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

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Confidential (FR) Class III FOMC

Part 2

August 14, 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

August 14, 1997

RECENT DEVELOPMENTS

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity decelerated in the second quarter and appears to be growing at a moderate pace this quarter. Consumer spending has picked up after its spring lull, and indicators of business equipment investment remain quite favorable. However, manufacturing output was held down in July by supply disruptions in the motor vehicles industry, and the rapid accumulation of business inventories over the first half of the year is likely to restrain activity in a few sectors. Although the unemployment rate remains at its lowest level in twenty-five years, price and labor compensation measures have shown no sign of breaking out of their recent subdued trends.

Real GDP

According to BEA's advance estimate, real GDP rose 2.2 percent at an annual rate in the second quarter, following a downward-revised 4.9 percent rate of increase in the first quarter.[1] The reported deceleration in activity last quarter reflected a sharp slowing in the growth of consumer spending. In addition, although inventory investment was up a bit from its already rapid first-quarter pace, the swing in stockbuilding contributed much less to overall GDP growth last quarter than in the first quarter. In contrast, gains in business fixed investment and residential investment were larger than in the first quarter, while real federal expenditures turned up sharply and more than reversed last quarter's decline.

Since the publication of the advance GDP estimate, we have received the usual monthly flow of data, including book-value inventories for June. Taken at face value, the inventory data could add $12 billion, in chained 1992 dollars, to the advance GDP figure. However, the monthly inventory figures for wholesale and retail trade are often revised substantially. Moreover, the second-quarter estimate of nonmerchant wholesale and other nonfarm inventory accumulation--which is based on relatively few hard data--seems much too high to us (especially coming on the heels of an even more

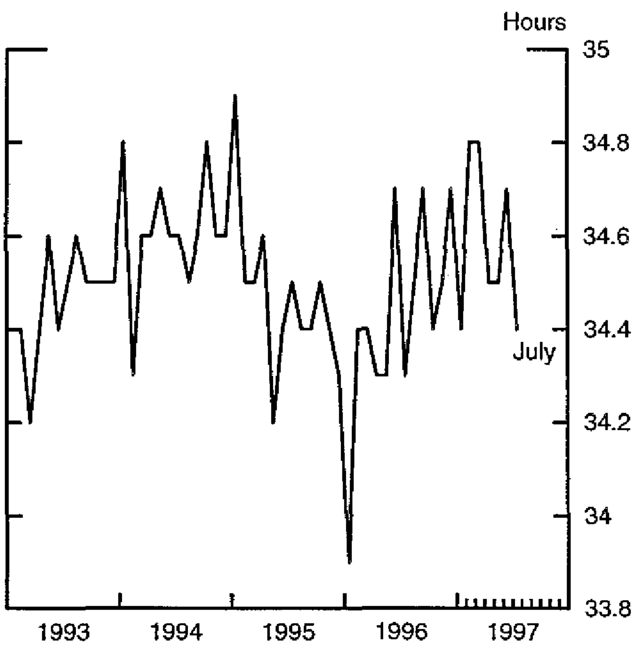
1. The downward revision to first-quarter growth was part of BEA's annual revision to the national income and product accounts. These NIPA revisions are discussed in detail in the appendix.

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

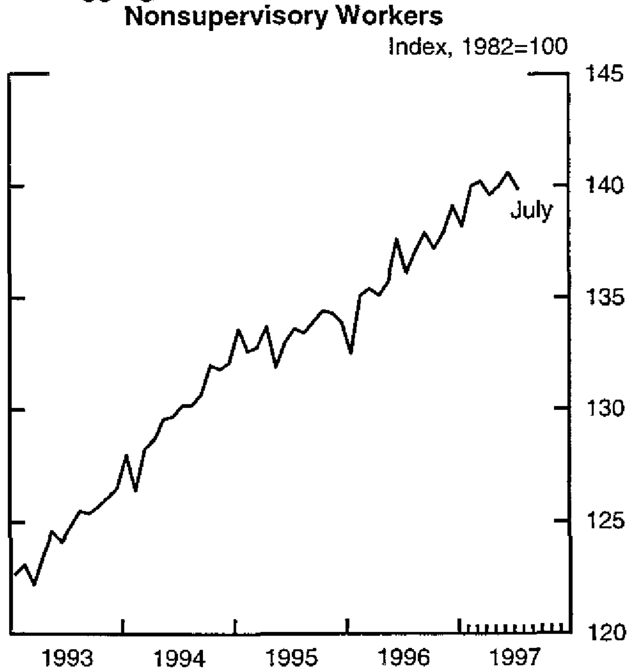
	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
	--------Average monthly changes-------							
Nonfarm payroll employment[1]	185	212	213	228	239	163	228	316
Private	176	198	213	218	207	177	151	260
Goods Producing	8	19	34	43	17	35	18	-4
Manufacturing	-1	-5	7	14	10	3	22	-5
Durable	11	5	11	15	14	8	26	20
Nondurable	-12	-10	-4	-1	-4	-5	-4	-25
Construction	10	24	27	29	5	29	-4	3
Service Producing	177	192	180	185	223	128	210	320
Transportation and utilities	8	9	-1	39	8	10	-1	31
Trade	48	60	80	28	52	5	55	94
Finance, insurance, real estate	-1	11	12	10	15	10	9	26
Services	113	98	88	97	115	117	70	113
Help supply services	10	13	3	17	-17	-10	-2	4
Total government	9	14	0	10	32	-14	77	56
Private nonfarm production workers[1]	151	168	180	195	155	201	77	202
Manufacturing production workers	-2	-5	7	9	6	16	0	7
Total employment[2]	32	232	202	440	63	255	-275	344
Nonagricultural	51	225	220	453	61	322	-236	253
Memo:								
Aggregate hours of private production workers (percent change)[1]	.1	.3	.3	.3	.1	.3	.4	-.5
Average workweek (hours)[1]	34.5	34.4	34.5	34.7	34.6	34.5	34.7	34.4
Manufacturing (hours)	41.6	41.5	41.8	41.9	42.0	42.0	41.8	41.7

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



REAL GDP AND SELECTED COMPONENTS

	1997:Q1	1997:Q2 BEA advance	1997:Q2 Staff estimate
	Percent change, annual rate		
Real GDP	4.9	2.2	2.6
Final sales	3.0	1.9	2.2
Private domestic final purchases	5.1	2.7	2.8
PCE	5.3	.8	.8
Business fixed investment	4.1	15.1	15.3
Residential investment	3.3	5.6	7.5
Federal government	-5.8	8.4	8.4
State and local government	2.7	1.3	1.1
	Level, billions of chained (1992) dollars		
Nonfarm inventory investment	58.3	60.7	64.7
Net exports	-126.3	-147.9	-144.2

outsized increase in the first quarter).[2] Given these considerations, we are inclined to assume that real inventory investment in the national accounts will eventually be revised up only a bit. Although BEA may report a larger upward revision in its preliminary GDP estimate later this month, our best estimate of second-quarter GDP growth is about 1/2 percentage point above BEA's advance estimate. *Unless otherwise noted, the discussion of second-quarter activity in the remainder of this section of the Greenbook incorporates our expected revisions to the GDP data.*

Labor Market Developments

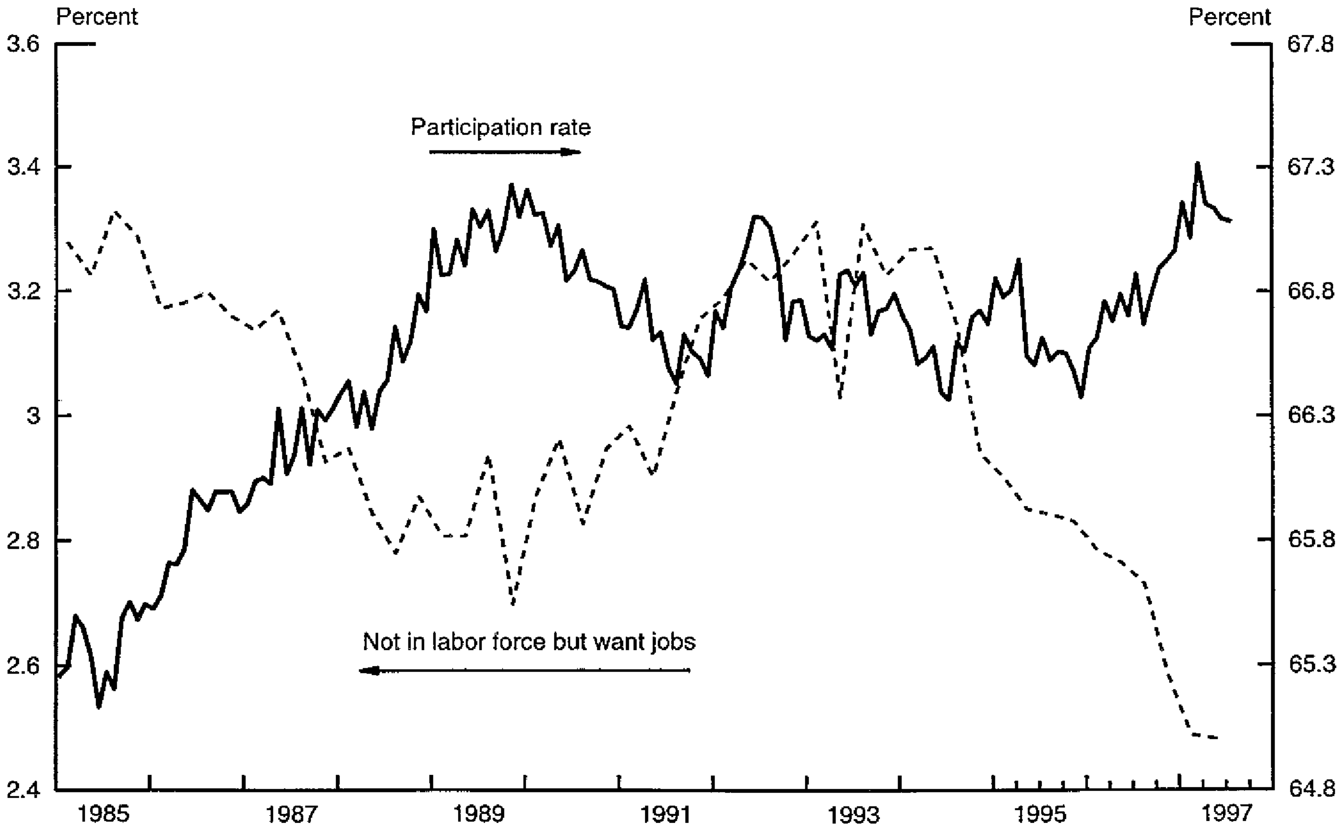
Employment rose sharply in both labor market surveys in July, and the unemployment rate moved back down to match its lowest level of the current expansion. At the same time, aggregate hours of production workers fell last month, implying a considerable decline in the average workweek to a relatively low level. This pattern has been repeated in the initial months of the past seven quarters, raising the possibility of a seasonal adjustment problem. We cannot identify the source of such a problem, but we share the view expressed by some other analysts that one should take care not to

2. Inventory accumulation in these categories was about $18.8 billion in the first quarter and $13.9 billion in the second quarter (both at an annual rate in chained 1992 dollars). This two-quarter pace of accumulation is the largest on record.

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

			1996	1997		1997		
	1995	1996	Q4	Q1	Q2	May	June	July
Civilian unemployment rate (16 years and older)	5.6	5.4	5.3	5.3	4.9	4.8	5.0	4.8
Teenagers	17.3	16.7	16.6	17.0	15.9	15.6	16.8	16.4
Men: 20 years and older	4.8	4.6	4.4	4.5	4.1	3.8	4.2	4.0
20-24 years	9.2	9.5	9.1	9.1	8.1	7.5	8.2	8.1
25-54 years	4.4	4.2	4.0	4.0	3.7	3.5	3.8	3.6
55 years and older	3.7	3.3	3.2	3.3	3.0	2.8	3.1	2.9
Women: 20 years and older	4.9	4.8	4.8	4.7	4.4	4.5	4.4	4.2
20-24 years	9.0	9.0	8.9	8.9	8.9	8.9	8.6	7.2
25-54 years	4.5	4.4	4.5	4.4	4.0	4.2	4.0	4.1
55 years and older	3.6	3.5	3.2	2.9	3.0	3.0	3.2	3.0

Labor Force Participation



Note. Labor force participation rate adjusted for the redesign of the CPS in 1994 and the introduction of updated population controls in 1990. The percentage of the population not in the labor force but reporting that they want jobs is adjusted for the redesign of the CPS in 1994.

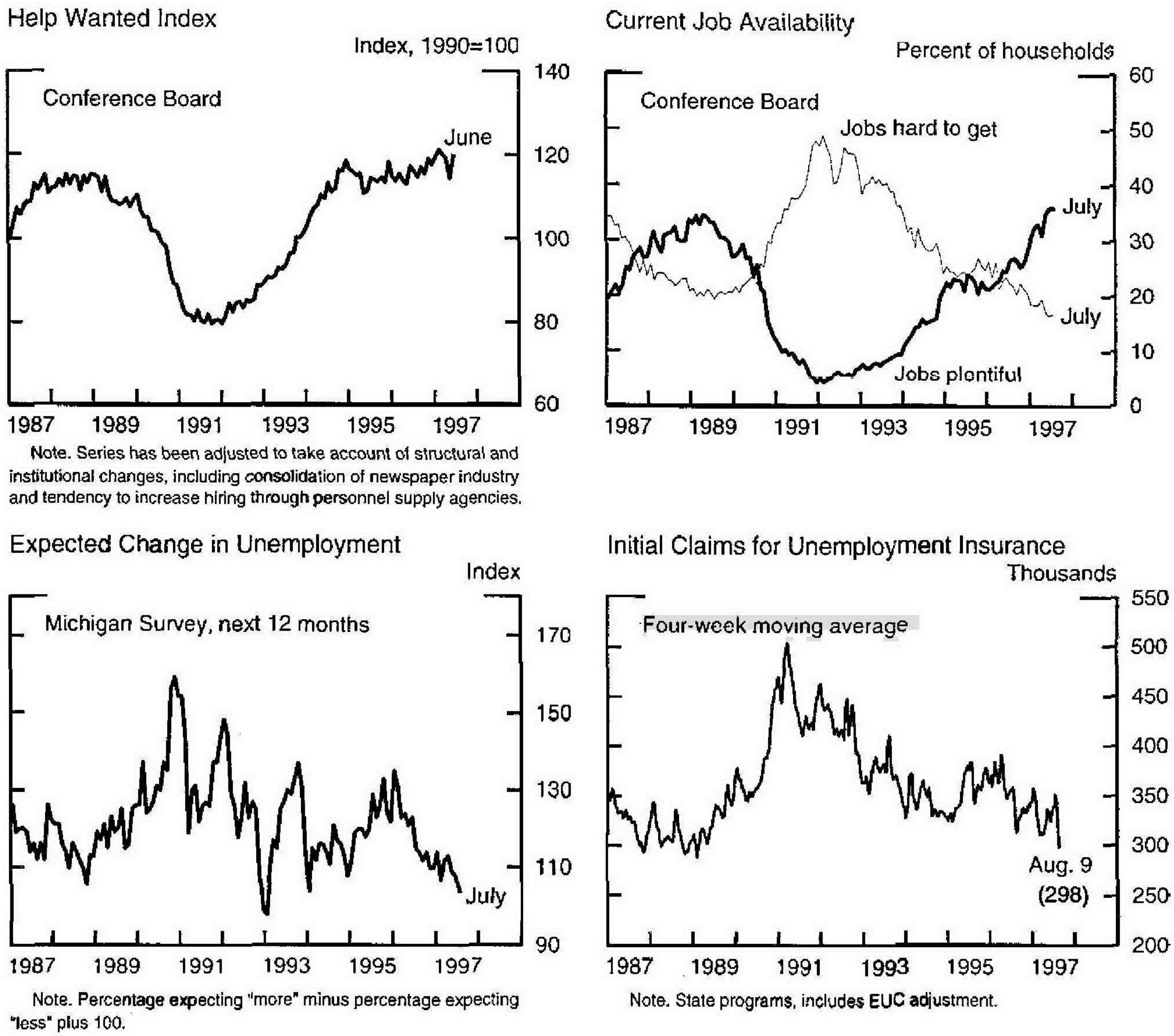
read too much into the July decline. Thus, on balance, we think that growth of labor demand maintained considerable momentum as the third quarter began.

Private nonfarm payrolls advanced 260,000 in July, up from an increase of 151,000 in June and well ahead of the average monthly gain of 213,000 posted over the first half of the year. The service-producing sector more than accounted for the July rise in private payrolls; gains were widespread, and payroll increases topped their first-half averages in all five major industry groups. In particular, employment growth in the services industries rebounded smartly from its weaker-than-average June pace, and retail trade posted a large gain. In contrast, employment dropped 4,000 in the goods-producing sector.

In the household survey, employment grew 344,000 in July, more than offsetting the June decline. Netting out the effects of the introduction of new population weights in January, employment gains in the household survey have averaged 220,000 per month over the first seven months of the year, only slightly below those in the payroll survey. The strong employment gains pushed the unemployment rate back down to 4.8 percent in July, 1/2 percentage point below the plateau of late 1996 and early 1997.

The labor force participation rate has held steady at 67.1 percent over the past three months after peaking at 67.3 percent in March. Adjusting for changes in survey design and population weights, labor force participation is about even with its highest level in the previous expansion. Evidence is mixed on the prospects for further increases in the participation rate. On one hand, the percentage of workers <u>not</u> in the labor force but saying they want a job has declined sharply since early 1996 and now is the lowest since the series was first published in 1970. In addition, anecdotal reports indicate that orders for temporary workers have been going unfilled because of a shortage of workers with the required skills. On the other hand, the increases in participation among some of the groups that accounted for much of the rise in the aggregate rate over the past year--men and women aged 20 to 24 and aged 55 and older, and women who maintain families--show, as yet, no sign of leveling off. This upward trend has been offset in recent months by some slippage in labor force participation among teenagers and prime-aged men (aged 25 to 54). If the labor market were to remain strong, these declines might not persist.

Labor Market Indicators



Help Wanted Index — Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Expected Change in Unemployment — Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

Initial Claims for Unemployment Insurance — Note. State programs, includes EUC adjustment.

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

			1996		1997		1996:Q2 to 1997:Q2
	1995[1]	1996[1]	Q3	Q4	Q1	Q2	
Output per hour							
Total business	.4	1.4	-1.1	1.9	1.8	.7	.8
Nonfarm business	.4	1.2	-1.0	1.8	1.4	.6	.7
Manufacturing	3.3	3.9	5.5	3.7	2.5	3.2	3.7
Nonfinancial corporations[2]	1.4	2.2	2.3	2.0	1.9	ND	ND

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. Nonfinancial corporate sector includes all corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

Other indicators we track confirm that labor demand is quite strong. The Conference Board's index of help-wanted advertising rebounded in June to a level that, when adjusted for the sharp rise of temporary help agencies, is above the level seen in the late 1980s.[3] Similarly, workers perceive strong demand for labor; the difference between the percentage of households believing jobs are plentiful and those believing jobs are hard to get has widened in recent months to its largest gap ever. Finally, the level of initial claims for unemployment insurance has remained low, which is consistent with robust employment growth in August.

Labor productivity in the nonfarm business sector rose 0.6 percent at an annual rate in the second quarter after an increase of 1.4 percent in the first. Smoothing through the recent fluctuations, output per hour in the nonfarm business sector has risen almost 1-1/4 percent at an annual rate in the last eight quarters, compared with increases of less than 1 percent per year from 1990 to 1995.[4] The better performance, even as highly qualified workers reportedly have become hard to find, hints at the possibility of a slight improvement in the underlying trend of late. However, this was also a period of output acceleration, and a pickup in labor productivity would be a typical pattern in that environment.

As of Greenbook publication, the International Brotherhood of Teamsters continued its strike against United Parcel Service (UPS). The strike, which began on August 4, reflects two key issues. First, UPS has offered its workers larger pension benefits in return for pulling out of the multi-employer plan currently run by the union. But the union opposes this proposal, possibly out of fear that, without UPS, the current Teamster-run pension plan may not be viable. Second, the Teamsters argue that UPS relies excessively on part-time jobs and would like the company to convert 10,000 part-time jobs to full-time positions; approximately 60 percent of the 185,000 employees covered by the Teamsters' contract are classified as part-time workers, who are paid substantially lower hourly wages than their full-time colleagues. If the strike were to continue

3. This difference could be even larger if some companies are replacing newspaper advertising with help-wanted ads on the Internet. We have little evidence on the extent of this use of the Internet, however, or on whether Internet ads simply duplicate other types of help-wanted advertising.

4. As is discussed in the appendix, the revision of the NIPAs did not greatly alter the labor productivity pattern of recent years.

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

	Proportion 1996	1996[1]	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
			-Annual	rate-	--Monthly	rate---	
Total index	100.0	3.9	4.4	3.7	.0	.3	.2
Previous		3.9	4.4	4.3	.2	.3	
Manufacturing	86.5	4.1	5.3	3.7	.1	.3	.1
Durables	47.1	5.7	8.2	6.7	.3	.5	.3
Motor vehicles and part	4.9	-1.6	14.1	-16.1	-1.3	.8	-2.7
Aircraft and parts	2.3	34.5	18.1	19.5	1.1		1.5
	39.4	2.3	2.0	.0	-.2		-.2
Consumer goods	26.1	2.6	-1.6	2.9	-.1	.3	.1
Durables	4.1	3.0	4.1	6.4	.9	1.8	2.1
Nondurables	22.0	2.5	-2.6	2.3	-.3	.0	-.3
Business equipment	12.7	9.1	11.0	11.1	.2	.8	.6
Information processing	5.8	10.8	12.0	12.9	.7	1.4	.7
Industrial	4.5	-.2	2.6	4.9	-.8	-.5	-.1
Transit	1.2	53.1	33.3	23.2	2.0	2.1	2.0
Other	1.3	3.6	15.2	14.6	-.4	.3	1.3
Construction supplies	5.7	5.7	3.0	2.5	.6	-.7	-.3
Materials						.0	

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-96 Avg.	1996 Q2	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
Manufacturing	85.7	81.7	82.1	82.5	82.4	82.4	82.3	82.1
Primary processing	88.9	82.8	86.0	86.8	87.0	87.2	86.8	86.5

through Saturday, which seems likely at this point, nonfarm payroll employment in August will be held down, on net, by disruptions from the strike.

Industrial Production

Industrial production rose 0.2 percent in July after rising at nearly a 4 percent annual rate in the first half of this year. Although a return to more normal weather boosted electric utility output in July, industrial production was held down by a 2-3/4 percent decrease in the output of motor vehicles and parts. Manufacturing excluding motor vehicles and parts increased 0.2 percent for a third consecutive month. Production of nondurable consumer goods edged lower, while output of appliances turned up and business equipment posted another solid gain. The overall factory operating rate edged down to 82.1 percent in July, the lowest level since last October.

Production of motor vehicles and parts has been a volatile component of industrial production throughout 1997. In July, production fell short of schedules made at the beginning of the month by more than 1 million units at an annual rate. Strikes at General Motors accounted for about 400,000 units of the underbuild; in addition, the company's start-up following the companywide shutdown was slower than expected, in part because of quality concerns. General Motors and Chrysler also curtailed output of a few models whose inventories were excessive; however, these losses were more than offset by stepped-up production at transplants. At the end of July, stocks of light trucks were at about 68 days' supply, just a little on the high side, while the days' supply of autos was running at a lean 54 days.

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

	1997				
			----------scheduled----------		
	Q2	July	Aug.	Sept.	Q3
U.S. production	11.5	11.0	12.8	13.0	12.3
Autos	5.7	5.8	6.3	6.4	6.2
Trucks	5.8	5.2	6.5	6.6	6.1
Days' supply					
Autos	60.6	54.3	...	...	...
Light trucks	78.6	67.9	...	...	...

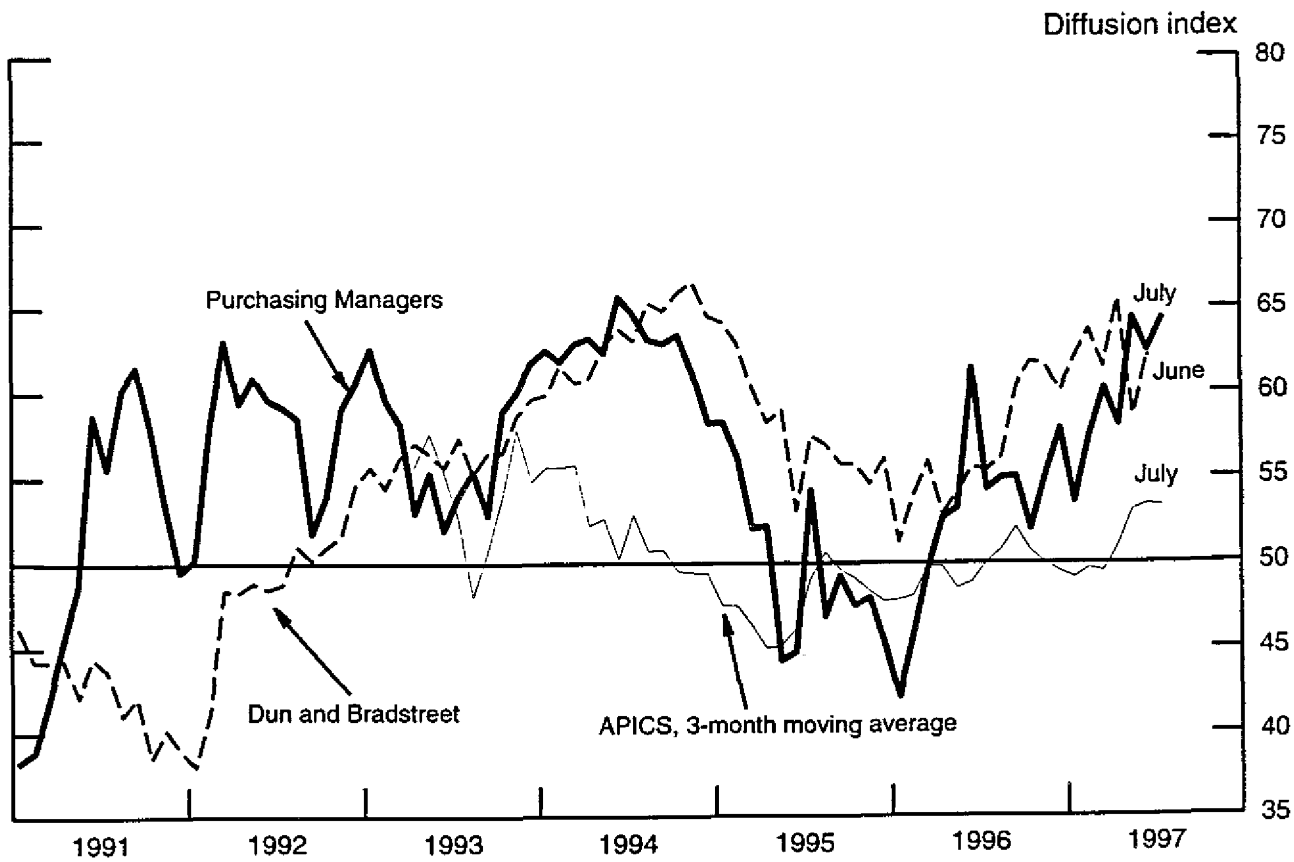
Note. Components may not sum to totals because of rounding.

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

	Share, 1997:H1	1997 Q1	1997 Q2	1997 Apr.	May	June
Total durable goods	100.0	1.9	1.1	1.8	-.4	2.4
Adjusted durable goods[1]	69.0	4.5	1.4	.8	.6	.4
Computers	5.0	.1	-1.6	-1.1	1.1	-3.7
Nondefense capital goods excluding aircraft and computers	17.0	7.2	.3	-1.6	-1.1	3.3
All other categories	47.0	4.0	2.2	1.9	1.1	-.2
Memo:						
Real adjusted orders[2]		4.7	2.3	1.3	1.3	.2

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.

Indicators of Future Production: New Orders Indexes



Note. Indexes above 50 indicate orders are increasing, and indexes below 50 indicate orders are decreasing.

After growing strongly in the first half of the year, production of consumer durable goods outside of motor vehicles surged another 2.1 percent in July, as output of appliances and computers rose smartly. In contrast, output of consumer nondurables, which accounts for about one-fourth of total industrial production excluding motor vehicles, contracted 0.3 percent in July.

The production of business equipment has continued to grow briskly. Although output of industrial equipment was down for a third month, information processing equipment posted another substantial gain, jumping 0.7 percent in July after increases of more than 12 percent at an annual rate in the first half. Transit equipment, mainly civilian aircraft, also grew rapidly, in large part because of Boeing's increased production. Although the media have reported that Boeing is facing difficulties in ramping up production further, our contacts at Boeing reiterated that current production is running as planned and that the 1997 schedules will be met. Construction supplies edged down again in July after growing moderately in the first half of this year, but materials output posted a strong gain, largely reflecting gains in semiconductors.

The various indicators of future production continue to be upbeat. The new-order index from the National Association of Purchasing Managers for July was at a historically high level. Likewise, new-order indexes from the American Production and Inventory Control Society and Dun and Bradstreet also indicated that orders are growing. Additionally, recent data from the Bureau of the Census continue to show an uptrend in new orders for durable goods.

Motor Vehicles

Sales of new light vehicles in July, adjusted for shifts in reporting periods, were 15.5 million units at an annual rate, well above the second-quarter pace of 14.7 million units. The dip in sales in the second quarter and the subsequent spurt in purchases in July reflected, in part, the effects on supplies of several UAW strikes and the limited availability of some popular Japanese models during the spring. Cutting through the volatility in the monthly data, the underlying trend of sales seems to have remained near 15 million units--the rate that had prevailed since the second half of 1995.

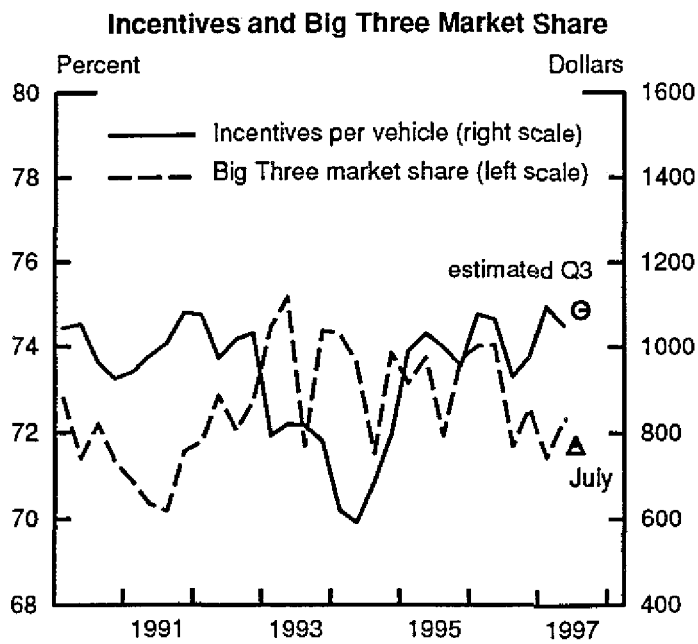
Sales are expected to be buffeted by supply problems again this month. As noted earlier, overall production in July fell well short

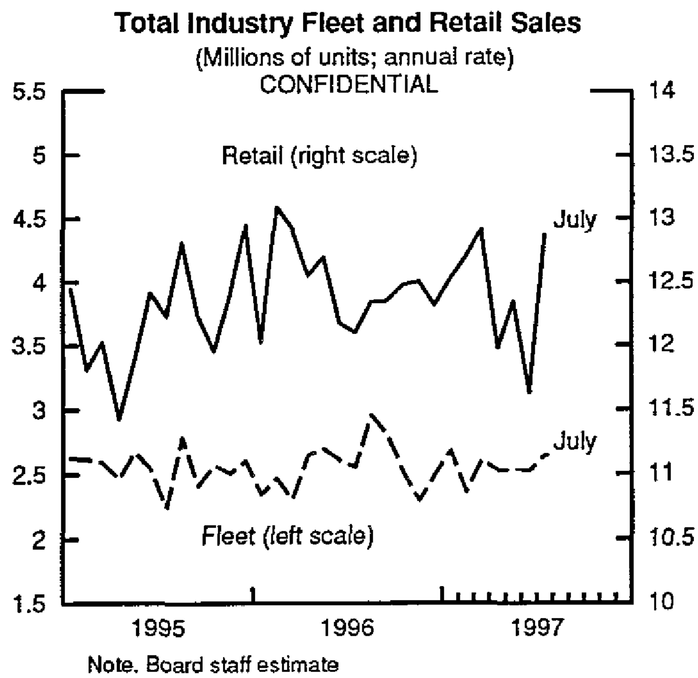
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
Total	14.7	15.1	14.9	15.3	14.5	14.9	14.2	15.5
Adjusted[1]	14.7	15.0	14.7	15.2	14.7	14.8	14.5	15.5
Autos	8.6	8.5	8.1	8.5	8.0	8.1	7.9	8.5
Light trucks	6.1	6.6	6.7	6.7	6.5	6.8	6.3	7.0
North American[2]	12.8	13.4	13.1	13.3	12.7	13.0	12.3	13.5
Autos	7.1	7.3	6.8	7.2	6.7	6.9	6.6	7.1
Big Three	5.4	5.3	4.9	5.1	4.8	4.9	4.7	5.1
Transplants	1.7	2.0	2.0	2.1	1.9	1.9	1.9	2.0
Light trucks	5.7	6.1	6.3	6.2	5.9	6.2	5.7	6.4
Foreign produced	1.9	1.7	1.8	1.9	1.8	1.8	1.8	2.0
Autos	1.5	1.3	1.3	1.4	1.3	1.2	1.3	1.4
Light trucks	.4	.4	.5	.5	.6	.6	.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





of plans at the beginning of the month because of strikes and start-up problems at General Motors. Although lean inventories may depress sales somewhat this month, these supply disruptions should be short-lived; General Motors resolved many of its production problems by the end of July and is, for the moment, strike-free.[5]

Based on confidential data from General Motors and Ford, retail demand so far this year seems well-maintained; through July, the average pace of sales was nearly the same as in 1996.[6] Overall fleet sales so far this year are also little changed from the strike-affected level in 1996, as some supply-related shortfalls in sales continued at GM; according to GM, these sales are expected to pick up later this year as these supply constraints ease.

The Michigan SRC survey indicates that consumers' attitudes toward car-buying conditions remained upbeat in July, largely because of favorable pricing. We expect that pricing, from the consumers' perspective, will remain favorable in the near term. Incentives offered by the Big Three should continue to be generous as these firms attempt to regain, or at least prevent further erosion of, market share. In addition, announcements of price increases for the 1998 models have been quite modest so far. For example, Ford's overall vehicle prices will be unchanged, while those for General Motors will increase an average of about 1.3 percent on a comparably equipped basis. Moreover, design modifications for some popular foreign nameplates will reduce their prices, putting additional pressure on the Big Three.

Consumption and Personal Income

After a lull in the early spring, consumer spending has picked up in the past couple of months. Moreover, the fundamentals driving consumption growth remain quite favorable: Real income gains have been strong this year, household net worth has continued to rise,

5. The UAW and GM reached an agreement over the past weekend, averting a strike at a Cadillac assembly plant. At present, fewer than ten UAW locals are without contracts. Of these, a couple of key parts plants remain vulnerable to possible strikes. One of these plants--a transmission facility in Ypsilanti, Michigan--faces a strike deadline on Friday, August 15. Another possible strike dispute is brewing at a Ford parts plant in Ypsilanti: The UAW local has asked workers for a strike authorization vote in case negotiations with Ford break down (main issues are health and safety).

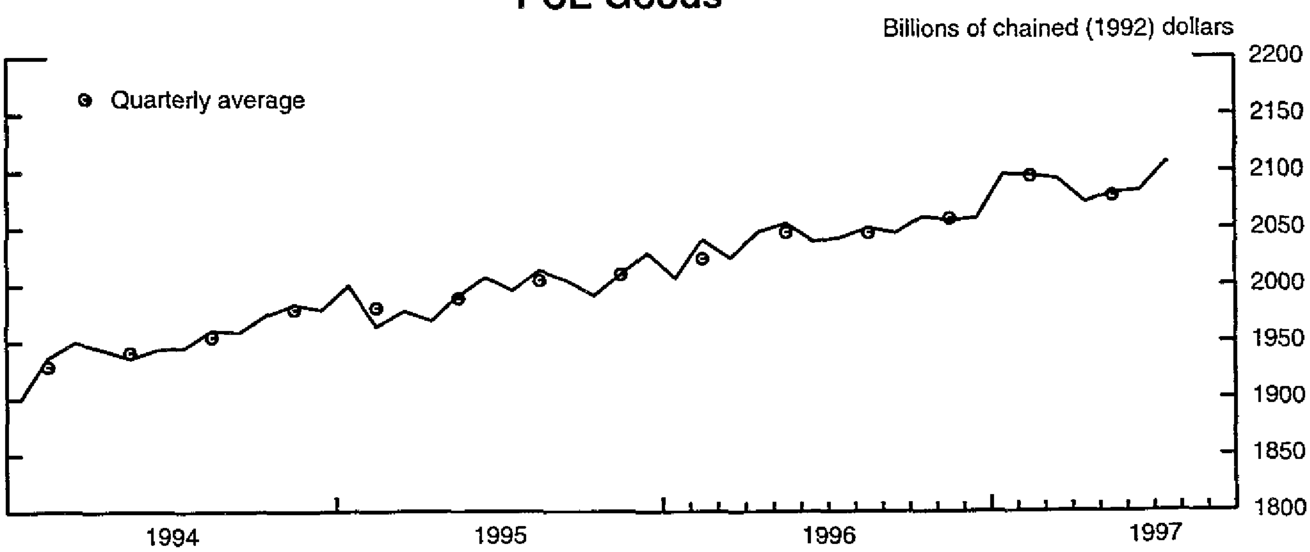
6. The retail and fleet figures are not corrected for shifts in reporting period, which exaggerate the monthly volatility in both series.

RETAIL SALES
(Percent change; seasonally adjusted)

	1997		1997		
	Q1	Q2	May	June	July
Total sales	2.7	-.9	-.3	.7	.6
Previous estimate		-.9	-.3	.5	
Building materials and supplies	4.4	1.9	-.4	.9	.9
Automotive dealers	3.8	-2.8	-1.0	1.4	1.0
Retail control[1]	2.1	-.4	.0	.4	.5
Previous estimate		-.4	.0	.4	
GAF	3.1	.3	.7	.7	.3
Durable goods	2.2	-.7	-.5	.5	-.0
Furniture and appliances	2.5	2.1	.5	.2	-.4
Other durable goods	2.0	-3.0	-1.3	.7	.3
Nondurables	2.1	-.3	.1	.4	.6
Apparel	2.4	-.4	1.3	1.2	.2
Food	.7	-.5	-.2	-.2	.4
General merchandise	3.6	-.2	.6	.8	.7
Gasoline stations	1.9	-3.3	-1.7	-.1	.8
Other nondurables[2]	2.2	.8	.4	.5	.7
Eating and drinking	2.1	-.6	.0	.4	.4
Drug and proprietary	3.2	.8	.2	.3	.9

1. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.
2. Also includes liquor stores and mail order houses.

