Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

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.

---

[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

May 15, 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

May 15, 1997

RECENT DEVELOPMENTS

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity was extraordinarily robust in the first quarter, but April data on employment, industrial production, and retail sales point to a marked slackening of growth in the current quarter. Increased pressures on resources have produced a hint of deterioration in the trends of hourly labor compensation, but this has yet to be clearly mirrored in price inflation.

Real GDP

According to BEA's advance estimate, real GDP rose 5.6 percent at an annual rate in the first quarter. Private domestic final purchases soared, reflecting large gains in both consumer spending and business fixed investment, and inventory investment also rose sharply. The only sector that showed significant weakness was net exports, which reversed most of the big increase in the fourth quarter.

REAL GDP AND SELECTED COMPONENTS

	1996:Q4	1997:Q1 BEA adv.	1997:Q1 Expected revision
	Percent change, annual rate		
Real GDP	3.8	5.6	6.0
Final sales	4.9	3.9	3.8
Private domestic final purchases	3.3	7.1	6.7
Consumption	3.4	6.4	5.8
Business fixed investment	5.5	11.9	12.2
Residential investment	-1.8	5.5	6.4
Federal government	-5.3	-3.5	-3.5
State and local government	1.9	1.2	1.9
	Level, billions of chained (1992) dollars		
Nonfarm inventory investment	19.3	46.5	52.6
Net exports	-98.4	-130.3	-128.5

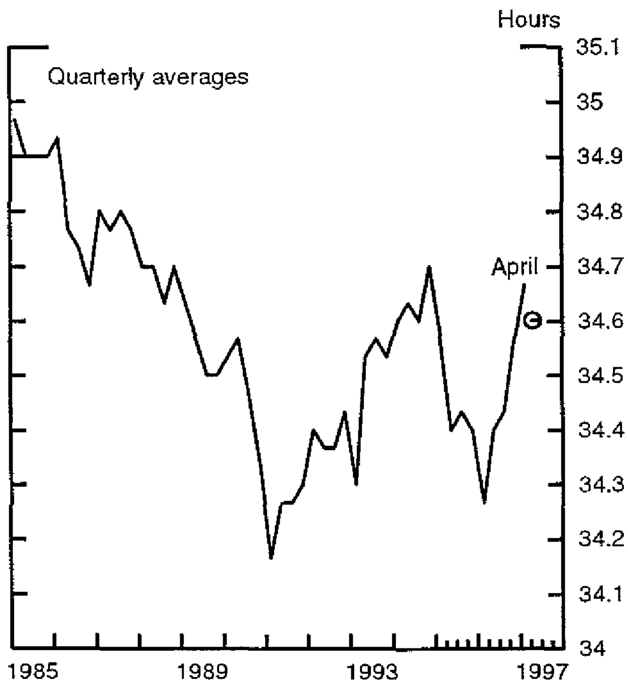
Since the publication of the advance GDP estimate, we have received the usual monthly flow of data as well as the Census Bureau's annual revisions to the retail and wholesale trade data and partial historical revisions to the NIPAs from the BEA. Taken together, the incoming information suggests that first-quarter GDP

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

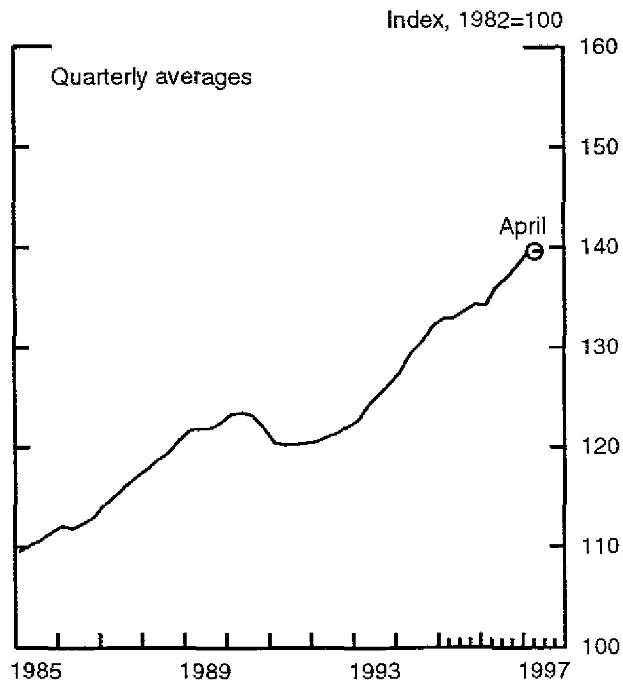
	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
	-----------Average monthly changes---------							
Nonfarm payroll employment[1]	185	216	171	224	237	314	139	142
Private	176	201	147	223	229	281	166	110
Manufacturing	-12	-8	-19	10	15	3	17	-14
Durable	5	4	-7	12	18	12	18	-3
Transportation equipment	-3	1	-4	4	7	0	8	-10
Nondurable	-17	-12	-12	-2	-3	-9	-1	-11
Construction	9	25	16	24	31	104	-25	-44
Trade	54	63	59	88	39	46	72	33
Finance, insurance, real estate	4	14	14	14	14	15	18	23
Services	110	100	76	86	103	86	72	93
Help supply services	8	12	12	-3	16	-40	19	-5
Total government	9	15	24	2	9	33	-27	32
Private nonfarm production workers[1]	152	168	120	184	201	354	169	34
Manufacturing production workers	-10	-8	-14	8	12	6	9	-13
Total employment[2]	32	232	219	202	440	-150	745	209
Nonagricultural	51	225	195	220	453	26	651	98
Memo:								
Aggregate hours of private production workers (percent change)[1]	.1	.3	.1	.3	.3	2.6	.0	-.8
Average workweek (hours)[1]	34.5	34.4	34.4	34.6	34.7	34.9	34.9	34.6
Manufacturing (hours)	41.6	41.5	41.7	41.8	41.9	41.9	42.1	42.2

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

Average Weekly Hours



Aggregate Hours of Production or Nonsupervisory Workers



growth may be raised fractionally: On balance, we expect final sales to be little changed, as a downward revision to consumer spending is offset by upward revisions to other components, but the reported pace of inventory investment in the manufacturing and trade sectors has been even greater than BEA had assumed. *Unless otherwise noted, the discussion of first-quarter activity in the remainder of this section of the Greenbook incorporates our expected revisions to the GDP data.*

Labor Market Developments

Growth in labor demand appears to have moderated slightly over the March-April period from its rapid pace of the winter. Payroll increases slowed, and in April, the average workweek dropped back from the high level in the previous two months. Labor markets remain tight, however: The unemployment rate moved down to 4.9 percent in April (5.0 percent on concurrent seasonals), and the labor force participation rate edged down only slightly from its historical high in March. In addition, initial claims for unemployment insurance, which had been boosted at least in part in late April and early May by flooding in the Midwest and strike-related layoffs, returned to about their first-quarter average during the week ended May 10.

Private nonfarm employment grew about 140,000 per month, on average, in March and April following increases averaging 240,000 per month over the previous five months. The slowing of employment growth was concentrated in the goods-producing sector. Construction posted job declines averaging 35,000 per month in the past two months. These decreases likely were exaggerated by the weather: The outsized gains during the mild weather of February apparently "borrowed" from later months and building conditions were subpar during the survey weeks in March and April. Manufacturing employment, which had grown about 15,000 per month, on average, in the first quarter, dropped 14,000 in April; 3,500 of the decline reflects striking GM workers in Oklahoma.

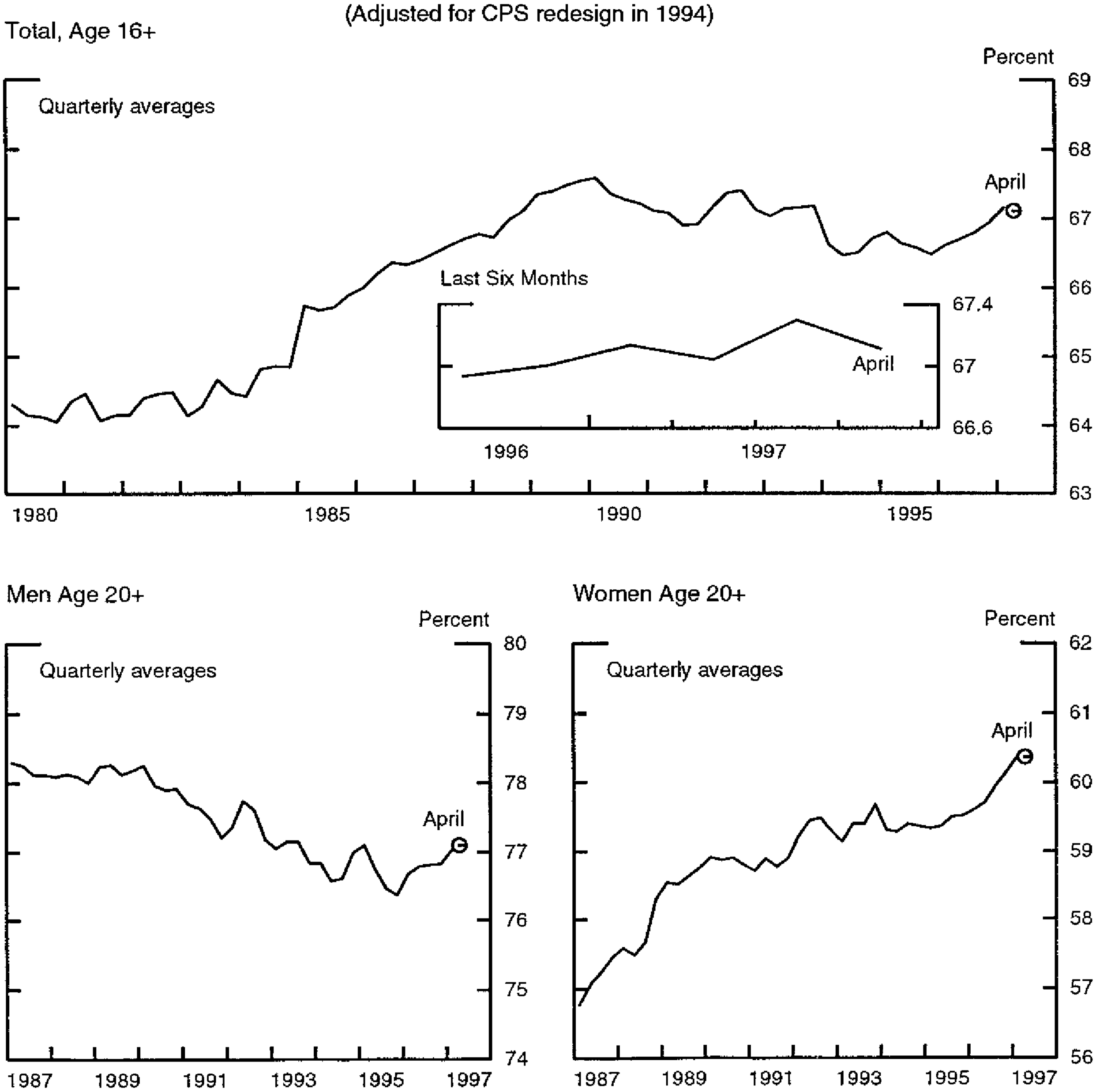
The average workweek of production or nonsupervisory workers dropped 0.3 hour in April, to 34.6 hours--about equal to its average over the past six months. Aggregate hours of production or nonsupervisory workers were unchanged in March and fell 0.8 percent in April, compared with average monthly growth rates of 0.4 percent from October to February.

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

			1996		1997	1997		
	1995	1996	Q3	Q4	Q1	Feb.	Mar.	Apr.
Civilian unemployment rate								
(16 years and older)	5.6	5.4	5.3	5.3	5.3	5.3	5.2	4.9
Teenagers	17.3	16.7	16.6	16.6	17.0	17.5	16.4	15.4
Men	4.8	4.6	4.5	4.4	4.5	4.4	4.4	4.2
Women	4.9	4.8	4.7	4.8	4.7	4.7	4.7	4.4
Full-time workers	5.5	5.3	5.2	5.2	5.2	5.1	5.1	4.8
Labor force participation rate	66.6	66.8	66.8	66.9	67.2	67.0	67.3	67.2

Labor Force Participation Rate

(Adjusted for CPS redesign in 1994)



The strength of economic activity in the past year has boosted labor force participation. The participation rate was little changed in April after reaching a record high in March; since the beginning of the year, it has fluctuated between 67.0 percent and 67.3 percent. Taking a slightly longer perspective, the participation rate has rebounded from its unexplained drop in 1995 and now stands above its level in late 1994. Participation rates of adult men and teenagers, which decrease noticeably in the early 1990s, have been little changed, on net, since late 1994. In addition, the participation of adult women, which had grown only slowly at the beginning of the current expansion, has been moving up more rapidly in the past year or so.

Some analysts have speculated that welfare reform has been a key driver of the upturn in the labor force participation rate. In fact, there has been rapid labor force growth recently among women who maintain families--the group most likely to be affected by welfare reform. However, this group accounts for only about 4 percent of the population, and its labor force increase has added at most 0.2 percentage point to the aggregate participation rate over the past year. Moreover, even within this group, only about 60 percent have children under 18 years--a key eligibility criterion for many welfare programs. Also, the rise in participation has not been limited to groups likely to be affected by welfare reform. This suggests that job availability has probably been a more important factor.

The staff estimates that output per hour of all persons in the nonfarm business sector grew at a 2-1/2 percent annual rate in the first quarter.[1] Smoothing through the quarterly fluctuations, productivity has risen about 1 percent per year since the first quarter of 1995, after having stagnated over the previous two years. In the nonfinancial corporate sector, productivity grew 1.7 percent at an annual rate in the fourth quarter and 2.1 percent over 1996 as a whole.[2]

1. BLS's preliminary estimate of productivity growth in the first quarter--which was based on the advance GDP release--was 2.0 percent.

2. Data on productivity growth in the nonfinancial corporate sector for the first quarter will not be available until the next Productivity and Cost release on June 18.

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

	Proportion 1996	1996[1]	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
			-Annual rate-		--Monthly rate---		
Total index	100.0	3.9	4.5	4.7	.5	.6	.0
Previous		3.9	4.5	5.6	.6	.9	
Manufacturing	86.5	4.1	4.3	5.7	.7	.5	-.2
Durables	47.1	5.7	2.8	8.5	1.1	.8	-.3
Motor veh. and parts	4.9	-1.6	-15.2	15.4	-1.6	.1	-6.8
Aircraft and parts	2.3	34.5	33.0	17.9	.9	2.3	.4
Nondurables	39.4	2.3	6.0	2.4	.2	.2	-.1
Manufacturing excluding motor vehicles & parts	81.6	4.5	5.6	5.1	.8	.5	.2
Mining	5.6	3.4	.5	5.8	2.1	.9	-.5
Utilities	7.9	1.4	9.5	-6.5	-2.6	.9	2.0
IP by market group, excluding motor vehicles & parts							
Consumer goods	26.1	2.6	7.2	-1.2	-.1	.7	.0
Durables	4.1	3.0	.0	4.5	2.2	2.2	-1.2
Nondurables	22.0	2.5	8.6	-2.1	-.5	.5	.2
Business equipment	12.7	9.1	9.3	11.6	1.3	.8	.8
Information processing	5.8	10.8	7.5	13.4	2.2	1.2	1.1
Industrial	4.5	-.2	1.1	2.5	.0	.0	.8
Transit	1.2	53.1	48.4	33.5	2.2	2.6	.4
Other	1.3	3.6	12.3	14.6	.9	.0	-.2
Construction supplies	5.7	5.7	-.4	.5	2.2	.5	.0
Materials	38.5	4.3	4.6	5.6	.8	.6	.3
Durables	21.5	6.3	4.9	7.8	1.2	.9	.3
Semiconductors	4.0	16.0	17.8	34.5	3.5	3.6	2.4
Metals	3.7	3.2	4.5	-1.6	.9	-.5	-.2
Nondurables	9.0	2.8	6.3	6.3	.8	.2	-.1

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-96 Avg.	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
Manufacturing	85.7	81.7	82.3	82.6	82.7	82.8	82.4
Primary processing	88.9	82.8	86.6	86.7	86.9	87.0	86.8
Advanced processing	84.2	81.2	80.4	80.8	80.8	81.0	80.4

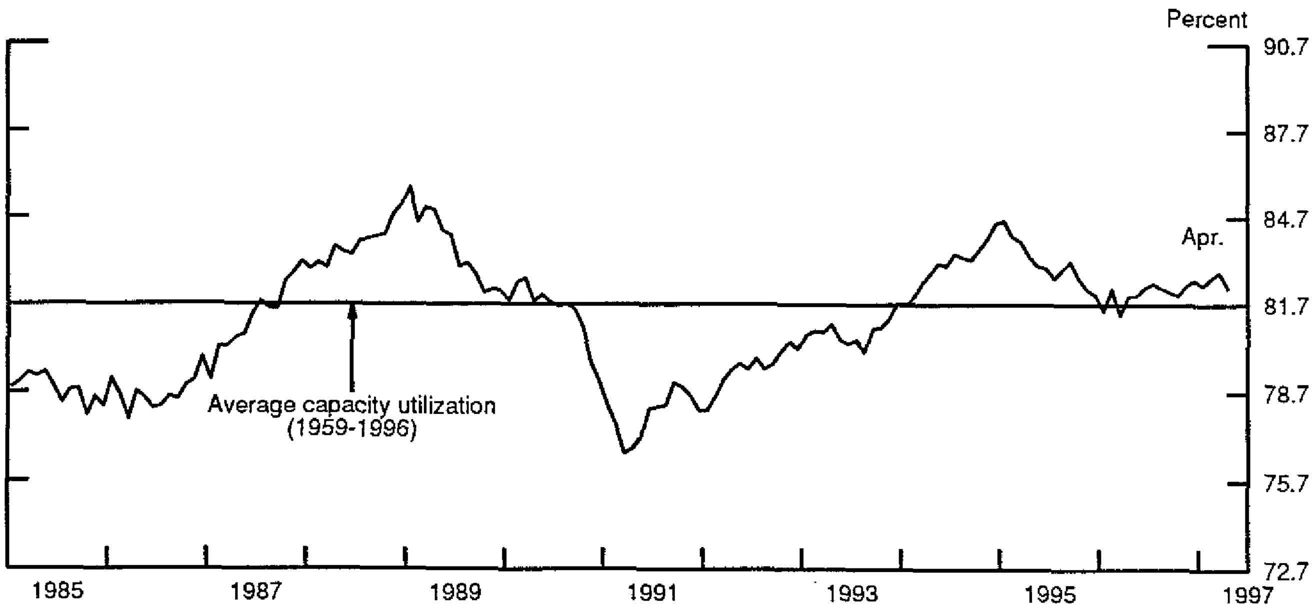
Industrial Production

Industrial production was unchanged in April after posting sizable gains in the fourth and first quarters. Output in the manufacturing sector is estimated to have slipped 0.2 percent, dragged down by a sharp drop in the production of motor vehicles and related parts and materials. All told, the slump in vehicle production probably depressed overall manufacturing output about 0.7 percent in April, taking into account both the direct effects of lower assemblies and spillovers to upstream industries like steel, metal stampings, and rubber. With the decline in motor vehicle output, factory utilization fell to 82.4 percent last month; about 3/4 percentage point above the 1959-1996 average. Utilization in advanced processing was a bit below its average, while the rate for primary processing was 4 percentage points above its long-term average.

Two factors contributed to the sharp drop in motor vehicle assemblies from 12.5 million units (annual rate) in March to 11.1 million units in April. First, the automakers had stepped up production over the winter to replenish stocks that were drawn down by the strikes in late 1996. And, with inventories of most models having been restored to comfortable levels by March, the companies planned to return output to more normal levels in April. Second, local strikes against Chrysler and GM cut April's assemblies almost a million units. The bulk of the strike-related production loss was associated with the recently settled dispute at a Chrysler plant that makes engines for popular models of light trucks. Because the assembly plants idled by the strike had already been operating at full capacity, Chrysler has little room to recoup the lost production over the near term. Current schedules for the industry as a whole, which show planned output of about 12-1/4 million units at an annual rate in May and June, are little changed from pre-strike plans. A brief strike against a GM parts plant was settled on May 14, but threats of additional work stoppages later this spring present a downside risk to production.

By major market group (excluding motor vehicles and parts), the output of consumer goods remained flat in April, as declines in consumer durables were largely offset by small gains in consumer nondurables. The output of business equipment posted another solid gain, led by a good performance of information processing equipment. Production of aircraft and parts grew moderately after a big gain in

Manufacturing Capacity Utilization



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

	Share, 1996:H2	1996 Q4	1997 Q1	1997 Jan.	Feb.	Mar.
Total durable goods	100.0	.6	1.8	3.8	1.0	-2.6
Adjusted durable goods[1]	68.0	.1	4.6	4.5	4.1	-2.1
Computers	5.0	.2	-1.2	-4.8	-2.4	-.7
Nondefense capital goods excluding aircraft and computers	17.0	-.7	6.9	5.8	10.2	-2.3
All other categories	46.0	.3	4.4	5.2	2.6	-2.1
Memo:						
Real adjusted orders[2]		.3	4.5	4.4	3.9	-2.4

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

2. Nominal adjusted durable goods orders were split into two components, computers and all other. These components were deflated and then aggregated in a chain-weighted fashion.

the first quarter. Output of construction supplies did not change in April and remains around the very high level reached last November. Another substantial advance in semiconductor output boosted growth in durable materials.

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

	1997			1996	1997	
	Feb.	Mar.	Apr.	Q4	Q1	Q2
						Sched.
U.S. production	12.4	12.5	11.1	11.8	12.4	11.9
Autos	6.1	6.2	5.7	5.8	6.1	5.9
Trucks	6.3	6.3	5.5	6.0	6.3	6.0
Days' supply						
Autos	57.3	55.2	61.3	61.2	55.2	---
Light trucks	68.7	69.4	77.3	67.5	69.4	---

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

The advance indicators of industrial activity, though remaining upbeat, are consistent with some slowdown from the robust first-quarter pace. The diffusion indexes of orders in the National Association of Purchasing Managers (NAPM) and the Dun & Bradstreet surveys decreased in April but continue to suggest future increases in production. In addition, the staff's adjusted durable goods orders series, derived from the M3 survey, declined substantially in March but remained at a relatively high level.

Motor Vehicles

Light motor vehicle sales slowed in April to 14.5 million units (annual rate) from 15.4 million units in March, after adjusting for GM's and Toyota's extension of the March reporting period into April. A drop in retail sales of autos and light trucks appears to account for most of the April decline because fleet sales (based on confidential data) fell only a bit, after jumping in March.

On average, the pace of vehicle sales over the first four months of the year was about the same as that over 1996 as a whole. The weakening of the yen over the past several quarters has enhanced the competitiveness of Japanese nameplates, and the popularity of several new models has also boosted sales. As a result, the share of new automobile sales going to the three largest Japanese manufacturers has increased from 27 percent in 1996 to 29 percent so far this year.

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

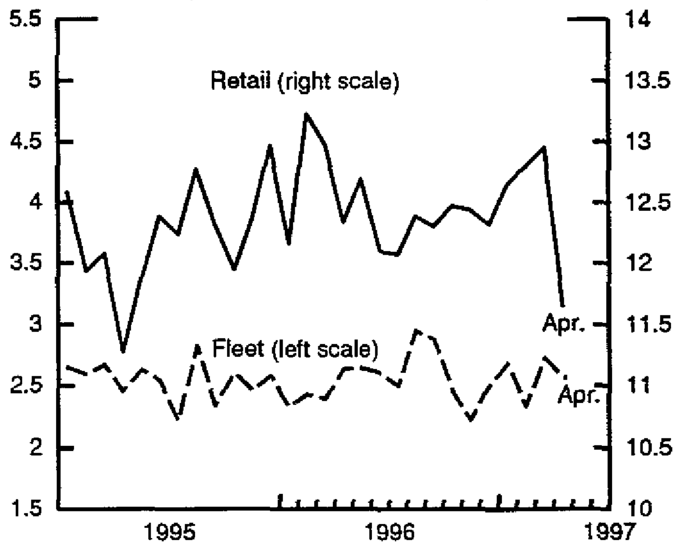
			1996		1997	1997		
	1995	1996	Q3	Q4	Q1	Feb.	Mar.	Apr.
Total	14.7	15.1	15.0	14.8	15.4	15.1	15.7	14.2
Adjusted[1]	14.7	15.0	15.1	14.7	15.3	15.2	15.4	14.5
Autos	8.6	8.5	8.6	8.0	8.6	8.4	8.6	7.8
Light trucks	6.1	6.6	6.4	6.8	6.8	6.7	7.1	6.3
North American[2]	12.8	13.4	13.3	13.1	13.5	13.3	13.7	12.4
Autos	7.1	7.2	7.3	6.7	7.2	7.0	7.2	6.6
Big Three	5.4	5.3	5.3	4.8	5.1	5.1	5.2	4.8
Transplants	1.7	1.9	2.1	1.9	2.1	1.9	2.1	1.8
Light trucks	5.7	6.1	6.0	6.3	6.2	6.2	6.5	5.8
Foreign produced	1.9	1.7	1.7	1.7	1.9	1.9	2.0	1.8
Autos	1.5	1.3	1.3	1.3	1.4	1.3	1.4	1.2
Light trucks	.4	.4	.4	.5	.6	.5	.6	.6

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

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

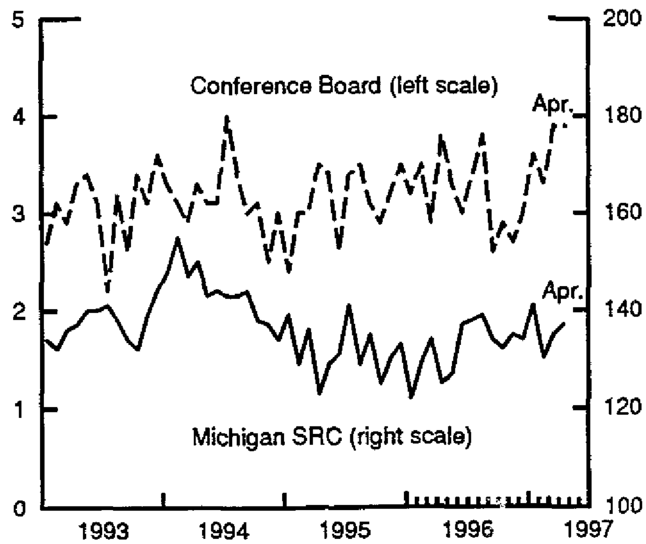
2. Excludes some vehicles produced in Canada that the industry classifies as imports

Total Industry Fleet and Retail Sales
(Millions of units; annual rate)



Note. FRB staff estimate

Buying Attitudes for New Vehicles



Several factors point to continued strength in consumer demand in the near term. The Conference Board survey in March and April reported that consumer plans to buy new automobiles in the next six months were among the highest in the past several years, while the Michigan Survey index of car buying conditions for April remained in the favorable range witnessed over the past year. In addition, the automakers are offering generous sales incentives this quarter. In the wake of its recently settled strike, Chrysler's supplies of light trucks are a bit tight but not lean enough to place an appreciable drag on sales in the near term.

Personal Income and Consumption

Growth in consumer spending appears to be moderating after the blockbuster first quarter. Nonetheless, the underlying trend in consumption remains consistent with the positive fundamentals in the sector, namely robust income growth, receding concerns about unemployment, and the huge gains in household net worth over the past two years.

Much of the statistical information for April is for spending on goods. As noted, motor vehicle sales sagged noticeably last month. In addition, according to Census' advance April report, nominal retail sales in the control category, which excludes sales at automotive dealers and building material and supply stores, fell 0.2 percent last month. In addition, the data for the preceding two months were revised down to show a 0.6 percent increase in February and no gain in March. The drop-off in spending in April was most pronounced at general merchandise stores, which had experienced a boom in sales in the first quarter. Based on the retail sales report and available information on prices, the staff estimates that real PCE for goods excluding motor vehicles in April was 0.2 percent (not at an annual rate) above the average level in the first quarter.

Spending on services rose 3.6 percent last quarter, despite warm winter weather that held down outlays for energy services; unseasonably cool temperatures in April prompted a rebound in energy spending last month. Expenditures on personal business services remained quite strong for the first quarter as a whole, reflecting, in part, the sharp increases in spending on brokerage services associated with the run-up in trading volumes on major U.S. exchanges around the turn of the year.

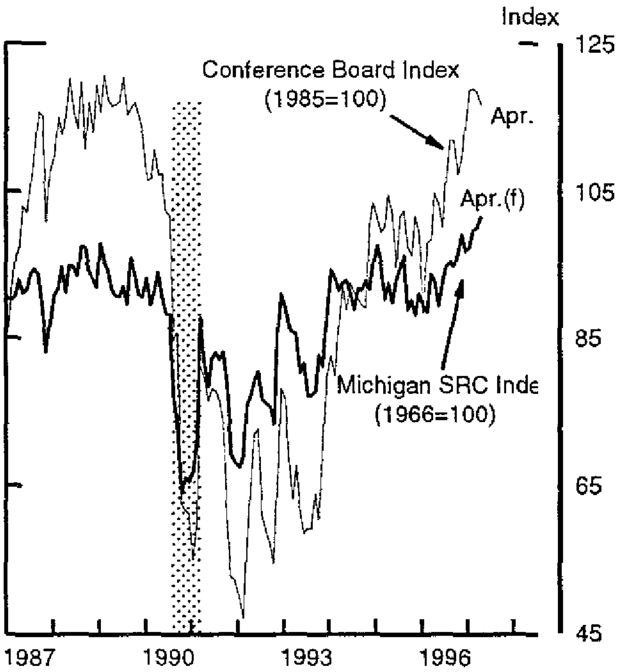
RETAIL SALES
(Percent change; seasonally adjusted)

	1996		1997	1997		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Total sales	.3	1.3	2.8	1.3	.0	-.3
Previous estimate[1]			3.5	1.5	.2	
Building materials and supplies	1.1	-.3	4.2	3.0	1.0	-.0
Automotive dealers	.8	1.4	4.1	2.9	-.3	-.9
Retail control[2]	.1	1.4	2.1	.6	.0	-.2
Previous estimate[1]			2.7	.8	.3	
Durable goods	-.7	1.5	2.2	2.2	-.8	.1
Furniture and appliances	.6	-.4	2.4	3.1	-1.1	-.3
Other durable goods	-1.6	3.0	2.1	1.6	-.6	.4
Nondurables	.2	1.4	2.1	.3	.2	-.3
Apparel	-.6	-.9	2.6	.3	-1.0	-.6
Food	1.0	.9	.6	.0	.6	-.5
General Merchandise	.5	1.2	3.7	.4	-.1	-.9
Gasoline stations	-2.5	2.6	1.9	-.6	-.5	-.1
Drug stores	2.2	2.2	3.4	2.0	.7	-.1
Other nondurables	.6	2.1	2.4	.7	.5	.5

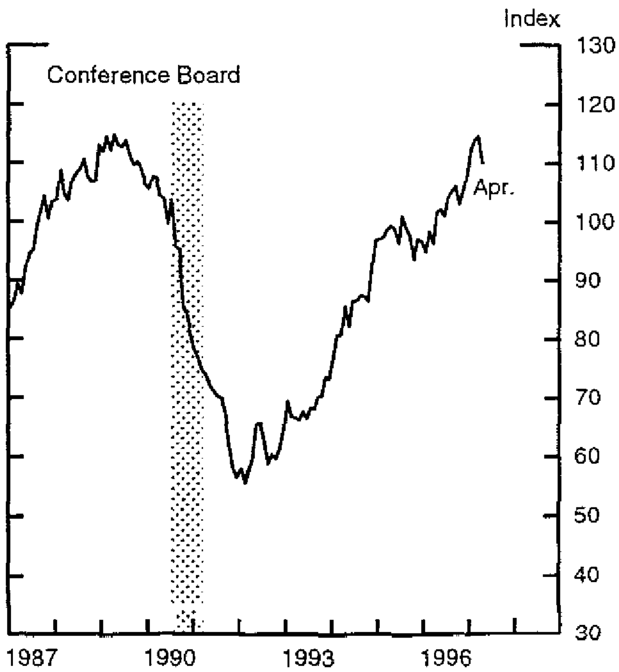
1. The "previous estimates" refer to March's regular retail sales release.
2. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.

