

Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,¹ and then making the scanned versions text-searchable.² Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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).

² A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

CONFIDENTIAL (FR)
CLASS III FOMC

November 8, 1996

SUPPLEMENT
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

TABLE OF CONTENTS

	Page
THE NONFINANCIAL ECONOMY	
Productivity and costs	1
Wholesale trade inventories.	2
<u>Tables</u>	
Labor productivity and costs	3
Changes in manufacturing and trade inventories	4
Inventories relative to sales.	4
Selected inventory-sales ratios.	5
<u>Chart</u>	
Inventory-sales ratios, by major sector.	6
THE FINANCIAL ECONOMY	
<u>Table</u>	
Selected financial market quotations	7

SUPPLEMENTAL NOTES

THE DOMESTIC NONFINANCIAL ECONOMY

Productivity and Costs

Output per hour in the nonfarm business sector increased 0.2 percent at an annual rate in the third quarter after increasing 0.5 percent in the second quarter. The third-quarter figure is based on BEA's advance estimate of a 2.3 percent gain in nonfarm business output and a 2.1 percent gain in the hours worked of all persons.¹ Growth in productivity from the same quarter of last year amounted to 0.3 percent, down from 0.8 percent in the previous four quarters.

Nonfarm compensation per hour increased 3.9 percent at an annual rate in the third quarter, little different from the revised 3.8 percent rate in the second quarter. By comparison, the growth in hourly compensation in the ECI reported last month was 2.5 percent in the third quarter, down from 3.2 percent in the second quarter. Although both measures of hourly compensation show the same long-run trends, large discrepancies between their rates of change are common in the quarterly data. Compared with the ECI, the productivity and cost data showed substantially faster growth in wages and salaries,² but a bit slower growth in benefits.

Unit labor costs in the nonfarm business sector rose 3.7 percent at an annual rate in the third quarter, bringing the change over the four quarters ended in September to 3.4 percent, up slightly from the 3.2 percent increase in the previous four-quarter period.

1. Hours of all persons include employees, unpaid family workers, and self-employed persons. The hours of unpaid family and self-employed workers are derived from the household survey, and quarterly changes in these hours have been unusually volatile since the redesign of the Current Population Survey at the start of 1994. Netting out the hours growth for these two groups, hours of all employees in the nonfarm business sector grew 2.9 percent in the third quarter.

2. One important difference between the two measures is that the productivity and cost data are based on changes in the quarterly averages while the ECI data are based on changes between the last months of the quarter. Average hourly earnings of production or nonsupervisory workers--a major source of the data used to construct the hourly wages and salaries estimate in the productivity and cost data--grew 2.7 percent at an annual rate from June to September, compared with 3.5 percent from the second-quarter average to the third-quarter average.

Wholesale Trade Inventories

Wholesale inventories declined in September at an annual rate of \$39.6 billion (book value). In addition, the change in wholesale stocks in August was revised down substantially; the data now show a drawdown of \$3.3 billion in that month compared with an increase of \$14.6 billion in the preliminary report. While sizable reductions in stocks of motor vehicles were reported for both August and September, stocks held by many other types of wholesale establishments also fell. For the quarter as a whole, inventories of non-automotive stocks in the wholesale trade sector declined at a \$10.4 billion annual rate, considerably less than the \$4 billion increase assumed by BEA in preparing the advance estimate of real GDP for the third quarter.

In the non-auto categories, stocks of farm products fell even more sharply in September than in the two preceding months. Given the steep price declines for crops in September, a large portion of the book-value drop in this category probably reflected changes in prices rather than changes in real quantities. Elsewhere, stock accumulation occurred at distributors of capital goods--machinery and professional and commercial equipment--but inventories in most other categories were reduced.

Sales at non-auto wholesale establishments rose 0.9 percent in September, and their inventory-sales ratio fell to 1.23 months.

