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Confidential (FR) Class III FOMC

Part 2

December 12, 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

December 12, 1996

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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DOMESTIC NONFINANCIAL DEVELOPMENTS

The economy exhibited moderate growth early in the fourth quarter. Employment continued to increase at a solid clip in the first two months of the quarter, and consumer spending revived after a summer lull. Meanwhile, inflation remained on a fairly steady trend, with the core CPI continuing to run just above 2-1/2 percent on a twelve-month basis.

Real GDP

According to BEA's preliminary estimate, real GDP rose at an annual rate of 2 percent in the third quarter, 0.2 percentage point less than in the advance report. The revision reflected sharp downward adjustments to inventory investment and net exports, which were partially offset by upward adjustments to consumer spending, business fixed investment, and government expenditures. Data received since the preliminary report suggest that slightly higher inventories will lead BEA to revise third-quarter GDP growth back up to the area of 2-1/4 percent. However, none of these revisions alters the basic expenditure mix portrayed in the advance report: strong business fixed investment and inventory accumulation but weak consumer spending and net exports.

The BEA report also indicated that gross domestic income (GDI), which rose 4 percent at an annual rate in the third quarter and 3-1/2 percent during the past year, continued to grow substantially faster than GDP.[1] Total economic profits (including inventory valuation and capital consumption adjustments) held steady in the third quarter after strong gains over the first half of the year, and the profit share edged down only a tad, to 8.6 percent. Domestic nonfinancial profits were up for the third straight quarter and about offset declines in profits from the domestic financial sector and the foreign sector.

Labor Market Developments

The November survey of establishments revealed continued solid demand for labor. Private nonfarm payrolls rose 140,000, after

1. The difference between the product- and income-side measures has led to a sharp widening in the statistical discrepancy in recent years. Because BEA truncated this year's normal annual revision process and because the swing in the statistical discrepancy is so dramatic, we find it useful to examine both the product-based and income-based measures.

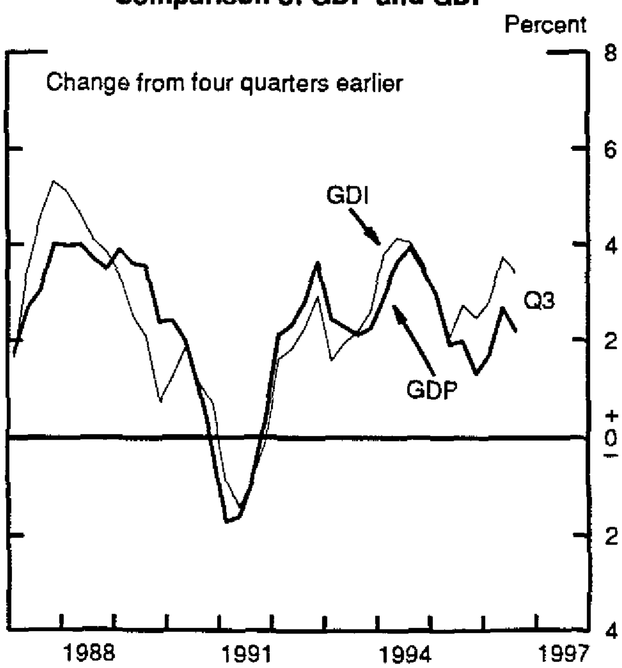
Real Gross Domestic Product and Related Items

(Percentage change from previous period at compound annual rates; based on seasonally adjusted data, chain–type indexes)

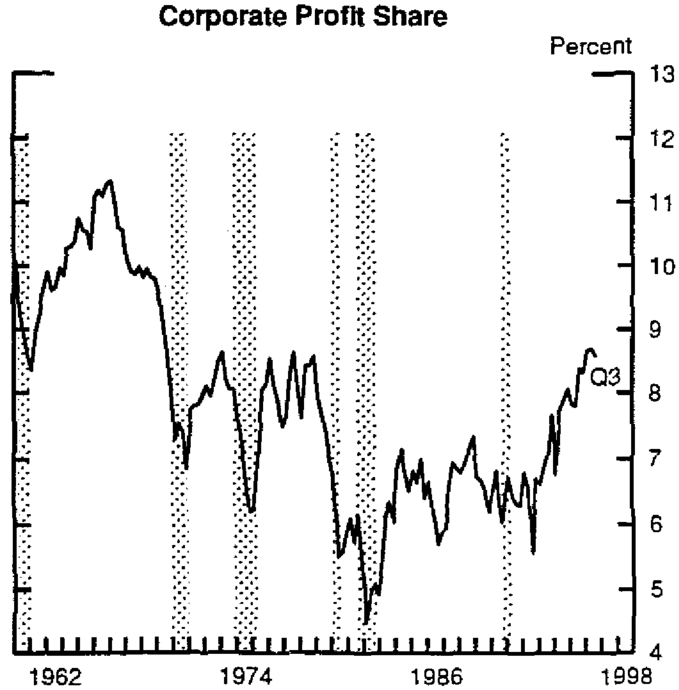
	1996:Q3 Advance	1996:Q3 Preliminary	1995:Q3 to 1996:Q3
1. Gross domestic product	2.2	2.0	2.2
2. Private domestic final purchases	1.9	2.3	3.1
3. Consumer spending	.4	.6	2.1
4. Business fixed investment	14.7	16.9	8.5
5. Residential investment	–5.8	–5.9	5.7
6. Federal government	–4.0	–3.4	–.7
7. State and local government	.2	1.7	2.2
MEMO:			
8. Nonfarm inventory investment [1]	41.2	33.0	37.2 [2]
9. Motor vehicles [1]	4.8	5.8	2.1 [2]
10. Excl. motor vehicles [1]	36.4	27.2	35.1 [2]
11. Farm inventory investment [1]	–2.2	–.5	–4.7 [2]
12. Net exports of goods and services [1]	–132.2	–138.8	–107.6 [2]
13. Nominal GDP	3.8	3.6	4.1
14. Gross domestic income	n.a.	4.1	3.4

1. Level, billions of chained (1992) dollars.
2. 1995 annual average.

Comparison of GDP and GDI



Corporate Profit Share



Note. Economic profits divided by nominal GNP.

surging 230,000 in October.[2] The average workweek of private production or nonsupervisory workers rose to 34.5 hours in November, reversing half of its October decline and lifting the workweek 0.1 hour above the average for the first ten months of the year. Aggregate hours of production workers in November stood 0.4 percent above their third-quarter average.

Private employment gains were widespread in November. Payrolls rose 118,000 in the service-producing sector, led by increases in health services, private educational services, and computer services. However, employment in help supply services, which had been at a high level since a big jump in August, dropped back 32,000, to below its July reading. Anecdotal reports suggest that a possible explanation for at least part of the weakness in employment in this industry is that firms had difficulty hiring additional workers. Employment in retail trade rose 17,000 in November after a sharp increase in October that BLS attributes, in large part, to unusually early seasonal hiring at general merchandise and apparel stores. In the goods-producing sector, both construction and manufacturing firms added jobs in November. The gains included a second consecutive strong month for aircraft and parts.

Employment, as measured by the household survey, fell 30,000 in November, and the labor force expanded 244,000. The published unemployment rate increased 0.2 percentage point, to 5.4 percent, but the unemployment rate estimated with concurrent seasonal factors edged up only 0.1 percentage point, to 5.3 percent. Among demographic groups, increases in unemployment rates were largest for teenagers (16.1 to 17.0 percent) and men aged 20 to 24 (8.7 to 9.3 percent). Unemployment rates for prime-age workers (those 25 to 54 years old) held steady at 4.0 percent for men and rose slightly from 4.3 to 4.5 percent for women. The labor force participation rate remained at 66.9 percent, 1/2 percentage point higher than a year ago.

Other labor market indicators hint at a bit more strength than is apparent in the recent household and payroll surveys. Weekly initial claims for unemployment insurance (state programs only) averaged 332,000 during the past four weeks--a level historically associated with faster employment growth. The Conference Board's help-wanted index (with FRB adjustments) was little changed in

2. With the November labor market report, BLS updated the seasonal factors in the payroll survey for September through November of this year.

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

	1994	1995	1996 Q1	1996 Q2	1996 Q3	1996 Sept.	1996 Oct.	1996 Nov.
	Average monthly changes							
Nonfarm payroll employment[2]	318	185	205	262	171	-2	224	118
Private	295	176	189	245	147	85	232	140
Manufacturing	33	-12	-29	6	-19	-50	9	9
Durable	28	5	-15	24	-7	-36	7	10
Transportation equipment	5	-3	-13	16	-4	-20	-2	6
Nondurable	5	-17	-14	-19	-12	-14	2	-1
Construction	25	9	39	20	16	12	12	14
Trade	91	54	22	82	59	46	108	20
Finance, insurance, real estate	-3	4	15	12	14	10	16	16
Services	134	110	126	113	76	75	88	70
Help supply services	28	8	9	29	12	-6	2	-32
Total government	23	9	16	17	24	-87	-8	-22
Private nonfarm production workers[2]	267	152	157	213	120	46	187	45
Manufacturing production workers	34	-10	-30	5	-14	-35	11	13
Total employment[3]	261	32	390	153	253	313	259	-30
Nonagricultural	225	51	336	188	202	198	336	73
Memo:								
Aggregate hours of private production workers (percent change)[2]	.4	.1	.3	.5	.1	.8	-.7	.4
Average workweek (hours)[2]	34.6	34.5	34.3	34.4	34.4	34.7	34.3	34.5
Manufacturing (hours)	41.9	41.6	40.9	41.7	41.7	41.7	41.7	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	1996 Q1	1996 Q2	1996 Q3	1996 Sept.	1996 Oct.	1996 Nov.
Civilian unemployment rate (16 years and older)	6.1	5.6	5.6	5.4	5.2	5.2	5.2	5.4
Teenagers	17.6	17.3	17.4	16.3	16.4	15.6	16.1	17.0
Men: 20 years and older	5.4	4.8	4.9	4.7	4.5	4.5	4.3	4.5
20-24 years	10.1	9.2	10.1	10.0	8.8	8.8	8.7	9.3
25-54 years	4.9	4.4	4.4	4.3	4.0	4.2	4.0	4.0
55 years and older	4.3	3.7	3.5	3.3	3.4	3.2	2.9	3.1
Women: 20 years and older	5.4	4.9	4.9	4.8	4.7	4.5	4.7	4.8
20-24 years	9.2	9.0	9.5	8.5	9.0	8.5	8.9	9.0
25-54 years	5.0	4.5	4.4	4.4	4.3	4.2	4.3	4.5
55 years and older	3.9	3.6	3.8	3.7	3.3	3.4	3.4	2.8
Full-time workers	6.1	5.5	5.5	5.3	5.1	5.1	5.1	5.3
Labor force participation rate	66.6	66.6	66.7	66.7	66.8	66.8	66.9	66.9

October from the relatively high level experienced during the past two years. The Manpower Inc. index of net hiring plans for the first quarter of 1997 was up from a year ago. (Judging from earlier patterns, this increase probably says more about the fourth quarter than the first.) Perceptions of labor market conditions, as reported by the Conference Board and Michigan surveys, also remained quite favorable through November.

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose 0.8 percent in November after edging down 0.1 percent in October. Averaging over those two months, wage increases were particularly large in the retail trade and services industries--industries where October's increase in the minimum wage most likely would appear. More broadly, the recent data provide further indication of acceleration in total average hourly earnings. Wages have risen 3.5 percent during the past twelve months--0.6 percentage point more than during the preceding twelve-month period.

Growth in output per hour in the nonfarm business sector in the third quarter was revised down 1/2 percentage point and now shows a slight decline. Productivity growth earlier in the year was revised up slightly, but growth during the four quarters of 1995 was revised down, from 0.3 percent to -0.1 percent.[3] All told, the data now show that nonfarm business productivity has grown at an annual rate of 0.9 percent since the last business cycle peak (1990:Q3), rather than the 1.0 percent pace estimated prior to the revision.

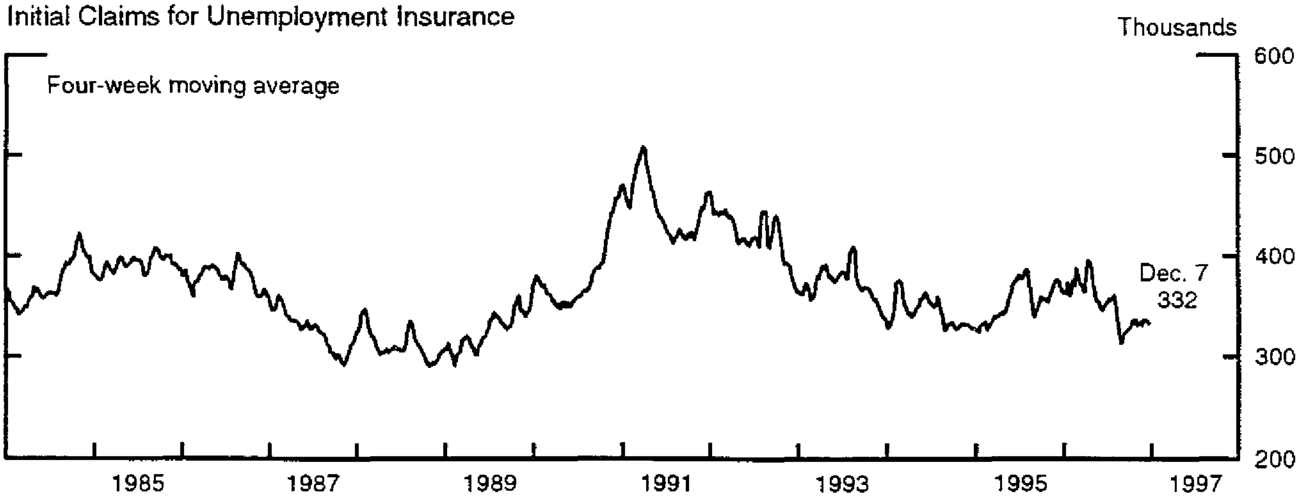
Output per hour in the nonfinancial corporate business sector increased at an annual rate of 3.6 percent in the third quarter and 1.7 percent annually since the last peak. This estimate is based on data from the income side of the NIPA and excludes productivity of financial and noncorporate businesses, which probably is more difficult to measure accurately.

Compensation per hour in the nonfarm business sector in the third quarter was also revised down--from an annual rate of 3.9 percent to 3.4 percent. During the past four quarters, compensation per hour increased 3.7 percent, up a bit from

3. The revisions to productivity and compensation per hour in 1995 incorporate the results of the 1995 Hours at Work Survey (HWS). BLS uses this survey to adjust hours for which private nonfarm employees are paid (reported in the BLS Current Establishment Survey) to hours at the workplace. The latest HWS indicated that hours at work grew more than previously estimated. Hours in manufacturing largely were unaffected by these revisions.

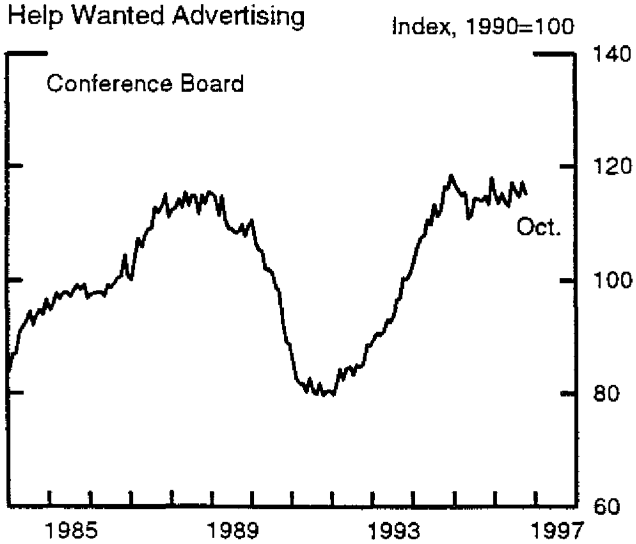
Labor Market Indicators

Initial Claims for Unemployment Insurance



Note. State programs, includes EUC adjustment.

Help Wanted Advertising

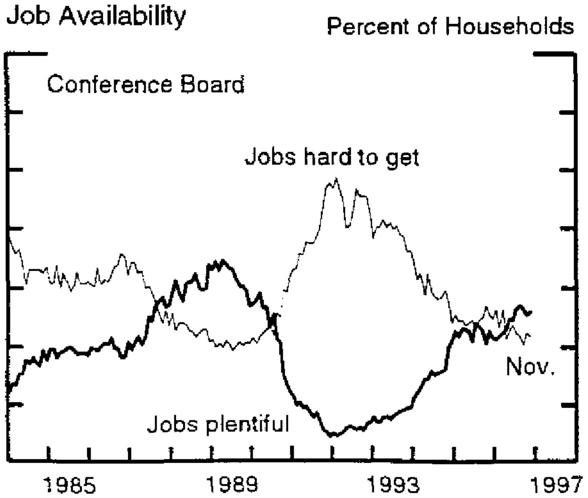


Note. Series has been adjusted to take account of various structural and institutional changes, including consolidation of the newspaper industry and a tendency toward increased hiring through personnel supply agencies.

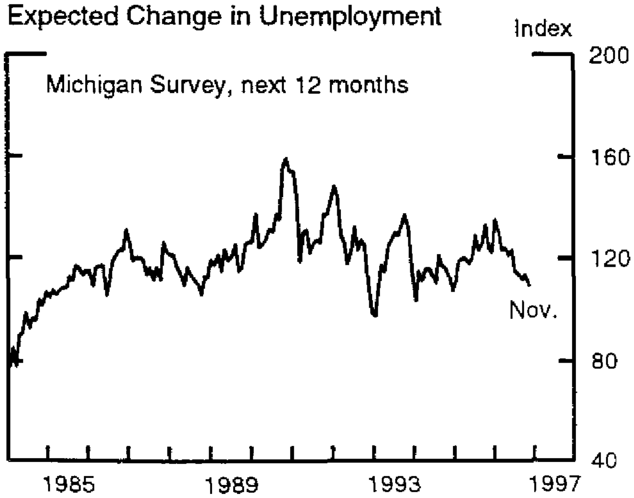
Net Hiring Strength

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.

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

	Twelve-month percent change			Percent change Nov. 1996 from		1996	
	Nov. 1994	Nov. 1995	Nov. 1996	May 1996	Aug. 1996	Oct.	Nov.
			-Annual rate-			-Monthly rate-	
Total private nonfarm	2.7	2.9	3.5	4.3	4.1	-.1	.8
Manufacturing	2.6	2.5	3.6	3.5	1.9	.1	.5
Contract construction	2.8	2.3	2.0	2.5	.3	.1	-.3
Transportation and public utilities	2.9	2.8	1.0	1.1	-.8	-.5	.5
Finance, insurance, and real estate	3.5	4.3	3.8	3.8	4.8	-.7	1.3
Retail trade	2.9	2.8	4.4	4.8	5.6	1.0	.4
Wholesale trade	2.9	3.0	3.9	5.3	5.1	-.7	1.1
Services	2.7	3.3	4.0	5.4	6.2	-.1	1.0

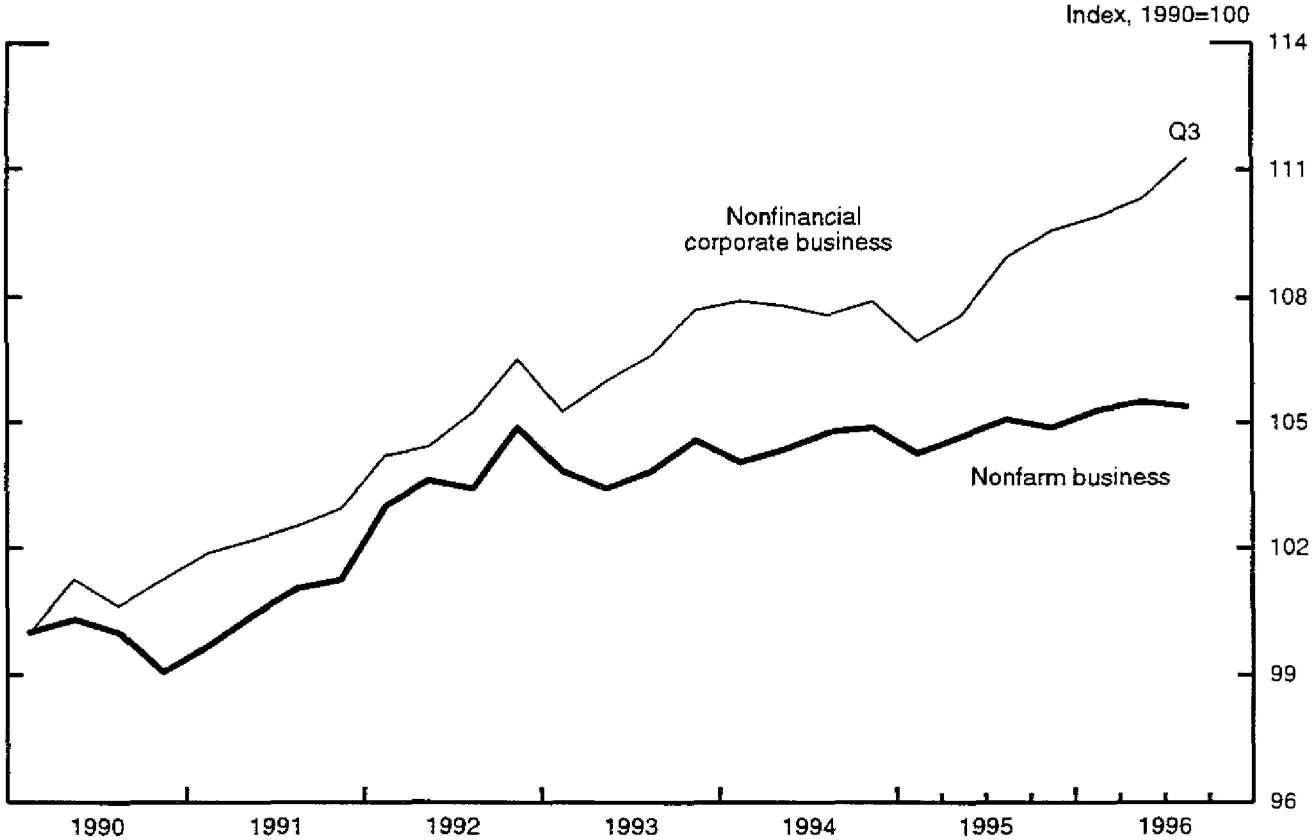
Note. Twelve-month percent changes use NSA data.

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

			1995	1996			1995:Q3 to 1996:Q3
	1994[1]	1995[1]	Q4	Q1	Q2	Q3	
Output per hour							
Total business	.2	-.1	-.6	2.1	1.2	.0	.7
Nonfarm business	.3	-.1	-1.2	1.9	.6	-.3	.3
Manufacturing	4.5	3.5	3.7	5.6	2.9	6.3	4.6
Nonfinancial corporations[2]	.2	1.5	2.4	1.3	1.5	3.6	2.2
Compensation per hour							
Total business	2.1	3.7	4.3	3.2	4.3	3.8	3.9
Nonfarm business	2.3	3.7	4.0	3.4	3.9	3.4	3.7
Manufacturing	2.7	4.2	4.2	.4	5.8	4.6	3.7
Nonfinancial corporations[2]	1.8	3.5	3.9	2.7	3.9	4.1	3.7
Unit labor costs							
Total business	1.9	3.8	5.0	1.1	3.1	3.8	3.2
Nonfarm business	2.0	3.7	5.2	1.5	3.3	3.7	3.4
Manufacturing	-1.7	.7	.4	-4.9	2.8	-1.6	-.9
Nonfinancial corporations[2]	1.5	1.9	1.5	1.5	2.4	.5	1.5

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.

Selected Measures of Productivity



3.5 percent during the year-earlier period. Compensation per hour in the nonfinancial corporate sector rose 4.1 percent at an annual rate in the third quarter and 3.7 percent over the past four quarters.

Industrial Production

According to production-worker hours and available physical product data, industrial production increased sharply in November. A large increase in motor vehicle assemblies and related activity after the production disruptions in October paced the advance; a surge in utilities output also contributed importantly.[4]

Motor vehicle assemblies rebounded to an annual rate of 12.1 million units in November, with increases for both autos and trucks. The assembly pace was somewhat below that scheduled at the beginning of the month, in part because GM did not come back from the strike as quickly as it had anticipated. GM also continues to be plagued by start-up problems with new models. Nonetheless, the increase in total assemblies was large enough to make a direct contribution of about 0.3 percentage point to the growth in industrial production, and upstream industries likely added 0.2 percentage point. Schedules call for assemblies of 12.4 million units at an annual rate in December and 12.6 million in the first quarter of 1997.

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

	1996				1997
	Q3	Oct.	Nov.	Dec.	Q1
				---scheduled--	
U.S. production	12.7	11.2	12.1	12.4	12.6
Autos	6.7	5.5	6.3	6.1	6.4
Trucks	6.0	5.7	5.9	6.4	6.2
Days' supply					
Autos	62.3	64.9	67.4		
Light trucks	74.8	65.3	64.2		

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

Manufacturing production-worker hours excluding motor vehicles and parts (FRB seasonals) were unchanged in November. But, together with productivity gains and the available physical output data, they suggest that output in manufacturing excluding motor vehicles and parts grew moderately last month. The movements in hours varied

4. By mid-November, the UAW and CAW had ratified new contracts with each of the Big Three.

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

	Proportion 1995:Q4	1995[1]	1996 Q1	1996 Q2	1996 Q3	1996 Aug.	1996 Sept.	1996 Oct.
			----Annual rate-----			--Monthly rate---		
Total index	100.0	1.6	3.0	6.7	4.4	.4	.3	-.5
Previous		1.6	3.0	6.7	4.4	.4	.3	
Manufacturing	86.5	1.4	2.4	7.1	5.5	.1	.3	-.5
Motor veh. and parts	5.5	-2.6	-20.7	46.6	15.4	-2.1	-2.2	-6.4
Aircraft and parts	1.7	-17.1	64.0	15.4	21.4	1.3	2.8	1.1
Manufacturing excluding motor vehicles, aircraft, and parts	79.2	2.2	3.0	4.6	4.4	.3	.4	-.1
Consumer goods	23.1	.1	.2	.4	1.6	-.6	.5	-.1
Durables	3.7	-.4	-5.4	8.2	-2.2	-1.2	.5	-.4
Nondurables	19.4	.2	1.2	-1.0	2.3	-.5	.5	-.1
Business equipment	13.6	7.7	13.9	8.1	8.9	.8	1.0	.8
Office and computing	3.1	36.2	48.4	45.5	44.1	2.5	3.0	2.1
Industrial	4.3	3.5	4.1	-3.7	-2.3	.6	-.2	-.1
Other	6.1	.8	4.9	-3.5	-1.3	.3	-.2	.3
Defense and space equipment	1.7	-7.3	-1.7	6.1	8.2	.7	-1.0	-.8
Construction supplies	5.3	-.4	.6	7.7	7.3	1.3	1.0	-.2
Materials	28.7	3.4	3.6	6.4	4.8	.6	-.1	-.4
Durables	20.3	6.3	7.1	4.1	5.9	1.3	-.2	-.6
Nondurables	8.2	-2.8	-5.0	12.6	2.4	-1.0	-.1	.2
Mining	6.0	-1.8	1.9	10.5	5.6	2.5	-.1	-1.0
Utilities	7.5	6.2	8.9	1.3	-8.7	1.9	.3	.0
Memo:								
Information-related products[2]	11.2	21.4	21.6	20.1	17.2	1.5	1.1	.8

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.

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1963-95 Avg.	1995 Q3	1996 Q2	1996 Q3	1996 Aug.	1996 Sept.	1996 Oct.
Manufacturing	85.2	82.1	82.6	82.2	82.4	82.3	82.3	81.6
Primary processing	89.0	83.4	86.6	86.1	86.6	86.6	86.5	86.0
Advanced processing	83.5	81.5	80.9	80.5	80.6	80.6	80.5	79.8

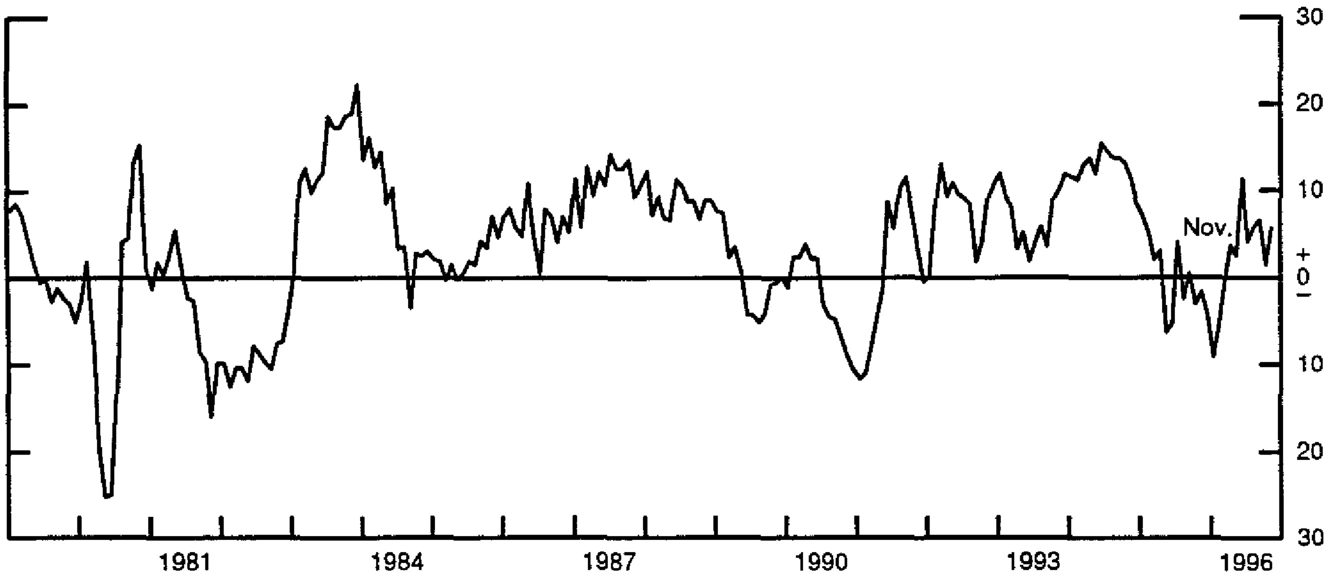
NEW ORDERS FOR DURABLE GOODS
(Percent change from preceding period, seasonally adjusted)

	Share 1996: H1	1996 Q2	1996 Q3	1996 Aug.	1996 Sept.	1996 Oct.
Total durable goods	100.0	1.6	1.7	-3.6	4.5	.3
Nondefense aircraft	4.0	-28.1	18.7	-39.7	127.7	-8.1
Adjusted durable goods orders[1]	68.0	2.0	1.7	-2.6	.4	2.8
Office & computing machines	5.0	1.6	5.0	-.3	-2.4	.6
Nondefense capital goods excluding aircraft and computers	17.0	-2.7	1.9	-6.3	3.7	2.6
Chain-weighted real adj. orders[2]		2.7	2.2	-2.5	.5	2.7

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.

NAPM New Orders



Note. Percent of respondents in the purchasing managers survey reporting increase in new orders minus those reporting decrease in new orders, seasonally adjusted.

