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CLASS II FOMC

January 27, 1995

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 DOMESTIC NONFINANCIAL ECONOMY	
Real GDP, 1994:Q4. . . . .	1
Business fixed investment. . . . .	1
Erratum. . . . .	3
<u>Tables</u>	
Real gross domestic product and related items. . . . .	4
Business capital spending indicators . . . . .	5
<u>Charts</u>	
Orders and shipments of nondefense capital goods . . . . .	6
Debt service burdens . . . . .	7
THE FINANCIAL ECONOMY	
January Senior Loan Officer Opinion Survey on Bank Lending Practices. . . . .	8
<u>Tables</u>	
Selected financial market quotations . . . . .	13
Commercial bank credit and short- and intermediate- term business credit . . . . .	14

THE DOMESTIC NONFINANCIAL ECONOMY

Real GDP, 1994:Q4

According to BEA's advance estimate, real GDP increased at a 4.5 percent annual rate in the fourth quarter of last year, 1/2 percentage point less than we had projected. Relative to our expectations, this estimate shows somewhat more inventory accumulation and a less substantial rise in final sales. The fixed-weight price index for gross domestic product increased at a 2.6 percent annual rate last quarter, a bit less than during the first three quarters of the year and about in line with our forecast.

Real inventory investment last quarter, which is estimated to have been \$68 billion (annual rate), was the largest quarterly accumulation since 1984. Final sales moved up at a 3.7 percent annual rate in the fourth quarter, a bit less than in the third quarter. The composition of sales was about as expected: strength in consumer and business spending, declines in residential construction and federal purchases, and further substantial increases in both exports and imports of goods and services. Nonetheless, spending was lower than we anticipated in a number of areas, most notably business fixed investment.

Business Fixed Investment

The acceleration in business fixed investment in the fourth quarter, to a 17.6 percent annual rate, was below the 22 percent rate that we forecast and accounted for half of our "miss" in final sales. Real spending on both structures and producers' durable equipment were somewhat below our expectations.

In large part, BEA's lower estimate of growth of PDE reflected the data on shipments of capital goods in December. Although

domestic demand for capital goods was quite robust, on average, during the fourth quarter of 1994, shipments of nondefense capital goods (excluding aircraft) were unchanged in December. A decrease in shipments for office and computing equipment was offset by a modest increase in shipments of other capital goods. December's decline in computer shipments is somewhat at odds with anecdotal reports we have been receiving from industry contacts. Several have confidentially indicated to us that they were unable to ship fast enough to stay ahead of surging demand in December. One possible explanation for the apparent conflict is that computer manufacturers are straining their capacity, and, as a result, the pickup in shipments in December was smaller than is typical for that month. Seasonally unadjusted computer shipments, for example, were up 31 percent in December. If this explanation is true, then we should expect to see a bounceback in computer shipments (on a seasonally adjusted basis) in the first few months of 1995.

New orders for nondefense capital goods excluding aircraft and parts also dipped 0.4 percent in December, the second consecutive monthly decline. Bookings for office and computing equipment dropped 1.6 percent. Bookings for other capital goods were flat, on balance, as large increases for railroad, communication, and search and navigation equipment were offset by declines in orders for nonelectrical machinery.

Because of a large advance in bookings for transportation equipment, new orders for total durable goods increased 1.4 percent in December. However, the staff's constructed series on real adjusted durable goods orders--which strips out nondefense aircraft, defense capital goods, and industries for which reported orders actually equal shipments--edged down 0.1 percent.

Erratum

The top two panels of the exhibit on page II-21 were mislabeled. The corrected exhibit is included on page 7.

