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Part 2

December 14, 1995

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

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Revised data suggest that growth of real GDP in the third quarter may have been even faster than the BEA initially estimated, and labor input in October and November appears to have expanded at a pace sufficient to support at least a moderate advance of real output in the fourth quarter. However, data on expenditures have been somewhat less robust, on the whole, than the labor market indicators. The trends in wage and price inflation appear to be holding steady.

Third-quarter GDP

Source data that have become available since the BEA's advance estimate of real GDP was prepared in late October suggest that growth may have been considerably stronger than initially indicated. Data that were missing in late October have come in on the high side of assumptions that BEA had incorporated into the advance estimate, and revisions to data that already were in hand have tended to run in a positive direction.

STAFF ESTIMATES OF REVISIONS TO THIRD-QUARTER GDP
(Billions of 1987 dollars)

Category	Revision
Real GDP	15.8
Change in business inventories	2.0
Personal consumption expenditures	1.6
Business fixed investment	3.0
Residential structures	-1.4
Federal purchases	.0
State and local purchases	1.9
Net exports	8.7

By our calculations, the new and revised source data would support a total upward revision to third-quarter GDP of about \$16 billion at an annual rate (1987 dollars) raising the net change for the quarter to about \$73 billion, or roughly 5-1/2 percent at an

CHANGES IN EMPLOYMENT¹
(Thousands of employees; based on seasonally adjusted data)

	1993	1994	1995			1995		
			Q1	Q2	Q3	Sept.	Oct.	Nov.
	-----Average monthly changes-----							
Nonfarm payroll employment ²	235	294	226	82	128	94	66	166
Private	215	273	216	70	116	120	82	174
Manufacturing	4	30	18	-32	-35	-35	-19	-32
Durable	3	25	20	-12	-8	-15	-7	-16
Nondurable	0	5	-2	-20	-27	-20	-12	-16
Construction	24	30	30	-9	11	29	23	4
Trade	57	75	20	24	42	68	16	86
Finance, insurance, real estate	19	4	2	-3	9	10	19	14
Services	100	117	130	87	88	61	36	87
Business services	36	46	28	6	52	64	5	8
Total government	20	21	10	12	12	-26	-16	-8
Private nonfarm production workers	194	242	194	54	103	119	124	35
Manufacturing production workers	10	31	16	-31	-26	-25	-19	-19
Total employment ³	209	326	235	-263	218	361	259	-389
Nonagricultural	219	289	179	-181	278	450	77	-210
Memo:								
Aggregate hours of private production workers (percent change)	.3	.4	.1	.0	.2	.5	.6	-.4
Average workweek (hours)	34.5	34.7	34.7	34.4	34.5	34.5	34.6	34.5
Manufacturing (hours)	41.5	42.0	42.1	41.5	41.5	41.7	41.5	41.5

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households. Data for 1994 are not directly comparable with earlier years because of a redesign of the CPS in January 1994.

SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES¹
(Percent; based on seasonally adjusted data)

	1993	1994	1995			1995		
			Q1	Q2	Q3	Sept.	Oct.	Nov.
Civilian unemployment rate (16 years and older)	6.8	6.1	5.5	5.7	5.6	5.6	5.5	5.6
Teenagers	19.0	17.6	16.8	17.2	17.8	17.5	17.1	17.9
20-24 years old	10.5	9.7	8.7	8.8	9.8	10.1	9.5	8.7
Men, 25 years and older	5.8	4.8	4.2	4.4	4.2	4.3	3.9	4.5
Women, 25 years and older	5.4	4.9	4.4	4.5	4.4	4.2	4.5	4.4
Full-time workers	6.8	6.1	5.4	5.6	5.6	5.6	5.4	5.6
Labor force participation rate	66.2	66.6	66.9	66.6	66.6	66.6	66.6	66.4
Teenagers	51.5	52.7	53.9	54.0	53.6	53.6	53.0	52.7
20-24 years old	77.1	77.0	77.3	76.7	76.3	76.1	75.8	76.0
Men, 25 years and older	76.2	76.0	76.4	76.0	75.8	75.9	75.8	75.7
Women, 25 years and older	57.1	58.1	58.2	58.1	58.5	58.4	58.6	58.6

1. Data for 1994 are not directly comparable with earlier years because of a redesign of the CPS in January 1994.

annual rate. As can be seen in the table, inventory accumulation likely was greater than the BEA initially estimated, but most categories of final sales apparently were stronger as well. In terms of 1994 dollars, third-quarter growth of real GDP probably was about 4-1/2 percent, by our rough estimate. The BEA's upcoming revisions will start to feature a "chain-type" GDP index with a "Laspeyres tail" that uses 1994 prices to measure recent changes in real output. Revised data in terms of 1987 dollars will not be reported.

Labor Market Developments

The BLS reported that nonfarm payroll employment rose 166,000 in November after a gain of 66,000 in October. However, interpretation of these data has been complicated by the agency's semiannual updating of seasonal factors, which, according to BLS convention, resulted in new factors being applied to the November level of payroll employment but left previous months' levels of payroll employment in terms of old seasonals. Had consistent seasonals been applied to the data, last month's rise in payroll employment would have been 44,000 smaller than the published figure, but the October gain would have been 42,000 larger. An additional complication is that the November survey date was late this year, so that more of the usual seasonal hiring was picked up in November, rather than December. The BLS estimated that the net effect of the late survey week was to add 25,000 to the November change in total payrolls.¹

1. The BLS said in its November employment release that the federal shutdown from November 14 to November 19 had no effect on data from the establishment survey. Schedules for collecting data in the household survey were disrupted to some extent, but the BLS said that sufficient interviews were conducted to provide an adequate sample and that the quality of the data did not appear to be "materially compromised" by the later-than-scheduled interviews.

According to the published figures, aggregate hours of production or nonsupervisory workers fell 0.4 percent in November after a cumulative gain of 1.1 percent over the two previous months. The average workweek was little affected by the revisions to seasonal factors, and that information, together with the data on payroll employment, points to a fourth-quarter rise in aggregate hours of roughly 2-1/2 percent at an annual rate, an advance sufficient to yield a sizable increase in real GDP if a moderate productivity gain is achieved this quarter. A similar message is conveyed by recent changes in the unemployment rate. Although the jobless rate edged back up to 5.6 percent in November, its average for October and November, using concurrent seasonal factors, was 5.5 percent, a little below the average for the third quarter.

The November detail on payroll employment showed job growth concentrated, once again, in the private service-producing sector. In retail trade, two-thirds of a sizable monthly rise in the published numbers stemmed from the updating of seasonal factors and the late survey. Other broad categories within the private service-producing sector were less affected by these influences.

EFFECT OF SPECIAL FACTORS ON PAYROLL EMPLOYMENT IN NOVEMBER
(Thousands of jobs)

Industry	Published estimate	Combined effect of special factors	Adjusted estimate
Total nonfarm	166	69	97
Mining	-3	1	-4
Construction	4	5	-1
Manufacturing	-32	-6	-26
Trans. & public util.	18	-2	20
Wholesale trade	12	6	6
Retail trade	74	49	25
Fin., insur. & real est.	14	4	10
Services	87	27	60
Government	-8	-15	7

Note. The two special factors are the updating of seasonals and the later-than-usual survey in November.

In the goods-producing sector, employment in construction was little changed in November. In manufacturing, employment fell 26,000 after adjustment for the effects of the aforementioned special factors. The published detail for manufacturing showed further increases in employment in the capital goods sectors. However, temporary layoffs cut into the payrolls of auto manufacturers, and small declines were reported in most other industries. The average workweek for all manufacturing was unchanged in November after having declined in October.

Initial claims for unemployment insurance were pushed up temporarily by the federal shutdown in mid-November. About 31,000 filings by furloughed federal workers were picked up in data for the week ended November 18, an additional 21,000 were taken up the following week, and 15,000 were reported in the first week of December.² Claims filed under state programs, which exclude federal workers, fluctuated relatively narrowly before dropping off in the week ended December 9.

INITIAL CLAIMS FOR UNEMPLOYMENT INSURANCE
(In thousands)

	Nov. 4	Nov. 11	Nov. 18	Nov. 25	Dec. 2	Dec. 9
All regular programs ¹	386	375	414	386	396	--
State programs	381	370	381	364	378	341

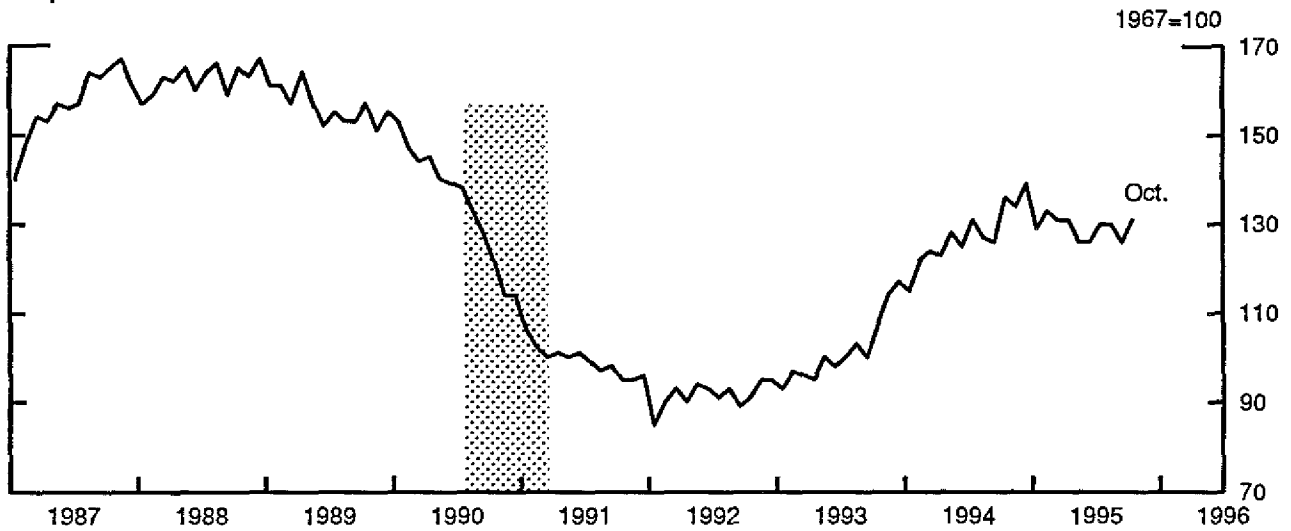
1. All regular programs include claims filed under state programs, federal workers, and ex-servicemen.

No big changes have been evident recently in other indicators of labor demand that we monitor. After dipping in September, the Conference Board's help wanted index turned up in October; the index

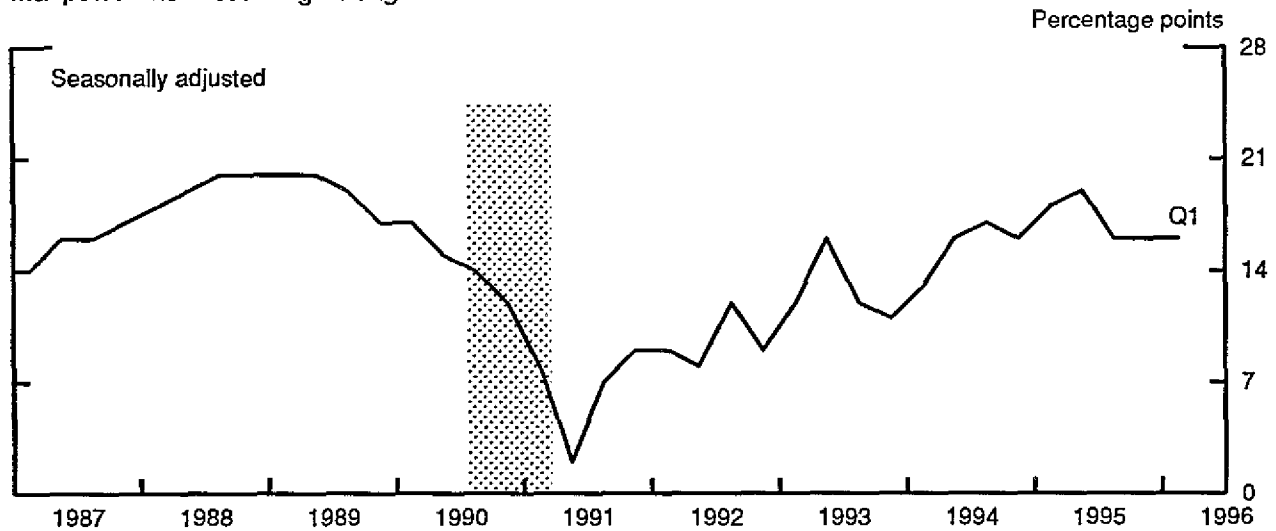
2. Some states refused to accept claims filed by the furloughed workers. Other states initially held up the claims but processed them later. In addition, some workers filed claims at their respective agencies, which were slow to forward the applications to the states.

Labor Market Indicators

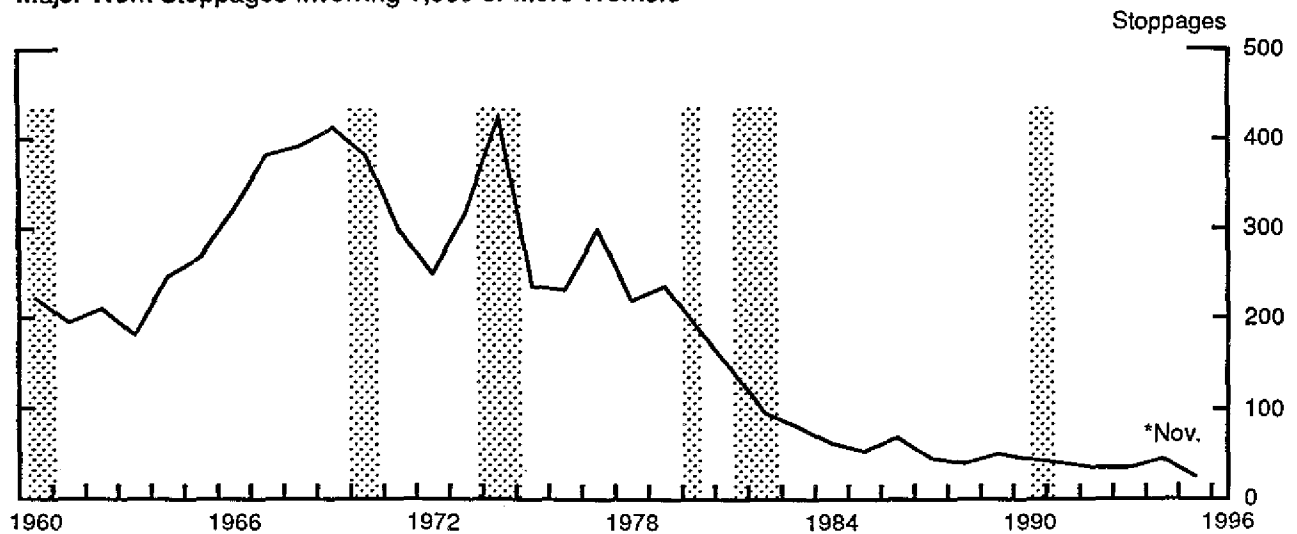
Help Wanted Index



Manpower Inc. Net Hiring Strength



Major Work Stoppages Involving 1,000 or More Workers



*Total from January through November 1995

has been moving sideways since the middle of 1994. The Manpower series of net hiring for the first quarter of 1996 was unchanged at 16 percentage points. Like the help wanted index, this series has traced out a relatively flat trend over the past year and a half.³

The published data on average hourly earnings show large increases in September and October and a small decline in November, but the application of consistent seasonals smooths out these ups and downs. Twelve-month changes in average hourly earnings have been trending up since 1992, and anecdotal reports of wage pressures seem to have become a little more numerous of late, both for skilled workers and entry-level workers. Fourth-quarter data from the employment cost index, which we consider to be the most reliable indicator of changes in the "price" of labor, will not be available until late January. The last ECI showed subdued rates of increase in hourly compensation persisting through the third quarter.

Two work stoppages that have been prominent in the labor market news of recent weeks have now ended, with dramatically different outcomes. On December 4, the United Auto Workers called off their long-running strike against Caterpillar, and the striking workers are returning to their jobs without a contract after having rejected the company's last offer. During the year and a half that the workers were on strike, Caterpillar maintained production with temporary replacement workers and UAW members who crossed the picket line. At Boeing, striking workers voted down a tentative agreement in mid-November, but a second agreement was ratified in a vote taken yesterday. The workers, who have been out on strike since October 6, are starting back to work today. The contract that they

3. The Manpower series is derived from a telephone survey of more than 15,000 businesses in 475 cities. Attempts are made to survey the same employers each quarter. Survey responses are not weighted by size of the firm.

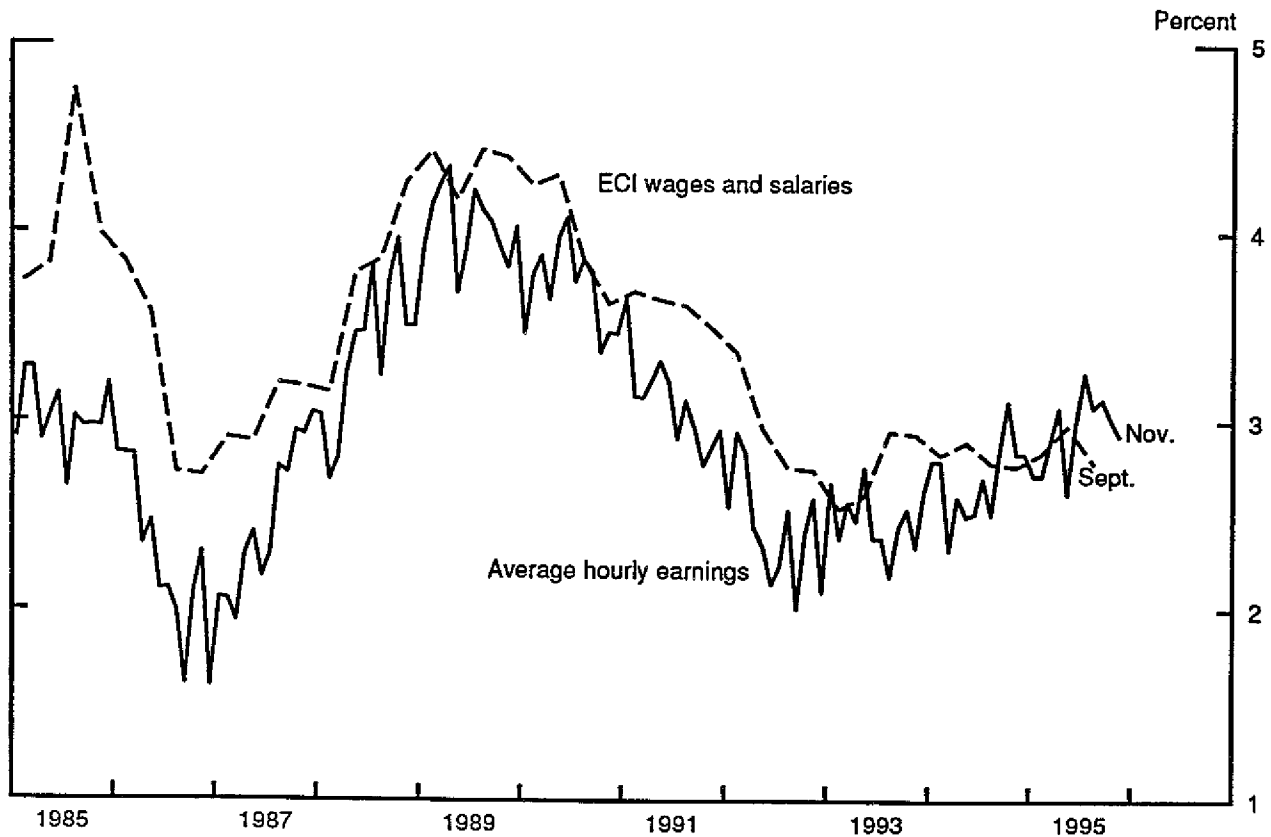
AVERAGE HOURLY EARNINGS
 (Percentage change; based on seasonally adjusted data)¹

	1993	1994	1995			1995		
			Q1	Q2	Q3	Sept.	Oct.	Nov.
			-Annual rate-			-Monthly rate-		
Total private nonfarm	2.6	2.8	2.5	3.2	3.9	.5	.4	-.1
Manufacturing	3.2	2.2	2.3	2.3	3.6	.2	.2	.2
Durable	3.4	2.0	1.9	.3	4.1	.1	.0	.1
Nondurable	2.5	2.3	2.8	3.9	3.5	.1	.6	.1
Contract construction	1.3	2.4	2.5	5.5	1.1	.3	.0	.3
Transportation and public utilities	1.3	2.3	1.1	4.6	2.8	.3	1.1	-.1
Finance, insurance, and real estate	5.5	3.4	5.1	4.7	5.0	.6	.8	-.5
Total trade	2.4	3.0	1.8	3.2	4.5	.3	.2	.0
Services	2.1	2.9	3.3	2.9	3.6	.7	.7	-.3

1. Annual and quarterly changes are measured from the final month of the preceding period to the final month of the period indicated.

Earnings of Production and Nonsupervisory Workers

(Twelve-month change)



ratified contains provisions for large lump-sum payments in the first and second years of a four-year contract and moderate increases in wage rates in the third and fourth years. Workers also obtained concessions from the company on contract provisions related to job security and subcontracting. With business starting to pick up, the company appears to have been eager to settle.

More generally, workers still appear reluctant to press their wage demands to the point of walking off the job. Through November, only twenty-five major strikes (those involving 1,000 workers or more) had occurred this year, and the total for the year as a whole is likely to fall short of last year's total of forty-five. In the 1970s, the annual number of work stoppages usually was in the hundreds, but the frequency of strikes fell sharply in the first half of the 1980s and has since remained low.

Industrial Production

Industrial production fell 0.3 percent in October but edged up 0.2 percent in November. The direct effect of the strike at Boeing accounted for about two-thirds of the October decline and had a slight further depressing effect on production in November. Production of motor vehicles and parts fell 2.4 percent in October but moved up 0.6 percent in November. Manufacturers assembled motor

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

	1995			1995	1996
	Oct.	Nov. ^e	Dec.	Q4	Q1
	-----scheduled-----				
U.S. production	11.6	11.7	12.1	11.8	12.2
Autos	6.1	6.0	6.2	6.1	6.3
Trucks	5.5	5.7	5.9	5.7	6.0
Days' supply					
Autos	74.1	71.9	n.a.	n.a.	n.a.
Light trucks	76.8	72.2	n.a.	n.a.	n.a.

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

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

	Proportion in total IP		1995			1995		
	1994:Q4	1994 ¹	Q1	Q2	Q3	Sept.	Oct.	Nov.
			----Annual rate-----			--Monthly rate---		
Total index	100.0	6.6	3.9	-1.4	3.2	.2	-.3	.2
Previous		6.6	3.9	-1.4	3.6	.1	-.4	
Manufacturing	86.6	7.6	3.9	-2.2	2.7	.6	-.2	.2
Motor veh. and parts	5.7	8.6	9.7	-18.2	.5	.8	-2.4	.6
Aircraft and parts	2.1	-7.9	-6.7	-1.9	-9.0	-1.7	-10.8	-4.9
Manufacturing excluding motor vehicles, aircraft, and parts	78.7	8.0	3.8	-1.0	3.1	.6	.2	.2
Consumer goods	23.4	4.7	-.3	-2.1	2.5	.4	-.2	.1
Durables	3.7	6.4	-2.4	-7.0	4.4	1.9	-1.4	.7
Nondurables	19.7	4.4	.2	-1.1	2.1	.1	.1	.0
Business equipment	12.9	13.1	11.4	3.8	7.5	.5	.8	.8
Office and computing	2.3	29.6	41.3	35.4	23.9	2.8	3.6	3.4
Industrial	4.2	8.6	7.1	-1.9	6.7	-.1	-.3	.6
Other	6.2	8.4	7.1	-5.0	2.4	-.1	-.4	.6
Defense and space equipment	1.9	-10.5	-2.7	-6.4	-2.6	-1.1	-1.5	-2.0
Construction supplies	5.4	8.0	-.2	-7.8	1.6	1.8	-.3	-.5
Materials	28.2	10.5	6.9	-.1	2.4	.8	.4	.3
Durables	19.4	12.1	8.7	.6	8.2	1.6	.2	.8
Nondurables	8.5	6.9	3.1	-1.4	-9.5	-.9	.8	-.9
Mining	6.2	1.2	2.1	.4	-1.8	.1	-1.2	.0
Utilities	7.2	.2	5.4	8.0	14.7	-4.5	-.4	1.3
Memo:								
Information-related products	9.4	20.7	22.1	19.8	21.0	2.2	1.9	1.8

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	1967-94	1995		1995			
	High	Avg.	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Total industry	84.9	82.0	83.7	83.6	83.8	83.7	83.2	83.1
Manufacturing	85.2	81.3	82.9	82.6	82.6	82.8	82.3	82.2
Primary processing	89.0	82.5	87.6	86.5	86.1	86.8	86.4	86.0
Advanced processing	83.5	80.7	81.0	80.9	81.2	81.1	80.7	80.5

vehicles at an estimated rate of 11.7 million units last month, somewhat below planned output at the beginning of the month.

Outside the motor vehicle and aircraft industries, manufacturing activity moved up 0.2 percent last month, the same as the increase in the previous month. Growth in information-related products--a category that makes up 9-1/2 percent of IP and includes computers, semiconductors, communications equipment, and selected instruments--continued to be the primary area of strength in manufacturing. In addition, the production of industrial equipment posted a solid gain. Spurred by gains in these categories, business equipment output rose 0.8 percent in November. A jump in the production of appliances provided a considerable boost to the output of consumer durables last month. By contrast, output of consumer nondurables continued to be sluggish. Production of construction supplies dropped 0.5 percent in November, a second month of decline after four strong months; nonetheless, the November index remained above its third-quarter average. Outside manufacturing, utilities output was boosted in November by cold weather, and mining production remained flat.

Utilization rates for the past two years have been revised down a little in conjunction with annual revisions to the data on production and capacity. The revisions left the October level of manufacturing production much the same as previously estimated. Annual growth in manufacturing capacity was revised up 1/2 percentage point in 1994, and much as before, capacity growth accelerated sharply in 1994 and 1995. The upward revision in 1994 was concentrated in advanced-processing industries, notably for motor vehicles and parts and office and computing equipment. Survey results suggest that operating rates in the computer industry were much lower than those previously estimated and, given the revised

estimates for production, imply that capacity growth was much higher. Among primary-processing industries, operating rates were altered little, on balance, in 1994 and 1995; upward revisions to primary metals and to petroleum products offset downward revisions in other categories. In November, the factory operating rate inched down 0.1 percentage point from its revised October level, to 82.2 percent, as capacity growth outpaced the small rise in manufacturing output.

Forward-looking indicators of manufacturing activity are somewhat varied. Current schedules of motor vehicle production call for an increase in assemblies in December and a more noticeable pickup in the first months of 1996. In recent years, however, initial first-quarter announcements have tended to be trimmed, and a similar outcome appears likely early next year, given that the days' supplies for automobiles and light trucks are above the ranges that the industry considers comfortable. All told, other indicators appear consistent with small production increases for manufacturing excluding motor vehicles. Real new orders for adjusted durable goods posted a third monthly increase in October. The purchasing managers' index of new orders--the part of the purchasing managers' report that we find most useful in forecasting manufacturing output--ticked up in November, a slight improvement from the October reading. Measures of industrial commodity prices, discussed in more detail in the section on prices, have been mixed in recent weeks after having declined earlier in the fall.

Personal Income and Consumption

Consumer spending firmed in November. Total nominal retail sales increased 0.8 percent last month after a decline of 0.4 percent in October. Spending in the retail control category, which excludes sales at automotive dealers and building material and

RETAIL SALES
(Percent change; seasonally adjusted)

	1995			1995		
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Total sales	.5	1.1	1.0	-.1	-.4	.8
Previous estimate			1.1	.1	-.2	
Retail control ¹	.9	1.1	.6	.5	-.6	.8
Previous estimate			.7	.8	-.5	
Total excl. automotive group	.8	.9	.5	.5	-.5	.9
Previous estimate			.6	.8	-.5	
GAF ²	.6	.8	1.3	1.1	-1.2	1.0
Previous estimate			1.4	1.5	-1.3	
Durable goods stores	-.4	1.3	2.0	-1.0	-.1	1.0
Previous estimate			2.0	-1.0	.2	
Bldg. material and supply	-1.0	-2.2	.5	.5	1.0	2.0
Automotive dealers	-.5	1.9	2.4	-2.0	-.1	.4
Furniture and appliances	-.2	.1	3.6	.6	.0	1.5
Other durable goods	.8	3.4	-.2	-.1	-1.0	3.0
Nondurable goods stores	1.0	1.0	.3	.6	-.6	.6
Previous estimate			.4	.9	-.5	
Apparel	-1.0	-.7	.0	2.6	-2.3	2.8
Food	1.2	-.2	.4	.6	.6	.1
General merchandise ³	1.5	1.7	.7	.8	-1.3	.0
Gasoline stations	2.0	2.1	-1.7	-.8	-1.7	-.1
Other nondurables ⁴	.7	1.8	.7	.4	-.5	1.0

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

2. General merchandise, apparel, furniture, and appliance stores.

3. Excludes mail-order nonstores; mail-order sales are also excluded from the GAF grouping.

4. Includes sales at eating and drinking places, drug stores, and proprietary stores.

SALES OF AUTOMOBILES AND LIGHT TRUCKS¹
(Millions of units at an annual rate; FRB seasonals)

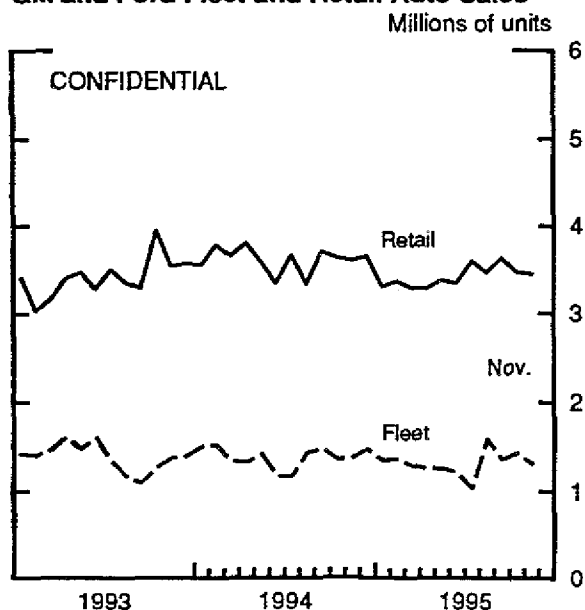
	1993	1994	1995			1995		
			Q1	Q2	Q3	Sept.	Oct.	Nov.
Total	13.9	15.0	14.7	14.4	15.0	14.9	14.1	14.8
(BEA seasonals)	13.9	15.0	14.9	14.4	14.7	14.8	14.4	14.7
Autos	8.7	9.2	8.9	8.7	9.2	9.1	8.6	8.7
Light trucks	5.2	5.8	5.9	5.7	5.9	5.8	5.6	6.0
North American²	11.7	12.9	12.7	12.5	13.2	13.0	12.4	13.0
Autos	6.7	7.3	7.1	6.9	7.5	7.4	7.0	7.1
Big Three	5.5	5.7	5.5	5.3	5.6	5.6	5.5	5.4
Transplants	1.3	1.5	1.5	1.6	1.9	1.8	1.5	1.7
Light trucks	5.0	5.7	5.7	5.5	5.7	5.6	5.4	5.9
Foreign produced	2.1	2.1	2.0	2.0	1.9	1.9	1.7	1.8
Autos	2.0	2.0	1.8	1.8	1.7	1.7	1.6	1.6
Light trucks	.2	.2	.2	.2	.1	.2	.2	.2

Note: Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

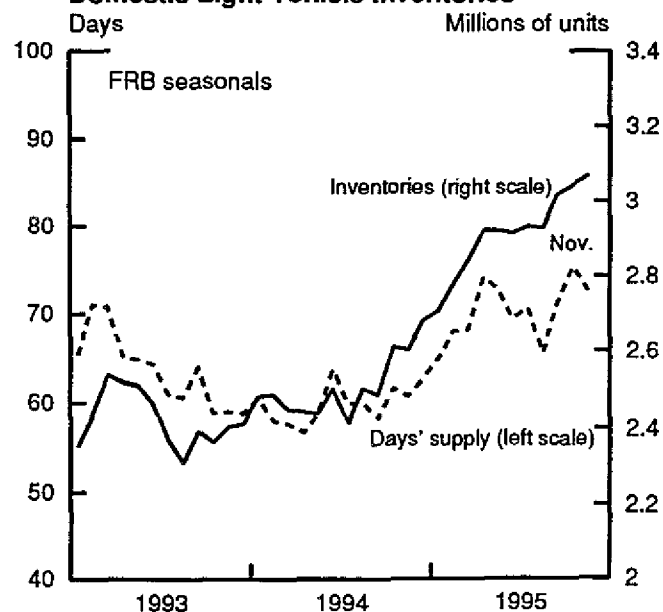
1. Components may not add to totals because of rounding.

2. Excludes some vehicles produced in Canada that are classified as imports by the industry; before January 1994, some vehicles produced in Mexico were also excluded.

GM and Ford Fleet and Retail Auto Sales



Domestic Light Vehicle Inventories



supply stores, also rose 0.8 percent last month, more than retracing its 0.6 percent October decline. Within the retail control, spending at durable goods stores recorded a strong gain, consistent with reports of continued robust demand for home electronics. Outlays at nondurable goods stores posted a solid 0.6 percent gain in November, but this rise merely offset a decline of similar size in October. The monthly swing was especially sharp at apparel stores. The retail sales data, together with the available information about prices, suggest that the November level of real consumer spending on goods other than motor vehicles was 1.0 percent above its third-quarter average, not at an annual rate.

Sales of light vehicles in November amounted to 14.8 million units at an annual rate, up considerably from the weak October reading and about the same as the average pace for the first three quarters of this year. The November increase represented a sharp gain in sales of light trucks, while unit sales of autos were little changed. At the Big Three, auto sales slipped a bit, and confidential reports from GM and Ford indicate that retail demand remained soft while sales to fleets edged off only a little from the high levels of the past several months. Dealers' inventories of cars and light trucks remained at high levels at the end of November. Thus, the industry still is in the difficult position of having to find a way to work off excess stocks through some combination of concessionary pricing and production restraint. Producers have said that they plan to maintain the current incentive plans into early 1996, but how consumers will react to this information is uncertain: Some potential buyers may choose to take advantage of the current incentives, but others, mindful of the industry's behavior in past situations when stocks were sizable, may choose to hold off in hopes that the deals will get sweeter.

At this point, evidence on consumer spending in December consists of anecdotal reports and various statistical indicators from private sources. The anecdotal reports generally indicate that electronic goods are moving well, but apparel sales are said to be soft. Most of the statistical indicators, such as the Johnson Redbook, suggest that retail sales were rather weak in the first ten days of December. However, it should be noted that these indicators have not proved to be very reliable in the past, probably in part because they tend to focus only on certain types of stores or categories of merchandise.

The BEA has not published any fourth-quarter data on expenditures for consumer services or personal income.⁴ However, some parts of the picture can be pieced together. Spending on energy services, which tends to vary predictably with weather changes, probably was boosted in November by the unusually cold temperatures in that month. But unless temperatures remain quite cold for the rest of December, average fourth-quarter spending for energy will likely fall short of the third-quarter average, which was elevated by unusually hot weather and a related surge in electricity consumption.

