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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

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Content last modified 6/05/2009.

Confidential (FR) Class III FOMC

Part 2

January 28, 1999

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

January 28, 1999

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 economy continued to surge in the fourth quarter. All sectors of domestic final demand were strong, driving solid gains in employment and income. Topping off the good news, inflation remained low despite the pressures on labor supplies.

Little statistical information is available for the current quarter, but what there is suggests some step-down in the growth of real GDP--the deceleration being centered in the motor vehicle sector, which contributed disproportionately to the late 1998 strength in activity.

Labor Market Developments

Private nonfarm payrolls jumped 319,000 in December, bringing the average monthly increase in the fourth quarter to 229,000--up from the average of 203,000 for the first three quarters of the year. The unemployment rate ticked down another tenth of a percentage point, to 4.3 percent, in December, returning to the low end of the narrow range that has prevailed since April.

Employment rose sharply during the fourth quarter, particularly in December, in the construction and the service-producing industries. Capping a robust quarter, construction payrolls soared 104,000 last month, boosted by strong underlying housing demand and unseasonably mild weather. Hiring in retail trade remained brisk at 53,000 in December. Gains at eating and drinking establishments accounted for half of this rise, but hefty increases also were reported at department stores, building materials and garden supply stores, auto dealers, and service stations. Hiring at finance, insurance, and real estate firms also remained robust last month. In the services industry, employment gains in business services (especially help- supply and computer and data-processing services), agricultural services, and engineering and management services accounted for much of the growth in December.

Factory payrolls dropped another 13,000 in December, the smallest decline in several months. Employment levels in the apparel and textiles industries continued their long slides; industrial machinery and electronic equipment also exhibited considerable weakness, as firms responded to the weakening international trade picture. Since March, manufacturers have cut 272,000 jobs, and this figure may underestimate the total job loss directly associated with the troubles in the sector because anecdotal reports suggest that help-supply firms have been able to place fewer temporary workers at industrial establishments.

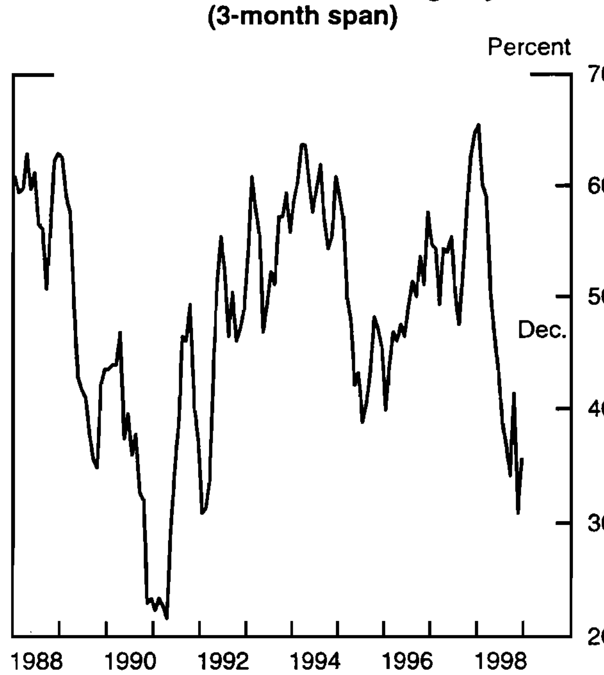
With both private employment and the average workweek rising in December, aggregate hours of production or nonsupervisory workers on private nonfarm payrolls increased 0.5 percent (not at an annual rate). For the fourth quarter

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

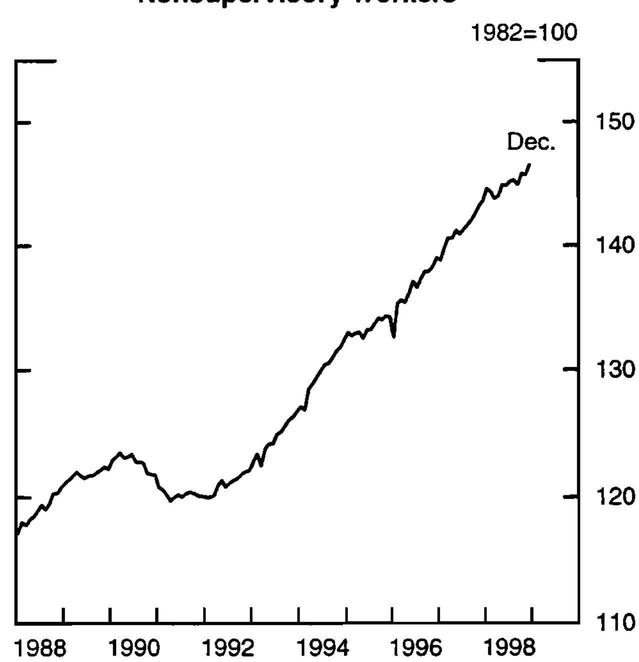
	1997	1998	1998 Q2	1998 Q3	1998 Q4	1998 Oct.	1998 Nov.	1998 Dec.
	--- Average monthly changes ---							
Nonfarm payroll employment [1]	282	239	279	204	264	164	251	378
Private	263	209	251	166	229	144	223	319
Manufacturing	21	-20	-16	-29	-45	-59	-63	-13
Nonmanufacturing	241	229	267	195	274	203	286	332
Construction	20	29	29	12	59	31	42	104
Transportation and utilities	14	16	11	14	21	16	14	32
Retail trade	34	39	63	48	38	-3	65	53
Finance, insurance, real estate	17	23	25	20	25	24	22	28
Services	142	113	129	91	128	137	136	111
Business services	61	39	48	16	53	72	39	49
Help supply services	26	7	11	-12	15	11	17	17
Total government	20	30	28	38	36	20	28	59
Private nonfarm production workers [1]	212	155	195	125	166	116	131	251
Manufacturing production workers	16	-20	-23	-26	-34	-44	-54	-3
Total employment [2]	235	157	115	188	236	40	255	413
Nonagricultural	239	171	52	153	319	-48	465	539
Memo:								
Aggregate hours of private production workers (percent change)[1,3]	3.4	2.0	0.8	1.6	2.4	0.6	-0.1	0.5
Average workweek (hours) [1]	34.6	34.6	34.6	34.5	34.6	34.6	34.5	34.6
Manufacturing (hours)	42.0	41.8	41.7	41.7	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.

Diffusion Index of Manufacturing Payrolls
(3-month span)



Aggregate Hours of Production or Nonsupervisory Workers



as a whole, aggregate hours were up at an annual rate of 2.4 percent, after having increased 1.6 percent in the third quarter. However, once we correct for a seasonal-adjustment problem with the September workweek, the growth rates are more even--closer to 2 percent in each quarter.

Data from the household survey point to tight labor markets at year-end. The unemployment rate in December moved back down to its low for the year, and the labor force participation rate returned to its earlier high of 67.2 percent. The percentage of the population (aged 16 to 64) not in the labor force who want jobs fell last quarter, after having held fairly steady over the first three quarters of the year. The uptrend in labor force participation among women maintaining families continued through year-end--no doubt influenced by welfare reform and the strong economy.

Some of the other readings of labor market conditions suggest that labor markets were still tight at year-end, but indicators of expected conditions have softened a bit recently. The Bureau of National Affairs' survey of positions that are hard to fill suggested that shortages, while less pressing at year-end than earlier in 1998, remained well above those reported during the late 1980s. At the same time, the National Federation of Independent Businesses' survey of small firms showed no real let-up in labor shortages. Respondents to the January Conference Board Survey of households noted a continued high level of job availability currently. The organization's index of help-wanted advertising remained at a historically high level in the fourth quarter of 1998 though a bit lower than earlier in the year. However, respondents to the Michigan and Conference Board surveys were less optimistic about the outlook for employment than they were last summer, although their employment expectations are still relatively positive.

After having moved up into the mid-to-upper 300,000s in late December and early January, weekly initial claims for unemployment insurance dropped back to 301,000 in the week ended January 23--similar to the readings in mid-December. This pattern suggests that the run-up around the turn of the year was, as had been suspected, the result of extremely harsh weather and, possibly, seasonal adjustment difficulties. The recent level remains consistent with solid net gains in jobs.

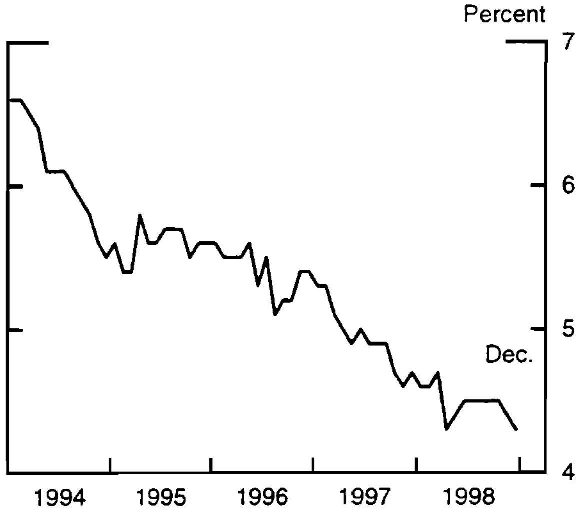
Initial Claims for Unemployment Insurance
(Seasonally adjusted; thousands)

	1998			1999			
	Dec. 12	Dec. 19	Dec. 26	Jan. 2	Jan. 9	Jan. 16	Jan. 23
State programs	300	289	372	356	360	316	301

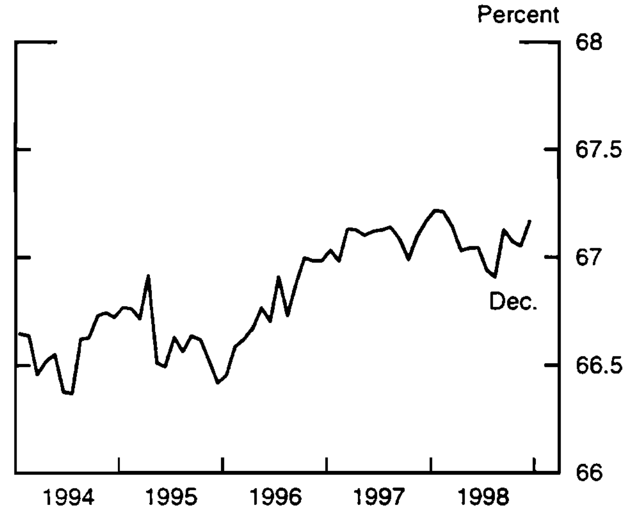
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

			1998			1998		
	1997	1998	Q2	Q3	Q4	Oct.	Nov.	Dec.
Civilian unemployment rate	4.9	4.5	4.4	4.5	4.4	4.5	4.4	4.3
Teenagers	16.0	14.6	14.2	14.7	14.9	15.7	15.0	14.0
Men, 20 years and older	4.2	3.7	3.6	3.8	3.6	3.6	3.5	3.6
Women, 20 years and older	4.4	4.1	4.0	4.0	4.0	4.0	4.0	3.9
Labor force participation rate	67.1	67.1	67.0	67.0	67.1	67.1	67.1	67.2
Teenagers	51.6	52.8	52.4	52.8	52.8	53.1	52.4	52.9
Men, 20 years and older	76.9	76.8	76.8	76.7	76.8	76.7	76.8	76.8
Women, 20 years and older	60.5	60.4	60.4	60.3	60.5	60.4	60.4	60.6
Women maintaining families	67.4	68.2	67.5	68.7	68.7	68.2	68.9	69.0

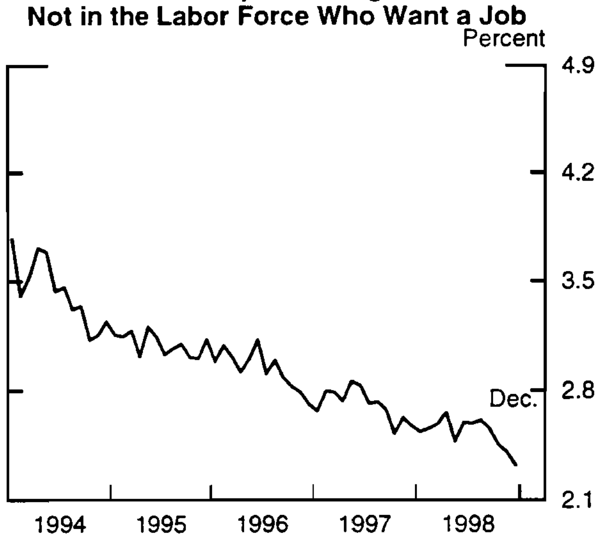
Unemployment Rate



Labor Force Participation Rate

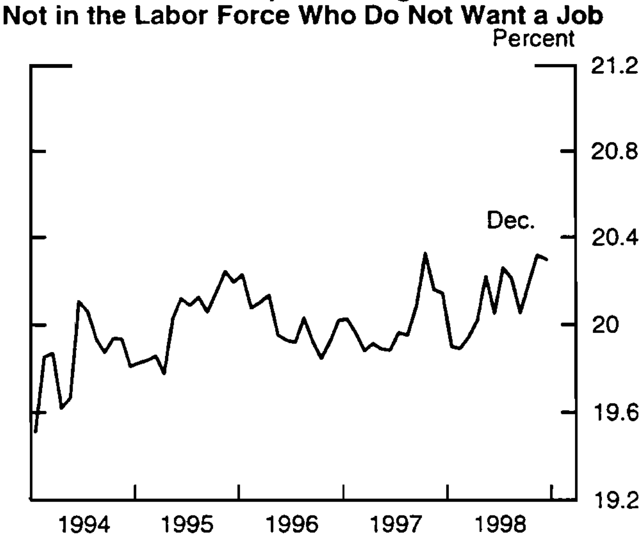


Share of the Population age 16 to 64
Not in the Labor Force Who Want a Job



Note. Seasonally adjusted by FRB staff.

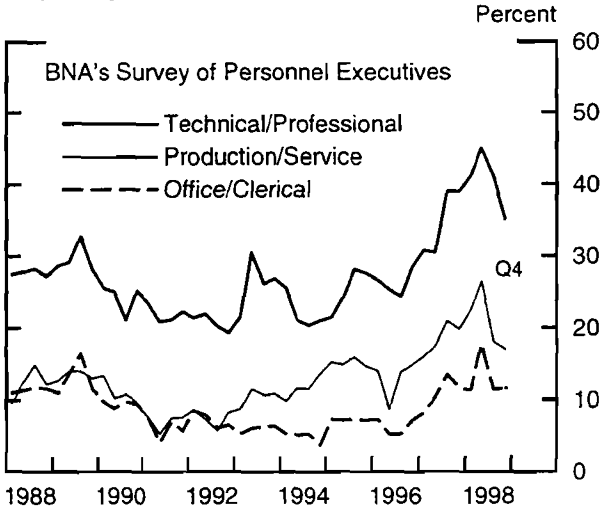
Share of the Population age 16 to 64
Not in the Labor Force Who Do Not Want a Job



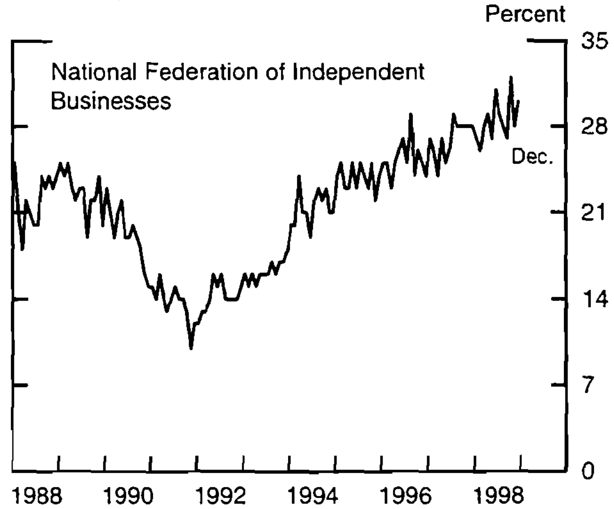
Note. Seasonally adjusted by FRB staff.

Labor Market Indicators

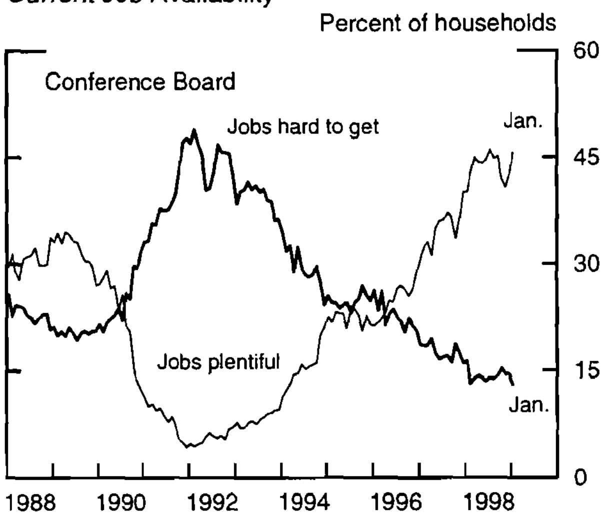
Reporting Positions Hard to Fill



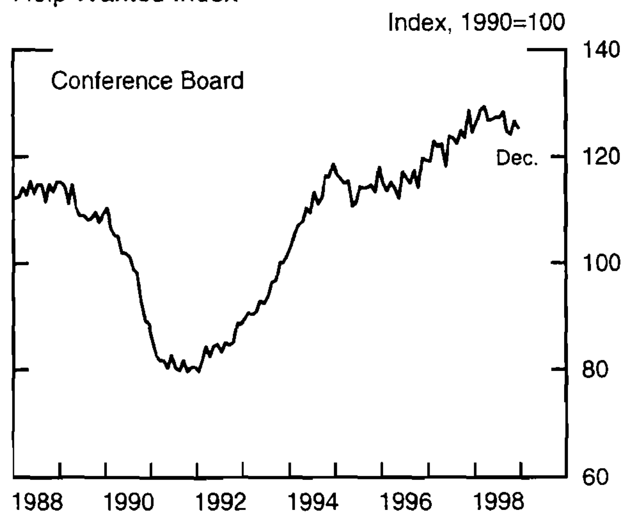
Reporting Positions Hard to Fill



Current Job Availability

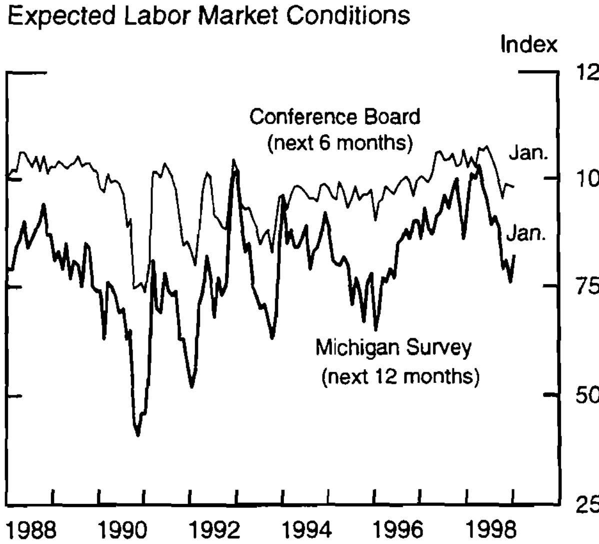


Help Wanted Index



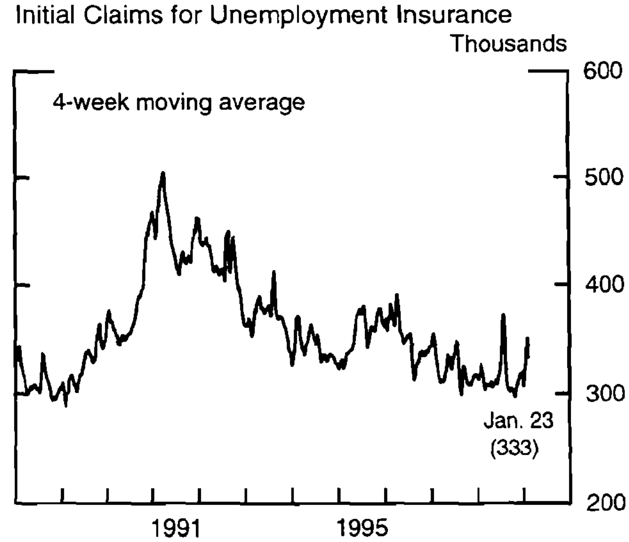
Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Expected Labor Market Conditions



Note. Michigan index: the proportion of households expecting unemployment to fall, less the proportion expecting unemployment to rise, plus 100. Conference Board index: the proportion of respondents expecting more jobs, less the proportion expecting fewer jobs, plus 100.

Initial Claims for Unemployment Insurance



Note. State programs, includes EUC adjustment.

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

	Proportion 1998	1998[1]	1998 Q3	1998 Q4	1998 Oct.	1998 Nov.	1998 Dec.
			-Annual rate-		--Monthly rate---		
Total index	100.0	2.1	.9	3.2	.5	-.1	.2
Mining	5.4	-4.2	-6.1	-8.4	-.6	-.4	-.6
Utilities	6.3	1.3	14.7	-12.5	-2.4	-2.9	1.6
Manufacturing	88.4	2.6	.4	5.1	.8	.1	.2
Motor vehicles and parts	5.1	1.1	5.7	39.4	.2	-.8	-.7
Aircraft and parts	3.1	9.2	2.3	-1.3	1.7	-1.3	-1.6
High-tech	8.4	26.9	28.7	32.7	2.5	1.8	2.2
Other manufacturing	71.7	-.3	-3.0	.5	.6	.1	.1
Consumer goods	23.2	-.9	-6.0	-.2	.5	.6	-.1
Business equipment	9.0	1.0	2.3	-.4	1.2	-1.0	-.4
Construction supplies	5.6	5.0	6.2	5.4	1.2	.5	.9
Materials	24.6	-1.8	-4.9	-.6	.1	-.1	.2
Durables	16.2	-1.0	-4.9	.9	.3	-.1	.3
Nondurables	8.2	-3.4	-3.7	-5.5	-.4	-.1	-.1
Memo: High-tech industries							
Computer equipment	2.5	54.1	37.6	50.0	4.1	3.8	2.2
Communication equipment	2.1	5.7	7.3	-6.1	-1.0	-2.6	1.1
Semiconductors[2]	3.9	25.3	37.6	49.8	3.7	3.0	2.8

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-98 Avg.	1998 Q2	1998 Q3	1998 Q4	1998 Oct.	1998 Nov.	1998 Dec.
Manufacturing	85.7	81.6	81.2	80.2	80.2	80.4	80.1	79.9
Primary processing	88.9	82.8	84.1	82.9	82.4	82.4	82.3	82.4
Advanced processing	84.2	81.1	80.2	79.3	79.5	79.8	79.5	79.2

Industrial Production

After having decelerated substantially in the third quarter, industrial production increased at an annual rate of 3.2 percent in the fourth quarter, even though the output of mines and utilities declined significantly. Much of the strength in the fourth quarter reflects the effects of a surge in the production of motor vehicles and parts, which also bolstered a variety of supplier industries.[1] Moreover, output of construction supplies continued to grow swiftly, and high-tech industries--computers, communications equipment, and semiconductors--again posted huge gains. Elsewhere, however, production remained weak. On balance, manufacturing production expanded at a 5.1 percent rate in the fourth quarter--about the same pace as productive capacity. As a result, the factory operating rate remained unchanged at 80.2 percent, the lowest year-end level in six years.

In December, motor vehicle assemblies edged down to 12.8 million units (annual rate), a still-elevated, post-strike level that boosted production of motor vehicles and parts nearly 40 percent in the fourth quarter. Despite the effort to rebuild strike-depleted stocks, the strong pace of sales has kept inventories lean, and manufacturers expect to maintain assemblies at relatively

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

Item	1998				1999	
	Nov.	Dec.	Q3	Q4	Jan[1]	Q1[2]
U.S. production	12.9	12.8	11.4	12.9	12.8	12.8
Autos	5.8	5.8	5.6	5.9	5.8	5.8
Trucks	7.1	7.0	5.8	7.0	7.0	7.0
Domestic stocks[3]						
Autos	1.3	1.3	1.2	1.3	n.a.	n.a.
Light trucks	1.3	1.4	1.3	1.4	n.a.	n.a.

NOTE. Components may not sum to totals because of rounding.
1. Staff estimate based on weekly production reports.
2. Production rates are manufacturers' schedules.
3. Quarterly data are for last month of quarter.
n.a. Not available.

1. The National Association of Purchasing Managers' diffusion index for manufacturing production suggests weaker output in the fourth quarter. However, the weighting scheme in the IP figures reflects more appropriately the sizable increase in the production of motor vehicles.

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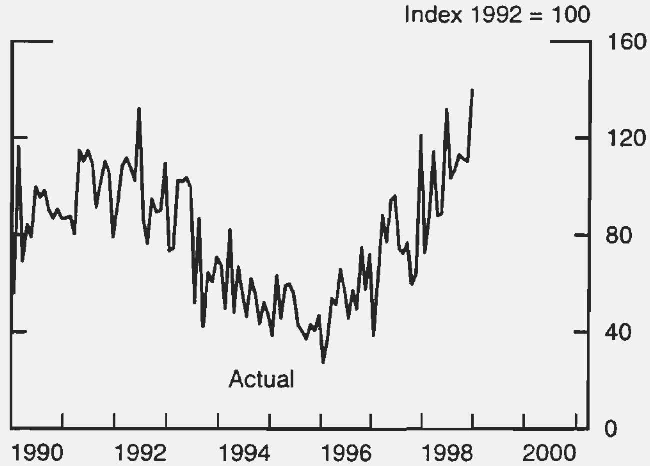
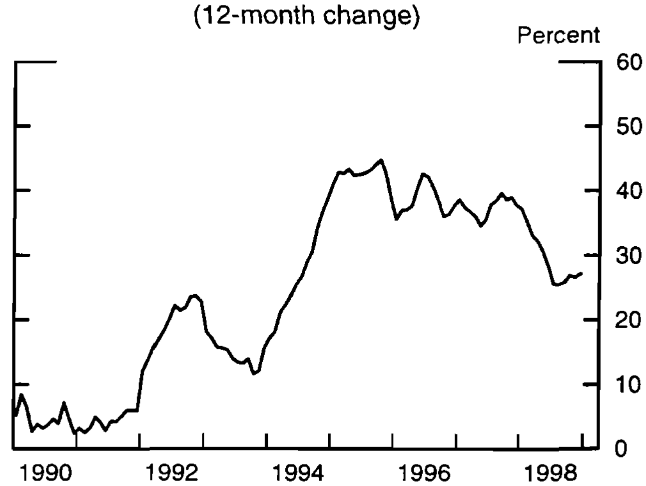
Boeing Commercial Aircraft Completions



Note. 1997 price-weighted index. Actual completions equal deliveries plus the change in the stock of finished aircraft.

Output of High-Tech Industries

(12-month change)

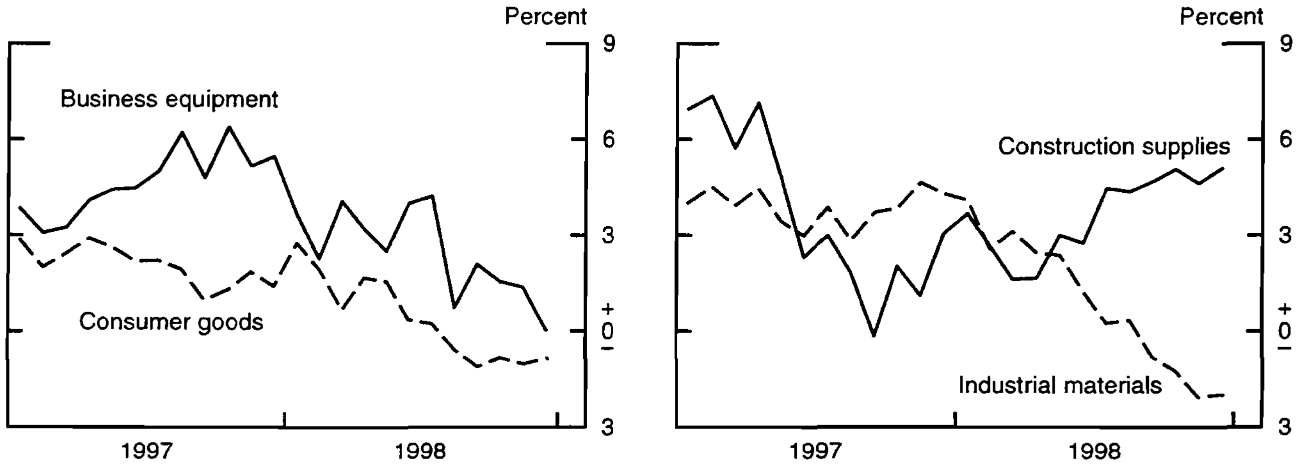


Note. Computers, semiconductors, and communications equipment.

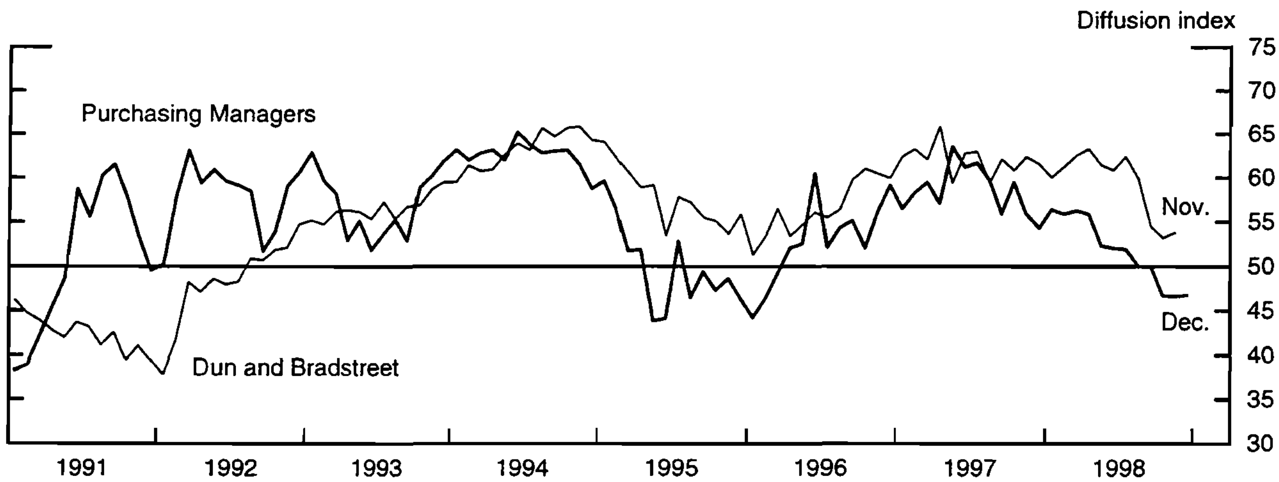
Manufacturing Production by Selected Market Groups

Excluding high-tech, motor vehicles and parts, and aircraft and parts

(12-month change)



Indicators of Future Production: New Orders Indexes



high levels, at least through the first quarter of 1999. Available weekly data suggest that assemblies will remain at about a 12.8 million unit annual rate in January, well below schedules for the month but consistent with manufacturers' quarterly plans. Output of aircraft and parts also fell slightly in December from a very high level and is expected to decline further during the next two years: The staff's price-weighted index of airplanes completed by Boeing reached a high in December. Boeing plans to reduce the pace of assemblies in 1999 and in 2000.

Production of semiconductors, computers, and communications equipment increased substantially again in December. The output of semiconductors and related electronic components surged at an annual rate of 50 percent in the fourth quarter after having increased 38 percent in the third quarter. The recent advances followed much smaller gains of around 9 percent, on average, in the first half of last year, when the glut of inventories took its toll of domestic production. Production of computer and office equipment also jumped 50 percent (annual rate) in the fourth quarter, bringing the rise in 1998 to 54 percent--significantly more than the average increase of 41 percent in the previous three years. Output of communications equipment fell 6 percent (annual rate) in the fourth quarter owing to a substantial decline in the production of telephone apparatus. However, for the year as a whole, the output of communications equipment increased about 6 percent.

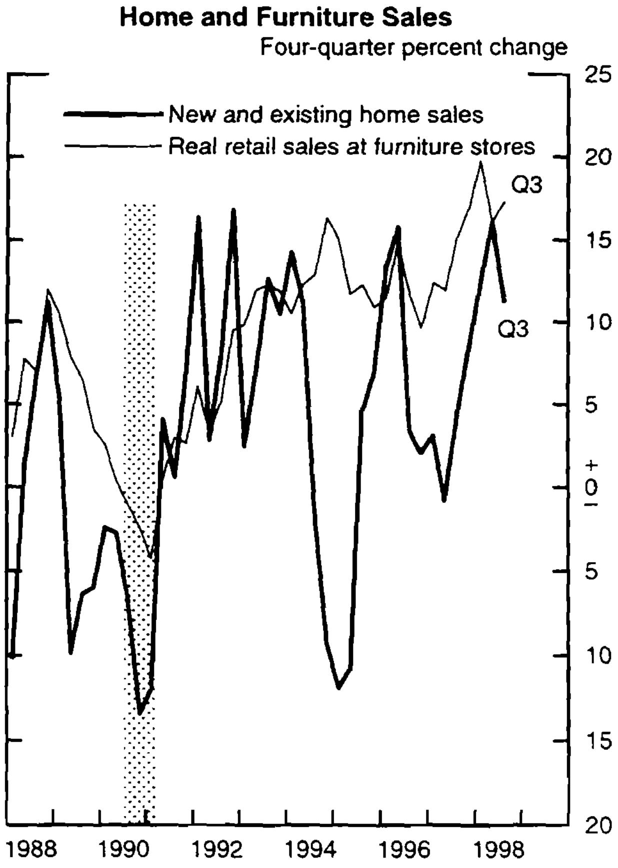
Manufacturing production outside the transportation and high-tech industries was little changed over the four quarters of 1998. Although output of manufactured construction supplies rose substantially, the production of consumer goods declined almost 1 percent, and production of other business equipment posted only a 1 percent gain. Despite a sharp increase in the production of construction machinery, the weak foreign demand for farm products and the low price of oil severely curtailed the growth of farm machinery and gas and oil field machinery last year. Materials production was held down by the steady decline in steel production and by widespread weakness within nondurable materials.

Anecdotal evidence from the Beige Book is consistent with the mixed trends seen in manufacturing production. Motor vehicle production and construction-related manufacturing were reported to have been quite strong in December. Nonetheless, almost every District noted some manufacturers who were hurt by weak exports, although incoming orders for the semiconductor industry are positive. In addition, the Beige Book reported that conditions in the energy and mining sectors worsened late last year. U.S. rig counts are near post-World War II lows, and producers of energy products were reported to have cut exploration, capital spending, and production plans.

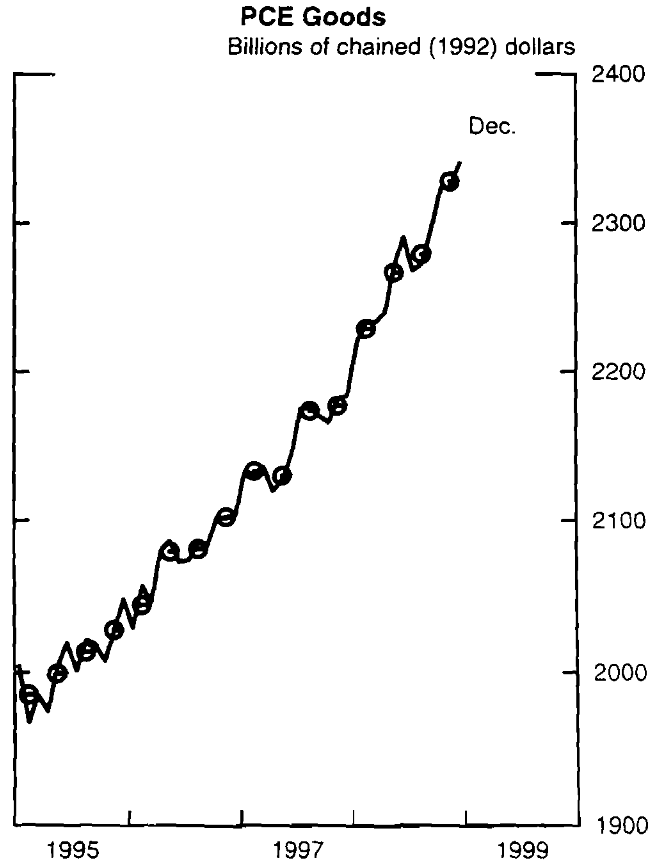
RETAIL SALES
(Percent change from preceding period)

	1998		1998		
	Q3	Q4	Oct.	Nov.	Dec.
Total sales	.0	2.2	1.2	.6	.9
Previous estimate	.0		1.2	.6	
Building materials and supplies	.4	3.0	1.1	1.6	1.3
Automotive dealers	-3.0	5.1	2.9	.7	2.5
Retail control[1]	1.0	1.1	.7	.5	.3
Previous estimate	1.0		.8	.4	
GAF[2]	.6	1.3	.7	1.1	-.1
Durable goods	1.9	1.2	.9	-.1	.6
Furniture and appliances	2.6	.6	.1	.6	.6
Other durable goods	1.3	1.6	1.6	-.6	.7
Nondurable goods	.8	1.1	.6	.6	.2
Apparel	-.6	.3	2.3	1.2	-.6
Food	1.1	1.0	.3	.6	.4
General merchandise	.1	1.9	.4	1.4	-.2
Gasoline stations	.4	-1.7	-.3	-.7	-.3
Other nondurable goods	1.6	1.7	.9	.4	.6

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



Note. Retail sales at furniture and appliance stores, chained (1992) dollars.



Note. The 1998:Q4 value is a staff estimate.

Looking ahead, anecdotal reports collected by Board staff indicate strong bookings at producers of computers and construction-related products, while new orders for steel products, agricultural machinery, and machine tools have been contracting. Our series for real adjusted durable goods orders, based on data from the Bureau of the Census, increased 0.7 percent in the fourth quarter, after having risen 4.9 percent in the third quarter, suggesting moderate production growth in coming months.

New Orders for Durable Goods

(Percent change from preceding period; seasonally adjusted)

Component	Share, 1998:H2	1998				
		Q3	Q4	Oct.	Nov.	Dec.
Total durable goods	100.0	2.7	.1	-2.2	.3	1.9
Adjusted durable goods[1]	70.0	3.3	-.2	-3.5	1.3	3.4
Computers	6.0	2.7	0.8	0.7	.0	5.9
Nondefense capital goods excluding aircraft and computers	18.0	5.4	-2.7	-12.8	2.5	7.0
Other	46.0	2.6	0.6	-.1	1.1	1.7
MEMO						
Real adjusted orders[2]	...	4.9	0.7	-3.4	1.7	3.7

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.

