for construction put in place, the staff estimates that investment in nonresidential structures fell at an annual rate of 1-3/4 percent last quarter. Construction of office space was unchanged at a high level, which reflects the continued decline in vacancy rates and the rapid pace of price increases for office properties. However, other commercial construction, which includes retail stores and warehouses, has fallen, as has institutional construction. In addition, industrial building ebbed further, a performance consistent with the relatively low rate of capacity utilization in manufacturing. In contrast, building of lodging facilities surged last summer, although declining contracts and trade reports of overbuilding suggest that strength in this sector is unlikely to persist for long.

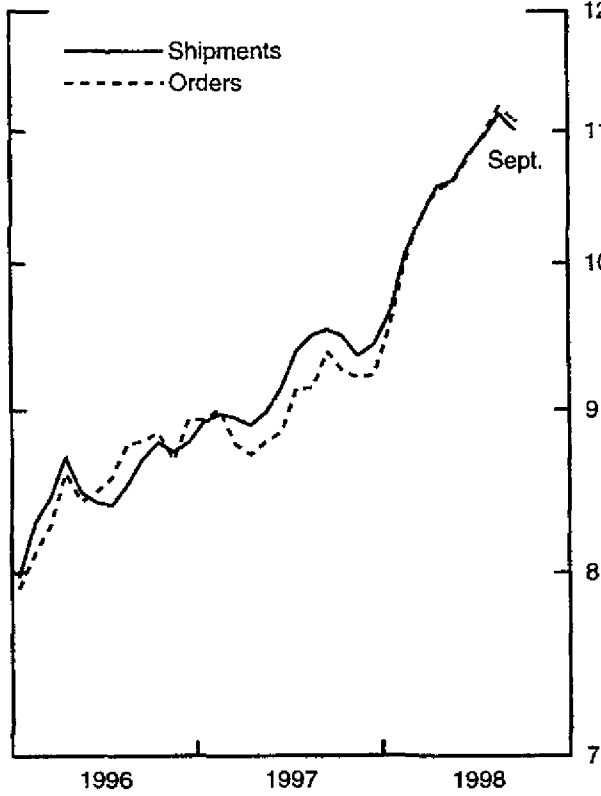
In late summer, the financial climate for nonresidential construction turned chilly, according to industry observers. In part because of calls by regulators for increased vigilance, banks and thrifts are giving loan requests more careful scrutiny. Large declines in their stock prices have limited the ability of mortgage REITs to raise capital with which to finance construction or to bid for commercial mortgages. Moreover, the bankruptcy filing in October by Criimi Mae, a REIT that had aggressively acquired the lower-rated tranches of commercial-mortgage-backed security issues, has limited the flow of credit from the CMBS market. As a result, large projects, which have relied more on financing supplied through the CMBS market, now face greater difficulty in obtaining financing and higher interest rates. However, real estate finance subsidiaries of firms such as GMAC and General Electric Capital reportedly are purchasing higher-risk CMBS issues, helping to support issuance of CMBS, but at higher rates and with less accommodative credit standards as compared with mortgage REITs. Furthermore, insurance companies and pension funds remain active suppliers of financing for commercial real estate.

Orders and Shipments of Nondefense Capital Goods

(3-month moving average)

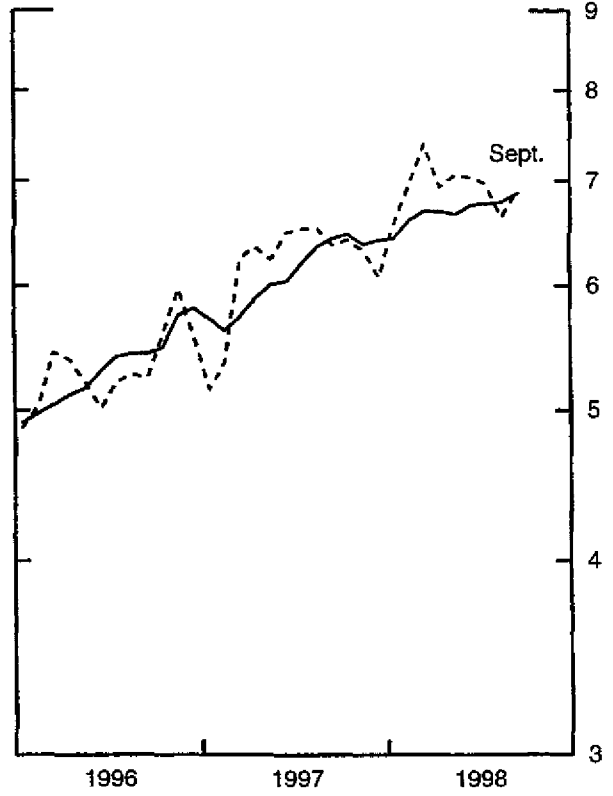
Office and Computing Equipment

Billions of dollars, ratio scale



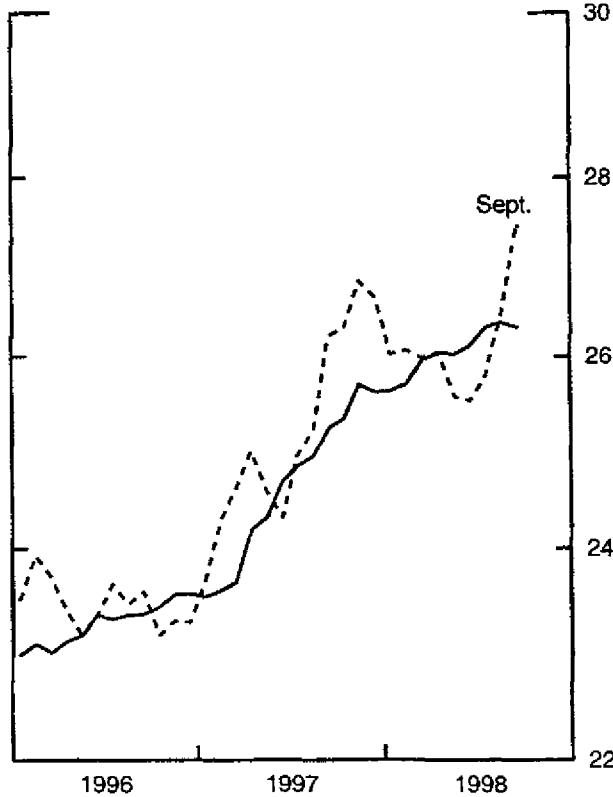
Communications Equipment

Billions of dollars, ratio scale



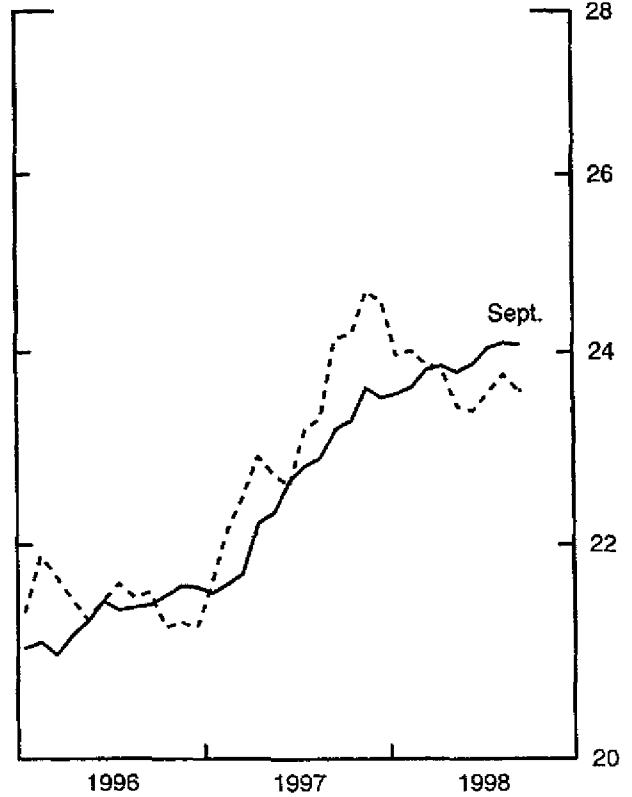
Other Equipment

Billions of dollars, ratio scale



Other Equipment Less Engines and Turbines

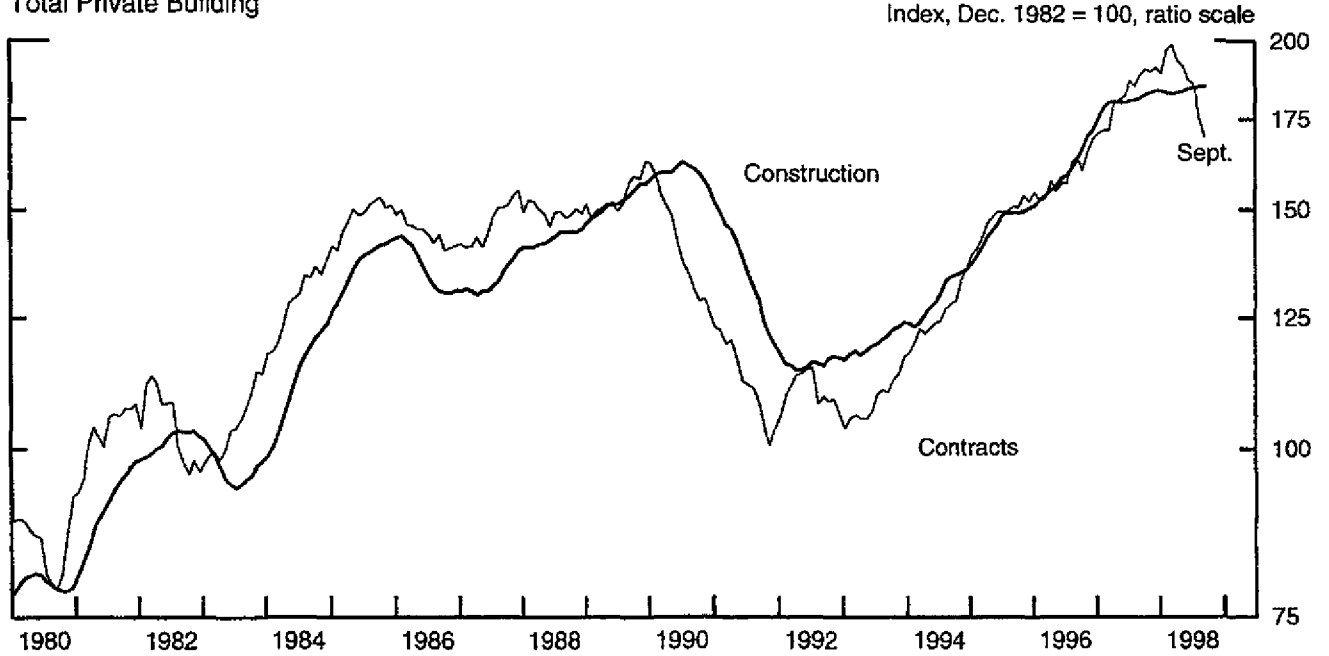
Billions of dollars, ratio scale



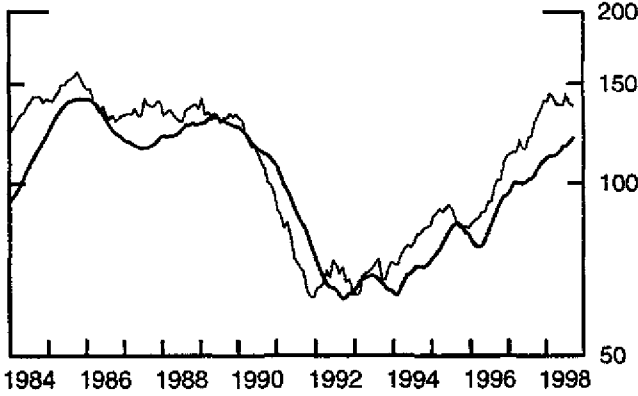
Nonresidential Construction and Contracts

(Six-month moving average)

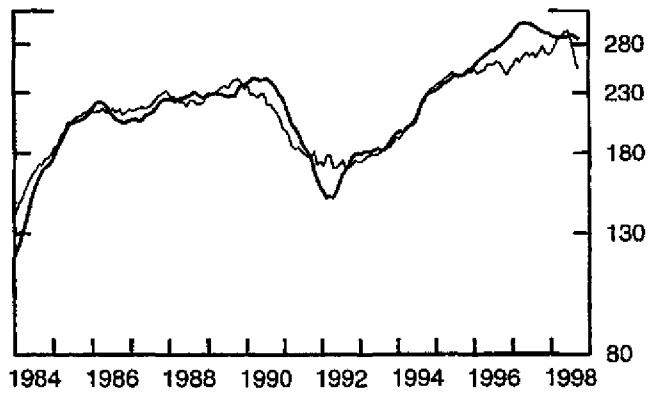
Total Private Building



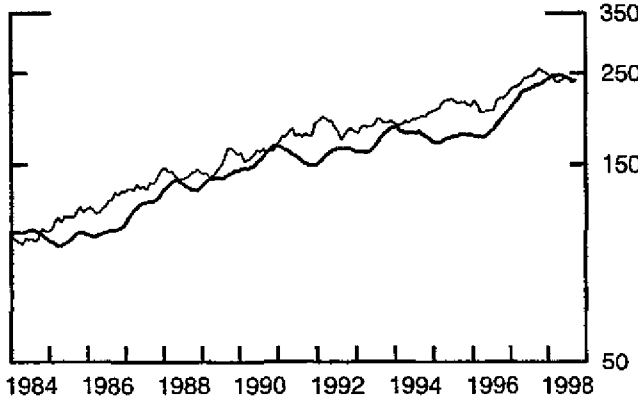
Office



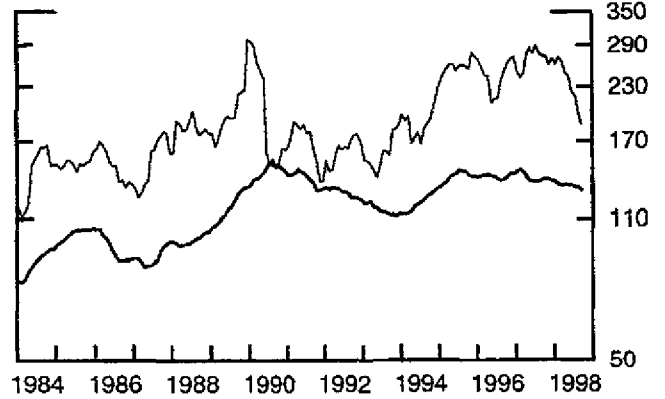
Other Commercial



Institutional



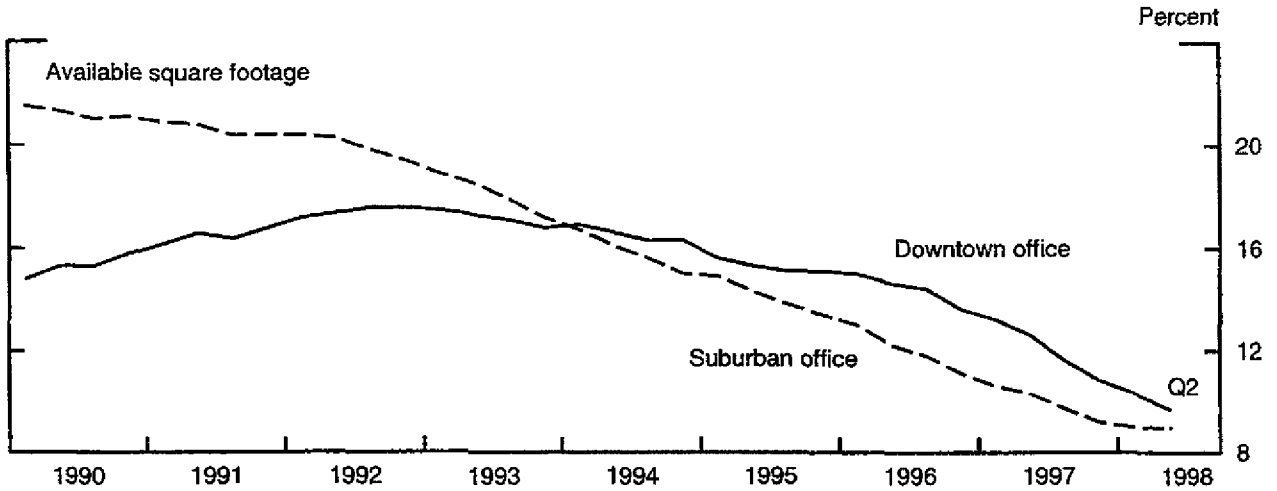
Industrial



Note. Individual sectors include both public and private building.

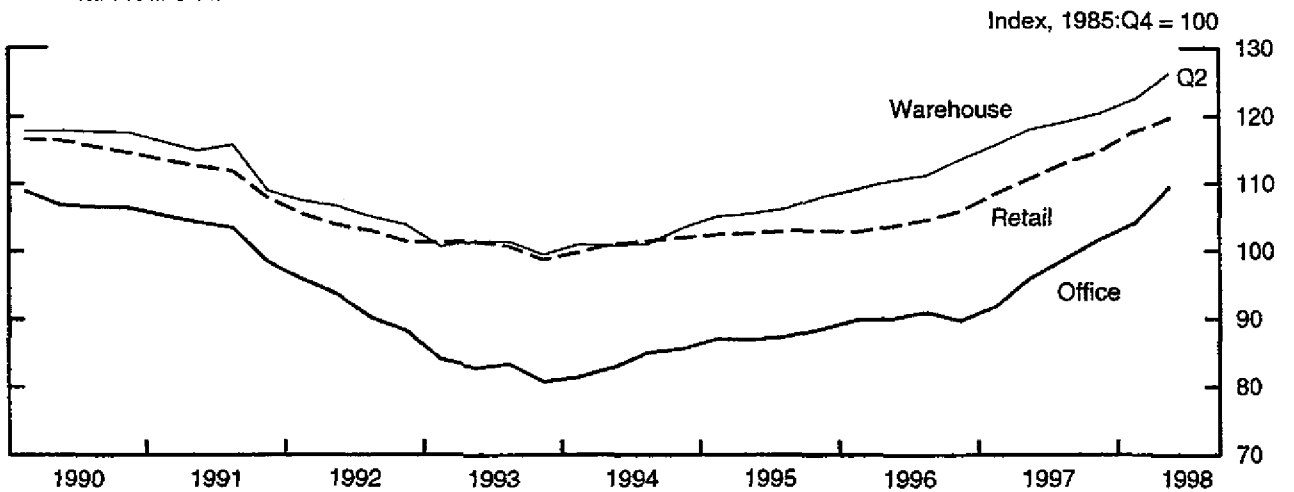
Nonresidential Construction Indicators

Vacancy Rates



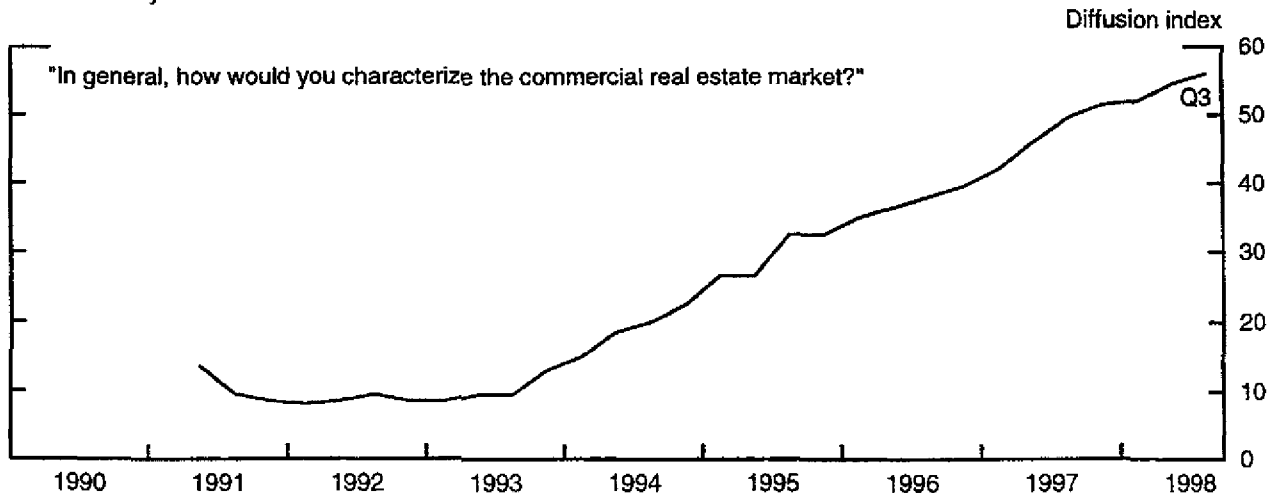
Source: CB Commercial Real Estate.

National Real Estate Price Index



Note. Data are semiannual from 1986 to 1991 and quarterly from 1992 forward.

FDIC Survey



Note. Calculated as $[(\text{Percent reporting tight supply} - \text{Percent reporting excess supply})/2] + 50$.

Business Inventories

The pace of business inventory accumulation picked up in the third quarter and (by our estimate) added 1.4 percentage points to the increase in real GDP--1.1 percentage points excluding the effect of a transfer of uranium stocks from federal to private hands.⁹ This faster pace was largely the result of two factors: a much smaller decline in motor vehicle stocks than during the second quarter and an accumulation of farm products by wholesalers. Excluding these two components, we currently estimate that real inventory accumulation was about flat at an elevated rate in the third quarter.

Manufacturers' stockbuilding slowed last summer. For the third quarter as a whole, book-value inventories increased \$8 billion (annual rate), down from an average pace of \$21 billion over the first half of the year. Excluding this year's sizable increase in inventories of aircraft and parts, the slowing in the pace of accumulation is even more pronounced, with non-aircraft inventories rising at a \$2 billion annual rate in the third quarter, down from a \$7 billion pace in the second quarter and a \$19 billion rate in the first quarter.¹⁰ The deceleration in stock building has roughly followed shipments; the inventory-shipments ratio was unchanged in the third quarter at just a touch above last year's average. Ratios have risen, however, in steel, chemicals, and paper, three industries that have been hit hard this year by import competition.

Non-auto wholesale inventories accumulated rapidly last quarter, with book-value stocks increasing at an annual rate of \$24 billion. The inventory-sales ratio for this category rose to its highest level since 1986. Almost half of the third-quarter accumulation is the result of a buildup of farm products. Good weather conditions led to an early harvest this year, and stocks rose significantly at wholesalers in September. Wholesalers of machinery, chemicals, and metals and minerals also appear to have experienced undesired buildups of stocks. Retail inventories excluding motor vehicles appear to be at comfortable levels; the slow pace of accumulation in July and August kept the inventory-sales ratio for this category flat and well within the narrow range seen over the past year.

9. In July, the federal government sold the United States Enrichment Corporation to private investors. The sale raised real business inventories \$5.1 billion (annual rate) in the third quarter and real PDE \$0.5 billion. The sale was reflected in the third-quarter NIPAs but did not show up in the monthly Census inventory data. The increases in NIPA inventories and PDE from this sale were offset by lower federal spending.

10. According to industry sources, Boeing has an estimated thirty-four finished aircraft in storage awaiting delivery. Most of these planes were ordered by Asian customers who have delayed delivery because of financing problems.

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

	1998			1998		
	Q1	Q2	Q3	July	Aug.	Sept.
<u>Book value basis</u>						
Total	62.7	7.0	n.a.	4.3	45.1	n.a.
Excluding wholesale and retail motor vehicles	55.3	35.0	n.a.	20.4	41.7	n.a.
Manufacturing	23.3	19.0	7.8	11.2	9.7	2.4
Excluding aircraft	19.2	6.9	2.3	4.0	-2.8	5.7
Wholesale	17.3	-.4	25.6	-.6	37.5	39.9
Excluding motor vehicles	11.5	10.9	24.0	5.0	30.2	36.9
Retail	22.1	-11.5	n.a.	-6.3	-2.1	n.a.
Auto dealers	1.6	-16.6	n.a.	-10.5	-4.0	n.a.
Excluding auto dealers	20.5	5.0	n.a.	4.2	1.9	n.a.

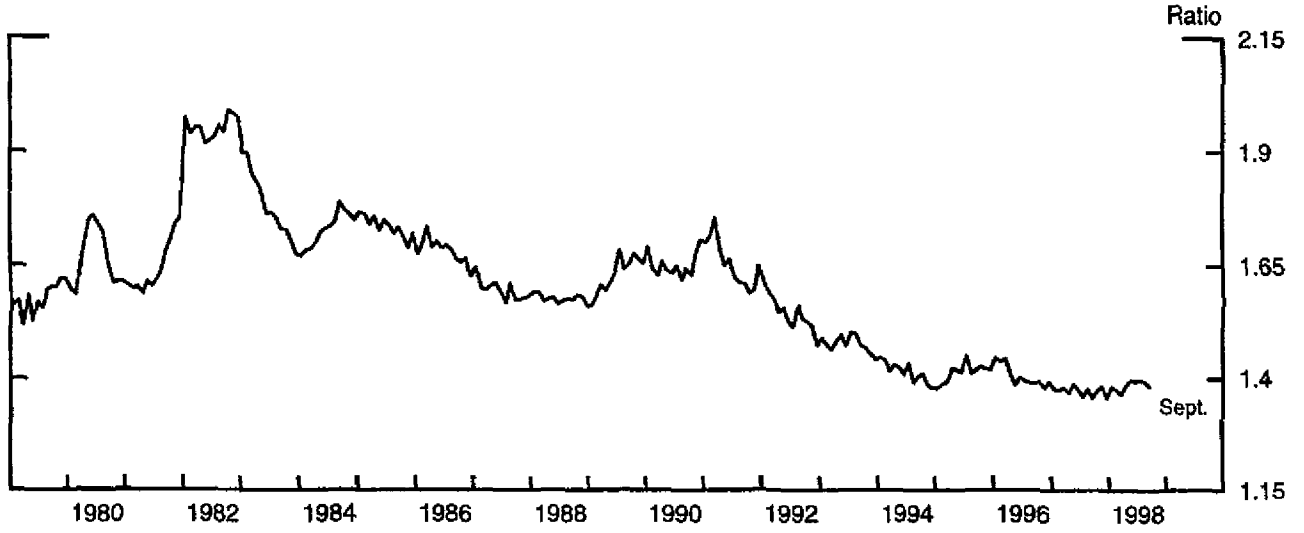
SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

	Cyclical <u>reference points</u>		Range over <u>preceding 12 months</u>		Sept. 1998
	1990-91 high	1995-96 low	High	Low	
Manufacturing and trade	1.58	1.38	1.39	1.37	1.39
Less wholesale and retail motor vehicles	1.55	1.35	1.37	1.34	1.37
Manufacturing	1.75	1.38	1.40	1.36	1.38
Primary metals	2.08	1.49	1.65	1.53	1.66
Steel	2.56	1.69	2.05	1.80	2.09
Nonelectrical machinery	2.48	1.77	1.75	1.61	1.66
Electrical machinery	2.08	1.41	1.39	1.29	1.25
Transportation equipment	2.93	1.51	1.85	1.57	1.64
Motor vehicles	.97	.56	.64	.54	.54
Aircraft	5.84	4.44	5.12	4.34	4.55
Nondefense capital goods	3.09	2.27	2.33	2.12	2.13
Textiles	1.71	1.42	1.54	1.40	1.57
Paper	1.32	1.06	1.21	1.13	1.26
Chemicals	1.44	1.25	1.45	1.32	1.43
Petroleum	.94	.80	.91	.85	.89
Home goods & apparel	1.96	1.63	1.69	1.59	1.70
Merchant wholesalers	1.36	1.26	1.33	1.27	1.33
Less motor vehicles	1.31	1.22	1.31	1.24	1.32
Durable goods	1.83	1.55	1.62	1.58	1.64
Nondurable goods	.95	.91	.99	.93	.98
Retail trade	1.61	1.50	1.50	1.45	1.45
Less automotive dealers	1.48	1.43	1.42	1.40	1.40
Automotive dealers	2.22	1.69	1.77	1.56	1.61
General merchandise	2.42	2.20	2.10	2.00	2.03
Apparel	2.53	2.27	2.45	2.33	2.41
GAF	2.42	2.23	2.14	2.06	2.07

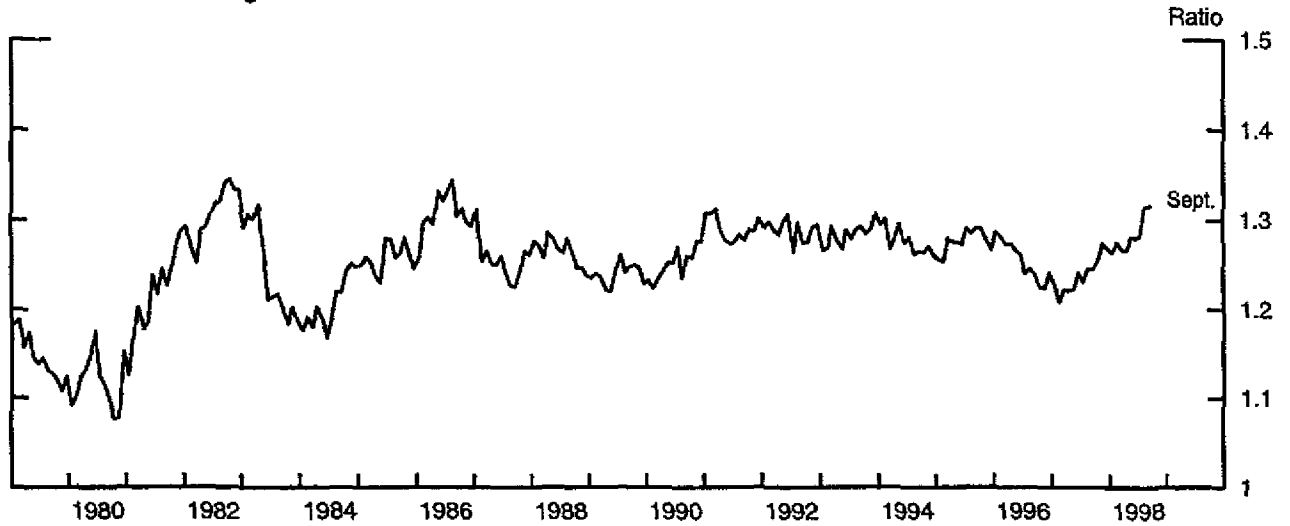
Note. September 1998 ratios for manufacturing and wholesale; August 1998 ratios for retail trade.

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

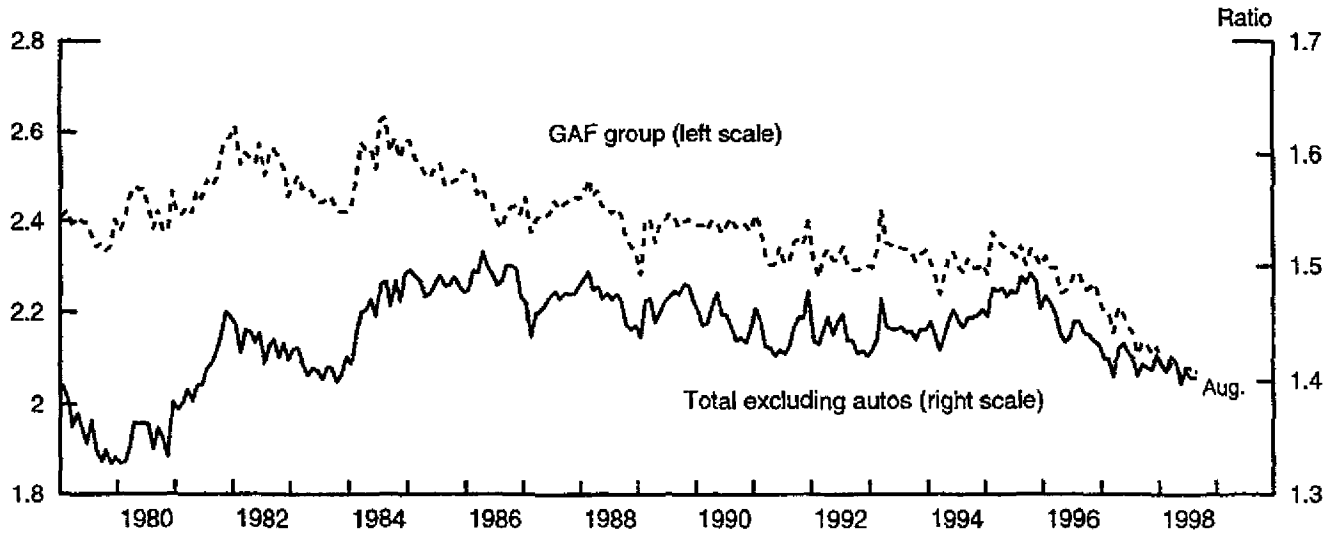
Manufacturing



Wholesale Excluding Motor Vehicles



Retail



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

	September			12 months ending in Sep.		
	1997	1998	Percent change	1997	1998	Percent change
Outlays	124.8	142.7	14.3	1600.9	1651.4	3.2
Deposit insurance	-0.4	-0.4	n.a.	-14.3	-4.4	n.a.
Spectrum auction	0.0	-1.5	n.a.	-11.0	-2.6	n.a.
Other	125.3	144.6	15.4	1626.3	1658.4	2.0
Receipts	174.8	180.9	3.5	1579.0	1721.4	9.0
Surplus (+)/deficit (-)	49.9	38.2	n.a.	-22.0	70.0	n.a.
Adjusted for payment timing shifts¹ and excluding deposit insurance and spectrum auction						
Outlays	132.9	144.6	8.8	1626.3	1658.4	2.0
National defense	23.3	24.7	6.0	272.6	270.4	-0.8
Net interest	17.1	16.0	-6.4	244.0	243.4	-0.3
Social security	30.4	31.8	4.4	365.3	379.2	3.8
Medicare	15.1	15.8	4.1	190.0	192.8	1.5
Medicaid	8.9	8.7	-2.3	95.6	101.2	5.9
Other health	1.8	2.6	39.4	27.9	29.8	6.8
Income security	15.9	17.3	9.0	230.6	233.0	1.0
Other	20.2	27.7	36.7	200.4	208.6	4.1
Receipts	174.8	180.9	3.5	1579.0	1721.4	9.0
Individual income and payroll taxes	124.8	132.7	6.3	1239.8	1363.9	10.0
Withheld + FICA	85.7	89.9	4.9	1054.6	1149.1	9.0
Nonwithheld + SECA	41.6	45.5	9.5	278.8	314.2	12.7
Refunds (-)	2.5	2.7	10.3	93.6	99.5	6.3
Corporate	37.3	36.8	-1.4	182.3	188.7	3.5
Other	12.6	11.5	-9.2	156.9	168.9	7.6
Surplus (+)/deficit (-)	41.9	36.4	n.a.	-47.3	63.0	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 Sector

Real purchases of consumption and investment goods by the federal government fell at an annual rate of more than 1-1/2 percent in the third quarter. The rise in real defense purchases of 4 percent (annual rate) was boosted by a rebound in defense investment from a below-trend second-quarter figure. Net nondefense purchases, which fell 12 percent (annual rate), were held down by the sale of the United States Enrichment Corporation. Nominal proceeds of the sale totaled \$3.1 billion: \$1.5 billion of financial assets and \$1.6 billion (\$6.4 billion at an annual rate) of machinery and inventories.

The Monthly Treasury Statement for September reported a unified budget surplus of \$70 billion for fiscal 1998, the first surplus since 1969 and the largest as a share of GDP since 1957. Receipts rose 9 percent in fiscal 1998, reaching 20.5 percent of GDP, the highest share in the postwar period; outlays increased 3 percent, falling to 19.7 percent of GDP, the lowest since the early 1970s. After excluding deposit insurance and spectrum auction proceeds and adjusting for payment timing dates, outlays rose only 2 percent, with reductions in defense and net interest and with a meager 1-1/2 percent rise in Medicare outlays. The sharp deceleration in Medicare reflects, in small part, the program cuts enacted last year and a slowdown in claims processing.

Receipts in September were only 3-1/2 percent higher than a year earlier, in part because of a delay in excise tax payments allowed under last year's Balanced Budget Act.¹¹ These factors notwithstanding, receipts appear to be slowing, particularly withheld personal taxes (income taxes and social insurance contributions) and corporate income taxes. Corporate income taxes in September were 1-1/2 percent lower than a year earlier, a drop perhaps reflecting the fall in corporate profits. Bucking the overall slowing in receipts were nonwithheld personal taxes (income and social insurance contributions), which rose a hefty 9-1/2 percent in September relative to a year earlier.

