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September 29, 2000

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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### The Domestic Nonfinancial Economy

#### Real Gross Domestic Product

According to BEA's final estimate, real GDP rose at an annual rate of 5.6 percent in the second quarter after having increased at a 4.8 percent pace in the first quarter. At 3.9 percent, the rise in second-quarter final sales was considerably slower than in the first quarter, but inventory accumulation swung from a large drag on GDP growth in the first quarter to a large positive contribution in the second. The deceleration in final sales in the second quarter was widespread across the broad sectors of private spending, including consumer spending, business fixed investment, and net exports. By contrast, federal government spending rose in the second quarter after having fallen in the first, although this pattern likely reflects erratic timing of defense purchases rather than any underlying movements in economic activity.

The final estimate of the increase in real GDP in the second quarter was 0.3 percentage point higher than the preliminary estimate that the BEA released a month ago. The upward revisions were in net exports and the services component of personal consumption expenditures, and reflected new and revised source data. Inflation as measured by the chain price index for GDP was revised down 0.2 percentage point to 2.4 percent (annual rate) in the second quarter. Inflation as measured by the price index for personal consumption expenditures other than food and energy was revised down by 0.3 percentage point, to an annual rate of 1.4 percent, mostly because of the incorporation of new source data on brokers' commissions.

The final estimate of the rise in real GDP growth in the second quarter was 0.4 percentage point higher than the staff had anticipated in the September Greenbook. About half of the difference was the result of the faster rise in real PCE, mostly in the services area. The remainder was the result of technical estimation errors related to the chain aggregation of inventories, an area where we find it difficult to replicate exactly BEA's aggregation techniques.<sup>1</sup>

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1. In particular, BEA uses changes in real inventories at a fine level of disaggregation in constructing its estimate of overall GDP. By contrast, we use the changes in the BEA's estimate of the *aggregate* levels of real farm and nonfarm inventories in 1996 dollars in our approximation. While this approximation works well in most circumstances, it can lead to errors when there are large swings in price deflators. In the case of farm inventories, extreme swings in price deflators are commonplace, as prices and inventories of individual commodities – which are not published by the BEA – can vary widely. Unfortunately, the second quarter was one such period: The level of deflator for farm inventory investment was negative, (a peculiar but mathematically possible occurrence) and had increased sharply from an even more negative value in the first quarter.

## Real Gross Domestic Product and Related Items

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

	2000:Q1	2000:Q2	2000:Q2
	Final	Advance	Final
1. Gross domestic product	4.8	5.3	5.6
2. Final sales	6.7	3.5	3.9
3. Consumer spending	7.6	2.9	3.1
4. Durables	23.6	-5.0	-5.0
5. Nondurables	6.0	3.4	3.6
6. Services	5.2	4.4	4.6
7. Business fixed investment	21.0	14.6	14.6
8. Equipment and software	20.6	17.8	17.9
9. Nonresidential structures	22.3	4.8	4.4
10. Residential investment	3.2	.0	1.3
11. Federal government consumption expenditures and investment	-14.2	16.9	17.2
12. State and Local government consumption expenditures and investment	6.6	-.9	-1.1
13. Exports of goods and services	6.3	13.5	14.3
14. Imports of goods and services	12.0	19.5	18.6
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<i>ADDENDA:</i>			
15. Nonfarm inventory investment <sup>1</sup>	33.0	72.9	72.3
16. Motor vehicles <sup>1</sup>	-1.7	13.6	13.5
17. Excl. motor vehicles <sup>1</sup>	34.7	59.3	58.8
18. Net exports of goods and services <sup>1</sup>	-376.8	-408.6	-403.4
19. Nominal GDP	8.3	8.0	8.2
20. GDP price index	3.3	2.6	2.4
21. Profit share <sup>2</sup>	9.6	9.7	9.7
22. (Excluding FR banks)	9.3	9.4	9.4
23. Real disposable personal income	1.9	3.3	3.7
24. Personal saving rate (percent)	.2	.2	.3

1. Level, billions of chained (1996) dollars.

2. Economic profits as a share of nominal GNP.

On net, BEA's estimate of second-quarter corporate profits was little changed, as a \$3 billion downward revision to domestic profits was offset by a similar-sized upward revision to rest-of-world profits. Thus, corporate profits as a share of GNP (excluding profits of Federal Reserve Banks) are estimated to have been 9.4 percent in the second quarter, the same as in the preliminary release and up just slightly from the first quarter. Elsewhere on the income side of the accounts, the increase in compensation was revised up as the BEA made adjustments in reaction to new data from the unemployment insurance program. This revision suggests that there will be a large upward revision to hourly compensation in the nonfarm business sector when those data are next released (in early November); incorporating new data on hours as well, we estimate that the increase in hourly compensation will be 5.9 percent (annual rate), 0.6 percentage point higher than currently published. We estimate that the second-quarter increase in productivity in the nonfarm business sector will be revised up a bit less, 0.4 percentage point.