PCE Goods



Note. Data for second quarter, May, June and July are staff estimates.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 June
			- - - Annual rate		- - -	Monthly rate	
PCE	2.2	2.7	3.3	5.3	.8	.3	.1
Estimated revision[1]					.8	.3	.1
Durables	3.0	3.9	3.5	14.1	-5.7	.8	-.4
Motor vehicles	-.4	-1.6	-3.1	9.9	-17.2	1.9	-1.9
Other durable goods	5.3	7.5	7.6	16.5	1.5	.2	.4
Nondurables	1.0	1.8	2.1	4.7	-2.1	.2	.3
Services	2.7	2.8	3.9	3.9	3.7	.3	.2
Energy	7.4	.7	10.5	-12.4	13.9	2.9	-1.7
Non-energy	2.4	2.9	3.6	4.7	3.3	.2	.3
Housing	1.7	1.7	1.8	2.0	2.1	.1	.2
Household operation	4.3	2.0	7.1	.3	6.5	.7	.6
Transportation	4.9	4.2	3.3	4.8	1.4	.0	.5
Medical	2.2	2.5	4.3	4.2	3.7	.3	.3
Other	2.3	4.3	3.8	8.3	3.7	.1	.1

Note. Derived from billions of chained (1992) dollars.
1. Staff estimate of revised PCE growth based on July retail sales report.

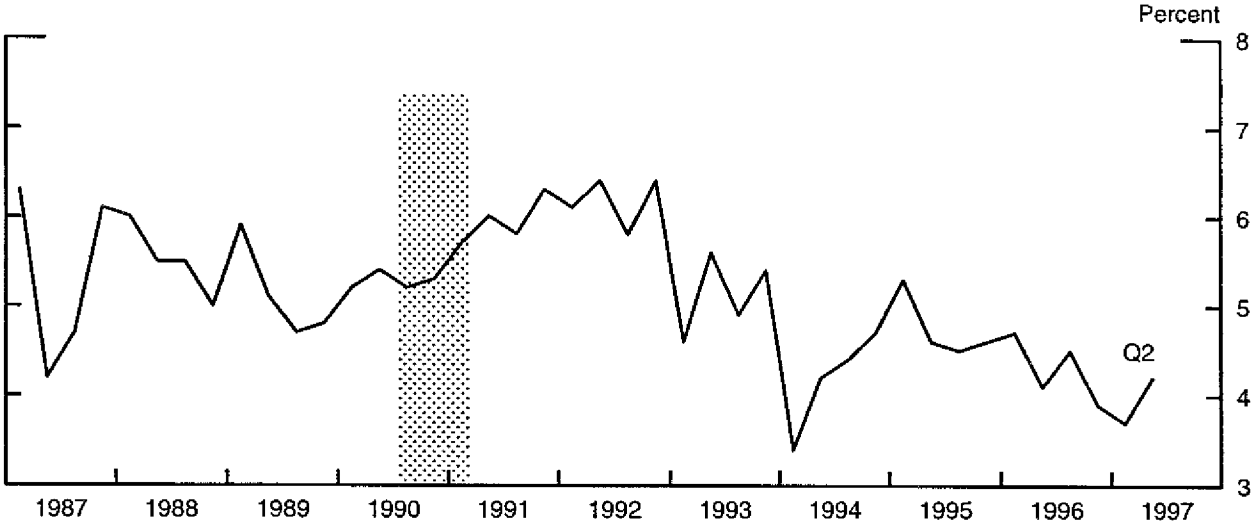
PERSONAL INCOME
(Average monthly percent change)

	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 Apr.	1997 May	1997 June
	- Q4/Q4	-		Annual rate		- - Monthly rate		- -
Total personal income	5.2	5.8	4.8	8.0	5.1	.2	.3	.6
Wages and salaries	5.0	6.4	6.0	8.3	5.4	.0	.3	.8
Private	5.4	7.1	6.9	8.9	6.0	.0	.4	1.0
Other labor income	-.9	.7	.7	3.2	2.8	-.1	.4	.5
Less: Personal tax and nontax payments	8.9	12.5	11.8	15.1	11.5	.6	.9	1.1
Equals: Disposable personal income	4.7	4.8	3.7	6.8	4.0	.1	.3	.5
Memo:								
Real disposable income[1]	2.4	2.0	.7	4.6	3.0	.0	.3	.4
Saving rate (percent)	4.8	4.3	3.9	3.7	4.2	4.2	4.1	4.4

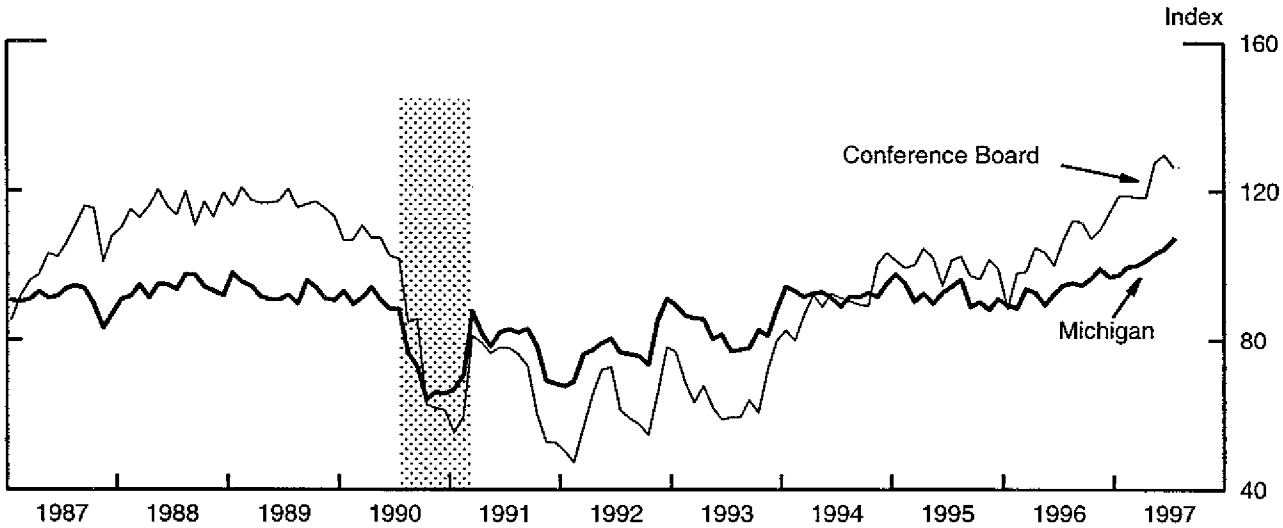
Note. Derived from BEA's advance estimates.
1. Derived from billions of chained (1992) dollars.

Household Indicators

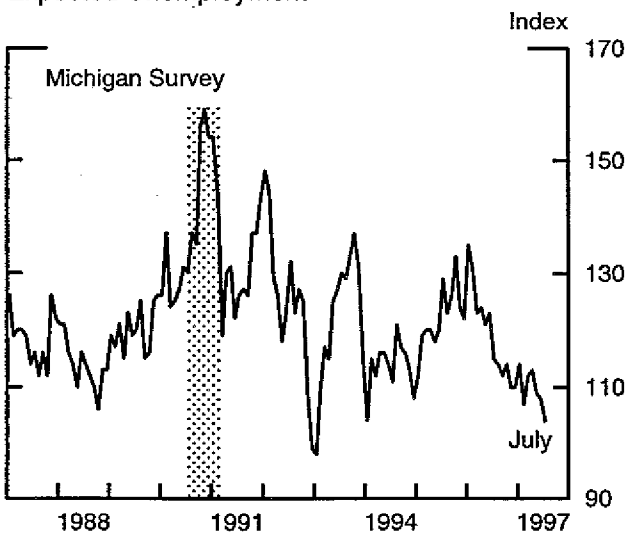
NIPA Personal Saving Rate



Consumer Confidence

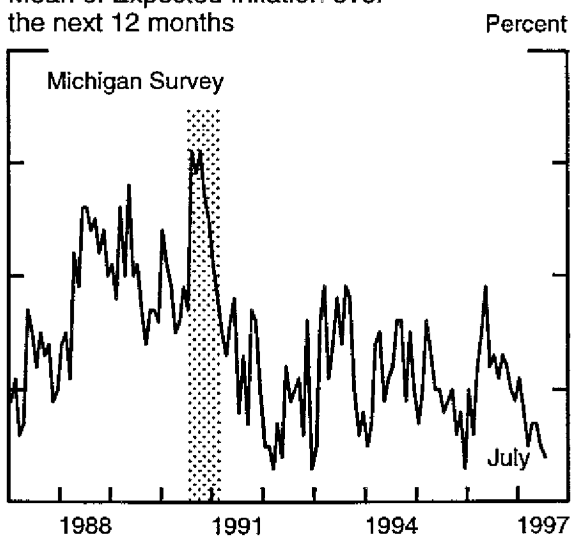


Expected Unemployment



Note: Percentage expecting more unemployment over the next 12 months minus those expecting less plus 100.

Mean of Expected Inflation over the next 12 months



and consumer sentiment is buoyant. In addition, credit is readily available to most consumers.

In the second quarter, PCE edged up just 0.8 percent at an annual rate after an increase of more than 5 percent in the first quarter. The deceleration was most evident in consumer durables, but spending on nondurables also dropped back after a strong first-quarter advance. In contrast, spending on services maintained the brisk rise observed in the previous two quarters because a rebound in spending on energy services offset some slowing in consumption of non-energy services.

The only spending data available for the third quarter are for goods. Total nominal retail sales moved up 0.6 percent in July. Nominal outlays in the retail control category, which excludes sales at automotive dealers and at building material and supply stores, rose 0.5 percent. The July retail sales report, together with the data on motor vehicles sales, suggests that real personal consumption expenditures for goods rose 1.2 percent in July, to a level about 1-1/2 percent above the second-quarter average.

Real disposable personal income rose at a 3-3/4 percent annual rate over the first half of the year, but it likely was held down in July by the weakness in weekly earnings. Nonetheless, the substantial rise in payroll employment in July suggests that the underlying trend in real income growth remains sound despite the monthly gyrations in the data.

Over the past year and a half, capital gains from the stock market have continued to push up the ratio of household net worth to disposable income. The revised NIPA data now show a decline in the personal saving rate over this span, consistent with the presence of a wealth effect spurring spending. Moreover, with the wealth-to-income ratio moving up further recently, household financial conditions appear likely to remain a factor supporting spending over the coming quarters.

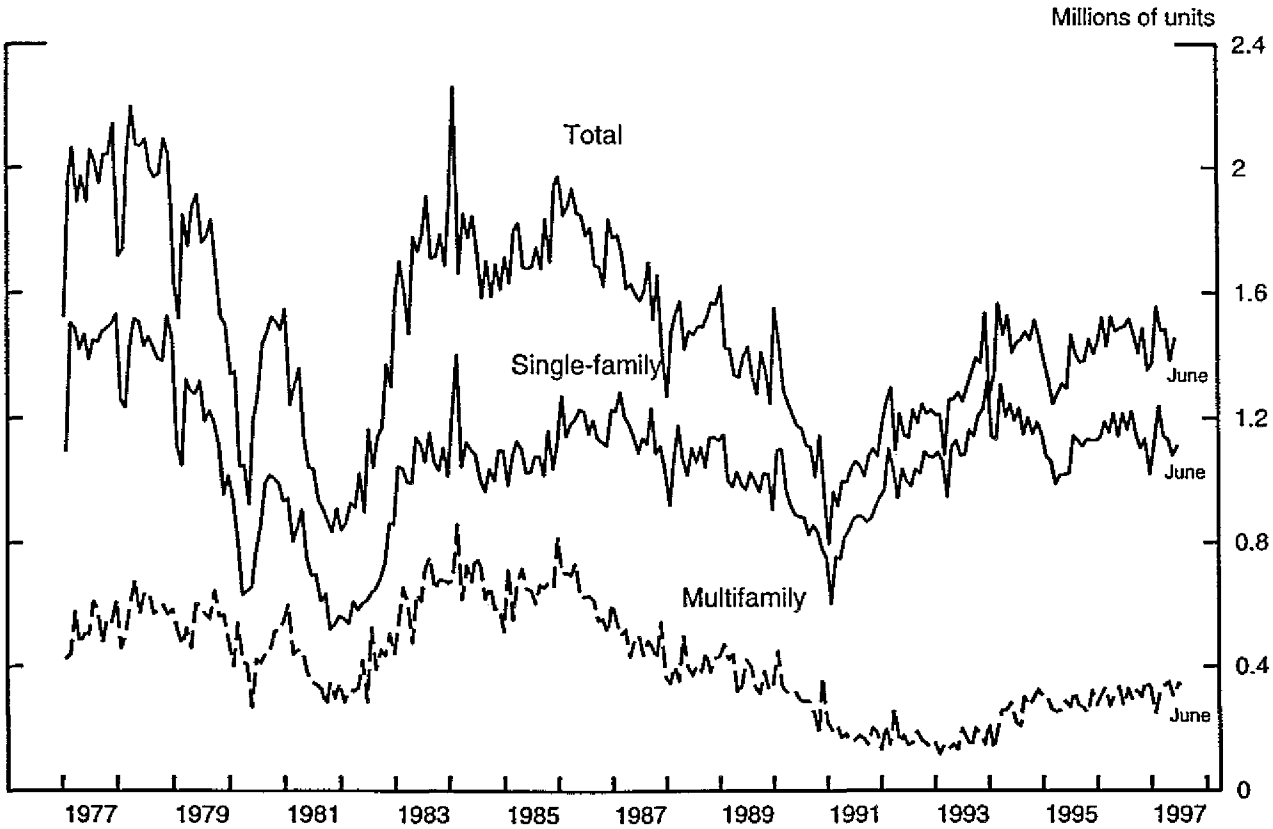
Consumer sentiment has also continued to climb in recent months, with the Michigan SRC index posting another historical high in July. Respondents to this survey continue to view their personal financial situations and business conditions very favorably. In addition, they remain optimistic about both business conditions and labor market prospects over the coming year. One factor presumably underlying consumers' buoyant outlook is lower expected inflation. The mean expected inflation over the next twelve months continued

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

		1996	1997				
	1996	Q4	Q1r	Q2p	Apr.r	May r	June.p
All units							
Starts	1.48	1.42	1.47	1.44	1.48	1.39	1.45
Permits	1.43	1.38	1.43	1.42	1.44	1.43	1.40
Single-family units							
Starts	1.16	1.09	1.17	1.11	1.13	1.08	1.11
Permits	1.07	1.01	1.05	1.05	1.06	1.05	1.05
New home sales	.76	.76	.82	.79	.76	.77	.82
Existing home sales	4.09	4.00	4.10	4.15	4.06	4.25	4.14
Multifamily units							
Starts	.32	.33	.30	.33	.35	.30	.34
Permits	.36	.38	.38	.37	.38	.38	.35
Mobile homes							
Shipments	.36	.35	.35	n.a.	.37	.36	n.a.

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

Private Housing Starts
(Seasonally adjusted annual rate)



its recent downward trend and was 3.4 percent in July, almost a full percentage point below its July 1996 level. And although the median expected inflation over the next twelve months was down less than the mean, the latest reading, at 2.7 percent, in July is one of the lowest in the past twenty years. The Conference Board index of consumer sentiment pulled back a bit in July but remained at a very high level.

Housing Markets

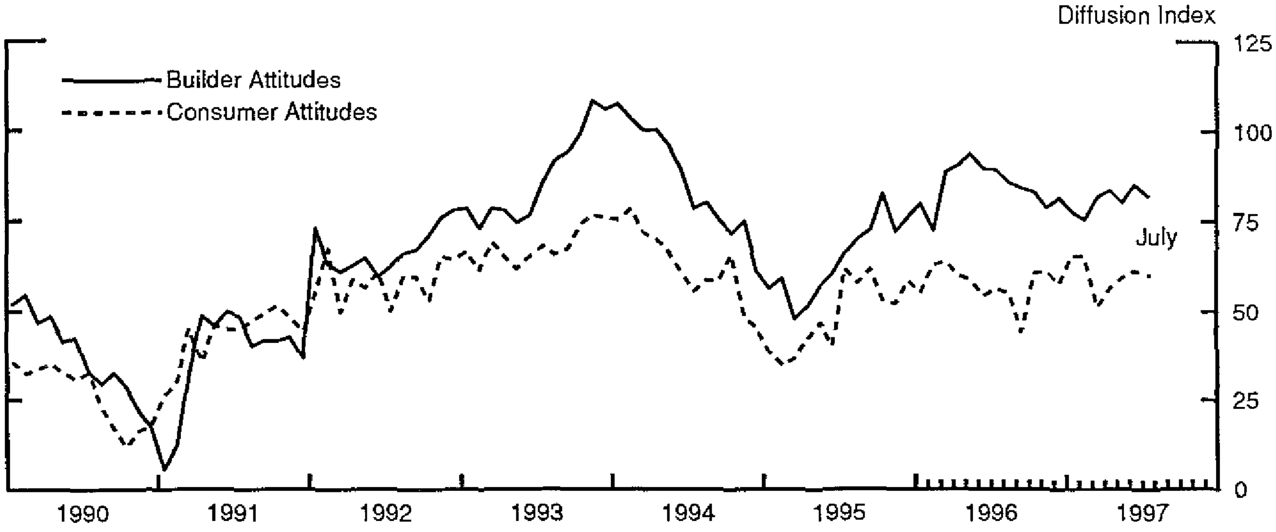
Housing activity maintained a healthy pace last quarter. Starts in the single-family sector averaged 1.11 million units in June and for the second quarter as a whole. This level is somewhat below the average for the two preceding quarters--a reference point that balances out most of the weather-induced volatility in starts seen late last year and early this year--and might be interpreted as a sign of some deceleration in this sector. However, permit issuance for single-family construction, which we view as a better indicator of construction activity, held at a robust 1.05 million unit rate in the second quarter.

Recent indicators of housing demand have also been relatively favorable. The Census report on sales of new homes is still subject to some question.[7] But, taken at face value, sales, which were at their strongest pace in eighteen years in the first quarter, fell back in April and May before rebounding in June. Cutting through the ups and downs, which may reflect, in part, the swings in mortgage rates last spring, new-home sales in the second quarter averaged 785,000 units at an annual rate, 3-1/2 percent above the 1996 pace. Sales of existing homes (measured mainly at settlement, rather than contract) declined a bit in June, but the average level of these sales during the second quarter was up about 1-1/2 percent from the strong 1996 pace. Among the indicators for July, builders' rating of the strength of new-home sales and consumer attitudes toward homebuying edged down, although each of them remained at a relatively healthy level. In addition, applications for mortgages to finance home purchases reached a record high in mid-July and continued to be strong in early August.

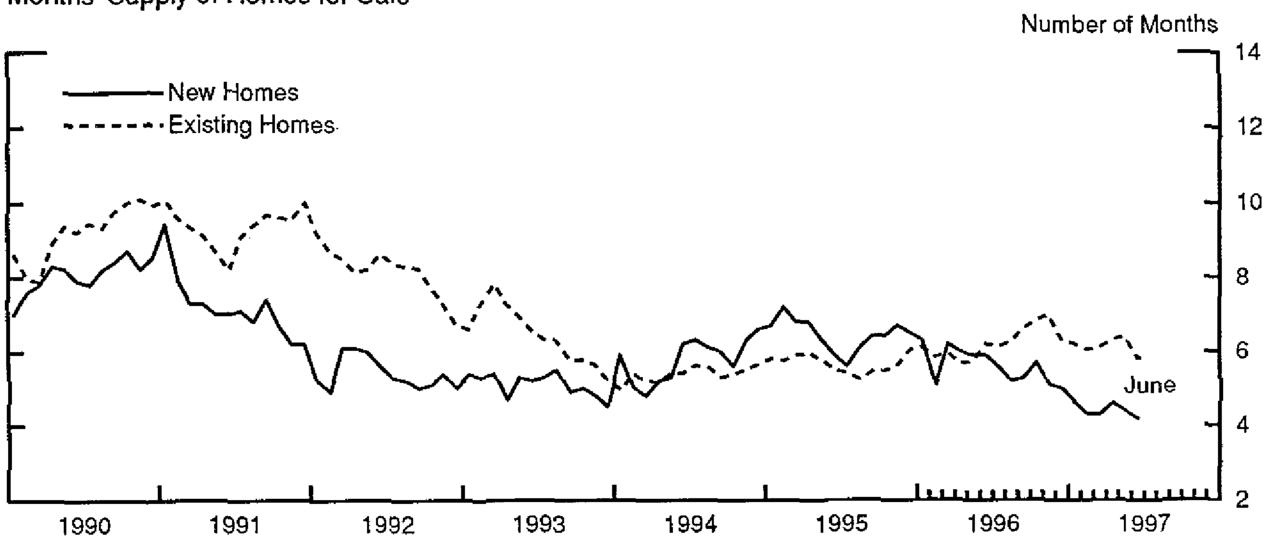
7. With the release of new-home sales figures for June, the Census Bureau has completed the transition to a new data collection procedure. During the past year or so, while this transition has been in progress, the reliability of the new-home sales figures has been uncertain.

Indicators of Housing Demand and Supply

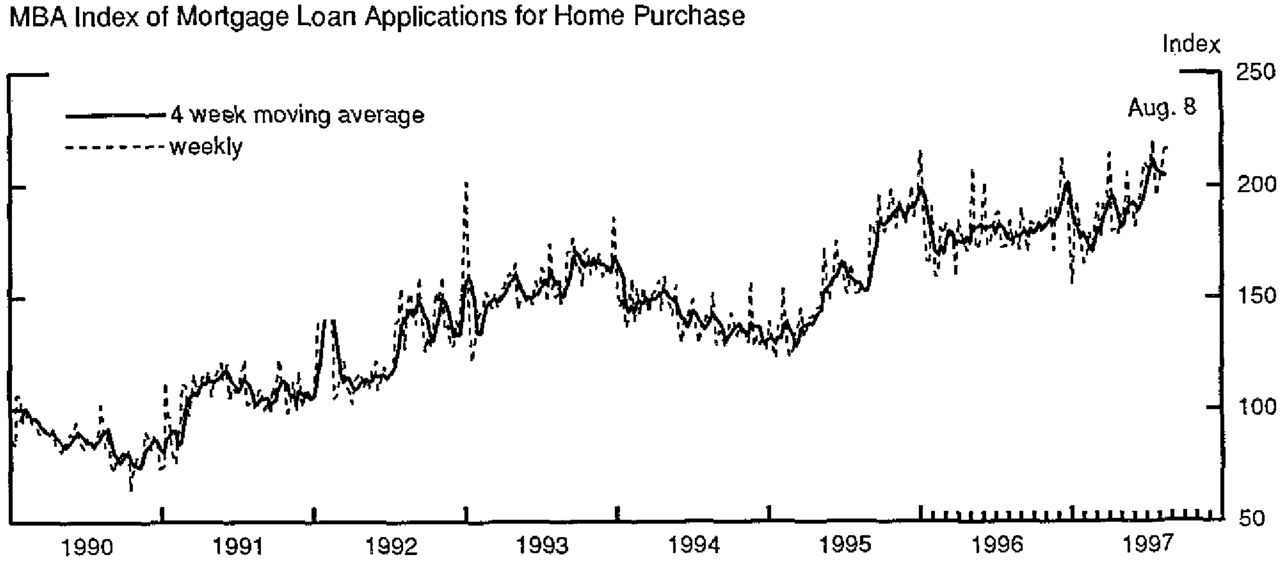
Attitudes toward Homebuilding and Homebuying



Months' Supply of Homes for Sale



MBA Index of Mortgage Loan Applications for Home Purchase



The strength of home sales has reduced the stock of both new and existing homes for sale, but the decline in new-home inventories has been especially notable. According to Census data, the months' supply of new homes for sale fell to 4.2 months in June, one of the lowest observations on record. However, information from Census Bureau analysts suggests that the extent of the inventory decline in recent months may be overstated. Part of the decline stems from the Census Bureau's new data collection procedure, which identifies some units that were included in the "for sale" inventory but that no longer were on the market. These units should have been removed from the inventory of new homes for sale in years past, but Census was unable to identify them until it introduced its new procedures.

Multifamily housing starts jumped nearly 13 percent in June, offsetting most of the falloff that occurred in May. For the second quarter as a whole, these starts were about 5 percent above the average pace in the preceding two quarters. However, permit issuance for multifamily units declined about 2 percent in the second quarter, suggesting that the recent strength in these starts may not be sustainable.

Business Fixed Investment

Real business fixed investment accelerated in the second quarter, increasing at an annual rate of 14-1/2 percent following a downward-revised first quarter advance of 4 percent.[8] The acceleration in the second quarter owed almost entirely to a surge in real outlays for producers' durable equipment. Underlying the surge was continued healthy growth in corporate cash flow and the delayed effects of the acceleration in business output around the turn of the year, along with the ongoing price declines for computing equipment and a pickup in aircraft deliveries.

Real business purchases of office and computing equipment posted another large gain in the second quarter, rising at a 32 percent annual rate. The rapid growth in real outlays on office and computing equipment seems likely to continue into the current quarter: Demand for personal computers and networking equipment remains strong, and the steep price declines that have been driving

8. Both NRS and PDE were revised down in the first quarter. The PDE revision largely reflected two factors: a change in BEA's seasonal factors for aircraft, and the smaller weights given to the fast-growing computer and computer parts components under BEA's new quarterly chain aggregation due to the rapid decline in the relative price of computers. Changes in NRS were basically caused by the annual revision to the construction put-in-place data.

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

	1996	1997		1997		
	Q4	Q1	Q2	Apr.	May	June
Producers' durable equipment						
Shipments of nondefense capital goods	1.5	1.4	5.1	1.6	-.1	1.3
Excluding aircraft and parts	.8	.8	3.7	.4	.3	2.4
Office and computing	-.7	2.6	.5	-2.0	1.6	.6
Communications equipment	4.1	-1.0	6.1	-3.8	5.1	1.8
All other categories	.5	.6	4.3	2.4	-1.3	3.3
Shipments of complete aircraft[1]	21.1	-7.8	30.6	5.5	2.0	-15.8
Sales of heavy trucks	-5.5	7.3	-1.8	-.4	.8	-11.9
Orders of nondefense capital goods	.2	2.5	-.9	-1.7	1.1	5.4
Excluding aircraft and parts	-.8	5.5	-.1	-1.5	-.6	1.7
Office and computing	-.6	.1	-1.6	-1.1	1.1	-3.7
Communications equipment	3.7	12.4	4.6	-8.0	8.1	13.8
All other categories	-1.9	5.9	-.8	.1	-3.4	.4
Nonresidential structures						
Construction put in place, buildings	5.2	1.8	-1.4	-2.5	4.4	-2.8
Office	2.2	4.1	-4.3	-4.9	4.0	3.1
Other commercial	5.6	2.7	-5.4	-6.0	5.8	-8.6
Institutional	7.5	4.6	5.4	7.5	-4.2	-3.6
Industrial	4.6	-4.2	-2.7	-3.5	5.6	1.3
Lodging and miscellaneous	6.8	2.7	5.9	-2.4	12.1	-2.2
Rotary drilling rigs in use[2]	-1.6	16.2	11.9	.8	2.5	2.2
Memo:						
Business fixed investment	5.9	4.1	15.1	n.a.	n.a.	n.a.
Producers' durable equipment	2.6	6.7	20.4	n.a.	n.a.	n.a.
Office and computing	31.0	27.9	32.6	n.a.	n.a.	n.a.
Communications equipment	-5.6	10.3	5.3	n.a.	n.a.	n.a.
Other equipment[3]	-2.8	6.0	20.1	n.a.	n.a.	n.a.
Nonresidential structures	15.3	-2.1	2.3	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. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

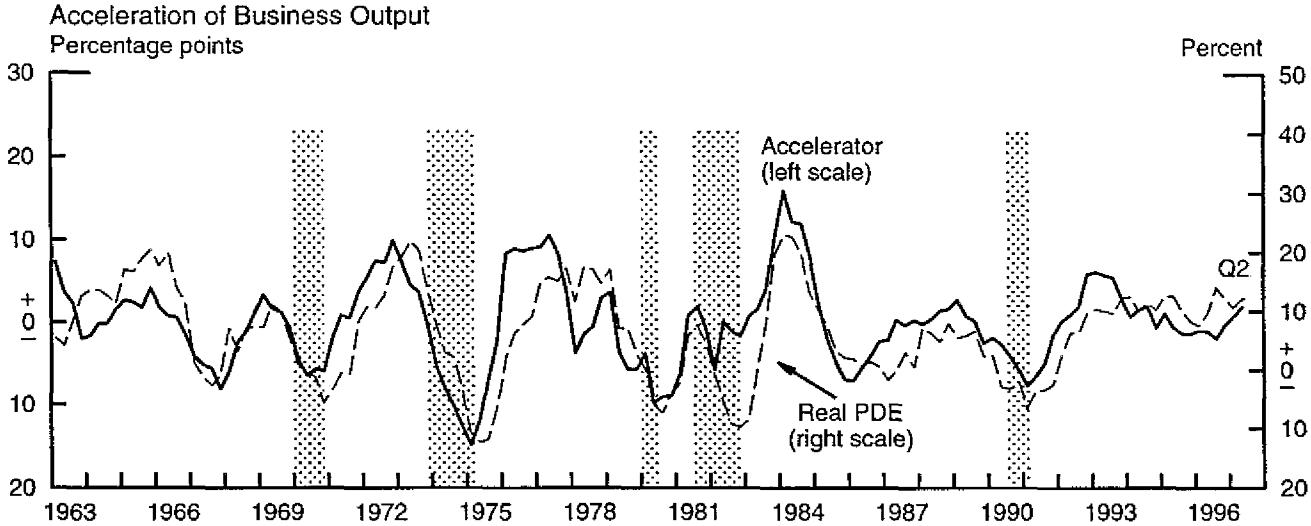
demand for some time are set to continue. In particular, Intel's recent round of price cuts for Pentium processors, which went into effect at the beginning of August, will be even deeper than previously expected and will include price reductions of 40 percent on the newer MMX chips; computer manufacturers already have begun to cut prices aggressively on complete systems.

Growth in real outlays for communications equipment slowed to a 5-1/2 percent increase at an annual rate in the second quarter. However, orders for communications equipment were up sharply in May and June, suggesting the potential for a larger gain in outlays in the current quarter. Telecommunications deregulation should continue to have a positive impact on spending on communications equipment. Although long distance providers have thus far realized little revenue from their local market operations, markets are opening and investment expenditures by these companies have proceeded apace. In particular, despite a recent U.S. Appeals Court ruling against the FCC's pricing rules for the fees that local phone companies can charge competitors for access to local networks, Bell Atlantic-Nynex has agreed to follow FCC guidelines, a move that is likely to speed up the process of increasing competition in local and long distance phone markets.

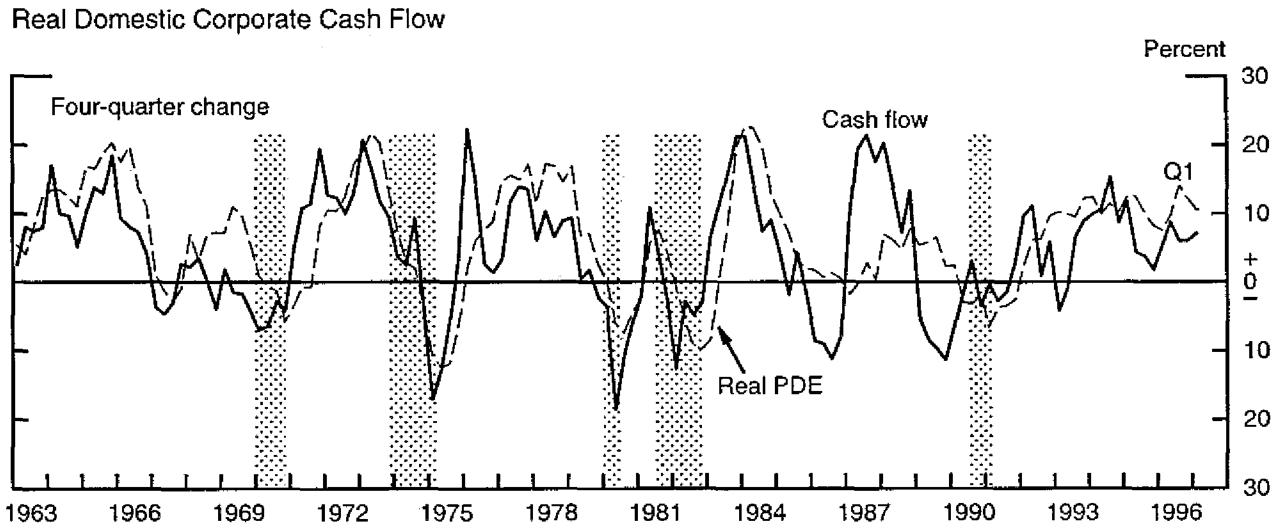
Outside of information technology, expenditures on capital goods excluding motor vehicles took off in the second quarter, expanding at a 33 percent annual rate. This increase was partly due to a sizable pickup in domestic deliveries of aircraft; but even excluding aircraft, expenditures in this category--which had grown slowly over the previous two years--rose at a 22 percent annual rate. Orders for this category also remain strong, suggesting that the second quarter's robust growth of shipments will continue in the current quarter.

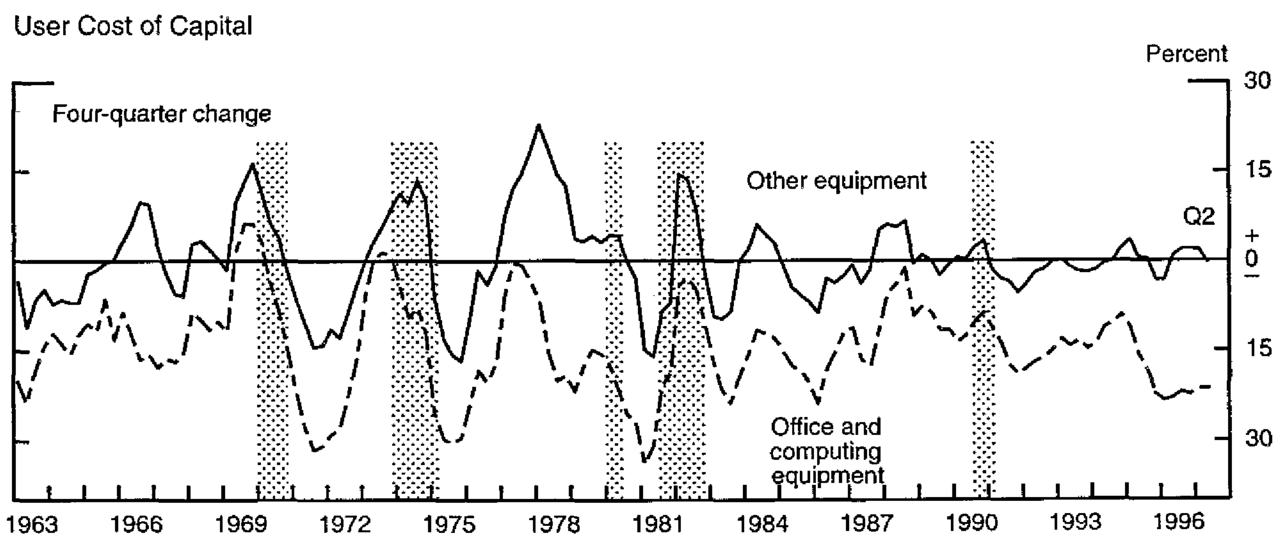
In contrast to the strength in equipment spending, the growth of expenditures on nonresidential structures has weakened this year. The annual revision to the data on construction put-in-place showed some significant changes in the timing of expenditures over the past year--revising expenditures up over the earlier part of 1996 and showing a flatter pattern over the first half of 1997. As a result, BEA's advance estimate shows little net change in outlays over the first half of this year. In addition, June's construction put-in-place data--not available for BEA's advance estimate--reported a 2 percent decline for nonresidential structures. We now estimate

Fundamental Determinants of Equipment Spending



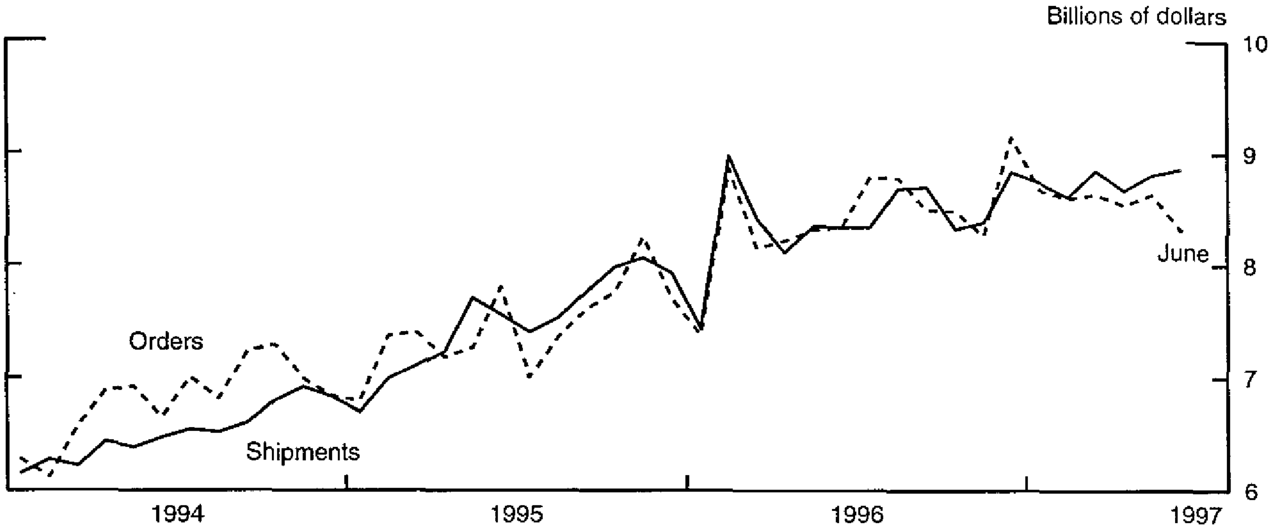
Note. The accelerator is the eight-quarter percent change in business output less the year-earlier eight-quarter percent change. Real PDE is the four-quarter percent change.



