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June 29, 1994

## **RECENT DEVELOPMENTS**

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

**DOMESTIC NONFINANCIAL  
DEVELOPMENTS**

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## DOMESTIC NONFINANCIAL DEVELOPMENTS

Although conflicting signals in the flow of economic data are not unusual, the degree of tension in the second-quarter figures is exceptional. Spending indicators, in the aggregate, seemingly point to only a moderate increase in output, but labor market indicators are indicative of a large gain. In balancing these conflicting signals, our assessment is that the economy probably has registered another quarter of growth at least somewhat in excess of potential. The remaining slack in labor markets appears to have been taken up, and the prices of industrial commodities seemingly are reflecting the pressures on manufacturing capacity. However, wages and prices of final goods and services have not exhibited any notable acceleration; at worst, one can point only to a lack of further slowing in recent months.

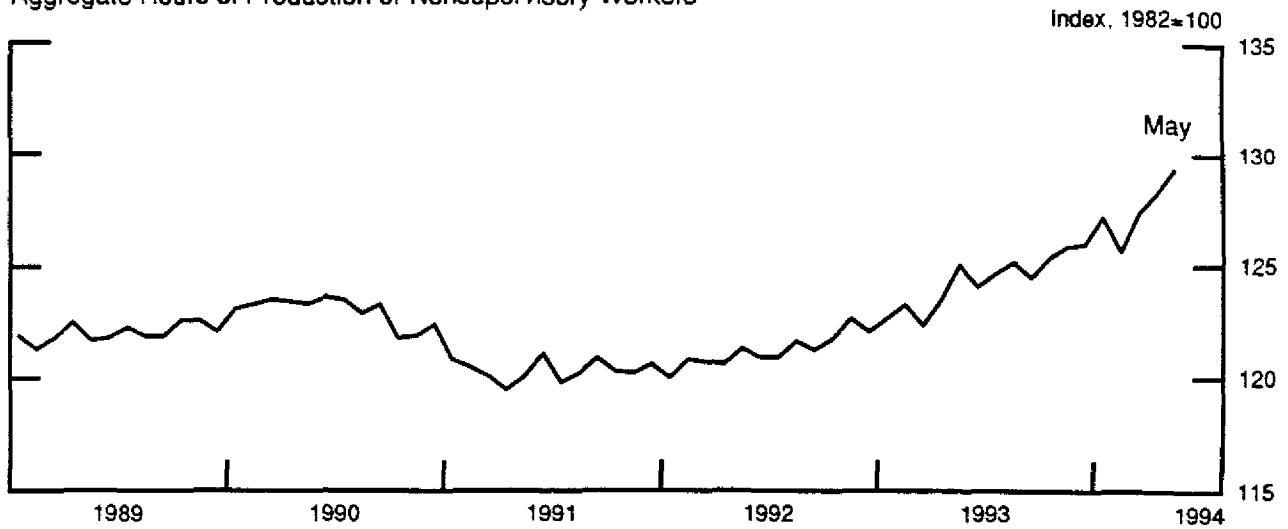
### Labor Market Developments

Labor demand has continued to strengthen. Although the growth of payroll employment slowed in May, it was still substantial. Moreover, the average workweek of production and nonsupervisory workers rose to 34.9 hours, the longest since 1987. All told, aggregate hours increased 0.9 percent and were 2.1 percent above the first-quarter average. Initial claims for unemployment insurance have averaged about 360,000 since the May survey week, a level that has been associated with payroll increases of roughly 200,000 per month during the past year. Looking forward, Manpower, Inc.'s Employment Outlook Survey for the third quarter of 1994 is the most positive reading in the series since the summer of 1989.

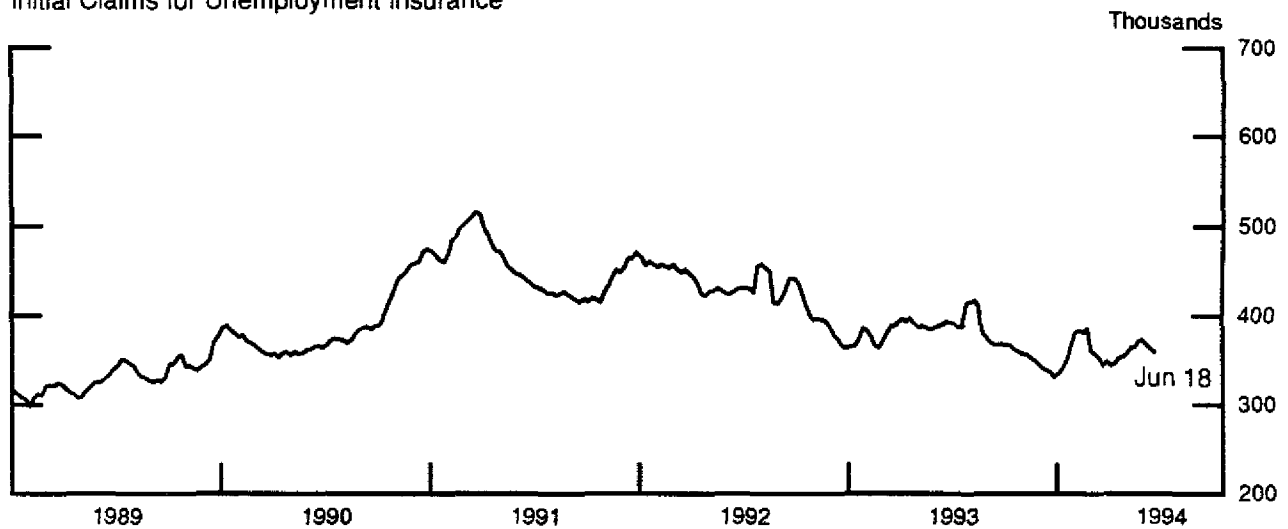
In the payroll survey, the service-producing sector once again dominated hiring in May, accounting for 183,000 of the 191,000

LABOR MARKET INDICATORS

Aggregate Hours of Production or Nonsupervisory Workers

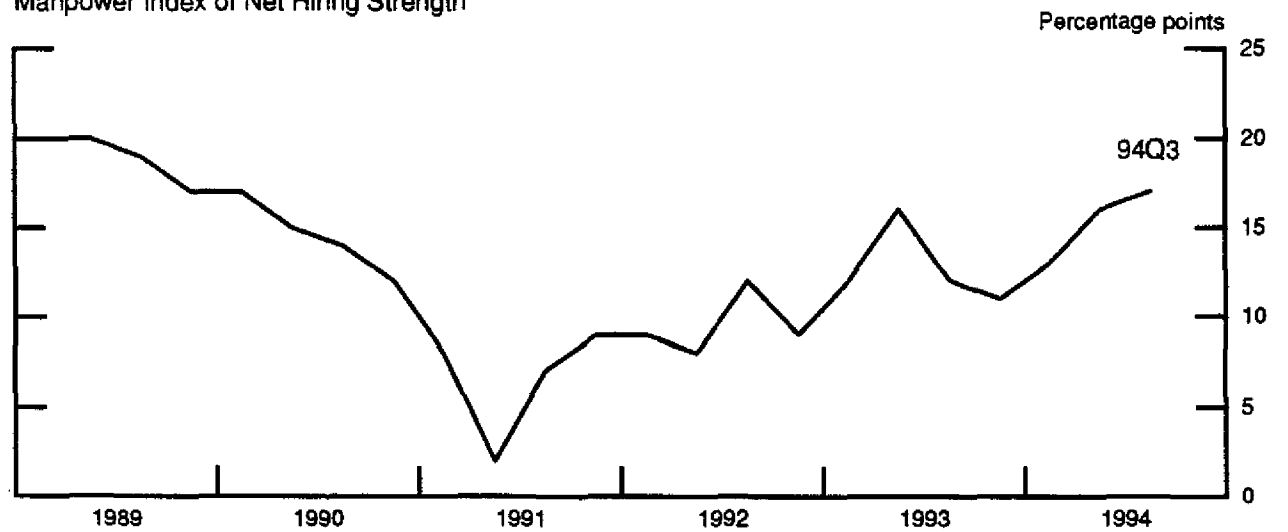


Initial Claims for Unemployment Insurance\*



\* Four week moving average including EUC adjustment.

Manpower Index of Net Hiring Strength



\* Percent planning an increase in employment minus percent planning a reduction.

increment in total nonfarm jobs. The services industry added 80,000 jobs, even though employment in personnel supply services edged down and business services as a whole added only a few jobs. Elsewhere, transportation employment rose 84,000, as striking Teamsters returned to work. Retail and wholesale trade also grew, but more slowly than in recent months. Finance, insurance, and real estate lost 15,000 jobs, partly owing to the slower pace of home sales and refinancing. Net hiring in the construction industry slowed from its rapid pace of the preceding two months, and employment in manufacturing was about unchanged.

The May labor market report also contained the annual revisions to payroll employment. The payroll data were benchmarked to a March 1993 job count derived primarily from unemployment insurance tax records, and the bias adjustment factors used to capture employment growth in small or newly created firms were updated. All told, employment growth since April 1992 was adjusted upward by about 25,000 per month, with a cumulative increment to nonfarm employment of more than 550,000 by February 1994.

In the May household report, the civilian unemployment rate fell 0.4 percentage point to 6.0 percent. Employment rose 534,000, while the number of unemployed dropped 506,000 in May; this left the size of the labor force about unchanged last month.

Determining the significance of movements in the unemployment rate has been especially difficult this year, owing to the introduction of the new Current Population Survey. Based on comparisons of the old CPS and the 1992-93 parallel survey, the BLS earlier this year estimated that the unemployment rate from the redesigned household survey would be comparable to rates about 1/2 percentage point lower under the old survey. Using this standard, the May unemployment rate of 6.0 percent would have been

**CHANGES IN EMPLOYMENT<sup>1</sup>**  
(Thousands of employees; based on seasonally adjusted data)

	1992	1993	1993		1994	1994		
			Q3	Q4	Q1	Mar.	Apr.	May
-----Average monthly changes-----								
Nonfarm payroll employment <sup>2</sup>	96	194	184	229	229	379	358	191
Strike-adjusted	95	194	186	223	229	379	432	121
Private	76	179	156	219	222	354	327	194
Manufacturing	-14	-11	-17	3	13	10	12	-2
Construction	-1	19	12	24	23	61	87	12
Trade	10	42	41	47	44	71	121	37
Finance, insurance, real estate	4	10	10	11	4	5	9	-15
Transportation, communications								
and public utilities			-2	3	8	13	-58	84
Services	78	116	113	127	133	197	159	80
Business services	31	46	45	62	61	83	74	6
Total government	20	15	28	10	8	25	31	-3
Private nonfarm production workers	86	164	146	185	211	346	318	221
Manufacturing production workers	-3	-1	-5	12	22	17	23	-2
Total employment <sup>3</sup>	127	209	127	364	459	-221	301	534
Nonagricultural	120	219	106	363	349	-256	269	557
<b>Memo:</b>								
Aggregate hours of private production								
workers (percent change)	.1	.3	.1	.4	.4	1.4	.7	.9
Average workweek (hours)	34.4	34.5	34.5	34.5	34.6	34.6	34.7	34.9
Manufacturing (hours)	41.1	41.5	41.5	41.7	41.7	42.1	42.2	42.1

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

2. Survey of establishments.

3. Survey of households.

**SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES<sup>1</sup>**  
(Percent; based on seasonally adjusted data)

	1992	1993	1993		1994	1994		
			Q3	Q4	Q1	Mar.	Apr.	May
Civilian unemployment rate (16 years and older)	7.4	6.8	6.7	6.5	6.6	6.5	6.4	6.0
Teenagers	20.0	19.0	18.2	18.3	18.0	17.8	19.9	18.3
20-24 years old	11.3	10.5	10.4	9.7	10.6	10.9	9.9	9.4
Men, 25 years and older	6.4	5.8	5.8	5.5	5.3	5.1	5.0	4.6
Women, 25 years and older	5.7	5.4	5.3	5.3	5.3	5.4	5.1	4.9
Full-time workers	7.4	6.8	6.5	6.2	6.7	6.6	6.4	6.0
Labor force participation rate	66.3	66.2	66.1	66.2	66.6	66.6	66.6	66.5
Teenagers	51.3	51.5	51.5	51.1	52.7	52.3	54.0	53.1
20-24 years old	77.1	77.1	77.0	76.7	77.0	77.4	76.7	77.1
Men, 25 years and older	76.6	76.2	76.2	76.2	76.3	76.1	75.9	75.9
Women, 25 years and older	57.0	57.1	57.1	57.5	58.0	58.0	57.9	58.1

1. Data for 1994 are not directly comparable for earlier years because of a redesign of the CPS in January 1994.

equivalent to a rate of 5.5 percent on the old basis, nearly a full percentage point below the reading for December 1993.

However, the actual decline in unemployment over this period likely is several tenths smaller. First, BLS analysts now believe that the difference between rates as measured by the old and new CPS may be less than 1/2 percentage point.<sup>1</sup> BLS analysts also think that seasonal adjustment problems may have overstated the May decline in the rate and biased the May unemployment rate down slightly. Nevertheless, even after correcting for these factors, the unemployment rate has exhibited a sharp decline since late 1993, seemingly moving from the high end of the range of estimates of the "natural" rate to a point in the middle portion of the range of estimates.

Relatively little additional information on wages and compensation has become available since the last Greenbook. Although average hourly earnings were reported to have increased 0.5 percent in May, after a 0.3 percent increase in April, their rise over the twelve months ended in May--2.7 percent--was about the same as the increase during the previous twelve-month period. Nor has there been any perceptible pickup in wage pressures in the incoming data on collective bargaining agreements. According to data from the Bureau of National Affairs, the median first-year wage increase negotiated between January 1 and June 23, 1994, was 3 percent, the same as the rise during the same period last year.

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1. For one thing, unemployment rates among women early this year were considerably lower than was suggested by the parallel survey, even accounting for the continued improvement in labor market conditions. Moreover, the small "follow-on" survey that the BLS hoped would aid in linking the new survey to the old actually produced higher unemployment rates than those from the new CPS, suggesting the possibility that the higher unemployment rate shown in last year's parallel survey owed to sampling variation rather than to the re-designed questionnaire.



Factoring in lump-sum bonuses also yields the same median increase this year as last.<sup>2</sup>

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

	1991	1992	1993	1994	1994			
					Feb.	Mar.	Apr.	May
	--Annual <sup>1</sup> --				--Monthly--			
Total private nonfarm	3.3	2.3	2.8	2.7	.1	-.1	.3	.5
Manufacturing	3.2	2.7	2.3	2.6	.5	-.1	.0	.1
Durable	3.3	2.7	2.3	2.6	.5	.0	.0	-.1
Nondurable	3.4	2.8	2.1	2.6	.4	-.1	-.3	.4
Contract construction	1.5	1.1	1.6	1.7	.8	-.5	.3	.5
Transportation and public utilities	2.7	1.4	1.6	1.7	.1	-.2	-.1	.4
Finance, insurance and real estate	4.6	4.1	5.6	4.8	-.5	.2	.7	1.0
Total trade	3.2	2.4	2.7	2.5	-.3	.0	.3	.3
Services	4.5	2.8	2.7	2.7	-.1	-.1	.4	.6

1. Annual change is measured from May of preceding year to May of year indicated.

### Industrial Production

Total industrial production slowed early in the second quarter, after strong first-quarter gains. Much of the recent slowing reflects a dropback in motor vehicle production from the rapid first-quarter pace. Output in manufacturing excluding motor vehicle and parts has continued to expand briskly.

Motor vehicle assemblies moved down in May to 11-1/2 million units at an annual rate, compared with an average of nearly 13 million units in the first quarter. Weekly data and preliminary industry estimates of actual production through the week ended June 25 suggest a further slight decline to 11.4 million units at an annual rate in June, a shortfall of about 300,000 units from the scheduled rate.

2. As reported in the last Greenbook, increases in ECI wages and salaries and in the total ECI including fringe benefits for the twelve months ended in March 1994 showed little change from the increases of a year earlier.

PRODUCTION OF DOMESTIC AUTOS AND TRUCKS  
(Millions of units at an annual rate: FRB seasonal basis)

	1994					
	Apr.	May	June <sup>e</sup>	Q1	Q2 <sup>e</sup>	Q3 <sup>s</sup>
U.S. production <sup>1</sup>	12.2	11.5	11.4	12.9	11.7	11.8
Autos	6.7	6.3	6.0	7.1	6.3	6.2
Trucks	5.5	5.2	5.4	5.8	5.4	5.5
Days' supply						
Autos	58.4	59.9		59.8		
Light trucks	58.0	61.7		55.2		

1. Components may not add to totals because of rounding.

e Industry estimates.

s Scheduled.

Excluding motor vehicles and parts, manufacturing output increased at an average monthly pace of 0.4 percent in April and May, similar to the rapid rate of growth in 1993 and only a bit less than the robust first-quarter pace. Ongoing strength in production of business equipment and construction supplies was moderated early in the second quarter by a slowing in the output of consumer goods.

Indicators of industrial production point to substantial near-term strength. The staff's series on real adjusted durable goods orders held at a high level in April and May, after climbing nearly 5 percent in March. Although new orders for nondefense capital goods except aircraft have retraced most of the March jump, the level of unfilled orders for these goods remains high, suggesting that strength in business equipment output will continue through June. Moreover, among other durable goods industries, orders for materials and consumer goods appear to have firmed recently. Weekly physical product data through mid-June show a surge in electricity generation, likely owing to unusually hot weather.

**GROWTH IN SELECTED COMPONENTS OF INDUSTRIAL PRODUCTION**  
(Percent change from preceding comparable period except as noted)

	Proportion in total IP 1993:Q4	1993 <sup>1</sup>	1993	1994	1994		
			Q4	Q1	Mar.	Apr.	May
			-Annual rate-		--Monthly rate--		
Total index	100.0	4.2	6.7	8.1	.6	.1	.2
Previous		4.2	6.7	8.1	.5	.3	
Manufacturing	85.2	5.0	8.4	7.6	.8	.2	.2
Motor vehicles and parts	5.6	16.6	91.4	37.9	-4.2	-1.6	-3.9
Mining	6.9	-.8	2.1	4.8	.7	-.4	.4
Utilities	7.9	.9	-6.5	15.8	-1.5	-.5	-.3
Manufacturing excl. motor vehicles and parts	79.6	4.3	4.4	5.7	1.2	.3	.5
Consumer goods	21.4	.6	-1.1	2.5	1.2	.1	.0
Durables	3.7	5.8	4.6	1.9	.2	.7	-.5
Nondurables	17.7	-.4	-2.2	2.7	1.4	.0	.1
Business equipment	14.9	9.1	7.6	11.7	1.0	.7	1.5
Office and computing	4.2	33.9	35.5	33.4	.6	2.0	3.1
Industrial	3.9	4.2	.2	5.4	1.4	1.0	.6
Other	6.8	.3	-2.2	3.1	1.0	-.4	1.0
Defense and space equipment	2.8	-9.5	-9.7	-10.2	-.1	-.1	-.3
Construction supplies	5.2	5.9	11.0	.2	1.2	1.7	.9
Materials	39.0	4.3	5.3	7.7	1.1	.0	
Durables	19.8	7.4	9.0	9.2	1.8	.6	
Nondurables	9.2	3.8	4.9	3.6	1.2	-.4	
Energy	10.0	-1.0	-1.3	8.6	-.2	-.7	.1

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

**CAPACITY UTILIZATION**  
(Percent of capacity; seasonally adjusted)

	1988-89	1967-93	1993	1993	1994	1994		
	High	Avg.	Avg.	Q4	Q1	Mar.	Apr.	May
Total industry	84.8	81.9	81.5	82.3	83.4	83.7	83.6	83.5
Manufacturing	85.1	81.2	80.6	81.5	82.5	82.8	82.8	82.8
Primary processing	89.1	82.2	84.0	85.5	85.8	86.2	86.4	86.6
Advanced processing	83.3	80.6	79.1	79.9	81.1	81.4	81.3	81.2

NEW ORDERS FOR DURABLE GOODS  
(Percent change from preceding period, seasonally adjusted)

	Share	1994	1994			
	1993		Q1	Mar.	Apr.	May
	H2					
Total durable goods	100.0	5.4	.7	.1	9	
Adjusted durable goods orders <sup>1</sup>	67.0	3.2	4.6	-.7	.1	
Nondefense capital goods excluding aircraft	22.0	1.7	3.3	.3	2.5	
All other categories <sup>2</sup>	45.0	3.9	5.3	-.9	1.5	
Memo:						
Real adjusted durable goods orders <sup>3</sup>	...	2.5	4.7	-.5	0	

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

2. Includes primary metals, most fabricated metals, most stone, clay and glass products, electronic components, household appliances, scientific instruments, and miscellaneous durable goods.

3. Nominal adjusted durable goods orders were deflated with a PPI for durable goods excluding transportation equipment and the BEA deflator for office, computing, and accounting machinery.

The rate of capacity utilization in manufacturing in May was 82.8 percent, roughly halfway between the long-run average operating rate of 81.2 percent and the 1988-89 high of 85 percent. Operating rates for most major industry groups generally remain several percentage points below their 1988-89 highs; the most noticeable exceptions are petroleum products and nonelectrical machinery, where earlier weakness in investment limited capacity. For some individual product lines--such as cellular phones, popular sport utility vehicles, and environmentally acceptable refrigerators--industry contacts report that capacity constraints are restricting output growth.

CAPACITY UTILIZATION BY INDUSTRY GROUP  
(Percent of capacity, seasonally adjusted)

	(1) 67-92 Avg.	(2) 1988-89 High <sup>1</sup>	(3) 1994 May	(2)-(3) Difference
Total industry	81.9	84.8	83.5	1.3
Manufacturing	81.2	85.1	82.8	2.3
Primary processing	82.2	89.1	86.6	2.5
Textile mill products	86.0	92.1	92.1	0
Lumber and products	83.0	93.3	90.5	2.8
Pulp and paper	92.2	98.1	94.1	4.0
Primary chemicals	83.3	92.3	85.9	6.4
Petroleum products	85.3	88.5	93.6	-5.1
Stone, clay, and glass	77.9	83.7	78.4	5.3
Primary metals	79.8	92.9	92.1	.8
Fabricated metal products	77.2	82.0	80.8	1.2
Advanced processing	80.7	83.3	81.2	2.1
Furniture and fixtures	81.8	86.8	82.8	4.0
Advanced chemicals	77.3	82.0	78.2	3.8
Nonelectrical machinery	80.7	83.7	89.4	-5.7
Electrical machinery	80.3	84.9	86.1	-1.2
Motor vehicles and parts	75.6	84.5	82.9	1.6
Aerospace and misc. transportation equipment	75.9	88.3	62.2	26.1
Instruments	82.3	81.2	73.1	8.1
Mining	87.4	87.0	90.0	-3.0
Utilities	86.7	92.6	86.6	6.0

1. The historical highs shown are specific to each series and did not occur in the same month.

#### Motor Vehicles

Sales of new light vehicles, which had turned down in April after two quarters of strong advances, eased further in May to an annual rate of 14.6 million units. So far this quarter, purchases of light vehicles have averaged about 1/2 million units below the robust pace of the first quarter, with nearly all the decline occurring among vehicles produced by the Big Three. The recent decline in sales reflects, in part, the constraining effects of limited supplies of some popular models and a return to a more

normal rate of fleet sales. However, some of the dropoff in sales may signal softening in the underlying strength of demand.

Short supplies of some models, particularly of light trucks, have existed for several months and likely continued to impede sales of these vehicles in June. Producers have been unable to boost output to match strong demand, owing to capacity constraints at either the assembly line or at plants that produce parts.<sup>3</sup> Further additions to capacity (primarily by adding shifts) are scheduled for the second half of this year, and supplies should increase a bit.<sup>4</sup> However, overall production schedules for the third quarter are the same as in the second quarter.<sup>5</sup>

Fleet sales, mainly those to rental car companies, returned to a more normal level in the second quarter, after surging in the first quarter. The first-quarter spurt in purchases by rental car companies reflected a catch-up for sales that had been delayed from the second half of 1993 because of supply shortages. According to Ford, the uptick in fleet sales in May may reflect some purchases that were moved forward from June.<sup>6</sup>

With regard to the underlying strength of demand for light motor vehicles, the highly favorable market fundamentals evident earlier this year have eroded somewhat. Prices have risen noticeably since the beginning of the year, and finance rates have

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3. Auto sales by General Motors also have been limited somewhat by model-changeover problems at a key Canadian plant. Operations at the plant were scheduled to be back to normal in April, but still appear to be short of expected levels.

4. See the May Greenbook for a detailed discussion of capacity. Since then, we have learned that stepped-up production at a Chrysler light truck plant in Mexico, which was scheduled to begin during the current quarter, has not yet materialized. In addition, we have heard that an anticipated shortage of engines may limit production later this year, even after assembly capacity has been raised.

5. Four domestic auto plants are undergoing lengthy model changeovers this summer. These unusually lengthy downtimes will reduce the level of output in both the second and third quarters by about 2 percent (0.3 million units at an annual rate).

6. The information on fleet and retail sales from Ford and General Motors is confidential.

SALES OF AUTOMOBILES AND LIGHT TRUCKS<sup>1</sup>  
(Millions of units at an annual rate; BEA seasonals)

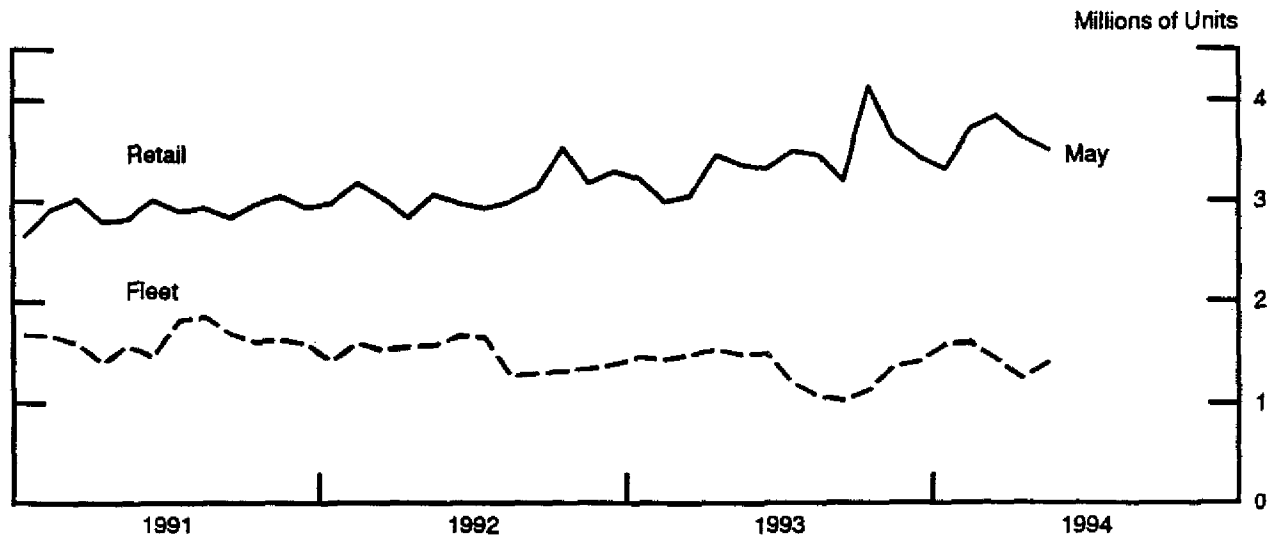
	1992	1993	1993		1994		1994	
			Q3	Q4	Q1	Mar.	Apr.	May
Total	12.8	13.9	13.6	14.5	15.5	15.9	15.3	14.6
Autos	8.4	8.7	8.6	8.9	9.5	9.9	9.5	9.0
Light trucks	4.4	5.2	5.0	5.6	6.0	6.0	5.8	5.6
North American <sup>2</sup>	10.5	11.7	11.4	12.5	13.4	13.5	13.1	12.5
Autos	6.3	6.7	6.6	7.1	7.5	7.7	7.5	7.1
Big Three	5.1	5.5	5.1	5.7	6.0	6.1	6.0	5.7
Transplants	1.2	1.3	1.5	1.4	1.4	1.5	1.5	1.4
Light trucks	4.2	5.0	4.8	5.5	5.9	5.8	5.7	5.4
Foreign produced	2.3	2.2	2.2	2.0	2.2	2.3	2.1	2.1
Autos	2.1	2.0	2.0	1.9	2.0	2.2	2.0	1.9
Light trucks	.2	.2	.2	.1	.2	.1	.1	.2
Memo: domestic name-plate market share								
Total	.72	.74	.71	.75	.74	.73	.74	.74
Autos	.63	.65	.61	.65	.64	.63	.64	.64

Note: Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

1. Components may not add to totals because of rounding.

2. Excludes some vehicles produced in Canada that are classified as imports by the industry; prior to January 1994, some vehicles produced in Mexico were also excluded.

GM AND FORD DOMESTIC AUTO SALES  
(Seasonally adjusted annual rate; FRB seasonals)



Note: Data are confidential. Retail includes consumer leasing.

also moved up. The Conference Board series on car buying plans fell sharply in June, and the series on buying conditions in the Michigan survey was up in June but remained a bit below the levels seen earlier this year. All told, we believe that the recent changes in these market indicators are consistent with a slight easing in the strength of demand in the near term.

#### Personal Income and Consumption

Available data seem to indicate that growth in personal consumption expenditures slowed this spring, after a strong first-quarter advance. Whether a sustained slowdown in spending is under way is not yet clear. A large part of the recent slowdown in spending reflects declines in outlays for motor vehicles, where, as noted, supply constraints apparently have limited sales. Another part of the slowdown, at least early in the second quarter, was in energy services and was related primarily to swings in weather conditions. Moreover, although the weakness in stock and bond markets this year may have put a dent in the spending plans of at least some households, the underlying pace of income growth has been well maintained, and consumer confidence is holding at a high level. Willingness to borrow also seems high, as evidenced by the rapid growth of consumer credit in recent months and by early responses to the June Michigan SRC survey.

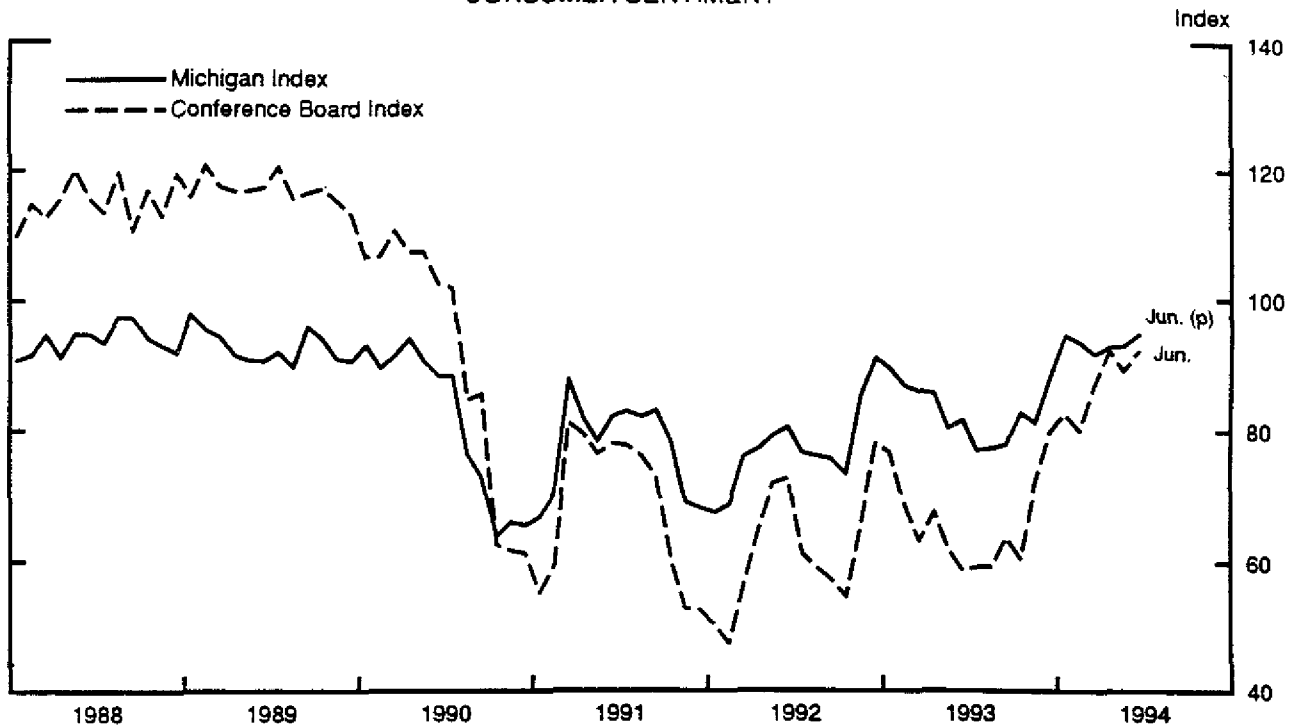
Total nominal personal income rose 0.4 percent in April, but nominal disposable personal income fell 0.2 percent.<sup>7</sup> Wage and salary income, which continued to advance in April, likely posted another solid gain in May, given the large increases in production

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7. The April decline in disposable personal income reflects provisions of the Omnibus Reconciliation Act of 1993: Under the Act, high income individuals have the option of paying retroactive taxes in three annual installments, the first of which was due April 15. BEA estimates that these tax payments reduced disposable personal income about 0.6 percentage point in April. The effect of these taxes on spending, however, is likely to be spread out over a considerable period of time.



CONSUMER SENTIMENT



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

	1993	1993		1994	1994	
		Q3	Q4	Q1	Mar.	Apr.
Total personal income	3.4	22.3	35.8	27.5	31.7	25.1
Wages and salaries	-8.3	11.5	14.5	16.6	14.5	11.8
Private	-10.1	9.0	14.1	14.3	13.9	10.5
Other labor income	2.7	2.7	2.8	3.1	3.2	3.3
Proprietors' income	3.9	.8	15.9	.6	5.7	2.9
Farm	1.6	-1.1	10.9	-1.4	1.1	.8
Rent	1.4	2.0	-.7	4.1	4.6	-1.8
Dividend	.3	.4	.1	.8	1.6	2.4
Interest	.0	1.9	-.5	2.1	2.4	2.5
Transfer payments	4.7	3.9	4.8	3.4	.8	5.0
Less: Personal contributions for social insurance	1.2	.7	1.1	3.3	1.0	.9
Less: Personal tax and nontax payments	-.1	3.0	4.4	5.0	3.5	35.2
Equals: Disposable personal income	3.5	19.4	31.4	22.5	28.2	-10.1
Memo: Real disposable income	-4.2	11.7	17.3	10.1	11.1	-17.7

worker hours and average hourly earnings reported in last month's labor market report. The year-to-year increase in real disposable personal income in the first half of 1994 appears to have been well above 3 percent.

In contrast to the recent downturn in consumer expenditures on motor vehicles, outlays on other goods are likely to post another solid gain in the second quarter. However, the increase largely reflects developments around the end of the first quarter. Nominal retail sales at stores other than auto dealers and building supply outlets (the "retail control" group) rose only 0.3 percent in May, after a 0.7 percent decline in April and a 1.0 percent increase in March. Combining these data with information on consumer prices, the staff estimates that real outlays for goods other than motor vehicles were little changed in May, and that the average level of real spending on these items in April and May was about 3 percent higher, at an annual rate, than in the first quarter.<sup>8</sup>

Within the retail control group in May, nominal sales were brisk at furniture and appliance stores and at establishments in the "other durable goods" category. In contrast, sales at stores in the nondurable goods category have fallen 3/4 percent over the past two months.<sup>9</sup> The decline brought spending for that category back closer to trend after outsized gains in February and March.

According to preliminary data, real consumer spending on services fell 0.2 percent in April after registering little change in March. Spending on energy services returned to normal levels in March after a weather-related surge earlier in the winter and then

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8. Final estimates for the first quarter of 1994 show a rise in real outlays for goods excluding motor vehicles of 3-3/4 percent at an annual rate, an upward revision of about 1/4 percentage point from the preliminary estimate.

9. Nominal sales at gasoline stations fell 1 percent last month, but separate physical product data from the Department of Energy indicate that gasoline sales were up in real terms.

RETAIL SALES

(Percent change from preceding period; seasonally adjusted)

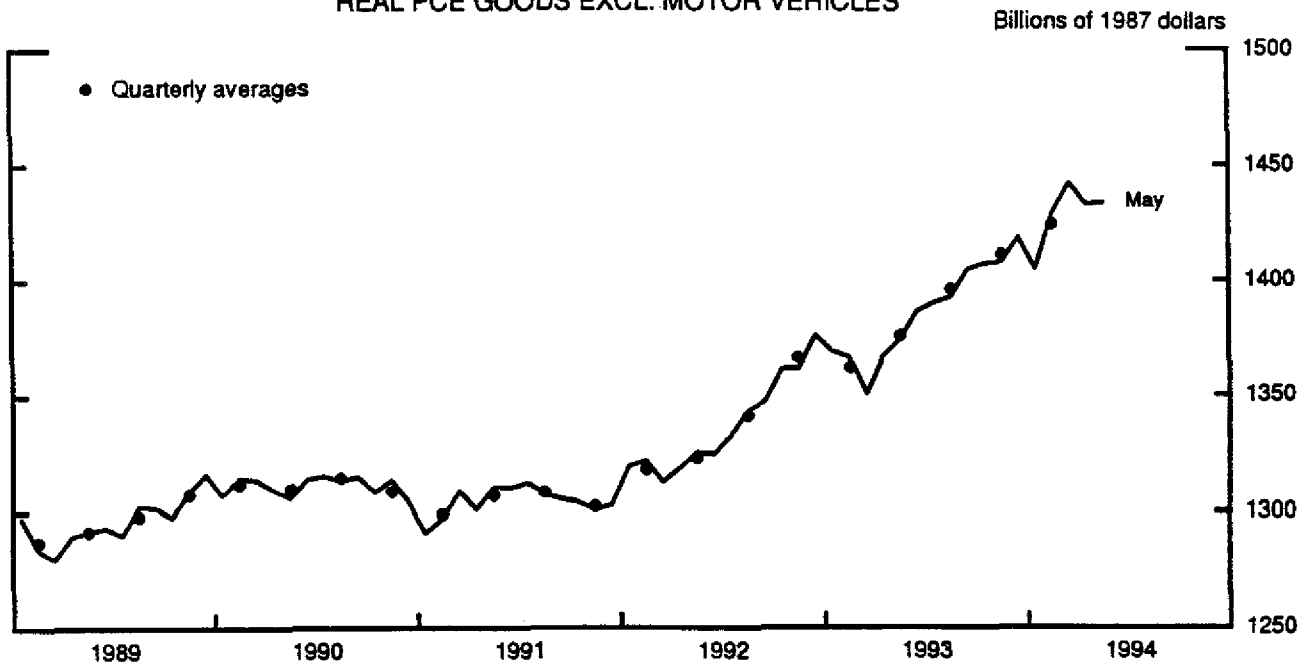
	1993	1994	1994		
	Q4	Q1	Mar.	Apr.	May
Total sales (Previous)	3.1 (1.4)	1.5 (1.7)	1.8 (-.8)	-1.1	-.2
Retail control <sup>1</sup> (Previous)	1.4	1.0	1.0 (.8)	-.7 (-.4)	.3
Nondurables <sup>2</sup>	1.4	1.0	.8	-.8	.1
General merchandise	1.3	1.9	.3	.2	.2
Apparel	1.0	-1.3	.0	-1.8	-.3
Food <sup>3</sup>	1.5	.7	.9	-.7	.2
Durables in retail control	1.6	.1	1.9	.5	1.3
Furniture and appliances	4.8	.0	1.5	.2	1.7
Other	-1.9	.1	2.3	.8	.8

1. Total excluding auto dealers and building material and supply stores.

2. Includes items not shown.

3. Food stores and eating and drinking establishments.

REAL PCE GOODS EXCL. MOTOR VEHICLES



Note: March, April, and May figures are staff estimates.

fell further during mild weather in April. With temperatures close to normal in May but unseasonably hot in June, outlays for energy services likely increased in each of those months. The currently available data indicate that outlays for non-energy services rose less than 0.1 percent in April. However, today's release on GDP includes a sharp upward revision in first-quarter outlays on non-energy services to an annual rate of 4.4 percent, and an updated assessment of the recent trend in these outlays awaits tomorrow's release on personal income.