### **Consumer Income and Spending**

Total nominal personal income increased 0.4 percent (\$34 billion) in August, following a gain of 0.3 percent (\$24 billion) in July. Wage and salary disbursements rose more slowly in August than over the first seven months of the year, and farm proprietors' income fell again, reflecting in part lower federal farm subsidy payments. In contrast, nonfarm proprietors' income turned up, and the increases in dividend and interest income and in transfer payments were larger in August than in July. Personal tax and nontax payments increased more than \$14 billion in August following a gain of just \$1 billion in July when tax payments were held down by a tax rebate in Minnesota. Real disposable personal income rose 0.3 percent in August and was up 2-3/4 percent from a year earlier.

Real personal consumption expenditures rose 0.6 percent in August, and the personal saving rate fell to -0.4 percent. Real outlays for durable goods jumped 2 percent last month reflecting increases in purchases of motor vehicles, appliances, computers, audio and video equipment, and miscellaneous household furnishings. Real expenditures for nondurable goods increased 0.6 percent, held down a bit by a small decline in real outlays for gasoline. However, higher spending was reported in a number of other categories including food, beverages, apparel, toiletries, and prescription drugs. Real expenditures for services rose 0.4 percent in August, boosted by a rebound in outlays for electricity and natural gas following unseasonably cool weather in July. Small spending gains were reported in August for medical care, personal business services, and recreation services. Outlays for transportation services were unchanged last month in part because of a decline in air travel.

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

	1999	1999		2000		2000	
		1999	Q4	Q1	Q2	July	Aug.
Total personal income	36.0	49.1	55.8	39.3	24.3	34.2	
Wages and salaries	23.7	25.0	27.7	25.9	24.7	14.1	
Private	21.0	22.7	22.1	23.7	21.6	13.4	
Other labor income	1.4	1.6	2.4	2.1	2.5	2.5	
Proprietors' income	3.5	8.7	8.5	3.4	-11.4	-.2	
Farm	-.5	.9	2.0	.7	-7.1	-4.9	
Rent	.1	5.7	1.0	-3.0	-1.4	-.9	
Dividend	2.1	2.2	2.2	2.0	2.4	5.0	
Interest	3.8	5.8	9.4	5.2	7.7	9.2	
Transfer payments	3.3	1.8	7.2	5.5	1.5	5.5	
Less: Personal contributions for social insurance	2.0	1.7	2.6	1.7	1.6	1.0	
Less: Personal tax and nontax payments	7.9	10.8	13.4	12.2	1.0	14.2	
Equals: Disposable personal income	28.1	38.4	42.3	27.0	23.4	20.0	
Memo: Real disposable income <sup>1</sup>	16.3	28.1	14.6	19.9	6.9	18.6	

1. Billions of chained (1996) dollars.

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

	1999	1999		2000		2000	
		1999	Q4	Q1	Q2	July	Aug.
		- - - Annual rate - - -				Monthly rate	
Personal consumption expenditures	5.6	5.9	7.6	3.1	.4	.6	
Durable goods	11.1	13.0	23.6	-5.0	.8	2.0	
Excluding motor vehicles	14.7	17.0	20.8	4.4	.6	1.8	
Nondurable goods	5.9	7.4	6.0	3.6	.6	.6	
Excluding gasoline	6.2	7.3	7.8	3.7	.4	.7	
Services	4.2	3.8	5.2	4.6	.2	.4	
Excluding energy	4.3	4.8	5.1	4.1	.3	.3	
Memo:							
Personal saving rate (percent)	2.2	1.5	.2	.3	.0	-.4	
Real disposable income <sup>1</sup>	3.1	4.5	1.9	3.7	.1	.3	