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

	1994 ¹	1995 ¹	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1995:Q3 to 1996:Q3
<u>Output per hour</u>							
Total business	.3	.3	-.6	2.0	1.1	.3	.7
Nonfarm business	.5	.3	-1.1	1.7	.5	.2	.3
Manufacturing	4.5	3.5	3.7	5.6	2.9	6.3	4.6
Nonfinancial corporations ²	.4	1.9	2.5	1.1	1.3	ND	ND
<u>Compensation per hour</u>							
Total business	2.3	4.1	4.4	3.0	4.1	4.3	4.0
Nonfarm business	2.5	4.1	4.1	3.3	3.8	3.9	3.8
Manufacturing	2.7	4.2	4.1	.4	5.8	4.6	3.7
Nonfinancial corporations ²	1.9	3.9	4.0	2.6	3.7	ND	ND
<u>Unit labor costs</u>							
Total business	1.9	3.9	5.0	1.0	3.0	4.0	3.3
Nonfarm business	2.0	3.8	5.2	1.5	3.3	3.7	3.4
Manufacturing	-1.7	.7	.4	-4.9	2.8	-1.6	-.8
Nonfinancial corporations ²	1.5	1.9	1.5	1.5	2.4	ND	ND

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.

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

	1996			1996		
	Q1	Q2	Q3	July	Aug.	Sept.
<u>Book value basis</u>						
Total	16.7	13.2	n.a.	61.0	38.6	n.a.
Excluding wholesale and retail motor vehicles	25.0	6.0	n.a.	39.1	25.5	n.a.
Manufacturing	12.3	-6.2	13.1	6.9	14.9	17.4
Excluding aircraft	6.3	-10.7	10.4	6.3	12.5	12.5
Wholesale	7.3	11.3	-15.0	-1.9	-3.3	-39.6
Excluding motor vehicles	7.3	7.6	-10.4	-4.2	-.9	-26.1
Retail	-2.9	8.2	n.a.	56.0	27.1	n.a.
Auto dealers	-8.4	3.5	n.a.	19.7	15.6	n.a.
Excluding auto dealers	5.5	4.6	n.a.	36.3	11.5	n.a.
<u>Chained (1992) dollars basis</u>						
Total	-5.4	7.9	n.a.	56.4	26.0	n.a.
Excluding motor vehicles	17.5	1.9	n.a.	46.0	27.2	n.a.
Manufacturing	12.0	-3.9	n.a.	13.7	5.6	n.a.
Wholesale	3.8	6.5	n.a.	1.5	15.9	n.a.
Excluding motor vehicles	4.0	3.3	n.a.	-.4	14.4	n.a.
Retail	-21.7	5.2	n.a.	41.5	4.5	n.a.
Auto dealers	-23.6	2.0	n.a.	10.5	-2.7	n.a.
Excluding auto dealers	3.0	3.2	n.a.	31.0	7.3	n.a.

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

	1996			1996		
	Q1	Q2	Q3	July	Aug.	Sept.
<u>Book value basis</u>						
Total	1.43	1.40	n.a.	1.39	1.40	n.a.
Excluding wholesale and retail motor vehicles	1.40	1.37	n.a.	1.36	1.37	n.a.
Manufacturing	1.45	1.40	1.39	1.39	1.39	1.39
Excluding aircraft	1.34	1.29	1.28	1.28	1.28	1.28
Wholesale	1.32	1.31	1.27	1.28	1.29	1.27
Excluding motor vehicles	1.30	1.28	1.24	1.25	1.26	1.23
Retail	1.49	1.49	n.a.	1.51	1.52	n.a.
Auto dealers	1.66	1.70	n.a.	1.74	1.76	n.a.
Excluding auto dealers	1.44	1.42	n.a.	1.43	1.45	n.a.
<u>Chained (1992) dollars basis</u>						
Total	1.38	1.36	n.a.	1.35	1.35	n.a.
Excluding motor vehicles	1.36	1.33	n.a.	1.32	1.33	n.a.
Manufacturing	1.39	1.35	n.a.	1.34	1.35	n.a.
Wholesale	1.35	1.34	n.a.	1.31	1.33	n.a.
Excluding motor vehicles	1.33	1.31	n.a.	1.28	1.30	n.a.
Retail	1.37	1.37	n.a.	1.38	1.39	n.a.
Auto dealers	1.54	1.57	n.a.	1.56	1.54	n.a.
Excluding auto dealers	1.34	1.33	n.a.	1.34	1.35	n.a.

