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

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

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Confidential (FR) Class III FOMC

Part 2

March 19, 1997

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

March 19, 1997

RECENT DEVELOPMENTS

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DOMESTIC NONFINANCIAL DEVELOPMENTS

Domestic demand has remained robust, and the economy consequently has continued to register sizable gains in employment in early 1997. Although increasingly tight labor markets have been mirrored in an uptrend in average hourly earnings, other signs of inflationary pressure are still few and far between. CPI inflation has been modest in the past two months, with increases in "core" prices running below even the reduced pace of 1996.

Labor Market Developments

Total nonfarm payroll employment grew briskly again in February, and aggregate hours of production or nonsupervisory workers on nonagricultural payrolls soared, more than reversing the sharp weather-related decline in January. In the household survey, the civilian unemployment rate has continued to fluctuate narrowly, averaging 5.3 percent over January and February. The labor force participation rate jumped to a historical peak of 67.2 percent in January and then slipped back to 67.0 percent in February.

Three special factors buffeted the employment numbers for January and February. First, as a result of seasonal adjustment problems associated with last year's January blizzard, employment gains in several industries--most notably help-supply services--were overstated this January and understated in February by approximately 80,000. Second, changes in the monthly patterns of post-Christmas layoffs resulted in a sharp drop in jobs at general merchandise stores in January and an offsetting bounceback in February.[1] Third, the BLS estimates that February's reported 109,000 jump in employment in the construction industry likely overstated the true strength in this industry by around 85,000. Only a small portion (perhaps 10,000) of this outsized gain represented a bounceback from the poor weather in the Midwest and South, which held back construction activity in January. More important, the unseasonably mild weather in February throughout much of the country led builders to begin their spring hiring earlier than usual. After netting out these factors, nonfarm payrolls still expanded very rapidly in

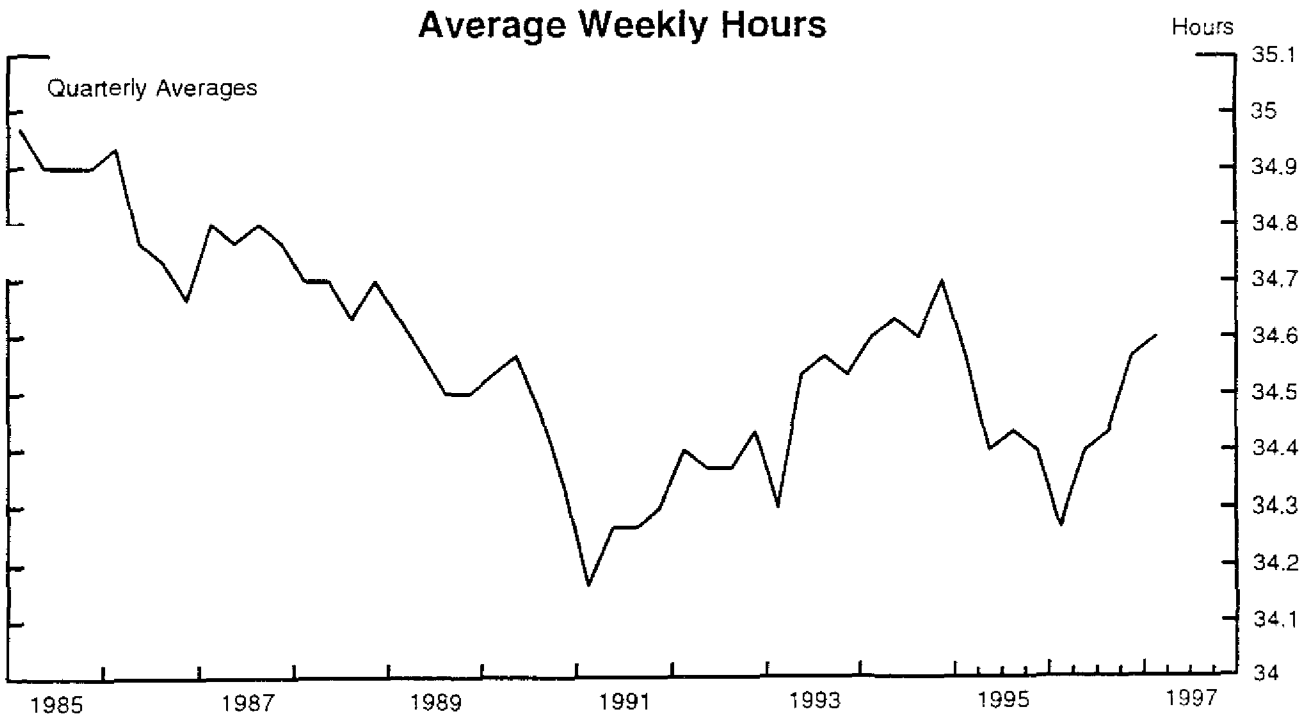
1. The late timing of the January reference period likely contributed to the odd monthly pattern in employment at general merchandise stores because some seasonal layoffs normally picked up in February were probably reported in January this year. The BLS estimates that the reported numbers understated January employment growth at general merchandise stores by about 50,000 and exaggerated the February rise in employment by the same amount.