Consumer Spending and Personal Income

Consumer spending remained robust through year-end. In December, nominal outlays in the retail control category, which excludes sales at automotive dealers and building material and supply stores, increased 0.3 percent after having risen 0.5 percent in November. For the fourth quarter as a whole, spending at retail control outlets rose 4.6 percent (annual rate). Nominal expenditures at apparel stores fell back in December after two months of hefty increases, but sales at furniture and appliance stores rose briskly. Although the strength partly reflects the robust housing market, purchases at these stores have grown rapidly in recent years, even during periods when home sales weakened; the category includes stores that sell a considerable volume of home electronics and computers, for which favorable pricing and

REAL PCE SERVICES
(Percent change from the preceding period)

	1997	1998 Q1	1998 Q2	1998 Q3	1998 Sept.	1998 Oct.	1998 Nov.
	Q4/Q4	----- Annual rate -----			--- Monthly rate ---		
PCE Services	3.8	3.5	5.4	5.4	.4	.0	.0
Energy	1.1	-24.2	27.4	24.0	1.2	-6.3	-3.5
Non-energy	3.9	4.9	4.6	4.7	.4	.3	.2
Housing	2.4	2.7	2.2	2.4	.2	.3	.2
Household operation	8.7	6.5	7.1	7.2	.6	.3	.3
Transportation	5.1	3.7	6.7	-1.7	.5	.1	.2
Medical	2.3	3.1	3.9	2.1	.3	.2	.2
Recreation	4.8	10.7	6.0	13.0	-.4	1.7	.6
Personal business	4.7	6.5	6.9	5.3	1.1	.1	-.2
Brokerage services	22.2	16.6	17.5	23.1	8.5	.3	-4.2
Other	6.8	8.2	6.4	15.7	.2	-.5	.1

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

PERSONAL INCOME
(Average monthly percent change)

	1996	1997	1998 Q1	1998 Q2	1998 Q3	1998 Sept.	1998 Oct.	1998 Nov.
	-- Q4/Q4 --		-- Annual rate --			--- Monthly rate ---		
Total personal income	5.9	5.4	5.9	4.5	4.5	.3	.4	.5
Wages and salaries	6.5	7.2	7.4	5.6	5.9	.3	.5	.6
Private	7.3	7.9	7.9	6.0	6.3	.2	.6	.6
Other labor income	-2.4	2.8	5.9	2.9	2.7	.2	.2	.2
Less: Personal tax and nontax payments	12.4	11.5	17.1	10.1	5.8	.1	.4	.6
Equals: Disposable personal income	4.9	4.4	4.0	3.5	4.3	.3	.5	.4
Memo:								
Real disposable income[1]	2.7	2.9	4.0	2.6	3.2	.4	.2	.4
Saving rate (percent)	2.9	2.1	1.2	.4	.2	.0	-.2	.1

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

new products have spurred demand. Indeed, recent anecdotal reports suggest that sales of personal computers were very strong in December.[2]

Based on the retail sales figures and the reported declines in prices for items in the retail control group, the staff estimates that real personal consumption expenditures for goods other than motor vehicles rose at an annual rate of 4-3/4 percent in the fourth quarter. After factoring in the sharp rise in motor vehicle outlays, we estimate that consumer spending on *all goods* surged at an annual rate of more than 8-1/2 percent in the final quarter of the year.

In contrast to the rapid increase in expenditures for goods last quarter, warm weather in late November and early December depressed real outlays for energy services in both months. Spending on non-energy services posted moderate gains in October and November. Weakness in brokerage services offset to some extent robust gains in spending for recreational services and steadily rising outlays for transportation, medical, and personal care services.[3] After a mild December, temperatures for the nation as a whole have been a bit closer to normal so far in January, which should generate a small increase in spending for electricity and natural gas this month, and brokerage services should receive a boost from the rise in trading volume seen early this year.

Consumer spending continues to be supported by strong gains in real income and net worth. Real disposable personal income increased an average of 1/4 percent per month over October and November. In December, the jump in production worker hours and wages, along with the moderate rise in overall consumer prices, likely will produce a sizable gain in real incomes. Although the ratio of net worth to disposable personal income fell in the third quarter, the rebound in equity markets pushed the ratio to new high ground by year-end.

Consumers evidently remain quite confident. The Michigan Survey Research Center index of consumer confidence edged up in early January; the Conference Board's index of consumer confidence also moved up this week. In both, respondents were more upbeat about current conditions, and their assessments of expected conditions were little changed.

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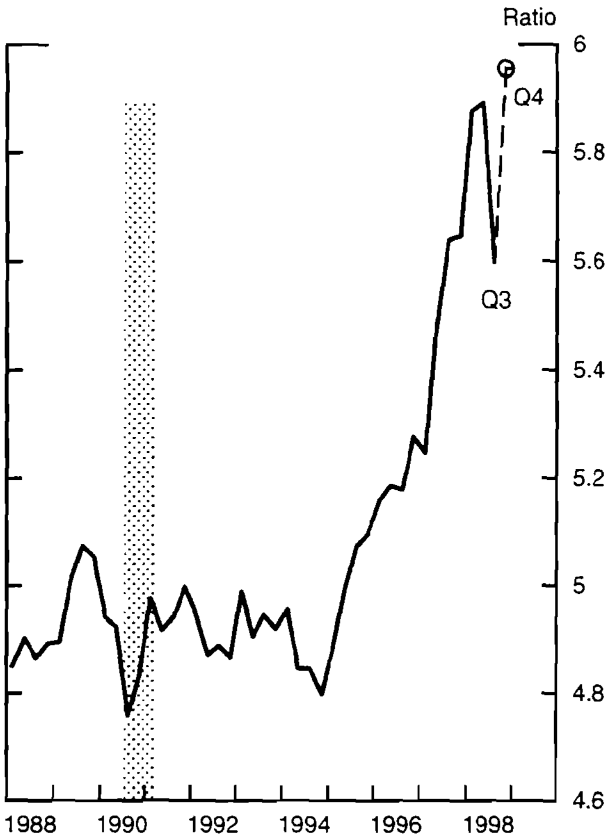
2. For example, PC Data Inc. estimates that unit sales of personal computers at retail outlets in December were 41 percent above the level a year earlier, with the strongest demand for PCs priced under $1,000.

3. The BEA estimates real brokerage services based on stock market volume on the NASDAQ, New York, and American stock exchanges. The combined volume on these exchanges fell in November and December.

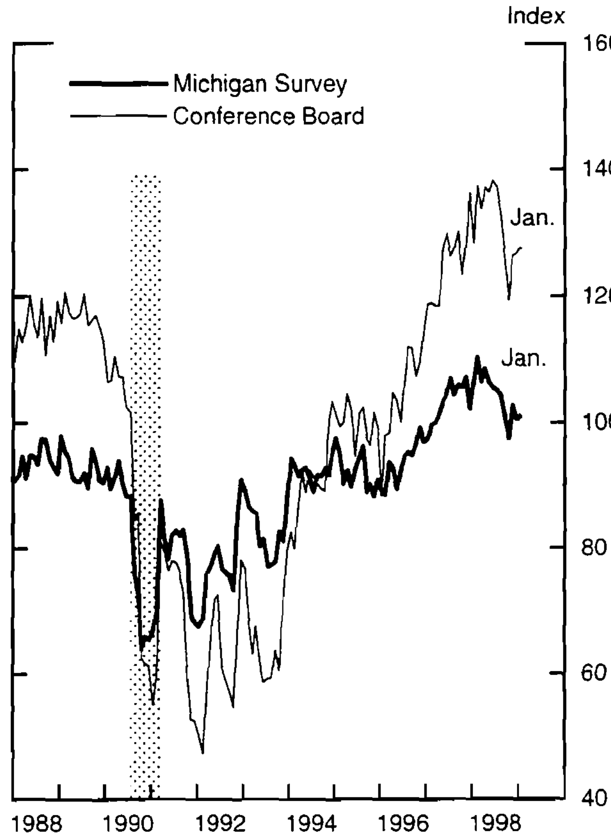
Household Indicators

Ratio of Net Worth to DPI

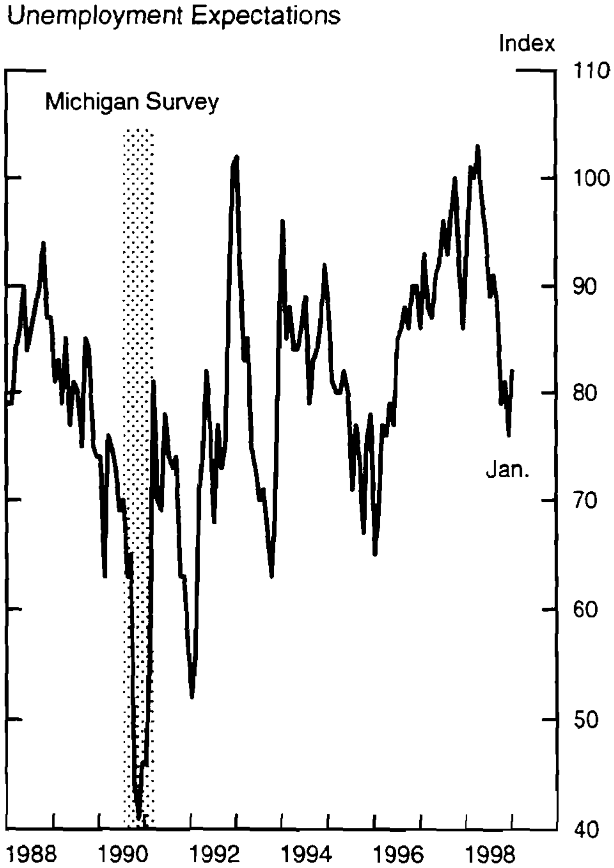


Note. The 1998:Q4 observation is a staff estimate.

Consumer Confidence

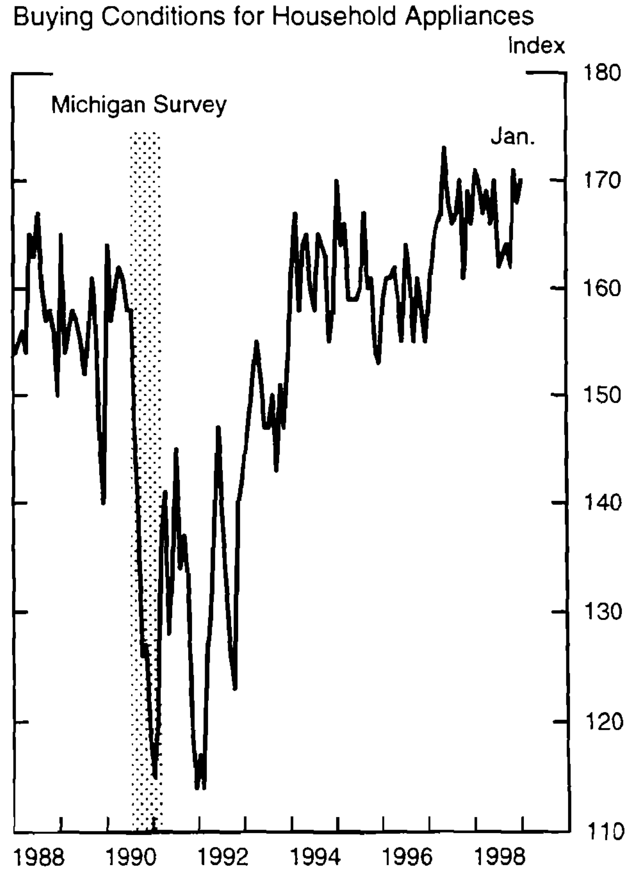


Unemployment Expectations



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

Buying Conditions for Household Appliances



Note. Percentage expecting better condition minus percentage expecting worse plus 100.

Motor Vehicles

Sales of light vehicles surged in December to an annual rate of 17.2 million units, an increase of almost 2 million units from the already strong pace in November. The jump last month reflected not only the generally favorable fundamentals of consumer demand but also year-end sales pushes, as GM sought to regain lost market share and other automakers battled for top car and truck sales titles. The December volume no doubt has taken something away from early 1999, and the manufacturers are expecting sales to step down sharply in January.

Nonetheless, the outlook for sales still appears favorable--in part because consumers perceive pricing to be attractive. U.S. auto producers have evidently achieved cost savings sufficient to permit them to hold down prices and still register substantial profits--particularly on the popular light truck lines. In the early-January Michigan SRC survey, consumers' appraisals of buying conditions for cars climbed to the highest level since 1986, boosted by improvements in consumers' views on pricing and interest rates. In contrast, the Conference Board index of buying plans for autos retreated in January. The divergence between the two measures of consumer sentiment may reflect the different objectives of the two surveys: The Michigan SRC index appraises general car-buying conditions while the Conference Board index measures perceived plans to buy a motor vehicle in the next six months. The drop in the Conference Board index is perhaps indicative of the large number of consumers who have recently bought a vehicle and, thus, are less likely to buy a car in early 1999--a reading that is consistent with the expectation of a near-term moderation in sales from the strong fourth-quarter pace.

Business demand for medium and heavy trucks continues to be exceptionally strong. Shipments set a new record of 596,000 units at an annual rate during the fourth quarter, smashing the previous record of 542,000 units that was set in the third quarter. Net new orders for heavy trucks firmed in December but remained noticeably below the highs reached earlier in the year. Nonetheless, a high level of backlogs suggests that production and shipments should remain little changed at a high level in the near term.

Housing Markets

All measures of housing activity continue to indicate a very robust market. Particularly noteworthy is the strength of the single-family segment, in which starts were little changed in December, thereby maintaining one of the highest levels in twenty years. Sales of new homes set a new record in November, as did sales of existing homes in December.

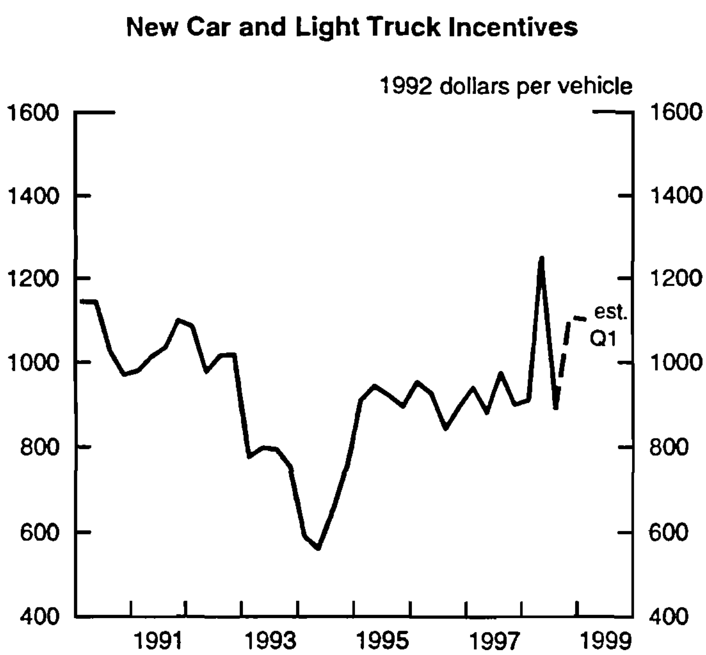
For the fourth quarter as a whole, single-family starts averaged a whopping 1.34 million units at an annual rate. Unusually favorable weather enabled

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

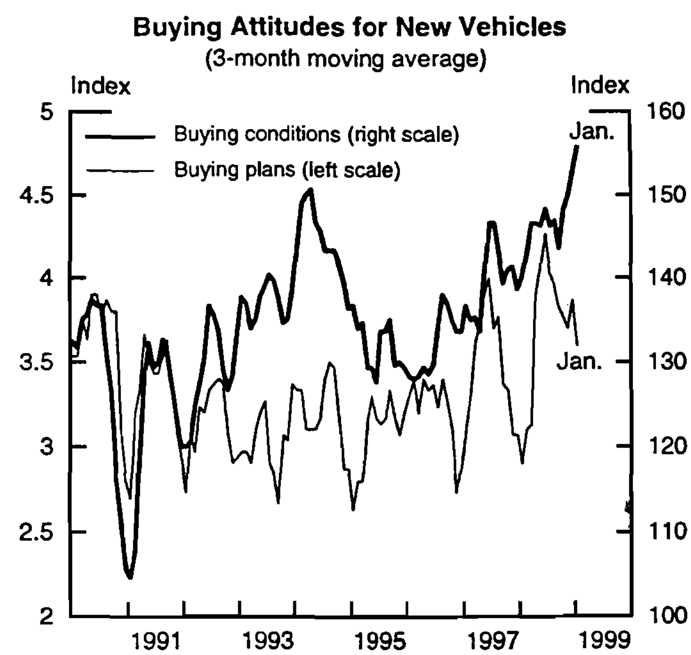
			1998			1998		
	1997	1998	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total	15.1	15.4	16.1	14.6	16.3	16.4	15.3	17.2
Adjusted[1]	15.0	15.5	16.0	14.6	16.3	16.3	15.4	17.2
Autos	8.3	8.1	8.4	7.7	8.6	8.7	7.9	9.1
Light trucks	6.8	7.3	7.6	6.8	7.7	7.7	7.4	8.1
North American[2]	13.1	13.4	14.1	12.5	14.1	14.3	13.2	14.8
Autos	6.9	6.8	7.1	6.4	7.1	7.3	6.5	7.5
Big Three	4.9	4.7	5.0	4.2	4.9	5.0	4.5	5.1
Transplants	2.0	2.1	2.0	2.3	2.2	2.2	2.0	2.4
Light trucks	6.2	6.7	7.0	6.2	7.0	7.0	6.7	7.3
Foreign Produced	1.9	2.0	2.0	2.0	2.2	2.1	2.1	2.4
Autos	1.4	1.4	1.4	1.3	1.5	1.4	1.4	1.6
Light trucks	.6	.6	.6	.7	.7	.7	.7	.8

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.



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



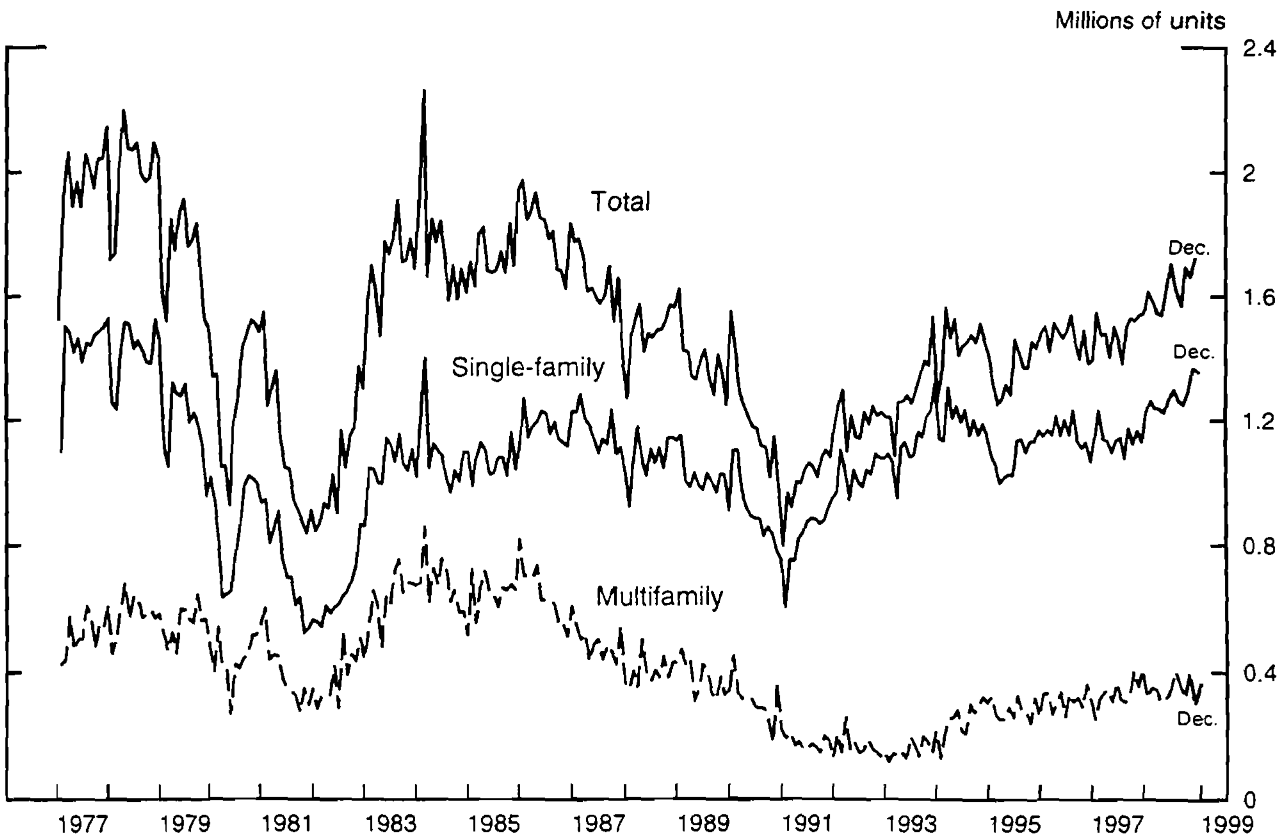
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

	1998p	1998 Q2	Q3	Q4p	Oct.r	Nov.r	Dec.p
All units							
Starts	1.62	1.57	1.63	1.69	1.69	1.66	1.72
Permits	1.60	1.53	1.58	1.69	1.69	1.66	1.72
Single-family units							
Starts	1.27	1.24	1.27	1.34	1.29	1.37	1.36
Permits	1.18	1.14	1.17	1.24	1.20	1.24	1.29
Adjusted permits[1]	1.27	1.23	1.26	1.33	1.29	1.33	1.38
New home sales	n.a.	.90	.85	n.a.	.90	.97	n.a.
Existing home sales	4.79	4.78	4.78	4.89	4.77	4.88	5.03
Multifamily units							
Starts	.35	.33	.36	.35	.40	.30	.36
Permits	.42	.38	.41	.45	.49	.42	.43
Mobile homes							
Shipments	n.a.	.37	.37	n.a.	.35	.39	n.a.

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

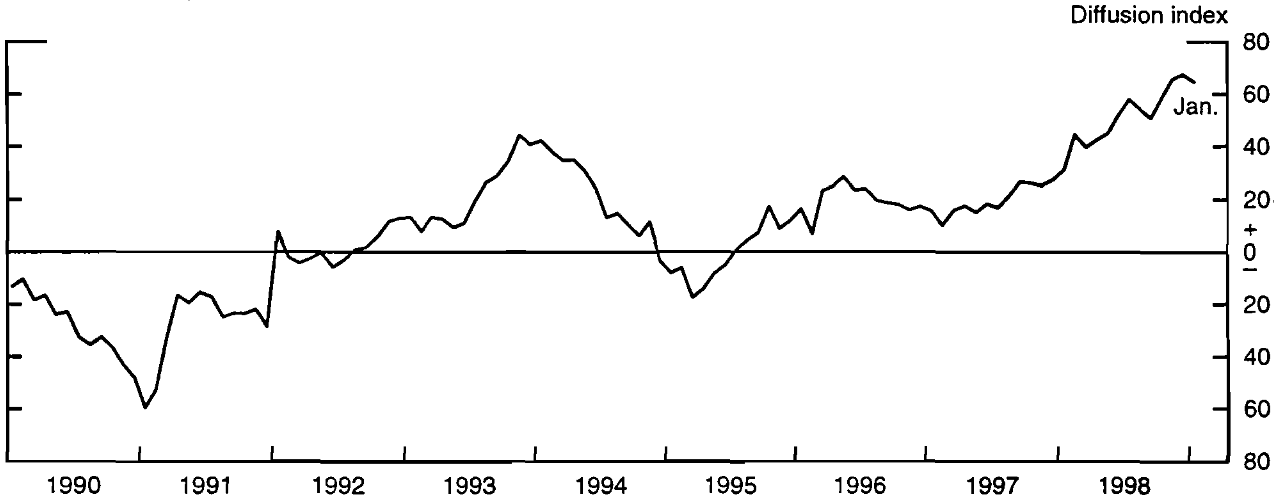
1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas, minus a correction for those starts in permit-issuing places that lack a permit.

Private Housing Starts
(Seasonally adjusted annual rate)



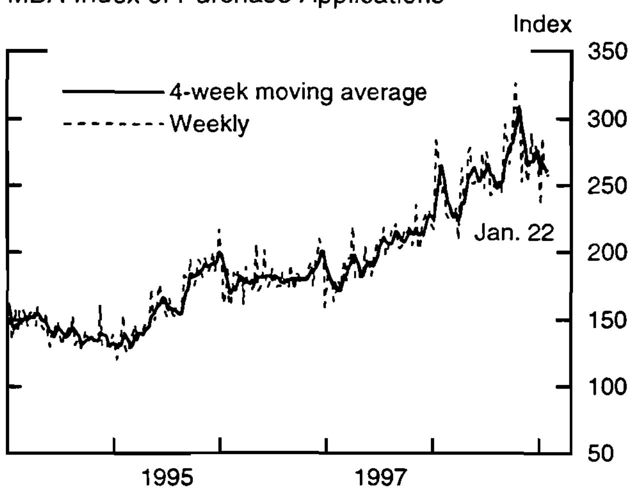
Indicators of Housing Demand and Prices

Builders' Rating of New Home Sales, SA

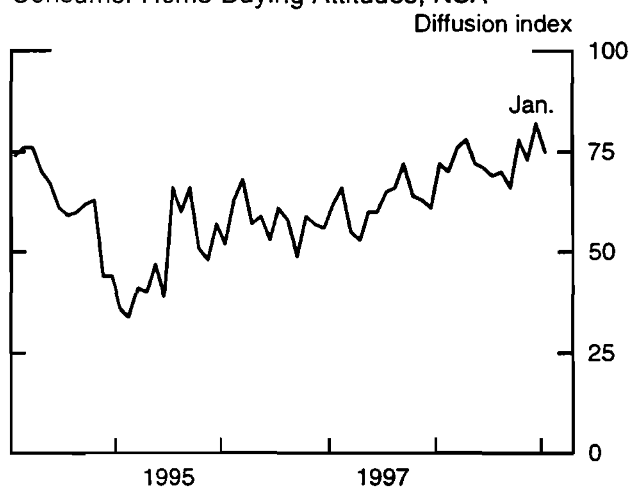


Note. The index is calculated from National Association of Homebuilders as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

MBA Index of Purchase Applications

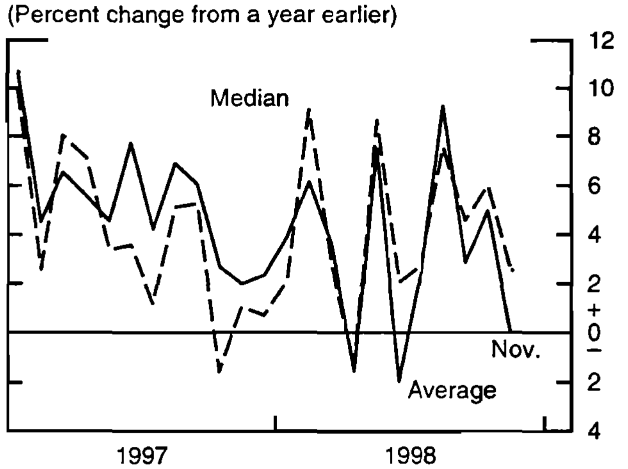


Consumer Home-Buying Attitudes, NSA

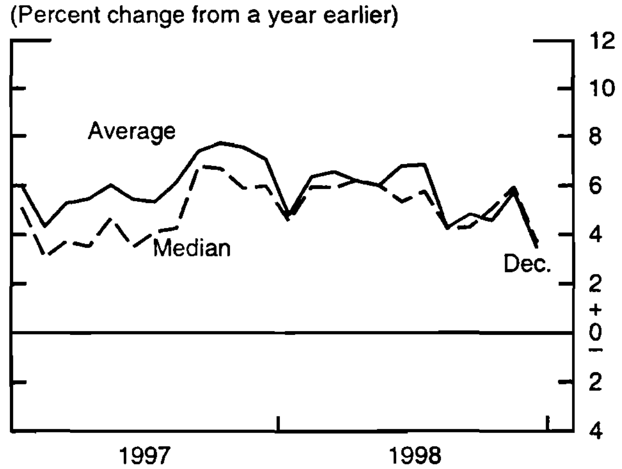


Note. The homebuying attitudes index is based on the Michigan Survey and is calculated as the proportion of respondents rating current conditions as good minus the proportion rating conditions as bad.

Change in Prices of New Homes
(Percent change from a year earlier)



Change in Prices of Existing Homes
(Percent change from a year earlier)



builders to work on satisfying a backlog of demand by extending the normal construction season in some areas. On a not-seasonally-adjusted basis, single-family starts dropped less than half as much as they usually do during the September-December period.

Sales of new homes remained strong into early January, according to the National Association of Home Builders' monthly survey of builders, and applications for mortgages to finance home purchases remained at a high level, though below the record reached late last year. The Michigan survey's index of homebuying attitudes dropped back a bit in early January after having recorded a new high in December. Respondents have continued to note that the low level of mortgage rates is a key reason that homebuying is attractive.

On an annual average basis, the rate on thirty-year conventional fixed-rate mortgages declined in each of the past four years. At 6.77 percent, the average rate in the fourth quarter of 1998 was the lowest in the twenty-seven-year history of the benchmark series published by Freddie Mac. Besides low rates, however, the house sales undoubtedly have been boosted by rapid employment growth, gains in net worth, and special financing programs designed to broaden opportunities for homeownership by reducing down payments.

The year-over-year increases in the average and median prices of new homes sold fell in November to 0 and 3 percent, respectively, both of which are toward the low end of the range seen over the past year. Year-over-year increases in the average and median prices for existing homes sold dipped in December; on a quarterly-average basis, these prices were 4-1/2 to 5 percent higher than a year earlier. That rate of change is roughly the rate recorded for the repeat-sales price index for existing homes in the third quarter (the latest data).

Multifamily housing starts fell back slightly in the fourth quarter to an annual rate of 354,000 units. Indicators of underlying conditions in the multifamily market are mixed. Residential rent continued to increase in real terms through the end of last year. The vacancy rate for multifamily rental housing, which is not seasonally adjusted, fell in the fourth quarter of 1998 to a level a bit below its level a year ago. However, the annual average of the vacancy rate, which may be a better indicator of underlying trends, has been about unchanged since 1994.

Business Fixed Investment

Real business fixed investment appears to have increased substantially in the fourth quarter, after having paused in the prior quarter. In particular,

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

	1998		1998		
	Q3	Q4	Oct.	Nov.	Dec.
Producers' durable equipment					
Shipments of nondefense capital goods	1.6	4.0	.8	.7	-.4
Excluding aircraft and parts	1.4	1.8	-.1	-.5	1.6
Office and computing	2.0	.9	3.1	-1.1	.3
Communications equipment	2.1	4.4	-3.9	2.0	-.4
All other categories	1.0	1.5	-.3	-.9	2.7
Shipments of complete aircraft	5.3	n.a.	66.0	-10.0	n.a.
Sales of heavy trucks	8.5	9.3	2.9	6.2	-4.4
Orders for nondefense capital goods	4.3	-4.7	-6.4	1.2	1.0
Excluding aircraft and parts	4.7	-1.8	-9.7	1.9	6.7
Office and computing	2.7	.8	.7	.0	5.9
Communications equipment	-3.0	4.9	-4.1	-5.1	-.1
All other categories	7.7	-4.6	-15.1	4.8	8.9
Nonresidential structures					
Construction put in place, buildings	1.7	n.a.	1.4	-.1	n.a.
Office	1.4	n.a.	5.8	1.8	n.a.
Other commercial	-.2	n.a.	1.0	3.8	n.a.
Institutional	-.6	n.a.	-.6	.4	n.a.
Industrial	.1	n.a.	-4.1	-2.8	n.a.
Lodging and miscellaneous	11.8	n.a.	4.1	-7.8	n.a.
Rotary drilling rigs in use[1]	-11.9	-14.7	-5.3	-6.7	-4.8
Memo (1992 Chained dollars):					
Business fixed investment	-.7	n.a.	n.a.	n.a.	n.a.
Producers' durable equipment	-1.0	n.a.	n.a.	n.a.	n.a.
Office and computing	50.0	n.a.	n.a.	n.a.	n.a.
Communications equipment	12.4	n.a.	n.a.	n.a.	n.a.
Other equipment[2]	2.5	n.a.	n.a.	n.a.	n.a.
Nonresidential structures	.2	n.a.	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.

equipment spending picked up markedly, and nonresidential construction strengthened, on balance, over the first two months of the quarter.

Producers' durable equipment. Most of the rebound in real expenditures on producers' durable equipment in the fourth quarter was attributable to a sizable bounceback in businesses' purchases of motor vehicles and a pickup in deliveries of aircraft to domestic carriers. Excluding the erratic transportation sector, equipment spending seems to have increased at about the same brisk pace last quarter as in the third quarter, although it is still down from the extremely rapid rate registered in the first half of the year.

The "high-technology" sectors of PDE continue to look strong. Although nominal shipments of office and computing equipment slowed in the fourth quarter, domestic businesses appear to have accelerated their purchases of computing equipment from abroad. On balance, the staff estimates that real expenditures on office and computing equipment increased at an annual rate of 44 percent, just off the third-quarter pace. Anecdotal evidence indicates that nominal computer shipments probably picked up in January. Notably, IBM's orders have been quite strong this month, partly because of the popularity of its S/390 computers--a line aimed at businesses engaging in electronic commerce; S/390 sales are a small share of IBM revenues, but demand for these machines has exploded recently.

Real outlays for communications equipment are estimated to have accelerated to an annual growth rate of 18 percent in the fourth quarter. Nominal shipments of communications equipment rose 4.4 percent (not at an annual rate) last quarter, and prices continued to fall moderately. The outlook for spending in this sector remains upbeat: Bookings for communications equipment rose at a 4.9 percent rate in the fourth quarter, and the backlog of unfilled orders increased.

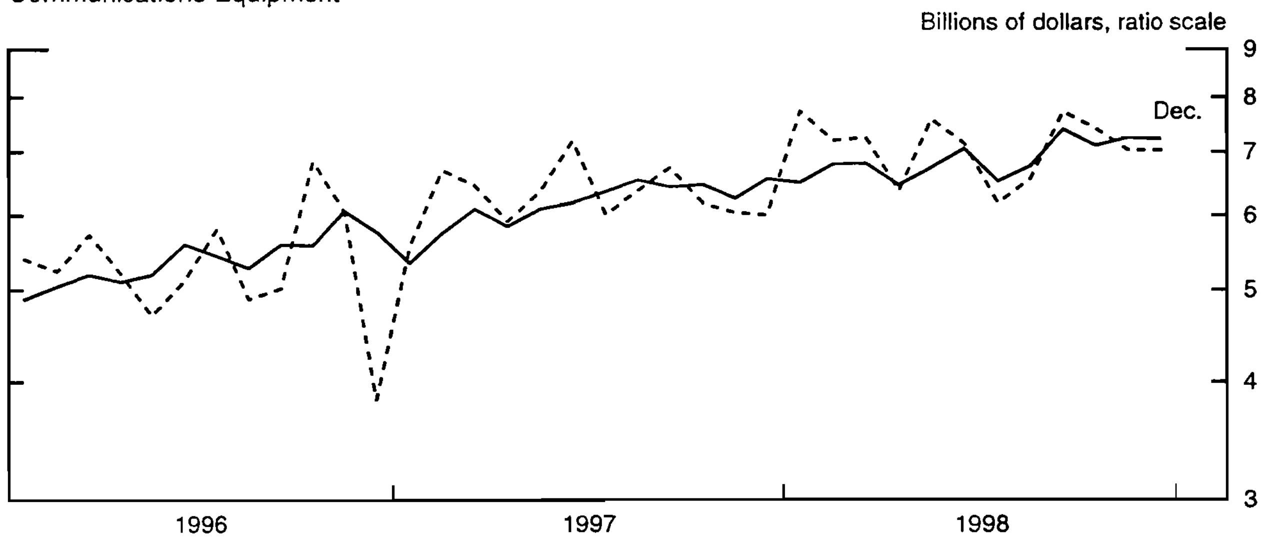
Business expenditures on aircraft appear to have provided a modest boost to producers' durable equipment in the fourth quarter. Boeing reportedly delivered a record number of planes last quarter, and the share delivered to domestic businesses appears to have remained stable.

Outside of the high-tech and transportation sectors, real domestic equipment spending appears to have slowed to a 2-1/4 percent pace in the fourth quarter. Although nominal shipments rose 1.5 percent (not at an annual rate), a bit above the third-quarter pace, a large share of the fourth-quarter shipments apparently were exported. New orders declined 4.6 percent last quarter, held down by a large decrease in new bookings of engines and turbines. Excluding this sector, which has registered large monthly fluctuations of late, new orders fell 1.4 percent.