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

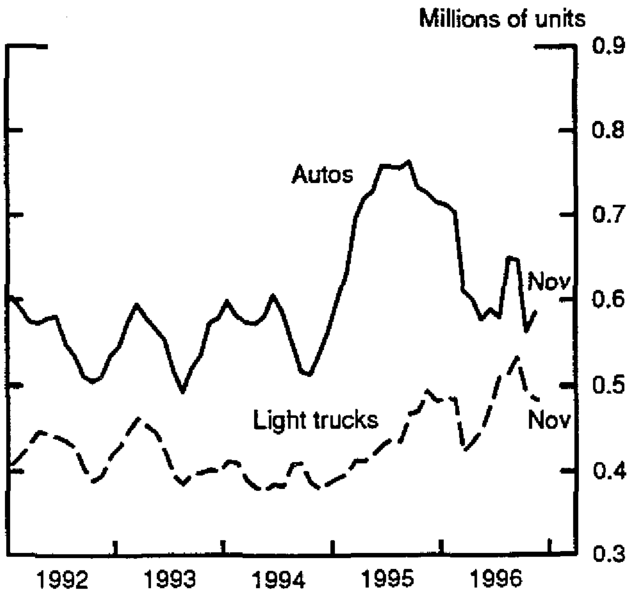
	1994	1995	1996 Q1	1996 Q2	1996 Q3	1996 Sept.	1996 Oct.	1996 Nov.
Total	15.0	14.7	15.2	15.1	14.9	14.9	14.8	14.8
Adjusted[1]	15.0	14.7	15.3	15.1	15.0	14.9	14.9	14.8
Autos	9.0	8.6	8.6	8.8	8.5	8.6	7.9	7.9
Light trucks	6.1	6.1	6.5	6.3	6.4	6.3	6.9	7.0
North American[2]	12.9	12.8	13.5	13.4	13.3	13.2	13.1	13.0
Autos	7.3	7.1	7.3	7.5	7.3	7.3	6.6	6.6
Big Three	5.7	5.4	5.4	5.6	5.2	5.2	4.8	4.6
Transplants	1.5	1.7	1.9	1.9	2.1	2.1	1.8	2.0
Light trucks	5.7	5.7	6.1	5.9	6.0	5.9	6.5	6.4
Foreign produced	2.1	1.9	1.7	1.7	1.7	1.7	1.7	1.8
Autos	1.7	1.5	1.3	1.3	1.2	1.3	1.2	1.3
Light trucks	.4	.4	.4	.5	.4	.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.

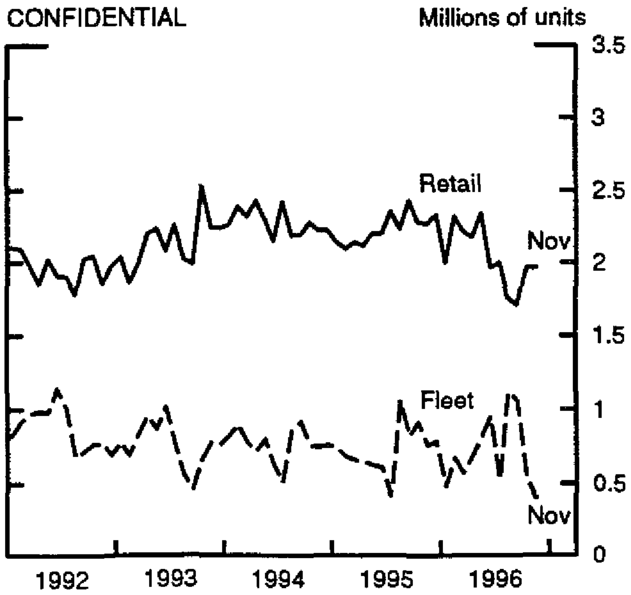
GM Inventories

(FRB seasonals)



GM Fleet and Retail Auto Sales

(FRB seasonals; annual rate)



considerably across the major groups--they rose more than 0.5 percent in foods, tobacco, petroleum products, paper, furniture, computers and semiconductors, but declined 0.5 percent or more in apparel, rubber and plastics, printing and publishing, and stone, clay and glass. Among industries with weekly physical output data available, production of appliances and meat products increased, while petroleum refining and the production of steel and wood products decreased.

Other indicators of industrial activity are consistent with sustained moderate output growth. In November, the National Association of Purchasing Managers' index of new orders, which had dropped in October, bounced back to the robust range experienced in the second and third quarters; the production index jumped similarly, and the index of vendor performance showed supplier deliveries slightly slower than in October. Real adjusted durable goods orders increased 2.7 percent in October after two sluggish months. The Beige Book, the latest Dun & Bradstreet survey, and business contacts maintained by Board staff corroborate the view that industrial output is growing roughly in line with capacity expansion.

The staff will publish the annual revision of IP, capacity, capacity utilization, and industrial use of electrical power in early January. IP, capacity, and capacity utilization revisions will incorporate updated source data and feature a change in the method of aggregating the indexes. From 1977 onward, the value-added proportions used to weight individual series will be updated annually, rather than quinquennially, and will be aggregated using a Fisher formula rather than a linked-Laspeyres formula. The new aggregation methods will lower growth of IP and capacity because a smaller weight will be applied, on average, to the fast-growing computer industry. Because operating rates in the computer industry are above average, the smaller weight should slightly lower the published manufacturing utilization rate.

Motor Vehicles

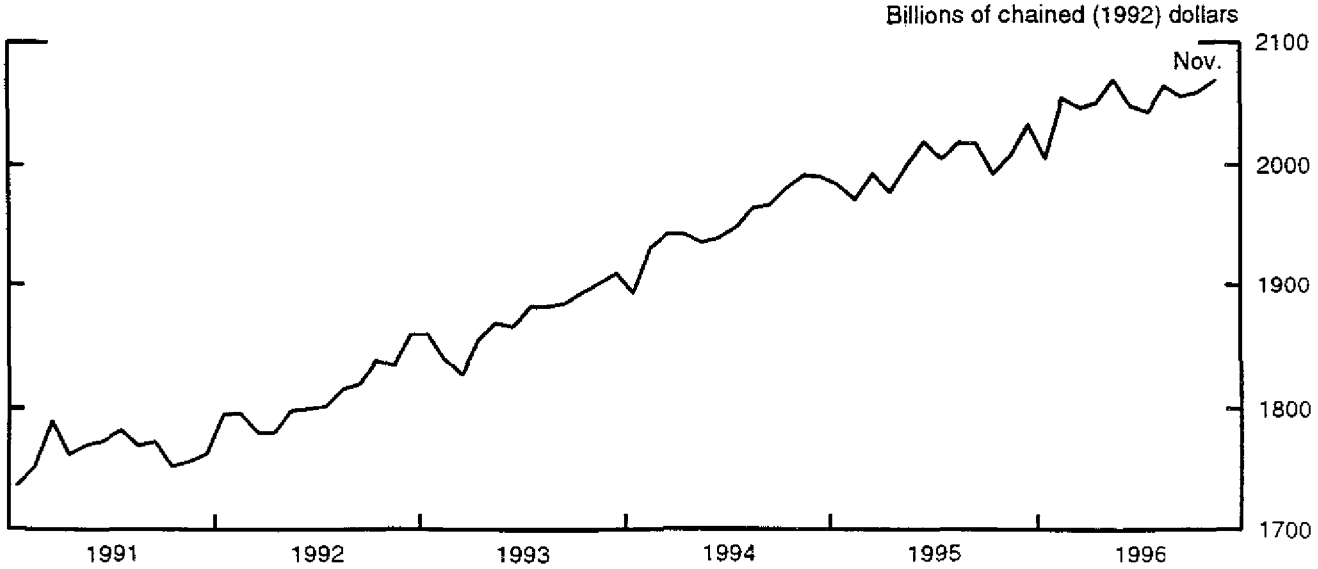
Sales of new light vehicles in November totaled 14.8 million units at an annual rate, the same as in October and only slightly below the average pace over the first nine months of the year. We estimate that sales were held down about 300,000 units per month, on average, in October and November because the strikes and start-up problems at GM limited vehicle availability; GM's fleet sales

RETAIL SALES
(Percent change; seasonally adjusted)

	1996			1996		
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Total sales	2.2	1.2	.2	.7	.3	-.4
Previous estimate			.2	.8	.2	
Building materials and supplies	-1.5	6.9	1.4	.6	-.2	-.0
Automotive dealers	4.9	-1.4	.7	1.4	.1	-2.6
Retail control[1]	1.6	1.7	.0	.5	.5	.4
Previous estimate			-.1	.5	.3	
Durable goods	1.6	3.3	-.8	-.4	1.2	1.4
Furniture and appliances	-.1	2.0	.7	.1	-.5	1.2
Other durable goods	3.1	4.3	-1.9	-.8	2.5	1.7
Nondurables	1.5	1.4	.1	.7	.4	.1
Apparel	2.4	1.5	-.7	1.1	-.6	-.9
Food	.9	.5	1.0	1.3	.1	-.2
General Merchandise	2.2	2.0	.4	-.1	.4	-.6
Gasoline stations	4.2	5.5	-3.1	.5	1.6	1.2
Drug stores	1.2	1.3	2.3	.1	1.7	.8
Other nondurables	.6	.5	.4	.7	.4	.8

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

PCE Goods



Note. September, October, and November values are staff estimates.

apparently absorbed much of the shortfall. November sales by firms other than GM were up, on balance, led by gains at major Japanese makers.

Relatively moderate price increases this year probably contributed to the sustained strength in light vehicle sales. Two factors--the dollar's strength relative to the yen and model redesigns that reduced assembly costs--allowed Japanese producers to restrain price increases without hurting profit margins. This strategy seems to have forced Big Three producers to follow suit to remain competitive. Indeed, prices of comparably equipped 1997 models for the Big Three are less than 2 percent higher than the 1996 models. In addition, incentives offered by makers in the fourth quarter, though down from the first half, are estimated to be little changed from the third quarter.

Personal Income and Consumption

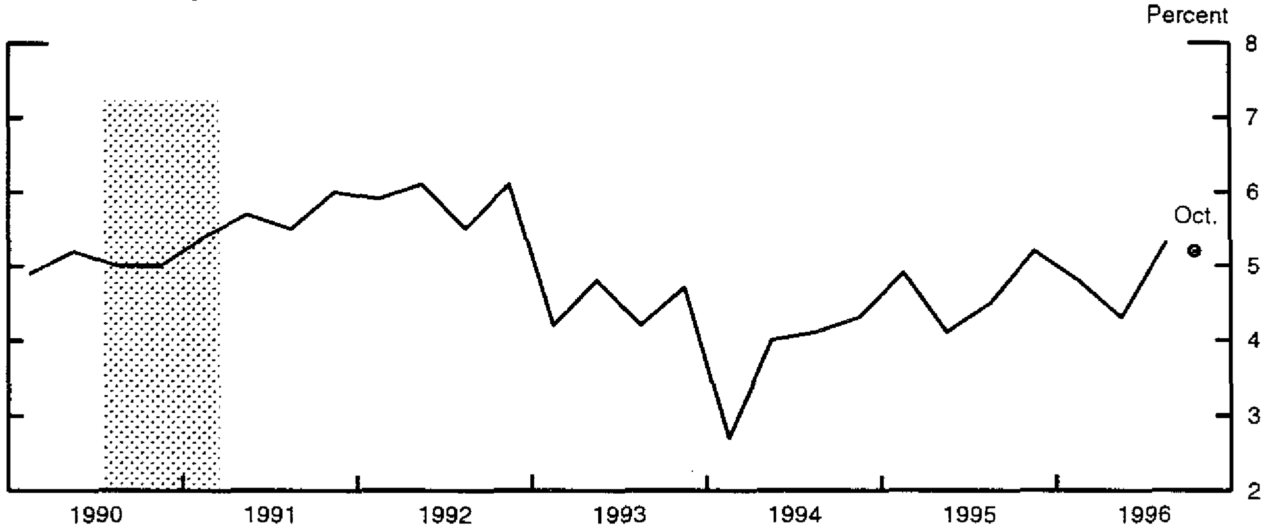
Consumer spending appears to have picked up after a lackluster performance in the third quarter. Available data suggest that real outlays for goods in November were noticeably above their third-quarter levels. Readings on consumer sentiment from the University of Michigan and the Conference Board also continue to be quite positive.

Total nominal retail sales fell 0.4 percent in November, reflecting a sharp drop in sales at automotive dealers.[5] Spending in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 0.4 percent last month after increasing 0.5 percent in both September and October. Within the retail control group in November, spending at durable goods stores was up smartly; sales at nondurable stores edged higher, with declines in sales at food, general merchandise, and apparel stores more than offset by gains at gasoline stations and "other nondurable goods" outlets. The retail sales data, together with available information about prices and auto sales, suggest that the November level of real consumer spending on goods was 0.7 percent above its third-quarter average (not at an annual rate).

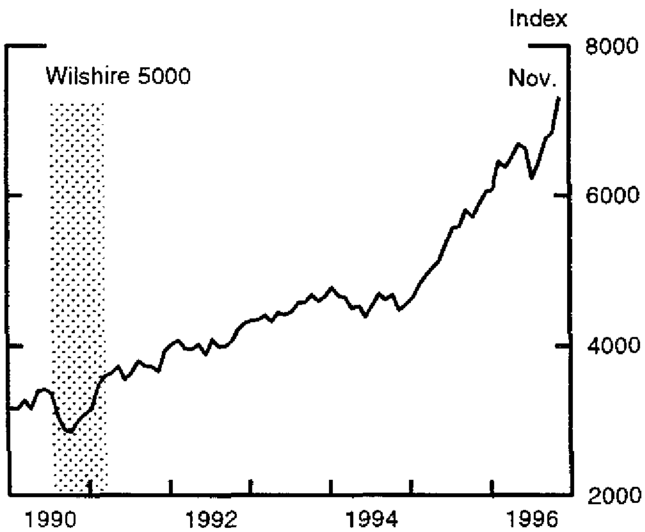
5. Discrepancies between retail sales at automotive dealers and unit sales of light vehicles are not uncommon. Differences can result from a variety of factors, including variations in the average expenditure per vehicle, sales of used cars, expenditures on repairs, or measurement error--particularly in the noisy advance estimates of retail sales.

Personal Saving and Related Indicators

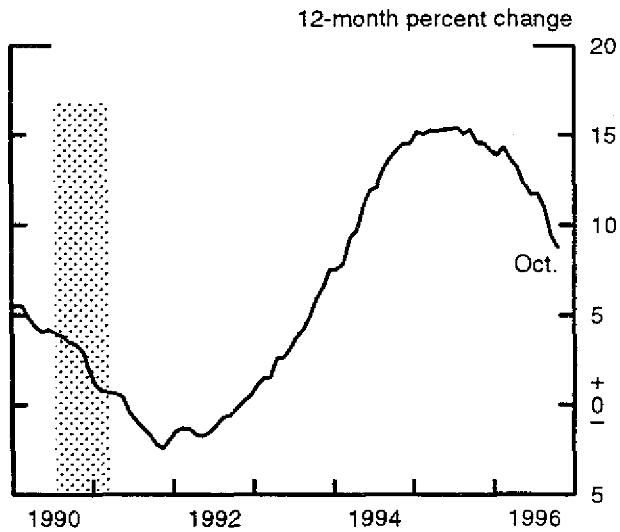
Personal Saving Rate



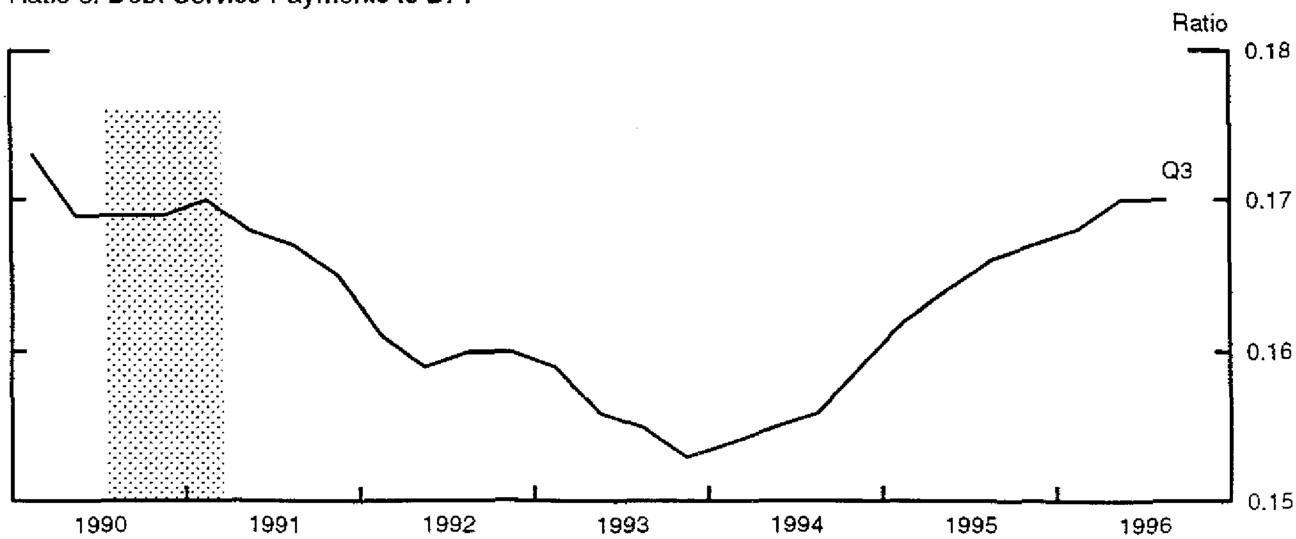
Stock Market



Consumer Credit



Ratio of Debt Service Payments to DPI



Real spending on services rose 0.4 percent in October following a relatively weak third quarter. Energy spending was up moderately in October after posting a large decline in the third quarter because of the unusually cool summer weather. Energy expenditures probably rose further in November, with lower-than-normal temperatures spurring demand for heat. Among nonenergy services, spending increased moderately in most major categories in October.[6]

The trends in income remain solid. Real disposable income rose 3 percent over the year ending in the third quarter. And although real DPI dipped in October, the growth in aggregate hours and the brisk rise in earnings provided a notable boost to overall income in November.

Sluggish spending during the summer and early autumn, coupled with robust growth in income, lifted the personal saving rate from 4-1/2 percent, on average, over the first half of the year to 5-1/4 percent, on average, from July through October. Moreover, the available data suggest that the saving rate remained elevated in November. The persistently higher saving rates since midyear in the face of booming stock prices remain puzzling. Of course, saving rates during the past couple of years are still vulnerable to potentially substantial revisions.

If the saving rate increase were to hold up, however, several other possibilities might explain recent behavior. One is that the factors we have cited frequently as offsetting the effects of stock market wealth--notably, the heavy debt-service burdens of some households, the tightening of credit standards, and perhaps a heightened awareness of the need to provide for retirement, educational, and medical costs--are imparting more restraint on spending than we had anticipated. A second possibility is that shareholders are simply being cautious in spending out of what has been a stunningly sharp increase in the value of their assets.

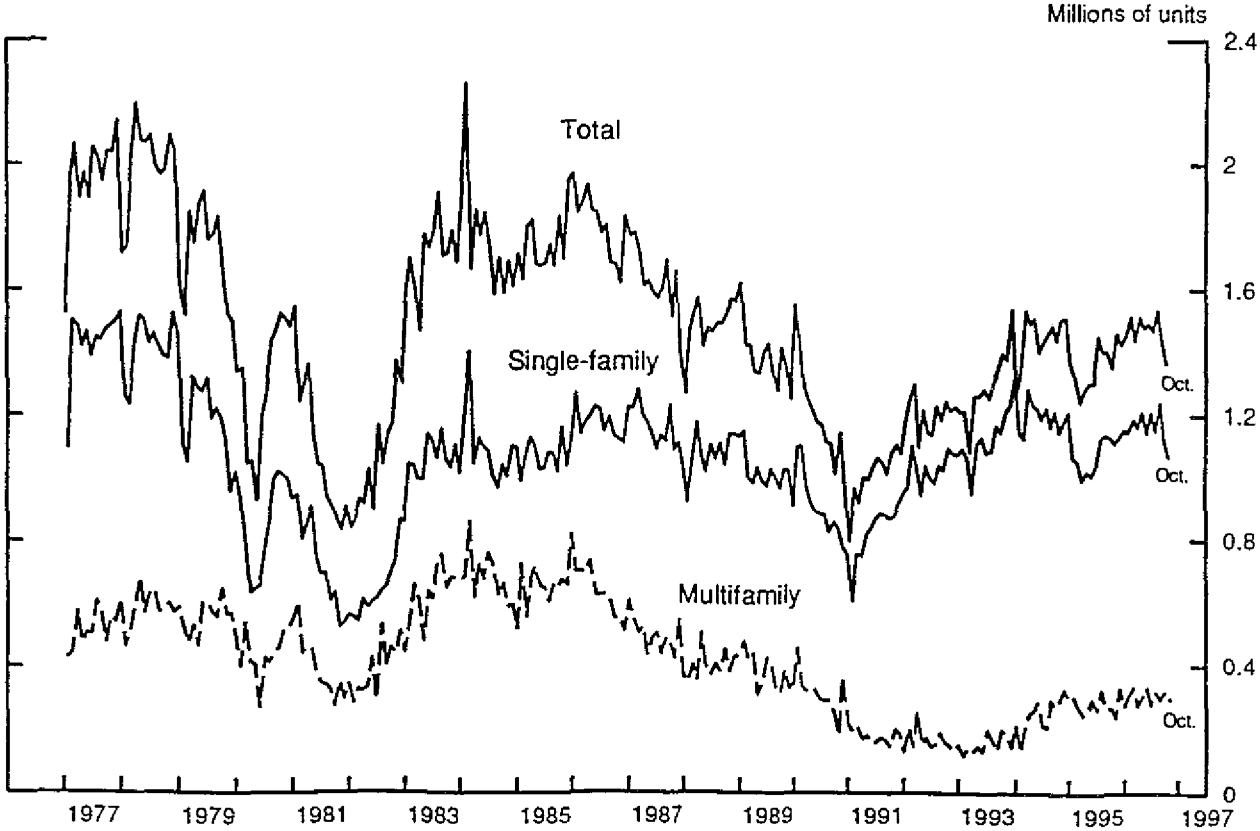
6. Spending on household operation services rebounded sharply in October as net outlays on household insurance services reversed their large September decline. BEA calculates net household insurance services as the difference between estimated insurance premiums and estimated insurance benefits paid. In September, estimated insurance benefits paid surged as a result of Hurricane Fran, depressing net household insurance services by $5.4 billion (annual rate).

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

	1995	1996 Q1	1996 Q2	1996 Q3^r	1996 Aug.^r	1996 Sept.^r	1996 Oct.^p
All units							
Starts	1.35	1.47	1.49	1.48	1.53	1.44	1.37
Permits	1.33	1.41	1.44	1.43	1.42	1.40	1.36
Single-family units							
Starts	1.08	1.16	1.19	1.17	1.24	1.12	1.07
Permits	1.00	1.08	1.10	1.06	1.08	1.04	1.01
New home sales	0.67	0.75	0.74	0.79	0.82	0.78	0.71
Existing home sales	3.80	3.95	4.21	4.11	4.14	4.03	3.97
Multifamily units							
Starts	0.28	0.31	0.31	0.31	0.29	0.32	0.30
Permits	0.33	0.33	0.34	0.36	0.35	0.36	0.35
Mobile homes							
Shipments	0.34	0.35	0.37	0.36	0.37	0.35	n.a.

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

Private Housing Starts
(Seasonally adjusted annual rate)



Housing

Single-family housing production softened noticeably in September and October. Starts declined appreciably in September and fell another 4-1/2 percent in October, to 1.07 million units, their lowest level since mid-1995. Permit issuance for single-family homes also decreased, confirming the recent weakening in this sector.

New home sales dropped from their high summer level and moved more in line with production and builders' assessment of sales. New home sales fell sharply in September and October to their lowest level since March. The latest survey of homebuilders indicates that sales continued to sag in November. Existing home sales also declined in October--for a fifth consecutive month--and now stand about 6 percent below their recent second-quarter high.

While sales waned, financial market conditions for homebuying improved. Mortgage rates have fallen about 75 basis points since early September. Perhaps relatedly, applications for home purchase financing (both new and existing) at mortgage bankers moved up noticeably in early December, after drifting up ever so slightly over the previous several months. Moreover, consumer appraisals of homebuying conditions, as sampled by the Michigan survey, were quite favorable in both October and November.

In the multifamily housing sector, starts dropped back to 300,000 units at an annual rate in October, more or less offsetting the uptick in September and extending their yearlong seesaw pattern. Construction in this sector continues to be damped by the rising inventory of unoccupied units. Vacancy rates for apartments rose to 9-1/2 percent in the third quarter, 1/2 percentage point more than the average reading during the previous two years.

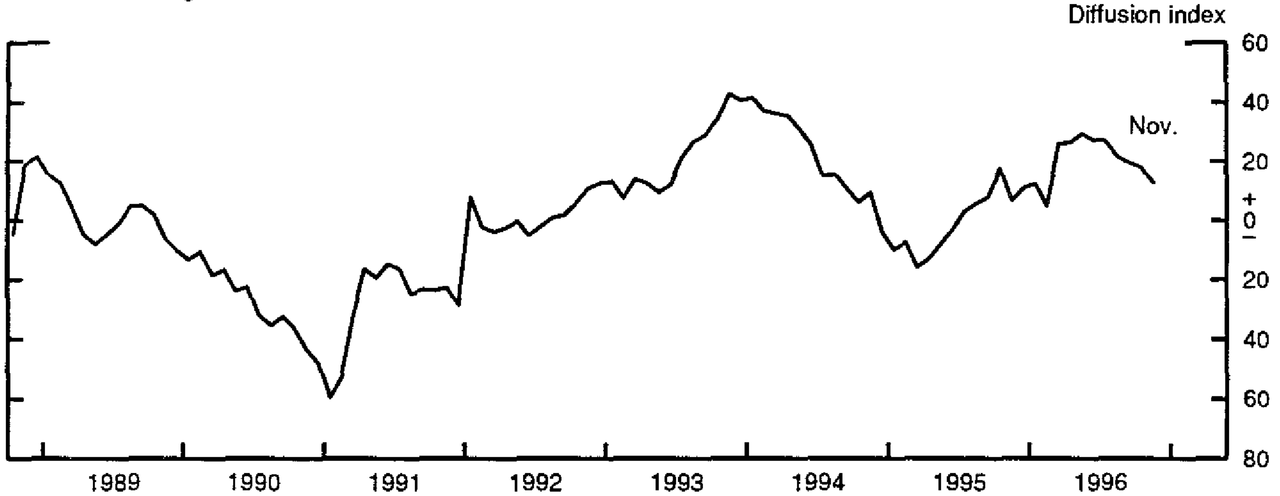
Business Fixed Investment

After a blockbuster third quarter, the growth of real business fixed investment appears to be slowing this quarter. In part, the deceleration reflects a sharp drop in business purchases of motor vehicles. In addition, shipments of nondefense capital goods were little changed, on balance, in nominal terms during September and October. On the other hand, nonresidential construction seems to be increasing at a fairly robust rate. Moreover, anecdotal reports and investment fundamentals remain consistent with continued growth of capital spending.

Indicators of Housing Demand

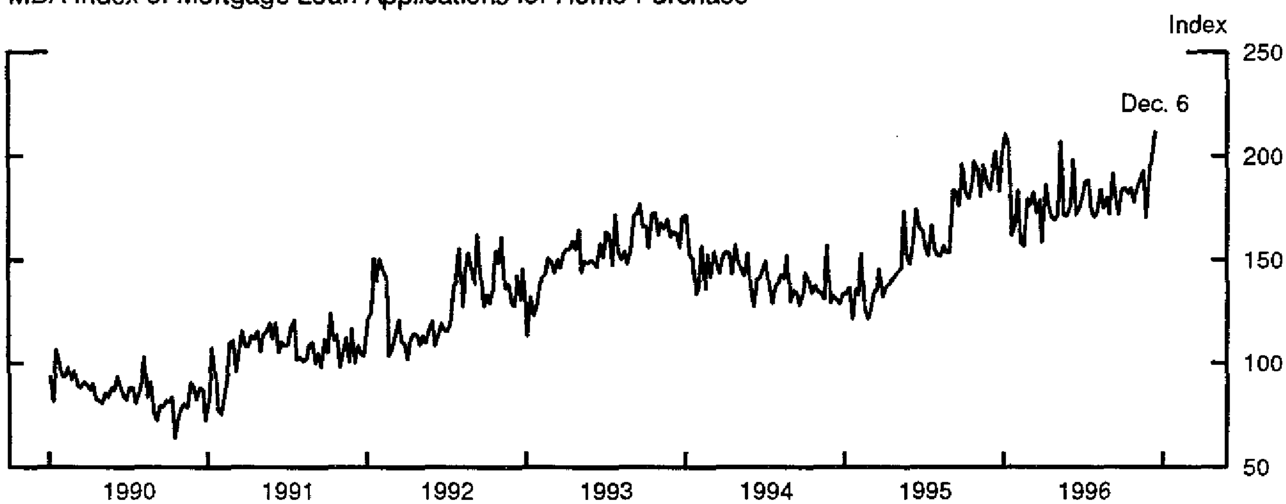
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



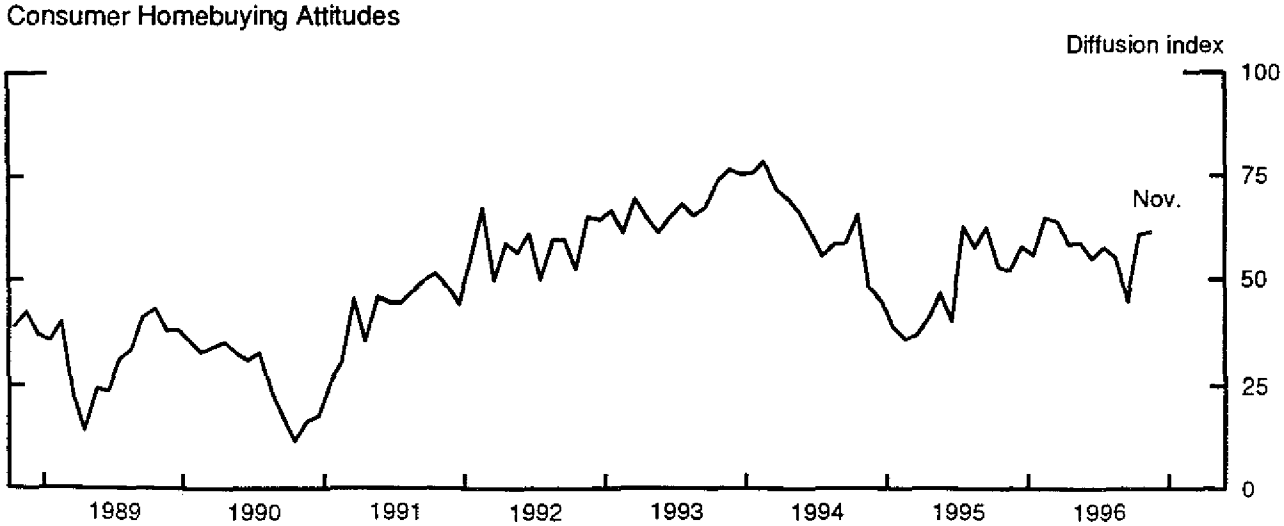
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

MBA Index of Mortgage Loan Applications for Home Purchase



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

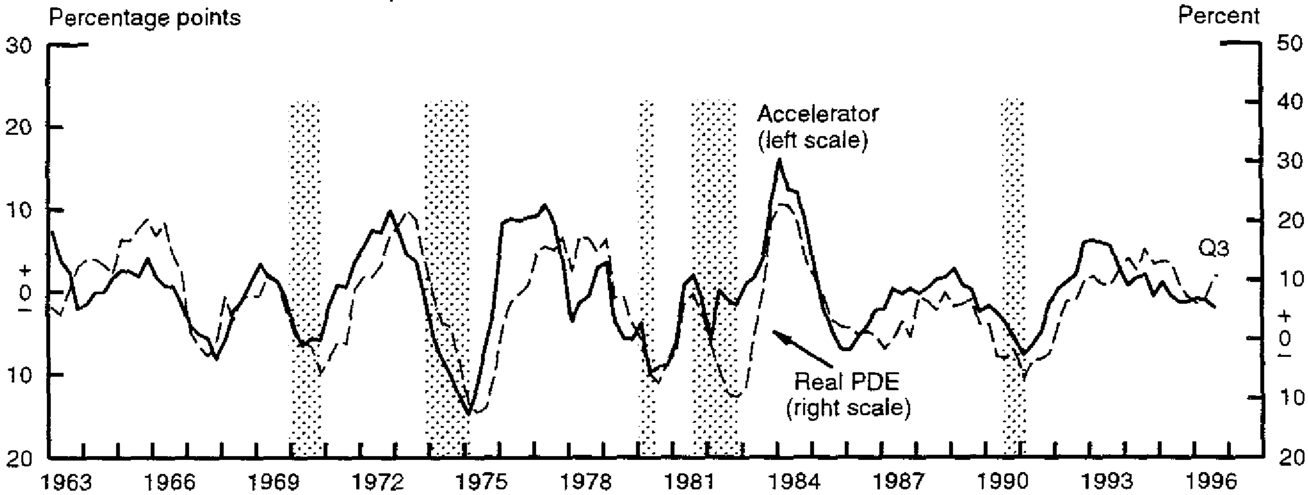
Consumer Homebuying Attitudes



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.

