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August 1999

IMF Staff Country Report No. 99/76

United States: Staff Report for the 1999 Article IV Consultation

This report was prepared by a staff team of the International Monetary Fund following discussions with the officials of the United States on economic developments and policies. The report was then considered by the IMF's Executive Board in the context of the IMF's periodic consultation with the United States, as required under Article IV of the IMF Articles of Agreement. The views expressed in the staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities of the United States; a supplementary statement by IMF staff may also be included. The views of the Executive Board as expressed in the discussion of the Article IV consultation report and as summarized in a Public Information Notice (PIN) are also included. In addition, a statement by the member country authorities may be appended. Further background documentation prepared by IMF staff for the consultation may be published separately at a later date.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

UNITED STATES OF AMERICA

Staff Report for the 1999 Article IV Consultation

Prepared by the Staff Representatives for the 1999 Consultation with the United States

Approved by Claudio M. Loser and Leslie Lipschitz

July 2, 1999

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EXECUTIVE SUMMARY

Economic setting

- **Real GDP** grew by 3.9 percent in 1998, and by 4.3 percent (annual rate) in the first quarter of 1999. Owing to the strength of domestic demand and the weakness of activity abroad, the **current account** deficit in 1998 surged to 2.6 percent of GDP from 1.8 percent in 1997.

- After hovering around 4½ percent in 1998, the **unemployment rate** has remained around 4¼ percent since March 1999, significantly below most estimates of the natural rate of unemployment.

- **Core CPI inflation** rose slightly from 2.2 percent in 1997 to 2.5 percent in 1998, but declined in the first five months of 1999 to an annual rate of 1.8 percent. Underlying moderation in nominal wage increases, strong productivity growth, and low commodity prices were all contributing factors.

- The Federal Reserve eased **monetary policy** in three steps during September–November 1998, lowering the federal funds rate by a total of 75 basis points. In May, it announced a shift in its bias toward a possible tightening and raised the target federal funds rate by 25 basis points on June 30, 1999.

- The unified **federal budget balance** has improved steadily since FY 1992, shifting from a deficit of 4.7 percent of GDP in FY 1992 to a surplus of 0.8 percent in FY 1998. Estimates for FY 1999 suggest a surplus of around 1 percent of GDP.

Policy issues

- Key challenges are to assess: (i) whether the pace of economic activity will slow sufficiently to avoid inflationary pressures emerging in the absence of a monetary tightening; and (ii) whether potential economic imbalances raise the risks of a "hard landing" and, if so, what policies can do to mitigate these risks.

- The possibility of a stock market correction is a principal risk to the outlook in the near term, as the favorable economic environment may have induced investors to take on more risk and could have pushed asset prices to unsustainable levels.

- It will be important to resist pressures to increase spending and to cut taxes, in the period immediately ahead to avoid further stimulus to domestic demand, and over the medium term measures are needed to ensure that the fiscal surpluses in prospect are used to address the longer-term financial problems of Medicare and Social Security. As growth in the rest of the world recovers, some reversal of safe-haven capital flows and some depreciation of the dollar can be expected, helping to narrow the U.S. external current account deficit.

- Competition faced by U.S. producers has intensified leading to increased protectionist pressures, which should be strongly resisted.

Staff views

- The decline in personal saving and the rise in the current account imbalance do not warrant any immediate policy response, but they do heighten the potential risks associated with any overheating and provide a strong additional reason to ensure that envisaged fiscal surpluses are realized.

- The economy still faces resource constraints, and the recent very strong growth in aggregate demand cannot be sustained for long without having inflationary consequences. Unless there is evidence soon that the strength of demand growth is abating, the authorities may need to tighten monetary policy further.

- A comprehensive solution to Social Security's and Medicare's long-term financial problems should involve small adjustments in the system's parameters (increases in contribution rates and/or cuts in net benefits), which need to be enacted soon.

- An appropriate longer-term fiscal objective would be to put the Social Security and Medicare programs into actuarial balance, and then keep the remainder of the budget balanced on average, allowing for changes in cyclical conditions.

- Protection from "unfair trade" in the form of antidumping and countervailing duties—even if they conform to WTO obligations—should not simply be used as a means of inhibiting competition from imports.

- The authorities should raise the priority assigned to ODA and re-establish the leadership role of the United States in this area, thereby helping to catalyze a resurgence in such assistance worldwide.

I. INTRODUCTION[1,2]

1. The staff report for the previous Article IV consultation discussions was considered by the Executive Board on August 3, 1998 (EBM/98/85).[3] Executive Directors noted at that time that the strength of the U.S. economy was facilitating adjustment in countries affected by the financial crisis in Asia and would help to continue to sustain growth in the world economy. With the U.S. economy estimated to be operating at a very high level of resource utilization, Directors considered that a key to successful policy would be to gauge the underlying strength of the economy so as to prevent the emergence of inflationary pressures. Although Directors believed that the stance of monetary policy was appropriate, they cautioned that labor market conditions were expected to remain tight and the influence of factors that had restrained inflation was likely to wane. Directors noted the rapid consolidation of the fiscal position in recent years and strongly supported efforts to preserve the budget surpluses in prospect over the medium term. Increasing strains would be placed on the fiscal situation as a result of the aging of the U.S. population, and Directors cautioned that prompt measures were needed to address the longer-term imbalances facing Medicare and Social Security. Directors welcomed U.S. efforts to promote trade liberalization and urged the authorities to strongly resist protectionist pressures that might arise as a result of the trade effects of the financial crisis in Asia.

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

2. ***Policy actions over the last six years have significantly improved the macroeconomic environment, helping to make the current economic expansion the second longest since World War II*** (Table 1).[4] The unemployment rate has come down to its lowest

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[1] The discussions for the 1999 Article IV consultation with the United States took place on May 20 in Washington, D.C., following technical meetings held during May 4–13. The staff comprised D. Goldsbrough, S. Dunaway, M. Leidy, M. Cerisola, J. Chan-Lau, P. DeMasi, S. Tokarick (all WHD) and H. Faruqee (RES). The Managing Director, the First Deputy Managing Director, and Mr. Loser took part in the concluding discussions with Federal Reserve Board Chairman Greenspan and Treasury Secretary Rubin on June 14. Ms. Lissakers, Executive Director for the United States, and Mr. Sobel, Advisor to the U.S. Executive Director, attended the meetings.

[2] Comprehensive economic data are available for the United States on a timely basis. The United States has subscribed to the Fund's Special Data Dissemination Standard and has submitted metadata, which have been posted on the Fund's Data Standards Bulletin Board.

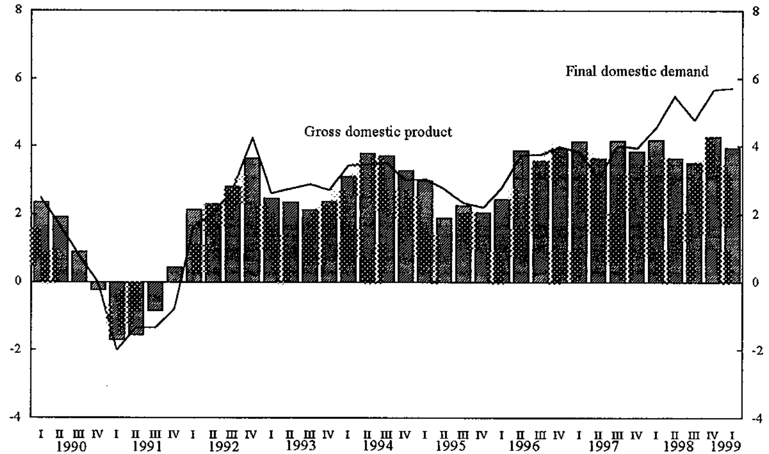
[3] SM/98/179, 7/13/98 and the selected issues paper, SM/98/188, 7/20/98.

[4] The National Bureau of Economic Research identifies the 106 months from February 1961 to December 1969 as the longest U.S. expansion and the current expansion (at 99 months through June 1999) as the second longest since 1854 when the data begin.

level in decades without signs of inflationary pressure, in part because of significant advances in labor productivity growth and the rapid pace of investment. However, recent inflation restraint has also been aided by a number of factors that may be temporary, including an appreciation of the dollar and a decline in world commodity prices. Steadfast efforts to improve the fiscal outlook have helped to turn the unified federal budget balance to a surplus in FY 1998 for the first time in 30 years. And while continued global economic and financial market turbulence has slowed U.S. export growth, it has also stimulated a flight to quality that, together with significant fiscal consolidation, helped to lower long-term U.S. interest rates, thereby stimulating spending on consumer durables and business fixed investment.

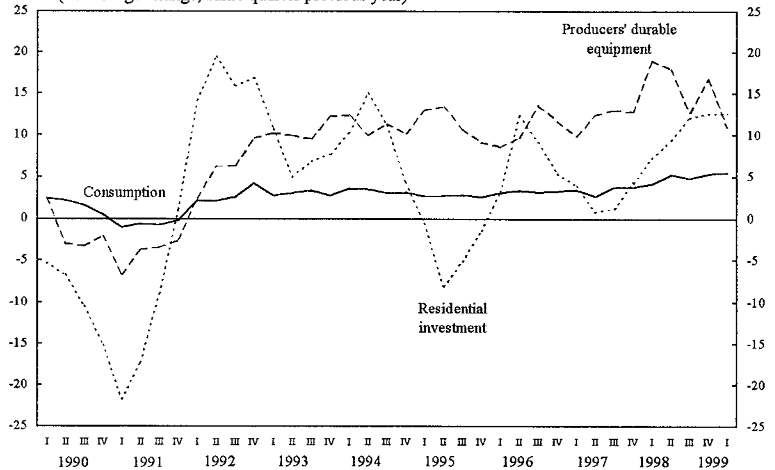
3. ***The unflagging strength of the U.S. economy has helped to facilitate external adjustment in those countries most affected by financial market turbulence, and thus has been a major factor in helping to ameliorate world economic conditions.*** At the same time, personal saving has declined sharply in the United States, in part because of the financial wealth created by the surging U.S. stock market, and the external current account deficit has widened, raising concerns over whether imbalances might be emerging that could threaten the sustainability of the current expansion.

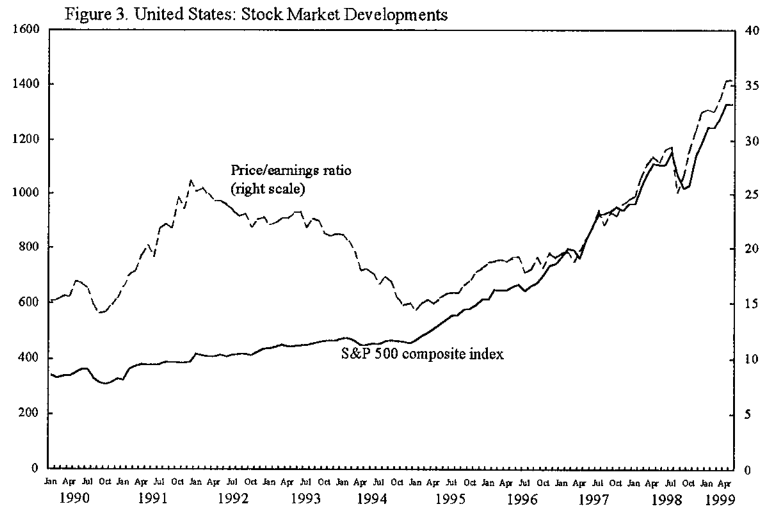
Figure 1. United States: Real GDP and Domestic Demand
(Percentage change, same quarter previous year)



4. ***Despite the risks emanating from global economic and financial turbulence during 1998, the U.S. economy maintained its solid footing with real GDP increasing by 3.9 percent in 1998, and by 4.3 percent on an annual basis in the first quarter of 1999 (Figure 1). Buoyant consumption and investment spending acted as dual engines of growth, overcoming the considerable drag on the economy arising from a decline in the contribution of net exports***

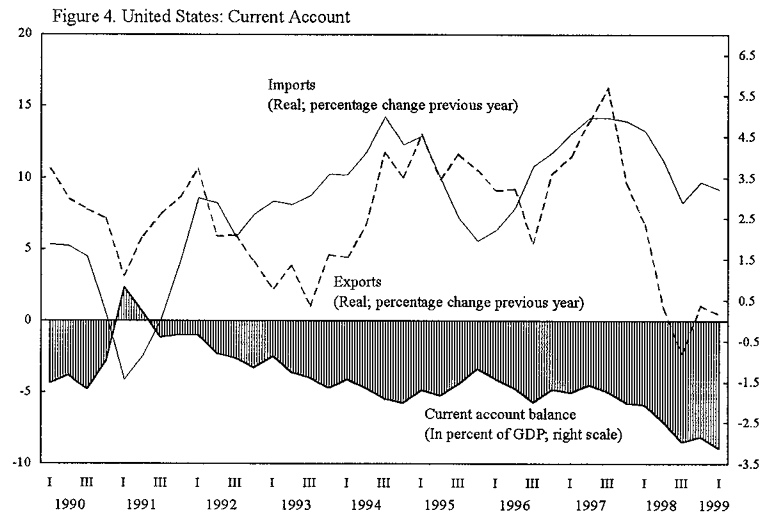
Figure 2. United States: Consumption and Investment
(Percentage change, same quarter previous year)





(Figure 2). Personal consumption expenditures increased by nearly 5 percent in real terms in 1998, the largest annual gain in 14 years. Durable goods consumption was especially strong with real outlays rising by 10 percent. Although rising personal income, strong consumer confidence, and declining real interest rates all played a role in boosting consumption in 1998, the continued sharp increase in net household wealth fueled by the rise in equity prices (Figure 3) also underpinned its strength. Household saving as a share of personal disposable income declined to just ½ percent in 1998, its lowest level since World War II, and in the first quarter of 1999 turned negative for the first time ever.

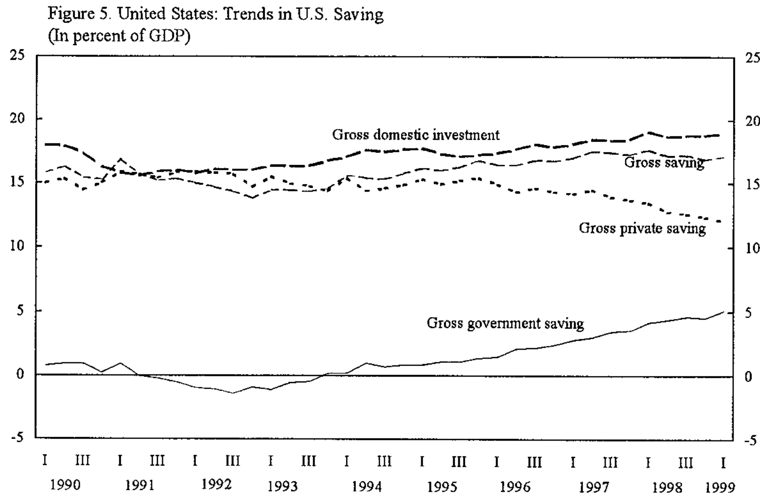
5. ***Investment spending contributed 1½ percentage points to overall GDP growth in 1998.*** Falling mortgage interest rates helped to support an increase in real residential investment spending of over 10 percent. Real nonresidential business fixed investment was also remarkably robust, increasing by almost 12 percent on the strength of business confidence, robust profits, low interest rates, ready access to credit, and a sharp decline in computer prices.



6. ***Owing to strong domestic demand and the weakness in economic activity abroad, net exports subtracted just over 1 percentage point from overall growth in 1998, as the current account deficit surged to $221 billion (2½ percent of GDP)*** (Figure 4 and Table 2). This deterioration largely reflected a widening in the merchandise trade deficit, as import volumes grew by 10½ percent while export volumes rose by 1½ percent. In addition, the balance on net investment income moved from a surplus of $3 billion in 1997 to a deficit of $12 billion in 1998. The international investment position of the United States deteriorated further, with the net foreign liability position rising to 18 percent of GDP.

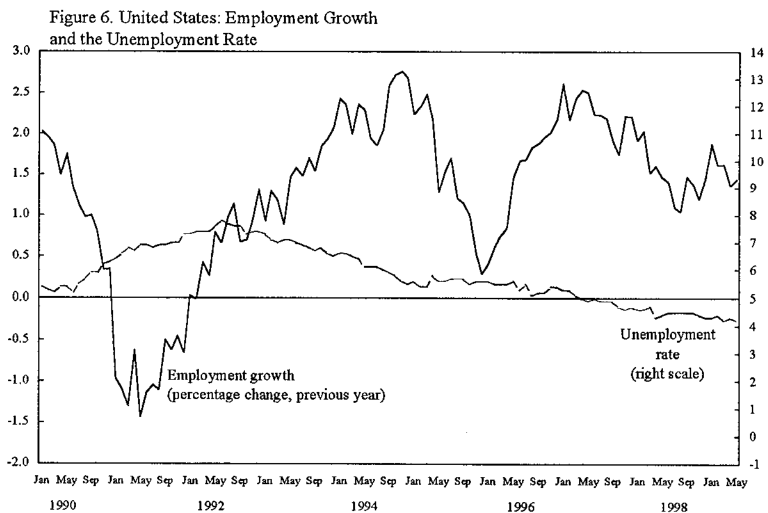
7. ***The steady improvement in government finances has helped to increase gross national saving as a share of GDP*** (Figure 5). After reaching a 50-year low of 14½ percent of GDP in 1992, national saving rose to about 17¼ percent in 1998. Net foreign investment in the United States rose from about ¾ percent of GDP in 1992 to 2½ percent of GDP in 1998, considerably above the average level of 1½ percent of GDP since the early 1980s. Gross domestic investment increased to 18¾ percent of GDP in 1998, from its low of 15¾ percent in 1991—real gross domestic investment as a share of real GDP is estimated to have increased to 20½ percent over this period. The strong investment is reflected in continued capital deepening.

