## Prefatory Note

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

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Confidential (FR) Class III FOMC

# Part 2

September 18, 1996

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

## Recent Developments

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

Confidential (FR) Class III FOMC

September 18, 1996

# RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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# DOMESTIC NONFINANCIAL DEVELOPMENTS

The available economic indicators point, on balance, to a considerable slowing in the pace of GDP growth this quarter. Employment growth is far from weak, however, and the resultant pressure on labor supplies is evident in continuing acceleration of wage rates. Even so, the August price indexes showed inflation to be still quite subdued.

Labor Markets

The labor market reports revealed slower growth in aggregate hours of private production workers during July and August than during the first half of the year. Nonetheless, labor demand has remained sufficiently strong to generate a further decline in the unemployment rate.

The average gain in private payrolls slipped to 180,000 per month in July and August, compared with the first-half pace of 220,000. Increases in the financial and real estate industries and in business services, including help-supply firms, remained relatively strong in the past two months, but hiring at health and hotel facilities and at retail establishments was unusually slow in August. Construction employment also slowed noticeably in August, posting growth of just 6,000. Manufacturing employment changed little, on net, in recent months after the fluctuations associated with seasonal shutdowns in the motor vehicle industry are taken into account. During July and August, the only notable gains occurred in motor vehicles and the related fabricated metals and rubber industries; those gains were offset by further declines in the apparel industry.

With the average workweek so far in the third quarter about in line with the average for the first half of the year, the recent slowing of private employment growth has been reflected in a deceleration in aggregate hours of private production or nonsupervisory workers. Aggregate hours in July and August averaged 1.4 percent above the second-quarter average (annual rate). Assuming a further moderate increase in September, the quarterly rise could be closer to 2 percent, still a noticeably lower rate of increase than the 2.7 percent over the first half of the year.

In contrast to the private sector, employment gains in the public sector have been surprisingly robust so far in the third quarter, boosted by sizable increases at state and local

CHANGES IN EMPLOYMENT[1]
(Thousands of employees; based on seasonally adjusted data)

| | 1994 | 1995 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July | 1996 Aug. |
|---|---|---|---|---|---|---|---|---|
| | -----------Average monthly changes--------- | | | | | | | |
| Nonfarm payroll employment[2] | 318 | 185 | 171 | 200 | 272 | 219 | 228 | 250 |
| Private | 295 | 176 | 164 | 185 | 253 | 226 | 189 | 173 |
| Manufacturing | 33 | -12 | -16 | -28 | 5 | -5 | -27 | 25 |
| Durable | 28 | 5 | 6 | -15 | 24 | 16 | -13 | 32 |
| Transportation equipment | 5 | -3 | -5 | -13 | 16 | 2 | -6 | 22 |
| Nondurable | 5 | -17 | -22 | -14 | -19 | -21 | -14 | -7 |
| Construction | 25 | 9 | 12 | 39 | 21 | 19 | 23 | 6 |
| Trade | 91 | 54 | 41 | 20 | 87 | 85 | 98 | 28 |
| Finance, insurance, real estate | -3 | 4 | 15 | 15 | 12 | 3 | 20 | 20 |
| Services | 134 | 110 | 95 | 125 | 116 | 109 | 74 | 81 |
| Business services | 54 | 33 | 29 | 32 | 44 | 37 | 39 | 47 |
| Total government | 23 | 9 | 7 | 16 | 19 | -7 | 39 | 77 |
| Private nonfarm production workers[2] | 267 | 152 | 128 | 163 | 208 | 220 | 157 | 138 |
| Manufacturing production workers | 34 | -10 | -13 | -30 | 6 | 3 | -20 | 16 |
| Total employment[3] | 261 | 32 | -18 | 390 | 153 | 148 | 274 | 171 |
| Nonagricultural | 225 | 51 | -15 | 336 | 188 | 257 | 154 | 253 |
| Memo: | | | | | | | | |
| Aggregate hours of private production workers (percent change)[2] | .4 | .1 | .1 | .3 | .5 | 1.7 | -1.2 | .6 |
| Average workweek (hours)[2] | 34.6 | 34.5 | 34.4 | 34.3 | 34.4 | 34.7 | 34.3 | 34.4 |
| Manufacturing (hours) | 41.9 | 41.6 | 41.4 | 40.9 | 41.7 | 41.8 | 41.6 | 41.7 |

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

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

| | 1994 | 1995 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July | 1996 Aug. |
|---|---|---|---|---|---|---|---|---|
| Civilian unemployment rate (16 years and older) | 6.1 | 5.6 | 5.5 | 5.6 | 5.4 | 5.3 | 5.4 | 5.1 |
| Teenagers | 17.6 | 17.3 | 17.6 | 17.4 | 16.3 | 15.9 | 16.4 | 17.2 |
| 20-24 years old | 9.7 | 9.1 | 9.2 | 9.8 | 9.3 | 9.3 | 9.6 | 8.3 |
| Men, 25 years and older | 4.8 | 4.3 | 4.2 | 4.3 | 4.1 | 4.0 | 4.0 | 3.8 |
| Women, 25 years and older | 4.9 | 4.4 | 4.3 | 4.3 | 4.3 | 4.1 | 4.3 | 4.1 |
| Full-time workers | 6.1 | 5.5 | 5.5 | 5.5 | 5.3 | 5.2 | 5.3 | 4.9 |
| Labor force participation rate | 66.6 | 66.6 | 66.4 | 66.7 | 66.7 | 66.7 | 66.9 | 66.7 |
| Teenagers | 52.7 | 53.5 | 52.9 | 52.6 | 52.5 | 51.4 | 52.2 | 50.1 |
| 20-24 years old | 77.0 | 76.6 | 76.1 | 76.9 | 77.0 | 76.5 | 76.6 | 75.6 |
| Men, 25 years and older | 76.0 | 76.0 | 75.6 | 76.0 | 76.1 | 76.3 | 76.4 | 76.5 |
| Women, 25 years and older | 58.1 | 58.3 | 58.5 | 58.4 | 58.6 | 58.7 | 58.9 | 58.9 |

governments. Two special factors contributed to these increases and suggest that much of the rise will be reversed in September. First, the bulk of the gain (100,000 over the July-August period) occurred in local education, where the trends toward earlier school openings and year-round schools apparently have not yet been completely incorporated into the seasonal adjustment factors; in both 1994 and 1995, for example, large advances in August were followed by dips in September. Second, this year's local summer jobs programs extended into the August survey reference week and, thus, may have boosted local noneducation employment.

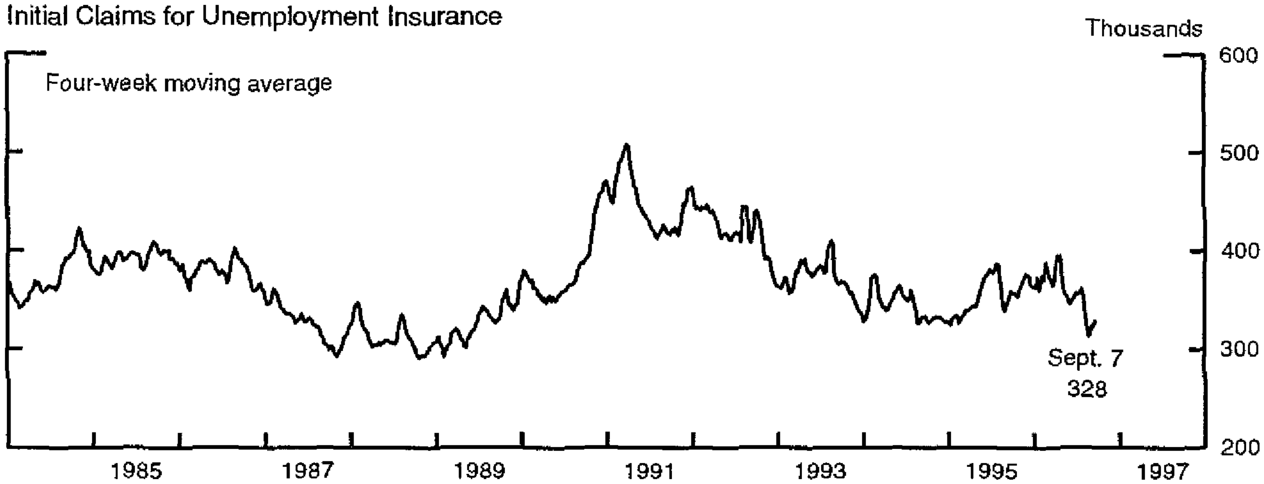
In the household survey, the unemployment rate dropped 0.3 percentage point in August to 5.1 percent, moving it below the 5.3 percent to 5.6 percent range that had prevailed since early this year. Several considerations caution against a literal reading of this drop. First, the fall in the unemployment rate was particularly dramatic for workers aged 20 to 24 years and for those more than 54 years, groups that have traditionally had more variable unemployment rates. In addition, this August's later-than-usual survey reference week may have overstated the decline in joblessness.[1] The unemployment rate for adults aged 25 to 54 years--which has shown less variability over this year--also fell in August, but by only 0.1 percentage point. The decline since May in the rate for this group, which probably is more indicative of the underlying trend in labor market conditions, has been 0.3 percentage point, compared with 0.5 percentage point for the overall labor force.

Other recent indicators support the picture of a still relatively strong labor market. Initial claims for unemployment insurance remained low into early September. The four-week moving average for the period ending September 7 was 328,000, compared with 359,000 for the same period last year. Moreover, expectations of labor market conditions, as measured by the Michigan Survey Research Center and Conference Board surveys of households and by the

1. The seasonal adjustment procedures for the Current Population Survey, unlike those for the establishment survey, do not account for the timing of the survey reference week. The BLS suggests that, because the survey week fell in the third week of August, many students who otherwise might have been unemployed or employed may have already left the labor force either to go on vacation or return to school. This hypothesis is consistent with the sharp drop in the labor force among men aged 16 to 24. However, a puzzling aspect of the story is why the labor force of student-aged women was essentially unchanged.

# Labor Market Indicators

## Initial Claims for Unemployment Insurance




Note. State programs, includes EUC adjustment.

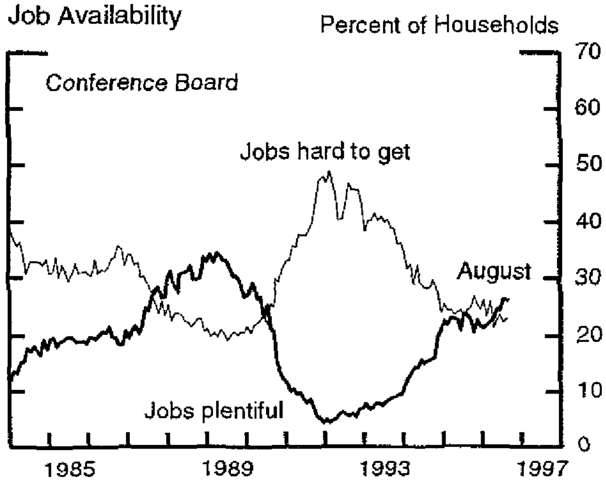
## Help Wanted Advertising


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

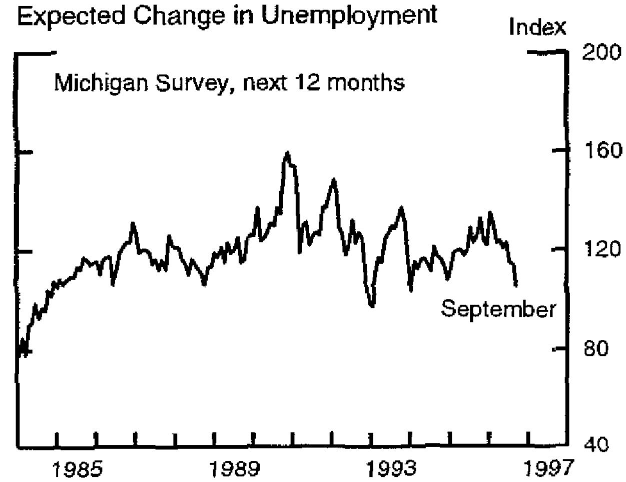
## Net Hiring Strength


Note. Percent planning an increase in employment minus percent planning a reduction.

## Job Availability




## Expected Change in Unemployment



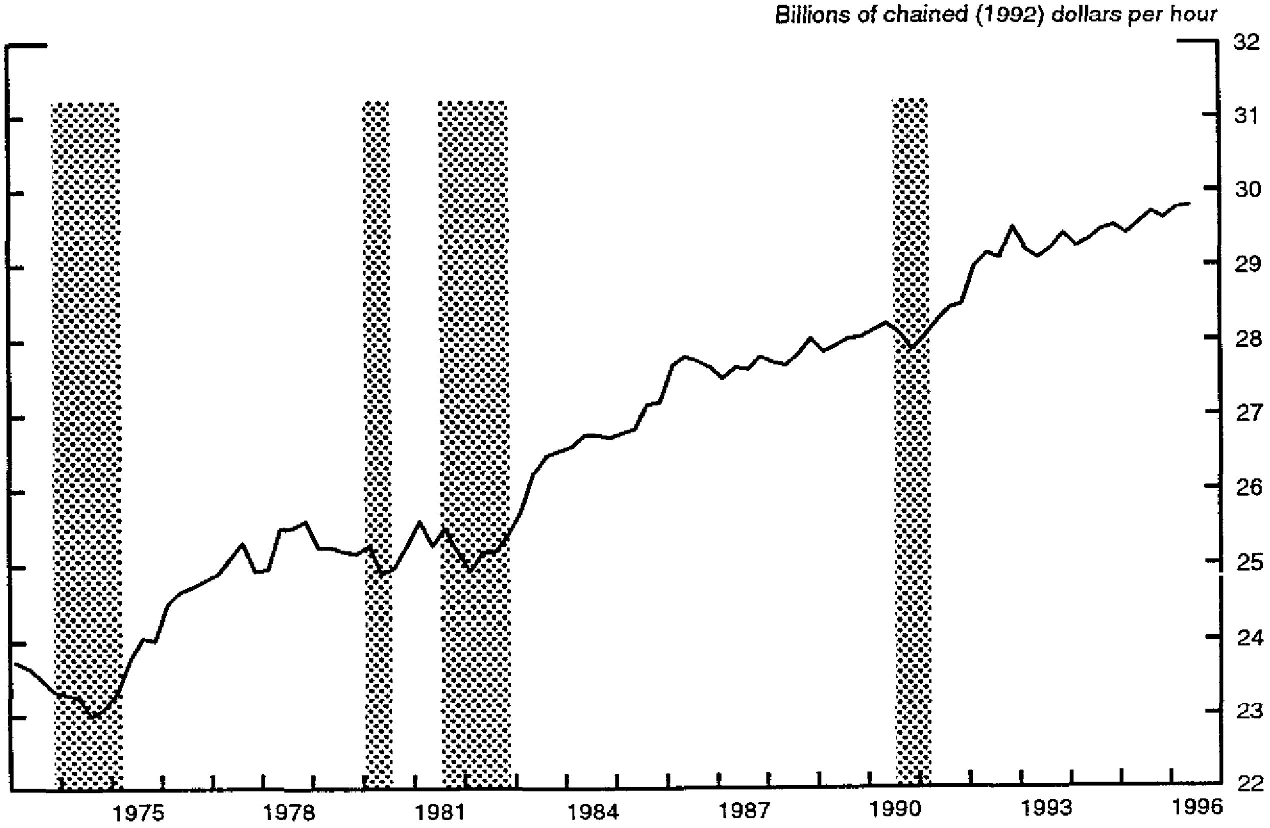

Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

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

| | 1994[1] | 1995[1] | 1995 Q3 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1995:Q2 to 1996:Q2 |
|---|---|---|---|---|---|---|---|
| Output per hour | | | | | | | |
| Total business | .3 | .3 | 1.7 | -.6 | 2.0 | 1.1 | 1.1 |
| Nonfarm business | .5 | .3 | 2.0 | -1.1 | 1.8 | .5 | .8 |
| Manufacturing | 4.5 | 3.5 | 5.3 | 3.7 | 5.6 | 2.2 | 4.2 |
| Compensation per hour | | | | | | | |
| Total business | 2.3 | 4.1 | 3.9 | 4.4 | 3.0 | 4.0 | 3.8 |
| Nonfarm business | 2.5 | 4.1 | 4.0 | 4.1 | 3.3 | 3.7 | 3.8 |
| Unit labor costs | | | | | | | |
| Total business | 1.9 | 3.9 | 2.2 | 5.0 | 1.0 | 2.9 | 2.8 |
| Nonfarm business | 2.0 | 3.8 | 1.9 | 5.2 | 1.5 | 3.2 | 2.9 |
| Memo: | | | | | | | |
| ECI compensation per hour | 3.1 | 2.6 | 2.6 | 2.6 | 2.9 | 3.2 | 2.9 |

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

## Productivity in the Nonfarm Business Sector



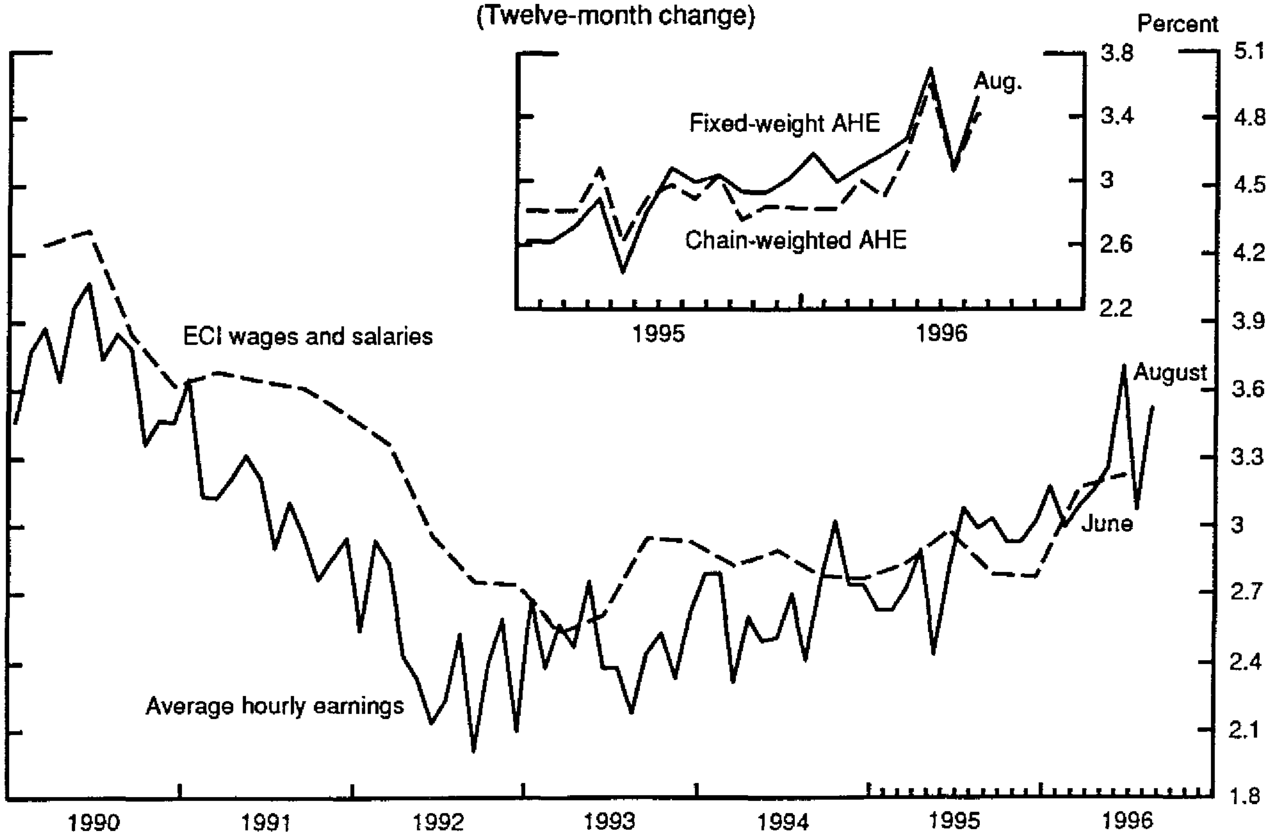
AVERAGE HOURLY EARNINGS
(Percentage change; based on seasonally adjusted data)

| | Twelve-month percent change | | | Percent change to Aug. 1996 from | | 1996 | |
|---|---|---|---|---|---|---|---|
| | Aug. 1993 | Aug. 1994 | Aug. 1995 | Feb. 1996 | May 1996 | July | Aug. |
| | | | -Annual rate- | | | -Monthly rate- | |
| Total private nonfarm | 2.2 | 2.4 | 3.0 | 3.8 | 4.9 | -.2 | .5 |
| Manufacturing | 2.2 | 2.6 | 2.8 | 6.0 | 6.8 | .2 | 1.0 |
| Durable | 2.2 | 2.8 | 2.2 | 7.2 | 8.1 | .3 | 1.3 |
| Nondurable | 2.2 | 2.2 | 3.3 | 3.8 | 4.4 | .2 | .4 |
| Contract construction | 1.5 | 2.4 | 2.6 | 3.3 | 4.5 | .5 | .1 |
| Transportation and public utilities | 1.0 | 1.6 | 2.9 | 2.7 | 3.4 | .0 | .4 |
| Finance, insurance, and real estate | 5.2 | 3.0 | 4.7 | 3.7 | 2.2 | -.7 | .5 |
| Total trade | 2.3 | 2.5 | 3.1 | 4.0 | 4.4 | -.6 | .5 |
| Services | 1.9 | 2.3 | 3.0 | 3.3 | 4.2 | -.2 | .3 |

Note. Twelve-month percent changes use NSA data.

## Earnings of Production or Nonsupervisory Workers

(Twelve-month change)



Manpower survey of businesses, improved or held steady at quite favorable levels in recent months.

Revised figures on productivity and costs now show that the strong gains in hours worked during the first half of this year were accompanied by some recovery in labor productivity. Taking into account BEA's revised estimates of output, productivity in the nonfarm business sector rose more in the second quarter than originally estimated, bringing the average growth rate for the first half of the year to 1.2 percent at an annual rate, up from last year's dismal 0.3 percent rate. BEA's revised estimates also show that compensation per hour in the nonfarm business sector rose at a 3-1/2 percent annual rate over the first half of the year. This measure of the change in hourly compensation, while down slightly from its 1995 pace, continues to run ahead of the rate of increase in ECI compensation. The latest four-quarter change in nonfarm hourly compensation was 3.8 percent, compared with 2.9 percent for the ECI.

The only current-quarter indicator of labor costs since last Greenbook is the August reading on average hourly earnings of production workers. The twelve-month change in this wage measure has now moved up to 3-1/2 percent--from 3 percent for the twelve months ending August 1995.

<u>Industrial Production</u>

After a pause in July, industrial production rose 0.5 percent in August, similar to its pace over the first half of the year.[2] Increases in August were widespread across manufacturing industries and were somewhat tempered by a drop in the output of motor vehicles and parts from its high July level. In addition, utilities generation surged, retracing part of the large weather-related declines earlier in the summer; mining activity also advanced solidly with gains in coal output and drilling activity.

Output of motor vehicles and parts dropped 2.1 percent last month after two months of solid gains. Outside the motor vehicle sector, manufacturing production rose 0.4 percent last month. Increases in the output of business equipment remained an important area of strength marked by continued robust growth in office and computing equipment, an uptick in industrial equipment, and an increase in defense and space equipment. Since the end of last

2. Growth of industrial production in May was revised up to 0.7 percent; the growth rates for June and July were unchanged.

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

| | Proportion in total IP 1995:Q4 | 1995[1] | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July | 1996 Aug. |
|---|---|---|---|---|---|---|---|---|
| | | | ----Annual rate----- | | | --Monthly rate--- | | |
| Total index | 100.0 | 1.6 | .6 | 3.0 | 6.5 | .6 | .1 | .5 |
| Previous | | 1.6 | .6 | 3.0 | 6.0 | .6 | .1 | |
| Manufacturing | 86.5 | 1.4 | 1.4 | 2.4 | 7.0 | .8 | .3 | .3 |
| Motor vehicles and parts | 5.5 | -2.6 | -.5 | -20.7 | 46.6 | 2.8 | 3.6 | -2.1 |
| Mining | 6.0 | -1.8 | -7.7 | 1.9 | 9.3 | 1.4 | -1.0 | 2.4 |
| Utilities | 7.5 | 6.2 | -2.1 | 8.9 | .9 | -1.8 | -1.8 | 1.5 |
| Manufacturing excluding motor vehicles and parts | 81.0 | 1.7 | 1.6 | 4.1 | 4.8 | .7 | .1 | .4 |
| Consumer goods | 23.1 | .1 | .0 | .2 | .1 | .1 | .3 | -.3 |
| Durables | 3.7 | -.4 | 4.0 | -5.4 | 7.3 | 3.4 | -2.2 | -1.3 |
| Nondurables | 19.4 | .2 | -.7 | 1.2 | -1.2 | -.5 | .7 | -.2 |
| Business equipment | 14.0 | 5.6 | 2.1 | 19.2 | 8.1 | 1.4 | .4 | 1.1 |
| Office and computing | 3.1 | 36.2 | 45.0 | 48.4 | 44.3 | 2.8 | 3.5 | 3.0 |
| Industrial | 4.3 | 3.5 | 2.6 | 4.1 | -3.2 | -.5 | -.3 | .1 |
| Other | 6.7 | -3.0 | -12.5 | 17.0 | -.1 | 1.8 | -.9 | .7 |
| Defense and space equipment | 2.2 | -9.1 | -16.4 | -.6 | 6.6 | -1.0 | .7 | 1.4 |
| Construction supplies | 5.3 | -.4 | 6.0 | .6 | 7.6 | 2.5 | -1.4 | -.3 |
| Materials | 29.5 | 3.1 | 3.9 | 4.0 | 6.9 | .8 | .2 | .7 |
| Durables | 21.1 | 5.9 | 6.9 | 7.6 | 4.9 | 1.1 | .0 | .8 |
| Nondurables | 8.2 | -2.8 | -2.9 | -5.0 | 12.5 | -.2 | .7 | .3 |
| Energy | 0.2 | -16.8 | -22.4 | 12.5 | 4.1 | 2.8 | -3.4 | 3.6 |
| Memo: | | | | | | | | |
| Information-related products[2] | 11.2 | 21.4 | 22.7 | 21.6 | 20.1 | 1.6 | 1.2 | 1.7 |

1. From the final quarter of the previous period to the final quarter of the period indicated.
2. Includes computer equipment, computer parts, semiconductors, communications equipment, and selected instruments.

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

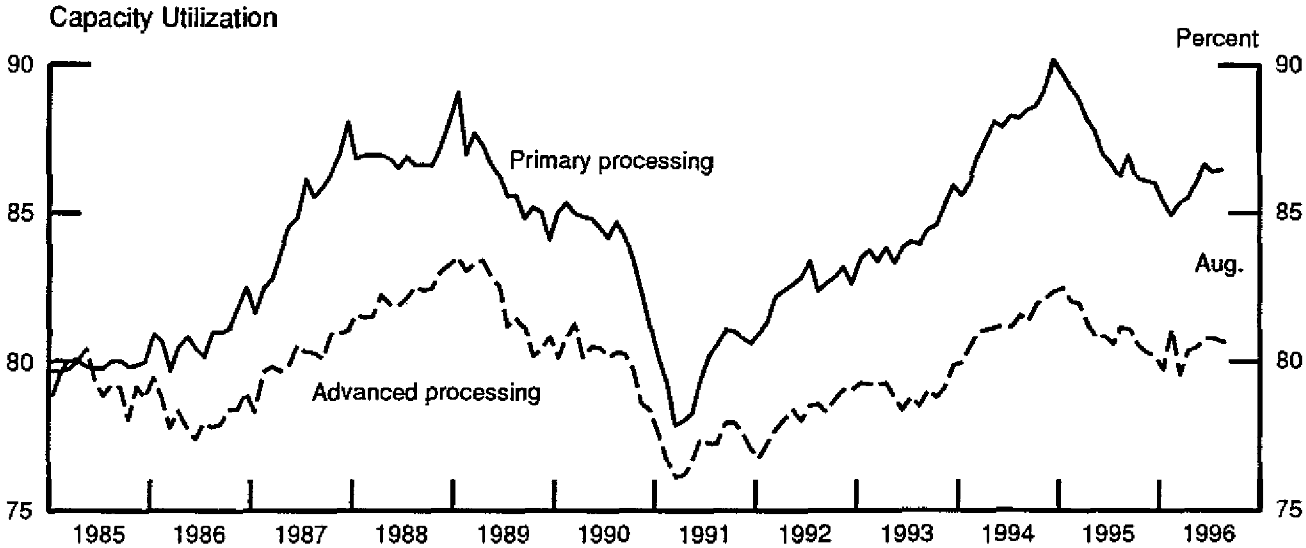
| | Share 1996 H1 | 1996 Q1 | 1996 Q2 | 1996 May | 1996 Jun | 1996 Jul |
|---|---|---|---|---|---|---|
| Total durable goods | 100.0 | 0.7 | 1.6 | 4.2 | -0.2 | 1.7 |
| Nondefense aircraft | 4.0 | 3.0 | -28.1 | 117.2 | -35.1 | 30.7 |
| Adjusted durable goods orders[1] | 68.0 | 0.1 | 2.0 | 1.1 | 1.1 | 2.3 |
| Office & computing machines | 5.0 | 2.1 | 1.6 | -1.2 | 5.0 | 3.8 |
| Nondefense capital goods excluding aircraft and computers | 17.0 | 3.4 | -2.7 | -0.0 | 1.8 | 4.3 |
| Chain-weighted real adj. orders[2] | | 0.7 | 2.5 | 1.1 | 1.5 | 2.0 |

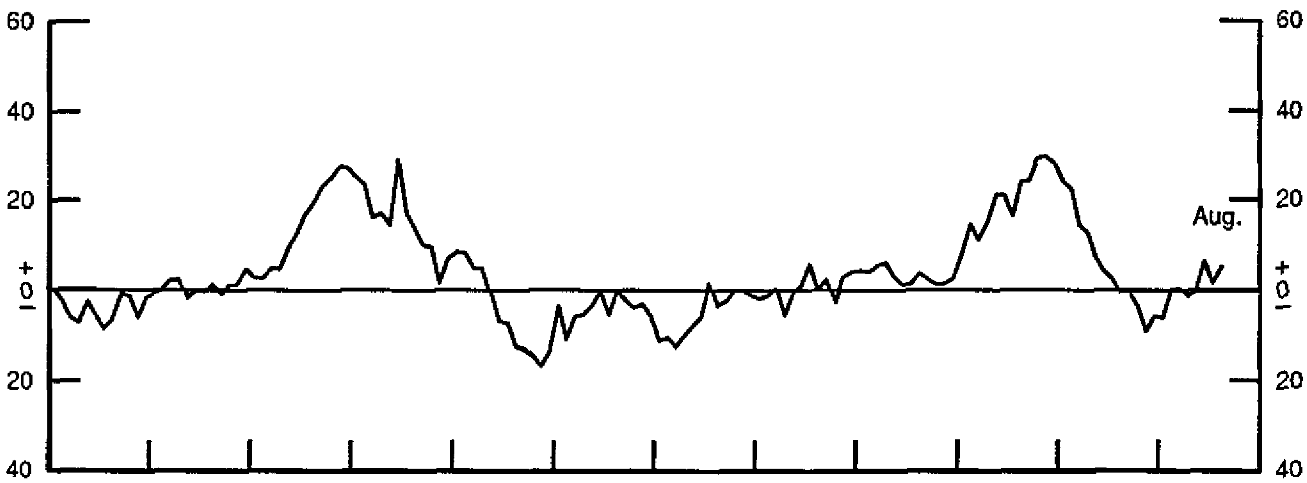
1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Nominal adjusted durable goods orders were split into two components, computers and all other. These components were deflated and then aggregated in a chain-weighted fashion.

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

| | 1988-89 | 1967-95 | 1995 | 1996 | | 1996 | | |
|---|---|---|---|---|---|---|---|---|
| | High | Avg. | Q2 | Q1 | Q2 | June | July | Aug. |
| Total industry | 84.9 | 82.1 | 83.7 | 82.8 | 83.3 | 83.5 | 83.3 | 83.5 |
| Manufacturing | 85.2 | 81.4 | 83.0 | 81.6 | 82.2 | 82.5 | 82.4 | 82.3 |
| Primary processing | 89.0 | 82.6 | 87.6 | 85.2 | 86.1 | 86.6 | 86.4 | 86.5 |
| Advanced processing | 83.5 | 80.7 | 81.0 | 80.1 | 80.5 | 80.8 | 80.8 | 80.6 |

## Manufacturing Sector




*Percent of respondents in the purchasing managers survey reporting slower supplier deliveries minus those reporting faster deliveries, seasonally adjusted.

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

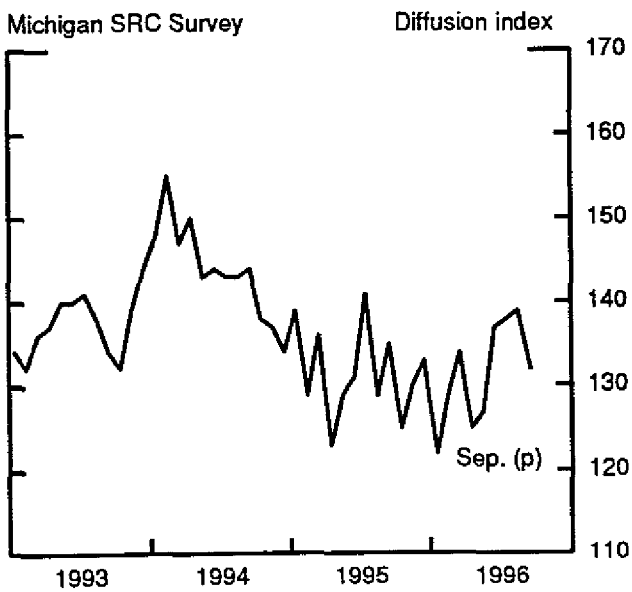
| | | | 1995 | 1996 | | 1996 | | |
|---|---|---|---|---|---|---|---|---|
| | 1994 | 1995 | Q4 | Q1 | Q2 | June | July | Aug. |
| Total | 15.0 | 14.7 | 14.9 | 15.2 | 15.1 | 15.1 | 14.2 | 15.7 |
| Adjusted[1] | 15.0 | 14.6 | 14.4 | 15.3 | 15.1 | 15.1 | 14.4 | 15.6 |
| Autos | 9.0 | 8.6 | 8.6 | 8.6 | 8.8 | 8.7 | 8.1 | 8.8 |
| Light trucks | 6.1 | 6.1 | 6.3 | 6.5 | 6.3 | 6.4 | 6.1 | 6.9 |
| North American[2] | 12.9 | 12.8 | 13.1 | 13.5 | 13.4 | 13.3 | 12.6 | 14.0 |
| Autos | 7.3 | 7.1 | 7.3 | 7.3 | 7.5 | 7.4 | 7.0 | 7.5 |
| Big Three | 5.7 | 5.4 | 5.5 | 5.4 | 5.6 | 5.5 | 5.1 | 5.3 |
| Transplants | 1.5 | 1.7 | 1.8 | 1.9 | 1.9 | 1.9 | 1.8 | 2.3 |
| Light trucks | 5.7 | 5.7 | 5.9 | 6.1 | 5.9 | 5.9 | 5.7 | 6.4 |
| Foreign produced | 2.1 | 1.9 | 1.8 | 1.7 | 1.7 | 1.8 | 1.5 | 1.7 |
| Autos | 1.7 | 1.5 | 1.4 | 1.3 | 1.3 | 1.3 | 1.2 | 1.3 |
| Light trucks | .4 | .4 | .4 | .4 | .5 | .4 | .4 | .5 |

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

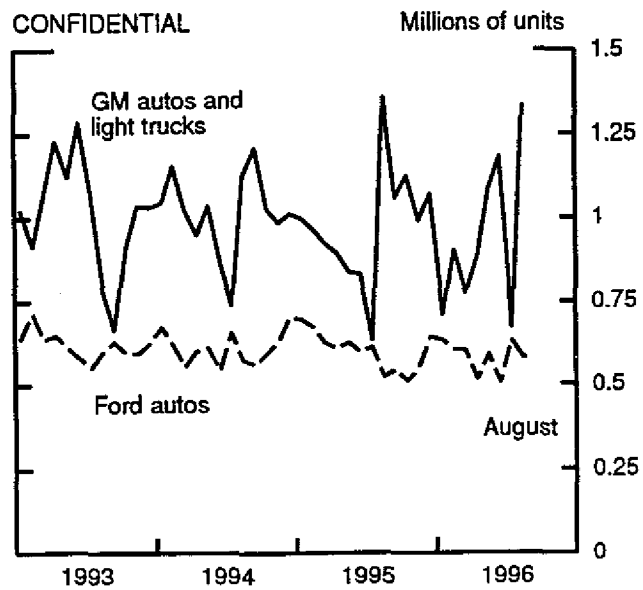
1. Excludes the estimated effect of automakers' changes in reporting periods.

