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Confidential (FR) Class III FOMC

Part 2

November 5, 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

November 5, 1997

RECENT DEVELOPMENTS

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Real GDP continued to grow rapidly in the third quarter. Domestic final demand surged ahead, while net exports and inventory investment slackened substantially. On average during the quarter, gains in private employment decelerated slightly, with a large increase in labor productivity accounting for most of the gain in nonfarm output. Price inflation remained low, as weak import prices, rapidly growing industrial capacity, and moderating inflation expectations offset the modest effects of tight labor markets on labor costs.

Labor Market Developments

The September labor market report was surprisingly weak, given the low level of initial claims and other indicators of labor demand. Net of the effects of the UPS strike, private payroll employment rose about 125,000 for the second month in a row.[1] Aggregate hours of production or nonsupervisory workers fell 0.1 percent. The unemployment rate held steady at 4.9 percent, and household employment and the labor force participation rate edged down.

For the third quarter as a whole, average monthly growth in private employment, at 187,000, was a bit slower than in the first half of the year, with moderation in both the goods- and service-producing sectors. Averaging through the monthly gyrations, growth in government employment in the third quarter was about on pace with that in the first half of the year.[2]

The average workweek of production or nonsupervisory workers fell slightly in September to 34.5 hours--its mean for the last six months. For the quarter as a whole, aggregate hours of production

1. The BLS estimates that the net effect of the UPS strike was to lower private employment growth in August by 167,000 and to raise September employment growth by 166,000. This estimate includes the loss and return of workers to UPS and the compensatory hiring and subsequent layoffs at other air transportation and trucking firms. In the government sector, the postal service is estimated to have hired an additional 5,000 workers in August and fired 4,000 workers in September.

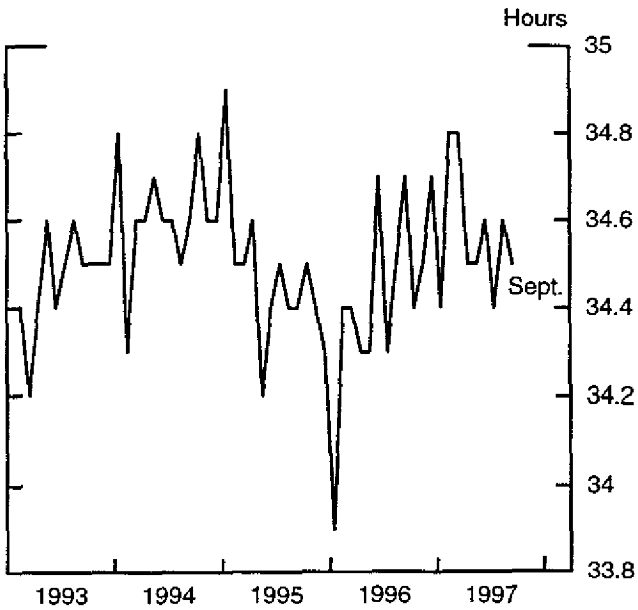
2. Government sector payrolls fell 78,000 in September, largely because of a drop in local education employment after three months of significant increases. This is the third consecutive year in which summer gains in state and local employment have been followed by a drop-off in September. The BLS acknowledges that there is a problem with the seasonal factors and is working to resolve it.

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

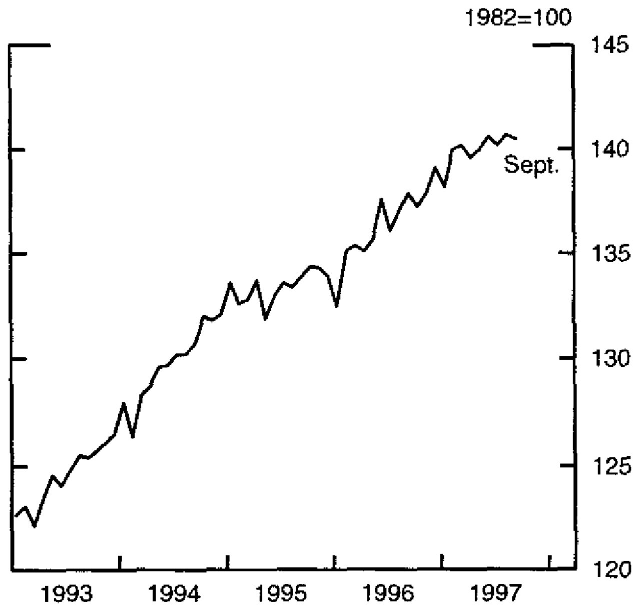
	1995	1996	1997 Q1	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
	---Average	monthly	changes---					
Nonfarm payroll employment [1]	185	212	228	237	213	384	40	215
Private	176	198	218	206	187	304	-36	293
Strike-adjusted							121	127
Goods Producing	8	19	43	15	14	-1	58	-14
Manufacturing	-1	-5	14	10	9	-4	48	-16
Durable	11	5	15	14	19	19	54	-17
Nondurable	-12	-10	-1	-5	-9	-23	-6	1
Construction	10	24	29	4	5	3	12	-1
Service Producing	168	178	175	191	173	305	-94	307
Transportation and utilities	8	9	39	10	6	9	-159	167
Trade	48	60	28	52	62	110	42	33
Finance, insurance, real estate	-1	11	10	14	14	24	8	9
Services	113	98	97	115	92	162	15	98
Help supply services	10	13	17	-17	0	18	-28	10
Total government	9	14	10	31	26	80	76	-78
Private nonfarm production workers [1]	151	168	195	163	116	278	-180	249
Manufacturing production workers	-2	-5	9	7	8	1	26	-4
Total employment [2]	32	232	440	63	117	344	96	-89
Nonagricultural	51	225	453	61	97	253	195	-156
Memo:								
Aggregate hours of private production workers (percent change)[1,3]	1.7	2.9	4.1	1.7	1.1	-0.3	0.4	-0.1
Average workweek (hours) [1]	34.5	34.4	34.7	34.5	34.5	34.4	34.6	34.5
Manufacturing (hours)	41.6	41.5	41.9	42.0	41.9	41.8	41.9	41.9

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Survey of households.
3. Annual data are percent change from Q4 to Q4. Quarterly data are percent change from preceding period at an annual rate. Monthly data are percent change from preceding month.

Average Weekly Hours



Aggregate Hours of Production or Nonsupervisory Workers



or nonsupervisory workers grew 1.1 percent at an annual rate, continuing a decelerating trend since the first quarter of the year.

RECONCILIATION OF HOUSEHOLD AND PAYROLL EMPLOYMENT
(Average monthly change; thousands)

	Sept. 96 to Sept. 97
Payroll jobs	223
Household employment	181
Less:	
Self-employed	10
Other	-4
Plus:	
Multiple jobholders	22
Agricultural services	3
Adjusted household	200
Payroll minus adjusted household	23

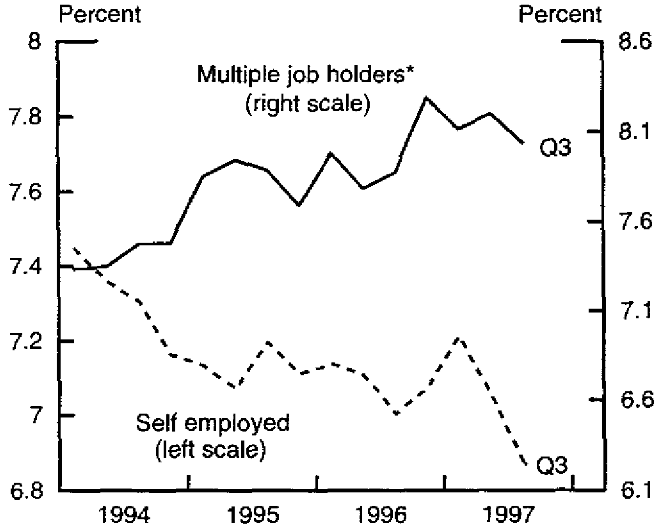
In the household survey, the unemployment rate and the labor force participation rate were unchanged in the third quarter from their second-quarter averages. Recently, growth of household employment has slowed appreciably--much more than has growth of payroll employment. Such divergences are not uncommon and often reflect differences in the makeup of the two surveys. After adjusting the household survey to payroll survey concepts, employment growth in the two surveys has been quite close over the past year. A rise in multiple-job holders and a switch out of self-employment, both of which boost payroll employment relative to household employment, account for the bulk of the difference in payroll and household employment growth over the past year.

Heading into the fourth quarter, most labor market indicators point to continued strength in demand. State initial claims have continued to run at a very low level. The help-wanted index was still at an elevated level in September, and BNA surveys of hiring plans for the fourth quarter have posted steep increases. Finally, the Michigan and Conference Board surveys continue to point to very favorable perceptions of labor market conditions, although a slight cooling of activity is suggested by the Conference Board survey.

SELECTED UNEMPLOYMENT RATES
(Percent; based on seasonally adjusted data)

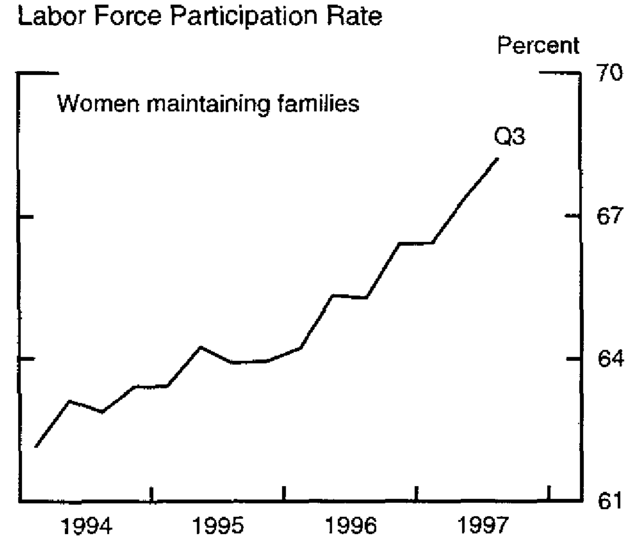
	1995	1996	1997 Q1	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
Civilian unemployment rate (16 years and older)	5.6	5.4	5.3	4.9	4.9	4.8	4.9	4.9
Teenagers	17.3	16.7	17.0	15.9	16.5	16.4	16.4	16.7
Men	4.8	4.6	4.5	4.1	4.1	4.0	4.1	4.1
Women	4.9	4.8	4.7	4.4	4.3	4.2	4.4	4.4
Labor force participation rate	66.6	66.8	67.2	67.1	67.1	67.1	67.1	67.0
Teenagers	53.5	52.3	52.6	51.8	50.9	51.4	50.5	50.7
Men, 20 years and older	76.7	76.8	77.0	77.0	76.9	77.0	77.0	76.8
Women, 20 years and older	65.2	65.6	65.8	65.8	66.0	65.8	66.0	66.0

Multiple Job Holders and Self Employed

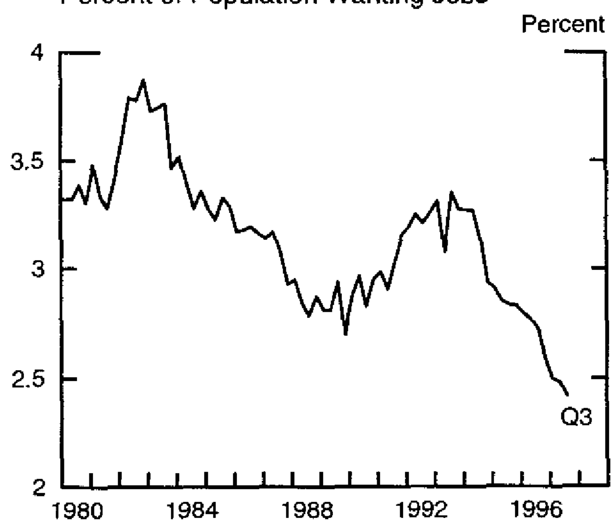


Note. As a percent of total household employment.

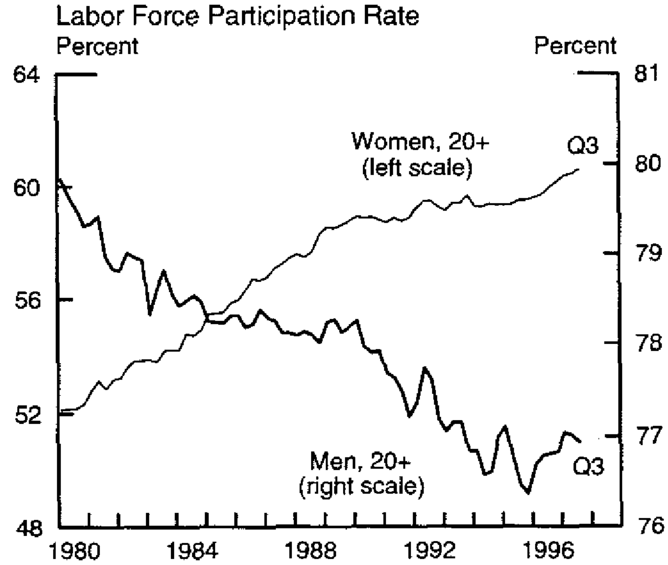
Labor Force Participation Rate



Percent of Population Wanting Jobs*



Labor Force Participation Rate



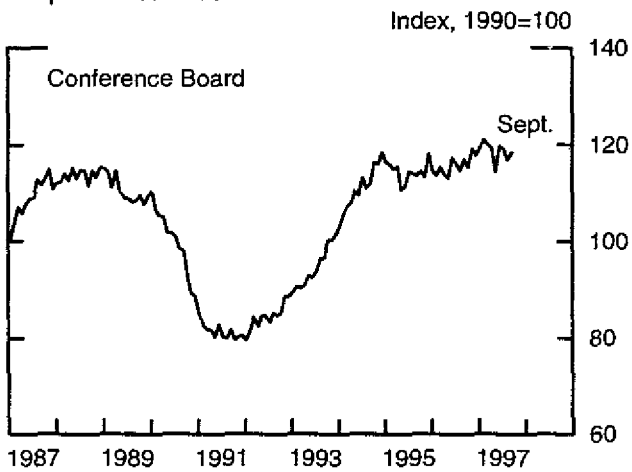
*Seasonally adjusted by FRB staff.

Labor Market Indicators

Initial Claims for Unemployment Insurance

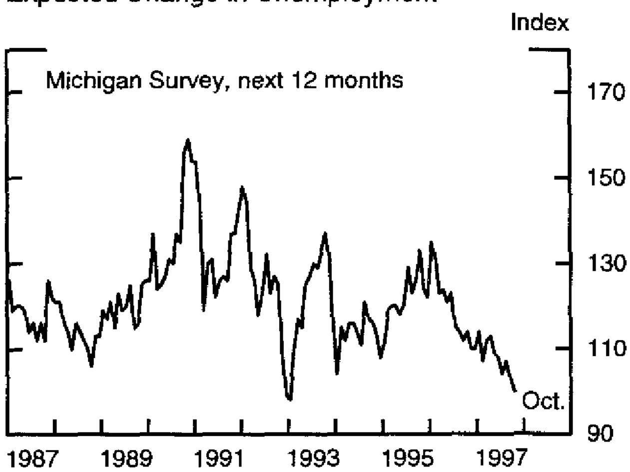
Note. State programs, includes EUC adjustment.

Help Wanted Index



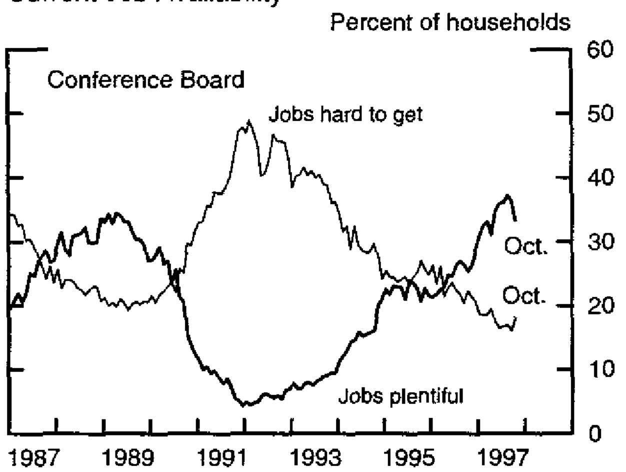
Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Expected Change in Unemployment

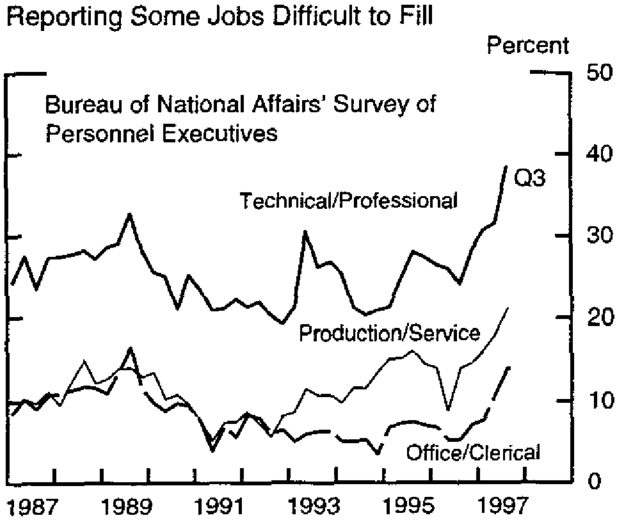


Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

Current Job Availability

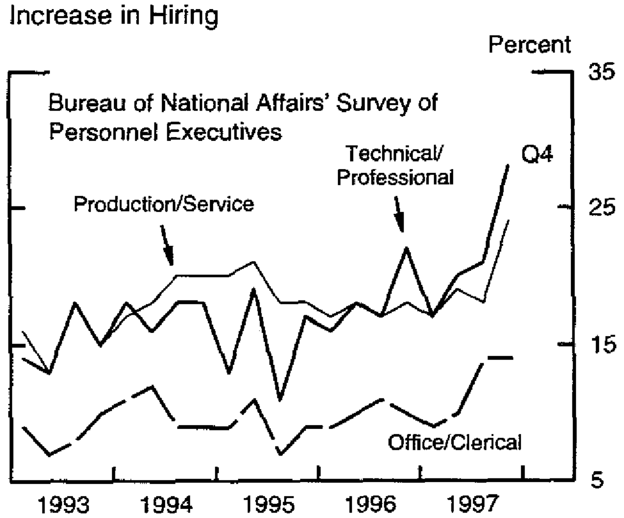


Reporting Some Jobs Difficult to Fill



Note. Seasonally adjusted by FRB staff.

Increase in Hiring



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

	Proportion 1996	1996[1]	1997 H1	1997 Q3	1997 July	1997 Aug.	1997 Sept.
			-Annual rate-		--Monthly rate---		
Total index	100.0	3.9	4.4	7.0	.8	.5	.7
Previous		3.9	4.4		.4	.7	
Manufacturing	86.5	4.1	4.8	7.9	.9	.8	.4
Durables	47.1	5.7	6.7	12.6	1.1	1.5	.4
Motor vehicles and parts	4.9	-1.6	-1.3	22.0	-.3	6.0	-.1
Aircraft and parts	2.3	34.5	21.8	18.2	1.9	1.2	1.1
Nondurables	39.4	2.3	2.5	2.5	.7	-.1	.5
Manufacturing excluding motor vehicles and parts	81.6	4.5	5.1	7.2	1.0	.5	.5
Mining	5.6	3.4	5.5	-2.7	-.2	-1.1	-.5
Utilities	7.9	1.4	.0	3.3	.9	-1.2	4.4
IP by market group							
Consumer goods	28.0	2.5	1.6	3.5	.3	.5	.7
Durables	6.0	2.4	2.3	9.9	-.9	2.8	-.1
Nondurables	22.0	2.5	1.4	1.8	.6	-.1	1.0
Business equipment	13.9	8.0	9.4	14.7	1.2	2.2	.0
Information processing	5.8	10.8	11.5	19.1	1.3	1.4	1.2
Industrial	4.5	-.2	2.9	11.0	1.9	2.3	-1.4
Transit	2.3	21.5	14.1	17.9	.2	4.7	.7
Other	1.3	3.6	14.4	2.6	.3	.8	-1.8
Construction supplies	5.7	5.7	2.1	.5	-.7	.9	.1
Materials	40.3	4.0	5.1	9.9	1.6	.1	1.1
Durables	23.2	5.5	7.0	15.1	1.9	1.0	.8
Semiconductors	4.0	16.0	28.8	39.0	3.8	2.4	2.1
Basic metals	3.7	3.2	2.6	6.0	.0	.0	2.5
Nondurables	9.0	2.8	4.7	3.6	1.7	-.9	.7

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1959-96 Avg.	1996 Q3	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
Manufacturing	85.7	81.7	82.3	82.5	83.2	82.9	83.3	83.4
Primary processing	88.9	82.8	86.6	87.0	87.4	87.3	87.3	87.7
Advanced processing	84.2	81.2	80.4	80.5	81.3	81.0	81.5	81.4

After rising to 67.2 percent in the first quarter, the aggregate labor force participation rate fell back a bit in the last two quarters. The participation rate for adult women has risen further, albeit at a slightly slower pace; in particular, the uptrend in the participation of women maintaining families--the group most likely to have been affected by welfare reform--has continued. However, the participation rates for adult men and teenagers have fallen over the past two quarters. Nonetheless, the percentage of the population that wants a job but is not currently in the labor force has also dropped sharply, to a historically low level, in recent months. And the BNA survey of jobs difficult to fill rose further in the third quarter, from an already high level. Given the stage of the expansion, these observations suggest that there may be relatively few people left to be readily drawn into the labor force.

Based on labor input and the advance NIPA data, the staff estimates that output per hour in the nonfarm business sector rose 3 percent at an annual rate in the third quarter. Over the year ended in 1997:Q3, labor productivity increased 2-1/4 percent--an acceleration of 1 percentage point over the same period a year earlier. Random fluctuations in self-employed hours could account for some of the strength in nonfarm business productivity, but the acceleration has been ongoing for two years now, seemingly indicating a stronger trend productivity performance than was seen earlier in the expansion.[3]

Industrial Production

Industrial production raced ahead at an annual rate of 7 percent in the third quarter, up from a 4-1/2 percent annual pace over the first half of the year. Growth was especially strong in the motor vehicle, aircraft, and information-processing industries. In September, industrial production rose 0.7 percent, boosted by a jump in the output of utilities. Manufacturing output grew 0.4 percent, pushing the factory operating rate to 83.4 percent--the highest level since April 1995. Despite this increase, capacity utilization in manufacturing remains 1.2 percentage points below its

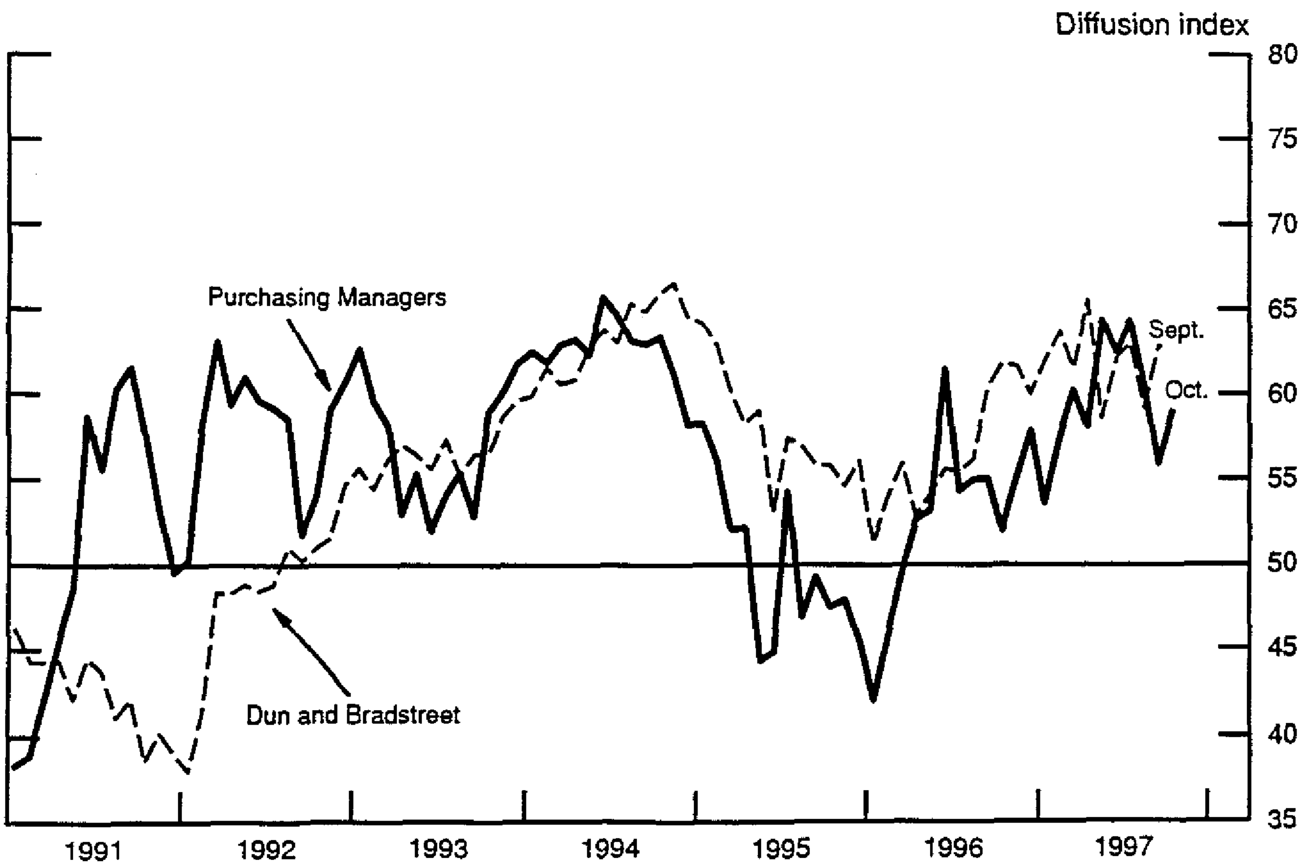
3. An acceleration in capital services per hour in the past few years is consistent with the emergence of more rapid growth in trend productivity. The staff estimates that capital services per hour increased 1-1/2 percent per year in the first half of the decade--a weak performance by historical standards--but picked up to a 3 percent pace in 1996. Based on information available, an increase similar to that in 1996 appears to be occurring in 1997.

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

	Share, 1997:H1	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
Total durable goods	100.0	1.2	3.6	.1	2.8	-.6
Adjusted durable goods[1]	69.0	1.5	3.5	.5	3.1	.8
Computers	5.0	.2	7.3	6.6	-2.8	3.1
Nondefense capital goods excluding aircraft and computers	17.0	.4	7.0	6.6	-5.7	6.9
Other	47.0	2.1	1.9	-2.3	7.2	-1.6
Memo:						
Real adjusted orders[2]		2.0	4.3	.8	3.3	1.1

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.

most recent peak in January 1995. The staff's current estimates show a marked acceleration in the growth of manufacturing capacity over the past three years, from a bit over 2 percent, on average, in the early 1990s, to around 4-1/4 percent recently.[4] This pickup has tempered the rise in utilization.

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

	1997					
	Aug.	Sept.	Oct.	Q2	Q3	Q4
						Sched.
U.S. production	12.4	12.6	12.6[e]	11.5	12.0	12.6
Autos	6.1	6.1	6.0	5.7	6.0	6.0
Trucks	6.3	6.5	6.6	5.8	6.0	6.6
Days' supply						
Autos	55.0	56.9	60.2	60.6	56.9	...
Light trucks	70.5	71.9	75.9	78.6	71.2	...

Note. Components may not sum to totals because of rounding.
e--Staff estimates based on weekly production data.

Production of motor vehicles and parts has been a volatile component of industrial production throughout 1997, in large part because of labor disputes. Nearly all local issues at GM have now been resolved, however, so that assemblies should begin to track industry fundamentals more closely. At the end of October, days' supply of light trucks was somewhat high at 76 days, while days' supply of autos was about 60 days. At present, industry schedules call for a 4 percent increase in motor vehicle assemblies in the fourth quarter.

By major market group, the production of consumer durable goods fell 0.1 percent in September, reflecting a drop in household appliance production, after a surge in August. The output of consumer nondurable goods rose 1.0 percent, owing mainly to increases in energy use and chemical products. Production of business equipment was flat in September, as continued strength in information processing equipment and aircraft production was offset by declines in industrial equipment (most notably construction equipment) and other equipment (especially farm machinery and

4. The annual revision to industrial production and capacity utilization will be published later this month. The revisions to capacity utilization will incorporate information from the most recent Survey of Plant Capacity, which will report year-end utilization rates for 1995 and 1996.

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

	1996	1997 Q1	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
	Q4/Q4	----- Annual rate	-----		---- Monthly rate	----	
PCE	2.7	5.3	.9	5.7	1.0	.2	.0
Durables	3.9	14.1	-5.4	16.7	3.7	.1	-1.3
Motor vehicles	-1.6	9.9	-16.6	23.7	6.3	-.9	-2.9
Computers	55.3	81.2	102.2	84.7	9.6	4.4	.1
Other durable goods	1.7	6.8	-13.6	-1.6	.2	-.4	-.5
Nondurables	1.8	4.7	-2.1	4.7	.8	.1	.0
Gas and oil	1.0	-.5	5.3	3.3	.4	-.6	1.3
Clothing and shoes	4.4	10.9	-4.7	13.0	1.3	1.1	-.8
Other nondurables	1.2	3.7	-2.2	2.8	.7	-.1	.1
Services	2.8	3.9	3.9	4.1	.6	.2	.3
Energy	.7	-12.4	14.3	3.6	2.1	-2.0	.8
Non-energy	2.9	4.7	3.4	4.1	.5	.3	.3
Housing	1.7	2.0	2.1	2.1	.2	.2	.2
Household operation	2.0	.3	5.4	5.2	.4	.4	.2
Transportation	4.2	4.8	3.3	6.3	.6	.2	.7
Medical	2.5	4.2	2.5	3.1	.3	.4	.2
Personal business	4.6	8.5	3.6	6.1	.8	.0	.5
Other	4.1	8.1	6.1	6.0	1.0	.7	.3
Memo:							
PCE excluding motor vehicles	2.9	5.1	1.9	4.9	.7	.2	.2

Note. Derived from billions of chained (1992) dollars.

PERSONAL INCOME
(Average monthly percent change)

	1996	1997 Q1	1997 Q2	1997 Q3	1997 July	1997 Aug.	1997 Sept.
	Q4/Q4	--- Annual rate	---		--- Monthly rate	---	
Total personal income	5.8	8.0	5.0	4.8	.2	.6	.4
Wages and salaries	6.4	8.3	5.4	5.8	.1	.9	.3
Private	7.1	8.9	6.0	6.3	.0	1.0	.3
Less: Personal tax and nontax payments	12.5	15.1	10.2	7.6	.2	.8	.3
Equals: Disposable personal income	4.8	6.8	4.2	4.3	.1	.6	.4
Memo:							
Real disposable income[1]	2.0	4.6	3.1	2.9	.0	.5	.2
Saving rate (percent)	4.3	3.7	4.2	3.6	3.3	3.6	3.8

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

equipment). The output of materials continued to grow briskly, with semiconductors the largest contributor to growth.

Consumption and Personal Income

Real personal consumption expenditures increased 5-3/4 percent at an annual rate in the third quarter, ar i the fundamentals underlying growth remain strong: Households have accrued tremendous gains in net worth over the past three years and real incomes have registered solid growth. The recent turmoil in world financial markets conceivably could dampen consumer confidence, but any declines would come from extremely lofty levels.

On a monthly basis, real PCE was unchanged in September, after a 0.2 percent gain in August and a 1 percent jump in July. Outlays for durable goods were held down by a decline in spending on new cars and trucks, while expenditures for computers and other electronic equipment were little changed after three months of robust gains. Real expenditures for nondurable goods were flat in September, as increased outlays for gasoline and food were offset by lower outlays for toys and clothing. Many press reports have attributed September's weakness in apparel purchases to unseasonably warm weather, which reportedly muted enthusiasm for purchases of fall and winter apparel. Real spending for services in September rose 0.3 percent--boosted by a rebound in energy outlays and solid gains in most other major components of services as well.

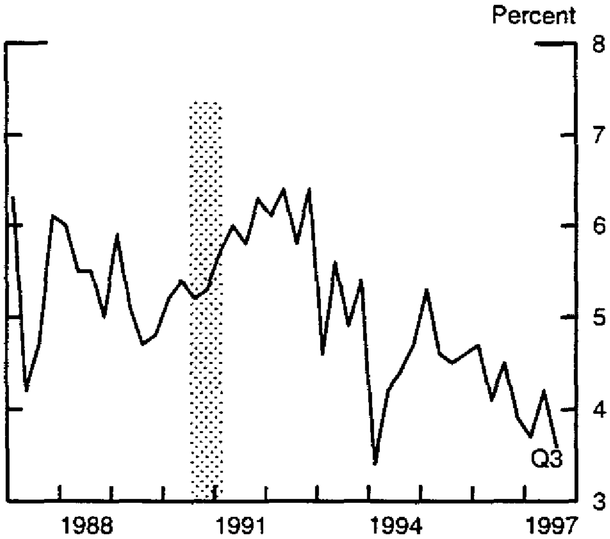
Real disposable personal income rose 0.2 percent in September, and for the third quarter as a whole, it increased at a healthy 2.9 percent annual rate. Given the strength of consumer demand, the personal saving rate fell back to 3.6 percent in the third quarter; over the past four quarters, it has declined almost a full percentage point.

As measured by both the Michigan SRC and Conference Board indexes, consumer confidence remained at quite favorable levels in October, although both measures were down somewhat from their September readings. Both of these surveys were largely completed before the recent turbulence in world stock markets and cannot be expected to accurately gauge the reaction of consumers to that episode.[5] The SRC collected only about 18 percent of its full

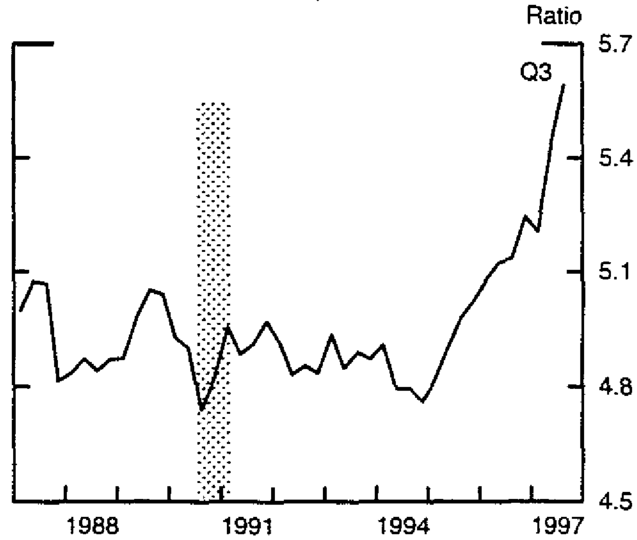
5. Indeed, in the Michigan survey, the share of households that expect good economic times rose to the highest level in almost two decades in October, and the proportion expecting the expansion to continue for another five years was at the highest level in more than three decades. In addition, the index of expected unemployment change fell for the second consecutive month.