## Real Gross Domestic Product and Related Items

(Percent change from previous period at compound annual rates;  
based on seasonally adjusted data, measured in 1987 dollars)

	1993-Q4 to 1994-Q4	1994-Q1 Final	1994-Q2 Final	1994-Q3 Final	1994-Q4 Advance
1. Gross domestic product	4.0	3.3	4.1	4.0	4.5
2. Final sales	2.9	2.2	1.5	4.3	3.7
3. Consumer spending	3.4	4.7	1.3	3.1	4.6
4. Business fixed investment	12.9	10.9	9.2	14.1	17.6
5. Producers' durable equipment	15.6	18.6	6.1	18.1	20.2
6. Nonresidential structures	4.2	-11.8	20.6	1.6	9.0
7. Residential investment	1.9	10.0	7.0	-6.0	-2.6
8. Federal government purchases	-6.2	-10.3	-7.9	10.9	-15.6
9. Defense purchases	-8.4	-16.0	-4.1	12.8	-22.5
10. Nondefense purchases	-1.6	2.9	-15.0	6.8	.4
11. State and local govt. purchases	2.0	-1.4	2.9	4.3	2.3
12. Imports of goods and services	14.9	9.5	18.9	15.6	16.0
13. Exports of goods and services	10.2	-3.5	16.6	14.8	14.2
-----					
<i>ADDENDA:</i>					
14. Nonfarm inventory investment <sup>1</sup>	45.3 <sup>2</sup>	22.1	51.7	47.4	59.9
15. Motor vehicles <sup>1</sup>	6.4 <sup>2</sup>	1.5	3.5	8.0	12.5
16. Excl. motor vehicles <sup>1</sup>	38.9 <sup>2</sup>	20.6	48.2	39.4	47.4
17. Farm inventory investment <sup>1</sup>	7.1 <sup>2</sup>	3.3	7.5	9.7	8.1
18. Net exports of goods and services <sup>1</sup>	-114.2 <sup>2</sup>	-104.0	-111.8	-117.0	-124.1
19. GDP fixed-weight price index	2.9	3.1	2.9	3.0	2.6
20. GDP implicit price deflator	2.3	2.9	2.9	1.9	1.6
21. Corporate profits <sup>3</sup>	n.a.	508.2	546.4	556.0	n.a.
22. Profit share <sup>4</sup>	n.a.	7.7	8.2	8.2	n.a.
23. Personal saving rate (percent)	4.1 <sup>2</sup>	3.6	4.1	4.1	4.6

1. Level, billions of 1987 dollars.

2. Annual average.

3. With inventory valuation and capital consumption adjustments; level, billions of dollars.

4. Economic profit as a share of nominal GNP.

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

	1994			1994		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	2.3	3.4	2.1	-.9	1.8	-1.0
Excluding aircraft and parts	4.6	3.2	2.9	.1	1.1	.0
Office and computing	1.7	2.5	4.5	1.2	-.3	-1.3
All other categories	5.4	3.4	2.5	-.2	1.5	.4
Shipments of complete aircraft <sup>1</sup>	-33.1	-4.5	n.a.	-41.8	62.5	n.a.
Sales of heavy trucks	5.3	1.3	8.2	4.8	8.6	-8.2
Orders of nondefense capital goods	.2	3.3	3.5	-2.0	6.4	-7.1
Excluding aircraft and parts	4.2	3.4	3.0	.8	-1.0	-.4
Office and computing	6.7	3.3	2.3	3.8	-7.9	-1.6
All other categories	3.5	3.5	3.2	-.1	1.1	-.0
<u>Nonresidential structures</u>						
Construction put-in-place	3.6	2.4	n.a.	1.5	3.7	n.a.
Office	3.7	2.8	n.a.	4.9	6.0	n.a.
Other commercial	11.9	1.9	n.a.	-.3	2.2	n.a.
Institutional	7.4	-1.3	n.a.	.1	3.6	n.a.
Industrial	6.6	3.5	n.a.	-1.4	7.6	n.a.
Public utilities	-4.5	5.4	n.a.	5.8	1.4	n.a.
Lodging and miscellaneous	-.6	-4.6	n.a.	-4.7	7.5	n.a.
Rotary drilling rigs in use	2.2	-.8	-6.5	-4.9	-3.6	-2.1
Memo:						
Business fixed investment <sup>2</sup>	9.2	14.1	17.6	n.a.	n.a.	n.a.
Producers' durable equipment <sup>2</sup>	6.1	18.1	20.2	n.a.	n.a.	n.a.
Nonresidential structures <sup>2</sup>	20.6	1.6	9.0	n.a.	n.a.	n.a.

