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CLASS III - FOMC

January 31, 1997

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

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SUPPLEMENTAL NOTES

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THE DOMESTIC NONFINANCIAL ECONOMY

Real GDP

Real GDP is estimated to have increased at a 4.7 percent annual rate in the fourth quarter of 1996. Final sales to domestic purchasers rose at a 2.8 percent annual rate. Consumer spending rebounded, increasing at a 3.4 percent rate after rising only fractionally in the third quarter. However, business fixed investment slowed sharply; although outlays for nonresidential structures surged at a 22.5 percent annual rate, spending for producers' durable equipment edged down. Government purchases were about unchanged in the fourth quarter, with declines in both the federal defense and nondefense areas offset by continued moderate growth in purchases by state and local governments.

The external sector--where the December merchandise trade figures and other information have yet to become available--added importantly to overall real GDP. Real exports of goods and services are estimated to have surged at a 25.5 percent annual rate. Unusually large gains were reported for both agricultural and nonagricultural goods. At the same time, imports grew at a moderate 4.7 percent rate, held down by a sharp decline in oil imports.

The pace of inventory investment--which is estimated largely from data through November--is reported to have declined only slightly from that in the third quarter. Stocks of motor vehicles declined a bit, and retail inventories are estimated to have moved up only slightly after a large increase in the third quarter. However, inventory accumulation by manufacturers and wholesalers is estimated to have been somewhat greater than in the prior quarter.

Real disposable personal income increased at a 2.5 percent annual rate in the fourth quarter, just under its pace earlier in the year. With the upswing in consumer spending, the personal saving rate dipped to 5.1 percent last quarter; the saving rate averaged 4.9 percent in 1996 compared with 4.7 percent in 1995.

On inflation, the chain-weighted price index for gross domestic product rose at a 1.8 percent annual rate in the fourth quarter, a bit below the pace that prevailed over the first three quarters of the year. Although the price index for gross domestic purchases accelerated somewhat as a result of the pickup in consumer energy

prices, falling export prices damped the rise in the overall product price index.

BEA's estimate for real GDP growth last quarter was 1-1/4 percentage point above our forecast in the January Greenbook. Real export growth was stronger than we had anticipated; while nominal trade flows were in line with our reading of the incoming data, we were surprised by the 2-1/4 percent (annual rate) drop in export prices. Furthermore, the decline in residential investment last quarter was much smaller than we had expected: In the third quarter, BEA's estimates for residential investment had been surprisingly low based on the pattern of housing starts, and we did not anticipate the prompt return to the path of spending that is implicit in the advance estimate. Together, the surprises in exports and residential investment accounted for about half of our miss on overall GDP. The remainder of our underestimate reflected smaller errors in our forecasts for expenditures on consumer durables, nonresidential construction, and motor vehicle inventories.

The 1-3/4 percent annual rate increase in the GDP chain price index last quarter was well below the 2-1/2 percent pace projected in the January Greenbook. The miss in GDP prices largely is attributable to unexpected movements in the prices of exports and, to a lesser extent, imports; the price index for gross domestic purchases increased at a 2-1/2 percent pace, in line with the Greenbook projection.

Although a good many of the source data for the fourth quarter, particularly the December readings for inventories and net exports, have yet to be released, we do not feel that BEA has made any unreasonable assumptions for the missing information. Accordingly, at this juncture, we have no statistical basis on which to expect a large revision to the advance estimate.

We shall make a more complete reassessment of the forecast when all of the detail underlying BEA's estimates becomes available on Monday. But our tentative reading of the data in hand leads us to anticipate that, in most sectors, we'll simply be adjusting the forecasted levels of spending to reflect the fourth-quarter surprises and leaving the projected growth rate of activity from here little changed. The elevation of the level of activity is small and is unlikely to imply a significant change in inflationary pressures from what was projected in the Greenbook.

Consumer Sentiment

Based on the full sample tabulations, the Michigan SRC index of consumer sentiment rose slightly in January, remaining at the upper end of the favorable range that has prevailed since early 1994. Respondents expressed more favorable views of business conditions in the next twelve months, as well as more positive views of buying conditions for large household appliances. Other components of the overall index declined somewhat, but generally remained in very positive ranges. On balance, the upbeat attitudes reversed the slight decline in the overall index registered in the preliminary report.

Among questions not included in the overall index, the results were also upbeat. The index of car buying conditions advanced strongly, and the index of home buying conditions also rose, with more households reporting that now is a good time to buy because "times are good." The expected change in unemployment in the next year moved up, but stayed in the favorable range that has prevailed since last summer.