Figure 5. United States: Trends in U.S. Saving
(In percent of GDP)



8. ***For the third consecutive year, output growth in 1998 was well in excess of the staff's revised estimate of potential GDP growth in the range of 2½ to 2¾ percent.***[5] ***Strong employment growth helped to reduce the unemployment rate to its lowest level since 1970*** (Figure 6). By June 1999, the unemployment rate had fallen to 4.3 percent, significantly below most estimates of the NAIRU (Figure 7).[6] The share of the

Figure 6. United States: Employment Growth and the Unemployment Rate

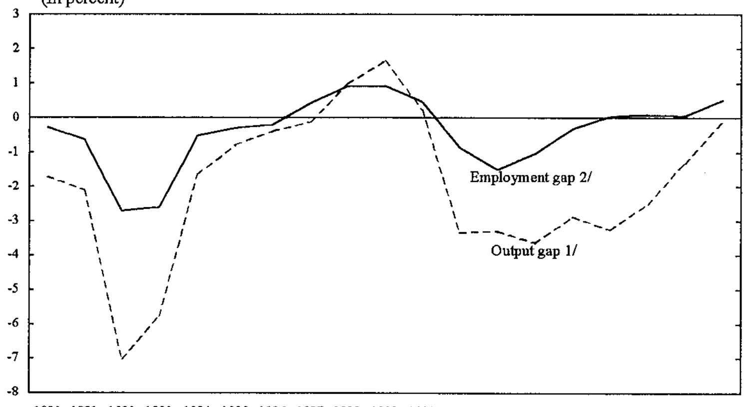


[5] As part of an examination of various estimates of potential growth and the NAIRU to be included in the forthcoming selected issues paper, the staff has revised upward its estimate of potential growth from 2¼ percent to 2½–2¾ percent.

[6] The staff estimates the NAIRU to be around 5 percent. The latest estimates of the NAIRU by the Congressional Budget Office (CBO) and the Council of Economic Advisors are 5.6 percent and 5.3 percent, respectively.

unemployed accounted for by those experiencing short spells of unemployment (less than 26 weeks) is near an all-time low. With the labor force participation rate broadly unchanged at 67 percent in 1998, the decline in the unemployment rate was led during most of this period by buoyant nonfarm employment growth.[7] In contrast, weakness in the manufacturing sector associated with a decline in exports and an expansion in industrial capacity related to the domestic investment boom led to a decline in industrial capacity utilization from 83½ percent in December 1997 to about 80½ percent in April 1999—the lowest level since 1992.

Figure 7. United States: Employment and Output Gaps
(In percent)



1/ Actual less potential, as a percent of potential GDP.
2/ NAIRU less actual unemployment rate.

9. ***Inflation has remained quiescent despite tight labor markets, largely reflecting the favorable impact of lower commodity prices, the strength of the U.S. dollar, and strong productivity growth*** (Figure 8). The annual rate of increase in the CPI edged down to 1.6 percent in 1998, but the core CPI (excluding food and energy) rose slightly to 2½ percent.[8] The core PPI, however, increased by about 2½ percent in 1998 after having remained unchanged in 1997. With

Figure 8. United States: Indicators of Inflation
(Percentage change, same period previous year)

[7] In a break with the trend decline in the real wages of the lowest paid workers from 1979 to 1993, the current expansion has been associated with an increase in the purchasing power of wages across the board, including strong gains in the bottom two deciles.

[8] The forthcoming selected issues paper will investigate again the recent behavior of wages and prices. Methodological revisions to the consumer price index introduced since 1994 have reduced the upward bias in the measurement of inflation in 1998 by approximately 0.4 percentage point, with about half of this reduction attributable to the revisions introduced last year.

an acceleration in the growth of output per hour in the nonfarm business sector (rising to 2½ percent in 1998 from 1½ percent in 1997), unit labor costs increased by only 1½ percent in 1998. Despite the underlying moderation in nominal wage increases, the declining rate of CPI inflation helped real wages to rise in 1998 by just over 2 percent. In the first five months of 1999, the core CPI increased at an annual rate of 1.8 percent, while the core PPI was unchanged. Although certain indicators of inflation expectations (including the spread between inflation-indexed and nominal bonds) have risen somewhat in recent months, these remain low.

Inflation 1/

(Percentage change, December-over-December)

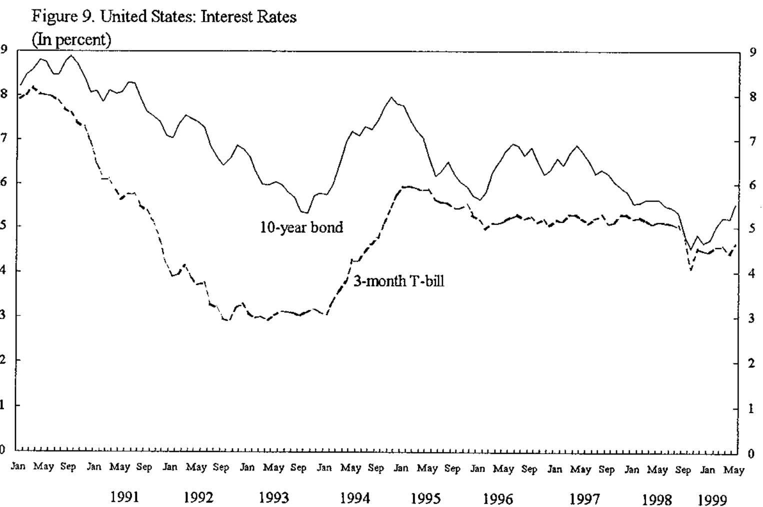
	CPI	Core CPI	PPI	Core PPI	Average Hourly Earnings	Employment Cost Index 2/ Total	Employment Cost Index 2/ Wages and Salaries	Unit Labor Costs
1993	2.8	3.1	0.2	0.4	2.5	3.6	3.1	2.0
1994	2.6	2.7	1.8	1.6	2.6	3.2	2.7	2.1
1995	2.6	3.0	2.2	2.6	2.9	2.7	2.9	1.5
1996	3.2	2.6	2.8	0.6	3.8	2.9	3.4	1.6
1997	1.7	2.2	-1.2	0.0	4.1	3.4	3.9	2.1
1998	1.6	2.5	-0.1	2.5	3.8	3.3	3.9	1.5
1999 3/	2.6	1.8	2.0	0.0	3.9	1.4	1.8	0.7

1/ Core inflation rates exclude changes in food and energy prices.
2/ Fourth quarter over fourth quarter.
3/ May 1999/December annualized for CPI, PPI, and average hourly earnings; 1999Q1/1998Q4 for employment cost index and unit labor costs.

10. ***The stance of monetary policy was unchanged during the first half of 1998.*** Thereafter, the Russian devaluation and unilateral debt restructuring in mid-August 1998 triggered a strong flight to quality and efforts by some financial institutions to unwind highly leveraged positions. This process resulted in a substantial decline in Treasury yields and a sharp rise in the risk premium on private debt. At the same time, commercial banks began to tighten credit standards, bid-ask spreads in many markets increased, the issuance of corporate debt slowed, and equity prices declined by almost 20 percent from their mid-July highs. ***Concerned that these developments might lead to a credit crunch and a sharp downturn in economic activity, the Federal Reserve eased monetary policy in three steps during September–November 1998, lowering the federal funds rate by a total of 75 basis points.*** Citing the potential for a buildup of inflationary pressures, the Federal Reserve announced following its regularly scheduled meeting in May 1999 that it had adopted a bias toward firming the stance of monetary policy in the period before the next meeting of the FOMC in late June. In the event, the FOMC raised its target federal funds rate by 25 basis points at its regularly scheduled meeting on June 30, 1999.

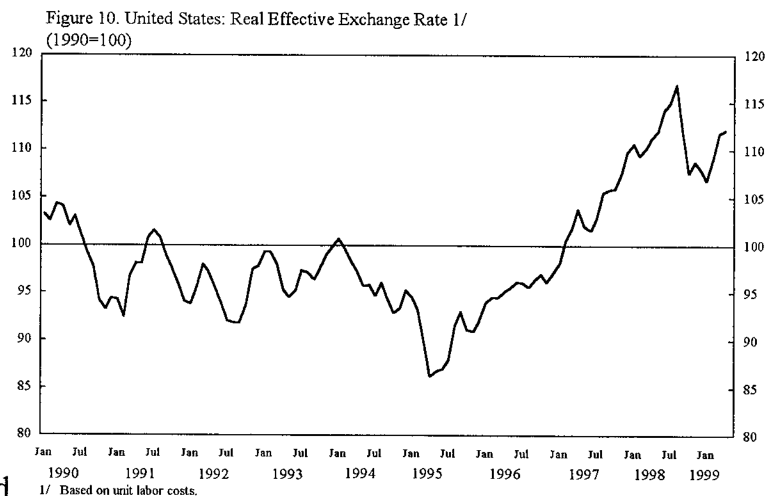
11. During the first half of 1998, short-term and long-term interest rates moved in narrow ranges just below 5¼ percent and just above 5½ percent, respectively. ***However, by late summer, as global financial turmoil intensified and investors sought safe and liquid assets, Treasury yields dropped sharply*** (Figure 9). The yield curve flattened further, with the spread between ten-year Treasury bonds and three-month Treasury bills narrowing to an average of just 7 basis points in September. The yield on three-month Treasury bills rebounded to about 4½ percent in November, and rose to 4¾ in June 1999. The yield on ten-year Treasury bonds increased to about 4¾ percent in December 1998, and then rose to almost 6 percent in June on concerns that the U.S. economy might be overheating. The broad monetary aggregates expanded rapidly in 1998, with M2 increasing by 8¾ percent (December over December) and M3 posting an 11 percent gain. This reflected, in part, ongoing innovations in money management, particularly by nonfinancial corporations.

Figure 9. United States: Interest Rates
(In percent)



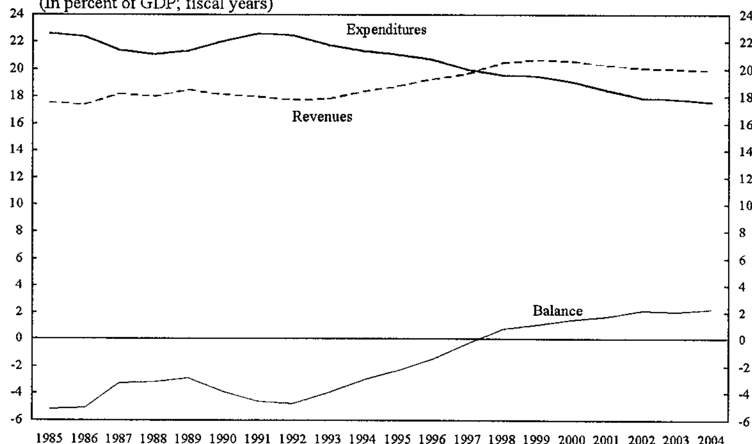
12. ***Following significant swings against other major currencies during the last year and a half, the dollar in real effective terms was only about 1¾ percent higher in May 1999 than in January 1998, although this was about 30 percent higher than its low in April 1995*** (Figure 10). After appreciating by 5½ percent in the first eight months of 1998, the dollar on a real effective basis depreciated by about 7½ percent from August to December. The appreciation of the dollar in the first half of the year reflected the strong cyclical position of the U.S. economy relative to other major countries, as generally higher returns on dollar-denominated assets continued to attract substantial capital inflows. After peaking in mid-August, the dollar depreciated sharply against the Japanese yen largely reflecting the unwinding of extensive yen-short positions

Figure 10. United States: Real Effective Exchange Rate 1/
(1990=100)



1/ Based on unit labor costs.

("yen-carry trades") by financial institutions, and changing sentiment over the expected future strength of the dollar vis-à-vis the yen.[9] In the first five months of 1999, the dollar appreciated in real effective terms by 5½ percent largely reflecting a 12 percent nominal appreciation against the euro.



13. ***The unified federal budget deficit has declined steadily since FY 1992, and it shifted to a surplus of ¾ percent of GDP in FY 1998*** (Figure 11).[10] Expenditure cuts and tax increases adopted as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA93) made lasting contributions to the improvement in the fiscal balance. The OBRA93 also extended budget enforcement provisions originally introduced in 1990, including caps on discretionary spending and a requirement that any changes to revenues or mandatory spending programs needed to provide their own financing (PAYGO), to help ensure that the deficit would not increase over a five-year period.[11] Policy actions contained in the Balanced Budget Agreement of 1997 helped to ensure a further improvement in the unified budget balance in FY 1998 and beyond. The Administration estimates in its Mid-Session Review of the FY 2000 budget that on a current services basis, the FY 1999 budget surplus will rise to

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[9] The role of the "yen-carry trade" and other factors contributing to the sharp dollar-yen exchange rate movements are examined in the IMF's *World Economic Outlook and International Capital Markets: Interim Assessment* (December 1998).

[10] Fiscal years end on September 30. In 1998, the staff estimated that most of the turnaround in the federal budget deficit was a result of policy measures (see United States—Selected Issues, SM/98/188). Based on these estimates, the structural budget balance improved in relation to GDP from a deficit of 4 percent in FY 1992 to a surplus of ¾ percent in FY 1998. The staff's revised estimates of potential output show a somewhat larger GDP gap in 1992, suggesting that the improvement in the structural balance over this period was somewhat less.

[11] Discretionary spending restraint, in particular, has entailed a significant retrenchment in outlays for national defense. As a share of GDP, defense outlays fell from 4.9 percent in FY 1992 to 3.2 percent in FY 1998.

$99 billion (1.1 percent of GDP).[12] The Congressional Budget Office estimated that the surplus would be even higher, at $120 billion. State and local governments increased their budget surpluses in 1998 to 1.7 percent of GDP (national accounts basis), reflecting the rapid growth in tax revenues and a slowdown in the rate of growth of transfer payments.

14. ***The staff projects that real GDP will grow by 3.9 percent in 1999, with growth slowing in the second half of the year to around its potential rate*** (Tables 3 and 4, and tabulation below). Consumption is expected to slow as households seek to rebuild their savings and the wealth effects of earlier stock market increases begin to taper off. Business investment spending is also projected to moderate in line with the slowdown in demand and growth, and somewhat higher interest rates will dampen residential investment. The economy is projected to grow in line with potential after 1999. The stance of monetary policy is assumed to adjust to help ensure that inflation does not rise above 2½ percent over the forecast horizon. Although net exports are expected to be somewhat less of a drag on growth in 1999, the current account deficit is expected to widen to about 3½ percent of GDP before beginning to decline over the medium term, as domestic demand slows to a more sustainable pace in the United States and strengthens abroad.

15. ***There are, however, considerable uncertainties about this forecast.*** So far, there are few signs of an autonomous slowdown in demand—which the staff and many other forecasters have been predicting for some time—and there are questions as to when, and to what degree, tight labor markets will begin to exert upward pressure on inflation. If growth in consumption and investment do not soon slow as expected, inflation may begin to rise and prompt further tightening of monetary policy. Given the relatively high stock market valuations, tighter monetary policy could act as a catalyst to a sharp market correction. In combination with the other channels through which monetary policy affects the economy, this could entail an overshooting of the intended effects of a monetary policy action and result in a more pronounced—at least in the short term—slowdown in U.S. growth. Alternatively, it is possible that economic activity abroad may be weaker than expected, in which case further downward pressure on U.S. net exports would add to the slowdown in GDP growth if consumption and investment slow as expected.

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[12] In late May, Congress passed, and the President signed, a $15.1 billion emergency spending bill. Of the total, $12 billion is intended to cover the cost of military and relief operations related to the Kosovo conflict, and the remainder represented other military expenditures. The "emergency" designation means that offsets are not required. About $4 billion of these funds are expected to be spent in FY 1999.

Staff Projections

(In percent)

	Q4/Q4		Annual Averages					
	1999	2000	1999	2000	2001	2002	2003	2004
Real GDP growth	3.3	2.5	3.9	2.6	2.6	2.6	2.6	2.6
CPI inflation	2.5	2.4	2.2	2.5	2.5	2.5	2.5	2.5
Unemployment rate	...	...	4.3	4.5	4.7	5.0	5.0	5.0
Current account balance/GDP	...	...	-3.5	-3.5	-3.4	-3.3	-3.2	-3.0

III. Policy Discussions

16. Against the backdrop of these recent developments, the following issues are central to the economic policy debate and were the main focus of the consultation discussions.

