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Part 2

August 15, 1996

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

Confidential (FR) Class III FOMC

August 15, 1996

RECENT DEVELOPMENTS

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

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The limited data now available for the third quarter suggest some slackening in the pace of economic expansion since the spring, but just how much is far from clear. Although private domestic final demand appears to be decelerating, lean inventory positions at midyear may be prompting some restocking. Employment continues to expand at a pace sufficient to maintain the tautness in the labor market that produced a pickup in wage gains in the first half of the year. However, major price measures have shown no signs of underlying acceleration.

GDP in the Second Quarter

According to BEA's advance estimate, real GDP grew 4.2 percent at an annual rate in the second quarter of 1996. As shown in the table, we anticipate a downward revision to this figure, to about 3.7 percent. In particular, June inventory investment came in below BEA's expectations. For final sales, revised estimates of June retail sales will likely pare the advance estimate of PCE. Although no new source data have become available, the second-quarter estimate of federal purchases looks oddly high and seems likely to be revised down. New information on construction put in place and capital goods shipments lead us to expect an upward revision to second-quarter business fixed investment. In addition, after reviewing the other available second-quarter information, we think that BEA's assumptions for imports in June may have been too skimpy.

SECOND-QUARTER GDP GROWTH
(Billions of 1992 chained dollars)

Category	BEA advance	Expected revision
Real GDP	70.8	-8.8
Inventory investment	13.3	-6.7
Final sales	59.0	-2.0
PCE	42.9	-3.6
BFI	1.0	5.2
Res. structures	9.7	1.2
Federal	9.5	-1.8
State and local	12.2	-.4
Net exports	-17.7	-2.8
Real GDP growth (percent)	4.2	-.5
Memo:		
Output per hour, nonfarm business (percent)	-.1	-.5

CHANGES IN EMPLOYMENT¹
(Thousands of employees; based on seasonally adjusted data)

	1994	1995	1995		1996		1996	
			Q4	Q1	Q2	May	June	July
	-----Average monthly changes-----							
Nonfarm payroll employment ²	318	185	171	200	273	407	220	193
Private	295	176	164	185	253	346	224	156
Manufacturing	33	-12	-16	-28	5	19	-4	-20
Strike-adjusted	35	-13	-20	-27	6	19	2	-21
Durable	28	5	6	-15	24	25	15	-7
Transportation equipment	5	-3	-5	-13	16	10	2	-1
Nondurable	5	-17	-22	-14	-18	-6	-19	-13
Construction	25	9	12	39	22	31	22	25
Trade	91	54	41	20	90	94	96	101
Finance, insurance, real estate	-3	4	15	15	12	22	4	19
Services	134	110	95	125	110	160	90	28
Business services	54	33	29	32	44	67	38	35
Total government	23	9	7	16	20	61	-4	37
Private nonfarm production workers ²	267	152	128	163	207	249	218	107
Manufacturing production workers	34	-10	-13	-30	5	9	1	-9
Total employment ³	261	32	-18	390	153	367	148	274
Nonagricultural	225	51	-15	336	188	245	257	154
Memo:								
Aggregate hours of private production workers (percent change) ²	.4	.1	.1	.3	.5	.1	1.7	-1.2
Average workweek (hours) ²	34.6	34.5	34.4	34.3	34.4	34.2	34.7	34.3
Manufacturing (hours)	41.9	41.6	41.4	40.9	41.7	41.7	41.9	41.6

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
(Percent; based on seasonally adjusted data)

	1994	1995	1995		1996		1996	
			Q4	Q1	Q2	May	June	July
Civilian unemployment rate (16 years and older)	6.1	5.6	5.5	5.6	5.4	5.6	5.3	5.4
Teenagers	17.6	17.3	17.6	17.4	16.3	16.4	15.9	16.4
20-24 years old	9.7	9.1	9.2	9.8	9.3	9.7	9.3	9.6
Men, 25 years and older	4.8	4.3	4.2	4.3	4.1	4.1	4.0	4.0
Women, 25 years and older	4.9	4.4	4.3	4.3	4.3	4.5	4.1	4.3
Full-time workers	6.1	5.5	5.5	5.5	5.3	5.5	5.2	5.3
Labor force participation rate	66.6	66.6	66.4	66.7	66.7	66.9	66.7	66.9
Teenagers	52.7	53.5	52.9	52.6	52.5	53.5	51.4	52.2
20-24 years old	77.0	76.6	76.1	76.9	77.0	77.5	76.5	76.6
Men, 25 years and older	76.0	76.0	75.6	76.0	76.1	76.3	76.3	76.4
Women, 25 years and older	58.1	58.3	58.5	58.4	58.6	58.6	58.7	58.9

Labor Market Developments

Labor market indicators have been mixed of late. Private nonfarm payroll employment rose 156,000 in July, a pace considerably slower than the average monthly increase of 219,000 for the first half of the year. And, with a 0.4 hour decline in average weekly hours, production-worker hours dropped back sharply to a level equal to the second-quarter average.

In the household survey, however, total employment increased 274,000 last month--maintaining the rapid pace of the first half. The labor force participation rate rose 0.2 percentage point in July, again reaching 66.9 percent--its high point for the year. Since bottoming out at 66.4 percent in the fourth quarter of 1995, the participation rate has returned to levels more consistent with our estimate of its trend. The rebound in participation has been widespread across demographic groups; only the rate for teenagers has shown a decline since the end of 1995.

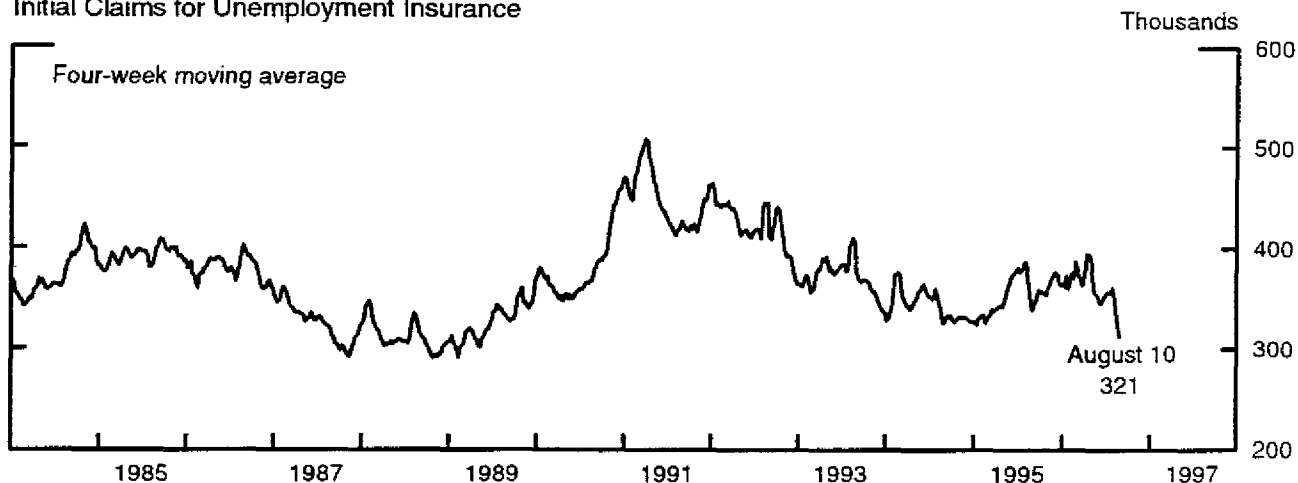
The published unemployment rate edged up to 5.4 percent in July, from 5.3 percent in June; however, on a concurrently seasonally adjusted basis, the rate was 5.4 percent in both months. Other recent indicators also suggest continued labor market strength. Initial claims for unemployment insurance have averaged 331,000 per week since the beginning of July--the lowest level for any six-week period since early 1995.¹ The adjusted Help Wanted Index rose appreciably in June, to the high end of the range that has prevailed for the past two years. Consumers' appraisals of job availability improved considerably in July in the Conference Board's survey of consumer attitudes. The July Michigan survey of consumers similarly showed an improvement in expectations for unemployment over the next twelve months.

According to the BLS, output per hour in the nonfarm business sector edged down at an annual rate of 0.1 percent in the second quarter--a figure the staff expects to be revised down to a

1. Claims were volatile in July and early August, rising to 370,000 during the week ended July 6 and then falling sharply to 294,000 during the week ended July 27, before rebounding somewhat in the first two weeks of August. This volatile pattern--seen each July for the past three years--reflects the inability of seasonal factors to account for annual variation in the timing of summer layoffs in the automobile and textile industries. In addition, unusually small layoffs at GM this year--as the automaker attempted to rebuild its inventories--contributed to the especially low July 27 claims figure.

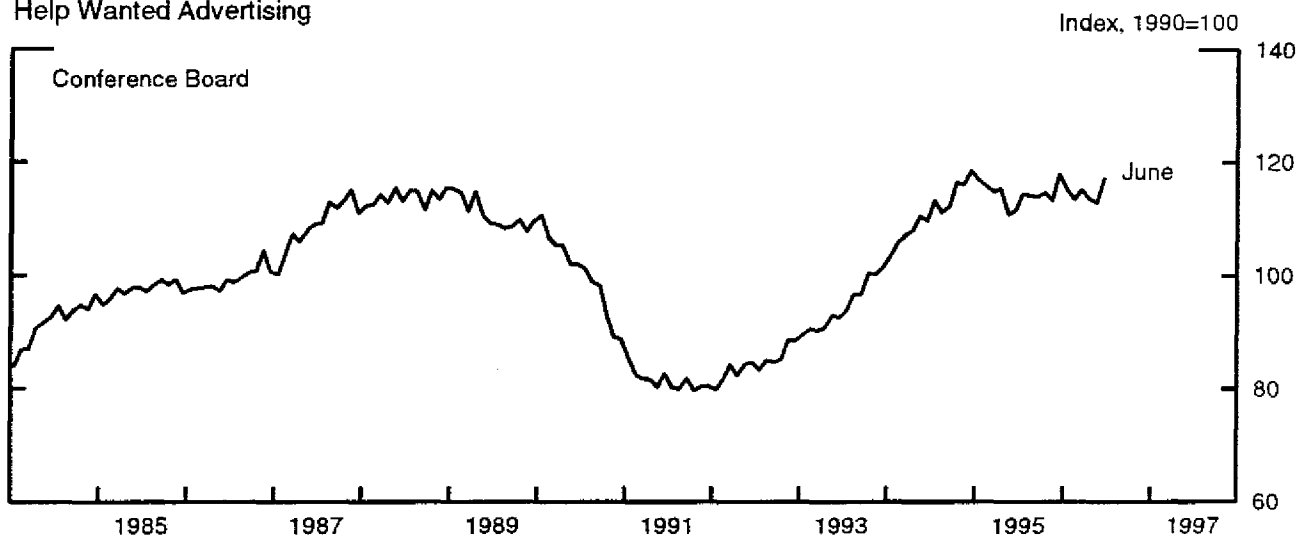
Labor Market Indicators

Initial Claims for Unemployment Insurance



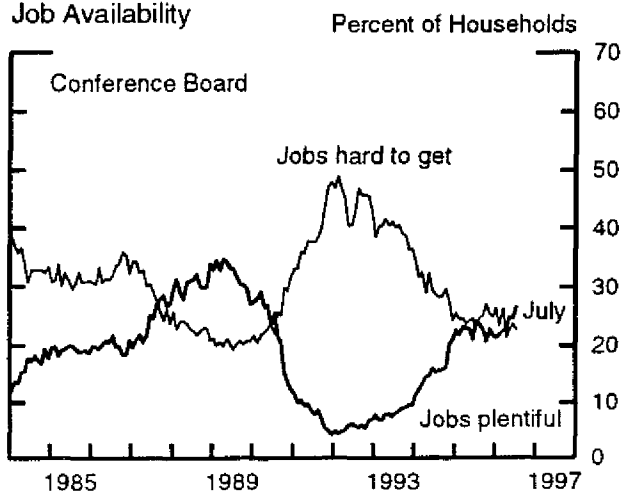
Note. State programs, includes EUC adjustment.

Help Wanted Advertising

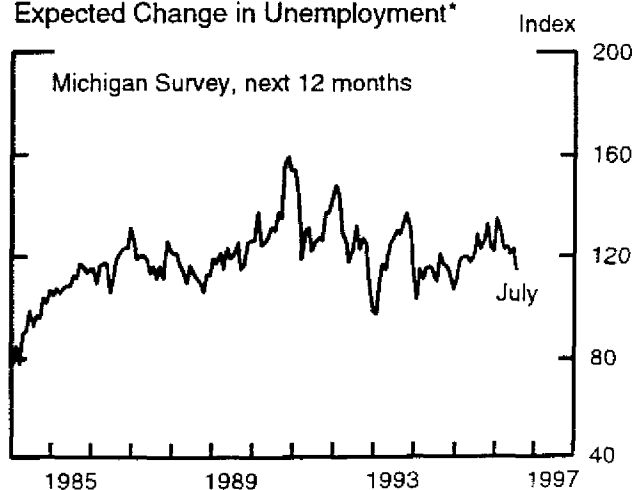


Note. Series has been adjusted to take account of various structural and institutional changes, including consolidation of the newspaper industry and a tendency toward increased hiring through personnel supply agencies.

Job Availability



Expected Change in Unemployment*



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

PUBLISHED LABOR PRODUCTIVITY
 (Percent change from preceding period at compound annual rate;
 based on seasonally adjusted data)

	1994 ¹	1995 ¹	1995		1996		1995:Q2 to 1996:Q2
			Q3	Q4	Q1	Q2	
<u>Output per hour</u>							
Total business	.3	.3	1.7	-.6	2.0	.5	.9
Nonfarm business	.5	.3	2.0	-1.1	1.8	-.1	.7
Manufacturing	4.5	3.5	5.3	3.7	5.6	1.5	4.0
Nonfinancial corporations ²	.4	1.9	5.2	2.5	1.1	N.A.	N.A.

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

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

Productivity in the Nonfarm Business Sector



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

	Proportion 1995:Q4	1994 ¹	1995 ¹	1996		1996		
				Q1	Q2	May	June	July
				-Annual rate-		--Monthly rate---		
Total index	100.0	6.6	1.6	3.0	6.0	.5	.6	.1
Previous		6.6	1.6	3.0	5.6	.5	.5	
Manufacturing	86.5	7.6	1.4	2.4	6.5	.5	.7	.3
Motor veh. and parts	5.5	8.6	-2.6	-20.7	46.5	.3	2.7	4.3
Aircraft and parts	1.7	-7.9	-17.1	64.0	15.2	1.2	.5	.3
Manufacturing excluding motor vehicles, aircraft, and parts	79.2	8.0	2.2	3.0	4.0	.5	.6	.0
Consumer goods	23.1	4.7	.1	.2	-.7	.2	.0	-.1
Durables	3.7	6.4	-.4	-5.4	7.4	.8	3.6	-.1
Nondurables	19.4	4.4	.2	1.2	-2.2	.1	-.7	.0
Business equipment	13.6	13.1	7.7	13.9	8.2	.0	1.1	-.1
Office and computing	3.1	29.6	36.2	48.4	41.4	2.5	1.9	1.7
Industrial	4.3	8.6	3.5	4.1	-3.2	-.4	-.5	-.2
Other	6.1	8.4	.8	4.9	-1.4	-.5	.2	-.4
Defense and space equipment	1.7	-10.5	-7.3	-1.7	5.9	.6	.1	-.5
Construction supplies	5.3	8.0	-.4	.6	5.5	1.1	2.2	.0
Materials	28.7	10.5	3.4	3.6	6.4	.8	.8	.4
Durables	20.3	12.1	6.3	7.1	4.0	.8	1.0	.5
Nondurables	8.2	6.9	-2.8	-5.0	12.5	.8	.3	.1
Mining	6.0	1.2	-1.8	1.9	8.8	-.2	1.7	-.3
Utilities	7.5	.2	6.2	8.9	.0	1.2	-1.5	-1.8
Memo: Information-related products ²	11.2	20.7	21.4	21.6	19.3	1.4	1.4	1.3

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

2. Includes computer equipment, computer parts, semiconductors, communications equipment, and selected instruments.

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89	1967-95	1995	1996		1996		
	High	Avg.	Q2	Q1	Q2	May	June	July
Total industry	84.9	82.1	83.7	82.8	83.2	83.2	83.4	83.2
Manufacturing	85.2	81.4	83.0	81.6	82.1	82.0	82.3	82.3
Primary processing	89.0	82.6	87.6	85.2	86.0	86.0	86.5	86.2
Advanced processing	83.5	80.7	81.0	80.1	80.4	80.3	80.6	80.7

0.6 percent decline. Nonfarm output now is estimated to have risen 3.7 percent at an annual rate (1/2 percentage point below the published BLS number), while hours worked jumped 4.2 percent (annual rate). Over the four quarters ended in the second quarter, labor productivity rose 0.5 percent--a bit less than in the year-earlier period.

Industrial Production

Industrial production edged up 0.1 percent in July, following three consecutive months of strong growth.² Manufacturing output posted a 0.3 percent gain that was mostly offset by declines in utilities and in mining; electricity generation dropped sharply for a second month, as a result of unseasonably cool weather, and coal production fell. Roughly two-thirds of the gain in manufacturing production was the direct result of a strong advance in the output of motor vehicles and parts. The remainder of the increase occurred in the output of information-related products and the production of aircraft and parts.³ The growth in these areas of manufacturing was tempered by lackluster production of non-auto consumer durables and industrial equipment.

Production of motor vehicles in July--13.4 million vehicles at an annual rate--came in well above both the announced schedules in place at the beginning of the month and the strong pace in June. With the pickup in production, the days' supply of cars moved back to more comfortable levels. In contrast, the days' supply of light trucks was at the upper end of the range that has prevailed since early 1995. Some of the surge in production may reflect precautionary stockbuilding against the possibility of a strike by

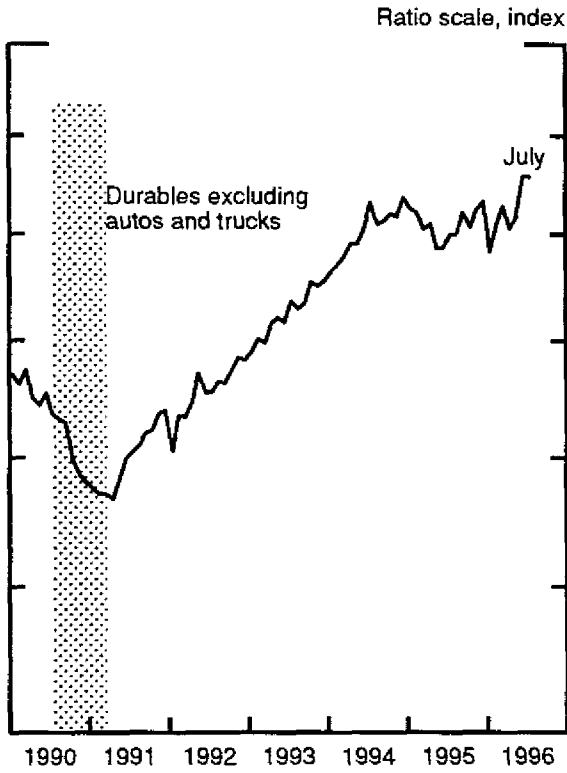
2. The July estimate of manufacturing activity shows an increase despite the considerable drop in manufacturing hours reported in the BLS payroll survey. Several factors account for this divergence: First, physical product data for paper, paperboard, and motor vehicles were strong compared with the corresponding hours data. Second, some of the decreases in hours occurred in industries that have lower value-added weights in IP than employment shares. Third, a few industries showed sharp decreases in hours because of unusually timed vacation periods during the payroll survey reference week that should have a smaller effect on output for the month as a whole. Finally, we were cautious in reading the July decline in hours for the computer and office equipment industry too literally because weakness in these hours through June did not turn out to be consistent with other input indicators.

3. The continuing strike at a McDonnell Douglas plant, which started on June 5 and involves about 6,700 workers, had a negligible effect on manufacturing output.

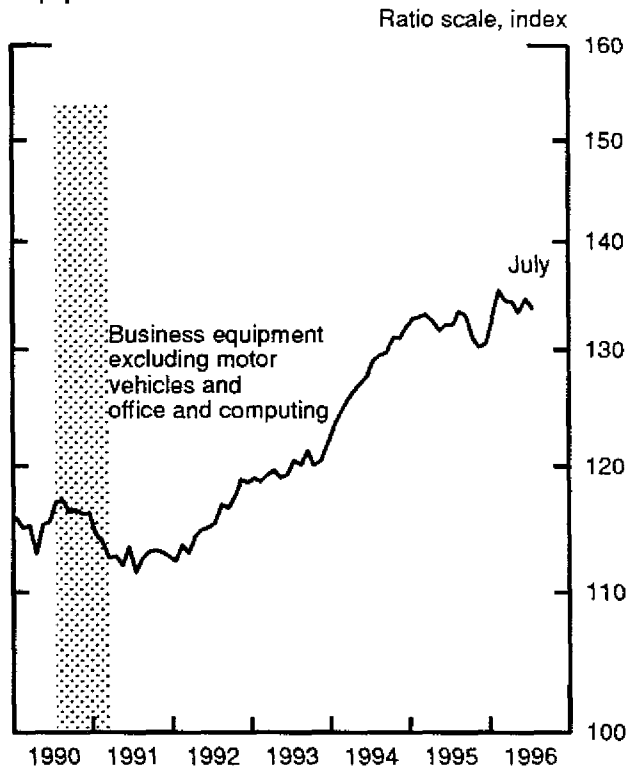
Selected Components of Industrial Production, by Market Group

(1987 = 100)

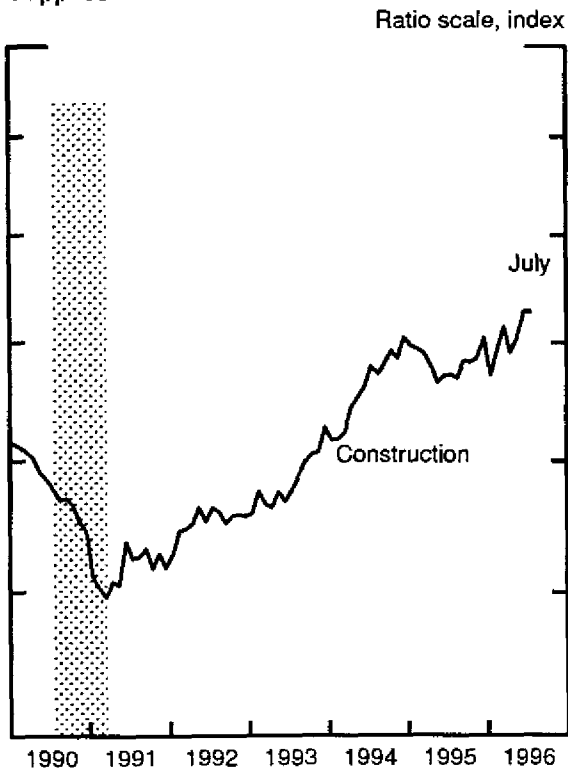
Consumer Goods



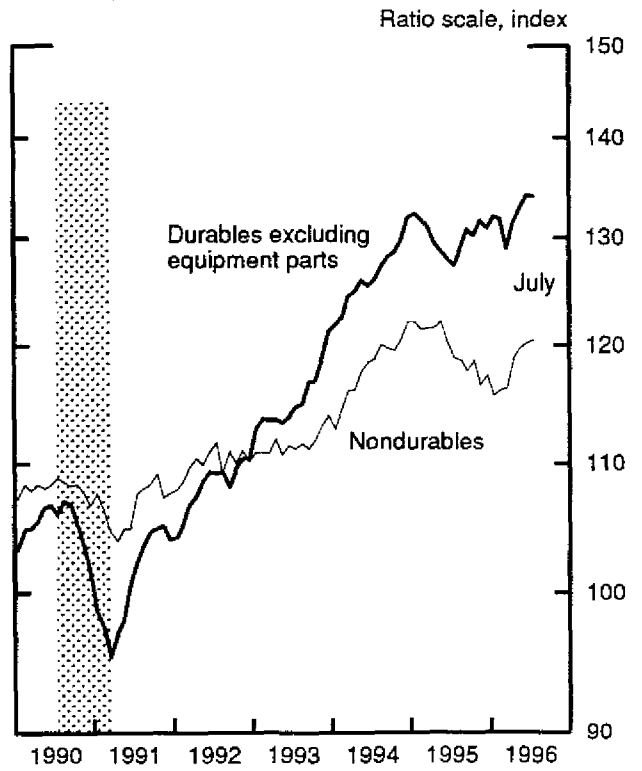
Equipment



Supplies



Materials



the UAW, although, not surprisingly, no company has indicated it is pursuing such a strategy.⁴

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

	1996				
	Q2	July	Aug.	Sept.	Q3
			-----scheduled-----		
U.S. production	12.2	13.4	12.6	12.9	12.9
Autos	6.5	7.0	6.8	7.0	6.0
Trucks	5.8	6.3	5.8	5.9	6.9
Days' supply					
Autos	58.2	65.8	...	...	...
Light trucks	72.5	78.0	...	...	...

Note: Components may not sum to totals because of rounding.

Outside of the motor vehicle and parts industry, manufacturing output ticked up 0.1 percent last month, after two months of strong gains. The deceleration stems in large part from an estimated flattening in production of construction supplies and a decline in output of non-auto consumer durables. Production of consumer nondurables, which has not expanded, on balance, in more than a year, was unchanged again in July. Output of business equipment, excluding motor vehicles and office and computing, also fell as production of industrial equipment registered its fifth monthly decline. Production in the materials industries was boosted by the output of motor vehicle parts and semiconductors. Outside of equipment parts, the production of durable goods materials fell while production of nondurable materials inched up after solid gains earlier in the year.

Although the manufacturing utilization rate is estimated to have eased back to 82.3 percent in July, it still stands about 1 percentage point above its 1967-95 average, boosted by sustained high readings for computer equipment, primary metals, and petroleum products. In primary processing industries, the average operating

4. Recent reports have suggested that while General Motors could be the strike target, Chrysler will more likely be hit. The official date for announcing the target is August 22. At this point, if a strike were to occur, it would probably be at the local and not the national level. Even so, the effects on overall output could be significant if the stoppage occurs at a key parts plant. A strike in Canada still remains more likely than a domestic strike. General Motors is the overwhelming favorite in Canada as the target, and if a strike shutting down parts production were to occur there, U.S. output would be crippled as well.

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

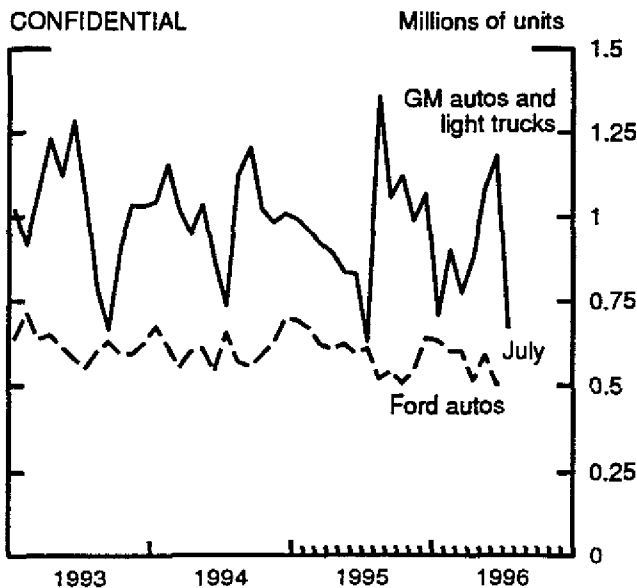
	1994	1995	1995		1996		1996	
			Q4	Q1	Q2	May	June	July
Total	15.05	14.71	14.91	15.16	15.11	15.75	15.10	14.21
Adjusted ¹	15.02	14.61	14.42	15.34	15.10	15.53	15.10	14.41
Autos	8.99	8.63	8.65	8.61	8.76	9.27	8.74	8.12
Light trucks	6.06	6.09	6.26	6.54	6.35	6.49	6.36	6.09
North American ²	12.91	12.81	13.12	13.46	13.39	13.98	13.31	12.66
Autos	7.26	7.12	7.26	7.32	7.51	7.97	7.39	6.95
Big Three	5.73	5.43	5.47	5.41	5.59	5.92	5.50	5.14
Transplants	1.52	1.69	1.79	1.91	1.91	2.06	1.89	1.81
Light trucks	5.66	5.69	5.87	6.15	5.89	6.00	5.92	5.71
Foreign produced	2.14	1.90	1.79	1.69	1.72	1.78	1.80	1.54
Autos	1.74	1.51	1.39	1.30	1.26	1.30	1.35	1.17
Light trucks	.40	.39	.39	.40	.46	.48	.45	.38

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

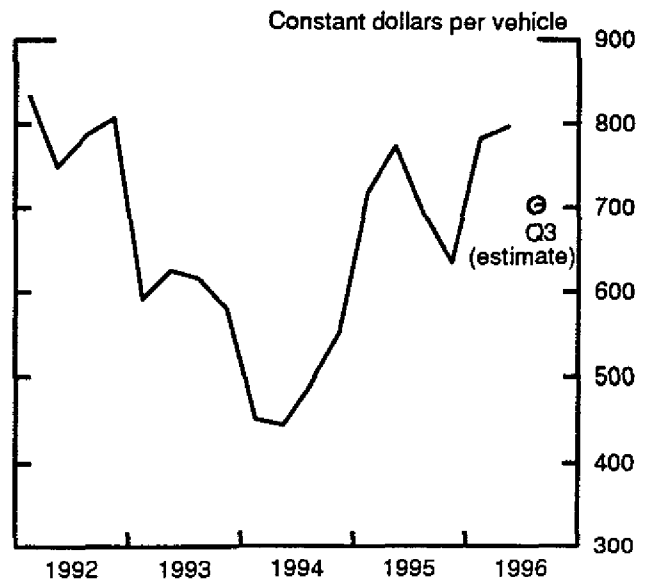
1. Excludes the estimated effect of automakers' changes in reporting periods.

2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

GM and Ford Fleet Sales



Marketing Incentives for Light Vehicles
(FRB seasonals)



Data from J.D. Powers, deflated by CPI for new motor vehicles.

rate dropped to 86.2 percent in July, above its long-term average but below the high levels seen in early 1995.

Personal Income and Consumption

Consumer spending evidently has weakened somewhat on average in the past couple of months after expanding briskly in the spring. Nonetheless, the fundamentals suggest that this should be no more than a temporary pause: The underlying trend in income appears solid, and recent readings on consumer sentiment have been very positive.

Sales of new light vehicles, adjusted for changes in reporting periods, dropped in July from the 15.1 million unit pace in June.⁵ Most of the weakness owed to a cutback in fleet sales by General Motors--by 0.5 million units, primarily in autos--while GM's retail sales were about unchanged (confidential).⁶ Consumer demand for light vehicles remained at a high level in July, and consumers' appraisals of buying conditions for new vehicles remained positive, encouraged by a continuation of sizable sales incentives.

Total nominal retail sales moved up 0.1 percent in July, despite a steep decline in spending at automotive dealers.⁷ Nominal outlays in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 0.5 percent. Within the retail control category in July, gains in outlays at food, drug, and "other durable goods" stores more than offset weak spending elsewhere. Many industry analysts have attributed the July weakness in some of the more discretionary categories of retail sales (such as apparel and furniture) to two special factors. First, the Olympics may have kept potential

5. The major Japanese firms counted sales during the first couple of days of July as June sales. We estimate that this shift reduced sales in July by about 0.2 million units. Sales in June were not distorted, however, because the May reporting period was extended into early June. Thus, the dip in July sales was an offset to the upward boost to May sales. The major Japanese firms intend to continue shifting their reporting periods as they see fit as long as the reporting period for Ford is different from that of GM and Chrysler.

6. General Motors may have deliberately curbed fleet sales in July to ensure that consumers were not inhibited by limited supplies. At the beginning of July, inventories of General Motors' autos were particularly lean, and with most assembly plants closed during the first two weeks of July, the prospects of limited stocks restricting overall sales likely increased. This situation also likely played some role in the firm's decision to step up production well beyond initial plans for the second half of the month.

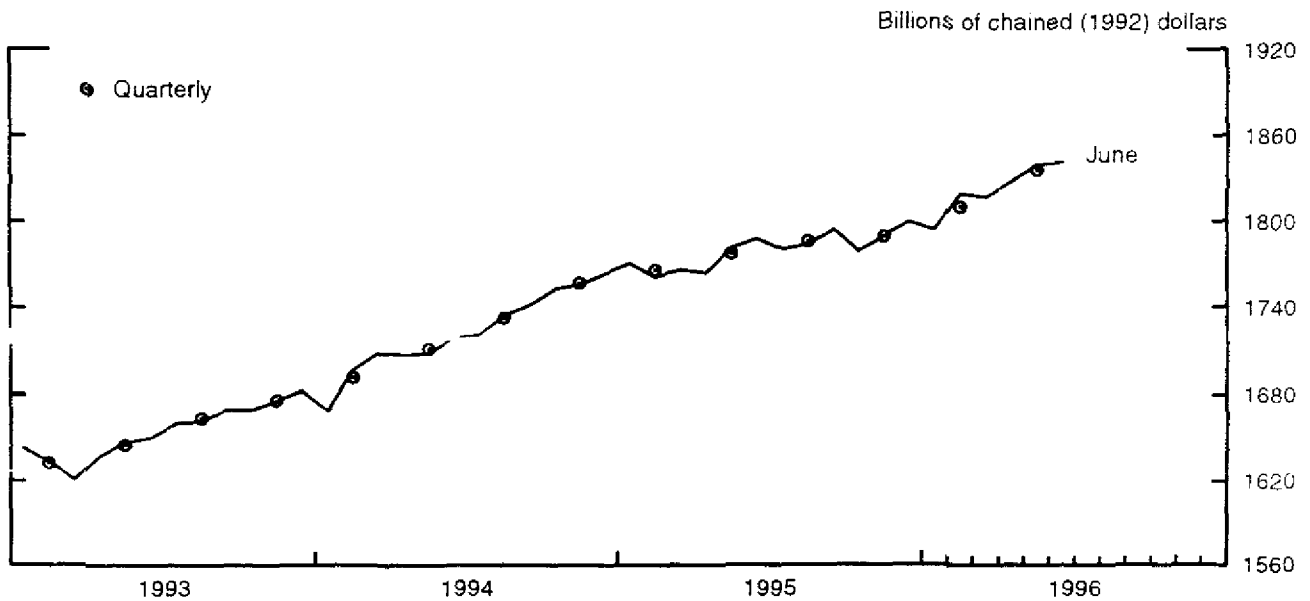
7. Sales of fleet vehicles typically occur through the dealer network and thus are captured in the retail sales data.

Retail Sales
(Percent change; seasonally adjusted)

	1996				
	Q1	Q2	May	June	July
Total sales	2.3	1.3	.8	-.5	.1
<i>Previous estimate</i>		1.4	.8	-.2	
Retail control ¹	1.6	1.8	.4	-.5	.5
<i>Previous estimate</i>		2.0	.5	.0	
Durables	1.6	3.3	1.1	-1.1	.8
Furniture and appliances	-.3	2.2	.1	-.1	-.0
Other durable goods	3.3	4.2	1.9	-1.8	1.5
Nondurables	1.6	1.5	.3	-.4	.4
General merchandise	2.3	1.9	1.1	-1.0	.1
Food	.9	.4	-.5	.2	.8
Drug and proprietary stores	1.1	1.4	1.0	.1	1.1
Other nondurable goods	1.9	2.0	.3	-.5	.1

1. Total retail sales excluding building material and supply stores and automotive dealers (but including auto and home supply stores).

PCE Goods Excluding Motor Vehicles



shoppers at home in front of the television. Second, the cooler weather may have reduced the appeal of air-conditioned malls and depressed sales of air conditioners and other summer merchandise. Be that as it may, the net gain in retail control in July merely offset a like decline in June. Consequently, it appears that in July real consumer spending on goods, excluding motor vehicles, was about 2-1/4 percent above its second-quarter average, at an annual rate.