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

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

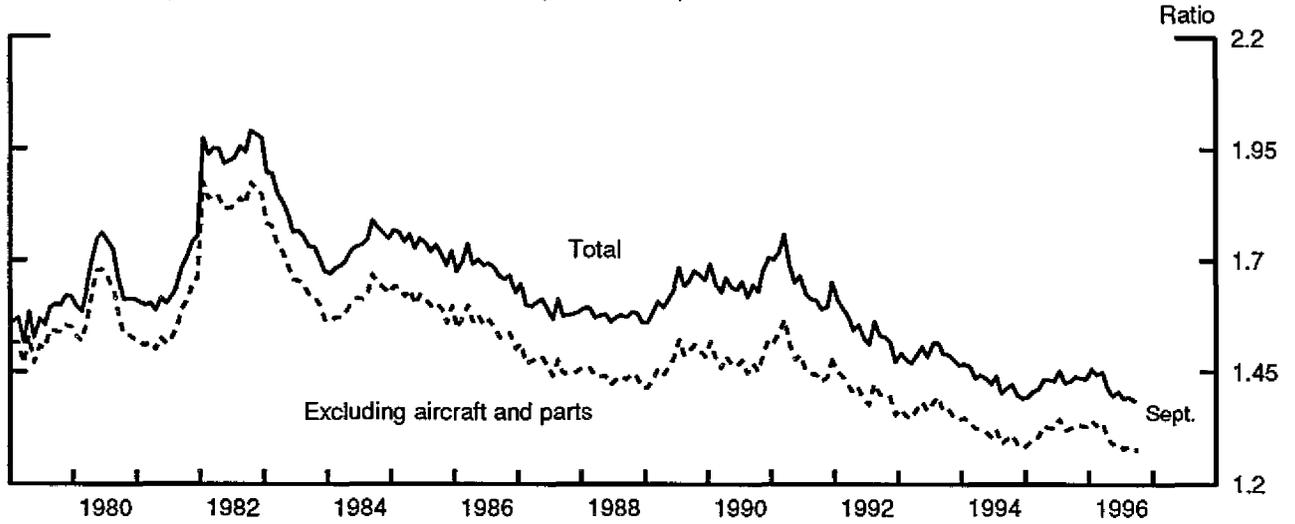
	Cyclical reference points		Most recent 12-month range		August/ September 1996 ¹
	1990-91	1994-95	High	Low	
	High	Low			
Manufacturing and trade	1.58	1.40	1.45	1.39	1.40
Less wholesale and retail motor vehicles	1.57	1.40	1.44	1.39	1.37
Manufacturing	1.75	1.39	1.46	1.39	1.39
Primary metals	2.08	1.45	1.62	1.55	1.61
Nonelectrical machinery	2.48	1.88	1.94	1.84	1.81
Electrical machinery	2.08	1.52	1.60	1.52	1.51
Transportation equipment	2.94	1.59	1.87	1.65	1.65
Motor vehicles	.97	.53	.67	.56	.55
Aircraft	5.85	4.42	5.95	4.89	5.14
Nondefense capital goods	3.09	2.33	2.58	2.38	2.39
Textile	1.71	1.44	1.66	1.49	1.55
Petroleum	.94	.88	.92	.80	.80
Home goods & apparel	1.96	1.70	1.89	1.70	1.72
Merchant wholesalers	1.36	1.28	1.34	1.28	1.27
Less motor vehicles	1.31	1.26	1.31	1.25	1.23
Durable goods	1.83	1.54	1.64	1.58	1.57
Nondurable goods	.96	.98	1.03	.97	.94
Retail trade	1.61	1.46	1.56	1.48	1.52
Less automotive dealers	1.48	1.42	1.48	1.41	1.45
Automotive dealers	2.21	1.60	1.82	1.64	1.76
General merchandise	2.43	2.21	2.34	2.20	2.26
Apparel	2.56	2.47	2.66	2.35	2.44
G.A.F.	2.44	2.24	2.37	2.23	2.27