Household Indicators

NIPA Personal Saving Rate

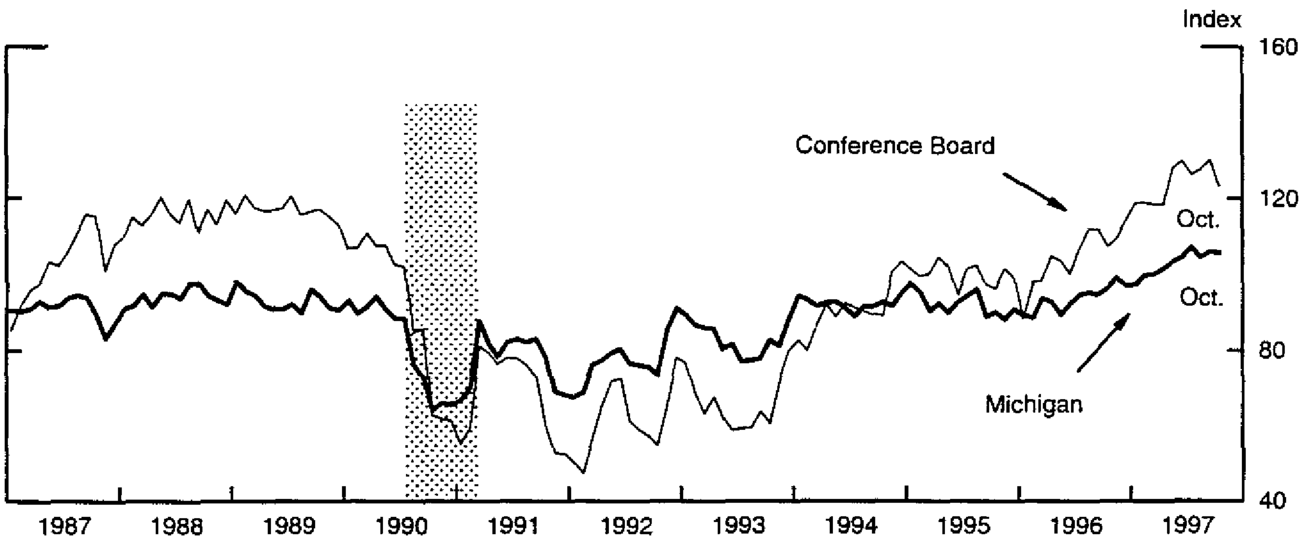


Ratio of Net Worth to Disposable Income

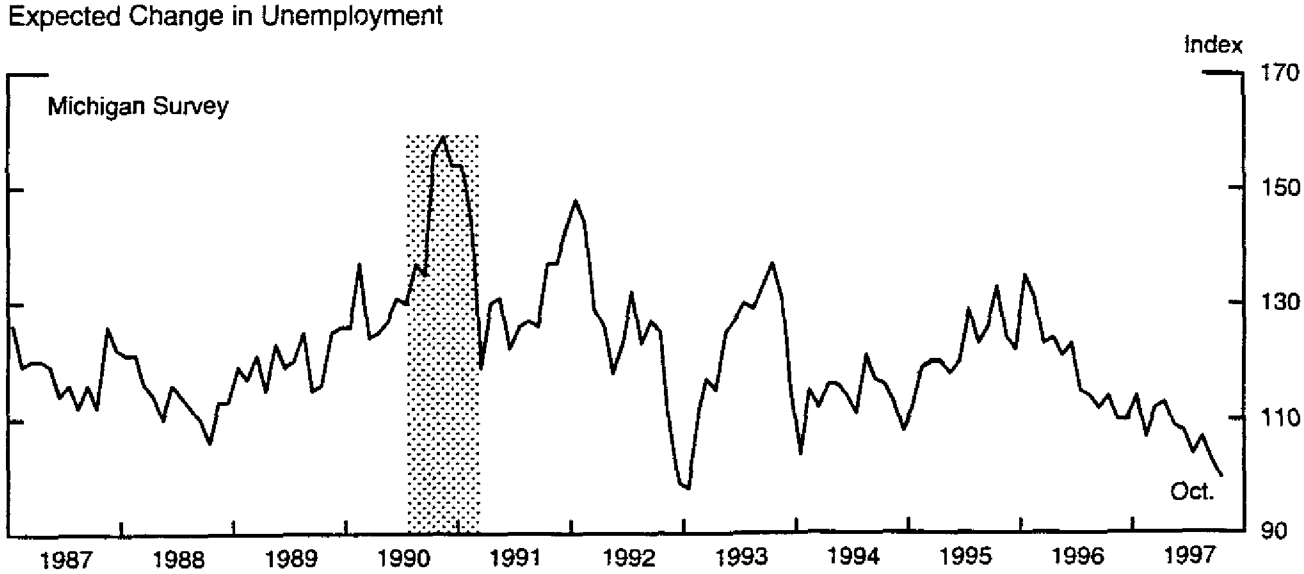


Note. Data for 1997:Q3 are staff estimates.

Consumer Confidence



Expected Change in Unemployment



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

sample in the last week of October. These ninety-two responses were insufficient to discern any response that could be considered reliable.[6]

Motor Vehicles

New light vehicles sold at an annual rate of about 14.7 million units in October, a deceleration from the elevated pace of the third quarter. The third-quarter spurt in sales was attributable, at least in part, to the end of supply disturbances at General Motors. A pickup of fleet sales accounted for about one-third of the gain in motor vehicle sales in the third quarter as GM, with its supply problems resolved, made up for shortfalls earlier in the year. On average, sales for the year to date have been at about the same pace as for 1996 as a whole.

Light vehicle sales dropped off in October despite improvements in sales at Toyota and Honda. The pickup at Toyota and Honda reflected some easing of supply constraints as well as the effects of a shift in reporting periods. A drop in sales at GM more than accounted for the overall industry decline. According to a source at the company, transport problems at Union Pacific significantly inhibited sales and could prove to be a problem for the next couple of months. Sources at Ford and Chrysler report their sales are largely immune to problems at Union Pacific because of the particular locations of their plants.

The strength of the dollar this year, coupled with weak demand for motor vehicles in Japan, induced Japanese automakers to aggressively price their 1998 models. In turn, the Big Three automakers have also held the line on many 1998 model prices and have offered generous incentive programs. Some list prices have been cut, including an unprecedented action by Saturn to mail rebates for purchases made before the announced reduction in prices. Consequently, price increases for light vehicles have been modest to nonexistent this model year, a factor that should help maintain demand into the fourth quarter.

Housing Markets

Housing starts climbed to 1.50 million units at an annual rate in September. The bounceback, which was in line with the staff's

6. In October 1987, the Michigan index fell sharply after the stock market crash: An index constructed from responses after October 19, 1987, was 10 percentage points below an index for the first part of the month. At that time, views on expected business conditions deteriorated noticeably, while appraisals of personal financial situations were little changed.

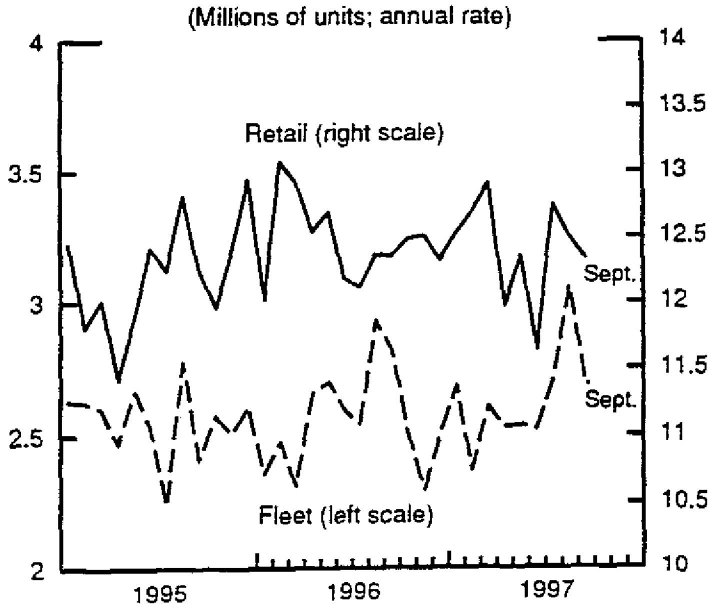
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

			1997			1997		
	1995	1996	Q1	Q2	Q3	Aug.	Sept.	Oct.
Total	14.72	15.09	15.27	14.52	15.35	15.56	15.02	14.68
Adjusted[1]	14.70	15.03	15.21	14.70	15.34	14.96	15.62	14.60
Autos	8.63	8.53	8.54	8.00	8.45	8.67	8.15	7.93
Light trucks	6.09	6.56	6.73	6.52	6.90	6.89	6.86	6.75
North American[2]	12.82	13.38	13.35	12.67	13.33	13.53	13.05	12.73
Autos	7.13	7.25	7.17	6.73	7.05	7.25	6.78	6.59
Big Three	5.43	5.28	5.10	4.85	5.07	4.99	5.08	4.77
Transplants	1.69	1.97	2.07	1.88	1.98	2.25	1.70	1.82
Light trucks	5.69	6.13	6.18	5.94	6.29	6.28	6.27	6.15
Foreign produced	1.90	1.71	1.92	1.85	2.01	2.03	1.97	1.95
Autos	1.51	1.27	1.37	1.27	1.40	1.42	1.37	1.35
Light trucks	.39	.43	.55	.58	.61	.61	.60	.60

Note. Components may not add to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

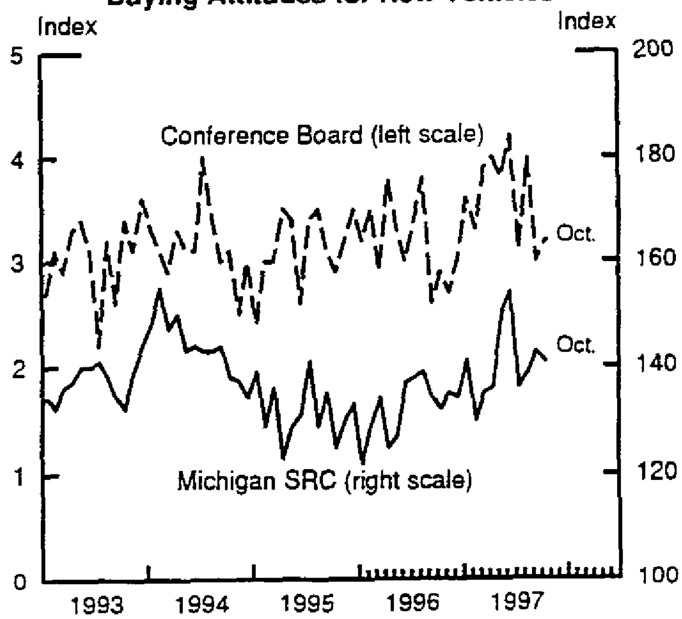
November 5, 1997

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



Note. FRB staff estimate

Buying Attitudes for New Vehicles

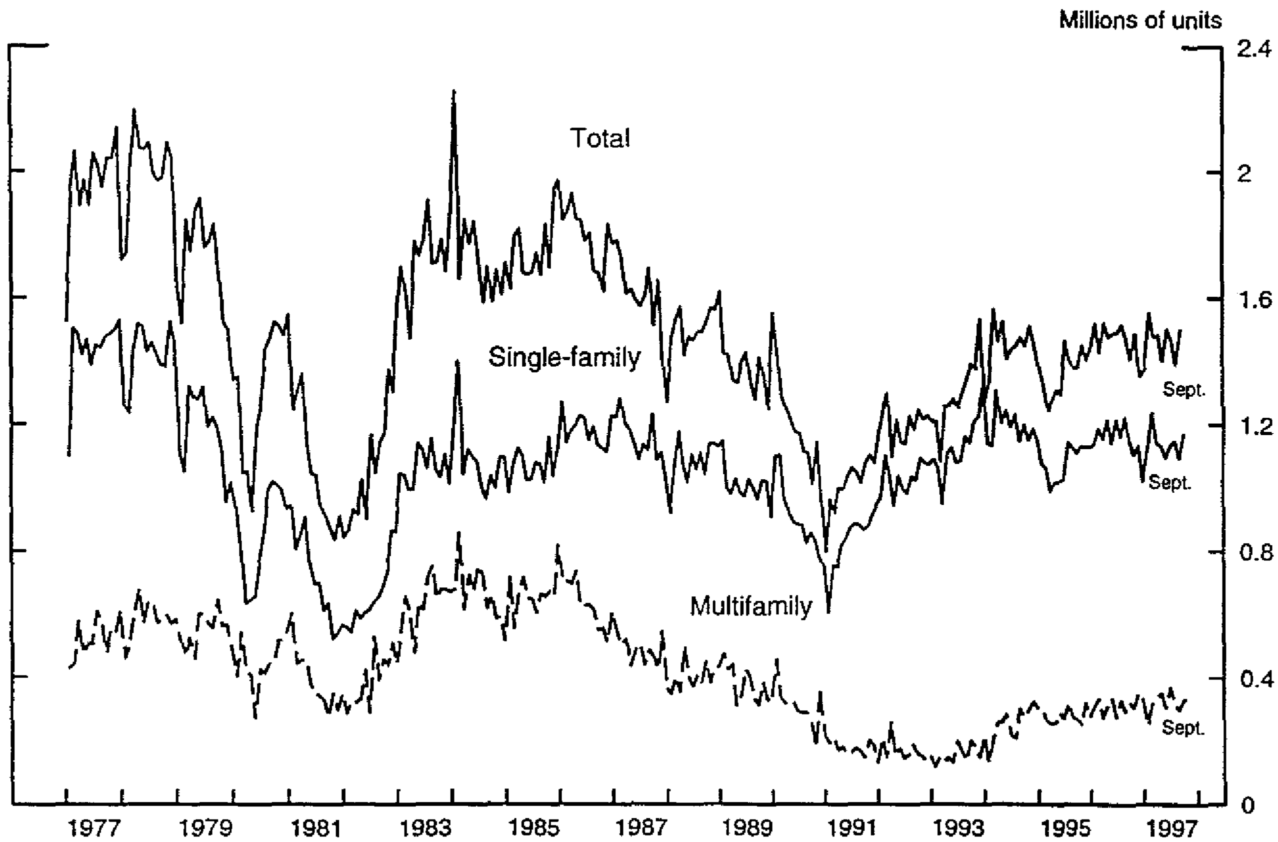


Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		1997					
	1996	Q1	Q2[r]	Q3[p]	July[r]	Aug.[r]	Sept.[p]
All units							
Starts	1.48	1.47	1.46	1.45	1.47	1.39	1.50
Permits	1.43	1.43	1.43	1.42	1.41	1.40	1.46
Single-family units							
Starts	1.16	1.17	1.12	1.14	1.15	1.09	1.17
Permits	1.07	1.05	1.05	1.04	1.03	1.03	1.07
New home sales	.76	.82	.78	.81	.82	.80	.80
Existing home sales	4.09	4.10	4.15	4.27	4.18	4.31	4.32
Multifamily units							
Starts	.32	.30	.34	.31	.32	.30	.33
Permits	.36	.38	.37	.38	.38	.37	.40
Mobile homes							
Shipments	.36	.35	.36	n.a.	.36	.36	n.a.

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

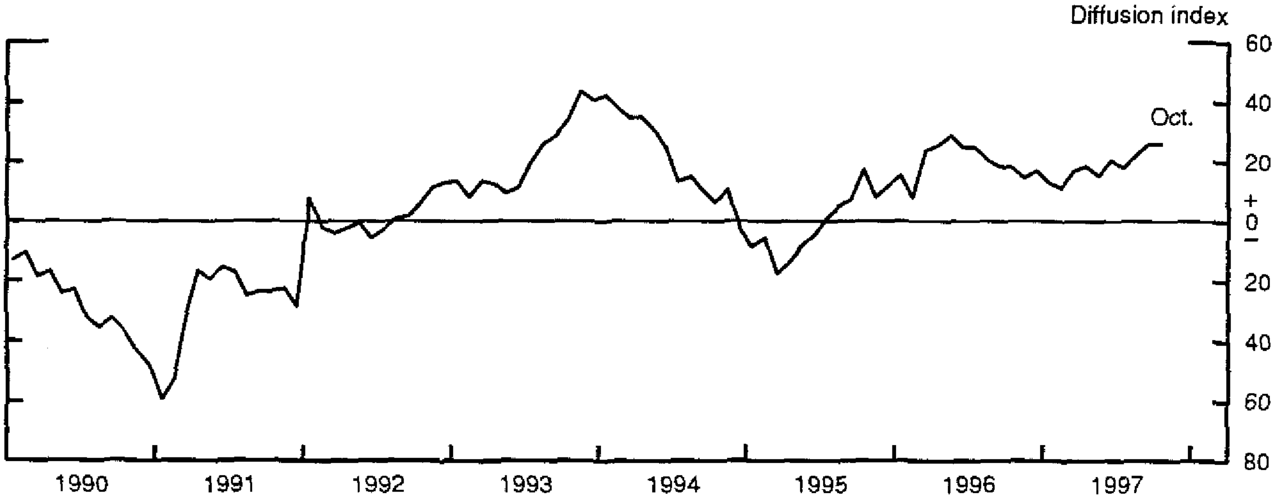
Private Housing Starts
(Seasonally adjusted annual rate)



Indicators of Housing Demand

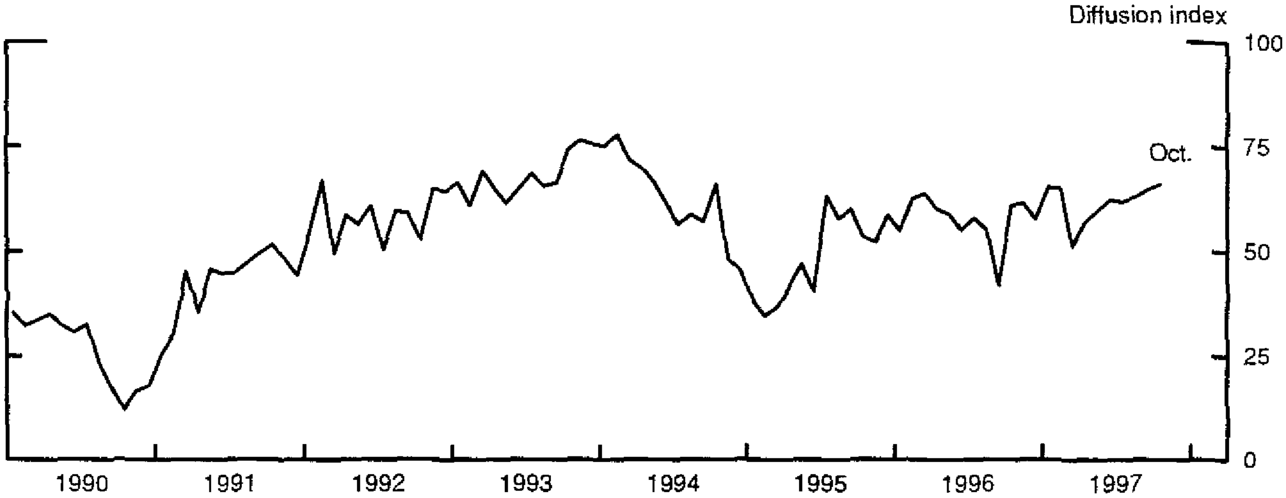
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



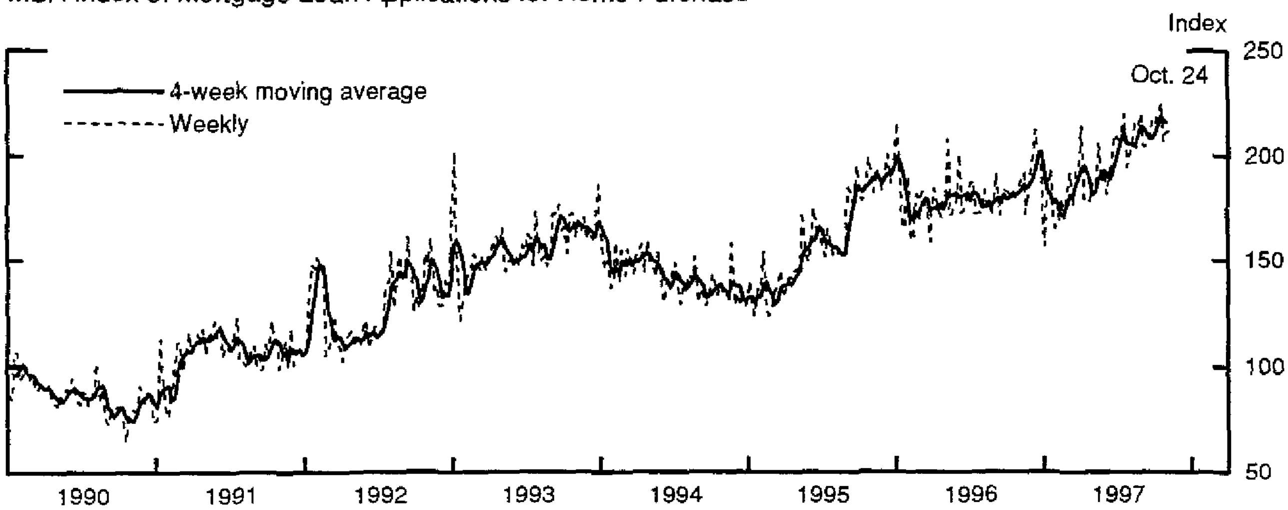
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

Consumer Homebuying Attitudes



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

MBA Index of Mortgage Loan Applications for Home Purchase



expectations, more than offset August's anomalous decline. Starts of single-family homes jumped to 1.17 million units, the second highest level of the year. Permit issuance for single-family units also strengthened, leaving starts well in line with permits (after adjustment for construction activity in areas where building permits are not required).

Indicators of demand for single-family housing have shown continued strength in recent months, reflecting strong support from growth in employment and income as well as declines in mortgage rates. The volume of new home sales was essentially unchanged at a high level in September, and home builders' rating of new home sales in early October remained at the most positive reading in a year and a half. Existing home sales--which because they are mainly recorded at closing, rather than at contract, respond to changing market conditions somewhat less rapidly than new home sales--rose to a new high in September. In October, consumer assessments of homebuying conditions were the most positive in 3-1/2 years. Furthermore, applications for mortgages to finance home purchases in early October reached the highest level since the advent of the series in 1990.

Home price increases remained moderate in the third quarter, with the rate of increase of both new and existing home prices at about the midpoint of their recent ranges. New house prices, adjusted for compositional changes in house quality and geographic location, rose 2.8 percent relative to a year earlier, while the index of existing home prices based on repeat sales climbed 4.6 percent from a year earlier.

Multifamily housing starts bounced back in September to 330,000 units, compared with an average of 319,000 units for the year to date. Permits for multifamily structures also rose substantially and are consistent with starts at the September level. The vacancy rate for multifamily rental units continued to edge down during the third quarter relative to a year earlier.

Business Fixed Investment

Businesses continued to make major contributions to aggregate demand in the third quarter as real business fixed investment advanced at a double-digit pace for the second quarter in a row. Sizable increases in outlays for all categories of producers' durable equipment led the advance, but there was also a modest upturn in expenditures on nonresidential structures. Much of the

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

	1997		1997		
	Q2	Q3	July	Aug.	Sept.
Producers' durable equipment					
Shipments of nondefense capital goods	5.5	4.0	2.7	-2.4	3.7
Excluding aircraft and parts	4.1	4.1	1.1	-1.2	3.5
Office and computing	2.3	5.6	1.6	-1.6	2.0
Communications equipment	6.2	8.5	2.9	3.8	-.5
All other categories	4.3	2.5	.5	-2.3	5.1
Shipments of complete aircraft[1]	27.2	n.a.	52.5	-32.0	n.a.
Sales of heavy trucks	-1.8	4.7	18.8	-8.0	3.6
Orders of nondefense capital goods	-.5	6.9	.4	1.2	2.2
Excluding aircraft and parts	.3	7.4	6.6	-4.8	6.7
Office and computing	.2	8.3	6.6	-2.2	4.8
Communications equipment	4.6	.0	-16.1	6.8	6.8
All other categories	-.7	9.1	13.6	-8.4	7.3
Nonresidential structures					
Construction put in place, buildings	-2.0	1.9	3.6	-.4	-5.1
Office	-3.3	6.5	3.0	1.1	-8.0
Other commercial	-5.8	-1.7	5.4	-6.0	-4.4
Institutional	4.6	.2	1.4	4.4	-.0
Industrial	-3.9	5.0	2.9	2.8	-6.8
Lodging and miscellaneous	3.5	1.5	4.0	-.6	-5.9
Rotary drilling rigs in use[2]	11.9	-3.5	-3.9	-1.4	-2.4
Memo:					
Business fixed investment	14.6	18.7	n.a.	n.a.	n.a.
Producers' durable equipment	23.0	22.1	n.a.	n.a.	n.a.
Office and computing	46.2	43.0	n.a.	n.a.	n.a.
Communications equipment	7.9	31.7	n.a.	n.a.	n.a.
Other equipment[3]	19.8	10.0	n.a.	n.a.	n.a.
Nonresidential structures	-4.7	10.1	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.

credit for the strong performance of investment comes from healthy cyclical fundamentals, such as the acceleration in business output and steady growth in corporate cash flow.

In the third quarter, the increase in expenditures on producers' durable equipment was again led by outlays on office and computing equipment. Nominal shipments advanced strongly, and rapid price declines continued. Anecdotal evidence suggests that the plunge in computer prices is set to continue in the near term. Cyrix and AMD now appear to pose a realistic challenge in some market segments to Intel's dominant position. Intel's recent price cuts were larger than normal, and its third-quarter profits were disappointing despite substantial growth in shipments. Along with falling prices for components, margins for PC manufacturers are declining. Sub-$1000 personal computers--such as those manufactured by Compaq and Hewlett-Packard and often featuring a non-Intel processor--have been the runaway success of this year's consumer market, and PC manufacturers' share prices have weakened in anticipation of a price war. Beyond PCs, the demand for networking equipment is expanding rapidly.

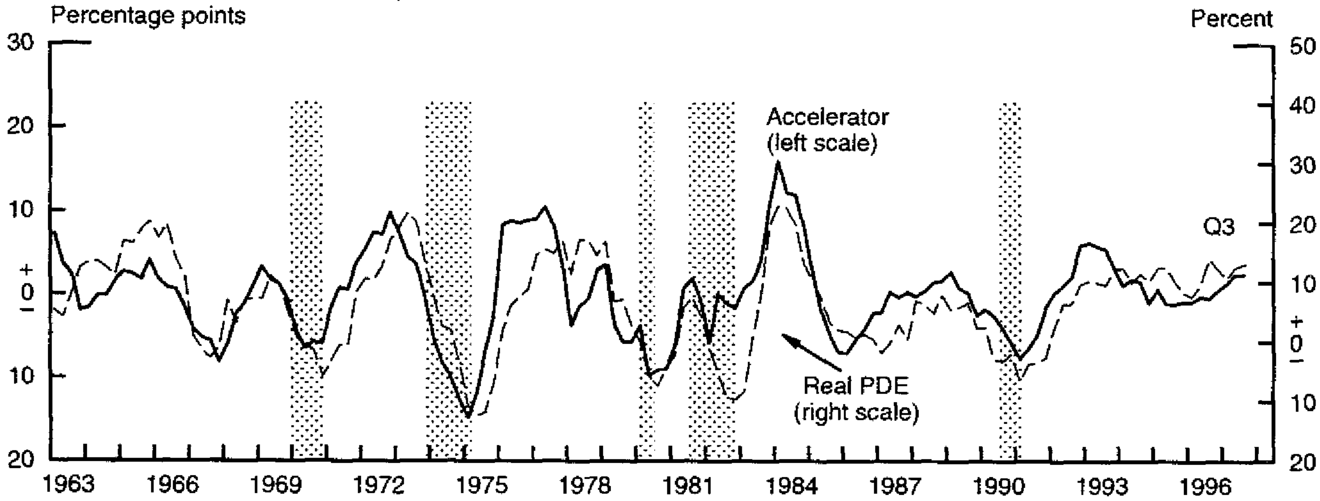
Expenditures on communications equipment advanced at a 32 percent annual rate in the third quarter as the large capital spending programs of the long-distance companies continued to lift demand. The FCC's regulations for opening local telephone markets to competition have continued to suffer legal setbacks, and just how deregulation will proceed over the next year remains unclear.[7] Nonetheless, the near-term spending picture still looks strong as orders for communications equipment advanced 7 percent per month in both August and September.

Expenditures on transportation equipment also contributed to the third-quarter boom in PDE. Domestic expenditures on aircraft were substantial in the third quarter, despite the well-publicized production difficulties experienced by Boeing. A lower-than-normal proportion of Boeing's deliveries were for export, boosting the domestic share of expenditures on aircraft. Boeing's production difficulties and a return to normal levels of exports are likely to depress domestic expenditures on aircraft in the current quarter. Business expenditures on motor vehicles raced ahead at a 25 percent

7. The latest setback to the deregulation process was the October 14 judgment by a U.S. appeals court that rejected the FCC's regulations governing the leasing of pieces of the Baby Bells' local phone networks to their rivals.

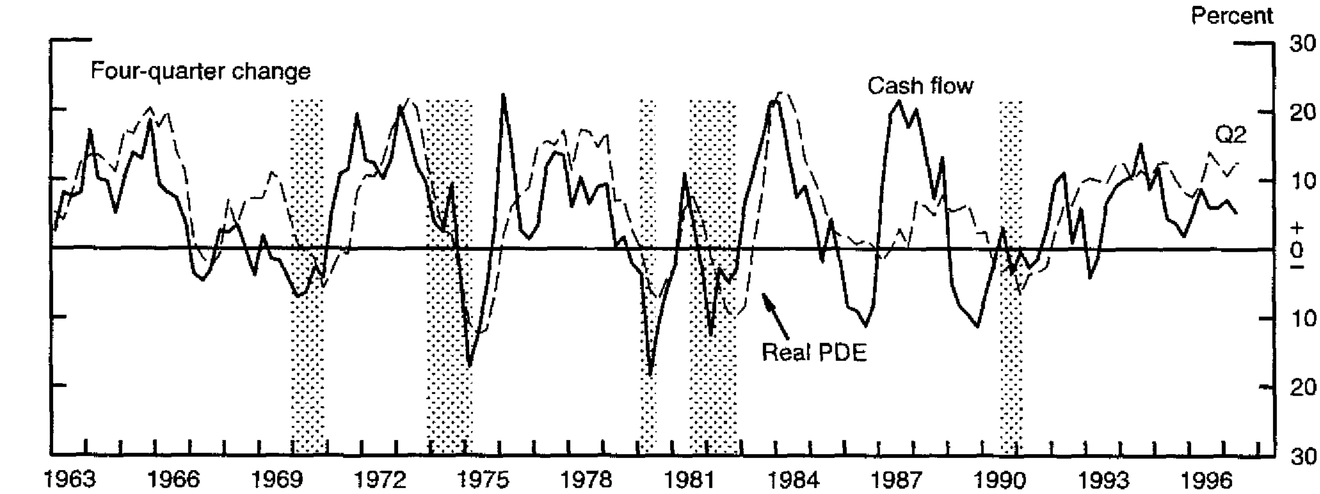
Determinants of Equipment Spending

Acceleration of Business Output

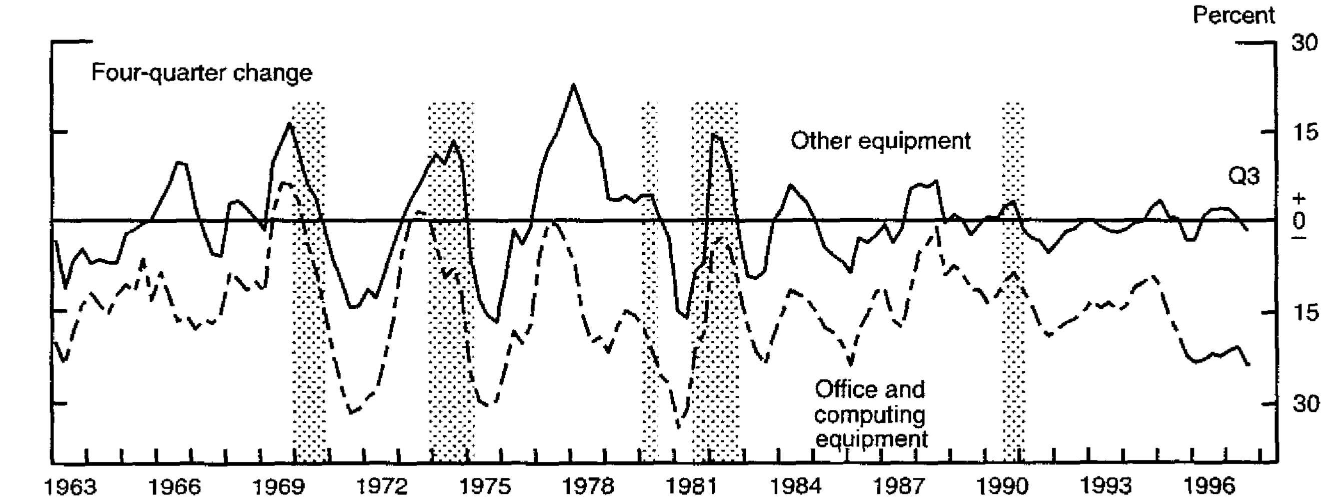


Note. The accelerator is the eight-quarter percent change in business output less the year-earlier eight-quarter percent change. Real PDE is the four-quarter percent change.