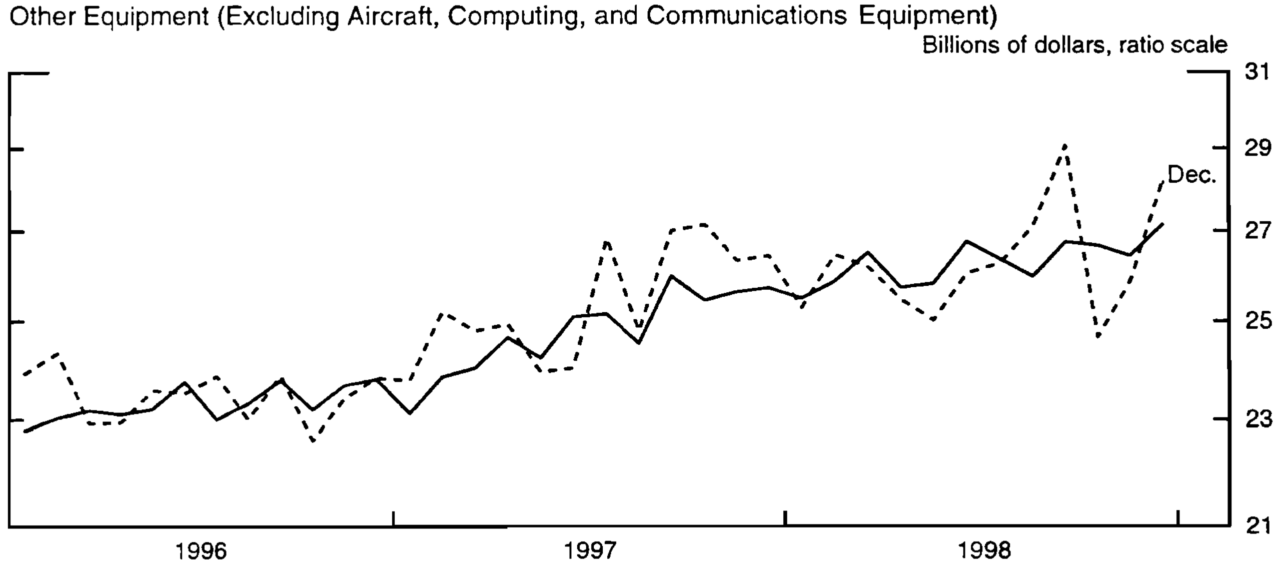
Orders and Shipments of Nondefense Capital Goods

Office and Computing Equipment

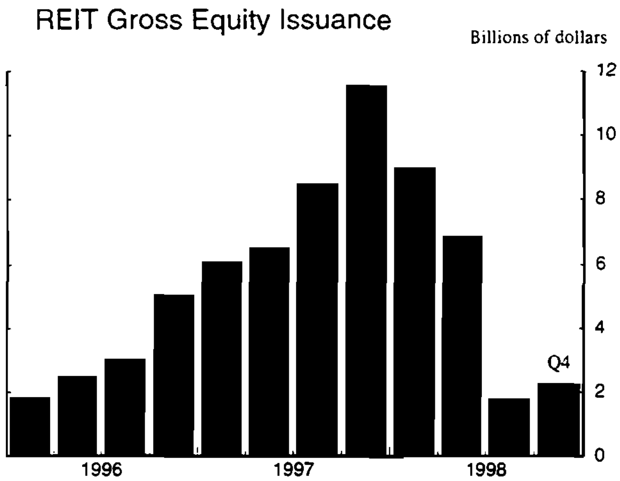
Communications Equipment



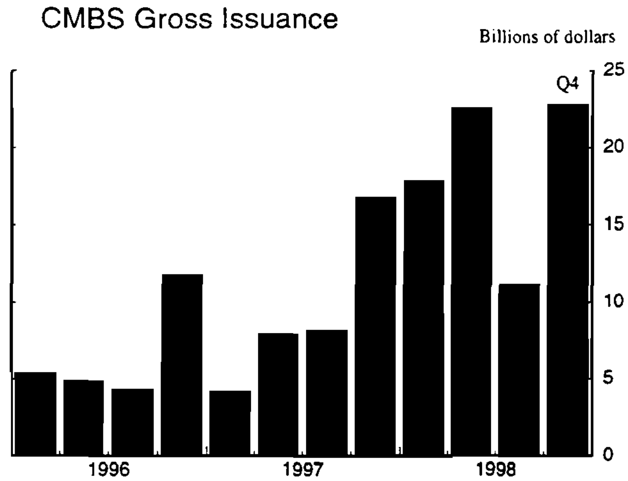
Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



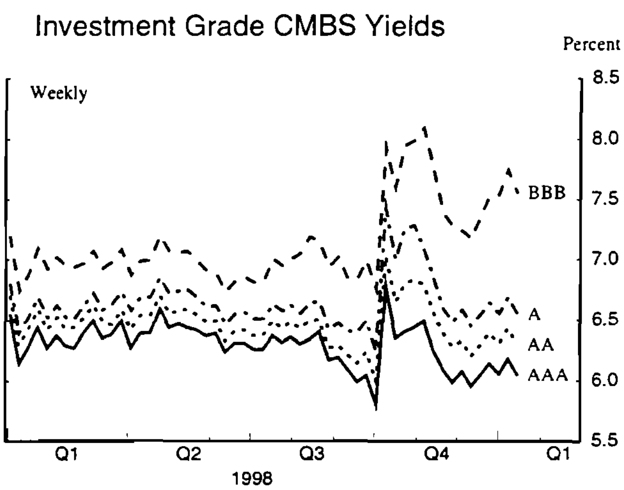
Commercial Real Estate Financing



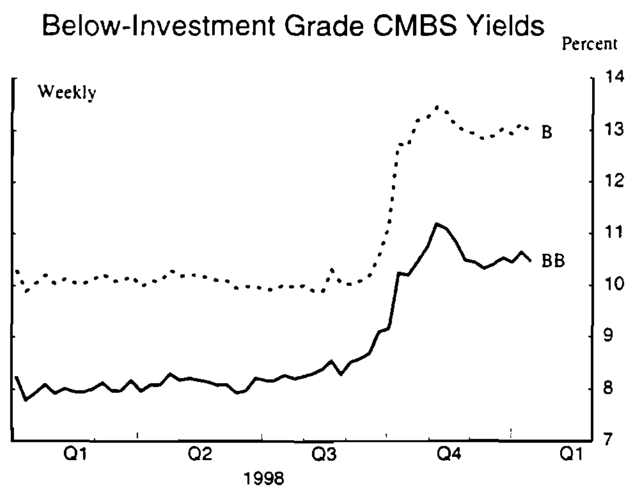
Source. National Association of Real Estate Investment Trusts



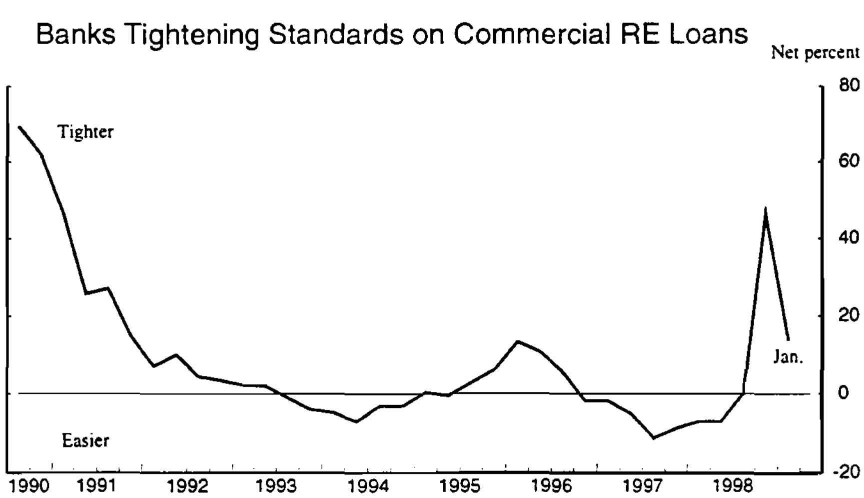
Source. Commercial Mortgage Alert



Source. Morgan Stanley



Source. Morgan Stanley



Source. Senior Loan Officer Opinion Survey

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

	1998			1998		
	Q2	Q3	Oct.-Nov.	Sept.	Oct.	Nov.
Manufacturing and trade	7.0	41.4	43.3	72.0	30.0	56.6
Less wholesale and retail motor vehicles	35.0	33.8	27.0	39.2	12.2	41.9
Manufacturing	19.0	7.4	18.2	1.3	29.7	6.7
Less aircraft	6.9	1.3	16.7	2.9	15.9	17.4
Merchant wholesalers	-.4	26.4	7.4	42.4	-4.2	19.1
Less motor vehicles	10.9	24.5	7.1	38.5	-9.2	23.3
Retail trade	-11.5	7.6	17.7	28.2	4.5	30.9
Automotive dealers	-16.6	5.7	15.9	28.8	12.8	19.0
Less automotive dealers	5.0	1.8	1.8	-.6	-8.4	11.9

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

	Cyclical reference points		Range over preceding 12 months		November
	1990-91 high	1995-96 low	High	Low	1998
Manufacturing and trade	1.58	1.38	1.39	1.38	1.39
Less wholesale and retail motor vehicles	1.55	1.35	1.37	1.35	1.37
Manufacturing	1.75	1.38	1.40	1.36	1.38
Primary metals	2.08	1.49	1.70	1.54	1.74
Steel	2.56	1.69	2.15	1.80	2.20
Nonelectrical machinery	2.48	1.77	1.75	1.61	1.66
Electrical machinery	2.08	1.41	1.39	1.24	1.24
Transportation equipment	2.93	1.51	1.85	1.57	1.58
Motor vehicles	.97	.56	.64	.53	.54
Aircraft	5.84	4.44	4.97	4.27	4.06
Nondefense capital goods	3.09	2.27	2.33	2.11	2.08
Textiles	1.71	1.42	1.59	1.40	1.57
Paper	1.32	1.06	1.23	1.13	1.23
Chemicals	1.44	1.25	1.45	1.34	1.45
Petroleum	.94	.80	.94	.87	1.00
Home goods & apparel	1.96	1.63	1.75	1.59	1.75
Merchant wholesalers	1.36	1.26	1.33	1.29	1.33
Less motor vehicles	1.31	1.22	1.32	1.26	1.32
Durable goods	1.83	1.55	1.66	1.59	1.67
Nondurable goods	.95	.91	.99	.94	.97
Retail trade	1.61	1.50	1.49	1.44	1.44
Less automotive dealers	1.48	1.43	1.42	1.39	1.38
Automotive dealers	2.22	1.69	1.73	1.56	1.62
General merchandise	2.42	2.20	2.10	2.00	1.99
Apparel	2.53	2.27	2.54	2.35	2.40
GAF	2.42	2.23	2.12	2.06	2.05

Nonresidential structures. Nonresidential building activity appears to have increased moderately in the fourth quarter. Estimates of construction spending in September and October were revised up substantially because of an unusually large number of late reports of construction contracts. In November, construction of nonresidential buildings was about flat, leaving nominal outlays in October and November, on average, up 8 percent (annual rate) from their third-quarter level. Among the major components, construction of office buildings increased in October and November, as did commercial construction, which includes stores and warehouses. However, consistent with the subpar rate of capacity utilization in many manufacturing industries, industrial construction continued to ebb, and building of lodging facilities decreased sharply in November, which more than offset an increase in October.

The availability of financing appears to be little changed in recent weeks. Gross issuance of CMBSs surged in the fourth quarter, more than doubling the sharply curtailed flow during the third quarter, but most of these issues reflected securitization of loans purchased some time ago rather than new funding. Anecdotal reports suggest that mortgage loans are available to those with good credit and sound projects, but with terms that reflect the more cautious lending criteria that took hold after the disruption of financial markets late last summer. The Senior Loan Officer Opinion Survey in January found that, on a net basis, 15 percent of commercial banks had tightened their lending standards for commercial real estate loans compared with 46 percent three months earlier.

Business Inventories

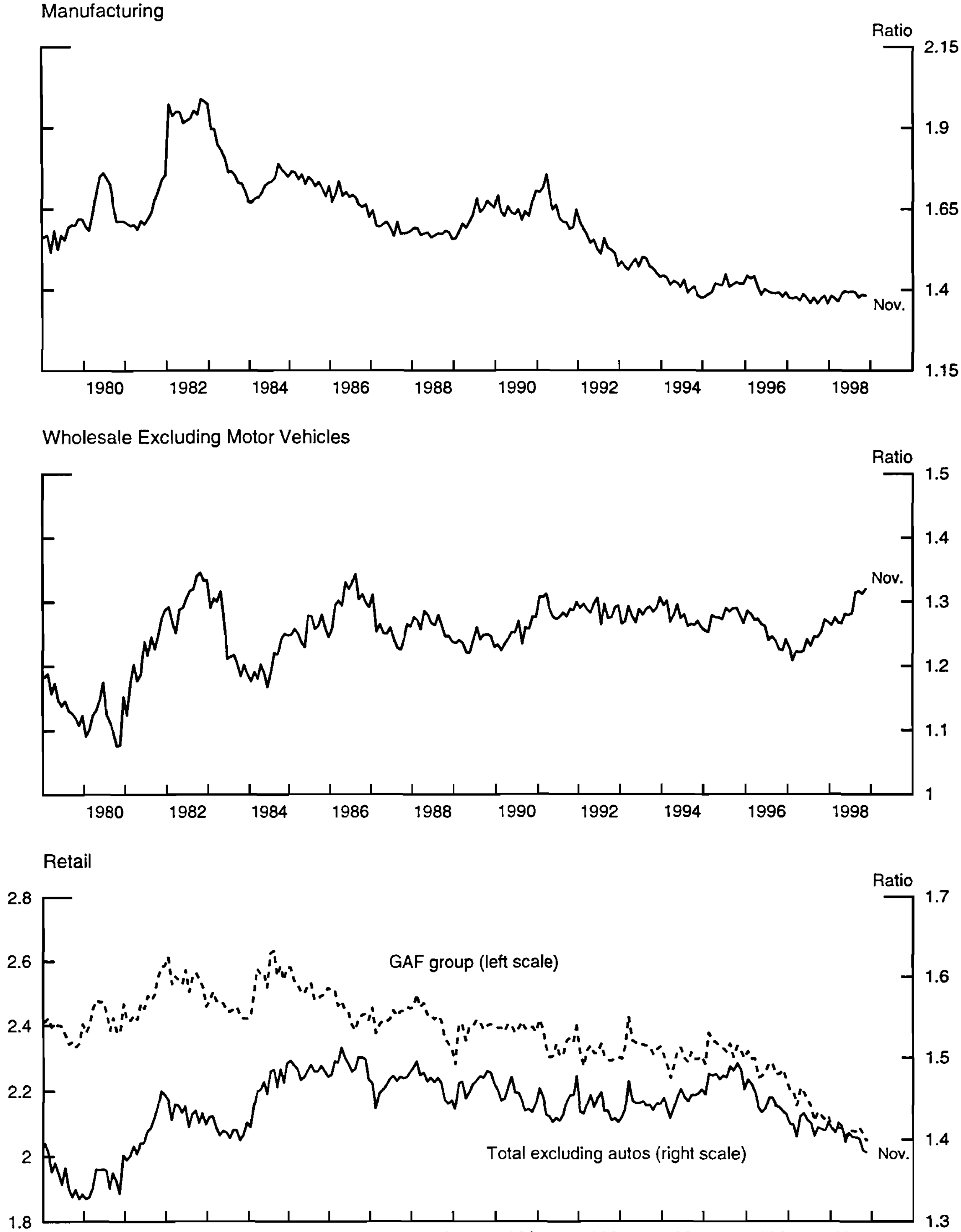
For manufacturing and trade establishments excluding motor vehicles, the book value of inventories rose at an annual rate of $27 billion, on average, in October and November. This was down $7 billion from the third-quarter pace, but the stock-sales ratio held steady. Dealer inventories of new motor vehicles remain quite lean relative to the pace of sales that the companies expect to prevail in the near term.

Manufacturers' inventories rose at an annual rate of $18.2 billion, on average, in the first two months of the quarter, up from the $7.4 billion pace posted in the third quarter.[4] Inventory investment outside of the aircraft industry averaged moderate increases in October and November after a $1.3 billion

4. The figures cited in the text are Census book-value numbers. However, in the NIPA, manufacturers' book-value stocks rose $12.8 billion at an annual rate in the third quarter. The difference between the Census and NIPA figures almost entirely reflects stocks purchased by private businesses from the federal government when it sold the United States Enrichment Corporation. This purchase was counted in the NIPA but not in the Census figures.

Inventory-Sales Ratios, by Major Sector

(Book value)



rise, at an annual rate, in the third quarter, while stocks of aircraft and parts were little changed, on balance. The November inventory-shipments ratio for manufacturing as a whole was near the middle of the narrow range that has prevailed for the past two years. Nonetheless, inventory overhangs persist at producers of chemicals and--to a less dramatic degree--steel and paper.

The book value of wholesale trade inventories excluding motor vehicles rose at a $7.1 billion annual pace in October and November, well off the $24.5 billion rate of accumulation posted in the third quarter. The farm products sector accounted for most of the swing, as the early harvest moved some of the usual seasonal accumulation of farm products forward from October to August and September. On average, inventory investment was also lower in October and November in nearly every other category of wholesaling. Nevertheless, stock-to-sales ratios at metals and minerals, machinery, and chemicals wholesalers remained very elevated, despite slower rates of accumulation in the fourth quarter. Apparently, production cuts in the domestic manufacturing industries associated with these wholesale categories were not sufficient to reduce wholesale inventories, perhaps, in part, because of increased import penetration.

In the retail trade sector, non-auto inventories rose at a very small $1.8 billion annual rate, on average, in October and November--the same rate as in the third quarter. Retail sales have remained robust, and the inventory-sales ratio has stepped down somewhat over the past seven months. The retail inventory-sales ratio (excluding motor vehicles) in November was the lowest since 1981.

Federal Government Sector

According to Monthly Treasury Statements, the federal budget deficit for the October-December period totaled $55 billion. However, the deficit was boosted by a surge in social security outlays that reflected a shift in benefit payments from early January to December 31.[5] Excluding such timing shifts, as well as deposit insurance and spectrum auction proceeds, the deficit was only $18 billion, about $13 billion under the year-earlier level. On this adjusted basis, the budget posted a surplus of $73 billion over the twelve months ending in December, compared with a deficit of $20 billion over the preceding year.

Despite the enactment of the fiscal year 1999 emergency spending bill last fall, national defense spending in nominal terms fell about 1 percent in the

5. Such a shift is unusual, occurring only when the first three days of January are not business days, which was the case this year.

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

	October-December			12 months ending in Dec.		
	1997	1998	Percent change	1997	1998	Percent change
Outlays	426.1	467.6	9.7	1621.8	1692.9	4.4
Deposit insurance	-0.9	-2.1	n.a.	-8.8	-5.6	n.a.
Spectrum auction	-0.2	-0.3	n.a.	-7.5	-2.8	n.a.
Sale of major assets	0.0	0.0	n.a.	0.0	-3.2	n.a.
Other	427.1	470.0	10.0	1638.1	1704.4	4.0
Receipts	386.4	412.6	6.8	1619.3	1747.6	7.9
Surplus	-39.7	-55.0	n.a.	-2.4	54.7	n.a.
	Outlays excluding deposit insurance and spectrum auction are adjusted for payment timing shifts[1]					
Outlays	417.3	430.2	3.1	1639.3	1674.6	2.2
National defense	69.6	68.8	-1.2	273.5	269.5	-1.4
Net interest	62.9	58.8	-6.5	245.3	239.3	-2.4
Social security	92.1	93.5	1.6	369.0	380.7	3.2
Medicare	47.1	46.9	-0.5	194.3	192.8	-0.8
Medicaid	25.6	26.4	3.0	97.5	102.0	4.6
Other health	7.3	8.4	15.1	27.9	30.9	10.9
Income security	52.7	54.4	3.3	230.2	234.6	1.9
Other	60.0	73.0	21.7	201.7	224.9	11.5
Receipts	386.4	412.6	6.8	1619.3	1747.6	7.9
Individual income and payroll taxes	296.2	316.9	7.0	1266.2	1384.6	9.4
Withheld + FICA	287.3	307.1	6.9	1080.1	1168.9	8.2
Nonwithheld + SECA	13.6	15.1	11.0	279.9	315.7	12.8
Refunds (-)	4.7	5.3	11.6	93.8	100.0	6.6
Corporate	51.2	47.6	-7.1	191.3	185.0	-3.3
Gross	56.2	56.5	0.4	211.1	213.5	1.1
Refunds (-)	5.0	8.9	77.1	19.8	28.5	44.0
Other	39.0	48.1	23.4	161.8	178.0	10.0
Surplus	-30.9	-17.6	n.a.	-20.0	73.0	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, or when the first three days of a month are nonworking days. Outlays for defense, social security, Medicare, income security, and "other" have been adjusted to account for these shifts.

n.a.--Not applicable

October-December period from the year-earlier level. These figures point to little change in NIPA defense purchases in the fourth quarter.[6] In addition, NIPA federal government compensation in real terms is estimated to have been held down about $1 billion in the fourth quarter because civilian employees were given a half-day off on Christmas Eve; employee salaries--and nominal compensation--are not affected by this leave, and the corresponding price deflator is increased.

Federal tax receipts in the October-December period were 6.8 percent higher than the year-earlier level.[7] The 7 percent growth in individual income and payroll taxes was fueled by the strong December inflow of withheld taxes. Withheld tax deposits reported in the Daily Treasury Statement for the January 1 through January 26 period were about 10 percent above year-earlier levels. This increase, combined with the strong December figures, suggests that bonuses may continue to be an important factor in receipts growth. The Daily Treasury Statement also reports that nonwithheld income tax receipts in the January 1-26 period increased only 5 percent over the comparable year-earlier period. A 7 percent decline in corporate income taxes in the final three months of last year reflected a sizable increase in refunds.

State and Local Government Sector

Indicators of state and local spending in the fourth quarter remain mixed. Employment jumped 80,000 in December, the largest increase since August. Much of the rise was at state and local educational facilities and appears to reflect the early timing of the survey week before most colleges and other schools began the winter holidays. Nonetheless, hiring at state and local governments has accelerated somewhat, particularly in the second half of 1998. The increase is fairly widespread across categories and likely reflects the continued strong fiscal position of most of these governments. In contrast, real construction spending by state and local governments was reported to have fallen, on average, during the first two months of the fourth quarter.

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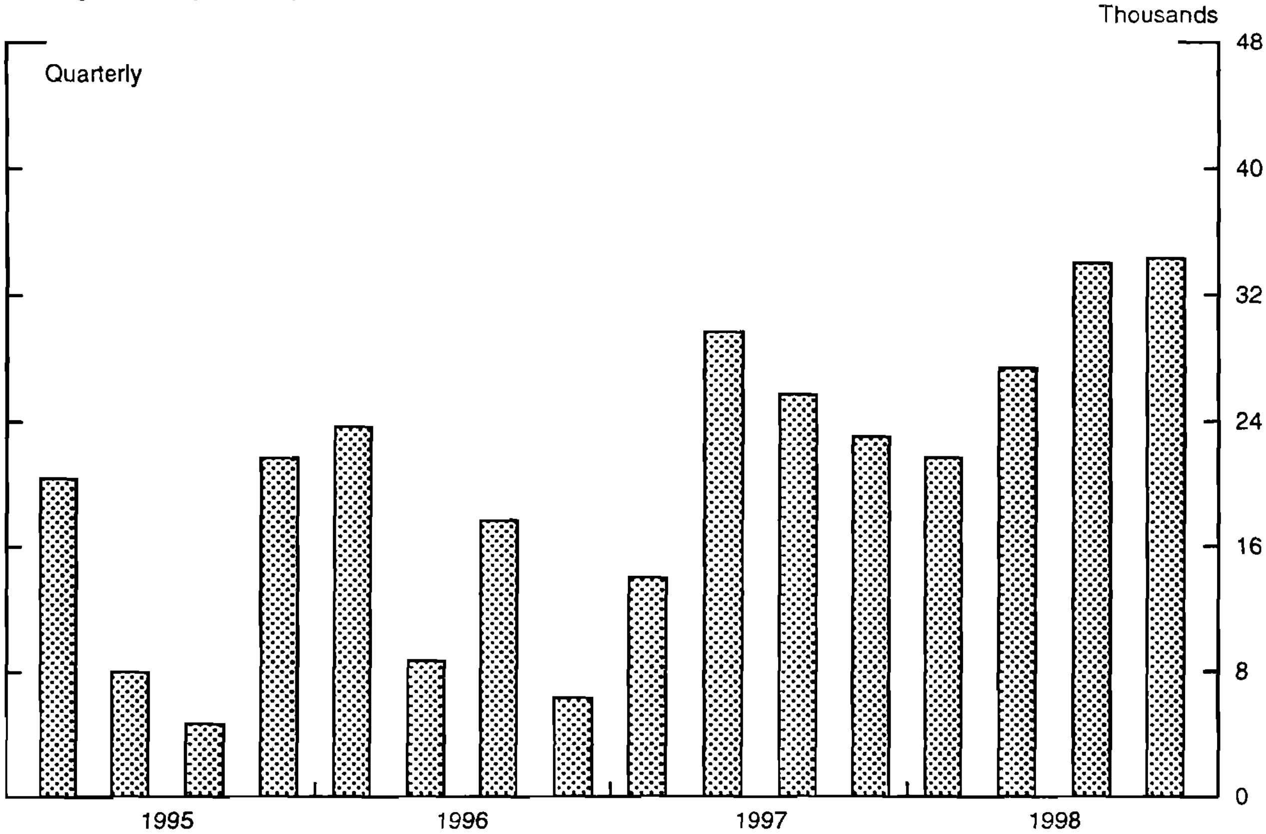
6. The bombs, missiles, and other defense expendables used in December during Operation Desert Fox will not have any effect on the NIPA defense figures in the fourth quarter. In general, if such expendables are sufficiently large in dollar value, the BEA convention is to reduce the federal government capital stock; depreciation or consumption of fixed government capital would not be affected, and, hence, GDP would be unaffected. In the case of Operation Desert Fox, the loss of expendables was deemed too small in dollar terms to make a dent in the capital stock. Over time, of course, federal defense expenditures would be affected as replacements are purchased.

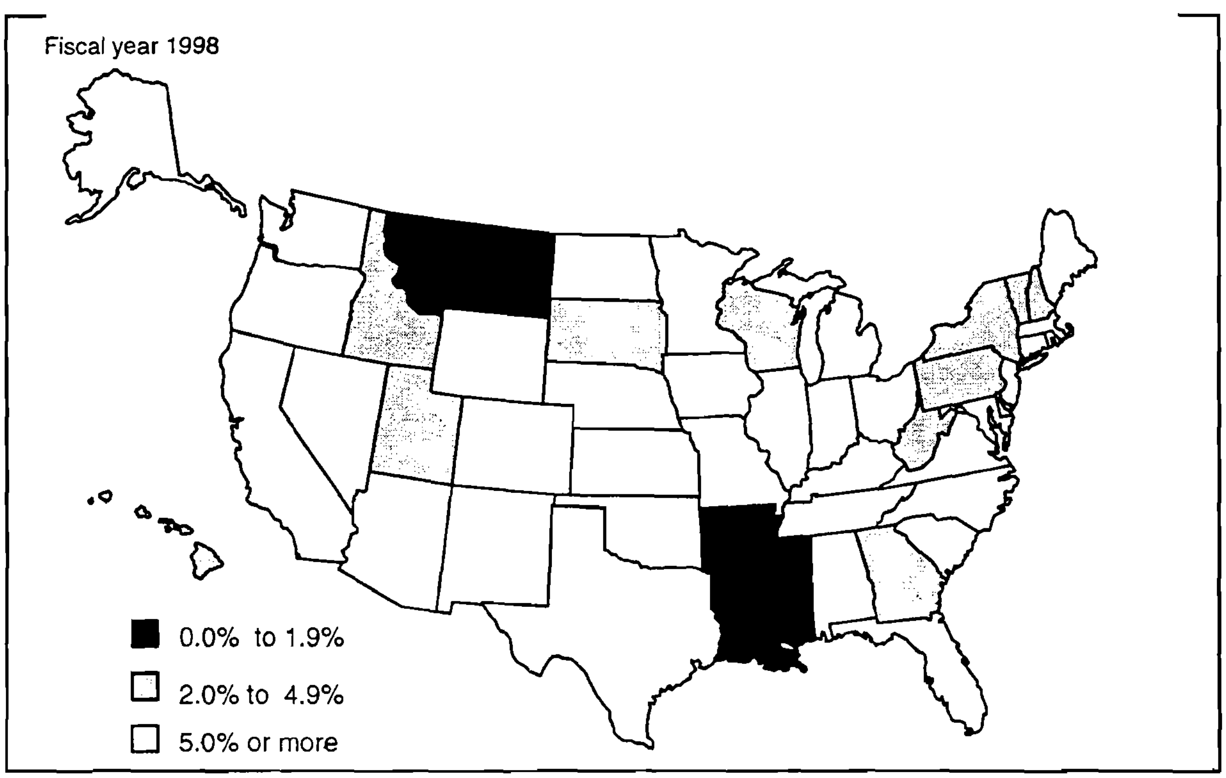
7. The large increase in "other" revenues resulted primarily from a provision of the 1997 Taxpayer Relief Act that allowed firms to defer the payment of August and September excise taxes until October; the allowance was made for 1998 only.

State and Local Sector

Average Monthly Employment Change



State Year-End Balances as a Percentage of General Fund Expenditures



Source. National Conference of State Legislatures.

In a recent survey by the National Conference of State Legislators, thirty-nine states reported that revenues came in above initial forecasts in fiscal 1998. At the same time, expenditures were nearly in line with projections, and all of the states reported positive year-end balances. Looking ahead, states are reporting continuing healthy finances in fiscal 1999--which is about half over for most states. Most states expect revenues this year to come in on target or above, although eight states and the District of Columbia are anticipating actual reductions in receipts.[8] All of the states expect to end fiscal 1999 with balanced budgets.

Prices

Inflation remains low. Over the twelve months of 1998, the consumer price index increased 1.6 percent, a shade less than in 1997. It was the best annual figure since 1986, when oil prices fell even more sharply than they did last year and the CPI rose just 1.1 percent. Excluding food and energy, the CPI increased 2.4 percent over the twelve months of 1998, up from 2.2 percent in 1997.

In December the CPI increased 0.1 percent after two months of 0.2 percent increases. Excluding food and energy, the CPI rose 0.3 percent last month after five consecutive months of 0.2 percent increases. However, in the wake of the settlement between the states and tobacco makers, tobacco prices shot up 18 percent in December; were it not for tobacco, the core CPI would have risen just 0.1 percent in December.

The CPI for food was unchanged in December, as declines for pork, poultry, and fresh fruits and vegetables offset increases elsewhere. Over the twelve months of 1998, food prices rose 2.3 percent, about the same pace as core prices and a somewhat faster pace than in 1997. That outcome is a little puzzling. Food prices have tended to rise less rapidly than core inflation over the past decade or so, and the big declines in farm commodity prices in 1998 seemingly should have reinforced that tendency, even though the farm share of the food market basket has declined further this decade. Rising labor costs in the food industries do not seem to explain the discrepancy: The past year brought larger increases in hourly earnings in some food industries but smaller increases in others and a deceleration overall. Because the lags between farm prices and food prices are not altogether predictable, the effects

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8. The eight states are Alaska, Connecticut, Hawaii, Iowa, Kansas, Ohio, Vermont, and Wyoming. The expected decreases are less than 2 percent in six of the states and generally can be explained by tax cuts or conservative forecasts. The biggest drops are in Alaska, reflecting weaker oil prices, and in Vermont, where one-time general fund revenues will not continue.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1998		1998	
	Dec. 1997	Dec. 1998	Q3	Q4	Nov.	Dec.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	1.7	1.6	1.7	2.0	.2	.1
Food (15.3)	1.5	2.3	2.8	2.9	.1	.0
Energy (7.0)	-3.4	-8.8	-5.6	-3.0	.0	-1.4
CPI less food and energy (77.7)	2.2	2.4	2.3	2.3	.2	.3
Commodities (24.1)	.4	1.3	1.2	.7	-.1	.6
New vehicles (5.1)	-.9	.0	1.3	-1.1	.0	.1
Used cars and trucks (1.9)	-4.9	3.5	4.7	5.2	.7	-.6
Apparel (4.9)	1.0	-.7	1.7	-1.4	.0	-.8
Tobacco (0.9)	7.2	31.8	16.9	35.6	-1.1	18.3
Other Commodities (11.3)	.4	-.1	-.8	-1.1	-.2	-.0
Services (53.6)	3.0	3.0	2.7	2.8	.3	.2
Shelter (29.4)	3.3	3.3	3.2	3.6	.3	.2
Medical care (4.4)	2.9	3.2	3.6	2.6	.2	.2
Other Services (19.8)	2.6	2.4	1.7	1.7	.2	.1
PPI						
Finished goods (100.0)[2]	-1.2	-.1	-.2	1.2	-.2	.4
Finished consumer foods (23.2)	-.8	-.1	1.2	.2	-.5	-.1
Finished energy (13.6)	-6.4	-12.1	-9.0	-4.8	-1.2	-2.3
Finished goods less food and energy (63.2)	.0	2.4	1.1	2.9	.1	1.0
Consumer goods (38.0)	.3	4.1	2.1	4.0	.1	1.7
Capital equipment (25.2)	-.6	-.1	-.1	.7	.1	-.1
Intermediate materials (100.0)[3]	-.8	-3.1	-2.1	-3.1	-.2	-.6
Intermediate materials less food and energy (81.8)	.3	-1.5	-1.3	-2.7	-.2	-.2
Crude materials (100.0)[4]	-11.3	-17.6	-17.9	-10.3	-1.4	-3.8
Crude food materials (42.1)	-4.0	-10.8	-17.1	-.7	-1.9	-3.4
Crude energy (36.4)	-23.1	-26.5	-21.7	-13.1	.0	-5.2
Crude materials less food and energy (21.5)	.0	-16.0	-14.0	-23.4	-2.5	-2.0

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.

of declining commodity prices may yet show through more strongly in the months ahead.

Consumer energy prices fell 1.4 percent in December. Prices of gasoline, heating oil, and natural gas all fell, while electricity rates were unchanged. For 1998 as a whole, energy prices fell 9 percent, primarily the result of lower world oil prices.

The CPI for commodities other than food and energy rose 0.6 percent in December, but excluding tobacco products as well, it would have fallen 0.2 percent last month. Used car prices dropped 0.6 percent in December after three months of rapid increases, and apparel prices registered a steep decline. Although apparel prices frequently are plagued by seasonal adjustment problems, December's decline does not appear to reflect such difficulties. Over the twelve months through December, commodity prices excluding food and energy rose 1.3 percent; excluding tobacco too, the increase was just 0.1 percent.

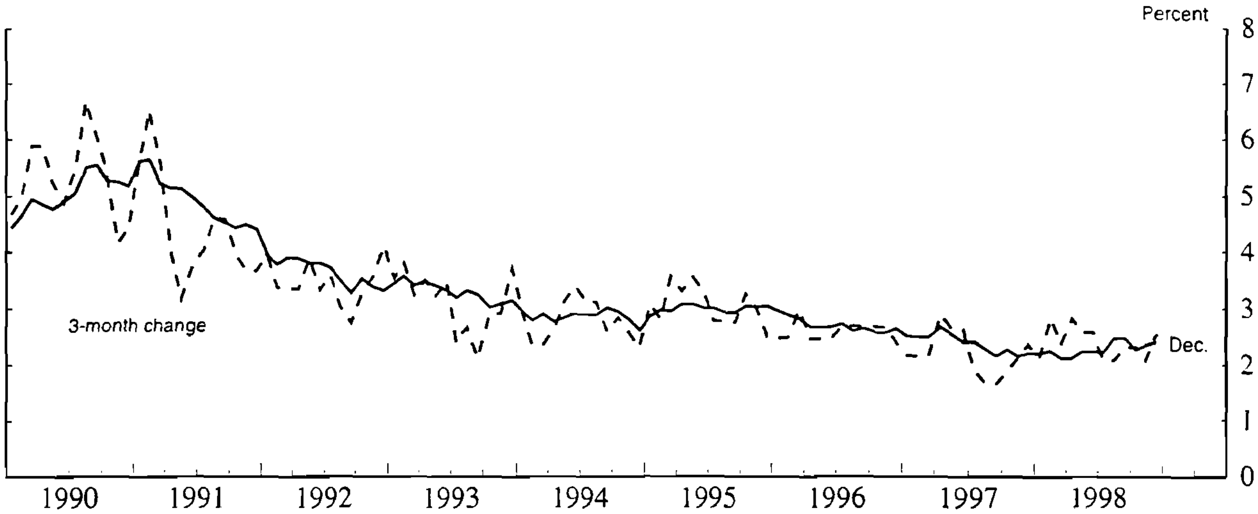
In 1998, prescription drug prices in the CPI increased 5 percent on a twelve-month change basis, up from a 2-1/2 percent rise in 1997. Because the CPI only captures out-of-pocket spending on prescription drugs, the weight of prescription drugs in the CPI is quite small--0.8 percent--and thus this pickup did not have a discernible affect on the overall index. However, prescription drugs play a bigger role in the costs of insurers, and the acceleration in prescription drug prices is reported to be having a more important effect on health insurance costs.

The index for services other than energy rose 0.2 percent in December after a 0.3 percent increase in November. The index for shelter was up 0.2 percent in December, as a 0.3 percent rise in owners' equivalent rent was partly offset by a reduction in the price of lodging-away-from-home. Airfares rose 1.0 percent after having dropped 2 percent in November. Over the twelve months of 1998, non-energy services prices increased 3.0 percent--the same rate as in 1997.

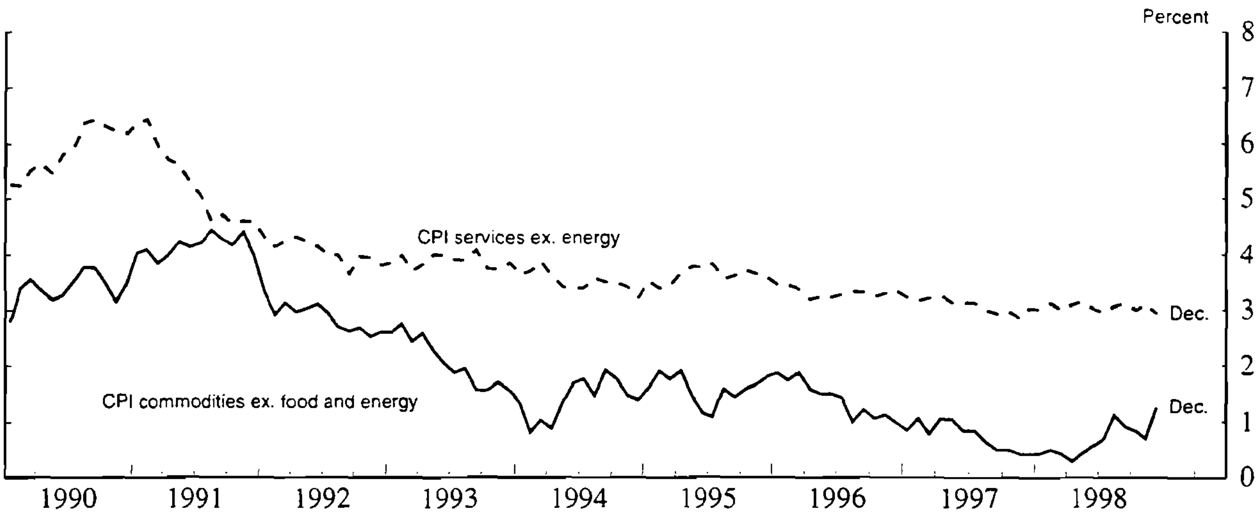
For the four-quarter period ending in the third quarter of 1998, the chain price index for GDP rose 1.0 percent, about ½ percentage point less than the increase in the CPI. While rapidly declining capital equipment prices have been one factor contributing to the lower pace of GDP inflation, the chain price index for personal consumption expenditures has also increased less than the CPI: Over the four quarters ended in the third quarter of last year, the PCE chain price index increased 0.7 percent, nearly 1 percentage point less than the rise in the CPI over this period. We expect part of the divergence

Measures of Core Consumer Price Inflation
(Twelve-month change except as noted)

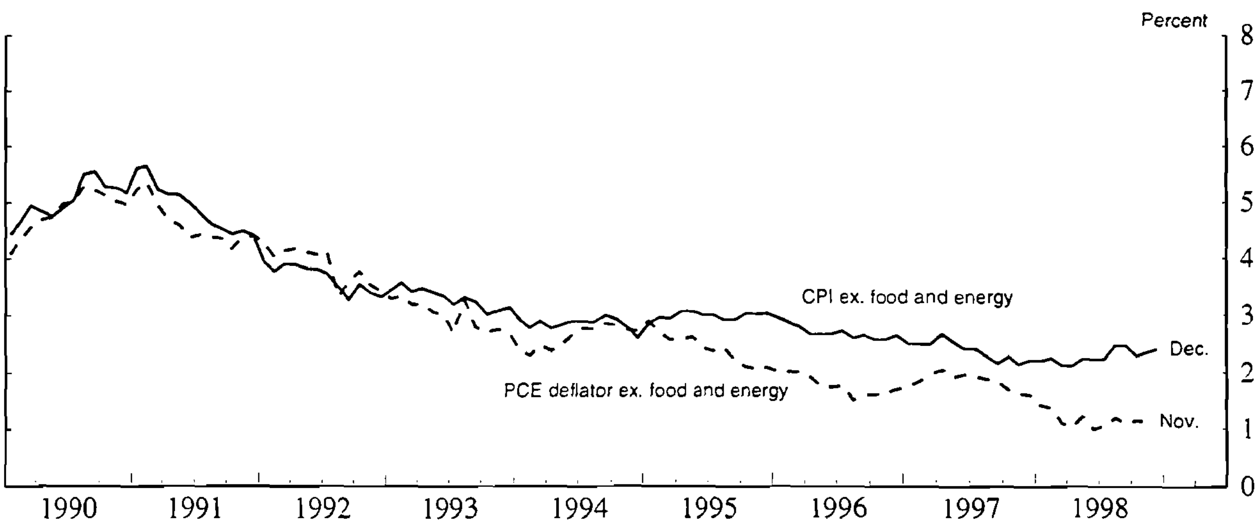
CPI Excluding Food and Energy



CPI Services and Commodities



CPI and PCE



(0.2 percentage point) to narrow this year as a result of the Bureau of Labor Statistics' adoption of geometric weighting of entry-level items; PCE prices already incorporate the geometric-weighted CPIs that the BLS has published on an experimental basis. Beyond that, PCE prices have been held down of late by unusually rapid deceleration in prices of some components (such as imputed service charges) that are poorly measured and extremely volatile.

Prices of capital equipment continue to be soft: The producer price index for capital equipment fell 0.1 percent in December, after a 0.1 percent increase in November. For 1998 as a whole, capital equipment prices were about unchanged. Computer prices, however, appear to have declined less rapidly in recent months than earlier in the year. The PPI for computers fell at an annual rate of 22 percent in the fourth quarter, somewhat less than the 27 percent pace of decline in the first three quarters of the year.

The PPI for intermediate materials other than food and energy fell 0.2 percent in December, about the same as the monthly declines since September. The PPI for crude materials other than food and energy dropped 2 percent in December, almost matching the declines in October and November. Prices of raw materials have been mixed since PPI prices were collected in mid-December. Steel scrap prices have rebounded in recent weeks, and prices of other metals have flattened out following steep declines in the second half of last year. Among foods, hog prices have moved up considerably since mid-December--from a very low level--while prices of most major crops have moved down further. Crude oil prices have moved up somewhat recently, although they remain at levels that are very low by historical standards.