With regard to income, the BLS data on aggregate hours and average hourly earnings in October and November would seem to point toward an appreciable gain in nominal wages and salaries this quarter. In addition, accounting data that we obtain from the Department of Agriculture show a sizable jump in farm subsidies in October.⁵ Growth of interest income probably has been moderate.

4. The next monthly report on personal income and consumption currently is scheduled for release on December 21. Complete monthly detail will not be available until January.

5. In the past, the BEA has not been adjusting farm subsidy payments for seasonal variation. If that accounting convention were maintained, farm income probably would show a monthly rise of about \$20 billion at an annual rate in October. However, the upcoming (Footnote continues on next page)

All told, these indicators of nominal income growth, together with the data on consumer prices, seem to point to a healthy gain in real disposable income this quarter. We suspect that the saving rate may have ticked up a bit from its third-quarter average.

The recent indicators of consumer sentiment have generally been on the positive side. The Michigan SRC index of consumer sentiment rose slightly in early December, reflecting more upbeat expectations of personal financial and business conditions. Other components of the overall index and the separate index of unemployment expectations were little changed. Although the overall Michigan index is now a few points below its strong readings in the summer, it remains in a range that historically has coincided with solid gains in consumer spending. The most recent Conference Board report pointed to greater consumer optimism than the Michigan survey; the November value of this index of consumer confidence was at the upper end of the favorable readings seen over the past year.

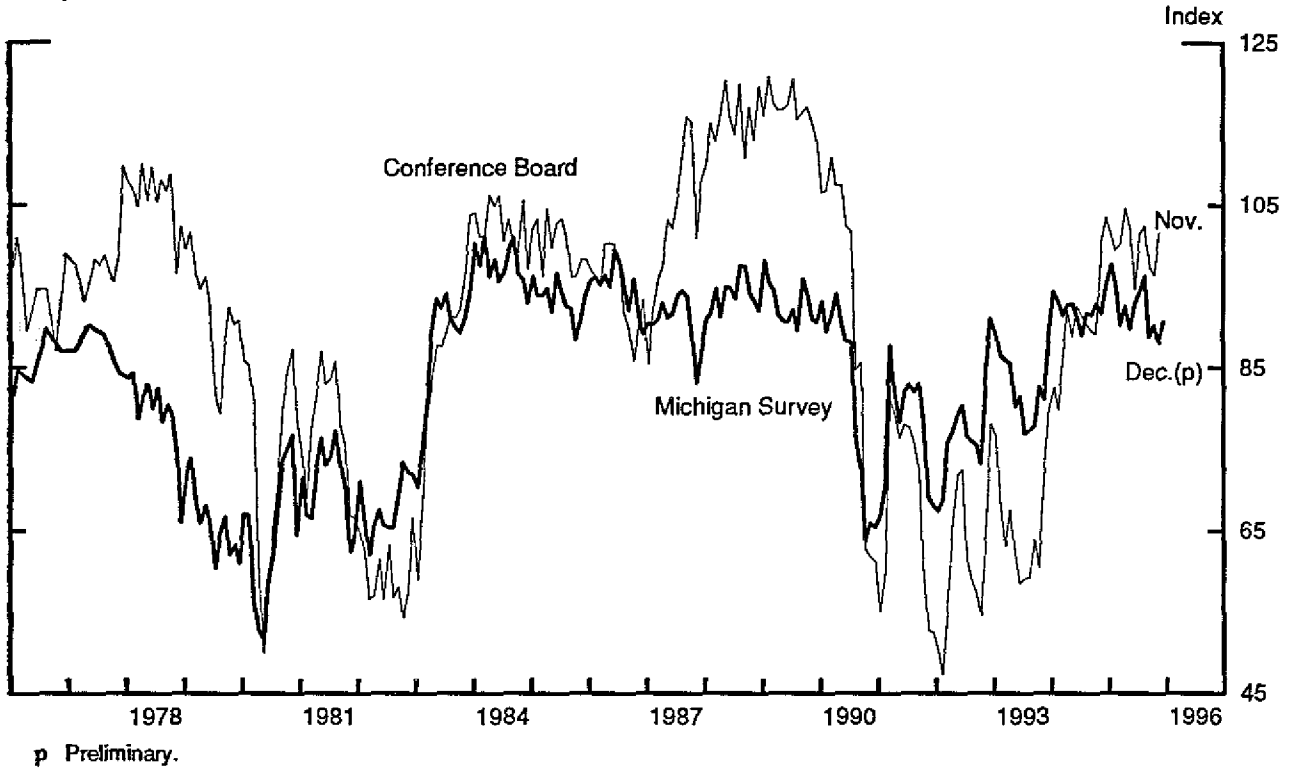
Finally, although a growing debt-service burden conceivably is exerting a negative force on consumer spending, the surge in stock market wealth probably is providing an offsetting positive force in the aggregate. The most recent balance sheet data indicate that household liabilities climbed further in the third quarter, raising debt service payments. At the same time, however, the run-up in stock prices increased household assets by a much larger amount. Consequently, the ratio of household net worth to disposable personal income has risen substantially.

(Footnote continued from previous page)

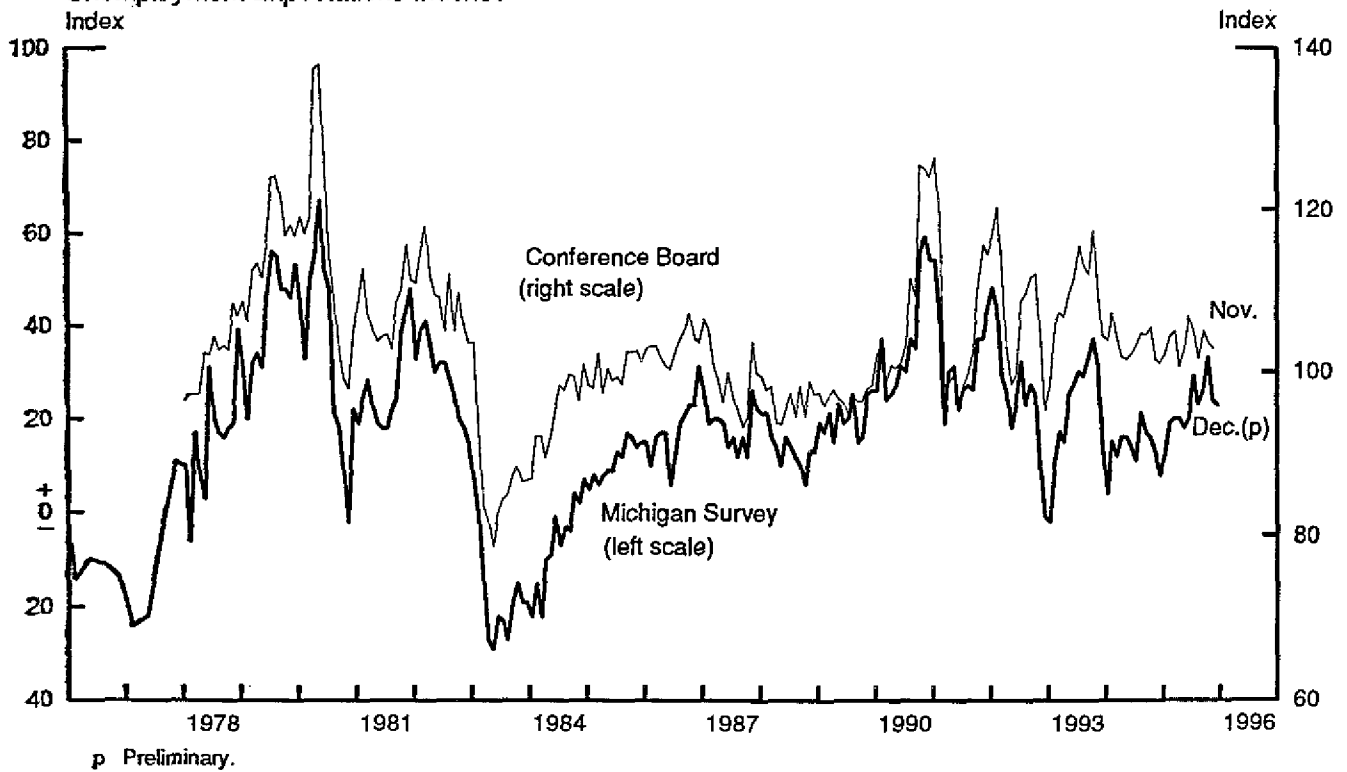
NIPA revision will bring a change in these accounting procedures that should smooth some of the monthly volatility in payments to farmers.

Consumer Surveys

Consumer Sentiment

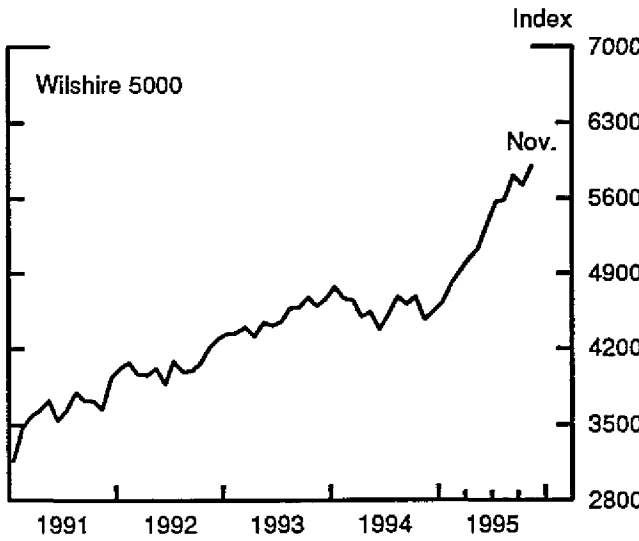


Unemployment Expectations Indexes

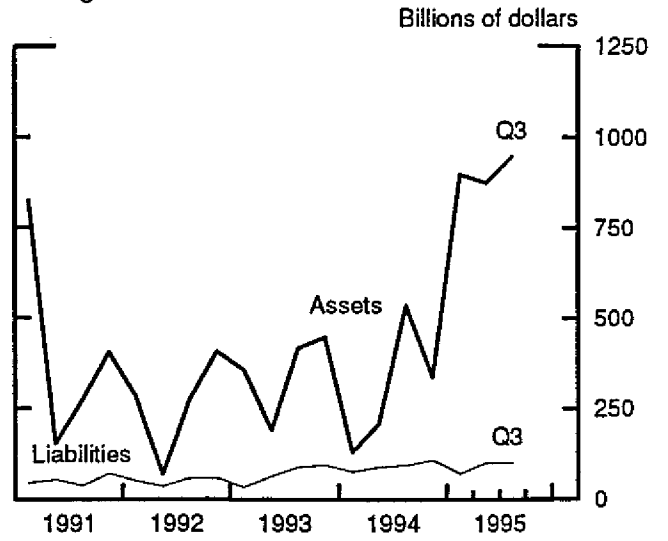


Household Balance Sheet Indicators

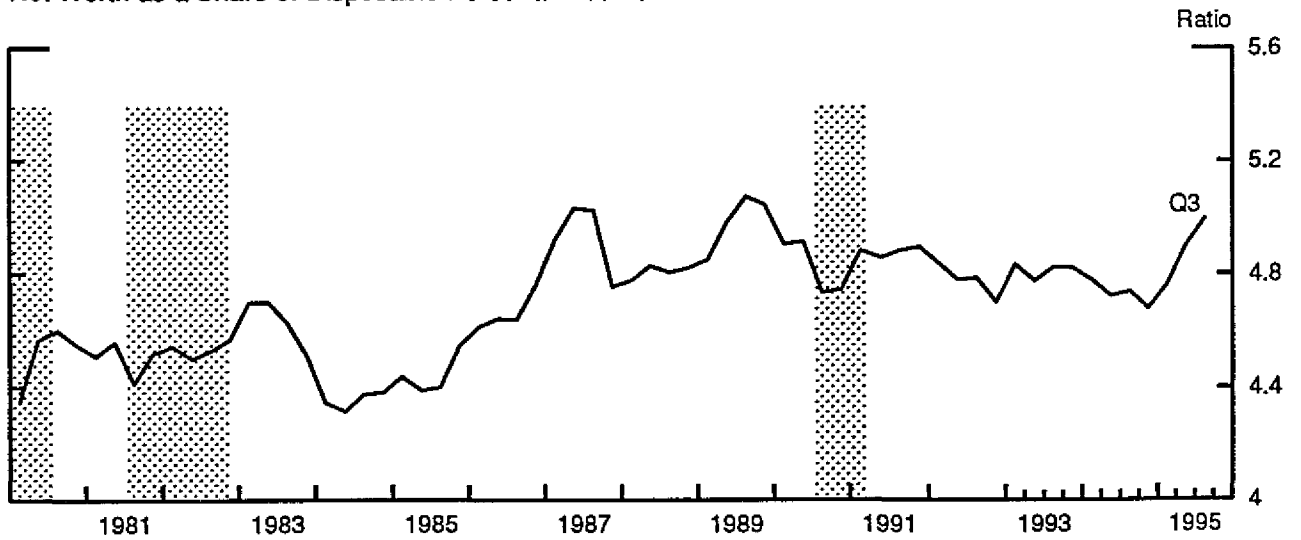
Stock Market



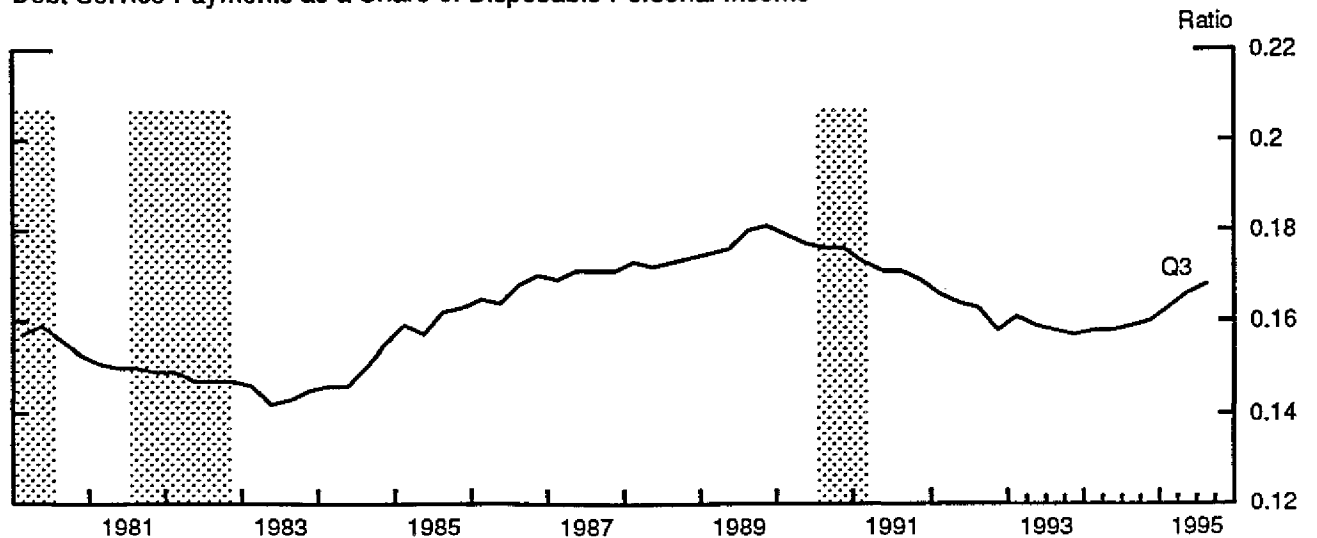
Change in Total Assets and Liabilities



Net Worth as a Share of Disposable Personal Income



Debt Service Payments as a Share of Disposable Personal Income



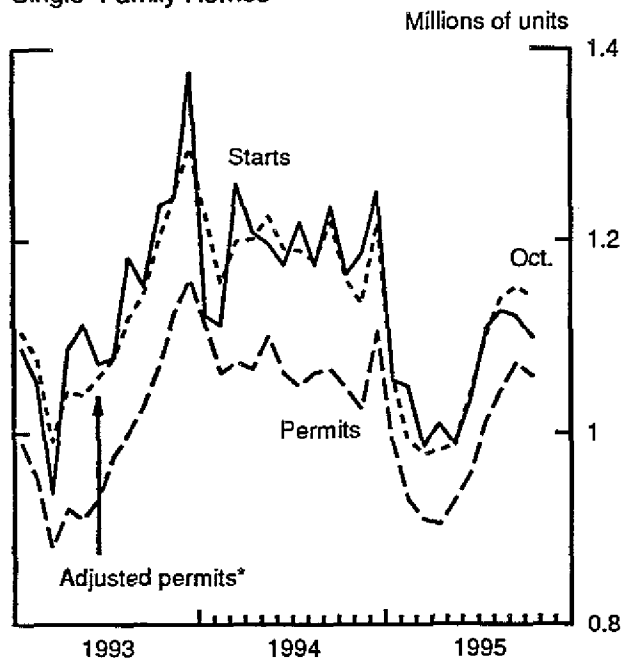
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

	1994	1995					
	Annual	Q1	Q2	Q3 ^r	Aug. ^r	Sept. ^r	Oct. ^p
<i>All units</i>							
Starts	1.46	1.31	1.28	1.40	1.39	1.39	1.34
Permit	1.37	1.27	1.25	1.38	1.37	1.41	1.40
<i>Single-family units</i>							
Starts	1.20	1.03	1.01	1.12	1.13	1.12	1.10
Permits	1.07	.94	.93	1.04	1.04	1.07	1.06
New-home sales	.67	.61	.67	.72	.70	.69	.67
Existing-home sales	3.95	3.55	3.58	4.09	4.12	4.15	4.07
<i>Multifamily units</i>							
Starts	.26	.28	.27	.29	.27	.27	.24
Permits	.31	.33	.32	.33	.32	.33	.34

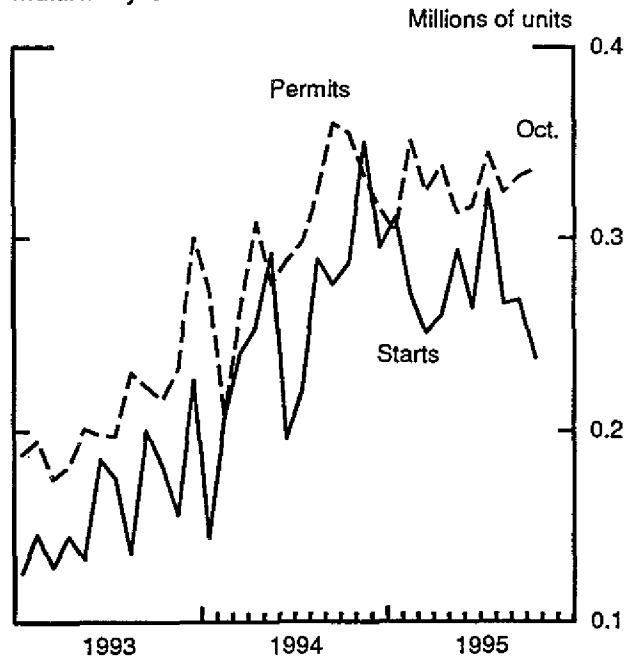
Note. p Preliminary. r Revised. n.a. Not available.

Starts and Permit Issuance

Single-Family Homes



Multifamily Units



* Starts outside permit-issuing places plus permits.

Housing Markets

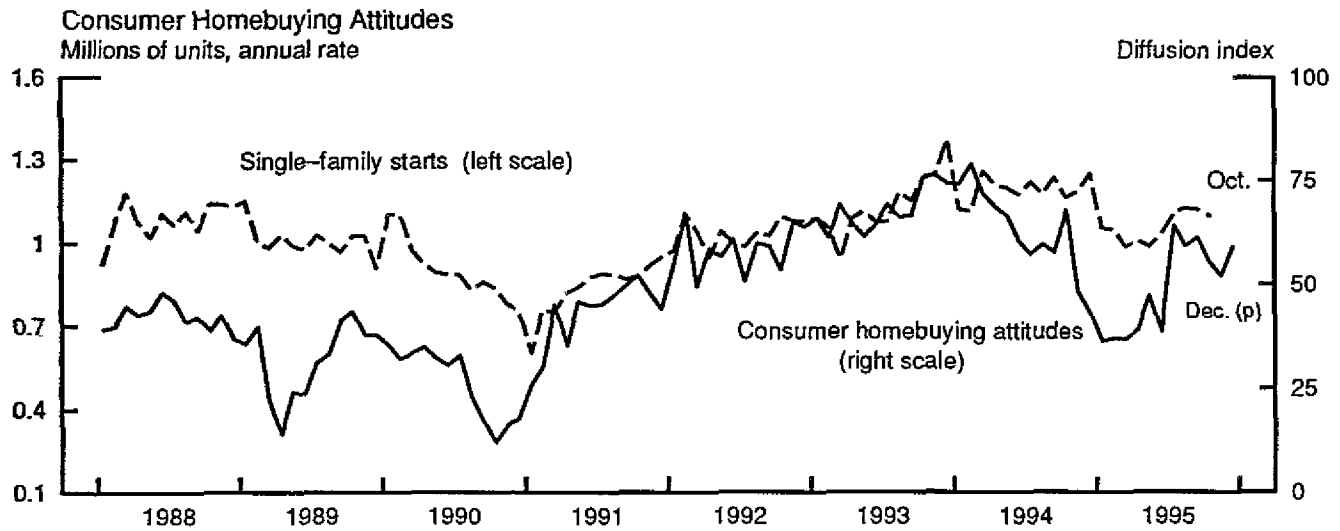
After a strong third quarter, most indicators of housing market activity either flattened or turned down early in the current quarter. In the single-family sector, production and demand both eased in October. Starts of single-family homes fell 2 percent, but permit issuance suggests that the true level of starts may have been a shade higher than the reported figures. Nonetheless, some easing of construction appears to have been warranted, given the most recent indicators of housing demand. New home sales declined about 3 percent in October from a downward-revised estimate for September. Existing home sales also backed down in October, but they remained near their most recent highs.

Indicators for the period since October present a mixed picture of change in single-family housing demand. Market assessments by home builders turned down in November after improving through most of the year. In contrast, applications for home purchase loans remained at a high level in recent weeks and would seem to imply more sales and starts than observed in October. Consumer attitudes toward home buying bounced back early this month after having slipped since midyear. The sector continues to be supported by favorable mortgage financing conditions, which have made new single-family housing as affordable as at any time in the past quarter century.

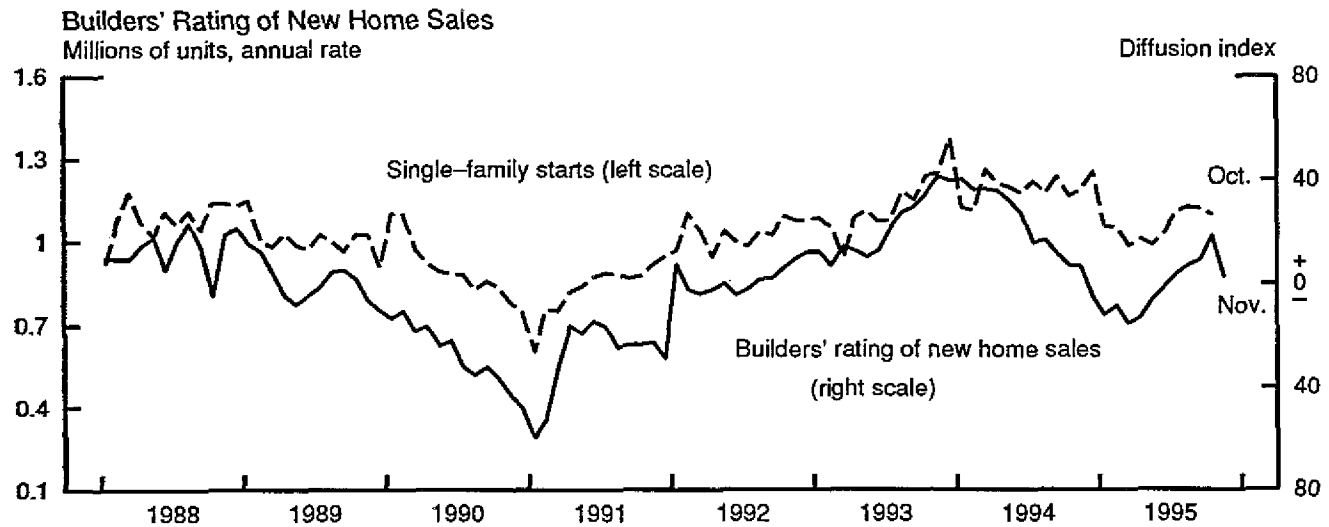
The multifamily sector has been soft since early this year, although probably not so weak as implied by October's reduced level of starts. Permit issuance for these projects exceeded starts by an unusually wide margin in September and October. Both the permit data and market fundamentals, including demographics and the availability of finance for construction, suggest some near-term rebound in multifamily starts.

Indicators of Housing Demand

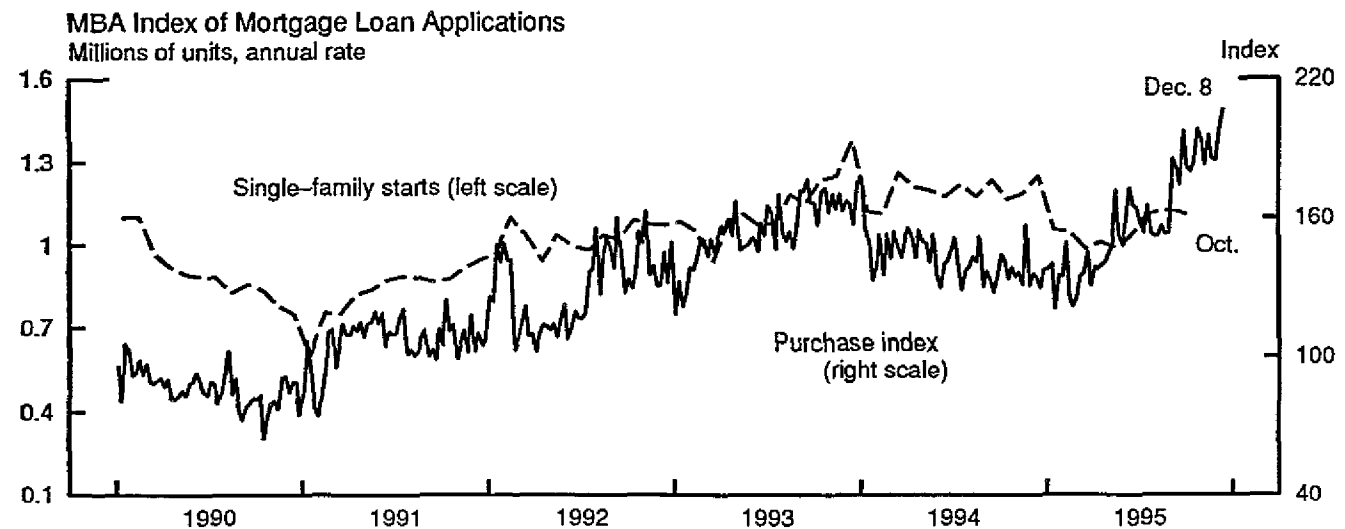
(Seasonally adjusted; FRB seasonals except starts)



Note. The homebuying attitudes index is calculated by the Survey Research Center (University of Michigan) as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.



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



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

Business Fixed Investment

Business fixed investment continues to be an area of strength in the economy, but its growth apparently has slowed from the extraordinary pace that was evident in 1994 and early 1995. Recent gains in investment have also been less widespread than those of a year ago, when large increases in spending were evident across nearly all major categories.

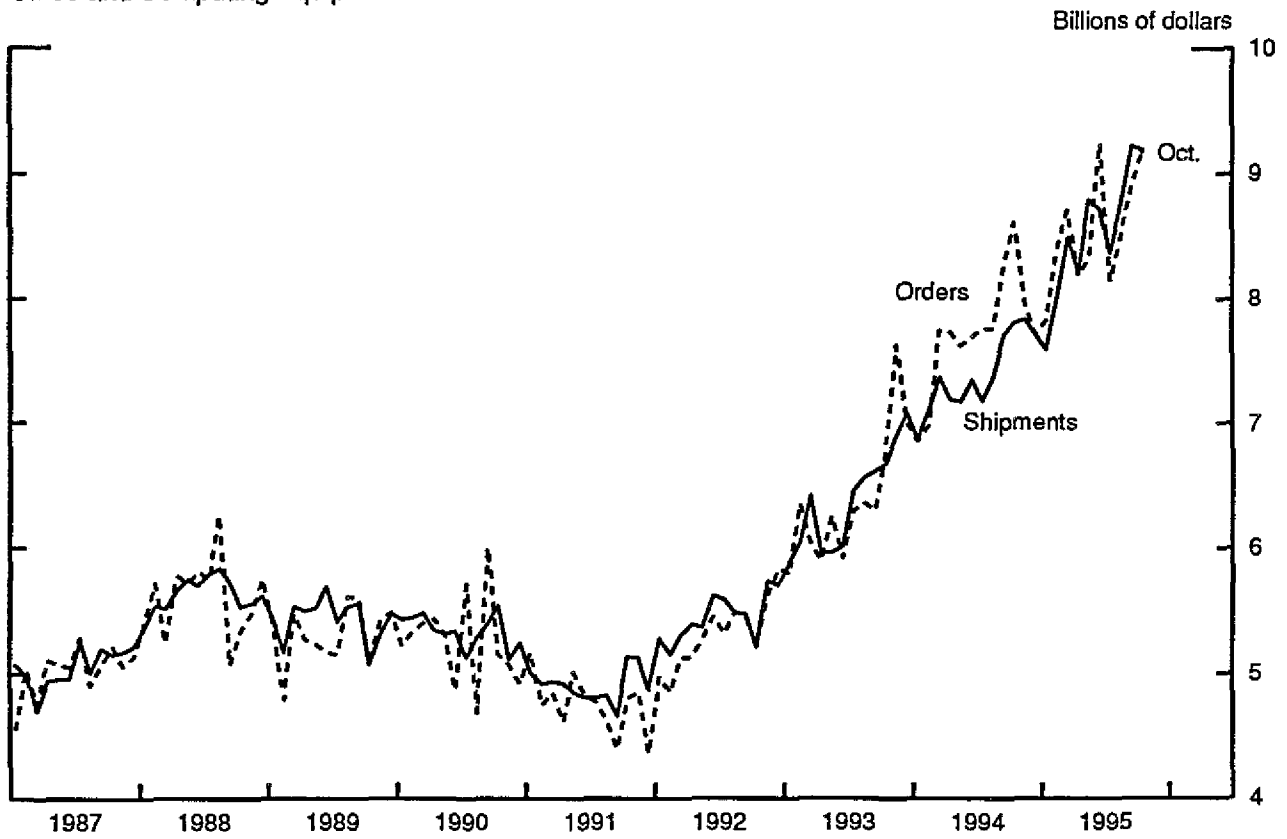
From all appearances, falling computer prices and the desire of businesses to stay current with changing technologies are still providing powerful impetus for investment in computers. After steep increases in August and September, the nominal shipments of office and computing equipment held at a high level in October, roughly 5 percent above the average for the third quarter. Moreover, our industry contacts provided extremely bullish reports about computer deliveries in November and December.

By contrast, investment in equipment other than computers appears to be slowing. Although shipments of nondefense capital goods other than computers were at a high level in October, the trends in new orders and unfilled orders for these goods have flattened. Reports from our industry contacts have become less upbeat of late, consistent with the deceleration evident in the incoming data. Technological imperatives for new investment in these types of goods are not so strong as for computers, and cyclical influences, working through the accelerator and business cash flow, are providing dwindling positive stimulus.

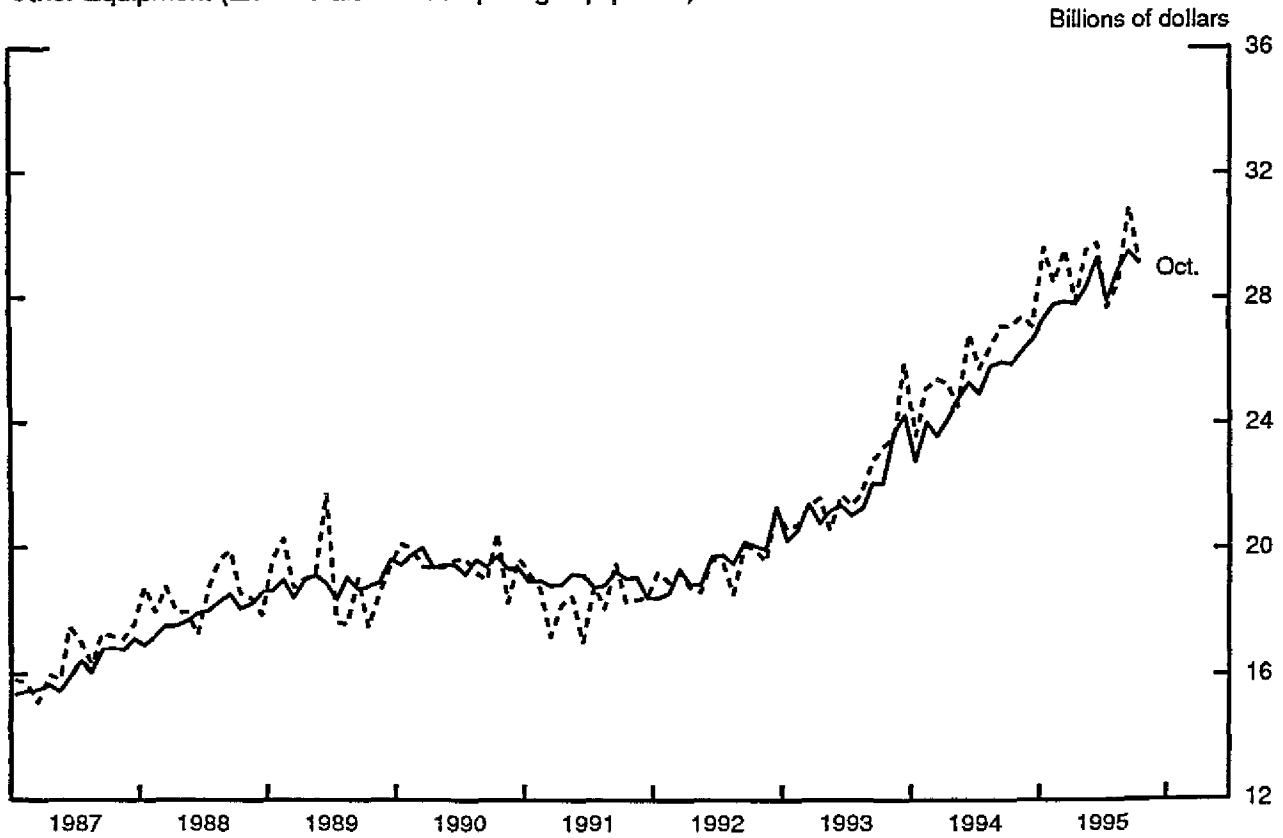
Recent indicators of business investment in transportation equipment have been mixed. Outlays for light vehicles have been supported this quarter by a high level of sales to daily rental companies. Sales of heavy trucks turned up in October and November. Shipments of heavy trucks could be propped up temporarily

Orders and Shipments of Nondefense Capital Goods

Office and Computing Equipment



Other Equipment (Ex. Aircraft and Computing Equipment)



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

	1995			1995		
	Q1	Q2	Q3	Sept.	Oct.	Nov.
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	5.3	3.3	.7	2.5	-1.5	n.a.
Excluding aircraft and parts	4.8	3.8	1.3	2.8	-1.0	n.a.
Office and computing	3.1	6.8	2.4	5.5	-.3	n.a.
All other categories	5.2	2.9	1.0	2.0	-1.2	n.a.
Shipments of complete aircraft ¹	12.5	-5.0	-7.3	14.0	-41.0	n.a.
Sales of heavy trucks	8.8	-3.6	-9.5	-2.8	2.0	5.4
Orders of nondefense capital goods	8.3	-.3	2.1	12.6	-7.4	n.a.
Excluding aircraft and parts	6.4	.3	-.3	7.8	-3.6	n.a.
Office and computing	2.8	3.3	-.7	4.6	3.1	n.a.
All other categories	7.4	-.5	-.1	8.7	-5.5	n.a.
<u>Nonresidential structures</u>						
Construction put-in-place	.5	2.4	2.6	-1.3	2.8	n.a.
Office	.1	3.9	6.0	-3.6	3.5	n.a.
Other commercial	5.7	-2.3	2.0	.6	4.7	n.a.
Institutional	-.1	.3	.9	-.4	.6	n.a.
Industrial	.4	5.6	-1.6	-.4	5.2	n.a.
Public utilities	-14.2	15.0	3.6	-1.0	-2.8	n.a.
Lodging and miscellaneous	9.1	1.5	11.9	-6.8	14.1	n.a.
Rotary drilling rigs in use	-1.7	1.3	.8	-1.6	-5.3	-2.8
Memo:						
Business fixed investment ²	21.5	11.3	8.3	n.a.	n.a.	n.a.
Producers' durable equipment ²	24.5	11.9	9.7	n.a.	n.a.	n.a.
Nonresidential structures ²	11.5	9.0	3.5	n.a.	n.a.	n.a.