Consumer Surveys

Consumer Sentiment



Current Labor Market Conditions*



* The index is defined as the proportion of respondents reporting that jobs are plentiful minus the proportion reporting that jobs are hard to get, plus 100.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period;
derived from billions of chained (1992) dollars)

	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Jan.	1997 Feb.	1997 Mar.
	- -Q4/Q4- -		- - Annual rate - -			- -Monthly rate- -		
PCE	1.9	2.7	.5	3.4	6.4	1.1	.2	.4
Durables	1.3	5.4	-2.6	5.0	19.9	3.6	.2	.7
Motor vehicles	-3.8	-.5	-10.0	-1.0	15.1	5.7	-4.1	1.6
Computers	52.3	57.7	40.8	36.3	76.7	5.8	5.3	3.5
Other durable goods	.4	2.2	-4.1	3.6	12.9	1.8	2.0	-.5
Nondurables	1.1	1.8	.4	1.8	6.3	1.2	.3	.5
Gas and oil	1.9	1.0	-3.2	5.3	-.4	-.3	1.4	.3
Clothing and shoes	.7	5.1	3.2	-1.0	14.1	2.0	1.0	.8
Other nondurables	1.1	1.1	.1	2.1	5.1	1.2	.0	.4
Services	2.4	2.6	1.3	3.8	3.6	.4	.1	.2
Energy	5.4	1.8	-11.4	3.7	-9.5	2.0	-4.4	-.2
Non-energy	2.3	2.6	1.9	3.8	4.2	.3	.3	.2
Housing	1.8	1.6	1.3	1.9	2.1	.2	.2	.2
Household operation	3.8	3.7	.1	9.5	4.4	.3	.4	.3
Transportation	3.1	4.4	4.2	6.1	7.6	.1	.3	.5
Medical	2.5	2.2	2.1	3.9	3.9	.3	.6	.5
Personal business	2.5	1.8	-3.0	5.6	6.0	.9	.0	-.4
Other	1.7	4.3	6.4	2.3	5.1	.3	.4	.3

Note. Derived from BEA's advance estimates.

PERSONAL INCOME
(Average monthly percent change)

	1995	1996	1996 Q4	1997 Q1	1997 Jan.	1997 Feb.	1997 Mar.
	- Q4/Q4 -		Annual rate		- - Monthly rate - -		
Total personal income	5.6	5.7	5.4	7.3	.3	.8	.6
Wages and salaries	5.3	6.2	6.3	8.5	.0	1.3	.7
Private	5.8	6.8	7.3	9.0	-.3	1.5	.8
Other labor income	5.5	3.0	4.0	2.9	.2	.2	.2
Less: Personal tax and nontax payments	7.9	9.9	6.9	-.1	-1.8	1.2	.6
Equals: Disposable personal income	5.3	5.1	5.2	8.4	.7	.8	.6
Memo:							
Real disposable income[1]	3.1	2.7	2.6	6.4	.6	.5	.5
Saving rate (percent)	4.6	4.9	5.1	5.1	4.9	5.2	5.3

Note. Derived from BEA's advance estimates.
1. Derived from billions of chained (1992) dollars.

According to the advance NIPA estimates, real disposable income rose 6.4 percent at an annual rate in the first quarter, and the saving rate held steady at 5.1 percent.[3] The apparent flatness of the saving rate is misleading, however. The rate was likely overstated by about 0.3 percentage point in the first quarter because BEA does not seasonally adjust the annual changes to government expenditures and the reindexation of tax brackets that take place in January.[4] Also, incoming data point to revisions to the advance estimates of disposable income as well as consumption. In particular, data from the Treasury indicate that BEA's advance estimate of seasonally adjusted tax payments in the first quarter was too low.[5] Taking into account the likely revisions to spending and income, we expect the saving rate to be lowered slightly in the next GDP release.

Readings on consumer sentiment remained buoyant in April. The Michigan SRC index rose to its highest level since the 1960s. Although many consumers mentioned concerns about rising interest rates, their views of buying conditions for homes, vehicles, and large durables changed little, partly because of an increase in the number of respondents who advocated buying now in advance of rate increases. The Conference Board confidence index slipped a bit in April, as views of current labor market conditions retreated from the extremely favorable level registered in March.

Housing Markets

Housing activity has been buffeted by unseasonable weather since late last year. However, cutting through the ups and downs, activity in the single-family sector has remained essentially flat over the past couple of quarters. Single-family starts in the first quarter were about equal to the average pace for 1996 as a whole, and permits have continued to fluctuate within a fairly narrow

---

3. These figures reflect BEA's recent revisions to its estimates of saving, which incorporate new estimates of capital depreciation and related income series. Although saving rates were raised 0.3 percentage point, on average, over 1981-93, the revisions to the data for recent years were minimal.

4. These annual adjustments include cost-of-living and other changes in federal transfer programs and increases in federal pay scales. By introducing the changes all at once, BEA overstates the level of disposable income in the first half of the year but understates the level of disposable income in the second half.

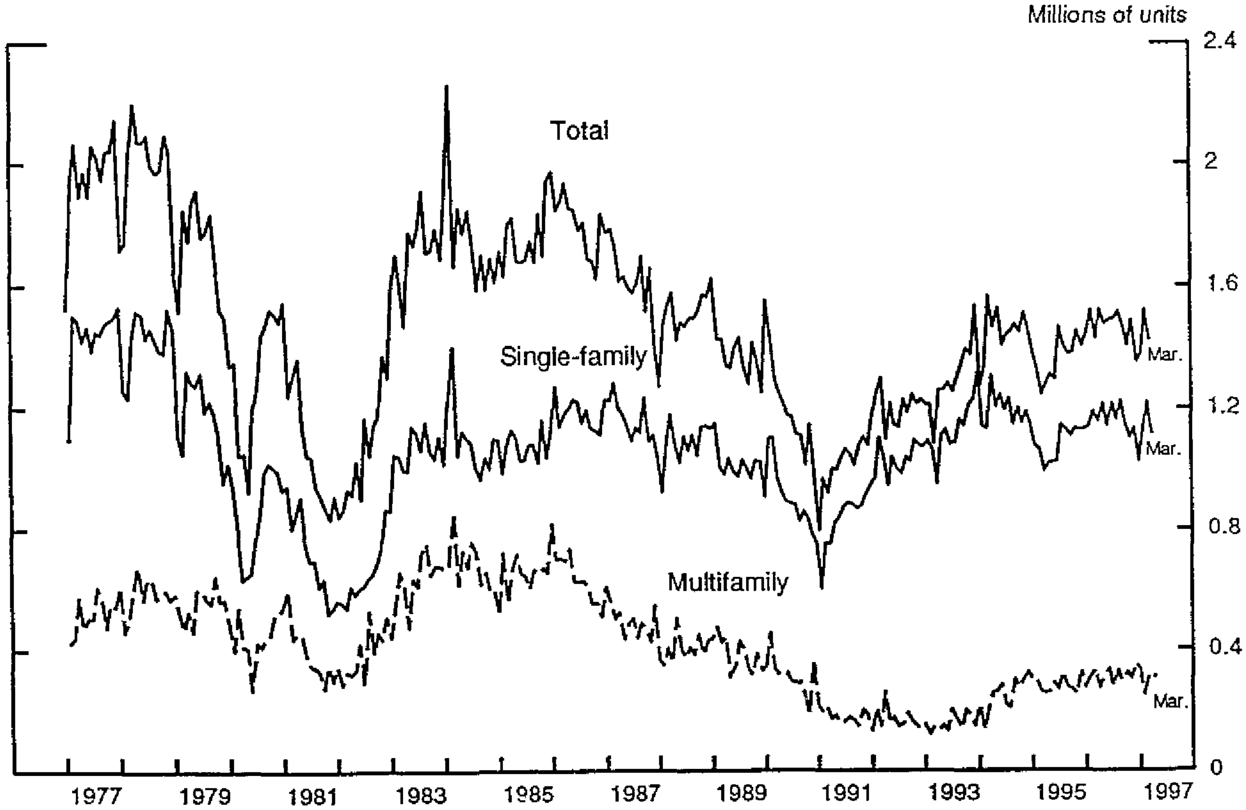
5. See the Federal section for more discussion of the tax surprise. Even though final tax payments are concentrated in April, BEA's normal procedure is to spread these payments over the year. The advance estimate for the first quarter is, of necessity, based on a projection of these payments.

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

		1996		1997			
	1996	Q3	Q4[r]	Q1[p]	Jan.[r]	Feb.[r]	Mar.[p]
All units							
Starts	1.48	1.49	1.42	1.44	1.38	1.52	1.43
Permits	1.43	1.43	1.40	1.43	1.40	1.44	1.45
Single-family units							
Starts	1.16	1.18	1.09	1.15	1.13	1.22	1.12
Permits	1.07	1.06	1.02	1.05	1.05	1.08	1.03
New home sales	0.76	0.79	0.76	0.82	0.83	0.83	0.81
Existing home sales	4.09	4.09	4.00	4.08	3.91	4.23	4.11
Multifamily units							
Starts	0.32	0.31	0.33	0.29	0.25	0.30	0.31
Permits	0.36	0.36	0.38	0.38	0.35	0.37	0.42
Mobile homes							
Shipments	0.36	0.37	0.35	n.a.	0.34	0.36	n.a.

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

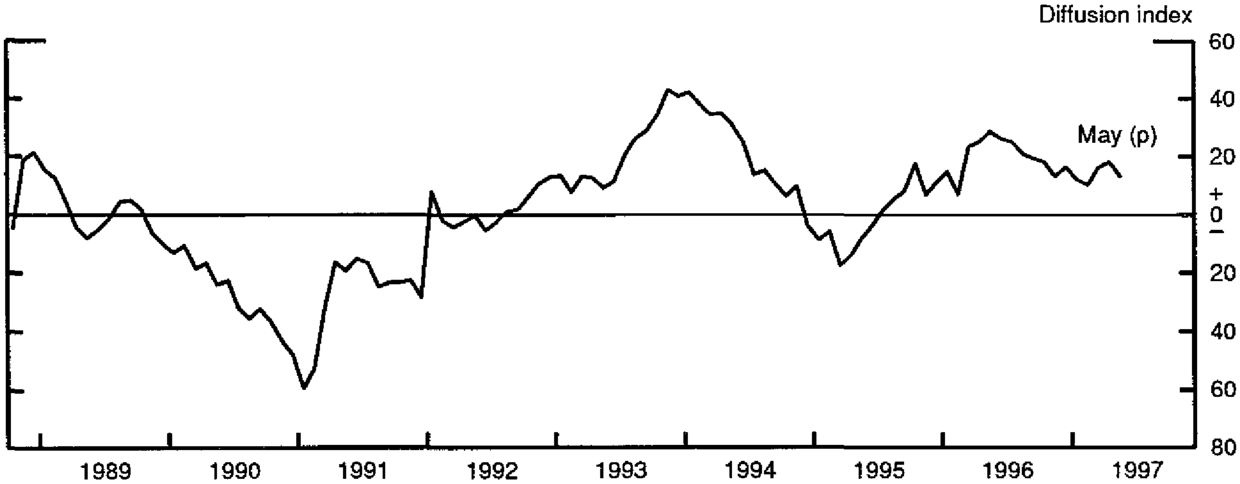
Private Housing Starts
(Seasonally adjusted annual rate)



Indicators of Housing Demand

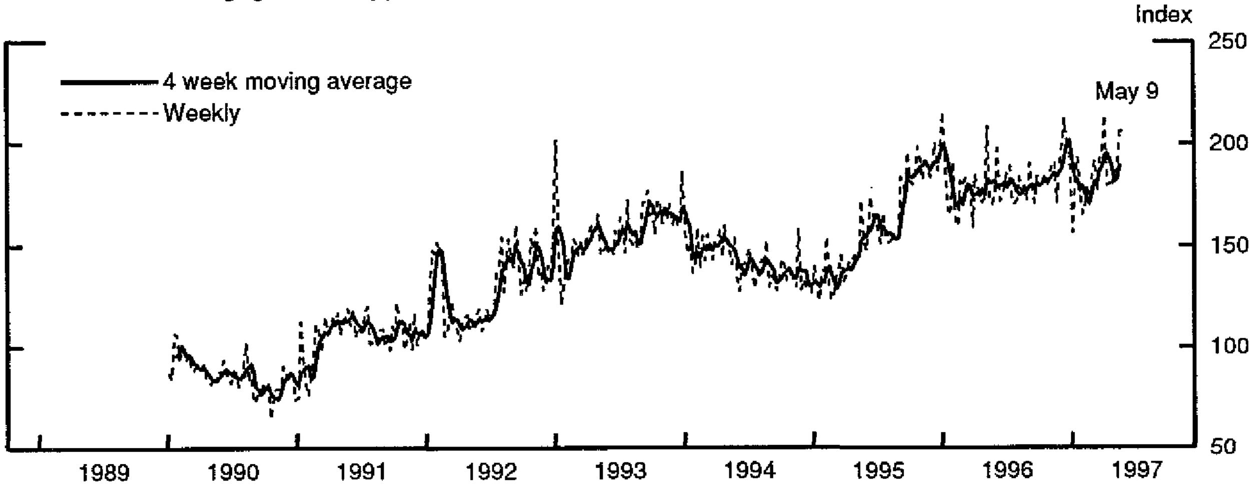
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales

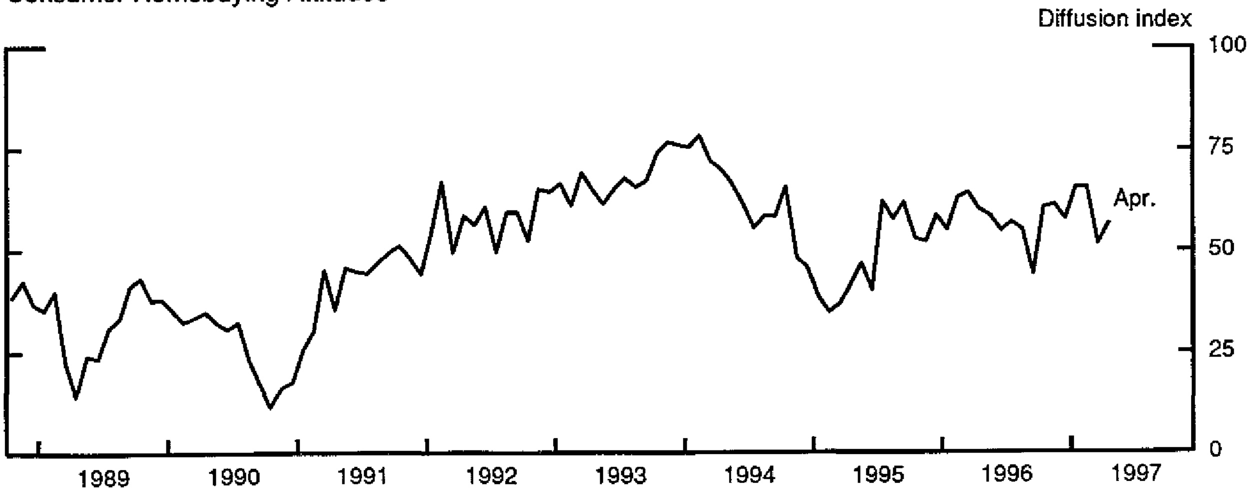


Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

MBA Index of Mortgage Loan Applications for Home Purchase



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 conditions as bad.

range. (April figures for starts and permits will be published this Friday.)

Despite dropping off a bit in March, new home sales jumped to an eighteen-year high in the first quarter. However, the Census Bureau is in the process of implementing a new data collection procedure that has made these notoriously unreliable data even more difficult to interpret than usual. Existing home sales tailed off in March after February's sharp gain. For the first quarter as a whole, existing home sales returned to just below the 1996 average.

More recent indicators of single-family housing demand show a mixed picture. Builders' assessments of new home sales have remained in a narrow range since late 1996. After smoothing through the gyrations in weekly readings, applications for new mortgages have firmed of late after a dip earlier in the year. However, home buying attitudes as measured by the Michigan survey were less positive in March and April than earlier in the year.

Multifamily housing starts dropped sharply in the first quarter of 1997, about offsetting the fourth-quarter surge. Averaging through the fourth and first quarters, multifamily starts were in line with their average for the first three quarters of 1996.

Business Fixed Investment

Real business fixed investment expanded at a 12 percent annual rate in the first quarter: Growth in outlays for producers' durable equipment rebounded from a weak fourth-quarter showing, and real investment in nonresidential structures posted a third consecutive quarter of substantial growth.

The strength in real PDE last quarter was widespread. In the high-tech sectors, the continuing wave of upgrades to Windows NT and strong demand for high-end servers for computer networks reportedly have provided considerable impetus to spending on computing and office equipment, and demand for communications equipment remained strong. In addition, expenditures on other equipment recouped the previous quarter's decline.

Recent data on orders suggest that equipment investment will continue to advance at a healthy clip. Orders for communications equipment were up more than 12 percent in the first quarter. Anecdotal reports reinforce the view that the outlook is for brisk growth in this sector: Competition is heating up among service providers in local phone markets in anticipation of deregulation, demand for wireless and personal communication systems is continuing

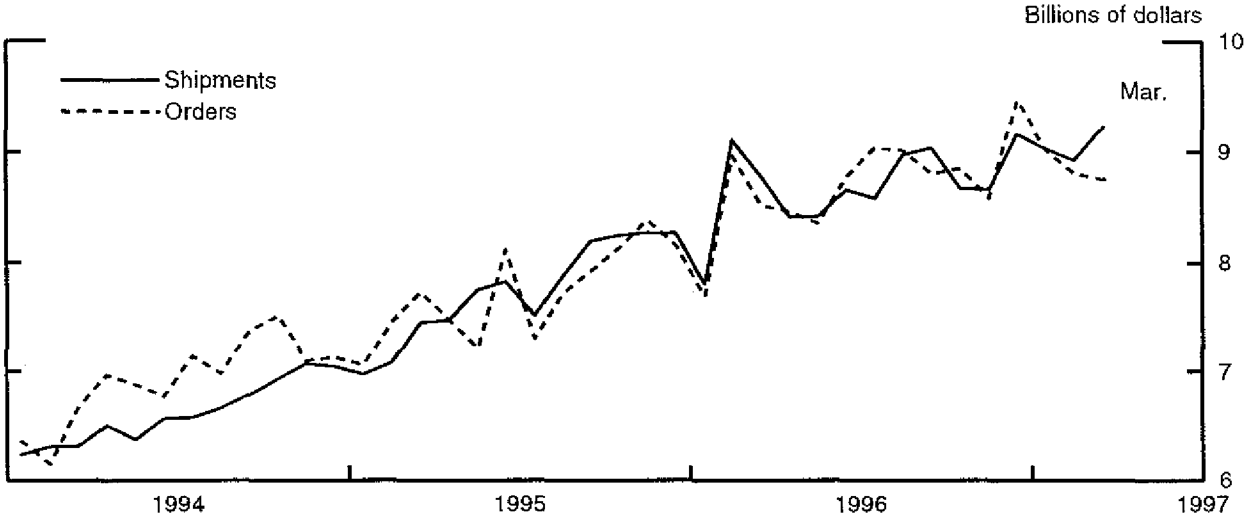
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	1996			1997	1997		
	Q2	Q3	Q4	Q1	Jan.	Feb.	Mar.
Producers' durable equipment							
Shipments of nondefense capital goods	2.9	1.8	1.5	1.0	-3.3	2.4	3.5
Excluding aircraft and parts	1.5	1.5	1.0	.5	-3.4	2.9	2.2
Office and computing	-.8	4.4	-.4	2.6	-1.4	-1.2	3.4
Communications equipment	4.7	4.5	4.2	-1.0	-8.1	9.7	4.5
All other categories	1.7	-.3	.6	.1	-2.9	2.9	1.2
Shipments of complete aircraft[1]	12.2	14.7	21.1	-10.2	-38.6	15.7	32.2
Sales of heavy trucks	1.3	-.8	-5.6	6.0	6.8	-.4	3.5
Orders of nondefense capital goods	-6.5	4.9	.5	1.9	4.4	2.4	-4.0
Excluding aircraft and parts	-1.7	2.6	-.5	4.9	3.1	7.2	-1.9
Office and computing	1.6	5.0	.2	-1.2	-4.8	-2.4	-.7
Communications equipment	-8.5	6.6	3.8	12.2	45.4	22.4	-5.6
All other categories	-1.2	.8	-1.8	5.5	-1.1	7.1	-1.3
Nonresidential structures							
Construction put in place, buildings	-.6	3.7	8.4	2.4	3.0	2.1	-2.3
Office	8.3	9.2	8.4	4.4	2.4	8.7	-4.8
Other commercial	-1.0	1.4	7.7	3.0	3.3	-1.1	-.9
Institutional	1.2	8.2	9.4	4.7	.7	2.4	1.5
Industrial	-8.0	-1.0	10.0	-5.8	3.3	-.8	-6.9
Lodging and miscellaneous	.0	4.5	6.6	8.5	5.2	4.3	-.2
Rotary drilling rigs in use[2]	9.9	-4.0	-1.6	16.2	6.0	8.3	8.8
Memo:							
Business fixed investment[3]	3.8	17.5	5.5	11.9	n.a.	n.a.	n.a.
Producers' durable equipment[3]	6.7	20.9	-.9	12.9	n.a.	n.a.	n.a.
Office and computing	29.6	42.3	28.9	25.7	n.a.	n.a.	n.a.
Communications equipment	14.9	28.2	-.7	18.9	n.a.	n.a.	n.a.
Other equipment[4]	5.3	1.9	-3.7	7.4	n.a.	n.a.	n.a.
Nonresidential structures[3]	-3.7	8.4	25.8	9.5	n.a.	n.a.	n.a.

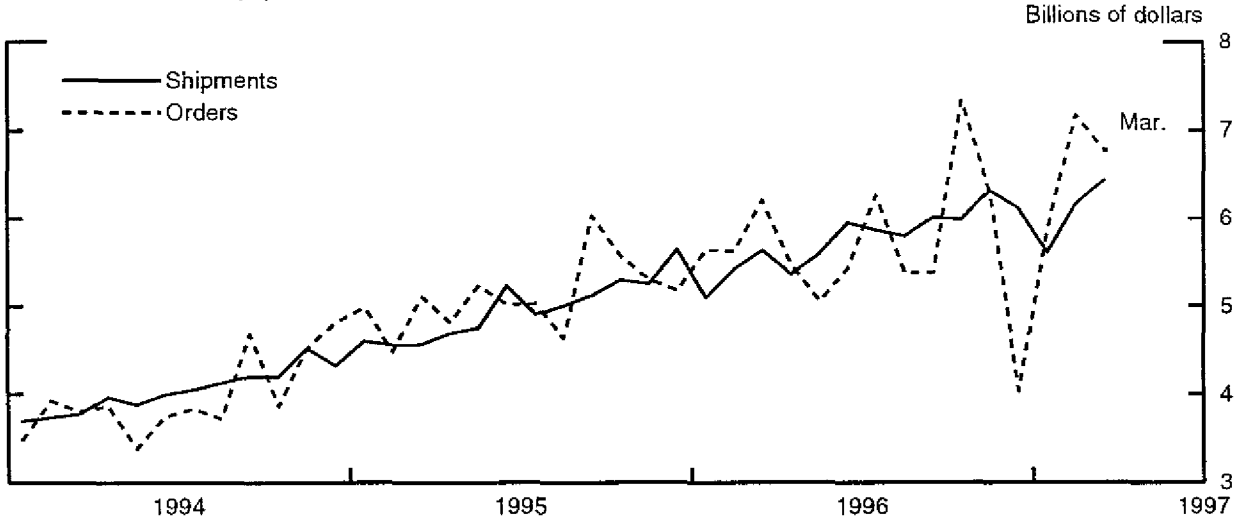
1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.
2. Percent change of number of rigs in use, seasonally adjusted.
3. 1997 Q1 is BEA's advance estimate. Based on 1992 chain-weighted data; percent change, annual rate.
4. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

Orders and Shipments of Nondefense Capital Goods

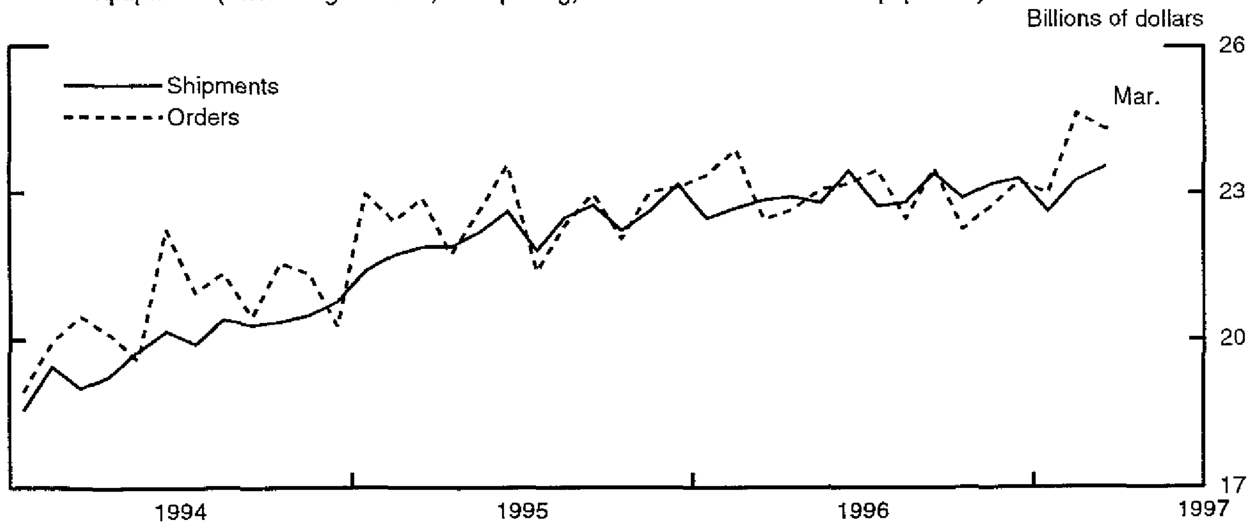
Office and Computing Equipment



Communications Equipment

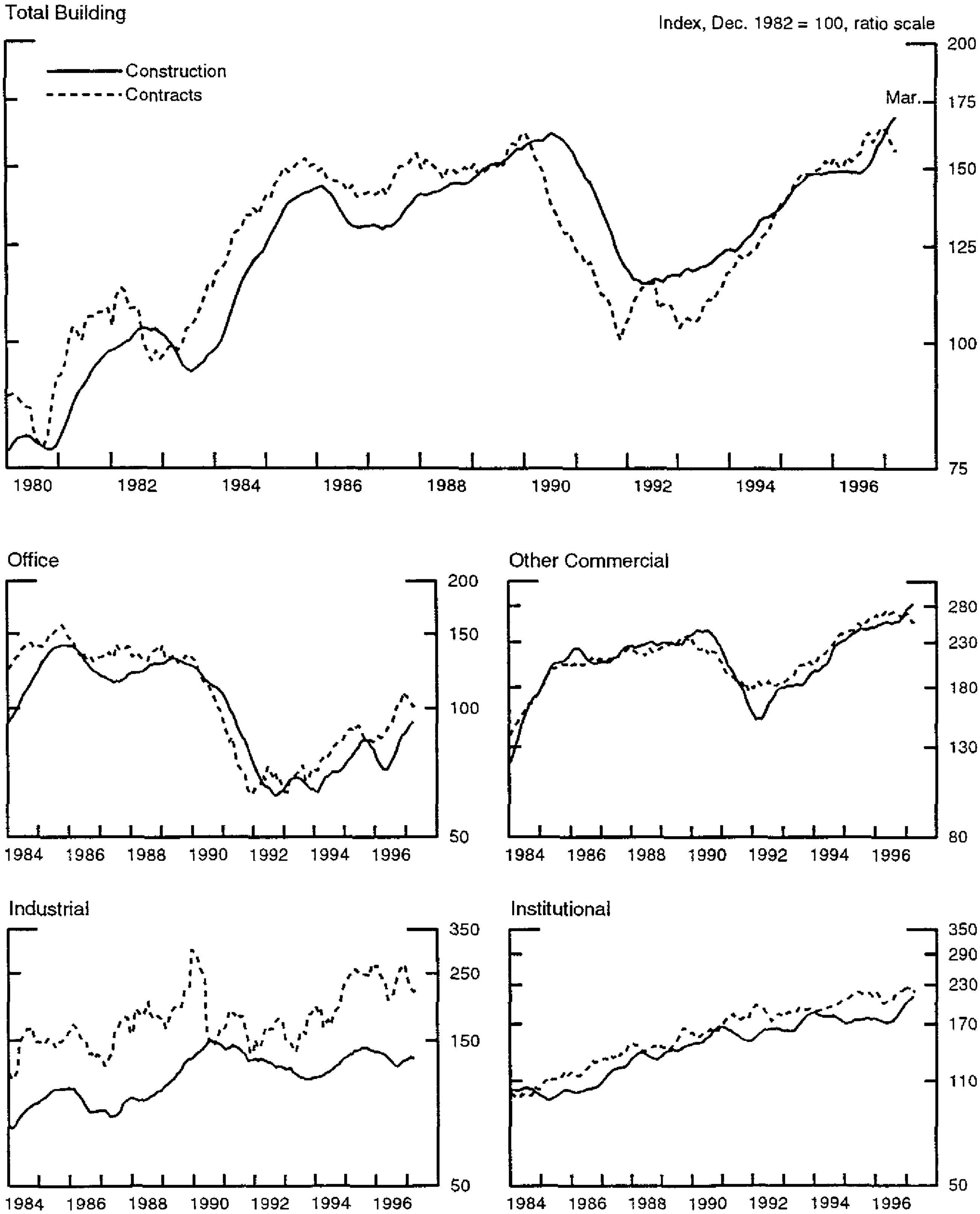


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



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

to boom, and traffic on the Internet is persistently bumping up against capacity constraints on phone and data lines. Orders for other capital goods, which had been on a plateau for most of 1995 and 1996, broke out of their recent range with a healthy 5.5 percent gain in the first quarter, suggesting further improvement in shipments of these items in the months ahead.

Business spending on motor vehicles was up considerably over the first four months of 1997. Fleet sales of light vehicles recovered from strike-depressed levels of late last year. Demand for medium and heavy trucks also appears to have firmed: Sales averaged 420,000 units at an annual rate from January to April, after a dip in late 1996, and the recent upturn in order backlogs bodes well for sales over the rest of the year.

Although Boeing continues to ramp up production, domestic spending on aircraft fell slightly in the first quarter, when a large share of deliveries were destined for foreign markets.

Real expenditures on structures rose sharply in the first quarter after the fourth quarter's outsized 26 percent annual rate gain. Among categories of buildings, office, other commercial, institutional, and lodging all registered double-digit increases; the only building category to decline was industrial, which slipped in the wake of a fourth-quarter surge.

Contracts for private nonresidential buildings fell in the first quarter. However, this series often takes misleading turns, and the preponderance of indicators of future construction activity is upbeat. Commercial vacancy rates have continued to decline, and the FDIC real estate survey of senior examiners and asset managers conducted in the first quarter reported improved prices for real estate, fewer rent concessions, and a higher volume of sales.

Business Inventories

BEA's advance GDP estimate showed real nonfarm inventory investment of $47 billion (SAAR), more than twice the fourth-quarter pace, and the newly available data for manufacturing and trade establishments point to an upward revision--perhaps to around $53 billion.[6] (Compared with BEA's assumptions in the advance GDP release, the incoming data for manufacturers and wholesalers

6. Aside from inventories held by manufacturing and trade establishments, which are estimated largely from the monthly Census surveys, BEA estimated that inventories held elsewhere in the economy expanded $13 billion in the first quarter, a rapid pace by historical standards.

