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February 5, 1988

SUPPLEMENT
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the staff
Board of Governors
of the Federal Reserve System

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SUPPLEMENTAL NOTES

THE DOMESTIC NONFINANCIAL ECONOMY

Employment and unemployment

The labor market surveys indicate that employment rose in January, but provide somewhat different assessments of the extent of that growth. Gains in nonfarm payroll employment, as measured by the establishment survey, slowed substantially last month from their brisk fourth-quarter pace. In contrast, employment, as measured by the household survey, was up sharply in January, bringing the rise over the past four months in line with that posted by payroll employment. However, last month's increase in household employment was about matched by labor force growth, and the civilian unemployment rate was unchanged at 5.8 percent.

In the payroll report, total nonfarm employment advanced about 110,000 in January. By industry, a substantial increase in the number of jobs at retail trade establishments more than accounted for the overall gains in employment. However, these gains were offset somewhat by employment declines in state and local government, mining, and construction. In manufacturing, employment was up 25,000 compared with average monthly gains of 60,000 during the second half of 1987, and the factory workweek edged up 0.1 hour to 41.1 hours. Factory job gains last month were somewhat uneven by industry: machinery, electrical equipment and food processing posted the largest increases, but employment gains in those industries were partly offset by layoffs in stone, clay, and glass, primary metals, motor vehicles, and apparel.

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

	1986	1987	1987			1987		1988
			Q2	Q3	Q4	Nov.	Dec.	Jan.
-Average Monthly Changes-								
Nonfarm payroll employment ²	159	252	163	205	387	302	311	107
Strike-adjusted	159	249	164	227	365	295	308	107
Manufacturing	-14	34	7	51	69	89	41	25
Durable	-17	19	0	31	44	48	34	12
Nondurable	4	15	7	21	25	41	7	13
Construction	13	16	-8	-6	44	21	48	-50
Trade	31	48	35	41	59	55	12	173
Finance and services	110	108	100	85	122	94	140	32
Total government	30	29	18	6	75	25	61	-67
Private nonfarm production workers	105	177	112	143	255	203	239	39
Manufacturing production workers	-7	28	11	38	55	68	40	12
Total employment ³	174 ^e	257	282	191	291	294	240	385
Nonagricultural	174 ^e	252	297	193	280	371	197	307

1. Average change from final month of preceding period to final month of period indicated.

2. Survey of establishments. Strike-adjusted data noted.

3. Survey of households.

e--Adjusted by board staff to eliminate distortions caused by the introduction of revised population estimates.

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

	1986	1987	1987			1987		1988
			Q2	Q3	Q4	Nov.	Dec.	Nov.
Civilian, 16 years and older	7.0	6.2	6.3	6.0	5.9	5.9	5.8	5.8
Teenagers	18.3	16.9	17.0	16.1	16.6	16.6	16.1	16.0
20-24 years old	10.7	9.7	10.0	9.5	8.8	8.9	8.5	9.1
Men, 25 years and older	5.4	4.8	4.9	4.6	4.4	4.4	4.4	4.4
Women, 25 years and older	5.5	4.8	4.7	4.7	4.7	4.7	4.7	4.6
White	6.0	5.3	5.4	5.1	5.0	5.1	4.9	5.0
Black	14.5	13.0	13.2	12.5	12.2	12.2	12.2	12.2
Fulltime workers	6.6	5.8	5.9	5.6	5.5	5.5	5.4	5.4
Memo:								
Total National ¹	6.9	6.1	6.1	5.9	5.8	5.8	5.7	5.7

1. Includes resident armed forces as employed.

HOURLY EARNINGS INDEX¹
 (Percentage change; based on seasonally adjusted data)²

	1986	1987	1987			1987		1988
			Q2	Q3	Q4	Nov.	Dec.	Jan.
	---Annual rate---					---Monthly rate---		
Total private nonfarm	2.3	2.7	2.6	2.7	3.3	.5	-.2	.5
Manufacturing	1.7	2.0	2.1	2.1	2.3	.2	.2	.2
Durable	1.3	1.8	2.1	2.6	2.3	.2	.2	.2
Nondurable	2.3	2.3	2.2	1.2	2.4	.2	.2	.2
Contract construction	2.2	.8	3.4	.2	2.4	1.2	-1.4	1.4
Transportation and public utilities	2.8	2.4	3.5	2.3	.6	.1	-.2	-.1
Finance, insurance and real estate	4.4	4.6	.5	3.4	5.1	1.4	-.7	.8
Total trade	1.8	2.2	2.5	3.5	2.1	.3	-.1	.5
Services	3.1	4.6	3.2	4.6	6.6	.7	-.2	.9

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime hours in manufacturing.