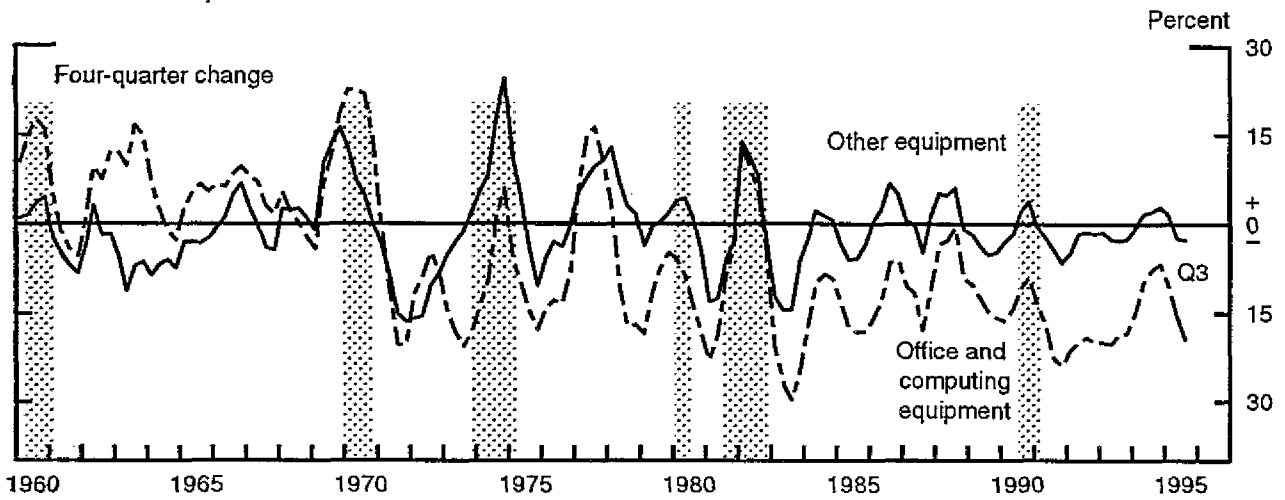
1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.

2. Based on constant-dollar data; percent change, annual rate.

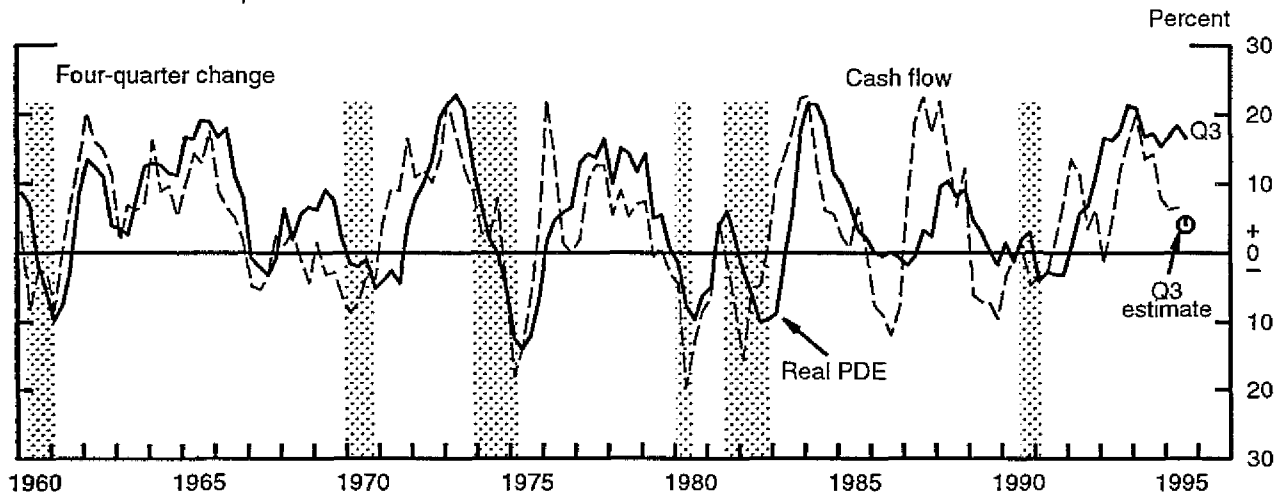
n.a. Not available.

Fundamental Determinants of Equipment Spending

User Cost of Capital

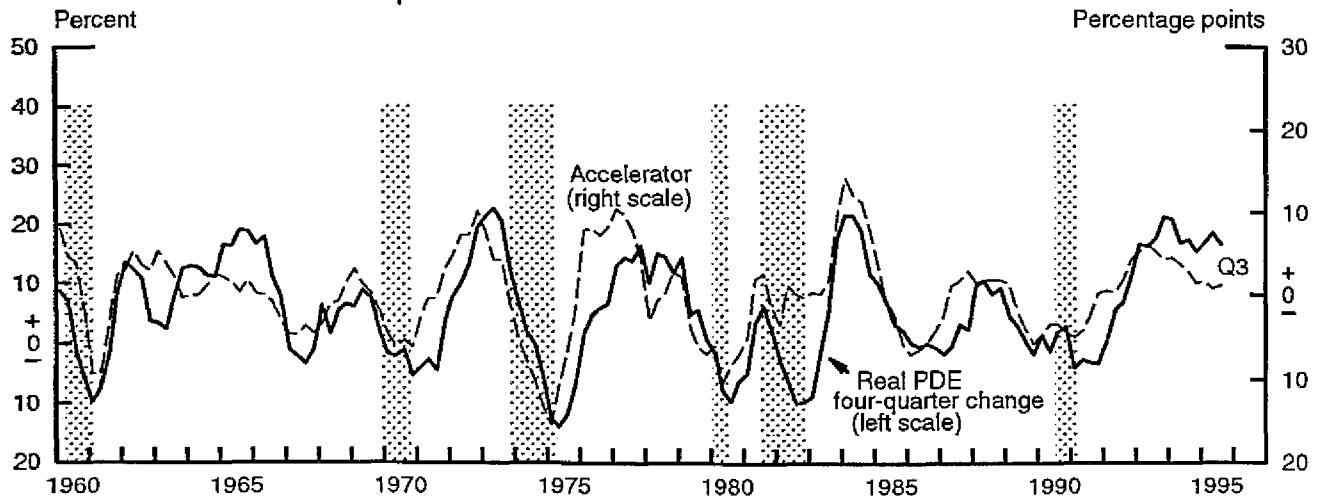


Real Domestic Corporate Cash Flow



Note. Data on cash flow are historical only through the second quarter.

Acceleration of Business Output



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

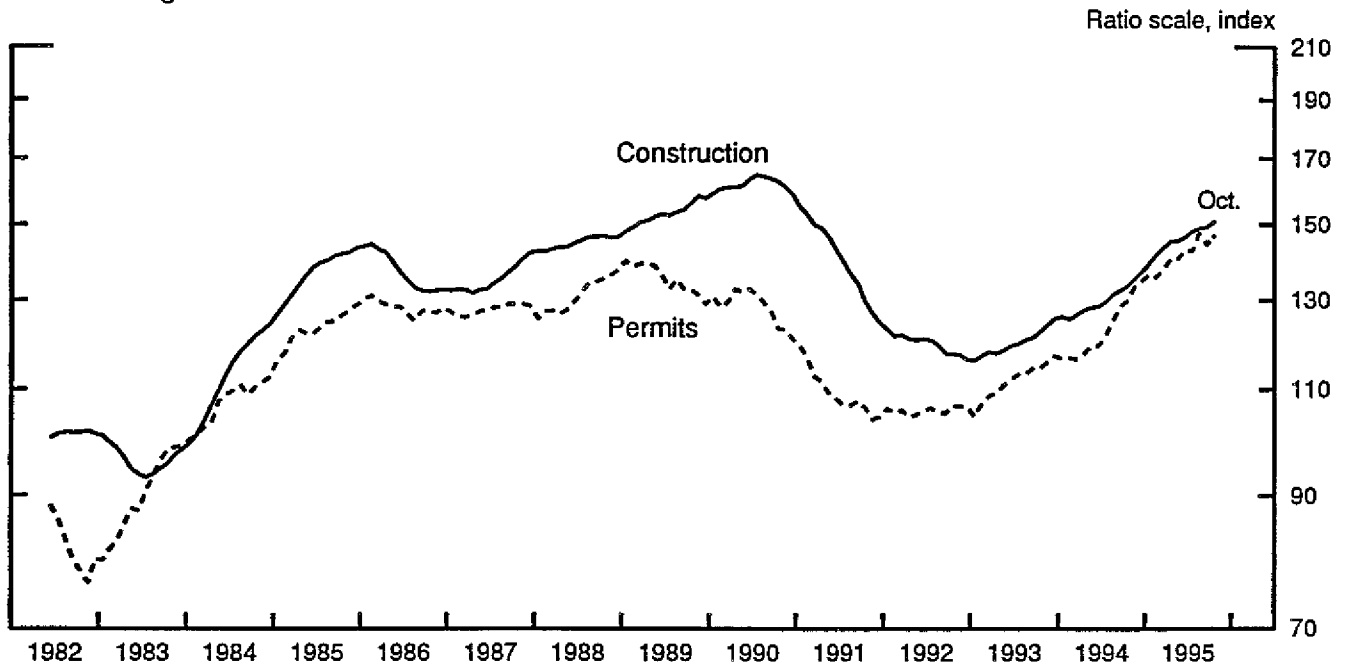
if buyers take delivery on orders they have already placed. However, net new orders have been very low in recent months, and comments from the industry are decidedly negative. Historically, outlays for heavy trucks have been highly cyclical, going through booms and busts larger in percentage terms than the cyclical swings in either total BFI or total equipment purchases.

Elsewhere in transportation, shipments of complete aircraft dropped 41 percent in October, in part reflecting the Boeing strike. Boeing's announced shipments of complete aircraft in November were low, and a major negative effect on fourth-quarter outlays now seems unavoidable. Looking ahead, Boeing announced a substantial new order from Singapore Airlines for thirty-four 777s with options for forty-three more. This order marks a significant victory for Boeing, as Airbus aggressively pushed its A330 in competing bids. This new order for 777s, combined with the other recent new orders received by both Boeing and McDonnell Douglas, suggests that the long decline in domestic aircraft production may be bottoming out.

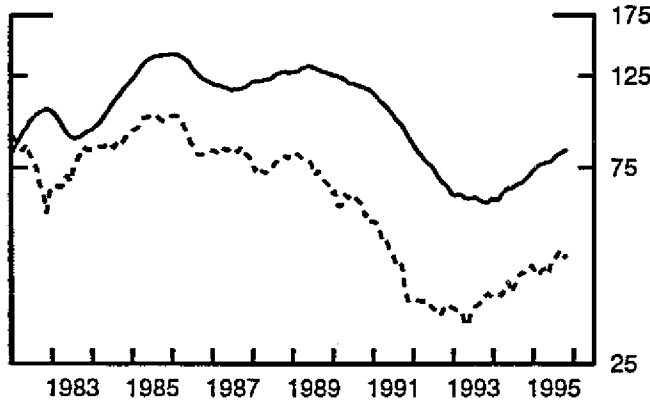
Outlays for nonresidential structures advanced strongly over the first three quarters of the year, and the most recent construction data are consistent with a continuation of this trend. Construction put in place in October was well above the third-quarter average. After a weak third quarter, industrial construction appears to be rebounding. Other commercial construction, which includes retail outlets, was also at a high level in October relative to the third quarter, despite anecdotal reports of overbuilding in the retail area. Construction of office and institutional buildings has been about flat. Leading indicators of future construction have been solid. A month or so ago, permits for nonresidential construction appeared to be dropping off their uptrend, but the sharp advance in October recovered most of the lost

Nonresidential Construction and Permits (Six-month moving average)

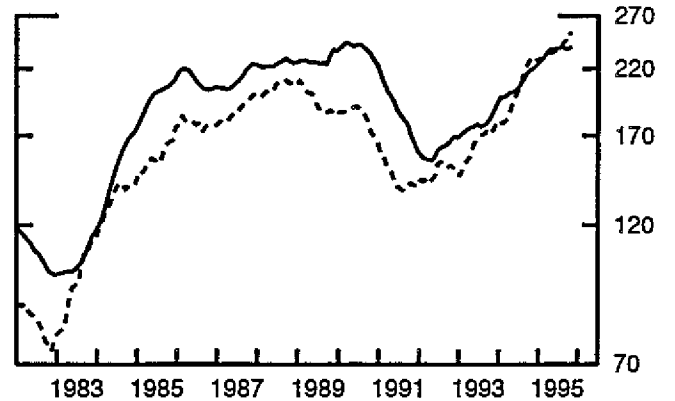
Total Building



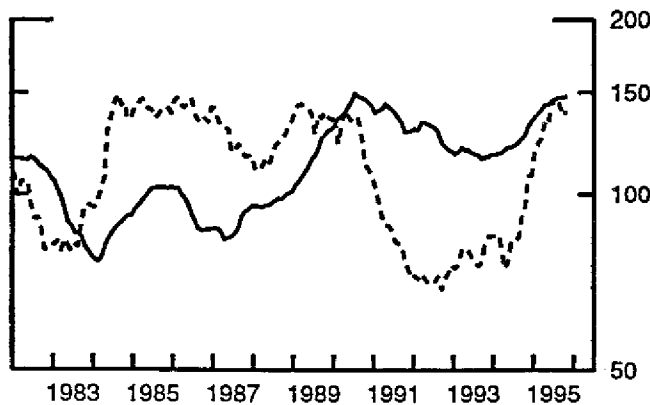
Office



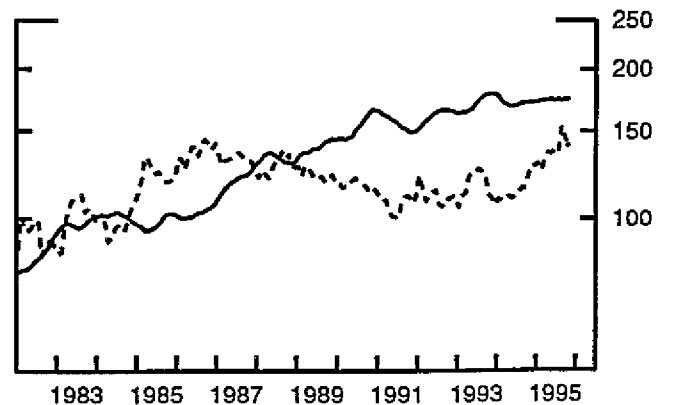
Other Commercial



Industrial



Institutional



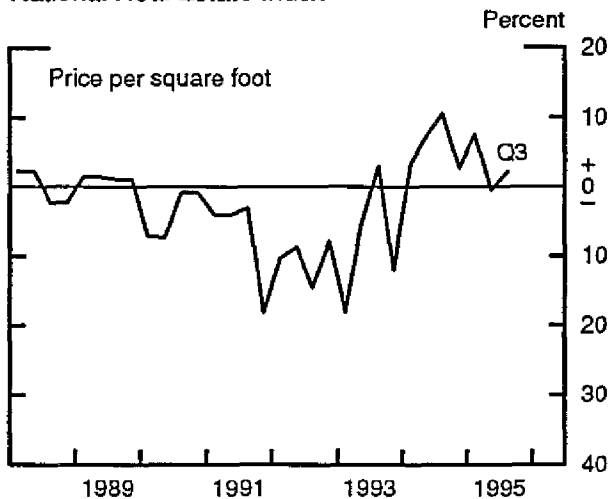
Note. The underlying monthly data were indexed to Dec. 1982 = 100; a six-month moving average was applied to the indexed data.

Indicators of Real Estate Conditions

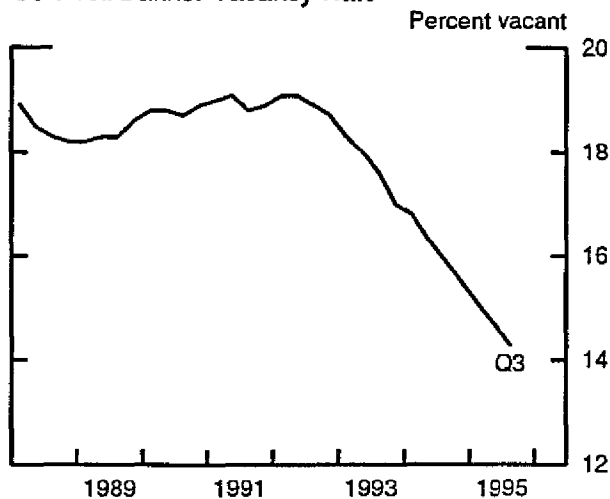
(Change; annual rate)

Office Sector

National Real Estate Index

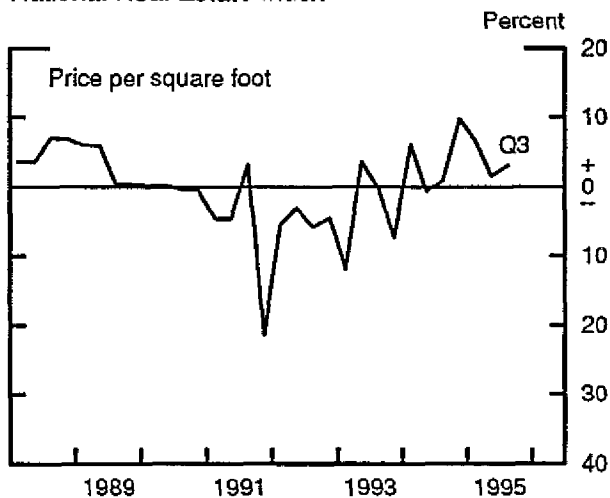


Coldwell Banker Vacancy Rate

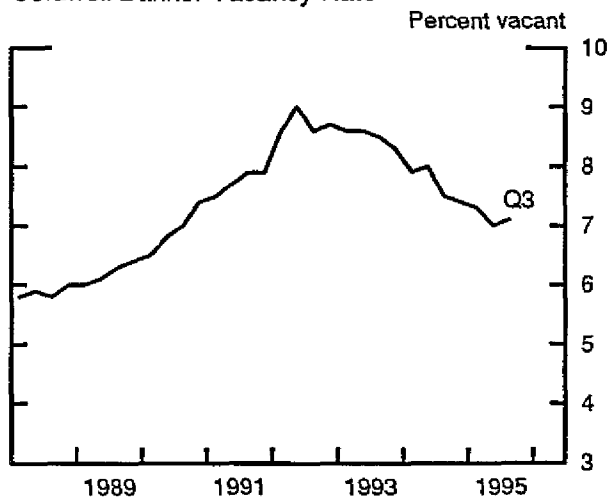


Industrial Sector

National Real Estate Index

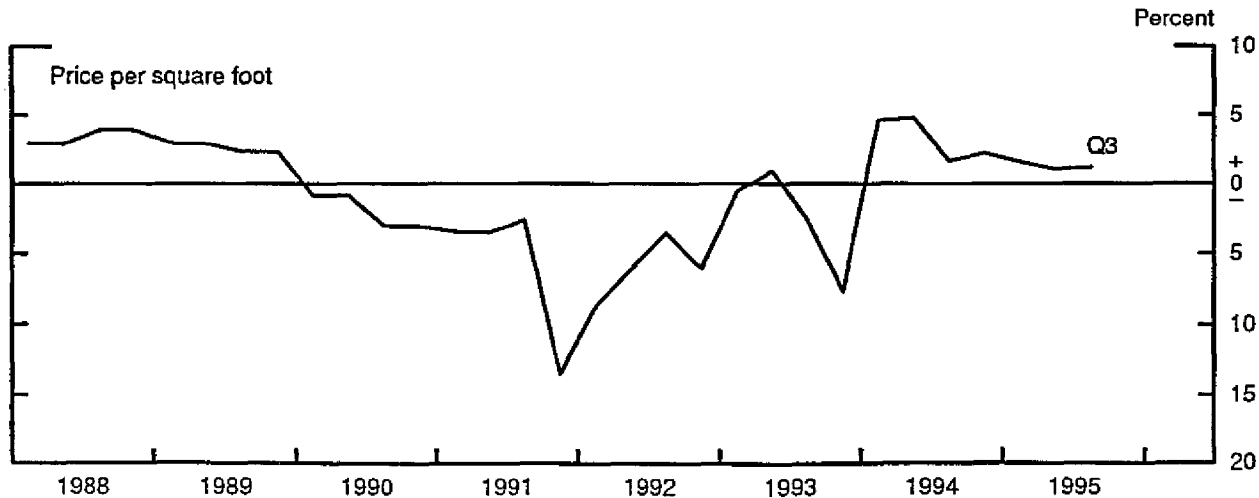


Coldwell Banker Vacancy Rate



Retail Sector

National Real Estate Index



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

	1995			1995		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Total	104.8	69.7	53.3	45.2	57.9	72.9
Excluding wholesale and retail motor vehicles	75.2	61.7	59.0	46.3	62.0	62.3
Manufacturing	41.1	31.7	24.7	8.7	36.4	19.7
Wholesale	35.0	25.4	17.0	-.5	12.6	21.5
Excluding motor vehicles	28.9	19.1	19.9	1.8	17.7	28.2
Retail	28.7	12.5	11.6	37.0	9.0	31.8
Automotive	23.4	1.7	-2.8	1.2	1.1	17.3
Excluding auto dealers	5.3	10.8	14.4	35.8	7.9	14.5
Constant-dollar basis						
Total	43.2	29.6	n.a.	5.4	n.a.	n.a.
Excluding motor vehicles	29.0	28.1	n.a.	34.7	n.a.	n.a.
Manufacturing	12.0	15.2	n.a.	1.3	n.a.	n.a.
Wholesale	21.5	13.1	n.a.	6.6	n.a.	n.a.
Excluding motor vehicles	16.4	8.4	n.a.	6.7	n.a.	n.a.
Retail	9.7	1.3	n.a.	-2.5	n.a.	n.a.
Automotive	8.9	-2.4	n.a.	-29.1	n.a.	n.a.
Excluding auto dealers	.8	3.7	n.a.	26.7	n.a.	n.a.

INVENTORIES RELATIVE TO SALES¹
(Months' supply; based on seasonally adjusted data at book value)

	1995			1995		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Total	1.40	1.42	1.42	1.41	1.41	1.43
Excluding wholesale and retail motor vehicles	1.36	1.38	1.39	1.38	1.38	1.39
Manufacturing	1.35	1.38	1.39	1.36	1.37	1.38
Wholesale	1.33	1.34	1.36	1.35	1.35	1.36
Excluding motor vehicles	1.30	1.32	1.33	1.33	1.32	1.34
Retail	1.54	1.54	1.54	1.53	1.54	1.56
Automotive	1.81	1.79	1.73	1.70	1.74	1.77
Excluding auto dealers	1.46	1.46	1.48	1.48	1.47	1.49
Constant-dollar basis						
Total	1.44	1.46	n.a.	1.45	n.a.	n.a.
Excluding motor vehicles	1.42	1.44	n.a.	1.43	n.a.	n.a.
Manufacturing	1.38	1.41	n.a.	1.39	n.a.	n.a.
Wholesale	1.42	1.44	n.a.	1.46	n.a.	n.a.
Excluding motor vehicles	1.40	1.42	n.a.	1.44	n.a.	n.a.
Retail	1.57	1.56	n.a.	1.55	n.a.	n.a.
Automotive	1.72	1.69	n.a.	1.59	n.a.	n.a.
Excluding auto dealers	1.53	1.52	n.a.	1.53	n.a.	n.a.

1. Ratio of end-of-period inventories to average monthly sales for the period.

ground. Other indicators of the general health of the nonresidential sector are also quite positive. Prices of existing properties are increasing moderately, and vacancy rates have been declining steadily.

Drilling and mining activity has continued to advance in recent quarters, lifted by increased exploration for natural gas. A trend toward gas-powered electricity generation is expected to spur the demand for natural gas for many years. Acting on that expectation, drillers have tended to look beyond the softness in natural gas prices of this past year, when technological gains in drilling and recovery increased the typical yield of a given existing rig, enabling production gains to outstrip the growth of demand, at least temporarily.

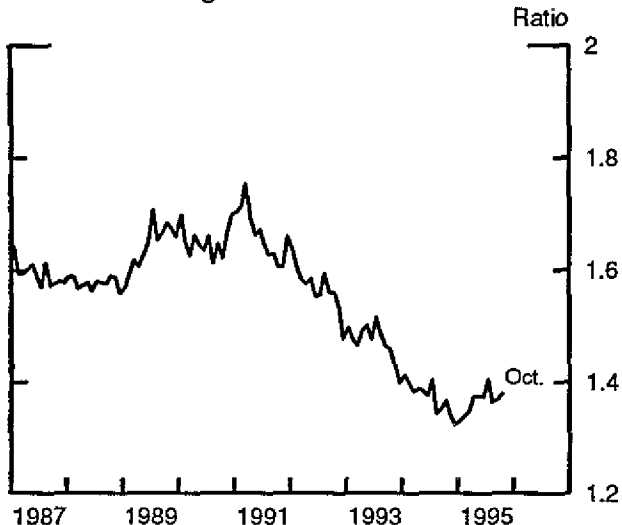
Inventories

Incoming data show that business inventories continued to accumulate at a brisk pace in October. Excluding motor vehicles, book-value stocks in manufacturing and trade expanded at an annual rate of \$62.3 billion in that month. Shipments and sales in manufacturing and trade were down 0.4 percent in October, and the non-auto inventory-sales ratio edged up. For some lines of products, inventories may have been to the high side of desired levels at the end of October, but serious overhangs have not been widely cited in recent anecdotal reports.

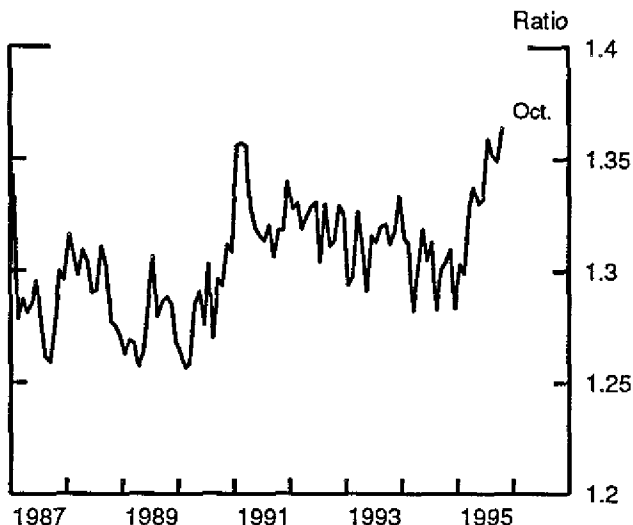
Manufacturers' inventory investment remained relatively robust in October. Factory stocks expanded about \$20 billion at an annual rate in that month, only moderately slower than the third-quarter pace. The basic pattern of manufacturers' inventory change that has prevailed through much of this year apparently continued in early autumn. In particular, the October increase was again concentrated in stocks held at capital goods industries, especially industrial

Inventory-Sales Ratios Manufacturing and Wholesale Trade

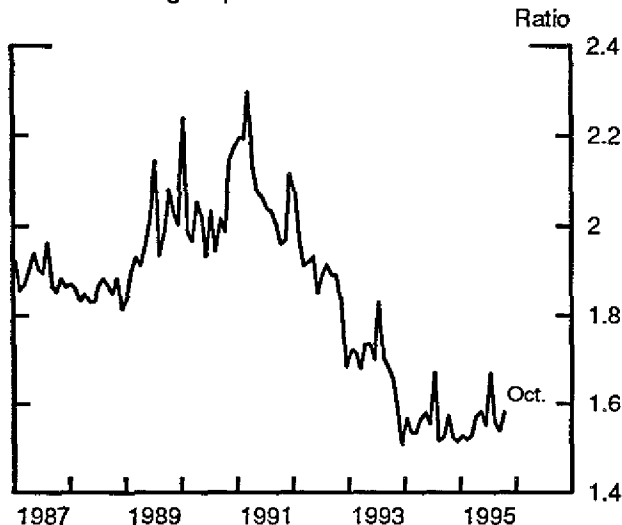
All Manufacturing



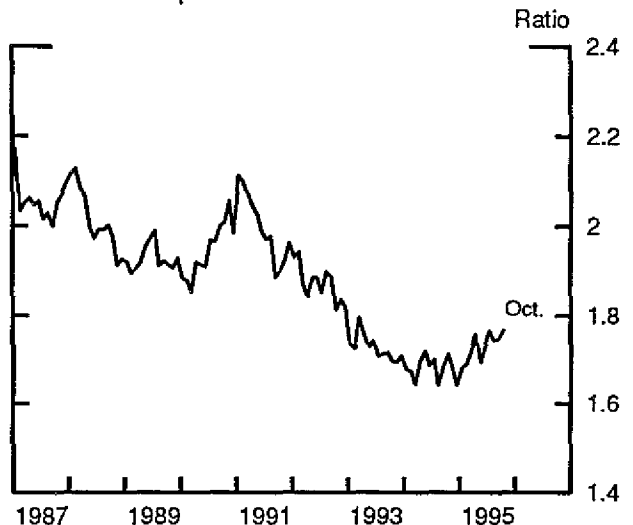
Wholesale



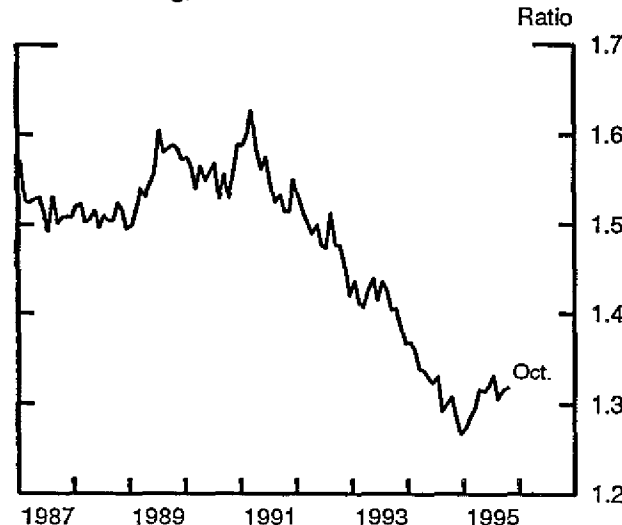
Manufacturing Capital Goods



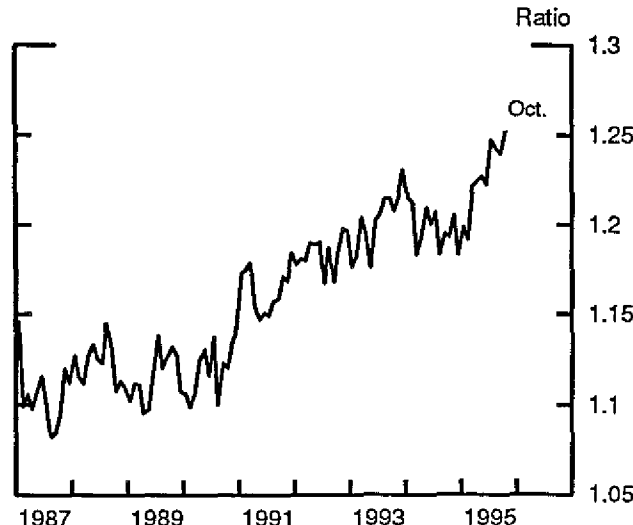
Wholesale Capital Goods



Manufacturing, Other

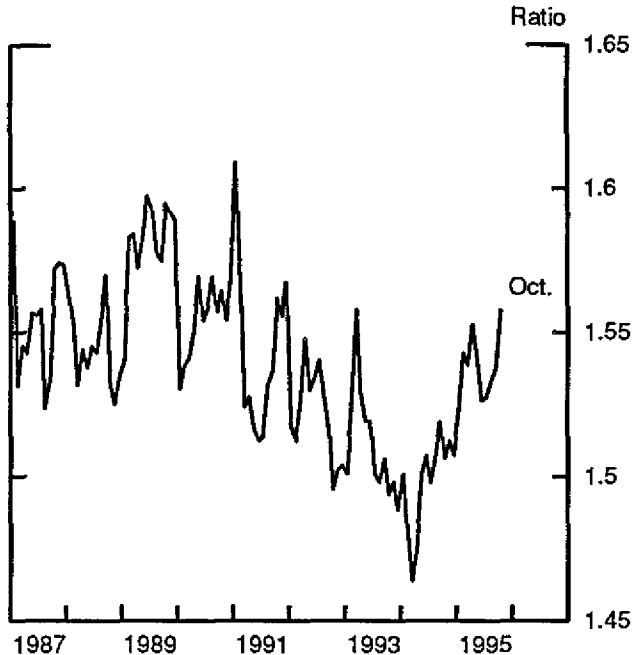


Wholesale, Other

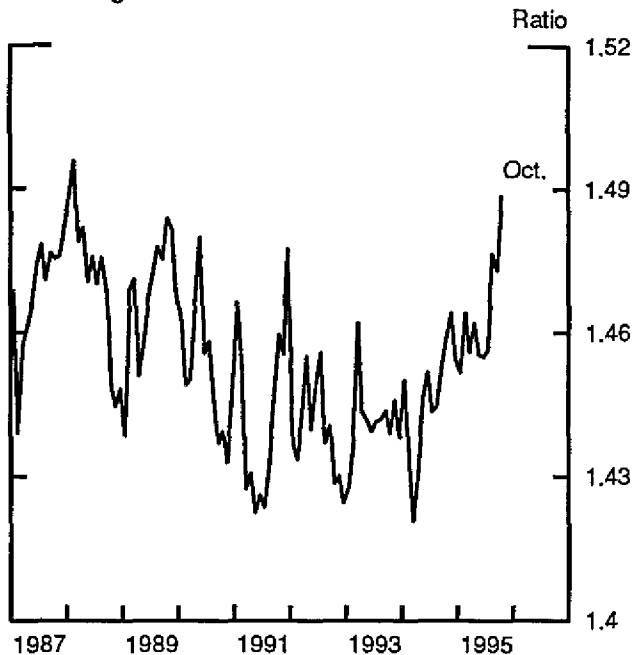


Inventory-Sales Ratios Retail Trade

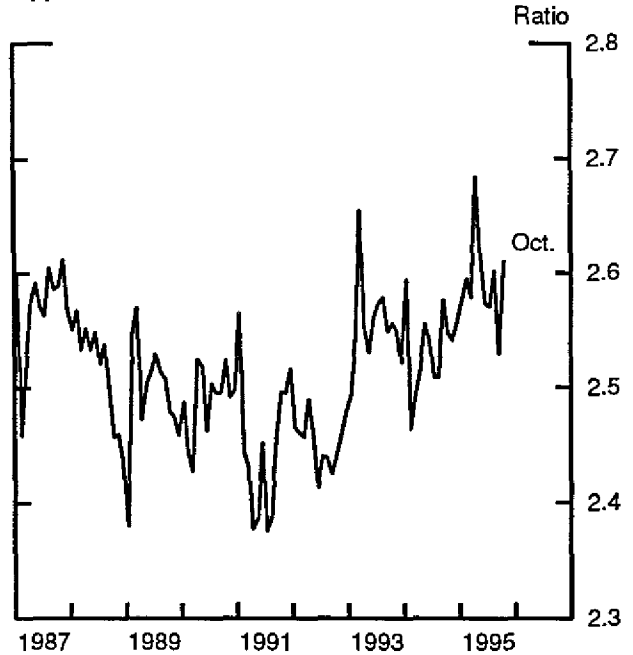
Total Retail



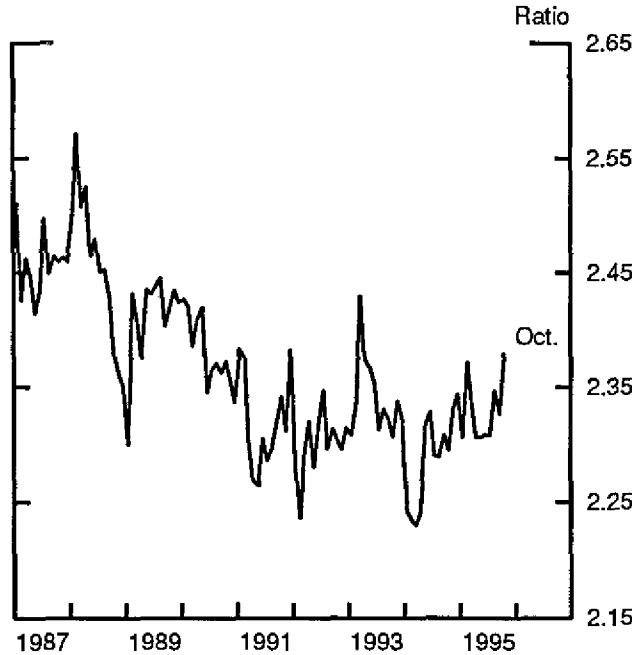
Excluding Autos



Apparel



General Merchandise



machinery, computers and computer peripherals, telecommunications equipment, and electronic components. Outside capital goods, manufacturers' net inventory investment was modest in October, as stocks at many materials-producing industries--including primary and fabricated metals, chemicals, and rubber and plastics--were trimmed. The aggregate ratio of inventories to sales for producers outside the capital goods lines has changed little, on net, in recent months and remains moderately above the lows of late 1994 and early 1995.