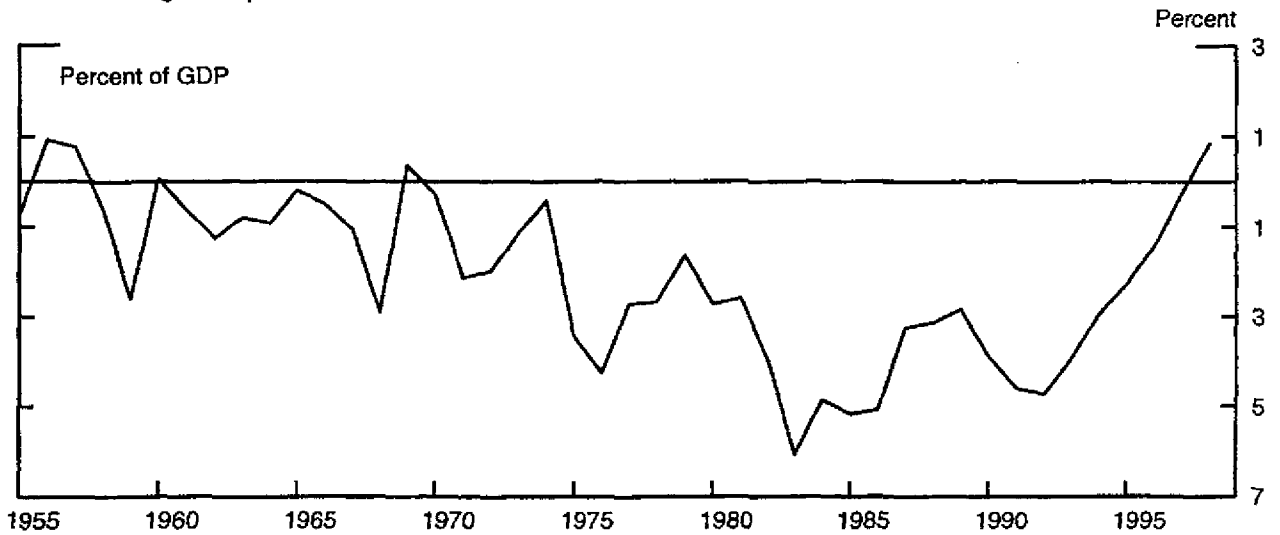
Outlays surged in September, rising nearly 9 percent after accounting for deposit insurance, spectrum auction proceeds, and shifts in payment timing. Outlays were lifted by a one-time charge of \$5 billion for spectrum auction payment subsidies because the government expects to receive less in payments from earlier auctions than had been booked earlier. A pickup in defense spending also pushed up September

11. In addition, the Monthly Treasury Statement data are not seasonally adjusted. Seasonal factors reduced this September's withheld income and social insurance taxes relative to a year ago because September had one fewer Monday than last year and Mondays tend to have higher collection rates than other days. Thus, these receipts were low relative to the year-earlier figures.

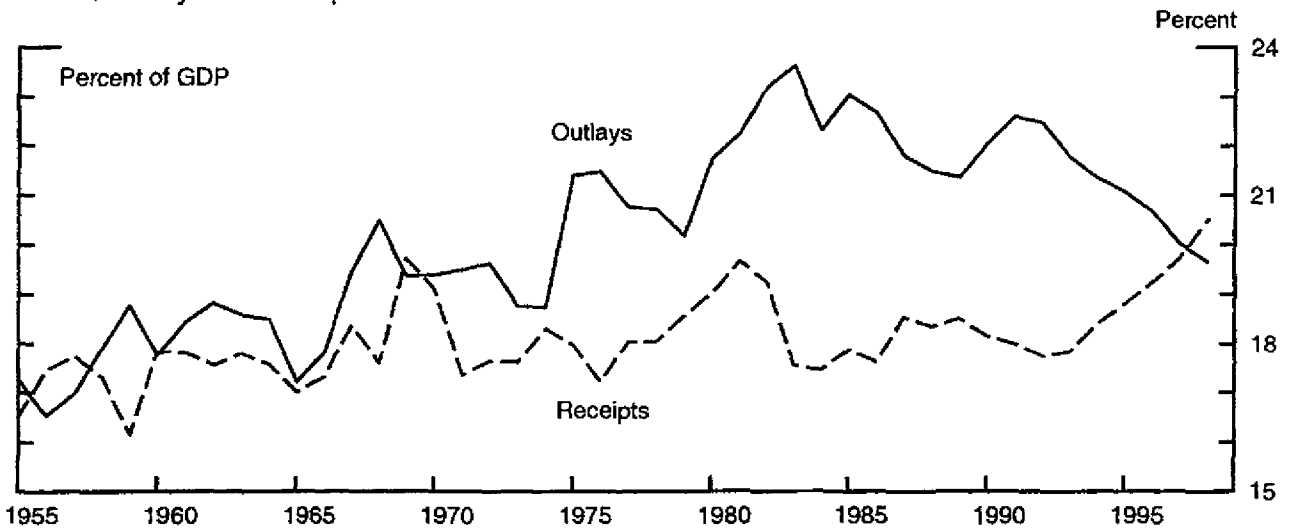
Federal Sector Developments

(Fiscal years)

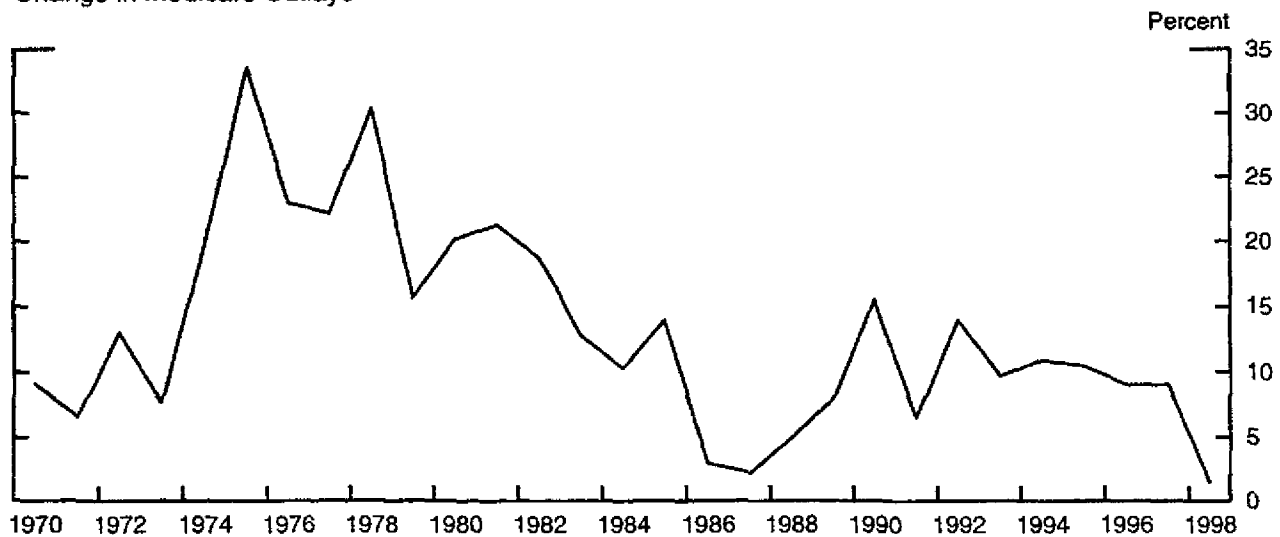
Unified Budget Surplus



Unified Outlays and Receipts



Change in Medicare Outlays



outlays. Despite difficulties in the farm sector, September's net Commodity Credit Corporation payments were a bit lower than last year.

The fiscal 1999 budget, which was completed about three weeks after the start of the fiscal year, contained \$21 billion in new budget authority for emergencies. No significant changes were made to entitlement programs or tax laws.¹² The Congressional Budget Office expects that the new emergency spending will boost outlays, relative to the discretionary spending caps, \$14 billion in fiscal 1999, \$5 billion in fiscal 2000, and \$2 billion in fiscal 2001. Budget authority for defense was raised \$8 billion to provide funds for Bosnia, Y2K readiness, missile defense research, and intelligence activities. Agriculture spending was raised \$6 billion, with about half directed to an increase for all farmers receiving Freedom to Farm transition payments and about half targeted to those farmers particularly exposed to unfavorable weather conditions this past year. About \$7 billion was added to other nondefense programs, including embassy security (\$2-1/2 billion), Y2K (\$2 billion), and disaster relief (\$1-1/2 billion).

State and Local Governments

Real purchases of goods and services by state and local governments rose at an annual rate of 3-1/4 percent in the third quarter, the largest increase since the beginning of 1997. Most of the strength was in investment spending, which advanced at an annual rate of almost 7 percent. Real consumption expenditures increased at a 2-1/2 percent rate, about the same as in the preceding six quarters. In nominal terms, construction spending in September rose considerably faster than the BEA had assumed for its third-quarter estimate, but the August figure was revised down. On balance, the third-quarter level of construction is expected to be revised up only a bit.

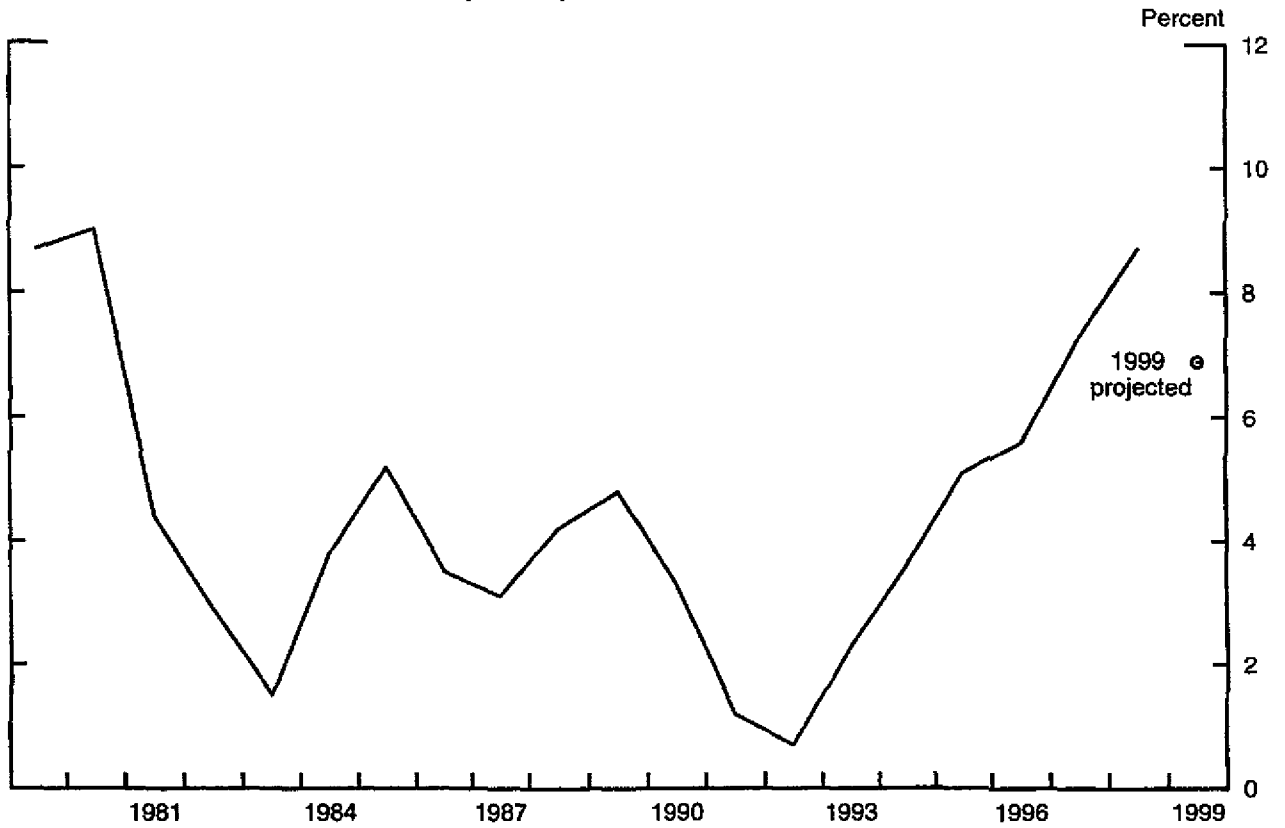
Survey data on the status of general fund budgets in fiscal year 1998, which ended June 30 for most states, indicate that state finances continued to improve for the sixth consecutive year. Once again, actual revenues surpassed the states' projections made during their 1997 legislative sessions, and state ending balances swelled to 8.7 percent of expenditures, the highest ratio since 1980. States are currently projecting that ending balances in 1999 as a share of expenditures will fall to 6.9 percent. As they have in recent years, states are using the excess funds largely to build reserves and reduce taxes. Tax cuts enacted during spring 1998 sessions are estimated to total \$6.1 billion, or 1.4 percent of previous-year collections, a slightly

12. A minor tax bill was passed that included tax cuts worth \$10 billion over ten years, with offsetting tax increases.

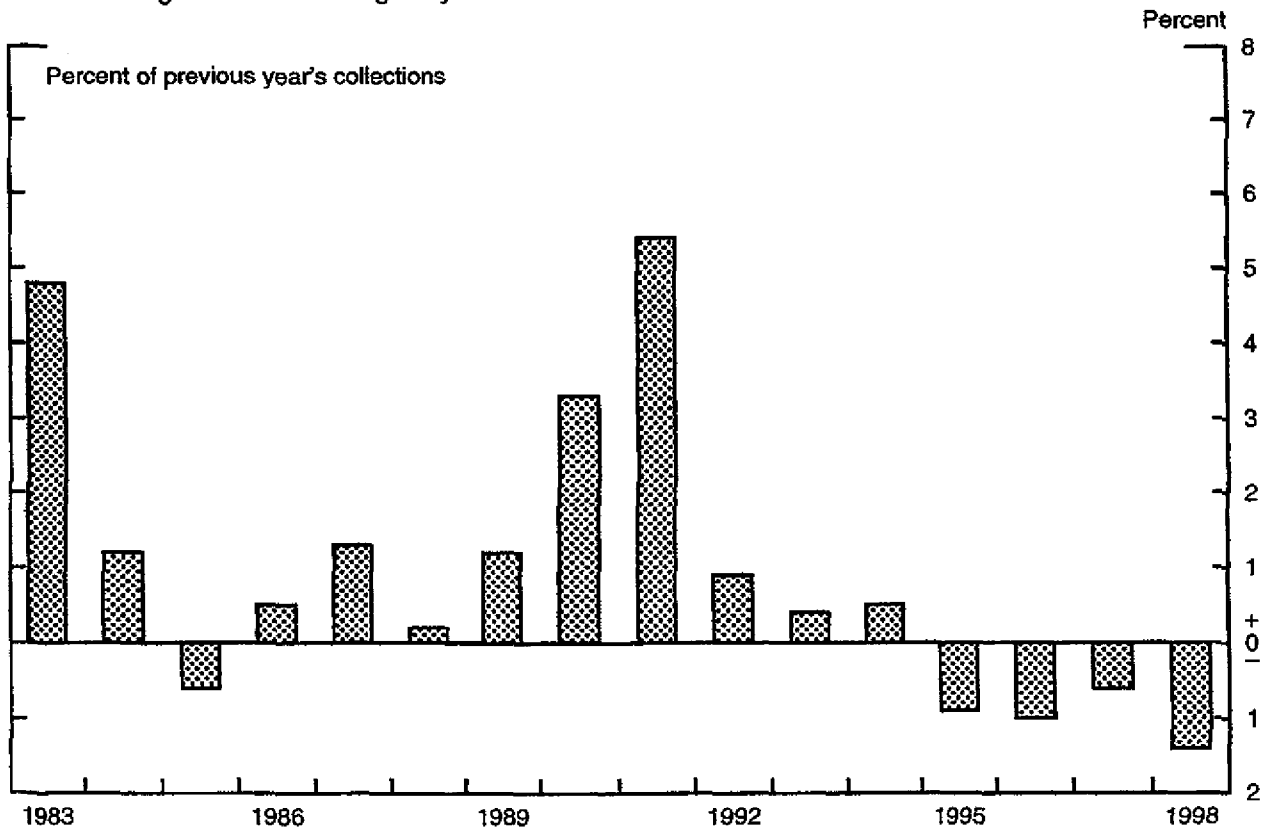
State Fiscal Positions

(State fiscal years)

General Fund Balances as a Percentage of Expenditures



Net State Legislated Tax Changes by Year of Enactment



bigger reduction than in recent years. As in past years, the largest reduction, nearly 60 percent of the total, was in personal income taxes. In the November elections, initiatives to alter taxes in some significant way were on the ballots of eleven states; in seven, the vote lowered taxes or prevented them from rising.

Labor Costs

According to the Employment Cost Index, hourly compensation of private industry workers increased at a seasonally adjusted annual rate of 4.4 percent over the three months ended in September, a pace well above the average change over the past year. The third-quarter figure was boosted by a sizable increase in finance, insurance, and real estate (FIRE), where the furious pace of activity likely raised commissions and bonuses yet again.

Over the twelve months ending in September, hourly compensation increased 3.8 percent, up from 3.2 percent over the preceding twelve months; the steep rise in compensation costs in FIRE (which has a weight of less than 10 percent) accounted for more than half of the acceleration. Wages and salaries moved up 4.3 percent over the preceding twelve months, while benefits were up 2.6 percent. Both wages and salaries and benefits have accelerated by similar amounts over the past year. Among the major components of benefits, health insurance costs and nonproduction bonuses have accelerated the most. However, retirement pension costs decelerated slightly over the past year as rising stock prices reduced the need for employers to contribute to defined benefit plans, and costs for state unemployment insurance and workers' compensation continued to decline sharply.

Among industries, compensation increases have been fairly stable in construction and manufacturing over the past year, but compensation has accelerated sharply for a number of service-producing industries, especially for their white collar workers. The most notable increase is for workers in FIRE, where the rise in compensation costs over the twelve months ending in September was 8 percent, up from 3 percent over the year-earlier period.¹³ Wholesale trade also recorded a sizable pickup in compensation costs, with the largest increases for sales workers. Also, compensation costs have accelerated somewhat in other service-producing industries, such as transportation and public utilities.

13. Compensation in FIRE tends to move with financial market activity. ECI wages and salaries for FIRE include commissions associated with home sales, mortgage refinancing, and stock market transactions, while ECI benefits include lump-sum bonuses associated with transactions in the stock market and other financial markets.

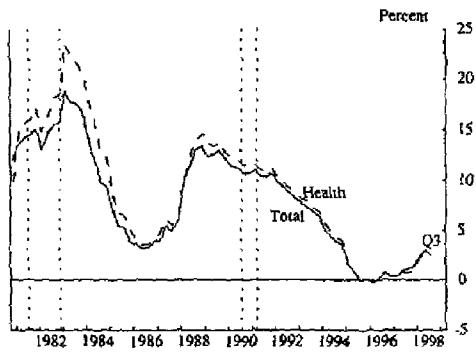
EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1997		1998		
	Sept.	Dec.	Mar.	June	Sept.
-----Quarterly percent change----- (Compound annual rate)					
Total hourly compensation ¹	3.4	4.3	2.7	3.6	4.4
Wages and salaries	4.1	4.7	3.4	3.9	5.1
Benefit costs	2.0	3.8	1.1	3.1	2.8
By industry					
Construction	2.8	1.9	2.8	5.0	1.8
Manufacturing	3.0	2.1	3.0	2.1	3.5
Trans., comm., and public utilities	3.1	4.0	3.9	5.4	3.8
Wholesale trade	3.3	2.1	7.6	1.5	7.4
Retail trade	3.8	2.5	5.3	3.0	3.6
FIRE	3.4	12.8	6.7	5.1	7.7
Services	3.9	4.8	1.7	3.2	4.3
By occupation					
White collar	3.6	5.1	3.3	3.8	5.3
Blue collar	3.1	2.8	1.8	3.0	3.0
Service occupations	6.6	2.1	4.3	2.7	3.6
Memo:					
State and local governments	2.4	2.4	3.3	3.0	3.2
-----Twelve-month percent change----					
Total hourly compensation	3.2	3.4	3.5	3.5	3.8
Excluding sales workers	3.0	3.4	3.4	3.4	3.5
Wages and salaries	3.6	3.9	4.0	4.0	4.3
Excluding sales workers	3.5	3.8	4.0	3.8	3.9
Benefit costs	2.0	2.3	2.3	2.6	2.6
By industry					
Construction	3.0	2.6	2.7	3.1	2.9
Manufacturing	2.5	2.4	2.9	2.5	2.7
Trans., comm., and public utilities	2.8	2.9	3.4	4.1	4.2
Wholesale trade	3.6	3.2	3.6	3.6	4.6
Retail trade	3.9	3.4	3.6	3.6	3.7
FIRE	3.0	6.7	6.3	7.0	8.0
Services	3.2	3.8	3.5	3.4	3.5
By occupation					
White collar	3.1	3.8	3.8	4.0	4.4
Sales	4.3	4.2	4.0	5.0	6.2
Nonsales	3.0	3.7	3.8	3.8	4.0
Blue collar	2.8	2.6	2.7	2.7	2.7
Service occupations	4.5	4.0	4.2	3.9	3.2
Memo:					
State and local governments	2.4	2.3	2.5	2.7	3.0

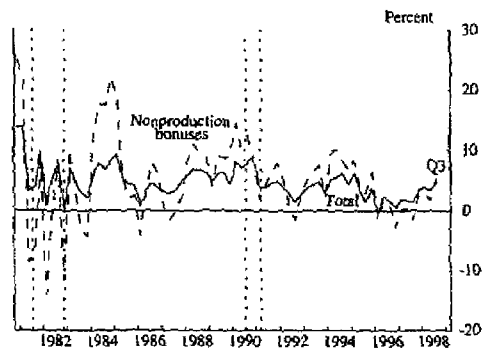
1. Seasonally adjusted by the BLS.

Components of ECI Benefits Costs (Private industry workers; twelve-month change)

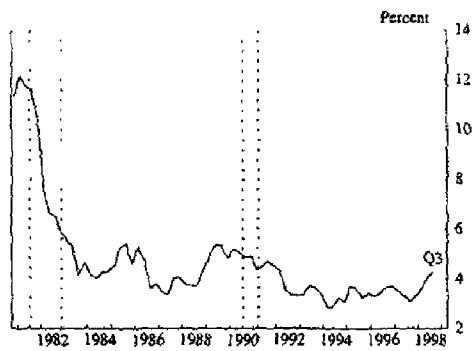
Insurance Costs



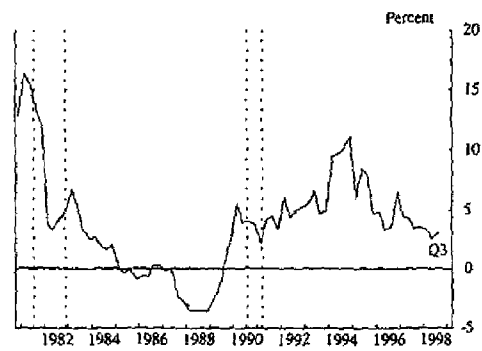
Supplemental Pay



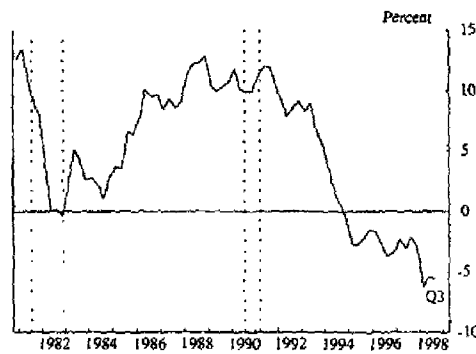
Paid Leave



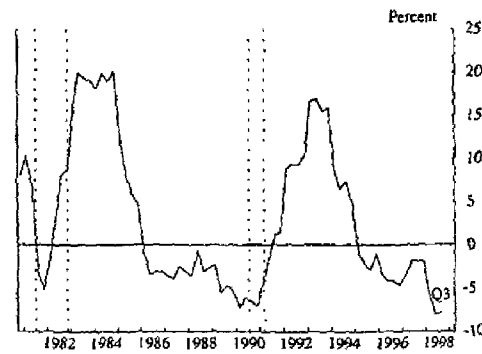
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



Note. Unpublished ECI benefits detail.

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

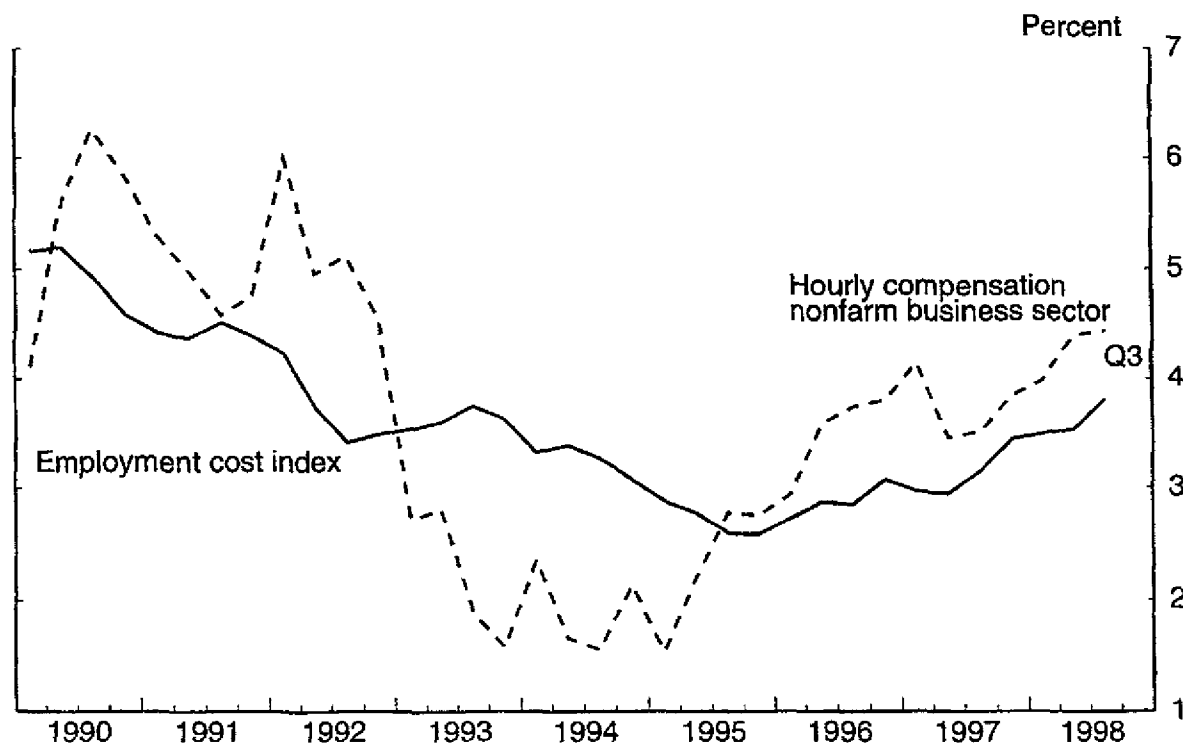
	1996 ¹	1997 ¹	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998:Q3 to 1998:Q3
<u>Output per hour</u>							
Total business	2.4	1.9	.9	4.1	.1	2.4	1.8
Nonfarm business	2.1	1.7	.9	3.5	.3	2.3	1.7
Manufacturing	4.6	4.5	4.9	1.4	2.3	3.7	3.1
Nonfinancial corporations ²	2.4	2.6	1.0	2.6	3.1	n.a.	3.1 ³
<u>Compensation per hour</u>							
Total business	3.9	4.0	5.3	4.9	4.1	3.8	4.5
Nonfarm business	3.7	3.9	4.9	4.6	4.0	4.0	4.4
Manufacturing	2.4	5.3	8.0	4.1	2.6	2.9	4.4
Nonfinancial corporations ²	3.4	3.9	5.0	3.6	4.6	n.a.	4.3 ³
<u>Unit labor costs</u>							
Total business	1.5	2.0	4.4	.8	4.0	1.4	2.6
Nonfarm business	1.6	2.1	4.0	1.1	3.7	1.7	2.6
Manufacturing	-2.1	.7	3.0	2.7	.3	-.7	1.3
Nonfinancial corporations ²	.9	1.2	4.0	.9	1.5	n.a.	1.2 ³

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

3. 1997:Q2 to 1998:Q2

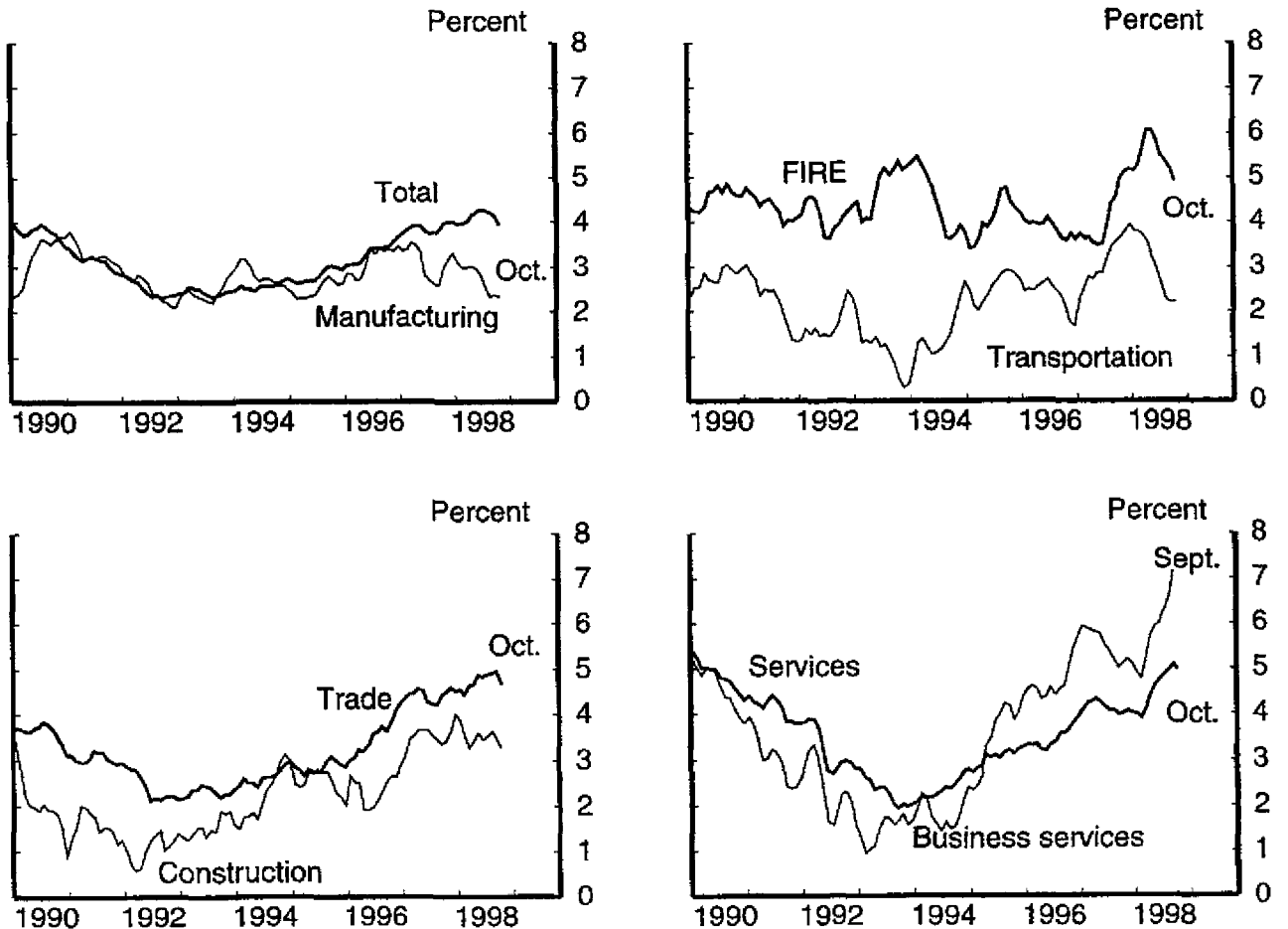
Measures of Compensation per Hour
(Four-quarter change)



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

	Twelve-month percent change			Percent change to Oct. 1998		1998	
	Oct. 1996	Oct. 1997	Oct. 1998	Apr. 1998	July 1998	Sept.	Oct.
	- - - - -Annual rate- - - - -					-Monthly rate-	
Total private nonfarm	3.5	4.1	3.6	2.9	2.8	.2	.1
Manufacturing	3.2	3.3	2.0	1.8	4.2	.5	-.2
Construction	2.7	3.7	3.2	2.9	1.2	-.7	.8
Transportation and public utilities	1.0	4.0	2.2	.8	1.3	.3	-.1
Finance, insurance, and real estate	3.7	5.3	4.7	3.5	4.0	.0	.6
Retail trade	4.4	4.6	4.1	2.5	1.4	.3	-.6
Wholesale trade	3.7	4.8	4.1	4.5	3.5	-.4	.6
Services	4.0	4.0	4.7	4.1	3.8	.4	.2

Average Hourly Earnings
(Smoothed twelve-month change)



Note. The data are three-month moving averages.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1998		1998	
	Sept. 1997	Sept. 1998	Q2	Q3	Aug.	Sept.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0) ¹	2.2	1.5	2.0	1.7	.2	.0
Food (15.3)	2.1	2.0	1.9	2.8	.2	.0
Energy (7.0)	2.0	-9.8	-6.7	-5.6	-1.0	-1.3
CPI less food and energy (77.7)	2.2	2.5	2.6	2.3	.2	.2
Commodities (24.1)	.4	.8	1.0	1.2	.2	-.1
New vehicles (5.1)	-.3	-.3	-1.1	1.3	.3	-.1
Used cars and trucks (1.9)	-5.6	2.5	4.9	4.7	-.1	.5
Apparel (4.9)	1.1	.5	.8	1.7	1.1	-.7
Tobacco (0.9)	5.3	15.0	16.5	16.9	.1	3.3
Other Commodities (11.3)	.5	.0	.3	-.8	-.2	-.1
Services (53.6)	2.9	3.1	3.4	2.7	.3	.3
Shelter (29.4)	3.0	3.6	3.8	3.2	.4	.5
Medical care (4.4)	2.7	3.5	4.1	3.6	.3	.2
Other Services (19.8)	3.1	2.3	2.8	1.7	.0	.0
PPI						
Finished goods (100.0) ²	.0	-.9	.2	-.2	-.4	.3
Finished consumer foods (23.2)	-.7	.5	.6	.9	-.4	.4
Finished energy (13.6)	.0	-11.6	-8.0	-8.3	-2.3	-.1
Finished goods less food and energy (63.2)	.4	1.1	2.0	.9	-.1	.4
Consumer goods (38.0)	.6	2.1	3.6	1.9	.0	.5
Capital equipment (25.2)	-.1	-.5	-.5	-.2	-.3	.4
Intermediate materials (100.0) ³	-.6	-2.4	-1.9	-2.2	-.3	-.2
Intermediate materials less food and energy (81.8)	.3	-.8	-.8	-1.1	-.1	-.3
Crude materials (100.0) ⁴	-3.9	-14.4	-3.8	-19.6	-2.7	-1.6
Crude food materials (42.1)	-11.4	-8.8	-1.9	-16.6	-1.1	-1.9
Crude energy (36.4)	2.7	-22.8	-2.9	-27.1	-5.1	-1.7
Crude materials less food and energy (21.5)	1.6	-11.5	-8.5	-14.0	-2.0	-1.3

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.

Hourly compensation in the nonfarm business sector--reported in the Productivity and Cost report--rose at an annual rate of 4.0 percent in the third quarter, the same pace as in the second quarter. Over the four quarters ending in 1998:Q3, compensation per hour was up 4.4 percent, nearly a percentage point faster than the increase over the previous four-quarter period. With productivity growth over the past year still averaging 1-3/4 percent, the pickup in hourly compensation was fully passed through to unit labor costs. Unit labor costs in the nonfarm business sector increased 2.6 percent over the four quarters ending in 1998:Q3, compared with 1.7 percent over the previous four-quarter period.

Information on labor costs this quarter are primarily limited to the BLS monthly data on average hourly earnings of production or nonsupervisory workers. In October, average hourly earnings rose 0.1 percent; the twelve-month change in average hourly earnings was 3.6 percent in October, down 1/2 percentage point from the year-earlier period.