The median value of expected inflation over the coming year was unchanged at 3 percent, while the mean shifted up 0.2 percentage point to 4.1 percent. The mean and median values of expected inflation over the next five to ten years moved up 0.1 percentage point to 4.0 percent and 3.1 percent, respectively.

Errata

The projections for industrial production (IP) and capacity utilization shown in Part 1 of the Greenbook did not reflect the new aggregation methods. The corrected forecast is shown below:

<u>Interval</u>	<u>IP (percent change, annual rate)</u>	<u>Capacity utilization-mfg. (percent)</u>
<u>Quarterly</u>		
1997-Q1	2.7	82.2
Q2	2.1	82.3
Q3	2.1	82.2
Q4	2.3	82.3
1998-Q1	2.3	82.3
Q2	2.2	82.3
Q3	2.4	82.3
Q4	2.5	82.4
<u>Four-quarter</u>		
1997-Q4	2.3	82.3
1998-Q4	2.4	82.4

## Real Gross Domestic Product and Related Items

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

	1995:Q4 to 1996:Q4	1996:Q2 Final	1996:Q3 Final	1996:Q4 Advance
1. Gross domestic product	3.4	4.7	2.1	4.7
2. Final sales	3.1	4.1	.5	4.9
3. Consumer spending	2.7	3.4	.5	3.4
4. Durables	5.5	11.4	-2.6	5.4
5. Nondurables	1.8	1.3	.4	1.7
6. Services	2.5	2.7	1.3	3.8
7. Business fixed investment	9.1	3.8	17.5	4.2
8. Producers' durable equipment	9.4	6.7	20.9	-1.7
9. Nonresidential structures	8.4	-3.7	8.4	22.5
10. Residential investment	4.0	16.3	-5.2	-1.3
11. Federal government consumption expenditures and investment	2.4	9.4	-3.5	-1.8
12. Defense	1.5	10.0	-5.5	-1.8
13. Nondefense	4.2	8.3	.6	-1.9
14. State and local government consumption expenditures and investment	2.2	6.7	1.1	2.2
15. Exports of goods and services	7.6	5.6	-9	25.5
16. Imports of goods and services	8.6	9.9	9.3	4.7
<hr/>				
<i>ADDENDA:</i>				
17. Nonfarm inventory investment <sup>1</sup>	20.2 <sup>2</sup>	11.7	34.6	31.5
18. Motor vehicles <sup>1</sup>	-3.3 <sup>2</sup>	5.7	7.2	-3.9
19. Excl. motor vehicles <sup>1</sup>	23.5 <sup>2</sup>	6.0	27.4	35.4
20. Farm inventory investment <sup>1</sup>	-3.0	-5.1	-4	.1
21. Net exports of goods and services <sup>1</sup>	-114.2 <sup>2</sup>	-114.7	-137.4	-100.7
22. Nominal GDP	5.2	6.5	3.8	6.2
23. GDP price index	2.1	2.2	2.0	1.8
24. GDP implicit price deflator	1.8	1.8	1.7	1.4
25. Profit share <sup>3</sup>	n.a.	8.7	8.7	n.a.
26. (Excluding FR banks)	n.a.	8.4	8.4	n.a.
27. Personal saving rate (percent)	4.9 <sup>2</sup>	4.3	5.3	5.1

1. Level, billions of chain (1992) dollars.

2. Annual average.

3. Economic profits as a share of nominal GNP.

January 31, 1997

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

	1996 May	1996 Jun	1996 Jul	1996 Aug	1996 Sep	1996 Oct	1996 Nov	1996 Dec	1997 Jan (f)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	89.4	92.4	94.7	95.3	94.7	96.5	99.2	96.9	97.4
Current conditions	105.1	105.4	107.5	107.8	102.0	106.6	107.5	104.9	106.8
Expected conditions	79.2	84.0	86.5	87.3	90.1	89.9	93.9	91.8	91.3
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Personal financial situation									
Now compared with 12 months ago*	114	118	115	119	109	115	121	117	116
Expected in 12 months*	122	128	129	129	130	127	133	132	128
Expected business conditions									
Next 12 months*	110	117	122	120	127	131	137	130	136
Next 5 years*	86	93	97	102	105	103	108	107	103
Appraisal of buying conditions									
Cars	127	137	138	139	134	132	135	134	141
Large household appliances*	159	155	164	161	155	161	158	155	160
Houses	159	153	161	158	149	159	157	156	162
Willingness to use credit									
Willingness to use credit	37	54	38	45	40	37	43	41	45
Willingness to use savings									
Willingness to use savings	64	66	67	60	62	62	70	63	71
Expected unemployment change - next 12 months									
Expected unemployment change - next 12 months	121	123	115	114	112	114	110	110	114
Expected inflation - next 12 months									
Mean	4.9	4.2	4.3	4.1	4.3	4.2	4.0	3.9	4.1
Median	3.0	2.9	2.9	3.0	3.2	3.0	3.0	3.0	3.0
Expected inflation - next 5 to 10 years									
Mean	4.8	4.0	4.2	4.6	4.1	4.2	3.7	3.9	4.0
Median	3.2	3.1	3.1	3.2	3.2	3.0	3.0	3.0	3.1