Real Domestic Corporate Cash Flow

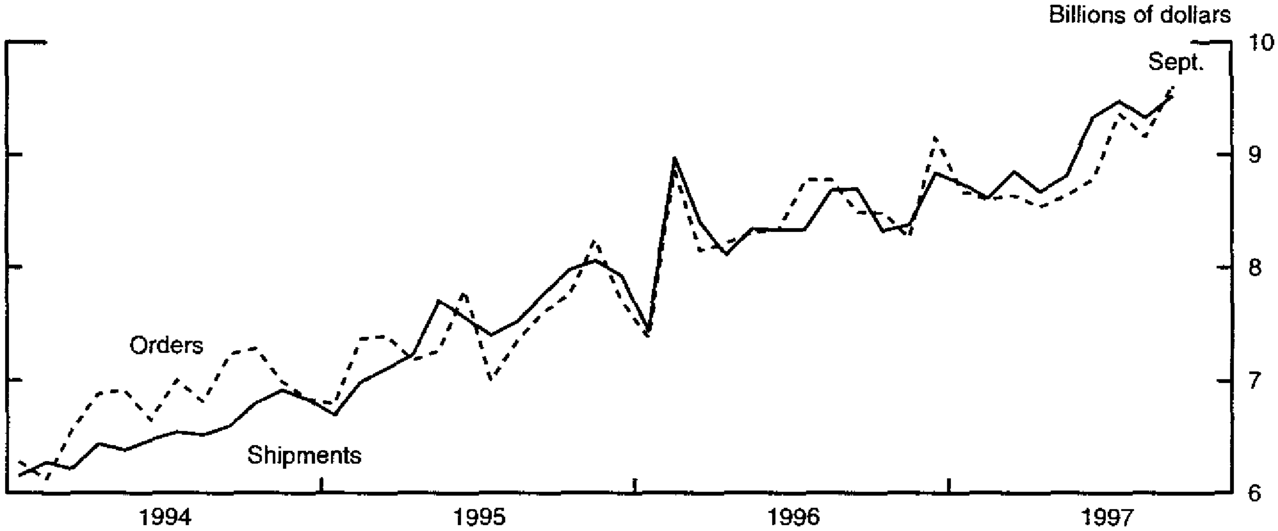


User Cost of Capital

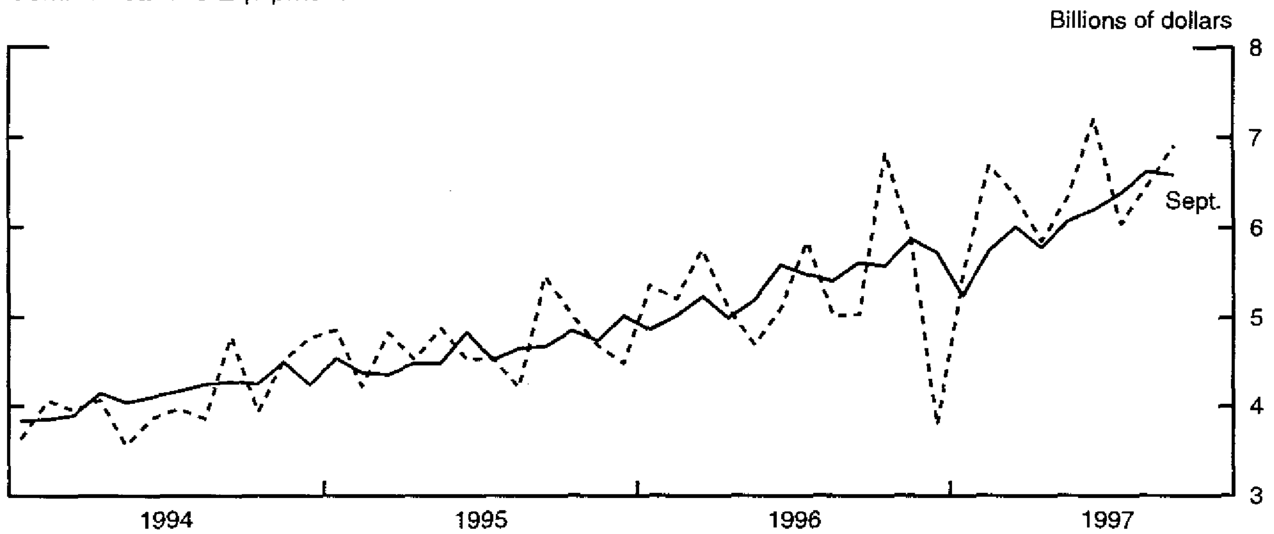


Orders and Shipments of Nondefense Capital Goods

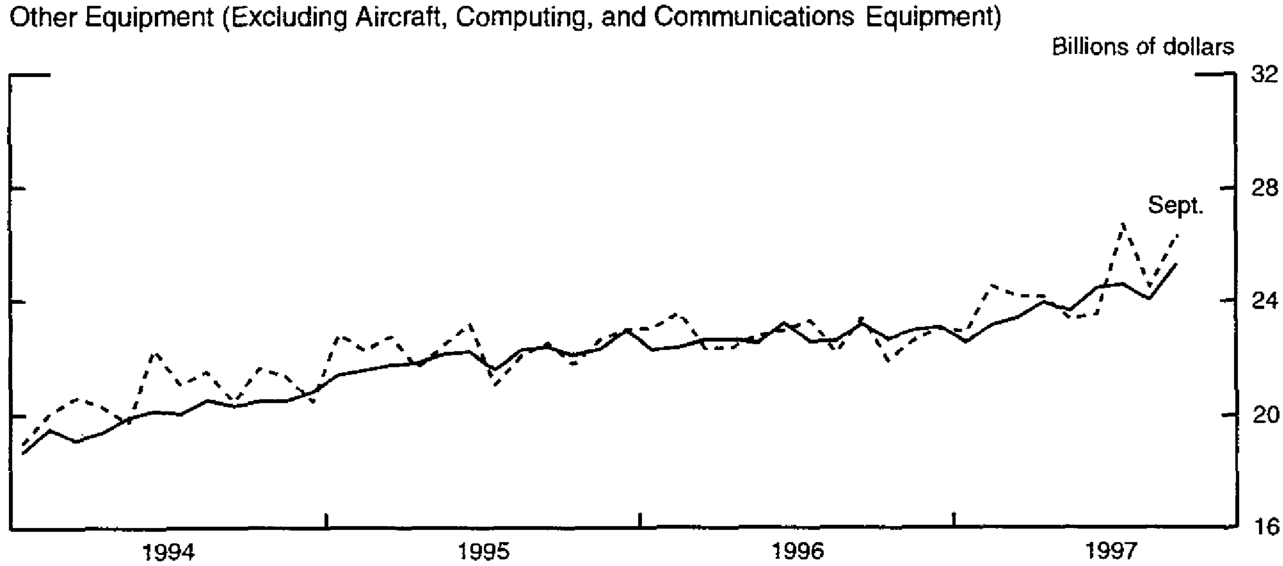
Office and Computing Equipment



Communications Equipment

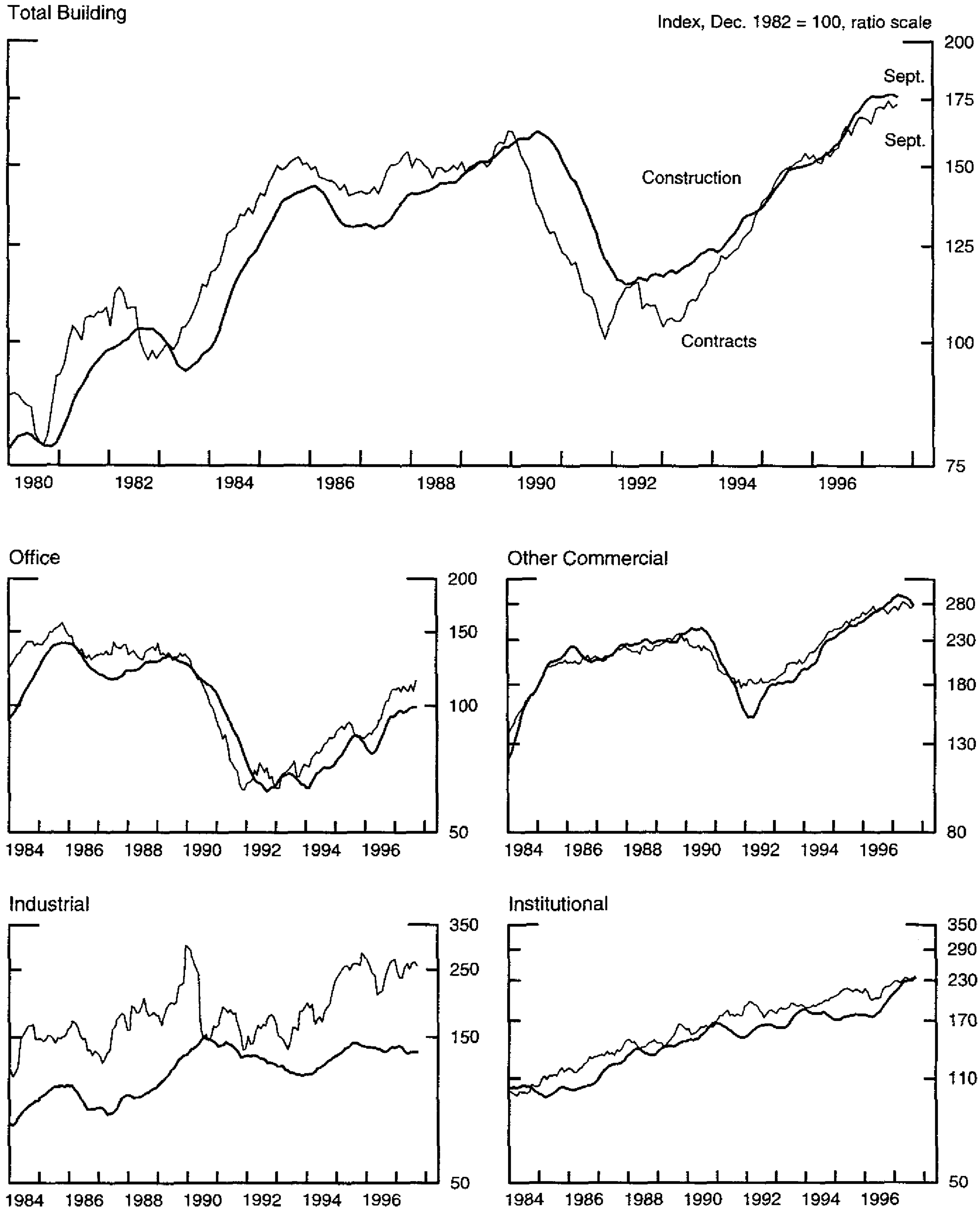


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



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

annual pace in the third quarter. At an annual rate of 430,000 units, sales of heavy trucks were high by historical standards and net new orders continued on the recent upward trend.

Outside the high-tech and transportation equipment categories, real expenditures increased at a 10 percent annual rate in the third quarter, fueled by strong orders from earlier this year and the healthy expansion in business output. The orders picture for this sector continues to look robust, with an increase of 7 percent in September and 9 percent for the third quarter as a whole. The growth in orders was broad based and is likely to translate into further strength in this sector in the fourth quarter.

Based on data that have become available since the GDP release, the staff now estimates that real outlays on nonresidential structures expanded at about a 4 percent annual rate in the third quarter, as industrial and office construction registered sizable advances while most other components remained flat. Our estimate is significantly below the 10 percent figure in the advance GDP release because of a 5 percent fall, for September, in nonresidential building construction put-in-place, a substantially weaker number than the BEA assumption underlying the advance release. While a bounceback from September's decline in construction put-in-place can be expected, the weakness of the recent data on construction contracts suggests that investment in nonresidential structures is at best on a modest uptrend at this time.

Business Inventories

Inventory investment evidently moderated substantially in the third quarter from the rapid pace of stockbuilding in the second quarter. According to BEA's advance estimate, the slowing lowered growth in real GDP last quarter by 1-1/2 percentage points.[8] In general, inventories remain lean relative to sales, and there may even be room for some additional stockbuilding in some sectors.

On a book-value basis, manufacturing inventories rose at an $8 billion annual rate in September, down from a revised $22 billion annual pace in August. The modest September restocking leaves the third-quarter average a touch under $20 billion, slightly below the second-quarter pace. The inventory-shipments ratio fell back to

8. The data on manufacturers' inventories received this morning were very close to BEA's assumption in the advance GDP report and imply only minor revisions to nonfarm inventory investment in the third quarter.

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

	1997			1997		
	Q1	Q2	Q3	July	Aug.	Sept.
Book value basis						
Total	35.8	51.5	n.a.	18.4	29.3	n.a.
Excluding wholesale and retail motor vehicles	30.9	48.9	n.a.	17.6	27.5	n.a.
Manufacturing	16.5	25.1	17.3	21.3	22.1	8.3
Excluding aircraft	9.1	19.8	12.1	15.9	12.0	8.3
Wholesale	14.3	19.1	n.a.	-22.1	30.0	n.a.
Excluding motor vehicles	11.5	14.3	n.a.	-16.9	26.1	n.a.
Retail	5.0	7.4	n.a.	19.1	-22.9	n.a.
Auto dealers	2.1	-2.1	n.a.	5.9	-2.2	n.a.
Excluding auto dealers	2.8	9.6	n.a.	13.2	-20.7	n.a.

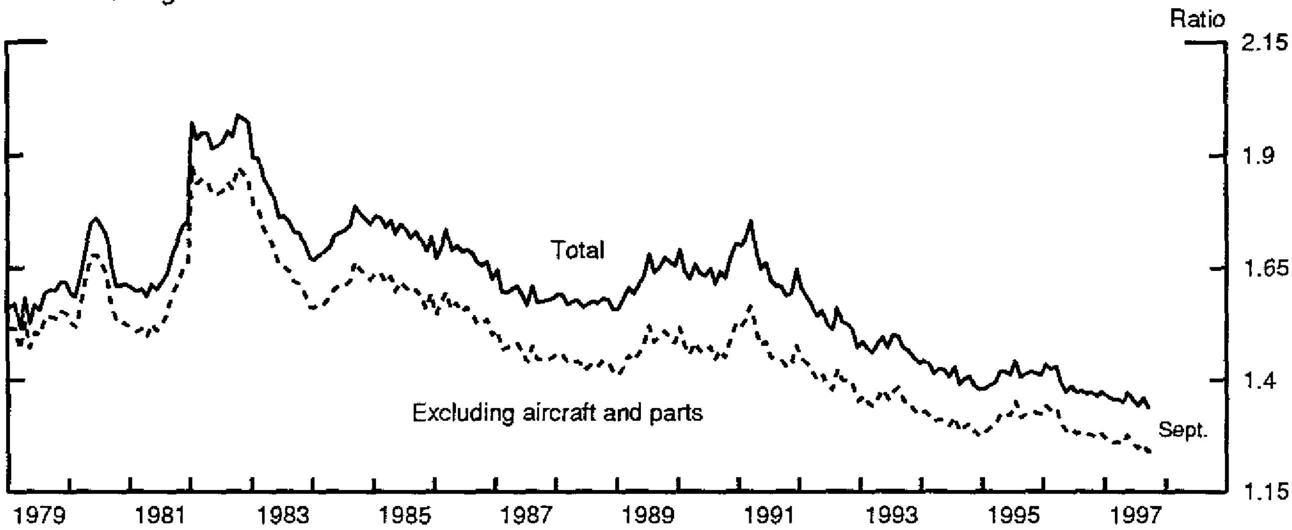
SELECTED INVENTORY-SALES RATIOS
(Months' supply, based on Census book-value data, seasonally adjusted)

	Cyclical reference points		Range over preceding 12 months		September
	1990-91 High	1995-96 Low	High	Low	1997
Manufacturing and trade	1.58	1.37	1.39	1.35	1.37
Less wholesale and retail motor vehicles	1.55	1.34	1.35	1.32	1.34
Manufacturing	1.75	1.36	1.38	1.34	1.34
Primary metals	2.08	1.49	1.70	1.59	1.60
Nonelectrical machinery	2.48	1.80	1.87	1.72	1.72
Electrical machinery	2.08	1.41	1.48	1.33	1.29
Transportation equipment	2.93	1.48	1.61	1.49	1.57
Motor vehicles	.97	.56	.62	.56	.58
Aircraft	5.84	4.15	4.73	4.09	4.37
Nondefense capital goods	3.09	2.31	2.39	2.23	2.21
Textile	1.71	1.44	1.54	1.47	1.49
Petroleum	.94	.75	.84	.75	.79
Home goods & apparel	1.96	1.67	1.72	1.65	1.68
Merchant wholesalers	1.36	1.24	1.26	1.22	1.27
Less motor vehicles	1.31	1.22	1.23	1.20	1.24
Durable goods	1.83	1.53	1.56	1.50	1.55
Nondurable goods	.96	.93	.95	.92	.97
Retail trade	1.61	1.50	1.53	1.48	1.48
Less automotive dealers	1.48	1.43	1.45	1.41	1.41
Automotive dealers	2.21	1.68	1.79	1.68	1.67
General merchandise	2.43	2.21	2.26	2.10	2.07
Apparel	2.56	2.42	2.56	2.43	2.45
GAF	2.44	2.23	2.27	2.14	2.09

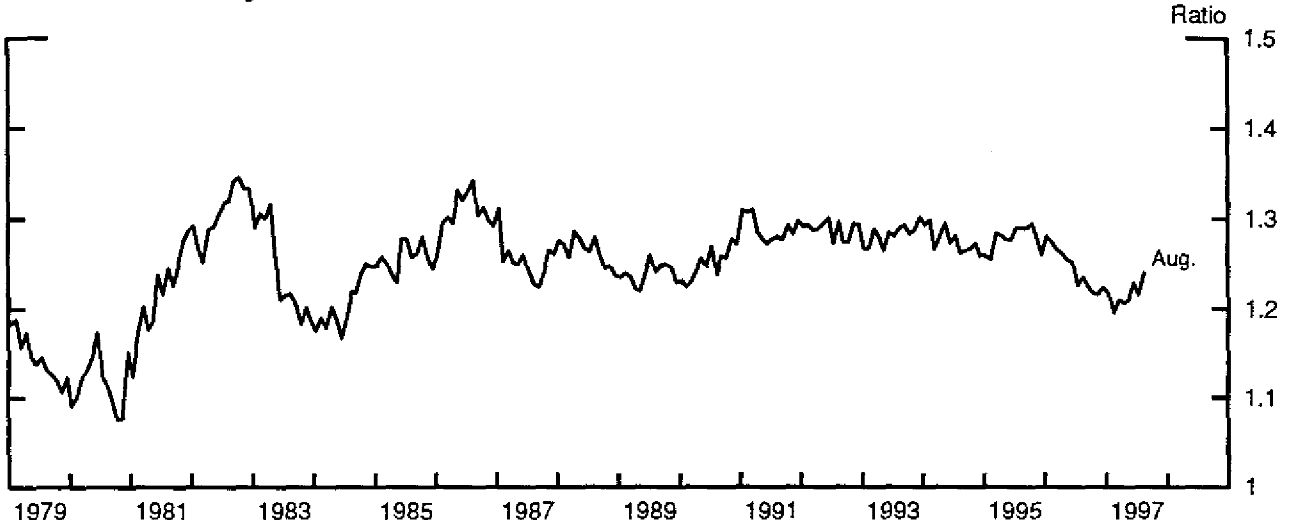
Note. September 1997 ratios for manufacturing; August 1997 ratios for wholesale and retail trade.

Inventory-Sales Ratios, by Major Sector
(Book value)

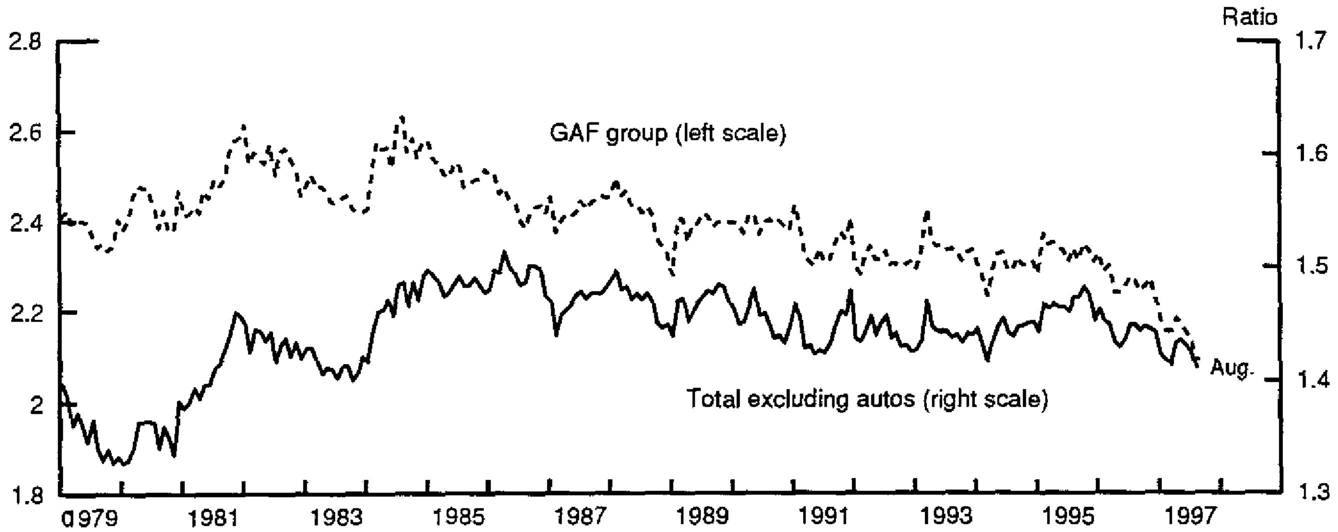
Manufacturing



Wholesale Excluding Motor Vehicles



Retail



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

	September		Fiscal year totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	122.4	125.5	1560.2	1601.6	41.4	2.7
Deposit insurance (DI)	-.7	-.4	-8.4	-14.4	-6.0	n.a.
Spectrum auction (SA)	-.1	.0	-.3	-11.0	-10.7	n.a.
Other	123.3	125.9	1568.9	1627.0	58.0	3.7
Receipts	157.7	174.8	1452.8	1579.0	126.2	8.7
Deficit (+)	-35.3	-49.3	107.4	22.6	-84.8	-78.9
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	130.3	133.2	1575.9	1627.0	51.0	3.2
National defense	22.2	23.2	267.8	270.1	2.3	.8
Net interest	19.2	17.1	241.1	244.1	3.0	1.2
Social security	29.1	30.4	349.7	365.3	15.6	4.5
Medicare and health	24.1	25.6	294.7	313.4	18.7	6.4
Income security	16.2	15.8	228.1	230.4	2.3	1.0
Other	19.5	21.1	194.6	203.8	9.2	4.7
Receipts	157.7	174.8	1452.8	1579.0	126.2	8.7
Personal income and social insurance taxes	112.0	125.8	1165.8	1276.8	111.0	9.5
Corporate	35.1	37.3	171.8	182.3	10.5	6.1
Other	10.5	11.6	115.1	119.9	4.7	4.1
Deficit(+)	-27.4	-41.6	123.2	48.0	-75.2	-61.1

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.

1.34 in September--the low end of the range recorded over the past twelve months.

In wholesale trade, nonvehicle inventories rose at about a $26 billion annual rate in August, more than reversing a downward-revised decline in July. The buildup was concentrated in the miscellaneous category, which includes tobacco products. Distributors may have stocked up in response to manufacturers' price hikes announced for early September. Nonvehicle wholesale sales were down 0.9 percent in August, and the inventory-sales ratio climbed to 1.24 months, its highest level in just over a year.

In retail trade, non-auto inventories fell at a $21 billion rate in August, enough to more than offset the July buildup. The decline was led by general merchandise, apparel, and furniture and home furnishings (GAF). The inventory-sales ratio for this group continued to fall in August, reaching 2.09 months, its lowest level in ten years. The inventory-sales ratio for the entire non-auto, retail trade sector moved down to 1.41 months, the low end of the past year's range.

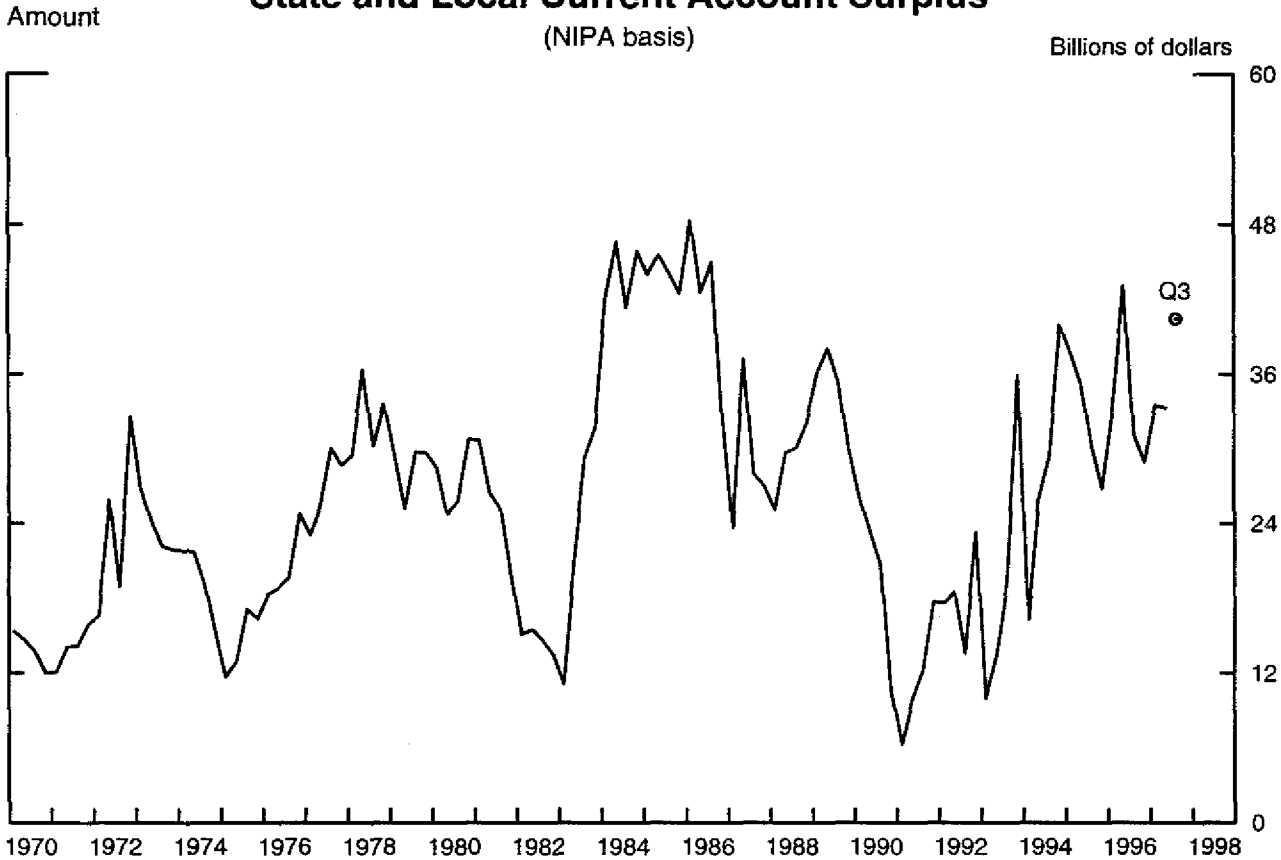
Federal Government

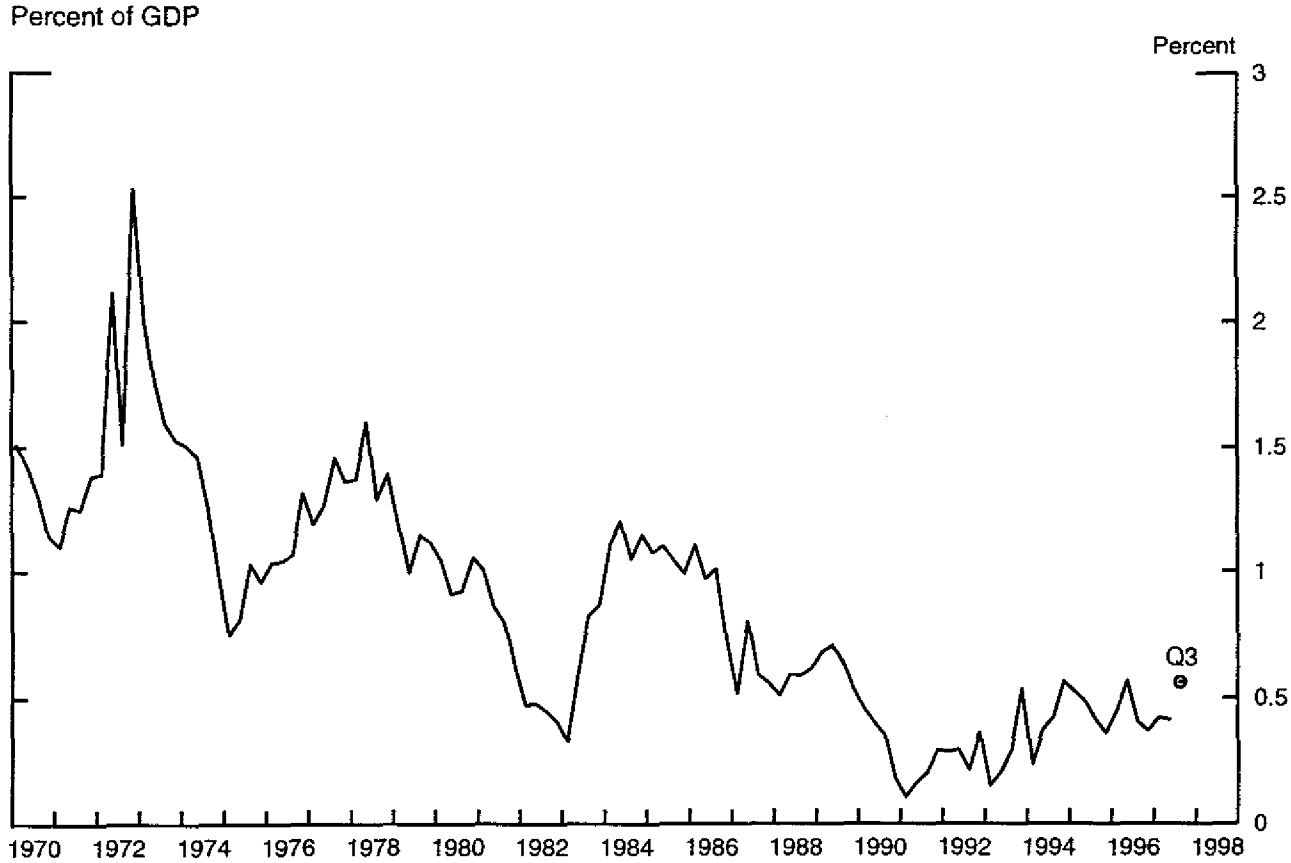
Federal government purchases continued to be a drag on aggregate demand in the third quarter, falling in real terms at an annual rate of a bit more than 1-1/4 percent, about in line with the recent trend. Nondefense purchases retreated from anomalous increases in the first half of the year, falling at a 5-1/2 percent annual rate. Defense purchases bucked the downward trend this quarter and rose 1 percent at an annual rate; increases over the last two quarters have made up for earlier declines that were larger than trend. Over the past four quarters, total real federal purchases are down 1-1/2 percent, defense purchases are down 3 percent, and nondefense purchases are up 1-1/2 percent.

The unified deficit for the fiscal year 1997 was $23 billion, the smallest for any year since 1974. Adjusted for payment timing shifts, and excluding deposit insurance and spectrum auction proceeds, the deficit was $48 billion, down $75 billion from last fiscal year. This improvement owed primarily to strong receipts (up 8-3/4 percent)--most notably personal income and social insurance taxes (up 9-1/2 percent). At 3-1/4 percent, adjusted outlay growth for the fiscal year was up about 1 percentage point from the 1996 pace. Defense spending edged up after several years of declines and "other" spending--principally nondefense discretionary spending--

State and Local Current Account Surplus

(NIPA basis)





Note. Excludes social insurance funds. Q3 is a staff estimate.

rose $9 billion in 1997 after having declined $10 billion in 1996. Expenditures on health care programs grew about 6-1/2 percent in each of the past two years, down about 3 percentage points from the average pace of the preceding three years.

The 1997 deficit was $15 billion less than estimated in the Administration's September Midsession Review. Lower-than-expected spending across a wide range of outlay categories accounts for the forecast error. The Administration's January estimate of the baseline deficit was also too high, by $105 billion. In this case, however, it was primarily a $75 billion underestimate of receipts that accounted for the forecast error. According to the Midsession Review, roughly 80 percent of the forecast error was attributable to higher-than-anticipated effective tax rates. One possible explanation is a surge in taxes paid on capital gains realizations, but it is likely that other sources of taxable income contributed as well.

Receipts continued to show strength in September, growing 11 percent from a year earlier. As has been true throughout this year, year-over-year growth in nonwithheld individual and social insurance taxes, at 18 percent, was very robust. The September figures for this category of receipts bears watching because that month included the due date for the third quarterly estimated payment on 1997 individual income tax liability.

State and Local Government Sector

Real spending by state and local governments rose to 2.2 percent at an annual rate in the third quarter, about the same average rate as recorded over the preceding three years. Total expenditures in the third quarter were held down by flat real spending on construction, following a string of negatives posted since February.

The surplus in state and local operating accounts, which excludes social insurance funds, appears to have moved up substantially in the third quarter but remained within the range seen in recent years. These surpluses have trended up for most of the 1990s (chart), as revenues continued to come in above expectations, and governments held the line on spending programs. However, recent surpluses, measured as a percentage of GDP, are not large by historical standards.

Two key deadlines of the welfare reform process were on October 1. For the maintenance-of-effort standard, states were

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	1996		1997		
	Sept.	Dec.	Mar.	June	Sept.
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	2.8	2.8	2.5	3.4	3.4
Wages and salaries	2.9	3.2	3.5	3.8	3.8
Benefit costs	2.1	2.9	0.0	2.9	2.0
By industry					
Construction	1.6	3.5	2.2	3.5	2.8
Manufacturing	3.4	2.8	0.6	3.7	3.0
Transportation and public utilities	2.5	4.1	1.2	2.5	3.4
Wholesale trade	2.8	3.4	6.9	0.9	3.3
Retail trade	4.6	5.2	3.5	2.5	4.4
FIRE	1.3	-2.2	8.5	2.5	3.4
Services	2.8	3.1	2.7	3.6	3.6
By occupation					
White collar	3.4	2.8	3.4	3.0	3.3
Blue collar	1.6	3.8	1.2	3.4	2.8
Service occupations	2.6	3.8	3.5	3.4	6.9
Memo:					
State and local governments	2.5	3.1	2.1	1.8	2.1
	-----Twelve-month percent change----				
Total hourly compensation	2.9	3.1	3.0	2.9	3.2
Excluding sales workers	2.9	2.9	2.8	2.9	3.0
Wages and salaries	3.3	3.4	3.4	3.3	3.6
Excluding sales workers	3.4	3.3	3.1	3.3	3.5
Benefit costs	1.8	2.0	2.0	2.0	2.0
By industry					
Construction	2.3	2.4	2.3	2.7	3.0
Manufacturing	3.1	3.0	2.6	2.6	2.5
Transportation and public utilities	2.6	3.0	2.7	2.6	2.8
Wholesale trade	3.0	3.1	4.2	3.5	3.6
Retail trade	2.9	3.8	3.2	3.9	3.9
FIRE	3.3	2.4	3.3	2.5	3.0
Services	2.9	3.1	3.0	3.0	3.2
By occupation					
White collar	3.2	3.2	3.2	3.2	3.1
Sales	2.8	4.0	4.2	3.0	4.3
Nonsales	3.3	3.0	2.9	3.1	3.0
Blue collar	2.4	2.7	2.4	2.5	2.8
Service occupations	2.2	3.0	3.2	3.5	4.5
Memo:					
State and local governments	2.5	2.6	2.5	2.4	2.4

1. Seasonally adjusted by the BLS.

required to maintain their own welfare expenditures at not less than 75 percent of their fiscal 1994 level for the year ending October 1. For the work participation standard, states were required to have 25 percent of their total 1997 welfare caseload and 75 percent of their two-caretaker families participating in work activities by October 1. Most states appear to have easily met two of the three requirements. With most states enjoying surpluses for several years, funds have been sufficient to maintain spending levels. Meanwhile, the strong job market, in combination with a provision in the federal law that gives states a break for reductions in caseloads since fiscal 1995, has brought the overall work participation goal within easy reach for most states. Only the two-caretaker requirement appears elusive for some states, likely because of the severe disadvantages faced by many of these families. States do not have to report their status on these goals to the Department of Health and Human Services until forty-five days after the end of the third quarter, and no penalty will be levied until the end of December. Consequently, no official tally on the achievement of these requirements is likely to be available until early next year.

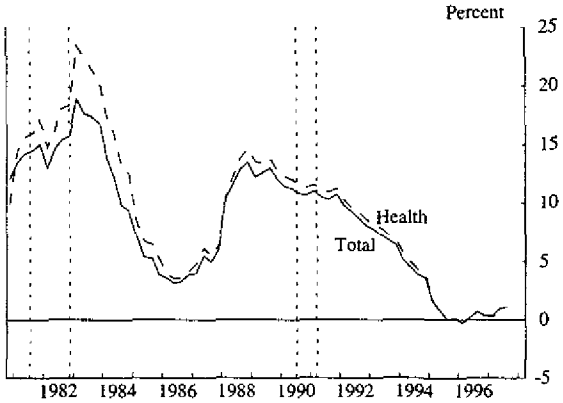
Labor Costs

According to the Employment Cost Index, hourly compensation of private industry workers increased at a seasonally adjusted annual rate of 3.4 percent in the three months ended in September, the same as in the previous three-month period. Over the twelve months ended in September, the ECI for private-sector hourly compensation increased 3.2 percent, up from 2.9 percent over the previous twelve months. Both benefits and wages and salaries show similar acceleration, although given the historical volatility in the benefits series, the latest pickup in benefits does not represent a significant pickup.