The buildup in capital equipment stocks has continued at the wholesale level as well. In October, stocks held by machinery dealers and distributors of professional and office equipment rose sharply again, accounting for the bulk of the wholesale inventory accumulation in that month. The October rise in stocks of capital goods followed sizable increases in the inventories of these goods through much of 1995, and the aggregate inventory-sales ratio for wholesalers of capital goods has moved up noticeably. Elsewhere in wholesale trade, the stocks held by distributors of paper products increased sharply in October, as did the inventories at some other miscellaneous categories of wholesalers. The ratio of inventories to sales for wholesalers outside the capital goods area turned back up in October; it has risen sharply since the start of 1995.

Retail inventories rose sharply in October, led by large run-ups in stocks at auto dealers and GAF stores. The October accumulation of GAF stocks, at an annual rate of \$11.6 billion, was considerably above the third-quarter pace. With sales sluggish at GAF stores in October, the inventory-sales ratio for the group rose to its highest level of the past two years. However, GAF sales rebounded strongly in November, according to the advance report on retail sales. Outside of auto dealers and GAF stores, retail inventory changes

were relatively modest in October, and inventory-sales ratios remained within the ranges posted over the past year.

Federal Sector

The federal government recorded a \$23 billion deficit in the unified budget in October. Excluding deposit insurance, the deficit for October was about \$8 billion less than a year earlier. Higher receipts accounted for \$7 billion of this deficit reduction and were paced by strong individual withheld income taxes. Lower outlays were responsible for the remaining \$1 billion decline in the deficit excluding deposit insurance. Increased spending for health-related programs, social security, and net interest was more than offset by a net reduction in all other spending. The spending restraint seen in October was consistent with the restrictions imposed by the continuing resolution that funded most discretionary programs between October 1 and November 13.

After a partial government shutdown from November 14 to November 19, a second continuing resolution was passed.⁶ This resolution has funded government operations that would have been covered by the six appropriations bills that are still pending.⁷ Not all of these remaining appropriations bills are likely to be signed into law before the continuing resolution expires tomorrow night, and, therefore, expedient passage of another continuing

6. In general, the current continuing resolution funds programs at a provisional level equal to the minimum of the fiscal 1995 level and the levels called for by the House and Senate versions of the appropriations bills. However, most programs that would have their funding "significantly reduced" under this formula can have their funding rate increased to 75 percent of the fiscal 1995 level, and adequate funding is ensured to avoid worker layoffs.

7. As of December 14, seven appropriations bills had been enacted (Agriculture, Defense, Energy-Water, Legislative Branch, Military Construction, Transportation, and Treasury-Postal Service-General Government) and six remain (Commerce-Justice-State-Judiciary, District of Columbia, Foreign Operations, Interior, Labor-Health-Human Services-Education, and Veterans Affairs-Housing-Urban Development).

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis, billions of dollars, except where otherwise noted)

	Oct. 1994	Oct. 1995	Fiscal year to date			
			FY1995	FY1996	Dollar change	Percent change
Outlays	120.4	118.4	120.4	118.4	-2.0	-1.7
Deposit insurance (DI)	-.7	-1.2	-.7	-1.2	-.5	73.0
Outlays excluding DI	121.1	119.5	121.1	119.5	-1.5	-1.2
National defense	18.8	18.4	18.8	18.4	-.5	-2.4
Net interest	18.7	20.6	18.7	20.6	1.9	10.2
Social security	26.7	28.1	26.7	28.1	1.4	5.1
Medicare and health	19.7	22.3	19.7	22.3	2.6	13.2
Income security	15.3	14.5	15.3	14.5	-.8	-4.9
Other	21.9	15.7	21.9	15.7	-6.2	-28.2
Receipts	89.0	95.6	89.0	95.6	6.6	7.4
Personal income taxes	43.2	51.8	43.2	51.8	8.6	19.9
Social insurance taxes	32.7	32.1	32.7	32.1	-.6	-1.8
Corporate income taxes	3.5	2.2	3.5	2.2	-1.3	-37.2
Other	9.6	9.5	9.6	9.5	-.2	-1.7
Deficit(+)	31.3	22.8	31.3	22.8	-8.6	-27.4
Excluding DI	32.0	23.9	32.0	23.9	-8.1	-25.2

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

CBO's December Budget Projections
(Fiscal years, billions of current dollars)

	1996	1997	1998	1999	2000	2001	2002
Budget Resolution baseline deficit	211	231	233	267	298	311	341
Economic and technical revisions	<u>-31</u>	<u>-26</u>	<u>-11</u>	<u>-19</u>	<u>-30</u>	<u>-26</u>	<u>-28</u>
December baseline deficit	180	205	222	248	268	285	313
Policy changes	-22	-24	-58	-100	-133	-179	-234
Fiscal dividend	<u>-7</u>	<u>-22</u>	<u>-37</u>	<u>-51</u>	<u>-62</u>	<u>-72</u>	<u>-82</u>
Deficit under Balanced Budget Act with December assumptions	151	159	127	97	73	34	-3
----- memorandum: Deficit under Balanced Budget Act with Budget Resolution assumptions	178	189	146	118	100	46	-4

Note. The Budget Resolution baseline is based on CBO's April projections adjusted for several minor factors. Both the Budget Resolution baseline deficit projections and the December baseline deficit projections in the table do not include the fiscal dividend, which measures the budgetary effects of economic changes resulting from deficit reduction.

resolution would be necessary to avoid a shutdown of government operations still lacking appropriations.

The President vetoed the budget reconciliation bill passed by the Congress, which proposed legislative changes to mandatory spending programs and taxes designed to balance the budget by fiscal 2002. With the intent of helping achieve a compromise budget bill, the recent continuing resolution required that the effects of the reconciliation bill be re-estimated using CBO's December update of economic and technical assumptions. Revisions of these underlying budget assumptions lowered CBO's baseline projections of the deficit through fiscal 2002. The CBO estimated that the reconciliation bill, in conjunction with the proposed discretionary spending caps, would result in a seven-year deficit total that is \$135 billion below their estimate with the April assumptions that were used in the budget resolution. However, the re-estimated budget surplus of \$3 billion in fiscal 2002 was little changed from the previous estimate, because reductions in the deficit for that year due to revised economic and technical assumptions were approximately offset by lower estimated budgetary savings from the policy proposals in the budget bill.

Legislation that would permanently increase the federal borrowing limit was part of the budget reconciliation bill that the President vetoed. However, before the veto, the Treasury took actions to reduce the near-term pressure of a debt limit impasse. On November 15, the Treasury exercised its authority not to fully reinvest securities in the Federal Employees Retirement System's Government Securities Investment Fund and to redeem a portion of the securities held by the Civil Service Retirement and Disability Fund. These actions created borrowing room of approximately \$61 billion, which should be sufficient to finance government operations until

State and Local Government Year-End Balances

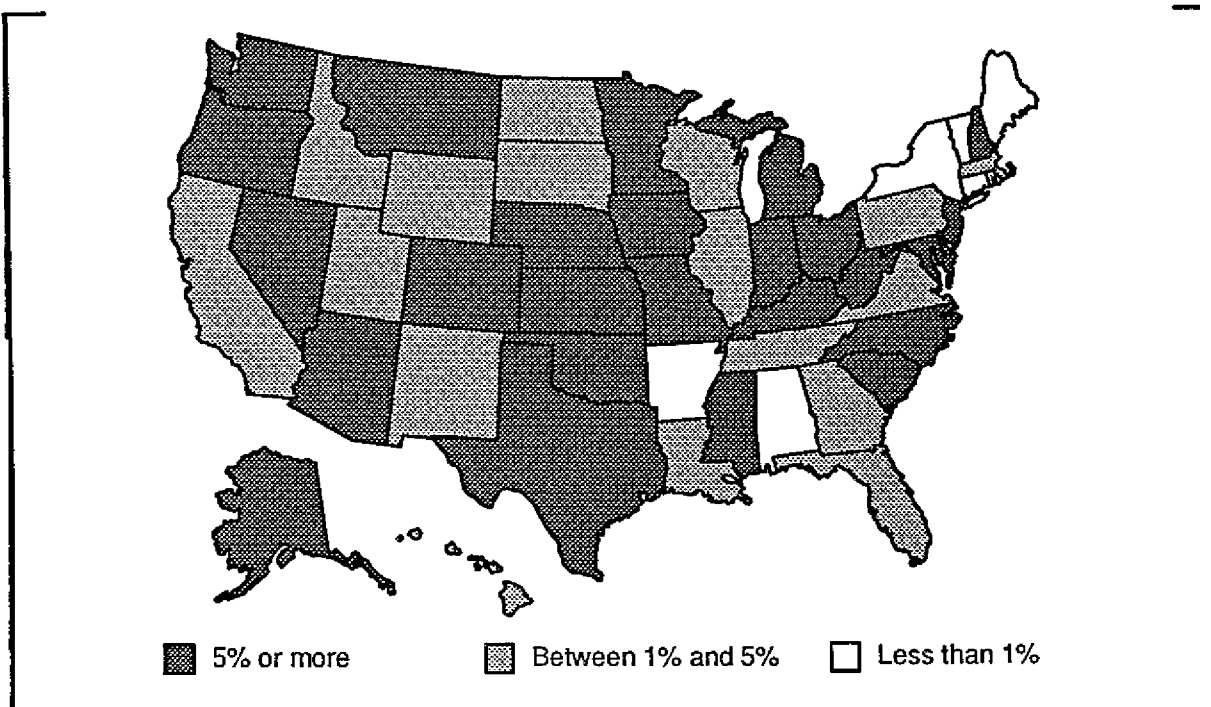
(As a percentage of fiscal year expenditures)

Sector Total



Note. National Association of State Budget Officers estimate (1995) and forecast (1996).

Fiscal 1995



Source. National Association of State Budget Officers.

the end of December. The Treasury has indicated that it will divert a \$14.5 billion interest payment owed to the Civil Service Fund at the end of this month, which would allow the Treasury to meet payment demands until about the end of January. Other options that would further allow federal financing under the current debt limit, such as tapping some of the \$83 billion assets held by the Federal Financing Bank, are being considered, but Treasury has not released any longer-term plans at this time.

State and Local Governments

Data available for the fourth quarter suggest that growth in purchases by state and local governments remained quite strong. Essentially all of the strength so far has been in construction spending, which rose 4.5 percent in October following a strong advance in September. As a result, the level of construction in October stands 6.4 percent above its average in the third quarter (not at an annual rate). The recent increases were widespread and lifted the major categories of construction to levels near or above past records. In contrast, employment of state and local workers was flat for the first two months of the fourth quarter.

The fiscal condition of many state governments continued to improve over the past fiscal year. According to a recent survey by the National Association of State Budget Officers, balances in state general fund budgets were equal to 5.7 percent of expenditures at the end of fiscal 1995, which ended in June 1995 for most states. The fiscal 1995 figure was up a bit from an already high 1994 level and resulted primarily from stronger-than-expected tax collections. Only in a handful of states are budgetary problems still apparent.

Prices

Retail inflation trends appear to be holding steady. Over the twelve months ended in November, the overall CPI rose 2.6 percent.

RECENT CHANGES IN CONSUMER PRICES
(Percent change; based on seasonally adjusted data)¹

	Relative importance, Dec. 1994	1993	1994	1995			1995	
				Q1	Q2	Q3	Oct.	Nov.
				-----Annual rate-----			-Monthly rate-	
All items ²	100.0	2.7	2.7	3.2	3.2	1.8	.3	.0
Food	15.8	2.9	2.9	.0	3.6	3.6	.3	-.1
Energy	7.0	-1.4	2.2	-1.1	5.4	-11.5	.4	-.9
All items less food and energy	77.2	3.2	2.6	4.1	3.0	2.8	.3	.1
Commodities	24.1	1.6	1.4	2.6	.6	2.3	.2	.0
Services	53.1	3.9	3.2	4.8	4.3	3.0	.3	.2
Memo: CPI-W ³	100.0	2.5	2.7	3.6	2.7	1.6	.3	.0

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

RECENT CHANGES IN PRODUCER PRICES
(Percent change; based on seasonally adjusted data)¹

	Relative importance, Dec. 1994	1993	1994	1995			1995	
				Q1	Q2	Q3	Oct.	Nov.
				-----Annual rate-----			-Monthly rate-	
Finished goods	100.0	.2	1.7	3.2	.6	1.3	-.1	.5
Consumer foods	22.8	2.4	1.1	-1.2	-4.6	8.8	.0	1.2
Consumer energy	13.6	-4.1	3.5	11.3	1.5	-14.3	-.9	-.5
Other finished goods	63.7	.4	1.6	2.9	2.6	2.3	.0	.4
Consumer goods	40.2	-.4	1.4	2.9	3.2	2.3	.1	.4
Capital equipment	23.5	1.8	2.0	3.0	1.8	2.1	-.1	.4
Intermediate materials ²	95.6	.8	4.8	10.6	3.9	-.6	-.4	-.1
Excluding food and energy	82.9	1.6	5.2	10.5	4.2	1.8	-.3	-.2
Crude food materials	40.4	7.2	-9.4	-4.6	-.8	42.3	2.1	3.6
Crude energy	34.5	-12.3	-.1	-4.5	14.6	-22.0	-.4	2.1
Other crude materials	25.1	10.7	17.3	21.9	4.6	-18.2	-2.6	-2.1

1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

little changed from the 2.7 percent increase in the preceding twelve months. The CPI excluding food and energy increased 3.0 percent in the latest twelve-month period, up only a touch from the 2.8 percent rise over the preceding twelve months. Monthly data for November showed a rise of just 0.1 percent in the index excluding food and energy; the CPI for all items was unchanged. In the PPI, the index for finished goods other than food and energy jumped 0.4 percent in November, but materials prices remained soft.

Consumer energy prices turned back down in November, after a one-month uptick in October. Gasoline prices fell for the fifth consecutive month, and heating oil prices also continued to decline. Price changes for the service fuels were mixed--natural gas prices fell, but electricity prices rose further after a large increase in October. In December, a firmer tone has been evident in some of the indicators of energy prices. Spot prices of fuel oil have been pushed up in recent weeks by cold temperatures and the related jump in demand. Upward pressure has also appeared in wholesale markets for gasoline in recent weeks, and data from Lundburg Surveys suggest that prices at the pump could move up considerably in December.

After a jump in September, food price increases slowed in October, and the November data brought a slight decline. Increases in the prices of cereals, meats, and dairy products were more than offset last month by a sharp decline in the prices of fresh fruits and vegetables. Over the past twelve months, the CPI for food has risen 2.8 percent, somewhat more than the increase over the previous year. Increases in the price index for food away from home, a category that is heavily dominated by value added from nonfarm inputs, has accelerated a little this year. At grocery stores, the CPI for meats, poultry, fish, and eggs has moved up 3.5 percent over the past year, after changing little over the previous twelve-month

INFLATION RATES EXCLUDING FOOD AND ENERGY

	Percent change from twelve months earlier		
	Nov. 1993	Nov. 1994	Nov. 1995
CPI	3.1	2.8	3.0
Goods	1.6	1.5	1.7
Alcoholic beverages (2.0) ¹	1.2	1.3	2.2
New vehicles (6.6)	3.2	3.4	2.0
Apparel (6.6)	1.1	-1.8	-0.4
House furnishings (4.5)	1.2	0.4	0.2
Housekeeping supplies (1.4)	1.3	0.5	5.4
Medical commodities (1.7)	3.3	3.1	1.8
Entertainment (2.5)	1.6	2.2	2.4
Tobacco (2.1)	-4.7	3.2	3.4
Used cars (1.7)	8.3	6.7	5.1
Services	3.7	3.5	3.6
Owners' equivalent rent (26.3)	3.0	3.6	3.4
Tenants' rent (7.5)	2.0	2.6	2.4
Other renters' costs (2.8)	3.1	2.9	4.4
Airline fares (1.3)	14.5	-5.6	7.7
Medical care (7.7)	5.9	5.2	4.6
Entertainment (3.1)	3.7	3.0	3.4
Auto financing (0.8)	-5.7	17.5	6.6
Tuition (3.4)	7.3	5.9	5.6
PPI finished goods	0.3	1.6	2.7
Consumer goods	-0.5	1.5	2.8
Capital goods, excluding computers	2.3	1.9	2.6
Computers	-12.6	-7.0	12.3
PPI intermediate materials	1.6	4.8	4.1
PPI crude materials	11.6	15.7	-1.5
<u>Factors affecting price inflation</u>			
ECI hourly compensation ²	3.7	3.3	2.6
Goods-producing	4.0	3.3	2.1
Service-producing	3.6	3.2	2.9
Civilian unemployment rate ^{3,4}	6.5	5.6	5.6
Capacity utilization ³ (manufacturing)	81.0	84.2	82.2
Inflation expectations ^{3,5,6}			
Michigan Survey	3.8	4.0	3.2
Conference Board	4.3	4.2	4.0
Non-oil import price ⁷	0.3	3.2	3.5
Consumer goods, excluding autos, food, and beverages	0.6	0.7	1.7
Autos	1.6	3.5	3.4

1. Relative importance weight in CPI excluding food and energy.
2. Private industry workers, periods ended in September.
3. End-of-period value.
4. Data after 1993 are not directly comparable with earlier values because of a redesign of the CPS in January 1994.
5. One-year-ahead expectations.
6. Latest reported values: December for the Michigan Survey; November for the Conference Board.
7. BLS import price index (not seasonally adjusted), periods ended in September.

period, and fruit and vegetable prices have increased appreciably. By contrast, coffee prices, which soared in 1994, have turned down in 1995.

The CPI for commodities other than food and energy was unchanged in November, after increasing 0.2 percent in October. Over the twelve months ended in November, this index for nonfood, nonenergy goods increased 1.7 percent, slightly more than the 1.5 percent increase recorded in the preceding year. The pickup resulted from an acceleration in prices of nondurables. Year-to-year declines in apparel prices have slowed, as these prices have changed little, on balance, over the past few months. Prices of household paper products also continue to show large increases from the levels of a year earlier; however, the twelve-month rate of rise for this category should start to slow because the prices of paper products at the intermediate materials stage have been declining in recent months. Durables prices have changed little over the past three months; the twelve-month change in these prices was 1.7 percent in November. Auto prices were almost flat in October and November. Twelve-month increases in new auto prices have slowed to a pace about half the year-earlier rate.

The prices of nonenergy services increased 0.2 percent in November, slightly less than the average for the past year. Auto finance charges continued to move down last month, and the index for airfares fell sharply, after a sizable rise in October. The indexes for owners' equivalent rent and residential rent each rose 0.3 percent in November; twelve-month changes in these two series were 3.4 percent and 2.4 percent respectively, about in line with recent trends.

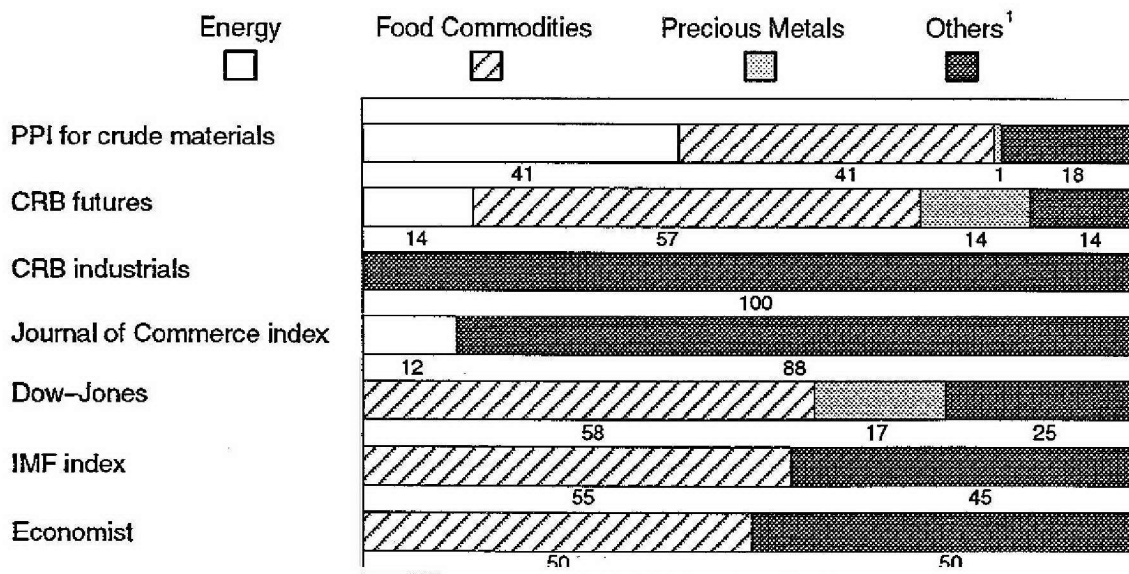
The November jump in the PPI for finished goods other than food and energy was the largest increase for that category since January.

COMMODITY PRICE INDEXES

	Last observ- ation	-----Percent change ¹ -----				Memo: Year earlier to date
		1993	1994	Dec. 94 to Nov. 07 ²	Nov. 07 ² to date	
PPI for crude materials ³	Nov.	0.1	-0.5	3.1	n.a.	4.5
Foods and feeds	Nov.	7.2	-9.4	12.1	n.a.	13.4
Energy	Nov.	-12.3	-0.1	-2.3	n.a.	-1.4
Excluding food and energy	Nov.	10.7	17.3	-4.0	n.a.	-1.5
Excluding food and energy, seasonally adjusted	Nov.	10.5	17.6	-3.6	n.a.	-1.5
Commodity Research Bureau						
Futures prices	Dec. 12	11.6	4.8	3.5	-0.2	6.4
Industrial spot prices	Dec. 12	-0.0	29.1	-1.1	-1.3	-1.3
Journal of Commerce industrials	Dec. 12	-2.9	22.1	-1.2	0.6	-0.2
Metals	Dec. 12	-1.8	31.9	-0.5	-0.4	0.8
Dow-Jones spot	Dec. 12	5.1	14.8	0.7	-1.0	1.7
IMF commodity index ³	Oct.	2.4	15.2	n.a.	n.a.	21.7
Metals	Oct.	-14.4	39.1	n.a.	n.a.	0.4
Nonfood agricultural	Oct.	0.2	14.8	n.a.	n.a.	5.3
Economist (U.S. dollar index)	Dec. 05	9.1	31.0	-4.0	-2.7	-4.9
Industrials	Dec. 05	4.4	38.6	-4.7	-1.7	-4.3

Note. Not seasonally adjusted. Copyright for Journal of Commerce data is held by CIBCR, 1994.
 1. Change is measured to end of period, from last observation of previous period.
 2. Week of the November Greenbook.
 3. Monthly observations. IMF index includes items not shown separately.
 n.a. Not available.

Index Weights



1. Forest products, industrial metals, and other industrial materials.

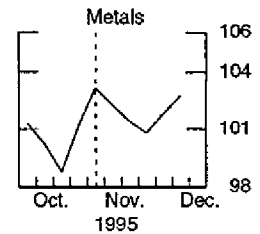
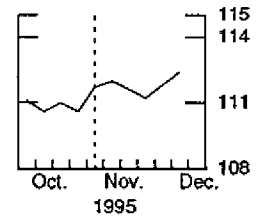
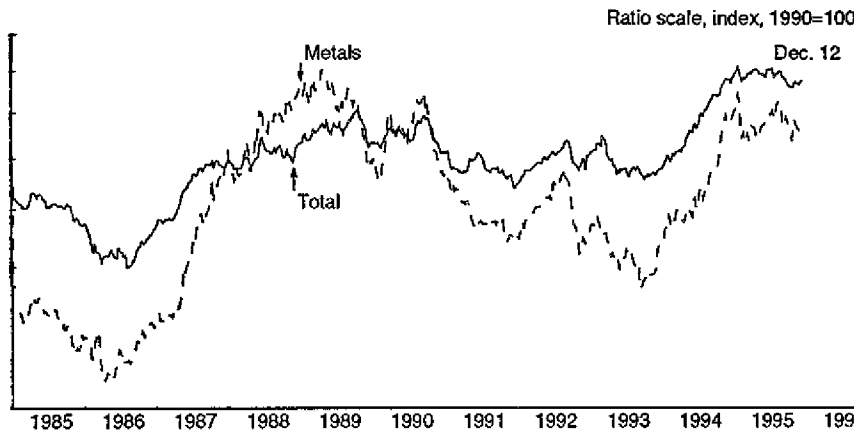
Prices of motor vehicles were boosted last month by the first appearance of some 1996 models in the PPI; more typically, new models are first captured in the data for October. At earlier stages of processing, inflation pressures still appear to be retreating. The PPI for intermediate materials other than food and energy fell in both October and November. Over the past six months, this measure has changed little, after rising 7.9 percent in the preceding twelve months. The improvement reflects the easing this year of operating rates in materials-producing industries, in the context of ongoing competitive pressures from foreign producers.

Measures of changes in the prices of raw industrial commodities have been mixed in recent weeks. The *Journal of Commerce* commodity price index has edged up since the week of the last Greenbook, but the CRB measure of industrial spot prices has moved down further. Prices of steel scrap have held steady since mid-November. Aluminum prices have continued to fall in the past six weeks in the face of higher-than-normal stocks in London Metal Exchange warehouses. Lumber and plywood prices have fallen moderately and are well below the levels of a year ago.

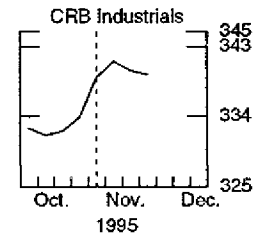
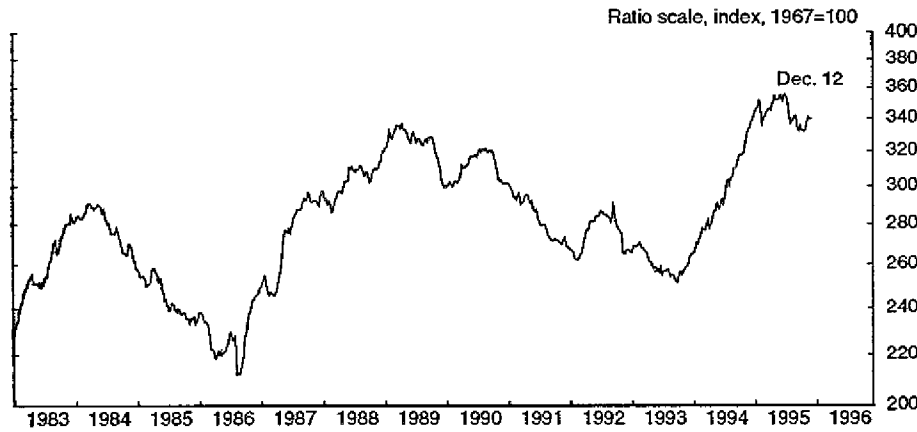
Prices for agricultural crops have moved higher, on net, since the last Greenbook. Although these prices fell back a little through the middle part of November, just after the release of the USDA's November crop forecast, they have turned back up in early December. Reduced production in the United States and rising export demand, especially on the part of China and Korea, has fueled the run-up in grain and oilseed prices this year. The Agriculture Department's December assessment of world supply and demand conditions, released earlier this week, contained no new information on U.S. production of grains and oilseeds, and revisions to the agency's forecasts of demand were small; market prices changed

Commodity Price Measures

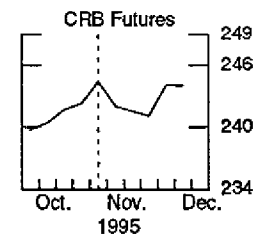
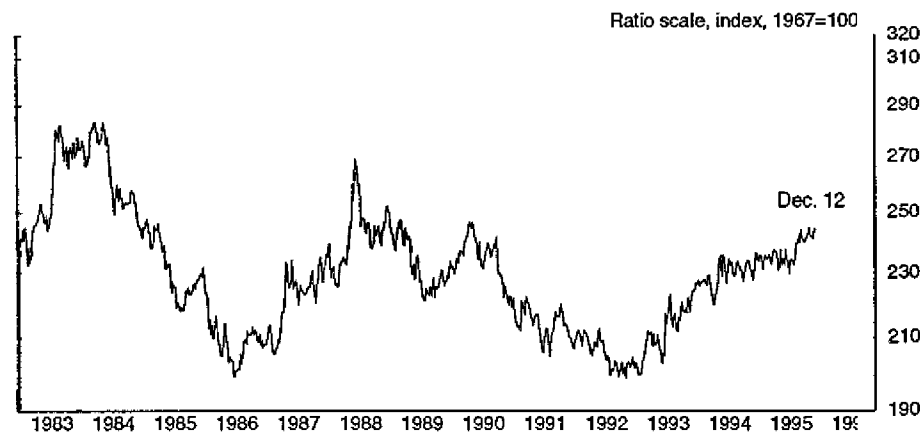
Journal of Commerce Index



CRB Spot Industrials



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 CRB spot price index consists entirely of industrial commodities, excluding energy. The 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.

little in the wake of the report. In the livestock markets, prices for slaughter steers have held steady in recent weeks, and hog prices have recovered some of the ground they lost earlier this fall. Increases in farm commodity prices also have been evident in futures markets and have lifted the CRB futures price index, which gives heavy weight to farm products.

Price developments of recent months appear to have left a favorable imprint on consumers' expectations of inflation. Based in part on preliminary data for December, one-year-ahead inflation expectations in the Michigan survey averaged 3.5 percent in the final three months of 1995, compared with year-ahead expectations of inflation of more than 4 percent in the final quarter of 1994 and in the first half of 1995. Other measures of inflation expectations reported by the Michigan survey--including the mean for five to ten years ahead--also have edged lower, and a little improvement has been evident as well in expectations data from the Conference Board. In the Michigan survey, mean expectations of inflation remain above actual rates of inflation, but the gap has narrowed this year.

SPOT PRICES OF SELECTED COMMODITIES

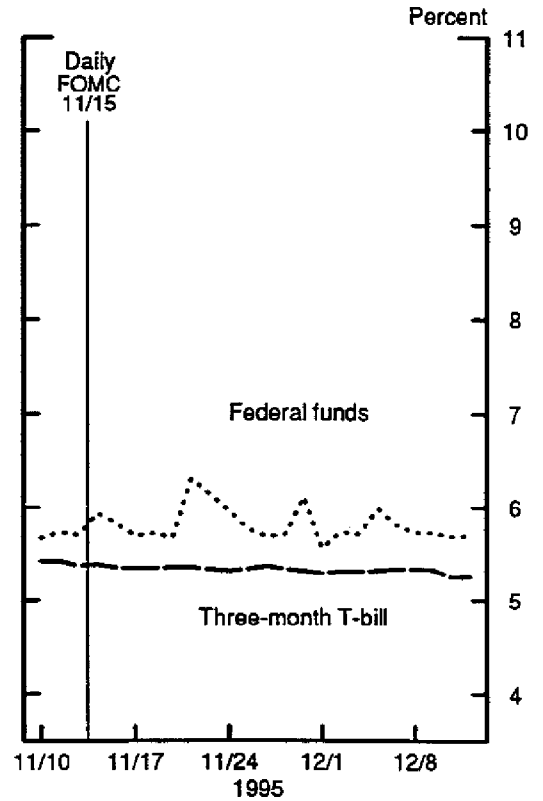
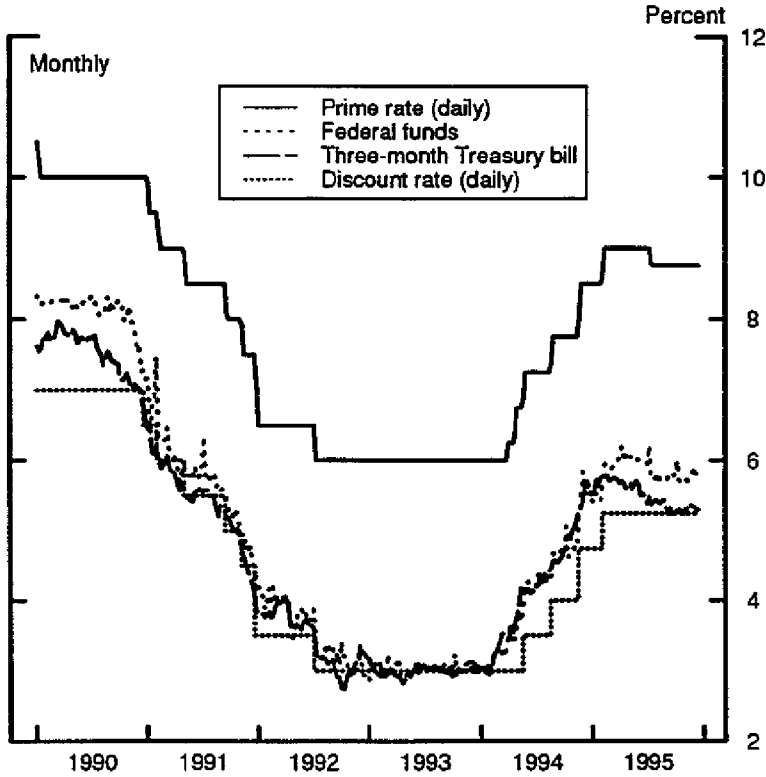
	Current price (\$)	-----Percent change ¹ -----				Memo: Year earlier to date
		1993	1994	To Nov. 07 ²	Nov. 07 ² to Dec. 12	
-----INDUSTRIAL COMMODITIES-----						
Metals						
Copper (lb.)	1.400	-19.0	64.9	-.7	.0	.7
Steel scrap (ton)	134.000	46.8	2.9	-6.3	-.4	-6.6
Aluminum, London (lb.)	.746	-10.7	73.5	-12.8	-1.4	-8.6
Lead (lb.)	.456	3.0	20.7	4.7	4.5	9.9
Zinc (lb.)	.510	-7.5	23.6	-8.6	-3.3	-10.5
Tin (lb.)	4.271	-14.1	21.4	6.4	1.1	6.9
Textiles and fibers						
Cotton (lb.)	.834	19.6	38.5	-1.4	-1.7	4.3
Burlap (yd.)	.350	8.2	10.2	25.0	-4.1	19.9
Miscellaneous materials						
Hides (lb.)	.725	1.3	14.2	-11.4	-9.4	-19.9
Rubber (lb.)	.870	-7.3	75.4	3.2	7.4	12.6
-----OTHER COMMODITIES-----						
Precious metals						
Gold (oz.)	388.800	16.6	-1.7	.9	1.0	2.6
Silver (oz.)	5.180	38.8	-5.0	11.2	-2.7	9.1
Platinum (oz.)	413.000	8.0	7.5	-1.5	1.2	-.2
Forest products						
Lumber (m. bdft.)	249.000	75.8	-37.1	-13.7	-1.2	-13.2
Plywood (m. sqft.)	307.000	-6.3	1.5	-3.6	-3.5	-15.9
Petroleum						
Crude oil (barrel)	17.430	-25.0	15.6	7.8	3.6	11.4
Gasoline (gal.)	.531	-31.0	32.4	1.0	7.1	13.3
Fuel oil (gal.)	.571	-22.4	12.7	2.9	12.7	17.2
Livestock						
Steers (cwt.)	67.000	-7.3	-3.4	-4.3	.0	-4.3
Hogs (cwt.)	45.500	.6	-12.9	15.5	11.0	42.2
Broilers (lb.)	.534	6.1	-4.9	18.5	-8.1	3.6
U.S. farm crops						
Corn (bu.)	3.330	41.7	-23.2	47.6	2.3	53.5
Wheat (bu.)	5.488	5.8	11.4	20.6	4.3	31.0
Soybeans (bu.)	7.050	24.5	-19.6	21.2	4.2	27.3
Other foodstuffs						
Coffee (lb.)	1.055	-2.3	153.1	-24.0	-14.9	-28.0
Memo:						
Exchange value of the dollar (March 1973=100)	85.558	3.4	-5.5	-6.4	1.6	-4.6
Yield on Treasury bill, 3-month ³	5.250	-14	247	-16	-12	-53

1. Changes, if not specified, are to the last week of the year indicated and from the last week of the preceding year.
2. Week of the November Greenbook.
3. Changes are in basis points.