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

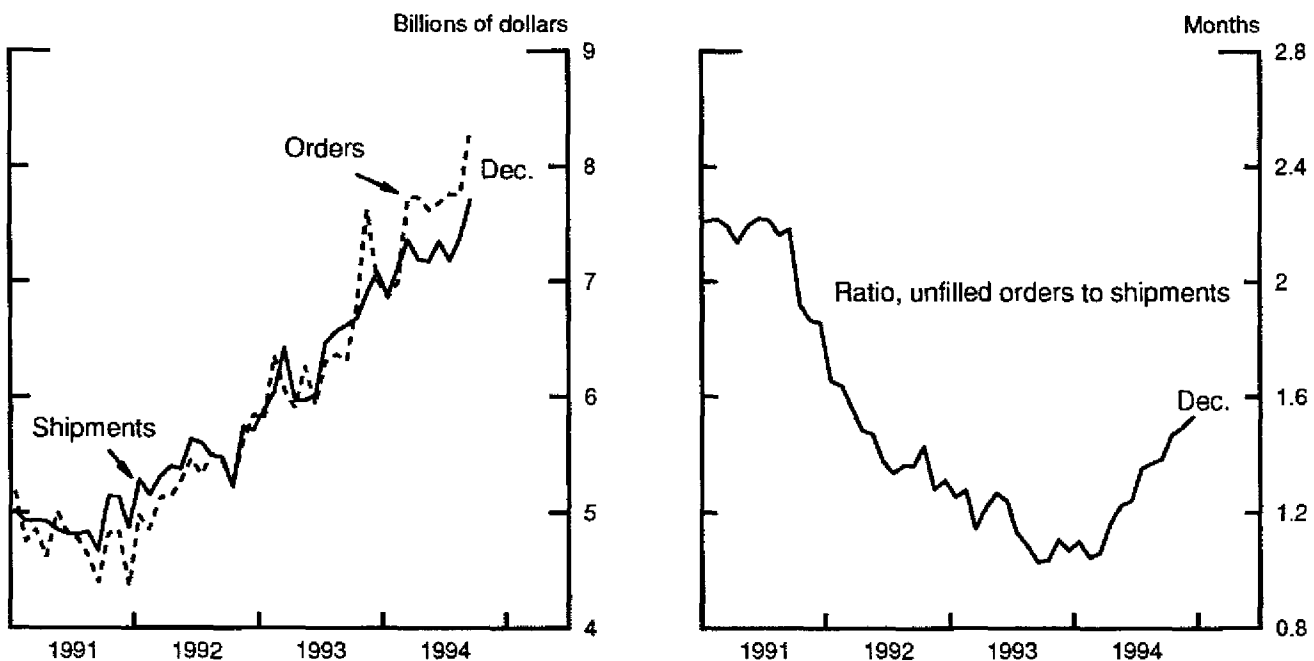
2. Based on constant-dollar data; percent change, annual rate.

n.a. Not available.