- ***Key challenges are to assess: (i) whether conditions are in place that would slow the pace of economic activity in line with potential to avoid a reemergence of inflationary pressures in the absence of a monetary policy tightening; and (ii) whether potential economic imbalances (particularly the possible overvaluation of the stock market) raise significant risks of a "hard landing".***

- ***With sustained federal budget surpluses in prospect under current policies, it will be important to resist pressures to increase spending and to cut taxes, particularly in the near term to avoid further stimulus to domestic demand.***

- ***The rising share of the elderly in the U.S. population will place increasing strains on the Medicare and Social Security systems. Measures are needed to ensure that the fiscal surpluses in prospect over the medium term are used to address the longer-term financial problems of these two programs.***

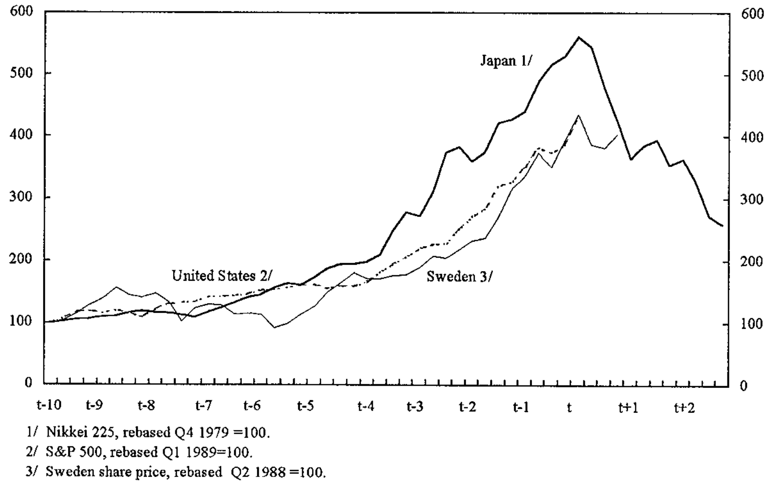
- ***As growth in the rest of the world recovers, some reversal of safe-haven capital flows and some depreciation of the dollar can be expected, helping to narrow the U.S. external current account deficit. It will be important to maintain sound monetary and fiscal policies in order to mitigate the risk of a disorderly adjustment.***

- ***Reflecting the past appreciation of the dollar and the weakness in domestic demand abroad, particularly in Asian markets, competition faced by U.S. producers has intensified leading to increased protectionist pressures, which should be strongly resisted.***

A. Economic Conditions and Prospects

17. ***During the discussions, the U.S. representatives indicated that the economy continued to benefit from a "virtuous cycle," underpinned by sound fiscal and monetary policies. Subdued inflation, low interest rates, and rising equity prices were providing stimulus to consumption and investment, which, in turn, was generating strong employment and output growth that fed back again into income growth and stock prices.*** The pace of demand growth in the final quarter of 1998 and the first quarter of 1999 was clearly unsustainable, and was expected to begin slowing autonomously in the course of 1999. Such a scenario hinged on a continued negative contribution from net exports, moderation in consumer spending, especially through cutbacks in outlays for consumer durables, and some easing of investment spending. In view of the strength of the first quarter and the momentum that was expected to be carried into the second quarter, the U.S. representatives indicated that the growth rate for real GDP in 1999 had been revised up to about 3 to 3½ percent, which reflected a significant slowdown in the second half of the year. If the stock market remained buoyant, the U.S. representatives believed that the upper end of this range was the most likely outcome. Wage growth and employment costs were expected to remain subdued, although the recent pickup in oil prices would likely lead to some uptick in the yearly inflation rate in 1999.

18. ***The authorities and the staff agreed that the supply side of the economy had behaved differently than expected in recent years, as reflected in the continued underprediction of economic growth and the overprediction of inflation.*** A higher than usual degree of uncertainty surrounded estimates of the natural rate of unemployment and potential GDP, making these indicators less useful as guides to policy. Although recent estimates of the natural rate (typically in the range of 5 to 5¾ percent) had declined somewhat, the unemployment rate remained well below these estimates, and yet nominal wage pressures remained modest. Considerable capital deepening over the last several years, together with the benefits of adopting advanced technologies, had increased productivity growth. Officials' estimate of the growth rate of potential output had been revised up to a range of 2½ to 3 percent. The U.S. representatives noted that this upward revision to potential GDP growth could be conservative. Although the authorities did not embrace the "new economic paradigm," they noted that the continued strength of productivity growth and the failure of traditional models to forecast the sustained strong performance of the economy did suggest that some favorable structural changes were underway which had helped propel the "virtuous cycle." Nevertheless, they emphasized, and the staff concurred, that while these changes made it more difficult to forecast the noninflationary limits of productive capacity, there was no doubt that such limits existed and they were determined not to be complacent in light of past policy successes.



19. ***The staff suggested that some imbalances had arisen in the U.S. economy that could present challenges for macroeconomic management and warranted close monitoring, particularly since they could be reversed suddenly.*** These included the unprecedented low level of personal saving, the sharply wider current account deficit, and indications that the U.S. equity market may be significantly overvalued, all of which were related (Figure 12 and Box 1). The U.S. officials noted that the widening of the current account deficit was, in part, attributable to the relative cyclical position of the United States vis-à-vis its trading partners in Europe and Japan, and would be at least partially corrected in due course with a restoration of a more evenly distributed pattern of world demand growth.

20. ***The authorities observed that low personal saving and the current account imbalance were highly dependent on the sharp and sustained appreciation of U.S. equity markets*** (Box 2).[13] National saving has risen in recent years, as corporate and government saving increased, more than offsetting the decline in personal saving. This decline was a rational response to rising net household wealth. The U.S. officials reasoned that buoyant investment spending was being driven by market-based opportunities and the overall strength of the economy. They saw no significant evidence of general or sector-specific overinvestment, although they were well aware that detecting such problems ex ante was difficult.

21. ***The staff and the authorities agreed that the imbalances provided a strong additional reason to ensure that envisaged fiscal surpluses are realized. Beyond this, however, it was not clear what macroeconomic policies could do, ex ante, to address these imbalances, even though eventual corrections might not occur smoothly.*** The prospects for sustained fiscal surpluses in coming years associated with efforts to shore up the longer-term finances of Social Security and Medicare should raise national saving and help to gradually ease pressures contributing to the relatively high external current account deficit. Indeed, the staff noted that there could be a case for a larger surplus in the near term, while demand growth was so strong, but accepted that this was not a politically feasible alternative.

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[13] The forthcoming selected issues paper provides an analysis of the factors helping to explain the trend decline in the personal saving rate.

Box 1. Stock Prices

In the past three years, concerns have grown that a speculative bubble was building in the U.S. stock market. ***Traditional indicators of stock market valuation have generally moved far out of line with historical norms.*** For instance, in the second quarter of 1999, the price/earnings (P/E) ratio for the S&P 500 stocks was 35, compared to a post-World War II average value of 17. For the P/E ratio to be sustained at its current, historically high level would suggest that investors may have developed unreasonable expectations as to the future growth of company earnings.

Since 1994, real earnings per share have grown at a 6 percent annual rate—far above historical trends and the growth rate of GDP. During the post-war period, real earnings growth has been in line with the growth rate of real GDP, reflecting the fact that the capital share of national income has been relatively stable over time. Using a basic model where the current stock price is specified as being equal to the present value of the future stream of dividend payments, the current P/E ratio would imply that investors expect real earnings to continue to grow by 6¼ percent a year, if it is assumed that the dividend payout ratio and the equity premium return to their historic averages of 50 percent and 4½ percentage points, respectively. ***If instead, expectations for real earnings growth were to move down in line with real output growth, then the current P/E ratio would suggest that investors were willing to accept an equity premium of only 1 percentage point.*** Alternatively, if the equity premium were 6 percent (its average over the period 1985–94), then a P/E ratio of 35 would suggest that investors expect real earnings growth of 7¾ percent, which would require an unrealistic sustained increase in the share of corporate profits in GDP.

This analysis (and other indicators, such as the dividend/price ratio and Tobin's q), suggests that stock prices may have moved significantly out of line with their fundamental determinants, but such a judgement cannot be made with a high degree of confidence. Investors' expectations of high real earnings growth might be realized at least over the next few years as firms continue to experience gains in productivity (and profitability) associated with the adaptation of computer technology. It is also possible that the equilibrium equity premium has fallen. Innovations in financial markets have made it easier for individuals to hold diversified stock portfolios; the increased availability of self-directed, tax-deferred retirement accounts has increased the demand for stocks; and changes in tax treatment favoring capital gains also may have boosted demand for equities.

If a significant correction in stock prices were to take place, it would be expected to affect the economy principally through consumption, by adversely affecting consumer confidence and reducing household wealth. Traditional econometric estimates of consumption and savings behavior suggest that a one dollar rise in household wealth will boost consumption by 3–7 cents over a two-year period. Taking the mid-point of this range, a 25 percent drop in stock prices, for example, would reduce equity wealth by about $3 trillion and consumption by $150 billion (1¾ percent of GDP) after two years. However, the effect of such a decline in stock prices could be less than this estimate suggests, because it would return prices to roughly their levels of last year, and a portion of the increase in wealth since that time has probably not yet been reflected in consumption. Moreover, the staff's estimates of savings behavior (see Box 2) which controls for the effects of improved household access to credit, suggest that such a correction in equity prices would have a significantly smaller effect on consumption. Investment also will be affected by a stock market decline, with significant indirect effects through business confidence. Equities, however, have not been a major source of funding for investment for the corporate sector as a whole; corporations have made large net repurchases of stocks in recent years, while significantly increasing their net debt.

A fall in stock prices might also affect the economy indirectly through the financial sector. While there is little direct financing of stock purchases in the United States through bank loans, rising personal wealth associated with the gains in the stock market could have facilitated access to credit, and default rates could well rise as equity prices fell.

Box 2. Explaining the Decline in the Personal Saving Rate

The rapid increase in consumer spending pushed the monthly personal saving rate into negative territory in late 1998 and early 1999 for the first time since monthly data have been collected. A declining personal saving rate, however, is not a new development in the U.S. economy. Personal saving began to decline in the early 1980s, with this trend continuing in the 1990s (figure below). Why might this decline be of concern? There are two possible reasons: (1) the effect on the sustainability of long-term growth; or (2) the risks for macroeconomic management associated with a sudden reversal in the saving rate. Concerns about long-term growth seem unwarranted, because gross national saving—the relevant factor in determining long-term growth—has recovered sharply in recent years. In contrast, the likelihood of a sudden reversal in the personal saving rate, with adverse effects on aggregate demand, depends on the nature of the factors which have contributed to its trend decline.

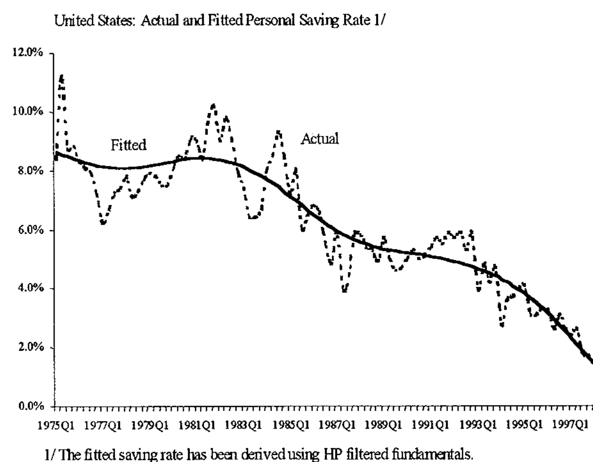
Staff analysis suggests that the trend decline in the personal saving rate during the 1990s is well explained by a rise in household equity wealth, tighter U.S. fiscal policy, improved access to credit, higher per capita Medicare transfers, and lower inflationary expectations—reflecting for example, the idea that less saving is needed to maintain the real value of non-indexed assets. The largest contributor to the decline in personal saving since 1990 has been the sharp increase in household equity wealth as a share of personal disposable income (see tabulation below). However, a significant decline in non-equity household wealth as a share of disposable income has had a partially offsetting effect. The shift in fiscal policy since 1994 has also been an important contributing factor, as higher government saving may be perceived to be associated with lower future tax liabilities (i.e., Ricardian equivalence). Lower inflationary expectations, together with higher Medicare transfers and improved household access to credit, account for the remainder. Of these factors, the one most likely to be subject to a sudden reversal—with implications for savings and aggregate demand—is the value of household equity holdings, in the event of a stock market correction.

Estimates of the Contribution of Long-Run Determinants to the Trend Personal Saving Rate (1990–98) 1/

Household equity net worth	35
Household non-equity net worth	-12
Fiscal policy	30
Expected inflation	19
Access to credit	15
Social Security and Medicare	13
Total	100

1/ Cumulative through mid-1998, and in percent of total decline in trend personal saving rate, based on econometric estimation (details are contained in the forthcoming selected issues paper).

United States: Actual and Fitted Personal Saving Rate 1/

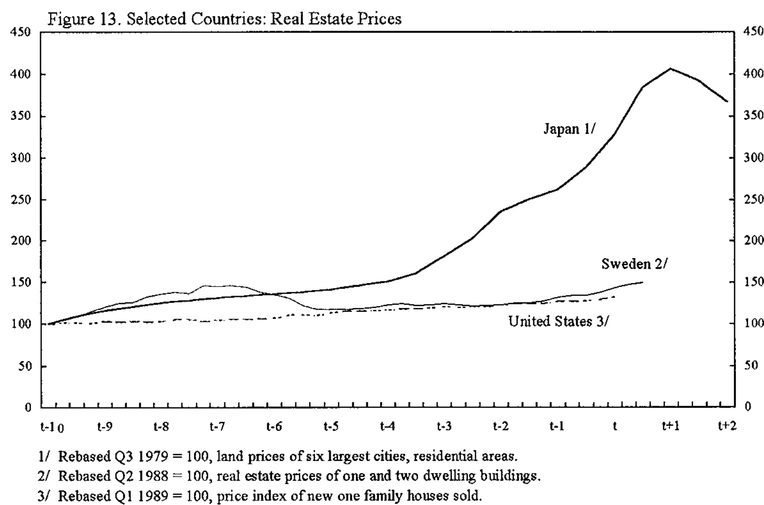


1/ The fitted saving rate has been derived using HP filtered fundamentals.

22. ***There was also agreement that the possibility of a stock market correction posed the principal risk to the outlook in the near term, as the favorable economic environment may have induced investors to take on more risk and could be pushing asset prices to unsustainable levels***. Officials observed, however, that although many of the traditional indicators had pointed to excessive stock valuations for some time, the market had proven to be quite resilient to a variety of shocks. Therefore, they suggested that one could not assert with a high degree of confidence that the market was overvalued. Even if such a judgement could be made, macroeconomic policy tools could not be finely calibrated to gently deflate a bubble. In the event of a significant stock market correction, the U.S. representatives did not envisage dire consequences for the economy, emphasizing that monetary policy would respond as necessary to promote continued noninflationary growth.[14]

23. ***The U.S. officials noted that there were no signs of general vulnerabilities in household and corporate balance sheets, a view which the staff shared, although it was recognized that problems could emerge in specific sectors in the event of an economic downturn*** (Box 3). Unlike equities, the U.S. real estate market did not appear to raise significant concerns of overvaluation, although there had been some general pickup in real estate prices recently and prices in some markets had recorded more sizeable increases (Figure 13). While household liabilities relative to disposable income had risen since 1992,debt-service payments had not increased commensurately because interest rates have fallen and households have refinanced mortgages at lower rates (Table 5).

Figure 13. Selected Countries: Real Estate Prices



1/ Rebased Q3 1979 = 100, land prices of six largest cities, residential areas.
2/ Rebased Q2 1988 = 100, real estate prices of one and two dwelling buildings.
3/ Rebased Q1 1989 = 100, price index of new one family houses sold.

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[14] Ongoing reforms in the U.S. equity market infrastructure have improved the system's ability to withstand the effects of a sudden and sustained equity market correction. Nevertheless, the capacity of the system to function smoothly under severe and persistent strain remains uncertain. These issues are discussed at greater length in the forthcoming *International Capital Markets Report*.

Box 3. Household and Corporate Balance Sheets

Is the sustained boom in consumption and investment contributing to balance sheet vulnerabilities that could cause problems in the event of an economic downturn or stock market correction? Aggregate data suggest that, while gross debt in relation to income has increased for both households and corporations during the 1990s, assets have grown even faster (even assuming some equity price correction) and debt-service ratios are not unduly high by historical standards. Of course, these aggregates can not indicate what vulnerabilities might emerge in specific sectors in the event of an economic downturn.

In the household sector:

- With continued strong growth in consumer spending, household debt as a share of disposable income increased to about 104 percent in 1998 (Table). This increase reflected primarily the rise in mortgage debt as households have taken advantage of low mortgage rates to purchase homes, or to increase the size of existing mortgages, using the additional funds to retire other debts.
- Lower interest rates have meant that despite the increase in debt levels, total interest payments as a share of disposable income have remained relatively flat at about 8 percent of personal disposable income (and the debt service ratio at about 17 percent). Because only about 15 percent of outstanding mortgages have adjustable rates, the shift toward mortgage debt has reduced the overall short-term vulnerability of household debt service to a rise in interest rates. Nevertheless, households would be vulnerable to a significant downturn in incomes associated with an economic slowdown.
- With the rise in equity prices, household net worth as a share of disposable income has increased to 610 percent in 1998 from about 494 percent in 1990.