1. Percent changes derived from billions of chained (1996) dollars.

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

	2000 Jan.	2000 Feb.	2000 Mar.	2000 Apr.	2000 May	2000 June	2000 July	2000 Aug.	2000 Sept. (f)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	112.0	111.3	107.1	109.2	110.7	106.4	108.3	107.3	106.8
Current conditions	117.3	116.8	115.4	117.8	119.9	115.1	114.2	112.4	112.0
Expected conditions	108.6	107.8	101.7	103.7	104.8	100.8	104.5	104.0	103.4
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Personal financial situation									
Now compared with 12 months ago*	135	132	135	130	138	129	130	126	124
Expected in 12 months*	141	138	136	137	137	137	139	139	132
Expected business conditions									
Next 12 months*	165	161	146	152	153	146	148	151	149
Next 5 years*	133	136	128	130	133	123	135	130	136
Appraisal of buying conditions									
Cars	144	153	134	148	145	138	141	147	145
Large household appliances*	169	172	165	176	173	170	167	166	167
Houses	152	153	150	151	136	128	136	138	144
Willingness to use credit	51	48	52	54	45	49	44	47	41
Willingness to use savings	85	75	67	70	65	79	70	71	70
Expected unemployment change - next 12 months	104	106	109	109	104	112	111	108	111
Prob. household will lose a job - next 5 years	19	21	20	19	18	21	23	21	21
Expected inflation - next 12 months									
Mean	3.5	3.5	3.8	3.5	3.5	3.4	3.7	3.5	3.7
Median	3.0	2.9	3.2	3.2	3.0	2.9	3.0	2.7	2.9
Expected inflation - next 5 to 10 years									
Mean	3.5	3.3	3.8	3.2	3.4	3.3	3.2	3.5	3.6
Median	3.0	2.9	3.1	2.8	2.9	2.8	2.8	2.9	3.0

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

(p) -- Preliminary

(f) -- Final

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



According to the final report, the overall index of consumer sentiment from the Michigan Survey Research Center edged down 1/2 point in September.<sup>2</sup> Still, the index remains in the middle of the narrow, elevated range recorded over the past two years. In September, consumers were not quite as optimistic about their financial situations over the next twelve months, but their assessments of their current personal finances and of buying conditions for large household appliances were little changed. The index of expected business conditions for the next twelve months inched down in September, but the index for the next five years rebounded after having dipped in August. Among those questions not included in the overall measure, respondents' views about current car buying conditions and expected unemployment conditions were slightly less favorable in September. In contrast, their views of home buying conditions turned significantly more favorable this month. Since June, the index for home buying conditions has reversed most of the decline that occurred over the first half of this year; nonetheless, the index remains considerably below the levels recorded in 1998 and the first half of 1999.

Inflation expectations moved up a little in September. Both the mean and the median of expected inflation over the next twelve months increased 0.2 percentage point to 3.7 and 2.9 percent, respectively. The mean and median of expected inflation over the next five years inched up 0.1 percentage point to 3.6 and 3.0 percent, respectively.

### **Prices**

The price index for personal consumption expenditures was unchanged in August. Over the past twelve months, the PCE price index rose 2.4 percent compared with a 1.7 percent increase over the preceding twelve-month period. Faster energy price inflation accounts for most of that acceleration in overall PCE prices. Excluding food and energy items, PCE prices rose 0.1 percent in August and were up 1.7 percent over the past twelve months--up about 1/4 percentage point from the year-earlier figure. This acceleration in core PCE prices is less pronounced than in the core CPI (on a current-methods basis).

Having discovered a programming error that affected the indexes for residential rent and owners' equivalent rent, as well as the higher-level aggregates that depend on them, the BLS released corrected CPI data for the first eight months of this year. The upper portion of the table below presents the corrected levels of the affected indexes in August 2000. As can be seen,

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2. In contrast, the preliminary report showed an increase in the index of 1-1/2 points during the first two weeks of September. The decline in the index for the month as a whole suggests a moderate deterioration in attitudes in the second half of the month.

PCE PRICE INDEXES  
(Percent changes)

	From twelve months earlier		2000		2000	
	Aug. 1999	Aug. 2000	Q1	Q2	July	Aug.
			-Annual rate-		-Monthly rate-	
All items	1.7	2.4	3.5	2.1	.2	.0
Food and Beverages	2.0	2.7	2.4	2.3	.5	.2
Energy	7.7	13.7	35.1	13.0	-.1	-3.0
PCE less food and energy	1.4	1.7	2.2	1.4	.2	.1
Commodities	-.9	-.3	-1.4	.6	.0	-.2
Services	2.4	2.7	3.8	1.8	.3	.3
Memo:						
CPI <sup>1</sup>	2.2	3.4	4.1	3.7	.2	-.1
CPI less food and energy <sup>1</sup>	1.9	2.6	2.3	3.0	.2	.2

1. Data for 1998 are on a current-methods basis

the corrections to the top-line indexes amount to less than 0.1 percentage point, and the revisions to the rent components themselves amount to 0.2 percentage point.