After declining earlier this year, most measures of inflation expectations changed little in recent quarters. The median response to the Michigan survey's question on inflation expectations over the next twelve months averaged 2.4 percent in the fourth quarter, the same as in the third quarter. However, the January reading suggests an uptick in inflation expectations, but it is a preliminary figure and may well be revised. Longer-term inflation expectations have been stable recently, with the median Michigan five-to-ten-year expectations unchanged for the past year at around 2.8 percent and the Professional Forecasts ten-year expectations flat at 2.5 percent.

Labor Costs

According to the Employment Cost Index, hourly compensation of private industry workers rose at an annual rate of only 2.9 percent over the three months ended in December; the moderate rise reduced the twelve-month change in the ECI from 3.8 percent in September to 3.5 percent in December. Wages and salaries of private industry workers also increased more

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1995 Q3	1996 Q3	1997 Q3	1998 Q3
Product prices				
GDP chain price index	2.2	1.9	1.8	1.0
Nonfarm business chain-type price index[1]	1.8	1.3	2.0	0.5
Expenditure prices				
Gross domestic purchases chain-type price index	2.2	1.7	1.6	0.5
Less food and energy	2.3	1.4	1.6	0.8
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) Mean[2]	University of Michigan (1-year) Median[3]	University of Michigan (5- to -10-year) Mean[4]	University of Michigan (5- to -10-year) Median[5]	Professional forecasters (10-year)[6]
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
Q4	1.5	2.7	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.	1.5	2.6	2.5	3.2	2.8	
Nov.	1.5	2.7	2.3	3.1	2.8	
Dec.	1.6	2.8	2.5	3.2	2.9	2.5
1999-Jan.		2.9	2.7	3.3	2.9	

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.

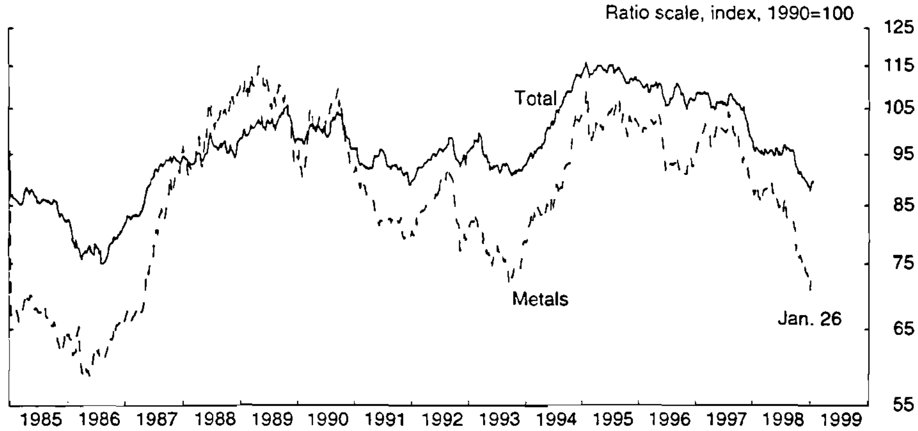
SPOT PRICES OF SELECTED COMMODITIES

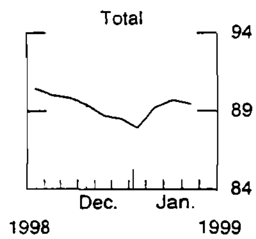
	Current price ($)	Percent change[1]: 1996	1997	Dec. 30 to Dec. 15[2]	Dec. 15[2] to Jan. 26	Memo: Year earlier to date
Metals						
Copper (lb.)	.690	-21.3	-24.3	-14.8	.0	-15.9
Steel scrap (ton)	85.167	-15.1	15.9	-47.5	17.2	-38.3
Aluminum, London (lb.)	.553	-8.5	-.6	-19.2	.3	-19.1
Precious metals						
Gold (oz.)	287.100	-4.8	-21.4	.8	-1.9	-3.9
Silver (oz.)	5.155	-6.1	28.3	-20.0	5.2	-14.3
Forest products						
Lumber (m. bdft.)	330.000	59.2	-29.6	-.7	13.8	15.8
Plywood (m. sqft.)	335.000	-3.2	-4.8	5.7	5.7	17.5
Petroleum						
Crude oil (barrel)	10.810	29.3	-31.7	-39.8	11.0	-30.8
Gasoline (gal.)	.321	27.2	-25.8	-35.8	-.2	-32.1
Fuel oil (gal.)	.316	18.3	-29.7	-34.0	-3.1	-32.6
Livestock						
Steers (cwt.)	58.000	-1.1	3.0	-14.7	.0	-9.4
Hogs (cwt.)	28.500	14.9	-36.4	-68.6	159.1	-22.4
Broilers (lb.)	.586	12.5	-21.2	18.4	.4	14.2
U.S. farm crops						
Corn (bu.)	2.075	-24.4	.2	-17.4	-1.7	-21.4
Wheat (bu.)	3.118	-12.8	-22.6	-9.1	-2.5	-15.1
Soybeans (bu.)	5.035	-3.7	-1.8	-19.6	-7.3	-25.4
Cotton (lb.)	.551	-8.7	-9.7	-7.3	-7.0	-10.8
Other foodstuffs						
Coffee (lb.)	1.045	34.7	25.4	-27.9	-15.0	-41.0
Memo:						
JOC Industrials	89.400	-4.1	-8.6	-8.9	.0	-7.4
JOC Metals	73.700	-8.3	-5.0	-17.3	.4	-17.3
CRB Futures	187.600	-.1	-3.2	-16.8	-2.1	-19.6
CRB Spot	262.720	.9	-8.4	-13.2	-1.4	-12.5

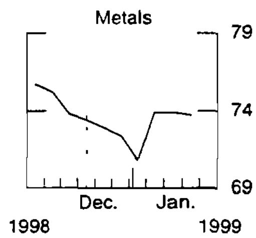
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the December Greenbook.

Commodity Price Measures

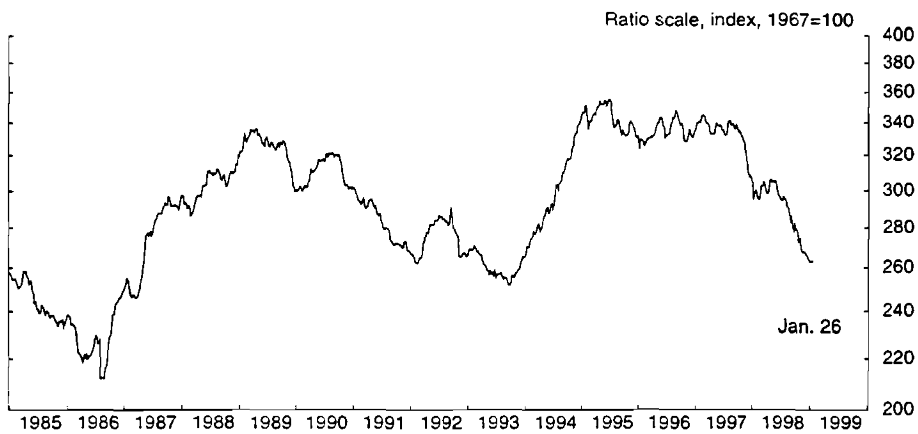
Journal of Commerce Index

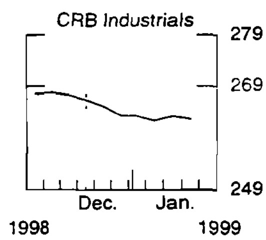




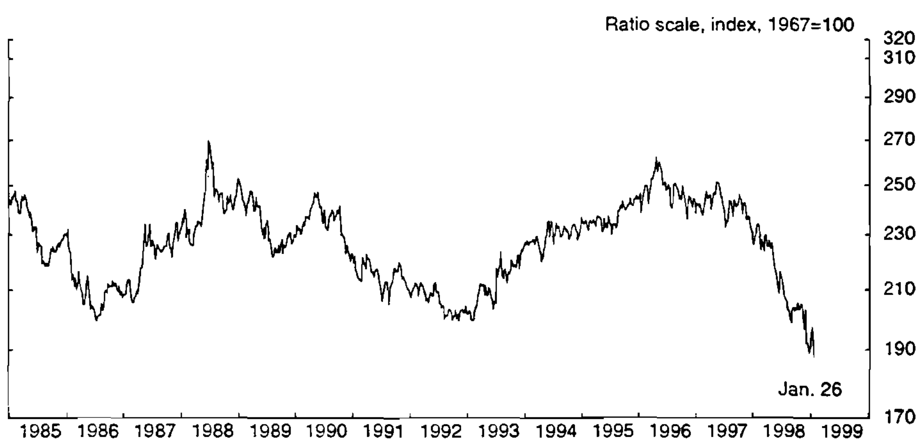


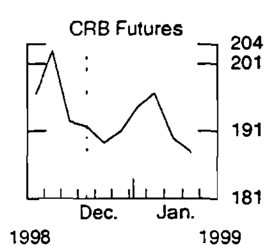
CRB Spot Industrials





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 CIBCR, 1994.

moderately in the latest three-month period, dropping the twelve-month change from 4.3 percent in September to 3.9 percent in December. In large part, the step-down reflects a more modest rise in the finance, insurance, and real estate industry, where intense activity had boosted compensation gains earlier in the year. Excluding FIRE, we estimate that hourly compensation rose 3-1/4 percent during 1998 and that wages and salaries increased 3-1/2 percent; both figures are roughly similar to their 1996 and 1997 rates.

Wages and salaries in the finance, insurance, and real estate industry rose 7 percent for a second year in 1998, continuing to outpace other broad industry categories. Wages in wholesale trade posted a significant acceleration last year, rising 5.8 percent following a 3.1 percent increase in 1997. Wages in manufacturing also accelerated last year, by 1/2 percentage point, to a 3.5 percent pace. By contrast, wages in services and in retail trade decelerated last year, perhaps reflecting the waning effects of the 1996 and 1997 minimum wage increases.

Hourly benefits costs rose at a 2.5 percent annual over the three months ended in December. Over the twelve months of 1998, the ECI for hourly benefits moved up 2.4 percent, about the same as in 1997. Beneath this steady and moderate rise are some notable cross currents. Health insurance costs increased 2.3 percent in 1998 after having risen less than 1 percent in each of the preceding three years. According to a recent survey of large employers by the Towers-Perrin consulting firm, health insurance costs will likely rise even faster in 1999 than in 1998.[9] However, benefit costs in other areas have been decelerating, to a large degree reflecting the strong economy: Costs for state-run unemployment insurance fell nearly 8 percent in 1998, as experience ratings improved with the drop in unemployment. Employer costs of retirement programs slowed to a modest 2 percent increase last year after having risen 6-1/2 percent as recently as 1996; the booming stock market cuts the costs to employers of funding defined-benefit pension plans, contributing to the deceleration in this area.

9. The Towers-Perrin survey suggests that health insurance rates rose 4 percent in 1998 and will rise 7 percent this year. The Towers-Perrin figures differ from the ECI in both coverage and concept: They survey only large firms, in contrast to the universal coverage of the ECI. And they ask about the change in the overall cost of health insurance, including both the employer's and employee's cost, whereas the ECI asks only about the employer's cost.

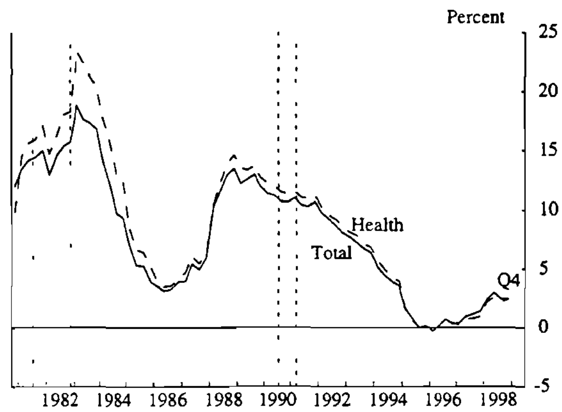
EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1997	1998			
	Dec.	Mar.	June	Sept.	Dec.
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	4.3	2.7	3.6	4.4	2.9
Wages and salaries	4.7	3.4	3.9	5.1	3.0
Benefit costs	3.8	1.1	3.1	2.8	2.5
By industry					
Construction	1.9	2.8	5.0	1.8	4.6
Manufacturing	2.1	3.0	2.1	3.5	2.0
Trans., comm., and public utilities	4.0	3.9	5.4	3.8	2.0
Wholesale trade	2.1	7.6	1.5	7.4	6.4
Retail trade	2.5	5.3	3.0	3.6	0.0
FIRE	12.8	6.7	5.1	7.7	4.3
Services	4.8	1.7	3.2	4.3	2.9
By occupation					
White collar	5.1	3.3	3.8	5.3	3.2
Blue collar	2.8	1.8	3.0	3.0	3.0
Service occupations	2.1	4.3	2.7	3.6	1.2
Memo:					
State and local governments	2.4	3.3	3.0	3.2	2.6
	-----Twelve-month percent change----				
Total hourly compensation	3.4	3.5	3.5	3.8	3.5
Excluding sales workers	3.4	3.4	3.4	3.5	3.1
Wages and salaries	3.9	4.0	4.0	4.3	3.9
Excluding sales workers	3.8	4.0	3.8	3.9	3.4
Benefit costs	2.3	2.3	2.6	2.6	2.4
By industry					
Construction	2.6	2.7	3.1	2.9	3.5
Manufacturing	2.4	2.9	2.5	2.7	2.7
Trans., comm., and public utilities	2.9	3.4	4.1	4.2	3.8
Wholesale trade	3.2	3.6	3.6	4.6	5.7
Retail trade	3.4	3.6	3.6	3.7	3.0
FIRE	6.7	6.3	7.0	8.0	5.9
Services	3.8	3.5	3.4	3.5	3.0
By occupation					
White collar	3.8	3.8	4.0	4.4	3.9
Sales	4.2	4.0	5.0	6.2	6.8
Nonsales	3.7	3.8	3.8	4.0	3.3
Blue collar	2.6	2.7	2.7	2.7	2.7
Service occupations	4.0	4.2	3.9	3.2	2.9
Memo:					
State and local governments	2.3	2.5	2.7	3.0	3.0

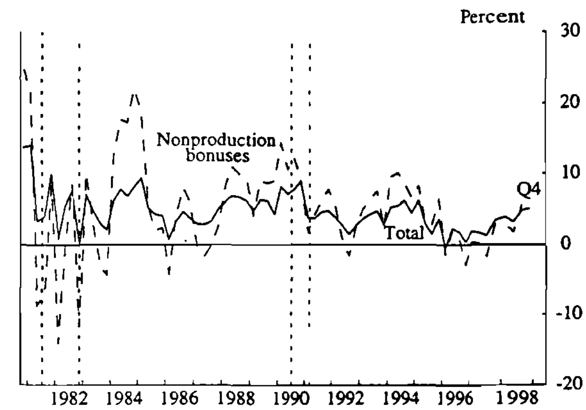
1. Seasonally adjusted by the BLS.

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

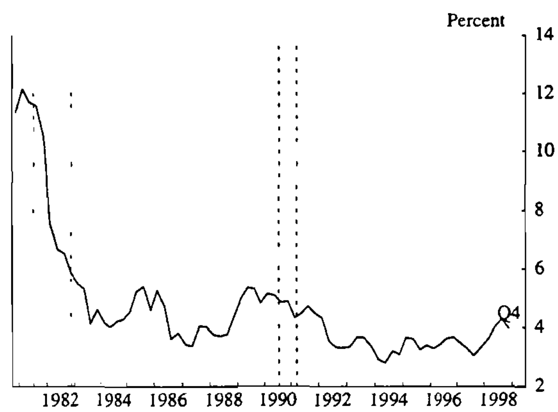
Insurance Costs



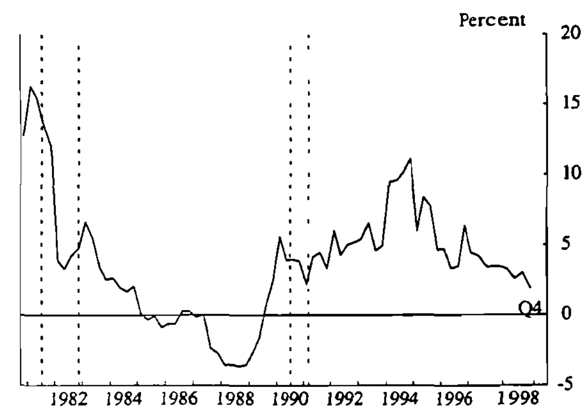
Supplemental Pay



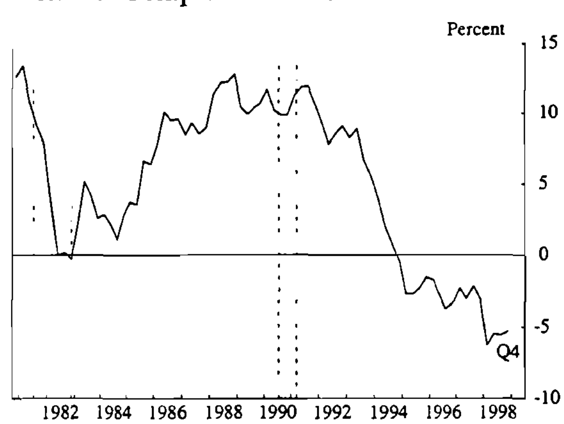
Paid Leave



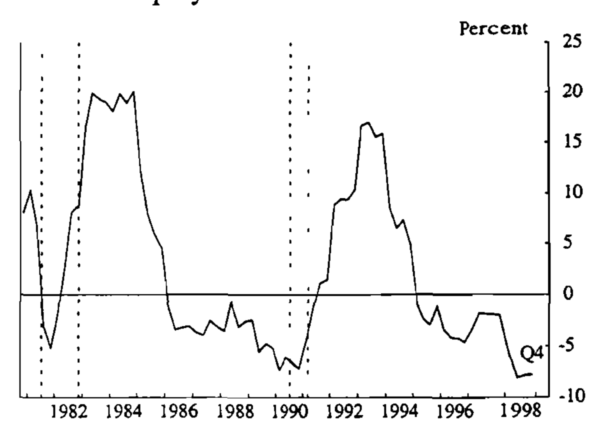
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



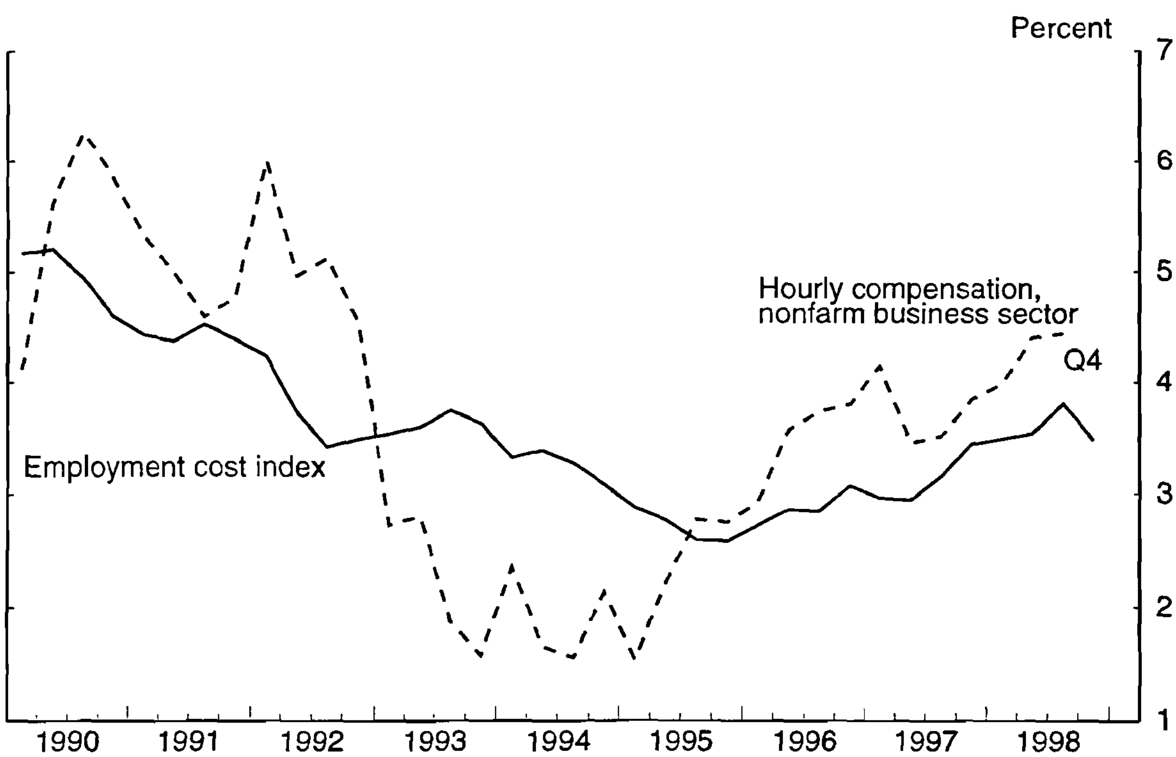
Note. Unpublished ECI benefits detail.

LABOR PRODUCTIVITY AND COSTS[1]
(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	3.1	2.0
Nonfarm business	2.1	1.7	.9	3.5	.3	3.0	1.9
Manufacturing	4.7	5.4	4.3	1.6	4.0	5.2	3.8
Nonfinancial corporations[2]	2.4	2.6	1.0	2.6	3.1	4.6	2.8
<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	4.1	4.4
Manufacturing	2.4	5.3	8.0	4.1	2.6	3.3	4.5
Nonfinancial corporations[2]	3.4	3.9	5.0	3.6	4.6	4.2	4.3
<u>Unit labor costs</u>							
Total business	1.5	2.0	4.4	.8	4.0	.7	2.5
Nonfarm business	1.6	2.1	4.0	1.1	3.7	1.1	2.5
Manufacturing	-2.2	-.1	3.6	2.4	-1.3	-1.8	.7
Nonfinancial corporations[2]	.9	1.2	4.0	.9	1.5	-.4	1.5

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.

Measures of Compensation per Hour
(Four-quarter change)



DOMESTIC FINANCIAL DEVELOPMENTS

Domestic Financial Developments

Overview
Credit markets made it through the much-feared year-end without incident, and the equity market extended its remarkable rally into 1999. The mid-January devaluation and then floating of the Brazilian *real* provided much less of a jolt to the markets than the Russian crisis in mid-August. The prospect of weaker earnings from Latin American business weighed on some companies' share prices, but the major indexes are still up on balance since the December 22 FOMC meeting--the NASDAQ by a hefty amount, led by gains on Internet and other "tech" stocks.

While the federal funds rate has remained at 4-3/4 percent, other short-term market yields have declined since the December FOMC meeting, as year-end premia in private securities unwound, and as investors were apparently encouraged that the step-up in Treasury bill issuance was smaller than expected. Long-term Treasury and private bond yields are little changed, on net, over the intermeeting period, leaving corporate and mortgage spreads over Treasuries unusually wide.

The wide spreads notwithstanding, low corporate rate levels have attracted an increasing number of issuers back to capital markets after the usual year-end lull. Partial data for January indicate that bank loans and commercial paper also have turned up after contracting in December. Total business borrowing, on net, in January appears to be near last year's pace. Gross equity issuance was robust in December, and is showing signs of rebounding from a drop-off early this year.

Borrowing by households grew rapidly in the fourth quarter. Low interest rates have continued to fuel heavy home purchase and refinancing activity, which has significantly increased mortgage debt. Consumer credit also grew at a fast clip, as expenditures on consumer durables surged.

The Treasury increased its net borrowing through bills in the fourth quarter, leading to a net paydown of coupon securities because of the modest overall need for funds. State and local debt expanded briskly, capping a year of near-record municipal issuance to raise new capital as well as to take advantage of current interest rates for advance refunding.

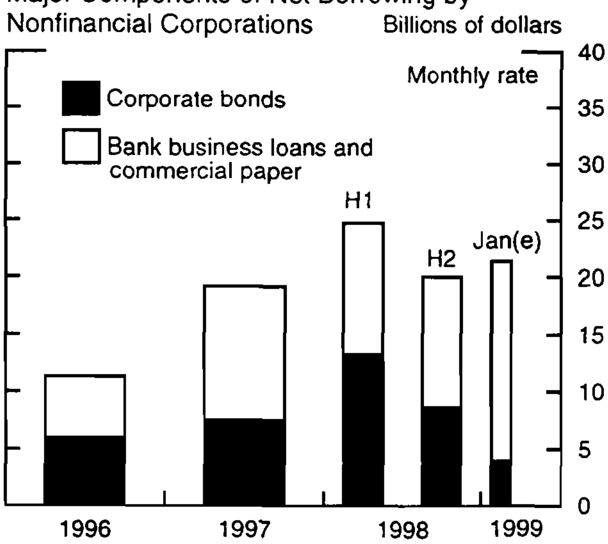
Growth of the broad monetary aggregates continued rapid in December, with much of the strength concentrated in money funds having attractive yields relative to short-term Treasury securities and in liquid deposits. Both M2 and M3 growth appear to have slowed in January. Bank credit growth decelerated around year-end, partly reflecting sluggish business lending as manybusinesses met their financing needs in capital markets. On the January Senior Loan Officer survey, domestic banks reported essentially no further

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

Type of security	1997	1998	1998 Q3	1998 Q4	1998 Nov.	1998 Dec.	1999 Jan.[e]
All U.S. corporations	69.7	85.9	70.1	82.2	106.1	73.5	59.6
Stocks[1]	9.8	10.5	6.0	8.7	8.9	8.5	4.0
Bonds	59.9	75.4	64.0	73.5	97.2	65.0	55.6
Nonfinancial corporations							
Stocks[1]	5.0	6.2	3.7	6.4	6.1	7.4	3.0
Initial public offerings	1.8	2.2	1.0	3.7	3.2	3.5	1.0
Seasoned offerings	3.2	4.0	2.8	2.7	2.9	3.8	2.0
Bonds	19.3	24.6	16.7	23.8	32.6	24.3	18.7
By rating, sold in U.S.[2]							
Investment grade	9.4	13.8	11.0	16.6	24.5	14.5	9.6
Speculative grade	8.0	9.4	4.2	6.6	8.1	8.4	8.1
Public	1.5	1.7	1.4	.4	.9	.4	.9
Rule 144A	6.5	7.7	2.8	6.2	7.2	8.0	7.2
Other (Sold Abroad/Unrated)	1.9	1.4	1.4	.6	.0	1.5	1.0
Financial corporations							
Stocks[1]	4.8	4.4	2.3	2.2	2.8	1.1	1.0
Bonds	42.6	52.5	48.3	52.2	65.6	45.0	36.9
Memo:							
Net issuance of commercial paper, nonfinancial corporations[3]	1.1	2.3	7.4	-3.3	.4	-5.2	7.9
Change in C&I loans at commercial banks[3]	6.3	6.8	8.9	5.7	.9	-8.2	

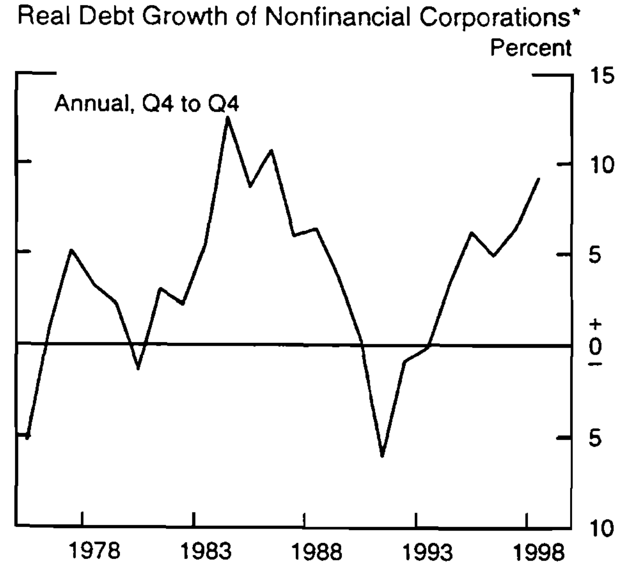
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. 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.
e Staff estimate.

Major Components of Net Borrowing by Nonfinancial Corporations



Calculated on a period-end basis. Loans include CLOs. Net corporate bond issuance is based on a staff estimate of retirements of 144(a) issues. January is estimated from data through January 27

Real Debt Growth of Nonfinancial Corporations*



*Nominal debt growth less growth in GDP chain-weight price index.

tightening of standards but a little more firming of terms on loans to both households and businesses.

Business Finance

Debt of nonfinancial corporations is estimated to have grown at an 8-1/2 percent rate in the fourth quarter of 1998--a robust pace but off from that of the first three quarters of the year. For the year, debt growth of nonfinancial corporations is estimated to have been near 10 percent; in real terms, this was the largest increase since 1986.

Since the December FOMC meeting, yields on investment-grade bonds have remained virtually unchanged, leaving spreads relative to comparable Treasuries wide by historical standards. However, the absolute level of yields is low, providing ongoing support to new issuance. Offerings of investment-grade bonds by nonfinancial corporations were sizable in December, with almost two-thirds of the funds raised earmarked to pay down commercial paper and bank loans. Issuance is estimated to have fallen in January.

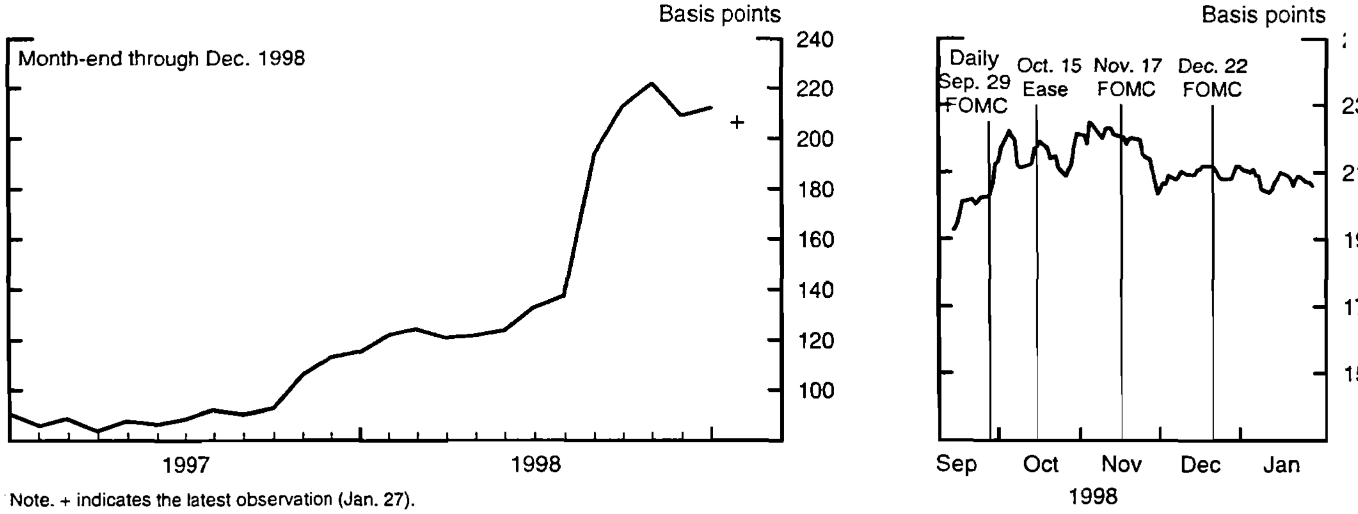
Junk bond yields and spreads relative to Treasuries have not changed appreciably since the last FOMC meeting. Activity in the junk bond market continued to pick up in December, with gross offerings at $8-1/2 billion, the most since June. The range of high-yield borrowers expanded in December to include firms in a wider variety of sectors, such as waste systems, equipment rental and leasing, health, and energy. As a result, telecommunications firms, which had accounted for the bulk of funds raised since August, made up only 20 percent of total high-yield bond issues in December. In addition, firms with bond ratings of B- and below accounted for nearly 40 percent of total junk bond issues in December, and yield spreads on the lower-rated junk issues dropped slightly, indicating that investors may have become a bit less risk-averse. High-yield offerings in January are on pace to about match December's rate. After the usual lull at the beginning of the year, the high-yield market heated up with a couple of large offerings that were upsized in response to strong demand.

Commercial paper outstanding fell sharply in December but has more than retraced that decline this month, as issuers have taken advantage of the drop in yields after year-end. Quality spreads have narrowed as well: The yield gap between thirty-day medium grade and prime commercial paper dropped back from more than 70 basis points in mid-December to a more normal level of about 20 basis points in January.

Most current indicators of credit performance for nonfinancial corporations remain favorable. The ratio of failed-business liabilities to total liabilities in 1998 was about half that reported in 1997. For nonfinancial firms with bonds

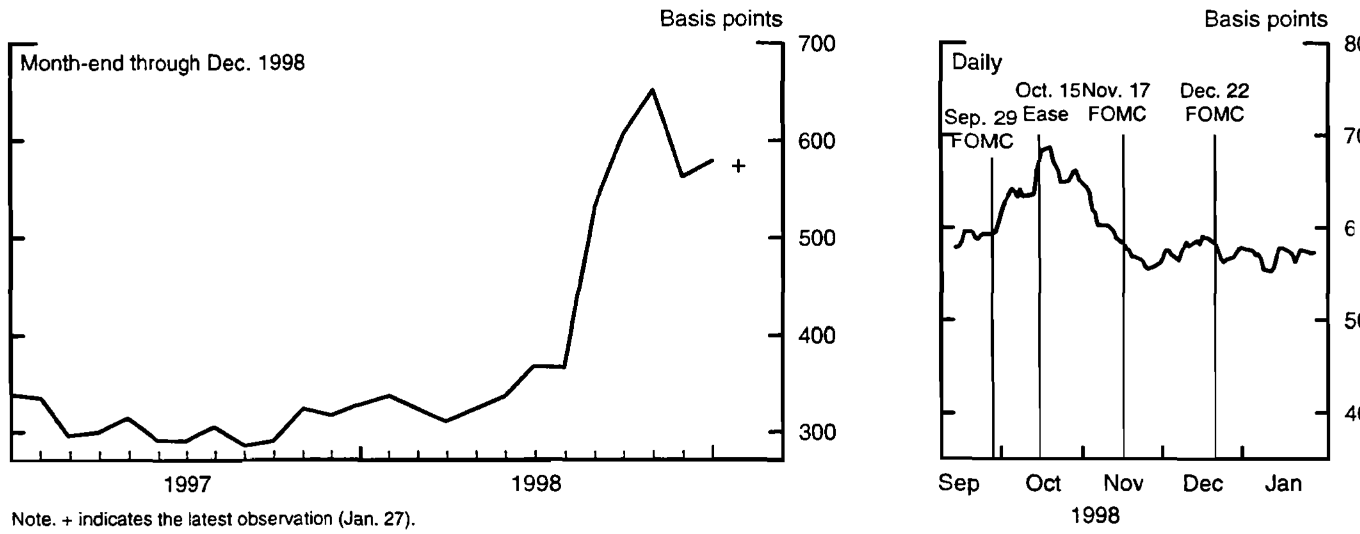
Spreads on Corporate Securities

BBB Corporate Bond Yield Less Ten-Year Treasury



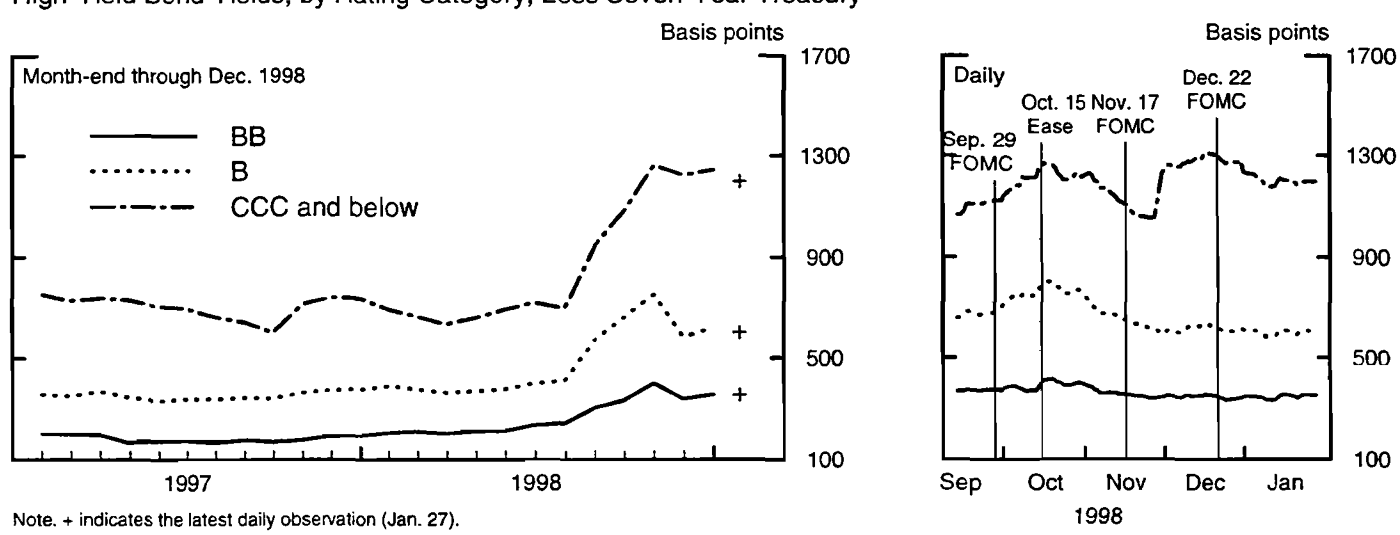
Note. + indicates the latest observation (Jan. 27).
Source. Merrill Lynch.

High-Yield Bond Yield Less Seven-Year Treasury



Note. + indicates the latest observation (Jan. 27).
Source. Merrill Lynch Master II.

High-Yield Bond Yields, by Rating Category, Less Seven-Year Treasury



Note. + indicates the latest daily observation (Jan. 27).
Source. Merrill Lynch.

outstanding, Moody's upgraded about the same amount of debt in the second half of 1998 as it downgraded, and its Watchlist of debt under review points to a small net upgrade in coming months. Median debt-to-asset ratios for nonfinancial firms increased in the third quarter (the most recent data available), especially for below-investment-grade firms, where this ratio is at its highest level since 1992. Nonetheless, the ratio of cash flow to interest expense for nonfinancial corporations has only slipped a bit, and the default rate on junk bonds outstanding only crept up in 1998.

Equity prices rose sharply after the December FOMC meeting, with the broad equity indexes reaching new highs in early January. Share prices then retreated, owing, in part, to fears related to events in Brazil and to concerns about earnings. But with a rebound in recent days, the DJIA and the S&P 500 are up 2 to 3 percent since the December FOMC meeting, while the NASDAQ is up almost 13 percent because of its heavier weight on technology firms. Internet stocks have continued to soar--they are up about 17 percent since year-end even after climbing nearly 150 percent in 1998--although some are off from their highs of mid-January.

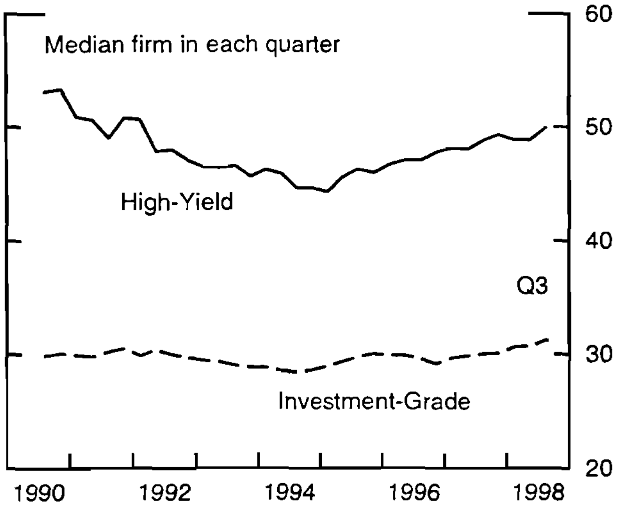
Gross public offerings of equity shares by nonfinancial corporations continued to revive in December. Equity offerings by seasoned issuers increased, with most of the proceeds used to fund acquisitions. IPO volume last month was dominated by one large issuer (Infinity Broadcasting), but the fifteen IPOs brought to market in December were twice the number in November. About half of the issuers were Internet or computer software-related firms, and the prices of these issues skyrocketed after being offered. Total issuance has been slow in January, but is expected to strengthen in light of strong investor interest and a pickup in the pace of registrations in the past two months.