Real expenditures on services fell 0.3 percent in June. Spending on energy services posted a particularly large decline, as temperatures returned to normal after unseasonably warm weather in May. Elsewhere, estimated declines in spending on transportation, medical care, and personal business services about offset increases in outlays for other types of services. For July, the indicators thus far are mixed: Although relatively cool temperatures likely led to a further decline in energy spending, the Olympics probably provided a significant boost to spending on recreation services.⁸

REAL PCE SERVICES
(Percent change from the preceding period)

	1994	1995	1995 Q4	1996		1996	
				Q1	Q2	May	June
			- Annual rate -			Monthly rate	
PCE Services	2.0	2.4	2.3	2.4	2.2	.3	-.3
Energy	-5.3	5.4	-12.2	7.3	9.5	5.8	-6.1
Non-energy	2.3	2.3	3.0	2.2	1.9	.1	.0
Housing	2.4	1.8	1.8	1.6	1.1	.1	.1
Household operation	5.4	3.8	4.7	-.4	3.8	.3	.5
Transportation	5.3	3.1	8.3	5.6	2.4	.7	-.6
Medical	1.9	2.5	3.1	-.1	1.6	-.2	-.2
Other	1.3	2.1	2.5	4.6	2.3	.1	.2

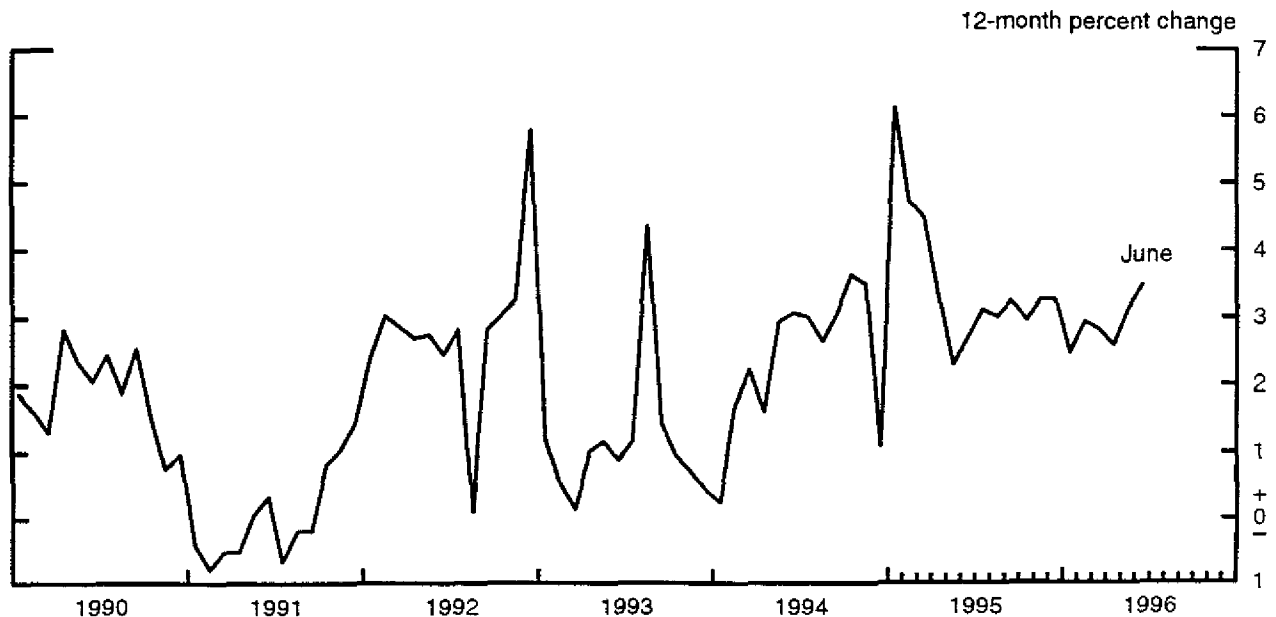
Total pre-tax household income grew rapidly in the second quarter, boosted in part by a spurt in private wages and salaries in June. However, real disposable income increased at only a 1-1/2 percent annual rate during the quarter, and with robust

8. BEA has in the past made a judgmental adjustment to the "spectator sports" subcategory of recreation services to capture increases in spending associated with major sports events. For example, BEA estimated that real outlays on spectator sports grew at an annual rate of 41 percent in the third quarter of 1984, when the Olympics were held in Los Angeles. This increase contributed less than 0.1 percentage point to annualized growth in total PCE in that quarter, however.

PERSONAL INCOME
(Average monthly percent change)

	1994	1995	1995	1996		1996	
			Q4	Q1	Q2	May	June
Total personal income	.3	.5	.5	.4	.6	.5	.9
Wages and salaries	.1	.4	.5	.4	.8	.5	1.3
Private	.1	.5	.5	.5	.9	.5	1.6
Other labor income	.4	.5	.3	-.1	.4	.4	.4
Proprietors' income	.7	.3	.5	1.0	1.0	1.0	.7
Farm	-1.2	.4	4.9	6.5	6.3	6.7	4.8
Rent	1.9	.6	2.9	-1.5	-.9	-.3	-.7
Dividend	.7	.6	1.0	.6	.3	.3	.2
Interest	.5	.6	.4	-.3	.6	.7	.7
Transfer payments	.4	.6	.4	.7	.3	.3	.4
Less: Personal contributions for social insurance	.5	.4	.3	.3	.6	.4	1.2
Less: Personal tax and nontax payments	.3	.6	.3	1.0	1.1	-5.0	1.2
Equals: Disposable personal income	.3	.4	.5	.3	.6	1.4	.9

Real Disposable Income



spending growth, the personal saving rate declined 1/2 percentage point to 4.3 percent. Both disposable income and the saving rate were held down by a temporary increase in personal tax payments associated with the final installment on 1993 tax liabilities incurred by high-income tax payers under the Omnibus Budget Reconciliation Act of 1993. If these OBRA-93 tax payments had been spread over all of 1996 (as is BEA's practice for regular tax payments), real disposable income would have risen 2.7 percent in the second quarter, and the saving rate would have declined by a smaller amount, to 4.5 percent. More recently, the decline in aggregate hours in July suggests a drop in private wages and salaries in that month, although the movement will likely retrace only a fraction of the huge June gain.

Consumer sentiment strengthened further in July. The Michigan Survey Research Center index of consumer sentiment rose 2 points, reaching its highest level since last summer, and the Conference Board index surged to its highest value in more than six years. Consumers expressed more positive views about most aspects of their personal situations and economic conditions more generally. Views of current and future employment conditions registered a particularly large improvement. The greater optimism may have been associated with the favorable June employment report, as many respondents to the SRC survey mentioned the decline in the unemployment rate when asked about recent economic developments.

Housing Markets

At least through June, this year's rise in mortgage rates appears to have put no more than a modest dent in single-family building activity. Starts in June are estimated to have risen to 1.23 million units, the highest level in more than two years, while permits--a more reliable indicator statistically--were off only modestly from the peak rate of the spring quarter.

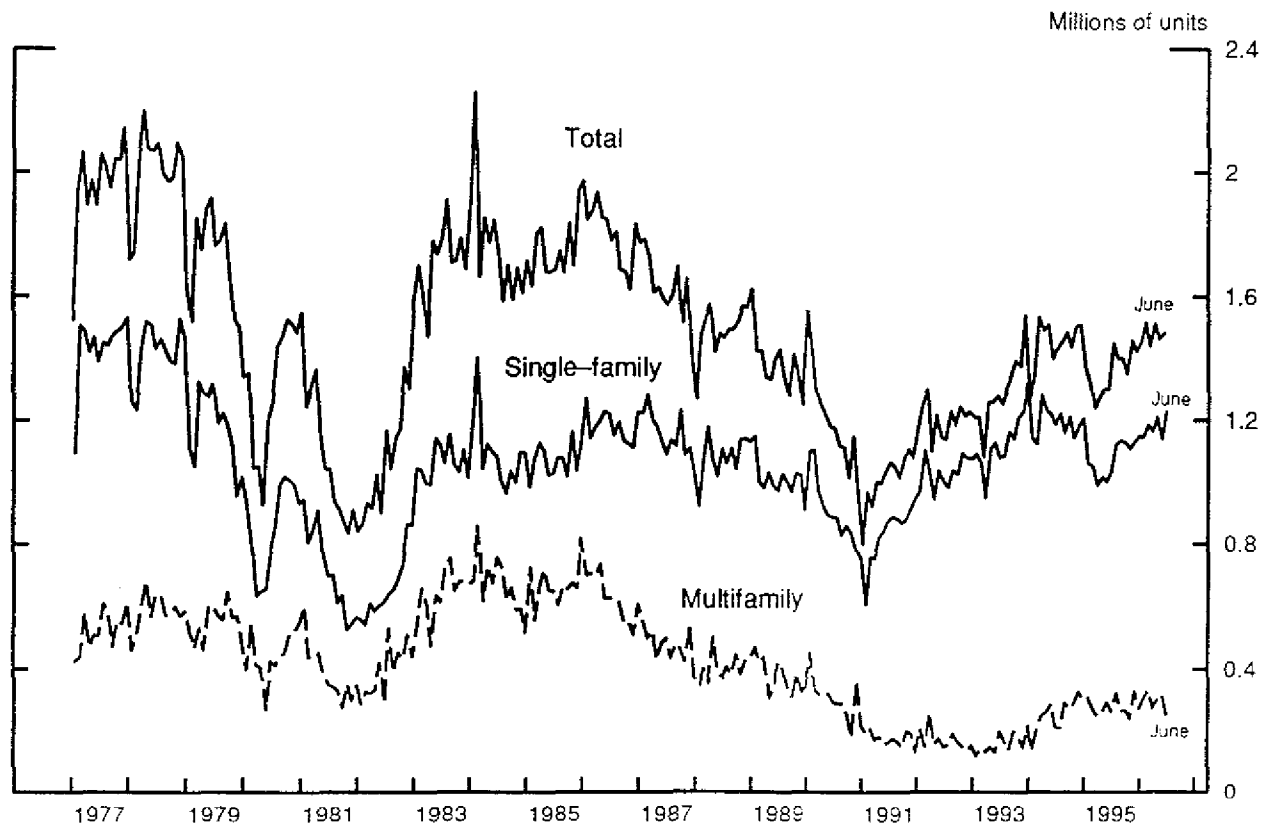
The June readings on sales of new and existing homes suggest some slackening in demand, but the still-high levels through early August for builders' ratings of new home sales (preliminary) and for mortgage applications to finance home purchases would seem to indicate that activity may be slipping quite gradually. As shown in the Michigan survey for July, consumer attitudes toward homebuying had leveled out in recent months, after turning slightly less positive early in the year. The proportion of households that mentioned a concern about rising mortgage rates as a reason for home

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

	1995		1996				
	1995	Q4	Q1 ^r	Q2 ^p	Apr. ^r	May ^r	June ^p
<i>All units</i>							
Starts	1.35	1.41	1.47	1.48	1.51	1.46	1.48
Permits	1.33	1.44	1.41	1.44	1.46	1.45	1.42
<i>Single-family units</i>							
Starts	1.08	1.13	1.16	1.19	1.21	1.14	1.23
Permits	1.00	1.08	1.08	1.10	1.12	1.10	1.09
New home sales	0.67	0.68	0.75	0.76	0.77	0.78	0.73
Existing home sales	3.80	3.98	3.95	4.22	4.20	4.28	4.18
<i>Multifamily units</i>							
Starts	0.28	0.28	0.31	0.29	0.30	0.32	0.26
Permits	0.33	0.36	0.33	0.34	0.34	0.35	0.33
<i>Mobile Homes</i>							
Shipments	0.34	0.35	0.35	n.a.	0.38	0.37	n.a.

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

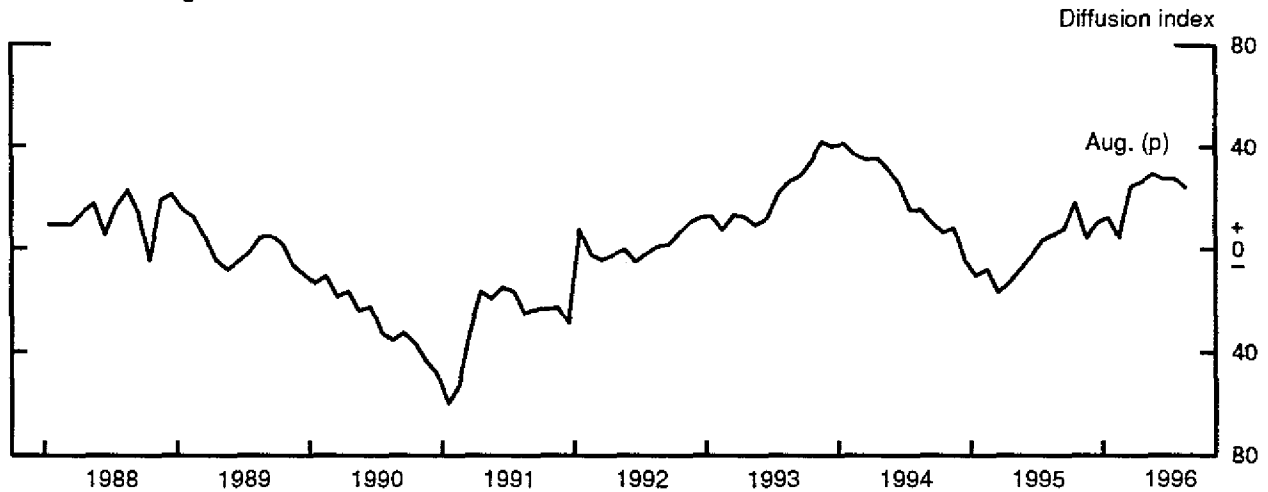
Private Housing Starts
(Seasonally adjusted annual rate)



Indicators of Housing Demand

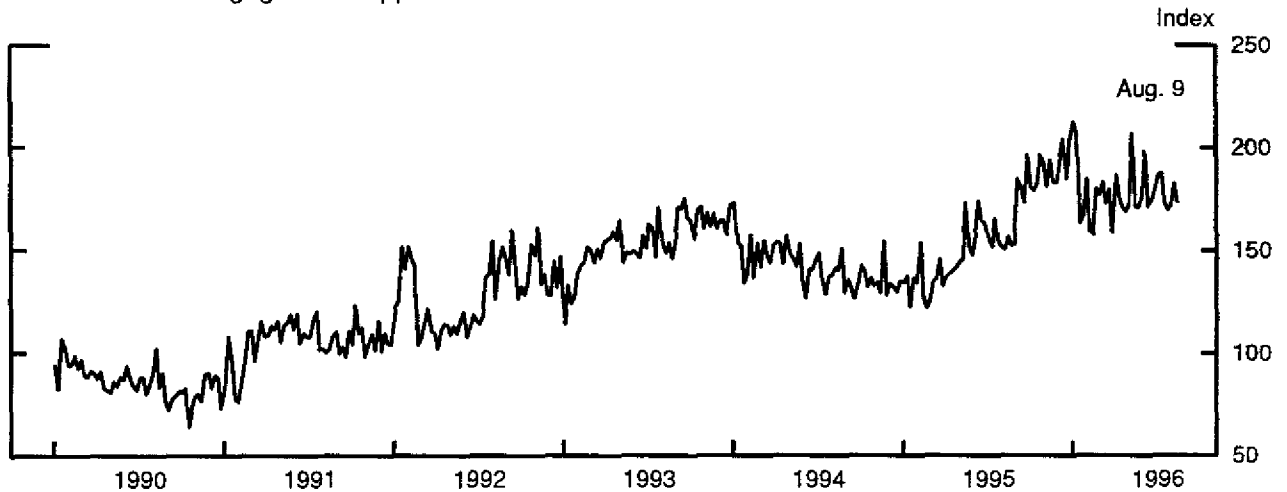
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



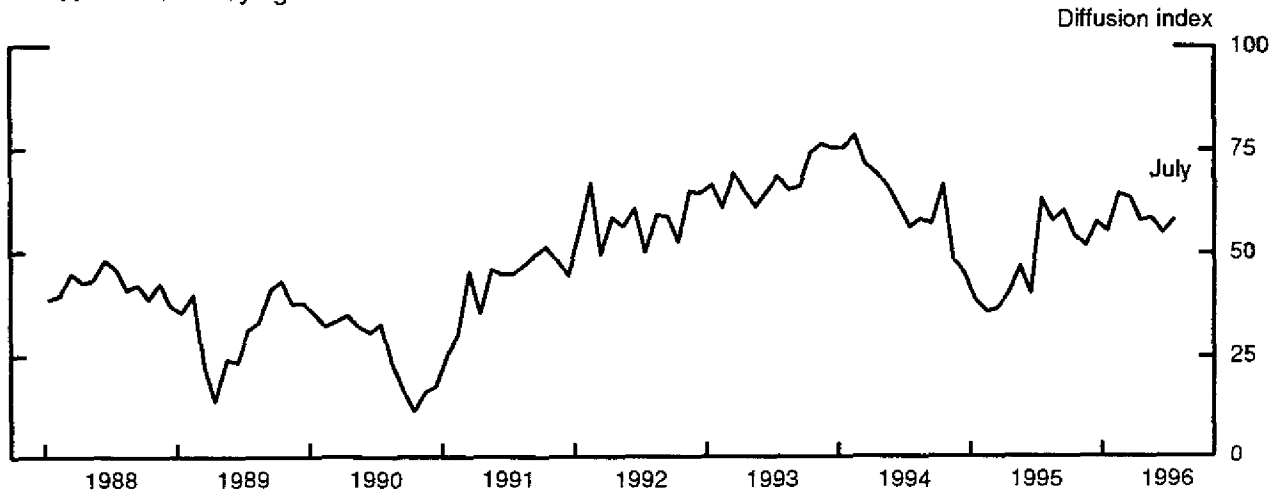
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good to excellent minus the proportion rating them as poor.

MBA Index of Mortgage Loan Applications for Home Purchase



Note. MBA index equals 100 on March 16, 1990, for NSA series.

Consumer Homebuying Attitudes



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

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

	1995	1996		1996		
	Q4	Q1	Q2	May	June	July
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	3.0	-5	2.7	2.8	-.2	n.a.
Excluding aircraft and parts	3.1	.8	1.3	.3	2.7	n.a.
Office and computing	5.1	3.7	-1.8	.1	-.1	n.a.
Communications equipment	7.7	-.3	4.4	4.2	5.5	n.a.
All other categories	1.4	.0	1.7	-.6	3.1	n.a.
Shipments of complete aircraft ¹	-3.9	1.4	10.4	38.2	-43.0	n.a.
Sales of heavy trucks	6.4	-2.2	1.2	10.0	-6.9	.1
Orders of nondefense capital goods	8.8	3.1	-6.7	11.1	-5.2	n.a.
Excluding aircraft and parts	3.4	3.1	-1.9	-.3	1.9	n.a.
Office and computing	7.5	2.1	.4	-1.2	1.4	n.a.
Communications equipment	2.3	8.7	-8.4	-7.7	8.0	n.a.
All other categories	2.2	2.2	-1.1	1.8	.7	n.a.
<u>Nonresidential structures</u>						
Construction put-in-place	-1.0	1.0	.5	-3.1	4.7	n.a.
Office	-10.8	-6.6	7.1	4.4	11.3	n.a.
Other commercial	1.0	3.0	-.7	-6.0	1.6	n.a.
Institutional	-1.2	-2.9	3.4	4.1	9.3	n.a.
Industrial	-1.9	-1.6	-7.3	-9.7	7.3	n.a.
Public utilities	-4.8	4.5	3.5	-1.6	-2.0	n.a.
Lodging and miscellaneous	26.6	10.6	.7	-4.3	8.9	n.a.
Rotary drilling rigs in use	-5.4	6.6	12.4	3.8	-3.1	-2.3
Memo:						
Business fixed investment ²	2.5	11.6	.5	n.a.	n.a.	n.a.
Producers' durable equipment ²	3.0	13.1	3.2	n.a.	n.a.	n.a.
Nonresidential structures ²	1.0	7.7	-6.6	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 1992 chain-weighted data; percent change, annual rate.

n.a. Not available.

buying has remained about unchanged in recent months after rising in the spring.

Price increases for new and existing homes slowed in the second quarter of this year. The constant-quality new home price index rose just 1.9 percent from the year-earlier level; this rise was roughly in line with the moderate rates of increase in 1995. The reduced growth of new home prices occurred despite a rapid increase in lumber prices and may reflect an effort by builders to avoid creating "sticker shock" that could result from a combination of rising mortgages rates and increasing home prices. A survey of home builders showed that concern about lumber prices and supply increased substantially in the second quarter but that somewhat greater concern was expressed about housing affordability. The repeat-sales price index for existing homes rose 5.1 percent, year over year, in the second quarter, down only slightly from its pace in the first quarter--the highest since late 1989.

Multifamily housing starts dropped 20 percent in June, continuing the up-and-down pattern that has prevailed so far this year. The vacancy rate for multifamily rental units edged up in the second quarter, compared with a year earlier, marking the third consecutive quarter in which vacancies have risen on a year-over-year basis; this suggests that apartment construction for the nation as a whole has outpaced demand.

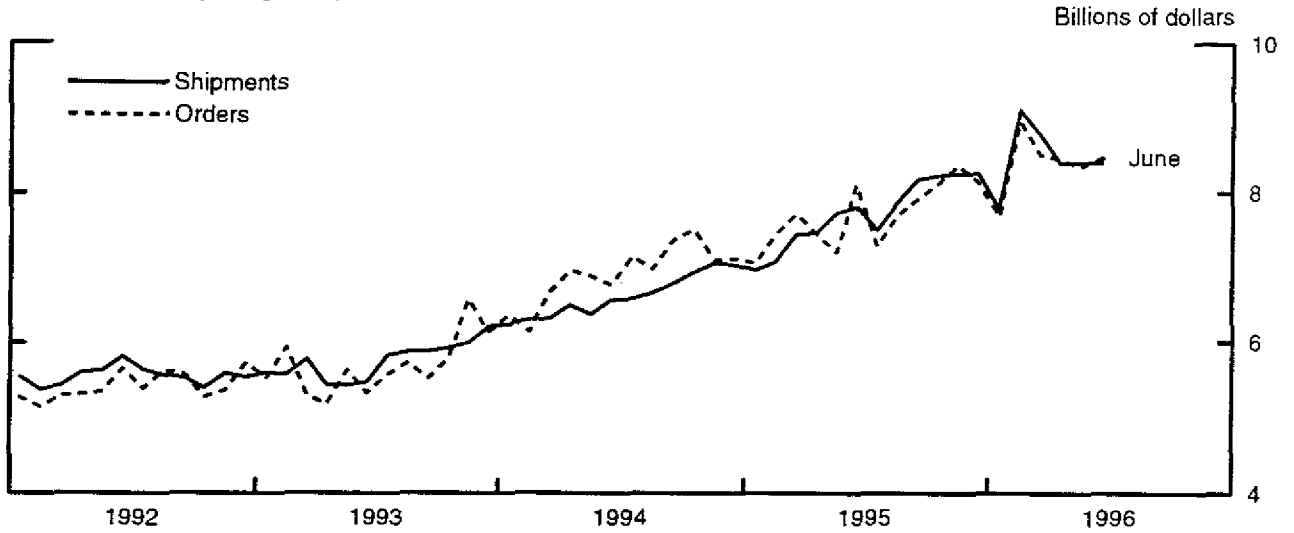
Business Fixed Investment

According to BEA's advance estimate, real business fixed investment increased at an annual rate of only 0.5 percent in the second quarter. Key source data released subsequently suggest that this estimate will be revised upward to something over 3 percent, a pace still much lower than the 11.6 percent gain posted in the first quarter. Smoothing through the quarterly swings, growth over the first half probably was about 7-1/4 percent at an annual rate, just a little above the 6.4 percent rise over the four quarters of 1995. These figures are below the peak rates of the cycle, as would be expected on the basis of waning accelerator effects and moderating cash flow growth.

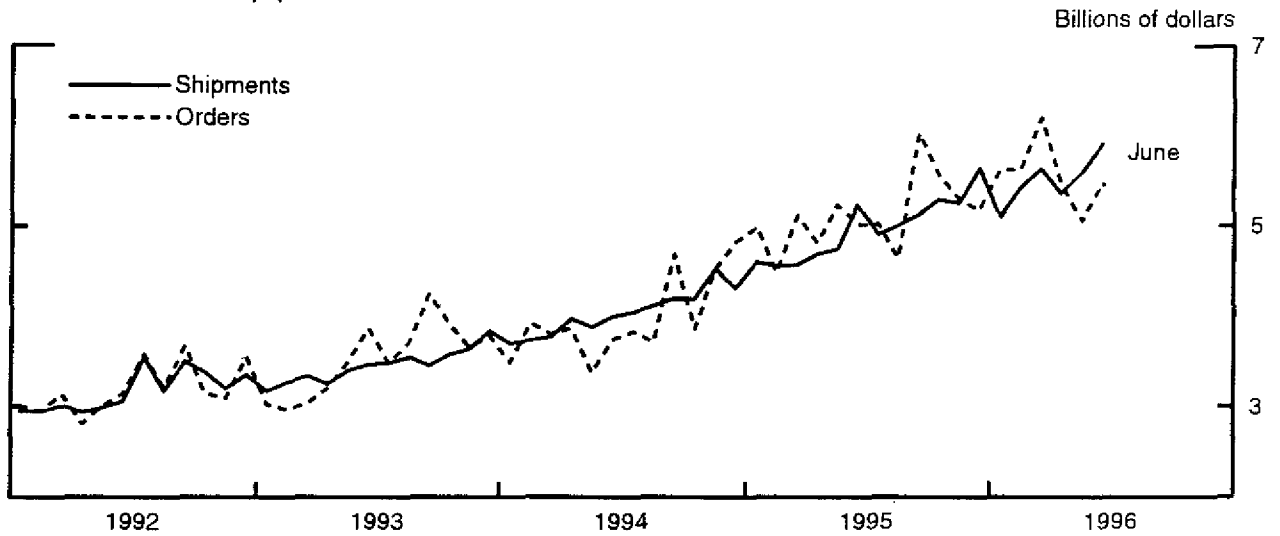
Factoring in shipments data for June, we estimate that real outlays for PDE rose between 4 and 5 percent at an annual rate in the second quarter, compared with a 13 percent annual pace in the first quarter. Real domestic aircraft outlays were particularly weak. While shipments by domestic producers increased 10 percent

Orders and Shipments of Nondefense Capital Goods

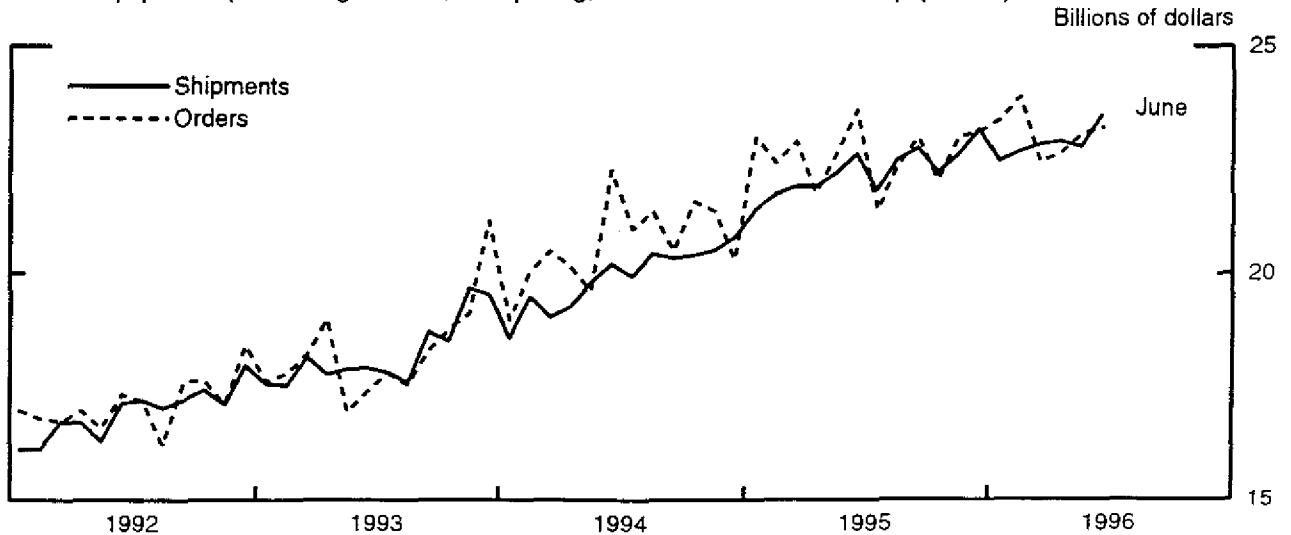
Office and Computing Equipment



Communications Equipment

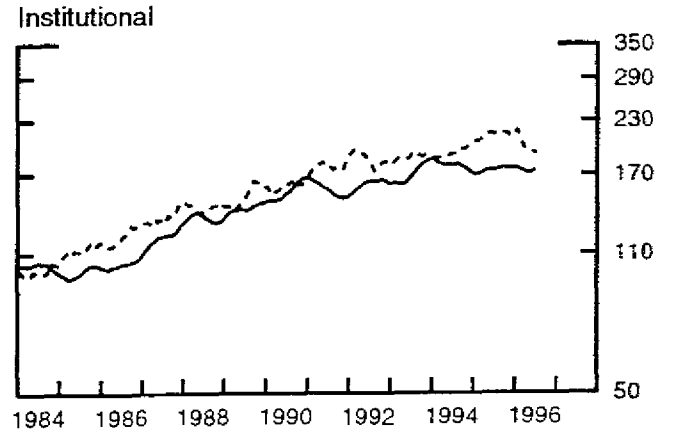
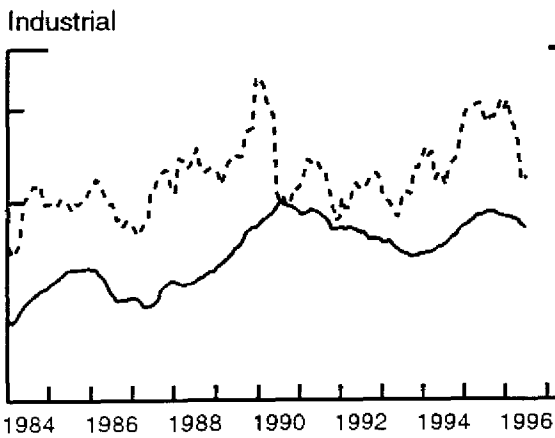
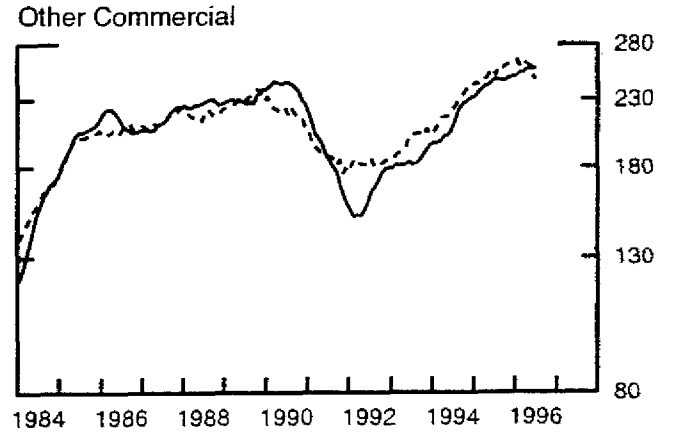
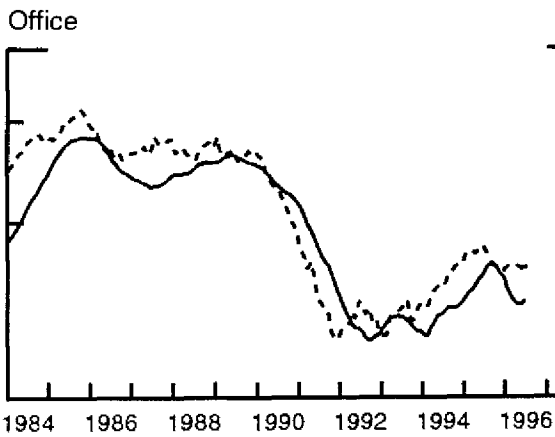
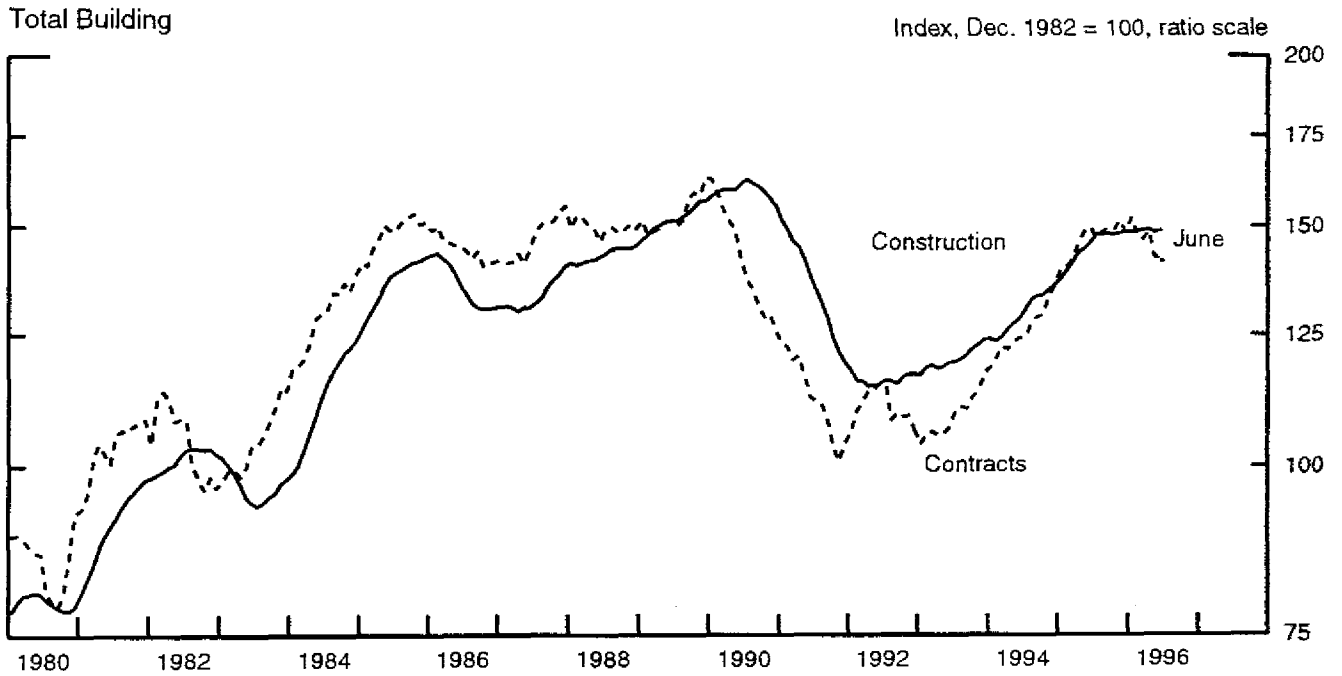


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



Note. For contracts, total includes private only, while individual sectors include public and private.

(quarterly rate) in the second quarter, an unusually large fraction of these shipments was exported. All told, the large drop in domestic aircraft outlays subtracted about 3 percentage points from real PDE growth in the second quarter.

Outlays for real office and computing equipment posted another hefty gain in the second quarter, although growth was down from the stratospheric rate posted in the first quarter. While expenditures tailed off in nominal terms, real expenditures were amplified by an accelerated decline in BEA's computer deflator, which dropped 20 percent at an annual rate in the second quarter versus 15 percent in the first. The fast descent of computer prices reflected in part a pass-through of the recent sharp decline in semiconductor prices.⁹

Other components of PDE continued to grow at a steady clip in the second quarter. Real business purchases of communications equipment increased at an annual rate of 10 percent, a slight step-up from the first-quarter pace. Purchases of other types of equipment advanced at about the same brisk pace as in the first quarter, with outlays for industrial equipment posting an especially noteworthy increase.

Very little information is available to get a fix on PDE for the current quarter. Nominal bookings for office and computing equipment rose in June but were about flat for the second quarter as a whole. Given the sharp price declines experienced in that sector on net over the past few months, this suggests that unit sales likely are holding up well.¹⁰ Elsewhere, the picture is more

9. The continued strength in this sector may seem surprising, given that many computer and semiconductor manufacturers have seen their stock prices drop off sharply. Memory chip manufacturer Micron, for example, has lost about three-quarters of its value over the past year. IOmega, a "hot" disk drive manufacturer has lost more than half of its value since May. Such corrections have generally affected semiconductor manufacturers, who face dramatically increased competitive forces this year spawned by rapid capacity growth, and trendy new technology issues, whose share prices arguably far outstripped any sensible valuation. In contrast, such blue chip computer companies as Intel, Microsoft, and Compaq have posted very positive earnings reports and have seen their share prices move quite favorably.