### Housing Markets

Housing activity has rebounded since the winter disruptions, but, apparently in response to higher interest rates, it has remained below the late 1993 pace.

In the single-family sector, starts edged down in May after declining substantially in April. Interest rates on fixed-rate mortgages in May averaged nearly 2 percentage points above the low reached last October. As a result, cash-flow affordability of new homes has deteriorated, although it remains better than it was during most of the past twenty years. Similarly, starts, even at their reduced May level, exceeded the annual average of every year since 1978.

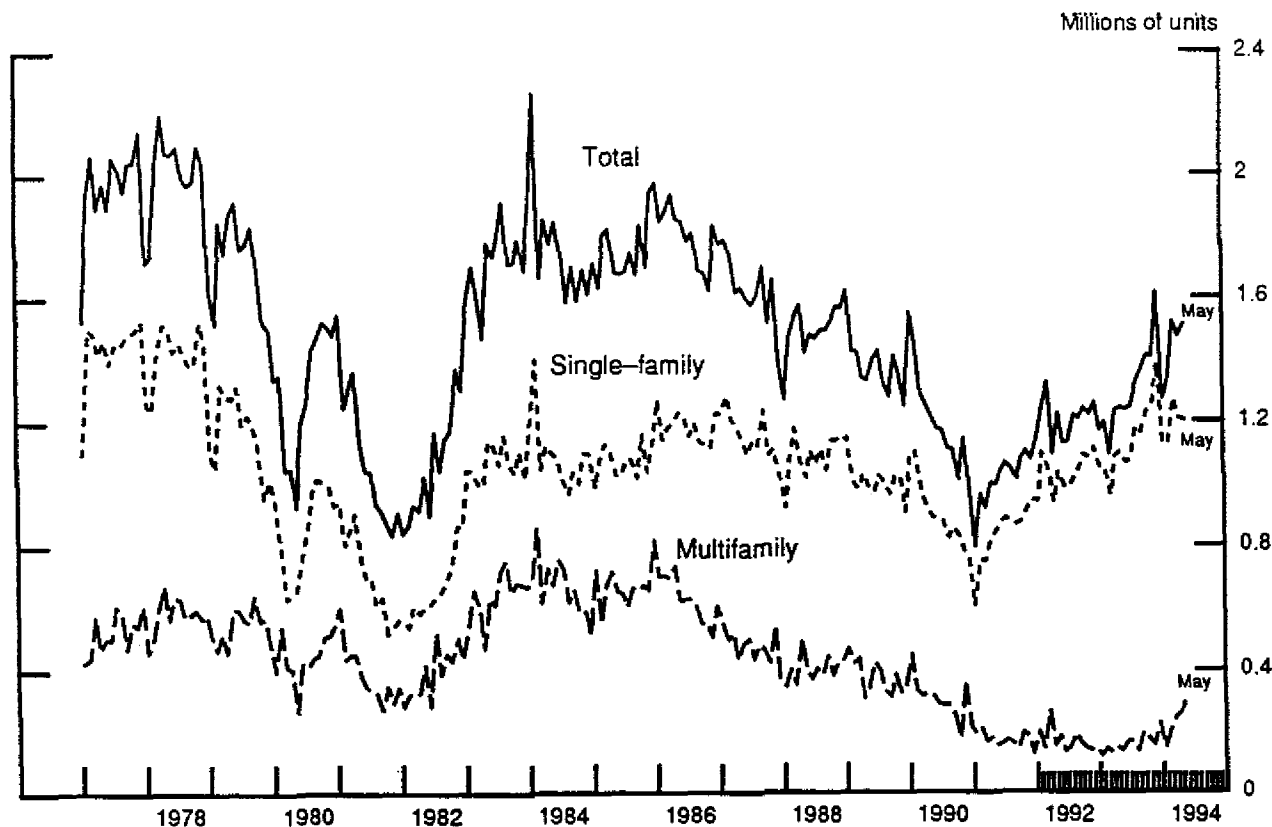
Home sales, though down from their levels of late last year, also remain quite high by historical standards. Sales of new homes in April and May averaged about 6 percent below the fourth-quarter level. Existing home sales have fallen by less, but because most of these transactions are recorded at the "closing" and reflect loan commitments made earlier, this series is slower to respond to changes in mortgage interest rates. Prices of new and existing homes sold in April and May averaged 2 to 3 percent above their levels of a year earlier, roughly in line with the increases posted

PRIVATE HOUSING ACTIVITY  
(Millions of units; seasonally adjusted annual rate)

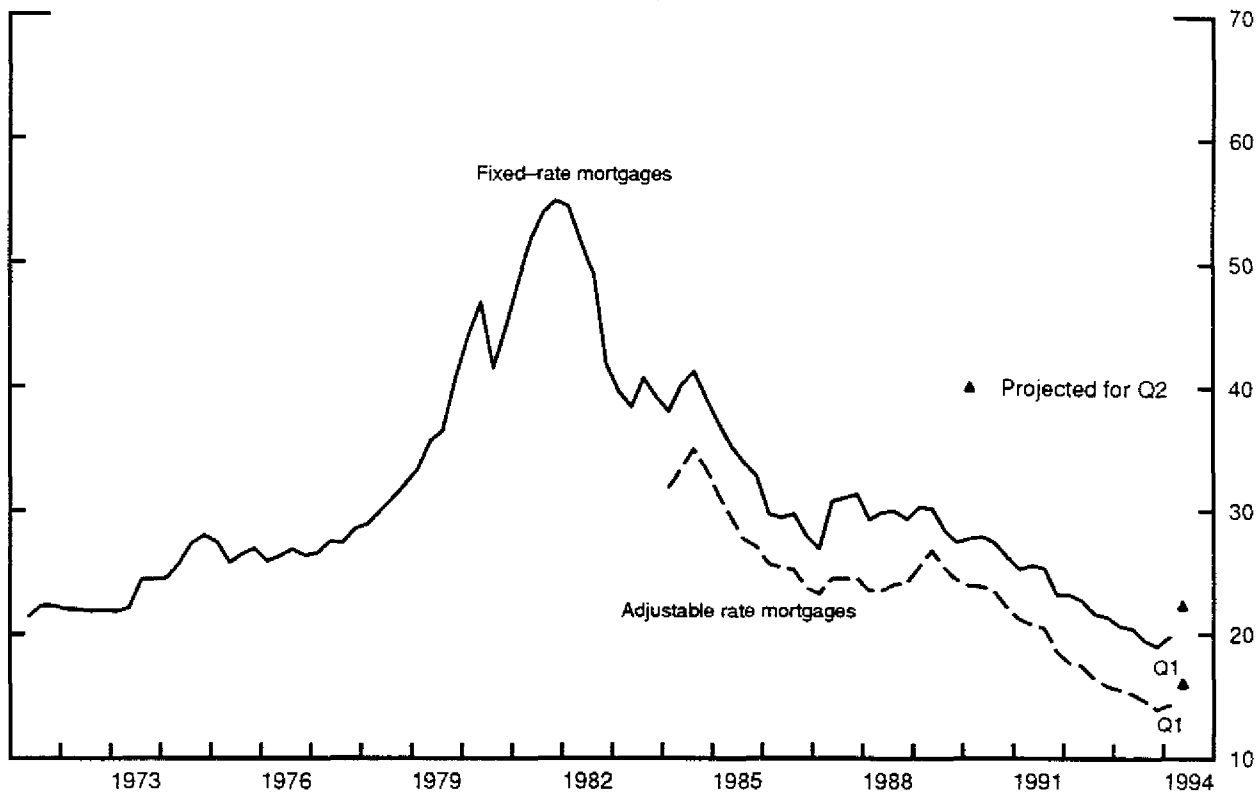
	1993	1993		1994	1994		
	Annual <sup>r</sup>	Q3 <sup>r</sup>	Q4 <sup>r</sup>	Q1 <sup>r</sup>	Mar. <sup>r</sup>	Apr. <sup>r</sup>	May <sup>p</sup>
All units							
Starts	1.29	1.31	1.48	1.37	1.52	1.47	1.51
Permits	1.21	1.22	1.38	1.29	1.31	1.38	1.36
Single-family units							
Starts	1.13	1.14	1.29	1.17	1.27	1.21	1.20
Permits	1.01	1.00	1.13	1.06	1.07	1.07	1.09
Sales							
New homes	.67	.68	.77	.69	.73	.71	.74
Existing homes	3.80	3.90	4.17	4.05	4.07	4.12	4.09
Multifamily units							
Starts	.16	.17	.19	.20	.25	.26	.31
Permits	.21	.22	.25	.23	.25	.31	.27

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

PRIVATE HOUSING STARTS  
(Seasonally adjusted annual rate)

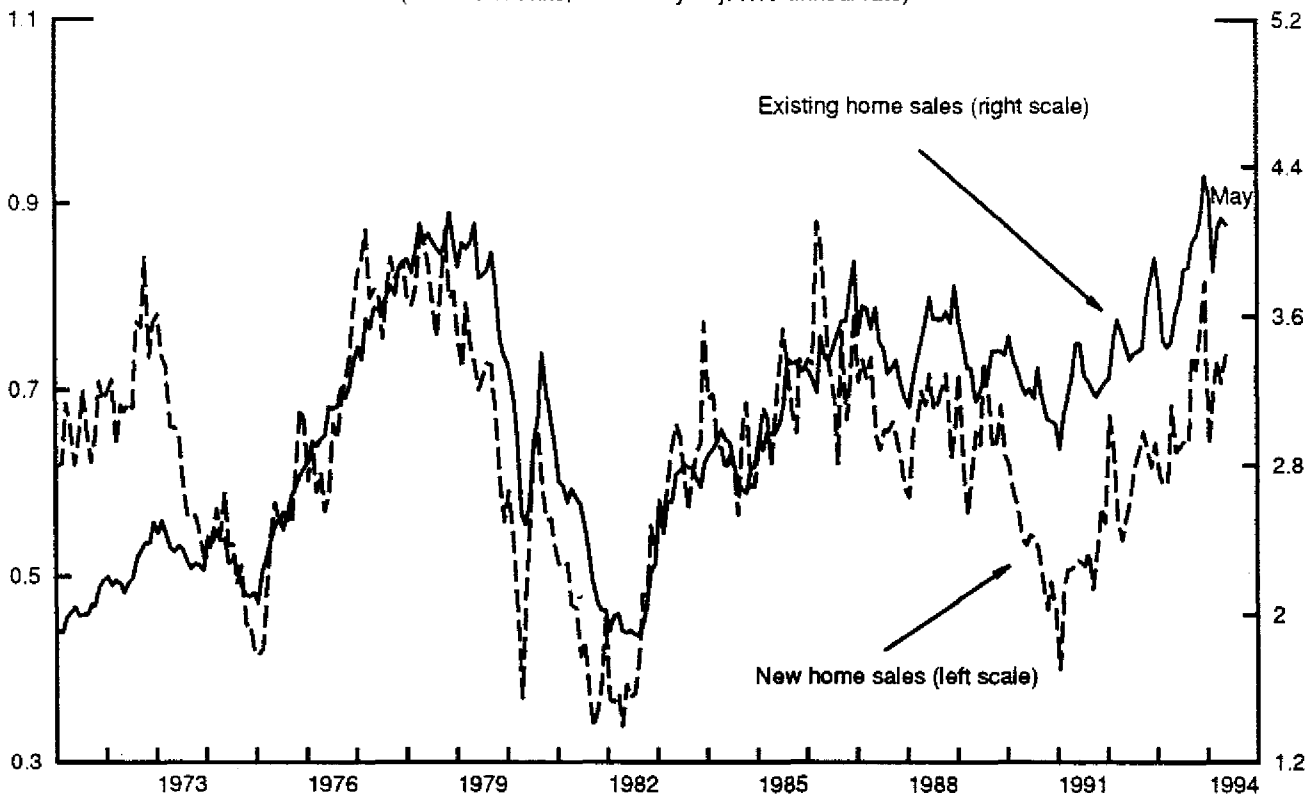


### CASH FLOW BURDEN OF HOMEOWNERSHIP (Percent\*)

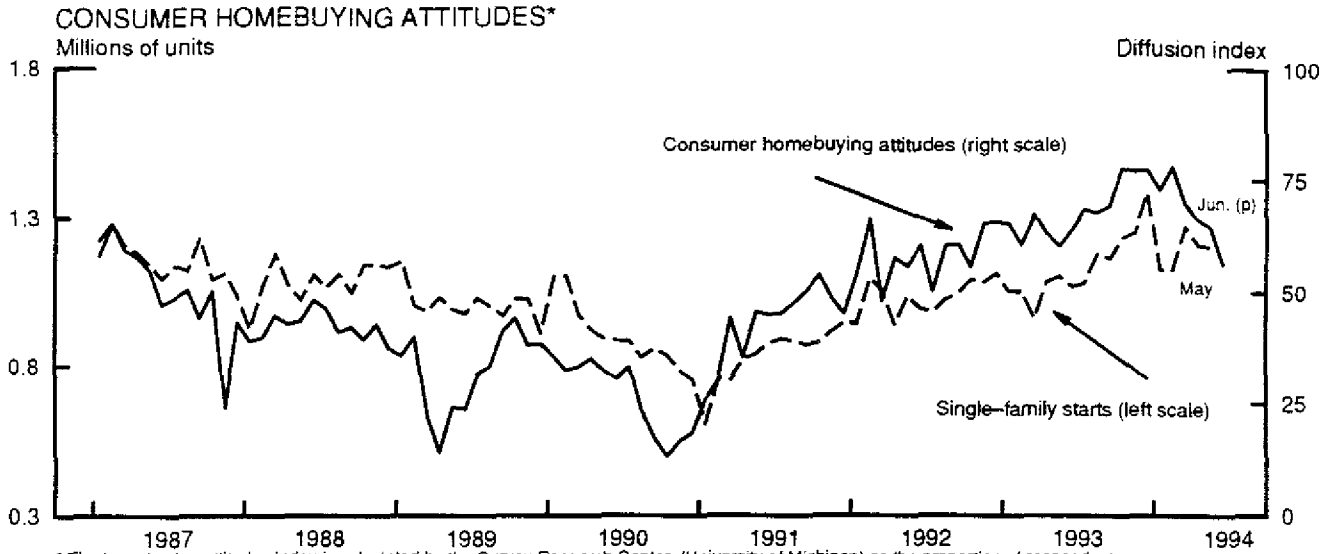


\* Financing cost of a constant-quality new home as a percentage of average household income.

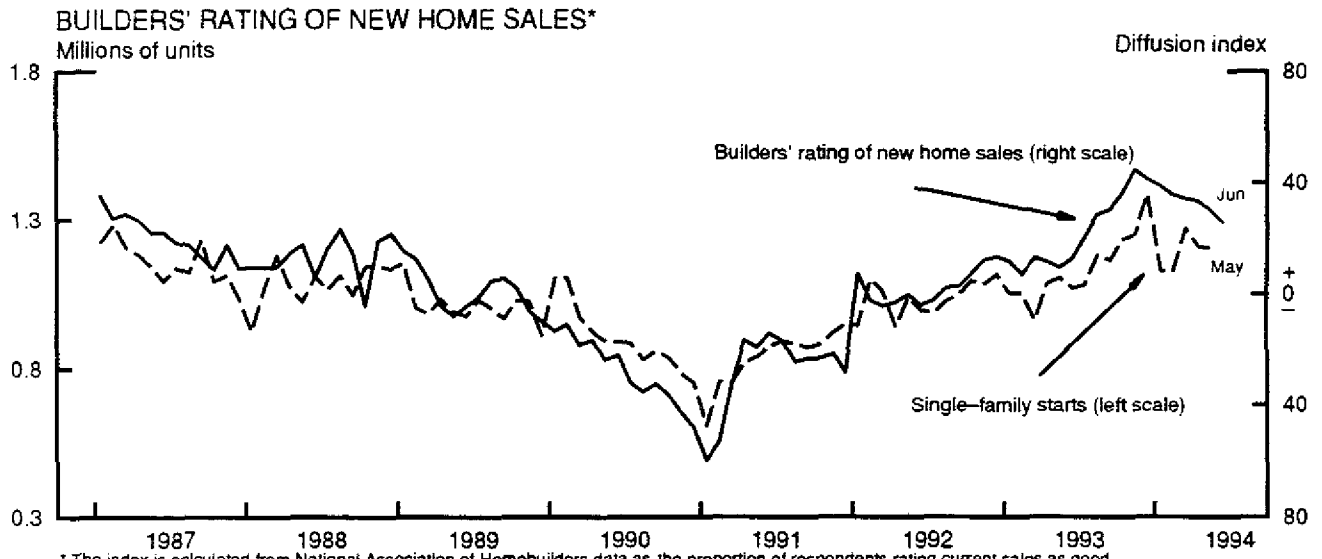
### NEW AND EXISTING HOME SALES (Millions of units; seasonally adjusted annual rate)



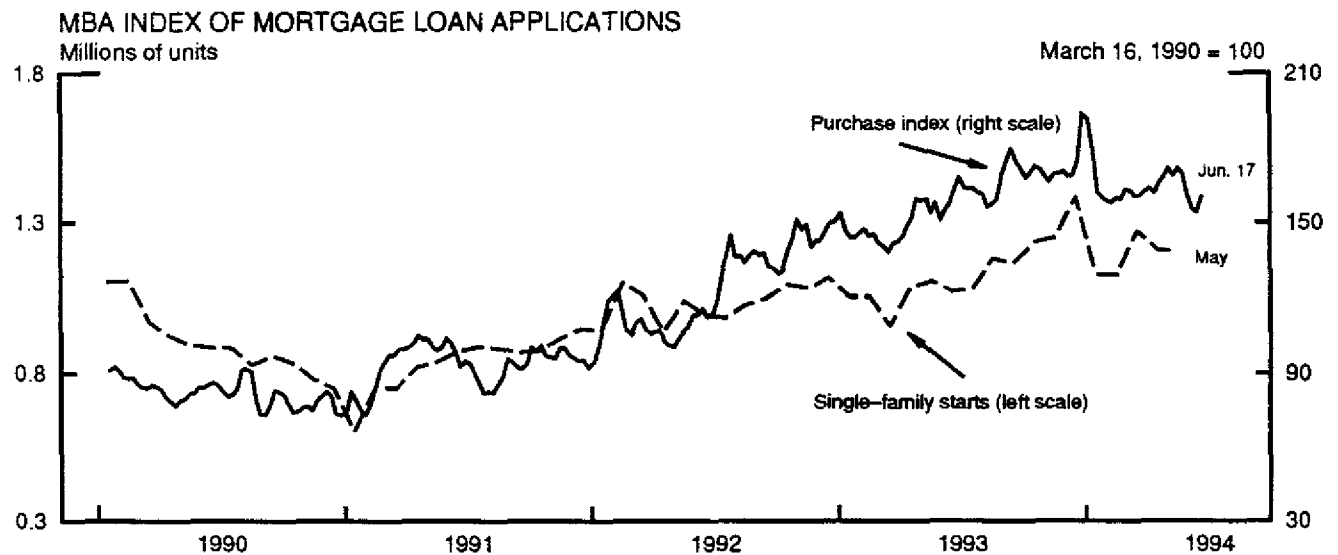
INDICATORS OF HOUSING DEMAND  
(Seasonally adjusted annual rate)



\* The homebuying attitudes index is calculated by the Survey Research Center (University of Michigan) as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.

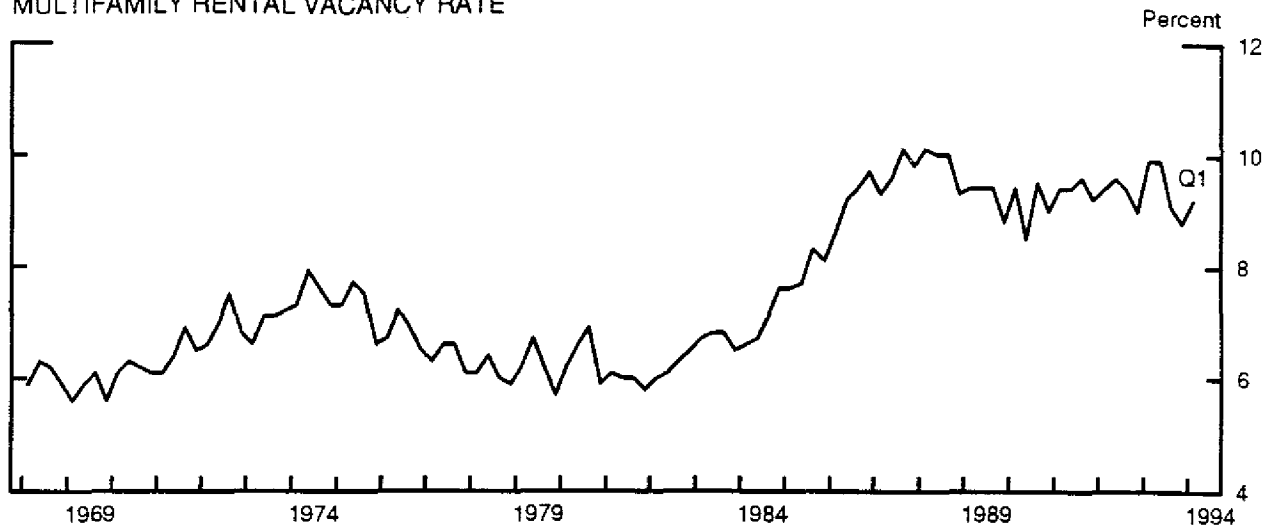


\* The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good to excellent minus the proportion rating them as poor.

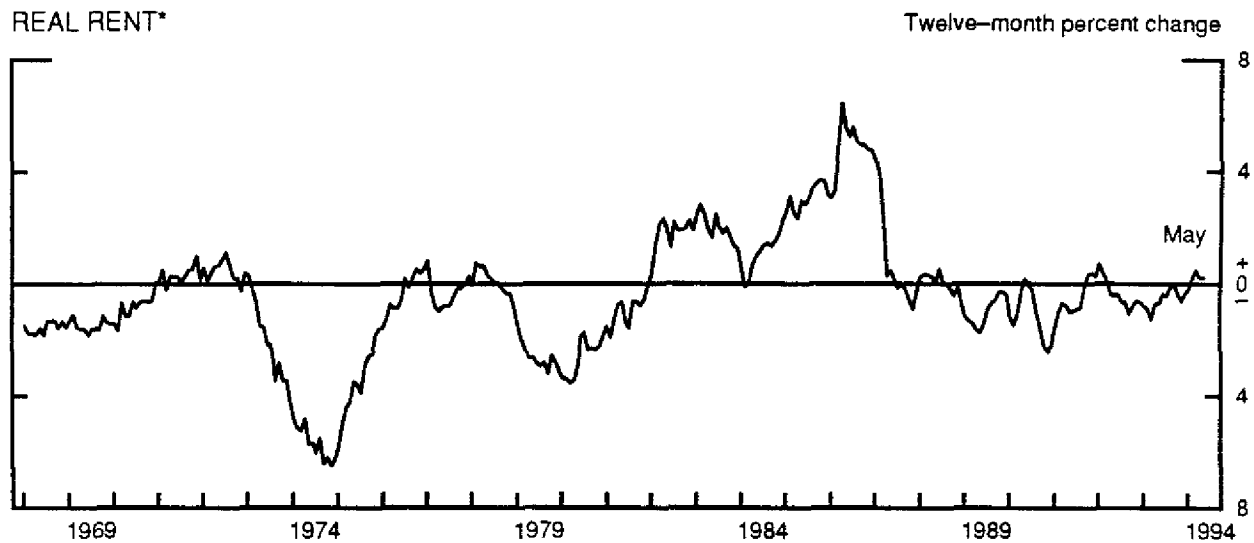


HOUSING INDICATORS

MULTIFAMILY RENTAL VACANCY RATE

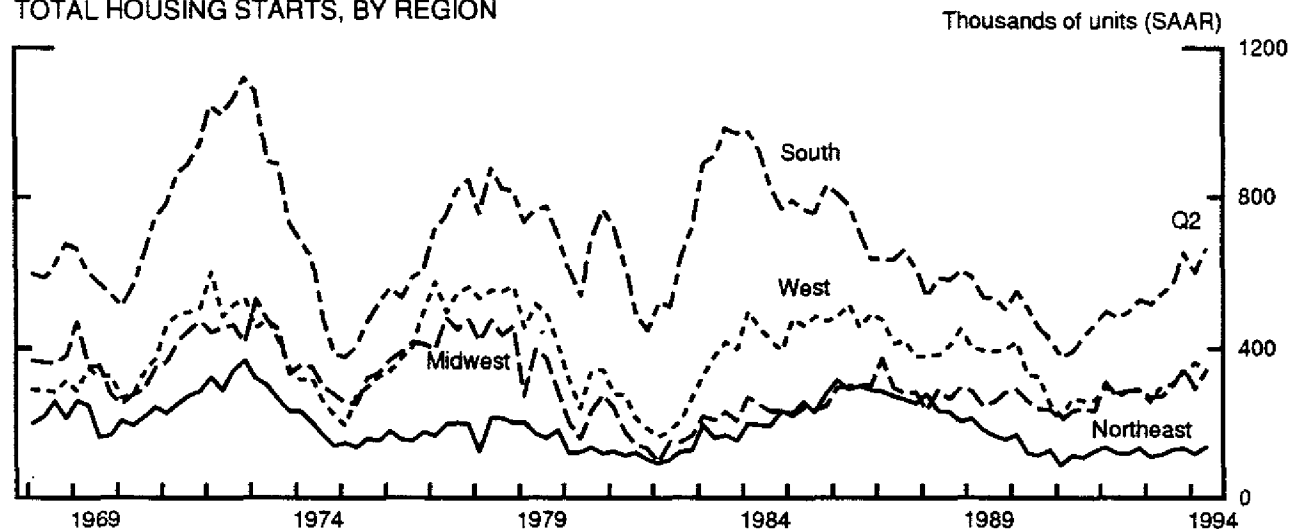


REAL RENT\*



\* CPI rent / CPI excluding shelter.

TOTAL HOUSING STARTS, BY REGION



Note: 1994:Q2 estimated from April/May data.



in the first quarter by "constant quality" price indexes for these two markets

The most recent data on single-family housing activity come from consumer and industry surveys fielded early in June. These surveys also indicate some softening in the market. Consumers' homebuying attitudes have been progressively less favorable in each of the past four months. Similarly, homebuilders' assessments of their current sales have been declining for some time. Applications for home purchase loans have been a bit more erratic, but this indicator too has been lower, on average, in recent weeks.

In the multifamily sector, the May increase in starts, to their highest level in 3-1/2 years, is supported by recent anecdotal reports of market tightening in some localities. Nevertheless, the national indicators of market conditions remain fairly negative. The vacancy rate for multifamily rental housing has stayed in the historically high range that has prevailed for the past several years. With vacancy rates still high, rent increases in the CPI have remained relatively low. Most of the gain in multifamily construction has occurred in the South, where vacancy rates have come down significantly. One stimulative influence for multifamily housing has been financing, which, by all accounts, has become more available in the past year. Investors once again have an appetite for multifamily projects, and depository institutions appear more willing to extend construction credit than at any other time since the mid-1980s.

#### Business Fixed Investment

The available monthly indicators point to a further rise in equipment spending in the second quarter, although the gain probably will be somewhat less strong than the very rapid rate of increase seen during the past year or so. Spending for nonresidential

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

	1993		1994		1994	
	Q3	Q4	Q1	Mar.	Apr.	May
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	.6	7.1	1.0	1.8	-1.5	1.2
Excluding aircraft and parts	3.4	8.0	1.2	-.6	1.3	2.2
Office and computing	9.4	5.2	3.3	3.5	-2.1	1.2
All other categories	1.7	8.8	.5	-1.8	2.4	2.5
Shipments of complete aircraft <sup>1</sup>	-39.5	34.1	10.0	110.8	-57.6	n.a.
Sales of heavy trucks	-1.1	8.5	-.1	.1	2.8	1.5
Orders of nondefense capital goods	-1.2	10.4	6.2	-.7	-.8	-.8
Excluding aircraft and parts	3.6	10.9	1.7	3.3	-.3	-2.5
Office and computing	4.9	12.9	.8	10.7	.0	.5
All other categories	3.2	10.4	1.9	1.2	-.5	-3.4
<u>Nonresidential structures</u>						
Construction put-in-place	1.2	4.6	-4.1	4.6	2.7	n.a.
Office	-1.8	3.5	-1.7	17.4	-5.5	n.a.
Other commercial	-.8	13.2	-3.6	8.9	1.4	n.a.
Institutional	2.9	-2.2	-6.6	3.1	5.0	n.a.
Industrial	4.1	6.4	-4.3	-.3	7.0	n.a.
Public utilities	1.6	3.1	-4.7	1.8	3.1	n.a.
Lodging and misc.	6.7	-.8	.4	1.7	5.9	n.a.
Rotary drilling rigs in use	14.2	-3.7	.8	.5	1.9	-1.6
Memo:						
Business fixed investment <sup>2</sup>	7.4	22.5	6.1	n.a.	n.a.	n.a.
Producers' durable equipment <sup>2</sup>	10.0	26.0	16.1	n.a.	n.a.	n.a.
Nonresidential structures <sup>2</sup>	.3	12.2	-20.1	n.a.	n.a.	n.a.

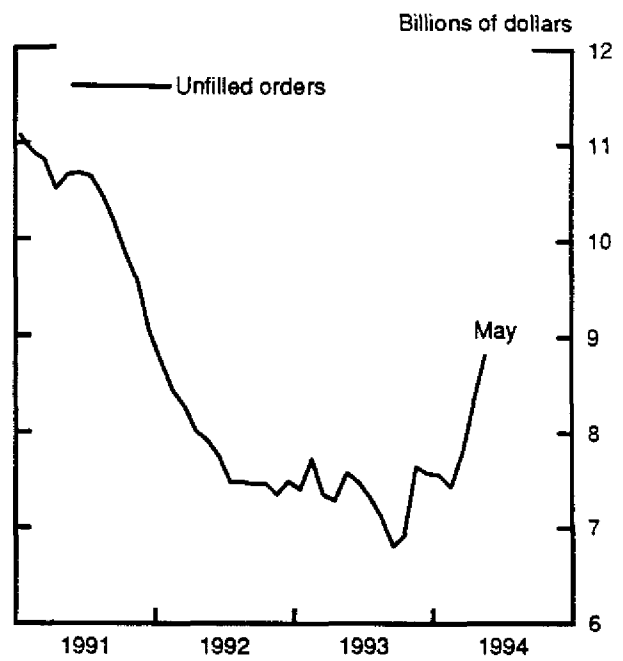
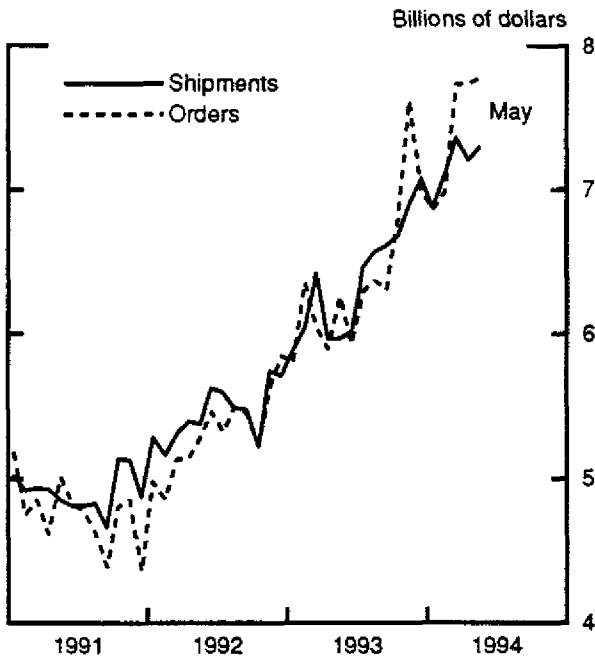
1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.

2. Based on constant-dollar data; percent change, annual rate.

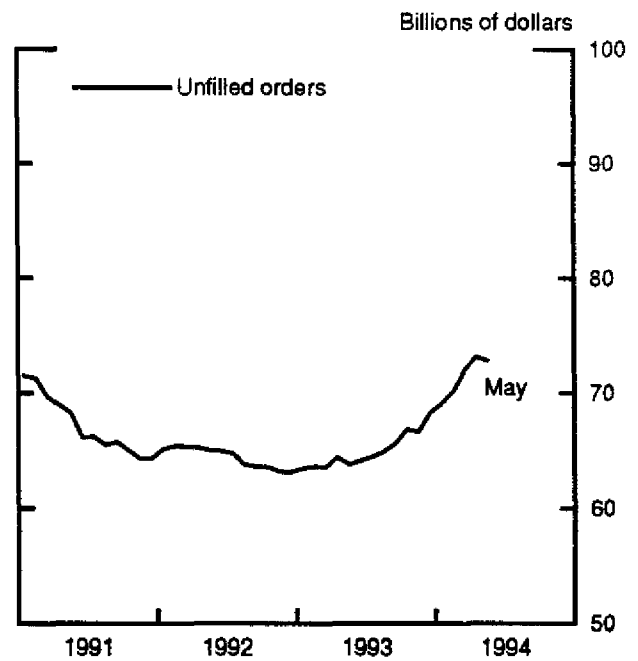
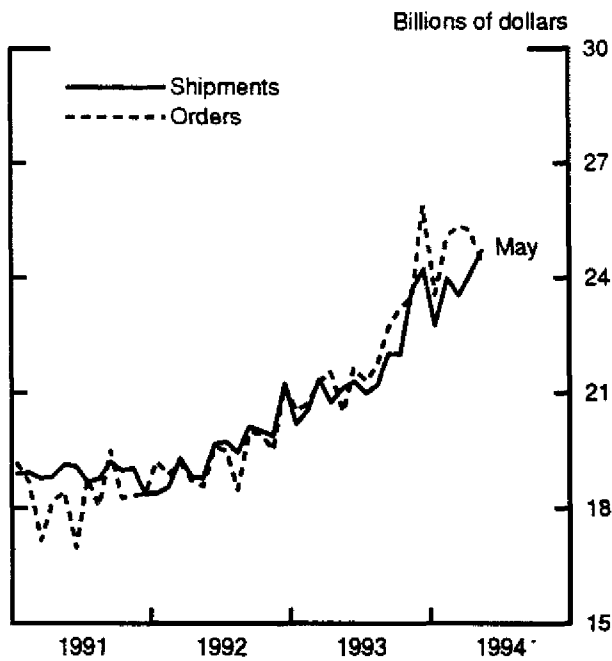
n.a. Not available.

ORDERS AND SHIPMENTS OF NONDEFENSE CAPITAL GOODS

OFFICE AND COMPUTING EQUIPMENT



OTHER EQUIPMENT (EXCLUDING AIRCRAFT AND COMPUTING EQUIPMENT)



structures appears to be headed for a substantial rebound this quarter, after a weather-related slump earlier in the year.

Shipments of nondefense capital goods excluding aircraft---an indicator of near-term equipment spending---posted a solid gain in May. The average level of these shipments during the first two months of the current quarter was 3-3/4 percent above the first-quarter average. Nominal shipments of computing equipment increased in May, partially retracing their April decline. The growth trend for these shipments appears to have moderated in recent months from about 2 percent, on average, per month in 1993, to a bit more than 1/2 percent per month so far this year. In addition, the rate of decline in the producer price index for computing equipment--a series that is designed to capture quality improvements as well as changes in nominal prices--has slowed. After dropping sharply last year, this index showed a comparatively small decline over the first five months of 1994.<sup>10</sup> Trade reports, by contrast, seem to suggest that rapid decreases in performance-adjusted prices are ongoing.