Prices

Inflation has remained subdued. The consumer price index was unchanged in September as another drop in energy prices offset a 0.2 percent increase in the index excluding food and energy. A sharp decline in energy prices kept the increase in the overall CPI to only 1.5 percent over the past twelve months, while the twelve-month change in the core CPI was 2.5 percent in September, up 1/4 percentage point from the rate recorded over the year-earlier period.

After having fallen 1 percent in August, the CPI for energy fell 1.3 percent in September, leaving the index 9-3/4 percent below its level twelve months ago. Prices of gasoline and heating oil dropped considerably further in September. However, survey evidence from October and early November suggests that, on a seasonally adjusted basis, retail prices of gasoline have moved back up a bit.

The index for consumer food prices was unchanged in September and has increased 2 percent over the past twelve months, about the same pace as in the preceding year. Declines in September in the volatile index for fruits and vegetables and in the index for meats, poultry, fish, and eggs were offset by price increases elsewhere, especially for dairy, butter, and margarine. At earlier stages of processing, the PPI for crude foodstuffs fell further in September, to 8-3/4 percent below its level a year earlier.

The index for consumer commodities other than food and energy edged down 0.1 percent in September despite another jump in the retail prices of tobacco products. Apparel prices fell, offsetting much of the large increase in August that was associated

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1995 Q3	1996 Q3	1997 Q3	1998 Q3
<u>Product prices</u>				
GDP chain price index	2.2	1.9	1.8	0.9
Nonfarm business chain-type price index ¹	1.8	1.3	2.0	0.5
<u>Expenditure prices</u>				
Gross domestic purchases chain-type price index	2.2	1.7	1.6	0.4
Less food and energy	2.3	1.4	1.6	0.7
PCE chain-type price index	2.1	1.9	1.9	0.7
Less food and energy	2.3	1.6	1.9	1.1
CPI	2.6	2.9	2.2	1.6
Less food and energy	3.0	2.7	2.3	2.4
Median CPI	3.2	3.1	2.9	2.8
Trimmed mean CPI	2.7	2.9	2.4	2.0

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation ¹	University of Michigan (1-year)		University of Michigan (5- to -10-year)		Professional forecasters (10-year) ⁶
		Mean ²	Median ³	Mean ⁴	Median ⁵	
1996-Q1	2.7	3.9	2.8	4.2	3.2	3.0
Q2	2.8	4.5	3.0	4.3	3.1	3.0
Q3	2.9	4.2	3.1	4.3	3.2	3.0
Q4	3.2	4.0	3.0	3.9	3.0	3.0
1997-Q1	2.9	3.8	2.9	3.8	3.1	3.0
Q2	2.3	3.6	2.9	3.8	3.0	2.9
Q3	2.2	3.4	2.7	3.6	3.0	3.0
Q4	1.9	3.3	2.8	3.8	3.1	2.7
1998-Q1	1.5	2.8	2.4	3.3	2.9	2.6
Q2	1.6	3.0	2.6	3.3	2.8	2.5
Q3	1.6	2.8	2.4	3.2	2.8	2.5
July	1.7	3.1	2.6	3.1	2.7	
Aug.	1.6	2.7	2.4	3.0	2.7	
Sept.	1.5	2.7	2.3	3.4	2.9	2.5
Oct.		2.6	2.5	3.2	2.8	

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

with seasonal adjustment difficulties around the Labor Day weekend. Prices of furniture and household equipment declined further in September, and the prices of new motor vehicles edged down as well. Several months of incentive-related swings have left motor vehicle prices little changed from the levels of six months earlier. Over the past twelve months, core commodity prices have increased 0.8 percent, up from a 0.4 percent pace in the year-earlier period.

Prices of non-energy services rose 0.3 percent for a second month in September. The index has risen 3.1 percent over the past year, up slightly from the pace recorded in the year-earlier period. Shelter costs rose 0.5 percent in September, after a 0.4 percent rise in August; in both months, rates for lodging away from home posted sizable increases. Prices of medical services rose only 0.2 percent in September, but were up 3-1/2 percent over the past twelve months after having increased only 2-3/4 percent in the year-earlier period. Among other services, prices were unchanged on average in both August and September.

Most other broad price measures have continued to rise less rapidly than the CPI and have decelerated somewhat more. The four-quarter change in the GDP chain price index was 0.9 percent in the third quarter, half of that recorded in 1997:Q3 and the lowest since 1961. Across components, the prices for most expenditure groups have decelerated over the past year. The index for producers' durable equipment dropped 4-3/4 percent over the past four quarters, a record decline, which almost certainly was a result of price declines for imports, lower prices for components and materials going into domestically assembled goods, rapid technological change, and the effects of import competition on equipment produced in the United States. The rate of change in PCE chain prices has also slowed considerably over the past year; the four-quarter change was only 0.7 percent in the third quarter, compared with 1.9 percent in the year-earlier period. Weak food prices, falling energy prices, and a moderation of services prices have accounted for a deceleration in prices over the past year that has been quite a bit sharper for PCE than for the CPI. Apart from food and energy, the gap between core CPI and core PCE inflation has widened over the past year, largely because of the deceleration in prices of services included in PCE but excluded from the CPI.¹⁴

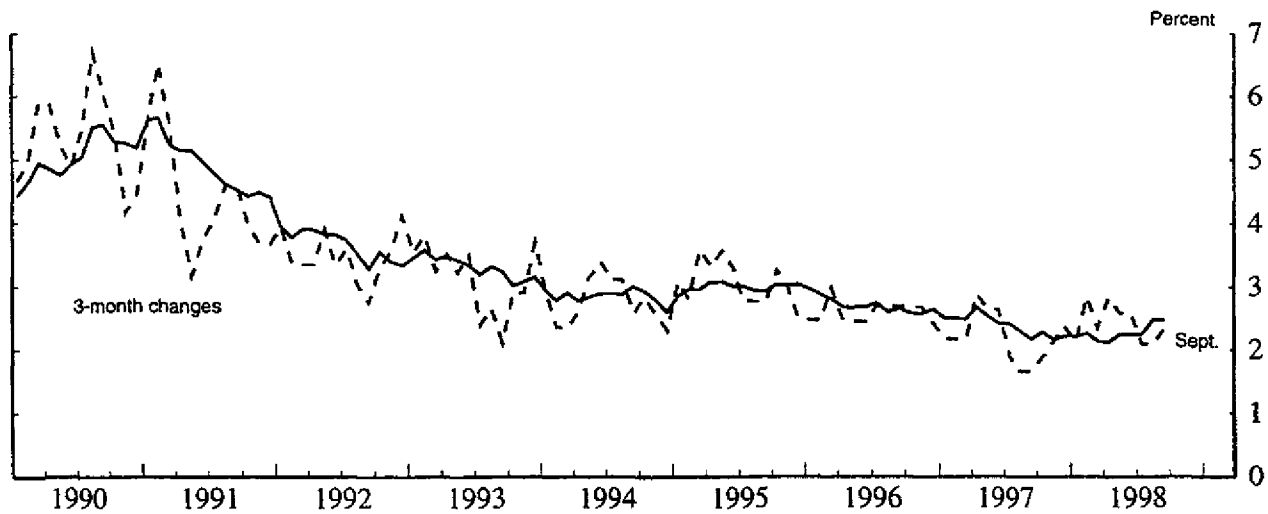
Inflation expectations appear to have stabilized in recent quarters after having declined through the first quarter of this year. According to the Michigan survey, the median one-year inflation expectation was 2.5 percent in October, a pace in line with

14. A decline in the rate of change in the imputed price index for services provided without charge by financial institutions accounted for more than one-third of the deceleration in PCE prices over the past year.

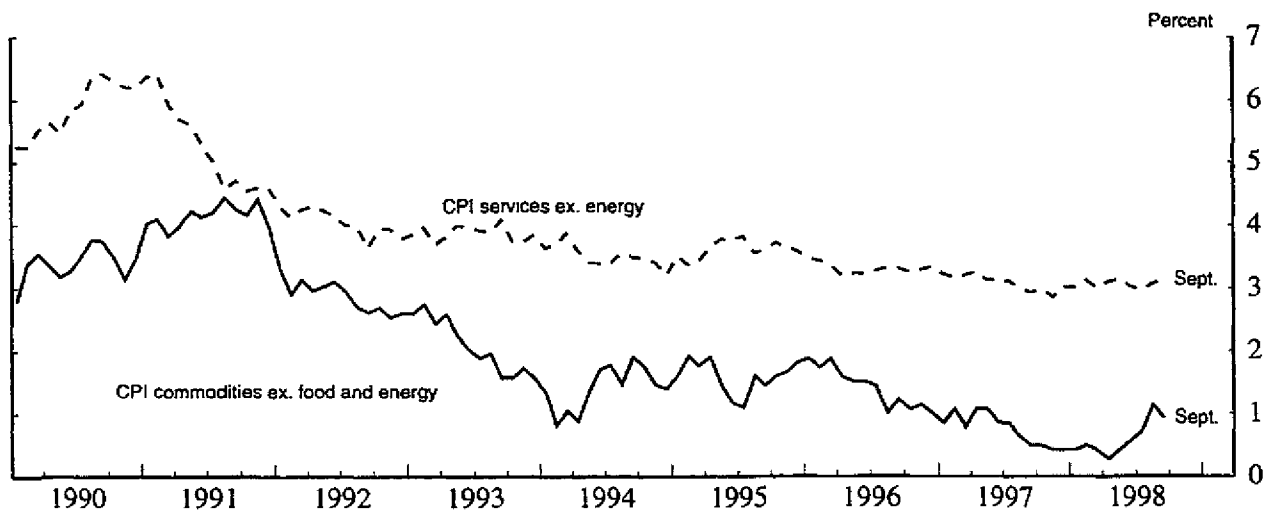
Measures of Core Consumer Price Inflation

(Twelve-month changes except as noted)

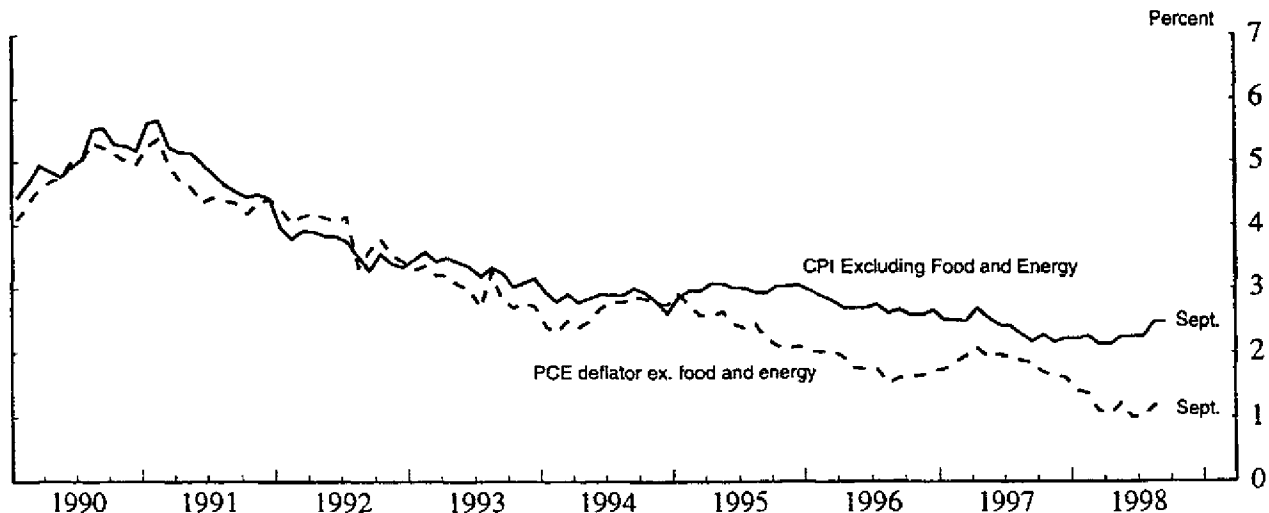
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE



the average recorded in the first three quarters of this year and 1/4 percentage point below expectations a year ago. Both the Michigan five-to-ten year median inflation expectation and the Philadelphia Fed's survey of professional forecasters' ten-year expectations have been little changed recently and are between 1/4 and 1/2 percentage point lower than the pace recorded at the same time last year.

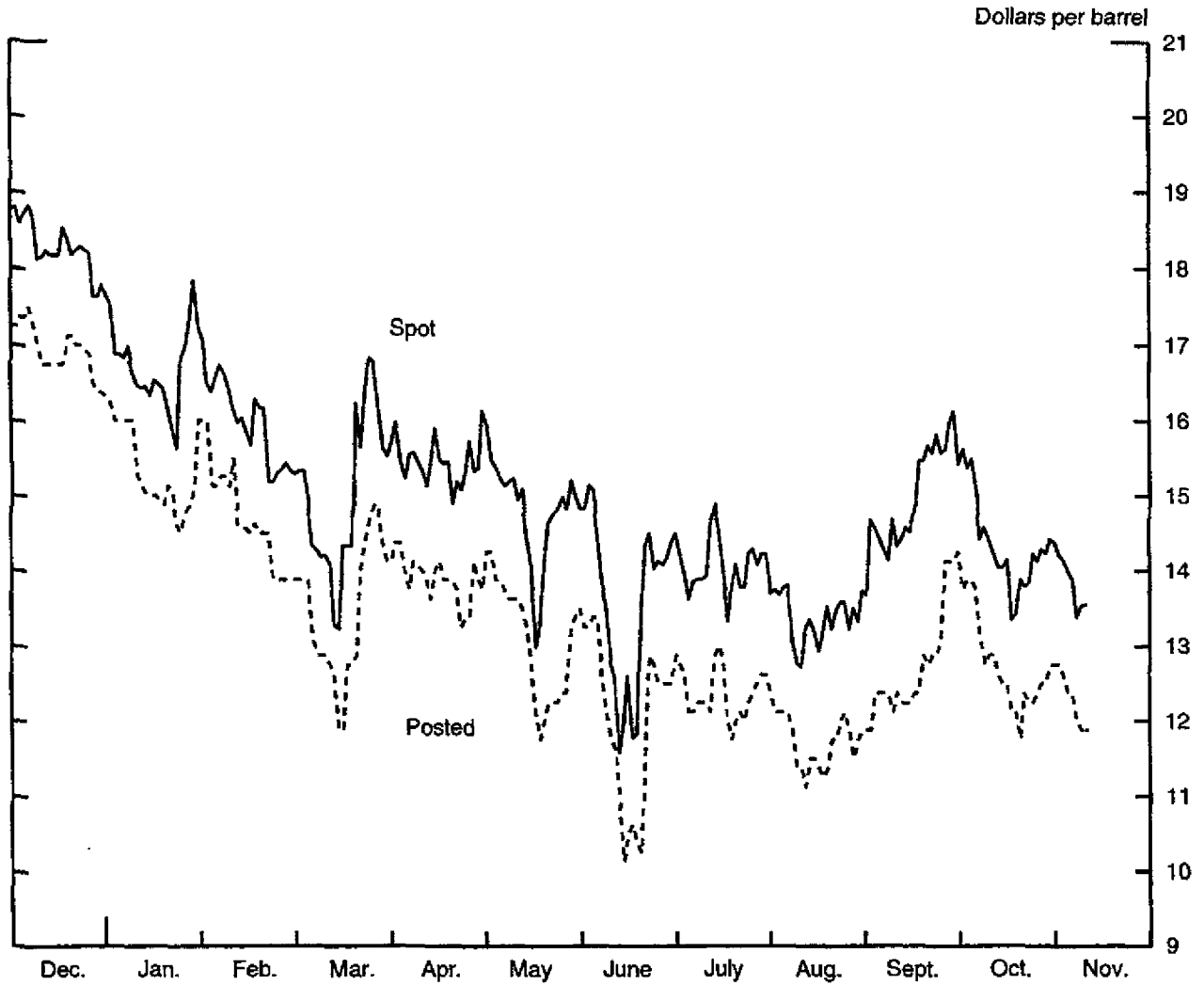
No signs of inflation are evident at earlier stages of processing. The PPI for intermediate materials other than food and energy declined in September to a level about 3/4 percent below a year earlier. The PPI for core crude materials dropped again in September and was down more than 11 percent during the past twelve months.¹⁵ Among crude materials, price declines have been fairly widespread during the past twelve months; the drop in metals prices has been especially large because of collapsing foreign demand and surging imports. Since the PPI reporting date of mid-September, many industrial commodity prices have declined further. The Journal of Commerce industrial price index is down about 5 percent since that time, while the CRB measure of spot industrial commodity prices has declined about 3-1/2 percent. Both the JOC and CRB measures include industrial materials, such as metals and fibers, but the JOC measure also includes energy commodities and forest products that are excluded from the CRB measure. Because prices for forest products, especially for plywood, are substantially lower than in mid-September, the JOC measure has declined more rapidly recently than the CRB measure. Over the past year, the other CRB measure, the futures index, has dropped nearly 16 percent; however, only a small share of this index reflects changes in industrial commodities prices, with over half of its weight from food commodities.¹⁶

In the agricultural sector, the widespread price declines that dominated the markets through the summer have given way to a somewhat firmer price picture in recent weeks. Futures prices for grains and oilseeds have gained support from the depreciation of the U.S. dollar, anticipation of the food aid package for Russia, and a small net downward revision in the USDA's estimate of 1998 crop production. Cattle prices have also moved higher since late September, and the markets have pushed back still further the timing of an anticipated plunge in the price of milk from its current elevated level. By contrast, spot prices of hogs have dropped in recent weeks to the lowest levels since the early 1970s.

15. Raw materials make up a small proportion of the cost structure of finished core consumer goods. Therefore, even for declines in raw materials prices of this magnitude, the effect on retail consumer goods prices is generally quite small.

16. The coverage of industrial commodities in the CRB futures index is narrow--only copper and cotton are included--and the weight is small.

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
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	12.09	13.66
July	12.36	14.08
August	11.73	13.36
September	12.65	14.95
October	12.81	14.39
November ¹	12.33	13.88

1. Through November 11, 1998.

SPOT PRICES OF SELECTED COMMODITIES

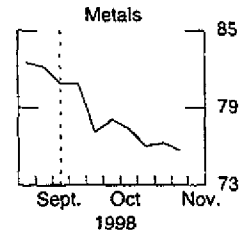
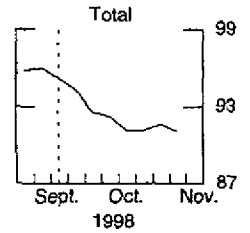
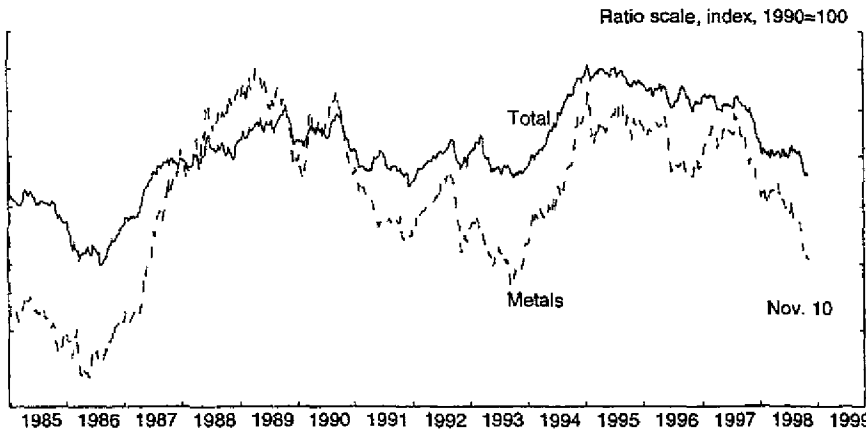
	Current price (\$)	-----Percent change ¹ -----				Memo: Year earlier to date
		1996	1997	Dec. 30 to Sept. 22 ²	Sept. 22 ² to Nov. 10	
Metals						
Copper (lb.)	.760	-21.3	-24.3	-1.2	-5.0	-18.3
Steel scrap (ton)	75.000	-15.1	15.9	-29.3	-23.3	-45.8
Aluminum, London (lb.)	.588	-8.5	-.6	-12.9	-1.1	-19.7
Precious metals						
Gold (oz.)	292.250	-4.8	-21.4	-.4	1.2	-6.5
Silver (oz.)	5.010	-6.1	28.3	-19.5	1.6	1.7
Forest products						
Lumber (m. bdft.)	272.000	59.2	-29.6	-5.5	-1.4	-6.8
Plywood (m. sqft.)	322.000	-3.2	-4.8	21.7	-11.8	3.2
Petroleum						
Crude oil (barrel)	11.170	29.3	-31.7	-12.2	-21.3	-41.5
Gasoline (gal.)	.391	27.2	-25.8	-9.0	-14.3	-29.8
Fuel oil (gal.)	.371	18.3	-29.7	-15.0	-11.7	-34.9
Livestock						
Steers (cwt.)	63.000	-1.1	3.0	-13.2	6.8	-7.4
Hogs (cwt.)	20.250	14.9	-36.4	-15.7	-31.4	-54.2
Broilers (lb.)	.615	12.5	-21.2	43.4	-13.1	20.6
U.S. farm crops						
Corn (bu.)	2.100	-24.4	.2	-31.5	20.0	-22.2
Wheat (bu.)	3.398	-12.8	-22.6	-19.0	19.2	-11.0
Soybeans (bu.)	5.615	-3.7	-1.8	-24.8	10.5	-23.1
Cotton (lb.)	.662	-8.7	-9.7	14.4	-9.5	-3.4
Other foodstuffs						
Coffee (lb.)	1.245	34.7	25.4	-36.4	14.7	-22.4
Memo:						
JOC Industrials	91.000	-4.1	-8.6	-3.0	-4.4	-12.6
JOC Metals	75.700	-8.3	-5.0	-8.9	-6.4	-19.6
CRB Futures	204.630	-.1	-3.2	-12.0	.9	-15.7
CRB Spot	269.890	.9	-8.4	-9.5	-2.9	-17.9

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

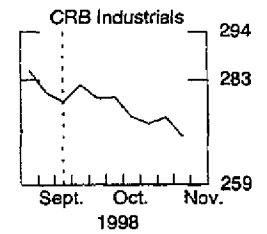
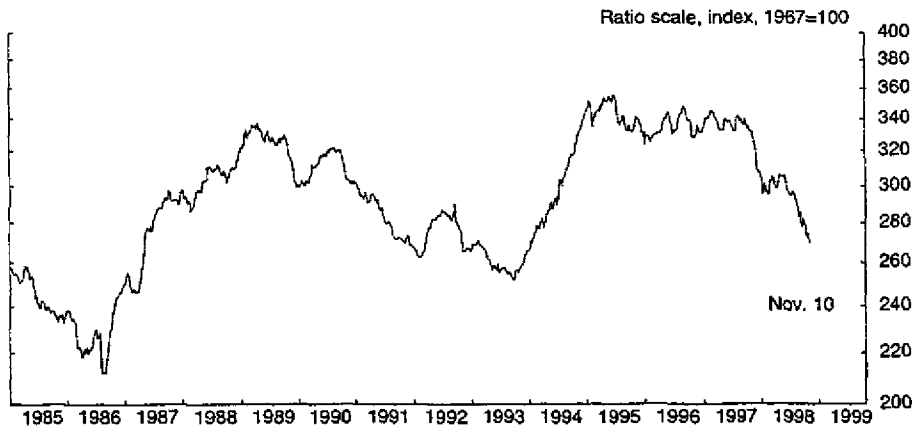
2. Week of the September Greenbook.

Commodity Price Measures

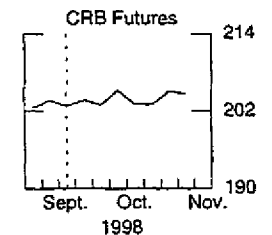
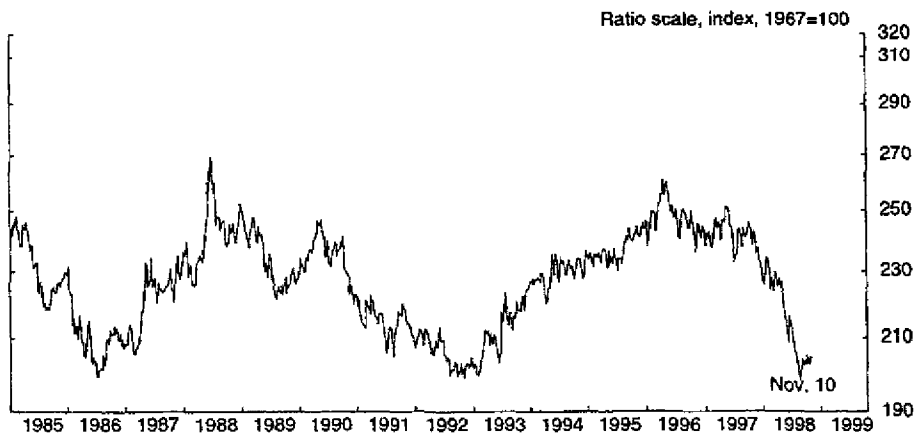
Journal of Commerce Index



CRB Spot Industrials



CRB Futures



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

Recent Developments in Agriculture

The small downward revision to the USDA production forecast since late summer has not altered the fact that 1998 was another reasonably good year for crops overall. The agency's November forecast, which was released on November 10, indicates that the total harvest in 1998 will be almost as large as that in 1997. Production has been boosted, especially, by high yields for the major grain and oilseed crops that account for a big share of total crop output. With exports expected to remain sluggish in coming quarters, the USDA is projecting that about 5 percent of this year's production of the three main crops--corn, wheat, and soybeans--will end up in inventories, adding to the substantial buildup in stocks of those crops that took place after the 1997 harvest.

Ironically, the large harvests of the past two years have coincided with repeated, strong alerts about potential disasters that the Pacific weather cycle--either El Niño or La Niña--might bring to U.S. agriculture. To be sure, some of the predicted effects of that weather cycle did come to pass. The strong El Niño episode that emerged in the spring of 1997 and persisted through this past spring brought to some regions disruptive flooding that weather forecasters had predicted. Similarly, the surprisingly abrupt shift toward La Niña conditions in the Pacific this past summer was accompanied by a marked change, broadly in line with forecasts, toward drier, hotter weather in some regions, especially across the South, that hurt crops such as cotton. But neither El Niño nor La Niña seems to have caused much trouble for farmers in the big crop-producing states of the Midwest, and aggregate farm production has held up well. Although some observers now are watching to see if La Niña conditions this coming winter will be similar to those that have preceded poor harvests in some previous years, traders in futures and options markets do not appear to be assigning a higher-than-usual probability to the risk of major crop losses.

DOMESTIC FINANCIAL DEVELOPMENTS

III-T-1
Selected Financial Market Quotations
(One-day quotes in percent except as noted)

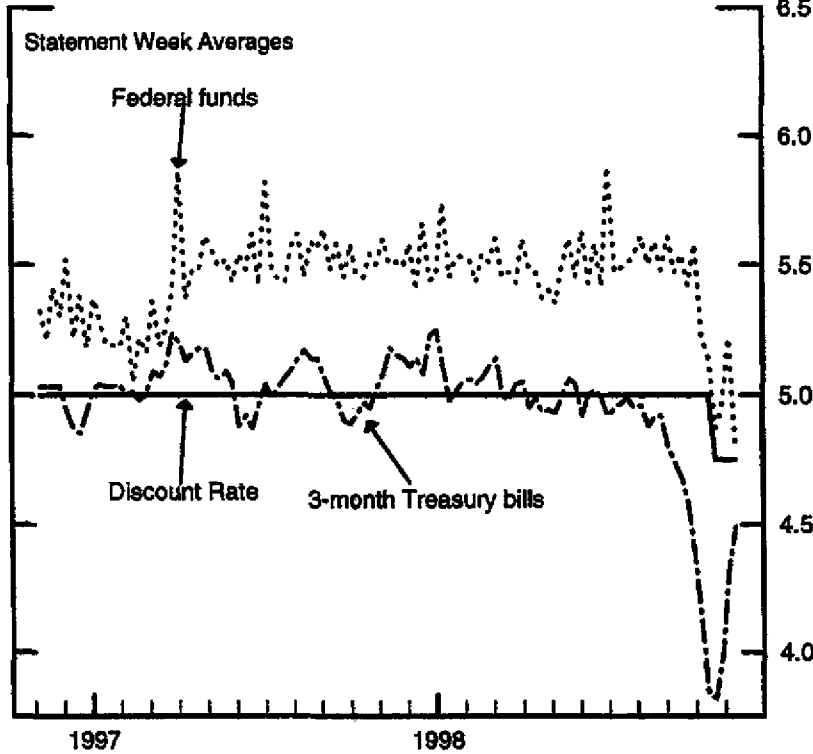
Instrument	1997	1998			Change to Nov. 10 from selected dates (percentage points)		
	Dec. 31	FOMC* Sept. 29	Oct. 15*	Nov. 10	Dec. 31	FOMC* Sept. 29	Oct. 15*
<i>Short-term</i>							
<i>Federal funds</i>							
FOMC intended rate	5.50	5.50	5.25	5.00	-.50	-.50	-.25
Realized rate ¹	5.44	5.48	5.40	4.79	-.65	-.69	-.61
<i>Treasury bills ²</i>							
3-month	5.22	4.36	3.93	4.43	-.79	.07	.50
6-month	5.23	4.41	4.06	4.44	-.79	.03	.38
1-year	5.22	4.33	4.01	4.32	-.90	-.01	.31
<i>Commercial paper</i>							
1-month	5.65	5.25	5.26	5.10	-.55	-.15	-.16
3-month	5.57	5.13	5.11	5.13	-.44	.00	.02
<i>Large negotiable CDs ²</i>							
1-month	5.65	5.29	5.34	5.19	-.46	-.10	-.15
3-month	5.72	5.22	5.30	5.30	-.42	.08	.00
6-month	5.74	5.12	5.09	5.10	-.64	-.02	.01
<i>Eurodollar deposits ³</i>							
1-month	5.63	5.25	5.25	5.19	-.44	-.06	-.06
3-month	5.72	5.19	5.25	5.31	-.41	.12	.06
Bank prime rate	8.50	8.50	8.25	8.00	-.50	-.50	-.25
<i>Intermediate- and long-term</i>							
<i>U.S. Treasury (constant maturity)</i>							
2-year	5.66	4.45	4.08	4.50	-1.16	.05	.42
10-year	5.75	4.61	4.58	4.81	-.94	.20	.23
30-year	5.93	5.15	5.00	5.27	-.66	.12	.27
U.S. Treasury 10-year indexed note	3.70	3.57	3.72	3.82	.12	.25	.10
Municipal revenue (Bond Buyer) ⁴	5.40	5.17	5.17	5.29	-.11	.12	.12
Corporate bonds, Moody's seasoned Baa	7.28	7.10	7.23	7.35	.07	.25	.12
High-yield corporate ⁵	9.06	10.46	11.20	10.80	1.74	.34	-.40
<i>Home mortgages (FHLMC survey rate) ⁶</i>							
30-year fixed	6.99	6.64	6.49	6.89	-.10	.25	.40
1-year adjustable	5.53	5.42	5.36	5.48	-.05	.06	.12

Stock exchange index	Record high		1998			Change to Nov. 10 from selected dates (percent)		
	Level	Date	FOMC* Sept. 29	Oct. 15*	Nov. 10	Record high	FOMC* Sept. 29	Oct. 15*
Dow-Jones Industrial	9,337.97	7-17-98	8,108.84	7,968.78	8,863.98	-5.08	9.31	11.23
S&P 500 Composite	1,186.75	7-17-98	1,048.69	1,005.53	1,128.26	-4.93	7.59	12.21
NASDAQ (OTC)	2,014.25	7-20-98	1,739.22	1,540.97	1,865.62	-7.38	7.27	21.07
Russell 2000	491.41	4-21-98	368.01	324.98	396.86	-19.24	7.84	22.12
Wilshire 5000	11,106.10	7-17-98	9,603.94	9,060.47	10,352.17	-6.79	7.79	14.26

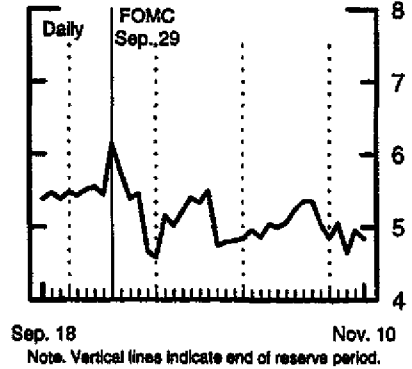
1. Average for two-week reserve maintenance period ending on or before date shown. Most recent observation is average for current maintenance period to date.
 2. Secondary market.
 3. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
 4. Most recent Thursday quote.
 5. Merrill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

Selected Interest Rates

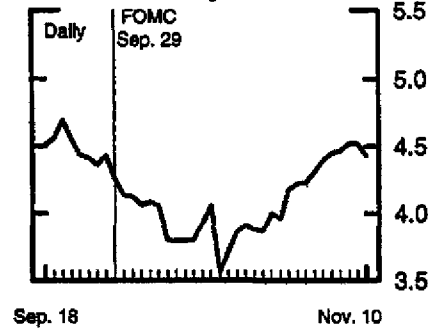
Selected Short-Term Interest Rates



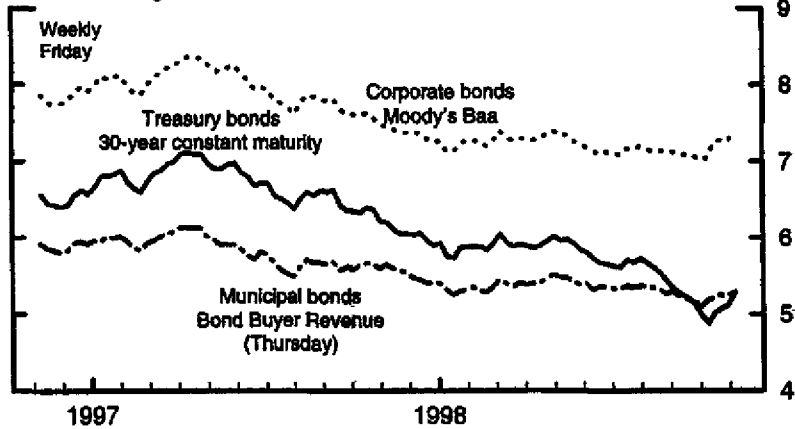
Federal Funds



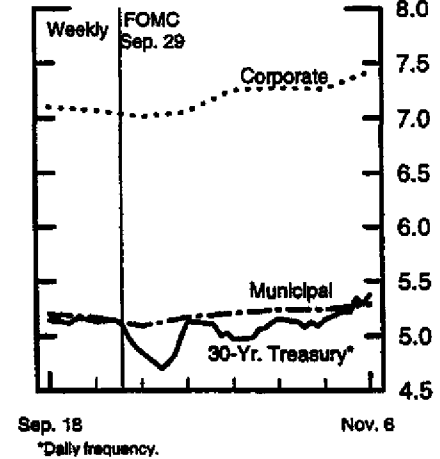
3-Month Treasury Bills



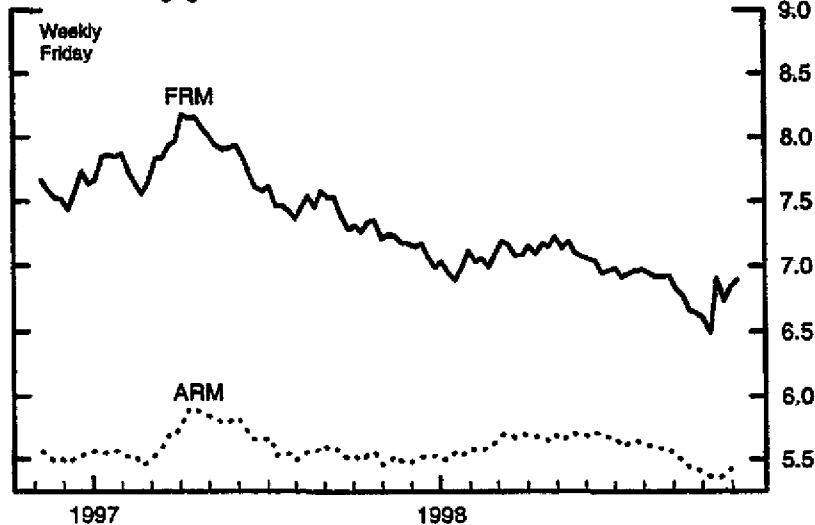
Selected Long-Term Interest Rates



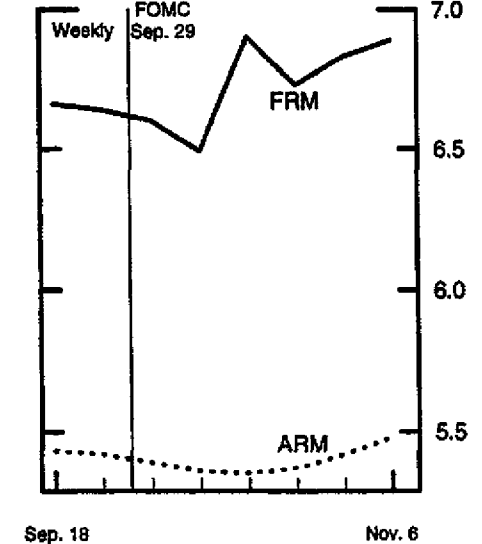
Corporate



Selected Mortgage Rates



FRM



Domestic Financial Developments

Overview

Market interest rates have swung widely during the intermeeting period, only in part reflecting shifting perceptions of System policy. Markets remain fearful and relatively illiquid, resulting in pronounced price responses to incoming news or rumors—of which there were more than a few in recent weeks. Unfortunately, a number of negative rumors were confirmed, notably those of large losses suffered by major commercial banks, investment banks, and hedge funds.