1. September 1996 ratios for manufacturing and wholesale; August 1996 ratios for retail trade.

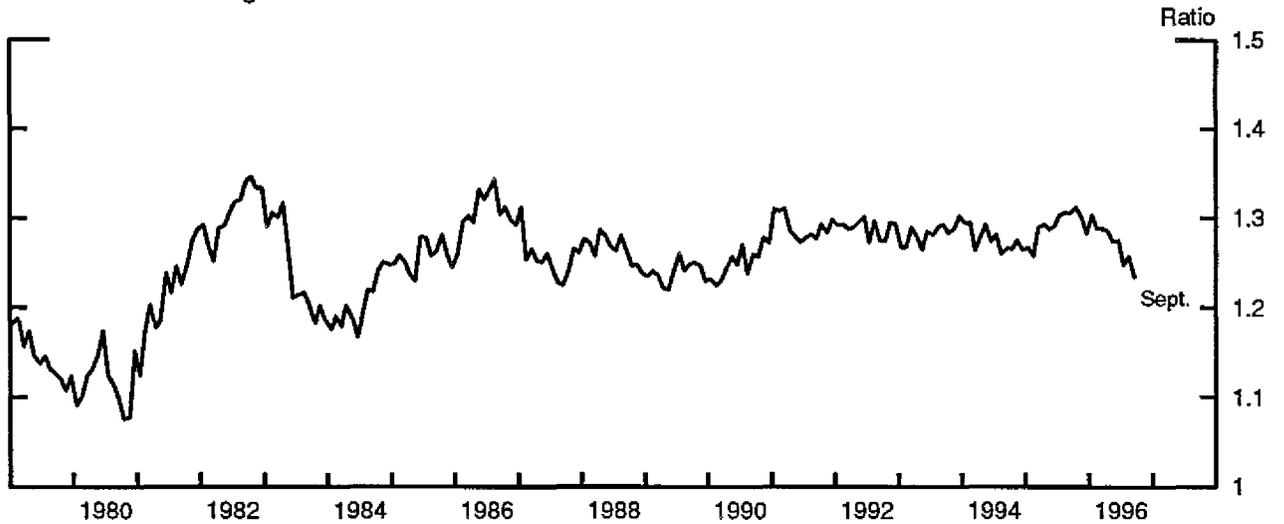
Inventory-Sales Ratios, by Major Sector

Manufacturing

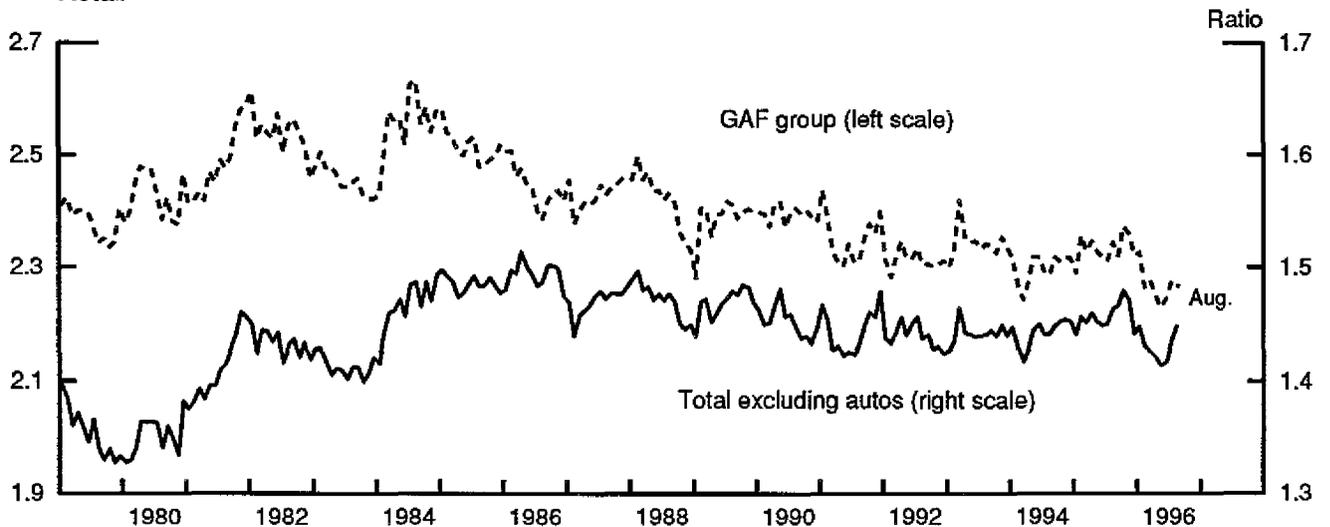
(Book value)