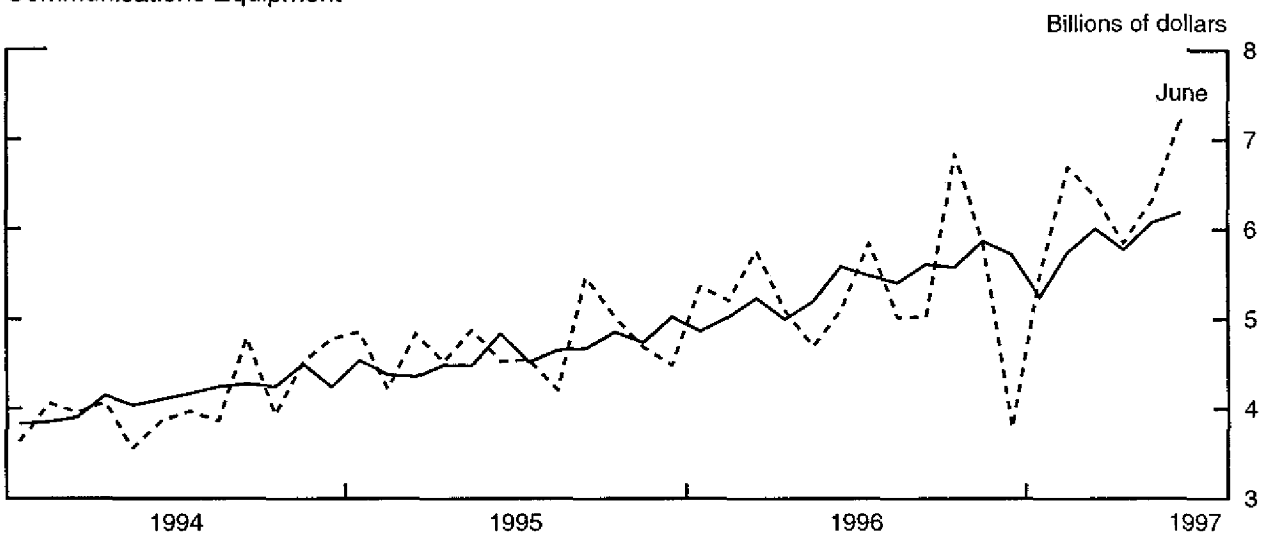


Orders and Shipments of Nondefense Capital Goods

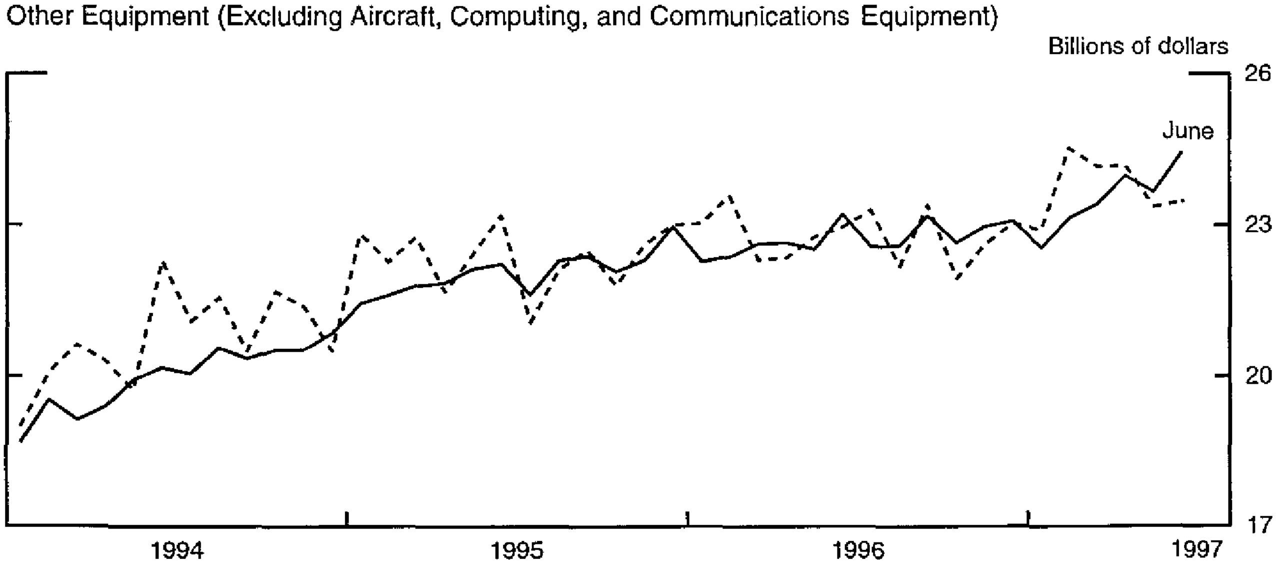
Office and Computing Equipment



Communications Equipment

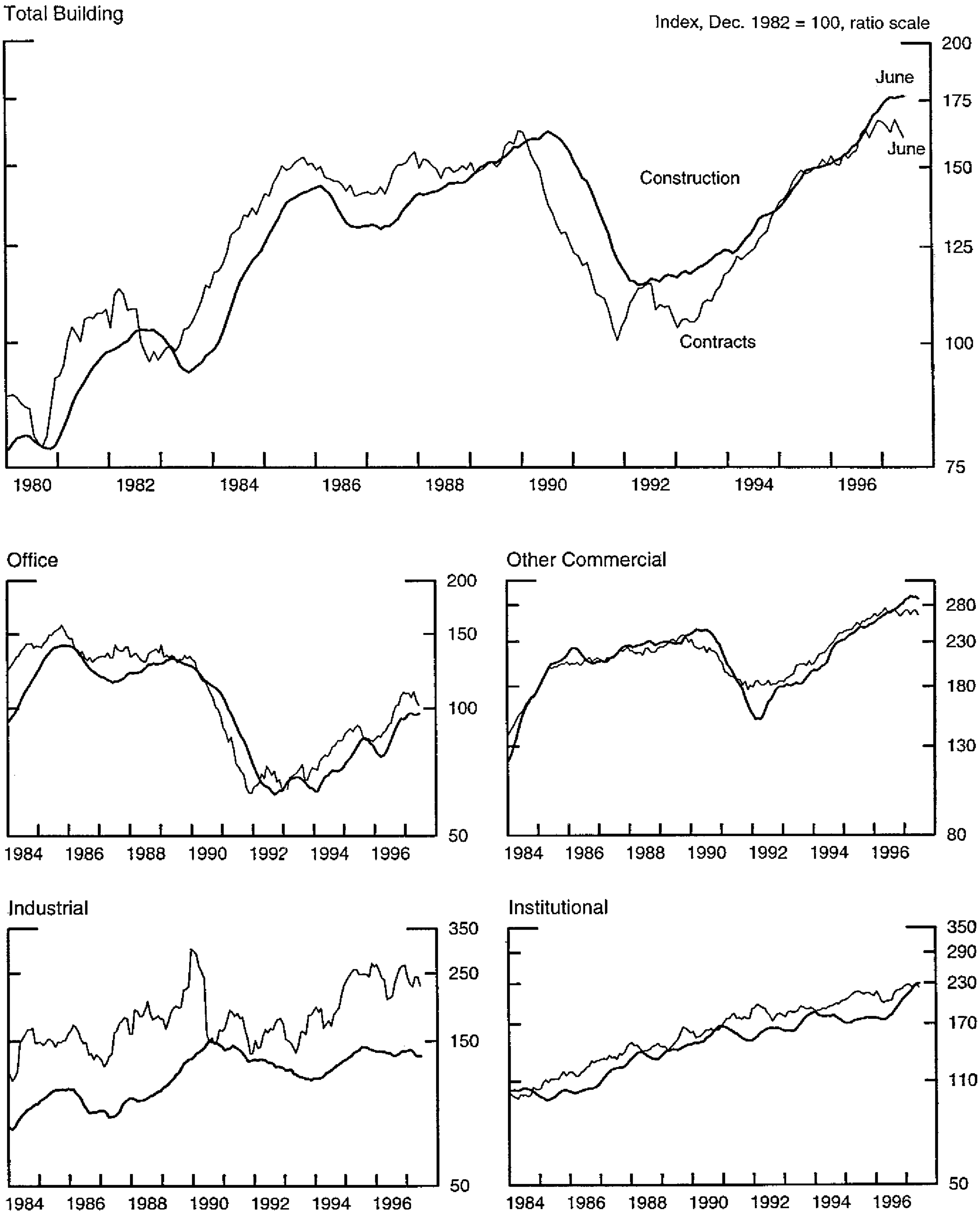


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



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

that expenditures in this category fell at a 1-1/2 percent annual rate in the second quarter.

Available indicators paint a mixed picture for future growth in nonresidential construction activity. Smoothing through their large monthly swings, contracts for construction have been relatively flat over the first half of the year, with contracts for office buildings down noticeably from their peak of late last year. But other indicators remain strong: Vacancy rates have declined, and prices for commercial real estate are edging up.

Business Inventories

Nonfarm businesses continued to accumulate inventories at a rapid rate in the second quarter. However, while this pace clearly is unsustainable, there are few signs of imbalances at this juncture.

In manufacturing, inventory investment slowed to a $16 billion annual rate (book value) in June--about half the average pace observed in April and May. For the second quarter as a whole, manufacturers invested a robust $25 billion. However, the inventory situation varied somewhat by industry last quarter. Inventories held by producers of aircraft and parts continued to rise at a brisk pace. Inventories of other nondefense capital goods also generally expanded over the second quarter, despite a dip in June. Nonetheless, orders and shipments of nondefense capital goods were generally robust, and the June inventory-shipments ratio for goods in this category was the lowest in recent years. Outside of capital goods, stocks held by producers of motor vehicles and other automotive products were drawn down substantially, while inventories in several consumer goods-oriented industries--fabricated metal products, food, textile, and apparel--expanded. Although factory stocks at midyear generally were well-aligned with orders and shipments, inventory-shipments ratios for several nondurable goods industries appeared a bit high in June.

In wholesale trade, nonvehicle inventories rose sharply in June after little net change in the preceding two months. In addition to a substantial buildup in stocks of business equipment, inventories held by some distributors of consumption goods--lumber, hardware and plumbing, alcoholic beverages, and drug store supplies--also posted significant increases. Despite a sizable jump in June, the inventory-sales ratio for the wholesale trade sector remained in the relatively narrow range seen over the past year. In retail trade,

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

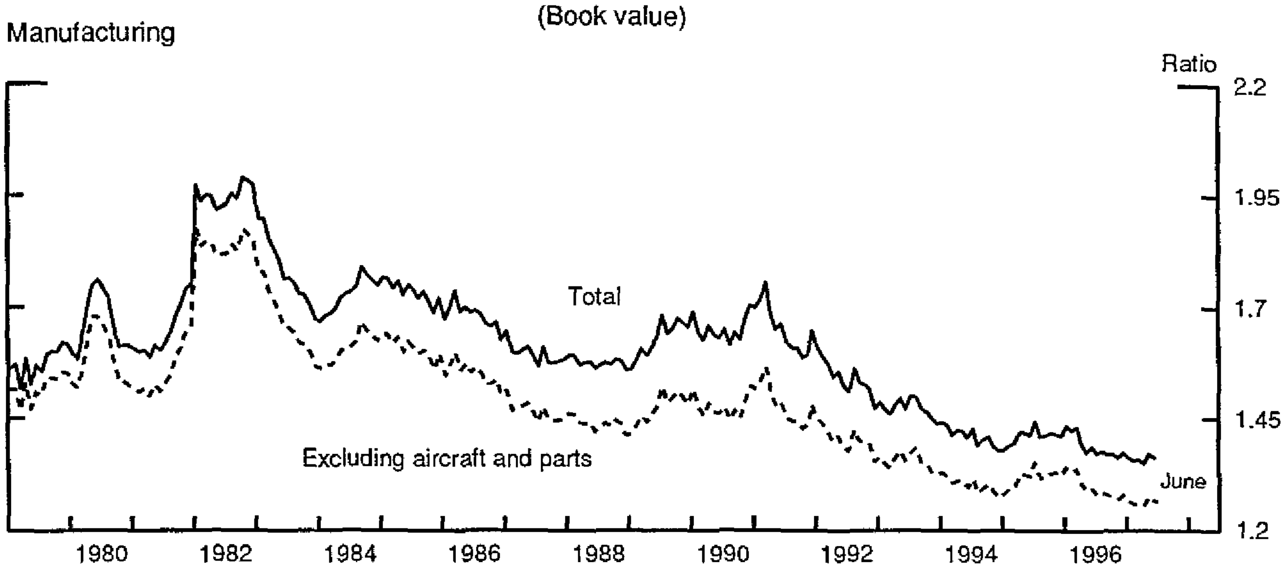
	1996	1997		1997		
	Q4	Q1	Q2	Apr.	May	June
Book value basis						
Total	16.0	35.8	50.3	45.3	22.5	83.0
Excluding wholesale and retail motor vehicles	22.2	30.9	49.1	46.8	35.1	65.4
Manufacturing	7.0	16.5	25.0	35.4	23.4	16.1
Excluding aircraft	2.5	9.1	20.0	29.3	22.0	8.5
Wholesale	4.1	14.3	18.2	-16.1	11.8	58.8
Excluding motor vehicles	6.0	11.5	13.5	-8.2	6.4	42.3
Retail	4.9	5.0	7.2	26.0	-12.7	8.1
Auto dealers	-4.3	2.1	-3.5	6.4	-18.0	1.2
Excluding auto dealers	9.1	2.8	10.6	19.7	5.3	7.0

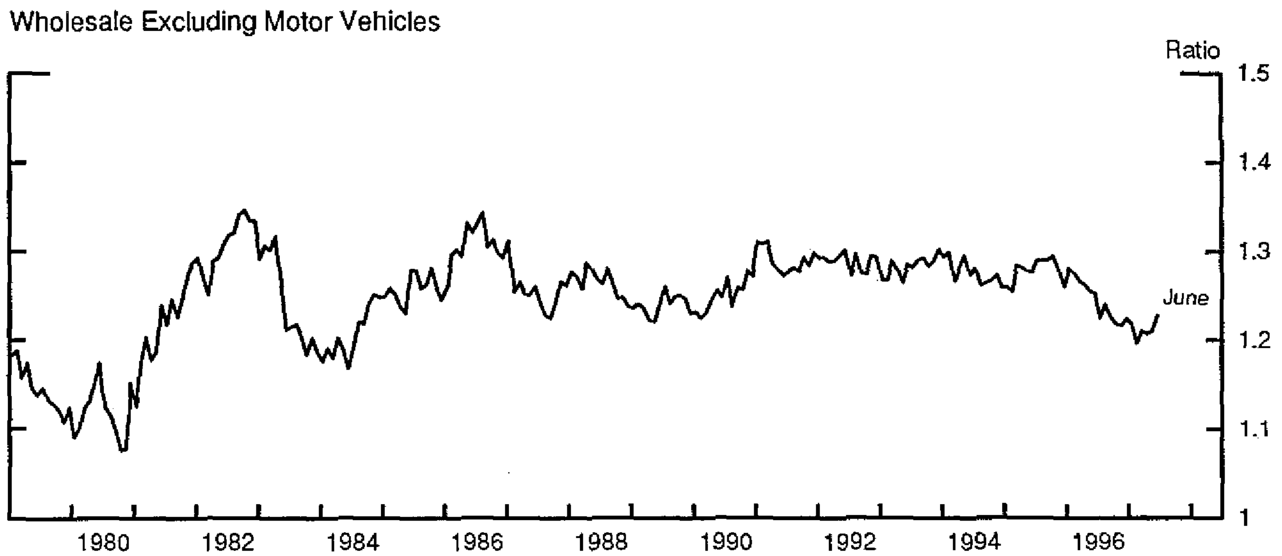
SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

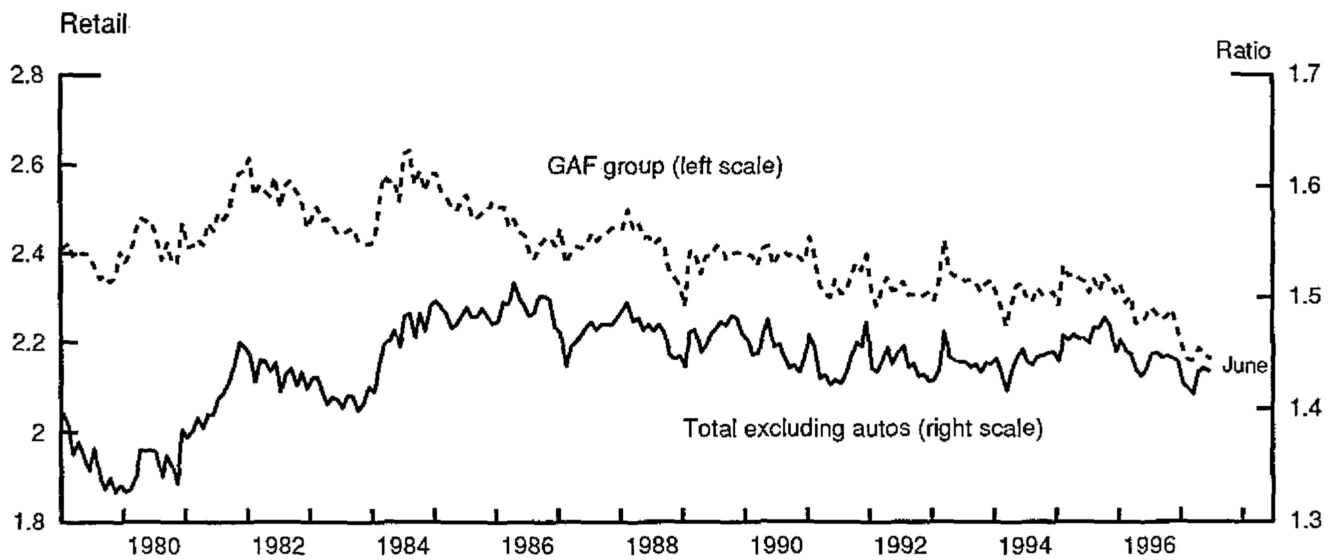
	Cyclical reference points		Range over preceding 12 months		
	1990-91 high	1995-96 low	High	Low	June 1997
Manufacturing and trade	1.58	1.37	1.39	1.35	1.37
Less wholesale and retail motor vehicles	1.55	1.34	1.36	1.32	1.34
Manufacturing	1.75	1.36	1.39	1.35	1.36
Primary metals	2.08	1.49	1.71	1.60	1.61
Nonelectrical machinery	2.48	1.80	1.89	1.78	1.77
Electrical machinery	2.08	1.41	1.48	1.33	1.34
Transportation equipment	2.93	1.48	1.61	1.49	1.58
Motor vehicles	.97	.56	.62	.57	.59
Aircraft	5.84	4.15	4.88	4.09	4.27
Nondefense capital goods	3.09	2.31	2.39	2.29	2.29
Textile	1.71	1.44	1.54	1.47	1.54
Petroleum	.94	.75	.84	.75	.85
Tobacco	2.83	1.92	2.16	1.94	1.94
Home goods & apparel	1.96	1.67	1.72	1.65	1.69
Merchant wholesalers	1.36	1.24	1.28	1.22	1.25
Less motor vehicles	1.31	1.22	1.25	1.20	1.23
Durable goods	1.83	1.53	1.57	1.50	1.55
Nondurable goods	.96	.93	.98	.92	.93
Retail trade	1.61	1.50	1.53	1.48	1.51
Less automotive dealers	1.48	1.43	1.45	1.41	1.43
Automotive dealers	2.21	1.68	1.79	1.68	1.73
General merchandise	2.43	2.21	2.27	2.12	2.13
Apparel	2.56	2.42	2.56	2.43	2.53
G.A.F.	2.44	2.23	2.27	2.16	2.16

Inventory-Sales Ratios, by Major Sector

(Book value)







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

	June		Fiscal year to date totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	117.7	118.8	1165.2	1202.4	37.2	3.2
Deposit insurance (DI)	-.5	-.3	-7.1	-12.9	-5.7	n.a.
Spectrum auction (SA)	.0	-5.2	-.2	-10.3	-10.1	n.a.
Other	118.2	124.4	1172.6	1225.5	53.0	4.5
Receipts	152.0	173.4	1091.2	1191.5	100.3	9.2
Deficit (+)	-34.3	-54.5	74.0	10.9	-63.1	-85.3
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	125.2	131.6	1179.6	1225.5	45.9	3.9
National defense	21.6	22.7	199.4	201.8	2.4	1.2
Net interest	19.0	19.5	180.1	184.3	4.2	2.3
Social security	32.7	34.1	262.0	273.7	11.7	4.4
Medicare	13.4	15.0	130.0	141.3	11.3	8.7
Medicaid	7.6	8.0	68.5	71.5	3.0	4.3
Other health	2.2	2.6	20.0	21.3	1.4	6.9
Income security	13.4	13.4	175.6	179.0	3.4	1.9
Other	15.3	16.3	143.9	152.6	8.7	6.0
Receipts	152.0	173.4	1091.2	1191.5	100.3	9.2
Individual income and payroll taxes	105.4	121.9	848.8	936.2	87.4	10.3
Withheld	76.3	87.8	737.4	795.8	58.4	7.9
Nonwithheld	31.2	35.9	195.2	227.9	32.7	16.8
Refunds (-)	2.1	1.8	83.8	87.4	3.6	4.3
Corporate	37.0	39.4	128.7	139.0	10.3	8.0
Other	9.6	12.1	113.7	116.3	2.6	2.3
Deficit(+)	-26.8	-41.8	88.4	34.0	-54.4	-61.5

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

1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. The monthly and fiscal year to date outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.

n.a. Not applicable.

INVENTORY INVESTMENT IN MANUFACTURING
(Book value, billions of dollars at annual rate)

	1996	1997		1997		
	Q4	Q1	Q2	Apr.	May	June
All manufacturing	7.0	16.5	25.0	35.4	23.4	16.1
Nondefense cap. goods	3.2	9.4	10.5	15.0	7.2	9.2
Aircraft and parts	6.8	8.0	6.3	5.6	3.0	10.3
Other	-3.6	1.4	4.2	9.4	4.2	-1.2
Other manufacturing	3.8	7.1	14.5	20.4	16.2	6.9

stores in the GAF grouping reported an inventory buildup of $1.8 billion in June, bringing the second-quarter accumulation to $5.5 billion; the buildup followed declines in the preceding two quarters. The modest buildup in GAF stocks was apparently consistent with recent increases in sales: The inventory-sales ratio for this broad category of retail stores edged down further in June to 2.16 months--among the lowest in recent years.

Federal Sector

The incoming news on the fiscal 1997 deficit has once again been surprisingly good. Neither OMB nor CBO has officially released its usual summer budget update. However, President Clinton announced that OMB now expects a deficit of $37 billion, and CBO announced an estimate of only $34 billion.

For the first nine months of fiscal 1997 (October 1996 to June 1997), the unified federal deficit, adjusted for payment timing shifts and excluding deposit insurance and spectrum auction proceeds, was $54 billion lower than for the same period in fiscal 1996. Receipts were more than 9 percent higher than the year-earlier level; in particular, individual income tax receipts have continued to be extremely strong.[9] Adjusted outlays were up only 3.9 percent through June, roughly in line with their pace over the past couple of years. While defense has edged up this year, after four years of decline, health spending has been quite subdued.

Two major pieces of legislation recently were enacted into law: the Balanced Budget Act of 1997 (BBA) and the Taxpayer Relief Act (TRA) of 1997. The legislation is expected to have only moderate effects on the deficit through fiscal 2001 but is expected to reduce

9. Preliminary data from the Daily Treasury Statements indicate that withheld income and payroll tax revenues were strong again in July.

PRELIMINARY ESTIMATES OF THE DEFICIT EFFECTS OF THE BALANCED BUDGET AND TAXPAYER RELIEF ACTS
(Fiscal years, billions of dollars)

	1998	1999	2000	2001	2002	1998-2002
Effects on deficit						
Discretionary spending	8	-3	-15	-33	-54	-97
Mandatory spending	1	-12	-33	-19	-55	-118
Medicare	-6	-16	-29	-20	-41	-112
Medicaid	0	-1	-2	-3	-4	-10
Asset sales (spectrum)	0	-2	-3	-4	-12	-21
Child health	4	4	4	4	3	20
Other	3	3	-3	4	-1	6
Revenues	9	9	26	30	18	92
Child credit	3	18	22	21	21	85
Education incentives	3	8	9	10	10	39
Capital gains/IRAs	-6	0	3	3	3	3
Estate tax	0	1	1	2	2	6
Other misc. tax cuts	17	-6	4	5	0	19
Excise Taxes	-6	-8	-8	-9	-10	-40
Other tax increases	-2	-4	-5	-2	-8	-20
Debt service	0	1	0	-1	-4	-2
Total	18	-5	-22	-23	-96	-125

Neither CBO nor OMB has released estimates of the effects of the reconciliation legislation on the deficit. However, CBO has released its estimates of the effects of the BBA on mandatory spending, and the Joint Committee on Taxation has released estimates of the effects of the legislation on revenues. We have estimated the effects of the new caps on discretionary spending using CBO's March baseline and have used unofficial CBO estimates of the effects on debt service.

it by $96 billion in 2002. Preliminary estimates from OMB (cited by President Clinton at his August 6 press conference) suggest that the legislation will result in a surplus of at least $20 billion in fiscal 2002 and keep the budget in balance or in surplus for the 2003-2007 period.

Under the BBA, new caps are established for discretionary spending.[10] Although these caps raise discretionary spending above the OBRA-1993 caps by roughly $8 billion in 1998 (according to CBO's most recent published estimate), total discretionary spending is cut roughly $100 billion over the 1998-2002 period (relative to a baseline that has discretionary spending at the OBRA-1993 cap in 1998 and growing with inflation thereafter). The BBA cuts mandatory spending $118 billion over the five-year period, with the lion's share of the mandatory cuts ($112 billion) from lower Medicare spending. Savings from Medicaid cuts and increased spectrum auction proceeds approximately balance out increases in spending on a child health initiative and other programs.

Finally, the TRA provides $92 billion in tax relief over the 1998-2002 period. Gross tax cuts, consisting largely of a child tax credit and new education tax incentives, total almost $150 billion. These are partially offset by about $55 billion in tax increases, representing about $40 billion in increased excise taxes on air travel and cigarettes and about $15 billion in miscellaneous small tax increases.

Earlier this week President Clinton struck three provisions of the BBA and TRA, inaugurating the use of the line-item veto.[11] All together, these provisions would have cost about $600 million over five years. The line-item veto will likely be challenged in the courts on the grounds that it is unconstitutional. In addition, several analysts have suggested that Congress may be able to protect provisions from the possibility of veto by making minor technical adjustments to the way that the legislation is introduced.

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10. The BBA establishes separate caps for defense and nondefense discretionary spending for 1998 and 1999. For fiscal 2000-2002, only total discretionary spending is capped.

11. The three provisions would have: (1) provided a tax break granted to banks, securities firms, and insurers doing business overseas; (2) allowed tax deferrals on the sale of certain food processing plants to farmers' cooperatives; and (3) allowed the state of New York to continue using "gimmicks" that boost federal Medicaid matching payments.

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1996			1997	
	June	Sept.	Dec.	Mar.	June
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	3.5	2.8	2.8	2.5	3.4
Wages and salaries	3.6	2.9	3.2	3.5	3.8
Benefit costs	3.0	2.1	2.9	0.0	2.9
By industry					
Construction	1.9	1.6	3.5	2.2	3.5
Manufacturing	3.5	3.4	2.8	0.6	3.7
Transportation and public utilities	2.9	2.5	4.1	1.2	2.5
Wholesale trade	3.8	2.8	3.4	6.9	0.9
Retail trade	-0.3	4.6	5.2	3.5	2.5
FIRE	5.9	1.3	-2.2	8.5	2.5
Services	3.4	2.8	3.1	2.7	3.6
By occupation					
White-collar	3.1	3.4	2.8	3.4	3.0
Blue-collar	2.9	1.6	3.8	1.2	3.4
Service occupations	2.9	2.6	3.8	3.5	3.4
Memo:					
State and local governments	2.5	2.5	3.1	2.1	1.8
	-----Twelve-month percent change----				
Total hourly compensation	2.9	2.9	3.1	3.0	2.9
Excluding sales workers	2.8	2.9	2.9	2.8	2.9
Wages and salaries	3.4	3.3	3.4	3.4	3.3
Excluding sales workers	3.2	3.4	3.3	3.1	3.3
Benefit costs	1.7	1.8	2.0	2.0	2.0
By industry					
Construction	2.7	2.3	2.4	2.3	2.7
Manufacturing	2.8	3.1	3.0	2.6	2.6
Transportation and public utilities	3.0	2.6	3.0	2.7	2.6
Wholesale trade	3.6	3.0	3.1	4.2	3.5
Retail trade	2.5	2.9	3.8	3.2	3.9
FIRE	3.7	3.3	2.4	3.3	2.5
Services	2.7	2.9	3.1	3.0	3.0
By occupation					
White-collar	3.0	3.2	3.2	3.2	3.2
Blue-collar	2.6	2.4	2.7	2.4	2.5
Service occupations	2.0	2.2	3.0	3.2	3.5
Memo:					
State and local governments	2.6	2.5	2.6	2.5	2.4

1. Seasonally adjusted by the BLS.

State and Local Governments

Total real consumption expenditures and gross investment by state and local governments rose at a 1.3 percent annual rate in the second quarter, about half the pace reported in the first quarter. In the second quarter, consumption expenditures increased 2.1 percent, while investment fell 1.9 percent after rising almost 6 percent during the preceding quarter. Construction put-in-place for June, which became available after the GDP report, rose 0.4 percent in real terms at a monthly rate, well below the figure assumed by BEA. Meanwhile, employment in July increased 55,000, after an even bigger rise in June. Both months saw outsized increases in the education component of local government employment: Apparently, school systems have been moving to earlier start dates and year-round sessions, and the seasonal adjustment factors for the summer months have not yet adequately captured these shifts.

According to the National League of Cities, the fiscal position of the nation's cities has improved in recent years, because of both favorable economic conditions and sound budgetary policies. Ending balances as a percentage of expenditures increased in every fiscal year between 1993 and 1996, and the balance is expected to remain high during fiscal 1997 (which still has not ended for many cities). As a result, cities have been expanding programs and adding to their reserve funds, while revenue-raising actions have subsided. Despite the good news, many cities continue to be pressed by infrastructure and public safety needs and the demands of growing populations.

Prices and Labor Costs

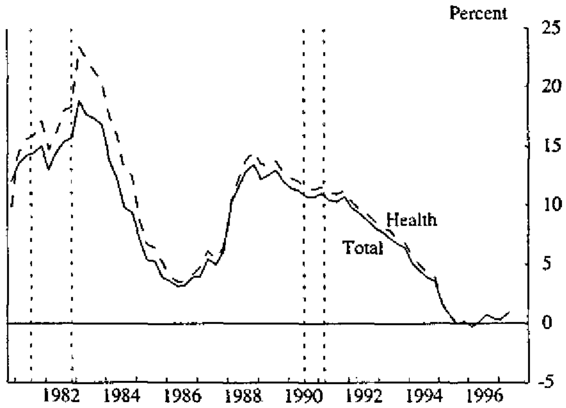
According to the employment cost index (ECI), hourly compensation of private industry workers rose 3.4 percent at an annual rate between March and June, following a 2.5 percent rise during the first quarter. This pickup resulted from a rebound in benefit costs, seasonally adjusted, in the second quarter and mimicked a similar pattern seen last year.[12]

Because of this quarterly volatility, the twelve-month changes in these series are probably more meaningful. The rise in hourly compensation over the twelve months ended in June was 2.9 percent--unchanged from the pace recorded in the prior two years. Hourly

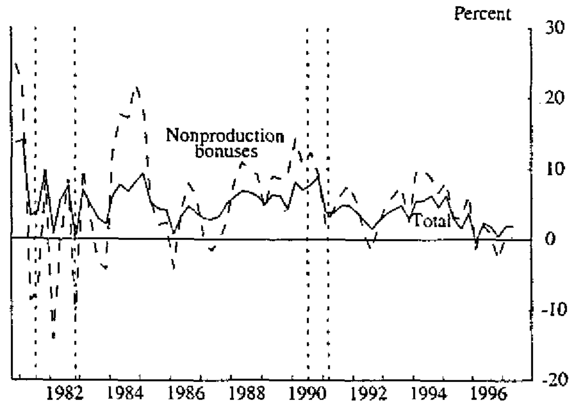
12. Prior to seasonal adjustment, benefits costs increased at a slightly slower pace in the second quarter than in the first quarter. The seasonal factors for the first quarter had expected an even larger increase, reflecting the influence of earlier years when first-quarter step-ups in benefit costs--especially for health insurance--were more sizable.

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

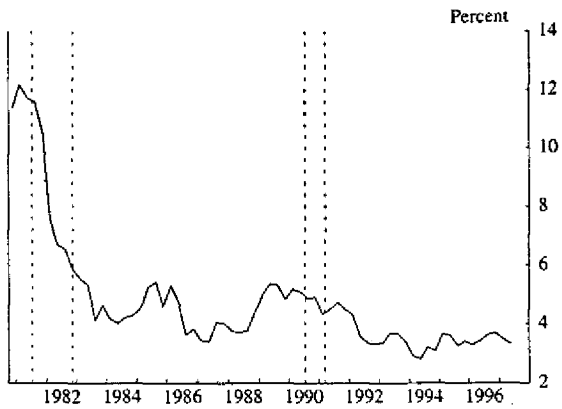
Insurance Costs



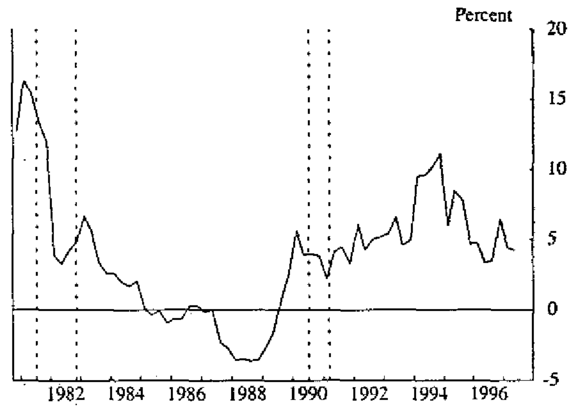
Supplemental Pay



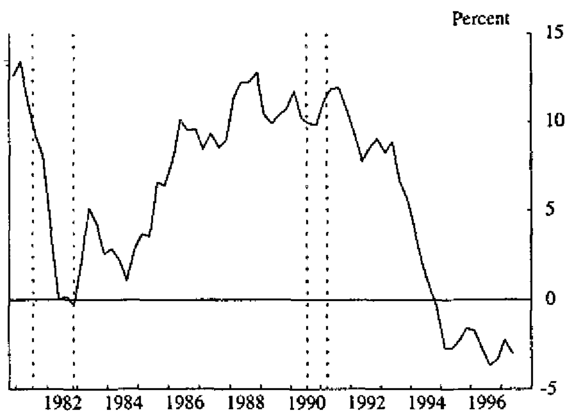
Paid Leave



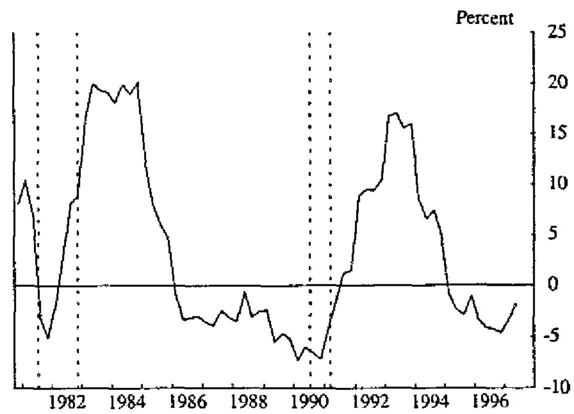
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



Note. Unpublished ECI benefits detail.

wages and salaries were up 3.3 percent during the year ended in June, while benefits rose 2 percent after an increase of 1.7 percent in the previous twelve months. Although increases in employers' costs for health insurance benefits have moved up a little over the past year, their rate of increase is still subdued. In addition, declines continue to be reported in contributions to workers' compensation plans and state unemployment insurance funds.

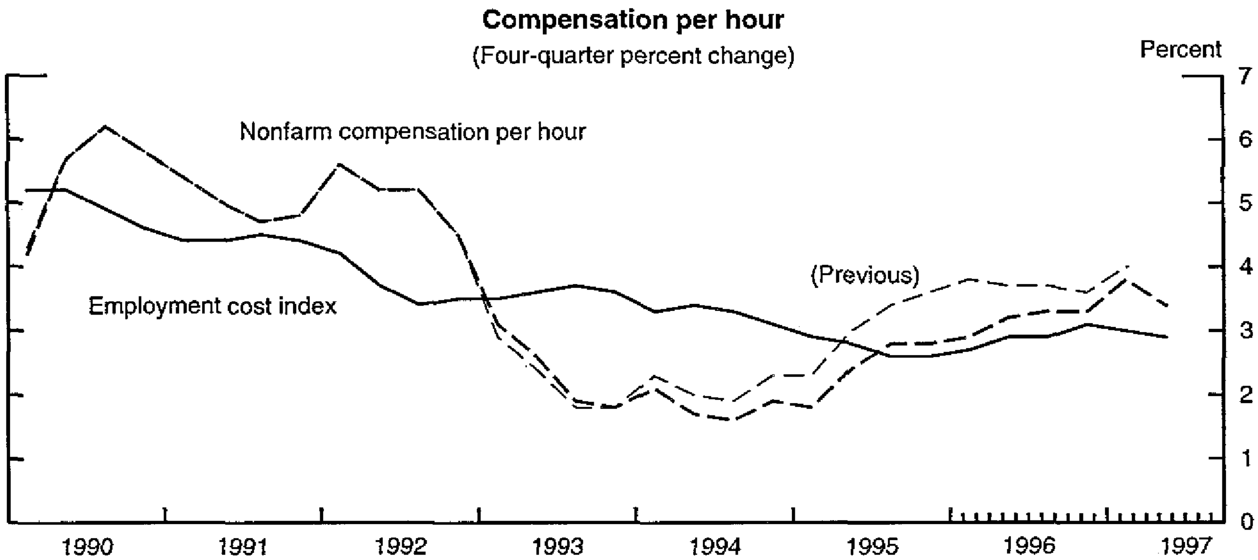
By occupation, compensation growth has remained fairly steady in white-collar and blue-collar jobs over the past year but has accelerated briskly in service occupations. By industry, hourly compensation has picked up noticeably in retail trade, the sector with the largest concentration of minimum-wage workers, and in business services, where labor shortages for both temporary workers and computer specialists have been reported. In contrast to these areas of wage pressures, compensation growth in the health services, FIRE, and transportation industries has diminished over the past year. Some analysts have noted that the ECI may be understating labor cost increases because it does not pick up some of the methods firms reportedly have been using to attract or retain workers in this tight labor market. For example, stock options, hiring bonuses, and special training promises--the use of which reportedly has increased over the past year or so--are excluded from the ECI.