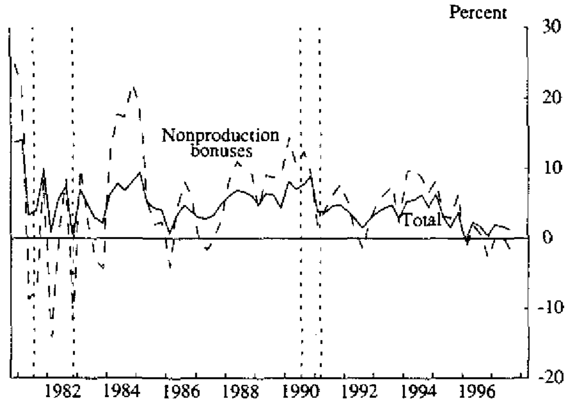
By occupation, the considerable acceleration over the past year in hourly compensation in service and sales occupations is noteworthy. The service grouping has a larger-than-average proportion of low-wage workers, and thus the large increase over the twelve months through September likely includes the two increases in the minimum wage over this period--one on October 1, 1996, and the other on September 1, 1997. The minimum wage hike may also have contributed to the acceleration for sales occupations, a category that includes, for example, retail cashiers. In contrast to the

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

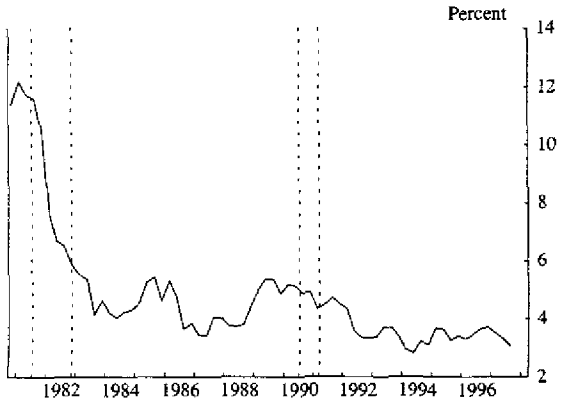
Insurance Costs



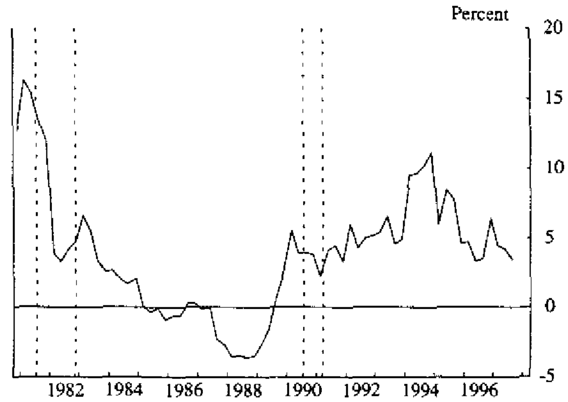
Supplemental Pay



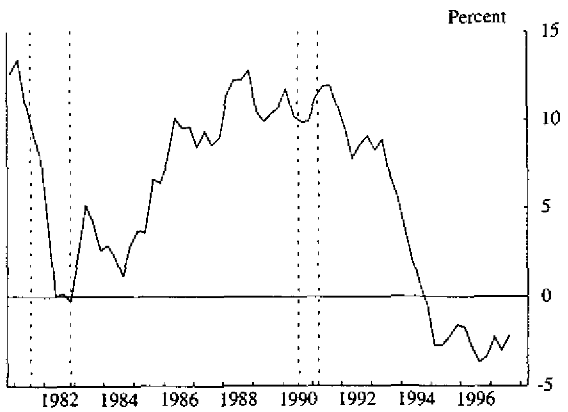
Paid Leave



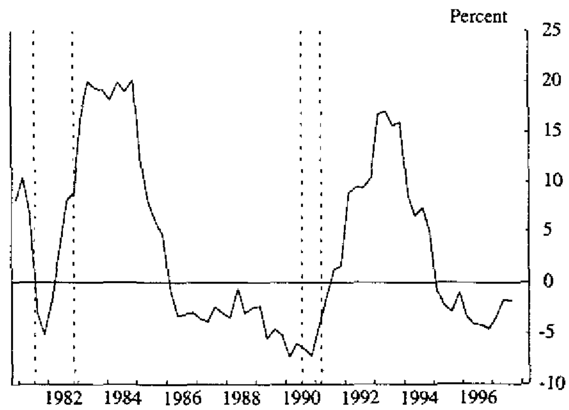
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



Note. Unpublished ECI benefits detail.

sales and service occupations, the acceleration in hourly compensation for blue-collar occupations was much more modest, and hourly compensation for non-sales white-collar workers decelerated.

Benefit costs continue to moderate overall compensation increases. Over the twelve months ended in September, the ECI for private industry benefit costs increased only 2 percent, considerably less than wages and salaries. Health insurance cost increases remain modest, rising only 3/4 percent in the most recent twelve-month period, the same as the year before.[9] Costs for unemployment insurance and workers' compensation for on-the-job injuries continued to decline, although less rapidly than in the previous twelve months.

Prices

The incoming news on price inflation has continued to be quite favorable. The September consumer price index rose 0.2 percent for the third consecutive month. Over the past twelve months, consumer prices have risen 2.2 percent, down from a 3.0 percent increase in the year-earlier period.

The CPI for energy increased 1.3 percent in September, on top of a 1.7 percent advance in August. Energy prices were pushed higher by a further increase in gasoline prices and a jump in natural gas prices. The hike in gasoline prices in August and September owed largely to a strong end-of-summer driving season; more recently, survey evidence suggests that prices at the pump receded in October. In contrast to the recent run-up in gasoline prices, the index for heating oil edged up only 0.1 percent in September, as ample supplies continued to hold down prices. Over the past twelve months, energy prices have risen 2 percent, down considerably from the 5.2 percent pace a year earlier.

Retail food prices rose 0.1 percent in September after slightly larger increases in the preceding two months. Coffee prices, which had risen considerably earlier in the year, dropped back in

9. Recent reports point to larger increases in health insurance premiums next year, as health insurers and providers attempt to rebuild diminished profit margins. In the public sector, the Office of Personnel Management recently announced that total premiums (including both the government and employee shares) for FEHB health insurance will rise 8-1/2 percent next year. The announcement earlier this year by CALPERS that overall premiums will rise 3 percent in 1998, after three years of declines, also supports this conclusion. In the private sector, a considerable amount of anecdotal evidence suggests that companies supplying health insurance will boost premiums next year.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1997		1997	
	Sept. 1996	Sept. 1997	Q2	Q3	Aug.	Sept.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	3.0	2.2	1.0	2.0	.2	.2
Food (15.9)	3.8	2.1	.9	3.6	.4	.1
Energy (7.0)	5.2	2.0	-15.6	2.5	1.7	1.3
CPI less food and energy (77.0)	2.7	2.2	2.9	1.7	.1	.2
Commodities (23.4)	1.2	.4	1.4	-1.2	-.3	.2
New vehicles (5.0)	2.3	-.3	-.2	-.1	-.1	.1
Used cars (1.3)	.3	-5.6	-7.4	-12.2	-.8	-.1
Apparel (4.8)	-1.3	1.1	3.6	-2.5	-1.0	.3
House furnishings (3.3)	-.2	-1.2	.5	-3.3	-.5	-.1
Other Commodities (9.0)	2.4	1.8	2.8	1.1	.1	.4
Services (53.7)	3.3	2.9	3.5	2.8	.2	.2
Shelter (28.2)	3.1	3.0	3.4	2.8	.2	.2
Medical care (6.1)	3.3	2.7	3.3	2.2	.3	.2
Auto finance charges (0.6)	-.9	-3.9	-1.0	-2.4	-1.0	-1.3
Other Services (18.8)	3.7	3.0	3.9	3.2	.1	.1
PPI						
Finished goods (100.0)[2]	3.0	.0	-3.9	.4	.3	.5
Finished consumer foods (23.6)	4.2	-.6	.1	-2.0	.3	.1
Finished energy (14.7)	8.0	-.1	-22.9	5.7	1.4	1.5
Finished goods less food and energy (61.6)	1.4	.4	-.5	.1	.1	.4
Consumer goods (38.1)	1.6	.6	.1	.2	.1	.5
Capital equipment (23.6)	1.2	-.1	-1.0	-.2	.0	.3
Intermediate materials (100.0)[3]	.6	-.6	-2.9	-.2	.1	.3
Intermediate materials less food and energy (81.3)	-1.6	.3	.3	.3	.1	.0
Crude materials (100.0)[4]	10.1	-4.2	-25.9	-3.4	.7	.6
Crude food materials (38.0)	14.8	-11.0	8.0	-13.6	-.1	-.3
Crude energy (42.4)	20.2	1.4	-58.6	8.0	1.7	2.6
Crude materials less food and energy (19.6)	-10.1	1.7	-3.3	.7	.8	-1.0

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.

September. Prices for food away from home moved up 0.3 percent in September; this category of the CPI may be boosted in coming months by the recent hike in the minimum wage. Overall, the CPI for food was up 2.1 percent from a year earlier versus 3.8 percent for the same period a year earlier.

For items other than food and energy, consumer prices rose 0.2 percent in September, continuing a string of very modest increases. On a twelve-month change basis, the core CPI was up 2.2 percent in September, down 1/2 percentage point from the pace registered a year earlier. Prices of goods and services each accounted for about half of this deceleration. Within goods--for which falling import prices have been an important restraining influence in recent years--new and used motor vehicles were a particularly notable contributor to the deceleration over the past year.[10] Although the pace of price increases for many other goods also slowed over the past year, deceleration was not universal among prices of goods; apparel and tobacco prices rose faster over the past twelve months than in the preceding year. Among services other than energy, price increases slowed for many items, including medical care and auto finance charges.

Turning to the details of the September movement in the core CPI, tobacco prices jumped 1.4 percent, reflecting the increase in cigarette prices put in place around Labor Day.[11] Apparel prices were up 0.3 percent after having declined 1 percent in August when stores delayed somewhat the typical seasonal introduction of fall merchandise. Among other commodities, prices for new cars and light trucks were flat in August, while used car prices edged down a touch further. Prices of services excluding energy rose only 0.2 percent in September for the second month in a row, restrained by an increase of just 0.1 percent in owners' equivalent rent. Elsewhere in nonenergy services, airfares bounced back in September, while tuition and school fees declined slightly and auto finance charges decreased further.

10. New and used motor vehicles more than accounted for the deceleration in prices of goods excluding food and energy. Within the overall core, motor vehicles accounted for 0.3 percentage point of the 0.5 percentage point deceleration over the past twelve months (0.4 percentage point deceleration on a technically consistent basis).

11. Because tobacco prices are sampled only bimonthly in some areas, the October CPI for this category also should register an increase as the Labor Day hike in cigarette prices is picked up in the areas that were not sampled in September.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994 Q3	1995 Q3	1996 Q3	1997 Q3
Product prices				
GDP chain price index	2.5	2.5	2.4	1.9
Nonfarm business chain-type price index[1]	2.6	2.1	1.7	1.6
Expenditure prices				
Gross domestic purchases chain-type price index	2.5	2.4	2.2	1.6
Less food and energy	2.5	2.6	2.0	1.6
PCE chain-type price index	2.7	2.4	2.4	1.9
Less food and energy	2.8	2.7	2.1	1.8
CPI	2.9	2.6	3.0	2.2
Less food and energy	2.9	3.0	2.7	2.3
Median CPI	2.9	3.1	3.0	2.8

1. Excluding housing

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan (1-year) Mean[2]	University of Michigan (1-year) Median[3]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1995-Q1	2.8	4.1	3.1	4.2	3.3
Q2	3.1	4.1	3.1	4.2	3.4
Q3	2.6	3.9	2.9	4.0	3.2
Q4	2.7	3.6	2.8	3.9	3.0
1996-Q1	2.7	3.9	2.9	4.1	3.0
Q2	2.8	4.5	3.0	4.3	3.0
Q3	2.9	4.2	3.0	4.3	3.0
Q4	3.2	4.0	3.0	4.2	3.0
1997-Q1	2.9	3.8	2.9	4.2	3.0
Q2	2.3	3.6	2.9	4.0	2.9
Q3	2.2	3.4	2.7	4.0	3.0
Jul	2.2	3.4	2.7	4.0	
Aug.	2.2	3.3	2.7	3.9	
Sept.	2.2	3.5	2.8	4.1	3.0
Oct.		3.2	2.8	4.1	

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.

Broad expenditure price measures other than the CPI also registered some slowing in inflation over the past year. Core PCE prices have decelerated about 0.3 percentage point over the past four quarters, a touch less than the deceleration in the core CPI over the same period. Among product prices, the pace of increase in the GDP chain price measure has ratcheted down about 1/2 percentage point over the past four quarters. At the same time, inflation expectations as measured by the Michigan index have also come down. In the third quarter of this year, one-year-ahead median expectations were about 1/4 percentage point lower than a year earlier, while mean expectations had fallen about 3/4 percentage point. In October, one-year-ahead mean expectations ticked down further.

Despite an uptick in September, the PPI for capital goods is down 0.1 percent over the past year, compared with an increase of 1.2 percent over the previous twelve months. In September, the capital goods index was pushed up by a jump in auto and truck prices. Although the PPI for cars and light trucks continued to decline on a not seasonally adjusted basis, automakers had offered end-of-model-year incentives earlier than usual this year and discounting in September was not as deep as in some previous years. Elsewhere among capital goods, computer prices fell 2.2 percent further in September. Prices at earlier stages of processing also have been restrained. The PPI for intermediate materials excluding food and energy was flat in September and has changed little over the past year. For core crude materials, prices dropped back in September, more than reversing the jump in August. In addition, the Journal of Commerce indexes and the KR-CRB industrial spot price measure have moved lower since the time of the last Greenbook.

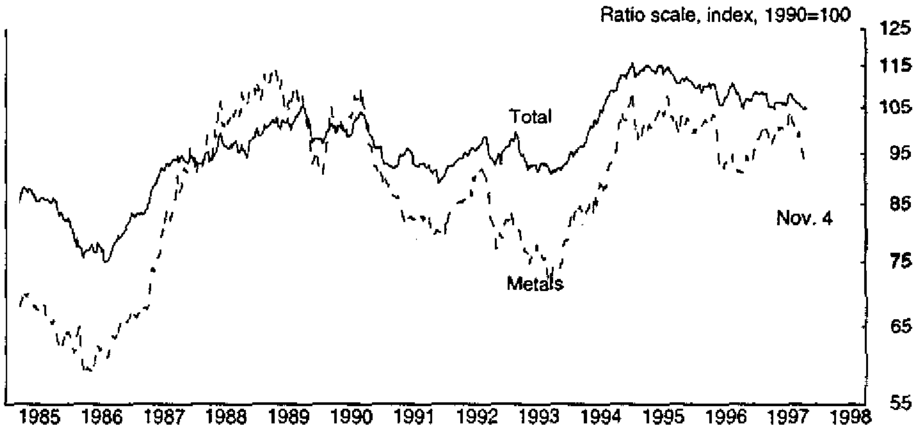
SPOT PRICES OF SELECTED COMMODITIES

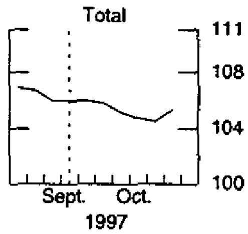
	Current price ($)	Percent change[1]: 1995	1996	Dec. 31 to Sept. 23[2]	Sept. 23[2] to Nov. 04	Memo: Year earlier to date
Metals						
Copper (lb.)	.950	-3.5	-18.3	-8.4	-3.1	-4.0
Steel scrap (ton)	139.500	-6.6	-13.7	18.0	1.5	10.3
Aluminum, London (lb.)	.718	-12.9	-9.8	9.3	-4.1	12.9
Precious metals						
Gold (oz.)	315.350	1.7	-5.1	-13.1	-1.7	-16.9
Silver (oz.)	4.865	7.2	-8.8	-2.5	4.5	1.5
Forest products						
Lumber (m. bdft.)	308.000	-14.4	66.0	-21.7	-5.2	-28.5
Plywood (m. sqft.)	306.000	-6.1	1.6	6.3	-8.7	-5.6
Petroleum						
Crude oil (barrel)	19.210	16.8	25.9	-21.0	2.8	-12.2
Gasoline (gal.)	.555	7.7	24.3	-12.2	-6.4	-16.5
Fuel oil (gal.)	.569	22.6	16.1	-22.8	4.8	-12.8
Livestock						
Steers (cwt.)	68.000	-5.7	.0	1.5	1.5	-4.2
Hogs (cwt.)	45.000	27.5	34.1	-10.9	-8.2	-15.9
Broilers (lb.)	.505	10.7	12.4	-13.7	-6.6	-16.7
U.S. farm crops						
Corn (bu.)	2.710	57.4	-29.5	.2	6.1	8.0
Wheat (bu.)	3.853	24.0	-16.6	-16.8	1.8	-13.5
Soybeans (bu.)	7.040	29.0	-7.1	-7.3	10.3	5.9
Cotton (lb.)	.701	-8.1	-10.9	1.1	-2.1	-.1
Other foodstuffs						
Coffee (lb.)	1.475	-39.1	43.2	54.4	-29.8	16.1
Memo:						
JOC Industrials	105.300	-1.7	-3.7	-1.2	-.7	.5
JOC Metals	94.500	-1.8	-7.7	6.6	-5.2	4.0
KR-CRB Futures	241.610	3.3	-2.6	1.4	.1	2.3
KR-CRB Spot	331.860	-3.5	1.0	1.2	-2.1	1.1

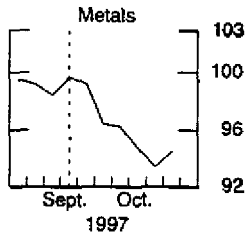
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the September Greenbook.

Commodity Price Measures

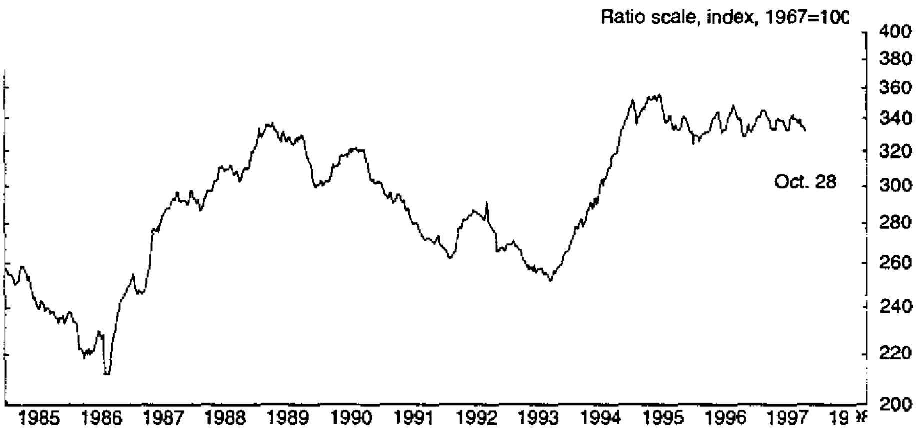
Journal of Commerce Index

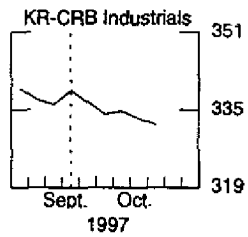




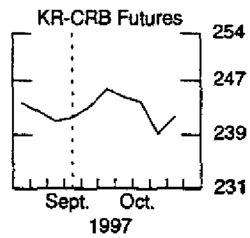


KR-CRB Spot Industrials





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.

DOMESTIC FINANCIAL DEVELOPMENTS

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

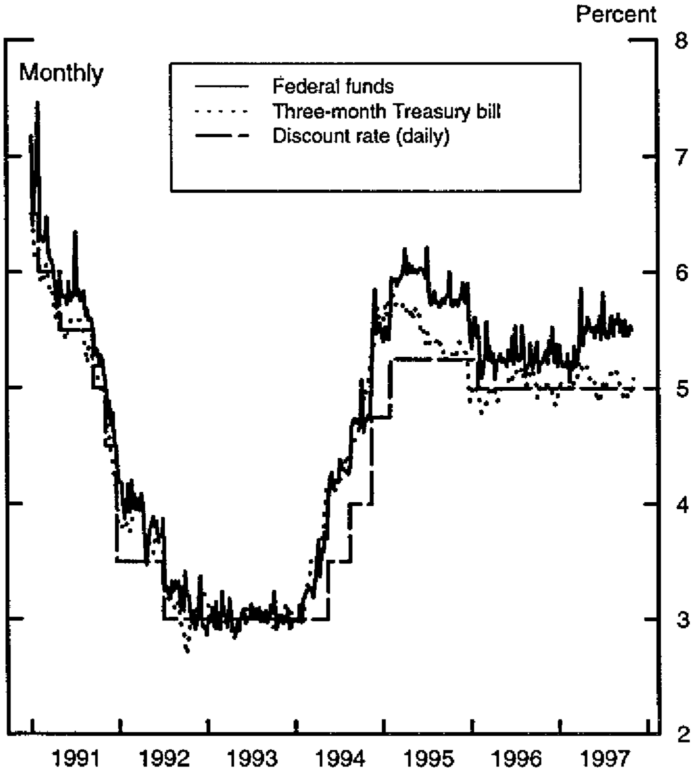
Instrument	1997 Jan. 2	1997 Mar. low	1997 FOMC* Sep. 30	1997 Nov. 4	Change to Nov. 4, from: Jan. 2	Change to Nov. 4, from: Mar. low	Change to Nov. 4, from: FOMC* Sep. 30
Short-term rates							
Federal funds [2]	5.79	5.27	5.58	5.50	-.29	.23	-.08
Treasury bills [3]							
3-month	5.05	5.04	4.87	5.11	.06	.07	.24
6-month	5.14	5.17	4.97	5.14	.00	-.03	.17
1-year	5.28	5.37	5.18	5.17	-.11	-.20	-.01
Commercial paper [4]							
1-month	5.48	5.40	5.51	5.54	.06	.14	.03
3-month	5.47	5.45	5.50	5.53	.06	.08	.03
Large negotiable CDs [3]							
1-month	5.39	5.32	5.59	5.59	.20	.27	.00
3-month	5.42	5.42	5.67	5.66	.24	.24	-.01
6-month	5.50	5.58	5.73	5.69	.19	.11	-.04
Eurodollar deposits [5]							
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	5.88	5.77	-.36	-.48	-.11
10-year	6.54	6.56	6.10	5.95	-.59	-.61	-.15
30-year	6.75	6.83	6.39	6.25	-.50	-.58	-.14
U.S. Treasury 10-year indexed note	n.a.	3.36	3.60	3.56	n.a.	.20	-.04
Municipal revenue (Bond Buyer) [6]	5.96	5.97	5.63	5.60	-.36	-.37	-.03
Corporate-A utility, recently offered	7.64	7.97	7.46	7.37	-.27	-.60	-.09
High-yield corporate [7]	9.72	9.49	9.02	9.09	-.63	-.40	.07
Home mortgages [8]							
FHLMC 30-yr fixed rate	7.64	7.84	7.28	7.21	-.43	-.63	-.07
FHLMC 1-yr adjustable rate	5.57	5.54	5.51	5.46	-.11	-.08	-.05

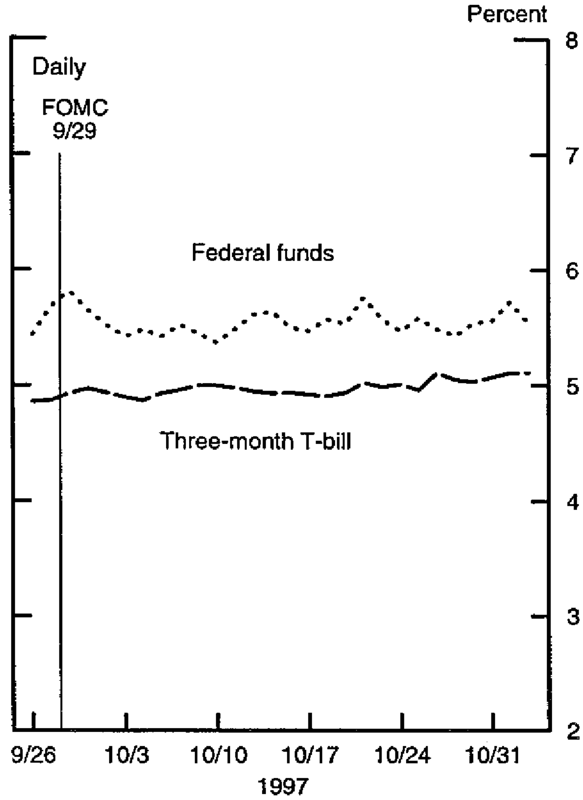
Stock exchange index	Record high Level	Record high Date	1997 Jan. 2	1997 FOMC* Sep. 30	1997 Nov. 4	Percentage change to Nov. 4, from: Record high	Percentage change to Nov. 4, from: Jan. 2	Percentage change to Nov. 4, from: FOMC* Sep. 30
Dow-Jones Industrial	8259.31	8/6/97	6441.49	7991.43	7689.13	-6.90	19.37	-3.78
S&P 500 Composite	983.12	10/7/97	736.01	953.34	940.76	-4.31	27.82	-1.32
NASDAQ (OTC)	1745.85	10/9/97	1279.70	1694.98	1631.15	-6.57	27.46	-3.77
Russell 2000	465.21	10/13/97	357.96	451.31	442.31	-4.92	23.56	-1.99
Wilshire	9486.69	10/7/97	7146.80	9215.39	9096.59	-4.11	27.28	-1.29

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 November 5, 1997.
3. Secondary market.
4. As of September 2, 1997, commercial paper rates are those collected by the Depository Trust Company; prior rates are averages of offering rates at several large dealers.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. Most recent observation based on one-day Thursday quote and futures market index changes.
7. Merrill Lynch Master II high-yield bond index composite.
8. Quotes for week ending Friday previous to date shown.
* Figures cited are as of the close on September 29, 1997.

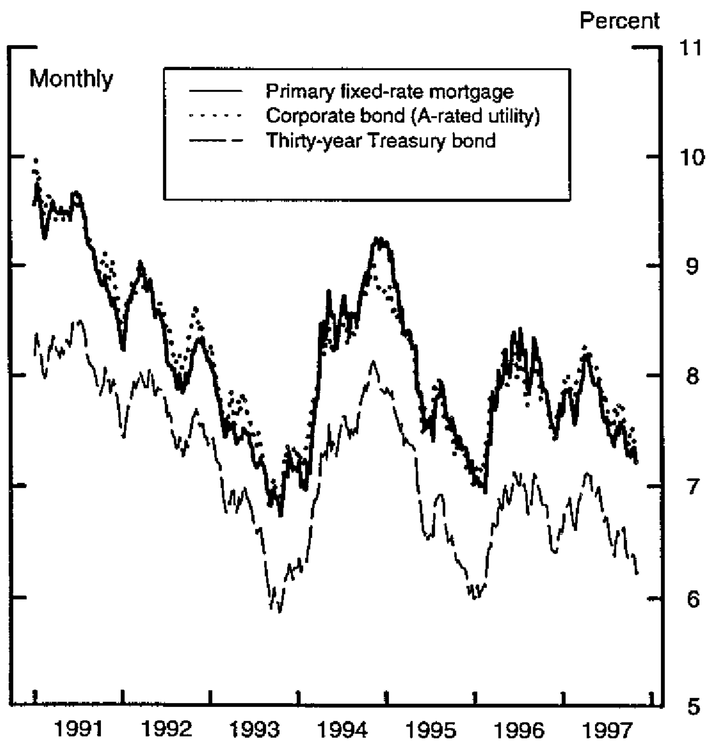
Selected Interest Rates

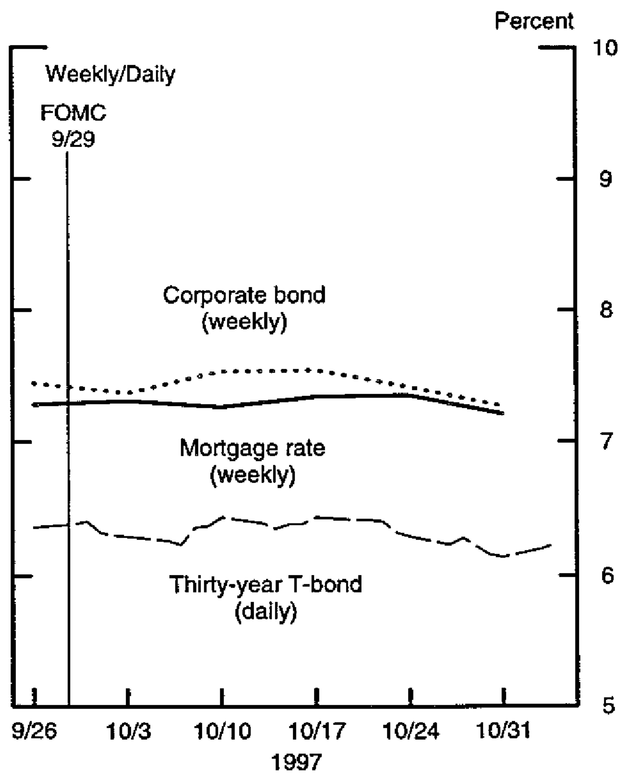
Short-Term





Long-Term





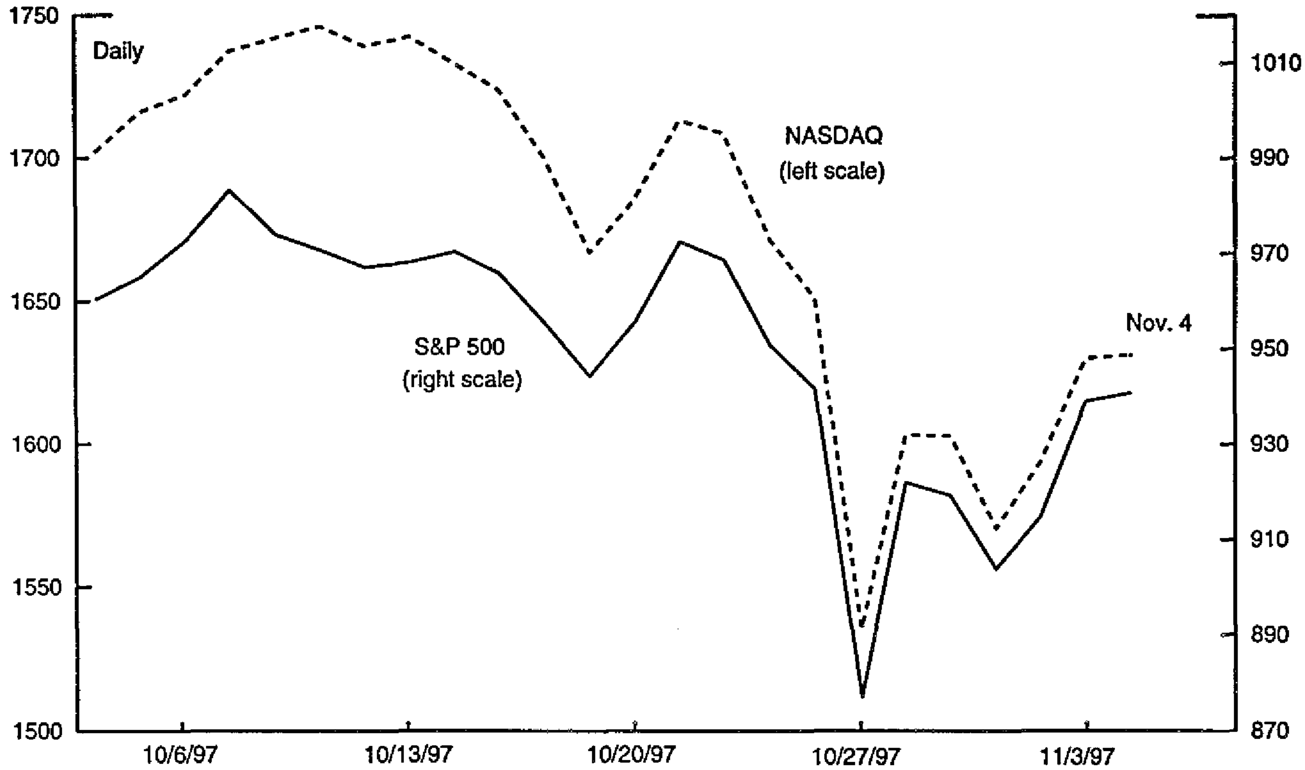
Over the intermeeting period, financial markets--especially equity markets--have been subject to heightened volatility triggered by instability in Asia. The major stock indexes plummeted 6 percent to 7 percent on October 27, but that was followed by a dramatic rebound the next day and by further price gains since. Indeed, share prices are down only a few percent on balance since the September 30 FOMC meeting. Stock prices of banks exposed to the mounting problems in emerging market economies have underperformed the broader market in the past couple of weeks.

The gyrations of the stock market have affected other markets. Steep daily declines in stock prices were associated with rising Treasury bond prices, as investors took refuge in this safer and more liquid market. A good portion of those increases have since been retraced, although news on inflation, which has been good, and the economic woes of emerging market economies have led market participants to rule out any prospect of a System tightening in the months ahead. Over the full intermeeting period, intermediate- and long-term Treasury yields have fallen 10 to 15 basis points. (Treasury bill rates have risen several points on net because of a rebound in issuance.) In the general flight to safety late last month, quality spreads for corporate bonds widened somewhat; spreads on prime corporate securities rose a few basis points while those on junk bonds widened about 30 basis points. Still, most quality spreads are fairly tight by historical standards.

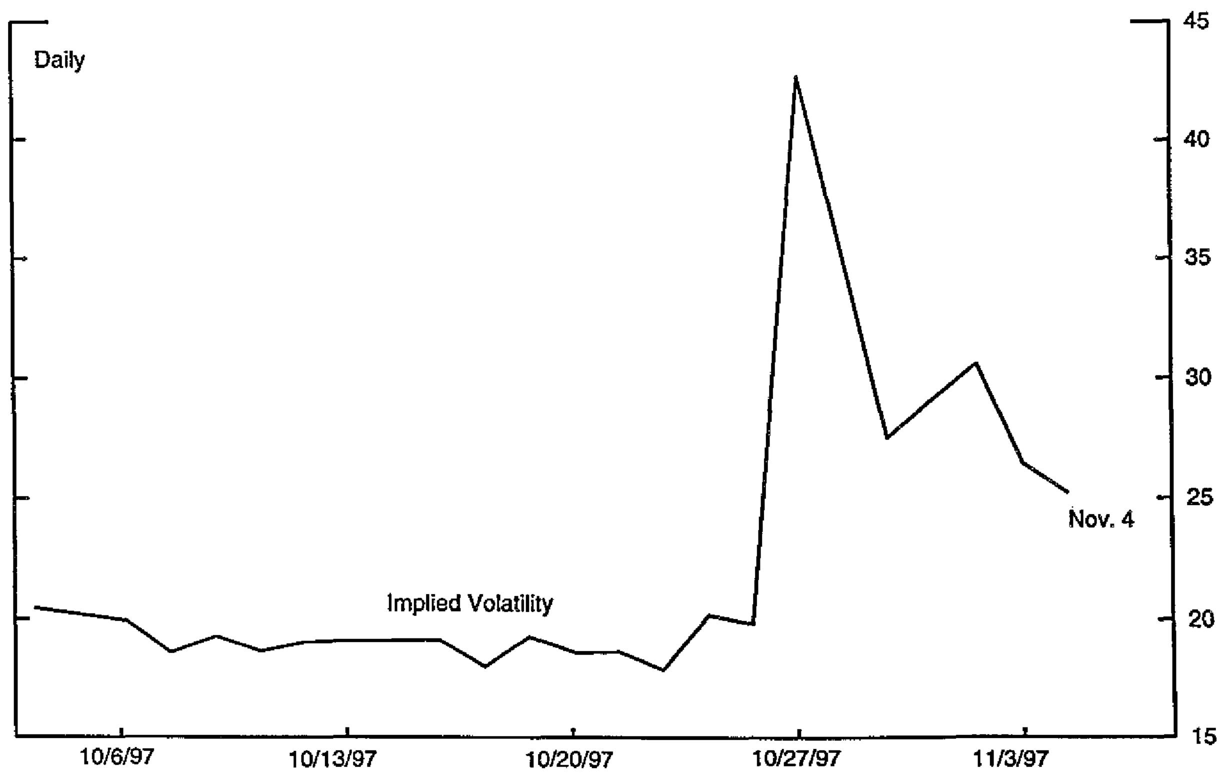
Borrowing by nonfinancial businesses remained brisk in October. Gross bond offerings increased and bank C&I loans grew rapidly, although slowing from the September pace. In the household sector, incoming data for the third quarter suggest that funds raised in mortgage markets picked up a bit while consumer credit extended the trend of gradual slowing that has been evident since the middle of last year. Net borrowing by state and local governments increased, reflecting a bulge in advance refundings in response to favorable rate movements. Measures of credit quality remained largely favorable in the business and municipal government sectors, while the picture was more mixed for households. The outlook for credit card accounts has brightened a bit, but storm clouds appear to be forming in the subprime segment of the home equity loan market.