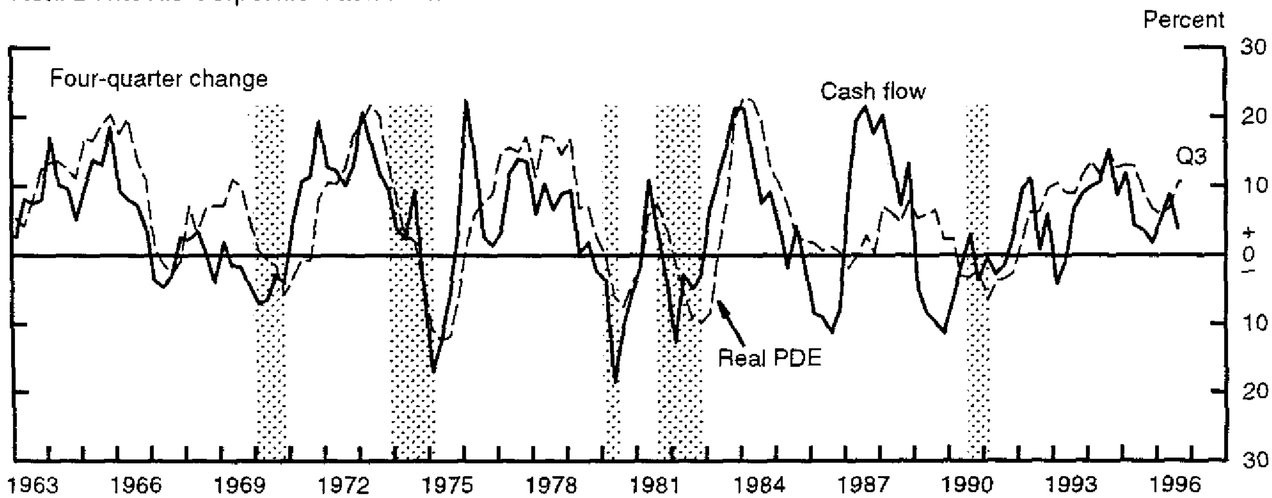
Fundamental Determinants of Equipment Spending

Acceleration of Business Output

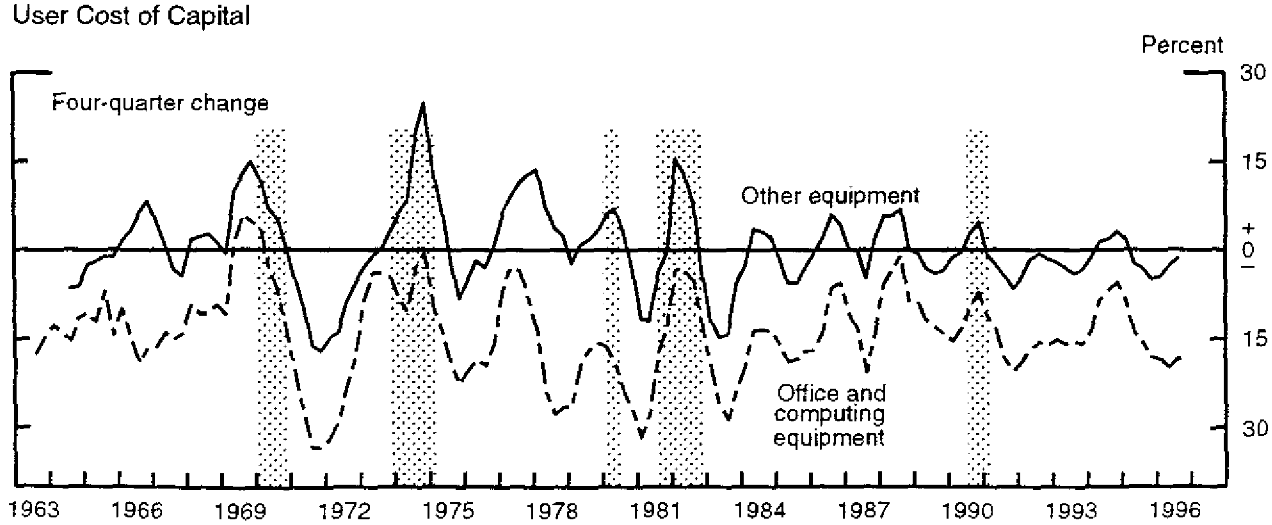


Note. The accelerator is the eight-quarter percent change in business output less the year-earlier eight-quarter percent change. Real PDE is the four-quarter percent change.

Real Domestic Corporate Cash Flow



User Cost of Capital



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

	1996			1996		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Producers' durable equipment						
Shipments of nondefense capital goods	-.5	2.9	1.8	2.4	1.8	-1.9
Excluding aircraft and parts	.8	1.5	1.5	1.1	2.3	-2.0
Office and computing	3.7	-.8	4.4	4.6	.7	-3.6
Communications equipment	-.3	4.7	4.5	-1.0	3.6	-.4
All other categories	.0	1.7	-.3	.3	2.6	-1.9
Shipments of complete aircraft[1]	1.4	12.2	14.7	51.4	17.8	-20.1
Sales of heavy trucks	-2.2	1.2	-4.3	-.2	-7.8	8.6
Orders of nondefense capital goods	3.1	-6.5	4.9	-10.4	15.4	.0
Excluding aircraft and parts	3.1	-1.7	2.6	-4.9	2.2	2.2
Office and computing	2.1	1.6	5.0	-.3	-2.4	.6
Communications equipment	8.7	-8.5	6.6	-14.0	.1	36.2
All other categories	2.2	-1.2	.8	-4.3	4.6	-5.1
Nonresidential structures						
Construction put-in-place	1.0	.0	2.4	3.7	.6	3.2
Office	-6.6	8.3	8.7	.9	2.1	2.6
Other commercial	3.0	-1.0	1.2	8.7	-4.2	7.2
Institutional	-2.9	1.2	7.9	7.3	1.6	4.5
Industrial	-1.6	-8.0	-1.2	-5.3	9.5	11.5
Public utilities	4.5	3.1	-1.1	4.7	-1.4	-4.1
Lodging and miscellaneous	10.6	.0	3.2	3.3	-1.0	-6.3
Rotary drilling rigs in use[2]	6.6	12.4	-4.7	-.1	-4.9	.7
Memo:						
Business fixed investment[3]	11.6	3.8	16.9	n.a.	n.a.	n.a.
Producers' durable equipment[3]	13.1	6.7	20.3	n.a.	n.a.	n.a.
Nonresidential structures[3]	7.7	-3.7	7.7	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. Percent change of number of rigs in use, seasonally adjusted.
3. Based on 1992 chain-weighted data; percent change, annual rate.
n.a. Not available.

October bookings for communications equipment posted their biggest increase in six years, and shipments held steady at a high level. Cellular providers reportedly are expanding coverage rapidly, and demand for satellite services is apparently quite strong. In contrast, shipments of office and computing equipment dropped 3-1/2 percent in October. But this movement conflicts with reports in the trade press that demand for computer equipment is robust. Meanwhile, orders for other capital goods have tailed off noticeably in recent months, and shipments of these goods dropped in October.

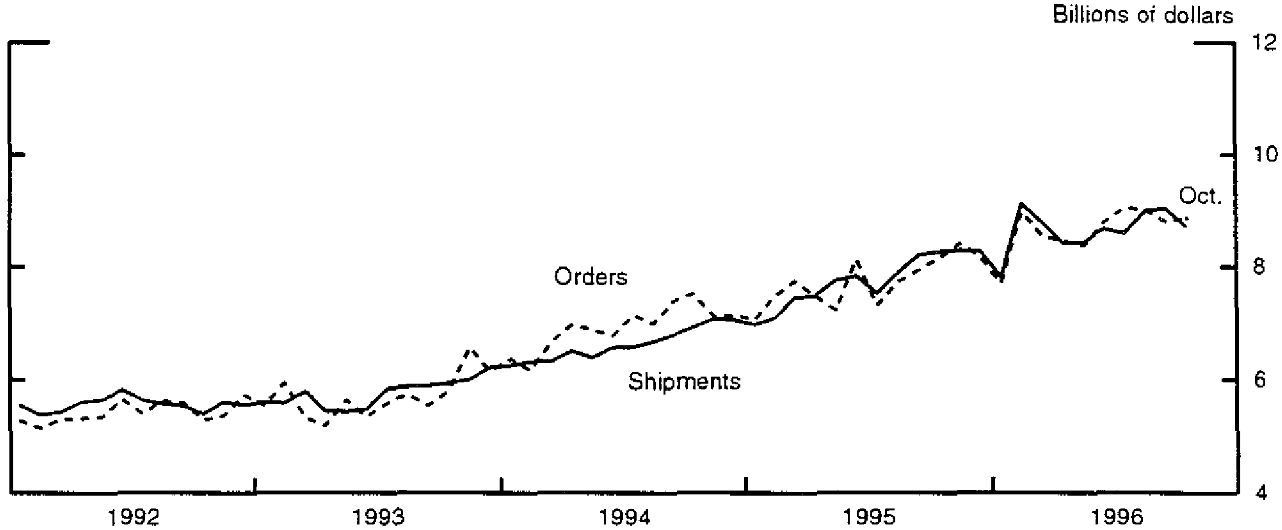
Several developments point to a steep fall in transportation equipment investment this quarter. As noted earlier, fleet sales of light vehicles in October and November were depressed by GM's production shortfalls; some drop was likely in any event because third-quarter fleet sales were exceptionally high. In addition, heavy truck sales have been moving sideways of late, ignoring monthly volatility. Despite a decline in October, shipments of complete aircraft have grown smartly thus far this year, though a sizable fraction was shipped to foreign carriers. A number of American carriers have recently placed large orders with Boeing, improving the outlook for domestic deliveries over the next few years.

Judging from October construction, fourth-quarter real outlays for nonresidential structures appear to be maintaining the solid growth recorded in the third quarter. Construction put in place advanced briskly in the office, other commercial, institutional, and industrial categories in October. Contracts dropped sharply in October, but their trend remains in line with that of construction. Among other indicators, commercial vacancy rates are about as low as they have been in the past fifteen years. Bank examiners surveyed by the FDIC report fairly strong price movements and are bullish about future conditions. Finally, real estate investment trusts have been quite successful this year at raising capital for construction projects in equity markets, and other financing appears amply available as well.

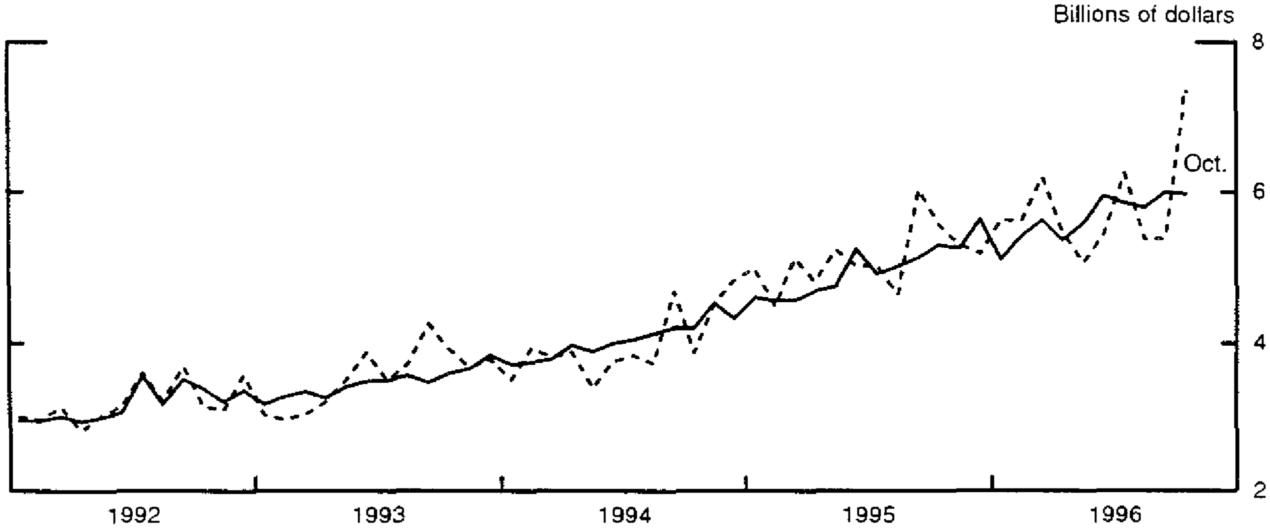
Drilling and mining activity edged down in the third quarter and is roughly flat so far in the fourth quarter. Some industry analysts have been predicting an acceleration in natural gas drilling activity over the next few months, at least partly in

Orders and Shipments of Nondefense Capital Goods

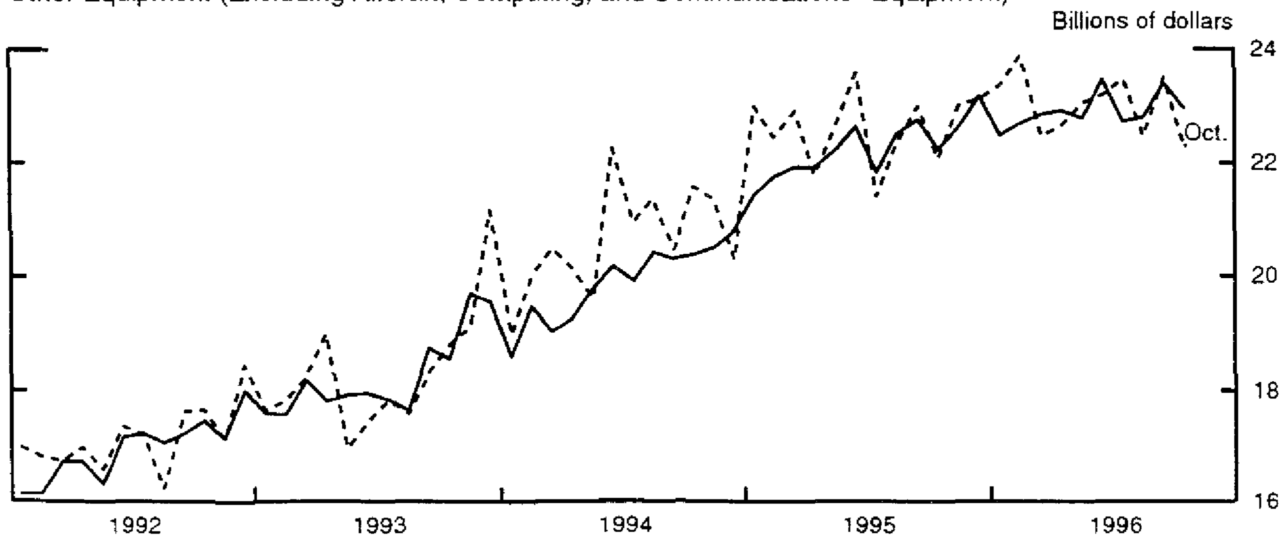
Office and Computing Equipment



Communications Equipment

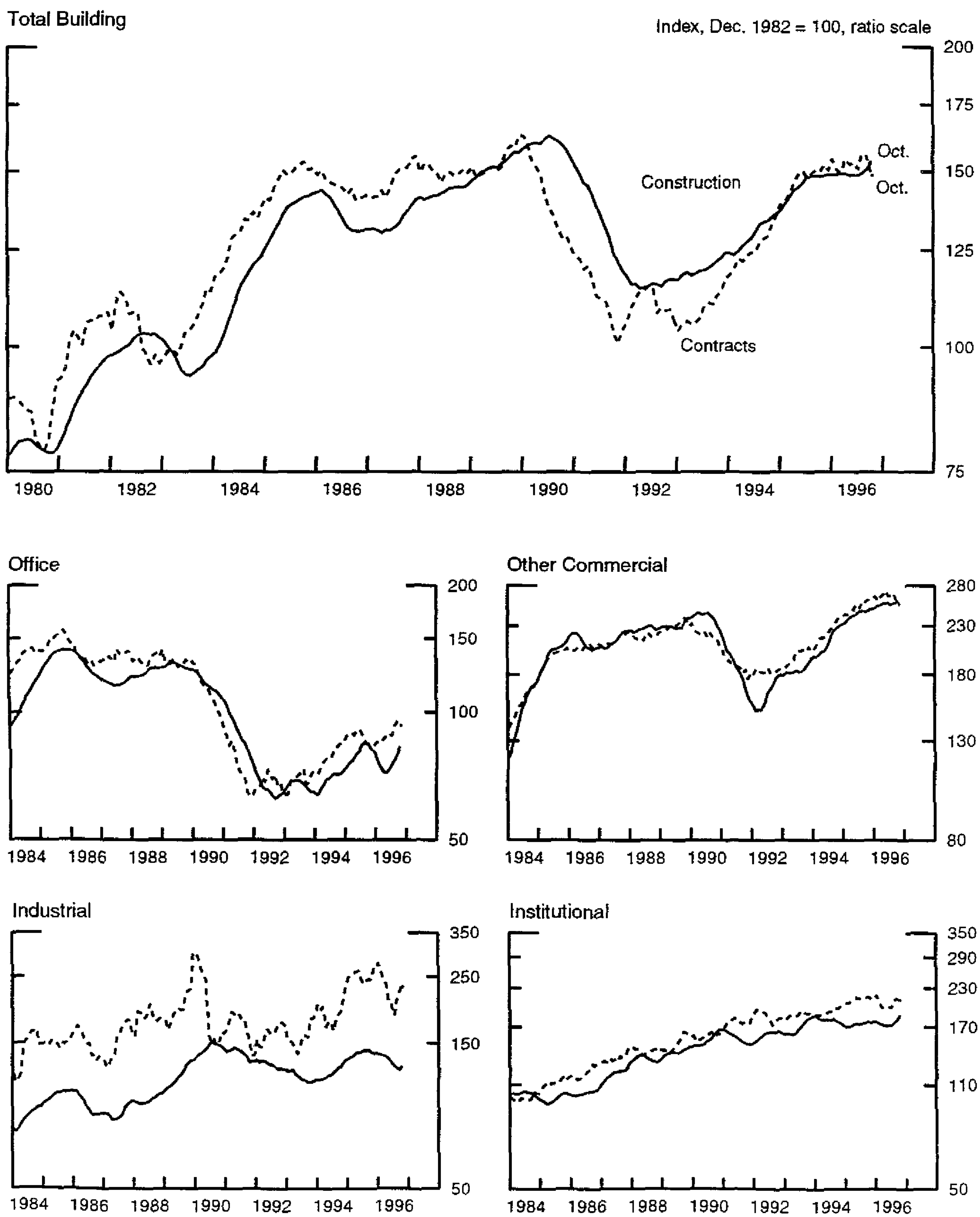


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



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)

	1996			1996		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Book value basis						
Total	16.7	13.2	39.5	36.4	21.3	n.a.
Excluding wholesale and retail motor vehicles	25.0	6.0	24.2	18.5	15.0	n.a.
Manufacturing	12.3	-6.2	11.3	14.9	12.2	14.5
Excluding aircraft	6.3	-10.7	8.6	12.5	7.1	11.7
Wholesale	7.3	11.3	-9.2	-3.3	-22.4	19.8
Excluding motor vehicles	7.3	7.6	-6.1	-.9	-13.4	12.5
Retail	-2.9	8.2	37.4	24.8	31.5	n.a.
Auto dealers	-8.4	3.5	18.4	20.3	15.2	n.a.
Excluding auto dealers	5.5	4.6	19.0	4.5	16.2	n.a.
Chained (1992) dollars basis						
Total	-5.4	7.9	29.3	13.1	14.5	n.a.
Excluding motor vehicles	17.5	1.9	23.5	14.4	10.7	n.a.
Manufacturing	12.0	-3.9	12.5	7.9	14.0	n.a.
Wholesale	3.8	6.5	-8.5	3.2	-27.9	n.a.
Excluding motor vehicles	4.0	3.3	-4.4	4.5	-15.5	n.a.
Retail	-21.7	5.2	25.5	2.0	28.7	n.a.
Auto dealers	-23.6	2.0	10.8	.2	16.9	n.a.
Excluding auto dealers	3.0	3.2	14.6	1.9	11.5	n.a.

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

	1996			1996		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Book value basis						
Total	1.43	1.40	1.40	1.40	1.39	n.a.
Excluding wholesale and retail motor vehicles	1.40	1.37	1.36	1.37	1.36	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	1.27	1.27
Wholesale	1.32	1.31	1.28	1.29	1.28	1.28
Excluding motor vehicles	1.30	1.28	1.25	1.26	1.25	1.25
Retail	1.49	1.49	1.53	1.52	1.52	n.a.
Auto dealers	1.66	1.70	1.78	1.76	1.76	n.a.
Excluding auto dealers	1.44	1.42	1.45	1.44	1.44	n.a.
Chained (1992) dollars basis						
Total	1.38	1.36	1.35	1.35	1.35	n.a.
Excluding motor vehicles	1.36	1.33	1.32	1.33	1.32	n.a.
Manufacturing	1.39	1.35	1.35	1.35	1.34	n.a.
Wholesale	1.35	1.34	1.31	1.33	1.30	n.a.
Excluding motor vehicles	1.33	1.31	1.28	1.29	1.28	n.a.
Retail	1.37	1.37	1.40	1.39	1.39	n.a.
Auto dealers	1.54	1.57	1.62	1.56	1.57	n.a.
Excluding auto dealers	1.34	1.33	1.35	1.34	1.35	n.a.

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

response to the recent uptrend in natural gas prices. But there is little evidence that such a surge is under way.

Business Inventories

Businesses entered the fourth quarter without discernible inventory imbalances, and inventory-sales ratios for most types of businesses were well within their recent ranges. Partial data indicate little change in the underlying inventory situation in October.

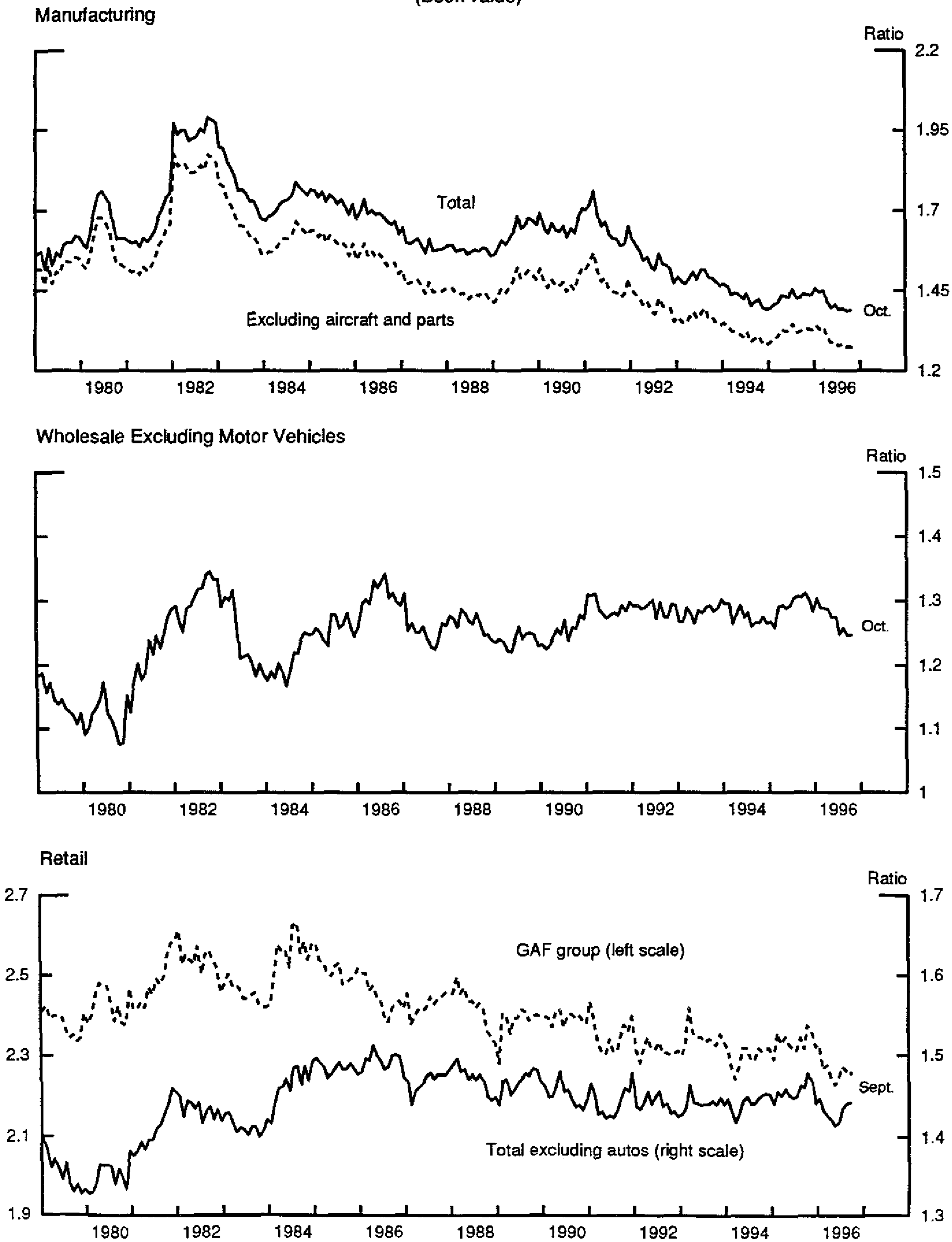
Manufacturers' inventories rose at a $14.5 billion annual rate (book value) in October, a pace similar to the third-quarter rate. Inventory investment was spread about evenly between durable and nondurable goods industries. About half of the October accumulation was in stocks of nondefense capital goods, notably nondefense aircraft and construction machinery; stocks of communications equipment posted a surprisingly small increase in light of soaring new orders. Investment in stocks of non-auto consumer goods--household durables, home goods, and apparel--slowed from the previous two months. Most manufacturing inventory-shipments ratios remained near their lowest points in recent years.

In wholesale trade, non-auto inventories expanded in October for the first time since April. Part of the increase resulted from higher stocks of farm products, which followed--but did not fully offset--a string of sharp declines in preceding months. Production information from the Agriculture Department suggests that some crop harvests (corn and soybeans in particular) were late this year. This delay may have led to drawdowns in stocks at many grain elevators and other wholesale grain distributors during the summer. As the harvest picked up momentum, stocks of wholesale farm products turned up sharply in October, reversing some of the previous declines. Aside from farm products, there was also a sizable buildup in petroleum inventories at the wholesale level; the increase likely reflected, in part, petroleum marketers' efforts to replenish their unseasonably low heating oil stocks. Elsewhere in wholesale trade, stocks of machinery and business equipment were drawn down in October, while inventories of most types of consumer goods, outside of motor vehicles, rose moderately.

October figures on retail inventories will be published tomorrow. Non-auto inventories posted a sizable increase in the third quarter, and the retail inventory-sales ratio moved back up to

Inventory-Sales Ratios, by Major Sector

(Book value)



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

	Cyclical reference points 1990-91 High	Cyclical reference points 1994-95 Low	Range over preceding 12 months High	Range over preceding 12 months Low	September/October 1996[1]
Manufacturing and trade	1.58	1.40	1.45	1.39	1.39
Less wholesale and retail motor vehicles	1.55	1.37	1.41	1.36	1.36
Manufacturing	1.75	1.39	1.46	1.39	1.39
Primary metals	2.08	1.45	1.62	1.55	1.59
Nonelectrical machinery	2.48	1.88	1.94	1.80	1.83
Electrical machinery	2.08	1.52	1.60	1.51	1.50
Transportation equipment	2.94	1.59	1.87	1.65	1.74
Motor vehicles	.97	.53	.67	.55	.58
Aircraft	5.85	4.42	5.95	4.89	5.44
Nondefense capital goods	3.09	2.33	2.58	2.39	2.45
Textile	1.71	1.44	1.66	1.49	1.57
Petroleum	.94	.88	.89	.79	.75
Home goods & apparel	1.96	1.70	1.89	1.70	1.72
Merchant wholesalers	1.36	1.28	1.34	1.28	1.28
Less motor vehicles	1.31	1.26	1.31	1.25	1.25
Durable goods	1.83	1.54	1.64	1.58	1.59
Nondurable goods	.96	.98	1.03	.95	.96
Retail trade	1.61	1.46	1.56	1.48	1.52
Less automotive dealers	1.48	1.42	1.48	1.41	1.44
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	2.40
G.A.F.	2.44	2.24	2.37	2.23	2.26

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

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

	October		Fiscal year totals			
	1995	1996	1996	1997	Dollar change	Percent change
Outlays	118.3	140.2	118.3	140.2	22.0	18.6
Deposit insurance (DI)	-1.2	-.1	-1.2	-.1	1.1	-89.3
Spectrum auction (SA)	.0	.0	.0	.0	.0	N.A.
Other	119.5	140.3	119.5	140.3	20.9	17.5
Receipts	95.7	99.9	95.7	99.9	4.3	4.5
Deficit (+)	22.6	40.3	22.6	40.3	17.7	78.3
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	126.5	140.3	126.5	140.3	13.8	10.9
National defense	20.2	22.3	20.2	22.3	2.0	10.1
Net interest	20.6	21.5	20.6	21.5	.9	4.4
Social security	28.1	29.4	28.1	29.4	1.3	4.6
Medicare	14.1	16.1	14.1	16.1	2.0	14.3
Medicaid	7.3	8.2	7.3	8.2	.9	13.0
Other health	2.4	2.2	2.4	2.2	-.3	-10.7
Income security	16.6	18.5	16.6	18.5	2.0	12.0
Other	17.3	22.2	17.3	22.2	4.9	28.2
Receipts	95.7	99.9	95.7	99.9	4.3	4.5
Individual	51.8	54.0	51.8	54.0	2.2	4.2
Withheld	46.9	48.9	46.9	48.9	1.9	4.2
Nonwithheld	5.9	5.6	5.9	5.6	-.3	-4.4
Refunds (-)	1.0	.5	1.0	.5	-.5	-48.4
Social insurance taxes	32.1	36.1	32.1	36.1	4.0	12.5
Corporate	2.2	.9	2.2	.9	-1.3	-60.5
Other	9.5	9.0	9.5	9.0	-.6	-5.9
Deficit(+)	30.8	40.4	30.8	40.4	9.6	31.0

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.

the middle of its recent range after having fallen appreciably during the first half of the year.