Wholesale Excluding Motor Vehicles



Retail



Selected Financial Market Quotations¹

(Percent except as noted)

Instrument	1996				Change to Nov. 7, from:			
	Feb. low	July high	FOMC,* Sep. 24	Nov. 7	Feb. low	July high	FOMC, Sep. 24	
Short-term rates								
Federal funds ²	5.15	5.39	5.23	5.28	0.13	-0.11	0.05	
Treasury bills ³								
3-month	4.76	5.21	5.15	5.02	0.26	-0.19	-0.13	
6-month	4.67	5.40	5.30	5.08	0.41	-0.32	-0.22	
1-year	4.55	5.64	5.52	5.14	0.59	-0.50	-0.38	
Commercial paper								
1-month	5.27	5.50	5.52	5.38	0.11	-0.12	-0.14	
3-month	5.12	5.59	5.59	5.41	0.29	-0.18	-0.18	
Large negotiable CDs ³								
1-month	5.21	5.44	5.45	5.28	0.07	-0.16	-0.17	
3-month	5.12	5.59	5.55	5.39	0.27	-0.20	-0.16	
6-month	4.99	5.83	5.74	5.45	0.46	-0.38	-0.29	
Eurodollar deposits ⁴								
1-month	5.13	5.38	5.38	5.25	0.12	-0.13	-0.13	
3-month	5.13	5.56	5.50	5.38	0.25	-0.18	-0.12	
Bank prime rate	8.25	8.25	8.25	8.25	0.00	0.00	0.00	
Intermediate- and Long-term Rates								
U.S. Treasury (constant maturity)								
3-year	4.98	6.62	6.40	5.87	0.89	-0.75	-0.53	
10-year	5.58	7.06	6.83	6.26	0.68	-0.80	-0.57	
30-year	6.02	7.19	7.02	6.48	0.46	-0.71	-0.54	
Municipal revenue (Bond Buyer) ⁵	5.67	6.24	6.10	5.92	0.25	-0.32	-0.18	
Corporate-A utility, recently offered	7.18	8.23	8.08	7.65	0.47	-0.58	-0.43	
High-yield corporate ⁶	9.57	10.36	9.95	9.80	0.23	-0.56	-0.15	
Home mortgages ⁷								
FHLMC 30-yr fixed rate	6.94	8.42	8.14	7.78	0.84	-0.64	-0.36	
FHLMC 1-yr adjustable rate	5.19	6.01	5.83	5.60	0.41	-0.41	-0.23	
Stock exchange index	Record high		1996			Percentage change to Nov. 7, from:		
	Level	Date	July low	FOMC, Sep. 24	Nov. 7	Record high	July low	FOMC, Sep. 24
Dow-Jones Industrial	6206.04	11/7/96	5346.55	5894.74	6206.04	0.00	16.08	5.28
NYSE Composite	384.91	11/7/96	336.07	365.51	384.91	0.00	14.53	5.31
S&P 500 Composite	727.65	11/7/96	626.65	686.48	727.65	0.00	16.12	6.00
NASDAQ (OTC)	1258.10	10/15/96	1042.37	1211.47	1254.14	-0.31	20.32	3.52
Wilshire	7045.82	11/7/96	6099.34	6723.87	7045.82	0.00	15.52	4.79

1. One-day quotes except as noted.

2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average to date for the maintenance period ending November 6, 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 Master II high-yield bond index composite. 1996.

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