Stock Prices and Volatility

Selected Equity Indexes



Implied Volatility on S&P 500 Call Options



The implied volatility is calculated by Bloomberg. It is derived using a Black-Scholes option pricing model and the price of an "at-the-money" S&P 500 call option.

Business Finance

With a number of firms moving to lock in attractive long-term interest rates, gross issuance of bonds by nonfinancial corporations was substantial in September and October (table). Indeed, although issuance fell off in the last week of October amid the turmoil in the stock market, it has picked up again in recent days as the markets have calmed. Merger-related financing boosted investment-grade offerings over the intermeeting period, and junk issuance was robust as well, accounting for almost half of total issuance (chart, bottom left). Firms rated B or below accounted for almost two-thirds of the junk issuance; active among them were oil drilling and exploration firms and telecommunications companies using proceeds for cable and wireless networks. Buttressed by robust demand from mutual funds, spreads in the junk bond market had stayed near historical lows well into October, but they widened 25 to 30 basis points late in the month.

Part of the recent bond issuance was used to pay down short-term debt, although C&I loans at banks continued to grow at a fairly rapid clip. Bank respondents to the November Senior Loan Officer Opinion Survey indicated that they continued to ease terms on business loans in response to competitive pressures from bank and nonbank sources. Nonfinancial commercial paper outstanding was up slightly on net in October.

Public equity issuance by nonfinancial corporations has been strong recently (table), led by technology-oriented firms (chart, bottom right). Initial public offerings were numerous and well received: The proportion of firms with offering prices above filing prices was the highest in more than a year. Investor enthusiasm was also evident in first-day price changes that were the largest since the summer of last year. The wild swings in stock prices on October 27 and 28 caused issuers to put new offers on hold for those two days, but issuance resumed quickly, accompanied by signs of only limited weakening in investor demand. At this point, it is hard to determine to what extent the near-term strength may reflect firms with completed registration statements rushing to market in fear of another large drop in prices.

Meanwhile, announcements of stock repurchase plans have continued at a record or near-record pace. The sharp drop in stock prices spurred a number of companies to announce that they would boost their repurchase programs, although the number of firms doing

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

Type of security	1995	1996	1997 Q2	1997 Q3	1997 Aug.	1997 Sept.	1997 Oct.
All U.S. corporations	47.6	58.4	68.8	74.6	57.1	88.9	64.3
Stocks[1]	6.1	10.2	9.1	8.6	5.6	10.3	11.8
Bonds	41.5	48.2	59.7	65.9	51.4	78.6	52.5
Nonfinancial corporations							
Stocks[1]	4.4	6.7	4.4	5.1	3.2	6.2	6.1
Initial public offerings	1.7	2.9	1.9	1.8	1.2	2.1	2.6
Seasoned offerings	2.7	3.8	2.5	3.4	1.9	4.2	3.5
Bonds	10.7	12.5	17.4	21.3	16.8	19.1	20.1
By rating, sold in U.S.[2]							
Investment grade	6.4	6.3	7.1	9.9	8.1	8.0	9.5
Speculative grade	3.0	4.8	8.7	9.1	7.0	9.0	9.2
Public	2.0	2.3	1.4	1.0	.8	1.1	.7
Rule 144A	1.1	2.5	7.4	8.1	6.2	7.9	8.5
Financial corporations							
Stocks[1]	1.7	3.5	4.7	3.5	2.5	4.0	5.7
Bonds	30.8	35.8	42.3	44.6	34.6	59.6	32.3
MEMO:							
Net issuance of nonfinancial commercial paper (end-of-period basis)	1.6	-.1	1.8	.8	2.0	-0.3	2.5

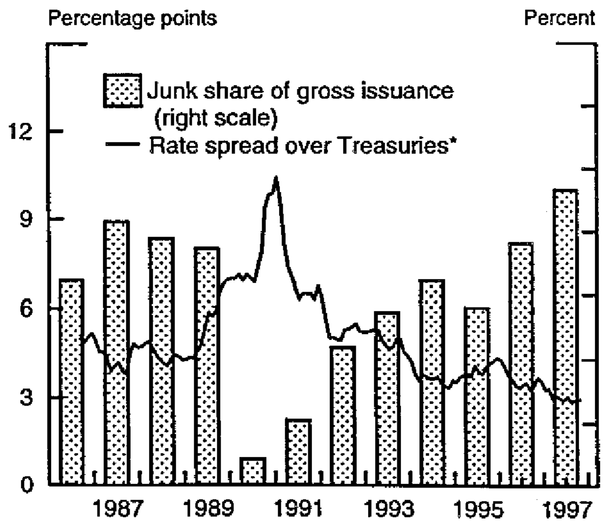
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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

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

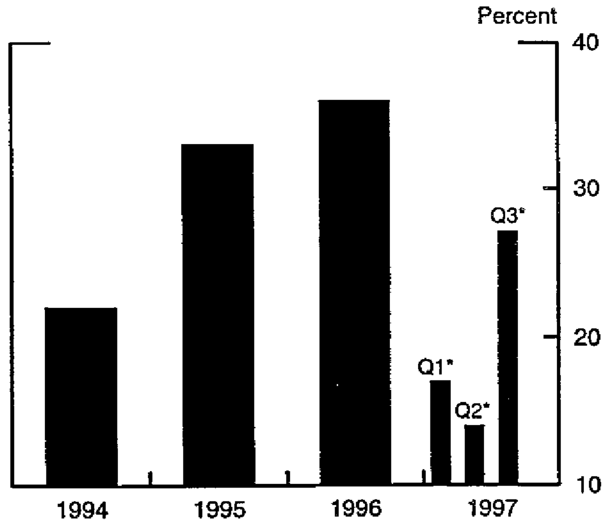
Nonfinancial Corporations

Junk Bonds



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

Technology Share of Equity Issuance



*Annual rate.

so is far fewer than the hundreds that made such announcements after the crash in October 1987. Sizable amounts of equity have also been retired through mergers and acquisitions (chart, top left).[1]

Recent data suggest that corporate credit quality, though currently quite solid, has weakened a little in recent months. Moody's downgraded slightly more debt than it upgraded in the third quarter, and its list of nonfinancial companies under review for a rating change suggests that a further, though small, net lowering of ratings is expected in coming months. Still, upgrades exceed downgrades for the year (chart, top right). The rate of nonfinancial business failures is running higher than last year and is now at about the average annual rate of the last decade. The largest failures have been in the retail, telecommunications, and waste-management sectors.

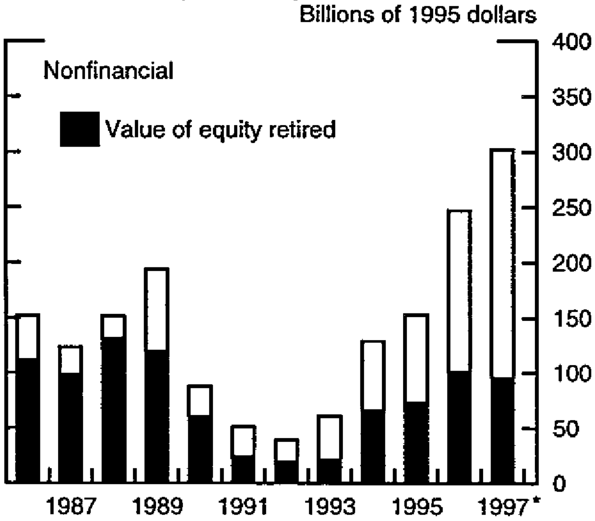
With about 90 percent of third-quarter earnings reports now in, growth in earnings per share for the S&P 500 appears to have accelerated to a 12 percent pace on a four-quarter basis (chart, middle left). Despite mildly disappointing news from Intel, Sun Microsystems, and a couple of other computer hardware manufacturers, earnings in the third quarter once again largely met or exceeded analysts' recent projections. Analysts expect profit growth to continue at the current rate: The five-year earnings growth forecast of analysts has trended upward since 1995 and stood in October at almost 13-1/2 percent (chart, middle right).

Stock prices, as noted, have declined 2 to 4 percent over the intermeeting period, a move that leaves the major indexes still up more than 20 percent for the year. In recent weeks, even before the gyrations of October 27 and 28, stocks of multinationals and high-technology corporations had been whipsawed by concerns that future earnings might be reduced by the dollar's strength and that currency devaluations in Southeast Asian countries could weaken sales abroad. U.S. stock prices moved broadly lower on October 23 and 24 in the wake of the rout in Hong Kong, then plummeted the following Monday, with the exchanges shutting down early after the

1. The record pace of mergers shown in the chart does not reflect the pending acquisition of MCI. Three firms have offers on the table, each of which entails compelling synergies: British Telecom would be able to link MCI lines to its global network, Worldcom would channel them toward business and Internet use, and GTE would combine them with their local phone networks. The value of the eventual deal would be at least $30 billion, making it the largest on record.

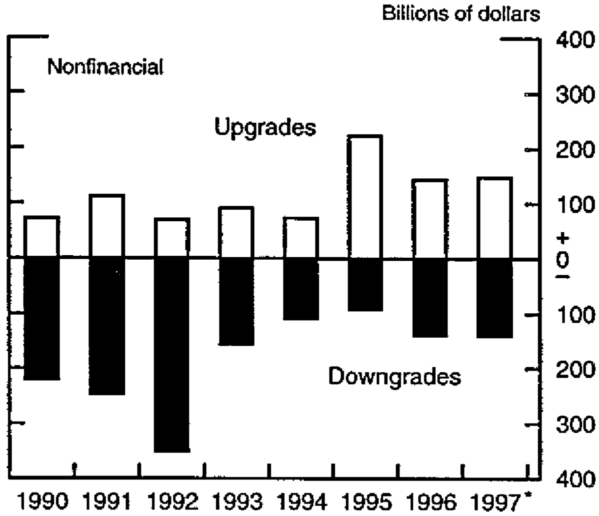
Corporate Finance

Volume of Merger Activity



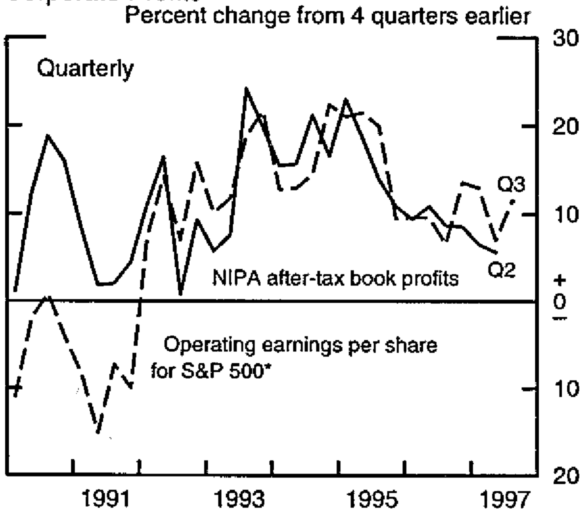
*January through September at an annual rate.
Source. Securities Data Company.

Rating Changes



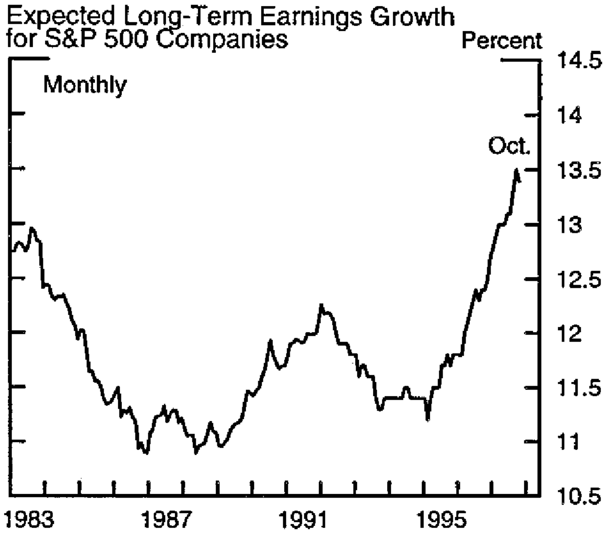
* Data for 1997 is through Q3 at an annual rate.
Source: Moody's

Corporate Profits



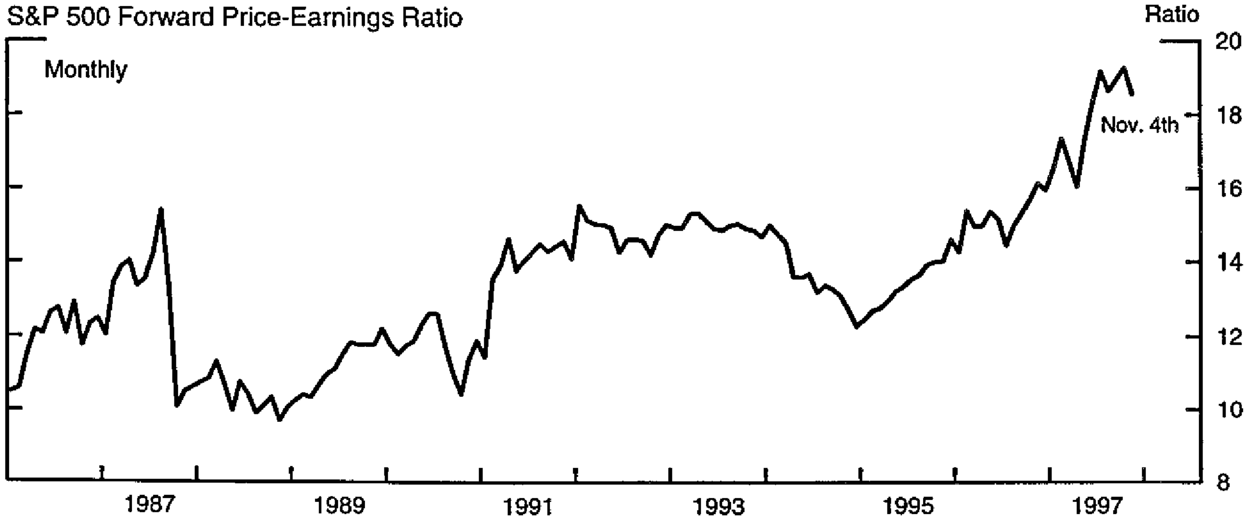
*Source. Goldman Sachs.

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



Source. I/B/E/S.

S&P 500 Forward Price-Earnings Ratio



selling wave tripped a market-closing circuit breaker. The market proved quite resilient in subsequent days, however. On Tuesday, prices made up more than half the losses of the day before on record NYSE and NASDAQ volume, and they continued to gain ground on heavy volume over the next few days.[2] The moderate net decline in stock prices since the last FOMC meeting has only slightly lowered the price-earnings ratio for the S&P 500 (chart, lower panel).

Household Sector

Borrowing by households in consumer credit markets stabilized in the third quarter at around a 4 percent annual rate of growth (table). Growth had ratcheted down from a 14 percent rate in 1994 and 1995 to around 7 to 8 percent last year before easing to its current moderate pace this spring. Revolving credit--primarily credit card debt--recovered with the pickup in consumer spending in the third quarter to a 9 percent pace from the unusually low 4 percent advance of the second quarter.

Information on home mortgage debt for the third quarter is still incomplete, although stepped-up issuance of mortgage-backed securities and modest portfolio increases of the government-sponsored enterprises suggest some pickup from the sluggish pace of the second quarter. According to indexes compiled by the Mortgage Bankers Association, mortgage applications were trending higher going into the quarter and have continued to advance (chart). In October, mortgage applications for home purchase were at the highest level recorded in the eight years the series has existed. Applications for refinancing, although well below peak levels, have climbed noticeably in the past few weeks.

Home equity loans continue to be the most rapidly growing segment of the mortgage market, particularly the "B" and "C" quality subsector serving borrowers with past credit problems. Securitization of home equity loans, a primary avenue of funding for subprime lenders, has outstripped credit card securitizations this year by a wide margin, although investors have become somewhat more

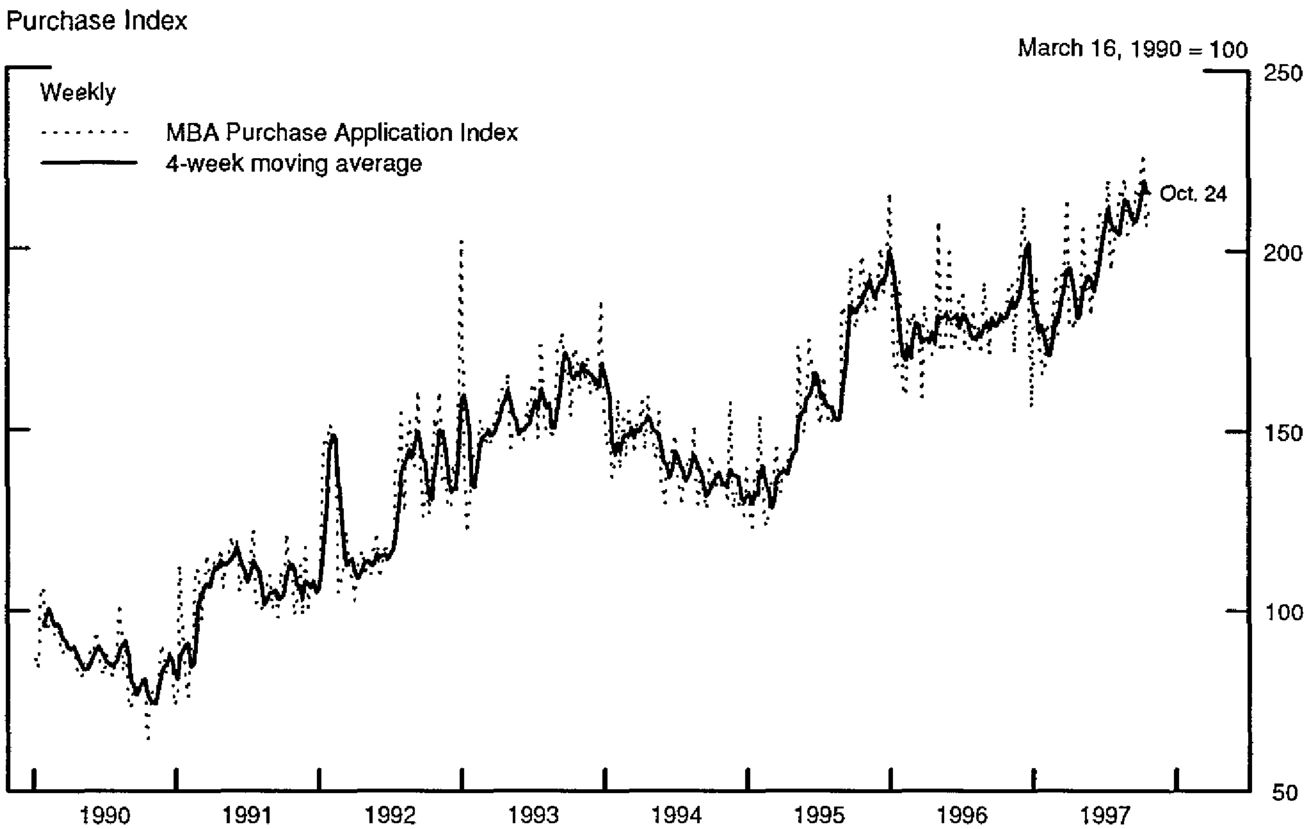
2. Brokerage firms were able to clear the massive volume of trades on October 28 with few evident problems. While the volume of trading forced NASDAQ to delay the release of its final composite index by 90 minutes, trading was not affected. Some investors experienced delays in executions of orders, but these delays apparently resulted from technical problems at a few brokerage houses, not from any breakdown at the exchanges. Also, the volume of orders placed on the Internet evidently overwhelmed the available capacity, so that some customers experienced long delays or gave up entirely.

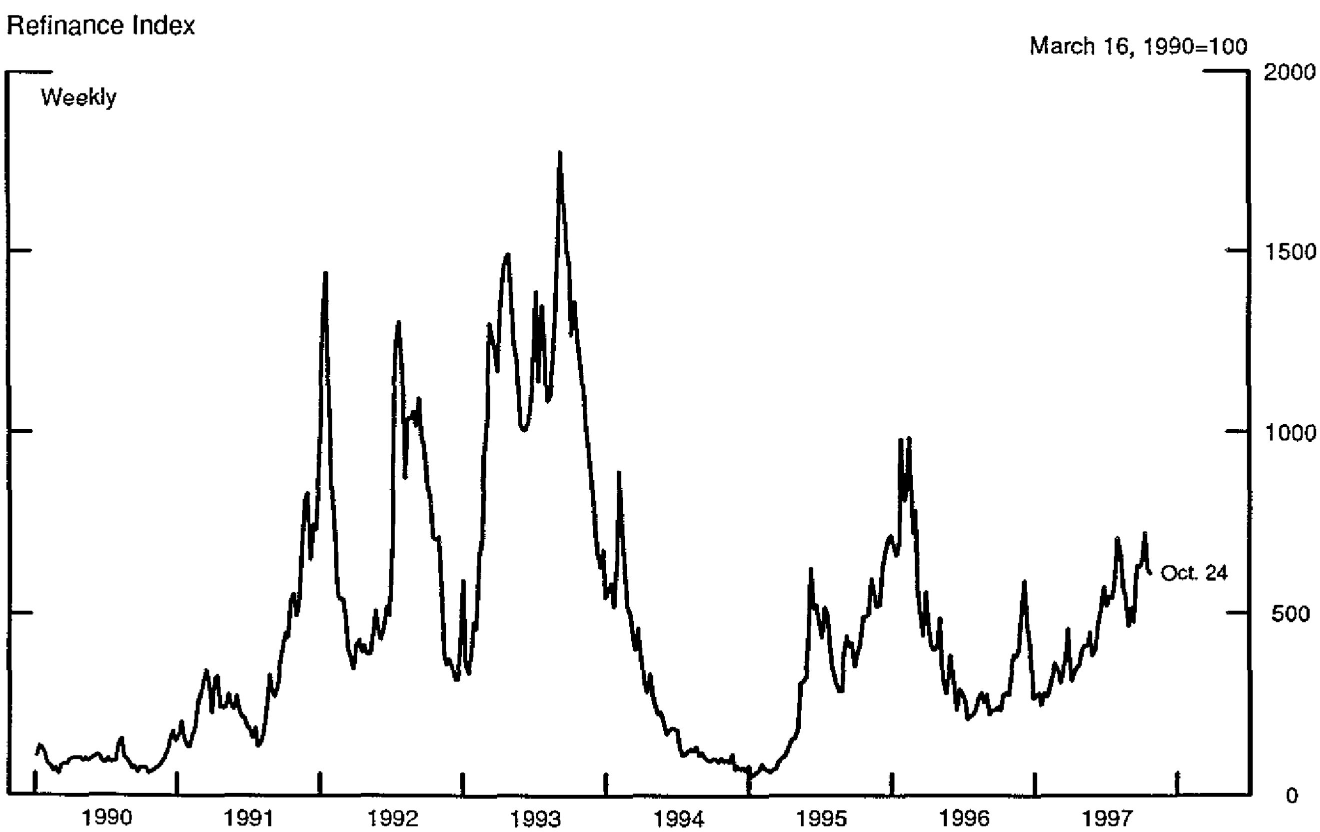
Consumer Credit

	1995	1996	1997 Q1	1997 Q2	1997 Q3^p	1997 Jul	1997 Aug	1997 Sep^p
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.1	7.6	7.0	2.8	4.0	5.9	4.2	1.9
(Previous)	*(14.1)*	*(7.6)*	*(7.3)*	*(4.3)*		*(5.9)*	*(4.2)*	
Auto	11.0	7.8	-0.3	8.2	2.2	7.4	-2.1	1.2
Revolving	21.2	12.7	9.3	3.9	8.9	15.1	7.0	4.5
Other	8.5	-0.3	12.7	-5.7	-2.0	-11.7	7.5	-1.7
Levels (billions of dollars, SA)								
Total	1100.7	1184.0	1204.8	1213.3	1225.5	1219.3	1223.5	1225.5
Auto	362.1	390.3	390.0	398.0	400.2	400.4	399.8	400.2
Revolving	441.9	498.0	509.6	514.6	526.1	521.0	524.1	526.1
Other	296.8	295.7	305.1	300.8	299.3	297.8	299.7	299.3
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	8.9	9.2	9.0	n.a.	9.0	n.a.
Personal (24 mo.)[2]	13.9	13.5	13.5	13.8	13.8	n.a.	13.8	n.a.
Credit cards[3]	16.0	15.6	15.9	15.8	15.8	n.a.	15.8	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	7.6	8.0	6.3	6.7	5.9	6.1
Used cars	14.5	13.5	13.1	13.4	13.4	13.5	13.4	13.3

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

MBA Indexes of Mortgage Loan Applications
(Seasonally adjusted by Federal Reserve Board staff)





cautious lately in light of some notable earnings disappointments at a few subprime mortgage lenders. Providing some additional boost to the sector, Freddie Mac has recently announced its intention to begin purchasing B and C mortgages.

Little new information on credit quality has emerged since the last Greenbook. However, some further signs of improved payment performance on credit cards are observable: Delinquency rates on securitized credit card receivables, as measured by Moody's and Standard & Poor's, continued a decline in August and September that began in February, and several of the major bank-card issuers have noted improved collection experience in their third-quarter earnings reports. Perhaps because of this better experience, the net fraction of banks reporting tighter standards for credit cards on the Senior Loan Officer Opinion Survey narrowed to 20 percent in October, after being as high as 50 percent earlier this year.

In contrast to the generally improving situation of credit card issuers, some issuers of subprime home equity loans have begun to experience a squeeze on profits from underwriting assumptions about credit and prepayment risk that were evidently too optimistic.[3] Cityscape Financial Corp., for instance, announced in late October that its third-quarter earnings would fall "materially below analysts' expectations," and warned that it could run out of cash to meet obligations by the end of the first quarter of 1998. Aames Financial Corp., one of the largest subprime home equity lenders, had taken a substantial charge against second-quarter earnings and in August put itself up for sale. Share prices of the two companies

3. The projected return on a subprime mortgage lender's business involves not only estimates of charge-off experience but also assumptions about the longevity of the loans made. Under the "gain-on-sale" accounting method used by these firms, profits can be adversely affected by unanticipated prepayments as well as higher-than-expected write-offs. When a company securitizes its loans, it records a gain and related "excess spread receivables" (ESRs). ESRs are intangible assets representing the present value of the excess spread, which is the difference between the loan rate and the pass-through rate on the security, less the costs of servicing and securitization and an estimate of future losses. The gain equals the ESR less the cost of loan originations. Excess spreads for subprime loans can be as much as 300 to 400 basis points, much more than for A-quality loans. However, if future loan losses or prepayment rates exceed the assumptions used to calculate present values, or if discount rates used in these calculations do not adequately reflect the risk of uncertain cash flows, then total capital could be impaired at some point from write-downs of ESRs. This appears to be happening to some of the subprime specialists at present.

have been battered since the summer, with Aames losing about half its market value and Cityscape losing 90 percent.

The consolidation that has been taking place in the credit card market intensified last month when the Bank of New York agreed to sell its $4 billion portfolio to Chase Manhattan, and Advanta Corp., after several months of shopping its underperforming portfolio, arranged a sale to Fleet. In addition, AT&T announced its intent to seek a buyer for its $14 billion credit card business.

As of June this year, the ten largest bank issuers of credit cards controlled 63 percent of all bank-card receivables, compared with the 48 percent share held by the top ten in June 1995. Striking as the trend is, the ongoing consolidation in the industry is likely having little net effect on the availability of credit. Some transfers might reduce credit supply while others tend to expand it. In cases in which a troubled portfolio is acquired by a lender with tighter underwriting standards than the seller's, the supply of credit might diminish. The sales by Advanta and, to a lesser extent, the Bank of New York have been in response to high charge-off rates for their portfolios. But the more common impetus to consolidation, particularly in the case of the many smaller portfolios that have changed hands, has been the substantial economies of scale in processing and customer service attributable to the industry's technological advances in recent years. In these cases the transfer of accounts to lenders that are more efficient, and often more aggressive, probably increases the availability of credit to some extent.

Government Finance

The Treasury is expected to fund about half its seasonal deficit in the fourth quarter by borrowing from the public and the remainder by drawing down its cash balance. The midquarter refunding consists of $14 billion of three-year notes, $11 billion of 9-3/4-year notes (a reopening of a previously issued note), and $10 billion of thirty-year bonds. As anticipated, the Treasury will need to raise a substantial amount of funds in the bill sector, a dramatic turnaround from the past several months.

The net cash borrowing of government-sponsored enterprises has picked up some, with much of the new issuance denominated in foreign currencies, as the GSEs continue efforts to tap global markets. To date, Fannie Mae has issued forty-five global bonds totaling about $24 billion.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1997 Q1	Q2	Q3	Aug.	Sep.	Oct.[e]
Total surplus/deficit (-)	-52.0	100.1	-11.5	-35.2	49.3	--
Means of financing deficit						
Net cash borrowing and repayments (-)	48.0	-69.2	10.6	30.3	-18.3	5.5
Nonmarketable	4.0	1.9	4.1	2.2	3.3	6.7
Marketable	44.0	-71.1	6.5	28.1	-21.6	-1.2
Bills	7.9	-81.4	-2.2	15.9	-20.1	0.9
Coupons	36.1	10.3	8.7	12.2	-1.5	-2.9
Decrease in cash balance	-.7	-17.8	7.6	15.4	-31.5	23.4
Other[1]	4.6	-13.1	-6.7	-10.6	0.6	--
Memo:						
Cash balance, end of period	33.5	51.3	43.6	12.1	43.6	20.3

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 Estimated.

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

Agency	1997 Q2	Q3	July	Aug.	Sep.
FHLBs	23.6	5.2	1.9	0.2	3.0
FHLMC	8.3	-1.9	-0.4	4.2	-5.6
FNMA	9.3	12.5	3.1	-0.5	9.9
Farm Credit Banks	1.2	-0.5	-0.2	-0.8	0.5
SLMA	1.7	-4.3	0.7	-0.3	-4.7

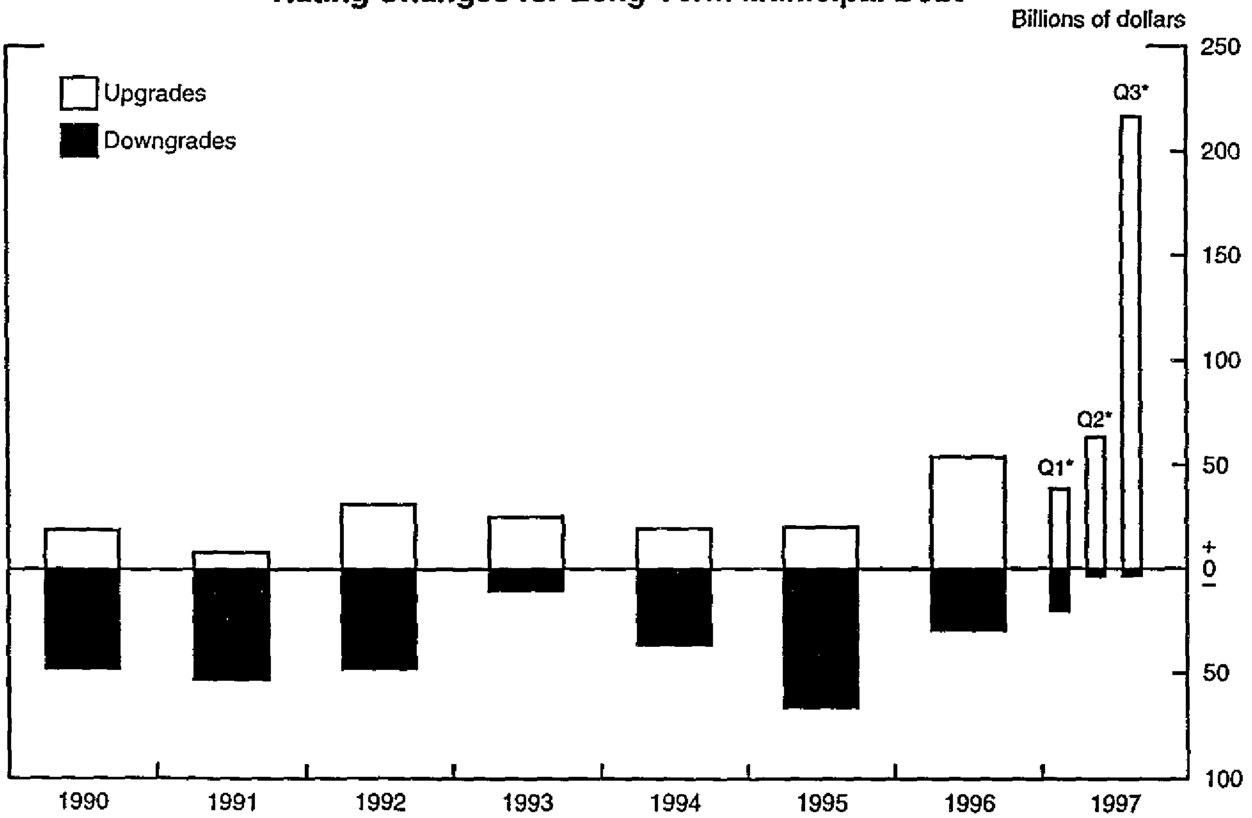
Note. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

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

	1994	1995	1996	1997 Q2	Q3	Aug.	Sept.	Oct.
Total tax-exempt	16.2	15.4	17.9	20.8	23.6	21.4	25.6	22.0
Long-term	12.8	12.1	14.3	16.9	17.9	16.6	20.5	18.6
Refundings[1]	4.0	3.6	4.9	4.6	8.7	7.7	11.0	7.1
New capital	8.8	8.5	9.4	12.3	9.2	8.9	9.5	11.5
Short-term	3.3	3.3	3.6	3.9	5.6	4.8	5.1	3.4
Total taxable	0.7	0.7	0.8	1.6	0.8	0.4	0.9	0.6

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

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1997 Q2	1997 Q3	1997 Aug.	1997 Sept	1997 Oct.	1996:Q4 to Oct. 97	Level (bil. $) Oct. 97
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-5.5	0.0	8.1	-10.0	-4.8	-2.5	1056.1
2. M2[2]	4.3	3.8	5.0	10.7	5.8	4.8	5.0	3974.8
3. M3	6.6	6.7	8.3	11.9	8.7	7.1	7.9	5235.5
Selected components								
4. Currency	5.7	5.8	6.7	5.6	9.6	7.8	7.1	418.1
5. Demand deposits	2.8	-6.7	-0.3	16.1	-34.7	-15.1	-4.4	385.0
6. Other checkable deposits	-23.1	-20.4	-9.9	0.0	-1.9	-9.7	-13.1	244.9
7. M2 minus M1[3]	8.4	7.4	6.8	11.6	11.8	8.2	8.0	2918.6
8. Savings deposits	11.7	9.3	6.1	10.4	13.6	12.7	9.7	1371.0
9. Small time deposits	1.4	2.5	3.7	1.9	2.0	2.6	2.6	965.9
10. Retail money market funds	14.5	11.4	14.0	31.5	23.9	7.1	13.8	581.7
11. M3 minus M2[4]	15.5	16.7	19.1	15.6	17.7	14.4	18.0	1260.8
12. Large time deposits, net[5]	16.6	20.3	24.8	12.9	25.9	7.4	19.6	572.3
13. Institution-only money market mutual funds	19.8	12.5	21.3	18.9	35.4	22.7	19.4	345.3
14. RPs	4.5	4.2	13.0	17.3	-15.9	46.7	11.9	216.3
15. Eurodollars	21.5	33.4	0.6	16.8	-5.5	-28.6	18.3	126.9
Memo								
16. Sweep-adjusted M1[6]	5.1	4.1	5.8	12.4	2.9	2.8	5.4	1301.2
17. Monetary base	3.8	3.2	6.1	5.9	7.5	4.3	5.2	471.1
18. Household M2[7]	4.5	5.0	5.8	10.5	9.2	7.0	6.2	3589.9
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	11.3	12.5	8.8	11.8	2.4	...	662.1
19. Net due to related foreign institutions	-2.0	2.7	-5.3	-8.3	-0.6	-17.5	...	188.6
20. U.S. government deposits at commercial banks	0.0	2.5	-3.3	0.0	1.1	4.4	...	22.9

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.

