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Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Confidential (FR) Class III FOMC

Part 2

January 29, 1997

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

January 29, 1997

RECENT DEVELOPMENTS

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Final demand revived once again as 1996 drew to a close, driving brisk growth in production, employment, and income. Although tight labor markets and an increase in the minimum wage sustained the uptrend in compensation increases, neither this additional cost nor that associated with higher energy prices left any discernible imprint last year on core inflation at the producer or consumer levels. Indeed, with only a modest further increment last month, the core CPI rose just 2.6 percent in 1996.

Labor Market Developments

The labor market ended 1996 on a high note, with all major indicators pointing to robust growth of labor demand. In December, nonfarm payrolls grew 262,000--bringing the average monthly gain for the quarter to 217,000--while aggregate production worker hours rose 0.9 percent for the month and 3.3 percent at an annual rate for the fourth quarter as a whole. The strength in the payroll survey was echoed by the household survey. Household employment increased at an average pace of 202,000 per month last quarter. Nonetheless, the unemployment rate held steady at 5.3 percent, as strong demand pulled more people into the labor market.

Hiring strength was widespread through year-end. Private payrolls posted monthly gains averaging 218,000 in the fourth quarter, led by continued advances in the services and trade industries. Construction employment rose 23,000 in December for the second straight month, reflecting, in part, unusually mild weather in some parts of the country during the survey period. Factories added 19,000 jobs in December and 32,000 for the quarter--the biggest increase since early 1995; aircraft and parts producers accounted for more than half of these gains.

Other indicators also point to strong labor demand. Although initial claims for unemployment insurance have fluctuated fairly widely of late, the recent range of readings appears consistent with solid employment growth. In addition, the proportion of respondents to the Conference Board's survey who indicated that jobs are plentiful rose in December and January, while those indicating that jobs are hard to get fell; similarly, the net percentage expecting higher unemployment in the Michigan Survey edged up only slightly in early January from its recent very low level.

CHANGES IN EMPLOYMENT[1]
(Thousands of employees; based on seasonally adjusted data)

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
	------------Average monthly changes---------							
Nonfarm payroll employment[2]	185	214	262	171	217	261	127	262
Private	176	200	245	147	218	272	150	231
Manufacturing	-12	-8	6	-19	11	13	0	19
Durable	5	3	24	-7	11	9	6	18
Transportation equipment	-3	1	16	-4	6	0	8	9
Nondurable	-17	-11	-19	-12	0	4	-6	1
Construction	9	24	20	16	20	15	23	23
Trade	54	59	82	59	73	125	37	57
Finance, insurance, real estate	4	14	12	14	15	17	10	17
Services	110	102	113	76	92	102	62	112
Help supply services	8	11	29	12	-5	4	-30	12
Total government	9	14	17	24	-1	-11	-23	31
Private nonfarm production workers[2]	152	166	213	120	174	257	64	202
Manufacturing production workers	-10	-8	5	-14	9	15	-1	12
Total employment[3]	32	232	176	219	202	369	27	211
Nonagricultural	51	225	197	195	220	399	123	139
Memo:								
Aggregate hours of private production workers (percent change)[2]	.1	.3	.5	.1	.3	-.7	.7	.9
Average workweek (hours)[2]	34.5	34.4	34.4	34.4	34.5	34.3	34.5	34.8
Manufacturing (hours)	41.6	41.5	41.7	41.7	41.8	41.7	41.7	42.0

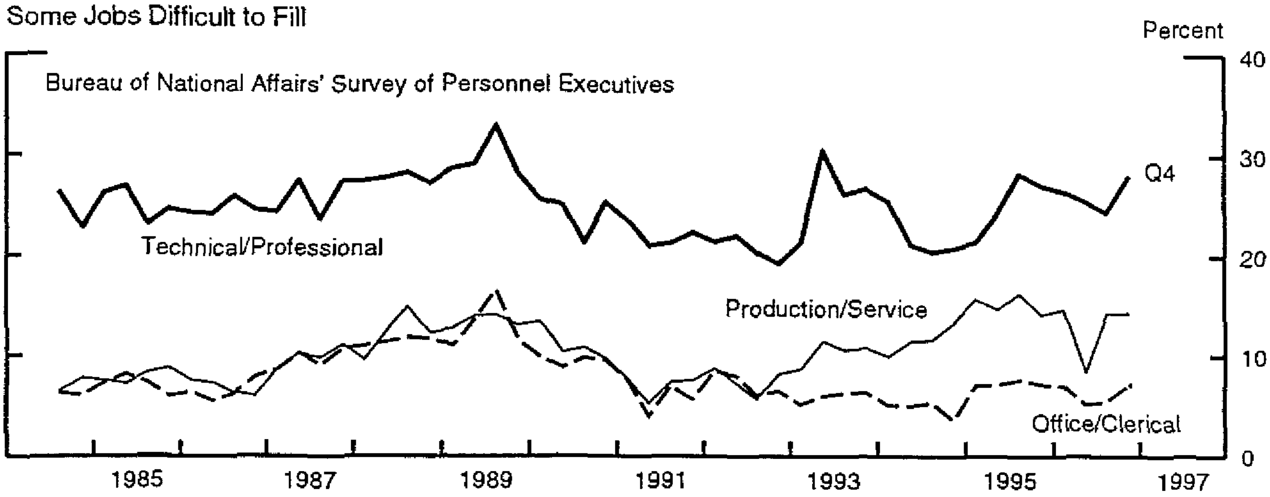
1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households.

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

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
Civilian unemployment rate (16 years and older)	5.6	5.4	5.4	5.3	5.3	5.2	5.3	5.3
Teenagers	17.3	16.7	16.5	16.6	16.6	16.3	16.8	16.5
Men: 20 years and older	4.8	4.6	4.7	4.5	4.4	4.4	4.4	4.4
20-24 years	9.2	9.5	9.8	9.0	9.1	8.9	9.2	9.3
25-54 years	4.4	4.2	4.3	4.0	4.0	4.0	4.0	3.9
55 years and older	3.7	3.3	3.3	3.4	3.2	3.0	3.1	3.4
Women: 20 years and older	4.9	4.8	4.8	4.7	4.8	4.7	4.8	4.9
20-24 years	9.0	9.0	8.7	9.0	8.9	8.9	8.9	8.9
25-54 years	4.5	4.4	4.4	4.4	4.5	4.4	4.5	4.7
55 years and older	3.6	3.5	3.7	3.3	3.2	3.4	3.0	3.3
Full-time workers	5.5	5.3	5.3	5.2	5.2	5.1	5.3	5.2
Labor force participation rate	66.6	66.8	66.7	66.8	66.9	66.9	66.9	67.0

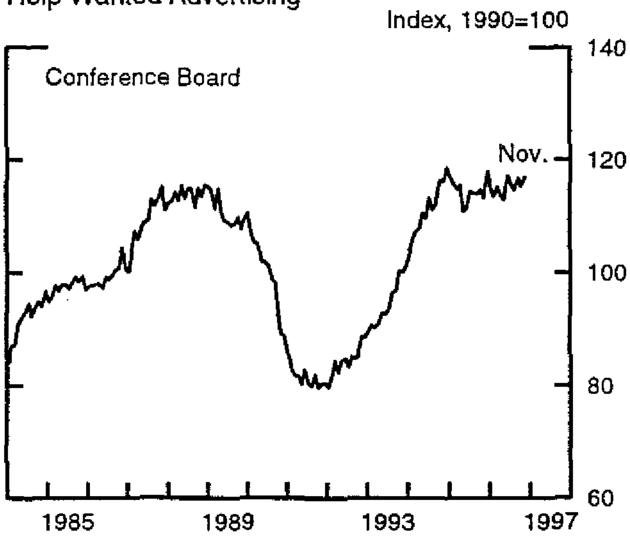
Labor Market Indicators

Some Jobs Difficult to Fill



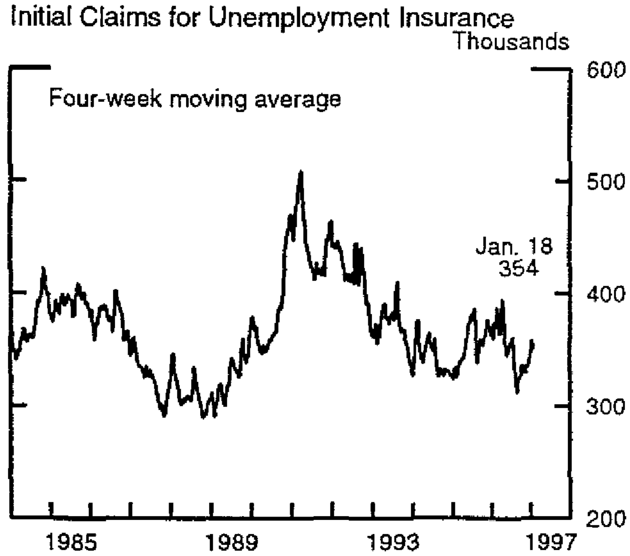
Note. Seasonally adjusted by FRB staff.

Help Wanted Advertising



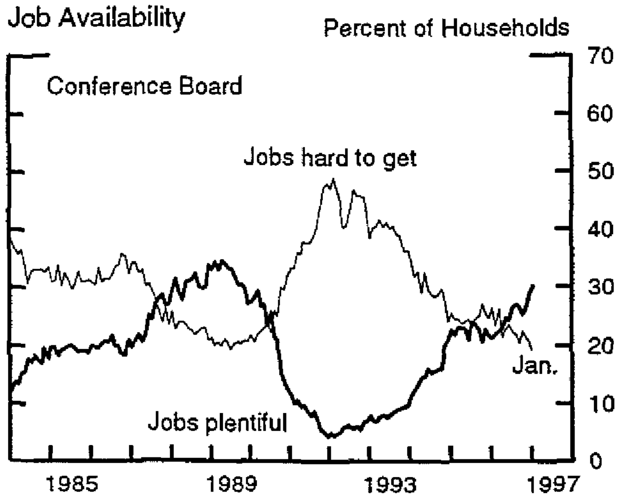
Note. Series has been adjusted to take account of various structural and institutional changes, including consolidation of the newspaper industry and a tendency toward increased hiring through personnel supply agencies.

Initial Claims for Unemployment Insurance

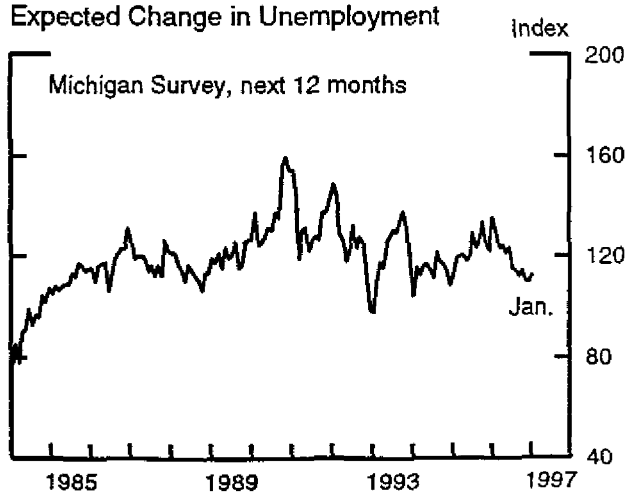


Note. State programs, includes EUC adjustment.

Job Availability



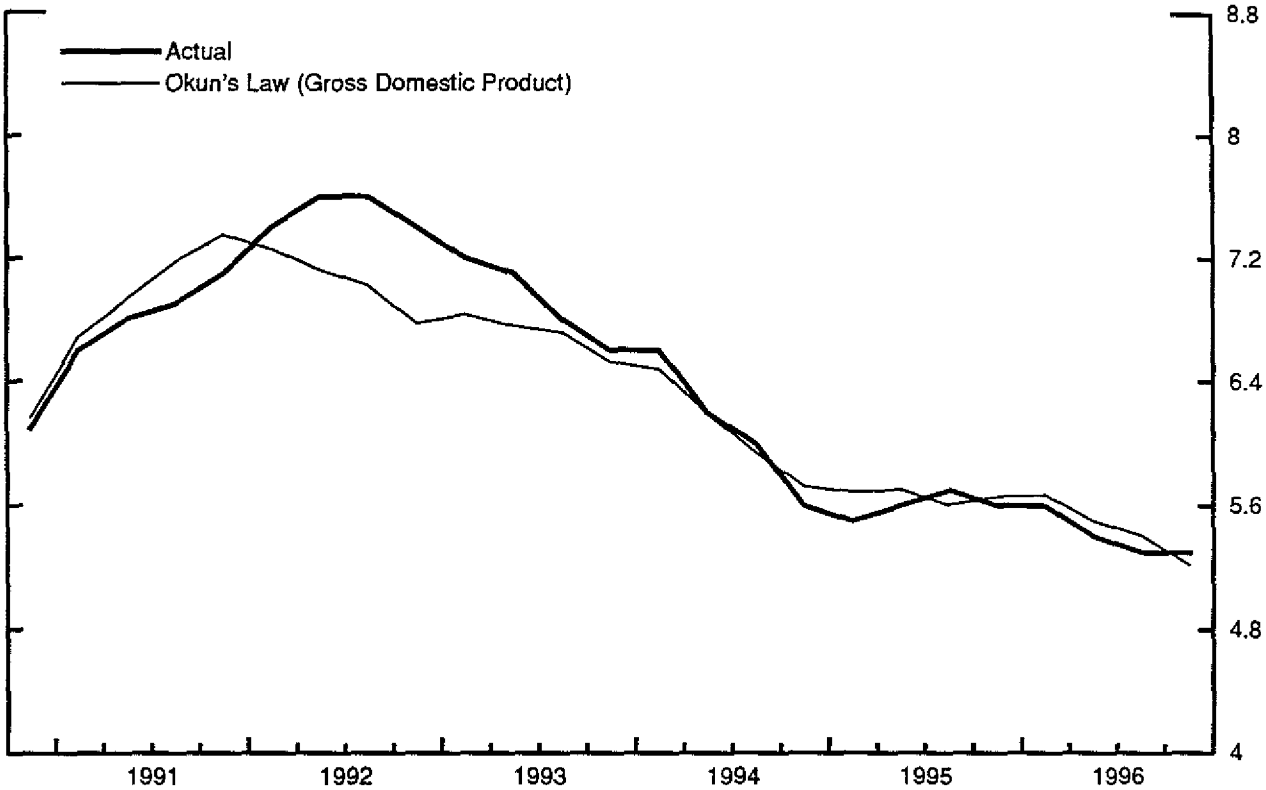
Expected Change in Unemployment



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

Unemployment Rates: Actual vs. Okun's Law Simulations

Simulation Begins in 1990:Q3



Note: The Okun's Law projection for 1996:Q4 is based on the staff's GDP projection.

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

	1990:Q3 to 1993:Q4	1994[1]	1995[1]	1995:Q4 to 1996:Q3
Total business	1.4	.2	-.1	1.1
Nonfarm business	1.4	.3	-.1	.7
Manufacturing	2.6	4.5	3.5	4.9
Nonfinancial corporations[2]	2.1	.2	1.5	2.1

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.

Over 1996 as a whole, nonfarm payrolls increased 2.56 million, while the household survey measure of employment--adjusted to make it better match the payroll concept--increased 2.71 million.[1] Yet, despite the rapid pace of employment growth over the year, the unemployment rate fell just 0.3 percentage point--from 5.6 percent in the fourth quarter of 1995 to 5.3 percent in the fourth quarter of 1996. This relatively small decline would seem at variance with Okun's Law, and reflects a run-up in the labor force participation rate--from 66.5 percent in the fourth quarter of 1995 to 66.9 percent in the fourth quarter of 1996. Last year's discrepancy is not unusual, however, as Okun's law often noticeably over- or underpredicts changes in the unemployment rate over periods as short as a year or two. Okun's law better explains unemployment rate fluctuations over longer periods. In the current cycle, for example, Okun's law predicted most of the rise in the unemployment rate over 1991 and 1992 and the subsequent decline to its current level.

One negative feature of last year's labor market was the continued slow growth of nonfarm business sector productivity--about 3/4 percent for the year, by our estimate. This actually would be an improvement over the performance in 1994 and 1995, but it calls into further question our long-standing assumption that the underlying, cyclically adjusted trend rate of productivity growth this decade has been 1.1 percent per year. Output per hour, according to the published data, has now grown, on average, only 0.8 percent per year since the middle of 1990.

At the same time, however, we would also note that productivity measurement is sensitive to the choice of output measure. In particular, using the income-side measure of nonfarm business output, one finds healthier productivity growth, averaging more than 1-1/2 percent in 1996 and 1.1 percent per year since the last business cycle peak. But there appears to be no tendency in the annual or benchmark NIPA revisions for the statistical discrepancy to be revised toward zero. And the reason the BEA advertises Gross Domestic Product as its official measure of domestic output is that they consider the preliminary spending indicators used to construct

1. The adjustment includes the removal from the household total of agricultural workers, self-employed workers, unpaid family workers, and workers on unpaid absences, and the addition of agricultural service workers and second jobs held by multiple-job holders.

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

	Proportion 1996:Q4	1995[1]	1996[1]	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
				-Annual rate-		--Monthly rate---		
Total index	100.0	1.8	3.7	3.3	3.8	.0	.8	.7
Previous		1.6	4.5	4.5	4.1	-.1	.8	.8
Manufacturing	86.6	1.6	4.0	5.0	3.7	.0	.6	1.0
Motor veh. and parts	4.6	-3.0	-3.7	2.7	-22.1	-6.1	5.0	.1
Aircraft and parts	2.5	-15.4	35.1	21.3	35.4	3.3	2.3	1.8
Manufacturing excluding motor vehicles, aircraft, and parts	79.4	2.4	3.7	4.7	4.7	.3	.3	1.0
Consumer goods	23.9	.2	2.6	2.2	6.1	.5	.8	.9
Durables	4.1	2.5	3.6	.2	2.5	-.5	.6	3.0
Nondurables	19.8	-.2	2.4	2.6	6.9	.7	.8	.5
Business equipment	11.9	8.1	5.7	5.7	6.0	1.1	-.4	1.0
Office and computing	1.7	42.8	39.5	44.3	24.4	1.5	1.8	1.7
Industrial	4.4	7.3	-.2	-.1	1.1	.7	-.6	1.1
Other	6.1	4.6	.8	2.2	2.9	.9	-.3	1.2
Construction supplies	5.7	-.8	5.9	9.3	.4	-1.6	1.1	.4
Materials	29.1	3.8	4.5	5.9	4.0	.1	.2	1.4
Durables	20.2	6.9	5.8	6.6	4.7	.2	-.1	1.7
Nondurables	8.7	-2.3	1.7	4.5	2.0	-.3	.9	.7
Mining	5.6	-1.3	3.9	.8	2.4	.1	.5	1.2
Utilities	7.9	6.5	.4	-12.0	5.3	.3	2.3	-3.4
Memo:								
Information-related products[2]	9.7	24.6	17.4	17.8	15.0	.8	1.3	1.8

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 High	1963-96 Avg.	1995 Q4	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
Manufacturing	85.7	81.9	82.3	82.3	82.2	81.8	82.1	82.6
Primary processing	88.9	83.0	86.2	86.6	86.4	86.4	86.1	86.7
Advanced processing	84.2	81.3	80.5	80.4	80.4	79.9	80.4	80.8

this product-side measure to be more reliable than the preliminary income-side indicators used to construct Gross Domestic Income. Still, there are reasons to suspect that the official output and productivity estimates for the nonfarm business sector are understating gains. As has been noted, for example, the nonfinancial corporate sector--which excludes many of the industries producing difficult-to-measure output and is measured on the income side--has shown consistently stronger productivity growth than the nonfarm business sector.

Industrial Production[2]

Industrial production increased 0.7 percent in December after a 0.8 percent gain in November. Increases were widespread across manufacturing industries; elsewhere, a steep decline in utilities output, reflecting unseasonably mild weather in December, was partly offset by an upturn in mining. The surge in activity brought IP growth in the fourth quarter to 3.8 percent at an annual rate, 1/2 percentage point above its third-quarter rate. The December surge in manufacturing output boosted the factory operating rate to 82.6 percent, the highest level since September 1995.

The output of motor vehicles and parts was little changed in December, although the composition of production shifted a bit toward trucks. Looking ahead, schedules call for increases in assemblies of both cars and trucks in January, reflecting, in part, a further easing of the lingering production disruptions at GM.

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

	1996			1997	
	Nov.	Dec.	Q4	Jan.	Q1
				---scheduled--	
U.S. production	12.0	12.0	11.7	12.6	12.4
Autos	6.1	5.8	5.8	6.1	6.1
Trucks	5.8	6.3	5.9	6.5	6.3
Days' supply					
Autos	67.3	60.5	60.5	---	---
Light trucks	67.2	67.5	67.5	---	---

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

The production of aircraft and parts moved up 1.8 percent in December, continuing the strong upturn that began a year ago. Reports indicate that the industry has scheduled a steady rate of

2. These data are the revised series released on January 27.

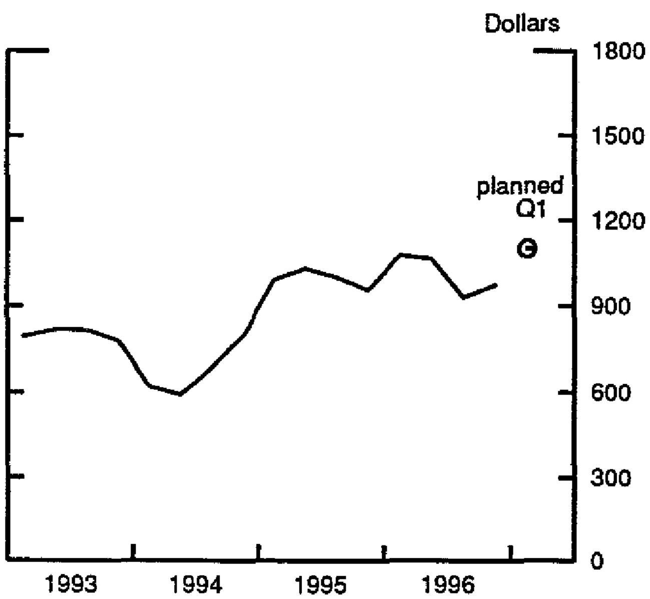
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

			1996			1996		
	1995	1996	Q2	Q3	Q4	Oct.	Nov.	Dec.
FRB Total	14.7	15.1	15.0	15.0	14.8	14.9	14.7	14.8
Adjusted[1]	14.7	15.0	15.0	15.1	14.7	15.0	14.6	14.5
Autos	8.6	8.5	8.7	8.6	8.0	8.0	7.9	8.1
Light trucks	6.1	6.6	6.3	6.4	6.8	7.0	6.8	6.7
North American[2]	12.8	13.4	13.3	13.3	13.1	13.2	12.9	13.2
Autos	7.1	7.2	7.4	7.3	6.8	6.7	6.6	7.0
Big Three	5.4	5.3	5.5	5.3	4.8	4.9	4.6	5.0
Transplants	1.7	2.0	1.9	2.1	1.9	1.8	2.0	2.0
Light trucks	5.7	6.1	5.9	6.0	6.3	6.5	6.3	6.2
Foreign produced	1.9	1.7	1.7	1.7	1.7	1.7	1.8	1.7
Autos	1.5	1.3	1.3	1.3	1.2	1.2	1.3	1.2
Light trucks	.4	.4	.4	.4	.5	.4	.5	.5
Memo:								
BEA Total	14.7	15.1	15.1	15.0	14.7	14.8	14.8	14.4

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.

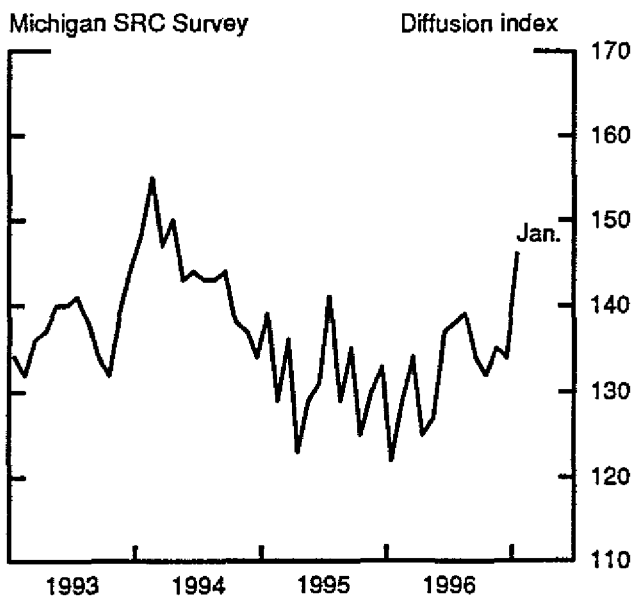
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Marketing Incentives for Light Vehicles
(FRB seasonals)



Note. Data from J.D. Powers.

Buyer Sentiment for New Vehicles



increase until the end of 1997.[3] Outside of motor vehicles and aircraft, manufacturing output increased 1.0 percent in December, with substantial advances in every major category.

The annual revision of IP, capacity, and capacity utilization released on January 27 incorporated updated source data and featured a change in the method of aggregating the indexes. From 1977 onward, the value-added proportions used to weight individual series were updated annually rather than every five years, and were aggregated using a Fisher formula rather than a linked-Laspeyres. The new aggregation methods lowered IP and capacity growth, reflecting in large part the smaller weights applied to the fast-growing computer industry. The new estimates of production and capacity from 1992 onward also incorporate additional and updated statistics. Overall, these revisions lowered the average annual rate of growth of IP over the past three years by about 1/2 percentage point.

The revision had only a minor influence on capacity utilization rates. The lower estimate of IP growth was, in general, accompanied by a downward revision in capacity growth (also reflecting the changed method of aggregation). The most recent peak in factory utilization (84.6 percent) still occurs at the end of 1994; the average rate of capacity utilization in manufacturing from 1963 to 1996, 81.9 percent, is just a tad below the previous estimate of 82.1 percent, and, as before, the December rate (82.6 percent) is just a bit above this longer-run average.

Motor Vehicles

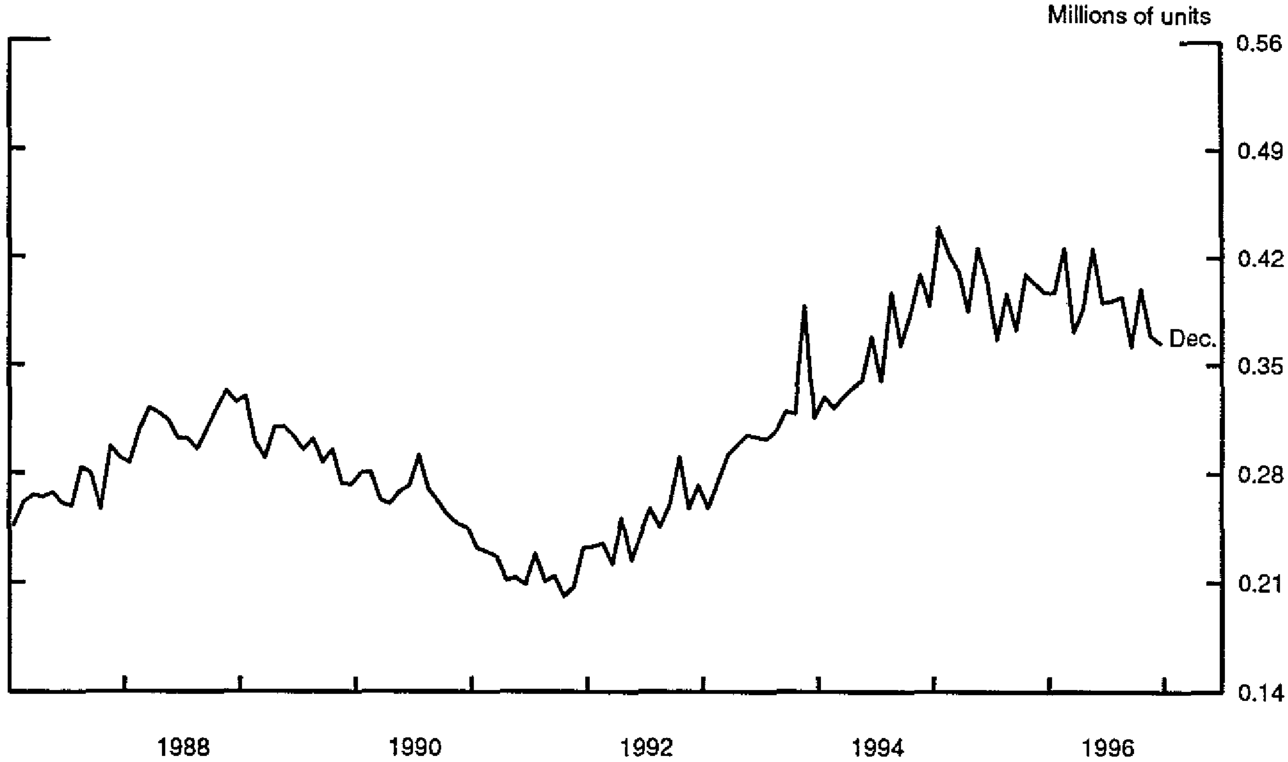
Reported sales of light motor vehicles in December were 14.8 million units at an annual rate, based on recently revised FRB seasonal factors, the same as the October-November average; actual sales were about 300,000 units below this pace because some automakers included an extra selling day in their December report.[4] Based on confidential data from company sources, sales in December were propped up by a bounceback in GM fleet sales, which had been unusually low in October and November owing to the

3. Boeing recently canceled the development of a new version of the 747. Given the long lead times of such a project, however, this change will not affect production in 1997 or 1998.

4. The new FRB seasonal factors improve the estimate of trading day weights. We expect that BEA will use older seasonal factors until their midsummer revision. Based on these factors, sales fell sharply in December. For the fourth quarter as a whole, however, sales differed by only 100,000 units at an annual rate.

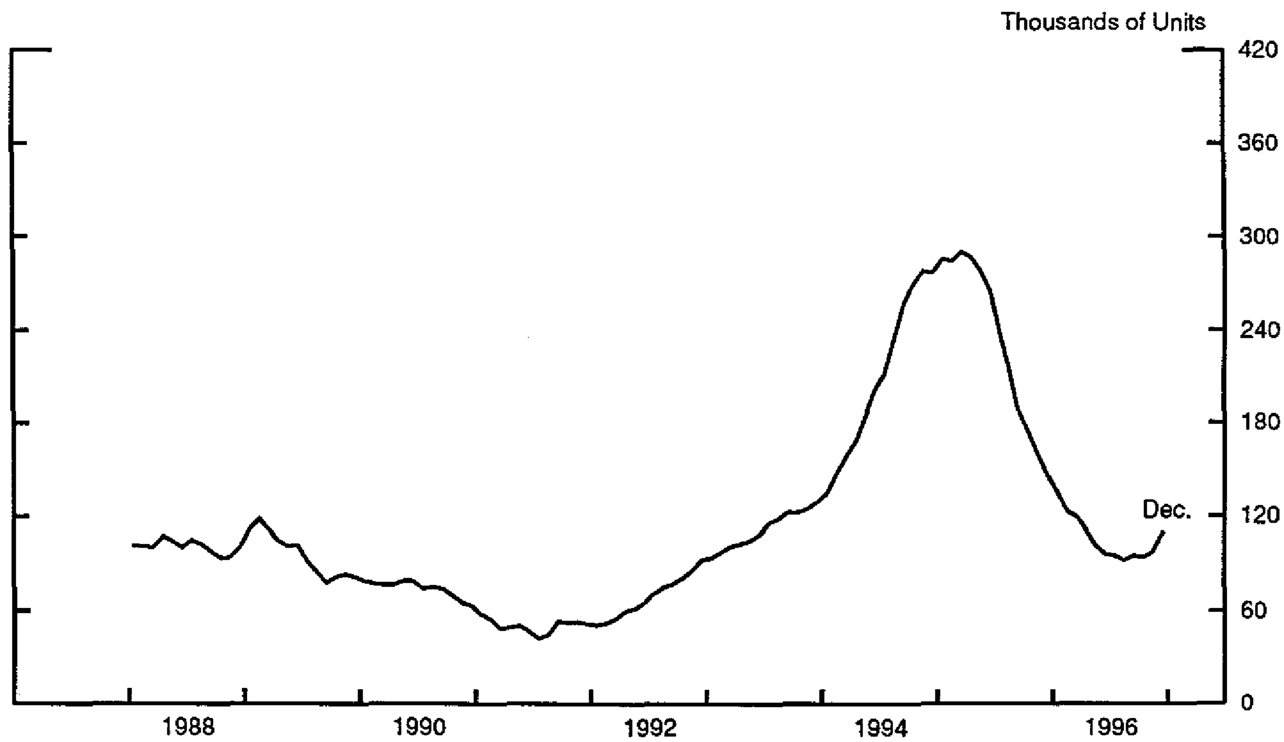
Medium and Heavy Truck Sales

(FRB seasonals; annual rate)



Backlog of North American Medium and Heavy Truck Orders

(Classes 5-8; FRB seasonals)



Note: Data from Americas Commercial Transportation Research Co.

strike-related supply disruptions at GM and subsequent model changeover problems. For the fourth quarter as a whole, total light vehicle sales declined a bit as the dip in fleet sales overshadowed a moderate rise in retail sales.

In the near term, a host of factors should encourage retail sales. Chief among these factors is favorable pricing. New car prices in the CPI fell 1.7 percent at an annual rate in the last three months of 1996, as Big Three sales incentives moved up in the fourth quarter; first-quarter plans call for further increases in incentives to above the high levels of a year ago. In addition, new car-buying attitudes zoomed in the preliminary Michigan Survey of Consumer Sentiment for January. Respondents cited low prices and the strong economy as reasons why it was a good time to buy a car.

Sales of medium and heavy trucks were essentially unchanged in December after having fallen 26,000 units at an annual rate in November. Sales have been trending down for about a year, but demand may have improved some recently. Orders for heavy trucks (class 8) have increased a bit, and backlogs have ticked up in the past few months after dropping steadily since early 1995. Orders have also improved for medium trucks (class 5-7), where backlogs had plummeted to very low levels. Over the past year, medium and heavy truck production mirrored sales, keeping inventories in line and leaving the days' supply at about its average level over the past four years.