2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Buying Conditions for New Vehicles




GM and Ford Fleet Sales



year, output of defense and space equipment has posted its first sustained rise since the 1980s. In contrast, the output of manufactured consumer goods other than motor vehicles fell last month as appliance production dropped substantially for a second month. The production of construction supplies declined as well, perhaps the result of some softening of building activity, while materials output advanced, with gains in both durable and nondurable materials.

Other indicators of manufacturing activity also point to a solid pace of industrial activity. The purchasing managers' indexes of new orders and production turned up in August and stand at levels consistent with an appreciable expansion of the manufacturing sector in the near term. Real adjusted new orders for durable goods increased markedly in July, on the heels of three consecutive monthly increases.

The factory operating rate was 82.3 percent in August. Both the utilization rate in primary processing industries and the rate in advanced processing industries continue to be in the upper end of the range observed this year. These relatively high operating rates have been associated with a modest tendency toward deteriorating vendor performance, as reported by purchasing managers.

Motor Vehicles

The United Auto Workers (UAW) reached a tentative three-year agreement with Ford this week; the vote by the UAW members will be completed by September 29. The highlights of the pact include Ford's concession to keep at least 95 percent of the skilled and unskilled UAW members at each of its forty-nine assembly and parts plants in the United States. While wage increases for current workers include a combination of lump-sum payments and annual increases, the UAW agreed to accept a permanently lower entry wage for new hires at parts facilities.

While negotiations are under way with both Chrysler and General Motors, the UAW may focus on Chrysler next because that firm is likely to have fewer problems with this tentative agreement than GM, for whom the guaranteed employment provision poses a major obstacle. Indications are that GM would not accept a level higher than 85 percent and would prefer an even lower level. If negotiations between GM and the UAW were to break off and a strike were to occur, the work stoppage probably would begin late this month or in October.

The Canadian Auto Workers (CAW) reached a tentative settlement with Chrysler this week, but this agreement also contains elements that GM will find difficult to accept, raising the likelihodd of a CAW strike against GM later this month. The potential effects on domestic production of a CAW strike against GM are quite serious. According to GM, some domestic production would be shut down because of parts shortages if the strike were to last more than one week, and, after three weeks, all of GM's assembly plants would be shut down. If strike disruptions were to prove lengthy, and underlying demand did not weaken noticeably, the catch-up in production likely would extend into next year. The effects of a strike on domestic sales would not be so immediate because overall inventories were near normal levels heading into the strike.

The industry has been experiencing strong demand, with sales of new light vehicles in July and August averaging about 15 million units at an annual rate after adjusting for shifts in the reporting periods by some firms. This pace is just a bit below the average sales rate in the first six months of the year. The ongoing strength in sales has been supported by consumers' relatively favorable appraisals of buying conditions for new vehicles, as revealed in the Michigan SRC survey (chart). In addition, J.D. Powers estimates that incentives in the current quarter, while down noticeably from earlier this year, remain at a relatively high level. At the same time, price changes have been moderate, although finance rates have moved up recently.

The monthly changes in sales this year have been quite volatile, and the results for recent months continue this pattern, falling in July and then rebounding sharply in August. Part of this swing reflects movements in GM's sales of autos to fleets. New cars make up about 75 percent of GM's total fleet sales (chart). The company began July with inventories on the lean side--at about 60 days--and with most assembly plants closed during the first two weeks of the month. Consequently, it deferred some fleet sales from July to August in order to ensure that retail sales were not unduly crimped by shortages of popular vehicles.[3] GM's fleet sales, which were at a twelve-month low, rebounded in August. Its retail

3. The overall swing in sales of light vehicles in July and August may be somewhat exaggerated because the current seasonal factors may not yet fully reflect the effects of GM's consolidated downtime during the first two weeks of July; this consolidation was introduced in 1994.

sales, which were flat in July, also moved up in August, but sales of light trucks more than accounted for the gain.

Automakers continued efforts this summer to rebuild inventories in the aftermath of the March strike and to meet the surprising strength in sales. Measured against the average pace of sales in July and August, days' supply of light vehicles in August is estimated to have been at about the usual target level of 65 days. However, days' supply of autos--at about 63 days--was still a little on the lean side, while days' supply of light trucks was about 70 days. Although the strike will have serious implications for fourth-quarter assembly plans, the level of the initial production schedules for the coming quarter--published a few weeks before the strike--was consistent with sales holding near the 15 million unit mark for the rest of the year.

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

| | 1996 | | | | |
|---|---|---|---|---|---|
| | July | Aug. | Sept. | Q3 | Q4 |
| | | | scheduled | | |
| U.S. production | 13.4 | 12.6 | 13.1 | 13.0 | 12.2 |
| Autos | 7.0 | 6.7 | 7.2 | 7.0 | 6.2 |
| Trucks | 6.3 | 5.9 | 6.0 | 6.1 | 6.0 |
| Days' supply[1] | | | | | |
| Autos | 59.4 | 62.8 | ... | ... | ... |
| Light trucks | 70.5 | 69.3 | ... | ... | ... |

Note: Components may not sum to totals because of rounding.
1. Based on average sales in July and August.

Personal Income and Consumption

Consumer spending slowed noticeably in the middle of the year. Spending on goods other than motor vehicles dropped sharply in June and was flat in July, with the weakness fairly widespread; outlays for services also were little changed, on balance, over this period. Advance estimates of retail sales in August, however, show a moderate upturn that suggests that consumer spending may be moving back to a pace more consistent with the sustained high levels of consumer confidence, further gains in the value of household assets, and continued ready access to credit for most potential borrowers.

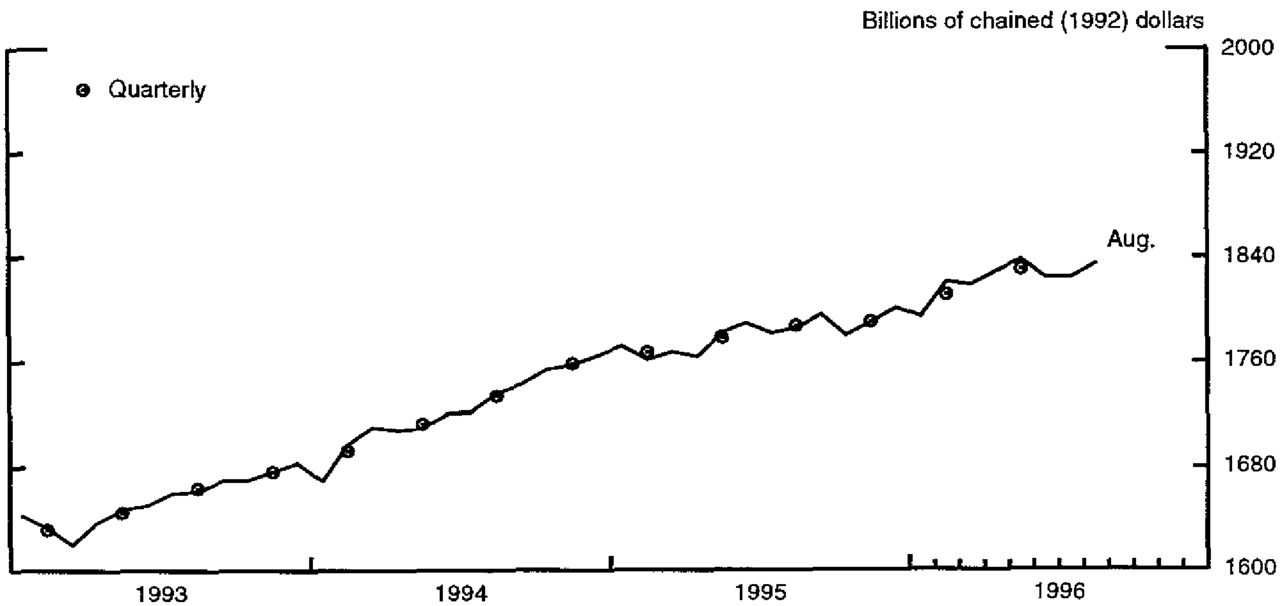
The sharpest rebounds in nominal retail sales in August occurred at general merchandisers and apparel stores, which would seem to bear out the anecdotal reports of relatively strong back-to-school sales. Moreover, the CPI for apparel fell in August, which

## Retail Sales
(Percent change; seasonally adjusted)

| | 1996 | | | | |
|---|---|---|---|---|---|
| | Q1 | Q2 | June | July | Aug. |
| Total sales | 2.3 | 1.2 | -.6 | .1 | .2 |
| *Previous estimate* | | *1.3* | *-.5* | *.1* | |
| Retail control[1] | 1.6 | 1.7 | -.7 | .2 | .2 |
| *Previous estimate* | | *1.8* | *-.5* | *.5* | |
| Durables | 1.6 | 3.3 | -1.2 | .3 | .8 |
| Furniture and appliances | -.3 | 2.0 | -.7 | .0 | -.2 |
| Other durable goods | 3.3 | 4.3 | -1.7 | .6 | 1.5 |
| Nondurables | 1.6 | 1.4 | -.6 | .2 | .1 |
| General merchandise | 2.3 | 2.0 | -.9 | .2 | .7 |
| Food | .9 | .5 | .2 | .9 | -.7 |
| Drug and proprietary stores | 1.1 | 1.3 | -.1 | 1.4 | .4 |
| Other nondurable goods | 1.9 | 1.8 | -1.0 | -.5 | .3 |

1. Total retail sales excluding building material and supply stores and automotive dealers (but including auto and home supply stores).

## PCE Goods Excluding Motor Vehicles




Note. June, July and August numbers are staff estimates.

PERSONAL INCOME
(Average monthly percent change)

| | 1994 | 1995 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July |
|---|---|---|---|---|---|---|---|
| Total personal income | .3 | .5 | .5 | .4 | .6 | .9 | .1 |
| Wages and salaries | .1 | .4 | .5 | .4 | .8 | 1.3 | -.1 |
| Private | .1 | .5 | .5 | .5 | .9 | 1.5 | -.2 |
| Other labor income | .4 | .5 | .3 | -.1 | .4 | .4 | .3 |
| Less: Personal tax and nontax payments | .3 | .6 | .3 | 1.0 | 1.1 | 1.2 | .0 |
| Equals: Disposable personal income | .3 | .4 | .5 | .3 | .6 | .8 | .1 |
| Memo: | | | | | | | |
| Real disposable income[1] | .1 | .3 | .4 | .1 | .4 | .8 | -.1 |
| Saving Rate (percent) | 3.8 | 4.7 | 5.2 | 4.8 | 4.4 | 5.3 | 5.3 |

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

REAL PERSONAL CONSUMPTION EXPENDITURES[1]
(Percent change from the preceding period)

| | 1994 | 1995 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July |
|---|---|---|---|---|---|---|---|
| | | | - - - Annual rate | - - - | | Monthly rate | |
| PCE | 3.1 | 1.9 | 1.1 | 3.5 | 3.4 | -.4 | -.0 |
| Estimated revision[2] | 3.1 | 1.9 | 1.1 | 3.5 | 3.3 | -.5 | -.2 |
| Durables | 7.0 | 1.3 | -1.0 | 8.2 | 11.8 | -2.1 | -1.2 |
| Motor vehicles | 1.8 | -3.8 | -9.8 | 6.6 | 4.0 | -3.2 | -3.9 |
| Computers | 31.8 | 52.3 | 95.6 | 50.8 | 113.8 | 3.5 | -1.5 |
| Other durable goods | 9.1 | .4 | -3.2 | 4.1 | 5.6 | -2.3 | .7 |
| Nondurables | 3.5 | 1.1 | -.4 | 3.7 | 1.6 | -.2 | .2 |
| Gas and oil | 2.1 | 1.9 | 4.5 | -3.8 | 6.4 | 3.2 | -2.5 |
| Clothing and shoes | 7.1 | .7 | -2.4 | 8.4 | 10.4 | -.7 | -.2 |
| Other nondurables | 2.9 | 1.1 | -.4 | 3.4 | -.9 | -.5 | .7 |
| Services | 2.0 | 2.4 | 2.3 | 2.4 | 2.5 | -.2 | .1 |
| Energy | -5.3 | 5.4 | -12.2 | 7.3 | 9.8 | -5.2 | -.8 |
| Non-energy | 2.3 | 2.3 | 3.0 | 2.2 | 2.2 | .1 | .1 |
| Housing | 2.4 | 1.8 | 1.8 | 1.6 | 1.6 | .2 | .2 |
| Household operation | 5.4 | 3.8 | 4.7 | -.4 | 5.8 | .6 | -.1 |
| Transportation | 5.3 | 3.1 | 8.3 | 5.6 | 2.0 | -.6 | .3 |
| Medical | 1.9 | 2.5 | 3.1 | -.1 | 2.5 | .1 | .3 |
| Other | 1.3 | 2.1 | 2.5 | 4.6 | 1.8 | .0 | -.1 |

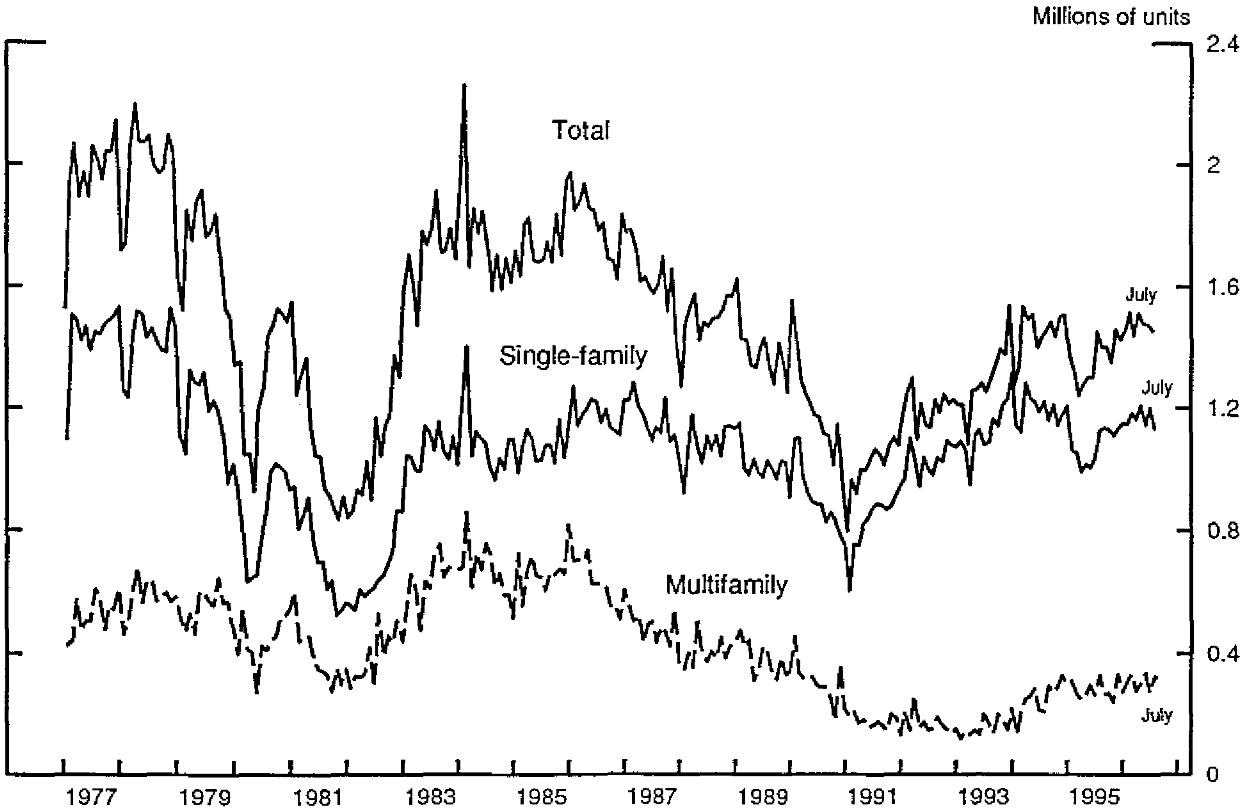
1. Derived from billions of chained (1992) dollars.
2. Staff estimate of revised PCE growth based on August retail sales report.

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

| | | 1995 | 1996 | | | | |
|---|---|---|---|---|---|---|---|
| | 1995 | Q4 | Q1 | Q2[r] | May[r] | June[r] | July[p] |
| *All units* | | | | | | | |
| Starts | 1.35 | 1.41 | 1.47 | 1.49 | 1.48 | 1.47 | 1.46 |
| Permits | 1.33 | 1.44 | 1.41 | 1.44 | 1.45 | 1.42 | 1.45 |
| *Single-family units* | | | | | | | |
| Starts | 1.08 | 1.13 | 1.16 | 1.19 | 1.14 | 1.20 | 1.13 |
| Permits | 1.00 | 1.08 | 1.08 | 1.10 | 1.10 | 1.09 | 1.07 |
| New home sales | 0.67 | 0.68 | 0.75 | 0.74 | 0.74 | 0.73 | 0.78 |
| Existing home sales | 3.80 | 3.98 | 3.95 | 4.21 | 4.28 | 4.16 | 4.14 |
| *Multifamily units* | | | | | | | |
| Starts | 0.28 | 0.28 | 0.31 | 0.30 | 0.33 | 0.27 | 0.32 |
| Permits | 0.33 | 0.36 | 0.33 | 0.34 | 0.35 | 0.33 | 0.38 |
| *Mobile homes* | | | | | | | |
| Shipments | 0.34 | 0.35 | 0.35 | 0.37 | 0.37 | 0.37 | n.a. |

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

**Private Housing Starts**
(Seasonally adjusted annual rate)



implies a sizable increase in real purchases of clothing and footwear for the month. Although sales at furniture and appliance dealers were flat in August, outlays for other durables posted a sizable gain. However, nominal sales at gasoline stations fell in August for the third straight month, only partly because of price declines. Nominal outlays at food stores and at eating and drinking places were down as well. The retail sales data suggest that real personal consumption expenditures (PCE) for goods excluding motor vehicles rose about 1/2 percent in August after no gain in July. This puts the average for July and August slightly below the second-quarter level.[4]

Growth in real expenditures for services was weak in June and July. Real outlays for energy services fell in both months, reflecting the return to more normal weather in June and slightly cooler than average temperatures in July. For the country as a whole, temperatures remained on the cool side again in August, which should hold down spending on energy services. Non-energy services were little changed in both months, in part because of estimated lower expenditures on brokerage and investment services as well as on moving and insurance outlays.[5]

Real disposable personal income edged down in July after two sizable monthly gains. Real DPI likely was up appreciably again in August; the sharp increases in production worker hours and average hourly earnings last month should translate into a sizable gain in private wages and salaries. Thus, the personal saving rate could well jump above the 5 percent mark again this quarter, as it did during the lull in spending at the end of 1995.

Housing Markets

Evidence of a slowdown in single-family housing activity continued to accumulate over the summer. Starts of single-family homes dropped 5-3/4 percent in July; smoothing through the month-to-month fluctuations, the series has been edging down since April.

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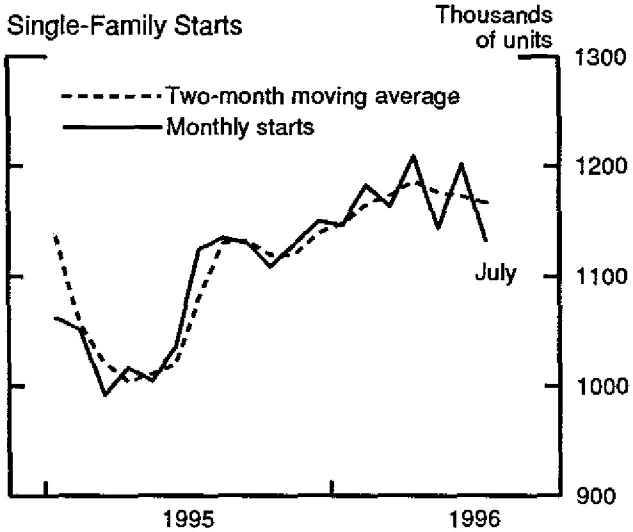
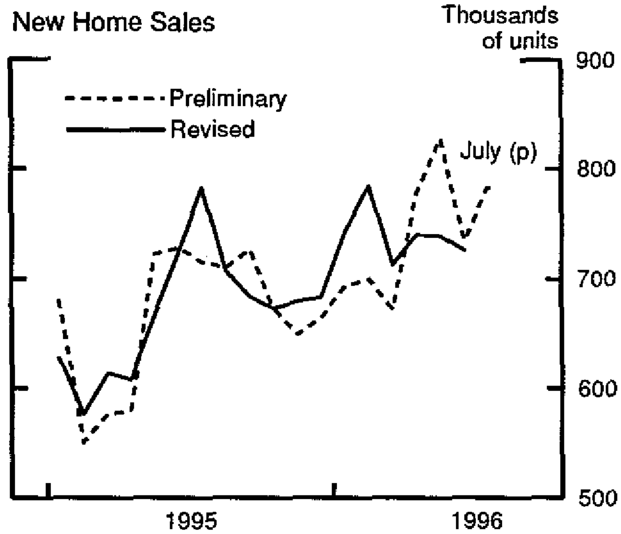
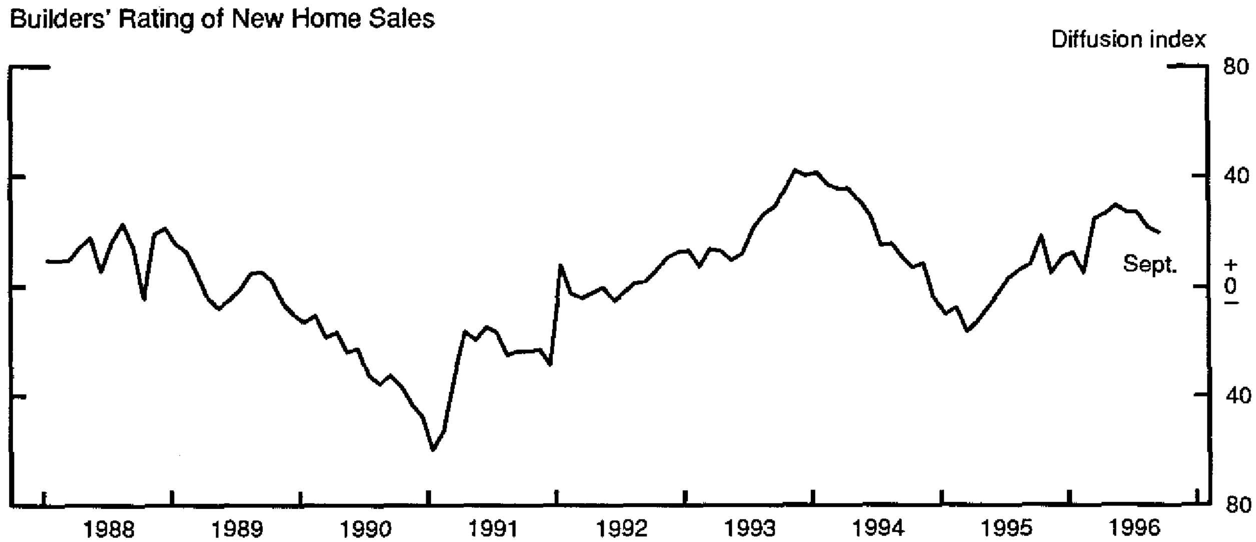
4. Based on the advance retail sales data, the staff estimates that real PCE for goods other than motor vehicles increased 0.3 percent in July. The revised retail sales figures indicate that, in addition to the downward revision for July, the drop in real PCE in June was steeper than previously estimated (-0.7 percent).

5. Although purchases of tickets to Olympic events boosted the "spectator sport" component of services about $3 billion in July, the added spending was largely offset by an abrupt $2 billion decline in outlays for movie tickets--a possible Olympics side effect.

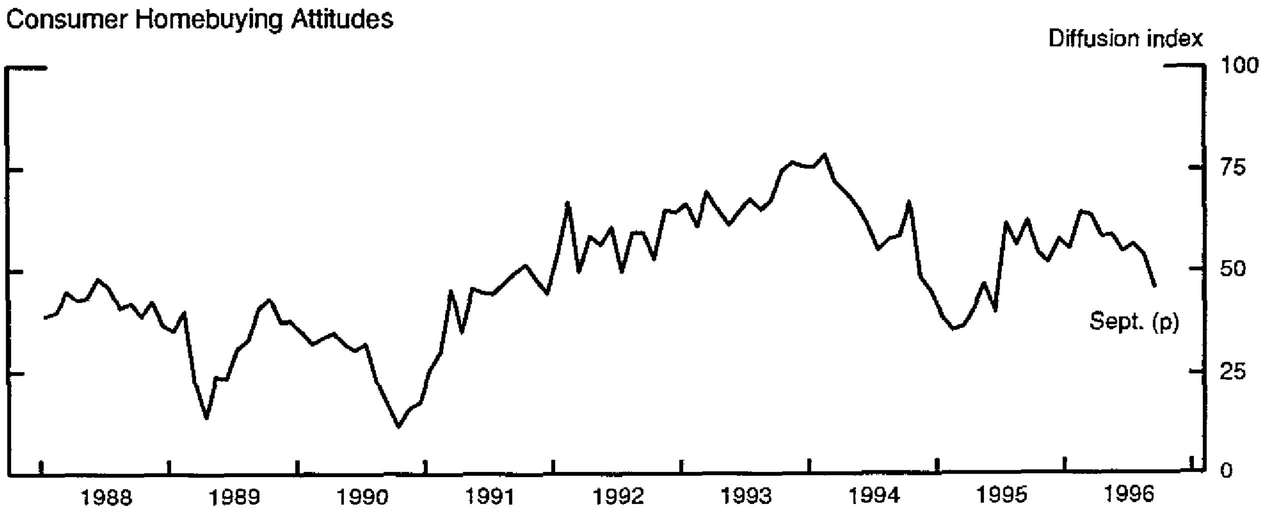
# Single-Family Housing Activity
(Seasonally adjusted)




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




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

In contrast to the decline in starts, new home sales jumped 8 percent in July. But the rise was accompanied by large downward revisions to the April and May estimates as well as a small reduction in the reading for June. The history of large revisions to preliminary estimates of new home sales suggests that little weight should be given to the July reading.[6] Of greater significance in the report on new home sales is the downward revision of sales in 1996:Q2, which now shows a slight decrease from the first quarter. This declining pattern is confirmed by the trajectory of existing home sales, which decreased in June and July. Sales of existing homes tend to lag other indicators of single-family activity because a substantial share are recorded at the closing, while new home sales are recorded mainly at the time a sales contract is signed.

More recent indicators suggest that, on the whole, sales of single family homes continued to soften late in the third quarter. A survey of builders showed that their assessments of new home sales continued to weaken a bit in August and September. Over the same period, homebuying attitudes, as measured by the Michigan survey, eroded further. However, applications for mortgages to purchase homes remained flat through early September at the relatively high level that has prevailed so far this year. Taken together, this evidence points to a modest slippage in the production and sales of single-family homes in recent months.

Multifamily housing starts jumped to 322,000 units (annual rate) in July, almost offsetting a decline in June. Building permits for multifamily housing, which also have had a zigzag pattern so far this year, surged to the highest level since early 1990. There are some indications that apartment construction at the national level may be outpacing the growth of demand. In particular, the vacancy rate for multifamily rental units was higher in the second quarter, compared with the year-earlier level, marking the third consecutive quarter in which vacancies have risen. Moreover, real residential rents, as measured in the CPI, continued

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6. The large revisions resulted mainly from the difficulty of estimating sales of houses that are sold before issuance of a building permit and therefore are not detected immediately by the sampling of permits conducted by the Census Bureau. In the past three and one-half years, homes that were sold before the start of construction accounted for more than half of the revisions to the series but constituted only about one-third of total new home sales.

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

| | 1995 | 1996 | | 1996 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | June | July |
| Producers' durable equipment | | | | | | |
| Shipments of nondefense capital goods | 3.0 | -.5 | 2.9 | 2.8 | .4 | -1.5 |
| Excluding aircraft and parts | 3.1 | .8 | 1.5 | .3 | 3.4 | -2.4 |
| Office and computing | 5.1 | 3.7 | -.8 | .1 | 2.8 | -1.8 |
| Communications equipment | 7.7 | -.3 | 4.7 | 4.2 | 6.4 | -.6 |
| All other categories | 1.4 | .0 | 1.7 | -.6 | 2.9 | -3.1 |
| Shipments of complete aircraft[1] | -3.9 | 1.4 | 12.2 | 38.2 | -39.4 | 2.7 |
| Sales of heavy trucks | 6.4 | -2.2 | 1.2 | 10.0 | -6.9 | .1 |
| Orders of nondefense capital goods | 8.8 | 3.1 | -6.5 | 11.1 | -4.6 | 7.6 |
| Excluding aircraft and parts | 3.4 | 3.1 | -1.7 | -.3 | 2.6 | 4.2 |
| Office and computing | 7.5 | 2.1 | 1.6 | -1.2 | 5.0 | 3.8 |
| Communications equipment | 2.3 | 8.7 | -8.5 | -7.7 | 7.5 | 16.1 |
| All other categories | 2.2 | 2.2 | -1.2 | 1.8 | .6 | 1.5 |
| Nonresidential structures | | | | | | |
| Construction put-in-place | -1.0 | 1.0 | -.3 | -3.4 | 3.0 | -2.2 |
| Office | -10.8 | -6.6 | 8.1 | 3.9 | 15.2 | -6.9 |
| Other commercial | 1.0 | 3.0 | -1.4 | -6.4 | .1 | -2.7 |
| Institutional | -1.2 | -2.9 | .9 | 3.6 | 2.9 | -1.6 |
| Industrial | -1.9 | -1.6 | -8.1 | -10.0 | 5.1 | -3.0 |
| Public utilities | -4.8 | 4.5 | 2.5 | -1.8 | -4.4 | 2.6 |
| Lodging and miscellaneous | 26.6 | 10.6 | .0 | -4.6 | 7.4 | -3.6 |
| Rotary drilling rigs in use | -5.4 | 6.6 | 12.4 | 3.8 | -3.1 | -2.3 |
| Memo: | | | | | | |
| Business fixed investment[2] | 2.5 | 11.6 | 4.0 | n.a. | n.a. | n.a. |
| Producers' durable equipment[2] | 3.0 | 13.1 | 6.0 | n.a. | n.a. | n.a. |
| Nonresidential structures[2] | 1.0 | 7.7 | -1.2 | 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 1992 chain-weighted data; percent change, annual rate.
n.a. Not available.

to edge down in the second quarter and were about flat in July and August.

Business Fixed Investment

Early indications for the current quarter suggest that real PDE will advance substantially faster than the 6 percent pace registered in the second quarter. New orders for nondefense capital goods rebounded in July after a decline in the second quarter. The biggest spurt was in orders for communication equipment, which rose 16 percent in July after an increase of 7-1/2 percent in June. Industry contacts report that the expanding array of services being offered over phone lines--call waiting, caller ID, voice mailboxes--require new software and upgrades to switching equipment, providing an ongoing boost to this component of PDE.[7] In addition, real spending on office and computing equipment has maintained substantial momentum. After adjusting for the continuing large price decreases in this sector, orders and shipments posted further gains in July. Elsewhere, orders for other capital goods have increased for three consecutive months, although they appear to have decelerated from the rapid pace of the past few years.

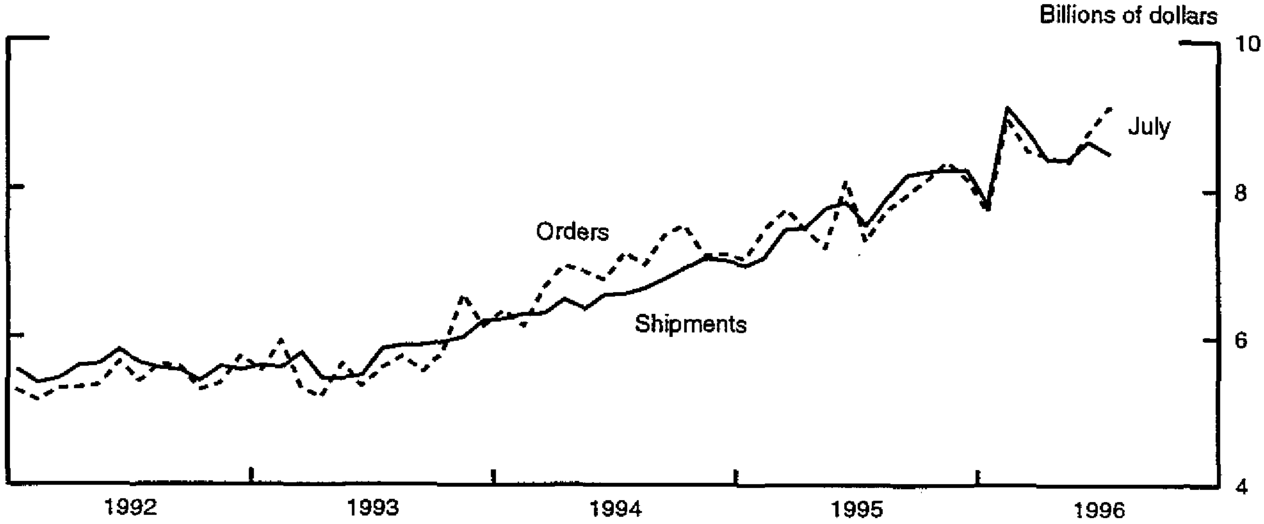
Spending on transportation equipment eased a bit in July and August from the second-quarter level. Sales of heavy trucks were flat in July, after a sharp drop in June. Fleet sales of light vehicles were off in July but appear to have snapped back in August. Boeing continued to build on its already large backlog of orders for commercial aircraft, but a major retooling effort and strained labor relations have hindered their ability to achieve planned increases in production.