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

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.	1997 Feb.
	-----------Average monthly changes--------							
Nonfarm payroll employment[1]	185	216	262	171	224	231	247	339
Private	176	201	245	147	223	204	221	293
Manufacturing	-12	-8	6	-19	10	8	16	-2
Durable	5	4	24	-7	12	16	20	5
Transportation equipment	-3	1	16	-4	4	4	11	-3
Nondurable	-17	-12	-19	-12	-2	-8	-4	-7
Construction	9	25	20	16	24	29	15	109
Trade	54	63	82	59	88	78	5	70
Finance, insurance, real estate	4	14	12	14	14	14	13	13
Services	110	100	113	76	86	85	136	80
Help supply services	8	12	29	12	-3	17	72	-47
Total government	9	15	17	24	2	27	26	46
Private nonfarm production workers[1]	152	168	213	120	184	177	47	362
Manufacturing production workers	-10	-8	5	-14	8	3	9	7
Total employment[2]	32	232	176	219	202	211	725	-150
Nonagricultural	51	225	197	195	220	139	683	26
Memo:								
Aggregate hours of private production workers (percent change)[1]	.1	.3	.5	.1	.3	.8	-1.6	2.7
Average workweek (hours)[1]	34.5	34.4	34.4	34.4	34.6	34.8	34.2	35.0
Manufacturing (hours)	41.6	41.5	41.7	41.7	41.8	42.0	41.7	41.9

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

Average Weekly Hours



Note. Value for 1997:Q1 is a monthly average of January and February 1997.

January and February, with job growth averaging more than 250,000 per month.[2]

In February, average weekly hours of production or nonsupervisory workers on nonagricultural payrolls soared 0.8 hour, to 35.0 hours, more than reversing a dip in the preceding month. The February increase in the workweek was widespread across major industry divisions, with all but the manufacturing industry showing a sharp jump in weekly hours. But even in manufacturing, the workweek increased 0.2 hour, to 41.9 hours--retracing much of its 0.3 hour January decline--and overtime hours turned up 0.1 hour to 4.7 hours per week. Largely because of the February run-up in the workweek, aggregate weekly hours of production or nonsupervisory workers in private industry were up 2.7 percent in February after falling 1.6 percent in January. Smoothing through the monthly volatility, the workweek has averaged 34.6 hours thus far in the first quarter, little changed from its fourth-quarter level. The January-February average of the aggregate index of production worker hours was up 0.5 percent (not at an annual rate) from its fourth-quarter average.

On a quarterly average basis, the average workweek has lengthened considerably since the end of 1995 and has now climbed most of the way back to its most recent peak in 1994.[3] The lengthening workweek may be an indication that firms are constrained in their hiring by a lack of suitable workers.

Other indicators of labor demand also remain on the strong side. Initial claims for unemployment insurance averaged just over 310,000 during the past four weeks--the lowest sustained level since early 1989. In addition, the Conference Board's index of help wanted advertising--a crude gauge of the number of unfilled positions--ticked up in January to its highest level in the past ten years. Meanwhile, respondents to the Conference Board and the Michigan Survey Research Center (SRC) consumer confidence surveys perceive strong current and future labor market conditions respectively. The Manpower, Inc., survey of hiring intentions for