Personal Income and Consumption

Household spending appears to have rebounded from its slump of last summer, with growth in real PCE probably picking up to about a 3 percent pace in the fourth quarter of 1996. Moreover, the continued solid uptrend in income and the very favorable recent readings of sentiment suggest plenty of room for spending to expand in the months ahead.

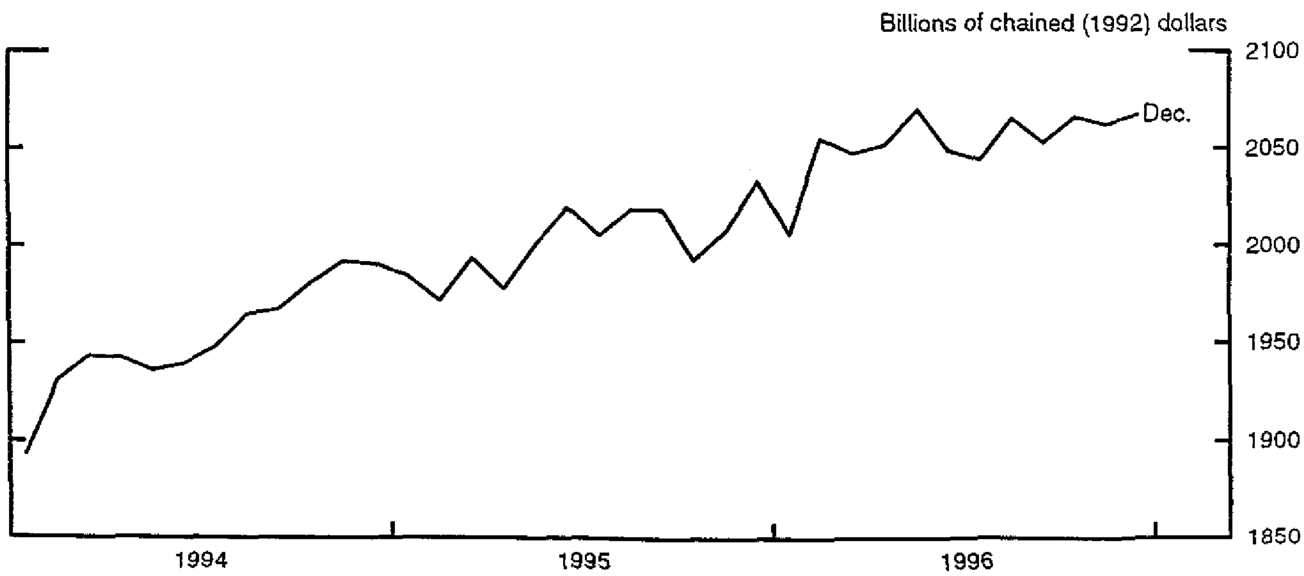
According to the advance report, total nominal retail sales increased 0.6 percent in December and 1.2 percent (not at an annual rate) for the quarter as a whole. Spending in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 0.7 percent last month and 1.3 percent (not at an annual rate) in the fourth quarter. In December, outlays at most types of stores within the retail control category posted moderate or large gains. The only area of weakness in December was furniture and appliance stores, where nominal sales

RETAIL SALES
(Percent change; seasonally adjusted)

	1996			1996		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total sales	1.2	.2	1.2	.7	-.2	.6
Previous estimate		.2		.3	-.4	
Building materials and supplies	6.9	1.4	-1.4	-.1	-.7	-1.6
Automotive dealers	-1.4	.7	1.4	.7	-1.0	.7
Retail control[1]	1.7	.0	1.3	.8	.0	.7
Previous estimate		.0		.5	.4	
Durable goods	3.3	-.8	2.1	1.8	.6	.8
Furniture and appliances	2.0	.7	-.1	-.3	-.3	.1
Other durable goods	4.3	-1.9	3.9	3.6	1.2	1.4
Nondurables	1.4	.1	1.1	.5	-.2	.7
Apparel	1.5	-.7	-.6	-.7	-1.7	1.5
Food	.5	1.0	.9	.2	-.1	.3
General Merchandise	2.0	.4	.5	.5	-.5	.5
Gasoline stations	5.5	-3.1	2.0	1.3	.2	.8
Drug stores	1.3	2.3	2.5	2.0	-.1	.7
Other nondurables	.5	.4	1.9	1.0	.3	.8

1. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.

PCE Goods



Note. October, November, and December values are staff estimates.

barely increased after declining in the two previous months. Although nominal spending in this category has been held down to some extent by falling prices of electronic goods, the trend in real purchases also seems to have weakened somewhat from the very strong pace of recent years. This pattern is consistent with anecdotal reports indicating that holiday spending on computers was weaker this year than last.[5]

The most recent data on services expenditures point to a moderate advance in November following a similar gain in October. Energy spending jumped in November, reflecting lower-than-normal temperatures. Energy expenditures likely fell back considerably in December, however, owing to the mild weather. This pattern should reverse in January, as the weather has been slightly cooler than normal thus far. Among non-energy services, spending in most major categories posted moderate increases in November.

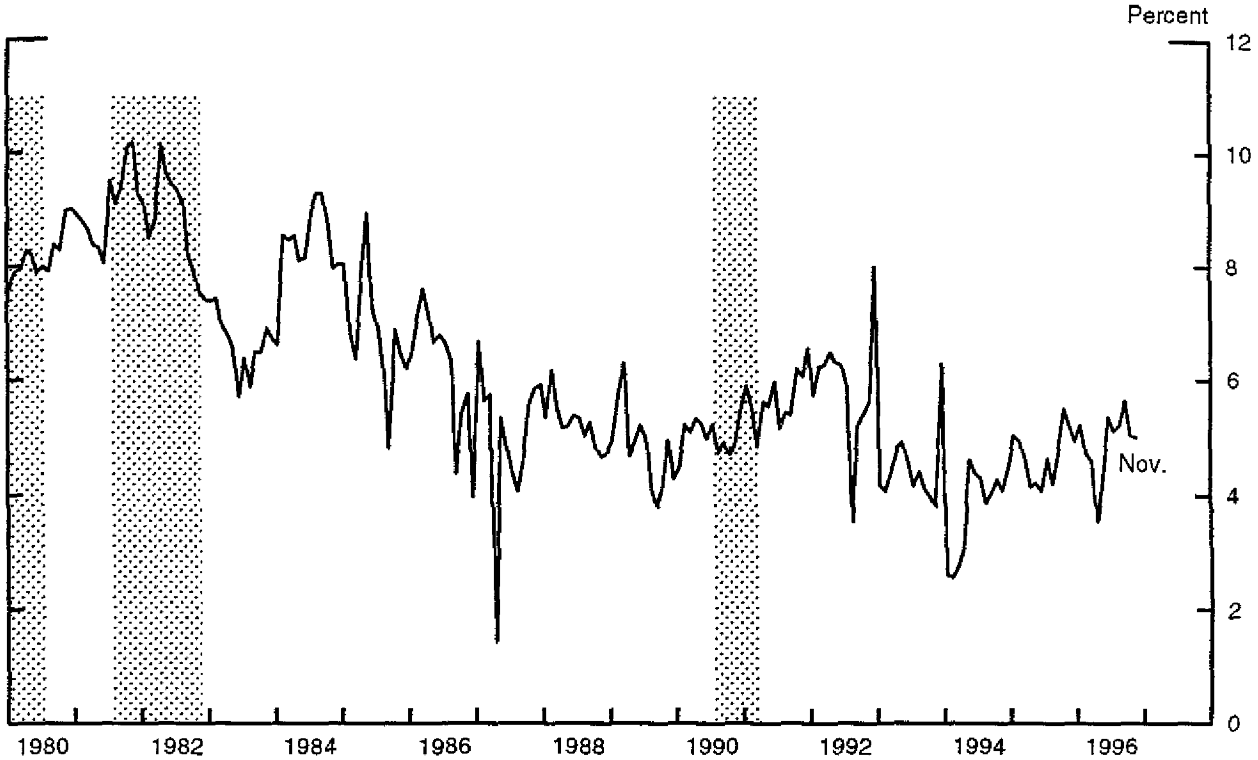
Despite the gains in spending last quarter, the saving rate likely held close to its third-quarter level of 5-1/4 percent, as personal income also posted a healthy increase. In November, real disposable income rose 0.3 percent, with more than two-thirds of the gain attributable to an increase in wages and salaries. Among components of nonwage income, farm proprietors' income fell, but other categories advanced moderately. In December, the large increases in aggregate hours and hourly earnings likely boosted labor income sharply further.

Although there are no reliable spending data yet available for January, readings of consumer sentiment have continued to be quite upbeat. According to the preliminary report, the Michigan SRC index of consumer sentiment edged down in early January but remained at the upper end of the favorable range that has prevailed since early 1994. In addition, the January Conference Board report showed confidence rising to the highest level since the late 1980s.

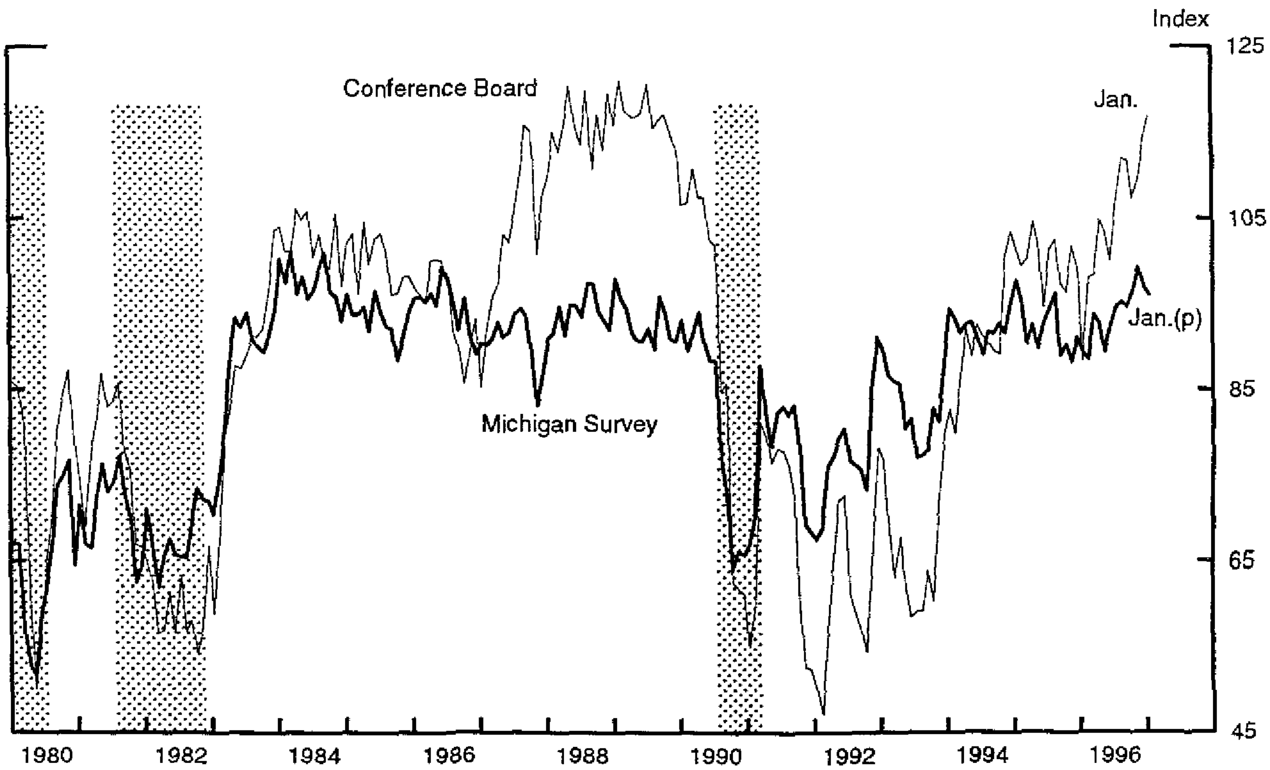
One negative in the consumer spending outlook is the possibility that debt burdens are constraining some households. The recently released 1995 Survey of Consumer Finances provides some interesting evidence on changes in debt by income group earlier in the decade. For almost all income groups, both the share of

5. Alternatively, consumers may have deferred purchases of computers in anticipation of the introduction of the new MMX technology early in 1997. If this factor was, in fact, important, one would expect the fourth-quarter weakness in computer sales to be made up in the first quarter.

Personal Saving Rate



Consumer Sentiment



p Preliminary.

households with debt and the mean amount borrowed (in real terms) rose between 1992 and 1995. However, changes in financial conditions were not uniform across income groups: Median ratios of payments to income rose considerably for households with incomes below $25,000,[6] while holding steady or declining for households in higher income brackets. Whether low-income households took on a greater debt burden because they perceived brighter future income prospects or because of aggressive marketing by lenders, their subsequent spending may have been pinched by the combination of the high payment burden and the inability or unwillingness to take on more credit; alternatively, however, greater access to credit may simply have allowed them to accelerate purchases they would have made later, thereby damping subsequent demands. Moreover, households in this group probably gained little from the run-up in stock prices during the past two years, because they typically hold very small amounts of equities. Thus, the experience of low-income households--which, according to the BLS's Consumer Expenditure Survey, account for a bit more than 20 percent of total spending--may be one factor that has held the aggregate saving rate up despite the increase in stock market wealth.

RATIO OF DEBT PAYMENTS TO INCOME,
BY INCOME GROUP, 1992 AND 1995
(Median ratio among households with debt)

Household income (thousands of 1995 dollars)	1992	1995
Less than 10	13.2	15.1
10-24.9	14.7	17.8
25-49.9	16.0	16.9
50-99.9	16.9	16.8
100 and more	14.6	11.4

Source. Survey of Consumer Finances, 1992 and 1995.

Housing Markets

There clearly was a slowdown in single-family housing activity in the final quarter, but the monthly noise in starts made it difficult to discern the degree of weakening. Starts dropped 12 percent in December, more than offsetting the November increase.

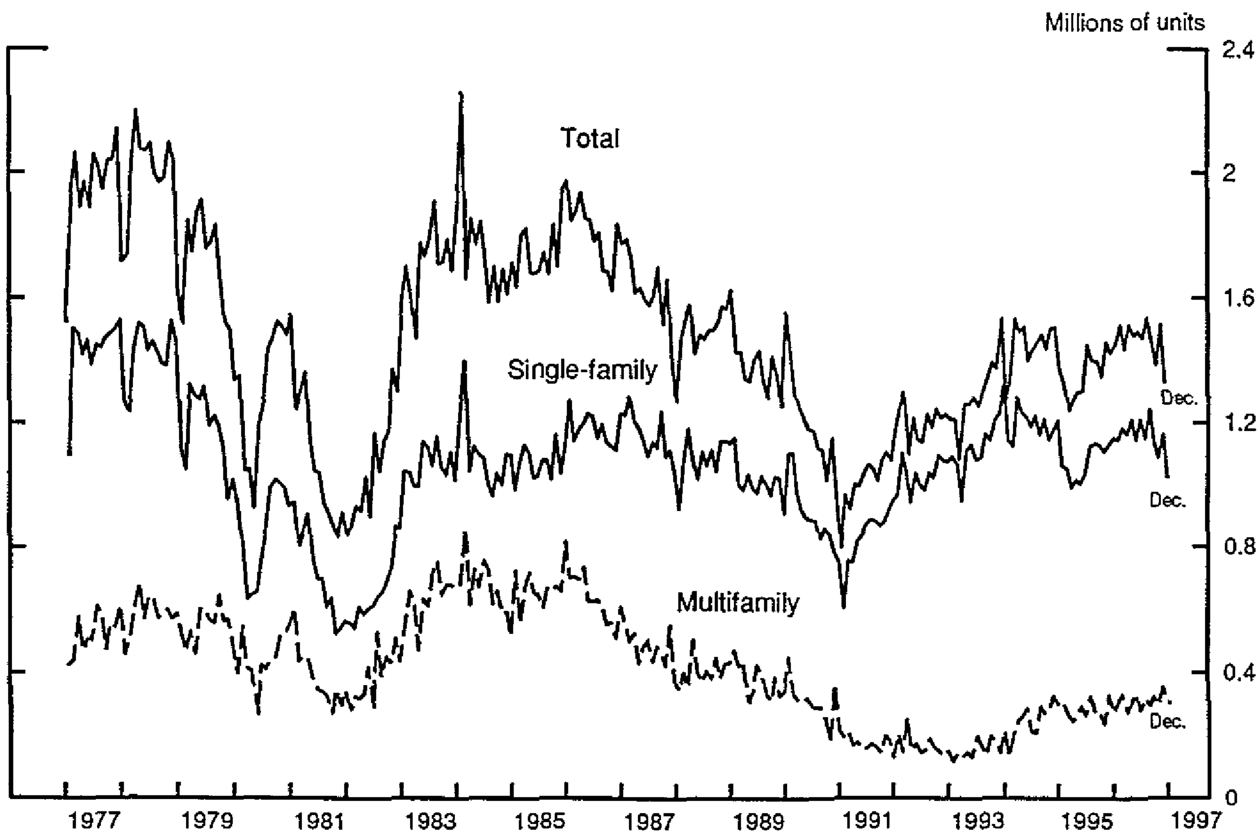
6. Households with incomes below $25,000 roughly correspond to the lowest two income quintiles.

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

	1996p	1996 Q2	1996 Q3r	1996 Q4p	Oct.r	Nov.r	Dec.p
All units							
Starts	1.47	1.49	1.49	1.41	1.39	1.51	1.33
Permits	1.43	1.44	1.43	1.40	1.36	1.42	1.41
Single-family units							
Starts	1.16	1.19	1.18	1.09	1.09	1.16	1.02
Permits	1.07	1.10	1.06	1.02	1.01	1.03	1.02
New home sales	n.a.	0.74	0.79	n.a.	0.68	0.77	n.a.
Existing home sales	4.09	4.21	4.11	3.95	3.97	4.01	3.87
Multifamily units							
Starts	0.31	0.31	0.31	0.32	0.30	0.35	0.31
Permits	0.36	0.34	0.36	0.38	0.35	0.39	0.39
Mobile homes							
Shipments	n.a.	0.37	0.37	n.a.	0.37	0.35	n.a.

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

Private Housing Starts
(Seasonally adjusted annual rate)



However, unusually heavy precipitation late in the month, particularly in the West, likely contributed to the falloff in housing starts.[7] Single-family permit issuance, which is more reliable statistically and less affected by weather, was little changed last month. For the fourth quarter as a whole, starts and permits were well aligned, and both were down appreciably from their third-quarter levels.

Home sales have also slowed from the rapid third-quarter pace. Although sales of new homes ticked up in November, the average sales pace in October and November was down nearly 9 percent from the average for the third quarter. In addition, the history of large revisions to preliminary estimates of new home sales leaves open the possibility that the November reading overstated the strength of housing demand; the initial estimates for the two preceding months were subsequently revised down about 35,000 units. Existing home sales declined 3.8 percent in the fourth quarter to a 3.95 million unit annual rate.

More recent indicators are somewhat ambiguous about the strength of demand for single-family homes. An industry survey showed that builders' assessments of new home sales weakened in early January; however, respondents who rated current sales as good still outnumber those who rate sales as poor. On the positive side, home buying attitudes, as measured by the preliminary January Michigan survey, jumped to their most optimistic level in nearly three years. Finally, as in some earlier year-end periods, applications for mortgages to purchase homes have been volatile in recent weeks, likely reflecting the difficulty of seasonally adjusting a rather short time series of weekly data to reflect the Christmas and New Year's holidays. Over the latter part of 1996, however, applications have shown no obvious trend.

Multifamily housing starts fell to 305,000 units in December, a touch above the October level. Nevertheless, multifamily starts increased nearly 13 percent in 1996 to the highest level for any year since 1989. The vacancy rate for multifamily rental units declined a bit in the fourth quarter but remains elevated relative to the rate before the building boom in the mid-1980s.

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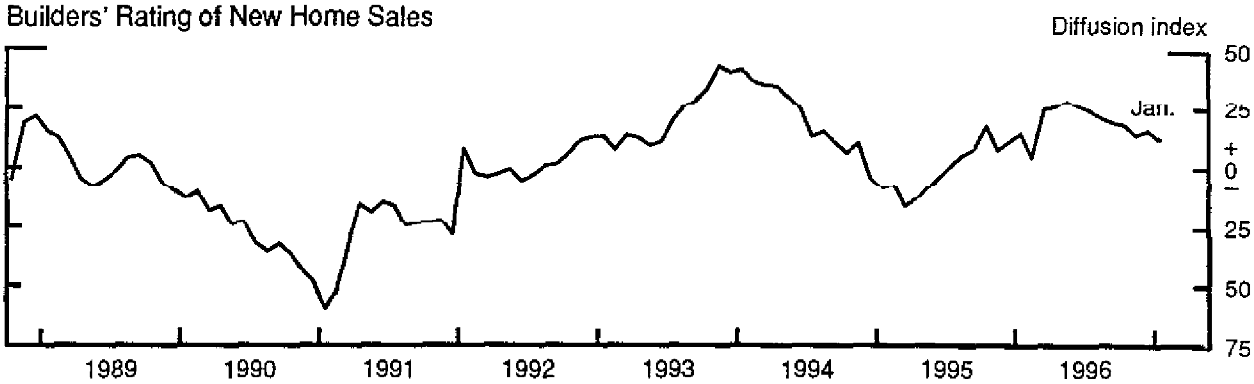
7. As mentioned previously, BLS's estimate of construction employment refers to the second week of the month, when the weather conditions were favorable. As a result, the employment figure was not affected by the poor weather later on.

Indicators of Housing Demand

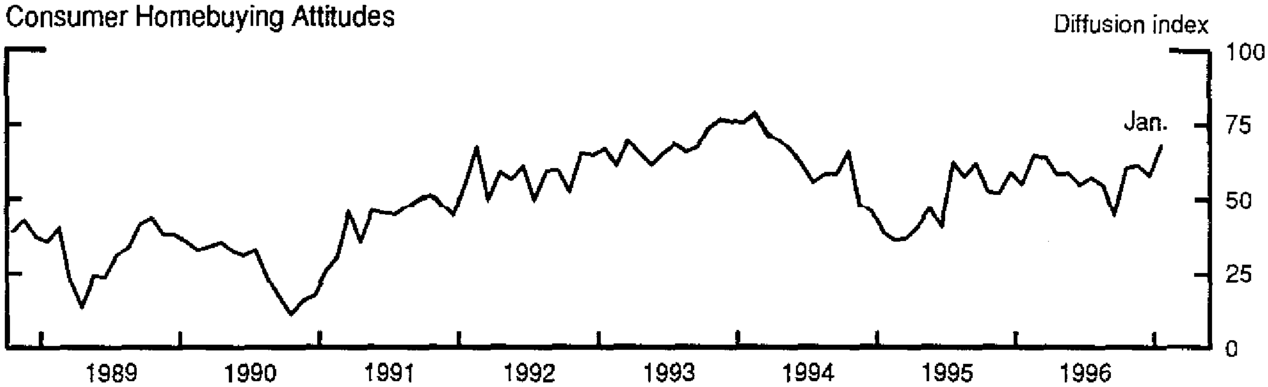
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



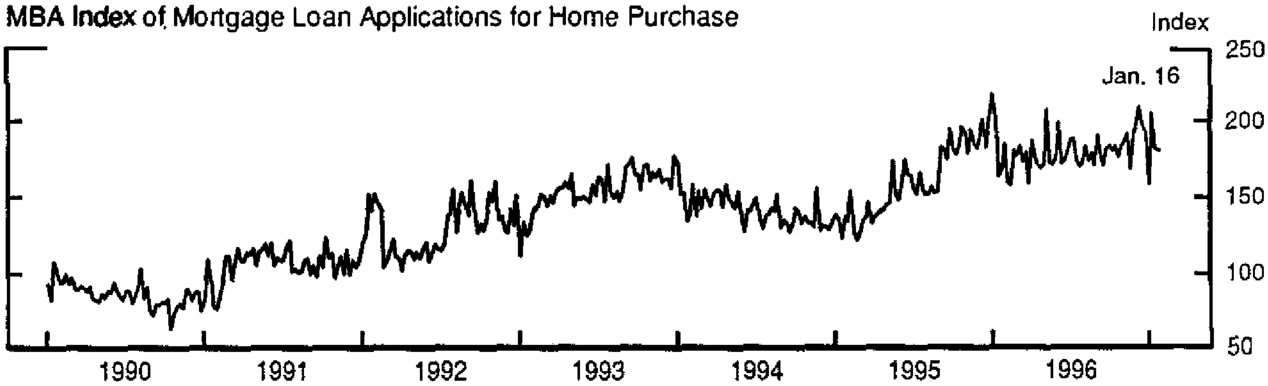
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

Consumer Homebuying Attitudes



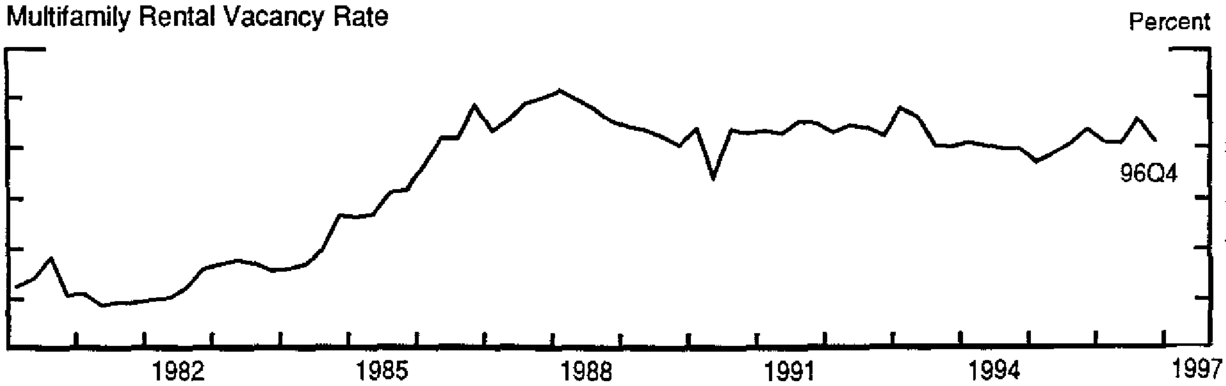
Note. The homebuying attitudes index is calculated from Survey Research Center data as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.

MBA Index of Mortgage Loan Applications for Home Purchase



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

Multifamily Rental Vacancy Rate



Business Fixed Investment

Growth in real business fixed investment slowed considerably in the fourth quarter from the 17-1/2 percent increase posted in the third. Although nominal construction expenditures on nonresidential structures reportedly skyrocketed during October and November, nominal purchases of producers' durable equipment appear to have been flat in recent months. Favorable financial market conditions, good cash flow, and technological change--leading to rapid obsolescence and falling prices--probably still are providing some impetus to outlays. However, the level of investment last year was already high enough to result in an increase in the stock of producers' durable equipment of nearly 6 percent--a rapid pace by historical standards.

Shipments of nondefense capital goods, excluding computers and aircraft, increased 0.6 percent in December and only 0.7 percent during the fourth quarter as a whole. Despite a strong December, nominal computer shipments--which increased 4.4 percent in the third quarter--fell 0.6 percent during the fourth quarter. The big swing in computer shipments may be due, in part, to a shift in seasonal patterns. There are reports that many computer manufacturers, hoping to avoid the bottlenecks that have emerged near year-end over the past few years, attempted to pull fourth-quarter demand into the third quarter with aggressive pricing schemes last year. Shipments of communications equipment edged down slightly in December from their robust pace in November. Shipments of such equipment were up 5 percent for the fourth quarter and 16 percent for the year as a whole, driven by healthy growth in the demand for cellular phone services. Shipments of nondefense capital goods excluding aircraft, office and computing, and communications equipment were little changed during the fourth quarter. Looking ahead, recent large increases in orders for communications equipment--which, though falling sharply in December, still posted a healthy gain for the fourth quarter--point to continued growth in spending. The stagnation of new orders outside of the high-tech area suggests a softening of demand for these goods.

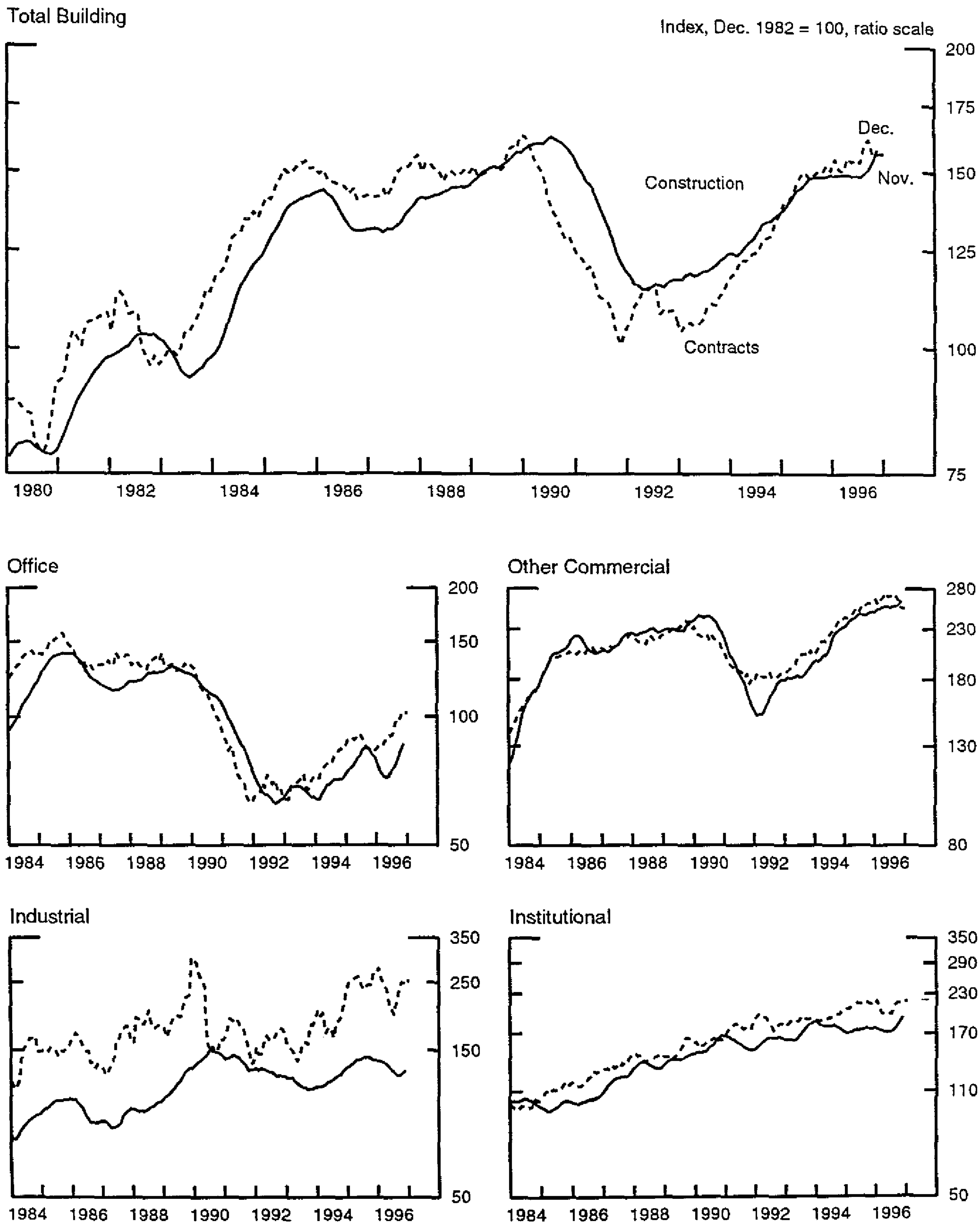
Business purchases of transportation equipment were weak in the fourth quarter. As had been expected, purchases of motor vehicles declined markedly, as production shortfalls from the GM strikes prompted cuts in fleet sales in October and November, and sales of heavy trucks fell. Aircraft outlays are also likely to be a drag on

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

	1996				1996		
	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.
Producers' durable equipment							
Shipments of nondefense capital goods	-.5	2.9	1.8	1.5	-2.2	1.9	1.4
Excluding aircraft and parts	.8	1.5	1.5	.7	-2.3	1.5	.6
Office and computing	3.7	-.8	4.4	-.6	-4.1	-.1	5.3
Communications equipment	-.3	4.7	4.5	5.1	-.4	5.4	-.5
All other categories	.0	1.7	-.3	.1	-2.2	1.2	-.8
Shipments of complete aircraft[1]	1.4	12.2	14.7	n.a.	-20.1	15.7	n.a.
Sales of heavy trucks	-2.2	1.2	-4.3	-1.8	8.6	-6.2	-1.0
Orders of nondefense capital goods	3.1	-6.5	4.9	.3	-.1	-7.5	-.5
Excluding aircraft and parts	3.1	-1.7	2.6	-.6	2.0	-2.2	-2.8
Office and computing	2.1	1.6	5.0	.3	.6	-2.8	10.4
Communications equipment	8.7	-8.5	6.6	4.5	36.2	-14.3	-33.8
All other categories	2.2	-1.2	.8	-2.3	-5.3	2.1	.8
Nonresidential structures							
Construction put-in-place	1.0	.0	2.7	n.a.	4.3	2.3	n.a.
Office	-6.6	8.3	9.2	n.a.	5.9	.9	n.a.
Other commercial	3.0	-1.0	1.4	n.a.	4.7	3.8	n.a.
Institutional	-2.9	1.2	8.2	n.a.	2.0	6.3	n.a.
Industrial	-1.6	-8.0	-1.0	n.a.	11.3	-6.3	n.a.
Public utilities	4.5	3.1	-1.3	n.a.	-.3	5.2	n.a.
Lodging and miscellaneous	10.6	.0	4.5	n.a.	1.4	5.4	n.a.
Rotary drilling rigs in use[2]	6.5	9.9	-4.0	-1.6	.9	-.5	1.5
Memo:							
Business fixed investment[3]	11.6	3.8	17.5	n.a.	n.a.	n.a.	n.a.
Producers' durable equipment[3]	13.1	6.7	20.9	n.a.	n.a.	n.a.	n.a.
Nonresidential structures[3]	7.7	-3.7	8.4	n.a.	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. Percent change of number of rigs in use, seasonally adjusted.
3. Based on 1992 chain-weighted data; percent change, annual rate.
n.a. Not available.