Share repurchases and M&A activity, including the $48 billion acquisition of Amoco by British Petroleum, led to a record $129 billion (not at an annual rate) of equity retirements at U.S. nonfinancial corporations in the fourth quarter. Retirements are expected to remain strong, based on the continued heavy pace of share repurchase and merger announcements through year-end. As in the fourth quarter, the bulk of the pending share retirements stemming from mergers involve foreign purchases of U.S. companies, which entails the retirement of U.S. equity and its replacement with foreign direct investment in the flow of funds accounts.

About half of the S&P 500 firms have reported fourth-quarter earnings, and these reports suggest that the four-quarter growth for S&P 500 earnings per share was about zero--up from a negative 6-1/2 percent in the third quarter. This swing largely reflects a rebound in earnings of technology firms. These earnings reports suggest that NIPA economic profits will show a strong gain

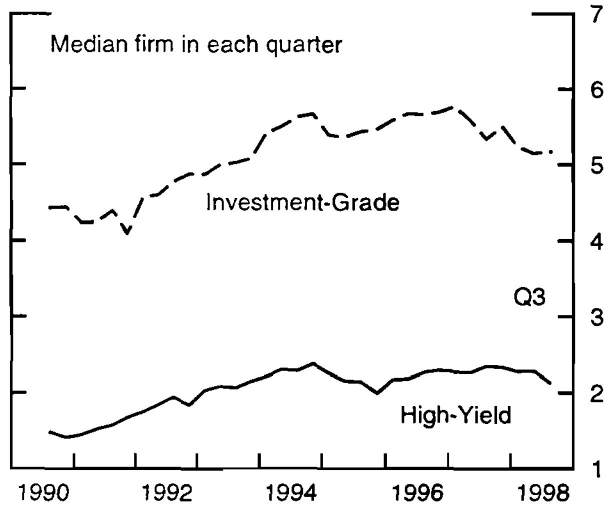
Credit Quality and Stock Prices

Debt to Assets
Nonfinancial Firms



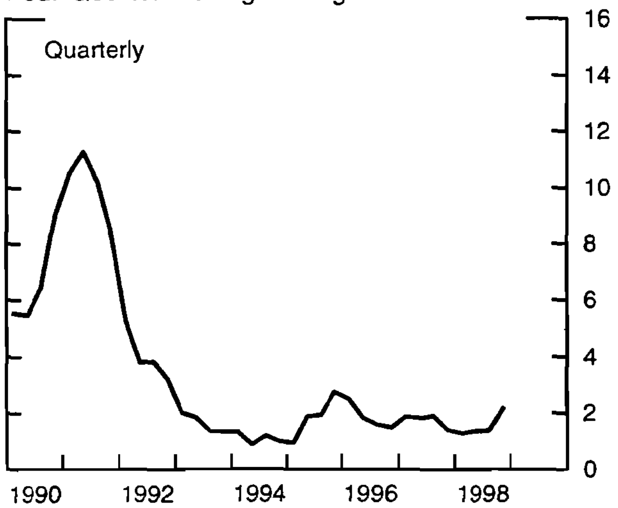
Note. Seasonally adjusted.
Source. Compustat.

Operating Cash Flow to Interest Expense
Nonfinancial Firms



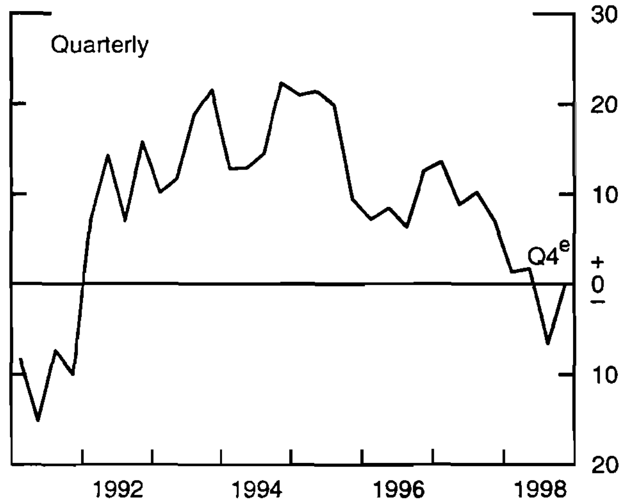
Note. Seasonally adjusted.
Source. Compustat.

Junk Bond Default Rate, US Corporations
Four-Quarter Moving Average



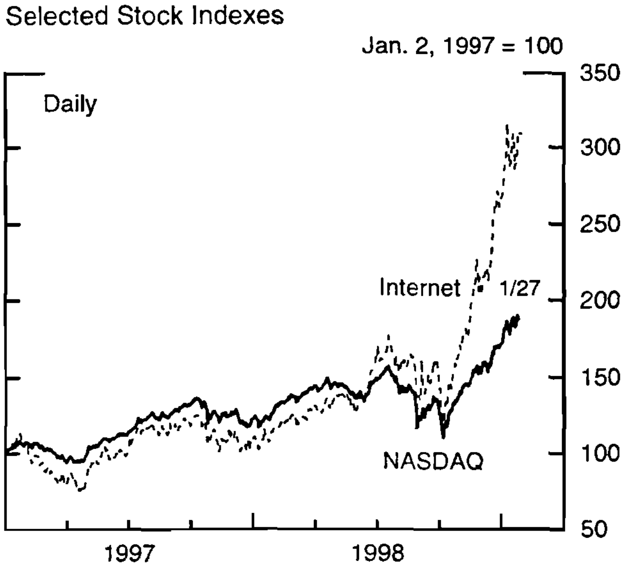
Source. Moody's.

S&P 500 Operating Earnings Per Share



Source. Goldman Sachs and IBES.

Selected Stock Indexes



Selected Stock Indexes

Percent change from last FOMC* to Jan. 27

1.	DJIA	2.4
2.	S&P 500	3.4
3.	Nasdaq	12.6
4.	Russell 2000	4.8
5.	Internet	22.3

*December 22, 1998.

in the fourth quarter relative to the third quarter, consistent with the robust domestic economic activity in the fourth quarter. Since mid-December, company analysts' projections for S&P 500 earnings growth in 1999 (on an annual average basis) have decreased only a shade, to about 16 percent; only energy producers have had their projected earnings marked down significantly.

Commercial Real Estate Finance
After a spurt in November, the issuance of commercial-mortgage-backed securities was light in December and appears to have remained so in January, a typically slow month. For the first quarter as a whole, however, market participants anticipate a healthy rebound as the overhang of mortgages originated before mid-1998 is securitized.

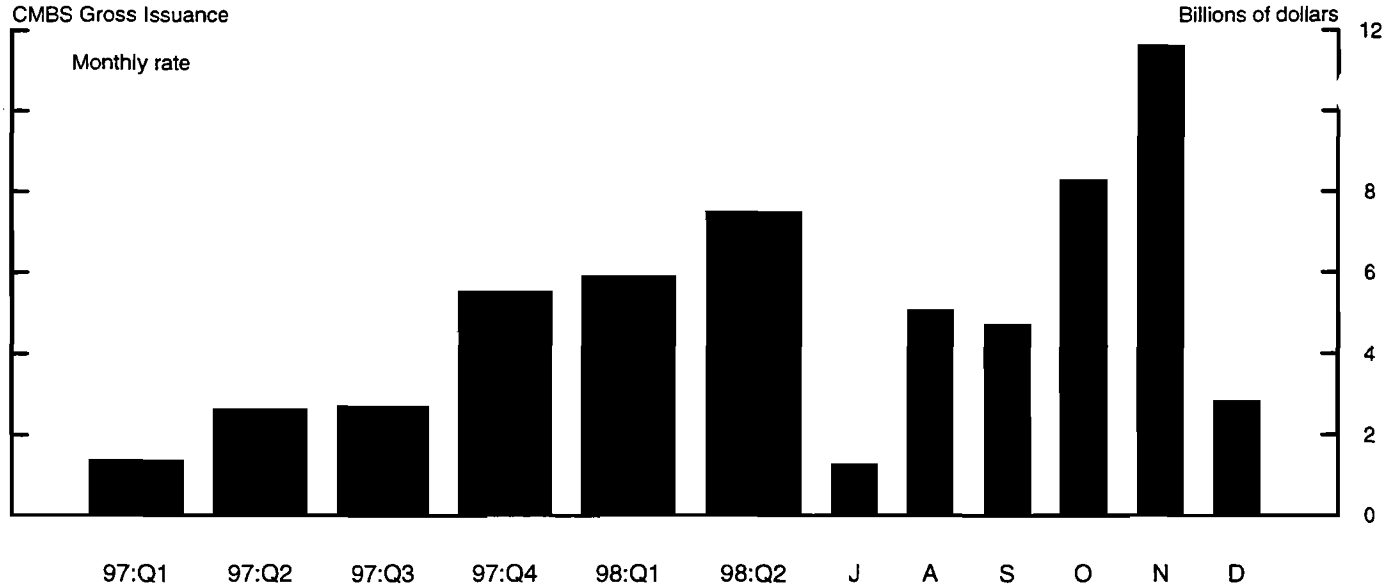
With the passing of year-end, spreads on AAA-rated CMBSs have tightened a bit, while spreads on lower-rated tranches have been unchanged or even widened slightly. Freddie Mac and some of the Federal Home Loan Banks are reported to be aggressive buyers of investment-grade securities. There are still few buyers of the subordinate tranches, and the underwriting standards for the mortgages in securitized pools remain tight relative to last summer.[1]

REIT stocks have continued to underperform the overall market: Share prices fell nearly 22 percent in 1998 and have dropped slightly further this year, with the hotel sector hit the hardest. Equity and public debt offerings by REITs are down substantially from the pace of 1997 and early 1998, and, as a result, their property acquisitions have slowed considerably. The REITs that have continued property development and acquisition have increasingly turned to alternative financing, including joint ventures with life insurance companies, pension funds, or private developers. In such ventures the partners frequently provide the initial funding, which does not show up on the balance sheet of the REIT until an agreed-upon-later date when the REIT buys out the partners.

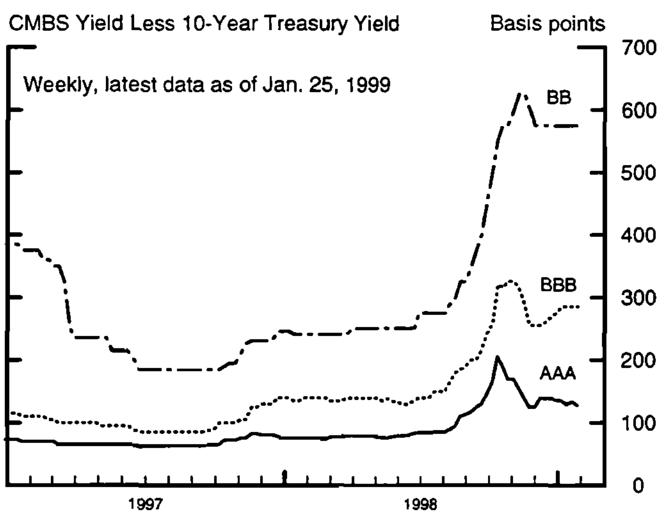
Household Finances
Household balance sheets were strengthened by the run-up in equity prices at the end of the year, and the ratio of net worth to income reached a new high. However, households showed some signs of caution in acquiring risky assets. Mutual fund shareholders added only $6 billion to domestic equity and hybrid

1. The buyer of the subordinate tranches buys all the tranches of a securitization below a certain rating--usually BB. The buyer also serves as the special servicer of the mortgage pool. One impediment to finding buyers for the subordinate tranches is that the buyer needs to be able to service mortgages. The costs of servicing and the credit risk of the issue are determined by the underwriting standards used for the underlying mortgages.

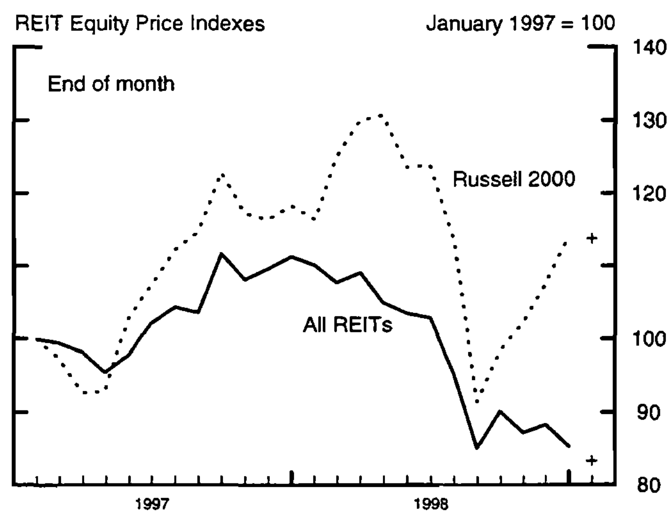
Commercial Real Estate



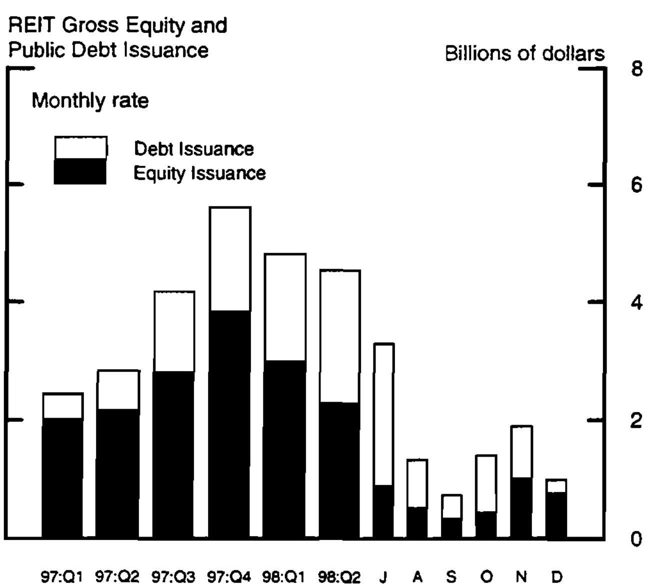
Source. Commerical Mortgage Alert.



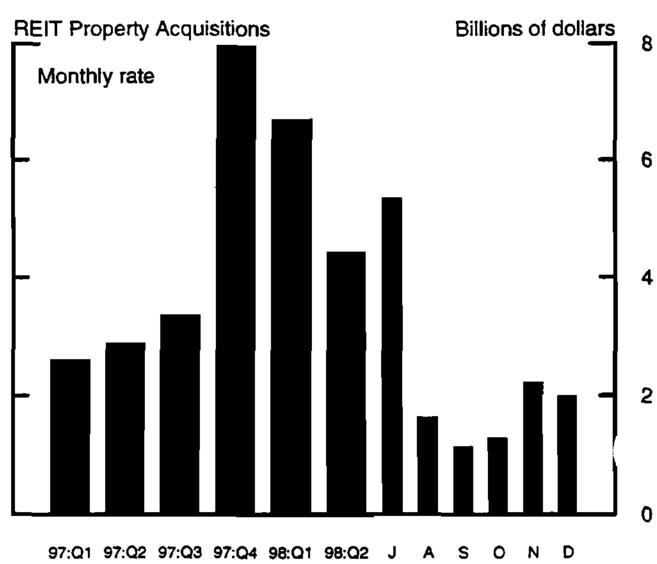
Source. Morgan Stanley.



Note. + indicates most recent daily price index (Jan. 27).
Source. National Association of Real Estate Investment Trusts.



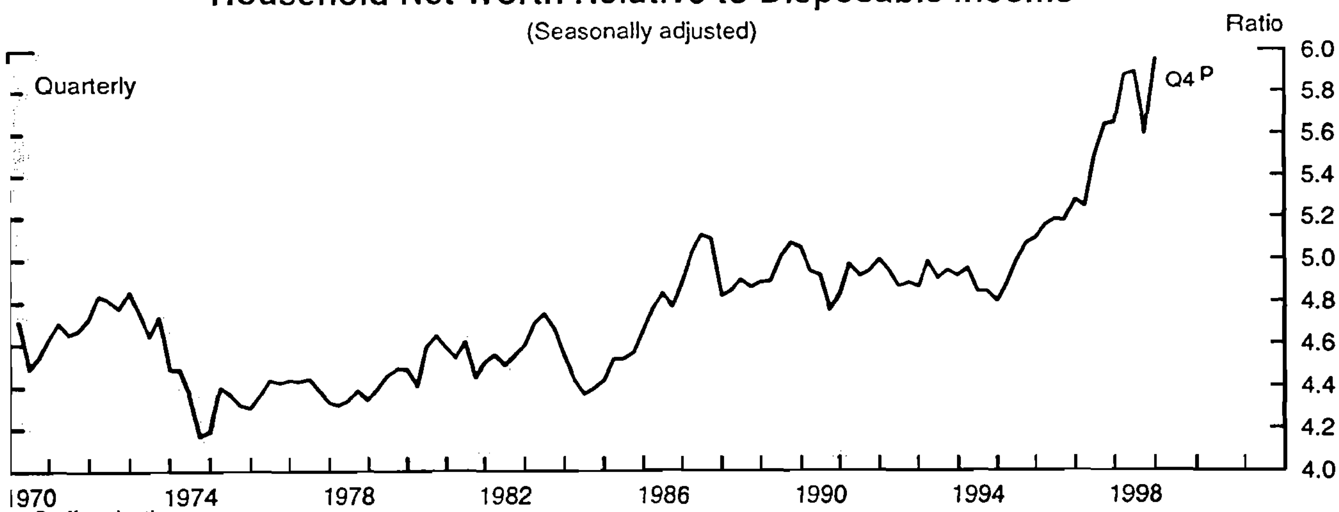
Source. National Association of Real Estate Investment Trusts.



Source. National Association of Real Estate Investment Trusts.

Household Net Worth Relative to Disposable Income

(Seasonally adjusted)



p. Staff projection.

Net Flows of Mutual Funds

(Excluding reinvested dividends; billions of dollars; monthly rates; not seasonally adjusted)

		1998					Memo: December	
	1997	H1	Q3	Oct.	Nov.	Dec.	Assets	Liquidity Ratio
Total long-term funds	22.7	29.3	10.5	7.6	22.9	7.2	4,177	4.6
Equity funds	19.0	21.1	4.7	2.5	12.8	3.4	2,981	4.8
Domestic	15.8	18.6	5.9	3.1	13.9	6.1	2,590	4.7
International	3.1	2.5	-1.2	-0.6	-1.2	-2.7	392	5.8
Hybrid funds	1.4	1.7	-0.1	-0.2	1.5	0.2	365	7.2
Bond funds	2.4	6.5	6.0	5.4	8.7	3.5	831	2.7
International	-0.1	0.0	-0.3	-0.3	0.1	-0.3	25	6.0
High-yield	1.4	1.8	-0.4	0.4	4.7	-1.0	117	4.5
Other taxable	1.0	3.5	5.3	4.7	1.8	3.6	390	2.4
Municipal	0.1	1.2	1.4	0.6	2.2	1.2	299	2.1

Source. Investment Company Institute (ICI).

401(k) Plan Contributions and Transfers

(Percent of total)

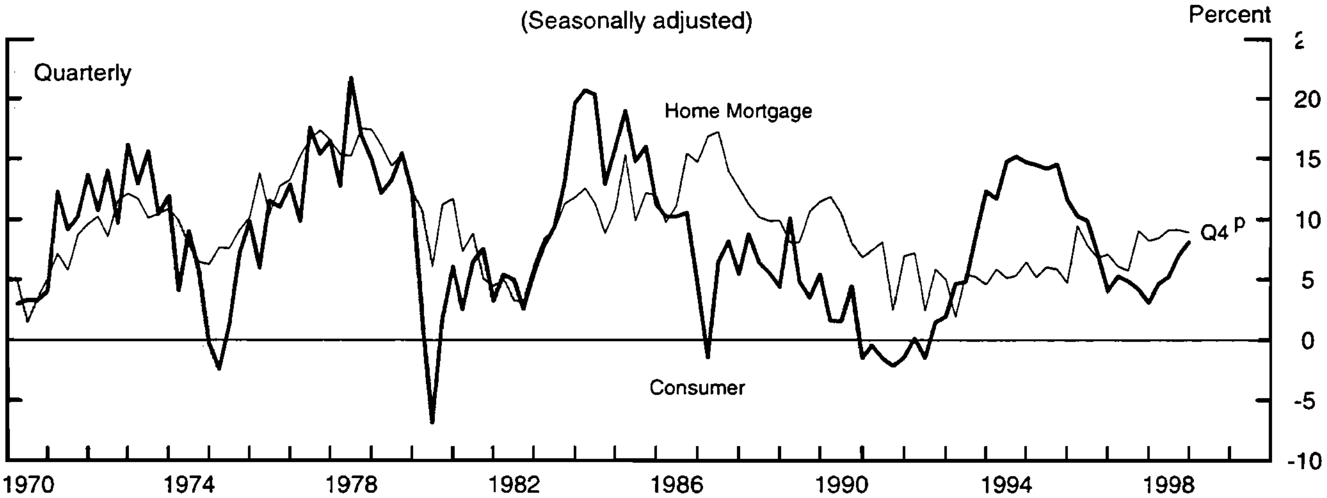
	Contributions[1]					Transfers[2]				
	1998					1998				
	H1	Q3	Oct.	Nov.	Dec.	H1	Q3	Oct.	Nov.	Dec.
Company stock	17	19	18	18	32	-35	-18	-40	-19	-30
Equity funds	47	49	49	49	37	19	-44	-46	55	-56
Domestic	41	44	44	44	33	22	-50	-45	71	-62
International	6	5	5	5	4	-3	7	-1	-16	6
Hybrid funds	13	11	11	11	9	14	-18	-5	25	-1
Fixed income[3]	23	21	22	22	22	2	80	91	-61	87

1. Allocation of new contributions to 401(k) plans; percentages sum to 100.
2. Allocation of transfers among existing assets within 401(k) plans; percentages sum to zero.
3. Includes bond and money funds and GIC/stable value investments.

Source. Hewitt Associates.

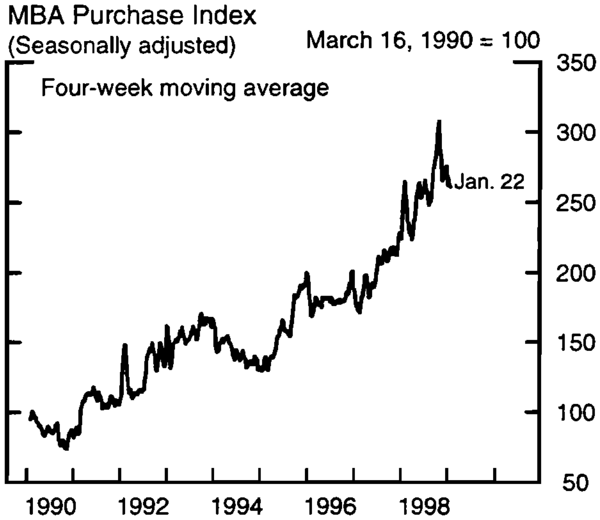
Household Debt Growth

(Seasonally adjusted)

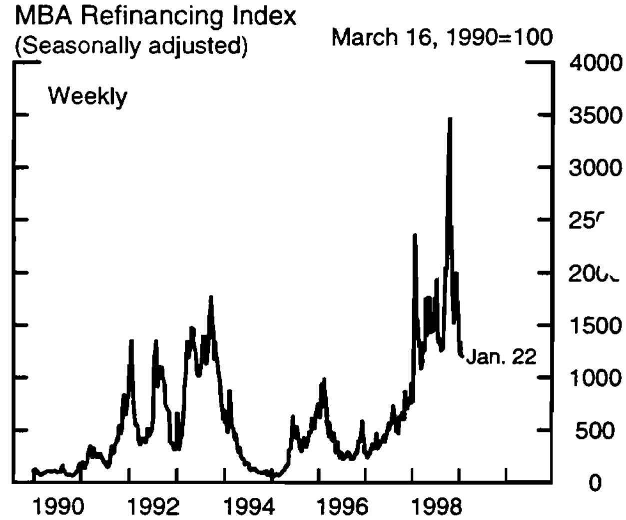


p Staff projection.

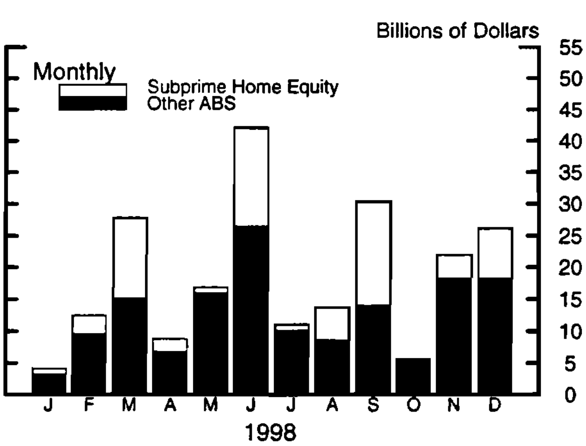
MBA Purchase Index
(Seasonally adjusted)



MBA Refinancing Index
(Seasonally adjusted)

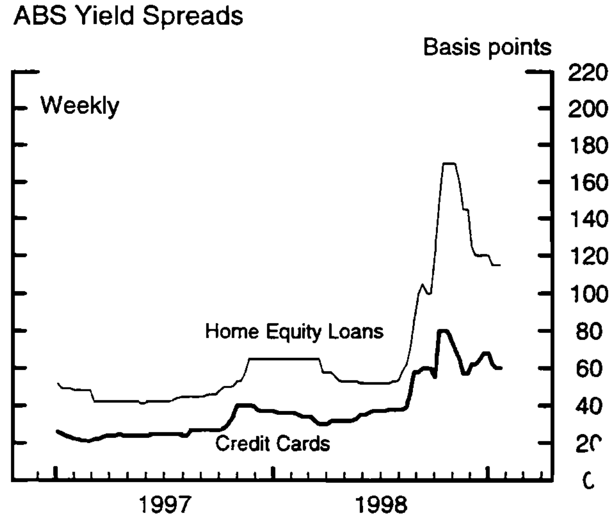


Asset-Backed Security Issuance



Note. Excludes securities backed by commercial mortgages and by first mortgages on residential properties.
Source. Inside MBS & ABS.

ABS Yield Spreads



Note. Latest observation is for Jan. 22.
Source. Salomon Smith Barney.

funds in December.[2] International funds--including both stock and bond funds--recorded outflows of almost $3 billion for the month, and $1 billion flowed out of high-yield bond funds. Likewise, 401(k) pension plan holders made some efforts to reduce their exposure to equities. Data for asset allocation decisions by 401(k) holders in December indicate that they transferred some of their existing plan assets from company stock and equity funds to fixed-income investments, although total transfer activity for the month involved only a little more than 1 percent of total plan balances.[3] Nonetheless, the allocation of new contributions to these plans was about the same as in prior months, with about two-thirds going to equity funds and company stock. Weekly mutual fund flow data for about half of January, provided by the ICI on a confidential basis, indicate that domestic equity fund inflows were modest, and international funds were still experiencing outflows. High-yield bond funds, however, experienced a resumption of inflows in early January.

Household debt grew rapidly in the fourth quarter. Reflecting high levels of both home purchase and refinancing activity, mortgage debt is estimated to have increased at a 9 percent rate in the fourth quarter. Consumer credit grew at an average 7-1/4 percent rate in October and November. December probably saw another sizable increase, given the strong spending on consumer durables, especially automobiles. Consumer credit is estimated to have accelerated in the fourth quarter, marking the fourth consecutive quarter in which consumer credit growth has risen.

Indicators of household credit payment performance remain favorable. Moody's reported that the delinquency rate on securitized credit card receivables continued its year-long decline in November. The delinquency rate at auto finance companies ticked up in November, but has fluctuated within a fairly narrow band throughout 1998.

Issuance of asset-backed securities increased in December, lifting offerings for the fourth quarter to around those of the third quarter. However, issuance of subprime home equity securities for the fourth quarter was the lowest since early 1997. This decline likely reflects a cutback in the availability of credit

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2. Flows to equity and hybrid funds are typically below-average in December, partly because households do not want to acquire the tax burden associated with the capital gains distributions made during the month. However, the net flows to these funds this December were more than 25 percent less than a year ago.

3. These monthly data are collected by Hewitt Associates, and track the contributions and transfers of a large, representative sample of 401(k) participants at large corporations. In the aggregate, 401(k) plans at large corporations represent more than half of the total assets in 401(k) plans.

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	1998					
	Q2	Q3	Q4	Oct	Nov	Dec
Total surplus, deficit (-)	**136.9**	**3.0**	**-55.0**	**-32.5**	**-17.1**	**-5.4**
Means of financing deficit						
Net borrowing	-81.8	-28.8	32.3	15.3	22.4	-5.4
Nonmarketable	15.9	10.1	8.2	3.6	1.9	2.7
Marketable	-97.7	-38.9	24.1	11.7	20.5	-8.1
Bills	-78.8	-3.5	53.3	13.6	34.2	5.5
Coupons	-18.9	-35.3	-29.2	-1.9	-13.7	-13.6
Decrease in cash balance	-44.6	33.4	21.4	2.7	20.3	-1.6
Other[1]	-10.5	-7.6	1.3	14.5	-25.6	12.4
MEMO						
Cash balance, end of period	72.3	38.9	17.5	36.2	15.9	17.5

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	Q4	Oct	Nov	Dec
FHLBs	10.5	14.7	n.a	24.1	6.5	n.a
FHLMC	7.0	32.7	54.4	13.7	21.2	19.5
FNMA	25.1	24.4	29.7	0.7	15.1	13.9
Farm Credit Banks	2.4	-0.4	n.a	-3.6	5.4	n.a
SLMA	-3.1	0.5	n.a	n.a	n.a	n.a

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

to subprime borrowers, in the wake of notable difficulties experienced by some subprime lenders and the reassessment of risk by the market late last summer. Spreads on asset-backed securities have changed little since the last FOMC meeting, and remain at relatively high levels.

Federal Government and Agency Finance

Because its overall need for borrowing was modest, the Treasury reduced the size of its weekly bill auctions from $16 billion to $15 billion in mid-December and used proceeds of bill sales in the fourth quarter to pay down coupon securities. Since year-end, short-term yields have fallen roughly 5 to 10 basis points, caused, in part, by the smaller than expected supply. Rates at intermediate and longer maturities likely have not followed short-term rates down because they have been supported by generally strong incoming data on the U.S. economy.

Fannie Mae and Freddie Mac raised another $14 billion in funds through offerings of their benchmark and reference securities in December, the proceeds of which go to finance the purchase of mortgages and mortgage-backed securities. Over the past year, Fannie Mae's and Freddie Mac's portfolios of mortgage-related assets expanded 31 percent and 55 percent respectively, as the agencies together added $190 billion of such holdings to their balance sheets. Spreads between ten-year benchmark or reference notes and Treasuries are about 60 basis points, down about 7 basis points since the last FOMC, but they are still high relative to early last summer.

Municipal Finance

Gross long-term municipal issuance increased in December to $27-1/2 billion, capping off a near-record year. Borrowing to raise new capital was strong, particularly bolstered by the financing of transportation projects in the fourth quarter. Nearly $10 billion of securities were sold to refund--currently or in the future--outstanding municipal debt. Total offerings in January are estimated to have come off this rapid pace but remain fairly strong. Rates on municipal bonds persist at unusually low levels; however, muni yields are high relative to Treasuries owing to weak institutional demand and continued investor preference for more liquid Treasury securities.

Credit quality in the municipal bond market has continued to improve across all sectors, except for issues used to finance health care facilities and some utility projects. The fourth quarter of 1998 was the twelfth consecutive quarter for which upgrades outnumbered downgrades in both number of issues and dollar amount.

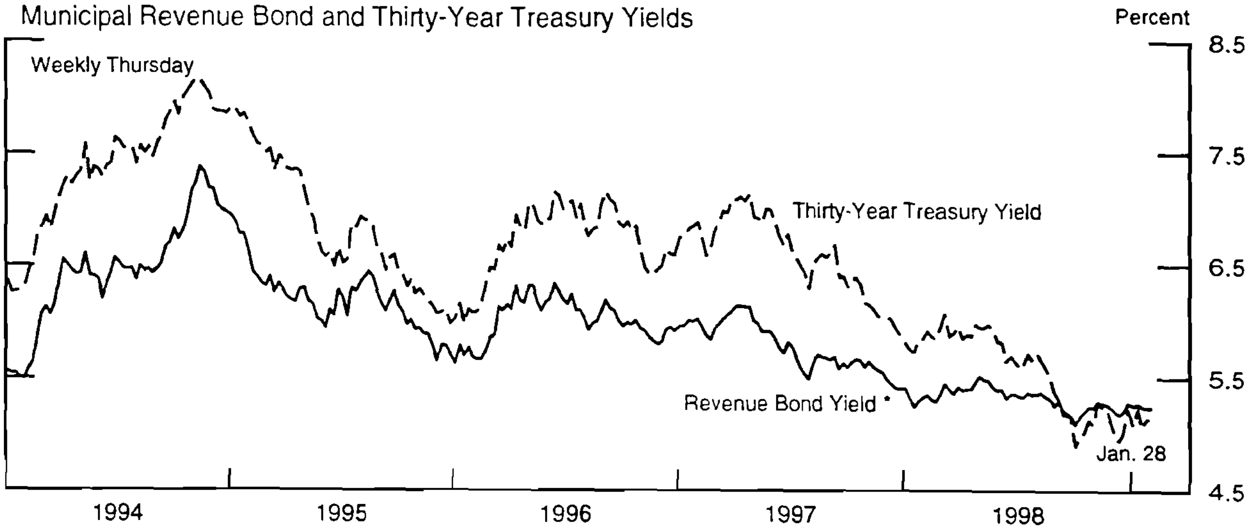
State and Local Finance

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

	1997	1998	1998 Q2	1998 Q3	1998 Q4	1998 Nov.	1998 Dec.	1999 Jan.[e]
Total tax-exempt	21.5	24.3	27.5	23.1	23.4	21.0	27.4	16.1
Long-term	17.9	21.9	24.3	20.2	21.0	19.3	24.3	14.7
Refundings[1]	6.6	8.5	8.5	8.1	7.8	6.9	9.8	4.3
New capital	11.3	13.4	15.7	12.1	13.2	12.5	14.5	10.4
Short-term	3.6	2.4	3.2	2.9	2.3	1.7	3.1	1.3
Total taxable	1.1	1.1	0.8	1.3	0.8	0.7	1.1	2.1

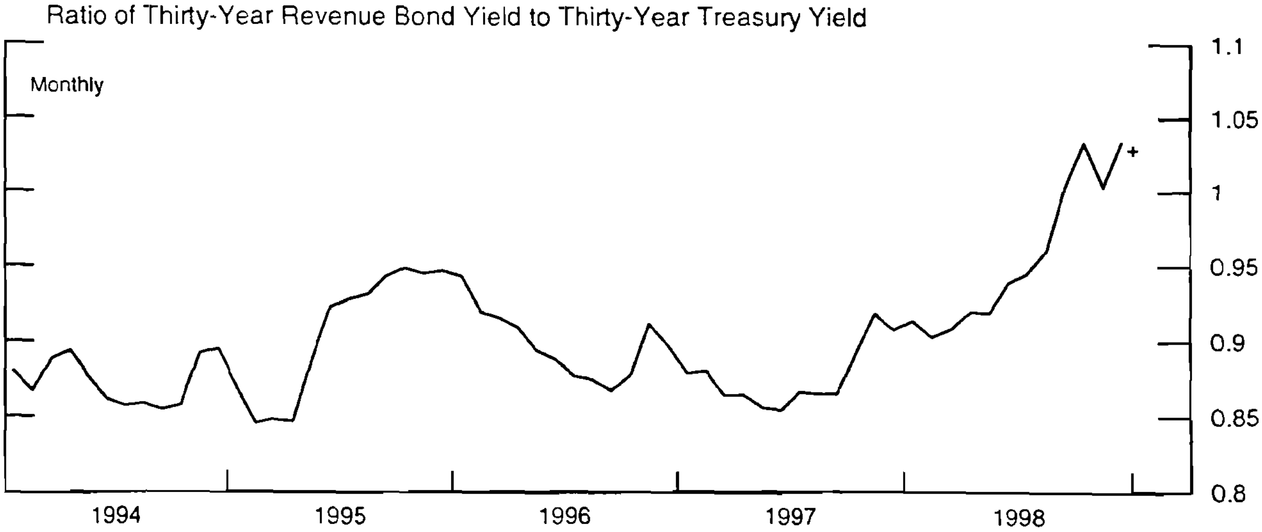
Note. Includes issues for public and private purposes.
1. All issues that include any refunding bonds.
e. Staff estimate based on data through Jan. 28.

Municipal Revenue Bond and Thirty-Year Treasury Yields



* Source. Bond Buyer.

Ratio of Thirty-Year Revenue Bond Yield to Thirty-Year Treasury Yield



Note. Average of weekly data.
Note. + indicates the latest observation (Jan. 28).

Money and Bank Credit
Growth of the broad monetary aggregates remained rapid in December, as M2 expanded at a 10-1/2 percent rate and M3 advanced at an 11-1/2 percent pace.[4] Much of the recent strength has been concentrated in money funds and liquid deposits. Money fund yields exceeded those on all Treasury bills, and although the average rates offered on bank savings accounts are not especially attractive, these accounts often are heavily tiered so that those with larger balances earn higher rates of return, with some yields matching those on retail money funds. Growth in M3 also was rapid last month, buoyed by continued hefty flows into institution-only money funds, which offered attractive yields and benefited from the persistent trend toward outsourcing of cash management functions by many corporations. Recent weekly data suggest that M2 and M3 growth may be slowing somewhat in January, although seasonal swings in late December and early January make preliminary assessments tenuous.

On balance, M2 and M3 expanded 8-3/4 percent and 11 percent, respectively, over the four quarters of 1998. This rapid growth--and the associated substantial decline in velocity--can be attributed partly to the declines in short- and long-term interest rates. However, money growth was also boosted by strong demands for liquidity and safety that accompanied the turmoil in the second half of the year, and possibly by the efforts of some households to rebalance their portfolios in light of the continued run up in equity prices.

Bank credit growth slowed markedly in December, and preliminary data in January suggest a decline. The weakness in bank credit growth has been evident in both securities and loans. Bank loans advanced at a tepid 4-3/4 percent pace in December with a decline in business loans accounting for much of this deceleration. Business loans were especially weak at Japanese institutions, but business lending at large domestic banks also dropped off, at least in part because of strong corporate bond issuance. Business loans appear to have picked up in January.