2. Changes over periods longer than one quarter are measured from final quarter of preceding period to final quarter of period indicated. Quarterly changes are compounded annual rates.

As measured by the household survey, employment rose 385,000 in January, with job gains relatively widespread by demographic group. However, most demographic groups also posted labor force gains, and jobless rates, on balance changed little over the month. By industry, unemployment rates rose in construction and in manufacturing, but were little changed in most other industries.

Hourly earnings

Wage rates, as measured by the hourly earnings index, rose 0.5 percent in January, after a small decline in December. Sharp increases in construction and services, which are the most volatile components of the overall index, accounted for much of the rise. Over the past 12 months, this measure of wage change has risen about 3 percent for the nonfarm sector and 2-1/4 percent in manufacturing.

CBO Budget update

The CBO reported to Congress yesterday that the FY1988 deficit is expected to rise to \$157 billion from last year's deficit of \$148 billion.

CBO estimates that the deficit will increase further in FY1989 to \$176 billion, assuming no changes in current spending and tax laws and that defense and nondefense discretionary appropriations are held constant in real terms. The CBO estimates for FY1988 and FY1989 take account of the budget summit agreement reached last November and the enactment of legislation implementing the agreement. However, they estimate that the effect of the legislation still falls nearly \$10 billion short of the \$45 billion of deficit reduction stipulated for FY1989.

Details of CBO's budget estimates and the underlying economic and technical assumptions are scheduled to be released on February 11.

Nonetheless, CBO made available the broad outlines of their economic forecast. As shown on the table, CBO projects real GNP to grow 1.8 percent from the fourth quarter of 1987 to the fourth quarter of 1988. In 1989, real GNP growth is expected to pick up to a 2.6 percent pace. Inflation, as measured by the GNP deflator, is forecast to run about 4 percent this year and 4-1/4 percent next year. However, inflation measured by the CPI, which affects anticipated cost-of-living adjustments for social security and a number of other entitlement programs, is projected to be higher--nearly 5 percent in both 1988 and 1989. Interest rates in the CBO forecast are shown to rise on average from those experienced in 1987. These assumptions are considerably more pessimistic than those being used by the Administration for their upcoming FY1989 budget proposals.

CBO AND ADMINISTRATION ECONOMIC FORECASTS FOR 1988 AND 1989
(By calendar year)

	Actual	Forecast	
		1988	1989
Fourth Quarter to Fourth Quarter (Percent change)			
Real Gross National Product			
CBO	3.8	1.8	2.6
Administration	3.8	2.4	3.5
GNP Deflator			
CBO	3.3	3.9	4.2
Administration	3.3	3.9	3.7
Consumer Price Index (CPI-U)			
CBO	4.4	4.9	4.8
Administration	4.4	4.3	3.9
Calendar-Year Average (Percent)			
Three-Month T-Bill Rate			
CBO	5.8	6.2	6.7
Administration	5.8	5.3	5.2
Ten-Year Gov. Note Rate			
CBO	8.4	9.3	9.5
Administration	8.4	8.0	7.4
Civilian Unemployment Rate			
CBO	6.2	6.2	6.1
Administration ¹	6.1	5.8	5.6

Sources: Congressional Budget Office, February 4, 1988 and Office of Management and Budget, December 23, 1987.

1. The Administration's projection is for the total labor force, including armed forces residing in the United States. In recent years, this rate has tended to be 0.1 to 0.2 percentage points below the civilian unemployment rate.

THE FINANCIAL ECONOMYBank Credit Developments

Bank credit is estimated to have grown at a strong 11-3/4 percent pace in January following two straight monthly declines. Despite a sharp pickup in acquisitions of U.S. government securities, growth of total securities slowed owing to faster runoffs of other securities. Total loans at banks rebounded in January largely reflecting a turnaround in security and other loans. Recent behavior of these loan categories likely reflects in part the pattern of financial activity since the October stock market crash. The November-December decline in financial activity appears to have depressed these components of bank credit; their January pickup coincides with evidence of increased corporate bond and equity issuance. Volatility in these two loan categories explains much of the variation in total loan growth in recent months. As illustrated in the table on the next page, total loans excluding the security and other loan categories have grown at a relatively stable 7 to 9 percent rate since October.