10. Anecdotal reports suggest that office and computing equipment will continue to be a source of strength for the remainder of the year. Indeed, a hardware upgrade wave may occur over the coming months. Microsoft announced the release of the MS Windows NT 4.0 operating system on July 31. This new operating system, which is expected to be in heavy demand by corporate users, incorporates an improved user interface, built-in Internet access, and expanded
(Footnote continues on next page)

mixed. Bookings for communications equipment dropped back significantly in the second quarter, suggesting a slowing in shipments of these goods in the third quarter. On the other hand, orders for nondefense capital goods besides aircraft and information processing equipment--the segment for which orders have the most value as a leading indicator--increased in April, May, and June after a sharp drop in March. In addition, unfilled orders for these goods remained at a relatively healthy level, suggesting continued gains in this component in the months ahead.

June data on nonresidential construction put-in-place were somewhat stronger than the assumptions built into the advance NIPA release, and we believe that the revised growth rate will be approximately zero. A large drop in industrial construction accounted for a good bit of the bad news in the second quarter. Other commercial construction was down a tad, while lodging and miscellaneous, office, institutional, and utility construction posted healthy advances, as did drilling and mining activity. Looking ahead, construction contracts have tailed off noticeably this year, with contracts for industrial building dropping especially sharply (chart). In contrast, anecdotal reports, including those in the Beige Book, continue to describe a more upbeat picture in the commercial building sector than is painted by the contracts data.

Inventories

Inventory accumulation was modest in the second quarter, and stocks in both manufacturing and trade appeared to be in good trim at the end of the period.

In the trade sector, inventory-sales ratios for retailers of some nondurable consumer goods in June were among their lowest levels in two years. For the broad range of stores in the GAF grouping, the ratio ticked up just a bit from its lowest level since the current expansion began (chart). Wholesale trade inventories

(Footnote continued from previous page)

tools for system administrators. At the same time, the new system will put greater demands on existing hardware and could boost purchases of computers based on Intel's Pentium and Pentium Pro processors. As these prices have fallen to more favorable levels, Intel expects unit shipments to grow significantly in the coming months. The possible scope of the upgrading is suggested by Dataquest's estimate that only about 25 percent of corporate PCs have been upgraded to Pentiums.

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

	1995	1996		1996		
	Q4	Q1	Q2	Apr.	May	June
<u>Book value basis</u>						
Total	13.9	16.7	13.9	53.0	-17.4	6.0
Excluding wholesale and retail motor vehicles	9.9	25.0	7.2	50.7	-23.0	-6.2
Manufacturing	9.5	12.3	-5.1	.3	-14.7	-1.1
Excluding aircraft	9.6	6.3	-9.8	-.1	-18.1	-11.2
Wholesale	6.0	7.3	9.2	37.8	-9.1	-1.2
Excluding motor vehicles	8.4	7.3	6.0	30.5	-7.9	-4.8
Retail	-1.7	-2.9	9.9	14.9	6.4	8.3
Auto dealers	6.4	-8.4	3.5	-4.8	6.8	8.6
Excluding auto dealers	-8.1	5.5	6.4	19.8	-.4	-.3
<u>Chained (1992) dollars basis</u>						
Total	7.5	-5.4	n.a.	48.1	-25.2	n.a.
Excluding motor vehicles	10.3	16.9	n.a.	40.2	-20.7	n.a.
Manufacturing	11.2	12.0	n.a.	-1.2	-7.9	n.a.
Wholesale	3.5	3.8	n.a.	30.4	-11.1	n.a.
Excluding motor vehicles	6.2	4.0	n.a.	23.6	-11.0	n.a.
Retail	-7.1	-21.7	n.a.	18.6	-6.1	n.a.
Auto dealers	.4	-23.6	n.a.	2.4	-4.3	n.a.
Excluding auto dealers	-7.5	2.0	n.a.	16.2	-1.8	n.a.

INVENTORIES RELATIVE TO SALES
(Months' supply; based on seasonally adjusted data)

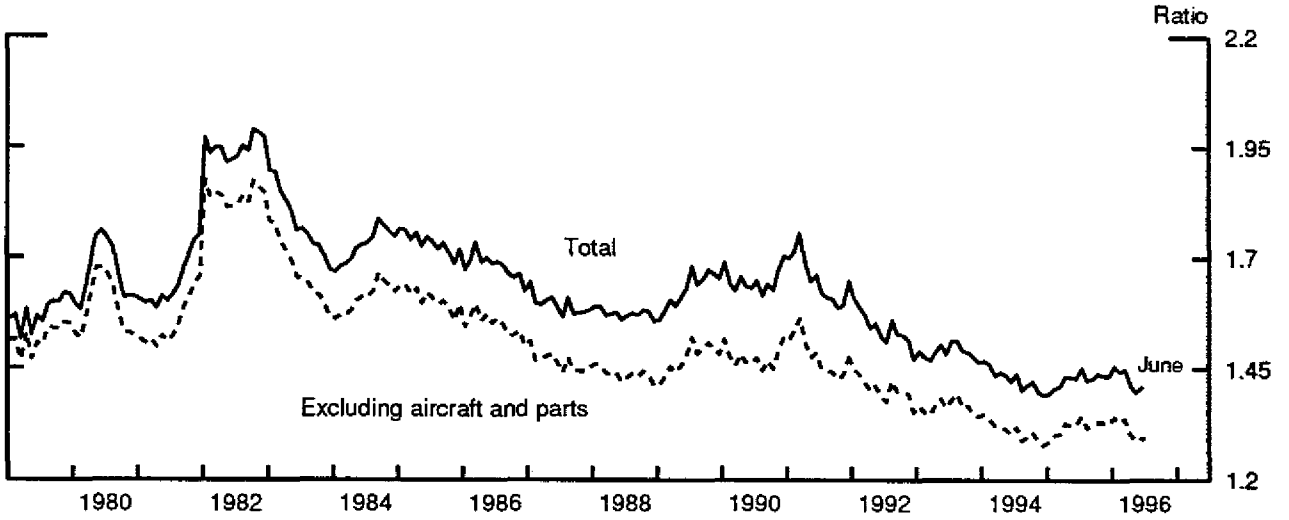
	1995	1996		1996		
	Q4	Q1	Q2	Apr.	May	June
<u>Book value basis</u>						
Total	1.43	1.43	1.40	1.41	1.39	1.40
Excluding wholesale and retail motor vehicles	1.40	1.40	1.37	1.38	1.37	1.37
Manufacturing	1.44	1.45	1.40	1.41	1.40	1.41
Excluding aircraft	1.33	1.34	1.29	1.30	1.29	1.29
Wholesale	1.33	1.32	1.31	1.31	1.31	1.30
Excluding motor vehicles	1.30	1.30	1.27	1.29	1.27	1.27
Retail	1.53	1.49	1.49	1.49	1.48	1.49
Auto dealers	1.79	1.66	1.71	1.69	1.67	1.72
Excluding auto dealers	1.45	1.44	1.42	1.42	1.41	1.42
<u>Chained (1992) dollars basis</u>						
Total	1.39	1.38	n.a.	1.36	1.35	n.a.
Excluding motor vehicles	1.36	1.36	n.a.	1.34	1.33	n.a.
Manufacturing	1.39	1.39	n.a.	1.36	1.35	n.a.
Wholesale	1.34	1.35	n.a.	1.35	1.35	n.a.
Excluding motor vehicles	1.32	1.33	n.a.	1.33	1.32	n.a.
Retail	1.43	1.37	n.a.	1.38	1.36	n.a.
Auto dealers	1.72	1.50	n.a.	1.54	1.51	n.a.
Excluding auto dealers	1.35	1.34	n.a.	1.33	1.32	n.a.

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

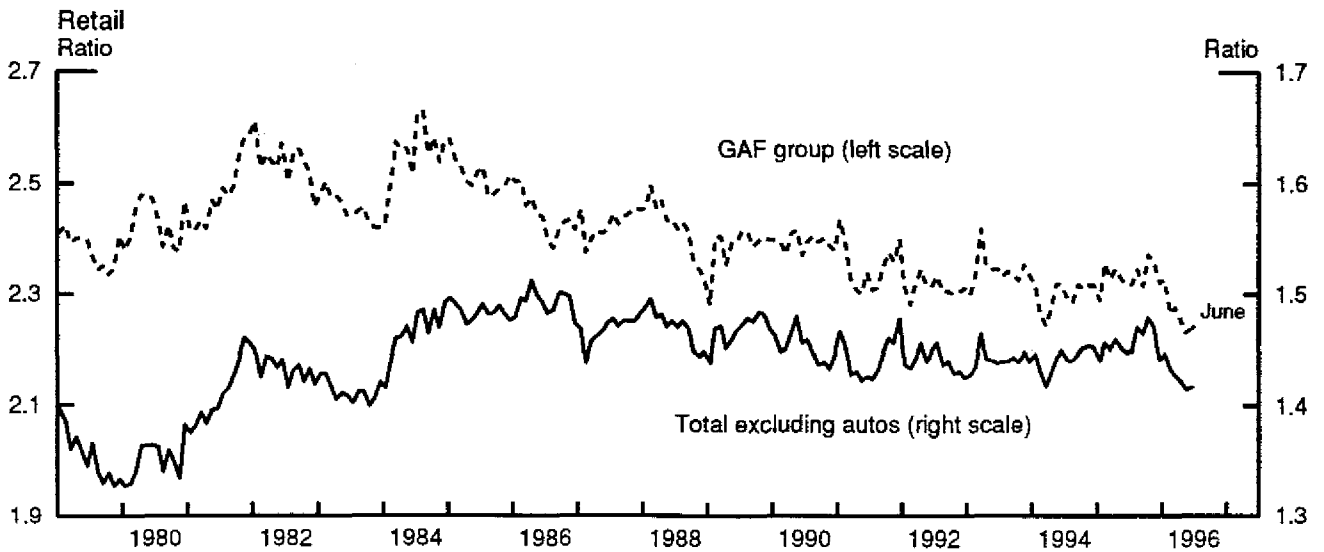
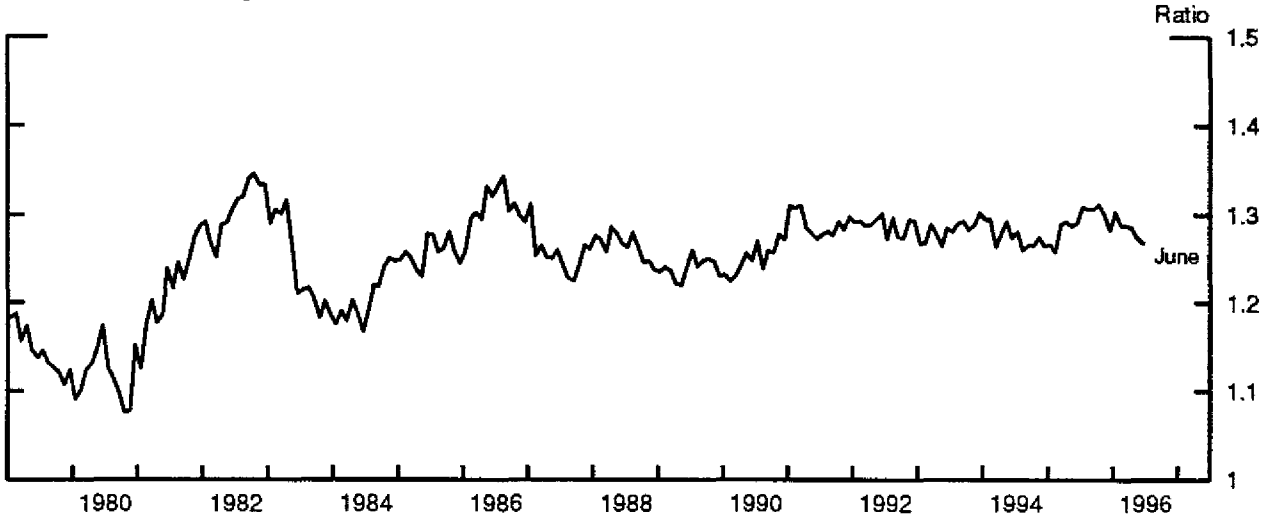
Inventory-Sales Ratios, by Major Sector

Manufacturing

(Book value)



Wholesale Excluding Motor Vehicles



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

	Fiscal year to date totals					
	June		1995	1996	Dollar change	Percent change
	1995	1996				
Outlays	135.1	117.8	1141.7	1165.5	23.8	2.1
Deposit insurance (DI)	-3.4	-.5	-16.0	-7.1	8.9	-55.5
Spectrum auction (SA)	.0	.0	-.6	-.2	.4	-.7
Other	138.4	118.3	1158.4	1172.9	14.5	58.3
Receipts	147.9	151.9	1018.0	1090.5	72.5	7.1
Deficit (+)	-12.8	-34.1	123.7	75.0	-48.6	-39.3
	Adjusted for payment timing shifts ¹ and excluding DI and SA					
Outlays	131.3	126.1	1158.4	1180.7	22.3	1.9
National defense	24.3	22.5	203.9	201.2	-2.7	-1.3
Net interest	18.6	19.0	172.4	180.1	7.8	4.5
Social security	32.1	32.7	251.7	262.0	10.3	4.1
Medicare	14.6	13.6	118.6	130.2	11.6	9.8
Medicaid	8.3	7.6	67.0	68.5	1.5	2.3
Other health	2.4	2.2	19.5	19.9	.4	2.3
Income security	14.2	13.4	167.9	175.3	7.4	4.4
Other	16.8	15.2	157.4	143.3	-14.0	-8.9
Receipts	147.9	151.9	1018.0	1090.5	72.5	7.1
Individual	61.5	60.8	442.3	491.8	49.5	11.2
Withheld	40.9	35.9	380.4	401.6	21.2	5.6
Nonwithheld	23.1	26.9	141.5	174.0	32.5	23.0
Refunds (-)	2.5	2.1	79.6	83.8	4.2	5.2
Social insurance taxes	41.3	45.6	368.3	385.8	17.6	4.8
Corporate	35.9	37.0	118.2	128.7	10.5	8.9
Other	9.2	8.6	89.3	84.2	-5.1	-5.7
Deficit(+)	-16.6	-25.8	140.3	90.2	-50.2	-35.7

Note. Components may not sum to totals because of rounding.
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. The monthly and fiscal year to date outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.

fell again in June, with the biggest declines in stocks of apparel and electrical goods; inventories held by most types of wholesale establishments remained in line with sales.

In manufacturing, inventory corrections continued through June. Excluding the volatile aircraft series, factory stocks fell at an annual rate of \$11.2 billion (book value) in June and \$9.8 billion for the second quarter as a whole. The sizable cutbacks left inventories in most industries well-aligned with new orders and shipments, and the stock-sales ratio for the manufacturing sector as a whole in June about matched the low last seen in January 1995. Much of manufacturers' recent book-value inventory liquidation occurred in stocks of materials and supplies, where declining prices likely played a part; the runoff may also reflect cautious plans for near-term production.

Federal Government

The incoming news on the unified budget for fiscal 1996 has continued to be favorable. For the first nine months of the fiscal year, the budget deficit was \$75 billion, \$49 billion less than last year.

Strong corporate profits and a probable increase in capital gains realizations by individuals have raised receipts so far this fiscal year 7 percent over the same period last year. Much of the 11 percent year-over-year growth in individual income taxes was recorded in April nonwithheld taxes; according to Treasury data, the April surge in nonwithheld taxes reflected extraordinary strength in both final payments on 1995 liability and the first quarterly estimated payment on 1996 liability. The second quarterly payment on 1996 liability apparently was also large, as individual nonwithheld taxes in June were 16 percent higher than last year.

The growth of outlays (adjusted for timing shifts and certain financial transactions) was a subdued 2 percent so far this fiscal year, owing in part to reductions in discretionary appropriations. In addition, Medicaid outlays have risen only 2 percent, reflecting restrained growth in health-care costs, tightened restrictions on disbursements for disproportionate share hospitals, and an overall slowing in caseloads.

Real federal expenditures for consumption and gross investment increased at an 8.4 percent annual rate in the second quarter, according to BEA's advance estimate. Large gains were recorded in both the defense and the nondefense categories. The jump in outlays

ADMINISTRATION BUDGET AND ECONOMIC PROJECTIONS

	1996	1997	1998	1999	2000	2001	2002
Budget projections (Billions of dollars; fiscal years)							
March Policy Deficit	146	140	98	64	28	-8	-44
<i>Changes</i>							
Technical Receipts	-27	-9	-10	-7	-7	-8	-8
Other	-2	-5	6	-3	-9	-10	-9
July Policy Deficit	117	126	94	55	11	-26	-61
Outlays	1570	1631	1680	1716	1759	1808	1864
Receipts	1453	1505	1586	1661	1748	1834	1925
Economic assumptions (Calendar years)							
-----Percentage change, Q4 to Q4-----							
Nominal GDP	5.0	5.1	5.1	5.1	5.1	5.1	5.1
Real GDP	2.6	2.3	2.3	2.3	2.3	2.3	2.3
CPI-U	3.2	2.8	2.8	2.8	2.8	2.8	2.8
-----Percent, annual average-----							
Unemployment rate	5.6	5.7	5.7	5.7	5.7	5.7	5.7
Yield on selected Treasuries							
Three-month	4.9	4.5	4.3	4.2	4.0	4.0	4.0
Ten-year	6.2	5.6	5.2	5.0	5.0	5.0	5.0

Note. The projections assume that the President's tax and spending proposals are enacted.

Source. Mid-Session Review of the 1997 Budget, Office of Management and Budget, July 16, 1996.

for defense was in line with the data on a unified basis. However, the second-quarter increase in nondefense spending appears a bit anomalous, as such growth does not appear in the corresponding unified budget accounts; consequently, we are anticipating a downward revision in the estimate.

The Administration released its Mid-Session Review of the Budget on July 16. The budget estimates incorporate revised economic and technical assumptions, the effects of legislation enacted between March and mid-July, and changes in proposed policies. Under the President's proposals, the Administration now projects that the deficit will be \$117 billion in fiscal 1996, edge up to \$126 billion in fiscal 1997, and then fall steadily--turning to surplus in fiscal 2001 and 2002. Relative to its March projections, most of the Administration's revisions were attributed to the unexpectedly large increase in individual income tax collections in April, which resulted in upward revisions to receipts of \$27 billion in fiscal 1996 and about \$10 billion in subsequent years. The largest changes to economic assumptions were to ten-year Treasury yields and near-term GDP growth; both were revised up.

Welfare reform legislation was recently passed by Congress, and the President is expected to sign it shortly. The bill establishes the Temporary Assistance for Needy Families block grant to replace the main federal cash assistance program, Aid to Families with Dependent Children, and three smaller, related programs. While each state will have wide discretion in designing its program, it must meet certain conditions in order to avoid a reduction in its federal grant. In particular, (1) except in hardship cases, it cannot use federal funds to provide assistance to families that have already received five years of benefits after the effective date of the block grant, (2) it must move a specified percentage of welfare recipients into qualifying work-related activities, and (3) its outlays for fiscal years 1997 through 2001 must equal or exceed 75 percent of its fiscal 1994 expenditures on the displaced federal programs. The bill also consolidates several child care programs into a single Child Protection block grant program, significantly reduces public assistance payments to legal and illegal aliens, reduces food stamp allotments, and limits the time that able-bodied adults, age 18 to 50 without dependents, may receive food stamps without working.

Other legislation passed by Congress raises the minimum wage, reduces taxes for small businesses, reinstates the airline ticket tax, and enacts a package of health insurance reforms.

State and Local Governments

Real spending by state and local governments jumped 6 percent at an annual rate in the second quarter. This followed weather-related weakness during the winter quarter and reflected strong advances in real compensation and construction. State and local government employment rose 40,000 in July, nearly twice the average monthly increase during the first six months of the year. As in June, the biggest advance was among educational workers employed by local governments, a category for which seasonal adjustment is especially difficult.

A recent survey from the National Conference of State Legislatures confirms the continuing improvement in state general fund budgets, as ending balances increased as a percentage of expenditures for the fourth consecutive year in fiscal 1996. The strengthening picture is attributed to rising revenues combined with restrained growth in spending. Reserves are expected to remain strong in fiscal 1997. Outlays for corrections once again should increase rapidly, and spending on higher education is expected to increase at its fastest pace since the late 1980s as states try to restore funding. Meanwhile, growth in spending for Medicaid is expected to slow to around 4 percent, owing to declining caseloads, federal reform actions, and state managed-care programs. The survey was taken before the federal welfare reform was enacted, but the states anticipated a further drop in outlays for AFDC this year on the expectation that the expanding national economy and various welfare reform measures in many states would help reduce growth in caseloads.

The recently passed federal welfare legislation is supportive of state programs that seek to reduce caseloads, and states will no longer have to receive federal waivers before reducing payments or imposing time limits. However, some provisions of the new federal bill--especially those affecting immigrants--could result in greater state funding of services. In addition, the administrative burdens of several programs likely will rise.

Labor Costs

Recent data on hourly compensation indicate that labor costs are gradually accelerating. In the second quarter, the employment

cost index (ECI) for private industry workers rose at an annual rate of 3.2 percent, somewhat faster than its first-quarter pace of 2.9 percent and the 2.6 percent rate registered in the second half of 1995. Over the year ended in June, ECI hourly compensation increased 2.9 percent--about a quarter percentage point above the low for the twelve-month change in the series reached in the second half of 1995.

The wages and salaries component of the ECI rose 3.6 percent (annual rate)--apart from the 4-1/4 percent surge in the first quarter, the biggest increase since the second quarter of 1991. One factor was the rapid acceleration in the wages and salaries of sales workers in wholesale trade and in finance, insurance, and real estate. But outside of sales workers, growth in wages and salaries was 1/4 percentage point higher in the past twelve months than in the year-earlier period, with greater wage gains for professional specialty workers and managerial workers leading the way.

Benefits costs were up at a 2.7 percent annual rate in the second quarter, but this came after essentially no change in the first three months of this year and did not reverse a favorable trend.¹¹ The twelve-month change in hourly benefits costs was smaller than in the year-earlier period; this slowing largely reflected decelerating costs for health insurance, workers' compensation, retirement and savings, and nonproduction bonuses.

Compensation per hour in the nonfarm business sector, as measured by the productivity and costs (P&C) data, rose 3.7 percent at an annual rate in the second quarter and 3.8 percent over the past year. The second-quarter increase in compensation per hour was somewhat faster than that in the ECI, but discrepancies between these two measures are common.¹² In the present instance, faster growth in the wages and salaries component of P&C compensation was only partially offset by slower growth in the benefits component.

11. The current report corrected processing errors in the previously published figures for 1995:Q4 and 1996:Q1. The most notable change was a 2.1 percentage point downward revision to the growth in benefits costs in 1995:Q4. For total compensation, growth in 1995:Q4 was revised down 0.6 percentage point. Growth in 1996:Q1 was not revised, as a downward revision to wages and salaries was offset by an upward revision to benefits. The general effect of the corrections was to smooth the progression of compensation gains over the past few quarters.

12. On a quarterly basis, the absolute difference between the two measures has averaged 1.5 percentage points (annual rate) since 1980.

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1995			1996	
	June	Sept.	Dec.	Mar.	June
-----Quarterly percent change----- (compound annual rate)					
Total hourly compensation ¹	2.9	2.6	2.6	2.9	3.2
Wages and salaries	3.0	3.0	2.6	4.3	3.6
Benefit costs	2.4	2.4	2.1	-0.3	2.7
By industry					
Construction	2.0	3.0	3.0	2.6	2.3
Manufacturing	2.2	2.2	3.2	1.9	3.8
Transportation and public utilities	3.3	4.2	3.2	1.9	2.5
Wholesale trade	3.6	5.2	3.5	1.6	4.1
Retail trade	1.0	2.7	2.3	6.0	-1.0
FIRE	5.4	3.0	1.3	4.6	5.9
Services	2.9	1.9	1.9	3.4	3.7
By occupation					
White-collar	2.9	2.9	2.5	3.5	3.1
Blue-collar	2.9	2.3	2.6	2.2	3.2
Service occupations	2.3	1.9	0.3	1.3	2.6
Memo:					
State and local governments	3.9	2.2	2.8	2.5	2.8
-----Twelve-month percent change-----					
Total hourly compensation	2.8	2.6	2.6	2.7	2.9
Excluding sales workers	2.8	2.5	2.6	2.6	2.8
Wages and salaries	2.9	2.8	2.8	3.2	3.4
Excluding sales workers	3.0	2.7	2.8	3.1	3.2
Benefit costs	2.6	2.1	2.2	1.6	1.7
By industry					
Construction	1.5	1.4	2.2	2.6	2.7
Manufacturing	2.8	2.3	2.6	2.5	2.8
Transportation and public utilities	4.1	3.8	3.7	3.1	3.0
Wholesale trade	4.3	4.6	4.5	3.5	3.6
Retail trade	2.2	1.8	2.2	3.0	2.5
FIRE	3.5	3.5	3.5	3.6	3.7
Services	2.6	2.4	2.2	2.5	2.7
By occupation					
White-collar	3.0	2.8	2.8	3.0	3.0
Blue-collar	2.6	2.3	2.4	2.5	2.6
Service occupations	2.5	2.4	1.9	1.9	2.0
Memo:					
State and local governments	3.1	3.0	2.9	2.8	2.6

1. Seasonally adjusted by the BLS.

EMPLOYMENT COST INDEX OF HOURLY WAGES AND SALARIES
FOR PRIVATE INDUSTRY WORKERS
(Twelve-month percent changes)

	1995			1996	
	June	Sept.	Dec.	Mar.	June
Hourly wages and salaries	2.9	2.8	2.8	3.2	3.4
By industry					
Construction	1.8	1.9	2.4	3.0	3.4
Manufacturing	3.3	2.9	2.9	2.9	2.9
Transportation and public utilities	4.1	3.4	3.4	2.8	2.5
Wholesale trade	3.7	4.2	4.7	4.3	4.3
Retail trade	2.2	2.1	2.4	3.5	2.9
FIRE	3.4	3.7	3.7	4.2	4.2
Services	2.6	2.5	2.4	3.0	3.5
By occupation					
White-collar	2.8	2.8	2.9	3.4	3.5
Blue-collar	3.1	2.8	2.9	2.9	3.0
Service occupations	2.7	2.7	2.2	2.3	2.5
Memo:					
State and local governments	3.2	3.1	3.2	2.8	2.8

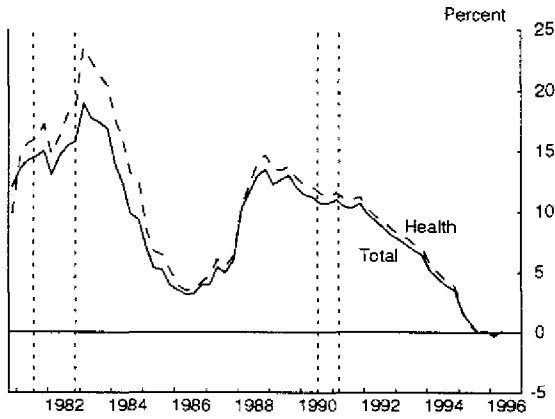
EMPLOYMENT COST INDEX OF HOURLY BENEFIT COSTS
FOR PRIVATE INDUSTRY WORKERS
(Twelve-month percent changes)

	1995			1996	
	June	Sept.	Dec.	Mar.	June
Hourly benefit costs ¹	2.6	2.1	2.2	1.6	1.7
Insurance costs	0.7	0.0	0.1	-0.3	0.1
Health care	0.6	-0.1	0.1	-0.3	0.1
Supplemental pay	3.0	1.4	3.6	-0.5	2.2
Retirement and savings	8.4	7.8	4.7	4.7	3.3
Paid leave	3.6	3.3	3.4	3.3	3.4
Legally required	0.9	0.9	1.2	1.2	0.9
By industry					
Goods-producing	1.5	1.0	1.7	1.3	2.0
Service-producing	3.4	2.7	2.4	1.7	1.6
By occupation					
White-collar occupations	3.3	2.9	2.6	1.8	1.8
Blue-collar occupations	1.6	1.1	1.7	1.4	1.9
Service occupations	1.9	1.1	1.0	0.5	0.5
Memo:					
State and local governments	2.9	2.5	2.6	2.7	2.2

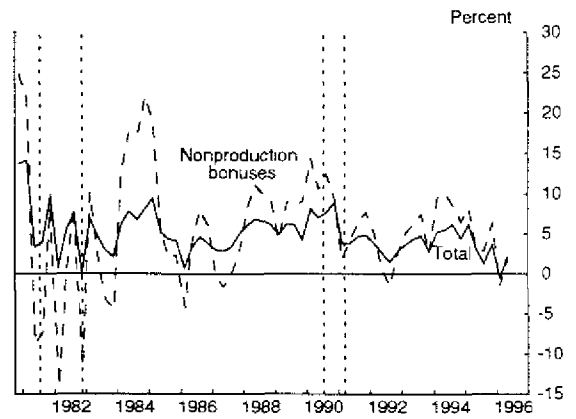
1. The detail on benefit costs is from unpublished data from the BLS.

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

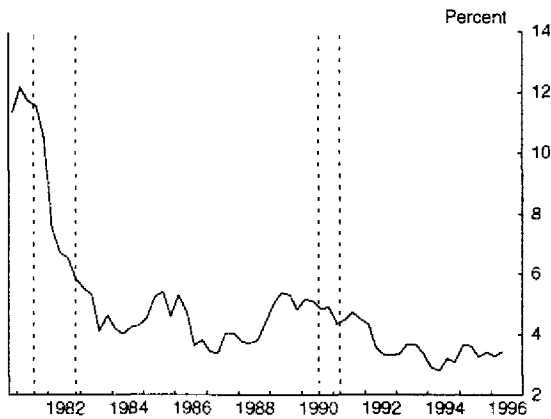
Insurance Costs



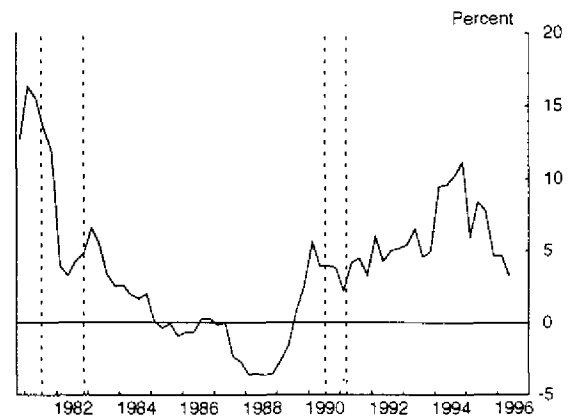
Supplemental Pay



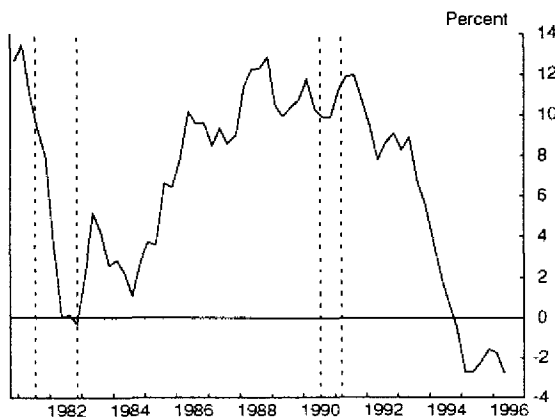
Paid Leave



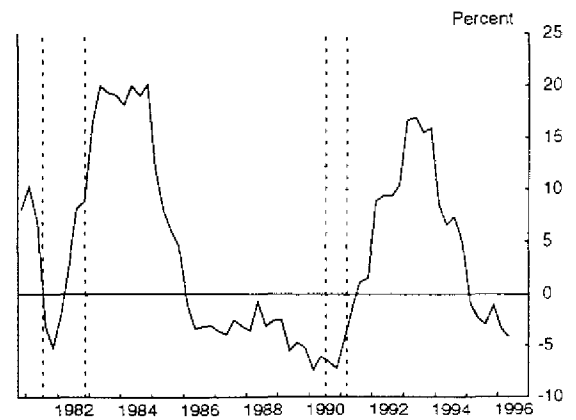
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



The latest data on labor costs are average hourly earnings in July, which fell 0.2 percent after a 0.8 percent rise in June. The decline reflected changes in the composition of employment by industry, and adjusting for these mix shifts, average hourly earnings were unchanged in July. Taking a longer view, average hourly earnings have risen 3.1 percent over the past year--in line with the 3.2 percent rise in the comparable ECI for wages and salaries of production or nonsupervisory workers.

An additional development that will shortly affect labor costs is the recent passage of legislation to raise the federal minimum wage a total of \$0.90 per hour: from \$4.25 per hour to \$4.75 per hour on October 1, 1996 and to \$5.15 per hour on September 1, 1997. The staff estimates that the direct effect of the 90-cent increase will be to raise the average wage between 0.3 percent and 0.4 percent by September 1997 or a bit less than 0.2 percent in each of the two years. As shown in the table, workers earning the current minimum of \$4.25 per hour (the second column) accounted for less than 1/2 percent of the aggregate wage bill in 1995, and we assume that this group's average hourly wage will increase about 20 percent.¹³ Some workers reporting current wage rates less than \$4.25 per hour (the first column) will likely receive wage increases in step with the minimum wage, while others, including tipped employees whose total hourly earnings already exceed \$5.15 or workers not covered by the legal minimum (such as certain agricultural workers) may not receive any increase. Averaging across these groups, we are assuming a 9 percent average increase in the hourly wage for those workers currently earning less than the minimum. Workers with wage rates somewhere between the current minimum and the new higher minimum (the third column) constitute a larger share of the aggregate wage bill and are assumed to receive wage increases averaging about 8 percent to bring them up to the new minimum. We also expect to see ripple effects on workers earning just above the new, higher minimum wage (the fourth column) as employers act to partially maintain the current structure of relative wages. Although the assumed percentage increase in the average wage rate of this latter group is smaller than for the other

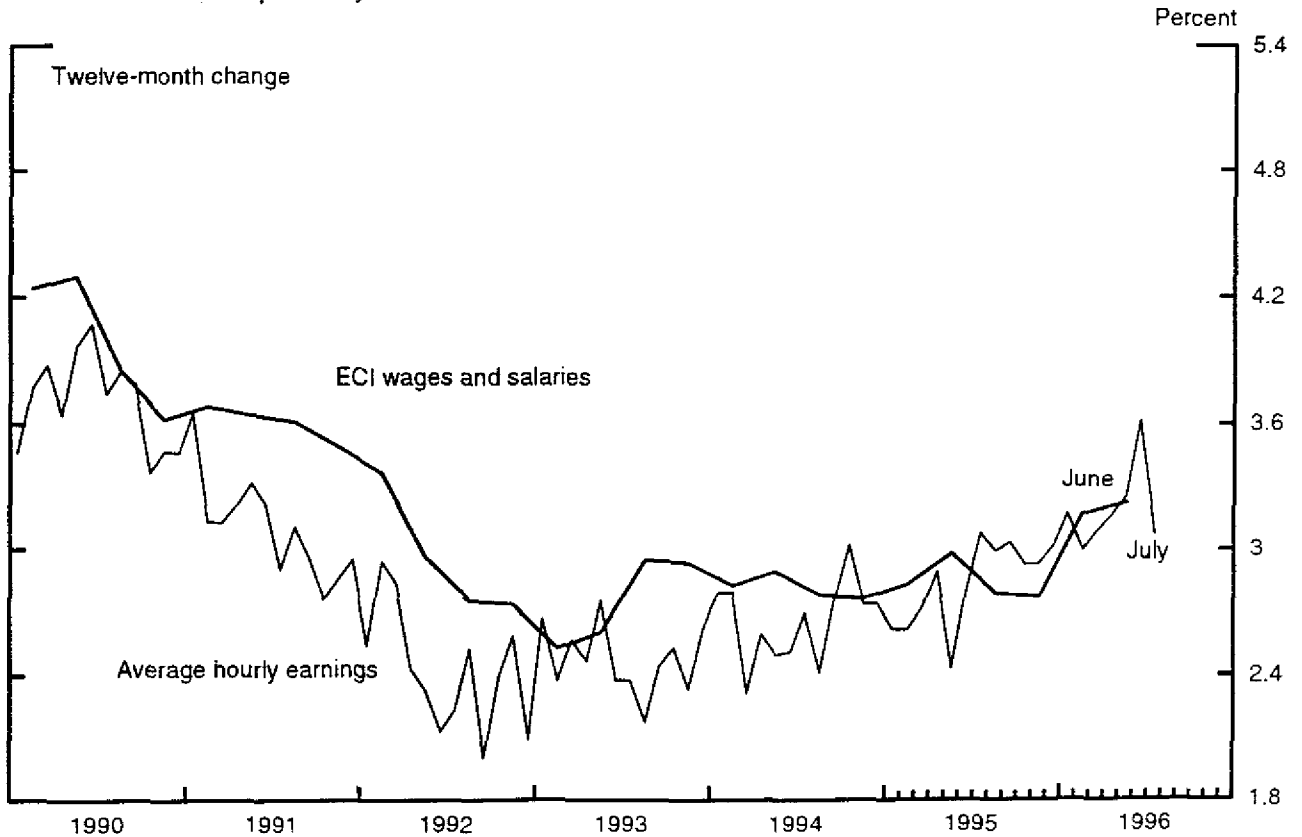
13. The legislated increase in the statutory minimum wage is 21.2 percent, but some would receive increases during the period anyway. In the second through fourth columns we have made allowances for this.