Anecdotal information suggests the bank syndicated loan market had been subdued in advance of the year-end and that banks remained cautious in their pricing of these loans. In response to questions on the January Senior Loan Officer Survey, banks indicated that the syndicated loan market still had not fully recovered, and that banks arranging syndications now require greater flexibility in adjusting loan rates during the process in order to raise the likelihood of a full subscription. Still, market contacts have noted that January typically is a fairly slow month and that there are signs of a pickup

4. All data for the monetary aggregates are reported on a post-benchmark basis and use new seasonal adjustment factors.

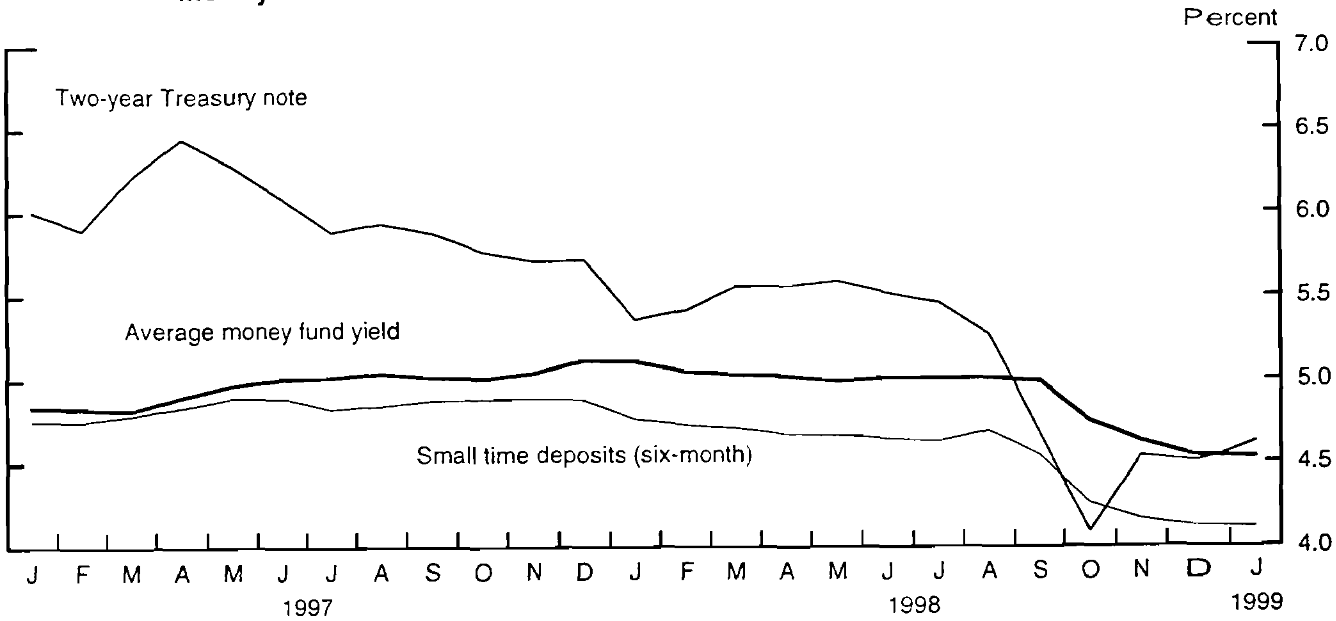
MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1998	1998 Q3	1998 Q4	1998 Nov.	1998 Dec.	1999 Jan. (pe)	Level (bil. $) Dec. 98
Aggregate	Percentage change (annual rate)[1]						
1. M1	1.8	-2.2	5.3	9.9	4.6	-5	1093.4
2. M2[2]	8.7	7.2	11.6	11.0	10.4	6	4413.4
3. M3	11.1	8.8	13.5	14.2	11.5	4	6011.3
Selected Components							
4. Currency	8.3	8.2	9.6	8.5	7.1	8	459.2
5. Demand deposits	-4.3	-11.4	.1	6.7	1.6	-29	377.3
6. Other checkable deposits	.4	-6.1	4.8	16.7	4.8	4	248.6
7. M2 minus M1[3]	11.2	10.4	13.8	11.4	12.3	10	3320.0
8. Savings deposits	14.0	14.0	15.6	15.0	17.1	13	1605.1
9. Small time deposits	-1.4	-2.4	-2.2	-2.9	-5.0	-6	951.8
10. Retail money market funds	25.4	21.3	31.9	22.6	24.2	24	763.1
11. M3 minus M2[4]	18.3	13.5	18.8	22.9	14.8	-1	1597.9
12. Large time deposits, net[5]	10.3	3.1	6.5	12.1	6.1	20	632.7
13. Institution-only money market mutual funds	34.7	26.6	41.8	42.2	29.5	-3	516.2
14. RPs	16.7	11.5	14.2	21.6	27.5	-25	294.7
15. Eurodollars	10.0	21.9	8.7	8.5	-20.6	-33	154.3
Memo							
16. Liquid Deposits[6]	8.8	7.0	11.7	13.9	13.0	5	2231.0
17. Sweep-adjusted M1[7]	6.0	3.9	7.6	10.0	7.0	-4	1406.4
18. Monetary base	7.1	6.8	8.9	8.8	8.3	15	513.1
19. Household M2[8]	10.1	8.7	12.4	11.3	11.2	9	4031.8
	Average monthly change (billions of dollars)[9]						
Memo							
Selected managed liabilities at commercial banks:							
20. Large time deposits, gross	5.1	0	8.1	12.4	4.8	11	745.0
21. Net due to related foreign institutions	2.6	7.7	7.5	-7.7	-1.2	-5	217.2
22. U.S. government deposits at commercial banks	.6	-.4	.5	3.1	-1.4	2	28.0

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.

The above monetary data incorporate revisions associated with the annual benchmark and seasonal review and are strictly confidential until released in early February.
pe--Preliminary estimate.

Money Fund Yields and Selected Other Short-Term Interest Rates



Commercial Bank Credit

(Percent change; seasonally adjusted annual rate)

Type of credit	1998	1998 Q3	1998 Q4	1999 Nov	1999 Dec	1999 Jan p	Level, Jan 1999 p (billions of $)
1. Bank credit: Reported	11.2	9.0	16.7	10.6	5.6	-2.6	4,539.3
2. Adjusted[1]	10.4	7.9	15.3	17.8	4.1	-1.1	4,420.0
3. Securities: Reported	15.0	12.7	24.9	8.8	8.9	-13.3	1,222.0
4. Adjusted[1]	12.3	8.5	20.0	37.4	3.2	-8.9	1,102.7
5. U.S. government	6.1	0.9	10.2	25.4	3.2	4.8	796.0
6. Other[2]	35.0	38.0	54.1	-20.6	19.3	-45.8	426.0
7. Loans[3]	9.8	7.6	13.7	11.3	4.3	1.5	3,317.3
8. Business	11.4	12.7	16.0	10.5	-2.7	0.0	945.2
9. Real estate	6.6	1.9	8.6	19.9	12.5	2.8	1,325.6
10. Home equity	0.4	-1.6	-2.0	3.7	-1.2	-9.9	96.4
11. Other	7.2	2.1	9.5	21.3	13.7	3.7	1,229.2
12. Consumer: Reported	-1.6	-7.1	2.5	4.8	7.2	2.9	503.0
13. Adjusted[4]	6.1	4.3	6.5	5.9	11.5	7.8	763.0
14. Other[5]	29.9	29.5	33.7	-1.8	-5.7	-0.2	543.6

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.

in new loan deals coming to market and increasing interest by institutional investors who had been on the sidelines late last year.

Through much of the third and fourth quarters of last year, banks had been rapidly expanding their securities portfolios. Banks responding to special questions on the January Senior Loan Officer Survey indicated that they viewed the return on debt securities as attractive relative to their cost of funds over this period. However, securities growth has ebbed in recent weeks, most notably at foreign (Japanese) institutions and at large domestic banks.

Available bank holding company earnings reports suggest that banks generally remained profitable in the fourth quarter, owing to strong loan growth and rising fee income. Nevertheless, many money center and some large regional banks reported earnings setbacks, mostly associated with losses on foreign operations and merger and restructuring expenses.

Appendix

January Senior Loan Officer Opinion Survey on Bank Lending Practices

The January 1999 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 the rapid growth in securities at banks in the fourth quarter of 1998 and developments in the market for syndicated commercial and industrial loans.

The survey results suggest that the broad tightening of business lending standards by domestic banks observed in the September and November surveys has largely drawn to a close; however, citing continued concern over the economic outlook, significant, though smaller, fractions of participants indicated that they had firmed terms on loans to large and middle-market businesses and standards and terms on commercial real estate loans. The share of branches and agencies of foreign banks that reported tightening lending standards and terms on business loans was large and down only a little from November; for commercial real estate loans, the share of branches and agencies reporting tighter standards and terms rose from the November survey. Some respondents, mainly domestic, indicated that demand for commercial and industrial loans had increased.

The survey found little evidence of substantial changes in lending practices with respect to households. Several banks said that they were more willing to make consumer installment loans, while modest percentages said that they had tightened standards on credit cards. Standards and terms on other consumer loans were reportedly little changed.

In responses to the additional questions, banks that had increased their holdings of securities in the fourth quarter of 1998 said that they had done so in part because of more attractive yields, a desire to increase the duration of their securities portfolios, and a willingness to boost leverage. Many respondents reported some deterioration in the condition of the market for syndicated loans--for example, its capacity to absorb new credits without significant modification of terms--relative to six months ago, although some judged the market to have improved. Many participants who originate these loans reported that they had increased the use of "flexible pricing" during the syndication period.[2]

Lending to Businesses

On net, only 7 percent of domestic respondents reported tightening lending standards for commercial and industrial loans to large and middle-market firms, and a mere 4 percent, on net, reported tightening lending standards for small firms. (In the

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1. This summary is based on a panel of fifty-five domestic respondents and twenty-three U.S. branches and agencies of foreign banks.

2. Flexible pricing is an agreement with the borrower to allow adjustments to the interest rate and other loan terms during the syndication period.

November survey 37 percent and 15 percent reported tightening standards for larger and small firms respectively.) By contrast, 56 percent, on net, of the branches and agencies of foreign banks reported tightening standards for these loans in the past three months, down only a bit from November.

Domestic respondents continued to report a tightening of business loan terms, but these reports were not so widespread as in November. For example, 31 percent, on net, reported widening loan spreads, down from 47 percent, on net, in November. The most important reasons given for tightening were a less favorable, or more uncertain, economic outlook, a worsening of industry-specific problems, and decreased liquidity in the secondary loan market.[3] Reports of tightening were much more widespread at the branches and agencies of foreign banks than at domestic banks.

In view of the general tightening of lending terms in recent months, banks were asked a special question about the share of their outstanding revolving loan commitments and other formal lending arrangements on which they would tighten terms--including fees and spreads over base rates--if the commitments were maturing and being repriced at the time of the survey. Seventy-seven percent of domestic banks reported that they would tighten terms for less than a fifth of these commitments. By contrast, over half of the branches and agencies of foreign banks--which have been tightening credit standards and terms much more than domestic banks for several months--would tighten on 80 percent or more of their outstanding commitments.

Twenty percent of domestic respondents, on net, reported increased demand for commercial and industrial loans from large and middle-market firms over the previous three months, while 11 percent reported increased demand from small firms. The most important reason given for the increase in demand, by a substantial margin, was shifting customer borrowing from other sources that had become less attractive. About 9 percent of foreign respondents, on net, reported stronger loan demand.

About 15 percent of domestic respondents, on net, reported tightened standards on commercial real estate loans, down from about 46 percent in November; similarly, fewer banks tightened terms on these loans than in the previous survey. By contrast, 57 percent of the foreign respondents tightened standards on these loans, up from 44 percent in November. The percentage of foreign banks tightening terms on commercial real estate loans also increased from the November survey. The primary reasons given by domestic banks for tightening were disruptions in the commercial mortgage-backed securities market, a less favorable, or more uncertain, economic

3. Of those domestic banks that reported tightening standards or terms on commercial and industrial loans to large or middle-market firms, only 17 percent tightened standards predominantly for middle-market firms, while 37 percent reported having tightened predominantly for large firms. The remaining half of the respondents tightened about the same for both types of borrowers.

outlook, and increased concern about the reliability of take-out financing. Foreign respondents cited these reasons and a worsening of the condition or outlook for the commercial real estate markets, a reduced tolerance for risk, and a deterioration in their parent bank's current or expected capital position. About 30 percent of the domestic and 23 percent of the foreign respondents reported an increase in demand for commercial real estate loans. The most important reason given by domestic banks for the increased demand was a shift in customer borrowing from lenders having difficulty securitizing commercial mortgages. The branches and agencies of foreign banks reported customer financing needs as the most important reason for the reported increase in demand.

Loan Syndication

In response to special questions, half of the domestic banks and two-thirds of the branches and agencies reported that the condition of the syndicated loan market--as measured, for example, by its capacity to absorb new credits without significant modification of terms--is worse now than it was six months ago, suggesting that conditions in this market may not have completely recovered from the turmoil of fall 1998. However, a significant percentage of respondents found this market not to have changed or even to have improved over this period. Among those domestic and foreign respondents that originate syndicated loans and perceive the market to have deteriorated, there has been an increased use of "flexible pricing" during the syndication period to raise the likelihood of full subscription. There was much less evidence that domestic respondents have trimmed originations in response to changes in the market for syndicated loans, or that loans on banks' books have grown faster than they otherwise would have because banks held a larger share of its originations. Branches and agencies, however, did report having reduced originations of their loans because of problems in the syndications market.

Lending to Households

About 14 percent of banks reported increased willingness to extend consumer installment loans, up slightly from the previous survey. No banks reported a decreased willingness to extend these credits. Seven percent, on net, reported having tightened standards on credit-card loans, while standards for other consumer loans were eased by one bank, on net. A few banks reported raising spreads a bit on credit cards and other consumer loans. Three quarters of respondents reported unchanged consumer loan demand, while the remaining respondents showed a small increase, on net. Credit standards for mortgage loans were little changed, and 10 percent of respondents, on net, reported increased demand for home mortgages, down substantially from more than 50 percent in the November survey and the smallest increase reported since mid-1997.[4]

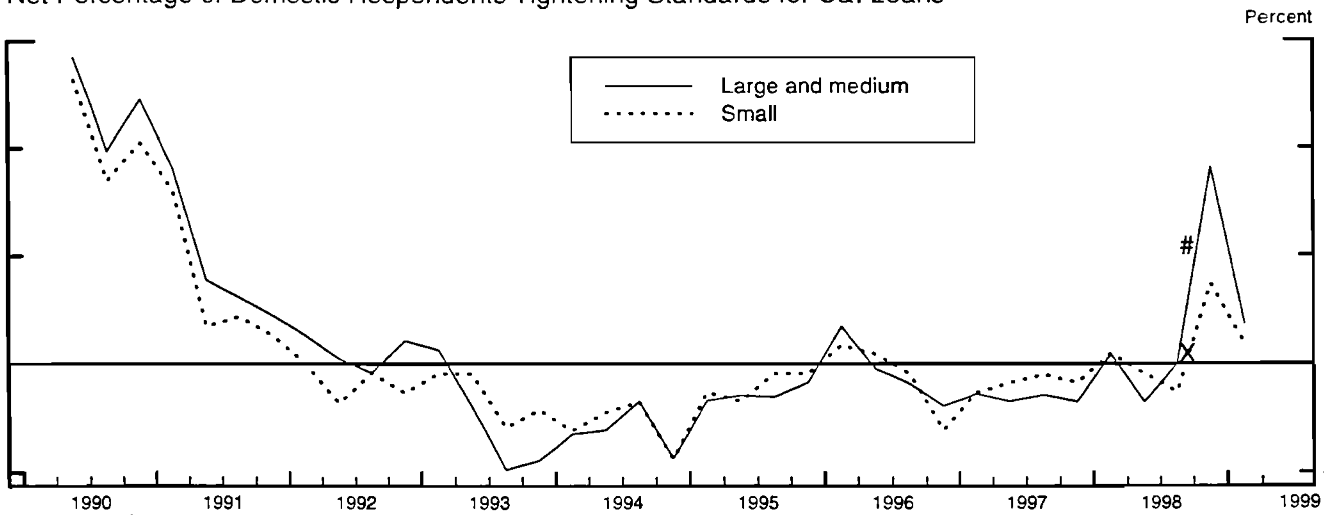
4. The wording of this question has been revised to make it clearer that demand owing to refinancing of existing mortgages is not to be considered when answering. The decline in the net percentage reporting increased demand for home mortgages may reflect, in part, this change.

In order to update staff estimates of household debt service requirements, two special questions asked about the minimum required payment on outstanding balances for credit cards now and in the late 1980s. The responses indicate that the minimum payment has declined a bit over the decade, and it is now in the range of 2 percent to 3 percent of the balance outstanding.

Growth in Bank Securities
Thirty-six percent of domestic respondents reported increasing their securities holdings in the fourth quarter of 1998, while 21 percent reduced their holdings. For those large banks that reported increased securities holdings, the most important reason given was that yields on some securities had increased relative to costs of funds, thus making the securities more attractive investments. Banks also increased holdings of long-term securities to compensate for the shorter expected duration of mortgage-backed securities resulting from the decline in longer-term interest rates in recent months and the consequent increase in prepayment risk. Small banks primarily reported the increase in prepayment risk as the reason for increasing securities holdings. Foreign respondents who had acquired securities also cited as an important reason the growing trend in securitization, which presented attractive new securities to purchase.

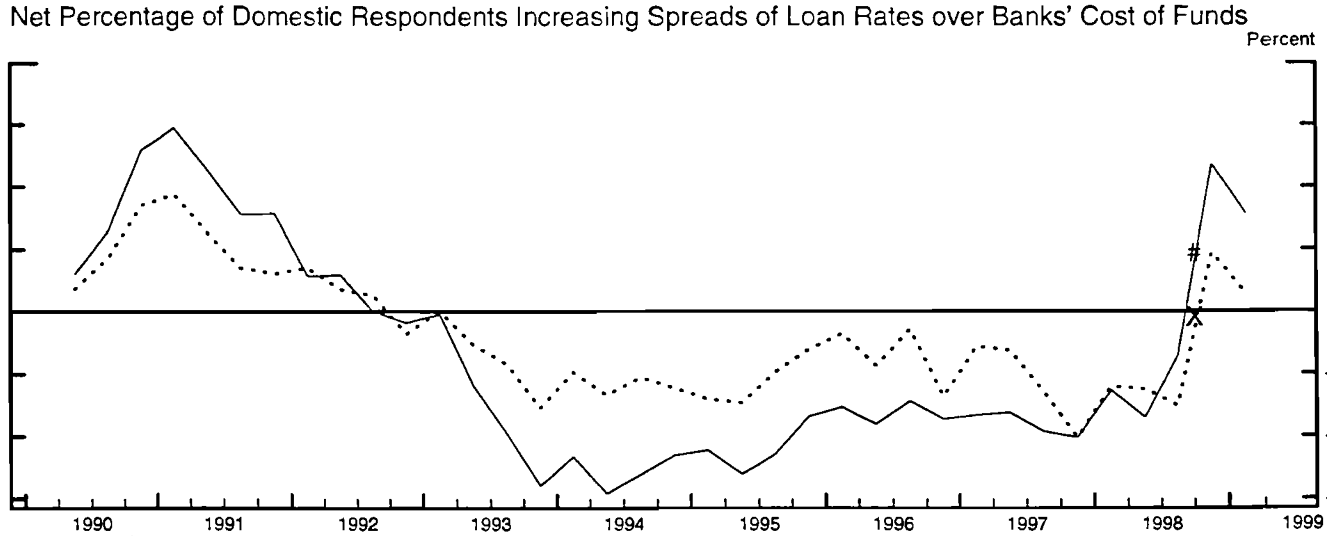
Measures of Supply and Demand for C&I Loans, by Size of Firm Seeking Loan

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



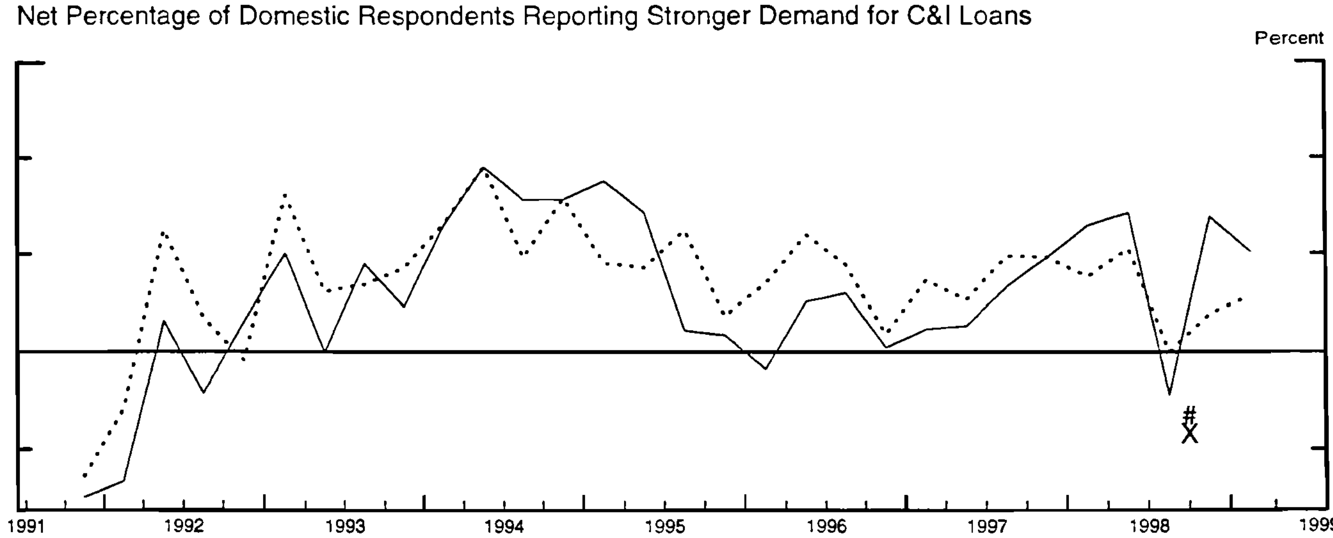
Result for September survey (large and medium)
X Result for September survey (small)

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



Result for September survey (large and medium)
X Result for September survey (small)

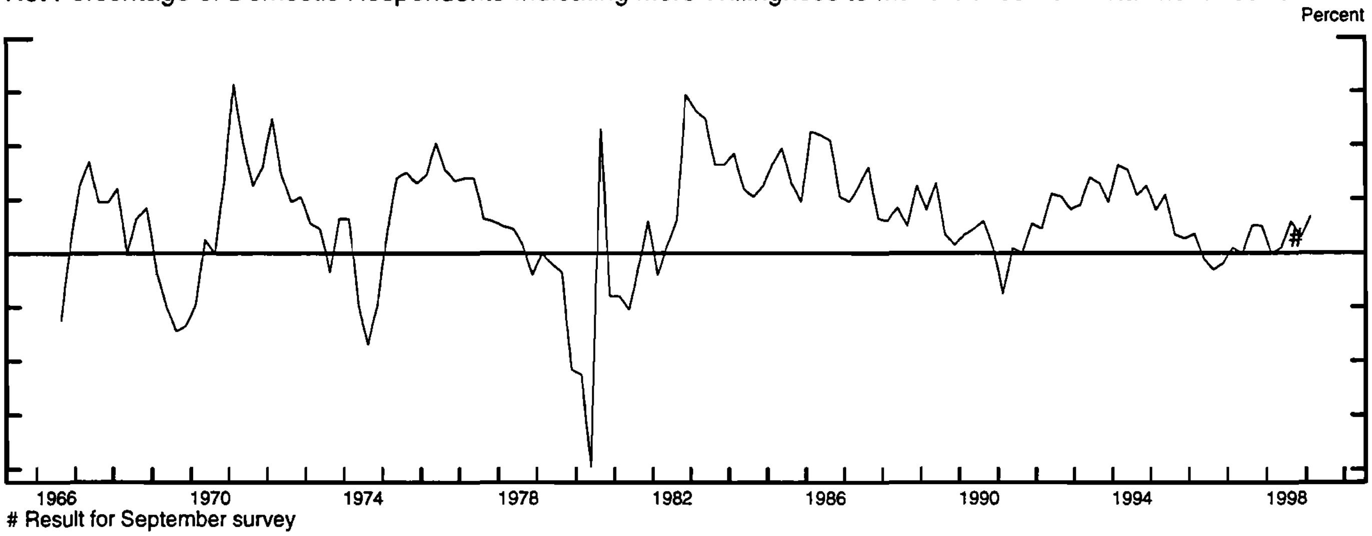
Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans



Result for September survey (large and medium)
X Result for September survey (small)

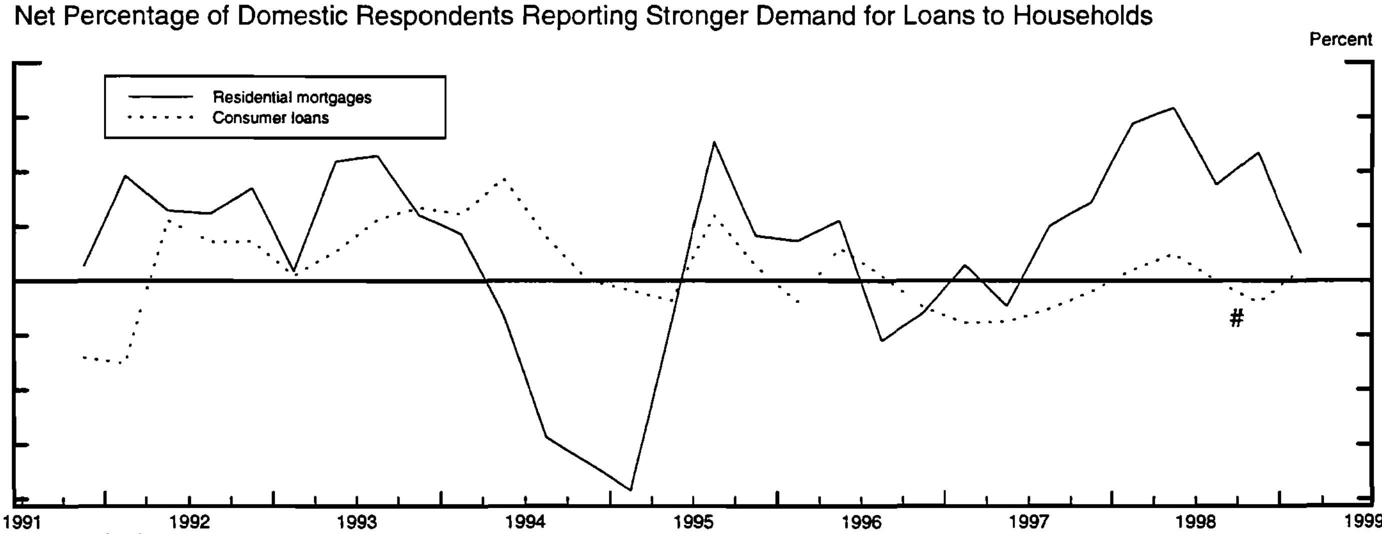
Measures of Supply and Demand for Loans to Households

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



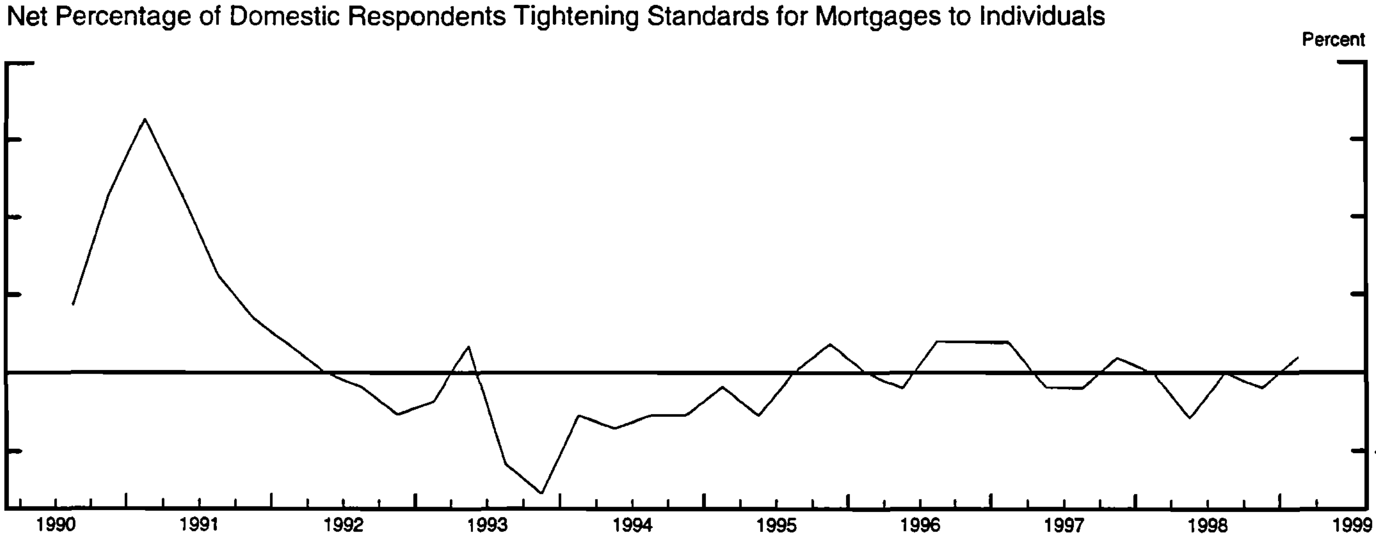
Result for September survey

Net Percentage of Domestic Respondents Reporting Stronger Demand for Loans to Households



Result for September survey (consumer loans)

Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



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Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	1998 June 30	1998 Nov. 16	1998 FOMC* Dec. 22	1999 Jan. 27	Change to Jan. 27 from selected dates (percentage points) June 30	Nov. 16	FOMC* Dec. 22
Short-term							
Federal funds							
FOMC intended rate	5.50	5.00	4.75	4.75	-.75	-.25	.00
Realized rate [1]	5.51	5.08	4.82	4.65	-.86	-.43	-.17
Treasury bills [2]							
3-month	4.97	4.41	4.42	4.36	-.61	-.05	-.06
6-month	5.04	4.42	4.43	4.31	-.73	-.11	-.12
1-year	5.10	4.34	4.33	4.31	-.79	-.03	-.02
Commercial paper							
1-month	5.54	5.13	5.37	4.80	-.74	-.33	-.57
3-month	5.47	5.09	5.01	4.75	-.72	-.34	-.26
Large negotiable CDs [2]							
1-month	5.60	5.19	5.58	4.86	-.74	-.33	-.72
3-month	5.61	5.31	5.15	4.86	-.75	-.45	-.29
6-month	5.68	5.12	5.00	4.86	-.82	-.26	-.14
Eurodollar deposits [3]							
1-month	5.56	5.19	5.50	4.81	-.75	-.38	-.69
3-month	5.59	5.31	5.13	4.81	-.78	-.50	-.32
Bank prime rate	8.50	8.00	7.75	7.75	-.75	-.25	.00
Intermediate- and long-term							
U.S. Treasury (constant maturity)							
2-year	5.49	4.56	4.56	4.57	-.92	.01	.01
10-year	5.44	4.85	4.64	4.68	-.76	-.17	.04
30-year	5.62	5.28	5.07	5.14	-.48	-.14	.07
U.S. Treasury 10-year indexed note	3.76	3.80	3.79	3.77	.01	-.03	-.02
Municipal revenue (Bond Buyer) [4]	5.36	5.28	5.21	5.24	-.12	-.04	.03
Corporate bonds, Moody's seasoned Baa	7.11	7.37	7.23	7.26	.15	-.11	.03
High-yield corporate [5]	9.20	10.62	10.49	10.47	1.27	-.15	-.02
Home mortgages (FHLMC survey rate) [6]							
30-year fixed	6.96	6.93	6.69	6.78	-.18	-.15	.09
1-year adjustable	5.68	5.56	5.55	5.57	-.11	.01	.02

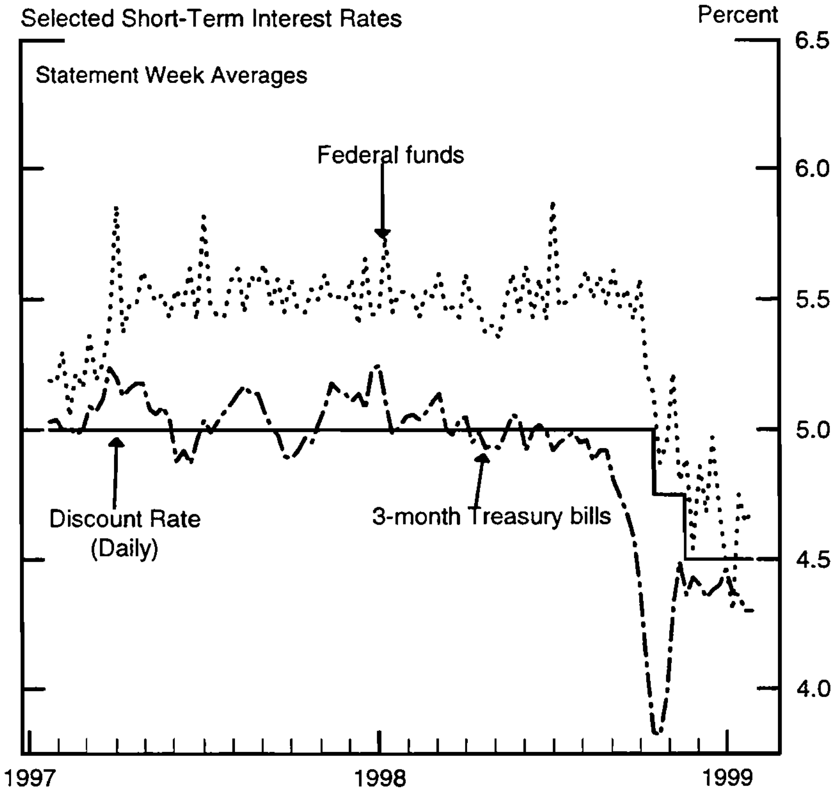
Stock exchange index	Record high Level	Record high Date	1998 Nov. 16	1998 FOMC* Dec. 22	1999 Jan. 27	Change to Jan. 27 from selected dates (percent) Record high	Nov. 16	FOMC* Dec. 22
Dow-Jones Industrial	9,643.32	1-8-99	9,011.25	8,988.85	9,200.23	-4.59	2.10	2.35
S&P 500 Composite	1,275.09	1-8-99	1,135.87	1,202.84	1,243.17	-2.50	9.45	3.35
NASDAQ (OTC)	2,433.41	1-26-99	1,861.68	2,138.03	2,407.14	-1.08	29.30	12.59
Russell 2000	491.41	4-21-98	390.42	401.83	421.12	-14.30	7.86	4.80
Wilshire 5000	11,702.09	1-8-99	10,383.89	10,956.28	11,445.57	-2.19	10.22	4.47

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.

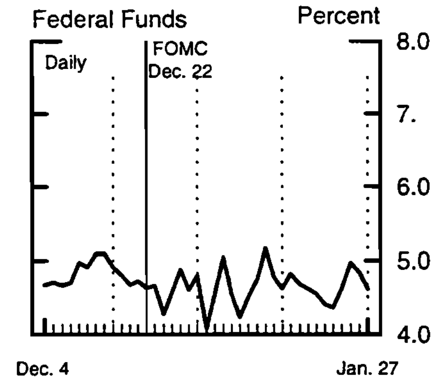
* Data are as of the close on December 21, 1998.

Selected Interest Rates

Selected Short-Term Interest Rates

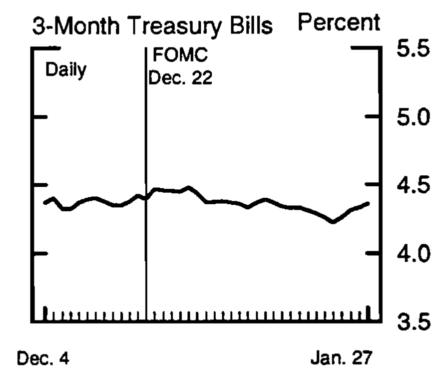


Federal Funds

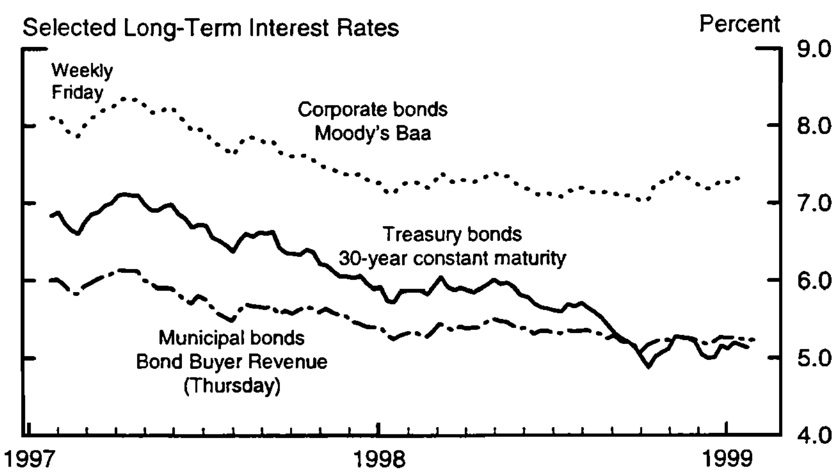


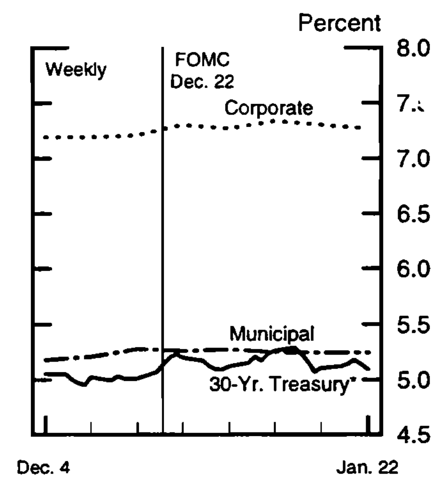
Note. Vertical dashed lines indicate end of reserve period.

3-Month Treasury Bills



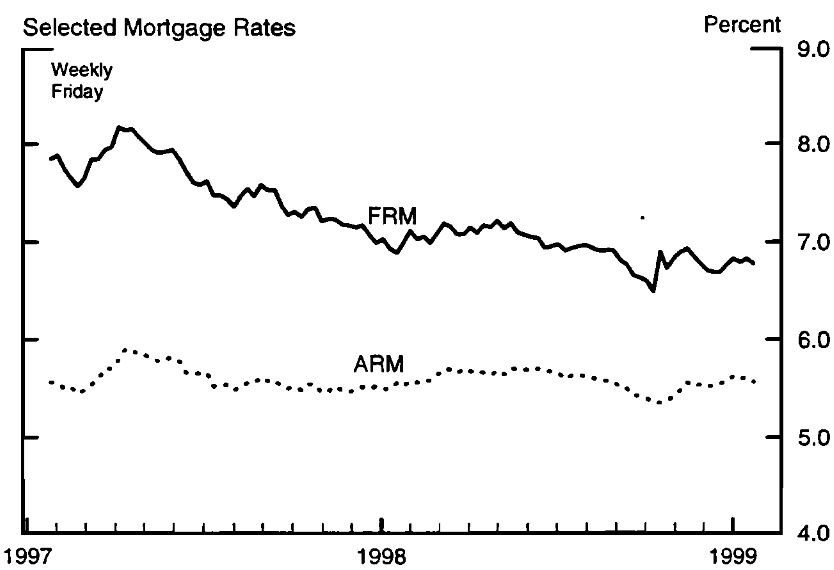
Selected Long-Term Interest Rates

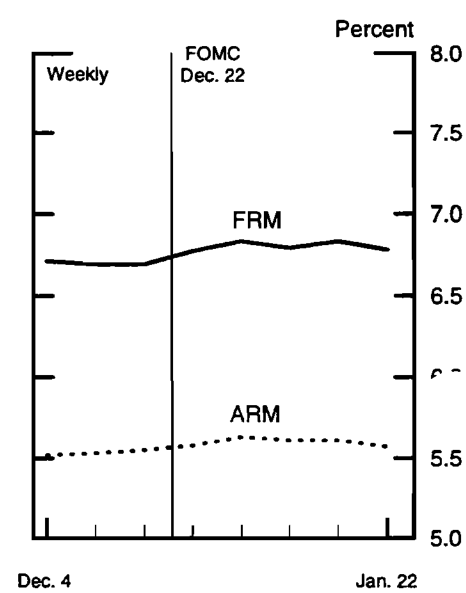




*Daily frequency.