Gross offerings of long-term municipal debt increased in September, reflecting a seasonal upturn in new capital issuance and a spate of refundings in response to the more attractive interest rate environment. The credit quality of municipal debt continued to improve in the third quarter. Standard & Poor's upgraded $54 billion of municipal debt and downgraded less than $1 billion (chart). Its upgrade of New York State's general obligation bonds accounted for about a third of the total. Four state credit enhancement programs in support of school districts and other local issuers were also upgraded--those of New York, Minnesota, Colorado, and South Carolina.

Money and Bank Credit

The monetary aggregates decelerated a bit further in October, but to a still-brisk pace that kept M2 at the top of its annual range and M3 well above its range. M2 grew at a 4-3/4 percent pace last month after recording a 5-3/4 percent advance in September. Growth of M2 for the third quarter was close to that of nominal GDP, implying little change in its velocity.[4]

The contours of M3 growth have been similar to its M2 component, growing at a 7 percent rate in October after posting a rate of 8-3/4 percent in September. The growth of the broader aggregate was bolstered by the continued rapid expansion of institution-only mutual funds, which have been gaining market share in the cash management business, but the growth of large time deposits cooled from its torrid pace of the past few months.

Bank credit, adjusted for the effects of mark-to-market accounting rules, grew at an estimated 4-3/4 percent annual rate in October. Security holdings were flat while loan growth, at a rate of 6 percent, was slightly faster than in September, buoyed by a rebound in the volatile security loan component. Business loans and the revolving home equity component of real estate credit remained quite strong, though off some from September. Consumer loans contracted again in October, reflecting the slower pace of household borrowing in the aggregate and some further substitution toward home equity loans. Real estate lending, apart from home equity loans, was weak.

4. The growth rates for M2 in 1996 and so far in 1997 have each been revised down by about 1/2 percentage point because of new information on IRA/Keogh money fund accounts. These retirement accounts are netted out of the money fund component of M2.

Commercial Bank Credit

(Percent change; seasonally adjusted annual rate)

Type of credit	1996	1997 Q2	1997 Q3	1997 Aug	1997 Sep	1997 Oct p	Level, Oct 1997 p (billions of $)
1. Bank credit: Reported	4.0	7.6	5.6	2.8	5.3	4.2	3,990.6
2. Adjusted[1]	4.5	9.4	4.7	0.6	8.6	4.7	3,906.3
3. Securities: Reported	-1.5	2.5	2.6	-8.6	4.6	-0.8	1,025.4
4. Adjusted[1]	0.0	9.1	-1.4	-18.6	18.1	0.6	941.1
5. U.S. government	-0.7	10.2	-1.9	-21.8	11.8	5.2	724.5
6. Other[2]	-3.7	-15.1	13.8	23.4	-12.5	-15.0	300.9
7. Loans[3]	6.1	9.5	6.7	6.7	5.6	5.9	2,965.1
8. Business	8.6	7.9	8.7	11.6	16.4	8.5	841.8
9. Real estate	4.0	12.2	7.0	5.4	6.6	2.4	1,207.3
10. Home equity	7.1	20.3	14.9	10.3	16.6	13.8	96.6
11. Other	3.8	11.5	6.4	5.0	5.9	1.3	1,110.7
12. Consumer: Reported	5.5	-2.8	-0.2	1.2	-9.7	-13.8	507.6
13. Adjusted[4]	10.8	0.5	1.8	6.0	-4.5	-5.0	695.3
14. Other[5]	7.9	21.8	10.8	7.6	-0.3	36.6	408.4

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.

p Preliminary.

Press reports on corporate earnings for the third quarter indicate that bank holding companies once again posted healthy returns, which owed importantly to continued strong fee income. On a finer reading, these reports contain little evidence that adverse performance of credit card portfolios depressed earnings any more than they had earlier this year. The three "monoline" credit card specialists (Advanta, MBNA, and Capitol One) all reported somewhat higher charge-off rates in the quarter, but each of them beat analysts' earnings expectations.

Mutual Funds

Investors redeemed shares from both domestic and international equity funds on October 27, but these outflows were more than made up by heavy inflows on the following day, according to confidential tabulations of daily activity at large funds.[5] The run on international funds had carried over from the previous week when substantial sell-offs were rocking foreign stock markets, but these funds reportedly have shared in the subsequent inflows. For October as a whole, net inflows to stock funds moderated some, but were only a little below the third-quarter pace. The slowing was concentrated at the riskier growth-oriented funds; inflows to international funds actually increased slightly for the month as a whole, despite the late-October redemptions. Among the major types of bond funds, high-yield funds posted record net inflows in September but smaller ones in October as the stock market turmoil led to some caution among investors.

5. Fund managers apparently weathered the short-lived wave of redemptions without major hitch. Among the very large fund complexes, only two drew upon credit lines to make redemptions.

Selected Mutual Fund Net Sales
(Billions of dollars; monthly rate)

			1997					Memo:
	1995	1996	Q2	Q3	Aug.	Sept.	Oct.	Sept. assets
Stock funds	10.7	18.5	17.6	22.2	14.0	25.8	19.5	2392
Domestic	9.7	14.6	12.9	18.7	12.8	22.3	15.7	2012
Growth & income	3.7	6.1	7.4	7.9	6.9	7.0	6.9	971
International	1.0	3.9	4.7	3.5	1.3	3.5	3.8	380
Bond funds	–.4	1.1	1.9	5.0	7.1	3.6	3.0	994
High–yield	.7	1.0	1.6	1.6	1.3	1.8	1.5	98
Balanced[1]	.5	.9	1.4	1.8	1.8	1.8	.9	304
Other	–1.5	–.8	–1.1	1.6	4.0	.1	.5	592

1. Calculated as the sum of "Income–Mixed", "Balanced", and "Flexible Portfolio" in the ICI data; these funds invest in both stocks and bonds.

Source. Investment Company Institute

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

The November 1997 Senior Loan Officer Opinion Survey on Bank Lending Practices (covering, for the most part, changes over the past three months) posed questions about bank lending standards and terms, loan demand by businesses and households, collateralized loan obligations, the causes of the recent rise in measured spreads on commercial and industrial loans, and the renegotiation of consumer loans on concessionary terms. The responses suggest that domestic banks became even more accommodative lenders to businesses and that the tightening of standards on loans to households continued to abate.[1]

Increased competition for business credit apparently led large percentages of the domestic respondents to ease terms on commercial and industrial loans over the past three months, and a small percentage of them to ease lending standards. By contrast, a few of the branches and agencies of foreign banks indicated that they had tightened lending standards and some loan terms. Demand for commercial and industrial loans and commercial real estate loans strengthened at many of the respondents.

Banks again reported tighter standards on consumer loans, but the percentage that tightened was lower than it had been earlier in the year. Moreover, several banks expressed increased willingness to make these loans. The respondents indicated that demand for consumer loans had softened somewhat.

Lending to Businesses

A small net percentage of the domestic respondents--about 5 percent--reported easing standards for commercial and industrial 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 cost of funds on loans to borrowers in both size categories. Smaller percentages eased other terms, including the costs of credit lines, the maximum size of credit lines, and loan covenants. Only a couple of banks eased collateralization requirements. The degree of easing of business loan standards reported in the November survey is broadly similar to that found in the other surveys this year, while the easing of loan terms was somewhat more widespread in November, especially for loans to small businesses. As in the earlier surveys, those banks that eased pointed to increased competition from other banks and from nonbank lenders as the main reasons for the changes.

In contrast, the branches and agencies of foreign banks reported a small net tightening of standards and a tightening of

1. About 40 percent of the survey responses were reported to the Reserve Banks on or before October 27, when the stock market fell sharply and risk spreads on private securities widened. Moreover, even for those responses received after October 27, some respondents may have decided on their responses well in advance of the time they were reported to the Reserve Banks. Thus, a larger share of the responses may reflect loan market conditions before the stock market's decline.

some loan terms for commercial and industrial loans. Those respondents tightening standards or terms most frequently indicated that they were doing so because of a reduced tolerance for risk by their institutions While this reduced tolerance for risk might reflect the turbulence in world financial markets last week, the less accommodative stance of the foreign respondents is also consistent with the last two surveys. In August and May, the foreign respondents were less likely than the domestic respondents to report easier terms or standards and more likely to report tighter ones. The November responses are also consistent with the slower growth in business loans at foreign branches and agencies than at large domestic banks since the second quarter.

The survey results suggest a broad rise in the demand for commercial and industrial loans. Nearly 20 percent of the domestic banks, on net, reported stronger demand from large and middle-market borrowers, roughly the same as the fraction reporting a pickup in demand by small businesses (chart). A similar net percentage of the foreign branches and agencies reported a rise in business loan demand. Respondents attributed the increased demand to greater customer financing needs for plant and equipment and also for mergers and acquisitions. In addition, some of the foreign respondents pointed to a shift in demand from other sources of finance.

The survey results show mixed changes in commercial real estate loan standards, while demand for such loans picked up sharply. Less than 10 percent of the domestic banks reported easier commercial real estate lending standards, and the foreign respondents posted a small net tightening. About a third of both the domestic and foreign respondents indicated that demand for commercial real estate loans had strengthened.

Lending to Households

The November survey was the eighth in a row to show a net tightening of standards for consumer loans. However, the net percentage of banks tightening was lower in the August and November surveys than earlier in the year, suggesting that many banks have completed adjustments to take account of the deterioration in the performance of these loans that occurred over the past three years. In the latest survey, about 20 percent of the respondents reported tighter standards for credit card applications and about 10 percent tighter standards for other consumer loans. Both percentages were little changed from the August survey. By contrast, these percentages peaked at nearly 50 percent and 25 percent, respectively, late last year.

Changes in consumer loan terms were mixed. While banks tightened credit limits and increased spreads on credit cards, a few also reported reducing required minimum payments. On other types of consumer loans, some banks increased maximum maturities and cut spreads. About 10 percent of the banks, on net, said that their willingness to make consumer installment loans had increased over the past three months, about the same as in August (chart). Consumer loan demand was reportedly a bit weaker on net.

Banks reported a very small net tightening of standards for approving applications for mortgage loans to purchase homes. About a quarter of the respondents reported increased demand for these loans.

Collateralized Loan Obligations

Recently, several large banks have established programs under which they package and sell securities backed by commercial and industrial loans. These securities are commonly called collateralized loan obligations, or CLOs.[2] The November survey asked the respondents about such programs. Four of the domestic banks and six of the foreign branches and agencies reported having a program to sell collateralized loan obligations, and three domestic respondents and four foreign respondents indicated that they would have such a program within a year. Thus, more than a tenth of the domestic respondents and nearly half of the foreign respondents will likely have issued CLOs by the end of next year. Moreover, nearly a third of the domestic respondents and a fifth of the foreign respondents indicated that they were considering establishing a CLO program. The respondents attributed the recent interest in CLOs to a desire by banks to deploy their capital efficiently by moving relatively low risk loans off their balance sheets. They also noted that the continued development of the asset-backed security market has reduced the cost of such programs and that, given current market interest rates, CLOs can reduce funding costs.

Although substantial, the total dollar volume of business loans that the respondents intend to securitize over the coming year is fairly modest compared with the total amount of business loans on banks' books. The seven domestic respondents that have or plan to have a program each intend to securitize an average of about $2.2 billion of commercial and industrial loans over the coming year, while the ten foreign respondents each intend to securitize an average of $1.8 billion. Thus, in sum, these respondents plan to securitize more than $30 billion of commercial and industrial loans, or about 4 percent of the more than $800 billion of bank commercial and industrial loans.

Reasons for the Rise in Measured Spreads on Large Business Loans

According to the Federal Reserve's quarterly Survey of Terms of Business Lending, spreads of rates on larger business loans (those of $1 million or more) over market rates have widened over the past year. This result appears to be at odds with press reports and the results of past Senior Loan Officer Surveys, which suggest that spreads have narrowed. The November survey asked the respondents what factors likely contributed to this divergence. They indicated that the rise in measured spreads on commercial and industrial loans found by the Survey of Terms of Business Lending most likely occurred despite a narrowing of spreads on loans of a given risk and reflected a more-than-offsetting rise in the average risk of new loans. They attributed the rise in risk to an increased demand for riskier credits, especially those for mergers and acquisitions. In addition, some banks reported that they had decided to accept increased risk in order to earn higher returns.

Concessionary Terms on Household Debt Repayment Plans

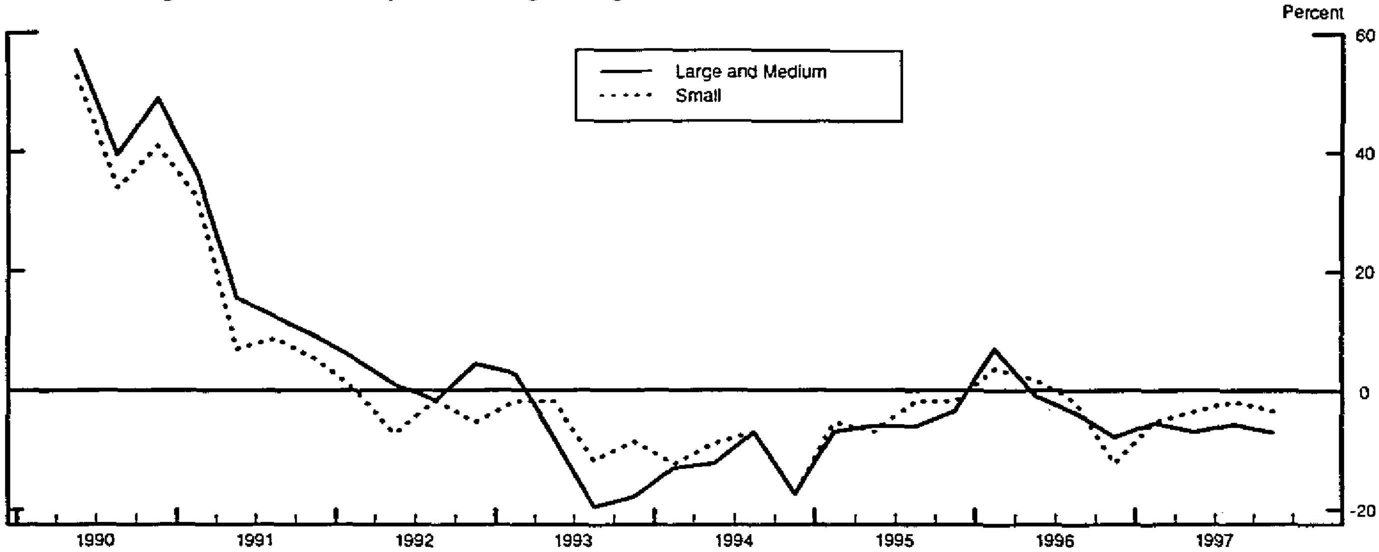
In recent years the number of households contacting credit counseling services has increased substantially, as has the number of households establishing debt repayment plans with their creditors

2. Banks have issued securities backed by loans guaranteed by the Small Business Administration for some time. These securities are distinct from CLOs.

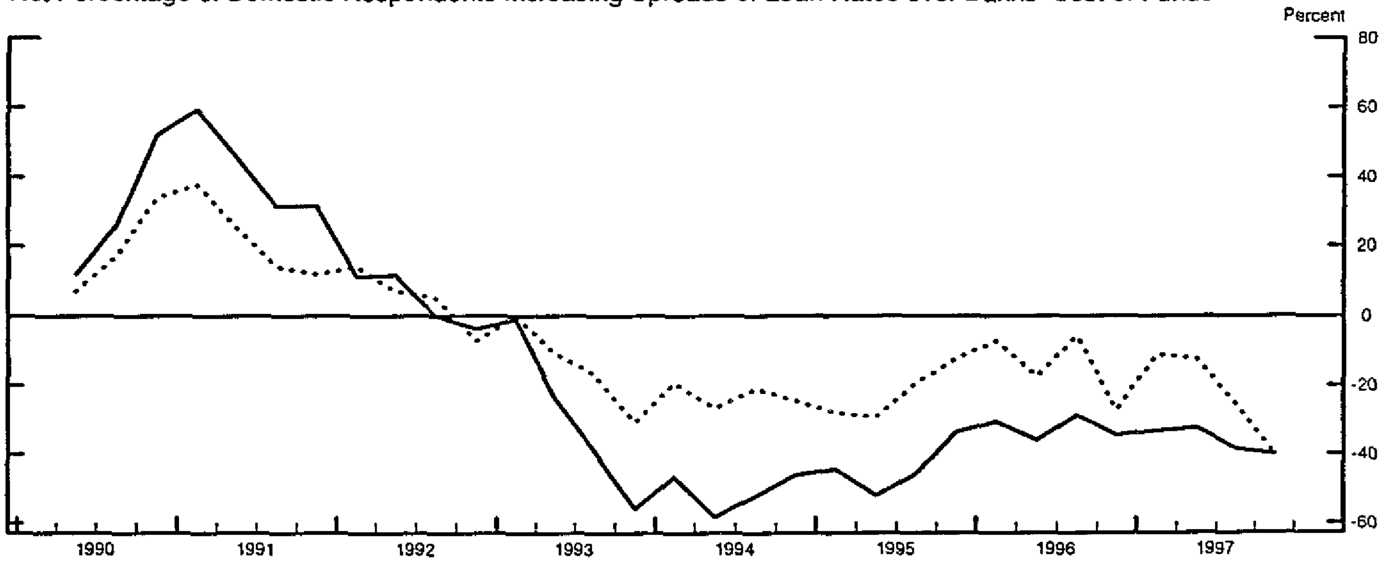
with the assistance of such services. The November survey asked banks about their willingness to agree to concessionary terms on consumer loans as a part of a debt repayment plan. The responses showed a widespread willingness to provide concessionary terms and an increase in the use of concessions in recent years. Three-quarters of the respondents indicated that they were willing to agree to either "substantial" or "some" concessions (perhaps including reduced late fees, lower interest rates, or longer repayment periods) as a part of a debt repayment plan. Less than 10 percent of the respondents were completely unwilling to make such concessions. Generally, the banks indicated that the fraction of their banks' consumer loan outstandings restructured on concessionary terms as a part of a debt repayment plan was fairly small--either less than 1 percent or between 1 percent and 3 percent of outstandings. About half the respondents indicated that this fraction had increased over the past three years. In part, the rise may reflect a greater willingness on the part of banks to make concessions. Nearly half of the banks were more willing to make such concessions today than they were three years ago. Somewhat surprisingly, many of the banks apparently restructure consumer loans on concessionary terms directly, rather than through a credit counseling service. Only 20 percent of the respondents indicated that debt repayment plans were arranged through a service "in most cases," and about 15 percent reported that counseling services were "rarely or never used." A majority of the respondents indicated that arrangements were "sometimes" made through a counseling service.

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

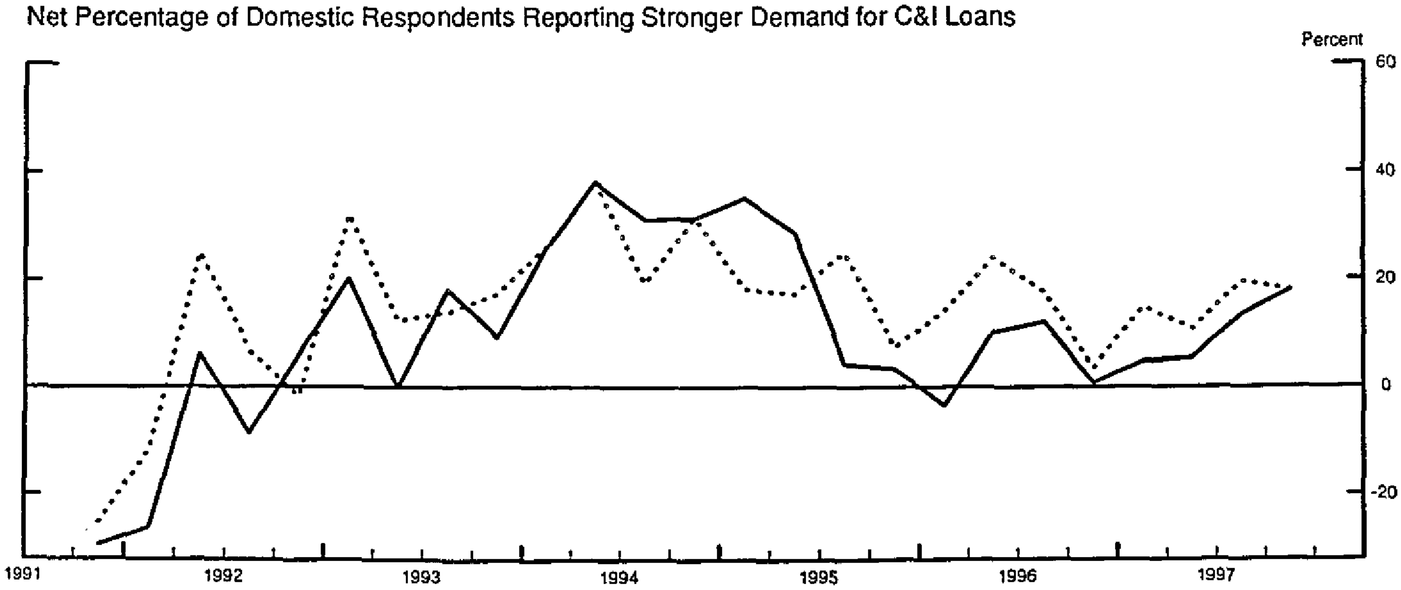
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

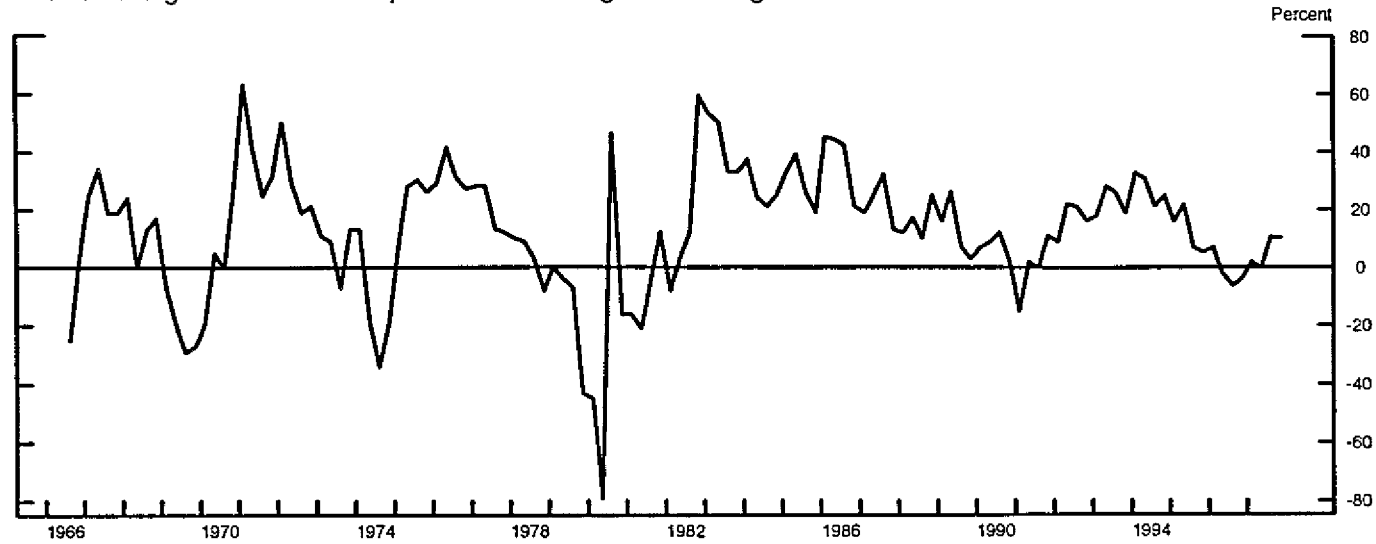


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

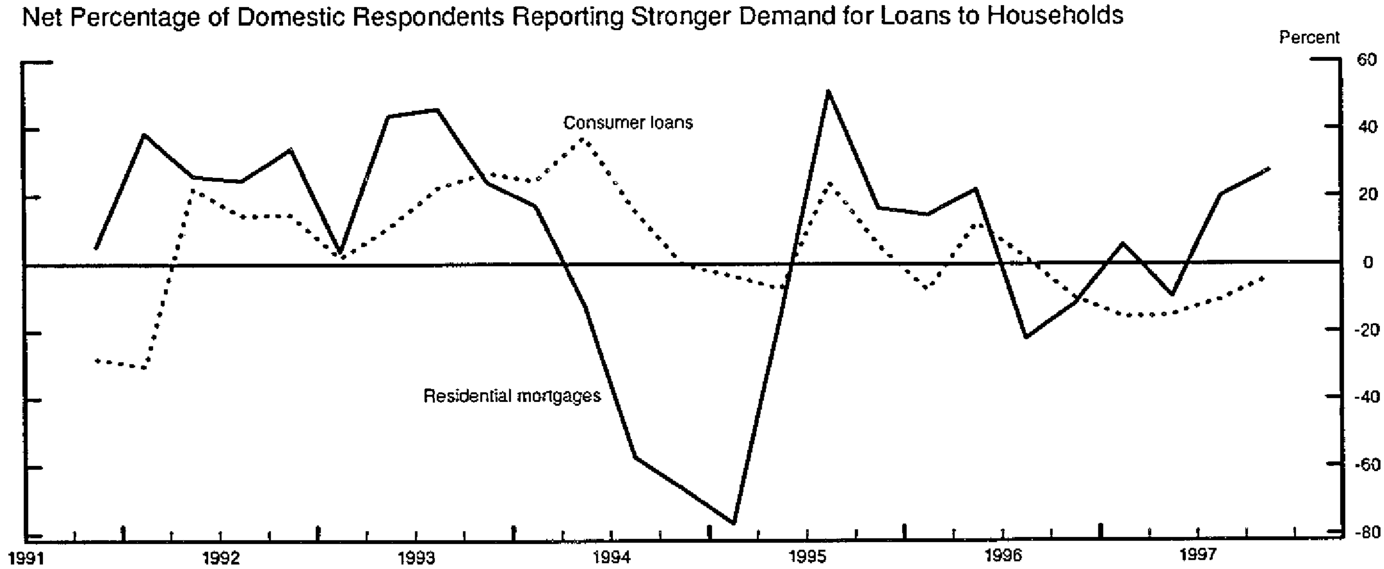


Measures of Supply and Demand for Loans to Households

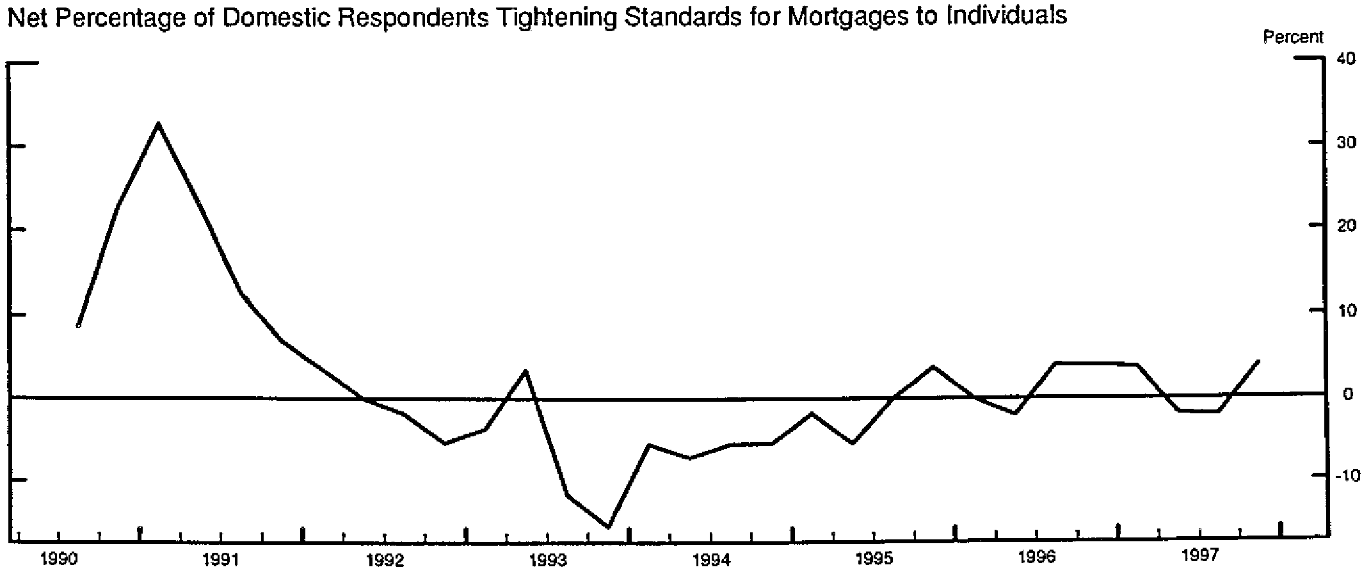
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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 August, the deficit in U.S. international trade in goods and services widened, as exports rose less than imports. In July/August combined, the deficit was significantly larger (at an annual rate) than the level recorded in the second quarter and somewhat larger than the deficit in the first quarter. Trade data for September will be released on November 20.

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

	1996	Annual rates 1997			Monthly rates 1997		
		Q1	Q2	Q3e/	Jun	Jul	Aug
Real NIPA 1/							
Net exports of G&S	-114.4	-126.3	-136.6	-160.0	...	...	...
Nominal BOP							
Net exports of G&S	-111.0	-117.2	-106.6	-122.3	-8.3	-10.0	-10.4
Goods, net	-191.2	-199.1	-188.5	-205.3	-15.2	-16.8	-17.4
Services, net	80.1	82.0	82.0	83.1	7.0	6.8	7.0

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

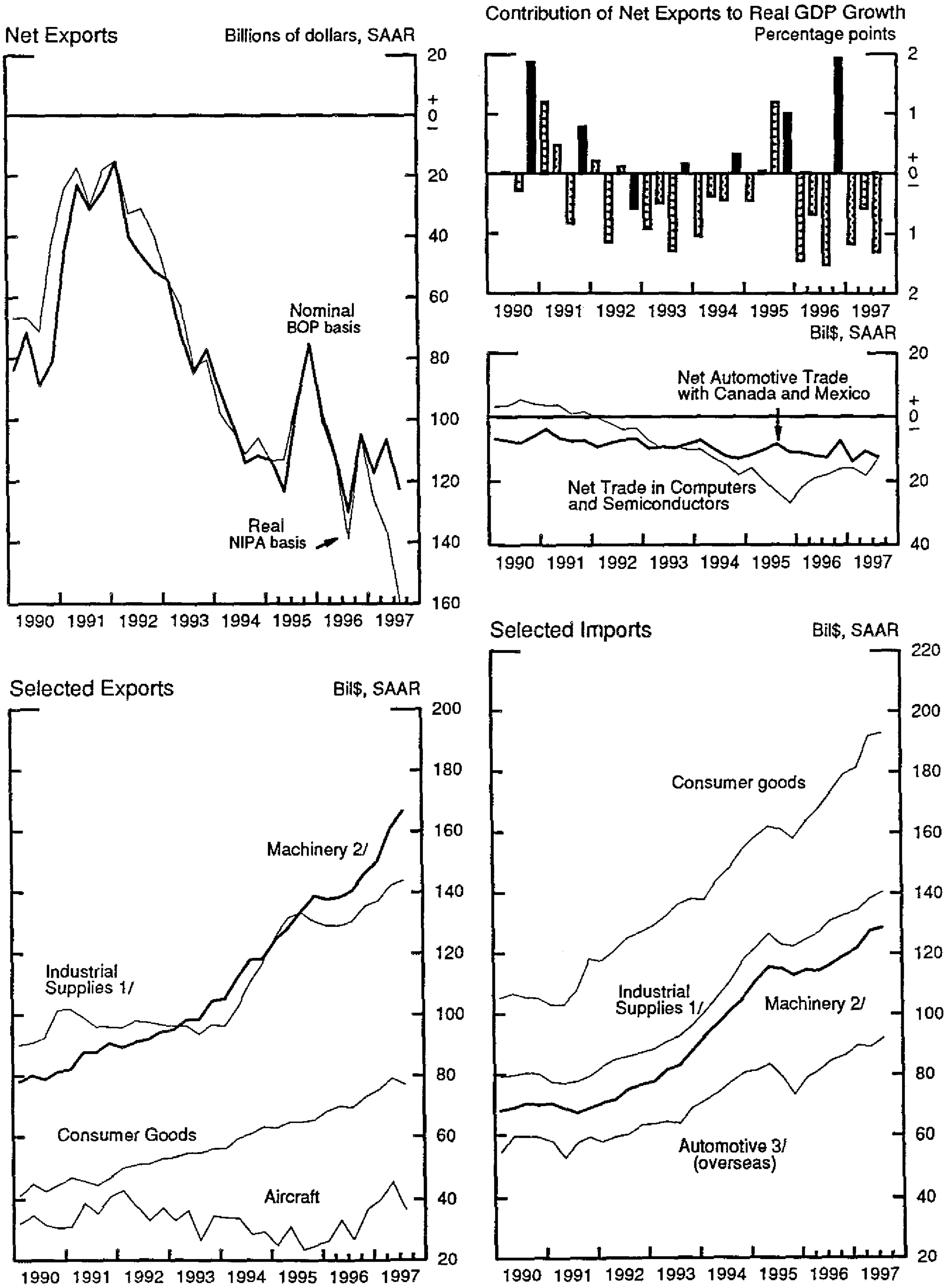
Exports of goods and services were nearly unchanged in July/August relative to the second-quarter level, as increases in several categories (especially machinery) were offset by large declines in exports of gold, aircraft, and aircraft parts.