Government Sector

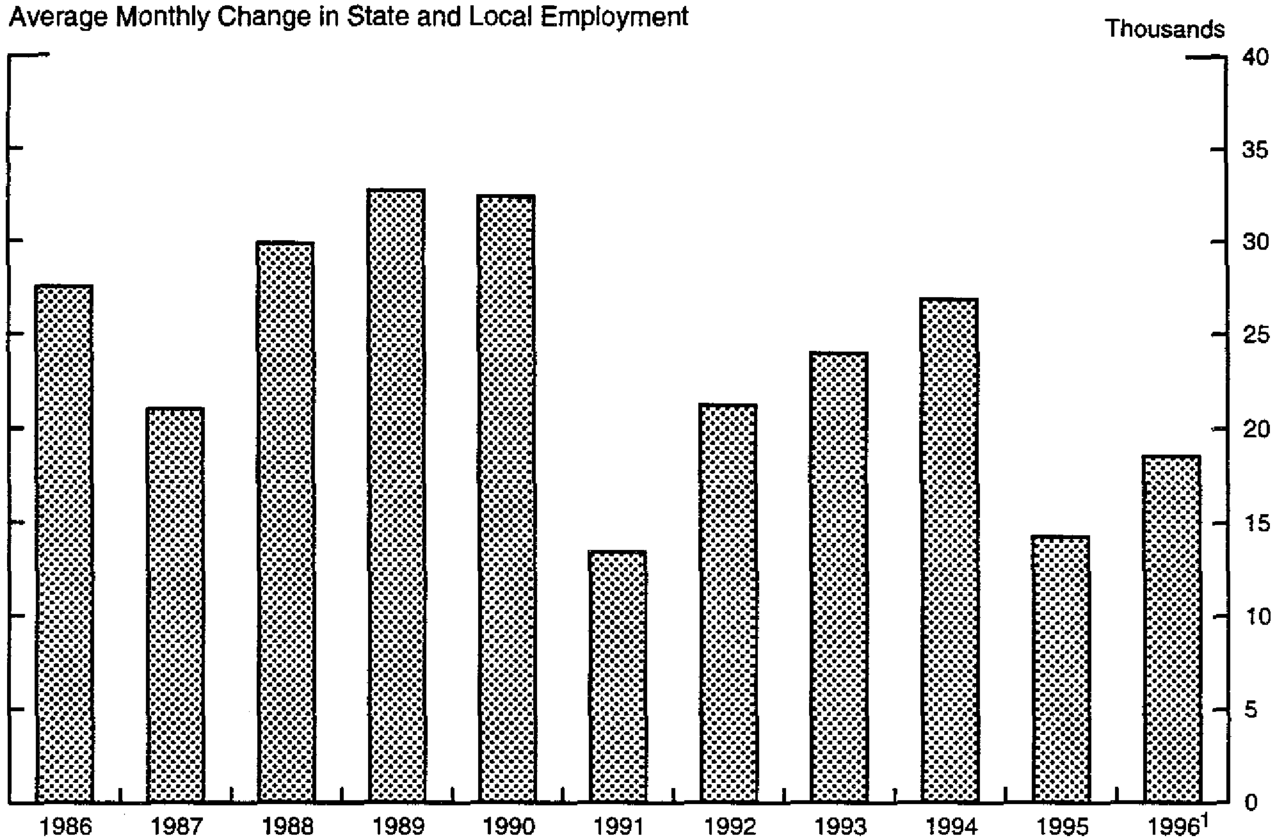
The federal government recorded a deficit of $40 billion in the unified budget in October, the first month of fiscal 1997. The deficit was nearly $18 billion larger than that recorded in October 1995, but outlays in October 1995 were depressed considerably by special factors. First, because October 1, 1995, fell on a weekend, about $7 billion of spending was moved into September. Second, in the absence of enacted appropriations, outlays for defense and a variety of nondefense programs were held down by a restrictive continuing resolution. Among other things, the resolution delayed disbursement of $3 billion in foreign assistance to Israel that is normally made in October. In addition, more than $1 billion of housing assistance payments scheduled for October 1995 were made in the previous month, apparently because HUD mistakenly thought the payments would be affected by a debt ceiling problem. The increase in the deficit between October 1995 and October 1996 was also swollen by a 14 percent rise in spending on Medicaid and Medicare. Although few analysts expect the unusually favorable developments seen in Medicaid during fiscal 1996 to be repeated, health outlays are volatile from month to month, and the latest reading clearly overstates the underlying trend. Receipts rose 4-1/2 percent between October 1995 and October 1996, about in line with the pace of income growth.

In the state and local sector, spending in the current quarter is likely to receive a considerable lift from a surge in construction outlays, which jumped 3-1/4 percent in real terms in October to a level 5 percent (not at an annual rate) above the third-quarter average. In contrast, state and local employment has edged down in recent months, and the average level of employment in October and November was about 25,000 below the third-quarter level. In part, the recent weakness in employment may reflect the difficulties in seasonally adjusting the data for this sector; so far this year, employment growth has averaged 18,000 per month, a bit more than the average monthly rise in 1995.

According to the National Association of State Budget Officers (NASBO), states have budgeted relatively small increases in general fund outlays for fiscal 1997, which ends on June 30 for most states. Indeed, they project a rise in real spending of only about

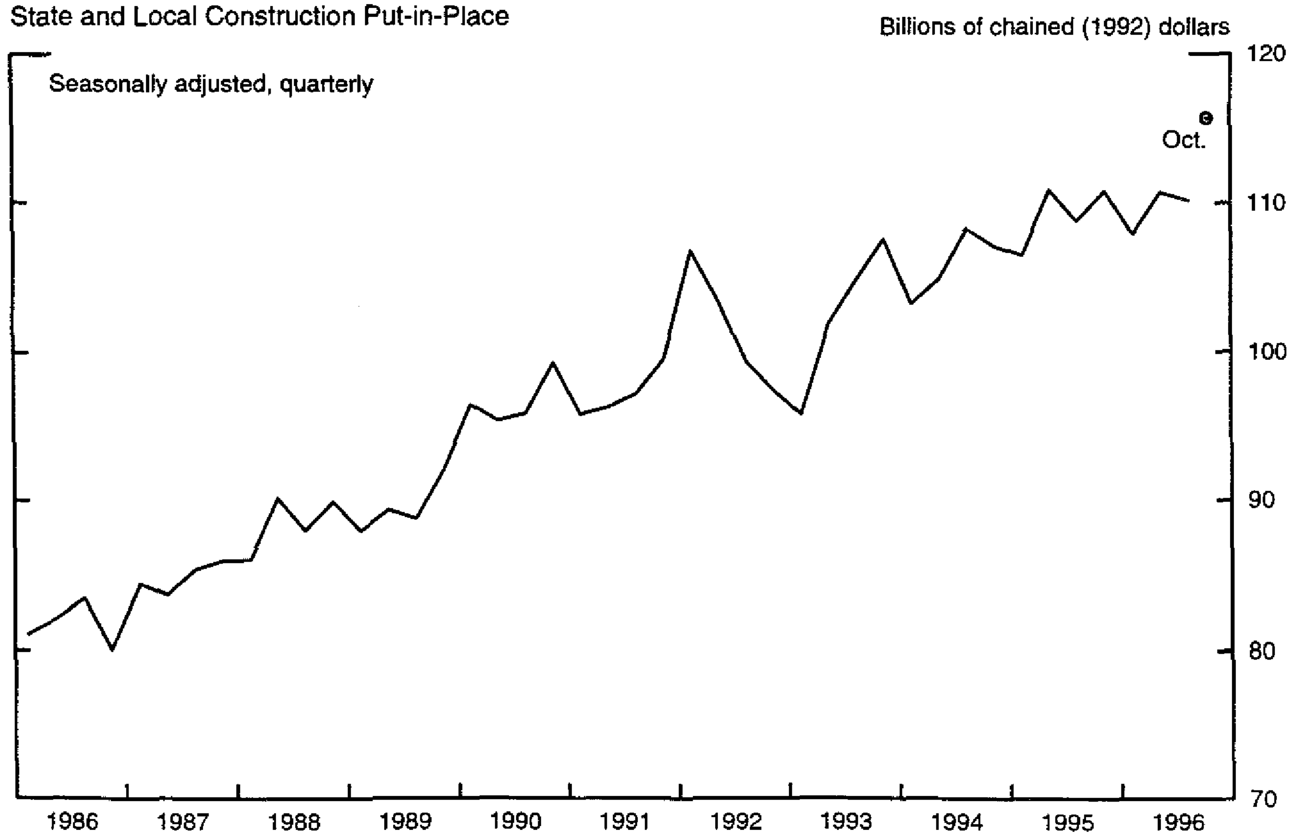
State and Local Employment and Construction

Average Monthly Change in State and Local Employment



1. 1996 is the average of the first 11 months of the year.

State and Local Construction Put-in-Place



1-1/2 percent--an unusually slow rate for a nonrecessionary year. NASBO indicated that spending on certain big-ticket items--salaries, welfare, and medical transfers--would grow only moderately. But the association also reported that many states have taken actions to aid local governments, including increases in grants, elimination of mandates, and the takeover of specific local government functions. For example, Connecticut will gradually assume responsibility for the local welfare general assistance program, and Wisconsin will provide funding for a substantially greater share of local education expenditures in fiscal 1997 than it did in 1996.

Prices

The incoming data on core consumer price inflation have remained favorable, as the CPI excluding food and energy rose a modest 0.2 percent in both October and November. However, another sizable rise in energy prices boosted the increase in the overall CPI to 0.3 percent in these months.

The CPI for energy rose 1.2 percent in November after increasing 0.7 percent in October. Gasoline prices were up 1.8 percent last month, as refiners were able to boost their margins from October's very low levels. But marketers' margins remained very low, and we anticipate another month or two of outsized increases in consumer gasoline prices. Heating oil prices were up another 2 percent in November, following two months of larger increases. Although refiners have been able to boost inventories a little bit in recent weeks, these stocks remain about 10 percent below year-earlier levels. As such, heating oil prices probably will remain sensitive to speculation about this winter's weather. In addition, natural gas prices jumped in November, as steady increases in spot prices since late October were passed through to the consumer unusually rapidly.

After several months of larger increases, consumer food prices were up 0.3 percent in November. The sharp decline in grain prices since midsummer has now begun to show through to smaller increases in prices of dairy products, meats, poultry, and eggs. Prices of fresh fruits and vegetables--volatile in the best of times--were up only modestly in November. At earlier stages of processing, the PPI for crude foodstuffs and feedstuffs declined for a fourth month in November, pointing to continued favorable consumer food price developments in the coming months.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996		1996	
	Nov. 1995	Nov. 1996	Q2	Q3	Oct.	Nov.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.6	3.3	3.9	2.3	0.3	0.3
Food (15.8)	2.8	4.4	4.3	5.6	0.6	0.3
Energy (6.7)	-2.7	8.1	18.4	-7.4	0.7	1.2
CPI less food and energy (77.5)	3.0	2.6	2.7	2.4	0.2	0.2
Commodities (23.9)	1.7	1.1	0.6	0.1	0.1	0.1
New vehicles (5.0)	2.0	1.8	2.4	3.2	-0.2	-0.1
Used cars (1.3)	5.1	-0.8	-5.8	-4.1	-0.3	-0.4
Apparel (5.0)	-0.4	-0.5	-1.8	-4.8	0.5	0.5
Services (53.6)	3.6	3.2	3.6	3.6	0.3	0.2
Owners' equivalent rent (19.7)	3.4	2.9	2.8	2.7	0.3	0.3
Tenants' rent (5.8)	2.4	2.8	2.6	3.0	0.2	0.2
Medical care (6.1)	4.6	3.3	3.1	3.3	0.2	0.4
Auto finance charges (0.6)	6.6	-1.3	0.3	13.7	-0.3	-1.2
PPI						
Finished goods (100.0)[2]	2.1	3.0	2.9	1.4	0.4	0.4
Finished consumer foods (23.4)	3.3	3.7	2.7	8.4	0.8	-0.1
Finished energy (13.4)	-3.2	12.9	12.9	-7.1	1.9	2.3
Finished goods less food and energy (63.2)	2.8	0.6	0.9	1.1	-0.3	0.1
Consumer goods (38.5)	2.9	0.8	1.3	1.1	-0.1	.0
Capital equipment (24.7)	2.6	0.3	0.4	0.8	-0.4	0.3
Intermediate materials (100)[3]	3.5	0.6	1.8	-1.1	.0	0.2
Intermediate materials less food and energy (82.6)	4.0	-1.2	-1.3	-0.6	-0.1	0.1
Crude materials (100)[4]	4.7	9.4	17.6	3.1	-0.6	1.8
Crude food materials (44.7)	13.7	3.2	41.3	16.8	-2.7	-1.9
Crude energy (31.4)	-1.4	30.5	11.8	-6.1	1.5	7.7
Crude materials less food and energy (23.9)	-1.2	-6.5	-11.3	-8.4	0.3	-0.3

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.

Core inflation remained tame in November: Prices of new vehicles edged off 0.1 percent and are up less than 2 percent from a year earlier. Non-energy service prices were up a modest 0.2 percent in November, a tad below their recent average. Even though apparel prices rose 1/2 percent for a third month in November, this followed a string of negative readings.

Prices of spot commodities have been mixed in recent weeks. The Journal of Commerce industrial materials index is up about 2 percent since the last Greenbook but remains below its year-ago level. Many farm commodity prices have moved up recently from their seasonal lows around harvest time. Prices of copper and aluminum have increased of late, but steel scrap prices have continued to fall, reflecting weak export demand. In addition, prices of lumber and plywood have come down a little from their very high levels earlier in the fall. The PPI for crude materials less food and energy edged down in November and stands 6-1/2 percent below its year-earlier level; the index for intermediate materials excluding food and energy has been about unchanged since the spring.

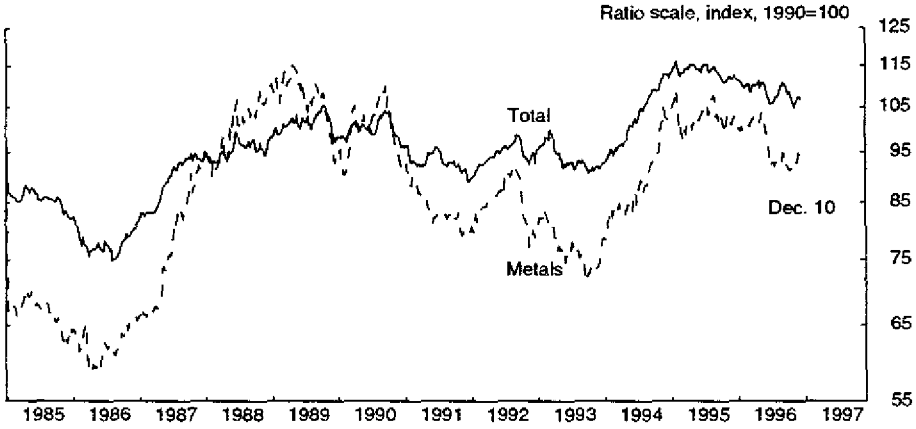
SPOT PRICES OF SELECTED COMMODITIES

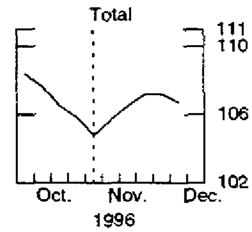
	Current price ($)	Percent change[1]: 1994	1995	Dec. 26 to Nov. 05[2]	Nov. 05[2] to Dec. 10	Memo: Year earlier to date
Metals						
Copper (lb.)	1.080	64.9	-3.5	-27.2	9.1	-22.9
Steel scrap (ton)	116.500	2.9	-6.6	-5.6	-7.9	-13.1
Aluminum, London (lb.)	.670	73.5	-12.9	-15.9	5.4	-10.2
Precious metals						
Gold (oz.)	368.250	-1.7	1.7	-2.1	-2.9	-5.3
Silver (oz.)	4.785	-5.0	7.2	-6.6	-.2	-7.6
Forest products						
Lumber (m. bdft.)	415.000	-37.1	-14.4	72.4	-3.7	66.7
Plywood (m. sqft.)	315.000	1.5	-6.1	4.5	-2.8	2.6
Petroleum						
Crude oil (barrel)	23.850	15.6	16.8	20.1	9.0	36.8
Gasoline (gal.)	.667	32.4	7.7	25.9	.3	25.7
Fuel oil (gal.)	.699	12.7	22.6	8.1	7.2	22.4
Livestock						
Steers (cwt.)	66.000	-3.4	-5.7	7.6	-7.0	-1.5
Hogs (cwt.)	56.000	-12.9	27.5	18.2	4.7	23.1
Broilers (lb.)	.622	-4.9	10.7	11.6	2.7	16.4
U.S. farm crops						
Corn (bu.)	2.610	-23.2	57.4	-27.7	4.0	-21.6
Wheat (bu.)	4.790	11.4	24.0	-17.6	7.5	-12.7
Soybeans (bu.)	6.790	-19.6	29.0	-7.7	2.2	-3.7
Cotton (lb.)	.725	38.5	-8.1	-11.2	3.4	-13.0
Other foodstuffs						
Coffee (lb.)	1.270	153.1	-39.1	27.6	.0	20.4
Memo:						
JOC Industrials	106.700	22.1	-1.7	-5.8	1.8	-5.1
JOC Metals	92.500	31.9	-1.8	-10.6	1.8	-9.9
KR-CRB Futures	240.870	4.8	3.3	-3.2	2.0	-1.3
KR-CRB Spot	331.810	29.1	-3.5	-.7	1.1	-.9

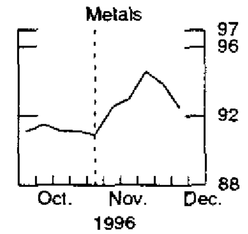
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the November Greenbook.

Commodity Price Measures

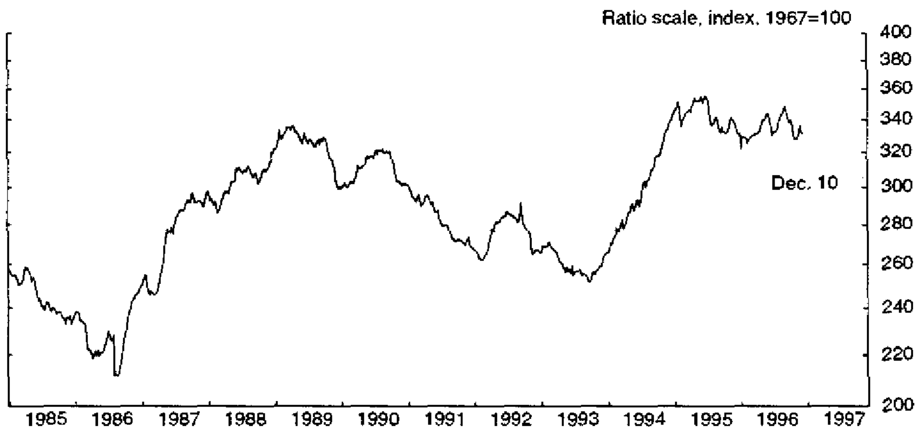
Journal of Commerce Index

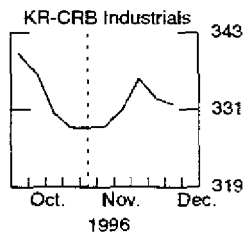




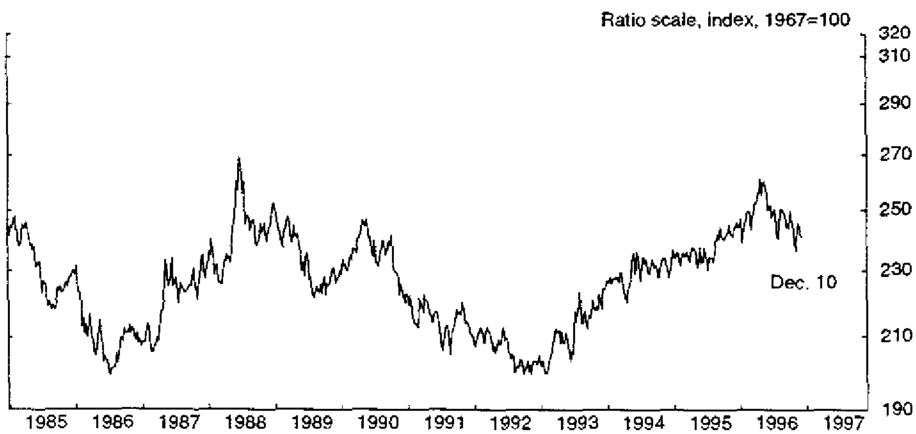


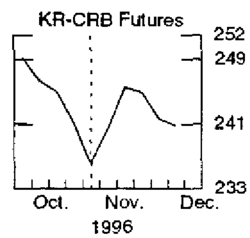
KR-CRB Spot Industrials





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.

DOMESTIC FINANCIAL DEVELOPMENTS

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

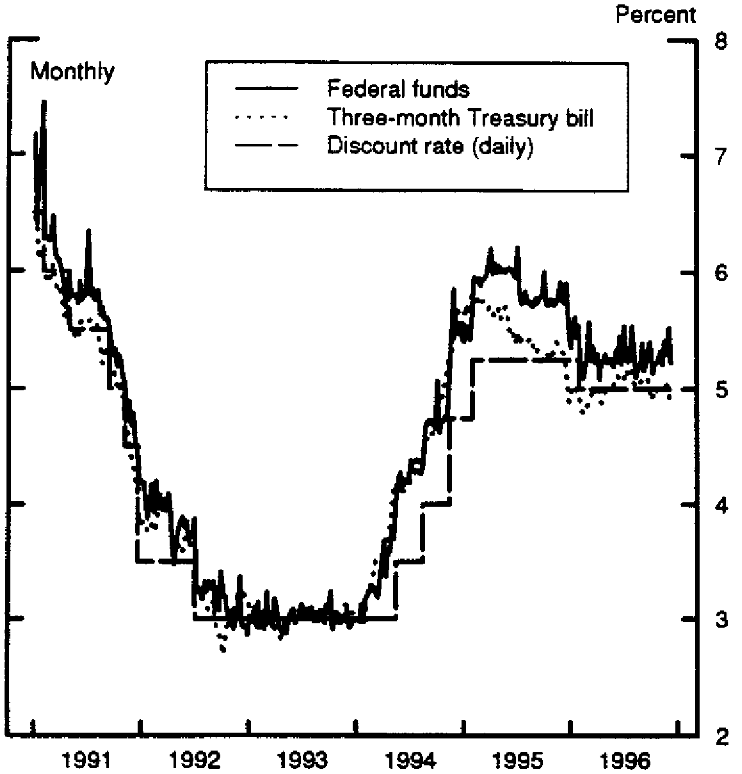
Instrument	1996 Feb. low	1996 July high	1996 FOMC,* Nov. 13	1996 Dec. 11	Change to Dec. 11, from: Feb. low	July high	FOMC, Nov. 13
Short-term rates							
Federal funds[2]	5.15	5.39	5.30	5.22	.07	-.17	-.08
Treasury bills[3]							
3-month	4.76	5.21	5.04	4.83	.07	-.38	-.21
6-month	4.67	5.40	5.08	5.02	.35	-.38	-.06
1-year	4.55	5.64	5.15	5.20	.65	-.44	.05
Commercial paper							
1-month	5.27	5.50	5.37	5.57	.30	.07	.20
3-month	5.12	5.59	5.40	5.44	.32	-.15	.04
Large negotiable CDs[3]							
1-month	5.21	5.44	5.28	5.49	.28	.05	.21
3-month	5.12	5.59	5.37	5.44	.32	-.15	.07
6-month	4.99	5.83	5.43	5.49	.50	-.34	.06
Eurodollar deposits[4]							
1-month	5.13	5.38	5.20	5.44	.31	.06	.24
3-month	5.13	5.56	5.38	5.38	.25	-.18	.00
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	5.84	5.95	.97	-.67	.11
10-year	5.58	7.06	6.19	6.38	.80	-.68	.19
30-year	6.02	7.19	6.44	6.61	.59	-.58	.17
Municipal revenue (Bond Buyer)[5]	5.67	6.24	5.92	5.83	.16	-.41	-.09
Corporate-A utility, recently offered	7.18	8.23	7.59	7.70	.52	-.53	.11
High-yield corporate[6]	9.57	10.36	9.78	9.74	.17	-.62	-.04
Home mortgages[7]							
FHLMC 30-yr fixed rate	6.94	8.42	7.67	7.57	.63	-.85	-.10
FHLMC 1-yr adjustable rate	5.19	6.01	5.56	5.52	.33	-.49	-.04

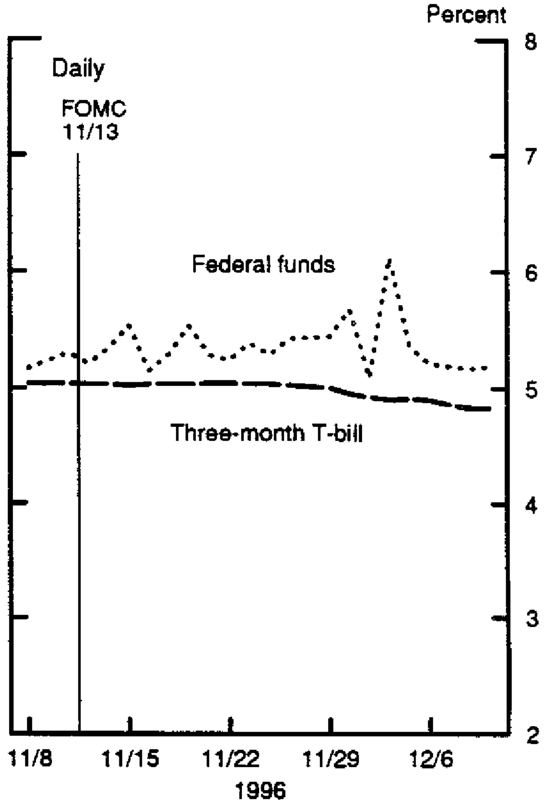
Stock exchange index	Record high Level	Record high Date	1996 July low	1996 FOMC,* Nov. 13	1996 Dec. 11	Percentage change to Dec. 11, from: Record high	July low	FOMC, Nov. 13
Dow-Jones Industrial	6547.79	11/25/96	5346.55	6266.04	6402.52	-2.22	19.75	2.18
NYSE Composite	398.86	11/25/96	336.07	386.18	389.54	-2.34	15.91	.87
S&P 500 Composite	757.03	11/25/96	626.65	729.56	740.73	-2.15	18.20	1.53
NASDAQ (OTC)	1316.27	12/9/96	1042.37	1256.53	1309.12	-.54	25.59	4.19
Wilshire	7295.57	12/2/96	6099.34	7067.63	7177.89	-1.61	17.68	1.56

1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average for maintenance period ending December 18, 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.
7. Quotes for week ending Friday previous to date shown, except most recent are figures for week ending December 13.
* Figures cited are as of the close on November 12.

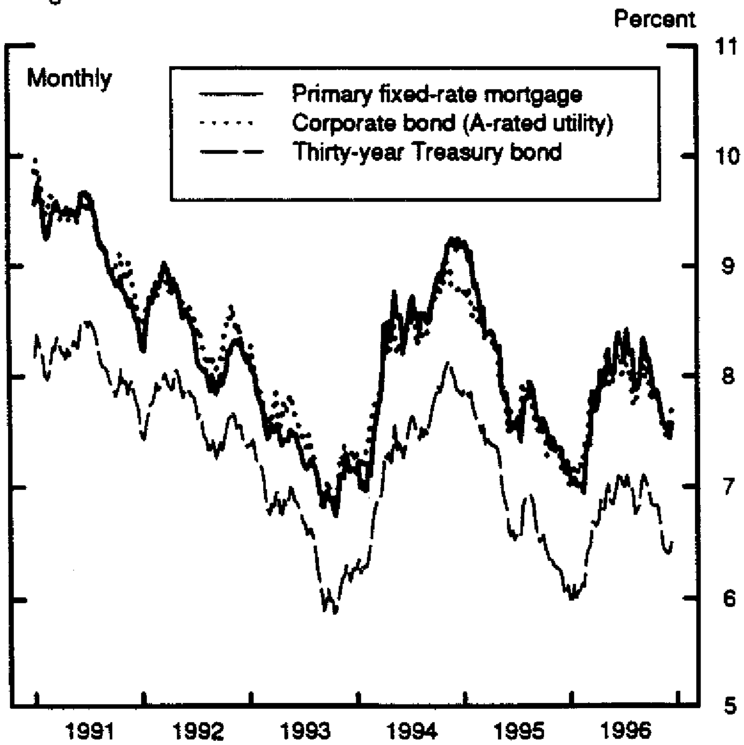
Selected Interest Rates

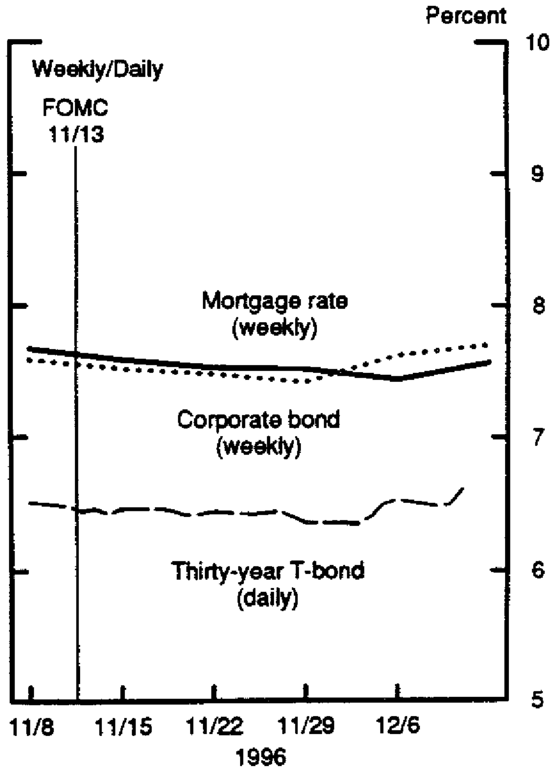
Short-Term





Long-Term





For the most part, data released in the latter half of November reinforced market participants' beliefs that the economy had downshifted in the second half and that inflationary pressures remain subdued. Interest rates moved substantially lower, especially at intermediate and long-term maturities. The bond markets have fluctuated in the past week, slumping when the Chairman's comments about asset valuation created concern over a possible System tightening, rallying on the report of slower employment growth and higher joblessness in November, and then falling again on concerns about weakness in the dollar and a possible lessening of foreign capital inflows. On net, short-term rates are slightly lower than at the time of the November FOMC meeting while intermediate and long-term rates are somewhat higher.[1] Current quotes on federal funds and Eurodollar futures contracts suggest an expectation that monetary policy will be on hold for at least the near term.

The market anticipation of moderate growth, low inflation, and stable interest rates propelled stock prices to new records during the intermeeting period. Although the stock market dipped following the Chairman's comments, it recovered quickly, more than gaining back its losses by the end of the next trading day. Further volatility this week has trimmed prices on net, but major indexes are still up 1 to 4 percent from their closing levels on November 13.

Overall credit growth appears to have remained moderate this quarter. Businesses have continued to take advantage of relatively low long-term rates by issuing bonds while cutting back on the use of commercial paper. Bank loans to businesses have expanded briskly. In the household sector, consumer credit turned back up in October, after a slight decline in September, but bank figures suggest only continued slow growth last month. Information on home mortgage flows this quarter is sparse, but available indicators

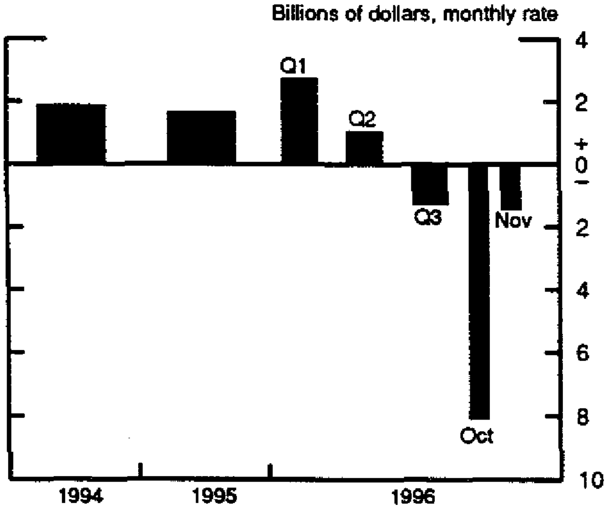
1. One exception to the general direction of short-term rates is the one-month rate, which built in a year-end premium estimated to be in excess of 2 percentage points when that maturity crossed over into the new year. Year-end funding pressures are on par with those of recent years, even though the last day of the year coincides with the end of a reserve maintenance period--a situation that in previous years has resulted in additional pressures.

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

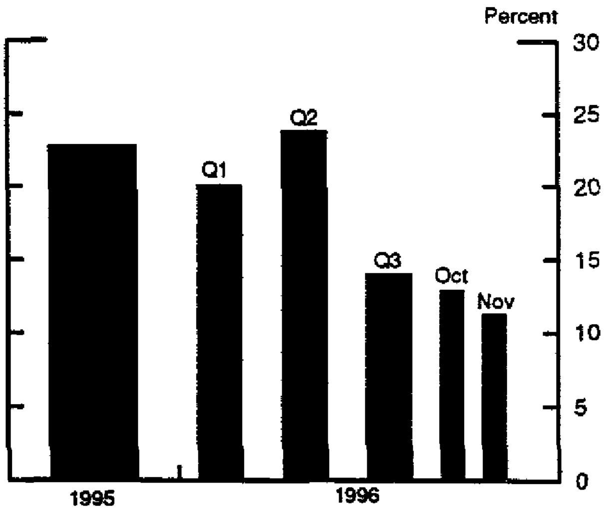
Type of security	1994	1995	1996 Q1	1996 Q2	1996 Q3	1996 Sept.	1996 Oct.p	1996 Nov.p
All U.S. corporations	41.3	47.6	58.3	65.0	50.1	62.3	62.8	59.6
Stocks[2]	5.5	6.1	7.3	13.9	6.9	6.7	13.0	11.7
Bonds	35.8	41.5	51.0	51.1	43.2	55.6	49.8	47.9
Nonfinancial corporations								
Stocks[2]	3.1	4.4	5.6	10.5	4.8	4.2	8.3	5.7
Initial public offerings	1.1	1.7	2.2	4.5	2.0	2.5	4.6	2.1
Seasoned offerings	2.0	2.7	3.4	6.1	2.8	1.8	3.7	3.6
Bonds	8.0	10.7	12.1	13.8	10.3	11.4	17.0	14.2
By rating, bonds sold in U.S.[3]								
Investment grade	4.4	6.4	5.9	6.3	5.2	5.0	9.2	7.0
Speculative grade	2.6	3.0	4.9	5.6	3.6	4.3	5.5	5.9
Public	2.0	2.0	2.7	3.3	1.8	1.8	2.1	1.1
Rule 144A	.6	1.1	2.3	2.3	1.8	2.5	3.4	4.8
Financial corporations								
Stocks[2]	2.4	1.7	1.8	3.4	2.1	2.5	4.6	6.0
Bonds	27.8	30.8	38.8	37.3	33.0	44.2	32.8	33.3

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 Issued by Nonfinancial Firms
(Change in outstandings over period shown)



Average First-Day Price Change of IPOs



suggest that demand for home loans has been buoyed by declining interest rates.