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

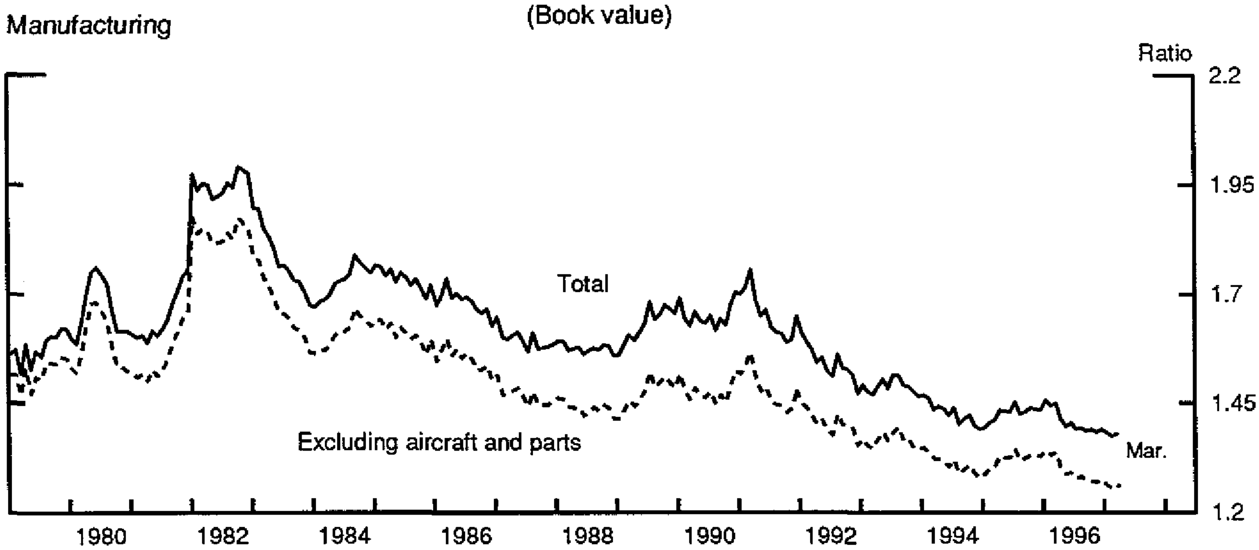
	1996		1997	1997		
	Q3	Q4	Q1	Jan.	Feb.	Mar.
Book value basis						
Total	32.7	13.8	44.8	47.8	48.5	38.3
Excluding wholesale and retail motor vehicles	18.6	20.0	37.1	45.9	43.2	22.1
Manufacturing	11.3	4.9	19.2	25.2	22.7	9.9
Excluding aircraft	8.6	.5	9.3	5.8	14.3	7.9
Wholesale	-7.8	4.1	16.3	25.0	2.3	21.6
Excluding motor vehicles	-4.9	6.0	11.8	16.4	7.8	11.2
Retail	29.2	4.9	9.3	-2.4	23.5	6.8
Auto dealers	17.0	-4.3	3.2	-6.9	10.7	5.8
Excluding auto dealers	12.2	9.1	6.1	4.4	12.8	1.1

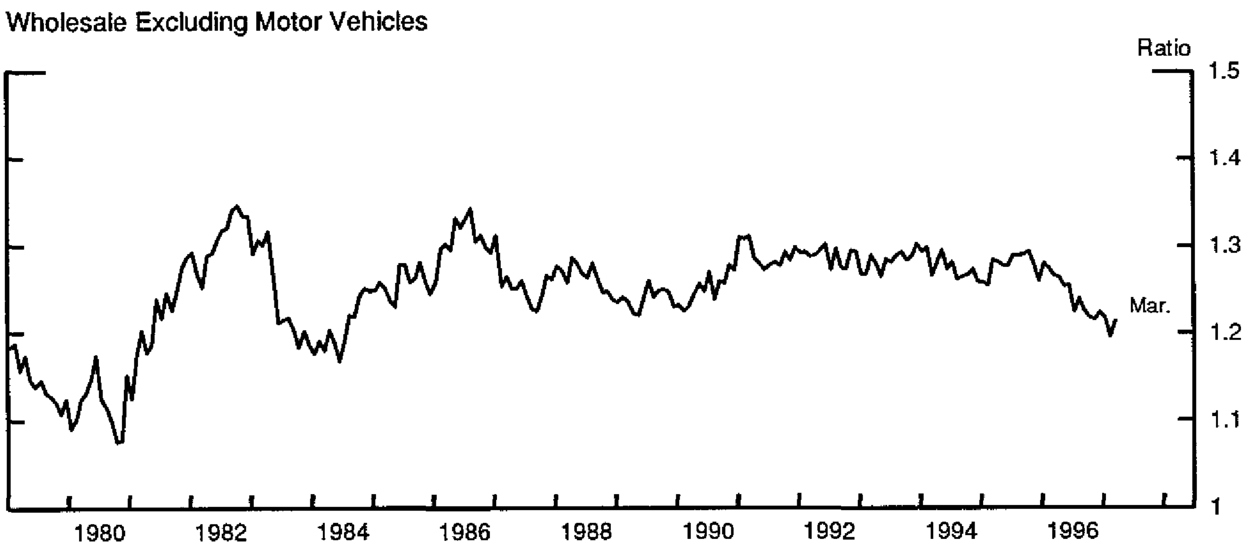
SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

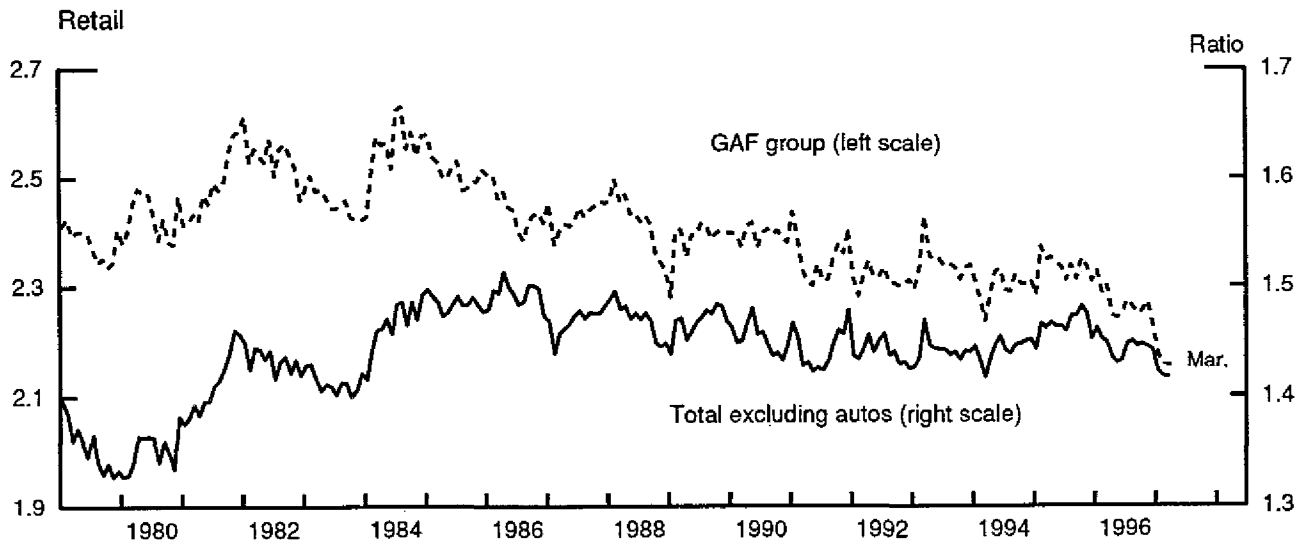
	Cyclical reference points		Range over preceding 12 months		March
	1990-91 High	1994-95 Low	High	Low	1997
Manufacturing and trade	1.58	1.40	1.42	1.36	1.37
Less wholesale and retail motor vehicles	1.55	1.37	1.40	1.33	1.34
Manufacturing	1.75	1.39	1.45	1.37	1.38
Primary metals	2.08	1.45	1.62	1.53	1.55
Nonelectrical machinery	2.48	1.88	1.92	1.77	1.76
Electrical machinery	2.08	1.52	1.54	1.43	1.38
Transportation equipment	2.94	1.59	1.87	1.65	1.78
Motor vehicles	.97	.53	.67	.55	.59
Aircraft	5.85	4.42	5.65	4.89	5.03
Nondefense capital goods	3.09	2.33	2.49	2.38	2.39
Textile	1.71	1.44	1.59	1.49	1.50
Petroleum	.94	.88	.85	.76	.85
Tobacco	2.83	1.99	2.18	1.93	1.98
Home goods & apparel	1.96	1.70	1.76	1.66	1.69
Merchant wholesalers	1.36	1.28	1.29	1.22	1.24
Less motor vehicles	1.31	1.25	1.27	1.20	1.21
Durable goods	1.83	1.54	1.57	1.50	1.54
Nondurable goods	.96	.98	.99	.92	.92
Retail trade	1.61	1.46	1.53	1.48	1.49
Less automotive dealers	1.48	1.42	1.45	1.42	1.42
Automotive dealers	2.21	1.61	1.79	1.68	1.70
General merchandise	2.43	2.20	2.29	2.12	2.11
Apparel	2.56	2.50	2.56	2.42	2.49
G.A.F.	2.44	2.23	2.30	2.16	2.16

Inventory-Sales Ratios, by Major Sector

(Book value)







were stronger, while the data for retail trade were weaker.) Nonetheless, for most manufacturing industries and trade groupings, the inventory-sales ratios in March were among the lowest in the current expansion.

In manufacturing, inventories rose at a $10 billion annual rate in book value terms in March and were up at a $19 billion rate for the first quarter as a whole. Stocks of nondefense aircraft and parts posted another sizable increase in the first quarter. Excluding aircraft, stocks of nondefense capital goods edged up. Changes were small in other categories.

In the trade sector, nonvehicle wholesale inventories continued expanding at a moderate pace in March and over the first quarter as a whole. Although inventory-sales ratios for most types of wholesale distributors edged up in March, they remained near the low end of the ranges observed in recent years. In the retail sector, stores in the GAF grouping (general merchandise, apparel, and furniture and appliance) reported a $7-1/2 billion drop in inventories in March, following little net accumulation during the first two months of the year. Inventory-sales ratios for most types of retail establishments in March were near their lowest levels in recent years.

Federal Sector

The incoming news on the fiscal 1997 budget has been very favorable. For the first half of fiscal 1997, the unified federal deficit, adjusted for payment timing shifts and excluding deposit insurance and spectrum auction proceeds, was $15 billion (11 percent) lower than for the same period in fiscal 1996. Receipts were more than 7-1/2 percent higher than last year, while adjusted outlays were up only 4 percent.[7] Spending growth was subdued across most categories. Outlays for income security programs were up less than 3 percent over last year, reflecting, in part, the strong economy. Spending on Medicare grew slightly less than 9 percent, on the low side of its recent trend. And, although outlays for Medicaid rose about 8 percent, the increase was exaggerated by an unusually low level of spending in the first part of fiscal 1996.

Individual nonwithheld tax payments surged in April. These payments, which reflect both final payments on 1996 tax liabilities

7. Real federal purchases in the NIPAs were down 3-1/2 percent at an annual rate in the first quarter of 1997, roughly in line with the trend over the past four years.

and estimated tax payments for the first quarter of calendar year 1997, were $30 billion higher than forecast in the last Greenbook and also substantially higher than OMB and CBO forecasts.

This 1997 "tax surprise" comes on the heels of a similar but smaller (roughly half the magnitude) surprise last year.[8] The surprise in the spring of 1996 appears to have arisen because total taxable income in 1995 was somewhat higher than expected (according to preliminary estimates), and the distribution of taxable income was more skewed toward taxpayers in the upper-income brackets.[9] Although no data are available on the source of this year's surprise, the factors that accounted for last year's tax surge may have played a role again in 1997.

We do not know whether the past two years of data point to a permanent structural shift toward higher average tax rates or whether temporary factors (perhaps related to the capital gains generated by a soaring stock market) account for the high level of tax payments. Despite the uncertainty, CBO notified the Congress that "a downward adjustment in the deficit of $45 billion in 1997 and similar amounts for 1998 through 2002 would be reasonable for planning the budget resolution."[10]

The CBO reading of the revenue surprise paved the way for the Administration and the Congress to reach agreement on the broad outlines of a plan to balance the budget by fiscal 2002. Under that plan, taxes would be cut $85 billion, on net, over the five years, reflecting up to $135 billion of gross tax cuts (including a child tax credit, reductions in capital gains and estate taxes, and new tax incentives for education) offset by up to $50 billion of ta increases. New spending initiatives include $16 billion for child

8. The March Greenbook forecast for tax payments on 1996 liabilities assumed that last year's tax surprise would persist. Thus, the tax surprise this year comes on top of a forecasted level of revenues that, as a share of income, was already high by recent standards.

9. Part of the increase in reported income of upper-income bracket taxpayers in 1995 may have reflected the exercising of stoc options and other forms of deferred compensation; however, the scan available information suggests that this factor could account for only a small part of the tax surprise.

10. Quoted from a letter to the Honorable Pete V. Domenici, Chairman of the Senate Committee on the Budget, from June E. O'Neill, Director of CBO, dated May 2, 1997. The $45 billion figur refers to the difference between CBO's current expectations of revenues in fiscal 1997 and CBO's estimates from early March. It includes $25 billion for higher-than-expected nonwithheld taxes in April and an upward revision of $20 billion to its estimates of withheld taxes over fiscal 1997 as a whole.

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

	March		Fiscal year to date totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	136.2	129.4	773.3	806.4	33.1	4.3
Deposit insurance (DI)	-.8	-1.4	-5.4	-10.1	-4.7	...
Spectrum auction (SA)	-.2	.0	-.2	-3.6	-3.4	...
Other	137.1	130.8	778.9	820.1	41.2	...
Receipts	89.1	108.1	645.6	695.1	49.5	7.7
Deficit (+)	47.1	21.3	127.7	111.3	-16.4	-12.9
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	137.1	138.1	786.0	820.1	34.1	4.3
National defense	22.3	22.0	130.8	133.2	2.3	1.8
Net interest	20.2	20.4	120.3	122.5	2.1	1.8
Social security	29.1	30.2	171.1	178.9	7.8	4.6
Medicare	14.1	15.2	85.2	92.8	7.5	8.8
Medicaid	7.8	8.1	44.0	47.4	3.4	7.8
Other health	2.5	2.4	13.1	14.0	.9	7.2
Income security	26.0	25.8	121.4	124.7	3.3	2.8
Other	15.1	14.0	100.1	106.7	6.6	6.6
Receipts	89.1	108.1	645.6	695.1	49.5	7.7
Individual	22.5	36.4	293.6	320.4	26.8	9.1
Withheld	41.8	50.0	281.4	302.3	20.9	7.4
Nonwithheld	5.8	6.4	51.2	58.1	6.9	13.5
Refunds (-)	25.1	20.0	39.0	40.1	1.1	2.7
Social insurance taxes	41.8	44.2	231.0	251.5	20.5	8.9
Corporate	15.5	18.7	64.2	67.9	3.7	5.8
Other	9.3	8.7	56.8	55.3	-1.6	-2.7
Deficit(+)	48.0	30.0	140.4	125.0	-15.3	-10.9

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.

health insurance and $15 billion to repeal parts of last year's welfare law; notably, the deal would make legal immigrants already in this country eligible for Medicaid and SSI benefits but not food stamps. The plan specifies $115 billion in Medicare cuts, $15 billion in Medicaid cuts, additional spectrum auctions, and reductions in discretionary spending, which are still unspecified.

State and Local Governments

Real expenditures on consumption and gross investment by state and local governments continued to grow slowly in the first quarter. Spending on consumption of goods and services increased moderately, while outlays for construction held steady at their high fourth-quarter level. Despite gyrations in employment growth over the past two months, average job gains thus far this year are about in line with the 1996 pace.[11]

Fiscal 1997 will end on June 30 for all but four states, and most are finding themselves with sizable surpluses primarily because tax collections have been higher than anticipated. Stronger-than-expected economic growth has contributed to the higher revenues: The Center for the Study of the States reports that revenue growth is running well ahead of the roughly 4 percent gains projected during the budget planning process. In addition, many states apparently experienced a surge in final payments in April.

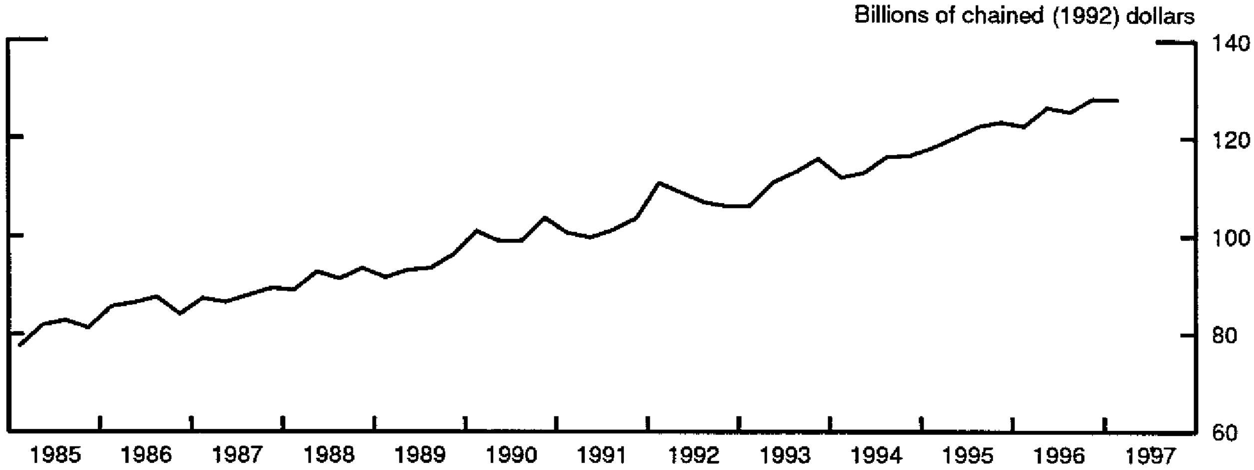
Developments on the spending side have also contributed to the strong fiscal picture at the state and local level. One key factor is the sharp decline in the number of families on welfare, which has fallen from a high of about 5 million per month, on average, in the mid-1990s to 4-1/4 million, on average, between October 1996 and January 1997 (the first four months of the federal fiscal year). The beneficial effects of declining caseloads on state and local budgets are especially great in the current circumstance: Federal welfare assistance is now provided in block grants that are based on caseloads over fiscal 1992-95, and thus the grants are unaffected by movements in the welfare rolls. In contrast, had Aid to Families with Dependent Children remained in place, federal grants would have fallen in lockstep with the shrinkage in the welfare rolls.

The states collect little information about the activities of former welfare recipients or the reasons they leave the rolls.

11. Seasonal adjustment problems related to the use of temporary election workers during the 1996 primary season boosted employment growth for noneducation workers at local governments in April after holding it down in March.

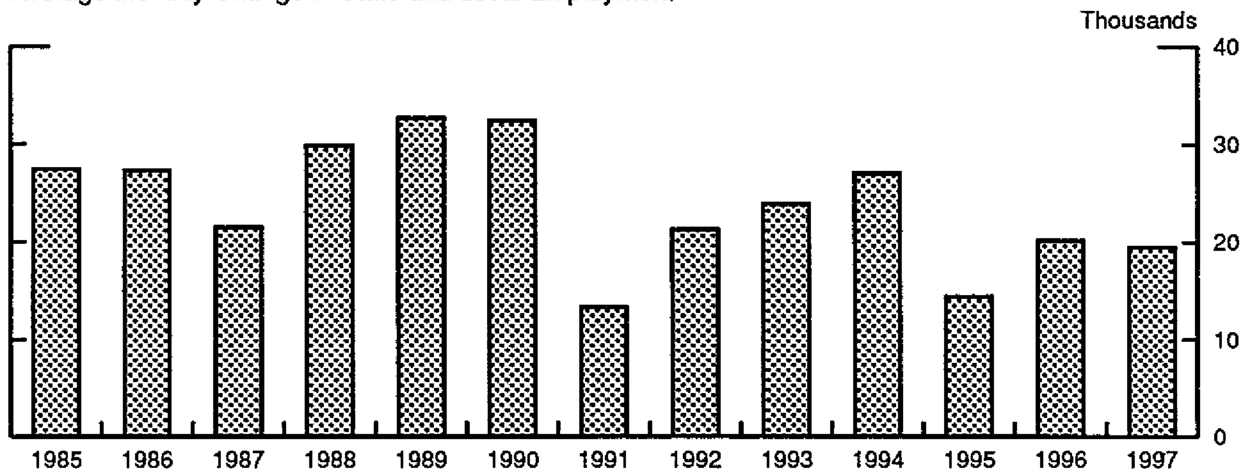
State and Local Sector

State and Local Construction



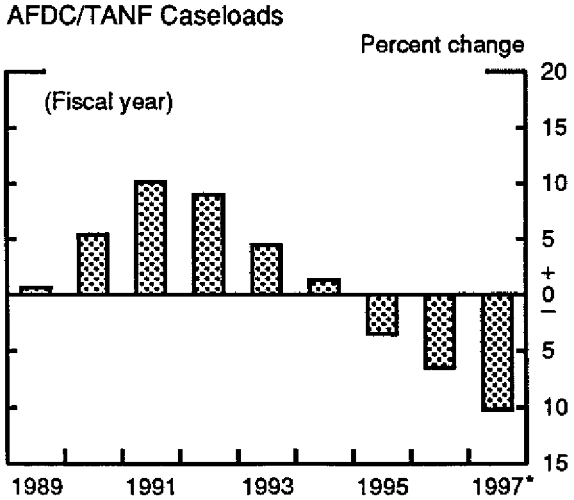
* 1997:Q1 is a staff estimate.

Average Monthly Change in State and Local Employment



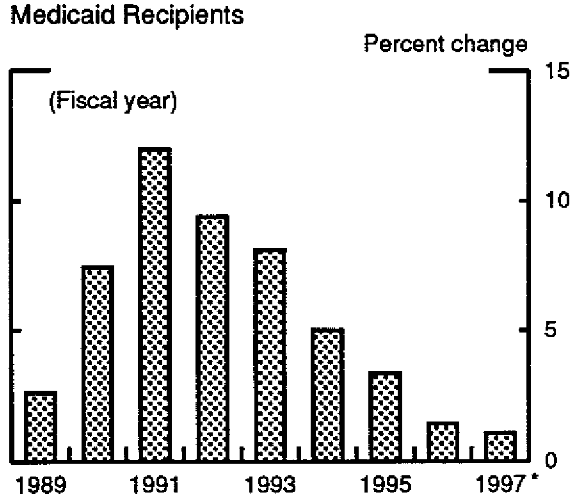
* Average of first four months.

AFDC/TANF Caseloads



* The first 4 months of fiscal 1997, compared to the same period in fiscal 1996.

Medicaid Recipients



* Figure for 1997 is estimated by the Health Care Financing Administration.

However, a recently released study by the Council of Economic Advisers suggests that more than 40 percent of the decrease in caseloads through fiscal 1996 can be explained by the strong economy, and almost a third is related to state welfare reform efforts, which were undertaken under federal waivers.

Pressures from Medicaid have also lessened recently. Although the program has continued to see a rise in the number of recipients, recent increases have been much smaller than those in the early 1990s. The slow growth in recipients, in conjunction with the moderation in medical price inflation and the revamping of many state Medicaid programs, has helped keep spending in check.

Labor Costs and Prices

Labor markets have tightened in recent quarters, and labor costs have accelerated gradually. Held down by flat benefit costs, hourly compensation, as measured by the Employment Cost Index, increased only 2.5 percent at an annual rate between December and March, compared with a rise of 2.8 percent over the preceding three months. However, quarterly changes in the ECI are quite volatile. Thus, we customarily focus on the twelve-month changes; these show that hourly compensation of private industry workers increased 3.0 percent in the year ended in March, up from a 2.7 percent rise in the twelve months ended in March 1996. Hourly wages and salaries increased 3.4 percent during the year ended in March, while benefits rose 2 percent.

Several factors have damped increases in benefits costs recently.[12] Employers' health insurance costs, as measured in the ECI, have remained nearly unchanged over the past two years, although there have been some reports that they are picking up recently. Moderating medical care costs have helped hold down increases in workers compensation. In addition, employers have benefited from reductions in state unemployment insurance premiums, which reflect the lagged effects of declining layoff rates on firms' experience ratings. In contrast, supplemental pay, which includes nonproduction bonuses, has picked up a bit; it rose 2 percent over the year ended in March after having fallen 1/2 percent over the preceding year.

12. As noted, seasonally adjusted benefit costs were flat in the first quarter. However, the weakness may have been exaggerated because the seasonal factors are estimated over a period that typically saw big first-quarter increases in employers' costs for health insurance, state unemployment insurance, and other benefits.

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1996				1997
	Mar.	June	Sept.	Dec.	Mar.
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	2.5	3.5	2.8	2.8	2.5
Wages and salaries	4.0	3.6	2.9	3.2	3.5
Benefit costs	0.0	3.0	2.1	2.9	0.0
By industry					
Construction	2.6	1.9	1.6	3.5	2.2
Manufacturing	2.2	3.5	3.4	2.8	0.6
Transportation and public utilities	2.2	2.9	2.5	4.1	1.2
Wholesale trade	2.2	3.8	2.8	3.4	6.9
Retail trade	6.0	-0.3	4.6	5.2	3.5
FIRE	4.6	5.9	1.3	-2.2	8.5
Services	3.4	3.4	2.8	3.1	2.7
By occupation					
White-collar	3.5	3.1	3.4	2.8	3.4
Blue-collar	2.6	2.9	1.6	3.8	1.2
Service occupations	1.9	2.9	2.6	3.8	3.5
Memo:					
State and local governments	2.5	2.5	2.5	3.1	2.1
	-----Twelve-month percent change----				
Total hourly compensation	2.7	2.9	2.9	3.1	3.0
Excluding sales workers	2.6	2.8	2.9	2.9	2.8
Wages and salaries	3.2	3.4	3.3	3.4	3.4
Excluding sales workers	3.1	3.2	3.4	3.3	3.1
Benefit costs	1.6	1.7	1.8	2.0	2.0
By industry					
Construction	2.6	2.7	2.3	2.4	2.3
Manufacturing	2.5	2.8	3.1	3.0	2.6
Transportation and public utilities	3.1	3.0	2.6	3.0	2.7
Wholesale trade	3.5	3.6	3.0	3.1	4.2
Retail trade	3.0	2.5	2.9	3.8	3.2
FIRE	3.6	3.7	3.3	2.4	3.3
Services	2.5	2.7	2.9	3.1	3.0
By occupation					
White-collar	3.0	3.0	3.2	3.2	3.2
Blue-collar	2.5	2.6	2.4	2.7	2.4
Service occupations	1.9	2.0	2.2	3.0	3.2
Memo:					
State and local governments	2.8	2.6	2.5	2.6	2.5

1. Seasonally adjusted by the BLS.

The twelve-month change in average hourly earnings of production or nonsupervisory workers fluctuated between 3.7 percent and 4.1 percent over the past couple of months. Even so, it remained well above the pace of the preceding year and thus continued to show a greater acceleration than hourly wages and salaries of production or nonsupervisory workers in the ECI. Shifts in the occupational composition of the workforce, which are not captured in the ECI, may explain part of the relatively greater acceleration in average hourly earnings. In addition, some of the discrepancy between the two wage series has arisen because hourly earnings have been boosted by the rise in overtime hours over the past several quarters, whereas the ECI is designed to measure only straight-time earnings. (Stock options and deferred compensation are not included in either the ECI or average hourly earnings.)

Hourly compensation in the nonfarm business sector--reported in the Productivity and Cost release--rose 4.7 percent in the first quarter. Smoothing through the considerable quarterly volatility, hourly compensation increased 3.9 percent on a year-over-year basis, essentially the same pace as during the previous year. However, this measure of hourly compensation has accelerated markedly since the second half of 1993, when the four-quarter rate of increase bottomed out at 1.8 percent--mirroring the pattern of average hourly earnings. In comparison, the acceleration in the ECI started later and has been much smaller than in nonfarm hourly compensation.

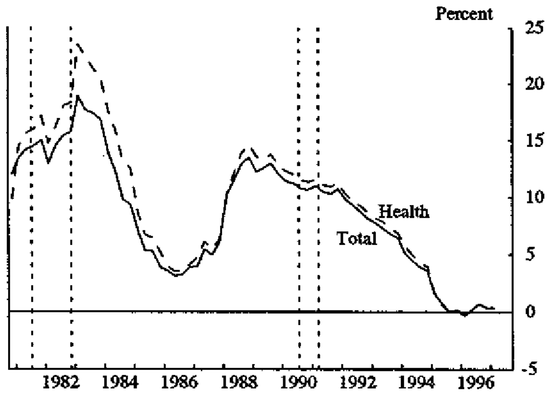
The consumer price index rose only 0.1 percent in April, bringing the increase over the past twelve months to just 2.5 percent. This measure of the inflation trend reached 3.3 percent late last year but has backed off virtually month by month as food and energy prices reversed their earlier run-ups.

The drop in crude oil prices has been quite apparent in retail prices in the past two months. The CPI for energy fell 1.5 percent in April after a 1.7 percent decline in March; prices of motor fuel, home heating oil, and natural gas decreased sharply in both months.

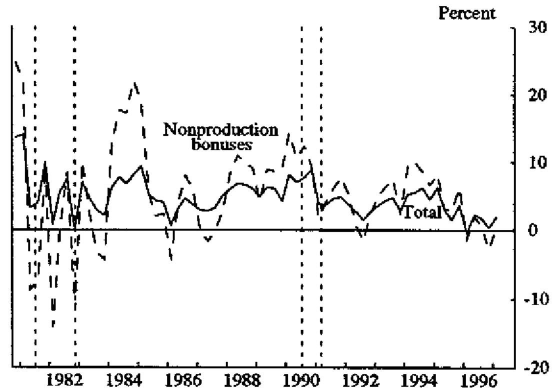
Consumer food prices have declined slightly over the past two months, though they remain 2.8 percent higher than a year earlier. At earlier stages of processing, the PPI for crude foodstuffs and feedstuffs rose in March and April following seven consecutive months of declines; the recent upturn reflected increases in livestock and soybean prices.