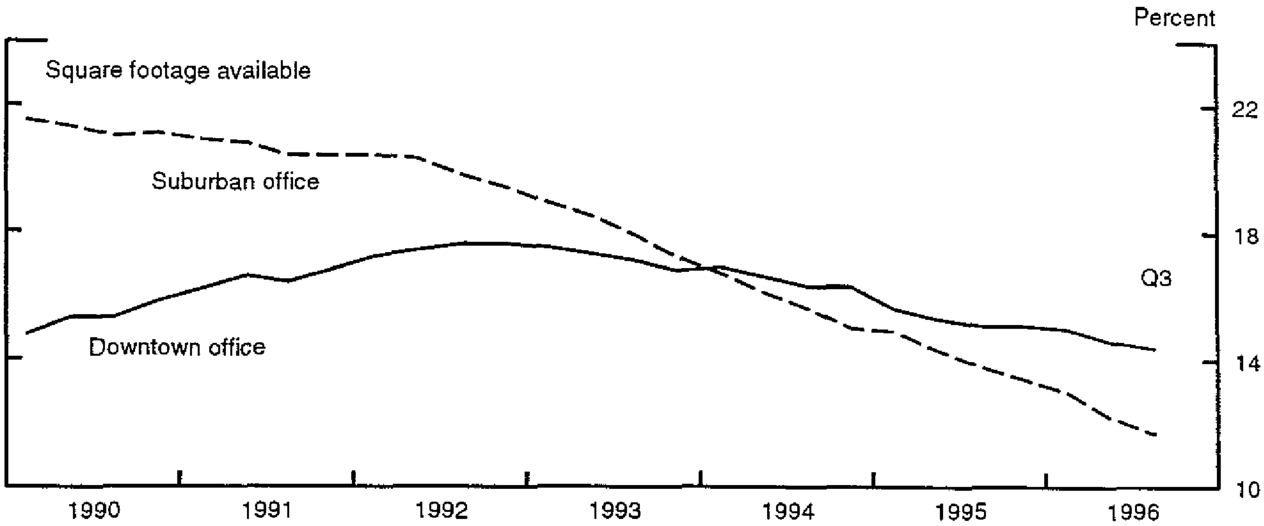
Nonresidential Construction and Contracts
(Six-month moving average)



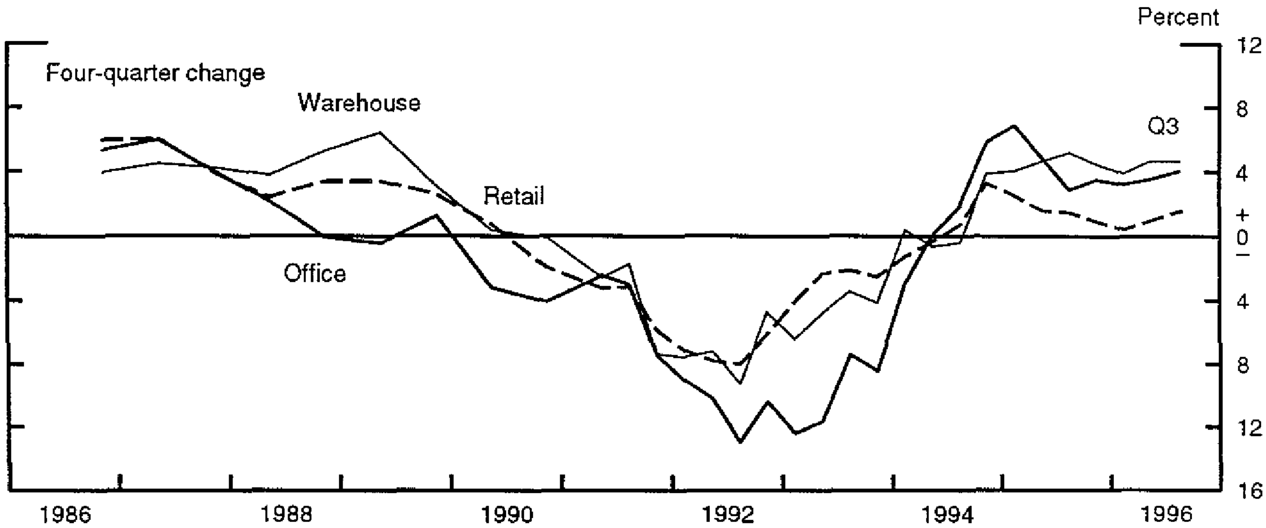
Note. For contracts, total includes private only, while individual sectors include public and private.

Nonresidential Construction Indicators

CB Commercial Vacancy Rates

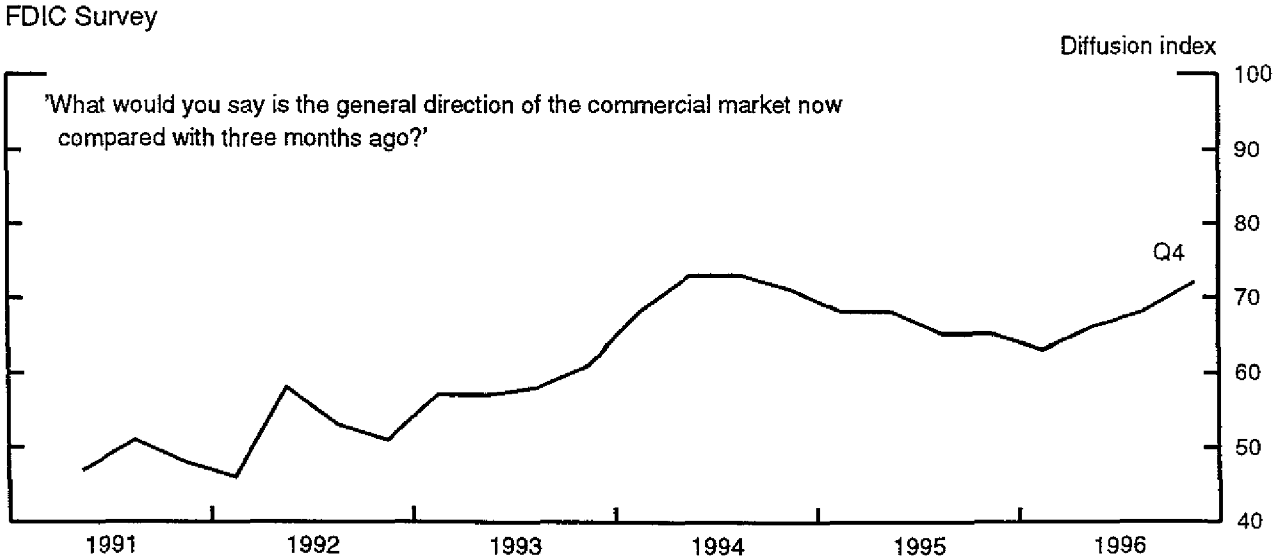


National Real Estate Price Index *



* Data are semiannual from 1986 to 1991, and quarterly from 1992 to present.

FDIC Survey



fourth-quarter PDE: Although shipments of aircraft likely moved up in the fourth quarter, an unusually large fraction of shipments reportedly went to foreign carriers.[8] However, the outlook for domestic deliveries over the next few years continues to be strong, as Boeing has built up an impressive backlog of orders from U.S. carriers.

Outlays for nonresidential structures surged in the first two months of the fourth quarter. Construction put-in-place advanced 2.3 percent during November after increasing 4.3 percent in October. The strong growth was most pronounced in office and institutional construction. Smoothing through the monthly gyrations, contracts for construction also appear to be on a solid uptrend.

Because the data on construction expenditures and contracts are highly variable and large gains may be revised substantially downward, one should be cautious in interpreting sharp movements such as these. However, other indicators of demand have been quite positive for some time, giving credence to the view that the rapid growth in outlays for nonresidential structures in the fourth quarter may be part of a solid uptrend in building. For example, vacancy rates for office buildings in suburban markets have continued to decline. In addition, the National Real Estate Index indicates that transaction prices for both office buildings and warehouses have been rising at around a 4 percent annual rate since early 1994, and the FDIC real estate survey of senior examiners and asset managers reports a very strong assessment of the strength of the commercial market.

Business Inventories

Business inventory investment picked up somewhat early in the fourth quarter. For all manufacturing and trade excluding motor vehicles, inventories, on a book-value basis, expanded at an annual rate of $39 billion in October and November, up from a $22 billion pace during the third quarter. On balance, the increased rate of stock accumulation was accompanied by relatively firm shipments and sales, and inventory-sales ratios for most industries and trade groupings edged lower from their third-quarter levels.

Much of the recent pickup in inventory investment occurred in the manufacturing sector. In book-value terms, factory stocks rose at an annual rate of $17.2 billion in October and $20.1 billion in

8. Of course, the deliveries to foreign carriers will boost net exports in the NIPAs, and the overall effect of the higher shipments will be positive for GDP.

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

	1996			1996		
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Book value basis						
Total	16.7	13.2	36.4	11.9	58.0	7.3
Excluding wholesale and retail motor vehicles	25.0	6.0	22.0	8.5	51.0	26.9
Manufacturing	12.3	-6.2	11.3	12.2	17.2	20.1
Excluding aircraft	6.3	-10.7	8.6	7.1	9.1	12.6
Wholesale	7.3	11.3	-9.2	-22.4	9.7	2.9
Excluding motor vehicles	7.3	7.6	-6.1	-13.4	6.8	1.7
Retail	-2.9	8.2	34.3	22.1	31.0	-15.7
Auto dealers	-8.4	3.5	17.5	12.4	4.1	-20.9
Excluding auto dealers	5.5	4.6	16.8	9.7	26.9	5.2

SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

	Cyclical reference points		Range over preceding 12 months		
	1990-91 high	1994-95 low	High	Low	November 1996
Manufacturing and trade	1.58	1.40	1.44	1.39	1.39
Less wholesale and retail motor vehicles	1.55	1.37	1.41	1.36	1.35
Manufacturing	1.75	1.39	1.46	1.39	1.39
Primary metals	2.08	1.45	1.62	1.56	1.58
Nonelectrical machinery	2.48	1.88	1.94	1.80	1.85
Electrical machinery	2.08	1.52	1.60	1.50	1.47
Transportation equipment	2.94	1.59	1.87	1.65	1.75
Motor vehicles	.97	.53	.67	.55	.57
Aircraft	5.85	4.42	5.95	4.89	5.22
Nondefense capital goods	3.09	2.33	2.58	2.39	2.45
Textile	1.71	1.44	1.66	1.49	1.55
Petroleum	.94	.88	.89	.76	.76
Home goods & apparel	1.96	1.70	1.89	1.70	1.67
Merchant wholesalers	1.36	1.28	1.33	1.27	1.26
Less motor vehicles	1.31	1.26	1.30	1.24	1.23
Durable goods	1.83	1.54	1.64	1.57	1.55
Nondurable goods	.96	.98	1.01	.95	.95
Retail trade	1.61	1.46	1.55	1.48	1.52
Less automotive dealers	1.48	1.42	1.46	1.41	1.45
Automotive dealers	2.21	1.60	1.81	1.64	1.74
General merchandise	2.43	2.21	2.32	2.20	2.27
Apparel	2.56	2.47	2.58	2.35	2.53
G.A.F.	2.44	2.24	2.35	2.23	2.28

November--nearly double the third-quarter pace. A substantial part of the buildup was in stocks of aircraft and parts, which have been trending up over the past year, likely reflecting increases in both work-in-process and materials in anticipation of the further growth in production needed to satisfy the increasing backlog in orders. Changes elsewhere generally were small.

COMPOSITION OF MANUFACTURERS' INVENTORY CHANGES
(Book value, billions of dollars at annual rate, seasonally adjusted)

	1996		1996			
	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Total manufacturing	-6.2	11.3	14.9	12.2	17.2	20.1
Nondefense capital goods	4.3	7.1	9.8	1.3	11.8	14.7
Aircraft & parts	5.2	5.6	7.0	6.6	10.5	8.1
Computer & office equip.	-2.7	-1.2	-2.2	-3.2	-3.3	-.2
Communications equip.	1.3	.9	2.8	.3	1.3	2.2
Construction machinery	.3	.3	.5	0	1.7	.9
Other	-.2	1.6	1.7	-2.4	1.7	3.7
Household durables	-.3	1.7	4.6	3.0	.8	1.0
Home goods & apparel	-1.7	1.4	3.1	3.1	1.1	-.2
Other	-8.5	1.1	-2.7	4.8	3.5	4.6

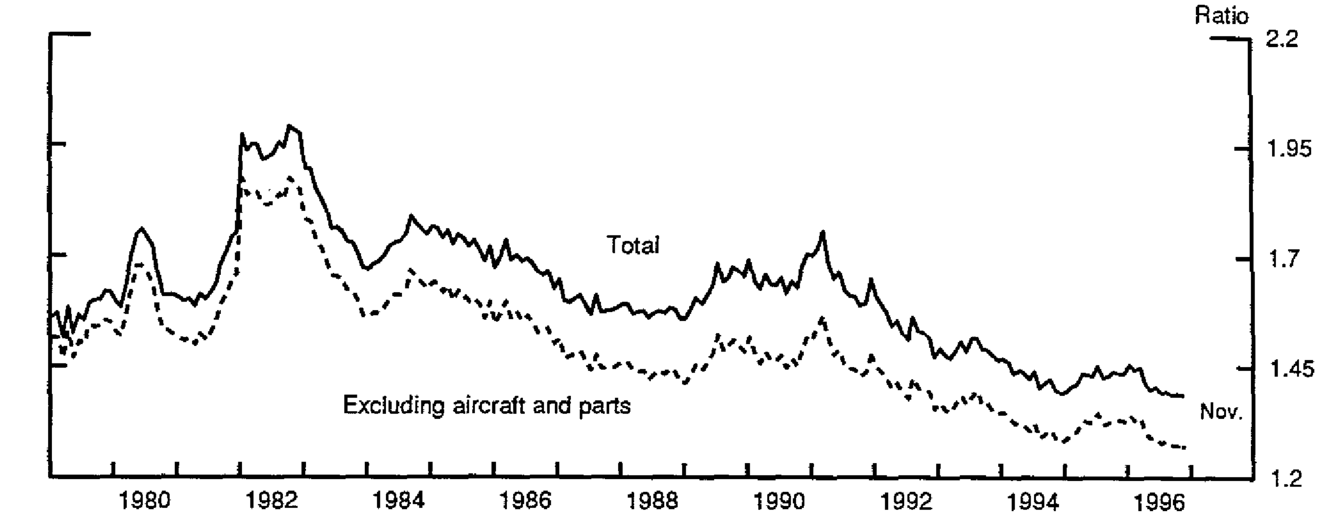
Trade inventories expanded moderately, on net, in October and November. Wholesale inventories, excluding motor vehicles, were up at an annual rate of only $1.7 billion in November after an accumulation of $6.8 billion in October. The relatively modest increases, in book-value terms, were, in part, the result of sharp declines in producers' food prices at the crude and intermediate stages of processing; wholesale inventories may have expanded somewhat more rapidly in real terms. In any event, given that wholesale inventories were drawn down during the third quarter, even the modest accumulation in October and November would contribute positively to the overall rate of economic growth in the fourth quarter. In retail trade, the average rate of buildup in non-auto inventories in October and November was about the same as in the third quarter.

On the whole, the moderate buildup in trade inventories in October and November was about in line with the growth in sales. As a result, neither the retail nor the wholesale trade sector appeared

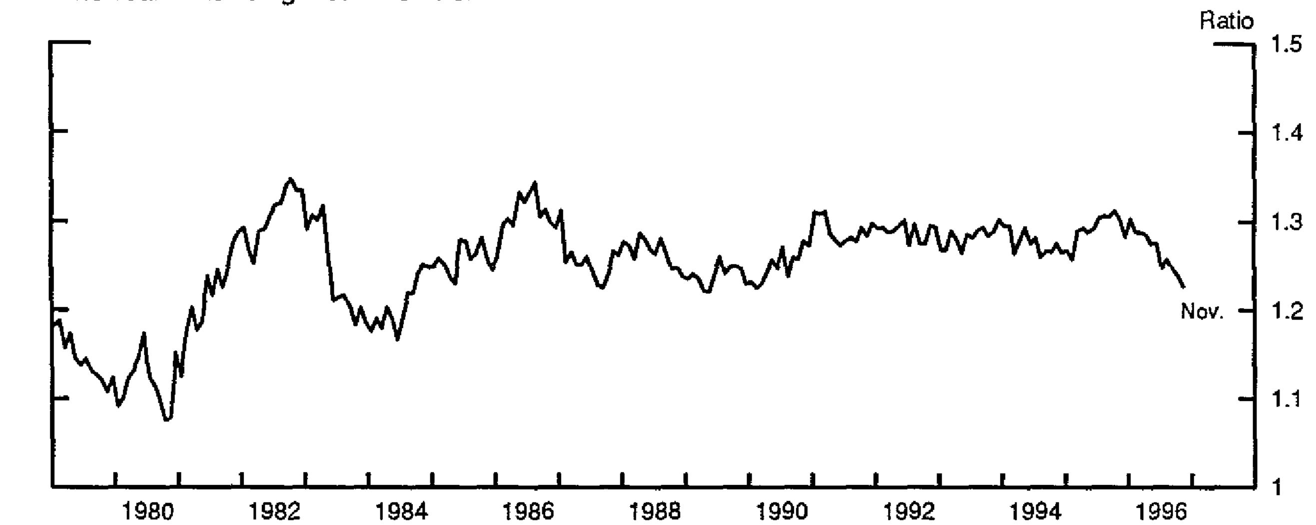
Inventory-Sales Ratios, by Major Sector

(Book value)

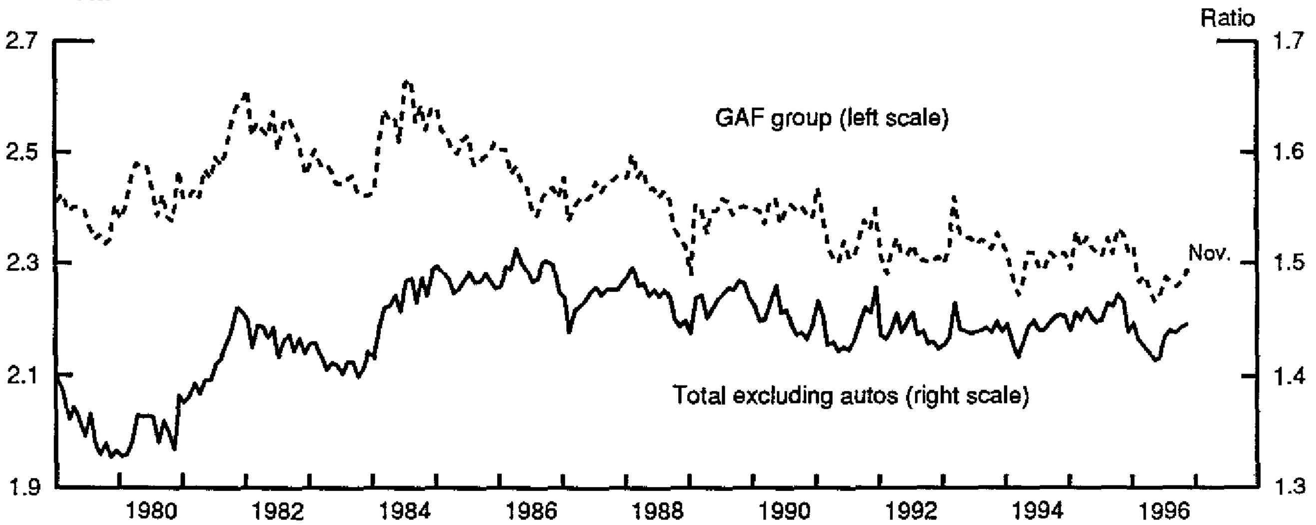
Manufacturing



Wholesale Excluding Motor Vehicles



Retail



to have any serious inventory imbalances as of the end of November.[9]

Federal Sector

For the first fiscal quarter of 1997, the federal government recorded a $59 billion unified budget deficit. Excluding spectrum auction proceeds and deposit insurance, and adjusting outlays for payment timing shifts, the deficit for October through December was $3 billion above a year earlier.[10] Receipts were $22 billion above the first fiscal quarter last year, while adjusted outlays were $25 billion higher than a year ago.

Compared with the same period last year, receipts from individual income taxes were up 11 percent and those from social insurance taxes were 8 percent higher. December contained the last of the four estimated quarterly corporate tax payments on 1996 tax year liabilities. Net corporate receipts in December were only $1 billion (2 percent) above a year ago. However, for the year as a whole, quarterly declarations on 1996 corporate liabilities were about $10 billion above those in 1995, which is roughly consistent with profits growth.

Contributing to the spurt in outlays was increased spending for Medicare, which was almost 12 percent above a year earlier. Medicaid expenditures were up more than 7 percent compared with last year, considerably above the restrained 3 percent increase seen in fiscal year 1996. Spending for defense rose 5 percent, while outlays for nondefense items other than social insurance programs (social security, health, income security) and net interest surged 15 percent. In the first fiscal quarter last year, these defense and nondefense outlays were held down significantly by a restrictive continuing resolution that funded programs covered by unpassed appropriations bills.

The Congressional Budget Office (CBO) released The Economic and Budget Outlook: Fiscal Years 1998-2007 on January 28. In the absence of legislative changes, CBO projects the fiscal 1997 unified federal budget deficit to be $124 billion, a $17 billion increase

9. The large accumulation of apparel inventories in November was probably unintended, as apparel sales dropped precipitously in that month and the inventory-sales ratio for apparel stores soared. However, apparel sales rebounded strongly in December according to the advance retail sales data, and retail apparel inventories were probably back in line with sales at year-end.

10. Deposit insurance proceeds included a $4.5 billion one-time assessment for capitalizing SAIF in November. Spectrum auction proceeds of $3.6 billion were recorded in December.

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

	December		Fiscal year totals			
	1995	1996	1996	1997	Dollar change	Percent change
Outlays	133.1	129.1	379.9	404.8	24.9	6.6
Deposit insurance (DI)	-.8	-.7	-2.7	-6.4	-3.7	136.1
Spectrum auction (SA)	.0	-3.6	.0	-3.6	-3.6	N.A.
Other	133.8	133.5	382.6	414.8	32.2	8.4
Receipts	138.3	148.5	324.1	346.0	21.9	6.8
Deficit (+)	-5.3	-19.4	55.7	58.8	3.0	5.4
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	126.8	133.5	382.6	407.7	25.1	6.6
National defense	23.3	23.1	64.7	68.2	3.5	5.3
Net interest	19.9	20.0	59.6	61.6	2.1	3.5
Social security	28.5	29.6	84.5	88.4	3.9	4.6
Medicare	13.4	15.2	41.5	46.3	4.8	11.5
Medicaid	6.7	8.3	22.0	23.7	1.6	7.4
Other health	1.9	2.3	6.5	7.3	.9	13.7
Income security	17.6	17.3	52.3	52.9	.7	1.3
Other	15.5	17.8	51.6	59.3	7.7	15.0
Receipts	138.3	148.5	324.1	346.0	21.9	6.8
Individual	53.2	59.4	144.5	159.8	15.2	10.5
Withheld	50.6	52.7	137.5	148.5	11.1	8.1
Nonwithheld	3.2	7.6	11.1	15.2	4.1	36.9
Refunds (-)	.6	.9	4.0	4.5	.4	10.9
Social insurance taxes	37.8	40.7	108.1	116.7	8.7	8.0
Corporate	38.0	39.0	41.9	42.2	.3	.6
Other	9.4	9.4	29.6	27.3	-2.3	-7.7
Deficit(+)	-11.6	-15.0	58.5	61.7	3.2	5.5

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.

relative to fiscal 1996. The deficit, assuming current policy, is projected to dip slightly to $120 billion in fiscal 1998 but to rise to $188 billion by fiscal 2002. It would rise steadily thereafter, reaching $278 billion in fiscal 2007.

Although the deficit is projected to be $188 billion in fiscal 2002, CBO estimates that legislative changes need to produce only $154 billion in savings (including associated debt service savings) to balance the budget by that year. This is because CBO is projecting a $34 billion "fiscal dividend" for that year if a balanced budget policy were adopted. The fiscal dividend is CBO's estimate of the budget consequences--reflecting lower interest rates and slightly higher output growth--that would stem from achieving a balanced budget in fiscal 2002 and maintaining that balance in subsequent years. CBO projects that maintaining budget balance after fiscal 2002 would require further legislated budget savings in subsequent years.

CBO's projections of the deficit, assuming current policy, are significantly below its last long-run projections published in May 1996. In the near term, the deficit for fiscal 1997 is projected to be $47 billion below CBO's estimate last May, and its deficit estimate for fiscal 1998 is $74 billion lower. A significant technical factor contributing to CBO's improved deficit outlook is its substantially lower projected growth rates for Medicaid and Medicare spending. The enactment of farm and welfare reform legislation in 1996 are additional sources of lower expected future spending.

Higher projected receipts also account for a substantial part of the reduction in CBO's deficit outlook. Their new economic projections show corporate profits and wages and salaries representing a larger share of nominal GDP, thereby pushing the tax base higher and boosting revenues. Relative to last May, CBO's expected real GDP growth for calendar 1997 is somewhat higher, its inflation is slightly lower, and unemployment is lower; however, these factors contribute only marginally to CBO's lower deficit projections. Their longer-term projections for real growth, inflation, and unemployment are little changed from last May.

<u>State and Local Governments</u>

State and local spending appears to have increased appreciably in the fourth quarter. Most of the strength was due to a large jump in real construction outlays in November, to a level more than

CBO BUDGET AND ECONOMIC PROJECTIONS

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
		Budget projections assuming current policy[1] (Billions of dollars; fiscal years)										
	actual											
Outlays	1560	1632	1687	1781	1877	1948	2049	2145	2252	2381	2492	2611
Receipts	1453	1507	1567	1634	1705	1781	1860	1943	2033	2127	2227	2333
Deficit	107	124	120	147	171	167	188	202	219	254	266	278
memoranda:												
Deficit with fiscal dividend[2]	--	124	119	143	158	143	154	160	170	198	203	208
Deficit, CBO May 1996 projections[3]	144	171	194	219	244	259	285	311	342	376	403	---
		Economic projections assuming current policy[1] (Calendar years)										
		Percentage change, year over year										
Nominal GDP	4.4	4.6	4.6	4.9	4.8	4.8	4.7	4.7	4.6	4.6	4.6	4.6
Real GDP	2.3	2.3	2.0	2.2	2.1	2.1	2.1	2.0	2.0	2.0	1.9	1.9
CPI-U	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0	3.1	3.1	3.1
		Percent, annual average										
Unemploy. rate	5.4	5.3	5.6	5.8	5.9	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Treasury yields:												
Three-month	5.0	5.0	5.0	4.9	4.7	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-year	6.4	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2

1. These projections assume that revenues and outlays evolve according to laws in effect when the projections were made. Discretionary spending is assumed to equal the cap in 1998 and to grow from that level at the rate of inflation in later years. The budget figures for fiscal 1996 are actual data. The economic estimates for 1996 incorporate published data (as of 11/27/96) for the first three quarters of 1996.
2. These projections use economic assumptions that are consistent with the budget achieving balance in fiscal 2002 and maintaining that balance in subsequent years.
3. CBO projections from its previous long-run forecast in The Economic and Budget Outlook, Fiscal Years 1997-2006, May 1996.

Source. Congressional Budget Office, The Economic and Budget Outlook, Fiscal Years 1998-2007, January 28, 1997.

6 percent above the third-quarter average.[11] The largest gains were in spending on educational and other buildings. Meanwhile, the rise in employment in December was not enough to offset the three preceding months of declines, and the level of state and local employment in the fourth quarter stood a bit below the third-quarter average.

A December survey of the states by the National Conference of State Legislatures suggests that the fiscal position of most states continues to be good. Most states expect revenue collections to be on or above target through the remainder of fiscal 1997, which ends on June 30; only Hawaii and Idaho expect a decline. The key fiscal issues facing the legislatures in the sessions just getting under way are implementing welfare reform, funding primary and secondary education and corrections, enacting tax cuts, and addressing Medicaid requirements.

Labor Costs and Prices

The latest data on wages and compensation give evidence of the pressures in the labor market. According to the employment cost index (ECI), hourly compensation of private industry workers rose 3.1 percent over the course of 1996, up from a 2.6 percent gain over 1995.[12] Hourly costs for wages and salaries accelerated more than overall compensation, from 2.8 percent over 1995 to 3.4 percent over 1996. Wages picked up relatively sharply in retail trade, the industry with the largest concentration of minimum-wage workers. Our estimate is that the hike in the minimum wage added one-tenth of a percentage point to the overall ECI compensation increase last year.

The ECI for benefits was up 2 percent over 1996, versus 2.2 percent in 1995 and 3.7 percent in 1994. Much of the slowing in benefits cost growth in recent years has been due to health insurance costs--which decelerated from about 4 percent in 1994 to about 1/2 percent in 1996. However, profit margins, at least of HMOs, are said to be squeezed, and there are some reports that health insurance costs may begin to turn less favorable.

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11. The data on construction expenditures, however, are highly volatile and often undergo substantial revisions.

12. There was some speculation in financial markets that the published fourth-quarter ECI estimate for financial industries contained an error and would be revised in the next release. BLS analysts we spoke with indicated that the figure accurately reflected the survey responses, although they did caution that the quarterly estimates for that industry are quite variable.

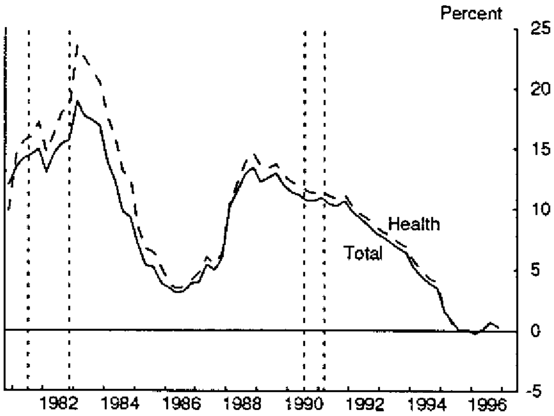
EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1995	1996			
	Dec.	Mar.	June	Sept.	Dec.
	-----Quarterly percent change------- (compound annual rate)				
Total hourly compensation[1]	2.6	2.9	3.2	2.5	3.1
Wages and salaries	2.6	4.3	3.6	2.6	2.9
Benefit costs	2.1	-0.3	2.7	2.7	2.9
By industry					
Construction	3.0	2.6	2.3	1.0	3.9
Manufacturing	3.2	1.9	3.8	3.4	2.8
Transportation and public utilities	3.2	1.9	2.5	2.5	5.0
Wholesale trade	3.5	1.6	4.1	2.8	3.7
Retail trade	2.3	6.0	-1.0	4.6	5.8
FIRE	1.3	4.6	5.9	1.3	-2.2
Services	1.9	3.4	3.7	2.5	2.7
By occupation					
White-collar	2.5	3.5	3.1	3.4	2.8
Blue-collar	2.6	2.2	3.2	1.6	3.8
Service occupations	0.3	1.3	2.6	2.6	4.8
Memo:					
State and local governments	2.8	2.5	2.8	1.8	3.4
	-----Twelve-month percent change----				
Total hourly compensation	2.6	2.7	2.9	2.9	3.1
Excluding sales workers	2.6	2.6	2.8	2.9	2.9
Wages and salaries	2.8	3.2	3.4	3.3	3.4
Excluding sales workers	2.8	3.1	3.2	3.4	3.3
Benefit costs	2.2	1.6	1.7	1.8	2.0
By industry					
Construction	2.2	2.6	2.7	2.3	2.4
Manufacturing	2.6	2.5	2.8	3.1	3.0
Transportation and public utilities	3.7	3.1	3.0	2.6	3.0
Wholesale trade	4.5	3.5	3.6	3.0	3.1
Retail trade	2.2	3.0	2.5	2.9	3.8
FIRE	3.5	3.6	3.7	3.3	2.4
Services	2.2	2.5	2.7	2.9	3.1
By occupation					
White-collar	2.8	3.0	3.0	3.2	3.2
Blue-collar	2.4	2.5	2.6	2.4	2.7
Service occupations	1.9	1.9	2.0	2.2	3.0
Memo:					
State and local governments	2.9	2.8	2.6	2.5	2.6

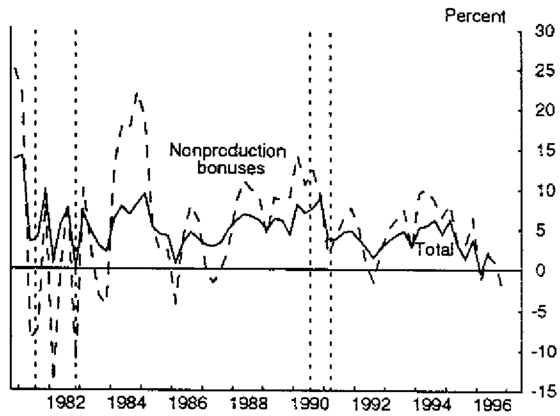
1. Seasonally adjusted by the BLS.