Business loans expanded at an 8-1/2 percent rate in January, close to the December pace. Strong C&I loan expansion since year end likely reflects financing needs associated with production and inventories and perhaps, most recently, a pickup in mergers and corporate restructurings. Business loans booked at overseas offices of U.S. banks were especially strong as borrowers switched to more favorable LIBOR-based pricing given the unusually wide spreads between the prime rate and market rates in January. Real estate loan growth weakened in January, likely reflecting recent declines in housing starts and sales of existing homes. Consumer loan growth is estimated to have picked up to about a 7-3/4 percent pace

in January, perhaps related to the reintroduction of auto sales incentive programs.

Growth in the sum of commercial paper of nonfinancial businesses and business loans slowed in January. Commercial paper declined sharply, although it has maintained much of the increase it posted during December when firms over-issued in anticipation of year-end rate pressures that failed to materialize. Some of the decline in commercial paper last month may also reflect increased issuance of corporate bonds related to the flattening of the yield curve since December.

	Total Bank Loans		Total Bank Loans less Security and Other Loans		Security and Other Loans	
	Net Change ¹	Growth Rate ²	Net Change ¹	Growth Rate ²	Net Change ¹	Growth Rate ²
Oct.	18.6	13.3	15.5	12.7	3.1	17.4
Nov.	-3.0	-2.1	9.2	7.4	-12.2	-67.4
Dec.	-4.1	-3.1	11.4	9.2	-15.5	-90.8
Jan. ³	20.7	14.3	11.3	9.0	9.4	59.6

1. Change in monthly averages in billions of dollars.

2. Seasonally adjusted annual rate.

3. Data for January are preliminary.

Consumer Credit

Consumer installment credit outstanding rose at an 8.8 percent annual rate in December, following a 5.2 percent gain in November. The pickup in December was about evenly split between automobile and revolving credit. Automobile lending rose at nearly a 12 percent rate

as consumers responded to the latest round of incentive programs offered by the big three auto-makers and on some imports. The very strong expansion of revolving credit (19.4 percent annual rate) was almost entirely at commercial banks and was widespread--both geographically and by size of bank. Many banks indicated that they were running promotions to boost normally strong seasonal gains. In addition, some banks reported increased takedowns on pre-arranged over-draft lines.

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)					Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
	1986	1987		1987		1987		1987
		H1	H2 ^P	Nov. ^r	Dec. ^P	Nov. ^r	Dec. ^P	Dec. ^P
Total ¹	10.5	3.5	8.4	5.2	8.8	2.63	4.45	612.6
Total, excluding auto	5.7	3.0	7.8	7.7	6.6	2.21	1.93	350.9
Selected types								
Auto	17.8	4.1	9.2	2.0	11.7	.42	2.52	261.7
Revolving	10.6	3.6	12.4	4.0	19.4	.48	2.32	145.9
All other	2.6	2.5	4.7	10.2	2.3	1.73	-.39	205.0
Selected holders								
Commercial banks	8.1	2.1	8.0	6.4	11.9	1.44	2.71	275.0
Finance companies	20.7	2.3	8.3	-2.9	8.6	-.35	1.02	143.8
Credit unions	8.0	7.0	10.6	11.2	6.0	.70	.42	84.8
Savings institutions ²	10.7	10.1	12.5	18.5	5.3	.98	.29	64.8

1. Includes items not shown separately.

2. Savings and loans, mutual savings banks, and federal savings banks.

r--revised. p--preliminary.

Note: Details may not add to totals due to rounding.

MONETARY AGGREGATES
(Based on seasonally adjusted data unless otherwise noted)¹

	1986:Q4 to		1987		1988		Growth Q4/87 - Jan./88 ^{pe}
	1987:Q4	Q3	Q4	Nov.	Dec.	Jan. ^{pe}	
	----- Percentage change at annual rates -----						
1. M1	5.9	-0.1	3.7	-6.5	-5.6	15	4
2. M2	4.1	3.0	4.3	-0.6	1.0	10	5
3. M3	5.4	4.8	5.7	4.3	1.1	7	5