BEA reported that real expenditures on nonresidential structures dipped slightly in the second quarter. Subsequent downward revisions to data on construction put-in-place point to a somewhat larger decline, at about a 2 percent annual rate. Construction in July was a near mirror image of June: all categories of buildings posted gains in June but fell back the subsequent month, while public utilities declined in June but bounced up in July. On balance, the declines in July retraced only

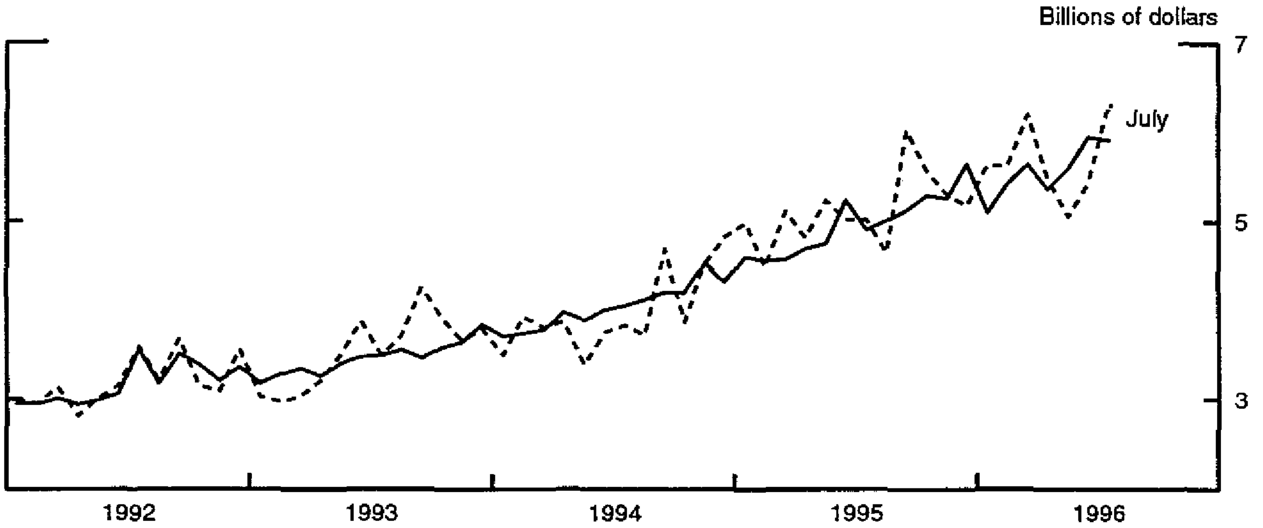
7. On August 8, the FCC announced new rules implementing the Telecommunications Reform Act of 1996. The act opens the local phone monopolies to competition and will have widespread effects in the telecommunications industry, including, perhaps, a substantial increase in equipment investment. However, the effects these changes most likely will not begin to be felt until sometime next year at the earliest.

# Orders and Shipments of Nondefense Capital Goods

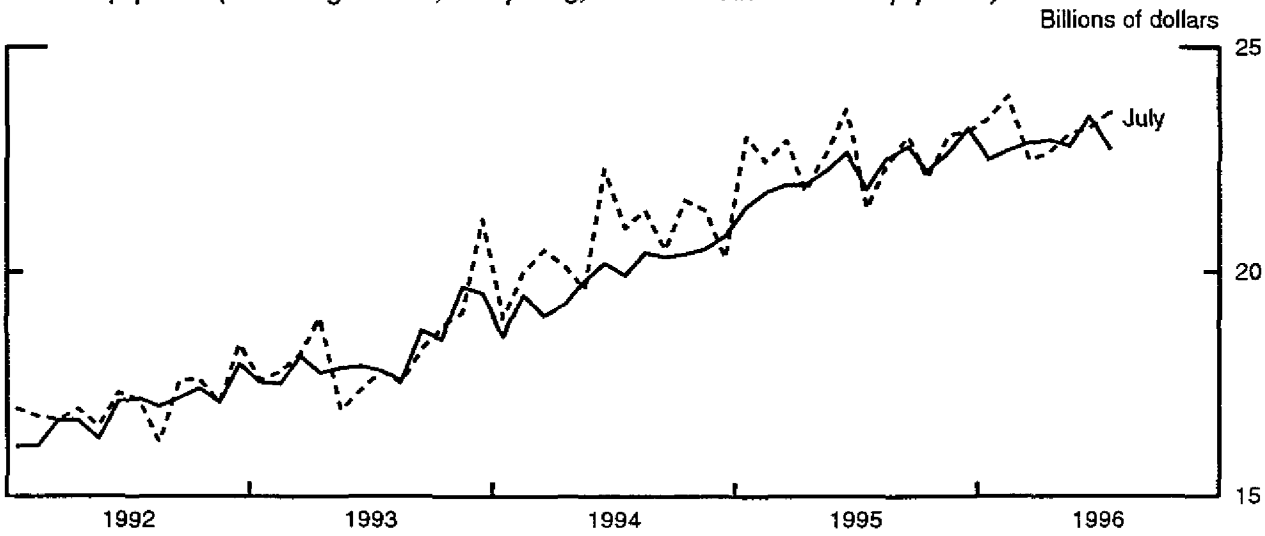
Office and Computing Equipment




Communications Equipment

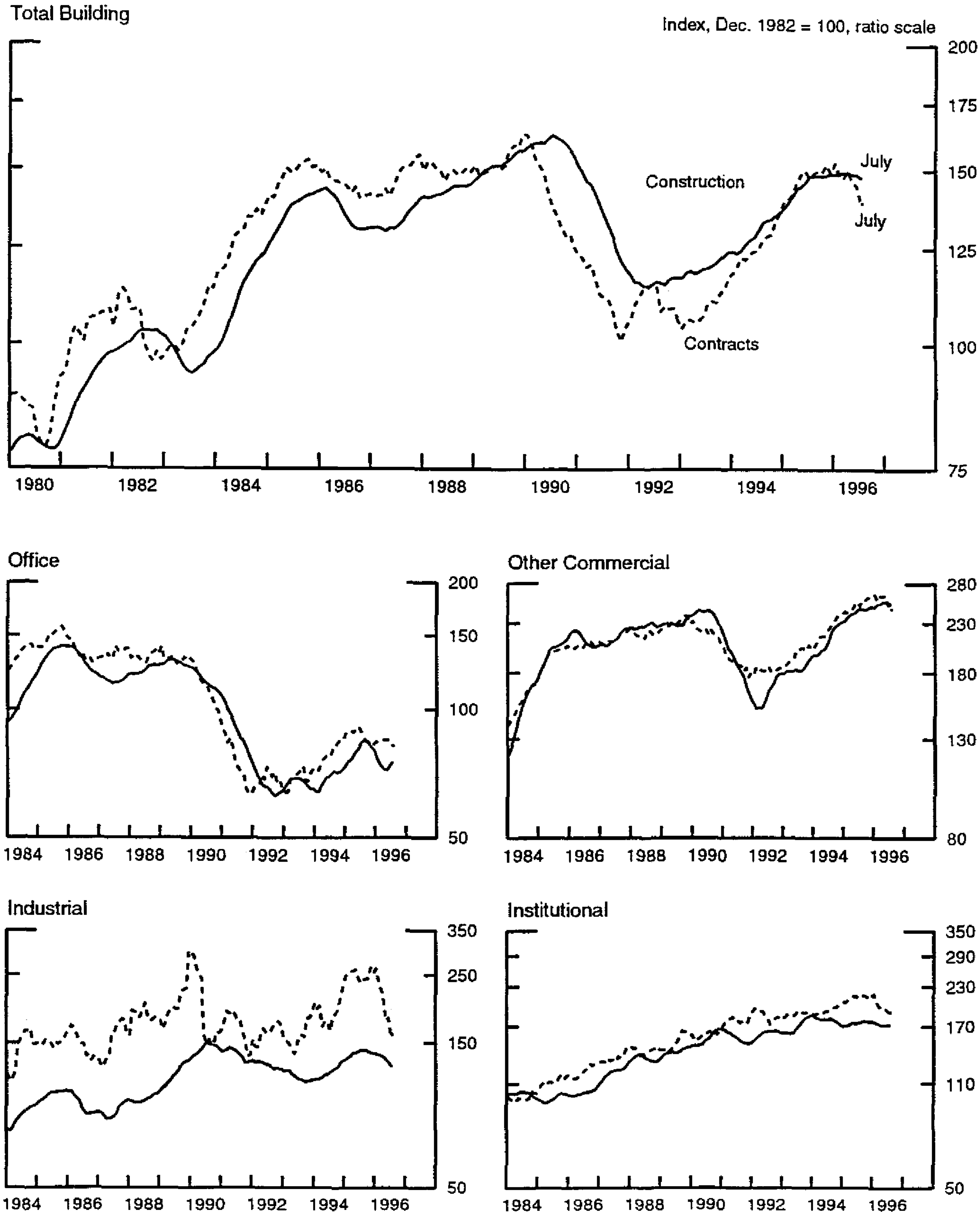



Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



## Nonresidential Construction and Contracts

(Six-month moving average)




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

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

| | 1995 | 1996 | | 1996 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | June | July |
| Book value basis | | | | | | |
| Total | 13.9 | 16.7 | 13.2 | -17.4 | 4.1 | 50.0 |
| Excluding wholesale and retail motor vehicles | 9.9 | 25.0 | 6.0 | -23.0 | -9.6 | 31.5 |
| Manufacturing | 9.5 | 12.3 | -6.2 | -14.7 | -4.2 | 7.8 |
| Excluding aircraft | 9.6 | 6.3 | -10.7 | -18.1 | -13.7 | 10.3 |
| Wholesale | 6.0 | 7.3 | 11.3 | -9.1 | 5.1 | 2.2 |
| Excluding motor vehicles | 8.4 | 7.3 | 7.6 | -7.9 | .0 | -1.7 |
| Retail | -1.7 | -2.9 | 8.2 | 6.4 | 3.1 | 40.0 |
| Auto dealers | 6.4 | -8.4 | 3.5 | 6.8 | 8.6 | 14.6 |
| Excluding auto dealers | -8.1 | 5.5 | 4.6 | -.4 | -5.4 | 25.4 |
| Chained (1992) dollars basis | | | | | | |
| Total | 7.5 | -5.4 | 5.4 | -22.5 | -12.7 | n.a. |
| Excluding motor vehicles | -14.3 | 16.4 | -.7 | -22.8 | -18.9 | n.a. |
| Manufacturing | 11.2 | 12.0 | -4.2 | -9.5 | -4.4 | n.a. |
| Wholesale | 3.5 | 3.8 | 4.2 | -12.7 | -5.0 | n.a. |
| Excluding motor vehicles | 6.2 | 4.0 | 1.4 | -11.2 | -8.3 | n.a. |
| Retail | -7.1 | -21.7 | 5.4 | -.1 | -3.3 | n.a. |
| Auto dealers | 25.0 | -23.2 | 1.9 | 1.6 | -2.3 | n.a. |
| Excluding auto dealers | -32.1 | 1.5 | 3.5 | -1.8 | -1.0 | n.a. |

INVENTORIES RELATIVE TO SALES
(Months' supply; based on seasonally adjusted data)

| | 1995 | 1996 | | 1996 | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | June | July |
| Book value basis | | | | | | |
| Total | 1.43 | 1.43 | 1.40 | 1.39 | 1.40 | 1.39 |
| Excluding wholesale and retail motor vehicles | 1.40 | 1.40 | 1.37 | 1.37 | 1.37 | 1.36 |
| Manufacturing | 1.44 | 1.45 | 1.40 | 1.40 | 1.40 | 1.39 |
| Excluding aircraft | 1.33 | 1.34 | 1.29 | 1.29 | 1.29 | 1.28 |
| Wholesale | 1.33 | 1.32 | 1.31 | 1.31 | 1.31 | 1.28 |
| Excluding motor vehicles | 1.30 | 1.30 | 1.28 | 1.27 | 1.27 | 1.24 |
| Retail | 1.53 | 1.49 | 1.49 | 1.48 | 1.49 | 1.50 |
| Auto dealers | 1.79 | 1.66 | 1.70 | 1.67 | 1.71 | 1.74 |
| Excluding auto dealers | 1.45 | 1.44 | 1.42 | 1.41 | 1.42 | 1.43 |
| Chained (1992) dollars basis | | | | | | |
| Total | 1.39 | 1.38 | 1.36 | 1.35 | 1.36 | n.a. |
| Excluding motor vehicles | 1.35 | 1.35 | 1.33 | 1.32 | 1.33 | n.a. |
| Manufacturing | 1.39 | 1.39 | 1.35 | 1.35 | 1.36 | n.a. |
| Wholesale | 1.34 | 1.35 | 1.34 | 1.34 | 1.33 | n.a. |
| Excluding motor vehicles | 1.32 | 1.33 | 1.31 | 1.31 | 1.30 | n.a. |
| Retail | 1.43 | 1.37 | 1.37 | 1.36 | 1.37 | n.a. |
| Auto dealers | 1.74 | 1.54 | 1.57 | 1.55 | 1.57 | n.a. |
| Excluding auto dealers | 1.33 | 1.32 | 1.31 | 1.31 | 1.31 | n.a. |

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

part of the June rise but left the nominal level of spending below the second-quarter average. These recent data--although only preliminary figures--could mark the beginning of a slowdown in nonresidential construction that has been suggested for some months by the drop in construction contracts. However, other market indicators have been generally upbeat; for example, the commercial vacancy rate reported by Coldwell Banker continued to decline in the second quarter, and property values appear to be stable.

Business Inventories

With a relatively small net change over the second quarter, businesses in manufacturing and trade (excluding automotive dealers and distributors) still faced low inventory-sales ratios around midyear. Incoming data for July showed a sharp pickup in inventory investment, mainly at retail trade establishments.

Manufacturers' inventories turned up at an $8 billion annual rate in July (book-value), after declining from March through June. The July accumulation was notable because it was predominantly in stocks of materials and supplies; inventories of finished goods were reduced further, while work-in-process stocks were about unchanged.

MANUFACTURERS' INVENTORY INVESTMENT
By stage of processing and market grouping
(Book value, billions of dollars at annual rate)

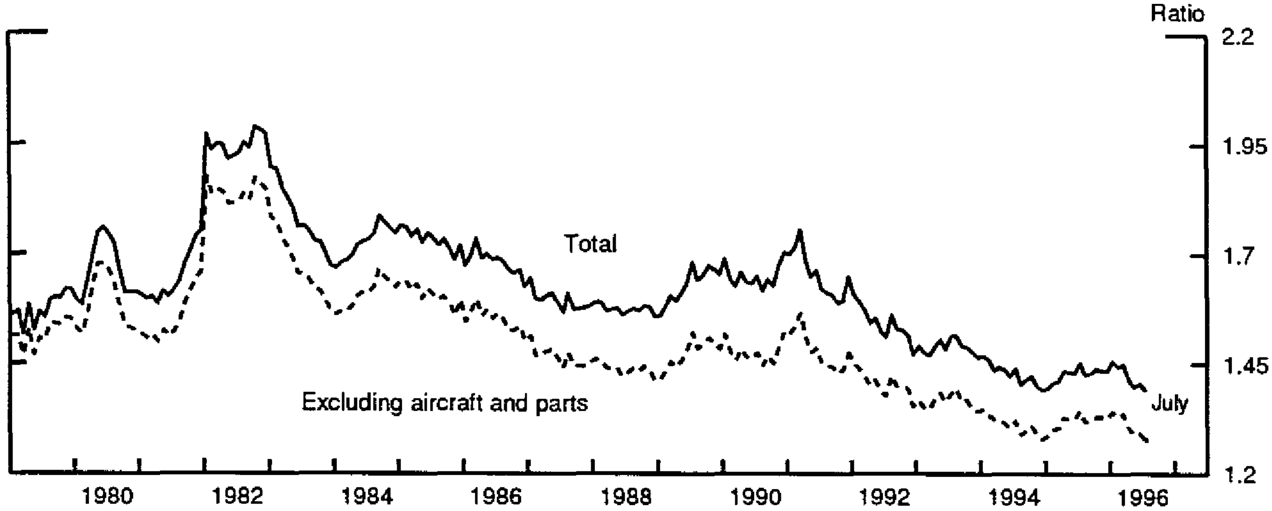
| | 1995 | 1996 | | | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | June | July |
| Total manufacturing | 9.5 | 12.3 | -6.2 | -14.7 | -4.2 | 7.8 |
| By stage of processing: | | | | | | |
| Materials and supplies | 1.5 | 2.0 | -10.4 | -12.9 | -16.9 | 10.8 |
| Work-in-process | 4.7 | 7.4 | 5.9 | 2.9 | 7.1 | -.3 |
| Finished goods | 3.3 | 2.9 | -1.7 | -4.7 | 5.6 | -2.6 |
| By market grouping: | | | | | | |
| Producers' durable equip. | 10.0 | 9.9 | .6 | -1.9 | -6.5 | 14.7 |
| Information equip. | 5.0 | 2.3 | -1.3 | -4.7 | -6.9 | 5.3 |
| Industrial equip. | .2 | -.4 | -2.1 | .2 | -6.3 | 7.5 |
| Transportation equip. | 3.2 | 7.1 | 3.1 | 2.1 | 5.7 | 2.2 |
| Other equipment | 1.6 | .9 | .9 | .5 | 1.0 | -.3 |
| Household durables | .9 | .3 | -.3 | -.3 | -.9 | -2.5 |
| Home goods and apparel | .4 | -1.0 | -1.7 | -2.6 | -1.2 | -1.8 |
| Other | -1.8 | 3.0 | -4.8 | -9.9 | 4.4 | -2.6 |

The sizable pickup in the accumulation of materials reversed several months of drawdowns and presumably is a favorable sign in regard to

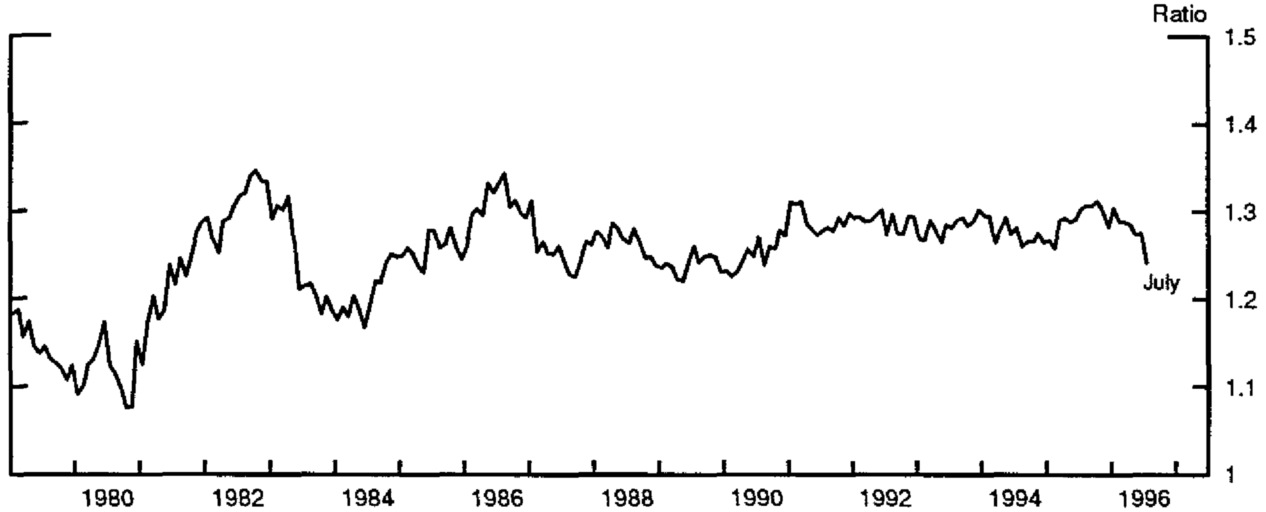
# Inventory-Sales Ratios, by Major Sector

(Book value)

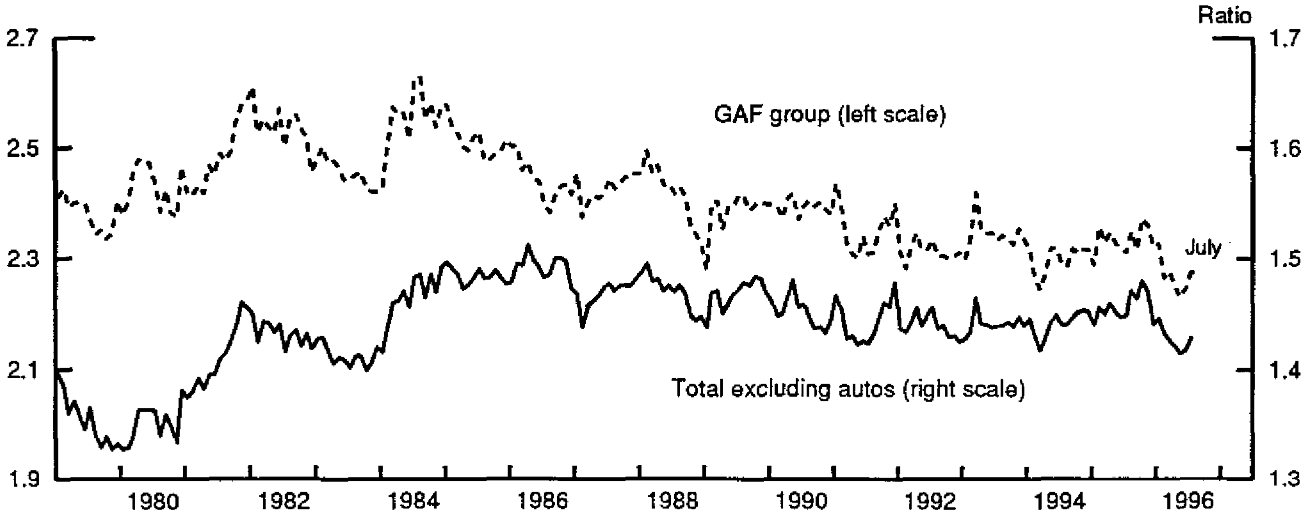
Manufacturing




Wholesale Excluding Motor Vehicles




Retail



production plans, especially in capital goods industries. By market grouping, the July buildup was concentrated in stocks of producers' durable equipment (table above) and coincided with strong gains in equipment orders. Data at more disaggregated levels show that the accumulation of PDE stocks in July was distributed fairly evenly among all major categories--information, industrial, and transportation equipment. In contrast, manufacturers' inventories of non-auto consumer goods continued to decline. For many manufacturing industries, inventory-shipments ratios edged down further in July from levels already low by historical standards.

In the trade sector, wholesale inventories posted only a modest net increase in July, held down by a substantial decline in stocks of farm products. Part of the decline in stocks of farm products may have resulted from declines in grain prices in June and July--especially prices of wheat and corn. Excluding farm products, wholesale inventories expanded at an $18 billion annual rate in July, considerably above the average pace of $7 billion over the second quarter. A pickup in inventory investment was also evident in retailing. Non-auto retail inventories expanded at a $25 billion annual rate in July, more than five times the pace over the second quarter. Although inventory-sales ratios for most retail categories turned up in July, they remained relatively low by historical standards. For retail GAF stores, where consumer spending is considered largely discretionary, the inventory-sales ratio in July was still near the low end of the range of recent years. On balance, as of July, most types of trade establishments appeared positioned for further restocking.

Federal Government

The incoming news on the unified budget continues to be quite favorable. For the first ten months of fiscal year 1996, the deficit (adjusted for payment shifts, deposit insurance, and spectrum auction proceeds) came to $117 billion, $52 billion less than in the comparable period a year ago. In part, the shrinkage of the deficit has reflected solid growth in receipts: Both individual and corporate income taxes have risen substantially above year-earlier levels. In addition, adjusted outlays have increased only 2-1/2 percent so far this fiscal year, in part because of reductions in discretionary appropriations. As for fiscal 1996 as a whole, the CBO's mid-August estimate was for a deficit of $116 billion, essentially the same as the estimate released by OMB in July.

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

| | July | | Fiscal year to date totals | | | |
|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1995 | 1996 | Dollar change | Percent change |
| Outlays | 106.3 | 130.9 | 1248.0 | 1296.4 | 48.4 | 3.9 |
| Deposit insurance (DI) | -.8 | -.2 | -16.8 | -7.3 | 9.5 | -56.6 |
| Spectrum auction (SA) | -7.0 | .0 | -7.6 | -.2 | 7.4 | -1.0 |
| Other | 114.2 | 131.1 | 1272.5 | 1304.0 | 31.4 | 61.5 |
| Receipts | 92.7 | 103.8 | 1110.8 | 1194.3 | 83.5 | 7.5 |
| Deficit (+) | 13.6 | 27.1 | 137.2 | 102.1 | -35.1 | -25.6 |
| | Adjusted for payment timing shifts[1] and excluding DI and SA | | | | | |
| Outlays | 121.3 | 131.1 | 1279.7 | 1311.8 | 32.1 | 2.5 |
| National defense | 20.6 | 22.5 | 224.6 | 223.6 | -1.0 | -.4 |
| Net interest | 20.2 | 20.3 | 192.6 | 200.4 | 7.8 | 4.1 |
| Social security | 28.0 | 29.3 | 279.7 | 291.3 | 11.6 | 4.1 |
| Medicare | 13.1 | 16.1 | 131.7 | 146.3 | 14.6 | 11.1 |
| Medicaid | 6.6 | 7.7 | 73.6 | 76.2 | 2.7 | 3.6 |
| Other health | 2.2 | 2.4 | 21.7 | 22.3 | .6 | 2.7 |
| Income security | 17.3 | 18.2 | 185.3 | 193.5 | 8.3 | 4.5 |
| Other | 13.2 | 14.6 | 176.3 | 158.1 | -18.3 | -10.3 |
| Receipts | 92.7 | 103.8 | 1110.8 | 1194.3 | 83.5 | 7.5 |
| Individual | 42.8 | 49.8 | 485.1 | 541.6 | 56.5 | 11.6 |
| Withheld | 41.5 | 48.1 | 422.0 | 449.7 | 27.7 | 6.6 |
| Nonwithheld | 3.1 | 3.6 | 144.6 | 177.6 | 33.0 | 22.8 |
| Refunds (-) | 1.8 | 1.9 | 81.4 | 85.7 | 4.3 | 5.2 |
| Social insurance taxes | 36.5 | 39.3 | 404.8 | 425.1 | 20.3 | 5.0 |
| Corporate | 3.4 | 5.0 | 121.6 | 133.6 | 12.0 | 9.9 |
| Other | 10.0 | 9.8 | 99.3 | 93.9 | -5.4 | -5.4 |
| Deficit(+) | 28.6 | 27.3 | 168.9 | 117.4 | -51.5 | -30.5 |

Note. Components may not sum to totals because of rounding.
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. The monthly and fiscal year to date outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.

In contrast, the NIPA data for the first half of 1996 show surprisingly robust growth in real federal consumption and investment expenditures. BEA now estimates that real defense spending rose at an annual rate of 6 percent in the first quarter and 10-1/2 percent in the second quarter; this growth is largely explained by a bulge in aircraft deliveries in the first half and the fact that the recorded spending increases were from a below-trend fourth-quarter level. In addition, as was noted in the August Greenbook with reference to the advance figures, NIPA estimates for nondefense expenditures seem strong relative to the trends in unified budget accounts.[8]

The Congress reconvened after Labor Day and is expected to stay in session about one month. The primary order of business has been fiscal 1997 appropriations. As of September 17, the President had signed appropriations for the District of Columbia, Agriculture, the legislative branch, and military construction. For the remaining nine appropriations bills, press reports suggest that the President is advocating about $4-1/2 billion more funding for domestic programs, and about $3 billion less for defense, than the Congress has indicated a willingness to accept. These differences are unlikely to be resolved in time to enact all appropriations bills before the beginning of fiscal 1997; hence, several appropriations bills will probably be rolled into either a full-year omnibus appropriations bill or a continuing resolution lasting at least six months. In the latter case, funding for the affected programs will likely be set in accordance with fiscal 1996 levels.

Finally, although federal regulations are still to be written, action on welfare reform has largely shifted to the states, which must submit their plans for reform to the federal government by July 1, 1997. The federal legislation sets out an ambitious timetable for moving welfare recipients into the labor market--indeed, a state will not receive its full federal grant unless 25 percent of the participants in its federally funded welfare program are engaged in "work-related activities" in fiscal 1997, and the percentage rises incrementally to 50 percent by fiscal 2002. However, the states have considerable discretion in designing their

8. BEA's quarterly estimates of nondefense purchases rely on various unpublished indicators of government spending. BEA will do a full reconciliation of its nondefense purchases figures, and other components of federal expenditures, with the final fiscal 1996 budget data when they are available. Revised NIPA data will be published with BEA's 1997 annual revision.

programs, and assessing how the reforms will affect the labor market and other economic variables is extremely difficult until more is known about how the new state programs will be shaped. Key uncertainties include how the states will define work-related activities and which individuals they will require to engage in such activities; adding to the uncertainty is the possibility that some of the more stringent features of the law will be reexamined by the next Congress.

State and Local Governments

Indicators of spending in the third quarter by state and local governments are mixed. As mentioned earlier, employment gains have been sizable in recent months. However, because much of the increase reflects the timing of school openings and of summer jobs programs, the apparent strength is likely to prove temporary. Otherwise, employment appears to have been trending up gradually over the past year or so. Real outlays for construction fell in July for the third consecutive month. Much of the weakness in the past three months was in the building of educational facilities and sewer systems. Overall, construction in the first seven months of this year about matches the average for 1995 as a whole. However, the fundamentals suggest that this lull will be temporary: State and local revenues have been quite strong of late, and infrastructure needs abound, particularly in education, as the population of school-age children is expected to continue to rise for another decade.

On the revenue side, strong growth in receipts in recent years has buoyed fiscal positions. According to the Center for the Study of the States, the states enjoyed robust gains in tax revenue in the second quarter of this year, when high final payments and strong estimated taxes boosted personal income receipts. Sales tax growth also was quite strong in the second quarter.

Prices

The incoming data on inflation at the retail level have continued to be quite favorable. Both the overall CPI and the CPI excluding food and energy edged up only 0.1 percent in August after rising 0.3 percent in July. Over the twelve months ended in August, the overall CPI increased 2.9 percent, up from the 2.6 percent pace over the preceding twelve months. Excluding food and energy, however, prices have risen 2.6 percent in the past year, down from the 2.9 percent increase in the year-earlier period. In contrast to the first half of this year, when both food and energy prices were contributing to inflation, rising food prices have been roughly offset by falling energy prices over the past few months.

In August, retail energy prices fell 0.6 percent, the third consecutive monthly decline. The price of gasoline continued to drop at the retail level, reflecting the earlier declines in crude oil prices, but fuel oil prices turned up in August following three months of large declines. Utility rates were mixed: Electricity prices rose further, while natural gas prices were flat. The initial run-up in crude oil prices, a result of the delay in Iraq's limited oil sale, was reflected in producer prices for gasoline in August. The conflict with Iraq in early September and subsequent suspension of its oil sale has driven up crude oil prices considerably further.

Retail food prices moved up 0.4 percent in August, about the same as the average increase over the past six months. High grain prices continued to boost prices for dairy products, beef, pork, and poultry. The index for dairy products jumped 2.0 percent last month, while the prices of beef, pork, and chicken advanced 1.7 percent, 2.1 percent, and 1.2 percent respectively. The index for cereals and bakery products was flat in August, as lower cereal prices offset price increases for flour and other bakery products. Over the past six months, cereal prices have dropped about 8 percent at an annual rate; however, large increases in the other components of the cereals and bakery products index have more than offset this decline in cereal prices.

The index for commodities other than food and energy edged down 0.1 percent in August after essentially no change in each of the preceeding three months. Apparel prices dropped 1.5 percent on a seasonally adjusted basis, reflecting retailers' decisions both to delay the introduction of higher-priced fall clothing and to offer large discounts on spring and summer clothing. Apart from apparel, the prices of other commodities excluding food and energy were unchanged in August. Among other commodities, used car prices were flat in August following four months of declines; over the past six months, used car prices have dropped at a 5 percent annual rate, offsetting a pickup of similar magnitude over the preceding six-month period.

CPI AND PPI INFLATION RATES
(Percent change)

| | From twelve months earlier | | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | Aug. 1995 | Aug. 1996 | Q1 | Q2 | July | Aug. |
| | | | -Annual rate- | | -Monthly rate- | |
| CPI | | | | | | |
| All items (100.0)[1] | 2.6 | 2.9 | 3.2 | 3.8 | 0.3 | 0.1 |
| Food (15.8) | 2.5 | 3.6 | 2.0 | 4.2 | 0.5 | 0.3 |
| Energy (6.7) | -1.0 | 3.9 | 12.9 | 18.4 | -0.4 | -0.6 |
| CPI less food and energy (77.5) | 2.9 | 2.6 | 2.8 | 2.5 | 0.3 | 0.1 |
| Commodities (23.9) | 1.5 | 1.0 | 2.2 | 0.6 | .0 | -0.1 |
| New vehicles (5.0) | 2.0 | 2.1 | 1.5 | 2.4 | 0.2 | 0.1 |
| Used cars (1.3) | 9.0 | -0.3 | 8.6 | -5.8 | -0.1 | .0 |
| Apparel (5.0) | -0.9 | -2.0 | 1.0 | -1.8 | -0.1 | -1.5 |
| Services (53.6) | 3.6 | 3.3 | 3.0 | 3.6 | 0.3 | 0.2 |
| Owners' equivalent rent (19.7) | 3.3 | 3.1 | 3.1 | 2.8 | 0.3 | 0.1 |
| Tenants' rent (5.8) | 2.4 | 2.7 | 2.9 | 2.6 | 0.3 | 0.1 |
| Medical care (6.1) | 5.1 | 3.5 | 3.7 | 3.1 | 0.3 | 0.2 |
| Auto finance charges (0.6) | 13.3 | -1.7 | -16.2 | 0.3 | 0.9 | 1.8 |
| PPI | | | | | | |
| Finished goods (100.0)[2] | 1.3 | 3.0 | 3.2 | 2.7 | .0 | 0.3 |
| Finished consumer foods (23.4) | 1.7 | 5.1 | 0.5 | 2.3 | 0.2 | 1.0 |
| Finished energy (13.4) | -2.5 | 6.4 | 21.2 | 12.9 | -0.9 | 0.7 |
| Finished goods less food and energy (63.2) | 1.9 | 1.4 | 0.6 | 0.9 | 0.1 | -0.1 |
| Consumer goods (38.5) | 2.1 | 1.6 | 0.7 | 1.2 | -0.1 | .0 |
| Capital equipment (24.7) | 1.7 | 1.0 | 0.4 | 0.2 | 0.3 | -0.1 |
| Intermediate materials (100)[3] | 5.4 | .0 | -0.2 | 1.8 | -0.3 | 0.2 |
| Intermediate materials less food and energy (82.6) | 6.9 | -1.8 | -3.4 | -1.2 | -0.3 | 0.1 |
| Crude materials (100)[4] | -1.4 | 13.9 | 19.2 | 17.6 | 2.0 | 0.2 |
| Crude food materials (44.7) | 2.9 | 23.5 | -0.9 | 40.1 | 2.7 | -0.3 |
| Crude energy (31.4) | -13.2 | 23.5 | 82.5 | 12.5 | 3.9 | 0.7 |
| Crude materials less food and energy (23.9) | 10.2 | -12.4 | -8.9 | -11.1 | -1.6 | 0.1 |

1. Relative importance weight for CPI, December 1995.
2. Relative importance weight for PPI, December 1995.
3. Relative importance weight for intermediate materials, December 1995.
4. Relative importance weight for crude materials, December 1995.