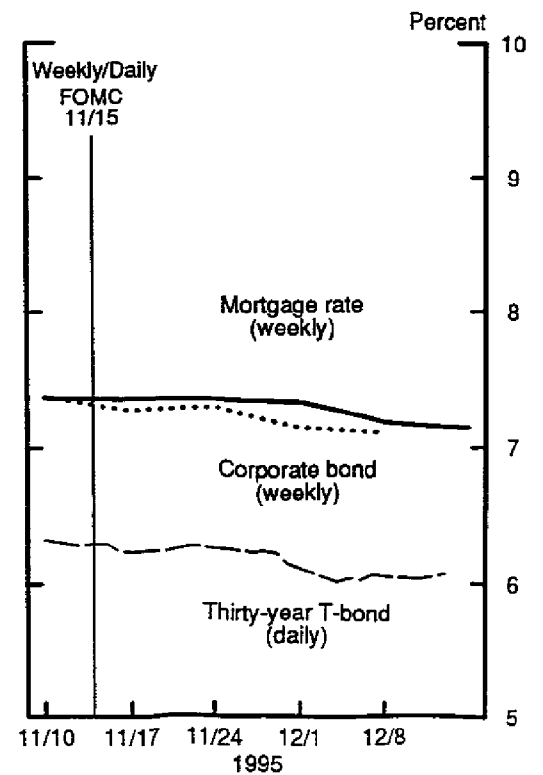
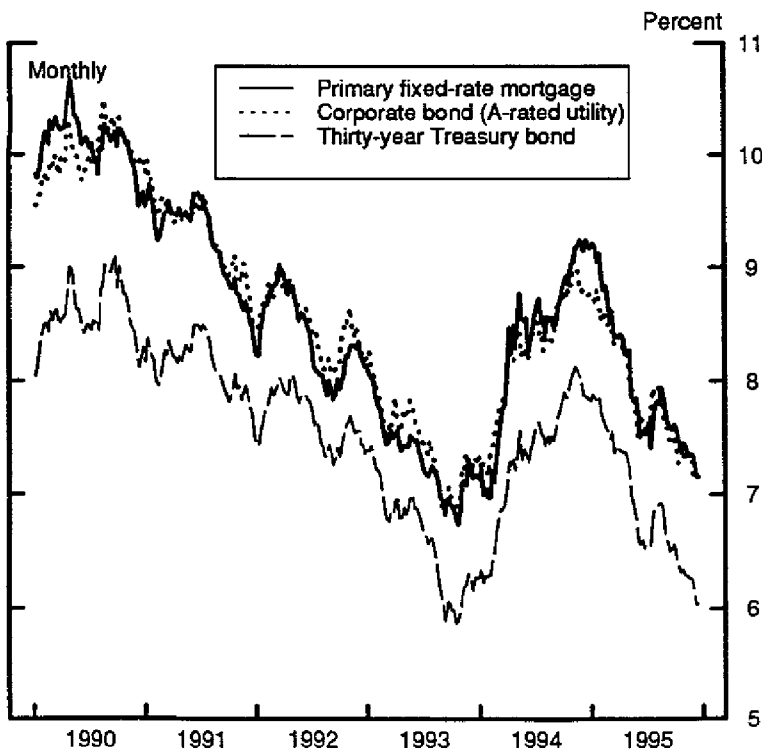
DOMESTIC FINANCIAL DEVELOPMENTS

Selected Interest Rates

Short-Term



Long-Term



Selected Financial Market Quotations¹

(Percent except as noted)

Instrument	1994		1995		Change to Dec 13, 1995 from:			
	Feb. 3	High	FOMC,	Dec. 13	1994	1994	FOMC,	
			Nov. 15		Feb. 3	high	Nov 15	
Short-term Rates								
Federal Funds ²	3.07	5.66	5.74	5.73	2.66	.07	-.01	
Treasury Bills ³								
3-month	3.13	5.78	5.39	5.26	2.13	-.52	-.13	
6-month	3.27	6.38	5.31	5.20	1.93	1.18	-.11	
1-year	3.52	6.84	5.19	5.08	1.56	1.76	-.11	
Commercial paper								
1-month	3.16	6.13	5.82	5.86	2.70	-.27	.04	
3-month	3.25	6.32	5.74	5.64	2.39	-.68	-.13	
Large negotiable CDs ³								
1-month	3.11	6.10	5.75	5.80	2.69	-.30	.05	
3-month	3.25	6.39	5.74	5.67	2.42	-.72	-.07	
6-month	3.41	6.89	5.64	5.53	2.12	-1.36	-.11	
Eurodollar deposits ⁴								
1-month	3.06	6.06	5.69	5.81	2.75	-.25	.12	
3-month	3.25	6.38	5.75	5.69	2.44	-.69	-.06	
Bank Prime Rate	6.00	8.50	8.75	8.75	8.75	.25	.00	
Intermediate- and Long-term Rates								
U.S. Treasury (constant maturity)								
3-year	4.60	7.82	6.63	5.45	.85	-2.37	-.18	
10-year	5.81	8.04	6.00	5.74	-.07	-2.30	-.26	
30-year	6.31	8.16	6.30	6.07	-.24	-2.09	-.23	
Municipal revenue (Bond Buyer) ⁵	5.49	7.37	5.94	5.65	.16	-1.72	-.29	
Corporate-A Utility, recently offered	7.35	9.05	7.34	7.11	-.24	-1.94	-.23	
Home mortgages ⁶								
FHLMC 30-yr fixed rate	6.97	9.25	7.37	7.15	.18	-2.10	.22	
FHLMC 1-yr adjustable rate	4.12	6.79	5.64	5.55	1.43	-1.24	-.09	
Stock Exchange Index								
Stock Exchange Index	Record high		1989	1995		Percentage change to Dec. 13 from:		
	Level	Date	Low, Jan. 3	FOMC, Nov. 15	Dec. 13	Record high	1989 low	FOMC, Nov. 15
Dow-Jones Industrial	5216.47	12/13/95	2144.64	4922.75	5216.47	.00	143.23	5.97
NYSE Composite	331.17	12/13/95	154.00	316.47	331.17	.00	115.05	4.64
NASDAQ (OTC)	1069.79	12/4/95	378.56	1041.85	1056.54	-1.24	179.09	1.41
Wilshire	6084.51	12/13/95	2718.59	5847.40	6084.51	.00	123.81	4.05

1. One-day quotes except as noted.

2. Average for two-week reserve maintenance period closest to date shown. Last observation is average to date maintenance period ending December 20, 1995.

3. Secondary market.

4. Bid rates for Eurodollar deposits at 11 a.m. London time.

5. Most recent observation based on one-day Thursday quote and futures market index changes.

6. Quotes for week ending Friday previous to date shown.

DOMESTIC FINANCIAL DEVELOPMENTS

Most interest rates declined over the intermeeting period as market participants apparently read incoming data as indicating that economic activity and inflationary pressures were sufficiently subdued to permit the Federal Reserve to ease money market conditions during the next several months. Early in the intermeeting period, the sense that a policy ease was imminent was bolstered by comments from System officials regarding the prospects for economic growth and inflation as well as the significance of potential fiscal restraint. The exception to the general direction of rates over the period was among maturities of one month, which crossed over the year-end during the intermeeting period. Apparently a year-end premium of about 1/2 percentage point, somewhat less than in previous years, is built into spot and future rates.

With relatively little news on earnings over the intermeeting period, recent stock market gains likely reflect the decline in interest rates. Share prices have moved up about 1 to 5 percent since the November 15 FOMC meeting, with the Dow pushing past 5200. Since the beginning of the year, the Dow and the S&P 500 have risen about 35 percent, while the Nasdaq composite index is up more than 40 percent.

Yields on corporate bonds have declined a bit less than Treasury rates, but spreads are still narrow by historical standards. The ratio of long-term tax-exempt to taxable yields has stayed high, in large part reflecting investors' ongoing concerns about the possibility of legislation that would reduce or eliminate the tax advantage of municipal debt. Meanwhile, quality spreads on long-term municipal bonds remain in the ranges that have prevailed

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1994	1995	1995	1995	1995	1995	1994:Q4	Level
		Q2	Q3	Sep.	Oct.	Nov.	to Nov. 95	(bil. \$) Nov. 95
						(p)	(p)	(p)
<u>Aggregate</u>		<u>Percentage change (annual rate)¹</u>						
1. M1	2.4	-0.9	-1.0	-3.9	-10.4	-3.4	-1.9	1126.6
2. M2	1.1	4.4	7.7	4.4	-1.0	2.9	4.2	3763.5
3. Redefined M2 ²	0.5	4.7	8.1	3.9	0.8	3.4	4.3	3649.5
4. M3	1.4	7.1	8.7	4.0	3.1	1.5	6.0	4551.8
<u>Selected components</u>								
5. Currency	10.2	8.2	1.2	2.6	4.6	1.6	5.2	371.0
6. Demand deposits	0.5	-0.8	7.1	-0.9	-7.7	-0.9	1.0	386.9
7. Other checkable deposits	-2.1	-9.9	-10.9	-13.4	-27.7	-11.9	-10.9	359.8
8. M2 minus M1	0.5	6.9	11.7	8.0	3.2	5.7	7.0	2636.9
9. Savings deposits	-4.5	-9.8	4.9	7.8	7.6	5.9	-3.5	1117.7
10. Small time deposits	2.5	24.6	7.4	2.1	1.9	4.0	15.2	933.9
11. Retail money market funds	7.3	18.1	43.3	17.6	9.9	12.6	22.8	471.3
12. Overnight RPs, n.s.a.	14.6	-1.8	-1.4	18.0	-25.9	-11.1	1.5	85.3
13. Overnight Eurodollars, n.s.a.	42.2	-36.5	18.7	53.2	-18.2	-62.8	-0.6	30.8
14. M3 minus M2	3.5	20.7	13.8	2.3	22.4	-5.2	15.8	788.3
15. Large time deposits, net ³	7.0	15.5	14.1	8.1	36.2	15.4	17.1	418.5
16. Institution-only money market mutual funds	-8.2	27.2	29.1	15.4	12.9	-5.6	18.9	214.8
17. Term RPs, n.s.a.	7.0	26.0	-9.0	-19.3	-1.0	-49.5	7.7	111.5
18. Term Eurodollars, n.s.a.	14.0	36.6	4.6	-31.2	-20.0	-16.3	9.8	58.2
<u>Memo</u>								
19. Monetary base	8.4	6.2	1.0	0.8	3.3	0.8	3.9	432.7
20. Household M2 ⁴	0.5	5.3	8.2	4.4	1.7	4.0	4.7	3253.3

Average monthly change (billions of dollars)⁵

<u>Memo</u>								
<u>Selected managed liabilities at commercial banks:</u>								
21. Large time deposits, gross	2.1	5.3	6.3	5.0	9.0	3.1	. . .	436.6
22. Net due to related foreign institutions	7.5	-2.4	2.4	6.2	5.0	4.4	. . .	263.6
23. U.S. government deposits at commercial banks	0.0	0.8	1.5	0.9	-2.6	-0.5	. . .	17.0

1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
 2. Sum of seasonally adjusted M1, retail money market funds, savings, and small time deposits. This redefinition will be officially implemented in February 1996.
 3. Net of holdings of depository institutions, money market mutual funds, U.S. government, and foreign banks and official institutions.
 4. Sum of seasonally adjusted currency, retail money funds, and other checkable, savings, and small time deposits.
 5. For the years shown, 'average monthly change' is the fourth quarter-to-fourth quarter dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.
- p Preliminary. n.s.a. Not seasonally adjusted.

for a couple of years. The commitment rate on fixed rate mortgages fell to 7.15 percent--the lowest level since early 1994.

Household debt growth has been running below its pace earlier in the year. While there has been some moderation in the growth of consumer credit, available evidence suggests that low mortgage rates continue to buoy the demand for mortgages. The decline in market yields has also stimulated bond offerings by nonfinancial firms, but much of the issuance has been used to pay down short-term credit. On balance, the expansion of debt of the nonfinancial sectors has remained moderate in recent months. The broad monetary aggregates, in contrast, slowed perceptibly in October and November, and their velocities appear to have turned up in the fourth quarter after two consecutive quarters of declines.

Monetary Aggregates and Bank Credit¹

In November, the broad monetary aggregates continued to grow more slowly than earlier in the year. Even so, M2 remained in the upper half of its growth range, and M3 hovered near the upper end of its range. M2 increased at a 3 percent annual rate in November, and its fourth-quarter pace is likely to be below that predicted by the staff's standard money demand model using short-term opportunity costs. A pickup in stock and bond mutual fund inflows may help to explain a portion of the slowdown, but by no means all. In fact, such flows were even heavier in the summer when M2 was unusually strong. For the year, it appears likely that M2 will exceed the prediction of the standard model by a couple of percentage points.

M1 fell at a 3-1/2 percent rate in November, with the further spread of OCD sweep programs depressing growth of this aggregate by 4-1/2 percentage points last month. With five more institutions implementing sweeps, a total of twenty-two bank holding companies

1. The appendix contains a summary of the growth of the credit and monetary aggregates for 1995.

Commercial Bank Credit
(Percentage change; seasonally adjusted annual rate)¹

Type of credit	1994	1995 Q2	1995 Q3	1995 Sep	1995 Oct	1995 Nov	Level, Nov 1995 (billions of \$)
	Commercial bank credit						
1. Total loans and securities	6.9	13.3	6.2	7.2	1.0	1.4	3,559.5
2. Securities	5.2	15.4	-2.6	6.8	-1.1	-4.8	971.9
3. U.S. government	1.2	-5.6	-2.3	-4.4	8.3	.0	712.5
4. Other ²	21.0	84.9	-3.3	37.2	-25.9	-17.8	259.4
5. Loans ³	7.6	12.4	9.6	7.4	1.8	3.8	2,587.6
6. Business	9.0	12.5	7.2	7.2	1.2	8.0	708.4
7. Real Estate	6.4	8.4	9.1	4.4	3.0	1.8	1,076.0
8. Home Equity	2.2	6.3	6.7	4.6	.0	6.1	79.1
9. Other	6.8	8.5	9.3	4.4	3.3	1.3	996.8
10. Consumer	15.1	11.7	9.6	7.2	-.2	4.9	491.1
11. Adjusted ⁴	15.2	16.1	15.4	17.4	10.3	12.0	607.4
12. Security	-12.6	69.8	3.7	35.5	-33.1	-11.3	83.9
13. Other ⁵	2.4	14.1	22.0	12.4	16.6	2.6	228.2

1. Monthly levels are *pro rata* averages of Wednesday data. Quarterly and annual levels (not shown) are simple averages of monthly levels and levels for the fourth quarter respectively. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.

2. Includes municipal securities, foreign government securities, corporate bonds, equities, and trading account assets.

3. Excludes interbank loans.

4. Includes estimates of consumer loans that have been securitized by banks and are still outstanding.

5. Includes loans to nonbank financial institutions, farmers, state and local governments, banks abroad, foreign governments, and all others not elsewhere classified. Also includes lease financing receivables.

were operating sweep programs at the end of November. The initial impact of these programs has been to reduce OCD balances by an estimated \$45 billion. M1 expansion also was held down by slow currency growth, which has been weak in part because foreign demand has fallen off in anticipation of the issuance of the new \$100 bill, which is viewed as a superior asset.

M3 grew at a 1 percent pace in November. A factor contributing to its deceleration was a decrease in large time deposits at foreign banks. Japanese banks, in particular, have recently increased their use of funding from their home offices and affiliates, in part because of rising funding costs in U.S. money markets. M3 was also held down by the slow expansion of bank credit, which grew at only a 1-1/2 percent pace in November, near October's sluggish rate (table). Loan growth accelerated a bit, owing largely to a pickup in business loans related to merger and balance sheet restructuring activities of a couple of large companies.

Household Debt

Household debt continues to increase at a good clip, although less rapidly than earlier this year. The latest data show that the growth in consumer installment credit rebounded in October to a 12-3/4 percent pace from a relatively weak September. Revolving credit was the fastest-growing component, climbing at a 16 percent rate after a quarter of relatively subdued gains.² The only data available for November are for commercial banks, where, after adjusting for securitization, consumer loans grew at a 12 percent rate, in line with October's pace and a little below the third-quarter rate. Even though consumer debt growth has been strong this

2. Contributing to the growth of credit card debt has been the increased use of credit cards that provide rewards tied to the dollar volume of charges. Based on various data sources, volume-related incentives appear to have stimulated transactions use of credit cards enough to boost the growth of revolving debt in recent quarters by two to four percentage points.

GROWTH OF CONSUMER CREDIT
(Percent change; seasonally adjusted annual rate)

Type of credit	1993	1994	1995		1995		Memo: Outstanding Oct. 1995 (billions of dollars)
			H1 ^r	Q3 ^r	Sept. ^r	Oct. ^p	
Installment	8.1	14.2	15.0	9.6	5.0	12.7	1,004.4
Auto	9.0	13.1	8.5	12.6	4.9	12.6	344.8
Revolving	11.0	16.7	22.6	10.5	7.7	16.0	387.2
Other	3.7	12.5	13.1	4.6	1.5	8.3	272.5
Noninstallment	-4.7	10.1	11.7	26.4	49.2	-41.0	63.5
Total	7.2	14.0	14.8	10.6	7.7	9.4	1,067.9

r Revised.

p Preliminary.

INTEREST RATES ON CONSUMER LOANS
(Annual percentage rate)

Type of loan	1993	1994	1995				
			Feb.	May	Aug.	Sept.	Oct.
At commercial banks ¹							
New cars (48 mo.)	8.1	8.1	9.7	9.8	9.4	n.a.	n.a.
Personal (24 mo.)	13.5	13.2	14.1	14.0	13.8	n.a.	n.a.
Credit cards	16.8	16.2	n.a.	n.a.	n.a.	n.a.	n.a.
Credit cards ²							
All accounts	n.a.	n.a.	16.1	16.2	16.0	n.a.	n.a.
Accounts assessed interest	n.a.	n.a.	15.3	16.2	15.9	n.a.	n.a.
At auto finance cos. ³							
New cars	9.5	9.8	11.9	11.4	10.9	10.8	10.9
Used cars	12.8	13.5	15.1	14.8	14.2	14.1	14.1

Note. Annual data are averages of quarterly data for commercial bank rates and of monthly data for auto finance company rates.

1. Average of "most common" rate charged for specified type and maturity during the first week of the middle month of each quarter.

2. The rate for *all accounts* is the stated APR averaged across all credit card accounts at all reporting banks. The rate for *accounts assessed interest* is the annualized ratio of total finance charges at all reporting banks to the total average daily balances against which the finance charges were assessed (excludes accounts for which no finance charges were assessed).

3. For monthly data, rate for all loans of each type made during the month regardless of maturity.

n.a. Not available.

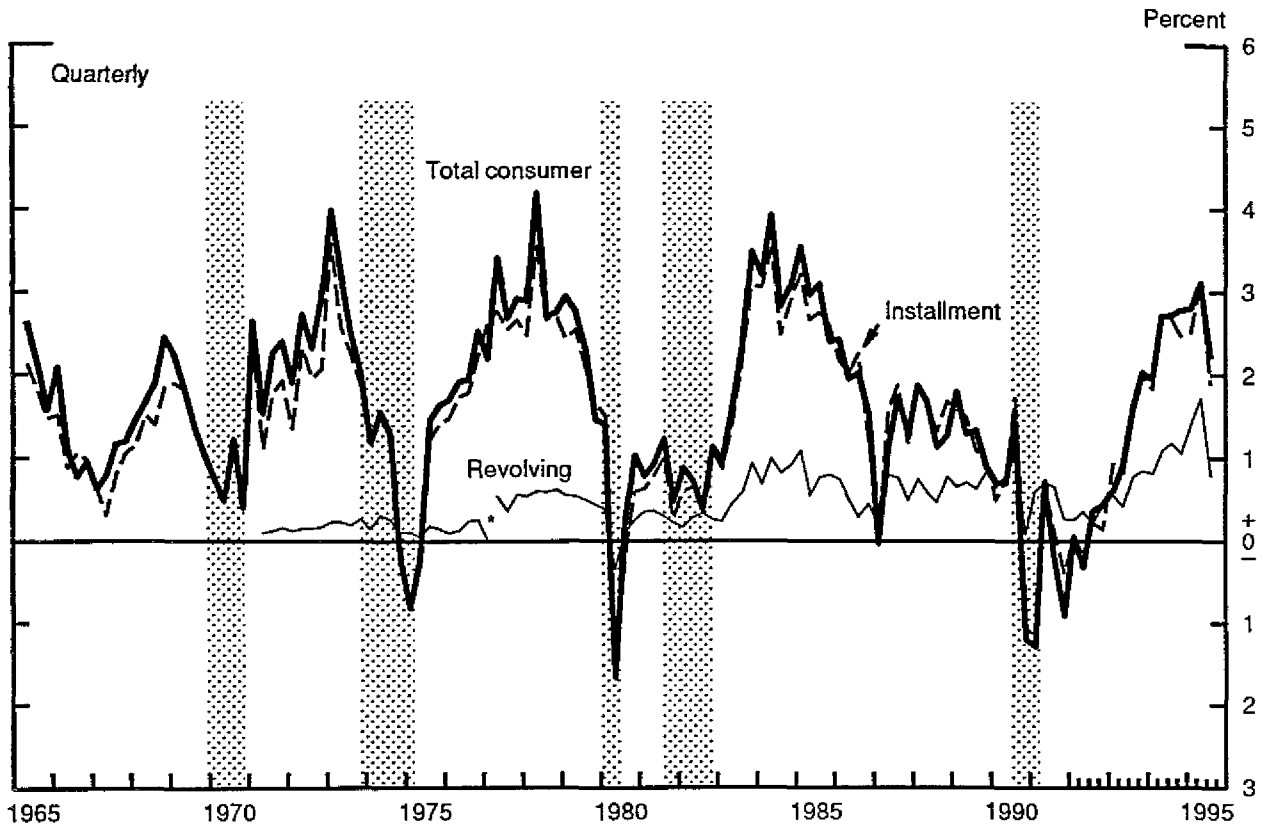
year, net consumer credit flows in relation to consumption expenditures are down some this year and are broadly in line with historical patterns (chart).

Declining mortgage rates have continued to undergird the demand for home mortgages. Single-family residential mortgage debt grew at a 6-1/2 percent pace in the third quarter, the most rapid pace since the end of last year. Although a number of indicators suggest some easing in housing demand in recent months, the purchase applications index compiled by the Mortgage Bankers Association in the past few weeks has climbed to its highest level in its six-year history. Moreover, the refinancing index has risen appreciably from its recent low in late August.³ Rates on adjustable rate mortgages have declined more gradually than those on fixed rate mortgages, and the ARM share of new loans has fallen sharply. Because commercial banks tend to hold ARMs and securitize fixed rate mortgages, real estate loan growth at commercial banks has slowed. In turn, net issuance of securitized mortgages by the agencies increased in October to a monthly rate of \$9.8 billion as compared with \$7.0 billion in the third quarter.

Although most measures of household debt quality have shown some deterioration over the past year, there is little evidence that credit supplies have measurably tightened. Delinquency rates on consumer loans generally have risen more than those for home mortgages. While some series for consumer debt are at or above peaks reached in previous business cycles, the mortgage delinquency rate remains low. The American Bankers Association (ABA) credit card delinquency rate, which measures the share of the number of accounts held by commercial banks that are delinquent, is close to

3. Revised data for the mortgage application indexes were released by the MBA in late November. The revision did not greatly alter the overall behavior of the indexes.

Consumer Credit Flows As Percent of Personal Consumption Expenditures (Seasonally adjusted)



* Denotes break in series.

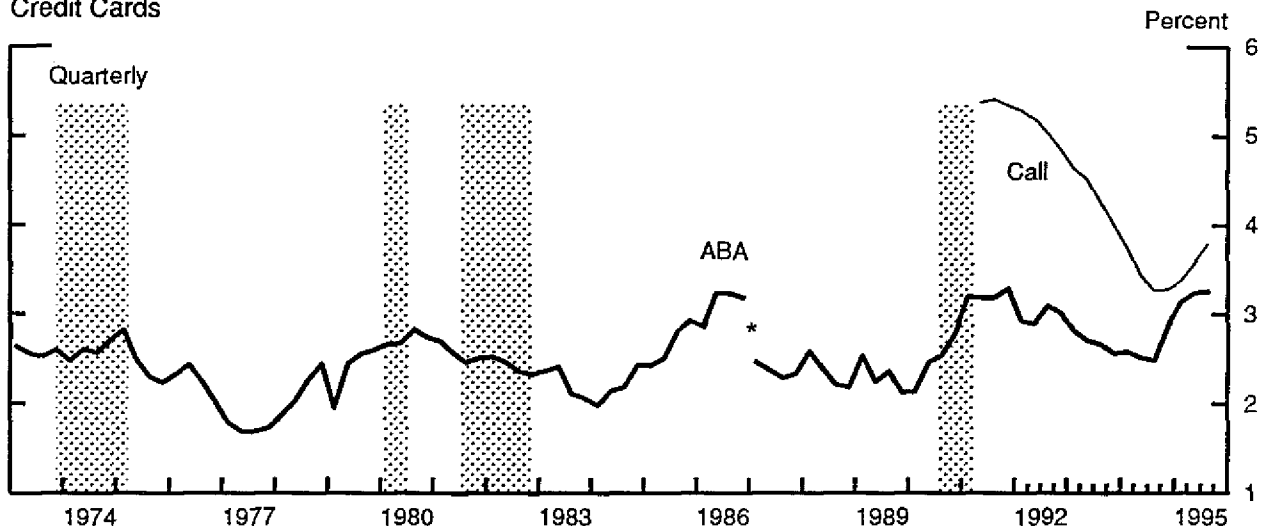
Growth in Mortgage Debt Outstanding (Percent, seasonally adjusted annual rate)

Period	Total	Single Family	Multi-family	Commercial	Farm
1990	7.7	10.0	0.4	0.7	-2.0
1991	4.1	6.6	-1.7	-1.4	0.5
1992	2.8	6.1	-3.6	-6.6	1.8
1993	3.6	5.4	-1.2	-1.7	0.6
1994	4.9	6.6	1.7	-0.7	2.2
1994:1	4.2	6.3	1.1	-3.4	0.7
1994:2	5.0	6.0	3.0	1.4	3.6
1994:3	5.2	6.7	3.5	-0.8	2.7
1994:4	5.1	6.9	-1.0	-0.1	1.7
1995:1	5.1	5.8	1.7	3.8	2.1
1995:2	5.7	6.2	6.1	3.4	2.1
1995:3	5.6	6.6	4.0	2.1	2.7

Household Loan Delinquency Rates

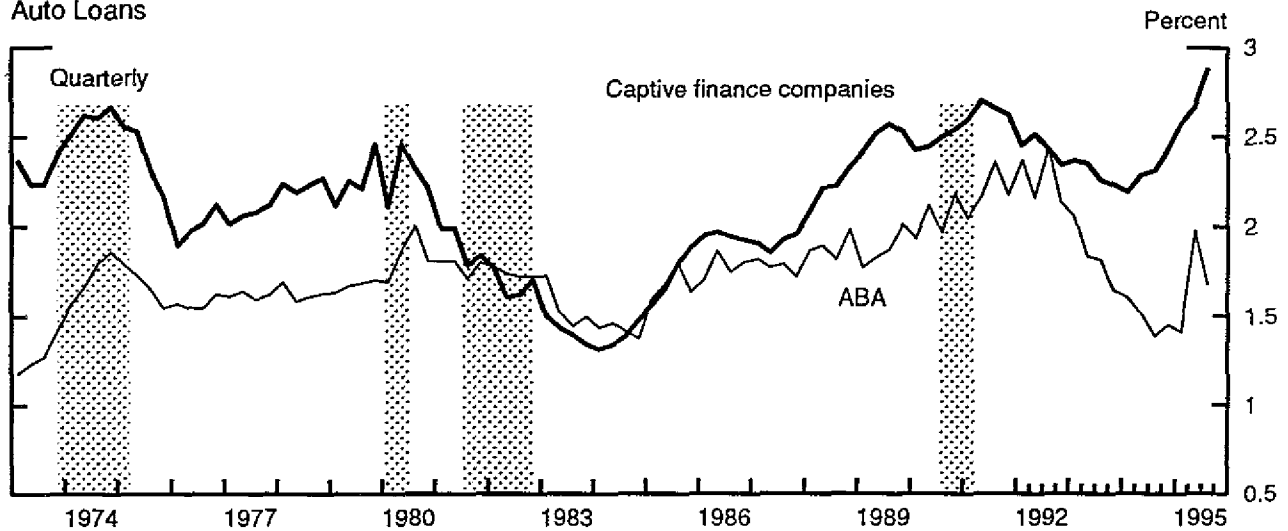
(Thirty days or more, seasonally adjusted)

Credit Cards

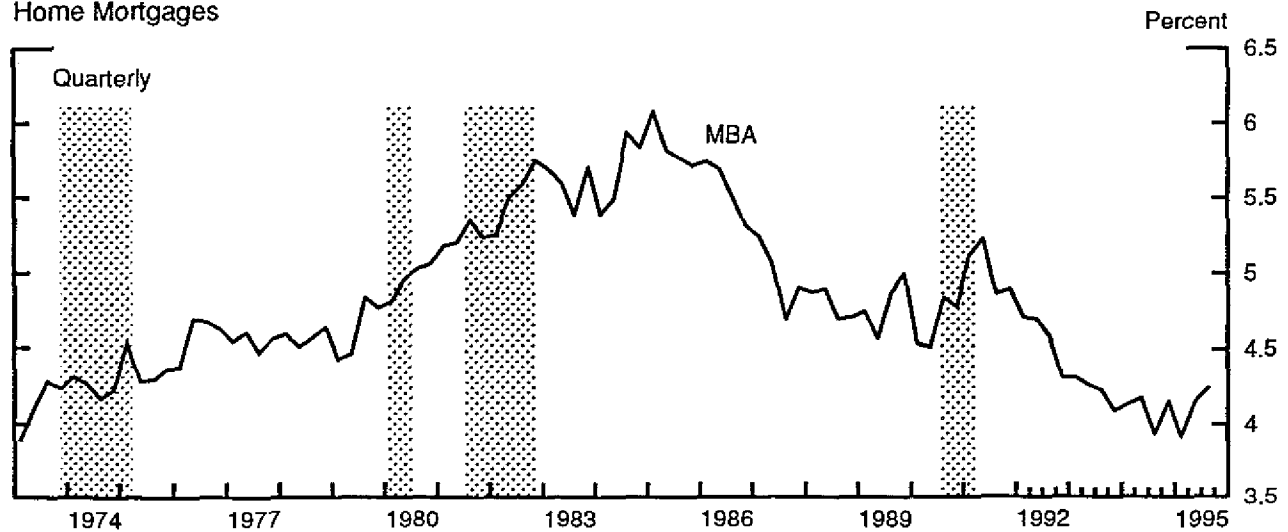


* Break in series.

Auto Loans



Home Mortgages



its previous high (chart). However, the delinquency rate from the Call Report, which is based on the dollar volume of loans held by commercial banks, has retraced only a portion of its earlier decline. Meanwhile, Moody's delinquency rate for accounts that underlie credit-card-backed securities, which are generally higher-grade accounts, is near its trough.

Delinquency rates on auto loans also have risen this year (chart). The rate at captive auto finance companies is above peak levels reached during recession periods.⁴ However, according to the ABA, auto loan delinquency rates at commercial banks are well below levels earlier in the decade. Auto loan delinquencies are not separately reported on the commercial bank Call Report but are part of a broader category for closed-end consumer loans. The delinquency rate on these loans has risen this year; however, the series is well below past peaks, as is the ABA's aggregate delinquency rate for all closed-end loans.

Delinquency rates on home mortgages increased slightly in the third quarter, according to information provided by the Mortgage Bankers Association, but nevertheless remain near their lowest levels in more than twenty years (chart). Call Report data for the third quarter show that delinquencies on home mortgages held by commercial banks (based on the dollar amount of mortgages outstanding) rose slightly as well from a very low level.

Business Finance

Gross public bond offerings by nonfinancial corporations were \$12-1/2 billion in November, a bit above the already strong pace in

4. The level has been boosted a bit by the shift away from loans toward leasing over the past few years because leases are not included in the auto loan delinquency rate and lease customers have tended to be better credit risks than borrowers. One company has provided confidential data on both its loan and lease delinquency rates. Based on these data, the staff estimate that the auto loan delinquency rate may be elevated by 10 to 20 basis points because of leasing.