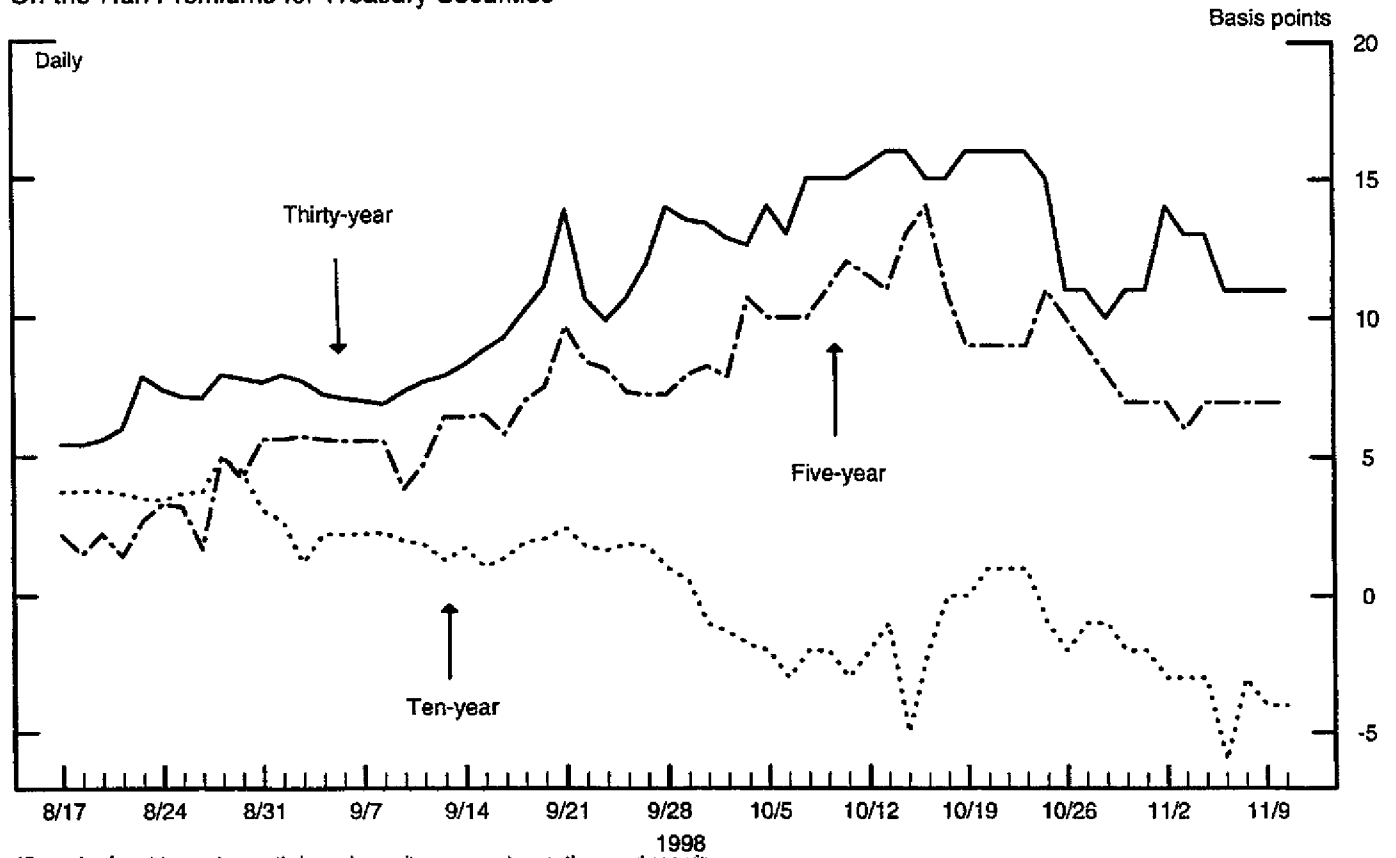
The quarter-point policy easing at the September FOMC meeting was viewed in some circles as disappointingly small in view of the troubles affecting the markets, and credit spreads and liquidity premiums widened in its wake. However, the unexpected October 15 intermeeting action lowering the funds rate another 1/4 percentage point and cutting the discount rate a like amount gave the markets the sense that the System was taking a more aggressive approach and would act to prevent an economic downturn or contain additional financial damage. Accordingly, right after the easing, traders pushed the yield on three-month Treasury bills down to a low of 3.56 percent, off 80 basis points from the level just before the September FOMC meeting; the thirty-year bond yield slipped below 5 percent, down 20 basis points from just before the last FOMC meeting.

In recent weeks, Treasury yields have more than rolled back these declines, reflecting both some reversal of the earlier flight to quality and a trimming of the extent of anticipated System policy easing. The sharpest rise was posted in the bill sector, exaggerated by unexpectedly large supply. On balance over the intermeeting period, Treasury yields were unchanged to up about 20 basis points. The equity markets have powered ahead, however, and major equity indexes are up 7 to 9 percent, on net.

Still, financial market participants remain somewhat skittish. While equity prices have nearly recovered their losses of the previous three months, one-month-ahead volatility implied by call options, though much reduced, remains high. A preference for liquidity is still clearly evident in the government markets. For instance, the yield on the most recently issued thirty-year Treasury bond is currently around 11 basis points below the next-most-recently issued security, an abnormally wide gap. Moreover, bid-asked spreads have not returned to normal, and sources report that market depth—gauged by the amount dealers are willing to transact at quoted spreads—continues to be poor. Spreads of Fannie Mae Benchmark and

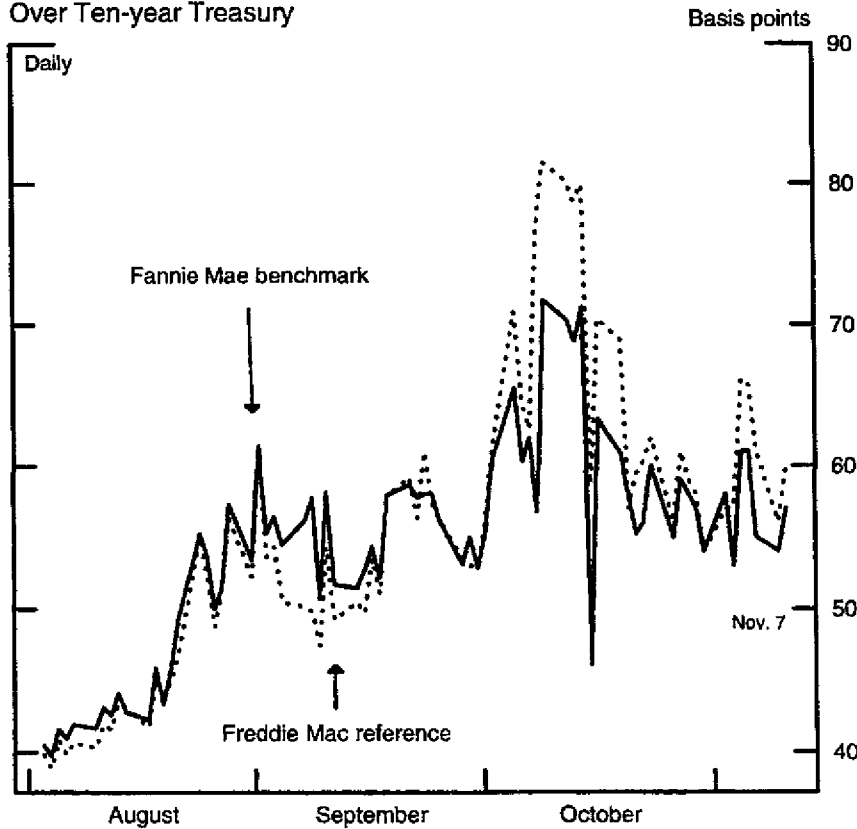
Spreads and Yields: Treasury and Agency Securities

On-the-Run Premiums for Treasury Securities*

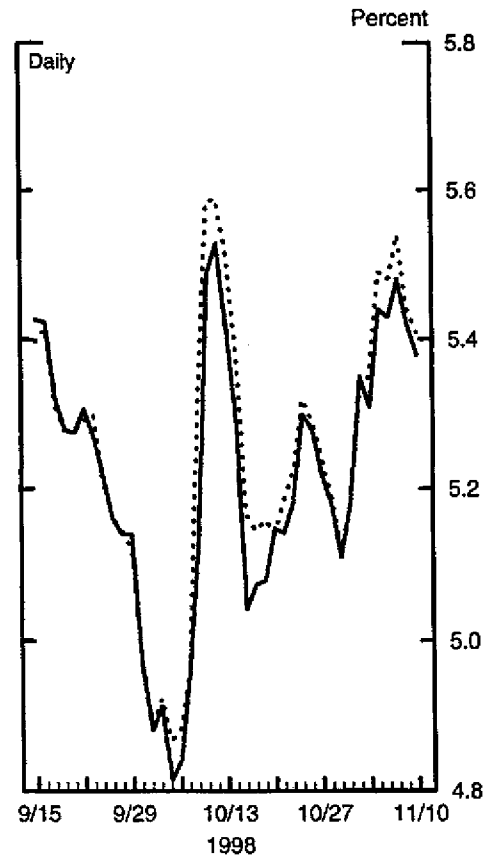


*Spreads of next-to-most-recently issued security over most-recently issued security.

GSE Securities Spreads Over Ten-year Treasury

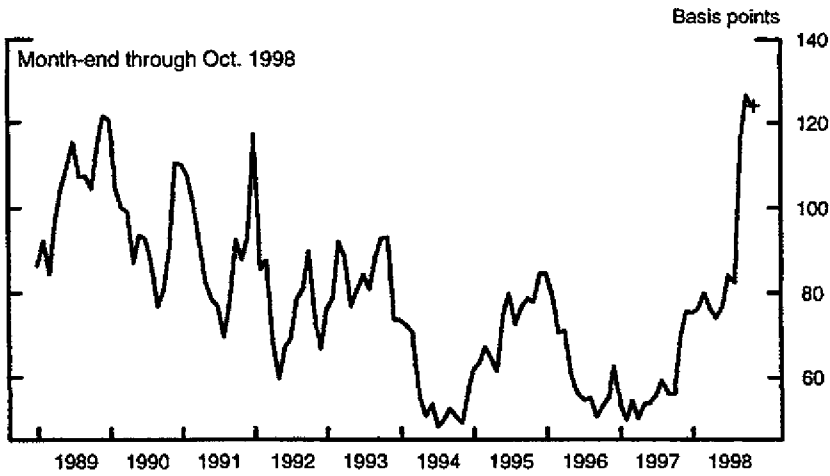


Yields on GSE Securities



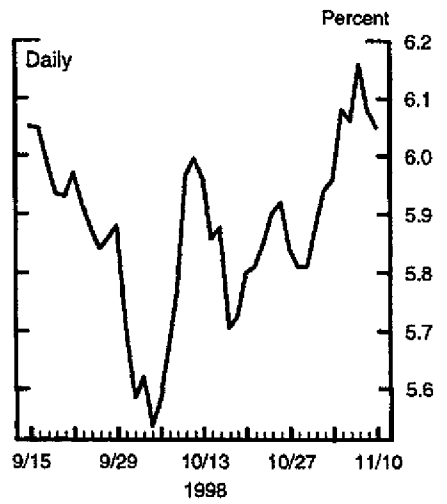
Spreads and Yields: Corporate Securities

AA Corporate Spread over 10-year Treasury

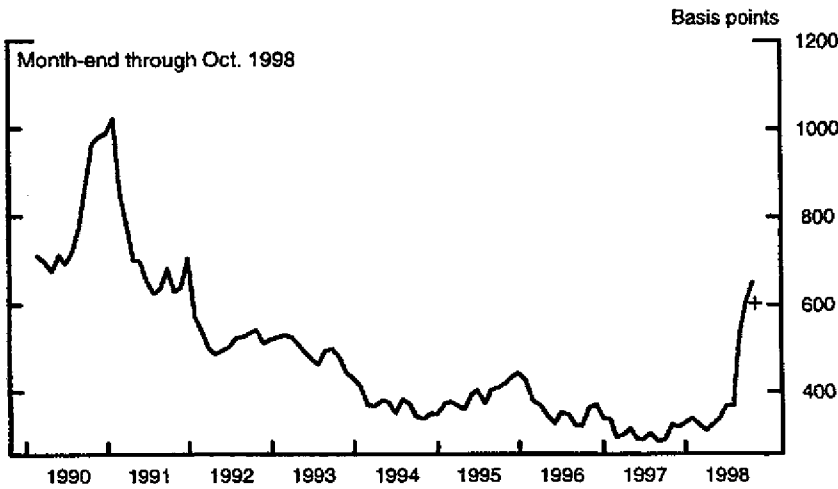


*Source: Merrill Lynch
+ most recent daily spread (Nov. 10).

AA Corporate Yield

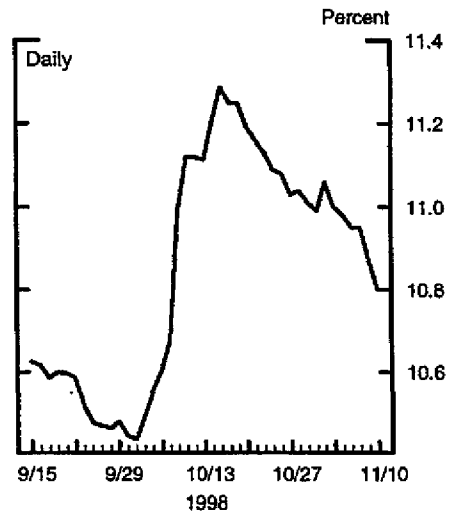


Junk Bond Spread Over 7-year Treasury

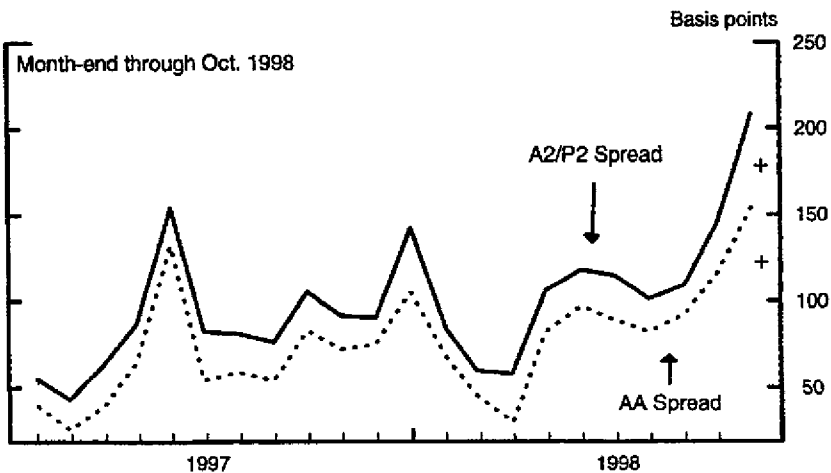


*Merrill Lynch Master II index
+ most recent daily spread (Nov. 10).

Junk Bond Yield

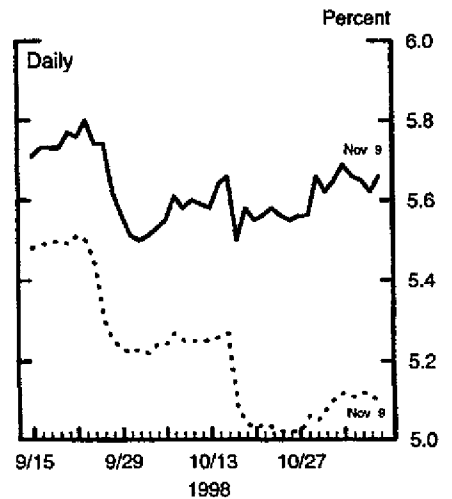


Commercial Paper Spreads Over 30-day Treasury



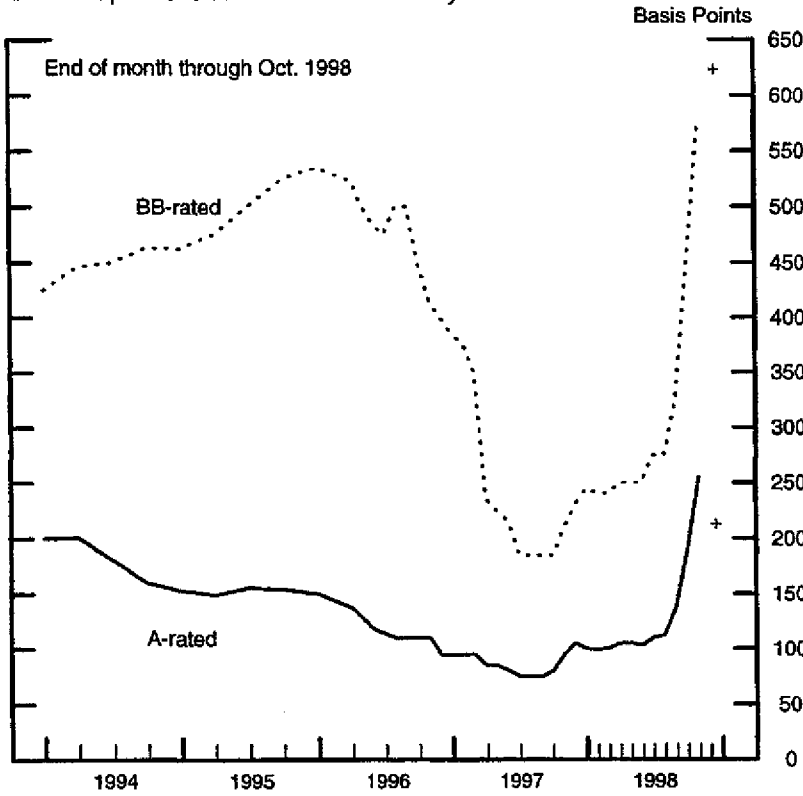
+ most recent daily spread (Nov. 9).

Commercial Paper Yields



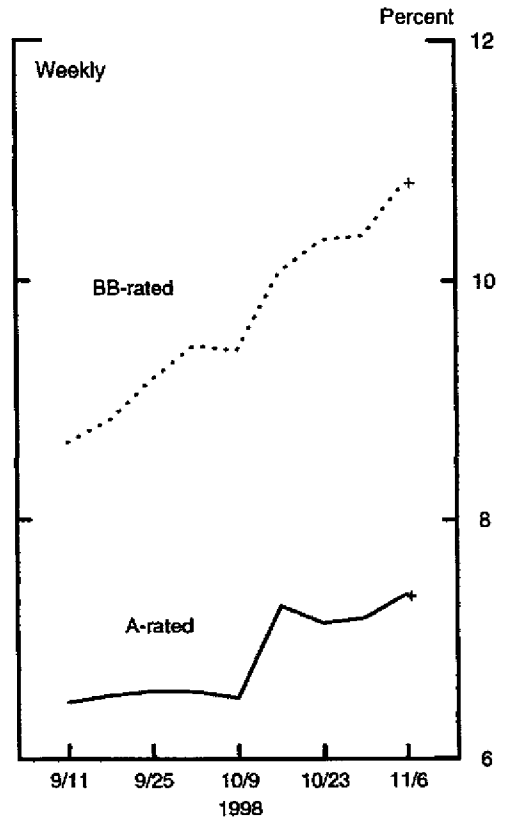
Spreads and Yields: Mortgage-Backed and Asset-Backed Securities

CMBS Spread Over 10-Year Treasury



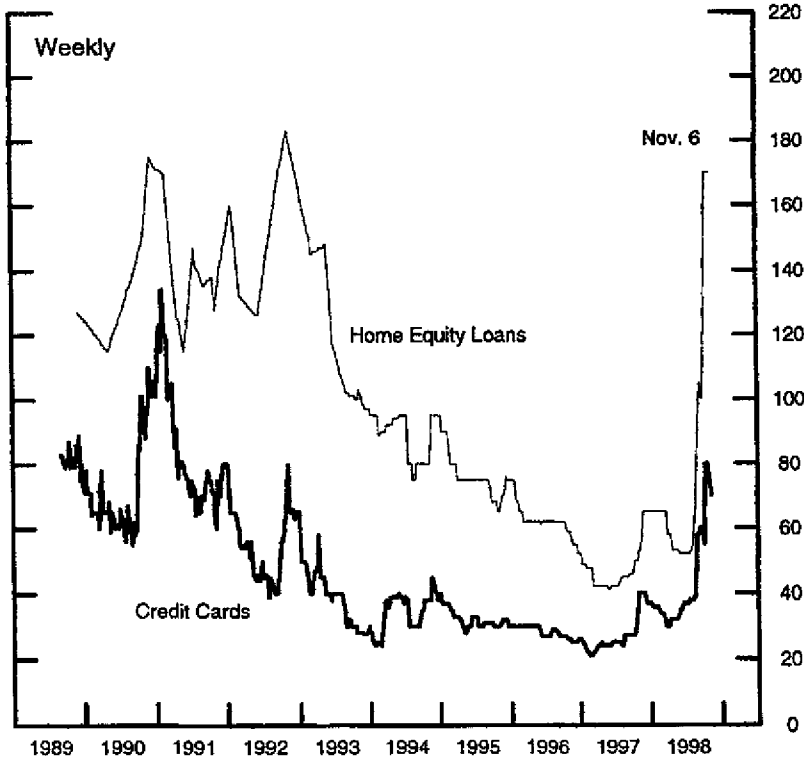
Source: Morgan Stanley.
+ most recent daily spread (Nov. 9).

CMBS Yields



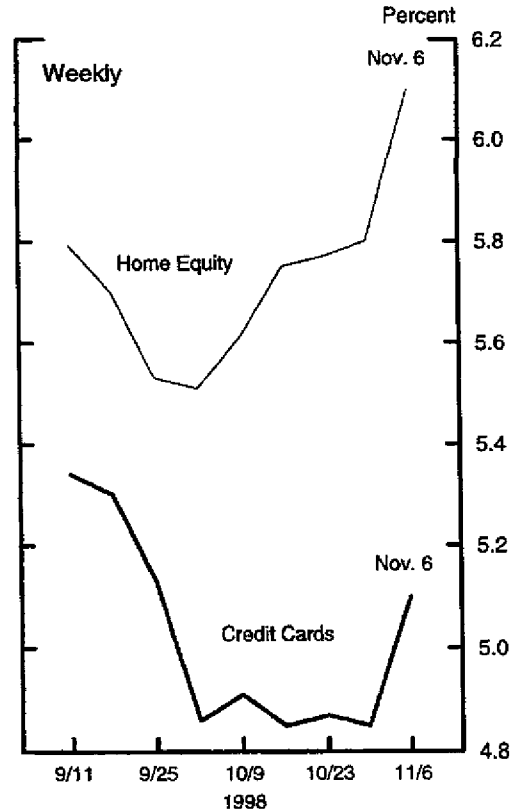
Source: Morgan Stanley.
+ most recent daily yield (Nov. 9).

ABS Spreads Over 2-Year Treasury



Source: Salomon Smith Barney.

ABS Yields



Source: Salomon Smith Barney.

Freddie Mac Reference note rates over comparable Treasuries remain above early-August levels, though below their recent highs. Measures of volatility inferred from bond options remain high, indicating uncertainty persists. Contributing to the more volatile setting is less capital being deployed by dealers in making markets and arbitrageurs in smoothing prices.

In the corporate bond sector, the mid-October policy easing reduced mounting strains and, on net, spreads on most investment-grade and high-yield bonds have narrowed from their recent peaks. Nonetheless, spreads for bonds and commercial paper remain wide, amid investor caution and lingering uncertainty about the amount of high-yield debt still in the hands of hedge funds. With markets unsettled, issuance of corporate debt and equity securities remained low in October, though signs of a recovery have emerged in these markets during the most recent couple of weeks. Financing for commercial real estate remains tight, although some renewed interest by investors for investment-grade commercial mortgage-backed securities has spurred new issuance, enabling conduits to trim some of their outsized inventories of previously originated loans.

The disruption of the capital markets has led to a surge in bank credit, especially business loans, which may be a portent of year-end credit demands likely to be placed on banks. Monetary aggregates also have risen sharply, reflecting both banks' need to fund new assets and extremely heavy inflows to money market funds.

Total household debt growth was strong in the third quarter, reflecting brisk mortgage debt expansion and a pickup in consumer debt growth. Nonetheless, with employment still high and many households' net wealth bolstered by the rebound in stock prices, consumers as a group remain in fine financial health.

In a turnaround from recent experience, the Treasury revised up its estimate of net borrowing needs for the fourth quarter, in part owing to unexpectedly slow growth of tax receipts. Meanwhile, the issuance of state and local debt obligations has been boosted by offerings to raise new capital for public investment projects, while refunding issuance has slowed further.

Business Finance

Conditions in bond markets were extremely difficult for many nonfinancial businesses through mid-October, but there has been something of a turnaround since that time. Investment-grade bond issuance picked up in late October and early November, though investors have favored bonds with shorter maturities, mostly ten years or under. Although spreads over Treasuries remain wide, the level of rates on investment-grade

111-6
GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS
 (Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1996	1997	1998				
			Q2	Q3	Aug.	Sept.	Oct.
All U.S. corporations	58.4	69.7	97.0	69.8	55.7	78.9	64.6
Stocks ¹	10.2	9.8	14.8	6.0	3.7	4.6	7.9
Bonds	48.2	59.9	82.2	63.8	52.0	74.2	56.7
Nonfinancial corporations							
Stocks ¹	6.7	5.0	8.4	3.7	2.6	2.3	5.3
Initial public offerings	2.9	1.8	2.8	1.0	1.1	.1	4.4
Seasoned offerings	3.8	3.2	5.6	2.8	1.5	2.2	.9
Bonds	12.4	17.0	26.8	15.7	15.2	10.4	12.0
By rating, sold in U.S. ²							
Investment grade	6.3	7.4	10.7	10.2	10.5	6.9	8.7
Speculative grade	4.8	8.0	14.3	4.2	3.0	2.7	3.3
Public	2.3	1.5	3.0	1.4	.6	1.4	.0
Rule 144A	2.5	6.5	11.3	2.8	2.4	1.3	3.3
Financial corporations							
Stocks ¹	3.5	4.8	6.4	2.3	1.2	2.4	2.6
Bonds	35.8	42.6	55.3	48.0	36.7	63.9	44.7
Memo:							
Net issuance of commercial paper, nonfinancial corporations ³	-.1	1.1	.5	7.4	11.9	7.2	-5.2
Change in C&I loans at commercial banks ³	5.3	6.2	8.6	7.9	10.9	7.7	24.9

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.

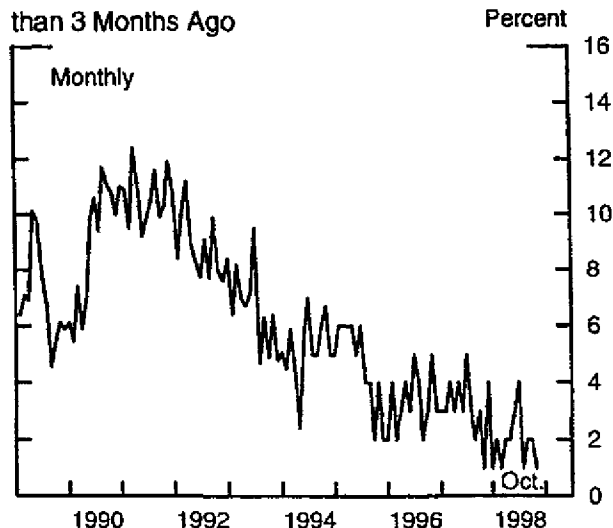
2. Bonds categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.

3. End-of-period basis. Seasonally adjusted.

National Federation of Independent Business Survey

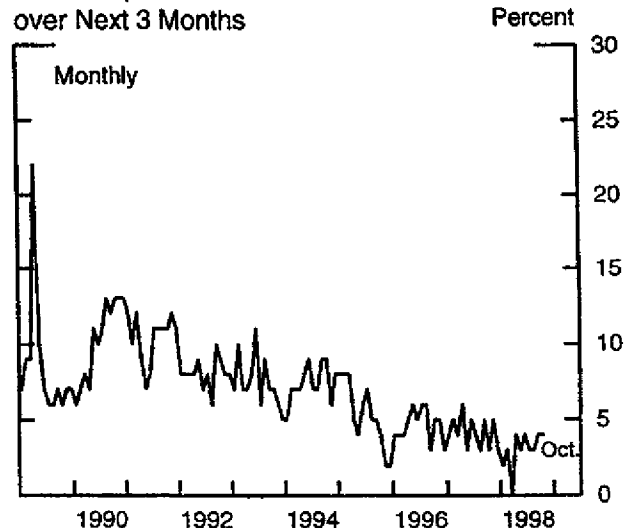
(Percent reporting credit harder to obtain, net of percent reporting credit easier to obtain; NSA)

Credit Harder to Obtain Now than 3 Months Ago



Note. Respondents consist of firms that sought credit in the past three months.

Credit Expected to Become Harder to Obtain over Next 3 Months



Note. Respondents consist of firms that sought credit in the past three months.

bonds is relatively low, and many companies have been using bond proceeds to pay off higher-coupon debt or commercial paper; outstandings of nonfinancial commercial paper fell in October and early November, reversing part of the substantial rise in August and September.

The commercial paper market has not been immune to investor selectivity, and quality spreads opened up in October. Notably, the spread of A2/P2 over AA thirty-day paper surged to about 55 basis points at the end of October, more than double the average annual premium of the past couple of years.¹ This jump occurred well before the usual year-end bulge, and market sources report particular difficulties in placing paper maturing after year-end; indeed, yields on the relatively limited amount of commercial paper with a maturity extending beyond year-end suggest that firms pay very healthy premiums—on average about 600 basis points on an annual basis—over those four or five days at year-end.

Junk-bond issuance picked up in late October and early November, after having been largely dormant since mid-August. Telecommunication firms that need to fund large amounts of fixed investment accounted for the majority of issues. Market reception for these issues has been surprisingly strong, even for those at the lower end of the ratings scale. More generally, well-known below-investment-grade firms in noncyclical industries appear able to issue bonds without much difficulty, but others seem to continue to face investor resistance.

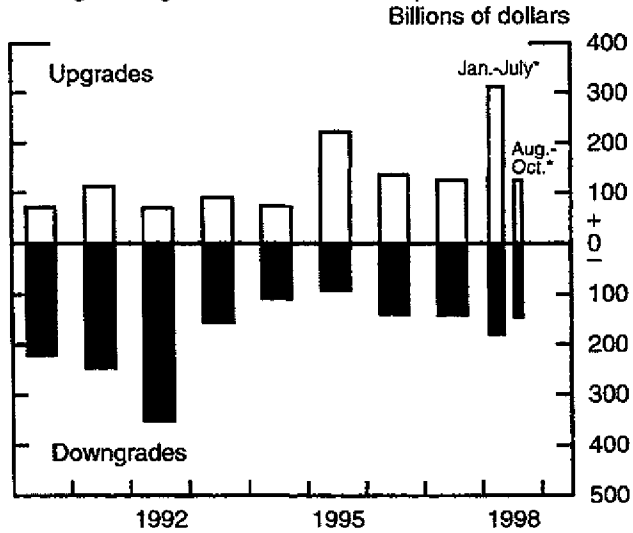
A number of businesses finding the public debt markets inhospitable turned to pre-established lines of credit at banks. As a result, business loan growth was exceptionally strong in October. Respondents to the most recent Senior Loan Officer Opinion Survey confirm that demand for business loans at banks has been boosted by substitution from the commercial paper and bond markets. They also suggest that banks are responding with tighter standards and terms on loans to large and middle-market businesses. Although banks also reported some tightening of standards for small businesses, it was a small move; also the October survey of the National Federation of Independent Business showed that smaller firms were having little difficulty obtaining credit and that they did not expect any material shift in credit availability over the next several months.

Gross public issuance of equity shares by nonfinancial firms remained quite light in October, with the record \$4.4 billion sale of Conoco—DuPont's oil and gas

1. The commercial paper credit rating A2/P2 typically is assigned to corporations having bond ratings between A+ and BBB-. The AA bond credit rating is assigned to corporations judged to be highly creditworthy.

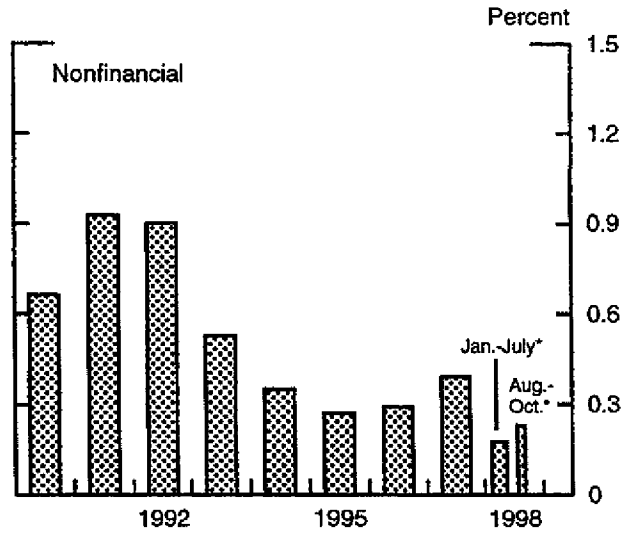
Credit Quality, Corporate Earnings, and Stock Market Prices

Rating Changes, Nonfinancial Corporations



Source: Moody's.
*At an annual rate

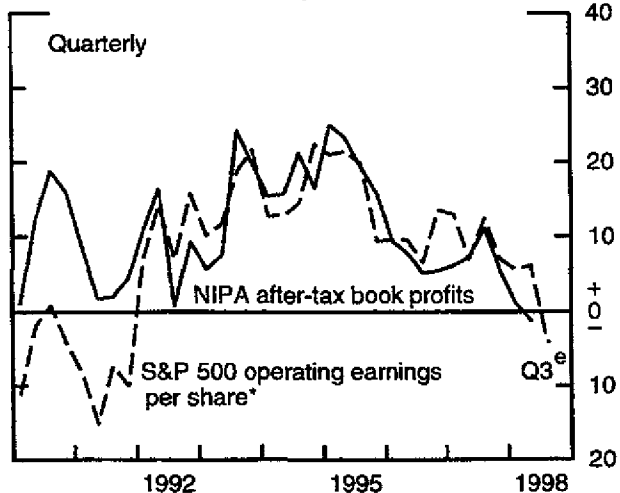
Liabilities of Failed Businesses to Total Liabilities



Source: Dun and Bradstreet.
*At an annual rate. Aug-Oct is based on preliminary data.

Corporate Earnings

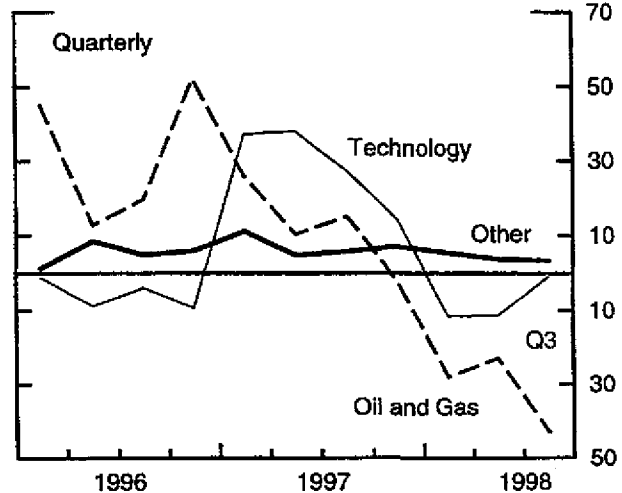
Percent change from 4 quarters earlier



*Source: Goldman Sachs.