Growth of M3 was substantial in October and November, with a faster expansion of bank credit. M2 increased relatively slowly in October, but picked up in November and generally has remained on a trend paralleling nominal GDP.

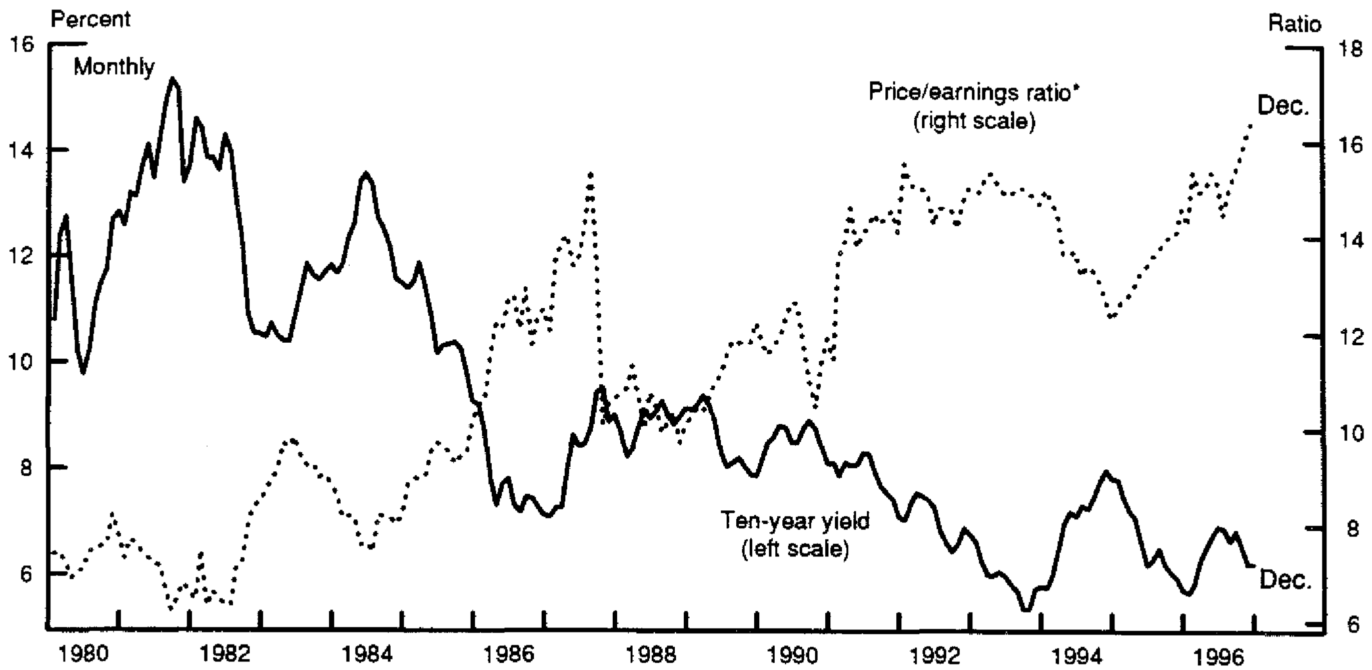
Business Finance

The decline of long-term interest rates over most of the intermeeting period spurred robust bond offerings by nonfinancial corporations in November (table). Speculative grade issuance was heavy, as it has been for most of the year; these issues have accounted for nearly half of all bond offerings in 1996, up from their roughly one-third share in 1994 and 1995. Nonfinancial commercial paper, meanwhile, continued to decline in November as issuers moved to lock in lower long-term rates (chart). In the current economic and financial environment, the indicators of credit quality of nonfinancial corporations have changed little in recent months, with the value of nonfinancial debt upgraded by Moody's in October and November about equal to the value downgraded.

Equity issuance by nonfinancial firms in November offered a mixed picture. Seasoned issuance showed continued strength, while initial public offerings fell after surging in October when many of the companies that had registered to issue shares earlier this year finally came to market (table). The market for IPOs has been less buoyant of late; for example, the first-day price increases for IPOs dropped back to a shade above 10 percent (on average) in October and November from already moderate third-quarter levels (chart). Equity retirements, meanwhile, continue apace: share repurchases remain very strong, while there is no indication that merger activity is slowing.

The S&P 500 price-to-earnings ratio (based on analysts' estimates of earnings over the coming twelve months) has risen to new highs for this series that began in 1979 (chart). The runup in the P/E ratio is broadly consistent over longer periods with changes in long-term interest rates--this indicator of stock market valuation tends to reach its highs as long-term rates reach their lows (chart). Still, the high valuation at present comes amid indications of a slowdown in corporate earnings growth. Third-quarter earnings of firms in the S&P 500 were up 8 percent from four quarters earlier, the slowest rate of growth in five years (chart).

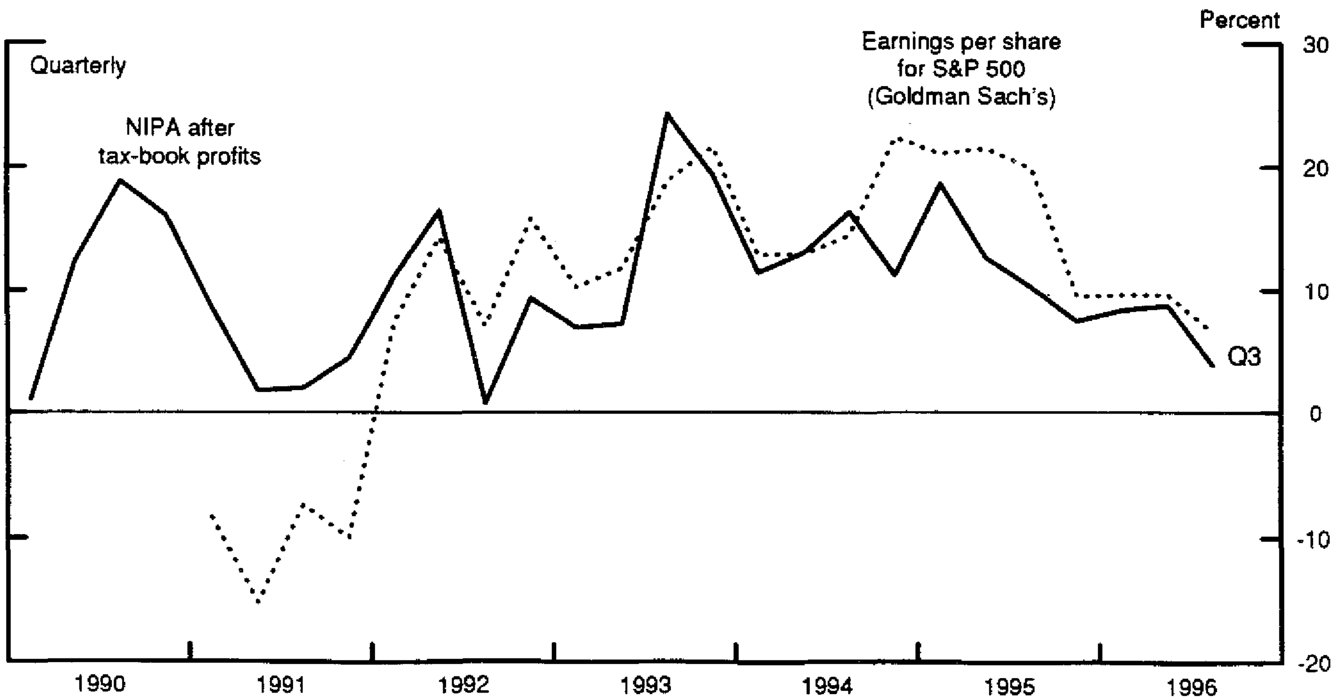
S&P 500 Valuation and Real Long-Term Interest Rates



* Based on consensus estimate of earnings over the coming 12 months. All observations reflect prices at mid-month.
Source: I/B/E/S.

Corporate Profits

(Change from four quarters earlier)



In the midst of the rapid increase in equity prices, net inflows to equity funds were up in November from their October levels but remained well below those of the first half of the year (table). Preliminary data for the week ending December 4 suggest that equity funds actually experienced a net outflow, for the first time since mid-July; however, industry sources indicate that there was not much investor reaction to the December 6 volatility in stock prices. The mix of inflows since midyear has had a slightly more conservative cast, with growth and income funds--which tend to invest in large, dividend-paying companies--accounting for about half of domestic equity net sales, up from about 40 percent over the first half. Cash ratios for stock funds declined to a historical low of 6.2 percent by the end of October, as the bull market continued to punish managers who did not try to stay fully invested.

Net Sales of Selected Mutual Funds
(Billions of dollars; quarterly and annual data at monthly rate)

			1996					Memo:
	1994	1995	H1	Q3	Sept.	Oct.	Nov.[e]	Oct. assets
Stock funds	11.0	12.2	23.9	14.2	19.8	14.0	18.7	1651.3
Domestic[1]	7.2	11.1	18.9	11.5	16.5	10.9	15.8	1387.6
Aggressive growth	2.2	3.2	6.0	3.3	4.8	3.4	4.9	260.8
Growth	2.0	3.5	5.1	2.6	4.3	1.8	4.0	457.6
Growth & income[2]	4.2	4.4	7.7	5.6	7.4	6.0	6.9	663.7
International	3.8	1.2	5.0	2.7	3.3	3.2	2.9	263.8
Bond funds	-1.4	2.0	3.8	2.6	4.9	1.2	4.8	806.5
High-yield	0.2	0.9	1.0	1.6	1.6	0.3	2.0	73.0
Income	2.2	1.7	2.9	1.6	2.9	1.5	2.9	311.8
Other	-3.8	-0.6	-0.1	-0.6	0.4	-0.6	-0.1	421.7

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 Staff estimate.
Source. Investment Company Institute.

CONSUMER CREDIT

	1994	1995	1996 Q1	1996 Q2	1996 Q3	1996 Aug	1996 Sep	1996 Oct[p]
Credit Outstanding, end of period								
Growth Rates (percent, SAAR)								
Total	14.5	14.2	11.9	7.7	6.1	6.0	-0.8	2.3
(Previous)	*(14.5)*	*(14.2)*	*(12.0)*	*(7.6)*	*(4.9)*	*(5.2)*	*(-2.7)*	
Auto	13.4	10.6	8.8	9.4	7.2	0.2	1.8	-0.2
Revolving	18.2	22.0	16.9	12.8	9.2	6.7	2.0	4.0
Other	11.8	9.2	9.1	-0.3	0.8	11.2	-7.1	2.8
Levels (billions of dollars, SA)								
Total	966.5	1103.3	1136.2	1158.1	1175.7	1176.4	1175.7	1177.9
Auto	317.2	350.8	358.6	367.0	373.6	373.1	373.6	373.6
Revolving	339.3	413.9	431.3	445.1	455.4	454.6	455.4	456.9
Other	309.9	338.6	346.2	346.0	346.7	348.7	346.7	347.5
Interest Rates[1] (annual percentage rate)								
Commercial banks								
New Cars (48 mo.)[2]	8.1	9.6	9.1	8.9	9.1	9.1	n.a.	n.a.
Personal (24 mo.)[2]	13.2	13.9	13.6	13.5	13.4	13.4	n.a.	n.a.
Credit cards[3]	15.7	16.0	15.8	15.4	15.7	15.7	n.a.	n.a.
Auto finance companies[4]								
New cars	9.8	11.2	9.8	9.5	10.5	10.5	10.5	10.4
Used cars	13.5	14.5	13.2	13.6	13.9	13.9	13.9	13.7

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

1. Annual data are averages of quarterly data for commercial banks and of monthly data for finance companies.
2. Average of most common rate charged for specified type and maturity during the first week of the middle month of each quarter.
3. Stated APR averaged across all credit card accounts at all reporting banks during the month.
4. Average rate for all loans of each type, regardless of maturity, made during the month.

Household Finance

Total consumer credit expanded about 2-1/4 percent, at an annual rate, in October following the small decline recorded in September (table). The sluggish growth in September and October confirms a substantial further slowing in consumer credit from its pace early in the year. Revolving credit grew at less than a 5 percent annual rate for the second straight month, well below the 15 percent growth averaged in the first half of this year.

Partial data for bank credit and mortgage-backed securities issuance so far in the current quarter suggest that mortgage borrowing has continued at about the same moderate pace as that recorded in the third quarter. Mortgage applications for home purchases have remained at a relatively high level, buoyed by the lower mortgage interest rates that prevailed for most of the intermeeting period. The decline in mortgage interest rates also more noticeably spurred refinancing activity, and the Mortgage Bankers Association's refi index in late November reached the highest level (seasonally adjusted) since early May. However, the refi index remains well off the peak reached in February.

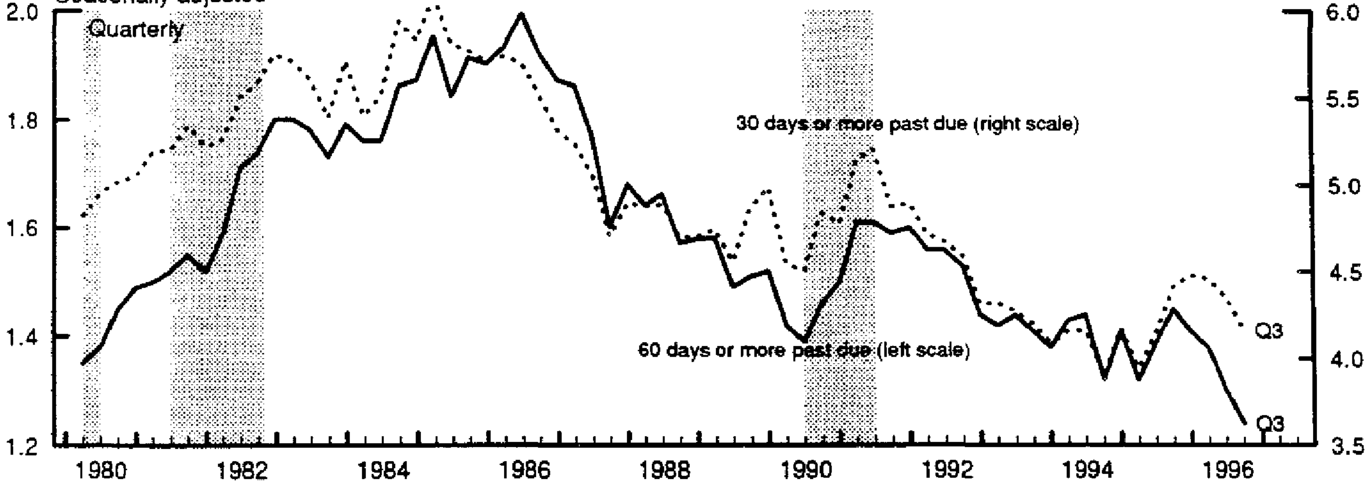
Thirty-year, fixed-rate loans have been the most popular type of new mortgage among refinancers, irrespective of the type of mortgage they originally owed. With mortgage rates hovering around 7-1/2 percent, about one-fifth of all outstanding fixed-rate loans could be considered likely candidates for refinancing. The potential net interest savings to homeowners is likely to be smaller than in earlier refinancing episodes because the average note rate on the outstanding stock of loans is much lower today than it was at the beginning of 1992 and because a large portion of the refinancing wave thus far has entailed shifting from ARMs to FRMs.

Lower mortgage rates and the associated reduction in payment burdens will likely help to sustain relatively strong mortgage payment performance. Recent reports indicate that the delinquency rate for mortgages edged lower in the third quarter. According to seasonally adjusted data from the Mortgage Bankers Association, the thirty-day delinquency rate on single-family loans declined for the second consecutive quarter (chart). The number of single-family loans sixty days or more past due, a measure of more serious payment problems, also declined, dropping this delinquency rate to a level last seen in 1979. And at banks, Call Reports for the third quarter continue to show very low levels of delinquencies and charge-offs.

Household Credit Quality

Mortgage Delinquency Rates at All Lenders

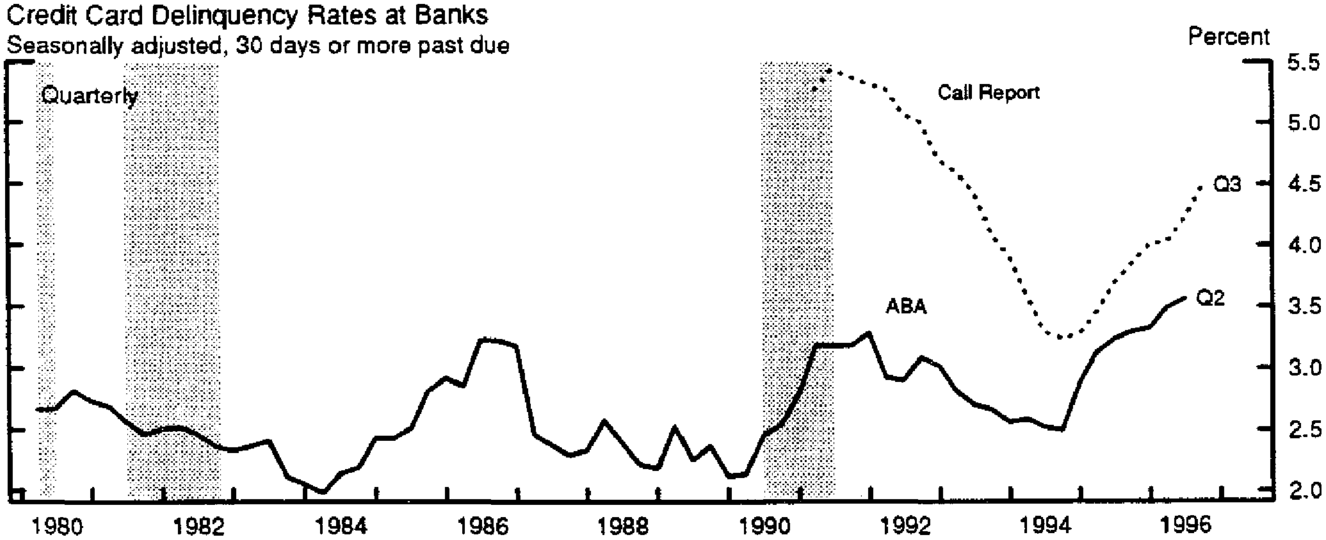
Seasonally adjusted



Source. Mortgage Bankers Association

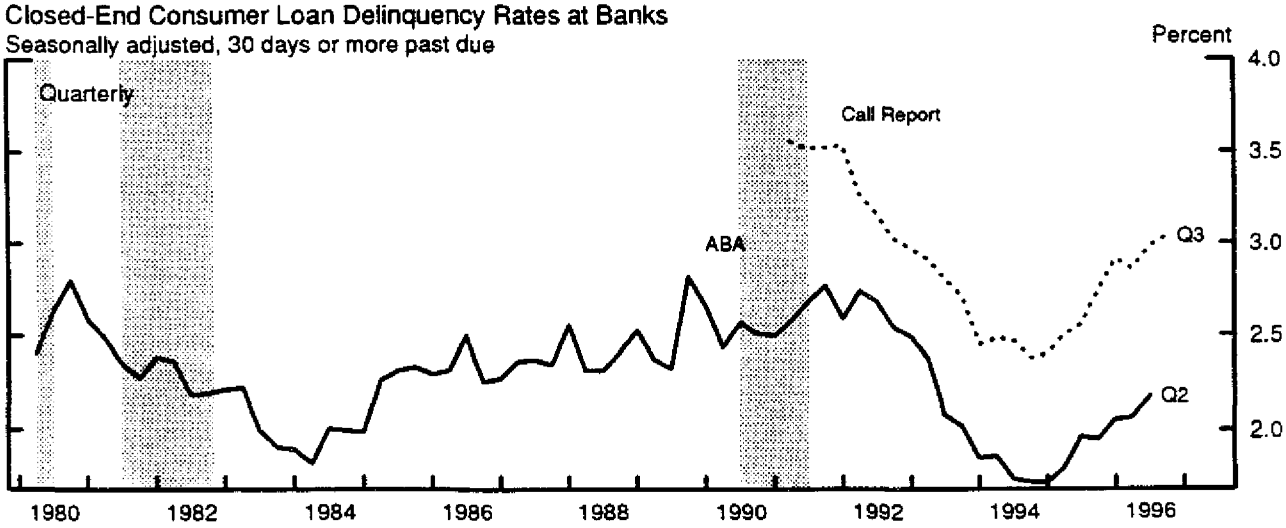
Credit Card Delinquency Rates at Banks

Seasonally adjusted, 30 days or more past due



Closed-End Consumer Loan Delinquency Rates at Banks

Seasonally adjusted, 30 days or more past due



However, indicators of credit quality of consumer loans suggest a more marked deterioration in household financial health (chart, middle and lower panels). Call Report data indicate that consumer loan delinquencies at banks continued to rise in the third quarter: Credit card delinquencies increased to 4.49 percent last quarter, the highest level reported for this series that began in the first quarter of 1992. Delinquency rates on other consumer loans also moved higher but remained well below prior peaks. Despite the deteriorating credit quality of consumer loans, bank profitability remained quite strong according to third-quarter Call Reports, even at credit card banks. Indeed, these banks have maintained a high ratio of loan loss reserves to delinquent loans and remain well capitalized.

Monetary Aggregates and Bank Credit

The growth of M2 strengthened last month to a 7-1/4 percent rate, more than double its rate in October. The reasons for the surge in growth are not clear at this time, but November's robust expansion follows two months of slowing growth, and averaging through the monthly gyrations, M2 continues to expand at about a 4-1/4 percent pace. Its growth for the entire year places it in the upper half of its annual range.

At 6-3/4 percent, M3 growth eased from its brisk October pace and remained just above the upper bound of its 2-to-6 percent range. Deceleration in M3 growth in November was accompanied by a slowing of bank credit growth. After adjusting for mark-to-market accounting effects, bank credit grew at an annual rate of 5-1/4 percent. The slowing in bank credit owed to a drop-off in loan growth to a 4 percent rate, less than half the pace of the previous two months, as business loans and the volatile "other loans" category decelerated.

Business loan growth eased off its extraordinarily rapid pace in September and October but to a still brisk 7 percent rate in November. Both delinquency and charge-off rates for business loans continued to be low in the third quarter (chart), and there are no signs that banks have become less accommodative lenders. Spreads on both large and small business loans were essentially unchanged in November from three months earlier, according to the November Survey of Terms of Bank Lending (chart). For large loans, these spreads remain quite narrow by standards of the past fifteen years.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1995	1996 Q2	1996 Q3	1996 Sept	1996 Oct.	1996 Nov. (p)	1995:Q4 to Nov. 96 (p)	Level (bil. $) Nov. 96 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-1.8	-0.7	-7.0	-8.7	-16.8	0.3	-4.7	1076.1
2. M2[2]	3.9	3.8	2.7	3.3	2.9	7.2	4.2	3796.2
3. M3	5.9	5.5	4.4	7.2	8.6	6.7	6.2	4841.5
Selected components								
4. Currency	5.4	3.7	7.9	7.8	8.7	7.1	5.6	392.6
5. Demand deposits	1.4	10.6	-2.1	-5.9	-27.2	13.9	3.1	400.7
6. Other checkable deposits	-11.1	-18.5	-30.6	-33.8	-37.7	-28.6	-23.7	274.2
7. M2 minus M1[3]	6.6	5.7	6.9	8.3	10.9	9.9	8.2	2720.1
8. Savings deposits	-3.3	11.2	8.0	7.0	13.1	11.0	11.8	1256.2
9. Small time deposits	15.0	-3.0	2.0	5.1	6.0	5.7	1.3	946.6
10. Retail money market funds	18.9	9.3	13.7	17.4	14.5	14.8	13.6	517.3
11. M3 minus M2[4]	14.7	12.4	10.7	21.8	29.8	5.0	14.0	1045.3
12. Large time deposits, net[5]	15.5	13.8	15.4	21.0	44.1	15.4	16.6	482.9
13. Institution-only money market mutual funds	23.1	8.8	18.5	25.7	7.3	13.2	18.7	267.2
14. RPs	5.4	23.3	-4.9	18.7	19.0	-31.4	4.1	193.6
15. Eurodollars	12.0	2.9	4.6	22.2	64.2	-17.3	10.9	102.8
Memo								
16. Sweep-adjusted M1[6]	1.5	7.0	3.1	2.7	-0.5	8.9	5.3	1238.0
17. Monetary base	4.1	2.1	5.9	4.6	3.5	5.6	3.6	449.3
18. Household M2[7]	4.1	3.0	3.4	3.7	6.4	6.4	4.4	3395.6
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	5.5	6.6	8.0	10.5	23.1	10.7	...	531.4
19. Net due to related foreign institutions	3.5	-4.8	-3.2	1.1	3.5	-4.1	...	244.0
20. U.S. government deposits at commercial banks	-0.1	0.0	1.7	3.0	-3.6	5.7	...	23.4

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. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs, on the basis of monthly averages of daily data.
7. M2 less demand deposits
8. 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.

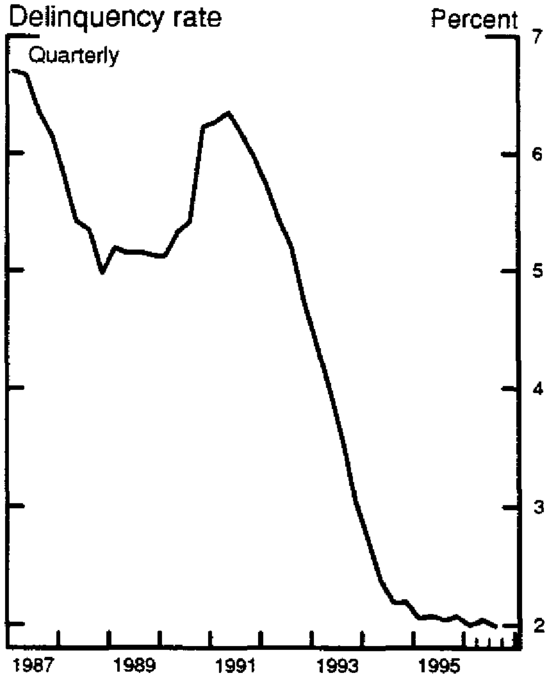
Commercial Bank Credit
(Percent change; seasonally adjusted annual rate)

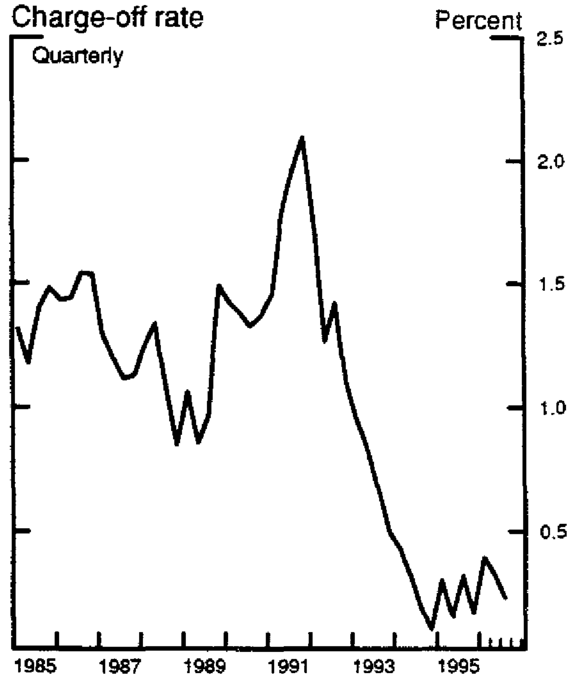
Type of credit	1995	1996 Q2	1996 Q3	1996 Sep	1996 Oct	1996 Nov	Level Nov 1996 (billions of $)
1. Bank credit - reported	8.8	2.6	1.3	5.1	6.6	8.7	3,740.3
2. - adjusted[1]	7.1	4.0	2.0	7.0	7.1	5.2	3,671.1
3. Securities - reported	4.1	-2.7	-6.4	-6.8	0.9	22.0	987.8
4. - adjusted[1]	-2.2	2.4	-4.3	0.1	2.8	8.7	918.6
5. U.S. government	-3.3	1.0	-2.3	2.6	-2.7	8.0	706.9
6. Other[2]	28.8	-11.5	-17.0	-30.8	10.4	58.7	280.9
7. Loans[3]	10.8	4.6	4.1	9.3	8.6	4.0	2,752.5
8. Business	11.6	5.1	6.7	22.4	13.5	7.0	770.9
9. Real estate	8.5	3.2	3.2	1.9	2.6	4.4	1,118.0
10. Home equity	5.2	-0.5	3.0	10.5	17.8	17.5	83.4
11. Other	8.7	3.5	3.2	1.3	1.4	3.5	1,034.7
12. Consumer - reported	10.7	4.9	5.8	9.3	-0.9	-0.7	517.2
13. - adjusted[4]	17.6	9.2	9.8	13.6	0.2	3.5	680.4
14. Other[5]	17.5	7.7	-1.1	4.7	32.1	2.4	346.3

Note. Adjusted for breaks caused by reclassifications. Monthly levels are *pro rata* averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates shown are percentage changes in consecutive levels, annualized but not compounded.

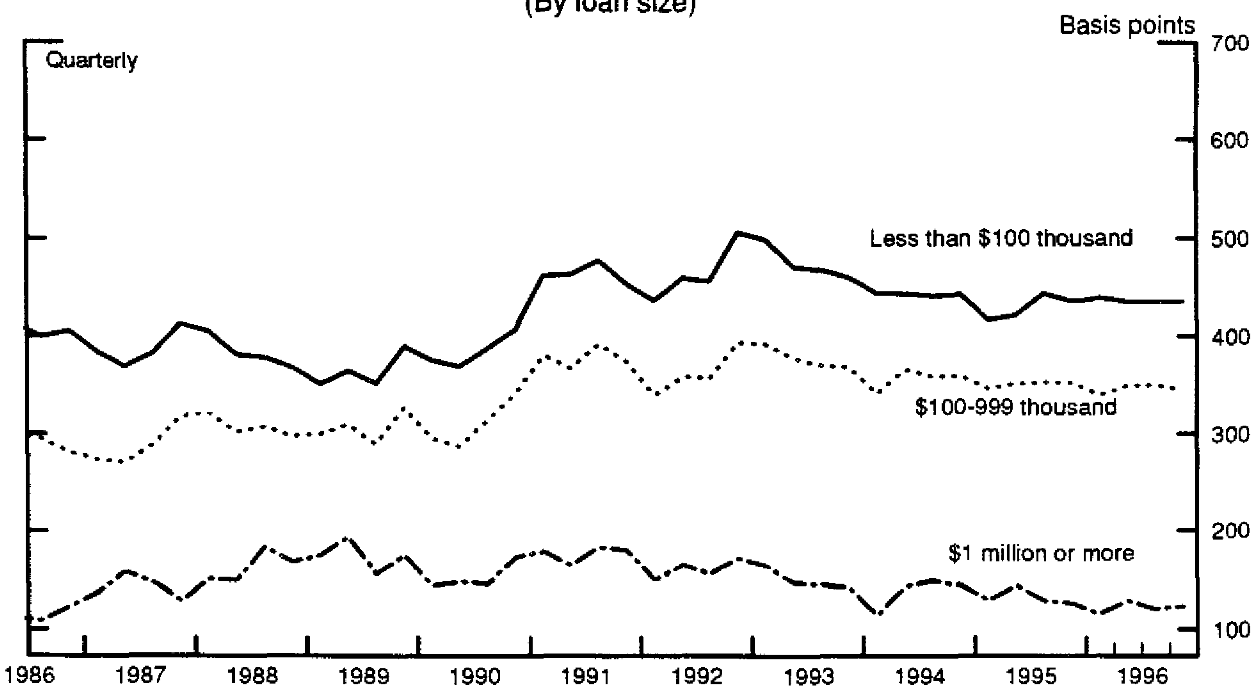
1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FASB 115).
2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not U.S. government securities.
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans, loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

Performance of Business Loans at Commercial Banks
(Seasonally adjusted)





Loan Rate Spreads
(By loan size)



Note. Spread over intended federal funds rate.