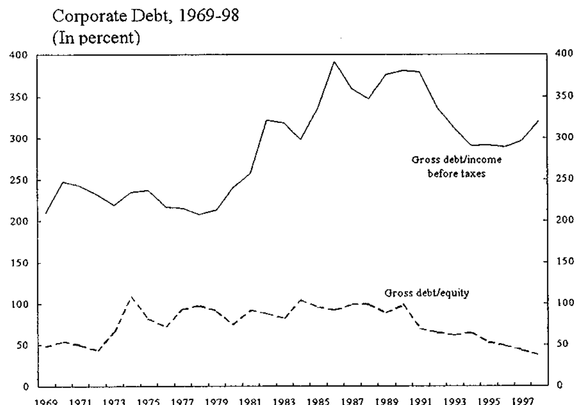
In the corporate sector:

- The corporate debt-to-equity ratio declined to about 37 percent in 1998 from nearly 100 percent in the early 1990s, reflecting the surge in equity prices (Chart). If equity prices were to decline by 25 percent, this ratio would rise to about 49 percent, which is lower than the levels that persisted throughout the 1970s and 1980s.
- The debt-to-income ratio increased in 1997–98, but remains well below the peaks reached in the 1980s.
- Despite the increase in the level of debt, the debt-service burden has remained low as interest rates have fallen. Corporate debt service (measured as the ratio of net interest payments to cashflow) increased slightly in 1998 from its low of about 9 percent in 1997, but this is less than half the peak level reached in 1989. However, many financial and nonfinancial firms have increased their off balance sheet operations, making it harder to assess how the sector would be affected by higher interest rates or a fall in profit margins.

Balance Sheet of Households
(In percent of disposable income)

	1990	1998
Total assets	583	714
Tangible	224	214
Financial	359	500
Total liabilities	89	104
Mortgages	60	68
Consumer credit	19	22
Net worth	494	610

Corporate Debt, 1969-98
(In percent)



Source: Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States.*

B. Monetary Policy and the Exchange Rate

24. ***In view of the recent strength of aggregate demand growth, the staff suggested that if demand did not slow of its own accord, capacity limits would likely soon be reached and inflationary pressures would begin to emerge.*** The authorities agreed that recent demand growth had outstripped the growth in the economy's productive capacity and that once capacity limits were reached, prices would certainly respond. However, they also pointed to the mixed signals being sent, as the rate of industrial capacity utilization had been falling over the last year while the unemployment rate hovered near a 30-year low. There were also indications that the economy had become less "inflation prone," for several reasons. Businesses appeared to be operating in an environment in which price increases were frequently not viewed as a viable option, and thus cost-cutting measures were constantly being sought to maintain profitability. Technological innovations and expanding international trade linkages had helped to make supply more elastic, with firms able to respond quickly to eliminate incipient capacity bottlenecks. These factors suggested that once capacity limits were reached, domestic inflationary pressures would likely build more slowly than in the past, although they agreed that some of the transitory factors that helped to dampen inflation—notably low oil and nonfuel commodity prices—could well be reversed in the period ahead.

25. ***With this background, Federal Reserve officials emphasized that the Fed continued to be forward looking in the formulation of monetary policy.*** While the inability of traditional macroeconomic models to fit well with recent developments had made them reluctant to adjust monetary policy on the basis of forecasts alone, they were prepared to act promptly on the first indications that inflationary pressures might be in the pipeline. With less weight placed on model-based forecasts, the authorities focused on a wide array of early warning indicators of emerging inflation (including credit conditions, wages, salaries, and other employment costs, profit margins, the stock market, and the monetary aggregates), although no single indicator would play a decisive role in determining the course of policy. While the recovery in financial markets, viewed in isolation, might have suggested at least a partial reversal earlier in 1999 of the 75 basis point reduction in the target federal funds rate implemented in late 1998, the FOMC had not done so because there were no signs of sustained wage or price pressures at that time. The staff noted that given the significant lag between monetary policy actions and its effect on the real economy, there were risks in waiting too long for clear evidence of emerging inflationary pressures. Federal Reserve officials emphasized that decisions would continue to take into account the lags with which changes in the stance of monetary policy affect the real economy. Subsequent to the completion of the consultation discussions, the FOMC raised the target federal funds rate by 25 basis points in late June 1999.

26. ***In formulating monetary policy, the authorities sought to sustain high levels of employment, maximum sustainable growth, and low inflation.*** The longer-term objective has been to move gradually toward price stability over time, but officials cautioned that with inflation as low as it has been recently, it was not clear how much lower it should go. The staff and the authorities agreed that a zero rate of inflation could present potential difficulties (arising principally from nominal wage rigidities and a zero lower bound on the nominal

interest rate). Federal Reserve representatives said that going forward their immediate goal would remain holding the line on the recent gains in lowering inflation.

27. ***Officials pointed out that in the formulation of monetary policy, international developments were taken into account only to the extent that they influenced U.S. domestic objectives***. The external economic environment clearly affected the outlook for U.S. employment, growth, and inflation, and thus entered into the formulation of monetary policy. Conditions in international financial markets were also important in this regard, as turbulence in these markets would affect U.S. markets. Consequently, potential feedback effects needed to be carefully considered in the formulation of monetary policy. The financial turmoil following events in Russia last year, which had a direct impact on U.S. credit markets, was a recent example in which the U.S. policy response was domestically focused, but also took into account and helped to ease the financial tremors being felt around the world. The authorities noted, however, the difficulties in trying to predict the feedback effects through international capital markets stemming from a change in U.S. monetary policy.

28. ***The dollar's strength has been supported by the cyclical position of the United States relative to its trading partners in Europe and Japan, as well as confidence in U.S. investment opportunities***. The authorities noted that the size of the U.S. current account deficit should, and would, be reduced in due course with a realignment in world demand growth. The staff agreed and noted that the current account deficit would move to a sustainable level provided policies that ensured the maintenance of a strong fiscal position continued to be followed.[15] The U.S. representatives observed that provided foreign investment was being employed productively in the United States, it would create the wherewithal to support future returns to foreign investors while also contributing to higher U.S. standards of living. Although the increasing stock of net foreign liabilities and the potential for shifts in investor sentiment suggested that adjustment in the exchange value of the dollar might not take place in a smooth manner, the staff and the authorities agreed that the continued implementation of sound macroeconomic policies would be the best safeguard against a disorderly adjustment. In the event that the dollar did experience a sharp and sudden realignment, the Federal Reserve, although not targeting the exchange rate, would be well positioned, if needed, to tighten monetary policy in order to limit the risk of a sustained inflationary effect.

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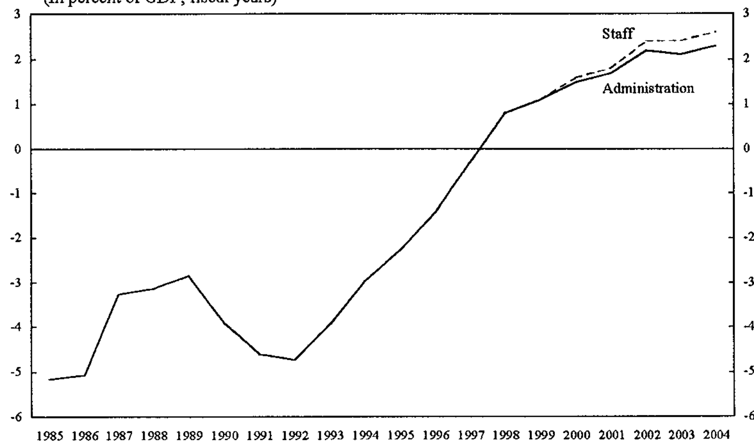
[15] The forthcoming selected issues paper will analyze the long-term sustainability of the U.S. current account balance and potential flows of capital to the United States.

C. Fiscal Policy

29. ***The current services baseline in the Administration's Mid-Session Review of the FY 2000 Budget released in June 1999 envisages sustained fiscal surpluses over the medium term, rising from $99 billion (1.1 percent of GDP) in FY 1999 to $254 billion (2.3 percent of GDP) in FY 2004*** (Figure 14 and Table 6).[16] Adjusting the budget projections for differences in the staff's and the Administration's economic assumptions produces a somewhat more favorable profile for the current services balance, reflecting the staff's higher real GDP growth and inflation projections that are only partly offset by the staff's higher interest rate assumptions.[17] For the current fiscal year, the U.S. representatives said that revenues were running somewhat ahead, and expenditures slightly behind projections in the Administration's Budget presented in February 1999, and thus a modestly more favorable budget surplus for FY 1999 was likely; this has been borne out in the more recent data.[18] The continued strength in economic activity underpinned the strength of revenues so far in FY 1999, and better-than-expected cost containment from the Medicare reforms enacted in the 1997 Balanced Budget Agreement appeared to be responsible for the lower-than-projected expenditures.

Figure 14. United States: Federal Budget Balance Projections
(In percent of GDP; fiscal years)



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[16] The current services baseline represents the level of government expenditures and revenues that would be expected in the absence of new policy actions.

[17] The Congressional Budget Office (CBO) also projects a somewhat more favorable outlook for budget surpluses under current services than the Administration. The CBO projects cumulative surpluses over FY 2000–04 totaling $1,113 billion compared to the Administration's projection of $1,007 billion and $1,114 billion projected by the staff. In view of the higher-than-usual uncertainty surrounding estimates of potential GDP and the GDP gap, the staff assumes the economy to be near full employment and its medium-term estimates of the structural and actual unified budget balances are thus identical.

[18] After completion of the consultation discussions, the projected fiscal surplus for FY 1999 was raised from $80 billion (0.9 percent of GDP) to $99 billion in the Mid-Session Review.

30. ***The Administration's budget contains two sets of proposals: (i) a set of basic spending and tax proposals that adhere to the discretionary spending caps and PAYGO restrictions; and (ii) the same set of basic proposals plus additional outlays that would be adopted only if the Administration's framework for improving the financial outlook for Social Security is also implemented.*** In keeping with the budget enforcement provisions (which expire under current law in FY 2002), the Administration proposes expenditure cuts and tax increases estimated to offset fully the basic spending and tax initiatives (Table 7).[19]

31. ***The precise outcome of deliberations in Congress on the FY 2000 budget was difficult to predict at the time of the consultation discussions, but in view of the broad support for preserving Social Security surpluses, the U.S. officials did not envisage any major change in the fiscal outlook.*** The staff and the U.S. representatives agreed that the discretionary spending caps and the PAYGO financing requirement had fostered budget discipline since FY 1992. The staff, however, also noted that the existing discretionary spending caps would become increasingly tight through FY 2002, and thus might become increasingly difficult to meet.[20] Acknowledging that some small, appropriate adjustment in the caps should be made, the staff suggested that these procedural disciplines should be extended beyond their scheduled expiration in 2002. The U.S. representatives indicated that in the context of a comprehensive agreement to correct the financial imbalances of Medicare and Social Security, the Administration also favored extending these disciplines with appropriate adjustments beyond their current expiration in order to help lock in the terms of any such agreement.

32. ***The staff suggested that an appropriate longer-term fiscal objective would be to put the Social Security and Medicare programs into actuarial balance, and then keep the remainder of the budget balanced on average over the business cycle.*** The former would prepare the federal government for the rising tide of unfunded liabilities associated with the aging of the population, while the latter establishes an appropriate focal point for policy makers in view of the low level of private saving and the likelihood of continuing, albeit smaller, current account deficits. The U.S. representatives, without endorsing such a goal, indicated that there was a good deal of support for limiting the size of any new tax or spending initiatives to the projected surpluses in the portion of the budget excluding Social Security and Medicare. However, in view of the remaining shortfall in the long-term

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[19] These basic proposals include a number of new tax expenditures, including a tax credit for long-term health care, an expansion of the child and dependent care tax credit, and tax credits for private employers to enhance child-care services. The two most significant offsets are a proposed increase in federal tobacco taxes and recouping a share of the legal settlements states will receive from tobacco companies. Congress recently rejected the latter proposal by barring the federal government from claiming any share of the state tobacco settlements.

[20] Under the current caps, discretionary spending as a percent of GDP would fall from 6.6 percent in FY 1999 to 5.7 percent in FY 2002.

balances of Social Security and Medicare, the staff and the authorities agreed that the prospective surpluses should be left intact until these critical social programs were placed on a sustainable path. The staff asked whether there might be merit in separating the revenues and expenditures for both of these programs from the rest of the federal budget, thereby possibly reducing temptations to use the surpluses generated to meet the long-term needs of Social Security and Medicare for other purposes. Both the Administration and Congress were trying to place greater emphasis on the "on-budget" accounts,[21] but because there would always be a tendency to add up on- and off-budget balances in budgetary deliberations, officials said that this approach would probably not have much effect on fiscal discipline.

33. ***The staff raised concerns over the Administration's continued use of targeted tax credits and other tax expenditures to promote specific economic or social objectives that might be better addressed through spending programs.*** The staff emphasized that targeted tax expenditures complicated the tax system and raised compliance costs. In addition, such measures could also undermine the efficiency of the tax system by eroding the tax base and requiring higher tax rates than otherwise. In the view of the U.S. representatives, there should be no "hard-and-fast" rule against using the tax system to promote social goals and they indicated that, at times, the tax system provided the best means of achieving such goals. While recognizing that efficiency considerations were important in the design of specific measures, they pointed to the strong productivity growth in the U.S. economy as suggesting that the tax code had not been a major inhibiting factor. They too would be concerned if the tendency to use targeted tax expenditures had undermined fiscal discipline, but this had not been the case in the United States.

34. ***As the baby-boom generation begins to retire in increasing numbers around 2010 and the share of elderly in the U.S. population rises, the Social Security and Medicare systems will experience financial strains, with important implications for the long-term fiscal outlook and national saving.***[22] To improve the long-term financial viability of Social Security and to extend the life of the Medicare Hospital Insurance (HI) Trust Fund, the

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[21] Under current budget accounting rules, revenues and expenditures for Social Security and the U.S. Postal Service are "off budget." The unified federal budget includes the balance on all on-budget and off-budget items.

[22] The 1999 Actuarial Report of the Board of Trustees of the Social Security System projected that without immediate changes, a negative cash flow would begin in 2014 and Trust Fund assets would be depleted in 2034. Overall, the Social Security System faces a long term (75-year) actuarial imbalance estimated to be equivalent to an immediate increase in the payroll tax of about 2 percentage points. As a result of cost-containment measures contained in the 1997 Balanced Budget Agreement and strong economic growth, Medicare Hospital Insurance (HI) is projected to remain solvent until 2015. An increase of about 1½ percentage points in the payroll tax would be needed to bring the HI component of Medicare into long-term actuarial balance.

Administration's FY 2000 Budget proposes specific transfers to these programs from general revenues. The Administration's proposal would also specify that a small share of Social Security Trust Fund assets be invested in equities (Box 4). The U.S. representatives said that an important rationale for using general revenues to improve the long-term financial condition of Medicare HI and Social Security was that by relying on the progressive income tax, it would satisfy an important equity consideration.

Box 4. The Administration's Approach to "Fixing" Social Security

The Administration's approach to restoring the long-term financial viability of the Social Security system presented in its FY 2000 Budget departs from past fixes in two substantive ways. First, general revenues would be used to bolster the funding of Social Security for the first time since the inception of the program. Second, a small portion of Social Security Trust Fund assets would be invested in private equities; Trust Fund assets are currently restricted by law to be invested in so-called "special issues"—Treasury securities designated for the Social Security Trust Fund.

The plan outlined in the FY 2000 Budget called for 62 percent of projected federal budget surpluses over the next 15 years (about $2.8 trillion) to be transferred to the Social Security Trust Fund. Of these amounts transferred on a yearly basis, 20 percent would be invested in private equities. According to Administration estimates, these measures would bring the Social Security system into actuarial balance over a 55-year horizon, falling short of the 75-year actuarial balance that is the norm for assessing the long-term financial viability of the system.

Subsequent to the consultation discussions, the Administration modified the details of its proposal, but retained the core elements (namely, equity investments and transfers from general revenues). The new proposal calls for preserving all of the projected Social Security surplus, with each dollar of that surplus used to reduce federal government debt held by the public (the so-called "lockbox"). This alone would do nothing to improve the estimated actuarial balance of the system, but, by reducing overall debt, would better prepare the federal government to meet future Social Security obligations. Moreover, the Administration's new proposal also calls for transferring the full amount of the interest saved from this debt reduction to the Social Security Trust Fund beginning in 2011. Between 2011 and 2014, a transfer of $543 billion from general revenues to Social Security would occur. Thereafter, transfers would be $189 billion annually. To further improve the financial outlook for Social Security, the Administration would invest these transfers in equities until these equity investments reached a maximum of 15 percent of the total Trust Fund. According to the Administration's estimates, this approach would achieve actuarial balance over a 53-year horizon. Under this proposal, the 75-year actuarial deficit would narrow from its current level equivalent to about 2 percent of taxable payroll to about ¾ percent. Therefore, additional measures (presumably higher payroll taxes and/or reduced benefits) equivalent to a ¾ percentage point increase in the payroll tax would still need to be adopted.

35. ***The Administration's proposal for mitigating Social Security's long-term financial imbalance would preserve current taxation and benefit levels, and leave the fundamental structure of the system essentially intact***. The staff agreed that the basic structure of Social Security should be left unchanged, and expressed the view that the Administration's proposal was a constructive first step, but noted that using general revenues and requiring limited equity investments raised important questions. Opening the doors to general-revenue financing, for example, could compromise the effectiveness of a budget constraint that probably had helped to restrain increases in Social Security benefits over the years. The U.S.

authorities emphasized that the retirement of the baby-boom generation represented a one-time demographic episode that was best addressed through recourse to general revenues. The original plan envisaged transfers from general revenues strictly limited to a 15-year period beginning in FY 2000, whereas the revised plan envisages transfers beginning in FY 2011 with no specified end date. Regarding the proposal to hold a small share of equities in the Social Security Trust Fund, the staff indicated that it was unlikely to increase national saving significantly—since it would largely result in a shift of equities and bonds between public and private portfolios. They also wondered whether an effective "firewall" could be built to insulate such investments from political influence.[23] The authorities expressed confidence that the institutional safeguards included in the Administration's proposal addressed this latter concern. By way of example, they noted that the federal employees' pension system stipulates that equity investments be restricted to broad market index funds, and there had never been a breach of that rule.