Imports of goods and services grew 1-1/4 percent in July/August relative to the second-quarter level. The strongest gains were seen in imports of automotive and aircraft products, although imports of computers, semiconductors, and industrial supplies also posted healthy increases. These increases were partly offset by a sharp decline in imported gold. (Gold exports and imports netted close to zero).

Oil Imports and Prices

The quantity of oil imported in the second quarter was sharply higher than in the first quarter and well above rates in 1996; imports also remained high in July/August. These relatively high import levels were driven by extremely strong consumption in the

U.S. International Trade in Goods and Services



Selected Exports:
1/ Excludes agriculture and gold.
2/ Excludes computers and semiconductors.

Selected Imports:
1/ Excludes oil and gold.
2/ Excludes computers and semiconductors.
3/ Excludes Canada and Mexico.

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

	Levels				Amount Change 1/			
	1997		1997		1997		1997	
	Q2	Q3e/	Jul	Aug	Q2	Q3e/	Jul	Aug
Exports of G&S	936.2	934.5	933.4	935.5	39.2	-1.7	-8.7	2.0
Goods exports	685.6	681.4	680.9	681.8	35.5	-4.3	-7.6	0.9
Agricultural	56.4	57.2	54.6	59.7	-0.9	0.7	-0.5	5.1
Gold	9.3	3.4	3.4	3.4	2.6	-5.9	-5.9	-0.0
Other goods	619.9	620.8	623.0	618.7	33.8	0.9	-1.2	-4.2
Aircraft & pts	45.5	36.7	41.3	32.1	5.8	-8.8	1.6	-9.2
Computers	50.1	52.6	52.1	53.2	3.8	2.5	0.5	1.0
Semiconductors	38.3	39.9	39.5	40.3	0.5	1.6	0.7	0.8
Other cap gds	163.0	168.5	165.9	171.0	10.8	5.5	2.1	5.1
Automotive	73.4	74.4	75.1	73.6	2.5	0.9	0.1	-1.6
to Canada	38.5	39.8	39.5	40.0	-0.2	1.2	0.3	0.5
to Mexico	11.3	10.7	10.5	10.8	0.9	-0.7	-2.1	0.4
to ROW	23.6	23.9	25.1	22.7	1.8	0.3	1.9	-2.4
Ind supplies	142.1	143.9	142.7	145.1	5.0	1.8	-2.9	2.4
Consumer goods	78.9	77.0	76.8	77.3	3.6	-1.9	-3.9	0.5
All other	28.6	27.9	29.6	26.2	1.8	-0.7	-2.6	-3.4
Services exports	250.5	253.1	252.5	253.7	3.6	2.5	-1.1	1.2
Imports of G&S	1042.8	1056.7	1053.7	1059.8	28.6	14.0	12.0	6.1
Goods imports	874.2	886.7	883.1	890.3	24.9	12.5	11.7	7.2
Petroleum	71.0	69.1	67.0	71.3	-5.7	-1.9	-4.6	4.3
Gold	11.0	2.8	3.0	2.6	2.3	-8.1	-7.1	-0.4
Other goods	792.2	814.8	813.1	816.4	28.3	22.6	23.3	3.3
Aircraft & pts	15.5	19.7	20.4	19.1	1.9	4.2	4.5	-1.3
Computers	70.5	73.4	72.1	74.7	5.1	2.9	1.2	2.5
Semiconductors	36.1	38.8	38.1	39.4	1.4	2.7	-0.1	1.3
Other cap gds	129.6	130.9	128.2	133.5	6.1	1.3	-1.6	5.2
Automotive	138.3	144.5	147.5	141.5	-3.9	6.2	8.4	-6.0
from Canada	49.2	52.2	54.5	49.9	-3.5	3.1	6.7	-4.6
from Mexico	26.0	24.8	24.1	25.4	1.8	-1.2	-1.7	1.3
from ROW	63.2	67.5	68.8	66.1	-2.2	4.3	3.4	-2.7
Ind supplies	138.1	140.6	139.5	141.7	3.9	2.4	2.9	2.2
Consumer goods	192.0	193.1	193.2	192.9	10.8	1.0	4.6	-0.3
Foods	39.9	40.5	40.7	40.3	1.9	0.6	1.7	-0.4
All other	32.1	33.3	33.3	33.3	1.2	1.3	1.9	-0.0
Services imports	168.6	170.0	170.5	169.5	3.6	1.4	0.3	-1.1
Memo:								
Oil qty (mb/d)	10.80	10.80	10.66	10.94	0.95	0.00	-0.30	0.29
Oil price ($/bbl)	18.01	17.52	17.21	17.83	-3.34	-0.49	-0.67	0.62

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

second and third quarters--up more than three percent compared to a year ago--and a rebuilding of oil stocks. Preliminary Department of Energy statistics indicate that oil imports remained strong in September due to continued high consumption demand and a substantial increase in stocks.

After rising 2-1/2 percent in August, the price of imported oil was nearly unchanged in September. Delays in deliveries of Iraqi oil and disruptions of shipments of oil from Colombia contributed to the increase in prices during August and their continued strength in September.

The WTI spot price rose $1.48 per barrel in October, averaging $21.27 per barrel, due primarily to uncertainty regarding oil supplies from the Middle East. A confrontation between the United States and Iran caused the spot price to spike above $23, and intensified fighting between Kurdish factions in northern Iraq and continued problems between Iraqi defense agencies and U.N. inspectors also contributed to firmer prices. Oil prices have recently been trading in the $20 to $21 per barrel range.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports decreased slightly in September. There were price declines in most major import categories, while prices of imported foods resumed an upward trend. For the third quarter, non-oil import prices continued to fall, but at a slightly slower rate than in the first and second quarters. Declines were recorded in all major end-use categories, with the exception of prices for non-oil industrial supplies and automotive products.

Prices of exports decreased slightly in September, following a small increase in August. The decline was attributable to lower prices for both agricultural and nonagricultural products (particularly to lower prices for semiconductors). On average in the third quarter, export prices decreased moderately. Prices of agricultural products declined sharply. Prices of nonagricultural exports, however, fell only slightly, as decreases in computer and semiconductor prices were partly offset by price increases in other major trade categories.

Trade prices for October will be released on November 19.

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

	Annual rates 1997 Q1	Q2	Q3	Monthly rates 1997 Jul	Aug	Sep
	-----------BLS prices (1995=100)-----------					
Merchandise imports	-4.6	-8.8	-1.5	-0.2	-0.1	-0.1
Oil	-23.8	-48.5	-2.3	-1.2	2.5	-0.1
Non-oil	-2.3	-3.4	-1.5	-0.2	-0.2	-0.2
Foods, feeds, bev.	4.9	7.9	-4.8	-2.6	-0.1	0.9
Ind supp ex oil	4.8	-6.0	1.6	0.3	-0.1	0.1
Computers	-13.8	-17.6	-14.5	-0.8	-2.3	-1.3
Semiconductors	-24.7	-2.2	-5.6	-1.3	-0.5	-0.8
Cap. goods ex comp & semi	-5.8	-3.8	-1.3	0.0	-0.4	-0.3
Automotive products	0.1	-0.7	1.7	0.1	0.1	0.1
Consumer goods	-0.8	-1.3	-0.8	0.1	-0.2	-0.2
Merchandise exports	0.5	-0.4	-1.3	-0.1	0.1	-0.4
Agricultural	2.5	-0.8	-10.9	-1.2	0.2	-0.1
Nonagricultural	0.1	-0.1	-0.3	0.0	0.0	-0.4
Ind supp ex ag	0.6	0.7	1.1	0.2	-0.3	-0.4
Computers	-9.4	-10.4	-7.9	-0.8	0.0	-0.5
Semiconductors	-5.2	-2.7	-9.4	-0.1	-0.3	-3.6
Cap. goods ex comp & semi	2.0	1.0	0.4	-0.1	0.0	-0.2
Automotive products	1.3	1.4	0.3	0.2	-0.1	-0.1
Consumer goods	0.8	0.1	1.6	0.2	0.1	0.1
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	-5.3	-7.6	n.a.	...	...	...
Non-oil merchandise	-4.2	-3.9	n.a.	...	...	...
Exports of gds & serv.	-1.8	-0.7	n.a.	...	...	...
Nonag merchandise	-2.5	-2.4	n.a.	...	...	...

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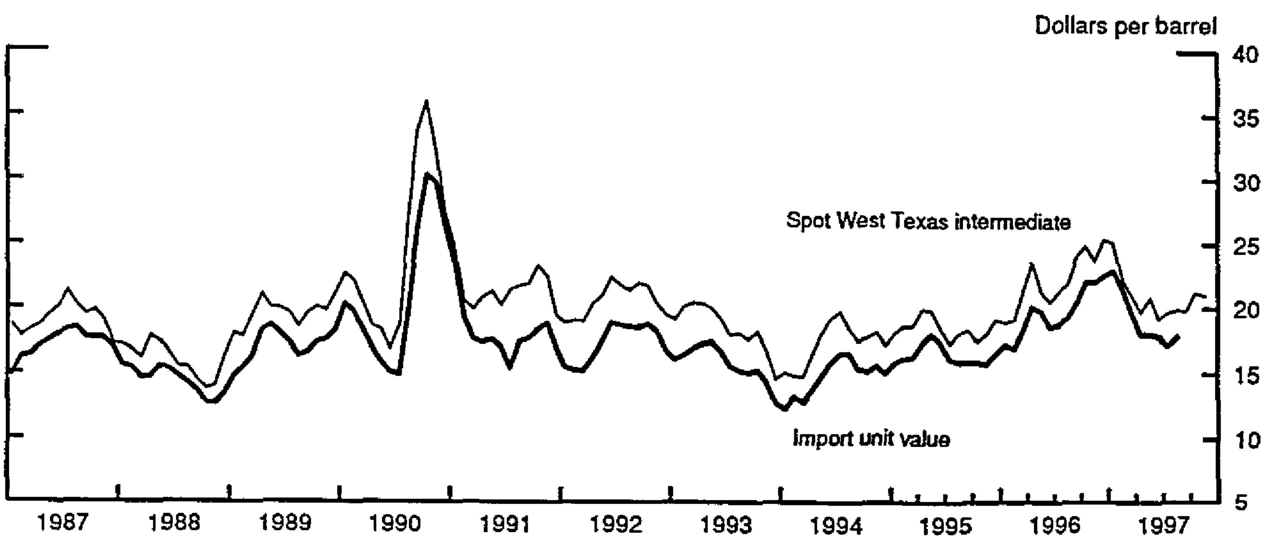
Oil Prices



U.S. International Financial Transactions

Since the last Greenbook, we have received Treasury data on capital flows during August and data on foreign official holdings at the FRBNY through late October. In August, private foreign purchases of U.S. securities remained strong with demand shifting further toward Treasuries and agency bonds at the expense of corporate bonds. Official holdings at the FRBNY declined modestly in September and declined significantly in October.

Foreign official reserve holdings in the United States rose by $11-1/2 billion in August (line 1 of the Summary of U.S. International Transactions Table), reflecting increases by OPEC and Mainland China. The increase by China reverses about one-quarter of the reduction registered in June when they shifted a large portion of their reserves to custodians outside of the United States. In Latin America, further increases by Argentina and Brazil were offset by a reduction in Mexican holdings associated with the retirement of some Brady bonds.

Official holdings at the FRBNY declined $2 billion in September as reductions in holdings by G-10 countries and Mainland China were partially offset by further increases in OPEC holdings. In October, official reserves at the FRBNY declined by another $17 billion. Developing economies in Asia account for much of this decline, reflecting efforts to resist pressures on their currencies. Reserve holdings of Argentina, Brazil, and OPEC members also registered significant declines.

Private foreign purchases of U.S. securities remained very strong in August (line 3). Purchases of Treasuries (line 4a) bounced back from their relative lull in July to resume their heady pace of the first two quarters. Nearly all of the Treasury purchases in August were attributable to UK residents, providing little information about the residence of the ultimate purchaser. Japanese residents on net sold $1-1/2 billion worth of Treasuries in August--the first month of significant net sales since December of 1995.

Foreign purchases of corporate and other bonds remained strong in August (line 4b). More than half of these net purchases ($7 billion) were U.S. government agency bonds. Japanese residents

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 Jul	1997 Aug
Official capital								
1. Change in foreign official reserve assets in U.S. (increase, +)	110.0	127.4	22.7	39.2	27.5	-6.0	.3	11.6
a. G-10 countries	33.1	36.7	1.4	3.4	7.5	4.6	-2.8	2.2
b. OPEC countries	4.3	15.3	5.3	5.5	7.0	2.6	-.7	5.5
c. All other countries	72.6	75.4	16.0	30.4	12.9	-13.1	3.8	4.0
2. Change in U.S. official reserve assets (decrease, +)	-9.7	6.7	7.5	-.3	4.5	-.2	-.2	-.4
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-30.9	-50.0	-4.5	-7.8	-26.4	16.8	20.8	-18.6
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	190.8	301.7	77.5	112.5	84.0	97.3	33.4	37.0
a. Treasury securities[3]	99.9	167.0	43.6	78.5	44.3	45.3	7.2	16.2
b. Corporate and other bonds[4]	82.6	122.6	33.5	32.4	29.0	29.9	15.2	13.0
c. Corporate stocks	8.2	12.1	.5	1.5	10.7	22.1	11.0	7.8
5. U.S. net purchases (-) of foreign securities	-98.7	-105.9	-20.9	-30.4	-17.1	-22.0	-18.8	-12.6
a. Bonds	-48.4	-48.8	-14.2	-19.9	-5.3	-8.6	-11.2	-4.5
b. Stocks	-50.3	-57.1	-6.7	-10.5	-11.8	-13.3	-7.6	-8.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-86.7	-87.8	-11.1	-30.9	-26.4	-29.1	n.a	n.a
7. Foreign direct investment in U.S.	67.5	77.0	26.0	17.7	30.6	28.9	n.a	n.a
8. Foreign holdings of U.S. currency	12.3	17.3	7.4	7.8	3.5	4.8	n.a	n.a
9. Other (inflow, +)[5]	-10.6	-91.3	-23.5	-67.6	-25.9	-33.2	n.a	n.a
U.S. current account balance (s.a.)	-129.1	-148.2	-42.8	-36.9	-40.0	-39.0	n.a	n.a
Statistical discrepancy (s.a.)	-14.9	-46.9	-38.3	-3.3	-14.3	-17.1	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.

purchased $3 billion of corporate and other bonds, nearly all of which were agency bonds. Foreign purchases of U.S. equities (line 4c) slowed slightly in August, but remained near the high pace of the second quarter, bringing total purchases for this year to $41 billion.

U.S. purchases of foreign securities slowed slightly in August (line 5) as a sizable slowing in bond purchases was only partly offset by a pickup in equity purchases. The slowing in bond purchases was widespread. The pickup in equity purchases was concentrated in Asia outside of Japan.

Banks recorded sizable net capital outflows in August (line 3), primarily through transactions with non-bank foreigners. We note that the bank flow data for July have been revised significantly since the last Greenbook--from an outflow of $22 billion to an inflow of $21 billion. (Most of this revision reflects the correction of a single bank's reporting error.) Since June, U.S. banks have, on net, reduced their net liabilities to their affiliated foreign offices (line 1 of the International Banking Data Table). Most of this reduction occurred at the U.S. branches and agencies of foreign banks, continuing a trend started in early 1996. Since last February, these branches and agencies have been shifting the composition of their managed liabilities--lowering the share of borrowing from foreign affiliates and raising the share of large CDs.

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

	1994 Dec.	1995 Dec.	1996 Sep.	1996 Dec.	1997 Mar.	1997 Jun.	1997 Aug.	1997 Sep.
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	-225.7	-206.1	-211.6
a. U.S.-chartered banks	-70.1	-86.1	-73.6	-66.4	-72.5	-79.9	-74.3	-77.9
b. Foreign-chartered banks	-153.9	-173.9	-173.8	-164.8	-147.9	-146.0	-131.8	-133.7
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	33.4	33.9	34.0
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	83.4	79.4	82.7	74.8	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	128.1	134.0	133.6	135.5
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	109.4	122.2	135.5	130.6	n.a	n.a
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	177.8	212.5	243.8	238.7	252.6	249.6	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	242.6	276.5	314.9	337.3	368.2	383.2	n.a.	n.a.

1. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts.
Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR2951.
Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s.
Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994.
Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. They include some foreign-currency denominated deposits and loans. Source: SCB

Foreign Exchange and Foreign Asset Markets

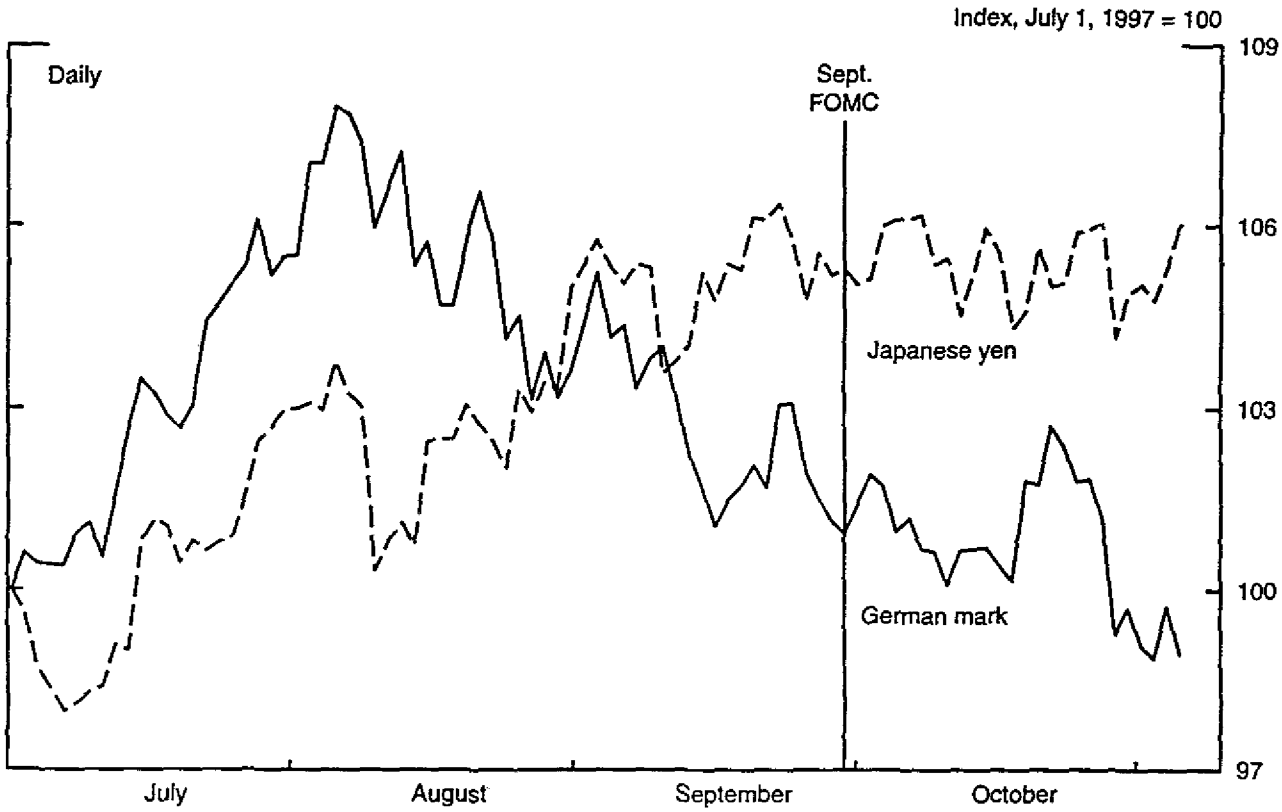
Equity prices around the globe have moved lower since the September 30 FOMC meeting. Foreign exchange market pressures that had emerged in southeast Asia in July eventually spread to other Asian Pacific nations, prompting monetary authorities in the region to raise interest rates to defend their currencies. The sharp downward reaction of local equity prices, particularly in Hong Kong, apparently fostered an increased degree of uneasiness about possibly lofty equity valuations in many other world markets, sending stock prices lower in Europe and the Americas.

A view that U.S. equity market weakness might restrain the Federal Reserve from tightening in the near term, in conjunction with the October 9 increase of 30 basis points in the Bundesbank's RP rate, has prompted a 2 percent decline in the dollar's foreign exchange value against the mark since the September FOMC meeting. Changes in market interest rate differentials are consistent with such a shift in sentiment about relative policy stances. At the short end of the maturity spectrum, the German three-month interbank deposit rate has risen 30 basis points during the period, while the U.S. rate is little changed. At the long end, the bond yield in Germany has firmed 5 basis points, relative to a comparable U.S. yield that has moved down 15 basis points.

Against the yen, the dollar has firmed about 1/2 percent. The yen has been depressed by expectations of sluggish growth in economic activity in Japan. The September Tankan survey, released in October, was interpreted as showing still more pessimism about Japanese business prospects. Furthermore, the absence of any clear plans for fiscal stimulus in Japan and the competitive pressures exerted by the depreciations of southeast Asian currencies have continued to weigh on the yen. With the monetary policy stance on hold until economic activity becomes more self-sustaining, the three-month CD rate in Japan is little changed. The bellwether bond yield in Japan ended the period down 25 basis points on balance to near its record low.

Whereas the multilaterally-weighted foreign exchange value of the dollar against the other G-10 currencies has declined about 1-1/2 percent during the intermeeting period, a broader, U.S. import-weighted average that includes also the dollar exchange rates of 10

Selected Dollar Exchange Rates



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Sept. 29	Nov. 4	Change	Sept. 29	Nov. 4	Change
Germany	3.33	3.63	0.30	5.55	5.60	0.05
Japan	0.54	0.51	-0.03	1.93	1.68	-0.25
United Kingdom	7.22	7.25	0.03	6.46	6.58	0.12
Canada	3.70	4.02	0.32	5.72	5.54	-0.18
France	3.32	3.53	0.21	5.52	5.62	0.10
Italy	6.44	6.63	0.19	6.14	6.13	-0.01
Belgium	3.63	3.77	0.14	5.65	5.75	0.10
Netherlands	3.34	3.59	0.25	5.53	5.59	0.06
Switzerland	1.44	1.81	0.37	3.38	3.46	0.08
Sweden	4.22	4.38	0.16	6.17	6.38	0.21
Weighted-average foreign	3.70	3.88	0.18	5.17	5.18	0.01
United States	5.67	5.66	-0.01	6.10	5.95	-0.15

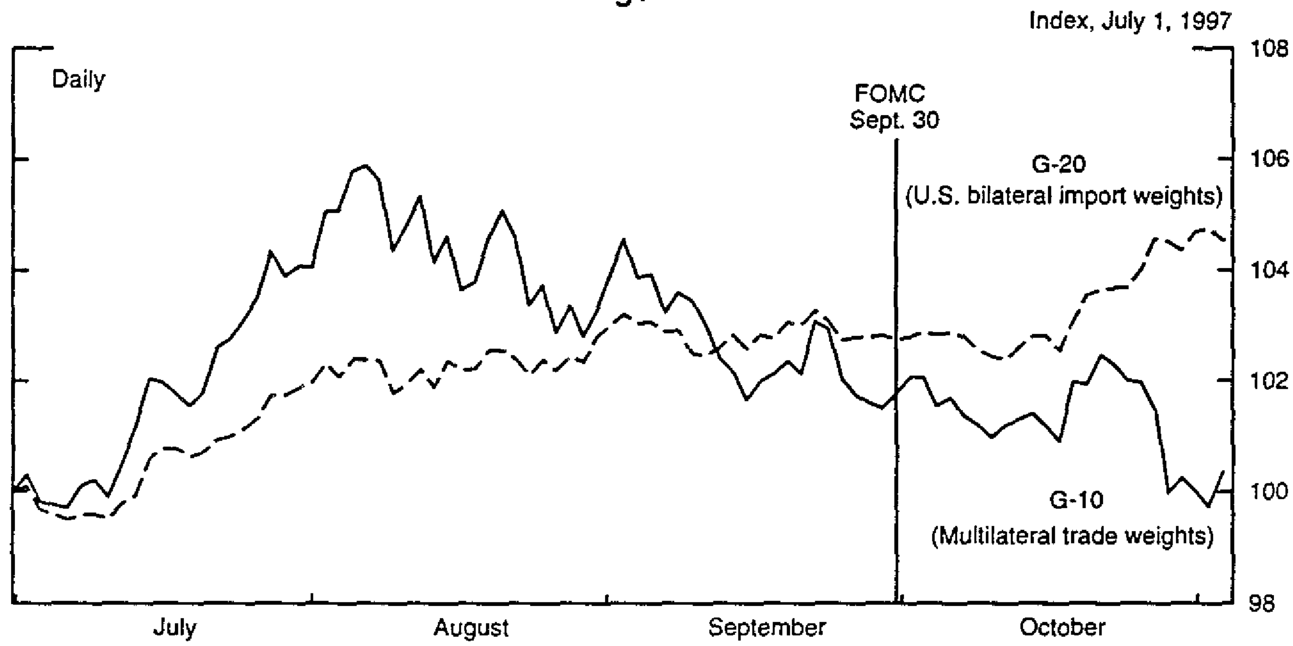
Note. Change is in percentage points.

developing economy currencies has risen more than 1-1/2 percent. Among the currencies in the broader index, the dollar's biggest gains have come against the Thai baht (8-1/4 percent), the Taiwan dollar (7-1/2 percent), the Korean won (5-3/4 percent), and the Mexican peso (5-1/2 percent). The baht came under renewed pressure amid disappointment with the financial reform package announced by the government and some subsequent doubts that Thailand will be able to deliver on the promised reforms. These pressures spilled over into the market for the Indonesian rupiah, which had been down more than 13 percent before recovering substantially following the announcement that Indonesia had reached an agreement with the IMF on a 3-year reform plan.

. The Taiwan dollar moved down following an announcement on October 17 that Taiwanese authorities had decided to let market forces determine the exchange value of their currency. This decline appears to have triggered the pressures on the Hong Kong dollar that arose during the period. Following actions on October 23 by the Hong Kong Monetary Authority to defend the peg of the Hong Kong currency to the U.S. dollar, short-term interest rates in Hong Kong soared to levels in the triple digits. The peg has held so far, and rates have since come back down, although at maturities beyond overnight they are still well above their pre-crisis levels. Pressures on Latin American currencies developed near the end of the intermeeting period, and Brady bond stripped yield spreads over U.S. Treasuries for Mexico, Argentina, and Brazil shot up 200 to 400 basis points before retracing about half of these increases.

The price of gold has declined about 3-1/2 percent on balance during the intermeeting period. The price had dropped further to a 12-year low, following an announcement by a Swiss commission recommending that the Swiss National Bank sell 1,400 metric tons of its monetary gold reserves (about $14 billion equivalent). Swiss government statements that only about 800 tons might be sold led to a partial rebound in the price of gold.

Dollar Exchange Rate Indices



Equity Price Changes
(as of close on November 4, 1997)

	Percent Changes From:		
	January 2, 1997	July 1, 1997	September 29, 1997
Thailand	-40.4	-15.9	-13.0
Indonesia	-22.5	-32.4	-9.4
Malaysia	-41.0	-32.7	-10.3
Singapore	-20.4	-13.4	-9.4
Philippines	-40.4	-33.2	-8.6
Taiwan	13.7	-13.5	-11.8
Korea	-17.1	-28.5	-13.3
Hong Kong	-18.4	-28.4	-27.5
Germany	29.1	-1.6	-7.2
Japan	-15.2	-18.2	-8.3
United Kingdom	20.7	3.6	-6.2
France	23.0	-5.8	-7.2
Mexico	44.5	7.7	-7.9
Argentina	10.6	-13.6	-14.4
Brazil	47.4	-21.1	-11.7
United States	26.8	6.0	-1.0

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

Developments in Foreign Industrial Countries

Available third-quarter data indicate robust growth in major industrial countries, except Japan. The Canadian and U.K. economies are continuing to grow rapidly, while economic expansion is solidifying in Germany, France and Italy. The Japanese economy has shown some signs of bounceback in the third quarter from a particularly weak second quarter, but serious concerns remain about the sustainability of the Japanese recovery.

The quickening pace of growth has raised concerns about inflationary pressures in some countries, but inflation rates remain low. In September, consumer-price inflation eased a bit in Germany and Canada after upticks during the summer. Japanese inflation has moved higher due to increased health insurance copayments, but underlying Japanese inflation remains subdued.

Individual country notes. In **Japan**, economic indicators suggest some improvement, following the sharp drop in domestic demand during the second quarter. There is evidence of a modest rebound in consumption: household expenditures during the third quarter were up 2½ percent (SAAR), and September new car registrations increased sharply. Industrial production, however, was down slightly during the third quarter, and housing starts registered large declines. The Bank of Japan's September Tankan survey suggested that business sentiment has become more pessimistic. Relative to the June survey, diffusion indices across all classes of firms fell sharply and forecasts of profit growth during FY1997 declined. Large manufacturers, however, were somewhat more positive than other classes of firms, apparently reflecting their greater access to foreign markets, where Japanese exports have been very competitive.

Twelve-month consumer-price inflation rose to 2.2 percent in September and 2.3 percent in October, reflecting an increase in copayments under reforms to the National Health Insurance System, but underlying inflationary pressures continue to be subdued. The September unemployment rate was unchanged at 3.4 percent.

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Industrial Production	2.5	-0.1	-0.6	1.7	-3.0	1.6	n.a.
Housing Starts	-11.5	-5.2	-10.8	-7.6	5.6	0.9	n.a.
Machinery Orders	-3.1	6.0	n.a.	0.6	-2.9	n.a.	n.a.
New Car Registrations	2.3	-23.9	4.8	1.6	-4.9	10.8	n.a.
Unemployment Rate (%)	3.3	3.4	3.4	3.4	3.4	3.4	n.a.
Job Offers Ratio[1]	0.74	0.73	0.72	0.74	0.72	0.71	n.a.
Business Sentiment[2]	2	7	...	...	...	...	...
CPI (Tokyo area)[3]	0.0	1.5	1.7	1.4	1.6	2.2	2.3
Wholesale Prices[3]	1.4	2.6	2.0	1.8	2.1	2.0	n.a.

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, NSA.

Japan's trade surplus declined slightly during the third quarter. Exports remained strong, but import volumes strengthened somewhat--another indication that consumption may be starting to recover.

Economic activity in **Germany** appears to have continued to advance at a brisk pace in the third quarter. Although industrial production declined in August and September following a sharp increase in July, it was up about 1½ percent for the quarter as a whole, and the September figure is expected to be revised up. Meanwhile, forward-looking indicators are quite positive. Orders were up 2½ percent in the July-August period relative to the second quarter, and the IFO business climate survey, an indicator of current and expected conditions in industry, rose significantly further in the third quarter. However, conditions in the labor market remain stagnant, with the all-German unemployment rate rising to 11.8 percent in October. CPI inflation rose over the summer but has fallen back recently.

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Industrial Production	0.3	1.0	1.4	3.9	-4.9	-1.6	n.a.
Orders	1.1	3.9	n.a.	1.0	1.2	n.a.	n.a.
Unemployment Rate (%)	11.2	11.3	11.6	11.5	11.6	11.7	11.8
Western Germany	9.8	9.9	9.9	9.8	9.9	9.9	9.9
Eastern Germany	17.0	17.5	18.8	18.3	18.8	19.2	19.4
Capacity Utilization[1]	84.1	85.1	86.0	...	...	...	...
Business Climate[1,2]	1.3	6.7	16.0	13.0	16.0	19.0	n.a.
Consumer Prices[3]	1.7	1.6	1.9	1.9	2.1	1.9	n.a.

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.

In late October, the autumn forecast from Germany's six economic research institutes projected real GDP growth of 2.4 percent in 1997 and 2.8 percent in 1998 (on an annual average basis). The institutes projected that inflation will remain modest, with the consumer price index rising less than 2 percent in 1997 and 1998. Despite the positive economic conditions, the institutes expect no significant improvement in labor market conditions, with unemployment remaining around current levels and an unemployment rate of 11.5 percent on average in 1998. The institutes predicted that Germany would register a fiscal deficit of 3 percent of GDP in 1997 and that monetary union would commence on schedule in 1999 with a broad group of European countries participating. The institutes' forecast was conditioned on an additional small increase in short-term interest rates before May 1998, with no further change later in the year.

In **France**, economic activity appears to have expanded at a robust pace in the third quarter on continued strength in net exports and a sharp increase in consumption. Industrial production surged in July-August on a broad-based increase in all categories of production, except energy. Business surveys attributed increased production primarily to foreign demand. Consumption of manufactured products rose 2½ percent during the third quarter, likely reflecting a 4-percent hike in the minimum wage and buoyant consumer confidence. Inflation pressures remained subdued as consumer prices in September were 1.3 percent above their year-earlier level.

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Consumption of Manufactured Products	0.8	-0.4	2.6	6.2	-1.9	-1.5	n.a.
Industrial Production	0.2	2.3	n.a.	2.8	0.0	n.a.	n.a.
Capacity Utilization	83.6	83.5	n.a.	...	...	...	...
Unemployment Rate (%)	12.5	12.5	12.5	12.5	12.5	12.5	n.a.
Business Confidence[1]	10.3	8.3	14.5	11.0	...	18.0	17.0
Consumer Prices[2]	1.5	0.9	1.3	1.0	1.5	1.3	n.a.

1. Percent balance of manufacturing firms citing an improvement in the outlook versus those citing a worsening; no August survey conducted.
2. Percent change from previous year.

In **Italy**, GDP rose a revised 6.7 percent (SAAR) in the second quarter. The accelerated pace of growth was due, for the most part, to strong durable goods purchases and positive calendar effects (due to two more working days in the quarter than usual). Private consumption and inventories rose, mostly in response to the passthrough effects of the government's tax incentive scheme on auto purchases. Business fixed investment and government expenditures remained flat, however, and net exports contributed negatively to growth.

Third-quarter indicators generally suggest further expansion. In July-August, industrial production rose relative to the second quarter. Consumer confidence reached its highest quarterly average since the first quarter of 1992, and business sentiment rose in July and August. Inflation remains low.

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

	1995	1996	1996		1997	
	Q4/Q4	Q4/Q4	Q3	Q4	Q1	Q2
GDP	2.3	0.3	2.9	-0.7	-1.1	6.7
Private Consumption	1.6	1.0	0.8	2.1	2.7	2.1
Investment	7.9	-1.6	-1.9	-2.0	-1.5	0.0
Government Consumption	-0.7	0.8	1.4	0.1	-0.7	0.5
Exports	4.9	3.4	11.2	-4.0	-15.6	40.2
Imports	5.6	-0.8	11.3	13.4	-13.1	55.5
Total Domestic Demand	2.4	-0.7	2.6	3.2	0.1	8.2
Net Exports (contribution)	0.0	1.0	0.5	-3.6	-1.2	-1.2

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Industrial Production	1.4	2.2	n.a.	-0.1	0.5	n.a.	n.a.
Cap. Utilization (%)	76.2	77.7	77.7	...	...	...	...
Unemployment Rate (%)	12.2	12.4	12.1	...	...	...	...
Consumer Confidence[1]	109.2	108.8	117.2	114.1	117.8	119.7	116.1
Bus. Sentiment[2] (%)	20.0	13.7	n.a.	15.0	21.0	18.0	n.a.
Consumer Prices[3]	2.4	1.6	1.5	1.6	1.5	1.4	1.6
Wholesale Prices[3]	0.6	-0.4	n.a.	-0.1	0.9	n.a.	n.a.