In contrast, consumer lending remained sluggish in part as banks appeared to have become more cautious in the face of rising debt burden problems. After gaining 10 percent at an annual rate between July and September, outstanding consumer loans at banks, adjusted for securitization, showed only small increases in October and November. Anecdotal reports suggested that some banks are steering customers away from consumer loans toward home equity lines, thus providing lenders with better collateral. While home equity loans expanded rapidly, overall real estate loans increased at a modest 4-1/2 percent pace in November.

Treasury and Agency Financing

The staff anticipates that the Treasury will finance the projected $59 billion fourth-quarter deficit by borrowing $43 billion from the public and by drawing down its cash balance by $13 billion. The Treasury has relied more heavily this quarter on coupon issues than in previous quarters, adding an extra ten-year note auction in mid-October and including a long-term bond in the November midquarter refunding for the first time since 1992. In total, fourth-quarter auctions of coupons are expected to raise $24 billion, while proceeds from bill auctions are expected to contribute only $12 billion. The Treasury still intends to auction an "inflation protection" note for settlement in mid-January.

Recently, considerable market attention has focused on reports of the heavy acquisition of Treasury securities by foreign purchasers. Foreign holdings of Treasuries have risen sharply in the past few years, with foreign entities estimated to hold almost 30 percent of outstanding Treasury securities at the end of the third quarter (chart). Nearly half of the increase can be attributed to purchases by official institutions, which tend to hold their securities in custody at the Federal Reserve Bank of New York (chart). Recently, custodial holdings at the Federal Reserve Bank of New York have topped $600 billion.

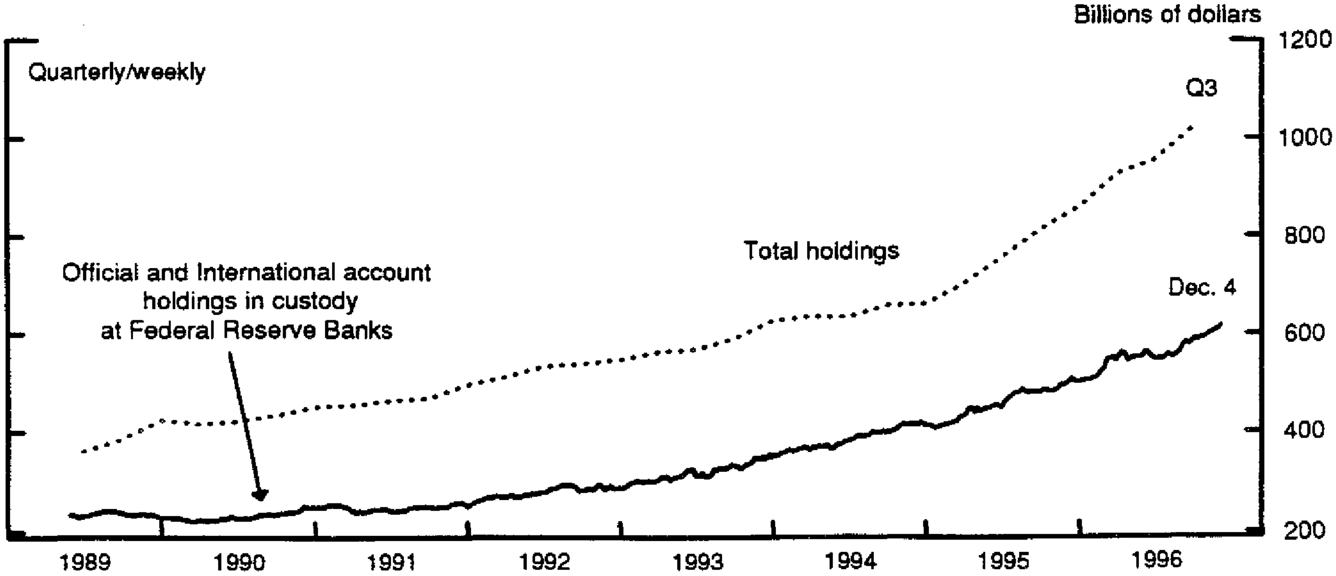
Issuance of securities by government-sponsored enterprises has remained steady; and spreads of GSE-issued securities over comparable Treasury securities are essentially unchanged at about 16 basis points for the five-year note and 25 basis points for the ten-year note.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q3	1996 Q4[p]	1996 Oct.	1996 Nov.[e]	1996 Dec.[p]
Total surplus/deficit (-)	-33.3	-59.1	-40.3	-40.5	21.6
Means of financing deficit					
Net cash borrowing and repayments (-)	39.4	43.1	15.6	44.8	-17.2
Nonmarketable	-1.0	6.8	2.9	2.4	1.6
Marketable	40.3	36.3	12.7	42.4	-18.8
Bills	-12.4	11.9	2.2	38.9	-29.1
Coupons	52.7	24.4	10.5	3.5	10.3
Decrease in cash balance	-6.2	12.7	18.6	-0.7	-5.2
Other	0.1	3.3	6.1	-3.6	0.8
Memo:					
Cash balance, end of period	44.2	31.5	25.6	26.3	31.5

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.

Foreign Holdings of Marketable U.S. Treasury Securities



Source: Flow of Funds and New York Federal Reserve Bank.

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

Agency	1996 Q2	Q3	Aug.	Sept.	Oct.
FHLBs	10.0	5.7	2.7	1.1	-1.1
FHLMC	19.1	3.6	2.2	-1.8	1.5
FNMA	1.6	10.8	1.9	6.8	2.0
Farm Credit Banks	2.8	-2.1	-.1	-.1	-.4
SLMA	-1.0	.2	.4	-1.5	n.a.

Note. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
n.a. Not available.

Municipal Financing

Totaling about $12-1/2 billion, gross offerings of long-term municipal debt in November were down from October, with the decline attributable to weaker issuance for new capital (table). Data for the first week of December, however, show a pickup in gross issuance.

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

	1994	1995	1996 Q1	Q2	Q3	Oct.	Nov.
Total tax-exempt	16.1	14.9	15.4	20.4	17.3	20.5	13.3
Long-term	12.8	12.1	13.7	15.6	12.0	16.3	12.4
Refundings[1]	4.0	3.6	5.5	4.5	4.1	4.4	4.4
New capital	8.8	8.5	8.2	11.1	7.9	11.9	8.0
Short-term	3.3	2.8	1.7	4.8	5.3	4.2	.9
Total taxable	.7	.7	.4	.6	.6	.6	1.8

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

The yield ratio of long-term tax-exempt bonds to comparable Treasuries increased to 0.84 in November from 0.82 in October. Analysts attributed the increase in the yield ratio, in part, to weak retail demand for tax-exempt debt in the first three weeks of the month, which may have stemmed from the strong performance of the stock market. More recently, though, there have been some reports that investors, such as property and casualty insurance companies, have stepped into the municipal market at what they view as attractive yields.

APPENDIX

REVIEW OF MONEY AND CREDIT IN 1996

Summary

Most broad money and credit aggregates have expanded moderately in 1996, at rates roughly in line with growth in nominal income. Total domestic nonfinancial debt is projected to come in near the middle of its monitoring range, with both the federal and nonfederal components decelerating a little from the previous year. More noticeable has been the slowing in depository credit--a weakening in bank credit growth offset only partially by a pickup in the expansion of thrift credit--as a larger share of borrowing has been financed in securities markets. Despite the stimulus early in the year from System policy easings, M2 growth has been a little below that of nominal GDP, but M2 is expected to finish the year in the upper half of its annual range. M3 has expanded somewhat faster than other broad money and credit measures as banks have shifted their funding toward large time deposits (and other managed liabilities in M3) and away from borrowing from their foreign offices. M3 is expected to end the year a little above its annual range.

Domestic Nonfinancial Debt

Total domestic nonfinancial debt expanded at a 5 percent pace through November--a bit slower than in 1995 but near the middle of its annual range. The deceleration in debt growth has been evident in both its federal and nonfederal components.

The Treasury's borrowing needs have been modest in 1996, reflecting both slower growth in outlays and strong receipts. Unexpected strength in Treasury tax receipts evidently stemmed largely from a jump in revenue from capital gains taxes associated with the stock market rally over 1995. Federal debt has expanded at about a 3-3/4 percent pace through November--down about 3/4 percentage point from the previous year and the slowest rate of expansion since 1974.

Nonfederal debt has expanded at about a 5-1/2 percent pace through November--a touch below that of 1995. State and local governments have continued to pay down tax-exempt debt on net as gross issuance has again fallen short of retirements of advance-refunded debt. Early in the political campaign season, yields on municipal securities were temporarily elevated relative to comparable Treasury yields amid the debate over "flat-tax" proposals that would have reduced or eliminated the federal tax exemption for state and local securities. Since then, the ratio of municipal bond yields to Treasury yields has drifted down to more normal levels.

Business Finance. Despite heavy investment expenditures, businesses have increased their debt at only a moderate rate during the year. To a large extent, strong profits have enabled businesses to rely on internal funds in financing new investment projects. Standard measures of financial stress in the business sector--such as net interest outlays relative to cash flow, the number of business failures, and the dollar value of corporate debt upgraded by major rating agencies--have all been quite favorable. Given the evident health of the business sector and the generally favorable outlook for the economy, capital markets have remained quite receptive to new offerings of corporate securities. Spreads on investment-grade bonds and commercial paper and also junk bonds relative to comparable Treasuries have remained quite narrow. Banks also have been quite eager to extend new business credits.

The commercial real estate market has continued its gradual recovery, contributing to the modest rise in commercial mortgage debt this year. Much of the debt financing for commercial real estate has been packaged in the form of mortgage-backed securities.

Household Finance. Consumer credit continued to expand briskly through the first few months of the year--albeit at a pace below that in 1995. However, consumer credit growth has slowed markedly in recent months, perhaps indicating some response by households to financial strains that have been evident over the year. Personal bankruptcies have climbed sharply, although some of the increase is likely attributable to recent changes in the bankruptcy code that have made declaring bankruptcy less onerous as well as the growing acceptability of declaring bankruptcy as a remedy for financial problems. Credit card delinquencies--as measured from bank Call Reports--have risen steadily during the year but have remained below the highs recorded in the early 1990s. Charge-off rates on credit card loans at banks have also risen through the year, reaching a level in the third quarter just below the previous peak attained in early 1992.

Consistent with the strength in home sales over much of the year, growth in home mortgage credit appears to have picked up to its most rapid pace since 1990. In contrast to consumer loans, most measures of delinquency rates on home mortgages have remained near the lower end of their historical ranges throughout the year.

Depository Credit

Depository credit growth has slowed considerably this year relative to 1995, with an appreciable deceleration in bank credit offset partly by stronger growth in thrift credit. Bank credit (adjusted for the impact of mark-to-market accounting rules) expanded through November at about a 4-1/2 percent rate--the slowest pace since 1992 and one that implies a slight decline in the share of total domestic nonfinancial credit flows funded by banks. Bank securities portfolios--adjusted for the effect of mark-to-market accounting rules--expanded slightly through November. Bank loans have grown moderately in 1996 but at a rate substantially below that of the previous two years.

The deceleration in bank loans has been apparent in nearly all major lending categories. In part, slower growth in bank loans reflects market conditions that have favored securitization. For example, with long-term interest rates quite low over much of the year, borrowers have tended to favor fixed-rate mortgages which, in turn, tend to be securitized. In addition, banks have moved a large volume of credit card receivables off their books in response to strong market demand for asset-backed securities.

Still, even apart from the effects of securitization, bank loan growth has moderated. Banks' lending to business--while still registering solid growth--has been more subdued than in the past two years. Businesses' greater reliance on internal funds and also their reduced inventory financing needs evidently have held down their bank borrowing, despite aggressive competition by banks for business customers. Delinquencies and charge-offs on business loans have remained at historically low levels, and surveys of senior loan officers throughout the year showed that banks had eased the terms and standards applied to business loans. However, data on loan rates charged by banks suggest that spreads of bank loan rates over market interest rates have changed little on balance over the year.

In contrast, banks have become considerably more cautious in lending to consumers. Delinquency rates on consumer loans have climbed significantly over the year. Survey evidence and anecdotal information suggest that many banks conducting aggressive credit card campaigns had allowed for some increase in delinquency rates and other loan performance problems. In the event, however, such loan performance problems appeared to be larger than anticipated. Indeed, surveys of senior loan officers indicate that many banks have tightened the terms and standards applied to consumer loans. Despite the increase in consumer loan performance problems at banks, the vast majority of banks have reported strong profits and capital positions. Even credit card banks continue to report healthy earnings.

The outlook in the thrift industry has also been improving. After several years of debate, the Congress recapitalized the Savings Association Insurance Fund (SAIF) with a special assessment of 66 basis points on SAIF deposits. The special assessment was booked in the third quarter and hence depressed the third-quarter profits of thrifts (and also of banks that had acquired SAIF deposits through mergers and acquisitions). Apart from the special assessment, thrift profits have been quite strong this year, and growth of thrift credit has picked up considerably.

Monetary Aggregates

Despite slower growth of depository credit this year, M3 has advanced briskly--expanding at a 6-1/4 percent pace from the fourth quarter of 1995 through November--and will likely end the year a little above the upper bound of its annual range. Reductions in deposit insurance premiums for most banks late in 1995 have likely helped to bolster M3 growth this year. In the previous two years, domestic banks had substantially increased borrowing from their offices abroad. In part, this funding strategy appeared designed to avoid the rather high deposit insurance premiums then in effect. By contrast, domestically chartered banks have reduced their borrowing from foreign offices in 1996 in favor of greater reliance on large time deposits and other managed liabilities that are included in M3. M3 has also been lifted by strong growth of money funds.

The strength in M3 over the year has not been matched by M2. From the fourth quarter of 1995 through November, M2 expanded at a 4-1/4 percent annual pace, placing it in the upper half of its annual range. Early in the year, M2 growth was quite robust. Returns on M2 assets became more attractive relative to yields on short-term money market instruments following the System policy easings in December 1995 and January 1996. In addition, the steep decline in long-term interest rates toward the end of 1995 sparked another round of home mortgage refinancings, and the associated prepayments on mortgage-backed securities helped fuel a notable rise in demand deposits over the first few months of the year. In later months, however, the advance in M2 moderated as demand deposit growth ebbed and growth in other accounts at depository institutions turned sluggish. Indeed, from March through November, deposits in M2 climbed only 1 percent at an annual rate.

In part, the tepid expansion of M2 deposits may have been a consequence of relatively attractive rates of return on alternative assets. Returns on bank and thrift deposits have certainly been no match for the realized returns on stocks over the year and have not been very competitive even with yields on money market mutual funds. From March through November, retail money funds increased at an 11-1/2 percent pace and accounted for more than half of the overall increase in M2 over the same period.

The transaction components of M2 have been dominated by special factors throughout the year. Through November, new retail sweep arrangements implemented during the year are estimated to have cut the level of other checkable deposits (OCDs) by more than $100 billion. In addition, a few large institutions have established so-called "weekend" sweeps of demand deposit accounts--arrangements in which demand deposit balances are swept into MMDA accounts over the weekend. While less widespread than OCD sweeps, new demand deposit sweeps depressed the growth of these accounts significantly in the third quarter.

With transaction deposits shrinking on balance through the year, required reserves have remained on a rather steep downward trajectory. The monetary base nonetheless has managed a little growth over the year, buoyed by a rise in currency. Currency decelerated early in the year; shipments of U.S. currency abroad had slowed from the pace of the previous year, and demand for the new $100 bill introduced in March initially fell short of expectations. However, subsequently, foreign shipments of U.S. currency picked up amid political and economic uncertainties in Russia that boosted the demand for dollars there.

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

Growth rates or flows	1992	1993	1994	1995	1996[1]	Memo: Recent 1996 levels (billions of dollars)[1]
Growth rates (percent)						
M1	14.3	10.5	2.4	-1.8	-4.7	1,076.1
Sweep-adjusted M1[2]	14.3	10.5	3.3	1.5	5.3	1,238.0
M2	1.8	1.4	0.6	3.9	4.2	3,796.2
M3	0.6	1.0	1.6	5.9	6.2	4,841.5
Domestic nonfinancial debt	4.7	5.1	5.2	5.5	5.1	14,528.3
Depository credit	1.1	3.5	5.1	5.6	4.1	4,857.6
Bank credit[3]	3.8	5.0	6.1	7.1	4.4	3,671.1
Thrift credit	-5.2	-0.2	2.6	1.6	4.2	1,223.8
Flows ($ billions, December to December)						
M1						
Currency	25.5	29.5	32.5	18.3	19.4	392.6
Demand deposits	49.6	45.2	-1.9	7.4	10.9	400.7
Other checkable deposits	51.7	29.8	-11.1	-49.9	-78.8	274.2
M2						
Nontransactions M2	-72.2	-48.9	-4.9	172.1	187.5	2,720.1
Savings & MMDAs	142.1	31.7	-69.9	-14.3	121.6	1,256.2
Small time deposits	-196.5	-83.4	35.6	114.2	8.9	946.6
General purpose and broker/dealer MMMF assets	-17.7	2.7	29.4	72.2	57.0	517.3
M3						
Non-M2 component	-46.2	7.1	54.4	104.9	130.4	1,045.3
Institution-only MMMF assets	20.3	-1.9	-14.2	43.5	40.0	267.2
Large time deposits	-62.9	-19.8	29.2	54.2	65.7	482.9
Total RPs, net (NSA)	8.9	29.4	23.0	-1.6	15.6	193.6
Total eurodollars, net (NSA)	-13.1	-1.1	15.8	8.5	10.9	102.8

1. For monetary aggregates, bank credit, and nonfinancial debt through November; for depository and thrift credit through September.
2. Sweep figures used to adjust this series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs, on the basis of monthly averages of daily data.
3. Adjusted for the estimated effects of mark-to-market accounting rules.

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In September, the U.S. deficit in trade in goods and services was somewhat larger than in August and close to the level reported for July. Exports declined slightly in September from their August level, while imports were about unchanged. In the third quarter, the deficit was significantly larger than in the second quarter or in any quarter in recent years.

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

	1995	Annual rates 1996 Q1	Annual rates 1996 Q2	Annual rates 1996 Q3	Monthly rates 1996 Jul	Monthly rates 1996 Aug	Monthly rates 1996 Sep
Real NIPA 1/							
Net exports of G&S	-107.6	-104.0	-114.7	-132.2	...	...	...
Nominal BOP							
Net exports of G&S	-105.1	-96.9	-112.2	-133.0	-11.6	-10.3	-11.3
Goods, net	-173.4	-170.9	-188.0	-206.4	-17.5	-16.4	-17.7
Services, net	68.4	74.0	75.8	73.4	5.9	6.1	6.3

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

Exports of goods and services were 1-1/2 percent lower in the third quarter compared with the second quarter, with virtually all of the decrease attributable to aircraft and gold. Automotive exports rose somewhat (especially passenger cars to Europe and Japan). Other major categories of exports were little changed from levels recorded in the second quarter. Exports to Western Europe declined sharply, mostly due to declines in aircraft and gold and more than accounted for the overall drop in total merchandise exports. A pickup in exports to Latin America partly offset the decline to other areas.

Imports of goods and services were only slightly higher in the third quarter than in the second quarter. Declines in imported gold and semiconductors almost offset increases in most other major trade categories. The largest increases were in consumer goods (with 40 percent of the rise from China) and automotive products (parts from Canada and vehicles from Japan).

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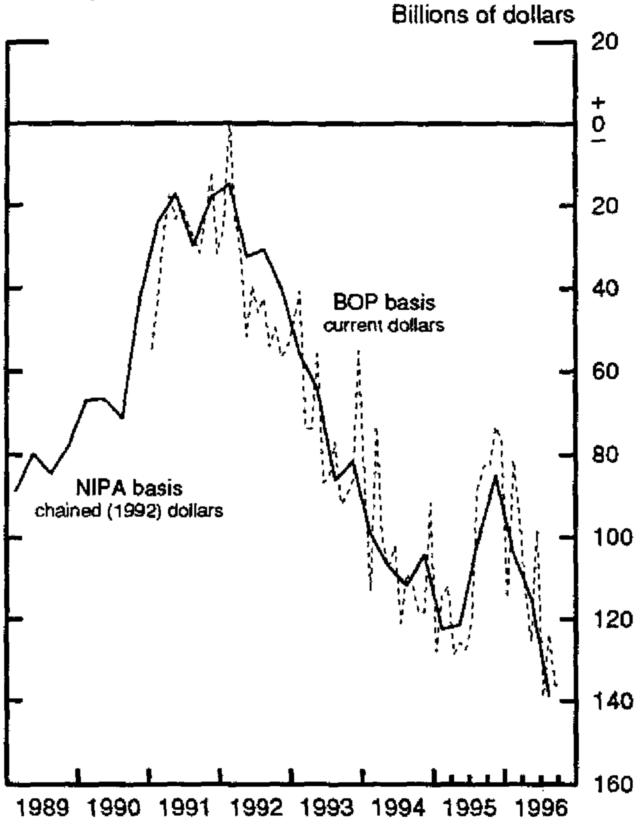
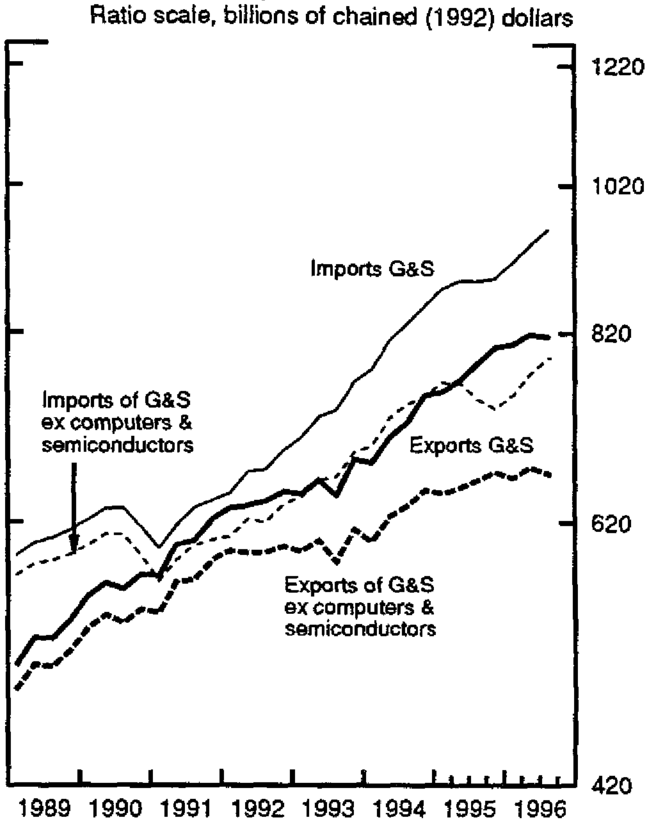
U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

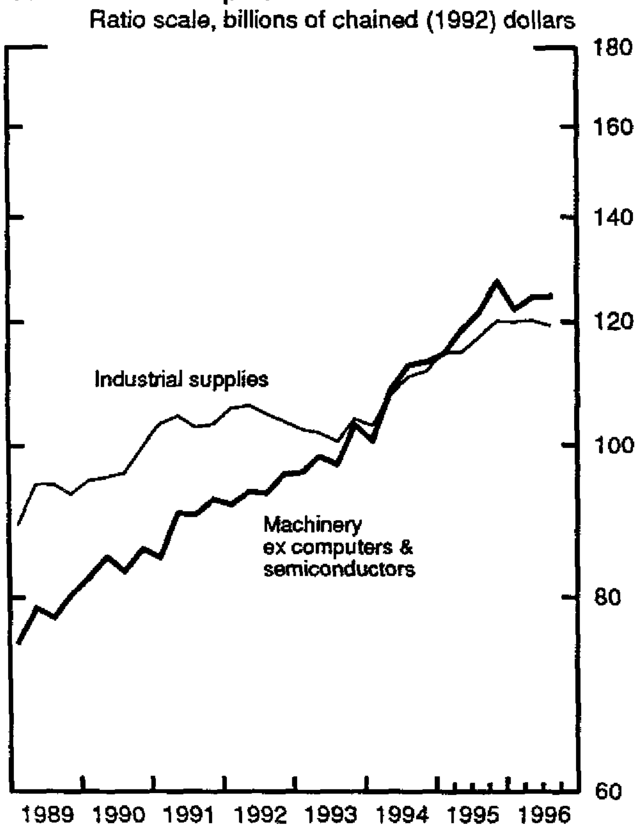
Net Exports



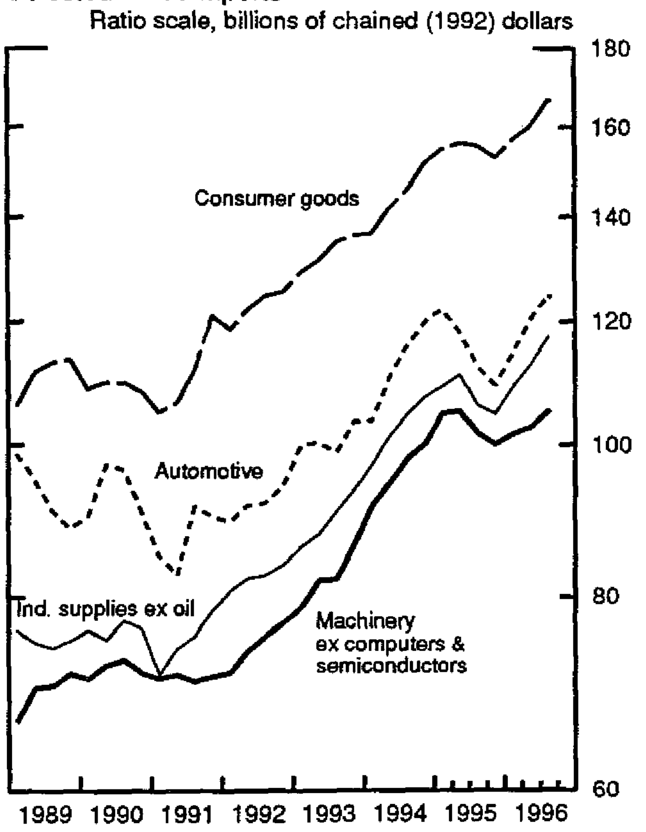
NIPA Exports and Imports



Selected NIPA Exports



Selected NIPA Imports



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

	Levels 1996 Q2	Levels 1996 Q3	Levels 1996 Aug	Levels 1996 Sep	Amount Change 1/ 1996 Q2	Amount Change 1/ 1996 Q3	Amount Change 1/ 1996 Aug	Amount Change 1/ 1996 Sep
Exports of G&S	836.4	823.5	837.4	825.4	15.8	-12.9	29.7	-12.0
Goods exports	612.4	599.8	613.1	600.8	12.3	-12.6	27.8	-12.4
Agricultural	60.2	59.9	61.8	58.0	-3.0	-0.3	1.8	-3.9
Gold	12.5	5.2	6.5	4.5	6.2	-7.3	1.8	-2.0
Other goods	539.7	534.6	544.8	538.3	9.1	-5.1	24.2	-6.5
Aircraft & pts	33.4	26.7	32.5	23.8	6.9	-6.6	8.5	-8.6
Computers	43.2	43.0	44.1	43.0	-2.2	-0.2	2.2	-1.1
Semiconductors	34.9	33.7	33.9	34.1	-2.6	-1.2	0.9	0.3
Other cap gds	140.2	140.9	142.1	140.0	1.7	0.8	1.5	-2.1
Automotive	63.0	66.1	65.3	70.9	1.0	3.1	3.0	5.7
to Canada	34.6	36.3	35.0	39.6	1.5	1.7	0.7	4.6
to Mexico	7.9	6.9	7.3	6.6	0.3	-1.0	0.4	-0.7
to ROW	20.5	22.9	23.0	24.7	-0.7	2.4	1.9	1.7
Ind supplies	129.3	128.7	130.3	130.9	0.4	-0.6	5.5	0.5
Consumer goods	70.5	69.2	70.1	70.9	2.6	-1.3	3.6	0.9
All other	25.2	26.3	26.6	24.6	1.3	1.1	5.8	-2.0
Services exports	224.0	223.7	224.3	224.7	3.5	-0.3	1.9	0.4
Imports of G&S	948.6	956.5	961.0	961.5	31.1	7.9	14.2	0.5
Goods imports	800.4	806.1	810.2	812.9	29.3	5.8	15.0	2.7
Petroleum	70.1	71.5	66.9	75.3	14.1	1.4	-5.3	8.4
Gold	14.6	6.2	9.6	3.5	7.8	-8.4	4.2	-6.1
Other goods	715.7	728.4	733.6	734.1	7.4	12.7	16.0	0.4
Aircraft & pts	12.7	13.2	13.5	13.4	1.7	0.4	1.0	-0.1
Computers	60.5	61.4	61.6	61.1	-1.7	0.9	0.2	-0.5
Semiconductors	37.0	33.4	33.4	34.0	-6.7	-3.6	0.5	0.6
Other cap gds	115.5	117.1	116.6	118.0	-1.2	1.6	-0.2	1.4
Automotive	131.1	135.7	138.9	134.5	6.1	4.6	5.3	-4.4
from Canada	49.2	51.5	53.8	51.2	3.5	2.3	4.2	-2.6
from Mexico	24.1	23.2	24.5	23.9	1.3	-0.8	3.2	-0.6
from ROW	57.8	60.9	60.6	59.4	1.3	3.1	-2.1	-1.2
Ind supplies	126.9	130.7	132.4	130.6	2.7	3.8	3.4	-1.8
Consumer goods	166.3	172.4	172.9	177.3	3.0	6.0	6.0	4.4
Foods	35.9	35.8	36.4	35.8	1.7	-0.1	1.2	-0.6
All other	29.7	28.9	27.9	29.4	1.7	-0.8	-1.4	1.6
Services imports	148.2	150.3	150.8	148.6	1.7	2.1	-0.8	-2.2
Memo:								
Oil qty (mb/d)	9.83	9.99	9.46	10.04	1.08	0.17	-1.03	0.58
Oil price ($/bbl)	19.53	19.57	19.37	20.53	1.97	0.04	0.52	1.16

1. Change from previous quarter or month.
Source. U.S. Dept. of Commerce, Bureaus of Economic Analysis and Census.

Oil Imports

The quantity of oil imported rose 7.0 percent (SAAR) during the third quarter -- an increase of 0.166 mb/d. Imports were boosted by strong consumption, which was only partially offset by a 0.117 mb/d drawdown of the Strategic Petroleum Reserve. Preliminary data from the Department of Energy indicate that oil imports in October and November remained near the third-quarter pace, as increased production and a drawdown in stocks nearly offset stronger oil consumption.

Oil Prices

While the price of imported oil increased about 2 percent in July and August and jumped another 7.4 percent in September, the third-quarter average was nearly the same as the second-quarter level, owing to a very high April level and substantial price declines in May and June. The price of imported oil rose again in October and was 37 percent above its October 1995 level. Spot WTI has been quite volatile in the fourth quarter. WTI rose $0.90 per barrel in October, in part, on skirmishes in the Kurdish region of Northern Iraq and concerns over the level of heating oil stocks in the United States and Europe. The announcement of an agreement between the United Nations and Iraq on all technical issues regarding Iraq's limited oil sale helped push down the November spot price $1.20 per barrel, as well as prices for future delivery. Prices firmed in early December, owing to strikes in France that interrupted refinery operations. Spot WTI has declined substantially, however, since Iraq commenced producing oil for export on December 9. Spot WTI is trading in the $23-24 per barrel range.