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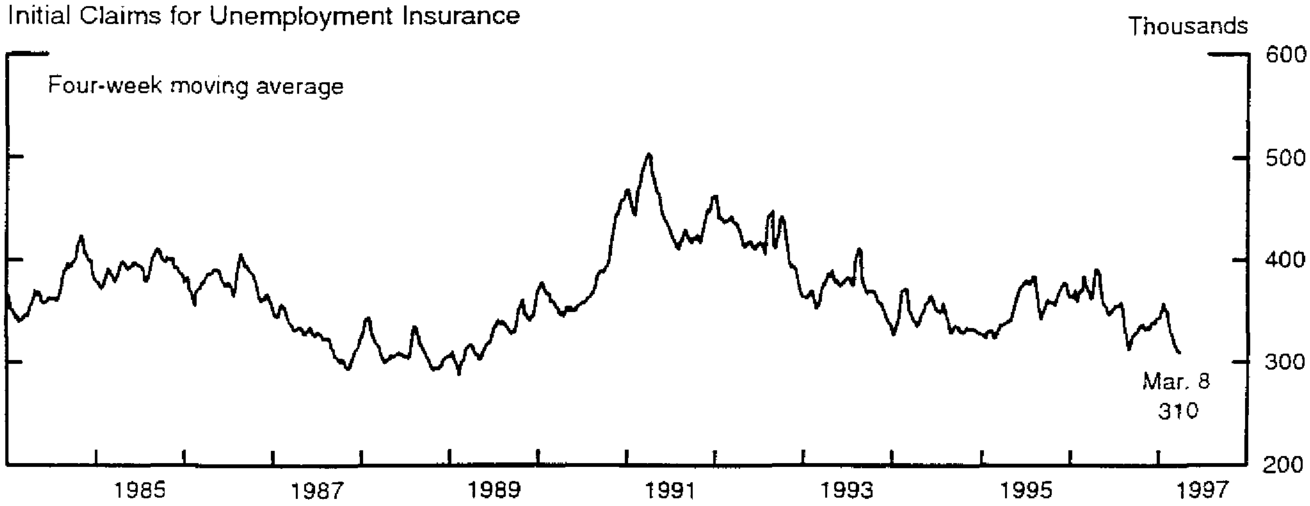
2. The Bureau of Labor Statistics also announced the results of its annual benchmarking. With the release of the May 1997 data, the BLS will increase job growth between March 1995 and March 1996 by an amount that cumulates to 57,000 by the end of that period. The relatively small size of the benchmark revisions will leave the employment picture for 1995 and 1996 essentially unchanged.

3. This comparison excludes the workweek reported for the first quarter of 1996 because it was held down by the East Coast blizzard.

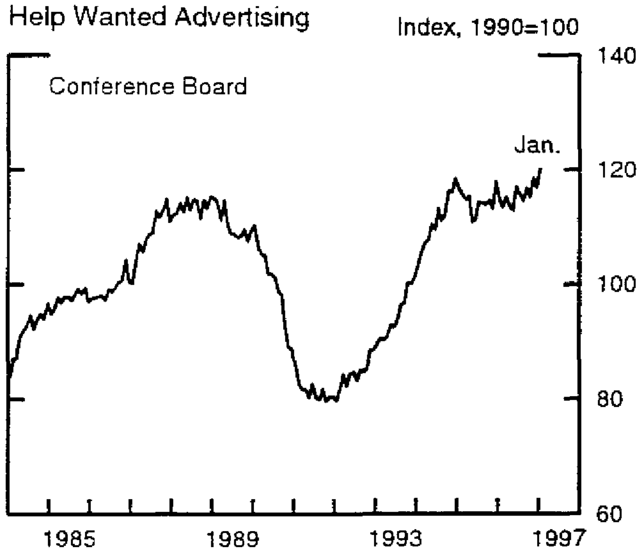
Labor Market Indicators

Initial Claims for Unemployment Insurance



Note. State programs, includes EUC adjustment.