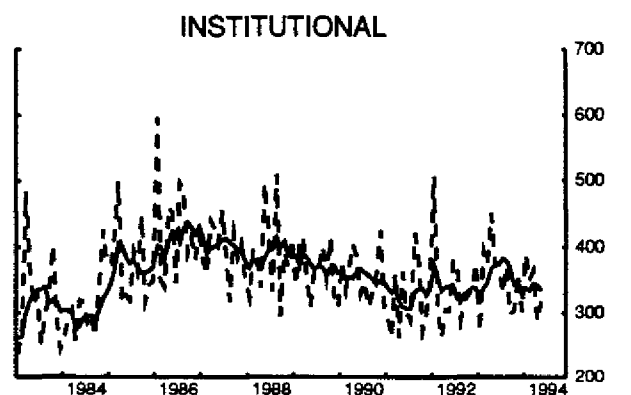
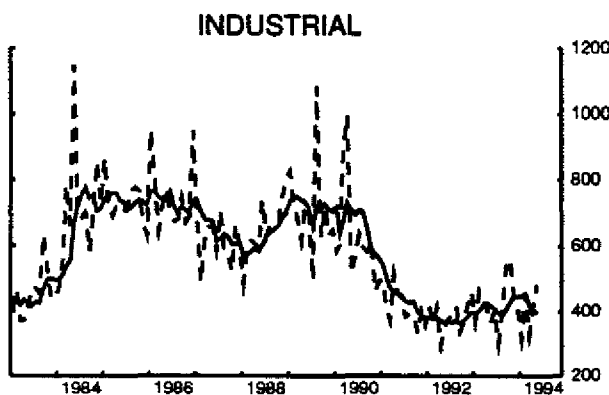
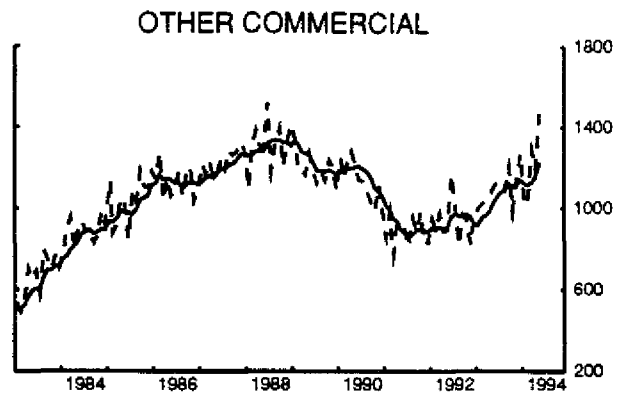
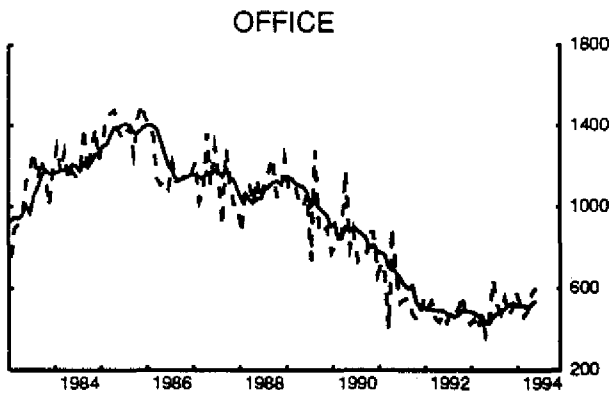
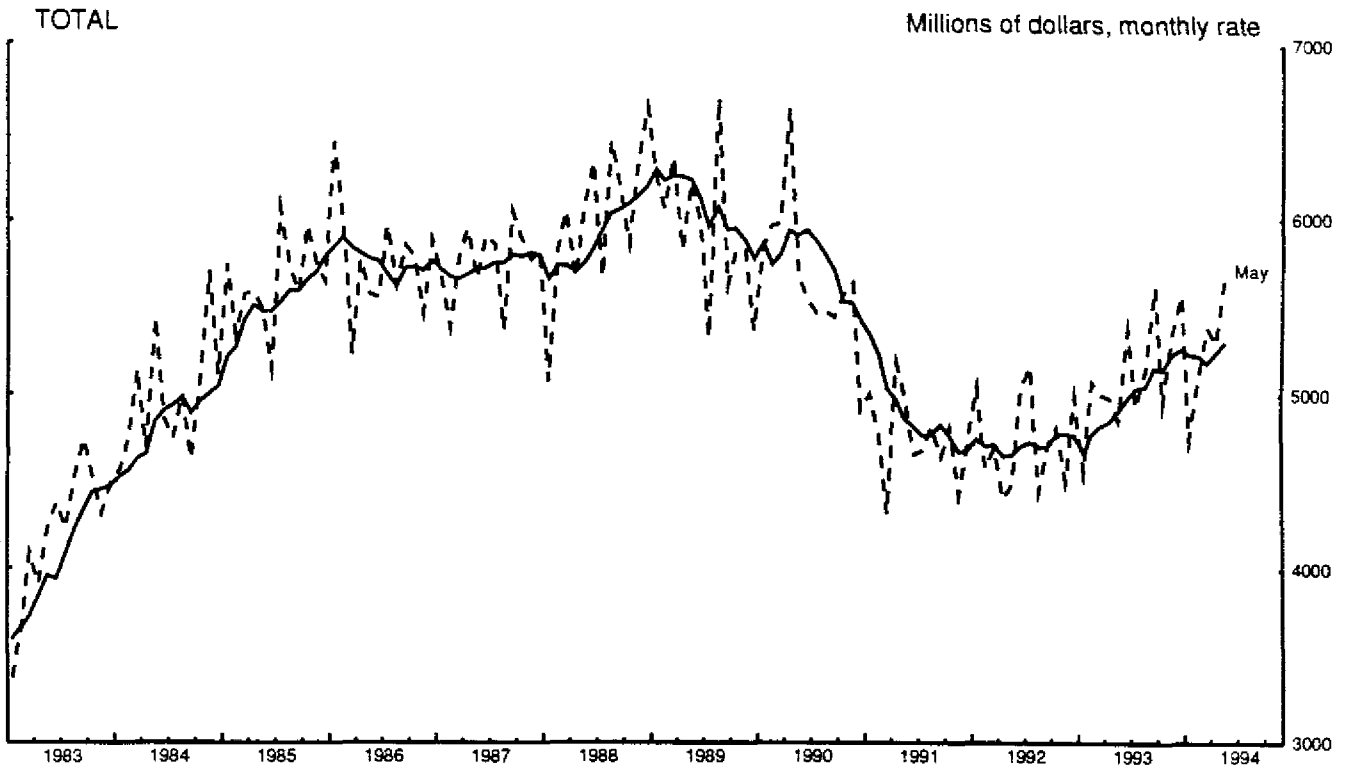
Excluding computing equipment and aircraft, shipments of nondefense capital goods have continued to trend up in recent months, and the average level of shipments in April and May was 4-1/4 percent above the first-quarter average. Looking ahead, orders for these goods dropped about 3-1/2 percent in May, reflecting fairly widespread declines. After bounding up late last year, orders have cooled off noticeably: The first-quarter gain was

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10. This producer price index is the main source used by BEA in constructing the deflator for business purchases of computing equipment. The deflator for business purchases of computers fell 13-1/2 percent last year, but only 4 percent (annual rate) in the first quarter. The level of the PPI for computers in May was less than 1 percent (not at an annual rate) below the first-quarter average, suggesting that the deflator for business purchases of computing equipment will show another relatively modest decline in the current quarter.

# Nonresidential Permits <1>

— Six-month moving average  
 - - Monthly



1. Data are seasonally adjusted using FRB seasonal factors. Total includes alterations and additions.

about 2 percent, and the level of these orders in April and May was only 1/2 percent above the first-quarter average. Nonetheless, backlogs have risen impressively since the middle of last year, suggesting further gains in shipments for at least the next few months.

Spending for motor vehicles by businesses jumped in the first quarter to a record level, bolstered by the increased popularity of leasing and a surge in fleet sales.<sup>11</sup> This quarter, however, business purchases of vehicles may be headed for a decline. Overall sales of light vehicles so far this quarter are lower than the first-quarter average, and the business share of auto purchases likely will recede from its unusually high reading earlier this year. Partially offsetting the decline, sales of heavy trucks during the first two months of the current quarter were up about 3 percent from the first-quarter average. Industry contacts report that demand for heavy trucks remains strong and that assemblies are at or near capacity. Business purchases of aircraft dropped further in the first quarter, and available monthly data suggest continued weakness in the current quarter. The problems that have been besetting domestic carriers do not appear to have abated to any significant degree, suggesting that domestic demand for new aircraft will remain languid for some time.

Turning to nonresidential structures, data on construction put-in-place rebounded in March and April after dipping sharply during the first two months of the year. Construction in April stood at a level slightly above the fourth-quarter average. Looking ahead, permits for these structures, which tend to lead construction by a

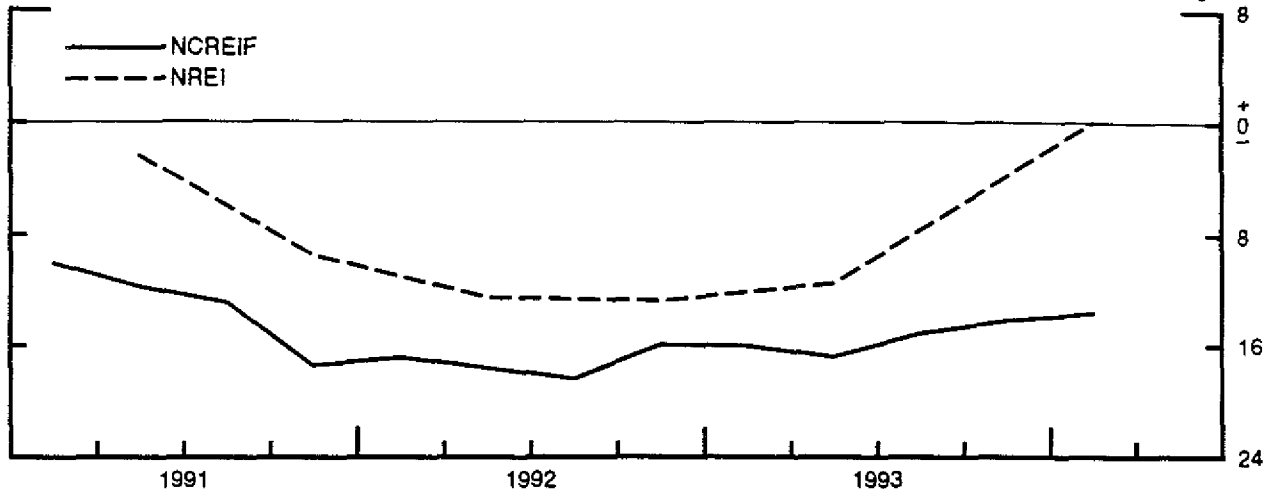
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11. In the National Income and Product Accounts, vehicles purchased by businesses and leased to consumers are included in outlays for producers' durable equipment.

INDICATORS OF PRICES OF NONRESIDENTIAL STRUCTURES

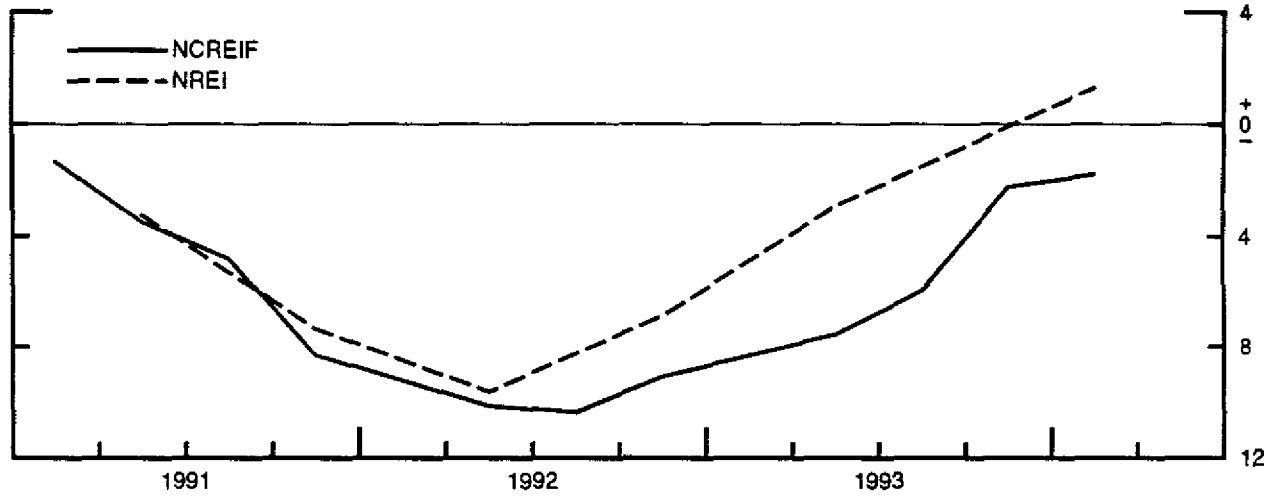
OFFICE STRUCTURES

Four-quarter percent change



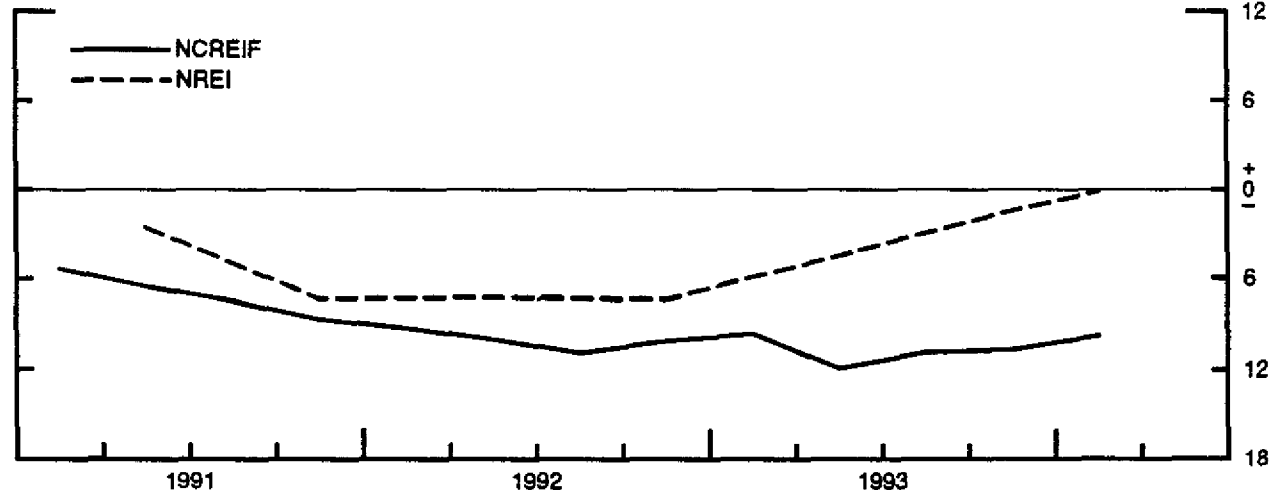
RETAIL STRUCTURES

Four-quarter percent change



WAREHOUSE STRUCTURES

Four-quarter percent change



Note: Historical data for the NREI were recently revised; only semiannual observations are available for most years.

few months, softened in the first quarter but have turned back more recently.

Recent data on prices for nonresidential structures indicate that the excess supply that had plagued this sector in previous years is slowly being worked off. The National Real Estate Index (NREI), which measures transactions prices, shows increases over the past year for retail structures and essentially no change over the year in the prices of offices and warehouses. The Russell-NCREIF index (NCREIF), which is based on appraised values that tend to lag transactions prices, still shows declines but of a smaller magnitude than before, especially for retail structures.

Roughly consistent with the pattern of property prices, the strongest component of construction activity during the past couple of years has been "other commercial" structures, which includes retail centers and warehouses. Within this category, the strength has been concentrated in the retail sector and includes both the construction of new stores and the modernization of existing space. Real estate investment trusts, which have grown substantially in recent years, have been important in providing the financing for mall construction.

#### Manufacturing and Trade Inventories

The pace of business inventory accumulation picked up slightly in early spring, with buildups largely concentrated in segments of the economy where market demand was robust. For all manufacturing and trade, inventories rose in April at an annual rate of \$19.7 billion (current-cost), \$2-1/2 billion above the first-quarter average. The pace remains quite moderate, however, and the inventory-sales ratio for manufacturing and trade was among the lowest in recent years.



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

	1993		1994		1994	
	Q3	Q4	Q1	Feb.	Mar.	Apr.
<b>Current-cost basis</b>						
Total	16.1	18.8	17.2	48.5	-14.8	19.7
Excluding auto dealers	23.5	5.5	14.6	46.2	-14.9	20.7
Manufacturing	-2.5	-13.1	9.4	13.9	-3.6	7.4
Total machinery	3.8	4.5	10.8	9.1	9.4	10.3
Fabricated metal	1.0	-.8	-.9	1.2	-3.5	1.1
Wholesale	12.0	6.1	1.8	17.2	-12.5	10.4
Motor vehicles	1.8	1.6	-5.2	-3.1	-10.0	5.8
Excluding motor vehicles	10.2	4.5	7.1	20.3	-2.5	4.6
Retail	6.6	25.8	5.9	17.4	1.2	1.9
Excluding auto dealers	14.0	12.5	3.4	15.1	1.2	3.0
<b>Constant-dollar basis</b>						
Total	16.4	5.4	12.4	35.8	-4.9	n.a.
Excluding auto dealers	23.5	3.0	2.0	25.6	-21.9	n.a.
Manufacturing	3.1	-5.3	6.0	7.0	-6.8	n.a.
Wholesale	8.5	-.4	-4.1	9.6	-16.6	n.a.
Motor vehicles	1.5	1.3	-5.7	-3.0	-11.6	n.a.
Excluding motor vehicles	7.0	-1.7	1.6	12.5	-5.1	n.a.
Retail	4.8	11.1	10.5	19.3	18.6	n.a.
Excluding auto dealers	11.8	8.6	.1	9.1	1.6	n.a.

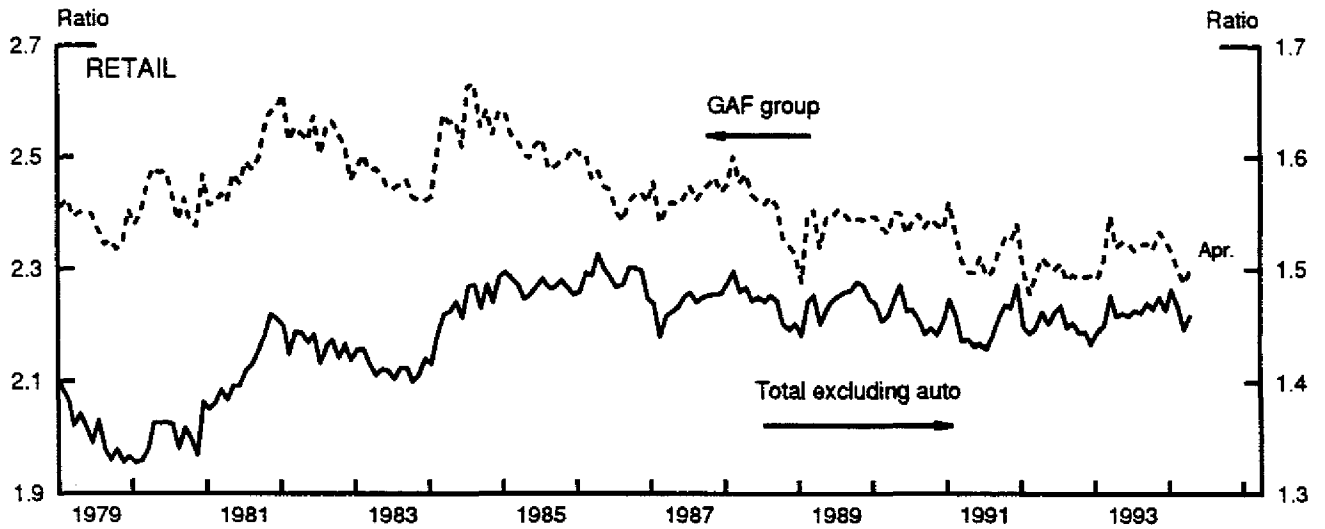
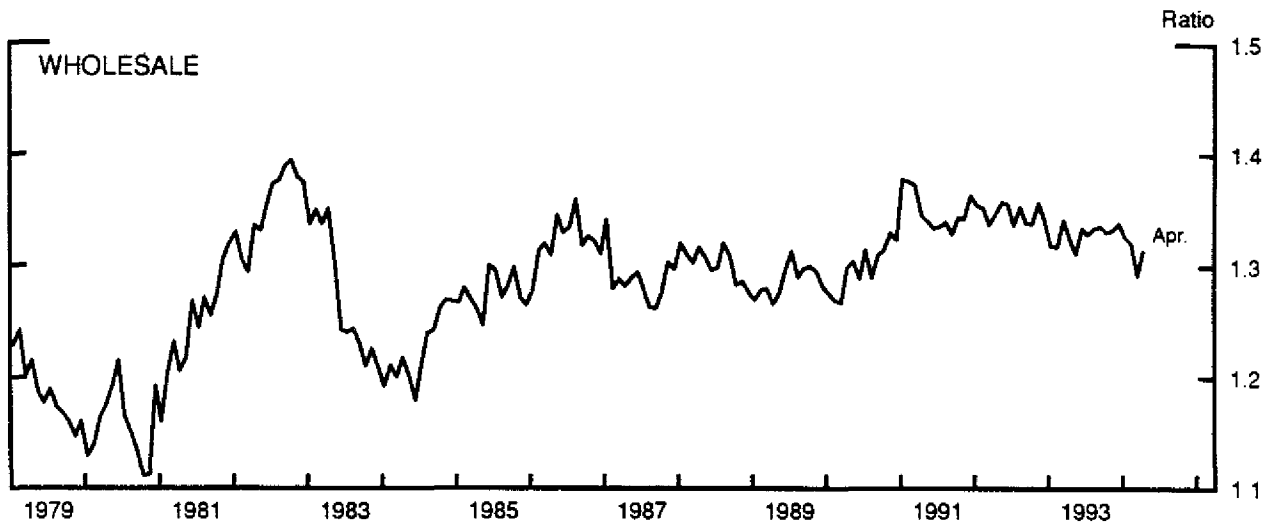
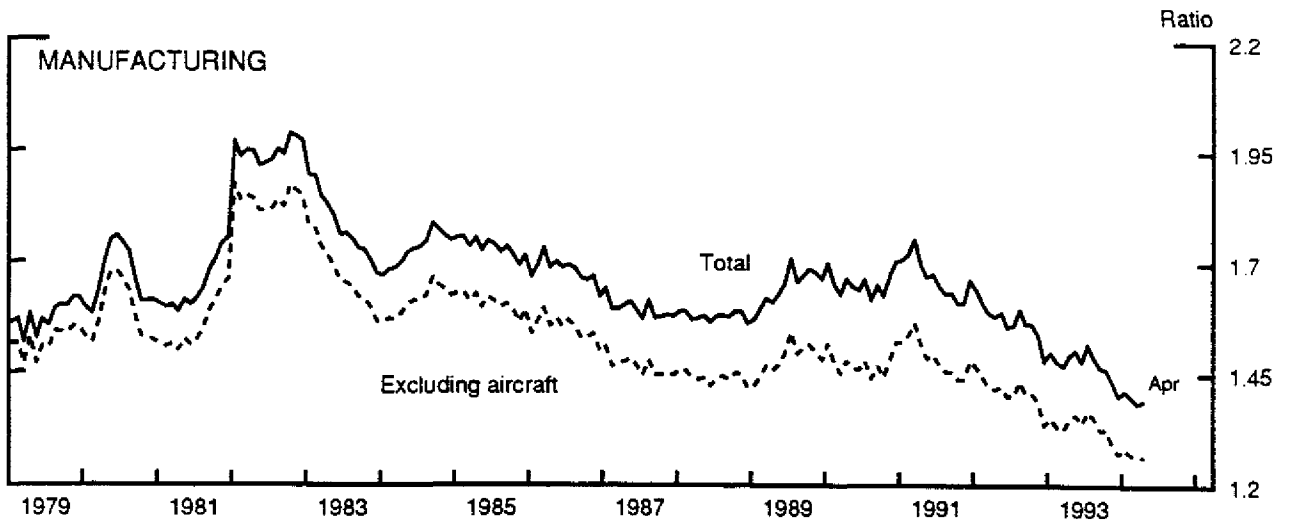
**INVENTORIES RELATIVE TO SALES<sup>1</sup>**  
(Months' supply; based on seasonally adjusted data)

	1993		1994		1994	
	Q3	Q4	Q1	Feb.	Mar.	Apr.
<b>Current-cost basis</b>						
Total	1.46	1.43	1.41	1.41	1.39	1.40
Excluding auto dealers	1.44	1.41	1.39	1.39	1.37	1.38
Manufacturing	1.49	1.42	1.40	1.40	1.38	1.39
Total machinery	1.81	1.74	1.75	1.71	1.72	1.72
Fabricated metal	1.65	1.58	1.53	1.56	1.52	1.53
Wholesale	1.34	1.34	1.31	1.32	1.29	1.31
Motor vehicles	1.63	1.68	1.47	1.51	1.45	1.46
Excluding motor vehicles	1.31	1.30	1.29	1.30	1.28	1.30
Retail	1.52	1.51	1.50	1.50	1.47	1.49
Excluding auto dealers	1.48	1.47	1.47	1.47	1.45	1.46
<b>Constant-dollar basis</b>						
Total	1.55	1.52	1.49	1.49	1.48	n.a.
Excluding auto dealers	1.54	1.50	1.48	1.48	1.46	n.a.
Manufacturing	1.60	1.53	1.51	1.51	1.49	n.a.
Wholesale	1.42	1.42	1.39	1.40	1.37	n.a.
Motor vehicles	1.60	1.65	1.44	1.50	1.43	n.a.
Excluding motor vehicles	1.40	1.40	1.38	1.39	1.37	n.a.
Retail	1.60	1.57	1.57	1.56	1.54	n.a.
Excluding auto dealers	1.55	1.54	1.53	1.53	1.51	n.a.

1. Ratio of end-of-period inventories to average monthly sales for the period.

### RATIO OF INVENTORIES TO SALES

(Current-cost data)



In manufacturing, producers of industrial machinery and electrical and electronic equipment expanded their stocks further in April; in particular, inventories at computer and office equipment makers posted a substantial \$2.3 billion increase, extending a long string of monthly buildups over the past year. In addition, stocks of metal fabricating companies, which produce many housing-related items and some consumer durables, also showed a sizable accumulation. By and large, these are industries that have received strong orders in recent months. Elsewhere in manufacturing, inventories have shown little net change so far this year. The inventory-sales ratio in manufacturing still appears to be on a downward trend.

In the trade sector, inventory changes have been moderate lately. Although stocks held by wholesale distributors of motor vehicles rose at a \$5.8 billion annual rate in April, the increase retraced only part of the declines in the first quarter, when strong motor vehicle sales drew down stocks. For most other wholesale categories, inventory changes generally were small. In retail trade, inventories rose markedly at outlets selling furniture, appliances, and home furnishings, after a large drawdown in March. In contrast, stocks at general merchandise and apparel stores were little changed in April. Indeed, non-auto retail inventories as a whole posted only small net increases in March and April. The conservative stockbuilding has left most types of retail establishments unencumbered with excess inventories; at the end of April, inventory-sales ratios for most retail categories were well within the ranges observed over the past year.

#### Federal Sector

The incoming news on the federal budget for fiscal 1994 has been favorable. The unified deficit for the fiscal year through May

was only \$165 billion. \$46 billion less than for the same period in fiscal 1993; the improvement reflected both strength in receipts and restraint on outlays. Moreover, officials from OMB and CBO have indicated that the estimates of the fiscal 1994 deficit that will be reported later this summer will be considerably smaller than those from last winter.

Receipts have risen about 10 percent so far this fiscal year, with sizable increases in all major categories. Corporate taxes have been especially robust, rising more than 20 percent between the first eight months of fiscal 1993 and the first eight months of fiscal 1994. Moreover, Daily Treasury Statements for June suggest that corporate estimated tax payments were strong relative both to June 1993 and, after allowing for normal seasonal patterns, to the first quarterly payment that was due on April 15. Meanwhile, both personal and social insurance taxes were about 8 percent higher than during the comparable period of fiscal 1993.

We have received little information since the May Greenbook that would allow us to refine our estimate of the effect of OBRA-93 on individual income tax liabilities for 1993. Taken together, the data from the Monthly Treasury Statements for April and May are identical to the daily data we reported last month.<sup>12</sup> Daily data for June suggest that payments of estimated personal taxes were appreciably higher than in June 1993, despite the relaxation of safe harbor provisions; the increase likely reflected a combination of solid growth in taxable incomes and the higher tax rates this year.

Excluding deposit insurance, federal outlays during April and May were essentially the same as a year earlier; for the 1994 fiscal

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12. In preparing its estimate of disposable personal income for April, BEA assumed that payments of the first installment of the increased 1993 tax liabilities added only about \$30 billion (SAAR) to personal tax payments that month. However, that estimate is based on little hard information, and BEA has indicated that it may be revised as additional data become available.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS  
(Unified basis, billions of dollars except as noted)

	Fiscal year to date					
	April thru May					
	FY1993	FY1994	FY1993	FY1994	Dollar change	Percent change
Outlays	231.5	239.5	941.5	966.3	24.8	2.6
Deposit insurance (DI)	-4.9	1.7	-18.5	-5.1	13.4	-72.6
Outlays excluding DI	236.5	237.8	960.0	971.4	11.4	1.2
National defense	47.7	44.0	193.7	183.6	-10.1	-5.2
Net interest	34.0	34.8	133.3	133.9	.5	.4
Social security	50.7	53.2	199.2	209.1	9.9	5.0
Medicare and health	38.2	40.2	148.7	163.6	14.9	10.0
Income security	36.3	36.8	145.2	149.8	4.7	3.2
Other	29.7	29.0	139.9	131.3	-8.6	-6.1
Receipts	202.7	224.9	729.8	801.0	71.2	9.8
Personal income taxes	73.8	84.4	320.7	346.1	25.5	7.9
Social insurance taxes	91.5	96.9	283.2	306.3	23.1	8.1
Corporate income taxes	20.2	23.4	63.4	77.1	13.7	21.6
Other	17.2	20.2	62.5	71.6	9.1	14.6
Deficit(+)	28.9	14.6	211.7	165.3	-46.4	-21.9
Excluding DI	33.8	12.9	230.2	170.4	-59.8	-26.0
Note:						
Withheld + FICA	127.6	137.8	534.1	573.4	39.3	7.4
Nonwithheld + SECA	60.9	67.9	113.9	122.4	8.5	7.5
Individual refunds	36.9	38.9	69.2	70.3	1.1	1.6

Details may not add to totals because of rounding.

year to date, they are up only about 1 percent. Spending on Medicare and other health programs, which had shown signs of accelerating earlier this fiscal year, has slowed significantly over the past several months; on balance, these outlays seem to be trending up about 10 percent per year. Defense outlays, after plunging in the first quarter, dropped further in April and May. In the aggregate, spending on other programs has shown a small increase in fiscal 1994.<sup>13</sup>

Various congressional committees continue to debate health reform, with details of the proposals changing daily. The Senate Labor and Human Resources Committee and the House Education and Labor Committee have reported out bills similar to that of the Clinton Administration. The House Ways and Means Committee is marking up a bill that contains employer mandates and small business subsidies; the committee is expected to vote on the bill by the end of this week. The Senate Finance Committee is focusing on plans that emphasize insurance reforms and subsidies for low-income groups; however, consensus remains elusive, with the employer mandate the main sticking point.

#### State and Local Government Sector

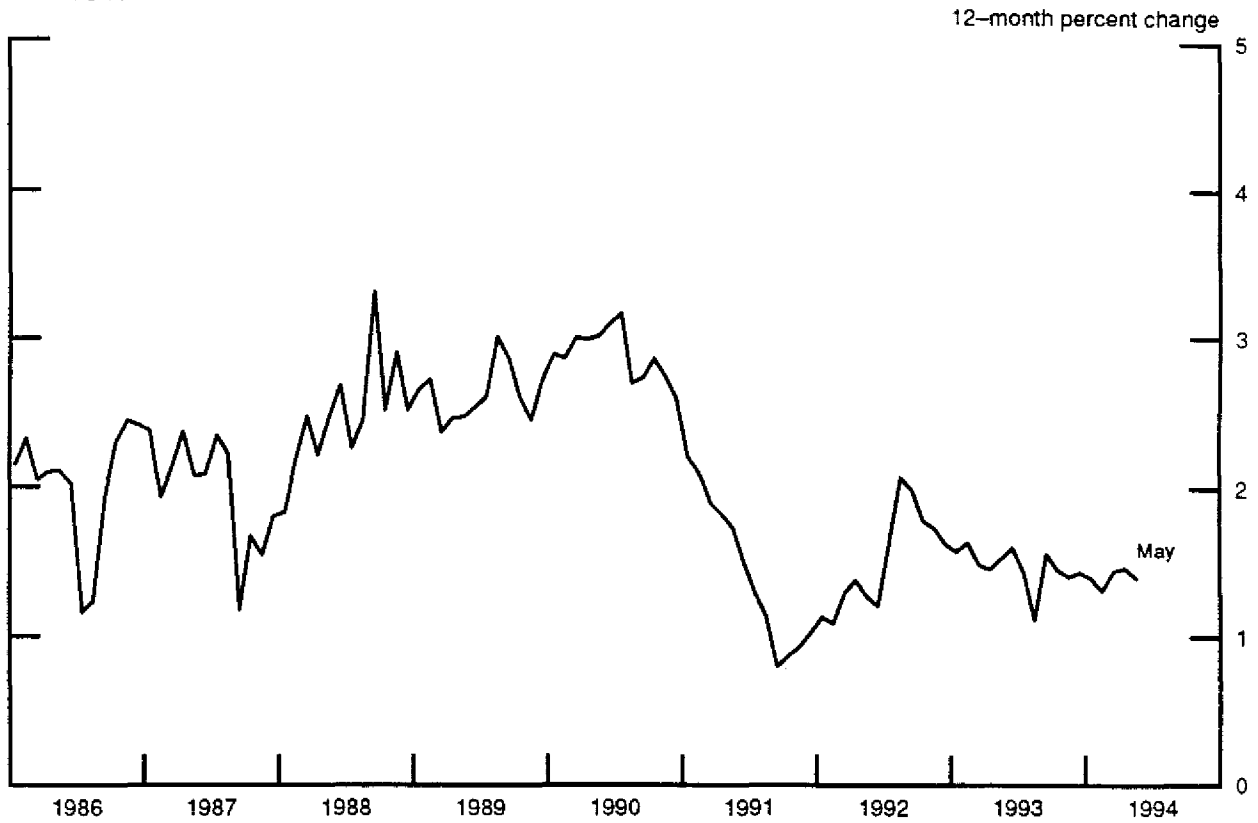
Indicators of state and local spending in the second quarter are mixed. Employment of state and local government workers edged up in May after a sizable rise the month before; most of the increase during the second quarter has been at local governments. Employment has been trending up at a fairly steady rate of about 1-1/2 percent per year for the past two years. State and local

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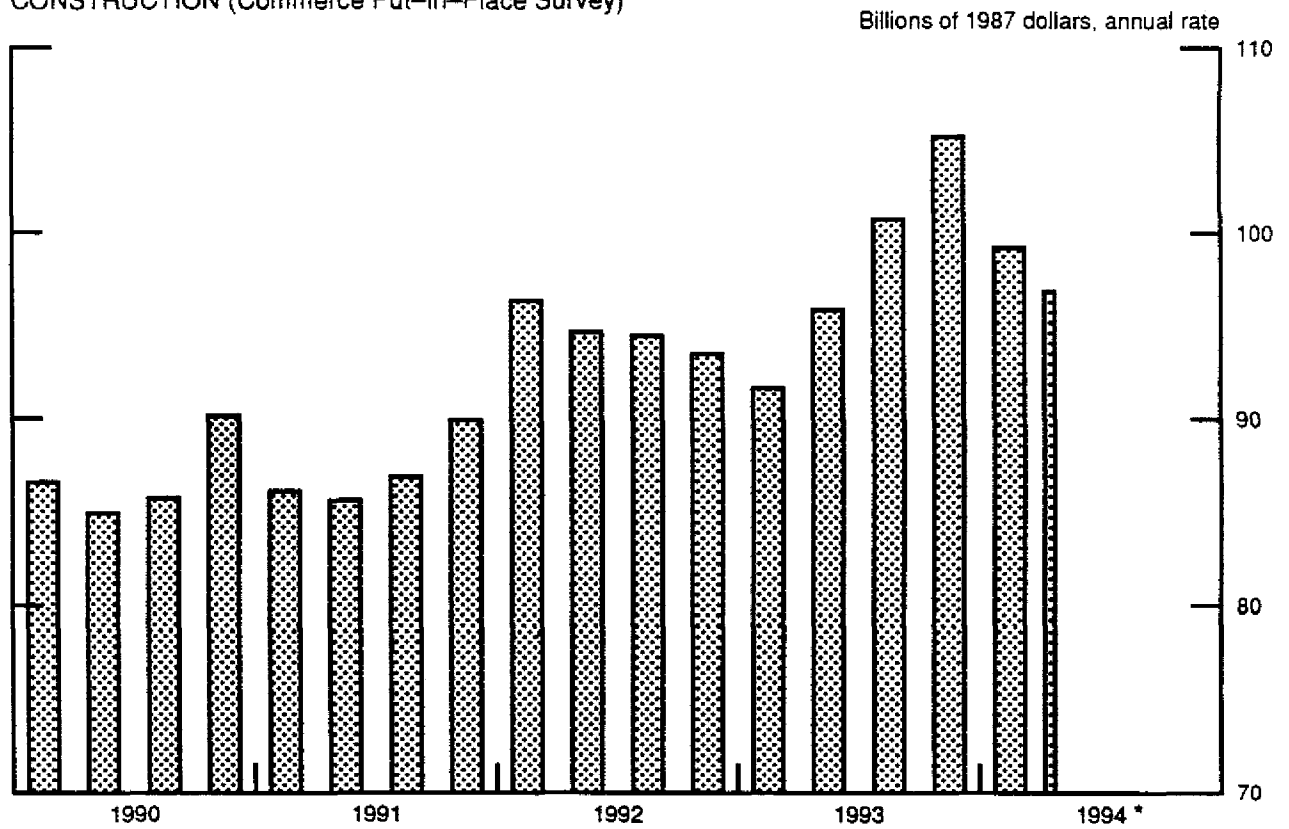
13. The revised NIPA data released today continue to show that real nondefense purchases rose at an annual rate of about 18-1/2 percent in the first quarter. The surge in outlays, which more than retraced the decline in the fourth quarter, reflected increases in many programs, including the IRS, NASA, NIH, and FEMA. Large quarterly changes in nondefense purchases are not unprecedented, but the OBRA caps on discretionary spending should limit further increases in these outlays in the quarters ahead.

### STATE AND LOCAL SECTOR

#### EMPLOYMENT



#### CONSTRUCTION (Commerce Put-In-Place Survey)



\* Last bar represents April 1994 data.

construction spending fell sharply in real terms in April, to a level 2.4 percent below the first-quarter average, which already was down appreciably from the level of late 1993. Much of the weakness this year has been in outlays for educational facilities and highways; for both of these categories, which together account for nearly 60 percent of state and local building, construction had trended up through 1993 but has since moved back substantially.