BROAD MEASURES OF INFLATION
(Four-quarter percent changes)

| | 1993 Q2 | 1994 Q2 | 1995 Q2 | 1996 Q2 |
|---|---|---|---|---|
| Product prices | | | | |
| GDP chain price index | 2.6 | 2.2 | 2.6 | 2.2 |
| GDP deflator | 2.6 | 2.1 | 2.6 | 2.1 |
| Nonfarm business chain price index[1] | 2.6 | 2.1 | 2.4 | 1.7 |
| Expenditure prices | | | | |
| Gross domestic purchases chain price index | 2.5 | 2.0 | 2.7 | 2.0 |
| Less food and energy | 2.6 | 2.2 | 2.7 | 1.8 |
| PCE chain price index | 2.8 | 2.1 | 2.7 | 2.1 |
| Less food and energy | 3.0 | 2.5 | 2.6 | 1.9 |
| PCE deflator | 2.8 | 2.1 | 2.7 | 2.0 |
| Less food and energy | 3.0 | 2.4 | 2.6 | 1.8 |
| CPI | 3.1 | 2.4 | 3.0 | 2.9 |
| Less food and energy | 3.4 | 2.8 | 3.0 | 2.7 |
| Median CPI | 3.0 | 2.9 | 3.1 | 3.0 |

1. Excluding housing.

The CPI for services other than energy was up 0.2 percent in August following increases of 0.3 percent in each of the four preceding months. Rent of shelter rose 0.3 percent, in line with its average monthly increase over the past year, while the price of services excluding energy and shelter rose 0.2 percent, down slightly from its recent monthly increases. Among the components of non-energy, non-shelter services, the index for medical services rose 0.2 percent in August; over the past twelve months the index has increased 3-1/2 percent, compared with roughly 5 percent in each of the two preceding years. In August, airfares fell slightly; although the reintroduction of a 10 percent federal tax on airfares affected some fares, those increases were more than offset by heavy price discounting on other fares. In contrast, auto finance charges moved up 1.8 percent last month, apparently reflecting less generous auto incentives this year relative to the normal seasonal pattern; over the past three months, auto finance charges have jumped nearly 17 percent at an annual rate, up from a 2 percent increase in the

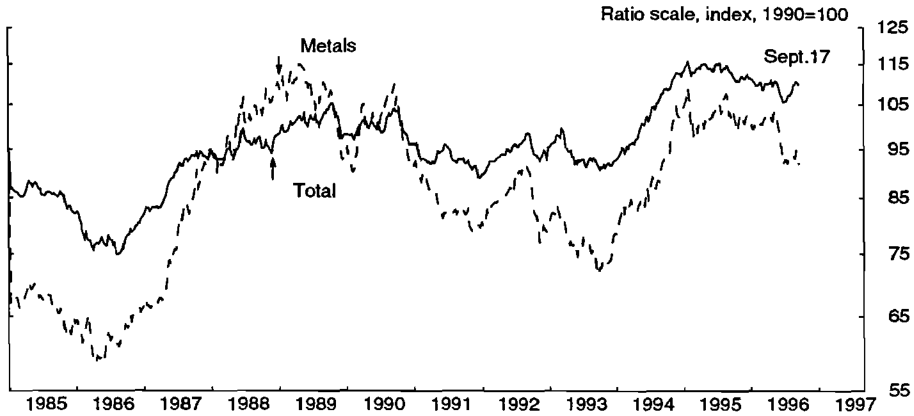
SPOT PRICES OF SELECTED COMMODITIES

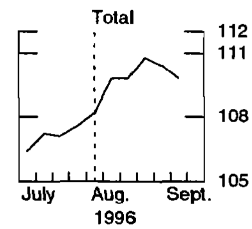
| | Current price ($) | Percent change[1]: 1994 | 1995 | Dec. 26 to Aug. 13[2] | Aug. 13[2] to Sept. 17 | Memo: Year earlier to date |
|---|---|---|---|---|---|---|
| **Metals** | | | | | | |
| Copper (lb.) | .920 | 64.9 | -3.5 | -29.4 | -4.2 | -31.9 |
| Steel scrap (ton) | 136.500 | 2.9 | -6.6 | 4.1 | -2.2 | -4.9 |
| Aluminum, London (lb.) | .627 | 73.5 | -12.9 | -11.6 | -6.2 | -21.2 |
| **Precious metals** | | | | | | |
| Gold (oz.) | 383.450 | -1.7 | 1.7 | .0 | -1.1 | -.4 |
| Silver (oz.) | 5.040 | -5.0 | 7.2 | -1.7 | -.2 | -7.4 |
| **Forest products** | | | | | | |
| Lumber (m. bdft.) | 433.000 | -37.1 | -14.4 | 61.6 | 7.2 | 50.3 |
| Plywood (m. sqft.) | 367.000 | 1.5 | -6.1 | 6.5 | 11.2 | .0 |
| **Petroleum** | | | | | | |
| Crude oil (barrel) | 22.070 | 15.6 | 16.8 | 14.3 | 6.0 | 28.3 |
| Gasoline (gal.) | .615 | 32.4 | 7.7 | 16.2 | .2 | 3.9 |
| Fuel oil (gal.) | .656 | 12.7 | 22.6 | -.9 | 9.6 | 28.6 |
| **Livestock** | | | | | | |
| Steers (cwt.) | 72.000 | -3.4 | -5.7 | .0 | 9.1 | 12.5 |
| Hogs (cwt.) | 54.500 | -12.9 | 27.5 | 34.8 | -10.7 | 10.1 |
| Broilers (lb.) | .627 | -4.9 | 10.7 | 12.0 | 3.1 | 2.1 |
| **U.S. farm crops** | | | | | | |
| Corn (bu.) | 3.240 | -23.2 | 57.4 | 42.1 | -34.3 | 12.3 |
| Wheat (bu.) | 4.600 | 11.4 | 24.0 | -5.9 | -9.6 | -7.2 |
| Soybeans (bu.) | 8.045 | -19.6 | 29.0 | 12.4 | -.6 | 27.2 |
| Cotton (lb.) | .743 | 38.5 | -8.1 | -2.1 | -3.9 | -18.2 |
| **Other foodstuffs** | | | | | | |
| Coffee (lb.) | 1.310 | 153.1 | -39.1 | 42.7 | -7.7 | 10.5 |
| **Memo:** | | | | | | |
| JOC Industrials | 109.800 | 22.1 | -1.7 | -2.7 | 1.5 | -2.7 |
| JOC Metals | 91.900 | 31.9 | -1.8 | -8.8 | -1.0 | -9.9 |
| KR-CRB Futures | 244.400 | 4.8 | 3.3 | 2.4 | -2.2 | .4 |
| KR-CRB Spot | 342.770 | 29.1 | -3.5 | 3.9 | -.2 | 3.2 |

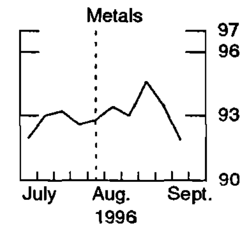
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the August Greenbook.

# Commodity Price Measures

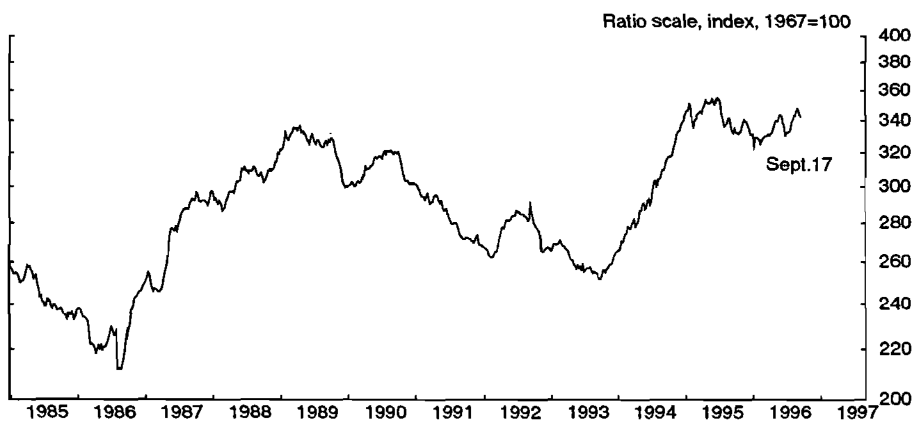
## Journal of Commerce Index

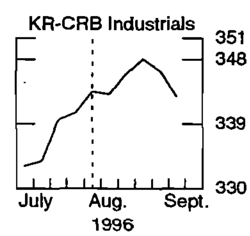


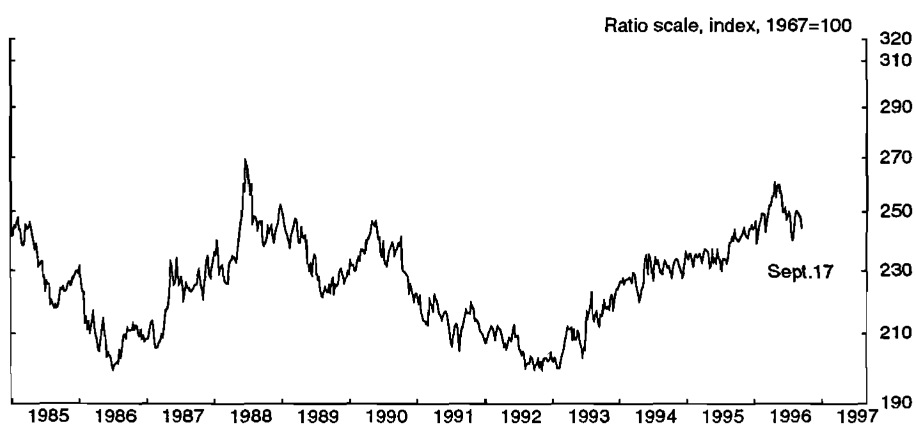



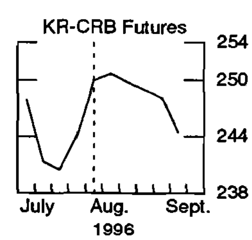

## KR-CRB Spot Industrials




## KR-CRB Futures




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

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

| | Actual inflation[1] | University of Michigan (1-year) Mean[2] | University of Michigan (1-year) Median[3] | Livingston (1-year)[4] | Conference Board (1-year) | Professional forecasters (10-year)[5] | University of Michigan (5- to -10-year) Mean[6] | University of Michigan (5- to -10-year) Median[7] |
|---|---|---|---|---|---|---|---|---|
| 1992-Q1 | 2.9 | 3.4 | 2.7 | | 4.6 | 3.7 | 4.8 | 3.7 |
| Q2 | 3.1 | 3.8 | 3.1 | 3.6 | 4.6 | 3.9 | 5.0 | 3.9 |
| Q3 | 3.1 | 4.0 | 3.0 | | 4.5 | 3.8 | 4.9 | 4.0 |
| Q4 | 3.1 | 3.8 | 2.9 | 3.4 | 4.5 | 3.6 | 5.3 | 3.7 |
| 1993-Q1 | 3.2 | 4.3 | 3.1 | | 4.6 | 3.5 | 5.2 | 3.9 |
| Q2 | 3.1 | 4.4 | 3.3 | 3.4 | 4.8 | 3.7 | 5.2 | 3.8 |
| Q3 | 2.7 | 4.7 | 3.1 | | 4.6 | 3.5 | 4.7 | 3.4 |
| Q4 | 2.7 | 3.8 | 3.2 | 3.2 | 4.4 | 3.5 | 4.7 | 3.7 |
| 1994-Q1 | 2.5 | 3.9 | 2.9 | | 4.3 | 3.5 | 5.0 | 3.3 |
| Q2 | 2.4 | 4.2 | 3.0 | 2.9 | 4.2 | 3.5 | 4.8 | 3.4 |
| Q3 | 2.9 | 4.5 | 3.2 | | 4.3 | 3.5 | 5.0 | 3.4 |
| Q4 | 2.7 | 4.1 | 3.1 | 3.5 | 4.2 | 3.5 | 4.3 | 3.2 |
| 1995-Q1 | 2.8 | 4.1 | 3.1 | | 4.2 | 3.3 | 4.1 | 3.1 |
| Q2 | 3.1 | 4.1 | 3.1 | 3.2 | 4.2 | 3.4 | 4.3 | 3.3 |
| Q3 | 2.6 | 3.9 | 2.9 | | 4.0 | 3.2 | 4.3 | 3.1 |
| Q4 | 2.7 | 3.6 | 2.8 | 2.9 | 3.9 | 3.0 | 3.9 | 3.1 |
| 1996-Q1 | 2.7 | 3.9 | 2.9 | | 4.1 | 3.0 | 4.2 | 3.2 |
| Q2 | 2.8 | 4.5 | 3.0 | 2.8 | 4.3 | 3.0 | 4.3 | 3.1 |
| Q3 | | 4.1 | 3.1 | | | 3.0 | 4.2 | 3.1 |
| 1995-Oct. | 2.8 | 3.6 | 2.9 | | 3.6 | | 3.7 | 3.1 |
| Nov. | 2.6 | 3.8 | 2.8 | | 4.1 | | 4.0 | 3.1 |
| Dec. | 2.5 | 3.3 | 2.7 | 2.9 | 4.0 | 3.0 | 3.9 | 3.1 |
| 1996-Jan. | 2.7 | 4.0 | 2.9 | | 4.1 | | 4.2 | 3.1 |
| Feb. | 2.7 | 3.6 | 2.8 | | 4.0 | | 4.2 | 3.2 |
| Mar. | 2.8 | 4.2 | 2.9 | | 4.1 | 3.0 | 4.3 | 3.2 |
| Apr. | 2.9 | 4.5 | 3.0 | | 4.2 | | 4.1 | 3.0 |
| May | 2.9 | 4.9 | 3.0 | | 4.5 | | 4.8 | 3.2 |
| June | 2.8 | 4.2 | 2.9 | 2.8 | 4.3 | 3.0 | 4.0 | 3.1 |
| July | 3.0 | 4.3 | 2.9 | | 4.2 | | 4.2 | 3.1 |
| Aug. | 2.9 | 4.1 | 3.0 | | 4.4 | | 4.6 | 3.2 |
| Sept. | | 3.9 | 3.3 | | | 3.0 | 3.9 | 3.1 |

1. CPI; percent change from the same period in the prior year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Average 12-month-ahead forecast of the CPI by 'informed' business economists. Constructed by the Federal Reserve Bank of Philadelphia from disaggregated Livingston data; data are for the last month of the period indicated.
5. Compiled by the Federal Reserve Bank of Philadelphia.
6. Average increase for responses to the question: By about what percent per year do you expect prices (CPI) to go up, on the average, during the next 5 to 10 years?
7. Median increase for responses to question above.

previous three months (when loan rates were lagging the rise in market yields).

After declining over much of this year, industrial materials prices have risen in recent weeks. The Journal of Commerce industrial materials index has risen 1.5 percent since mid-August but remains just below the level recorded at the end of last year. Metals prices are down slightly, on balance, since mid-August. However, the prices of lumber and plywood have surged in recent weeks.[9] The PPI for crude materials less food and energy edged up in August but remains 6-1/4 percent below its level last December.

Changes in indicators of consumers' inflation expectations have been mixed since July. Mean expected inflation over the next twelve months fell to 3.9 percent in the preliminary September Michigan Survey of consumers; median expected inflation, a less volatile series, edged up to 3.3 percent. Expectations for inflation for the next five to ten years, as measured by the median response, remained in the range of other readings this year, at 3.1 percent.

Agriculture

Because much of the uncertainty about production is behind us, agricultural markets have been less volatile in recent weeks than earlier in the summer. The USDA's most recent crop production estimates showed little change from previous published numbers. Corn production is projected to be about 19 percent above last year's level, and soybean production is expected rise 5 percent. With the harvest of this year's spring wheat crop mostly completed, total wheat production this year is projected to be up about 5 percent. The cattle herd has continued to decline: The number of cattle on feed as of August 1 was 14 percent below the level at the same point last year. On the other hand, poultry production for the

9. Since the last Greenbook, lumber and plywood prices have increased sharply. As of early September, the plywood price nearly equaled its 1995 high, and the lumber price was only moderately below its peak in early 1994. These prices have responded to unexpectedly high demand owing to the continued strength of housing construction. The supply of wood products has been limited by environmental protections that have constrained production in some areas of the United States. Also, inventory positions going into the third quarter were unusually low because of uncertainty about pricing of wood products imported from Canada; quotas on Canadian products result in taxes if specified limits are exceeded. Hurricane Fran may have played a small role but is not mentioned by market analysts as a significant factor in the recent rise in prices.

seven months ended in July--the most recent reliable production estimate--showed a 7 percent increase from the the same period a year ago.

Prices for crops traded in futures markets have been mixed. Prices of corn and wheat have dropped about 10 percent on most futures contracts for delivery of this year's crop. On the other hand, the price of soybeans has edged up a bit in recent weeks, owing mostly to concerns about the weather across the Midwest in late August. Cash prices for crops have moved in the same direction as futures prices. However, the cash price of corn has dropped much more than futures prices--about 35 percent--since mid-August, perhaps reflecting earlier delivery of some corn grown in the Southeast, as farmers took advantage of high prices on the cash market in advance of this year's harvest in the corn belt. Prices for cattle have moved up further on both cash and futures markets, and hog prices have dropped back some.

U.S. CROP PRODUCTION

| | | | | Latest USDA projections for 1996 | |
|---|---|---|---|---|---|
| | 1993 | 1994 | 1995 | Aug. 12 | Sept. 12 |
| | Billions of bushels | | | | |
| Corn | 6.34 | 10.10 | 7.37 | 8.70 | 8.80 |
| Soybeans | 1.87 | 2.52 | 2.15 | 2.30 | 2.27 |
| Wheat | 2.40 | 2.32 | 2.19 | 2.25 | 2.30 |
| | Billions of hundredweight | | | | |
| Rice | .16 | .20 | .17 | .17 | .17 |
| | Millions of bales | | | | |
| Cotton | 16.13 | 19.66 | 17.91 | 18.58 | 17.90 |
| | Billions of 1992 dollars | | | | |
| Memo: Value, all crops[1] | 60.05 | 74.50 | 64.04 | 68.62 | 68.74 |

1. Calculated by the Federal Reserve staff from USDA data: includes production of most field crops.
Source. U.S. Department of Agriculture.

# DOMESTIC FINANCIAL DEVELOPMENTS

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

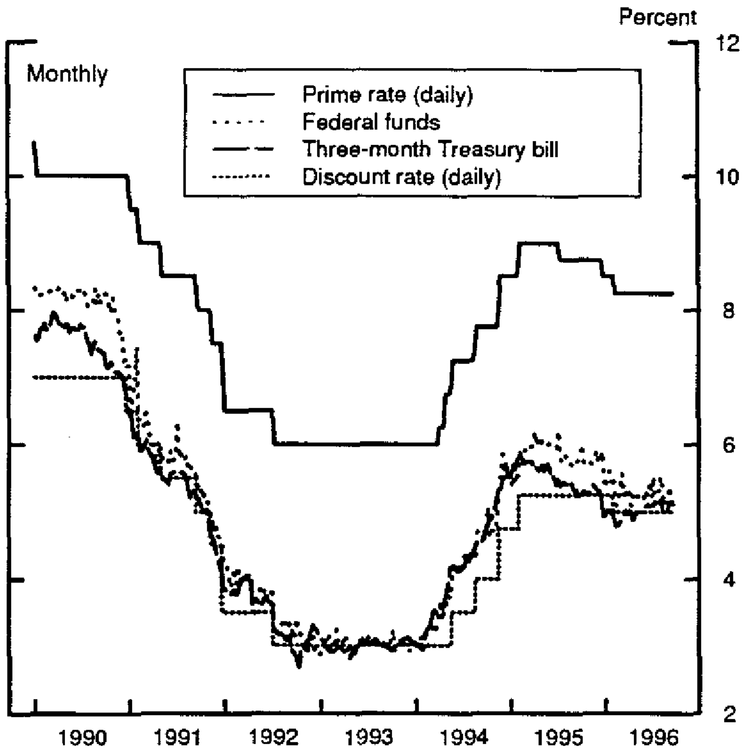
| Instrument | 1996 Feb. low | 1996 July high | 1996 FOMC, Aug. 20 | 1996 Sep. 17 | Change to Sep. 17, from: Feb. low | Change to Sep. 17, from: July high | Change to Sep. 17, from: FOMC, Aug. 20 |
|---|---|---|---|---|---|---|---|
| **Short-term rates** | | | | | | | |
| Federal funds[2] | 5.15 | 5.39 | 5.24 | 5.28 | .13 | -.11 | .04 |
| Treasury bills[3] | | | | | | | |
| 3-month | 4.76 | 5.21 | 5.04 | 5.17 | .41 | -.04 | .13 |
| 6-month | 4.67 | 5.40 | 5.11 | 5.25 | .58 | -.15 | .14 |
| 1-year | 4.55 | 5.64 | 5.32 | 5.51 | .96 | -.13 | .19 |
| Commercial paper | | | | | | | |
| 1-month | 5.27 | 5.50 | 5.37 | 5.44 | .17 | -.06 | .07 |
| 3-month | 5.12 | 5.59 | 5.40 | 5.50 | .38 | -.09 | .09 |
| Large negotiable CDs[3] | | | | | | | |
| 1-month | 5.21 | 5.44 | 5.31 | 5.36 | .15 | -.07 | .05 |
| 3-month | 5.12 | 5.59 | 5.38 | 5.45 | .33 | -.14 | .06 |
| 6-month | 4.99 | 5.83 | 5.54 | 5.64 | .65 | -.19 | .09 |
| Eurodollar deposits[4] | | | | | | | |
| 1-month | 5.13 | 5.38 | 5.28 | 5.31 | .18 | -.07 | .03 |
| 3-month | 5.13 | 5.56 | 5.38 | 5.44 | .31 | -.12 | .06 |
| Bank prime rate | 8.25 | 8.25 | 8.25 | 8.25 | .00 | .00 | .00 |
| **Intermediate- and Long-term Rates** | | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | | |
| 3-year | 4.98 | 6.62 | 6.14 | 6.39 | 1.41 | -.23 | .25 |
| 10-year | 5.58 | 7.06 | 6.59 | 6.81 | 1.23 | -.25 | .22 |
| 30-year | 6.02 | 7.19 | 6.80 | 7.00 | .98 | -.19 | .20 |
| Municipal revenue (Bond Buyer)[5] | 5.67 | 6.24 | 5.98 | 6.12 | .45 | -.12 | .14 |
| Corporate-A utility, recently offered | 7.18 | 8.23 | 7.83 | 8.03 | .85 | -.20 | .20 |
| High-yield corporate[6] | 9.57 | 10.36 | 10.00 | 9.96 | .39 | -.40 | -.04 |
| Home mortgages[7] | | | | | | | |
| FHLMC 30-yr fixed rate | 6.94 | 8.42 | 7.88 | 8.28 | 1.34 | -.14 | .40 |
| FHLMC 1-yr adjustable rate | 5.19 | 6.01 | 5.89 | 5.90 | .71 | -.11 | .01 |

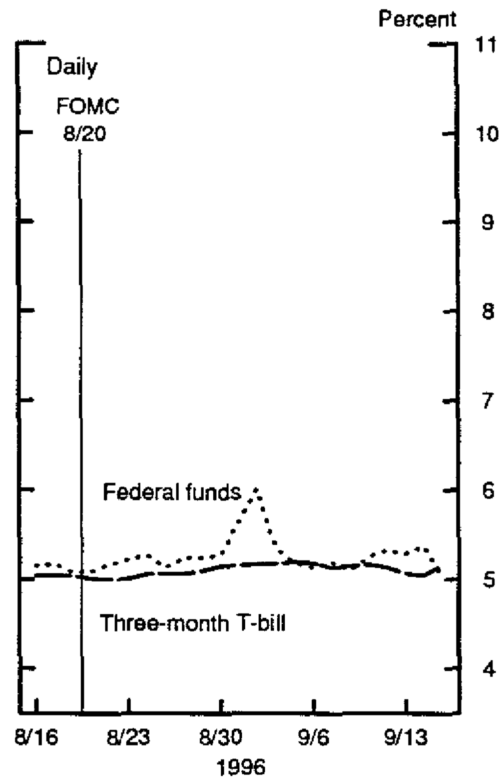
| Stock exchange index | Record high Level | Record high Date | 1996 July low | 1996 FOMC, Aug. 20 | 1996 Sep. 17 | Percentage change to Sep. 17, from: Record high | Percentage change to Sep. 17, from: July low | Percentage change to Sep. 17, from: FOMC, Aug. 20 |
|---|---|---|---|---|---|---|---|---|
| Dow-Jones Industrial | 5889.20 | 9/16/96 | 5346.55 | 5721.26 | 5888.83 | -.01 | 10.14 | 2.93 |
| NYSE Composite | 365.42 | 9/16/96 | 336.07 | 356.61 | 364.43 | -.27 | 8.44 | 2.19 |
| S&P 500 Composite | 683.98 | 9/16/96 | 626.65 | 665.69 | 682.94 | -.15 | 8.98 | 2.59 |
| NASDAQ (OTC) | 1249.15 | 6/5/96 | 1042.37 | 1124.67 | 1203.31 | -3.67 | 15.44 | 6.99 |
| Wilshire 5000 | 6758.69 | 5/24/96 | 6099.34 | 6504.57 | 6701.87 | -.84 | 9.88 | 3.03 |

1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average to date ending September 25 1996.
3. Secondary market.
4. Bid rates for Eurodollar deposits at 11 a.m. London time.
5. Most recent observation based on one-day Thursday quote and futures market index changes.
6 Merrill Lynch MasterII high bond index composite.
7. Quotes for week ending Friday previous to date shown.

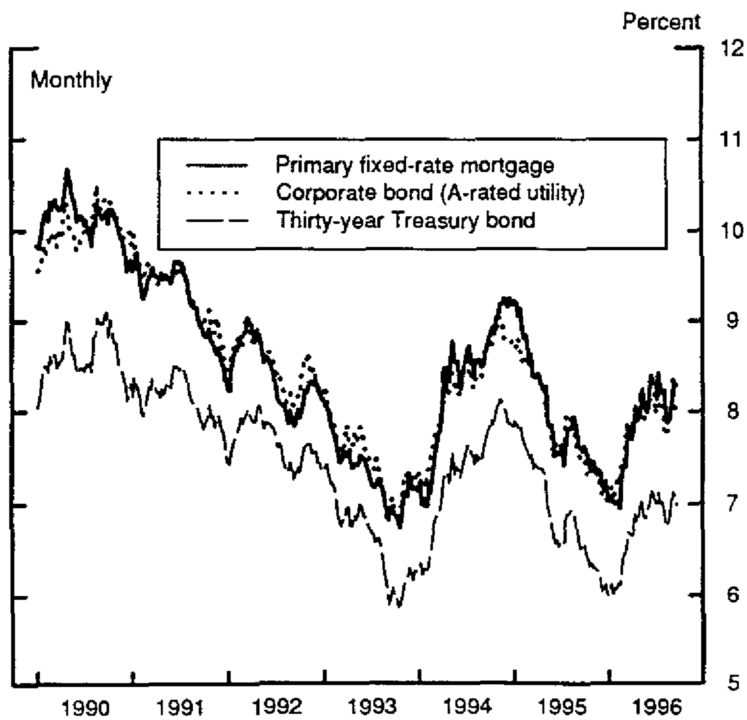
# Selected Interest Rates

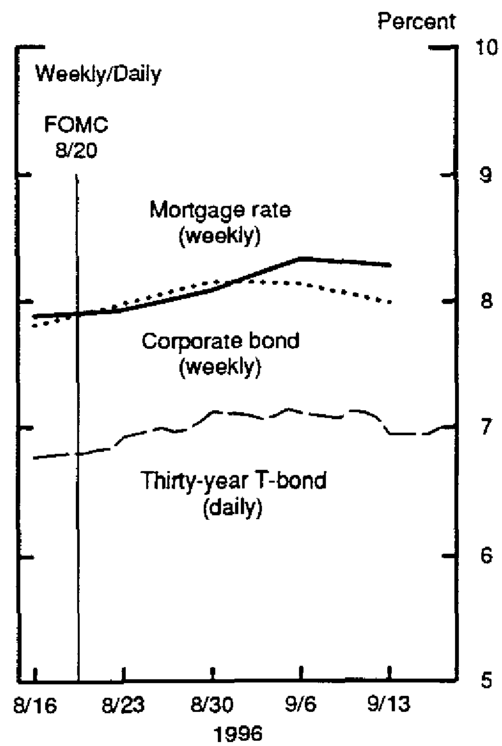
Short-Term




Long-Term



The decision at the August FOMC meeting to keep reserve conditions unchanged had little impact on financial market prices. However, interest rates have been volatile over the intermeeting period, responding sharply at times on the release of data suggesting greater or lesser growth and inflationary pressure. Reports of the attitudes of Federal Reserve officials also precipitated significant market moves on occasion, with a reported leak of discount rate proposals causing rates to rise yesterday. All told, on net, short-term yields have risen around 15 basis points over the intermeeting period, and long-term rates are up 20 to 25 basis points.

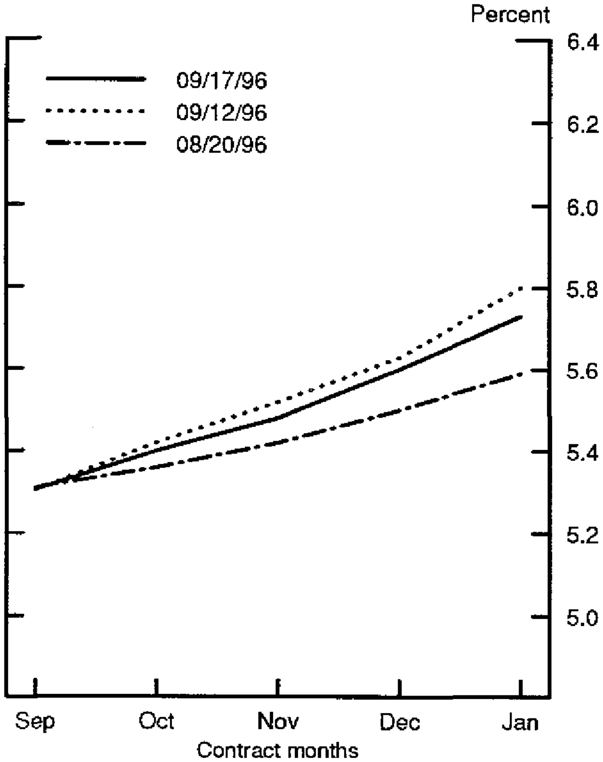
Despite the higher rates, stock prices rose over the intermeeting period, with the blue chip indexes up about 3 percent or so, establishing new highs (chart). Small-capitalization stocks, which had fallen particularly sharply in the mid-July selloff, fared even better, with the NASDAQ composite rising 7 percent. Still, this index remains around 3-3/4 percent below its previous peaks. In mid-September the price-earnings ratio for the S&P 500 stood at the high end of its range over the past decade.

Money and credit flows appear to have remained subdued in the third quarter. Business borrowing from banks and in the securities markets has been sluggish, apparently because ample internal funds have damped credit needs. In the household sector, consumer credit growth has continued at a pace well below that reported earlier in the year; and while there is only partial data on mortgage credit growth, in the current quarter signs suggest some slowing. State and local debt has contracted this quarter, more than offsetting the small increase in the previous quarter. In contrast, the federal government has stepped up its borrowing a little in the third quarter, after taking advantage of unusually large tax inflows to pay down bills in the second. Growth in the broader monetary aggregates picked up a bit in August from July's sluggish pace, and partial data for September point to possibly another pick up this month.

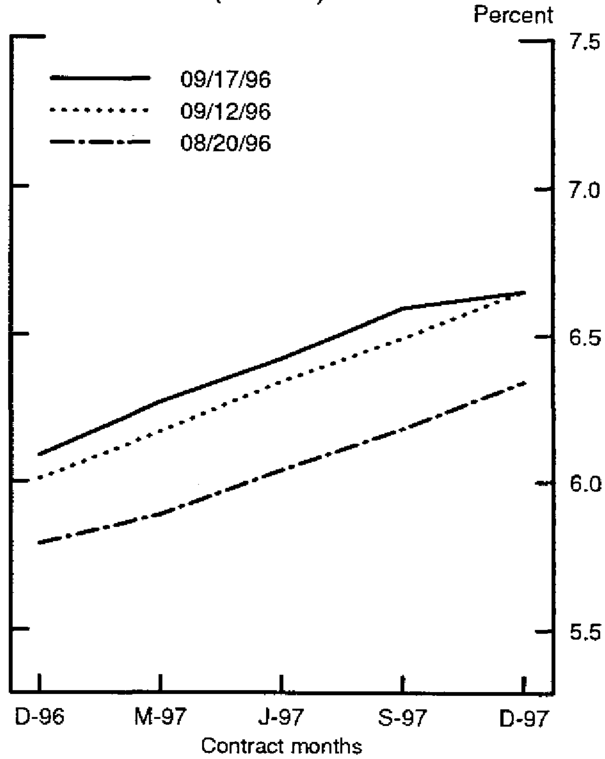
The slowdown in business borrowing in August occurred even as supply conditions remained very favorable. Rate spreads on corporate debt and business loans were quite low, and banks evidently still were aggressive lenders to firms, likely because

## Selected Short-Term Futures Rates and Stock Market Indexes

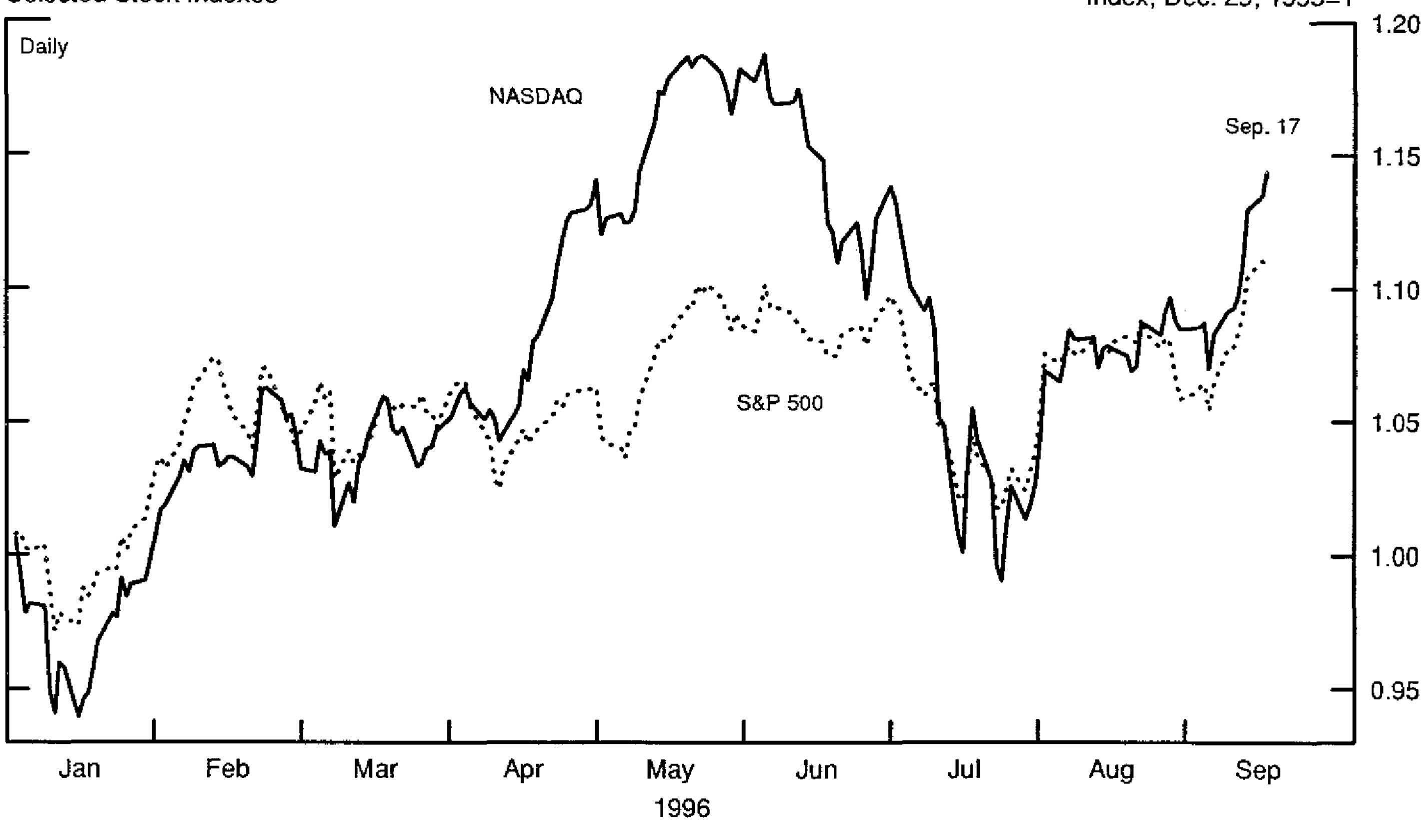
Federal Funds Rates




Eurodollar Rates (3-Month)




Selected Stock Indexes



measures of business credit quality remained positive. By contrast, household credit quality has continued to deteriorate somewhat, and some survey and anecdotal reports show that banks are raising their standards for lending to households, particularly for credit cards.