Selected Mortgage Rates





INTERNATIONAL DEVELOPMENTS

International Developments

U.S. International Transactions

Trade in Goods and Services

In November, the U.S. nominal trade deficit in goods and services was $15.5 billion, somewhat larger than in October. For October-November combined, the deficit was a bit smaller than the third-quarter average.

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

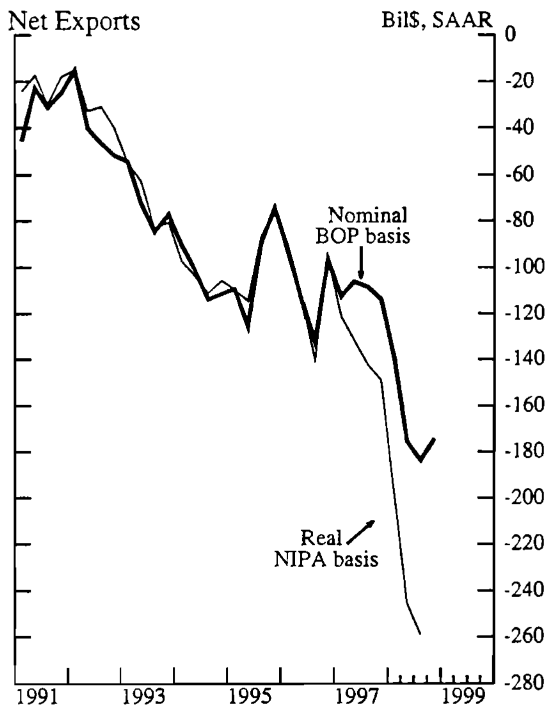
	1997	Annual rate 1998			Monthly rate 1998		
		Q2	Q3	Q4[e]	Sep.	Oct.	Nov.
Real NIPA[1]							
Net exports of G&S	-136.1	-245.2	-259.0	n.a.	...	...	...
Nominal BOP							
Net exports of G&S	-110.2	-175.5	-183.8	-174.5	-14.4	-13.6	-15.5
Goods, net	-198.0	-257.8	-258.3	-252.3	-20.8	-20.2	-21.9
Services, net	87.7	82.3	74.4	77.8	6.4	6.6	6.4

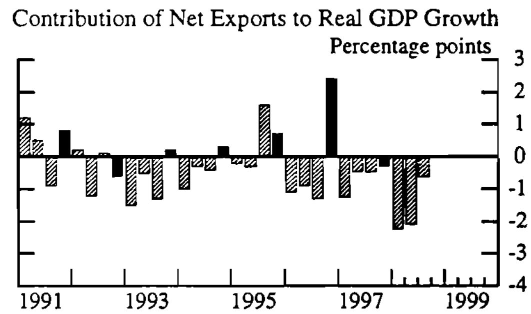
1. Billions of chained (1992) dollars.
e. BOP data are two months at an annual rate.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

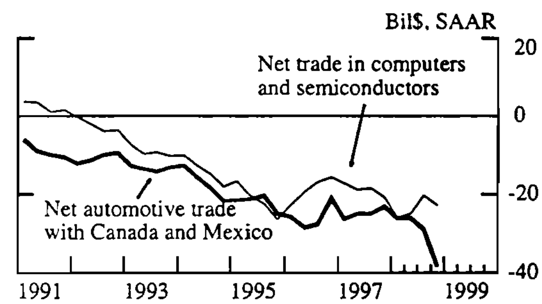
The value of exports fell in November following two months of strong increases. The decrease in November was largely in capital goods with smaller declines in most other categories of trade. These declines were partly offset by a sharp increase in exports of automotive products, particularly to Canada. For October-November combined, exports were 4.8 percent higher (not at annual rate) than the third-quarter average. The sharpest increases were in automotive products to Canada (two-thirds of which were parts), aircraft, and machinery. Healthy increases were also recorded for exported agricultural products and services. By area, most of the increase in October-November was to Canada, Europe, and developing countries in Asia, particularly to China, Korea, and Taiwan. Exports to Mexico rose, but exports to other countries in Latin America declined.

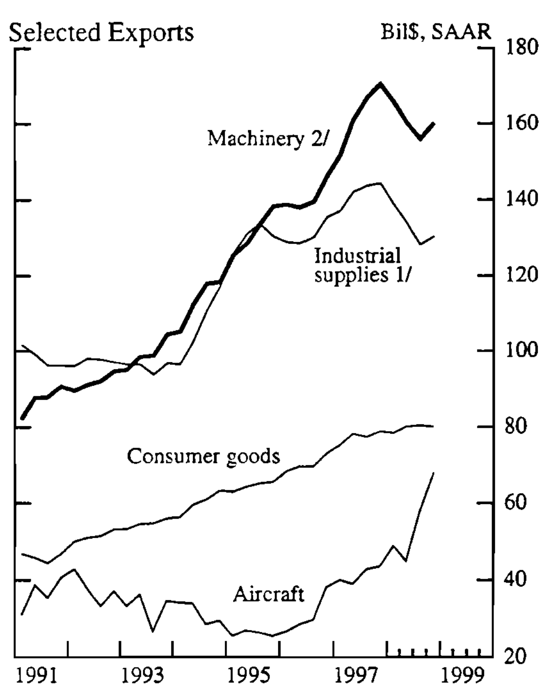
The value of imports rose slightly in November, with the sharpest increases in computers, semiconductors, other machinery, and automotive products. The value of imported oil declined, mostly as a result of lower oil prices. For October-November combined, imports were 3.1 percent higher (not at annual rate) than the third-quarter average. There were increases in most major trade categories, with particularly strong increases recorded in automotive products from Canada and Mexico and imported computers. Small declines were recorded in imported non-oil industrial supplies (including the quantity of steel) and foods.

U.S. International Trade in Goods and Services

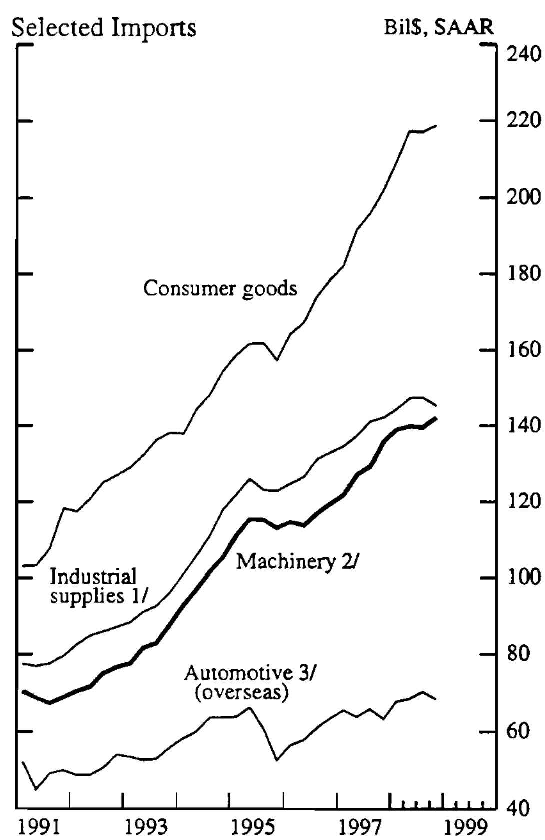








1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.



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	
	Q3	Q4[e]	Oct.	Nov.	Q3	Q4[e]	Oct.	Nov.
Exports of G&S	909.8	953.2	962.6	943.8	-12.5	43.4	33.0	-18.8
Goods exports	654.8	691.1	700.1	682.0	-4.5	36.3	28.0	-18.0
Agricultural	49.0	53.1	53.6	52.6	-3.1	4.2	8.4	-0.9
Gold	5.2	8.9	9.8	7.9	1.0	3.7	3.5	-1.9
Other goods	600.6	629.1	636.7	621.5	-2.4	28.5	16.2	-15.2
Aircraft & pts	58.0	68.0	70.2	65.7	13.3	9.9	-2.5	-4.4
Computers	45.1	46.0	46.8	45.2	0.3	0.9	1.5	-1.6
Semiconductors	37.4	39.0	39.6	38.5	1.9	1.6	1.1	-1.1
Other cap gds	158.7	163.4	165.7	161.1	-4.1	4.7	9.0	-4.6
Automotive	65.3	74.1	71.8	76.5	-6.9	8.8	-0.1	4.7
to Canada	33.8	42.9	41.4	44.4	-5.2	9.0	3.7	3.0
to Mexico	10.5	12.5	12.3	12.6	-1.9	2.0	-0.8	0.3
to ROW	21.0	18.8	18.1	19.5	0.2	-2.2	-3.0	1.3
Ind supplies	128.3	130.6	131.1	130.1	-5.8	2.3	3.6	-1.0
Consumer goods	80.3	80.2	81.7	78.6	0.3	-0.2	0.9	-3.2
All other	27.4	27.8	29.8	25.7	-1.4	0.4	6.0	-4.1
Services exports	255.0	262.2	262.6	261.8	-8.0	7.1	5.0	-0.8
Imports of G&S	1093.6	1127.7	1125.7	1129.8	-4.2	34.1	23.7	4.1
Goods imports	913.0	943.3	942.1	944.6	-4.0	30.3	20.4	2.5
Petroleum	49.2	50.4	52.4	48.3	-4.7	1.1	4.3	-4.2
Gold	7.3	7.7	8.1	7.3	1.9	0.4	0.5	-0.9
Other goods	856.5	885.3	881.5	889.1	-1.2	28.8	15.6	7.6
Aircraft & pts	21.9	25.0	26.3	23.8	-0.5	3.1	4.4	-2.6
Computers	71.1	76.0	74.5	77.5	-0.5	4.8	2.4	3.0
Semiconductors	31.6	31.9	30.5	33.3	-2.0	0.4	-0.7	2.8
Other cap gds	142.3	145.1	144.1	146.2	-0.5	2.8	2.5	2.1
Automotive	143.5	162.0	160.4	163.7	-2.5	18.5	4.9	3.3
from Canada	47.4	62.3	60.9	63.7	-1.6	14.9	5.5	2.8
from Mexico	25.8	31.5	32.8	30.2	-2.7	5.7	4.1	-2.6
from ROW	70.3	68.2	66.7	69.7	1.8	-2.0	-4.8	3.1
Ind supplies	147.6	145.3	146.2	144.5	0.2	-2.2	-0.3	-1.8
Consumer goods	217.0	218.8	218.3	219.3	-0.3	1.7	2.1	1.0
Foods	40.5	40.1	40.1	40.2	-1.3	-0.3	0.1	0.1
All other	40.9	40.9	41.1	40.7	6.2	-0.0	0.2	-0.3
Services imports	180.6	184.4	183.6	185.1	-0.2	3.8	3.3	1.5
Memo:								
Oil qty (mb/d)	11.63	11.53	11.58	11.48	-0.17	-0.10	0.36	-0.10
Oil price ($/bbl)	11.59	11.96	12.40	11.52	-0.91	0.37	0.66	-0.88

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

Quantity and price of imported oil. The quantity of imported oil declined slightly to 11.5 million barrels per day in November, due to unusually high inventories and a late start to the winter heating season. Preliminary Department of Energy statistics indicate slightly higher imports in December, largely reflecting declines in domestic production and the onset of colder weather.

The price of imported oil declined sharply in November and December after increasing in October. The decline in price was driven by higher than expected production by OPEC, weaker than expected consumption (especially in OECD Asia), and surprisingly high inventories. OPEC's unwillingness to extend production cuts also contributed to falling prices. The price of imported oil decreased more than 17 percent at an annual rate in the fourth quarter, a slightly smaller rate of decline than in the third quarter. The spot price of West Texas Intermediate (WTI) fell to $11.28 per barrel in December from $12.94 in November. This decline largely reflected Iraq's ability to maintain unexpectedly high exports, despite coming under military attack. Unseasonably warm weather and high inventories also contributed to weaker prices. More recently, the spot price rose above $12 per barrel in response to the arrival of colder winter weather, shipping delays from Nigeria, Mexico, and Russia, and slightly lower crude oil inventories.

Prices of non-oil imports and exports. Prices of non-oil imports were unchanged in December after edging up in October and November. Nonetheless, non-oil import prices declined 1/2 percent at an annual rate between the third and fourth quarters. This was the smallest rate of decline recorded since the fourth quarter of 1996. Prices of imported "core" goods (which exclude oil, computers, and semiconductors) rose 1/2 percent at an annual rate. Prices swung to increases in the fourth quarter from declines in previous quarters for all major import categories except computers and non-oil industrial supplies. Prices of imported non-oil industrial supplies decreased 4-1/2 percent at an annual rate in the fourth quarter. BLS indicated that shifts in the exchange value of the dollar (especially against the yen and European currencies) influenced these price movements, particularly for finished goods.

Prices of exports declined slightly in December after rising in November (the first increase recorded since May). An increase in prices of agricultural exports in December was more than offset by small price declines in other trade categories. In the fourth quarter, prices of exports declined 2 percent at an annual rate. Prices of exported "core" goods (which exclude agricultural products, computers, and semiconductors) decreased 1 percent at an annual rate, the smallest rate of decline since the fourth quarter of 1997; declines in prices of exported industrial supplies were nearly offset by increases in prices of exported automotive products and consumer goods.

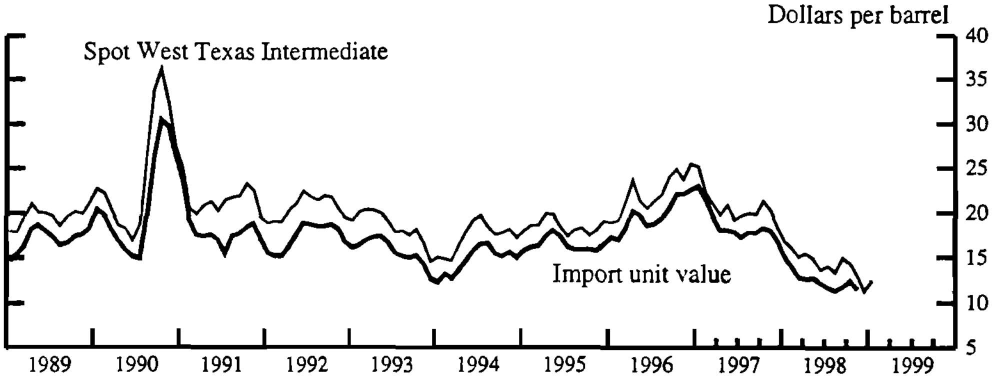
Prices of U.S. Imports and Exports

(Percentage change from previous period)

	Annual rates 1998			Monthly rates 1998		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
	--------------- BLS prices (1995=100)---------------					
Merchandise imports	-5.8	-6.0	-1.4	0.2	-0.5	-0.7
Oil	-31.6	-23.3	-17.4	2.0	-9.9	-11.9
Non-oil	-3.7	-4.5	-0.4	0.1	0.1	0.0
Core goods*	-2.7	-3.6	0.4	0.3	0.1	0.0
Foods, feeds, beverages.	-0.1	-7.0	3.1	1.0	-1.3	1.4
Industrial supplies ex oil	-4.0	-8.4	-4.6	-0.5	0.1	-0.4
Computers	-19.1	-10.4	-16.1	-2.8	-1.1	0.5
Semiconductors	-4.9	-12.1	4.7	0.6	0.9	0.1
Cap. goods ex comp & semi	-2.4	-3.7	2.9	0.6	0.6	-0.1
Automotive products	-0.8	-1.6	1.5	0.2	0.4	0.1
Consumer goods	-2.7	-1.3	0.7	0.3	0.1	-0.2
Merchandise exports	-3.3	-4.5	-2.1	-0.1	0.2	-0.1
Agricultural	-7.0	-11.5	-7.3	0.1	1.7	0.7
Nonagricultural	-2.8	-3.7	-1.4	-0.1	0.0	-0.2
Core goods*	-2.1	-2.5	-1.1	0.0	0.0	-0.2
Industrial supples ex ag	-5.2	-9.1	-5.1	-0.5	0.0	-0.3
Computers	-11.8	-14.0	-5.0	-0.4	0.0	-0.3
Semiconductors	-8.6	-10.2	-2.0	-0.1	-0.6	-0.1
Cap. goods ex comp & semi	-0.1	-0.6	0.1	0.0	0.0	0.1
Automotive products	0.3	0.4	1.7	0.4	0.1	-0.1
Consumer goods	-1.4	-0.8	0.4	0.1	0.0	-0.2
Chain-weight	-----Prices in the NIPA accounts (1992=100)-----					
Imports of goods & services	-4.5	-4.8	n.a.	...	...	...
Non-oil merchandise	-3.7	-4.4	n.a.	...	...	...
Core goods*	-1.8	-3.2	n.a.	...	...	...
Exports of goods & services	-1.8	-2.8	n.a.	...	...	...
Nonag merchandise	-2.8	-3.4	n.a.	...	...	...
Core goods*	-1.7	-2.3	n.a.	...	...	...

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

Oil Prices



U.S. International Financial Transactions
Major changes reported for November were very large purchases of U.S. securities by private foreigners and substantial capital outflows associated with bank transactions. (See lines 3 and 4 of the Summary of U.S. International Transactions table.)

Private net purchases of U.S. securities were strong in all asset categories. Purchases of Treasuries were especially heavy at almost $23 billion, after small changes in September and October (line 4a). In November, Japanese residents bought over $7 billion in Treasuries and the bulk of the rest were acquired in international financial centers such as the United Kingdom, Luxembourg, Switzerland, and the Caribbean. The large net purchases of U.S. corporate and other bonds reflected heavy issuance in both categories (line 4b); of the total, 40 percent were U.S. agency bonds, as Fannie Mae and Freddie Mac floated large note issues. As was the case for Treasuries, purchases in November were concentrated in Japan ($1 billion), the Caribbean, and the United Kingdom. Stock purchases, which revived a bit in October, were robust for the first time since last spring (line 4c). Once again, most of the net purchases were in international financial centers.

U.S. residents resumed net purchases of foreign stocks and bonds in November, but the net amounts were small (line 5). The net for foreign bonds was more than accounted for by $1.3 billion in purchases of Brazilian bonds, probably reflecting the flotation by the government of a new series of U.S. dollar-indexed securities.

Both U.S.- and foreign-chartered banks contributed to the large net banking outflow in line 3. For U.S.-chartered banks in November, strong growth in domestic bank credit was financed by a large issuance of domestic time deposits, allowing a reversal of recent borrowing from offices abroad; foreign-chartered banks, on the other hand, saw little growth in bank credit in November. Monthly average data from the International Banking Data table indicate only small net flows in December (line 1).

Foreign official holdings in the United States increased moderately in November (line 1 of the Summary table). Increases were widely distributed, including Israel, Korea, and Venezuela. Brazilian reserves fell substantially. Hong Kong reserves also fell considerably, but, according to preliminary data from FRBNY, the change was reversed in December. These latter data suggest another moderate rise in December for official reserves held at the New York Fed.

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

	1996	1997	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Oct.	1998 Nov.
Official capital								
1. Change in foreign official assets in U.S. (increase, +)	127.7	20.0	-26.3	12.4	-9.8	-46.1	12.4	6.4
a. G-10 countries	36.6	1.8	-12.6	4.0	-10.0	*	3.0	6.7
b. OPEC countries	15.4	12.9	-1.0	-.4	.1	-11.6	-.1	1.8
c. All other countries	76.3	5.2	-12.7	8.8	.1	-34.6	9.5	-2.1
2. Change in U.S. official reserve assets (decrease,)	6.7	-1.0	-4.5	-.4	-1.9	-2.0	-.1	-.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-50.1	34.7	46.3	-5.8	5.4	43.1	29.0	-35.4
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	287.2	346.7	71.2	75.4	98.9	20.1	2.8	50.4
a. Treasury securities[3]	155.6	147.2	35.5	-2.4	26.0	-1.2	-3.6	22.6
b. Corporate and other bonds[4]	118.9	128.1	25.8	46.6	57.7	25.6	4.1	19.0
c. Corporate stocks	12.7	71.3	9.8	31.0	15.3	-4.2	2.3	8.7
5. U.S. net purchases (-) of foreign securities	-110.6	-89.1	-8.8	-12.4	-30.2	15.6	24.0	-3.4
a. Bonds	-51.4	-48.2	-9.1	-9.6	-27.2	7.5	16.0	-.8
b. Stocks	-59.3	-40.9	.3	-2.8	-3.0	8.1	8.0	-2.6
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-81.1	-121.8	-35.5	-34.3	-40.5	-21.2	n.a.	n.a.
7. Foreign direct investment in U.S	77.6	93.4	28.5	25.9	19.1	27.1	n.a.	n.a.
8. Foreign holdings of U.S. currency	17.4	24.8	9.9	.7	2.3	7.3	n.a.	n.a.
9. Other (inflow, +)[5]	-80.3	-52.8	16.2	-11.7	11.8	20.9	n.a.	n.a.
U.S. current account balance (s.a.)	-134.9	-155.2	-45.0	-46.7	-56.7	-61.3	n.a.	n.a.
Statistical discrepancy (s.a.)	-59.6	-99.7	-52.0	-3.1	1.6	-3.5	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.

International Banking Data
(Billions of dollars)

	1996	1997	1998					
	Dec.	Dec.	Mar.	Jun.	Sept.	Oct.	Nov.	Dec.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-231.2	-195.8	-196.8	-183.3	-198.8	-232.9	-216.4	-214.4
a. U.S.-chartered banks	-66.4	-69.8	-78.0	-84.1	-102.5	-122.7	-112.8	-109.6
b. Foreign-chartered banks	-164.8	-126.0	-118.8	-99.2	-96.3	-110.2	-103.6	-104.8
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	31.9	34.4	35.2	36.2	36.7	38.8	39.1	38.3
b. By Caribbean offices of foreign-chartered banks	79.4	90.1	107.0	108.8	113.9	n.a.	n.a.	n.a.
3. Eurodollar holdings of U.S. nonbank residents								
a. At all U.S.- chartered banks and foreign- chartered banks in Canada and the United Kingdom	119.5	151.1	142.0	138.6	142.5	156.4	159.0	159.6
b. At the Caribbean offices of foreign- chartered banks	122.2	115.0	119.1	119.8	129.3	n.a.	n.a.	n.a.
Memo: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	239.0	287.2	309.2	322.2	350.3	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	336.7	415.2	436.9	425.2	453.5	n.a.	n.a.	n.a.

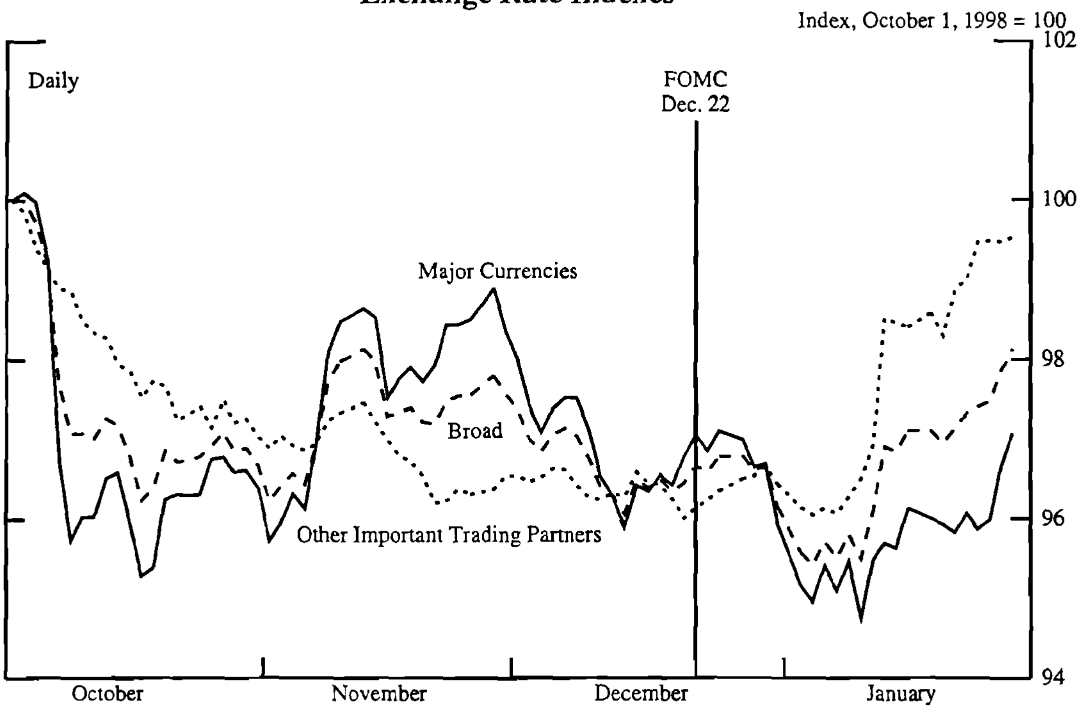
NOTE. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts. Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR2951. Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s. Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994. Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. They include some foreign-currency denominated deposits and loans. Source: SCB.

n.a. Not available.

Foreign Exchange Markets

Since the December FOMC meeting, the exchange value of the dollar is little changed on balance as measured by the major currencies index while rising 3-3/4 percent versus the currencies of other important trading partners. Overall, as measured by the broad index, the dollar has appreciated 1-3/4 percent. The dollar appreciated against some currencies and depreciated versus others, driven largely by developments in the respective foreign economies. As the period ended, events in Brazil became the primary concern in international financial markets.

Exchange Rate Indexes



On balance, the value of the dollar against the yen was little changed. On January 11, after the dollar depreciated versus the yen to a level not seen in over two years, the Bank of Japan intervened to weaken its currency, buying a large amount of dollars. The dollar appreciated over 4 percent in response to the intervention and has remained near or above its post-intervention level since. Despite the continuing recession in Japan, higher Japanese government bond yields and some optimism about the ongoing repair of the banking sector--evidenced by a 10-basis-point reduction in the Japan premium since the first of the year--may have contributed to support for the yen.

The euro began trading on January 4, rising immediately against the dollar, but its appreciation was short-lived. Rumors of a few settlement-system problems during the first week were followed by data releases confirming a slowdown in growth and the lack of inflationary pressures in many parts of the euro area, particularly in Germany. As a result, many market participants came to believe that the first reduction in interest rates by the European System of Central Banks would come sooner in the year than had been anticipated. On balance, the dollar has appreciated about 2 percent versus the euro since the December 31 fixing of the convergence rates between the legacy currencies and the euro. As the value of the dollar against the mark was little changed between the December FOMC meeting and December 31, the dollar also appreciated about 2 percent versus the mark/euro over the intermeeting period.

The dollar appreciated 2-1/2 percent with respect to sterling. The Bank of England lowered its repo rate 25 basis points on January 7, surprising most market analysts, who had not expected another cut so soon. In contrast, the dollar depreciated 3-1/2 percent versus the Swedish krona, which was buoyed by renewed public discussion of Sweden's entrance into the euro zone, and 2-1/2 percent against the Norwegian krone, as crude oil prices recovered somewhat. The dollar also depreciated 1-1/2 percent against the Australian dollar and the Canadian dollar.

Whatever optimism there had been in December and early January about emerging market assets was shaken by subsequent events in Brazil. The declaration on January 6 of a moratorium in its debt payments to the central government by the state of Minas Gerais, a relatively minor event in its own right, fueled fears that the Brazilian central government lacked broad political support and would be unable to accomplish the deep reforms necessary for sustainable fiscal and monetary stability. Faced by continuing outflows of capital, the Brazilian central bank devalued the *real* 8 percent on January 13, retaining a pegged exchange rate system. As capital flight increased, the central bank let the *real* float two days later. The initial reaction was euphoric, with stock prices soaring 33 percent in one day, retracing most of their recent losses, and Brady bond yield spreads narrowing quickly. After a few days, however, as the *real* depreciated further and capital flight continued despite rising interest rates, pessimism returned, and the fear of contagion to other countries in Latin America and beyond increased. Brady spreads widened rapidly but somewhat surprisingly, Brazilian stock prices continued to rise. The central bank increased the overnight interbank rate about 600 basis points to near 35 percent, but capital outflows averaging about $350 million a day continued. As this Greenbook went to press, the *real* had depreciated, on balance, about 36 percent from its pre-devaluation (and December FOMC) levels, and the Brazilian Emerging Market Bond Index (EMBI+) yield spread had widened over 300 basis points.

Financial Indicators in Latin America, Asia, and Russia

Country	Currency per U.S. dollar		Short-term interest rates		Yield spread on dollar-denominated bonds		Equity prices
	Jan. 28	Change	Jan. 27/28	Change	Jan. 27/28	Change	Change
Mexico	10.175	4.26	32.75	0.62	11.27[b]	1.66	-1.47
Brazil	1.9300	59.64	49.00	21.00	21.28[b]	7.91	8.04
Argentina	.9999	0.01	11.00	3.00	10.98[b]	2.54	-14.53
Chile	484.10	2.96	n.a.	n.a.	n.a.	n.a.	-3.72
Venezuela	572.50	1.69	n.a.	n.a.	11.40[b]	0.40	-9.94
China	8.2778	0.00	n.a.	n.a.	2.66[g]	0.19	-1.17
Korea	1174.3	1.81	6.21	-0.99	3.15[g]	-0.75	1.09
Taiwan	32.28	-0.06	5.15	0.45	n.a.	n.a.	-7.55
Singapore	1.6905	2.39	1.38	0.13	n.a.	n.a.	-0.27
Hong Kong	7.7488	0.04	6.00	0.67	n.a.	n.a.	-9.96
Malaysia	3.7998	0.00	6.10	-0.09	4.97[e]	-0.18	8.10
Thailand	36.90	1.77	5.75	-0.25	3.02[y]	-0.21	8.60
Indonesia	9100	19.74	39.15	-1.93	11.54[y]	1.26	0.68
Philippines	38.55	-0.90	n.a.	n.a.	4.34[e]	-0.16	6.71
Russia	22.85	7.28	n.a.		74.13[c]	1.71	-9.28

NOTE. Change is in percentage points from December 21 to January 27/28. *b* Stripped Brady par bond yield spread over U.S. Treasuries. *g* Global bond yield spread. *e* Eurobond yield spread.
y Yankee bond yield spread. *c* Russian prin bond yield spread.
n.a. Not available. p Preliminary.

The perceived risk of contagion to the rest of Latin America was evidenced by increases in the Brady bond yield spreads of the debt of other Latin American countries (to levels still short of those reached during the Russian crisis), widespread but moderate declines in stock prices, and increases in domestic interest rates. As the period ended, however, the contagion seemed somewhat contained. The Mexican peso, which had depreciated as much as 10 percent, ended the period down only about 4 percent. Three-month cetes rates, which initially rose about 300 basis points, subsequently declined a bit. The widely publicized announcement by Argentina that it was considering a full dollarization of its economy was seen, at least in part, as an attempt to insulate its currency board regime from the Brazilian crisis. Argentine share prices declined about 10 percent from pre-Brazilian devaluation levels, and Brady spreads increased about 300 basis points. The reaction of Venezuela's financial markets was also fairly muted.

The impact of the Brazilian crisis was felt in emerging Asia, with rumors of possible devaluations in Hong Kong and China resurfacing in foreign exchange markets. However China's strong reaffirmation of its commitment to the renminbi's peg seemed to calm some fears. The strong yen continued to be seen as a positive influence on the region's economic performance. Three-month Hong Kong interbank rates, after a brief 100-basis-point spike following the Brazilian devaluation, ended the period about 50 basis points higher, and the Hang Seng index fell 10 percent over the period. Share prices in Taiwan also declined, but stock indexes rose in other Asian markets, led by Thailand with an 8 percent increase.

Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equity prices
	Jan. 28	Change	Jan. 28	Change	Change
Canada	5.12	-0.13	4.91	0.04	5.01
Japan	.53	0.00	1.86	0.34	1.34
Germany/euro area	3.08	-0.12	3.65	-0.22	7.01
United Kingdom	5.75	-0.65	4.22	-0.25	0.41
France	--	--	3.73	-0.14	6.77
Italy	--	--	3.89	-0.09	4.77
Switzerland	1.18	-0.25	2.61	0.31	0.29
Australia	4.78	-0.02	5.06	0.25	5.08
United States	4.87	-0.28	4.70p	0.06	2.38
Memo: Weighted-average foreign	3.18	-0.48	3.65	0.04	n.a.

NOTE. Change is in percentage points from December 21 to January 27/28.
n.a. Not available. p Preliminary.

Stock prices in industrial economies have been, on balance, mixed since the December FOMC meeting. Share prices in the euro area increased the most (from 2 percent in Spain to 7 percent in Germany), but prices in other European countries saw slight declines. Japanese share prices increased about 1-1/2 percent, with banking sector shares outperforming the general market. Ten-year benchmark government bond yields fell 9 to 24 basis points in the euro area and 25 basis points in the United Kingdom. In Japan, the yield on the 10-year government bond rose another 34 basis points during the intermeeting period.

. The Desk did not intervene on behalf of the System or the Treasury.

Developments in Foreign Industrial Countries

Recent data suggest that economic activity in the fourth quarter weakened in the major foreign industrial countries. In Japan, activity likely contracted in the fourth quarter. Although some consumption indicators have improved there recently, private sector investment continues to act as a major drag on the economy. In Germany, manufacturing production continues to decline, as manufacturing orders from abroad have weakened considerably in recent months. In addition, evidence of sluggish growth in the service sector is consistent with a sharp slowdown in Germany. Similarly, growth was estimated to have diminished considerably in the United Kingdom, as weakness in the external sector appears to have spilled over to domestic demand. In contrast, indicators in Canada suggest that the economy continued to rebound from a strike-depressed third quarter.

Price data in foreign industrial countries continue to show little inflationary pressure, despite a temporary uptick in prices in Japan and the United Kingdom. Consumer price inflation remains around one percent or lower in a number of countries, and wholesale and producer prices are down considerably from last year's levels.

In **Japan**, available data suggest that economic activity continued to contract during the fourth quarter. Industrial production declined during the fourth quarter. Private "core" machinery orders and housing starts during October and November were down sharply from their already weak third-quarter averages. The unemployment rate in November rose to a new all-time high of 4.4 percent, while the offers-to-applicants ratio dropped to 0.47, a new all-time low. New car registrations during the fourth quarter fell to their lowest level in over a decade, but other consumption indicators have improved somewhat in recent months. Retail sales edged up during the fourth quarter and the household expenditure index has increased steadily from July through November.

Four-quarter consumer price inflation turned positive during the fourth quarter, as prices were up 0.7 percent from a year earlier due to a temporary surge in fresh produce prices after several typhoons, but "core" inflation, which excludes perishables, remained slightly negative. Wholesale prices during the fourth quarter dropped a sizable 3.6 percent from a year earlier, largely reflecting sharp declines in the import prices following the yen's appreciation during September and October.

The Japanese trade surplus rose to $108.1 billion during 1998, up sharply from $83 billion in 1997. In yen terms, Japan's exports to the United States and the euro area rose 9.2 percent and 17.5 percent, respectively, during 1998, while its exports to Asia dropped a sizable 17.9 percent. The weakness of Japanese domestic demand during 1998 weighed heavily on imports. Japan's imports from the United States declined 4.1 percent from 1997; imports from the euro area were down 5.8 percent; and imports from Asia fell 10.4 percent.

Japanese Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production	-5.1	.0	-.4	3.3	-1.1	-2.1	1.3
Housing starts	-6.2	-7.6	n.a.	-3.2	1.7	-7.8	n.a.
Machinery orders	-6.5	-4.6	n.a.	15.1	-10.2	0.3	n.a.
New car registrations	-3.4	2.2	-11.5	6.7	-11.8	-7.4	7.4
Unemployment rate[1]	4.2	4.3	n.a.	4.3	4.3	4.4	n.a.
Job offers ratio[2]	.53	.50	n.a.	.49	.48	.47	n.a.
Business sentiment[3]	-38	-51	-56	...	...	...	...
CPI (Tokyo area)[4]	.6	-.1	.7	-.1	.4	1.0	.7
Wholesale prices[4]	-1.6	-.7	-3.6	-1.5	-2.8	-3.5	-4.4

1. Percent.
2. Level of indicator.
3. Tankan survey, diffusion index.
4. Percent change from previous year, NSA.
n.a. Not available. ... Not applicable.

In mid-December, the Japanese government announced a ¥9 trillion package of tax cuts to be implemented during 1999. (The government previously had indicated that such tax cuts would amount to only ¥6 trillion.) The package contains ¥4 trillion of permanent income tax cuts, ¥2 trillion of permanent corporate income tax cuts, and about ¥3 trillion of so-called "policy tax cuts," including incentives for residential and business investment and a proposal to abolish the securities transactions tax. In addition, the proposed FY1999 budget appears to contain a ¥1 trillion increase in "real-water" expenditure relative to the original FY1998 budget; previous indications had suggested that spending in the FY1999 budget would be neutral relative to its predecessor.

Limited forward-looking indicators, together with national data, confirm weakening real economic activity across the **Euro-11** countries. Although consumer confidence edged higher from third quarter's low levels, business confidence continued to fall. On a more positive note, the unemployment rate for the Euro-11 countries most likely continued to decline in the fourth quarter, and consumer price inflation through November edged lower.

Euro-11 Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
GDP[1]	.8	.6	.7	...	...	...	...
Industrial production[2]	1.0	.5	.7	-.9	-.8	.5	n.a.
Unemployment rate[3]	11.3	11.1	10.9	11.0	10.9	10.8	10.8
Business confidence[4]	2.0	2.0	-.7	-1.0	-2.0	-5.0	-8.0
Consumer confidence[4]	-7.7	-5.3	-4.7	-5.0	-5.0	-3.0	-2.0
Consumer prices[5]	1.2	1.4	1.2	1.2	1.0	1.0	.9

NOTE. Series are GDP-weighted averages of the eleven countries in EMU, except as noted.
1. Figures are actual data when available and forecasts by WPEA otherwise.
2. Quarterly and monthly data exclude Luxembourg (for which there are no data), and Austria, Ireland, and Portugal (where recent data have not been released). Data for Spain have been seasonally adjusted using X-11 ARIMA.
3. Quarterly and monthly data exclude Luxembourg and Austria, Portugal, and Spain (where recent data have not been released). Monthly data for Italy is interpolated from Q4 data.
4. Diffusion index, Eurostat.
5. Harmonized CPI; percent change from previous year, weighted by shares in private final domestic consumption, Eurostat.
n.a. Not available. ... Not applicable

German economic data point to a significant slowing in growth and are consistent with a GDP growth rate close to zero in the fourth quarter.[1] Industrial production fell sharply in November, pushing the October/November average of the index to nearly 2 percent below its average in the third quarter. Manufacturing orders continued to fall in November and were nearly 5 percent

1. The government has announced a preliminary 1998 year-over-year GDP growth rate of 2.8 percent. This implies a fourth-quarter growth rate of 1.6 percent at an annual rate, which seems too optimistic in view of recent developments. Accordingly, if this yearly preliminary estimate is not revised, there may be revisions to earlier quarters when details are announced in March.

below their third quarter average in November, with orders from abroad especially weak. Business confidence deteriorated further in November due to the sharp drop in orders from abroad as well as uncertainty about the new government's tax and fiscal policies. In addition, a survey of the service sector indicates that service sector growth slipped for the fifth straight month in December. The unemployment rate also rose in December, its first increase since August 1997, even as the number of government-sponsored and subsidized labor force positions increased.

Price data continue to show the absence of any inflationary pressure. In December, consumer prices were up 0.5 percent, while producer prices, wholesale prices, and import prices were down 1.7 percent, 4.5 percent, and 6.0 percent, respectively, from year-earlier levels.

German Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production	-.5	1.7	n.a.	-2.5	1.4	-2.2	n.a.
Orders	.3	-.6	n.a.	.3	-2.7	-1.5	n.a.
Unemployment rate[1]	11.2	10.9	10.7	10.8	10.7	10.7	10.8
Western Germany	9.4	9.2	9.1	9.2	9.1	9.1	9.1
Eastern Germany	18.5	17.6	17.1	17.3	17.0	17.0	17.4
Capacity utilization[1]	87.2	87.0	n.a.	...	...	...	...
Business climate[2]	16.0	6.0	n.a.	-1.0	-6.0	-8.0	n.a.
Consumer prices[3]							
All Germany	1.3	.8	.6	.8	.7	.7	.5
Western Germany	1.3	.8	.6	.7	.7	.6	.5

1. Percent.
2. Percentage of manufacturing firms citing an improvement in the outlook less percentage citing a worsening.
3. Percent change from previous year.
n.a. Not available. ... Not applicable.