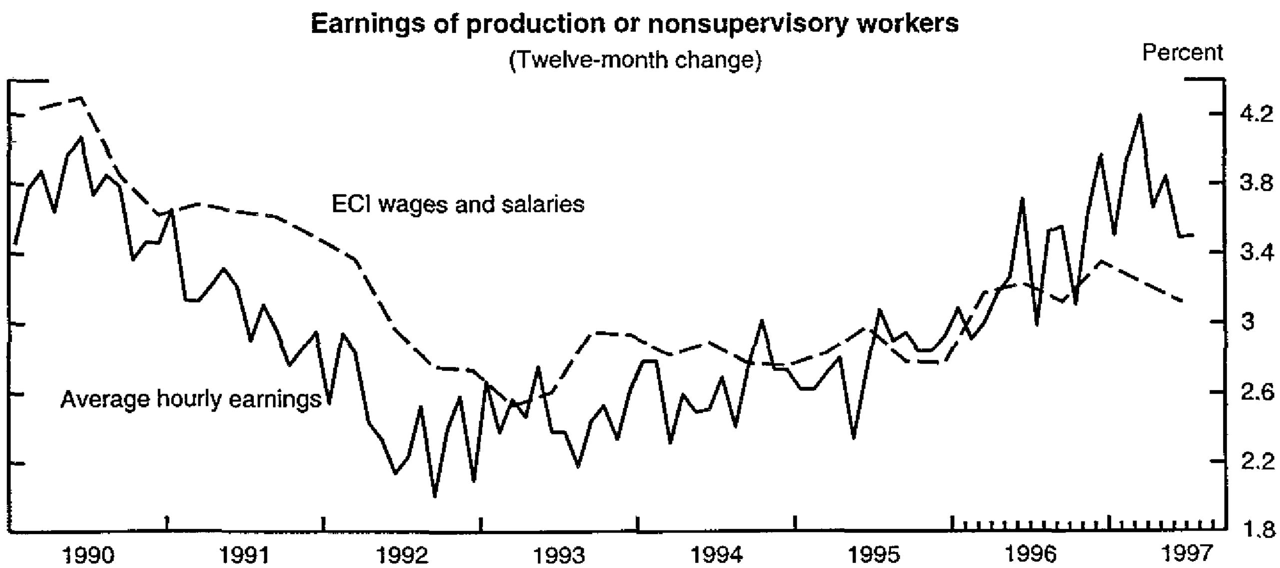
Indeed, one measure that eventually captures some of these alternative pay arrangements, hourly compensation in the nonfarm business sector as reported in the Productivity and Cost release, has risen somewhat faster than the ECI over the past few years. This measure of compensation has increased 3.4 percent over the past four quarters, up about a quarter point from the rate recorded a year earlier. Although more inclusive in measuring pay gains, hourly compensation in the Productivity and Cost data tends to lag on the benefit side, and it has been revised down in the past two years to reflect a reduction in estimated employer contributions for health insurance. These revisions have eliminated some--but not all--of the difference between the nonfarm and ECI measures of compensation growth in the past two years. The faster growth in the productivity and cost measure of compensation relative to the ECI is entirely in the wages and salary components of the two series. Although this difference is consistent with the greater use of some forms of compensation excluded from the ECI, it could also reflect

Compensation Per Hour
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

			1996		1997		1996:Q2 to
	1995[1]	1996[1]	Q3	Q4	Q1	Q2	1997:Q2
Nonfarm business	2.8	3.3	2.9	3.3	4.5	3.1	3.4
Previous	3.6	3.6	3.5	3.7	5.2	n.a.	n.a.
Nonfinancial corporations[2]	2.6	3.2	3.4	2.9	4.3	n.a.	n.a.
Previous	3.4	3.4	4.0	3.3	4.8	n.a.	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.





increases in hourly pay associated with the rise in increased use of overtime hours or a higher incidence of job promotions.

Average hourly earnings of production and nonsupervisory workers--the only wage data available for the third quarter--were unchanged in July; the twelve-month change held steady at 3.5 percent. This series is also running slightly ahead of the comparable ECI figure, likely reflecting the rise in overtime hours evident over the past year.

The consumer price index rose 0.2 percent in July, following four consecutive months of increases of 0.1 of a percentage point. On a twelve-month change basis, the CPI has remained steady at 2-1/4 percent in recent months, down from 3 percent in July 1996.

The CPI for energy was little changed for a second month in July after falling sharply over the first half of this year. An increase in the price of natural gas in July about offset price declines for other energy products. However, in coming months, prices of petroleum-based energy products may start rising. After bottoming out at roughly $18.50 per barrel in mid-June, the spot price of West Texas intermediate has averaged more than $20 per barrel thus far in August. Furthermore, private survey data suggest that, on a seasonally adjusted basis, the retail price of gasoline turned up early this month.

Consumer food prices rose 0.3 percent in July. The price index for fruits and vegetables was up in July for a third consecutive month. Retail coffee prices also moved higher again in July, although futures prices and a decline in the PPI for coffee suggest that prices will move lower in coming months. Among other items, prices for beef and eggs moved up in July, while the index for dairy products fell further. As of July, consumer food prices were 2-1/2 percent above the level of a year earlier; substantial deceleration in the twelve-month rate of change has taken place since the end of last year. Although prices of crude foods edged up in July, these prices were more than 14 percent below the elevated levels of the previous year, when grain prices were peaking. Although dry weather has hurt crops in some regions of the country since mid-July, the USDA still is forecasting large crops overall. Moreover, rain and cooler temperatures in the last week or so have allayed some of the concern about crop conditions. Our translation of the recent data on futures prices suggests that year-to-year declines in crude food prices will persist into 1998.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1997		1997	
	July 1996	July 1997	Q1	Q2	June	July
			-Annual rate-		-Monthly rate-	
<u>CPI</u>						
All items (100.0)[1]	3.0	2.2	2.3	1.0	.1	.2
Food (15.9)	3.4	2.5	.3	.9	.2	.3
Energy (7.0)	4.1	-1.0	7.3	-15.6	.0	-.1
CPI less food and energy (77.0)	2.7	2.4	2.2	2.9	.1	.2
Commodities (23.4)	1.4	.9	1.0	1.4	-.2	-.1
New vehicles (5.0)	2.1	.3	-.5	-.2	.0	.1
Used cars (1.3)	-.4	-4.5	1.6	-7.4	-1.8	-1.1
Apparel (4.8)	-.2	1.4	2.2	3.6	-.3	.1
House furnishings (3.3)	.1	-.4	-.7	.5	-.2	-.6
Other Commodities (9.0)	2.6	2.0	1.7	2.8	.0	.1
Services (53.7)	3.3	3.1	2.7	3.5	.3	.3
Shelter (28.2)	3.3	3.0	3.1	3.4	.2	.2
Medical care (6.1)	3.7	2.7	2.6	3.3	.2	.1
Auto finance charges (0.6)	-3.7	.0	-1.8	-1.0	-.4	1.6
Other Services (18.8)	3.4	3.4	2.1	3.9	.4	.4
<u>PPI</u>						
Finished goods (100.0)[2]	2.6	-.2	-.7	-4.0	-.1	-.1
Finished consumer foods (23.6)	4.2	.1	-4.2	.0	-.9	-.2
Finished energy (14.7)	5.4	-1.4	1.4	-22.7	.7	.1
Finished goods less food and energy (61.6)	1.4	.0	.4	-.6	.1	-.1
Consumer goods (38.1)	1.6	.1	.5	.0	.1	-.1
Capital equipment (23.6)	1.1	-.1	.1	-1.1	.1	-.1
Intermediate materials (100.0)[3]	-.1	-.3	.7	-2.9	.0	-.2
Intermediate materials less food and energy (81.3)	-1.8	.4	.8	.2	.1	.0
Crude materials (100.0)[4]	13.2	-7.3	1.3	-24.7	-3.3	-.1
Crude food materials (38.0)	25.1	-14.4	-15.5	8.2	-5.4	.3
Crude energy (42.4)	19.9	-3.8	15.3	-56.6	-2.9	-.4
Crude materials less food and energy (19.6)	-13.9	3.0	12.8	-3.8	.4	-.5

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 0.2 percent in July, the same as the average monthly increase in the first half of the year. On a twelve-month basis, core consumer prices increased 2.4 percent in July, down from the 2.7 percent pace recorded a year earlier, but similar to the pace recorded in the previous couple of months. Falling import prices have helped hold down the rate of change of core CPI commodities to 0.9 percent over the twelve months ended in July, while prices of services other than energy advanced 3.1 percent over this period.

PCE prices excluding food and energy have not decelerated over the past year as have core CPI prices; in contrast, core PCE prices had decelerated considerably more in the preceding year. Other broad measures of prices show little sign of acceleration, and short-term inflation expectations are lower than a year ago. Furthermore, prices at earlier stages of processing remain relatively subdued. The PPI for intermediate materials less food and energy has edged up a little over the past twelve months; although the PPI for core crude materials turned down in July, the index is now about 3 percent above its year-earlier level. Since mid-July, the Journal of Commerce and KR-CRB industrial price indexes have turned up somewhat, reflecting the recent rise in metals prices; both indexes, however, are little changed on balance this year.

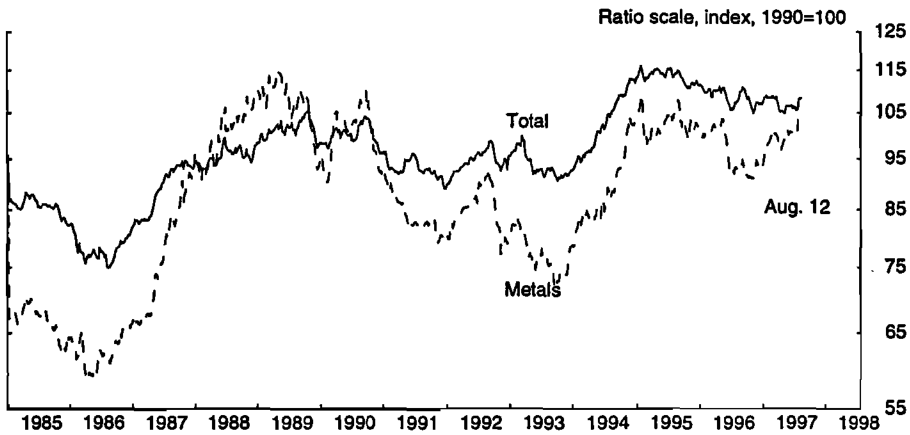
SPOT PRICES OF SELECTED COMMODITIES

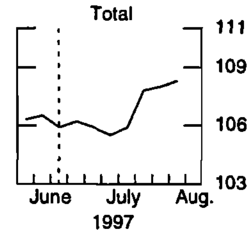
	Current price ($)	Percent change[1]: 1995	1996	Dec. 31 to June 24[2]	June 24[2] to Aug. 12	Memo: Year earlier to date
Metals						
Copper (lb.)	1.100	-3.5	-18.3	15.0	-10.6	14.6
Steel scrap (ton)	146.500	-6.6	-13.7	18.9	5.8	5.0
Aluminum, London (lb.)	.780	-12.9	-9.8	3.1	10.3	16.7
Precious metals						
Gold (oz.)	326.150	1.7	-5.1	-8.4	-3.6	-15.9
Silver (oz.)	4.410	7.2	-8.8	-.1	-7.5	-12.7
Forest products						
Lumber (m. bdft.)	355.000	-14.4	66.0	-10.4	-4.6	-12.1
Plywood (m. sqft.)	345.000	-6.1	1.6	12.7	-2.8	4.5
Petroleum						
Crude oil (barrel)	18.580	16.8	25.9	-24.7	4.3	-10.8
Gasoline (gal.)	.680	7.7	24.3	-21.8	28.7	10.8
Fuel oil (gal.)	.544	22.6	16.1	-27.1	6.1	-9.1
Livestock						
Steers (cwt.)	64.000	-5.7	.0	-4.5	1.6	-3.0
Hogs (cwt.)	55.000	27.5	34.1	11.8	-10.6	-9.8
Broilers (lb.)	.646	10.7	12.4	-2.2	5.5	6.3
U.S. farm crops						
Corn (bu.)	2.590	57.4	-29.5	-2.0	3.6	-47.5
Wheat (bu.)	3.788	24.0	-16.6	-23.3	8.5	-25.6
Soybeans (bu.)	7.160	29.0	-7.1	19.1	-12.6	-11.6
Cotton (lb.)	.724	-8.1	-10.9	2.0	.2	-6.5
Other foodstuffs						
Coffee (lb.)	2.140	-39.1	43.2	66.2	-5.3	50.7
Memo:						
JOC Industrials	108.300	-1.7	-3.7	-1.3	2.3	.1
JOC Metals	103.600	-1.8	-7.7	7.2	3.4	11.6
KR-CRB Futures	243.090	3.3	-2.6	1.4	.7	-2.7
KR-CRB Spot	ND	-3.5	1.0	.1	1.7	.2

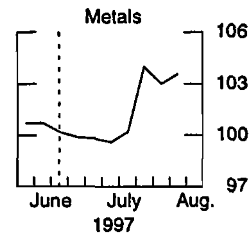
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the June Greenbook.

Commodity Price Measures

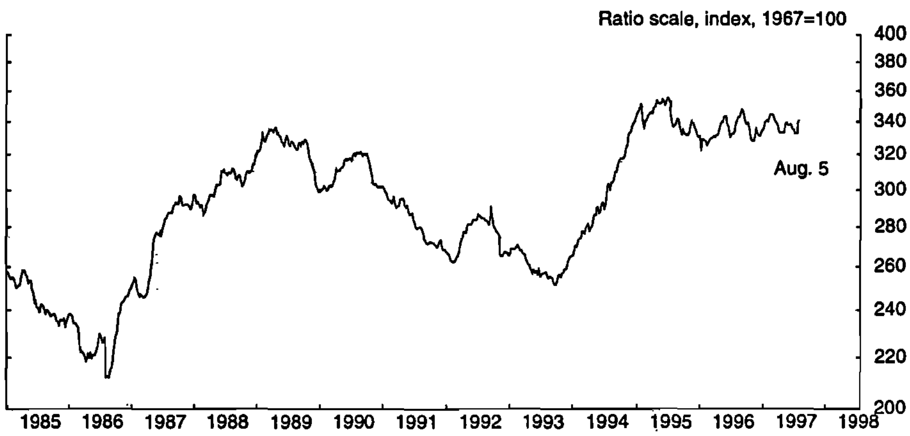
Journal of Commerce Index

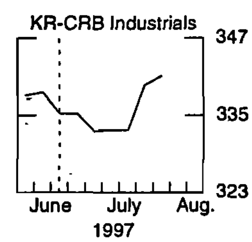




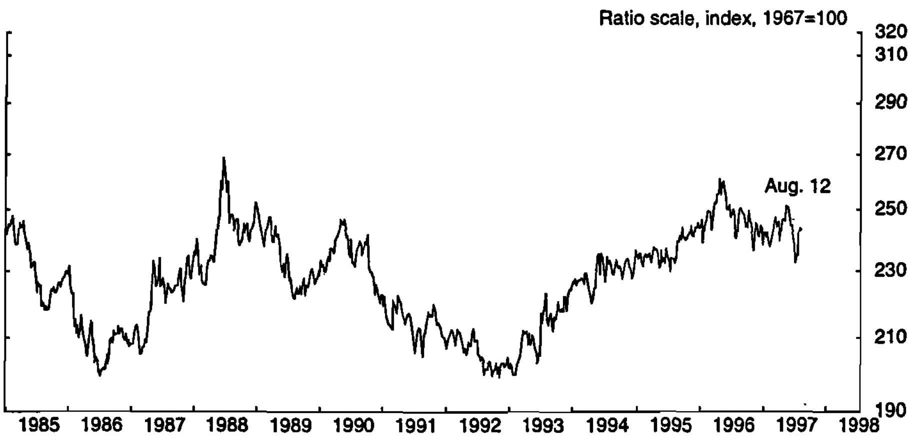


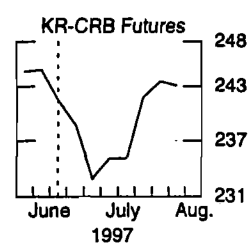
KR-CRB Spot Industrials





KR-CRB Futures





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

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994 Q2	1995 Q2	1996 Q2	1997 Q2
Product prices				
GDP chain-type price index	2.3	2.6	2.2	2.1
Nonfarm business chain-type price index[1]	2.2	2.6	1.6	1.7
Expenditure prices				
Gross domestic purchases chain-type price index	2.1	2.7	2.0	1.8
Less food and energy	2.4	2.7	1.8	1.9
PCE chain-type price index	2.2	2.9	2.3	2.1
Less food and energy	2.5	2.8	2.0	2.2
CPI	2.4	3.0	2.8	2.4
Less food and energy	2.8	3.0	2.7	2.5
Median CPI	2.8	3.0	3.1	2.7

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
			2.9	4.1	
			3.0	4.3	
			3.0	4.3	
			3.0	4.2	
Apr.	2.5	3.7	3.0	4.1	
May	2.2	3.7	2.9	4.0	
Jun	2.3	3.5	2.8	4.0	2.9
Jul	2.2	3.4	2.7	4.0	

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.

APPENDIX

ANNUAL REVISION TO THE NIPA

Background

On July 31 the BEA published revised national income and product accounts for the period 1993:Q1 to 1997:Q1. The revision incorporated updated seasonal factors and more comprehensive source data. These data include federal budget data, IRS tabulations of tax returns, BLS data on employer costs for health and life insurance, BEA price data for certain types of high-tech equipment, and Census Bureau annual surveys of consumption services, manufactures, merchant wholesale trade and retail trade. Most of these sources run through 1995, although preliminary figures for 1996 are available in some cases, such as wages and salaries.

The revision also included an important methodological change. When the BEA introduced chain-weighted Fisher aggregation last year, it continued to use fixed prices to estimate real GDP for the most recent quarters. It has now decided to eliminate this so-called Laspeyres tail by using quarterly Fisher aggregation to construct the estimates of GDP in the most recent quarters.[1] The new approach will produce estimates that are on roughly the same conceptual basis as those for earlier periods. Before the change, output growth in the most recent quarters tended to be slightly overstated in the official statistics because the weights for some fast-growing industries (notably, computers and semiconductors) had been fixed when relative prices in these sectors had been falling. We estimate that the elimination of the Laspeyres tail lowered measured GDP growth about 0.1 to 0.2 percentage point over the past year.[2]

Revisions to Real GDP and Its Components

Growth of real GDP was revised up a bit in 1993, 1995, and 1996, but down in 1994. The estimate for the first quarter of 1997 was revised down a full percentage point to 4.9 percent. For the period from 1992:Q4 to 1997:Q1 as a whole, real GDP growth was revised up an average of just 0.1 percentage point per year. The new estimates of consumer spending on services and of investment in business inventories are higher, while the new figures for consumer

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1. The BEA does not use the data for a given calendar year to construct annual weights until after they have passed through their first annual revision. Thus, the annual revision that just occurred made data for 1996 available for use as annual weights, which allows for annual Fisher aggregation through 1996:Q2. Under the previous procedures, spending aggregates for each quarter after 1996:Q2 would have been calculated using fixed weights based on 1996 prices. Now, the aggregates for each of the recent quarters will be constructed using weights from that quarter and the previous quarter.

2. The growth rates of the major components of output were overstated by varying amounts, depending largely on the importance of high-tech equipment in the different sectors. For example, we estimate that the elimination of the Laspeyres tail lowered measured growth in PDE for recent quarters by more than 1 percentage point and lowered growth in imports and exports by an even larger amount. In contrast, measured growth in PCE was likely lowered less than 0.1 percentage point.

spending on goods, business fixed investment, and government spending are lower. On balance, the changes leave inventory-sales ratios for the revision period higher; in particular, the data no longer show a sharp decline in the ratio of nonfarm inventories to final sales of goods and structures over the past year.

Income-Side Issues

The revision only partially resolved the large and widening gap between the product and income sides of the national accounts. The difference between gross domestic product and gross domestic income--the statistical discrepancy--remains large by historical standards, amounting (in absolute value terms) to 0.8 percent of GDP in 1997:Q1. However, the revision did narrow the difference between the growth rates of real GDP and real GDI in the past two years; the change owed about as much to downward revisions to income growth as to upward revisions to output growth.[3]

The staff at the BEA continues to believe that, at least for the most recent years, the product measures of output are more reliable indicators of economic performance. However, they acknowledge that there are a number of places on both sides of the accounts where measurement is especially difficult. Among other things, these include the amount by which proprietors' income is misstated in tax data and, on the product side, the volume of such consumer services as Internet access, cellular phone service, and gambling. Moreover, the source data throughout the accounts are much less complete after 1995, leaving open the possibility of a future narrowing of the statistical discrepancy over the past year and a half.

The level of nominal national income was revised up by increasing amounts in each year from 1993 to 1996. Sizable increases in the estimates of rental income, corporate profits, and net interest all contributed to this pattern. The revision to corporate profits accentuates the uptrend in profits as a share of GNP over the past several years. Compensation of employees was revised down in 1995 and 1996 because of a reduction in estimated employer contributions for health insurance (which are part of "other labor income"). As a result, the revised labor share of national income shows a much sharper decline over the past four years, leaving the current level at the very low end of the range seen since 1970.

The combination of revisions to income and outlays significantly altered the contour of the personal saving rate over the past several years. Before the revision, the saving rate appeared to have a slight uptrend beginning in 1995, but the new data show a decline from more than 5 percent in the first quarter of 1995 to about 4-1/4 percent in the second quarter of this year. Given the dramatic rise in the stock market over this period, the behavior of the revised saving rate over the past two years is in

3. The GDP deflator--used to deflate both GDP and GDI--was revised up by 1/2 percentage point in 1996. As a result, growth in nominal GDI was revised up a bit even though growth in real GDI was revised down. The GDP price index (discussed below) was not revised up as much as the deflator because it had been overstated before the elimination of the Laspeyres tail.

better alignment with what would be expected based on the historical relationship between wealth and saving.[4]

Revisions to Labor Productivity and Prices

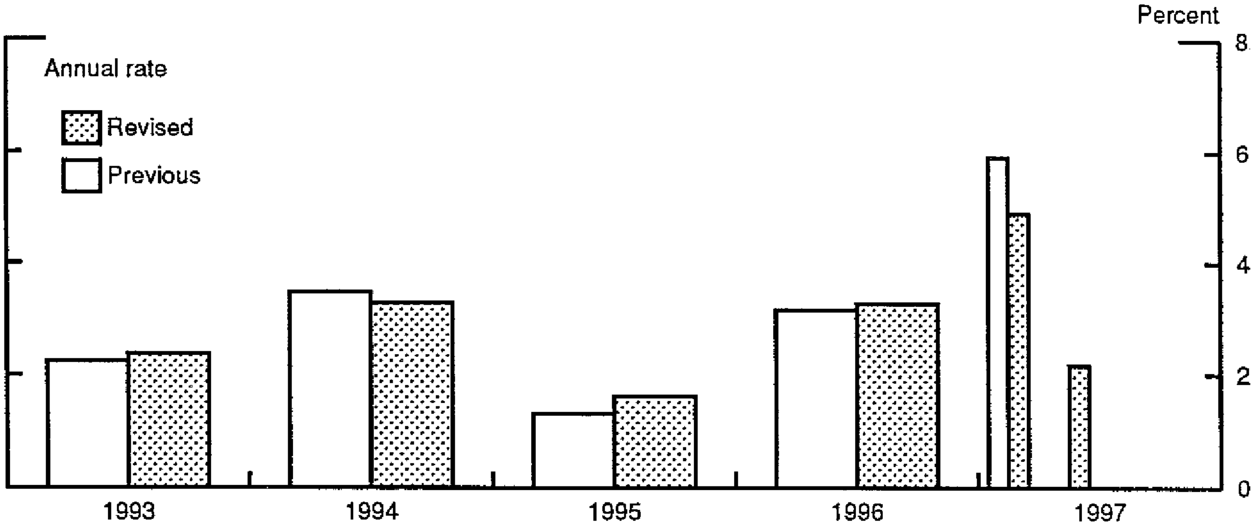
The modest upward revision to output boosted the level of labor productivity in the nonfarm business sector in 1997:Q1 by only a small amount. Thus, average productivity growth since the last business cycle peak in mid-1990 is little changed. However, the new output data do hint at a slightly stepped-up rate of growth beginning in the middle of 1995--1-1/4 percent (annual rate) over the past two years, as compared with 1 percent in the first half of the 1990s. Although our econometric models cannot determine whether the higher growth rate is a cyclical response to the acceleration in output growth last year or a more fundamental improvement in the productivity trend, the data are consistent with the observed faster growth of the capital stock relative to trend labor input as well as the many anecdotal reports of a pickup in the trend rate of multifactor productivity growth in recent years.

Finally, the annual revision to the NIPA data boosted very slightly the average increase in the GDP chain-type price index over the past four years. Upward revisions to prices for PCE services and government spending more than offset downward revisions to prices of some types of high-tech equipment.

4. If one assumed that no factors besides the appreciation of stock prices influenced the saving rate, the decline in the saving rate since the beginning of 1995 would imply that consumption rose (with some lag) about three cents for every additional dollar of stock market wealth. Econometric models of the relationship between saving and wealth based on historical data suggest that the marginal propensity to consume could be anywhere between zero and six cents on the dollar, depending on the exact specification, with most estimates clustered between three and four cents.

Revisions to Real GDP

Change in Real GDP



Note. Annual changes are Q4 to Q4.

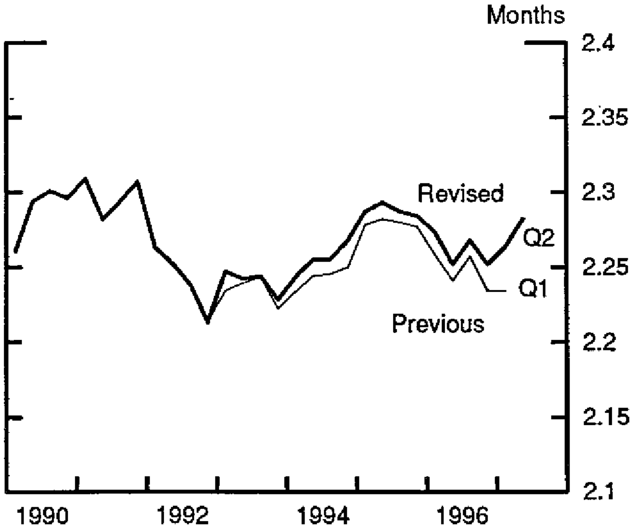
Real GDP and Selected Components

(Annualized percent change from 1992:Q4 to 1997:Q1, except as noted)

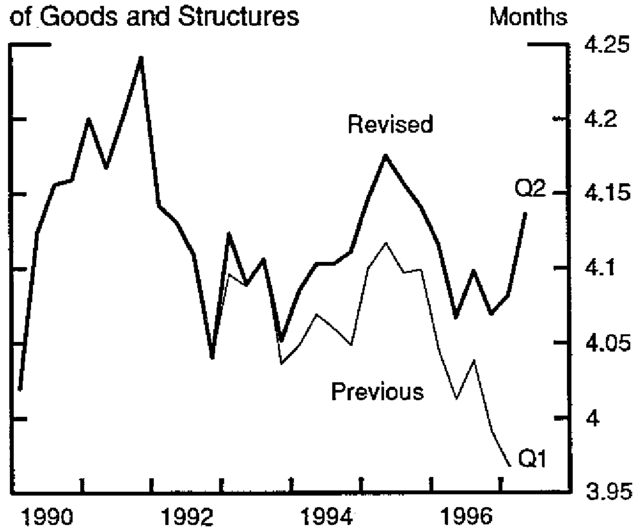
	Previous Estimate	Revised Estimate
1. Gross domestic product	2.7	2.8
2. PCE goods	3.1	3.0
3. PCE services	2.3	2.6
4. Business fixed investment	8.8	8.6
5. Federal spending	–3.5	–3.8
6. State and local spending	2.4	2.1
7. Nonfarm inventory investment [1]	49.2	58.3

1. 1997:Q1 level, billions of chained (1992) dollars.

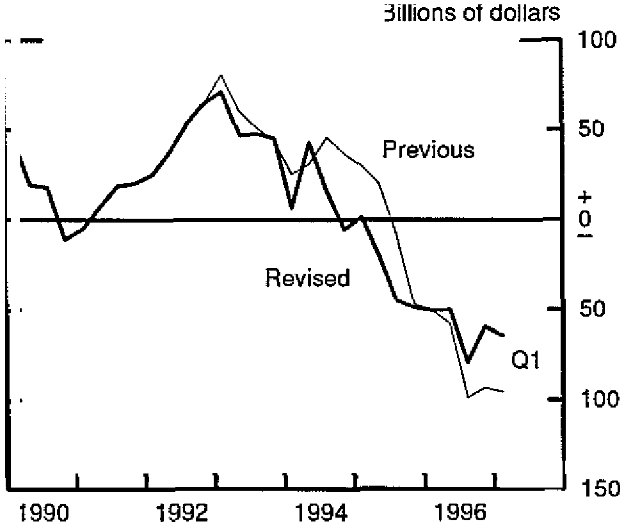
Nonfarm Inventories Relative to Final Sales



Nonfarm Inventories Relative to Final Sales of Goods and Structures



Statistical Discrepancy



Real GDP and GDI Growth

(Percent change, annual rate)

	1995	1996	1997:Q1
Previous			
1. GDP	1.3	3.1	5.9
2. GDI	2.5	3.7	5.9
3. Difference	−1.2	−.6	.0
Revised			
4. GDP	1.6	3.3	4.9
5. GDI	2.2	3.4	5.1
6. Difference	−.6	−.1	−.2

Note. Annual changes are Q4 to Q4.

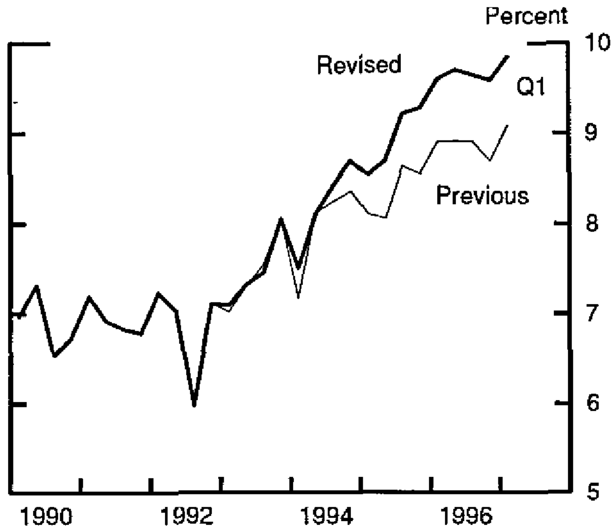
Revisions to National Income

(Annual level, billions of dollars)

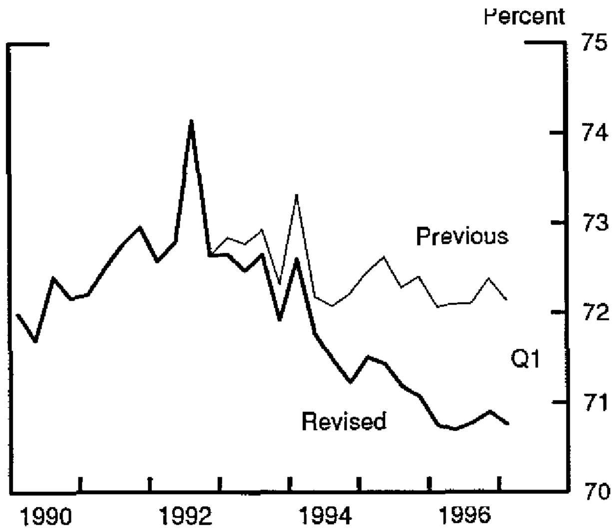
	1993	1994	1995	1996
1. National income	28.3	55.5	83.4	90.3
2. Compensation of employees	5.4	2.2	−7.3	−21.6
3. Proprietors' income[1]	14.9	7.2	2.9	−7.0
4. Rental income[2]	3.5	12.3	21.1	31.3
5. Corporate profits[1]	.7	16.4	45.2	65.7
6. Net interest	3.6	17.4	21.5	21.8

1. With inventory valuation adjustment and capital consumption adjustment.
2. With capital consumption adjustment.

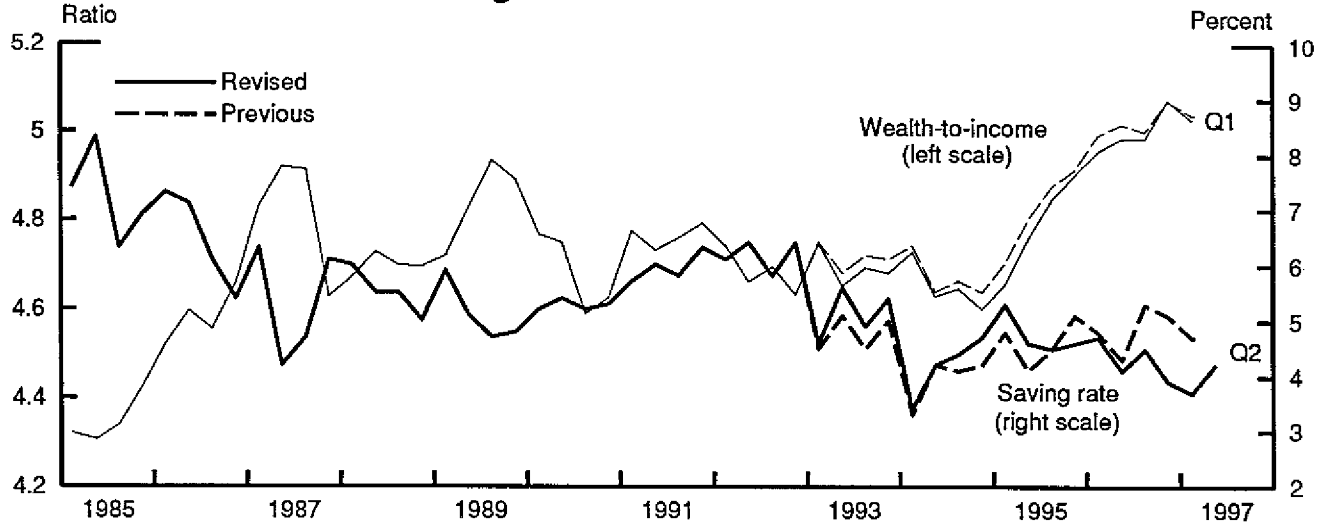
Profit Share of GNP



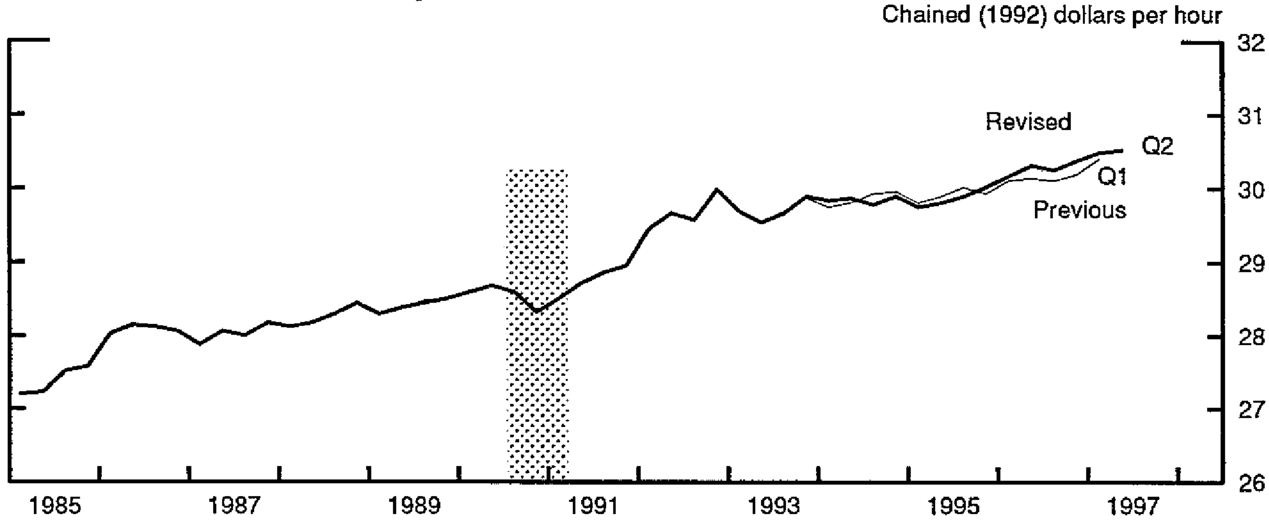
Labor Share of National Income



Personal Saving Rate and Wealth-to-Income Ratio

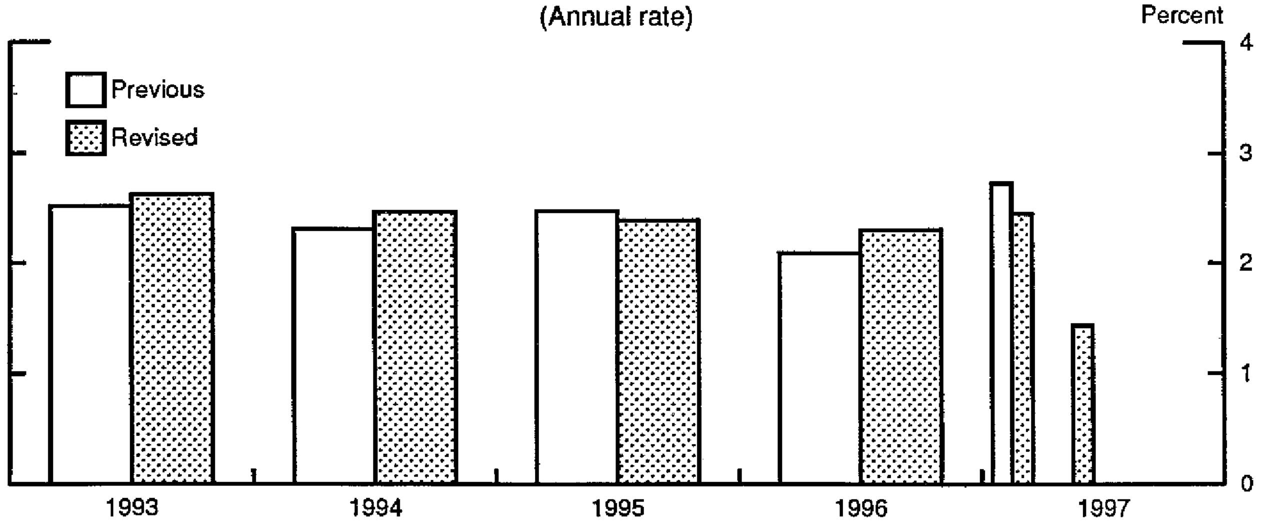


Productivity in the Nonfarm Business Sector



Growth in GDP Price Index

(Annual rate)



Note. Annual changes are Q4 to Q4.