Bank Credit and the Monetary Aggregates

Bank credit contracted in August at an annual rate of 1 percent, extending a period of weakness evident since the spring. The weakness was concentrated at large banks, where loans fell at a 4 percent rate last month; because of fairly brisk growth at small banks, however, loans expanded at a 2-1/2 percent pace overall. Large banks also shed securities at a rapid clip, as they have over much of this year. Data for the first half of September show only anemic growth in bank credit.

Business loans grew at a pace of only 2-1/2 percent in August, even though banks reportedly continued to price such loans aggressively for large customers. The spread of the C&I loan rate for large loans over the intended federal funds rate, as reported in the Survey of Terms of Bank Lending to Business, narrowed somewhat in August compared with three months earlier and is near record low levels (chart, top panel). The spread for small and medium-sized business loans was unchanged, remaining appreciably under the wide spreads of the early 1990s but above those of the late 1980s.

Growth of real estate loans bounced back in August to a 7-1/4 percent annual growth rate. Some of the increase likely reflects the relatively large share of new mortgages that carry adjustable rates, as banks are more likely to keep such mortgages on their books. By contrast, the growth of consumer loans, at 4 percent, was again held down by securitization. With the addition of securitized loans, consumer loans grew at a 10-1/2 percent annual rate last month.

The most recent data on bank earnings suggest that the trend to move assets off the balance sheet has not hurt profitability (bottom left panel). The sharp rise in second-quarter profits at commercial banks mainly reflected a substantial rise in noninterest income, which encompasses revenue generated from many off-balance-sheet activities, including servicing and fee income from securitized consumer and real estate loans. Second-quarter profits also benefited from a slight widening of the net interest margin but were held down by higher loan-loss provisioning. Even so, banks have been able to hold provisioning to a relatively low level because

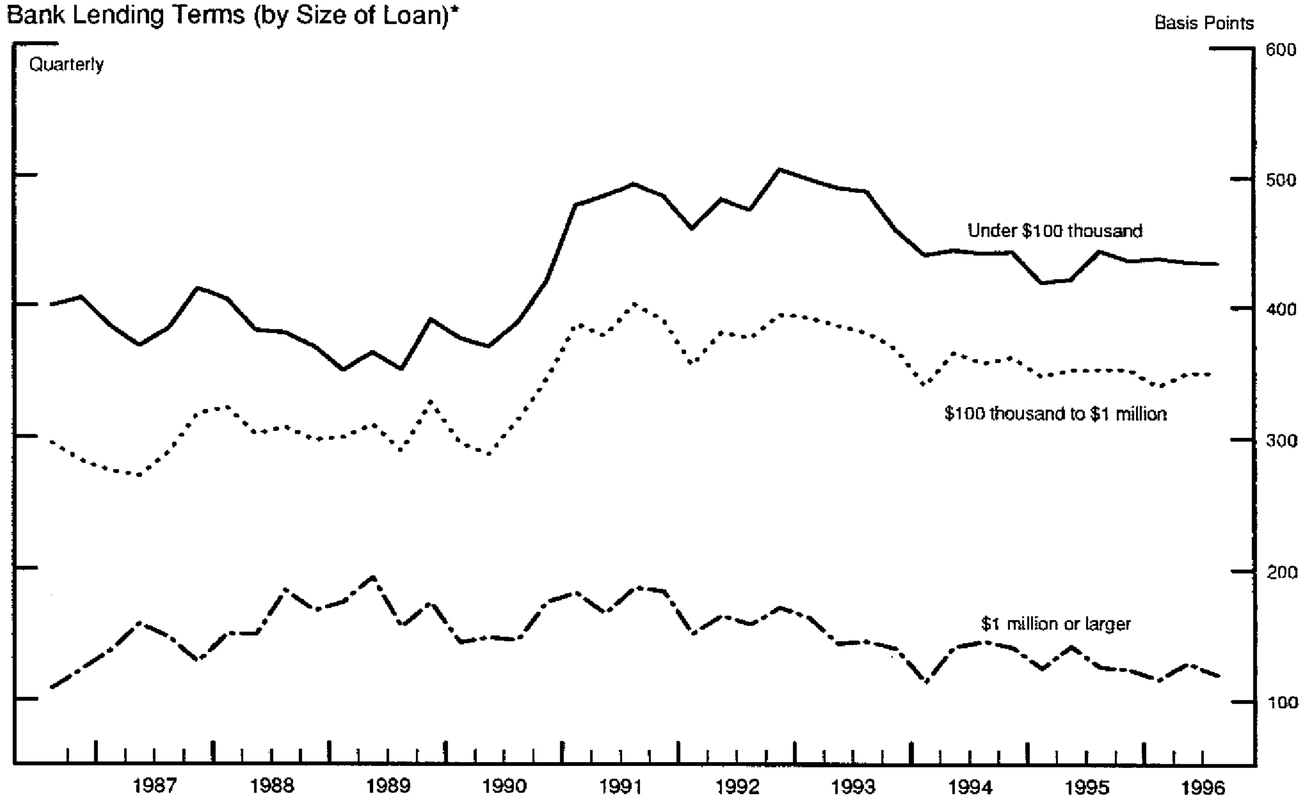
## Commercial Bank Credit

(Percentage change; seasonally adjusted annual rate)[1]

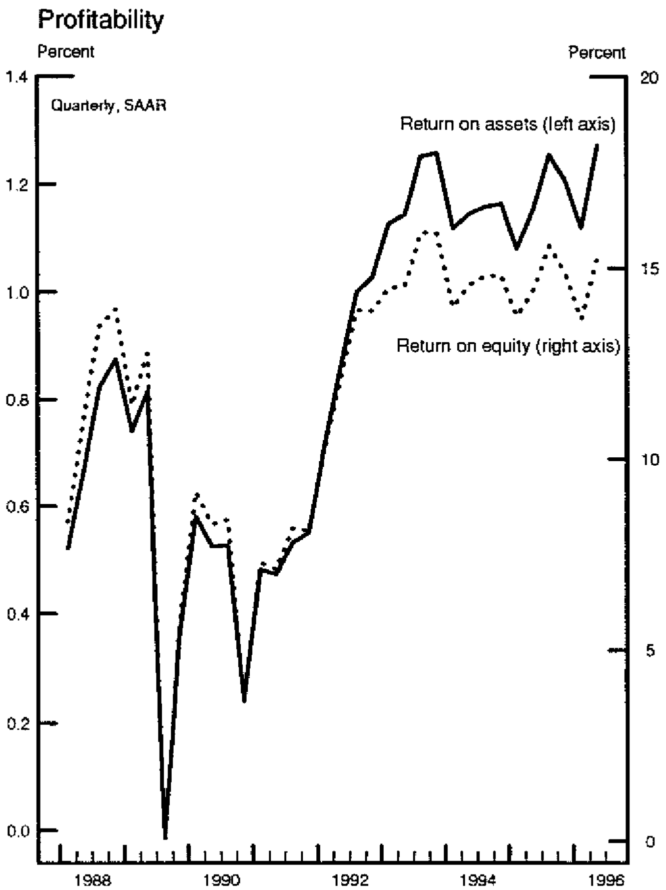
| | Type of credit | 1995 | 1996 Q1 | 1996 Q2 | 1996 Jun | 1996 Jul | 1996 Aug | Level, Aug 1996 (billions of $) |
|---|---|---|---|---|---|---|---|---|
| 1. | Total loans and securities | 8.7 | 5.3 | 2.6 | 1.5 | 1.0 | -1.0 | 3,668.9 |
| 2. | Securities | 3.5 | 0.6 | -2.9 | -10.2 | -6.7 | -11.0 | 966.3 |
| 3. | U.S. government | -3.1 | -2.5 | 0.7 | -11.1 | -0.2 | -9.7 | 702.3 |
| 4. | Other[2] | 25.6 | 8.4 | -11.5 | -7.9 | -23.8 | -14.4 | 264.0 |
| 5. | Loans[3] | 10.8 | 7.1 | 4.6 | 5.9 | 3.8 | 2.5 | 2,702.5 |
| 6. | Business | 11.6 | 7.4 | 5.2 | 5.1 | 6.3 | 2.4 | 744.3 |
| 7. | Real estate | 8.5 | 4.8 | 3.2 | 3.6 | 1.1 | 7.2 | 1,109.2 |
| 8. | Home equity | 5.2 | 4.6 | -1.0 | -6.0 | 6.1 | 9.1 | 80.1 |
| 9. | Other | 8.7 | 4.8 | 3.5 | 4.2 | 0.7 | 7.2 | 1,029.1 |
| 10. | Consumer | 10.7 | 6.9 | 4.9 | 12.3 | 4.9 | 4.0 | 514.3 |
| 11. | Adjusted[4] | 17.7 | 13.9 | 9.3 | 15.2 | 6.9 | 10.6 | 671.4 |
| 12. | Security | 14.4 | -3.3 | -8.0 | -7.3 | -26.3 | -53.8 | 76.7 |
| 13. | Other[5] | 18.4 | 21.0 | 12.8 | 10.0 | 15.5 | -3.2 | 257.9 |

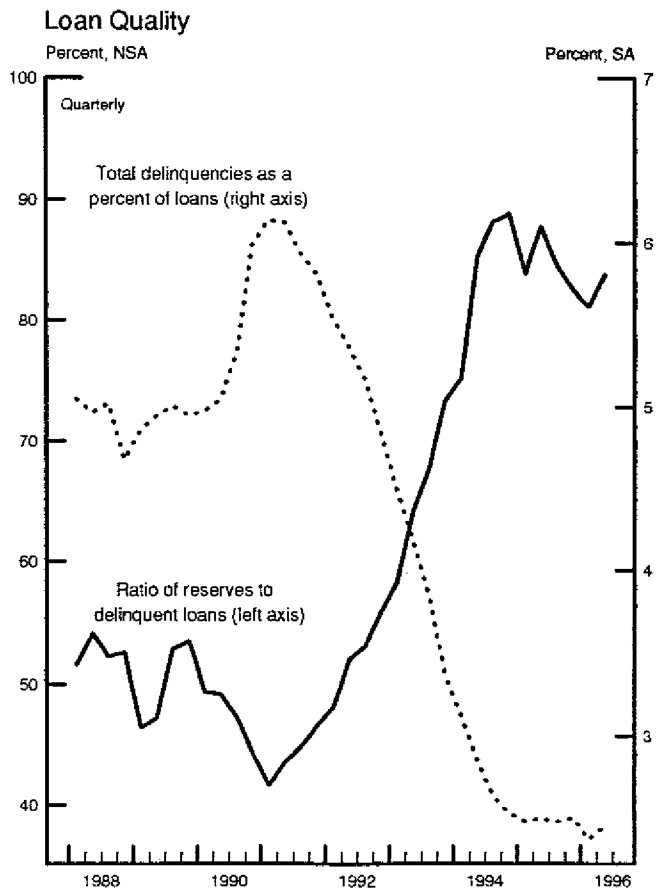
1. Monthly levels are *pro rata* averages of Wednesday data. Quarterly and annual levels (not shown) are simple averages of monthly levels and levels for the fourth quarter respectively. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.
2. Includes municipal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

# Commercial Bank Data




* Average commercial and investment loan rate spread over intended federal funds rate.



MONETARY AGGREGATES
(Based on seasonally adjusted data)

| Aggregate or component | 1995 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July | 1996 Aug. (p) | 1995:Q4 to Aug. 96 (p) | Level (bil. $) Aug. 96 (p) |
|---|---|---|---|---|---|---|---|---|
| Aggregate | Percentage change (annual rate)[1] | | | | | | | |
| 1. M1 | -1.8 | -2.7 | -0.7 | -0.5 | -8.8 | -9.9 | -3.4 | 1099.4 |
| 2. M2[2] | 3.9 | 5.8 | 3.9 | 5.3 | 1.9 | 3.7 | 4.2 | 3757.2 |
| 3. M3 | 5.8 | 7.1 | 5.3 | 4.5 | 2.6 | 5.1 | 5.5 | 4744.8 |
| Selected components | | | | | | | | |
| 4. Currency | 5.4 | 2.3 | 3.7 | 7.3 | 10.1 | 7.5 | 4.7 | 385.0 |
| 5. Demand deposits | 1.4 | 10.9 | 10.6 | 11.7 | -9.0 | -9.1 | 6.4 | 407.5 |
| 6. Other checkable deposits | -11.1 | -22.7 | -18.5 | -25.4 | -31.2 | -32.1 | -22.5 | 298.6 |
| 7. M2 minus M1[3] | 6.6 | 9.6 | 5.9 | 7.7 | 6.4 | 9.3 | 7.6 | 2657.7 |
| 8. Savings deposits | -3.3 | 15.2 | 11.2 | 9.4 | 6.7 | 10.0 | 11.9 | 1223.7 |
| 9. Small time deposits | 15.0 | 0.6 | -3.0 | -0.9 | 2.7 | 5.4 | -0.1 | 933.8 |
| 10. Retail money market funds | 18.9 | 14.2 | 10.5 | 20.0 | 13.0 | 14.8 | 13.1 | 500.2 |
| 11. M3 minus M2[4] | 14.5 | 12.3 | 10.5 | 1.5 | 5.3 | 10.9 | 10.6 | 987.7 |
| 12. Large time deposits, net[5] | 15.5 | 7.6 | 13.6 | 16.5 | 16.3 | 15.8 | 12.9 | 454.1 |
| 13. Institution-only money market mutual funds | 23.1 | 27.9 | 8.8 | 29.1 | 16.8 | 20.4 | 18.9 | 257.2 |
| 14. RPs | 4.6 | -3.0 | 11.6 | -50.4 | -42.9 | -13.3 | -4.3 | 178.5 |
| 15. Eurodollars | 12.0 | 11.7 | 7.5 | 16.0 | -17.1 | 26.0 | 9.3 | 99.2 |
| Memo | | | | | | | | |
| 16. Monetary base | 4.1 | 1.6 | 2.1 | 5.8 | 7.4 | 6.2 | 3.2 | 444.1 |
| 17. Household M2[6] | 4.1 | 5.2 | 3.1 | 4.5 | 3.2 | 5.8 | 4.1 | 3351.9 |
| | Average monthly change (billions of dollars)[7] | | | | | | | |
| Memo | | | | | | | | |
| Selected managed liabilities at commercial banks: | | | | | | | | |
| 18. Large time deposits, gross | 5.5 | 2.9 | 6.6 | 3.9 | 8.7 | 9.7 | ... | 487.3 |
| 19. Net due to related foreign institutions | 3.5 | 2.7 | -4.7 | -1.0 | -7.0 | -4.7 | ... | 243.4 |
| 20. U.S. government deposits at commercial banks | -0.1 | -1.3 | 0.0 | 5.1 | 5.1 | -3.7 | ... | 18.3 |

1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
2. Sum of seasonally adjusted M1, retail money market funds, savings deposits, and small time deposits.
3. Sum of retail money funds, savings deposits, and small time deposits, each seasonally adjusted separately.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees, each seasonally adjusted separately.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government, and foreign banks and official institutions.
6. M2 less demand deposits
7. 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.

overall loan quality remains excellent: Some deterioration in the performance of consumer loans has been offset by improvements in commercial real estate loans, while delinquency and charge-off rates on other types of loans have remained very low. As a result, banks' loan-loss reserves continue to be high relative to their delinquent loans (bottom right panel).

Despite the weakness in bank credit in August, M3 grew at a 5 percent annual rate, faster than in July but below the pace set in the first half of the year. M3 is being supported by banks' substitution toward large time deposits, which are included in M3, and away from borrowings from foreign offices, which are not. Institution-only money market mutual funds also grew briskly again last month, likely owing to the drop in short-term market rates in early August: Because changes in yields on these funds lag changes in market rates, declines in market rates provide an incentive to shift money into these funds temporarily.

M2 growth also picked up in August, rising at a 3-3/4 percent rate, as the attractiveness of holding M2 assets improved in the wake of the early August decline in short-term market rates. Retail money market mutual funds, which have posted double-digit growth rates for several quarters, rose at a 14-3/4 percent annual pace in August.

M1 rose in August at a 4-1/2 percent pace after adjusting for the initial effects of sweeps. While the sweep-adjusted growth of other checkable deposits was moderate, currency continued to expand rapidly, likely fueled by overseas demand. Demand deposits, a relatively volatile component of M1, rebounded from their July runoffs, growing at a 4-3/4 percent annual rate after adjusting for the effects of a large new retail sweep program.

Mutual Funds

Net sales of equity mutual funds snapped back smartly in August from the retrenchment in the wake of the mid-July drop in equity prices; still, they remained somewhat below the record volume in the first half of the year (chart, top panel). In addition, investor demand for the more speculative of the equity funds resurfaced last month (bottom panel). Inflows to bond funds also picked up in August, fueled by stronger net sales at high-yield bond funds and at income funds--which hold a mixture of bonds and stocks. The heavy inflows at high-yield funds suggest that investors remain confident about the earnings prospects of speculative-grade firms.

Preliminary data for the first two weeks of September show that inflows to stock and bond funds remained reasonably firm.

Although we lack hard data on the types of investors that pulled back from mutual funds in July, industry sources indicate that retirement accounts were largely unaffected by the volatile market conditions. It is thought that most individuals with defined-contribution plans or IRA or Keogh accounts tend to review their accounts only after receiving periodic statements, not on a daily basis. Furthermore, most contributions are through automatic payroll deductions and cannot be altered easily. These factors suggest that retirement-related inflows may not be much affected by short, relatively mild corrections.

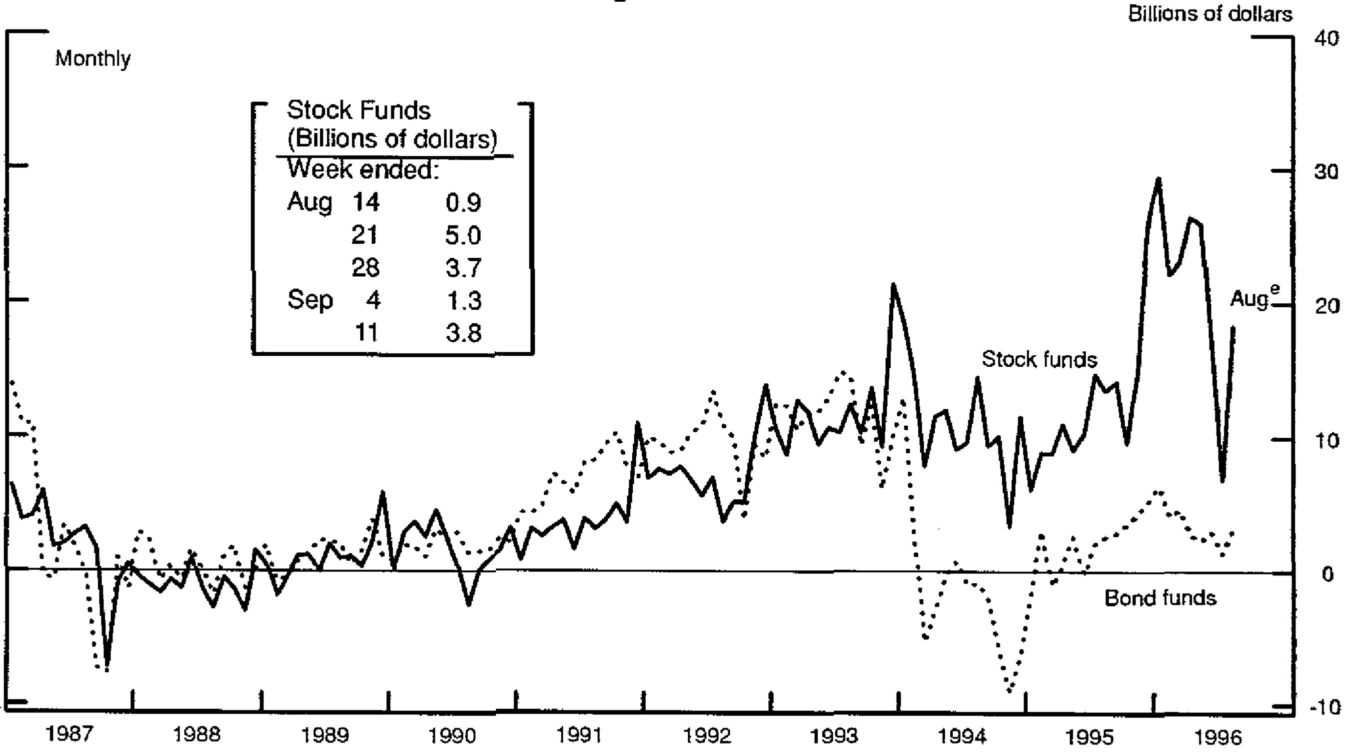
Business Finance

Gross bond offerings by nonfinancial corporations in August continued at about the reduced pace of July (table). Preliminary data indicate that issuance slowed further in the first two weeks of September. Issuance by investment-grade firms has likely been held down of late by a limited need for external funding as well as by the usual summer fall off in activity. Even so, speculative-grade offerings rebounded in August from the lull in July. However, even with the upturn, junk bond issuance in August remained below the monthly average so far this year, and investors continued to take a cautious view toward a few of the most speculative issues. With no merger-related issuance, the volume of outstanding nonfinancial commercial paper declined in August for a second month (chart, lower left panel); data for the first few weeks of September show further declines this month.

Gross equity issuance by nonfinancial firms, which plunged in July, posted another sharp decline in August, leaving its level at only one-quarter of the record high set in June (table). The slowdown, which was likely magnified by July's market correction, brings issuance into more normal alignment with past price movements (lower right panel). Gross issuance remained weak in early September.

Nonfinancial merger activity shows no sign of slowing, with the volume of large deals through August running nearly 30 percent ahead of last year's record pace (chart, upper panel). So far this year, equity retirements have accounted for roughly half of the total value of large nonfinancial mergers, about the same proportion as in the preceding two years. However, with most of the pending mergers

## Net Sales of Long-Term Mutual Funds




## Net Sales of Selected Mutual Funds

(Billions of dollars; quarterly and annual data at monthly rate)

| | 1994 | 1995 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July | 1996 Aug[e] | Memo: July assets |
|---|---|---|---|---|---|---|---|---|
| **Stock Funds** | 11.0 | 12.2 | 24.9 | 23.1 | 16.8 | 6.9 | 18.3 | 1468.0 |
| Domestic[1] | 7.2 | 11.1 | 19.4 | 18.4 | 12.7 | 5.0 | 14.9 | 1225.4 |
| Aggressive growth | 2.2 | 3.2 | 5.3 | 6.8 | 3.6 | 1.3 | 4.9 | 227.3 |
| Growth | 2.0 | 3.5 | 5.6 | 4.7 | 2.7 | 0.2 | 3.5 | 401.5 |
| Growth & income[2] | 4.2 | 4.4 | 8.4 | 7.1 | 7.1 | 3.5 | 6.2 | 591.2 |
| International | 3.8 | 1.2 | 5.5 | 4.7 | 4.1 | 1.8 | 3.4 | 242.6 |
| **Bond Funds** | -1.4 | 2.0 | 5.0 | 2.6 | 2.9 | 1.3 | 3.1 | 829.2 |
| High-yield | 0.2 | 0.9 | 0.8 | 1.2 | 0.7 | 1.1 | 1.9 | 67.1 |
| Income | 2.2 | 1.7 | 3.6 | 2.2 | 2.4 | 0.9 | 1.7 | 314.1 |
| Other | -3.8 | -0.6 | 0.6 | -0.8 | -0.2 | -0.7 | -0.5 | 448.0 |

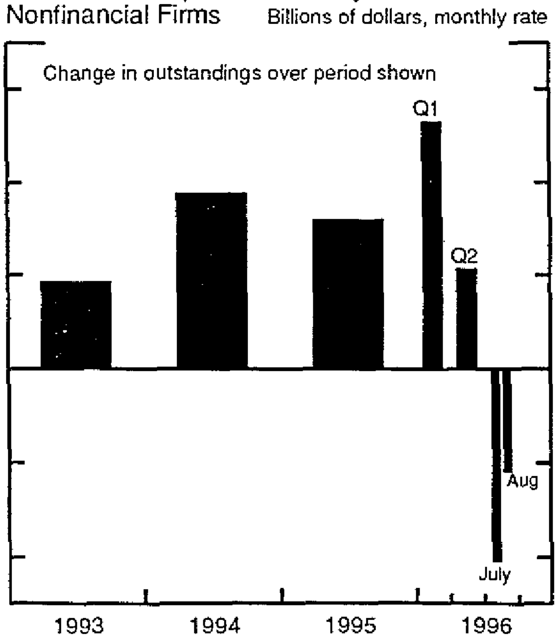
1. Includes precious metals funds, not shown elsewhere.
2. Calculated as the sum of 'Growth and income' and 'Income equity' in the ICI data.
e Estimate.
Source: Investment Company Institute.

GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS[1]
(Billions of dollars; monthly rates, not seasonally adjusted)

| Type of security | 1994 | 1995 | 1996 Q1 | 1996 Q2 | 1996 June | 1996 July[p] | 1996 Aug.[p] |
|---|---|---|---|---|---|---|---|
| All U.S. corporations | 41.29 | 47.64 | 58.31 | 64.44 | 67.66 | 41.51 | 41.65 |
| Stocks[2] | 5.49 | 6.10 | 7.41 | 13.75 | 13.44 | 7.69 | 5.29 |
| Bonds | 35.80 | 41.54 | 50.90 | 50.69 | 54.22 | 33.82 | 36.36 |
| Nonfinancial corporations | | | | | | | |
| Stocks[2] | 3.10 | 4.39 | 5.25 | 10.24 | 11.43 | 6.10 | 3.17 |
| Initial public offerings | 1.14 | 1.70 | 2.17 | 4.42 | 4.00 | 1.49 | 1.86 |
| Seasoned offerings | 1.96 | 2.69 | 3.09 | 5.82 | 7.43 | 4.61 | 1.31 |
| Bonds | 7.99 | 10.73 | 12.07 | 13.56 | 15.16 | 10.42 | 10.56 |
| By rating, bonds sold in U.S.[3] | | | | | | | |
| Investment grade | 4.41 | 6.45 | 5.87 | 6.29 | 7.63 | 7.10 | 5.45 |
| Speculative grade | 2.65 | 3.02 | 4.95 | 5.57 | 5.34 | 2.32 | 4.11 |
| Public | 2.01 | 1.95 | 2.68 | 3.26 | 4.04 | 1.20 | 2.25 |
| Rule 144A | .63 | 1.07 | 2.27 | 2.31 | 1.30 | 1.12 | 1.86 |
| Financial corporations | | | | | | | |
| Stocks[2] | 2.39 | 1.71 | 2.16 | 3.50 | 2.02 | 1.59 | 2.12 |
| Bonds | 27.81 | 30.81 | 38.83 | 37.13 | 39.06 | 23.40 | 25.80 |

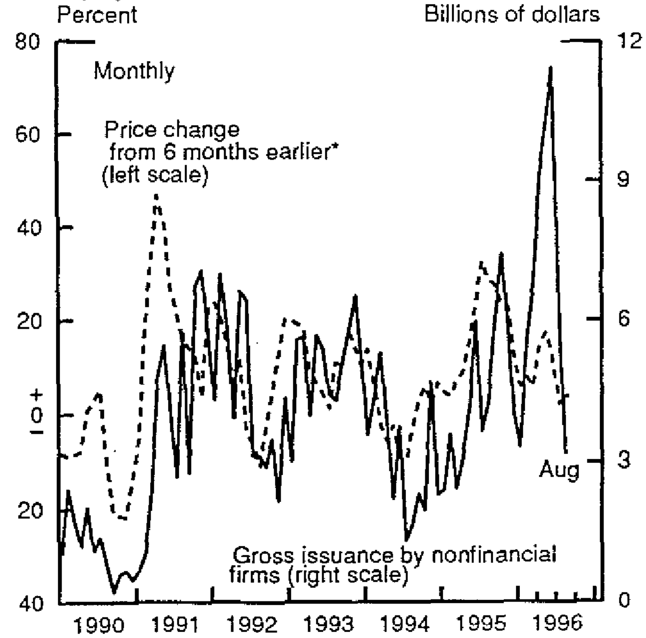
Note. Components may not sum to totals because of rounding.
1. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with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

Commercial Paper Issuance by Nonfinancial Firms



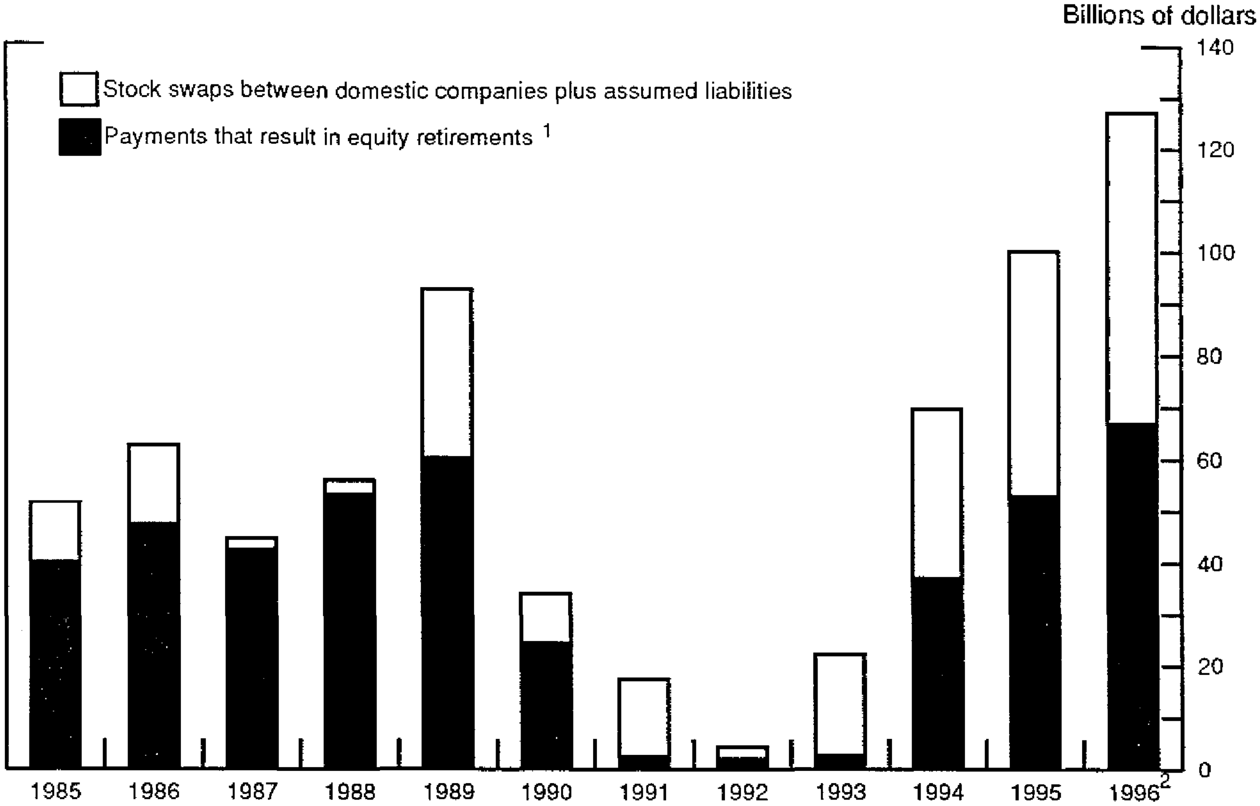
Note. Seasonally adjusted.

Equity Issuance and Prices



* NASDAQ price index.