	Levels bill. \$ Dec./87						
<u>Selected components</u>							
4. M1-A	2.6	-2.2	4.3	-6.0	-6.7	14	498.3
5. Currency	8.6	6.7	9.9	13.5	7.9	16	199.7
6. Demand deposits	-1.3	-8.1	0.4	-18.8	-16.6	12	291.6
7. Other checkable deposits	13.1	4.6	2.4	-7.9	-3.8	17	254.7
8. M2 minus M1 ²	3.4	4.1	4.6	1.5	4.5	8	2142.5
9. Overnight RPs and Eurodollars, NSA	14.2	17.4	7.6	-92.7	-24.4	72	77.2
10. General purpose & broker/dealer money market mutual fund shares, NSA	6.1	5.0	14.1	11.6	7.1	19	221.5
11. Commercial banks	2.4	1.7	3.4	7.3	5.4	6	919.1
12. Savings deposits, SA, plus MMDAs, NSA ³	2.3	-2.4	-4.7	-5.4	1.0	2	534.5
13. Small time deposits	3.4	8.0	15.4	25.1	12.3	11	384.7
14. Thrift institutions	3.7	3.6	2.1	2.6	6.6	8	929.6
15. Savings deposits, SA, plus MMDAs, NSA ³	9.6	-4.0	-14.4	-25.3	-12.8	-7	399.8
16. Small time deposits	5.8	10.1	16.2	25.1	21.9	19	529.9
17. M3 minus M2 ⁴	10.9	11.8	11.1	23.0	0.2	-1	766.7
18. Large time deposits	8.3	6.2	14.2	23.4	8.9	-5	489.0
19. At commercial banks, net ⁵	10.6	4.1	9.2	21.6	0.7	-11	322.9
20. At thrift institutions	4.1	10.7	24.3	27.2	24.3	8	166.0
21. Institution-only money market mutual fund shares, NSA	2.3	1.9	17.9	101.5	1.4	60	88.6
22. Term RPs, NSA	32.5	26.4	-2.6	31.4	-32.8	-9	106.7
23. Term Eurodollars, NSA	15.1	16.6	11.1	9.0	6.5	-46	92.3

-- Average monthly change in billions of dollars --

<u>MEMORANDA:</u>							
24. Managed liabilities at commercial banks (25+26)	5.5	2.9	5.2	4.5	5.1	-9	563.1
25. Large time deposits, gross	3.4	-0.8	5.4	7.3	1.7	0	386.7
26. Nondeposit funds	2.1	3.7	-0.2	-2.8	3.4	-9	176.4
27. Net due to related foreign institutions, NSA	2.1	3.2	1.0	-3.7	7.3	-6.5	14.0
28. Other ⁶	2.4	-0.6	-1.2	0.7	-3.9	5.7	162.4
29. U.S. government deposits at commercial banks	0.2	-1.5	0.2	3.1	-14.6	-4	24.0

1. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
 2. Nontransactions M2 is seasonally adjusted as a whole.
 3. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs) not seasonally adjusted. Commercial bank savings deposits excluding MMDAs increased during December and January at rates of 2.0 percent and 1 percent, respectively. At thrift institutions, savings deposits excluding MMDAs decreased during December and January at rates of 8.2 and 4 percent, respectively.
 4. Non-M2 component of M3 is seasonally adjusted as a whole.
 5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
 6. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
 7. Consists of Treasury demand deposits and note balances at commercial banks.
- pe--preliminary estimates.

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT,
(Percentage changes at annual rates, based on seasonally adjusted data)¹

	1986:Q4	1987				1988	Levels bil. \$ Jan. ^P
	to 1987:Q4	Q3	Q4	Nov.	Dec.	Jan. ^P	
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	7.5	7.3	2.8	-1.1	-0.9	11.8	2244.8
2. Securities	5.0	8.4	3.0	2.1	6.6	3.8	532.2
3. U.S. government securities	9.1	18.7	2.8	-4.3	10.9	17.2	338.9
4. Other securities	-1.3	-7.9	3.5	13.0	-0.6	-18.9	193.3
5. Total loans	8.3	7.0	2.7	-2.1	-3.1	14.3	1712.6
6. Business loans	7.4	1.9	7.3	2.8	8.3	8.4	574.9
7. Security loans	0.8	28.4	-102.7	-198.7	-160.8	64.3	35.4
8. Real estate loans	18.1	13.6	15.1	14.0	13.2	10.0	582.4
9. Consumer loans	3.8	6.5	4.3	4.5	2.6	7.8	324.7
10. Other loans	-3.9	0.0	-24.0	-26.6	-61.2	48.6	195.2
----- Short- and Intermediate-Term Business Credit -----							
11. Business loans net of bankers acceptances	7.4	1.5	7.8	4.1	8.1	7.6	568.7
1. Loans at foreign branches ²	-4.1	28.2	-38.3	7.1	-140.4	171.3	16.5
13. Sum of lines 11 & 12	7.0	2.2	6.4	4.0	3.5	10.3	585.1
14. Commercial paper issued by nonfinancial firms	-2.3	-11.4	24.6	10.7	60.8	-34.7	80.6
15. Sums of lines 13 & 14	5.8	0.6	8.6	4.8	10.6	4.5	665.7
16. Bankers acceptances: U.S. trade related ^{3,4}	13.7	23.7	3.4	13.1	-29.2	n.a.	36.1 ⁵
17. Line 15 plus bankers acceptances: U.S. trade related	6.2	1.6	8.4	5.2	8.5	n.a.	699.3 ⁵
18. Finance company loans to business ³	n.a.	14.2	14.5	17.2	7.2	n.a.	199.9 ⁵
19. Total short- and intermediate- term business credit (sum of lines 17 & 18)	n.a.	4.3	9.7	7.8	8.2	n.a.	899.1 ⁵