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

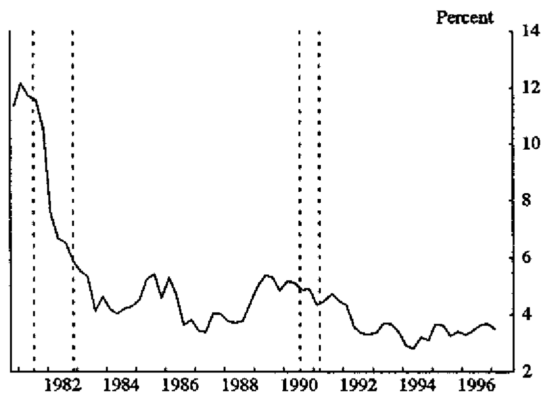
Insurance Costs



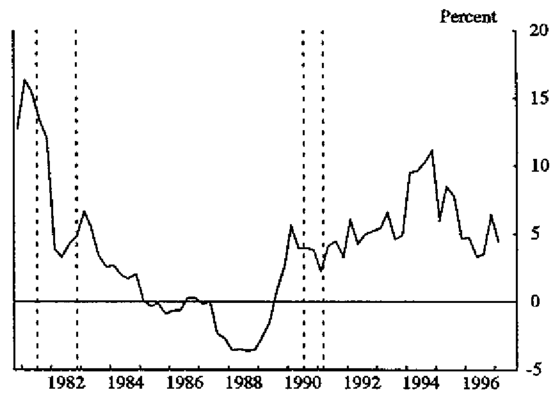
Supplemental Pay



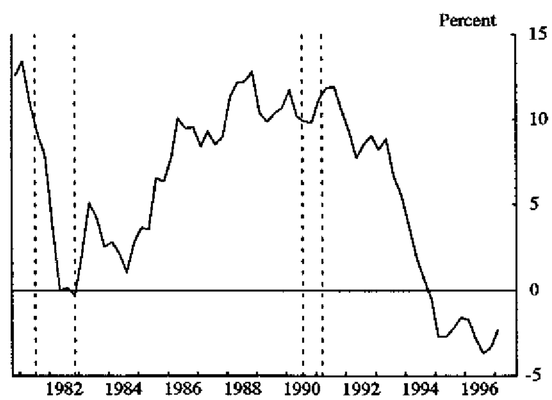
Paid Leave



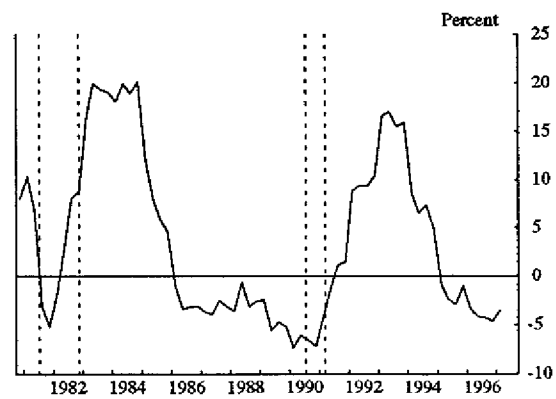
Retirement and Savings



Workers' Compensation Insurance

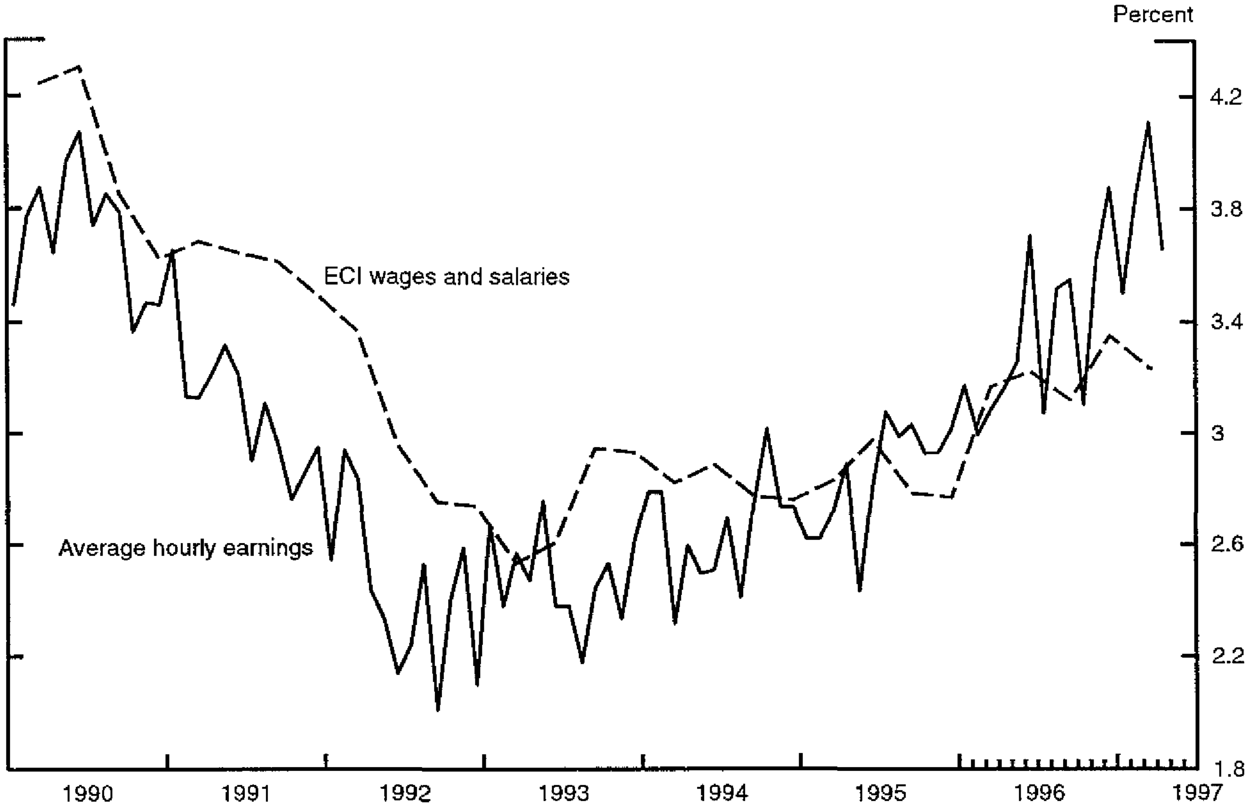


State Unemployment Insurance



Note. Unpublished ECI benefits detail.

Earnings of Production or Nonsupervisory Workers
(Twelve-month change)



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

			1996			1997	1996:Q1 to 1997:Q1
	1995[1]	1996[1]	Q2	Q3	Q4	Q1	
Compensation per hour							
Nonfarm business	3.7	3.6	3.9	3.3	3.6	4.7	3.9
Manufacturing	4.2	3.4	5.8	4.6	2.7	4.5	4.4
Nonfinancial corporations[2]	3.5	3.5	3.9	4.1	3.2	ND	ND
Unit labor costs							
Nonfarm business	3.7	2.6	3.3	3.3	2.5	2.7	2.9
Manufacturing	.5	-.7	3.6	-1.2	-1.5	1.4	.5
Nonfinancial corporations[2]	1.9	1.3	2.3	.1	1.5	ND	ND

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.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996	1997	1996	
	Apr. 1996	Apr. 1997	Q4	Q1	Mar.	Apr.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.9	2.5	3.3	2.3	0.1	0.1
Food (15.9)	2.6	2.8	4.7	0.3	.0	-0.2
Energy (7.0)	5.9	.0	10.2	7.3	-1.7	-1.5
CPI less food and energy (77.0)	2.7	2.7	2.7	2.2	0.2	0.3
Commodities (23.4)	1.6	1.1	1.4	1.0	0.1	0.3
New vehicles (5.0)	1.7	1.2	0.9	-0.5	0.1	.0
Used cars (1.3)	0.4	-2.0	-1.8	1.6	1.2	-1.6
Apparel (4.8)	.0	0.8	2.1	2.2	-0.4	1.1
House furnishings (3.3)	0.6	-0.7	0.1	-0.7	-0.3	-0.2
Other Commodities (9.0)	2.9	2.1	2.2	1.7	0.2	0.5
Services (53.7)	3.2	3.3	3.1	2.7	0.3	0.3
Shelter (28.2)	3.3	3.1	2.7	3.1	0.2	0.3
Medical care (6.1)	3.9	3.0	2.9	2.6	0.3	0.3
Auto finance charges (0.6)	-10.1	3.0	-3.0	-1.8	1.2	0.7
Other Services (18.8)	3.1	3.8	3.9	2.1	0.4	0.3
PPI						
Finished goods (100.0)[2]	2.4	0.8	3.9	-0.7	-0.1	-0.6
Finished consumer foods (23.6)	1.9	2.4	4.9	-4.2	0.9	-0.4
Finished energy (14.7)	6.5	-1.3	17.6	1.9	-3.4	-2.6
Finished goods less food and energy (61.6)	1.6	0.6	0.4	0.2	0.4	-0.1
Consumer goods (38.0)	1.8	1.0	0.6	0.3	0.3	.0
Capital equipment (23.6)	1.4	0.1	.0	0.5	0.3	-0.4
Intermediate materials (100.0)[3]	0.6	-0.1	0.9	1.1	-0.6	-0.3
Intermediate materials less food and energy (81.2)	-1.0	0.2	0.1	0.9	.0	.0
Crude materials (100.0)[4]	10.4	-4.8	6.4	5.5	-6.9	-0.9
Crude food materials (38.9)	17.5	-2.3	-28.1	-15.5	2.1	3.3
Crude energy (41.1)	21.3	-9.9	76.4	29.0	-19.2	-5.2
Crude materials less food and energy (20.0)	-13.1	-1.0	1.0	11.6	0.6	-2.3

1. Relative importance weight for CPI, December 1996.
2. Relative importance weight for PPI, December 1996.
3. Relative importance weight for intermediate materials, December 1996.
4. Relative importance weight for crude materials, December 1996.

The index for consumer prices excluding food and energy rose 1/4 percent per month in March and April. On a twelve-month basis, core inflation was 2.7 percent in April, the same as a year earlier and up from the 2.5 percent figures of the prior couple of months. The increase last month included sizable rises in tobacco and apparel prices that likely will prove to be outliers.

The BLS recently introduced an experimental CPI using geometric means. This alternative index--which differs from the headline index by its method of weighting observations at the most detailed level--reduces the within-strata substitution bias that plagues the official CPI. The BLS intends to introduce geometric weighting in some of the detailed strata in the official index in January 1999.[13] Based on comparisons of the relative performance of the official and alternative indexes over the past several years, the BLS estimates that applying the geometric mean formula within all strata would lower the growth rate of the CPI about 1/4 percentage point per year; thus, this figure can be taken as an upper-bound estimate of the impact of the planned change to the CPI.

Other broad measures of prices present a mixed bag of small accelerations and decelerations, and measures of inflation expectations are lower than, or unchanged from, a year ago. The PPI for intermediate materials less food and energy held steady over the past two months and has been essentially flat over the past year. The PPI for core crude materials dropped sharply last month; smoothing through the considerable volatility, it has fallen 1 percent from its year-earlier level. On balance, the Journal of Commerce index of industrial commodity prices and the KR-CRB index of spot prices have been largely unchanged this year. However, metals prices have continued to tick up in recent weeks and have now mostly recovered from their steep decline in 1996.

13. The BLS is examining which categories it will switch over to geometric means and plans to make an announcement of the results by the end of the year. In addition, at the beginning of 1998, the BLS will introduce new expenditure weights, which may reduce CPI inflation roughly 0.1 percentage point per year.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994 Q1	1995 Q1	1996 Q1	1997 Q1
Product prices				
GDP chain price index	2.3	2.4	2.2	2.2
GDP deflator	2.2	2.5	2.1	1.8
Nonfarm business chain price index[1]	2.1	2.4	1.6	2.2
Expenditure prices				
Gross domestic purchases chain price index	2.1	2.5	2.2	2.2
Less food and energy	2.3	2.5	2.2	1.9
PCE chain price index	2.2	2.5	2.0	2.5
Less food and energy	2.5	2.6	2.0	2.1
PCE deflator	2.2	2.6	2.0	2.1
Less food and energy	2.5	2.6	1.9	1.8
CPI	2.5	2.9	2.8	2.9
Less food and energy	2.9	3.0	2.9	2.5
Median CPI	3.0	2.7	3.3	2.7

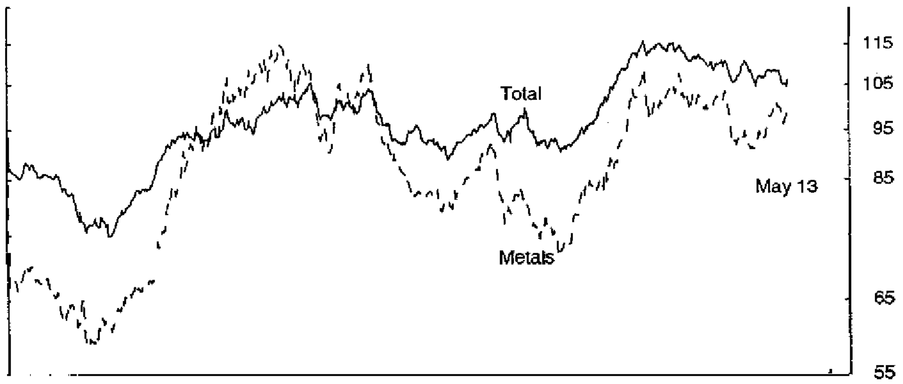
1. Excluding housing

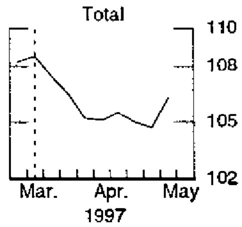
SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

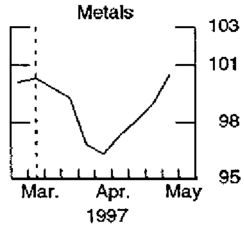
	Actual inflation[1]	University of Michigan (1-year) Mean[2]	University of Michigan (1-year) Median[3]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1995:Q1	2.8	4.1	3.1	4.2	3.3
Q2	3.1	4.1	3.1	4.2	3.4
Q3	2.6	3.9	2.9	4.0	3.2
Q4	2.7	3.6	2.8	3.9	3.0
1996:Q1	2.7	3.9	2.9	4.1	3.0
Q2	2.8	4.5	3.0	4.3	3.0
Q3	2.9	4.2	3.0	4.3	3.0
Q4	3.2	4.0	3.0	4.2	3.0
1997:Jan.	3.0	4.1	3.0	4.3	
Feb.	3.0	3.8	3.0	4.3	
Mar.	2.8	3.5	2.8	4.1	3.0
Apr.	2.5	3.7	3.0	4.2	

1. CPI; percent change from the same period in the preceding 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.

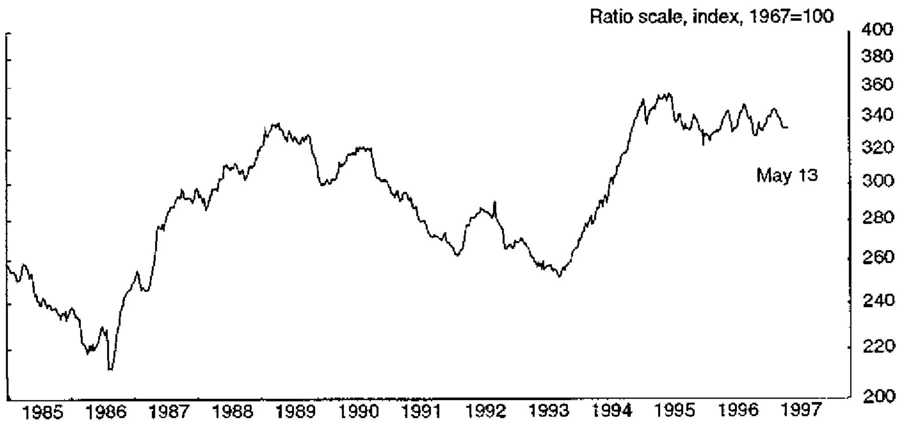
Commodity Price Measures

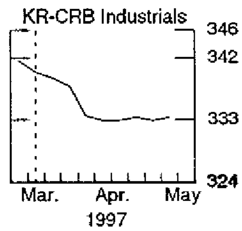




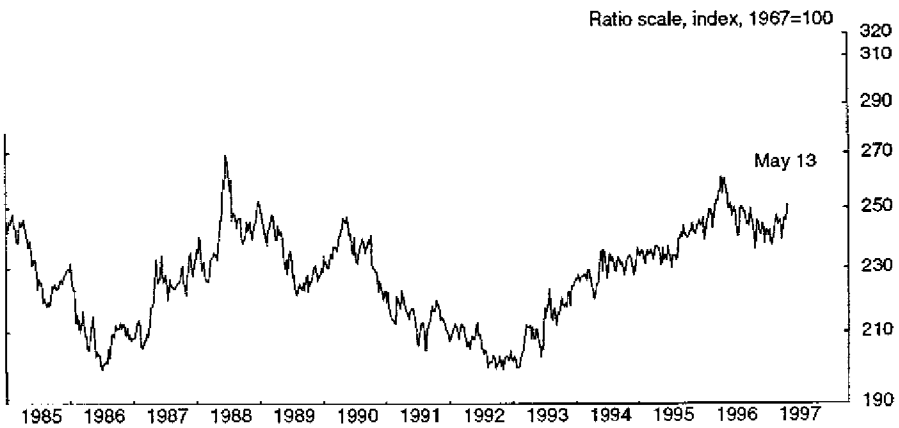


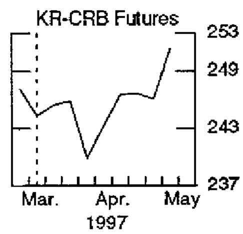
KR-CRB Spot Industrials





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.

SPOT PRICES OF SELECTED COMMODITIES

	Current price ($)	1995	1996	Dec. 31 to Mar. 18[2]	Mar. 18[2] to May 13	Memo: Year earlier to date
		Percent change[1]				
Metals						
Copper (lb.)	1.180	-3.5	-18.3	9.3	.9	-12.6
Steel scrap (ton)	138.500	-6.6	-13.7	17.2	1.5	-2.8
Aluminum, London (lb.)	.741	-12.9	-9.8	6.5	1.5	.8
Precious metals						
Gold (oz.)	348.900	1.7	-5.1	-6.2	.8	-10.7
Silver (oz.)	4.860	7.2	-8.8	7.9	-5.6	-9.6
Forest products						
Lumber (m. bdft.)	386.000	-14.4	66.0	-9.4	2.7	5.2
Plywood (m. sqft.)	310.000	-6.1	1.6	6.3	-7.5	-3.7
Petroleum						
Crude oil (barrel)	19.450	16.8	25.9	-19.4	2.0	.2
Gasoline (gal.)	.634	7.7	24.3	-6.7	.7	-7.2
Fuel oil (gal.)	.565	22.6	16.1	-19.9	.2	-5.2
Livestock						
Steers (cwt.)	69.000	-5.7	.0	3.0	1.5	14.0
Hogs (cwt.)	61.000	27.5	34.1	-12.7	27.1	2.5
Broilers (lb.)	.567	10.7	12.4	-13.2	4.5	-10.6
U.S. farm crops						
Corn (bu.)	2.770	57.4	-29.5	12.7	-3.7	-44.0
Wheat (bu.)	4.533	24.0	-16.6	-.1	-.2	-37.4
Soybeans (bu.)	8.655	29.0	-7.1	18.1	6.5	7.7
Cotton (lb.)	.693	-8.1	-10.9	-.1	-2.0	-16.4
Other foodstuffs						
Coffee (lb.)	2.825	-39.1	43.2	50.7	37.8	106.2
Memo:						
JOC Industrials	106.300	-1.7	-3.7	1.1	-2.0	-4.0
JOC Metals	100.500	-1.8	-7.7	7.3	.2	-3.0
KR-CRB Futures	251.300	3.3	-2.6	2.6	2.8	-3.4
KR-CRB Spot	338.410	-3.5	1.0	1.5	-.4	-.4

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

DOMESTIC FINANCIAL DEVELOPMENTS

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

Instrument	1996 Feb. low	1996 July high	1997 FOMC,* Mar. 25	1997 May 14	Change to May 14, from: Feb. low	July high	FOMC,* Mar. 25
Short-term rates							
Federal funds[2]	5.15	5.39	5.29	5.49	.34	.10	.20
Treasury bills[3]							
3-month	4.76	5.21	5.25	5.05	.29	-.16	-.20
6-month	4.67	5.40	5.35	5.30	.63	-.10	-.05
1-year	4.55	5.64	5.53	5.53	.98	-.11	.00
Commercial paper							
1-month	5.27	5.50	5.61	5.61	.34	.11	.00
3-month	5.12	5.59	5.66	5.69	.57	.10	.03
Large negotiable CDs[3]							
1-month	5.21	5.44	5.56	5.59	.38	.15	.03
3-month	5.12	5.59	5.63	5.70	.58	.11	.07
6-month	4.99	5.83	5.77	5.87	.88	.04	.10
Eurodollar deposits[4]							
1-month	5.13	5.38	5.50	5.56	.43	.18	.06
3-month	5.13	5.56	5.56	5.69	.56	.13	.13
Bank prime rate	8.25	8.25	8.25	8.50	.25	.25	.25
Intermediate- and Long-term Rates							
U.S. Treasury (constant maturity)							
3-year	4.98	6.62	6.45	6.41	1.43	-.21	-.04
10-year	5.58	7.06	6.72	6.68	1.10	-.38	-.04
30-year	6.02	7.19	6.94	6.90	.88	-.29	-.04
U.S. Treasury indexed bond	n.a.	n.a.	3.47	3.57	n.a.	n.a.	.10
Municipal revenue (Bond Buyer)[5]	5.67	6.24	6.06	5.98	.31	-.26	-.08
Corporate-A utility, recently offered	7.18	8.23	8.11	7.98	.80	-.25	-.13
High-yield corporate[6]	9.57	10.36	9.66	9.60	.03	-.76	-.06
Home mortgages[7]							
FHLMC 30-yr fixed rate	6.94	8.42	7.94	7.91	.97	-.51	-.03
FHLMC 1-yr adjustable rate	5.19	6.01	5.71	5.82	.63	-.19	.11

Stock exchange index	Record high Level	Record high Date	1996 July low	1997 FOMC,* Mar. 25	1997 May 14	Percentage change to May 14, from: Record high	July low	FOMC,* Mar. 25
Dow-Jones Industrial	7292.75	5/12/97	5346.55	6905.25	7286.16	-.09	36.28	5.52
S&P 500 Composite	837.66	5/12/97	626.65	790.89	836.04	-.19	33.41	5.71
NASDAQ (OTC)	1388.06	1/22/97	1042.37	1242.64	1335.55	-3.78	28.13	7.48
Russell 2000	370.65	1/22/97	307.78	349.48	364.48	-.68	19.61	4.29
Wilshire	7885.88	5/12/97	6099.34	7501.44	7874.56	-.14	29.11	4.97

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 May 21,1997.
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 March 24, 1997.

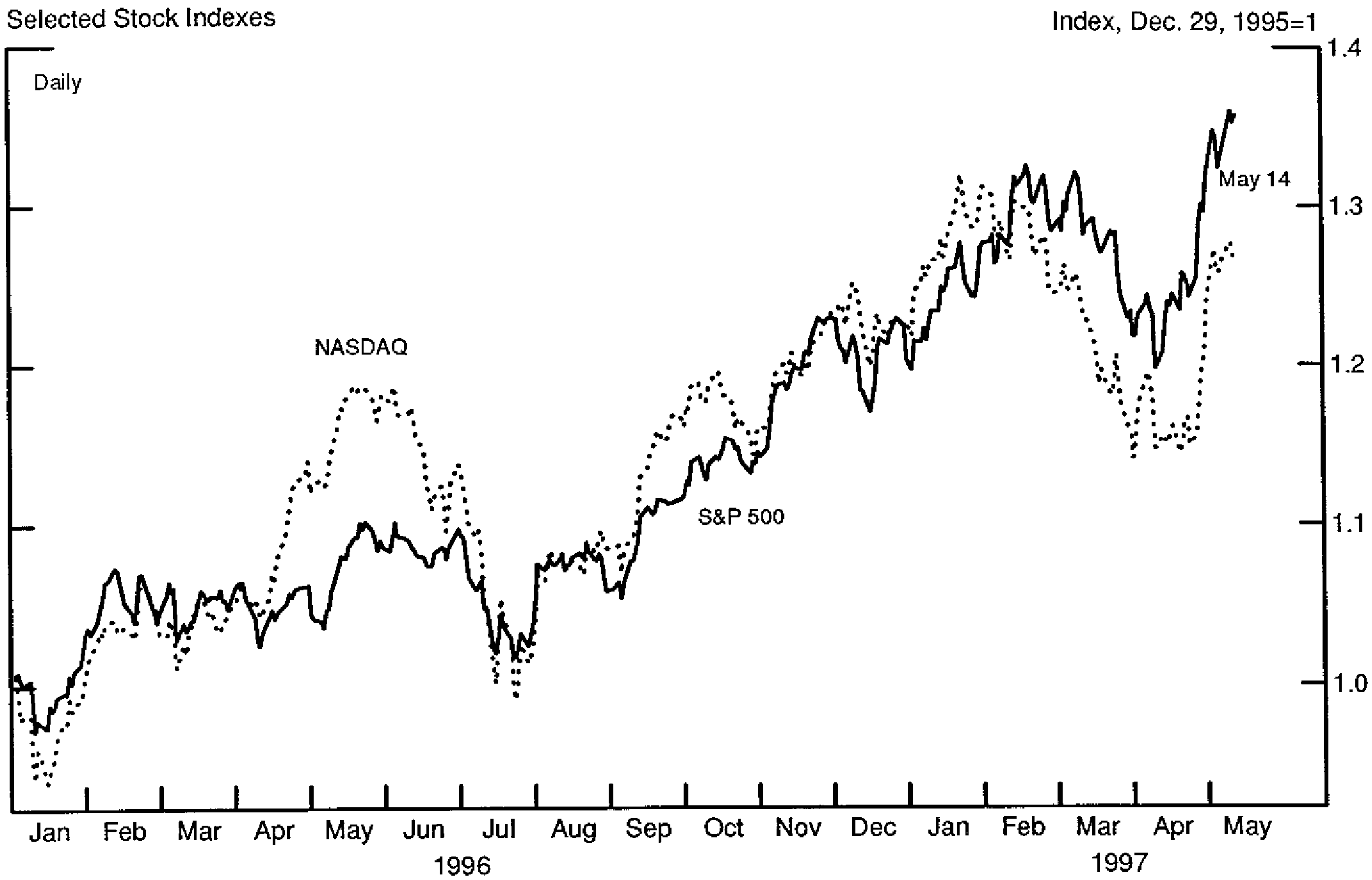
The FOMC's action at the March meeting to raise the intended federal funds rate from 5-1/4 percent to 5-1/2 percent was widely anticipated, and yields on Treasury coupon issues shifted up only 1 to 5 basis points that day. Yields rose further through mid-April on data releases suggesting that economic activity was much stronger than expected. However, those increases were more than rolled back after the employment cost index and other reports suggested subdued inflation pressure and slowing growth, and after the release of favorable news on the federal budget deficit. In addition, Chairman Greenspan's speech of May 8 was interpreted as reducing the likelihood of further tightening. On net, yields on Treasury notes and bonds are down slightly since the March FOMC meeting. Market odds on a 25-basis-point tightening at the May meeting, as read from federal funds futures contracts, are less than 50-50 (chart).

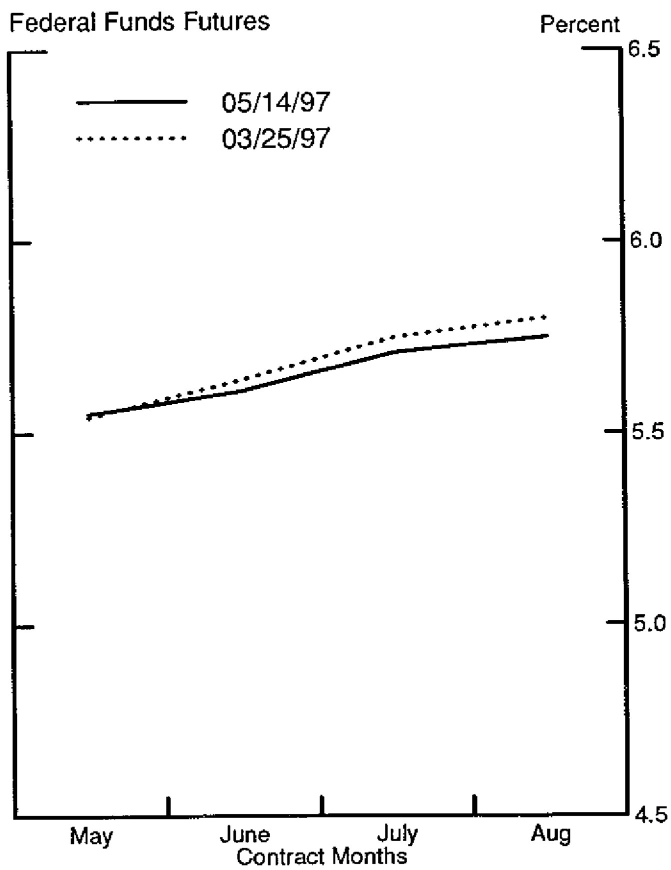
Yields on private money market instruments have risen somewhat since late March. Three-month Treasury bill rates, however, are down 20 basis points because of a sharp cutback in supply, which resulted from the Treasury's continued reliance on coupon securities in the face of surprisingly large tax receipts.

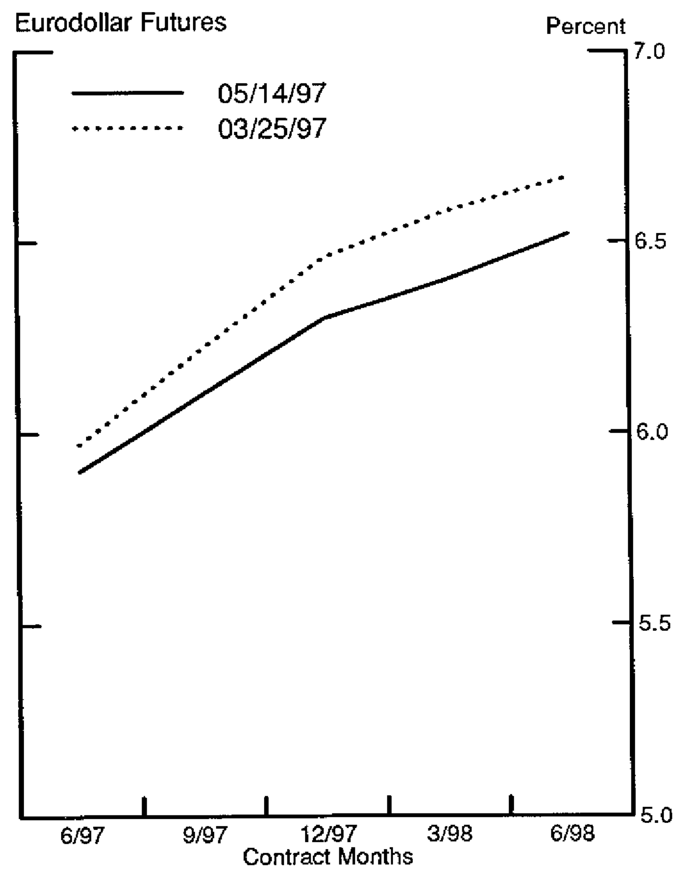
Major stock price indexes gyrated throughout the intermeeting period (chart) but were up 4 percent to 7-1/2 percent, on balance, boosted by unexpectedly strong corporate earnings in the first quarter. The Dow and the S&P 500 hit new highs on May 12, bringing their total increase since year-end to about 13 percent. The NASDAQ composite, while up strongly in recent weeks, has not fully retraced the decline from its peak in January. Price-earnings multiples remain elevated, suggesting that market participants expect substantial growth in earnings from the already high levels.

Borrowing by the nonfinancial business sector so far this quarter appears to have held at its strong first-quarter pace. Business lending at banks has remained robust, and merger deals have continued to generate considerable issuance in the markets. In the household sector, commercial bank data suggest a continuation of the moderate first-quarter growth of home mortgage debt but possibly a further deceleration in consumer credit. State and local government debt remains on a slow growth path, while borrowing by the federal government has plummeted because of the elevated tax receipts. With

Selected Stock Market Indexes and Short-Term Futures Rates







bank credit growing robustly and households building up liquid assets to pay taxes, growth in the broad monetary aggregates remained strong in April.

Business finance

After a solid first quarter, gross issuance of nonfinancial corporate bonds slowed just a bit in April (table) and then jumped in the first half of May. Investment-grade offerings were strong throughout the intermeeting period, supported by large merger-related issues. In contrast, speculative-grade issuance turned down in April, amid weak inflows to junk bond mutual funds; investors apparently became more cautious regarding the prospects for low-rated companies--mirroring the slide in the stock market. This caution seems to have abated in recent weeks, as speculative-grade issuance and inflows to junk bond funds have both recovered. Yield spreads of speculative-grade bonds over Treasuries have widened a shade, on net, since the March FOMC meeting but remain very narrow by historical standards.

Borrowing by nonfinancial firms from banks remained robust in April, with domestic banks providing most of the loans. Respondents to the May Senior Loan Officer Opinion Survey indicated very little change over the past three months in credit standards for C&I loans but did note some easing of terms, especially spreads of loan rates over market rates for large and medium-sized companies. About one-fifth of respondents, on net, expected charge-offs of business loans to increase in the remainder of 1997 from the extraordinarily low rates of the past few quarters. Standards for commercial real estate loans were reportedly unchanged, on net, but the vast majority of respondent banks said that their competitors had eased standards. Significant fractions of banks reported easing spreads on such loans over the past year, but other terms were little changed.

Nonfinancial commercial paper outstanding fell sharply in April after rising moderately in the first quarter (chart). The most likely explanation for the decline is that strong profits reduced the need to issue paper to make first-quarter tax payments. Commercial paper issuance is poised to pick up in coming weeks as several companies tap the market to finance large merger deals.