PUBLISHED LABOR PRODUCTIVITY AND COSTS, NONFARM BUSINESS SECTOR
 (Percent change from preceding period at compound annual rate;
 based on seasonally adjusted data)

	1994 ¹	1995 ¹	1995		1996		1995:Q2 to 1996:Q2
			Q3	Q4	Q1	Q2	
Output per hour	.5	.3	2.0	-1.1	1.8	-.1	.7
Compensation per hour	2.5	4.1	4.0	4.1	3.3	3.7	3.8
Unit labor costs	2.0	3.8	1.9	5.2	1.5	3.8	3.1
Memo: ECI compensation per hour	3.1	2.6	2.6	2.6	2.9	3.2	2.9

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

Production or Nonsupervisory Workers



DIRECT EFFECT OF A \$0.90 INCREASE IN THE MINIMUM WAGE
ON AVERAGE WAGES

	Hourly workers in 1995 earning				Total
	Less than \$4.25	\$4.25	\$4.26 to \$5.14	\$5.15 to \$6.00	
Number of workers (millions)	1.699	1.956	4.247	7.698	
Average hourly wage	\$3.21	\$4.25	\$4.70	\$5.58	
Share of total wage bill (percent)	.29	.40	1.07	2.51	
Average percent wage increase attributable to the min. wage	9.0	20.0	8.0	6.5	
Contribution to total effect (percentage points)	.03	.08	.09	.16	.36

Source: Bureau of Labor Statistics and Federal Reserve staff estimates.

groups, it represents a larger share of the aggregate wage bill and thus makes a larger contribution to the total effect.¹⁴ The overall effect of the minimum wage hike will tend to be a bit greater than the table indicates, to the extent that there are feedbacks to wages from the price increases precipitated by the minimum wage impulse.

Prices

Price inflation remained moderate on balance in June and July. The consumer price index increased 0.3 percent in July but only 0.1 percent in the prior month. Excluding food and energy, the index has been increasing 0.2 to 0.3 percent per month of late. Over the twelve months ended in July, the overall CPI rose 3 percent, about the same as over the preceding twelve months; the core index increased 2-3/4 percent in the latest twelve-month period, down from a 3 percent increase in the year-earlier period.

14. Hourly workers earning more than \$6 per hour and non-hourly workers are assumed to be unaffected--which may result in a slight understatement of the impact effect. In addition to the changes in average wage rates for each group, we assume that employment will be about 150,000 lower than otherwise; some of these workers will remain structurally unemployed, effectively raising the NAIRU by a small amount. In the above calculations, the workweek of the disemployed workers is assumed to be 30 hours.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996		1996	
	July 1995	July 1996	Q1	Q2	June	July
			-Annual rate-		-Monthly rate-	
<u>CPI</u>						
All items (100.0) ¹	2.8	3.0	3.2	3.8	0.1	0.3
Food (15.8)	2.6	3.4	2.0	4.2	0.7	0.5
Energy (6.7)	1.2	4.1	12.9	18.4	-2.2	-0.4
CPI less food and energy (77.5)	3.0	2.7	2.8	2.5	0.2	0.3
Commodities (23.9)	1.1	1.4	2.2	0.6	.0	.0
New vehicles (5.0)	2.1	2.1	1.5	2.4	0.3	0.2
Used cars (1.3)	10.4	-0.4	8.6	-5.8	-1.1	-0.1
Apparel (5.0)	-2.2	-0.2	1.0	-1.8	-0.5	-0.1
Services (53.6)	3.8	3.3	3.0	3.6	0.3	0.3
Owners' equivalent rent (19.7)	3.6	3.2	3.1	2.8	0.1	0.3
Tenants' rent (5.8)	2.6	2.7	2.9	2.6	0.2	0.3
Medical care (6.1)	5.1	3.7	3.7	3.1	0.2	0.3
Auto finance charges (0.6)	15.5	-3.7	-16.2	0.3	1.2	0.9
<u>PPI</u>						
Finished goods (100.0) ²	1.7	2.6	3.2	2.9	0.2	.0
Finished consumer goods (23.4)	1.8	4.0	0.5	2.4	1.6	0.2
Finished energy (13.4)	0.4	5.3	21.2	13.1	-2.1	-0.9
Finished goods less food and energy (63.2)	2.0	1.5	0.6	1.1	0.2	0.1
Consumer goods (38.5)	2.2	1.7	0.7	1.4	0.3	-0.1
Capital equipment (24.7)	1.8	1.2	0.4	0.4	-0.1	0.3
Intermediate materials (100) ³	6.1	-0.2	-0.2	1.8	-0.5	-0.3
Intermediate materials less food and energy (82.6)	7.4	-1.8	-3.4	-1.2	-0.1	-0.3
Crude materials (100) ⁴	-0.1	11.6	19.2	17.5	-2.3	1.2
Crude food materials (44.7)	1.0	24.7	-0.9	39.7	1.4	2.7
Crude energy (31.4)	-9.4	15.1	82.5	12.3	-7.7	1.4
Crude materials less food and energy (23.9)	13.8	-13.5	-8.9	-10.2	-1.4	-1.6

1. Relative importance weight for CPI, December 1995.

2. Relative importance weight for PPI, December 1995.

3. Relative importance weight for intermediate materials, December 1995.

4. Relative importance weight for crude materials, December 1995.

Retail energy prices have begun to follow crude oil prices back down: The CPI for energy fell 2.2 percent in June and 0.4 percent in July, after three months of large increases. Gasoline prices posted large declines in June and July, while fuel oil prices have been falling since May. Electricity rates were about flat, on balance, in June and July, although consumer rebates for some utilities in June generated large monthly swings.

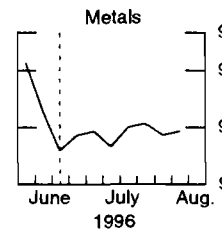
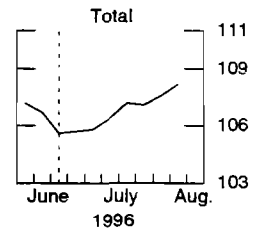
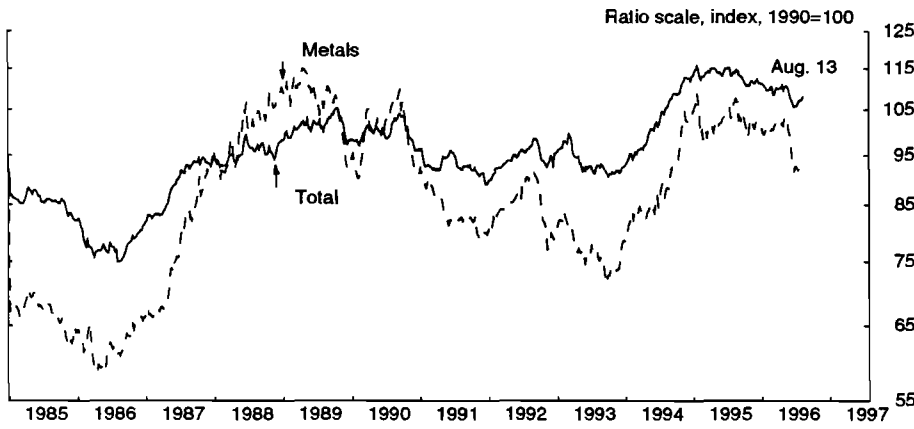
Retail food prices increased 0.5 percent in July after a 0.7 percent increase in June. Meat prices pushed up food prices in both months; fruit and vegetable prices were responsible for the especially large increase in June. Prices of poultry and pork have continued to increase rapidly, reflecting higher costs of feed grains. Beef prices have also begun to be affected by rising feed costs; earlier in the year, beef prices had been depressed by the slaughter of cattle in anticipation of higher feed costs.

The CPI for commodities other than food and energy was unchanged for the third consecutive month in July. Over the past six months, nonfood, non-energy goods prices have increased just 0.4 percent at an annual rate, down from a 2.3 percent pace in the previous six-month period. Among categories contributing to this deceleration were apparel and housekeeping supplies. The deceleration in apparel prices may reflect exchange rate developments, as the strength in the dollar early this year depressed import prices. Prices of housekeeping supplies have likely benefited from recent declines in input costs, notably for paper and chemicals. Used car prices, which are quite volatile, have also contributed to the recent deceleration in CPI goods prices.

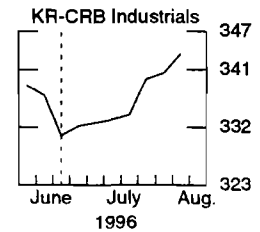
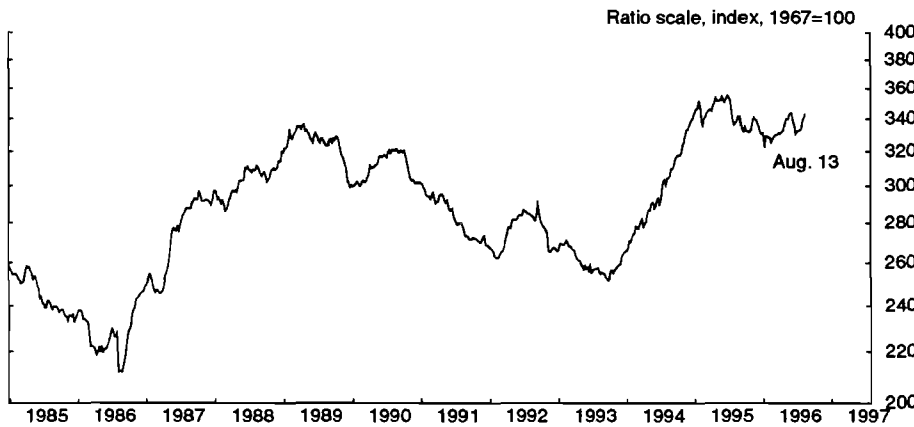
The CPI for services other than energy increased 0.3 percent in June and July, in line with the average pace over the past year and a half. Owners' equivalent rent--the largest component of the CPI--increased 0.3 percent in July and just 0.1 percent in June, bringing the increase over the past six months to 2.7 percent at an annual rate, down from 3.6 percent over the preceding twelve-month period. The volatile airfares component of the CPI has increased rapidly so far this year. Looking ahead, a 10 percent federal air ticket tax was reinstated in recent legislation, and, ceteris paribus, should lead to further increases in air fares beginning this month.

Commodity Price Measures

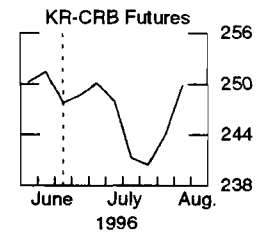
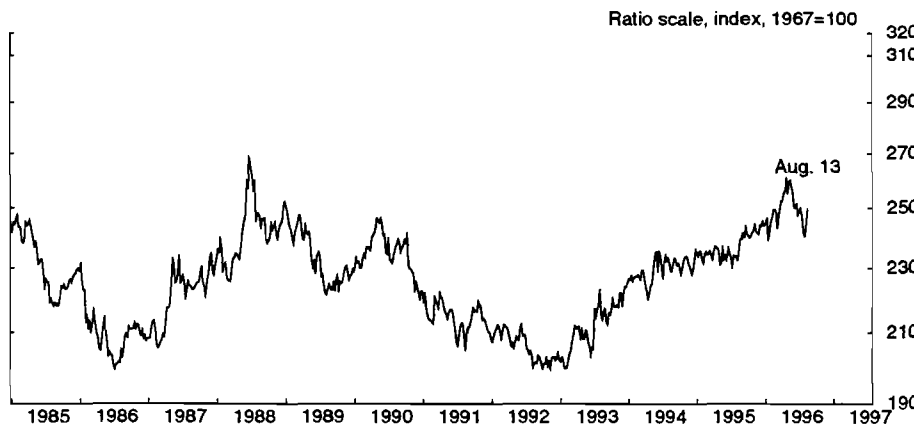
Journal of Commerce Index



KR-CRB Spot Industrials



KR-CRB Futures



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

BROAD MEASURES OF INFLATION
(Four-quarter percent changes)

	1993	1994	1995	1996
	Q2	Q2	Q2	Q2
<u>Product prices</u>				
GDP chain-type price index	2.6	2.2	2.6	2.1
GDP deflator	2.6	2.1	2.6	2.1
Nonfarm business chain-type price index ¹	2.6	2.1	2.5	1.7
<u>Expenditure Prices</u>				
Gross domestic purchases chain-type price index	2.5	2.0	2.7	2.0
Less food and energy	2.6	2.2	2.7	1.8
PCE chain-type price index	2.8	2.1	2.7	2.1
Less food and energy	3.0	2.5	2.6	1.8
PCE deflator	2.8	2.1	2.7	2.0
Less food and energy	3.0	2.4	2.6	1.7
CPI	3.1	2.4	3.0	2.9
Less food and energy	3.4	2.8	3.0	2.7
Median CPI	3.0	2.9	3.1	3.0

1. Excluding housing.

Various broad measures of inflation are painting rather different pictures of recent inflation developments. For example, the GDP chain-type price index increased 0.5 percentage point less in the four quarters ending in the second quarter of 1996 than in the preceding four-quarter period, while the rate of increase in the overall CPI has come down only 0.1 percentage point. As we noted in the June Greenbook, the recent small increase in health care costs is one of the main reasons that measures of inflation in the national accounts have moved down more over the past year than has the CPI: The recent deceleration in health services costs matters more for PCE prices (and therefore for the rest of the national accounts) both because the PCE data incorporate the PPI for medical care and other data that have decelerated more sharply than the CPI

SPOT PRICES OF SELECTED COMMODITIES

	Current price (\$)	-----Percent change ¹ -----				Memo: Year earlier to date
		1994	1995	Dec. 26 to June 25 ²	June 25 ² to Aug. 13	
Metals						
Copper (lb.)	.960	64.9	-3.5	-23.5	-7.7	-32.4
Steel scrap (ton)	139.500	2.9	-6.6	3.4	.7	-4.8
Aluminum, London (lb.)	.669	73.5	-12.9	-11.7	.0	-23.1
Precious metals						
Gold (oz.)	387.600	-1.7	1.7	-.6	.6	.3
Silver (oz.)	5.050	-5.0	7.2	.5	-2.1	-6.5
Forest products						
Lumber (m. bdft.)	404.000	-37.1	-14.4	36.0	18.8	75.7
Plywood (m. sqft.)	330.000	1.5	-6.1	-4.5	11.5	-9.1
Petroleum						
Crude oil (barrel)	20.830	15.6	16.8	.4	13.8	32.4
Gasoline (gal.)	.614	32.4	7.7	8.4	7.2	14.3
Fuel oil (gal.)	.598	12.7	22.6	-15.5	17.2	23.7
Livestock						
Steers (cwt.)	66.000	-3.4	-5.7	-9.1	10.0	7.3
Hogs (cwt.)	61.000	-12.9	27.5	24.9	8.0	22.0
Broilers (lb.)	.608	-4.9	10.7	9.9	1.9	-1.3
U.S. farm crops						
Corn (bu.)	4.930	-23.2	57.4	37.0	3.7	86.0
Wheat (bu.)	5.090	11.4	24.0	9.8	-14.2	8.3
Soybeans (bu.)	8.095	-19.6	29.0	6.4	5.7	40.4
Cotton (lb.)	.774	38.5	-8.1	.0	-2.1	-7.8
Other foodstuffs						
Coffee (lb.)	1.420	153.1	-39.1	44.2	-1.0	-6.3
Memo:						
JOC Industrials	108.200	22.1	-1.7	-5.0	2.5	-5.0
JOC Metals	92.800	31.9	-1.8	-9.7	1.1	-13.2
KR-CRB Futures	249.910	4.8	3.3	1.5	.9	6.7
KR-CRB Spot	343.520	29.1	-3.5	.0	3.9	1.5

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

2. Week of the June Greenbook.

for medical services, and because the PCE chain-type price index puts a larger weight on medical services than does the CPI.¹⁵

Industrial materials prices have continued to fall so far this year: The PPI for intermediate materials excluding food and energy is down 1-1/4 percent through July, while the *Journal of Commerce* industrial materials price index is off about 3 percent so far this year. Apart from the general lack of pressure on industrial capacity, a number of special factors have contributed to the continued softness in nonfarm metals prices in particular. Most notably, copper prices have plummeted in recent weeks after an attempt by a Sumitomo Corporation unit to corner the copper market was exposed. Less dramatically, aluminum prices have been depressed over the past year or so by increased exports by Russia and other nations of the former Soviet Union, where reduced defense expenditures have freed capacity for the export market.¹⁶ Reduced defense spending may also be restraining increases in the prices of other metals, such as zinc and manganese, because the federal government has been reducing its stockpiles as part of the ongoing downsizing of the defense establishment.

Agriculture

Spot prices of agricultural crops have been extremely volatile since June. The spot price for corn rose sharply in early July as dry weather in the Corn Belt threatened this year's crop, but it then began to drop in mid-July when rainfall in the Midwest reduced fears of a poor harvest. This week it has surged once again in response to a surprisingly low USDA estimate of the harvest. The cash price of wheat, which has been less volatile, has generally trended lower since June but remains in a high range by historical standards.

The latest USDA crop production estimates, which now incorporate data from actual field surveys of wheat, corn, and soybeans, indicate that total crop output in 1996 is likely to show

15. Another factor that has contributed to smaller increases in the PCE chain-type price index than in the CPI in recent years is the use of more up-to-date weights in the PCE index than in the CPI. The PCE chain-type price index uses weights from years adjacent to the period for which the price change is calculated, whereas the CPI currently uses weights from the 1982-to-1984 period. We estimate that the difference in weights may explain 0.2 percentage point of the difference between the CPI and PCE inflation rates in recent years. The CPI will get revised weights--for the 1993-to-1995 period--in January 1998.

16. An earlier agreement to curtail production by the former Soviet nations has unraveled over the past year.

a partial rebound from last year's low level. In its August report, the USDA substantially lowered its estimate of corn yields this year. In addition, harvested acreage is expected to be lower than had been projected previously. The downward revisions to this year's production estimates indicate that stocks of corn will likely remain below comfortable levels over the coming year. The USDA estimate of soybean production in 1996 was also lowered a bit; soybean stocks have been tightening of late.

The USDA also has revised down its estimate of meat production this year, reflecting reduced production estimates for pork.¹⁷ Smaller herds of both cattle and hogs and a reduction in the number of cattle coming off feedlots have apparently begun to push up farm-level prices for livestock somewhat sooner than most analysts had expected. Prices for livestock have edged up in both spot and futures markets, with cash prices of cattle and hogs substantially higher than at the time of the last Greenbook.

U.S. CROP PRODUCTION

	1993	1994	1995	USDA projections for 1996	
				June 12	Aug. 12
----- Billions of bushels -----					
Corn	6.34	10.10	7.37	9.13	8.70
Soybeans	1.87	2.52	2.15	2.31	2.30
Wheat	2.40	2.32	2.19	2.08	2.25
----- Millions of bales -----					
Cotton	16.13	19.66	17.91	19.00	18.58
----- Billions of 1992 dollars -----					
Memo: Value, all crops ¹	60.05	74.50	64.04	69.57	68.62

1. Calculated by the Federal Reserve staff from USDA data; includes production of most field crops.
Source. U.S. Department of Agriculture.

17. The USDA released a midyear count of the cattle herd which showed a 1 percent reduction from the January level, a bit more than most analysts had expected.

DOMESTIC FINANCIAL DEVELOPMENTS

III-T-1

Selected Financial Market Quotations¹
(Percent except as noted)

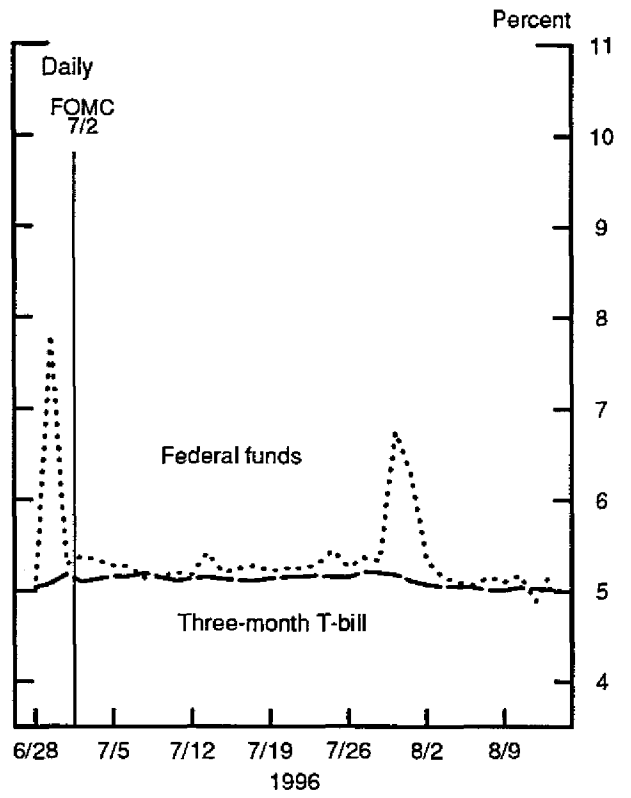
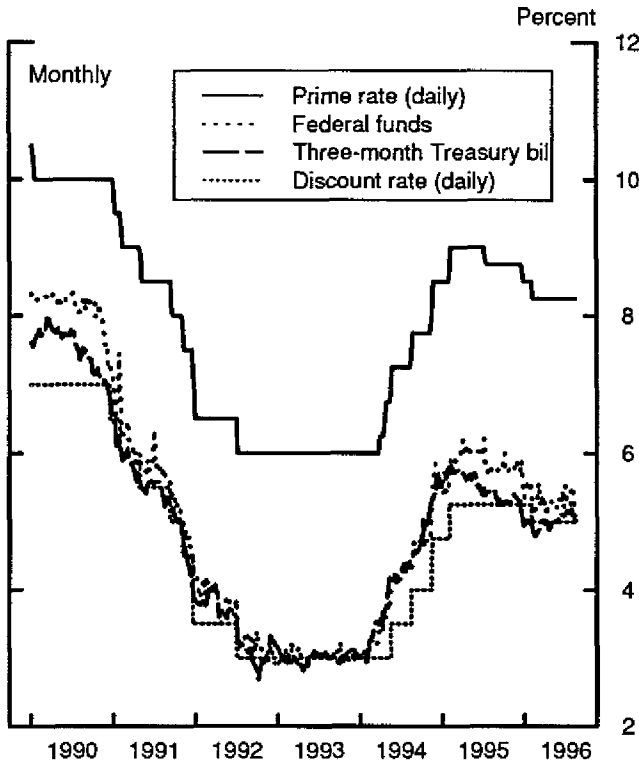
Instrument	1996				Change to Aug. 14, from		
	Feb. low	FOMC, July 2	July high	Aug. 14	Feb. low	FOMC, July 2	July high
Short-term rates							
Federal funds ²	5.15	5.37	5.39	5.24	.09	-.13	-.15
Treasury bills ³							
3-month	4.76	5.18	5.21	5.02	.26	-.16	-.19
6-month	4.67	5.27	5.40	5.10	.43	-.17	-.30
1-year	4.55	5.48	5.64	5.29	.74	-.19	-.35
Commercial paper							
1-month	5.27	5.48	5.50	5.39	.12	-.09	-.11
3-month	5.12	5.50	5.59	5.40	.28	-.10	-.19
Large negotiable CDs ³							
1-month	5.21	5.38	5.44	5.32	.11	-.06	-.12
3-month	5.12	5.45	5.59	5.39	.27	-.06	-.20
6-month	4.99	5.64	5.83	5.54	.55	-.10	-.29
Eurodollar deposits ⁴							
1-month	5.13	5.34	5.38	5.28	.15	-.06	-.10
3-month	5.13	5.47	5.56	5.38	.25	-.09	-.18
Bank prime rate	8.25	8.25	8.25	8.25	.00	.00	.00
Intermediate- and Long-term Rates							
U.S. Treasury (constant maturity)							
3-year	4.98	6.40	6.62	6.14	1.16	-.26	-.48
10-year	5.58	6.80	7.06	6.58	1.00	-.22	-.48
30-year	6.02	6.94	7.19	6.78	.76	-.16	-.41
Municipal revenue (Bond Buyer) ⁵	5.67	6.20	6.24	5.67	.00	-.53	-.57
Corporate-A utility, recently offered	7.18	7.99	8.23	7.81	.63	-.18	-.42
High-yield corporate ⁶	9.57	10.12	10.36	9.99	.42	-.13	-.37
Home mortgages ⁷							
FHLMC 30-yr fixed rate	6.94	8.29	8.42	7.88	.94	-.41	-.54
FHLMC 1-yr adjustable rate	5.19	5.98	6.01	5.89	.70	-.09	-.12

Stock exchange index	Record high		1996			Percentage change to Aug. 14, from		
	Level	Date	FOMC, July 2	July low	Aug. 14	Record high	FOMC, July 2	July low
Dow-Jones Industrial	5778.00	5/22/96	5720.38	5346.55	5666.88	-1.92	-.94	5.99
NYSE Composite	363.74	5/24/96	351.01	336.07	353.64	-2.78	.75	5.23
S&P 500 Composite	678.51	5/24/96	673.60	626.65	662.05	-2.43	-1.71	5.65
NASDAQ (OTC)	1249.15	6/5/96	1191.36	1042.37	1133.51	-9.26	-4.86	8.74
Wilshire	6758.69	5/24/96	6649.91	6099.34	6469.93	-4.27	-2.71	6.08

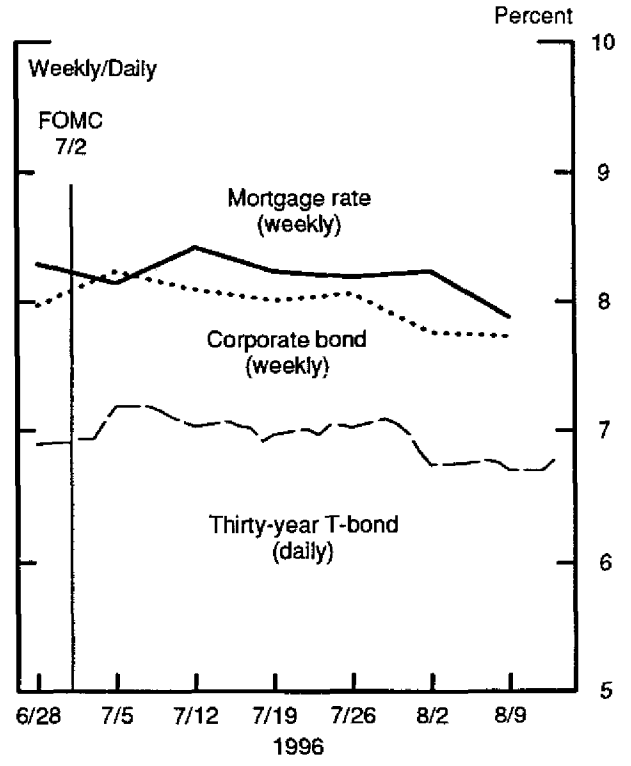
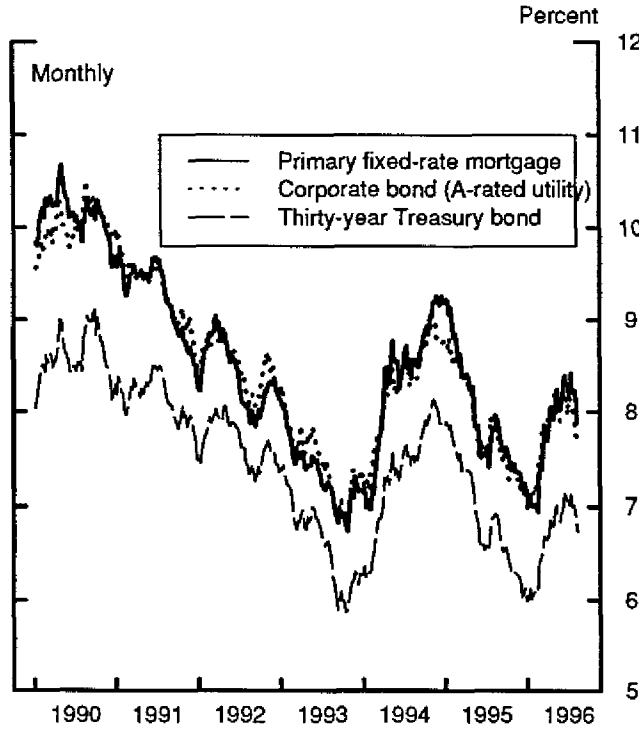
1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average for the maintenance period ending August 14, 1996.
3. Secondary market.
4. Bid rates for Eurodollar deposits at 11 a.m. London time.
5. Most recent observation based on one-day Thursday quote and futures market index changes.
6. Merrill Lynch Master II high-yield bond index composite.
7. Quotes for week ending Friday previous to date shown.

Selected Interest Rates

Short-Term



Long-Term



DOMESTIC FINANCIAL DEVELOPMENTS

On balance, economic data released in recent weeks seem to have diminished concerns somewhat among market participants that the economy is overheating, and the associated bond market rally has more than rolled back the jump in long-term yields posted in early July. The thirty-year Treasury bond rate has declined about 40 basis points from its high last month and 15 points on net over the intermeeting period, leaving it at its lowest level since April. The markets remain jittery, however, exhibiting substantial volatility in response to each piece of news.

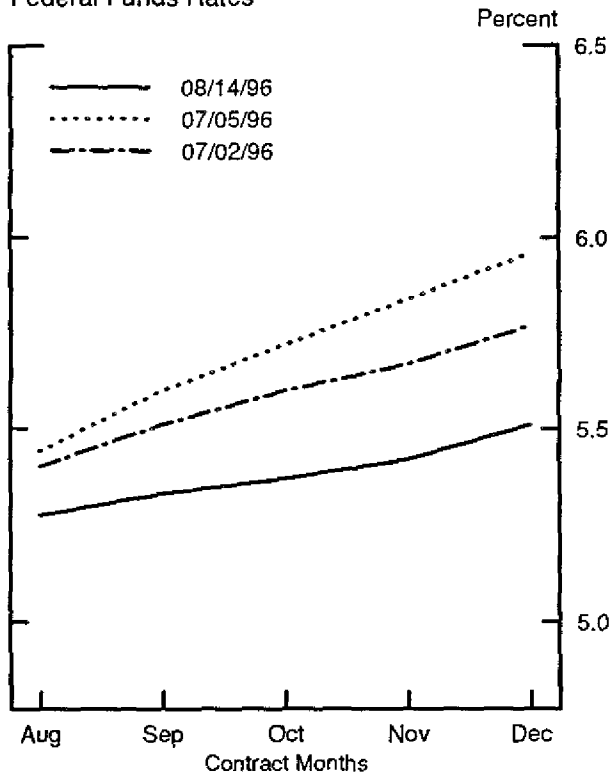
Short-term rates have declined as well. Investors apparently had been convinced that the stronger-than-expected June employment report, released immediately after the July FOMC meeting, portended a System tightening action in August. Data releases since then, along with the Humphrey-Hawkins testimony, eroded that conviction, and rates on federal funds futures contracts now indicate that even a modest tightening in the near term is viewed as not very likely (chart, top panels).

Turbulent conditions have frequently prevailed in the stock market as well, with intraday movements in the S&P 500 reaching their highest level in more than five years. Stock prices declined along with bond prices early in the intermeeting period and then fell sharply in mid-July after several high-tech companies released disappointing news about earnings and sales. By late in the month, the S&P 500 was 7-1/2 percent below the peak reached in the spring, while the NASDAQ Composite was down nearly 17 percent (chart, bottom panel). Stock prices then began to recover, lifted by the rally in the bond market and generally reassuring earnings reports. By mid-August, the NYSE Composite index, the S&P 500, and the Dow had almost returned to their record highs, but the NASDAQ Composite remained well below its peak.

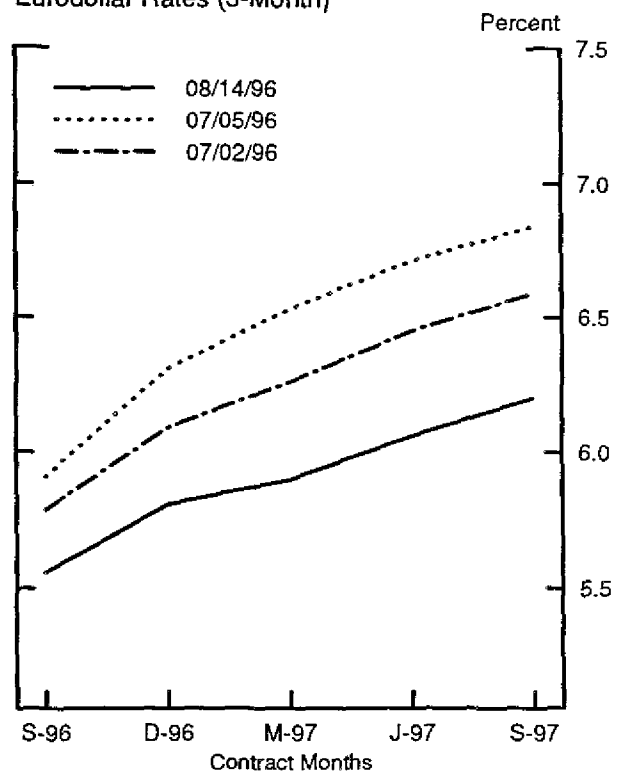
Borrowing by nonfederal sectors was moderate in the second quarter and appears to have remained so early in the current quarter. In the household sector, consumer credit growth has continued to slow, while mortgage debt growth likely has subsided further from the brisk first-quarter pace. Borrowing by nonfinancial firms has been held down by still-healthy cash flows and modest inventory investment. As has been true for a while,

Selected Short-Term Futures Rates and Stock Market Indexes

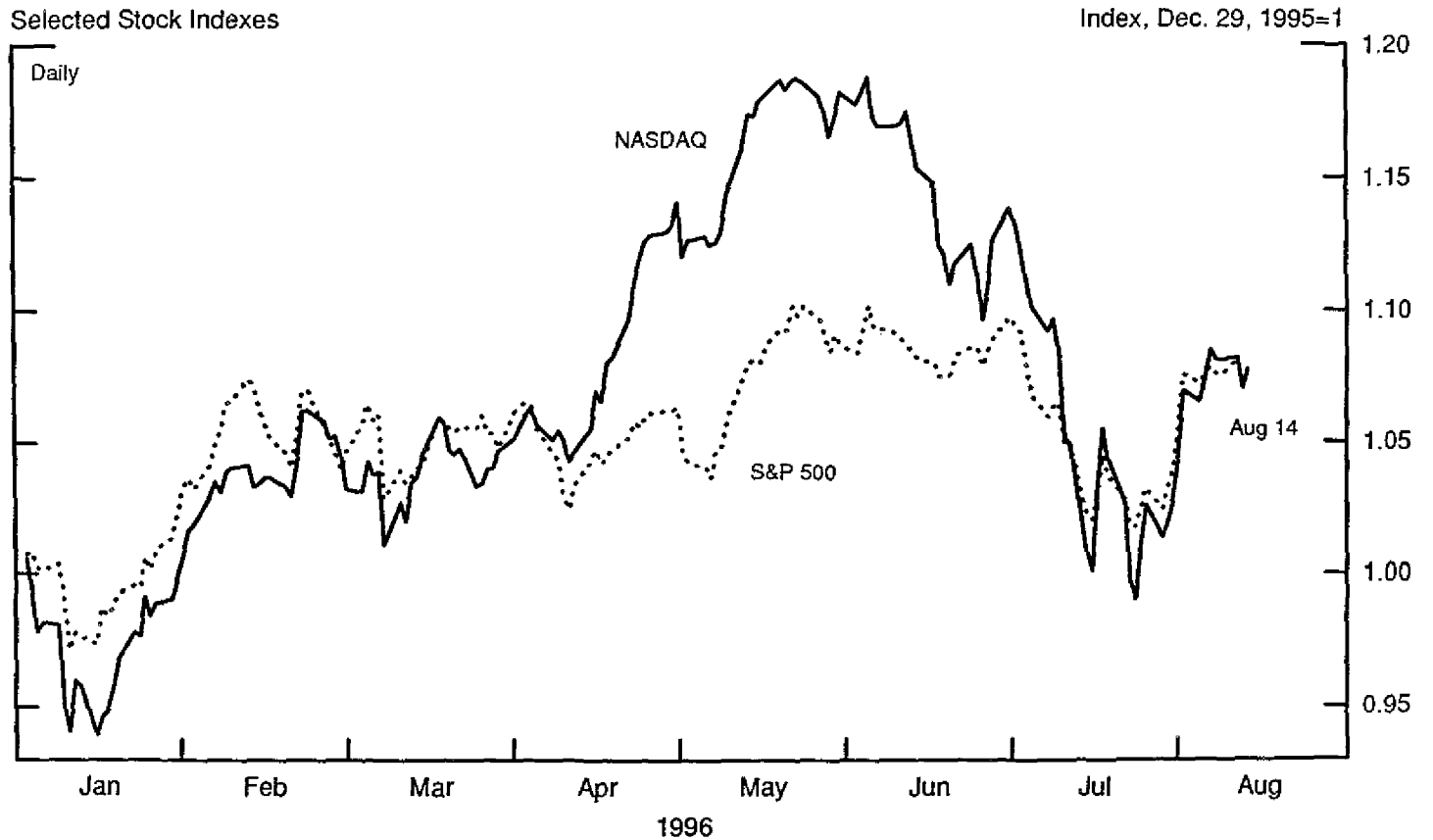
Federal Funds Rates



Eurodollar Rates (3-Month)



Selected Stock Indexes



state and local governments continue to pay down their outstanding debt. The broad monetary aggregates decelerated last month, while growth in bank credit remained sluggish.