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

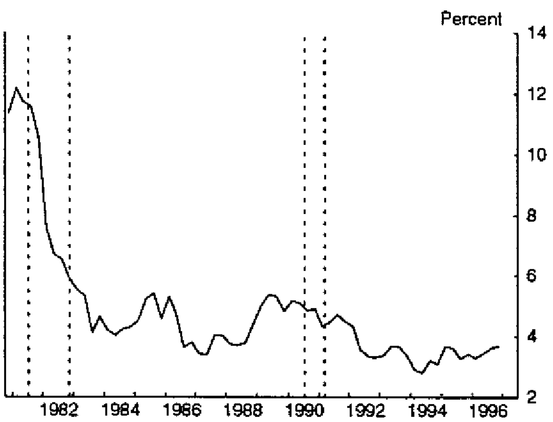
Insurance Costs



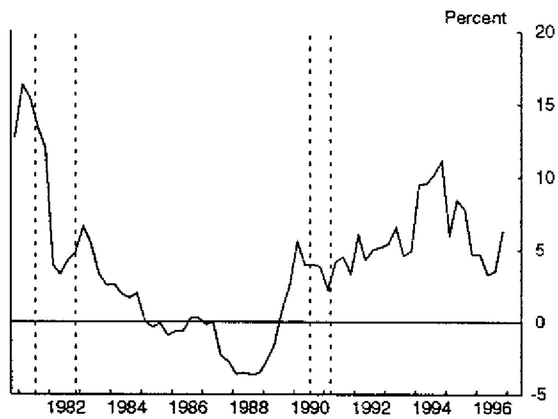
Supplemental Pay



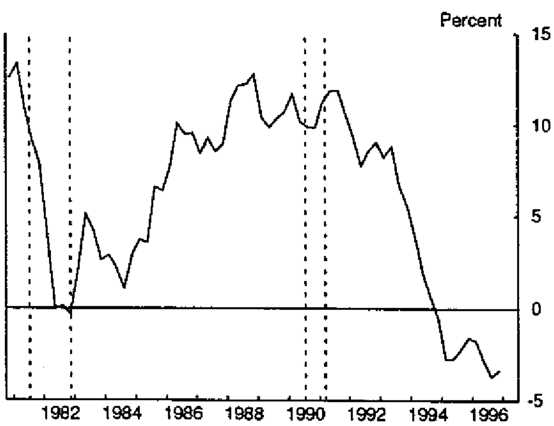
Paid Leave



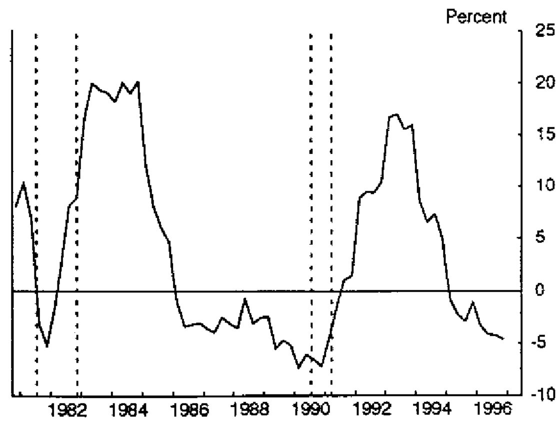
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996		1996	
	Dec. 1995	Dec. 1996	Q3	Q4	Nov.	Dec.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.5	3.3	2.3	3.1	0.3	0.3
Food (15.8)	2.1	4.3	5.6	5.2	0.3	0.1
Energy (6.7)	-1.3	8.6	-7.4	7.6	1.2	1.6
CPI less food and energy (77.5)	3.0	2.6	2.4	2.7	0.2	0.1
Commodities (23.9)	1.7	1.1	0.1	1.3	0.1	0.1
New vehicles (5.0)	1.9	1.8	3.2	0.5	-0.1	.0
Used cars (1.3)	4.4	-1.6	-4.1	-1.6	-0.4	-0.2
Apparel (5.0)	-0.1	-0.5	-4.8	2.8	0.5	0.1
Services (53.6)	3.6	3.3	3.6	2.9	0.2	0.2
Owners' equivalent rent (19.7)	3.7	2.8	2.7	3.0	0.3	0.2
Tenants' rent (5.8)	2.5	2.8	3.0	2.7	0.2	0.2
Medical care (6.1)	4.4	3.2	3.3	2.8	0.4	0.3
Auto finance charges (0.6)	2.0	-2.0	13.7	-1.2	-1.2	-1.1
PPI						
Finished goods (100.0)[2]	2.3	2.8	1.5	4.2	0.4	0.5
Finished consumer foods (23.4)	1.9	3.4	8.3	4.8	-0.1	-0.1
Finished energy (13.4)	1.1	12.0	-7.0	21.2	2.3	3.1
Finished goods less food and energy (63.2)	2.6	0.6	1.2	0.1	0.1	0.1
Consumer goods (38.5)	2.8	0.7	1.1	0.4	.0	0.2
Capital equipment (24.7)	2.2	0.5	1.0	-0.0	0.3	0.1
Intermediate materials (100)[3]	3.3	0.8	-0.9	1.9	0.2	0.4
Intermediate materials less food and energy (82.6)	3.2	-0.9	-0.6	0.4	0.1	0.1
Crude materials (100)[4]	5.5	12.2	4.8	1.5	1.8	4.2
Crude food materials (44.7)	12.9	-0.9	17.0	-28.3	-1.9	-4.3
Crude energy (31.4)	3.7	43.2	-1.8	54.7	7.7	16.5
Crude materials less food and energy (23.9)	-4.2	-5.6	-8.0	2.6	-0.3	0.2

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.

The acceleration in average hourly earnings of production or nonsupervisory workers has been more pronounced than has the rise in wages and salaries for comparable workers in the ECI. In December, average hourly earnings stood 4 percent above their year-earlier level--a full percentage point faster growth than over 1995. The chain-weighted average hourly earnings measure also has accelerated about 1 percentage point over the past year, suggesting that changes in the industrial composition of the work force have not contributed to the acceleration in the published average hourly earnings series. However, given the increase in the average workweek between December 1995 and December 1996, some of the acceleration in average hourly earnings may be due to an increase in overtime hours--which is not counted as an increase in compensation rates in the ECI.

In addition to labor cost pressures, there have been substantial increases in energy prices. The CPI for energy rose 1.6 percent in December, bringing the rise in 1996 to 8.6 percent. December's sizable increases in the prices of gasoline and heating oil reflected rising crude oil prices and continued low inventories. Although stocks of gasoline remained rather low in early January, refiners have been able to boost inventories of heating oil considerably in recent weeks, and these stocks now stand close to year-earlier levels. Still, with the unusually cold weather in Europe spurring demand, the energy price situation is unlikely to improve markedly in the near future.

Non-energy price increases have been quite modest of late. Consumer food prices were up 0.1 percent in December, after a 0.3 percent increase in November and larger increases in preceding months. At earlier stages of processing, the PPI for crude foodstuffs and feedstuffs declined again in December and has now completely reversed its run-up earlier in the year. The recent freeze in Florida will probably result in a temporary run-up in fresh fruit and vegetable prices. The CPI excluding food and energy also rose only 0.1 percent in December, as small price increases were widespread. Prices of new vehicles were unchanged in December, and apparel prices rose 0.1 percent on a seasonally adjusted basis following larger increases in the preceding three months.

Over the year as a whole, core consumer prices increased 2.6 percent, down from a 3 percent rise over 1995 and the same as the increase over 1994. A similar deceleration occurred in core PCE prices, which we estimate to have slowed to a 2 percent rate of

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1993 Q4	1994 Q4	1995 Q4	1996 Q4
<u>Product prices</u>				
GDP chain price index[1]	2.5	2.3	2.5	2.2
GDP deflator[1]	2.5	2.3	2.5	2.0
Nonfarm business chain price index[1,2]	2.4	2.4	2.0	2.1
<u>Expenditure Prices</u>				
Gross domestic purchases chain price index[1]	2.3	2.4	2.3	2.2
Less food and energy[1]	2.5	2.4	2.5	1.8
PCE chain price index[1]	2.4	2.5	2.1	2.5
Less food and energy[1]	2.6	2.6	2.3	2.0
PCE deflator[1]	2.4	2.5	2.1	2.3
Less food and energy[1]	2.7	2.6	2.3	1.8
CPI	2.7	2.6	2.7	3.1
Less food and energy	3.1	2.8	3.0	2.6
Median CPI	2.8	3.0	3.3	2.9

1. 1996:Q4 value is staff estimate.
2. Excludes housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan (1-year) Mean[2]	University of Michigan (1-year) Median[3]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1995-Q1	2.8	4.1	3.1	4.2	3.3
Q2	3.1	4.1	3.1	4.2	3.4
Q3	2.6	3.9	2.9	4.0	3.2
Q4	2.7	3.6	2.8	3.9	3.0
1996-Jan.	2.7	4.0	2.9	4.1	
Feb.	2.7	3.6	2.8	4.0	
Mar.	2.8	4.2	2.9	4.1	3.0
Apr.	2.9	4.5	3.0	4.2	
May	2.9	4.9	3.0	4.5	
Jun	2.8	4.2	2.9	4.3	3.0
Jul	3.0	4.3	2.9	4.2	
Aug.	2.9	4.1	3.0	4.3	
Sept.	3.0	4.3	3.2	4.4	3.0
Oct.	3.0	4.2	3.0	4.3	
Nov.	3.3	4.0	3.0	4.3	
Dec.	3.3	3.9	3.0	4.1	3.0
1997-Jan.		3.9	3.0	4.3	

1. CPI; percent change from the same period in the prior year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Compiled by the Federal Reserve Bank of Philadelphia.

increase over 1996. The comparatively small rise in core PCE prices relative to the core CPI can be attributed to a variety of factors, but the most important is the difference in how the two indexes treat prices of medical services. Unlike most components of PCE, medical prices do not use the CPI as source data; rather, PCE medical prices are based on PPIs that attempt to price a treatment path rather than inputs, and these prices have increased more slowly than the CPI for medical services. (The CPI is about to change its method for measuring hospital prices--but not doctors' services--toward the treatment-path approach.) In addition, medical services have a much larger weight in PCE than in the CPI--the latter only includes out-of-pocket medical care costs--which magnifies the effect of the price slowdown in the PCE index.

Unlike the core consumption price measures, increases in both the overall PCE chain price index and the overall CPI accelerated over the past year, reflecting the sizable increases in both food and energy prices. However, price increases for investment goods, exports, and government purchases all slowed last year, and we estimate that the GDP chain-type price index increased 2-1/4 percent over 1996, down a bit from 2-1/2 percent over 1995.

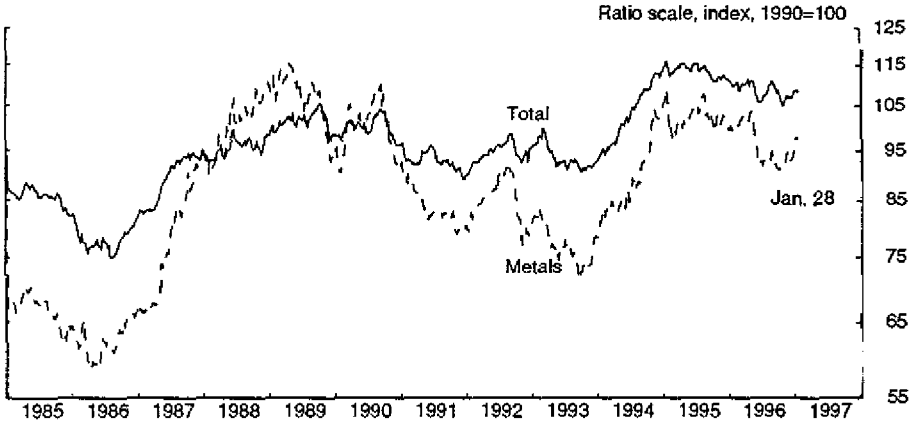
Prices of intermediate goods have yet to show the effects of the higher energy prices. As measured by the producer price index, increases in prices of energy-intensive intermediate goods, such as plastics and chemicals, have been moderate of late. Similarly, energy-intensive intermediate goods have not been prominent on the purchasing managers lists of goods whose prices are increasing.

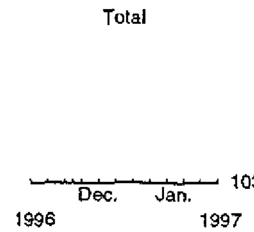
Nor has the energy-driven acceleration in the overall CPI led to rising inflationary expectations. Indeed, the mean expected price increase over the next twelve months, as measured by the Michigan survey, is now running a bit lower than it was six months ago, and the median expected price increase is about unchanged from six months ago. Similarly, the Conference Board's survey of inflation expectations over the next twelve months and the Philadelphia Fed's survey of inflation expectations over the next ten years have remained flat in recent months.

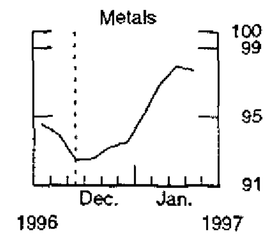
Prices of spot commodities have generally increased in recent weeks. Prices of many metals--especially steel scrap--have firmed of late, and the Journal of Commerce index of industrial materials is up about 1-1/2 percent since the last Greenbook. However, most farm commodity prices have remained low recently. The PPI for crude

Commodity Price Measures

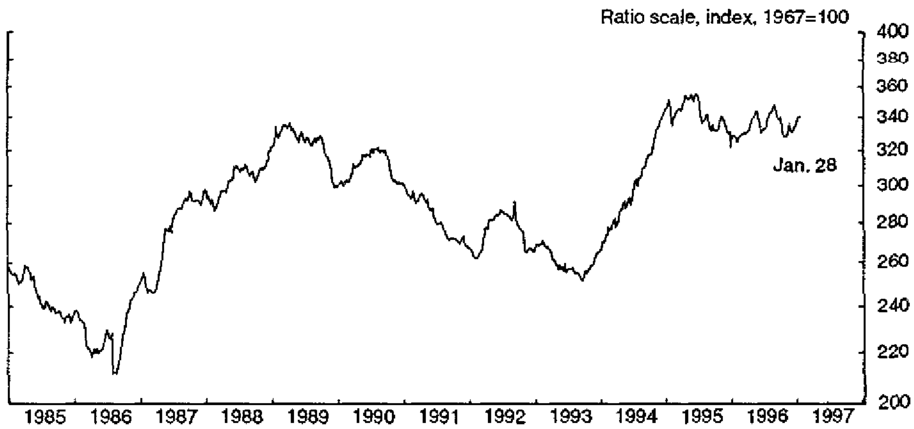
Journal of Commerce Index

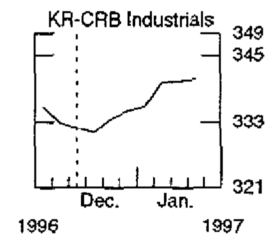




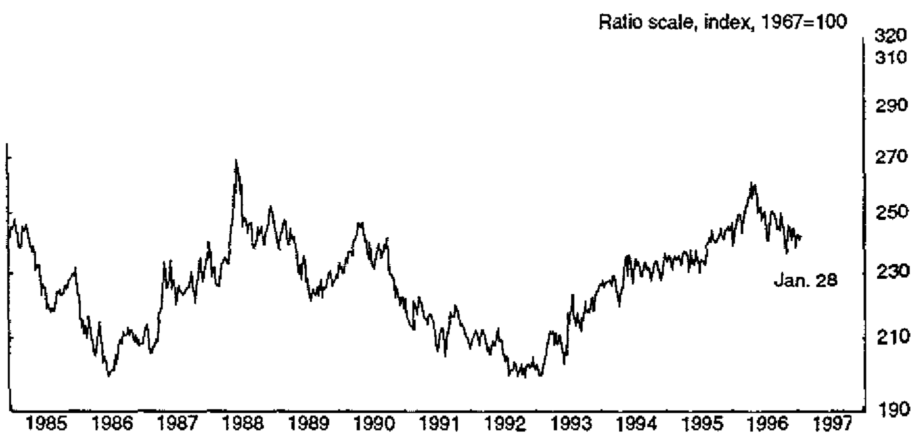


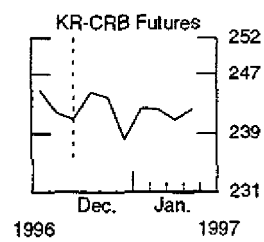
KR-CRB Spot Industrials





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 CIBCR, 1994.

materials less food and energy moved up in December but remains more than 5 percent below its year-earlier level.

DOMESTIC FINANCIAL DEVELOPMENTS

Selected Financial Market Quotations[1]
(Percent except as noted)

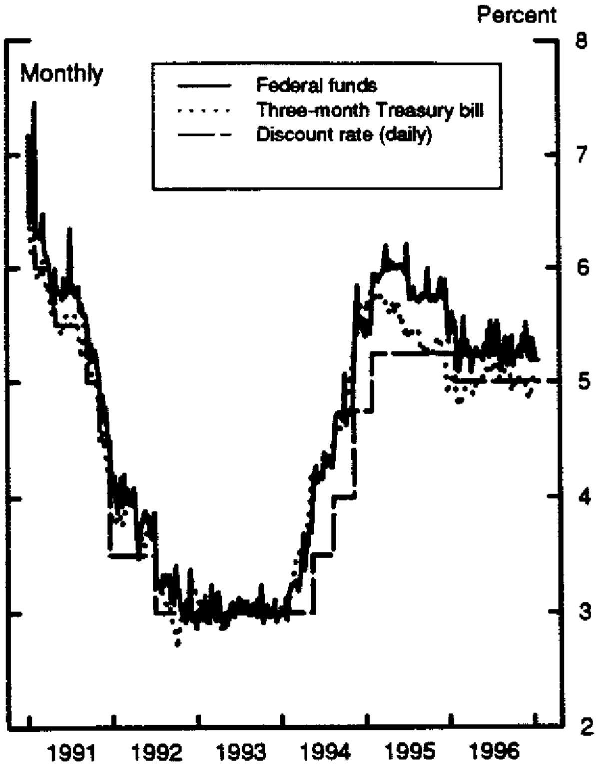
Instrument	1996 Feb. low	1996 July high	1996 FOMC,* Dec. 17	1997 Jan. 28	Change to Jan. 28, from: Feb. low	July high	FOMC, Dec. 17
Short-term rates							
Federal funds[2]	5.15	5.39	5.27	5.20	.05	-.19	-.07
Treasury bills[3]							
3-month	4.76	5.21	4.86	5.04	.28	-.17	.18
6-month	4.67	5.40	5.03	5.10	.43	-.30	.07
1-year	4.55	5.64	5.20	5.29	.74	-.35	.09
Commercial paper							
1-month	5.27	5.50	5.65	5.43	.16	-.07	-.22
3-month	5.12	5.59	5.48	5.45	.33	-.14	-.03
Large negotiable CDs[3]							
1-month	5.21	5.44	5.52	5.34	.13	-.10	-.18
3-month	5.12	5.59	5.43	5.42	.30	-.17	-.01
6-month	4.99	5.83	5.49	5.53	.54	-.30	.04
Eurodollar deposits[4]							
1-month	5.13	5.38	5.50	5.31	.18	-.07	-.19
3-month	5.13	5.56	5.44	5.44	.31	-.12	.00
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	6.62	5.95	6.19	1.21	-.43	.24
10-year	5.58	7.06	6.39	6.64	1.06	-.42	.25
30-year	6.02	7.19	6.63	6.91	.89	-.28	.28
Municipal revenue (Bond Buyer)[5]	5.67	6.24	5.93	6.00	.33	-.24	.07
Corporate-A utility, recently offered	7.18	8.23	7.67	8.02	.84	-.21	.35
High-yield corporate[6]	9.57	10.36	9.76	9.72	.15	-.64	-.04
Home mortgages[7]							
FHLMC 30-yr fixed rate	6.94	8.42	7.57	7.85	.91	-.57	.28
FHLMC 1-yr adjustable rate	5.19	6.01	5.52	5.57	.38	-.44	.05

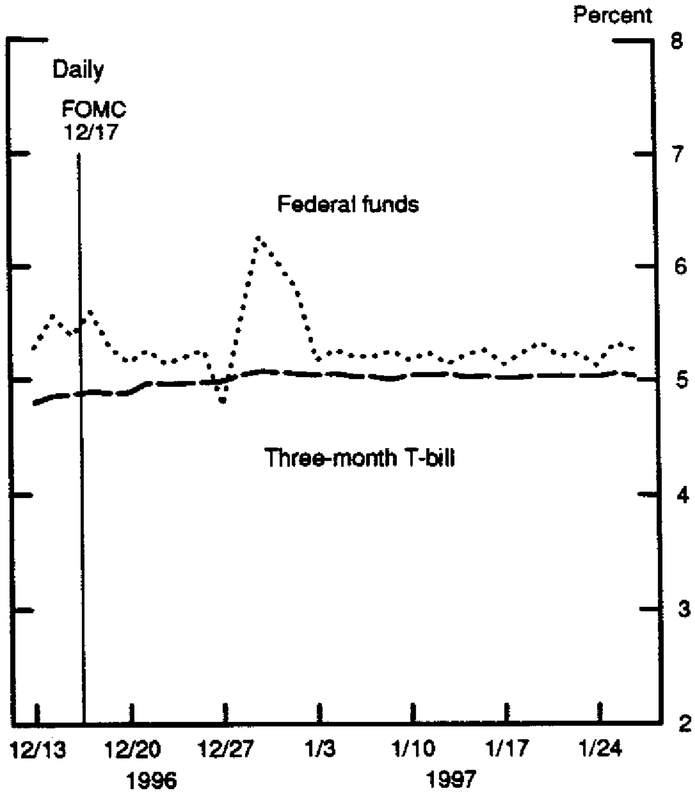
Stock exchange index	Record high Level	Record high Date	1996 July low	1996 FOMC,* Dec. 17	1997 Jan. 28	Percentage change to Jan 28, from: Record high	July low	FOMC, Dec. 17
Dow-Jones Industrial	6883.90	1/21/97	5346.55	6268.35	6656.08	-3.31	24.49	6.19
S&P 500 Composite	786.23	1/22/97	626.65	720.98	765.02	-2.70	22.08	6.11
NASDAQ (OTC)	1388.06	1/22/97	1042.37	1260.98	1354.37	-2.43	29.93	7.41
Russell 2000	370.65	1/22/97	307.78	350.48	366.47	-.68	19.61	4.56
Wilshire	7594.85	1/22/97	6099.34	6998.62	7414.93	-2.37	21.57	5.95

1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average to date for maintenance period ending January 29, 1997.
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.
* Figures cited are as of the close on December 16.

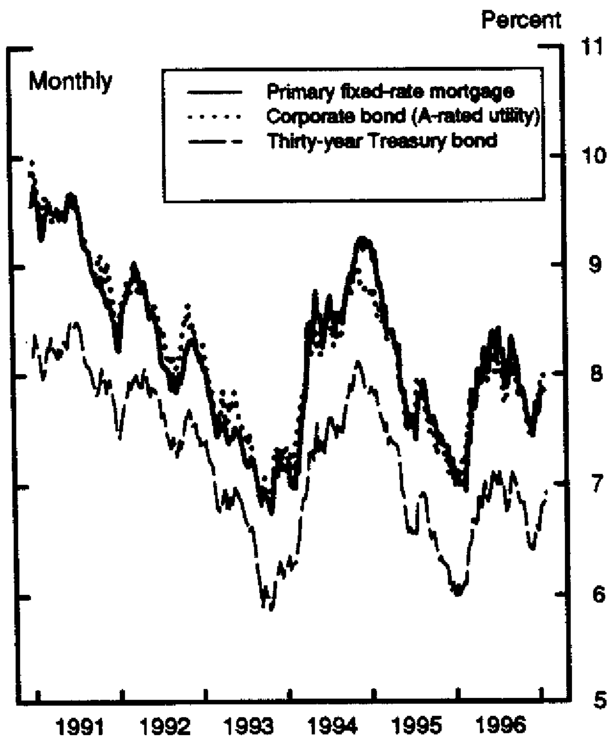
Selected Interest Rates

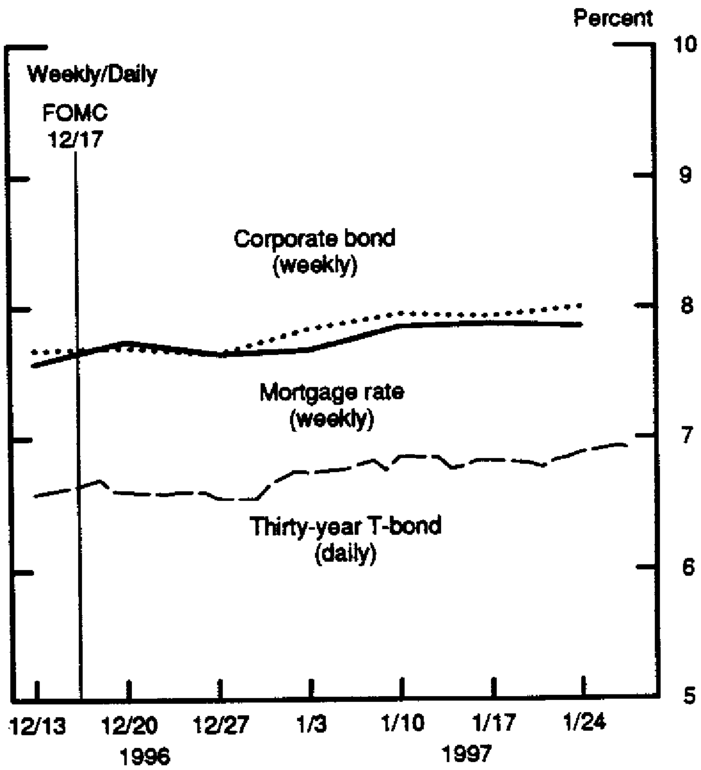
Short-Term





Long-Term





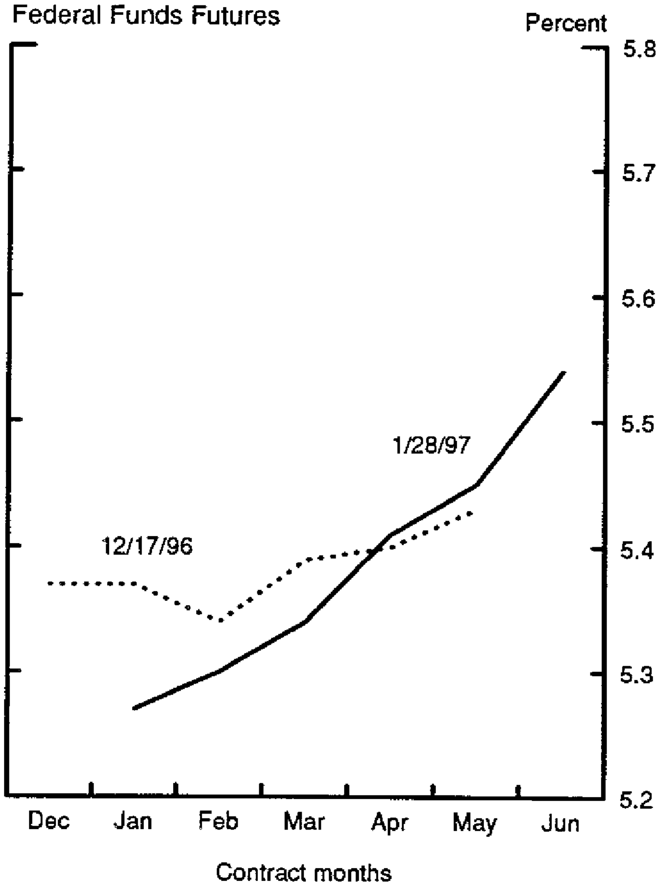
Since the December FOMC meeting, most readings on the strength of economic activity have exceeded expectations, putting upward pressure on interest rates. Although better-than-expected inflation reports and an appreciating dollar have tempered the rise, long-term rates still have increased about a quarter percentage point over the intermeeting period. The thirty-year Treasury yield has reached 6.9 percent--more than a half point above its recent low at the end of November. Changes in short-term rates were mixed since mid-December: Treasury bill rates increased modestly, while private rates fell as the year-end premium disappeared. Quotes for federal funds futures contracts continue to suggest that market participants expect the Federal Reserve to hold policy unchanged at the February FOMC meeting, but the perceived odds of a tightening by the spring have moved up a shade.

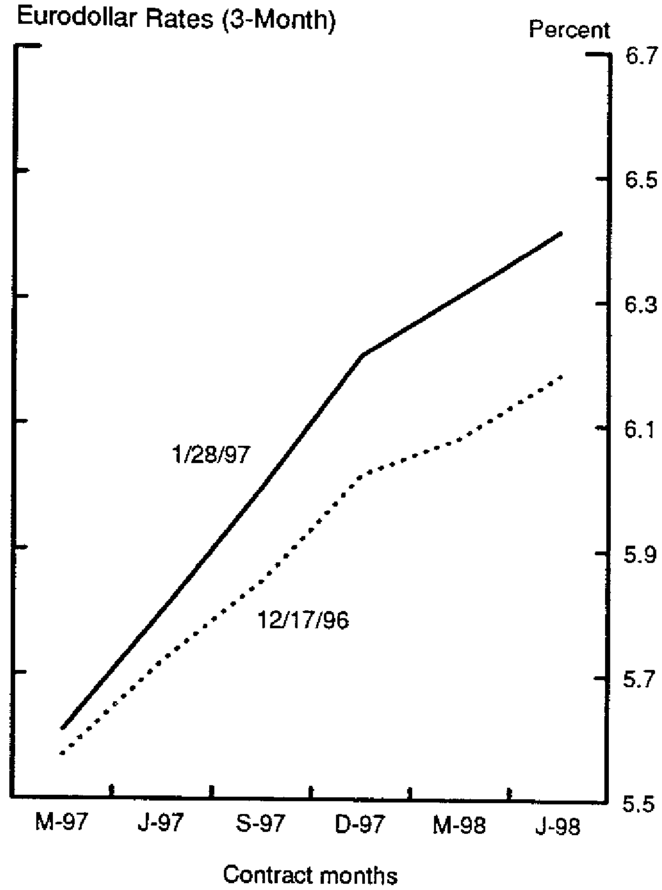
Despite the increase in long-term interest rates, stocks have risen on net during the intermeeting period in reaction to surprisingly strong news on fourth-quarter earnings. Major stock indexes have increased 4 to 8 percent. Although the sharpest gains have been recorded for large companies, indexes that include the stocks of smaller firms, such as the Russell 2000, also set new highs through mid-January.

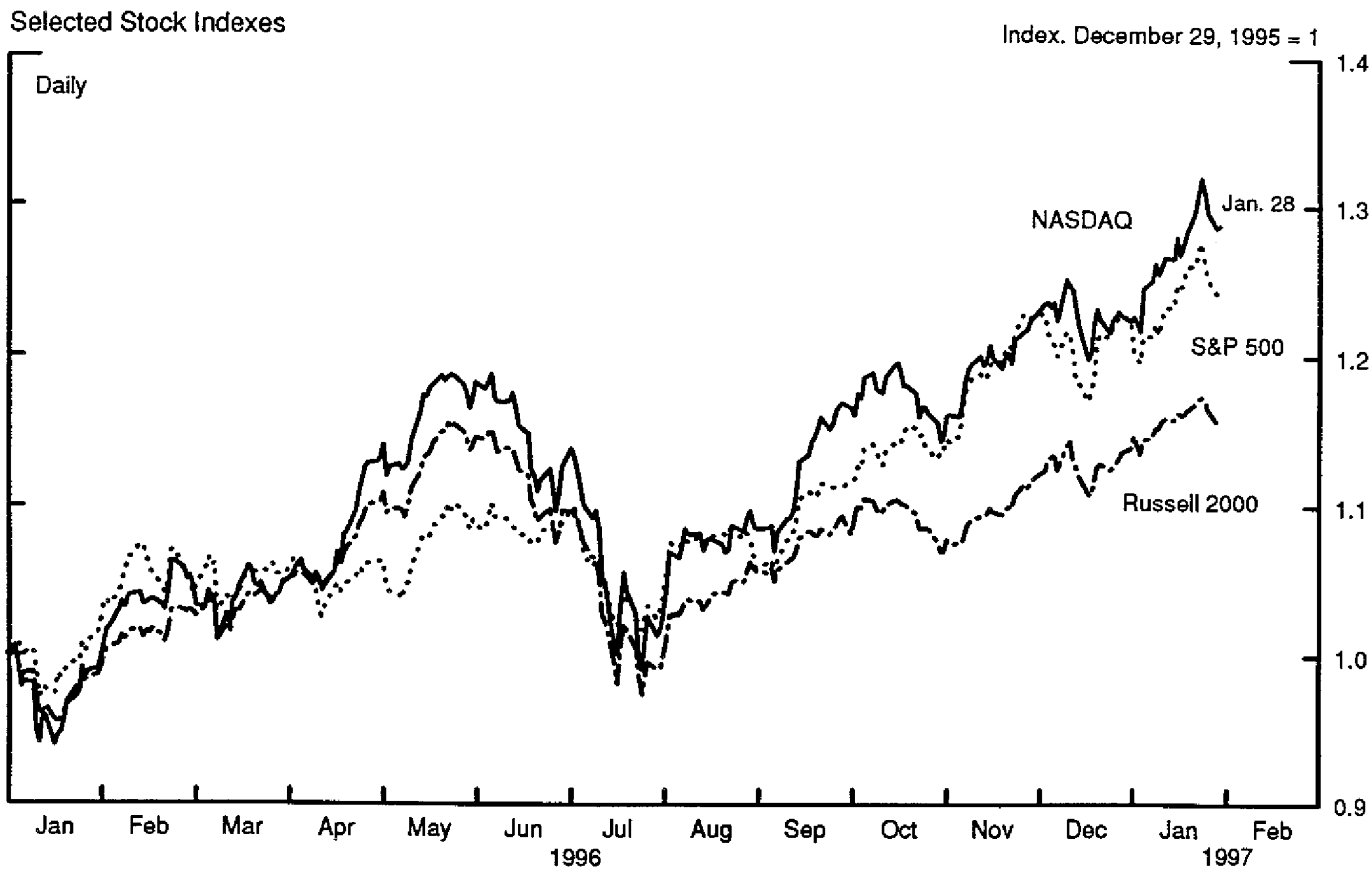
For the most part, financial intermediaries and the markets appear willing to provide financing on very favorable terms. The elevated price-earnings ratios in stock markets have kept equity a cheap source of finance, and spreads on junk bonds have narrowed further from already low levels. Recent survey data indicate that banks have continued to ease slightly underwriting standards on business loans and, more notably, terms. Although banks have tightened their standards for issuing credit cards, home equity loans have been promoted more heavily as an alternative.

The growth of business and household debt slackened a bit, on balance, late last year. While businesses borrowed heavily from banks over the fall and stepped up their net issuance of bonds, paydowns of commercial paper increased. In the household sector, growth of consumer credit fluctuated quite a bit but remained well below the double-digit pace of 1995 and early 1996. Home mortgage borrowing appears to have edged off in the fourth quarter, in keeping with some softening of housing activity, despite a boost

Selected Short-Term Futures Rates and Stock Market Indexes







from home equity lending, which grew briskly. In contrast, state and local governments were active borrowers in the fourth quarter, and the run-off of tax-exempt debt seems to have run its course, as the retirements of pre-refunded issues are tapering off.