Equity issuance by nonfinancial firms was sluggish in March and April in large part because of the extremely slow pace of initial public offerings (IPOs). The IPO market has been tepid this year,

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

Type of security	1995	1996	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
All U.S. corporations	47.7	58.4	59.5	56.7	52.5	59.2	39.8
Stocks[1]	6.1	10.2	12.1	9.9	8.4	7.9	5.6
Bonds	41.6	48.2	47.4	46.8	44.1	51.3	34.2
Nonfinancial corporations							
Stocks[1]	4.4	6.7	6.4	4.9	5.8	4.1	2.4
Initial public offerings	1.7	2.9	2.8	1.1	1.9	.7	1.0
Seasoned offerings	2.7	3.8	3.6	3.9	3.9	3.4	1.4
Bonds	10.8	12.5	13.6	13.2	14.0	13.1	12.6
By rating, bonds sold in U.S.[2]							
Investment grade	6.5	6.3	7.6	5.7	6.9	4.4	6.8
Speculative grade	3.0	4.8	4.9	6.2	6.2	8.2	5.0
Public	2.0	2.3	1.4	2.7	1.1	3.7	.9
Rule 144A	1.1	2.5	3.5	3.6	5.1	4.5	4.1
Financial corporations							
Stocks[1]	1.7	3.5	5.8	4.9	2.6	3.9	3.2
Bonds	30.8	35.8	33.8	33.6	30.2	38.2	21.5

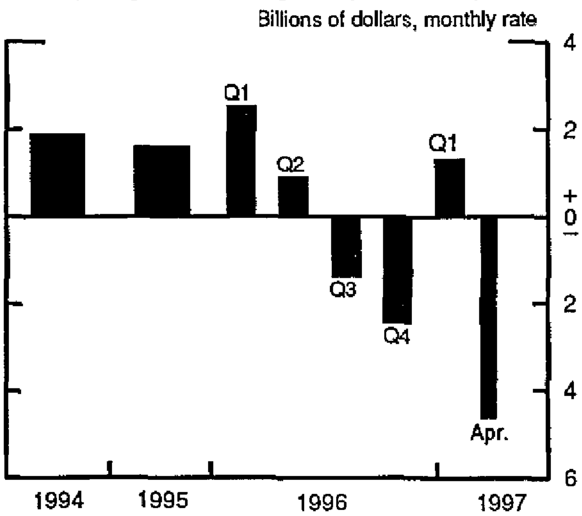
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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

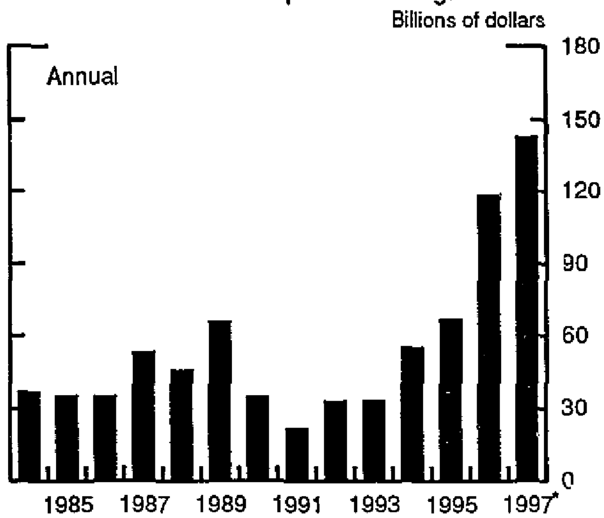
2. Bonds categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.

Nonfinancial Corporations

Net Commercial Paper Issuance
(Change in outstandings over period shown)



Announced Share Repurchase Programs



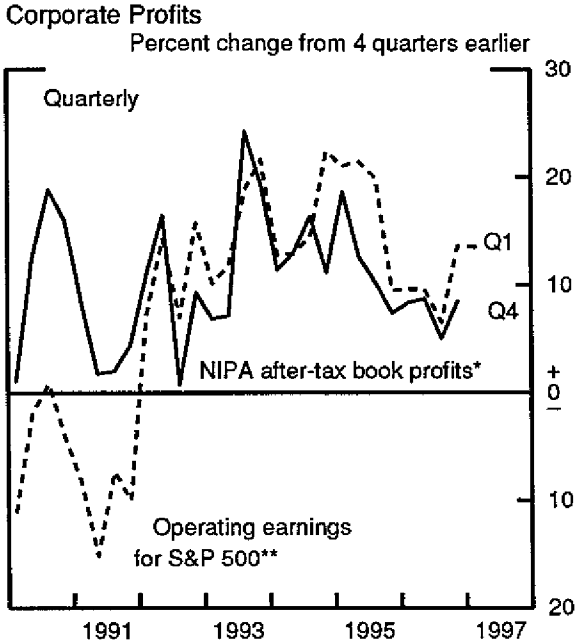
* Data through April, at an annual rate.

with a sizable share of IPOs being offered at prices below their filing ranges and first-day returns on IPO shares dropping to their lowest level since 1994. Overall, the equity issuance that has occurred has been overwhelmed by retirements through mergers and share repurchases. Announcements of new repurchase programs have continued to rise this year, reflecting the accumulation of cash at large companies (chart).

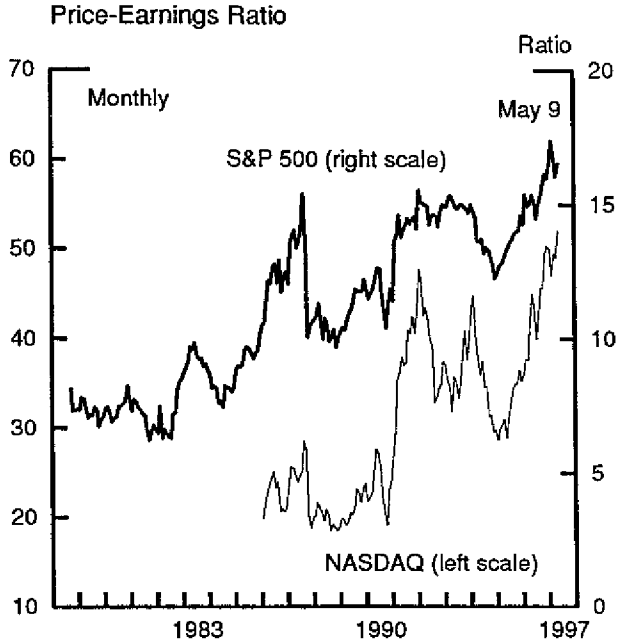
Recent reports on corporate profits have been extremely favorable. After-tax earnings in the first quarter for S&P 500 firms were about 14 percent above earnings posted four quarters earlier (chart). This robust growth, which was widespread across industries, surpassed expectations of securities analysts by a large margin. Equity price indexes fell sharply from the March FOMC meeting through mid-April, partly in response to higher interest rates and the anticipation of future FOMC tightenings. Prices recovered on the favorable earnings news and surged in early May amid declining bond yields and lessening fears of further Fed rate hikes. These broad market swings were accompanied by substantial intraday price volatility, as market participants reacted strongly to economic news or statements by Fed officials seen as providing hints about the near-term course of monetary policy. Despite the favorable earnings, price-to-earnings ratios for both the S&P 500 and NASDAQ indexes are high by historical standards (chart).

The merger wave among nonfinancial companies that began in 1994 has shown no signs of abating. The pace of megamergers during the first four months of this year, expressed in dollars at an annual rate, was fairly close to the record volume in 1996 (chart), and the backlog of announced, but uncompleted, deals remained huge. Unlike the wave of hostile takeovers of the 1980s, the current one continues to be dominated by friendly intra-industry mergers that look for potential economies of scale or are driven by regulatory and technological changes. Also in contrast to the 1980s, stock swaps have dominated cash-financed purchases. Structuring deals as stock swaps rather than cash purchases allows shareholders of the acquired firm to avoid an immediate tax liability on any capital

Stock Market and Corporate Profits



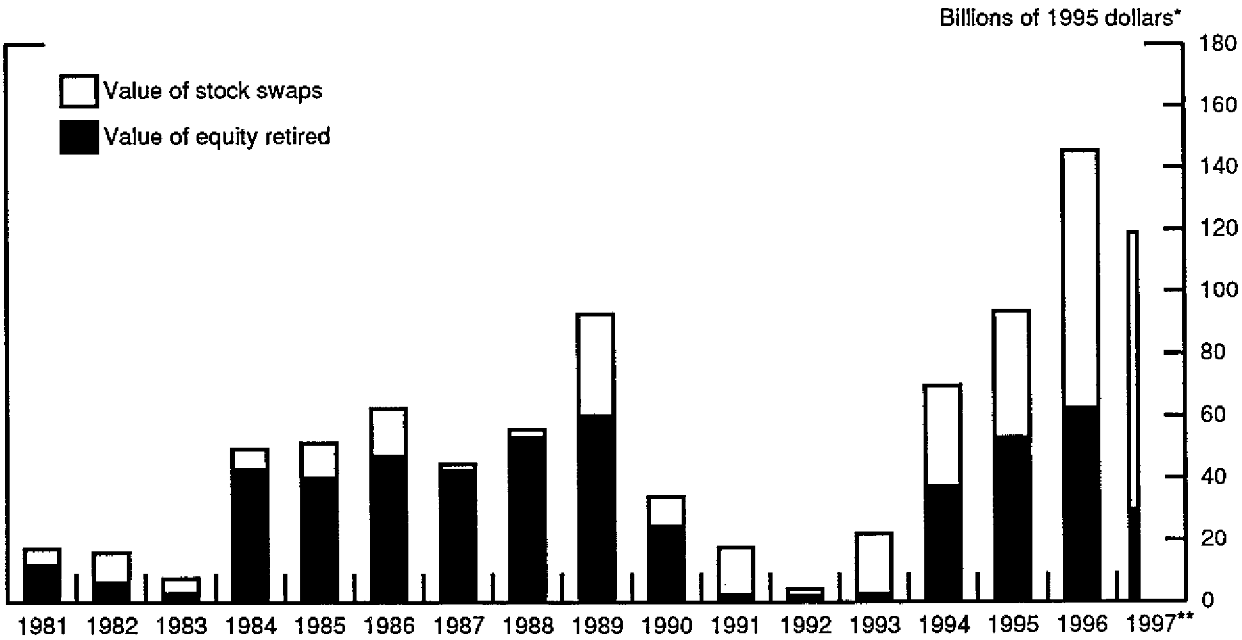
* 1996:Q4 value adjusted to exclude effect of charge to recapitalize SAIF.
** Goldman Sachs estimate.



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.

Volume of Megamergers

(Completed transactions where target firm is valued at $1 billion or more)



* Deflated to 1995 dollars using GDP deflator.
**Data through April, at an annual rate.

gains and often enables the combined firm to use a more advantageous method of financial accounting.[1]

Corporate credit quality has remained generally good. According to Moody's, the value of nonfinancial company debt upgraded in the first quarter about equaled that downgraded, and among companies under review for a rating change at the end of the first quarter, anticipated upgrades slightly exceeded anticipated downgrades. In addition, the default rate on speculative-grade debt during the first four months of the year dropped below the already very low rate in 1996. The only negative news was the increase in business failures in the first quarter, which owed largely to start-up difficulties for firms with new licenses in wireless telecommunications.

Household finance

Growth in total consumer credit outstanding picked up a bit in the first quarter to a 6-1/2 percent annual rate (table). Growth of revolving and "other" credit moved slightly higher, while the level of automobile credit was about unchanged. Consumer credit decelerated, however, as the quarter proceeded. That trend, together with the sluggish pace of bank consumer loans in April, is consistent with the view that credit availability has tightened a little and--more important--that consumer spending has moderated. In the May Senior Loan Officer Survey, about half the banks, on net, reported tightening standards on new credit card accounts over the past three months, with a smaller fraction reining in other consumer loans. The most common tightening action on loan terms was to lower credit limits. In addition, a fifth of the respondents, on net, reported a decline in demand for consumer loans.

Household borrowing in mortgage markets increased slightly in the first quarter, and data from large commercial banks suggest that growth in home equity and other residential real estate loans remained solid this spring. Mortgage applications for home purchases surged in the week following the System's tightening. In similar episodes in the past, borrowers have rushed to lock in mortgage rates in anticipation of further increases in interest rates, but the active encouragement of lenders and the faster turnaround now

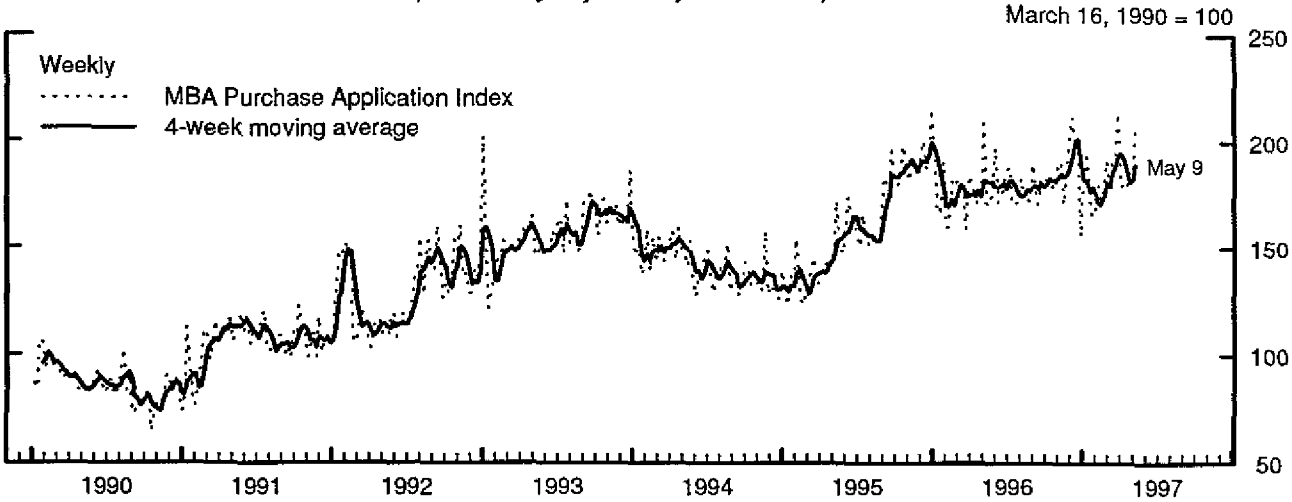
1. When cash is used in an acquisition, the combined firm's subsequent income statements must include charges to write off "goodwill" (the excess of the purchase price over the value of the net assets of the acquired firm). By contrast, if the deal is a stock swap and meets other technical requirements, goodwill is not recognized and subsequent charges against income are avoided.

Consumer Credit

	1995	1996	1996 Q3	1996 Q4	1997 Q1[p]	1997 Jan	1997 Feb	1997 Mar[p]
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.2	8.1	7.8	5.3	6.4	10.3	6.7	2.0
(Previous)	*(14.2)*	*(8.3)*	*(8.1)*	*(5.6)*		*(10.3)*	*(6.7)*	
Auto	10.6	6.9	6.2	1.9	0.2	3.1	0.7	-3.3
Revolving	22.0	13.0	7.7	12.2	12.7	21.6	12.7	3.7
Other	9.2	3.4	9.7	-0.1	4.5	3.0	5.1	5.4
Levels (billions of dollars, SA)								
Total	1103.3	1193.2	1177.6	1193.2	1212.2	1203.5	1210.2	1212.2
Auto	350.8	375.2	373.4	375.2	375.3	376.1	376.4	375.3
Revolving	413.9	467.9	454.0	467.9	482.8	476.3	481.3	482.8
Other	338.6	350.2	350.2	350.2	354.1	351.0	352.5	354.1
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	9.1	9.0	8.9	n.a.	8.9	n.a.
Personal (24 mo.)[2]	13.9	13.5	13.4	13.6	13.5	n.a.	13.5	n.a.
Credit cards[3]	16.0	15.6	15.7	15.6	15.9	n.a.	15.9	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	10.3	9.8	7.6	7.2	7.4	8.1
Used cars	14.5	13.5	13.9	13.6	13.1	12.9	13.1	13.2

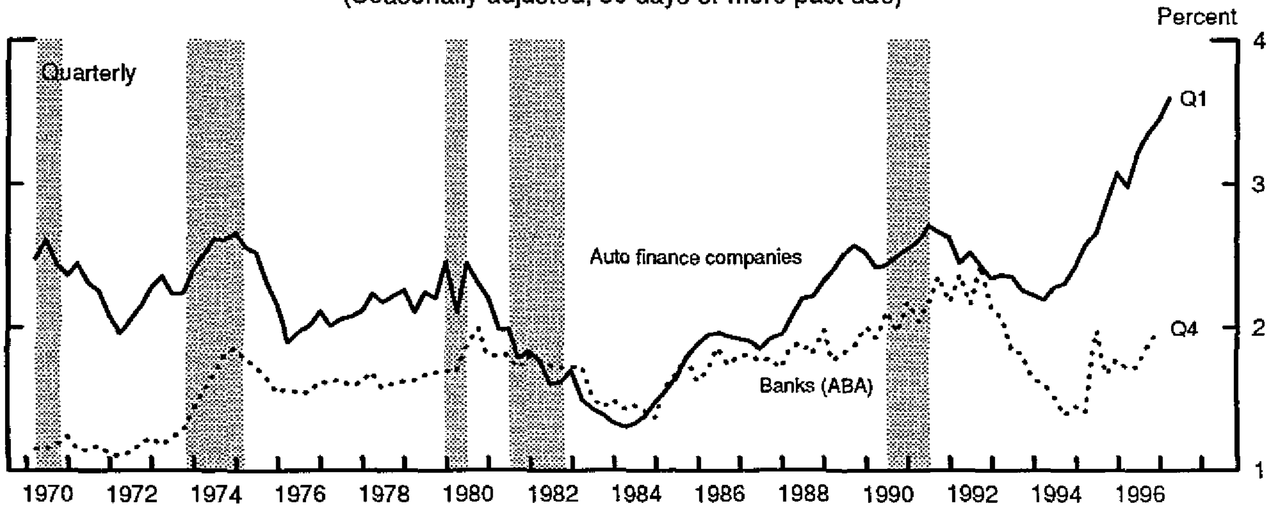
1. Annual data are averages of quarterly data for commercial banks and of monthly data for finance companies.
2. Average of most common rate charged for specified type and maturity during the first week of the middle month of each quarter.
3. Stated APR averaged across all credit card accounts at all 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.

MBA Mortgage Purchase Application Index
(Seasonally adjusted by Board staff)



Adjustable Rate Mortgage Rate Less 1-Year Treasury Rate
(Not seasonally adjusted)

Auto Loan Delinquency Rates
(Seasonally adjusted, 30 days or more past due)



Source. Federal Reserve, American Bankers Association.

available on applications have amplified this effect. The volume of applications has dropped back somewhat since then but remains relatively high (chart).

Like other long-term interest rates, the average commitment rate on thirty-year, fixed-rate mortgages rose through mid-April but subsequently has drifted down to a level slightly below that at the March FOMC meeting. Rates on adjustable-rate mortgages (ARMs) are up, on balance, over the intermeeting period, but relative to their indexes, ARMs are still being heavily discounted by lenders. The average initial contract rate on mortgages tied to the Treasury one-year constant maturity yield is now below that index (chart).

The few recent indicators of household credit quality suggest some further deterioration. The average delinquency rate on auto loans at the three captive auto finance companies rose to a new high of 3.59 percent in the first quarter (chart). Moody's reported that losses on securitized credit card loans rose sharply in March from the year-earlier period to an annual rate of 6.72 percent, the highest in the seven-year history of this series (not shown). About one-third of banks reporting on the Senior Loan Officer Survey expected charge-off rates on consumer loans to increase over the remainder of this year because of an increased willingness of households to declare bankruptcy, worsening household financial conditions, and previous aggressive solicitation of borrowers by the banks themselves.

Federal government finance

The seasonal inflow of federal tax receipts has surpassed all expectations and should produce a budget surplus of $85 billion in the second quarter (table). The staff anticipates that this surplus, together with $12 billion to be raised from coupon issues, will be used to pay down $97 billion in bills, on net, this quarter. Weekly bill auction sizes have been cut substantially since the last FOMC meeting, and considerably more than is typical for the second quarter, with the weekly competitive supply falling about $6 billion.

For most of this decade the average maturity of the Treasury's debt fell, reaching a low point in 1996 of a little over five years. However, the recent cut in bill auction sizes has reinforced the increase in the average maturity of the debt that began last year. Auctions of ten-year notes were added last July and October, an auction for the thirty-year bond was added in November, and four

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q4	1997 Q1	1997 Q2[p]	1997 Apr.[e]	1997 May[p]	1997 June[p]
Total surplus/deficit (-)	-59.3	-52.0	85.3	88.4	-45.8	42.8
Means of financing deficit						
Net cash borrowing and repayments (-)	48.7	48.0	-86.0	-40.3	-23.8	-21.9
Nonmarketable	7.4	3.4	-0.4	-0.3	-0.1	0.0
Marketable	41.3	44.6	-85.5	-39.9	-23.7	-21.9
Bills	16.2	8.1	-97.2	-44.2	-26.6	-26.4
Coupons	25.1	36.5	11.6	4.2	2.9	4.5
Decrease in cash balance	11.4	-0.7	-6.9	-55.9	71.8	-22.8
Other[1]	-0.8	4.6	7.6	7.8	-2.2	2.0
Memo:						
Cash balance, end of period	32.8	33.5	40.4	89.4	17.6	40.4

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.
e Estimate.
p Projection.

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

Agency	1996 Q4	1997 Q1	1997 Jan.	1997 Feb.	1997 Mar.
FHLBs	8.5	3.1	-6.3	-1.6	11.0
FHLMC	10.0	-3.4	6.2	-1.6	-7.9
FNMA	12.1	4.9	2.0	-1.3	4.1
Farm Credit Banks	-0.1	0.8	7.6	-7.5	0.8
SLMA	-0.2	-1.7	4.0	-0.1	-5.6

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

auctions were set for the indexed-linked ten-year note. The Treasury's actions reflected concern that issuance at the long end had become bunched since 1993, leading to cash management difficulties. Given the budget projections then available, more auctions of long-term debt with slightly smaller auction sizes were not expected to affect the average maturity of the debt in a significant way. However, because auction sizes at the long end can only be cut back so much without undermining the liquidity of specific issues, the debt managers have been forced by this year's unexpectedly small deficit to pare both bills and intermediate-maturity notes.

In April, the Treasury held its second auction of indexed-linked ten-year notes, reopening the existing issue. This auction was less successful than the first, held in January. The ratio of bids to the amount offered was about half that observed at the prior auction, although, at 2-1/4, it was similar to the ratios observed at conventional ten-year note auctions. The market for these securities is still immature. Trading volumes remain very low, and a market for stripped securities has yet to emerge, but the Chicago Board of Trade plans to begin trading in futures and options contracts based on inflation-indexed securities in July.

In other news, the Treasury announced at the end of April some changes to its savings bond program to make these instruments more attractive to savers. Interest rates on Series EE bonds issued after May 1, 1997, will be set at 90 percent of the constant maturity yields on five-year Treasury notes, a noticeable increase from the rates set under the old procedures. The new bonds will accrue interest monthly instead of semiannually, making it easier to cash them in without losing interest. However, to encourage longer-term holdings, there will be a three-month interest penalty for redemption within five years of issuance.

After a robust performance in late 1996, bond issuance by federal agencies slowed substantially in the first quarter of this year as interest rates rose (table). Nonetheless, the trend toward global issues continued apace, as Fannie Mae and Freddie Mac issued bonds totaling $1.9 billion that were offered simultaneously in the United States, Europe, and Asia and in some cases were denominated in foreign currencies.

Perhaps looking ahead to eventual privatization, some agencies have sought to diversify their activities and in the process have run into opposition. Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System have all raised congressional eyebrows by, respectively, flirting with the life insurance market, investing in Philip Morris' debt, and moving toward direct lending to individuals. House Banking Committee Chairman Leach has called for a review of the investment and expansion plans of these government-sponsored enterprises, citing the possible use of their special status to gain an unfair competitive advantage.

The Student Loan Marketing Association is well on its way to privatization. Some directors think that Sallie Mae ought to originate student loans as well as buy them in the secondary market and repackage them. Once a proxy fight over this strategy is resolved, Sallie Mae could become a holding company with one of its subsidiaries containing all of the government-related financial assets. This subsidiary would wind down gradually over the next ten years.

State and local government finance

Gross issuance of long-term municipal debt rose about 20 percent in April from the subdued first-quarter pace (table), owing to stronger new capital issuance reportedly in anticipation of higher long-term interest rates. However, refunding issuance fell in April in response to the rise in long-term interest rates that had already occurred. Net issuance remained positive, reflecting the reduced pace of retirements of pre-refunded bonds.

The credit quality of municipal debt improved further in the first quarter, with Standard and Poor's upgrading nearly twice as much debt as it downgraded (chart). The net upgrades reflected more solid fiscal positions that have accompanied the expanding economy and better financial management by state and local governments. As in 1996, the improvement in credit quality would have been greater if not for the net downgrades at municipal utilities, which continue to be under pressure from deregulation.

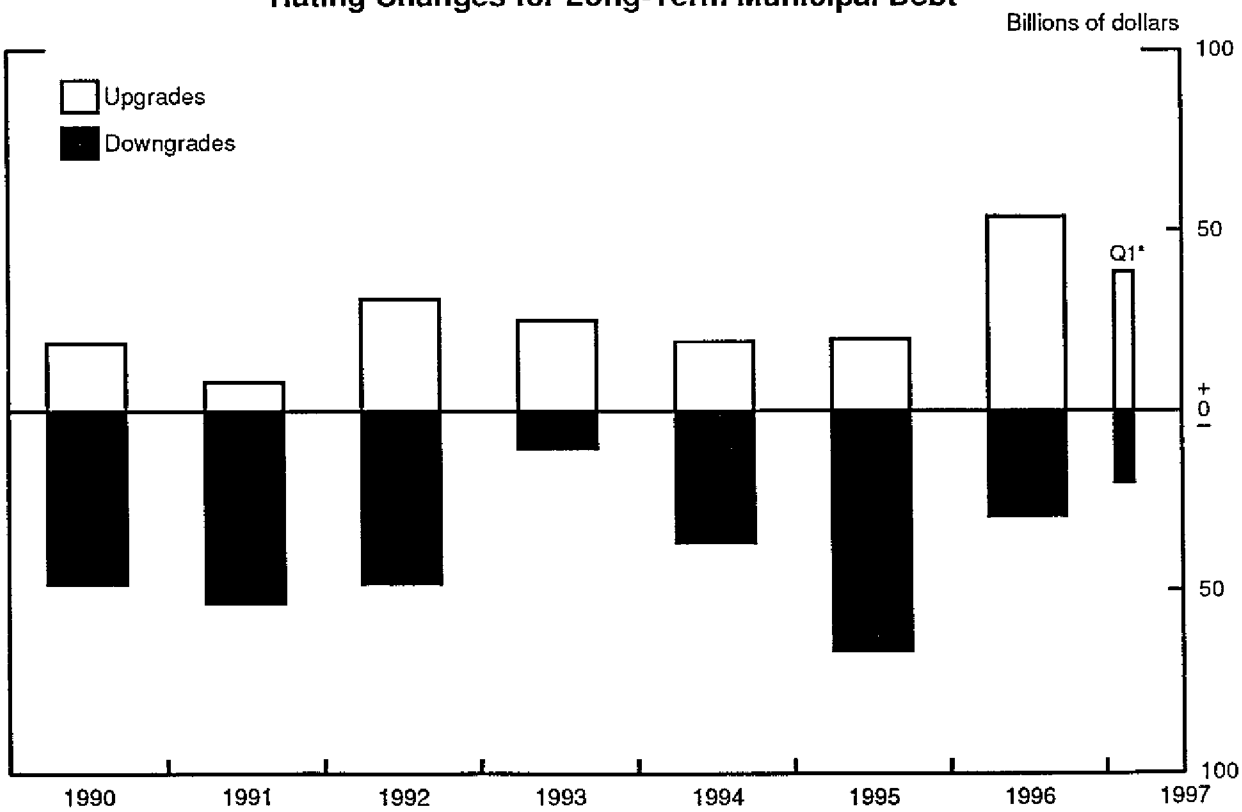
The record $2.9 billion offering of taxable pension bonds, announced by New Jersey in March and reported in the last Greenbook, has been delayed. At issue is the use of bond proceeds to cover some unfunded pension liabilities, which would enable the state to reduce current contributions to the pension plan. Governor Whitman wants to use this tool to free up some revenues for other programs while maintaining a balanced budget. The opposition is portraying it as a financial gimmick, and at least one rating agency is

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

	1994	1995	1996	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
Total tax-exempt	16.2	15.4	17.9	18.7	13.7	14.5	15.0	15.5
Long-term	12.8	12.1	14.3	16.2	12.1	12.1	13.8	14.7
Refundings[1]	4.0	3.6	4.9	5.2	4.3	3.6	4.9	3.1
New capital	8.8	8.5	9.4	11.0	7.8	8.4	8.9	11.6
Short-term	3.3	3.3	3.6	2.5	1.6	2.4	1.3	0.8
Total taxable	0.7	0.7	0.8	1.5	0.7	0.8	0.8	0.3

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

Rating Changes for Long-Term Municipal Debt



* Annual rate.
Source. Standard & Poor's

questioning the need to use any such savings for budget purposes in an expanding economy.

Financial intermediaries and money

Net inflows to stock and bond mutual funds slowed substantially in March and April from the robust pace earlier in the year, as investors pulled back in response to heightened volatility (table). Less affected were conservatively managed growth and income funds, which invest in large, well-known companies. International funds, which had the highest total returns in the first quarter among all equity fund categories, also posted solid net sales in March and April. Weekly data from the Investment Company Institute (ICI) for early May show some pickup in net sales of equity funds from the April pace, consistent with press reports suggesting an upswing of investor interest. After posting an outflow in March, net sales of bond funds (excluding reinvested dividends) were zero in April. However, weekly data indicate that flows have turned positive lately, with the increase mainly at junk-bond funds.

Liquidity ratios of stock funds are very low, and the substantial decline over the past several years can be explained in part by the large and reasonably stable inflows to such funds (chart). In this environment, portfolio managers have less concern about redemptions, and they seek to extract more yield in a rising market by holding fewer liquid assets. So far this year, fund managers have not experienced any serious difficulty because of the low level of liquid assets. The ICI's daily monitoring of large fund complexes, which is done when there are substantial stock market declines, indicated that during the downturn at the end of March none of the funds had been forced to draw on credit lines to meet redemptions.

Credit provided by commercial banks expanded at a brisk 11 percent annual rate in April, above its first-quarter pace and driven by strong growth in securities holdings (table). The main increase in securities occurred in U.S. government obligations held in investment accounts at domestic banks and likely reflected the tax-related buildup in deposits of households. Still, there were noticeable increases in other securities and in securities holdings at foreign banks, for which household deposits are not a significant source of funds.