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

(p) -- Preliminary

(f) -- Final

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



THE FINANCIAL ECONOMY

Senior Loan Officer Opinion Survey on Bank Lending Practices--  
Correction

Complete results of the Senior Loan Officer Opinion Survey on Bank Lending Practices now show respondents' willingness to make consumer installment loans to be essentially unchanged over the last three months. Preliminary results discussed in Part 2 of the Greenbook (pp. III-7 and III-A-2) had suggested a slight decline.

**Selected Financial Market Quotations<sup>1</sup>**  
(Percent except as noted)

Instrument	1996			1997	Change to Jan. 30, from:		
	Feb. low	July high	FOMC,* Dec. 17	Jan. 30	Feb. low	July high	FOMC, Dec. 17
<b>Short-term rates</b>							
Federal funds <sup>2</sup>	5.15	5.39	5.27	5.30	0.15	-0.09	0.03
Treasury bills <sup>3</sup>							
3-month	4.76	5.21	4.86	5.04	0.28	-0.17	0.18
6-month	4.67	5.40	5.03	5.10	0.43	-0.30	0.07
1-year	4.55	5.64	5.20	5.28	0.73	-0.36	0.08
Commercial paper							
1-month	5.27	5.50	5.65	5.44	0.17	-0.06	-0.21
3-month	5.12	5.59	5.48	5.45	0.33	-0.14	-0.03
Large negotiable CDs <sup>3</sup>							
1-month	5.21	5.44	5.52	5.33	0.12	-0.11	-0.19
3-month	5.12	5.59	5.43	5.42	0.30	-0.17	-0.01
6-month	4.99	5.83	5.49	5.53	0.54	-0.30	0.04
Eurodollar deposits <sup>4</sup>							
1-month	5.13	5.38	5.50	5.31	0.18	-0.07	-0.19
3-month	5.13	5.56	5.44	5.44	0.31	-0.12	0.00
Bank prime rate	8.25	8.25	8.25	8.25	0.00	0.00	0.00
<b>Intermediate- and Long-term Rates</b>							
U.S. Treasury (constant maturity)							
3-year	4.98	6.62	5.95	6.16	1.18	-0.46	0.21
10-year	5.58	7.06	6.39	6.61	1.03	-0.45	0.22
30-year	6.02	7.19	6.63	6.88	0.86	-0.31	0.25
Municipal revenue (Bond Buyer) <sup>5</sup>	5.67	6.24	5.93	6.02	0.35	-0.22	0.09
Corporate-A utility, recently offered	7.18	8.23	7.67	8.02	0.84	-0.21	0.35
High-yield corporate <sup>6</sup>	9.57	10.36	9.76	9.72	0.15	-0.64	-0.04
Home mortgages <sup>7</sup>							
FHLMC 30-yr fixed rate	6.94	8.42	7.57	7.88	0.94	-0.54	0.31
FHLMC 1-yr adjustable rate	5.19	6.01	5.52	5.57	0.38	-0.44	0.05

Stock exchange index	Record high		1996		1997	Percentage change to Jan 30, from:		
	Level	Date	July low	FOMC,* Dec. 17	Jan. 30	Record high	July low	FOMC, Dec. 17
Dow-Jones Industrial	6883.90	1/21/97	5346.55	6268.35	6823.86	-0.87	27.63	8.86
S&P 500 Composite	786.23	1/22/97	626.65	720.98	784.17	-0.26	25.14	8.76
NASDAQ (OTC)	1388.06	1/22/97	1042.37	1260.98	1371.02	-1.23	31.53	8.73
Russell 2000	370.65	1/22/97	307.78	350.48	368.29	-0.68	19.61	5.08
Wilshire	7594.85	1/22/97	6099.34	6998.62	7556.79	-0.50	23.90	7.98

1. One-day quotes except as noted.
  2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average for 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.