Household Sector

Total household debt is estimated to have grown at an annual rate of about 6 percent in the fourth quarter, a touch slower than during the third quarter. Consumer credit expanded near its moderate third-quarter pace, reversing an outright run-off in September that was preceded by robust growth in July and August (table). Fourth-quarter information on home mortgage debt is relatively sparse, but indicators suggest that growth was slightly below the pace of the third quarter: Total real estate loans at banks grew a bit more rapidly, but net issuance of mortgage-backed securities plus portfolio purchases by the government-sponsored agencies slowed marginally.

The slower pace of consumer credit growth since the end of 1995 has been accompanied by more rapid extensions of home equity loans (chart, top panel). According to the January Senior Loan Officer Survey, banks further tightened their terms and standards for approving new credit card loans in response to rising delinquency and charge-off rates, but reported easing terms and standards, on net, for home equity loans, which in most cases provide some measure of collateralization. However, finance companies have provided the biggest boost to the expansion of home equity debt; much of this debt has been funneled into securitized pools (chart, lower left panel). To make inroads into the highly profitable credit card segment of consumer lending, finance companies have embraced home equity lending as a logical extension of their traditional business of lending to individuals on a largely unsecured basis. Home equity loans have been promoted, in part, as a debt consolidation tool; relative to credit card debt, such loans feature both lower interest rates and longer repayment periods, so these substitutions can reduce monthly payments substantially.

Although high-quality loans have constituted the bulk of home equity lending in past years, much of the recent growth at finance companies has been fueled by subprime loans--that is, loans made with high loan-to-value ratios, or to higher-risk borrowers, or both. To be sure, rates for subprime home equity loans--averaging about 12 to 14 percent, by some industry estimates--are higher than

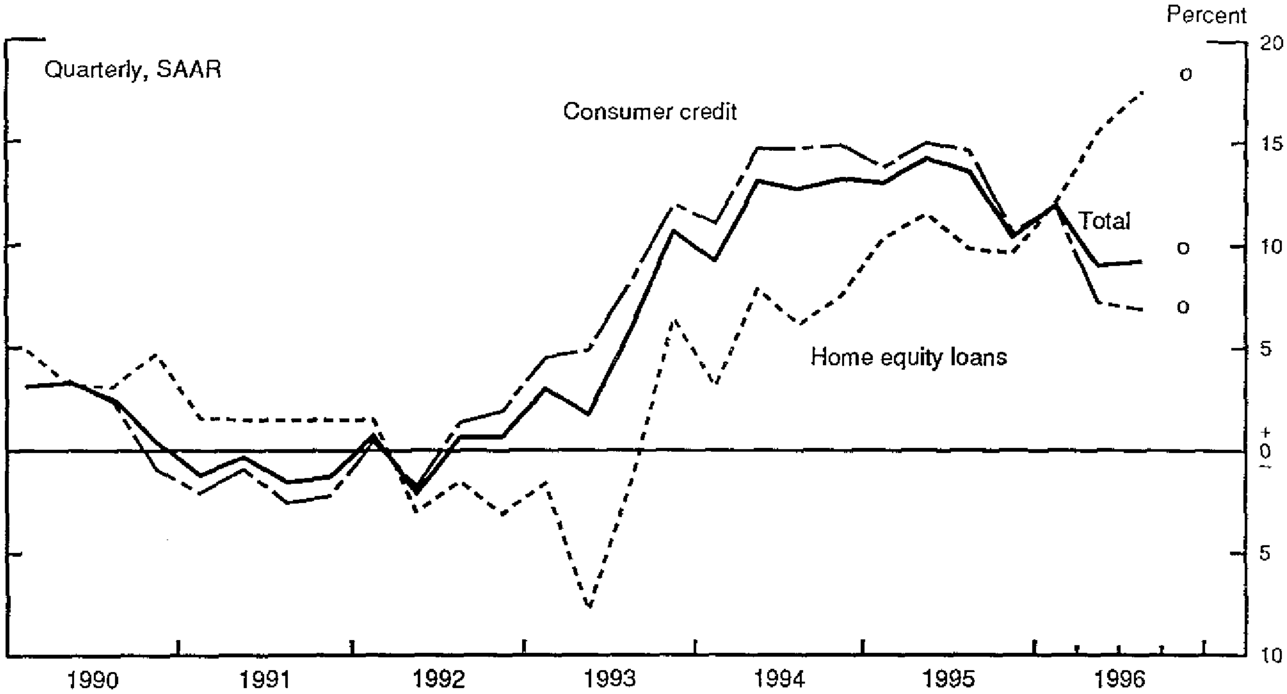
Consumer Credit

	1994	1995	1996 Q1	1996 Q2	1996 Q3	1996 Sep	1996 Oct	1996 Nov[p]
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.5	14.2	11.9	7.2	6.9	-0.1	6.7	7.4
(Previous)	*(14.5)*	*(14.2)*	*(11.9)*	*(7.7)*	*(6.1)*	*(-0.8)*	*(2.3)*	
Auto	13.4	10.6	8.8	10.2	9.3	4.3	3.1	1.5
Revolving	18.2	22.0	16.9	12.8	9.2	2.0	3.8	8.5
Other	11.8	9.2	9.1	-2.7	1.4	-7.5	14.5	12.3
Levels (billions of dollars, SA)								
Total	966.5	1103.3	1136.2	1156.7	1176.7	1176.7	1183.2	1190.6
Auto	317.2	350.8	358.6	367.7	376.2	376.2	377.2	377.7
Revolving	339.3	413.9	431.3	445.1	455.4	455.4	456.8	460.0
Other	309.9	338.6	346.2	343.9	345.1	345.1	349.2	352.8
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	8.1	9.6	9.1	8.9	9.1	n.a.	n.a.	9.0
Personal (24 mo.)[2]	13.2	13.9	13.6	13.5	13.4	n.a.	n.a.	13.6
Credit cards[3]	15.7	16.0	15.8	15.4	15.7	n.a.	n.a.	15.6
Auto finance companies[4]								
New cars	9.8	11.2	9.8	9.5	10.3	10.5	10.4	10.3
Used cars	13.5	14.5	13.2	13.5	13.9	13.9	13.7	13.6

1. Annual data are averages of quarterly data for commercial banks and of monthly data for finance companies.
2. Average of most common rate charged for specified type and maturity during the first week of the middle month of each quarter.
3. Stated APR averaged across all credit card accounts at all reporting banks during the period.
4. Average rate for all loans of each type, regardless of maturity, made during the period.
p Preliminary. n.a. Not available.

Consumer and Home Equity Credit

Growth in Consumer and Home Equity Loans



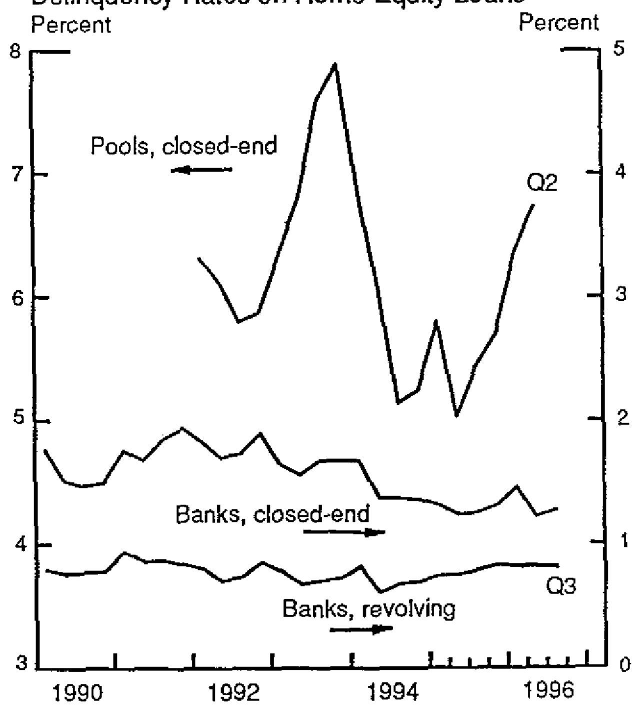
o Fourth-quarter values are October-November averages.

Distribution of Home Equity Debt by Holder

Holder	Amount ($ billions) (1) 1996-Q3	Growth rate (percent) (2) 1995	Growth rate (percent) (3) 1996[1]
1. All holders	335.2	10.7	15.6
2. Banks	148.3	8.2	7.5
3. Revolving	81.8	4.8	4.4
4. Closed-end	66.5	13.1	11.5
5. Finance cos.	56.3	10.4	20.8
6. Asset pools	46.6	37.9	72.7
7. Others	84.0	6.5	4.9

1. First three quarters, at an annual rate.

Delinquency Rates on Home Equity Loans



Sources. American Bankers Association, Moody's.

Commercial Bank Credit
(Percent change; seasonally adjusted annual rate)

Type of credit	1996	1996 Q3	Q4	Oct	Nov	Dec	Level Dec 1996 (billions of $)
1. Bank credit - reported	4.0	1.0	6.5	9.1	8.9	7.1	3,767.7
2. - adjusted[1]	4.6	1.7	6.3	10.1	5.5	4.0	3,690.5
3. Securities - reported	-1.6	-7.3	3.6	2.5	22.3	8.8	993.7
4. - adjusted[1]	.0	-5.2	2.5	6.1	9.3	-3.3	916.5
5. U.S. government	-1.2	-2.8	-0.1	-2.2	8.2	-2.4	704.3
6. Other[2]	-2.7	-18.5	13.0	15.0	59.2	36.8	289.4
7. Loans[3]	6.2	4.0	7.6	11.4	4.2	6.5	2,774.0
8. Business	9.0	7.3	15.0	17.7	7.2	17.0	785.9
9. Real estate	3.9	3.0	3.8	2.6	3.9	7.7	1,125.0
10. Home equity	6.2	5.0	15.4	17.7	14.6	25.9	85.2
11. Other	3.8	2.9	2.8	1.4	2.9	6.4	1,039.8
12. Consumer - reported	5.5	6.2	2.3	-.9	1.6	.9	518.6
13. - adjusted[4]	10.6	10.1	6.9	4.4	5.3	7.4	687.3
14. Other[5]	8.7	-2.7	11.5	45.2	3.1	-13.1	344.5

Note. Adjusted for breaks caused by reclassifications. Monthly levels are *pro rata* averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FASB 115).
2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not U.S. government securities.
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans, loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

those on their high-quality cousins, but they are generally a few percentage points lower than rates on credit card debt. The subprime loans that back the securitized pools have experienced delinquency rates that are far in excess of those for the mostly high-quality home equity loans made by banks (chart, lower right panel). For the most part, banks themselves have not competed in the subprime market directly, but some mortgage lending subsidiaries of bank holding companies are active participants in the subprime segment.

Money and Bank Credit

Bank credit, adjusted for mark-to-market accounting effects, grew at an annual rate of about 4 percent in December, somewhat slower than in November (table). Security holdings ran off in December after having grown at a 9-1/4 percent rate in November. However, loan growth accelerated from November's 4-1/4 percent pace, largely owing to a spurt in business loans and a pickup in real estate lending.

After moderating in November, business loans surged to a 17 percent rate last month, approaching the elevated pace of September and October. Although we cannot account fully for the strength in C&I loans, a stronger pace of inventory investment in recent months likely has boosted demand for bank loans. According to responses to the January Senior Loan Officer Survey, lending associated with mergers and acquisitions is also part of the explanation. Reportedly, foreign banks in particular have been active in merger financing. Foreign banks increased their share of all business lending a few percentage points over the latter half of 1996; however, U.S. offices of Japanese banks cut back sharply their business lending, perhaps in response to their capital troubles and the associated rise in their funding costs. In January, business loan growth has dropped back somewhat.

Real estate lending quickened in December, bolstered by increased bookings of residential mortgages and the shift toward home equity loans noted above. Consumer lending at banks, adjusted for securitized loans, grew at a 7-1/2 percent rate in December and 7 percent for the full fourth quarter, a moderation from early 1996 that mirrors the trend of overall consumer credit growth. For the fourth consecutive loan officer survey, a small net fraction of banks indicated reduced willingness to make consumer loans.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996 (p)	1996 Q3	1996 Q4 (p)	1996 Nov.	1996 Dec. (p)	1997 Jan. (pe)	1996:Q4 to Jan. 97 (pe)	Level (bil. $) Jan. 97 (pe)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-6.5	-7.3	-0.1	1.1	-4.1	-1.7	1077.3
2. M2[2]	4.6	3.4	5.0	6.8	7.4	5.2	6.2	3849.5
3. M3	6.9	5.4	8.5	7.5	11.3	6.8	8.4	4963.8
Selected components								
4. Currency	5.7	7.6	7.7	6.8	8.3	5.8	6.7	397.0
5. Demand deposits	2.7	-0.9	-5.4	11.8	1.5	-1.8	1.5	402.0
6. Other checkable deposits	-23.2	-29.8	-29.6	-26.7	-8.7	-21.8	-18.1	269.8
7. M2 minus M1[3]	8.8	7.7	10.1	9.6	9.9	8.9	9.4	2772.1
8. Savings deposits	11.6	8.4	12.0	12.0	11.3	13.7	12.7	1285.1
9. Small time deposits	1.4	2.2	3.8	3.2	1.5	1.1	1.6	945.5
10. Retail money market funds	17.1	16.3	17.2	15.2	21.6	11.2	15.3	541.6
11. M3 minus M2[4]	15.5	12.9	21.0	10.2	24.8	12.3	16.1	1114.4
12. Large time deposits, net[5]	17.7	16.4	25.5	15.4	29.8	26.9	26.1	511.1
13. Institution-only money market mutual funds	19.8	20.6	19.8	16.2	30.0	-8.4	8.4	297.2
14. RPs	4.6	-3.7	6.0	-1.2	-6.7	-1.9	-3.4	194.2
15. Eurodollars	16.8	8.3	32.8	-9.0	45.5	27.4	27.5	111.9
Memo								
16. Sweep-adjusted M1[6]	5.3	3.6	4.9	8.7	9.3	1.8	5.5	1253.6
17. Monetary base	3.8	5.9	5.4	5.6	11.2	-6.1	1.6	451.2
18. Household M2[7]	4.8	4.1	6.0	6.3	7.2	6.0	6.5	3444.2
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	8.5	15.3	11.3	15.7	10.0	...	563.5
19. Net due to related foreign institutions	-2.1	-2.5	-4.0	-7.0	-6.9	-13.2	...	216.7
20. U.S. government deposits at commercial banks	0.0	1.0	0.0	3.9	-4.8	3.4	...	20.1

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. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs, on the basis of monthly averages of daily data.
7. M2 less demand deposits
8. 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.

Note: Data incorporate revisions from the annual benchmark andseasonal review. These data are scheduled to be published in early February and until that time are strictly confidential.

According to reports now in for forty-five of the fifty largest bank holding companies, commercial bank profits rose again in the fourth quarter. Overall, net income was 25 percent greater than in the final quarter of 1995, largely as a result of a 10-basis-point widening of the net interest margin and increased fees, particularly those related to investment banking and asset securitization. Once again, problem credit card accounts were a modest drag on profits, and industry analysts expect some further deterioration.

The broad monetary aggregates grew rapidly in December, and preliminary data suggest that growth in January, while below the December pace, remained buoyant (table).[1] M2 growth in recent months has likely been boosted by strong income growth and the decline in market interest rates since mid-1996. M3 has grown faster than M2, as banks continued to rely heavily on managed liabilities in M3 to fund loan growth. U.S. branches of foreign banks have been particularly heavy issuers of large time deposits in recent months, as they have experienced rapid asset growth and have reduced their use of overseas funding. Despite continuing sweep activity in December, M1 rose slightly. In January, however, this aggregate appears headed for another sizable decline, the runoff being entirely attributable to the implementation of new sweeps.

Business Finance

Gross bond issuance by nonfinancial corporations slowed in December as long-term interest rates retraced some of the decline posted during the preceding two months; nonetheless, the pace of issuance for the fourth quarter as a whole was robust (chart, top panel). December's downshift also reflected the usual lull around the holidays--no bonds were sold during the final ten days of the month. Nonfinancial issuance remained slack in early January but has begun to build more recently. Market participants note that the calendar of new issues is expanding, and, judging by the experience last fall and over the past several years (chart, bottom left panel), firms will jump into the market if rates drop again.

During the fourth quarter, many bond offerings were earmarked to repay commercial paper, as firms sought to lock in relatively low

1. The monetary aggregates data incorporate revisions from the annual benchmark. The benchmark took into account revised deposit data, information from quarterly bank Call Reports including IRA-Keogh account data, and new information on retail and institution-only money market mutual funds. Overall, these adjustments added .1, .1, and .3 percentage points, respectively, to the 1996 growth rates of M1, M2, and M3.

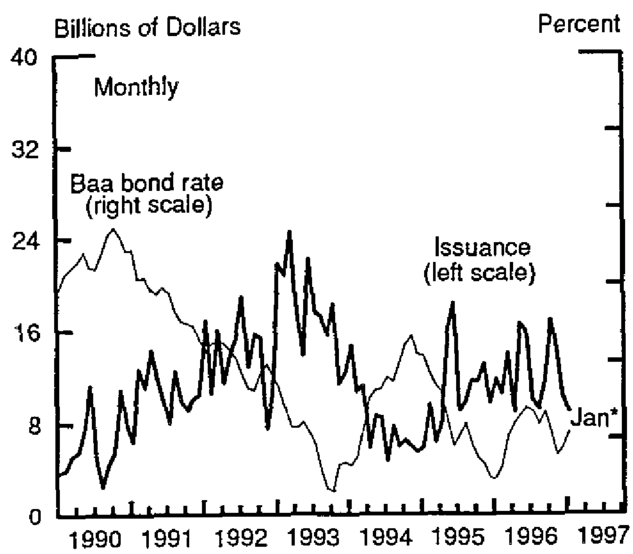
GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS[1]
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1995	1996	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
All U.S. corporations	47.6	57.9	50.3	57.8	61.3	61.7	50.4
Stocks[2]	6.1	10.1	6.9	12.0	13.2	13.4	9.5
Bonds	41.5	47.8	43.4	45.8	48.1	48.3	41.0
Nonfinancial corporations							
Stocks[2]	4.4	6.8	4.8	6.2	8.4	6.3	4.0
Initial public offerings	1.7	2.8	2.0	2.7	4.7	2.1	1.4
Seasoned offerings	2.7	3.9	2.8	3.5	3.7	4.2	2.6
Bonds	10.7	12.5	10.2	13.8	16.9	14.1	10.4
By rating, bonds sold in U.S.[3]							
Investment grade	6.4	6.3	5.2	7.6	9.3	6.8	6.7
Speculative grade	3.0	4.7	3.6	4.8	5.5	6.0	3.0
Public	2.0	2.3	1.8	1.3	2.1	1.2	.8
Rule 144A	1.1	2.5	1.8	3.5	3.4	4.8	2.2
Financial corporations							
Stocks[2]	1.7	3.3	2.1	5.8	4.8	7.1	5.5
Bonds	30.8	35.3	33.1	32.0	31.2	34.2	30.6

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.

Nonfinancial Corporations

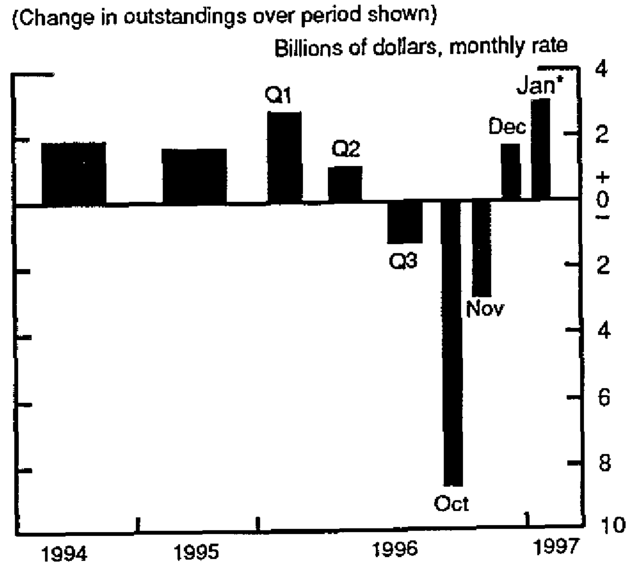
Gross Bond Issuance and Baa Rate



*Staff estimate

Net Commercial Paper Issuance

(Change in outstandings over period shown)



*Staff estimate

long-term interest rates. In December, however, these paydowns were more than offset by a pickup in merger-related financing that boosted the amount of outstanding nonfinancial commercial paper for the first time since June (chart, bottom right panel). Nonfinancial commercial paper issuance has strengthened further in January, bolstered by merger needs.

Nonfinancial firms again retired equity on net in the fourth quarter, bringing the contraction for 1996 as a whole to nearly $80 billion, similar to that in 1995. Based on our estimates for the fourth quarter, completed share repurchases in 1996 were about 30 percent above the 1995 level (chart, upper left panel). Announcements of new repurchase programs have jumped even more sharply, driven by the accumulation of excess cash at large companies. Merger-related share retirements also rose further last year (chart, upper right panel). Although most of the large transactions were structured entirely or largely as stock swaps, cash transactions were sizable and produced substantial retirements.

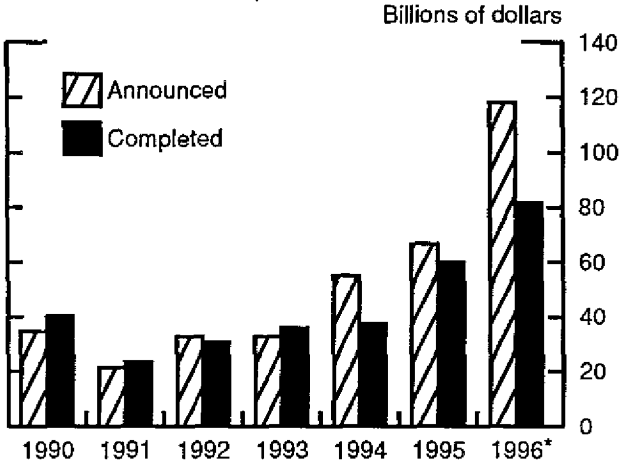
Although initial public offerings totaled $34 billion for the year as a whole--more than two-thirds greater than the prior record in 1995--such issues slowed appreciably as the year progressed. Both IPOs and seasoned offerings dropped abruptly in December, typical of the holiday season, and remained subdued in January.

The rally in stock prices over the intermeeting period pushed up price-earnings ratios even further (chart, middle left panel). Investors evidently shrugged off the rise in bond rates, focusing instead on the surprising strength in fourth-quarter earnings reports. To date, 60 percent of the S&P 500 firms have issued reports, with almost 60 percent coming in above expectations of market analysts and 30 percent below. Overall, operating earnings for the S&P 500 are expected to have grown roughly 11 percent over the four quarters of 1996, an acceleration from earlier in the year (chart, middle right panel). The reports of higher earnings are consistent with the robust growth in real activity late this year, but the market reaction suggests that investors viewed the fourth-quarter reports as signaling stronger earnings growth going forward.

The continued healthy growth in corporate profits has been beneficial for credit quality. For the fourth quarter and for 1996 as a whole, Moody's upgrades of nonfinancial debt issues far outnumbered downgrades (although they were similar when measured in terms of the dollar volume of affected bonds). Moreover, the rate

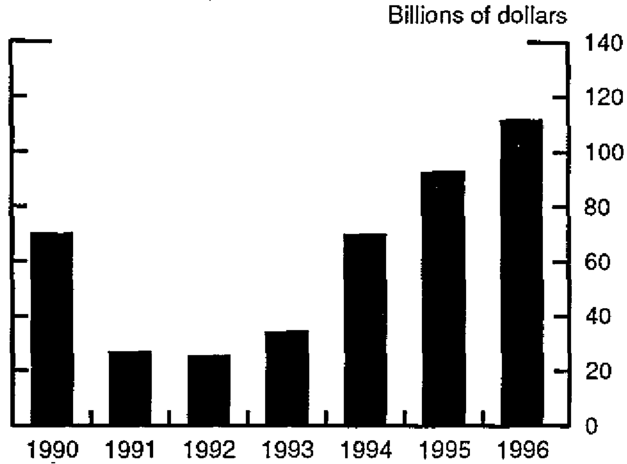
Corporate Finances

Share Repurchases by
U.S. Nonfinancial Coporations



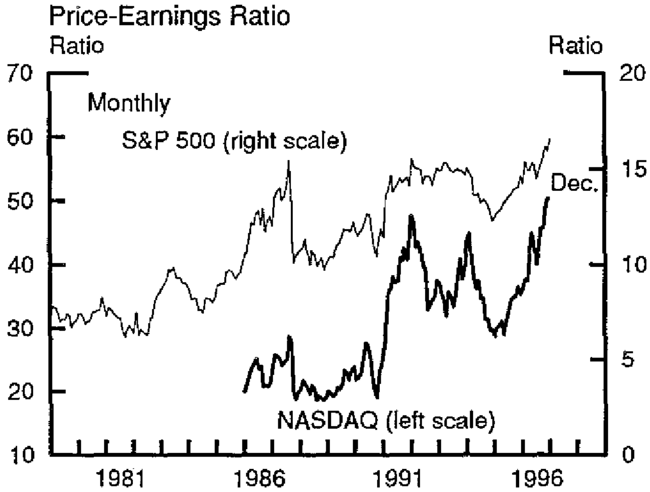
*Staff estimates
Source. Securities Data Company

Merger-Related Equity Retirements at U.S.
Nonfinancial Corporations



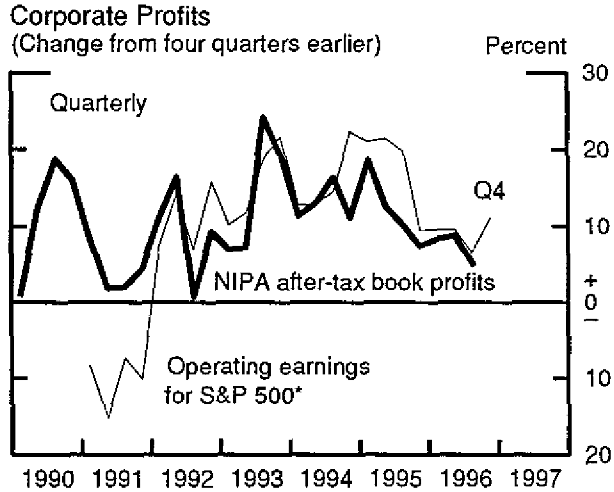
Source. Securities Data Company

Price-Earnings Ratio



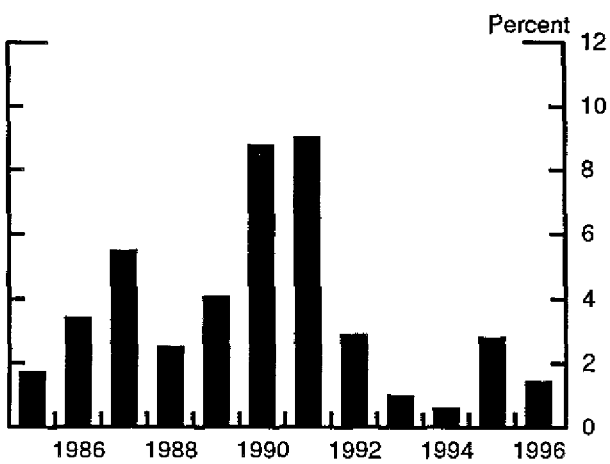
Note. S&P 500 ratio based on consensus estimate of earnings over the coming 12 months. Nasdaq ratio based on earnings over the previous 12 months.

Corporate Profits
(Change from four quarters earlier)



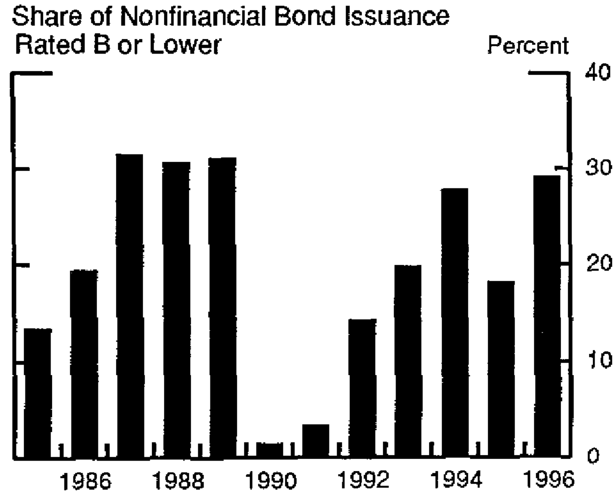
*Goldman-Sachs's estimate.

Default Rate on Junk Bonds*



Note. Ratio of junk bond defaults to junk bonds outstanding at end of previous year
Source. Edward Altman, CS First Boston.

Share of Nonfinancial Bond Issuance
Rated B or Lower



of business failures from January through November of 1996 was low by historical standards, and default rates on speculative-grade bonds (chart, lower left panel) declined from the previous year.

The market for speculative-grade bonds has been especially robust. In December, quality spreads over Treasury yields narrowed about 30 basis points, bringing the decline since the end of 1995 to somewhat more than 100 basis points. Spreads have narrowed despite the heavy issuance of high-yield bonds, reflecting extraordinary demand for these issues, led by record flows into junk bond mutual funds last year. The limited concern about credit risk has greatly enhanced market access for the lowest-rated companies. Last year, nonfinancial issues rated B or lower accounted for almost 30 percent of all nonfinancial bond offerings, the highest share since 1989 (chart, lower right panel). Many of these firms are in high-tech industries that hold out the prospect of sharply increasing earnings. Nonetheless, these bonds would be vulnerable if earnings prove disappointing, and some market participants worry about the effects of a stock market correction that would discourage firms from issuing equity. Equity issuance has allowed many junk-grade firms to decrease leverage over the past few years, thereby improving their credit ratings and giving them better entree to the bond market.

Mutual Funds

Inflows to equity mutual funds remain very strong: For all of 1996, net sales of equity funds totaled about $223 billion, surpassing the previous record, set in 1993, by nearly 75 percent. In December, net sales of equity funds, excluding reinvested dividends, were a little below the average monthly pace since midyear (chart, upper panel).[2] Preliminary data for January indicate that flows into stock funds strengthened, likely driven in part by a confluence of seasonal influences, most associated with the management of retirement accounts.

Net sales of bond funds picked up in December. As was the case throughout 1996, high-yield and income funds fully accounted for

2. To date, we have reported mutual fund net sales *including* reinvested dividends. Most investors elect to obtain additional shares by reinvesting dividend distributions automatically, and these transactions are included as net sales in the month of the distribution. However, because these credits do not occur smoothly across months and are especially heavy in December, it is difficult to discern underlying trends in demand without excluding the reinvested dividends.

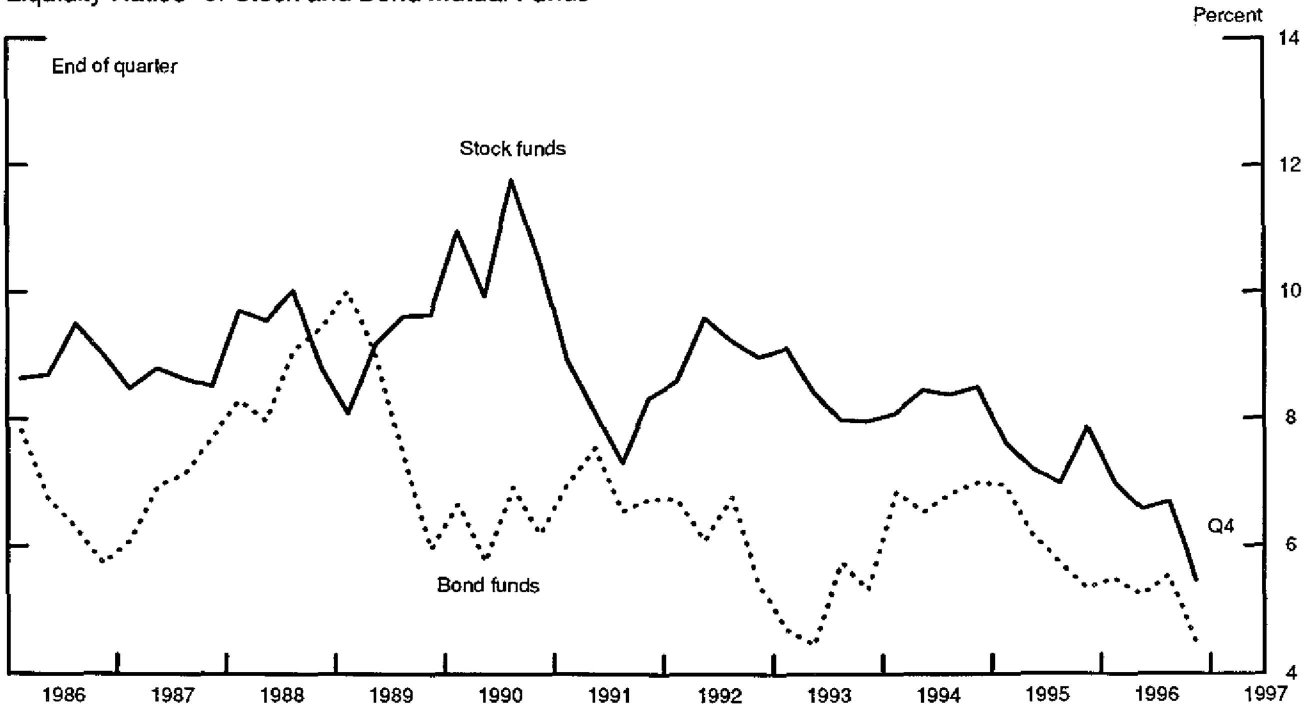
Net Sales of Selected Mutual Funds Excluding Reinvested Distributions

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

			1996					Memo:
	1995	1996	Q3	Q4	Nov	Dec	Jan[e]	Dec assets
Stock funds	10.7	18.6	13.2	14.3	17.1	12.2	25.0	1752.0
Domestic[1]	9.7	14.7	12.0	11.6	13.2	10.2		1468.3
Aggressive growth	3.1	4.7	4.1	3.2	3.4	3.1		274.7
Growth	3.1	3.9	3.8	2.8	4.1	1.8		482.8
Growth & income[2]	3.7	6.2	4.2	5.6	5.8	5.4		705.9
International	1.0	3.9	1.2	2.7	4.0	2.0		283.7
Bond funds	-0.4	1.1	0.3	1.3	1.4	2.8	4.5	886.5
High-yield	0.7	1.0	1.3	1.3	1.6	1.8		78.2
Income	0.9	1.6	0.8	1.6	1.5	2.3		351.7
Other	-2.0	-1.5	-1.8	-1.6	-1.7	-1.3		456.6

1. Includes precious metals funds, not shown elsewhere.
2. Calculated as the sum of "Growth and income" and "Income equity" in the ICI data.
e Staff estimate.
Source. Investment Company Institute.