DOMESTIC FINANCIAL DEVELOPMENTS

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

Instrument	1997 Jan. 2	1997 Mar. low	1997 FOMC * July 2	1997 Aug. 13	Change to Aug. 13, from: Jan. 2	Change to Aug. 13, from: Mar. low	Change to Aug. 13, from: FOMC * July 2
Short-term rates							
Federal funds [2]	5.79	5.27	5.63	5.54	-.25	.27	-.09
Treasury bills [3]							
3-month	5.05	5.04	5.04	5.18	.13	.14	.14
6-month	5.14	5.17	5.10	5.21	.07	.04	.11
1-year	5.28	5.37	5.33	5.29	01	-.08	-.04
Commercial paper							
1-month	5.48	5.40	5.63	5.58	.10	.18	-.05
3-month	5.47	5.45	5.64	5.57	.10	.12	-.07
Large negotiable CDs [3]							
1-month	5.39	5.32	5.59	5.56	.17	.24	-.03
3-month	5.42	5.42	5.68	5.60	.18	.18	-.08
6-month	5.50	5.58	5.81	5.72	.22	.14	-.09
Eurodollar deposits [4]							
1-month	5.38	5.31	5.56	5.50	.12	.19	-.06
3-month	5.44	5.44	5.63	5.63	.19	.19	.00
Bank prime rate	8.25	8.25	8.50	8.50	.25	.25	.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.13	6.25	6.19	6.09	-.04	-.16	-.10
10-year	6.54	6.56	6.45	6.36	-.18	-.20	-.09
30-year	6.75	6.83	6.74	6.64	-.11	-.19	-.10
U.S. Treasury 10-year indexed note	n.a.	3.36	3.63	3.61	n.a.	n.a.	-.02
Municipal revenue (Bond Buyer) [5]	5.96	5.97	5.82	5.62	-.34	-.35	-.20
Corporate-A utility, recently offered	7.64	7.97	7.84	7.69	.05	-.28	-.15
High-yield corporate [6]	9.72	9.49	9.38	9.18	-.54	-.31	-.20
Home mortgages [7]							
FHLMC 30-yr fixed rate	7.64	7.84	7.58	7.46	-.18	-.38	-.12
FHLMC 1-yr adjustable rate	5.57	5.54	5.66	5.53	-.04	-.01	-.13

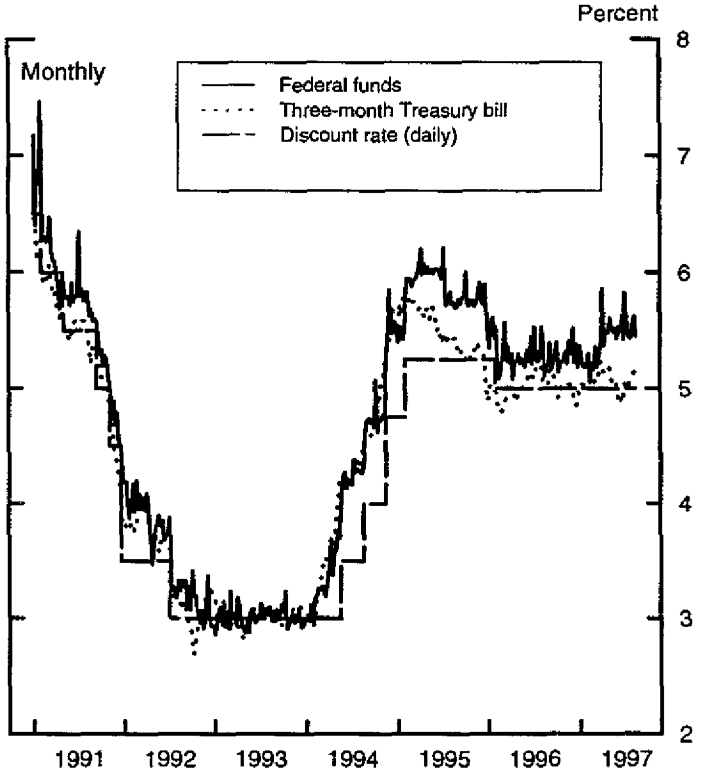
Stock exchange index	Record high Level	Record high Date	1997 Jan. 2	1997 FOMC * July 2	1997 Aug. 13	Change to Aug. 13, from: Record high	Change to Aug. 13, from: Jan. 2	Change to Aug. 13, from: FOMC * July 2
Dow-Jones Industrial	8259.31	8/6/97	6442.49	7722.33	7928.32	-4.01	23.06	2.67
S&P 500 Composite	960.32	8/6/97	737.01	891.03	922.02	-3.99	25.10	3.48
NASDAQ (OTC)	1630.44	8/6/97	1280.70	1438.25	1583.40	-2.89	23.64	10.09
Russell 2000	420.73	8/6/97	358.96	394.13	411.64	-2.16	14.68	4.44
Wilshire	9110.42	8/6/97	7147.80	8441.43	8784.77	-3.57	22.90	4.07

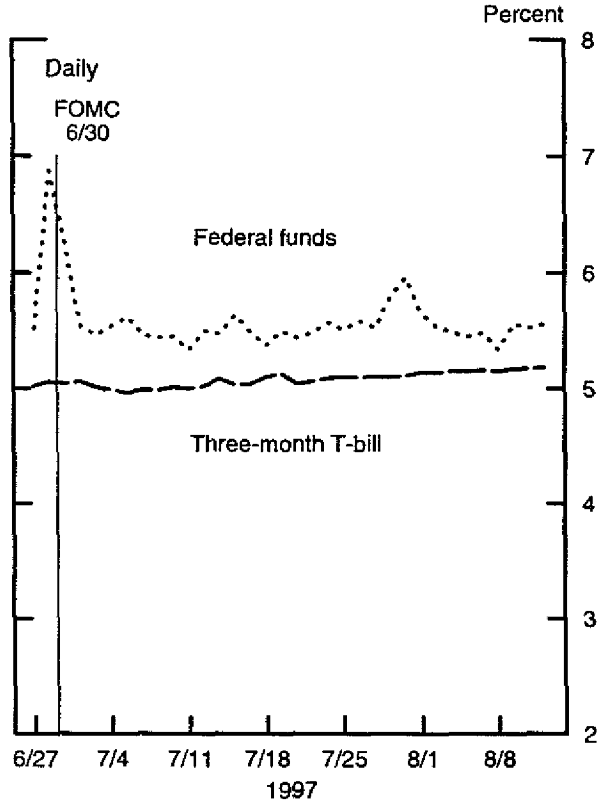
1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average to date for maintenance period ending August 20, 1997.
3. Secondary market.
4. Bid rates for Eurodollar deposits at 11 a.m. London time.
5. Most recent observation 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 July 1,1997.

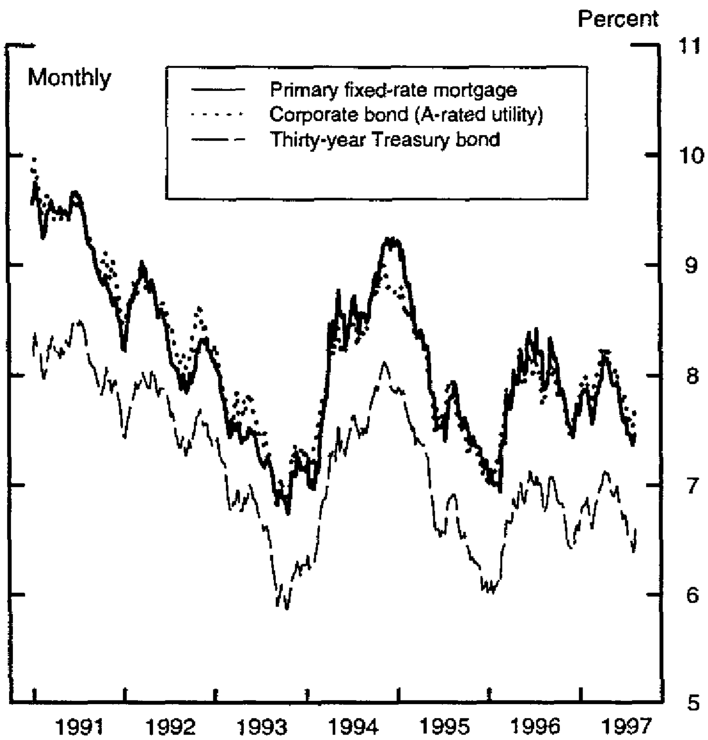
Selected Interest Rates

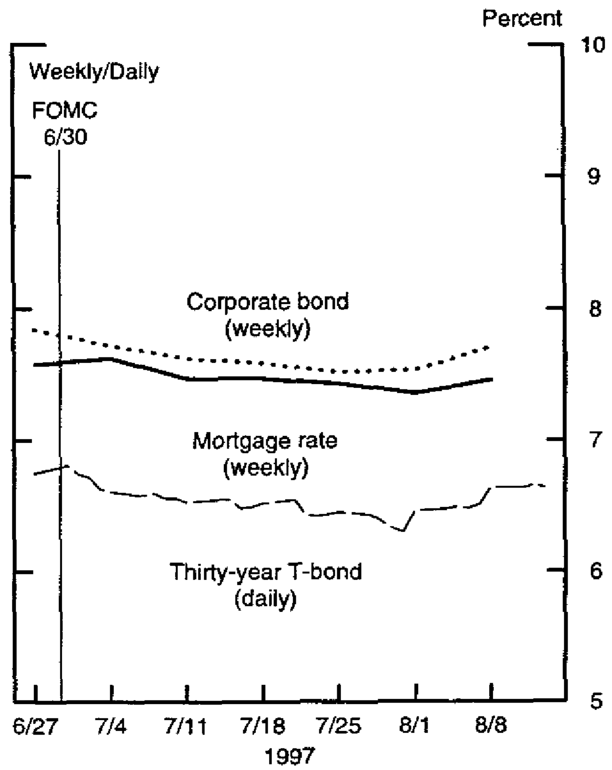
Short-Term





Long-Term





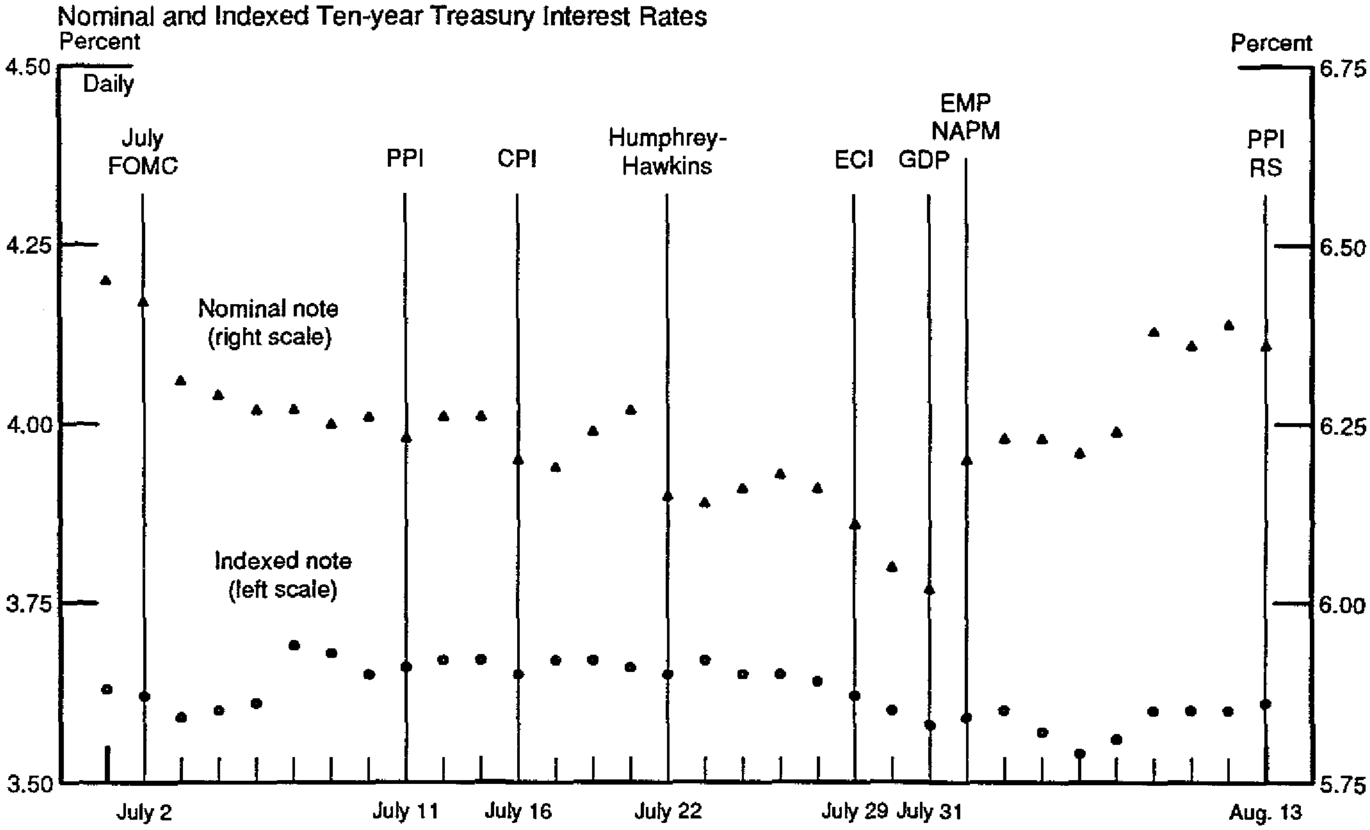
Over the four weeks immediately following the July FOMC meeting, yields on intermediate- and long-term securities declined as much as 1/2 percentage point. The rally was spurred by incoming data indicating subdued inflation and also by Chairman Greenspan's Humphrey-Hawkins testimony, which was read by market participants as expressing the view that inflation might remain in check without further System tightening.

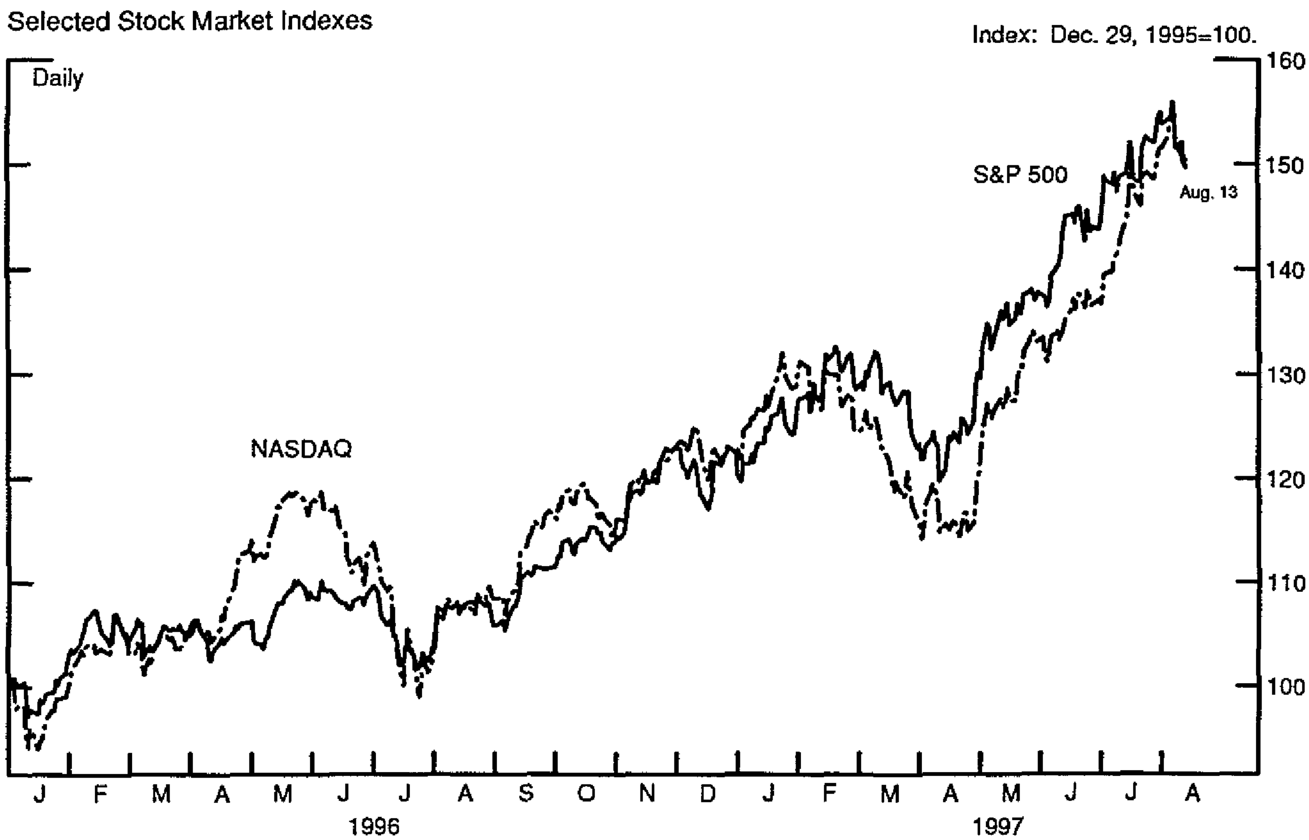
In the past two weeks, however, amid data for July indicating strength in hiring and a vibrant manufacturing sector as well as a weakening of the dollar on foreign exchange markets, bond rates moved sharply higher (chart, top panel). This souring of market sentiment made it more difficult for dealers to place securities issued at the Treasury's August midquarter refunding, which may have exacerbated the downturn. On net, much of the decline posted earlier in the intermeeting period was rolled back, and yields on Treasury coupon securities ended the period about 10 basis points lower.

The recent rise in interest rates contributed to a selloff in equity markets (chart, lower panel). Still, major equity indexes have increased 3 percent to 10 percent since the July FOMC meeting, supported by generally favorable earnings reports. Equity-price volatility over the intermeeting period has continued on the slight upward trend that began in 1996.

Borrowing by nonfinancial businesses was very strong in July: corporate bond issuance posted record levels, and growth of business loans also remained relatively brisk. Of late, the financing requirements of nonfinancial corporations likely have been boosted by rapid expansion of capital expenditures even though, in the aggregate, growth of internal funds has remained robust. By contrast, borrowing by households shows further signs of moderation; while home equity loans continue to grow strongly, the volume of such lending has not been large enough to offset the deceleration in consumer loans. Reflecting the decline in the federal budget deficit, Treasury borrowing remains light, but issuance of bills has recovered. Net offerings of debt by state and local governments remain on track for a moderate advance this year. The expansion of M2 was damped in July, in part because the strong performance of the

Selected Financial Market Quotes





stock market attracted inflows to long-term mutual funds at the expense of deposits.

<u>Business Finance</u>

Gross issuance of nonfinancial corporate bonds set successive records in June and July (table) and remained brisk in the first half of August. Investment-grade borrowers took advantage of the drop in long-term interest rates in July and boosted bond issuance to its highest level in recent years. A number of companies issued 100-year bonds to lock in those low rates and in light of the withdrawal of legislation that would have limited the tax deductibility of coupons on such bonds.

Speculative-grade offerings soared in July, almost matching the torrid pace of June. Most of these offerings were in the 144A sector, which exempts firms from certain SEC filing requirements if the securities are placed among only a limited number of sophisticated investors.[1] Over the first seven months of this year, junk bonds have accounted for almost half of total nonfinancial bond issuance, higher than any previous annual share (chart, lower left). The recent strength in junk bond financing largely reflects firms' needs to support ongoing capital spending--such as building wireless and cable networks. Robust inflows to junk bond mutual funds have helped to hold junk bond spreads to near historic lows.

Net issuance of nonfinancial commercial paper remained positive in July, though below the pace for the second quarter, when merger-related offerings accounted for more than half of net issuance (chart, lower right). While merger-related commercial paper issuance remained strong in July, paydowns of existing paper with proceeds from bond offerings increased.

The news on corporate credit quality has remained quite favorable. In the second quarter, Moody's upgraded $15 billion more nonfinancial debt than it downgraded, and its Watchlist of companies under review for a rating action suggests that there will be little net change in ratings in the near term. Also, the default rate on speculative-grade debt fell in the second quarter from an already low first-quarter rate. In contrast, the rate of nonfinancial

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1. Most 144A bonds have SEC registration rights, and firms generally convert the bonds to public status shortly after issue. The 144A market attracts firms that wish to raise funds more quickly than they can with public issues, which require SEC registration prior to issue.

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

Type of security	1995	1996	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
All U.S. corporations	47.7	58.4	61.4	68.5	60.9	96.2	71.5
Stocks[1]	6.1	10.2	9.9	8.9	8.5	11.8	8.0
Bonds	41.6	48.2	51.4	59.5	52.4	84.4	63.4
Nonfinancial corporations							
Stocks[1]	4.4	6.7	4.9	4.3	4.1	6.0	5.1
Initial public offerings	1.7	2.9	1.1	1.8	1.0	3.4	1.7
Seasoned offerings	2.7	3.8	3.8	2.5	3.1	2.6	3.3
Bonds	10.8	12.5	13.3	17.5	18.1	21.0	27.7
By rating, sold in U.S.[2]							
Investment grade	6.5	6.3	5.7	7.0	7.2	6.8	13.7
Speculative grade	3.0	4.8	6.2	8.9	8.2	13.4	11.1
Public	2.0	2.3	2.7	1.5	2.0	1.5	.8
Rule 144A	1.1	2.5	3.6	7.4	6.1	11.9	10.3
Financial corporations							
Stocks[1]	1.7	3.5	5.0	4.7	4.4	5.8	3.0
Bonds	30.8	35.8	38.1	42.0	34.3	63.4	35.7

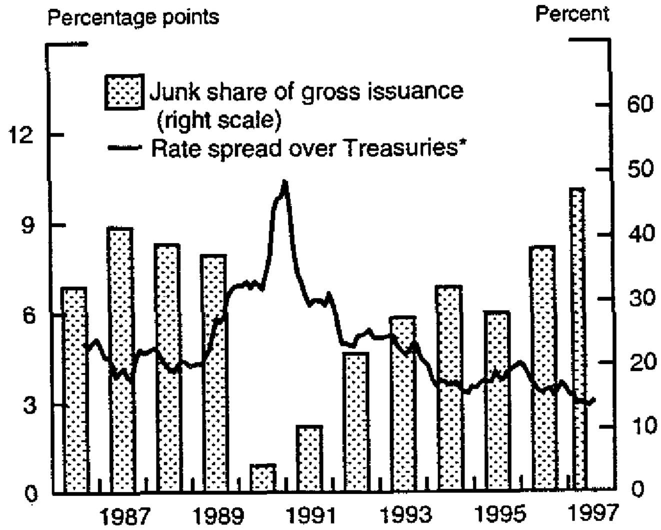
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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.

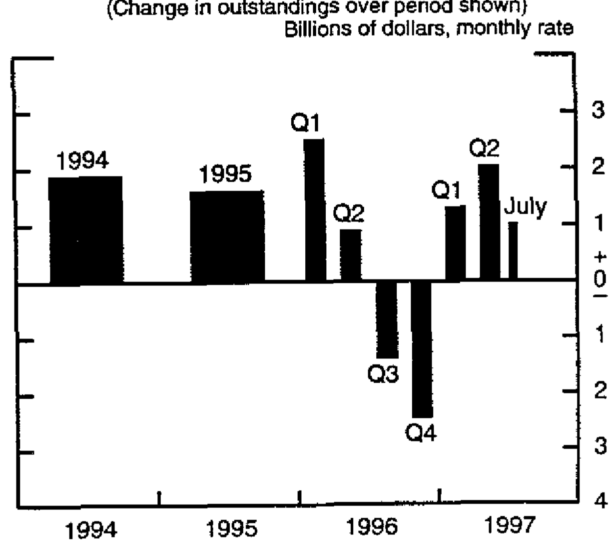
Nonfinancial Corporations

Junk Bonds



Note. Data for 1997 are through July.
*Merrill Lynch Master II Index less 7-year Treasury yield.
Source. Securities Data Company.

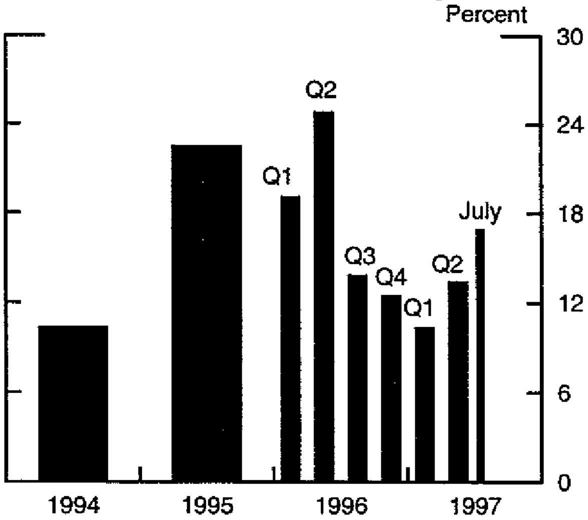
Commercial Paper
(Change in outstandings over period shown)



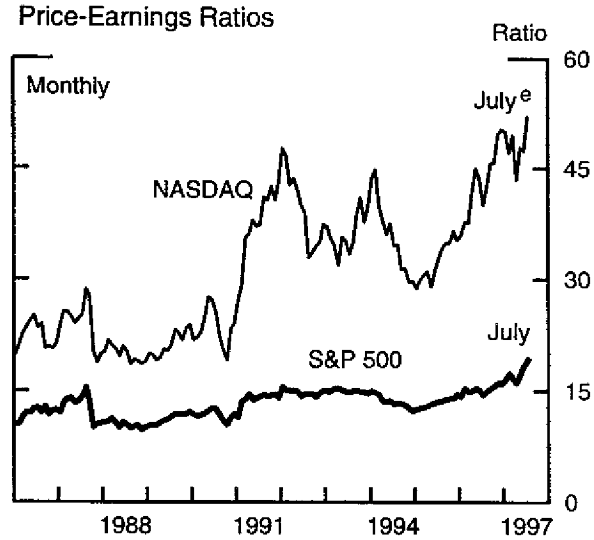
Note. Value for July 1997 is a staff estimate.

Stock Market and Earnings

IPOs: Average First-Day Price Change

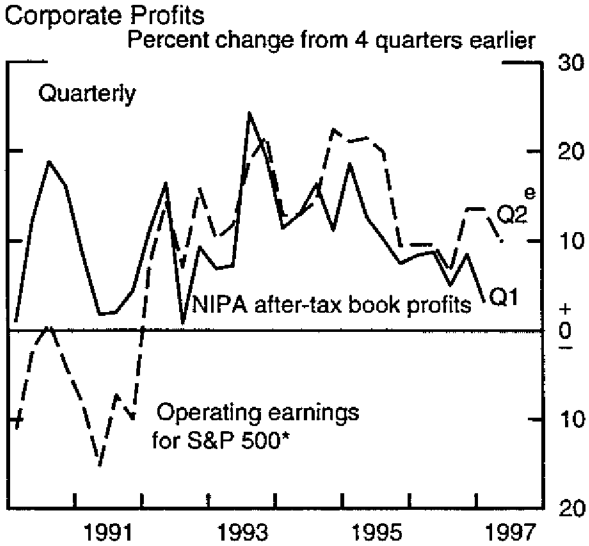


Price-Earnings Ratios



Note. Based on trailing four-quarter earnings.

Corporate Profits

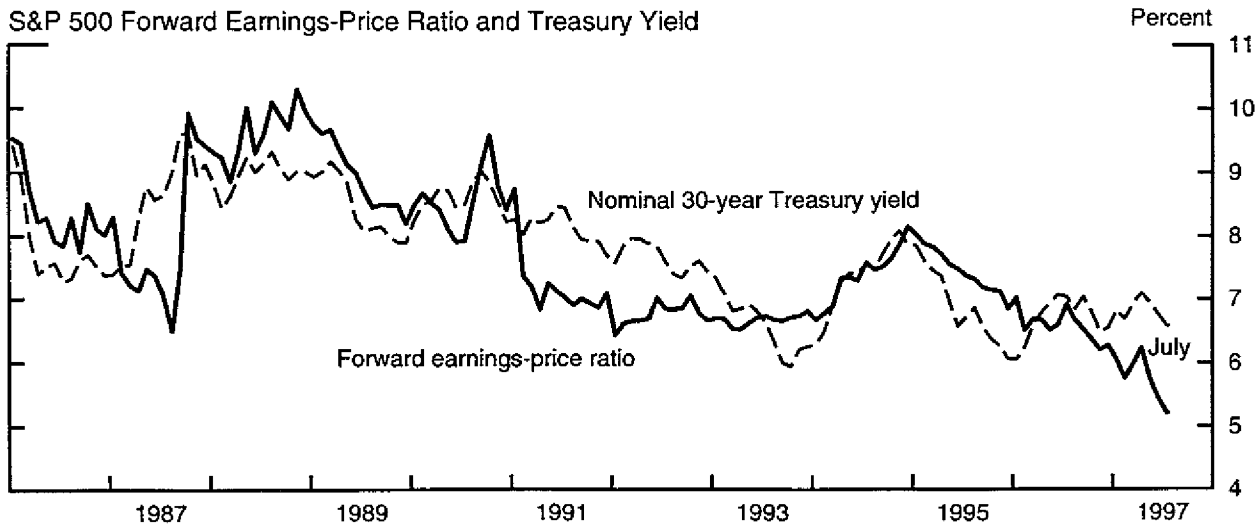


*Source. Goldman Sachs.

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

Source. I/B/E/S.

S&P 500 Forward Earnings-Price Ratio and Treasury Yield



business failures so far this year has been somewhat above the low levels in the preceding three years, with the failure rate in July boosted by the bankruptcy filing of retailer Montgomery Ward.

Elevated price-earnings ratios have encouraged equity issuance by nonfinancial firms, which was higher in July than in the first half of the year although below last year's rapid pace. The volume of initial public offerings in July and the first week of August was also up a touch over the first-half pace, likely reflecting stronger investor demand, as signaled by the uptrend in first-day returns to IPOs (chart, top left). Nevertheless, net issuance of nonfinancial equity remained firmly negative, as it has been since 1994. Both retirements from mergers and announcements of share repurchases continued to be strong in the second quarter, and the large number of transactions currently pending suggests that retirements from mergers and repurchases will remain robust in the near term.[2]

With more than 90 percent of the S&P 500 companies' second-quarter financial reports now in, earnings rose about 10 percent over the past four quarters, again exceeding analysts' projections.[3] Although earnings growth slowed somewhat from its four-quarter growth rate of nearly 15 percent recorded in the two preceding quarters, the positive earnings surprises reinforced investor enthusiasm for equities, pushing major stock price indexes to new records in July and early August. As has been true for some time now, prices have been boosted by expectations of higher long-term earnings growth. Indeed, the July reading on expected earnings growth for the S&P 500 over the next three to five years stood at its highest level since the start of the series in the early 1980s (chart, middle right panel). With the rise in share prices accompanied by only a small net decline in long-term Treasury yields, equity valuations became even richer relative to bonds over the intermeeting period (chart, lower panel).

Household Finance

The deceleration of personal consumption expenditures in the second quarter of 1997 left its mark on demands for consumer credit.

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2. Share repurchases are being offset partly by shares issued when employees exercise stock options. The exercise of stock options has increased substantially since 1994. However, companies have bought back about twice as many shares than needed to meet current stock option exercises.

3. The growth in reported earnings continues to exceed that for the closest analogue in the NIPAs--book profits after tax. Still, the recent upward revisions to NIPA profits narrowed the gap through 1997:Q1, the latest quarter with published NIPA data.

After a first-quarter spurt, borrowing in consumer credit markets returned to the moderate pace posted at the end of last year (table). Consumer credit outstanding was unchanged in June, on the heels of a sluggish gain in May, and grew at a 3-3/4 percent annual rate for the quarter. This continues a trend of moderation that began early last year (chart, top panel).[4] Revolving credit--primarily credit card debt--grew at a 5-1/2 percent rate during the second quarter, its slowest advance since the second quarter of 1993.

Data on consumer credit quality from the Call Report and the American Bankers Association are not yet available for the second quarter. The limited information now in hand provides signs of stabilization or even improvement in some market segments in which payment performance had been problematic. Both Moody's and Standard & Poor's indicate that delinquency rates on securitized credit card receivables have been edging lower since February (chart, bottom left panel). In addition, some of the major bankcard issuers have cited improved or stable delinquency rates on credit card receivables in their second-quarter earnings reports. For example, Citicorp reported a delinquency rate of 2.7 percent, up from 2.4 percent in the year-ago period but unchanged from the first quarter. MBNA reported increased earnings and stable write-offs. Similarly, auto loan delinquency rates at the finance "captives" of the three major domestic automakers declined in the second quarter after three years of virtually uninterrupted rise (chart, bottom right panel). Still, while delinquency rates have flattened out, they remain on the high side of what is typical for an expansion.

Information on the growth in home mortgage debt is still incomplete for the second quarter; partial data suggest that the net flow may have edged off from the sizable first-quarter total. The rate of mortgage purchases and securitizations at Fannie Mae and Freddie Mac slowed measurably, but growth in total real estate loans at commercial banks picked up, partly reflecting continued strength in home equity loans. More recently, mortgage applications have strengthened, according to indexes compiled by the Mortgage Bankers Association, as mortgage interest rates have declined on net. Applications for home purchase in July were at the highest level recorded in the four years the series has existed, and applications

4. The consumer credit statistics have been revised from January 1985 to reflect the benchmarking of the finance company components, but the effect on overall growth rates was quite small.

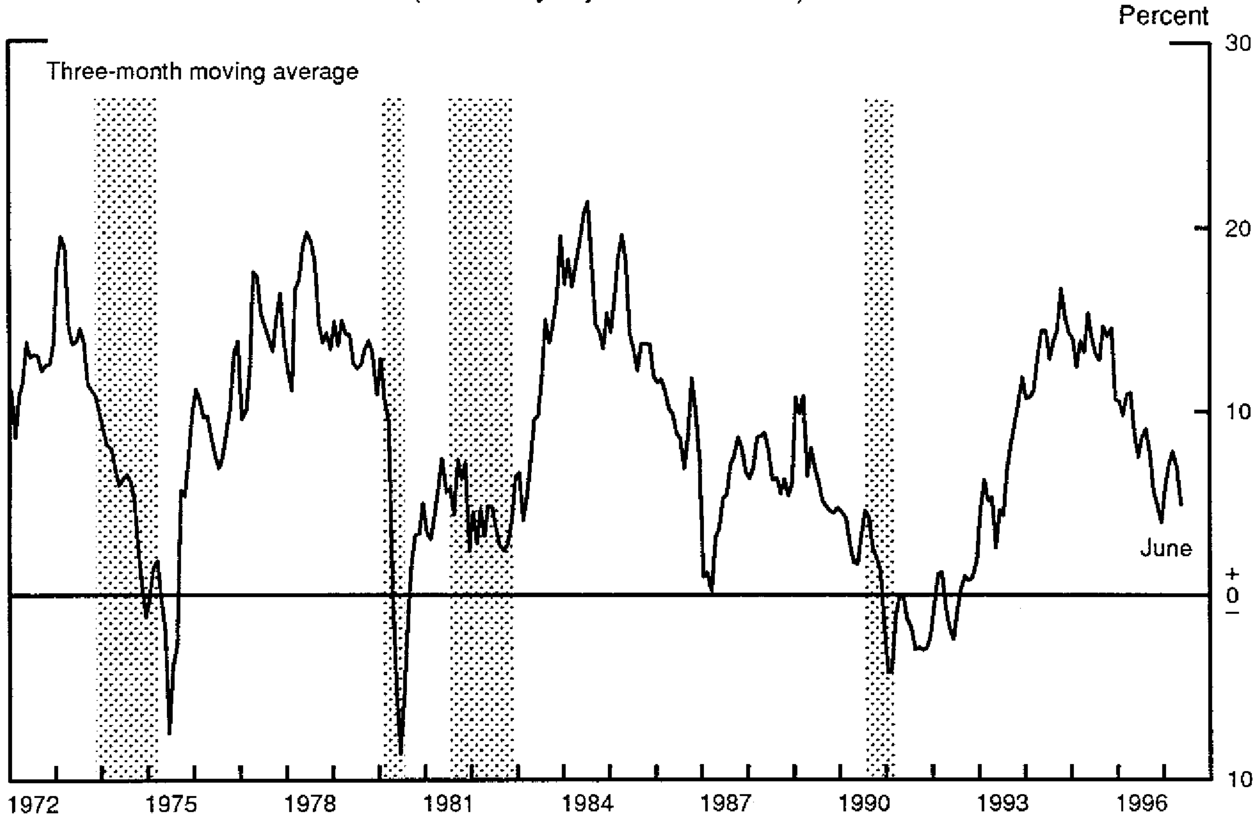
Consumer Credit

	1995	1996	1996 Q4	1997 Q1	1997 Q2^p	1997 Apr	1997 May	1997 Jun^p
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.1	7.6	3.4	7.3	3.8	8.9	2.5	0.0
(Previous)	*(14.2)*	*(8.1)*	*(5.1)*	*(6.3)*		*(9.7)*	*(2.9)*	
Auto	11.0	7.8	3.5	0.1	4.0	11.7	0.4	-0.2
Revolving	21.2	12.7	10.9	9.2	5.6	6.8	4.1	5.8
Other	8.5	-0.3	-8.5	13.4	0.6	8.8	2.5	-9.5
Levels (billions of dollars, SA)								
Total	1100.7	1184.0	1184.0	1205.6	1217.0	1214.5	1217.0	1217.0
Auto	362.1	390.3	390.3	390.4	394.3	394.3	394.4	394.3
Revolving	441.9	498.0	498.0	509.5	516.6	512.4	514.1	516.6
Other	296.8	295.7	295.7	305.6	306.1	307.9	308.5	306.1
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	9.0	8.9	9.2	n.a.	9.2	n.a.
Personal (24 mo.)[2]	13.9	13.5	13.6	13.5	13.8	n.a.	13.8	n.a.
Credit cards[3]	16.0	15.6	15.6	15.9	15.8	n.a.	15.8	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	9.8	7.6	8.0	8.6	7.8	7.6
Used cars	14.5	13.5	13.6	13.1	13.4	13.3	13.5	13.6

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

Growth in Consumer Credit

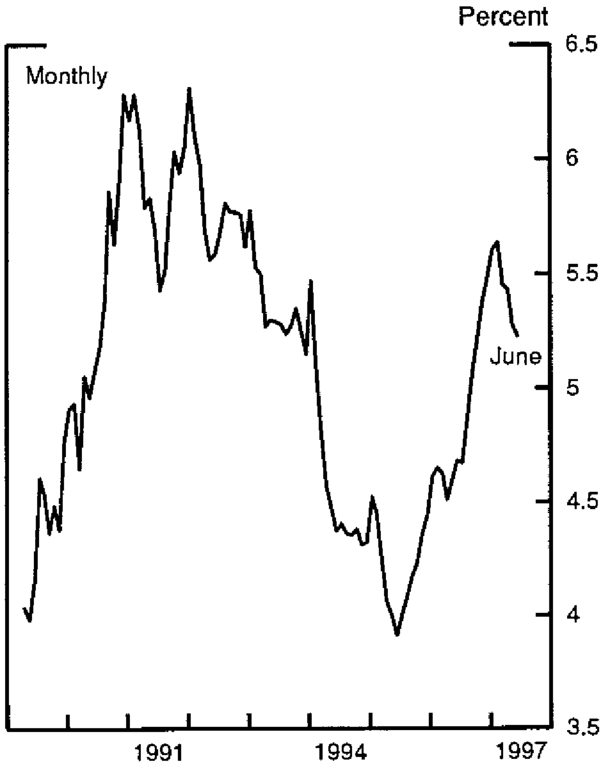
(Seasonally adjusted annual rate)



Loan Delinquency Rates

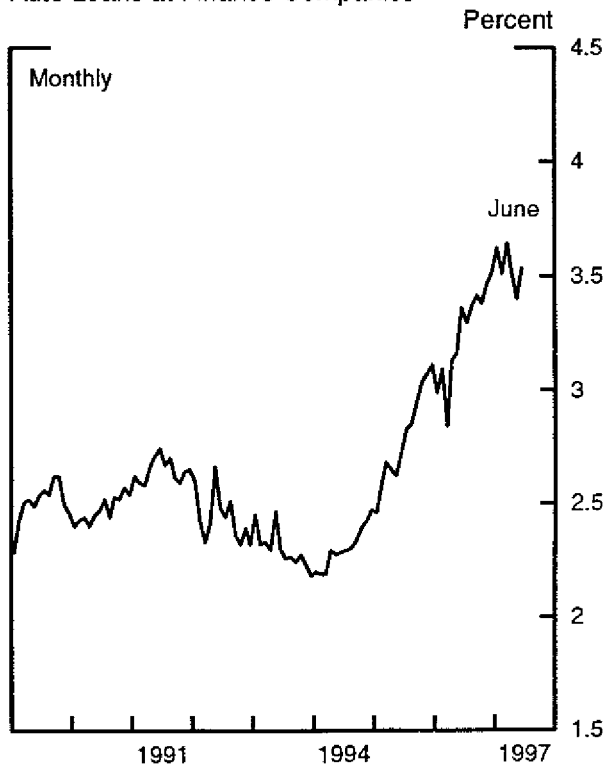
(Thirty days past due)

Securitized Credit Cards



Source. Moody's Investors Service.