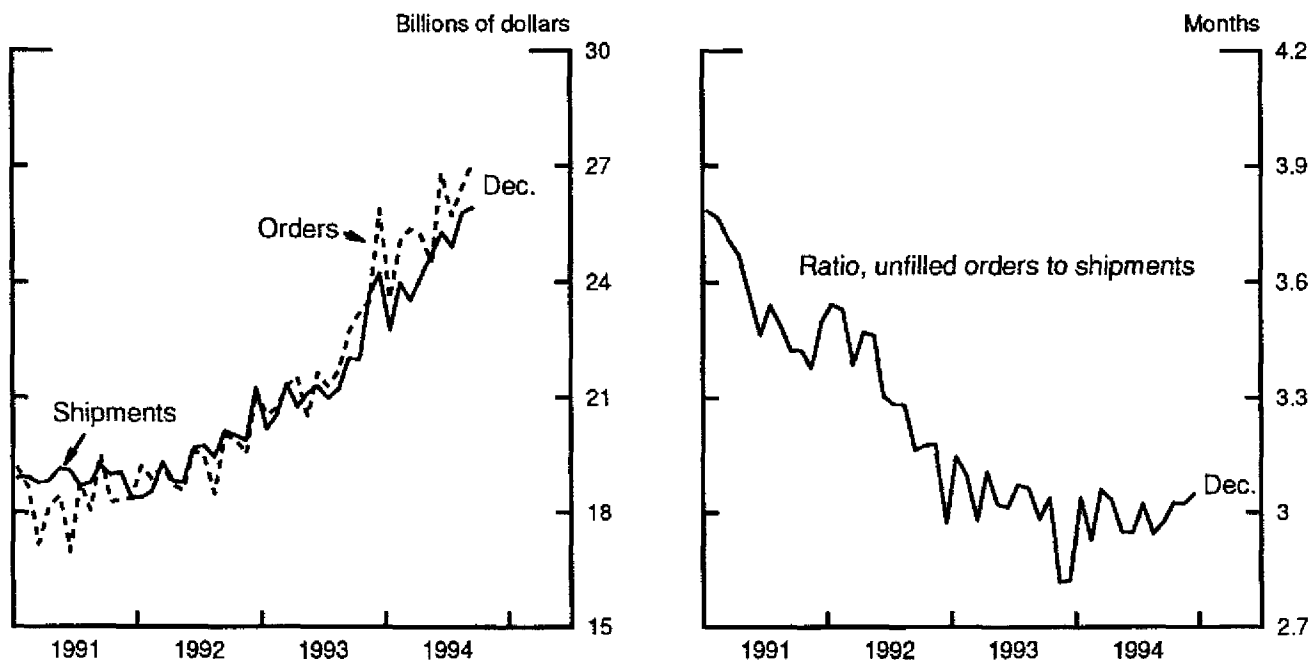


### Orders and Shipments of Nondefense Capital Goods

#### Office and Computing Equipment



#### Other Equipment (Excluding Aircraft and Computing Equipment)

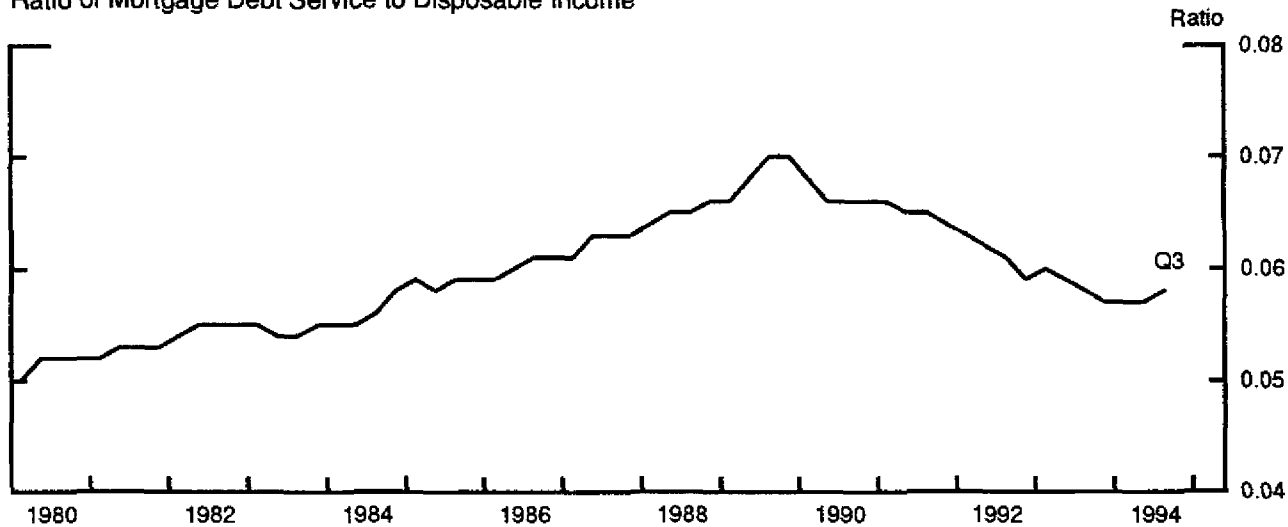


## Debt Service Burdens

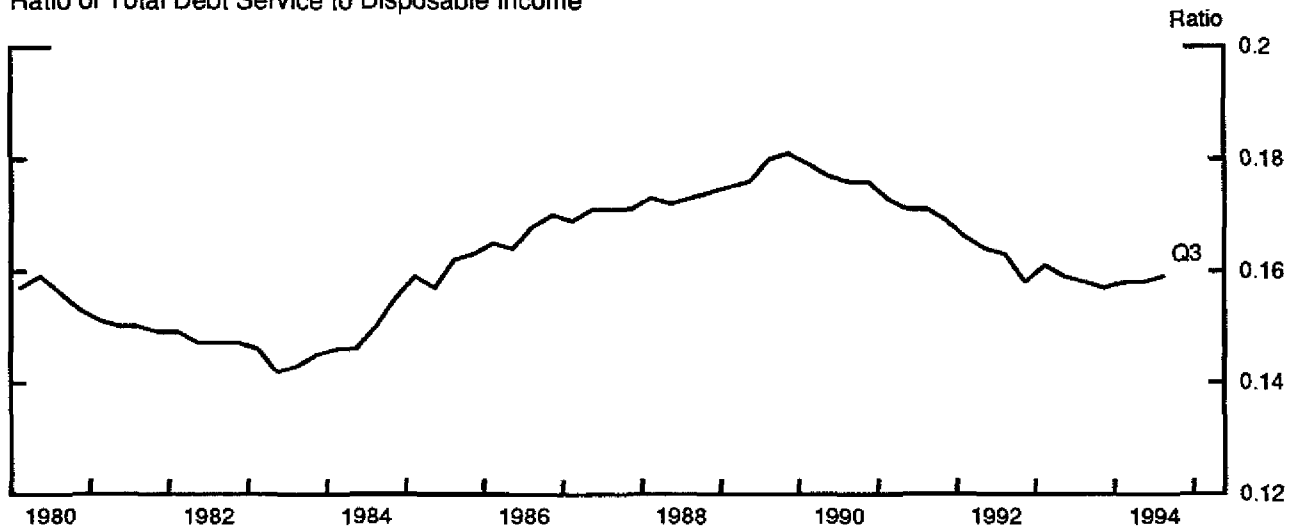
Ratio of Consumer Installment Debt Service to Disposable Income



Ratio of Mortgage Debt Service to Disposable Income



Ratio of Total Debt Service to Disposable Income



THE FINANCIAL ECONOMY

The January Senior Loan Officer Opinion Survey on Bank Lending Practices

The January 1995 Senior Loan Officer Opinion Survey on Bank Lending Practices posed questions about changes in bank lending standards and terms, changes in loan demand by businesses and households, merger and acquisition lending, and co-branded and affinity credit card programs. Fifty-nine domestic commercial banks and twenty-four U.S. branches and agencies of foreign banks participated in the survey.

The survey found that relatively small fractions of banks eased standards for approving commercial and industrial loans to firms of all sizes over the past three months--less than half as many as had reported easing in the November survey. Despite the fact that significant fractions of respondents reported having eased standards for the past six surveys, more than half the banks reported that their current standards are now tighter than they were in the late 1980s. Large fractions of the domestic and foreign respondents reported easing some terms on commercial and industrial loans over the past three months, particularly spreads over base rates. By contrast, domestic and foreign respondents reported a slight tightening of standards for commercial real estate loans, ending the modest easing that had been reported in 1994. Banks continued to report a greater willingness to make consumer loans, but by a smaller margin than in recent surveys. As has been true for the past several surveys, many banks reported increased demand for business loans. The demand for consumer loans was characterized as little changed on balance, and a large majority of banks indicated weaker demand for home mortgages.