Liquidity Ratios* of Stock and Bond Mutual Funds



* Cash and short-term securities as a percent of total assets.
Source: Investment Company Institute.

December's inflows to bond funds and for the majority of such flows in the first half of January. As noted above, the appeal of high-yield funds likely reflects the improvement in corporate earnings and a perceived decline in default risk, while income funds have proved attractive because they invest a portion of their assets in equities. Accordingly, returns on these funds have exceeded those on other bond funds.

In December, liquidity ratios for equity funds averaged only 5-1/2 percent, the lowest since 1977 (chart, bottom panel). Although this statistic could be taken as an indicator of fund managers' views on the prospects for further stock market gains, other factors are also involved. Much of the downward trend in the liquidity ratio in recent years reportedly reflects a growing reliance on backup lines of credit which have allowed funds to absorb more risk by keeping a greater share of fund assets fully invested. In addition, indexed funds, which hold minimal cash reserves, represent a growing share of total mutual fund assets.

Treasury and Agency Financing

The Treasury will likely finance the projected $71 billion deficit this quarter by borrowing about $58 billion in the market and by drawing down its cash balance by $13 billion (table). The steady shrinkage of the federal budget deficit has reduced the borrowing needs of the Treasury, which are now estimated to be about $130 billion for the 1997 calendar year. Strong revenues around the end of the year also have led the Treasury to cut the size of this quarter's two-year note and weekly bill auctions.

On Wednesday, January 29, the Treasury sold price index-linked securities for the first time in an auction of ten-year notes worth $7 billion. As with Canada's inflation-indexed bond, the principal adjusts to changes in the price index, while the coupon rate remains unchanged. Accordingly, investors are compensated for price level changes through gradually increasing coupon payments and receipt of the fully adjusted principal value at maturity.

The Treasury plans quarterly auctions of indexed debt; bidders will submit tenders in terms of a real yield, and winning bids will be awarded at the highest accepted yield. In the first sale, the winning bid equaled 3.45 percent. Reportedly, the first sale went well; demand was strong, with bids exceeding awards by five to one. The security had traded on a "when-issued" basis, yielding 3-1/4 to 3-1/2 percent, although reports suggested that the market was

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q3	1996 Q4	1997 Q1^p	1997 Jan.^p	1997 Feb.^p	1997 Mar.^p
Total surplus/deficit (-)	-33.3	-58.8	-71.0	11.7	-53.4	-29.4
Means of financing deficit						
Net cash borrowing and repayments (-)	39.4	48.7	57.6	-19.7	41.7	35.6
Nonmarketable	-1.0	7.4	6.2	2.2	2.0	2.0
Marketable	40.3	41.3	51.3	-21.9	39.7	33.6
Bills	-12.4	16.2	14.2	-18.4	2.3	30.3
Coupons	52.7	25.1	37.2	-3.5	37.4	3.3
Decrease in cash balance	-6.2	11.4	12.9	-2.3	26.6	-11.4
Other[1]	0.1	-1.4	0.5	10.3	-14.9	5.1
Memo:						
Cash balance, end of period	44.2	32.8	19.9	35.1	8.5	19.9

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.

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

Agency	1996 Q3	1996 Q4	1996 Oct.	1996 Nov.	1996 Dec.
FHLBs	5.7	8.5	-1.1	-1.0	10.5
FHLMC	3.6	10.0	1.5	9.7	-1.2
FNMA	10.8	12.1	2.0	3.3	6.9
Farm Credit Banks	-2.1	-0.1	-0.4	0.1	0.3
SLMA	0.2	-0.2	2.3	-0.2	-2.2

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

illiquid. While it is tempting to interpret the difference between real and nominal yields as a measure of inflation expectations, the difference is not a clean measure because nominal rates include an inflation risk premium that is absent from the real yields, while real yields likely include a risk premium that reflects illiquidity in the new indexed-bond market.

Issuance by federally sponsored agencies was subdued over the intermeeting period, as the rise in interest rates discouraged refinancing. The Federal Home Loan Bank was authorized by federal regulators to sell inflation-indexed bonds; however, no plans to sell such bonds have been announced.

Municipal Securities

Gross issuance of long-term municipal securities was strong through mid-December and then entered the usual lull spanning year-end (table). Offerings have picked up lately, but January's total likely will be somewhat below December's. For 1996 as a whole, long-term gross issuance increased about 16 percent from the level in 1995, with both new capital and refunding volume moving up. At the same time, retirements of long-term issues fell about 10 percent, owing primarily to a decline in the amount of maturing debt. Together, these developments slowed the run-off of outstanding long-term debt, to about $5 billion, down markedly from the $50 billion decline in 1995. Market analysts expect positive net issuance in 1997.

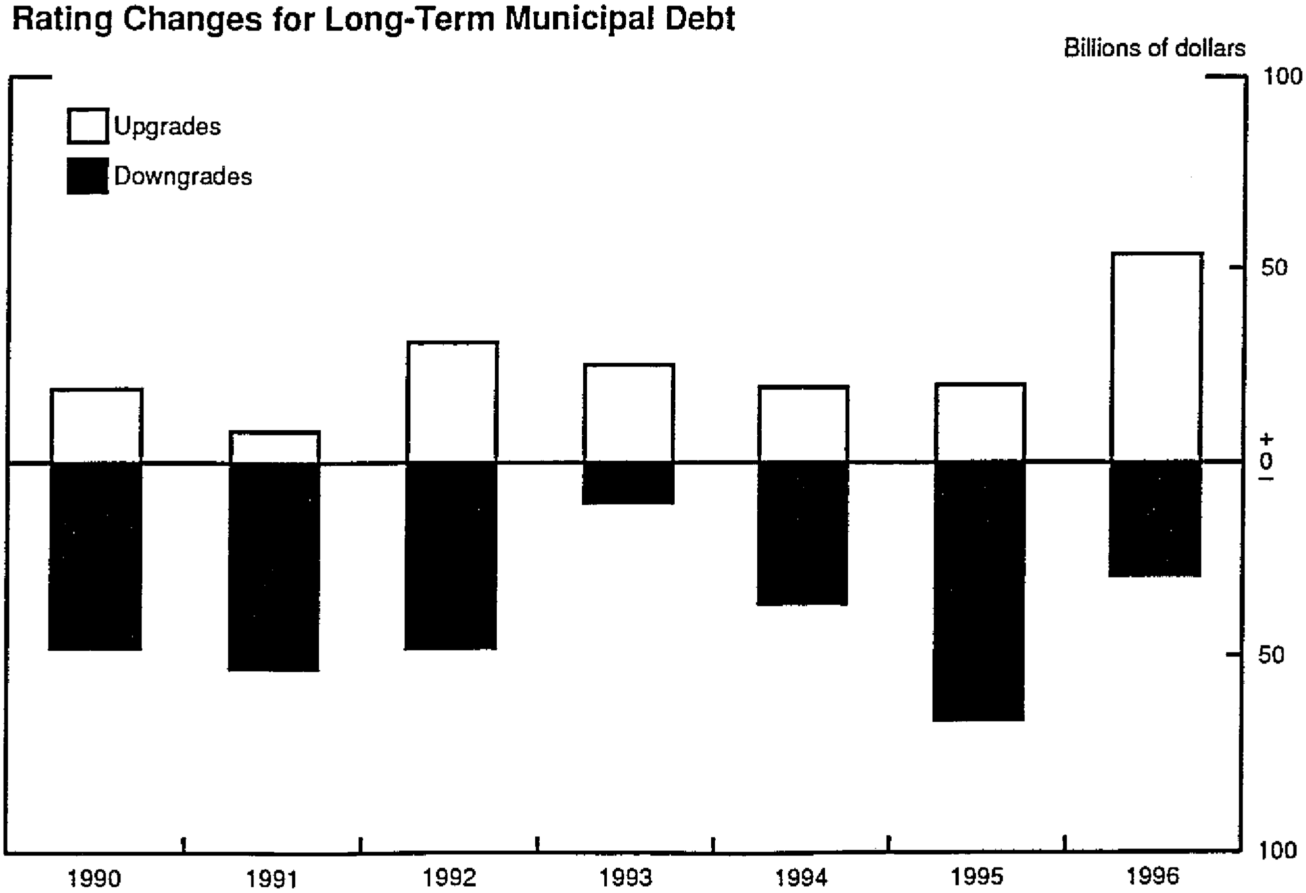
State and local credit rating upgrades surged to new records in 1996, while downgrades were more limited than the previous year (chart, bottom panel). Analysts cite both conservative budget practices and the continued economic expansion as the primary factors behind the improvement in overall credit quality. In fact, this improvement would have been even greater were it not for the difficulties of public utilities, which are facing deregulation and alone accounted for nearly 75 percent of total municipal downgrades last year. For 1997, Standard & Poor's anticipates another net improvement in ratings for the municipal sector.

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

	1994	1995	1996	1996 Q3	1996 Q4	1996 Nov.	1996 Dec
Total tax-exempt	16.1	14.9	17.7	17.3	18.5	15.8	18.7
Long-term	12.8	12.1	14.3	12.0	16.1	14.8	16.8
Refundings[1]	4.0	3.4	4.5	4.1	4.6	5.5	3.7
New capital	8.8	8.7	9.8	7.9	11.5	9.3	13.1
Short-term	3.3	2.8	3.4	5.3	2.4	1.0	1.9
Total taxable	.7	.7	.8	.6	1.4	2.4	1.2

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

Rating Changes for Long-Term Municipal Debt



Source: Standard & Poors

APPENDIX

THE JANUARY SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

The January 1997 Senior Loan Officer Opinion Survey on Bank Lending Practices posed questions about bank lending standards and terms, loan demand by businesses and households, the recent rapid growth in home equity loans, and the use of credit scoring models for small business lending.

The survey results suggest that competition for commercial credits remains stiff. Many of the respondents reported that they had eased terms on business loans over the past three months, citing pressure from other banks and nonbanks as the cause. While competing aggressively on loan terms, only a few banks said they had relaxed standards on these loans. The survey also found little evidence of looser standards for commercial real estate loans. Only a few banks, on net, reported increased demand for business loans from large and middle-market customers, although several reported greater demand from small businesses. Several domestic and many foreign respondents also experienced an increase in demand for commercial real estate loans.

The results were consistent with the recent slowdown in consumer loan growth and the marked pick-up in the growth of home equity loans. A large number of banks said they had raised standards on credit card loans and many said they had done so for other consumer loans. However, several banks eased standards on home equity loans. In addition, several banks reported weaker demand for consumer loans, but many experienced increased demand for home equity loans. The responses to special questions on the survey suggest that much of the recent rapid growth in home equity loans was a result of substitution for unsecured forms of consumer credit. This shift reportedly has arisen from bank promotions of such substitution as well as from the initiative of borrowers attempting to consolidate their debt.

Other special questions found that about two-thirds of the respondents use credit scores in their small business lending. The scores are most commonly used as part of the application process, often for automatic acceptance or rejection of applicants, and rarely for the setting of loan terms.

Lending to Businesses

The survey found a slight easing of lending standards for business loans over the past three months (chart). For loans to large, middle-market, and small businesses, less than 10 percent of domestic banks indicated that they had eased standards; about 5 percent of foreign banks eased standards. Much larger fractions of banks reported easing terms on business loans. One-third of the domestic respondents reported a decrease in the spreads of loan rates over market rates for loans to large and middle-market firms, and about one-tenth reported narrower spreads for small businesses. Smaller net fractions eased other terms, including credit line costs, size of credit lines, loan covenants, and collateralization requirements. Banks generally said they had eased standards and terms to meet competition from other banks and, to a lesser extent, from nonbank lenders. These results suggest a similar degree of easing of standards and terms as found in the November survey.

Also as in November, only slight net margins of banks reported stronger demand for business loans. About 15 percent, on net, of domestic respondents reported increased demand for business loans from small firms and somewhat fewer indicated increased demand from large or middle-market firms. Demand was up at about 10 percent of the foreign respondents. Banks attributed the increased demand from small firms to plant and equipment investment and inventory financing needs. The increased demand from large and middle-market firms reportedly also derived somewhat from these factors but mainly from greater merger and acquisition financing.

Only one domestic respondent, on net, and two foreign respondents indicated an easing of standards on construction and land development loans. About 15 percent of the domestic respondents and nearly one-third of the foreign respondents experienced an increase in demand for these loans.

Lending to Households

For the fifth consecutive survey, significant fractions of banks said they had tightened standards on consumer loans. Nearly 40 percent of the banks, on net, said they had tightened standards over the past three months for approving new credit card accounts, and over 20 percent tightened standards on other consumer loans. A small net fraction of banks indicated less willingness to make consumer installment loans--the fourth survey in a row to show a slight decline in willingness to make these loans (chart). Terms on credit cards tightened: About one-fourth of the respondents, on net, lowered credit limits and a few raised spreads. About 10 percent of banks tightened spreads on other consumer loans. Other terms on consumer loans were reportedly about unchanged. On net, respondents reported a slight decline in demand for consumer loans.

Banks indicated a slight tightening in standards for approving home mortgages over the past three months and a slight increase, on net, in demand for these loans. About 15 percent of the banks reported easing standards for home equity loans and similar fractions reported easing maximum loan-to-value levels. Smaller net fractions eased spreads and fees on these loans.

The easing of terms for home equity loans was reportedly a factor in the recent rapid growth in these loans. About one-fourth of the respondents said that easing terms on home equity loans, including entering the market for low- or no-equity loans, had boosted the amount of these loans on their books. However, a significantly larger fraction of the banks, about three-quarters, said that encouraging specific customers to switch from unsecured consumer loans to home equity loans had boosted home equity outstandings. About three-quarters also said increased demand for these loans was a factor in the recent growth.

Those banks that had followed policies to increase their holdings of home equity loans said they did so because the increased riskiness of, and the increased competition for, unsecured consumer loans had made the risk-adjusted yield on home equity loans relatively more attractive. Those banks that experienced increased demand for home equity loans attributed the increase to debt consolidation and to the increased credit needs of their customers.

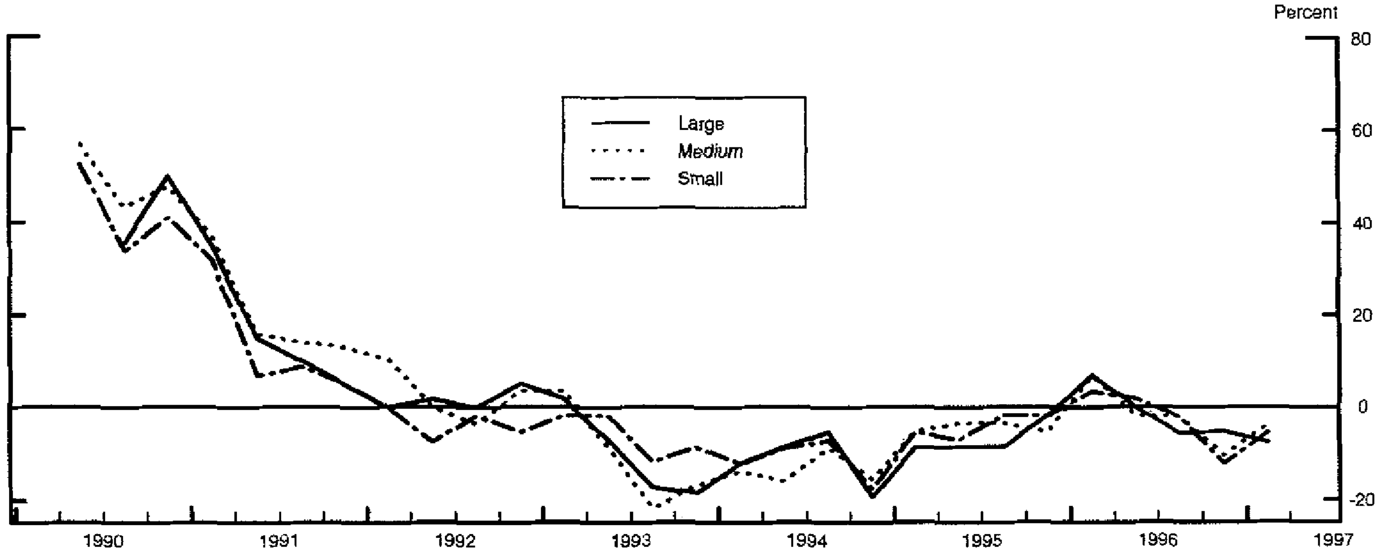
Credit Scores and Small Business Loans

Special questions on the survey examined respondents' use of credit scores for small business lending. Two-fifths of the respondents said they always use credit scores when making small business loans, and one-fourth said they sometimes use them. Of those banks that used credit scores, two-fifths used them for the automatic acceptance or rejection of some applications and nearly all used them as part of the evaluation process other than automatic acceptance or rejection. Two-fifths of the banks used the scores to evaluate existing loans. Only a few of the banks--15 percent--used the scores to set loan terms. Most of the banks purchase their scores, although one-fourth used scores from an internally developed credit scoring model.

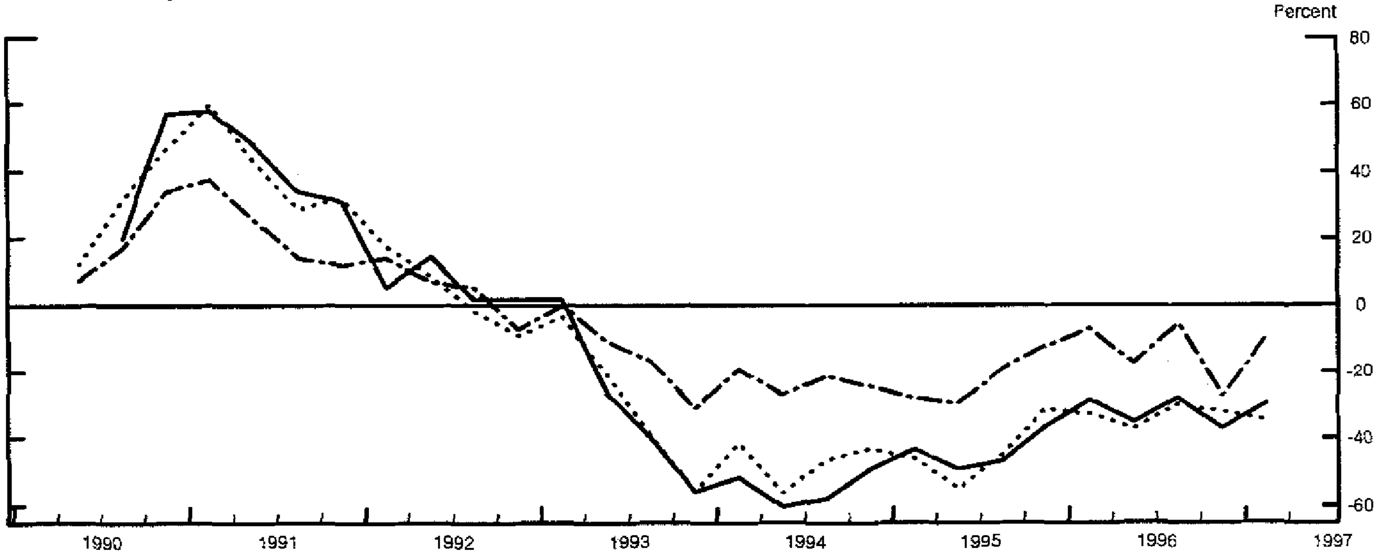
Only two of the respondents reported having securitized any small business loans, and these two had securitized only SBA-guaranteed loans. One of these banks said the use of credit scores had not facilitated the securitization of the loans, and the other bank said scoring had helped, but only slightly.

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

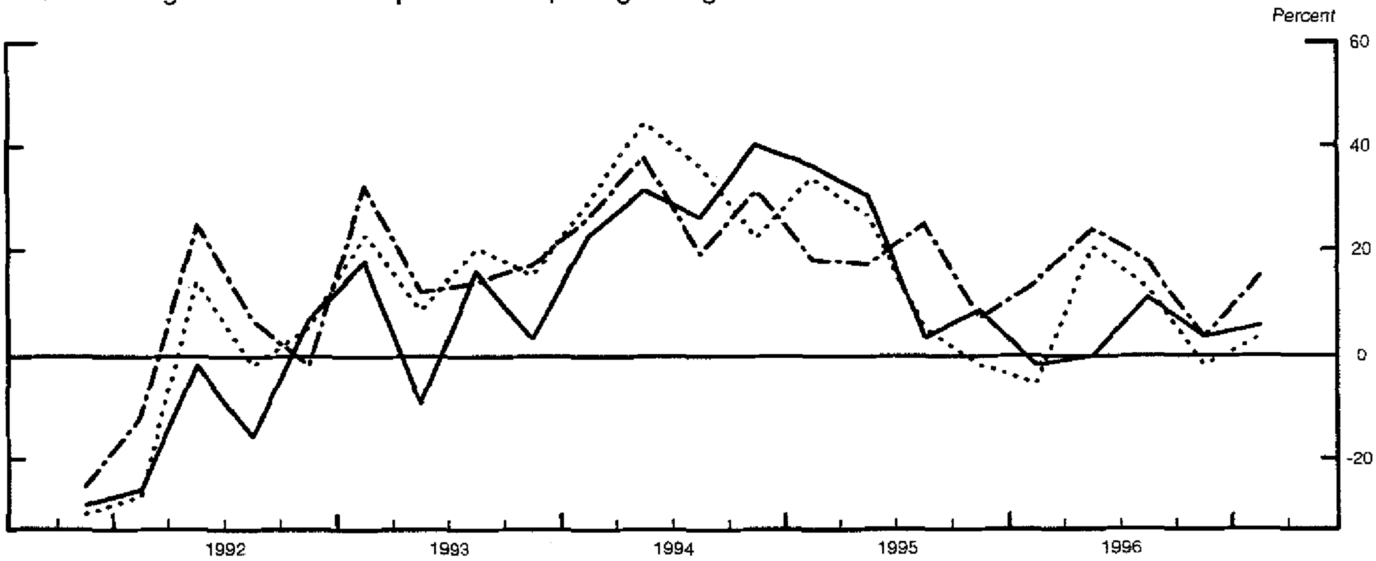
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

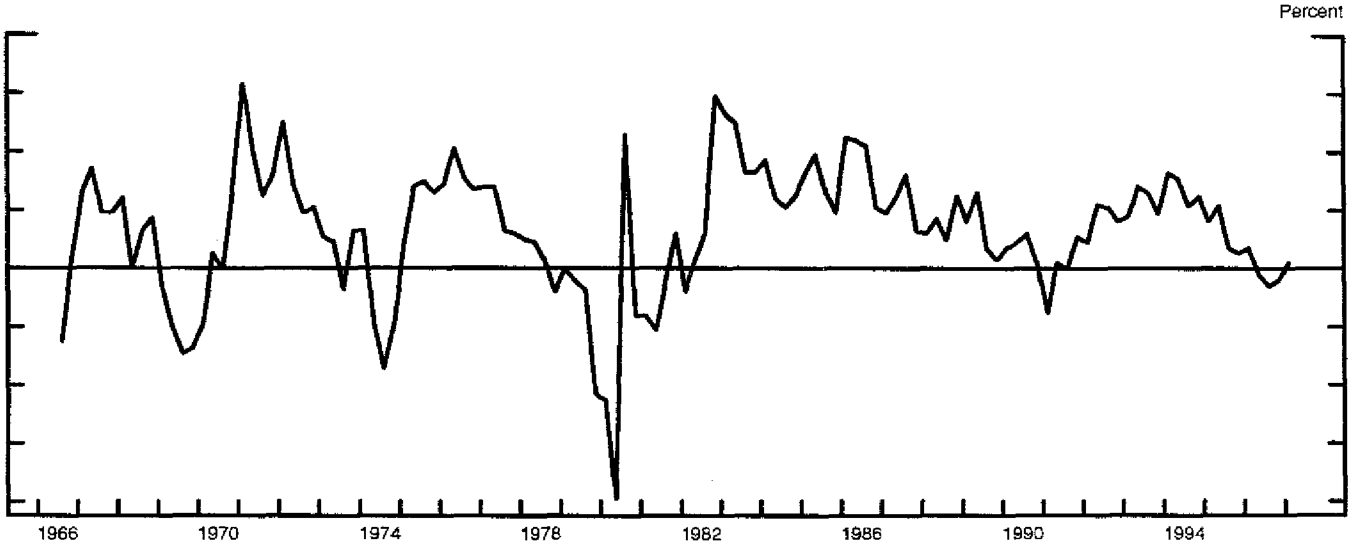


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

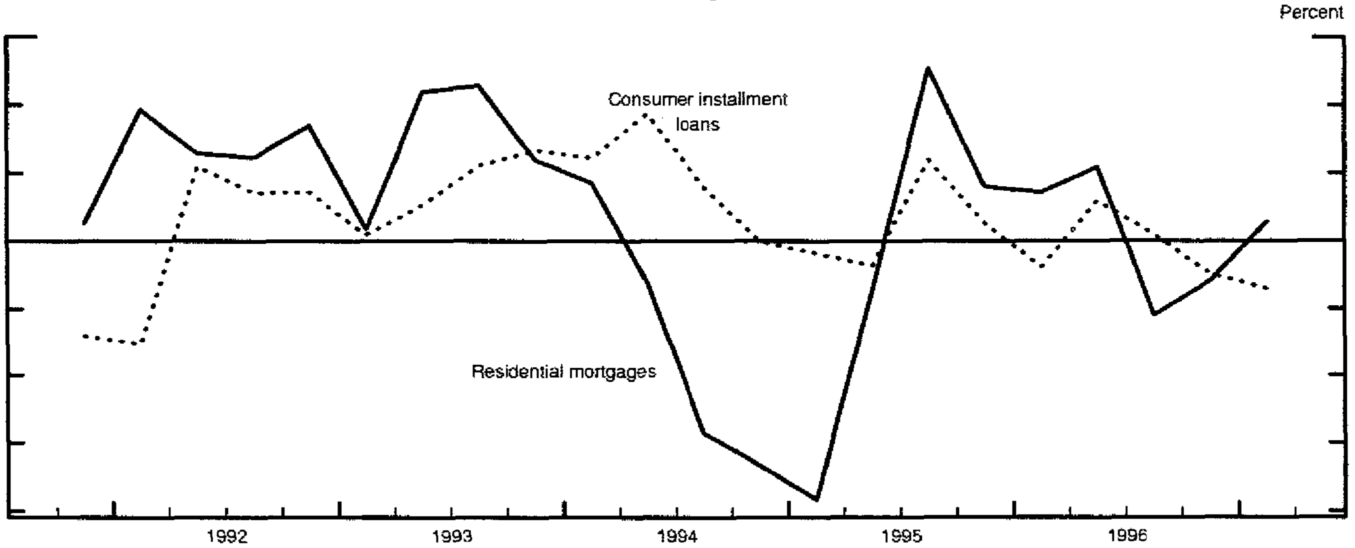


Measures of Supply and Demand for Loans to Households

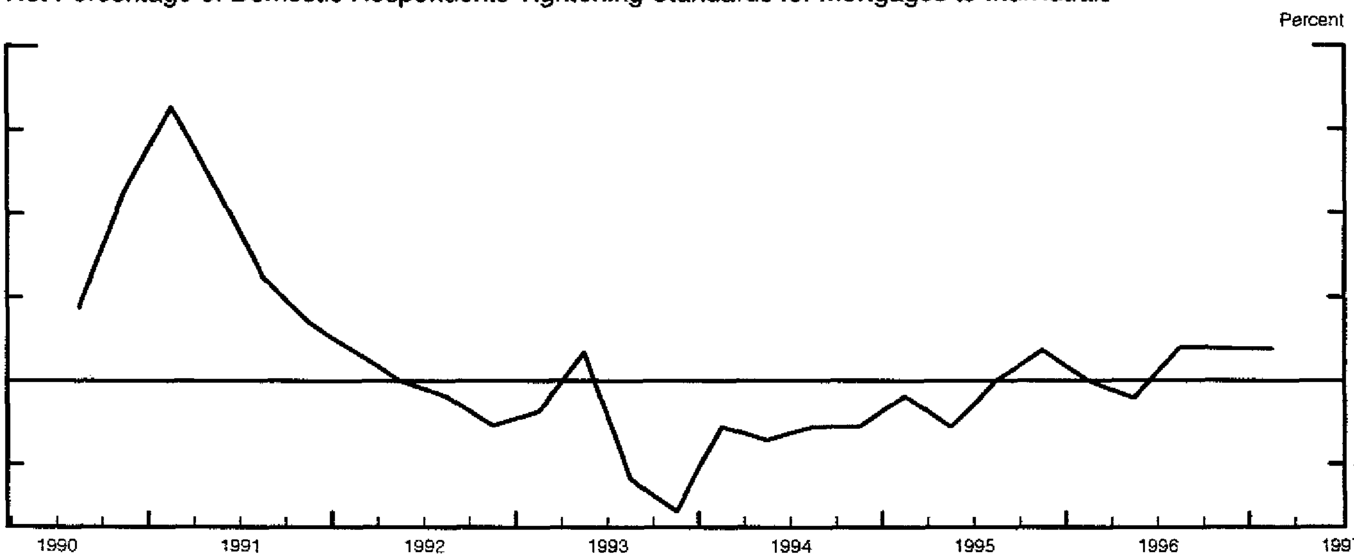
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

The U.S. deficit in trade in goods and services was about the same in November as in October as both exports and imports rose slightly. The size of these two deficits was considerably smaller than in any month since June and about the same, at an annual rate, as in the first quarter of 1996. Trade data for December will be released on February 19.

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

	1995	Annual rates 1996 Q2	Q3	Q4e/	Monthly rates 1996 Sep	Oct	Nov
Real NIPA 1/							
Net exports of G&S	-107.6	-114.7	-137.4	...	...	...	...
Nominal BOP							
Net exports of G&S	-105.1	-114.3	-134.7	-98.4	-11.4	-8.0	-8.4
Goods, net	-173.4	-188.0	-205.8	-173.0	-17.5	-14.1	-14.7
Services, net	68.4	73.7	71.0	74.6	6.1	6.1	6.3

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.

Exports of goods and services reached record levels (AR) in October-November and were 5 percent higher than in the third quarter. The increase was spread among all major trade categories except automotive products (which were held down by the effects of strikes against GM). Aircraft and service exports rebounded from low third-quarter levels. Exports of machinery and industrial supplies moved to new record levels. Over the past year, the value of merchandise exports rose 6 percent. Most of the rise went to Canada and Latin America (to Mexico, and especially in the second half of the year, to countries in South America). Exports to Western Europe and Asia were only marginally higher than a year earlier. [Note: NIPA data charted on the next page were available only through 1996-Q3 on Greenbook day. Data for 1996-Q4 will be released on January 31.]