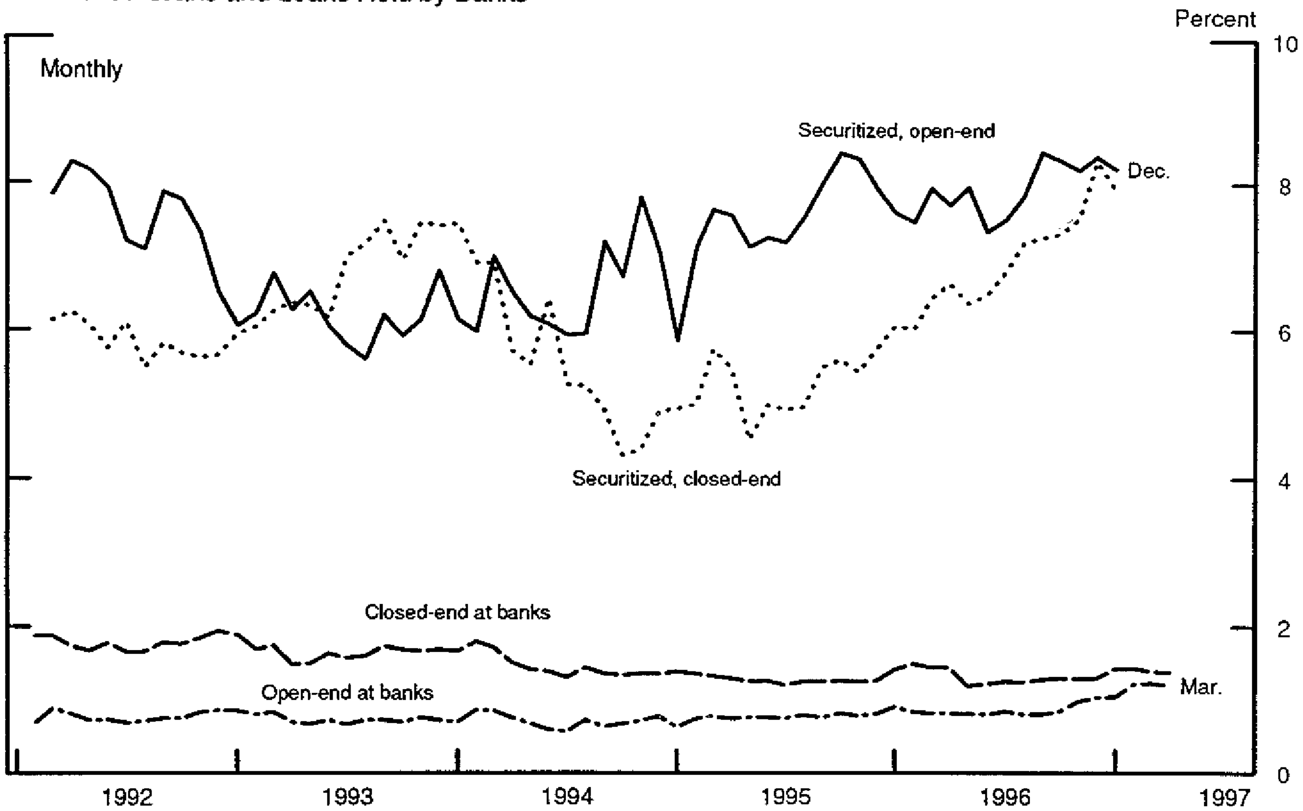
Auto Loans at Finance Companies



Source. Company reports.

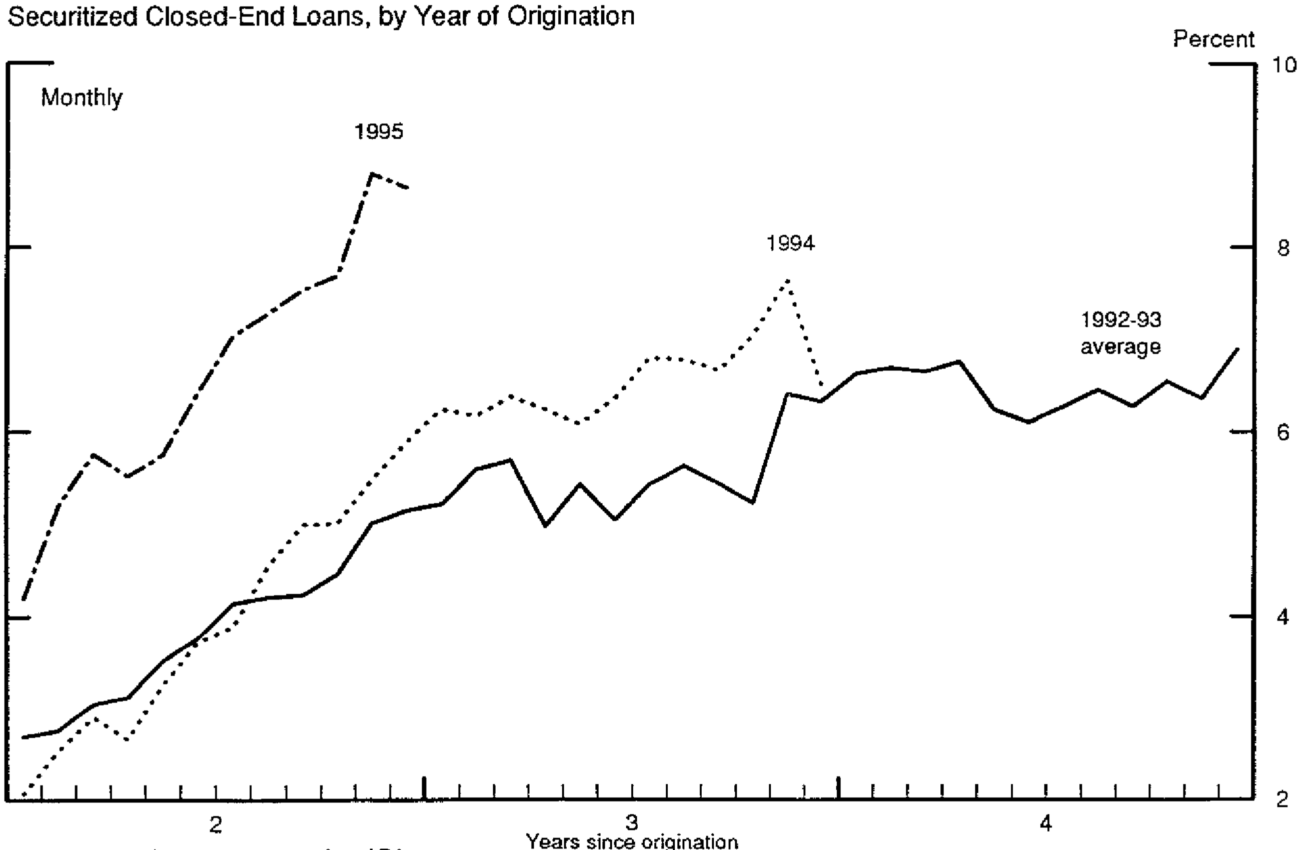
Delinquency Rates on Home Equity Loans

Securitized Loans and Loans Held by Banks



Source. Moody's Investors Service, ABA.

Securitized Closed-End Loans, by Year of Origination



Source. Moody's Investors Service, ABA.

for refinancing, although well below peak levels, have climbed noticeably.

Home equity loans in the second quarter continued the rapid expansion in train since the spring of last year. In addition to the strong increase at banks, finance company holdings grew at a 14 percent rate. The biggest gains occurred in pools of securitized home equity loans, which expanded at an estimated 76 percent rate over the first half of the year. Finance companies and mortgage companies have originated the bulk of recently securitized home equity loans, most of which are closed-end loans classified as "subprime" or "B and C" quality loans.[5] The proceeds from these loans are frequently used to consolidate other debt. Indeed, securitization has been the primary funding source for many of the firms specializing in subprime home equity loans. Heavy investor demand for the securities has ensured a ready supply of financing.[6]

At the end of last year, delinquency rates on securitized home equity loans were around 8 percent compared with less than 2 percent on those on bank books (chart, upper panel). The growing dominance of lower-quality loans in securitized pools also shows through in the time paths of delinquency rates for pool cohorts by year of origin (chart, lower panel). The delinquency rate for closed-end loans backing pools created in 1995 was much higher after two years than it was for earlier cohorts at the same point in their seasoning. Information on more recently formed pools is still fragmentary, but anecdotal reports suggest that the credit performance of the 1996 cohort is similar to that of the 1995 cohort.

Treasury, Agency, and State and Local Finance

The staff forecasts that the Treasury will borrow about $30 billion in the market this quarter to fund a budget deficit of similar size. The Treasury announced that it will satisfy two-thirds of its borrowing need through the issuance of bills and one-third through the issuance of notes and bonds.

5. In contrast, home equity lending by banks is about evenly split between revolving lines--which typically are extended to better credit risks--and closed-end loans.

6. According to market sources, institutional investors such as hedge funds have been among the investors attracted to subordinate classes, while banks and thrift institutions have sought the senior certificates, which have received AAA ratings because of substantial credit enhancements and the structure of the securities themselves.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 June	1997 July[e]
Total surplus/deficit (-)	-58.9	-52.0	100.0	-48.5	54.5	--
Means of financing deficit						
Net cash borrowing and repayments (-)	48.7	48.0	-69.2	-19.1	-11.1	-1.2
Nonmarketable	7.4	4.0	1.9	-.4	1.4	-1.5
Marketable	41.3	44.0	-71.1	-18.6	-12.6	.4
Bills	16.2	7.9	-81.4	-21.7	-15.5	1.8
Coupons	25.1	36.1	10.3	3.1	3.0	-1.5
Decrease in cash balance	11.4	-.7	-17.8	72.5	-34.4	23.7
Other[1]	-1.3	4.6	-13.0	-5.0	-9.0	--
Memo:						
Cash balance, end of period	32.8	33.5	51.3	16.9	51.3	27.5

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.

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

Agency	1997 Q1	1997 Q2	1997 Apr.	1997 May	1997 June
FHLBs	3.1	23.6	11.4	7.0	5.2
FHLMC	-3.4	8.3	9.3	4.5	-5.5
FNMA	4.9	9.3	5.6	2.6	1.1
Farm Credit Banks	.8	1.2	.1	.4	.7
SLMA	-1.7	1.7	5.4	-.9	-2.8

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

At its midquarter refunding in August, the Treasury sold three-year notes ($16 billion), ten-year notes ($12 billion), and thirty-year bonds ($10 billion). Customer demand at the refunding was unexpectedly weak, and, as a result, dealers were awarded more securities than they had expected, putting downward pressure on bond prices after the auction. Demand for the thirty-year tranche of the refunding was particularly weak, with the yield on that security in the when-issued market shooting up 18 basis points after the auction.

The Treasury indicated that in October it will reopen the just-auctioned five-year indexed notes and confirmed that it will sell a thirty-year indexed bond next year. With regular quarterly sales of indexed debt all but guaranteed and net borrowing from the public projected to be substantially smaller than in recent fiscal years, the Treasury appears committed to raising a substantial fraction of its anticipated net financing need with indexed debt.

A proxy battle at the Student Loan Marketing Association ended with the replacement of the current management with a dissident group of directors. The new leadership favors direct origination of loans to students, which the ousted management opposed. Sallie Mae is expected to become fully private soon. Spreads between Sallie Mae issued securities and Treasuries have held steady over the intermeeting period.[7]

Gross offerings of long-term municipal debt decreased to $15 billion in July, from about $19 billion in June, reflecting a typical seasonal decline in new capital issuance at the start of the fiscal year of many municipalities (chart, top panel). However, with long-term yields approaching the lows reached in late 1993, refunding volume increased nearly 25 percent in July. For the first seven months of 1997, gross issuance of long-term municipal debt was little changed from last year, while retirements declined about 15 percent, boosting net issuance from its 1996 pace.

The credit quality of municipal debt continued to improve. In the second quarter, Standard and Poor's upgraded nearly $16 billion of municipal debt and downgraded less than $1 billion, attributing the recent improvement in credit quality to the economic expansion, coupled with better financial management on the part of state and

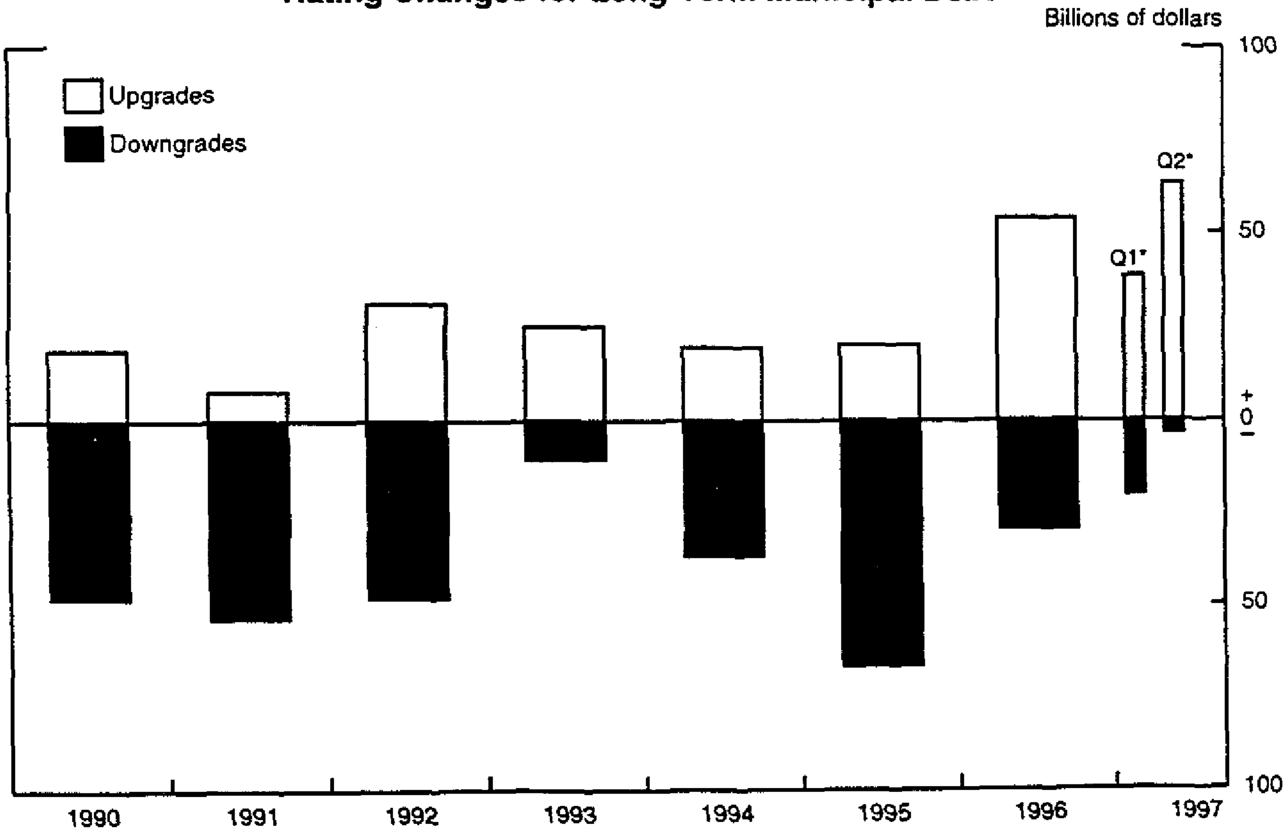
7. The legal status and attributes of all of the outstanding debt obligations, including SEC and state tax exemptions, will be fully preserved after the privatization. With minor variations, these attributes are the same as for other GSEs.

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

	1994	1995	1996	1997 Q1	1997 Q2	1997 June	1997 July
Total tax-exempt	16.1	15.4	17.9	13.7	20.8	28.9	22.0
Long-term	12.8	12.1	14.3	12.1	16.9	19.4	15.5
Refundings[1]	4.0	3.6	4.9	4.3	4.4	4.4	5.7
New capital	8.8	8.5	9.4	7.8	12.5	15.0	9.8
Short-term	3.3	3.3	3.6	1.6	3.9	9.5	6.5
Total taxable	.7	.7	.8	.7	1.6	3.5	1.0

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

local governments (chart, bottom panel). General obligation bonds, which are especially sensitive to the prospects for tax receipts, accounted for most of the net upgrades in the second quarter.

Financial Intermediaries and Monetary Aggregates

The rally in the stock market over the intermeeting period was again accompanied by heavy inflows to mutual funds. Net sales of stock funds are estimated to have increased in July, up 30 percent from their second-quarter pace (table). July net sales of bond funds are currently estimated to be at least twice as large as the monthly pace in the second quarter. Still, net sales of bond funds remain small relative to those of stock funds.

Liquidity ratios for both domestic bond and stock funds were about 5-1/2 percent at the end of June (chart). For bond funds, this figure is close to the average since 1990, while the ratio for stock funds is well below the average. The declining liquidity ratio for stock funds reflects a growing reliance on backup lines of credit and expectations of heavy future inflows of cash from new investors, as well as the acquisition of liquid fixed income securities with maturities beyond one year, which are not counted as liquid assets by the SEC.

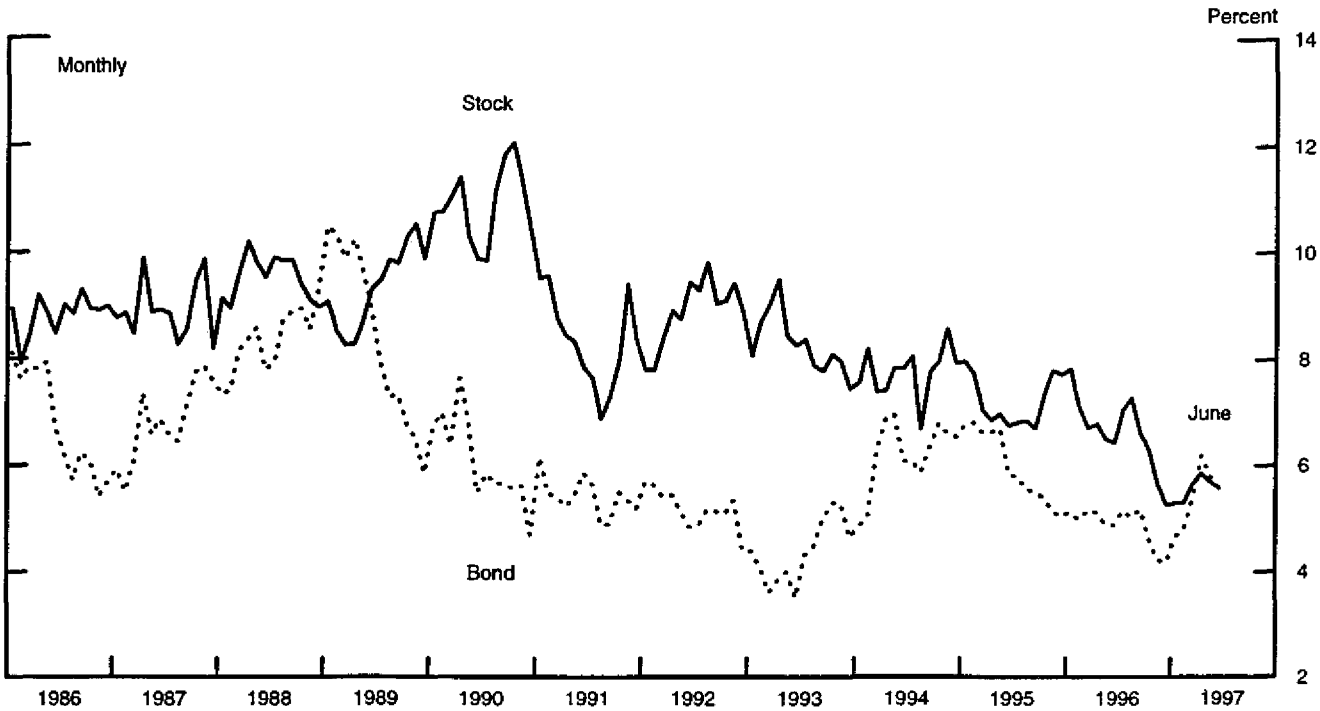
Credit provided by commercial banks, adjusted to remove the effects of mark-to-market accounting rules, expanded at a 9-1/2 percent rate in the second quarter, fueled by strong increases in both its business and real estate components (table). Most likely, some of that C&I lending helped firms to finance a further buildup of inventories in the second quarter, while real estate lending was supported by the strength in housing activity and the attractiveness of home-equity loans. Supply conditions also appeared to be accommodative: The August Senior Loan Officer Survey indicated that a large fraction of banks eased terms on both C&I and commercial real estate loans, and a significant share of respondents, for the first time, eased standards on commercial real estate loans. Consumer lending, in contrast, was subdued in the second quarter, even after adjusting for the effects of securitization, in line with the marked slowdown in personal consumption expenditures. Results from the August Senior Loan Officer Survey showed that banks continued to tighten standards on consumer loans, especially on credit cards, but by notably less than the previous couple of surveys. Nonetheless, over 10 percent of

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

			1997					Memo:
	1995	1996	Q1	Q2	May	June	July[e]	June assets
Stock funds	10.7	18.6	19.3	17.6	20.5	16.6	23.0	2,125.6
Domestic[1]	9.7	14.7	14.9	12.6	16.1	12.0	17.9	1,767.4
Aggressive growth	3.1	4.7	1.9	2.4	3.8	2.0	3.2	315.0
Growth	3.1	3.9	3.7	3.1	4.3	3.0	5.6	573.2
Growth and income[2]	3.7	6.2	9.3	7.4	7.9	7.2	9.1	875.1
International[3]	1.0	3.9	4.4	4.7	4.2	4.6	5.1	358.2
Bond funds	-.4	1.1	1.2	1.9	2.8	2.1	4.0	941.8
High-yield	.7	1.0	.9	1.6	2.0	1.5	1.8	89.8
Balanced[4]	1.4	2.6	1.6	1.4	1.5	1.7	1.3	284.0
Other	-4.7	-2.5	-1.3	-1.1	-.8	-1.0	.9	568.1

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.

Liquidity Ratios for Domestic Long-Term Mutual 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	1997 Q1	1997 Q2	1997 May	1997 June	1997 July	Level, July 1997 (billions of $)
1. Bank credit: Reported	3.9	9.9	7.5	2.4	6.8	10.1	3,956.7
2. Adjusted[1]	4.5	7.3	9.5	5.1	7.7	6.2	3,870.9
3. Securities: Reported	-1.6	13.8	2.6	-21.3	-3.8	27.6	1,034.6
4. Adjusted[1]	-0.0	3.8	10.5	-12.4	-1.0	13.0	948.8
5. U.S. government	-0.7	0.7	9.6	-0.7	5.0	1.3	725.8
6. Other[2]	-3.7	47.4	-13.6	-69.2	-25.0	94.3	308.9
7. Loans[3]	6.0	8.5	9.2	10.9	10.5	4.0	2,922.1
8. Business	8.7	8.2	9.4	8.5	9.6	6.3	821.5
9. Real estate	4.0	7.6	10.3	10.6	9.3	3.9	1,185.5
10. Home equity	6.9	11.9	16.6	14.8	18.6	13.1	92.6
11. Other	3.8	7.3	9.7	10.3	8.4	3.3	1,093.0
12. Consumer: Reported	5.5	-0.1	-1.4	6.5	5.1	-1.4	520.0
13. Adjusted[4]	10.8	4.7	1.4	4.5	4.3	2.4	701.2
14. Other[5]	7.9	24.6	20.7	22.2	23.4	7.0	395.1

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.

respondents reported increased willingness to make consumer loans, the largest fraction since May 1995.

Data for July indicate that the growth of total bank credit slowed to a 6-1/4 percent rate. A deceleration across all major loan categories was, in part, offset by an acceleration in securities lending. In particular, real estate loan growth was anemic, except for the home equity component, and consumer loans slowed to a 2-1/2 percent pace. The expansion of business lending eased off as well, perhaps because firms turned to market sources of finance.

Earnings reports for the second quarter for the top 150 bank holding companies suggest that profits expanded at about the moderate first-quarter pace, despite the negative effects of nonrecurring charges relating to the cost of mergers and restructuring. Indeed, non-interest income increased, and the return on assets stayed at a historically high level. Meanwhile, loan-loss provisions remained stable as a percentage of average assets even though the ratio of charge-offs to loans edged up.

M2 increased at a 4-1/2 percent annual rate in July, near its pace in the second quarter (table). The growth of M2 has been restrained by ongoing sluggishness in household deposits. Households continue to favor assets such as retail money market mutual funds, which are included in M2, and stock and bond mutual funds, which are not. Growth in M2 from the fourth quarter of 1996 through July averaged just under 5 percent, near the upper end of its annual growth cone.

M3 was particularly robust in July, registering a 10-3/4 percent advance. Although bank credit slowed in July, M3 was bolstered by heavy offerings of large time deposits at U.S. branches of foreign banks, evidently to pay down borrowings from their overseas offices. Domestic banks also increased their issuance of large time deposits, in part to counter the falloff in government deposits held at these institutions. Institution-only money funds advanced rapidly in July, as they have done, on average, over the last year and a half, apparently reflecting their appeal over in-house money management by businesses. Growth in M3 from the fourth quarter of 1996 through July averaged 7-1/2 percent, well above its annual growth cone.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1997 Q1	1997 Q2	1997 May	1997 June	1997 July (p)	1996:Q4 to July 97 (p)	Level (bil. $) July 97 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-0.7	-5.5	-2.7	0.6	-1.2	-2.5	1062.1
2. M2[2]	4.7	6.1	4.3	-0.1	4.6	4.4	4.9	3934.2
3. M3	6.8	8.1	6.9	1.5	5.7	10.7	7.6	5141.4
Selected components								
4. Currency	5.7	7.5	5.8	7.1	4.7	7.7	6.8	410.3
5. Demand deposits	2.7	2.0	-6.8	0.6	5.2	-3.3	-1.8	396.2
6. Other checkable deposits	-23.1	-16.1	-20.4	-22.8	-12.8	-13.4	-16.7	247.3
7. M2 minus M1[3]	8.8	8.7	8.1	0.9	6.2	6.5	7.8	2872.1
8. Savings deposits	11.7	10.7	9.3	-0.2	4.1	6.3	8.8	1332.4
9. Small time deposits	1.4	1.9	2.6	5.4	5.7	3.1	2.8	960.9
10. Retail money market funds	17.1	16.3	14.7	-4.2	12.1	12.6	14.4	578.9
11. M3 minus M2[4]	15.4	15.5	15.8	7.1	9.2	31.8	17.4	1207.2
12. Large time deposits, net[5]	16.6	12.9	20.6	3.4	23.8	43.1	21.0	553.3
13. Institution-only money market mutual funds	19.8	15.6	12.5	0.0	28.1	19.6	15.9	324.1
14. RPs	4.1	7.8	1.6	-3.0	-15.0	42.0	7.5	204.1
15. Eurodollars	21.5	40.5	27.7	56.1	-56.4	0.0	23.6	125.8
Memo								
16. Sweep-adjusted M1[6]	5.0	6.7	4.0	6.1	4.4	2.6	5.0	1279.9
17. Monetary base	3.8	5.6	3.2	3.7	4.7	7.5	4.9	464.3
18. Household M2[7]	4.9	6.7	5.6	1.1	4.5	5.8	5.8	3540.2
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	12.7	11.3	2.2	12.3	18.9	...	639.1
19. Net due to related foreign institutions	-2.0	-7.2	2.9	22.0	-4.2	-12.9	...	216.6
20. U.S. government deposits at commercial banks	0.0	0.5	2.5	5.4	-9.1	-5.9	...	17.4

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.

APPENDIX
THE AUGUST SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

The August 1997 Senior Loan Officer Opinion Survey on Bank Lending Practices (covering, for the most part, changes over the preceding three months) posed questions about bank lending standards and terms, loan demand by businesses and households, and securities backed by commercial mortgages. The responses suggest that banks became even more accommodative lenders to businesses and that the tightening of standards on loans to households slackened somewhat.

Increased competition for business credit apparently led large percentages of surveyed banks to ease terms on C&I and commercial real estate loans over the past three months. Furthermore, a small, but significant, share of banks reported easing standards on commercial real estate loans. Demand for C&I and commercial real estate loans strengthened at many of the respondents.

Banks again reported tightening standards on consumer loans, but the percentage that tightened was lower than in recent surveys. Moreover, several banks expressed increased willingness to make these loans. Demand for consumer loans reportedly declined.

Lending to Businesses

A small net percentage of the domestic respondents--about 5 percent--reported easing standards for C&I loans to large and middle market firms and to small businesses over the past three months (chart). About 40 percent, on net, narrowed spreads of C&I loan rates over their bank's cost of funds on loans to large and middle market borrowers, and about 25 percent, on net, narrowed spreads on loans to small businesses. Similar percentages indicated lower costs of credit lines, and smaller percentages eased other terms, including the maximum size of credit lines, loan covenants, and collateralization requirements. The degree of easing found in the August survey is similar to that found in the January and May surveys. Those banks that eased said they did so because of increased competition from other banks, and, to a lesser extent, from nonbank lenders. Foreign respondents reported no change in standards for C&I loans, and only a few indicated a change in terms.

Increased demand for C&I loans, on net, from large and middle market borrowers and from small business borrowers was reported by 15 percent and 20 percent, respectively, of the domestic banks. Respondents attributed the increased demand to greater customer financing needs for mergers and acquisitions, plant and equipment investment, and inventories. Foreign respondents reported essentially no change in demand for C&I loans.

The survey results suggest that banks are cautiously increasing their participation in the market for commercial real estate loans. More than 10 percent of the domestic respondents, on net, reported easing standards for these loans over the past three months. The three preceding surveys also found small net percentages easing standards on these loans, and the August results mark the largest, albeit still modest, net percentage easing since the question was added to the survey in 1990. In addition, two-fifths of the domestic respondents narrowed spreads on these loans over the past three months, and smaller fractions increased maximum loan sizes, extended maximum loan maturities, and eased pre-leasing or pre-sale agreements. The survey found little change in required loan-to-value ratios, requirements for take-out financing, and debt-service coverage ratios. Foreign respondents reported essentially no change in standards and, other than a few that narrowed spreads, little change in terms. Increased competition was reportedly the principal reason for the eased standards and terms, although many banks also cited improvements in the condition of or the outlook for commercial real estate. About 15 percent of the domestic and 25 percent of the foreign respondents reported increased demand for commercial real estate loans.

Lending to Households

The August survey was the seventh in a row that found a tightening in standards for loans to households. However, the net percentages tightening were smaller in August, suggesting that many banks may now believe they have adjusted their lending stance appropriately to the deterioration in the performance of these loans that occurred over the past two years. In August, less than 25 percent of the respondents said they had tightened standards for credit card applications over the past three months and less than 10 percent, on net, had tightened standards for other consumer loans. These percentages, while significant, are about half those found in May. One-fourth of the respondents also lowered credit limits on credit card lines, although only small net fractions of banks tightened other terms on consumer loans. Despite these tighter standards and terms, about 10 percent of the banks, on net, said that their willingness to make consumer installment loans had increased over the past three months--the largest net percentage expressing increased willingness since the May 1995 survey (chart). About 10 percent of the respondents, on net, reported decreased demand for consumer loans.

Banks reported essentially no change in their standards for approving applications for mortgage loans to purchase homes. Twenty percent of the respondents, on net, reported increased demand for these loans.

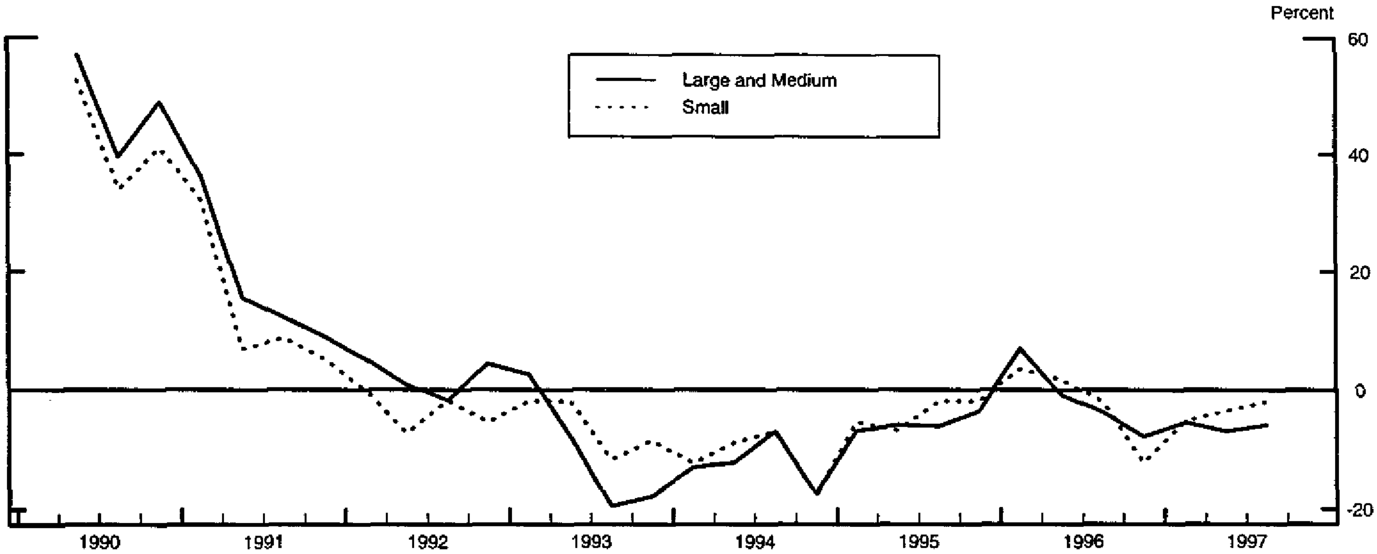
Commercial Mortgage-Backed Securities

Special questions on the survey asked about banks' issuance and holdings of commercial mortgage-backed securities, which have grown rapidly in recent years. About one-fourth of the domestic respondents, concentrated among the larger banks, and one-fifth of the foreign respondents had securitized commercial mortgages. Almost all the respondents that had securitized commercial mortgages had done so, at least in part, through a conduit program. These programs are typically arrangements sponsored by an investment bank to package loans originated by correspondent lenders. The investment bank establishes lending guidelines under which the correspondents originate their loans, thus promoting uniformity in the loans backing the securities.

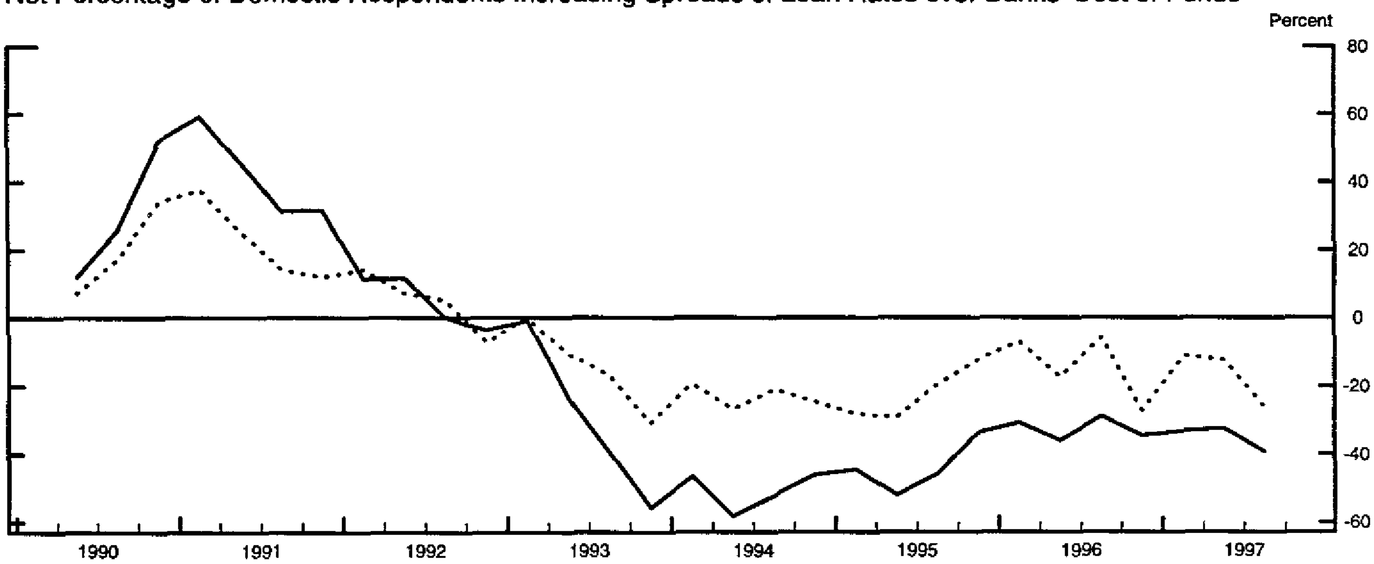
About half of those banks that had securitized commercial mortgages retained at least some of the servicing responsibilities for them. Only a couple of the banks retained junior or senior classes of the securities backed by the commercial mortgages they had originated. However, about one-fourth of the respondents, especially the larger respondents, did hold some commercial mortgage-backed securities.