1. Level of index, NSA.
2. Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.
3. Percent change from previous year.

On September 26, the government presented its 1998 budget proposal to parliament. The proposal includes a total of $15 billion equivalent in deficit cutting measures, with roughly $3 billion of the planned reductions arising from lower welfare spending. On October 9, Prime Minister Romano Prodi resigned after the Communist Refoundation Party (CRP)--which adamantly opposes welfare cuts and on which the coalition government relies to have absolute control in the lower house of parliament--temporarily withdrew its support.

On October 16, President Scalfaro revoked the resignation of Prime Minister Romano Prodi, as the government reached a deal with the CRP over the budget. The accord includes a $290 million reduction in spending cuts (approximately ten percent of the planned cuts in the 1998 deficit) and the reduction of the work week to 35 hours by 2001. The agreement restores Italy's prospects to be an entry member of EMU as it virtually ensures the passage of the 1998 budget through both houses of the parliament.

Economic activity in the **United Kingdom** continued at a robust pace in the third quarter, with the preliminary GDP estimate indicating real growth of 4 percent (SAAR), the same rate as in the second quarter. Growth was strong in both the service and production sectors. The average volume of retail sales increased 1 percent in the third quarter. A sharp drop in sales in September largely reflected special factors, including especially low sales during the week leading up to the funeral of Princess Diana and unseasonably warm weather. There was also reduced consumer spending out of building society windfalls in September. The Office of National Statistics estimated that without the special factors, spending would have been little changed in September and would have risen about 1.6 percent in the third quarter.

Retail prices excluding mortgage interest payments rose 2.7 percent over the year to September, still somewhat above the government's inflation target of 2½ percent for underlying inflation. Producer input prices continued to decline in the third quarter, reflecting the strength of sterling. Conditions in the labor market continued to tighten. The official claimant unemployment rate dropped further in September to 5.2 percent, the lowest rate since August 1980. The unemployment rate derived from the Labor Force Survey for the June-August period was 7.1 percent. Growth of annual nominal earnings remains moderate; when earnings are adjusted for the impact of bonuses, the rate of growth in underlying earnings has been largely unchanged at slightly under 4½ percent since early this year. However, this rate is up from the 3.75 percent rate in the first half of last year.

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
Real GDP (AR)	3.4	4.0	4.0	...	...	...	...
Non-oil GDP (AR)	3.7	4.0	n.a.	...	...	...	...
Industrial Production	-0.0	0.6	1.3	1.0	-0.7	-0.3	n.a.
Retail Sales	1.1	1.9	1.0	0.5	0.3	-1.9	n.a.
Unemployment Rate (%)	6.3	5.8	5.3	5.5	5.3	5.2	n.a.
Business Confidence[1]	18.3	17.7	18.0	21.0	16.0	17.0	20.0
Consumer Prices[2]	2.9	2.6	2.8	3.0	2.8	2.7	n.a.
Producer Input Prices[3]	-7.1	-9.6	-8.4	-8.9	-8.5	-7.8	n.a.
Average Earnings[3]	4.6	4.3	n.a.	4.5	4.5	n.a.	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.

On October 27, Chancellor of the Exchequer Gordon Brown announced in Parliament that "it is not in this country's interest to join in the first wave of EMU starting on 1st January 1999" and "barring some fundamental and unforeseen change in economic circumstances" a decision to join within the life of the current parliament "is not realistic." Chancellor Brown also stated that "if a single currency works and is successful Britain should join it," and said that Britain should begin to prepare so a decision can be made to join a successful single currency early in the next Parliament, due by 2002.

The **Canadian** economy showed signs of continued strong growth in the third quarter. Monthly GDP at factor cost was 4 percent higher (at an annual rate) in the July/August period than its second quarter average. While August retail sales data and September employment data were a bit weaker than expected in the headline data, a closer reading showed strength in both reports. Retail sales contracted 0.1 percent overall, but rose 0.7 percent excluding the volatile auto sector. Employment grew only 0.1 percent, but there was a significant shift of jobs from part-time to full-time.

August trade data provided another sign of strong domestic demand, with the trade surplus shrinking due to rapid import growth.

The Canadian Finance Ministry issued its mid-year economic and fiscal update on October 15. It was announced that the 1996/97 federal budget was in deficit by only C$8.9 billion, well below the original target of C$24.3 billion and the most recent government estimate (in May 1997) of about C$16 billion. The government has projected fiscal balance by in the 1998/99 fiscal year, but it is on a path to achieve balance before then. Although the government did not change its 1997/98 target of a C$14 billion deficit, monthly budget data show tax receipts running 10 percent above year-ago levels and spending 5 percent below year-ago levels, so that the budget may well be in surplus this fiscal year.

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

	1997						
	Q1	Q2	Q3	Jul	Aug	Sep	Oct
GDP at Factor Cost	0.9	1.1	n.a.	0.8	0.0	n.a.	n.a.
Industrial Production	0.7	1.6	n.a.	2.1	-0.5	n.a.	n.a.
Manufacturing Survey: Shipments	2.9	0.9	n.a.	4.1	-2.3	n.a.	n.a.
New Orders	4.5	1.4	n.a.	7.5	-2.4	n.a.	n.a.
Retail Sales	2.1	1.6	n.a.	1.4	-0.1	n.a.	n.a.
Housing Starts	19.9	-6.3	n.a.	2.8	2.3	n.a.	n.a.
Employment	0.3	0.9	0.8	0.1	0.4	0.1	n.a.
Unemployment Rate (%)	9.6	9.4	9.0	9.0	9.0	9.0	n.a.
Consumer Prices[1]	2.1	1.6	1.7	1.8	1.8	1.6	n.a.
Consumer Attitudes[2]	108.0	116.7	119.3	...	...	...	...
Business Confidence[3]	160.1	165.0	164.9	...	...	...	...

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

In **Greece**, the "hard drachma" policy of pegging to the ECU came under speculative attack in late October, forcing a sharp rise in Greek short-term interest rates. Under the ECU peg, Greece has seen a decline of inflation from 9 percent in 1995 to 4.9 percent in September 1997, a 25-year low, but the current account deficit has widened from 2.5 percent of GDP in 1995 to 3.7 percent in 1996 and has widened further in the first half of 1997.

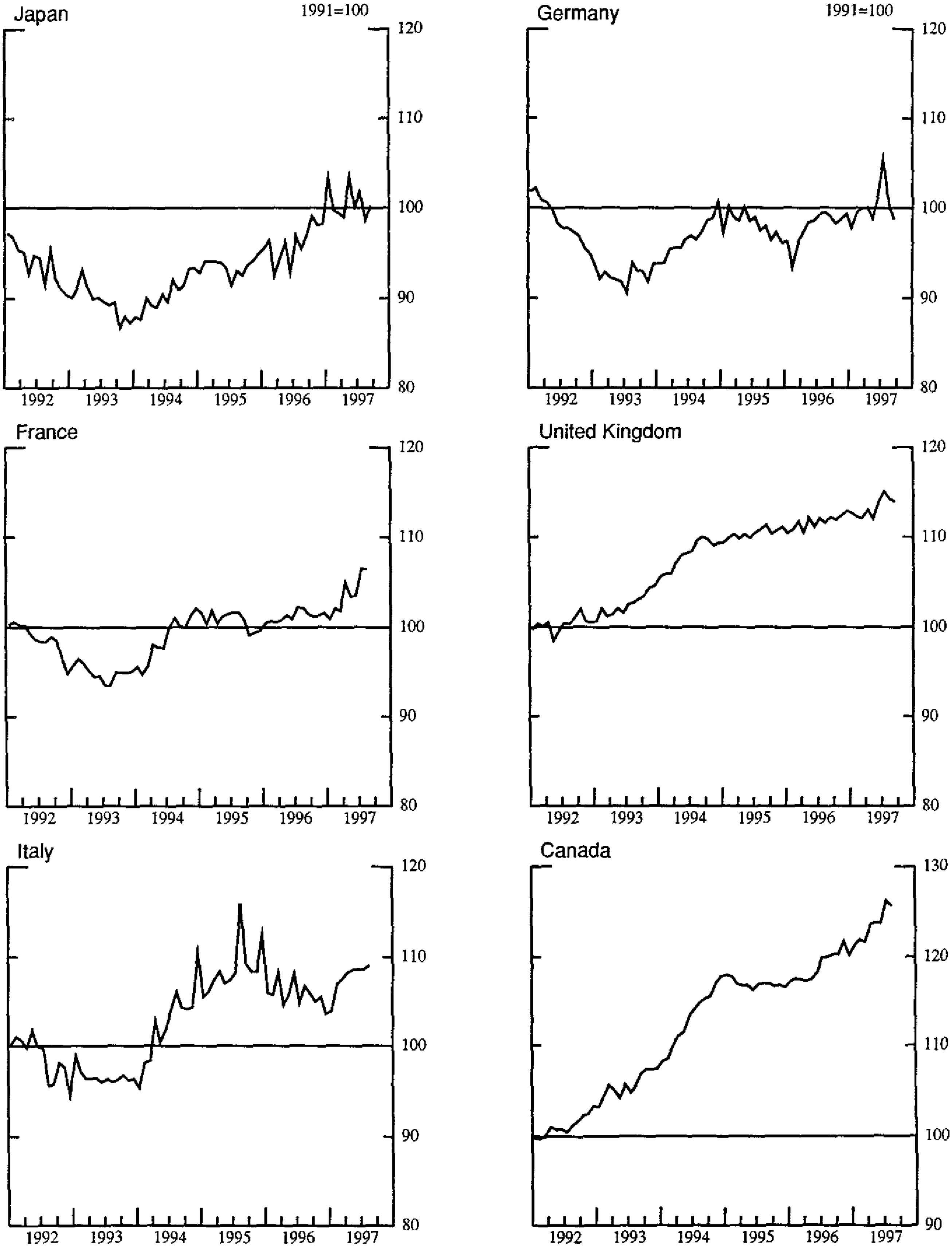
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1996	1997						
		Q1	Q2	Q3	Jun	Jul	Aug	Sep
Japan: trade	61.4	12.9	23.3	21.7	7.6	6.3	9.1	6.2
current account	65.9	15.4	26.4	n.a.	8.3	8.1	10.2	n.a.
Germany: trade[1]	65.4	14.7	19.3	n.a.	7.6	6.2	4.7	n.a.
current account[1]	-13.1	-5.8	2.9	n.a.	2.7	-1.5	-2.8	n.a.
France: trade	17.4	5.5	8.8	n.a.	3.2	3.5	1.8	n.a.
current account	21.9	8.9	11.2	n.a.	3.2	4.1	n.a.	n.a.
U.K.: trade	-19.0	-3.0	-4.1	n.a.	-1.6	-1.1	-0.8	n.a.
current account	0.0	2.7	1.5	n.a.	...	...	...	...
Italy: trade	44.5	8.7	7.9	n.a.	1.8	n.a.	n.a.	n.a.
current account[1]	41.1	8.8	7.0	n.a.	2.3	n.a.	n.a.	n.a.
Canada: trade	30.0	6.0	4.2	n.a.	1.6	1.2	1.0	n.a.
current account	2.8	-0.6	-2.3	n.a.	...	...	...	...

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

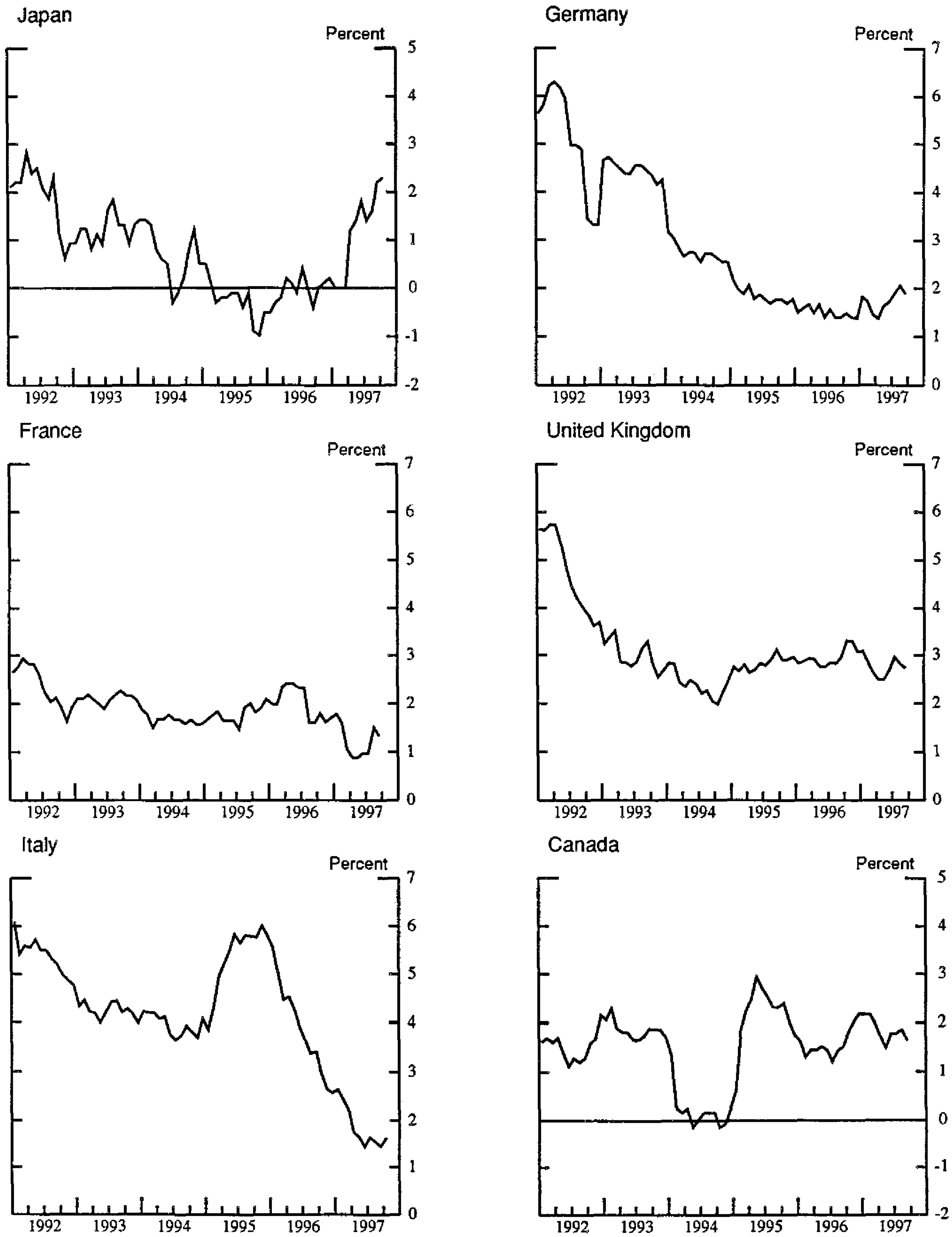
NOVEMBER 5, 1997

Industrial Production in Selected Industrial Countries



NOVEMBER 5, 1997

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



Economic Situation in Other Countries

In the major Asian and Latin American countries growth has remained steady, and inflation to date is low to moderate. With the exception of Thailand, the financial crises that erupted in Southeast Asia during the summer and have since spread have yet to yield discernable indications of a slowdown of activity in the region. External balances in most Latin American countries have deteriorated.

Southeast Asia's financial market crises have moved north to Northeast Asia and, to a certain extent, have spilled over to other emerging markets as well. Many of the ASEAN currencies and some Latin American currencies have depreciated against the dollar or come under downward pressure. Policy responses to the currency turmoil have differed across countries.

Individual country notes. **Thailand's** prime minister announced that he would resign on November 6, after less than a year in office. It has been reported, but not yet officially confirmed, that the new Prime Minister is opposition leader Chuan Leekpai. It is not clear how long any new prime minister might be asked to serve; the Thai Parliament is scheduled to vote on election laws under a new Constitution this week and an election could be held early next year.

The political instability has made it difficult to move forward with implementation of the reforms envisaged under the country's IMF program. On October 14, the government announced a financial reform package, the core elements of which were to: (1) establish a financial restructuring agency to supervise and restructure 58 finance companies, and set the terms of repayment for depositors and creditors of those companies; (2) establish an asset management agency to act as a "bad loans" bank; (3) offer deposit insurance to the surviving finance companies and commercial banks; (4) raise the cap on foreign equity participation in Thai financial institutions to allow majority control on a case-by-case basis for a ten-year period; (5) tighten loan classification rules starting December 1997; (6) set conditions under which suspended finance companies will be allowed to re-open--they must meet a 15 percent capital adequacy requirement, with an independent audit by an internationally recognized firm to verify that this requirement is met; and (7) state that there would be no discrimination between domestic and foreign creditors to suspended institutions.

The financial reform package won qualified support from the IMF but fell short of market expectations. Market concern was due to the lack of specifics about how much the package would cost, who would pay for it, and when it would be implemented. The government's ability to meet its fiscal targets is also becoming doubtful, in part because the Thai cabinet rescinded an oil tax hike that was intended to raise a substantial part of the new revenues needed to meet fiscal targets under the IMF package.

Thailand's economic indicators are starting to show the impact of the financial crisis and the political turmoil. According to indicators released by the Bank of Thailand, an index of manufacturing activity declined at an annual rate of 5 percent in August, with particularly sharp declines in interest-sensitive sectors such as vehicles and transportation production. Private investment also slowed down, driven by a significant reduction of investment in the construction sector.

On November 1, **Indonesian** authorities announced the elements of an IMF-led assistance plan to be implemented over a three-year period. There are four main elements of the program. First, the program's exchange rate policy is aimed at reversing some of the rupiah's depreciation, or at least preventing its further depreciation, initially through partially sterilized intervention. Second, the plan calls for financial sector restructuring through bank closures and regulatory reforms. Third, the fiscal program aims for a surplus this fiscal year (ending March 31, 1998) and next, primarily to cover the current cost of bank restructuring. Fourth, various structural measures, such as the elimination of some monopolies and the gradual reduction of import tariffs, are planned to improve the functioning of the Indonesian economy.

Indonesia's reform package is backed by financial support from numerous sources. IMF Managing Director Camdessus stated that the "first line of defense" is a package consisting of loans from the IMF ($10 billion over three years), the World Bank, the Asian Development Bank and "part of Indonesia's own substantial external assets." The United States and other countries are providing contingent additional financial support that could be made available for a temporary period, if necessary to supplement the resources made available by the IMF package. The United States is prepared to provide up to $3 billion in assistance from the Exchange Stabilization Fund.

On the day after the announcement of the IMF package, the Finance Minister announced that the government was closing 16 banks that "are insolvent to the point of endangering business continuity, disturbing the overall banking system, and harming the interests of society." The government intends to reimburse depositors for up to 20 million rupiah ($5,555) per account, which covers over 90 percent of depositors.

On November 3, the Monetary Authority of Singapore, the Bank of Japan and Bank Indonesia intervened in the Singapore forex market; the rupiah strengthened about 9 percent against the dollar following the concerted intervention. In a statement confirming the operations, Singapore's Finance Minister said "the depreciation of the rupiah in recent months is excessive. Today's joint intervention is aimed at promoting a strengthening of the rupiah to levels more consistent with the fundamentals of the Indonesian economy." Japan's Finance Minister and Indonesia's Finance Ministry issued similar statements.

To add to the troubles in the **ASEAN** region, smoke from forest fires--set on the Indonesian islands of Borneo and Sumatra to clear land for crops--have continued to spread from Indonesia into other ASEAN countries, mingling with urban air pollution. The haze has affected economic activity as a result of disruptions in transportation, loss of working days as people have fallen ill with respiratory ailments, and loss of tourism revenues.

The **Malaysian** Finance Minister presented a belt-tightening budget to allay market concerns about the rapid credit growth in the economy and the burgeoning current account deficit. The key measures are to: (1) defer several infrastructure projects; (2) raise import duties on heavy construction equipment 5-10 percentage points; (3) raise employers' Provident Fund contributions by 2 percentage points to 19 percent; and (4) cut corporate taxes two percentage points to 28 percent.

In the **Philippines**, the government has been attempting to follow an IMF program under difficult circumstances. Over the last few months the authorities have attempted to bolster the peso through direct intervention in the spot market; forward transactions with commercial banks (in limited amounts); direct restrictions such as suspension of nondeliverable forward contracts to nonresidents; and somewhat erratic attempts at tightening liquidity either by increasing official interest rates or raising reserve requirements. These measures have had limited success in preventing a slide of the peso. On October 7, the Bankers Association introduced a volatility band for the peso/dollar rate with the intent of limiting movements in the exchange rate to 4 percent in either direction on any day.

An important element of the IMF program with the Philippines is passage of a comprehensive tax reform bill, which is currently languishing in the legislature. According to news reports, the IMF has urged the Philippine authorities to look for alternate sources of revenue to offset possible losses if legislators dilute the proposed package.

In **Korea**, industrial production in August grew by about 8-1/2 percent from year-earlier levels. Inflation remained moderate in September. Korea's trade surplus in August was $0.1 billion, compared with a deficit of $2.9 billion in the same month last year; the current account deficit was $0.7 billion, compared with $3.5 billion a year ago.

The health of the Korean financial sector continues to be a source of concern. The government announced a plan for restructuring the financially strapped Kia Group. Meanwhile, the parade of near-bankruptcies that started in February this year continued in mid-October, with the country's largest computer parts maker facing serious cash flow problems; creditors have extended $12 million in emergency loans to the company and granted a grace period for debt repayment. Sangyong Group, the country's sixth-largest conglomerate, is also said to be facing cash flow problems, which may have motivated its recent decision to agree to sell a controlling share of its paper company to Proctor & Gamble.

There has been substantial pressure on the Korean won in the wake of these domestic financial troubles and some spillover effects from the currency crisis in the rest of Asia. The won has depreciated about 8 percent since July 1 and by nearly 15 percent since the start of the year. Overnight interest rates are about 150 basis points above their July 1 level, whereas the yield on three-year corporate bonds, a benchmark long-term interest rate, has edged up by over 100 basis points.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	6.8	5.3	6.3	n.a.	...	...	...
Industrial Production	8.4	7.0	9.7	n.a.	7.9	8.6	n.a.
Consumer Prices	5.0	4.7	4.0	4.0	3.7	4.0	4.2
Trade Balance[1]	-15.3	-5.4	-0.8	n.a.	-0.3	0.1	n.a.
Current Account[1]	-23.7	-7.9	-3.0	n.a.	-1.0	-0.7	n.a.

1. Billions of U.S. dollars, NSA

In **Taiwan**, industrial production grew strongly in the third quarter, while consumer prices remained relatively flat. Strong import growth contributed to a narrowing of Taiwan's trade surplus in the first nine months of 1997, compared with the comparable period last year. Exports rose 5 percent over this period, while imports rose 10 percent. Import growth was particularly strong in the third quarter, rising 19 percent from the year-earlier period.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	5.7	6.8	6.3	n.a.	...	...	...
Industrial Production	1.6	5.4	6.2	7.4	4.0	7.3	9.0
Consumer Prices[1]	2.5	1.1	1.8	0.6	3.3	-0.6	0.6
Trade Balance[2]	14.3	1.8	1.7	2.0	0.5	0.3	1.1
Current Account[2]	10.5	1.9	1.0	n.a.	...	...	...

1. End of period
2. Billions of U.S. dollars, NSA

Following speculative pressure on Taiwan's currency and a 23 percent decline in the stock market since late August, authorities announced on October 17 that they would no longer defend the Taiwanese dollar. Taiwan's currency depreciated about 6 percent against the U.S. dollar, bringing total depreciation of the currency since July to about 10 percent. At the end of September, international reserves were $86 billion, down $2 billion from a month earlier. According to press reports, Taiwan's central bank governor has indicated that reserves probably fell by another $4-5 billion in the first half of October.

In **Hong Kong**, GDP grew 6.1 percent in the first quarter of 1997 (the latest period available) from a year earlier, and the current account has been roughly in balance. Nevertheless,the spread between U.S. and Hong Kong interest rates widened by 1-2 percentage points beginning in mid-July. In addition Hong Kong's stock market came under downward pressure in September. Following Taiwan's currency depreciation, speculative pressure mounted against the Hong Kong dollar. After intervening to support the Hong Kong dollar for several days the Hong Kong Monetary Authority countered exchange market pressure by tightening liquidity conditions on October 23, when overnight interest rates temporarily reached more than 250 percent. Overnight rates soon came back down, but the spread between the U.S. notes and Hong Kong notes remained. As of November 4, the Hang Seng stock market index was down 35 percent from its peak in August, and down 20 percent for the year. The property component of the Hang Seng fell even further to a two-year low. Historically, the property component is a statistically significant predictor of future property price movements.

On October 30, Moody's downgraded its outlook for Hong Kong banks from stable to negative, reflecting concern that higher interest rates and lower property prices would reduce bank profitability. As of June 1997, local property loans accounted for 43 percent of the domestic loans of Hong Kong banks and about 20 percent of total (domestic and foreign) loans of those banks.

In **China**, output growth has continued to moderate in 1997, while inflation has remained low. For the first three quarters, GDP rose 9.0 percent from the year-earlier period. (For the third quarter alone, Chinese statistical authorities report only that GDP grew "an estimated 8 percent" from the year-early period.) In the first nine months of 1997, surging exports led to a trade surplus of nearly $31 billion, compared with a surplus of $8 billion in the year-earlier period. The value of exports rose 24 percent while the value of imports rose 3 percent from the year-earlier period. Although no details are available on the components of GDP, the strength of net exports, combined with moderating GDP, suggests a weakening of domestic demand.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP[1]	9.7	9.4	9.5	9.0	...	...	...
Industrial Production	15.6	13.0	14.2	n.a.	10.0	13.0	n.a.
Consumer Prices[2]	7.0	4.0	2.8	1.8	2.7	1.9	1.8
Trade Balance[3]	12.2	6.8	11.0	12.8	2.8	5.0	5.1

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

The People's Bank of China cut interest rates on both loans and deposits in October 1997. The one-year deposit rate, for example, which stood at 11 percent from the middle of 1993 through April 1996, currently stands at 5.7 percent.

So far, China has remained relatively unaffected by the current financial crisis in Asia. China's exchange rate has remained stable against the U.S. dollar, while foreign exchange reserves have risen steadily; through September, foreign exchange reserves were up $29 billion for the year, reaching a level of $136 billion. China's currency is not convertible on the capital account, making a speculative attack difficult.

Mexico's economy apparently continued to grow strongly in the third quarter. The unemployment rate declined to levels prevailing before the 1995 recession, while seasonally adjusted industrial production in July and August averaged 3.4 percent above its second quarter level. The rise in the construction component of the industrial production index was particularly marked, pointing to the increasing importance of domestic demand in the recovery. Notwithstanding continued growth, monthly consumer price inflation remained subdued in July and August, while an uptick in September reflected seasonal pressures associated with the new school year: inflation subsequently dropped in the first half of October.

The trade balance moved into deficit in the third quarter for the first time since the 1994 devaluation, reflecting both the growth of domestic demand and the continued real appreciation of the peso during that period. In spite of these developments, export growth remained strong, although it has slowed from earlier high rates.

Mexican financial markets experienced significant downward pressures following the sharp sell-offs in the Hong Kong stock market and their spillover into other markets around the globe on October 27. Since October 22, Mexican stock prices have declined about 8 percent on balance, the exchange rate has depreciated by about 6 percent to 8.2 pesos per dollar, and 28-day interest rates have climbed by about 170 basis points to 18.95 percent at the most recent Treasury bill auction. Additionally, spreads on Mexican Brady bonds, adjusted for collateral, have climbed about 130 basis points.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	5.1	5.1	8.8	n.a.	...	...	...
Industrial Production	10.4	6.3	11.3	n.a.	9.9	8.2	n.a.
Unemployment Rate (%)	5.5	4.3	3.9	3.7	4.1	3.5	3.4
Consumer Prices[1]	27.7	5.6	2.9	3.0	0.9	0.9	1.2
Trade Balance[2]	6.3	1.5	0.6	-0.3	0.0	-0.1	-0.2
Imports[2]	89.6	23.5	26.8	28.4	9.4	9.1	10.0
Exports[2]	95.9	25.0	27.4	28.2	9.4	9.0	9.8
Current Account[2]	-1.9	-0.3	-1.4	n.a.	...	...	...

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

In **Argentina**, output growth continues to be strong; industrial production rose 15.1 percent in September over a year ago, although partially this high number is a result of a general strike in September 1996. Inflation remains non-existent. Strong imports of capital goods have led to a trade deficit of $0.8 billion over the period from January to August, compared with a surplus of $1.8 billion over the same period a year ago.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	4.3	8.1	7.8	n.a.	...	...	...
Industrial Production (SA)	3.4	8.0	8.0	9.3	6.8	5.9	15.1
Unemployment Rate (%)[2]	17.2	...	16.1	...	...	...	...
Consumer Prices[1]	0.1	0.4	-0.2	0.4	0.2	0.2	0.0
Trade Balance[3]	1.6	-0.4	0.0	n.a.	-0.3	-0.4	n.a.
Current Account[3]	-4.0	-2.4	n.a.	n.a.	...	...	...

1. Percentage change from previous period.
2. Unemployment figures available only in May and October of each year. The annual figure is the average of the two surveys.
3. Billions of U.S. dollars.

In the Argentine congressional elections on October 26 the Peronists party lost substantial ground and its majority in the lower house to the Alliance formed by the two leading opposition parties. The balance of power is now in the hands of the small provincial parties. The Peronists still control the Senate, in which there were no elections this year. Alliance gains were expected due to voter concerns about high unemployment (currently over 16 percent) and corruption. The Alliance has vowed to support the free-market reforms and currency convertibility and no short-term changes in economic policies are expected.

The Argentine blue-chip Merval stock index fell by roughly 25 percent over the period October 23-30. Since then, it has recovered partially, closing on November 3 at 16 percent below its value on October 23. International reserves (excluding gold) fell over 3 percent between October 24-28 and stood at $18 billion at the end of October, down 5 percent over a month ago, but still up about a third over a year ago. Overnight interbank lending rates were over 13 percent on November 3 and have risen by more than 3 percentage points over the past week. Argentine Brady spreads have increased by about 150 basis points since October 22. These developments have most likely been touched off by events in Asia, rather than the increased uncertainty of the economic outlook following the election results. So far, there is no evidence that these changes have put any pressure on bank deposits.

In **Brazil**, indications are that economic activity moderated in the third quarter after real GDP surged by a whopping 14 percent at an annual rate in the second quarter. Consumer prices changed little in September. Year-over-year, inflation in September was about 4 percent.

Brazil has been experiencing considerable financial turmoil over the past two weeks. Between October 21 and November 4, the Bovespa index fell by about 25 percent on balance. The spread between stripped yields on Brazilian Brady bonds and comparable U.S. Treasuries has risen by nearly 200 basis points. The "real" has come under heavy downward pressure and the Central Bank of Brazil sold, net of repurchases, about $7 billion of its $62 billion in reserves between October 28 and 30. Only a portion of the amount sold has been sterilized, leading to a liquidity squeeze that has sent the 30-day interbank rate from 21 percent to 29 percent on October 29. On October 31, the central bank also raised its minimum discount rate from 21 to 43 percent.

In another show of support for the "real", on October 29 the central bank sold $1 billion in 7-month dollar-indexed bonds at a average rate of 9 percent. However, it canceled its planned auction of 2-year dollar-linked bonds. Since early 1997, the central bank has held several special auctions of dollar-indexed bonds during periods of exchange rate turmoil.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP, s.a.a.r.[1]	2.9	-2.2	13.9	n.a.	...	...	...
Industrial Production (SA)[2]	2.3	-1.6	1.3	n.a.	-1.3	n.a.	n.a.
Open Unemployment Rate (%)	5.4	5.6	5.8	5.8	6.0	6.0	5.6
Consumer Prices[3]	9.4	2.0	1.0	n.a.	0.2	0.0	n.a.
Trade Balance[4]	-5.5	-3.1	-1.7	-2.2	-0.7	-0.3	-1.2
Current Account[4]	-24.3	-6.9	-8.8	n.a.	-2.8	-1.9	n.a.

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

Possibly fueling some of the downward pressure on the "real" is the perception that the currency is overvalued and that some realignment is thus needed to restore international competitiveness. The "real" has appreciated by about 25 percent in real terms since mid-1994, when the government began to limit the extent to which the currency would depreciate against the dollar to restrain inflationary pressures. The Cardoso government has announced that it will devote more effort to enacting fiscal reforms that are necessary for long run fiscal and monetary stability, and is expected to announce a package of austerity measures within the next few days.

In **Venezuela**, there are indications that the recent pick-up in economic activity continues as evidenced by a fall of about 1 percentage point in the unemployment rate in the third quarter. The economy grew by 4 percent in the first half of this year, with the non-oil sector growing by 2 percent and the oil sector by roughly 9 percent. Inflation has been on an upward trend since about June this year, partly reflecting increases due to public sector workers as a result of the recent labor reform. The increase in economic activity widened the non-oil trade deficit somewhat for January - July 1997, compared with the same period last year. As a result of contagion effects from the Asian situation, the Caracas stock index has fallen about 10 percent since October 22.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	-1.6	...	...	...	...	...	...
Unemployment Rate (NSA, %)	11.8	12.6	12.1	11.0	...	...	...
Consumer Prices[1]	103.3	6.6	7.5	9.8	2.8	3.3	3.4
Non-oil Trade Balance[2]	-4.8	-1.2	-1.6	n.a.	-0.7	n.a.	n.a.
Trade Balance[2]	13.8	3.3	2.8	n.a.	0.7	n.a.	n.a.
Current Account[2]	8.8	...	...	...	...	...	...

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

In **Russia**, recent economic trends have been favorable. For the third quarter as a whole, real GDP showed an increase from its year-earlier level of 1 percent, while industrial production registered a rise of over 3 percent over the same period. This suggests at least some overall increase in economic activity this year following sharp declines in recent years. The inflation rate has continued to moderate, with the 12-month increase in consumer prices declining to a record low 14 percent in September.

Despite these favorable macroeconomic trends, at the end of October it was announced by the IMF that the current quarterly disbursement under the Fund's EFF agreement with Russia was being withheld, due to a continued substantial shortfall of tax revenues relative to target. Russian Finance Minister Chubais recently acknowledged that in the first nine months of this year actual tax collections had only been slightly over half of the budgeted amount.

Negotiations between the government and the opposition-controlled Duma over the 1998 budget are continuing. At one point President Yeltsin seemed to indicate that the government would withdraw its proposal for a new federal tax code--a key element in the government's fiscal reform measures--as part of an agreement to dissuade the Communist Party and other opposition groups from pursuing a vote of no-confidence in the government. However, subsequent statements by other government officials suggest that the new tax code remains a priority and will not be withdrawn.

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

	1996	1997			1997		
		Q1	Q2	Q3	Jul	Aug	Sep
Real GDP	-6	0	-1	1	0	1	2
Industrial Production	-5	0.9	0.9	3.2	3.4	3.0	3.3
Consumer Prices[1]	1.7	1.7	1.0	0.2	0.9	-0.1	-0.3
Ruble Depreciation[1]	1.5	1.0	0.7	0.6	0.7	0.6	0.4
Trade Balance[2]	23.1	5.9	n.a.	n.a.	n.a.	n.a.	n.a.
Current Account[2]	9.6	3.4	n.a.	n.a.	n.a.	n.a.	n.a.

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

On October 6, Russian officials and representatives of the London Club of commercial banks signed an agreement to restructure over $30 billion of debts owed by the former Soviet Union to foreign bankers.

Russian financial markets have not entirely escaped the fallout from the recent turmoil in emerging country financial markets. While the ruble exchange rate and domestic interest rates have remained relatively stable, stock prices (which had risen more than in any other major market this year) have fallen. The main Russian equity index dropped nearly 20 percent last Tuesday, and, although nearly three-quarters of this decline was reversed the next day, for the week as a whole stock prices were down about 10 percent. (Equity markets in Eastern European countries registered similar declines last week.)