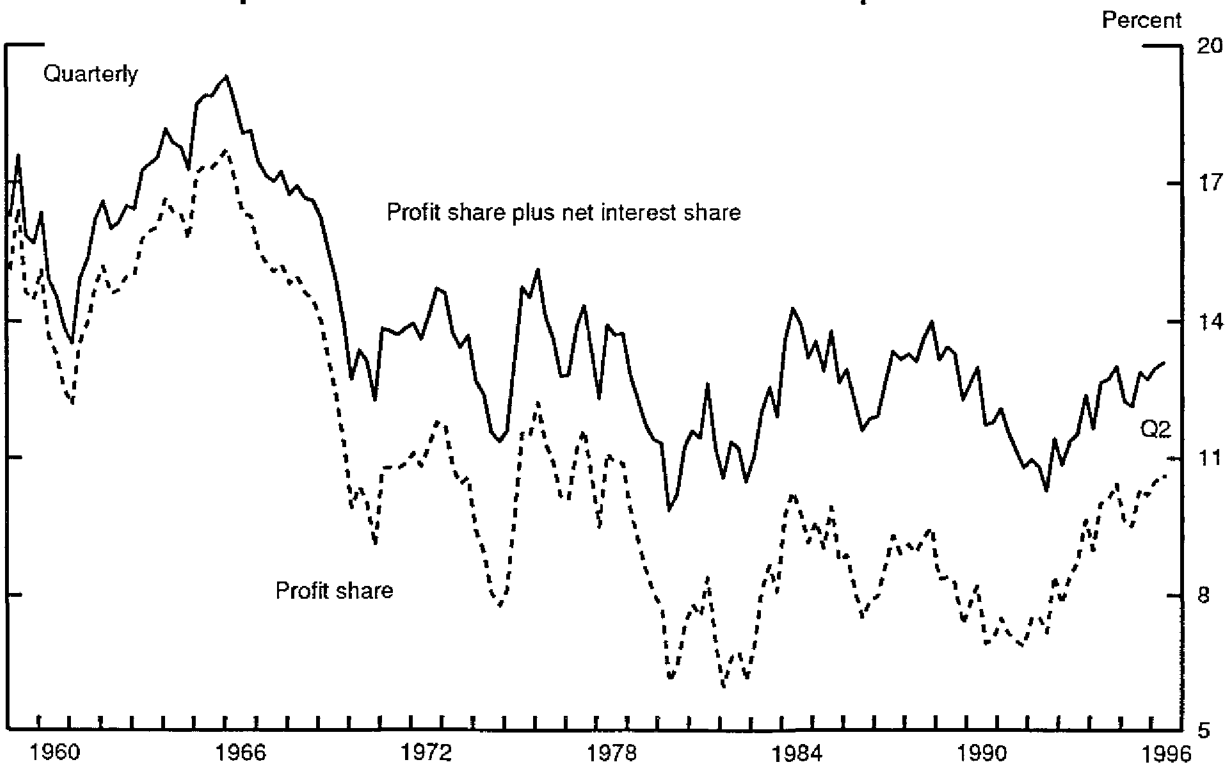
## Megamerger Activity of Domestic Nonfinancial Corporations




Note. Deals in which the value of the target is $1 billion or greater. Excludes acquisitions in which the target company remains an independent entity after the transaction.

1. Includes payments to target company's shareholders in the form of cash or debt, as well as stock swaps between a foreign acquiror and a U.S. target.
2. Through August at an annual rate.

## Capital Shares of Domestic Nonfinancial Corporations




Note. Profit share equals economic profits before tax expressed as a percentage of sector GDP.

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

| Type of credit | 1994 | 1995 | 1996 Q1[r] | 1996 Q2[r] | 1996 June[r] | 1996 July[p] | Memo: Outstanding July, 1996 (billions of dollars) |
|---|---|---|---|---|---|---|---|
| Total | 14.5 | 14.2 | 11.8 | 7.1 | 7.0 | 8.0 | 1163.7 |
| Auto | 13.4 | 10.7 | 7.9 | 10.6 | 18.5 | 6.3 | 369.1 |
| Revolving | 18.2 | 22.0 | 16.8 | 14.4 | 5.7 | 19.4 | 454.0 |
| Other | 11.8 | 9.1 | 9.7 | -5.4 | -3.5 | -5.1 | 340.6 |

r Revised.
p Preliminary.

INTEREST RATES ON CONSUMER LOANS
(Annual percentage rate)

| Type of loan | 1994 | 1995 | 1995 Nov. | 1996 Feb. | 1996 May | 1996 June | 1996 July | 1996 Aug. |
|---|---|---|---|---|---|---|---|---|
| At commercial banks[1] | | | | | | | | |
| New cars (48 mo.) | 8.1 | 9.6 | 9.4 | 9.1 | 8.9 | n.a. | n.a. | 9.1 |
| Personal (24 mo.) | 13.2 | 13.9 | 13.8 | 13.6 | 13.5 | n.a. | n.a. | 13.4 |
| Credit cards | 16.2 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit cards[2] | | | | | | | | |
| All accounts | n.a. | 16.0 | 15.8 | 15.8 | 15.4 | n.a. | n.a. | n.a. |
| Accounts assessed interest | n.a. | 15.8 | 15.7 | 15.4 | 15.4 | n.a. | n.a. | n.a. |
| At auto finance cos.[3] | | | | | | | | |
| New cars | 9.8 | 9.8 | 10.8 | 9.9 | 9.6 | 9.5 | 9.8 | n.a. |
| Used cars | 13.5 | 13.5 | 14.0 | 13.3 | 13.3 | 13.6 | 13.8 | n.a. |

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.

structured as stock swaps--including virtually all of the large telecommunications deals--merger-related equity retirements should moderate in coming months. In contrast, announcements of share repurchases have continued at a brisk pace, with large cash-rich firms accounting for the bulk of the buybacks.

Recent movements in credit quality--as measured by changes in Moody's ratings--remain favorable, with the value of debt upgraded in July and August exceeding that downgraded by a sizable margin. In addition, among the nonfinancial companies on Moody's Watchlist at the beginning of September, the majority of debt--especially speculative-grade debt--was on review for an upgrade. The pace of junk bond defaults this year continues to run well below its historical average, and junk bond spreads have returned to historic lows after having widened a bit in July.

Another favorable indicator of business financial health is the continued growth of corporate profits. Before-tax economic profits of domestic nonfinancial corporations, as measured in the national income and product accounts, posted another strong gain in the second quarter, rising 19 percent from a year earlier. Healthy profit growth throughout the current expansion has raised the profit share of sector output for domestic nonfinancial corporations to its highest level since the late 1970s (lower panel). Part of the improvement in profits in recent years has resulted from lower interest payments by firms. The share of profits plus net interest, a broader measure of the return on capital that includes income to creditors as well as equity holders, has increased less dramatically.

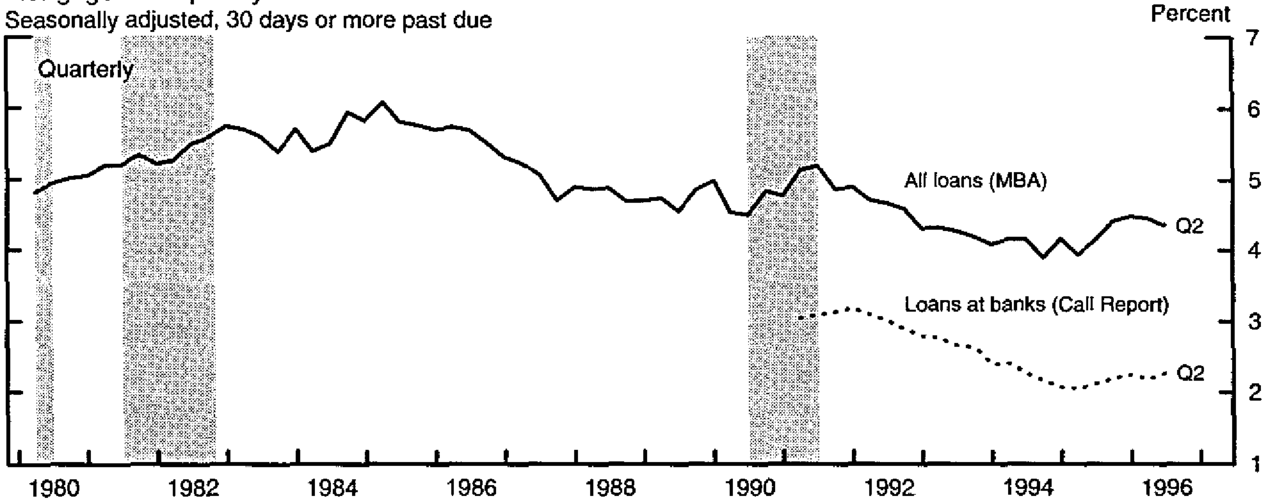
Household Sector Finance

Household borrowing slowed in the second quarter, but growth appears to be holding steady in more recent months. The growth of total consumer credit picked up a bit in July, to an 8 percent seasonally adjusted annual rate, still well below the 12 percent pace early in the year (table). The growth of revolving credit rebounded in July following an unusually small rise in June; over the two-month period, revolving credit advanced at a 12-1/2 percent pace--below the first-half rate of almost 16 percent.

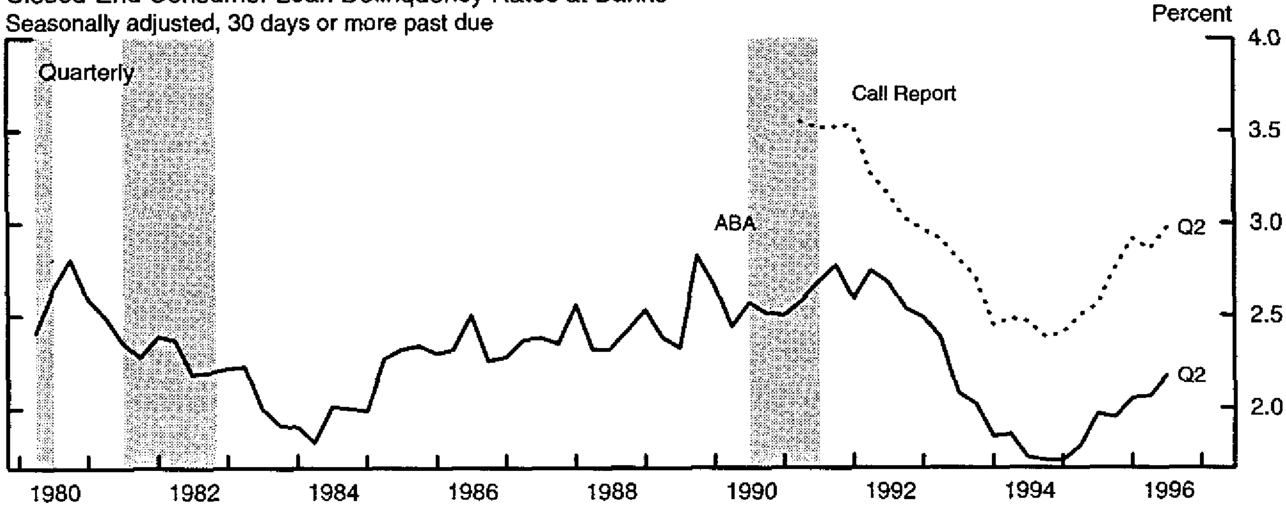
The growth of mortgage credit slowed in the second quarter from its robust first-quarter pace. The few available indicators of mortgage activity in the third quarter are mixed although leaning on the side of some slowing. Builders' assessments of new home sales

## Household Credit Quality

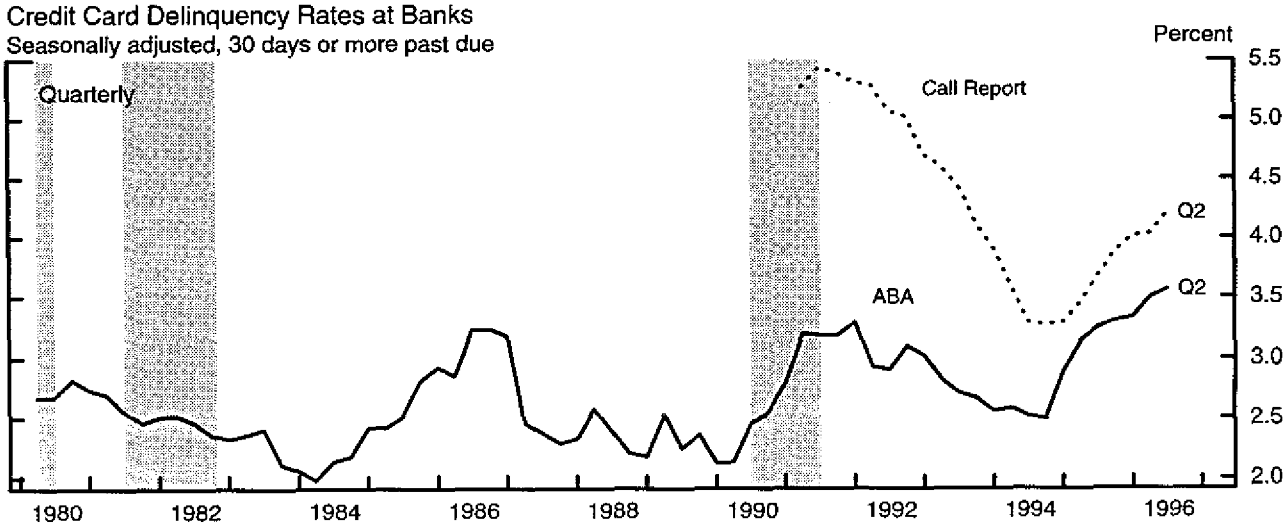
Mortgage Delinquency Rates
Seasonally adjusted, 30 days or more past due




Closed-End Consumer Loan Delinquency Rates at Banks
Seasonally adjusted, 30 days or more past due




Credit Card Delinquency Rates at Banks
Seasonally adjusted, 30 days or more past due




Note. The MBA and ABA series are by number of loans; the Call Report series are by dollar volume.

activity have deteriorated in recent months, based on survey data. Still, mortgage applications for home-purchase loans remain at a relatively high level, and the average growth rate for real estate loans at commercial banks over July and August was close to the second-quarter rate.

Indicators of household credit quality in the second quarter paint a mixed picture but on balance suggest some further deterioration. Mortgage delinquency rates were little changed and remain on the low side of historical experience. According to the Mortgage Bankers Association survey, the delinquency rate for home mortgages edged down in the second quarter; Call Report data, in contrast, showed a slight increase (chart, top panel). The Call Report delinquency rate for revolving home equity loans edged lower, while the rate for other home mortgage loans increased a bit but remained relatively low.

Delinquency rates for consumer loans in the second quarter suggest that repayment problems worsened slightly, although most delinquency rates remain well below historical peaks (middle panel). The American Bankers Association (ABA) series for closed-end loans has reversed about half of its decline from the 1991:Q3 high, and bank Call Report data show a similar pattern.

Credit card delinquencies continue to portray a less reassuring picture. The ABA series for credit card delinquencies reached another new high in the second quarter (bottom panel). Data from the Call Report also show that delinquencies moved higher but have yet to approach the previous peak. A Moody's series for delinquencies on credit card receivables in securitized pools rose in June but is well below the level it reached in the last recession. Problems with credit card loans have been linked with personal bankruptcies, which rose to more than 1 million at an annual rate in the first half of this year.

<u>Treasury and Agency Financing</u>

The staff anticipates that the Treasury will finance the projected $40 billion third-quarter fiscal deficit mostly by borrowing from the public and that the cash balance will decline only slightly (table). Because the midquarter refunding included a thirty-year bond, borrowing has tilted toward coupon issues and away from bills, with net bill redemptions of $15 billion. By contrast, coupon auctions are expected to raise $51 billion.

**TREASURY FINANCING**
(Billions of dollars: total for period)

| Item | 1996 Q2 | 1996 Q3[p] | 1996 July | 1996 Aug.[e] | 1996 Sep.[p] |
|---|---|---|---|---|---|
| Total surplus/deficit (-) | 53.2 | -40.1 | -27.1 | -41.2 | 28.2 |
| Means of financing deficit | | | | | |
| Net cash borrowing and repayments (-) | -23.5 | 33.9 | 29.1 | 15.3 | -10.5 |
| Nonmarketable | 2.1 | -1.9 | -4.0 | 1.4 | 0.8 |
| Marketable | -25.6 | 35.7 | 33.1 | 13.9 | -11.3 |
| Bills | -38.3 | -15.2 | 16.2 | -8.8 | -22.7 |
| Coupons | 12.7 | 51.0 | 16.9 | 22.7 | 11.4 |
| Decrease in cash balance | -16.2 | 4.2 | 1.3 | 23.7 | -20.8 |
| Other[1] | -13.6 | 2.1 | -3.3 | 2.2 | 3.1 |
| Memo: | | | | | |
| Cash balance, end of period | 38.0 | 33.9 | 36.8 | 13.1 | 33.9 |

Note. Data reported on a payment basis. Details may not sum to totals because of rounding.
1. Accrued items, checks issued less checks paid, and other transactions.
p Projection.
e Estimate.

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

| | 1993 | 1994 | 1995 | 1996 Q1 | 1996 Q2 | 1996 Jul. | 1996 Aug. |
|---|---|---|---|---|---|---|---|
| Total tax-exempt | 27.2 | 16.1 | 14.9 | 15.4 | 20.9 | 18.3 | 17.0 |
| Long-term | 23.3 | 12.8 | 12.1 | 13.7 | 16.1 | 11.6 | 12.7 |
| Refundings[1] | 15.7 | 4.0 | 3.6 | 5.5 | 4.5 | 2.6 | 4.8 |
| New capital | 7.6 | 8.8 | 8.5 | 8.2 | 11.6 | 9.0 | 7.9 |
| Short-term | 3.9 | 3.3 | 2.8 | 1.7 | 4.8 | 6.7 | 4.3 |
| Total taxable | .7 | .7 | .7 | .4 | .5 | .6 | .9 |

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

Over the intermeeting period, the General Accounting Office released a study concluding that Treasury Secretary Rubin had operated within his authority in shifting securities out of government trust funds to avoid a default during the debt-ceiling crisis late in 1995.

Little time remains in the current session for the Congress to pass legislation to shore up the Savings Association Insurance Fund. The plan approved by the House Banking Committee will likely face opposition by independent insurance agents, who have opposed any banking bill that does not roll back the insurance powers of banks.[1] Treasury Secretary Rubin also opposes the bill partly on the grounds that it would unacceptably weaken consumer protection rules. Despite the lack of legislation, FICO spreads over Treasuries actually narrowed 1 to 3 basis points over the past month, to 29 basis points for the three-year strips and 40 basis points for the nineteen-year strips. Spreads of other agency-issued securities over comparable Treasuries remained stable at about 15 basis points for five-year notes and 30 basis points for ten-year notes.

Municipal Bonds

Gross offerings of long-term municipal debt totaled nearly $13 billion in August, up slightly from the pace in July but off a good bit from the second quarter (table). Much of the decline is attributable to a seasonal slowdown in new capital volume. Refunding issuance picked up in August to about the average pace in the first half of the year. Indeed, trade reports indicate that several large issuers tapped the market to take advantage of the light supply of and strong investor demand for debt. Although retirements of long-term debt dropped back in August from July's heavy pace, they again exceeded gross issuance, resulting in a net decline in debt outstanding. The ratio of yields on thirty-year tax-exempt securities to comparable Treasuries has maintained its low level over the intermeeting period; in mid-September, it was the lowest it has been since early 1995.

1. A proposal to use of the Federal Reserve surplus to support FICO bonds was approved by committee, but was dropped by Representative Leach.

# INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

The deficit in U.S. international trade in goods and services widened substantially in July. Exports were 3-1/2 percent lower than the level in June, while imports rose 1-1/4 percent. The decline in exports reflected a temporary drop in shipments of aircraft, reduced transfers of gold, a further decline in exports of semiconductors, and decreased exports of volatile categories such as automotive products, consumer goods, and other industrial supplies. It appears that a portion of the overall decline in exports in July reflects a residual seasonal in the data.

A large portion of the increase in imports in July was in services (payment of Olympic-related fees and royalties) and oil (almost entirely quantity).

Data for August will be released on October 18.

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

| | | Annual rates | | | Monthly rates | | |
|---|---|---|---|---|---|---|---|
| | 1995 | 1995 | 1996 | | 1996 | | |
| | | Q4 | Q1 | Q2 | May | Jun | Jul |
| Real NIPA 1/ | | | | | | | |
| Net exports of G&S | -107.6 | -84.9 | -104.0 | -115.2 | ... | ... | ... |
| Nominal BOP | | | | | | | |
| Net exports of G&S | -105.1 | -77.6 | -97.4 | -113.4 | -10.5 | -8.2 | -11.7 |
| Goods, net | -173.4 | -152.1 | -171.0 | -188.0 | -16.8 | -14.6 | -17.5 |
| Services, net | 68.4 | 74.5 | 73.5 | 74.6 | 6.2 | 6.4 | 5.8 |

1. In billions of chained (1992) dollars.
Source. U.S. Dept. of Commerce, Bureau of Economic Analysis and Census.

In the second quarter, the deficit in net exports of goods and services was substantially larger than in the first quarter, and moved back to levels last recorded a year ago. Between the first and second quarters, NIPA real exports grew at a 6 percent annual rate; real imports rose at a 10 percent annual rate.

The increase in real exports of goods and services in the second quarter was largely in aircraft and computers and to a lesser extent in consumer goods and automotive products to Canada (partly a rebound in shipments after the strike in March against GM). Shipments of gold rose sharply in the second quarter, largely

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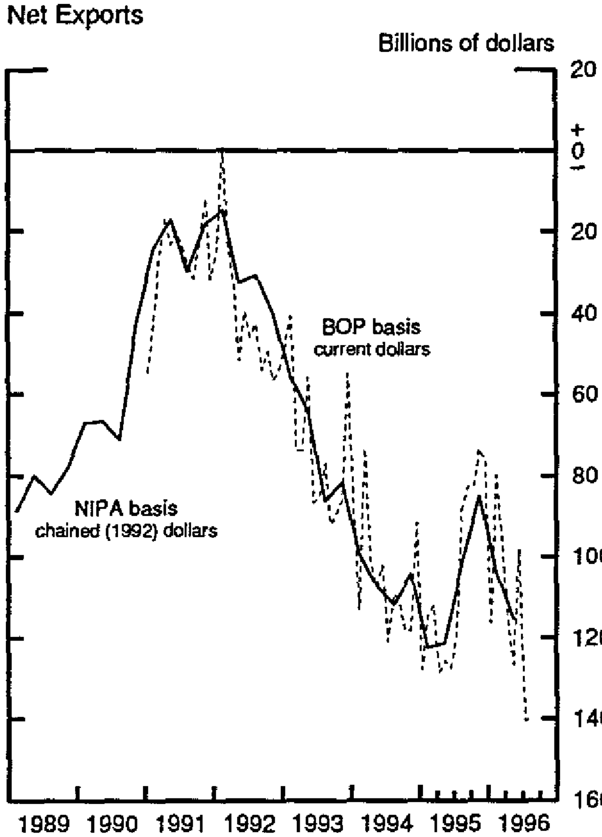
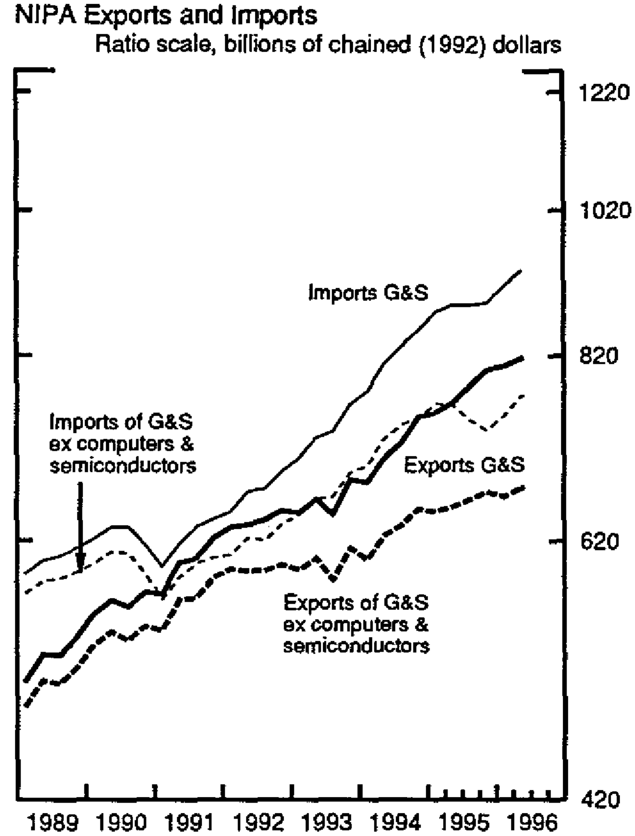
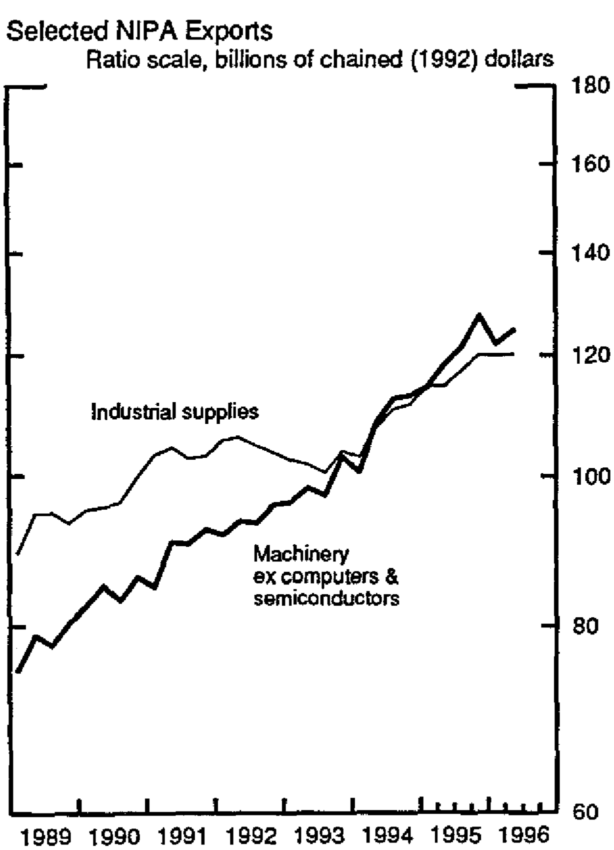
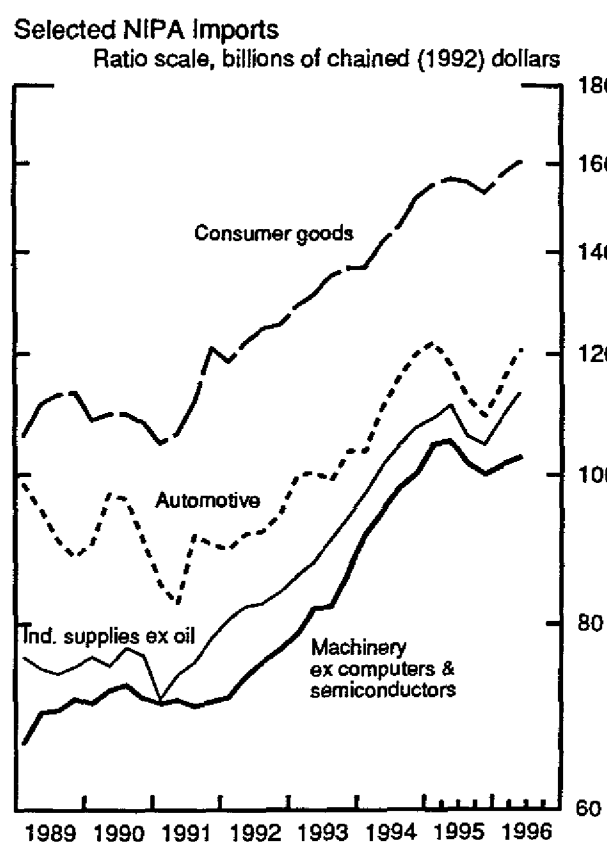
# U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)



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

| | Levels | | | | Amount Change 1/ | | | |
|---|---|---|---|---|---|---|---|---|
| | 1996 | | 1996 | | 1996 | | 1996 | |
| | Q1 | Q2 | Jun | Jul | Q1 | Q2 | Jun | Jul |
| Exports of G&S | 819.7 | 834.5 | 836.8 | 806.3 | 5.3 | 14.7 | -2.0 | -30.5 |
| Goods exports | 600.1 | 612.4 | 611.7 | 583.5 | 2.4 | 12.3 | -4.9 | -28.2 |
| Agricultural | 63.2 | 60.2 | 58.7 | 59.9 | 2.6 | -3.0 | -2.7 | 1.2 |
| Gold | 6.3 | 12.5 | 10.4 | 4.7 | 2.6 | 6.2 | -1.3 | -5.7 |
| Other goods | 530.5 | 539.7 | 542.6 | 518.9 | -0.7 | 2.3 | -1.0 | -23.7 |
| Aircraft & pts | 26.5 | 33.4 | 32.3 | 24.0 | 1.4 | 6.9 | -2.3 | -8.3 |
| Computers | 45.4 | 43.2 | 42.1 | 42.0 | 2.0 | -2.2 | -1.2 | -0.1 |
| Semiconductors | 37.5 | 34.9 | 34.6 | 33.1 | -0.2 | -2.6 | -0.2 | -1.5 |
| Other cap gds | 138.4 | 140.2 | 140.0 | 141.2 | -4.1 | 1.7 | -0.5 | 1.2 |
| Automotive | 62.0 | 63.0 | 66.3 | 62.2 | 0.0 | 1.0 | 2.0 | -4.1 |
| to Canada | 33.1 | 34.6 | 36.5 | 34.3 | -1.1 | 1.5 | 2.3 | -2.2 |
| to Mexico | 7.6 | 7.9 | 8.4 | 6.9 | 0.6 | 0.3 | -0.5 | -1.5 |
| to ROW | 21.3 | 20.5 | 21.4 | 21.0 | 0.5 | -0.7 | 0.2 | -0.4 |
| Ind supplies | 128.9 | 129.3 | 130.7 | 125.0 | -1.7 | 0.4 | 1.7 | -5.7 |
| Consumer goods | 67.9 | 70.5 | 71.3 | 66.6 | 2.1 | 2.6 | 0.3 | -4.6 |
| All other | 23.9 | 25.2 | 25.3 | 24.8 | -2.3 | 1.3 | 1.2 | -0.6 |
| Services exports | 219.7 | 222.1 | 225.1 | 222.8 | 2.9 | 2.4 | 3.0 | -2.3 |
| Imports of G&S | 917.1 | 947.8 | 935.0 | 946.5 | 25.1 | 30.7 | -30.2 | 11.4 |
| Goods imports | 771.0 | 800.4 | 787.1 | 793.7 | 21.2 | 29.3 | -31.0 | 6.6 |
| Petroleum | 55.9 | 70.1 | 67.5 | 72.2 | 2.4 | 14.1 | -5.0 | 4.7 |
| Gold | 6.8 | 14.6 | 9.9 | 5.5 | 3.3 | 7.8 | -5.2 | -4.4 |
| Other goods | 708.3 | 715.7 | 709.7 | 716.1 | 3.9 | 1.8 | -20.8 | 6.4 |
| Aircraft & pts | 11.0 | 12.7 | 14.5 | 12.2 | 0.4 | 1.7 | 1.6 | -2.3 |
| Computers | 62.2 | 60.5 | 57.6 | 61.4 | 0.3 | -1.7 | -4.2 | 3.9 |
| Semiconductors | 43.7 | 37.0 | 34.4 | 32.9 | -0.9 | -6.7 | -3.5 | -1.6 |
| Other cap gds | 116.7 | 115.5 | 116.8 | 116.4 | 1.8 | -1.2 | 1.4 | -0.3 |
| Automotive | 125.0 | 131.1 | 129.4 | 133.2 | 5.7 | 6.1 | -8.3 | 3.8 |
| from Canada | 45.7 | 49.2 | 49.1 | 49.6 | -0.1 | 3.5 | -1.8 | 0.4 |
| from Mexico | 22.8 | 24.1 | 24.0 | 21.3 | 1.7 | 1.3 | -1.4 | -2.7 |
| from ROW | 56.4 | 57.8 | 56.3 | 62.3 | 4.1 | 1.3 | -5.1 | 6.0 |
| Ind supplies | 124.2 | 126.9 | 126.2 | 128.9 | 2.5 | 2.7 | -2.2 | 2.7 |
| Consumer goods | 163.4 | 166.3 | 166.2 | 166.8 | 4.8 | 3.0 | -4.4 | 0.6 |
| Foods | 34.2 | 35.9 | 35.2 | 35.2 | 1.5 | 1.7 | -1.1 | 0.0 |
| All other | 28.0 | 29.7 | 29.4 | 29.0 | -0.6 | 1.7 | -0.1 | -0.3 |
| Services imports | 146.1 | 147.5 | 147.9 | 152.7 | 3.9 | 1.3 | 0.8 | 4.8 |
| Memo: | | | | | | | | |
| Oil qty (mb/d) | 8.74 | 9.83 | 9.93 | 10.51 | -0.56 | 1.08 | -0.10 | 0.58 |
| Oil price ($/bbl) | 17.56 | 19.53 | 18.62 | 18.80 | 1.80 | 1.97 | -1.16 | 0.18 |

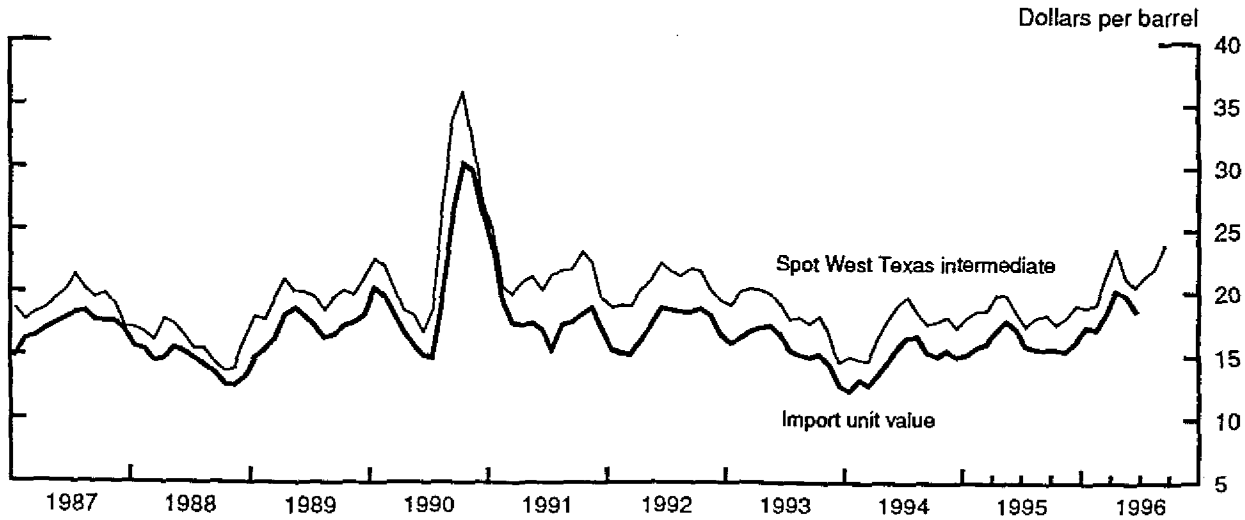
1. Change from previous quarter or month.