GROSS OFFERINGS OF SECURITIES BY U.S. CORPORATIONS¹
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1993	1994	1995				
			Q2	Q3 ^P	Sept. ^P	Oct. ^P	Nov. ^P
All U.S. corporations	52.90	40.57	47.67	44.16	50.70	50.61	49.73
Stocks ²	9.12	5.46	6.31	6.34	7.82	9.11	6.73
Bonds	43.78	35.11	41.36	37.82	42.89	41.50	43.00
<u>Nonfinancial corporations</u>							
Stocks ²	5.04	3.12	4.42	4.54	5.86	6.93	5.14
Sold in U.S.	4.64	2.90	4.05	4.25	5.35	6.13	4.90
Utility	1.05	.37	.23	.24	.34	.10	.41
Industrial	3.82	2.55	3.83	4.01	5.02	6.03	4.49
Sold abroad	.40	.22	.36	.29	.50	.80	.25
Bonds	16.19	7.35	11.85	8.38	9.28	11.70	12.40
Sold in U.S.	15.55	6.44	10.76	7.06	8.44	10.20	10.90
Utility	7.34	2.19	3.74	2.77	4.51	4.70	4.00
Industrial	8.21	4.26	7.02	4.29	3.93	5.50	6.90
Sold abroad	.64	.90	1.10	1.32	.83	1.50	1.50
By quality ³							
Aaa and Aa	2.56	.58	1.55	.70	1.25	1.84	1.79
A and Baa	8.70	3.82	6.94	4.39	4.47	5.84	6.56
Less than Baa	4.17	2.01	2.27	2.12	3.34	2.43	2.58
Unrated or rating unknown	.09	.01	n.a.	.05	.00	.09	.00
<u>Financial corporations</u>							
Stocks ²	4.08	2.36	1.89	1.79	1.96	2.18	1.58
Sold in U.S.	3.83	2.11	1.89	1.76	1.87	2.10	1.55
Sold abroad	.25	.25	.00	.03	.10	.08	.04
Bonds	27.60	27.77	29.51	29.44	33.61	29.80	30.60
Sold in U.S.	25.04	23.98	24.31	24.02	29.28	24.80	26.10
Sold abroad	2.56	3.78	5.19	5.42	4.33	5.00	4.50
By quality ³							
Aaa and Aa	1.78	3.72	3.91	4.37	6.00	2.28	1.54
A and Baa	9.02	9.02	10.45	8.55	10.10	11.28	6.90
Less than Baa	.49	.31	.17	.12	.15	.10	.00
Unrated or rating unknown	.08	.10	.46	.11	.05	.00	.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.

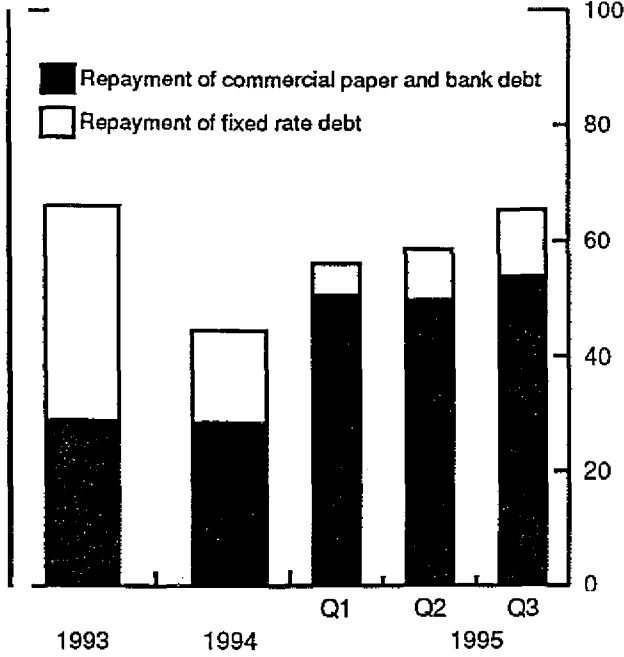
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.

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

p Preliminary. e Staff estimate. n.a. Not available.

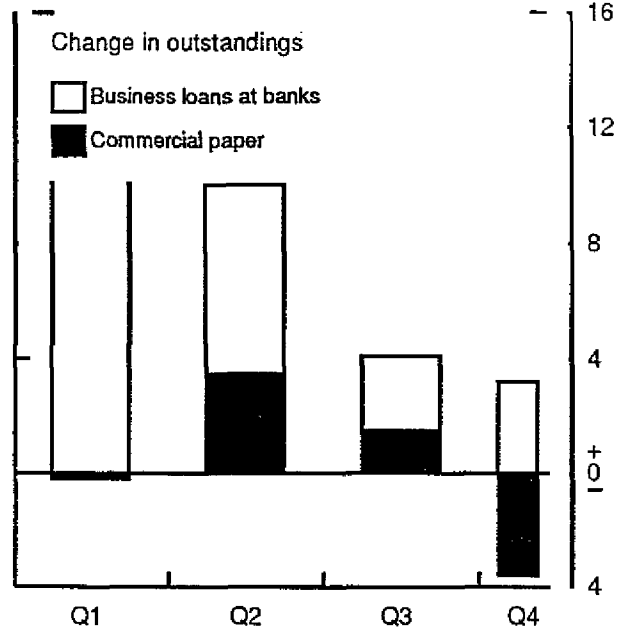
Indicators of Nonfinancial Business Finances

Primary Use of Proceeds from Bond Issuance
Percent of face value



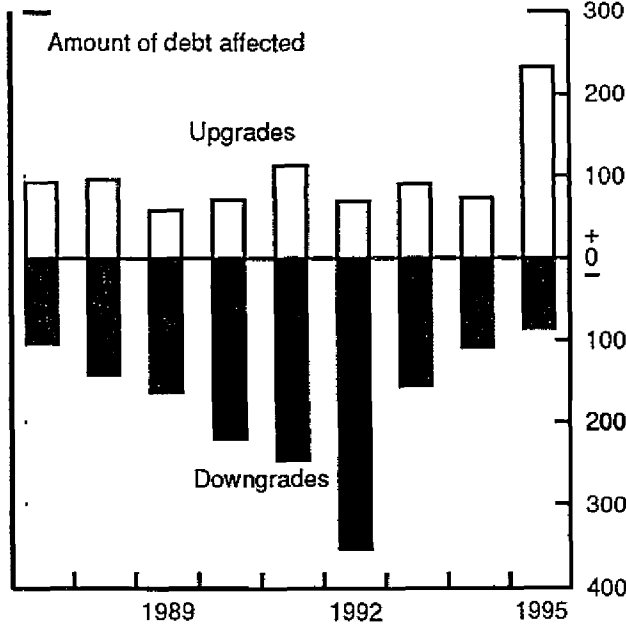
Note. 1993 data cover only Q3 and Q4.

Business Loans at Banks and Commercial Paper of Nonfinancial Firms, 1995
Billions of dollars



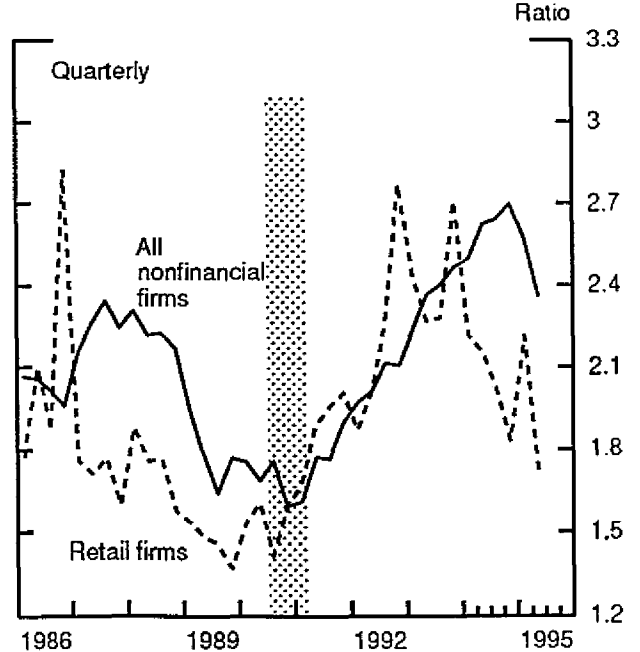
Note. Changes are quarter-end to quarter-end at monthly rates; Q4 data are through November.

Rating Changes of Nonfinancial Corporations
Billions of dollars



Note. 1995 data are through November 28.
Source. Moody's

Ratio of Operating Income to Interest Expense for Firms with Junk Bonds Outstanding



Source. Compustat.

October (table). The bond markets have been supported recently by the strongest inflows to bond funds in two years. The maturity of newly issued debt has lengthened recently as nonfinancial corporations seek to lock in the lowest long-term rates since 1972 other than the brief stretch two years ago. Nonfinancial bond volume this year is running about 30 percent ahead of last year, although it remains well below that in 1993, when firms refinanced a chunk of their outstanding long-term debt. This year, in contrast, more than half of all bond issuance is estimated to have been used to pay down commercial paper and bank loans (chart, upper left panel). This substitution of long-term for short-term debt reduced the level of nonfinancial commercial paper outstanding over October and November (chart, upper right panel)

Despite the paydowns of bank loans by some nonfinancial corporations, business loans increased at a 9 percent rate in November, in large part because of lending to support Westinghouse's all-cash acquisition of CBS. In addition, a large retailer withdrew from the commercial paper market in anticipation of a potential downgrade of its debt to below investment grade and tapped its bank lines.

Credit quality of below-investment-grade firms has slipped somewhat this year. The default rate on junk bonds this year--at 2.7 percent--has moved up from the historically low levels of the past two years, but remains below the average of the prior decade. The ratio of operating income to interest expense for firms with junk bonds outstanding has receded from its peak of last year, in part reflecting higher short-term interest rates (chart, lower right panel). Because of increased concerns about credit quality, interest rate spreads on junk bonds relative to Treasuries have widened on average by 70 or more basis points this year. Even so,

the spreads remain fairly narrow, and inflows to junk bond funds have continued at a strong pace. Among firms with junk bonds outstanding, one area of greater concern is the retail sector, where the interest coverage ratio has retraced most of its improvement between 1989 and 1992. In addition, a number of discounters have filed for bankruptcy protection this year.

In contrast, credit quality of investment-grade firms has shown no significant deterioration. Balance sheets generally remain strong, and some large corporations that undertook major cost-cutting efforts have had their debt ratings raised. As a result, the value of nonfinancial bonds upgraded by Moody's so far this year has exceeded those downgraded; this net upgrade is the first in a number of years (chart, lower left panel). Looking ahead to future rating changes, the value of debt on Moody's Watchlist for an immediate review as of November 30 was fairly evenly balanced between possible upgrades (\$27 billion) and downgrades (\$36 billion).

Merger activity remained strong during the intermeeting period with the announcement of five new deals in which the target company's stock was valued at more than \$1 billion. The merger activity of late appears to have spread to a broader range of industries than earlier in the year. In particular, a number of mergers have been announced in the public utility sector as ongoing deregulation heightens competitive pressures. The wave of mergers this year generally has not had an adverse effect on credit ratings, reflecting both the limited amount of leverage involved and the expectation of strategic gains from the mergers. Taken together, the announced but not yet completed deals rely even more heavily on stock swaps than the mergers already completed.

Equity issuance by nonfinancial firms was strong last month, although off somewhat from October's two-year high (table). The market for initial public offerings (IPOs), which heated up this summer, has remained active in recent months; measured by dollar volume, the average pace of IPO issuance in October and November was the strongest since late 1993. Preliminary data for the first half of December suggest that both IPOs and seasoned issuance held at a fairly high level. Nonetheless, the equity retirements from ongoing share repurchases and merger activity have continued to outstrip the pace of new issues.

Municipal Securities

Gross offerings of long-term municipal securities strengthened in October and November (table). Owing to the continued decline in long-term rates, refunding activity in recent months has picked up to the strongest pace since early 1994. However, market contacts suggest that refunding volume is unlikely to increase much from recent levels even if long-term rates were to fall somewhat further, in part because of the limited volume of outstanding bonds remaining that are eligible for refunding.

GROSS OFFERINGS OF MUNICIPAL SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

	1993	1994	1995			Oct.	Nov.
			Q1	Q2	Q3		
Total tax-exempt	27.2	16.1	10.9	16.3	15.0	15.3	16.6
Long-term	23.3	12.8	9.0	12.7	11.2	13.3	15.9
Refundings ¹	15.7	4.0	1.8	3.4	3.9	5.5	4.9
New capital	7.6	8.8	7.2	9.3	7.3	7.8	11.0
Short-term	3.9	3.3	1.9	3.6	3.8	2.0	.7
Total taxable	.7	.7	.4	.7	.6	.9	1.4

Note. Includes issues for public and private purposes.

1. Includes all refunding bonds, not just advance refundings.

Despite the recent rise in issuance, the volume of long-term offerings so far this year has been about 10 percent below last year's pace and has been only half that in 1993, when there was a burst of refundings. Retirements of advance refunded and maturing bonds continue to outpace gross issuance, causing a sizable drop in outstanding municipal debt.

With some exceptions, the budget positions of many state and local governments appear to have improved over the past year. Quality spreads on long-term municipal bonds have changed little of late. The spread between the Baa-rated general obligation bond and a comparable AAA-rated bond stood slightly below 60 basis points in November, near the middle of the range that has prevailed since the beginning of 1994.

Treasury and Agency Financing

To avoid default on government obligations maturing in November, the Secretary of the Treasury announced that he was liquidating up to \$39.8 billion of nonmarketable securities from the Civil Service Retirement and Disability Fund (CSRDF) and all of the \$21.5 billion of securities in the Federal Employees Retirement Fund (FERs). The FERs has been disinvested during several debt-ceiling impasses in the past, but the disinvestment of the CSRDF was exceptional. To free up \$61.3 billion of room under the \$4.9 trillion debt ceiling, the Secretary made the determination that the debt-ceiling crisis could last a year, allowing him to disinvest twelve months of securities associated with the payment of civil service benefits.

By disinvesting these trust funds, the Treasury was able to hold the auctions of the three- and ten-year notes, which had been delayed. Auction delays and the threat of a possible debt default have not had any visible lasting effect on the yields of Treasury

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1995				
	Q3	Q4 ^P	Oct.	Nov. ^e	Dec. ^P
Total surplus/deficit (-)	-40.1	-56.6	-22.8	-39.2	5.3
Means of financing deficit					
Net cash borrowing and repayments (-)	20.1	38.3	13.4	52.7	-27.7
Nonmarketable	-5.7	-4.9	-1.0	-1.5	-2.4
Marketable	25.8	43.2	14.4	54.3	-25.4
Bills	-5.9	13.9	-3.9	43.1	-25.4
Coupons	31.7	29.3	18.2	11.1	0.0
Decrease in cash balance	22.6	19.4	16.8	-4.9	7.5
Other ¹	-2.5	-1.1	-7.3	-8.6	14.9
Memo:					
Cash balance, end of period	37.9	18.6	21.2	26.1	18.6

Note. Data reported on a payment basis. Details may not sum to totals because of rounding.

p Projection.

e Estimate.

1. Accrued items, checks issued less checks paid, and other transactions.

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

Agency	1995				
	Q2	Q3	Aug.	Sept.	Oct.
FHLBs	12.9	13.8	5.2	8.6	-2.7
FHLMC	6.8	3.1	0.9	-0.7	4.0
FNMA	12.3	6.3	6.8	1.9	3.4
Farm Credit Banks	0.0	1.9	0.3	0.8	0.7
SLMA	-0.3	0.4	0.0	0.3	0.0

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

n.a. Not available.

securities. The Treasury has not lifted the suspension of sales of special issues to state and local governments and has continued to include foreign official purchases in announced auction amounts, rather than adding them on, as had been the practice.

Secretary Rubin announced that, by withholding a year-end interest payment due to CSRDF, the Treasury could stretch its borrowing into February should the debt ceiling not be raised. Under this assumption, the staff anticipates that the Treasury will finance the projected fourth-quarter fiscal deficit of \$57 billion by borrowing \$38 billion from the public and by drawing down its cash balance \$19 billion. With no long-term bond in its midquarter refunding, the Treasury has relied on bills for a third of the funds raised this quarter and has increased the size of the two- and the five-year note auctions by \$500 million each.

Agencies continue to borrow at the same moderate pace of the third quarter. New issues are primarily callable debentures, and, with the exception of step-up notes, few structured notes are being issued. The agencies continue to be active in the global bond market; for example, the Federal Housing Finance Board recently granted the Federal Home Loan Banks a large increase in the amount that they are authorized to raise in the global market from \$5 billion to \$31.5 billion.

APPENDIX

GROWTH OF THE MONETARY AND CREDIT AGGREGATES IN 1995

Summary

M1 contracted in 1995. Weakness in this aggregate reflected two main factors. First, the spread of sweep arrangements shifted other checkable deposit (OCD) balances into savings deposits, reducing both M1 (leaving M2 unchanged) and required reserve balances. Second, foreign demands for U.S. currency moderated, removing a factor that had supported growth for the past few years.

In contrast, M2 strengthened in 1995 to its fastest growth in six years. The nontransaction part of M2 grew faster than it had in 1994, even accounting for sweeps of OCDs to savings. Market interest rates declined relative to deposit rates, boosting small time and savings deposits. M2-type money market mutual funds (MMMF) benefited from the built-in lag of their yields to falling market interest rates and the flatter yield curve this year.

M3 in 1995 posted its strongest rate of growth in seven years. In addition to the impetus from M2, the non-M2 portion of M3 rocketed upward, as large time deposits became instrumental in funding stronger credit expansion at depository institutions. Growth in M3-type MMMFs was lifted by the decline in short-term market rates.

Depository credit accelerated in 1995. Some of the pickup in bank credit reflected the accounting treatment of securities on the balance sheet and derivative contracts off the balance sheet. Abstracting from this effect, bank credit expanded 6-1/2 percent this year, only slightly more than last year's 6 percent. Loan growth was strong, funded partly by runoffs in security holdings. Thrift assets ended their long slide, begun in 1989, even as substantial amounts of assets were lost to commercial banks during mergers. The stock of depository credit as a share of total domestic nonfinancial debt edged up for the first time in more than a decade.

Growth of domestic nonfinancial debt in 1995 continued near the previous year's rate. A shrinking deficit reduced the growth of federal debt. A sizable volume of maturing debt and retirements of callable issues caused state and local debt to run off even faster than in 1994. Household debt grew somewhat less than it did last year, as consumer credit, though remaining quite robust, slowed. All of these components, however, were offset by stronger business borrowing to finance rapid increases in capital expenditures. Firms initially tapped the money market and intermediaries and then swung more toward bond financing when long-term rates fell. Also boosting debt growth was the hefty volume, on net, of equity retirements associated with mergers and acquisitions, although many firms took advantage of the exuberant stock market to issue new equity.

M1

M1 fell 2 percent in 1995, the first annual decline since the beginning of the Board's official series in 1959. Sweeps of deposits from OCDs, a component of M1, to money market deposit

accounts (MMDA), a part of savings deposits in M2, were a major influence. Without these sweeps, M1 would have risen about 1 percent this year. Since their appearance at _____ in early 1994, sweeps have spread to twenty-five bank holding companies. At the end of November 1995, the initial impacts of these programs caused a cumulative decline of \$45 billion in transaction deposits. The corresponding decline in required reserves of about \$4.5 billion largely showed¹ through to reserve balances maintained at Federal Reserve Banks.

The currency component slowed in 1995, primarily owing to reduced shipments abroad. Foreign demand moderated with the stabilization of financial conditions in some countries where dollars circulate widely. In addition, demand for the existing series of notes slowed in anticipation of a new series, starting with the \$100 bill early next year. Indeed, reduced demand from the former Soviet Union and reflows from Argentina contributed to actual declines in the currency component for two months this past summer. Such monthly declines have been rare, the last occurring in the early 1960s.

M2

M2 began 1995 hugging the lower bound (1 percent growth) of its target range. It surged at midyear to touch the upper bound (5 percent growth) of the range and then edged down in its range, growing at 4-1/4 percent since the fourth quarter of 1994 and about matching the projected growth of nominal GDP. This year was the first since 1991 without a significant increase in the income velocity of M2.

Declines in interest rates and a flattening of the yield curve helped to increase demand for household nontransaction components of M2, holding down the velocity of the entire aggregate. Although they ran off for the year as a whole, savings deposits were boosted by sweeps of OCDs into MMDAs. These shifts, which left M2 unaffected, were concentrated in the second half of the year. With the stance of monetary policy unchanged for several months after the System's tightening in early February and then eased slightly at midyear, short-term market interest rates fell somewhat, making savings deposits, whose offering rates adjust very sluggishly, more attractive investments and raising growth as the year progressed. M2-type MMMFs also were aided by the decline in short-term interest rates, as their yields tend to lag the market. Falling short- and intermediate-term market interest rates and some upward adjustment of offering rates narrowed the opportunity cost of small time deposits and contributed to rapid growth of this component in the first half of 1995. Although growth of small CDs subsided in the second half, the net result for the year was a sizable pickup from growth in 1994.

1. Although the drop in reserve balances has been slightly offset by an increase in required clearing balances, the net decline in operating balances at the Reserve Banks has brought them near the low levels experienced in early 1991, after the Board lowered the reserve ratios on net Eurocurrency liabilities and nonpersonal time deposits from 3 percent to zero. That episode was marked by a considerable increase in volatility in the federal funds market (since operating balances were close to the level that institutions would have held voluntarily for clearing purposes) until a partly seasonal upswing in transaction deposits raised required reserves.

Falling interest rates for comparable maturity instruments were not the whole story for the growth of nontransactions M2, however. Declines in long-term interest rates flattened the yield curve by more than a percentage point. The reduced opportunity cost of liquidity probably strengthened the household components of M2, as consumers allocated more of their wealth to these assets.

Nonetheless, the evidence that yield-curve flattening drew money back into M2 from longer-term assets was mixed. Bond mutual funds rebounded from their runoffs in 1994, although net sales were much weaker than they were in the 1992-93 period of steep yield curves. (Equity mutual funds continued to have robust inflows throughout the year.)² On the other hand, direct investment in debt instruments appears to have lessened, at least as seen in the abrupt fall of noncompetitive tenders for Treasury securities after the beginning of 1995. By themselves, noncompetitive tenders can explain only a small part of the pickup in M2 deposits, but noncompetitive tenders for Treasuries are only a part of direct retail demand for debt securities.

The volatile overnight RP and overnight Eurodollar components exerted a drag on M2 growth in 1995 as they both slowed from hefty increases the previous year. Despite their overnight maturity these liabilities have behaved in recent years more like managed liabilities than like core deposits, and their weakness this year reflected a shift toward large time deposits, discussed in the next section.³

M3

M3 grew at a 6 percent rate in 1995, its fastest rise since 1988. Like M2, the M3 aggregate expanded moderately early in the year, surged in the second and third quarters, and cooled off near year-end. M3 breached the upper bound of its 2 to 6 percent target range by midyear and remained substantially⁴ above it until returning almost to the upper bound near year-end.

M3-type MMMFs rebounded smartly in 1995 after having run off the previous two years. These funds benefited from the typical lag in their yields to the decline in short-term market interest rates. Increases in the sum of the term RP and term Eurodollar components of M3 about matched those in 1994.

2. Strong flows into stock mutual funds are not inconsistent with a revival of M2 deposits, however, especially since flows out of household direct holdings of equity were substantial in the first half of 1995.

3. The negative correlation between overnight RPs and demand deposits, evident in the 1970s before overnight RPs were included in M2, has disappeared. Increasingly, depository institutions have managed these instruments to smooth out funding needs instead of merely responding to customer demand. As a result these components will be removed from M2 during the February 1996 benchmark of the monetary aggregates and combined with their corresponding term liabilities in non-M2 M3. The table shows that, except for 1994, the combined effect of these components on annual growth of M2 has been very small. Comparisons of monthly and quarterly growth rates (not shown on the table) suggest that M2 at these frequencies will be little affected by this further redefinition.

4. In July 1995 the FOMC revised up the range for M3 from 0 to 4 percent to 2 to 6 percent.

Even though these nondeposit components as a group accelerated in 1995, the pickup in M3's growth this year owed importantly to the use of large time deposits to fund credit growth at depository institutions. After bottoming out in the middle of 1994, the large time deposit component began a climb that steepened through 1995, as large CDs were, in general, substituted for nondeposit sources of funds, first at domestic banks and thrift institutions and shortly thereafter at U.S. branches and agencies of foreign banks. Late in the year branches and agencies of Japanese banks, facing some resistance in U.S. funding markets, ran off CDs while continuing to increase their funding from overseas offices.

Depository Credit

The composition of bank credit growth for most of 1995 followed the pattern of 1994--rapid growth of loans and subdued growth of securities. Business loans grew robustly in the first part of 1995, boosted by the need to finance inventories and by shifts toward short-term financing as nonfinancial firms waited for a more favorable climate for bond issuance. Business loan growth then cooled off in the second half as capital markets rallied. Qualitative information suggested that the easing of business loan standards by lenders virtually ceased, although some easing of credit terms continued. Real estate loans, too, had an impressive first half but slowed near year-end despite declines in mortgage interest rates throughout the year. The increasing share of fixed rate mortgages (which tend to be securitized) in total originations probably contributed to the slowdown. In addition, bank loan officers indicated a slight movement toward tighter mortgage underwriting standards during the year. Consumer loans on the books of banks began the year growing at very high rates; this growth decelerated throughout 1995 as the volume of securitization increased. Adjusted for estimated securitizations, consumer loans maintained an elevated 15 percent rate of growth before slowing a bit in the last quarter of the year.

Mark-to-market effects inflated the growth of the securities component of bank credit by an estimated 4-3/4 percentage points in 1995. Without these influences, securities in bank credit would have run off slightly, thereby clearly showing that banks drew down their liquid assets to meet loan demand.

Data through the second quarter showed total assets of thrift institutions rising at a 1-3/4 percent annual rate, for the first increase since 1989. Growth at healthy thrifts more than offset a substantial transfer of thrift assets to commercial banks through mergers. These acquisitions raised the growth of bank credit by 3/4 percentage point in 1995. The revival of growth in thrift assets, along with the strong showing of bank credit, helped to nudge up depository credit as a share of domestic nonfinancial debt.

5. A solution to the mismatch between BIF and SAIF insurance premiums, by recapitalizing SAIF with a one-time assessment and by sharing between banks and thrifts the responsibility for paying off the (FICO) bonds issued as part of the thrift bailout, has been agreed to by the legislative and executive branches. However, it is tied up as part of the federal budget reconciliation bill, which has not yet been passed. This part of the bill also would provide some tax relief to thrifts that lose their status as qualified thrift lenders and could spur more movement of thrift assets into the (Footnote continues on next page)

Domestic Nonfinancial Debt

Debt growth for nonfinancial sectors was little changed in 1995 relative to 1994, as a slowdown in federal borrowing was offset by an acceleration in nonfederal borrowing. Although the business sector's internal funds from profits and depreciation rose in 1995, they did not keep pace with capital expenditures, leading to increased demands for credit. Net borrowing by nonfinancial businesses rose sharply, as firms financed both inventory and equipment with bank loans and commercial paper. As the year went on, businesses took advantage of lower long-term interest rates to increase bond issuance, some of which replaced short-term financing and some of which was net new funding.

In contrast to the nonfinancial business sector, debt growth among households ebbed somewhat from last year's pace. Home mortgage debt expanded at about the same rate as last year, even though mortgage interest rates fell substantially. Consumer credit growth was lower than last year's rate, reflecting the slowdown in spending on durables and perhaps added caution as debt service burdens rose.

Debt of state and local governments fell more in 1995 than in 1994, as retirements, especially of issues pre-refunded a few years earlier, further outpaced sluggish gross issuance. Despite the overall reduction in supply, the ratio of tax-exempt yields to taxable yields jumped in the first half of the year on concerns about the effect of congressional tax proposals on demands for municipal debt. Continued uncertainty about tax treatment kept the yield ratio for long-term debt at an elevated level for the remainder of the year.

In the fiscal year ended on September 30, 1995, the unified federal deficit shrank about \$40 billion, to \$164 billion, resulting in a slowdown in federal debt growth. On a calendar-year basis the deficit appears to have declined by about the same amount, with outlays in the fourth quarter of 1995 held down by conflict over the budget.

(Footnote continued from previous page)

commercial banking system either through charter conversions by existing thrifts or through mergers with banks.

THE GROWTH AND FLOW OF MONETARY AND CREDIT AGGREGATES
(Q4 to Q4 averages, seasonally adjusted unless otherwise noted)

Growth rates or flows	1991	1992	1993	1994	1995 ¹	Memo: Recent 1995 levels (billions of dollars) ¹
<u>Growth rates (percent)</u>						
M1	7.9	14.3	10.5	2.4	-1.9	1,126.6
M2	2.9	2.0	1.7	1.1	4.2	3,763.5
M2 adjusted ²	3.1	1.8	1.4	0.5	4.3	3,649.5
M3	1.2	0.5	1.0	1.4	6.0	4,551.8
Domestic nonfinancial debt	4.6	4.7	5.2	5.2	5.3	13,786.5
Bank credit	3.5	3.7	5.0	6.9	7.7	3,559.5
Thrift assets	-10.4	-4.9	-2.4	-0.3	1.7	1,319.5
<u>Flows (\$ billions, December to December)</u>						
M1						
Currency	20.6	25.4	29.3	32.4	17.1	371.0
Demand deposits	12.1	49.4	45.0	-1.7	7.3	386.9
Other checkable deposits	38.8	51.9	30.1	-11.8	-53.5	359.8
M2						
Nontransactions M2	30.4	-69.7	-35.9	13.9	190.7	2,636.9
Savings & MMDAs	120.7	142.4	32.1	-71.5	-13.7	1,117.7
Small time deposits	-107.4	-197.4	-84.1	35.8	115.0	933.9
General purpose and broker/dealer money market mutual fund assets	16.0	-17.3	3.2	28.9	87.0	471.3
Overnight RPs, net (NSA)	-0.5	2.2	15.1	10.3	1.7	85.3
Overnight Eurodollars, net (NSA)	2.5	1.0	-1.7	10.4	1.0	30.8
M3						
Non-M2 component	-49.1	-50.5	-8.9	28.3	104.4	788.3
Institution-only money market mutual fund assets	46.0	20.2	-2.1	-17.3	36.1	214.8
Large time deposits	-64.3	-62.7	-21.2	28.7	59.3	418.5
Term RPs, net (NSA)	-17.5	8.7	15.4	8.2	2.2	111.5
Term Eurodollars net (NSA)	-12.3	-13.5	0.6	5.7	5.9	58.2

1. For monetary aggregates, bank credit, and nonfinancial debt, through November; for thrift assets, through June.

2. Excluding overnight RPs and Eurodollars.

INTERNATIONAL DEVELOPMENTS

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In September, the deficit in goods and services was about the same as in August but well below the July level, as both exports and imports rose by about 1-1/2 percent. For the third quarter, the deficit was significantly less than in the second quarter.

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

	1994	Annual rates			Monthly rates		
		1995			1995		
		Q1	Q2	Q3	Jul	Aug	Sep
<u>Real NIPA 1/</u>							
Net exports of G&S	-110.0	-118.5	-126.7	-125.8	...	...	...
<u>Nominal BOP</u>							
Net exports of G&S	-106.2	-116.0	-132.5	-111.6	-11.2	-8.4	-8.3
Goods, net	-166.1	-178.4	-195.2	-173.8	-16.2	-13.5	-13.7
Services, net	59.9	62.4	62.7	62.2	5.0	5.1	5.4

1. In billions of 1987 dollars.

Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

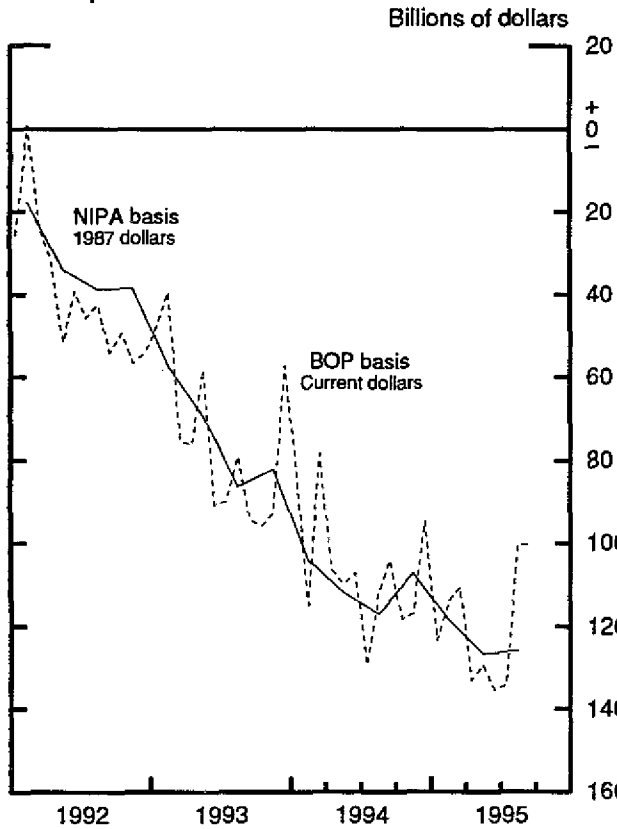
Exports of goods and services rose 1 percent in the third quarter, with increases recorded in most major categories of trade. The sharpest increases were in machinery (particularly to developing Asian countries), automotive products to Canada (from relatively low levels) and to other countries, and agricultural products (especially quantities of wheat and corn, reversing second-quarter declines). These increases were partly offset by a drop in exports of aircraft and gold.

Imports of goods and services declined about 1 percent in the third quarter. Most of the decline occurred in trade categories in which imports had increased sharply in the second quarter -- oil, gold, other industrial supplies, and automotive products from countries other than Canada or Mexico.