Help Wanted Advertising

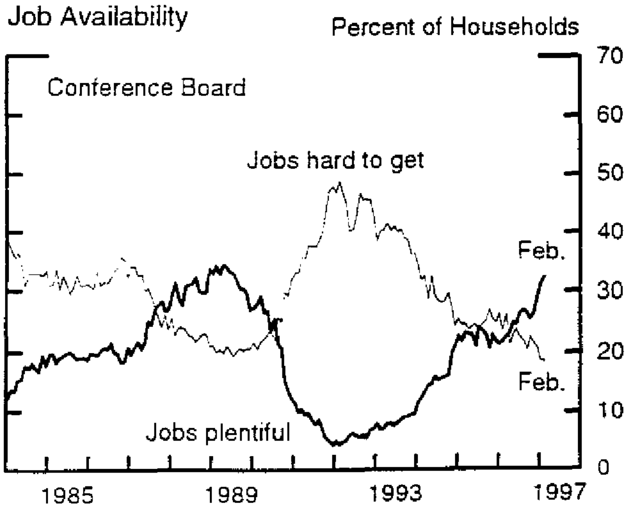


Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

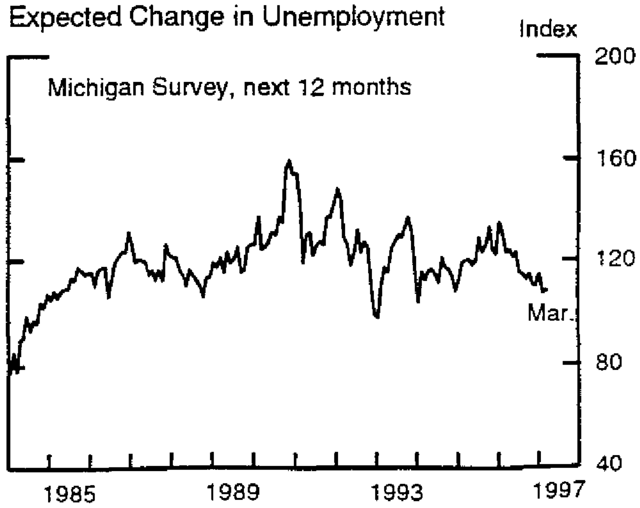
Net Hiring Strength

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.

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

			1996			1996	1997	
	1995	1996	Q2	Q3	Q4	Dec.	Jan.	Feb.
Civilian unemployment rate (16 years and older)	5.6	5.4	5.4	5.3	5.3	5.3	5.4	5.3
Teenagers	17.3	16.7	16.5	16.6	16.6	16.5	17.0	17.5
Men: 20 years and older	4.8	4.6	4.7	4.5	4.4	4.4	4.6	4.4
20-24 years	9.2	9.5	9.8	9.0	9.1	9.3	9.8	8.6
25-54 years	4.4	4.2	4.3	4.0	4.0	3.9	4.1	4.0
55 years and older	3.7	3.3	3.3	3.4	3.2	3.4	3.2	3.3
Women: 20 years and older	4.9	4.8	4.8	4.7	4.8	4.9	4.6	4.7
20-24 years	9.0	9.0	8.7	9.0	8.9	8.9	8.9	8.8
25-54 years	4.5	4.4	4.4	4.4	4.5	4.7	4.3	4.5
55 years and older	3.6	3.5	3.7	3.3	3.2	3.3	2.9	2.6
Full-time workers	5.5	5.3	5.3	5.2	5.2	5.2	5.2	5.1
Labor force participation rate	66.6	66.8	66.7	66.8	66.9	67.0	67.2	67.0

Labor Force Participation Rate

Note. Value for 1997:Q1 is a monthly average of January and February 1997. Labor force participation rate adjusted for the redesign of the CPS in 1994 and the introduction of updated population controls in 1990.

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

	Proportion 1996	1996[1]	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.	1997 Feb.
			-Annual rate-		--Monthly rate---		
Total index	100.0	3.9	3.3	4.5	.4	-.1	.5
Previous		3.8	3.3	4.3	.5	.0	
Manufacturing	86.5	4.1	5.0	4.3	.6	-.2	.8
Durables	47.1	5.7	6.0	2.9	.4	.1	1.2
Motor veh. and parts	4.9	-1.6	2.7	-15.2	-.7	1.9	.8
Aircraft and parts	2.3	34.4	21.3	32.9	1.4	.7	1.1
Nondurables	39.4	2.3	3.7	6.0	.8	-.6	.3
Mining	5.6	3.6	.8	1.1	1.4	-.6	1.3
Utilities	7.9	1.4	-12.0	9.6	-1.6	1.3	-3.5
IP by market group, excluding energy:							
Consumer goods	24.6	2.5	2.8	4.7	.9	-.8	.5
Durables	6.0	2.4	2.6	-4.9	1.1	-.9	1.3
Nondurables	18.7	2.5	2.8	7.9	.8	-.8	.3
Business equipment	13.9	7.9	8.1	5.4	.5	1.0	1.1
Information processing	5.8	10.7	9.5	7.2	.7	.7	1.3
Industrial	4.5	-.2	-.1	1.2	.3	.4	.6
Transit	2.3	21.4	22.2	5.9	.3	2.3	1.9
Other	1.3	3.5	6.4	11.8	1.0	1.8	.4
Construction supplies	5.7	5.8	9.3	-.1	-2.2	.0	1.4
Materials	32.2	4.7	5.6	4.5	.9	-.4	.9
Durables	23.2	5.5	6.2	3.9	1.0	-.4	1.3
Semiconductors	4.0	16.0	15.3	17.8	2.9	.6	2.1
Metals	3.7	3.4	7.7	5.0	1.4	-1.0	2.4
Nondurables	9.0	2.7	4.2	6.1	.9	-.2	-.3