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

| | Annual rates | | | Monthly rates | | |
|---|---|---|---|---|---|---|
| | 1995 | 1996 | | 1996 | | |
| | Q4 | Q1 | Q2 | May | Jun | Jul |
| | -----------BLS prices (1990=100)----------- | | | | | |
| Merchandise imports | -1.1 | 2.4 | 1.6 | -0.6 | -1.1 | -0.2 |
| Oil | 0.4 | 47.4 | 41.4 | -3.3 | -6.5 | 1.5 |
| Non-oil | -1.1 | -1.2 | -2.3 | -0.4 | -0.5 | -0.4 |
| Foods, feeds, bev. | -7.4 | -4.5 | 11.5 | 0.5 | -2.7 | -1.2 |
| Ind supp ex oil | 0.2 | -3.1 | -5.0 | -0.9 | -0.4 | -0.8 |
| Computers | -7.5 | -8.1 | -16.9 | -1.5 | -1.7 | -0.4 |
| Capital goods ex comp | -2.5 | -0.4 | -4.4 | -0.4 | -0.3 | -0.2 |
| Automotive products | 1.6 | -0.8 | -0.3 | -0.1 | -0.2 | 0.2 |
| Consumer goods | -0.0 | 1.2 | -0.9 | 0.0 | -0.3 | -0.2 |
| Merchandise exports | 0.0 | 1.0 | 2.6 | 0.4 | -0.2 | -0.5 |
| Agricultural | 23.0 | 13.8 | 31.4 | 3.1 | -2.2 | -2.0 |
| Nonagricultural | -2.7 | -0.9 | -1.0 | 0.0 | 0.1 | -0.3 |
| Ind supp ex ag | -11.0 | -3.6 | -4.8 | 0.0 | -0.1 | -0.5 |
| Computers | -7.4 | -9.2 | -7.5 | -0.7 | -0.1 | -2.0 |
| Capital goods ex comp | 1.8 | 2.3 | 1.8 | 0.0 | 0.4 | -0.1 |
| Automotive products | 5.0 | -0.1 | 0.2 | 0.2 | 0.0 | 0.0 |
| Consumer goods | 0.4 | 2.3 | 1.5 | -0.3 | 0.1 | 0.0 |
| | ---Prices in the NIPA accounts (1992=100)-- | | | | | |
| Fixed-weight | | | | | | |
| Imports of gds & serv. | -2.3 | 0.1 | 0.8 | ... | ... | ... |
| Non-oil merchandise | -2.4 | -3.1 | -3.5 | ... | ... | ... |
| Exports of gds & serv. | -1.0 | 0.2 | 1.6 | ... | ... | ... |
| Nonag merchandise | -4.0 | -2.2 | -2.3 | ... | ... | ... |

9-18-96

## Oil Prices



reflecting foreign holdings at the FRBNY being transferred out of the country; imports of gold were raised by a similar amount in the second quarter as the gold left the FRBNY and moved into U.S. customs territory. Net exports of gold in the second quarter were close to zero. By area, the increase in merchandise exports over the first half of 1996 was largely to Canada, Mexico, and the United Kingdom.

The sharp increase in imports in the second quarter was spread among almost all major trade categories and largely reflected the strength of U.S. economic activity during the first half of the year. One exception to this trend was imports of semiconductors which dropped substantially.

About half of the rise in the value of imports was in imported oil. The increase in the second quarter was about evenly split between price and quantity. A larger than normal seasonal inventory accumulation that has rebuilt stocks from historically low levels offset the seasonal decline in oil consumption. Preliminary Department of Energy statistics indicate that oil imports declined a bit on average in August from the brisk July pace as refiners trimmed stocks in anticipation of a decline in crude prices once oil shipments from Iraq commence.

Oil prices. In July, the price of imported oil increased slightly. This increase followed substantial price declines during the previous two months. The decline in oil prices between April and July reflected an unwinding of temporary weather and production shocks to the oil market earlier in the year. Even after declines in May and June, the price of imported oil in the second quarter was 11 percent higher than in the first quarter. Spot WTI rose nearly $0.90 per barrel in July, averaging $21.32 per barrel and rose another $0.70 per barrel in August. Following recent political upheaval in Northern Iraq, spot WTI has been quite volatile and is trading in the $22.00-24.00 per barrel range. Although Iraq reached an agreement in July with the United Nations to export a limited quantity of oil (estimated to be 800,000 b/d) under U.N. supervision, oil prices have remained firm since then because of uncertainty regarding the timing of these oil flows. On September 1, the U.N. Secretary General announced that these oil sales would be postponed.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports declined slightly in July, about the same as in each of the two previous months. There were decreases in prices of all major end-use categories (particularly foods and industrial supplies) with the exception of automotive products (which rose slightly).

In the second quarter, prices of non-oil imports decreased at a rate that was slightly more than in the two previous quarters. Prices of imported capital goods (especially computers and semiconductors) and industrial supplies fell sharply. These decreases were only partly offset by substantial price increases in a broad array of imported foods (coffee, grains, and vegetables) that occurred early in the quarter.

Prices of exports declined slightly in July, primarily because of falling prices of agricultural products, as agricultural developments in the northern hemisphere reported recently have pointed to a robust supply response this fall. Agricultural export prices had been recording double-digit increases from September 1995 through May 1996, following disappointing grain harvests last year at a time of vigorous world demand. Prices of nonagricultural products have declined in each of the past four quarters at a 5-10 percent annual rate (led by decreases in prices of exported industrial supplies and computers). These prices also declined in July.

Price data for August will be released on September 24.

U.S. Current Account through 1996-Q2

The U.S. current-account deficit widened $15.6 billion SAAR in the second quarter. The increase in the deficit on goods and services (described above) and a shift to a deficit on investment income more than offset lower net unilateral transfers.

Net investment income swung back into deficit in the second quarter as income payments to foreigners on investments in the United States rose more than U.S. income receipts on earnings from investments abroad. Net unilateral transfers were smaller in the second quarter than in the first quarter because of a reduction in U.S. Government grants; grants in the first quarter had been boosted by outflows displaced from the fourth quarter of 1995 by temporary Federal Budget constraints.

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

| | Goods & services balance | Investment income, net | Transfers, net | Current acct balance |
|---|---|---|---|---|
| Years | | | | |
| 1994 | -104.4 | -4.2 | -39.9 | -148.4 |
| 1995 | -105.1 | -8.0 | -35.1 | -148.2 |
| Quarters | | | | |
| 1994-1 | -90.8 | 4.7 | -32.7 | -118.8 |
| 2 | -103.5 | -2.5 | -38.0 | -144.1 |
| 3 | -113.8 | -6.4 | -39.9 | -160.0 |
| 4 | -109.4 | -12.4 | -48.9 | -170.6 |
| 1995-1 | -118.1 | -3.6 | -34.6 | -156.2 |
| 2 | -127.3 | -3.4 | -33.2 | -163.9 |
| 3 | -97.3 | -17.4 | -36.0 | -150.8 |
| 4 | -77.6 | -7.6 | -36.6 | -121.7 |
| 1996-1 | -96.9 | 1.0 | -43.6 | -139.5 |
| -2 | -111.5 | -6.4 | -37.2 | -155.1 |
| Memo: | | | | |
| $ Change | | | | |
| Q4-Q3 | 19.8 | 9.9 | -0.6 | 29.0 |
| Q1-Q4 | -19.3 | 8.6 | -7.0 | -17.7 |
| Q2-Q1 | -14.6 | -7.5 | 6.4 | -15.6 |

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

U.S. International Financial Transactions

Net private foreign purchases of U.S. Treasury securities were huge in July. (See line 4a of the Summary of U.S. International Transactions table.) About 60 percent of this total was booked in a single location, the Netherlands Antilles; moreover, these latter purchases were financed primarily by RP transactions with banks and securities dealers in the United States, accounting for more than half of the large net outflow reported in line 3 of the Summary table. However, monthly average data for banks (but excluding securities dealers and IBFs) show none of the outflow registered in the end-of-month data for July, and only a small net outflow in August (line 1 of the International Banking Data table).

Net foreign private purchases of corporate and other bonds were also quite strong in July, but almost half of the total was for U.S. government agency bonds (line 4b of the Summary table). Although private foreigners sold U.S. corporate stocks net in July,

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

| | 1994 | 1995 | 1995 Q3 | 1995 Q4 | 1996 Q1 | 1996 Q2 | 1996 Jun | 1996 Jul |
|---|---|---|---|---|---|---|---|---|
| Official capital | | | | | | | | |
| 1. Change in foreign official reserve assets in U.S. (increase, +) | 38.0 | 109.8 | 39.6 | 10.8 | 52.2 | 13.4 | 6.6 | 3.1 |
| a. G-10 countries | 28.9 | 33.1 | 5.6 | -3.6 | 28.5 | 3.5 | 1.5 | -2.6 |
| b. OPEC countries | -3.3 | 4.3 | 6.2 | -2.1 | -.8 | 5.3 | .9 | .6 |
| c. All other countries | 12.4 | 72.5 | 27.7 | 16.6 | 24.5 | 4.5 | 4.2 | 5.1 |
| 2. Change in U.S. official reserve assets (decrease, +) | 5.3 | -9.7 | -1.9 | .2 | * | -.5 | -.1 | -.2 |
| Private capital | | | | | | | | |
| Banks | | | | | | | | |
| 3. Change in net foreign positions of banking offices in the U.S.[1] | 102.6 | -30.1 | -7.0 | 10.0 | -28.7 | -11.3 | -25.3 | -29.4 |
| Securities[2] | | | | | | | | |
| 4. Foreign net purchases of U.S. securities (+) | 92.9 | 190.7 | 69.8 | 23.5 | 48.5 | 60.3 | 22.8 | 46.1 |
| a. Treasury securities[3] | 34.7 | 99.8 | 37.4 | 1.8 | 12.0 | 31.3 | 14.2 | 38.3 |
| b. Corporate and other bonds[4] | 53.9 | 82.6 | 27.0 | 17.7 | 32.7 | 22.7 | 7.6 | 9.3 |
| c. Corporate stocks | 4.3 | 8.2 | 5.3 | 4.0 | 3.8 | 6.3 | .9 | -1.4 |
| 5. U.S. net purchases (-) of foreign securities | -57.3 | -98.8 | -35.7 | -32.5 | -34.5 | -19.9 | -9.4 | -7.0 |
| a. Bonds | -9.2 | -48.5 | -13.6 | -18.7 | -12.0 | -2.6 | -1.9 | -3.4 |
| b. Stocks | -48.1 | -50.3 | -22.1 | -13.8 | -22.5 | -17.5 | -7.5 | -3.6 |
| Other flows (quarterly data, s.a.) | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -54.5 | -95.5 | -18.0 | -44.1 | -23.2 | -23.0 | n.a | n.a |
| 7. Foreign direct investment in U.S. | 49.8 | 60.2 | 25.0 | 14.8 | 28.7 | 10.7 | n.a | n.a |
| 8. Other (inflow, +)[5] | -42.1 | -9.9 | 5.6 | 18.3 | -12.2 | 1.5 | n.a | n.a |
| U.S. current account balance (s.a.) | -148.4 | -148.2 | -37.7 | -30.4 | -34.9 | -38.8 | n.a | n.a |
| Statistical discrepancy (s.a.) | -13.7 | 31.5 | -41.5 | 29.4 | 4.1 | 7.6 | n.a | n.a |

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

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.
2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.
3. Includes Treasury bills.
4. Includes U.S. goverment agency bonds.
5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

| | 1992 Dec. | 1993 Dec. | 1994 Dec. | 1995 Dec. | 1996 Mar. | 1996 Jun. | 1996 Jul. | 1996 Aug. |
|---|---|---|---|---|---|---|---|---|
| 1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs | -71.6 | -122.1 | -224.0 | -260.0 | -260.1 | -245.0 | -245.8 | -240.4 |
| a. U.S.-chartered banks | -17.0 | 4.2 | -70.1 | -86.1 | -84.1 | -77.2 | -72.3 | -70.7 |
| b. Foreign-chartered banks | -88.6 | -126.3 | -153.9 | -173.9 | -176.0 | -167.8 | -173.5 | -169.7 |
| 2. Credit extended to U.S. nonbank residents | | | | | | | | |
| a. By foreign branches of U.S. banks | 24.8 | 21.8 | 23.1 | 26.5 | 27.3 | 28.8 | 28.9 | 28.6 |
| b. By Caribbean offices of foreign-chartered banks | n.a. | 90.9 | 78.4 | 86.3 | 90.0 | 85.4 | 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 | 91.2 | 95.7 | 101.0 | 100.1 | 101.1 |
| b. At the Caribbean offices of foreign-chartered banks | n.a. | 79.2 | 86.0 | 92.3 | 96.6 | 97.7 | n.a. | n.a. |
| MEMO: Data as recorded in the U.S. international transactions accounts | | | | | | | | |
| 4. Credit extended to U.S. nonbank residents | 172.8 | 180.1 | 172.6 | 207.3 | 212.7 | n.a. | n.a. | n.a. |
| 5. Eurodeposits of U.S. nonbank residents | 218.8 | 213.7 | 243.8 | 276.9 | 290.0 | n.a. | n.a. | n.a. |

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

Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR2951.

Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s.

Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994.

Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. They include some foreign-currency denominated deposits and loans. Source: SCB the absolute size of the outflow continued at the low levels observed in recent months (line 4c).

U.S. investors purchased foreign securities net at a moderate rate in July, about equally divided between bonds and stocks (lines 5a and 5b of the Summary table). These purchases were not concentrated in any particular country or region.

The increase in foreign official reserve assets held in the United States was smaller in July than in June (line 1). Partial information from FRBNY indicates more substantial increases in August and early September.

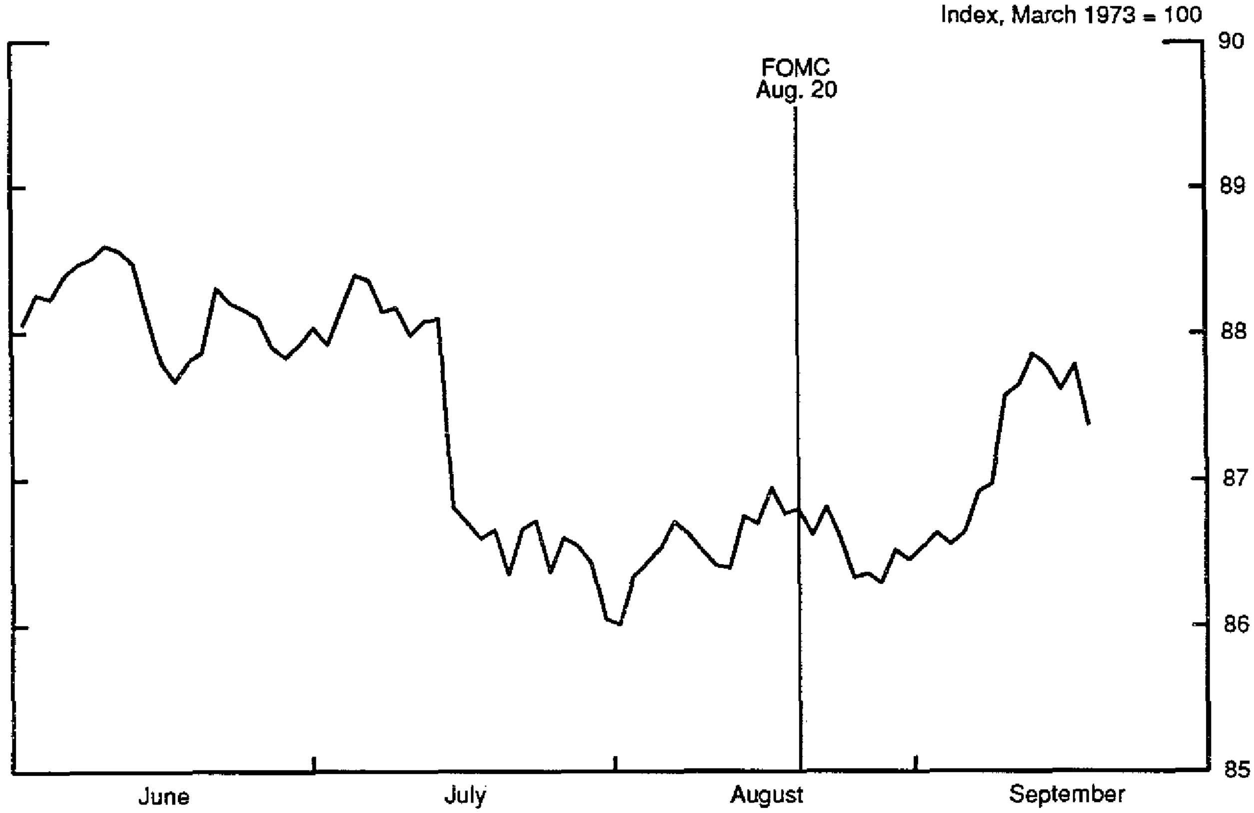
Recently released data on direct investment capital flows for the second quarter show a continuation of strong capital outflows from the United States (line 6). Direct investment capital inflows fell significantly in the second quarter (line 7); since there was no evidence of a fall-off in foreign takeovers in the United States, the lower capital inflows suggest a shift in the financing of these activities to domestic U.S. sources.

Foreign Exchange and Foreign Financial Markets

The weighted-average dollar has appreciated about 1/2 percent on balance since the time of the August FOMC meeting. The dollar rose during the first week and a half of September amid heightened market expectations of an imminent tightening of U.S. monetary policy. These expectations receded somewhat after the release of softer-than-expected data on retail sales and consumer prices. The dollar fell back on September 18, mainly on the release of data showing a bigger-than-expected jump in the U.S. trade deficit in July. The dollar's move upward earlier in the period was preceded by a rise in U.S. long-term interest rates, that on average, was not matched abroad. On balance, during this period, the differential between U.S. and average foreign long-term interest rates has widened about 35 basis points in favor of the dollar.

Since August 20, the dollar gained 3/4 percent against the Japanese yen, as market participants reassessed the strength of the current economic expansion in Japan. The weaker-than-expected Tankan survey for August suggested a lower likelihood of a near-term increase in official interest rates. The release of data showing that real GDP declined in the second quarter as well as the increased likelihood of an early general election in October

## Weighted Average Exchange Value of the Dollar
(Daily data)




## Interest Rates in Major Industrial Countries

| | Three-month rates | | | Ten-year bond yields | | |
|---|---|---|---|---|---|---|
| | Aug. 20 | Sept. 18 | Change | Aug. 20 | Sept.18 | Change |
| Germany | 3.25 | 3.00 | -0.25 | 6.25 | 6.16 | -0.09 |
| Japan | 0.60 | 0.53 | -0.07 | 3.12 | 2.86 | -0.26 |
| United Kingdom | 5.72 | 5.75 | 0.03 | 7.76 | 7.78 | 0.02 |
| Canada | 4.29 | 4.05 | -0.24 | 7.24 | 7.37 | 0.13 |
| France | 3.91 | 3.53 | -0.38 | 6.38 | 6.21 | -0.17 |
| Italy | 8.81 | 8.44 | -0.37 | 9.27 | 8.98 | -0.29 |
| Belgium | 3.26 | 2.95 | -0.31 | 6.59 | 6.37 | -0.22 |
| Netherlands | 2.89 | 2.71 | -0.18 | 6.20 | 6.02 | -0.18 |
| Switzerland | 2.25 | 1.81 | -0.44 | 4.09 | 3.89 | -0.20 |
| Sweden | 5.18 | 4.75 | -0.43 | 7.99 | 7.73 | -0.26 |
| Weighted-average foreign | 3.86 | 3.63 | -0.23 | 6.38 | 6.25 | -0.13 |
| United States | 5.38 | 5.51[P] | 0.13 | 6.59 | 6.82[P] | 0.23 |

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

contributed to this change in market perceptions. Rising tensions in Iraq and heightened concerns about the vulnerability of the Japanese economy to a sharp rise in oil prices also seemed to weigh on the yen. The yen recovered with the news of the unexpectedly large U.S. trade deficit, reversing more than half of the dollar's earlier gains against the yen.

The dollar appreciated 1-1/4 percent against the mark since the time of the August FOMC meeting. On August 22, the Bundesbank Council surprised the market and lowered the German repo rate 30 basis points to 3.00 percent, the first change in this rate since February. Central banks in Austria, Belgium, France, and the Netherlands followed the Bundesbank's action with smaller 20 basis point reductions in their official rates. The Bank of Canada also cut its official rates on August 22, bringing down its target band for the overnight rate 25 basis points to 3.75 to 4.25 percent. Sweden's Riksbank gradually lowered its repo rate 25 basis points since the August FOMC meeting.

Although prospects for German economic expansion appear to have improved, recent statements by Bundesbank officials hinting that there may be room for a further reduction in official rates if money growth continues to moderate have rekindled hopes that monetary policy will be eased a bit further. Prospects of easier monetary policy in Germany weakened the mark against several other European currencies, such as the French franc, relieving pressures felt earlier in the period. Factors that recently have weighed on the franc include worries about the weak pace of French economic expansion, concerns about the government's ability to lower the deficit/GDP ratio to 3 percent in 1997, and fears of renewed labor unrest in protest of planned public spending cuts.

Since the August FOMC meeting, 10-year rates have fallen abroad, on average nearly 15 basis points. Long-term interest rates fell in all of the major foreign industrial countries except Canada, where they rose about 15 basis points, and the United Kingdom, where they did not change, on balance, as recent indicators in both these countries have suggested a pickup in economic activity. The biggest declines in long-term rates occurred in Sweden and Italy (25-30 basis points), amid improved prospects for fiscal consolidation, better-than-expected progress in reducing inflation, and gathering evidence that economic activity has slowed. Japanese long-term rates also fell about 25 basis points, in part owing to a less sanguine view of the recent strength of the economic expansion.

Short-term interest rates in the major foreign industrial countries have fallen on average almost 25 basis points during this period. The biggest declines in 3-month rates (40-45 basis points) occurred in Italy, France, Sweden, and Switzerland. In the United Kingdom, 3-month interest rates rose slightly from their level at the time of the August FOMC meeting.

The dollar has risen more than 2-1/2 percent against the Swiss franc during this period, reflecting large liquidity injections by the Swiss National Bank aimed at reinvigorating the flagging economy and preventing, and hopefully reversing, appreciation of the franc against the mark. Over the past few years, the franc has become overvalued relative to the mark. Recently, the Swiss National Bank seems to have effectively abandoned its medium-term money supply target for an exchange rate target against the DM. Swiss call-money rates decreased more than a full percentage point since the August FOMC meeting, while 3-month rates are down nearly 45 basis points, and 10-year rates declined 20 basis points.

The dollar has weakened 3/4 percent against sterling, amid mounting evidence that U.K. economic activity has picked up lately, reducing the probability of further official interest rate cuts. The pound may have also benefited from higher oil prices as the United Kingdom is a small net exporter of oil. The dollar also declined slightly against the Canadian dollar, but appreciated about 1/2 percent against the Mexican peso during the period.

Foreign equity prices, which fell sharply in June and July, have risen on balance since the August FOMC meeting. U.K., German, and Canadian stock prices, have recovered to levels near peaks reached earlier this year. In contrast, the recovery of stock prices in France, Italy, and Japan has lagged behind, probably reflecting less optimism about economic activity in those countries.

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

Developments in Foreign Industrial Countries

A now-complete set of second-quarter GDP data for the foreign G-7 countries confirm some pickup in growth in the first half of 1996 relative to the preceding year. Despite a drop in GDP in the second quarter, Japanese growth on balance was strong in the first half, and the economy appears to have continued to expand into the summer months. German GDP rebounded sharply in the second quarter, and more recent indicators suggest further expansion. Although second-quarter GDP in the United Kingdom was held down by slower inventory investment, final demand was robust, and other indicators have been positive. Recent indicators in Canada also suggest that activity is picking up following a sluggish second quarter. In contrast, both the French and Italian economies have been stagnant in recent months.

Unemployment rates are still high in most countries, and inflation pressures remain subdued. Recent year-over-year consumer-price inflation has averaged about 1-1/2 percent in Germany and Canada, slightly more in France, and under 3 percent in the United Kingdom. Italian inflation has continued to trend down, dipping below 3-1/2 percent in August. As a result of yen depreciation, Japanese prices have risen slightly this year after declining throughout most of 1995.

Fiscal policy continues to be restrictive in most countries, with Germany and France in particular attempting to reduce their budget-deficit-to-GDP ratios to or below the Maastricht reference value of 3 percent by 1997. Although the Italian government does not expect to reach a 3 percent budget balance ratio, a substantial reduction is planned there as well.

Individual country notes. In **Japan** real GDP declined 2.9 percent (SAAR) in the second quarter, after a downward-revised 12.2 percent increase in the first quarter. A sharp drop in private consumption accounted for the entire decrease in GDP, while growth in private residential and nonresidential investment roughly offset declines in inventory investment, government consumption, and net exports. About 2 percentage points of the decline in GDP is accounted for by the extra leap-year day in the first quarter.

JAPANESE REAL GDP
(Percent change from previous period, SAAR)[1]

| | 1994 | 1995 | 1995 Q3 | 1995 Q4 | 1996 Q1 | 1996 Q2 |
|---|---|---|---|---|---|---|
| GDP | 0.4 | 2.5 | 2.3 | 4.8 | 12.2 | -2.9 |
| Total Domestic Demand | 0.4 | 3.8 | 4.6 | 7.2 | 13.7 | -2.2 |
| Consumption | 1.1 | 2.6 | 4.7 | 2.5 | 9.9 | -5.0 |
| Investment | -1.4 | 6.2 | 4.3 | 19.1 | 19.7 | 6.8 |
| Government Consumption | 0.6 | 2.8 | 1.0 | -1.5 | 13.9 | -5.2 |
| Inventories (contribution) | 0.2 | 0.1 | 0.3 | 0.3 | 0.4 | -0.7 |
| Exports | 9.0 | 3.8 | -6.3 | 5.1 | -7.0 | 4.0 |
| Imports | 11.3 | 16.5 | 12.6 | 28.4 | 3.6 | 10.8 |
| Net Exports (contribution) | -0.0 | -1.3 | -2.1 | -2.3 | -1.3 | -0.7 |

1. Annual changes are Q4/Q4.

Recent indicators point to continued expansion. In July, industrial production was about 2-1/2 percent above its second-quarter level, while machinery orders and housing starts grew at a robust pace. New car registrations dipped in August following a large gain in July, but remain on an upward trend. The unemployment rate dropped slightly in July, and the ratio of job offers to job applicants has increased gradually since late last year.

The Bank of Japan's August survey (Tankan) registered a small decrease in the diffusion index of business sentiment at major manufacturers from its May level, contrary to market expectations of a slight increase. Although the indexes for smaller manufacturers and major non-manufacturers increased modestly in the August survey, the index for smaller non-manufacturers edged down. Fixed investment plans for the current fiscal year of both large and small manufacturers increased sharply over their year-ago levels.

Month-to-month changes in wholesale and consumer prices have been positive in recent months. These increases stem from the effect of past yen depreciation on import prices, as prices of domestically produced goods have continued to decline.

The current account surplus increased sharply in May following many months of decline and rose further in June before edging down in July. The merchandise trade surplus was $6.7 billion (SA) in August, up sharply from the second-quarter average.

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

| | 1996 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | May | Jun | Jul | Aug |
| Industrial Production | 0.4 | -0.3 | n.a. | 2.4 | -4.3 | 4.9 | n.a. |
| Housing Starts | 1.6 | 1.4 | n.a. | 3.5 | -11.0 | 13.4 | n.a. |
| Machinery Orders | 3.4 | 0.8 | n.a. | -5.0 | -7.6 | 24.4 | n.a. |
| New Car Registrations | 2.4 | -7.7 | n.a. | 11.8 | -7.8 | 8.0 | -3.1 |
| Unemployment Rate (%) | 3.3 | 3.5 | n.a. | 3.5 | 3.5 | 3.4 | n.a. |
| Job Offers Ratio[1] | 0.67 | 0.69 | n.a. | 0.69 | 0.71 | 0.72 | n.a. |
| Business Sentiment[2] | -12 | -3 | -7 | ... | ... | ... | ... |
| CPI (Tokyo area)[3] | -0.3 | 0.1 | n.a. | 0.1 | -0.1 | 0.4 | 0.1 |
| Wholesale Prices[3] | 0.0 | 1.3 | n.a. | 1.3 | 1.4 | 1.4 | 0.5 |

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

Real GDP in **Germany** rebounded sharply in the second quarter, rising more than 6 percent (SAAR), following a 2 percent decline in the first quarter. Domestic demand and net exports contributed about equally to second-quarter growth. Investment was particularly strong, as construction activity surged following the unseasonably cold winter, although spending on machinery and equipment remained lackluster. Private consumption registered a healthy increase, while government expenditures rose despite a freeze on federal expenditures imposed by the Finance Ministry in mid-March. The improvement in net exports reflected an increase in exports coupled with a drop in imports. A sizable decline in the level of inventory investment, which is a residual in the national accounts and can be subject to substantial revision, made a significant negative contribution to growth in the second quarter.

Limited information available for the third quarter suggests that activity continued to expand, albeit at a somewhat more muted pace. Industrial production in July was nearly 1 percent above its second-quarter average level, and manufacturing orders continued to trend up. A rise in the IFO business climate survey in July more than reversed the surprising drop in June. Unemployment, while still high, has levelled out at just above 3.9 million workers (s.a.), and the all-German unemployment rate has remained at

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

| | 1994 | 1995 | 1995 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q3 | Q4 | Q1 | Q2 |
| GDP | 3.6 | 1.1 | 0.4 | 0.0 | -1.9 | 6.1 |
| Total Domestic Demand | 4.0 | 0.9 | -0.5 | 0.3 | -1.8 | 3.1 |
| Consumption | 0.3 | 3.0 | -0.2 | -0.9 | 2.4 | 3.5 |
| Investment | 8.8 | -2.2 | -2.1 | -5.1 | -20.8 | 30.9 |
| Government Consumption | 2.4 | 2.5 | 3.8 | 0.8 | 2.7 | 7.0 |
| Inventories (contribution) | 1.5 | 0.0 | -0.7 | 1.8 | 1.3 | -6.2 |
| Exports | 9.5 | 5.4 | 3.5 | 3.1 | -0.2 | 3.2 |
| Imports | 11.1 | 4.6 | -0.2 | 4.2 | 0.0 | -7.0 |
| Net Exports (contribution) | -0.4 | 0.2 | 1.0 | -0.3 | -0.1 | 2.9 |

1. Annual changes are Q4/Q4.

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

| | 1995 | 1996 | | | | | |
|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | Jun | Jul | Aug |
| Industrial Production | -1.9 | -2.4 | 2.9 | 0.7 | 0.7 | 0.2 | n.a. |
| Orders | -2.9 | -0.5 | 3.7 | -0.7 | 1.9 | 0.9 | n.a. |
| Unemployment Rate (%) | 9.7 | 10.3 | 10.3 | 10.3 | 10.3 | 10.3 | 10.3 |
| Western Germany | 8.5 | 8.9 | 9.0 | 9.0 | 9.0 | 9.0 | 9.1 |
| Eastern Germany | 14.9 | 16.1 | 15.6 | 15.6 | 15.5 | 15.3 | 15.2 |
| Capacity Utilization[1] | 84.3 | 83.0 | 82.1 | ... | ... | ... | ... |
| Business Climate[1,2] | -10.3 | -15.3 | -17.3 | -16.0 | -21.0 | -14.0 | n.a. |
| Retail Sales (real)[3] | -2.0 | -1.3 | n.a. | -3.0 | n.a. | n.a. | n.a. |
| Consumer Prices[1,3] | 1.6 | 1.4 | 1.4 | 1.5 | 1.2 | 1.3 | 1.4 |

1. Western Germany.
2. Percent of firms (in manufacturing, construction, wholesale, and retail) citing an improvement in business conditions (current and expected over the next six months) less those citing a deterioration in conditions.
3. Percent change from previous year.

10.3 percent since April. Inflation remains subdued, with producer prices down over the past 12 months and consumer prices up by a little under 1-1/2 percent.

The 1997 draft federal budget was approved by Chancellor Kohl's cabinet in mid-July. Many of the austerity measures incorporated into the 1997 draft budget stem from the fiscal plan proposed last April. Measures in the plan have been split into five different pieces of legislation, three of which received final parliamentary approval on September 13. The remaining two pieces of legislation require the explicit approval of the Bundesrat (the upper house of the German parliament). With the draft budget, which includes very low wage increases for public sector employees, as well as some spending reductions at the state and local level, the German Finance Ministry hopes to move the deficit of the consolidated general government sector to 2-1/2 percent of GDP in 1997, below the Maastricht reference value.

In **France**, real GDP contracted 1.5 percent (SAAR) in the second quarter following a 4.5 percent increase in the first quarter. The swing in growth between the first and second quarters was exaggerated by both inadequate adjustment for leap year as well as a first-quarter rebound from the public sector strikes at the end of last year. However, even abstracting from these effects some slowing in demand appears to have occurred in the second quarter. Private consumption, the category most affected by the strike, was only slightly above its average level over the preceding half-year in the second quarter, while investment declined for the third straight quarter and government spending slowed. Inventories continued to be drawn down, although at a more moderate pace than in the first quarter. Net exports contributed negatively to GDP growth as a result of a sharp decline in exports.

Monthly indicators for the third quarter are scant (and combined July-August data will not be available until late September). In July, the unemployment rate was unchanged at its all-time high, and business and consumer sentiment remained subdued. The fall in consumer prices in July and August reflected lower food and energy prices, as well as soft domestic demand.

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

| | 1994 | 1995 | 1995 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q3 | Q4 | Q1 | Q2 |
| GDP | 4.2 | 0.4 | 0.5 | -1.8 | 4.5 | -1.5 |
| Total Domestic Demand | 4.9 | 0.4 | 3.4 | -3.2 | 2.3 | -0.2 |
| Consumption | 1.6 | 1.1 | -0.3 | -1.0 | 10.5 | -3.8 |
| Investment | 4.7 | 0.1 | 6.8 | -1.6 | -1.5 | -2.3 |
| Government Consumption | 0.6 | 1.1 | 1.6 | 1.5 | 1.9 | 0.8 |
| Inventories (contribution) | 2.8 | -0.5 | 1.9 | -2.6 | -4.0 | 2.4 |
| Exports | 7.6 | 0.8 | -3.9 | -4.2 | 14.6 | -6.7 |
| Imports | 10.2 | 0.9 | 5.7 | -9.0 | 6.5 | -2.5 |
| Net Exports (contribution) | -0.7 | -0.0 | -2.8 | 1.5 | 2.2 | -1.3 |

1. Annual changes are Q4/Q4.

On September 18, the government unveiled its 1997 central government budget, designed to reduce the consolidated deficit to 3 percent in 1997. The central government deficit is projected to narrow only a small amount, as tax reform implies a gross cut of FF25 billion (1/4 percent of GDP), while nominal spending is held to the 1996 budgeted levels. The 3 percent target is expected to be attained through an improvement in the social security deficit, expected surpluses on other welfare accounts, and creative accounting measures (such as a one-time payment from France Telecom worth 1/2 percent of GDP).

Earlier in September the government announced a five-year tax reform program beginning next year that includes lower income tax rates and payroll taxes partially offset by fewer deductions, higher excise taxes, and a one-percent hike in the CSG (a flat tax on most forms of income), the base of which will also be widened. One objective of the reform is to boost consumption by lowering income taxes, while raising other taxes in order to underline the government's commitment to fiscal consolidation.