Loan growth fell back in April from its first-quarter rate, with business and real estate loans remaining strong but consumer

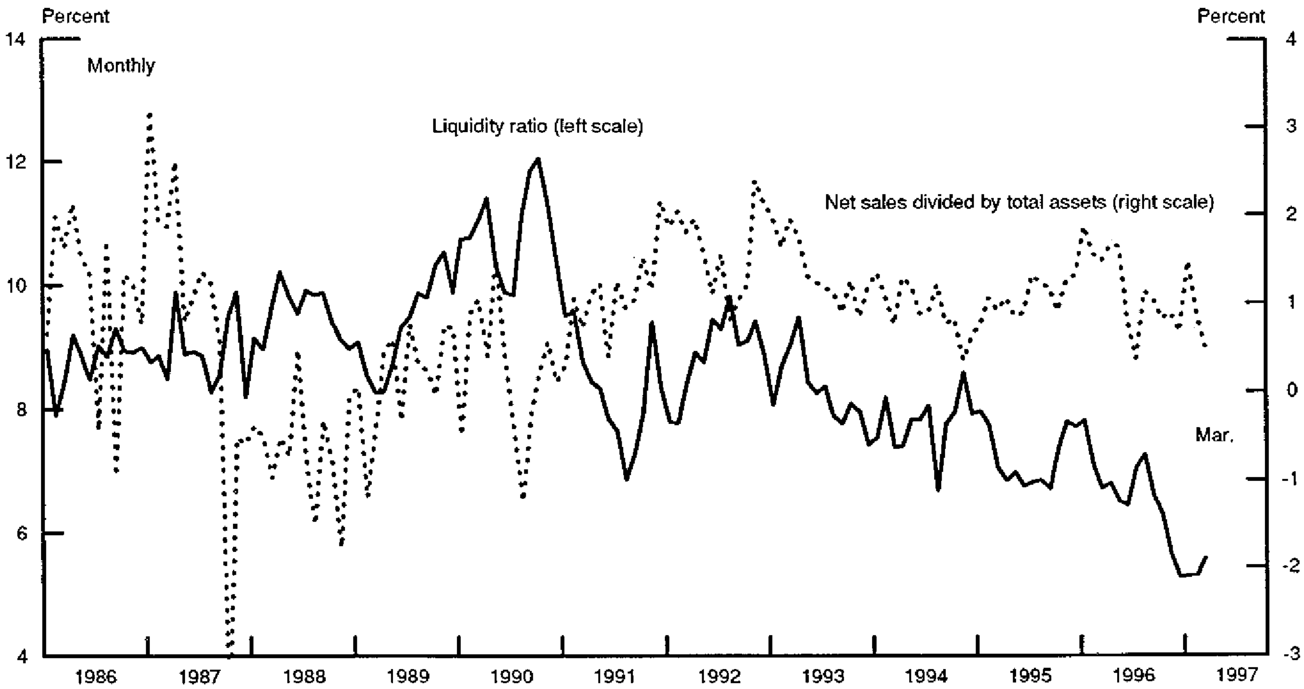
Net Sales of Selected Mutual Funds Excluding Reinvested Distributions
(Billions of dollars; quarterly and annual data at monthly rate)

			1996	1997				Memo:
	1995	1996	Q4	Q1	Feb	Mar	Apr[e]	March assets
Stock funds	10.7	18.6	14.2	19.2	18.2	10.5	13.5	1809.7
Domestic[1]	9.7	14.7	11.4	14.8	13.7	7.7	9.3	1504.9
Aggressive growth	3.1	4.7	3.2	1.8	0.6	-0.2	1.6	265.1
Growth	3.1	3.9	2.7	3.7	3.1	1.4	1.3	489.0
Growth and income[2]	3.7	6.2	5.6	9.2	9.4	6.9	6.4	746.1
International[3]	1.0	3.9	2.7	4.5	4.4	2.8	4.2	304.8
Bond funds	-0.4	1.1	1.1	1.2	2.3	-2.0	0.0	890.4
High–yield	0.7	1.0	1.3	0.8	2.1	-1.3	0.5	81.1
Balanced[4]	1.4	2.6	0.6	1.7	1.7	1.5	0.4	256.7
Other	-4.7	-2.5	-0.8	-1.3	-1.5	-2.2	-0.9	552.6

1. Includes precious metals funds, not shown elsewhere.
2. Calculated as the sum of "Growth and income" and "Income equity" in the ICI data.
3. Calculated as the sum of "International" and "Global equity" in the ICI data.
4. Calculated as the sum of "Income–Mixed", "Balanced", and "Flexible Portfolio" in the ICI data; these funds invest in both stocks and bonds.

e Aggregate Stock and Bond are ICI estimates, components are staff estimates.
Source. Investment Company Institute.

Net Sales and Liquidity at Domestic Stock Funds



Note. Liquidity ratio is cash and short-term securities as a percent of total assets.
Source. Investment Company Institute.

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

Type of credit	1996	1996 Q4	1997 Q1	1997 Feb	1997 Mar	1997 Apr	Level, Apr 1997 (billions of $)
1. Bank credit: Reported	4.1	6.7	10.2	12.3	6.7	11.2	3,903.9
2. Adjusted[1]	4.6	6.9	7.0	9.0	10.2	11.3	3,805.5
3. Securities: Reported	-1.7	2.2	13.6	18.9	-7.5	22.8	1,033.1
4. Adjusted[1]	-0.2	2.4	0.7	6.1	5.0	24.9	934.7
5. U.S. government	-0.8	0.7	0.1	-5.1	6.7	24.6	721.7
6. Other[2]	-4.0	6.1	48.3	74.8	-38.6	18.4	311.3
7. Loans[3]	6.3	8.3	9.0	9.9	11.9	7.0	2,870.8
8. Business	8.9	13.6	9.9	14.8	8.4	9.9	809.2
9. Real estate	4.0	4.6	7.6	6.3	14.1	9.3	1,162.6
10. Home equity	6.8	18.9	10.9	12.6	16.6	19.2	89.1
11. Other	3.7	3.5	7.3	5.8	13.9	8.4	1,073.5
12. Consumer: Reported	6.3	6.3	1.2	-0.5	-2.8	-5.7	519.3
13. Adjusted[4]	11.5	10.2	5.6	3.8	3.3	1.9	700.6
14. Other[5]	8.5	12.0	23.8	26.1	33.1	11.8	379.7

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.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr. (p)	1996:Q4 to Apr. 97 (p)	Level (bil. $) Apr. 97 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-7.3	-0.7	1.0	-6.0	-11.4	-3.4	1065.0
2. M2[2]	4.6	5.0	5.9	5.1	5.1	6.6	5.9	3903.9
3. M3	6.7	7.9	7.7	9.0	6.8	8.8	8.0	5052.6
Selected components								
4. Currency	5.7	7.7	7.5	10.6	5.7	3.9	6.8	403.7
5. Demand deposits	2.7	-5.5	2.0	7.5	-4.2	-22.6	-3.4	395.2
6. Other checkable deposits	-23.1	-29.4	-16.1	-22.9	-25.6	-17.4	-17.7	257.8
7. M2 minus M1[3]	8.8	10.1	8.5	6.7	9.4	13.6	9.6	2838.9
8. Savings deposits	11.7	12.1	10.7	7.5	12.8	17.5	12.3	1323.3
9. Small time deposits	1.3	3.8	1.1	1.5	-1.4	1.7	0.9	946.4
10. Retail money market funds	17.1	17.2	16.3	13.9	19.9	24.5	18.7	569.2
11. M3 minus M2[4]	15.0	18.5	14.1	22.8	12.8	16.3	15.2	1148.7
12. Large time deposits, net[5]	16.1	20.1	12.6	15.9	21.2	28.9	17.6	518.9
13. Institution-only money market mutual funds	19.8	19.8	15.6	36.9	25.1	-0.8	15.1	311.6
14. RPs	4.1	1.9	8.4	23.8	-9.6	9.7	7.3	200.3
15. Eurodollars	18.8	39.9	28.2	14.4	-17.3	18.6	19.4	117.9
Memo								
16. Sweep-adjusted M1[6]	5.3	5.0	6.8	7.5	5.3	0.5	5.4	1270.4
17. Monetary base	3.8	5.1	5.6	5.8	3.4	1.8	4.6	458.3
18. Household M2[7]	4.8	6.0	6.4	6.2	6.3	8.7	6.9	3505.9
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	15.3	12.7	14.8	10.3	16.4	...	605.7
19. Net due to related foreign institutions	-2.0	-4.7	-6.9	-4.2	-8.3	2.2	...	212.6
20. U.S. government deposits at commercial banks	0.0	0.0	0.5	-4.5	10.2	1.6	...	27.0

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

p--Preliminary.

and other loans weakening considerably. Consumer loans ran off in April and were quite weak even after adjusting for securitization and special factors.[2] Some of the weakness may have owed to continued substitution of home equity credit for consumer loans and some to a firming of credit standards and terms by lenders.

The monetary aggregates expanded briskly in April (table). M2 grew at a 6-1/2 percent annual rate, slightly faster than in the first quarter. Strong growth in its household liquid components suggests that individuals built up deposits to make tax payments. Weekly data for the latter half of April and early May show a drop-off in these accounts, confirming the tax story. The strength in M2 showed through to M3, which grew at an 8-3/4 percent annual rate in April. M3 was also boosted by the need to fund strong credit growth. Banks generally, but foreign banks in particular, continued their heavy issuance of large time deposits, in part to replace other sources of funds. Assets at wholesale money market mutual funds ran off slightly last month because the lag in their yields caused institutional depositors to move cash directly into money market instruments in the wake of the policy tightening in late March.

2. Consumer loan growth in March was damped about 7-1/2 percentage points by a shift of receivables from a bank to a nonbank subsidiary of a bank holding company. In April, growth was depressed about 1-1/4 percentage points by the move from RAP to GAAP accounting on the call report, which enabled banks to remove more assets from their books.

APPENDIX

THE MAY SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

The May 1997 Senior Loan Officer Opinion Survey on Bank Lending Practices (which generally covered changes over the preceding three months) posed questions about bank lending standards and terms, loan demand by businesses and households, and expectations about charge-off rates for consumer and C&I loans. The responses suggest that domestic banks have become even more accommodative lenders to businesses but have tightened credit to households. They also indicate that foreign banks have taken some steps to restrict credit supply.

Citing stiff competition as their reason, large fractions of banks reported having eased terms on C&I and commercial real estate loans, though few banks reported having reduced standards for these loans. The responses were mixed but suggest, on net, that borrower demand for both types of business credit strengthened slightly.

Once again, both standards and terms for consumer loans were tightened over the preceding three months, and banks reported less demand for these loans. Standards on home mortgages were about unchanged, and demand weakened a little.

Lending to Businesses

Like the January survey results, the May results suggest that standards for commercial and industrial loans did not change much over the preceding three months but that terms eased further. Almost no domestic respondents reported having changed standards on C&I loans to large and small businesses, but a few more than 10 percent eased standards for middle-market customers (chart). By contrast, 10 percent of foreign banks, on net, tightened standards for C&I loans. Regarding terms for large and middle-market borrowers, one-third of domestic respondents reported having narrowed the spreads of loan rates over market rates, about one-fourth reduced costs of credit lines and eased loan covenants, and about one-tenth increased credit lines or eased collateralization requirements. Terms for small borrowers were eased by only a small share of banks. By contrast, small net fractions of foreign respondents reported having tightened various terms on C&I loans, (whereas for the past several surveys foreign banks reported having eased terms on these loans). Those banks that eased standards or terms on C&I loans said they had done so because of more aggressive competition from other banks and from nonbank sources of credit. The banks that tightened cited a lower tolerance for risk and a deterioration in their current or expected future capital position.

On net, domestic respondents reported no change in demand for C&I loans from large customers, but about 10 percent reported increased demand from middle-market and small borrowers. However, about 15 percent of foreign respondents, which typically lend to large firms, indicated weaker demand for C&I loans. Domestic banks attributed stronger demand to increased financing needs for plant and equipment investment, inventories, and, for larger borrowers, mergers and acquisitions. Weaker demand was attributed to customers switching to other sources of credit and increases in customers' internal funds.

On net, about 5 percent of domestic respondents said that over the preceding three months they had eased their standards for commercial real estate loans (construction and land development loans and loans secured by nonfarm, nonresidential real estate); but a similar fraction of foreign respondents said they had tightened their standards for these loans. The May survey was the fourth consecutive survey to find little evidence of changes in the standards for these loans following the modest tightening of standards reported in late 1995 and early 1996. Even so, 90 percent of the domestic banks and 70 percent of the foreign banks said that their competitors had eased their standards for these loans over the preceding twelve months. With respect to terms on commercial real estate loans, about one-half domestic banks and one-fourth of foreign banks reported having eased spreads over the preceding twelve months, but only small net fractions reported having changed other terms, including maximum loan size, maximum loan maturity, loan-to-value ratios, debt-service coverage ratios, and requirements for take-out financing. As with C&I loans, those banks that eased terms most commonly said they had done so because of increased competition from banks and nonbanks; many also cited the increased liquidity of these loans resulting from a more-developed secondary market for them and the improved condition of the commercial real estate industry. On net, about 10 percent of domestic respondents and nearly 50 percent of foreign respondents reported having experienced increased demand for commercial real estate loans.

Lending to Households

As has been true since the beginning of 1996, significant fractions of banks reported having tightened standards on consumer loans. Nearly one-half the banks said they had tightened standards for new credit card accounts over the preceding three months, and one-fourth reported having tightened standards on other consumer loans. Nevertheless, banks' willingness to make consumer installment loans was virtually unchanged from three months ago (chart). The net fraction of banks more willing to make these loans has hovered near zero for the past six surveys. Forty percent of the respondents lowered credit limits on credit card lines, and about 15 percent raised spreads of loan rates over market rates. Terms on other consumer loans were about unchanged. On net, 20 percent of the respondents reported a decline in demand for consumer loans.

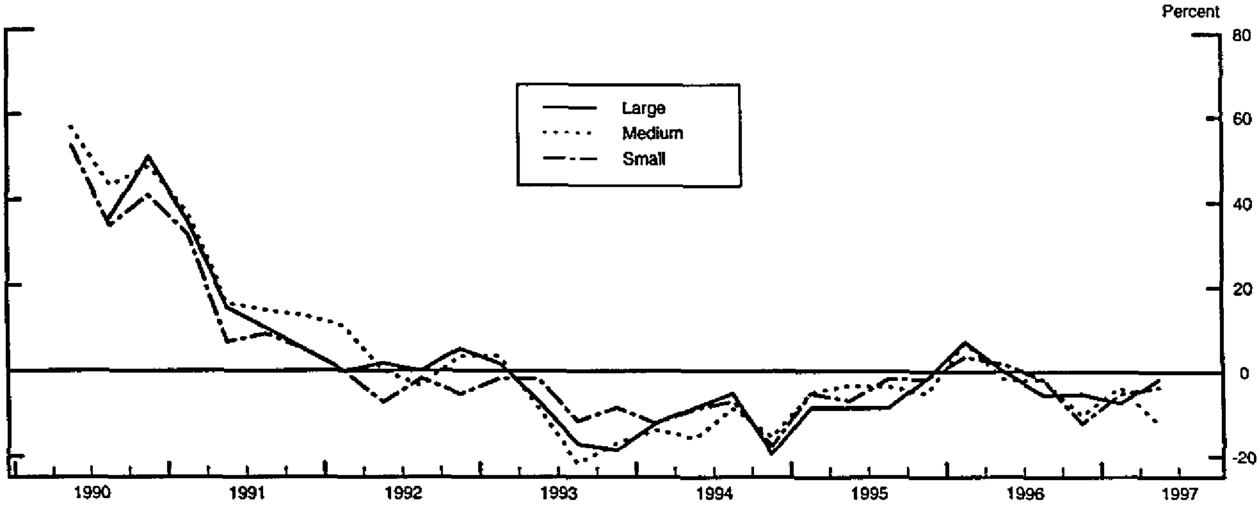
Banks reported little change in their standards for approving mortgage applications of individuals to purchase homes. Ten percent more banks reported weaker demand for residential mortgages than reported stronger demand.

Expectations for Charge-off Rates

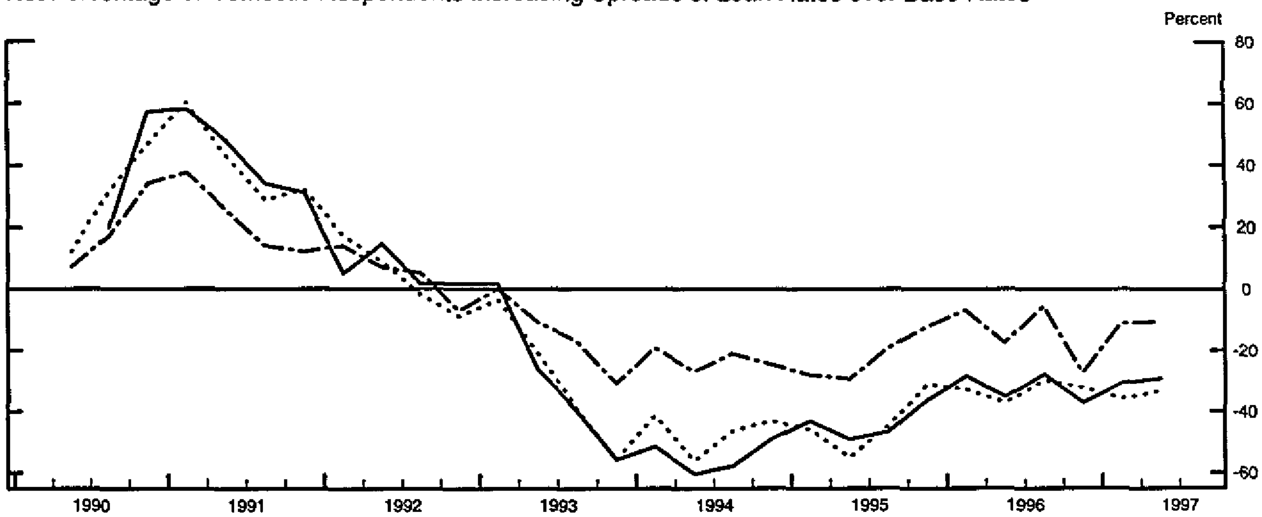
Additional questions on the survey asked loan officers how they expected charge-off rates for consumer and C&I loans to change over the remainder of 1997. About one-third of respondents, on net, expected charge-off rates for consumer loans to go up, an eventuality most attributed to a greater willingness on the part of households to declare bankruptcy; somewhat fewer blamed worsening household financial conditions and aggressive solicitations by their bank for these loans. One-fifth of the banks, on net, expected charge-off rates for C&I loans to go up. Banks pointed to eased standards for these loans, a deterioration in business financial conditions, and a deterioration in the economy generally as the reasons for their outlook. Several banks also noted that recent declines in the gross charge-off rate on C&I loans would translate into fewer future recoveries, raising the net charge-off rate.

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

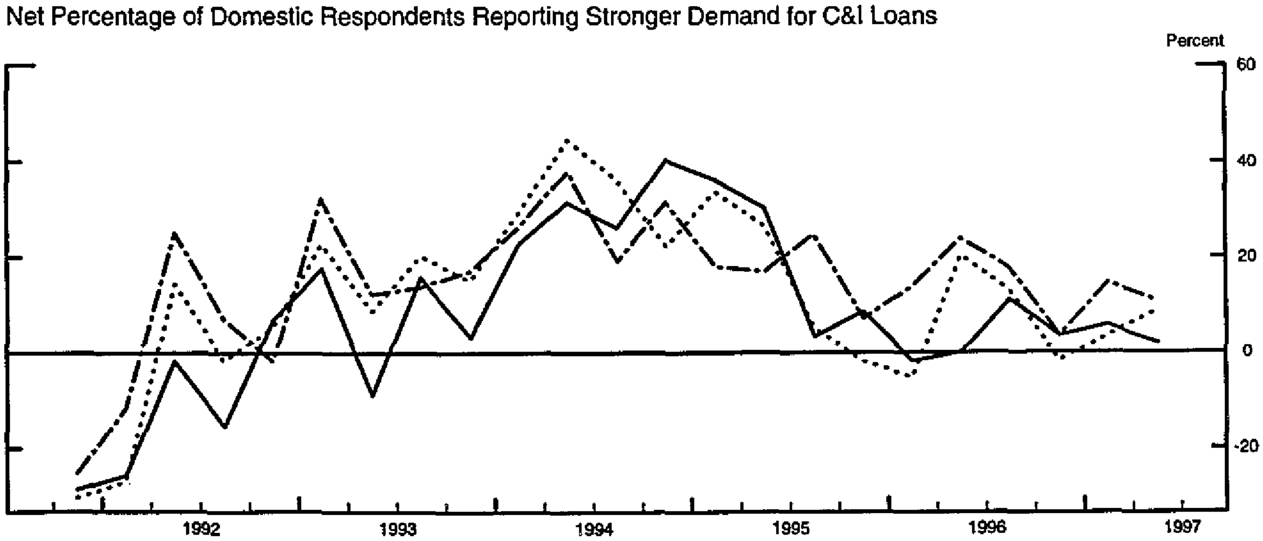
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

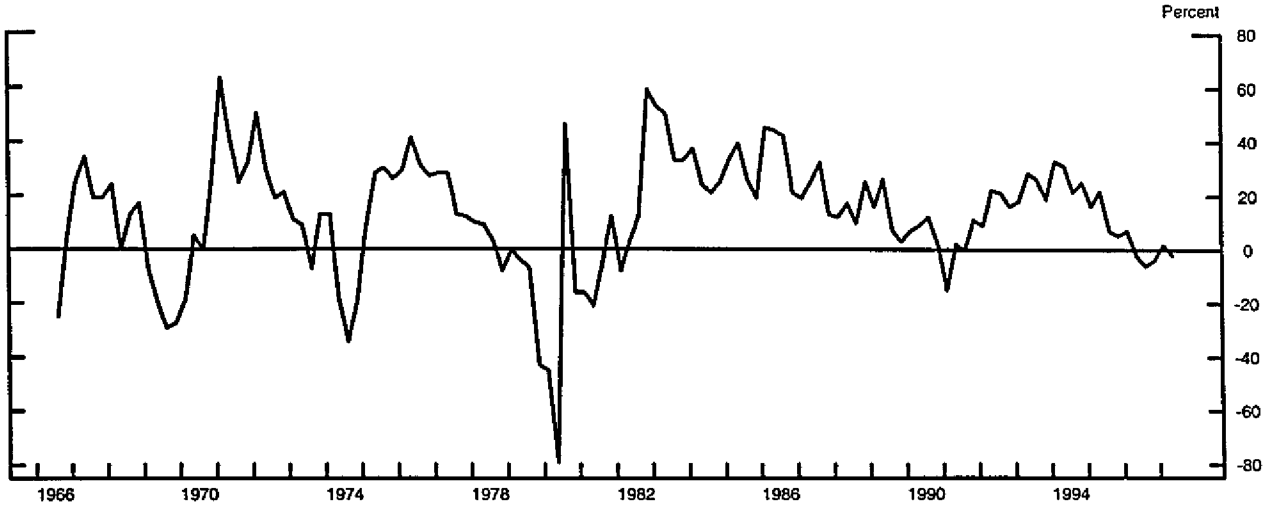


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

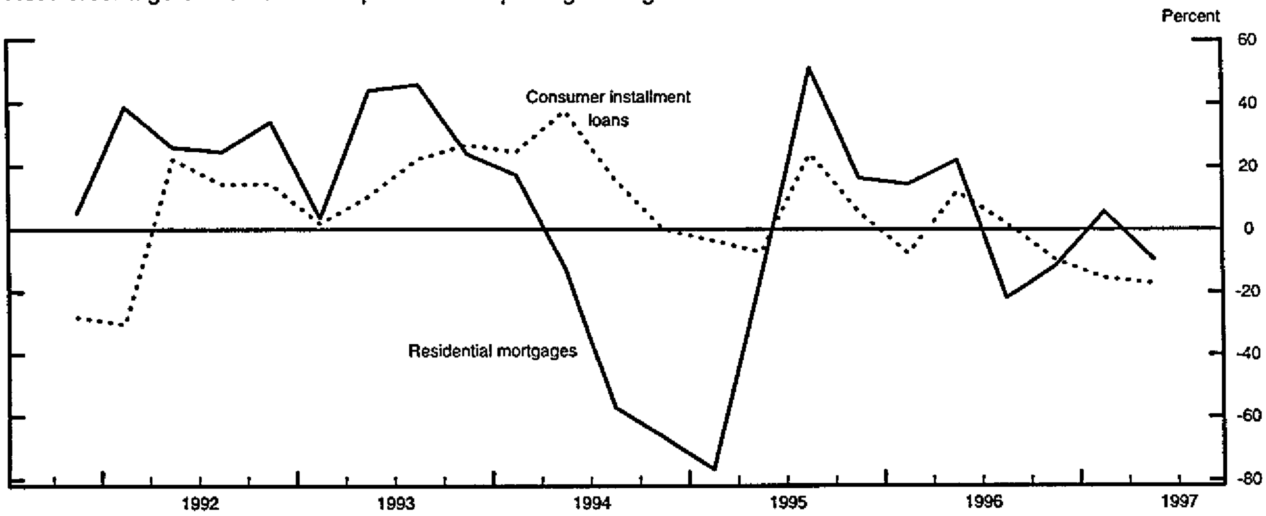


Measures of Supply and Demand for Loans to Households

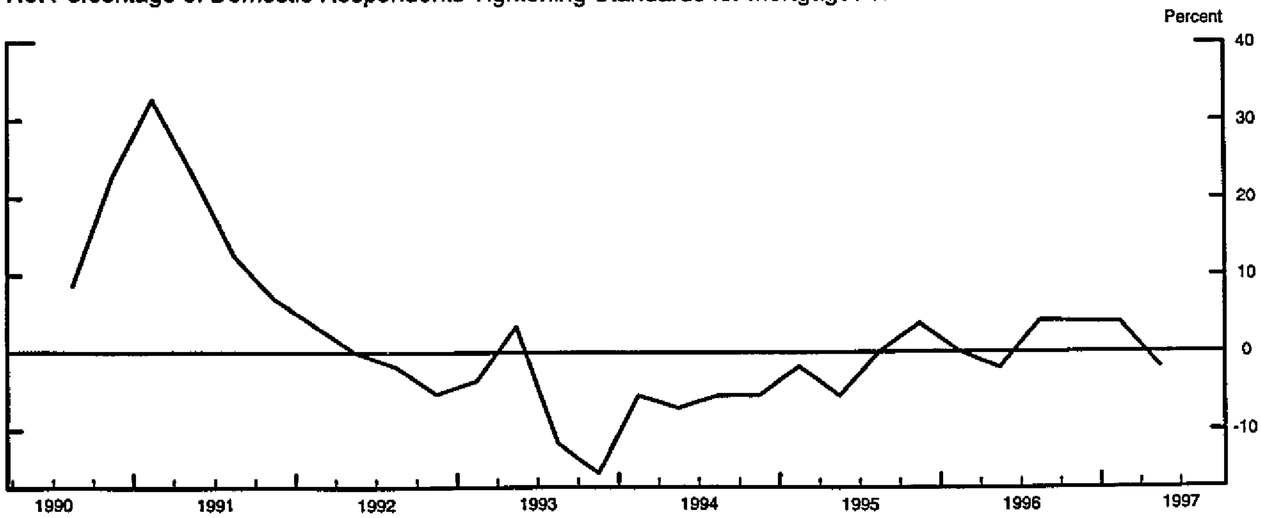
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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

For January-February combined, the U.S. deficit in trade in goods and services was substantially larger than in the fourth quarter of last year and about the same as in the third quarter. Relative to the fourth quarter, exports increased only slightly and imports rose sharply. Data for March will be released on May 21.

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

		Annual rates			Monthly rates		
	1996	1996		1997	1996	1997	
		Q3	Q4	Q1e/	Dec	Jan	Feb
Real NIPA 1/							
Net exports of G&S	-113.6	-137.4	-98.4	-130.3	...	...	...
Nominal BOP							
Net exports of G&S	-114.3	-136.8	-106.1	-136.5	-10.5	-12.3	-10.4
Goods, net	-187.8	-207.2	-181.9	-213.1	-16.9	-18.6	-16.9
Services, net	73.5	70.4	75.9	76.6	6.4	6.3	6.5

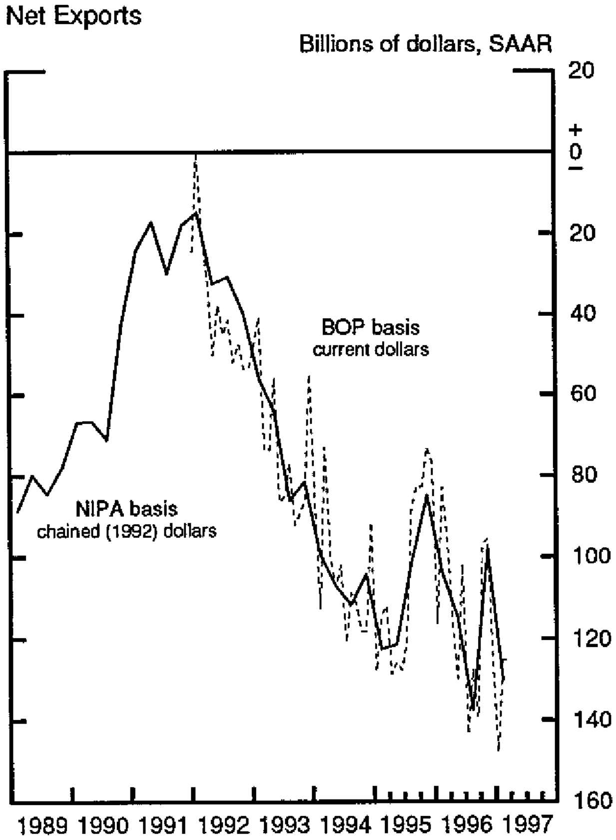
1. In billions of chained (1992) dollars.
e. BOP data are two months at an annual rate.
Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

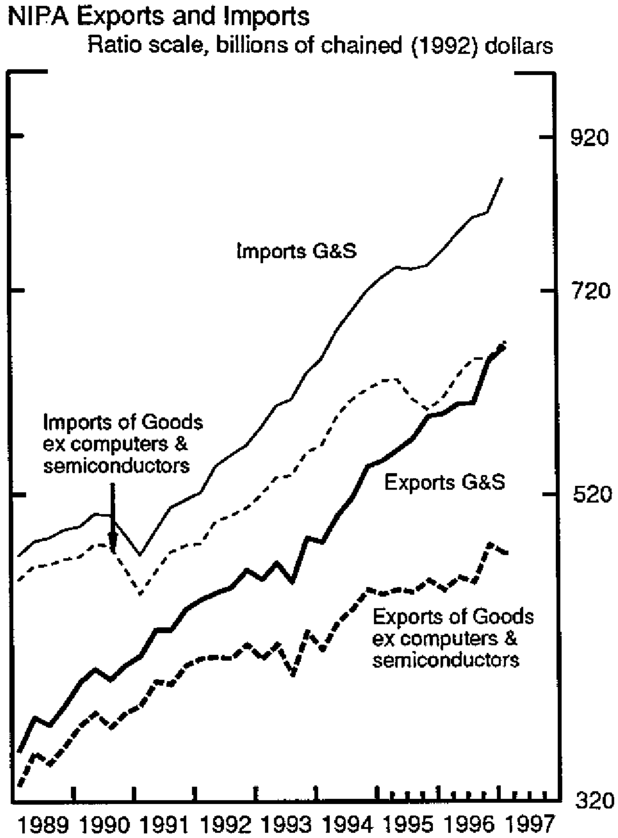
Exports of goods and services were only 1/2 percent higher in January-February relative to the fourth quarter. A sharp rise in exports of automotive products to Canada (from strike-reduced levels in the fourth quarter), and solid increases in exports of computers, semiconductors, and chemicals were nearly offset by declines in other categories of trade (mostly agricultural products, aircraft, and fuels). The decline in agricultural exports primarily reflected a reversal of a surge in shipments of grains and oilseeds in the fourth quarter, and the decrease in aircraft exports was due to a temporary drop in January deliveries. Most of the decline in the value of fuel exports, however, was in price.