Stock Market and Mutual Funds

Stock price movements over the past two months reflect a cooling of enthusiasm for smaller, speculative companies. The Russell 2000--a diversified index of small companies--has moved lower in sync with the computer-laden NASDAQ Composite. Furthermore, investor ardor for initial public offerings has weakened quite a bit, although better-quality firms still have access to the market. On net, nearly 20 percent of the IPOs completed in the second half of June were priced below the low end of the range filed in the registration statements about six weeks earlier, a sharp reversal from the pattern in the spring, and this measure turned even more negative in July and the first half of August (chart, top panel). In addition, the average first-day price increase for IPOs has fallen to a two-year low so far this quarter, albeit from a high level.

The decline in broad equity indexes since midyear has left only a modest imprint in standard measures of stock valuation. The price-earnings ratio for the S&P 500 remains at the high end of the range of the past decade (middle panel). The P-E ratio for the NASDAQ Composite came down somewhat in July as well but was still elevated by historical standards.

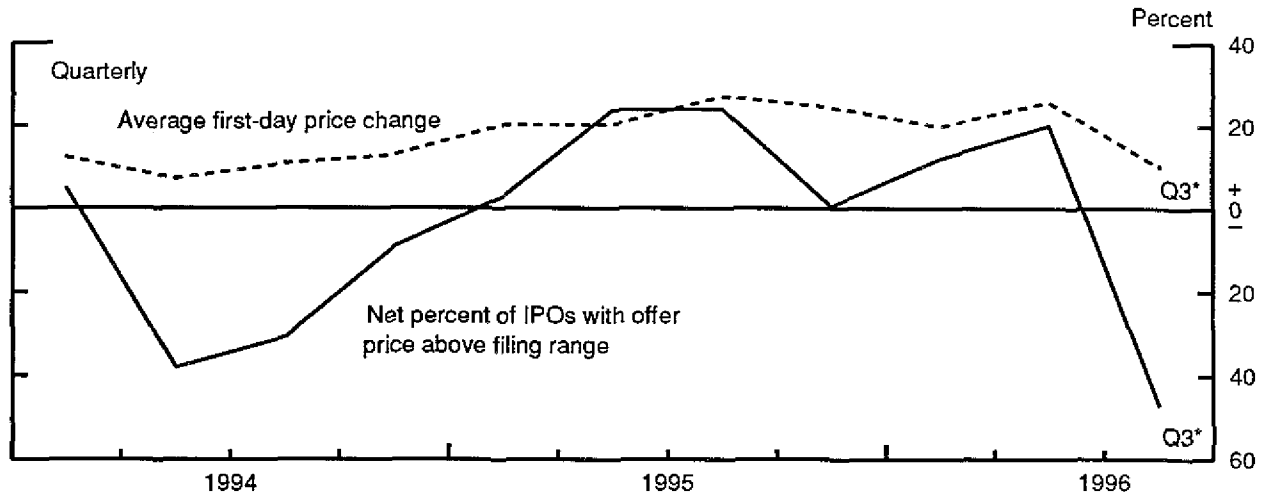
With nearly all reports on second-quarter earnings now in, operating income appears to have remained on a healthy growth path. Operating earnings at S&P 500 firms are estimated to have increased about 8 percent for the year ending in June, near what was posted in the previous quarter but well below the very rapid gains from mid-1994 to mid-1995 (lower left panel).¹ Analysts expect earnings growth to pick up by year-end and hold extremely bullish views about long-term prospects (lower right panel), even though the economy is thought to be pressing against capacity.

Retail investors' accumulation of stocks likely flagged in July, as net sales of equity mutual funds declined substantially from the record pace in the first half of the year (chart, upper panel). Equity funds actually posted a net outflow in the week

1. The closest analogue to this measure in the national income and product accounts is book profits after tax. That measure, which covers all U.S. corporations, also has decelerated from the high growth rates posted from mid-1994 to mid-1995.

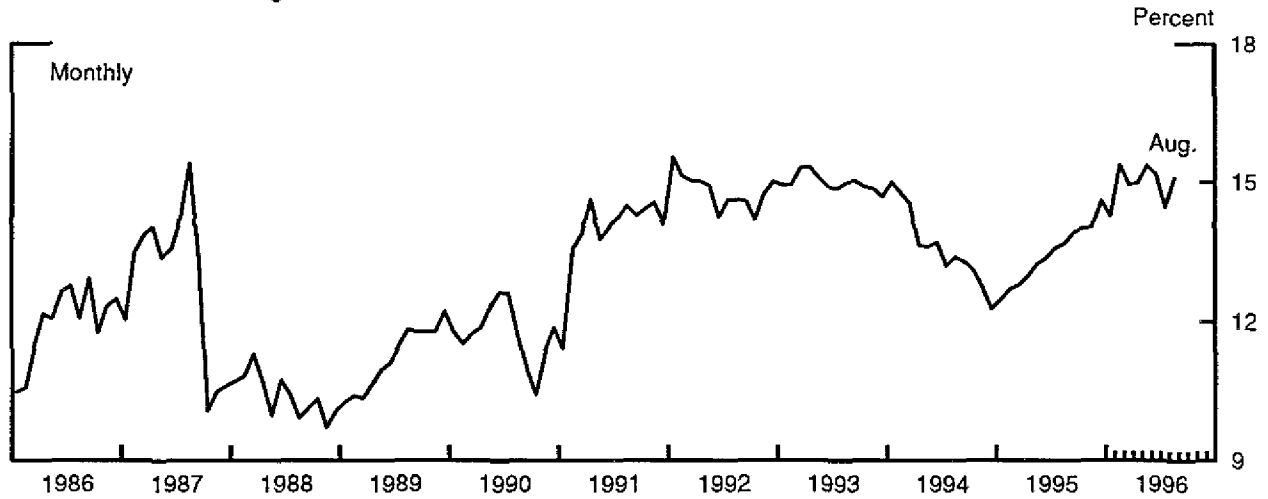
Stock Market and Earnings

Pricing of IPOs



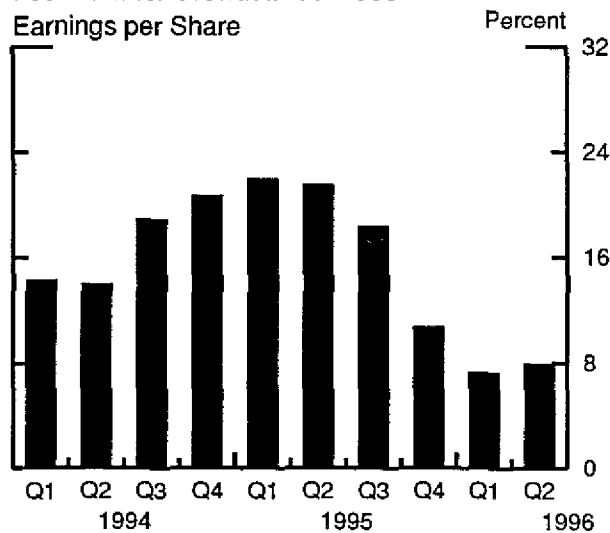
*Based on data through August 14.

S&P 500 Price-Earnings Ratio*



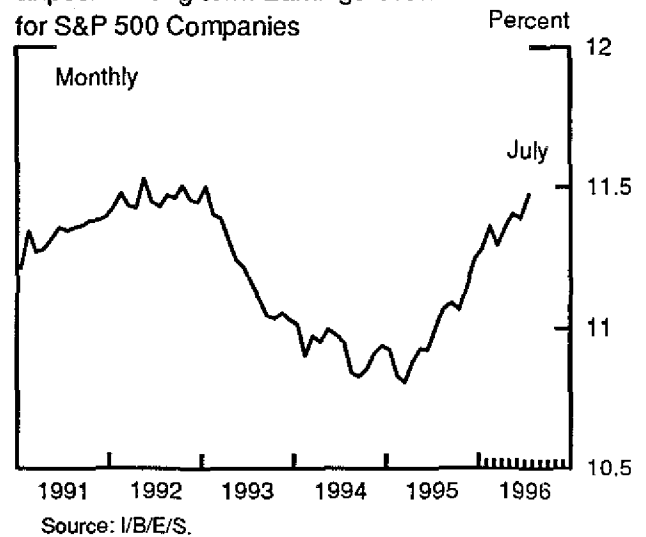
*Based on consensus estimate of earnings over the coming 12 months. All observations reflect prices at mid-month.
Source: I/B/E/S.

Four-Quarter Growth in S&P 500 Earnings per Share



Source: I/B/E/S.

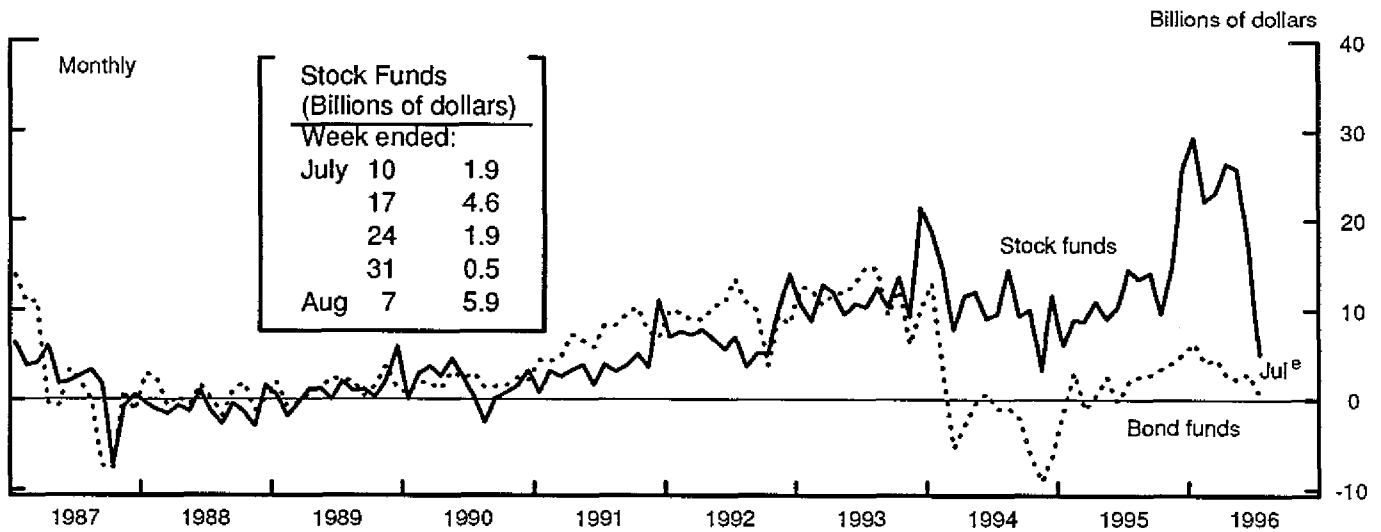
Expected Long-term Earnings Growth for S&P 500 Companies



Source: I/B/E/S.

Mutual Funds

Net Sales of Long-Term Mutual Funds



Selected Mutual Fund Net Sales

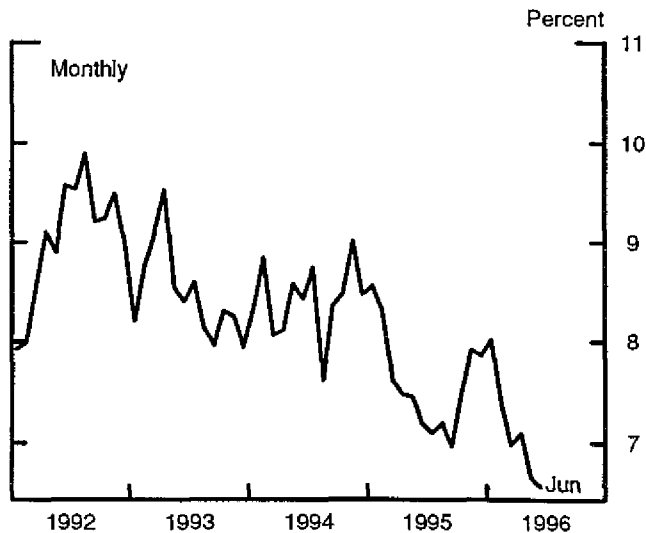
(Billions of dollars; quarterly and annual data at monthly rate)

	1994	1995	1996					Memo: June Assets
			Q1	Q2	May	June	July ^e	
Stock Funds	11.0	12.2	24.9	23.1	25.8	17.0	5.1	1532.9
Domestic ¹	7.2	11.1	19.4	18.4	21.7	12.9	3.7	1283.6
Aggressive Growth	2.2	3.2	5.3	6.8	9.2	3.7	0.4	245.2
Growth	2.0	3.5	5.6	4.7	5.8	2.9	0.3	421.2
Growth & Income ²	4.2	4.4	8.4	7.1	6.4	7.1	3.5	611.7
International	3.8	1.2	5.5	4.7	4.2	4.1	1.4	249.3
Bond Funds	-1.4	2.0	5.0	2.6	2.3	3.0	1.2	830.3

1. Includes precious metals funds, not shown elsewhere.

2. Calculated as the sum of 'Growth and Income' and 'Income Equity' in the ICI data.

Liquidity Ratio, Equity Funds



Liquidity Ratios by Type of Equity Fund (Percent)

	Aggressive Growth	Growth	Growth & Income
1995: H1	8.3	7.6	6.7
H2	8.0	7.6	6.7
1996: H1	7.6	7.7	6.1
May	6.9	7.2	5.9
Jun	7.7	6.9	5.7

^e Estimate.

Source: Investment Company Institute.

ended July 17, when the stock market was most turbulent. Net sales of aggressive growth funds, which invest in small and medium-sized firms, dried up last month (middle panel). The same was true for growth stock funds, a diverse group that focuses on achieving capital gains. In contrast, growth and income funds, the most conservative group of equity funds, experienced a far milder slowing of inflows last month. Preliminary data show that inflows to equity funds jumped during the first week in August.

In light of the outflow in mid-July, some industry observers have raised concerns about the liquidity of stock funds. However, even though the average liquidity ratio for all stock funds has declined to 6-1/2 percent (bottom left panel), the one-week outflow last month represented less than 1/2 percent of stock fund assets. Moreover, the riskier funds, which accounted for most of the outflows, generally have higher liquidity ratios than the average stock fund (bottom right panel). Many fund complexes also have reportedly taken steps in recent years to augment their liquidity positions by taking out committed lines of credit, establishing informal arrangements with custodian banks, and even arranging for inter-fund borrowing in the event of a liquidity crisis.

Monetary Aggregates and Bank Credit

The recent volatility in capital markets does not seem to have enhanced the appeal of monetary assets. In fact, M2 and M3 slowed to 2-1/4 and 3-3/4 percent annual rates, respectively, in July, placing both aggregates below the upper bounds of their annual ranges. Retail money market mutual funds, which typically serve as a refuge during periods of gyrating capital markets, registered reduced inflows in July. A steep decline in demand deposits also held down growth in the aggregates. While the extent of the runoff in demand deposits is surprising, it does follow several months of unexplained strength. Other checkable deposits continued to fall, as about \$8 billion of new sweep arrangements came on line in July.

The weaker growth in M2 showed through to M3, despite the brisker expansion of large time deposits, in part because inflows to institutional money market mutual funds abated some. In addition, bank funding needs have been weak, with bank credit in July growing at a rate in the neighborhood of 1 percent for a third month. Loan growth slowed to a 3-3/4 percent rate, as a small pickup in business loan growth was more than offset by slower expansion of consumer and real estate loans held in banks' portfolios.

III-7

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1995	1996		1996			1995:Q4	Level
		Q1	Q2	May	June	July	to July 96	(bil. \$)
						(p)	(p)	July 96
								(p)
Percentage change (annual rate) ¹								
1. M1	-1.8	-2.7	-0.6	-6.8	-0.5	-8.8	-2.7	1108.5
2. M2 ²	4.0	5.9	4.1	-1.7	5.5	2.3	4.4	3755.0
3. M3	5.9	7.2	5.4	3.0	4.7	3.7	5.8	4738.2
Selected components								
4. Currency	5.4	2.3	3.7	3.5	7.3	10.1	4.3	382.6
5. Demand deposits	1.4	10.9	10.6	9.7	12.0	-9.0	8.5	410.6
6. Other checkable deposits	-11.1	-22.7	-18.7	-38.6	-25.0	-31.2	-21.9	306.8
7. M2 minus M1 ³	6.8	9.7	6.1	0.6	8.1	7.0	7.6	2646.5
8. Savings deposits	-3.3	15.2	11.2	4.3	9.4	7.7	12.1	1214.6
9. Small time deposits	15.1	0.6	-2.9	-2.3	-0.5	2.3	-0.7	930.0
10. Retail money market funds	20.1	14.7	11.5	-3.2	21.2	14.0	13.6	501.8
11. M3 minus M2 ⁴	14.5	12.6	10.6	21.2	1.5	9.3	11.1	983.2
12. Large time deposits, net ⁵	15.4	8.3	14.1	15.0	16.5	22.7	13.6	452.0
13. Institution-only money market mutual funds	23.1	27.9	8.8	-10.3	29.1	16.8	18.5	252.9
14. RPs	4.6	-3.0	11.6	86.2	-50.4	-37.2	-2.4	181.4
15. Eurodollars	12.0	11.7	6.3	17.6	17.3	-17.1	6.8	96.9
Memo								
16. Monetary base	4.1	1.6	2.1	1.1	5.8	7.4	2.8	441.8
17. Household M2 ⁶	4.3	5.3	3.3	-2.6	4.7	3.7	4.0	3344.8

Average monthly change (billions of dollars)⁷

Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	5.5	2.9	6.6	8.3	3.9	8.8	. . .	477.7
19. Net due to related foreign institutions	3.5	2.7	-4.7	1.5	-1.0	-6.6	. . .	248.5
20. U.S. government deposits at commercial banks	-0.1	-1.3	0.0	-5.6	5.1	5.1	. . .	22.0

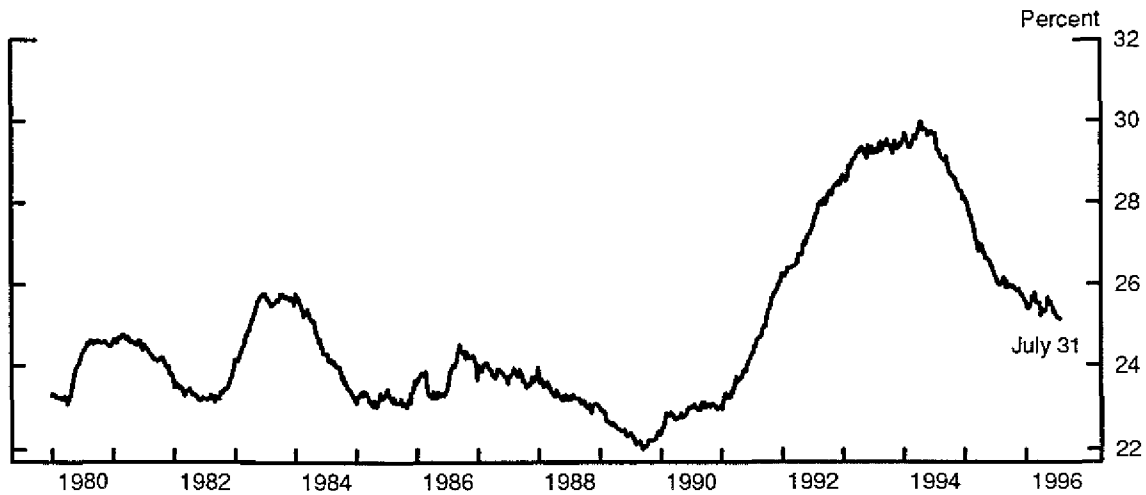
1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
 2. Sum of seasonally adjusted M1, retail money market funds, savings deposits, and small time deposits.
 3. Sum of retail money funds, savings deposits, and small time deposits, each seasonally adjusted separately.
 4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees, each seasonally adjusted separately.
 5. Net of holdings of depository institutions, money market mutual funds, U.S. government, and foreign banks and official institutions.
 6. M2 less demand deposits
 7. For the years shown, 'average monthly change' is the fourth quarter-to-fourth quarter dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.
- p--Preliminary.

COMMERCIAL BANK CREDIT
(Percentage change; seasonally adjusted annual rate)¹

Type of credit	1995	1996 Q1	1996 Q2	1996 May	1996 Jun	1996 Jul	Level, Jul 1996 (billions of \$)
1. Total loans and securities	8.7	5.3	2.5	1.4	1.6	.9	3,671.1
2. Securities	3.5	.6	-3.0	8.1	-10.0	-6.7	974.8
3. U.S. government	-3.1	-2.5	.5	15.0	-11.3	-.2	707.7
4. Other ²	25.6	8.4	-11.9	-9.1	-7.0	-23.8	267.1
5. Loans ³	10.7	7.1	4.6	-1.1	5.9	3.7	2,696.3
6. Business	11.5	7.3	5.0	3.6	4.7	5.5	741.3
7. Real estate	8.5	4.9	3.2	1.9	3.6	1.3	1,103.4
8. Home equity	5.2	5.6	-.5	-6.0	-6.0	6.0	79.8
9. Other	8.7	4.8	3.6	2.5	4.2	.9	1,023.6
10. Consumer	10.7	6.7	4.9	-5.9	12.4	4.5	512.0
11. Adjusted ⁴	17.6	13.7	9.4	-.7	16.9	7.1	666.1
12. Security	14.4	-3.3	-8.0	-46.1	-7.3	-26.3	80.3
13. Other ⁵	18.4	21.2	13.0	-2.4	10.4	16.9	259.3

1. Monthly levels are *pro rata* averages of Wednesday data. Quarterly and annual levels (not shown) are simple averages of monthly levels and levels for the fourth quarter respectively. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.
2. Includes municipal securities, foreign government securities, corporate bonds, equities, and trading account assets.
3. Excludes interbank loans.
4. Includes estimates of consumer loans that have been securitized by banks and are still outstanding.
5. Includes loans to nonbank financial institutions, farmers, state and local governments, banks abroad, foreign governments, and all others not elsewhere classified. Also includes lease financing receivables.

Securities' Share of Bank Credit
(Adjusted for FIN 39 and FAS 115; Seasonally adjusted)



Security holdings at banks, which had grown sluggishly for the last two years, contracted in June and July. In part, this behavior seems to represent a return to a more typical relationship between security holdings and bank credit (chart). In the early 1990s, when bank loan portfolios were troubled and banks became highly cautious lenders, the share of securities in bank portfolios climbed substantially. Beginning in 1994, after bank capital positions became comfortable again and loan demand strengthened, the securities share began to decline. This trend has continued in 1996, even as loan demand has moderated.

The subdued lending in recent months does not appear to have been driven by a more restrictive posture on credit availability. Banks reported strong earnings for the second quarter, and capital positions are favorable. Results from the August Senior Loan Officer Survey showed some tightening for loans to households, but otherwise banks reported little change in loan supply.

Household Sector

Household borrowing is estimated to have moderated in the second quarter, and the sparse data available do not point to a rebound in the current quarter. Much of the slowing reflects weaker growth in consumer credit, which slid to a 7-1/2 percent annual rate last quarter, despite some firming in June (table and chart). In July, consumer loans at banks grew at a 7 percent rate after adjusting for securitization, somewhat below its second-quarter pace.

The deceleration in consumer debt probably owes more to slower growth in demand for credit than to a cutback in supply. Interest rates on consumer loans have been fairly steady this year (table), and unused lines of credit on credit card accounts at commercial banks continued to expand very rapidly through the first quarter, reaching \$1.2 trillion. Furthermore, any tightening of standards in granting new credit lines would not prevent people from drawing on existing lines of credit.

That said, tighter lending standards may exert some damping effect on consumer credit growth going forward. Banks are continuing to scrutinize their consumer lending programs and, on net, have become less willing to make consumer loans in recent months according to participants in the August loan officer survey (chart, middle panel). A tightening of standards was most evident in the credit card area, where delinquencies and charge-offs have

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

Type of credit	1994	1995	1996				Memo: Outstanding June, 1996 (billions of dollars)
			Q1 ^r	Q2 ^p	May ^r	June ^p	
Total	14.5	14.2	10.8	7.4	5.9	8.7	1153.7
Auto	13.4	10.7	7.6	10.3	3.9	17.6	366.9
Revolving	18.2	22.0	16.6	14.5	15.6	7.6	446.7
Other	11.8	9.1	7.0	-4.8	-4.4	.6	340.1

r Revised.

p Preliminary.

INTEREST RATES ON CONSUMER LOANS
(Annual percentage rate)

Type of loan	1994	1995	1995				1996	
			May	Aug.	Nov.	Feb.	May	June
At commercial banks ¹								
New cars (48 mo.)	8.1	9.6	9.8	9.4	9.4	9.1	8.9	9.2 ^e
Personal (24 mo.)	13.2	13.9	14.0	13.8	13.8	13.6	13.5	n.a.
Credit cards	16.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
² Credit cards								
All accounts	n.a.	16.0	16.2	16.0	15.8	15.8	15.4	n.a.
Accounts assessed interest	n.a.	15.8	16.2	15.9	15.7	15.4	15.4	n.a.
At auto finance cos. ³								
New cars	9.8	9.8	11.4	10.9	10.8	9.9	9.6	9.5
Used cars	13.5	13.5	14.8	14.2	14.0	13.3	13.3	13.6

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

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

2. The rate for *all accounts* is the stated APR averaged across all credit card accounts at all reporting banks. The rate for *accounts assessed interest* is the annualized ratio of total finance charges at all reporting banks to the total average daily balances against which the finance charges were assessed (excludes accounts for which no finance charges were assessed).

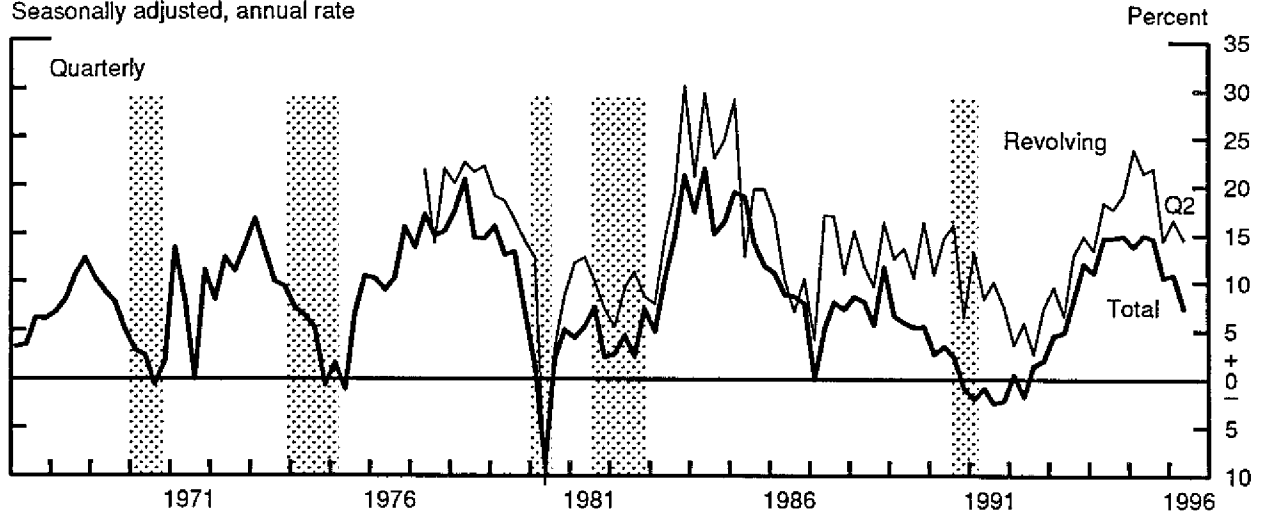
3. For monthly data, rate for all loans of each type made during the month regardless of maturity.

e estimate based on data from Bank Rate Monitor.

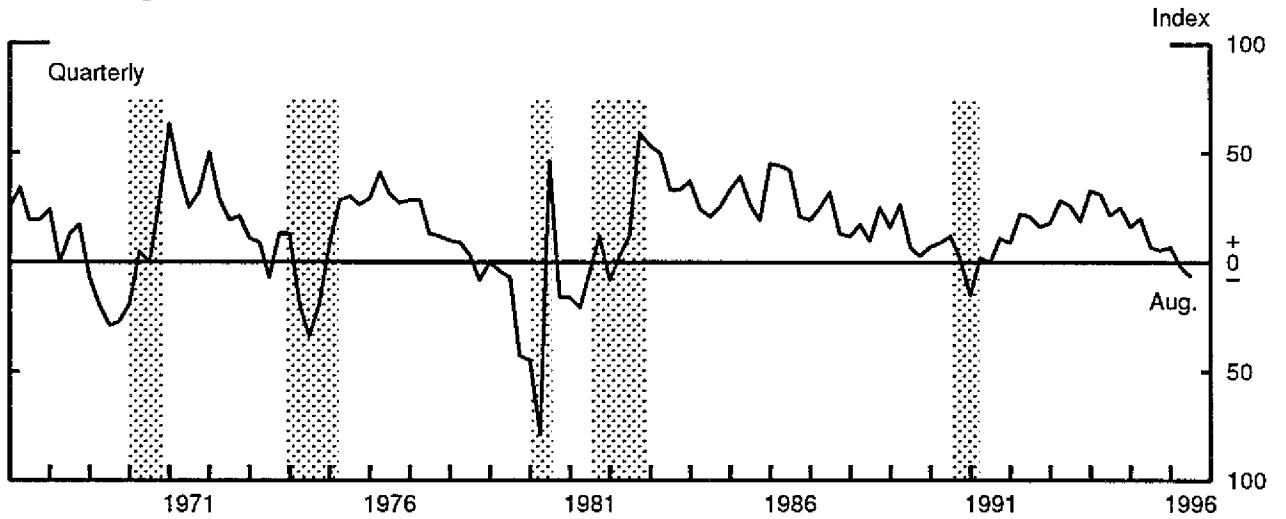
n.a. Not available.

Household Sector

Consumer Credit Growth
Seasonally adjusted, annual rate

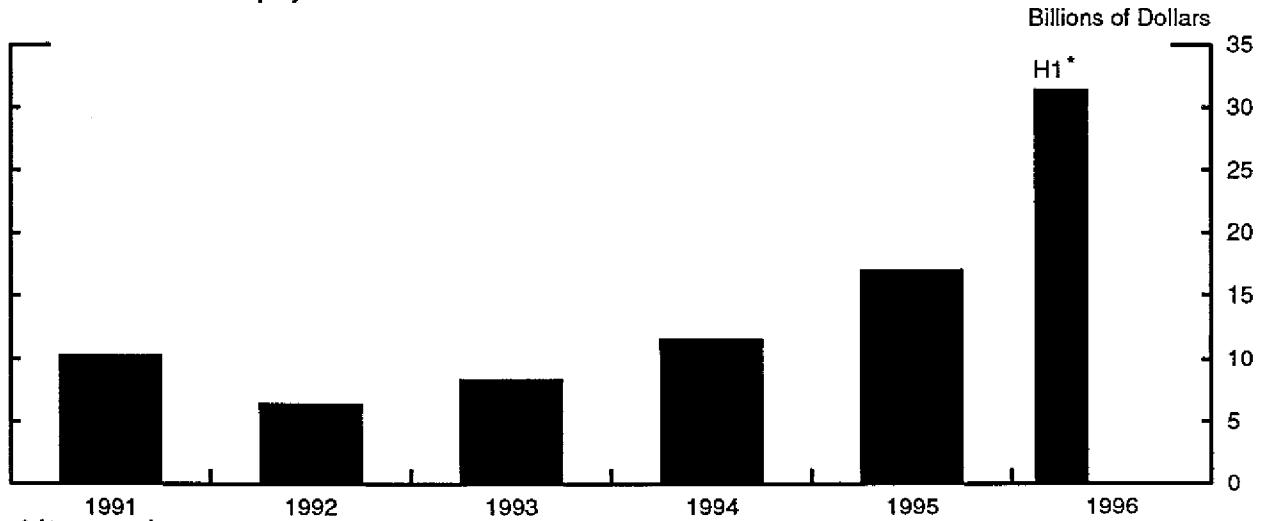


Bank Willingness to Make Consumer Loans*



* Weighted responses of banks more willing to lend minus those less willing.

Issuance of Home Equity Loan Securities



* At an annual rate.
Source: Inside Mortgage Securities.

risen the most, although a number of respondents reported tightening standards for other installment loans as well. Asked specifically about the use of credit scoring to evaluate applications, 90 percent of the card-issuing banks employed this tool, and 40 percent of those had set cutoff scores at more restrictive levels in the past three months.²

Among the few data series now available on consumer loan repayments in the second quarter, the captive auto finance companies experienced a rise in delinquency rates to a historical high, after a decline in the first quarter. Earlier, these companies indicated that they had anticipated an uptrend as a result of having liberalized credit standards in 1993-94 to help boost car sales.³

A definitive estimate of mortgage debt growth for the second quarter cannot be made until data become available from Call Reports, but the heavy issuance of mortgage-backed securities suggests that, all else equal, loan originations were quite strong. Real estate loan growth at commercial banks slowed last quarter, but some of that deceleration apparently owed to heavy securitization of home equity loans: During the first half of the year, securitizations at all lenders were about double the pace set last year, and the second-quarter volume was the highest on record (bottom panel). Growth in real estate loans at commercial banks remained modest in July.

Business Finance

Gross issuance of bonds by nonfinancial corporations in July backed off from the strong pace of the previous two months (table). Speculative-grade issuance accounted for most of the decline, falling to less than half its average monthly pace during the first half of the year. Market contacts indicated that a number of highly speculative offerings that had been on the calendar were postponed or withdrawn as investors backed away amidst the turbulence in the capital markets last month. Of the investment-grade bonds issued in July, some of the proceeds were used to pay down commercial paper. As a result, outstanding commercial paper of nonfinancial firms

2. A more detailed summary of the August loan officer survey is included in an appendix to the Greenbook.

3. The level of the delinquency rate at captive finance companies has also been boosted a bit by the shift away from loans toward leasing. Leases are not included in the loan delinquency data, and lease customers tend to be better credit risks than the average borrower.

GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS¹
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1994	1995	1996				
			Q1	Q2 ^P	May ^P	June ^P	July ^P
All U.S. corporations	41.29	47.64	57.46	63.25	70.63	68.24	40.68
Stocks ²	5.49	6.10	7.41	13.75	14.34	13.44	7.56
Bonds	35.80	41.54	50.05	49.51	56.29	54.80	33.12
<u>Nonfinancial corporations</u>							
Stocks ²	3.10	4.39	5.25	10.24	10.19	11.43	6.00
Initial public offerings	1.14	1.70	2.17	4.42	3.41	4.00	1.66
Seasoned offerings	1.96	2.69	3.09	5.82	6.77	7.43	4.35
Bonds	7.99	10.73	12.07	13.64	16.60	15.34	10.42
By rating, bonds sold in U.S. ³							
Investment grade	4.41	6.45	5.86	6.34	7.94	7.82	7.04
Speculative grade	2.65	3.02	4.95	5.60	6.65	5.34	2.30
Public	2.01	1.95	2.68	3.29	3.56	4.04	1.18
Rule 144A	.63	1.07	2.27	2.31	3.09	1.30	1.12
<u>Financial corporations</u>							
Stocks ²	2.39	1.71	2.16	3.50	4.16	2.02	1.56
Bonds	27.81	30.81	37.98	35.87	39.69	39.46	22.70

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

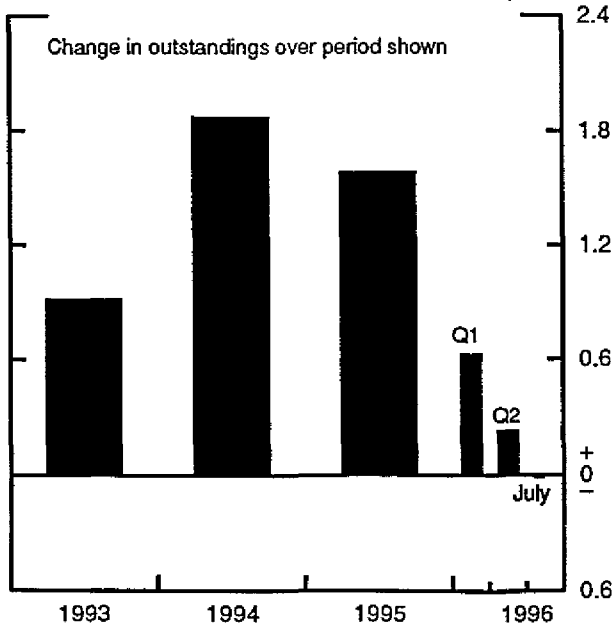
1. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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.

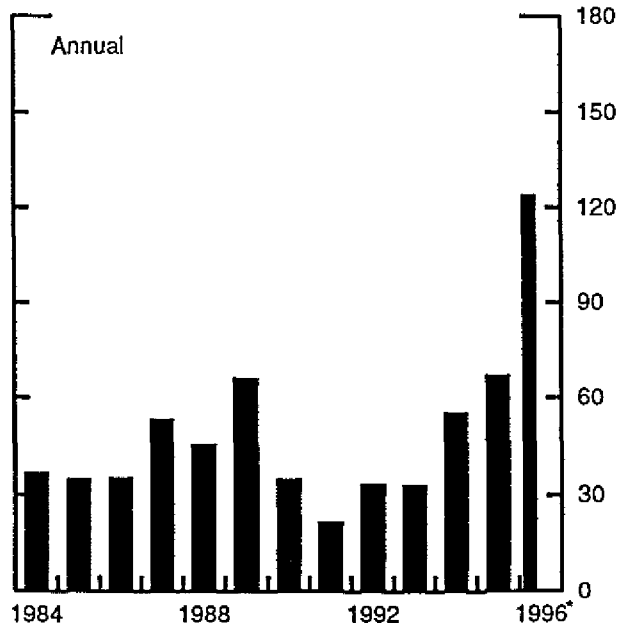
p Preliminary.

Commercial Paper Issuance by Nonfinancial Firms* Billions of dollars, monthly rate



*Seasonally adjusted.

Announced Share Repurchase Programs of Nonfinancial Firms Billions of dollars



*1996 is based on data through July and is at an annual rate.

declined slightly last month, after having grown only a bit over the second quarter (bottom left panel).

The drop in stock prices damped equity issuance by nonfinancial firms from the record pace of the second quarter. Still, issuance in July slightly exceeded the first-quarter pace, and data on securities registrations suggest that issuance will be fairly well maintained this month.

Meanwhile, equity retirements at nonfinancial firms remained heavy in the second quarter, with the retirements coming about equally from mergers and share repurchases. Merger activity has remained robust since early July. However, because most of the recently announced mergers have been structured as stock swaps, merger-related share retirements for 1996 will likely fall below last year's pace. In contrast, announcements of share repurchase programs have continued to come at a blistering pace (bottom right panel), and completed repurchases are expected to increase 20 percent this year.

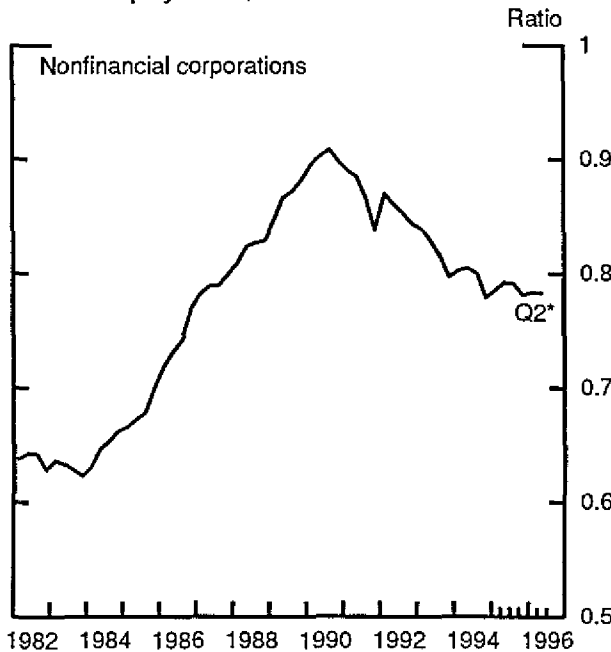
The creditworthiness of firms in the nonfinancial sector has remained strong in the past few months. The business failure rate and the default rate on junk bonds are near their lows of the past decade. The aggregate debt-to-equity ratio for nonfinancial firms has held to its lowest level in the current decade, and gross interest expense to cash flow remains quite low as well (chart, upper panels). Spreads of speculative-grade bonds over those on Treasuries have dropped back this year and the current level is extremely tight (bottom left panel). The narrow spreads have spurred an increased volume of junk bond issuance in recent years, boosting the share of these bonds in total nonfinancial bonds outstanding to the highest level in the past decade (bottom right panel). This increased share, while a favorable indicator of current credit availability for speculative-grade firms, does raise the possibility of higher corporate bond defaults down the road.

Treasury and Agency Financing

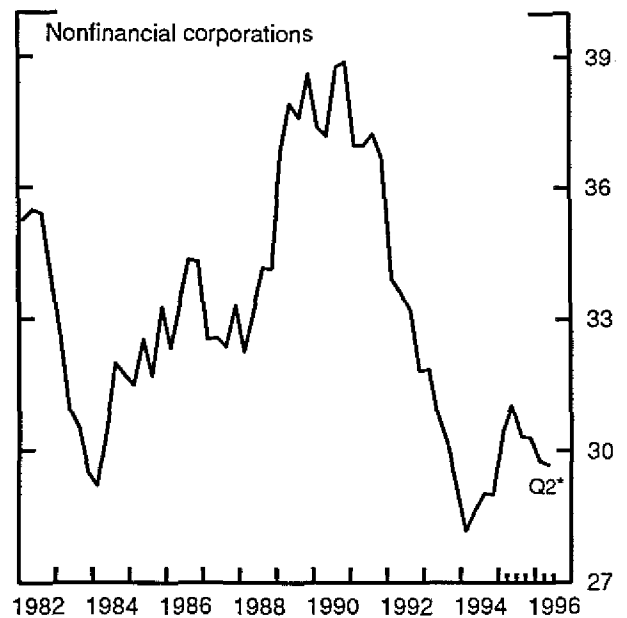
The federal government is expected to post a budget deficit of \$43 billion during the current quarter (table). Much of the associated financing need was met by the midquarter refunding, which raised \$39 billion and included three-, ten-, and thirty-year securities. As is typical when the midquarter refunding includes a thirty-year bond, the Treasury will pay down bills during the quarter.

Indicators of Corporate Credit Quality

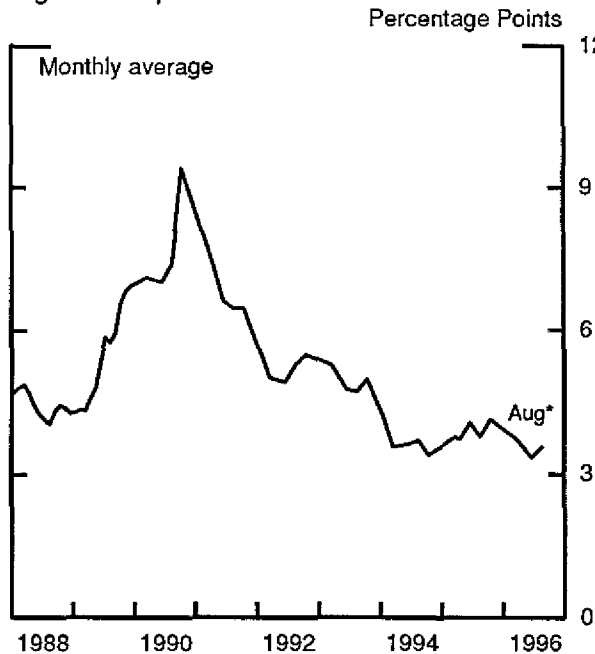
Debt to Equity Ratio, At Book Value



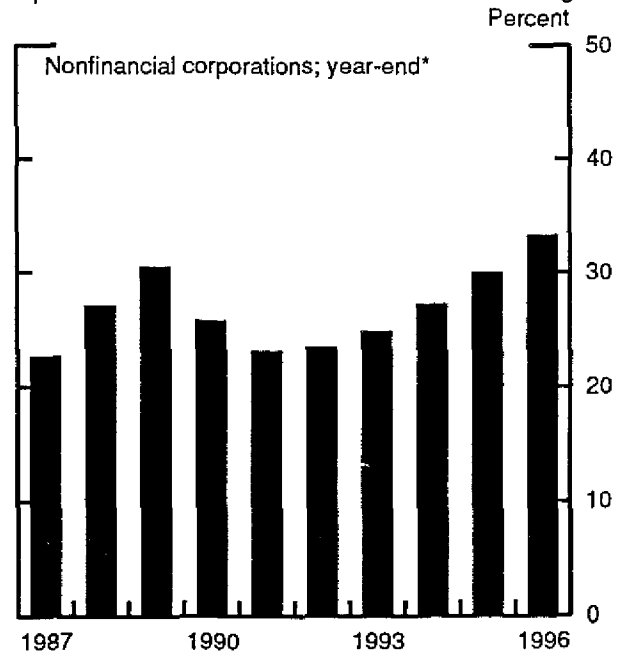
Gross Interest Payments as a Percent of Cash Flow



High-Yield Spread¹



Speculative-Grade Share of Bonds Outstanding



1. Merrill Lynch Master II Index less seven year Treasury.
*Average of daily data through August 14.

*1996 bar refers to end of Q2.
Source: Moody's Investors Service and Board Survey of MTNs.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996				
	Q2	Q3 ^P	July ^e	Aug. ^P	Sep. ^P
Total surplus/deficit (-)	53.2	-42.6	-27.1	-41.9	26.3
Means of financing deficit					
Net cash borrowing and repayments (-)					
Nonmarketable	-23.5	42.7	27.2	14.6	0.8
Marketable	2.1	-1.5	-2.1	0.9	-0.4
Bills	-25.6	44.2	29.3	13.7	1.2
Coupons	-38.3	-5.4	12.6	-9.7	-8.3
Decrease in cash balance	12.7	49.6	16.7	23.4	9.5
Other ¹	-16.2	-6.0	1.3	27.1	-34.4
	-13.6	5.9	-1.4	0.1	7.2
Memo:					
Cash balance, end of period	38.0	44.0	36.8	9.6	44.0

Note. Data reported on a payment basis. Details may not sum to totals because of rounding.

1. Accrued items, checks issued less checks paid, and other transactions.

p Projection.

e Estimate.

NET CASH BORROWING OF GOVERNMENT-SPONSORED ENTERPRISES
(Billions of dollars)

Agency	1996				
	Q1	Q2	Apr.	May	Jun.
FHLBs	-3.9	10.0	3.2	1.0	5.9
FHLMC	4.3	19.1	11.9	5.1	2.1
FNMA	7.6	1.6	-0.5	-1.3	3.3
Farm Credit Banks	2.0	2.8	1.4	0.4	1.0
SLMA	-1.8	-1.0	1.3	-0.3	-2.0

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

n.a. Not available.

At its midquarter refunding announcement, the Treasury clarified several aspects of its proposal to issue index-linked debt. Even though it has not fully decided the characteristics of the new bonds, it announced that they will be eligible for the Treasury's stripping program from the date of issuance and that it will eventually issue several maturities of inflation-protected securities. The Treasury also announced that it will make the complete specifications known in September and may conduct an auction for the new debt instruments before the end of the year.

Fannie Mae and Freddie Mac have been under increased scrutiny in recent months, with both the Treasury and the Congressional Budget Office claiming that these institutions fail to pass on to mortgage borrowers all of the implicit subsidies they receive from the government. These government-sponsored enterprises have strong political support, and the market evidently sees little chance that the agencies would be privatized, as spreads on their securities to comparable Treasuries have remained tight.

The House Banking Committee approved a plan to fund the payment of interest on the Financing Corporation (FICO) bonds issued to finance the savings and loan bailout. A floor vote could be scheduled in early September. The bonds' principal is backed by zero-coupon Treasury securities, but interest is currently paid out of the premiums of the Savings Association Insurance Fund. The House Banking Committee's plan would require thrifts to pay 58 percent of the annual interest payments for three years, while banks would pay the remainder; thereafter, payments would be proportional to deposit holdings, implying that banks would pay roughly three-quarters of FICO interest. Yield spreads on FICO securities suggest that the market has been placing negligible odds on default all through the recent legislative wrangling.

Municipal Financing

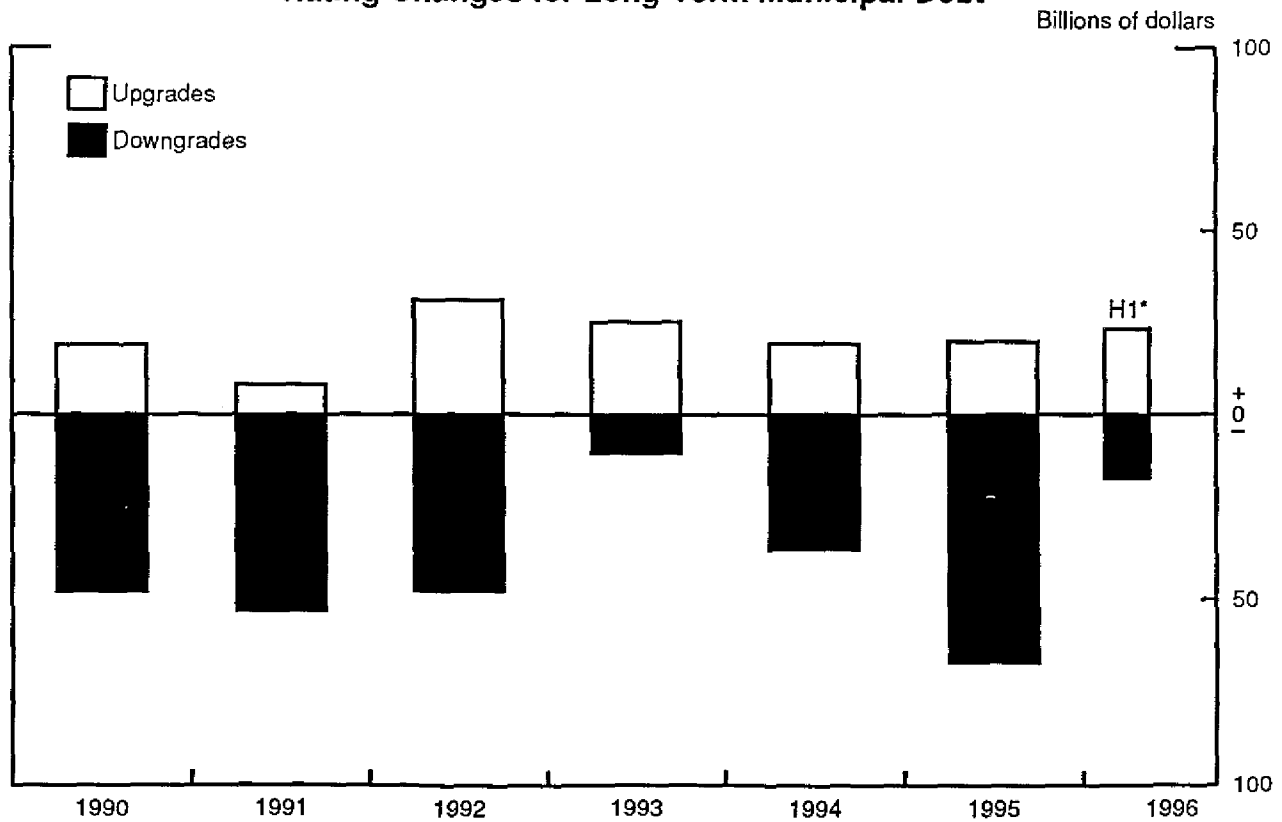
Gross offerings of long-term municipal debt decreased to \$11 billion in July from about \$18 billion in June (table). Both new capital issuance and refundings were down in July, consistent with the usual seasonal pattern, and remained relatively low in early August. In contrast, retirements increased substantially in July, causing a sharp reduction in the supply of outstanding municipal debt. Partly as a result, the tax-exempt yield on thirty-year bonds fell to 81 percent of that of comparable Treasury bonds in early August, the lowest level in a year.

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

	1993	1994	1995	1996			
				Q1	Q2	Jun.	Jul.
Total tax-exempt	27.2	16.1	14.9	14.3	19.0	25.6	17.7
Long-term	23.3	12.8	12.1	12.7	15.4	17.6	11.2
Refundings ¹	15.7	4.0	3.6	4.9	3.9	2.9	1.8
New capital	7.6	8.8	8.5	7.8	11.5	14.7	9.4
Short-term	3.9	3.3	2.8	1.6	3.6	8.0	6.5
Total taxable	.7	.7	.7	.5	.5	.7	.5

Note. Includes issues for public and private purposes.
 1. Includes all refunding bonds, not just advance refundings.

Rating Changes for Long-Term Municipal Debt



*At an annual rate
 Source: Standard & Poors

The credit quality of municipal debt, as measured by changes in ratings, improved in the first half of the year (chart). Virtually all sectors of the municipal market experienced a net upgrade. The only deterioration occurred among utilities, which accounted for more than 90 percent of all municipal debt downgraded in the first half. As in the private sector, municipal utilities face heightened competitive pressures as a result of ongoing deregulation.

APPENDIX

THE AUGUST SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

The August 1996 Senior Loan Officer Opinion Survey on Bank Lending Practices posed questions about changes in bank lending standards and terms, changes in loan demand by businesses and households, credit-scoring models used to evaluate credit card applications, charge-off rates on consumer loans, and commercial credit card programs.

The survey results showed little change in lending standards for loans to businesses but a tightening of standards for loans to consumers. Lending standards for commercial and industrial loans to borrowers of all sizes were generally unchanged, as were standards for commercial real estate loans. Standards for home mortgages were also about unchanged, but many banks tightened standards for credit card and other consumer installment loans.

Loan terms were reportedly eased moderately for businesses but tightened somewhat for consumers. Terms were eased for business loans to borrowers of all sizes, although more banks reported easing them for large borrowers than for small borrowers. Terms on credit card loans, especially credit limits, were tightened by many banks, and a few banks tightened terms on other consumer installment loans.

Changes in demand for bank loans were mixed across loan types. Several banks reported increased demand for commercial and industrial loans, and a few reported increased demand for commercial real estate loans. However, demand for home mortgages was reportedly weaker at many banks while, for consumer installment loans, the number of respondents who reported weaker demand was about the same as the number who reported stronger demand.

Regarding credit-scoring models, most banks use such models to evaluate some or all of their credit card applications, and about half of those banks said that they had tightened the cutoff scores necessary to qualify for a card. Responses to other special questions indicate that many banks are charging off consumer loans at a higher-than-expected rate given the delinquency rate on these loans at their bank. These banks attribute this development largely to a rise in bankruptcies with a short intervening period of delinquency. A series of special questions on commercial credit card programs found that many banks have adopted such programs over the past few years, but the credit balances represent only a small fraction of commercial and industrial loans.

Lending to Businesses

As in May, the survey found little change, on net, in lending standards for business loans to firms of all sizes over the past three months (chart). A few banks, on net, eased standards for loans to large corporations, but standards for smaller firms were essentially unchanged. The survey again found an easing of terms on commercial and industrial loans; about a quarter of the banks, on net, eased spreads over base rates for loans to large and middle-market firms, although only about 5 percent, on net, eased spreads for small businesses (chart). The proportions that reported

easing spreads were a bit smaller than in the May survey, continuing the downward trend evident over the past year. The proportion that reported reducing credit line costs was similar to the proportion that reported easing spreads over base rates. Smaller proportions eased other terms, including maximum credit line sizes, loan covenants, and collateralization requirements. In contrast, respondents that are U.S. offices of foreign banks indicated a slight tightening of both standards and terms on commercial and industrial loans. Those banks that eased terms or standards indicated that they did so primarily because of increased competition from other banks and, to a lesser extent, from nonbank lenders. Those banks that tightened terms or standards indicated that they did so because of a reduced tolerance for risk and because of reduced competition from other banks.

On net, between 10 and 20 percent of respondents indicated an increase in demand for commercial and industrial loans, with the largest proportion reporting increased demand from small businesses (chart). Banks attributed changes in demand to variations in their customers' investment in inventories, plant, and equipment and to substitution toward and away from other sources of finance. Banks also indicated that demand from large corporations and middle-market firms was boosted by merger and acquisition financing.

Domestic respondents reported a slight tightening of standards for commercial real estate loans while foreign respondents indicated little change in standards for these loans. Small net proportions of both foreign and domestic respondents experienced an increase in demand for commercial real estate loans.

Lending to Households

The survey found little evidence of changing standards for home mortgages; only two banks indicated tighter standards and all the rest reported no change. About a quarter of the banks, on net, reported weaker demand for these loans (chart). This reported weakness is in line with the recent modest growth in the outstanding value of these loans at commercial banks but is at odds with recent strength in the housing market.

The survey results were generally supportive of the view that banks are pulling back, somewhat, in their lending to consumers. As in May, a small net fraction of the respondents--less than ten percent--reported a decline over the preceding three months in their willingness to make consumer installment loans. These results represent the first two consecutive surveys finding a net reduction in willingness to make consumer installment loans since 1981. Moreover, larger net proportions of banks reported having tightened consumer loan standards and terms than did so in May. Nearly half of the banks tightened their standards for approving credit card applications and about a quarter tightened standards for other consumer installment loans. Nearly a third of the banks lowered their credit limits on new or existing credit card accounts, and smaller proportions increased spreads over market rates on credit cards and other consumer installment loans. Banks reported little net change in demand for consumer installment loans.

In response to special questions, about 90 percent of the banks reported using credit-scoring models to evaluate some or all of their credit card applications. Of those using such models, 40 percent had made the average cutoff score to qualify for a credit

card more restrictive over the past three months and just over half had done so over the past year.

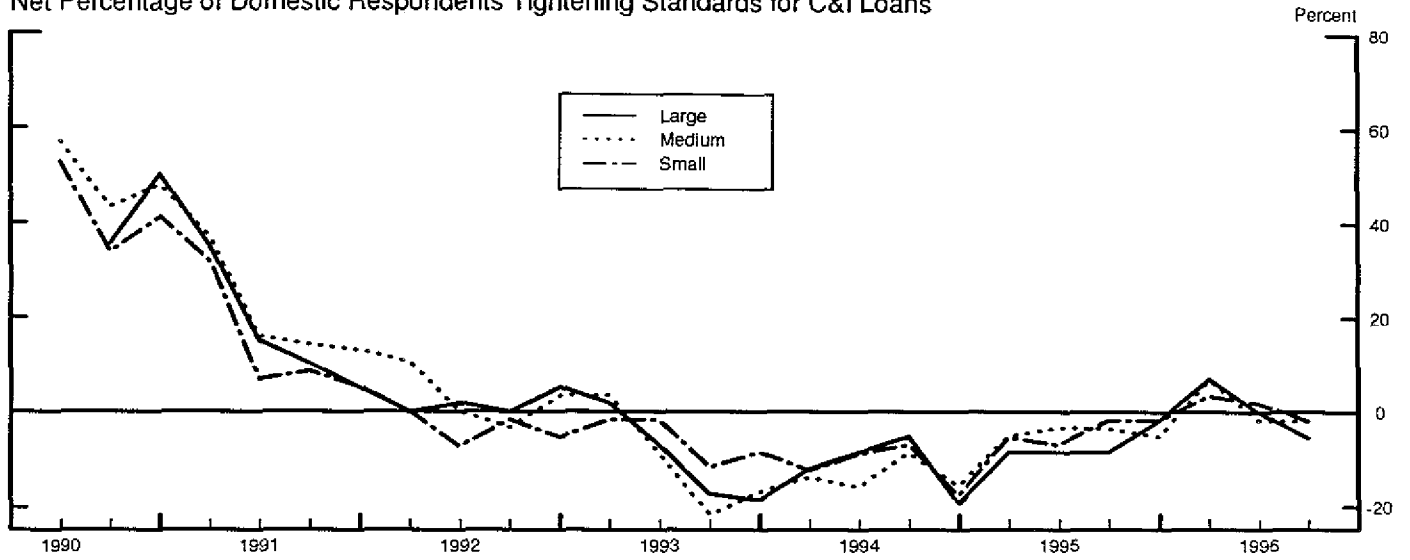
Responses to other special questions revealed that two-thirds of the banks are charging off consumer loans at a higher rate than they would have expected at current delinquency rates, given their past experience. Virtually all of the banks experiencing higher charge-off rates indicated that a very important reason for the high rate was that more customers were declaring bankruptcy with little or no intervening period of delinquency. Many banks also indicated that a larger fraction of their delinquent loans were remaining delinquent long enough to be charged off.

Commercial Credit Cards

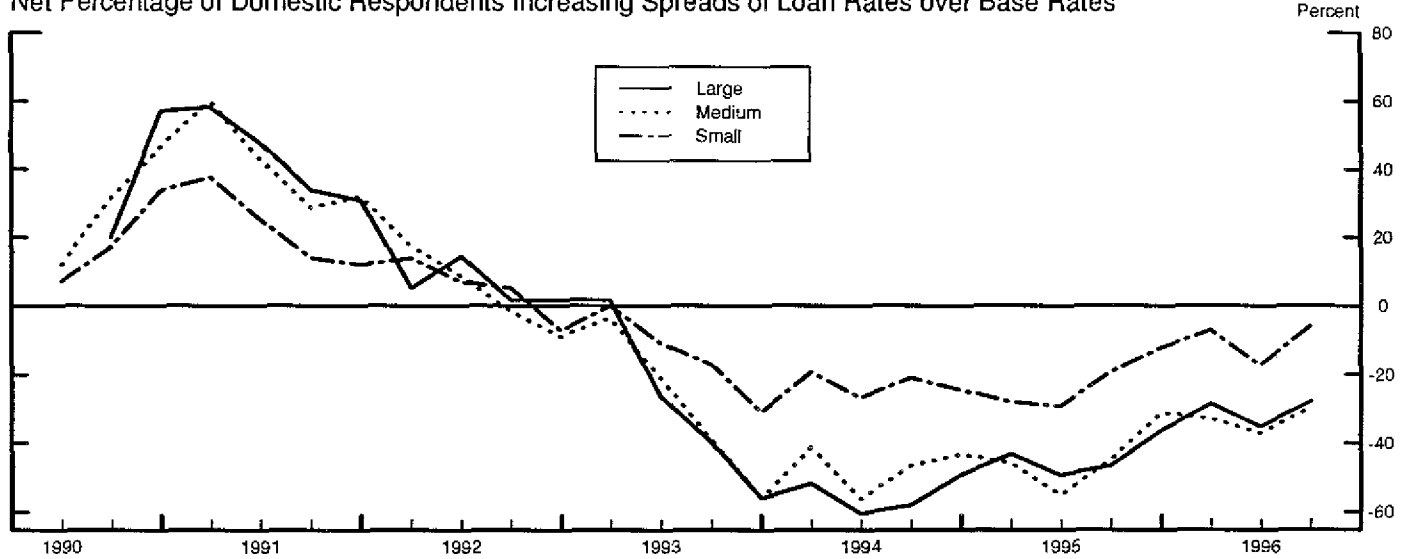
A series of special questions asked banks about commercial credit card programs. Commercial card products include business cards, which are generally for smaller businesses; corporate cards, which are generally for travel and entertainment expenses incurred by large corporations; and purchasing cards, which are generally for modest business purchases, other than for travel and entertainment, by large corporations. About two-thirds of the respondents indicated that they currently offer at least one of these types of credit card, and many banks offer all three. Of the programs, the largest number of banks offered business cards, followed by corporate and then purchasing cards. About half of the banks offering one or more of these programs had started them within the past three years, and many of them reported growth in outstandings over the past year of more than 10 percent. Nevertheless, the outstanding balances on these cards do not represent a large fraction of business lending. Almost all the banks said that the balances account for less than 2 percent of their commercial and industrial loans and less than 5 percent of their lending to small businesses. When asked about their plans to start new programs, a few banks expressed an intention to offer business or corporate cards in the near future while a somewhat larger number planned to offer purchasing cards.

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

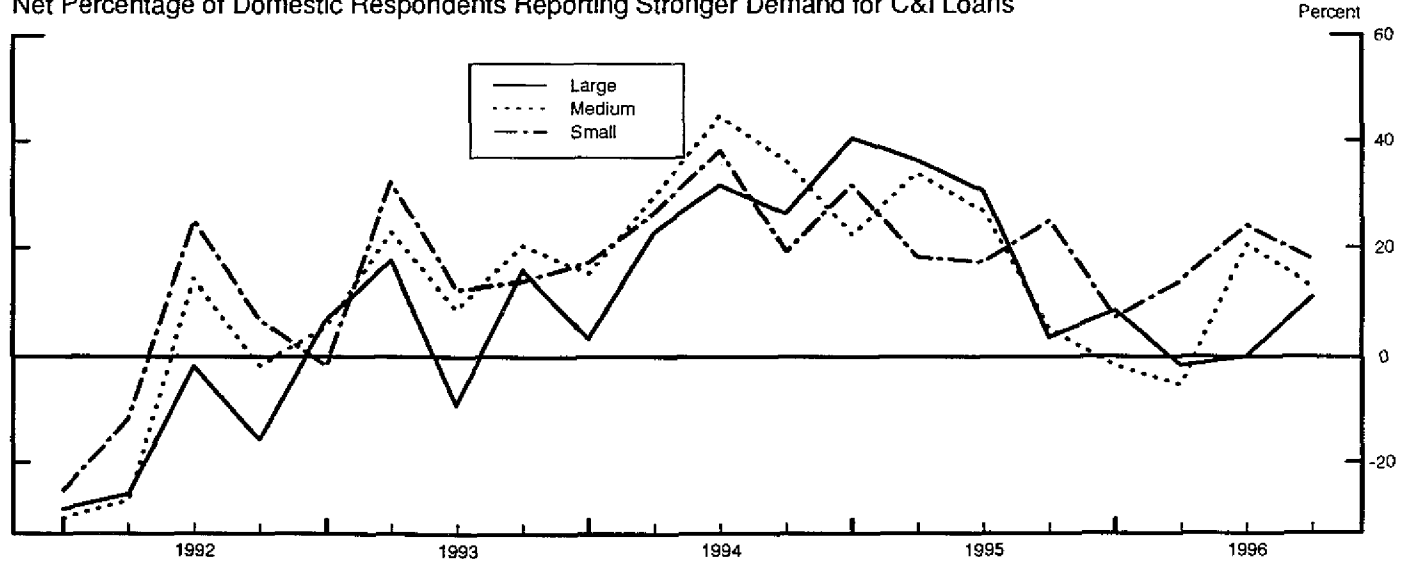
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



Net Percentage of Domestic Respondents Increasing Spreads of Loan Rates over Base Rates

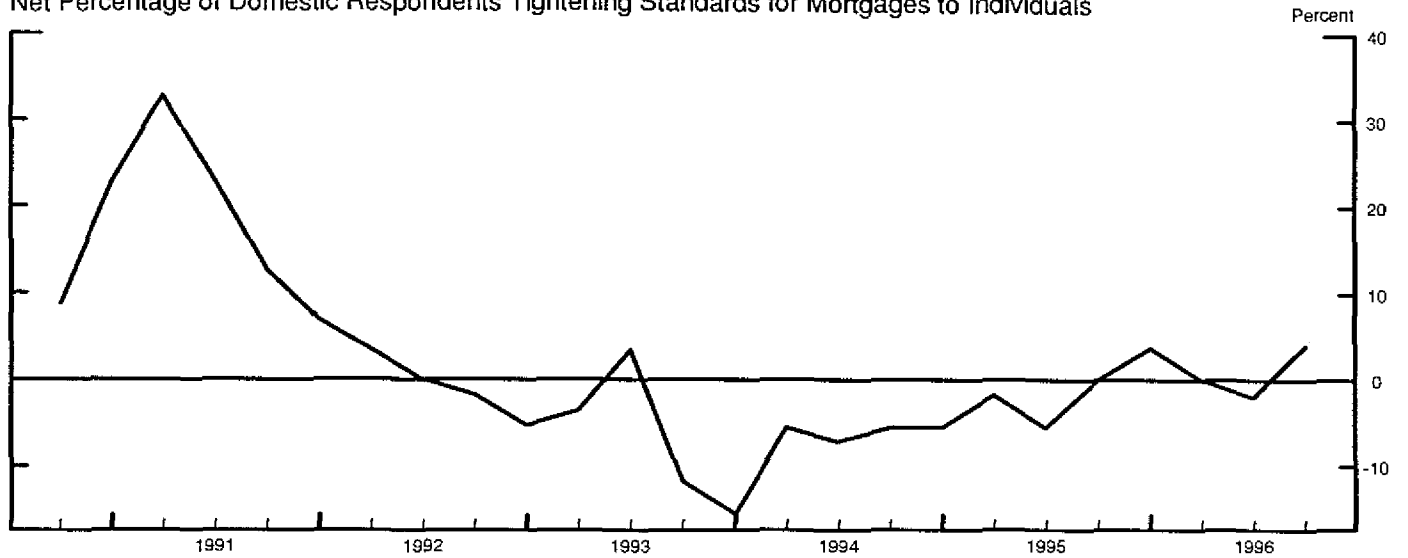


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

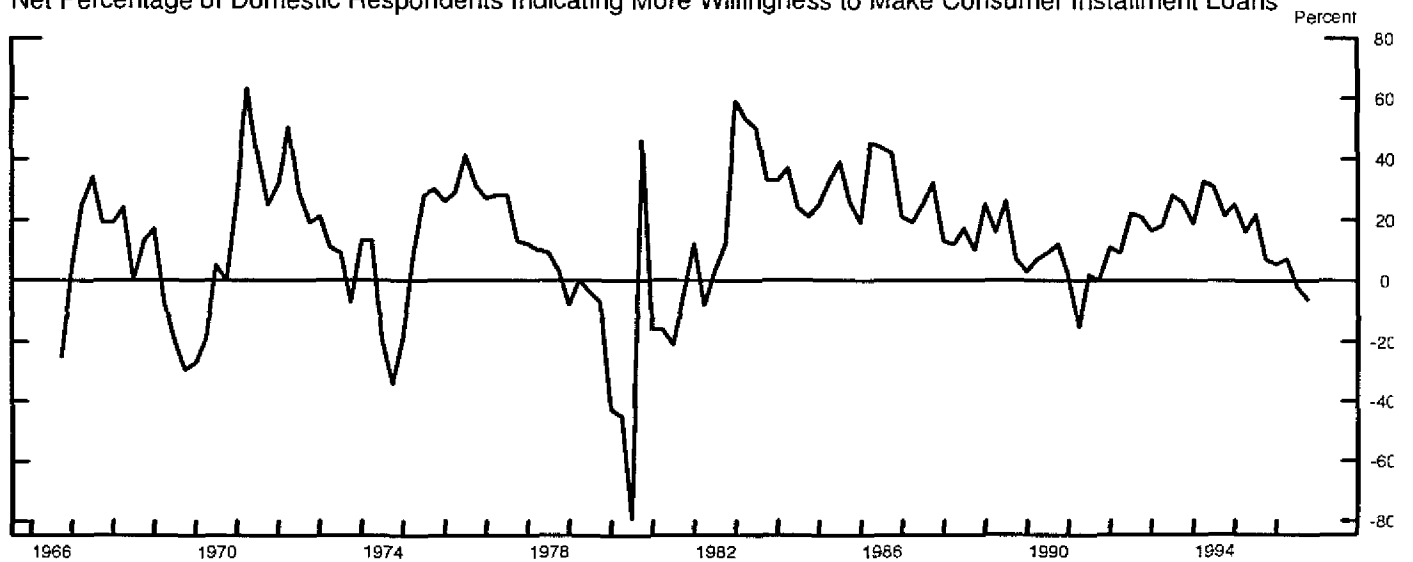


Measures of Supply and Demand for Loans to Households

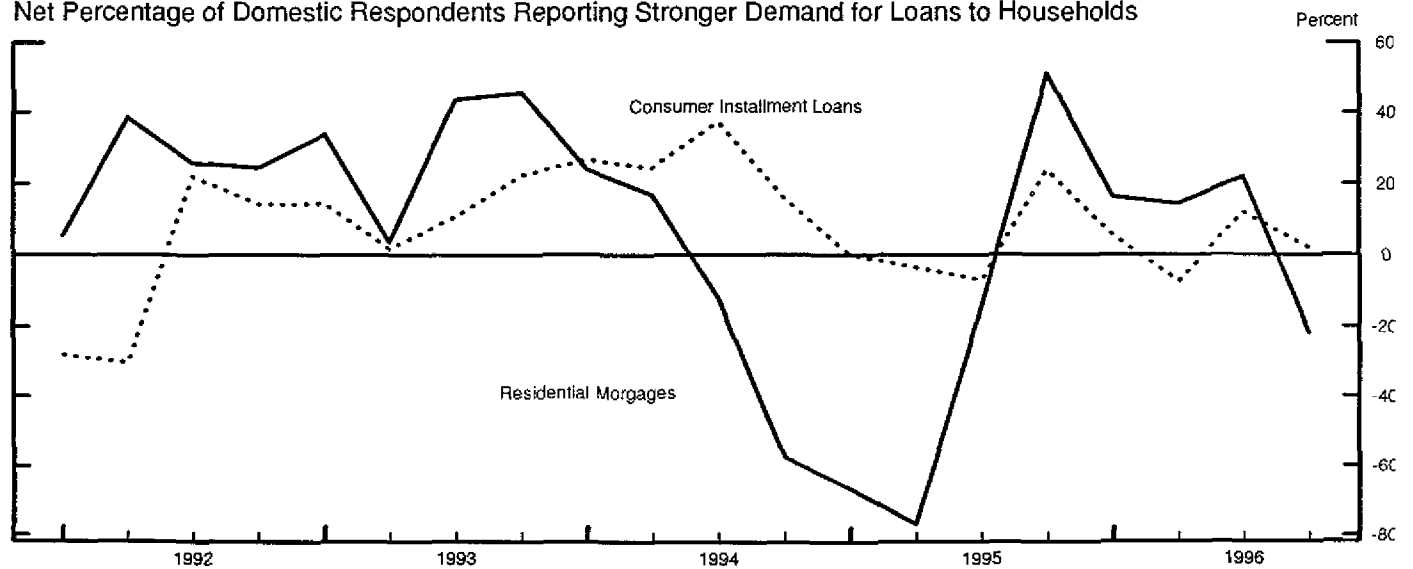
Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



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



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



INTERNATIONAL DEVELOPMENTS

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

The deficit in U.S. international trade in goods and services widened in May. Exports were 1 percent higher than the downward-revised April level, while imports rose 2-1/2 percent. Data for June will be released on Tuesday, August 20.