1. From the final quarter of the previous period to the final quarter of the period indicated.

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

	1988-89 High	1963-96 Avg.	1995 Q4	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.	1997 Feb.
Manufacturing	85.7	81.9	82.3	82.3	82.3	82.5	82.1	82.5
Primary processing	88.9	83.0	86.2	86.6	86.6	86.6	86.0	86.6
Advanced processing	84.2	81.3	80.5	80.4	80.4	80.7	80.3	80.6

the second quarter also paints an upbeat picture of labor demand; experience suggests, however, that the reading may say more about the strength of hiring in the current quarter than in the spring.

The strong demand for labor has been pulling additional people into the labor market. Looking through the zigs and zags of the past two years, one can now discern something akin to a cyclical pickup in labor force participation.[4] The labor force participation rate has averaged 67.1 percent through the first two months of the first quarter, up from 66.9 percent in the fourth quarter of 1996, while the unemployment rate has held steady at 5.3 percent.

The flip side of the strong employment and workweek gains in 1996 was disappointing productivity growth. The most recent published data show that labor productivity in the nonfarm business sector grew 0.9 percent over the four quarters of 1996. This marked the largest annual increase since 1992; nonetheless, the 1996 reading still left average productivity growth during the current expansion below its long-run trend rate of expansion.[5]