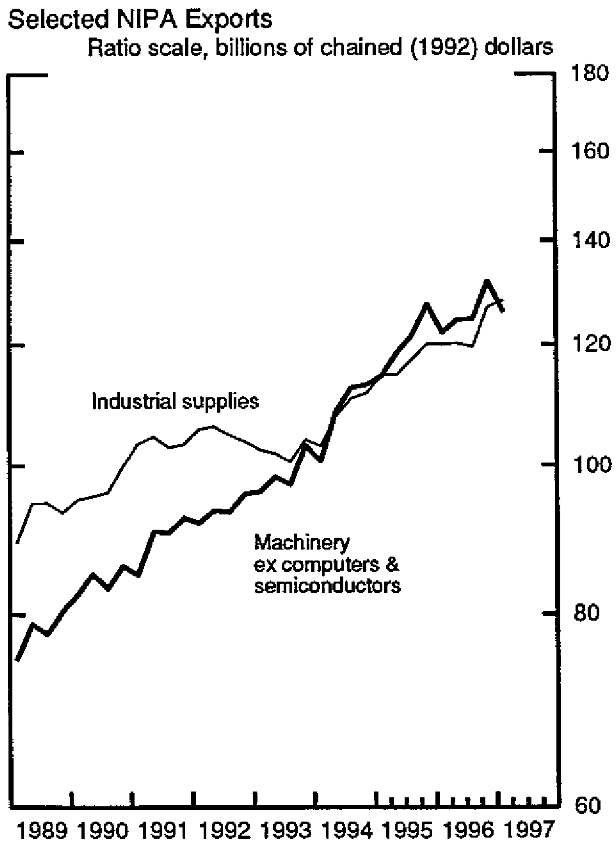
Imports of goods and services were about 3-1/2 percent higher in January-February relative to the fourth quarter. About three-fourths of the increase was in imports of automotive products (largely a rebound from strike-reduced levels in the fourth quarter) and in imports of computers and semiconductors. The CAW and UAW strikes against GM in the fall had a greater effect on automotive imports than on automotive exports: The value of imported computers

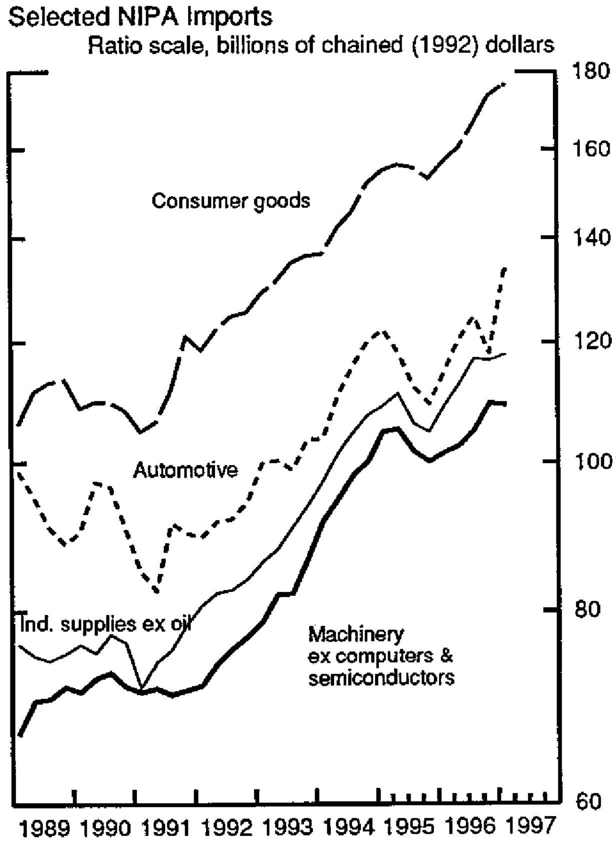
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)









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

	Levels				Amount Change 1/			
	1996	1997	1997		1996	1997	1997	
	Q4	Q1e/	Jan	Feb	Q4	Q1e/	Jan	Feb
Exports of G&S	862.1	864.7	847.7	881.6	39.0	2.5	-6.8	33.8
Goods exports	632.5	632.5	616.3	648.7	31.6	0.0	-6.8	32.4
Agricultural	61.7	57.8	57.7	57.8	1.6	-4.0	-1.6	0.0
Gold	3.7	3.6	2.7	4.4	-1.5	-0.1	-0.8	1.7
Other goods	567.0	571.2	555.8	586.5	31.5	4.1	-4.4	30.7
Aircraft & pts	36.7	33.8	29.4	38.2	10.0	-2.9	-10.0	8.8
Computers	43.3	46.0	45.7	46.4	0.4	2.7	4.2	0.7
Semiconductors	36.9	38.8	38.4	39.1	3.2	1.9	1.9	0.7
Other cap gds	150.1	145.9	143.0	148.7	9.2	-4.2	-3.9	5.7
Automotive	65.2	70.8	68.3	73.4	-1.6	5.6	4.8	5.1
to Canada	33.4	39.2	38.6	39.7	-2.9	5.8	5.6	1.1
to Mexico	10.6	10.1	9.4	10.8	2.7	-0.5	-2.4	1.4
to ROW	21.2	21.6	20.3	22.9	-1.4	0.4	1.6	2.6
Ind supplies	135.5	136.7	133.3	140.1	6.7	1.1	-2.3	6.8
Consumer goods	73.3	74.0	72.0	75.9	4.3	0.7	-0.2	3.9
All other	26.0	25.2	25.7	24.7	-0.6	-0.8	-2.0	-1.0
Services exports	229.7	232.2	231.4	232.9	7.4	2.5	0.0	1.4
Imports of G&S	968.2	1001.2	995.7	1006.6	8.3	32.9	15.4	10.8
Goods imports	814.4	845.6	839.7	851.5	6.4	31.1	14.1	11.8
Petroleum	74.7	78.0	79.8	76.2	2.9	3.2	1.4	-3.6
Gold	3.4	3.7	2.7	4.7	-2.7	0.2	-0.2	2.0
Other goods	736.2	763.9	757.2	770.6	6.2	27.7	12.9	13.4
Aircraft & pts	13.9	13.8	13.7	13.8	0.8	-0.2	-1.8	0.1
Computers	61.6	67.1	66.4	67.9	0.0	5.6	3.5	1.5
Semiconductors	32.6	35.0	34.5	35.6	-0.8	2.4	0.9	1.1
Other cap gds	121.9	121.4	121.0	121.7	4.4	-0.6	-2.8	0.8
Automotive	128.6	145.7	144.0	147.5	-7.1	17.2	16.7	3.5
from Canada	42.3	54.9	56.4	53.3	-9.0	12.6	13.2	-3.1
from Mexico	23.2	23.9	23.0	24.7	-0.0	0.7	2.6	1.7
from ROW	63.1	66.9	64.5	69.4	1.9	3.9	1.0	4.8
Ind supplies	130.6	132.7	132.7	132.6	-0.3	2.1	2.3	-0.1
Consumer goods	180.2	181.8	180.6	183.0	7.1	1.5	-3.0	2.4
Foods	36.7	37.0	36.7	37.3	0.8	0.4	-1.5	0.7
All other	30.2	29.4	27.6	31.2	1.3	-0.8	-1.5	3.6
Services imports	153.8	155.6	156.1	155.1	1.9	1.8	1.2	-1.0
Memo:								
Oil qty (mb/d)	9.18	9.62	9.51	9.72	-0.86	0.45	0.06	0.21
Oil price ($/bbl)	22.31	22.21	22.96	21.45	2.73	-0.11	0.27	-1.51

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

(including accessories and parts) in January-February was 9 percent higher than in the fourth quarter, and the trade deficit in computers widened about $12 billion. The value of imported semiconductors turned up following four quarters of declines.

Oil Imports and Prices

The quantity of oil imported during January-February increased slightly from the level recorded in the fourth quarter of 1996, as a lower-than-normal seasonal inventory drawdown offset a decline in oil consumption. Preliminary Department of Energy statistics indicate that oil imports picked up in March and April due to a build-up in oil inventories.

Prices of imported oil declined substantially in the first quarter, partly reversing the very large increase recorded in the fourth quarter of 1996. Prices had risen significantly in the fourth quarter and at yearend stood 37 percent above the December 1995 level. Spot WTI dropped $1.27 per barrel in April, averaging $19.72 per barrel, its lowest level since February 1996. Prices traded near the April average in early May, but jumped last weekend due to increased tensions in the Middle East. Spot prices are now trading near $21 per barrel.

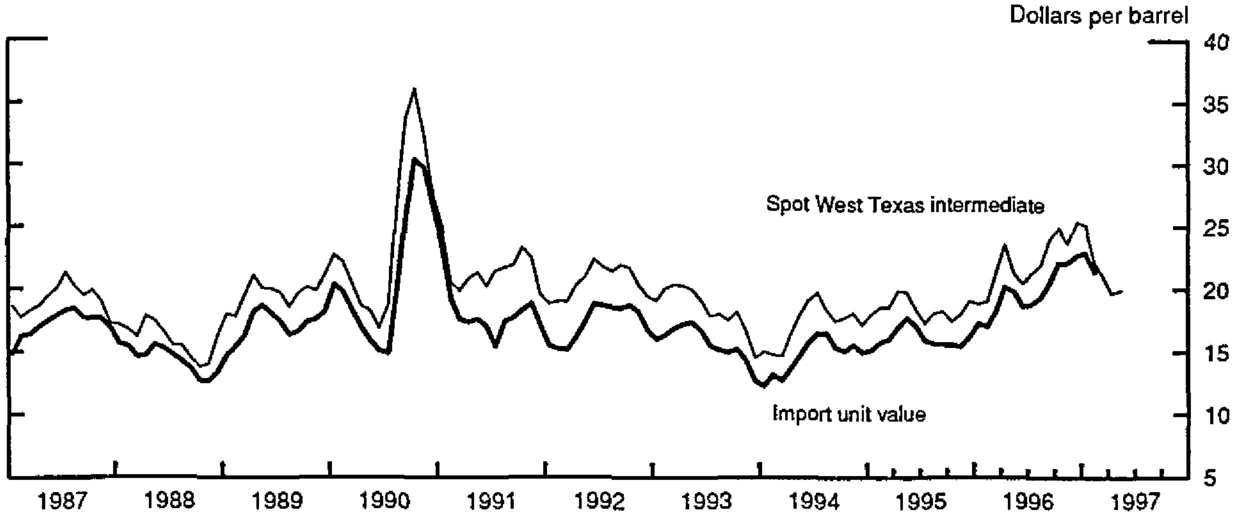
Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports declined somewhat in the first quarter. Declines in prices of computers, semiconductors, other capital goods, and consumer goods were partly offset by moderate increases in prices of industrial supplies and foods. Prices of non-oil imports have declined for six consecutive quarters.

Prices of exports rose slightly in the first quarter. Prices of agricultural products increased somewhat after posting large declines in the third and fourth quarters of 1996, mostly because of higher grain and oilseed prices, reflecting renewed concerns of lower crop production in 1997. Prices of nonagricultural exports were little changed in the first quarter (as in the fourth quarter) with increases spread among major trade categories with the exception of computers and semiconductors. These two quarters of small price changes followed five quarters of modest price declines for nonagricultural products (related primarily to industrial supplies).

Oil Prices

5-14-97



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

	Annual rates			Monthly rates		
	1996		1997	1997		
	Q3	Q4	Q1	Jan	Feb	Mar
	-----------BLS prices (1995=100)-----------					
Merchandise imports	-2.4	5.3	-4.5	-0.3	-0.8	-1.4
Oil	1.9	64.3	-24.9	0.6	-7.5	-10.9
Non-oil	-2.8	-0.4	-1.9	-0.4	0.0	-0.3
Foods, feeds, bev.	-10.5	1.8	4.7	-0.1	1.9	2.8
Ind supp ex oil	-5.3	1.0	6.0	1.0	0.3	-1.3
Computers	-10.9	-8.5	-13.6	-1.7	-1.2	-1.1
Semiconductors	-15.4	-15.0	-24.1	-5.4	-0.1	3.1
Cap. goods ex comp & semi	-0.4	0.1	-5.1	-0.8	-0.5	-0.5
Automotive products	0.7	0.1	0.0	-0.1	0.0	0.0
Consumer goods	-0.8	-0.5	-0.8	-0.1	0.2	-0.6
Merchandise exports	-3.5	-4.2	0.4	0.1	0.2	0.0
Agricultural	-18.0	-31.9	2.5	0.1	2.2	1.4
Nonagricultural	-0.9	0.4	0.1	0.0	0.0	-0.1
Ind supp ex ag	-3.2	0.8	0.7	0.0	0.2	0.1
Computers	-11.9	-10.6	-10.1	-0.2	-1.0	-1.3
Semiconductors	-15.5	-3.6	-6.1	-1.3	-0.1	-0.6
Cap. goods ex comp & semi	2.1	1.2	2.0	0.4	0.0	-0.1
Automotive products	0.3	1.3	1.3	0.2	0.0	0.2
Consumer goods	0.7	0.9	0.5	0.0	0.2	-0.4
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	-2.0	3.6	-3.7	...	...	...
Non-oil merchandise	-3.0	-1.5	-2.2	...	...	...
Exports of gds & serv.	-1.8	-2.2	0.1	...	...	...
Nonag merchandise	-2.3	-0.9	-0.8	...	...	...

U.S. International Financial Transactions

Very large gross capital inflows and outflows continued during the first quarter of 1997. Foreign official assets in the United States increased by $28 billion, despite the absence of substantial G-10 exchange market intervention and the appreciation of the dollar against most currencies during much of the period (line 1 of the Summary of U.S. International Transactions table). Apart from the OPEC countries, which benefitted from high oil prices, the largest increases in holdings were shown by Spain and China. Preliminary data from the FRBNY suggest that net changes in official assets in the United States were modest in April.

Foreign private net purchases of U.S. securities continued at a very rapid pace in March, bringing the first quarter total to $86 billion (line 4). Purchases of U.S. Treasury securities (line 4a) were particularly strong. As is frequently the case, the largest purchases were reported for the United Kingdom, a major center for trading U.S. Treasury securities. Foreign private net purchases of U.S. corporate and government agency bonds (line 4b) fell off in March, but the total for the quarter remained strong. Foreigners showed renewed interest in U.S. stocks in the first quarter, particularly in February (line 4c).

U.S. net purchases of foreign stocks were also substantial in March and in the first quarter as a whole (line 5b); net purchases were concentrated in Europe and Japan. In contrast, U.S. net purchases of foreign bonds were modest for the quarter as a whole (line 5a).

Banks and securities dealers reported large net capital outflows in March and the first quarter as a whole (line 3). Monthly average data on net claims of banking offices in the United States on their IBFs and own foreign offices also showed net outflows during this period (line 1 of the International Banking Data table), concentrated at foreign-chartered banks.

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

	1995	1996	1996			1997		
			Q2	Q3	Q4	Q1	Feb	Mar
Official capital								
1. Change in foreign official reserve assets in U.S. (increase, +)	110.0	121.6	13.4	23.2	32.9	28.0	8.9	8.6
a. G-10 countries	33.1	35.5	3.5	1.4	2.2	7.9	5.6	1.8
b. OPEC countries	4.3	13.4	5.3	5.3	3.6	8.2	3.4	2.6
c. All other countries	72.6	72.7	4.5	16.5	27.2	11.9	.1	4.2
2. Change in U.S. official reserve assets (decrease, +)	-9.7	6.7	-.5	7.5	-.3	4.5		.2
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-30.9	-58.0	-12.6	-5.4	-14.0	-29.2	-4.0	-13.7
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	190.8	290.9	61.7	78.9	100.5	86.2	32.1	25.3
a. Treasury securities[3]	99.9	156.2	31.8	43.6	67.7	47.1	15.6	17.8
b. Corporate and other bonds[4]	82.6	120.9	23.6	33.4	31.1	28.4	11.1	5.2
c. Corporate stocks	8.2	13.8	6.3	2.0	1.7	10.7	5.4	2.3
5. U.S. net purchases (-) of foreign securities	-98.7	-107.4	-20.2	-22.4	-30.4	-16.2	-5.8	-6.0
a. Bonds	-48.4	-48.8	-2.8	-14.2	-19.9	-4.3	-1.5	-2.1
b. Stocks	-50.3	-58.6	-17.4	-8.2	-10.5	-11.8	-4.4	-3.8
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-95.5	-88.3	-26.2	-9.1	-29.8	n.a	n.a	n.a
7. Foreign direct investment in U.S.	60.2	84.0	17.4	21.1	16.8	n.a	n.a	n.a
8. Other (inflow, +)[5]	-9.5	-31.3	16.9	-24.1	-7.7	n.a	n.a	n.a
U.S. current account balance (s.a.)	-148.2	-165.1	-40.6	-47.9	-41.4	n.a	n.a	n.a
Statistical discrepancy (s.a.)	31.5	-53.1	-9.3	-21.8	-26.6	n.a	n.a	n.a

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

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

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

3. Includes Treasury bills.

4. Includes U.S. 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.

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

	1994	1995	1996			1997		
	Dec.	Dec.	Jun.	Sep.	Dec.	Jan.	Feb.	Mar.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-247.3	-247.4	-231.2	-230.3	-230.3	-220.6
a. U.S.-chartered banks	-70.1	-86.1	-77.1	-73.6	-66.4	-70.4	-79.5	-72.5
b. Foreign-chartered banks	-153.9	-173.9	-170.2	-173.8	-164.8	-159.9	-150.8	-148.1
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	29.0	29.2	31.9	30.8	32.1	32.9
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	85.4	83.3	79.4	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	101.0	101.4	113.0	119.8	121.2	120.0
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	103.7	109.4	112.1	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	176.6	211.3	223.8	242.2	n.a.	n.a	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	248.2	281.2	297.3	313.3	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

Foreign Exchange and Foreign Financial Markets

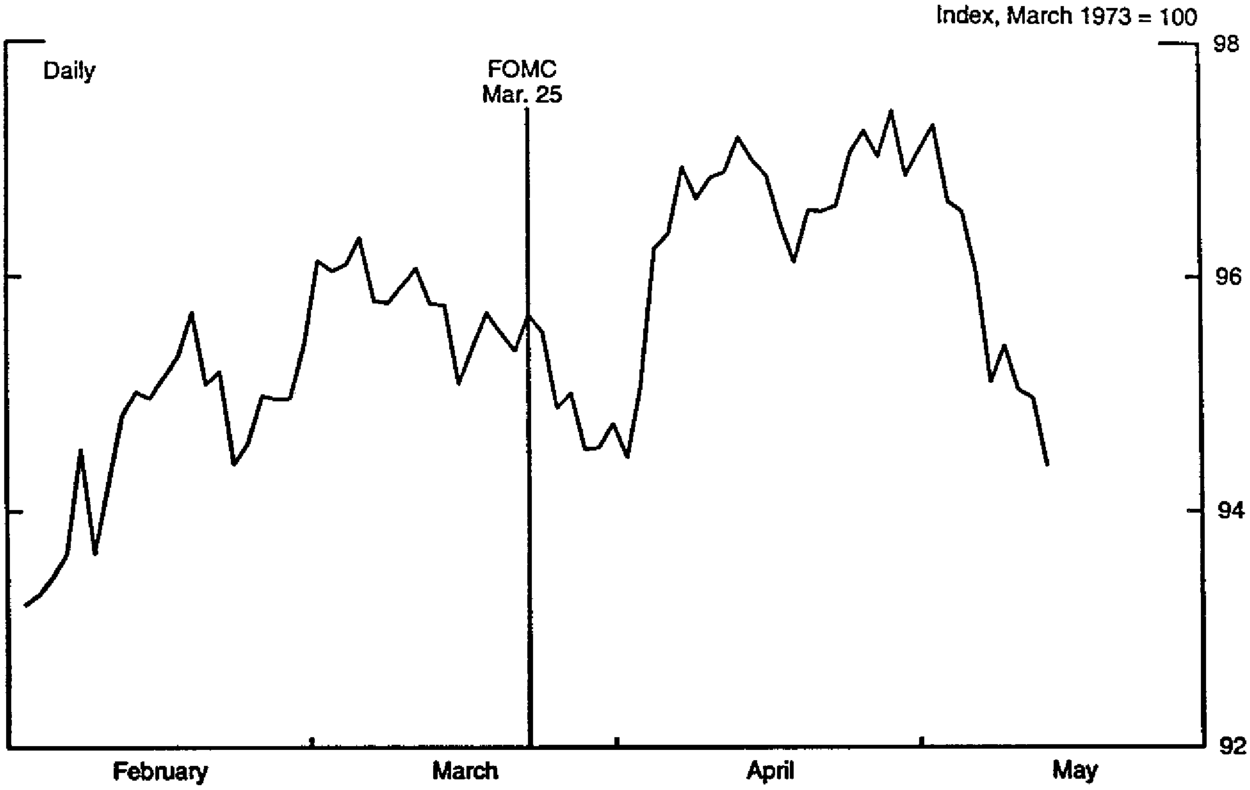
The foreign-exchange value of the dollar rose significantly in April only to give back those gains in early May. On balance, the weighted-average value of the dollar has declined 1 percent since the March 25 FOMC meeting. The dollar's see-saw behavior has occurred amid alternating views on the next U.S. monetary policy action and alternating interpretations of official views on the appropriate level for the dollar.

The release in early April of a stronger-than-expected labor market report for the United States and remarks from Treasury Secretary Rubin, who indicated in Tokyo that he does not believe in using currencies for trade policy, started the dollar on its April rise. After some mid-month declines, particularly against the mark, amid comments from Bundesbank President Tietmeyer indicating that the Bundesbank is not interested in a further weakening of the mark, the dollar rebounded later in the month as the market came to the conclusion that the April 27 G-7 meeting would not result in any further qualification of the strong dollar policy espoused by Secretary Rubin. While the formal statement on exchange rates and financial markets from the G-7 finance ministers and central bank governors "emphasized the importance of avoiding exchange rates that could lead to the reemergence of large external imbalances," market participants evidently interpreted that statement and the accompanying language,[1] at least initially, as offering no objections to the dollar's rise. Immediately following the release of the statement, the dollar resumed its move higher, although subsequent remarks from Mr. Tietmeyer indicating concern about

---

[1] The April 27 statement contained the following paragraph on exchange rates and financial markets: "We discussed developments in exchange and financial markets since our last meeting in Berlin where we noted that major misalignments in exchange markets had been corrected. We agreed that exchange rates should reflect economic fundamentals and that excess volatility and significant deviations from fundamentals are undesirable. In this context, we emphasized the importance of avoiding exchange rates that could lead to the reemergence of large external imbalances. We agreed to monitor developments and to cooperate as appropriate in exchange markets."

Weighted Average Exchange Value of the Dollar



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Mar. 24	May 15	Change	Mar. 24	May 15	Change
Germany	3.18	3.10	-0.08	5.93	5.71	-0.22
Japan	0.56	0.56	0.00	2.40	2.59	0.19
United Kingdom	6.25	6.38	0.13	7.60	7.00	-0.60
Canada	3.33	3.40	0.07	6.59	6.57	-0.02
France	3.27	3.28	0.01	5.81	5.56	-0.25
Italy	7.44	6.81	-0.63	7.70	7.12	-0.58
Belgium	3.46	3.17	-0.29	6.06	5.80	-0.26
Netherlands	3.14	3.14	0.00	5.81	5.61	-0.20
Switzerland	1.88	1.69	-0.19	3.59	3.34	-0.25
Sweden	4.23	4.15	-0.08	7.13	6.66	-0.47
Weighted-average foreign	3.59	3.51	-0.08	5.80	5.57	-0.23
United States	5.63	5.72[p]	0.09	6.72	6.72[p]	0.00

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

currency overshoots seemed to restrain the dollar's upward momentum by month-end.

Market readings of official intentions reversed quickly in early May amid reports of discussions about the possibility of concerted intervention by the United States, Germany, and Japan to restrain the dollar's rise. Consistent with sentiment that official concern over dollar strength was increasing, Bundesbank Council member Welteke indicated that a further rise of the dollar would not be welcome. Subsequent remarks by Japanese (Ministry of Finance) officials suggesting that they would like to see some yen appreciation and that the strength of the G-7 statement on exchange rates had been misunderstood seemed to exert additional downward pressure on the dollar, particularly against the yen. Reduced expectations for further tightening of U.S. monetary policy, triggered by Chairman Greenspan's May 8 speech at New York University in the wake of somewhat softer data on U.S. activity, also weighed on the dollar.

The widely expected tightening by the FOMC announced after its March meeting generated little immediate movement in the foreign exchange value of the dollar, even though the action seemed to prompt a rise in U.S. long-term interest rates relative to those abroad in the days immediately following the meeting. U.S. rates have subsequently eased, reflecting in part reduced prospects for further monetary policy tightening in the United States, with the ten-year Treasury yield little changed on balance during the intermeeting period. Over the same period, the bellwether bond yield in Japan has risen nearly 20 basis points, perhaps reflecting more optimism among investors about Japanese economic activity, although data supporting this view has not yet materialized and the roughly unchanged three-month rate fails to support the view that expectations for Japanese monetary policy have changed substantially. The German bond yield has declined more than 20 basis points during the intermeeting period, for reasons that are not entirely clear, and the three-month rate in Germany has moved down almost 10 basis points. Resulting changes on net in corresponding long-term interest rate differentials are roughly consistent with the dollar's movements against individual currencies. The dollar has risen 3/8 percent against the mark during the intermeeting period but has declined 5-1/2 percent against the yen.

Election results or pre-election nervousness appear to be affecting financial markets in several countries. While sterling has risen 1-1/2 percent on balance against the dollar during the intermeeting period, long-term interest rates have declined sharply in United Kingdom, moving down 60 basis points, largely in reaction to the announcement by the new Labour government that it is taking steps to make the Bank of England more independent. This decline occurred even as U.K. authorities moved to tighten monetary policy, prompting an increase in the base lending rate of 25 basis points to 6-1/4 percent on May 6. This move had been widely expected to occur soon after the election.

The dollar has firmed less than 1/2 percent against the Canadian dollar, as Canadian authorities have evidently chosen to accept the stimulative effects of a weaker currency rather than respond to the March action by the FOMC with increases in short-term Canadian policy rates ahead of Canadian elections in June.

French financial markets have also been affected by the announcement of national elections to be held on May 25 and June 1. The franc had weakened shortly after mid-April as the market began to suspect that President Chirac might call an election, and short- and long-term interest rate differentials against the mark rose significantly. Subsequent polls giving the ruling center-right coalition a substantial lead have led to a recovery of the franc and an unwinding of the movement in the long-term interest rate differential. The short-term spread has not completely reversed its earlier rise, however, ending the intermeeting up 9 basis points on balance.

. The Desk did not intervene for the U.S. monetary authorities during the period.

Developments in Foreign Industrial Countries

Recent indicators suggest that economic activity picked up in the first quarter, although the pace varied considerably across the major industrial countries. First-quarter growth appears to have continued at a robust pace in Canada, the United Kingdom, and Japan, while activity expanded at a modest pace in continental Europe. More forward-looking indicators suggest that activity will pick up further in Germany and France in the second quarter, continue at a modest rate in Italy, and slow temporarily in Japan.

Inflationary pressures generally remain subdued in the foreign industrial countries. CPI inflation is under 2 percent in Germany, France, Italy, and Canada. In Japan, an increase in the VAT rate was responsible for an increase in CPI inflation to a little over one percent. In the United Kingdom, CPI inflation eased somewhat further in April, largely reflecting a decline in food and energy prices and recent sterling appreciation.

On May 1, the Labour Party in the United Kingdom won the general election by a wide margin. One of the new government's first moves was to increase the Bank of England's independence by giving it the operational responsibility to set interest rates. A general election has been called in France, with the first round of voting on May 25 and the second round on June 1. Recent polls point to a much-reduced majority for the Center-Right Coalition, but the outcome is likely to be close. In Canada, the Liberal Party is expected to be re-elected by a wide margin in the June 2 election.

Individual country notes. **In Japan**, economic activity continued to expand strongly on average in the first quarter. Production and consumption spending were front-loaded in advance of the April 1 increase of the VAT from 3 to 5 percent, but spending likely fell off in the second quarter. Strong gains in industrial production, machinery orders, and new car registrations in January were partially reversed in February and March, and new car registrations fell nearly 29 percent further in April.

Although some of the surge in durable goods spending was related to the change in the VAT rate, it was also related to last year's strong housing cycle that seems to have come to an end. Housing starts fell during the first quarter to a level 11-1/2 percent below the fourth-quarter average.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Industrial Production	1.6	3.1	2.1	5.6	-3.7	-1.5	n.a.
Housing Starts	2.6	4.3	-11.5	-2.8	-3.2	-2.6	n.a.
Machinery Orders	2.8	7.4	-4.9	16.1	-5.9	-3.8	n.a.
New Car Registrations	5.8	10.6	2.3	2.6	-1.6	-2.3	-28.7
Unemployment Rate (%)	3.3	3.3	3.3	3.3	3.4	3.2	n.a.
Job Offers Ratio[1]	0.72	0.75	0.74	0.76	0.73	0.73	n.a.
Business Sentiment[2]	-7	-3	2	...	...	...	...
CPI (Tokyo area)[3]	0.0	0.1	0.0	0.0	0.0	0.0	1.2
Wholesale Prices[3]	0.7	0.6	1.4	1.0	1.6	1.6	3.2

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 unemployment rate fell to 3.2 percent in March while the job offers/applicants ratio remained at 0.73. The Tokyo CPI and wholesale prices rose in April, largely as a result of the VAT increase. Wholesale prices have also been boosted in recent months by rising import prices.

The Bank of Japan's March survey (Tankan) revealed a striking contrast in sentiment between manufacturing firms and non-manufacturing firms. The yen's depreciation since the time of the previous Tankan has raised expected sales and profits of many manufacturing firms. The survey showed a modest increase in the diffusion index of business sentiment at major manufacturers to 2 from -3 last November. This is the first positive value of the index since November 1991. Meanwhile, firms' sentiment has deteriorated in other sectors, particularly in construction, retailing, and other services, largely owing to concerns about the impact of the fiscal contraction.

The current account surplus narrowed in the first quarter. A strong expansion in exports was offset by a surge in imports as consumers and firms made purchases before the April 1 increase in the VAT.

Economic activity in **Germany** appears to have picked up in the first quarter from its tepid pace in the fourth quarter of last year, although growth likely remained well below potential rates, probably in the 1 to 2 percent (AR) range. Industrial production for February and March indicate that the construction sector recovered from its weather-related slump in January, and total output increased 0.5 percent in the first quarter from its fourth-quarter level. Real manufacturing orders increased strongly in the first quarter, led by a surge in export orders. The IFO business climate survey, an indicator of current and expected conditions in industry, continued to improve in the first quarter, with the index crossing into the positive range for the first time since mid-1995. The labor market situation appears to have stabilized following the jump in unemployment at the beginning of the year, but total unemployment remains near the 4.3 million (SA) level. Consumer price inflation in Germany remains subdued, with inflation registering 1.4 percent over the year to April.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Industrial Production	1.1	-0.0	0.5	-1.8	2.0	0.5	n.a.
Orders	1.0	-0.4	1.4	2.7	-0.2	1.1	n.a.
Unemployment Rate (%)	10.4	10.8	11.3	11.3	11.3	11.2	11.2
Western Germany	9.2	9.5	9.8	9.8	9.8	9.8	9.8
Eastern Germany	15.4	15.9	17.3	17.3	17.5	17.2	17.1
Capacity Utilization[1]	82.6	83.0	84.1	...	...	...	...
Business Climate[1,2]	-11.3	-3.3	1.3	-1.0	3.0	2.0	n.a.
Consumer Prices[3]	1.4	1.4	1.7	1.8	1.7	1.5	1.4

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.

A number of recent outside forecasts, including the spring joint forecast from the German economic institutes, the German Council of Economic Experts, and the IMF's recent *World Economic Outlook*, project a narrowing in the general government deficit this year to about 3-1/4 percent from 3.9 percent in 1996. On May 15, tax experts estimated a shortfall in tax revenue of DM18 billion (0.5 percentage point of GDP) this year, DM10 billion (0.3 percentage point) more than the Finance Ministry had accounted for in its deficit estimate of 2.9 percent of GDP. Thus, supplemental measures will be necessary if Germany is to meet the Maastricht deficit target of 3 percent of GDP. Although no formal announcement has been made of supplementary budget measures to bridge the shortfall, there has been talk of additional cuts in social expenditures, an increase in the mineral oil tax, and revaluation of the Bundesbank's gold reserves to market prices in order to increase the profits paid over to the government.

In **France**, first-quarter growth of economic activity is estimated to have remained modest. While industrial production rose sharply in February on strength in manufacturing output, the January-February average is little changed from the fourth-quarter average. In recent months, business confidence has risen sharply, mostly on strength in foreign demand. In the first quarter, consumption of manufactured products rose about 2-1/4 percent, at an annual rate, after a sharp fourth-quarter decline (associated with the end of the government's earlier car-buying incentive program). After edging up in February, the unemployment rate was unchanged in March, and consumer price inflation through April remains subdued.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Consumption of Manufactured Products	2.7	-3.5	0.6	2.6	-1.3	-0.1	n.a.
Industrial Production	2.2	-1.3	n.a.	-1.1	1.6	n.a.	n.a.
Capacity Utilization	82.3	81.4	81.1	...	...	...	...
Unemployment Rate (%)	12.5	12.7	12.8	12.7	12.8	12.8	n.a.
Business Confidence[1]	-26.7	-19.7	2.3	1.0	6.0	0.0	-3.0
Consumer Prices[2]	1.8	1.7	1.5	1.8	1.6	1.1	1.0

1. Percent balance of respondents citing an improvement in the outlook versus those citing a worsening.
2. Percent change from previous year.