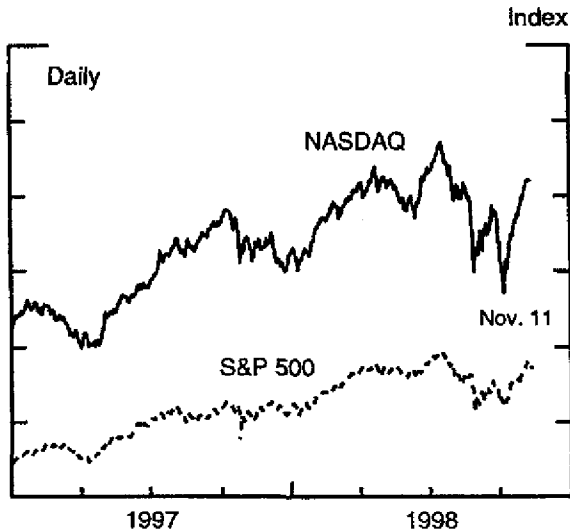
Nonfinancial S&P 500 Earnings

Percent change from 4 quarters earlier

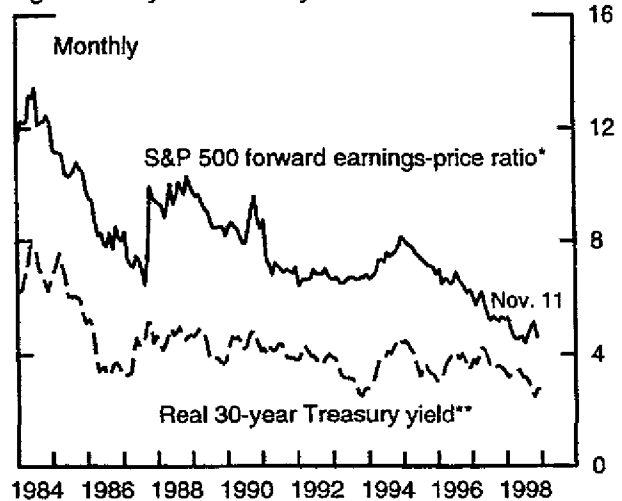


Source: I/B/E/S.

Selected Stock Indexes



Forward Earnings-Price Ratio against 30-year Treasury Yield



*Based on I/B/E/S operating earnings over coming 12 months.
**Nominal yield less Philadelphia Fed ten-year inflation expectations.

subsidiary—accounting for the bulk of the activity. Demand for new shares of high-risk growth companies has shown only limited signs of recovery in early November. While stock prices for small companies have surged since mid-October, the gains have only partly reversed losses earlier this year, and volatility of prices remains high. Further, with new registrations turning up only recently, IPO issuance is expected to remain light through year-end.

Merger activity among nonfinancial firms continued at a strong pace, despite large swings in the market capitalization of both targets and acquiring companies. More than \$30 billion in megamerger deals (mergers larger than \$1 billion) have been completed since late September, and smaller mergers continued at their strong first-half pace. In addition, after virtually halting in September, announcements of mergers surged in October, with the larger new deals pending among grocery, telecommunications, and household-products firms.

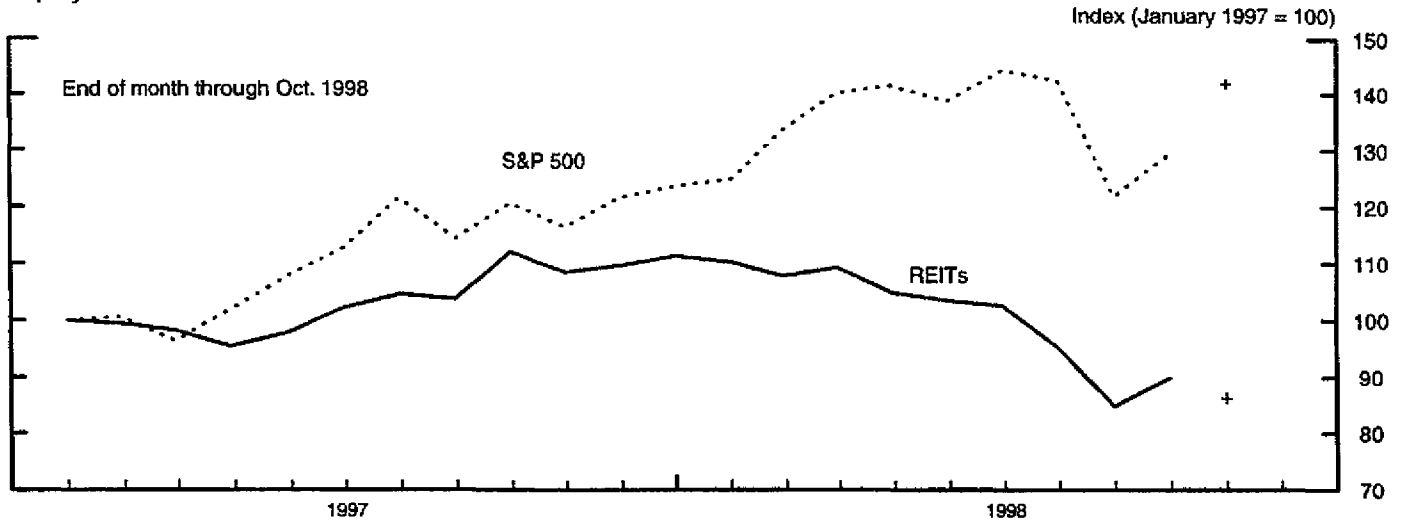
There are some signs that the creditworthiness of U.S. businesses has deteriorated, though nothing that would explain the marked widening of risk spreads of late. On net, Moody's upgraded nonfinancial corporate debt through September but followed with a sizable net downgrade in October. Similarly, the default rate on junk bonds has moved up lately—boosted by \$2 billion of defaults in the first three weeks of October—but it remains low by historical standards. Finally, the rate of failure of nonfinancial businesses has risen in recent months, although it also remains near the low end of the range seen during the 1990s.

Looking ahead, Moody's Watchlist does not point to a significant further deterioration in credit quality. For nonfinancial firms, the amount of debt awaiting review for a potential upgrade almost equals the amount on review for a potential downgrade. The outlook for the credit quality of financial firms, which have been buffeted by turmoil in world financial markets, is not quite so solid: The list of financial firms on the Watchlist suggests a sizable net downgrade in coming months. Bankers' Trust and Republic New York together had \$40 billion in debt placed on watch for a downgrade; Lehman Brothers, which had \$50 billion of its securities on watch for a possible upgrade as recently as July, was removed from Moody's list of potential upgrades, and was placed on watch by S&P for a downgrade. Reflecting these concerns, an index of money center banks' subordinated debt spreads over ten-year Treasuries, which rose sharply from 90 basis points in early August to 240 basis points in early October, remains elevated at about 158 basis points.

About 90 percent of S&P 500 firms have now reported third-quarter earnings. These reports indicate that earnings per share fell about 3 percent from a year earlier,

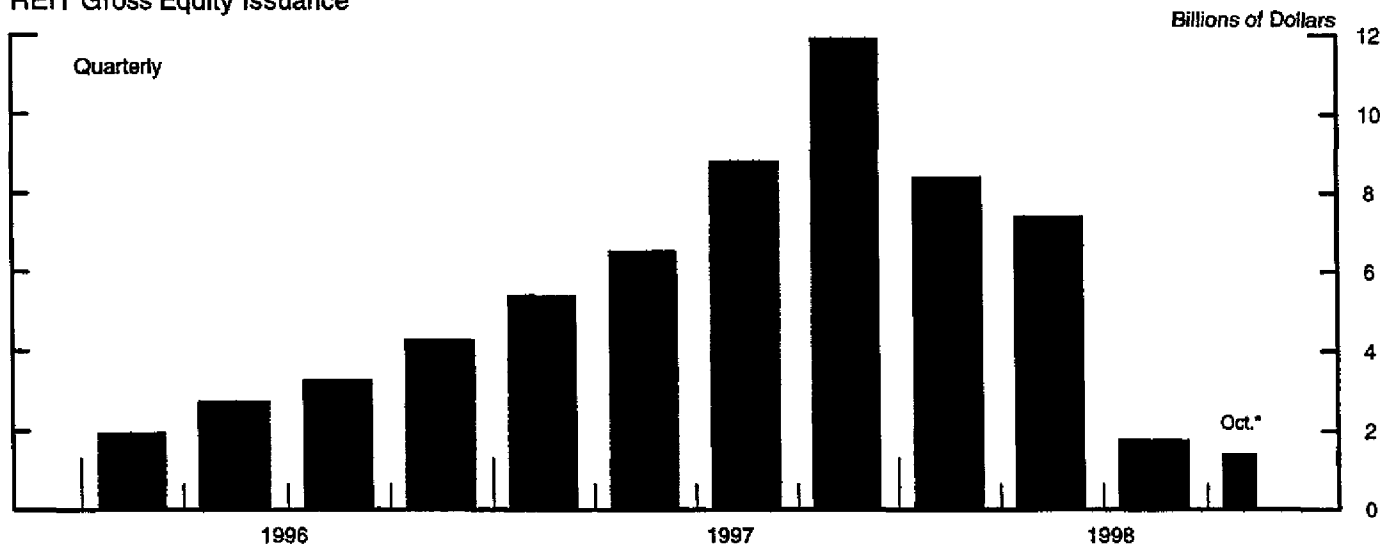
Commercial Real Estate

Equity Prices



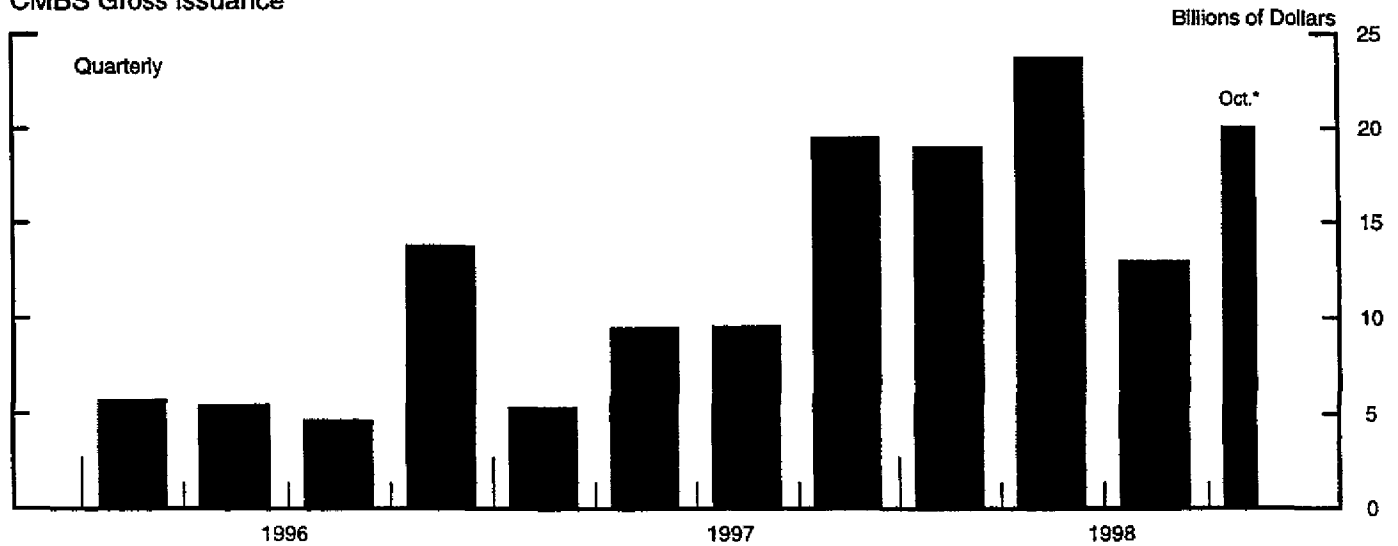
Source. National Association of Real Estate Investment Trusts.
 + most recent daily index value (Nov. 11).

REIT Gross Equity Issuance



Source. National Association of Real Estate Investment Trusts.
 * At a quarterly rate. Excludes issues associated with equity-for-equity swaps that occurred in mergers.

CMBS Gross Issuance



Source. Commerical Mortgage Alert.
 * At a quarterly rate.

the first such decline since late 1991. By sector, earnings for oil and gas companies slid further in the third quarter, while earnings for technology companies were about even with year-earlier levels. Growth of earnings for other nonfinancial companies, which account for the bulk of the S&P 500, eased further in the third quarter, continuing the slowing that started in late 1997. In the financial industry, sharp declines in earnings occurred among money-center banks and investment banks, owing to trading losses and declines in underwriting fees and other corporate-finance-related income. Analysts evidently view the recent weakness as temporary, as they continue to call for a substantial rebound in profits over the coming twelve months.

Equity prices have surged, on net, over the intermeeting period, reflecting relief that third-quarter earnings were not so bad as had been feared, a bit more optimism about foreign financial conditions, and growing confidence that the System would take the actions needed to keep the economy chugging along. The expected S&P 500 forward-earnings yield, which rose when stock prices slipped in August and September, dipped back down as equity prices rebounded in the second half of October. Comparing this S&P earnings yield to an estimate of the real long-term Treasury yield is a common gauge of equity valuations. The gap between these two yields narrowed in October and early November, reversing much of the widening that occurred during the third quarter and suggesting a return to richer pricing.

Commercial Real Estate Finance

The supply of finance for commercial real estate continues to be constrained. Equity issuance by REITs has dropped sharply from its first-half pace. Originations of commercial mortgages by Wall Street conduits have reportedly ground to a near halt as the industry continues to work through a substantial backlog of previously originated mortgages that have yet to be securitized. Since the mid-October easing, spreads on the highest-tier investment-grade commercial mortgage-backed securities have narrowed by about 45 to 50 basis points. However, spreads on lower-rated issues have widened further by 50 to 75 basis points as the major investors in such subordinate securities, particularly mortgage REITs, have pulled out of the market. Well-capitalized market players, such as GMAC Mortgage and GE Capital, appear likely to boost their purchases of subordinate CMBS at current valuation levels, but it is unlikely that spreads will tighten to the levels that mortgage REITs accepted over the past two years.

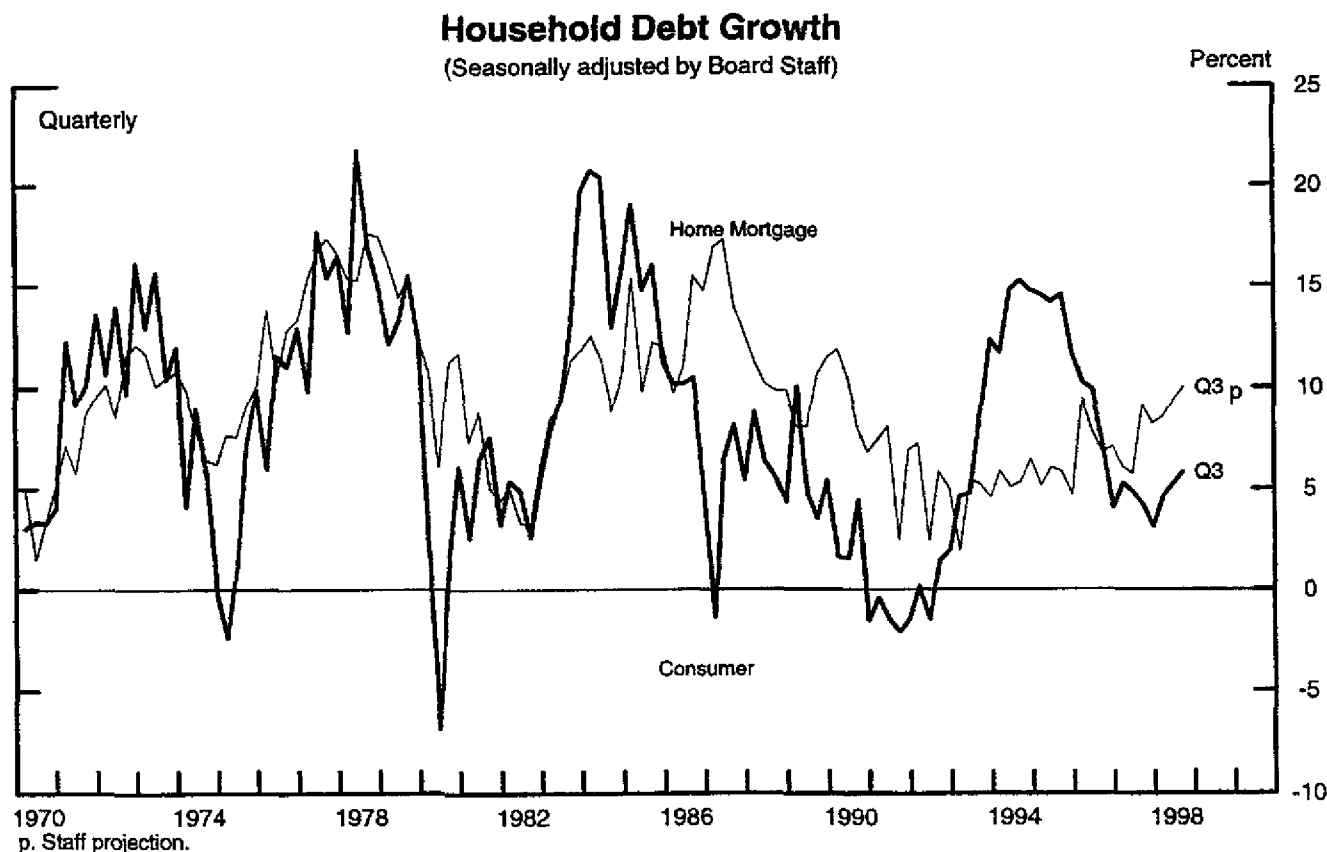
The decline in investment-grade yields since mid-October has enabled the conduits to work down bloated inventories of previously originated loans by issuing

Net Flows of Mutual Funds
 Excluding Reinvested Distributions
 (Billions of dollars; monthly rates; not seasonally adjusted)

	1997	1998						Memo: Sept. Assets
		H1	Q3	Aug.	Sept.	Oct. 1- Oct. 14 ^e	Oct. 15- Nov. 4 ^e	
Total Long-Term Funds	22.7	29.3	10.6	-7.2	11.7	-22.6	29.9	3,629
Equity Funds	19.0	21.1	4.8	-11.7	6.5	-25.5	19.5	2,485
Domestic	15.8	18.6	5.9	-6.6	9.0	-20.2	18.4	2,144
International	3.1	2.5	-1.2	-5.2	-2.5	-5.3	1.1	341
Hybrid Funds	1.4	1.7	-0.1	-0.9	-0.5	-1.8	1.4	333
Bond Funds	2.4	6.5	6.0	5.4	5.6	4.7	9.1	811
International	-0.1	0.0	-0.3	-0.5	-0.3	-0.3	-0.1	24
High-yield	1.4	1.8	-0.4	-3.4	0.3	-2.9	4.6	111
Other Taxable	1.0	3.5	5.3	7.2	4.6	7.6	2.2	381
Municipals	0.1	1.2	1.4	2.2	1.0	0.3	2.3	295

Source: Investment Company Institute (ICI).

^e Staff estimates based on ICI weekly data.



new investment-grade CMBS. Since mid-October, nearly \$9 billion of CMBS have been issued, including a record \$4 billion deal, and a substantial amount is scheduled to come to market in the remaining weeks of November.

Reports suggest that life insurance companies and pension funds, institutions that typically hold commercial mortgages, have increased their lending activities in response to the shutoff of public market funds. Fannie Mae and Freddie Mac have also increased the amount of funds available to the multifamily housing sector. While credit appears to be available from these institutions, terms and pricing are reportedly much stiffer than earlier in the year. The most recent Senior Loan Officer Survey indicates that a number of banks have tightened standards on commercial real estate loans, in part because of disruption in the CMBS market.

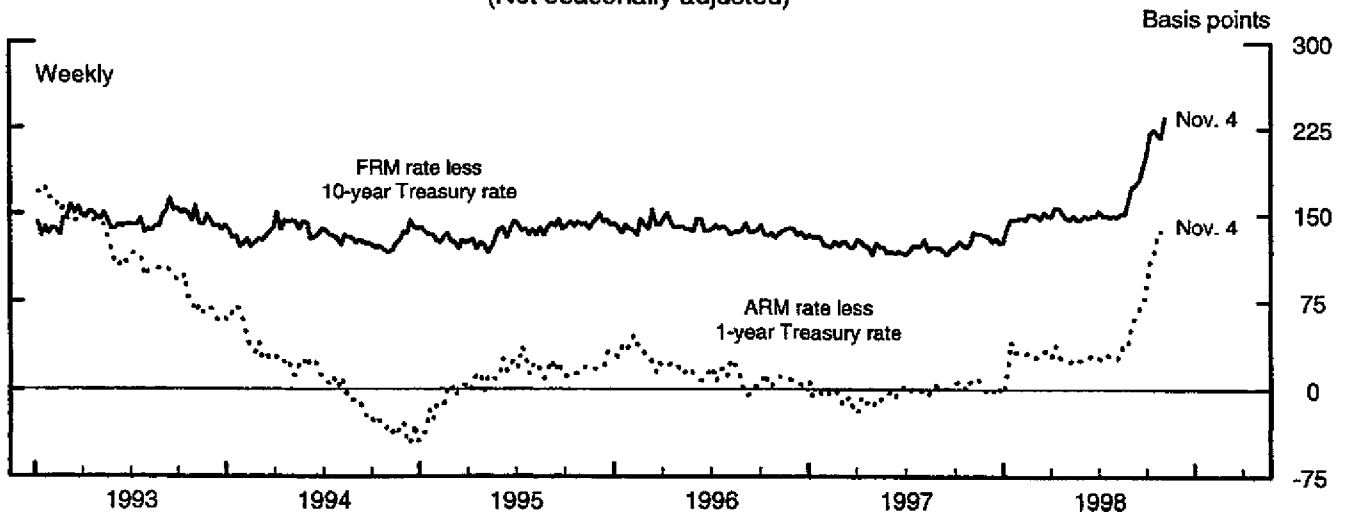
Household Sector Finance

The ratio of household net worth to income declined in the third quarter but has recovered considerably more recently with the increase in stock prices in the second half of October and early November. Household preferences for financial assets have shifted in response to price movements, as indicated by flows into mutual funds. According to preliminary weekly data, provided by the Investment Company Institute on a confidential basis, net flows to equity and high-yield bond funds were negative in the first half of October, while flows to less risky funds—such as investment-grade bonds, government bonds, and money market funds—were generally maintained. The inflows to equity funds and high-yield bond funds, however, resumed at a fairly strong pace in late October and early November.

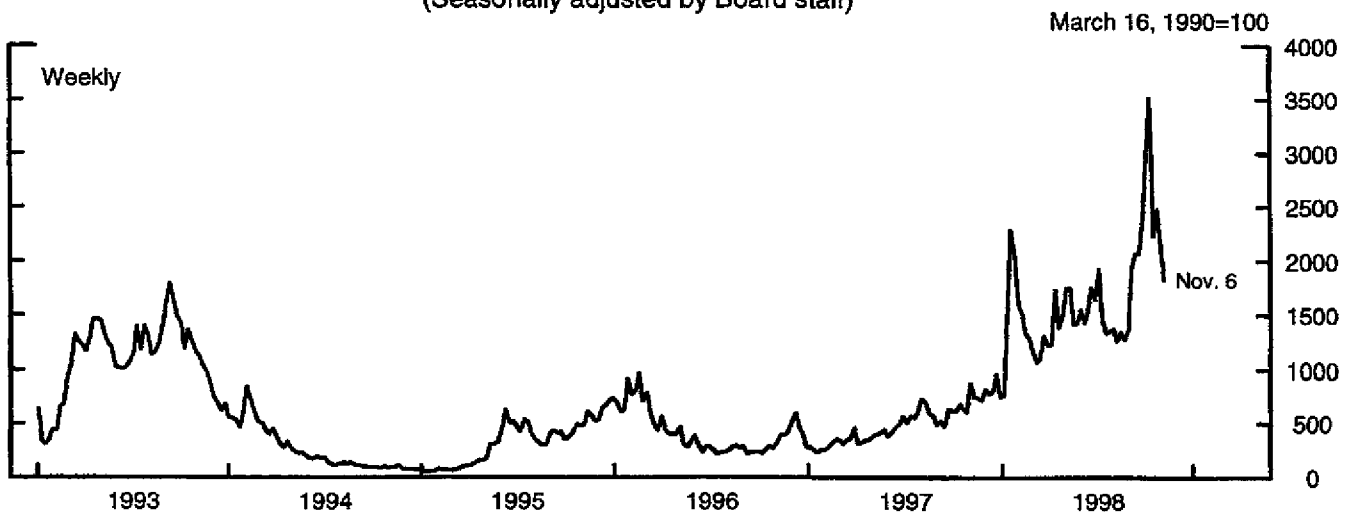
Preliminary data suggest household debt grew rapidly in the third quarter. Mortgage borrowing increased at an estimated 10 percent annual rate, and consumer credit increased 5-3/4 percent. Mortgage debt has been fueled by vigorous home purchase and refinancing activity in response to mortgage rates that have been attractive despite a wide spread over Treasury rates. However, reports suggest a softness in the subprime, high loan-to-value, and jumbo mortgage markets.

Despite increased debt, household debt service performance remained good in the third quarter. Moody's reported that the delinquency rate on credit card accounts in securitized pools was lower in August relative to a year ago—its ninth straight monthly decline. Auto delinquencies at finance companies were down slightly in September from August and remain well below their recent peak in early 1997. Nonetheless, spreads on asset-backed securities are stuck at very high levels, particularly for securities backed by home equity loans. Only a few of the highest-

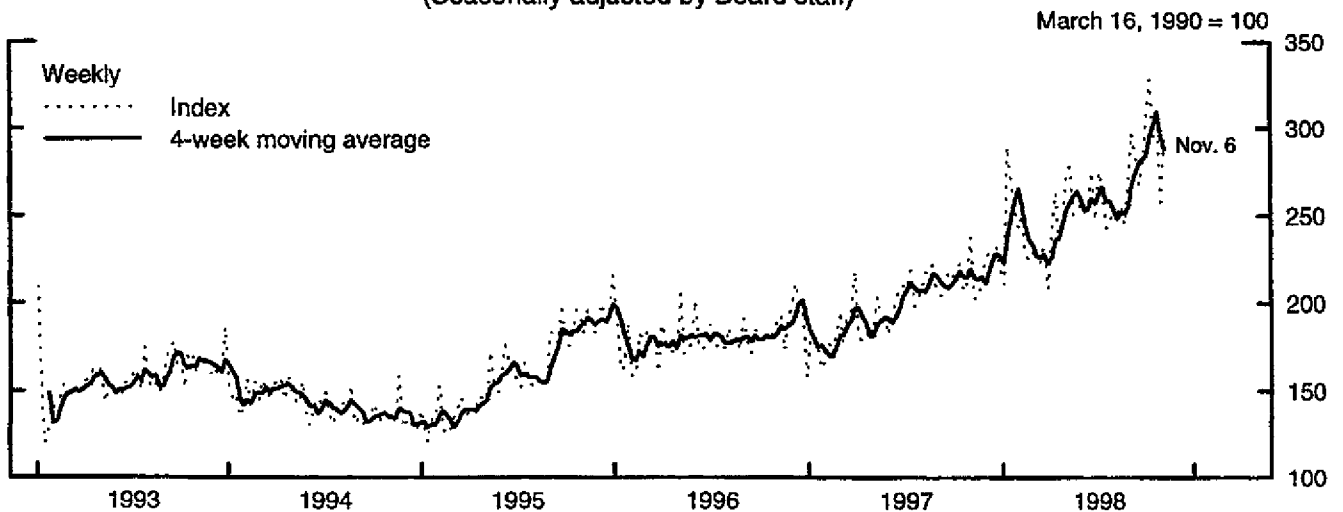
Spreads of Mortgage Rates Over Treasury Rates (Not seasonally adjusted)



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



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



quality credit card and auto loan issuers were able to place securities in October, though issuance appears to be growing in November. But, to date, only one new asset-backed home equity issue has been sold this quarter.

Respondents to the Senior Loan Officer Survey indicate these difficulties in the capital markets have had little effect on terms for consumer loans at banks. However, home equity lenders that rely exclusively on securitizations for funding are facing tighter restrictions on their lines of credit from banks, and therefore may reduce lending.

Federal Government Finance

In a turnaround from recent experience, the Treasury revised up its estimated net market borrowing needs for the fourth quarter to \$30 billion, from \$15 billion as of August 3. The increase reflects slower growth in tax receipts, as well as smaller net issuance of State and Local Government Series securities (SLGS) resulting from the drying up of advanced refundings by municipal issuers in light of the turmoil in financial markets. The increased borrowing needs can be more than met by the \$3 billion boost to weekly bill auctions that began in mid-September.

The Treasury's midquarter refunding package closely paralleled that in August, with \$16 billion of five-year notes, \$12 billion of ten-year notes, and \$10 billion of thirty-year bonds. Market reception for the auction was tepid, with some of the lowest coverage ratios seen in years, as competing agency and high-grade corporate issues commanded renewed interest from investors. The Treasury also announced that, henceforth, all of its marketable securities will be sold on a uniform price basis. The Treasury has read the experience of its sale of two- and five-year notes, which have been sold on a uniform price basis since 1992, as indicating that this auction format produces a broader distribution of awards, improves the efficiency of market operations, and reduces the financing cost of the federal debt.

In early October, the Treasury raised \$8 billion in a reopening of January's ten-year TIPS bond. Over the intermeeting period, yields on TIPS, which are less liquid than nominal Treasuries, remained remarkably close to those on nominal securities. The spread of nominal Treasuries over the ten-year TIPS narrowed from 104 basis points at the September FOMC meeting to 86 basis points before the October easing, but has subsequently retraced this drop and stands at 99 basis points, roughly half what it was in August before the markets were shaken by the Russian debacle.

Treasury and Agency Finance

Treasury Financing (Billions of dollars)

Item	1998					
	Q1	Q2	Q3	August	Sept	Oct
Total surplus, deficit (-)	-39.7	-30.2	136.9	-11.2	38.2	n.a.
Means of financing deficit						
Net borrowing	33.7	25.9	-81.8	34.0	-46.4	9.0
Nonmarketable	15.8	17.3	15.9	.3	7.2	-2.7
Marketable	17.9	8.6	-97.7	33.7	-53.6	11.7
Bills	14.4	4.1	-78.8	38.3	-38.8	13.5
Coupons	3.5	4.6	-18.9	-4.7	-14.8	-1.9
Decrease in cash balance	11.7	4.3	-44.6	-.4	-2.5	1.8
Other ¹	-5.7	.0	-10.5	-22.5	10.6	n.a.
MEMO						
Cash balance, end of period	31.9	27.6	72.3	36.4	38.9	37.0

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

1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

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

Agency	1998				
	Q2	Q3	August	Sept	Oct
FHLBs	10.5	14.7	6.5	8.7	n.a.
FHLMC	7.0	32.7	5.0	19.2	n.a.
FNMA	25.1	24.4	8.0	7.4	0.7
Farm Credit Banks	2.4	-0.4	-6.6	6.4	n.a.
SLMA	-3.1	0.5	0.1	0.4	n.a.

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

Efforts by some government-sponsored enterprises to tap global markets have proceeded swiftly, with about \$25 billion of global issues in the intermeeting period. Fannie Mae and Freddie Mac accounted for \$14 billion of this issuance, as they continue to position their benchmark and reference notes as close substitutes for the dwindling supply of Treasury debt. These new securities seem particularly popular with Asian investors, who according to market reports bought about half of some recent issues; also, bond traders report that the agency notes are more advantageous than Treasuries for some hedging purposes, because the yields on agency notes may be more highly correlated with corporate debt yields than are Treasury rates. Despite requests by government-bond dealers to include agency debt in its outright open-market operations, the domestic desk of the Federal Reserve Bank of New York has not announced plans to do more than replace its maturing holdings of GSE-issued securities.

Municipal Finance

Gross long-term municipal bond issuance strengthened in October, owing to heavier financing of new capital, which more than offset a drop-off in refundings. Advance refunding activity has been slowed by the negative arbitrage that occurred when yields on Treasury bonds (bought by issuers to fund their escrow accounts) fell below those on the refunded bonds. In the November elections, voters approved a record amount of municipal bond issuance, the largest portion to go towards education.

Investor demand for municipal bonds has increased with the turmoil in other financial markets, but remains moderate. Flows to tax-exempt mutual funds have been strong since August; however, market sources indicate that direct demand by retail investors has remained tempered, likely owing to the relative illiquidity of individual bonds. The moderate overall demand and heavy new supply of municipal bonds continues to put pressure on yields, possibly reinforced by the unwinding of municipal-versus-Treasury trades by hedge funds, which reportedly were heavy buyers of municipal bonds earlier in the year. The most recent thirty-year revenue bond-to-Treasury yield ratio stands at 1.00, down only slightly from October's high.

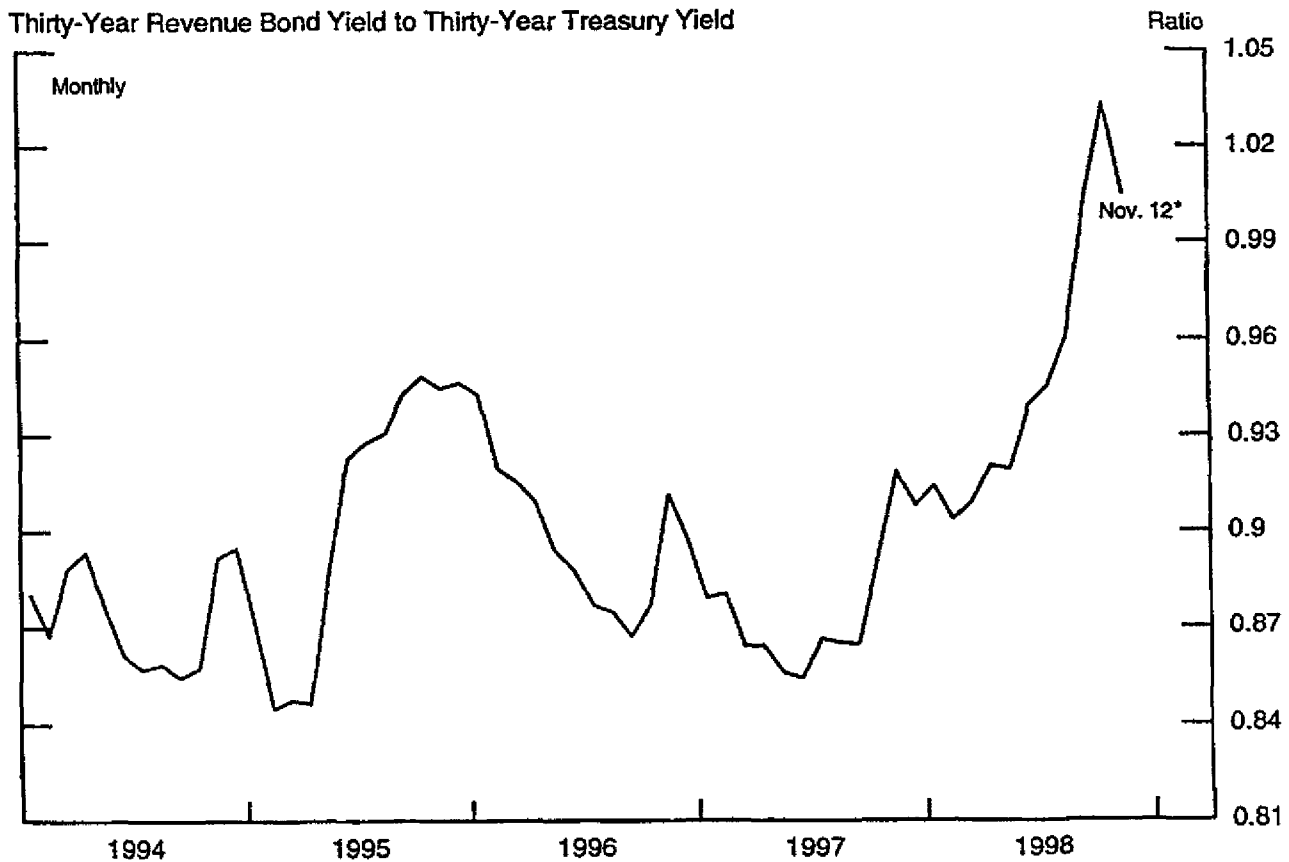
State and Local Finance

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

	1995	1996	1997	1998				
				Q2	Q3	Aug.	Sept.	Oct.
Total tax-exempt	15.4	17.9	21.5	27.5	23.1	23.7	20.6	21.7
Long-term	12.1	14.3	17.9	24.3	20.2	20.3	17.5	19.5
Refundings ¹	3.6	4.9	6.6	8.5	8.1	9.1	8.4	6.8
New capital	8.5	9.4	11.3	15.7	12.1	11.3	9.1	12.7
Short-term	3.3	3.6	3.6	3.2	2.9	3.3	3.1	2.2
Total taxable	0.7	0.8	1.1	0.8	1.3	1.6	1.0	0.5

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.
*Staff estimate.