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

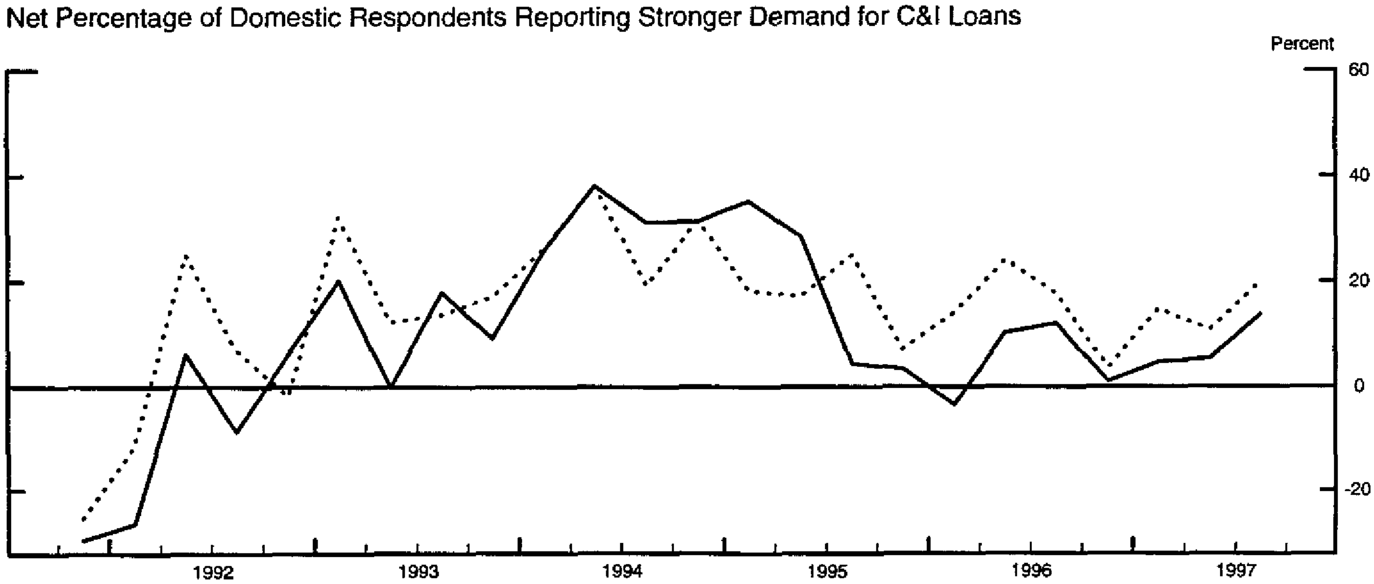
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



Net Percentage of Domestic Respondents Increasing Spreads of Loan Rates over Banks' Cost of Funds

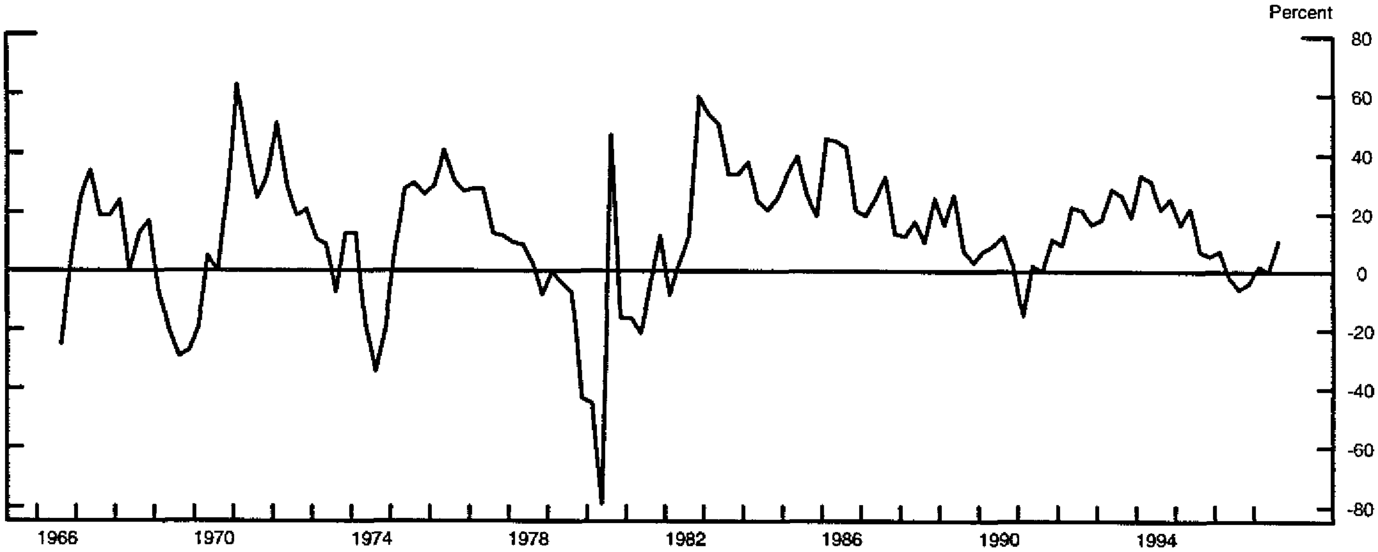


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

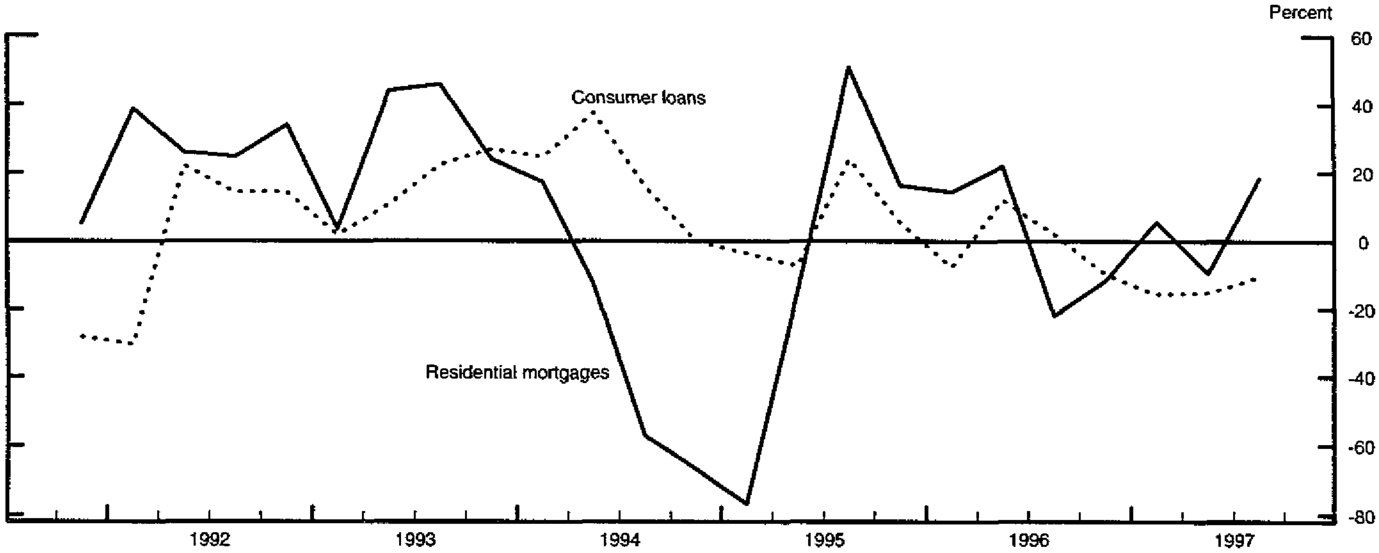


Measures of Supply and Demand for Loans to Households

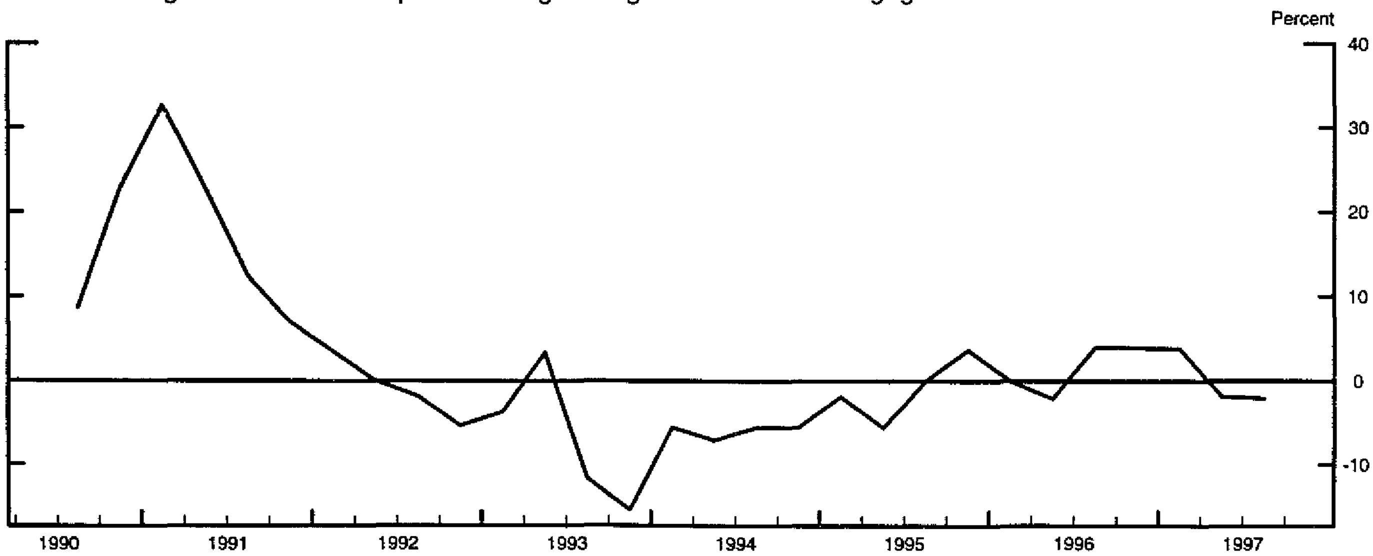
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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

In May, the deficit in U.S. international trade in goods and services widened, as exports fell and imports rose. In April/May combined, the deficit was slightly smaller (at an annual rate) than the level recorded in the first quarter and a bit larger than the deficit for 1996. Trade data for June will be released on August 20.

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

		Annual rates			Monthly rates		
	1996	1996	1997		1997		
		Q4	Q1	Q2e/	Mar	Apr	May
Real NIPA 1/							
Net exports of G&S	-113.6	-98.4	-120.7	n.a	...	...	...
Nominal BOP							
Net exports of G&S	-111.0	-104.8	-116.5	-113.9	-7.8	-8.7	-10.2
Goods, net	-191.2	-192.8	-199.1	-195.4	-14.9	-15.5	-17.0
Services, net	80.1	88.0	82.7	81.6	7.1	6.8	6.8

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 expanded 3-1/2 percent in April/May, relative to the first-quarter level. The largest increases were in exports of machinery and in exports of aircraft and aircraft parts. Most of the gains were due to increases in volumes rather than in prices. In contrast, agricultural exports continued to fall, mostly because of declines in prices of agricultural products.

Imports of goods and services grew 3 percent in April/May, relative to the first-quarter level. The strongest gain was seen in imports of consumer goods, although imports of computers and other capital goods (mostly machinery) also posted sharp increases. As with exports, most of the strength in these import categories was attributable to increases in import volumes.

Oil Imports and Prices

The quantity of imported oil in April/May was sharply higher than rates recorded during the first quarter of 1997 and well above rates recorded in 1996. Imports were driven by extremely strong consumption -- up 3.4 percent from rates observed a year ago. Preliminary Department of Energy statistics indicate that oil

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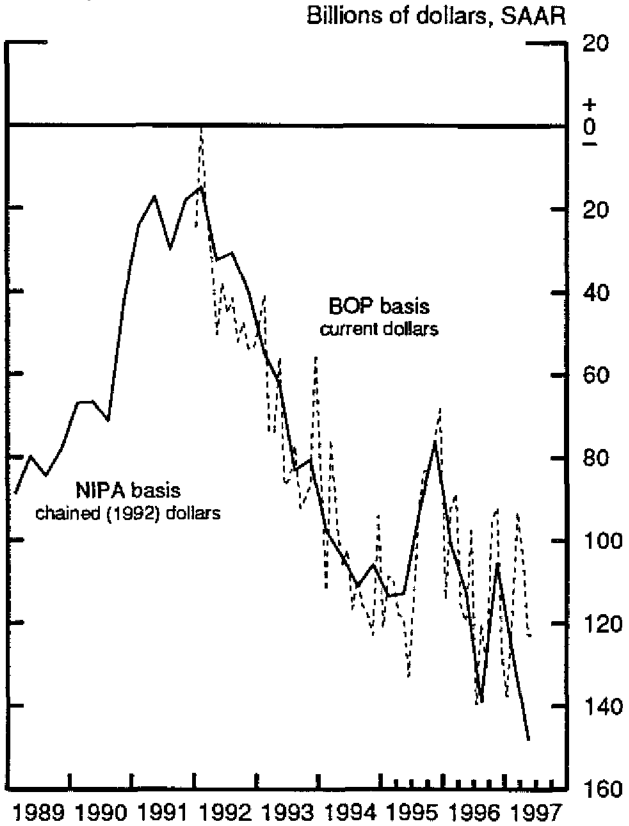
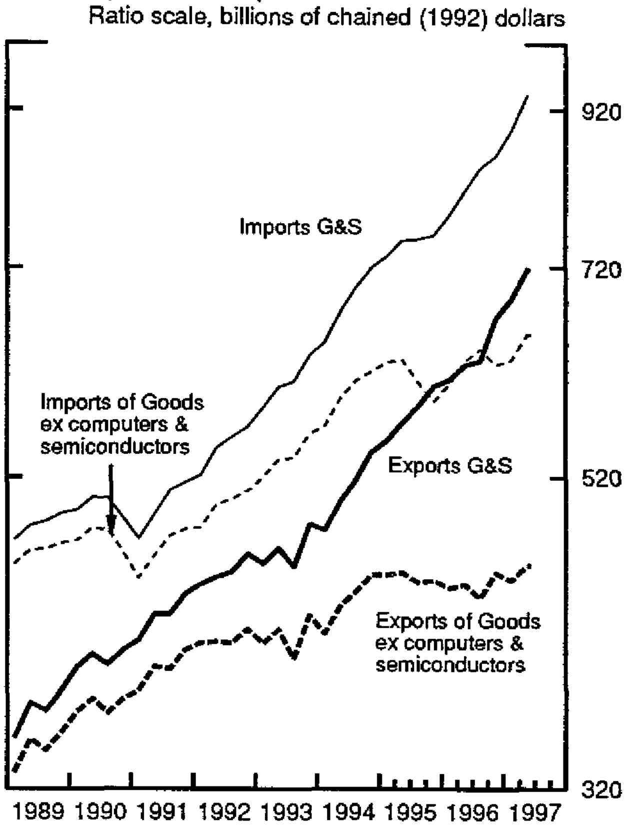
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

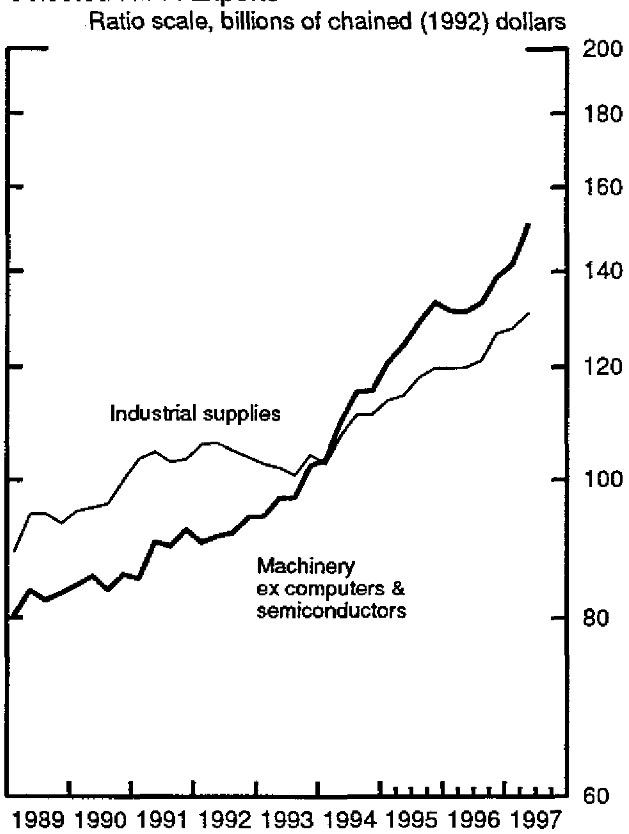
Net Exports



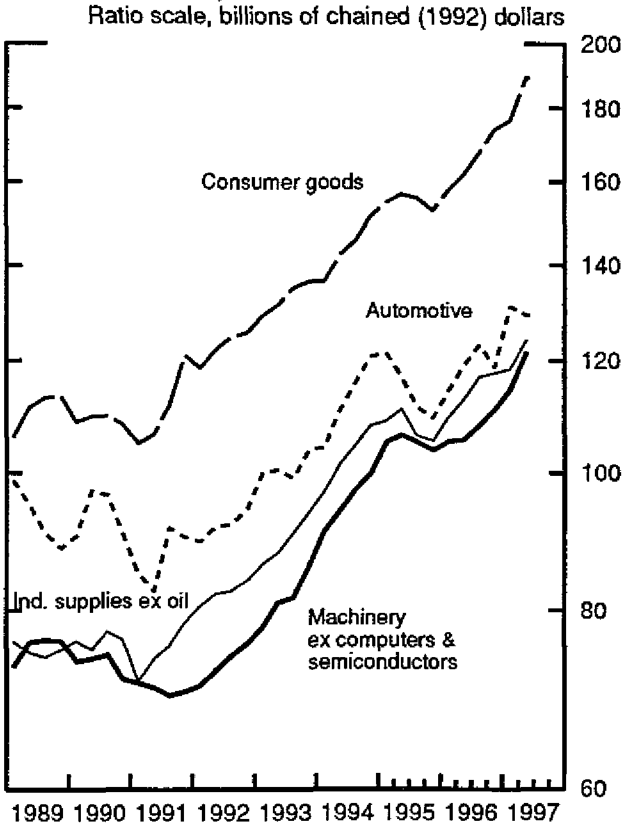
NIPA Exports and Imports



Selected NIPA Exports



Selected NIPA Imports



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

	Levels				Amount Change 1/			
	1997		1997		1997		1997	
	Q1	Q2e/	Apr	May	Q1	Q2e/	Apr	May
Exports of G&S	898.1	930.7	934.6	926.8	20.1	32.7	-3.7	-7.8
Goods exports	650.1	681.1	685.9	676.2	18.7	31.0	0.1	-9.8
Agricultural	57.3	56.9	57.1	56.7	-4.5	-0.4	0.1	-0.4
Gold	6.7	9.3	10.9	7.7	3.0	2.6	-2.2	-3.2
Other goods	586.1	614.9	617.9	611.8	20.2	28.8	2.1	-6.2
Aircraft & pts	39.6	48.4	47.6	49.1	2.9	8.7	-4.1	1.5
Computers	46.3	49.4	49.4	49.4	3.0	3.0	1.2	0.0
Semiconductors	37.8	38.0	37.8	38.2	0.8	0.2	0.7	0.4
Other cap gds	152.2	162.2	164.8	159.6	4.0	10.0	5.4	-5.3
Automotive	70.9	72.5	74.1	71.0	3.9	1.6	-0.7	-3.1
to Canada	38.7	38.2	38.5	37.9	3.6	-0.6	-1.6	-0.6
to Mexico	10.4	10.7	11.6	9.7	0.7	0.2	0.5	-1.9
to ROW	21.8	23.7	23.9	23.4	-0.4	1.9	0.4	-0.5
Ind supplies	137.2	139.9	140.2	139.6	1.7	2.8	-0.3	-0.6
Consumer goods	75.3	77.6	76.1	79.1	2.3	2.3	-1.7	3.0
All other	26.8	26.8	27.9	25.8	1.6	0.1	1.1	-2.1
Services exports	248.0	249.7	248.7	250.6	1.3	1.7	-3.8	1.9
Imports of G&S	1014.5	1044.6	1039.6	1049.6	31.7	30.1	8.2	10.0
Goods imports	849.3	876.5	872.3	880.7	25.1	27.2	7.9	8.4
Petroleum	76.7	70.3	68.0	72.6	-5.6	-6.4	-5.2	4.6
Gold	8.7	11.4	12.1	10.7	5.2	2.7	-6.6	-1.3
Other goods	763.9	794.8	792.2	797.4	25.4	30.9	19.7	5.2
Aircraft & pts	13.6	15.5	14.6	16.5	-0.3	1.9	1.2	1.9
Computers	65.5	70.3	70.0	70.6	2.7	4.9	3.8	0.6
Semiconductors	34.7	34.9	35.1	34.7	1.1	0.2	-1.6	-0.4
Other cap gds	123.5	129.7	128.5	130.9	2.4	6.2	-0.2	2.4
Automotive	142.2	138.4	136.4	140.4	13.3	-3.9	-3.8	4.0
from Canada	52.6	49.8	49.1	50.6	10.2	-2.8	-0.8	1.5
from Mexico	24.2	26.1	25.5	26.7	1.0	1.9	0.6	1.1
from ROW	65.4	62.5	61.8	63.1	2.2	-2.9	-3.6	1.3
Ind supplies	134.3	138.9	139.7	138.0	1.4	4.6	1.9	-1.6
Consumer goods	181.2	194.1	194.6	193.6	1.8	12.9	15.4	-1.0
Foods	38.0	40.6	40.3	40.9	1.3	2.6	0.4	0.6
All other	30.9	32.4	33.0	31.7	1.7	1.5	2.6	-1.3
Services imports	165.3	168.1	167.3	168.9	6.6	2.8	0.3	1.6
Memo:								
Oil qty (mb/d)	9.85	10.66	10.31	11.02	-0.29	0.81	0.12	0.71
Oil price ($/bbl)	21.35	18.06	18.07	18.05	-0.87	-3.29	-1.59	-0.02

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

imports remained strong in June and July due to continued high consumption demand.

The price of imported oil rose 2.4 percent in June, following a 1.1 percent rise in May. The June price increase was induced by concerns about the renewal of the Iraq oil-for-food arrangement. Despite these recent modest price increases, the price of imported oil in June was significantly below the level at the beginning of the year, as sharp declines occurred between February and April in response to deliveries of oil from Iraq and mild winter weather. Spot WTI rose $0.46 per barrel in July, averaging $19.63 per barrel, reflecting continuing market concerns about Iraq's shipments under U.N. supervision and the interruption of exports from Colombia due to repeated bombing of the oil pipeline by terrorists. Prices have been trading recently near the $20 per barrel level.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports increased slightly in June. There were price increases in most major import categories; the exceptions were imported prices of computers and consumer goods. For the second quarter, non-oil import prices declined moderately, continuing a downward trend that began in late 1995. Declines were recorded in all major end-use categories, with the exception of imported food prices.

Prices of exports decreased slightly in June, following slightly larger declines in April and May. The decline was attributable to lower prices for agricultural products, and, to a lesser degree, decreases in prices of computers and semiconductors. On average in the second quarter, export prices decreased moderately. Prices of agricultural products declined sharply. Prices of nonagricultural exports were unchanged, on balance, with decreases in computer and semiconductor prices offsetting price increases in other major trade categories.

Trade prices for July will be released on August 19.

U.S. International Financial Transactions

Private foreign net purchases of U.S. securities were very strong in June and for the second quarter (line 4 of the Summary of U.S. International Transactions table). Net purchases for the first half of 1997 are on a pace that would break the record set only last year. Net private purchases of Treasury securities (line 4a) and

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

	Annual rates			Monthly rates		
	1996	1997		1997		
	Q4	Q1	Q2	Apr	May	Jun
	----------BLS prices (1995=100)----------					
Merchandise imports	5.3	-4.6	-8.2	-1.1	0.0	0.4
Oil	64.3	-23.8	-45.6	-7.4	1.1	2.4
Non-oil	-0.4	-2.3	-3.2	-0.5	-0.1	0.2
Foods, feeds, bev.	1.8	4.9	9.1	-1.8	1.6	1.1
Ind supp ex oil	1.0	4.8	-6.0	-0.9	0.3	0.2
Computers	-8.5	-13.8	-17.6	-2.0	-1.8	-1.0
Semiconductors	-15.0	-24.7	-1.7	-2.2	-0.4	1.3
Cap. goods ex comp & semi	0.1	-5.6	-3.7	-0.2	-0.3	0.4
Automotive products	0.1	0.1	-0.7	-0.2	-0.3	0.5
Consumer goods	-0.5	-0.8	-0.9	0.0	0.2	-0.1
Merchandise exports	-4.2	0.5	-2.9	-0.7	-0.2	-0.1
Agricultural	-31.9	2.5	-24.0	-6.9	-1.1	-1.9
Nonagricultural	0.4	0.1	0.0	0.1	-0.1	0.1
Ind supp ex ag	0.8	0.6	1.5	0.1	0.1	0.4
Computers	-10.6	-9.4	-9.7	-0.6	-1.7	-0.5
Semiconductors	-3.6	-5.2	-3.0	0.0	-0.1	-1.5
Cap. goods ex comp & semi	1.2	2.1	0.9	0.1	0.0	0.4
Automotive products	1.3	1.3	1.4	0.3	-0.1	0.0
Consumer goods	0.9	0.8	0.3	0.1	0.2	0.0
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	3.6	-4.1	n.a	...	...	...
Non-oil merchandise	-1.5	-2.5	n.a	...	...	...
Exports of gds & serv.	-2.2	0.1	n.a	...	...	...
Nonag merchandise	-0.9	-0.7	n.a	...	...	...

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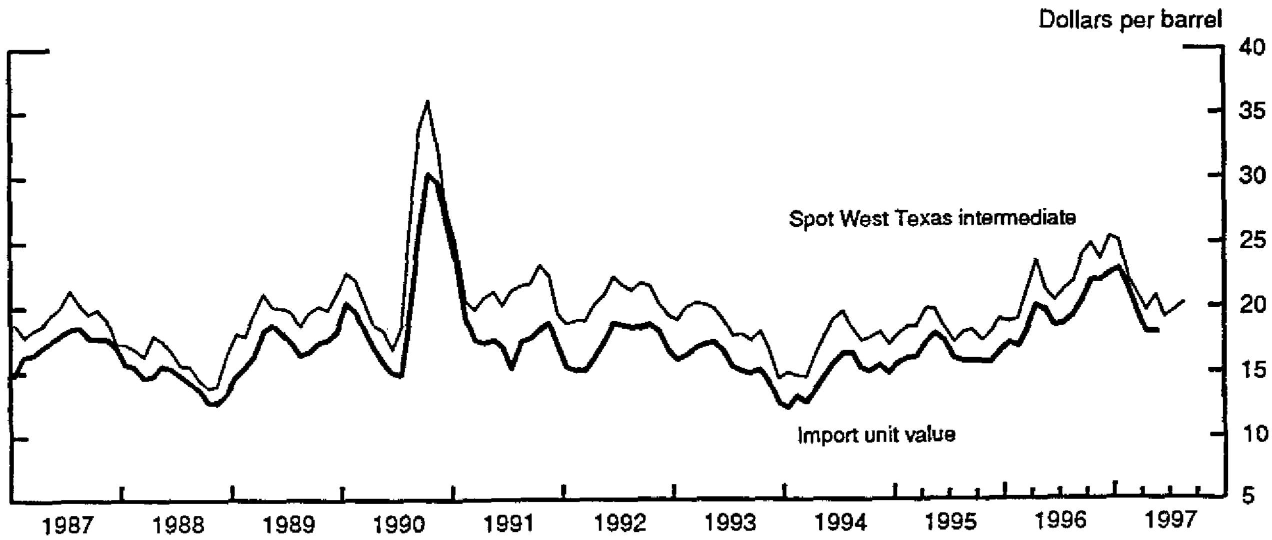
Oil Prices



U.S. agency bonds (approximately 1/3 of line 4b) accounted for about one half of the total; about $16 billion of the net private purchases of Treasuries went directly to residents of Japan. In addition to the purchases of U.S. government securities, foreign net purchases of corporate bonds remained strong in the second quarter, and the revival of foreign interest in U.S. stocks continued (lines 4b and 4c). Net purchases of U.S. stocks in the second quarter were almost twice the total for the year 1996. Information on Eurobond purchases in July indicates continued strong foreign interest in U.S. corporate bonds.

U.S. net private purchases of foreign bonds were strong in June, although modest for the quarter as a whole (line 5a). Considerable interest was shown in Latin American bonds, most of it coming in June. U.S. investors continued moderate net purchases of foreign stocks, both in June and for the quarter (line 5b); net purchases in Japan accounted for the bulk of the total in both June and the quarter as a whole.

Foreign official holdings in the United States fell modestly in June and for second quarter (line 1). However, the net masked large changes in the reserve holdings for several countries. Chinese holdings in the United States fell very sharply in June -- by about 30 percent. It appears that China did not immediately liquidate these dollar holdings, but only transferred them outside the United States. By contrast, Mexican reserves increased strongly in June, probably in preparation for the planned prepayment in August of notes backed by oil revenues. Brazil, Russia, and Spain also had significant increases for the second quarter. Preliminary information from the FRBNY for July indicates only modest changes.

Large outflows in June from banks almost offset inflows during the rest of the quarter, yielding a small net inflow for the quarter (line 3). Monthly average data for July show continued outflows from U.S. banking offices to own foreign offices and IBFs (line 1 of the International Banking Data table).

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

	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 Jun
Official capital								
1. Change in foreign official reserve assets in U.S. (increase, +)	110.0	121.7	23.4	32.8	28.4	-4.5	4.9	-5.7
a. G-10 countries	33.1	35.5	1.4	2.2	7.4	5.8	3.5	1.5
b. OPEC countries	4.3	13.4	5.3	3.6	8.8	2.7	.7	-1.3
c. All other countries	72.6	72.8	16.7	27.1	12.3	-13.2	.7	-5.8
2. Change in U.S. official reserve assets (decrease, +)	-9.7	6.7	7.5	-.3	4.5	-.2	-.2	-.1
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-30.9	-58.0	-4.6	-14.8	-25.0	2.5	24.6	-36.3
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	190.8	290.0	77.3	101.3	87.2	86.0	16.0	34.0
a. Treasury securities[3]	99.9	156.2	43.6	67.7	48.0	34.2	1.6	13.6
b. Corporate and other bonds[4]	82.6	121.7	33.3	32.1	28.5	29.8	7.6	11.2
c. Corporate stocks	8.2	12.1	.5	1.5	10.7	22.1	6.9	9.2
5. U.S. net purchases (-) of foreign securities	-98.7	-105.9	-20.9	-30.4	-17.1	-17.3	-5.4	-13.5
a. Bonds	-48.4	-48.8	-14.2	-19.9	-5.3	-7.0	-1.3	-11.4
b. Stocks	-50.3	-57.1	-6.7	-10.5	-11.8	-10.3	-4.1	-2.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-86.7	-87.8	-11.1	-30.9	-24.6	n.a	n.a	n.a
7. Foreign direct investment in U.S.	67.5	77.0	26.0	17.7	21.7	n.a	n.a	n.a
8. Foreign holdings of U.S. currency	12.3	17.3	7.4	7.8	3.5	n.a	n.a	n.a
9. Other (inflow, +)[5]	-10.6	-65.9	-23.9	-43.1	-19.5	n.a	n.a	n.a
U.S. current account balance (s.a.)	-129.1	-148.2	-42.8	-36.9	-41.0	n.a	n.a	n.a
Statistical discrepancy (s.a.)	-14.9	-46.9	-38.3	-3.3	-18.1	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 Dec.	1995 Dec.	1996 Sep.	1996 Dec.	1997 Mar.	1997 May.	1997 Jun.	1997 Jul.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-247.4	-231.2	-220.4	-231.0	-225.7	-214.4
a. U.S.-chartered banks	-70.1	-86.1	-73.6	-66.4	-72.5	-84.3	-79.8	-79.4
b. Foreign-chartered banks	-153.9	-173.9	-173.8	-164.8	-147.9	-146.7	-145.9	-135.0
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	29.2	31.9	32.9	33.6	33.4	33.8
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	83.4	79.4	82.7	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	86.3	94.6	103.4	119.5	128.3	136.1	131.2	129.7
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	109.4	122.2	135.6	n.a	n.a	n.a
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	178.2	212.9	244.1	239.1	243.9	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	241.7	275.5	313.9	336.4	345.0	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 Markets

The dollar has appreciated against most currencies since the first day of the July FOMC meeting. The dollar's gains have come unevenly, with increases of 5-1/2 percent against the mark, 4-1/2 percent against sterling, and 1-1/2 percent against the yen. Among developing countries, the dollar has appreciated sharply against several Southeast Asian currencies although it has depreciated 1-3/4 percent vis-a-vis the Mexican peso. On a trade-weighted average against the currencies of 18 countries (using weights based on multilateral trade flows from 1992-1994) the dollar is up a bit more than four percent.[1]

Continuing favorable economic developments in the United States appear to have accounted for a portion of the dollar's appreciation over the intermeeting period. The July labor market report and other signs of strong growth and subdued price pressures have boosted the dollar. Late in the period, the dollar weakened with other U.S. asset prices on talk of renewed inflation concerns, although the latest PPI and CPI releases appeared to allay these concerns.

Most noteworthy among developed countries has been the depreciation of the mark and other continental European currencies against the dollar--a decline attributed to EMU-favorable developments and the absence of official German action to curb the mark's fall. In mid-July, the mark fell on positive comments by German officials regarding French deficit-reduction proposals announced with the release of an audit of French government finances. Exchange market participants interpreted the continuation of Bundesbank repo operations at unchanged interest rates as evidence of German officials' acceptance of the mark's depreciation. The mark also weakened on July's larger-than-expected increase in unemployment. The release of the August Bundesbank report, which noted the risks to price stability presented by recent currency developments, pushed the mark up 1-3/4 percent against the dollar in the middle of this week.

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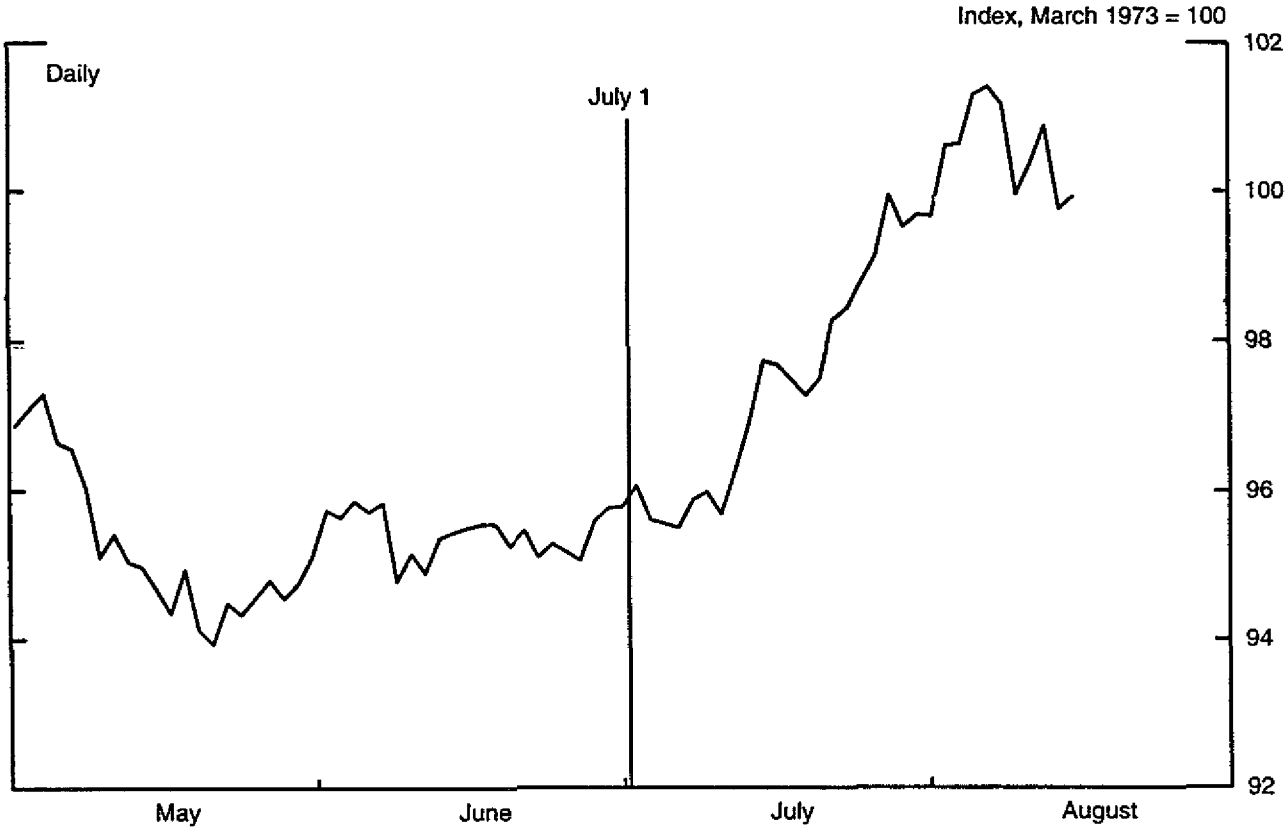
[1]Against the currencies of 10 industrial countries (using multilateral trade weights based on trade flows from 1972-1976) the dollar has appreciated 4-1/4 percent over the period.

Weighted Average Exchange Value of the Dollar



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	July 1	Aug. 15	Change	July 1	Aug. 15	Change
Germany	3.02	3.20	0.18	5.72	5.67	-0.05
Japan	0.70	0.58	-0.12	2.38	2.14	-0.24
United Kingdom	6.81	7.13	0.32	7.06	7.05	-0.01
Canada	3.55	3.70	0.15	6.32	5.98	-0.34
France	3.29	3.32	0.03	5.59	5.60	0.01
Italy	6.81	6.88	0.07	6.75	6.58	-0.17
Belgium	3.25	3.54	0.29	5.78	5.76	-0.02
Netherlands	3.13	3.36	0.23	5.58	5.62	0.04
Switzerland	1.44	1.38	-0.06	3.23	3.30	0.07
Sweden	4.11	4.32	0.21	6.39	6.37	-0.02
Weighted-average foreign	3.58	3.70	0.12	5.48	5.39	-0.09
United States	5.68	5.61[p]	-0.07	6.45	6.32[p]	-0.13

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

Movements of the yen against the dollar have largely been attributed to two factors: prospects for the Japanese current account surplus and market perceptions of weak Japanese economic performance. The dollar rose sharply against the yen immediately following comments by Ministry of Finance official Sakakibara that Japan has no intention of using the exchange rate as a trade policy tool. Suggestions of flagging activity contained in the quarterly report of the Bank of Japan and data releases for industrial production, retail sales, and domestic auto sales have also weighed on the yen. Over the period, the Japanese 10-year interest rate has fallen 24 basis points.

Sterling has retreated from five-year and eight-year highs against the dollar and mark respectively on renewed concerns over the prospects for British exports. Uneven GDP growth in the second quarter that pointed to a slowing export sector initiated the decline in sterling. Over the period, the Bank of England's Monetary Policy Committee twice raised the repo rate 25 basis points. Following the second increase on August 7, the committee noted the negative effect of sterling's rise and suggested that exchange pressures should ease as interest rates have reached levels consistent with the inflation target. Since August 7, sterling has lost 1/4 percent of its value against the dollar and 2-1/4 percent of its value against the mark..

The dollar has appreciated against many Southeast Asian currencies which until recently were closely linked to the dollar. After several episodes of exchange rate pressure, the Thai baht was allowed to float on July 2. The baht depreciated 18 percent initially and is now down 28 percent against the dollar since the float. The Philippines floated the peso on July 11, with the peso depreciating 11 percent against the dollar since July 1. Indonesia widened and then abandoned the band on its managed float and the rupiah has depreciated 14 percent. Finally, Malaysia has imposed capital controls and raised interest rates to counter pressures on the ringitt, which has fallen 10 percent over the period. Developments in these countries are discussed in Section IV. In contrast, the Mexican peso appreciated 1-3/4 percent against the dollar over the past six weeks reflecting market satisfaction with an election little tainted by fraud.

The two interest rate increases in the United Kingdom over the intermeeting period have pushed up the three-month interest rate there more than 30 basis points. Three-month rates in Belgium, the Netherlands, and Sweden have increased a bit less in response to domestic currency weakness. Interest rates at the 10-year maturity have fallen in most countries, on average almost matching the 13 basis point decline of the 10-year rate in the United States. An exception is the Canadian 10-year rate, which has shed 34 basis points as the federal budget moves into surplus. At the same time, the Canadian dollar has lost 3/4 percent of its value against the U.S. dollar.

Over the intermeeting period, gold prices have slipped more than $6 per ounce on balance, having partly recovered from the $10 per ounce decline in early July following the announcement that the Reserve Bank of Australia had sold two-thirds of its gold holdings in the forward market over the first half of the year.

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

Developments in Foreign Industrial Countries

Economic activity in the major foreign industrial countries appears to have continued to expand at a moderate pace in recent months, with all countries except Japan registering increases. Indicators suggest that Canada and the United Kingdom grew at robust rates, with falling unemployment, rising retail sales, and strong business confidence. The German and French economies also expanded, but consumption appears to have been weak. In Italy, second-quarter data point to a pick-up in activity, following a first-quarter decline. The Japanese economy, by contrast, has contracted in recent months, due to the effects of the April 1 hike in the consumption tax.

Twelve-month increases in consumer prices remained below 2 percent in all major foreign industrial countries except the United Kingdom, where a rise in gasoline excise taxes pushed inflation (excluding mortgage interest) to 3 percent in July, a half percentage point above the government's inflation target.

Individual country notes. In **Japan**, economic activity has weakened considerably, largely reflecting the effects of the April 1 increase in the consumption tax from 3 to 5 percent. Household expenditure, retail sales, and new car registrations have all declined sharply in recent months, reversing increases recorded in the months before the tax hike, and housing starts have declined for two consecutive quarters. Industrial production during the second quarter, however, was unchanged from its first-quarter level, as rapid export growth offset weak domestic demand. Machinery orders, an important leading indicator, increased during the second quarter, suggesting rising investment expenditures in coming months.