36. ***Acknowledging that additional measures would be required to achieve long-term balance in the Social Security accounts, the U.S. representatives said that everything was "on the table," although they also emphasized that the President was on record saying that a payroll tax increase was not needed at this time***. They suggested that there would likely be a multipart solution that would include small changes in the parameters of the system (increases in contribution rates and cuts in benefits). The staff observed that elimination of the cap on the Social Security payroll tax in conjunction with a general cut in income taxes might satisfy the Administration's equity objectives and close much of the financing gap, while avoiding the use of general revenues to fund the system.[24] More generally, the staff agreed that a comprehensive solution to Social Security's long-term financial problem was likely to involve small adjustments in the system's parameters, provided these changes were enacted soon.

37. ***Despite recent improvements in the outlook for Medicare, its financial problems remain more urgent than those of Social Security and are also subject to greater uncertainty.*** Reflecting fundamental differences on an appropriate approach to reform, the bipartisan commission established in 1996 to make recommendations for rescuing Medicare disbanded in March 1999 without agreeing on a set of policy proposals. The Administration indicated that it intended to propose its own plan for Medicare reform. The staff urged

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[23] The forthcoming selected issues paper discusses in more detail the Administration's proposal to fix Social Security.

[24] If benefits were left unchanged, the Office of the Chief Actuary of the Social Security Administration has estimated that removing the ceiling on gross wages subject to the payroll tax in 2000 would improve the long-range actuarial balance of the Social Security System by the equivalent of a 2.02 percentage point increase in the payroll tax, virtually eliminating the 75-year financing gap. If instead benefits were increased in line with current links to contributions, lifting the ceiling on taxable payroll would improve the long-run actuarial balance by an amount equivalent to a 1.53 percentage point increase in the payroll tax.

consideration of a menu of options, (reducing net benefits—which could still allow for some rebalancing of the overall benefits package to provide greater prescription drug coverage—raising co-payments and deductibles, and increasing contribution rates) in order to distribute the cost of improving Medicare's finances in an equitable fashion while also retaining the funding of the HI component of Medicare through the payroll tax.[25] Because of the difficulties in projecting health care costs, the staff noted that periodic adjustments in the system's parameters were likely to be required, and suggested that an institutional mechanism could be established for revisiting such adjustments on a regular basis.

D. Trade Policy

38. ***The staff observed that the impact of the financial crisis in Asia and elsewhere on the U.S. external position had fostered a rise in protectionist pressures (particularly in agriculture and steel), and that it was important to resist these pressures***. The U.S. representatives agreed that pressures had risen, and said that WTO rules provided several avenues (so-called "trade remedy" laws, including antidumping and countervailing duty procedures, and so-called "safeguards" or "emergency protection") for dealing with trade problems. The United States would continue to enforce its trade remedy laws in conformity with WTO obligations. The Administration was strongly opposed to an initiative in the U.S. House of Representatives that sought to impose quantitative restrictions on steel imports outside of WTO-sanctioned procedures. The authorities said that the Administration had also been working to relieve protectionist pressures by encouraging Japanese and European Union officials to undertake policies that would help facilitate a return to stronger growth, and by working with the IMF to support policies that would accelerate recovery in Asia. The staff noted that the economy's overall efficiency could be promoted if antidumping and countervailing duty laws were administered with a view to preventing anticompetitive behavior by foreign producers (in line with the objectives of antitrust laws), instead of using them more generally to provide relief to domestic producers in cases where import penetration has increased.

39. ***The U.S. authorities said that they would continue to pursue the advancement of greater trade liberalization in keeping with WTO rules, through bilateral, regional, and multilateral fora***. The multilateral trading system provided an umbrella of rules and procedures under which U.S. regional and sectoral initiatives fit in a complementary and mutually supporting manner. The world had been in a period of implementation and enforcement since the completion of the Uruguay Round agreement. Now the time was right to help foster continued momentum in multilateral trade liberalization, and the U.S.

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[25] The Administration announced its proposal for Medicare reform on June 29, 1999. The main features include measures to increase price competition, extensions of prescription drug and preventive healthcare benefits, and transfers from general revenues to the Medicare HI Trust Fund. The forthcoming selected issues paper will review the structure of Medicare and discuss approaches to reforming the system, including the Administration's recent proposal.

representatives expected that a new round of multilateral negotiations would be initiated in Seattle in December 1999. Among their priorities for a new round of trade talks, the authorities emphasized the importance of greater liberalization in agriculture and services trade; the need for institutional reform to promote greater transparency in the operations of the WTO; and the need to conclude agreements on transparency in government procurement and electronic commerce. In the meantime, the U.S. Administration would also continue to pursue an active agenda to promote further trade liberalization on a regional basis.

40. ***The U.S. representatives expressed broad satisfaction with the WTO's dispute-settlement procedures, but also indicated that recent experience had clarified the need for some fine tuning***. Most of the disputes brought by the United States to the WTO had led to relatively quick resolutions, while only a few high-profile cases had resulted in frustrating delays owing, in part, to certain procedural ambiguities in the WTO's Dispute Settlement Understanding. The U.S. representatives indicated that the dispute-settlement process was under review, and they expected to reach agreement on revisions that would improve compliance and enhance transparency. The staff encouraged the U.S. authorities to continue to seek cooperative solutions to trade disputes under WTO procedures, and to refrain from adopting restrictive trade measures.

E. Other Issues

41. ***Although there is widespread agreement on the need to modernize the basic legislation regulating financial institutions (most notably the Glass-Steagall Act's restrictions on the activities of commercial banks, insurance companies, and securities dealers), progress toward enacting the needed reforms has stalled***. This situation, in part, reflects a disagreement between the Federal Reserve and the Treasury over the appropriate structure for financial institutions. In particular, they differ over whether activities that would be permitted within a commercial banking firm should be organized under a holding company format (the Federal Reserve's position), or as separately capitalized operating subsidiaries (the Treasury's position). Federal Reserve officials expressed concern over ensuring that there was adequate coordination of the regulation of financial institutions, that deposit insurance was not effectively extended to other more risky activities, and that the Federal Reserve's role as lender of last resort and in ensuring the security of the payments system was appropriately defined. All parties, including the staff, agreed that such safeguards would be essential, but Treasury officials continued to believe that these concerns would be adequately addressed in the operating subsidiary approach. More generally, the U.S. officials indicated that despite these differences over how to proceed, there was widespread support for reforming the financial system. In the meantime, the staff and the authorities agreed that markets were running ahead of the reform process, and practices in the financial services sector were adapting despite the delay in achieving regulatory reform. While noting that international experience did not offer any clear-cut "best practice" in this area, the staff urged the authorities to resolve their differences quickly.

42. ***The staff inquired whether increased consolidation of the structure of supervision and regulation in the U.S. financial sector (which is relatively fragmented), would be***

appropriate in the longer term to match the ongoing integration of financial markets. The U.S. representatives acknowledged that the current system was in a sense an accident of history and would probably not be chosen if policy makers were handed a blank slate. Nevertheless, it had generally functioned well because of an intensive exchange of information between supervisors. Moreover, Federal Reserve officials noted that the central bank's prominent role in supervisory and regulatory activities provided "hands on" experience that served it well in conducting monetary policy, particularly in times of strain or crisis in the financial system. In their view, it was not at all clear that consolidating supervisory and regulatory functions under one institution that was separate from the central bank would be an improvement.

43. ***Profitability of the banking system remains strong, with net income of U.S. commercial banks growing by about 4¾ percent in 1998 following record earnings in 1997, although the performance of individual banks has varied significantly.*** The U.S. representatives pointed out that available indicators suggested that the quality of the aggregate loan portfolio of national commercial banks remained sound and although interest rate margins had narrowed in 1998, non-interest income showed strong growth. Despite anecdotal information that credit underwriting standards had been declining, the authorities—based on the Federal Reserve's periodic survey of bank lending practices and other indicators—could identify no objective evidence of a material slippage in this area. However, they noted that— as a byproduct of the increased efficiency of the U.S. financial system, in which corporations increasingly turned directly to the credit markets to place commercial paper—commercial banks' business loan portfolios had become more heavily concentrated in lower-tiered assets. The soundness of these business loan portfolios had not yet been tested in an economic downturn, and thus warranted close observation since a slowdown would naturally place some strain on asset quality. Regarding the difficulties of the hedge fund Long-Term Capital Management and the possible implications for the banking system, the Federal Reserve and the Office of the Comptroller of the Currency issued supervisory guidance letters on counterparty credit risk management in February 1999, consistent with the guidance on sound risk management practices issued by the Basle Committee on Bank Supervision.

44. ***Federal Reserve officials noted that, in cooperation with other government agencies, they had been engaged in a number of activities intended to monitor and help ensure Y2K compliance by commercial banks.*** Under the so-called "key players" program, the Federal Reserve had communicated forcefully to all key foreign and domestic banking institutions operating in the United States high expectations for achieving full Y2K compliance, and officials were confident that these key banking institutions would be fully compliant. They also indicated that banks operating in the United States had begun to eliminate foreign counterparties judged to be subject to significant Y2K risk. The Federal Reserve was prepared to provide liquidity to the banking system as needed.

45. ***In early 1999, Argentine officials raised the possibility of replacing their currency board with full dollarization.***[26] While emphasizing that unilateral dollarization was a national decision on which the U.S. authorities had not taken an a priori view, officials also stressed that dollarization initiatives would not affect the orientation of U.S. monetary policy, and that the United States would not be willing to supervise foreign financial institutions, or to act as a lender-of-last resort in dollarized economies. They noted that if dollarization improved the outlook for economic stability and growth in trading-partner countries, the United States would benefit. However, they also recognized certain risks if dollarization failed to achieve the benefits commonly attributed to it; moreover, bilateral relations might come under strain whenever the economic cycle—and hence monetary policy—of the United States diverged from that in the dollarized economies.

46. ***The staff observed that the Administration's FY 2000 Budget would hold official development assistance (ODA) at historically low levels as a percentage of GDP over the five-year budget horizon.*** ODA as a share of GDP fell from an average of 0.2 percent in the early 1990s to around 0.1 percent since 1995.[27] The authorities emphasized that while ODA had declined as a percent of GDP, U.S. assistance was being targeted more closely to those countries undertaking market-oriented structural reforms and was expected to be utilized more effectively than in the past. The authorities also pointed out that they continued to be strongly supportive of initiatives designed to help highly indebted poor countries (the HIPC Initiative), and would like to see the program enlarged and deepened.

IV. Staff Appraisal

47. ***The U.S. authorities are to be highly commended for their sound fiscal and monetary policies, which have contributed significantly to what is now approaching the longest economic expansion in U.S. history.*** Steadfast efforts to improve the fiscal outlook have helped to turn the unified federal budget balance to a surplus in FY 1998 for the first time in 30 years, and structural budget surpluses are expected to be sustained under current policies over the longer term. Monetary policy has continued to support the expansion while containing inflation. At the same time, strong employment growth, partly attributable to the flexibility of U.S. labor markets, has contributed to a decline in the unemployment rate to its lowest level in decades. During the recent difficult period of turbulence in the world economy, the United States economy has been the principal engine of global growth, and U.S. monetary policy played a key role in stabilizing international financial markets. In the

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[26] Total seignorage in the United States amounts to about ¼ percent of GDP, of which estimates suggest that from 50 percent to 70 percent is attributable to foreign holdings of U.S. dollars. The forthcoming selected issues paper will examine the implications of dollarization for the United States.

[27] The OECD's Development Assistance Committee (DAC) reports that U.S. ODA in 1997 (the most recent figure available on a DAC basis) was 0.09 percent of GNP.

period ahead, however, U.S. growth will need to slow from its recent rapid pace to a rate more in line with the economy's long-run potential. The policy challenge for both the United States and its international partners will be to ensure that a restoration of a more evenly distributed pattern of demand growth is accomplished in a nondisruptive manner.

48. ***In recent years, the supply side of the U.S. economy has behaved differently than expected by most analysts, including the staff, with growth exceeding projections and inflation continuing to decline well into the period of sustained growth***. Despite tight labor markets, wage demands have remained moderate, in part reflecting the effects of favorable price shocks that have contributed to unanticipated increases in real wages. At the same time, the appreciation of the dollar and the fall in commodity prices, along with stiffer competition in U.S. markets, have served to contain inflation. At this stage, a good deal of uncertainty surrounds estimates of potential output and the natural rate of unemployment, making these indicators less useful as guides for macroeconomic policy. Strong investment and continued productivity gains have probably raised potential output more rapidly than in preceding periods, but it is difficult to gauge the extent to which recent developments reflect a sustainable change in structural economic conditions and how much is attributable to transitory factors. Regardless of the uncertainty about the new limits of productive capacity, the economy still faces resource constraints, and the recent very strong growth in aggregate demand cannot be sustained for long without having inflationary consequences.

49. ***Although the performance of the U.S. economy has been remarkable, some significant risks have emerged.*** In particular, while national saving has increased substantially since 1992, personal saving has fallen to an unprecedentedly low level, partly reflecting the effects of the large gains in wealth associated with what many indicators suggest is a significantly overvalued U.S. equity market. At the same time, the external current account deficit has widened sharply, owing to the appreciation of the dollar and the rapid pace of domestic demand growth in the United States. Moreover, the factors that have contributed to the favorable wage and inflation performance in recent years may have only transitory effects. A reversal of these conditions, if it were to unfold rapidly, could cause problems for macroeconomic management. ***While the decline in personal saving and the rise in the current account imbalance, which reflects the relative cyclical positions of the U.S. and other major economies, do not warrant any immediate policy responses, they do heighten the potential risks associated with any overheating.***

50. ***In these circumstances, unless there is evidence soon that the strength of demand growth is abating, the authorities may need to tighten monetary policy further to ensure that the expansion remains on a sustainable, noninflationary path***. Since economic conditions in the rest of the world and in global financial markets have improved somewhat, a modest tightening would have a less damaging effect than it would have had earlier. While judgements on the timing of such action are especially difficult in the current circumstances, waiting too long to act would risk having to raise rates more sharply to stem a pickup in inflation, which would increase the likelihood of a sharp stock market correction and a "hard landing." It will be especially important for the Federal Reserve to continue to respond rapidly and to be forward looking in its conduct of policy.

51. The Administration's intention to preserve a substantial portion of the federal budget surpluses in prospect over the medium term and beyond is laudable. ***Maintenance of substantial budget surpluses is appropriate for both short-term stabilization and long-term structural reasons.*** In the near term, resisting new tax and spending initiatives in order to realize the projected budget surpluses is essential to avoid adding further fuel to already strong aggregate demand pressures. In the long term, allowing surpluses to materialize will help prepare the federal government for the rising tide of unfunded liabilities associated with the aging of the population. ***The staff believes that an appropriate longer-term fiscal objective would be to put the Social Security and Medicare programs into actuarial balance, and then keep the remainder of the budget balanced on average, allowing for changes in cyclical conditions.***

52. ***Although a consensus appears to have emerged in Congress to maintain substantial surpluses, it will be necessary to continue to resist pressures to cut taxes and increase spending as the budget deliberations proceed.*** In this regard, discretionary spending caps and the PAYGO financing requirement have fostered discipline in the budget process, contributing to the sustained fiscal consolidation since FY 1992. These budget enforcement measures are set to expire in 2002, and the staff believes that long-term budget discipline would be well served by appropriate modest adjustments to the spending caps and by extending both measures beyond their expiration.

53. ***Tax cuts proposed by the Administration in its FY 2000 Budget continue a tendency to use tax incentives to promote specific economic or social goals. These incentives complicate the income tax system and increase compliance costs.*** With the aim of simplifying the income tax system, the staff continues to take the view that the authorities should limit recourse to the use of tax expenditures.

54. ***The Administration's proposal for Social Security is a useful first step toward shoring up the system's finances, but further efforts are needed to achieve long-term actuarial balance.*** The total size of the funding gap is relatively small by international standards, and in principle, could be corrected without radical changes to the system. The staff endorses the Administration's intention to maintain the system's current structure, which has been highly successful in reducing poverty among the elderly. Nevertheless, the proposed use of general revenues and the plan to invest a small portion of Trust Fund assets in equities raises some concerns. Removing the link between outlays and Social Security payroll taxes could potentially erode an effective budget constraint—one that probably has provided a check on unwarranted growth in Social Security benefits over the years. The Administration's plan to invest some Trust Fund assets in equities would contribute to improving the finances of Social Security, but its overall macroeconomic impact would be to simply shift the composition of public and private asset portfolios without substantially contributing to a needed increase in national saving. There is also the potential risk that investment of these funds in private securities could ultimately be influenced by political considerations, creating distortions which could adversely affect private sector investment decisions. In the view of the staff, a comprehensive solution to Social Security's long-term financial problem should involve small adjustments in the system's parameters (increases in

contribution rates, an increase in the retirement age, and/or cuts in benefits), which need to be enacted soon.