Prices of Non-oil Imports and Exports

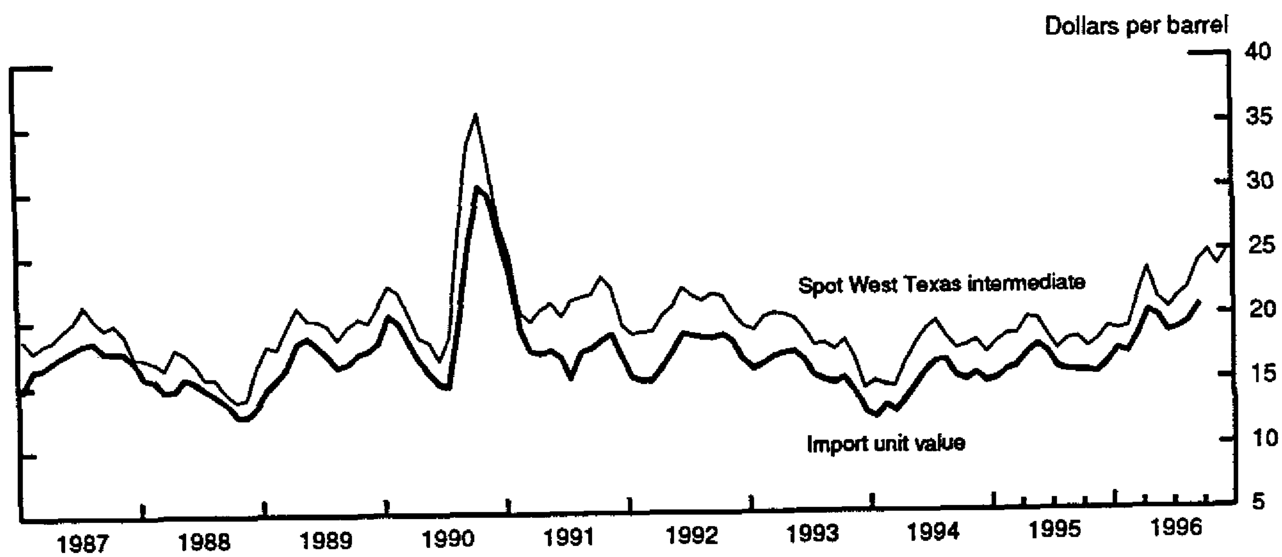
Prices of U.S. non-oil imports decreased 3 percent during the third quarter, a bit more than the BLS recorded declines in the first and second quarters. Prices of imported computers, semiconductors, and industrial supplies continued to fall sharply. Prices of imported foods also fell in the third quarter, nearly reversing a substantial increase in the second quarter. In October, prices of non-oil imports declined further; decreases were recorded in all major trade categories except foods (which rose slightly).

Prices of exports also fell in the third quarter. While the bulk of the decline was due to rapidly falling agricultural prices

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

	Annual rates 1996 Q1	Q2	Q3	Monthly rates 1996 Aug	Sep	Oct
	-----------	-BLS prices	(1990=100)	-----------		
Merchandise imports	2.4	1.5	-2.3	0.1	1.1	0.4
Oil	47.4	41.0	1.8	2.1	7.4	6.1
Non-oil	-1.2	-2.3	-3.0	-0.1	0.3	-0.3
Foods, feeds, bev.	-4.5	11.6	-10.7	-0.8	1.9	0.1
Ind supp ex oil	-3.1	-5.0	-5.2	0.0	0.4	-0.5
Computers	-8.1	-16.7	-10.8	-0.7	-1.0	-0.6
Semiconductors	-11.8	-16.6	-17.6	-2.5	-0.3	-1.3
Cap. goods ex comp & semi	1.3	-2.8	-0.4	0.0	0.1	-0.1
Automotive products	-0.8	-0.3	0.6	0.0	0.3	-0.3
Consumer goods	1.2	-0.9	-0.9	0.0	0.2	-0.2
Merchandise exports	1.0	2.6	-3.7	-0.2	-0.8	-0.3
Agricultural	13.8	31.4	-18.0	-0.2	-7.2	-2.7
Nonagricultural	-0.9	-1.2	-1.0	-0.2	0.1	0.1
Ind supp ex ag	-3.6	-4.8	-3.4	-0.5	0.5	0.3
Computers	-9.2	-7.5	-11.8	-0.9	-1.3	-0.5
Semiconductors	-2.0	-5.3	-15.5	-0.3	-0.1	-0.1
Cap. goods ex comp & semi	2.7	2.4	1.8	0.0	0.0	0.1
Automotive products	-0.1	0.2	0.4	0.2	0.0	0.2
Consumer goods	2.3	1.5	0.7	0.1	0.2	0.0
	---Prices in	the NIPA	accounts	(1992=100)--		
Fixed-weight						
Imports of gds & serv.	0.1	0.7	-2.1	...	...	...
Non-oil merchandise	-3.1	-3.8	-3.2	...	...	...
Exports of gds & serv.	0.2	1.4	-1.9	...	...	...
Nonag merchandise	-2.2	-2.6	-2.4	...	...	...

Oil Prices



(especially grains), prices of nonagricultural exports also fell, on balance, with the largest declines in prices of computers and semiconductors. There were small increases in prices of exported consumer goods, automotive products, and capital goods (other than computers and semiconductors). In October, the drop in export prices of agricultural products, computers, and semiconductors more than offset small increases in prices of other export categories.

U.S. Current Account

The U.S. current-account deficit widened $31 billion SAAR in the third quarter. Larger deficits on net goods and services and net investment income accounted for the increase.

The deficit in net investment income widened $10 billion SAAR in the third quarter. Income receipts on assets abroad edged up (primarily private portfolio receipts). Income payments on foreign assets in the United States increased $11 billion SAAR. U.S. Government payments rose strongly, reflecting substantial foreign acquisitions of U.S. Treasury securities in recent quarters. Direct investment payments also rose strongly.

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	-114.3	-9.1	-37.5	-160.8
3	-135.3	-18.8	-37.7	-191.8
Memo:				
$ Change				
Q1-Q4	-19.3	8.6	-7.0	-17.7
Q2-Q1	-17.4	-10.1	6.1	-21.4
Q3-Q2	-21.0	-9.8	-0.2	-31.0

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

U.S. International Financial Transactions

Much of the recorded net capital inflow in October was accounted for by net increases in private holdings of U.S. securities. (See line 4 of the Summary of U.S. International Transactions table.) Private foreign net purchases of U.S. Treasury bonds were very large in October (line 4a). The United Kingdom and Japan accounted for most of these recorded net purchases. In contrast to earlier in the year, the net change in holdings of Treasury securities by financial institutions located in the Caribbean was small. Foreign net purchases of U.S. corporate and government agency bonds were also strong in October (line 4b). Both U.S. corporations and government agencies have actively tapped the Eurobond markets in recent months. Foreign investors only added modestly to their holdings of U.S. corporate stock in October (line 4c).

U.S. interest in foreign bonds also remained strong in October (line 5a). While the bulk of the net purchases were made in Europe, it is notable that Russia and certain developing countries in Latin America have successfully raised funds in international bond markets in recent months and attracted U.S. investors. U.S. net purchases of foreign stocks continued to be relatively small in October compared with the first half of the year.

Foreign official assets in the United States rose only a few billion dollars in October (line 1). However, during the first 10 months of 1996, foreign official assets in the United States increased by over $90 billion, and partial information from the FRBNY suggests another large increase in November. The increase in official holdings in 1996 seems likely to match the record increase of 1995. As in 1995, only part of the increase in 1996 reflects foreign exchange market intervention by the other G-10 countries. In the first 10 months of 1996, the G-10 countries accounted for less than 40 percent of the increase in official holdings in the United States; in 1995 the G-10 share of the increase was even lower, about 30 percent.

Banks reported a net inflow in October on a month-end basis, reversing only in small part the large capital outflows recorded since the end of 1995 (line 3). On a monthly-average basis net outflows from banks to their own foreign offices and IBFs have also

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

	1994	1995	1995	1996				
			Q4	Q1	Q2	Q3	Sept	Oct
Official capital								
1. **Change in foreign official reserve assets in U.S. (increase, +)**	38.0	109.9	10.6	52.2	13.3	23.2	15.7	3.1
a. G-10 countries	28.9	33.1	-3.9	28.5	3.5	1.4	.5	2.2
b. OPEC countries	-3.3	4.3	-2.1	-.8	5.3	5.3	4.0	*
c. All other countries	12.4	72.6	16.7	24.5	4.5	16.5	11.1	1.0
2. **Change in U.S. official reserve assets (decrease, +)**	5.3	-9.7	.2	*	-.5	7.5	-.1	-.1
Private capital								
Banks								
3. **Change in net foreign positions of banking offices in the U.S.**[1]	102.8	-33.1	10.7	-25.9	-11.7	-7.3	19.4	13.6
Securities[2]								
4. **Foreign net purchases of U.S. securities (+)**	92.9	190.7	23.5	48.6	61.0	77.1	9.6	25.4
a. Treasury securities[3]	34.7	99.9	1.8	12.0	31.3	42.0	-3.3	14.7
b. Corporate and other bonds[4]	53.9	82.6	17.7	32.8	23.4	33.1	12.7	10.2
c. Corporate stocks	4.3	8.2	4.0	3.8	6.3	2.0	.2	.5
5. **U.S. net purchases (-) of foreign securities**	-57.3	-98.8	-32.5	-34.5	-20.0	-20.0	-6.2	-7.9
a. Bonds	-9.2	-48.5	-18.7	-12.0	-2.6	-13.0	-4.4	-5.8
b. Stocks	-48.1	-50.3	-13.8	-22.5	-17.4	-6.5	-1.7	-2.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-54.5	-95.5	-44.1	-23.2	-26.2	-8.4	n.a	n.a
7. Foreign direct investment in U.S.	49.8	60.2	14.8	28.7	17.4	25.1	n.a	n.a
8. Other (inflow, +)[5]	-14.9	-7.0	17.8	-15.1	16.5	-27.8	n.a	n.a
U.S. current account balance (s.a.)	-148.4	-148.2	-30.4	-34.9	-40.2	-48.0	n.a	n.a
Statistical discrepancy (s.a.)	-13.7	31.5	29.4	4.1	-9.6	-21.4	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)

	1993 Dec.	1994 Dec.	1995 Dec.	1996 Mar.	1996 Jun.	1996 Sep.	1996 Oct.	1996 Nov.**
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-122.1	-224.0	-260.0	-260.1	-245.0	-246.5	-242.0	-234.7
a. U.S.-chartered banks	4.2	-70.1	-86.1	-84.1	-77.2	-72.7	-73.3	-66.2
b. Foreign-chartered banks	-126.3	-153.9	-173.9	-176.0	-167.8	-173.8	-168.7	-168.5
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	21.8	23.1	26.5	27.3	28.8	29.2	30.5	31.1
b. By Caribbean offices of foreign-chartered banks	90.9	78.4	86.3	90.0	85.4	83.3	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	77.8	85.6	91.2	95.7	101.0	101.4	106.5	105.0
b. At the Caribbean offices of foreign-chartered banks	79.2	86.0	92.3	96.6	103.7	109.4	n.a.	n.a.
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	180.1	173.9	208.6	214.1	221.2	n.a.	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	213.7	245.8	278.9	292.0	295.0	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

**Data for November are through November 25, 1996.

been substantial for 1996 as a whole. (See line 1 of the International Banking Data table.) These outflows coincided with a slowing in the growth of bank credit and growing reliance on large time deposits, perhaps spurred in part by a reduction in deposit insurance premiums in late 1995.

Recently released data on direct investment capital flows for the third quarter indicate continued strength in foreign direct investment in the United States. (See line 7 of the Summary of U.S. International Transactions table.) In contrast, U.S. direct investment abroad fell sharply (line 6). However, the weakness in U.S. direct investment abroad was largely attributable to large shifts in intercompany debt between U.S. parents and finance affiliates in the United Kingdom; these intercompany accounts are highly volatile. The statistical discrepancy in the U.S. international transactions accounts for the third quarter was large and negative, indicating omitted net payments or capital outflows. The statistical discrepancy would have been even more negative if estimated net increases in foreign holdings of U.S. paper currency had been included in the accounts.

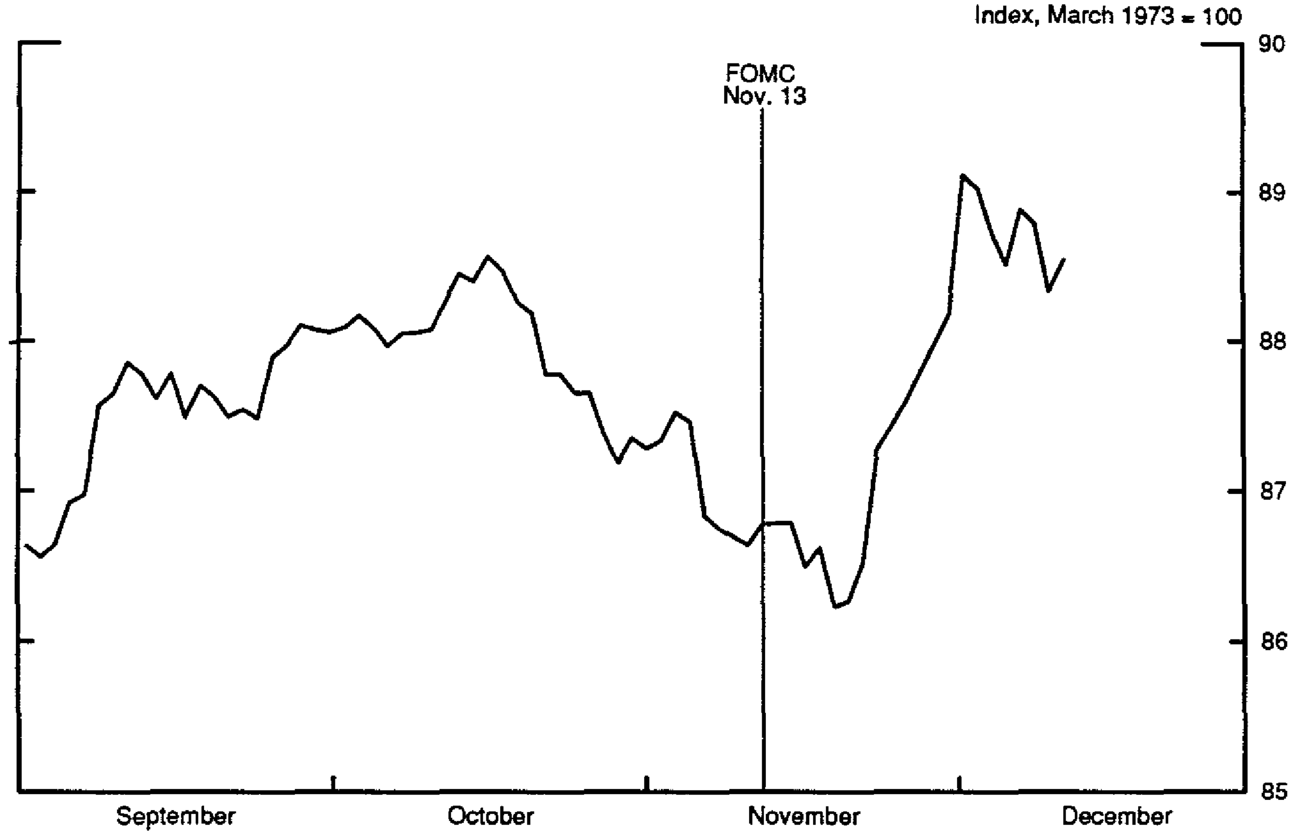
Foreign Exchange and Foreign Financial Markets

Since the November meeting of the FOMC, the G-10 weighted average of the dollar has appreciated about 2 percent. The dollar is up somewhat more, on average, against core European currencies in the wake of calls by officials in a number of those countries for a stronger dollar. The dollar rose about 1-1/2 percent against the yen as market participants appear to have concluded that there is little prospect for an increase in official Japanese interest rates anytime soon. The dollar is up somewhat less relative to sterling and the Italian lira. The latter currency has benefited from its re-entry to the Exchange Rate Mechanism of the EMS on November 24, while sterling has benefited from new evidence of healthy economic growth.

Stock prices are mixed, on balance, since the last FOMC meeting in spite of sharp declines over the last week. Japanese stocks are down about 3 percent from their November 13 level. British stock prices are down about 1/2 percent over the intermeeting period, while other major European markets are up between 1/2 and 3 percent, on balance.

Weighted Average Exchange Value of the Dollar

(Daily data)



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Nov. 13	Dec. 12	Change	Nov. 13	Dec. 12	Change
Germany	3.08	3.13	0.05	5.87	5.88	0.01
Japan	0.52	0.51	-0.01	2.71	2.53	-0.18
United Kingdom	6.28	6.28	0.00	7.68	7.60	-0.08
Canada	3.09	3.17	0.08	6.17	6.46	0.29
France	3.34	3.36	0.02	5.87	5.81	-0.06
Italy	7.50	7.31	-0.19	7.54	7.46	-0.08
Belgium	3.02	3.02	0.00	6.02	5.99	-0.03
Netherlands	2.87	3.00	0.13	5.77	5.82	0.05
Switzerland	1.75	2.06	0.31	3.65	3.73	0.08
Sweden	4.45	3.90	-0.55	7.25	6.78	-0.47
Weighted-average foreign	3.52	3.52	0.00	5.80	5.77	-0.03
United States	5.37	5.44[p]	0.07	6.20	6.33[p]	0.13

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

Yields on ten-year foreign government bonds are little changed, on average, since the last FOMC meeting. Early in the intermeeting period foreign long-term interest rates declined by about 1/4 percentage point on average. But those declines have been largely reversed in volatile trading over the last week. Yields on long-term bonds increased 10 to 60 basis points in other major markets between last Wednesday's close and their high-point on Friday. Bond prices subsequently recovered on Monday and Tuesday, but fell again on Wednesday.

A number of factors account for the superior performance of foreign bond markets, relative to U.S. markets, since the November FOMC. Japanese interest rates fell, and the yen depreciated, following the release of the October Tankan and other data in the week of November 25. Market participants seem to have interpreted these data as suggesting that there is little prospect of a significant acceleration of Japanese economic activity in the near future and therefore the Bank of Japan is unlikely to raise interest rates soon.

Long-term interest rates in core European countries, including Germany, may have been affected by the recent public debate over the external value of the French franc. On November 20, former French President Giscard d'Estaing called for a substantial devaluation of the French franc in order to stimulate the French economy. These comments touched off a lively debate among current and former government officials. Public statements have focused on the external value of the franc, particularly relative to the dollar, but many comments favoring franc depreciation were implicitly critical of current French and German monetary policy. A number of prominent French and German officials, including Bank of France Governor Trichet and French Finance Minister Arthuis, strongly reaffirmed their commitment to the current franc/DM exchange rate. But in responding to this debate German officials, including Bundesbank President Tietmeyer, indicated that they are not opposed to a stronger dollar. This, combined with weaker-than-expected German industrial production data for October, raised the possibility, in the minds of some market participants, of a more accommodative German monetary policy.

After protracted negotiations the Italian lira re-entered the ERM on November 24 at a central parity of 990 lire/DM. The lira has strengthened about 2 percent against the mark since mid-November when rumors began to circulate that the lira's ERM re-entry was imminent. Italian interest rates are little changed since the lira re-entered the ERM. Both short and long-term rates had fallen significantly in the week preceding the lira's re-entry as declining inflation and the passage of a tight budget for 1997, including a substantial tax increase, made it possible for the Bank of Italy to ease monetary policy.

Bond market turmoil over the last week seemed to have the greatest impact in Canada. In fact, Canadian bond prices began falling well before those in other markets. Yields on Canadian 10-year government bonds increased 30 basis points last Thursday, that is, the day of Chairman Greenspan's AEI speech. Yields increased further on Friday morning but moved down thereafter. Canadian long-term bond yields are now 30 basis points above where they were at the last FOMC meeting. Over recent months, Canadian bonds had been supported by declines in official interest rates. Over the last few weeks, however, the Canadian dollar has depreciated about 1-3/4 percent. Given the Bank of Canada's use of its MCI as a guide to monetary policy, market participants appear to have concluded that further declines in official rates are unlikely.

The dollar is little changed against sterling since the November FOMC meeting. In the early intermeeting period sterling appreciated significantly as new data seemed to indicate good growth in the British economy and prospects for an increase in interest rates seemed to be on the rise. But much of sterling's recent gains were reversed last week after Chancellor Clarke noted that some British exporters had expressed concerns about sterling's recent appreciation and Bank of England Governor Eddie George said that large increases in interest rates were not needed.

On a weighted-average basis foreign short-term interest rates are little changed since the last FOMC. There are some significant deviations from this general pattern, however. Short-term rates are down significantly in both Italy and Sweden, as declining inflation and other factors made it possible to ease monetary conditions. Short-term rates have moved up in both Canada and Switzerland. In Canada's case this may reflect the market's perception that monetary policy is now on hold after considerable easing in previous months.

Swiss rates have edged up in recent weeks, apparently due to an increase in banks' demand for central bank balances. But this does not appear to reflect a change in Swiss monetary policy. On December 9, the Vice President of the Swiss National Bank said that the Bank was pleased with the recent depreciation of the Swiss franc. Since the last FOMC meeting, the Swiss franc has depreciated by 4 percent against the dollar and by more than 1 percent against the mark.

Interest rates in Sweden continued to decline. The Riksbank lowered its securities repurchase rate by 25 basis points on November 26. This followed the release of better-than-expected inflation data for October. Both short- and long-term- interest rates have declined about 1/2 a percentage point since the November FOMC meeting.

The Mexican peso has been relatively stable over the last four weeks after depreciating 5 percent in October. The sharp increases in Mexican interest rates during October, which were maintained through November, helped to stabilize the peso. Declines in U.S. long-term interest rates between mid-November and the middle of last week also supported the peso, as did the release of stronger-than-expected GDP data for the third quarter. With a stable peso interest rates have come down somewhat in December. The rate on 91-day Cetes has come down about 3 percentage points over the last four weeks.

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

Developments in Foreign Industrial Countries

Economic activity in most of the major foreign industrial countries picked up in the third quarter from the pace recorded in the first half of this year. A notable exception was Japan where real GDP grew a tepid 0.4 percent (SAAR), compared with 3.5 percent in the first half. In Canada and all the major European countries but Italy output expanded at more than a 3 percent rate.

Available indicators for the fourth quarter generally suggest a slower rate of growth in the major industrial countries. German industrial production fell in October for the second consecutive month, and French consumption of manufactured products dropped again in October. In contrast, output appears to have picked up in Japan following last quarter's weak activity; in October, Japanese industrial production jumped 3.5 percent.

Labor market slack has contributed to subdued wage and price pressures abroad: Recent twelve-month rates of consumer-price inflation have been near zero in Japan and have averaged 1-1/2 percent to 1-3/4 percent in Germany, France, and Canada. Italian consumer-price inflation continued its steep downward trend, falling to 2-1/2 percent in November (from more than double that rate about a year ago). In contrast, underlying inflation in the United Kingdom was 3-1/4 percent in November, solidly above the government's target rate.

Individual country notes. In **Japan**, real GDP rose 0.4 percent (SAAR) in the third quarter, after a downward revised 3.5 percent in the first half. Strong growth in private nonresidential investment, government consumption, and net exports was nearly offset by small declines in private consumption and residential investment along with large declines in public investment and inventory investment. The Economic Planning Agency also released revised GDP data that show slightly stronger growth for 1994 and 1995 than previously estimated and slightly weaker growth in the first half of 1996.

Available fourth-quarter indicators point to renewed expansion. Industrial production rose 3.5 percent in October, while housing starts, machinery orders, and new car registrations also grew at a robust pace. The ratio of job offers to job applicants increased in October to its highest level in three years, and the unemployment rate edged up as many workers quit their jobs in search of better positions. The Bank of Japan's November survey (Tankan) registered a modest improvement in business sentiment at major manufacturers and confirmed the findings of the May and August surveys that capital spending plans are improving. Consumer prices remain stable, while the recent, modest depreciation of the yen

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

	1994	1995	1995	1996		
			Q4	Q1	Q2	Q3
GDP	0.8	2.6	5.5	8.4	-1.1	0.4
Total Domestic Demand	0.8	4.0	7.3	9.8	-0.3	-0.6
Consumption	1.3	3.0	3.9	8.3	-3.9	-0.4
Investment	-1.1	5.6	15.6	14.2	9.9	0.4
Government Consumption	2.6	3.2	0.4	3.2	0.4	5.6
Inventories (contribution)	0.1	0.2	0.3	0.3	-0.9	-1.0
Exports	9.0	3.8	4.0	-2.6	0.5	6.1
Imports	11.1	17.3	20.0	8.2	7.6	-2.8
Net Exports (contribution)	-0.0	-1.3	-1.7	-1.3	-0.8	1.1

1. Annual changes are Q4/Q4.

appears to be contributing to a pickup in wholesale prices. Japan's current account surplus in October was well below the third-quarter average, reflecting higher oil prices and the depressing effect of the depreciation of the yen on Japan's export prices.

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

	1996						
	Q2	Q3	Q4	Aug	Sep	Oct	Nov
Industrial Production	-0.3	1.6	n.a.	-2.3	1.5	3.5	n.a.
Housing Starts	1.4	2.6	n.a.	-9.1	9.3	7.7	n.a.
Machinery Orders	0.8	2.8	n.a.	-19.5	6.5	21.0	n.a.
New Car Registrations	-7.7	6.8	n.a.	-3.1	8.7	2.7	5.6
Unemployment Rate (%)	3.5	3.3	n.a.	3.3	3.3	3.4	n.a.
Job Offers Ratio[1]	0.69	0.71	n.a.	0.71	0.71	0.73	n.a.
Business Sentiment[2]	-3	-7	-3	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	n.a.	0.0	-0.4	0.0	0.1
Wholesale Prices[3]	1.3	0.7	n.a.	0.5	0.0	0.3	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.

The newly installed minority government of Prime Minister Ryutaro Hashimoto has announced plans to unveil a supplementary budget for fiscal 1996 and an initial budget for fiscal 1997 in December for consideration by the Diet in January. The cabinet announced a headline figure of 4.8 trillion yen (about 1 percent of GDP) for the supplemental budget, but details have yet to be released, and it is not clear how much represents new spending as opposed to a reallocation of previously authorized spending or new loans. Members of the cabinet have indicated that they do not favor extending the temporary income tax rebate into 1997 or boosting public works spending significantly in the supplemental budget.

Prime Minister Hashimoto has declared his intention to pursue financial-market reform in a number of areas. He has supported proposals to grant more independence to the Bank of Japan; to remove the authority of the Ministry of Finance to inspect and supervise depository institutions; and to deregulate banks, insurance companies, and securities firms in order to make Tokyo an international financial market comparable to New York or London.

Real GDP in **Germany** advanced at a pace of 3.3 percent (SAAR) in the third quarter due almost entirely to a surge in exports, as domestic demand was little changed from its second-quarter level. Construction spending increased at a moderate pace, while expenditure on machinery and equipment was unchanged from its second-quarter level. The contribution of inventories was negative in both the second and third quarters, but the change in inventories is a residual in the German accounts and is subject to substantial revision.

Few indicators are available for the fourth quarter. Although industrial production declined almost 2 percent in October, real manufacturing orders rose nearly 3 percent owing to a surge in orders from both domestic and foreign firms. The IFO business climate survey, an indicator of current and expected conditions in industry, showed continued improvement in October, particularly in the expectations component of the index. Inflation remains subdued, with consumer prices up 1.4 percent over the twelve months to November.

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

	1994	1995	1995 Q4	1996 Q1	1996 Q2	1996 Q3
GDP	3.7	1.1	0.3	-1.6	6.0	3.3
Total Domestic Demand	4.0	0.9	0.6	-1.7	4.8	0.2
Consumption	0.4	1.5	-0.4	3.0	2.4	0.9
Investment	8.8	-2.1	-3.3	-20.6	32.3	2.6
Government Consumption	2.4	2.5	1.3	2.4	4.5	5.0
Inventories (contribution)	1.4	0.0	1.3	1.1	-3.7	-2.0
Exports	9.6	5.5	3.0	0.8	-0.2	15.6
Imports	11.1	4.6	4.4	0.6	-4.2	3.0
Net Exports (contribution)	-0.4	0.2	-0.4	0.1	1.1	3.1

1. Annual changes are Q4/Q4.

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

	1996 Q1	Q2	Q3	Aug	Sep	Oct	Nov
Industrial Production	-2.4	3.0	1.2	0.1	-0.6	-1.8	n.a.
Orders	-0.5	3.8	0.8	0.1	-3.4	2.9	n.a.
Unemployment Rate (%)	10.3	10.2	10.4	10.3	10.5	10.6	10.7
Western Germany	8.9	9.0	9.2	9.2	9.3	9.4	9.5
Eastern Germany	16.1	15.6	15.3	15.2	15.3	15.5	15.8
Capacity Utilization[1]	83.1	82.1	82.5	...	...	...	...
Business Climate[1,2]	-15.3	-17.7	-11.3	-12.0	-8.0	-2.0	n.a.
Consumer Prices[3]	1.6	1.5	1.5	1.4	1.4	1.5	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.

The 1997 federal budget was approved by the Bundestag (the lower house of the German parliament) in late November. Before passage, the 1997 federal budget was revised to include additional expenditure cuts of DM3 billion, due to an overestimate of tax receipts for 1996. A vote in the Bundesrat (the upper house) is scheduled for December 19. The Kohl government continues to maintain that the overall fiscal package will be sufficient to reduce the deficit to 2-1/2 percent of GDP in 1997 from more than 4 percent this year.

In **France**, real GDP grew 3.7 percent (SAAR) in the third quarter of 1996, following a drop of 0.6 percent (revised from -1.4 percent) in the second quarter--exhibiting the same degree of volatility that has characterized the quarterly pattern of GDP since late last year. Part of the swing in growth between the second and third quarters reflects the influence of working-day effects that had reduced second-quarter growth. In addition, consumption surged in the third quarter prior to the expiration of the "Juppette" car-buying incentive program. Investment expanded after having declined for three consecutive quarters, as business investment picked up. An inventory drawdown reduced growth, while a strong rebound in exports underpinned the positive contribution from net exports.

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

	1994	1995	1995	1996		
			Q4	Q1	Q2	Q3
GDP	4.2	0.4	-1.9	4.6	-0.6	3.7
Total Domestic Demand	4.9	0.4	-3.4	2.2	1.1	2.4
Consumption	1.6	1.1	-1.1	10.3	-3.4	4.2
Investment	4.7	0.0	-1.2	-3.5	-0.9	4.2
Government Consumption	0.6	1.0	1.4	1.4	2.3	1.8
Inventories (contribution)	2.8	-0.5	-2.8	-3.4	2.9	-1.3
Exports	7.5	0.7	-2.5	17.3	-7.3	13.1
Imports	10.2	0.7	-7.7	8.4	-1.9	8.5
Net Exports (contribution)	-0.7	0.0	1.6	2.4	-1.7	1.2

1. Annual changes are Q4/Q4.

Economic activity in the fourth quarter is likely to be flat or slightly negative owing to a smaller number of working days in the quarter and weaker consumption. In October, consumption of manufactured products registered a sharp decline led by a fall in car purchases following the expiration of the "Juppette" subsidy.

While consumer confidence rose slightly in October and November, its continuing, low level largely reflects general discontent with the government. Business surveys suggested that manufacturing output declined in October and November. Inventories seem to have returned to more normal levels, but there is likely to be further destocking because firms expect the prices of intermediate materials to decline. Unemployment, which rose to a new post-war high in September, remained at 12.6 percent in October. Consumer-price inflation in November remained moderate.

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

	1996						
	Q1	Q2	Q3	Aug	Sep	Oct	Nov
Consumption of Manufactured Products	4.9	-1.6	2.6	3.5	-1.6	-2.6	n.a.
Industrial Production[1]	0.7	0.2	1.9	0.0	-1.3	n.a.	n.a.
Capacity Utilization	83.8	82.7	82.7	...	...	...	...
Unemployment Rate (%)	12.1	12.4	12.5	12.5	12.6	12.6	n.a.
Consumer Prices[2]	2.1	2.4	1.8	1.6	1.6	1.8	1.6

1. For the months of July and August, INSEE publishes a composite number for industrial production.
2. Percent change from previous year.

In the **United Kingdom**, real GDP moved up 3.1 percent (SAAR) in the third quarter. Personal and government consumption expenditures rose briskly, while fixed investment dropped following a bunching of aircraft deliveries in the second quarter. Stock accumulation contributed somewhat to growth following a substantial rundown in the second quarter. The contribution of net exports has been slightly negative on balance so far this year, following two years of large positive contributions to growth.