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

| | 1995 | 1996 | | | | | |
|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | Jun | Jul | Aug |
| Industrial Production | -1.6 | 1.3 | 0.2 | 0.8 | -0.2 | n.a. | n.a. |
| Capacity Utilization | 83.6 | 83.8 | 83.0 | ... | ... | ... | ... |
| Unemployment Rate (%) | 11.9 | 12.2 | 12.4 | 12.4 | 12.5 | 12.5 | n.a. |
| Consumption of Manufactured Products | -2.0 | 4.9 | -1.6 | 0.2 | 2.0 | n.a. | n.a. |
| Consumer Prices[1] | 1.9 | 2.1 | 2.4 | 2.4 | 2.3 | 2.3 | 1.7 |

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

Second-quarter GDP growth for the **United Kingdom** was revised downward slightly to 1.5 percent (SAAR), about the same rate as in the first quarter. Growth of final domestic demand was quite robust (3.7 percent, SAAR), as both private consumption and investment expanded strongly. A sharp slowdown in inventory accumulation provided the main offset to positive growth in other components of domestic demand.

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

| | 1994 | 1995 | 1995 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q3 | Q4 | Q1 | Q2 |
| GDP | 4.3 | 1.9 | 2.5 | 1.6 | 1.6 | 1.5 |
| Total Domestic Demand | 3.4 | 0.9 | 1.8 | 1.6 | 3.5 | 0.7 |
| Consumption | 2.6 | 1.6 | 0.0 | 2.6 | 3.8 | 2.7 |
| Investment | 3.4 | -2.8 | -2.4 | 0.5 | 6.3 | 8.7 |
| Government Consumption | 1.9 | 1.1 | 0.5 | 0.5 | 0.3 | 2.7 |
| Inventories (contribution) | 0.8 | 0.1 | 2.1 | -0.2 | 0.0 | -2.9 |
| Exports | 10.6 | 5.1 | 13.2 | 2.2 | 5.3 | n.a. |
| Imports | 7.3 | 2.1 | 8.9 | 2.4 | 12.1 | n.a. |
| Net Exports (contribution) | 0.7 | 0.8 | 1.1 | -0.1 | -1.9 | n.a. |
| Non-oil GDP | 4.1 | 1.7 | 2.3 | 1.5 | 1.5 | 1.5 |

1. Annual changes are Q4/Q4.

Indicators from the third quarter on balance point to a pickup in the pace of economic activity. Retail sales fell in July but rebounded strongly in August, confirming recent survey evidence suggesting a significant increase in consumer demand. Industrial production moved up in July following a sharp fall in June to a level a little above the second-quarter average. The purchasing managers' index for August was at its highest level in a year and signaled particular strength in manufacturing output, while the unemployment rate continued to decline, reaching 7.5 percent in August. Consumer price inflation has held steady around 2-3/4 percent in recent months, a little above the government's target rate of 2-1/2 percent or less.

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

| | 1995 | 1996 | | | | | |
|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | Jun | Jul | Aug |
| Industrial Production | -0.1 | 0.2 | 0.1 | 1.0 | -0.8 | 0.5 | n.a. |
| Retail Sales | 0.7 | 0.4 | 1.2 | 0.3 | 1.5 | -0.5 | 1.0 |
| Unemployment Rate (%) | 8.0 | 7.9 | 7.7 | 7.7 | 7.7 | 7.6 | 7.5 |
| Consumer Prices[1] | 2.9 | 2.9 | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 |
| Producer Input Prices[2] | 6.5 | 3.0 | 0.0 | 0.3 | -2.3 | -2.4 | -2.2 |
| Average Earnings[2] | 3.3 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 | n.a. |

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

In **Italy**, the advance GDP release stated that real economic activity declined 2 percent (SAAR) in the second quarter. [No further details will be available until final second-quarter GDP is released on October 4.] This drop reversed the first-quarter increase, with both movements largely due to inadequate adjustment for the leap year. Little information is available beyond the second quarter; consumer confidence declined in July, although it was a little above its second-quarter average.

News on inflation continues to be encouraging. Consumer price inflation on a year-over-year basis fell in August to its lowest level in 27 years. Further progress on consumer price inflation is likely in light of continued moderation in wholesale and producer price inflation, reflecting the appreciation of the lira over the past year and a half.

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

| | 1995 | 1996 | | | | | |
|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | Jun | Jul | Aug |
| Industrial Production | -0.9 | -2.0 | -1.4 | 0.4 | 2.9 | n.a. | n.a. |
| Cap. Utilization (%) | 78.5 | 75.9 | 76.6 | ... | ... | ... | ... |
| Unemployment Rate (%) | 11.9 | 12.0 | 12.2 | ... | ... | ... | ... |
| Consumer Confidence[1] | 110.0 | 107.7 | 113.8 | 114.8 | 117.9 | 115.0 | n.a. |
| Bus. Sentiment[2] (%) | 11.3 | 15.7 | -1.0 | -4.0 | -9.0 | n.a. | n.a. |
| Consumer Prices[3] | 5.9 | 5.0 | 4.3 | 4.3 | 3.9 | 3.6 | 3.4 |
| Wholesale Prices[3] | 10.6 | 7.7 | 3.5 | 3.5 | 2.4 | 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.

Prime Minister Romano Prodi is expected to present his government's 1997 federal budget to parliament by the end of September. The government's 1997-1999 economic planning document--which forms the basis of next year's budget--calls for the general government deficit to improve to 4.4 percent of GDP, falling short of the Maastricht Treaty reference value of 3 percent in 1997.[1]

Economic activity in **Canada** expanded at a slow pace in the second quarter. Although the rate of growth was the same as in the first quarter, it reflected a considerably weaker domestic economy offset by a rebound in net exports. Consumption expenditures were about flat, while business fixed investment declined, as a pickup in residential construction was offset by declines in machinery and equipment investment and non-residential construction. A large draw-down in inventories, following ten consecutive quarters of accumulation, subtracted 2.9 percent from the quarter's growth. Net exports made a large positive contribution, as exports increased

[1] The 4.4 percent figure is on a cash basis, not a national income basis; when adjusted to conform to the Maastricht definition, the figure is closer to 5.4 percent.

while imports declined, reflecting the weakness in consumer spending and the decline in machinery and equipment investment.

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

| | 1994 | 1995 | 1995 Q3 | 1995 Q4 | 1996 Q1 | 1996 Q2 |
|---|---|---|---|---|---|---|
| GDP | 4.9 | 0.7 | 1.2 | 0.9 | 1.3 | 1.3 |
| Total Domestic Demand | 2.5 | -0.1 | -1.5 | -0.5 | 3.8 | -3.2 |
| Consumption | 3.1 | 0.9 | 2.5 | 0.0 | 5.1 | 0.2 |
| Investment | 4.9 | -1.8 | -5.2 | 6.6 | 12.0 | -2.8 |
| Government Consumption | -1.5 | -1.4 | -4.7 | -1.1 | -1.9 | 1.1 |
| Inventories (contribution) | -0.1 | 0.1 | -1.0 | -1.6 | -1.4 | -2.9 |
| Exports | 20.9 | 5.0 | 10.7 | 12.3 | -1.6 | 6.5 |
| Imports | 14.0 | 4.0 | 4.5 | 9.5 | 4.1 | -5.6 |
| Net Exports (contribution) | 2.2 | 0.4 | 2.4 | 1.1 | -2.4 | 5.2 |

1. Annual changes are Q4/Q4.

Indicators for the third quarter suggest that activity is expanding at a moderate pace. Manufacturing shipments and new orders both advanced markedly in July, and strong employment growth in August more than offset declines in May and June. Housing starts retreated in July and were little changed in August, although the average of the two months was about 3 percent above the second-quarter level. Consumer price inflation remains subdued and near the bottom of the Bank of Canada's 1-3 percent target band.

The Canadian Auto Workers (CAW) reached a tentative three-year labor agreement with Chrysler Corporation Canada on September 17, averting a possible strike at Chrysler's Canadian facilities. The possibility of a Canadian auto strike remains, however, as the CAW will now attempt to extend the agreement to cover workers at Ford Canada and General Motors of Canada.

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

| | 1995 | 1996 | | | | | |
|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | May | Jun | Jul | Aug |
| Industrial Production | -0.3 | 0.3 | 0.6 | 0.6 | -0.2 | n.a. | n.a. |
| Manufacturing Survey: | | | | | | | |
| Shipments | -0.4 | -0.5 | 2.5 | 2.1 | 0.0 | 3.0 | n.a. |
| New Orders | -0.1 | -0.0 | 2.7 | 5.2 | -1.7 | 3.7 | n.a. |
| Retail Sales | -0.7 | 1.0 | 0.4 | 0.2 | 0.6 | n.a. | n.a. |
| Housing Starts | 5.8 | 1.8 | 10.9 | 21.4 | 3.8 | -5.2 | 0.1 |
| Employment | 0.3 | 0.7 | 0.2 | -0.1 | -0.4 | 0.1 | 0.6 |
| Unemployment Rate (%) | 9.4 | 9.5 | 9.6 | 9.4 | 10.0 | 9.8 | 9.4 |
| Consumer Prices[1] | 2.1 | 1.4 | 1.4 | 1.5 | 1.4 | 1.2 | 1.4 |

1. Percent change from year earlier.

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

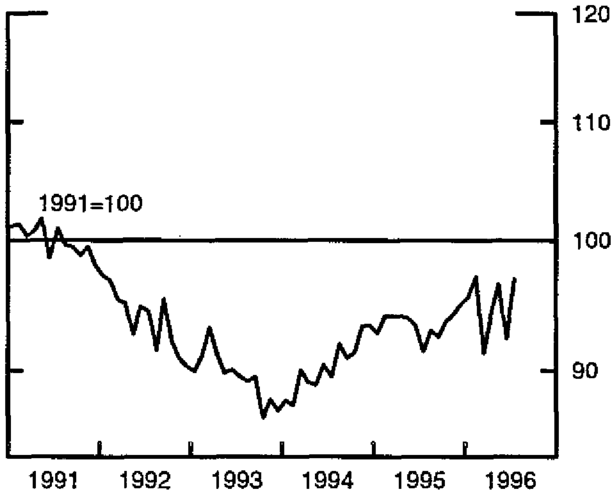
| | 1995 | 1996 | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Apr | May | Jun | Jul | Aug |
| Japan: trade | 106.6 | 16.6 | 14.0 | 2.5 | 4.8 | 6.7 | 3.3 | 6.7 |
| current account | 110.6 | 15.5 | 15.3 | 3.4 | 5.8 | 6.2 | 6.0 | n.a. |
| Germany: trade[1] | 63.6 | 14.1 | 16.2 | 5.5 | 6.2 | 4.6 | n.a. | n.a. |
| current account[1] | -16.7 | -2.5 | -3.4 | -0.3 | -1.6 | 1.4 | n.a. | n.a. |
| France: trade | 20.0 | 5.8 | 4.7 | 0.6 | 2.2 | 1.9 | n.a. | n.a. |
| current account | 16.7 | 7.3 | 3.8 | 0.9 | 1.3 | 1.6 | n.a. | n.a. |
| U.K.: trade | -18.3 | -5.4 | n.a. | -2.1 | -1.5 | n.a. | n.a. | n.a. |
| current account | -10.6 | -1.6 | n.a. | ... | ... | ... | ... | ... |
| Italy: trade | 27.6 | 8.5 | 12.6 | 3.5 | 6.8 | 4.2 | n.a. | n.a. |
| current account[1] | 27.4 | 5.9 | n.a. | 3.0 | 4.8 | n.a. | n.a. | n.a. |
| Canada: trade | 20.7 | 5.8 | 7.2 | 2.1 | 2.8 | 2.4 | 2.2 | n.a. |
| current account | -8.1 | -1.2 | 0.8 | ... | ... | ... | ... | ... |

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

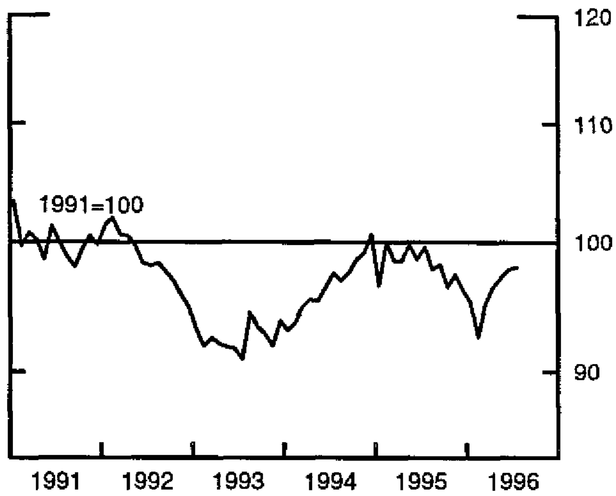
# Industrial Production in Selected Industrial Countries

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

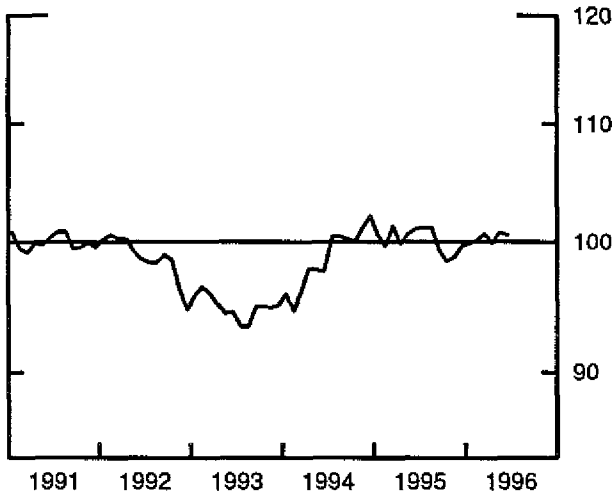
Japan



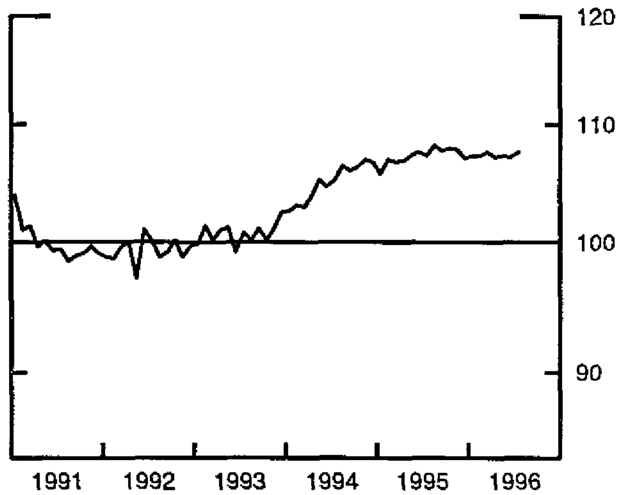

Germany



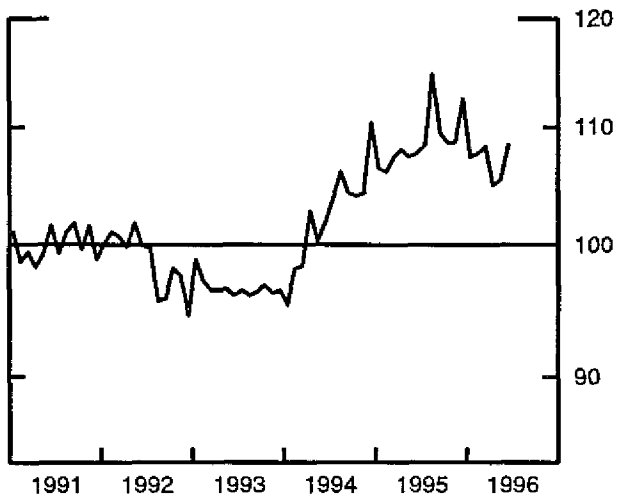

France



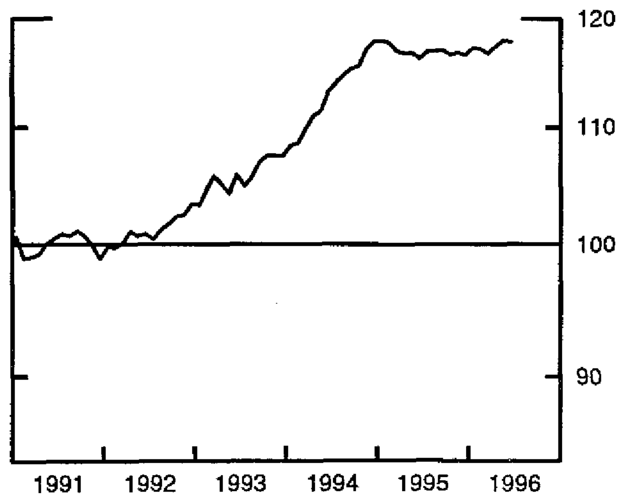

United Kingdom




Italy



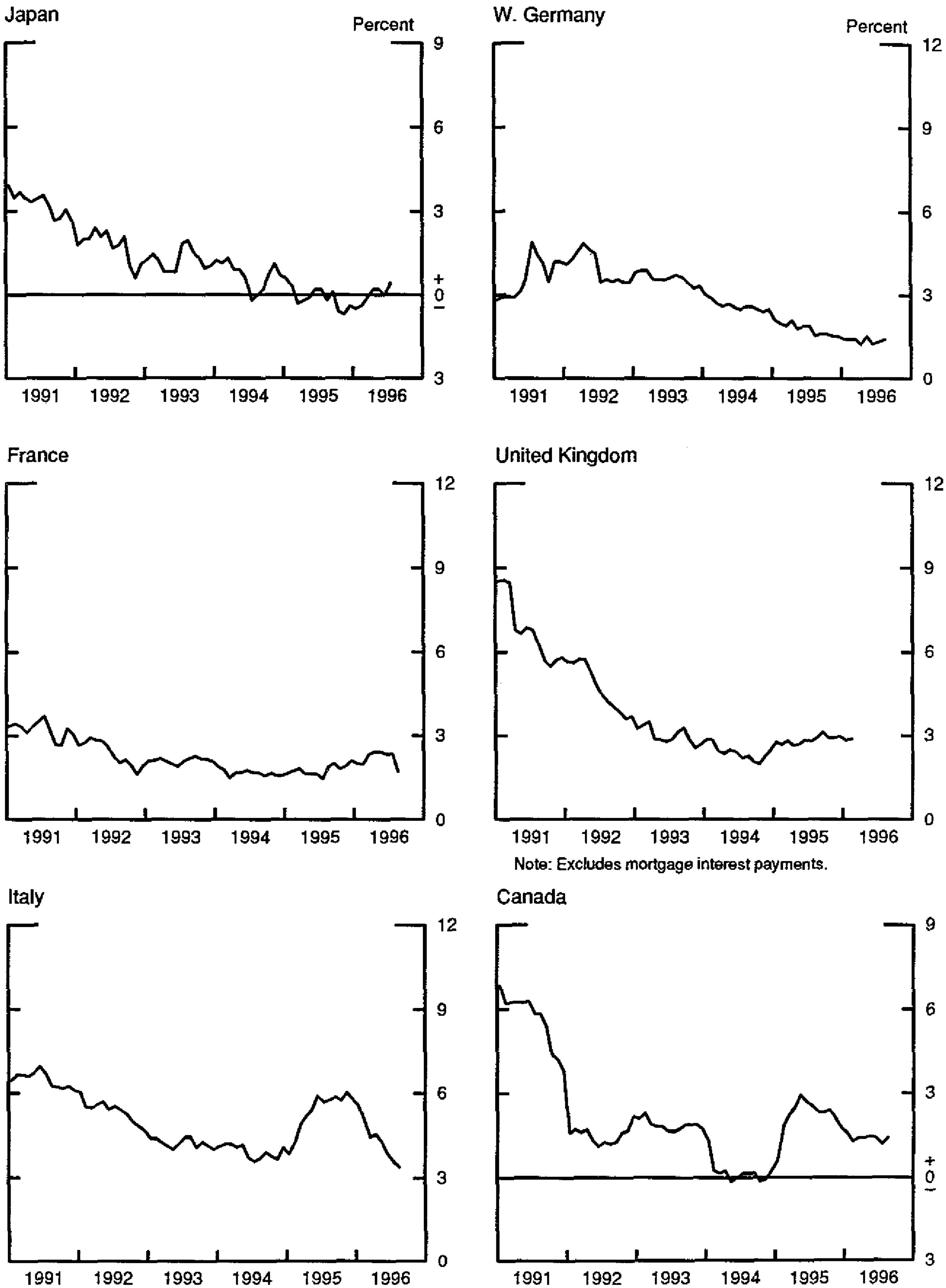

Canada



September 18, 1996

# Consumer Price Inflation in Selected Industrial Countries

(12-month change)




Note: Excludes mortgage interest payments.

Economic Situation in Other Countries

In Latin America, the economies of Argentina and Brazil are recovering from their low points in 1995, while the Mexican economy slowed a bit in the second quarter and Venezuela's domestic demand fell sharply. The Russian economy has continued to decline. Inflation slowed in Mexico, Venezuela, and Russia in recent months, and has been low in Brazil by that country's standards. In the major Asian developing economies, economic growth is proceeding at a moderate pace, with Korea showing some evidence of an increase in inflationary pressures. Mexico's trade surplus narrowed slightly and Brazil and Argentina secured small trade deficits, while Venezuela's deficit has increased substantially in the last few months. In Asia, Taiwan's trade balance has improved markedly despite slow export growth, while China's surplus has decreased and Korea's deficit has shown a considerable widening.

Individual country notes. In **Mexico**, economic growth slowed in the second quarter, following three quarters of strong recovery from the sharp downturn in the first half of 1995. Real GDP declined an estimated 0.3 percent (SA, not annual rate) in the second quarter and industrial production rose less than 2 percent (SA, not annual rate), half the average quarterly growth rate in the three previous quarters. Imports grew in July to reach their highest level since December 1994, indicating that domestic demand is continuing to recover. Exports also grew substantially, but not as fast as imports, resulting in some narrowing of the trade surplus. The current account balance improved in the second quarter, but most of the gain was due to a decrease in net factor payments, especially interest payments.

Monthly inflation fell from a recent peak of 2.8 percent in April to 1.3 percent in August. While the decline partly reflects seasonal factors, the stability of the exchange rate and continued tight monetary policy are expected to continue to keep inflationary pressures subdued in the coming months.

On August 7, the Bank of Mexico began a program to rebuild its international reserves, without appearing to manage the exchange rate, by selling dollar put options at auction to commercial banks. The strike price of the options on any given day is the previous day's reference exchange rate (providing that the rate is no weaker than the average of the preceding twenty trading days). The Bank sold $130 million in options at the first auction on August 7, all of which were exercised within a few days of the auction.

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP | 4.5 | -6.2 | -1.0 | 7.2 | ... | ... |
| Industrial Production (SA) | 4.5 | -7.5 | 2.8 | 13.7 | n.a. | n.a. |
| Unemployment Rate (%) | 3.6 | 6.3 | 6.2 | 5.6 | 5.8 | n.a. |
| Consumer Prices[1] | 7.1 | 52.1 | 8.3 | 6.4 | 1.4 | 1.3 |
| Trade Balance[2] | -18.5 | 7.0 | 1.9 | 2.2 | 0.4 | n.a. |
| Imports[2] | 79.4 | 72.5 | 19.9 | 21.4 | 7.6 | n.a. |
| Exports[2] | 60.8 | 79.5 | 21.9 | 23.6 | 8.0 | n.a. |
| Current Account[2] | -29.5 | -0.7 | -0.1 | 0.6 | ... | ... |

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

Due to the success of the program in its first month and the continued stability of the peso, the amount sold at the second auction on August 30 was raised to $200 million. The 20-day constraint remained binding for the first half of September (thus no options were exercised), though the recent firming of the peso removed that constraint by September 17.

In **Argentina**, real GDP grew 3.2 percent in the second quarter from a year earlier and July industrial production showed an increase of 7.3 percent compared with a year earlier, providing solid evidence that the economy is recovering. Notwithstanding higher economic activity, inflation has remained low, with August consumer prices 0.1 percent above their year-earlier level. The trade surplus remained almost unchanged in July. International reserves less gold and securities reached $14.6 billion at end-August, a bit lower than in May and June due to the political uncertainty created by the dismissal of Finance Minister Cavallo.

Argentina's slow recovery from the recession led to lower than expected tax revenues and the larger than expected fiscal deficit for the first half of 1996. The package of measures sent to Congress by the government to compensate for the shortfall has been continuously delayed, and it is expected to yield only about $600-800 million in savings this year, instead of the $1.6 billion

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP | 7.4 | -4.4 | -3.2 | 3.2 | ... | ... |
| Industrial Production (SA) | 5.7 | -6.2 | -9.1 | 2.6 | 7.3 | n.a. |
| Unemployment Rate (%)[2] | 11.7 | 17.4 | ... | 17.1 | ... | ... |
| Consumer Prices[1] | 3.9 | 1.5 | -0.3 | -0.1 | 0.5 | -0.1 |
| Trade Balance[3] | -4.0 | 3.0 | 0.2 | 1.3 | 0.2 | n.a. |
| Current Account[3] | -9.9 | -3.2 | 0.6 | 1.3 | ... | ... |

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

originally planned. These measures were not well received by Argentines, and the largest union federation, the CGT, called for another general strike on September 26 and 27. Menem angered the unions further in early September, when he announced his intention to pass a labor reform package that includes suspending collective wage bargaining and replacing redundancy payouts with unemployment insurance. On September 16, the IMF released a statement indicating that it supports Argentina's program to reduce the fiscal deficit to about $5 billion (1.7 percent of GDP) in 1996.

In addition to the efforts to contain its fiscal difficulties, Argentina is working to strengthen its banking system. The Central Bank has announced a program with foreign private banks in Argentina to create a contingency fund against possible banking liquidity crises of between $3-5 billion (which represents about 10 percent of deposits). The Repo Program, as it is called, involves an automatic credit line in exchange for dollar-denominated government bonds from foreign private banks to the Central Bank in case of a liquidity crisis. It is not yet clear when the system will go into effect.

In **Brazil**, there are indications that the economy is beginning to recover. Real GDP grew 1.7 percent (SA, not annual rate) in the second quarter from the previous period, and industrial output (SA) increased in July. Inflation has remained low by Brazilian standards. The cumulative trade deficit for January to July was $0.5 billion, compared with a $4.3 billion deficit a year earlier. International reserves at the end of July 1996 totalled $60 billion (liquidity concept), up considerably from $42 billion a year ago.

On September 5, Brazil announced new rules allowing Brazilian banks to raise capital overseas by placing bonds abroad and using the resources to lend to exporters with 180-day maturities. Previously, raising capital overseas for exports had been limited to agricultural goods. In mid-September, President Cardoso signed a bill exempting shipments from export taxes.

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP | 5.9 | 4.2 | -2.1 | 2.3 | ... | ... |
| Industrial Production (SA)[1] | 7.9 | 3.6 | -1.5 | 0.3 | 4.3 | n.a. |
| Open Unemployment Rate (%) | 5.1 | 4.4 | 6.4 | 5.9 | 5.9 | n.a. |
| Consumer Prices[1] | 929.0 | 22.0 | 2.5 | 3.6 | 1.2 | 0.5 |
| Trade Balance[2] | 10.4 | -3.2 | -0.4 | 0.1 | -0.2 | n.a. |
| Current Account[2] | -1.8 | -17.8 | -3.4 | -4.1 | ... | ... |

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

In addition, Brazil has removed some products from a low-tariff group of import items, effectively increasing import tariffs on the items from 4-6 percent to 12-16 percent. On September 12, the Brazilian Senate approved a Central Bank request to conduct unlimited buybacks of the country's $57 billion Brady Bonds.

In **Venezuela**, consumer price inflation fell further in August, partly due to an estimated 18 percent drop in consumer demand since the start of its IMF austerity program in mid-April. The non-oil trade deficit has widened slightly in July, but has remained fairly stable every month since April. Total reserves less gold have increased since the stabilization package was announced in April and reached $8.4 billion at the end of July, up from $6.7 billion in May. This increase in net capital inflows has led to a 17 percent rise in M2 and a subsequent drop in interest rates by 48 percentage points to around 20 percent a year over the past three months.

On July 31, Venezuela announced the creation of a special fund, the Debt Rescue Fund, which will use windfall revenues from oil prices higher than $14.70 per barrel to pay off foreign and

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

| | 1994 | 1995 | 1996 Q1 | 1996 Q2 | 1996 Jul | 1996 Aug |
|---|---|---|---|---|---|---|
| Real GDP | -2.8 | 2.2 | ... | ... | ... | ... |
| Unemployment Rate (%) | 8.8 | 10.8 | ... | 11.1 | ... | ... |
| Consumer Prices[1] | 70.9 | 56.6 | 24.0 | 30.9 | 5.0 | 4.1 |
| Trade Balance[2] | -3.6 | -6.0 | -0.8 | -1.9 | -0.6 | n.a. |
| Current Account[2] | 2.5 | 2.4 | ... | ... | ... | ... |

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

domestic debt commitments. As of September 5, Venezuela's basket of crude and products had risen to $20 per barrel, while the average for the year so far is $17 per barrel. The higher oil prices are expected to yield about $2.5 billion in additional revenue.

Although Venezuela has been doing well overall with the new IMF program, its privatization program is in shambles. On August 28, Venezuela cancelled the sale of Banco de Venezuela after rumors and confusion led to the withdrawal of bids, and the program could be threatened by political disputes. Venezuela's top banks have traditionally been associated with different political parties that have used them to bankroll election campaigns and to provide jobs for supporters. Only days earlier, the sale of Alucasa, a small aluminum concern, was delayed, and at the beginning of September union protests began over the proposed year-end privatization of the state-owned holding company Corporacion Venezolana de Guayana (CVG).

In **China**, real GDP increased by 9.8 percent in the first half of 1996 from its year-earlier level, as strong growth in consumption demand offset much weaker growth in investment. The central bank cut its lending rate by about 40 basis points on August 22, following an earlier interest rate cut in May. The apparent easing in credit conditions in recent months reflects the authorities' perception that a more accommodative stance is warranted, given a sharp fall in inflation over the past year, as well as to help alleviate the heavy debt-servicing burden of state-run enterprises. The authorities estimate that 50 percent of state-run enterprises are unprofitable, though this figure appears conservative. China's trade surplus in the first eight months of the year declined to $5 billion, compared with $15.4 billion in the same period last year.

The decline in the surplus reflected a fall in the level of exports of about 4 percent over the period from its year-earlier level. Consumer prices in July were 8.3 percent higher than their year-earlier level.

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP[1] | 11.8 | 10.2 | 10.2 | 9.8 | ... | ... |
| Industrial Production | 22.0 | 17.8 | 16.2 | n.a. | n.a. | n.a. |
| Consumer Prices | 25.5 | 10.1 | 9.9 | 8.6 | 8.3 | n.a. |
| Trade Balance[2] | 5.2 | 16.7 | -1.2 | 2.1 | 1.1 | 3.0 |

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

Real GDP in **Taiwan** expanded 5.4 percent in the second quarter from its year-earlier level. The central bank announced a cut in the discount rate of 25 basis points on August 9, following a similar reduction in late May. The interest rate cuts are intended to stimulate domestic demand, which has experienced weak growth by historical standards for more than a year. Slow domestic demand growth has been reflected in a fall of about 1 percent in the level of Taiwan's imports during the first eight months of the year. This decline contributed to a widening of the trade surplus to $8.2 billion over the same period, compared with $3.5 billion a year earlier. Taiwan's 12-month inflation rate rose to 5.1 percent in August, a noticeable increase from an average rate of below 3 percent during the first seven months of the year. However, most of the jump in the inflation rate in August was attributed to temporary factors, mainly reflecting a spike in food prices following Typhoon Herb.

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP | 6.5 | 6.1 | 5.3 | 5.4 | ... | ... |
| Industrial Production | 6.6 | 4.2 | 0.1 | -0.5 | 1.7 | n.a. |
| Consumer Prices | 2.6 | 4.6 | 3.0 | 2.3 | 1.4 | 5.1 |
| Trade Balance[1] | 7.8 | 8.3 | 2.5 | 3.2 | 1.4 | 1.1 |
| Current Account[1] | 6.2 | 5.0 | 1.5 | n.a. | ... | ... |

1. Billions of U.S. dollars, NSA

In **Korea**, real GDP grew 6.7 percent in the second quarter from its year-earlier level, a marked decline from output growth rates of nearly 10 percent in the first three quarters of last year. Fixed investment spending has been particularly sluggish, expanding only 4.2 percent in the second quarter from its year-earlier level. Despite the slowdown in activity, the central bank has raised interest rates several hundred basis points during the past few months, after having maintained an accommodative monetary policy stance during the latter part of 1995 and first few months of this year. The recent tightening apparently reflects concern about a significant widening of the current account deficit and some evidence of a modest pickup in inflation. The current account deficit widened to $11.7 billion in the first seven months of this year, compared with $6.5 billion a year earlier. Weak export growth contributed to the larger deficit, as exports expanded only 9 percent over the period from their year-earlier level. The authorities have allowed the won to depreciate about 6 percent against the dollar since late April to partly offset a deterioration in Korea's external competitiveness associated with the strong appreciation of the won against the yen during the past year. The consumer price index increased 5.3 percent in August from its year-earlier level, compared with a rise of 3.5 percent a year earlier.

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jul | Aug |
| Real GDP | 8.4 | 9.0 | 7.9 | 6.7 | ... | ... |
| Industrial Production | 10.7 | 11.7 | 8.9 | 7.3 | 8.0 | n.a. |
| Consumer Prices | 6.2 | 4.5 | 4.9 | 5.1 | 5.6 | 5.3 |
| Trade Balance[1] | -3.1 | -4.7 | -2.4 | -2.8 | -1.7 | n.a. |
| Current Account[1] | -4.5 | -8.9 | -4.6 | -4.7 | -2.3 | n.a. |

1. Billions of U.S. dollars, NSA

In **Russia**, Boris Yeltsin essentially disappeared from public view after having won the mid-June election. However, in a break from past reluctance to admit health problems, he announced last week that he will undergo heart surgery in Moscow at the end of September, and calmed financial markets.

Economic activity has continued to decline in 1996. Second-quarter GDP and industrial production were down 7 and 5 percent respectively from their levels a year ago. Consumer price inflation has been at the lowest levels since the 1992 beginning of the reforms. Cumulative inflation for the first seven months of 1996 was 16.1 percent. The ruble has declined about 1 percent in the past two weeks, which is slightly faster than its planned depreciation of about 1.5 percent per month. However, the ruble still remains well within the corridor established by the Central Bank. Interest rates on government securities remain high in nominal terms: the six-month treasury bill yield averaged 78 percent this week, up from last week's 74 percent, indicating continuing political and economic uncertainty.

Russia has now completed two quarterly reviews and four monthly reviews under its three-year, $10.1 billion Extended Fund Facility (EFF). The program's conditions must be met for funds to be disbursed. Although the IMF has not yet denied a payment, the

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

| | 1994 | 1995 | 1996 | | 1996 | |
|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Jun | Jul |
| Real GDP | -15 | -4 | -3 | -7 | -9 | -9 |
| Industrial Production | -21 | -3 | -4 | -5 | -8 | -7 |
| Consumer Prices[1] | 10 | 7 | 3 | 2 | 1 | 1 |
| Ruble Depreciation[1] | 9 | 2 | 2 | 2 | 1 | 2 |
| Trade Balance[2] | 14.3 | 18.1 | 5.6 | n.a. | ... | ... |
| Current Account[2] | 3.2 | 5.3 | 2.6 | n.a. | ... | ... |

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

July payment was delayed for two weeks until Russian authorities took steps to boost inadequate tax collections. However, the IMF approved an increase in the target for the 1996 budget deficit from 4 percent of GDP to 5.25 percent when it became clear that the original target would not be met.