Despite continuing large budget deficits for the state and local sector as a whole, news about the fiscal situation of the states' general fund budgets, which represent 25 percent of the sector's spending, has been quite good of late. Indeed, just ten states were forced to make midyear adjustments to meet their balanced budget requirements during fiscal 1994, which ends June 30 in all but four states. This performance compares quite favorably with that of recent years: Twenty-three states made midyear changes in fiscal 1993, and thirty-five states made adjustments in fiscal 1992. Tax receipts, which have been coming in at or above target in most states, have been boosted by growth in tax bases owing to the economic expansion. State revenue in real terms, adjusted to exclude legislated actions, rose 3.5 percent, on average, during the first three quarters of fiscal 1994, compared with a 1.6 percent increase during fiscal 1993 and a small decline during the prior fiscal year.

#### Prices

The major price indexes suggest that the pace of inflation has remained relatively subdued in recent months. At the same time, however, the warning signs of inflation would seem to be flashing a bit more strongly, given the apparent exhaustion of labor market slack, the persistent increases in the prices of a broad range of industrial commodities, recent increases in crude oil prices, and



RECENT CHANGES IN CONSUMER PRICES  
(Percent change; based on seasonally adjusted data)<sup>1</sup>

	Relative importance, Dec. 1993	1992	1993	1993		1994	1994	
				Q3	Q4	Q1	Apr.	May
				-----Annual rate-----			-Monthly rate-	
All items <sup>2</sup>	100.0	2.9	2.7	2.0	3.3	2.5	.1	.2
Food	15.8	1.5	2.9	2.6	4.9	-1.1	.1	.3
Energy	7.0	2.0	-1.4	-4.2	1.2	4.7	-.4	-1.0
All items less food and energy	77.2	3.3	3.2	2.1	3.4	2.9	.2	.3
Commodities	24.4	2.5	1.6	.0	2.4	.6	.1	.4
Services	52.8	3.7	3.9	3.5	3.7	4.2	.2	.2
Memo:								
CPI-W <sup>3</sup>	100.0	2.9	2.5	1.4	3.1	2.5	.1	.1

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

RECENT CHANGES IN PRODUCER PRICES  
(Percent change; based on seasonally adjusted data)<sup>1</sup>

	Relative importance, Dec. 1993	1992	1993	1993		1994	1994	
				Q3	Q4	Q1	Apr.	May
				-----Annual rate-----			-Monthly rate-	
Finished goods	100.0	1.6	.2	-2.5	-.3	3.9	-.1	-.1
Consumer foods	22.9	1.6	2.4	3.2	5.2	-.9	-.5	-.9
Consumer energy	13.3	-.3	-4.1	-7.4	-15.6	16.6	-.1	-1.0
Other finished goods	63.7	2.0	.4	-3.5	.9	3.3	.1	.4
Consumer goods	40.3	2.1	-.4	-6.4	1.5	2.3	-.1	.4
Capital equipment	23.4	1.7	1.8	2.2	.3	4.6	.4	.4
Intermediate materials <sup>2</sup>	95.2	1.1	.8	-1.0	-.3	2.8	.0	.2
Excluding food and energy	82.3	1.2	1.6	1.0	1.6	1.6	.2	.3
Crude food materials	44.1	3.0	7.2	13.1	18.4	-4.8	-1.1	-3.4
Crude energy	34.4	2.3	-12.3	-28.1	-22.1	18.9	-.1	1.0
Other crude materials	21.5	5.7	10.7	-4.5	15.4	23.4	-.3	-1.1

1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

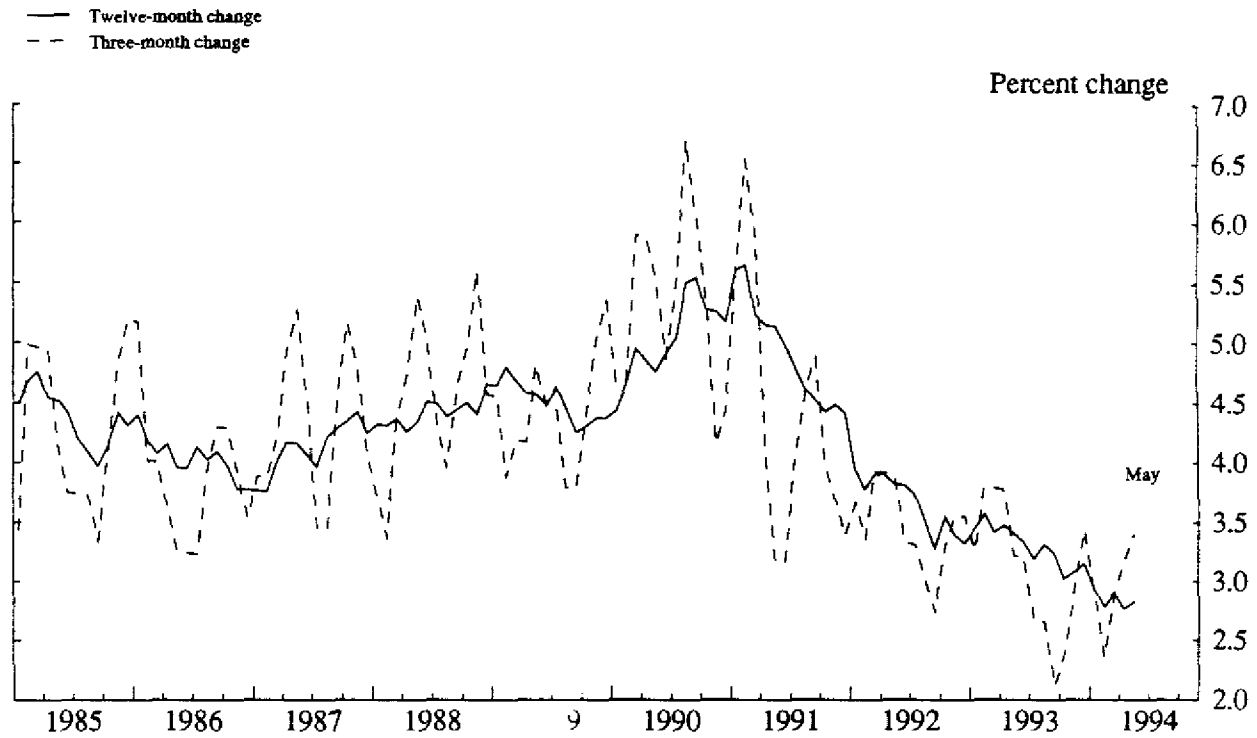
the potentially less favorable outlook for import prices in view of recent depreciation in the foreign exchange value of the U.S. dollar.

Consumer prices rose 0.2 percent in May, and the index excluding food and energy was up 0.3 percent after similar increases in the preceding three months. The increases since February in the index excluding food and energy have been large enough to forestall further deceleration in the twelve-month rate of change. Among durable goods, prices of new cars rose 0.3 percent last month, and light truck prices were up 0.8 percent. Among nondurable goods, apparel prices increased 0.5 percent in May after an equivalent decline in April. In addition, tobacco prices were up 1.3 percent in May; more than half of that increase reflected the one-time effect of higher taxes on tobacco products in Michigan. The prices of non-energy services rose 0.2 percent in May. Owners' equivalent rent and residential rent both posted small increases for a second month. The volatile airfares category dropped more than 5 percent, but auto finance costs surged nearly 4 percent, a second month of large increases.

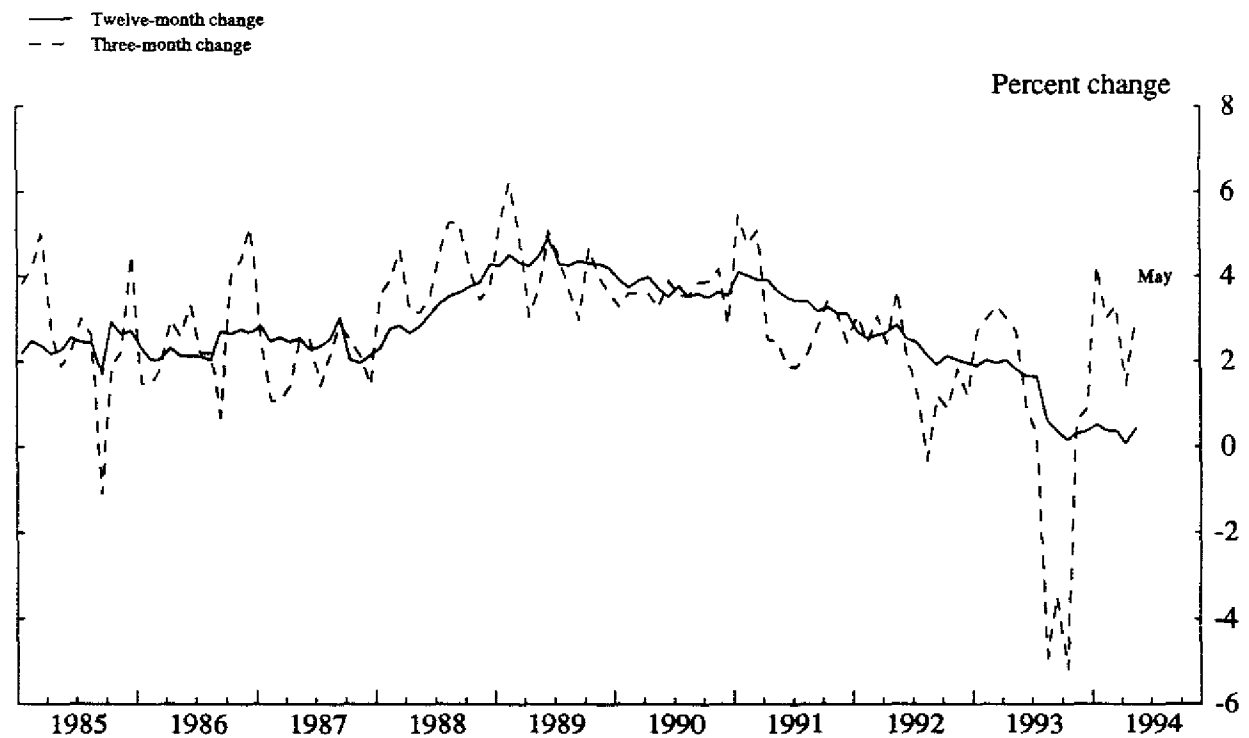
The CPI for food moved up 0.3 percent in May, the first monthly rise of any consequence since December. Most of the May increase resulted from a 2.4 percent jump in fruit and vegetable prices, which had fallen sharply, on net, over the first four months of the year. Prices of other food items only edged up in May, and have increased at a 2.2 percent annual rate since December. Consumer energy prices dropped 1 percent in May, as motor fuel, heating oil, and natural gas all posted sizable declines. Over the past twelve months, energy prices have fallen nearly 1-1/2 percent. However, crude oil prices have moved up sharply since April, pointing to more sizable increases in coming months.

## RECENT CHANGES IN FINISHED-GOODS PRICES

### CONSUMER PRICE INDEX LESS FOOD AND ENERGY



### PRODUCER PRICE INDEX LESS FOOD AND ENERGY



## INFLATION RATES EXCLUDING FOOD AND ENERGY

	Percent change from twelve months earlier		
	May 1992	May 1993	May 1994
CPI	3.8	3.4	2.8
Goods	3.0	2.3	1.3
Alcoholic beverages	3.3	1.4	1.3
New vehicles	2.6	2.5	3.6
Apparel	2.8	1.2	0.2
House furnishings	1.0	0.1	1.9
Housekeeping supplies	0.4	1.4	0.5
Medical commodities	7.0	3.5	3.0
Entertainment	2.4	1.4	2.4
Tobacco	9.9	8.5	-7.3
Services	4.2	4.0	3.5
Owners' equivalent rent	3.5	3.3	3.2
Tenants' rent	2.5	2.5	2.3
Other renters' costs	6.0	4.1	3.5
Airline fares	2.9	13.4	3.3
Medical care	7.9	6.9	5.0
Entertainment	3.5	2.8	4.1
Auto financing	-11.8	-9.7	2.9
Tuition	9.4	8.4	6.8
PPI finished goods	2.8	1.8	0.4
Consumer goods	3.5	1.8	-0.7
Capital goods, excluding computers	2.9	2.5	2.7
Computers	-19.4	-15.2	-7.5
PPI intermediate materials	0.4	1.6	1.5
PPI crude materials	-1.3	9.6	6.6
<u>Factors affecting price inflation</u>			
ECI hourly compensation <sup>1</sup>	4.2	3.5	3.3
Goods-producing	4.6	4.0	3.2
Service-producing	4.0	3.2	3.4
Civilian unemployment rate <sup>2,3</sup>	7.5	6.9	6.0
Capacity utilization <sup>2</sup> (manufacturing)	78.9	80.2	82.8
Inflation expectations <sup>4,5</sup>			
Mean of responses	4.2	4.8	3.9
Median, bias-adjusted <sup>6</sup>	4.1	4.6	3.6
Non-oil import price <sup>7</sup>	0.1	0.1	2.0
Consumer goods, excluding autos, food, and beverages	1.8	1.3	1.1
Autos	1.1	0.5	4.1

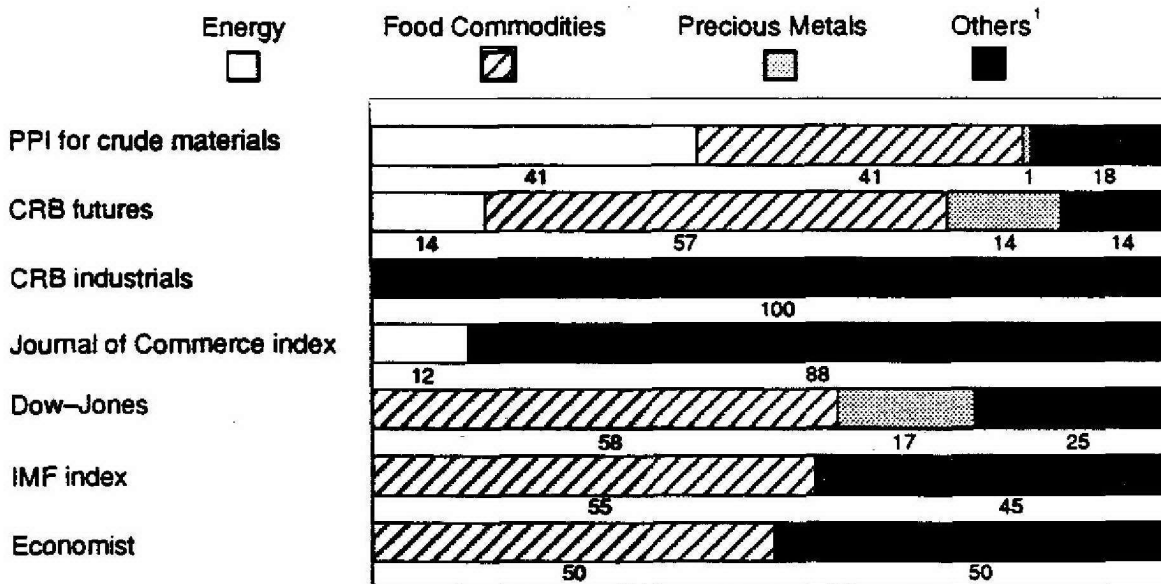
1. Private industry workers, periods ended in March.
2. End-of-period value.
3. Data for 1994 are not directly comparable with earlier values because of a redesign of the CPS in January 1994.
4. Michigan Survey one-year-ahead expectations.
5. Latest reported value: June.
6. Median adjusted for average downward bias of 0.9 percentage points, relative to actual inflation, since 1978.
7. BLS import price index (not seasonally adjusted), periods ended in March.

COMMODITY PRICE INDEXES<sup>1</sup>

	Last observation	-----Percent change <sup>2</sup> -----				Memo: Year earlier to date
		1992	1993	Dec 93 to May 10 <sup>3</sup>	May 10 <sup>3</sup> to date	
1. PPI for crude materials <sup>4</sup>	May	3.3	0.1	2.3	n.a.	-3.0
1a. Foods and feeds	May	3.0	7.2	-1.9	n.a.	-2.0
1b. Energy	May	2.3	-12.3	5.3	n.a.	-9.3
1c. Excluding food and energy	May	5.7	10.7	5.6	n.a.	6.6
1d. Excluding food and energy, seasonally adjusted	May	6.1	10.6	3.9	n.a.	6.7
2. Commodity Research Bureau						
2a. Futures prices	Jun 28	-2.9	11.6	-0.2	2.4	12.3
2b. Industrial spot prices	Jun 28	-0.7	-0.0	7.8	2.1	14.6
3. Journal of Commerce industrials	Jun 28	5.0	-4.0	6.7	1.7	6.5
3a. Metals	Jun 28	1.9	-2.6	3.8	0.5	5.2
4. Dow-Jones Spot	Jun 28	10.4	5.1	6.3	3.9	17.2
5. MF commodity index <sup>4</sup>	May	-2.6	2.4	4.5	n.a.	11.7
5a. Metals	May	-3.1	-14.4	9.9	n.a.	6.8
5b. Nonfood agricultural	May	2.4	0.2	7.9	n.a.	9.3
6. Economist (U.S. dollar index)	Jun 21	1.6	9.1	8.7	7.7	32.2
6a. Industrials	Jun 21	4.5	4.4	9.9	7.4	29.1

- 1. Not seasonally adjusted.
- 2. Change is measured to end of period, from last observation of previous period.
- 3. Week of the May Greenbook.
- 4. Monthly observations. IMF index includes items not shown separately.
- n.a. Not available.

INDEX WEIGHTS

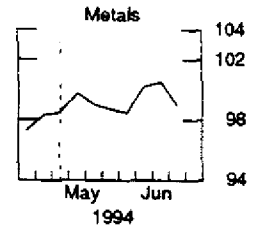
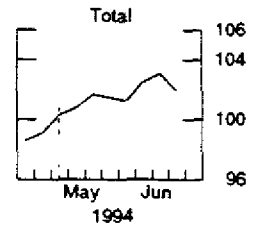
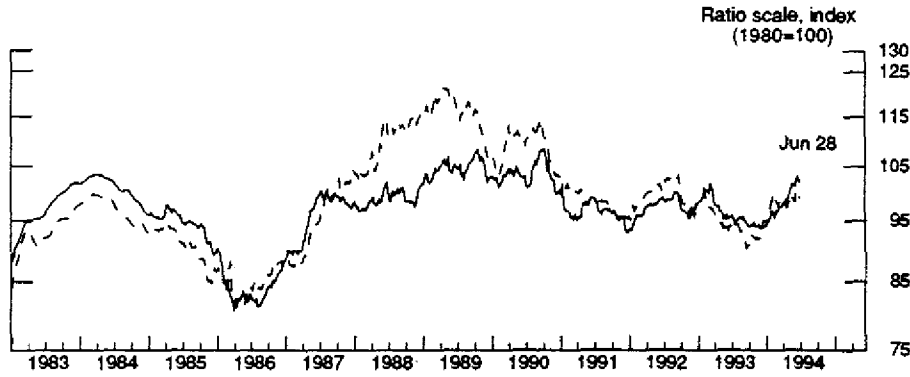


1. Forest products, industrial metals, and other industrial materials.

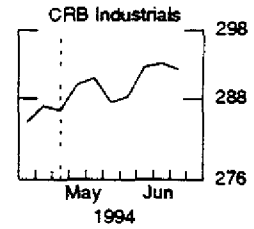
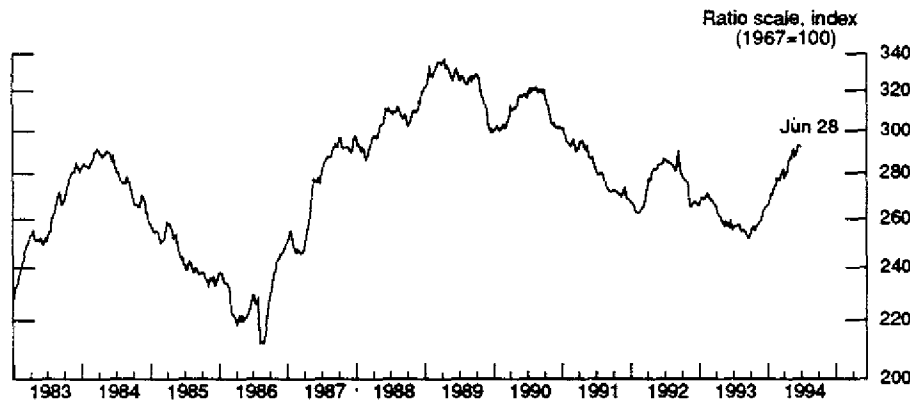
# COMMODITY PRICE MEASURES \*

## JOURNAL OF COMMERCE INDEX

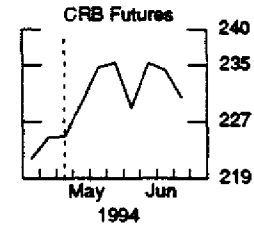
— Total  
 - - Metals



## CRB SPOT INDUSTRIALS



## CRB FUTURES



\* Weekly data, Tuesdays; Journal of Commerce data monthly before 1985

Dashed lines indicate week of last Greenbook.

## SPOT PRICES OF SELECTED COMMODITIES

	Current price (\$)	-----Percent change <sup>1</sup> -----				Memo: Year earlier to Date
		1992	1993	To May 10 <sup>2</sup>	May 10 <sup>2</sup> to Jun 28	
-----INDUSTRIAL COMMODITIES-----						
Metals:						
Copper (lb.)	1.110	4.1	-19.0	18.1	9.9	24.0
Steel scrap (ton)	111.500	1.1	46.8	-7.9	-13.2	.0
Aluminum, London (lb.)	.648	9.9	-10.7	18.3	9.5	18.6
Lead (lb.)	.355	-4.3	3.0	.0	2.9	6.0
Zinc (lb.)	.485	-10.3	-7.5	-1.5	5.4	8.3
Tin (lb.)	3.616	6.5	-14.1	12.4	-1.6	5.9
Textiles and fibers:						
Cotton (lb.)	.732	-3.2	19.6	25.6	-6.1	38.0
Burlap (yd.)	.275	-9.6	8.2	3.8	.0	12.2
Miscellaneous materials:						
Hides (lb.)	.885	11.4	1.3	10.8	1.1	18.0
Rubber (lb.)	.583	12.3	-7.3	15.1	13.1	33.0
-----OTHER COMMODITIES-----						
Precious metals:						
Gold (oz.)	386.550	-5.9	16.6	-1.9	1.7	3.0
Silver (oz.)	5.305	-5.7	38.8	6.0	-.7	19.1
Platinum (oz.)	398.750	5.5	8.0	2.1	1.3	3.7
Forest products:						
Lumber (m. bdft.)	338.000	47.5	75.8	-20.3	-8.6	3.
Plywood (m. sqft.)	322.000	53.5	-6.3	-.9	.0	-.9
Petroleum:						
Crude oil (barrel)	17.000	1.4	-25.0	20.7	4.3	-1.7
Gasoline (gal.)	.534	-2.9	-31.0	34.5	7.1	-2.0
Fuel oil (gal.)	.502	21.9	-22.4	10.2	4.2	-4.1
Livestock:						
Steers (cwt.)	60.500	10.6	-7.3	-4.8	-12.3	-20.4
Hogs (cwt.)	43.500	10.4	.6	6.7	.0	-8.4
Broilers (lb.)	.509	-5.3	6.1	20.2	-17.9	2.7
U.S. farm crops:						
Corn (bu.)	2.515	-16.1	41.7	-13.4	1.2	19.5
Wheat (bu.)	3.365	-11.7	5.8	-8.7	-5.8	13.5
Soybeans (bu.)	6.720	1.1	24.5	-5.1	2.1	8.4
Other foodstuffs:						
Coffee (lb.)	1.693	17.9	-2.3	60.5	63.5	235.1
Memo:						
Exchange value of the dollar (March 1973=100)	89.554	10.1	3.4	-2.0	-4.1	-4.0
Yield on Treasury bill, 3-month <sup>3</sup>	4.180	-68	-14	118	-6	115

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

2. Week of the May Greenback.

3. Changes are in basis points.

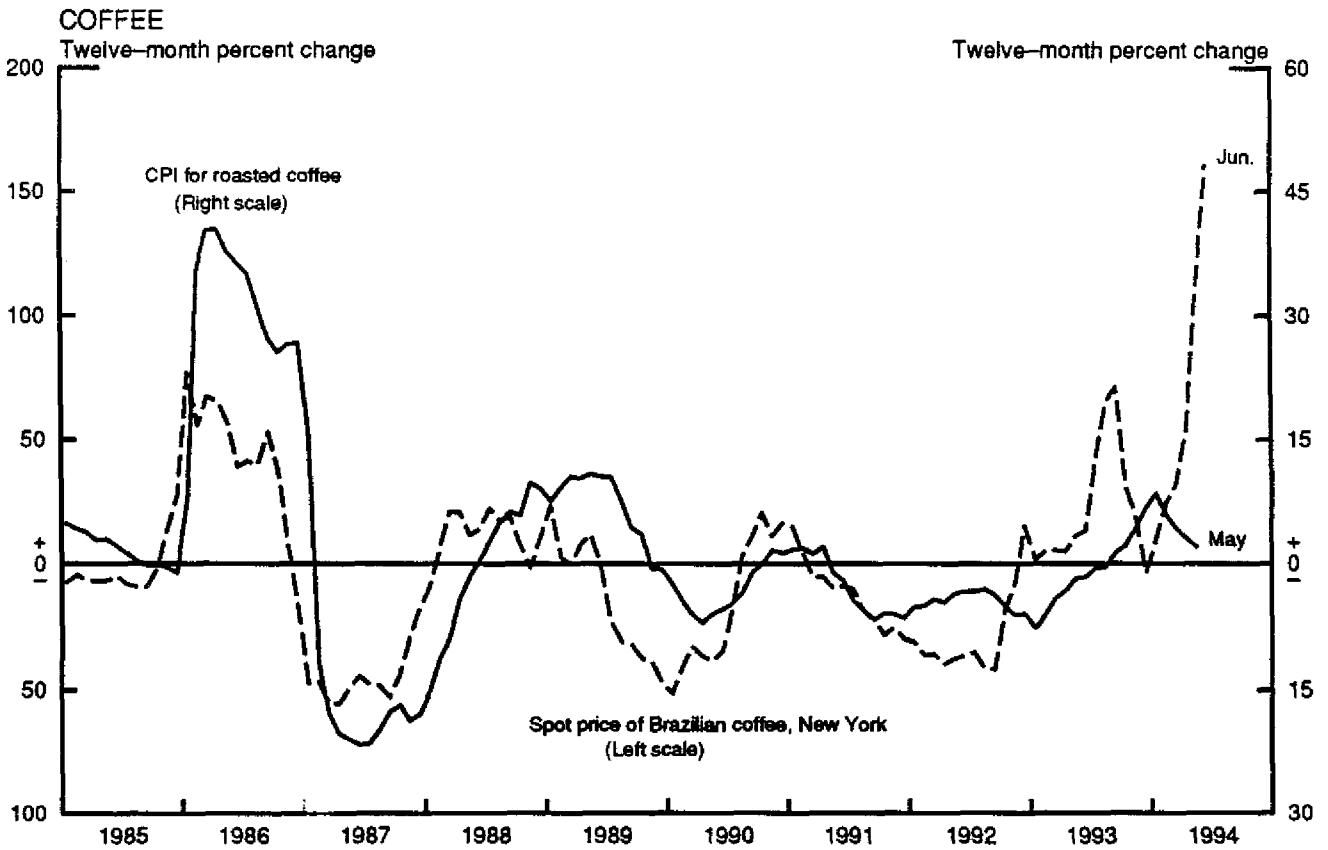
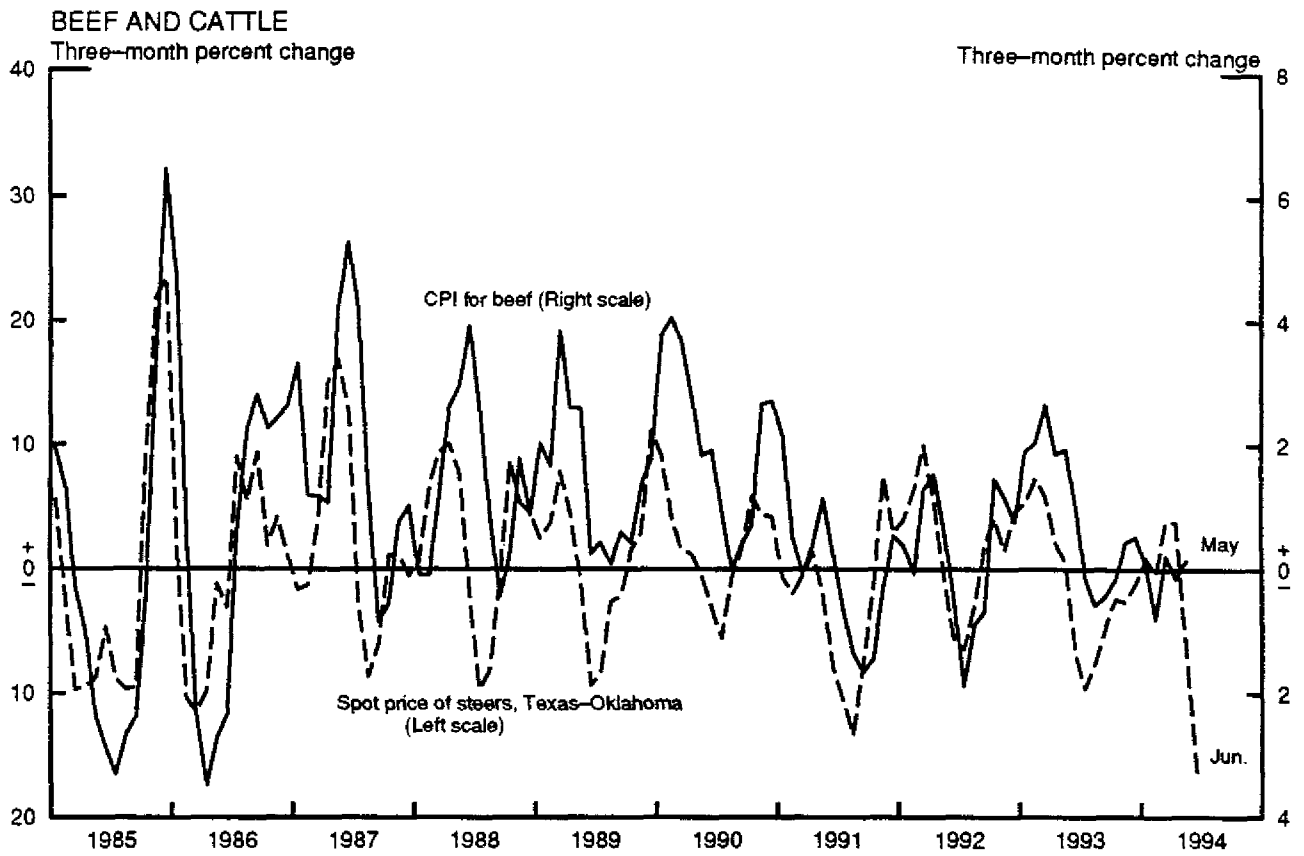
Consumer price expectations had shown signs of turning up earlier in the spring, but those signs now seem to have dissipated. The Michigan survey showed average expectations of inflation for the next twelve months rising to near 4-1/2 percent in March and April, but then falling back below 4 percent in May and June (preliminary). In addition, this survey's measure of inflation expectations over the next five to ten years rose above 5 percent in March and April, but then dropped back to the 4-1/2 percent range in May and June. In the Conference Board survey, expectations held about unchanged at around 4-1/4 percent throughout this period. That price expectations are so high after several years of substantially slower inflation remains a bit of a puzzle.

The PPI for finished goods declined 0.1 percent in May. Food prices fell 0.9 percent--the fourth decline in the last five months--and energy prices moved down 1 percent after holding essentially flat in March and April. Excluding food and energy items, the PPI rose 0.4 percent in May. Advances were led by the motor vehicle sector: New car prices rose 0.8 percent last month, and light truck prices were up 2 percent. Tobacco prices shot up nearly 2 percent last month on a seasonally adjusted basis. In addition, computer prices were down only 0.2 percent in May; price declines in that component of the PPI have slowed dramatically in the past several months. Over the twelve months ended in May, the overall PPI declined 0.4 percent, while the PPI excluding food and energy was up 0.4 percent. Over the three months ended in May, the rate of rise in the PPI excluding food and energy picked up to a 2.8 percent annual rate, but this upturn may not be very meaningful given the short-run volatility of the series.

At earlier stages of processing, the index for intermediate materials excluding food and energy posted a rise of 0.3 percent in



FOOD COMMODITY PRICES



May. The increase in this index over the twelve months ended in May was a modest 1-1/2 percent. The index for crude materials other than food and energy moved down 1.1 percent in May, after a small decline in April that followed six months of sizable increases. Prices of logs and timber fell off slightly in May from a very high level. By contrast, prices of copper scrap, cotton, and waste paper rose appreciably last month.

Prices of industrial commodities generally have moved higher since the last Greenbook, with especially large increases for nonferrous metals such as copper and aluminum. Prices of steel scrap and lumber have declined, on net, since mid-May but remain at relatively high levels. The Journal of Commerce index of industrial prices has moved up about 1-3/4 percent since the last Greenbook, and the KR-CRB index for spot industrials has increased about 2 percent.

In the markets for food commodities, some unusually strong cross-currents have been evident in the recent price data, with the balance seemingly pointed toward increases in food prices over the near term and perhaps sharp increases in the PPI. Pass-through of a recent steep decline in cattle prices likely will be a restraining influence on retail prices for at least the next couple of months. However, retail coffee prices seem likely to climb as the effects of a surge in raw coffee prices begin to show up at grocery stores. Fresh vegetable prices may also exhibit a strong upward move over the very near term. After a stretch of several months in which the (not seasonally adjusted) wholesale prices of vegetables had remained in a low range, they recently have jumped sharply higher-- at a time when seasonal factors in the CPI, and especially in the PPI, want to see further sharp declines.

USDA WEEKLY RATINGS OF CROP CONDITIONS

Date rated	Percentage of crop					Composite <sup>1</sup> rating	Yield <sup>2</sup> per acre	Ratio: yield/ rating
	Very Poor	Poor	Fair	Good	Excel- lent			
- - - - - CORN - - - - -								
1994: Jun 26	0	3	18	61	18	73.50	122.1	1.661
Jun 19	0	2	21	67	10	71.25	122.1	1.714
Jun 12	0	2	25	65	8	69.75	122.1	1.751
Jun 5	0	2	25	66	7	69.50	122.1	1.757
1993: Jun 27	1	6	36	51	6	63.75	122.7	1.925
<u>Season ending</u>								
1993: Oct 3	3	12	36	44	5	59.00	100.7	1.707
1992: Oct 4	2	3	16	61	18	72.50	131.4	1.812
1991: Oct 6	5	9	33	44	9	60.75	108.6	1.788
1990: Sep 30	1	4	20	63	12	70.25	118.5	1.687
1989: Oct 1	2	8	24	54	12	66.50	116.3	1.749
1988: Sep 4	10	36	37	14	3	41.00	84.6	2.063
- - - - - SOYBEANS - - - - -								
1994: Jun 26	1	3	25	63	8	68.50	35.0	.511
Jun 19	0	3	29	63	5	67.50	35.0	.51
1993: Jun 27	1	7	38	50	4	62.25	35.1	.564
<u>Season ending</u>								
1993: Oct 3	3	11	40	41	5	58.50	32.0	.547
1992: Oct 4	1	2	19	64	14	72.00	37.6	.522
1991: Oct 6	5	9	33	44	9	60.75	34.2	.563
1990: Sep 30	2	9	35	48	6	61.75	34.0	.551
1989: Oct 1	2	8	37	47	6	61.75	32.3	.523
1988: Sep 4	5	23	50	20	2	47.75	27.0	.565

1. The composites, which are constructed by the Federal Reserve staff, are weighted averages of the percentages reported by the USDA. We have used the following weights: excellent = 1.00; good = .75; fair = .50; poor = .25; very poor = 0. As indicated in the right-hand column, an additional index point on the composite rating for corn appears to translate into a yield increment of about 1-3/4 bushels per acre. Similarly, an index point for soybeans translates into an increment in average yields of a bit more than 1/2 bushel per acre.

2. Yields are in bushels. Data for 1994 are the USDA's trend projections; those for June 1993 are the trend projections that were available as of that date. Other observations on yields represent the final outcomes for the years indicated.

More important for the longer-term food price outlook is the progress of this year's grain and oilseed crops. Production of these crops was hurt last year by the Midwest floods and other lesser disasters, and stocks are now at unusually low levels. Planting of this year's crops proceeded fairly smoothly during the spring, and the condition of the crops as of late June generally was good, with some improvement showing up as the month progressed. However, because July and August usually are the critical months for these crops, uncertainty about the potential size of the harvest could persist for several more weeks despite the favorable developments to date.