Money and Bank Credit

Amid the turbulence in financial markets, bank credit grew in October at a robust 18-1/2 percent annual rate, after adjusting for mark-to-market accounting effects.² The strength primarily owed to the hefty growth in business and security loans and in securities holdings. Growth of real estate loans strengthened, but to only a 4 percent rate in October, apparently held down by substitution by households from home equity loans and variable-rate first mortgages into fixed-rate mortgages, for which there is greater competition from nonbank lenders. Despite heavy mortgage refinancing activity, consumer loans grew at a brisk 6-3/4 annual rate last month, after adjustment for securitization, down only slightly from September.

M2 increased at a robust 12 percent annual rate in October, off only a bit from its torrid September pace of 14-3/4 percent. Growth over the past two months in part was fueled by increased demand for safe, liquid assets, likely reflecting the reduced attractiveness of equity and other risky securities. This source of growth was augmented by a continued decline in the opportunity costs of M2 assets following the policy easings in September and October. Growth of retail money market mutual funds and of currency outstanding, both domestically and overseas, was also strong over the most recent two months.

M3 growth was only slightly faster than that of M2 on average over September and October, despite significant shifts within its non-M2 components. Expansion in large time deposits softened over the two months, as bank funding requirements largely were met by core deposit growth. By contrast, institutional money market funds, whose yields fall more slowly than market rates, advanced at a 50 percent rate over September and October.

2. The turbulence in financial markets has also led to more caution on the part of banks in the interbank market. According to the November survey of loan officers, many banks have scrutinized carefully their bank counterparties and have selectively shortened credit lines, required more collateral, and reduced maturities of their exposures.

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

Type of credit	1997	1998					Level, Oct 1998 p (billions of \$)
		Q2	Q3	Aug	Sep	Oct p	
1. Bank credit: Reported	9.0	5.4	8.9	17.4	15.8	26.7	4,496.1
2. Adjusted ¹	8.6	6.0	7.7	17.0	10.4	18.4	4,339.4
3. Securities: Reported	10.3	0.4	12.0	26.9	21.7	48.7	1,222.2
4. Adjusted ¹	8.5	2.2	7.1	26.5	0.3	17.4	1,065.5
5. U.S. government	6.2	-3.6	0.6	16.1	-4.5	15.6	776.8
6. Other ²	20.8	9.4	36.4	49.1	74.4	111.0	445.4
7. Loans ³	8.6	7.3	7.8	13.9	13.7	18.7	3,273.9
8. Business	8.9	7.2	12.9	11.4	15.4	27.8	944.4
9. Real estate	9.2	6.5	1.9	8.7	1.2	3.9	1,285.6
10. Home equity	15.5	-0.4	-2.4	0.0	4.9	-6.1	97.2
11. Other	8.7	7.1	2.2	9.4	1.0	4.8	1,188.5
12. Consumer: Reported	-1.5	1.7	-7.8	-2.4	7.8	-2.4	495.9
13. Adjusted ⁴	4.1	9.1	2.4	-0.2	8.7	6.8	744.3
14. Other ⁵	20.5	15.9	31.2	49.3	48.3	58.8	548.0

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

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

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

3. Excludes interbank loans.

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

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

p Preliminary.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1997	1998		1998			1997:Q4 to Oct. 98 (p)	Level (bil. \$) Oct. 98 (p)
		Q2	Q3	Aug.	Sept	Oct. (p)		
Percentage change (annual rate) ¹								
Aggregate								
1. M1	-1.2	.2	-2.4	-3.1	3.6	7.2	1.0	1078.6
2. M2 ²	5.7	7.5	6.7	8.5	14.8	12.3	8.6	4339.8
3. M3	8.8	10.3	7.1	11.7	14.4	13.6	10.6	5842.1
Selected Components								
4. Currency	7.5	5.1	8.4	6.8	15.7	10.1	8.1	453.4
5. Demand deposits	-2.0	-5.6	-11.6	-12.1	-1.9	1.3	-5.5	374.0
6. Other checkable deposits	-12.2	1.1	-7.0	-7.8	-9.9	10.0	-.9	243.2
7. M2 minus M1 ³	8.5	10.1	9.9	12.5	18.6	14.1	11.3	3261.2
8. Savings deposits	9.9	13.6	11.9	11.8	15.8	13.7	13.4	1555.4
9. Small time deposits	2.3	-2.6	-1.3	-.9	1.5	1.5	-.7	962.7
10. Retail money market funds	16.3	21.7	21.8	33.1	48.3	31.5	26.0	743.1
11. M3 minus M2 ⁴	19.6	18.8	8.0	21.1	13.3	17.2	16.7	1502.3
12. Large time deposits, net ⁵	17.1	15.2	-2.6	8.9	-2.0	2.5	9.1	614.3
13. Institution-only money market mutual funds	21.0	36.5	21.6	36.5	38.4	60.9	33.3	480.7
14. RPs	17.4	14.6	10.2	32.5	32.1	-19.8	18.0	267.7
15. Eurodollars	31.2	-7.7	9.9	4.2	-33.7	10.4	1.6	139.6
Memo								
16. Liquid Deposits ⁶	4.3	8.5	5.4	5.3	9.7	11.2	8.0	2172.6
17. Sweep-adjusted M1 ⁷	6.1	4.9	3.7	2.5	7.6	8.4	5.5	1385.0
18. Monetary base	5.9	4.1	6.9	8.9	11.5	9.4	6.9	506.1
19. Household M2 ⁸	6.6	8.8	9.0	10.5	14.7	12.9	10.1	3963.5
Average monthly change (billions of dollars) ⁹								
Memo								
Selected managed liabilities at commercial banks:								
20. Large time deposits, gross	11.2	5.0	-2.1	9.3	3.8	5.0	...	719.0
21. Net due to related foreign institutions	-3.9	-15.8	7.0	15.1	-1.1	21.4	...	221.5
22. U.S. government deposits at commercial banks	.1	4.3	-2.4	-22.4	2.0	7.0	...	26.1

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. Sum of seasonally adjusted demand deposits, other checkable deposits, and savings deposits.

7. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs, on the basis of monthly averages of daily data.

8. M2 less demand deposits.

9. For the years shown, "average monthly change" is the 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.

Appendix

November Senior Loan Officer Opinion Survey on Bank Lending Practices

The November 1998 Senior Loan Officer Opinion Survey on Bank Lending Practices focused primarily on changes over the past three months in the supply and demand for bank loans to businesses and households.¹ Additional questions concerned interbank lending and potential risks arising from business customers' year-2000 difficulties.

The survey results suggest a broad tightening of business lending practices. Citing increased concern over the economic outlook, a large share of the participants indicated that they had firmed standards and terms on loans to large and middle-market businesses and on commercial real estate loans. Unlike recent surveys, a few banks also reported tighter standards and terms on loans to small businesses. Respondents indicated that demand for business and commercial real estate loans had increased, boosted somewhat by customers that were having difficulty raising funds in the securities markets.

The survey found little evidence of any changes in lending practices on loans to households. A few banks said they were more willing to make consumer installment loans, while modest percentages said they had tightened standards on credit cards and on other consumer loans. Terms on these loans were reportedly unchanged.

The responses to the questions on interbank lending show many banks have reduced the amount they are willing to lend to certain financial institutions and some banks are requiring shorter maturities, more collateral, or higher premiums on interbank loans. Nearly all those restricting their interbank lending applied the adjustments to selected individual banks, many banks restricted terms to Japanese institutions generally, and a few did so for European institutions generally.

The respondents reported making good headway in assessing risks arising from year-2000 problems of their customers. Most of the banks noted that the large majority of their important business customers were *satisfactorily approaching year-2000 preparedness*.

Lending to Businesses

More than one-third, on net, of the domestic banks said that over the past three months they had tightened *standards* on C&I loans to large and middle-market borrowers (up from one-quarter in September), and two-thirds of the foreign respondents said they had tightened (up from two-fifths). This is the largest share of the domestic respondents reporting tightened standards on these loans since 1990. Similar fractions reported tightening *terms* on C&I loans to large and middle-market customers, with a large number raising the spreads of loan rates over the banks' cost of funds and the premiums charged on riskier loans. Of those that tightened standards or terms on loans to large and middle-market firms, about two-fifths said the tightening had applied predominantly to large firms, about 10 percent said predominantly to middle-market firms, and the remainder said policies toward both groups of firms were tightened about equally. The largest domestic respondents--those with more than \$15 billion

1. This summary is based on fifty-four of the fifty-six domestic respondents and all of the twenty-three branches and agencies in the panel.

in assets--more commonly reported tightening standards and terms for these loans than the smaller respondents, perhaps in part because larger banks are more likely to compete with the capital markets--where borrowing conditions have deteriorated in recent months--as a source of funds. About 15 percent, on net, of the domestic respondents tightened standards and terms on loans to small businesses; the respondents had reported no change in standards or terms, on net, on these loans in September.

A less favorable or more uncertain economic outlook was the most commonly cited reason for having tightened standards and terms on C&I loans. Many banks also pointed (in decreasing order of frequency) to a worsening of industry-specific problems, a reduced tolerance for risk, and less aggressive competition from other banks and nonbank lenders. Both the September and November surveys generally asked about changes in lending practices since August, so for banks that reported tightening on both surveys it cannot be concluded that the tightening reported in November reflects additional changes in policies since September. However, a special question on the November survey found that a large share of the respondents had tightened their standards or terms for C&I loans since September.

These results are broadly consistent with anecdotal reports from participants in the syndicated loan market. The reports indicate terms on syndicated loans are significantly tighter than those available a few months ago. Originations of these loans reportedly had dried up because borrowers were resistant to the higher cost of funds, but in recent weeks, as firms have become more comfortable with higher fees and wider spreads, origination volume has picked up somewhat.

In contrast to September, when many of the banks said demand for C&I loans had fallen, responses to the November survey indicate an increase in demand for these loans. One quarter, on net, of the domestic respondents experienced greater demand from large and middle-market firms, and 10 percent, on net, experienced increased demand from smaller firms. About 15 percent, on net, of the foreign banks reported stronger demand. The respondents pointed to shifts from other sources of credit--a response not commonly cited in the past--as the primary cause of the increased demand. Specifically, about three-quarters of the largest domestic and the foreign respondents said substitution from the bond market, and half said substitution from the commercial paper market, had boosted loan demand. Few of the smaller domestic respondents reported experiencing such substitution.

Nearly half of the domestic and foreign respondents tightened standards on commercial real estate loans over the past three months. About half of the respondents widened loan rate spreads and smaller fractions tightened other terms, including loan-to-cost ratios, debt-service coverage ratios, requirements for take-out financing, and maximum loan sizes. Most commonly the respondents said they had tightened because of a worsening of the economic outlook, but many also pointed to disruption in the commercial mortgage-backed securities market and to increased concern about the reliability of take-out financing. More respondents experienced decreased demand for these loans than experienced increased demand. Nevertheless, many respondents said the decline in issuance of CMBS had led to increased demand at their bank by borrowers encountering difficulty getting credit elsewhere.

Lending to Households

Less than 10 percent of the banks said their willingness to make consumer installment loans increased over the past three months, about the same as in September; no banks said their

willingness to make these loans decreased. Fifteen percent tightened standards on credit card loans and ten percent tightened standards on other consumer loans. Few banks reported any change in terms on consumer loans of either type. About ten percent of respondents, on net, experienced weaker demand for consumer loans. Almost all of the banks said that disruption in the market for asset-backed securities had not affected their balance sheets or lending practices with respect to household lending.

Few banks indicated a change in standards for home mortgages. More than half reported stronger demand for these loans, with many stating that demand for mortgages was substantially stronger. Although the question specifically asked about demand for mortgages to purchase homes, the responses perhaps reflect, in part, the recent high level of mortgage refinancing activity.

Interbank Lending

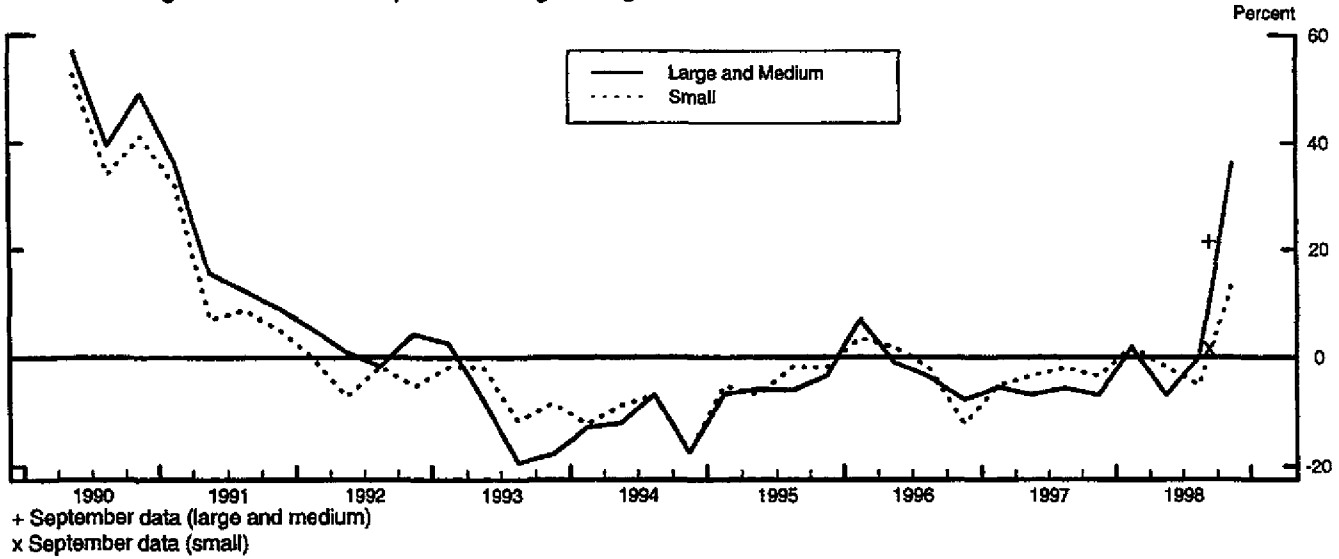
Many reports in recent months have indicated that increasing concern about the financial health of counterparties had led to changes in banks' interbank lending policies, the subject of special questions on the November survey. The responses show that nearly two-thirds of the domestic and half of the foreign respondents have taken steps to restrict their interbank lending during the past three months. About half reduced the amount they are willing to lend to some or all institutions, and about a third stopped lending entirely to some institutions. Significant percentages also cut back maturities on term loans, stopped making term loans altogether, required greater interest-rate premiums, and increased the amount or type of collateral required when entering into repurchase agreements. Of those banks that made changes to their interbank lending policies, most applied the restrictions to selected institutions they considered less creditworthy. Many also adopted a more restrictive posture toward Japanese institutions generally and a few toward European institutions generally. Only two applied them to domestic money center banks generally.

Year 2000 Risks

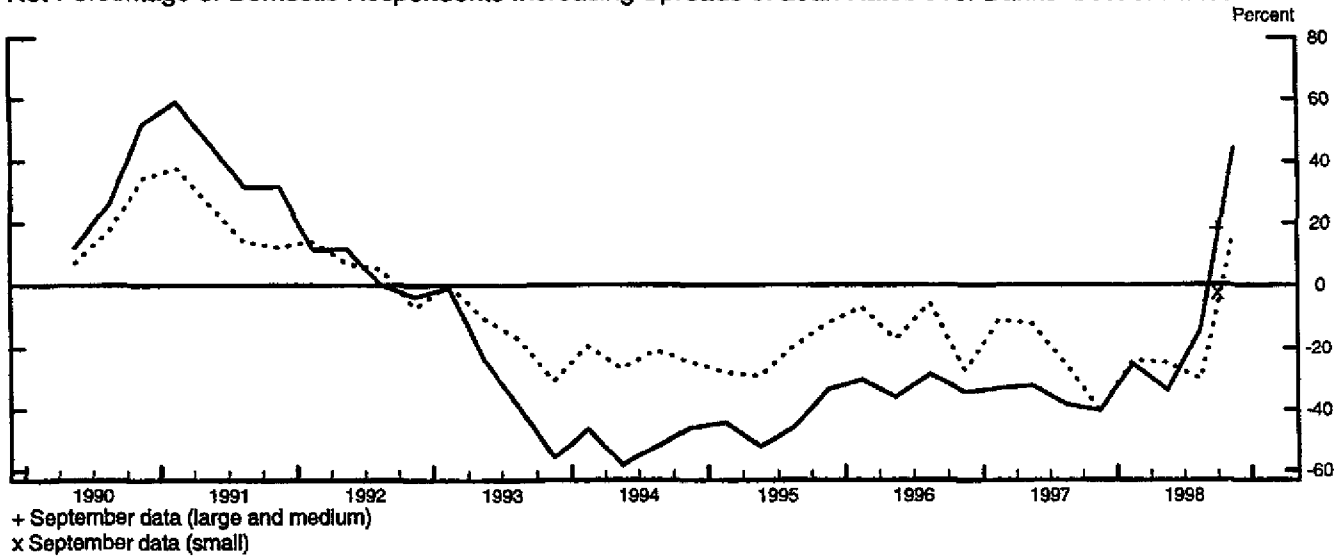
Additional special questions asked respondents about the management of risks resulting from the possible year-2000 problems of their customers. The results show significant progress in the respondents' evaluation of these problems since the May survey, which included similar questions. Half of both the domestic and the foreign respondents reported having evaluated the year-2000 preparedness of more than 90 percent of the business customers that account for a material proportion of their loans. None of the respondents have evaluated less than 25 percent. In May, less than half of domestic respondents and less than one-fourth of the foreign respondents had evaluated even 25 percent of their customers. Virtually all of the respondents found that less than 15 percent of their material business customers were not making satisfactory progress toward achieving year-2000 preparedness. Likely for this reason, nearly all the survey participants had downgraded less than 3 percent of their material business customers for inadequate preparedness.

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

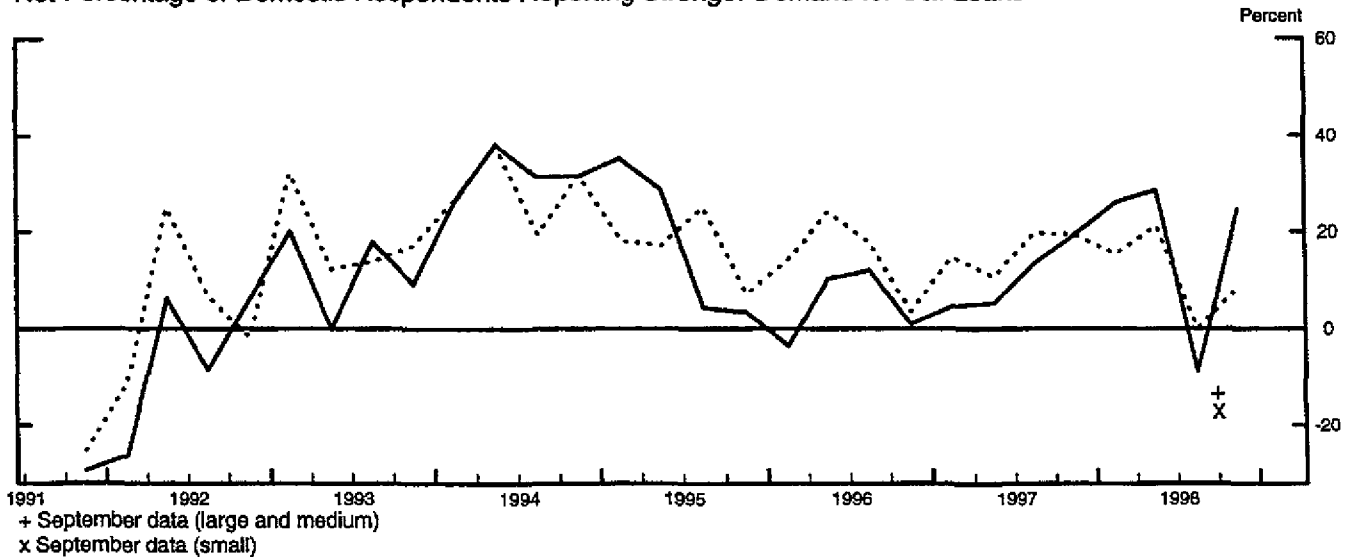
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

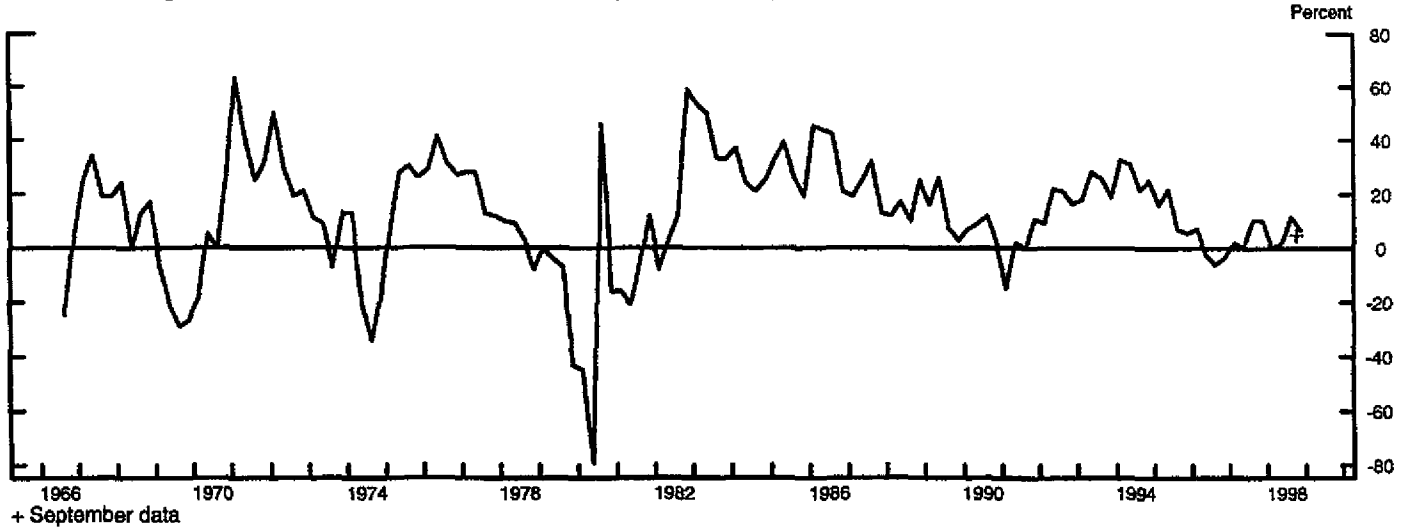


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

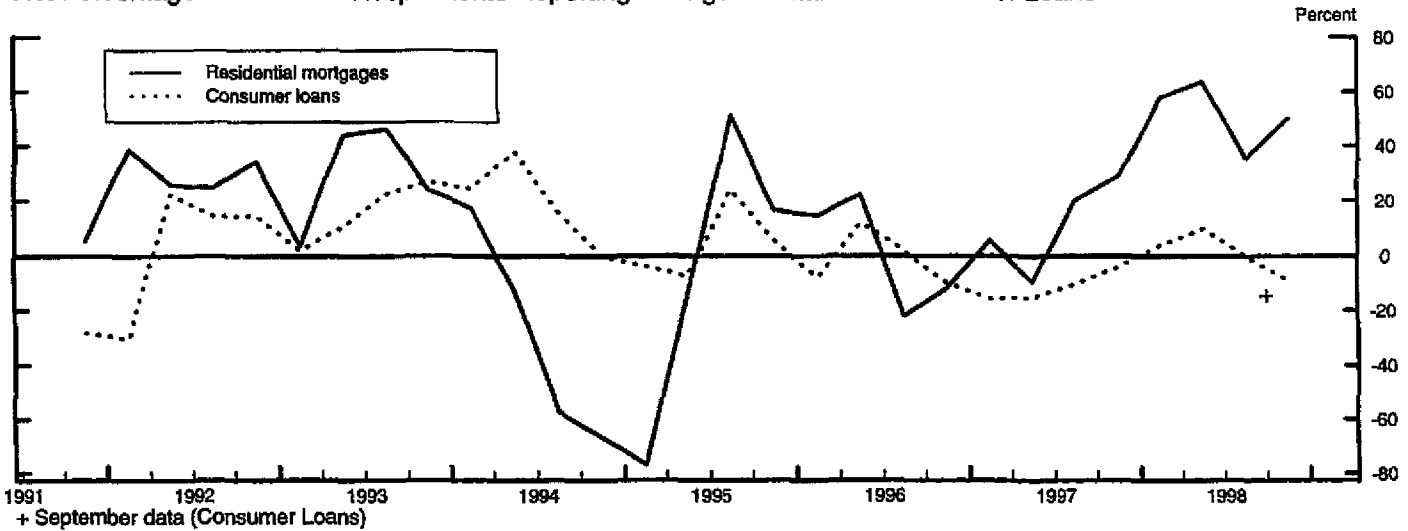


Measures of Supply and Demand for Loans to Households

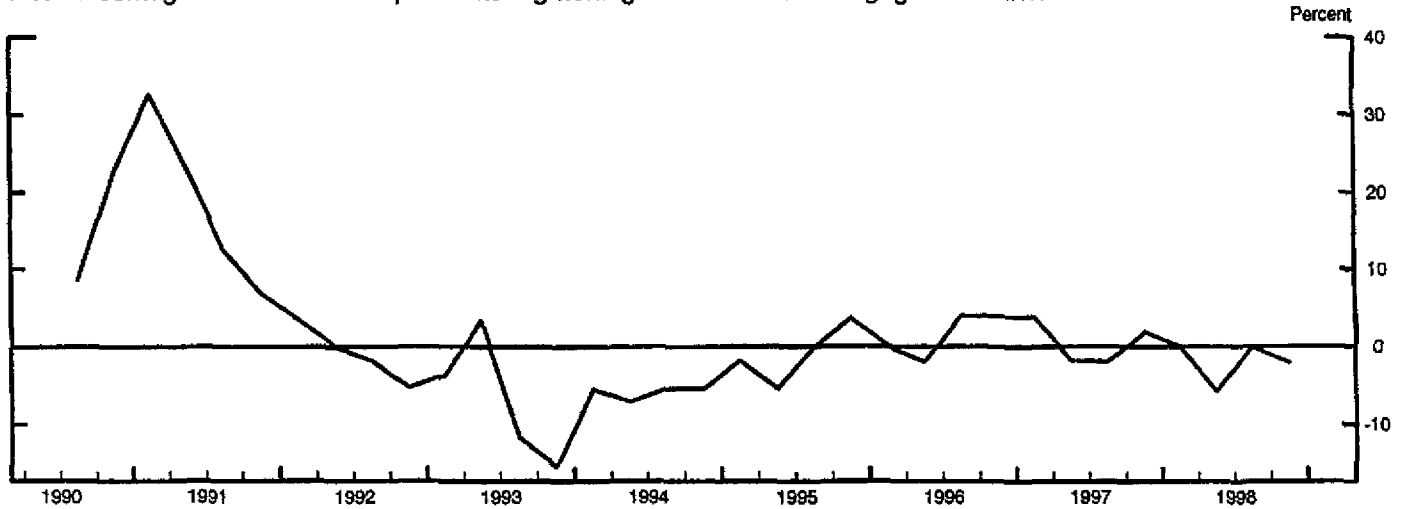
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



Net Percentage of Domestic Respondents Reporting Stronger Demand for Consumer Loans



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



INTERNATIONAL DEVELOPMENTS

International Developments

U.S. International Trade in Goods and Services

In August, the U.S. nominal trade deficit in goods and services was \$16.8 billion, significantly larger than in July. For July-August combined (AR), the trade deficit was moderately larger than in the second quarter. Trade data for September will be released on November 18.

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

	1997	Annual rates			Monthly rates		
		1998			1998		
		Q1	Q2	Q3 ^e	Jun	Jul	Aug
Real NIPA¹							
Net exports of G&S	-136.1	-198.5	-245.2	-262.5	...	...	...
Nominal BOP							
Net exports of G&S	-110.2	-140.0	-174.3	-187.9	-13.6	-14.5	-16.8
Goods, net	-198.0	-222.8	-257.8	-265.4	-20.5	-21.0	-23.2
Services, net	87.7	82.8	83.5	77.5	6.9	6.5	6.4

1. In billions of chained (1992) dollars.

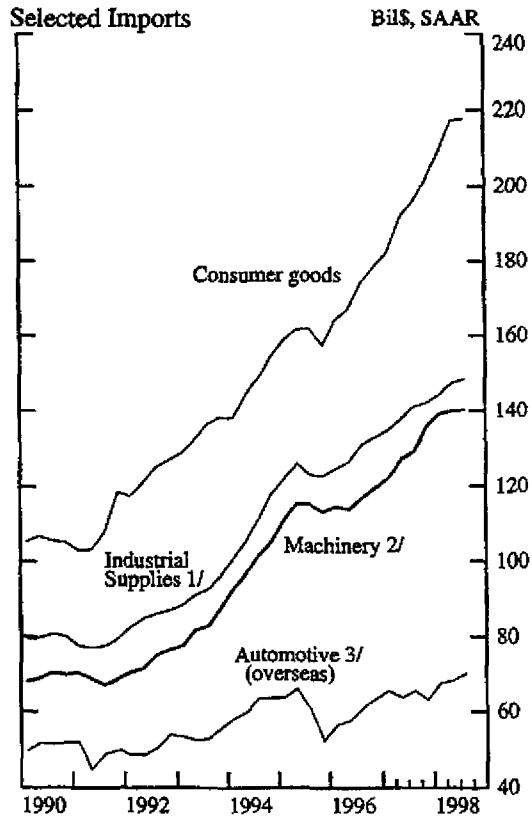
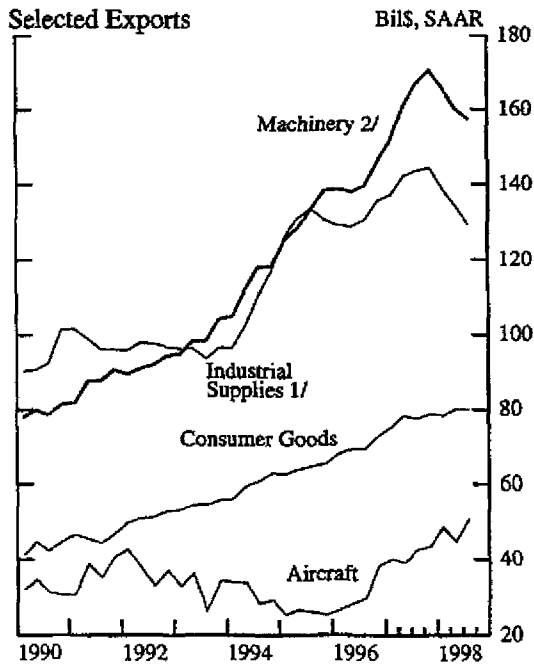
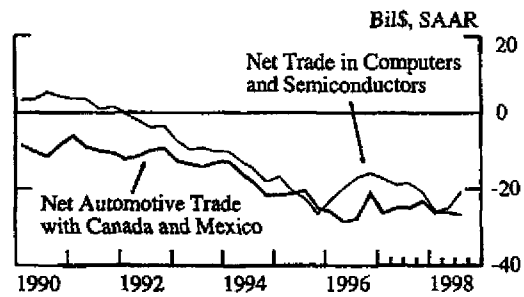
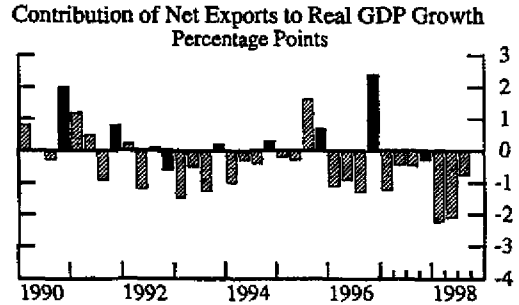
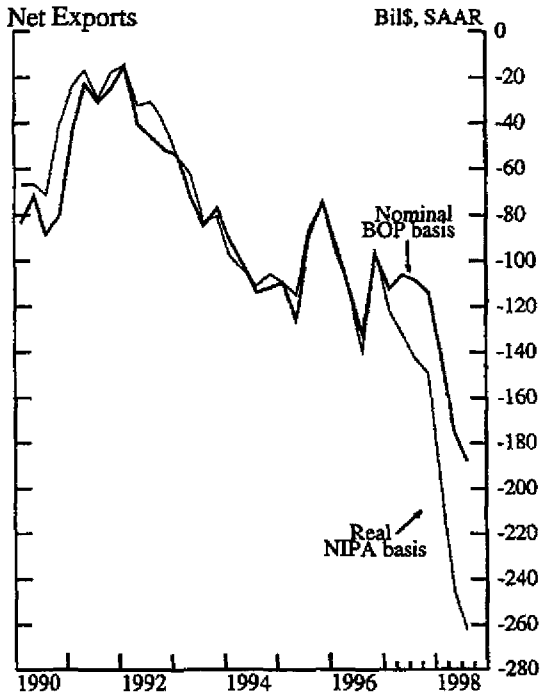
e. BOP data are two months at an annual rate.

Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

The value of exports declined slightly in August, following a much sharper drop in July. In August, decreases in deliveries of large jet aircraft (industry data suggest a reversal in September) and exported machinery were partly offset by a sharp increase in automotive exports to Canada and Mexico (reflecting the end of the strike against GM at the end of July). Strike-affected decreases in the value of automotive products to Canada and Mexico accounted for most of the drop in exports in July. Exports were 2¼ percent lower in July-August combined, relative to the second quarter. About half of the decrease was in automotive products, and much of the remaining decline was in industrial supplies and service transactions (primarily receipts from foreigners for travel and passenger fares). Exports of machinery (other than computers and semiconductors) edged down at a slightly slower rate than in the first and second quarters. By area, most of the decline in goods exports was to Canada, with very small decreases recorded to Western Europe and developing countries in Asia.

The value of imports rose 2¼ percent in August, virtually all in imports of vehicles and parts from Canada and Mexico (largely the effect of the end of the strike at GM). For July-August, imports were ¾ percent lower than in the second quarter.