Imports of goods and services in October-November (AR) were only slightly higher than in the third quarter as declines in automotive imports from Canada (which were affected to a larger extent than automotive exports by strikes against GM) nearly offset

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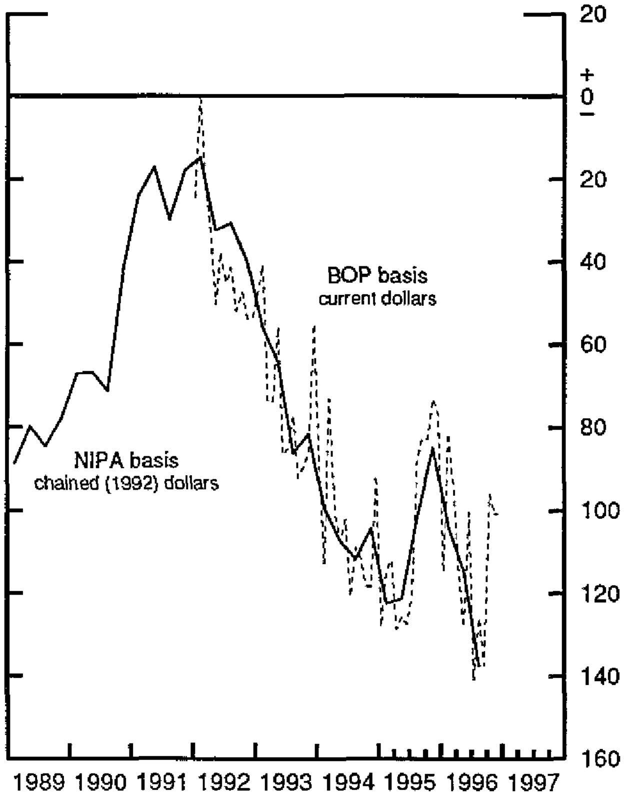
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

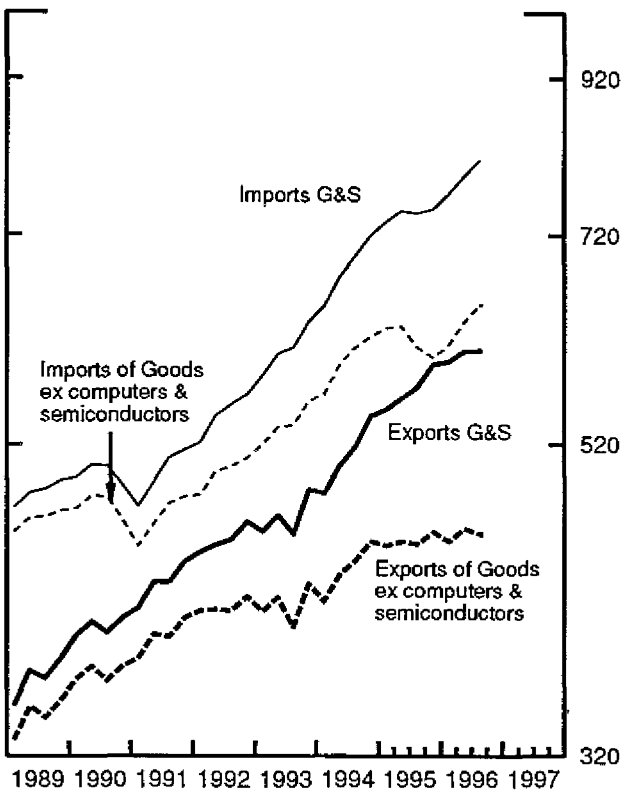
Net Exports

Billions of dollars



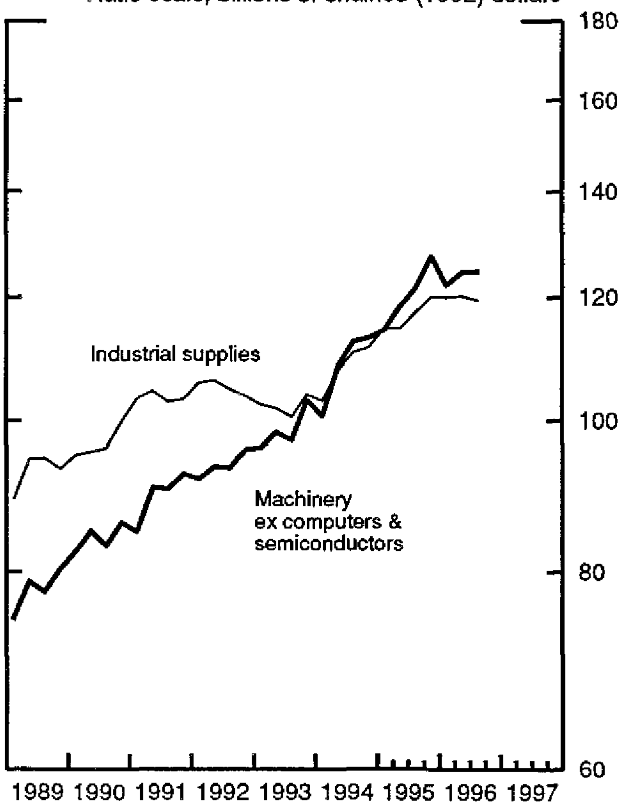
NIPA Exports and Imports

Ratio scale, billions of chained (1992) dollars



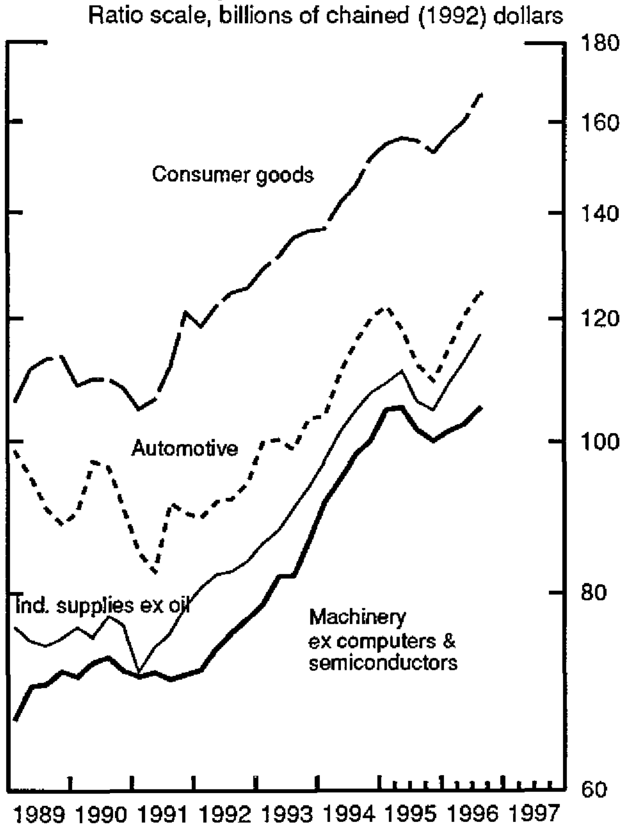
Selected NIPA Exports

Ratio scale, billions of chained (1992) dollars



Selected NIPA Imports

Ratio scale, billions of chained (1992) dollars



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

	Levels				Amount Change 1/			
	1996		1996		1996		1996	
	Q3	Q4e/	Oct	Nov	Q3	Q4e/	Oct	Nov
Exports of G&S	823.1	862.2	860.7	863.7	-12.9	39.1	34.6	3.0
Goods exports	600.7	633.6	634.5	632.8	-11.7	33.0	30.9	-1.7
Agricultural	59.9	62.8	59.3	66.2	-0.3	2.9	1.5	6.9
Gold	5.2	3.8	4.4	3.2	-7.3	-1.4	-0.1	-1.3
Other goods	535.5	567.1	570.8	563.4	-4.1	31.5	29.6	-7.4
Aircraft & pts	26.7	35.2	37.0	33.4	-6.6	8.4	13.2	-3.6
Computers	43.0	44.1	44.1	44.1	-0.2	1.1	1.0	0.1
Semiconductors	33.7	36.9	36.8	37.1	-1.2	3.3	2.7	0.2
Other cap gds	140.9	151.2	151.1	151.3	0.7	10.3	11.1	0.3
Automotive	66.9	64.5	62.9	66.1	3.8	-2.4	-10.3	3.3
to Canada	36.3	33.6	30.1	37.1	1.7	-2.7	-9.5	7.0
to Mexico	7.9	8.6	10.5	6.7	-0.0	0.7	1.0	-3.8
to ROW	22.7	22.3	22.3	22.3	2.2	-0.4	-1.8	0.1
Ind supplies	128.7	135.6	138.5	132.7	-0.6	6.9	7.6	-5.9
Consumer goods	69.0	73.7	74.6	72.9	-1.4	4.7	4.0	-1.8
All other	26.6	25.9	25.9	25.9	1.4	-0.7	8.9	-0.0
Services exports	222.4	228.5	226.2	230.9	-1.2	6.1	3.6	4.7
Imports of G&S	957.8	960.6	956.7	964.5	7.5	2.8	-6.6	7.7
Goods imports	806.4	806.7	803.6	809.7	6.1	0.2	-10.2	6.1
Petroleum	71.6	72.4	76.3	68.5	1.6	0.8	0.6	-7.7
Gold	6.2	3.7	3.9	3.5	-8.4	-2.5	0.4	-0.4
Other goods	728.6	730.6	723.5	737.6	13.0	1.9	-11.2	14.2
Aircraft & pts	13.1	13.1	12.8	13.4	0.4	0.0	-0.5	0.6
Computers	61.4	60.7	60.3	61.1	0.9	-0.7	-0.8	0.7
Semiconductors	33.4	32.2	31.8	32.5	-3.6	-1.3	-2.2	0.7
Other cap gds	117.2	120.7	119.3	122.0	1.7	3.5	1.1	2.7
Automotive	135.7	129.2	123.1	135.4	4.6	-6.5	-11.5	12.3
from Canada	51.5	42.0	37.2	46.8	2.3	-9.5	-13.9	9.6
from Mexico	23.2	24.6	25.7	23.5	-0.8	1.3	1.8	-2.2
from ROW	61.0	62.7	60.2	65.1	3.2	1.7	0.7	4.9
Ind supplies	130.7	130.5	131.1	129.9	3.8	-0.2	0.4	-1.2
Consumer goods	172.4	177.7	178.7	176.7	6.1	5.3	1.2	-2.0
Foods	35.8	35.8	36.2	35.5	-0.1	0.0	0.4	-0.8
All other	28.9	30.6	30.0	31.2	-0.8	1.8	0.6	1.2
Services imports	151.4	153.9	153.1	154.8	1.4	2.6	3.7	1.6
Memo:								
Oil qty (mb/d)	10.01	8.96	9.46	8.46	0.18	-1.05	-0.64	-1.00
Oil price ($/bbl)	19.58	22.13	22.08	22.18	0.05	2.54	1.54	0.10

1. Change from previous quarter or month.
Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

increases in a wide range of other trade categories, especially imported consumer goods, machinery (other than computers and semiconductors), and services. Over the past year imports rose 7-1/2 percent with the increases spread over most major trade categories. Exceptions were imports of semiconductors, which declined sharply through most of the year and have only begun to move back up, and automotive products from Canada.

Oil Imports

The value of imported oil in October-November was about the same (AR) as in the third quarter, as a 10 percent drop in quantity was offset by a sharp increase in price. The quantity of oil imported fell 10.5 percent (1.05 mb/d) on average during October-November after rising 2.0 percent during the third quarter. Weaker consumption accompanied by the normal seasonal stock drawdown led to the lower rate of oil imports. Preliminary Department of Energy statistics for December indicate that oil imports rebounded in response to stronger consumption in December but have remained below their third-quarter pace.

Prices of imported oil were significantly higher in the fourth quarter than in the third quarter. Prices rose 7 percent in October and remained at or above that higher level through year-end. The price of imported oil now stands 37 percent above its December 1995 level. The price of spot WTI rose $1.68 per barrel in December after declining $1.20 per barrel in November. Skirmishes in the Kurdish region of Northern Iraq, strikes in France that have interrupted refinery operations, and concern over the level of heating oil stocks in the United States and Europe because of extremely cold weather in Europe helped push prices up in December. Deliveries of oil from Iraq put downward pressure on prices during January, offsetting the effects of the cold winter. The price of spot WTI remains quite volatile and is trading in the $23-25 per barrel range.

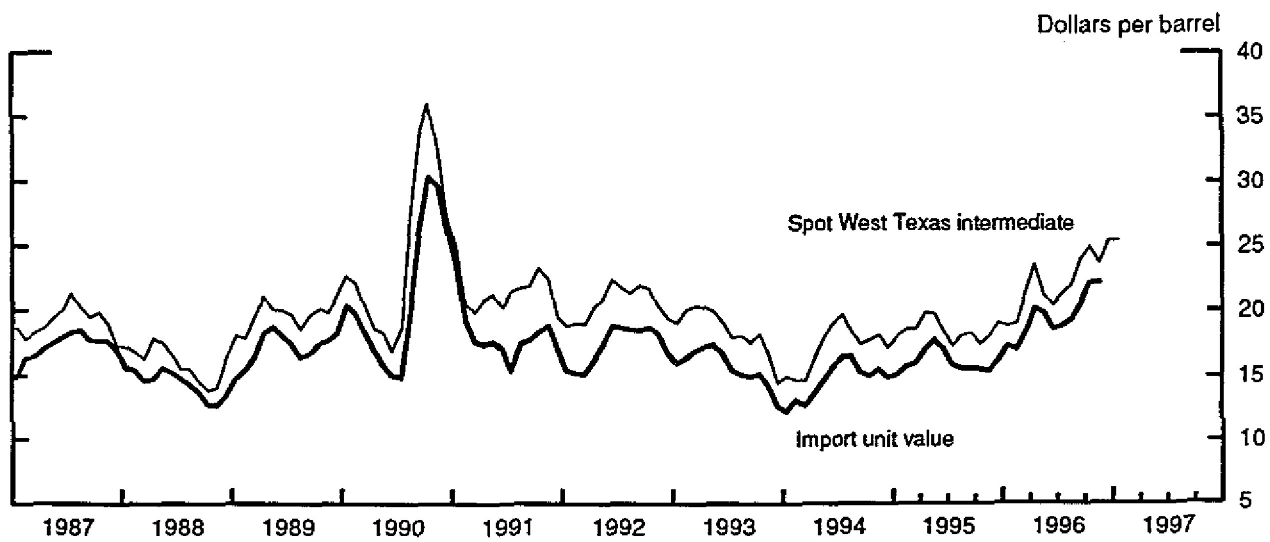
Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports increased slightly in December after two consecutive months of decline. Most of the increase was attributable to higher prices for non-oil industrial supplies, and to a lesser degree, automotive vehicles and consumer goods. For the fourth quarter, non-oil import prices declined only slightly, as

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

	Annual rates 1996 Q2	Q3	Q4	Monthly rates 1996 Oct	Nov	Dec
	----------BLS prices (1990=100)----------					
Merchandise imports	1.5	-2.3	5.1	0.6	-0.2	0.1
Oil	41.0	2.1	60.8	7.0	-0.8	0.3
Non-oil	-2.3	-2.9	-0.4	-0.3	-0.1	0.1
Foods, feeds, bev.	11.6	-10.7	3.8	0.2	0.3	-1.2
Ind supp ex oil	-5.0	-5.2	0.9	-0.6	0.5	0.6
Computers	-16.7	-10.8	-8.4	-0.4	-0.9	-0.6
Semiconductors	-16.6	-15.5	-14.9	-2.2	-2.5	-2.3
Cap. goods ex comp & semi	-2.8	-0.4	-0.2	-0.1	-0.1	0.1
Automotive products	-0.3	0.6	0.1	-0.2	-0.2	0.3
Consumer goods	-0.9	-0.9	-0.4	-0.2	-0.1	0.1
Merchandise exports	2.6	-3.6	-4.2	-0.3	-0.4	0.0
Agricultural	31.4	-18.0	-32.0	-2.6	-2.3	-0.9
Nonagricultural	-1.2	-0.9	0.4	0.0	0.0	0.1
Ind supp ex ag	-4.8	-3.4	1.1	0.3	-0.4	0.3
Computers	-7.5	-11.8	-9.9	-0.6	-0.6	-1.2
Semiconductors	-5.3	-15.5	-3.5	-0.7	-0.1	0.1
Cap. goods ex comp & semi	2.4	1.8	1.0	0.1	0.2	0.2
Automotive products	0.2	0.2	1.2	0.2	0.2	0.0
Consumer goods	1.5	0.7	0.8	0.0	0.0	0.2
	---Prices in the NIPA accounts (1992=100)--					
Fixed-weight						
Imports of gds & serv.	0.7	-2.0	n.a	...	...	...
Non-oil merchandise	-3.8	-3.0	n.a	...	...	...
Exports of gds & serv.	1.4	-1.8	n.a	...	...	...
Nonag merchandise	-2.6	-2.3	n.a	...	...	...

Oil Prices



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

	1994	1995	1995	1996				
			Q4	Q1	Q2	Q3	Oct	Nov
Official capital								
1. Change in foreign official reserve assets in U.S. (increase, +)	38.0	109.9	10.6	52.2	13.4	23.2	3.1	15.0
a. G-10 countries	28.9	33.1	-3.9	28.5	3.5	1.4	2.2	-3.1
b. OPEC countries	-3.3	4.3	-2.1	-.8	5.3	5.3	*	1.7
c. All other countries	12.4	72.6	16.6	24.5	4.5	16.5	1.0	16.3
2. Change in U.S. official reserve assets (decrease, +)	5.3	-9.7	.2	*	-.5	7.5	-.1	-.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	102.8	-33.1	10.7	-25.6	-11.9	-8.4	15.8	-25.3
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	92.9	190.8	23.6	49.8	61.7	78.9	28.4	30.8
a. Treasury securities[3]	34.7	99.9	1.9	13.1	31.8	43.6	17.6	16.6
b. Corporate and other bonds[4]	53.9	82.6	17.7	32.8	23.6	33.4	10.1	13.5
c. Corporate stocks	4.3	8.2	4.0	3.8	6.3	2.0	.4	.7
5. U.S. net purchases (-) of foreign securities	-57.3	-98.7	-32.3	-34.4	-20.2	-21.1	-8.1	-2.9
a. Bonds	-9.2	-48.4	-18.5	-11.9	-2.8	-13.0	-5.8	-.9
b. Stocks	-48.1	-50.3	-13.8	-22.5	-17.4	-8.1	-2.3	-2.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-54.5	-95.5	-44.1	-23.2	-26.2	-8.4	n.a	n.a
7. Foreign direct investment in U.S.	49.8	60.2	14.8	28.7	17.4	25.1	n.a	n.a
8. Other (inflow, +)[5]	-14.9	-7.2	17.5	-16.7	16.2	-27.4	n.a	n.a
U.S. current account balance (s.a.)	-148.4	-148.2	-30.4	-34.9	-40.2	-48.0	n.a	n.a
Statistical discrepancy (s.a.)	-13.7	31.5	29.4	4.1	-9.6	-21.4	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. goverment 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.

increases in prices of industrial supplies and automotive products offset declines in other categories.

Prices of exports remained unchanged in December, primarily because the continuing decline in prices of agricultural products offset the rise in prices of nonagricultural exports. In the fourth quarter, prices of agricultural exports dropped 32 percent at an annual rate. Prices of nonagricultural exports rose slightly in the fourth quarter with increases spread among all major trade categories except computers and semiconductors.

U.S. International Financial Transactions

Foreign official reserve assets in the United States rose by $15 billion in November (line 1 of the Summary of U.S. International Transactions table). This increase is entirely attributable to countries outside of the G-10. Spain, Brazil, China, and Taiwan all recorded substantial increases. Partial data for December from FRBNY show a further increase in foreign official reserves of $13 billion. Again, the increase came from countries outside the G-10. OPEC reserves rose as did those of China, Spain, and several Latin American countries.

Foreign private purchases of U.S. securities remained strong in November (line 4). Of the $31 billion in net purchases in the month, roughly one half was in Treasury securities, one-sixth in agency securities, and most of the rest in corporate bonds. These proportions are similar to the year 1996 through November. As is generally the case, about half of the foreign purchases of corporate and agency bonds in November (line 4b) were recorded in the United Kingdom. Japanese residents recorded net purchases of about $2 billion in November, slightly above their average share for the year through November.

Of the $17 billion in foreign purchases of Treasuries in November (line 4a), almost $13 billion was attributable to offshore financial centers in the Caribbean. Purchases and sales of Treasuries by these centers tend to be large and volatile, and they have shown little net accumulation over the course of 1996.

Transactions by these offshore centers are also reflected in the monthly movements of international bank flows, as U.S. banks and securities dealers provide some of the financing for these purchases. Of the $25 billion net outflow recorded by banking

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

	1994 Dec.	1995 Dec.	1996 Mar.	1996 Jun.	1996 Sep.	1996 Oct.	1996 Nov.	1996 Dec.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-260.1	-245.0	-246.5	-242.0	-234.4	-230.6
a. U.S.-chartered banks	-70.1	-86.1	-84.1	-77.2	-72.7	-73.3	-66.3	-65.8
b. Foreign-chartered banks	-153.9	-173.9	-176.0	-167.8	-173.8	-168.7	-168.1	-164.8
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	27.3	28.8	29.2	30.5	31.2	31.9
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	90.0	85.4	83.3	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	85.6	91.2	95.7	101.0	101.4	106.5	106.1	110.2
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	96.6	103.7	109.4	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	173.9	208.6	214.1	221.2	n.a.	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	245.8	278.9	292.0	295.0	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. They include some foreign-currency denominated deposits and loans. Source: SCB offices in November (line 3) roughly half is attributable to lending by securities dealers.

Smoothing through the monthly swings, there have been large net outflows through banking transactions over the course of the year. As shown in line 1 of the International Banking Table, on a monthly average basis, U.S. banking offices increased their net claims on related foreign offices and IBFs by almost $30 billion during 1996. In addition, Eurodollar holdings of U.S. non-bank residents increased substantially during the year (line 3). BEA has not fully incorporated the increase in Eurodollar holdings into the accounts for the third quarter, which explains part of the large negative statistical discrepancy in that quarter (last line of the Summary Table).

U.S. private purchases of foreign bonds slowed markedly in November, while purchases of foreign equities remained at roughly their subdued third-quarter pace (lines 5a and 5b of the Summary Table). Large net securities purchases in Asia, outside of Japan, were offset by sales in the Caribbean.

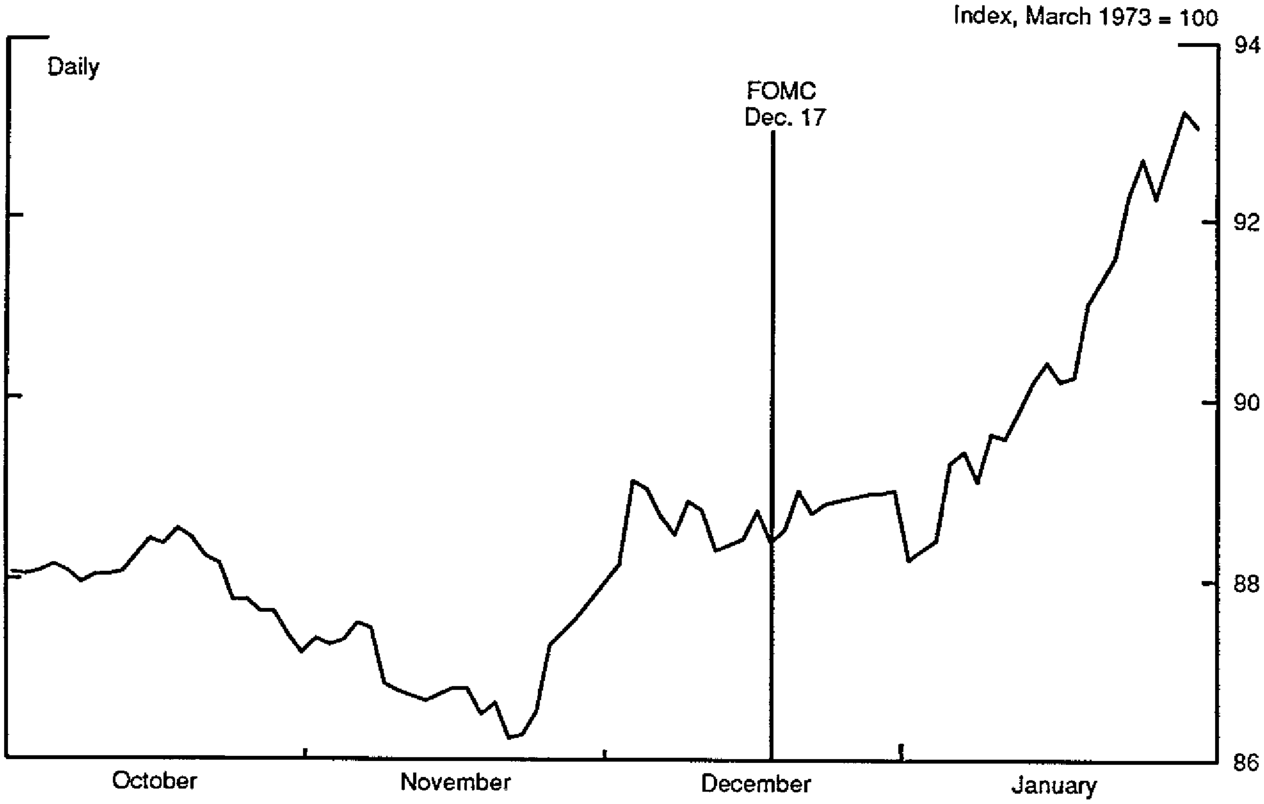
Foreign Exchange Markets

The weighted-average value of the dollar in terms of the other G-10 currencies has risen 4-3/4 percent since the December 17 FOMC meeting. The dollar strengthened 6-3/4 percent against the yen and 5-3/4 percent against the mark and most other ERM currencies. The dollar appreciated 2-1/2 percent on balance against sterling, but depreciated 1-1/2 percent against the Canadian dollar.

Concerns over the near-term health of the Japanese economy and the attendant implications for Japanese monetary policy have contributed to the dollar's rise against the yen. These concerns appear to be related to the restrictive budget for the fiscal year beginning in April that was approved by the Japanese cabinet in late December. In addition, renewed worries about the financial condition of Japanese banks may have weighed on the yen. "Verbal intervention" by Japanese officials in January did little to reverse the yen's decline.

The dollar's strength over the intermeeting period against the mark and other ERM currencies is related to the apparent divergence in economic activity between the United States and most continental European countries. Recent data releases in the United States have

Weighted Average Exchange Value of the Dollar



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Dec. 16	Jan. 29	Change	Dec. 16	Jan. 29	Change
Germany	3.15	3.05	-0.10	5.84	5.82	-0.02
Japan	0.51	0.53	0.02	2.47	2.42	-0.05
United Kingdom	6.28	6.19	-0.09	7.57	7.50	-0.07
Canada	3.23	3.18	-0.05	6.55	6.70	0.15
France	3.33	3.24	-0.09	5.77	5.64	-0.13
Italy	7.25	7.31	0.06	7.39	7.10	-0.29
Belgium	2.99	2.98	-0.01	5.94	5.87	-0.07
Netherlands	2.98	2.87	-0.11	5.75	5.65	-0.10
Switzerland	1.94	1.69	-0.25	3.67	3.74	0.07
Sweden	3.79	4.00	0.21	6.69	6.56	-0.13
Weighted-average foreign	3.51	3.46	-0.05	5.73	5.66	-0.07
United States	5.43	5.43[p]	0.00	6.39	6.64[p]	0.25

Note. Change is in percentage points. [p] Preliminary.

suggested an acceleration in U.S. economic activity. In contrast, recent economic indicators in most continental European countries generally have been weaker than market expectations. As suggested by implied yields on Euromark futures contracts, market participants now expect Bundesbank policy, especially in 1998, to be less restrictive than they did at the time of the December 17 FOMC meeting.

The dollar appreciated against sterling as recent data on U.K. manufacturing output and retail sales suggested that the economy was not expanding as rapidly as the market had feared. The reduced concern about excessive growth, in conjunction with lower-than-expected retail price inflation in December, appear to have diminished expectations of a near-term tightening by the Bank of England.

Foreign short-term interest rates were little changed over the intermeeting period as monetary policy remained on hold in most foreign countries. On January 21 the Bank of Italy reduced its discount rate by 3/4 percentage point to 6-3/4 percent following the release of benign inflation data. The easing was widely expected, although the reduction came about 1 month sooner than expected. Foreign long-term interest rates declined about 5 basis points on a weighted-average basis as foreign economic activity appeared to decelerate.

Since the last FOMC meeting, the Japanese stock market (as measured by the TOPIX index) has declined 10 percent due to concerns about the near-term outlook for the Japanese economy, discussed previously. Prices of Japanese bank shares, which slid 22 percent over the intermeeting period, have also been depressed by renewed worries about the effect of financial deregulation on the profitability of Japanese banks.

The Desk did not intervene in the foreign exchange market over the intermeeting period.

Developments in Foreign Industrial Countries

Economic activity in the major foreign industrial countries on average appears to have continued to expand at a moderate rate in the fourth quarter. Recent indicators suggest strong performances in Japan, Canada, and the United Kingdom, while growth appears to have slowed in the major continental European countries. Forward-looking indicators are mixed, with measures of business sentiment up on balance in the fourth quarter in Canada, Japan, Germany, and France, but down a little in the United Kingdom as a result of a less optimistic outlook for exports, and still quite weak in Italy.

Unemployment rates remain high in most countries (with the notable exception of the United Kingdom), and consumer price inflation has generally stayed low. Prices are currently little changed from year-ago levels in Japan and are up less than 2 percent in Germany and France and only slightly more in Canada. Italian inflation is currently running at just over 2-1/2 percent, about half the rate recorded a year ago. In contrast, underlying inflation in the United Kingdom edged above 3 percent on a twelve-month basis in December.

Individual country notes. In **Japan**, available information points to renewed expansion in the fourth quarter following a weak third quarter. Virtually all indicators, including industrial production, housing starts, machinery orders, and new car registrations have shown large gains in recent months. The ratio of job offers to applicants increased in November to its highest level in three years, and the unemployment rate has held steady although many workers have quit their jobs in search of better positions. The Bank of Japan's November survey (Tankan) registered a modest improvement in business sentiment at major manufacturers and confirmed the findings of the May and August surveys that capital spending plans are improving.

Consumer prices remain stable, although the recent further depreciation of the yen appears to be contributing to some pickup in wholesale prices. Japan's merchandise trade balance rose sharply in the fourth quarter, to $17.1 billion, despite a large increase in the price of imported oil. However, the balance for the year 1996 was $61.8 billion, down substantially from $106.6 billion in 1995.

The cabinet approved a supplementary budget for fiscal year 1996 (ending in March) and an initial budget for fiscal year 1997 to be presented to the Diet this month. The proposed budgets imply a fiscal contraction of about 1-1/2 percent of GDP this year. This contraction is due almost entirely to tax increases, including an end to the temporary income tax rebate (effective January 1) and an increase in the consumption tax by 2 percentage points (effective April 1). Government purchases are expected to decline by 3/4 percent of GDP, but transfer payments should increase by nearly as much.

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

	1996						
	Q2	Q3	Q4	Sep.	Oct	Nov	Dec
Industrial Production	-0.3	1.6	3.3	1.5	3.9	-1.4	0.3
Housing Starts	1.4	2.6	n.a.	9.3	7.7	-5.5	n.a.
Machinery Orders	0.8	2.8	n.a.	6.5	21.0	-3.6	n.a.
New Car Registrations	-7.7	6.8	10.9	8.7	2.7	5.6	-1.1
Unemployment Rate (%)	3.5	3.3	n.a.	3.3	3.4	3.3	n.a.
Job Offers Ratio[1]	0.69	0.71	n.a.	0.71	0.73	0.74	n.a.
Business Sentiment[2]	-3	-7	-3	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	0.1	-0.4	0.0	0.1	0.2
Wholesale Prices[3]	1.3	0.7	0.6	0.0	0.3	0.5	0.9

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 government continues to stress the importance of bureaucratic and economic reform. Prime Minister Hashimoto has lent his support to measures that would increase the independence of the Bank of Japan and establish a depository institutions supervisory agency independent of the Ministry of Finance. Prospects for serious reform of the financial sector appear to have improved. The proposed reforms would encourage greater competition and efficiency with fewer regulatory restrictions.

German economic activity appears to have slowed in the fourth quarter following a half-year of above-trend growth. Industrial production in October and November was a little below its third-quarter average, while the unemployment rate continued to rise, reaching a new postwar high in December. Forward-looking indicators are mixed. New orders for manufactured goods in October and November were little changed on average relative to their third-quarter level following substantial increases in the two previous quarters. The IFO business climate index improved on average in the fourth quarter, and capacity utilization in manufacturing registered another small gain. Twelve-month inflation remains low, registering a little under 1-1/2 percent in December. Consumer prices in the western states rose 1.8 percent over the year to January, but this appears to have been largely due to higher energy prices and is expected to be temporary.

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

	1996						1997
	Q2	Q3	Q4	Oct	Nov	Dec	Jan
Industrial Production	2.8	1.2	n.a.	-0.7	0.8	n.a.	n.a.
Orders	3.7	0.8	n.a.	2.7	-0.6	n.a.	n.a.
Unemployment Rate (%)	10.2	10.4	10.7	10.6	10.7	10.9	n.a.
Western Germany	9.0	9.2	9.5	9.4	9.5	9.6	n.a.
Eastern Germany	15.6	15.3	15.8	15.5	15.8	16.2	n.a.
Capacity Utilization[1]	82.2	82.6	83.0	...	...	...	...
Business Climate[1,2]	-17.7	-11.3	-3.3	-2.0	-4.0	-4.0	n.a.
Consumer Prices[3]	1.5	1.5	1.4	1.5	1.4	1.4	1.8

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 German government estimates a general government budget deficit-to-GDP-ratio of 3.9 percent for 1996, and projects a ratio of 2.9 percent for 1997, just below the Maastricht reference value of 3 percent. The 1997 projection has been revised up from 2.5 percent incorporated into the budget passed by the parliament in December, reflecting higher estimated levels of unemployment. In response, it is expected that a freeze on large federal expenditures will be imposed, similar to measures that have been taken in the two previous years.

In **France**, real GDP is likely to have fallen a little in the fourth quarter as a result of a drop in the number of working days, as well as a decline in auto output following the expiration of an auto incentive scheme at the end of September. Consumer confidence stabilized last quarter, but was still low, reflecting general discontent with the government, while the unemployment rate has continued to rise, reaching 12.7 percent in November. Producers' expectations of future output improved a little in the fourth quarter, while inventories appear to have returned to a more normal level following a sizable decumulation last year. Twelve-month consumer-price inflation has remained low, averaging about 1-3/4 percent through December.

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

	1996						
	Q2	Q3	Q4	Sep	Oct	Nov	Dec
Consumption of Manufactured Products	-1.7	2.7	-3.3	-1.2	-3.1	-0.6	-0.8
Industrial Production[1]	0.4	1.9	n.a.	-1.1	-0.7	0.2	n.a.
Capacity Utilization	82.7	82.7	n.a.	...	...	...	...
Unemployment Rate (%)	12.4	12.5	n.a.	12.6	12.6	12.7	n.a
Business Confidence[2]	-25.7	-26.7	-19.7	-29.0	-23.0	-21.0	-15.0
Consumer Prices[3]	2.4	1.8	1.7	1.6	1.8	1.6	1.7

1. For the months of July and August, INSEE publishes a composite number for industrial production.
2. Percent balance of respondents citing an improvement in the outlook versus those citing a worsening.
3. Percent change from previous year.

Recent indicators suggest that economic activity in the **United Kingdom** continues to expand at a healthy pace. Real GDP growth picked up to 3 percent (SAAR) in the fourth quarter on the strength of services, construction, electricity output, and oil extraction. Retail sales were up a robust 1 percent for the fourth-quarter on average, despite a drop in December. The unemployment rate fell to 6.7 percent in December, its lowest level since early 1991. However, some of the decline in registered unemployment in the fourth quarter is the result of recent changes to the unemployment benefit system. In the current quarter, surveys of consumer confidence rebounded in January to the high level recorded in November. Surveys of manufacturers in January suggest a slower pace of expansion, with continued strength in domestic demand, particularly for consumer goods, while optimism about export orders dropped considerably.