**DOMESTIC FINANCIAL  
DEVELOPMENTS**

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1  
SELECTED FINANCIAL MARKET QUOTATIONS  
(Percent except as noted)

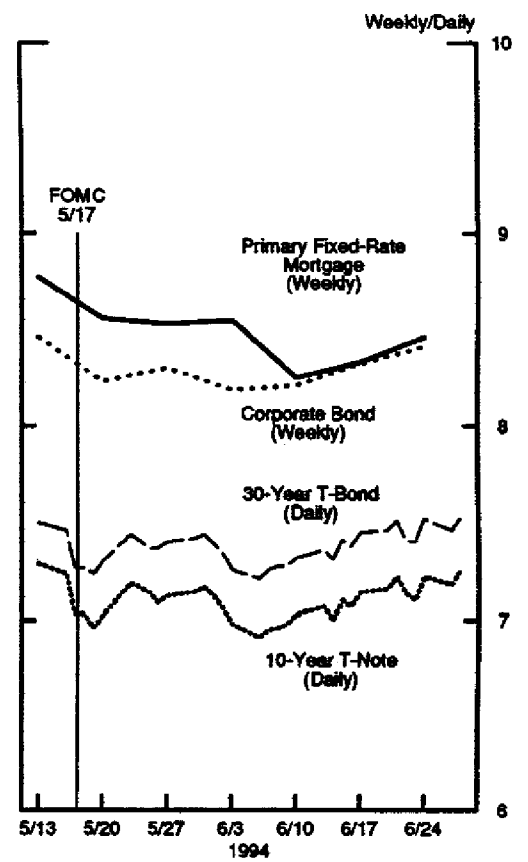
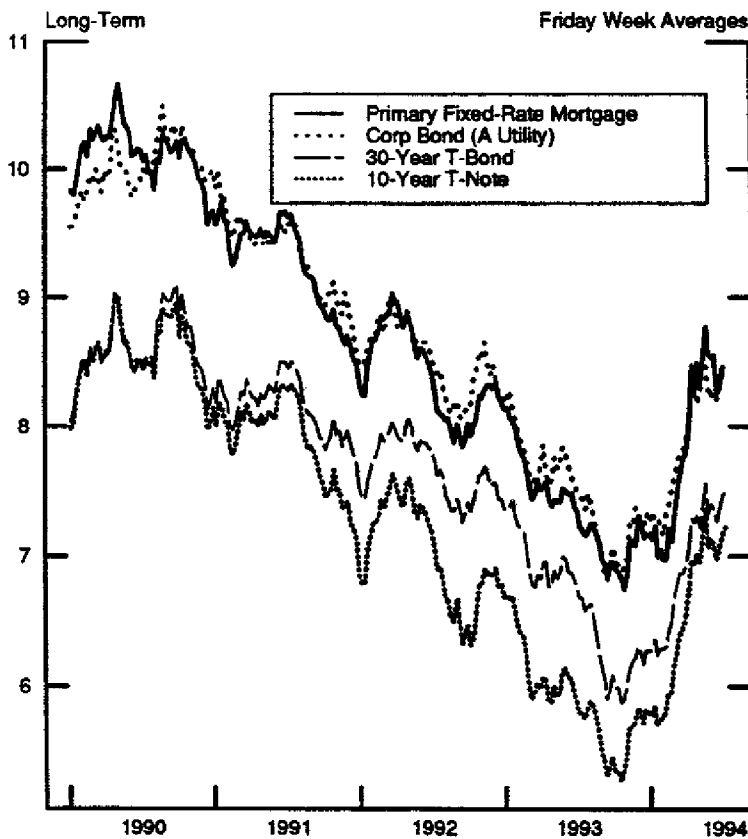
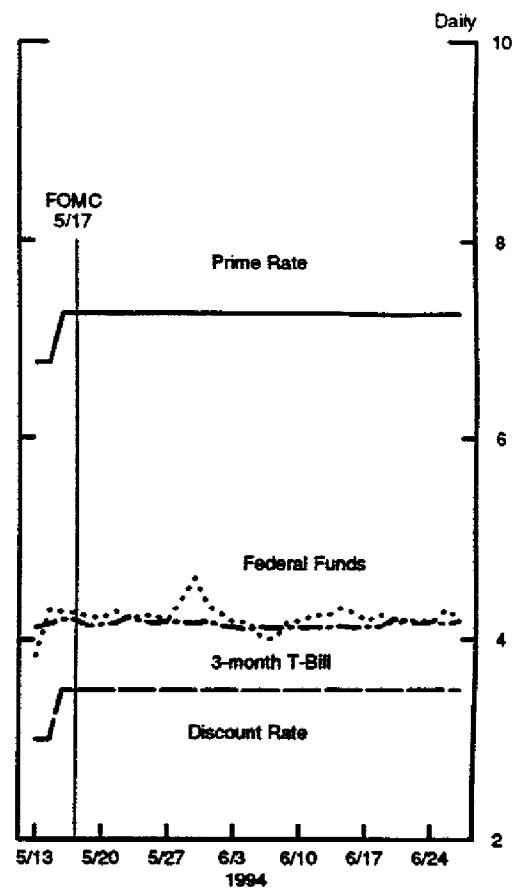
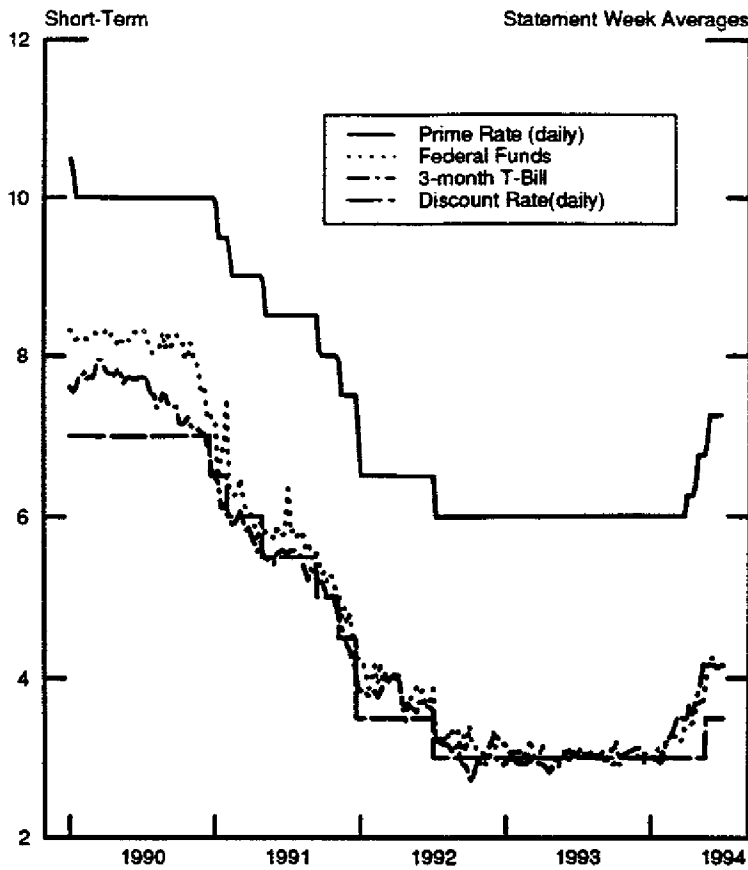
Instrument	1993		1994			Change to Jun 28, 1994:		
	Mid-Oct lows		Feb 3	FOMC.* May 17	Jun 28	From Mid-Oct lows	From Feb 3	From FOMC. May 17
<b>SHORT-TERM RATES</b>								
Federal funds <sup>2</sup>	3.07		3.07	3.73	4.20	1.13	1.13	.47
Treasury bills <sup>3</sup>								
3-month	3.01		3.13	4.15	4.18	1.17	1.05	.03
6-month	3.09		3.27	4.65	4.58	1.49	1.31	-.07
1-year	3.23		3.52	5.11	5.19	1.96	1.67	.08
Commercial paper								
1-month	3.13		3.16	4.37	4.44	1.31	1.28	.07
3-month	3.23		3.25	4.70	4.66	1.43	1.41	-.04
Large negotiable CDs <sup>3</sup>								
1-month	3.08		3.11	4.28	4.40	1.32	1.29	.12
3-month	3.22		3.25	4.61	4.65	1.43	1.40	.04
6-month	3.23		3.41	5.05	5.00	1.77	1.59	-.05
Eurodollar deposits <sup>4</sup>								
1-month	3.06		3.06	4.25	4.38	1.32	1.32	.13
3-month	3.25		3.25	4.63	4.63	1.38	1.38	.00
Bank prime rate	6.00		6.00	6.75	7.25	1.25	1.25	.50
<b>INTERMEDIATE- AND LONG-TERM RATES</b>								
U.S. Treasury (constant maturity)								
3-year	4.06		4.60	6.40	6.46	2.40	1.86	.06
10-year	5.19		5.81	7.24	7.26	2.07	1.45	.02
30-year	5.78		6.31	7.46	7.53	1.75	1.22	.07
Municipal revenue <sup>5</sup> (Bond Buyer)	5.41		5.49	6.60	6.43	1.02	.94	-.17
Corporate--A utility, recently offered <sup>6</sup>	6.79		7.35	8.20	8.41	1.62	1.06	.21
Home mortgages								
FHLMC 30-yr fixed rate	6.74		6.97	8.77	8.46	1.72	1.49	-.31
FHLMC 1-yr. adjustable rate	4.14		4.12	5.54	5.41	1.27	1.29	-.13
<b>Stock exchange index</b>								
	Record high		1989	1994		Percentage change to Jun 28:		
	Level	Date	Low, Jan. 3	FOMC.* May 17	Jun 28	From record high	From 1989 low	From FOMC.* May 17
Dow-Jones Industrial	3978.36	1/31/94	2144.64	3671.50	3669.64	-7.76	71.11	-.05
NYSE Composite	267.71	2/2/94	154.00	245.78	245.80	-8.18	59.61	.01
NASDAQ (OTC)	803.93	3/18/94	378.56	711.91	702.05	-12.67	85.45	-1.39
Wilshire	4804.31	2/2/94	2718.59	4404.46	4400.52	-8.40	61.87	-.09

1. One-day quotes except as noted.  
2. Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for maintenance period ending Jul 6, 1994.  
3. Secondary market.

\* Rates are as of the close on May 16, 1994.

4. Bid rates for Eurodollar deposits at 11 a.m. London time.  
5. Most recent observation based on one-day Thursday quote and futures market index changes.  
6. Quotes for week ending Friday previous to date shown.

# Selected Interest Rates\* (percent)



\* Statement weeks are plotted through Jun 22; Friday weeks through Jun 24, 1994.

Short-term interest rates rose slightly in the wake of the half-point increases of the federal funds and discount rates on the day of the May FOMC meeting, while intermediate- and long-term rates fell appreciably. Most observers interpreted the size of the action and the accompanying press release as implying that further tightening was unlikely soon. Major commercial banks followed the firming moves by boosting the prime rate 50 basis points, bringing the rate to 7-1/4 percent, and preserving its wide spread over the federal funds rate.

Since that initial response, market interest rates generally have been buffeted by cross-currents in economic news and weakness in the exchange value of the dollar. In recent days, persistent downward pressure on the dollar has prompted a backup in long-term rates on renewed concerns about potential inflation and speculation about System tightening. The yield on the thirty-year Treasury bond, for example, has retraced its initial drop and now stands slightly above the level prevailing prior to the May FOMC meeting. Major equity price indexes are little changed to down 1-1/2 percent.

Net inflows to stock mutual funds slowed a bit in May but appear to have increased in early June; flows to bond funds have turned positive in recent weeks, after three consecutive monthly declines. Retail money market funds have begun to run off, reversing the pattern of the past couple of months when investors moved from long-term funds into money market accounts. With the impetus from money funds gone and opportunity costs of holding deposits much higher, M2 growth was flat in May and appears likely



MONETARY AGGREGATES  
(Based on seasonally adjusted data)

Aggregate or component	1993	1994		1994			1993:Q4 to Jun 94 (pe)	Level (bil \$) May 94
		Q1	Q2 (pe)	Apr.	May	Jun. (pe)		
Aggregate		Percentage change (annual rate) <sup>1</sup>						
1. M1	10.5	6.0	2	-1.2	2.0	4	4	1143.2
2. M2	1.4	1.8	1½	2.3	0.3	-3	1	3590.4
3. M3	0.6	0.2	-½	2.1	-2.7	0	-½	4213.2
Selected components								
4. M1-A	11.7	9.5	3½	2.3	-0.3	5	6	731.6
5. Currency	10.3	11.8	10½	8.7	10.0	10	11½	337.6
6. Demand deposits	13.3	7.7	-2½	-3.4	-9.6	2	2	385.8
7. Other checkable deposits	8.4	-0.2	-½	-7.0	6.2	2	0	411.6
8. M2 minus M1	-2.3	-0.1	1	3.9	-0.5	-6	0	2447.2
9. Overnight RPs and Eurodollars, n s a	11.6	19.9	-4½	-45.4	-5.1	8	7	93.7
10. General-purpose and broker- dealer money market funds	-2.1	-0.1	17½	45.1	12.0	-20	6	365.1
11. Commercial banks	-1.0	0.7	-2	-2.9	-1.5	0	-½	1248.2
12. Savings deposits	4.2	4.3	-3	-3.2	-6.2	-6	-½	784.1
13. Small time deposits	-8.6	-5.2	½	-2.6	6.2	9	-1	464.0
14. Thrift institutions	-5.8	-4.6	-3	-1.1	-4.2	-8	-4	736.9
15. Savings deposits	0.6	0.5	½	2.2	-1.9	-9	½	431.7
16. Small time deposits	-13.2	-11.5	-7½	-6.2	-7.0	-6	-8½	305.2
17. M3 minus M2	-3.5	-8.6	-9½	1.1	-19.9	14	-7½	622.8
18. Large time deposits	-6.9	-4.7	-4	-1.5	9.1	4	-3	333.0
19. At commercial banks <sup>3</sup>	-6.6	-3.6	-3½	-3.1	16.9	5	-1½	273.1
20. At thrift institutions	-8.2	-9.5	-7½	5.9	-27.5	2	-8½	59.8
21. Institution-only money market mutual funds	-5.4	-26.8	-23½	-2.7	-52.2	-4	-23½	169.3
22. Term RPs, n s a	16.8	-16.5	16	36.8	-33.2	76	5	91.4
23. Term Eurodollars, n s a	-0.9	5.2	16	22.5	-2.5	27	11½	48.7
Average monthly change (billions of dollars) <sup>2</sup>								
Memo								
24. Managed liabilities at com'l. banks (lines 25 + 26)	5.5	22.9	10½	36.6	-4.3	-2	. .	933.9
25. Large time deposits, gross	-2.3	-3.3	2	0.4	6.4	-1	. .	340.5
26. Nondeposit funds	7.8	26.2	8	36.2	-10.7	-1	. .	593.4
27. Net due to related foreign institutions	4.5	12.7	9	14.9	1.4	11	. .	173.8
28. Other <sup>4</sup>	3.3	13.5	-1	21.4	-12.2	-12	. .	419.6
29. U.S. government deposits at commercial banks <sup>5</sup>	0.2	0.2	-½	10.1	-3.1	-9	. . .	30.1

1. For years, "percentage change" is percentage change in quarterly average from fourth quarter of preceding year to fourth quarter of specified year. For quarters, it is the percentage change in quarterly average from preceding quarter to specified quarter, annualized.

2. For years, "average monthly change" is the dollar change from December to December, divided by 12. For quarters, it is the dollar change from the last month of the preceding quarter to the last month of the specified quarter, divided by 3.

3. Net of holdings of money market mutual funds, depository institutions, U.S. government, and foreign banks and official institutions.

4. Borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs, and other minor items). Data are partially estimated.

5. Treasury demand deposits and note balances at commercial banks.

to decline in June. The weakness in M2 has shown through to M3, which declined over the two months.

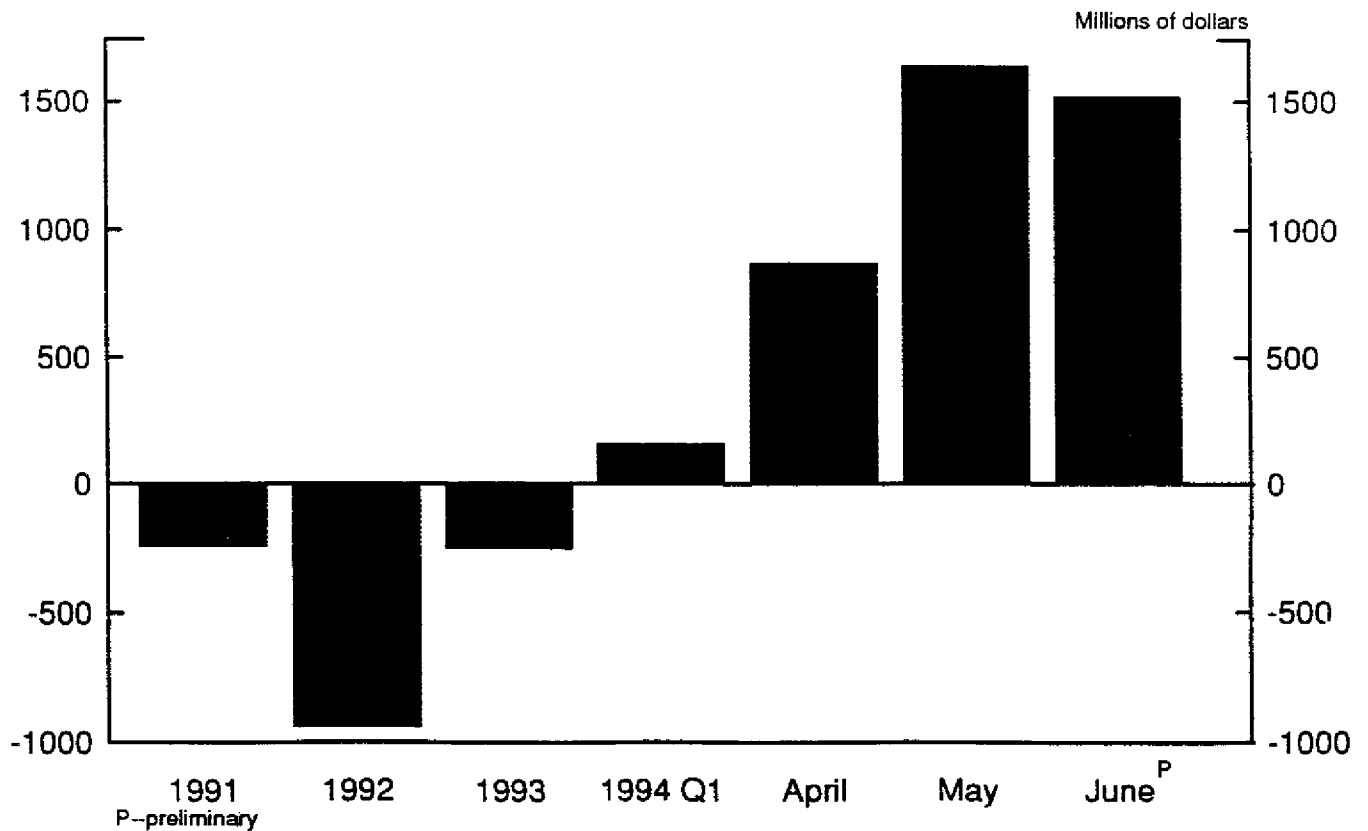
Business borrowing seems to have slowed slightly in the second quarter and a greater portion has been concentrated in shorter-maturity securities and in bank and finance company loans. With long-term interest rates more than 1-1/2 percentage points above their October lows, gross public issuance of bonds by nonfinancial corporations has continued at a reduced pace. Bond offerings by state and local governments also remain subdued, with few new refundings coming to market. Treasury borrowing has declined a bit more than seasonally in the second quarter, owing to stronger tax receipts and continued weakness in growth of outlays. In the household sector, available data suggest some slowing in home mortgage borrowing, while consumer credit growth continued at a brisk pace in April despite a substantial slowdown in auto-related credit.

#### Monetary Aggregates and Bank Credit

M2 was flat in May and is estimated to have declined at nearly a 3 percent rate in June. The boost to M2 growth earlier in the year that likely resulted from net redemptions of bond mutual funds appears to have largely disappeared in recent weeks. Bond mutual funds again began experiencing net cash inflows in late May, and retail money funds have begun to run off. The falloff in money growth also owes to rising opportunity costs resulting from the increase in short-term interest rates since early this year and the usual sluggish response of liquid deposit rates. Some household balances have been diverted from liquid deposits to small time deposits and thus remain within M2, while a portion has left the monetary aggregates, as evidenced by a significant pickup in noncompetitive tenders at Treasury auctions (chart). While retail

time deposits at banks posted increases in May and June, the first growth in more than three years, their acceleration falls well short of historical patterns, as depositories have not increased offering rates on them as quickly as in past episodes of increasing market rates. Demand deposits, and to a lesser extent money market deposit accounts, have been weakened not only by higher opportunity costs, but also by the continued slowing in mortgage prepayments associated with the backup in long-term rates over the past half year. Thus, despite sustained strong growth of currency, M1 grew at only a 2 percent rate in May and about a 4 percent rate in June, well below its rate of growth over the past three years.

Net Noncompetitive Tenders for Treasury Bills  
(Average monthly flows)



The weakness in M2 has shown through to M3, which declined at a 2-3/4 percent rate in May and appears to have been flat in June. Institution-only money market mutual funds, whose rates have lagged the rise in market rates, have dropped sharply, but some of the weakness in the non-M2 part of M3 has been offset by increases in large time deposits at banks. Banks have resumed raising funds through issuance of large CDs, while use of nondeposit sources, which had grown quite rapidly earlier in the year, has slowed.

Total bank credit is expected to expand at about a 4 percent rate in June, up a bit from the very weak May pace but well below growth registered earlier in the year. The weakness in bank credit in May and June mainly reflected runoffs of U.S. government securities at large domestic banks and foreign banks, after two months of substantial acquisitions. Securities sales at two domestic banks and one foreign bank in May accounted for a large fraction of the decline. Reported holdings of securities in May likely were also depressed by the revaluation of available-for-sale and trading account securities, as bond interest rates rose on balance over the month.<sup>1</sup> Growth of other securities, meanwhile, remained strong in May, with all of the strength recorded at branches and agencies of foreign banks, several of which bought large amounts of foreign government securities. In June, holdings of government and other securities rose only slightly.

Loan growth averaged 4 percent in the May-June period. Business loans slowed in May from a robust April pace and are expected to expand at only a 1 percent rate in June. The slowdown from earlier in the year mainly occurred at large domestic and

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1. Under FASB 115, banks are required to mark to market government securities considered available for sale as well as those in trading accounts. According to the March 1994 Call Report, 60 percent of Treasury securities and 55 percent of agency pass-throughs were classified as "available for sale," and about 4 percent of government securities were held in trading accounts.

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT<sup>1</sup>  
 (Percentage change at annual rate, based on seasonally adjusted data)

Type of credit	Dec. 1992 to Dec. 1993	1994 Q1	1994 Q2 p	1994 Apr.	1994 May	1994 Jun. p	Level, May 1994 (Billions)
Commercial bank credit							
1. Total loans and securities	5.3	7.9	5	10.1	2.1	4	3,198.2
2. Securities	8.5	17.2	7	21.2	-1.7	2	965.5
3. U.S. government	9.6	11.5	3	18.0	-10.4	2	752.2
4. Other	4.4	39.5	22	33.8	30.0	2	213.3
5. Loans	4.0	4.0	5	5.4	3.9	4	2,232.8
6. Business	-1.8	8.4	8	13.5	8.0	1	606.6
7. Real estate	4.5	.1	3	2.8	1.8	6	944.7
8. Consumer	9.0	10.6	10	18.2	9.7	3	410.7
9. Security	35.1	-18.3	-3	-92.2	9.4	79	77.5
10. Other	-.6	6.3	-8	8.0	-12.9	-20	193.2
Short- and intermediate-term business credit							
11. Business loans net of bankers acceptances	-2.1	8.5	7	11.4	8.5	1	597.1
12. Loans at foreign branches <sup>2</sup>	-12.1	-7.4	21	45.1	16.3	0	22.4
13. Sum of lines 11 and 12	-2.5	7.9	7	12.6	8.8	1	619.5
14. Commercial paper issued by nonfinancial firms	4.4	-12.2	-2	-11.0	-15.8	21	149.5
15. Sum of lines 13 and 14	-1.1	3.7	6	7.7	4.1	5	769.0
16. Bankers acceptances, U.S. trade-related <sup>3,4</sup>	-12.2	17.9	n.a.	11.4	n.a.	n.a.	21.2 <sup>5</sup>
17. Loans at finance companies <sup>4</sup>	-.5	9.4	n.a.	15.3	n.a.	n.a.	317.0 <sup>5</sup>
18. Total (sum of lines 15, 16, and 17)	-1.2	5.6	n.a.	10.0	n.a.	n.a.	1,104.6 <sup>5</sup>

1. Except as noted, levels are averages of Wednesday data and percentage changes are based on averages of Wednesday data; data are adjusted for breaks caused by reclassification; changes are measured from preceding period to period indicated.

2. Loans to U.S. firms made by foreign branches of domestically chartered banks.

3. Acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.

4. Changes are based on averages of month-end data.

5. April 1994.

p Preliminary.

n.a. Not available.

foreign banks, which apparently had benefited from business credit demands deflected from capital markets. Preliminary evidence from the Survey of Terms of Bank Lending suggests that loan pricing for some very large loans continues to be aggressive, but loan spreads overall are little changed from a year ago. Consumer lending slowed in both May and June, largely reflecting a strong pickup in securitizations. Adjusted for securitizations, consumer loans expanded at a double-digit pace in both months.

Growth of real estate loans slowed in May to near a 2 percent rate but are expected to rise in June at about a 6 percent pace. This would bring growth in the second quarter to about 3 percent at an annual rate, following a flat first quarter. The March Call Report shows that the weakness in real estate lending in the first quarter was attributable mainly to its residential mortgage component, although commercial lending edged down over the period. Part of the increase in real estate loans at banks since the end of the first quarter may owe to increased consumer demand for adjustable-rate mortgages, which banks and savings institutions prefer to hold in portfolio rather than to sell off. In addition, now that opportunities for cashing out home equity provided by last year's mortgage refinancing activity have come to an end, growth of home equity loans has picked up to the fastest pace since April of last year.

#### Mutual Funds

The weakness in mutual funds continued through mid-May, but inflows appear to have since picked up. Data for May and for early June show a substantial increase in net sales of equity funds, with bond funds posting inflows for the first time since March.

Among equity funds, net sales of international funds stabilized in May, after declining in each of the preceding two months. Trade

reports attributed the change to renewed interest in funds that invest primarily in the Japanese market. Net sales of domestic equity funds slowed in May, but appear to have edged up in early June and on average remain near the healthy pace of recent quarters.

NET SALES OF MUTUAL FUNDS CLASSIFIED BY TYPE  
(Billions of dollars, monthly rate)

Type of fund	1993			1994			Memo: Assets April 1994
	Q2	Q3	Q4	Q1	Apr.	May <sup>e</sup>	
Total stock and bond	22.8	23.8	24.2	17.6	8.7	7.5	
Total stock	10.6	10.9	14.7	13.8	11.7	9.5	784.7
International	2.2	4.1	5.8	6.2	3.0	3.2	136.3
Domestic	8.4	6.8	8.9	7.6	8.7	6.3	648.4
Total bond	12.2	12.9	9.5	3.8	-3.0	-2.0	725.8
GNMA	0.6	0.4	-0.9	-1.6	-1.4	-1.1	63.8
High yield	1.1	0.3	1.1	0.0	-0.4	0.9	45.8
Tax-exempt	4.1	3.9	2.7	1.0	-1.0	-0.9	240.1
International	0.3	1.2	0.7	0.4	-0.5	0.0	37.3
Other	6.1	7.1	5.9	4.0	0.3	-0.9	338.8

e Estimate.

Source: Investment Company Institute.

Bond funds continued to contract in May, as further outflows from mortgage and government bond funds offset a modest turnaround at high-yield bond funds. Weekly data for late May and early June show small net inflows to total bond funds, the first since February of this year. The turnaround in net sales owes mostly to income and tax-exempt funds, as mortgage and government funds again experienced outflows. Outflows from the latter are associated in part with losses on investments in derivative securities. In some instances, the funds' advisors have been forced to compensate shareholders for derivative losses and have had to buy derivative securities from the

funds to prevent further losses. SEC staff suggest that the published incidents are not isolated cases.

Losses requiring assistance from advisors also were recorded for some money market mutual funds, including a few advised by banks. Most notably, BankAmerica disclosed in June that it had injected \$17.4 million into its institutional money fund, after the fund had to sell assets at a loss to meet heavy redemptions. Without this injection, the net asset value of the money fund would have dropped below the one dollar per share mark.<sup>2</sup>

#### Business Finance

Yields on corporate bonds have risen slightly on net over the intermeeting period and are now about 1-1/2 percentage points above their lows last October. As a result, issuance in the bond market generally remained subdued, and offerings of nonfinancial firms were concentrated in short to intermediate maturities, with greater reliance on floating-rate issues. Gross public issuance of bonds by nonfinancial corporations picked up a bit in May and June, but at \$7-1/2 billion, is about \$3 billion short of the first-quarter pace and less than half the average monthly pace of last year (table). Offerings in the investment-grade sector have tended to come back somewhat, but with issuers returning to the sidelines during intermittent periods of market volatility. Junk bond issuance

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2. Representatives at the SEC indicate that certain types of variable-rate notes have been especially troublesome for money funds. During periods of high interest rate volatility, structured products such as "range notes" or "range accruals" and "index amortizing notes," for which the note holders may receive zero interest if rates move past a certain level in effect, can turn into principal-only instruments and expose a fund to high levels of market risk. There is a concern that investments in such derivative securities could possibly lock a mutual fund into a liquidity spiral; that is, as investors redeem shares, the fund is forced to sell liquid securities, leaving a greater proportion of the fund's assets in these risky securities. The SEC may deem these securities to be unsuitable investments for money funds.



GROSS OFFERINGS OF SECURITIES BY U.S. CORPORATIONS<sup>1</sup>  
 (Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1992	1993	1993		1994		
			Q4	Q1 <sup>p</sup>	Apr <sup>p</sup>	May <sup>p</sup>	Jun <sup>e</sup>
All U.S. corporations	40.84	53.46	51.78	53.00	33.28	37.41	31.00
Stocks <sup>2</sup>	7.04	9.60	10.89	8.35	7.48	3.91	5.00
Bonds	33.80	43.86	40.89	44.65	25.80	33.50	26.00
<u>Nonfinancial corporations</u>							
Stocks <sup>2</sup>	4.42	5.28	6.08	4.56	5.55	2.45	3.50
Sold in U.S.	4.03	5.12	6.08	3.99	3.63	2.23	3.10
Utility	.87	1.06	1.60	.65	.18	.37	n.a.
Industrial	3.16	4.00	4.48	3.34	3.45	1.86	n.a.
Sold abroad	.39	.16	.00	.56	1.92	.22	.40
Bonds	13.67	16.20	12.41	11.20	6.77	7.47	7.50
Sold in U.S.	12.83	15.56	12.10	10.46	6.00	6.50	7.00
Utility	5.33	7.34	5.15	4.57	2.50	2.00	n.a.
Industrial	7.50	8.22	6.96	5.89	3.50	4.50	n.a.
Sold abroad	.84	.64	.31	.74	.77	.97	.50
By quality <sup>3</sup>							
Aaa and Aa	2.18	2.56	1.78	.80	.70	1.05	n.a.
A and Baa	7.74	8.71	5.78	5.52	3.39	2.92	n.a.
Less than Baa	2.86	4.17	4.45	3.91	1.75	2.40	n.a.
Unrated or rating unknown	.09	.09	.10	.00	.00	.00	n.a.
<u>Financial corporations</u>							
Stocks <sup>2</sup>	2.62	4.61	5.30	3.79	1.92	1.46	1.50
Sold in U.S.	2.51	4.16	4.73	3.52	1.72	1.35	1.40
Sold abroad	.11	.45	.57	.27	.21	.12	.10
Bonds	20.13	27.66	28.48	33.45	19.03	26.03	18.50
Sold in U.S.	18.67	25.10	26.05	29.08	17.00	22.00	17.00
Sold abroad	1.46	2.56	2.44	4.37	2.03	4.03	1.50
By quality <sup>3</sup>							
Aaa and Aa	1.55	1.87	1.57	3.27	4.19	1.78	n.a.
A and Baa	6.77	8.99	8.78	11.17	5.79	8.70	n.a.
Less than Baa	.31	.49	.69	.66	.12	.10	n.a.
Unrated or rating unknown	.04	.08	.13	.02	.17	.03	n.a.

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.

2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.

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

p Preliminary. e Staff estimate.

rebounded slightly in May and strengthened further in early June, as inflows into junk bond funds resumed, bringing yield spreads in a bit. Junk issuance, however, still remains low relative to last year's monthly volumes.

Bond offerings by utilities have slowed markedly of late, as negative indications regarding utility sector prospects continue to trickle out. Moody's issued a report that suggested that the current cost of generating electricity varies across utilities much more than previously believed, suggesting that many of them will be hard-pressed in a more competitive environment. Separately, Moody's downgraded about \$5.3 billion of Long Island Lighting Company's debt, citing high costs and economic difficulties in the company's service area, as well as concerns about the company's overall financial flexibility. Several major California utilities remain on Standard and Poor's CreditWatch with negative implications; electricity prices in California are expected to come under downward pressure owing to the state utility commission's plan to spur competition by allowing customers to choose among suppliers.

Gross public equity issuance by nonfinancial corporations dropped sharply in May, to \$2.5 billion, about half the pace of the first four months of the year. There were no large issues, and while the number of initial public offerings remained sizable, all were very small. Prices and volumes of IPOs have generally come in well below issuers' expectations. Equity issuance appears to have edged up somewhat in June, but offerings remain sporadic. Issuance by financial firms in June is expected to be lifted a tad over the May pace by some large REIT offerings.

Stock prices were quite volatile over the intermeeting period, but, on balance, most major indexes are little changed from mid-May levels. The NASDAQ index, however, has lost ground since mid-May.

reflecting weakness in prices of small cap and high-tech businesses. Small bank stocks have held up well, spurred in part by the anticipation of further consolidation within the industry. Among the industrials, the basic materials group--which includes producers of steel, aluminum, and paper--registered the only gains since mid-May.

#### State and Local Government Finance

Gross issuance of long-term tax-exempt debt was \$12.4 billion in May, slightly above April's sluggish pace of about \$10 billion. The volume of new offerings thus far in June suggests issuance for the month as a whole will total roughly \$12 billion. As a consequence, the second quarter will likely post the lowest level of gross issuance since the first quarter of 1991. The slowdown reflects a sharp drop in advance refundings. The volume of offerings to raise new capital appears to be up slightly in the second quarter from the reduced level recorded in 1993.<sup>3</sup>

In line with past seasonal patterns, short-term volume is estimated to have jumped in June to about \$6-3/4 billion from less than \$1 billion in May. Short-term issuance will likely continue to be heavy throughout the summer months before declining sharply over the remainder of the year. This pattern largely reflects the adoption of budgets at this time of the year by many state and local government units that, in turn, authorize these entities to borrow to cover working capital needs in the new fiscal year.

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3. Attracting considerable attention in June was an offering of 100-year revenue bonds by the Port Authority of New York and New Jersey. The bonds are noncallable for thirty years and reportedly were sold to a handful of institutional investors. The issue is thought by market observers to be the first 100-year bond during this century, although it is not the longest on record. In the late 1860s and early 1870s, a small municipality outside New York City, in anticipation of being annexed by the city, sold noncallable bonds maturing in 2147 to finance road construction.

GROSS OFFERINGS OF MUNICIPAL SECURITIES  
(Monthly rates, not seasonally adjusted, billions of dollars)

	1992	1993	1993	1994				
			Q4	Q1	Q2 <sup>P</sup>	April	May <sup>P</sup>	June <sup>P</sup>
Total offerings <sup>1</sup>	21.8	27.8	24.4	18.5	14.5	11.0	13.4	19.1
Total tax-exempt	21.2	27.1	23.6	17.7	14.2	10.7	13.2	18.7
Long-term	17.9	23.3	21.5	15.5	11.5	10.1	12.4	12.0
Refundings <sup>2</sup>	7.9	15.7	13.7	7.4	2.9	2.0	3.3	3.5
New capital	10.0	7.6	7.8	8.1	8.6	8.1	9.1	8.5
Short-term	3.3	3.8	2.1	2.2	2.7	.6	.8	6.7
Total taxable	.6	.7	.8	.8	.3	.3	.2	.4

1. Includes issues for public and private purposes.

2. Includes all refunding bonds, not just advance refundings.

p Preliminary.

From the last FOMC meeting through early June, yields on tax-exempt bonds generally declined relative to those on taxable bonds. Investors began to focus on the implication of an estimated \$29 billion of bond retirements in July. Retirements of this magnitude would represent nearly 2-1/2 percent of the outstanding stock of tax-exempt bonds and would be more than double the level of retirements experienced during July in the past two years.<sup>4</sup> A

4. These retirements largely represent bonds reaching their first call date that were issued in the mid 1980s, a period of exceptionally heavy issuance. Most of these bonds have been pre-refunded and thus are scheduled to be redeemed. Those that have not been pre-refunded are likely to be called and refinanced with current offerings, as bond yields now are well below those prevailing during the mid 1980s. January and July are the most common anniversary months for tax-exempt bonds, and thus the level of retirements swells during these two months relative to those in other months.

TREASURY FINANCING<sup>1</sup>  
(Total for period: billions of dollars)

Item	1994		1994		
	Q2 <sup>P</sup>	Q3 <sup>P</sup>	Apr.	May	June <sup>2</sup>
Total surplus/deficit (-)	3.2	-57.4	17.5	-32.1	17.7
Means of financing deficit:					
Net cash borrowing/repayments(-)	9.8	50.8	-21.8	27.7	3.9
Nonmarketable	2.2	.7	1.3	1.0	-.1
Marketable	7.6	50.1	-23.1	26.7	4.1
Bills	-23.1	12.4	-15.8	-5.1	-2.2
Coupons	30.7	37.7	-7.3	31.8	6.3
Decrease in the cash balance	-7.8	6.1	-4.1	21.5	-25.3
<sup>2</sup> Other	-5.1	.4	8.5	-17.1	3.6
Memo:					
Cash balance, end of period	52.4	46.3	48.7	27.2	52.4

1. Data reported on a payment basis.

2. Includes checks issued less checks paid, accrued items, and other transactions.

p--Projected.

Note: Details may not add to totals because of rounding.

NET CASH BORROWING OF FEDERALLY SPONSORED CREDIT AGENCIES<sup>1</sup>  
(Billions of dollars)

Agency	1993		1994	1994	
	Q3	Q4	Q1	Apr.	May
FHLBs	5.4	8.9	5.7	6.2	--
FHLMC	17.1	-2.7	12.9	2.7	5.7
FNMA	19.3	5.3	15.3	2.4	--
Farm Credit Banks	-.1	1.5	-.7	.2	-.1
SLMA <sup>2</sup>	-.1	1.0	1.3	--	--
FAMC <sup>2</sup>	0	0	0	0	0

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

2. Federal Agricultural Mortgage Corporation.

reduction in the pace of selling by tax-exempt bond funds also contributed to the better performance of municipal bonds. More recently, however, renewed selling pressure from bond funds, which apparently has come despite modest inflows of new cash, has caused tax-exempt yields to back up more than long-term Treasury rates.

Moody's Investor Service has placed its Aa rating of California's bonds under review for a possible downgrade. The rating agency has expressed concern that the proposed budget for fiscal year 1995 does not include satisfactory remedies for the \$3 billion shortfall accumulated from the past two years and a projected \$1 billion deficit in the upcoming fiscal year. The governor's budget plan calls for the deficit to be covered with short-term borrowing that would not be paid off fully until the 1996 fiscal year. However, the state's attorney general has stated that this would constitute deficit financing and therefore is illegal. Yields on outstanding California bonds were not affected by Moody's announcement, as the bonds already trade as if they carry a lower rating. Standard and Poor's rates California's bonds as A+.