U.S. International Trade in Goods and Services



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

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

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

	Levels				Amount Change ¹			
	1998		1998		1998		1998	
	Q2	Q3 ^e	Jul	Aug	Q2	Q3 ^e	Jul	Aug
Exports of G&S	921.2	899.6	901.2	898.1	-25.0	-21.5	-15.3	-3.1
Goods exports	659.3	645.1	645.9	644.4	-26.6	-14.1	-11.3	-1.5
Agricultural	52.0	50.7	52.2	49.1	-4.4	-1.3	-0.5	-3.1
Gold	4.2	4.6	2.7	6.6	-1.1	0.4	-2.1	3.9
Other goods	603.0	589.8	591.0	588.7	-21.2	-13.2	-8.8	-2.3
Aircraft & pts	44.8	50.9	55.1	46.7	-4.1	6.1	6.5	-8.5
Computers	44.8	44.9	44.6	45.3	-0.7	0.2	-1.4	0.7
Semiconductors	35.5	36.8	35.8	37.9	-2.3	1.4	0.4	2.1
Other cap gds	162.8	159.9	162.6	157.2	-5.6	-3.0	0.2	-5.5
Automotive	72.2	61.7	56.8	66.6	-5.5	-10.5	-10.4	9.8
to Canada	39.0	31.9	27.9	36.0	-1.8	-7.1	-6.1	8.1
to Mexico	12.3	9.2	8.2	10.1	-0.9	-3.2	-2.6	2.0
to ROW	20.8	20.6	20.7	20.5	-2.9	-0.2	-1.8	-0.3
Ind supplies	134.1	129.1	129.4	128.7	-4.7	-5.1	-0.5	-0.6
Consumer goods	80.1	79.9	79.9	80.0	1.7	-0.1	-2.5	0.1
All other	28.8	26.6	26.8	26.4	0.0	-2.2	-1.3	-0.4
Services exports	261.9	254.5	255.3	253.7	1.6	-7.4	-4.0	-1.6
Imports of G&S	1095.4	1087.6	1075.8	1099.4	9.2	-7.8	-4.4	23.6
Goods imports	917.1	910.5	898.2	922.8	8.4	-6.5	-5.3	24.6
Petroleum	53.9	49.9	50.1	49.7	-1.0	-4.1	0.6	-0.4
Gold	5.5	7.2	5.1	9.2	-1.2	1.7	-0.5	4.1
Other goods	857.7	853.5	843.1	863.9	10.6	-4.2	-5.4	20.8
Aircraft & pts	22.4	22.3	24.2	20.4	4.6	-0.1	0.5	-3.8
Computers	71.7	70.7	71.0	70.3	-0.7	-1.0	1.5	-0.7
Semiconductors	33.5	31.8	31.2	32.4	-3.3	-1.8	-1.1	1.2
Other cap gds	142.9	142.9	141.0	144.8	1.1	0.1	0.5	3.8
Automotive	146.0	138.0	128.1	148.0	-2.0	-7.9	-13.2	19.9
from Canada	49.0	43.4	39.8	47.0	-4.0	-5.6	-3.6	7.2
from Mexico	28.5	24.4	20.3	28.5	1.3	-4.1	-6.6	8.2
from ROW	68.5	70.3	68.0	72.5	0.8	1.8	-2.9	4.4
Ind supplies	147.3	148.3	146.9	149.6	2.9	0.9	0.8	2.7
Consumer goods	217.4	217.9	219.2	216.5	8.2	0.5	1.1	-2.7
Foods	41.8	40.6	41.2	40.0	0.0	-1.1	-1.8	-1.2
All other	34.7	41.0	40.2	41.8	-0.1	6.3	6.5	1.7
Services imports	178.4	177.0	177.5	176.6	0.8	-1.3	0.9	-1.0
<i>Memo:</i>								
Oil qty (mb/d)	11.80	11.83	11.71	11.95	0.98	0.03	0.59	0.23
Oil price (\$/bbl)	12.51	11.55	11.70	11.39	-1.39	-0.96	-0.47	-0.31

1. Change from previous quarter or month. e. Average of two months.

Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

Most of the decline was in automotive products and oil. Imports of steel rose at a slightly slower pace in July-August than in the second quarter.

Oil imports and prices. The quantity of imported oil edged up in August, reflecting both weak domestic production and strong consumption and inventory demand. The quantity of oil imports in July-August combined was about the same as for the second quarter. Preliminary Department of Energy statistics indicate lower imports in September and October, reflecting unusually high stocks and delivery delays caused by weather.

The price of imported oil dropped sharply in July (due to unexpectedly high levels of oil stocks) and was about flat in August and September. For the third quarter as a whole, the price of imported oil declined 25 percent (AR) relative to the second quarter. The spot price for WTI fell, on balance, during October and early November, reflecting stronger exports from Iraq and non-OPEC producers and forecasts for weaker global demand. Oil prices rebounded briefly in late October due to civil disturbances in Nigeria and Colombia. Currently, WTI is trading in the \$13 to \$14 range.

Prices of non-oil imports and exports. Prices of non-oil imports decreased 0.2 percent in September. Declines were recorded in all major trade categories of imports, except foods, which rebounded from a sharp drop in August. The greatest declines were in prices of computers. Prices of semiconductors remained unchanged. For the third quarter as a whole, prices of non-oil imports declined 4½ percent (AR), with decreases recorded in prices of all trade categories. The price of "core" imports (which exclude computers and semiconductors) decreased 3½ percent (AR), a somewhat greater rate of decline than in the preceding quarter.

Prices of exports declined in September for the fourth month in a row. The greatest decline was in agricultural export prices. Prices of capital goods excluding computers and semiconductors have changed little since the beginning of the year. For the third quarter, the price of goods exports declined 4 percent (AR). The price of "core" exports (which excludes computers, semiconductors, and agricultural products) declined 2½ percent (AR), a slightly greater rate of decline than in the second quarter largely because of prices of industrial supplies.

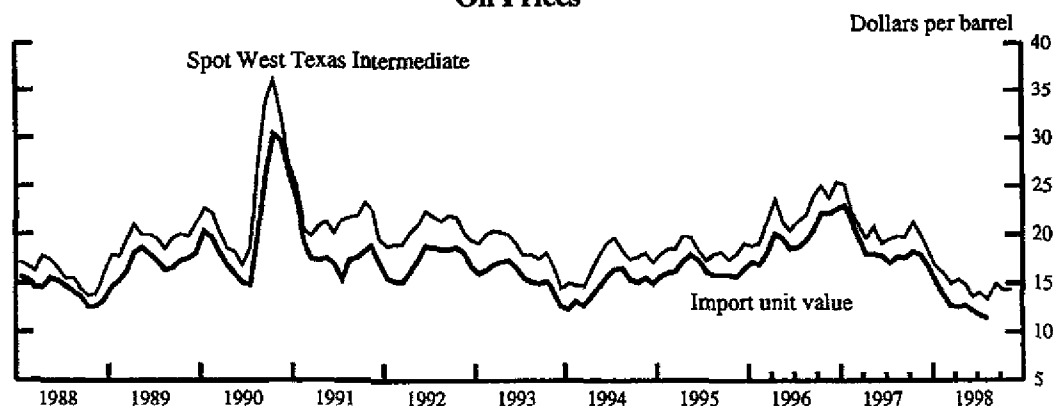
Price data for October will be released on November 18.

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

	Annual rates			Monthly rates		
	1998			1998		
	Q1	Q2	Q3	Jul	Aug	Sep
	-----BLS prices (1995=100)-----					
Merchandise imports	-11.6	-5.8	-6.2	-0.9	-0.3	-0.1
Oil	-61.5	-31.6	-25.3	-5.3	0.9	1.1
Non-oil	-5.3	-3.7	-4.5	-0.4	-0.4	-0.2
Core goods*	-3.8	-2.7	-3.5	-0.3	-0.4	-0.1
Foods, feeds, beverages.	-5.1	-0.1	-6.4	-0.7	-2.4	1.6
Industrial supplies ex oil	-11.1	-4.0	-8.1	-0.9	-0.6	-0.4
Computers	-17.3	-19.1	-10.6	-0.8	-0.9	-1.1
Semiconductors	-17.2	-4.9	-14.2	-1.6	-0.8	0.0
Cap. goods ex comp & semi	-3.2	-2.4	-3.9	-0.5	-0.1	-0.4
Automotive products	-0.1	-0.8	-1.6	-0.1	-0.2	-0.1
Consumer goods	-1.1	-2.7	-1.3	-0.1	-0.2	-0.1
Merchandise exports	-5.0	-3.3	-4.1	-0.2	-0.5	-0.5
Agricultural	-15.6	-7.0	-10.9	0.3	-4.0	-2.6
Nonagricultural	-3.7	-2.8	-3.4	-0.3	-0.1	-0.3
Core goods*	-3.5	-2.1	-2.5	-0.3	0.0	-0.3
Industrial supplies ex ag	-9.0	-5.2	-9.2	-1.1	-0.4	-1.0
Computers	-10.5	-11.8	-14.6	-0.5	-1.1	-1.0
Semiconductors	-6.8	-8.6	-4.4	-0.1	-0.1	-0.1
Cap. goods ex comp & semi	0.0	-0.1	-0.1	0.0	-0.1	0.0
Automotive products	-0.1	0.3	0.4	0.1	0.0	0.0
Consumer goods	-0.5	-1.4	-0.8	0.0	0.0	0.1
	-----Prices in the NIPA accounts (1992=100)-----					
Chain-weight						
Imports of goods & services	-10.4	-4.5	-4.8	...	...	...
Non-oil merchandise	-5.6	-3.7	-4.5	...	...	...
Core goods*	-3.3	-1.8	-3.3	...	...	...
Exports of goods & services	-3.4	-1.8	-2.9	...	...	...
Nonag merchandise	-3.5	-2.8	-3.6	...	...	...
Core goods*	-2.4	-1.7	-2.3	...	...	...

* / Excludes computers and semiconductors.

Oil Prices



U.S. International Financial Transactions

In September and the third quarter as a whole, private capital inflows through banks and foreign purchases of U.S. securities more than offset large official outflows (lines 1, 3 and 4 of the U.S. International Transactions table).

A fall in the holdings of Latin American countries accounted for about 40 percent of the third quarter's \$46 billion decline in foreign official assets held in the United States (line 1). Brazil accounted for almost all of this region's decline; however, partial data from the FRBNY indicate that Brazilian official holdings remained steady in October. OPEC reserve holdings also fell substantially in the third quarter. On the positive side, Korean holdings increased steadily in the quarter and continued to do so in October.

At \$24 billion, private foreign net purchases of U.S. securities were moderate in the third quarter, and were more than accounted for by net purchases of corporate and other bonds (lines 4 and 4b); less than 20 percent of this latter total went to U.S. agency bonds. For the quarter, net purchases of Treasury securities were essentially zero and foreigners sold U.S. stocks on net -- with heavy sales of the latter in September (lines 4a and 4c).

The zero net for foreign purchases of Treasury securities masked wide movements in the holdings of residents of individual countries, particularly in international financial centers. Hedge fund activity accounted for a \$15 billion drop in holdings in the Netherlands Antilles and an almost \$11 billion increase in Bermuda and the British West Indies. Holdings in the United Kingdom and Hong Kong increased by a total of \$10 billion. As for the large corporate bond purchases shown in line 4b, almost \$21 billion of the total was accounted for by residents of the United Kingdom. Finally, virtually all of the large private net sales of U.S. stocks in September were transacted by hedge funds in the Caribbean (line 4c).

U.S. investors had moderate net sales of both foreign bonds and stocks in September and the quarter (lines 5a and 5b). Sales of European and Japanese securities were significant.

Banks in the United States reported large net inflows in both September and the third quarter (line 3). These inflows facilitated the recorded expansion of domestic bank credit. Preliminary end-of-month data indicate a continuation of significant banking inflows in October.

Summary of U.S. International Transactions
(Billions of dollars, not seasonally adjusted except as noted)

	1996	1997	1997		1998			Aug	Sept
			Q4	Q1	Q2	Q3			
Official capital									
1. Change in foreign official assets in U.S. (increase, +)	127.7	19.9	-26.3	12.4	-9.9	-46.0	-14.3	-25.7	
a. G-10 countries	36.6	1.8	-12.6	4.0	-10.0	*	-.1	-1.7	
b. OPEC countries	15.4	13.0	-.9	-.5	.1	-11.6	-3.3	-4.8	
c. All other countries	76.3	5.1	-12.7	8.9	*	-34.4	-11.0	-19.2	
2. Change in U.S. official reserve assets (decrease, +)	6.7	-1.0	-4.5	-.4	-1.9	-2.0	-.4	-.1	
Private capital									
Banks									
3. Change in net foreign positions of banking offices in the U.S.¹	-50.1	34.6	46.2	-5.7	5.6	55.3	11.5	30.7	
Securities²									
4. Foreign net purchases of U.S. securities (+)	287.2	346.6	71.2	77.3	99.4	24.2	8.9	5.8	
a. Treasury securities ³	155.6	147.2	35.5	-1.5	27.1	*	-.2	5.9	
b. Corporate and other bonds ⁴	118.9	128.1	25.8	47.7	57.0	28.4	7.0	9.9	
c. Corporate stocks	12.7	71.3	9.8	31.1	15.2	-4.2	2.1	-10.1	
5. U.S. net purchases (-) of foreign securities	-110.6	-89.1	-8.8	-12.5	-27.4	15.2	6.6	9.0	
a. Bonds	-51.4	-48.2	-9.1	-9.7	-26.4	7.0	1.0	3.0	
b. Stocks	-59.3	-40.9	.3	-2.8	-1.0	8.1	5.6	6.1	
Other flows (quarterly data, s.a.)									
6. U.S. direct investment (-) abroad	-81.1	-121.8	-35.5	-34.3	-40.3	n.a	n.a	n.a	
7. Foreign direct investment in U.S.	77.6	93.4	28.5	25.9	22.0	n.a	n.a	n.a	
8. Foreign holdings of U.S. currency	17.4	24.8	9.9	.7	2.3	n.a	n.a	n.a	
9. Other (inflow, +) ⁵	-80.3	-50.9	14.9	-13.6	16.1	n.a	n.a	n.a	
U.S. current account balance (s.a.)	-134.9	-155.2	-45.0	-46.7	-56.5	n.a	n.a	n.a	
Statistical discrepancy (s.a.)	-59.6	-99.7	-52.0	-3.1	-9.4	n.a	n.a	n.a	

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

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

2. Includes commissions on securities transactions and 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

In the period following the September FOMC meeting, the foreign exchange value of the dollar declined 1½ percent on a weighted average basis against other major currencies, led by a depreciation of 9 percent, on balance, against the yen. The dollar's dramatic decline against the yen, which occurred almost entirely in a 30-hour period bridging October 7 and 8, appeared to be related to decisions by hedge funds and other investors to reduce leverage and exchange rate exposure inherent in so-called yen carry-trade positions.¹ While it is not entirely clear what prompted the rush for the door on those days, it seems likely that for many investors the sustained financial turmoil over the past year, which reached a peak in August and September, reduced capital cushions and tolerance for risk, prompting an unwinding of highly leveraged positions. In the aftermath of the dollar's sharp move down against the yen, trading conditions in foreign exchange markets became thin and illiquid, with bid/asked spreads even in major currency pairs unusually wide and foreign exchange dealers unwilling to conduct transactions in customary size. Liquidity conditions in foreign exchange markets subsequently improved, particularly for transactions involving the dollar and European currencies, but some nervousness remains.

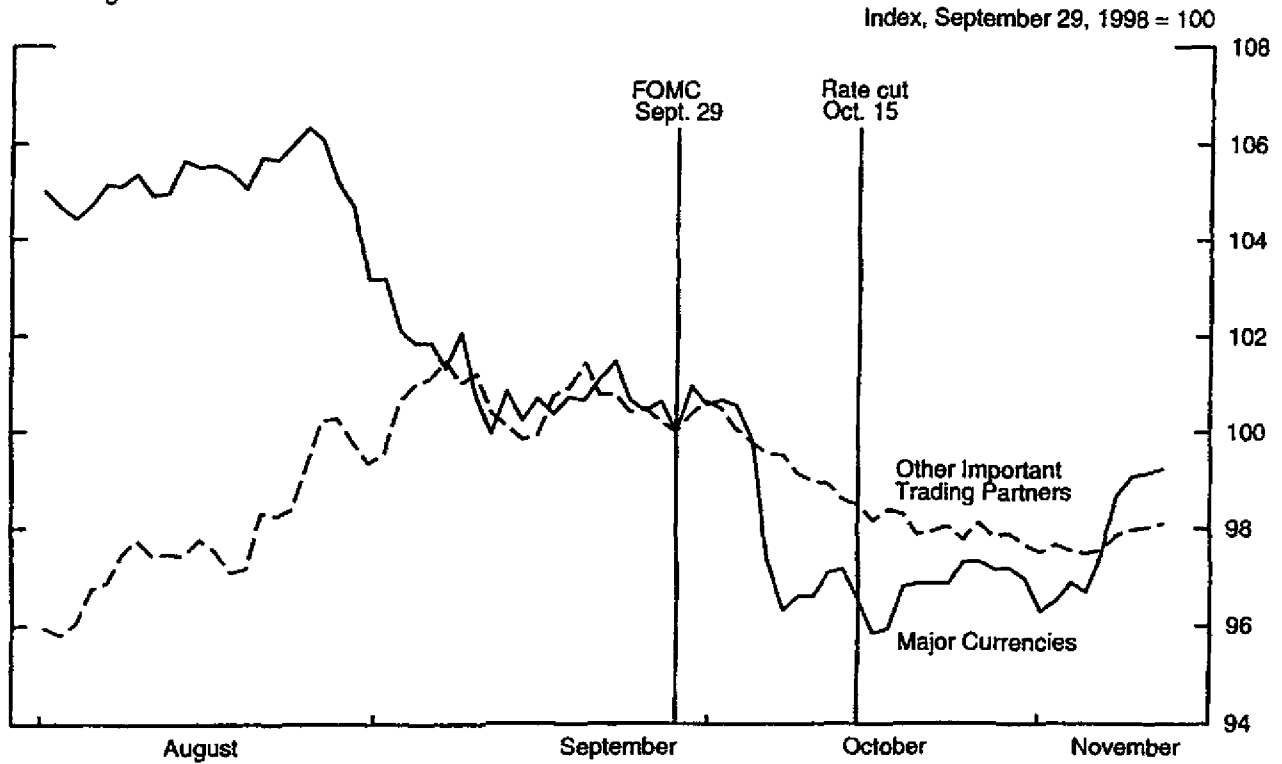
The sharp re-alignment of the dollar-yen exchange rate prompted some significant adjustments in other currency rates in the Asian-Pacific region, with currency values moving to intermediate positions, stronger against the dollar but weaker against the yen. As a consequence, the dollar depreciated between 2 percent and 7 percent against the currencies of Taiwan, Korea, Singapore, Thailand, and the Philippines. Local short-term interest rates declined as these currencies moved higher against the dollar, perhaps reflecting some easing of monetary policies in reaction to the move down of the dollar.

The dollar depreciated 26 percent against the Indonesian rupiah during the period. This large decline can be explained only in part by the movement in the dollar-yen exchange rate. Other factors include the relatively restrictive monetary environment of Indonesia in which short-term interest rates stayed at levels of nearly 60 percent or higher

1. These positions, which were apparently widespread and are generated by funding investments in non-yen assets with low-interest yen loans, were seen as profitable when the risk of yen appreciation seemed small.

Exchange Rates (Daily data)

Exchange Rate Indexes



Financial Indicators in Major Industrial Countries

	Three-month rates		Ten-year yields		Equity prices
	Nov. 12	Change	Nov. 12	Change	Change
Canada	5.47	0.09	5.13	0.08	7.39
Japan	0.51	0.11	0.85	0.02	1.19
Germany	3.53	0.11	4.13	0.17	1.99
United Kingdom	6.81	-0.44	4.95	0.00	6.34
France	3.50	0.09	4.22	0.12	5.71
Italy	3.95	-0.70	4.47	0.04	8.53
Switzerland	1.50	0.25	2.54	-0.21	8.88
Australia	4.91	0.02	5.24	0.12	4.50
Weighted-average foreign	3.58	-0.02	3.67	0.06	
United States	5.33 ^P	0.11	4.75 ^P	0.14	6.66 ^P

Note. Change is in percentage points from September 28 to November 12. ^P Preliminary.

during the period and perceived progress in the reform and restructuring program Indonesia agreed to with the IMF.

In contrast to these fluctuations, the dollar's movements against other currencies were more moderate. The dollar appreciated $\frac{1}{2}$ percent against the mark. Initially, the easier stance of U.S. monetary policy relative to the unchanged stance of the Bundesbank weighed on the dollar, as did perceptions that U.S. economic activity would be more vulnerable to financial turbulence in Latin America. But, market perceptions of an ease have decreased somewhat due to a robust recovery in U.S. markets, and expectations of forthcoming aid to Brazil have alleviated some of the worries of U.S. banks' exposure to financial turmoil. Other euro-area central banks lowered official interest rates during the period, bringing their short-term market interest rates closer to the corresponding German rates, but these moves were seen as part of the convergence process ahead of the launch of the monetary union in January and were largely expected. The Central Bank of Ireland reduced its key policy rate twice for a total of 250 basis points, the Bank of Italy reduced its Lombard and discount rates 100 basis points, and the central banks of Spain and Portugal each reduced their key policy rates 50 basis points.

The dollar rose $2\frac{3}{4}$ percent against sterling, as the Bank of England lowered its official RP rate 75 basis points in two steps during the period, somewhat more than had been expected, in response to indications of weakening economic activity in the United Kingdom. The U.S. dollar rose $2\frac{1}{2}$ percent against the Canadian dollar, as slower economic activity weighed on the Canadian dollar. Moving in tandem with the policy actions by the Federal Reserve during the period, the Bank of Canada reduced its bank rate twice, in steps of 25 basis points each.

The widespread declines in short-term interest rates around the world were generally accompanied by indications of reductions in financial stress, with the flight to quality that prompted a shift out of equities and into liquid government securities appearing to reverse. Ten-year yields on U.S. and German government securities rose about 20 basis points during the period. Yields on comparable government securities in other euro-area countries were also higher, but spreads between those yields and the German bond yield declined. Industrial country equity prices rose between 4 and 10 percent on balance during the intermeeting period.

Financial Indicators in Latin America, Asia, and Russia

	Currency/US dollar		Short-term interest rates		Dollar-denominated bond spread		Equities
	Nov. 12	Change	Nov. 11/12	Change	Nov. 10	Change	Change
Mexico	10.064	-0.36	32.50	-4.75	9.85 ^b	-0.29	10.2
Brazil	1.1910	0.55	36.20	-2.10	11.63 ^b	-1.38	13.4
Argentina	.9998	0.00	7.58	-4.92	8.74 ^b	-0.33	19.6
Chile	462.10	-0.96					14.2
Venezuela	567.50	-2.11			17.72 ^b	1.19	-1.6
China	8.2775	-0.01			2.41 ^g	0.01	4.3
Korea	1315.70	-4.92	8.40	-0.40	6.08 ^g	-1.38	32.0
Taiwan	32.65	-5.66	5.25	-1.45			-3.7
Singapore	1.6575	-2.21	2.38	-1.62			19.0
Hong Kong	7.7420	-0.08	5.75	-1.45			25.2
Malaysia	3.7999	0.00	6.60	-0.80	6.93 ^e	-3.01	22.1
Thailand	36.90	-6.11	8.25	-2.25	4.49 ^y	-1.55	30.3
Indonesia	7950	-26.05	56.93	-12.87	9.48 ^y	-4.74	30.2
Philippines	40.70	-6.86			4.40 ^e	-2.53	40.9
Russia	17.80	11.32			60.81 ^b	2.60	30.9

Note. Change is in percentage points from Sept. 28 to Nov. 10, 11, 12. ^b Stripped Brady bond yield spread over U.S. Treasuries.
^g Global bond yield spread. ^e Eurobond yield spread. ^y Yankee bond yield spread.

Internationally coordinated efforts to contain a possible financial crisis in Brazil also appear to have reassured investors in emerging market assets. Emerging market equity prices also rose substantially, many turning in double-digit increases. In addition, Asian and Latin American dollar-denominated bond yield spreads declined on balance during the period.

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

Developments in Foreign Industrial Countries

Incoming data suggest that the pace of economic activity in the major foreign industrial countries has slowed in the second half of the year. In Japan, third quarter real GDP is likely to register its fourth consecutive quarterly decline, with virtually all indicators of private demand showing further deterioration from already low second-quarter levels. Available data for the European economies are mixed but on balance suggest that output growth is slowing, especially in Germany. Although official data for the United Kingdom show that real GDP continued to expand at a moderate pace in the third quarter, survey data point to considerable weakness in the near term, and indicators suggest that the Canadian economy is slowing more than previously expected.

Low or falling producer and import prices are helping to keep consumer price inflation subdued. On a twelve-month basis, consumer price inflation is close to zero in Japan, below one percent in Germany, France, and Canada, and below two percent in Italy. In the United Kingdom, retail price inflation is somewhat higher but has declined in the past two months to meet the 2½ percent target.

Softer domestic demand and a weaker outlook for the global economy have led to policy rate reductions of 75 basis points in the United Kingdom and 50 basis points in Canada. In line with the process of EMU convergence, official rates have also been reduced in several continental European countries, including a 100-basis point reduction in Italy.

Individual country notes. In **Japan**, evidence suggests that the economy registered its fourth consecutive quarterly decline during the third quarter. Unemployment remained at an all-time high of 4.3 percent in September, and the offers-to-applicants ratio declined to a record low of 0.49. Industrial production during the third quarter was at its lowest level in over four years, down 0.3 percent from the already weak second-quarter average. Household expenditure, housing starts, and

machinery orders also registered sizable declines. In October, new car registrations fell to their lowest level since spring 1987. In a piece of good news, public works contracts increased almost 30 percent in September, relative to July and August levels, suggesting that fiscal stimulus measures are beginning to come on line.

Japan's current account surplus during the first eight months of the year was \$116 billion at an annual rate, up from \$94.2 billion during all of 1997. Merchandise exports (valued in dollars) are down 8.2 percent from the 1997 average, but imports have slumped 17.2 percent.

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

	1998						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Industrial Production	-1.2	-5.1	-0.3	-0.6	-1.3	2.5	n.a.
Housing Starts	1.1	-6.2	-7.6	-9.3	7.2	-3.2	n.a.
Machinery Orders	-4.2	-6.5	-4.6	-9.4	-8.1	15.1	n.a.
New Car Registrations	-7.5	-3.4	2.2	0.8	-3.5	6.7	-11.8
Unemployment Rate (%)	3.6	4.2	4.3	4.1	4.3	4.3	n.a.
Job Offers Ratio ¹	0.61	0.53	0.50	0.50	0.50	0.49	n.a.
Business Sentiment ²	-31	-38	-51	...	...	...	...
CPI (Tokyo area) ³	2.1	0.6	-0.1	0.0	-0.1	-0.1	0.4
Wholesale Prices ³	-0.4	-1.6	-0.7	-0.3	-0.2	-1.5	n.a.

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.

The Bank of Japan's September "Tankan" survey showed further deterioration in business sentiment, with the diffusion index for large manufacturers plunging from -38 in June to -51. The diffusion index for small manufacturers dropped from -49 to -57, the lowest score since these firms first were included in the survey in 1967. The outlook for non-manufacturing firms also worsened, with the business sentiment index for large firms falling from -28 to -36 and that for small firms falling from -42 to -44 (also a record low). All

classes of firms marked down their forecasts for profit growth during FY1998. Major manufacturers cut their projections from -1.4 percent in June to -11.6 percent in September, while small manufacturers slashed their projections from -3.5 percent to -33.2 percent.

In mid-October, the Japanese Diet approved banking reform legislation, allocating ¥35 trillion (about \$290 billion equivalent) for protecting depositors, resolving insolvent financial institutions (either through temporary nationalization or a bridge bank facility), and funding the Resolution and Collection Corporation or RCC (an RTC-like entity authorized to purchase non-performing loans from both failed and open banks). The legislation provides ¥25 trillion (about \$210 billion) for recapitalizing weak institutions. The Diet also created the Financial Revitalization Committee, headed by a Cabinet-level Minister, which will be jointly responsible with the Ministry of Finance for overseeing banking sector restructuring. While this legislation likely provides adequate funding to resolve the banking sector's difficulties, it remains to be seen whether the authorities will require banks to provision against bad loans, remove bad debts from their balance sheets, and improve the efficiency of their operations.

On October 23, the Long-Term Credit Bank of Japan filed an application for temporary nationalization. The Financial Supervision Agency announced that, once marked to market, the bank's liabilities exceeded its assets by ¥340 billion (about \$2.8 billion). The Deposit Insurance Corporation (DIC) will acquire all LTCB's outstanding shares (with previous shareholders being effectively wiped out) and provide other support, including the extension of temporary liquidity to LTCB and the provision of funds to cover losses. The bank's obligations, including deposits, debentures, interbank borrowings and derivative transactions will be protected, and the RCC will purchase LTCB's problem loans. Funds to finance the DIC and RCC operations will come as government-guaranteed loans from the BOJ. LTCB is expected to continue its banking activities under the direction of a new management team headed by BOJ Executive Director Takashi Anzai.

Third-quarter indicators for the **euro area** are mixed. Industrial production declined in August, but is up 1.1 percent from the second quarter for July and August on average. Business confidence through September has weakened while consumer confidence remains subdued. The unemployment rate in July and August moved down a bit from the second quarter average. For the third quarter as a whole, harmonized consumer price inflation remained comfortably below the 2 percent upper bound of the European Central Bank's announced inflation target.

EURO-11 ECONOMIC INDICATORS¹
(Percent change from previous period except where noted, SA)

	1998						
	Q1	Q2	Q3	Jun	Jul	Aug	Sep
GDP	0.8	0.5	n.a.	...	...	...	...
Industrial Production ²	1.0	0.5	n.a.	-0.4	1.7	-1.1	n.a.
Unemployment Rate ³	9.6	9.4	n.a.	9.4	9.3	9.3	n.a.
Business Confidence ⁴	2.0	2.0	-0.7	2.0	1.0	-1.0	-2.0
Consumer Confidence ⁴	-7.7	-5.3	-4.7	-5.0	-4.0	-5.0	-5.0
Consumer Prices ⁵	1.2	1.5	1.2	1.5	1.4	1.2	1.1

1. Weighted by GDP shares, except as otherwise noted.
2. Excludes Austria, Luxembourg, and Ireland.
3. Excludes Luxembourg, Portugal and Spain.
4. Level of index.
5. Harmonized CPI; percent change from previous year, weighted by shares in private final domestic consumption expenditure.

Data released over the past several months point to a more subdued pace of GDP growth in **Germany** in the second half of 1998, even allowing for a bounceback in the third quarter from the second quarter's 0.4 percent growth rate (SAAR). The volume of orders for manufactured products received by German industry fell in August and again in September. Orders placed by foreigners (not shown in table) have been sliding down over the course of the year and are now 3½ percent below their level a year earlier, while domestic orders (not shown) have begun to slow more recently as well. Manufacturing capacity utilization has retreated slightly over the past half year although the utilization rate remains at a high level. Orders to plant and machinery producers (not shown) plummeted during the past several months, with September orders showing a decline of 24 percent compared to one year earlier. Although third-quarter industrial production is up from the second quarter average, production actually fell in both August and September. The business climate appears to have darkened considerably, with a September survey of business confidence (the IFO survey) showing that for the first time since January 1997 the number of firms citing a deterioration in business conditions exceeded the number citing an improvement.

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

	1998						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Industrial Production	1.9	-0.5	1.5	3.8	-1.0	-3.2	n.a.
Orders	2.2	0.2	-0.8	0.9	-1.5	-0.5	n.a.
Unemployment Rate (%)	11.5	11.2	10.8	10.9	10.8	10.7	10.6
Western Germany	9.6	9.4	9.2	9.2	9.2	9.2	9.1
Eastern Germany	19.2	18.5	17.5	17.8	17.6	17.2	16.9
Capacity Utilization ¹	87.3	87.2	87.0	...	...	...	...
Business Climate ^{1,2}	18.3	16.0	6.0	12.0	7.0	-1.0	n.a.
Consumer Prices ³							
All-Germany	1.2	1.3	0.8	0.9	0.8	0.8	0.7
Western Germany	1.1	1.3	0.8	0.9	0.7	0.7	0.7

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.

Price data confirm the absence of inflationary pressure. In October, consumer prices rose 0.7 percent on a year-over-year basis. Compared to September one year earlier, producer prices, wholesale prices, and import prices (none shown) were down 1.0, 4.2, and 5 percent, respectively.

In France, third-quarter data are mixed, but suggest some slowdown in economic growth; the October business outlook shows decreased confidence and has fallen each month since June. Industrial production fell 0.3 percent in July-August. However, consumption of manufactured products rose 2.0 percent in September and 2.6 percent in the third quarter.

Consumer prices in October rose 0.5 percent on a twelve-month basis, down slightly from the 0.7 percent rate recorded in August. Inflation remains near 40-year lows. Inflationary pressures are likely to remain contained owing to deregulation of prices of some public services (i.e., state telecoms) and ongoing price competition among manufacturers.

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

	1998						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Consumption of Manufactured Products	1.4	0.8	2.6	2.7	-1.4	2.0	n.a.
Industrial Production	0.8	1.1	n.a.	-0.3	0.0	n.a.	n.a.
Capacity Utilization	84.8	84.7	n.a.	...	...	...	...
Unemployment Rate (%)	12.2	11.9	11.8	11.8	11.8	11.7	n.a.
Business Confidence ¹	18.0	19.7	18.0	21.0	17.0	16.0	12.0
Consumer Prices ²	0.7	1.0	0.7	0.8	0.7	0.5	0.5

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

In **Italy**, official estimates of third-quarter economic activity are likely to show an increase, in large part because there were more working days than in the second quarter. However, available indicators still show weakness. Although industrial production recovered in September, it was down 0.3 percent for the quarter, the third consecutive quarterly decline. Business sentiment weakened notably in September and remains well below levels registered earlier this year. For the quarter as a whole, the unemployment rate edged up.

Consumer prices rose 1.7 percent on a year-over-year basis in October. The inflation data continue to support the view that lower oil and commodity import prices and ongoing sluggishness in the domestic economy will keep price pressures subdued in the near term.

In a move widely anticipated by market participants, on October 26 the Bank of Italy lowered its key policy rates 100 basis points each. The Bank's discount and Lombard rates now stand at 4 percent and 5.5 percent, respectively. Since July 1996, both rates have been lowered seven consecutive times for a cumulative 500 basis points.

In September, the Prodi government presented its 1999 budget to Parliament which, on October 9, led to a failed confidence vote and the ousting of the prime minister. On October 21, Massimo D'Alema, an ex-communist and the leader of the Democrats of the Left Party, was sworn in as the new Italian Prime Minister. Seven ministers from the out-going cabinet, including Budget and Finance Minister Ciampi, Finance Minister Visco, and

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

	1998						
	Q1	Q2	Q3	July	Aug	Sep	Oct
Industrial Production	-0.1	-0.2	-0.3	0.8	-1.6	1.7	n.a.
Cap. Utilization ¹ (%)	78.2	79.5	76.6	...	...	...	...
Unemployment Rate (%)	12.1	12.3	12.4	...	...	...	...
Consumer Confidence ²	118.6	122.8	117.0	118.9	117.0	115.2	116.6
Bus. Sentiment ³ (%)	32.0	11.7	9.0	8.0	14.0	5.0	n.a.
Consumer Prices ⁴	1.7	1.8	1.8	1.8	1.9	1.8	1.7

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

Minister of Foreign Affairs Dini, retained their posts. The new government's 1999 budget proposal is identical to that of the former government. By law, Parliament has to ratify the government's proposal before the end of the year. (If the budget is not passed, expenditure and revenue targets specified in last year's budget would remain in effect on a monthly basis.)

Economic activity in the **United Kingdom** continued to expand at a moderate pace in the third quarter, but survey indicators point to considerable weakness in the near term. According to the preliminary estimate, GDP in the third quarter grew a somewhat faster than expected 2 percent (SAAR), at about the same rate of growth as in the second quarter. Third quarter GDP growth is likely to be revised down in the next release, as industrial production data for September, released after the GDP estimate, declined more than expected. Manufacturing surveys for October showed further sharp drops in business confidence, output expectations, and orders. Consumer confidence has also weakened noticeably in recent months, and the Purchasing Managers' service sector survey indicated that activity registered only a modest increase in October.

The twelve-month rate of British retail price inflation (excluding mortgage interest payments) was 2.5 percent in September, meeting the inflation target for the second consecutive month. The official claims-based unemployment rate remained 4.6 percent in October, the lowest rate since 1980.

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

	1998						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Real GDP (s.a.a.r.)	3.1	1.9	2.0	...	...	...	...
Industrial Production	-0.3	1.1	0.1	0.1	-0.4	-0.6	n.a.
Retail Sales	0.9	0.3	0.7	0.9	0.4	-0.4	n.a.
Unemployment Rate (%)	4.9	4.8	4.6	4.7	4.6	4.6	4.6
Business Confidence ¹	10.7	-0.7	-11.7	-8.0	-15.0	-12.0	-29.0
Consumer Confidence ²	0.0	3.3	-13.3	1.0	-8.0	-15.0	-22.0
Consumer Prices ³	2.5	3.0	2.6	2.6	2.5	2.5	n.a.
Producer Input Prices ⁴	-9.7	-8.0	-9.0	-8.2	-9.2	-9.5	-9.8

1. Percent of firms expecting output to increase in the next four months minus those expecting output to decrease.
2. Level of index, expectations of general economic situation over the next 12 months.
3. Retail prices excluding mortgage interest payments. Percent change from previous year.
4. Percent change from previous year.