55. ***Although the Administration's proposal to transfer general revenues to the HI Trust Fund would also lessen the actuarial imbalance facing Medicare, it falls short of restoring the long-term financial viability of the system.*** The staff urges the Administration to consider a more comprehensive solution to Medicare's financial problems that would involve a menu of options, including reducing net benefits, raising co-payments and deductibles, and increasing contribution rates. Periodic adjustments to the program are likely to be required because of the difficulties in projecting Medicare outlays, and a mechanism for making adjustments in the program's parameters on a regular basis should be established. Timely adoption of a comprehensive plan to shore up the longer-term financial viability of Medicare would avoid the need for more draconian measures at a later stage.

56. ***Over the past year and a half, the appreciation of the U.S. dollar has shifted demand abroad, helping to avert overheating in the United States and mitigating the adverse effects of global economic turbulence.*** As growth outside the United States recovers, especially in the economies of key trading partners, some reversal of safe-haven capital flows, and some depreciation of the dollar can be expected, helping to narrow the U.S. external current account deficit. Continued implementation of sound macroeconomic policies will increase the likelihood that any correction in the dollar's value will be an orderly process. In particular, the prospects for sustained fiscal surpluses in coming years should raise national saving and help gradually to ease pressures contributing to the relatively high external current account deficit. Furthermore, if the dollar were to depreciate suddenly and sharply, the Federal Reserve, although not targeting the exchange rate, would be well-positioned, if needed, to tighten monetary policy in order to limit the risk of a sustained effect on inflation.

57. ***In the last year, the appreciation of the U.S. dollar and the weakness in domestic demand abroad has heightened competition faced by U.S. import-competing producers and is stimulating protectionist sentiment. It is in the interest of both the United States and the international community that these protectionist pressures be strongly resisted.*** In particular, steps need to be taken to ensure that protection from "unfair trade" in the form of antidumping and countervailing duties—even if they conform to WTO obligations—is not simply used as a means of inhibiting competition from imports. Rather, there are sound economic reasons for administering these procedures with the objective of providing import protection only in those cases where foreign producers are engaged in anticompetitive behavior. At the same time, the United States should continue to be a major force for the advancement of multilateral trade liberalization in order to foster a more hospitable global environment for trade. The ability of the United States to play such a leadership role would be enhanced by approval of fast-track negotiating authority. U.S. reliance on the WTO's dispute-settlement mechanism to resolve trade disputes, rather than pursuing unilateral actions, has supported the WTO's rules-based approach to international trade. The staff hopes that the United States and the authorities in other countries will continue to seek cooperative

solutions in recent high-profile disputes, refrain from resorting to restrictive trade measures, and work together to improve the dispute-settlement mechanism.

58. Under the Administration's FY 2000 budget, official development assistance (ODA) would be held at its recent historically low level of less than 0.1 percentage of GDP over the five-year budget horizon. ***The staff urges the authorities to raise the priority assigned to ODA and to re-establish the leadership role of the United States in this area, thereby helping to catalyze a resurgence in such assistance worldwide.***

59. ***The quality, coverage, periodicity, and timeliness of U.S. economic data are considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance.*** The United States has subscribed to the Special Data Dissemination Standard and its metadata are posted on the Dissemination Standard Bulletin Board.

60. It is recommended that the next Article IV consultation takes place within the standard 12-month cycle.

United States: Fund Relations
(As of May 31, 1999)

I. **Membership Status**: Joined 12/27/45; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	37,149.30	100.0
Fund holdings of currency	21,017.70	56.6
Reserve position in Fund	16,127.88	43.4
Operational budget transfers (net)	612.00	

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	4,899.53	100.0
Holdings	7,275.38	148.5

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Payments Restrictions**: The United States has notified the Fund under Decision No. 144 of restrictions on payments and transfers for current international transactions to Libya, Iraq, North Korea, Cuba, and Iran. The United States restricts the sale of arms and petroleum to UNITA and to the territory of Angola and has prohibitions against transactions with terrorists and international narcotics traffickers. The United States notified the Fund under Decision No. 144 on August 2, 1995 of the imposition of further restrictions on current transactions with Iran (EBS/95/107).

VIII. **Statistical Issues**: The quality, coverage, periodicity, and timeliness of U.S. economic data are considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance (see Attachment for a summary). The United States has subscribed to the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Dissemination Standard Bulletin Board (DSBB).

United States of America: Core Statistical Indicators

as of June 30, 1999

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of latest observation	Same day	May 1999	June 16	June 16	June 16	Same day	May 1999	April 1999	99Q1	June 1999	99Q1	1998
Date released	Same day	June 17	June 25	June 25	June 25	Same day	June 16	June 17	June 17	June 21	June 25	July 1999
Frequency of data	daily	monthly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	quarterly	annual
Frequency of reporting	daily	monthly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	monthly	annual
Source of data	Federal Reserve	Treasury	Federal Reserve	Federal Reserve	Federal Reserve	Federal Reserve	Dept. of Labor	Dept. of Commerce	Dept. of Commerce	Treasury	Dept. of Commerce	Dept. of Commerce
Mode of reporting 1/	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic
Confidentiality	none	none	none	none	none	none	none	none	none	none	none	none
Frequency of Publication	daily	monthly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	monthly	annual

1/ Most data are available from statistical releases and from private electronic databases.

Table 1. United States: Historical Economic Indicators

	Averages								
	1960s	1970s	1980s	1993	1994	1995	1996	1997	1998
Economic activity and prices									
Real GDP	4.4	3.2	2.8	2.3	3.5	2.3	3.4	3.9	3.9
Real net exports 1/	0.0	0.2	-0.1	-0.6	-0.5	0.1	-0.2	-0.3	-1.1
Real final domestic demand	4.4	3.0	2.8	2.7	3.3	2.6	3.6	3.7	5.1
Private final consumption	4.4	3.5	3.0	2.9	3.3	2.7	3.2	3.4	4.9
Nonresidential fixed investment	7.0	5.2	2.6	7.6	8.0	9.6	9.3	10.7	11.8
Labor force	1.7	2.7	1.7	0.8	1.4	1.0	1.2	1.7	1.0
Employment	1.9	2.4	1.7	1.5	2.3	1.5	1.4	2.2	1.5
Unemployment rate	4.8	6.2	7.3	6.9	6.1	5.6	5.4	4.9	4.5
Labor productivity 2/	2.8	1.9	1.1	0.1	0.5	0.6	2.4	1.2	2.2
Total factor productivity 2/	1.9	1.1	0.1	0.1	0.4	0.3	1.5	0.4	...
Capital stock 3/	3.7	3.5	2.7	1.9	2.2	2.4	2.7	2.8	...
GDP deflator	2.4	6.7	5.0	2.6	2.4	2.3	1.9	1.9	1.0
Implicit price deflator for GDP	2.4	6.7	5.0	2.6	2.4	2.3	1.9	1.9	1.0
Consumer price index	2.3	7.1	5.6	3.0	2.6	2.8	2.9	2.3	1.6
Unit labor cost 2/	2.1	6.4	4.6	2.2	1.4	1.8	1.1	2.3	2.0
Nominal effective exchange rate 4/	0.5	-2.4	0.2	3.0	-1.8	-6.0	5.3	8.1	4.9
Real effective exchange rate 4/	...	...	...	2.6	-1.4	-6.1	5.9	8.4	7.3
Three-month Treasury bill rate (percent) 5/	4.0	6.3	8.8	3.0	4.2	5.5	5.0	5.1	4.8
Ten-year Treasury note rate (percent) 5/	4.7	7.5	10.6	5.9	7.1	6.6	6.4	6.4	5.3
				(In percent of GDP or NNP)					
Balance of payments									
Current account	0.5	0.0	-1.7	-1.3	-1.8	-1.6	-1.7	-1.8	-2.6
Merchandise trade balance	0.6	-0.5	-2.2	-2.0	-2.4	-2.4	-2.5	-2.4	-2.9
Invisibles, net	-0.1	0.5	0.5	0.7	0.6	0.8	0.8	0.7	0.3
Real net exports 6/	-1.2	-1.4	-1.6	-1.1	-1.6	-1.4	-1.6	-1.9	-3.2
Fiscal indicators									
Unified Federal deficit	-0.8	-2.1	-4.0	-3.9	-3.0	-2.3	-1.4	-0.3	0.8
Central government fiscal balance (NIPA) 7/	-0.2	-1.7	-3.5	-3.9	-2.7	-2.3	-1.4	-0.1	...
General government fiscal balance (NIPA) 7/	-0.1	-1.0	-2.6	-3.6	-2.3	-1.9	-0.9	0.4	...
Savings and investment 8/									
Gross national saving	21.4	19.8	18.0	14.5	15.5	16.3	16.6	17.3	17.2
General government	5.1	2.6	0.8	-0.5	0.7	1.1	2.1	3.3	4.4
Of which: Federal government	2.2	-0.5	-2.1	-2.8	-1.7	-1.4	-0.5	0.6	1.7
Private	16.4	17.2	17.1	14.9	14.8	15.2	14.5	14.1	12.8
Personal	5.2	5.8	5.1	3.2	2.5	2.5	2.1	1.5	0.3
Business	11.2	11.3	12.1	11.7	12.3	12.7	12.5	12.6	12.5
Gross domestic investment	20.6	20.2	19.8	16.5	17.5	17.4	17.8	18.4	18.8
Private investment	15.4	16.6	16.4	13.4	14.5	14.3	14.8	15.5	16.1
Public investment	5.2	3.6	3.4	3.1	3.0	3.0	3.0	2.9	2.8
Of which: Federal government	2.3	1.2	1.4	1.1	1.0	0.9	0.9	0.7	0.7
Net foreign investment	0.6	0.2	-1.6	-1.2	-1.7	-1.4	-1.6	-1.7	-2.5
Net national saving	15.3	12.5	9.2	6.1	7.1	8.2	8.6	9.5	...
Net private investment	8.7	9.0	7.4	4.8	6.0	6.0	6.5	7.4	...
In real terms									
Gross domestic investment	17.5	17.0	17.4	16.7	17.7	17.7	18.5	19.5	20.4
Public	4.6	3.1	3.0	3.1	3.0	3.0	3.0	2.9	2.8
Private	12.9	14.0	14.4	13.5	14.8	14.7	15.5	16.6	17.6

Sources: U.S. Department of Commerce; and Board of Governors of the Federal Reserve System.

1/ Contribution to GDP growth.
2/ Private nonfarm business sector.
3/ Business sector in chained 1992 dollar.
4/ Monthly average on a unit labor cost basis (1990=100).
5/ Yearly average.
6/ On a NIPA basis.
7/ Current surplus or deficit excluding net investment.
8/ Gross national saving does not equal gross domestic investment and net foreign investment because of capital grants and statistical discrepancy. Net national saving and net private investment are expressed in percent of NNP.

Table 2. United States: Balance of Payments

(In billions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Current account	-79	4	-51	-85	-122	-114	-129	-143	-221
Percent of GDP	-1.4	0.1	-0.8	-1.3	-1.8	-1.6	-1.7	-1.8	-2.6
Goods and services	-80	-29	-37	-70	-98	-98	-104	-105	-164
Merchandise trade	-109	-74	-96	-133	-166	-174	-191	-197	-247
Exports	389	417	440	457	502	576	612	680	670
Imports	-498	-491	-536	-589	-669	-750	-803	-876	-917
Services	29	45	59	63	68	76	87	92	83
Receipts	147	163	176	185	200	218	238	259	264
Payment	-118	-118	-116	-122	-132	-141	-151	-167	-181
Investment income	28	24	22	23	16	19	17	3	-12
Receipts	172	150	133	135	166	212	225	259	258
Payment	-144	-126	-110	-111	-150	-193	-207	-255	-271
Unilateral transfers	-28	10	-36	-39	-39	-35	-42	-42	-44
Government transfers	-10	29	-16	-17	-15	-11	-15	-12	-13
Private transfers	-17	-19	-20	-21	-24	-24	-27	-30	-31
Capital account transactions, net	-7	-4	1	0	0	0	1	0	1
Financial account	60	47	97	82	131	137	194	286	210
Private capital	26	21	54	12	86	38	61	269	239
Direct investment	11	-15	-28	-32	-33	-40	-4	-1	61
Outflows	-38	-38	-49	-84	-81	-99	-93	-110	-133
Inflows	49	24	21	53	47	60	89	109	193
Securities	-11	24	31	-23	54	108	187	278	178
Outflows	-29	-46	-49	-146	-60	-100	-116	-89	-103
Inflows	18	69	81	123	115	208	303	367	281
Net U.S. bank flows	9	3	37	56	100	-45	-75	4	16
Nonbank capital	17	8	13	11	-35	14	-47	-13	-16
U.S. official reserves	-2	6	4	-1	5	-10	7	-1	-7
Foreign official assets	34	17	40	72	40	110	127	18	-22
Other items	2	3	-2	0	0	-1	-1	0	0
Statistical discrepancy	25	-46	-47	3	-9	-24	-65	-143	10

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

Table 3. United States: Economic Outlook

(In percent changes from previous period, unless otherwise indicated)

	1996	1997	1998	Staff Projection 1999	2000	2001	2002	2003	2004
NIPA in constant prices									
Real GDP	3.4	3.9	3.9	3.9	2.6	2.6	2.6	2.6	2.6
Net exports 1/	-0.2	-0.3	-1.1	-1.0	-0.2	-0.1	0.0	0.0	0.0
Total domestic demand	3.6	4.2	5.0	5.2	3.0	2.7	2.6	2.6	2.5
Final domestic demand	3.6	3.7	5.1	5.4	3.0	2.8	2.6	2.6	2.5
Private final consumption	3.2	3.4	4.9	5.1	2.8	2.7	2.5	2.6	2.4
Public consumption expenditure	0.7	1.3	1.1	1.5	1.5	1.5	1.5	1.4	2.0
Gross fixed domestic investment	7.8	7.2	9.6	9.0	4.4	3.8	3.6	3.4	3.4
Private	8.8	8.3	11.4	9.2	4.9	4.1	3.9	3.7	3.7
Public	3.4	1.4	0.2	7.7	1.5	1.6	1.5	1.6	1.6
Change in business inventories 1/	0.0	0.5	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0
Real GNP	3.4	3.7	3.7	3.9	2.6	2.6	2.6	2.6	2.6
Addenda:									
GDP in current prices	5.4	5.9	4.9	5.4	4.7	4.9	4.9	4.9	4.9
GNP in current prices	5.3	5.6	4.8	5.4	4.7	4.9	4.9	4.9	4.9
Employment and inflation									
Unemployment rate	5.4	4.9	4.5	4.3	4.5	4.7	5.0	5.0	5.0
CPI	2.9	2.3	1.6	2.2	2.5	2.5	2.5	2.5	2.5
GDP deflator	1.9	1.9	1.0	1.4	2.1	2.2	2.2	2.3	2.2
Financial indicators									
Unified Federal deficit 2/	-107	-22	69	99	145	155	188	202	223
(as a share of GDP)	-1.4	-0.3	0.8	1.1	1.6	1.6	1.8	1.9	2.0
Central government fiscal balance (NIPA)	-107	-10	65	101	142	159	189	207	197
(as a share of GDP)	-1.4	-0.1	0.8	1.1	1.5	1.6	1.8	1.9	1.7
General government fiscal balance (NIPA)	-70	29	108	146	191	211	245	266	261
(as a share of GDP)	-0.9	0.4	1.3	1.6	2.0	2.1	2.4	2.5	2.3
Three-month Treasury bill rate	5.0	5.1	4.8	4.8	5.3	5.3	5.3	5.3	5.3
Ten-year Treasury bond rates	6.4	6.4	5.3	5.6	6.3	6.3	6.3	6.3	6.3
Balance of payments									
Current account balance	-129	-143	-221	-315	-331	-340	-343	-351	-346
(as a share of GDP)	-1.7	-1.8	-2.6	-3.5	-3.5	-3.4	-3.3	-3.2	-3.0
Merchandise trade balance	-191	-197	-247	-320	-342	-362	-379	-391	-398
(as a share of GDP)	-2.5	-2.4	-2.9	-3.6	-3.6	-3.7	-3.7	-3.6	-3.5
Export volume (NIPA)	8.5	12.8	1.5	3.6	5.7	6.7	7.6	7.5	8.0
Import volume (NIPA)	9.2	13.9	10.6	10.7	6.4	6.5	6.6	6.6	6.6
Invisibles, net	62	53	26	5	12	22	36	41	53
(as a share of GDP)	0.8	0.7	0.3	0.1	0.1	0.2	0.3	0.4	0.5

Source: Staff estimates for the World Economic Outlook.

1/ Contribution to GDP growth.

2/ Projections assume that the Administration's FY2000 budget proposal as described in the June 1999 Mid-Session Review is adopted.