Available indicators in **France** are mixed, but suggest that economic growth may have slowed in the fourth quarter. On the negative side, consumption of manufactured goods fell 0.5 percent (SA) in the fourth quarter. The index of business confidence based on future output also continued to worsen in

December. On the positive side, however, industrial production in October and November on average was up 0.8 percent above the third-quarter average. The unemployment rate continued to edge down in November.

French Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Consumption of manufactured products	.8	2.7	-.5	1.9	-.8	-.5	-.4
Industrial production	1.2	.0	n.a.	-.7	.7	1.0	n.a.
Capacity utilization	86.5	85.5	n.a.	...	...	...	...
Unemployment rate[1]	11.9	11.8	n.a.	11.7	11.6	11.5	n.a.
Business confidence[2]	20.3	18.0	5.3	15.0	6.0	6.0	4.0
Consumer prices[3]	1.0	.7	.3	.5	.4	.3	.3

1. Percent.
2. Percentage of manufacturing firms citing an improvement in the outlook less percentage citing a worsening.
3. Percent change from previous year.
n.a. Not available. ... Not applicable.

Consumer price inflation remains at 40-year lows. In December, the consumer price index was essentially flat, which brought 1998 consumer price inflation to 0.3 percent.

In **Italy**, real GDP rose 2 percent (SAAR) in the third quarter, and second-quarter growth was revised up to 2.3 percent from 1.7 percent. In the third quarter, all components of final domestic demand and net exports were strong. Imports declined a sizeable 8.3 percent while exports rose 1.4 percent. A large rundown in inventories, which contributed to the decline in imports, was mainly responsible for keeping the growth rate relatively modest.

Limited fourth-quarter monthly indicators suggest that growth may have eased somewhat. For the fourth quarter as a whole, consumer confidence was up slightly, and the unemployment rate remained unchanged. However, in October and November business sentiment remained significantly below the third-quarter level.

Italian Real GDP
(Percent change from previous period, SAAR)

Component	1996[1]	1997[1]	1997 Q4	1998 Q1	1998 Q2	1998 Q3
GDP	-.2	2.8	1.0	-.6	2.3	2.0
Total domestic demand	-1.1	3.8	3.2	3.8	1.7	-.5
Consumption	.9	2.1	-.2	.8	2.6	3.7
Investment	-2.7	2.9	4.1	2.6	-1.4	4.7
Government consumption	-.3	-.1	.6	2.0	1.5	1.3
Inventories (contribution)	-1.1	1.8	2.4	2.4	.1	-3.8
Exports	3.8	9.0	-2.6	-7.7	9.3	1.4
Imports	.6	14.4	5.6	9.2	7.4	-8.3
Net exports (contribution)	.8	-.9	-2.0	-4.2	.6	2.5

1. Q4/Q4.

Italian Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998 Q2	1998 Q3	1998 Q4	1998 Sept.	1998 Oct.	1998 Nov.	1998 Dec.
Industrial production	-.2	-.3	n.a.	1.7	1.1	n.a.	n.a.
Capacity utilization[1,2]	79.5	76.6	n.a.	...	...	...	...
Unemployment rate[1]	12.3	12.4	12.4	...	...	...	...
Consumer confidence[3]	122.7	117.0	117.8	115.2	116.6	119.7	117.2
Business sentiment[1,4]	11.7	9.0	n.a.	5.0	-3.0	-3.0	n.a.
Consumer prices[5]	1.8	1.8	1.6	1.8	1.7	1.5	1.5

1. Percent.
2. NSA.
3. Level of index, NSA.
4. Percentage of manufacturing firms having a favorable view of business conditions less percentage having an unfavorable outlook.
5. Percent change from previous year.

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

On December 20, the lower house of the Italian Parliament approved the 1999 draft budget, which contains $9 billion (or roughly 3/4 percent of GDP) of deficit-cutting measures. One-third of the budgeted measures come from new revenue and two-thirds from reduced spending.

The pace of economic activity in the **United Kingdom** slowed markedly in the fourth quarter, as the preliminary estimate of real GDP showed growth of 0.7 percent (SAAR). Output of production industries was estimated to have declined for the quarter primarily due to lower manufacturing output. Although surveys of service sector activity indicated a slight contraction in both November and December following a modest increase in October, service sector output was estimated to have grown 2.4 percent. Retail sales fell in December; for the fourth quarter on average, the volume of sales declined 0.2 percent. The official claims-based unemployment rate remained 4.6 percent in December, with the number of unemployed falling to the lowest level since 1980.

United Kingdom Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						1999
	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.
Real GDP (SAAR)	2.0	1.6	.7	...	...	...	...
Industrial production	1.2	.2	n.a.	.0	-.1	n.a.	n.a.
Retail sales	.2	.5	-.2	-.4	.9	-1.0	n.a.
Unemployment rate[1]	4.8	4.6	4.6	4.6	4.6	4.6	n.a.
Business confidence[2]	-.7	-11.7	-23.0	-29.0	-27.0	-13.0	-13.0
Consumer confidence[3]	3.3	-13.3	-17.7	-22.0	-14.0	-17.0	-12.0
Retail prices[4]	3.0	2.6	2.6	2.5	2.5	2.6	n.a.
Producer input prices[5]	-7.9	-9.2	-9.2	-10.0	-8.6	-9.1	n.a.

1. Percent.
2. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
3. Level of index, expectations of general economic situation over the next 12 months.
4. Excluding mortgage interest payments. Percent change from previous year.
5. Percent change from previous year.
n.a. Not available. ... Not applicable.

Producer input prices continued to decline in December. Higher seasonal food prices contributed to an uptick in retail price inflation; the twelve-month rate of retail price inflation (excluding mortgage interest payments) edged up to 2.6 percent in December, slightly above the inflation target. On an EU-harmonized basis, consumer price inflation is somewhat lower, registering 1.5 percent in December.

At its January meeting, the Monetary Policy Committee (MPC) of the Bank of England reduced the official repo rate 25 basis points to 6.0 percent, the fourth consecutive easing from its most recent peak at 7.5 percent. The MPC noted that since the December meeting, domestic data and survey evidence point to a continuing slowdown in the U.K. economy, while risks from the international environment "remain clearly on the downside."

Economic activity in **Canada** appears to be rebounding from the 1.8 percent (SAAR) pace recorded in the third quarter. Monthly growth in GDP at factor cost moved higher in October to 0.2 percent from 0.1 percent in September. Although industrial production fell in both September and October, new

Canadian Economic Indicators
(Percent change from previous period except as noted, SA)

Indicator	1998						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
GDP at factor cost	.3	.3	n.a.	.1	.2	n.a.	n.a.
Industrial production	.2	-.4	n.a.	-.2	-.1	n.a.	n.a.
New manufacturing orders	-.6	1.6	n.a.	-2.3	4.4	-3.4	n.a.
Retail sales	1.6	.6	n.a.	1.1	-1.7	1.1	n.a.
Employment	.7	.3	1.4	.5	.4	.7	.2
Unemployment rate[1]	8.4	8.3	8.0	8.3	8.1	8.0	8.0
Consumer prices[2]	1.0	.9	1.1	.7	1.0	1.2	1.0
Consumer attitudes[3]	114.9	103.2	109.8	...	...	...	
Business confidence[4]	148.9	128.6	132.3	...	...	...	

1. Percent.
2. Percent change from year earlier.
3. Level of index, 1991 = 100.
4. Level of index, 1977 = 100.
n.a. Not available. ... Not applicable.

manufacturing orders in October and November on average were up 5.3 percent above the third-quarter average. This is consistent with a sizeable pickup in manufacturing activity from strike-depressed levels in the third quarter. Retail sales in October and November on average were down 0.5 percent from the third-quarter average. However, in the fourth quarter, consumer confidence rebounded somewhat, and employment growth was exceptionally strong, posting the largest quarterly increase since 1985.

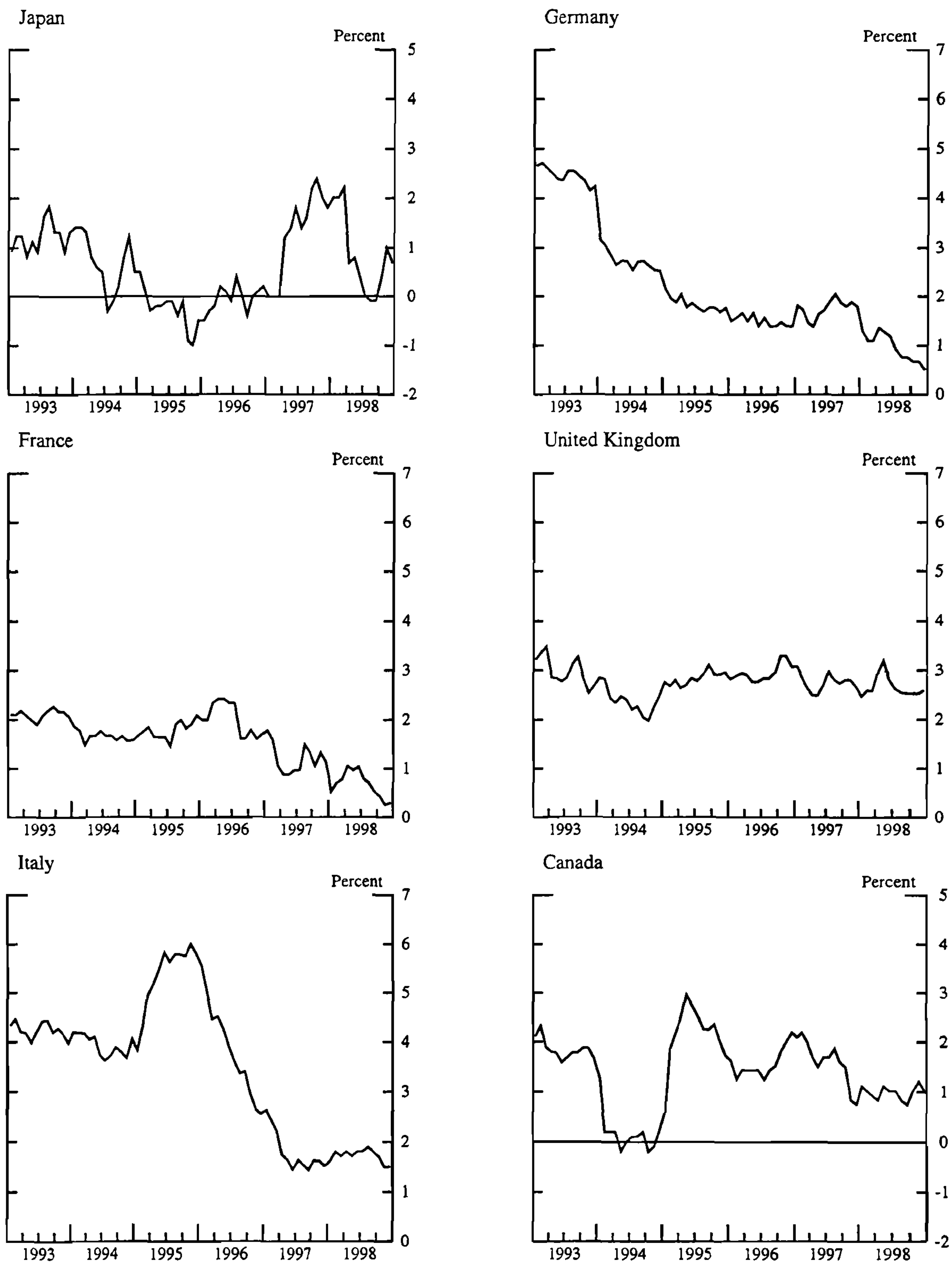
Consumer price inflation remains subdued. In December, the twelve-month change in consumer prices was 1.0 percent, the lower bound of the Bank of Canada's inflation target.

External Balances
(Billions of U.S. dollars, SAAR)

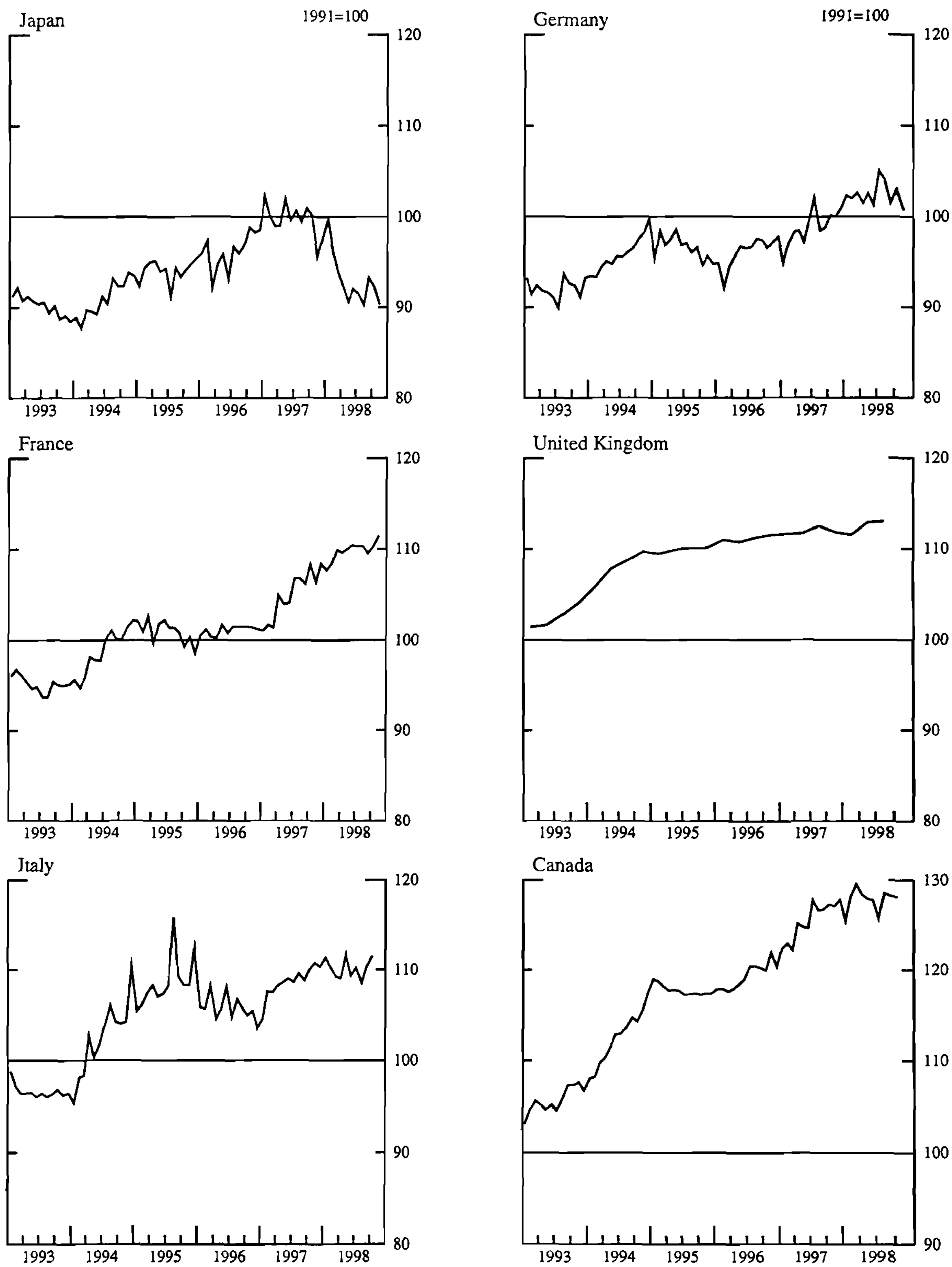
Country and balance	1998					
	Q2	Q3	Q4	Oct.	Nov.	Dec.
Japan						
Trade	114.0	107.3	113.2	144.6	88.7	106.3
Current account	106.8	131.4	n.a.	145.3	129.8	n.a.
EU-11						
Trade[1]	108.7	111.0	n.a.	n.a.	n.a.	n.a.
Current account[1]	108.7	94.7	n.a.	...	...	...
Germany						
Trade[1]	81.8	77.6	n.a.	92.0	119.1	n.a.
Current account[1]	15.4	-15.7	n.a.	-32.1	-24.3	n.a.
France						
Trade	26.4	30.6	n.a.	21.5	n.a.	n.a.
Current account	36.9	41.1	n.a.	53.1	n.a.	n.a.
Italy						
Trade	29.9	27.4	n.a.	28.9	n.a.	n.a.
Current account[1]	30.9	42.0	n.a.	n.a.	n.a.	n.a.
United Kingdom						
Trade	-31.0	-34.7	n.a.	-33.3	-43.5	n.a.
Current account	4.0	15.1	n.a.	...	...	...
Canada						
Trade	10.0	13.2	n.a.	13.5	15.0	n.a.
Current account	-14.5	-11.5	n.a.	...	...	...

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

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



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

After months of trying to defend its currency peg and stem capital outflows with high interest rates, Brazil was forced to abandon its fixed exchange rate policy and allow the *real* to float. The change in exchange rate policy came against a background of weakening economic activity in Brazil, with real GDP contracting sharply in the third quarter of 1998. Real GDP was also down sharply in Argentina in response to the high interest rates needed to defend its currency and in Venezuela due to extremely low oil prices. All of these countries still show substantial trade deficits despite slower import growth, owing largely to the effects of lower commodity prices. Inflation is currently low in Brazil, but is expected to rise sharply in response to the *real*'s devaluation. Elsewhere, inflation remains relatively high in Mexico and Venezuela, but is quite low in Argentina.

Although activity in most of the Asian developing economies remains depressed, there are signs that Korea may be beginning to recover and that the ASEAN economies may be nearing a trough. Chinese growth has shown a modest pickup recently, likely reflecting a surge in investment by state-owned enterprises. Trade balances across the region have improved sharply over the past year owing primarily to reductions in imports, while export revenues remain weak. Inflation in these countries has generally stabilized, although in many cases it remains higher than before the crisis began.

The economic situation in Russia continues to deteriorate. Russia has missed a payment on its debts to London Club creditors, and its latest draft budget falls well short of what the IMF has indicated will be necessary to win further assistance.

On January 15, **Brazil's** central bank abandoned the fixed exchange rate policy that had been the anchor of the government's 4-1/2 year old anti-inflation program, the Plano Real, after an unsuccessful attempt two days earlier to engineer a limited depreciation of the currency (by 8 percent) and adopt a new peg. The January 13 decision to devalue the *real* resulted in the resignation of Central Bank President Gustavo Franco, who had been a strong advocate of a fixed exchange rate policy. Franco was replaced by Francisco (Chico) Lopes, who had been the head of monetary policy and who had been advocating a "more flexible" exchange rate policy. On January 18, the central bank widened the overnight interest rate band from 29-36 percent to 25-41 percent and announced that it will continue to let the *real* float but will "occasionally intervene in the market to limit wide swings in the value of the currency." Statements of support for the float were made by the IMF and by several foreign governments, but now Brazil will need to renegotiate the terms of any additional international financial support.

In the weeks prior to the abandonment of the peg, capital flowed out of Brazil at an alarming rate. Net capital outflows rose from roughly $2 billion in October and November to $5 billion in December, and continued to be high in the first half of January, reaching $1.2 billion on January 12 and $1.8 billion on January 14. These outflows reflected the perception that the abandonment of the peg was increasingly likely, due to the mounting toll of high interest rates on the fiscal position of the government and on the economy, as well as the perception that the currency was overvalued and that the current account deficit--$35 billion in 1998, or about 4-1/2 percent of GDP--was unsustainable under current market conditions. Moreover, in early January, markets were roiled when the governor of Minas Gerais declared a 90-day moratorium on its debts to the federal government and questioned whether the state had enough money to honor its $110 million in Eurobonds maturing on February 10.

Since the currency was allowed to float, several other governors have sought to reschedule their debts to the federal government through the intervention of the courts. The Brazilian congress, on the other hand, has responded to the financial turmoil more positively. On January 13, the senate overwhelmingly approved tax increases and a few days later approved a controversial financial transactions tax (CPMF). This bill still must be approved by the lower house, where support for President Cardoso has been much weaker. On January 20, the lower house approved social security taxes on public sector workers, a controversial measure whose rejection in December fueled downward pressure on the *real*.

Although overnight interest rates have declined from a peak of roughly 42 percent in September, they remain very high at about 35 percent in recent days. High interest rates are destabilizing fiscally because two-thirds of the federal government's R$300 billion stock of securities (about one-third of 1998 GDP) is indexed to the overnight rate. High interest rates also caused economic activity to plummet in the third quarter, and indications are that the economy continued to weaken in the fourth quarter; industrial output declined 0.5 percent (SA) in November and has fallen close to 7 percent since May 1998.

Brazilian Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	3.5	n.a.	-5.9	n.a.	...	...	...
Industrial production[2]	3.9	n.a.	-1.5	n.a.	-1.2	-.5	n.a.
Unemployment rate[3]	6.1	n.a.	8.5	n.a.	8.0	7.8	n.a.
Consumer prices[4]	4.3	2.4	3.6	2.7	3.0	2.6	2.4
Trade balance[5]	-8.4	-6.4	-7.2	-13.0	-12.4	-19.7	-7.1
Current account[5]	-33.8	-34.9	-37.1	-45.9	-54.5	-35.2	-47.9

1. Percent change from previous period, SAAR.
2. Percent change from previous period, SA.
3. Percent. "Open" unemployment rate.
4. Percent change from year earlier.
5. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

Recent **Mexican** data indicate that the economy grew at a slower pace during the fourth quarter of 1998. While industrial production was up 3.8 percent in November on a year-over-year basis, it slowed since the 6.1 percent growth in the third quarter. The trade deficit widened since the last Greenbook, primarily due to a fall-off in oil exports. Consumer prices rose 18.6 percent in 1998—2.9 percentage points higher than in 1997. Monthly inflation in December jumped to 2.4 percent from 1.8 percent a month earlier, reflecting the elimination of tortilla subsidies and a cut in price controls on fuel. The unemployment rate remained unchanged at 2.6 percent in December. Mexican financial markets were initially rocked by Brazil's devaluation, but have since recovered.

In December, the Mexican Congress approved a broad set of financial reforms, ending a nine-month impasse between the government and Congress over a plan to rescue the bank bailout fund, Fobaproa. Under the agreement, the Bank Deposit Insurance Institute (IPAB) will be created along with a new set of debt-relief programs for bank debtors. In addition, foreign investors will be allowed to hold a majority share in Mexican commercial banks, regardless of size.

On December 31, the Mexican Congress approved the 1999 budget after a last-minute deal between the Institutional Revolutionary Party (PRI) and the National

Action Party (PAN) scrapped a 15 percent tax on telephone use. President Zedillo's administration had proposed the tax as part of measures to offset dwindling income from oil exports. Instead of the telephone tax, the approved budget included 14 billion pesos ($1.4 billion) in spending cuts, a 5 percent hike in diesel fuel prices, and increased duties on imports from countries without trade pacts with Mexico. The budget keeps to the administration's goal of a budget deficit of 1.25 percent of GDP.

Mexican Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	7.0	n.a.	7.7	n.a.	...	...	...
Industrial production[2]	9.2	n.a.	6.1	n.a.	3.1	3.8	n.a.
Unemployment rate[3]	3.7	3.2	3.2	2.8	3.1	2.6	2.6
Consumer prices[2]	15.7	18.6	15.6	17.6	16.7	17.4	18.6
Trade balance[4]	.6	-7.7	-9.2	-10.1	-9.6	-10.5	-10.2
Imports[4]	109.8	125.2	123.4	133.4	133.2	133.4	133.8
Exports[4]	110.4	117.5	114.2	123.3	123.6	122.8	123.6
Current account[4]	-7.4	n.a.	-18.7	n.a.	...	...	...

1. Percent change from previous period; SAAR estimated by staff.
2. Percent change from year earlier.
3. Percent.
4. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

In **Argentina**, the impact on real activity of higher interest rates and enhanced uncertainties resulting from the global financial turmoil continued. Real GDP declined in the third quarter of 1998 by about 6 percent (SAAR) after having increased by the same amount in the second quarter. Industrial production was down nearly 7 percent in November on a year-over-year basis. Somewhat puzzlingly, given the behavior of output, the unemployment rate declined slightly in the fourth quarter; while there was job creation, roughly half the jobs added since May have been part-time positions.

Inflation in Argentina remained low and the year-end annual inflation rate for 1998 was well under 1 percent. Although imports are now beginning to decline as a result of the fall in activity, external balances continue to show significant deficits: the cumulative trade deficit through November of last year was $4 billion (AR), over double its value over the same period in 1997. However, the trade deficit did narrow slightly in November over its October value.

Argentine Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	8.6	n.a.	-5.9	n.a.	...	...	...
Industrial production[2]	8.6	n.a.	.0	n.a.	-6.4	-6.9	n.a.
Unemployment rate[3]	14.9	12.9	13.2	12.4	...	...	...
Consumer prices[2]	.3	.7	1.1	.8	.9	.9	.7
Trade balance[4]	-2.2	n.a.	-5.9	n.a.	-5.9	-5.0	n.a.
Current account[4]	-9.3	n.a.	n.a.	n.a.	...	...	...

1. Percent change from previous period; SAAR.
2. Percent change from year earlier; annual consumer price changes use end of period data.
3. Percent. The third and fourth quarter figures are from surveys conducted in August and October, respectively.
4. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

Venezuelan economic activity continues to decline, driven by the slump in oil prices; real GDP contracted about 5 percent in the third quarter on a year-over-year basis, which we estimate translates into a 15 percent (SAAR) decline from the second quarter. The inflation rate remained high at 30 percent in December, although it was down slightly from the previous month and ended just inside IMF targets for the year. Weak oil prices and an overvalued currency continue to hurt external balances.

Since his landslide victory in early December elections, president-elect Hugo Chavez has toned down most of the populist rhetoric which brought him victory at the polls. Other than requests for a modest rescheduling of Venezuela's debt, plans for consolidation of the bloated public sector and continued privatization of state-owned entities, Chavez has not unveiled any major economic proposals. Chavez has stated publicly that though he will extend a shadow arrangement with the IMF through the upcoming year, he does not plan to ask the Fund for financial assistance.

Venezuelan Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	5.1	n.a.	-14.9	n.a.	...	...	...
Unemployment rate[2]	11.7	n.a.	11.0	n.a.	...	...	...
Consumer prices[3]	37.6	30.1	36.2	31.3	32.6	31.2	30.1
Non-oil trade balance[4]	-7.5	n.a.	-9.0	n.a.	-9.9	n.a.	n.a.
Trade balance[4]	10.5	n.a.	3.0	n.a.	n.a.	n.a.	n.a.
Current account[4]	4.7	n.a.	1.6	n.a.	...	...	...

1. Percent change from previous period, SAAR.
2. Percent. NSA.
3. Percent change from year earlier.
4. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

In **Korea**, recent data have provided further evidence that the steep drop of activity of earlier last year has bottomed out and that recovery may be beginning. Industrial production posted year-over-year gains in November and December. Other positive indicators in November included: the plant utilization rate, which rose from the previous month; the inventory index, which declined to its lowest level in nearly three years; and the leading composite index, which rose for the fifth straight month. The unemployment rate also eased in November, but at 8 percent was well above its year-earlier level of just under 3 percent, and, with major industrial restructuring initiatives yet to be implemented, appears more likely to rise than fall over the he remainder of this year. Inflation eased further to a 12-month rate of 4 percent in December, held down by the strength of the won.

As a significant step in its effort to restructure the banking sector, the government announced that First Korea Bank, which was nationalized last year to keep it from failing, was being sold to a U. S. consortium led by Newbridge Capital Ltd. This is the first post-crisis acquisition of a Korean bank by foreign interests. Newbridge is expected to inject about $1 billion into the bank to boost its capital adequacy.

Korean Economic Indicators

Indicator	1997	1998	1998 Q3	1998 Q4	1998 Oct.	1998 Nov.	1998 Dec.
Real GDP[1]	5.5	n.a.	2.3	n.a.	...	...	...
Industrial production[2]	6.9	-7.1	-8.2	-.8	-8.3	1.4	4.7
Consumer prices[2]	6.6	4.0	7.0	6.0	7.2	6.8	4.0
Trade balance[3]	-3.2	n.a.	42.4	n.a.	41.4	42.0	n.a.
Current account[3]	-8.2	n.a.	38.0	n.a.	33.0	39.6	n.a.

1. Percent change from previous period; SAAR estimated by staff.
2. Percent change from year earlier.
3. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

In an indication of the improved assessment by the international investor community of Korea's financial health, Fitch IBCA, a London-based credit rating agency, has become the first of the major credit rating agencies to restore Korea's sovereign rating to investment grade. All major credit rating agencies cut their ratings on Korea to junk bond status when the country plunged into a severe foreign currency crisis in late 1997. Fitch said that the prospect of Korea's falling into another external liquidity crisis now appeared remote.

Recent indicators for the **ASEAN** region show some signs that the pace of contraction has slowed. In Indonesia, real GDP contracted 13.7 percent in 1998. We estimate that real GDP growth in Indonesia was zero in the fourth quarter of 1998 at a seasonally adjusted annual rate, compared with a decline of 25 percent in the third quarter. Although industrial production remains well below year-earlier levels across the region, only in the Philippines, and to a lesser extent Singapore, has the decline intensified in recent months.

ASEAN financial markets were relatively unaffected by events in Brazil, with stock markets across the region giving back hardly any of their gains of recent months. Currencies also held firm in the face of Brazil's devaluation, except for the Indonesian rupiah which weakened significantly against a background of mounting ethnic and religious violence in the country.

All the ASEAN countries are running trade surpluses, with balances up sharply across the region relative to last year. The improvement has resulted mainly from a reduction in imports rather than increases in export revenues. However, in recent months imports across the region appear to have stabilized.

ASEAN Economic Indicators: Growth

Indicator and country	1997	1998	1998				
			Q3	Q4	Sept.	Oct.	Nov.
Real GDP[1]							
Indonesia	4.9	-13.6	-25.0	-.0	...	...	...
Malaysia	7.8	n.a.	-2.3	n.a.	...	...	...
Philippines	5.2	n.a.	4.4	n.a.	...	...	...
Singapore	7.7	n.a.	-3.8	n.a.	...	...	...
Thailand	-.4	n.a.	...	...	...	...	...
Industrial production[2]							
Indonesia	6.4	-12.9	-18.4	-19.5	...	...	...
Malaysia	10.7	n.a.	-10.3	n.a.	-10.9	-10.9	-11.5
Philippines	8.9	n.a.	-5.9	n.a.	-7.8	-8.0	n.a.
Singapore	4.7	n.a.	-4.1	n.a.	-.8	-7.5	-3.3
Thailand	-.4	n.a.	-11.1	n.a.	-8.8	-3.4	-3.1

1. Percent change from previous period; SAAR estimated by staff.
2. Percent change from year earlier.
n.a. Not available. ... Not applicable.

Indonesia and Thailand recently took small steps toward reforming their troubled banking sectors. The government in Indonesia announced that over 70 banks are eligible to enter its recapitalization program. The government will provide 80 percent of the funds needed to recapitalize the eligible private banks, as long as their owners or new investors supply the other 20 percent in cash. In Thailand, the country's fourth largest bank applied to enter the government's tier-one recapitalization program—the first Thai bank to do so.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars; annual rate; not seasonally adjusted)

Country	1997	1998	1998 Q3	1998 Q4	1998 Sept.	1998 Oct.	1998 Nov.	1998 Dec.
Indonesia	11.9	n.a.	23.3	n.a.	22.9	16.6	n.a.	n.a.
Malaysia	-.2	n.a.	16.5	n.a.	19.8	20.9	20.4	n.a.
Philippines	-10.5	n.a.	2.0	n.a.	4.0	1.5	2.5	n.a.
Singapore[1]	-5.8	8.3	10.9	8.9	15.8	12.4	10.3	3.8
Thailand	-4.6	n.a.	12.6	n.a.	14.9	13.1	13.3	n.a.

1. Non-oil trade balance.
n.a. Not available. ... Not applicable.

ASEAN Economic Indicators: CPI Inflation
(Percent change from year earlier)

Country	1997	1998	1998 Q3	1998 Q4	1998 Sept.	1998 Oct.	1998 Nov.	1998 Dec.
Indonesia	6.0	77.6	76.3	78.4	82.4	79.4	78.0	77.6
Malaysia	3.3	5.3	5.7	5.4	5.5	5.2	5.6	5.3
Philippines	6.6	10.4	10.4	10.6	10.0	10.2	11.2	10.4
Singapore	2.1	-1.5	-.8	-1.6	-1.3	-1.7	-1.5	-1.5
Thailand	7.6	4.3	8.2	5.0	7.0	5.9	4.7	4.3

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

In **Hong Kong**, the unemployment rate in the fourth quarter rose to 5.8 percent, well over twice its rate at the beginning of the year. In November, the price level was below its year-earlier level. Hong Kong's merchandise trade deficit has continued to narrow in recent months, reflecting continued weakening of imports.

Spreads between Hong Kong government debt and U.S. Treasuries, which peaked in August 1998 at nearly 700 basis points at a one-year maturity, declined steadily to only 90 basis points on January 8, the lowest spread since October 1997. Spreads widened substantially the following week, reflecting increasing concerns about China as well as the Brazilian devaluation. On January 10, Chinese authorities announced that they would not give preferential treatment to foreign creditors of the Guangdong International Trust and Investment Company (GITIC, discussed below), raising concern about Hong

Kong banking exposure to Chinese entities; the Hong Kong Monetary Authority has announced that exposure by local Hong Kong banks to Chinese firms (including trust and investment companies) is about $12 billion, which staff estimates is about 50 percent of bank capital. On January 27, spreads stood at 209 basis points. Foreign exchange reserves were $89 billion at the end of November, up very slightly from their recent low in September.

Hong Kong Economic Indicators

Indicator	1996	1997	1998				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP[1]	4.5	5.3	-1.4	-5.4	...	...	...
Consumer prices[2]	6.5	5.2	4.4	2.8	2.4	.1	-.9
Trade balance[3]	-17.8	-20.6	-18.0	-9.7	-2.3	-1.1	-1.1

1. Percent change from previous period; SAAR estimated by staff.
2. Percent change from year earlier.
3. Billions of U.S. dollars, AR, NSA. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In **China**, GDP rose 7.8 percent in 1998. In the fourth quarter alone, GDP rose about 9 percent from the year-earlier period. (China generally releases its annual growth figure in the last week of December, as it did this year; although this early release is labeled "preliminary," the data are rarely revised.) The rise in growth appears to reflect a surge in investment by state enterprises in the second half of the year. Nominal state investment in 1998 was 22 percent higher than a year earlier; most of the increase was in the second half, since investment rose only 11 percent in the first half.

China's trade surplus was slightly higher in 1998 than 1997. However, the surplus has fallen in recent months, reflecting weakening exports. The value of exports in the fourth quarter fell 7 percent from its year-earlier level, while the value of imports fell 5 percent. Foreign direct investment inflows were $45.5 billion in 1998, almost unchanged from a year earlier. Total reserves less gold were $149 billion at the end of 1998, up about $6 billion from the end of 1997.

In early January, Chinese authorities announced that they plan to put GITIC into bankruptcy. Authorities closed GITIC in October without any clear explanation of how its outstanding liabilities (currently reported at $4.4 billion, compared with assets of $2.6 billion) would be treated. The announcement generally disappointed foreign creditors, who had hoped for preferential treatment for foreign banks. The announcement also indicated that even foreign debt officially registered with the central government would not necessarily be honored, despite the assumption of many creditors to the contrary. Given the outcome, foreign lenders are likely to remain wary about lending to Chinese non-bank financial institutions. Nevertheless, the announcement appears to signal that Chinese authorities are serious about trying to crack down on financial "irregularities."

Chinese Economic Indicators
(Percent change from year earlier except as noted)

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP	8.8	7.8	7.6	9.3	...	...	...
Industrial production	11.1	n.a.	8.6	n.a.	10.6	11.0	n.a.
Consumer prices	0.4	-1.0	-1.4	-1.1	-1.1	-1.2	-1.0
Trade balance[1]	40.3	43.6	51.2	32.8	37.0	33.6	27.6

1. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

In **Taiwan**, industrial production growth slowed in the fourth quarter. Taiwan's trade balance remained in surplus in 1998, although it was down slightly from its 1997 surplus. The value of exports fell 9 percent from a year-earlier, while the value of imports fell 8 percent. Inflation moderated somewhat in December, following a sharp rise in October and November. Foreign exchange reserves rose above $90 billion in December, up about $7 billion for the year and the highest level since July 1997. Taiwan's stock market remained relatively stable in late 1998 and early 1999, but this stability appears to reflect continuing intervention by the government's stock stabilization fund.

The **Russian** economy remains in turmoil. Real GDP fell sharply in September, and industrial output was down almost 7 percent year-over-year in December. So far this year, the ruble has fallen by about 9 percent relative to the dollar and is down roughly 75 percent since mid-August. The sharp increase in the cost of imports since August has caused inflation to soar, from 6 percent on a twelve-month basis in July to over 80 percent in December.

The current version of Russia's 1999 budget, recently passed in its second of four readings, aims to trim the deficit from 5½ percent of GDP in 1998 to 2½ percent this year, with a primary (non-interest) surplus of 1¾ percent. This plan has so far failed to win favor with the IMF, which has made known that it would like to see a primary surplus of 3-4 percent of GDP next year. Several

Taiwan Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	6.8	n.a.	6.2	n.a.	...	...	...
Industrial production[2]	6.8	3.8	5.0	1.3	1.6	3.5	-0.8
Consumer prices[2]	.2	2.1	.6	2.9	2.6	3.9	2.1
Trade balance[3]	7.7	6.0	14.0	5.2	-.2	19.2	3.6
Current account[3]	7.7	n.a.	2.1	n.a.	...	...	...

1. Percent change from previous period; SAAR estimated by staff.
2. Percent change from year earlier.
3. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

Russian Economic Indicators

Indicator	1997	1998	1998				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	.8	n.a.	-22.4	n.a.	n.a.	n.a.	n.a.
Industrial production[2]	1.8	-5.2	-11.7	-8.9	-11.1	-9.1	-6.6
Unemployment rate[3]	10.8	11.8	11.5	11.8	11.6	11.7	11.8
Consumer prices[2]	11.0	84.4	26.2	70.0	58.8	66.7	84.4
Ruble depreciation[2]	12.7	71.3	39.4	67.0	64.0	65.7	71.3
Trade balance[4]	19.8	n.a.	12.6	n.a.	36.0	36.0	n.a.
Current account[4]	3.3	n.a.	.9	n.a.	...	...	...

1. Percent change from previous period, AR.
2. Percent change from year earlier.
3. Percent.
4. Billions of U.S. dollars, AR, NSA.
n.a. Not available. ... Not applicable.

assumptions underlying the budget seem overly optimistic, including an annual inflation rate of 30 percent and an exchange rate of 21.5 rubles per dollar. Furthermore, the budget assumes the resumption of IMF and World Bank lending as well as the successful "re-rescheduling" of about $7 billion in Soviet-era debt. The IMF continues to stress that further assistance will not be forthcoming without a coherent budget and some signs that it is being implemented.

The government also continues to negotiate with foreign creditors on rescheduling of its Soviet-era external debt, while maintaining that it will meet in full all obligations of the Russian Federation, issued since 1991. In December, Russia failed to make payment on $360 million in interest owed to the London Club. The government had offered to restructure the debt in new paper, but failed to raise the 95 percent agreement from creditors necessary to approve the deal. Negotiations on restructuring Russia's $40 billion debt to the Paris Club will not begin until after the government's economic plan wins approval from the IMF.