#### Federal Finance

The federal budget is projected to run a small surplus in the second quarter, reflecting the seasonal inflow of federal tax receipts. Nonetheless, the Treasury added to its cash balance by borrowing about \$7-1/2 billion in the market, raising \$31 billion in coupon auctions while paying down \$23 billion in bills. The Treasury had pared weekly bill offerings in mid-June to \$22 billion, but more recently increased auction sizes again to \$24 billion, ahead of a sizable deficit projected for the third quarter. The staff currently projects a third-quarter budget deficit of roughly \$57 billion, which the Treasury is expected to finance through

\$50 billion of marketable borrowing, once again concentrated in coupon offerings; bills are expected to raise only \$12 billion.

During the intermeeting period, yield spreads on government-sponsored agency securities have stabilized, but they remain above levels prevailing before the System's tightening actions. Spreads on ten-year issues are now about 30 basis points above Treasuries, roughly 10 basis points greater than the fourth-quarter average, while spreads on one-year to two-year securities have more than doubled to near 15 basis points. Debt issuance by government-sponsored agencies has slowed recently from the rapid first-quarter pace, primarily because of a drop in offerings by FNMA and FHLMC. However, gross issuance by the two housing agencies is expected to be boosted in coming months by sales of global debentures. FNMA sold \$1.5 billion of global debentures in late June, the first ever by a government-sponsored agency. FHLMC recently announced plans to offer \$1.5 billion of five-year global notes in July.

#### Mortgage Markets

Interest rates on conventional, thirty-year, fixed-rate mortgages have declined roughly 30 basis points on net since the last FOMC meeting. Initial rates on one-year, adjustable-rate mortgages, meanwhile, have declined about 15 basis points. The initial rate advantage of ARMs when compared to FRMs now favors ARMs by more than 3 percentage points. Thus, with long-term interest rates remaining well above their lows of last year, the ARM share of loan originations at most major institutional lenders has surged. According to the Federal Housing Finance Board, 36 percent of conventional mortgage loans closed in May carried adjustable rates, up from 31 percent in April and 23 percent in March. The May ARM share is the highest proportion since June 1989.

A sign that higher mortgage interest rates may have discouraged some homebuyers is evident in the Mortgage Bankers Association's index of applications for loans to purchase new and existing homes, which has continued to edge lower in recent weeks. Growth of total real estate loans at banks slowed in May but appears to have strengthened in June, boosting the average for the second quarter to about a 3 percent seasonally adjusted annual rate.

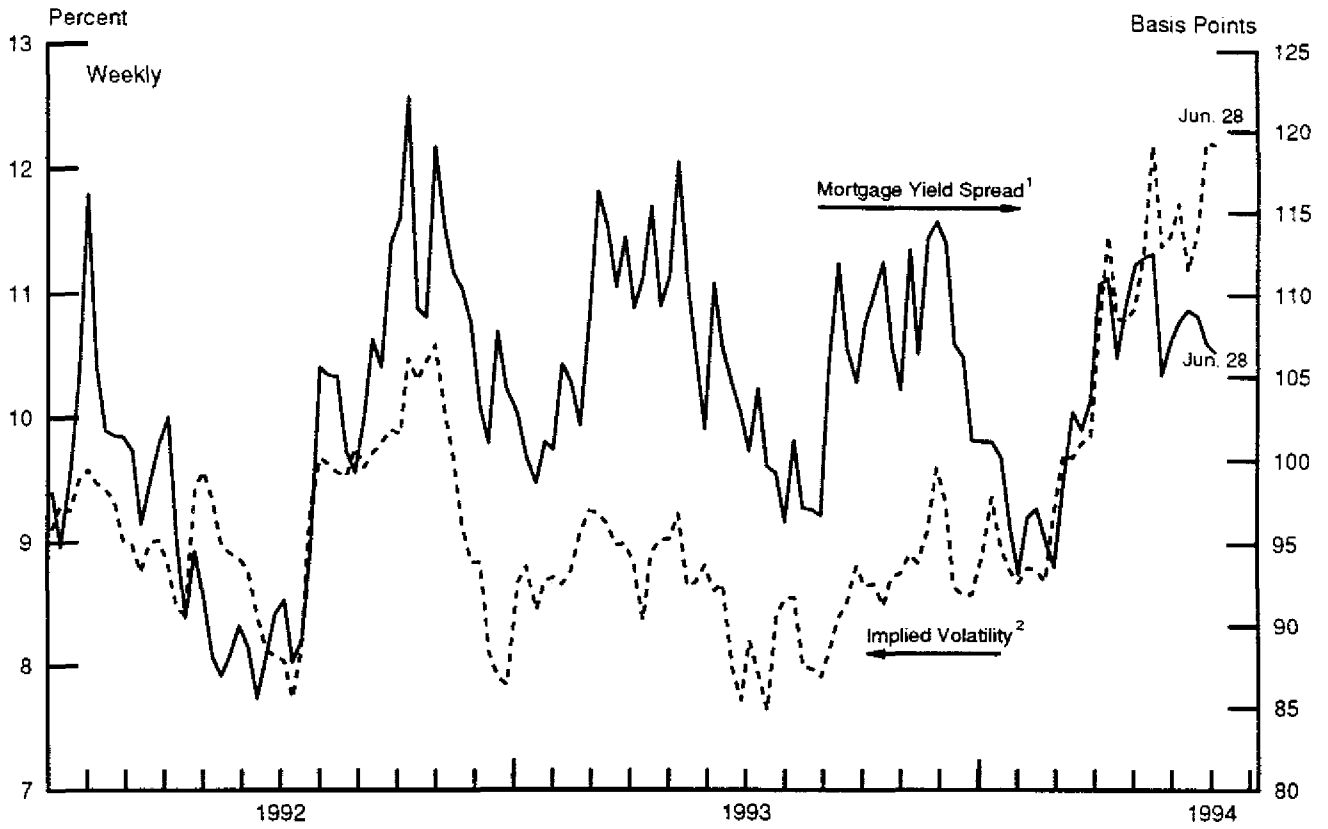
In the secondary mortgage market, spreads on thirty-year conventional, mortgage-backed pass-through securities have fluctuated in recent weeks but have changed little, on net, despite high volatility (chart), a flatter yield curve, and the lack of significant demand for REMIC collateral. These factors, which typically would be expected to exert upward pressure on mortgage-to-Treasury yield spreads, have been offset for the most part by a dwindling supply of new pass-through issues. Gross issuance of agency pass-throughs slowed again in May (chart), as refinancing volume declined further and single-family housing activity continued to ease. Net issuance edged up in April and May but remains well below the first quarter's record pace.

The pickup in net issuance owes in part to the slowdown in early repayments on existing mortgage securities. With the rise in mortgage interest rates since late last year, prepayments on agency mortgage-backed securities have slowed sharply in recent months (chart). The Mortgage Bankers Association's refinancing index, meanwhile, has continued to trend downward, suggesting that prepayments will probably slow a bit further in coming months.

In the multiclass sector, GNMA brought to market in late May its first ever REMIC issue, backed by \$500 million of 8 percent GNMA coupons. The issue was priced at spreads 5 to 10 basis points tighter than on REMICs backed by GNMA collateral issued by either

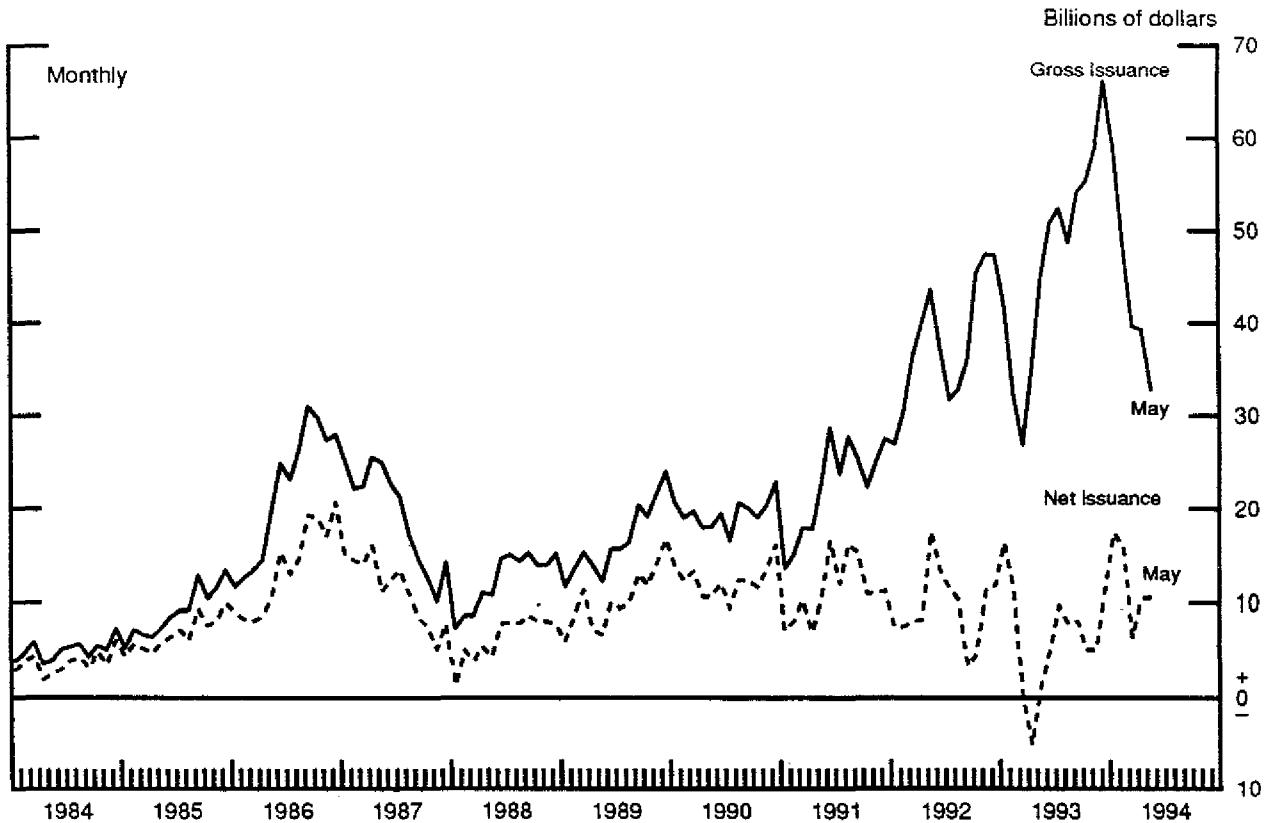


### Mortgage Yield Spread and Implied Volatility

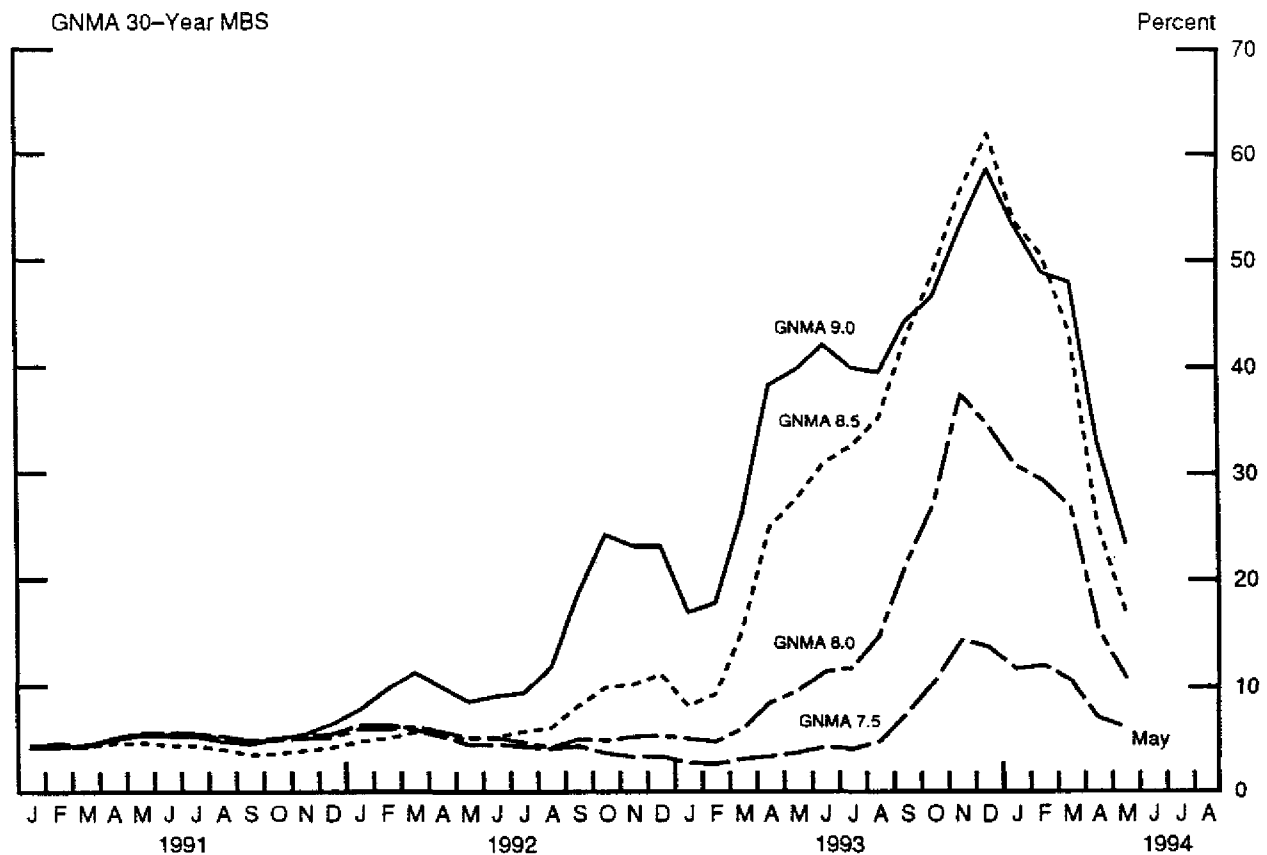
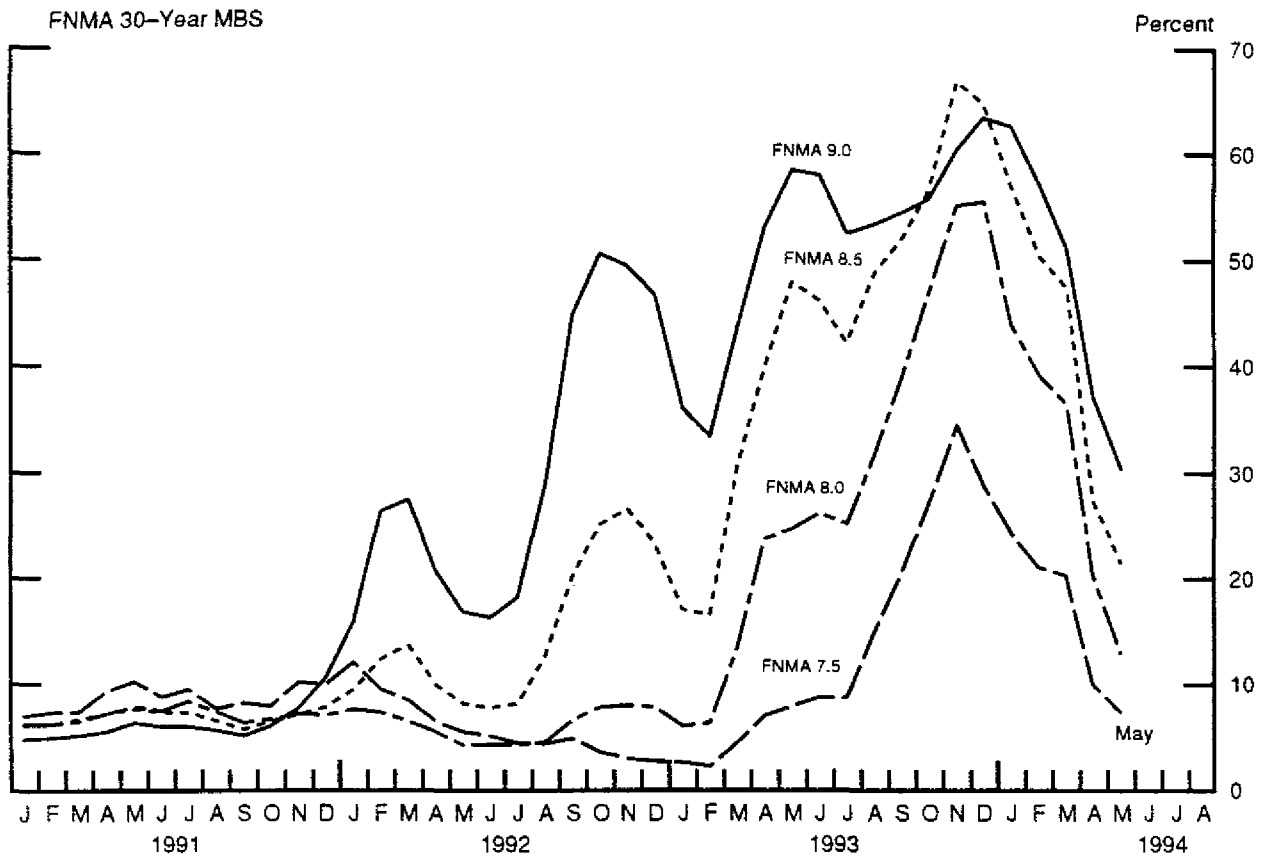


- 1 Yield spread is the FNMA 30-year mortgage-backed security current coupon less average of the yields on the 10-year and 7-year Treasury bonds.
- 2. Implied volatility is volatility of option price on Treasury bond futures contract.

### Agency Issuance of Mortgage Pass-Through Securities



Mortgage-Backed Security Prepayment Rates<sup>1</sup>  
 (Seasonally adjusted annual rate)



1. Prepayment rate is the annualized percentage of principal outstanding at the beginning of the month that prepays by the end of the month. Prepayment rates are shown for selected categories of MBS by security coupon rate.

GROWTH OF CONSUMER CREDIT  
(Percent change: seasonally adjusted annual rate)

Type of credit	1992 <sup>r</sup>	1993 <sup>r</sup>	1993	1994	1994		Memo: Outstanding April 1994 (Billions of dollars)
			Q4 <sup>r</sup>	Q1 <sup>r</sup>	Mar. <sup>r</sup>	Apr. <sup>r</sup>	
Installment	.2	9.3	11.6	12.9	20.1	12.4	834.4
Auto	-1.1	9.3	13.8	10.4	16.7	4.5	288.4
Revolving	3.8	11.2	12.3	15.4	24.1	19.1	295.2
Other	-2.0	7.3	8.4	13.0	19.3	13.5	250.8
Noninstallment	6.2	-5.3	14.1	-3.6	.6	-15.7	52.4
Total	.7	8.3	11.8	11.9	18.9	10.7	886.8

Type of loan	1991	1992	1993	1993	1994		
				Nov.	Feb.	Apr.	May
At commercial banks <sup>1</sup>							
New cars (48 mo.)	11.1	9.3	8.1	7.6	7.5	...	7.8
Personal (24 mo.)	15.2	14.0	13.5	13.2	12.9	...	13.0
Credit cards	18.2	17.8	16.8	16.3	16.1	...	16.2
At auto finance cos. <sup>2</sup>							
New cars	12.4	9.9	9.5	9.0	8.9	9.7	...
Used cars	15.6	13.8	12.8	12.4	12.2	13.3	...

1. Average of "most common" rate charged for specified type and maturity during the first week of the middle month of each quarter.

2. For monthly data, rate for all loans of each type made during the month regardless of maturity.

Note: Annual data are averages of quarterly data for commercial bank rates and of monthly data for auto finance company rates.

GROWTH OF CONSUMER INSTALLMENT CREDIT  
Originally published vs. revised  
(Percent change: seasonally adjusted annual rate)

Period	Total Installment		Automobile		Revolving		Other	
	Original	Revised	Original	Revised	Original	Revised	Original	Revised
1989 <sup>1</sup>	6.7	6.6	1.9	1.2	14.9	15.0	8.6	7.1
1990	2.0	2.2	-2.7	-3.3	12.1	11.6	-.8	1.2
1991	-.7	-.5	-8.4	-8.1	9.4	9.1	-1.0	-.4
1992	1.0	.2	-.5	-1.1	4.4	3.8	-.8	-2.0
1993	6.6	9.3	7.2	9.3	10.7	11.2	1.4	7.3
1992:Q1					4.5	2.3	-5.3	-0.5
					4.0	4.7	-3.4	-1.6
					2.7	1.6	-1.7	-1.6
					6.1	6.5	7.2	-4.4
1993:Q1	4.9	5.8	4.1	3.0	8.4	10.1	1.7	4.1
Q2	1.3	6.9	4.7	8.9	5.7	7.0	-7.8	4.6
Q3	8.5	11.8	7.9	10.5	15.7	13.6	.9	11.3
Q4	11.2	11.6	11.3	13.8	11.4	12.3	10.8	8.4
1994:Q1 <sup>P</sup>	9.0	12.9	6.6	10.4	10.2	15.4	10.4	13.0

FNMA or FHLMC. Zero-risk weighting for risk-based capital reportedly enhanced the willingness of insurance companies, pension funds, and banks to pay a premium for the GNMA-issued REMIC, while the full faith and credit guarantee attracted retail interest. Nonetheless, FNMA, not GNMA, was the largest issuer of REMICs backed by GNMA collateral. Out of a reported \$2.6 billion in GNMA-backed REMICs priced in May, an estimated \$2 billion were brought to market by Fannie. However, since that time, GNMA has brought four additional issues to market.

#### Consumer Credit

Growth of consumer installment credit slowed in April from the rapid advance recorded in March, but at 12-1/2 percent it remained close to its first-quarter pace.<sup>5</sup> Revolving credit again grew rapidly, while growth of auto and "other" credit slowed. Noninstallment credit contracted at a 15-3/4 percent annual rate in April.

Interest rates on consumer loans at commercial banks edged up between February and May. The average "most common" rate on a forty-eight-month new car loan rose about 1/4 percentage point, to 7.8 percent--still quite low by historical standards. Rates on personal loans and credit cards also inched up over the period to

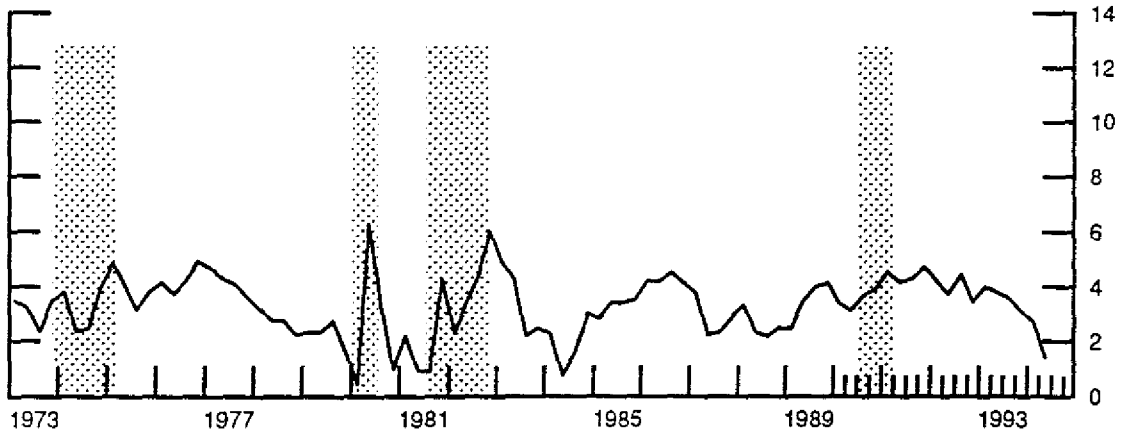
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5. The consumer installment credit data, scheduled for publication on July 8, have been revised from 1989 forward to incorporate annual benchmark revisions and new seasonal factor estimates (table, bottom panel). Changes in consumer indebtedness in earlier years were little affected by the annual benchmark revisions; however, growth in 1992 now is estimated to have been a bit less than estimated previously, while that for 1993 and the first quarter of 1994 is significantly more robust. Revised estimates for the more recent periods owe to the annual benchmarking of some series to Call Report data and to revisions in other series that reflect new data sources, including more complete information on pools of securitized assets held by institutions outside of current reporting panels. The largest overall revisions occurred in the "other" category; securitizations data have been weakest in this area and have benefited from the additional information received for pools of securitized assets.

COMMERCIAL BANK CONSUMER LOAN RATE SPREADS  
(Consumer Rate Less Yield on 3-Year Treasury Note)

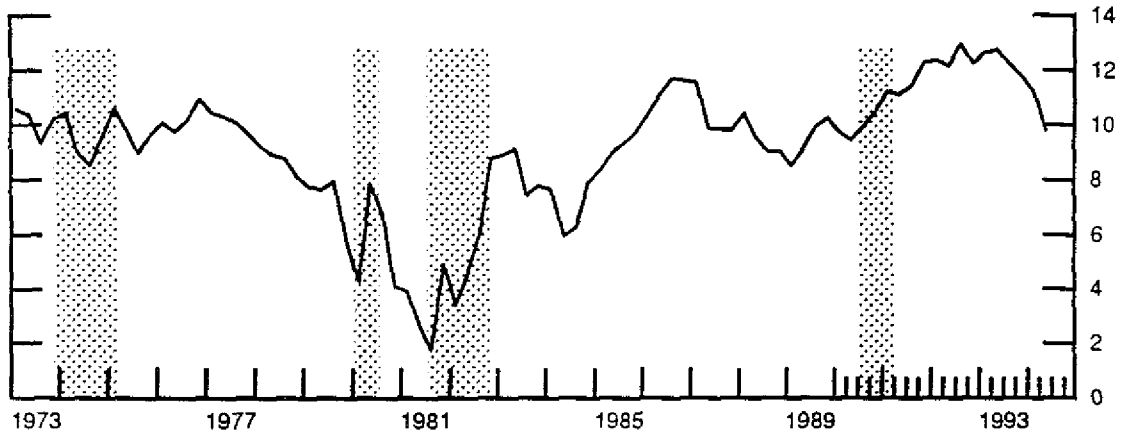
Auto

Percent



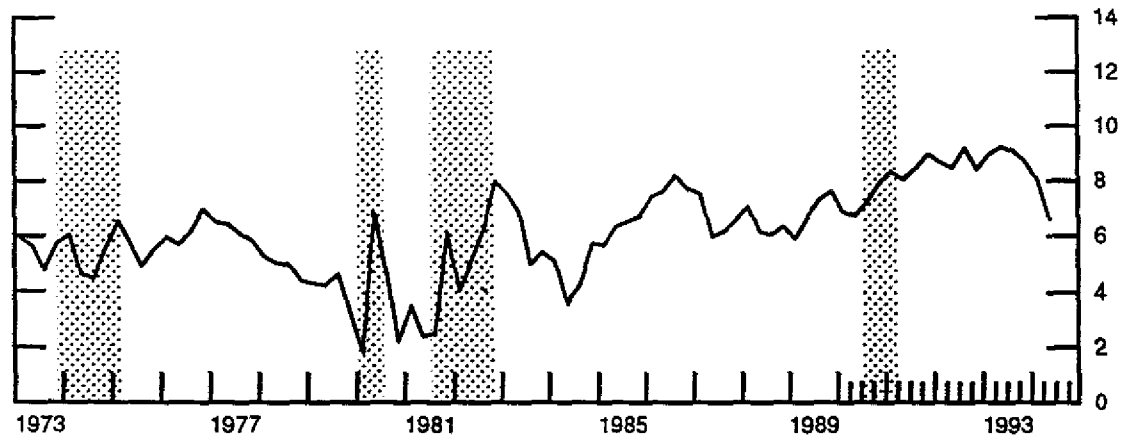
Credit cards

Percent



Personal

Percent

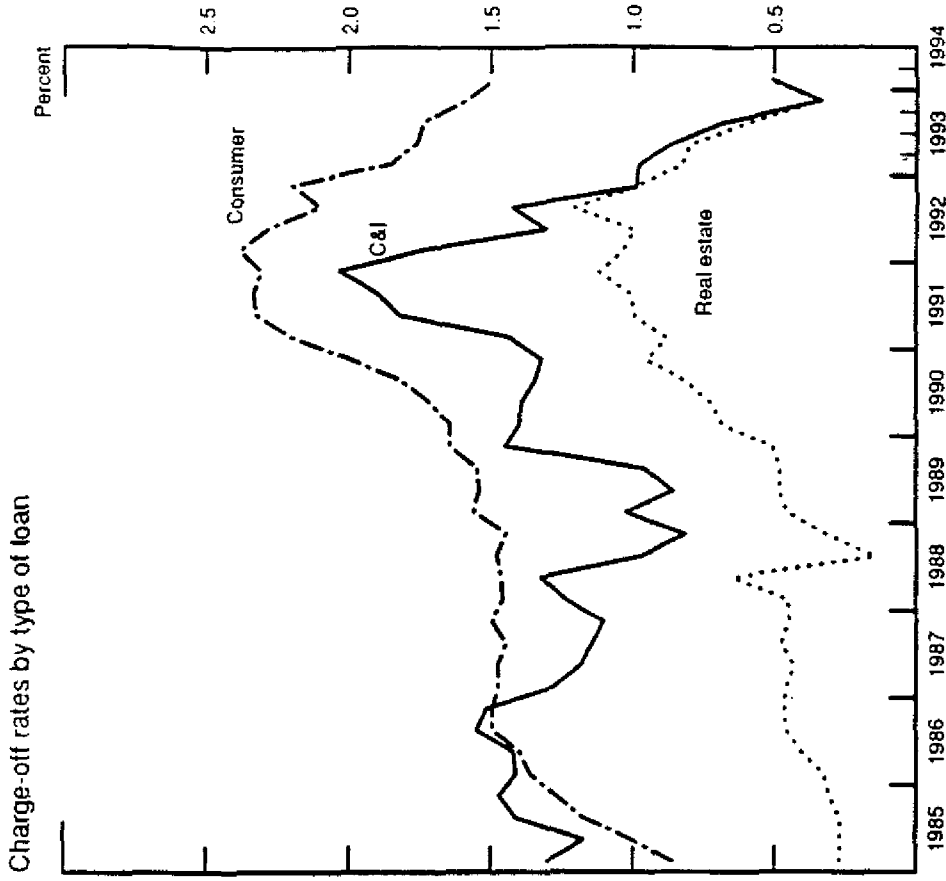
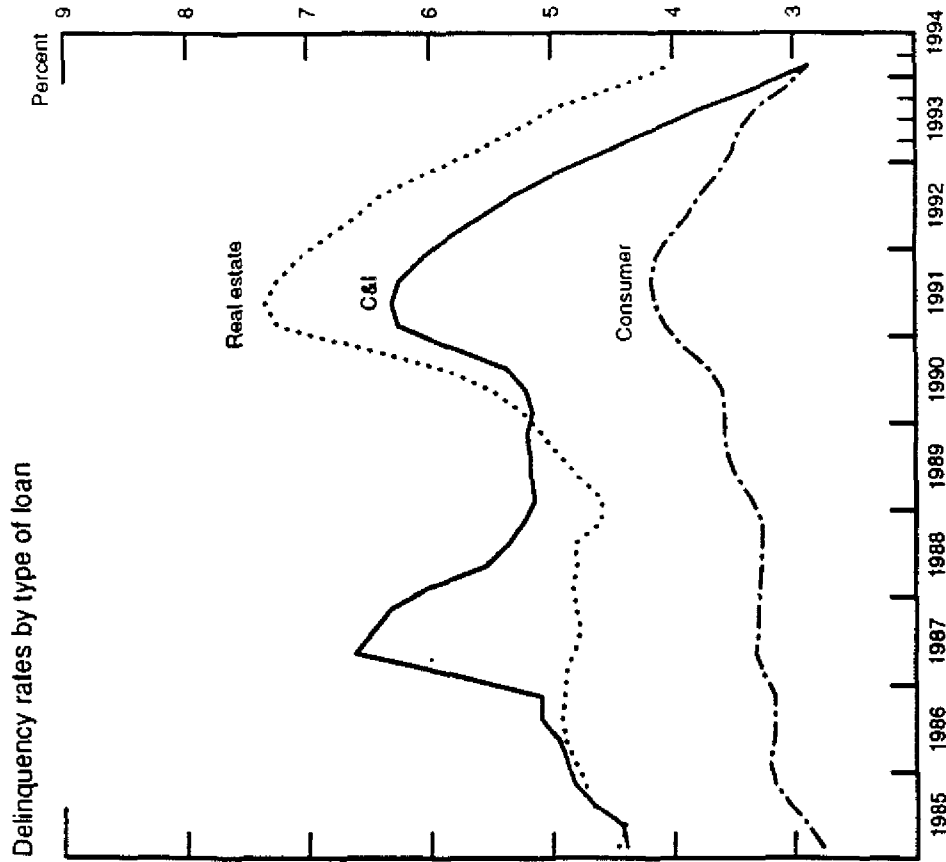


levels just above their historic lows. However, spreads between consumer loan rates and yields on comparable Treasury securities narrowed further (chart), as banks continued to price loans aggressively. Reports from survey respondents in recent months indicate that banks have been actively seeking to recapture some of the auto lending business lost in recent years to the "captive" auto finance companies. Competition for credit card accounts also is reported to have increased.

Most indicators of household financial distress have remained relatively favorable. In the first quarter, personal bankruptcy filings continued to decline, falling more than 9 percent at a seasonally adjusted annual rate after having dropped at a 17-1/2 percent pace in the fourth quarter of 1993. In addition, the share of closed-end consumer loans at banks that were thirty days or more past due was about unchanged in the first quarter, with delinquencies on auto loans declining slightly. Revolving credit delinquencies also were about unchanged.

First-quarter delinquency data for residential mortgages presented a slightly mixed picture. Call Report data show a continued decline in delinquency rates for loans at banks (chart). In contrast, the Mortgage Bankers Association reported small increases in thirty-day delinquency rates for both conventional and government-backed mortgage loans at all lenders. However, both ratios remained close to the lowest levels of the past decade. In addition, the American Council of Life Insurance reported a small increase in first-quarter delinquencies in residential mortgage loan portfolios at life insurance companies.

### Delinquency and Charge-Off Rates at All Banks (seasonally adjusted)



Note: Data are from FFIEC's quarterly Reports of Condition. Delinquent loans include those past due 30 days or more and still accruing interest, as well as those on nonaccrual status. Charge-off rates are annualized, net of recoveries. Before 1987, the data on delinquency rates are for domestic loans only.

# **INTERNATIONAL DEVELOPMENTS**

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INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In April, the U.S. trade deficit in goods and services was \$8.4 billion, seasonally adjusted, larger than in March but smaller than in February. For the first four months of 1994, the deficit was \$98 billion at an annual rate, significantly larger than that recorded in the fourth quarter of last year.

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

	Year	Quarters			Months		
	1993	93Q3	93Q4	94Q1	Feb	Mar	Apr
		(annual rates)			(monthly rates)		
Real NIPA 1/ <u>Net Exports of G&amp;S</u>	-76.5	-86.3	-84.5	-100.8	--	--	--
Nominal BOP <u>Net Exports of G&amp;S</u>	-75.7	-89.0	-79.9	-97.1	-9.6	-6.9	-8.4
Goods, net	-132.6	-146.0	-132.7	-147.8	-13.5	-11.5	-13.3
Services, net	56.8	56.9	52.8	50.8	3.9	4.6	4.9

1/ In billions of 1987 dollars, SAAR.

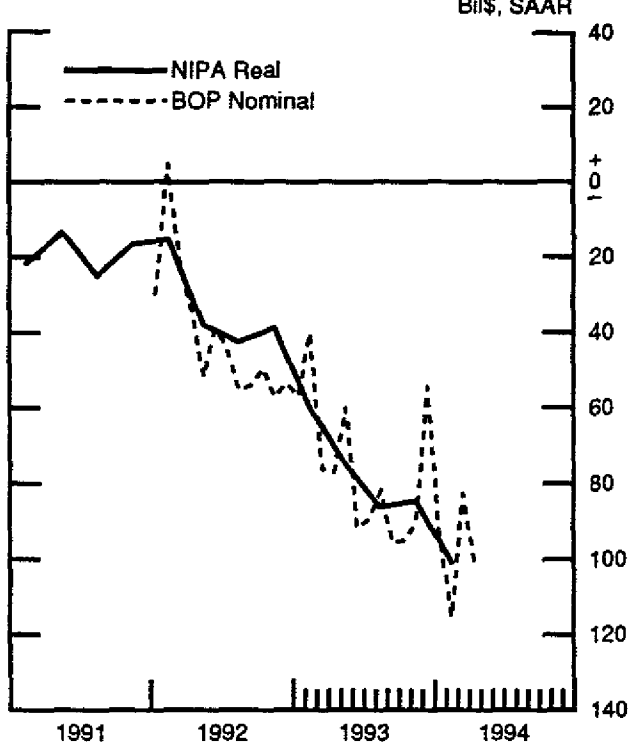
Source: U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census

Exports of goods and services were 3 percent less in April than in March; declines were recorded in most trade categories (especially capital goods and gold) and partly reversed the sharp runup in March. For the first four months of the year, exports (SAAR) were only slightly lower than in the fourth quarter, and were well above the level reported in any other previous quarter. The growth in exports since last fall has been led by shipments of machinery especially to expanding markets in Asia.