### Corrections to the Consumer Price Index

	Index levels, August 2000 (NSA)				
	Current	Previous	Revision (percent)		
Total CPI	172.8	172.7	.06		
Excluding food and energy	181.7	181.6	.06		
Rent of Shelter	202.7	202.3	.20		
Owners' equivalent rent	199.2	198.8	.20		
Residential rent	184.6	184.2	.22		
Twelve-month percent changes					
		With revised 1999 data		As published	
		Aug. 2000	Aug. 1999	Aug. 2000	Aug. 1999
Total CPI		3.3	2.3	3.4	2.3
<i>Previous</i>				3.4	2.3
<b>Excluding food and energy</b>		<b>2.5</b>	<b>2.0</b>	<b>2.6</b>	<b>1.9</b>
<i>Previous</i>				<b>2.5</b>	<b>1.9</b>
Rent of Shelter		3.2	2.9	3.4	2.8
<i>Previous</i>				3.2	2.8
Owners' equivalent rent		2.8	2.8	3.0	2.6
<i>Previous</i>				2.8	2.6
Residential rent		3.6	3.1	3.8	3.0
<i>Previous</i>				3.5	3.0

The published data present a misleading impression about the timing of these corrections, however. Although the programming errors affected data back to January 1999, BLS only revised data for this calendar year.<sup>3</sup> That is, BLS put the levels of this year's indexes in their proper place, but did not change the

3. The current-methods CPI series shown on the table, "Broad Measures of Inflation," on page 10 incorporates both the published revisions to the CPI for 2000 as well the revisions that would have been made to the CPI for 1999 had the BLS revision covered the entire period over which the programming error affected the data. It presents our best guess of a consistently measured, error-free series. These current-methods CPI data are confidential.

index levels for 1999; thus, there is now a discontinuity in the published series between December 1999 and January 2000. The lower portion of the table presents twelve-month changes based on both the new published data and the unpublished data that incorporates revisions to 1999. As can be seen, the series with revised 1999 data, which adjust for the discontinuity, suggests that the acceleration in the core CPI between 1999 and 2000 — from 2 percent a year ago to 2.5 percent in the most recent twelve months — is slightly smaller than the published data would indicate. However, the 2 percent rise now shown for 1999 is a tenth higher than the previous data had indicated.

The BEA uses these CPI rent estimates as source data for the housing components of PCE prices, and the corrected CPIs will be brought into the NIPAs with next summer's annual revision.<sup>4</sup> We expect that the corrections will result in a slight upward revision to PCE prices at that time. However, those revisions should have no effect on real PCE or GDP, because the housing components of PCE are based on real (not nominal) source data.

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4. The NIPAs will not be affected by the break in the series between December 1999 and January 2000 because the BEA uses the current-methods CPIs, which will be revised to incorporate the corrections to the data in 1999 as well as 2000.

BROAD MEASURES OF INFLATION  
(4-quarter percent change)

	1997 Q2	1998 Q2	1999 Q2	2000 Q2
<u>Product prices</u>				
GDP chain price index	2.1	1.2	1.5	2.1
Less food and energy	2.2	1.3	1.6	2.0
Nonfarm business chain price index <sup>1</sup>	2.2	0.8	1.3	1.7
<u>Expenditure prices</u>				
Gross domestic purchases chain price index	1.8	0.8	1.5	2.4
Less food and energy	1.8	1.0	1.5	1.8
PCE chain price index	2.0	1.0	1.7	2.4
Less food and energy	2.1	1.3	1.6	1.6
CPI	2.3	1.6	2.1	3.3
Less food and energy	2.5	2.2	2.1	2.4
Current-methods CPI	2.0	1.4	2.0	3.3
Less food and energy	2.2	2.1	2.0	2.4
Median CPI	2.9	2.9	2.6	2.5
Trimmed mean CPI	2.5	2.0	1.8	2.4

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS  
(Percent)