Indicators for the fourth quarter are limited but appear to show continued strength. After falling in September, retail sales picked up in October. Industrial production edged down in October as oil extraction, which is quite volatile, dropped. In contrast, manufacturing output rose 0.4 percent. Surveys of consumer confidence have shown increased optimism in recent months, with confidence in November at its highest level since the late 1980s.

Surveys of manufacturers continued to report strength in orders in November, particularly for consumer goods, while recent surveys of production plans edged back from their high third-quarter level. The unemployment rate fell to 7.2 percent in October, its lowest level since early 1991.

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

	1994	1995	1995	1996		
			Q4	Q1	Q2	Q3
GDP	4.2	1.9	2.2	2.3	1.9	3.1
Total Domestic Demand	3.4	0.6	1.6	3.8	-0.4	2.8
Consumption	2.6	1.4	1.4	4.9	2.3	4.6
Investment	3.4	-1.9	6.4	6.8	8.5	-8.4
Government Consumption	1.6	1.4	0.9	-0.7	0.4	4.2
Inventories (contribution)	0.9	-0.2	-0.6	-0.2	-3.4	0.7
Net Exports (contribution)	0.7	1.0	0.1	-2.1	1.8	0.0
Non-oil GDP	4.1	1.8	2.3	2.3	1.5	3.4

1. Annual changes are Q4/Q4.

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

	1996						
	Q1	Q2	Q3	Aug	Sep	Oct	Nov
Industrial Production	0.1	0.3	0.3	-0.6	0.7	-0.1	n.a.
Retail Sales	0.4	1.3	0.8	0.9	-0.3	0.4	n.a.
Unemployment Rate (%)	7.9	7.7	7.5	7.5	7.4	7.2	n.a.
Consumer Prices[1]	2.9	2.8	2.9	2.8	2.9	3.3	3.3
Producer Input Prices[2]	3.0	0.0	-2.8	-2.6	-3.2	-2.5	-5.5
Average Earnings[2]	3.7	3.8	4.0	4.0	4.0	n.a.	n.a.

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

Retail prices excluding mortgage interest payments rose 3.3 percent in November from a year earlier, solidly above the government's target rate of 2-1/2 percent or less. This pickup, however, reflects in large part the runup in oil prices this year. The underlying rate of increase of average earnings was unchanged in September, while producer input prices in November dropped considerably below year-earlier levels.

On November 26, the Chancellor of the Exchequer Kenneth Clarke delivered to Parliament the British government's budget and medium-term financial strategy. The government aims to reduce the general government deficit from about 5 percent of GDP in the 1995/96 fiscal year (that ended March 30) to 4 percent of GDP in the current fiscal year and to 2-1/2 percent of GDP in FY1997/98. The reduction in the deficit is to come almost entirely from slow growth of public expenditures.

In **Italy**, the advance estimate of GDP growth in the third quarter was 2 percent (SAAR). (No further details will be available until final third-quarter GDP is released on January 7.) The latest monthly indicators have been weak. Business sentiment has remained gloomy, while consumer confidence has continued to decline in recent months. Consumer-price inflation on a twelve-month basis fell in November to 2.6 percent, after peaking at 6 percent in November a year ago.

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

	1996						
	Q1	Q2	Q3	Aug	Sep	Oct	Nov
GDP	1.7	-1.6	2.0	...	...	...	...
Industrial Production	-2.0	-1.4	n.a.	0.5	n.a.	n.a.	n.a.
Cap. Utilization (%)	75.9	76.6	75.6	...	...	...	...
Unemployment Rate (%)	12.0	12.2	12.2	...	...	...	...
Consumer Confidence[1]	107.7	113.8	114.1	115.2	112.0	106.0	102.7
Bus. Sentiment[2] (%)	15.7	-1.0	-1.0	2.0	1.0	-3.0	n.a.
Consumer Prices[3]	5.0	4.2	3.5	3.4	3.4	3.0	2.6
Wholesale Prices[3]	7.7	3.4	2.0	2.0	1.4	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.

On November 16, the lower house of the Senate, where the governing central-left coalition relies on the outside support of the Communist Refoundation Party (CR), approved the 1997 budget.

The budget includes a $41 billion equivalent deficit reduction package and aims to reduce Italy's 1997 fiscal deficit to 3 percent of GDP. The upper house of the Senate, where the proposed budget is currently under discussion, has until the end of the year to ratify it.

Economic activity in **Canada** expanded at a robust pace in the third quarter, reflecting a strong rebound in machinery and equipment investment and continued growth in residential construction. After a large inventory drawdown in the second quarter, inventory accumulation contributed 3.3 percentage points to third-quarter growth. Consumption expenditures remained weak, however, and government expenditures declined. Net exports also subtracted from growth, as export growth was offset by the surge in machinery and equipment imports.

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

	1994	1995	1995	1996		
			Q4	Q1	Q2	Q3
GDP	4.9	0.7	0.9	1.1	1.2	3.3
Total Domestic Demand	2.5	-0.1	-0.5	2.6	-2.4	7.3
Consumption	3.1	0.9	0.0	5.1	0.7	1.3
Investment	4.9	-1.8	6.6	9.6	-1.5	18.3
Government Consumption	-1.5	-1.4	-1.1	-1.9	0.5	-3.7
Inventories (contribution)	-0.1	0.1	-1.6	-2.1	-2.6	3.3
Exports	20.9	5.0	12.3	-1.7	9.7	8.5
Imports	14.0	4.0	9.5	2.5	-1.5	18.2
Net Exports (contribution)	2.2	0.4	1.1	-1.8	4.7	-3.6

1. Annual changes are Q4/Q4.

Indicators for the fourth quarter are very limited but suggest that economic activity is expanding at a moderate pace. Employment edged up in October and November, but the unemployment rate has remained high as labor force growth has risen as well. Housing starts, which have been volatile this year, jumped in November to a level 7.5 percent above the third-quarter average. A major part of the increase in twelve-month consumer-price inflation to 1.8 percent in October came from higher energy prices, including an increased natural gas tax and higher gasoline prices.

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

	1996						
	Q1	Q2	Q3	Aug	Sep	Oct	Nov
Industrial Production	0.3	0.4	1.7	0.1	-0.1	n.a.	n.a.
Manufacturing Survey:							
Shipments	-0.5	2.4	3.3	-0.8	0.8	n.a.	n.a.
New Orders	-0.0	2.5	2.8	-1.9	0.1	n.a.	n.a.
Retail Sales	1.0	0.3	0.4	-0.3	0.2	n.a.	n.a.
Housing Starts	1.8	10.9	3.2	0.8	2.4	-9.8	17.0
Employment	0.7	0.2	0.1	0.6	-0.3	0.3	0.1
Unemployment Rate (%)	9.5	9.6	9.7	9.4	9.9	10.0	10.0
Consumer Prices[1]	1.4	1.4	1.4	1.4	1.5	1.8	n.a.

1. Percent change from year earlier.
2. Level of index, 1991 = 100.
3. Level of index, 1977 = 100.

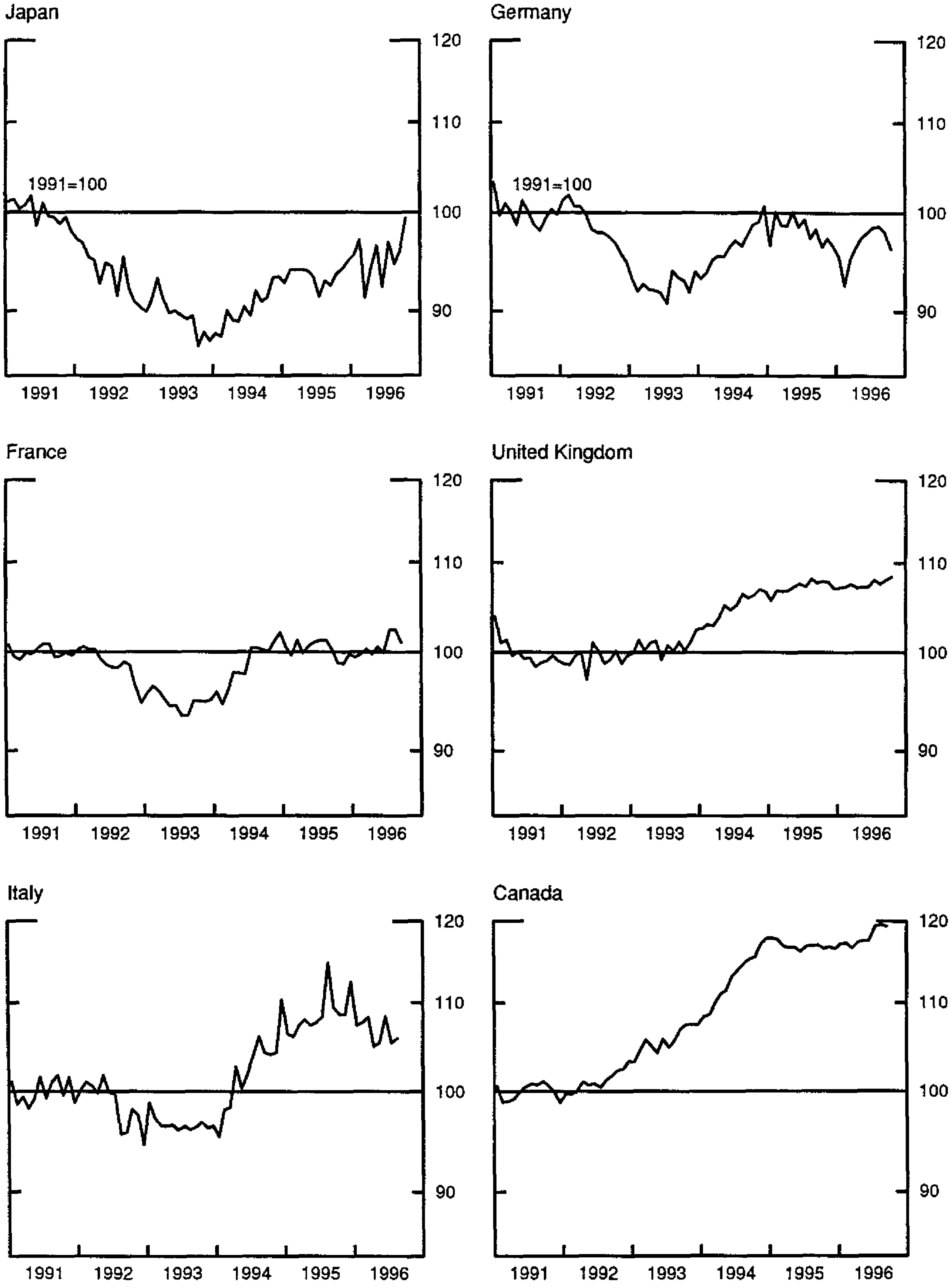
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1995	1996						
		Q1	Q2	Q3	Jul	Aug	Sep	Oct
Japan: trade	106.6	16.6	13.6	14.4	3.3	6.5	4.7	4.7
current account	110.6	15.4	15.3	18.9	6.0	8.2	4.7	4.9
Germany: trade[1]	59.5	13.1	15.3	17.8	6.9	5.5	5.5	n.a.
current account[1]	-16.7	-2.5	-3.7	-7.4	-3.3	-3.1	-1.1	n.a.
France: trade	20.0	5.8	4.6	6.6	2.0	2.6	2.0	n.a.
current account	16.6	7.3	3.8	n.a.	0.0	2.1	n.a.	n.a.
U.K.: trade*	-18.3	-5.6	-4.9	-4.2	-1.9	-0.9	-1.4	n.a.
current account	-6.2	-2.0	1.2	n.a.	...	...	...	...
Italy: trade	27.7	8.7	12.3	n.a.	3.9	3.6	n.a.	n.a.
current account[1]	27.4	5.9	11.1	n.a.	8.4	4.4	n.a.	n.a.
Canada: trade	20.7	5.9	7.3	7.4	2.3	2.7	2.4	n.a.
current account	-8.1	-1.2	0.8	0.4	...	...	...	...

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

Industrial Production in Selected Industrial Countries

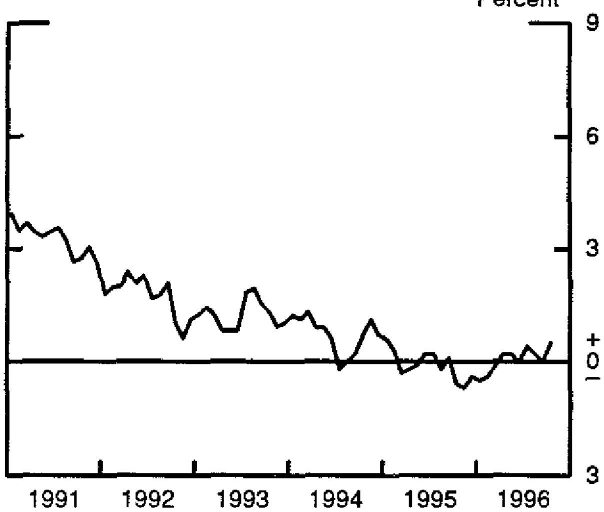
(Monthly data; seasonally adjusted; ratio scale, index)



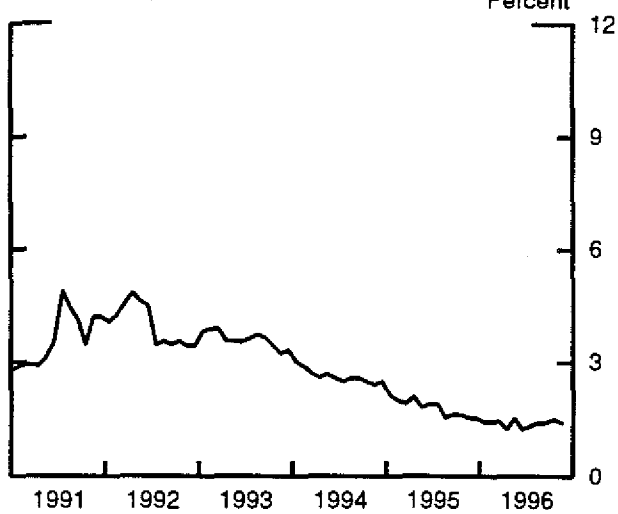
Consumer Price Inflation in Selected Industrial Countries

(12-month change)

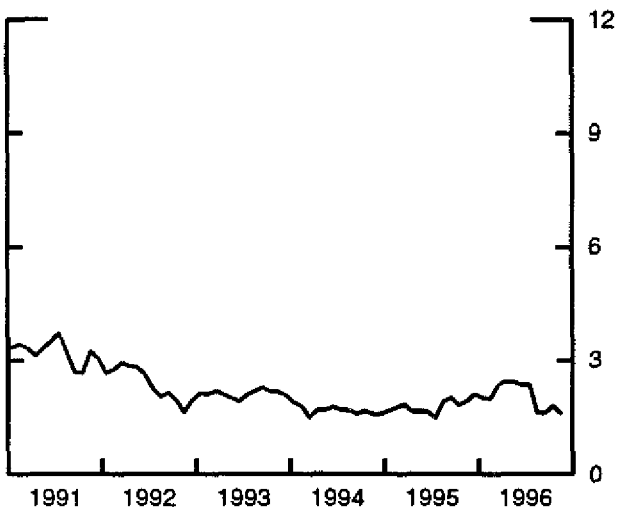
Japan



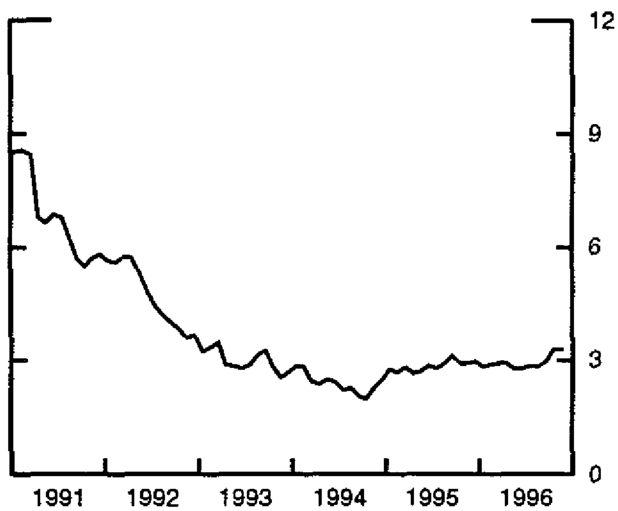
W. Germany



France

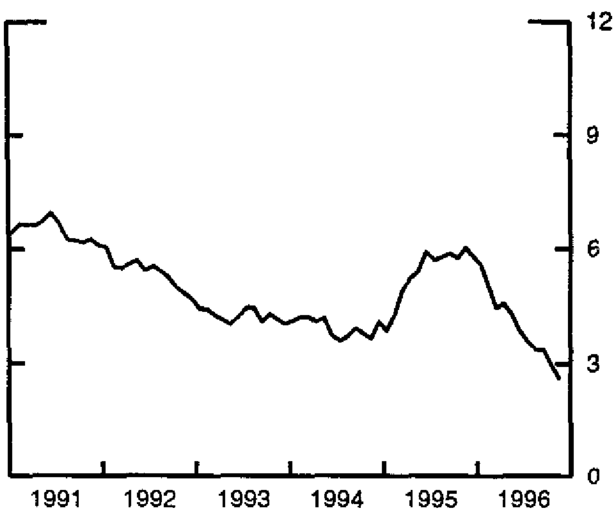


United Kingdom

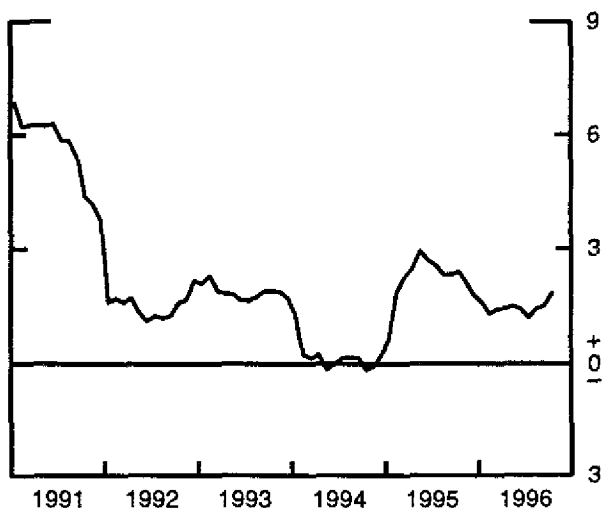


Note: Excludes mortgage interest payments.

Italy



Canada



Economic Situation in Other Countries

In Latin America, indications of output growth generally have been strong. Mexico and Argentina have continued to bounce back from their 1995 recessions while Brazilian output surged in the third quarter and Venezuela showed some signs of recovery, led by its oil sector. In Asia, output continues to grow at a more moderate pace than in recent years, with the moderation greater in Korea and Taiwan than in China.

Inflation mostly is on a downward trend in the developing countries. In particular, Brazil, Mexico, and Russia have achieved twelve-month inflation rates sharply lower than those of the previous year. Inflation is also down in China and remains low in Taiwan, Korea, and, especially, Argentina. As Latin American economies have grown, a pickup in domestic demand has worsened trade balances, most of all in Brazil. A rise in imports has also widened the trade deficit in Korea, while trade balances have improved in Taiwan and China.

Individual country notes. In **Mexico**, there were solid signs of growth in the third quarter. GDP rose 7.4 percent from its year-earlier level. On a seasonally adjusted basis, GDP is estimated to have risen about 10 percent (a.r.) in the third quarter, after being about flat in the second quarter. Monthly indicators also showed strong growth. Industrial production rose 14 percent in September from a year earlier, while the unemployment rate declined to 5.2 percent in October, its lowest level since January 1995. The recovery in domestic demand led to a rise in imports in the third quarter and a reduction in the trade surplus in October to its lowest level since January 1995.

Monthly inflation has averaged about 1.5 percent over the past three months, well below the recent peak of 2.8 percent in April. On a twelve-month basis, inflation has declined to below 28 percent versus 52 percent during 1995.

The Mexican government in early November released the details of its 1997 budget and economic projections. The government forecasts a budget deficit of 0.5 percent of GDP for 1997, versus a balanced budget in 1996, due largely to the cost of pension reforms and support for the banking system. GDP is projected to grow at least 4 percent in 1997. The government projects an inflation rate

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

	1994	1995	1996		1996	
			Q2	Q3	Sep	Oct
Real GDP	4.5	-6.2	7.2	7.4	...	...
Industrial Production (SA)	4.5	-7.5	11.1	16.3	14.0	n.a.
Unemployment Rate (%)	3.6	6.3	5.6	5.5	5.5	5.2
Consumer Prices[1]	7.1	52.1	6.4	4.4	1.6	1.2
Trade Balance[2]	-18.5	7.0	2.2	1.4	0.6	0.3
Imports[2]	79.4	72.5	21.4	22.9	7.8	8.9
Exports[2]	60.8	79.5	23.6	24.3	8.4	9.2
Current Account[2]	-29.5	-0.7	0.6	-0.7	...	...

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

of 15 percent (December-over-December) in 1997, down from about 27 percent in 1996. The current account deficit is projected to widen to 1.2 percent of GDP in 1997 from 0.3 percent in 1996.

The program of privatization moved forward in December after the October setback in the secondary petrochemical sector. On December 5, the Mexican government approved a bid of $1.4 billion by a Mexican-U.S. joint venture to operate Mexico's Northeast railroad line, the busiest Mexican railway, which connects Mexico City with Laredo, Texas and includes trunk lines to key gulf ports.

In **Argentina**, the economic recovery following the Tequila recession has taken a firm hold. Real GDP displayed strong and considerably higher-than-expected growth of 6.6 percent in the third quarter from a year earlier. Led by the auto industry, industrial production in October was 11.3 percent higher than the same month in 1995. Inflation is still very low; consumer prices have increased just 0.3 percent over the past twelve months. During the recovery both exports and imports have risen, with the third-quarter trade surplus being around $0.8 billion, almost unchanged from a year earlier.

The Convertibility Plan appears to be in no immediate danger even though the Argentine government missed by a considerable margin its original fiscal targets agreed upon with the IMF, which were subsequently renegotiated, and international reserves (excluding gold) have fallen to $14 billion in October from $15 billion in September. Government revenues have turned around in November and the Congress has approved a 1997 budget that provides for a deficit

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

	1994	1995	1996		1996	
			Q2	Q3	Sep	Oct
Real GDP	7.4	-4.4	2.6	6.6	...	...
Industrial Production (SA)	5.7	-6.2	2.6	8.6	9.2	11.3
Unemployment Rate (%)[2]	11.7	17.4	17.1	n.a.	...	...
Consumer Prices[1]	3.9	1.5	-0.2	0.5	0.0	0.5
Trade Balance[3]	-4.0	3.0	2.2	0.8	0.1	0.0
Current Account[3]	-9.1	-1.6	1.0	n.a.	...	...

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.

of about $3.2 billion, close to the target of $3 billion agreed with the IMF. The central bank has taken two preventive measures to avoid a repeat of last year's liquidity crisis. One measure is a $5 billion foreign-funded private safety net that will pay out funds to local banks in case of a run on deposits. The other is a three percentage point increase in bank liquidity requirements to be phased in gradually over the next eighteen months. The peso-dollar deposit spread has also narrowed since December 1995.

The benefits of the recent growth have not yet done much to alleviate Argentina's stubbornly high unemployment rate. That is in part because output is still below its peak level of two years ago, and Congress has delayed in passing a labor reform package that would promote the hiring of new workers.

In **Brazil**, real GDP grew by 11.4 percent in the third quarter (s.a.a.r.), after growth of 6.5 percent in the second quarter. On a year-over-year basis, third-quarter real GDP growth was 6.5 percent. Growth was strong in most sectors, including manufacturing (which grew by 18 percent). Inflation has remained low by Brazilian standards under the nearly two and a half year-old exchange rate-based stabilization program, the Plano Real. On a twelve-month basis, inflation was 12.2 percent in October 1996, down from 23.7 percent in October 1995, and the lowest rate since the early 1970s.

Strong aggregate demand has contributed to a sharp deterioration in the trade balance in recent months, with the trade deficit reaching $1.3 billion in October. However, central bank officials project a current account deficit of about 3 percent of GDP for 1996, about the same as in 1995. In late November, in

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

	1994	1995	1996 Q2	1996 Q3	1996 Sep	1996 Oct
Real GDP	5.9	4.2	2.3	6.5	...	...
Industrial Production (SA)[1]	7.9	3.6	0.3	5.3	1.8	n.a.
Open Unemployment Rate (%)	5.1	4.4	5.9	5.5	5.2	n.a.
Consumer Prices[1]	929.0	22.0	3.6	1.9	0.2	0.4
Trade Balance[2]	10.4	-3.2	0.1	-1.2	-0.7	-1.3
Current Account[2]	-1.8	-17.8	-4.1	-3.7	...	...

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

response to concern about the deterioration in the external balance, the government unveiled measures to boost exports through more preferential credit terms and tax exemptions on exports.

Central bank officials have stated that current monetary and exchange rate policies will be not be changed by the external balance situation. The exchange rate has depreciated slowly in nominal terms against the dollar since mid-1995, remaining about unchanged in real terms, after a 25 percent appreciation of the real exchange rate in the first year of the Plano Real. Indications are that new capital flows have remained positive in recent weeks. International reserves at the end of October (latest data available) stood at $59 billion, unchanged from September's level.

In **Venezuela**, the economy is slowly emerging from recession, helped by the recent run-up in oil prices and an IMF-supported adjustment program. The Venezuelan oil export basket has increased steadily since January and reached around $23 per barrel in mid-October, the highest price since 1990. This has led to record international reserves, which in mid-November stood at around $12 billion (excluding gold) and have increased around 90 percent since the start of the year.

The high oil prices have allowed Venezuela to meet almost all of its IMF targets with considerable margins, but inflation remains a problem. Since July, monthly inflation has been around 4 percent, although for November it has come down to 3.1 percent. On a twelve-month basis, consumer prices have risen around 110 percent through November. Despite this inflation, the exchange rate has remained broadly stable, around 470 bolivars per dollar since exchange controls were relaxed in April. The Venezuelan government seems

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

	1994	1995	1996		1996	
			Q2	Q3	Sep	Oct
Real GDP	-2.8	2.2	n.a.	n.a.	...	...
Unemployment Rate (%)	8.8	10.8	11.1	...	...	...
Consumer Prices[1]	70.9	56.7	30.9	13.2	3.6	4.2
Trade Balance[2]	-3.6	-6.0	-1.8	n.a.	n.a.	n.a.
Current Account[2]	2.7	2.6	...	...	...	...

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

committed to economic reform, and the privatization program has picked up steam with the sale in November of most of the remaining government stake in the national telephone company (CANTV) on the local and New York stock markets.

Real GDP in **China** has continued to expand briskly, albeit at a more sustainable pace than in the 1992-94 period when GDP growth averaged over 13 percent per year. Consumption growth has remained very strong, with real retail sales up 13 percent in October from their year-earlier level. Although China's generally tight monetary policy since the middle of 1993 resulted in a marked deceleration in investment spending in 1994-95, there are indications that investment growth has picked up noticeably in recent months. The 12-month consumer price inflation rate fell to 7.4 percent in September, compared with an inflation rate of 25.5 percent in 1994. The trade balance in the first 10 months of this year registered a surplus of $12.0 billion, compared with a surplus of $17.8 billion over the year-earlier period. Most of this year's surplus is attributable to a strong pickup in exports in the second half of this year, following a contraction in exports of about 8 percent from their year-earlier level in the first half of 1996. China's foreign exchange reserves rose to slightly over $100 billion by mid-November.

The central bank announced in late November that China would make its currency (the yuan) convertible for current account transactions effective December 1 of this year by accepting Article VIII of the IMF Agreement. Article VIII prohibits restrictions on payments and transfers for current account transactions, except with IMF approval.

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

	1994	1995	1996 Q2	1996 Q3	1996 Sep	1996 Oct
Real GDP[1]	11.8	10.2	9.8	9.6	...	...
Industrial Production	22.0	17.8	n.a.	n.a.	n.a.	...
Consumer Prices	25.5	10.1	8.6	7.9	7.4	...
Trade Balance[2]	5.2	16.7	2.1	7.3	3.2	3.9

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

In **Taiwan**, real GDP rose 5.6 percent in the third quarter from its year-earlier level. While consumption spending has accelerated a bit since the beginning of this year, investment growth has remained very weak, despite a shift toward a more accommodative monetary policy. The 12-month rate of consumer price inflation was 3.2 percent in November, close to its average value during the past year. Taiwan's trade surplus rose to $10.7 billion in the first 10 months of this year, compared with a surplus of $5.6 billion over the year-earlier period. The rise in the trade surplus mainly reflected a fall in the dollar value of imports of 3 percent over the period, due to sluggish domestic demand; exports rose by only 3 percent over the same period. Foreign exchange reserves stood at $87.3 billion at the end of October, compared with $91.5 billion a year earlier.

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

	1994	1995	1996 Q2	1996 Q3	1996 Sep	1996 Oct
Real GDP	6.5	6.1	5.4	n.a.	...	...
Industrial Production	6.6	4.2	-0.5	1.9	3.9	5.1
Consumer Prices	2.6	4.6	2.3	3.5	3.8	3.7
Trade Balance[1]	7.8	8.3	3.2	4.6	2.1	0.5
Current Account[1]	6.2	5.0	n.a.	n.a.	...	...

1. Billions of U.S. dollars, NSA

In **Korea**, real GDP grew 6.4 percent in the third quarter from its year-earlier level, the slowest quarterly growth in three years. The slowdown was concentrated in the investment and export sectors, which both rose at an annual rate of 9 percent, compared with rates exceeding 20 percent a year ago. As a result of continued robust growth in imports, Korea's trade deficit widened to $10.4 billion in the first nine months of the year. Industrial production in October grew 10.8 percent from its year-earlier level, compared with 7.3 percent in September. The higher growth in October reflected fewer holidays in the month and a recovery of sales of vehicles and oil products. Consumer prices in October were 5.1 percent above their year-earlier level. On November 26, Korea's Parliament ratified the country's membership in the OECD.

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

	1994	1995	1996		1996	
			Q2	Q3	Sep	Oct
Real GDP	8.4	9.0	6.7	6.4	...	...
Industrial Production	10.7	11.7	7.3	7.2	7.3	10.8
Consumer Prices	6.2	4.5	5.1	5.2	4.7	5.1
Trade Balance[1]	-3.1	-4.7	-2.8	-4.4	-0.8	n.a.
Current Account[1]	-4.5	-8.9	-4.7	-7.3	-1.4	n.a.

1. Billions of U.S. dollars, NSA

In **Russia**, the economy and economic reform are muddling along as President Boris Yeltsin completes his recovery from quintuple bypass surgery. Indications are that real economic activity has continued to decline, but the decline has been slowing. Monthly inflation has been under two percent for the past three months. The ruble-dollar exchange rate has depreciated by less than two percent per month the last three months, staying well within the crawling band "corridor" established by the central bank. The central bank announced that it will continue to use the corridor in 1997, and is predicting inflation of around 12 percent for 1997. However, the government also intends to allow the money supply to expand by 30 percent.

Russia's three-year, $10 billion IMF Extended Fund Facility has been held up, but it appears that it will move back on track with revised fiscal targets soon. For the second time since the program began eight months ago, the IMF delayed the release of the month's tranche. The IMF's chief concern in this review was Russia's failure to meet its revenue targets. Tax revenue for January through October 1996 was only 75 percent of planned

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

	1994	1995	1996		1996	
			Q2	Q3	Sep	Oct
Real GDP	-15	-4	-7	-7	-5	-6
Industrial Production	-21	-3	-5	-8	-7	-5
Consumer Prices[1]	10	7	2	1	0.3	1.2
Ruble Depreciation[1]	9	2	2	6	1.0	0.9
Trade Balance[2]	12.1	18.3	5.3	4.9	0.7	n.a.
Current Account[2]	1.3	5.7	n.a.	n.a.	...	...

1. Percent change from previous period.
2. Billions of U.S. dollars.

revenue, although the government has been taking action to strengthen tax collection and expects to have 85 percent compliance for the year as a whole.

Russia continues to integrate itself into world capital markets: on November 20, Russia's debut Eurobond was well-received, with the $1 billion offering oversubscribed and selling at a yield of 9.45 percent, 350 basis points above U.S. Treasuries and below yields for similar instruments of countries with similar debt ratings.