At its November meeting, the Monetary Policy Committee (MPC) of the Bank of England reduced the official repo rate 50 basis points to 6.75 percent, following a 25 basis point reduction in October. The MPC noted that news about the international environment and prospects for domestic activity had led to a downward revision in the forecast for growth next year. In the November *Inflation Report*, the MPC stated that the outlook for inflation will depend on developments in the labor market, where conditions remain tight although there are indications that it is no longer continuing to tighten. The MPC expects inflation to pick up slightly next year, reflecting wage developments associated with the introduction of the minimum wage, but to return to the inflation target rate through the end of 2000. The MPC also stated that while there had been some increase in volatility and reduction in liquidity in financial markets, there was no evidence of a "credit crunch," noting that in the United Kingdom the banking system is the main external source of business finance and "there has so far been no sharp deterioration of credit conditions."

In **Canada**, recent data indicate that the economy has lost momentum. Although GDP at factor cost picked up in August, it declined slightly from the second quarter's level for July and August on average. Some of this summer's weakness in GDP reflected

production disruptions of the GM strike. However, lackluster gains in retail sales as well as declines in consumer and business confidence in the third quarter suggest that the economy is slowing more than previously expected.

Although virtually all other indicators suggest that the Canadian economy has slowed considerably, recent employment growth has been stronger than expected. Employment in October was up 2.9 percent over October one year ago and has posted four straight months of solid gains. Other bright spots in Canada are trade and inflation. After narrowing in the second quarter, the trade surplus widened sharply in July and August. Lingering effects of the GM strike have complicated the interpretation of monthly trade data, but some of the recent improvement likely reflects the year-long decline in the Canadian dollar combined with weak domestic demand. Consumer price inflation on a year-over-year basis was less than 1 percent in the third quarter mainly due to falling energy prices.

After raising its Bank Rate 100 basis points in August, the Bank of Canada seized the opportunity to reverse some of this rate hike by matching the two 25 basis point cuts in the federal funds rate. The Bank Rate is currently 5.5 percent.

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

	1998						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
GDP at Factor Cost	0.6	0.4	n.a.	-0.3	0.7	n.a.	n.a.
Industrial Production	-0.4	0.7	n.a.	-1.4	2.1	n.a.	n.a.
New Manufacturing Orders	-1.7	-0.7	n.a.	-1.2	8.2	n.a.	n.a.
Retail Sales	0.3	1.6	n.a.	1.5	-0.2	n.a.	n.a.
Employment	0.7	0.7	0.3	0.2	0.3	0.5	0.4
Unemployment Rate (%)	8.7	8.4	8.3	8.4	8.3	8.3	8.1
Consumer Prices ¹	1.0	1.0	0.9	1.0	0.8	0.7	n.a.
Consumer Attitudes ²	118.4	115.0	103.3	...	...	...	...
Business Confidence ³	155.0	148.9	128.6	...	...	...	...

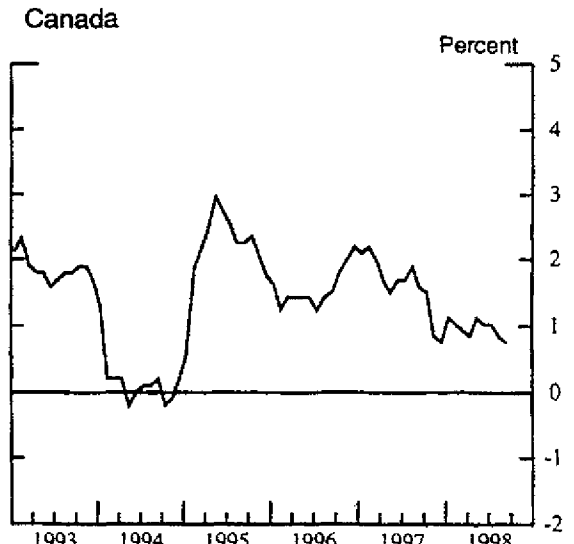
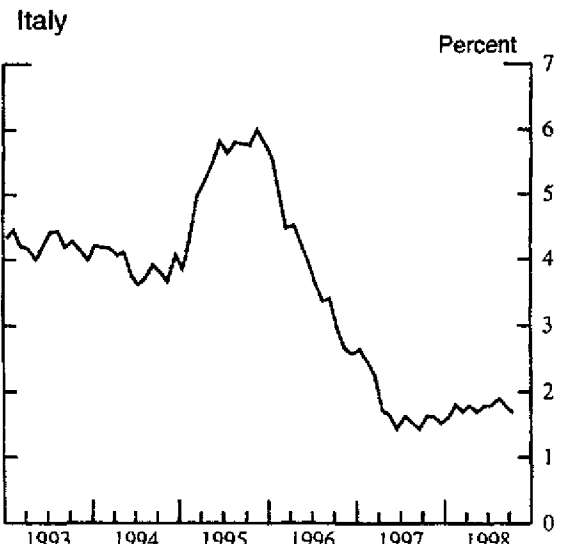
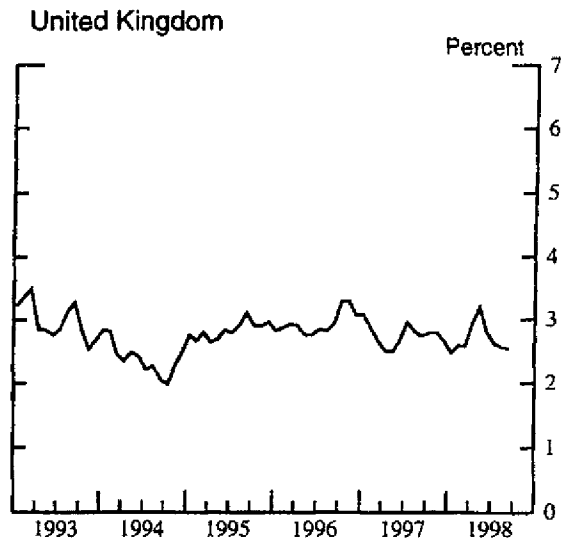
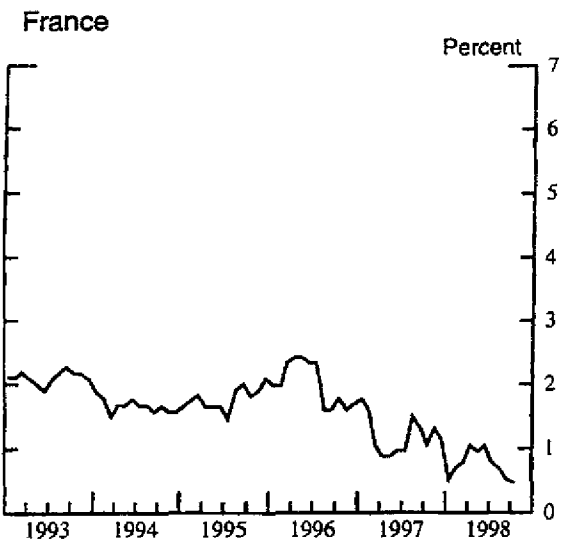
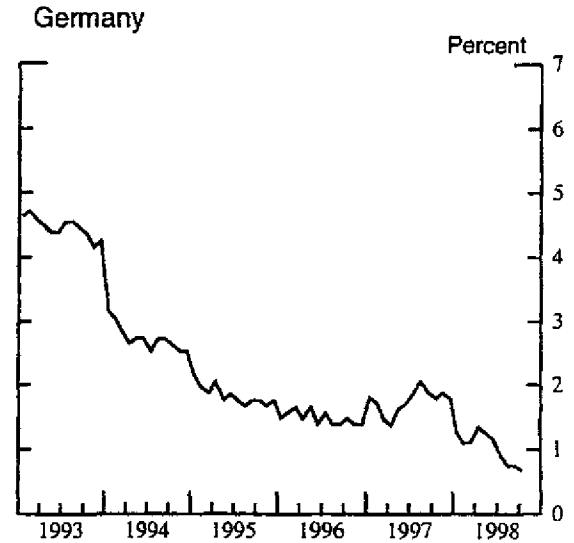
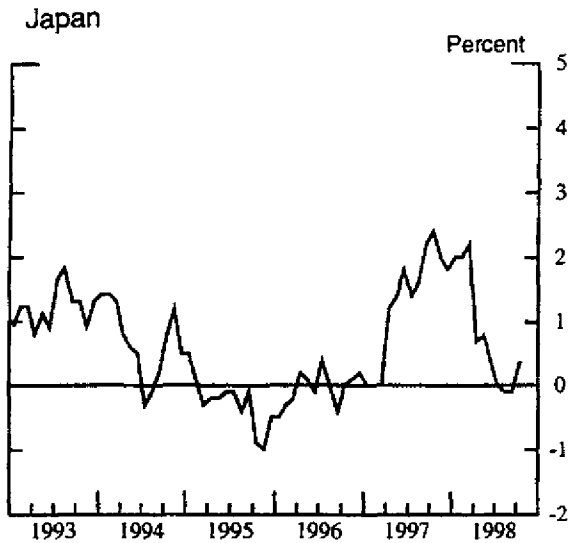
1. Percent change from year earlier.
2. Level of index, 1991 = 100.
3. Level of index, 1977 = 100.

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

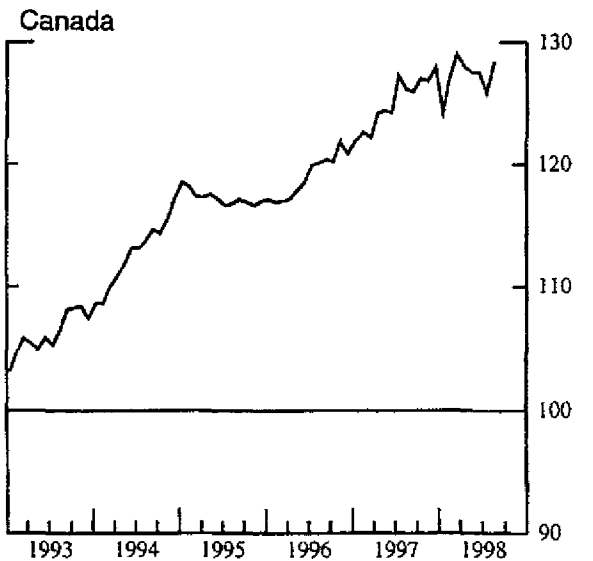
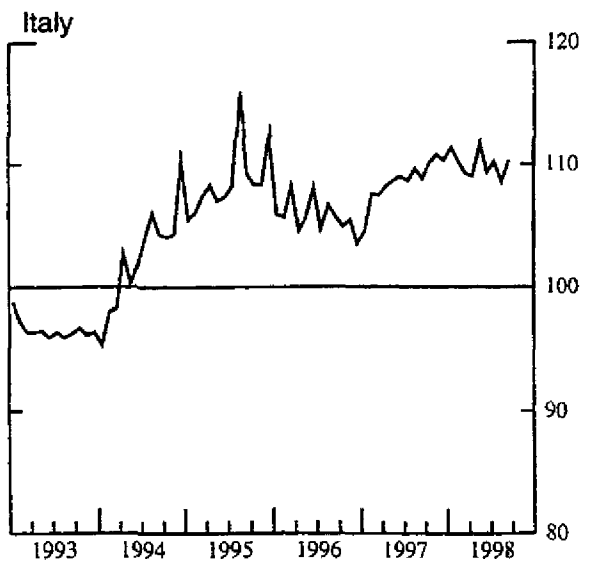
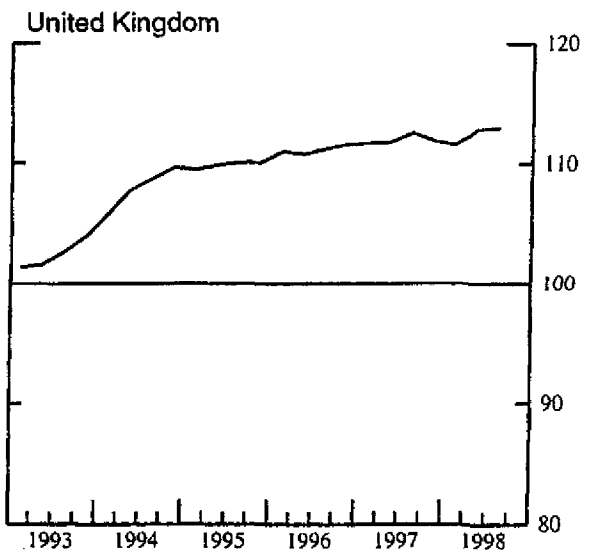
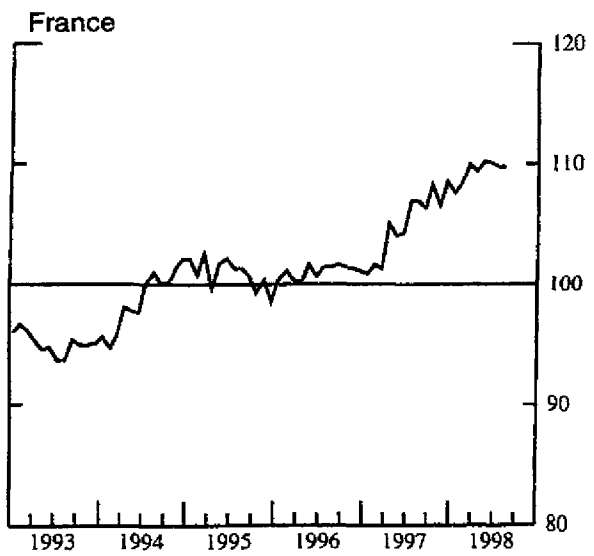
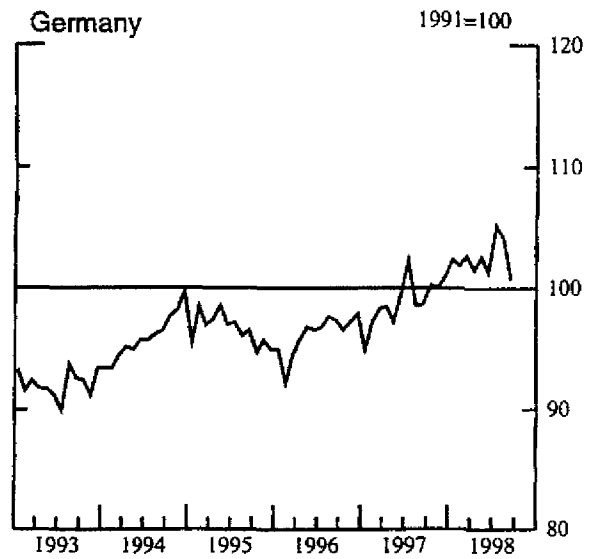
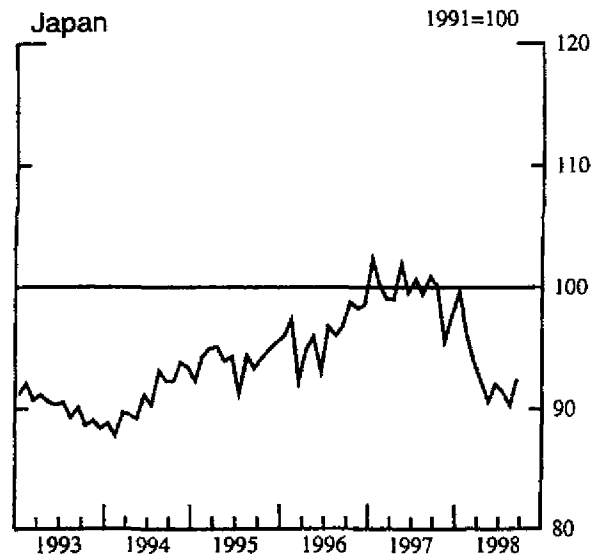
	1998					
	Q1	Q2	Q3	Jul	Aug	Sep
Japan: trade	98.0	114.0	107.3	114.3	94.9	112.7
current account	115.9	111.8	n.a.	111.9	103.3	n.a.
Germany: trade ¹	65.4	81.8	n.a.	94.7	57.1	n.a.
current account ¹	-16.0	15.4	n.a.	-3.6	-28.6	n.a.
France: trade	26.2	27.0	n.a.	26.3	25.7	n.a.
current account	35.7	36.8	n.a.	n.a.	n.a.	n.a.
U.K.: trade	-31.5	-30.2	n.a.	-27.4	-24.5	n.a.
current account	-3.3	4.0	n.a.	...	...	...
Italy: trade	22.7	30.3	n.a.	25.8	29.0	n.a.
current account ¹	10.3	30.3	n.a.	n.a.	n.a.	n.a.
Canada: trade	14.3	10.0	n.a.	13.1	16.9	n.a.
current account	-12.0	-11.7	n.a.	...	...	...

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

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



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In Asia, there is some evidence that trends in economic activity may have improved somewhat during the third quarter; growth reversed its slowing trend in China, and in Korea and the ASEAN economies, data appear to suggest some moderation in the pace of output declines. Asian trade balances generally remained in sizeable surplus, primarily reflecting declines in the value of imports. The merchandise trade deficit narrowed in Hong Kong, although the narrowing appears to have been offset somewhat by a declining services surplus. Inflation in Asia generally remained steady, or, in some cases, eased slightly in the third quarter.

In Latin America, Brazil is nearing an agreement with the IMF amid strong pressure on the currency. Economic activity appears to have weakened in Argentina and Venezuela. Latin American trade balances remain in deficit; these deficits have tended to widen in recent months. Inflation was little changed on balance.

In Russia, output has fallen sharply in recent months, and inflation has surged.

Individual country notes. In Korea, recent data appear to suggest some bottoming out of activity, although special factors tended to distort measures of activity upwards, thereby complicating interpretation. Industrial production in September was slightly above its year-earlier level, after posting a nearly 12 percent year-over-year drop in August. Similarly, retail sales showed a 12-month decline of 12 percent in September, substantially less than the 17 percent year-over-year drop the previous month. However, the level of measured activity in September was artificially raised because of the timing of the three-day Korean Thanksgiving holiday, which fell in October this year but September last year. In addition, production in September was boosted to compensate for losses from labor disputes and torrential rains in August. The unemployment rate continued to rise in September, moving up to 8.4 percent (SA) from 8.1 percent the previous month.

Korea's current account showed a surplus of \$42 billion (AR) in the first three quarters, compared with a deficit of \$16 billion in the year-earlier period. In the first three quarters, the dollar value of exports fell 6 percent from their year-earlier level; the dollar value of imports fell 37 percent.

With the inflation rate remaining moderate and the won strengthening, the authorities have continued to reduce interest rates; the overnight rate is now down to 7 percent.

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

	1996	1997	1998				
			Q2	Q3	Aug	Sep	Oct
Real GDP	6.8	5.5	-6.6	n.a.	...	...	...
Industrial Production	7.1	6.7	-12.0	-8.2	-11.8	0.3	n.a.
Consumer Prices	4.9	4.4	8.2	7.0	6.9	6.9	7.2
Trade Balance ¹	-15.0	-3.2	45.6	42.4	34.8	45.6	n.a.
Current Account ¹	-23.0	-8.2	46.4	38.0	26.4	44.4	n.a.

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

In the ASEAN region, weakness in domestic demand (in part reflecting tight credit conditions) and foreign demand (especially from Japan) continued to dampen economic activity, although the pace of declines may have moderated somewhat. Preliminary estimates indicate that output in Indonesia declined much less sharply in the third quarter of 1998 than

ASEAN ECONOMIC INDICATORS: GROWTH

	1996	1997	1998				
			Q2	Q3	Jul	Aug	Sep
Real GDP, SAAR							
Indonesia	8.0	4.7	-31.6	-4.4	...	...	...
Malaysia	8.6	7.8	-7.4	n.a.	...	...	...
Philippines	5.8	5.2	-7.4	n.a.	...	...	...
Singapore	6.9	7.7	-2.2	-3.5	...	...	...
Thailand	6.4	-0.4	...	...	...	...	...
Industrial Production¹							
Indonesia	6.6	6.2	-19.3	n.a.	...	...	...
Malaysia	11.0	10.7	-6.1	n.a.	-8.0	-4.1	n.a.
Philippines	8.4	8.8	-2.1	n.a.	-1.0	n.a.	n.a.
Singapore	3.3	4.6	-1.0	-4.4	-5.6	-6.3	-1.7
Thailand	7.2	-0.4	-15.7	-11.7	-13.8	-11.2	-9.9

1. Year-over-Year.

in previous quarters. Industrial production continued to fall in Singapore, Malaysia and Thailand through August and September, although at a slower rate than in previous months.

Inflation appears to have stabilized across the region, in part reflecting weak domestic demand and recent currency strength. Singapore now shows signs of deflation. In Indonesia, 12-month inflation declined somewhat in October as consumer prices were virtually unchanged from their September level, reflecting the rupiah's sharp appreciation.

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

	1996	1997	1998					
			Q2	Q3	Jul	Aug	Sep	Oct
Consumer Prices								
Indonesia	8.0	6.5	52.2	79.7	72.0	81.0	82.4	79.4
Malaysia	3.5	2.7	5.7	5.6	5.8	5.6	5.5	n.a.
Philippines	8.4	5.1	9.0	9.6	10.1	10.5	10.0	10.2
Singapore	1.4	2.0	0.3	-0.8	-0.4	-0.8	-1.4	n.a.
Thailand	5.8	5.6	10.3	8.2	10.0	7.6	7.0	6.7

All the ASEAN countries are running trade surpluses, reflecting sharply lower imports than a year ago, rather than improvements in export revenues. However, in August and September, the widening of trade surpluses in most ASEAN countries largely reflected increased exports to industrial countries.

ASEAN ECONOMIC INDICATORS: TRADE BALANCE¹

	1996	1997	1998					
			Q2	Q3	Jun	Jul	Aug	Sep
Indonesia	6.9	11.9	24.8	n.a.	28.2	26.4	21.6	n.a.
Malaysia	-0.1	-0.2	13.8	16.5	18.2	11.7	18.0	19.8
Philippines	-11.9	-10.5	-1.0	n.a.	1.5	0.4	1.7	n.a.
Singapore ²	-5.9	-5.8	9.5	11.0	10.5	7.5	9.7	15.9
Thailand	-16.1	-4.6	10.4	12.7	11.1	11.7	11.2	15.2

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

2. Non-oil trade balance.

As a possible sign of returning confidence in the region, ASEAN stock markets have rallied and currencies across the region have strengthened significantly since mid-September.

The Indonesian rupiah posted especially strong gains, in part reflecting continued high domestic interest rates, perceived progress on economic reforms, and the strengthening of the yen.

In **Hong Kong**, the unemployment rate, which nearly doubled from the fourth quarter of 1997 to the second quarter of 1998, appeared to stabilize somewhat at 5 percent in the third quarter. Inflation in September fell to Hong Kong's lowest rate since 1976. Reflecting substantial declines in imports, Hong Kong's merchandise trade deficit has narrowed sharply during 1998. However, data on the components of GDP for the first half of the year suggest that the improvement in merchandise trade has been offset somewhat by a deterioration in net services exports. Hong Kong's foreign exchange reserves were \$88 billion at the end of September, down from a recent peak of \$97 billion at the end of July. The decline largely reflected the August stock market intervention by the Hong Kong authorities, which amounted to \$15 billion. (The decline in foreign reserves was smaller than the announced share purchases, which may reflect some use of domestic as well as foreign-currency assets for intervention, as well as investment earnings and portfolio revaluations). In October, authorities also announced that there had been no additional share purchases after August.

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

	1996	1997	1998				
			Q2	Q3	Jul	Aug	Sep
Real GDP ¹	5.0	5.3	-3.8	n.a.	...	...	...
Consumer Prices ²	6.5	5.2	3.9	2.3	3.2	2.7	2.3
Trade Balance ³	-17.8	-20.6	-18.0	-9.7	-6.2	-1.1	-2.3

1. Percent change from previous period, SAAR.

2. End of period.

3. Billions of U.S. dollars, AR, NSA. Imports are c.i.f.

In **China**, official statistics indicate that GDP growth in the third quarter reversed its recent declines, even as consumer prices continued to fall. The resurgence of growth appears to reflect substantial increases in investment in infrastructure and by state enterprises, including strong inventory investment. The increase in investment by state enterprises appears to have been financed by substantially faster third-quarter lending by the four major banks. Hence, the increase in growth appears to be at the expense of previously announced enterprise and bank reform.

Net exports remained strong, reflecting weak import growth. In the first ten months, the dollar value of exports rose about 1 percent from the same period in 1997, while imports fell about 1 percent. In the four months since June, however, however, the dollar value of exports fell nearly 6 percent from the year-earlier period, while imports fell more than 4 percent. Total reserves less gold, which increased \$33 billion in 1997 before stabilizing in the first nine months of 1998, were \$145 billion in September.

CHINESE ECONOMIC INDICATORS

(Percent change from year earlier except where noted)

	1996	1997	1998				
			Q2	Q3	Aug	Sep	Oct
Real GDP	9.7	8.8	6.8	7.6	...	...	...
Industrial Production	13.0	11.1	8.1	8.6	7.9	10.2	10.6
Consumer Prices ¹	7.0	0.4	-1.3	-1.5	-1.4	-1.5	-1.1
Trade Balance ²	12.2	40.3	47.4	51.2	56.4	46.8	37.0

1. End of period.

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

In October, central government authorities closed the Guangdong International Trust and Investment Company (GITIC) because of the institution's inability to repay maturing debt obligations. GITIC was owned by Guangdong Province and was one of China's largest non-bank financial institutions. Although the four state banks dominate China's financial landscape, accounting for almost 80 percent of financial assets, non-banks grew relatively rapidly in the 1990s and were largely unregulated. The closure of GITIC indicates that authorities may be serious about trying to crack down on financial "irregularities." However, most foreign creditors had assumed that loans to China's ITICs were implicitly guaranteed by the government, a presumption that the central government now disclaims. The government has so far made few announcements about what loans will be repaid and in what proportion. Hence, foreign banks have reportedly become much less willing to lend to Chinese entities.

In Taiwan, industrial production rose strongly in August and September from year-earlier levels, while inflation picked up in October. Unemployment in September was virtually unchanged from August at 3.0 percent. Taiwan's trade balance improved sharply in the third quarter, primarily reflecting weak imports. In the third quarter, the dollar value of exports fell nearly 10 percent from its year-earlier level, but the value of imports fell 16

percent. The trade balance declined in October, largely reflecting a temporary surge in aircraft deliveries. Total official reserves less gold rose \$2 billion in October to \$87 billion.

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

	1996	1997	1998				
			Q2	Q3	Aug	Sep	Oct
Real GDP ¹	5.7	6.8	2.1	n.a.	...	...	...
Industrial Production	1.8	6.8	4.3	5.0	4.6	6.7	n.a.
Consumer Prices ²	2.5	0.2	1.4	0.4	0.4	0.4	2.6
Trade Balance ³	14.8	7.7	5.4	14.0	15.6	13.2	-0.2
Current Account ³	11.0	7.7	3.0	n.a.	...	...	...

1. Percent change from previous period, SAAR.

2. End of period.

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

In **Mexico**, recent economic reports have been mixed. Industrial production figures for August showed some rebound in output that month. However, other economic reports offer partial evidence that output deceleration is taking place and that tight policies are restraining domestic demand. For example, the unemployment rate rose in September to 3.3 percent, up from 3.0 percent in August. The September trade deficit was again sizeable, reflecting continued low oil prices. Consumer price inflation edged up slightly in September.

The government is due to send its 1999 budget plan to Congress on November 13. It had wanted a solution to the problem of bailing out Mexico's weakened banking system to be resolved beforehand to help determine appropriate spending levels. It now appears that no agreement on the bailout fund, Fobaproa, is likely before the 1999 budget is presented to Congress, as Mexico's main opposition party continues to disagree with the government's proposal to formally incorporate Fobaproa's liabilities as part of the national debt. The opposition party wants to replace Fobaproa with a new Bank Deposit Insurance Institute to manage its liabilities and have the banks take on a greater share of the cost. Currently it is not clear how this debate will be resolved. It is anticipated that the government will refrain from introducing any new initiatives into the budget in order to have some chance of passing it by the legal deadline of December 15. The government is expected to hold the 1999 deficit no higher than 1.25 percent of GDP, unchanged from 1998.

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

	1996	1997	1998				
			Q2	Q3	Jul	Aug	Sep
Real GDP	5.1	7.0	4.3	n.a.	...	...	...
Industrial Production	10.4	9.2	5.0	n.a.	5.3	7.0	n.a.
Unemployment Rate (%)	5.5	3.7	3.2	3.2	3.2	3.0	3.3
Consumer Prices	27.7	15.7	15.3	15.9	15.4	15.5	15.9
Trade Balance ¹	6.5	0.6	-4.8	-9.2	-9.6	-8.3	-8.4
Imports ¹	89.5	109.8	124.0	123.2	118.8	119.8	130.8
Exports ¹	96.0	110.4	119.2	114.4	109.2	111.5	122.4
Current Account ¹	-2.3	-7.4	-13.8	n.a.	...	...	...

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

Events in international financial markets and uncertainty in Brazil continue to influence financial markets in Mexico. In recent weeks, financial markets in Mexico have begun to stabilize. Between the end of September and November 11, the peso strengthened about 1 percent; the stock market rose over 12 percent; and spreads on Mexican Brady bonds, adjusted for collateral, declined over 100 basis points. The 28-day Cetes rate also eased to 32.0 percent, down from a recent peak of 47.7 percent in mid-September.

In Brazil, real GDP rose by 5.9 percent in the second quarter, despite interest rates that were high in nominal and real terms. Rates rose even higher in early September, when they were raised from 20 to 40 percent to defend the *real*. In September, industrial output fell nearly 25 percent (SAAR), reflecting in large part a plunge in auto production. Unemployment fell slightly in September, but remains very high. In recent months, price indices have fallen slightly, mainly reflecting declines in food prices. The decline in economic activity in September led to a narrowing of the September trade deficit relative to the year-earlier level. However, the current account deficit widened considerably that month, largely reflecting a sharp increase in profit remittances and dividend payments abroad.

The currency remained under strong downward pressure during much of the intermeeting period. Pressures on the currency have been fueled by the perception that fiscal

trends remain incompatible with the government's commitment to limit the depreciation of the currency against the dollar to 7½ percent per year. Brazil's overall fiscal deficit reached 7½ percent of GDP in July, and a recent increase in interest rates has exacerbated fiscal pressures because two-thirds of the government's securities debt is indexed to the overnight interest rate. International reserves fell roughly \$2 billion during the intermeeting period to about \$44 billion on November 11, despite having been boosted by inflows associated with foreign acquisitions of Brazilian banks.

President Cardoso was re-elected on October 4, but new policy measures to address investor concerns were delayed until after congressional and gubernatorial run-off elections on October 25. On October 28, Finance Minister Pedro Malan unveiled a package of measures aimed at tackling Brazil's serious fiscal problems. Malan also declared, as he has previously, that the current exchange rate regime would not be altered. The new package aims to improve the overall public sector budget balance by about 4 percent of GDP in 1999 relative to the government's baseline forecast, which projects a rising deficit because of the deteriorating deficit of the social security systems for private and public sector workers. The package of fiscal measures entails some tax increases that are intended to be temporary, but takes significant steps towards addressing the two most important sources of fiscal pressures: the growing social security imbalances and the fiscal profligacy of Brazil's state governments. Congress on November 4 approved by a wide margin a social security reform measure that caps pension payments to civil servants.

Financial market responses to these developments have been positive, with reserve outflows diminishing, the stock market rising, and some measures of interest rates declining somewhat, although they still remain high. The letter of intent for an IMF program to support Brazil's adjustment measures, along with additional financing by the World Bank, Inter-American Development Bank, and official bilateral creditors, is now expected, after several delays, to be announced shortly.

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

	1996	1997	1998				
			Q2	Q3	Jul	Aug	Sep
Real GDP ¹	2.9	3.0	5.9	n.a.	...	...	...
Industrial Production ¹	5.4	2.0	10.1	-3.8	-5.7	0.0	-25.3
Open Unemployment Rate (%)	5.4	5.6	8.0	8.2	8.0	8.5	8.3
Consumer Prices ²	9.4	4.3	4.1	-4.0	-3.3	-5.7	-3.7
Trade Balance ³	-5.5	-8.4	-1.6	-7.2	-4.6	-8.4	-9.6
Current Account ³	-24.3	-33.8	-31.6	-37.7	-24.3	-30.0	-58.2

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.

In **Argentina**, declining industrial production in September fell below its level 12-months earlier, suggesting that economic activity is beginning to contract. The unemployment rate in August was unchanged from the previous job survey in May. Inflation remained low, with the 12-month consumer price inflation rate falling to under 1 percent in October. The trade balance continues to show a significant deficit; in the third quarter, the trade deficit of more than \$5 billion (AR) compares with a deficit of about \$3 billion (AR) in the year-earlier period.

On the financial front, there has been relative improvement. The stock market has rallied to make up some of the losses incurred since mid-August. Domestic interest rates have come down in recent weeks; the rate on 30-day peso deposits is back to its pre-Russian devaluation level of about 8 percent. Total bank deposits and international reserves have not fallen from their mid-August levels. However, there has been a modest shift of about 7 percent from peso-denominated to dollar-denominated deposits. Also, Brady spreads, despite falling in recent weeks, remain elevated relative to the levels prevailing just before the Russian devaluation.

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

	1996	1997	1998				
			Q2	Q3	Aug	Sep	Oct
Real GDP	4.2	8.4	6.9	n.a.	...	...	...
Industrial Production (SA)	3.1	8.6	5.1	0.0	0.7	-2.2	n.a.
Unemployment Rate (%) ²	17.2	14.9	13.2	13.2	13.2	...	...
Consumer Prices ¹	0.1	0.3	1.1	1.1	1.1	1.1	0.9
Trade Balance ³	1.8	-2.3	-0.2	-5.1	-4.6	-4.9	n.a.
Current Account ³	-3.8	-9.5	-7.2	n.a.	...	...	...

1. End of period.

2. Unemployment figures available only twice a year (May and August for 1998). The annual figure is the average of the two surveys.

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

The Venezuelan economy has moved modestly into a recession, with real GDP contracting about ½ percent in the second quarter from a year earlier. This decline in activity continued into the third quarter, as indicated by automobile sales, which plunged about 40 percent in September from a year-earlier. Inflation remains high, although it moderated slightly in October. In addition to weak oil prices, an overvalued currency has contributed to continuing weak external balances; the non-oil trade deficit of \$11 billion (AR) in August compares to a deficit of about \$8½ billion (AR) in the year-earlier month.

In mid-October, the Venezuelan Macroeconomic Stabilization Fund was finally put in place. This fund is intended to smooth the effects of swings in oil prices by storing windfall oil revenues to be used in times of need. In political developments, the newly formed alliance of the radical presidential candidate, Hugo Chavez, was the clear winner in the congressional elections held on November 8, taking about 35 percent of the total seats. The presidential elections are scheduled for December 6. In the presidential race, Henrique Salas, the candidate favored by the business community, has considerably narrowed Chavez's lead in the polls.

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

	1996	1997	1998				
			Q2	Q3	Aug	Sep	Oct
Real GDP	-0.4	5.1	-0.6	n.a.	...	...	...
Unemployment Rate (NSA, %)	11.8	11.7	11.9	n.a.	...	...	...
Consumer Prices ¹	103.3	37.6	39.0	34.4	36.5	34.4	32.8
Non-oil Trade Balance ²	-4.9	-6.8	-7.4	n.a.	-11.0	n.a.	n.a.
Trade Balance ²	13.6	11.4	4.8	n.a.	n.a.	n.a.	n.a.
Current Account ²	8.8	6.0	-0.3	n.a.	...	...	...

1. End of period.

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

The **Russian** economy remains in crisis. Real GDP has contracted sharply, with the September level 10 percent below that of the previous year; prices in September were more than 50 percent above their year-ago level. The ruble has lost over 60 percent of its value since the government defaulted on its domestic debt and abandoned the ruble corridor in mid-August. The banking system has been paralyzed by the debt freeze as well as by the large losses incurred by the many banks with sizable dollar-denominated obligations. The chaos in the banking system has exacerbated the impact of the sharp rise in costs on the volume of imports, as many importers have been unable to obtain credit to make payments. Domestic payments have been disrupted as well, further depressing economic activity. The monetary base rose by about 17 percent between August and October as the central bank has sought to prop up the banking system, and is likely to increase sharply further if the government follows through on its promises to pay back sizable wage and pension arrears.

As the crisis has deepened, the new government has yet to produce a convincing plan for economic revival. The latest anti-crisis plan, currently under debate in the Duma, reportedly contains a list of measures that suggest increased government intervention in the economy. The 1999 budget, which should indicate how much monetary expansion will be necessary to fund the plan, will not be released until December 1. Financing of the plan is also contingent on whether additional foreign aid will be available; Russian officials continue to hope some money will be forthcoming, although the IMF is still unsatisfied with the plans that have been presented so far. Negotiations with foreign creditors on debt rescheduling are also continuing, with investors remaining dissatisfied with the terms that have been offered.