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

	1995	Annual rates			Monthly rates		
		1995	1996		1996		
		Q4	Q1	Q2e/	Mar	Apr	May
<u>Real NIPA 1/</u>							
Net exports of G&S	-107.6	-84.9	-104.0	-121.7	...	...	...
<u>Nominal BOP</u>							
Net exports of G&S	-105.1	-77.6	-97.4	-122.9	-8.0	-9.6	-10.9
Goods, net	-173.4	-152.1	-171.0	-194.7	-14.5	-15.6	-16.9
Services, net	68.4	74.5	73.5	71.8	6.4	6.0	6.0

1. In billions of chained (1992) dollars.

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

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

In April-May, the deficit in net exports at an annual rate was substantially larger than in the first quarter, back to levels last recorded a year earlier.

Exports of goods and services were 1-1/2 percent higher in April-May on average than in the first quarter, with most of the increase in deliveries of aircraft and shipments of gold abroad¹. Over the past year, the value of exports rose 7 percent (Q2e/Q2).

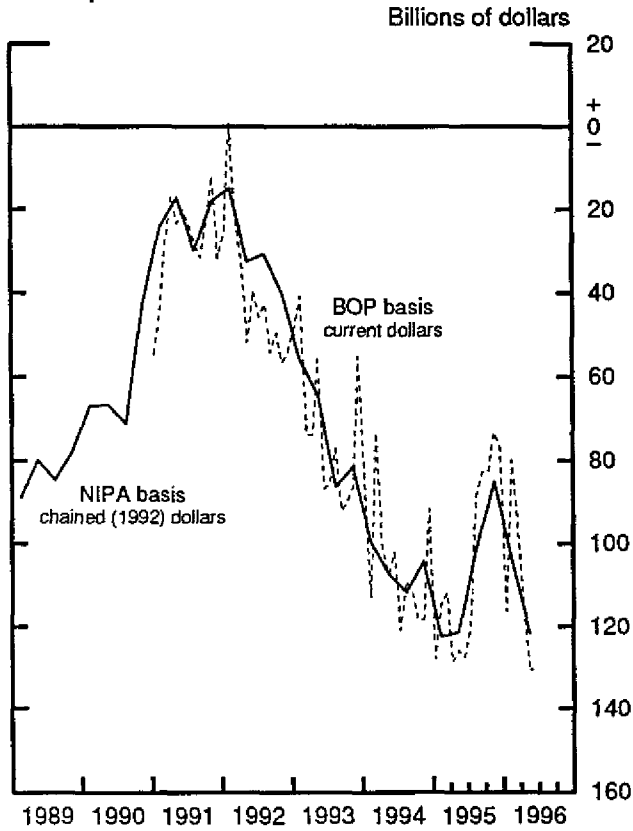
Imports of goods and services were 4 percent higher in April-May on average than in the first quarter, with two-thirds of the increase attributable to oil and transfers of gold. The remaining increase was predominantly in automotive products (reflecting the strength of sales) and consumer goods. Partly offsetting these increases was a sharp decline in imported semiconductors. The strong pick-up in imports in the first five months of the year is consistent with rising U.S. domestic demand.

¹ Gold transferred from foreign holdings at the Federal Reserve Bank of New York is recorded first as an import into the United States and shows up as an export when gold is shipped out of the country.

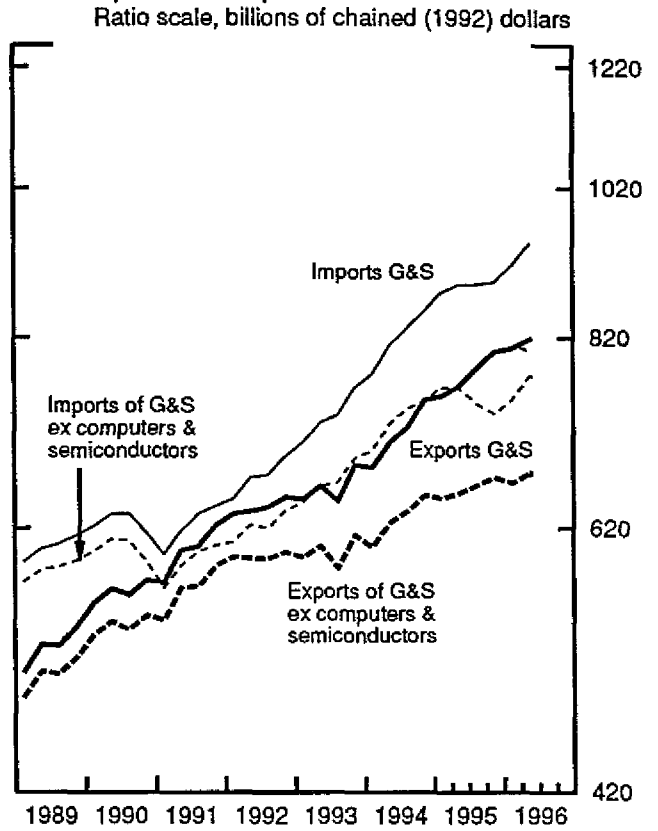
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

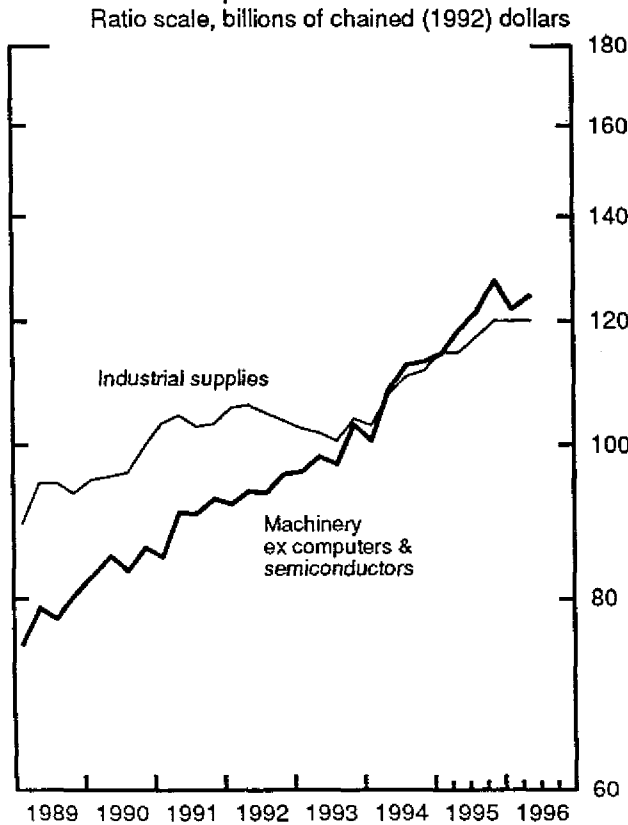
Net Exports



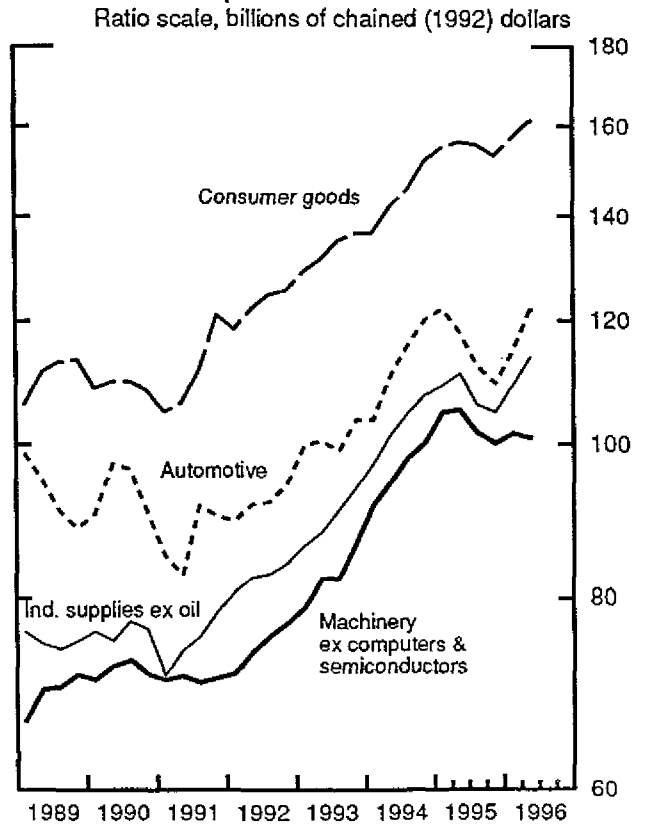
NIPA Exports and Imports



Selected NIPA Exports



Selected NIPA Imports



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

	Levels				Amount Change 1/			
	1996		1996		1996		1996	
	Q1	Q2e/	Apr	May	Q1	Q2e/	Apr	May
<u>Exports of G&S</u>	819.7	832.5	827.9	837.1	5.3	12.8	-3.4	9.3
Goods exports	600.1	612.2	608.9	615.5	2.4	12.1	3.0	6.6
Agricultural	63.2	61.1	60.6	61.5	2.6	-2.2	-3.9	0.8
Gold	6.3	13.6	15.4	11.7	2.6	7.2	4.1	-3.7
Computers	45.4	43.7	44.3	43.1	2.0	-1.7	0.2	-1.2
Other goods	485.1	493.8	488.5	499.2	-4.7	8.8	2.5	10.6
Aircraft & pts	26.5	33.9	33.2	34.6	1.4	7.4	4.3	1.4
Semiconductors	37.5	35.0	35.3	34.7	-0.2	-2.5	-1.8	-0.6
Other cap gds	138.4	140.2	140.1	140.3	-4.1	1.8	0.9	0.2
Automotive	62.0	61.4	58.5	64.3	0.0	-0.6	-0.6	5.8
to Canada	33.1	33.7	33.1	34.2	-1.1	0.5	2.2	1.1
to Mexico	7.6	7.7	6.5	8.9	0.6	0.1	-1.6	2.4
to ROW	21.3	20.1	18.9	21.2	0.5	-1.2	-1.2	2.3
Ind supplies	128.9	128.7	128.3	129.1	-1.7	-0.2	-1.0	0.8
Consumer goods	67.9	70.0	69.2	70.8	2.1	2.1	0.6	1.6
All other	23.9	24.7	24.0	25.3	-2.3	0.8	-1.8	1.3
Services exports	219.7	220.3	219.0	221.6	2.9	0.7	-6.4	2.6
<u>Imports of G&S</u>	917.1	955.4	943.2	967.7	25.1	38.3	15.7	24.5
Goods imports	771.0	806.9	795.9	817.8	21.2	35.8	16.6	21.9
Petroleum	55.9	71.4	70.2	72.6	2.4	15.4	16.5	2.4
Gold	6.8	17.0	18.8	15.1	3.3	10.2	4.9	-3.7
Computers	62.2	61.9	62.1	61.7	0.3	-0.2	2.2	-0.4
Other goods	646.2	656.6	644.8	668.4	15.2	10.4	-7.0	23.5
Aircraft & pts	11.0	11.9	10.8	12.9	0.4	0.9	-1.2	2.2
Semiconductors	43.7	38.3	38.7	37.9	-0.9	-5.4	-6.0	-0.8
Other cap gds	116.7	114.8	114.5	115.1	1.8	-1.9	-3.3	0.6
Automotive	125.0	131.9	126.1	137.7	5.7	6.9	5.6	11.6
from Canada	45.7	49.3	47.6	50.9	-0.1	3.5	5.9	3.3
from Mexico	22.8	24.1	22.9	25.4	1.7	1.3	0.8	2.5
from ROW	56.4	58.5	55.6	61.4	4.1	2.0	-1.2	5.8
Ind supplies	124.2	127.3	126.2	128.4	2.5	3.1	-1.4	2.2
Consumer goods	163.4	166.3	162.2	170.4	4.8	3.0	-1.8	8.2
Foods	34.2	36.3	36.2	36.4	1.5	2.1	0.6	0.2
All other	28.0	29.8	30.2	29.5	-0.6	1.9	0.5	-0.7
Services imports	146.1	148.5	147.3	149.8	3.9	2.4	-0.9	2.6
Memo:								
Oil qty (mb/d)	8.74	9.78	9.52	10.04	-0.56	1.04	1.49	0.53
Oil price (\$/bbl)	17.56	19.99	20.18	19.79	1.80	2.44	1.89	-0.39

1. Change from previous quarter or month.

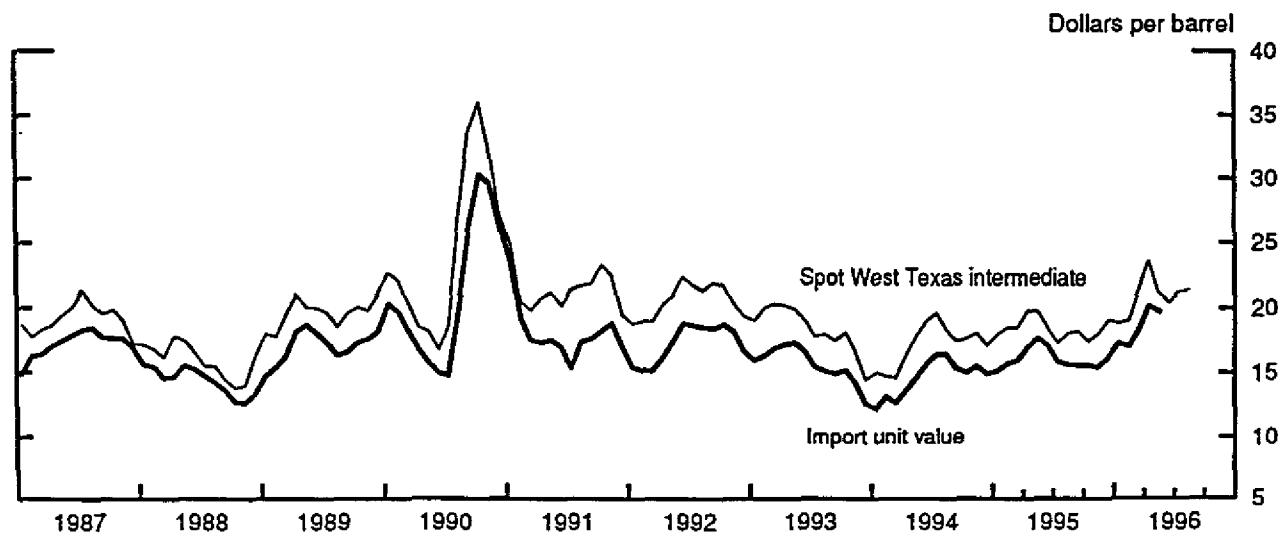
e. Average of two months.

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

	Annual rates			Monthly rates		
	1995	1996		1996		
	Q4	Q1	Q2	Apr	May	Jun
	-----BLS prices (1990=100)-----					
<u>Merchandise imports</u>	-1.1	2.4	1.5	0.8	-0.6	-1.2
Oil	0.4	47.4	41.0	8.4	-2.8	-7.4
Non-oil	-1.1	-1.2	-2.3	0.0	-0.4	-0.5
Foods, feeds, bev.	-7.4	-4.5	11.2	3.4	0.3	-2.7
Ind supp ex oil	0.2	-3.1	-4.9	-0.6	-0.8	-0.2
Computers	-7.5	-8.1	-16.9	-1.0	-1.8	-1.6
Capital goods ex comp	-2.5	-0.4	-4.6	-0.5	-0.4	-0.4
Automotive products	1.6	-0.8	-0.5	0.1	-0.2	-0.1
Consumer goods	-0.0	1.2	-0.7	0.0	0.0	-0.2
<u>Merchandise exports</u>	0.0	1.0	2.3	0.5	0.4	-0.1
Agricultural	23.0	13.8	31.4	4.8	3.1	-2.2
Nonagricultural	-2.7	-0.9	-1.2	-0.1	0.0	0.2
Ind supp ex ag	-11.0	-3.6	-4.8	-0.4	0.0	-0.1
Computers	-7.4	-9.2	-8.1	-1.3	-0.7	-0.1
Capital goods ex comp	1.8	2.3	1.7	0.3	-0.1	0.5
Automotive products	5.0	-0.1	0.4	0.0	0.2	0.1
Consumer goods	0.4	2.3	1.5	0.4	-0.3	0.1
	---Prices in the NIPA accounts (1992=100)---					
<u>Fixed-weight</u>						
Imports of gds & serv.	-2.3	0.1	1.1	...	...	...
Non-oil merchandise	-2.4	-3.1	-3.3	...	...	...
Exports of gds & serv.	-1.0	0.2	1.6	...	...	...
Nonag merchandise	-4.0	-2.2	-2.5	...	...	...

8-14-96

Oil Prices



Oil Imports

The quantity of oil imported during April and May was well above the 1996-Q1 rate. A larger than normal seasonal inventory accumulation that has rebuilt stocks from historically low levels offset the seasonal decline in oil consumption. Preliminary Department of Energy statistics indicate that oil imports continued at a brisk pace in June, due to a pick-up in consumption and a continuation of the rebuilding of oil stocks, but fell in July as consumption declined and the accumulation of stocks ceased.

After a sharp rise in April, the price of imported oil fell back in May and decreased sharply in June. Spot WTI declined more than \$0.80 per barrel in June, averaging \$20.45 per barrel. The decline in oil prices from April through June reflected an unwinding of temporary shocks to the oil market (unusually cold weather in North America and Japan and weather related production disruptions in the North Sea and Australia). Although Iraq reached an agreement with the United Nations in early July to export a limited quantity of oil (estimated to be 800,000 b/d) under U.N. supervision, oil prices have remained firm since then because of uncertainty regarding the timing of these oil flows. Prices rose nearly a dollar per barrel in July and have changed little in August. Spot WTI is now trading in the \$22.00 per barrel range.

Prices of Non-oil Imports and Exports

Prices of non-oil imports decreased in the second quarter at a rate that was slightly more than in the two previous quarters. The prices of imported capital goods and industrial supplies fell sharply. These decreases were only partly offset by substantial price increases in a broad array of imported foods (coffee, grains, and vegetables).

Prices of exports increased in the second quarter with most of the rise due to a rapid increase in agricultural prices (especially grains). On balance, prices of non-agricultural exports fell, with continued declines seen in prices of industrial supplies and computers.

U.S. International Financial Transactions

The pace of foreign official inflows into the United States slowed sharply in the second quarter from the record pace of the first quarter. (See line 1 of the Summary of U.S. International

Transactions table.) Intervention purchases of dollars by the G-10 countries were modest. In addition, the increases in holdings by several developing countries in Latin America in the first quarter were partially reversed in the second quarter. In July and early August partial information from FRBNY suggests that increases in official holdings in the United States picked up somewhat.

Net portfolio investment by private foreigners in U.S. securities (line 4) exceeded U.S. investment in foreign securities (line 5) by a wider margin in the second quarter than in the first. Private foreign net purchases of U.S. Treasury securities (line 4a) picked up from the first-quarter pace, largely reflecting the volatile transactions of financial institutions in the Caribbean. The large net purchases of U.S. Treasury securities by official and private foreigners in the first half of 1996 brought the foreign share of U.S. Treasury securities privately held to almost 29 percent at the end of June, the highest level in recent decades. Private foreign net purchases of U.S. corporate and government agency bonds (line 4b) were also large in the second quarter, as were foreign net purchases of U.S. corporate stocks (line 4c).

U.S. net purchases of foreign securities (line 5) in the second quarter were substantial, but below the first-quarter pace. Net purchases of foreign bonds (line 5a) fell sharply and purchases of stocks (line 5b) also declined. In the second quarter, the United Kingdom replaced Japan as the single country where U.S. net purchases of stocks were largest. During the first half of 1996 there was a modest pickup in U.S. investor interest in emerging stock markets in Asia and Latin America, but net purchases remained far below the 1993 peak rate.

Banks continued to report substantial net capital outflows in the second quarter on a month-end basis (line 3). On a monthly average basis, net outflows also were recorded from U.S. banking offices to their own foreign offices and IBFs (see line 1 of the International Banking Data table). These outflows coincided with slow growth in U.S. commercial bank credit and a pickup in growth of large time deposits.

SUMMARY OF U. S. INTERNATIONAL TRANSACTIONS
(Billions of dollars, not seasonally adjusted except as noted)

	1994	1995	1995		1996			
			Q3	Q4	Q1	Q2	May	Jun
<u>Official capital</u>								
1. Change in foreign official reserve assets in U.S. (increase, +)	38.0	109.8	39.6	10.8	52.2	13.0	2.5	6.2
a. G-10 countries	28.9	33.1	5.6	-3.6	28.5	3.5	6.0	1.5
b. OPEC countries	-3.3	4.3	6.2	-2.1	-.8	5.3	2.1	.9
c. All other countries	12.4	72.5	27.7	16.6	24.5	4.2	-5.5	3.8
2. Change in U.S. official reserve assets (decrease, +)	5.3	-9.7	-1.9	.2	*	-.5	-.4	-.1
<u>Private capital</u>								
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	102.6	-30.1	-7.0	10.0	-28.7	-11.2	6.8	-26.7
Securities ²								
4. Foreign net purchases of U.S. securities (+)	92.9	190.6	69.8	23.5	48.5	60.9	21.5	22.8
a. Treasury securities ³	34.7	99.8	37.4	1.8	12.0	31.8	9.9	14.2
b. Corporate and other bonds ⁴	53.9	82.6	27.0	17.7	32.7	22.7	10.2	7.6
c. Corporate stocks	4.3	8.2	5.3	4.0	3.8	6.4	1.4	.9
5. U.S. net purchases (-) of foreign securities	-57.3	-98.8	-35.7	-32.5	-34.5	-19.9	-3.6	-9.4
a. Bonds	-9.2	-48.5	-13.6	-18.7	-12.0	-2.6	-.5	-1.9
b. Stocks	-48.1	-50.3	-22.1	-13.8	-22.5	-17.2	-3.1	-7.5
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-54.5	-95.5	-38.0	-44.1	-26.8	n.a	n.a	n.a
7. Foreign direct investment in U.S.	49.8	60.2	25.0	14.8	29.5	n.a	n.a	n.a
8. Other (inflow, +) ⁵	-42.1	-9.8	27.4	18.3	2.9	n.a	n.a	n.a
U.S. current account balance (s.a.)	-148.4	-148.2	-37.7	-30.4	-35.6	n.a	n.a	n.a
Statistical discrepancy (s.a.)	-13.7	31.5	-41.5	29.4	-7.5	n.a	n.a	n.a

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

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

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

3. Includes Treasury bills.

4. Includes U.S. government agency bonds.

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

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

INTERNATIONAL BANKING DATA¹
(Billions of dollars)

	1992	1993	1994	1995	1996			
	Dec.	Dec.	Dec.	Dec.	Mar.	May	Jun.	Jul.**
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-71.6	-122.1	-224.0	-260.0	-260.1	-253.5	-245.0	-245.7
a. U.S.-chartered banks	-17.0	4.2	-70.1	-86.1	-84.1	-90.1	-77.2	-72.2
b. Foreign-chartered banks	-88.6	-126.3	-153.9	-173.9	-176.0	-163.2	-167.8	-173.5
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	24.8	21.8	23.1	26.5	27.3	27.9	28.8	28.9
b. By Caribbean offices of foreign-chartered banks	n.a.	90.9	78.4	86.3	90.0	n.a.	n.a.	n.a.
3. Eurodollar holdings of U.S. nonbank residents								
a. At all U.S.-chartered banks and foreign-chartered banks in Canada and the United Kingdom	90.0	77.8	85.6	91.2	95.7	97.8	101.0	100.1
b. At the Caribbean offices of foreign-chartered banks	n.a.	79.2	86.0	92.3	96.6	n.a.	n.a.	n.a.
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	172.4	179.7	172.2	206.9	n.a.	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	223.8	218.7	248.8	281.9	n.a.	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 FR 2950 and FR2951.

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

Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994.

Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. It includes some foreign-currency denominated deposits and loans. Source: SCB

** Data for the month of July 1996 were only available up through July 29.

Foreign Exchange and Foreign Financial Markets

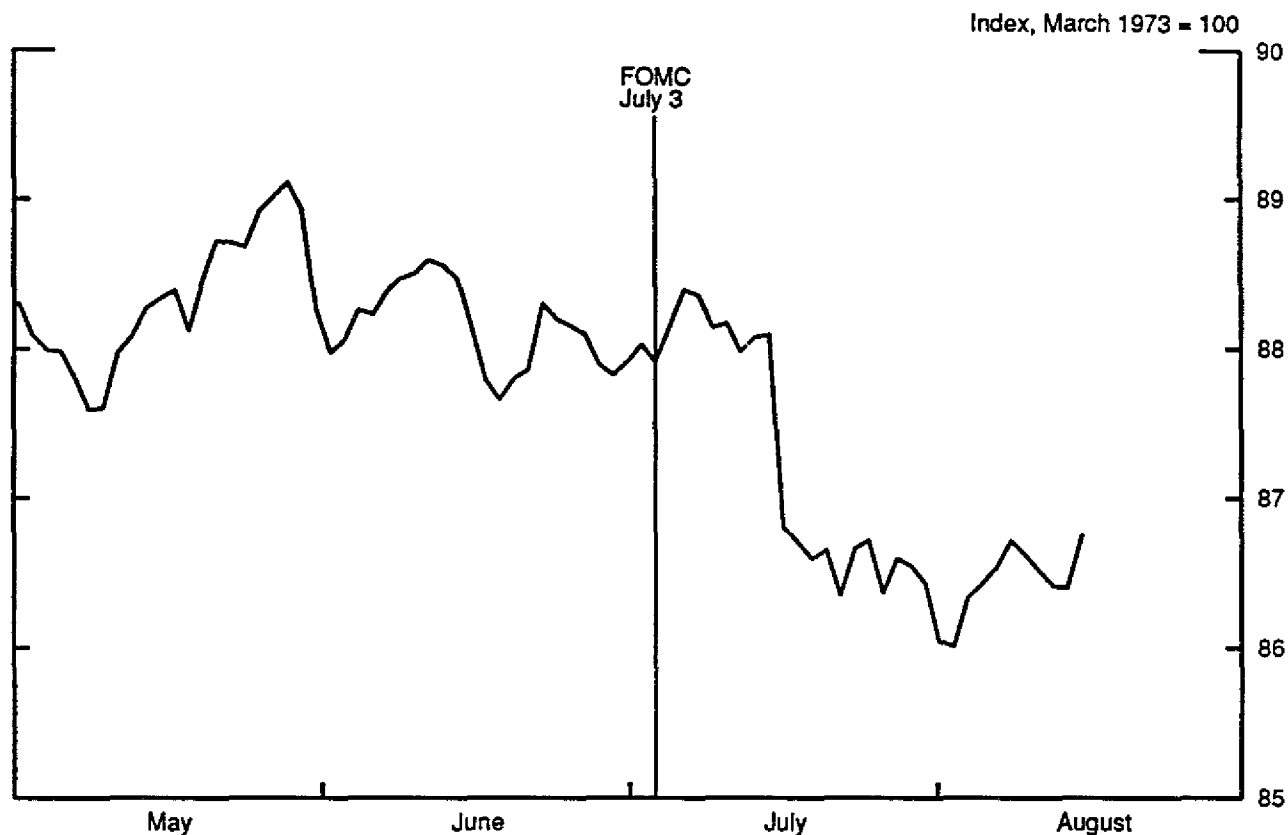
The weighted-average dollar has declined 1-3/8 percent on balance since the time of the July FOMC meeting. Contributing to the dollar's decline was a reduction of market expectations about the pace of U.S. activity and the consequent probability of a near-term tightening of U.S. monetary policy.

Against individual currencies, the dollar's movements during the period have been diverse. The dollar has declined 2-1/4 percent against the mark, but it has moved down significantly less against many other major European currencies, as doubts reemerged about the timetable for, and perhaps even the ultimate success of, European Monetary Union (EMU). The decision of the Bundesbank Council to leave the German RP rate unchanged after its July 25 meeting took markets by surprise, coming as it did after numerous statements from Council members indicating that such a reduction would not be unreasonable, and resulted in a strengthening of the mark against many of the other European currencies. The French franc came under additional downward pressures, sinking to a 4-month low against the mark during the period, amid rumors--later denied--that high-level French and German officials had met to discuss delaying the start of EMU, reports that France's fiscal deficit may come in well over the Maastricht criterion of 3 percent of GDP in 1997, and indications that the French government was seeking to pressure Bank of France Governor Trichet into taking an easier policy stance to help the ailing French economy. While the Bank of France did on separate occasions lower its money-market intervention rate and its 5-to-10-day RP rate 5 and 15 basis points, respectively, during the period, both short-term and long-term differentials between market rates in France and Germany have widened somewhat.

Despite the steady policy of the Bundesbank, the Bank of Italy lowered its discount rate during the period 3/4 percentage point to 8-1/4 percent, as the Italian inflation rate in both June and July came in below 4 percent. The move had been widely anticipated and caused little immediate reaction in the markets.

Weighted Average Exchange Value of the Dollar

(Daily data)



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	July 3	Aug. 14	Change	July 3	Aug. 14	Change
Germany	3.30	3.26	-0.04	6.55	6.30	-0.25
Japan	0.61	0.63	0.02	3.22	3.16	-0.06
United Kingdom	5.72	5.75	0.03	7.92	7.83	-0.09
Canada	4.87	4.30	-0.57	7.73	7.31	-0.42
France	3.80	3.96	0.16	6.56	6.41	-0.15
Italy	8.63	8.81	0.18	9.46	9.27	-0.19
Belgium	3.26	3.29	0.03	6.79	6.64	-0.15
Netherlands	2.92	2.99	0.07	6.48	6.28	-0.20
Switzerland	2.50	2.25	-0.25	4.26	4.12	-0.14
Sweden	5.64	5.25	-0.39	8.22	8.19	-0.03
Weighted-average foreign	3.92	3.89	-0.03	6.61	6.44	-0.17
United States	5.49	5.39	-0.10	6.78	6.58	-0.20

Note. Change is in percentage points.

The Swiss franc has risen more than 1 percent against the mark during the period and 3-1/2 percent against the dollar, as financial market uncertainties and perhaps also concerns about the health of Russian President Yeltsin led investors to seek the Swiss currency as a safe haven. The strength of the franc prompted Swiss National Bank officials to declare that the currency was massively overvalued--a judgment confirmed by Federal Reserve Staff back from a recent visit to Basle.

The dollar has declined more than 2 percent against the yen, against a background of data releases during the period showing the Japanese current account surplus beginning to widen again. Public complaints from major U.S. exporters that the yen was too weak provided further reminders to the market of the resumption of growing trade imbalances. The dollar has firmed 1/2 percent against sterling, for reasons that are not clear. The dollar has also firmed against the Canadian dollar, up 1 percent since the July 3 meeting. In reaction to data showing Canadian economic activity still well below potential and inflation still low, Canadian authorities reduced their target range for the overnight interest rate a cumulative 1/2 percentage point in two moves during the period.

Foreign equity prices moved down on balance during the intermeeting period, although for many countries they ended somewhat above the period lows. The largest net declines occurred in Italy and Japan, whose stock prices moved down more than 8 percent and 6 percent, respectively. The latter country's market was particularly hard hit by news of further problems in its banking sector.

In a new foray into international capital markets, on August 7 the Bank of Mexico conducted its first monthly auction of dollar put options. The purpose of these auctions is to offer instruments by which the Bank of Mexico can build its international reserves gradually without unduly affecting the day-to-day peso market. The central bank sold all of the options it offered at the auction at an average premium of 1.168 centavos per dollar. The strike price of the options on any given day will be the previous day's reference exchange rate (providing that the rate is no weaker than the average

exchange rate of the preceding twenty trading days.) By August 13, all of \$130 million in outstanding options had been exercised.

. The Desk did not intervene for U.S. monetary authorities during the period. In reserve management activity, the Desk invested DM 325 million of System balances and DM 175 million of Treasury balances in 6-month "Bubills," which were auctioned for the first time by the German Finance Ministry on July 17. The bills yield 3.18 percent.

Developments in Foreign Industrial Countries

Available indicators for the second quarter suggest that the pace of economic activity varied considerably across the major foreign industrial countries. In Japan, activity appears to have been positive but obviously well below its remarkable first-quarter pace. The German economy shows signs of having rebounded sharply from the contraction in the first quarter, with industrial production and orders well above their first-quarter levels. In France and Italy, growth has fallen back from its pace in the first quarter, with both economies evidencing signs of contraction. The United Kingdom and Canada continue to experience modest rates of expansion.

Inflationary pressures remain subdued. Recent consumer-price inflation has averaged about 1-1/2 percent in Germany and Canada and under 3 percent in the United Kingdom and France. Italian inflation, while higher than in the other foreign G-7 countries, has slowed considerably since January and neared 3-1/2 percent in July. In Japan, prices are rising slightly this year, reflecting depreciation of the yen, after declining through most of 1995.

Individual country notes. In **Japan**, economic indicators for the second quarter point to positive but much slower expansion of growth in real GDP after an increase of 12.7 percent (SAAR) in the first quarter. New machinery orders and housing starts continued to rise in the second quarter, while industrial production fell slightly and new car registrations declined. Although the unemployment rate reached a 40-year high of 3.5 percent in May and June, this increase was largely due to new entrants into the labor

market, as the ratio of job offers to job applicants continued to increase gradually.

Month-to-month changes in wholesale and consumer prices have been positive in recent months. These increases stem from the effect of past yen depreciation on import prices as prices of domestically produced goods have continued to decline.