The survey found that the share of merger and acquisition loans in total business loans had increased slightly over the past year. Survey questions on credit-card lending found evidence of only a

modest effect of co-branded or affinity cards on the level of credit card outstandings. Many of the respondents reported having eased their terms or standards on their credit cards during the past year. Commercial and industrial loans other than for mergers

The survey found that a small number, less than 10 percent, of banks eased standards on commercial and industrial loans to large firms over the past three months and, on net, even fewer reported having eased standards on loans to small and middle-market borrowers. Foreign banks reported little change in business lending standards. In the November survey, for all three size categories of borrowers, about 20 percent of the respondents reported having eased standards. In 1990 and 1991, large fractions of the domestic respondents reported tightening standards on C&I loans. From the second half of 1993 to the present, substantial, albeit smaller, fractions of banks reported having eased standards. The cumulative effect of the period of tightening still appears to outweigh the period of easing: Half the survey participants reported that their banks' standards are tighter now than they were in the late 1980s.

Many of the respondents reported that they had eased their terms on business loans since November. About two-fifths of the domestic respondents reported lower yield spreads over base rates for middle-market and large firms and a quarter did so for small firms. Smaller fractions reported easing other terms including the size of credit lines, the costs of credit lines, loan covenants, and collateralization requirements. Foreign branches and agencies also eased many terms. Almost all the banks that reported an easing of terms or standards on business loans cited increased competition from other banks as the principal reason. The survey results regarding terms on business loans have been similar since the end of 1993 with about half the banks indicating a narrowing of spreads on

loans to large and middle-market firms, about a quarter narrowing spreads to smaller firms, and smaller fractions of banks easing other terms.

As has been true for the past several surveys, many banks reported increased demand for business loans over the preceding three months. On net, about 40 percent of the respondents reported greater demand from large firms, 30 percent for middle-market firms, and just under 20 percent for small firms. Respondents attributed the increased demand primarily to growth in customers' inventory financing needs and investment in plant and equipment. Several banks also cited merger and acquisition financing needs as a reason for increased demand. Less than 10 percent of foreign respondents, on net, reported greater demand.

#### Commercial real estate loans

Both domestic and foreign respondents indicated that credit standards for commercial real estate loans were little changed over the past three months. Banks that reported tighter standards on loans for industrial structures and for commercial office buildings exceeded slightly the number that reported easier standards. The four surveys in 1994 had found modest evidence of easing of standards on loans for commercial office buildings. Standards on these loans do not appear to have changed appreciably since the substantial tightening reported in 1990 and 1991.

#### Loans to individuals

About 15 percent of the domestic respondents reported that they are more willing to make consumer installment loans now than they were three months ago, below the percentage that reported easing on the November survey. The responses indicate that standards for approving residential mortgage applications were little changed. The survey found some evidence of a decline in credit demand from

households, perhaps as a result of recent increases in mortgage and consumer loan rates. Nearly three-quarters of the domestic respondents reported a decrease in demand for residential mortgages. Moreover, 10 percent of banks, on net, reported lower demand for home equity loans, and a couple more banks reported a decline in demand for consumer installment loans than reported an increase. The survey results had not shown a net decline in demand for consumer installment credit since the beginning of 1992.

#### Loans to finance mergers and acquisitions

Most of the domestic respondents indicated that loans for mergers and acquisitions accounted for the same share of total business loans in recent months as they had a year ago. A few, however, reported that the percentage of the dollar volume of outstanding commercial and industrial loans used to finance merger-related activity is currently between 6 and 10 percent, whereas it had been between 1 and 5 percent a year ago. While loans to finance mergers and acquisitions accounted for less than 5 percent of C&I lending at more than half the domestic banks in the survey, foreign respondents reported somewhat larger fractions and also reported a slight increase in these shares over the past year.