Unemployment reached 3.5 percent in May and June, matching a record high set during the second quarter of 1996. Employment, however, continued to register year-over-year increases, and labor force participation continued to rise. Inflationary pressures have remained subdued, despite a jump in the price level following the consumption tax increase.

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	2.1	2.5	0.0	-0.5	4.5	-3.1	n.a.
Housing Starts	4.3	-11.5	-5.2	-0.3	2.7	-11.6	n.a.
Machinery Orders	5.0	-3.1	6.0	2.0	11.5	-1.9	n.a.
New Car Registrations	10.6	2.3	-23.9	-28.7	14.7	-2.2	1.6
Unemployment Rate (%)	3.3	3.3	3.4	3.3	3.5	3.5	n.a.
Job Offers Ratio[1]	0.75	0.74	0.73	0.71	0.73	0.74	n.a.
Business Sentiment[2]	-3	2	7	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	1.5	1.2	1.4	1.8	1.4
Wholesale Prices[3]	0.6	1.4	2.6	3.2	2.7	1.9	1.8

1. Level of indicator.
2. Percent of large manufacturing firms having a favorable view of business conditions less those with an unfavorable view (Tankan survey).
3. Percent change from previous year.

Japan's current account and trade surpluses rose sharply during the second quarter. Import volumes declined, reflecting the weakness of domestic demand, and export volumes surged as the lagged effects of the yen's depreciation over the past two years strengthened the competitive position of exporting firms. Notably, Japanese vehicle exports increased over 30 percent from year-earlier levels.

Economic activity in **Germany** continued to expand in the second quarter, with strong increases in industrial production and orders. Based on preliminary figures for June (which are anticipated to show a significant upward revision) production rose 2-1/2 percent at an annual rate in the second quarter from its level in the first quarter. Real manufacturing orders surged, boosted by orders from both domestic and foreign firms. The IFO business climate survey, an indicator of current and expected conditions in industry, continued to improve, with the index now firmly in the positive range. Conditions in the labor market remain stagnant, however, with total unemployment above the 4.3 million (SA) level in July and the all-German unemployment rate at 11.5 percent. Consumer-price inflation for the year ending in July rose to 1.9 percent, reflecting higher prices for medical drugs in July due to an increase in the consumer's share of medication costs.

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	-0.5	0.3	0.6	0.3	-1.5	1.4	n.a.
Orders	0.2	1.0	3.8	3.5	-1.4	1.5	n.a.
Unemployment Rate (%)	10.8	11.2	11.3	11.2	11.4	11.4	11.5
Western Germany	9.5	9.8	9.9	9.8	9.9	9.9	9.8
Eastern Germany	16.0	17.1	17.5	17.2	17.6	17.8	18.2
Capacity Utilization[1]	83.2	84.1	85.1	...	...	...	...
Business Climate[1,2]	-3.3	1.3	6.0	5.0	7.0	6.0	n.a.
Consumer Prices[3]	1.4	1.7	1.6	1.4	1.6	1.7	1.9

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.

On July 11, the German cabinet approved a draft federal budget for 1998 and a 1997 supplemental budget. The supplemental 1997 budget involved no new measures to reduce Germany's general government deficit to 3 percent of GDP, the Maastricht Treaty's reference value. The supplemental budget is necessary, however, because under Germany's constitution, the federal deficit may not exceed government investment unless the higher deficit is necessary to correct an economic imbalance. The supplemental budget thus declares that a federal deficit of DM71.2 billion (up from DM53.3 in the draft budget approved last year) is required to combat the high level of unemployment. The supplemental budget also authorizes additional privatization and the sale of government oil stocks in order to reduce the federal deficit on a budget basis (but not on a national accounts basis, which is relevant for Maastricht compliance). Most analysts estimate that the deficit on a Maastricht basis will be about 3-1/4 percent of GDP in 1997. The draft federal budget for 1998 pegs the deficit at DM57.8 billion and incorporates a number of new tax initiatives, which are being reviewed in a separate legislative process. Following parliamentary debate and possible revision, the draft budget for 1998 is likely to be approved in early December.

In **France**, measured GDP in the second quarter is expected to be boosted by favorable calendar effects and strong net exports. Recent indicators suggest, however, that domestic demand was relatively subdued. Continued firmness in manufacturing output, largely reflecting robust foreign orders and a strong bounce in energy production, underpinned the 2-1/2 percent increase in industrial production in April-May over its first-quarter average. However, consumption of manufactured products declined during the second quarter, due in part to weakness in car purchases. The unemployment rate edged up in June, while consumer-price inflation remained subdued through July.

On July 21, an official audit of France's public finances concluded that the 1997 trend deficit was on course to register between 3.5 and 3.7 percent of GDP. The same day, the government

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
Consumption of Manufactured Products	-3.5	0.8	-0.7	0.8	-0.5	-2.9	n.a.
Industrial Production	-0.6	0.0	n.a.	3.1	-1.6	n.a.	n.a.
Capacity Utilization	81.4	81.1	n.a.	...	...	...	...
Unemployment Rate (%)	12.5	12.5	12.5	12.5	12.5	12.6	n.a.
Business Confidence[1]	3.3	10.3	8.3	8.0	7.0	10.0	11.0
Consumer Prices[2]	1.7	1.5	0.9	0.9	0.9	1.0	1.0

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

announced a series of measures designed to contain the deficit to between 3.1 and 3.3 percent of GDP. Two-thirds of the projected adjustment stems from a temporary increase in the rate of corporate taxation (both the basic rate and the rate applied to long-term capital gains). The remaining savings measures consist of still unspecified spending cuts. Non-tax receipts are likely to be enhanced by contributions from profitable state-owned enterprises as well.

Economic activity in the **United Kingdom** remained robust in the second quarter, but the pace of expansion continued to diverge across sectors. Real GDP increased 3.6 percent (SAAR), with service sector output estimated to have increased 5.3 percent. Retail sales registered another quarter of strong growth, led by purchases of household goods. The unemployment rate has continued to fall, reaching 5.5 percent in July, its lowest level in seven years. Manufacturing output was little changed during the second quarter, while industrial production as a whole recorded a moderate increase. After declining for several months, business confidence turned up in July, apparently reflecting increased optimism that domestic orders will offset weak export orders.

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
Real GDP (AR)	4.4	3.3	3.6	...	...	...	...
Non-oil GDP (AR)	4.5	3.7	4.0	...	...	...	...
Industrial Production	0.4	-0.2	0.4	0.9	-1.0	1.4	n.a.
Retail Sales	1.1	1.1	1.8	0.3	1.2	0.6	n.a.
Unemployment Rate (%)	6.9	6.3	5.8	5.9	5.8	5.7	5.5
Business Confidence[1]	18.0	18.3	17.7	23.0	17.0	13.0	21.0
Consumer Prices[2]	3.2	2.9	2.6	2.5	2.5	2.7	3.0
Producer Input Prices[3]	-4.6	-7.1	-9.6	-10.9	-9.3	-8.6	-9.0
Average Earnings[3]	4.2	4.6	4.3	4.5	4.3	4.3	n.a.

1. Percent of firms expecting output to increase in the next four months minus those expecting output to decrease.
2. Retail prices excluding mortgage interest payments. Percent change from previous year.
3. Percent change from previous year.

The twelve-month rate of increase in retail prices excluding mortgage interest payments jumped to 3 percent in July, a half percentage point above the government's target. Much of the acceleration was due to higher gasoline excise taxes included in last month's budget. Although service-price inflation eased in July, it remained higher than goods-price inflation, which has benefitted from the strength of sterling. The underlying rate of increase in average earnings declined somewhat in May to 4.3 percent and remained at that level in June. Nonetheless, the most recent rate is up from 3.75 percent a year ago, reflecting the tighter labor market.

Chancellor of the Exchequer Gordon Brown presented the Labour government's first budget on July 2. As promised, the cornerstone of the budget was the announcement of the "Welfare to Work" program financed by a windfall tax on excess profits of privatized utilities. The budget deficit is projected to decline from 4 percent of GDP in 1996-97 to 1.5 percent in the current fiscal year and 0.25 percent next year. In its quarterly Inflation Report released on August 13, the Bank of England projected a likely slowing of the expansion in coming months due to recent monetary and fiscal tightening, as well as to the appreciation of sterling and the unwinding of windfall gains in consumer income from building society conversions. The report concludes that the 100 basis point increase in official rates since May has left monetary policy in a position "at which it should be possible to pause in order to assess the direction in which the risks (to inflation) are likely to materialize."

In **Italy**, real GDP declined a revised 0.7 percent (SAAR) in the first quarter, largely reflecting a drop in net exports and the fact that there were fewer working days than in the previous quarter. On the positive side, household consumption increased, due to tax incentives on auto purchases, and business fixed investment rose modestly.

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

	1995	1996		1996		1997
	Q4/Q4	Q4/Q4	Q2	Q3	Q4	Q1
GDP	2.3	0.2	-1.8	2.9	-1.9	-0.7
Private Consumption	1.5	1.0	1.2	1.2	1.4	2.2
Investment	8.6	-2.4	-1.8	-1.5	-2.9	0.8
Government Consumption	-0.7	0.8	1.5	1.4	0.0	-0.7
Exports	4.6	3.8	3.9	11.3	-4.5	-14.9
Imports	5.2	-0.7	-16.0	10.9	12.5	-11.2
Total Domestic Demand	2.3	-0.8	-6.3	2.5	1.8	0.8
Net Exports (contribution)	0.0	1.0	4.5	0.6	-3.6	-1.4

Second-quarter monthly indicators generally point to a pick-up in activity. Industrial production and capacity utilization increased during the second quarter; both indicators currently stand at their highest levels since the end of 1995. Consumer confidence, after improving significantly in the first quarter, remained strong during the second quarter. Positive calendar effects in the second quarter will also provide a modest impetus to measured GDP, which is not adjusted for this factor.

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
Industrial Production	-1.0	1.4	2.3	0.7	0.3	0.4	n.a.
Cap. Utilization (%)	75.1	76.2	77.7	...	...	...	...
Unemployment Rate (%)	12.0	12.2	12.4	...	...	...	...
Consumer Confidence[1]	104.7	109.2	108.8	108.1	109.4	108.9	114.1
Bus. Sentiment[2] (%)	1.3	20.0	13.7	16.0	14.0	11.0	n.a.
Consumer Prices[3]	2.7	2.5	1.6	1.7	1.6	1.4	1.6
Wholesale Prices[3]	1.8	0.6	-0.4	-0.7	-0.2	-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.

Inflation remains low. Consumer prices were up 1.6 percent for the year ending in July, a slight increase from June due largely to statistical factors. Inflationary pressures are likely to remain subdued given continued moderation in producer prices, a sizable output gap, and lagged effects of lira appreciation.

Italian public sector balances are showing further signs of improvement. On August 1, the government announced that the public sector deficit through the end of July was slightly under $17 billion equivalent. Although there is still uncertainty regarding fiscal performance during the remainder of 1997 (historically, about 40 percent of total public expenditure is incurred during the last four months of the year), the end-July balance is generally in line with the three percent Maastricht budget deficit criterion.

The **Canadian** economy continued to expand strongly in the second quarter. Real GDP at factor cost rose 0.3 percent (SAAR) in May after rising 0.9 percent in April, bringing the average for the two months to a level 1 percent above the first-quarter average. Employment gains boosted real disposable income, and consumer confidence and retail sales have been very strong. Business confidence reached a new high in the second quarter.

Preliminary indicators for the third quarter point to continued expansion. Employment, which rose substantially in the second quarter, edged up again in July, while the unemployment rate declined to 9 percent, the lowest since October 1990. The annual survey of investment intentions reported an 11 percent expected increase in firms' plant and equipment expenditures, which would be the biggest rise since 1993.

Consumer price inflation rose slightly in June. Weakness in the Canadian dollar in late June prompted the Bank of Canada to raise its Bank Rate by 1/4 percentage point to 3-1/2 percent.

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

	1996	1997					
	Q4	Q1	Q2	Apr	May	Jun	Jul
GDP at Factor Cost	1.0	0.9	n.a.	0.9	0.3	n.a.	n.a.
Industrial Production	0.5	0.9	n.a.	1.6	-0.0	n.a.	n.a.
Manufacturing Survey:							
Shipments	-0.2	2.9	n.a.	0.7	-0.2	n.a.	n.a.
New Orders	0.2	4.5	n.a.	5.1	-2.4	n.a.	n.a.
Retail Sales	2.5	2.0	n.a.	1.3	0.5	n.a.	n.a.
Housing Starts	0.4	19.9	-6.3	-8.7	4.5	-6.5	2.7
Employment	0.4	0.3	0.9	0.2	0.4	0.4	0.1
Unemployment Rate (%)	9.9	9.6	9.4	9.6	9.5	9.1	9.0
Consumer Prices[1]	2.0	2.1	1.6	1.7	1.5	1.8	n.a.
Consumer Attitudes[2]	104.8	108.0	116.2	...	...	...	...
Business Confidence[3]	153.1	160.1	165.0	...	...	...	...

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

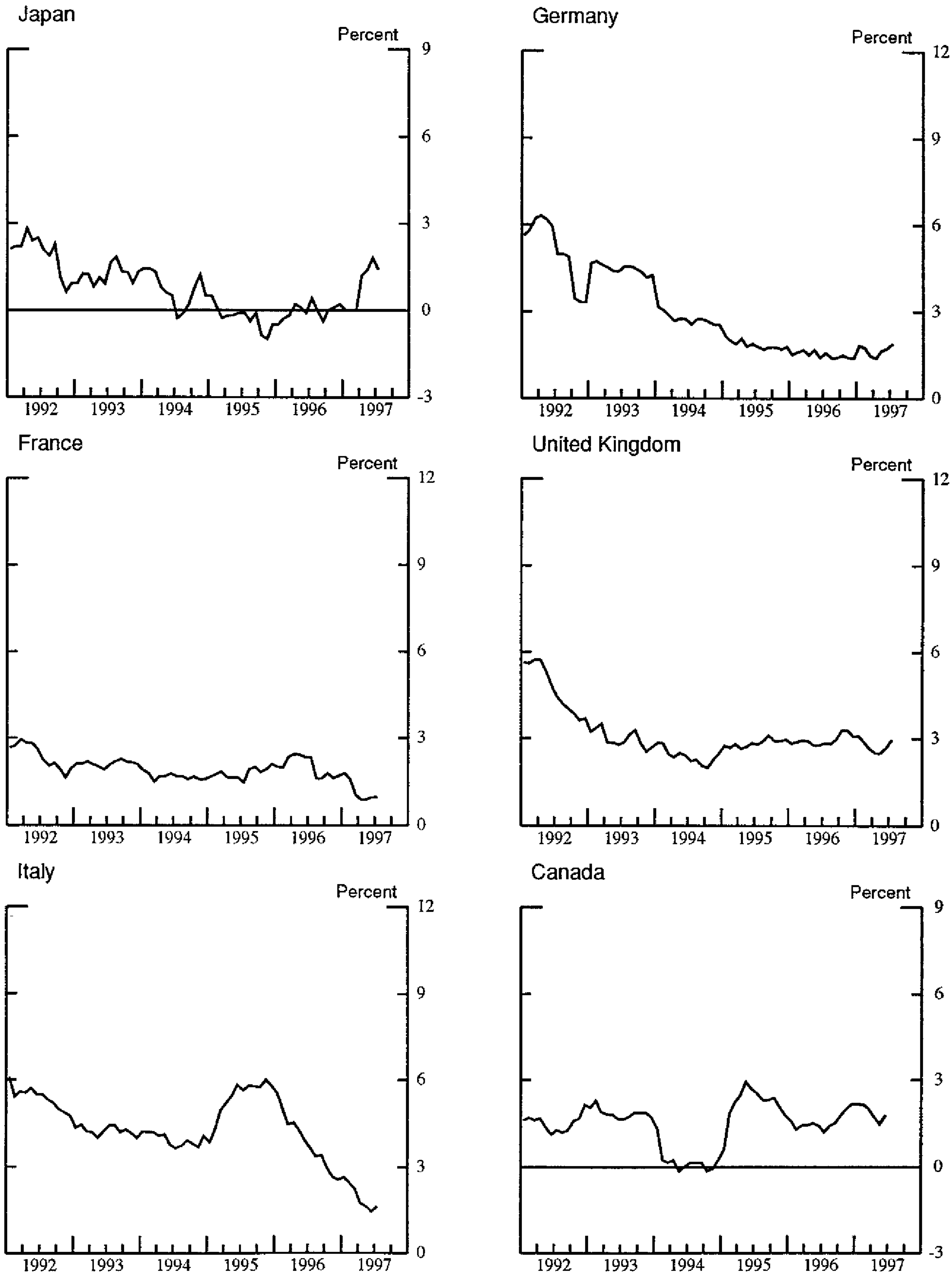
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1996	1997						
		Q1	Q2	Feb	Mar	Apr	May	Jun
Japan: trade	61.4	12.9	23.3	3.8	3.6	6.5	9.3	7.6
current account	65.9	15.4	27.3	4.7	4.0	8.1	10.7	8.5
Germany: trade[1]	65.4	14.7	n.a.	5.5	5.9	6.1	5.7	n.a.
current account[1]	-14.3	-5.4	n.a.	-0.9	1.7	1.6	n.a.	n.a.
France: trade	17.4	5.5	8.2	2.0	1.7	2.7	2.9	n.a.
current account	21.9	8.9	n.a.	3.4	1.6	4.1	3.9	n.a.
U.K.: trade	-19.4	-3.2	n.a.	-1.3	-1.1	-1.6	-0.8	n.a.
current account	-0.3	2.4	n.a.	...	...	...	...	...
Italy: trade	44.4	8.7	n.a.	2.9	2.7	3.5	n.a.	n.a.
current account[1]	41.1	8.8	n.a.	2.4	2.1	2.4	n.a.	n.a.
Canada: trade	30.0	5.9	n.a.	2.0	1.8	1.2	1.5	n.a.
current account	2.8	-0.9	n.a.	...	...	...	...	...

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

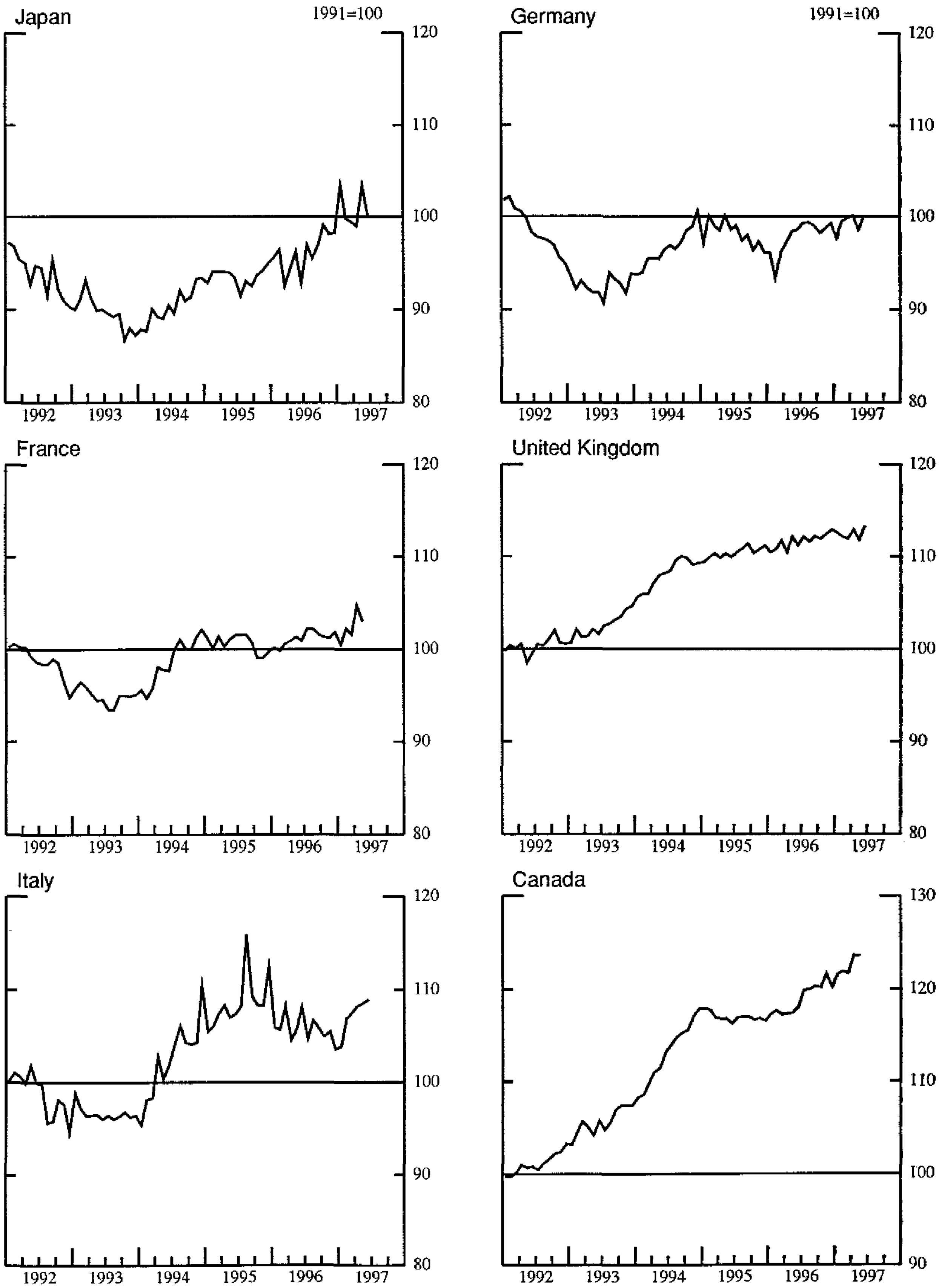
AUGUST 14, 1997

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



AUGUST 14, 1997

Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In recent months, growth has generally remained strong in the major Latin American and Asian countries. Inflation rates in these countries have generally been stable or moderated further. Recent movements in their external balance positions have been mixed, with incoming data tending to show Argentina, Brazil, and Venezuela moving toward deficit, while China and Korea move toward surplus.

There was intense exchange market pressure in the ASEAN countries in July, resulting in de facto devaluations in Thailand and the Philippines, a widening of Indonesia's exchange rate band, and downward pressures on the currencies of Malaysia and Singapore. These pressures spilled over, in varying lesser degrees, to several other emerging market countries, including Korea, Taiwan, Brazil and Venezuela.

Individual country notes. The turmoil in exchange markets in the five major ASEAN countries intensified in July. The central banks of **Thailand** and the **Philippines** announced they would permit greater market determination of exchange rates; in both cases, the announcements were followed by de facto devaluations of their currencies. **Indonesia** initially widened its exchange rate band from 8 percent to 12 percent, then allowed its currency to float. The currencies of **Malaysia** and **Singapore** came under pressure. The currencies of all five countries have depreciated over the past month, despite substantial increases in overnight interest rates in each of the countries.

Some of these countries have sought technical assistance and financial help from international sources to help overcome potential payments problems. The Philippines will be able to draw on $1.1 billion under an extension of an IMF Extended Fund Facility. The Philippine authorities are also expected to reactivate a financing arrangement with Japan's Export-Import Bank (JEXIM) for about $450 million. Thailand has been offered a financial package of $16 billion, including a three-year IMF Stand-by Agreement totalling $4 billion, which is about five times Thailand's quota. JEXIM will provide $4 billion, and the remainder of the financing comes from bilateral donors in Asia, Australia, and multilateral agencies such as the World Bank and the Asian Development Bank.

The announcement of the financial support for Thailand came after its cabinet approved a package of measures, including actions to reform the financial system. The overall framework of the package is similar to the one that the IMF had been working on with the Thai authorities, but all the details of the program have not been negotiated as yet. As part of the reforms, the central bank and finance ministry announced the suspension of operations of 42 finance companies, bringing the total suspended since June this year to 58. (There were previously 91 such companies.) The suspended companies are required to complete the process of due diligence and submit a rehabilitation plan within 60 days. Holders of promissory notes and certificates of deposit issued by these companies can exchange them for those of Krung Thai Bank, a large commercial bank in which the government has a majority share. A deposit insurance scheme is being set up to insure the liabilities of financial institutions "which can conduct their normal business." The Thai authorities stated that "the Government will be responsible for any financial obligations arising from this insurance undertaking." Other elements of the plan to restructure the financial sector include the setting up of new government agencies to rate the credit-worthiness of Thai financial institutions in an attempt to separate healthy institutions from troubled ones. The setting up of these agencies reduces the supervisory role of the Bank of Thailand.

On the fiscal side, the plan endorses further cuts in the government budget for fiscal year 1997/98 (starting October 1), an increase in the VAT from the current 7 percent to 10 percent (effective August 16), an increase in the excise tax on luxury items, and reductions in subsidies to state enterprises. Other announced measures include a government pledge not to let gross foreign reserves fall below $25 billion. Thailand will continue the managed float exchange rate regime introduced on July 2; the system of capital controls imposed over the last several months will be removed. These steps are being taken with the stated goals of reducing the current account deficit to 5 percent of GDP in 1997 and 3 percent in 1998 (compared with 8 percent in 1996), limiting the annual inflation rate to the 8 to 9 percent range, and achieving real GDP growth of between 2 and 3 percent.

In **Taiwan**, growth has been strong while inflation rose only slightly in the first seven months of 1997. Industrial production in the second quarter continued the strength that started to become evident in the second half of last year. Consumer price inflation rose sharply in July from the rates of earlier in the year, reflecting poor weather that damaged crops, but remained relatively moderate on a year-over-year basis. Strong import growth contributed to a narrowing of Taiwan's trade surplus in the first seven months of 1997, compared with the comparable period last year. Exports rose 5 percent over this period, while imports increased 11 percent. Foreign-exchange reserves stood at $90 billion in June, up less than $2 billion from the beginning of 1997.

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

	1996	1996	1997		1996		
		Q4	Q1	Q2	May	Jun	Jul
Real GDP	5.7	6.6	6.8	n.a.	...	...	...
Industrial Production	1.6	4.8	5.4	6.2	7.3	5.3	...
Consumer Prices	2.5	2.5	1.1	1.8	0.8	1.8	3.3
Trade Balance[1]	14.3	4.0	1.8	1.7	1.6	0.3	0.5
Current Account[1]	10.5	2.8	1.9	n.a.	...	...	...

1. Billions of U.S. dollars, NSA

In the wake of turmoil in currency markets throughout Asia, Taiwan's exchange rate depreciated about 1 percent against the U.S. dollar in the last week of July ad the first week of August. Taiwan's central bank has intervened actively in the currency market in the past, but has vowed not to intervene now. Most analysts have not viewed the depreciation with alarm, seeing it as reflecting a reasonable market response to the weakness of other Asian currencies.

Korean conglomerates ("chaebols") have continued to experience financial troubles. On July 15, the nation's eighth-largest chaebol, Kia Business Group, was placed under a "bankruptcy protection pact" to prevent its imminent collapse. The creditors have decided to grant the troubled group a two-month reprieve to repay its debts. This is the fifth chaebol to experience financial problems this year. Citing the "deteriorating asset quality and heightening industry risks faced by Korean banks" as a result of the financial difficulties of the chaebols, Standard and Poor's has placed five banks on credit watch, and S&P has revised the Republic of Korea's sovereign long-term rating outlook to negative from stable. There has been some pressure on the won in the wake of the currency crises in ASEAN countries and the problems in the financial sector.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	May	Jun	Jul
Real GDP	6.8	6.6	5.3	n.a.	n.a.	n.a.	n.a.
Industrial Production	8.4	9.8	7.0	9.7	6.1	12.4	n.a.
Consumer Prices	5.0	4.8	4.7	4.0	3.8	4.0	3.7
Trade Balance[1]	-15.3	-3.9	-5.4	-0.8	-0.3	0.3	n.a.
Current Account[1]	-23.7	-6.2	-7.9	-3.0	-0.9	-0.4	n.a.

1. Billions of U.S. dollars, NSA

Korea's current account deficit narrowed sharply in the second quarter. The trade balance posted a surplus in June, the first since December 1995. Industrial production grew at a robust rate in the second quarter. Inflation remained moderate in July.

In **China**, growth in the first half of the year remained steady, inflation continued to moderate, and the trade surplus continued to grow. In the first half of this year, the value of exports rose 26 percent from the year-earlier period, while the value of imports was unchanged. International reserves have risen steadily over this period. In the first half of 1997, reserves rose $16 billion to $123 billion, the second highest in the world after Japan.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Apr	May	Jun
Real GDP[1]	9.7	9.7	9.4	9.5	...	...	...
Industrial Production	15.6	15.6	13.0	14.2	14.2	14.2	14.2
Consumer Prices	7.0	7.0	4.0	2.8	3.2	2.8	2.8
Trade Balance[2]	12.2	4.0	6.8	11.0	3.5	3.6	3.9

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

In **Mexico**, data on industrial production and retail sales continued to show strength, with domestic demand emerging as the driving force in economic growth. Industrial production rose strongly in May, confirming the rapid pace of growth shown in the March-April period. Retail sales, which had shown negative year-on-year growth as recently as the first quarter, gained 6.6 percent in May versus the same month in the previous year. The trade surplus remained narrowly positive in May and June. Monthly consumer price inflation remained just below 1 percent in July, moderated by the continued stability of the peso and seasonal factors that usually suppress inflation in the summer.

As expected, the July 6 midterm elections resulted in an historic loss of majority for the ruling Institutional Revolutionary Party (PRI) in the lower house of Congress. The main immediate impact of the opposition's congressional gains will be seen in legislative consideration of the government budget this fall, with both opposition parties calling for a reduction in the value-added tax, while the PRI wants to maintain a nearly balanced fiscal position.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	May	Jun	Jul
Real GDP	5.1	7.6	5.1	n.a.	...	...	...
Industrial Production	10.4	12.8	6.2	n.a.	9.0	n.a.	n.a.
Unemployment Rate (%)	5.5	4.7	4.3	3.9	3.9	3.4	n.a.
Consumer Prices[1]	27.7	6.1	5.6	2.9	0.9	0.9	0.9
Trade Balance[2]	6.3	0.7	1.4	0.5	0.2	0.3	n.a.
Imports[2]	89.6	25.5	23.5	26.7	8.6	9.1	n.a.
Exports[2]	95.9	26.2	24.9	27.2	8.8	9.4	n.a.
Current Account[2]	-1.8	-1.4	-0.4	n.a.	...	...	...

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

On July 30, citing the continued real appreciation of the peso and the possibility that this could reduce the attractiveness of investment in the traded goods sector, the Mexican Exchange Commission announced an increase in the amount of dollar put options auctioned at the end of each month from $300 million to $500 million. As before, if at least 80 percent of dollar put options are exercised in the first half of a month, there will be another auction of dollar put options, and that amount was also raised from $300 million to $500 million. If all options are exercised, the Bank of Mexico would acquire another $1 billion each month. In the first year of the dollar put options program, which began in August 1996, the Bank of Mexico has acquired $3.26 billion in reserves through the program.

In **Argentina**, growth in economic activity continues to be strong. Industrial production in the second quarter and real GDP in the first quarter both registered substantial year-over-year gains. Despite high growth, inflation has remained subdued, likely the result of the economy still operating at less than full-employment.

The recovery has increased job creation and is finally beginning to alleviate Argentina's stubbornly high unemployment rate. Bringing unemployment down further is probably the biggest economic challenge facing the government, but reaching an agreement on labor reform has thus far proved difficult. After failing to get labor reform legislation approved by the Congress or implemented through executive decrees (which the court rejected),

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Apr	May	Jun
Real GDP	4.3	8.8	8.1	n.a.	...	...	...
Industrial Production (SA)	3.4	11.7	8.0	8.0	8.1	5.3	10.7
Unemployment Rate (%)[2]	17.2	17.3	...	16.1	...	...	...
Consumer Prices[1]	0.2	0.2	0.2	-0.2	-0.3	-0.1	0.2
Trade Balance[3]	1.6	0.0	-0.4	0.3	0.1	0.2	0.1
Current Account[3]	-4.0	-1.7	-2.4	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.

President Menem, in late May, negotiated a watered-down agreement with major unions. However, this agreement has been rejected by business leaders and some break-away unions. Polls indicate that Argentines regard joblessness as the main problem facing the country, and this could hurt the government in the upcoming congressional elections in October.

Strong economic growth has raised imports, but, until recently, export growth, driven in part by strong Brazilian demand, had been an offsetting force. However, the current account moved from a deficit of $1.4 billion in the first quarter of 1996 to a deficit of $2.4 billion in the first quarter of this year. Also, over the first half of this year, the trade balance was roughly in balance, compared with a surplus of $1.4 billion in the same period a year ago. International reserves remain high, at around $19 billion (excluding gold) at the end of July, roughly 30 percent higher than a year ago.

In **Brazil**, July 1 marked the third anniversary of Brazil's stabilization program, the Plano Real. Under the plan, inflation has fallen dramatically. Consumer prices in July were only 4.9 percent above a year earlier, which is a marked contrast from the 2,000 percent inflation experienced in 1994. Economic activity, on the other hand, has been very uneven in recent months. After negative real GDP growth in the first quarter, industrial output rose sharply in April, declined in May, and grew strongly in June. The difficulty of gauging economic activity in recent months stems in part from residual seasonal effects in the April data (because the Easter holiday fell in March this year). Industrial and retail sales figures show similar seesaw patterns. On the whole, however, activity was stronger in the second quarter than in the first.

Brazil's external balance has continued to deteriorate. The trade deficit through the first seven months of this year was already as large as it was for 1996 as a whole. The widening trade deficit plus higher interest payments has led to a growing current account deficit, which reached 4.3 percent of GDP in the first seven months of 1997. The deterioration in the external balance plus the fallout from the devaluation of the Thai baht in early July have led to a rise in Brazilian domestic interest rates. One-month CD rates have risen by about 2 percentage points since early July; most of this increase reflects investors' perceptions of an increased risk of devaluation. Brazilian stock prices plunged by nearly 20 percent in early July but have since recovered about half of that decline. (The *real*/dollar exchange rate has depreciated only very slightly in recent weeks.) In late July, the Brazilian government also removed a tariff exemption on 3,700 capital goods imports that had been granted when trade liberalization began in 1990, making them subject to tariffs of up to 17 percent.

High domestic interest rates plus other factors have helped keep net capital inflows strongly positive. There have been some recent privatizations by the federal and state governments. In early July, the federal government awarded the rights to operate cellular phone services in the Sao Paulo metropolitan region (the largest market in Latin America) to a consortium led by Bell South

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	May	Jun	Jul
Real GDP, s.a.a.r.[1]	2.9	5.9	-2.2	n.a.	...	...	...
Industrial Production (SA)[2]	2.3	0.0	-1.6	1.3	-1.7	2.1	n.a.
Open Unemployment Rate (%)	5.4	4.5	6.0	n.a.	6.0	n.a.	n.a.
Consumer Prices[3]	9.4	1.0	2.0	1.0	0.1	0.3	0.2
Trade Balance[4]	-5.5	-3.9	-3.1	-1.7	0.3	-0.5	-0.8
Current Account[4]	-24.3	-10.7	-6.9	-8.8	-2.2	-2.7	-2.8

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

for $2.6 billion. In late July, the state of Bahia sold Coelba, an electrical utility, for $1.6 billion to a Spanish firm. Aside from these developments, indications are that firms in the financial and nonfinancial sectors have been issuing a sizeable amount of bonds abroad. Central bank reserves stood at $60 billion at the end of July, up slightly from the end of May.

On July 29, Central Bank President Gustavo Loyola announced that he will resign. President Cardoso nominated Gustavo Franco, head of the International Affairs Department of the Central Bank of Brazil, to be the new central bank chief, and the Senate overwhelmingly confirmed Franco, despite concerns that were raised over the central bank's policy of maintaining very high nominal (and real) interest rates. One-month CD rates have recently been about 20 percent, and some consumer credit rates have been recently as high as 80 percent. Franco has been an outspoken advocate of Brazil's fixed exchange rate policy and of maintaining a tight monetary policy.

In **Venezuela**, indicators of aggregate demand continue to point to a pick-up in economic activity. According to the Minister of Trade and Industry, economic growth over the first half of the year was around 1.5 percent. The twelve-month consumer price inflation rate in July was around 40 percent. The pick-up in economic activity has been reflected in increased imports, and the non-oil trade balance deficit was $2.5 billion in the period from January through May this year, compared with a deficit of $1.7 billion over the same period last year. Including oil, the trade balance over the period from January through April showed a surplus of $11 billion.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	May	Jun	Jul
Real GDP	-1.6	...	...	...	...	...	...
Unemployment Rate (NSA, %)	11.8	12.4	12.6	n.a.	...	...	...
Consumer Prices[1]	103.3	10.6	6.6	7.5	3.1	1.8	2.8
Trade Balance[2]	-4.7	-1.2	-1.4	n.a.	-0.5	n.a.	n.a.
Current Account[2]	7.6	...	...	...	...	...	...

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

Largely as a result of increased expenditures by the government and the government-controlled state oil company, Venezuela's money markets are currently suffering from excess liquidity. In an effort to mop up the excess liquidity, the central bank has increased reserve requirements on commercial banks twice in the last month and has tightened restrictions on inter-bank currency trading.

The increase in liquidity and the perception by market participants that the Venezuelan currency is overvalued have put downward pressure on the bolivar. The bolivar depreciated 2 percent in July, compared with a depreciation of just 2.5 percent over the entire first half of the year. However, it is still within the bands set by the government, which slide over time in line with the government's inflation target. Apparently as a signal to the market that it intends to continue its strong bolivar policy, the government, on August 8, lowered its monthly depreciation rate on the foreign exchange bands to 1.16 percent from 1.32 percent. In the short run, the government has adequate international reserves to maintain the value of the bolivar; reserves (excluding gold) at the end of July stood at $13.2 billion, unchanged from a month ago, but roughly 60 percent higher than a year ago.

In **Russia**, recent data continue to present a relatively favorable picture. After years of decline, output and industrial production have stabilized so far this year. Official figures show real GDP in the first half of the year only slightly below the level in the corresponding period last year. Inflation has stabilized in recent months, after declining earlier in the year. In June, the year-over-year consumer price inflation rate was 14.5 percent. The ruble-dollar exchange rate has remained well within the corridor set by the central bank. In an attempt to indicate confidence that financial conditions will remain stable, the government has announced its intention to redenominate the ruble at the beginning of next year, with 1,000 old rubles equaling one new ruble.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Apr	May	Jun
Real GDP	-6	-5	0	-1	-1	0	0
Industrial Production	-5	-5.4	0.9	0.9	0.5	0.2	2.0
Consumer Prices[1]	1.7	1.5	1.7	1.0	1.0	0.9	1.1
Ruble Depreciation[1]	1.5	0.9	1.0	0.7	0.3	0.4	0.0
Trade Balance[2]	23.1	9.2	n.a.	n.a.	n.a.	n.a.	n.a.
Current Account[2]	9.6	5.3	n.a.	n.a.	n.a.	n.a.	n.a.

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

Recent developments in the fiscal situation have been mixed. On the positive side, the government met its promise to pay all pension arrears (worth $2-1/2 billion) by the beginning of July, and total tax revenues in the first half of 1997 were up 50 percent from last year. On the negative side, tax revenues in the first half remained more than 10 percent below target, and substantial arrears remained in many other areas (including tax payments by businesses and wages to local government workers).