	Actual inflation <sup>1</sup>	University of Michigan				Professional forecasters (10-year) <sup>4</sup>
		1 year		5 to 10 years		
		Mean <sup>2</sup>	Median <sup>2</sup>	Mean <sup>3</sup>	Median <sup>3</sup>	
1998-Q4	1.5	2.7	2.4	3.2	2.8	2.5
1999-Q1	1.7	3.0	2.6	3.3	2.8	2.3
Q2	2.1	3.1	2.7	3.3	2.8	2.5
Q3	2.3	3.1	2.7	3.4	2.9	2.5
Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3		3.6	2.9	3.4	2.9	2.5
Apr.	3.1	3.5	3.2	3.2	2.8	
May	3.2	3.5	3.0	3.4	2.9	
June	3.7	3.4	2.9	3.3	2.8	2.5
July	3.7	3.7	3.0	3.2	2.8	
Aug.	3.4	3.5	2.7	3.5	2.9	
Sept.		3.7	2.9	3.6	3.0	2.5

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

**Selected Financial Market Quotations**  
(One-day quotes in percent except as noted)

Instrument	1999	2000			Change to Sept. 28 from selected dates (percentage points)		
	June 29	May 15	FOMC* Aug. 22	Sept. 28	1999 June 29	2000 May 15	FOMC* Aug. 22
<i>Short-term</i>							
FOMC intended federal funds rate	4.75	6.00	6.50	6.50	1.75	.50	.00
<i>Treasury bills</i> <sup>1</sup>							
3-month	4.70	5.94	6.09	6.07	1.37	.13	-.02
6-month	4.92	6.24	6.07	6.03	1.11	-.21	-.04
1-year	4.89	6.05	5.88	5.77	.88	-.28	-.11
<i>Commercial paper</i>							
1-month	5.18	6.47	6.48	6.52	1.34	.05	.04
3-month	5.12	6.59	6.47	6.47	1.35	-.12	.00
<i>Large negotiable CDs</i> <sup>1</sup>							
1-month	5.21	6.55	6.55	6.57	1.36	.02	.02
3-month	5.32	6.74	6.61	6.71	1.39	-.03	.10
6-month	5.43	6.97	6.75	6.67	1.24	-.30	-.08
<i>Eurodollar deposits</i> <sup>2</sup>							
1-month	5.13	6.53	6.53	6.53	1.40	.00	.00
3-month	5.25	6.72	6.60	6.69	1.44	-.03	.09
Bank prime rate	7.75	9.00	9.50	9.50	1.75	.50	.00
<i>Intermediate- and long-term</i>							
<i>U.S. Treasury (constant maturity)</i>							
2-year	5.68	6.88	6.28	6.02	.34	-.86	-.26
10-year	5.93	6.47	5.79	5.82	-.11	-.65	.03
30-year	6.07	6.17	5.71	5.89	-.18	-.28	.18
U.S. Treasury 10-year indexed note	4.01	4.21	4.01	3.97	-.04	-.24	-.04
Municipal revenue (Bond Buyer) <sup>3</sup>	5.62	6.23	5.76	5.85	.23	-.38	.09
<i>Private instruments</i>							
10-year swap	6.81	7.82	7.07	6.95	.14	-.87	-.12
10-year FNMA	6.59	7.70	6.91	6.79	.20	-.91	-.12
Merrill Lynch BBB	7.60	8.86	8.26	8.15	.55	-.71	-.11
High yield <sup>4</sup>	10.53	11.94	11.80	11.97	1.44	.03	.17
<i>Home mortgages (FHLMC survey rate)</i> <sup>5</sup>							
30-year fixed	7.63	8.52	7.96	7.90	.27	-.62	-.06
1-year adjustable	5.93	6.96	7.21	7.27	1.34	.31	.06

  

Stock exchange index	Record high		2000			Change to Sept. 28 from selected dates (percent)		
	Level	Date	May 15	FOMC* Aug. 22	Sept. 28	Record high	May 15	FOMC* Aug. 22
Dow-Jones Industrial	11,723	1-14-00	10,808	11,080	10,824	-7.67	.15	-2.31
S&P 500 Composite	1,527	3-24-00	1,452	1,499	1,458	-4.53	.41	-2.75
Nasdaq (OTC)	5,049	3-10-00	3,608	3,953	3,778	-25.16	4.73	-4.42
Russell 2000	606	3-9-00	498	516	524	-13.58	5.22	1.43
Wilshire 5000	14,752	3-24-00	13,438	13,970	13,786	-6.54	2.59	-1.31

1. Secondary market.
  2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
  3. Most recent Thursday quote.
  4. Merrill Lynch 175 high-yield bond index composite.
  5. For week ending Friday previous to date shown.
- \* Data are as of the close on August 21, 2000.

NOTE. June 29, 1999 is the day before the beginning of the most recent sequence of policy tightenings.  
May 15, 2000 is the day before the most recent tightening.