#### Credit cards

Questions on the survey addressed banks' issuance of co-branded and affinity credit cards. A co-branded card is jointly offered by a credit card issuer and a for-profit partner, such as an airline, and provides credits toward the partner's product. With an affinity card, the partner is a particular interest group, often a nonprofit organization, that receives a percentage of each charge made with the card. About 60 percent of the respondents indicated that less than 10 percent of their credit card receivables were from co-branded or affinity cards. About one-fifth of the respondents

reported that more than 30 percent of their receivables were associated with these cards. The responses indicate that these shares are up only modestly from a year earlier.

Another development in the past few years has been the increased number of nontraditional outlets for credit cards, for example, grocery stores. Press reports have suggested that these new outlets as well as the popularity of co-branded and affinity cards have resulted in an increase in convenience use, that is, in charges that are paid off within the billing cycle. The median bank stated that between 11 and 20 percent of its credit card receivables represented convenience use. While 30 percent of the respondents indicated that this percentage was up from a year earlier, about half as many indicated that convenience use had declined over the past year, and only two banks reported that convenience use had increased by more than 5 percent. However, of those banks that had experienced an increase in convenience use, most cited the greater popularity of co-branded and affinity cards as a reason and several cited the wider acceptance of credit cards at nontraditional outlets. Nevertheless, the survey results do not support the view that the dramatic growth in consumer loans outstanding at banks in 1994 was the result of increased convenience use of credit cards.

On net, one-fifth of the respondents reported having eased standards for approving credit card applications over the past year and more than two-fifths reported having eased terms. Of those banks that eased terms, the largest fraction reported having narrowed spreads on financing charges, and many respondents reported having increased credit limits and reduced annual fees.

1  
SELECTED FINANCIAL MARKET QUOTATIONS  
(Percent except as noted)

Instrument	1993	1994		1995	Change to Jan 26, 1995:			
	Oct lows	Feb 3	FOMC, Dec 20	Jan 26	From Oct 93 lows	From Feb 3	From FOMC, Dec 20	
<b>SHORT-TERM RATES</b>								
Federal funds <sup>2</sup>	3.07	3.07	5.44	5.43	2.36	2.36	-0.01	
Treasury bills <sup>3</sup>								
3-month	3.01	3.13	5.48	5.77	2.76	2.64	0.29	
6-month	3.09	3.27	6.19	6.16	3.07	2.89	-0.03	
1-year	3.23	3.52	6.61	6.46	3.23	2.94	-0.15	
Commercial paper								
1-month	3.13	3.16	6.10	5.96	2.83	2.80	-0.14	
3-month	3.23	3.25	6.27	6.25	3.02	3.00	-0.02	
Large negotiable CDs <sup>3</sup>								
1-month	3.08	3.11	6.01	5.92	2.84	2.81	-0.09	
3-month	3.22	3.25	6.27	6.22	3.00	2.97	-0.05	
6-month	3.23	3.41	6.77	6.65	3.42	3.24	-0.12	
Eurodollar deposits <sup>4</sup>								
1-month	3.06	3.06	6.00	5.94	2.88	2.88	-0.06	
3-month	3.25	3.25	6.25	6.19	2.94	2.94	-0.06	
Bank prime rate	6.00	6.00	8.50	8.50	2.50	2.50	0.00	
<b>INTERMEDIATE AND LONG-TERM RATES</b>								
U.S. Treasury (constant maturity)								
3-year	4.06	4.60	7.68	7.54	3.48	2.94	-0.14	
10-year	5.19	5.81	7.81	7.76	2.57	1.95	-0.05	
30-year	5.78	6.31	7.85	7.85	2.07	1.54	0.00	
Municipal revenue <sup>5</sup> (Bond Buyer)	5.41	5.49	7.02	6.78	1.37	1.29	-0.24	
Corporate--A utility, recently offered <sup>6</sup>	6.79	7.35	8.77	8.84	2.05	1.49	0.07	
Home mortgages <sup>6</sup>								
FHLMC 30-yr. fixed rate	6.74	6.97	9.25	9.05	2.31	2.08	-0.20	
FHLMC 1-yr. adjustable rate	4.14	4.12	6.75	6.82	2.68	2.70	0.07	
Stock exchange index	Record high		1989	1994	1995	Percentage change to Jan 26:		
	Level	Date	Low, Jan. 3	FOMC, Dec 20	Jan 26	From record high	From 1989 low	From FOMC, Dec 20
Dow-Jones Industrial	3978.36	1/31/94	2144.64	3767.15	3870.44	-2.71	80.47	2.74
NYSE Composite	267.71	2/2/94	154.00	249.80	254.92	-4.78	65.53	2.05
NASDAQ (OTC)	803.93	3/18/94	378.56	728.51	757.56	-5.77	100.12	3.99
Wilshire	4804.31	2/2/94	2718.59	4491.92	4616.05	-3.92	69.80	2.76