In the **United Kingdom**, the economy has continued to expand rapidly, although sterling's recent strength has begun to cloud the outlook for exports. Real GDP growth picked up to almost 4 percent (SAAR) in the first quarter, while the unemployment rate has continued to drop, reaching 5.9 percent in April. About half of the decline in the unemployment rate since last October has been attributed to changes in the unemployment benefit system. Consumer demand remains strong, and business confidence rebounded in March and remained high in April. However, export orders have fallen since last fall in response to the strength of sterling. In addition, industrial production was unchanged in March, with a small decline in manufacturing, although the purchasing managers survey indicated that manufacturing output rose in April in response to continued strength in domestic demand.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Real GDP (AR)	2.6	3.4	3.9	...	...	...	...
Non-oil GDP (AR)	2.6	3.0	4.1	...	...	...	...
Industrial Production	0.4	0.6	0.1	0.1	-0.8	0.0	n.a.
Retail Sales	0.9	1.1	0.9	0.8	0.4	0.4	n.a.
Unemployment Rate (%)	7.5	6.9	6.3	6.5	6.2	6.1	5.9
Business Sentiment	21.3	18.0	18.3	14.0	16.0	25.0	23.0
Consumer Prices[1]	2.9	3.2	2.9	3.1	2.9	2.7	2.5
Producer Input Prices[2]	-2.7	-4.6	-7.0	-6.3	-6.8	-8.0	-10.5
Average Earnings[2]	4.0	4.2	4.6	4.8	4.5	4.5	n.a.

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

The twelve-month rate of increase in retail prices excluding mortgage interest payments dropped to 2.5 percent in April, meeting the government's inflation target. Prices of goods were up only 1.7 percent, reflecting a sharp drop in seasonal food prices, lower energy costs, and the impact of the strength of sterling. In contrast, services prices rose 3.3 percent. The underlying rate of increase in average earnings backed off from the high January rate in February and March. Nonetheless, the most recent rate of 4.5 percent is up from 3.75 percent a year ago, reflecting the tighter labor market.

As expected, the Labour Party won the May 1 general election by a wide margin. One of the new Government's first moves was to raise official interest rates by 25 basis points, a change which had been widely anticipated. More surprising was a decision to make the Bank of England more independent by giving it the operational responsibility to set interest rates. Decisions will be made by majority vote of a nine-member Monetary Policy Committee, which will include the Governor of the Bank of England along with two Deputy Governors and several appointed members from outside the Bank. These changes bring the authority of the Bank more in line with that of other G-7 central banks. The reforms stop short of full compliance with the Maastricht treaty, however, because the Treasury will retain control of the inflation target as well as the ability to instruct the Bank on interest rates for a "limited period" in "extreme economic circumstances." The Government has also pledged to introduce an early budget which will include a welfare-to-work program to tackle unemployment, financed by a levy on excess profits of privatized utilities industries.

In **Italy**, real economic activity declined 0.9 percent (SAAR) in the fourth quarter, mostly accounted for by about one percent declines in both business fixed investment and government spending, a very large drop in net exports, and two fewer working days in the fourth quarter than in the third quarter. Household consumption, which showed some signs of improvement due to the feed through of tax incentives on auto purchases, rose a modest one percent.

First-quarter monthly indicators point to a modest pick-up in activity. Industrial production rose in the first quarter, more than offsetting the decline in the fourth quarter of last year. Business sentiment rose significantly in the first quarter. Consumer confidence rose in January but has since declined slightly, and remains below its 1996 average. The quarterly unemployment rate edged up.

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

	1995	1996	1996			
	Q4/Q4	Q4/Q4	Q1	Q2	Q3	Q4
GDP	2.5	0.1	0.8	-1.5	2.2	-0.9
Private Consumption	1.6	0.9	0.6	1.0	0.9	1.0
Investment	8.4	-1.9	-3.9	-1.0	-1.4	-1.2
Government Consumption	-0.5	0.4	0.3	1.1	1.3	-1.1
Exports	5.5	3.4	-2.9	7.6	14.1	-4.0
Imports	5.6	-1.4	-8.1	-16.0	11.8	9.2
Total Domestic Demand	2.4	-1.0	-0.3	-6.9	1.2	2.1
Net Exports (contribution)	0.1	1.1	1.1	5.3	1.0	-2.8

Inflationary pressures are likely to remain subdued in light of continued moderation in wholesale and producer price increases, reflecting both the appreciation of the lira over the past two years and the productivity gains due to contained labor costs since 1993.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Industrial Production	-0.3	-1.0	1.2	0.3	2.9	0.7	n.a.
Cap. Utilization (%)	75.6	75.1	76.2	...	...	...	...
Unemployment Rate (%)	12.1	12.0	12.2	...	...	...	...
Consumer Confidence[1]	114.1	104.7	109.2	109.9	109.0	108.6	108.1
Bus. Sentiment[2] (%)	-1.0	1.3	20.0	21.0	22.0	17.0	n.a.
Consumer Prices[3]	3.5	2.7	2.4	2.6	2.4	2.2	1.7
Wholesale Prices[3]	2.0	1.8	0.6	1.0	0.6	0.3	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 March 27, the government announced a supplemental budget worth approximately $9 billion (about 3/4 percent of GDP) in response to the greater-than-projected deficit in the first-quarter. Key measures of the package include advanced taxation of anticipated severance fund outlays by private firms in 1997 and 1998, a temporary freeze in severance pay for public sector employees, and the elimination of advanced payments and cash outlays on public work projects.

Indicators for the first quarter point to continued strong growth in **Canada**. Industrial production, retail sales, manufacturing shipments, and new orders registered sizeable increases for the average of January and February over their fourth-quarter levels. Housing starts in the first quarter registered the largest quarterly increase in 6 years, but retreated somewhat in April. The Index of Business Attitudes reached a record high in the first quarter. Employment was little changed in January and February, but employment growth resumed in March and April. After declining to 9.3 percent in March, the unemployment rate rose in April as labor force participation increased. Consumer price inflation has eased in recent months and currently is slightly below the midpoint of the Bank of Canada's target range of 1-3 percent.

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

	1996		1997				
	Q3	Q4	Q1	Jan	Feb	Mar	Apr
Industrial Production	2.1	0.6	n.a.	1.1	0.4	n.a.	n.a.
Manufacturing Survey:							
Shipments	3.2	-0.2	n.a.	2.0	0.6	n.a.	n.a.
New Orders	2.7	0.3	n.a.	4.6	-2.0	n.a.	n.a.
Retail Sales	1.2	2.7	n.a.	1.0	1.1	n.a.	n.a.
Housing Starts	3.9	0.4	19.9	8.3	11.0	-2.2	-7.8
Employment	0.1	0.4	0.3	0.0	-0.1	0.4	0.2
Unemployment Rate (%)	9.8	9.9	9.6	9.7	9.7	9.3	9.6
Consumer Prices[1]	1.4	2.0	2.1	2.2	2.2	2.0	1.7
Consumer Attitudes[2]	101.7	104.8	106.9	...	...	...	...
Business Confidence[3]	148.3	153.1	160.1	...	...	...	...

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

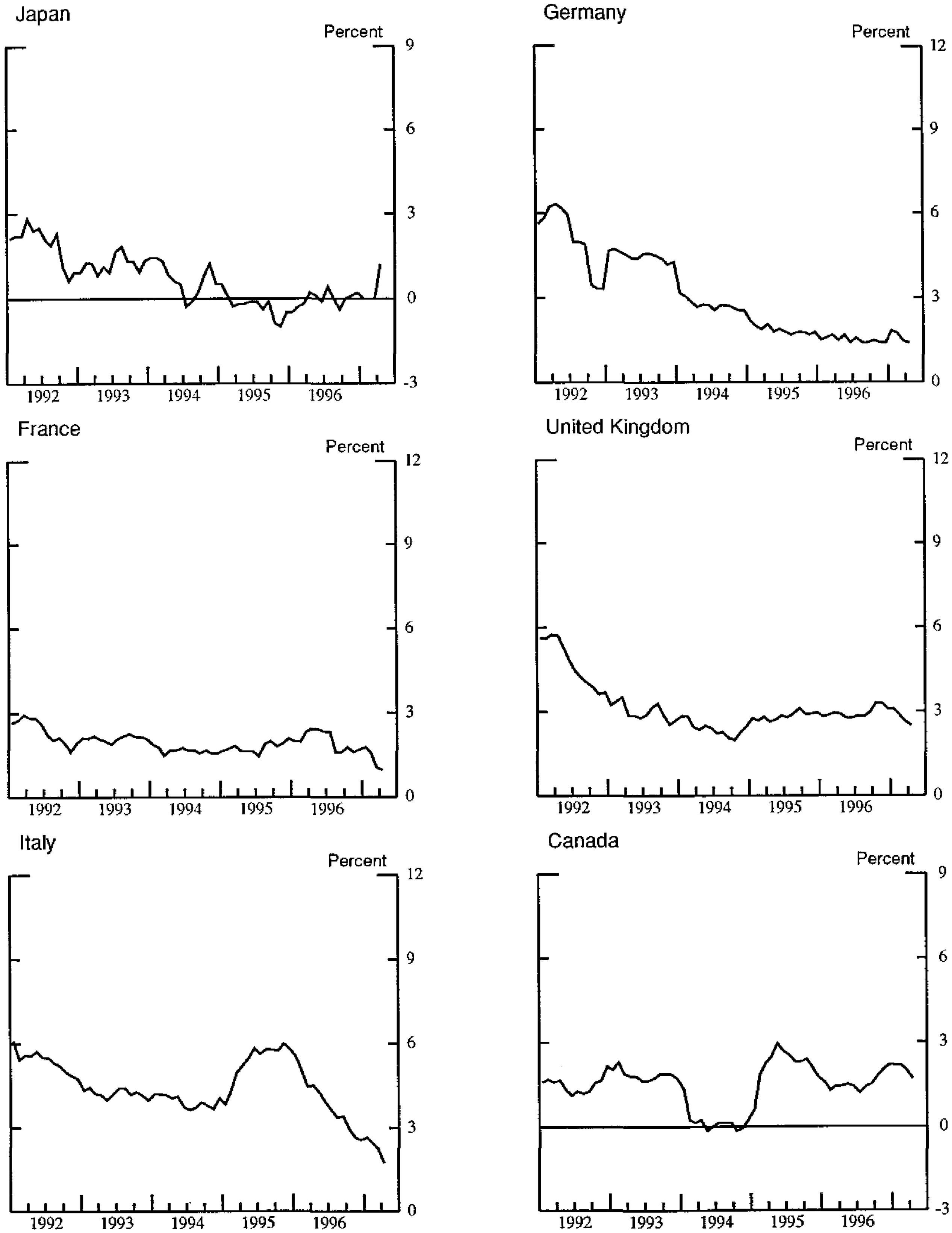
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1996	1996		1997				
		Q3	Q4	Q1	Dec	Jan	Feb	Mar
Japan: trade	61.4	14.3	16.5	12.9	4.4	5.5	3.8	3.6
current account	66.9	18.9	17.4	15.5	5.1	6.8	4.8	3.9
Germany: trade[1]	65.4	18.1	19.0	n.a.	5.0	3.5	5.5	n.a.
current account[1]	-14.3	-8.4	-1.6	n.a.	-0.3	-6.1	-0.9	n.a.
France: trade	18.2	5.2	5.1	n.a.	1.6	2.2	2.0	n.a.
current account	21.9	5.4	5.4	n.a.	1.9	3.9	3.4	n.a.
U.K.: trade	-19.4	-4.6	-4.3	n.a.	-1.4	-0.9	-1.2	n.a.
current account	-0.3	-0.5	1.3	n.a.	...	...	...	...
Italy: trade	41.6	9.6	11.0	n.a.	2.3	n.a.	n.a.	n.a.
current account[1]	41.1	14.7	9.4	n.a.	1.4	n.a.	n.a.	n.a.
Canada: trade	25.8	7.1	5.3	n.a.	2.1	1.5	1.6	n.a.
current account	-1.2	0.2	-1.3	n.a.	...	...	...	...

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

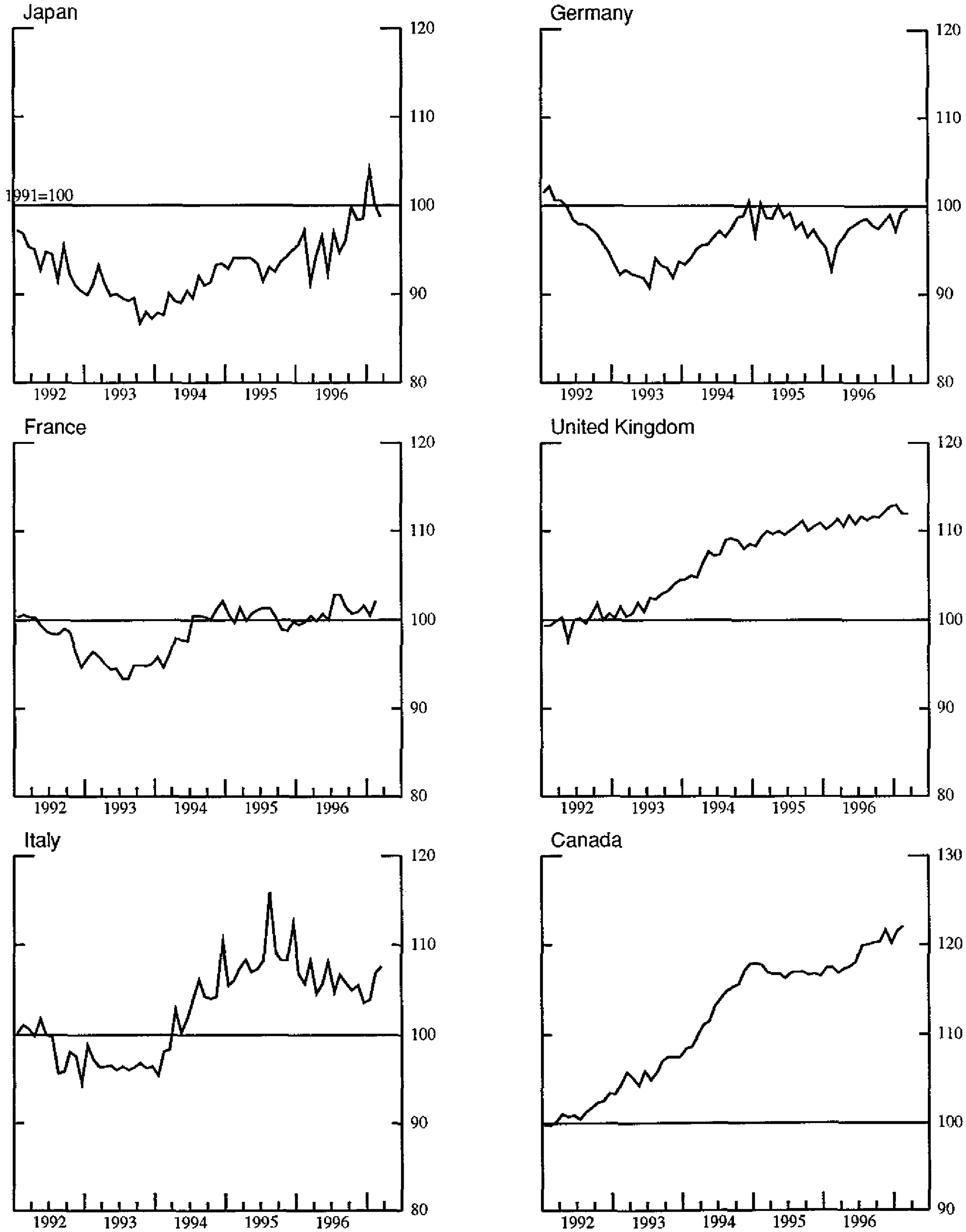
MAY 15, 1997

Consumer Price Inflation in Selected Industrial Countries
(12-month change)



MAY 15, 1997

Industrial Production in Selected Industrial Countries
(12-month change)



Economic Situation in Other Countries

Growth has slowed in Mexico, Argentina, Brazil, and China, while in Korea and Taiwan it has picked up. Indications are that Russia is on the verge of a turnaround, as GDP appears to have leveled off in the first quarter, but concerns about the reliability of the data remain. Inflation performance has been good in most cases, surprisingly so in Brazil. Also notable are recent declines in inflation in Mexico, China and Russia, and a fall in the price level in Argentina.

Mexico's trade surplus rose in the first quarter despite a recovery in consumption and the real appreciation of the peso. China's trade surplus also improved, as did Argentina's. Brazil continued to record trade deficits in the first quarter. Strong domestic demand contributed to narrowing of the trade surplus in Taiwan and a widening of Korea's trade deficit. In Thailand, the baht has come under renewed downward pressures.

Individual country notes. In **Mexico**, monthly data show that the economy continued to grow in the first quarter but at less than the rapid rate shown in the fourth quarter of 1996. Industrial production rose 6.2 percent in the first quarter from a year earlier. That is slower than the 12.8 percent growth rate in the fourth quarter, reflecting in part the higher base period. The unemployment rate moved a bit lower in February, to 4.2 percent, and remained at that level in March. The unemployment rate has declined from its post-crisis high of 7.6 percent in August 1995 but remains above its pre-crisis level of about 3-1/2 percent. Other indications point to some weakness in the first quarter. Retail sales fell 3.4 percent in the January-February period from the same period a year earlier. Earnings reported by Mexican corporations fell short of expectations in most sectors as reported sales declined by 1.2 percent from the first quarter a year ago.

Consumer price inflation has continued to moderate in recent months, registering a monthly rate of only 1.1 percent in April. Increases in public sector prices and minimum wages in December now appear to have been reflected in consumer prices, and inflation has returned to the post-crisis lows of last October. The stability of the peso so far this year and the usually low seasonal price pressures during the summer make it likely that the inflation rate will remain near its current rate in coming months.

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Feb	Mar
Real GDP	-6.2	5.1	7.6	n.a.	...	...
Industrial Production	-7.5	10.4	12.8	6.2	8.2	n.a.
Unemployment Rate (%)	6.3	5.5	4.7	4.3	4.2	4.2
Consumer Prices[1]	52.1	27.7	6.1	5.6	1.7	1.2
Trade Balance[2]	7.0	6.3	0.7	1.4	0.3	0.6
Imports[2]	72.5	89.6	25.5	23.5	7.7	8.2
Exports[2]	79.5	95.9	26.2	24.9	8.0	8.7
Current Account[2]	-1.6	-1.8	-1.4	n.a.	...	...

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

Recent trade data have been stronger than expected despite the continued real appreciation of the peso and the recovery of domestic demand. After declining in the fourth quarter, the trade surplus rebounded in the first quarter to nearly the level of the third quarter, even as oil exports declined nearly 13 percent from the previous quarter (due in part to a decline in oil prices). The trade surplus for March showed a particularly large rise, with the gains coming largely from increased automotive and agricultural exports.

In **Argentina**, the growth in economic activity continues but at a slower pace than the very high rates seen at the end of 1996 and the beginning of 1997. Industrial production in the first quarter was 8 percent above a year earlier, down from nearly 12 percent in the fourth quarter of 1996. Somewhat unexpectedly, consumer prices fell in March and April, offsetting the increase in prices that occurred in the first two months of this year. Accordingly, consumer price inflation over the past twelve months was 0.8 percent. The first quarter fiscal deficit of the central government was $1 billion, equal to the target for this quarter agreed upon with the IMF.

Strong Brazilian demand and a record harvest continue to boost Argentine exports; in the first quarter of 1997, they were up 19 percent over a year ago. However, imports in the first quarter were

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP	-4.6	4.4	9.2	n.a.	...	...
Industrial Production (SA)	-6.2	3.4	11.7	8.0	4.1	n.a.
Unemployment Rate (%)[2]	17.4	17.2	17.3	...	...	...
Consumer Prices[1]	1.5	0.2	0.3	0.3	-0.5	-0.3
Trade Balance[3]	3.0	3.8	0.7	-0.2	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.

up 42 percent over the same period as a result of a stronger dollar and, hence, a stronger peso. Consequently, the trade balance in the first quarter shifted to a small deficit from a small surplus a year earlier. International reserves (excluding gold) were $17 billion at the end of April, roughly 25 percent higher than a year ago.

Taking advantage of relatively favorable borrowing conditions, the Argentine government has been placing large amounts of debt in international capital markets recently. The government anticipates raising about $9 billion in international capital markets for 1997 financing needs, of which about two thirds has already been achieved. In April, in a move that was widely expected, Standard and Poor's upgraded its sovereign debt rating for Argentina to BB from BB-. However, other rating agencies have not followed suit.

In **Brazil**, industrial production (s.a.) fell by 2.1 percent in March, after very little change in January and February. Retail sales have been volatile in recent months, making it difficult to determine whether there is any clear trend. Economic activity in recent months has been boosted to some extent by a good agricultural harvest. Inflation has remained remarkably low; consumer prices rose only 8.2 percent in the year through April 1997, making it one of the lowest twelve-month increases since the 1950s.

Brazil continued to record trade deficits in March and April, bringing the deficit for the year through April to $4 billion, compared with near balance over the same period in 1996. Import growth has been very strong; imports over the January-April period were 30 percent higher than a year earlier. Some of the deterioration in the trade balance can be attributed to the stronger

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP	4.2	2.9	5.4	n.a.	...	...
Industrial Production (SA)[1]	3.6	2.3	0.0	-2.3	-2.1	n.a.
Open Unemployment Rate (%)	4.6	5.4	4.5	6.0	6.0	n.a.
Consumer Prices[2]	22.0	9.4	1.0	2.0	0.7	0.6
Trade Balance[3]	-3.2	-5.5	-3.9	-3.1	-1.0	-0.9
Current Account[3]	-17.8	-24.3	-10.7	-6.8	-2.4	-2.5

1. Annual data are from national income accounts.
2. INPC, Percentage change from previous period. Annual data are Dec/Dec.
3. Billions of U.S. dollars, NSA

dollar, and, hence, the stronger currency. (Under the government's stabilization program, the central bank limits the extent to which it will allow the *real* to depreciate against the dollar.) In April, the government tightened credit restrictions on imports and in early May increased a tax on other forms of credit that were aimed at reducing the demand for automobiles and other durable goods, the two major sources of upward pressures on imports.

The current account deficit in the first quarter exceeded the capital account surplus by $1 billion, resulting in a drawdown in the central bank's international reserves. The desire to maintain interest rates high enough to attract capital from abroad (and thus avoid further drawdowns in reserves) also prompted the central bank in late April to leave its two key lending rates to financial institutions unchanged in May. This represents a departure from the practice of gradually reducing interest rates since early 1995, after the central bank no longer confronted strong downward pressures on the *real*. International reserves stood at $59 billion at the end of March, down slightly since the end of 1996, but up considerably from $32 billion in early 1995.

On May 6, the government sold its controlling stake in CVRD (Companha Vale do Rio Doce), a mining conglomerate, for $3 billion. The sale was the largest of a government-owned firm to date in Latin America. The sale of CVRD has symbolized the Cardoso government's determination to enact needed fiscal and other economic reforms that are crucial to the long-run success of its stabilization program. Privatization and other proposed reforms have been extremely controversial.

In **Venezuela**, recent labor market developments have increased uncertainty about the short-term economic outlook. In mid-March, the government signed an agreement on a severance payment reform with unions and private sector representatives that replaces the present severance payment system with one that is far less generous by international standards. Because the agreement, which is expected to be approved by Congress, will reduce the cost of firing workers in the future, the reform is expected to increase labor productivity and growth in the long run. However, existing employees will receive very large payoffs from the government over the next few years, which Finance Minister Matos estimates will cost the government 10 percent of GDP. The huge fiscal cost of the reform has thus raised concerns that the government will resort to more inflationary finance of fiscal deficits in the future. (Although the government ran a sizeable fiscal surplus in 1996, it was due to a windfall generated by the rise in oil prices that year.)

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP	2.2	-1.6	...	...	...	...
Unemployment Rate (%)	10.8	11.8	12.4	...	...	...
Consumer Prices[1]	56.7	103.3	10.6	6.6	1.6	2.4
Trade Balance[2]	-6.0	-5.1	-1.2	n.a.	n.a.	n.a.
Current Account[2]	2.6	n.a.	...	...	...	...

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

Other recent developments in the labor market have also fueled inflationary pressures. The minimum wage was increased by 44 percent on May 1 and public employees salaries were increased by 75 percent on average in February. Thus, although consumer prices posted their lowest monthly increases in five years in March and April, inflationary expectations are running high.

Real GDP declined year-over-year by 1.6 percent in 1996. The recession led to a narrowing of the non-oil trade deficit from $6 billion in 1995 to about $5 billion in 1996. International reserves (excluding gold) at the end of April were $12 billion, compared with $6.4 billion a year ago. At the end of April, the IMF approved a

Venezuelan request to extend its stand-by agreement, which is due to expire in July, for another eighteen months.

China's soft landing continued in the first quarter, as growth slowed slightly but remained high, and inflation moderated. GDP rose 9.4 percent in the first quarter of 1997, the lowest quarterly growth rate reported since 1992. Industrial production, in particular, moderated. Twelve-month consumer price inflation of 4.0 percent in March was at its lowest level since 1991. In the first four months of 1997, China recorded a trade surplus of $10.3 billion, compared with a deficit of $0.6 billion in the year earlier period; the value of exports rose 27 percent and the value of imports fell 2 percent from the year-earlier period. The surging exports and falling imports appear to reflect in part a base-period effect, since the beginning of 1996 had the reverse pattern of falling exports and surging imports. International reserves reached $114 billion in March, up $7 billion since the end of 1996.

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP[1]	10.5	9.7	9.7	9.4	...	...
Industrial Production	17.8	15.6	15.6	13.0	16.1	...
Consumer Prices	10.1	7.0	7.0	4.0	4.0	...
Trade Balance[2]	16.7	12.2	4.0	6.8	3.0	3.5

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

In **Taiwan**, inflation has plummeted in recent months, with consumer prices rising only 0.5 percent in the twelve months ending in April. Industrial production grew strongly in the first quarter, following strong growth at the end of 1996. Taiwan ran a trade surplus of $1.6 billion in the first four months of 1997, down from the surplus of $3.4 billion in the year-earlier period. Exports rose 3 percent, while imports rose 9 percent. Foreign exchange reserves were $89 billion at the end of March, virtually unchanged since the beginning of the year.

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

	1995	1996	1996	1997	1996	
			Q4	Q1	Mar	Apr
Real GDP	6.1	5.7	6.6	...	...	...
Industrial Production	4.2	1.6	4.8	5.4	10.0	...
Consumer Prices	4.6	2.5	2.5	1.1	1.1	0.5
Trade Balance[1]	8.3	14.3	4.0	1.8	0.6	-0.2
Current Account[1]	5.0	10.5	2.8	...	...	...

1. Billions of U.S. dollars, NSA

An epidemic of foot-and-mouth disease hit Taiwan's pig stocks in March, leading Taiwan to ban the export of pork. The decline in pork exports contributed to the April trade deficit, as exports fell 3 percent compared with April 1996; the deficit was only Taiwan's fifth monthly trade deficit since 1983, and the first since 1995.

In **Korea**, more financial scandals have appeared in the wake of the collapse of Hanbo Steel Company in January. Sammi Steel, the country's third-largest steelmaker, defaulted on loan payments on March 19. This was followed a month later by the near-bankruptcy of the Jinro Business Group; the group's creditors have agreed to provide an emergency loan package to allow it to restructure its operations. The ongoing investigation into the collapse of Hanbo Steel has led to the imprisonment of many top government officials and bankers on charges of graft and embezzlement. The son of President Kim Young-sam was among those who testified concerning their alleged involvement in the financial scandal.

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP	9.0	6.8	6.6	n.a.	n.a.	n.a.
Industrial Production	11.7	8.4	9.8	7.0	9.1	n.a.
Consumer Prices	4.5	5.0	4.8	4.7	4.5	4.3
Trade Balance[1]	-4.7	-15.3	-3.9	-5.4	-1.4	n.a.
Current Account[1]	-8.9	-23.7	-6.2	-7.9	-2.3	n.a.

1. Billions of U.S. dollars, NSA

The current account deficit jumped to nearly $8 billion in the first quarter, compared with a deficit of $4.6 billion a year earlier. However, the monthly figures indicate a downward trend ($2.3 billion in March versus $3.1 billion in January); customscleared trade numbers for April indicate a continuation of the trend. Industrial production in March grew at a robust rate of just over 9 percent (year-over-year), with some signs of pickup in key industries such as semiconductors. Inflation remained at moderate levels in April.

In **Thailand**, the baht has come under renewed strong downward pressures, prompting strong intervention support. On May 14 the Bank of Thailand issued the following statement: "Today the Bank of Thailand and the Monetary Authority of Singapore jointly intervened in the foreign exchange market to stabilize the value of the Thai baht. This concerted operation is aimed at stemming excessive speculative activities which may lead to disorderly conditions in the Thai and regional financial markets. Other appropriate measures will be taken as necessary." Also on May 14, the overnight interbank interest rate rose sharply from 11.5 percent to 18 percent. On May 15, the central bank was reported to have raised short-term interest rates to 25 percent.

Since 1984, the baht has been tied to a basket of currencies with a heavy weight on the dollar, but a number of adverse developments over the past year have shaken investor confidence and put downward pressures on the currency. Thailand has been running large current account deficits (8 percent of GDP in 1995 and 1996), and the banking sector has experienced a rise in non-performing loans as a result of plunging real estate prices. The stock market index fell by 25 percent in 1996, and has plunged by a further 30 percent since the beginning of this year. The rise in interest rates in February during an earlier attack against the currency weakened the banking sector further. In early April, Moody's downgraded Thailand's long-term foreign debt from A2 to A3, citing Thailand's high current account deficit and the fragility of the banking sector. Despite Thailand's economic problems, the overall economy managed to grow by almost 7 percent in 1996, and the most recent consensus forecast called for 6 percent growth in 1997.

In **Russia**, President Yeltsin has made a strong return from his eight-month illness, and the economy seems to be on the verge of a turnaround. Year-on-year GDP growth rates were very slightly positive for January and February, although there is some concern that the figures are an artifact of a change in methodology.

Inflation continues to decline; for the first four months of 1997, it came in at 6.3 percent, higher than would be consistent with the targeted annual rate of 12 percent but still lower than last year's inflation for the same period. The ruble-dollar exchange rate has continued to remain well within the corridor set by the Central Bank; on May 6, the ruble traded at 5,755 to the dollar.

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

	1995	1996	1996	1997	1997	
			Q4	Q1	Mar	Apr
Real GDP	-4	-6	-6	0.2	-0.3	n.a.
Industrial Production	-3	-5	-5	n.a.	0.4	n.a.
Consumer Prices[1]	7	1.7	2	2	1.4	1.0
Ruble Depreciation[1]	2	1.5	1	1	0.9	0.3
Trade Balance[2]	18.3	n.a.	n.a.	n.a.	n.a.	n.a.
Current Account[2]	5.7	n.a.	n.a.	n.a.	n.a.	n.a.

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

Yeltsin's return to full-time work may give a needed jolt to economic reform, which had been stalled. In March he reshuffled his cabinet, bringing in well-known reformers, including the dynamic former governor of Nizhny, Novgorod Boris Nemtsov, and the effective but unpopular Anatoly Chubais. Nemtsov has begun to tackle the necessary but difficult task of restructuring Russia's government monopolies.

The fiscal situation is still problematic. Tax revenues for the first quarter of 1997 were less than 60 percent of projections. Wage, pension, and tax arrears continue to accumulate. While some proposals to help firms settle their tax arrears have been made, a long-term resolution of the fiscal problems will not occur without both comprehensive tax reform and restructuring or closure of loss-making firms. In late April, a sequestration plan for bringing expenditures in line with reduced revenue and a tax reform package were submitted to the Duma.

The fiscal reform measures removed important obstacles to the continuation of Russia's three-year, $10 billion IMF Extended Fund Facility, which had been held up since late 1996. The IMF reached an agreement with Russia on a plan for 1997 in late April, and the IMF Executive Board is expected to vote on the plan on May 16. The

IMF and Russia have agreed to move from monthly to quarterly reviews.