1. Average of Wednesdays.

2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.

3. Based on average of data for current and preceding ends of month.

4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.

5. December data.

n.a.--not available.

III-T-1
SELECTED FINANCIAL MARKET QUOTATIONS 1/
(percent)

	1987				1988	Change from:	
	Jan-Feb lows	2/ Sept 3	3/ Oct 16	FOMC Dec 16	Feb 4	3/ Oct 16	FOMC Dec 16
Short-term rates							
Federal funds 4/	5.95	6.85	7.59	6.71	6.75	-0.84	0.04
Treasury bills 5/							
3-month	5.30	6.19	6.93	5.94	5.65	-1.28	-0.29
6-month	5.31	6.30	7.58	6.40	6.05	-1.53	-0.35
1-year	5.35	6.98	7.74	6.71	6.23	-1.51	-0.48
Commercial paper							
1-month	5.81	6.88	7.94	8.22	6.57	-1.37	-1.65
3-month	5.73	6.97	8.65	7.93	6.59	-2.06	-1.34
Large negotiable CD's 5/							
1-month	5.85	6.90	7.92	8.09	6.58	-1.34	-1.51
3-month	5.80	7.01	8.90	7.81	6.63	-2.27	-1.18
6-month	5.78	7.35	9.12	7.81	6.71	-2.41	-1.10
Eurodollar deposits 6/							
1-month	6.00	7.01	7.79	8.41	6.71	-1.08	-1.70
3-month	6.00	7.11	8.69	8.13	6.81	-1.88	-1.32
Bank prime rate	7.50	8.25	9.25	8.75	8.50	-0.75	-0.25
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.34	8.48	9.52	8.15	7.44	-2.08	-0.71
10-year	7.01	9.29	10.23	9.00	8.24	-1.99	-0.76
30-year	7.29	9.47	10.24	9.14	8.46	-1.78	-0.68
Municipal revenue 7/ (Bond Buyer index)	6.92	8.47	9.59	8.57	7.84	-1.75	-0.73
Corporate—A utility Recently offered	8.78	10.60	11.50	10.59	9.70	-1.80	-0.89
Home mortgage rates 8/ Fixed-rate	9.10	10.63	11.58	10.66	10.16	-1.42	-0.50
ARM, 1-year	7.52	7.84	8.45	7.91	7.74	-0.71	-0.17
	1986	1987		1988	Percent change from:		
	Year end	Record highs	FOMC Dec 16	Feb 4	Record highs	FOMC Dec 16	
Stock prices							
Dow-Jones Industrial	1895.95	2722.42	1974.47	1923.57	-29.34	-2.58	
NYSE Composite	138.58	187.99	138.34	141.89	-24.52	2.57	
AMEX Composite	263.27	365.01	252.10	269.84	-26.07	7.04	
NASDAQ (OTC)	348.83	455.26	319.25	344.66	-24.29	7.96	

1/ One-day quotes except as noted.

2/ Day prior to increase in discount rate on Sept. 4, 1987.

3/ Last business day prior to stock market decline on Monday Oct. 19, 1987.

4/ Average for two-week reserve maintenance period closest to date shown, except Jan-Feb. low, which is one-week average ending Feb. 25, and Sept. 3, which is one-week average ending Sept. 2. Last observation is average for current maintenance period to date.

5/ Secondary market.

6/ Average for statement week closest to date shown.

7/ One-day quotes for closest Thursday.

8/ Quotes for week ending Friday closest to date shown.
e—estimate