1. One-day quotes except as noted.  
 2. Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for maintenance period ending Feb 1, 1995.  
 3. Secondary market.

4. Bid rates for Eurodollar deposits at 11 a.m. London time.  
 5. Most recent observation based on one-day Thursday quote and futures market index changes.  
 6. Quotes for week ending Friday previous to date shown.



COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT<sup>1</sup>  
 (Percentage change at annual rate, based on seasonally adjusted data)

Type of credit	Dec. 1993 to Dec. 1994	1994 Q3	1994 Q4	1994 Oct	1994 Nov	1994 Dec	Level, Dec 1994 (\$billions)
Commercial bank credit							
1. Total loans and securities	7.0	7.0	5.2	2.6	3.5	9.5	3,323.4
2. Securities	4.3	-2.7	-7.3	-13.0	-8.8	-.1	950.5
3. U.S. government	-1.3	-5.2	-12.7	-21.4	-13.2	-3.8	717.6
4. Other	26.2	6.1	10.2	14.3	5.2	10.9	232.8
5. Loans	8.2	11.2	10.5	9.2	8.4	13.4	2,372.9
6. Business	10.4	11.5	10.4	11.7	10.0	9.2	644.3
7. Real estate	6.3	9.7	8.5	5.8	7.8	11.6	999.9
8. Consumer	15.1	18.2	14.0	19.0	7.6	14.8	450.4
9. Security	-12.7	-37.3	43.4	52.1	20.0	54.0	76.6
10. Other	5.9	21.8	1.6	-17.9	4.2	18.7	201.7
Short- and intermediate-term business credit							
11. Business loans net of bankers acceptances	10.6	11.6	11.2	13.0	11.1	9.1	635.7
12. Loans at foreign branches <sup>2</sup>	5.5	17.9	-6.9	-36.1	5.3	10.6	22.9
13. Sum of lines 11 and 12	10.4	11.8	10.5	11.2	10.7	9.4	658.6
14. Commercial paper issued by nonfinancial firms	5.1	11.0	31.8	32.8	23.6	36.6	165.7
15. Sum of lines 13 and 14	9.3	11.6	14.6	15.2	13.6	14.6	824.3
16. Bankers acceptances, U.S. trade-related <sup>3,4</sup>	-9.5	-3.9	-37.8	-35.8	-30.8	-50.5	18.2
17. Loans at finance companies <sup>4</sup>	n.a.	7.2	n.a.	17.0	15.0	n.a.	348.2 <sup>5</sup>
18. Total (sum of lines 15, 16, and 17)	n.a.	10.0	n.a.	15.0	13.1	n.a.	1,181.5 <sup>5</sup>

1. Except as noted, levels are averages of Wednesday data and percentage changes are based on averages of Wednesday data; data are adjusted for breaks caused by reclassification; changes are measured from preceding period to period indicated.

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

3. Acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.

4. Changes are based on averages of month-end data.

5. November 1994.

n.a. Not available.