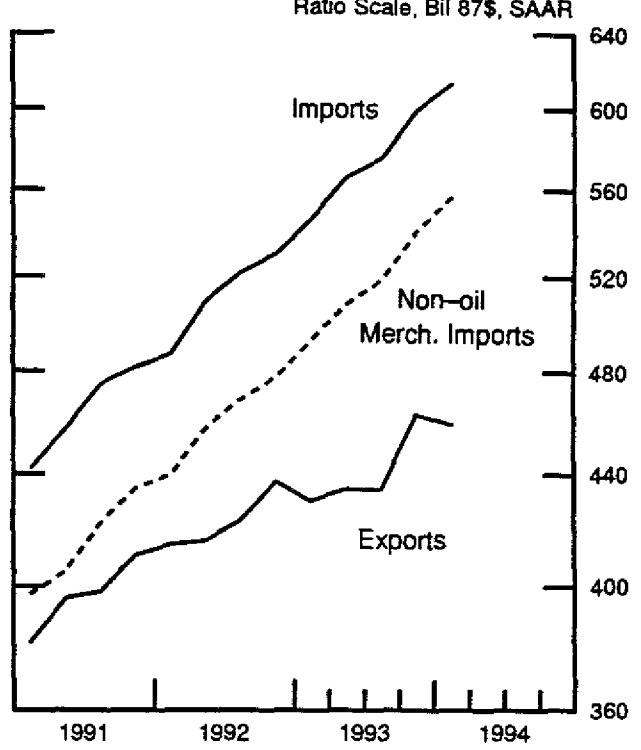
Imports of goods and services were about the same in April as in March; increases in imported consumer goods, machinery, and oil were offset by declines in other categories. All of the increase in the value of oil was in price. For the first four months of the year, imports (SAAR) were about 2 percent higher than in the fourth

U.S. International Trade in Goods & Services

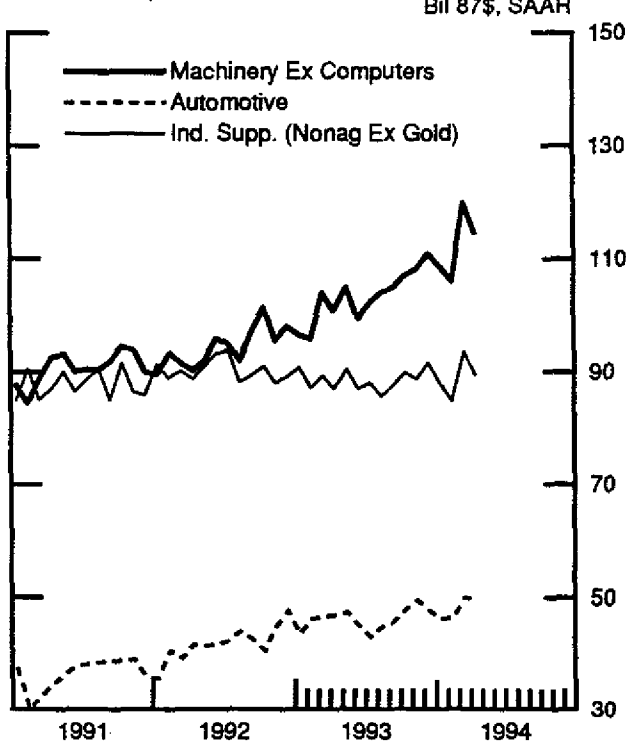
Net Exports of Goods & Services



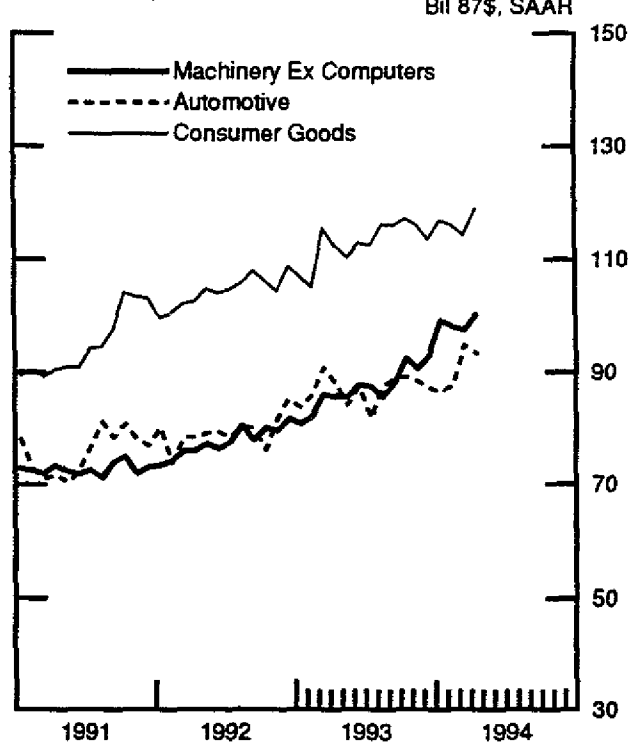
NIPA Goods & Services



Selected Exports



Selected Imports



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

	Quarters				Months		
	Levels		\$Change 1/		Levels		\$Chg 1/
	93Q4	94Q1	Q4	Q1	Mar	Apr	Apr
<u>Exports of G&amp;S</u>	665.1	656.8	32.9	-8.3	696.9	674.2	-22.7
Goods Exports	478.7	472.1	31.8	-6.6	504.7	483.5	-21.2
Agricultural	45.4	43.7	3.2	-1.6	45.5	42.9	-2.7
Gold	13.1	9.4	3.6	-3.8	17.7	8.5	-9.1
Computers	30.6	31.3	1.1	0.7	32.6	30.6	-2.0
Other Goods	389.7	387.7	23.9	-2.0	408.9	401.6	-7.4
Aircraft & Parts	34.5	34.2	7.8	-0.2	35.7	37.8	2.1
Semiconductors	20.6	23.5	0.9	2.8	24.2	23.4	-0.8
Other Capital Goods	105.7	105.6	5.5	-0.1	115.2	109.9	-5.3
Automotive Products	55.0	54.4	4.6	-0.6	57.1	56.7	-0.4
to Canada	29.4	29.0	1.9	-0.4	31.4	31.5	0.2
to Mexico	8.4	7.9	2.2	-0.4	8.8	7.9	-0.9
to Rest of World	17.3	17.5	0.5	0.2	16.9	17.3	0.3
Industrial Supplies	96.4	96.2	2.1	-0.2	101.8	98.3	-3.5
Consumer Goods	56.9	55.4	1.7	-1.5	58.6	56.2	-2.4
All Other	20.5	18.4	1.3	-2.1	16.3	19.3	3.1
Services Exports	186.4	184.7	1.1	-1.7	192.1	190.7	-1.5
<u>Imports of G&amp;S</u>	745.0	753.8	23.8	8.8	779.4	774.9	-4.4
Goods Imports	611.4	619.9	18.5	8.5	642.1	643.2	1.0
Petroleum	47.6	41.6	-2.5	-6.0	44.0	46.5	2.5
Gold	10.0	8.8	-1.6	-1.2	12.5	6.3	-6.2
Computers	40.3	41.8	1.4	1.5	42.0	43.6	1.5
Other Goods	513.6	527.7	21.2	14.2	543.6	546.8	3.2
Aircraft & Parts	12.4	11.3	1.9	-1.1	14.3	11.5	-2.8
Semiconductors	21.8	23.1	2.1	1.3	22.5	23.8	1.4
Other Capital Goods	88.8	94.4	4.8	5.6	94.8	96.9	2.1
Automotive Goods	105.9	108.1	4.4	2.2	114.6	113.7	-0.8
from Canada	38.0	36.9	0.7	-1.1	40.4	40.1	-0.3
from Mexico	13.0	13.4	2.3	0.4	14.8	13.7	-1.1
from Rest of World	54.9	57.8	1.4	2.9	59.4	60.0	0.6
Industrial Supplies	95.9	101.3	3.4	5.4	106.0	104.7	-1.3
Consumer Goods	137.9	137.8	1.3	-0.2	136.0	142.2	6.1
Foods, Feeds, Bev.	28.9	29.4	0.9	0.5	30.5	29.9	-0.6
All Other	22.0	22.5	2.3	0.4	24.9	24.0	-0.9
Services Imports	133.6	133.9	5.3	0.3	137.2	131.8	-5.5
Memo:							
Oil Quantity (mb/d)	9.24	9.00	0.22	-0.24	9.51	9.39	-0.12

1/ Change from previous quarter or month.

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

quarter; the growth of imports was led by capital goods (particularly machinery other than computers) and non-oil industrial supplies (especially metals) reflecting the strength of U.S. expenditures on business equipment and construction supplies.

The quantity of imported oil fell only slightly in April from the strong March rate. For the first quarter, imports averaged almost 9.0 mb/d (one half of consumption) despite a larger than seasonal drawdown in stocks. Preliminary Department of Energy statistics for May suggest that consumption remained strong and that inventories were partially rebuilt, with imports remaining above 9.0 mb/d.

#### Prices of U.S. Imports and Exports

Prices of imported oil rose almost \$1 per barrel in April and rose further in May, consistent with the pick-up in spot and futures prices that began in late March. In the last four months, the spot price for West Texas Intermediate (WTI) has increased almost \$5 per barrel, with roughly \$1.25 of the increase coming since the May Greenbook. Currently, the spot price for WTI is \$19.15 per barrel. The increase in oil prices appears to be the result of a pick-up in economic activity in Europe and Japan coupled with OPEC production restraint, as well as some near-term supply difficulties in the North Sea and Yemen. Prices of imported oil should continue to move with spot and futures prices, reaching about \$16 per barrel in June.

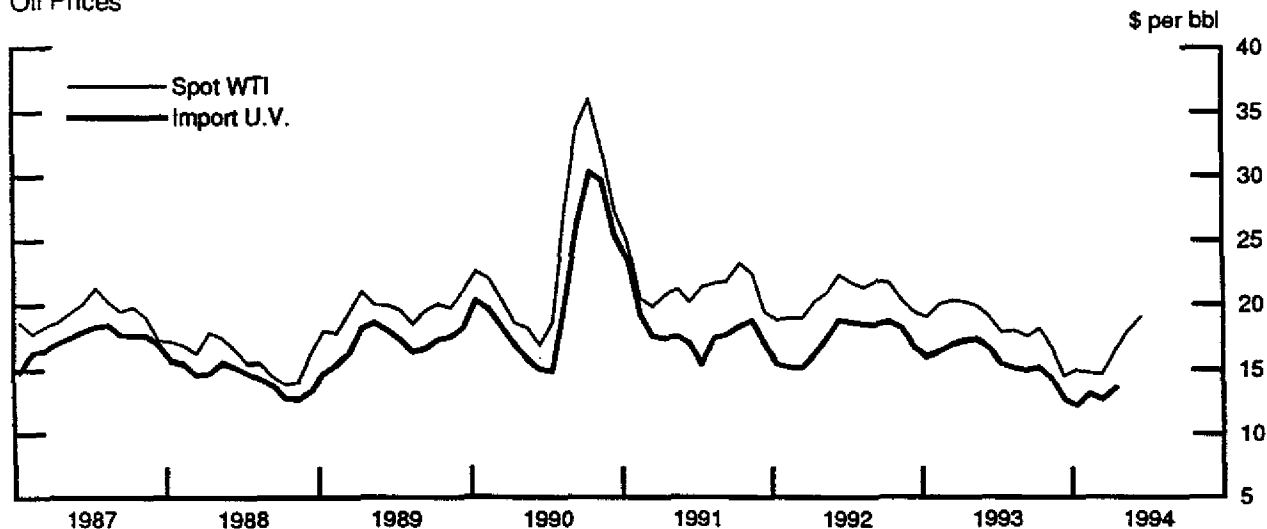
Prices of U.S. non-oil imports in May rose slightly for the third consecutive month. For April-May combined, prices rose slightly more than in the first quarter but well within the 1-1/2 to 2-1/2 percent range recorded for the past four quarters. In April-May, the largest increases were in foods. Prices of non-oil industrial supplies also moved up in April and May, continuing a pattern of increases begun in February.

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

	Quarters			Months		
	93Q4	94Q1	94Q2e/	Mar	Apr	May
	(annual rates)			(monthly rates)		
-----BLS Prices-----						
<u>Merchandise Imports</u>	-0.7	-2.1	6.3	0.2	0.7	1.1
Oil	-24.3	-30.2	55.8	-1.9	5.4	11.1
Non-Oil	2.0	1.3	2.2	0.3	0.3	0.2
Foods, Feeds, Bev.	5.9	0.7	10.9	0.9	1.4	1.7
Ind Supp Ex Oil	-0.9	5.5	3.8	0.9	0.4	0.0
Computers	-6.1	-5.1	-6.4	-1.0	-0.4	-1.0
Capital Goods Ex Comp	2.3	-0.1	2.2	0.4	0.2	0.1
Automotive Products	6.9	2.1	1.2	0.3	0.1	0.2
Consumer Goods	0.9	-0.1	1.2	-0.1	0.2	0.2
Memo:						
Oil Imports (\$/bbl)	14.09	12.67	--	12.66	13.57	--
<u>Merchandise Exports</u>	0.5	4.1	1.2	0.2	0.0	0.4
Agricultural	8.2	19.9	-5.4	0.7	-2.1	1.4
Nonagricultural	-0.6	2.2	2.2	0.1	0.4	0.1
Ind Supp Ex Ag	-4.0	7.8	6.8	0.2	0.9	0.4
Computers	-6.9	-10.0	-4.6	-0.4	-0.3	-0.8
Capital Goods Ex Comp	2.3	0.9	-0.4	0.1	-0.2	0.0
Automotive Products	1.3	1.5	0.9	0.4	-0.1	0.2
Consumer Goods	0.7	0.8	0.6	-0.2	0.2	0.1
-----Prices in the NIPA Accounts-----						
<u>Fixed-Weight</u>						
Imports of Gds & Serv.	0.4	-2.1	--	--	--	--
Non-oil Merch Ex Comp	3.5	1.2	--	--	--	--
Exports of Gds & Serv.	0.7	4.4	--	--	--	--
Nonag Merch Ex Comp	0.5	2.9	--	--	--	--

e/ Average of two months.

Oil Prices



Nonagricultural export prices increased slightly in May. For April-May combined prices rose 2.2 percent at an annual rate, the same as in the first quarter; most of the increase during both periods was in industrial supplies.

Prices of agricultural exports continued to fluctuate, rising in May after falling in two of the prior three months.

#### U.S. Current Account

The U.S. current account deficit widened by \$5 billion SAAR from 1993-Q4 to 1994-Q1. An increase in the deficit on goods and services was partly offset by lower unilateral transfers and a small reduction in the deficit on investment income.

Merchandise exports declined 1 percent in the first quarter from a strong fourth-quarter level; merchandise imports rose 1 percent (primarily capital goods and industrial supplies) despite a sharp drop in the value of imported oil. Most of the weakening in net services derived from reduced receipts from foreigners traveling in the United States. Unilateral transfers dropped back in Q1 from

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

	Goods & Services Balance	Investment Income, net	Transfers net	Current Acct Balance
<b>Years</b>				
1992	-40.4	4.5	-32.0	-67.9
1993	-75.7	3.9	-32.1	-103.9
<b>Quarters</b>				
1992-1	-15.5	9.8	-27.7	-33.4
2	-41.5	6.5	-31.1	-66.2
3	-51.2	4.9	-28.2	-74.4
4	-53.4	-2.9	-41.2	-97.5
1993-1	-57.7	7.4	-29.1	-79.4
2	-76.3	2.7	-28.8	-102.4
3	-89.0	8.1	-30.5	-111.4
4	-79.9	-2.4	-40.1	-122.3
1994-1	-97.1	-1.5	-29.1	-127.6

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

Q4 levels that were elevated by the annual payment of grants to Israel at the beginning of the U.S. fiscal year. Income receipts on U.S. assets abroad rose more than income payments on assets in the United States. Receipts on U.S. portfolio investments abroad rose with the general level of interest rates and large outflows from the United States of portfolio capital; payments to foreigners on portfolio investments in the the United States fell slightly as coupon-timing effects more than offset the impact of large capital inflows. Net direct investment income receipts continued strong at nearly \$50 billion (SAAR) mainly reflecting strong gross receipts from U.S. businesses operating abroad.

#### U.S. International Financial Transactions

Banks and securities dealers again recorded large net capital inflows in April (line 3 of the Summary of U.S. International Transactions table). Part of the inflow was to fund a general expansion of bank credit during the month. In addition, about \$6 billion of the inflow was attributable to increased borrowing by securities dealers under repurchase agreements. Finally, another \$5 billion of the inflow reflected a reduction of U.S. bank claims on own foreign offices associated with the restructuring of Brazilian debt. The restructuring replaced loans booked at the offshore offices of U.S. banks with bonds now held by the parent banks in the United States.

The swap of debt for bonds with Brazil accounts for nearly all of the net purchases of foreign bonds shown on line 5a. Apart from this transaction, and net sales of \$1 billion in Mexican bonds, U.S. activity in foreign bonds was relatively small in April. This contrasts with the first quarter when large sales in the United Kingdom were more than offset by purchases in continental Europe, Canada, Mexico, and Japan. U.S. net purchases of foreign stocks

SUMMARY OF U.S. INTERNATIONAL TRANSACTIONS<sup>1</sup>  
 (Billions of dollars, not seasonally adjusted except as noted)

	Year		Quarter				Month		
			1993			1994	1994		
	1992	1993	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.
<u>Official capital</u>									
1. Changes in foreign official reserve									
assets in U.S. (+ = increase)	38.3	70.0	17.3	18.5	23.1	10.8	-.6	1.6	-12.9
a. G-10 countries	4.8	29.9	17.8	9.1	4.8	10.9	1.3	3.5	1.3
b. OPEC countries	4.9	-5.1	-1.7	-3.1	-.9	-2.3	.2	.7	-2.0
c. All other countries	28.6	45.3	1.2	12.1	19.2	2.2	-2.1	-2.7	-12.2
2. Changes in U.S. official reserve									
assets (+ = decrease)	3.9	-.7	1.5	-.5	-.7	-.1	.1	*	.5
<u>Private capital</u>									
Banks									
3. Change in net foreign positions of									
banking offices in the U.S. <sup>2</sup>	35.6	10.5	-.2	23.1	9.0	39.1	23.9	22.7	16.2
Securities <sup>3</sup>									
4. Foreign net purchases of									
U.S. securities (+) <sup>4</sup>	68.1	106.7	14.8	21.4	46.5	30.3	17.1	9.4	-9.8
a. Treasury securities <sup>4</sup>	37.4	25.5	-.5	3.6	8.2	8.9	9.0	4.1	-11.4
b. Corporate and other bonds <sup>5</sup>	34.3	61.6	14.8	14.9	26.1	14.4	4.3	5.6	3.1
c. Corporate stocks	-3.7	19.6	.5	2.8	12.2	7.0	3.8	-.3	-1.5
5. U.S. net purchases (-) of									
foreign securities	-47.9	-124.3	-25.4	-42.0	-31.6	-27.1	-11.0	-.8	-6.9
a. Bonds	-15.6	-61.0	-11.7	-21.6	-10.7	-9.0	-4.8	5.2	-5.8
b. Stocks	-32.3	-63.3	-13.7	-20.4	-20.9	-18.1	-6.2	-6.0	-1.1
Other flows (quarterly data, s.a.)									
6. U.S. direct investment (-) abroad	-41.0	-57.9	-17.7	-6.3	-22.7	-20.4	n.a.	n.a.	n.a.
7. Foreign direct investment in U.S.	9.9	21.4	8.9	3.0	8.1	8.1	n.a.	n.a.	n.a.
8. Other (+ = inflow) <sup>6</sup>	18.1	57.1	16.7	19.1	-5.1	-13.5	n.a.	n.a.	n.a.
<u>U.S. current account balance (s.a.)</u>	-67.9	-103.9	-25.6	-27.9	-30.6	-31.9	n.a.	n.a.	n.a.
<u>Statistical discrepancy (s.a.)</u>	-17.1	21.1	9.7	-8.4	4.0	4.7	n.a.	n.a.	n.a.

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

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

3. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

4. Includes Treasury bills.

5. Includes U.S. government agency bonds.

6. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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



INTERNATIONAL BANKING DATA 1/  
(Billions of dollars)

	1991	1992	1993			1994		
	Dec.	Dec.	June	Sept.	Dec.	Mar.	April	May
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFS	-35.8	-71.6	-80.4	-114.6	-122.1	-157.5	-168.4	-177.3
a. U.S.-chartered banks	12.4	17.0	16.8	12.5	4.2	-15.1	-20.2	-29.5
b. Foreign-chartered banks	-48.3	-88.6	-97.2	-127.1	-126.3	-142.4	-148.2	-147.9
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.9	24.8	23.1	21.4	21.8	21.4	22.1	22.4
b. By Caribbean offices of foreign-chartered banks	n.a.	n.a.	101.1	95.9	90.9	88.6	n.a.	n.a.
3. Eurodollar holdings of U.S. nonbank residents								
a. At U.S.-based banks in the Caribbean and at all banks in Canada and the United Kingdom	102.9	90.0	86.1	77.0	77.8	75.1	69.8	72.1
b. At the Caribbean offices of foreign-chartered banks	n.a.	n.a.	80.2	82.4	79.2	84.2	n.a.	n.a.
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	49.8	52.6	76.4	70.3	74.9	82.5	80.9	n.a.
5. Eurodeposits of U.S. nonbank residents	271	268	262	252	254	n.a.	n.a.	n.a.

1. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts.

Lines 1a, 1b, and 2a are averages of daily data reported on the FR2950 and FR2951.

Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s.

Line 3a is an average of daily data for the overnight component (FR2050) and an average of Wednesday data for the term component (FR2077) supplemented by the FR2502 and end of quarter data supplied by the Bank of Canada and the Bank of England. Line 3a includes holdings by money market mutual funds.

Line 4 is end-of-period data from the Treasury International Capital (TIC) Reports. Much of the increase since December 1992 is the result of improved reporting (\$38 billion in 1993 and \$7 billion in 1994 Q1).

Line 5 is end-of-period data estimated by BEA on the basis of data provided by the BIS and the Bank of England, supplemented by TIC reports of banks' custody claims. It includes some foreign-currency denominated deposits.

also slowed in April (line 5b). The most notable decline was in Japan where net purchases were less than \$1/2 billion after averaging more than \$3 billion per month in the first quarter.

Private foreign transactions in U.S. securities swung from large net purchases in the first quarter to large net sales in April (line 4). The largest swing was in U.S. treasury securities which registered net sales of \$11 billion. The swing was concentrated in the United Kingdom and offshore financial centers. Japanese residents purchased \$1 billion in Treasuries in April, compared with net sales of \$3 billion in the first quarter. Foreign purchases of corporate bonds slowed in April and the pace of net equity sales increased.

Foreign official reserves in the United States declined sharply in April, more than reversing the \$11 billion increase in the first quarter (line 1). About half of the decline in April is attributable to Mexico, reflecting exchange market intervention to support the peso after the assassination of presidential candidate Colosio in March. Significant declines were also recorded for Singapore, Taiwan, Spain, and Switzerland. Japanese official reserves in the United States rose in April, although by an amount less than their reported exchange market intervention. Partial data for May from the FRBNY record official inflows of about \$7 billion. Increases in Japanese reserves account for about one-third of this inflow.

Recently released data for the first quarter continue to show near-record U.S. direct investment abroad (line 6). However, a large part of this outflow was not related to the accumulation of plant and equipment. A few U.S. securities firms lent large amounts to their U.K. affiliates. Since a few U.S. securities firms also account for nearly all of the previously mentioned sales of foreign securities to the United Kingdom, it seems likely that a large part

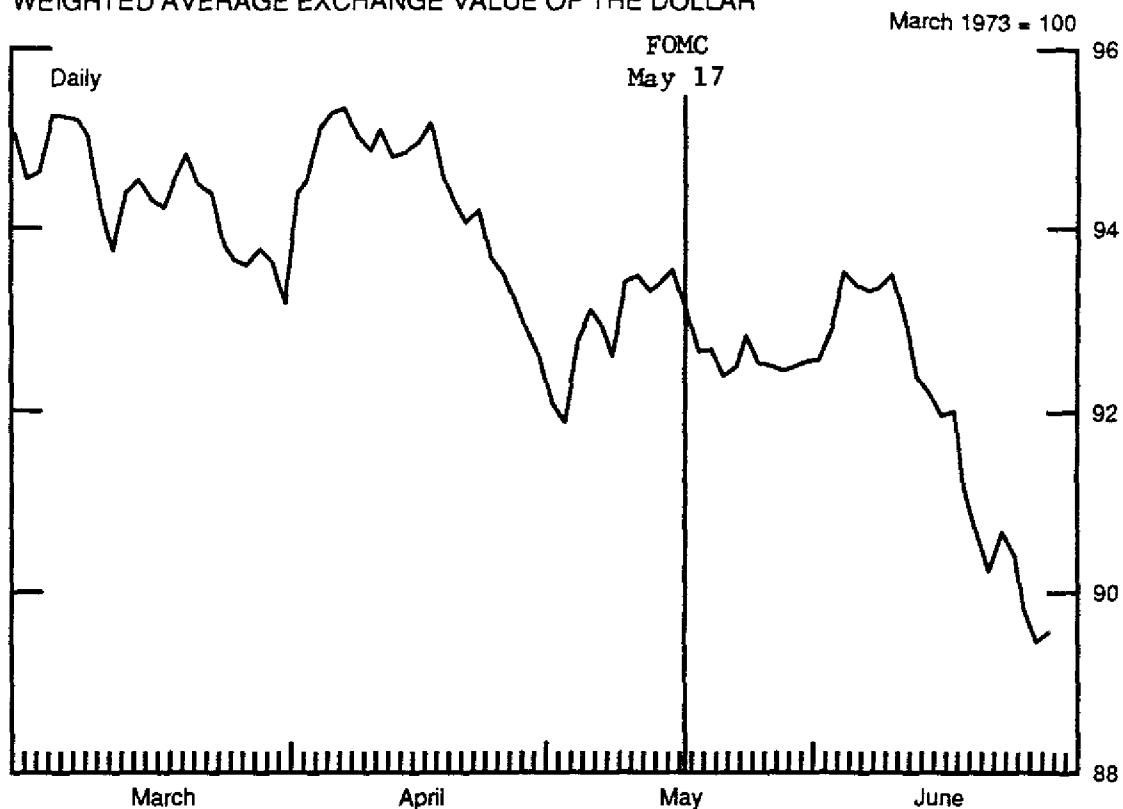
of the direct investment lending went to finance U.K. affiliates' purchases of securities from their U.S. parents. Foreign direct investment inflows to the United States also remained high in the first quarter (line 7), although considerably less than the record levels reached in the late 1980s.

#### Foreign Exchange Markets

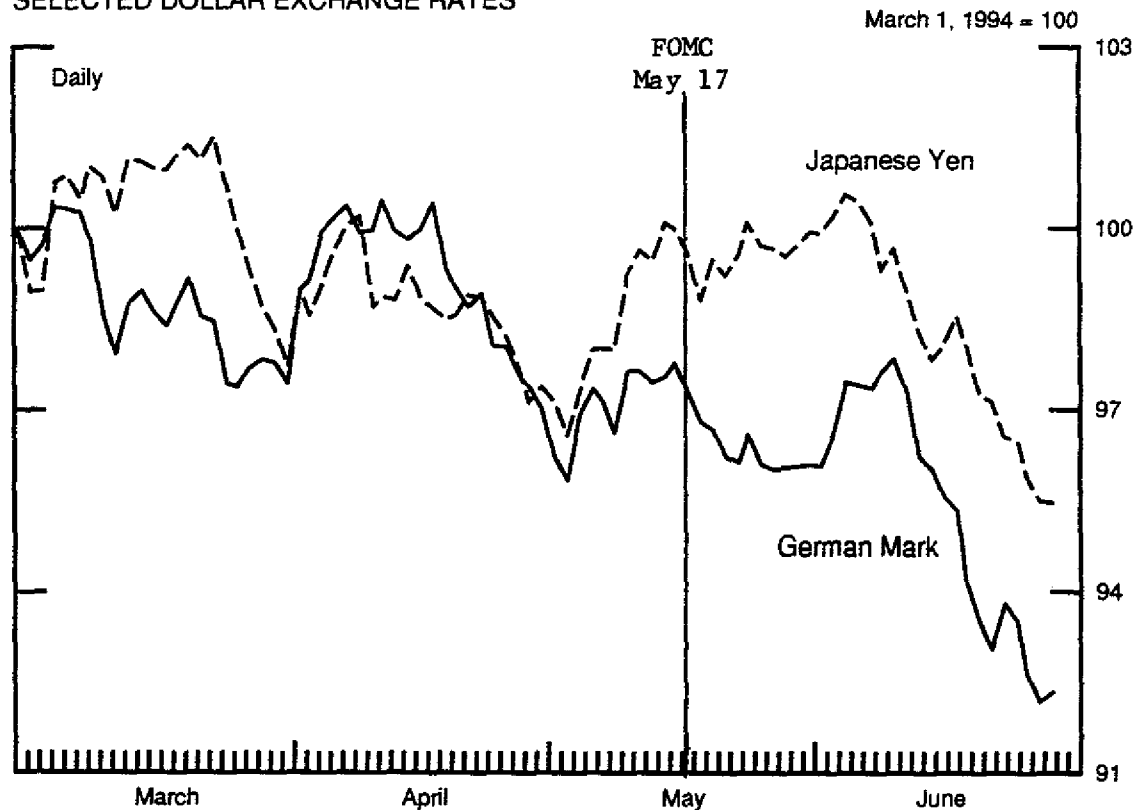
The weighted-average foreign exchange value of the dollar has declined about 4 percent on balance since the May 17 FOMC meeting. The dollar's weighted-average value showed little net change over the latter half of May and the first two weeks of June, but has declined sharply since then. Perceptions that recovery in several major foreign industrial countries is more firmly taking hold have contributed to a rise in foreign relative to U.S. long-term interest rates over this period. Since the May FOMC meeting, the weighted-average of long-term interest rates in the foreign industrial countries has increased about 55 basis points while the comparable U.S. long-term rate has risen only about 25 basis points on balance. The dollar's recent weakness also may have reflected in part concerns about possible increasing inflationary pressures in the United States, related to tightening U.S. labor market conditions.

On June 21, the dollar briefly fell below 100 yen per dollar, a new post-war low. In response, the Bank of Japan made large-scale intervention purchases of dollars and Treasury Secretary Bentsen issued a public statement expressing concern about exchange market developments. The dollar remained weak against the yen and mark over the remainder of the week and, when the dollar began to fall further on June 24, the Desk joined other central banks in concerted intervention . The Desk purchased a total of \$1,560 million--\$950 million against marks and \$610 against yen.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



SELECTED DOLLAR EXCHANGE RATES



Shortly after the concerted intervention began, Treasury Secretary Bentsen issued a statement noting the cooperation between the United States and its G-7 partners in the day's actions, and saying that the operations "reflect a shared concern about recent developments in financial markets." The intervention operation appeared to have little impact on exchange rates, and the dollar actually declined a bit further against the mark over the course of the day.

The dollar has declined about 5-1/4 percent relative to the yen over the intermeeting period. Earlier in the period, the dollar was given some support against the yen when U.S. Trade Representative Mickey Kantor announced that the United States and Japan had reached understandings that would allow a resumption of the framework trade talks that had been broken off in February. However, the perception of somewhat improved U.S.-Japan trade relations was reversed and the dollar came under strong downward pressure against the yen following the June 7 statement by Mr. Kantor indicating that U.S. goals in terms of access to the Japanese market had not changed, and that the United States would open Japanese markets either through the framework talks or through U.S. trade laws. The political turmoil in Japan may also have contributed to the dollar's weakness against the yen by raising doubts about the government's ability to take measures to counter the yen's rise. Short-term interest rates in Japan have shown little net change over the period.

The dollar has depreciated about 5 percent relative to the mark since the May FOMC meeting. The mark's strength appears to have reflected in part a growing market perception that the Bundesbank is unlikely to make additional cuts in official interest rates in the near-term or to reduce short-term market rates much further. A plethora of statements by Bundesbank officials over the period have

generally been seen as confirming this view, particularly a statement by Bundesbank President Tietmeyer interpreted as indicating that the May 11 lowering of the discount rate would be the last reduction in German official rates for the time being. Reinforcing the view that the Bundesbank will be unlikely to ease further has been the rapid growth of the targeted M3 monetary aggregate. As of May, M3 had grown at a 13.7 percent rate from its fourth-quarter base, well above its 4 to 6 percent target range.

Reflecting the diminishing market assessment of the likelihood of further Bundesbank easing, the German three-month interest rate has eased only about 15 basis points on balance since the May FOMC meeting, despite continued weekly reductions in the Bundesbank's repo rate that have totaled 39 basis points over this period. Short-term interest rates in most other European countries have shown little net change over this period. The major exception has been Italy, where the three-month rate has increased about 75 basis points as the Italian lira has come under downward pressure relative to its EMS partner currencies.

The only major foreign currency to decline against the U.S. dollar over the intermeeting period has been the Canadian dollar, which has depreciated about 1/2 percent on balance, apparently reflecting continued market concerns over the upcoming Quebec election and large government budget deficits. In response to the downward pressure on the Canadian dollar, Canadian authorities moved to raise the three-month interest rate about 30 basis points over the period.

Long-term interest rates in all major foreign industrial countries have continued to move higher since the May FOMC meeting. The increases have ranged from about 40 basis points in Japan and Germany to about 125 basis points in Italy. In both Japan and

Germany, incoming data appear to have been generally interpreted by the market as signaling increased prospects of economic recovery, thus putting upward pressure on long-term rates. The especially sharp rise in the Italian long-term rate followed a ruling by the Italian Constitutional Court overturning legislation capping increases in second pensions, potentially substantially increasing the public sector budget deficit.

With long-term interest rates rising sharply, equity prices have dropped in nearly all of the major foreign industrial countries since the May FOMC meeting. The declines have varied from about 7 percent in Canada to about 13 percent in Italy; German stock prices have fallen about 9 percent on balance over the period. The only exception to this general decline in equity prices has been Japan, where the Nikkei index has risen about 2 percent.

#### Developments in Foreign Industrial Countries

After following divergent paths in 1993, economic activity expanded in all the major foreign industrial countries in the first quarter of 1994. First-quarter data suggest that each of the countries is now past its trough. In Japan, western Germany, and France growth resumed, after contracting or remaining flat in the fourth quarter of last year. In Italy, monthly indicators suggest the moderate pace of recovery evident late last year continued, while growth in the United Kingdom and Canada remained at a healthy pace.

Despite the upturn in economic activity, considerable economic slack persists. Unemployment rates remain high even in countries where recovery is firmly established, although they have begun to come down in the United Kingdom and Canada. Slow wage growth and slack economic conditions have contributed to low or declining consumer price inflation.

Individual Country Notes. In Japan, GDP data released since the May Greenbook show that real GDP rose 3.9 percent (SAAR) in the first quarter of 1994. Most of the increase came from domestic demand as strength in household and government expenditures more than offset a sharp decline in private investment. Net exports also rose, reflecting high export growth in excess of a strong increase in imports. Because high GDP growth in the first quarter of 1993, stimulated by government fiscal packages, was followed by a resumption of weakening, the performance of GDP in the second quarter of this year should provide key information on whether the recovery is established.

JAPANESE REAL GDP  
(percent change from previous period, SAAR)

	1992	1993	1993		1994
	Q4/Q4	Q4/Q4	Q3	Q4	Q1
GDP	-0.3	-0.1	1.1	-2.8	3.9
Consumption	0.2	1.8	1.8	3.0	5.8
Investment	-2.0	-0.6	1.3	-5.3	-3.7
Government Consumption	2.0	2.8	2.5	3.7	1.8
Exports	1.8	-4.0	-1.9	-0.2	8.8
Imports	-4.3	2.8	-1.3	10.3	8.5
Net Exports (contribution)	0.7	-1.1	0.4	-2.6	0.8

Monthly data for the second quarter are mixed, but on balance are consistent with continued, albeit slower, growth. The Bank of Japan's May (Tankan) survey of business sentiment showed its first increase since 1989, and firms predicted a smaller decline in investment for FY 1994 than in the February survey. Industrial



production fell in April and May, but less than anticipated, the unemployment rate has remained essentially flat in recent months, and the job offers-to-applicants ratio declined slightly in May.

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

	1993		1994				
	Q3	Q4	Q1	Q2	Mar.	Apr.	May
Industrial Production	0.1	-3.7	1.9	--	4.6	-1.9	-0.8
Machinery Orders	0.4	-0.7	6.9	--	9.1	-23.1	--
New Car Registrations	1.6	-3.3	8.5	--	11.9	-12.3	-4.6
Job Offers Ratio*	0.71	0.66	0.66	--	0.66	0.66	0.64
Index Leading Ind.*	42.9	35.8	69.6	64.9	76.9	80.0	--
Business Sentiment**	-51	-56	-56	-50	n.a.	n.a.	-50

\* Level of indicator.

\*\* Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.

On June 23, the upper house of the Diet approved the budget for FY 1994, allowing it to be enacted into law. Since the start of the fiscal year on April 1, the government has been running on two successive stop-gap budgets. The passage of the formal FY 1994 budget reduces uncertainties concerning the government's ability to maintain its recent pace of fiscal stimulus, and also opens the door to additional stimulus packages, if necessary.

On June 29, Socialist Party chairman Tomiichi Murayama was elected prime minister by the lower house of the Diet with the support of both Socialist Party and Liberal Democratic Party (LDP) members. Murayama succeeds Tsutomu Hata, who resigned on June 25 after only two months in office rather than risk a likely defeat in a vote of no confidence introduced by the LDP. Since Hata assumed the leadership of the minority government on April 25, the various opposition parties had pledged not to attempt to replace the government until after the budget was enacted.

Real GDP in western Germany rose 2.2 percent (SAAR) in the first quarter, led by a surge in construction during the mild

winter. While real GDP (NSA) in eastern Germany increased 10.4 percent over the year-earlier level in the first quarter, data adjusted using west German seasonal factors show a decline of 5.8 percent (AR) from fourth-quarter levels. Accordingly, for total Germany, real GDP advanced 1.6 percent (SAAR) in the first quarter.

WESTERN GERMAN REAL GDP  
(percent change from previous period, SAAR)

	1992	1993	1993		1994
	Q4/Q4	Q4/Q4	Q3	Q4	Q1
GDP	0.1	-0.8	3.4	-1.7	2.2
Consumption	3.2	-1.1	5.3	0.2	0.0
Investment	-1.1	-6.8	2.5	-9.0	16.4
Government Consumption	2.5	-1.2	5.2	1.7	-5.3
Exports	-3.9	-2.2	6.6	9.6	8.4
Imports	0.3	-9.5	5.6	-0.7	14.2
Net Exports (contribution)	-1.5	1.9	0.7	3.2	-0.7

Available data on production in the second quarter indicate that the recovery in western Germany is continuing. However, the volume of retail sales (SA) in western Germany slumped in April, declining more than 7 percent relative to the average level in the first quarter. In eastern Germany, industrial production (NSA) has continued to show strong gains, advancing 17.8 percent over the year ending in April.

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

	1993				1994		
	Q1	Q2	Q3	Q4	Q1	Apr.	May
Industrial Production	-2.9	0.0	0.7	-0.4	0.0	2.5	n.a.
Manufacturing Orders	-1.0	0.3	1.9	-1.1	2.6	0.6	n.a.
Capacity Utilization	79.5	78.7	78.2	78.1	79.4	n.a.	n.a.
Unemployment Rate (%)	7.6	8.0	8.5	9.0	9.2	9.3	9.4
Production Plans*	-25.7	-21.7	-15.0	-8.0	3.3	6.0	n.a.

\* Percent of manufacturing firms planning to increase production in the next three months minus those that plan to decrease production.

Growth of the targeted monetary aggregate M3 has moderated since the early months of this year but remains high. In May, German M3 increased 13.7 percent (SAAR) relative to the fourth quarter of 1993, down from 15.4 percent in April. It appears highly unlikely that M3 will fall within its official target range of 4 to 6 percent this year. In its mid-year review on July 21, the Bundesbank Council is expected to evaluate this year's target range for M3 growth.