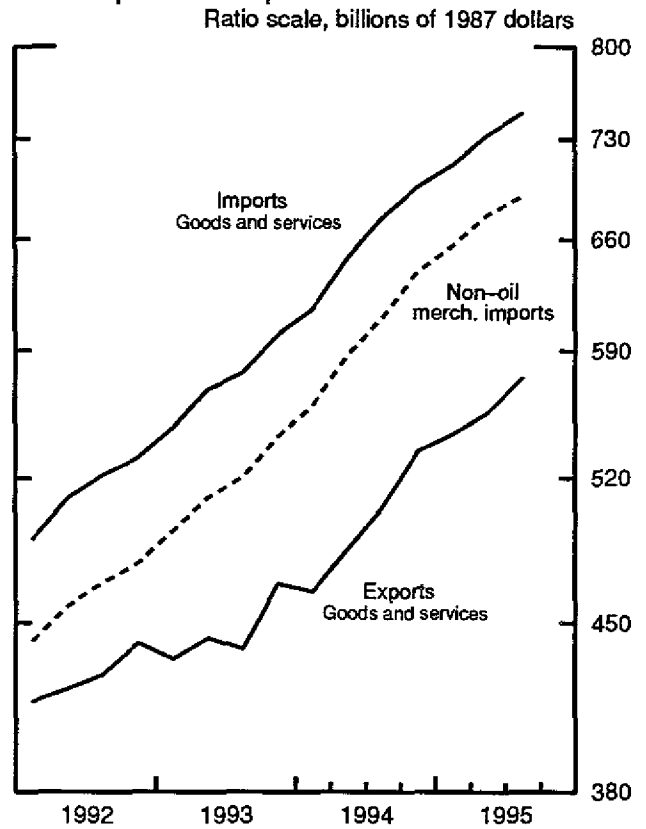
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

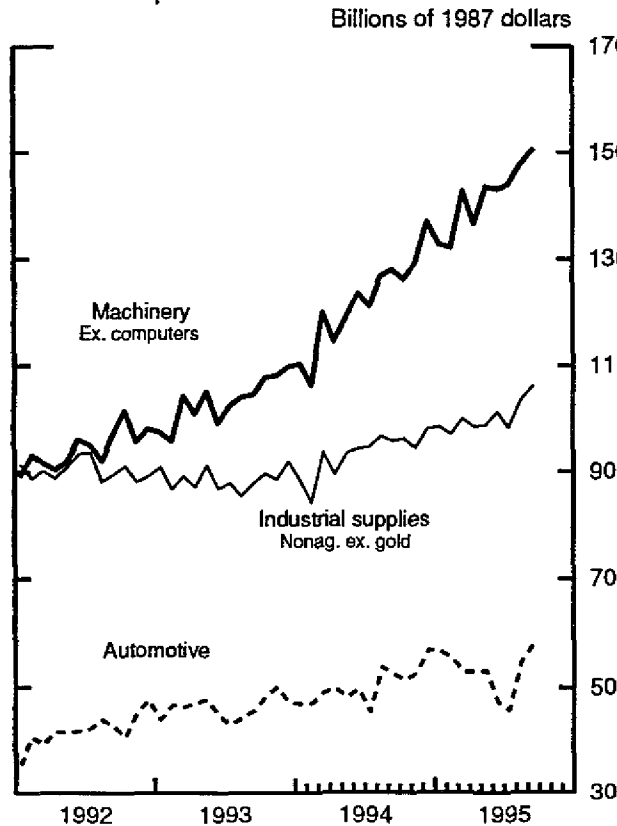
Net Exports



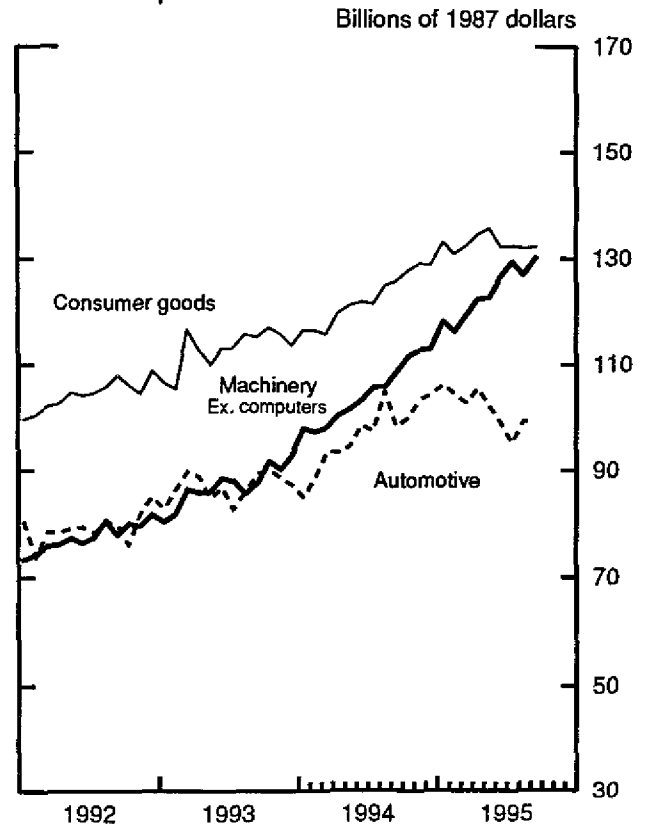
NIPA Exports and Imports



Selected Exports



Selected Imports



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

	Levels				Amount Change 1/			
	1995		1995		1995		1995	
	Q2	Q3	Aug	Sep	Q2	Q3	Aug	Sep
<u>Exports of G&S</u>	778.4	787.4	794.3	806.9	19.9	8.9	33.4	12.6
Goods exports	571.4	581.2	589.0	598.3	17.4	9.9	32.6	9.3
Agricultural	53.6	59.1	59.8	63.3	-2.5	5.5	5.6	3.5
Gold	7.7	3.4	2.6	3.6	2.1	-4.4	-1.3	1.0
Computers	37.1	41.4	42.6	41.6	0.7	4.4	2.6	-1.0
Other goods	473.0	477.4	484.0	489.8	17.0	4.4	25.7	5.8
Aircraft & pts	31.1	23.6	27.5	20.8	5.9	-7.5	5.0	-6.7
Semiconductors	32.6	35.6	35.6	37.0	2.6	3.0	1.2	1.4
Other cap gds	129.9	134.6	134.5	137.7	4.7	4.6	3.0	3.2
Automotive	58.8	61.1	63.1	67.3	-4.7	2.2	10.2	4.2
to Canada	31.3	32.3	36.8	32.2	-4.5	1.0	8.9	-4.6
to Mexico	6.5	6.7	7.6	6.9	-0.7	0.2	2.0	-0.7
to ROW	21.0	22.1	18.7	28.2	0.5	1.1	-0.7	9.4
Ind supplies	131.8	133.3	134.1	136.0	6.1	1.5	4.4	1.8
Consumer goods	64.5	64.9	66.2	66.2	1.4	0.4	3.8	-0.0
All other	24.2	24.3	23.0	24.9	1.0	0.1	2.7	1.9
Services exports	207.0	206.1	205.3	208.6	2.5	-0.9	0.8	3.4
<u>Imports of G&S</u>	911.0	898.9	894.6	907.1	36.5	-12.0	-0.5	12.5
Goods imports	766.6	755.0	751.1	762.8	34.2	-11.6	-0.1	11.7
Petroleum	58.3	56.2	54.6	57.5	6.0	-2.1	-2.0	2.8
Gold	10.8	2.5	2.3	3.3	6.4	-8.3	0.4	0.9
Computers	53.0	58.8	59.1	62.0	2.2	5.8	3.9	2.9
Other goods	644.5	637.5	635.0	640.0	19.6	-7.0	-2.4	5.0
Aircraft & pts	11.2	10.4	10.5	10.7	0.6	-0.8	0.5	0.2
Semiconductors	37.2	42.1	41.8	43.6	5.3	4.9	0.9	1.8
Other cap gds	117.9	117.1	115.1	116.1	5.4	-0.8	-5.1	0.9
Automotive	128.6	123.6	125.3	125.2	-1.3	-5.0	5.1	-0.1
from Canada	42.8	43.7	51.7	45.1	-5.5	0.9	17.5	-6.7
from Mexico	17.6	18.2	18.4	20.0	-0.2	0.6	2.3	1.7
from ROW	68.2	61.8	55.2	60.2	4.4	-6.4	-14.7	4.9
Ind supplies	127.6	123.1	121.8	122.2	4.8	-4.5	-3.4	0.4
Consumer goods	163.1	161.6	161.4	161.7	4.0	-1.6	-0.2	0.2
Foods	32.7	33.2	33.1	33.6	-1.4	0.5	0.2	0.5
All other	26.2	26.4	25.9	26.9	2.1	0.2	-0.4	1.0
Services imports	144.4	143.9	143.5	144.4	2.3	-0.4	-0.4	0.8
Memo:								
Oil qty (mb/d)	9.10	9.62	9.39	9.91	0.15	0.52	-0.18	0.52
Oil price (\$/bbl)	17.55	16.01	15.94	15.88	1.55	-1.54	-0.26	-0.06

1. Change from previous quarter or month.

Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

Oil Imports

The total quantity of oil imported in September rose despite lower oil consumption, partly because of seasonal inventory accumulation and partly because of a decline in production. Preliminary Department of Energy statistics indicate that oil imports fell in October due to a reversal of both of these factors.

The price of imported oil fell \$1.50 per barrel in the third quarter, reflecting previous declines in spot prices as the market came to expect an over-abundant world oil supply. More recently, the September WTI spot price rose \$0.20 per barrel on concerns about low U.S. inventories and possible production disruptions due to hurricane damage. The October spot price declined about \$0.80 as the hurricane season neared its end and on the possible return of Iraqi crude to the market. Spot WTI rose \$0.55 in November due to an output loss in Mexico, concerns of oil worker strikes in Venezuela and Brazil, and an OPEC decision to maintain its existing production quota.

Prices of Merchandise Non-Oil Imports and Exports

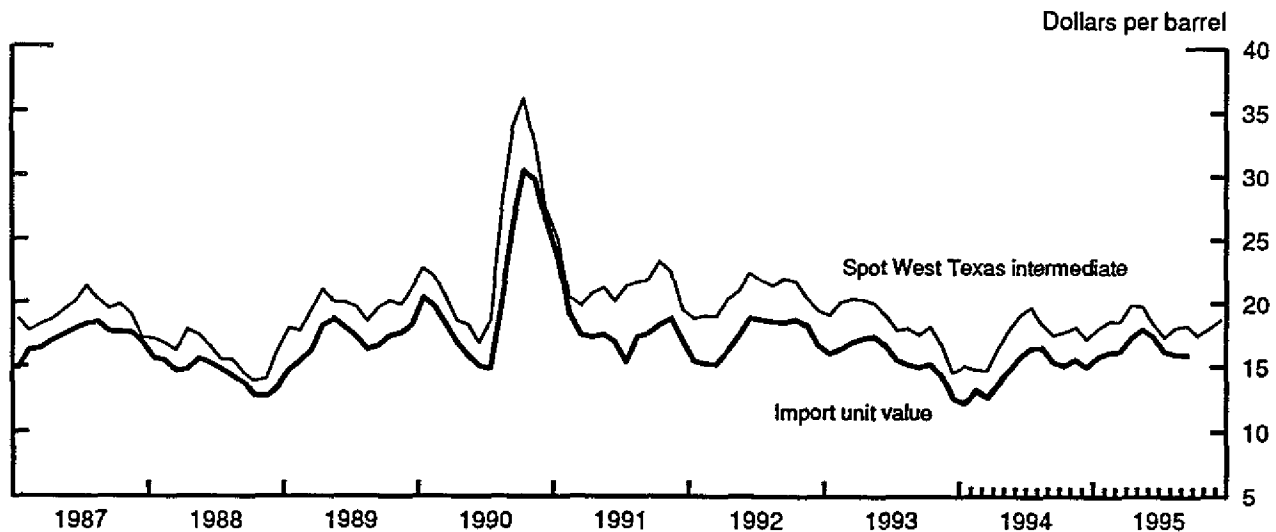
In October, the average price of U.S. non-oil imports decreased for the second consecutive month. The sharpest declines were in prices of imported foods and capital goods. Smaller price declines were recorded for imported industrial supplies and consumer goods. The price of imported automotive products increased slightly.

The average price of U.S. exports increased very slightly in October, about the same as in September. As in September, the October increase was led by an upswing in prices of exported agricultural products, especially grains. Prices of nonagricultural products decreased for the fourth consecutive month as prices of industrial supplies continued to drop.

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

	Annual rates			Monthly rates		
	1995			1995		
	Q1	Q2	Q3	Aug	Sep	Oct
	-----BLS prices-----					
<u>Merchandise imports</u>	4.4	8.5	-1.7	-0.2	0.0	-0.6
Oil	15.2	36.3	-29.3	-2.6	2.3	-3.7
Non-oil	3.3	5.8	1.8	0.0	-0.2	-0.2
Foods, feeds, bev.	-0.4	-3.8	1.0	0.3	-1.2	-1.2
Ind supp ex oil	15.3	10.4	5.5	0.1	0.4	-0.2
Computers	-3.5	-4.4	-1.9	0.0	-0.8	-1.6
Capital goods ex comp	0.6	9.5	0.1	-0.1	-0.6	-0.4
Automotive products	0.7	5.2	1.9	-0.2	0.3	0.3
Consumer goods	1.3	3.4	1.2	0.1	-0.2	-0.2
<u>Merchandise exports</u>	8.6	7.1	0.9	-0.5	0.1	0.1
Agricultural	11.8	17.0	21.7	-1.4	3.0	2.0
Nonagricultural	23.5	13.8	-6.8	-0.9	-1.0	-0.9
Ind supp ex ag	23.5	13.8	-6.8	-0.9	-1.0	-0.9
Computers	-5.6	-2.4	-6.9	-1.3	-0.4	-0.8
Capital goods ex comp	3.0	3.9	2.2	0.1	0.1	0.1
Automotive products	1.0	-0.2	0.9	0.0	0.2	0.9
Consumer goods	1.9	2.9	0.7	0.0	0.0	0.0
	-----Prices in the NIPA accounts-----					
<u>Fixed-weight</u>						
Imports of gds & serv.	4.5	8.4	-1.3	...	...	...
Non-oil merch ex comp	3.6	5.5	1.9	...	...	...
Exports of gds & serv.	9.3	7.0	1.0	...	...	...
Nonag merch ex comp	9.7	6.3	-0.9	...	...	...

Oil Prices



U.S. Current Account through 1995-Q3

In the third quarter, the U.S. current account deficit narrowed \$15.1 billion (SAAR) from the level reported (revised) in the second quarter. A reduction in the trade deficit was partially offset by larger net outflows of investment income and unilateral transfers.

U.S. CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	Goods & services balance	Investment income, net	Transfers, net	Current acct balance
<u>Years</u>				
1993	-74.8	9.0	-34.1	-99.9
1994	-106.2	-9.3	-35.8	-151.2
<u>Quarters</u>				
1994-1	-92.1	0.5	-29.5	-121.1
2	-107.7	-9.1	-35.1	-151.9
3	-115.2	-10.1	-33.5	-158.9
4	-109.9	-18.3	-45.0	-173.1
1995-1	-116.0*	-7.8	-30.5	-154.3*
2	-133.7	-10.5	-28.9	-173.1
3	-110.1	-16.6	-31.2	-157.9
<u>Memo:</u>				
<u>\$ Change</u>				
Q2-Q1	-17.7	-2.6	1.6	-18.8
Q3-Q2	23.7	-6.2	-2.4	15.1

* Includes an upward revision to exports not yet shown in the published current account.

Source. U.S. Department of Commerce, Bureau of Economic Analysis.

The larger deficit in investment income was mostly accounted for by reduced net direct investment income, as direct investment payments rose with increased U.S. earnings and receipts declined on lower earnings abroad. Net portfolio income payments also increased slightly, as U.S. net liabilities edged higher.

The small increase in unilateral transfers in the third quarter resulted from a rise in U.S. government grants.

U.S. International Financial Transactions

Foreign official assets in the United States declined marginally in October, following a very strong third quarter (line 1 of the Summary of U.S. International Transactions table). Japanese official assets fell somewhat in October, after moderate increases throughout the third quarter (increases far less than reported Japanese intervention purchases of dollars during the same period). The October data also showed a decline in Brazilian and Mexican official holdings, after substantial buildups in the third quarter. Increases in Chinese holdings in the United States slowed in October from a rapid third-quarter pace, but information from the FRBNY indicates a renewed pickup in November.

A large banking inflow in October reversed the outflow registered in the third quarter (line 2). Over half of the October net inflow was attributable to affiliates of Japanese banks, continuing a pattern set in the third quarter in response to their funding needs and the premia they faced. Monthly average data show further net inflows to foreign-chartered banks in November (line 1b of International Banking Data table).

Net foreign private purchases of U.S. Treasuries were negative in September, but rebounded somewhat in October (line 4a of the Summary table). Much of the variability was caused by the high volatility of holdings in the Netherlands Antilles (presumably controlled by hedge funds): net sales of \$6 billion in September turned around to net purchases of \$15 billion in October. Japanese residents sold Treasuries net in both months, \$2.9 billion in September and \$8.6 billion in October, almost reversing the large net purchases in July and August.

Net foreign purchases of corporate and other bonds remained strong throughout the third quarter and into October (line 4b).

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

	1993	1994	1994	1995				Oct
			Q4	Q1	Q2	Q3	Sept	
<u>Official capital</u>								
1. Change in foreign official reserve assets in U.S. (increase, +)	70.4	37.6	-.8	22.2	37.3	39.3	6.6	-1.3
a. G-10 countries	30.1	28.9	-6.1	16.9	14.1	5.6	4.0	-1.7
b. OPEC countries	-5.1	-3.3	.4	.4	-.2	6.2	.9	-1.0
c. All other countries	45.5	12.0	4.9	4.9	23.3	27.5	1.8	1.4
2. Change in U.S. official reserve assets (decrease, +)	-1.4	5.3	-.2	-5.3	-2.7	-1.9	*	.5
<u>Private capital</u>								
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	17.1	102.9	17.9	-11.8	-22.0	-7.2	-8.2	24.1
Securities ²								
4. Foreign net purchases of U.S. securities (+)	105.8	92.8	36.5	46.2	51.5	68.3	2.9	7.1
a. Treasury securities ³	24.8	34.6	26.0	30.1	30.5	37.3	-6.4	1.8
b. Corporate and other bonds ⁴	61.4	53.9	12.9	19.6	18.6	25.7	8.9	6.6
c. Corporate stocks	19.6	4.4	-2.4	-3.5	2.4	5.3	.4	-1.3
5. U.S. net purchases (-) of foreign securities	-143.1	-56.6	-17.9	-8.0	-22.8	-35.7	-12.8	-11.1
a. Bonds	-80.4	-9.3	-8.5	-3.8	-12.7	-13.6	-4.9	-5.6
b. Stocks	-62.7	-47.2	-9.3	-4.1	-10.2	-22.0	-8.0	-5.5
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-72.6	-49.4	-11.9	-22.5	-17.1	-21.7	n.a	n.a
7. Foreign direct investment in U.S.	41.1	49.4	19.6	17.2	12.9	19.3	n.a	n.a
8. Other (inflow, +) ⁵	46.5	-16.5	-13.6	-18.5	-13.1	2.4	n.a	n.a
<u>U.S. current account balance (s.a.)</u>	-99.9	-151.2	-43.3	-39.0	-43.2	-39.5	n.a	n.a
<u>Statistical discrepancy (s.a.)</u>	36.0	-14.3	13.7	19.5	19.2	-23.3	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. government agency bonds.

5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

n.a. Not available. * Less than \$50 million

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1992	1993	1994	1995				
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Oct.	Nov.*
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFS	-71.6	-122.1	-224.0	-242.7	-235.3	-244.3	-254.4	-258.0
a. U.S.-chartered banks	17.0	4.2	-70.1	-88.6	-88.7	-86.1	-89.7	-85.6
b. Foreign-chartered banks	-88.6	-126.3	-153.9	-154.1	-147.6	-158.2	-164.8	-172.4
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	24.8	21.8	23.1	23.5	25.2	25.7	26.2	26.0
b. By Caribbean offices of foreign-chartered banks	n.a.	90.9	78.4	80.3	85.3	86.4	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	90.0	77.8	85.6	90.5	92.3	94.6	93.8	89.8
b. At the Caribbean offices of foreign-chartered banks	n.a.	79.2	86.0	96.3	108.9	n.a.	n.a.	n.a.
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	184	191	187	196	205	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	235	230	261	270	288	n.a.	n.a.	n.a.

1. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts.

Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR 2951.

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. It includes some foreign-currency denominated deposits and loans. Source: SCB

* November data is only through Nov. 27.

Eurobond sales by U.S. companies remained strong in November. Worth noting is the high percentage of newly issued Eurobonds that have been denominated in foreign currencies: almost 50 percent of new issues in September and 32 percent in October. Nine different foreign currencies were represented among the 28 such issues in October, among them the Czech Koruna and the South African Rand. Anecdotal evidence points to a number of factors that have played a role in the proliferation of foreign-currency denominated issues. Favorable swap spreads have been cited, as well as the desire to tap new sources of capital.

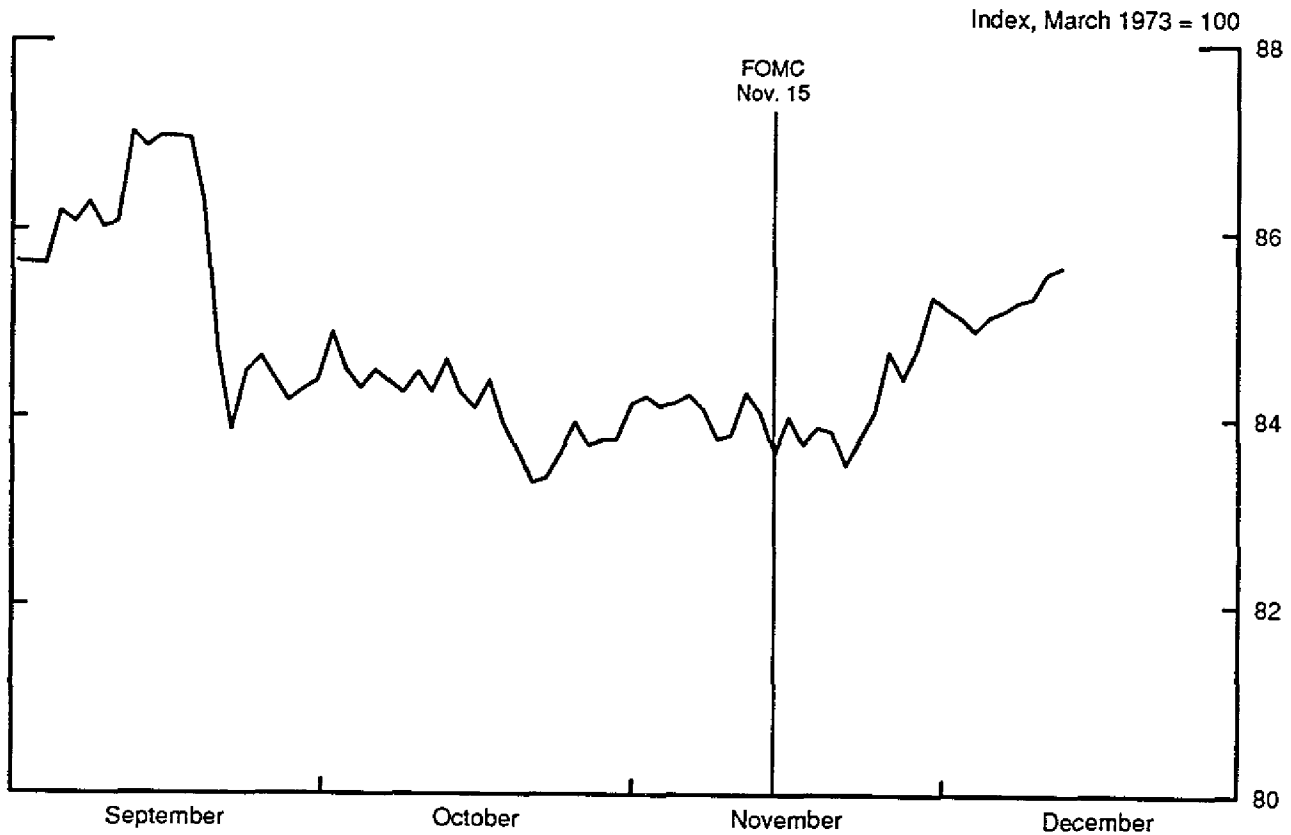
U.S. purchases of foreign securities were substantial in September, leading to a strong third quarter, and continued in October (line 5). Bond purchases for the quarter were concentrated in Europe, Canada and Japan. Over half the net purchases of foreign stocks in the third quarter were from Japan; another \$7 billion was from Europe, with virtually nothing from Latin America. In October, most of the bond and stock purchases were in Europe and the Caribbean, with little net activity in Japan.

Recently released balance-of-payments data for the third quarter showed a strong outflow of U.S. direct investment abroad and an almost equally strong inflow to foreign direct investors in the United States; flows in both directions were swelled by takeovers. The statistical discrepancy for the third quarter was a negative \$23.3 billion, in contrast to the positive values for the first two quarters of the year.

Foreign Exchange Markets

The weighted-average value of the dollar has risen slightly more than 1-1/2 percent since the time of the November 15 FOMC meeting. Over the intermeeting period, the dollar rose almost 2-3/4 percent against the German mark and the French franc, but firmed only 1/2 percent against

Weighted Average Exchange Value of the Dollar (Daily data)



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Nov. 15	Dec. 14	Change	Nov. 15	Dec. 14	Change
Germany	3.90	3.70	-0.20	6.31	6.05	-0.26
Japan	0.53	0.51	-0.02	2.88	2.79	-0.09
United Kingdom	6.63	6.38	-0.25	7.76	7.40	-0.36
Canada	6.05	6.10	0.05	7.60	7.35	-0.25
France	5.85	5.37	-0.48	7.03	6.76	-0.27
Italy	10.69	10.56	-0.13	11.66	11.15	-0.51
Belgium	3.93	3.65	-0.28	6.82	6.68	-0.14
Netherlands	3.75	3.55	-0.20	6.37	6.07	-0.30
Switzerland	1.94	1.88	-0.06	3.58	3.75	0.17
Sweden	8.75	8.49	-0.26	9.16	8.60	-0.56
Weighted-average foreign	4.91	4.72	-0.19	6.74	6.48	-0.26
United States	5.74	5.75 ^P	0.01	6.00	5.73 ^P	-0.27

Note. Change is in percentage points. p. Preliminary

the Japanese yen. The dollar appreciated about 1-1/4 percent against the Canadian dollar while it rose 1 percent against the British pound and 1/2 percent against the Italian lira.

During the intermeeting period, market expectations have focused on the potential for further monetary easing in Germany amid gathering evidence that German economic growth and inflation have slowed. Recent data have been suggestive of weakness in other European countries as well, and European 10-year government bond yields declined during the intermeeting period. Yields on German and French 10-year bonds decreased about 25 basis points, while 10-year rates were down about 35 basis points in the United Kingdom, and more than 50 basis points in Italy and Sweden. One factor behind the substantial decline in Italian long-term interest rates has been reports that the Italian government is considering the elimination of a withholding tax currently levied on foreign bond holders. The yield on Canadian 10-year government bonds fell 25 basis points, about the same magnitude of the decline in U.S. 10-year rates over the period.

Short-term market interest rates in Germany fell 20 basis points from their level at the time of the November 15 FOMC meeting. The decline in short-term rates occurred on December 14, when the Bundesbank announced 50-basis-point cuts in its discount and Lombard rates to 3 percent and 5 percent, respectively. The Bundesbank also announced that its next three repurchase tenders would be conducted at a fixed rate of 3.75 percent, compared with a minimum rate of 3.98 percent at the past three repo operations. The Belgian, Dutch, Austrian and Danish central banks swiftly followed the German lead and lowered official rates, but the Bank of France did not immediately respond to the German rate cut. The Swiss National Bank also cut its discount rate by 50 basis points to 1-1/2 percent on December 14. U.K. monetary authorities lowered their official minimum lending rate 25 basis points to 6-1/2 percent on

December 13 and 3-month interest rates in the United Kingdom fell about 25 basis points over the intermeeting period.

In France, official rates had been lowered about 1/4 percentage point on November 16, in support of the government's social welfare reform package released the day earlier. However, since then a series of public sector strikes in protest of the proposed fiscal reforms have raised questions about the viability of the government's budget deficit reduction goals. At times during the intermeeting period, concerns over the magnitude of government concessions to the unions weighed on the franc. The Bank of France lowered its intervention rate by 10 basis points on December 7, in part to signal its support for the reform effort. French short-term interest rates rose and fell as pressures on the French franc waxed and waned during this period. On balance, French 3-month rates fell almost 50 basis points as strike activity currently seems to have ebbed, reducing pressures on the franc.

Japanese short-term interest rates were little changed since the last FOMC meeting and the rate on 10-year benchmark bonds declined only slightly. Japanese stock prices rose 9 percent, led by a 12 percent rise in bank stocks. The banks' disclosure of the total amount of their restructured loans was ahead of schedule and may have reassured market participants. The announcement by the Ministry of Finance that it will reveal a plan to deal with bad loans at financial institutions by the end of the year also may have helped bolster bank stock prices. The premium that Japanese banks paid in recent months on 3-month dollar deposits narrowed considerably since the November 15 FOMC meeting while the premium paid by Japanese banks on 1-month dollar deposits widened, mainly reflecting year-end funding pressures.

The Mexican peso appreciated about 2 percent against the dollar over the intermeeting period, as pressures on Mexican financial markets abated. Short-term interest rates declined about 10 percentage points on balance while stock prices surged nearly 15 percent. Since the

November 15 FOMC meeting, spreads on Mexican Brady bonds narrowed nearly 2 percentage points. Following a period of no significant foreign exchange intervention since March, Mexican authorities recently have adopted a slightly more aggressive approach to exchange rate management.

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

Developments in Foreign Industrial Countries

Third-quarter GDP data and available fourth-quarter indicators point to subdued economic growth in the major foreign industrial countries. The Japanese economy has yet to begin a sustained recovery. There was little or no growth in France and Germany in the third quarter, and the current quarter also looks weak. Growth in Canada and the United Kingdom is modest. Only in Italy does growth in the second half of 1995 appear strong.

Inflation abroad remains low on average. Prices have continued to fall in Japan, while consumer-price inflation in Canada has declined from its peak in the first half of the year. In the United Kingdom inflation has fallen slightly after being pushed up by temporary factors in the summer. Italy has experienced the highest inflation rate among the major industrial countries, as consumer-price inflation edged up to 6 percent in the twelve months through November.

Major economic and financial uncertainties exist in several countries. In France, the outcome of the showdown between the government and public-sector unions may determine whether EMU will proceed on schedule. In Japan, concerns about the health of the banking sector persist, although the funding premium for Japanese banks in Eurocurrency markets has declined to a modest level. In Canada, uncertainty remains

about the future of the federal structure following the narrow defeat of the Quebec sovereignty referendum in late October.

Individual country notes. In Japan, recently released third-quarter data confirm a very slow growth rate of GDP in 1995. However, the underlying data present a more promising picture, as domestic demand has continued to strengthen, led by rising consumption. After three years of declining, investment has increased so far this year despite some weakness in the third quarter. Higher domestic demand has not led to higher output because the yen appreciation of 1994 and early 1995 has depressed real net exports. If the more recent yen depreciation persists, the current quarter should be the last quarter in which real net exports are a significant drag on growth.

	JAPANESE REAL GDP ¹ (Percent change from previous period, SAAR) ²					
	1994	1994		1995		
		Q3	Q4	Q1	Q2	Q3
GDP	0.4	2.6	-4.2	0.5	2.6	0.6
Total Domestic Demand	0.4	3.0	-3.7	1.3	2.4	2.8
Consumption	1.1	6.3	-2.2	0.4	2.9	4.8
Investment	-1.4	-4.1	-7.2	-2.1	4.8	-1.3
Government Consumption	0.6	-0.5	-8.7	17.8	-4.6	1.1
Inventories (contribution)	0.2	0.6	0.7	0.2	-0.3	0.2
Exports	9.0	2.6	7.9	-0.2	17.9	-7.4
Imports	11.3	7.3	16.5	8.0	18.1	10.9
Net Exports (contribution)	-0.0	-0.4	-0.5	-0.8	0.2	-2.2

1. The Economic Planning Agency has revised its quarterly estimates of GDP using 1990 prices instead of 1985 prices.

2. Annual changes are Q4/Q4.

Prices have continued to fall. The November CPI for the Tokyo area was 1.0 percent below year-earlier levels, while wholesale prices were unchanged in November on the same basis. The GDP deflator in the third quarter was 0.2 percent below its level of four quarters earlier.

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

	1995						
	Q2	Q3	Q4	Aug	Sept	Oct	Nov
Industrial Production	0.0	-2.3	n.a.	2.5	-1.7	1.2	n.a.
Housing Starts	-7.7	-1.2	n.a.	-3.6	7.7	4.4	n.a.
Machinery Orders	-3.8	0.7	n.a.	5.9	-12.6	9.9	n.a.
New Car Registrations	-8.9	6.4	n.a.	4.9	2.4	-0.6	n.a.
Unemployment Rate (%)	3.1	3.2	n.a.	3.2	3.2	3.2	n.a.
Job Offers Ratio ¹	0.63	0.60	n.a.	0.61	0.60	0.61	n.a.
Business Sentiment ²	-16	-18	-14	--	--	--	--
CPI (Tokyo area) ³	-0.1	-0.2	n.a.	-0.4	-0.0	-0.9	-1.0
Wholesale Prices ³	-1.7	-0.6	n.a.	-1.0	-0.2	-0.1	0.0

1. Level of indicator.

2. Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.

3. Percent change from previous year.

In the Bank of Japan's November survey (Tankan), the index of business sentiment of major manufacturing firms (the percentage having a favorable view of business conditions minus the percentage with an unfavorable outlook) registered -14, slightly less negative than the previous survey taken in August.

The Japanese current account surplus has continued to decline, registering \$114 billion (SAAR) in the year through October, down about \$16 billion from the same period last year. In the year through October the merchandise trade surplus (SAAR) was \$108 billion, down about \$11 billion from a year earlier.

In Germany, data for the third quarter confirm a marked slowing of real activity from the 2-1/2 percent annual rate pace registered in the first half of this year. A 1.2 percent (SAAR) increase in domestic demand (due largely to inventories) was offset by a drop in net exports.

Few monthly indicators are available for the fourth quarter, but those that are do not suggest a rebound in activity. Labor market data indicate a rise in unemployment of 42,000 in November, putting total unemployed at more than 3.7 million. Consumer price inflation has

remained subdued, with the twelve-month increase just at 1.5 percent in November.

GERMAN REAL GDP
(Percent change from previous period, SAAR)¹

	1994	1994		1995		
		Q3	Q4	Q1	Q2	Q3
GDP	3.7	2.5	2.5	0.8	4.3	-0.1
Total Domestic Demand	4.0	4.7	3.1	0.2	2.4	1.2
Consumption	0.3	4.0	0.2	2.1	3.1	-0.3
Investment	8.8	6.5	10.4	-6.1	3.4	-4.8
Government Consumption	1.7	1.6	-3.2	6.7	2.4	1.6
Inventories (contribution)	1.5	0.6	1.4	-0.8	-0.7	2.2
Exports	8.9	-1.3	5.0	-6.2	16.0	-2.7
Imports	9.9	7.2	7.3	-8.2	7.4	2.3
Net Exports (contribution)	-0.3	-2.1	-0.6	0.6	2.0	-1.3

1. Annual changes are Q4/Q4.

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

	1995						
	Q1	Q2	Q3	Aug	Sept	Oct	Nov
Industrial Production	-1.9	1.0	-1.2	-3.1	0.1	-1.6	n.a.
Orders	-3.0	-0.4	-0.4	-3.1	0.2	n.a.	n.a.
Unemployment Rate (%)	9.3	9.3	9.4	9.4	9.5	9.6	9.7
Western Germany	8.2	8.2	8.4	8.4	8.4	8.4	8.5
Eastern Germany	13.8	13.7	14.0	13.8	14.3	14.3	14.7
Capacity Utilization ¹	85.2	85.9	85.4	--	--	--	--
Business Confidence ^{1,2}	15.3	3.0	-4.3	-6.0	-5.0	n.a.	n.a.
Retail Sales ³	-2.3	-3.0	-2.7	-2.0	-2.0	-5.0	n.a.
Consumer Prices ^{1,3}	2.0	1.9	1.7	1.5	1.6	1.6	1.5

1. Western Germany.

2. Percent of firms expecting an improvement in business conditions during the next six months less those expecting a deterioration in conditions.

3. Percent change from previous year.

On December 14, the Bundesbank announced an objective for the growth of the targeted monetary aggregate M3 of 4 to 7 percent in 1996 (fourth quarter to fourth quarter). Through October, M3 was 1.7 percent (SAAR) above its base in the fourth quarter of 1994.

The Bundestag has approved the 1996 budget, which now awaits approval by the Bundesrat. Opposition Social Democrats have suggested that a shortfall in tax revenue in 1996 may necessitate a supplementary budget.

In France, modest GDP growth in the third quarter, coupled with a downward revision to 0.8 percent in second-quarter growth (from 1.6 percent SAAR), suggest a pronounced slowing of the economy. Private consumption contracted, after growing strongly during the second quarter in anticipation of the expiration of the government's auto subsidy program and the 2 percentage point increase in the VAT on August 1. A rebound in investment coupled with a slight rise in government consumption contributed positively to third-quarter growth. A negative contribution from net exports, associated with a sharp increase in imports, was almost entirely offset by inventory accumulation.