Table 4. United States: Indicators of Economic Performance

	1993	1994	1995	1996	1997	1998	Projection 1999	2000
	(Annual percent change)							
Real GDP								
United States	2.3	3.5	2.3	3.4	3.9	3.9	3.9	2.6
Japan	0.3	0.6	1.5	5.0	1.4	-2.8	0.2	0.8
Germany 1/	-1.1	2.3	1.7	0.8	1.8	2.3	1.4	2.7
Canada	2.3	4.7	2.8	1.7	4.0	3.1	3.3	2.6
France, Italy, and United Kingdom 2/	-0.1	3.1	2.6	1.7	2.4	2.3	1.4	2.5
G-7 countries 3/	1.1	2.8	2.2	3.0	2.9	2.2	2.4	2.3
Real domestic demand								
United States	2.9	3.9	2.1	3.6	4.2	5.0	5.2	3.0
Japan	0.1	1.0	2.3	5.7	0.1	-3.5	0.5	0.7
Germany 1/	-1.1	2.2	1.7	0.3	1.0	2.6	2.1	2.4
Canada	1.4	3.2	1.7	1.6	5.7	2.2	2.5	2.4
France, Italy, and United Kingdom 2/	-1.6	2.6	1.9	1.4	2.4	3.3	2.0	2.5
G-7 countries 3/	0.9	2.9	2.0	3.1	2.8	2.8	3.3	2.4
GDP deflator								
United States	2.6	2.4	2.3	1.9	1.9	1.0	1.4	2.1
Japan	0.6	0.2	-0.6	-1.4	0.1	0.3	-0.1	-0.4
Germany 1/	3.7	2.5	2.0	1.0	0.7	1.1	0.8	1.1
Canada	1.5	1.1	2.3	1.6	0.8	-0.6	0.8	1.4
France, Italy, and United Kingdom 2/	3.2	2.2	2.7	3.1	2.0	2.0	1.5	1.5
G-7 countries 3/	2.5	1.9	1.9	1.5	1.4	1.1	1.1	1.4
	(As percent of GDP)							
General government financial balance								
United States	-3.6	-2.3	-1.9	-0.9	0.4	1.3	1.6	2.0
Japan	-1.6	-2.3	-3.6	-4.2	-3.4	-5.3	-7.7	-7.6
Germany 1/	-3.1	-2.4	-3.2	-3.4	-2.6	-2.0	-2.2	-1.6
Canada	-7.6	-5.6	-4.3	-1.8	0.8	0.9	1.4	1.4
France, Italy, and United Kingdom 2/	-7.6	-7.2	-6.3	-5.1	-2.6	-1.8	-2.0	-1.8
G-7 countries 3/	-4.2	-3.5	-3.4	-2.7	-1.2	-0.9	-1.2	-0.8
Gross savings								
United States	14.5	15.5	16.3	16.6	17.3	17.2	15.8	15.1
Japan	32.8	31.4	30.7	31.4	31.0	29.7	28.8	28.5
Germany 1/	22.0	22.1	22.0	21.4	21.7	22.3	22.3	23.3
Canada	13.1	15.4	17.6	18.1	18.6	17.8	18.3	18.2
France, Italy, and United Kingdom 2/	17.0	18.3	19.2	18.8	19.4	19.2	19.3	19.4
G-7 countries 3/	19.1	19.6	20.1	20.3	20.7	20.3	19.5	19.2
Fixed private investment								
United States	13.0	13.6	13.9	14.4	14.7	15.4	15.7	15.7
Japan	21.0	20.0	19.9	20.7	20.6	18.4	17.0	17.5
Germany 1/	20.4	20.6	20.1	19.6	19.4	19.1	18.4	18.4
Canada	14.8	15.5	14.5	15.0	16.8	17.1	17.2	17.1
France, Italy, and United Kingdom 2/	14.1	14.0	14.7	14.9	14.8	14.6	14.9	15.0
G-7 countries 3/	15.5	15.6	15.8	16.2	16.3	16.1	16.1	16.2
Current account balance								
United States	-1.3	-1.8	-1.6	-1.7	-1.8	-2.6	-3.5	-3.5
Japan	3.1	2.8	2.2	1.4	2.2	3.2	3.2	2.9
Germany 1/	-0.5	-1.1	-0.8	-0.2	-0.1	-0.2	-0.2	0.0
Canada	-3.9	-2.3	-0.8	0.5	-1.6	-1.8	-1.4	-1.2
France, Italy, and United Kingdom 2/	0.1	0.5	0.8	1.5	2.1	1.2	0.9	0.9
G-7 countries 3/	-4.9	-3.1	-1.0	0.7	-2.2	-2.7	-2.0	-1.9

Source: Staff estimates for the World Economic Outlook.

1/ Data refer to unified Germany.
2/ Composites for the country groups are averages of individual countries weighted by the average value of their respective GDPs converted using PPP weights over the preceding three years.
3/ Includes statistical discrepancies.

Table 5. United States: Real Household Wealth

(In trillions of 1997 dollars) 1/

	1992	1993	1994	1995	1996	1997	1998
Total assets	31.1	31.7	32.0	34.3	36.2	39.2	42.6
Of which:							
Real estate holdings	8.8	8.7	8.7	8.8	9.0	9.5	10.1
Consumer durable goods	2.3	2.3	2.4	2.4	2.5	2.5	2.6
Deposits	3.7	3.5	3.4	3.5	3.6	3.8	4.1
Credit market instruments	1.9	1.9	2.1	2.0	2.0	1.8	1.6
Corporate equities	3.3	3.5	3.2	4.2	4.6	5.3	6.2
Mutual funds	0.8	1.1	1.1	1.3	1.6	2.1	2.5
Pension fund	5.0	5.4	5.5	6.1	6.7	7.7	8.6
Total liabilities	4.6	4.8	5.0	5.2	5.4	5.7	6.1
As percent of disposable income	87.8	89.6	92.0	94.4	96.2	98.3	102.8
Of which:							
Home mortgages	3.2	3.2	3.3	3.4	3.5	3.7	4.0
Consumer credit	0.9	1.0	1.1	1.2	1.2	1.3	1.3
Net worth 2/	26.5	27.0	27.0	29.1	30.7	33.5	36.5
As percent of disposable income	503.1	506.7	497.1	523.6	542.1	578.8	614.2
Consumer price index	87.4	90.0	92.3	94.9	97.7	100.0	101.6

Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, Table B.100.

1/ Deflated by the consumer price index.

2/ Net worth equals total assets minus total liabilities.

Table 6. United States: Fiscal Indicators

(In percent of GDP, fiscal years)

			Projections					
	1997	1998	1999	2000	2001	2002	2003	2004
FY2000 budget current-services baseline								
Administration								
Outlays	20.0	19.6	19.5	19.1	18.5	17.9	17.8	17.6
Debt service	3.1	2.9	2.6	2.4	2.2	1.9	1.7	1.6
Other	16.9	16.8	16.9	16.7	16.4	16.0	16.1	16.0
Revenue	19.7	20.5	20.7	20.6	20.3	20.1	20.0	19.9
Unified balance	-0.3	0.8	1.1	1.5	1.7	2.2	2.1	2.3
Primary balance 1/	2.9	3.7	3.7	3.9	3.9	4.1	3.9	3.9
Unified balance excluding social security	-1.3	-0.4	-0.3	0.0	0.3	0.7	0.5	0.7
Debt 2/	47.2	44.2	41.3	38.2	35.1	31.6	28.2	24.8
Staff								
Outlays	20.0	19.6	19.5	19.0	18.4	17.7	17.6	17.3
Debt service	3.1	2.9	2.6	2.4	2.3	2.1	1.9	1.7
Other	16.9	16.8	16.9	16.6	16.2	15.7	15.7	15.7
Revenue	19.7	20.5	20.7	20.6	20.3	20.1	20.0	20.0
Unified balance	-0.3	0.8	1.1	1.6	1.8	2.4	2.4	2.6
Primary balance	2.9	3.7	3.7	4.0	4.1	4.4	4.3	4.3
Unified balance excluding social security	-1.3	-0.4	-0.3	0.1	0.4	0.9	0.8	1.1
Debt 2/	47.2	44.2	41.2	38.0	34.6	30.8	27.1	23.4
FY2000 budget with proposed measures and social security reform								
Administration								
Outlays	20.0	19.6	19.5	19.2	18.9	18.6	18.4	18.2
Debt service	3.1	2.9	2.6	2.4	2.2	2.0	1.8	1.6
Other	16.9	16.8	16.9	16.8	16.7	16.6	16.6	16.5
Revenue	19.7	20.5	20.7	20.7	20.4	20.2	20.1	19.8
Unified balance	-0.3	0.8	1.1	1.5	1.5	1.7	1.6	1.6
Primary balance	2.9	3.7	3.7	3.9	3.7	3.6	3.4	3.3
Unified balance excluding social security	-1.3	-0.4	-0.3	0.1	0.0	0.1	0.0	0.1
Debt 2/	47.2	44.2	41.3	38.2	35.4	32.4	29.5	26.6
Staff								
Outlays	20.0	19.6	19.5	19.1	18.8	18.4	18.2	17.9
Debt service	3.1	2.9	2.6	2.4	2.3	2.1	1.9	1.7
Other	16.9	16.8	16.9	16.7	16.5	16.3	16.3	16.1
Revenue	19.7	20.5	20.6	20.7	20.4	20.2	20.1	19.9
Unified balance	-0.3	0.8	1.1	1.6	1.6	1.8	1.9	2.0
Primary balance	2.9	3.7	3.7	4.0	3.9	3.9	3.8	3.7
Unified balance excluding social security	-1.3	-0.4	-0.3	0.1	0.1	0.3	0.3	0.4
Debt 2/	47.2	44.2	41.3	38.0	34.8	31.5	28.3	25.2
Memorandum items:								
Structural unified balance (staff) 3/	-0.3	0.8	1.1	1.6	1.8	2.4	2.4	2.6
Administration economic projections (calendar years)								
Real GDP growth		3.9	3.9	2.4	2.1	2.2	2.5	2.5
CPI inflation rate		1.6	2.2	2.4	2.4	2.5	2.5	2.5
Three-month Treasury bill rate		4.8	4.5	4.5	4.5	4.5	4.6	4.6
Unemployment rate		4.6	4.8	5.0	5.3	5.3	5.3	5.3

Sources: Budget of the United States Government: Fiscal Year 2000, Mid-Session Review (June 1999); and staff estimates. Staff estimates adjust the Administration projections for differences between the Administration and staff macroeconomic assumptions.

1/ Excludes net interest outlays.
2/ Debt held by the public includes debt held by the Federal Reserve Banks.
3/ In view of the high degree of uncertainty in the present circumstances attached to estimates of potential GDP, for the purposes of calculating the structural balance, the staff assumed that the output gap was closed in 1997, and will remain zero over the medium term.

Table 7. United States: Administration FY 2000 Budget Proposals

(In billions of dollars)

	1999	2000	2001	2002	2003	2004
Programmatic changes:						
Discretionary:						
Offset discretionary spending	--	17.2	12.9	13.5	15.8	15.3
Mandatory offsets designated for discretionary:						
Federal tobacco revenues	0.1	-8.0	-7.1	-6.6	-6.4	-6.4
Tobacco recoupment	0.0	0.0	0.0	-1.8	-3.3	-4.0
FAA user fees	0.0	-1.1	-1.2	-1.1	-1.0	-0.9
Health care savings	0.0	-1.1	-0.9	-1.0	-1.0	-1.1
Superfund revenues	-0.1	-1.5	-1.2	-1.2	-1.2	-1.3
Other specified offsets	0.0	-6.0	-2.5	-1.8	-2.8	-1.7
Subtotal, discretionary	0.0	-0.5	0.0	0.0	0.1	-0.1
Mandatory and revenues:						
Initiatives:						
Class size and child care	0.0	1.2	1.6	1.9	2.1	2.5
Health care	0.0	0.2	1.3	1.6	1.2	1.0
Revenue initiatives	0.7	4.1	7.7	6.6	6.9	7.3
Other	0.1	0.9	1.6	1.7	1.3	1.6
Subtotal, initiatives	0.8	6.5	12.2	11.8	11.6	12.4
Offsets:						
Tobacco recoupment	0.0	0.0	-2.8	-2.1	-1.2	-0.7
Health care	0.0	-0.2	-1.1	-1.3	-1.5	-1.6
Student loans	-0.1	-0.8	-0.6	-0.6	-0.6	-0.3
Revenue offsets	-0.3	-4.7	-6.9	-7.1	-7.3	-7.4
Other	0.0	-0.7	-0.8	-0.7	-0.9	-2.4
Subtotal, offsets	-0.5	-6.5	-12.2	-11.8	-11.6	-12.4
Subtotal, mandatory and revenues	0.4	0.0	0.0	0.0	0.0	0.0
Debt service	0.0	0.0	0.0	0.0	0.0	-0.1

Source: Budget of the United States Government: FY 2000 (February 1999). Totals may differ slightly from Administration's due to rounding.

Statement by the IMF Staff Representative
July 30, 1999

1. Since the staff report (SM/99/159, 7/9/99) was issued, the Chairman of the Federal Reserve Board, Mr. Alan Greenspan, presented the biannual report to Congress on the economic situation and monetary policy; the Congressional Budget Office (CBO) provided an updated analysis of the Administration's budget proposals; and new data releases indicate that real GDP growth slowed in the second quarter of 1999 and that labor costs may have begun to pick up. The thrust of the staff appraisal is unchanged by these developments.

Chairman Greenspan's testimony

2. In his congressional testimony on the Federal Reserve's *Semiannual Report on Monetary Policy* (Humphrey-Hawkins testimony) on July 22, Chairman Greenspan indicated that by late June it had become apparent that much of the financial strain that emerged in the later part of 1998 had eased, the near-term outlook for foreign economies had improved, and U.S. demand was growing at an unsustainable pace. These developments prompted the FOMC to raise interest rates to avoid putting the economic expansion at risk.

3. Mr. Greenspan indicated that, in his view, factors were in place that should help to slow the growth in domestic demand to a pace more in line with potential output growth in the period immediately ahead. Consumption growth would slow if, as seemed likely, the strong equity price appreciation of the past several years did not continue. This would also induce businesses to trim capital outlays, a tendency that would be reinforced by the higher level of market interest rates borrowers now faced. GDP growth was expected by most of the Federal Reserve governors and Bank presidents to slow in 2000 to between 2½ percent and 3 percent.

4. Mr. Greenspan emphasized the major role of increased productivity growth in helping to keep inflationary pressures in check in recent years. He said that the accelerating use of newer technologies, business restructuring, and the synergies of the new technologies had enhanced productive efficiencies. Nevertheless, he cautioned that it was necessary to be modest about the ability to project that more rapid productivity growth would continue in the future.

5. Mr. Greenspan observed that for monetary policy to foster maximum sustainable economic growth, it was useful to preempt forces of imbalance before they threatened economic stability, although at times this may not be possible given the limits on forecasting ability. He emphasized that, whenever it was possible, a preemptive policy should be followed in order to avoid a more severe response at a later date that could destabilize the economy. Consequently, the Federal Reserve would act promptly and forcefully in the event that new data suggested inflationary pressures would be picking up.

6. Mr. Greenspan indicated that equity prices figured importantly in the Federal Reserve's forecasting process because they influenced aggregate demand. Nevertheless, he reiterated his earlier view that the central bank could not effectively target equity or other

asset prices. He said that identifying an asset bubble as it inflated was among the most formidable challenges confronting a central bank, as it would pit the central bank's judgement against that of millions of investors. In the event of an adjustment in stock prices, it was the job of economic policymakers to mitigate the fallout and to ease the transition to the next expansion.

7. Mr. Greenspan's remarks appeared to be interpreted by market participants as potentially foreshadowing a further increase in interest rates. Stock prices declined following the Chairman's remarks and yields on long-term Treasury securities rose modestly.

CBO's budget outlook

8. The CBO recently released testimony before the Senate Budget Committee on the Administration's Mid-Session Review of the FY 2000 Budget. The CBO now estimates that under current policies the unified federal budget surplus will be $120 billion in FY 1999 (1.3 percent of GDP), and will reach $266 billion in FY 2004 (2.4 percent of GDP); this is a somewhat higher surplus than that projected by the Administration. Despite the more favorable surpluses under current policies, the CBO estimates that the Administration's updated proposals as laid out in the Mid-Session Review would reduce the surplus in FY 2004 to $174 billion (1.6 percent of GDP), somewhat less than the surplus projected by the Administration. The CBO's slightly less favorable medium-term budget projections under the Administration's policy proposals is the result of their lower estimate of projected savings arising from the Administration's proposed reforms of Medicare, and a significantly higher estimated cost for the Administration's proposed addition of a Medicare prescription drug benefit.

Recent economic data

9. Real GDP grew by 2.3 percent (annual rate) in the second quarter of 1999, compared with 4.3 percent in the first quarter. The slowdown in growth was largely the result of a decline in the growth of consumer spending and residential investment. Business investment continued to rise at a relatively rapid rate. The unemployment rate in June edged up by 0.1 percentage point to 4.3 percent, but remains below most estimates of the natural rate.

10. Although inflation has remained subdued, employment costs rose sharply in the second quarter. The core CPI rose by 0.1 percent in June, and at an annual rate of 1.6 percent during the first half of 1999. The core PPI declined by 0.2 percent in June, and by an annual rate of 0.4 percent during the first half of the year. The employment cost index (ECI), on the other hand, rose by 1.1 percent (seasonally adjusted) in the second quarter, following a 0.4 percent rise in the first quarter. Both the benefits component of the index and the wages and salaries component contributed to this rise, with benefit costs growing at their fastest rate since the final quarter of 1997 and wages and salaries rising at a pace not seen during the current expansion.

Bank soundness

11. A table containing the latest summary indicators on the soundness of U.S. banks is attached for the convenience of Directors (Table 1). These indicators do not alter the position discussed in paragraph 43 of the staff report.