In France, GDP growth recovered in the first quarter after registering zero growth in the fourth quarter. The rise was largely the result of a positive contribution from inventories as consumption was flat and investment fell while net exports made a large negative contribution. Although consumption of manufactured goods registered moderate growth, it was offset by a large drop in

FRENCH REAL GDP  
(percent change from previous period, SAAR)

	1992	1993	1993		1994
	Q4/Q4	Q4/Q4	Q3	Q4	Q1
GDP	0.6	-0.5	1.2	0.0	2.0
Consumption	1.8	0.3	2.4	0.0	0.0
Investment	-2.1	-4.4	2.0	-2.4	-1.6
Government Consumption	1.2	0.2	2.9	-0.2	2.5
Exports	5.6	2.6	12.1	1.2	-7.0
Imports	2.3	-3.0	2.0	-3.6	4.5
Net Exports (contribution)	0.8	1.6	2.7	1.3	-3.3

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

	1993				1994	
	Q1	Q2	Q3	Q4	Q1	Apr.
Industrial Production	-1.0	-0.6	0.9	-0.5	0.7	--
Consumption of Manufactured Products *	-2.7	-0.6	1.9	-1.5	0.6	1.2
Unemployment Rate (%)	10.6	11.5	11.7	12.1	12.2	12.3

\* Roughly 1/3 of total real consumption

energy consumption due to unusually warm weather. In April, consumption of manufactured goods rose strongly. Survey data from INSEE for May show continued improvement in business confidence and that businesses intend to increase investment, suggesting that the inventory rise occurred largely in anticipation of future sales.

Activity in the United Kingdom appears to be holding up in spite of large tax increases that took effect at the beginning of April. Industrial production in April surged unexpectedly, and

UNITED KINGDOM REAL GDP  
(percent change from previous period, SAAR)

	1992	1993	1993		1994
	Q4/Q4	Q4/Q4	Q3	Q4	Q1
GDP	0.2	2.6	3.6	2.7	2.6
Consumption	1.3	3.2	4.7	4.7	2.3
Fixed Investment	0.7	1.3	4.6	10.3	8.5
Government Consumption	-0.1	1.0	0.7	-1.1	2.3
Exports	3.0	3.1	12.5	2.3	9.3
Imports	6.2	3.7	6.5	11.3	3.2
Net Exports (contribution)	-0.9	-0.3	1.3	-2.5	1.4
Non-oil GDP	0.0	2.2	3.3	2.4	2.0

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

	1993			1994			
	Q2	Q3	Q4	Q1	Apr	May	Jun
Industrial Production	0.8	1.2	1.2	0.7	1.6	n.a.	n.a.
Retail Sales	0.6	1.0	0.8	1.0	0.5	0.0	n.a.
Average Earnings	3.8	3.3	3.1	3.8	3.8	n.a.	n.a.
Production Plans* (%)	16.3	12.0	9.7	20.7	16.0	23.0	22.0
Consumer Confidence** (%)	5.3	-4.7	-12.0	-7.7	-22.0	-10.0	-10.0
Unemployment Rate (%)	10.4	10.4	10.0	9.8	9.5	9.4	n.a.
RPI ex. MIP (NSA)***	2.8	3.1	2.7	2.7	2.3	2.5	n.a.

\* Percent of manufacturing firms planning to increase production in the next four months minus those that plan to decrease production.

\*\* Percent of individuals who expect the general economic situation to improve minus those who expect it to worsen.

\*\*\* Retail prices excluding mortgage interest payment, percent change from year earlier.

retail sales have slowed less than expected. After falling in April, consumer and business confidence picked up considerably in May. Underlying inflation continues subdued, and labor costs, after accelerating in the first quarter, edged back somewhat in April.

In elections for the European parliament in June, the Conservative Party received only 27 percent of the national vote. Despite the weak showing, the Conservatives did better than expected by retaining 19 of their current 45 seats.

Following a strong performance in the fourth quarter, growth in Italy appears to have remained positive in the first quarter as industrial production continued to rise and capacity utilization and unemployment held steady. Available indicators for the second quarter suggest that economic activity likely has continued its gradual recovery. Industrial production on a year-over-year basis edged down in April, but there were two fewer working days this year compared with April 1993. Although the second quarter unemployment rate rose, business sentiment has continued to show strength, and consumer confidence recently has soared.

ITALY ECONOMIC INDICATORS (NSA)

	1993		1994				
	Q3	Q4	Q1	Q2	Mar.	Apr.	May
Industrial Production*	-2.7	0.1	2.6	n.a.	2.6	-1.0	n.a.
Capacity Utilization (%)	73.7	74.4	74.5	n.a.	n.a.	n.a.	n.a.
Unemployment Rate (%)	10.3	11.3	11.3	11.6	n.a.	n.a.	n.a.
Consumer Confidence	98.5	96.3	100.6	n.a.	103	108.3	112.6
Business Sentiment** (%)	-3	4	19	n.a.	21	25	n.a.

\* Percent change from year earlier level.

\*\* Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.

Since coming to power in May, the Berlusconi government has implemented a series of measures to boost employment. The government has reduced taxes for companies that create net new employment and initiated an investment tax credit. On the spending

side, the government plans to resume public works projects that were suspended by corruption investigations. Because project funds already were allocated, resumption will have no effect on this year's deficit. The government is negotiating with labor unions over proposals to make the labor market more flexible, such as more freedom for employers to hire and fire workers and less stringent rules on part-time and temporary employment. On June 14, Italy's highest court ruled that the government must make payments that may amount to nearly 2 percent of GDP for back years on second pensions. The government is considering options for compliance with the court ruling.

In Canada, economic activity expanded at a vigorous pace in the first quarter of 1994, with consumption expenditure especially strong. A decline in construction offset a modest increase in machinery and equipment investment. Recent data suggest economic activity remains robust, although retail sales fell in April after five consecutive monthly increases. Employment continues to grow at a steady pace, with full-time jobs more than accounting for the increase so far this year. In 1993, full-time jobs accounted for only 30 percent of increased employment. The unemployment rate is still high as increased labor force participation has accompanied employment growth.

CANADA REAL GDP  
(percent change from previous period, SAAR)

	<u>1992</u>	<u>1993</u>	<u>1993</u>		<u>1994</u>
	<u>Q4/Q4</u>	<u>Q4/Q4</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>
GDP	0.5	3.2	1.3	3.6	4.2
Consumption	0.6	2.2	1.7	2.4	3.7
Fixed Investment	-5.8	4.5	3.6	11.3	-1.2
Government Consumption	0.8	-0.1	-0.8	0.2	-0.7
Exports	9.4	10.9	6.8	14.3	4.4
Imports	3.3	11.1	4.4	15.6	-2.9
Net Exports (contribution)	1.7	-0.3	0.7	-0.7	2.7

Excluding the effect of cigarette tax reductions in February and other excise tax changes in May, inflation in Canada in recent months has averaged less than 1.5 percent over the year-earlier level. Wage settlements remain moderate in early 1994, after the lowest annual increase on record in 1993.

CANADA ECONOMIC INDICATORS  
(percent change from previous period except where noted, SA)

	1993				1994		
	Q1	Q2	Q3	Q4	Q1	Apr.	May
Industrial Production	1.8	0.8	0.9	1.1	0.4	n.a.	n.a.
Retail Sales	1.2	0.9	1.3	1.0	3.2	-1.7	n.a.
Employment	0.6	0.2	0.2	0.3	0.4	0.0	0.5
Unemployment Rate (%)	10.9	11.4	11.4	11.1	11.0	11.0	10.7
Consumer Prices*	2.1	1.8	1.7	1.8	0.6	0.2	-0.2

\* Percent change from year earlier.

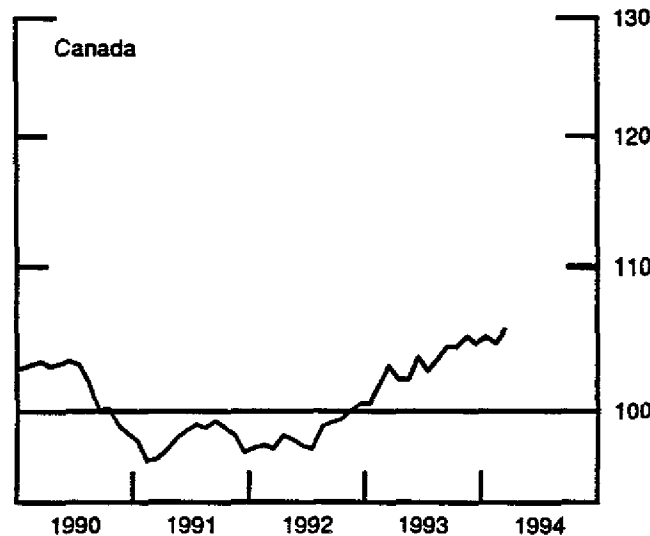
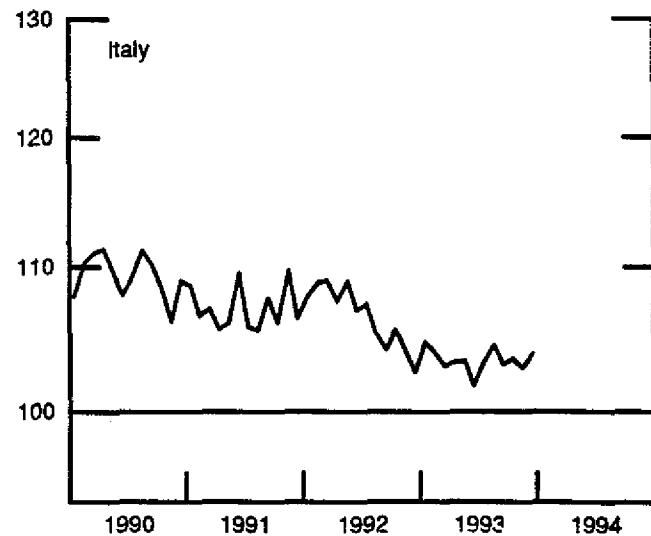
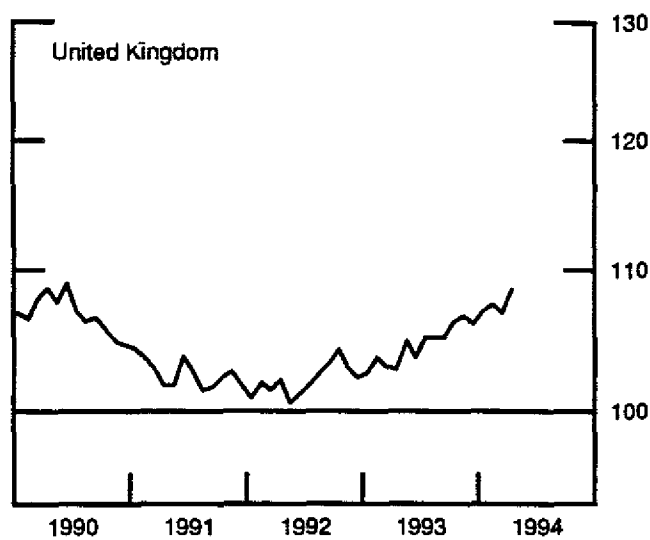
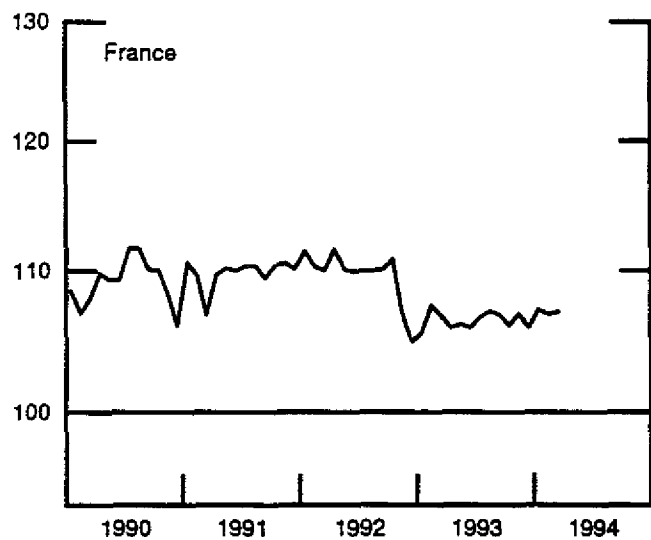
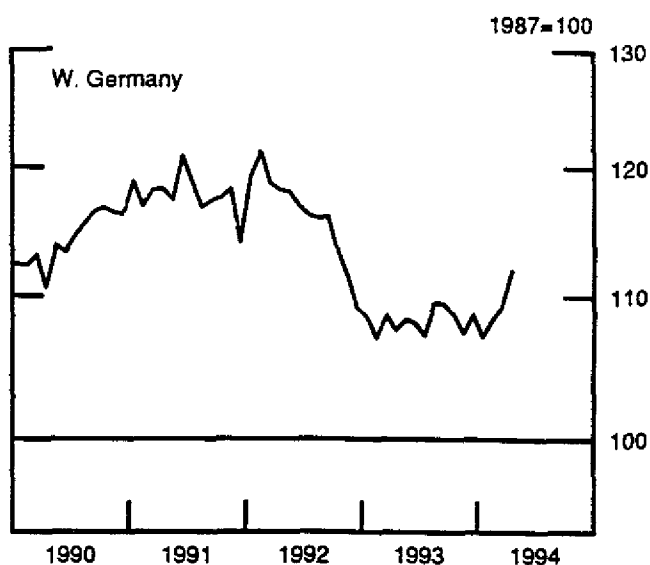
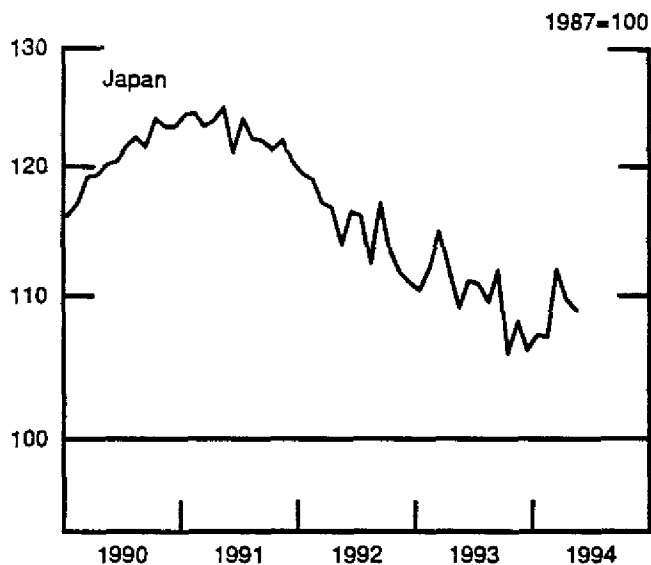
EXTERNAL BALANCES  
(Billions of U.S. dollars, seasonally adjusted)

	1993				1994		
	Q2	Q3	Q4	Q1	Mar.	Apr.	May
Japan: trade	29.9	29.5	30.5	31.3	10.0	11.6	8.5
current acct	31.6	32.3	30.6	32.3	9.9	12.5	n.a.
Germany: trade*	7.9	8.1	14.4	10.2	3.6	3.5	n.a.
current acct*	-3.8	-9.9	-3.4	-5.4	-1.3	-1.1	n.a.
France: trade	3.9	5.0	5.5	2.8	1.5	1.3	n.a.
current acct	1.7	4.0	n.a.	n.a.	--	--	--
U.K.: trade	-5.1	-4.8	-5.3	-4.6	-1.8	n.a.	n.a.
current acct	-5.3	-3.0	-3.1	-1.0	--	--	--
Italy: trade	4.9	5.2	6.1	n.a.	n.a.	n.a.	n.a.
current acct*	2.2	3.8	6.4	2.6	2.3	2.8	n.a.
Canada: trade	1.8	1.7	1.8	1.8	0.6	0.9	n.a.
current acct	-5.7	-5.6	-6.1	-5.3	--	--	--

\* Not seasonally adjusted.

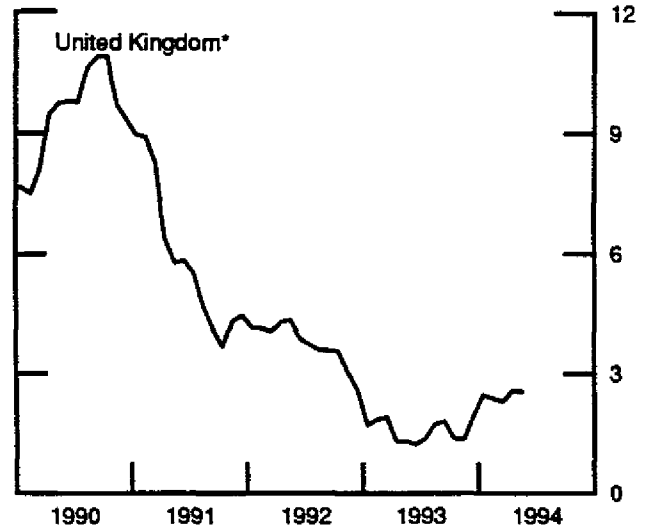
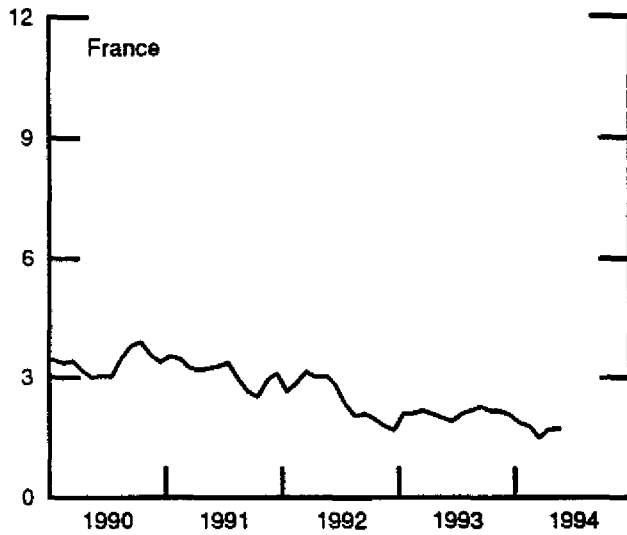
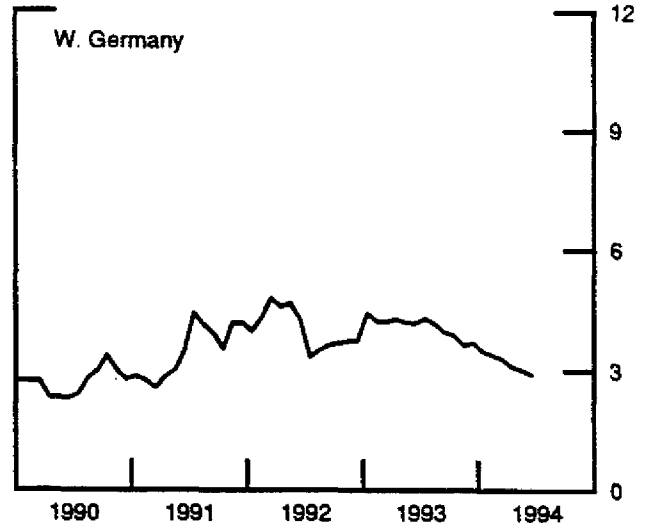
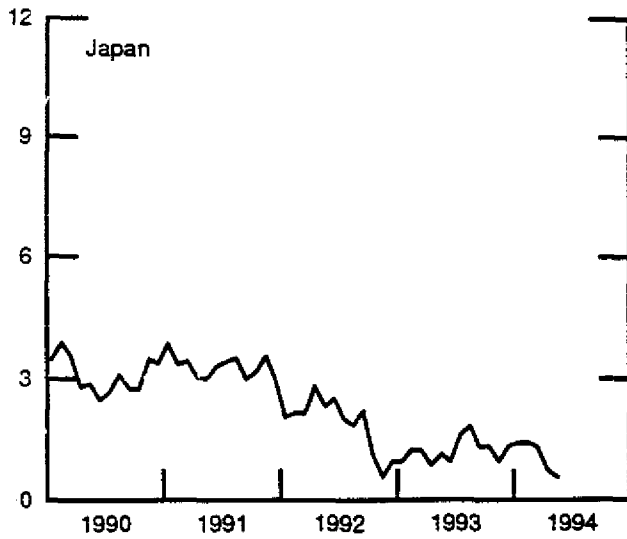
### Industrial Production for Major Foreign Countries

Ratio Scale, Seasonally Adjusted, Monthly

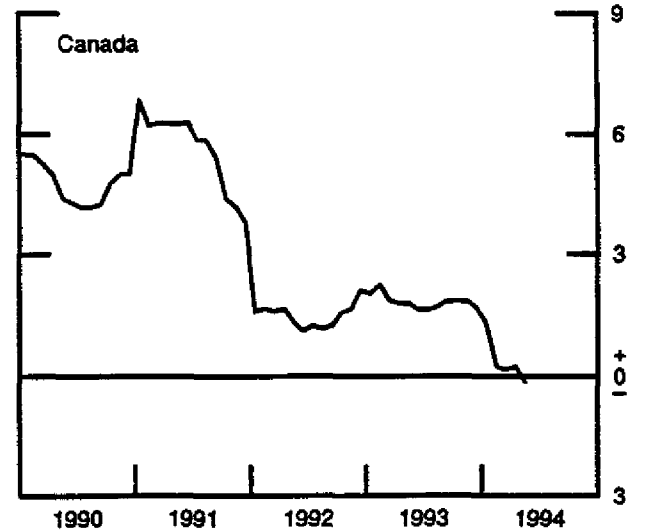
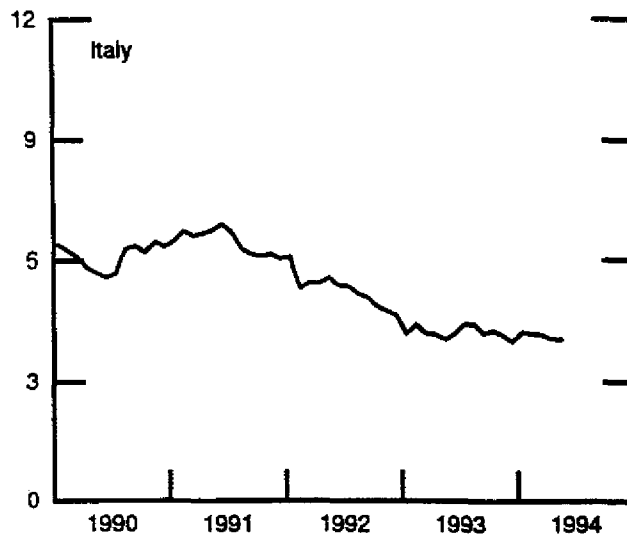




### Consumer Price Inflation for Major Foreign Countries Yearly Percent Change



\* Excluding mortgage interest payments.



Economic Situation in Other Countries

Mexican real GDP rebounded somewhat during the first quarter of 1994, and Mexican imports and exports have expanded significantly, due mainly to trade liberalization resulting from NAFTA. In other developing countries, economic activity has been generally robust. During the first quarter of 1994, real GDP grew (year/year) by 5.7 percent in Brazil, by 5.5 percent in Taiwan, and by 9.1 percent in Korea. Chinese industrial production during May was 17 percent above its year-earlier level. Argentina continues to experience an investment boom: construction expenditure and capital goods imports have increased sharply.

Brazil will introduce a new currency on July 1, as part of a program to tame its 40 percent monthly inflation rate. Russian consumer prices increased by 8.1 percent during May, the smallest increase since October 1991. Venezuela, in the midst of a banking and financial crisis, implemented foreign exchange and price controls on June 27.

Individual country notes. Mexico's real GDP was 0.5 percent higher in the first quarter of 1994 than in the same period last year. This is the first quarter of positive year-over-year growth following two quarters of contraction. Imports in January-April 1994 were 17.5 percent higher than in the same four months of 1993, reflecting in part the lowering of trade barriers as NAFTA went into effect. Exports in January-April were 15.7 percent higher than a year earlier (even though petroleum exports were 17.3 percent lower), as non-oil exports increased by 21.8 percent. As a result, the cumulative four-month trade deficit was \$1 billion higher than a year earlier.

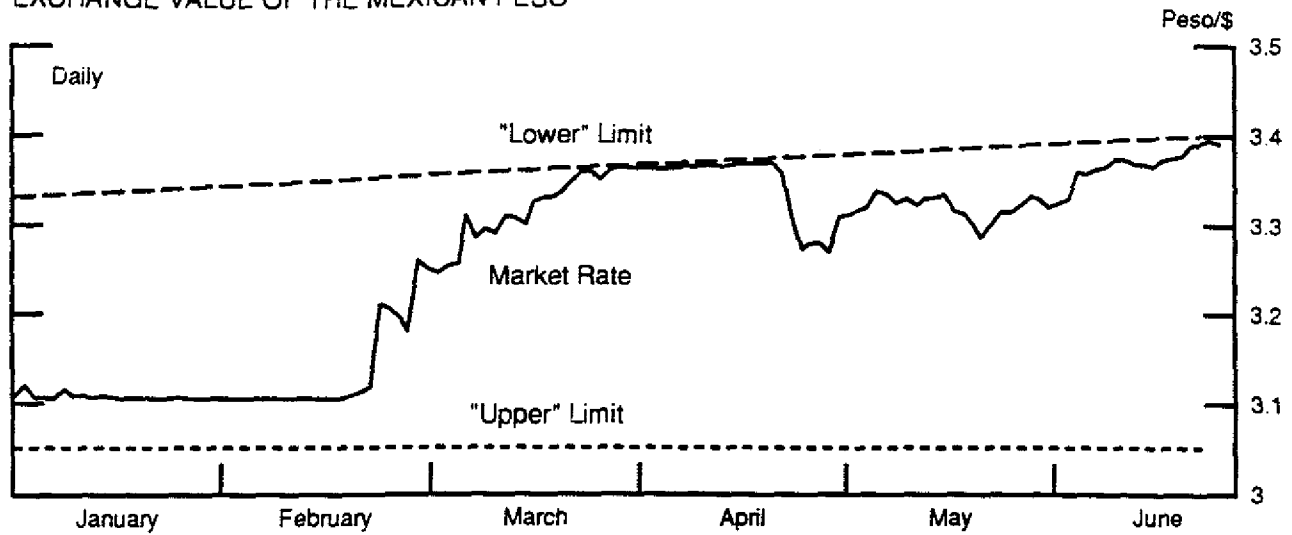
The monthly inflation rate was 0.5 percent in May, unchanged since February, leaving the May CPI 6.9 percent higher than a year earlier.

The financial crisis that gripped Mexico after the leading presidential candidate was assassinated on March 23 abated in May. However, nervousness returned in June when the Chiapas rebels rejected the tentative peace agreement negotiated in February. Further volatility ensued when the chief government peace negotiator resigned June 16, complaining that his effectiveness had been undermined by critical comments from government party presidential candidate Ernesto Zedillo.

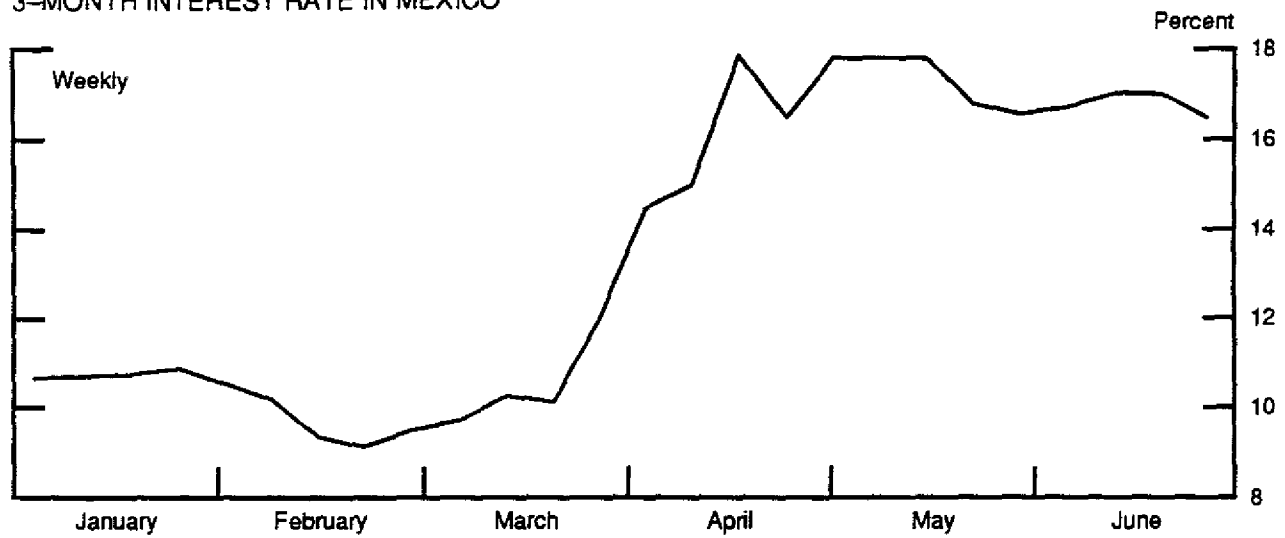
As shown on the following table, which charts the behavior of Mexican financial markets, on June 28 the peso was only 0.3 percent above the lower limit of its fluctuation band against the dollar, having depreciated by 8.4 percent since mid-February. Also on June 28, the Mexico City stock market closed 22.5 percent below its February all-time high and 14 percent above its 1994 low. The rate on 3-month peso-denominated Treasury bills at the June 29 auction was 16.5 percent, up sharply from 9.1 percent in mid-February.

In Brazil, economic activity remains robust. Real GDP rose by 5.7 percent in the first quarter of 1994 over a year earlier, led by strong performance in agriculture. Monthly inflation in May, however, was 42 percent, continuing the high level seen in recent months. The cumulative trade surplus for the year through April 1994 was \$4.2 billion, down from a surplus of \$4.9 billion over the same period in 1993. Imports grew by 13 percent, while exports stagnated. The deterioration in the trade balance reflects strong internal demand, trade liberalization, and a 12.5 percent appreciation of the real exchange rate between Q1 1993 and Q1 1994.

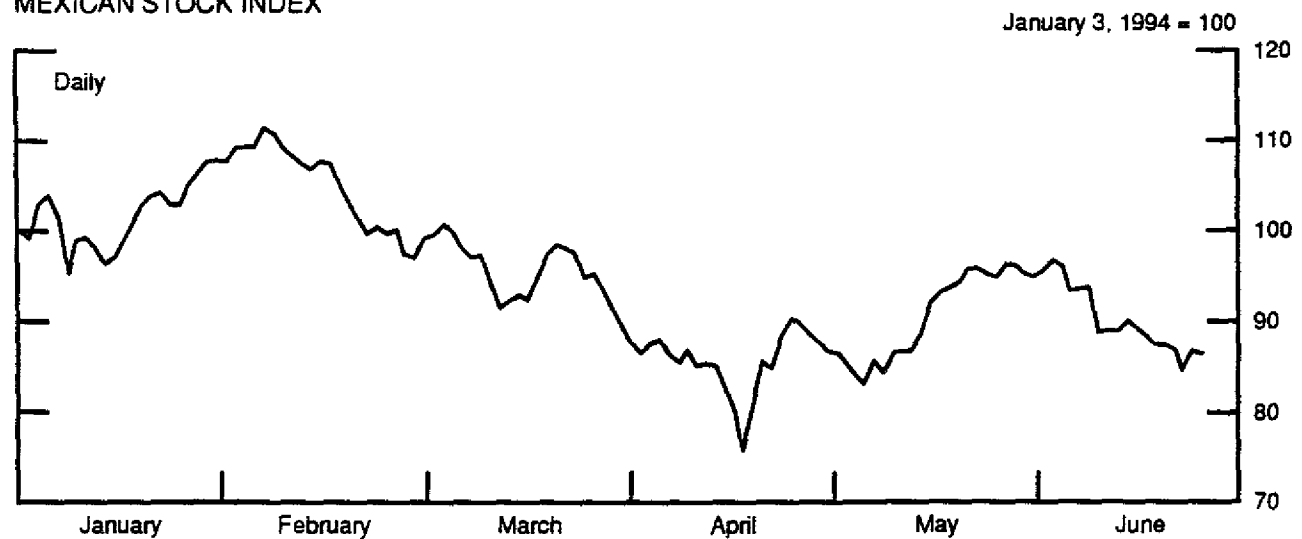
EXCHANGE VALUE OF THE MEXICAN PESO



3-MONTH INTEREST RATE IN MEXICO



MEXICAN STOCK INDEX



On July 1, Brazil will introduce a new currency, the "real," as part of its current anti-inflation program. The government announced in mid-June that the real will be temporarily pegged to the dollar and will be backed "in part" by international reserves. Finance Minister Ricupero recently stated that the government is willing to commit as much as \$10 billion in reserves to support the new currency. (Total international reserves were \$38 billion at the end of April.) Nevertheless, in a recent survey of Brazilians, over half the respondents did not believe that the anti-inflation program would succeed.

In Argentina, the ongoing investment boom is contributing to higher industrial output and a larger trade deficit. During the first quarter of 1994, gross fixed investment was over 30 percent higher than a year earlier, reflecting large construction expenditures and an increase of 110 percent in capital goods imports. Industrial production during January-April was about 7 percent higher than a year earlier, surpassing the previous cyclical peak reached in 1987. Consumer prices in May were 3.3 percent higher than a year earlier.

According to preliminary estimates, exports during January-May were up about 9 percent (year/year), as strong manufactured exports swamped the influence of a poor wheat harvest. Soaring capital goods imports, however, generated a 46 percent increase in total imports during January-April, causing the trade deficit to widen to \$1.85 billion from \$186 million over the same period last year. Faced with weak grain exports and a burgeoning trade deficit, the Menem administration has announced tax measures to encourage the agricultural sector to increase exports.

On June 14, authorities in Venezuela intervened and closed eight financial institutions holding more than 20 percent of the

public's deposits in the banking system. These institutions had received about \$3 billion in credit from the deposit insurance agency and the central bank since January. Despite government assurances that all eight institutions would resume operations by June 20, only three banks had been reopened by the end of June.

Continued large monetary emissions to the financial system stimulated a jump in monthly consumer price inflation to 5 percent in May and an estimated 5.5 percent in June, up from 3 percent per month a year earlier. Rising inflation and falling confidence in the banking system contributed to a renewed surge in capital flight and currency depreciation. The central bank spent an estimated \$1 billion in foreign exchange in June (about 20 percent of its international reserves, excluding gold) to support the bolivar. Nevertheless, the bolivar lost 21 percent of its value over nine days, and closed at about 200 bolivars per dollar on June 23, down from 106 bolivars per dollar at the beginning of the year.

On June 27, President Caldera announced the immediate adoption of foreign exchange and price controls and the suspension of various constitutional guarantees concerning civil and economic rights. The central bank suspended foreign exchange trading until currency control measures are implemented on July 6. Price controls were imposed on about 100 basic goods and services. In a nationally televised speech, Caldera also promised to provide public subsidies to reduce the cost of food and transport to low-income households. Since Caldera received strong support for the emergency measures from opposition party leaders, the Venezuelan congress is likely to expedite its approval of the decree.

Growth and inflation in China remain high, while the trade deficit appears to be narrowing. Industrial production rose 17 percent in May over a year earlier, after an 18 percent increase in

April. Consumer prices were up 21 percent in May (year/year); in 35 major cities, prices increased by 23 percent. During the first five months of 1994, the trade deficit was \$1.8 billion, down from \$3.1 billion in the same period last year. Exports rose 24 percent, and imports rose 18 percent.

Official reports indicate that China eased credit controls in May and June, largely in response to the number of state-owned enterprises (SOEs) that were unable to meet their payrolls. In June, Chinese authorities ordered most of the country's 40-odd futures exchanges to cease trading, and prohibited brokerages from placing orders on international markets. Many SOEs have been active traders on international futures markets, reportedly losing large amounts of money.

Real GNP growth in Taiwan was 5.5 percent in the first quarter of 1994 (year/year), compared with 6.3 percent growth in the same period last year. Exports, through May, were up 3.7 percent over the same period a year earlier, while imports were up 7.2 percent. Consumer prices were 4.3 percent higher in May than a year earlier.

In recent months, Taiwan has taken steps to liberalize its financial sector. It is opening the insurance market to all foreign insurers, and it has lifted its ban on foreigners establishing new commercial banks. The authorities also agreed to raise the ceiling on foreign investment in Taiwan's stock market to 10 percent of total capitalization, an increase of about 35 percent over the previous fixed-dollar limit.

Economic recovery in Korea is firmly established. Real GDP increased by 9.1 percent in the first quarter of 1994 from a year earlier. Strong growth has been fueled, in part, by a recovery in fixed capital investment from the depressed levels recorded in the first half of 1993; capital investment during the first quarter of

1994 increased by 13.5 percent, compared with the same period last year. Despite strong growth, inflation has slowed somewhat. Consumer prices were 5.7 percent higher in May 1994 than a year earlier.

Merchandise imports increased by 14.1 percent in the first four months of 1994 from a year earlier, while exports grew by 8 percent. This contributed to a widening of the current account deficit for the first four months of 1994 to \$2.8 billion from \$700 million a year earlier.

In Russia, consumer prices increased by only 8.1 percent in May, a 30-month low. Industrial production, however, continued to contract. According to official statistics, industrial production during April and May was 28 percent lower than during the same period a year ago; the accuracy of these figures, however, is increasingly questioned, since they do not appear to capture the burgeoning growth of the private sector.

Since late-February, the ruble has depreciated against the dollar at a steady rate of 1 percent a week. On June 29, the MICEX ruble-dollar exchange rate was 1992. During the last two months, the Central Bank of Russia has progressively lowered its monthly refinance rate from 17.5 percent to 14.2 percent, still well above the monthly inflation rate.

In mid-June, the Russian government reversed a November 1993 decree prohibiting foreign banks from serving Russian customers. This reversal, however, applies only to banks from countries that have allowed Russian banks to enter. Since Russian banks have not satisfied regulatory requirements to enter the United States (indeed, only one Russian bank has made formal application for entry), U.S. banks are still banned from serving Russian customers.



On June 24, the Russian parliament approved the 1994 budget. The final version outlines a deficit estimated at 9.5 percent of 1994 GDP. (Russia's fiscal accounting procedures deviate from IMF conventions; the deficit falls to slightly below 9 percent of GDP when IMF conventions are used.) Russia's Systemic Transformation Facility with the IMF authorizes a deficit of only 7.2 percent of GDP. Nonetheless, the IMF has not criticized the budget, perhaps because the government showed significant commitment to fiscal discipline by rejecting the military's demands for large funding increases.