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

	1996						1997
	Q2	Q3	Q4	Oct	Nov	Dec	Jan
Real GDP (AR)	2.2	2.7	3.0	...	...	...	...
Non-oil GDP (AR)	1.9	2.6	3.0	...	...	...	...
Industrial Production	0.3	0.3	n.a.	-0.1	0.4	n.a.	n.a.
Retail Sales	1.3	0.9	1.0	0.4	0.9	-0.8	n.a.
Unemployment Rate (%)	7.7	7.5	6.9	7.2	6.9	6.7	n.a.
Business Sentiment	14.0	21.3	18.0	20.0	21.0	13.0	14.0
Consumer Prices[1]	2.8	2.9	3.2	3.3	3.3	3.1	n.a.
Producer Input Prices[2]	0.0	-2.8	-4.6	-2.5	-5.4	-6.0	n.a.
Average Earnings[2]	3.8	4.0	n.a.	4.0	4.0	n.a.	n.a.

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

Retail prices excluding mortgage interest payments rose 3.1 percent in December from a year earlier, well above the government's target rate of 2-1/2 percent or less. Excluding fuel, the twelve-month change in retail prices was more moderate in December--about 2-3/4 percent--and has edged down over the past year. The underlying rate of increase of average earnings remained at 4 percent in November for the fifth consecutive month, while producer input prices in December dropped considerably below year-earlier levels, in part as a result of the appreciation of the pound last year.

In **Italy**, third-quarter real GDP growth was revised up to 2.4 percent, compared with 2 percent in the preliminary release. The government has recently announced tax incentives for auto purchases in an attempt to stimulate durable goods spending, which fell in the third quarter.

Available monthly indicators point to a weak fourth quarter. Industrial output in October and November was about unchanged relative to the third-quarter level, while industrial orders dropped in October and business sentiment has remained gloomy. Consumer confidence rose in January but remained below the levels recorded earlier last year. Meanwhile, inflation has stabilized. In January, the consumer price index was up 2.6 percent on a year-over-year basis for the third consecutive month.

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

	1995			1996		
	Q2	Q3	Q4	Q1	Q2	Q3
GDP	0.5	2.4	0.2	1.8	-1.6	2.4
Private Consumption	2.7	1.2	-0.5	0.4	0.9	0.8
Investment	6.9	4.1	6.0	-1.6	-0.3	0.7
Government Consumption	-0.8	-0.2	-1.8	-0.9	0.4	0.1
Exports	17.9	-1.0	-9.9	0.9	1.8	8.1
Imports	14.4	11.9	-1.7	-5.9	-16.6	4.7
Total Domestic Demand	-0.8	5.4	2.5	0.3	-5.9	1.4
Net Exports (contribution)	1.3	-2.7	-2.2	1.6	4.2	1.0
Inv. Change(contribution)	-3.4	3.7	2.0	0.4	-6.3	0.7

In response to the stagnant economy and declining inflation, the Bank of Italy on January 21 lowered its official rates for the third time since July. Both the discount and Lombard rates, which currently stand at 6-3/4 percent and 8-1/4 percent respectively, are at their lowest levels since September 1975.

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

	1996						1997
	Q2	Q3	Q4	Oct	Nov	Dec	Jan
Industrial Production	-1.4	-0.4	n.a.	-0.9	1.0.	n.a.	n.a.
Cap. Utilization (%)	76.6	75.6	n.a.	...	...	...	...
Unemployment Rate (%)	12.2	12.1	12.0	...	...	...	...
Consumer Confidence[1]	113.8	114.1	104.7	106.0	102.7	105.3	109.9
Bus. Sentiment[2] (%)	-1.0	-1.0	n.a	-3.0	-5.0	n.a.	n.a.
Consumer Prices[3]	4.2	3.5	2.8	3.0	2.6	2.6	2.6
Wholesale Prices[3]	3.4	2.0	n.a.	2.2	1.8	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 December 21, the Senate approved the 1997 budget, which includes a $41 billion equivalent deficit reduction package. The package aims to reduce Italy's 1997 fiscal deficit to 3 percent of GDP. On January 2, the government announced that the preliminary 1996 budget deficit as a share of GDP was 7.5 percent, an overrun of close to three quarters of one percent from the latest official target.

In **Canada**, recent indicators suggest that economic activity expanded at a healthy pace in the fourth quarter. Retail sales increased sharply in both October and November, and were 2 percent above their third-quarter level on average. If sustained, this would be the strongest quarterly increase in two years. The index of consumer attitudes also continued to rise, while the index of business confidence reached a record high.

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

	1996						
	Q2	Q3	Q4	Sep	Oct	Nov	Dec
Industrial Production	0.4	1.8	n.a.	0.0	0.1	n.a.	n.a.
Manufacturing Survey:							
Shipments	2.4	3.1	n.a.	1.0	-2.8	3.0	n.a.
New Orders	2.5	2.6	n.a.	-0.1	-1.3	1.9	n.a.
Retail Sales	0.3	0.7	n.a.	0.5	1.3	0.9	n.a.
Housing Starts	10.9	3.2	1.8	2.4	-9.8	16.9	-1.1
Employment	0.2	0.1	0.4	-0.3	0.3	0.1	0.2
Unemployment Rate (%)	9.6	9.7	9.9	9.9	10.0	10.0	9.7
Consumer Prices[1]	1.4	1.4	2.0	1.5	1.8	2.0	2.2
Consumer Attitudes[2]	101.5	102.3	104.6	...	...	...	...
Business Confidence[3]	149.1	148.3	153.1	...	...	...	...

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

Manufacturing shipments fell in October but recovered in November, reflecting large swings in shipments of motor vehicles and parts as a result of the Canadian GM strike. For October and November on average, both shipments and new factory orders were slightly below the third-quarter average. Although employment edged up in both November and December, the unemployment rate remained high in the fourth quarter. Headline consumer price inflation rose a little more in December, but remains close to the midpoint of the Bank of Canada's target range of 1-3 percent.

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

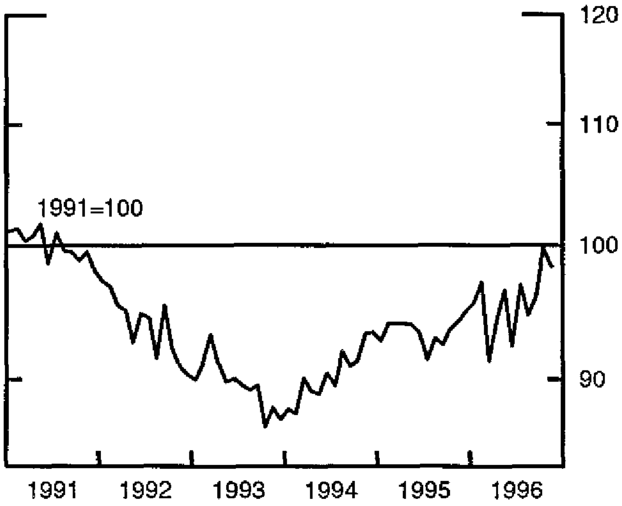
	1996	1996						
		Q2	Q3	Q4	Sep	Oct	Nov	Dec
Japan: trade	61.8	13.6	14.4	17.1	4.7	4.6	8.0	4.5
current account	n.a.	15.3	18.9	n.a.	4.7	4.9	7.4	n.a.
Germany: trade[1]	n.a.	15.3	17.9	n.a.	5.5	7.3	n.a.	n.a.
current account[1]	n.a.	-3.7	-7.2	n.a.	-1.0	n.a.	n.a.	n.a.
France: trade	n.a.	4.6	6.4	n.a.	1.8	3.2	1.9	n.a.
current account	n.a.	3.8	4.8	n.a.	2.8	2.6	n.a.	n.a.
U.K.: trade	n.a.	-5.0	-5.0	n.a.	-1.9	-1.1	-1.6	n.a.
current account	n.a.	0.4	-0.5	n.a.	...	...	...	...
Italy: trade	n.a.	12.3	10.1	n.a.	2.8	n.a.	n.a.	n.a.
current account[1]	n.a.	11.1	14.2	n.a.	1.0	n.a.	n.a.	n.a.
Canada: trade	n.a.	7.3	7.4	n.a.	2.3	1.1	1.4	n.a.
current account	n.a.	0.8	0.4	n.a.	...	...	...	...

1. Not seasonally adjusted.
... Data not available on a monthly basis.

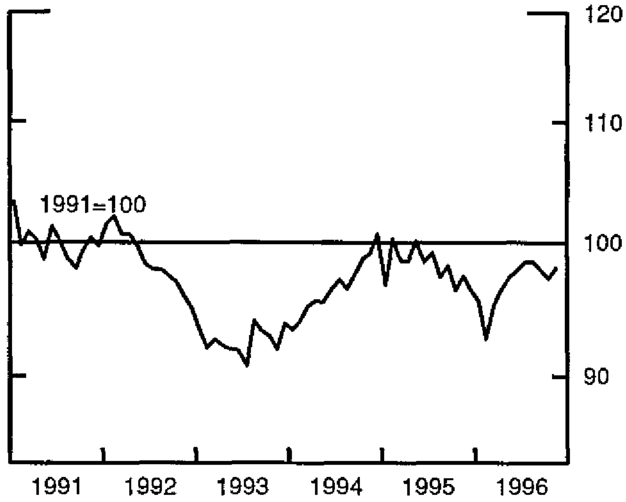
Industrial Production in Selected Industrial Countries

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

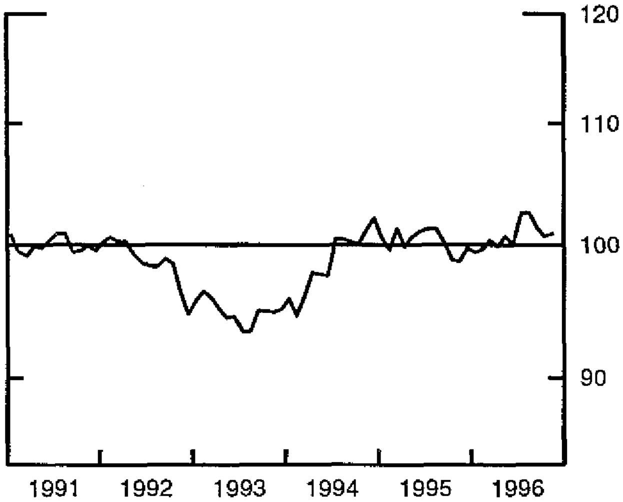
Japan



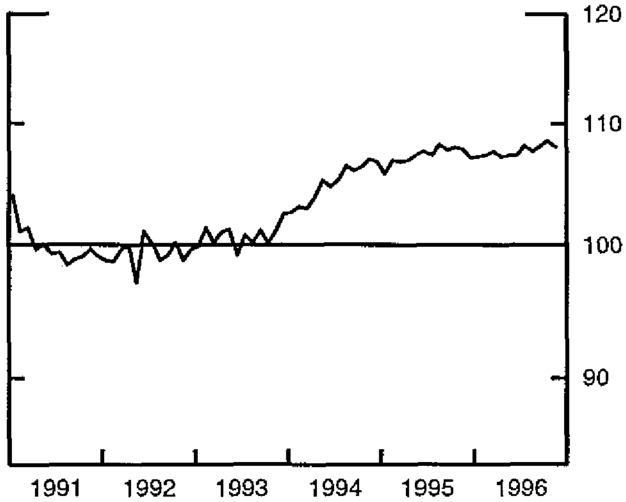
Germany



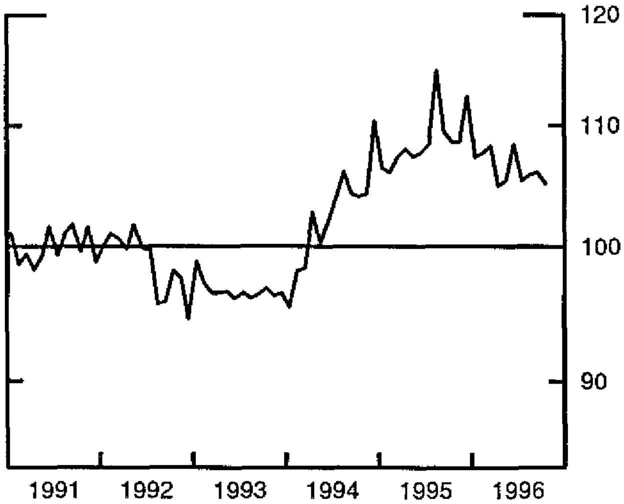
France



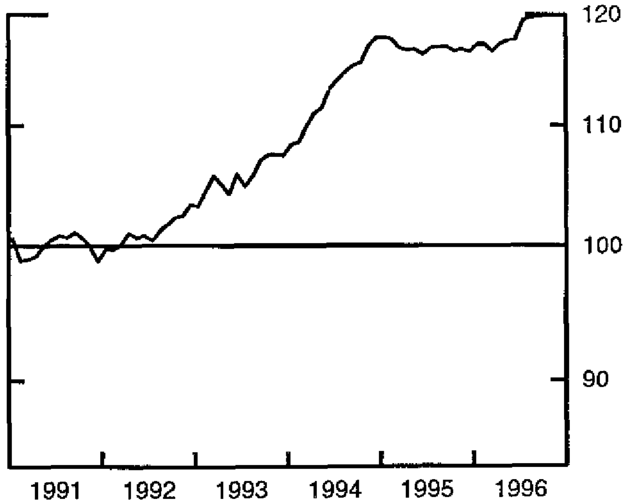
United Kingdom



Italy



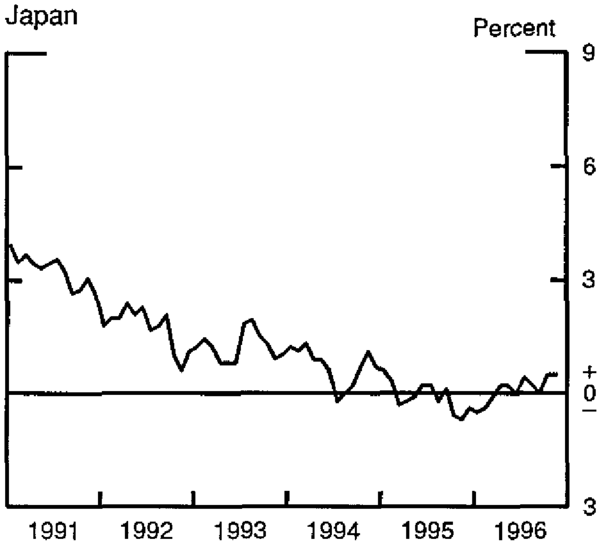
Canada



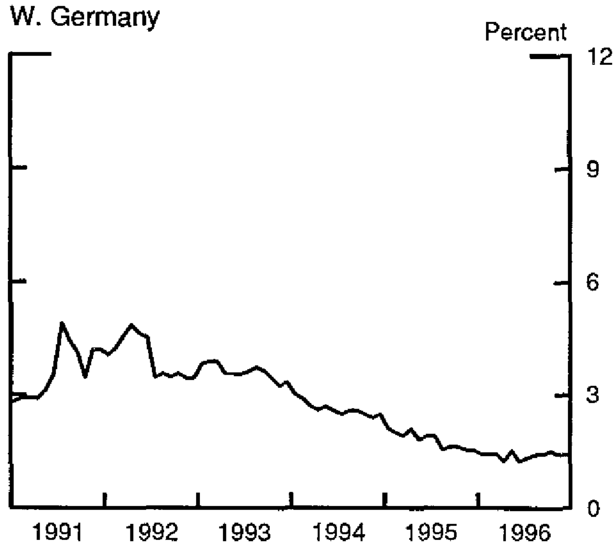
Consumer Price Inflation in Selected Industrial Countries

(12-month change)

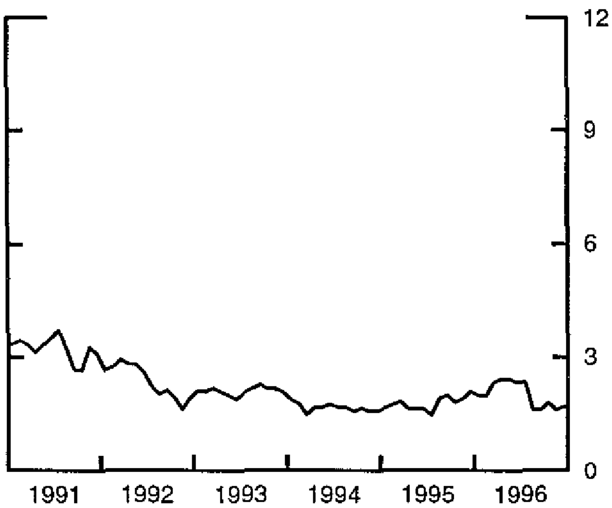
Japan



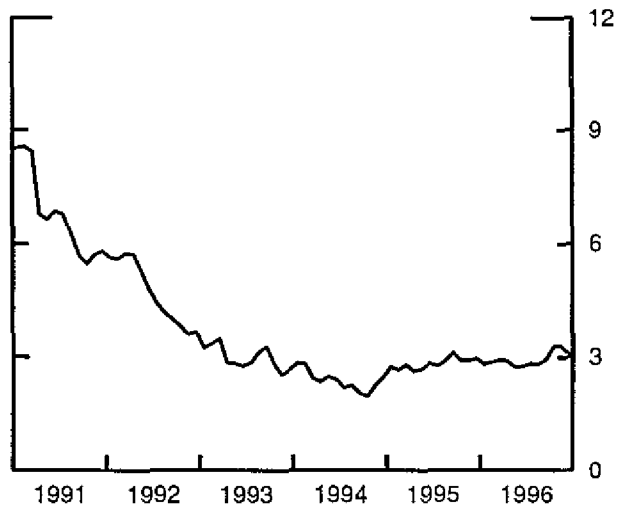
W. Germany



France

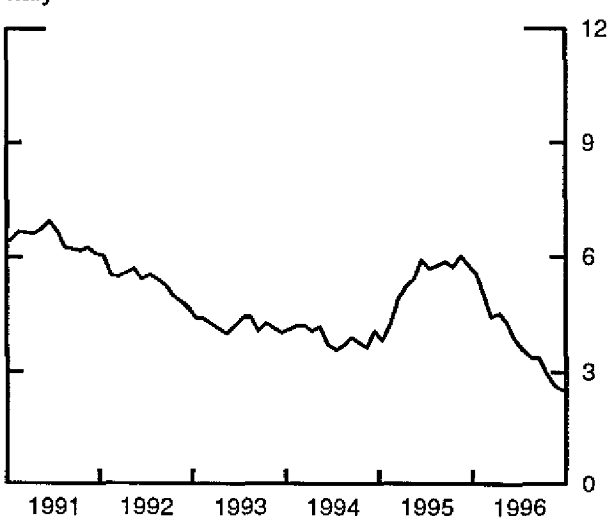


United Kingdom

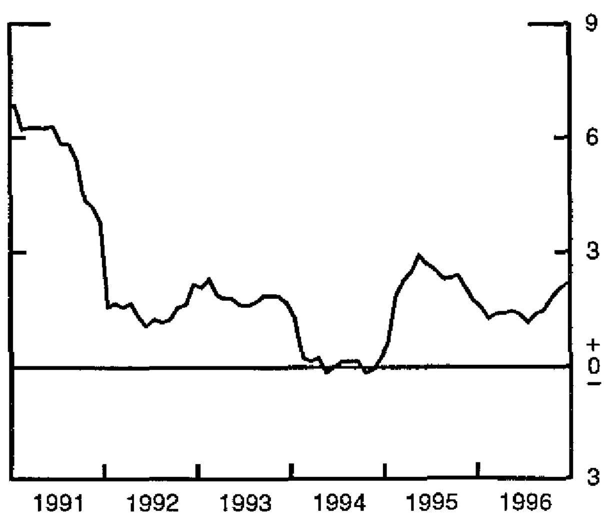


Note: Excludes mortgage interest payments.

Italy



Canada



Economic Situation in Other Countries

In Latin America, the strong expansion in economic activity in Mexico, Argentina, and Brazil continues, and prospects for Venezuela also look slightly better. In Asia, output growth, although still high, has slowed somewhat in China, but prospects look better for Taiwan, which seems to have recovered from a mild slowdown earlier in the year. The situation in Korea is uncertain as nationwide strikes have disrupted economic activity. In Russia, economic activity has continued to decline, but the pace of decline has been slowing.

Inflation for 1996 in the developing economies varied considerably across countries, but is generally on a downward trend. The fall in inflation rates for 1996 to single-digits in Brazil and China is notable, and Argentine prices were almost flat. Russian inflation also declined sharply in 1996. External balances have deteriorated in Mexico, Brazil, and Korea. For Mexico and Brazil this reflects the pick-up in aggregate demand. In Korea, it is the result of a slump in semi-conductor exports, combined with a rise in the value of oil imports due to higher international crude prices. In Taiwan, Argentina, and Venezuela, external balances have improved owing to a relatively weak domestic economy in Taiwan, strong export growth in Argentina (caused partly by strong Brazilian demand), and high oil prices in Venezuela. In China, the trade surplus was down relative to 1995, but exports picked up in the second half of 1996.

Individual country notes. On January 15, the government of **Mexico** repaid early the remaining $3.5 billion in emergency loans from the United States government (out of a maximum of $12.5 billion outstanding in mid-1995) and repaid $1.5 billion to the International Monetary Fund (reducing to less than $10-1/2 billion the amount owed on the $13 billion in drawings on the 1995 stand-by arrangement). The repayments were financed by borrowing from the private financial markets over the past several months and by revenues from PEMEX, the state oil company. The Mexican government is currently negotiating an Extended Fund Facility with the IMF that is likely to be for about $4 billion.

Economic data have continued to show a rebound in the Mexican economy. Industrial production was nearly 12 percent higher in November than it was a year earlier. The unemployment rate declined to 4.1 percent in December from 5.5 percent in December 1995. Data on the components of GDP in the third quarter of 1996 showed a 28 percent increase in investment spending from a year earlier and a more modest 5 percent increase in consumption, while net exports declined sharply from a year earlier. Those figures highlight the fact that the recovery is now being driven by a pickup in domestic demand, with net exports providing a negative contribution to GDP as imports accelerate and export growth slows. Trade data for December showed a continued narrowing of the trade surplus, as strong imports outweighed the continued positive effect of high oil prices on oil exports.

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

	1995	1996	1996		1996	
			Q3	Q4	Nov	Dec
Real GDP	-6.2	n.a.	7.4	n.a.	...	...
Industrial Production (SA)	-7.5	n.a.	16.3	n.a.	11.8	n.a.
Unemployment Rate (%)	6.3	5.5	5.5	4.7	4.8	4.1
Consumer Prices[1]	52.1	27.7	4.4	6.1	1.5	3.2
Trade Balance[2]	7.0	6.3	1.4	0.7	0.3	0.2
Imports[2]	72.5	89.6	22.9	25.5	8.2	8.2
Exports[2]	79.5	95.9	24.3	26.2	8.5	8.4
Current Account[2]	-0.7	n.a.	-0.7	n.a.	...	...

1. Percentage change from previous period.
2. Billions of U.S. dollars, NSA

Monthly inflation surged to 3.2 percent in December as the seasonal effects of greater spending and bonuses paid during the Christmas season were exacerbated by the 17 percent increase in the minimum wage, an 8 percent increase in gasoline prices, and a 20-50 percent increase in public transportation fares in Mexico City. The 5 percent net depreciation of the peso during October may also have added to the inflation uptick at year-end.

In **Argentina**, output growth is strong and there is virtually no inflation. Industrial production was up 10.9 percent in December from a year-earlier. Consumer prices fell in December, and Argentina ended 1996 with almost zero consumer price inflation for the year. However, unemployment remains very high and is up slightly, reported at 17.3 percent in the October survey. To alleviate the situation, President Menem recently used executive decrees to make some labor reforms. The unions challenged these in court and won, but the government will appeal.

Despite the strong growth, the trade balance has not deteriorated. Strong Brazilian demand has kept growth of Argentine exports high, and the trade surplus for January-November 1996 stood at $3.5 billion, up from $2.5 billion over the same period in 1995. International reserves (excluding gold) were at a record high of $18 billion at the end of December, up from $14 billion at the end of November. The sharp December increase was due to heavy government debt issuance in anticipation of 1997 financing needs and a seasonal increase in the private sector's demand for pesos. The government has also issued a $2 billion global bond in January and plans to issue another $1 billion in other bonds before the end of March.

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

	1995	1996	1996		1996	
			Q3	Q4	Nov	Dec
Real GDP	-4.4	n.a.	6.6	n.a.	...	...
Industrial Production (SA)	-6.2	3.4	8.6	11.7	12.8	10.9
Unemployment Rate (%)[2]	17.4	17.2	17.3	...	...	...
Consumer Prices[1]	1.5	0.2	0.5	0.2	0.0	-0.3
Trade Balance[3]	3.0	n.a.	0.8	n.a.	0.0	n.a.
Current Account[3]	-1.6	n.a.	n.a.	n.a.	...	...

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.

The current fiscal situation remains in control but is likely to be complicated down the road by another court ruling. The Convertibility Plan had discontinued the indexation of pension payments to cost of living changes, but the Supreme Court has now ruled that back payments must be made. These payments, which the government said it will honor, will cost about $3.5 billion. Argentina has agreed with the IMF on a three-year Extended Fund Facility arrangement to take over from the current stand-by accord, which will expire at the end of 1997.

In **Brazil**, monthly indicators suggest that economic activity continued to expand in the fourth quarter of 1996, but at a slower pace than in the third quarter, when real GDP grew by over 11 percent (s.a.a.r.). Consumer price inflation slowed from 22 percent in 1995 to roughly 9-1/2 percent in 1996 (December-over-December), the lowest 12-month increase in 40 years. Inflation has been remarkably low despite the government's slow progress enacting fiscal reforms.

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

	1995	1996	1996		1996	
			Q3	Q4	Nov	Dec
Real GDP*	4.2	3.2	6.5	n.a.	...	...
Industrial Production (SA)[1]	3.6	n.a.	5.3	n.a.	n.a.	n.a.
Open Unemployment Rate (%)	4.4	n.a.	5.5	n.a.	4.6	n.a.
Consumer Prices[1]	22.0	9.4	1.9	1.0	0.3	0.3
Trade Balance[2]	-3.2	-5.5	-1.2	-3.9	-0.9	-1.8
Current Account[2]	-17.8	-24.3	-3.7	-10.7	-2.1	-4.6

1. INPC, Percentage change from previous period. Annual data are Dec/Dec.
2. Billions of U.S. dollars, NSA
* Government estimate.

Strong aggregate demand contributed to a deterioration in the trade balance in the second half of 1996. As a result, Brazil's trade deficit widened from $3.2 billion in 1995 to $5.5 billion in 1996. The current account deficit in 1996 widened to $24.3 billion, roughly 3-1/4 percent of GDP. The deterioration in the external balance in recent months has renewed concerns over the loss of international competitiveness since the stabilization program was launched in mid-1994. (In real terms, the currency has appreciated by 25 percent since mid-1994, most of which occurred over the first year.) The Brazilian government has maintained that the current exchange rate policy, under which the domestic currency has depreciated slowly against the dollar in nominal terms within a wide band since mid-1995, will not be altered. (As of mid-January, the *real*/dollar exchange rate stood at 1.04, near the upper limit of 1.06.) International reserves stood at $60.1 billion at the end of December, down slightly from November, but well above the recent low of $32 billion that was registered in early 1995.

In **Venezuela**, growth prospects for the non-oil sector look better with the continuation of free-market reforms. The recent auctioning of the second and fourth largest Venezuelan banks and the sale of a 40 percent stake in the country's largest bank will create much-needed competition in the country's financial sector. While continuing the reforms, the Venezuelan government has decided not to use the remainder of its $1.4 billion stand-by IMF loan facility. Boosted by oil revenues, the trade balance (including oil) was around $9 billion for January-September 1996, compared with $5.5 billion for the same period in 1995, and the central government budget for 1996 is expected to show a surplus of about 1 percent of GDP. International reserves (excluding gold) were $11.8 billion at the end of 1996, almost double from a year ago.

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

	1994	1995	1996		1996	
			Q3	Q4	Nov	Dec
Real GDP	-2.8	2.2	n.a.	n.a.	...	...
Unemployment Rate (%)	8.8	10.8	...	11.2	...	...
Consumer Prices[1]	70.9	56.7	13.2	10.6	3.1	3.0
Trade Balance[2]	-3.6	-6.0	-2.1	n.a.	n.a.	n.a.
Current Account[2]	2.7	2.6	...	...	...	...

1. Percentage change from previous period.
2. Billions of U.S. dollars, NSA, non-oil trade balance.

Concerns about inflation remain. Although inflation has been trending downward from about July 1996, the year as a whole saw consumer prices rise by 103 percent, roughly twice the inflation seen in 1995. There is also concern that the bolivar is overvalued. In July the government established a central parity of 470 bolivars per dollar, with the bolivar to be depreciated at 1.5 percent per month in line with the government's inflation target. However, the government has not allowed the bolivar to depreciate much. The central parity was adjusted at the end of December, but only to 472.5 bolivars per dollar.

Real GDP growth in **China** slowed to 9.7 percent in 1996, after average growth of more than 12 percent from 1992-95. Although China's tight monetary policy since the middle of 1993 resulted in a marked deceleration in investment spending in 1994-95, investment growth appears to have picked up since the middle of 1996. The 12-month consumer price inflation rate fell to 6.9 percent in November, compared with 25.5 percent in 1994. The trade surplus of $12.2 billion was down from a surplus of nearly $17 billion in 1995. The surplus largely reflected a pickup in exports in the second half of 1996; exports fell 8 percent in the first half from their year-earlier level, but rose 10 percent in the second half. China's foreign exchange reserves rose to $107 billion at the end of 1996, up from $75 billion a year earlier.

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

	1995	1996	1996		1996	
			Q3	Q4	Nov	Dec
Real GDP[1]	10.2	9.7	9.6	9.7	...	...
Industrial Production	17.8	n.a.	n.a.	n.a.	14.9	n.a.
Consumer Prices	10.1	n.a.	7.9	n.a.	6.9	n.a.
Trade Balance[2]	16.7	12.2	7.3	4.0	2.0	-1.9

1. Cumulative from the beginning of the year
2. Billions of U.S. dollars, NSA

In December and January, eight foreign banks, including Citibank, received permission to conduct local currency business in Shanghai. Previously, foreign banks in China were permitted to engage in foreign-currency transactions only. Officials in Shanghai have consistently urged central authorities to allow greater activity by foreign financial firms, as a step towards consolidating Shanghai's position as China's financial center.

In **Taiwan**, economic activity appeared to recover in the fourth quarter of 1996 from a mild slowdown earlier in the year. Industrial production, which had declined in the first half of 1996 from a year earlier, rose nearly 5 percent in the fourth quarter. In October, the unemployment rate reached 3.1 percent, its highest level since 1986, but fell slightly to 2.9 percent in November. Inflation remained low, with consumer prices rising 2.5 percent in 1996. Taiwan's trade surplus rose to $14.3 billion in 1996, as a relatively weak domestic economy led to a 2 percent fall in the dollar value of imports compared with 1995; exports grew 4 percent. Foreign exchange reserves stood at $88 billion at the end of November, up from its recent low of $83 billion in March 1996, following Chinese missile tests near Taiwan.

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

	1995	1996	1996 Q3	1996 Q4	1996 Nov	1996 Dec
Real GDP	6.1	n.a.	5.6	n.a.	...	...
Industrial Production	4.2	1.6	1.9	4.8	3.2	6.1
Consumer Prices	4.6	2.5	3.8	2.5	3.2	2.5
Trade Balance[1]	8.3	14.3	4.6	4.0	1.3	2.2
Current Account[1]	5.0	n.a.	4.0	n.a.	...	...

1. Billions of U.S. dollars, NSA

In **Korea**, nationwide labor strikes have disrupted economic activity since December 26 when the government passed two new laws. The first would have altered Korea's labor market to allow employers to lay off workers, replace strikers, and implement flexible work hours, and the second would have restored power to a controversial domestic intelligence agency. On January 20, President Kim agreed to send both laws back to Parliament to re-open the debate on them.

According to preliminary data, Korea's trade deficit in 1996 exceeded $23 billion; its trade deficit with the United States alone was over $11 billion, higher than the total trade deficit for 1995. Industrial output rose 9.8 percent in November from its year-earlier level, compared with 10.9 percent in October. Consumer prices in December were 4.5 percent above their year-earlier level.

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

	1994	1995	1996 Q2	1996 Q3	1996 Nov	1996 Dec
Real GDP	8.4	9.0	6.7	6.4	...	...
Industrial Production	10.7	11.7	7.3	7.2	9.8	n.a.
Consumer Prices	6.2	4.5	5.1	5.2	4.8	4.5
Trade Balance[1]	-3.1	-4.7	-2.8	-4.4	-1.2	n.a.
Current Account[1]	-4.5	-8.9	-4.7	-7.3	-1.9	n.a.

1. Billions of U.S. dollars, NSA

In **Russia**, the economy and economic reform are muddling along as President Boris Yeltsin, having recovered from quintuple bypass surgery, is now said to be recovering from pneumonia. Indications are that real economic activity has continued to decline, but the rate of decline has been slowing. In fact, although official statistics indicate an output decline of about six percent in 1996, some observers believe that growth in 1996 was actually positive, but that weakness in Russian statistics and accounting for the rapidly developing private sector hides an important part of growth. Inflation for 1996 as a whole came in at 22 percent. The ruble-dollar exchange rate remained well within the corridor set by the Central Bank, which has announced a corridor for 1997 that allows for between three and fifteen percent depreciation during 1997. The Central Bank is predicting inflation of around 12 percent for 1997. However, the government also intends to allow the money supply to expand by 30 percent.

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

	1994	1995	1996		1996	
			Q2	Q3	Nov	Dec
Real GDP	-15	-4	-7	-7	-7	-4
Industrial Production	-21	-3	-5	-8	-6	-6
Consumer Prices[1]	10	7	2	1	1.9	1.4
Ruble Depreciation[1]	9	2	2	6	1.1	0.8
Trade Balance[2]	12.1	18.3	5.3	4.9	...	...
Current Account[2]	1.3	5.7	n.a.	n.a.	...	...

1. Monthly rate.
2. Billions of U.S. dollars.

Disbursements on Russia's three-year, $10 billion IMF Extended Fund Facility were halted in October and November, but have been moving back on track. The IMF's chief concern has been Russia's failure to meet its revenue targets. Although figures for 1996 as a whole have not been announced, they are expected to be around 90 percent. IMF attention is now turning to Russia's 1997 budget, which will be presented for its final reading in the Duma next week.