FRENCH REAL GDP
(Percent change from previous period, SAAR)¹

	1994	1994		1995		
		Q3	Q4	Q1	Q2	Q3
GDP	4.3	4.0	4.0	2.7	0.7	0.8
Total Domestic Demand	5.0	4.2	3.8	0.6	-0.1	4.4
Consumption	1.7	2.4	1.2	1.4	5.6	-0.5
Investment	4.6	7.7	4.9	2.3	-5.4	3.9
Government Consumption	1.0	2.0	1.6	2.4	2.4	3.7
Inventories (contribution)	2.8	0.8	1.8	-1.2	-2.6	3.1
Exports	7.6	6.8	11.8	10.8	1.5	-1.7
Imports	10.2	7.2	10.7	3.0	-1.2	10.7
Net Exports (contribution)	-0.7	-0.1	0.3	2.1	0.8	-3.5

1. Annual changes are Q4/Q4.

Monthly indicators suggest that economic activity is slowing further in the current quarter. In October, consumer spending on manufactured goods (equal to one-third of total consumption) registered the sharpest decline since January 1993. A consumer confidence survey by INSEE (taken before the onset of the public sector strikes) indicates that consumer confidence continued to decline in November, reaching its lowest level in over two years. The unemployment rate remained unchanged in October after having risen slightly in September.

In November, year-over-year consumer price inflation was little changed from the third-quarter average. The modest pick-up in inflation since August is attributable to an increase in the VAT on August 1.

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

	1995						
	Q1	Q2	Q3	Aug	Sept	Oct	Nov
Industrial Production	1.1	0.5	0.4	0.0	1.8	n.a.	n.a.
Capacity Utilization	84.8	84.8	n.a.	--	--	--	--
Unemployment Rate (%) ¹	n.a.	11.6	11.4	11.4	11.5	11.5	n.a.
Consumption of Manufactured Product	-0.1	2.7	-1.0	-0.1	-0.4	-4.4	n.a.
Consumer Prices ²	1.7	1.6	1.8	1.9	2.0	1.8	2.0

1. Break in series starting in March due to annual benchmark revision. Historical data are not yet available.

2. Percent change from previous year. Includes the increase in the VAT on August 1, 1995

In November, the French government outlined new measures designed to reform the social welfare system. These measures are intended to eliminate the deficit on social security (estimated at more than \$12 billion in 1995) by 1997 and reduce France's general government deficit to 3 percent of GDP, as required by the Maastricht Treaty for European Monetary Union. The announced package includes a combination of spending cuts and tax increases. The major proposals entail reforms to limit the growth in health care expenditures, a freeze on family benefits in 1996 and 1997 (with such benefits becoming taxable in 1997), a lengthening of the number of years public sector employees must work in order to obtain

full pension benefits, and a widening of the broad-based income tax known as the GSG.

Several national trade unions have mounted a series of broad-based public-sector strikes aimed at derailing this social welfare reform. In negotiations with the unions the government has agreed to some weakening of the reforms, but a final agreement has not been reached. We expect that these strikes, which have extended into their third week, will further depress economic activity in the current quarter.

In Italy, consumer price inflation rose further in November. The year-over-year change in the consumer price index reached 6.0 percent in November, slightly higher than the 5.8 percent increase in the previous three months. Wholesale price inflation in September was also up a little from the August level while wage inflation in October remained at 4 percent on a year-over-year basis, the same as in September.

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

	1995						
	Q1	Q2	Q3	Aug	Sept	Oct.	Nov
Industrial Production	0.1	1.1	3.0	6.0	-4.4	n.a.	n.a.
Cap. Utilization (%)	78.2	78.6	77.5	--	--	--	--
Unemployment Rate (%)	12.0	12.0	12.1	--	--	--	--
Consumer Confidence ¹	112.2	113.2	116.1	117.7	114.1	110.7	110.9
Bus. Sentiment ² (%)	30	18	17.3	21	13	8.0	n.a.
Consumer Prices ³	4.4	5.5	5.7	5.8	5.8	5.8	6.0
Wholesale Prices ³	7.5	11.3	11.3	10.8	11.9	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.

Monthly indicators suggest strong real GDP growth in the third quarter. Industrial production rose sharply in August and was nearly 4 percent above the second-quarter level on average in July and August.

Consumer confidence also increased. In the second quarter, real GDP had declined by a small amount primarily due to a drop in inventory investment.

On November 21, the Italian government launched its biggest ever privatization by offering 14.7 percent of the state energy firm ENI. Together with earlier privatization receipts, the \$3.9 billion revenue from the offer would allow the government to reach its 1995 privatization target of \$6.2 billion. In 1995, privatization receipts are projected to total approximately 7.5 percent of the budget deficit.

The slowdown in output growth in the United Kingdom now appears more pronounced as the most recent national income data lowered real GDP growth in the third quarter to 1.6 percent from the preliminary estimate of 2.0 percent. GDP growth was even more sluggish when oil and gas extraction are excluded. A sharp contraction of investment held down domestic demand even though consumption grew at a pace close to its recent average. There was also a noticeable increase in inventory accumulation in the third quarter.

UNITED KINGDOM REAL GDP
(Percent change from previous period, SAAR)¹

	1994	1994		1995		
		Q3	Q4	Q1	Q2	Q3
GDP	4.0	4.4	2.1	2.4	1.9	1.6
Total Domestic Demand	3.4	0.5	6.9	-2.1	3.9	1.4
Consumption	2.7	1.9	4.7	-0.3	3.3	2.8
Investment	2.9	-0.9	6.2	-0.8	6.3	-8.5
Government Consumption	1.4	-1.1	-0.2	-0.5	3.1	0.8
Inventories (contribution)	0.9	-0.3	2.8	-1.8	0.2	1.1
Exports	10.6	9.7	10.5	3.0	-2.6	9.8
Imports	6.7	3.0	20.4	-13.2	6.0	10.5
Net Exports (contribution)	0.5	1.7	-2.7	4.1	-2.4	-0.1
Non-oil GDP	4.1	4.0	2.7	1.9	3.1	1.2

1. Annual changes are Q4/Q4.

Recent activity data appear to be consistent with a softening trend in aggregate demand. The purchasing managers' index fell to 49.6 in November from 50.5 in October and 50.4 in September. The October quarterly survey by the Confederation of British Industry also showed that firms are lowering near-term output plans as they express concerns about excessive stock holding and weaker export orders. Industrial output fell nearly 1 percent in October.

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

	1995						
	Q1	Q2	Q3	Aug	Sept	Oct	Nov
Industrial Production	0.7	0.2	0.4	-0.2	0.5	-0.9	n.a.
Retail Sales	-0.7	0.9	0.1	-0.8	0.3	0.1	0.6
Unemployment Rate (%)	8.5	8.3	8.2	8.2	8.1	8.1	8.0
Consumer Prices ¹	2.8	2.7	2.9	2.9	3.1	2.9	2.9
Producer Input Prices ²	11.1	10.9	9.6	9.4	9.2	7.8	6.2
Average Earnings ²	3.6	3.6	3.3	3.3	3.3	3.3	n.a.

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

2. Percent change from previous year.

After rising to 3.1 percent in September, retail price inflation excluding mortgage interest payments fell slightly in October and was unchanged in November. Recent movements in producer prices indicate that inflationary pressures may be moderating. The growth rate of average earnings continues to be modest, although there may be some slight upward pressure on labor costs. According to a survey of private-sector pay settlements, the average pay increase in new wage agreements rose to 3.5 percent in October after remaining in the low 3 percent range earlier this year.

On November 28, the government released its budget in which the projected public-sector borrowing requirement for the current fiscal

year was lowered to £29 billion (4 percent of GDP) from £36 billion in FY94/95.

Economic activity in Canada expanded 2.1 percent (SAAR) in the third quarter, following a 0.6 percent contraction in the second quarter. Statistics Canada attributed much of the increase to a resurgence of growth in the United States that boosted Canadian exports. Final domestic demand contracted slightly, as robust consumption expenditures were offset by decreases in machinery and equipment investment, residential construction, and government expenditures. A reduced pace of inventory accumulation also subtracted from growth.

CANADIAN REAL GDP
(Percent change from previous period, SAAR)¹

	1994	1994		1995		
		Q3	Q4	Q1	Q2	Q3
GDP	5.4	5.7	4.6	1.4	-0.6	2.1
Total Domestic Demand	2.7	0.1	3.3	3.0	0.6	-1.6
Consumption	3.3	1.6	3.9	0.1	0.9	2.5
Investment	6.1	-0.2	8.3	-1.5	0.4	-3.8
Government Consumption	-1.8	0.0	-1.4	0.7	-1.6	-5.9
Inventories (contribution)	-0.2	-0.8	-0.4	3.2	0.3	-1.1
Exports	20.4	25.5	30.7	7.1	-10.5	9.9
Imports	13.0	10.0	25.0	9.9	-5.5	0.8
Net Exports (contribution)	2.4	5.0	1.8	-1.1	-2.2	3.6

1. Annual changes are Q4/Q4.

Preliminary indicators of economic activity for the fourth quarter are limited but suggest that growth remains modest. Employment fell in November, offsetting October's gains, and average employment in October and November was only 0.2 percent above the third-quarter average. Housing starts picked up somewhat in November, but the level remained below the third-quarter average. After rising to near the top of the Bank of Canada's inflation target band of 1 to 3 percent in the second

quarter, consumer price inflation has continued to decline through November.

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

	1995						
	Q1	Q2	Q3	Aug	Sept	Oct	Nov
Industrial Production	0.8	-0.5	0.6	0.4	0.1	n.a.	n.a.
Manufacturing Survey:							
Shipments	3.6	-1.3	1.5	3.1	0.0	n.a.	n.a.
New Orders	3.4	-2.9	1.5	0.4	-0.5	n.a.	n.a.
Retail Sales	-0.1	0.2	1.0	0.9	0.1	n.a.	n.a.
Housing Starts	-10.0	-14.9	-3.3	8.8	1.4	-10.7	7.5
Employment	0.3	0.1	0.1	0.2	0.2	0.1	-0.3
Unemployment Rate (%)	9.7	9.5	9.5	9.6	9.2	9.4	9.4
Consumer Prices ¹	1.6	2.7	2.4	2.3	2.3	2.4	2.1

1. Percent change from year earlier.

Prime Minister Chrétien introduced a three-part package in Parliament that fulfills promises made during the Quebec referendum campaign. The plan includes recognition of Quebec as a distinct society, the right of any of five regions of Canada -- Quebec, Ontario, British Columbia, the prairie provinces, and the Atlantic provinces -- to veto proposed changes in the Constitution, and decentralization of some government programs. Although the House of Commons has passed the first two parts of the package, polls suggest that the proposals have limited popular support both inside and outside of Quebec.

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

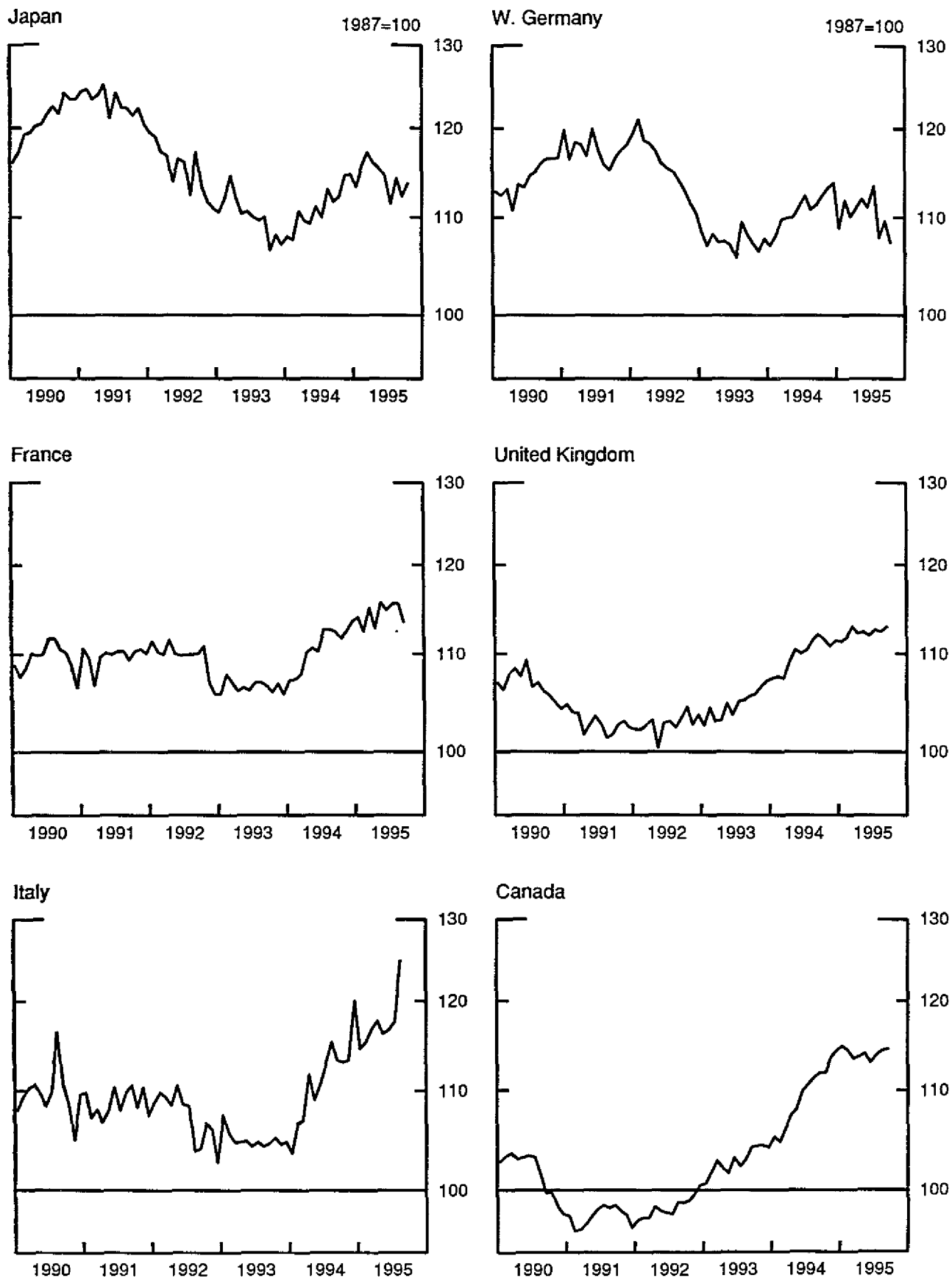
	1994		1995					
		Q4	Q1	Q2	Q3	Aug	Sept	Oct
Japan: trade	120.7	29.7	27.3	32.7	25.3	8.6	8.6	4.8
current account	129.1	30.1	28.8	30.9	29.6	11.8	8.2	5.4
Germany: trade ¹	45.4	11.9	14.1	17.7	15.3	5.3	5.6	n.a.
current account ¹	-21.7	-7.9	-3.5	-0.8	-9.3	-3.3	-1.9	n.a.
France: trade	15.1	4.9	5.7	6.0	4.1	1.7	1.6	n.a.
current account ¹	8.1	2.6	7.0	4.9	1.8	--	--	--
U.K.: trade	-16.2	-4.7	-3.2	-5.2	-5.3	-2.0	-1.5	n.a.
current account	-2.5	-0.8	-2.1	-3.8	n.a.	--	--	--
Italy: trade	21.7	3.0	7.6	7.6	n.a.	1.5	n.a.	n.a.
current account ¹	15.6	4.8	2.6	7.8	n.a.	4.2	n.a.	n.a.
Canada: trade	11.0	4.0	4.2	4.1	5.2	1.9	2.1	n.a.
current account	-16.3	-2.9	-3.4	-3.5	-2.5	--	--	--

1. Not seasonally adjusted.

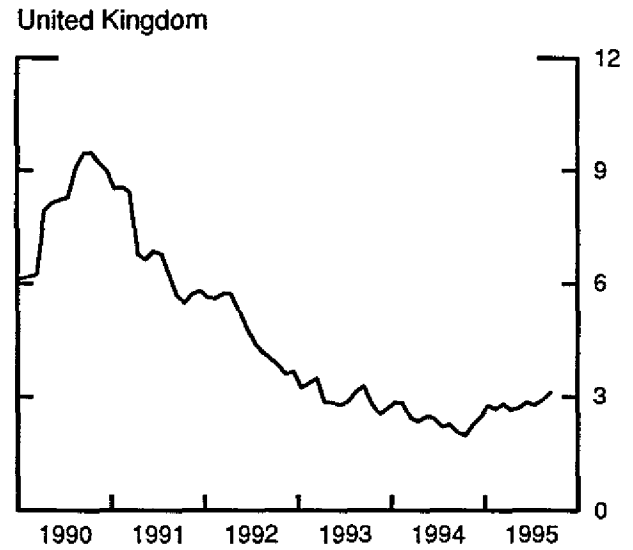
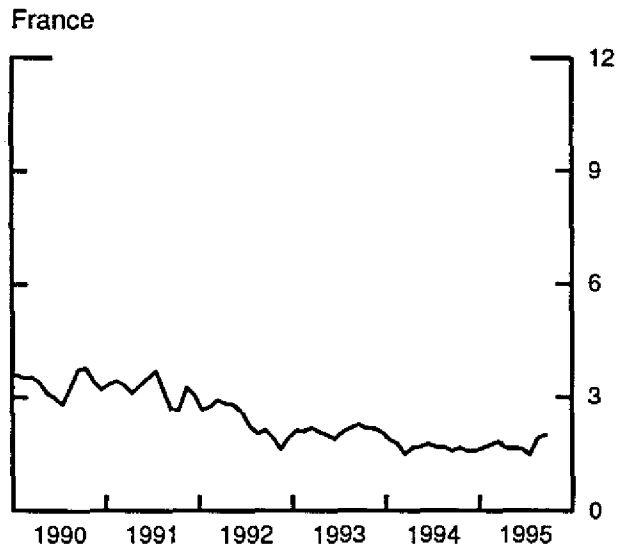
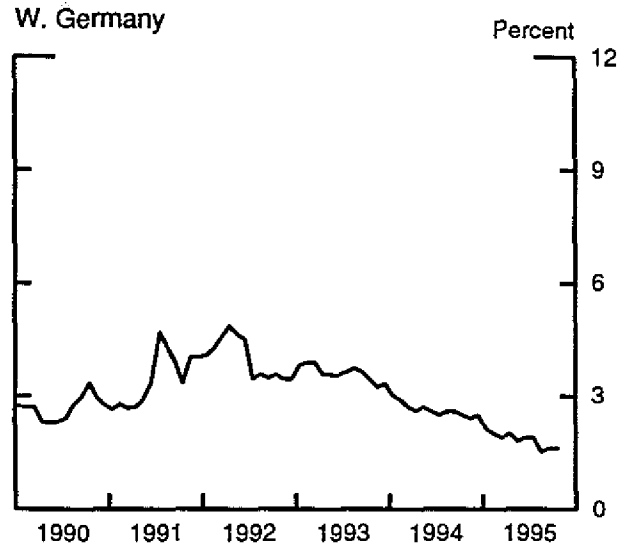
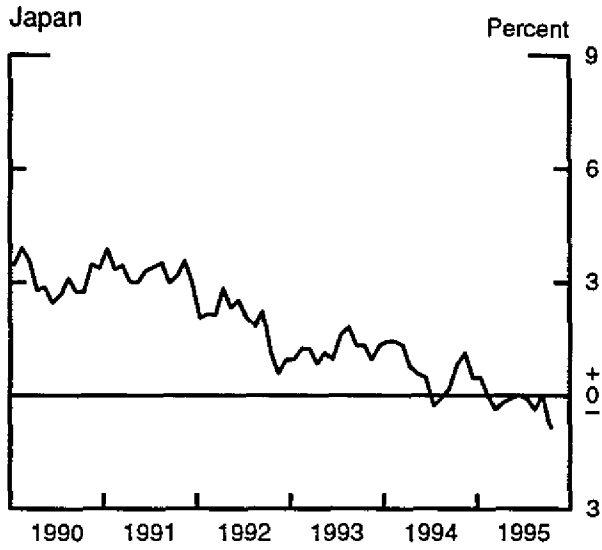
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Industrial Production in Selected Industrial Countries

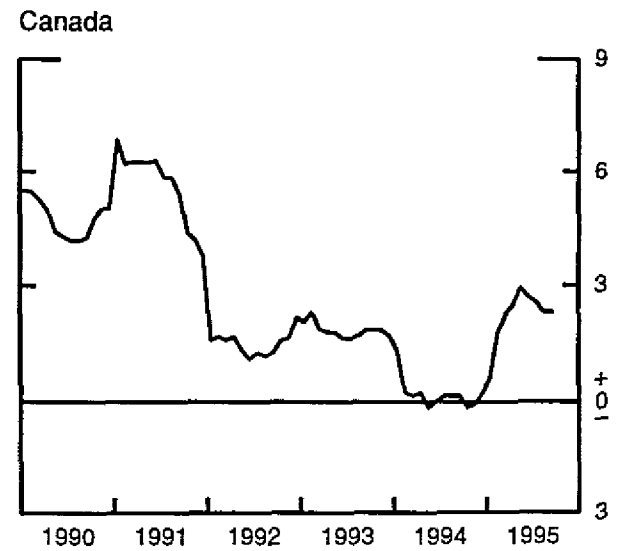
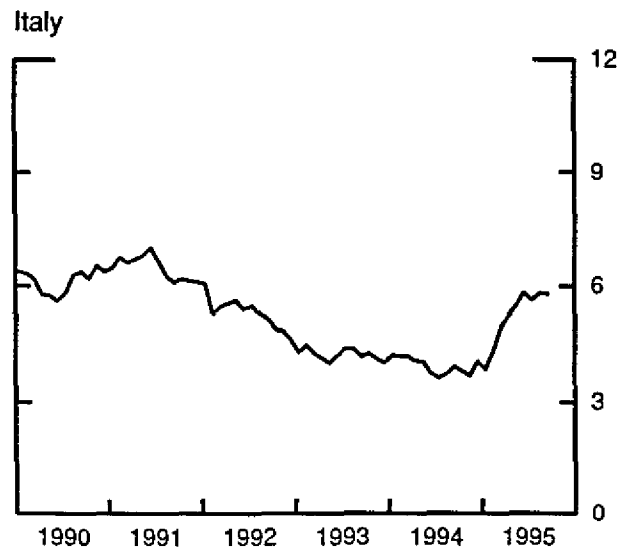
(Monthly data; seasonally adjusted; ratio scale, index)



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



Note: Excludes mortgage interest payments.



Economic Situation in Other Countries

Economic activity picked up in Mexico in the third quarter, but declined in Argentina and Brazil. Growth remained strong in the major Asian developing countries, although the pace has moderated recently in China and Taiwan. In Russia, economic activity appears to have stabilized.

The weakness in economic activity in Mexico, Argentina, and Brazil has contributed to the turnaround in these countries' trade balances. However, in Venezuela, import growth was high, and the trade deficit remains sizable. On December 11, Venezuela devalued the bolivar by 41 percent. Both exports and imports grew rapidly in the Asian developing countries, while movements in trade balances have been mixed.

Inflation in Argentina and Brazil has continued to decline, but progress toward reducing inflation in Mexico and Venezuela appears to have slowed in recent months. Inflation in the Asian countries continues to slow.

Individual country notes. In **Mexico**, output is estimated to have increased about 1-1/2 percent in the third quarter, on a seasonally adjusted basis (not an annual rate), after declining 8 percent in the second quarter. However, for statistical reasons, both the second-quarter decline and third-quarter increase are somewhat overstated. The year-over-year decline in industrial production was about 11 percent in September, a little bit smaller than the August decline. The unemployment rate (n.s.a.) fell in both September and October.

Inflation, after declining steadily from its April peak of 8 percent at a monthly rate, ticked up to 2.1 percent in September and October, and to 2.5 percent in November. These developments raise concerns that progress toward reducing inflation in the wake of last December's devaluation of the peso may be slowing, although the November rise in part reflects a seasonal, year-end upturn in inflation.

In part reflecting the continued weakness of the economy, Mexico's trade performance remains strong. The trade surplus for the January-October period registered \$6.2 billion compared with a \$15.2 billion deficit for the same period in 1994. Moreover, the current account surplus continued to rise in the third quarter, reducing the deficit for the first three quarters of the year to \$0.2 billion compared with a deficit of \$21.3 billion in the first three quarters of 1994.

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

	1994	1995				
		Q2	Q3	Aug	Sep	Oct
Real GDP	3.5	-10.5	-9.6	--	--	--
Industrial Production (s.a.)	3.8	-11.6	-11.7	-12.1	-11.2	--
Unemployment Rate (%)	3.2	6.5	7.5	7.6	7.3	6.8
Consumer Prices ¹	7.1	16.1	5.9	1.7	2.1	2.1
Trade Balance ²	-18.5	2.4	2.3	0.7	0.9	0.8
Imports ²	79.4	17.0	17.9	6.4	6.1	6.7
Exports ²	60.8	19.5	20.2	7.1	7.0	7.5
Current Account ²	-28.9	0.4	0.5	--	--	--

1. Percentage change from previous period.

2. Billions of U.S. dollars, n.s.a.

Mexico's non-financial public sector registered a fiscal surplus of about 1.5 percent of GDP in the first three quarters of 1995, well in excess of the target of 0.5 percent of GDP specified in the authorities' economic program for 1995. The primary (non-interest) surplus, about 6 percent of GDP, was also higher than the target of 4.4 percent. Based on Mexico's compliance with the end-September performance criteria, the IMF is expected to release a further \$1.6 billion disbursement.

The condition of the Mexican banking sector has continued to deteriorate, partly because of recent sharp increases in interest rates and weak economic activity. The share of non-performing loans in total loans outstanding has risen from 9 percent at end-1994 to 18 percent at the end of October. On December 1, the authorities announced that they would take majority control of Banco Inverlat, Mexico's fifth largest

bank, owing to its weakened financial condition, although the bank's management would be left unchanged for the present.

In Argentina, consumer prices rose 1.9 percent in November from a year earlier. Real GDP for the second quarter was 4.6 percent below its year-earlier level. However, recent data suggest that the economy may have bottomed out in the third quarter. In the first ten months of 1995, exports rose by 36 percent over a year earlier, while imports declined almost 10 percent. Gross international reserves have remained steady in the last month and stood at \$14.8 billion on November 30, of which \$2.5 billion is in dollar-denominated Bonex bonds. The monetary base was \$11.1 billion, leaving \$3.7 billion in excess reserves.

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

	1994	1995				
		Q2	Q3	Sep	Oct	Nov
/Real GDP	7.4	-4.6	--	--	--	--
Industrial Production (sa)	4.3	-4.8	-11.5	-11.5	-9.9	--
Unemployment Rate (%) ²	11.7	18.6	--	--	--	--
Consumer Prices ¹	3.9	0.3	0.5	0.3	0.3	-0.1
Current Account ³	-9.9	-1.0	--	--	--	--
Trade Balance ³	-4.0	-0.2	1.9	0.2	0.0	--

1. Percentage change from previous period.

2. Unemployment figures available only in May and October of each year. The figure for 1994 is the average of the two surveys.

3. Billions of U.S. dollars, n.s.a., current account under Q2 is for the first half of 1995.

Argentina met the fiscal and monetary performance criteria under its IMF program for the third quarter, which will allow the government to receive about \$400 million from the IMF before the end of 1995. Moreover, the government is negotiating with the IMF for a new one-year \$1 billion stand-by arrangement. However, tax revenues are still consistently under target, and it appears that the government will reach its IMF-agreed criterion for 1995 of an overall balanced budget only with the proceeds of a tax moratorium, which has yielded approximately \$3.9 billion.

In **Venezuela**, twelve-month consumer price inflation was 53 percent in November, almost unchanged from October. Venezuela registered a merchandise (non-oil) trade deficit of \$4.3 billion for the first eight months of 1995, up from a deficit of \$2.6 billion during the same period in 1994, reflecting a 40 percent increase in imports and a 17 percent increase in exports.

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

	1994	1995				
		Q1	Q2	Aug	Sep	Oct
Real GDP ³	-3.3	1.6	1.1	--	--	--
Unemployment Rate (%)	8.5	11.4	--	--	--	--
Consumer Prices ¹	70.8	9.0	12.2	3.1	3.4	4.5
Current Account ²	3.6	--	--	--	--	--
Trade Balance ²	8.0	-1.0	-1.7	-0.9	--	--

1. Percentage change from previous period.

2. Billions of U.S. dollars, n.s.a., non-oil trade balance.

3. GDP under Q2 is for first half of 1995.

On December 11, following several weeks of speculation that a devaluation was imminent, Venezuela devalued the bolivar by 41 percent.

Negotiations with the IMF continue without significant progress. In addition, President Caldera's decision to replace the progressive President of the Venezuelan Investment Fund (FIV), Carlos Bernardez, on November 20 has been interpreted in financial markets as an indication of his reluctance to carry out free market reforms. The rise in the expectations of a devaluation over the last month, as well as President Caldera's lack of commitment to reform, contributed to a fall in international reserves excluding gold to their lowest levels this year; they stood at \$5.6 billion at the end of October compared with \$7 billion at the end of June.

In an effort to cover external and domestic debt-service payments through the end of the year, Venezuela returned to financial markets for the first time since 1993 by issuing a 3-year DM500 million (\$357 million) bond at a 10 percent fixed rate with a spread of 559 basis points

over a comparable German government bond. Between late November and year-end 1995, the government owes about \$450 million in external obligations, including Brady bond interest payments (with \$231 million due on December 18), monies owed to multilaterals, and amortization of the Austrian schilling bond issue in 1993. While the government has set money aside to cover some of these external obligations, it plans to accumulate around \$850 million in arrears with the Paris Club as a means of financing the deficit.

In Brazil, seasonally adjusted real GDP declined sharply in both the second and third quarters. However, on a year-over-year basis, real GDP growth was still positive. Inflation has remained low by Brazilian standards.

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

	1994	1995				
		Q2	Q3	Aug	Sep	Oct
Real GDP	5.7	5.5	0.9	--	--	--
Industrial Production (s.a.) ¹	7.8	-7.5	-3.5	-2.7	1.8	--
Open Unemployment Rate (%)	5.1	4.5	4.8	4.9	5.2	--
Consumer Prices ¹	929.0	6.9	3.1	1.0	1.2	1.4
Trade Balance ²	10.5	-2.0	0.8	0.3	0.5	6.3
Current Account ²	-1.5	-6.1	-2.2	--	--	--

1. Percentage change from previous period.

2. Billions of U.S. dollars, n.s.a.

The economic contraction contributed to a narrowing of the current account deficit in the third quarter of 1995, as the sizeable trade deficits over the first two quarters shifted to small trade surpluses in the third quarter.

In November, the Central Bank enacted a new program that will inject funds and provide other assistance to encourage weak banks to merge with healthier banks. The program is the latest attempt by the

Central Bank to respond to banking difficulties that have emerged in recent months due to the deterioration in asset quality.

In China, the rate of growth of economic activity and the inflation rate appear to be moderating. China ran a trade surplus of \$17.8 billion in the first ten months of 1995, well above its surplus of \$2.2 billion in the same period a year ago. This surplus largely reflects a surge in exports in the first half of 1995, when the value of exports rose 45 percent; for the July-October period, exports rose 19 percent. Import growth, by contrast, has been relatively steady over the year, with growth of 16 percent in the first ten months of 1995. At the end of October 1995, China's total reserves less gold reached \$73 billion, up \$21 billion from the end of 1994.

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

	1994	1995				
		Q2	Q3	Aug	Sep	Oct
Real GDP ¹	11.8	10.3	9.8	--	9.8	--
Industrial Production	22.0	16.8	--	14.0	13.6	--
Consumer Prices	25.5	18.3	15.2	14.5	14.4	12.1
Trade Balance ²	5.2	6.1	3.2	0.9	1.1	1.4

1. Cumulative from the beginning of the year

2. Billions of U.S. dollars, n.s.a.

In mid-November, Chinese authorities announced plans to cut tariffs on about 4,000 goods. Although few details were given, the reductions are expected to be implemented in the next few months. However, authorities reportedly have decided to eliminate provisions allowing foreign-invested enterprises to import capital equipment free of tariffs and value added tax. Foreign commentators suggest this may raise the cost of direct investment in China by 20 to 50 percent, depending on the extent of Chinese tariff cuts.

In Taiwan, real GDP growth slowed slightly in the third quarter, and industrial production growth slowed substantially in October. The trade surplus in the first eleven months of 1995 declined slightly from

its year-earlier level; the value of exports rose 23 percent while imports rose 25 percent.

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

	1994	1995				
		Q2	Q3	Sep	Oct	Nov
Real GDP	6.5	6.5	6.0	--	--	--
Industrial Production	6.6	2.8	5.6	3.4	0.3	--
Consumer Prices ¹	2.6	4.7	2.0	2.0	2.9	4.2
Trade Balance ²	12.0	0.3	2.4	0.7	1.4	1.4
Current Account ²	6.0	-0.5	0.6	--	--	--

1. Percentage change from a year earlier.

2. Billions of U.S. dollars, n.s.a.

Real GDP in Korea expanded rapidly during the third quarter. However, recent data indicating a marked deceleration of capital goods imports in the past few months and of industrial production in October suggest that the pace of the current expansion has begun to slow. The central bank seems likely to keep inflation below its target rate of 5 percent: consumer prices were 4.3 percent higher in November than their year-earlier level.

Merchandise exports rose by 35 percent during the first ten months of this year from their year-earlier level. However, imports expanded by 36 percent, reflecting in part extremely rapid growth in capital goods imports during the first half of the year. Because imports began from a higher base, this contributed to a substantial deterioration of Korea's current account balance over that period.

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

	1994	1995				
		Q2	Q3	Sep	Oct	Nov
Real GDP	8.4	9.6	9.9	--	--	--
Industrial Production	10.7	13.0	13.0	11.4	9.7	--
Consumer Prices	5.6	4.3	4.7	4.8	4.4	4.3
Trade Balance ¹	-3.1	-1.7	-0.8	-0.3	0.0	--
Current Account ¹	-4.7	-2.0	-2.1	-0.7	-0.1	--

1. Billions of U.S. dollars, n.s.a.

During November, Russian monthly consumer price inflation remained at 5 percent, and the ruble depreciated slightly against the dollar. The monetary base during October increased by only 1 percent, following monthly growth of over 10 percent earlier in the year. Real GDP and industrial production during the first ten months of 1995 were only slightly below their levels during the same period of 1994, following several years of sharp declines.

Russia has successfully completed two quarterly reviews and seven monthly reviews under its IMF stand-by arrangement, satisfying all of the program's performance criteria and quantitative indicative targets. The fiscal deficit during October was somewhat larger than in previous months (reflecting spending pressures as the December 17 parliamentary elections approach), but the cumulative 1995 deficit remained well below the requirements of the IMF program.

In late November, Sergei Dubinin, the Acting Minister of Finance in 1994, was confirmed as Chairman of the Central Bank of Russia. Dubinin indicated that he intends to continue the tight policies initiated by Mrs. Paramonova. On November 30, the ruble exchange rate band was extended through June 1996. Effective January 1, however, the band will be 4550-5150 rubles per dollar, rather than the current 4300-4900 rubles per dollar.

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

	1994	1995				
		Q2	Q3	Sep	Oct	Nov
Real GDP	-15	-2	-1	-1	-3	--
Industrial Production	-21	-2	1	0	-3	--
Consumer Prices ¹	10	8	5	5	5	5
Ruble Depreciation ¹	9	-3	0	1	0	2
Trade Balance ²	11.9	2.0	--	--	--	--
Current Account ²	0.6	-0.8	--	--	--	--

1. Monthly Rate.

2. Billions of U.S. dollars, excludes intra-FSU transactions.

Russia's commercial bank creditors have agreed to reschedule \$25.5 billion of Russian principal payments and \$7 billion of interest arrears over 25 years. The agreement is expected to be concluded by mid-1996.