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

	1995			1996			
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	2.1	0.4	-0.3	3.2	2.4	-4.3	n.a.
Housing Starts	11.5	1.6	1.4	2.8	3.5	-11.0	n.a.
Machinery Orders	4.7	3.4	0.8	13.1	-5.0	-7.6	n.a.
New Car Registrations	2.7	2.4	-7.7	-10.1	11.8	-7.8	8.0
Unemployment Rate (%)	3.3	3.3	3.5	3.4	3.5	3.5	n.a.
Job Offers Ratio ¹	0.63	0.67	0.69	0.67	0.69	0.71	n.a.
Business Sentiment ²	-14	-12	-3	...	...	...	...
CPI (Tokyo area) ³	-0.8	-0.3	0.2	0.3	0.2	0.0	0.6
Wholesale Prices ³	-0.1	0.0	1.3	1.3	1.3	1.4	1.4

1. Level of indicator.

2. Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook (Tankan survey).

3. Percent change from previous year.

The Japanese trade surplus has increased over the past two months following many months of decline. The June merchandise trade surplus was \$6.4 billion (SA) compared with \$4.8 billion in May. The June current account surplus was \$6.2 billion (SA) compared with \$5.8 billion in May.

Real activity in Germany appears to have picked up sharply in the second quarter following the slowdown in 1995 and a contraction of 1-1/2 percent (SAAR) in the first quarter of this year. Much of the rebound owes to a resurgence in construction activity, which was depressed by unseasonably cold winter weather, although activity in manufacturing picked up as well. Both industrial production and manufacturing orders rose strongly in the second quarter. Some reports have suggested that the large unexpected decline in the IFO business climate survey in June resulted from statistical anomalies and does not give an accurate reading of current business sentiment.

Unemployment, while still high, has levelled out at just above 3.9 million workers (s.a.), and the all-German unemployment rate ticked down in July to 10.2 percent. Price pressures remain modest, with producer prices down over the past 12 months.

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

	1995			1996			
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	-1.9	-2.4	2.9	1.4	0.7	0.6	n.a.
Orders	-2.9	-0.5	3.5	2.9	-0.7	1.2	n.a.
Unemployment Rate (%)	9.7	10.3	10.3	10.3	10.3	10.3	10.2
Western Germany	8.5	8.9	9.0	8.9	9.0	9.0	9.0
Eastern Germany	14.9	16.1	15.6	15.8	15.6	15.5	15.4
Capacity Utilization ¹	84.3	83.0	82.1	...	...	...	...
Business Climate ^{1,2}	-10.3	-15.3	-17.3	-15.0	-16.0	-21.0	n.a.
Retail Sales (real) ³	-2.0	-1.3	n.a.	2.0	-3.0	n.a.	n.a.
Consumer Prices ^{1,3}	1.6	1.4	1.4	1.3	1.5	1.2	1.3

1. Western Germany.

2. Percent of firms (in manufacturing, construction, wholesale, and retail) citing an improvement in business conditions (current and expected over the next six months) less those citing a deterioration in conditions.

3. Percent change from previous year.

The 1997 draft federal budget was approved by Chancellor Kohl's cabinet in mid-July. Many of the savings measures incorporated into the 1997 draft budget stem from the fiscal plan proposed last April that is currently under consideration by the German parliament. Measures in the plan have been split into five different pieces of legislation, two of which require the explicit approval of the Bundesrat (the lower house of the German parliament). With the draft budget, the savings measures, very low wage increases for public sector employees, and some spending reductions at the state and local level, the German Finance Ministry hopes to move the deficit of the consolidated general government sector below the Maastricht reference value of 3 percent of GDP in 1997.

In France, monthly indicators suggest that economic activity contracted in the second quarter. Although industrial production rose slightly in May, the April-May average was about 1/2 percent

below the first-quarter level. Although real consumption of manufactured products rose in June, the second-quarter average still was below that in the first quarter. Consumer confidence in June and July stabilized near the low level registered last December. Weakness in consumer confidence was matched by a rise in June unemployment to match the all-time high of March 1994. According to INSEE, business sentiment in July remained soft as contemporaneous production conditions ticked down, owing to high inventory levels and expectations about future production dropped further. Consumer prices fell in June and July due to lower prices for food and energy.

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

	1995		1996				
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	-1.6	1.3	n.a.	-1.0	0.5	n.a.	n.a.
Capacity Utilization	83.6	83.8	83.0	...	...	...	...
Unemployment Rate (%)	11.9	12.2	12.4	12.3	12.4	12.5	n.a.
Consumption of Manufactured Products	-2.0	4.9	-1.6	-1.4	0.2	2.0	n.a.
Consumer Prices ¹	1.9	2.1	2.4	2.4	2.4	2.3	2.3

1. Percent change from previous year. Includes the increase in the VAT on August 1, 1995

In the **United Kingdom**, preliminary estimates indicate that real GDP rose 2 percent (SAAR) in the second quarter. Although incoming second-quarter data for the consumer and manufacturing sectors continue to be somewhat mixed, they are generally positive on balance. Retail sales rose in June at the most rapid monthly pace since early 1994, while industrial output fell from its upwardly revised May level. The purchasing managers' index showed an increase in new orders and a decrease in stocks of finished goods in July.

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

	1995		1996				
	Q4	Q1	Q2	Apr	May	Jun	Jul
Real GDP	1.6	1.6	2.0	...	...	...	...
Industrial Production	-0.1	0.2	0.2	-0.7	0.9	-1.1	n.a.
Retail Sales	0.7	0.4	1.1	0.1	0.3	1.3	n.a.
Unemployment Rate (%)	8.0	7.9	7.7	7.8	7.7	7.7	7.6
Consumer Prices ¹	2.9	2.9	2.8	2.9	2.8	2.8	2.8
Producer Input Prices ²	6.5	3.0	0.4	2.4	1.0	-2.3	-2.2
Average Earnings ²	3.3	3.7	3.8	3.8	3.8	3.8	n.a.

1. Retail prices excluding mortgage interest payments. Percent change from previous year.
2. Percent change from previous year.

Price pressures remain subdued. Headline inflation fell to 2.2 percent in July from 2.3 percent in the second quarter due to declining housing costs. A large drop in commodity prices reduced June producer input prices noticeably. Nevertheless, targeted inflation (measured as the change from a year earlier in retail prices excluding mortgage interest payments) has fallen only slightly.

In Italy, final data indicate that real GDP rose 2 percent (SAAR) in the first quarter, following a sharp contraction in the final quarter of 1995. In the first quarter, private consumption remained sluggish and business fixed investment declined. Inventories accounted for about one-fourth of the increase in GDP. A sizable positive contribution from net exports was due in large part to a sharp drop in imports of raw materials and intermediate goods. Most available indicators point to a contraction in real economic activity in the second quarter. Industrial production was down in April and May on average from its level in the first quarter, and business sentiment dropped further in the second quarter. In addition, unemployment rose and machine tool orders were down sharply in the second quarter compared with the same period a year ago.

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

	1994		1995			1996
	Q4	Q1	Q2	Q3	Q4	Q1
GDP	-0.1	4.9	0.4	8.7	-4.3	2.0
Private Consumption	1.3	1.2	2.4	2.0	0.0	0.8
Investment	-0.4	13.4	7.4	10.0	5.7	-1.6
Government Consumption	-0.3	-0.4	-0.8	-2.0	-1.6	-1.2
Exports	7.3	22.5	17.9	-0.4	-9.6	2.8
Imports	15.5	-14.0	9.1	7.4	-0.8	-2.8
Total Domestic Demand	1.3	1.3	-1.9	12.6	-1.8	0.4
Net Exports (contribution)	-1.3	8.2	2.4	-1.6	-2.3	1.3
Inv. Change(contribution)	0.6	-1.6	-4.4	9.2	-2.4	0.4

In July, the CPI declined on a month-on-month basis for the first time in 28 years. Although this decline owed in large part to a one-time reduction in electricity tariffs, further progress on consumer price inflation is likely in light of recent moderation in wholesale and producer price inflation.

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

	1995			1996			
	Q4	Q1	Q2	April	May	June	July
Industrial Production	-0.9	-2.0	n.a.	-3.1	0.0	n.a.	n.a.
Cap. Utilization (%)	78.5	75.9	76.6	...	...	...	...
Unemployment Rate (%)	11.9	12.0	12.2	...	...	...	...
Consumer Confidence ¹	110.0	107.7	113.8	108.8	114.8	117.9	115.0
Bus. Sentiment ² (%)	11.3	15.7	-1.0	10.0	-4.0	-9.0	n.a.
Consumer Prices ³	6.0	5.0	4.3	4.5	4.4	3.9	3.6
Wholesale Prices ³	10.5	7.7	n.a.	4.5	3.5	n.a.	n.a.

1. Level of index, NSA.

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

3. Percent change from previous year.

On July 17, the parliament approved the 1997-1999 budget planning document, which outlines the government's macroeconomic targets for the next three years. Even if the announced objectives are realized, Italy's deficit will improve to 4.4 percent of GDP, falling short of the Maastricht Treaty reference value of 3 percent

in 1997. Nonetheless, government officials have indicated that additional fiscal measures might be taken, especially if real economic activity picks up in the second half of next year. On August 2, Prime Minister Romano Prodi won a confidence vote on his supplemental mini-budget. The \$10.5 billion measure aims to limit Italy's budget deficit to 6 percent of GDP in 1996.

Incoming data for Canada are mixed, but on balance suggest that economic growth continued at a modest pace in the second quarter. Industrial production and manufacturing shipments and orders picked up in April and May, in part reflecting a rebound in economic activity following the end of the GM strike in March. Both consumer and business sentiment improved in the second quarter, although retail sales were flat for four consecutive months through May. Housing starts rose in June, but fell back in July. Employment declined in both May and June before ticking up in July. Nevertheless, the unemployment rate remains near its highest level in more than one year.

Consumer-price inflation remains subdued and has been in the lower half of the Bank of Canada's target band of 1 to 3 percent since last December.

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

	1995		1996				
	Q4	Q1	Q2	Apr	May	June	July
Industrial Production	-0.4	0.4	n.a.	0.5	0.5	n.a.	n.a.
Manufacturing Survey:							
Shipments	-0.4	-0.5	n.a.	2.6	1.8	n.a.	n.a.
New Orders	-0.1	0.0	n.a.	3.2	4.6	n.a.	n.a.
Retail Sales	-0.7	1.0	n.a.	0.0	0.0	n.a.	n.a.
Housing Starts	5.8	1.8	10.9	-11.9	21.4	3.8	-4.5
Employment	0.3	0.7	0.2	0.3	-0.1	-0.4	0.1
Unemployment Rate (%)	9.4	9.5	9.6	9.4	9.4	10.0	9.8
Consumer Prices ¹	2.1	1.4	1.4	1.4	1.5	1.4	n.a.
Consumer Attitudes ²	87.9	95.4	101.4	...	...	...	...
Business Confidence ³	135.3	137.6	149.1	...	...	...	...

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

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

	1995	1995			1996			
			Q4	Q1	Q2	Mar	Apr	May	Jun
Japan: trade	106.6	22.5	16.6	13.7	7.0	2.5	4.8	6.4
current account	110.6	23.5	15.5	15.4	5.7	3.4	5.8	6.2
Germany: trade ¹	63.6	17.8	14.1	n.a.	4.6	5.5	6.2	n.a.
current account ¹	-17.4	-5.3	-2.5	n.a.	-0.4	-0.3	-1.6	n.a.
France: trade	20.6	5.6	5.9	n.a.	2.3	0.7	2.2	n.a.
current account	16.7	3.0	7.3	n.a.	2.4	0.9	1.3	n.a.
U.K.: trade	-18.3	-5.0	-5.4	n.a.	-1.2	-2.1	-1.5	n.a.
current account	-10.6	-3.6	-1.6	n.a.	...	...	...	...
Italy: trade ¹	27.6	6.9	6.1	n.a.	3.4	2.9	n.a.	n.a.
current account ¹	27.4	7.4	5.9	n.a.	3.0	3.0	n.a.	n.a.
Canada: trade	20.7	6.2	5.4	n.a.	1.8	2.3	3.0	n.a.
current account	-8.1	-0.2	-1.4	n.a.	...	...	...	...

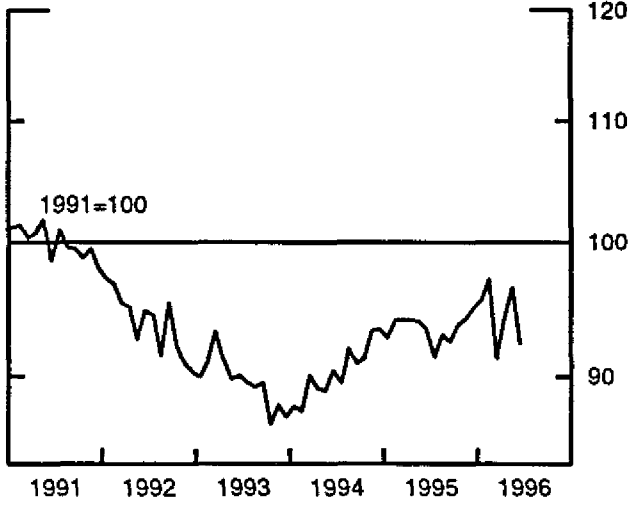
1. Not seasonally adjusted.

... Data not available on a monthly basis.

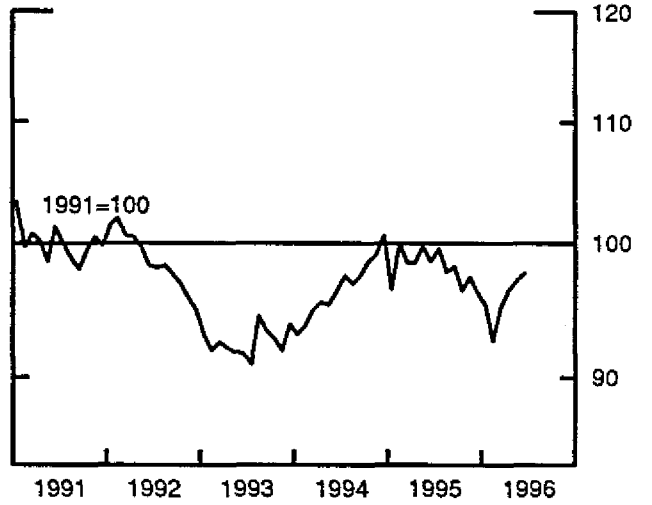
Industrial Production in Selected Industrial Countries

(Monthly data; seasonally adjusted; ratio scale, index)

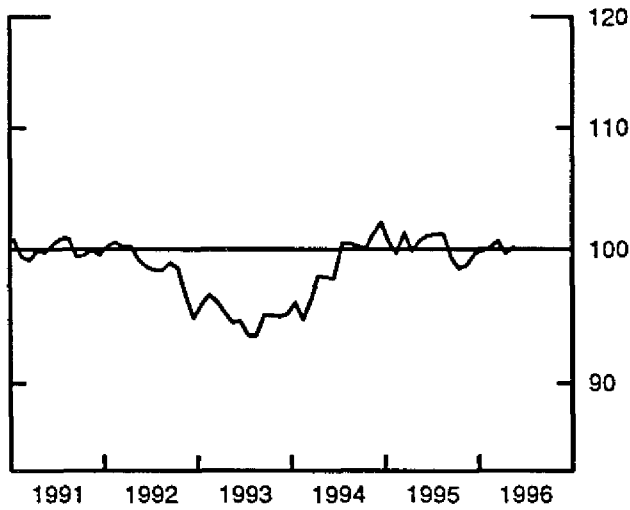
Japan



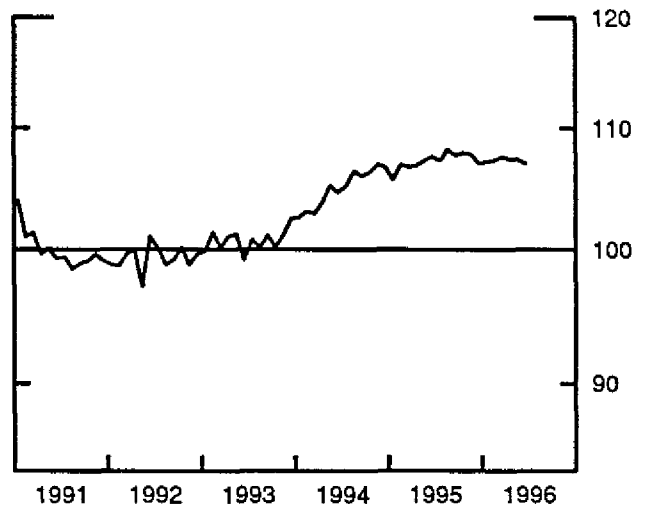
Germany



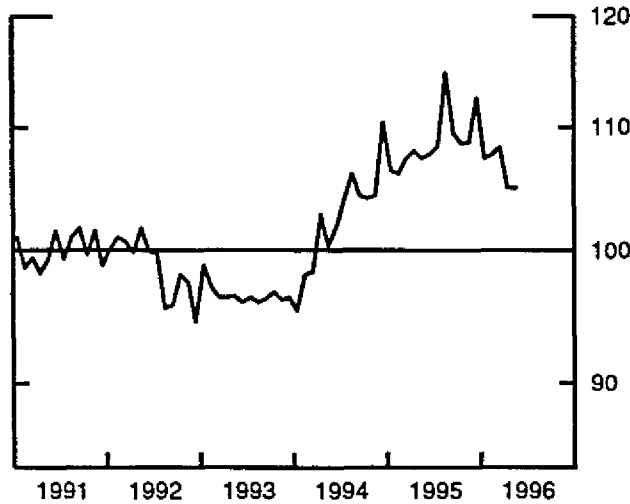
France



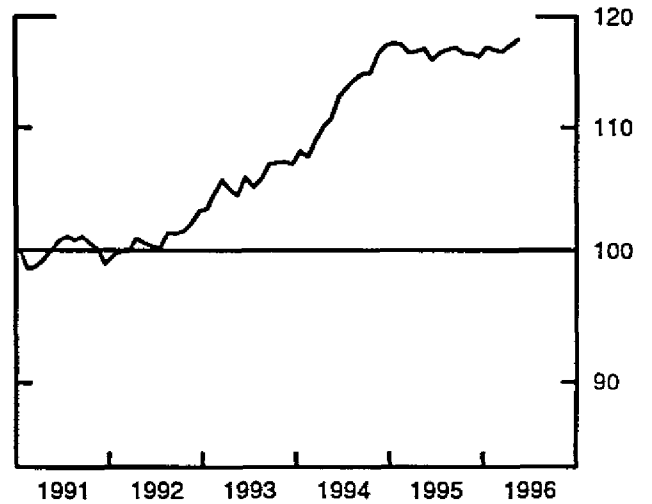
United Kingdom



Italy

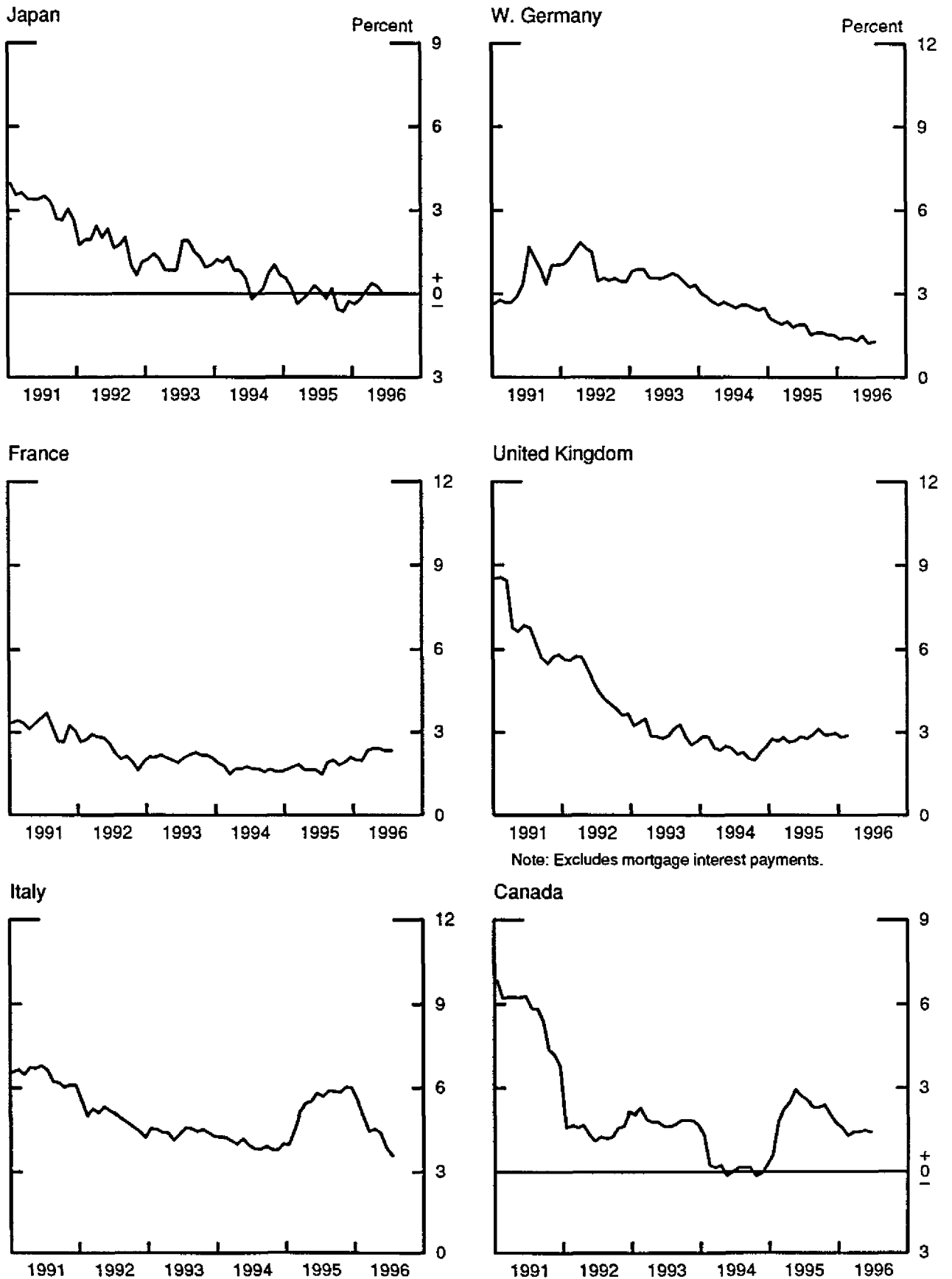


Canada



Consumer Price Inflation in Selected Industrial Countries

(12-month change)



Economic Situation in Other Countries

The economies of Argentina and Mexico appear to have continued to recover from their low points in 1995, but measures of economic activity in Brazil remain mixed, and the Russian economy has continued to decline. Inflation declined in Mexico, Venezuela, and Russia in recent months, but picked up somewhat in Brazil. In the major Asian developing economies, economic growth is proceeding at a moderate pace, with only Korea showing evidence of some increase in inflationary pressures. Mexico has continued to run trade surpluses, while Brazil has substantially reduced its trade deficit and Taiwan's trade surplus is up sharply. By contrast, Korea's current account deficit has widened to historic highs, and China's large trade surplus has declined to near balance. In July, the IMF approved a \$1.4 billion 12-month stand-by arrangement for Venezuela to support reduction of the fiscal deficit and the rate of inflation.

Individual country notes. In Mexico, monthly indicators suggest that recovery continued in the second quarter following the estimated 2.2 percent increase in real GDP in the first quarter (SA, not annual rate). May industrial production (SA) was up about 3 percent from its April level. The urban unemployment rate (NSA) declined from an average of 6.2 percent in the first quarter to 5.6 percent in the second quarter. Imports also grew substantially in the second quarter, but strong export growth has kept Mexico's trade surpluses from declining.

Monthly inflation fell from a recent peak of 2.8 percent in April to 1.4 percent in July. The decline reflects seasonal factors and the relative stability of the exchange rate, both of which are expected to keep inflationary pressures subdued in the coming months.

On July 25, Mexico announced that, based on higher than expected demand for a five-year syndicated commercial bank loan paying LIBOR plus 200 basis points, it would prepay \$7 billion of its \$10.5 billion debt to the Treasury's Exchange Stabilization Fund (ESF); the repayment took effect on August 5. The syndicated bank loan will be supported by a portion of Mexico's oil export revenues that currently provide greater assurance of repayment of ESF

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	4.5	-6.2	-1.0	n.a.	...	...
Industrial Production (SA)	4.5	-7.5	2.2	n.a.	n.a.	n.a.
Unemployment Rate (%)	3.6	6.3	6.2	5.6	5.6	n.a.
Consumer Prices ¹	7.1	52.1	8.3	6.4	1.6	1.4
Trade Balance ²	-18.5	7.0	1.9	2.2	0.7	n.a.
Imports ²	79.4	72.5	19.9	21.4	6.8	n.a.
Exports ²	60.8	79.5	21.9	23.6	7.6	n.a.
Current Account ²	-29.5	-0.7	-0.5	n.a.	...	...

1. Percentage change from previous period.

2. Billions of U.S. dollars, NSA

credits. The loan originally was announced on June 19 as being for \$3 billion, which Mexico had intended to use, along with additional funds previously raised in international capital markets, to prepay \$4.7 billion in medium-term swaps from the ESF. Due to high demand, the size of the loan was increased to \$6 billion, permitting a larger repayment to the ESF, along with a repayment of \$1 billion to the International Monetary Fund.

In **Argentina**, there is continued evidence that the economy is recovering. June industrial production (SA) showed an increase of 1.7 percent compared with a year earlier, although it fell 4.7 percent from May. In part because the recovery has been slower than expected, unemployment increased slightly in May to 17.1 percent from 16.4 percent in October 1995. Notwithstanding higher economic activity, inflation has remained low, with July consumer prices 0.1 percent above their year-earlier level, and the trade surplus rose in the second quarter. International reserves less gold and securities have reached new highs since last year's drain and were \$14.4 billion at end-July, about unchanged from their level at the end of 1995.

Argentina's \$2.5 billion fiscal deficit in the first half of this year was \$1 billion over the target agreed with the IMF, in part reflecting the slow pace of economic recovery and congressional delays on the approval of the privatization of nuclear plants and the hydroelectric dam, Yacyreta. To reduce the deficit, the government announced a series of public payroll reduction measures

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	7.4	-4.4	-3.2	n.a.	...	...
Industrial Production (SA)	5.7	-6.2	-9.1	2.6	1.7	n.a.
Unemployment Rate (%) ²	11.7	17.4	...	17.1	...	...
Consumer Prices ¹	3.9	1.5	-0.3	-0.1	0.1	0.5
Trade Balance ³	-4.0	3.0	0.2	1.3	0.2	n.a.
Current Account ³	-9.9	-3.2	...	...	...	...

1. Percentage change from previous period.

2. Unemployment figures available only in May and October of each year. The annual figure is the average of the two surveys.

3. Billions of U.S. dollars, NSA

that will save an estimated \$2 billion per year. These measures were not well received by Argentines, and the largest union federation, the CGT, led a general strike on August 8th.

Increasing political pressures over the fiscal adjustment measures renewed frictions between President Menem and Finance Minister Cavallo, culminating in Menem's ouster of Cavallo on July 26. Roque Fernandez, formerly the President of the Central Bank, replaced Cavallo as Finance Minister on July 29. The new Central Bank President, Pedro Pou, was previously vice president of the Central Bank. Financial market reaction to Cavallo's departure, following a short initial period of instability, subsequently was calm in Argentina and elsewhere in Latin America as Fernandez vowed to continue with current economic policy and renegotiate targets with the IMF.

In spite of public dissatisfaction with fiscal tightening, on August 12, the government announced a wide-ranging set of tax increases that will more than offset a reduction in the general value-added tax from 21 percent to 20 percent. The government estimates that the new package, on balance, will yield \$1.2 billion in 1996 and \$4 billion in 1997.

In **Brazil**, industrial production (SA) has been essentially flat so far this year, indicating that the economy has yet to resume strong growth. Inflation picked up slightly in the last couple of months, but has remained low by Brazilian standards. The cumulative trade deficit for January to June was \$0.3 billion, compared with a \$4.3 billion deficit a year earlier. International reserves at the end of June totalled \$60 billion (liquidity concept), up

considerably from \$31.5 billion a year ago, despite a payment of nearly \$1.4 billion to the Paris Club at the end of June. However, Brazil had \$263 million in net foreign capital outflows in June, against inflows of \$345 million in May.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	5.9	4.2	-2.1	n.a.	...	...
Industrial Production (SA) ¹	7.9	3.6	-1.5	n.a.	-1.1	n.a.
Open Unemployment Rate (%)	5.1	4.4	6.4	5.9	5.9	n.a.
Consumer Prices ¹	929.0	22.0	2.5	3.6	1.3	2.0
Trade Balance ²	10.4	-3.2	-0.4	0.1	-0.3	n.a.
Current Account ²	-1.8	-17.8	-3.4	-4.1	...	...

1. Percentage change from previous period.

2. Billions of U.S. dollars, NSA

Brazil's efforts to accelerate its fiscal reforms have stagnated. The Brazilian Congress gave a first-round approval to a new 0.2 percent temporary tax on financial transactions. However, it is not expected that this tax will have much of a fiscal impact. In addition, Brazil's lower house of Congress approved, in a second round vote, a watered-down version of the pension reform bill that has been stuck in the Congress for over a year. The bill is scheduled to be voted on by the Senate soon.

On July 1, Brazil's central bank lowered reserve requirements on bank deposits from 83 to 75 percent in order to free up funds for agriculture and spur a gradual decline of loan interest rates. Between August and December, the requirement will be lowered by 1 percent a month, and in January it will be dropped 3 percent.

The growing weakness of Brazil's banking system was underscored by the July 29 announcement that the federally owned Banco do Brazil, Latin America's largest bank, posted a loss of \$7.8 billion for the first half of 1996, one of the worst in the region's corporate history. The size of the loss reflected an unprecedented bid to address bad debt accumulated over years of political meddling. On August 7, the government announced steps to restructure the state-owned banks, including acquisition of banks from respective state governments, support for liquidation or

privatization, and partial financing to clean up bank balance sheets.

In Venezuela, consumer price inflation, while still very high, has fallen in the wake of the stabilization program announced in April and the July agreement on a stand-by arrangement with the IMF. The non-oil trade deficit increased in May. Total reserves less gold have increased in recent months to \$8.4 billion at the end of July, about five months of imports.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	-2.8	2.2	...	...	...	...
Unemployment Rate (%)	8.8	10.8	...	11.6	...	...
Consumer Prices ¹	70.9	56.6	24.0	30.9	7.1	5.0
Trade Balance ²	-3.6	-6.0	-0.9	n.a.	n.a.	n.a.
Current Account ²	2.5	2.4	...	...	...	...

1. Percentage change from previous period.

2. Billions of U.S. dollars, NSA, non-oil trade balance.

The IMF's Executive Board approved a \$1.4 billion equivalent 12-month stand-by loan for Venezuela on July 12. The principal program objectives are (1) a reduction of Venezuela's overall fiscal deficit from 8.3 percent of GDP in 1995 to 1.7 percent of GDP this year and 0.5 percent in 1997, and (2) a reduction of inflation to 1.5 percent per month by the end of 1996. The exchange rate, which was allowed to float on April 22, has remained around 470 bolivars per dollar. On July 8, the Central Bank announced a system of a gradually depreciating exchange rate band as an anti-inflationary device. The initial central parity was set at Bs.470 per dollar with a 7.5 percent band on either side. The band will be adjusted in line with a 1.5 percent per month targeted inflation rate for the last quarter of 1996.

In China in the first half of 1996, real GDP growth and inflation remained relatively steady, trade was roughly balanced, and capital inflows continued strongly. Real GDP rose 9.8 percent from the year-earlier period, and consumer prices in July were 8.3 percent higher than a year earlier. China's small trade surplus of

\$2.0 billion in the first seven months of 1996 compares with a surplus of \$14.3 billion in the year-earlier period. The value of exports fell 7 percent, reflecting the elimination of certain export subsidies at the beginning of this year and the real appreciation of China's currency against the yen, while the value of imports rose 10 percent. Net inflows of foreign direct investment were \$20 billion in the first half of 1996, compared with inflows of \$16 billion in the year-earlier period. Foreign exchange reserves reached \$87 billion at the end of June, up \$13 billion from the end of 1995.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP ¹	11.8	10.2	10.2	9.8	...	...
Industrial Production	22.0	17.8	16.2	n.a.	n.a.	n.a.
Consumer Prices	25.5	10.1	9.9	8.6	8.6	8.3
Trade Balance ²	5.2	16.7	-1.2	2.1	1.5	1.1

1. Cumulative from the beginning of the year

2. Billions of U.S. dollars, NSA

In **Taiwan**, industrial production appears weak while inflation has slowed. Industrial production fell 0.5 percent in the second quarter from the year-earlier period, while consumer prices were 1.4 percent higher in July from a year earlier. The trade balance in the first seven months of 1996 was \$7.1 billion, up from \$2.5 billion in the year-earlier period. The value of exports rose 4 percent, while the value of imports fell 3 percent. Following Chinese missile tests, Taiwan's foreign exchange reserves fell to a recent low of \$83 billion in March. Reserves have stabilized since then, however, standing at \$86 billion at the end of June.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	6.5	6.1	5.3	n.a.	...	...
Industrial Production	6.6	4.2	0.1	-0.5	-0.4	n.a.
Consumer Prices	2.6	4.6	3.0	2.3	2.3	1.4
Trade Balance ¹	7.8	8.3	2.5	3.2	0.4	1.4
Current Account ¹	6.2	5.0	1.5	n.a.	...	...

1. Billions of U.S. dollars, NSA

In Korea, economic activity appears to have expanded at a moderate pace by historical standards during the second quarter, although industrial production in June was particularly weak due to serious labor disruptions. Korea's current account deficit widened to a historic high of \$9 billion during the first half of this year, as exports continued to decelerate markedly following rapid growth through most of last year. The pronounced slowing in export growth during 1996 has reflected a considerable appreciation of the won against the yen and falling prices for Korea's major electronics exports. Korea has allowed its exchange rate to depreciate by around 5 percent against the dollar since late-April in order to improve its external competitiveness. Inflation has picked up somewhat in recent months, as prices rose by 5.6 percent in July from their year-earlier level, compared with a 3.8 percent increase over a comparable period in July 1995.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	8.4	9.0	7.9	n.a.	...	...
Industrial Production	10.7	11.7	8.9	7.3	3.8	n.a.
Consumer Prices	6.2	4.5	4.9	5.1	5.5	5.6
Trade Balance ¹	-3.1	-4.7	-2.4	-2.8	-0.5	n.a.
Current Account ¹	-4.5	-8.9	-4.4	-4.7	-1.1	n.a.

1. Billions of U.S. dollars, NSA

In Russia, Boris Yeltsin coasted to a surprisingly easy victory over Communist candidate Gennady Zyuganov in the final round of the Presidential election on July 3. On August 12, parliament approved Yeltsin's nomination of Viktor Chernomyrdin to continue as Prime Minister. Despite the favorable election results, concerns about Yeltsin's health have been a source of political uncertainty in recent weeks.

Monthly inflation has continued to decline, registering only 1 percent in both June and July. The ruble has depreciated slowly against the dollar in recent months, remaining comfortably within the announced band. Measures of economic activity indicate that the economy continued to contract during the first seven months of the year. Russian authorities have linked this decline to weak

investment due to political uncertainty in the run-up to the election.

Russia has failed to satisfy some of the conditions of its IMF Extended Fund Facility (EFF). Gross international reserves, net domestic assets of the monetary authorities, and central bank credit to the consolidated government all breached end-June targets by small margins. The fiscal deficit during the first half of 1996 was equal to 5.7 percent of GDP, just below the EFF ceiling, but real tax revenues were substantially below the program's floor. Due to these difficulties, the IMF postponed an EFF disbursement of \$340 million scheduled for July. In response, the Russian government has agreed to implement a number of policy measures, including strong action to increase tax revenues through stricter enforcement.

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

	1994	1995	1996		1996	
			Q1	Q2	Jun	Jul
Real GDP	-15	-4	-3	-7	-9	-9
Industrial Production	-21	-3	-4	-5	-8	-7
Consumer Prices ¹	10	7	3	2	1	1
Ruble Depreciation ¹	9	2	2	2	1	2
Trade Balance ²	14.3	18.1	5.6	n.a.	...	...
Current Account ²	3.2	5.3	2.6	n.a.	...	...

1. Monthly Rate.

2. Billions of U.S. dollars.