Table 1. U.S. Commercial Banks: Selected Performance Indicators 1/

(In percent, unless otherwise noted)

	1993	1994	1995	1996	1997	1998	1999Q1
Return on average equity	15.3	14.6	14.6	14.4	14.8	14.0	15.4
Net interest margin	4.4	4.4	4.3	4.3	4.3	4.1	4.1
Provisions to average loans	0.8	0.5	0.5	0.6	0.7	0.7	0.7
Noninterest income to total revenue	0.4	0.3	0.4	0.4	0.4	0.4	0.4
Annual asset growth	5.7	8.2	7.5	6.2	9.5	8.5	-2.3
Annual loan growth	5.8	9.7	10.3	8.0	5.7	9.0	1.5
Total loans/assets	58.0	58.8	60.4	61.4	59.2	59.5	60.1
Equity capital /assets	8.0	7.8	8.1	8.2	8.3	8.5	8.7
Leverage ratio	7.7	7.7	7.6	7.6	7.6	7.5	7.7
Tier 1 ratio (risk-based)	10.6	10.5	10.2	10.0	9.6	9.5	9.7
Estimated total risk-based capital	13.1	13.0	12.7	12.5	12.2	12.2	12.4
Net charge offs/average loans	0.9	0.5	0.5	0.6	0.7	0.7	0.6
Loans past due 90+ days as a percentage of total loans	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Number of failed banks	40	11	6	5	1	3	1
Assets of failed banks ($ billions)	2.6	0.8	0.8	0.2	0.3	0.4	0.0
Number of problem banks	426	247	144	82	75	69	64
Assets of problem banks ($ billions)	242.3	33.4	16.7	5.1	4.6	5.4	4.7
Memorandum items:							
Number of banks	10,957	10,450	9,938	9,528	9,144	8,775	8,722
Total assets ($ billions)	3,707	4,011	4,312	4,578	5,015	5,440	5,410
Total loans ($ billions)	2,151	2,359	2,603	2,811	2,971	3,238	3,251

Source: Board of Governors of the Federal Reserve System, Summary Profile of all Insured Commercial Banks.

1/ Includes all commercial banks insured by the FDIC.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 99/70
FOR IMMEDIATE RELEASE
August 5, 1999

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with the United States

On July 30, 1999, the Executive Board concluded the Article IV consultation with the United States.[1]

Background

Reflecting buoyant consumption and investment spending, real GDP grew by 3.9 percent in 1998, maintaining the same pace set in 1997. In the first quarter of 1999, real GDP grew by 4.3 percent (annual rate) before slowing to 2.3 percent in the second quarter. Consumption has been boosted by a sharp fall in personal saving, with the ratio of personal saving to personal disposable income declining to ½ percent in 1998, and turning negative in the first quarter of 1999. After hovering around 4½ percent in 1998, the unemployment rate has remained around 4¼ percent since March 1999, significantly below most estimates of the natural rate of unemployment. Inflation has remained quiescent despite tight labor markets, largely reflecting the favorable impact of lower commodity prices, the strength of the U.S. dollar, and strong productivity growth. The annual rate of increase in the CPI edged down to around 1½ percent in 1998, while the core CPI (excluding food and energy) rose slightly to 2½ percent. In the first half of 1999, the core CPI increased at an annual rate of 1½ percent.

In the wake of the turbulence in domestic and world financial markets, the Federal Open Market Committee (FOMC) eased monetary policy in three steps during September–November 1998, lowering the target federal funds rate by a total of 75 basis points. Subsequently, in June 1999 the FOMC raised its target federal funds rate by 25 basis points.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

The unified federal budget deficit has declined steadily since FY 1992, and it shifted to a surplus of ¾ percent of GDP in FY 1998. Expenditure cuts and tax increases adopted as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA93) made lasting contributions to the improvement in the fiscal balance. Policy actions contained in the Balanced Budget Agreement of 1997 helped to ensure a further improvement in the unified budget balance in FY 1998 and beyond. Developments in FY 1999 have been favorable, and the federal budget surplus is expected to reach about 1¼ percent of GDP.

The dollar has been subject to significant swings in its value against other major currencies during the last year and a half. In May 1999, the real effective value of the dollar was only 1¾ percent higher than in January 1998, although this was about 30 percent higher than its low in April 1995. After appreciating by 5½ percent in the first eight months of 1998, the dollar on a real effective basis depreciated by about 7½ percent from August to December. The appreciation of the dollar in the first half of the year reflected the strong cyclical position of the U.S. economy relative to other major countries, as generally higher returns on dollar-denominated assets continued to attract substantial capital inflows. After peaking in mid-August, the dollar depreciated sharply against the Japanese yen largely reflecting the unwinding of extensive yen-short positions by financial institutions, and to changing sentiment over the expected future strength of the dollar vis-à-vis the yen. In the first five months of 1999, the dollar appreciated in real effective terms by 5½ percent largely reflecting a 12 percent nominal appreciation against the euro. The external current account deficit rose to $221 billion (about 2½ percent of GDP) in 1998, largely reflecting a widening in the merchandise trade deficit, as import volumes grew by 10½ percent while export volumes rose by 1½ percent. The international investment position of the United States deteriorated further, with the net foreign liability position rising to 18 percent of GDP.

Executive Board Assessment

Executive Directors commended the authorities for their sound fiscal and monetary policies, which together with the remarkable flexibility of the labor and product markets, had helped produce what is now approaching the longest economic expansion in U.S. history. This expansion, but primarily deliberate policy measures to improve the fiscal stance, had helped to turn the unified federal budget balance to a surplus in fiscal year 1998 for the first time in 30 years, and the outlook under current policies is for sustained structural budget surpluses over the longer term. Directors noted that during the recent period of global economic turbulence, the United States had been the principal engine of world growth, and its monetary policy had played a key role in stabilizing international financial markets. In the period ahead, however, Directors considered that the growth of demand would need to slow to a rate more in line with the economy's long-run productive potential. The policy challenge for both the United States and its international partners would be to restore a more sustainable pattern of demand growth in a nondisruptive manner.

Although the performance of the U.S. economy had been remarkable, Directors noted the contribution of possibly transitory factors and cautioned that there were significant risks. Principal among these is the danger of a substantial and abrupt decline in U.S. equity prices. Directors noted that the strength of demand, including corporate investment as well as household consumption, had been underpinned by the high level of stock prices—a level that was difficult to explain—and they were concerned that a sharp market decline could have significant effects on both domestic and foreign economies. Some Directors were particularly concerned that a decline in equity prices could lead to an abrupt adjustment in the household savings rate, which was now at a historic low. Others were less concerned because they considered that national savings, which had been increasing, was the more relevant concept.

Directors also noted that the sharp widening of the external current account deficit and the appreciation of the dollar had been important—but could not be permanent—factors in allowing rapid domestic demand growth without rekindling inflation. Further, Directors suggested that some other factors that had contributed to favorable wage and inflation performance in recent years, such as lower commodity prices, may also have transitory effects. Any abrupt reversal of these conditions could cause problems for macroeconomic management.

Directors considered that more than the usual uncertainty surrounded current estimates of potential output and the natural rate of unemployment, reducing the usefulness of these indicators as guides for macroeconomic policy. They recognized that strong investment and continued productivity gains had probably raised potential output more rapidly than in preceding periods, but agreed that it was difficult to gauge the respective contributions of underlying productivity performance and transitory factors. Regardless of these uncertainties, however, Directors cautioned that the economy still faced resource constraints, and the recent very strong growth in domestic demand could not be sustained for much longer without having inflationary consequences.

In these circumstances, many Directors considered that, unless there was evidence soon that the strength of demand growth was abating, the authorities should tighten monetary policy further to ensure that the expansion remained on a sustainable noninflationary path. Notwithstanding the inevitable uncertainties about the macroeconomic outlook, these Directors considered that the aforementioned risks to the economic outlook underscored the importance of acting promptly to keep inflationary pressures in check. They emphasized that waiting too long to act would risk having to raise interest rates more sharply later to stem a pickup in inflation, which would increase the likelihood of a sharp stock market correction and a "hard landing". Some other Directors, however, were less inclined to think that an increase in interest rates would be called for in the near future.

Directors strongly supported the Administration's intention to preserve a substantial portion of the federal budget surpluses in prospect over the medium term. For the near term, they emphasized the importance of resisting tax-cut and spending initiatives, which they saw as particularly inappropriate in view of the present strength of aggregate demand. For the longer term, preserving these surpluses would help the federal government address the currently

unfunded liabilities associated with the aging of the population and allow early retirement of public debt. Directors considered that an appropriate longer-term fiscal objective would be to put the Social Security and Medicare programs on a sound long-term financial foundation, and to keep the remainder of the budget balanced on average over the business cycle. In this connection, they suggested that ongoing budget discipline could be facilitated by an extension, with appropriate modifications, of discretionary spending caps and the PAYGO financing requirement beyond their scheduled expiration in 2002.

Directors agreed that prompt measures were needed to address the longer-term imbalances facing Social Security and Medicare. They broadly supported the Administration's intention to maintain the basic structure of the Social Security system but also noted some concerns about the proposed use of general revenues to finance the Trust Fund. A number of Directors suggested that removing the link between outlays and Social Security payroll taxes could potentially erode an important constraint on unwarranted growth in Social Security benefits, and noted the significant contribution that changes in contribution rates and entitlements could make to placing the Social Security Trust Fund on a sustainable long-term footing.

Directors noted that, although the Administration's proposals on Medicare would extend the solvency of the system, they fall short of restoring the long-term financial viability of the system. Directors considered that periodic adjustments to the program were likely to be required because of the difficulties in projecting Medicare outlays. It would therefore be helpful to establish a mechanism for making adjustments in the program's parameters on a regular basis.

Directors noted that tax cuts proposed by the Administration in its fiscal year 2000 budget continued a tendency to use tax incentives to promote specific economic and social goals. While recognizing that such measures could in practice sometimes be the best available method of achieving such goals, Directors noted their potential to complicate the income tax system and increase compliance costs.

Directors agreed that the appreciation of the U.S. dollar over the past year and a half had shifted demand abroad, helping to avert overheating in the United States and mitigating the adverse effects of global economic turbulence. As growth outside the United States recovered, however, some reversal of safe-haven capital flows, and some exchange rate realignment was expected by Directors, which would help to narrow the relatively high U.S. external current account deficit. Directors considered that continued implementation of sound macroeconomic policies would increase the likelihood that any correction in the dollar's value would be orderly. In particular, they observed that the prospects for sustained fiscal surpluses in coming years should raise national saving and ease the pressures contributing to the widening external current account deficit.

Some Directors noted that indicators of banking sector vulnerability tend to be procyclical. They stressed the importance of continuing vigilance to ensure that supervisory arrangements remain strong in the face of potential vulnerabilities, and are able to cope with changes in the array of financial instruments and of the ongoing global integration of financial markets. Directors

emphasized that the possible overvaluation in the major U.S. asset markets added to the need for such vigilance. Some Directors expressed special concern over the potential vulnerabilities of the financial system resulting from the activities of highly leveraged institutions.

Directors noted that the appreciation of the U.S. dollar and the weakness in foreign economies had heightened competition faced by U.S. import-competing producers and had stimulated a worrisome degree of protectionist sentiment, notably regarding trade in steel and agricultural products. Directors stressed that it was in the interest of both the United States and the international community to strongly resist these protectionist pressures. At the same time, they encouraged the U.S. authorities to continue to be a major force for the advancement of multilateral trade liberalization in order to foster a more hospitable global environment for trade. Directors also encouraged the United States and the authorities in other countries to continue to seek cooperative solutions in recent high-profile disputes, to refrain from resorting to restrictive trade measures, and to work together to improve the dispute settlement mechanism.

Directors expressed concern about the decline in U.S. official development assistance (ODA) as a ratio to GDP, and urged the authorities to raise the priority assigned to ODA and to re-establish the leadership role of the United States in this area, thereby helping to catalyze a resurgence in such assistance worldwide.

Directors noted that the quality, coverage, periodicity, and timeliness of U.S. economic data were considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance.

Directors welcomed the authorities' decision to participate in the pilot project for the release of the Article IV consultation staff report.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 1999 Article IV consultation with United States is also available.

United States: Selected Economic Indicators

	Averages								
	1960s	1970s	1980s	1993	1994	1995	1996	1997	1998
Economic activity and prices									
Real GDP	4.4	3.2	2.8	2.3	3.5	2.3	3.4	3.9	3.9
Real net exports 1/	0.0	0.2	-0.1	-0.6	-0.5	0.1	-0.2	-0.3	-1.1
Real final domestic demand	4.4	3.0	2.8	2.7	3.3	2.6	3.6	3.7	5.1
Private final consumption	4.4	3.5	3.0	2.9	3.3	2.7	3.2	3.4	4.9
Nonresidential fixed investment	7.0	5.2	2.6	7.6	8.0	9.6	9.3	10.7	11.8
Labor force	1.7	2.7	1.7	0.8	1.4	1.0	1.2	1.7	1.0
Employment	1.9	2.4	1.7	1.5	2.3	1.5	1.4	2.2	1.5
Unemployment rate	4.8	6.2	7.3	6.9	6.1	5.6	5.4	4.9	4.5
Labor productivity 2/	2.8	1.9	1.1	0.1	0.5	0.6	2.4	1.2	2.2
Total factor productivity 2/	1.9	1.1	0.1	0.1	0.4	0.3	1.5	0.4	...
Capital stock 3/	3.7	3.5	2.7	1.9	2.2	2.4	2.7	2.8	...
GDP deflator	2.4	6.7	5.0	2.6	2.4	2.3	1.9	1.9	1.0
Implicit price deflator for GDP	2.4	6.7	5.0	2.6	2.4	2.3	1.9	1.9	1.0
Consumer price index	2.3	7.1	5.6	3.0	2.6	2.8	2.9	2.3	1.6
Unit labor cost 2/	2.1	6.4	4.6	2.2	1.4	1.8	1.1	2.3	2.0
Nominal effective exchange rate 4/	0.5	-2.4	0.2	3.0	-1.8	-6.0	5.3	8.1	4.9
Real effective exchange rate 4/	...	...	...	2.6	-1.4	-6.1	5.9	8.4	7.3
Three-month Treasury bill rate (percent) 5/	4.0	6.3	8.8	3.0	4.2	5.5	5.0	5.1	4.8
Ten-year Treasury note rate (percent) 5/	4.7	7.5	10.6	5.9	7.1	6.6	6.4	6.4	5.3
	(In percent of GDP or NNP)								
Balance of payments									
Current account	0.5	0.0	-1.7	-1.3	-1.8	-1.6	-1.7	-1.8	-2.6
Merchandise trade balance	0.6	-0.5	-2.2	-2.0	-2.4	-2.4	-2.5	-2.4	-2.9
Invisibles, net	-0.1	0.5	0.5	0.7	0.6	0.8	0.8	0.7	0.3
Real net exports 6/	-1.2	-1.4	-1.6	-1.1	-1.6	-1.4	-1.6	-1.9	-3.2
Fiscal indicators									
Unified Federal deficit	-0.8	-2.1	-4.0	-3.9	-3.0	-2.3	-1.4	-0.3	0.8
Central government fiscal balance (NIPA) 7/	-0.2	-1.7	-3.5	-3.9	-2.7	-2.3	-1.4	-0.1	...
General government fiscal balance (NIPA) 7/	-0.1	-1.0	-2.6	-3.6	-2.3	-1.9	-0.9	0.4	...
Savings and investment 8/									
Gross national saving	21.4	19.8	18.0	14.5	15.5	16.3	16.6	17.3	17.2
General government	5.1	2.6	0.8	-0.5	0.7	1.1	2.1	3.3	4.4

Of which: Federal government	2.2	-0.5	-2.1	-2.8	-1.7	-1.4	-0.5	0.6	1.7
Private	16.4	17.2	17.1	14.9	14.8	15.2	14.5	14.1	12.8
Personal	5.2	5.8	5.1	3.2	2.5	2.5	2.1	1.5	0.3
Business	11.2	11.3	12.1	11.7	12.3	12.7	12.5	12.6	12.5
Gross domestic investment	20.6	20.2	19.8	16.5	17.5	17.4	17.8	18.4	18.8
Private investment	15.4	16.6	16.4	13.4	14.5	14.3	14.8	15.5	16.1
Public investment	5.2	3.6	3.4	3.1	3.0	3.0	3.0	2.9	2.8
Of which: Federal government	2.3	1.2	1.4	1.1	1.0	0.9	0.9	0.7	0.7
Net foreign investment	0.6	0.2	-1.6	-1.2	-1.7	-1.4	-1.6	-1.7	-2.5
Net national saving	15.3	12.5	9.2	6.1	7.1	8.2	8.6	9.5	...
Net private investment	8.7	9.0	7.4	4.8	6.0	6.0	6.5	7.4	...
In real terms									
Gross domestic investment	17.5	17.0	17.4	16.7	17.7	17.7	18.5	19.5	20.4
Public	4.6	3.1	3.0	3.1	3.0	3.0	3.0	2.9	2.8
Private	12.9	14.0	14.4	13.5	14.8	14.7	15.5	16.6	17.6

Sources: U.S. Department of Commerce; and Board of Governors of the Federal Reserve System.

1/ Contribution to GDP growth.
2/ Private nonfarm business sector.
3/ Business sector in chained 1992 dollar.
4/ Monthly average on a unit labor cost basis (1990=100).
5/ Yearly average.
6/ On a NIPA basis.
7/ Current surplus or deficit excluding net investment.
8/ Gross national saving does not equal gross domestic investment and net foreign investment because of capital grants and statistical discrepancy. Net national saving and net private investment are expressed in percent of NNP.