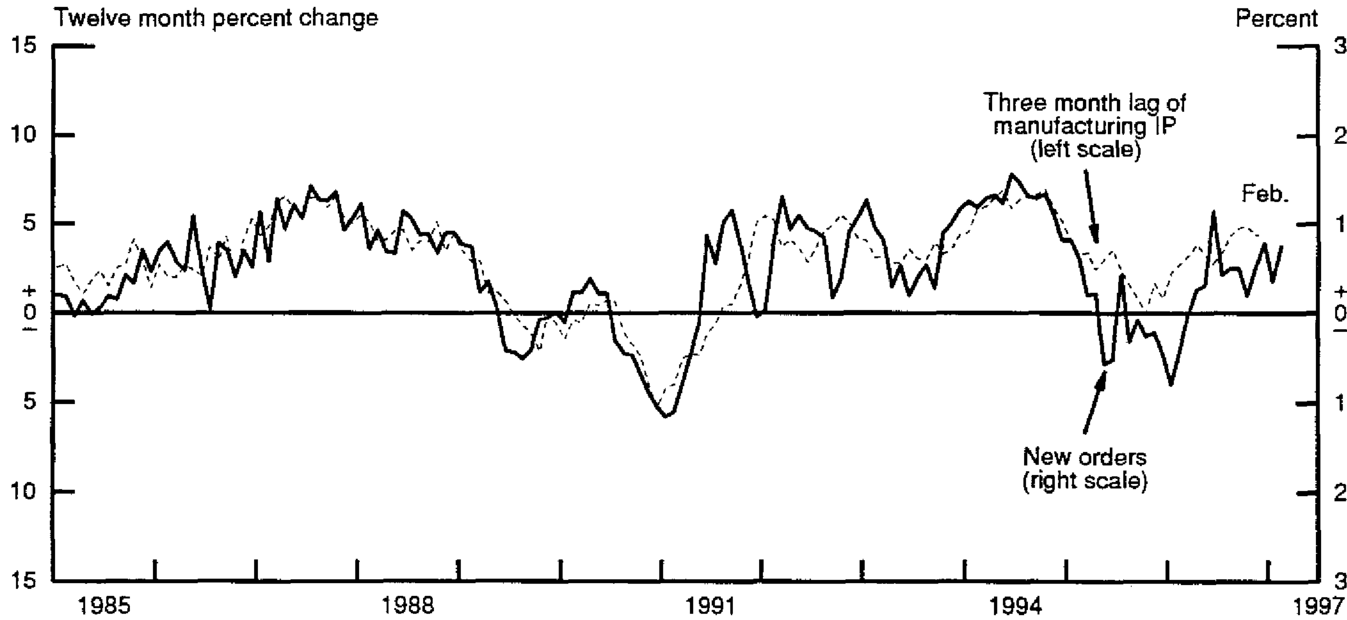
<u>Industrial Production</u>

Industrial production rebounded 1/2 percent in February after declining a bit in January. Increases were particularly sharp among producers of durable goods, whose output advanced 1-1/4 percent after changing little in January. The February increase in total industrial production was moderated by a plunge in the output of utilities, reflecting the unseasonably mild weather last month, and only a small gain in the production of nondurable goods. The upsurge in production brings the factory utilization rate in February back to 82-1/2 percent, the upper end of the 82 percent to 82-1/2 percent range that generally has prevailed for more than a year.

4. With the release of the January employment data, the BLS attempted to correct the population weights used to construct estimates of employment and the labor force from the monthly CPS for a systematic undercounting of recent immigrants to the United States, primarily Hispanic males. This change added 298,000 to employment and 317,000 to the labor force in January but had no perceptible effect on estimates of the unemployment rate or the labor force participation rate.

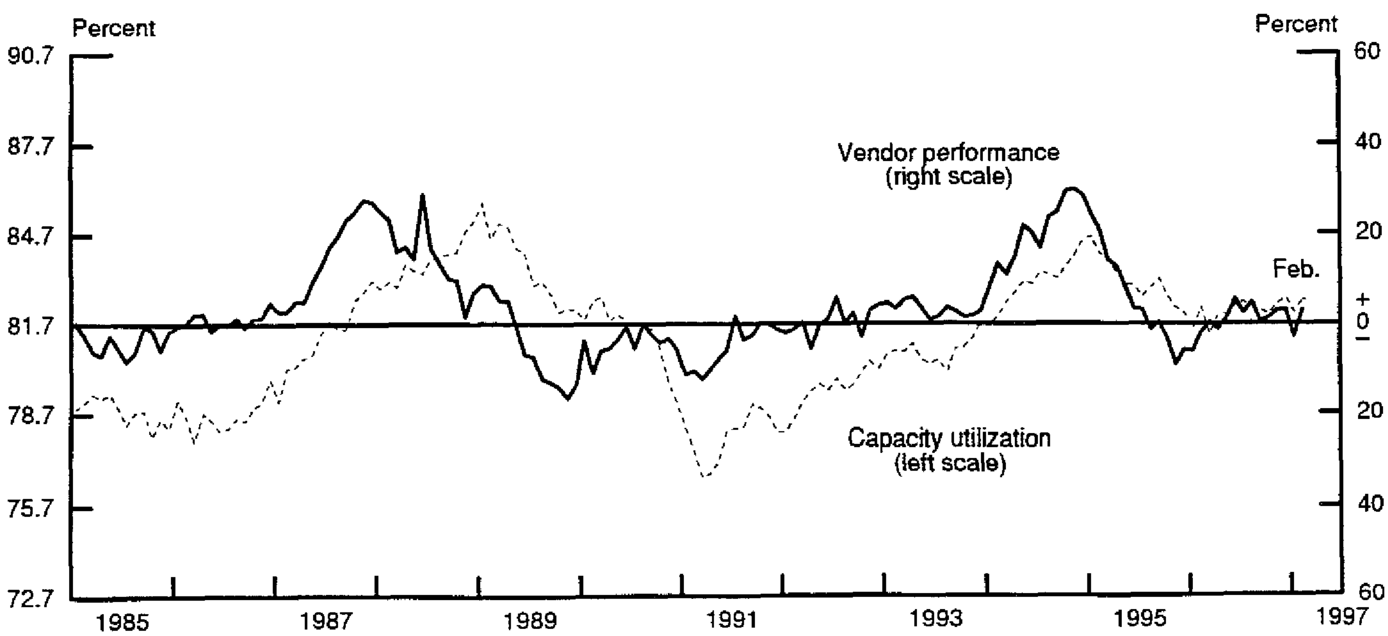
5. As we discussed in the January Greenbook, the gap between the product-side and income-side measures of output growth has been sizable over the past several years. Along with other considerations, the large gap suggests the possibility that the BEA will revise up its estimates of GDP and of nonfarm business sector output growth over 1993-96 when it releases its annual revisions this summer.

Manufacturing IP and 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.

Manufacturing Capacity Utilization and Vendor Performance



Note. Percent of respondents in the Purchasing Managers' Survey reporting supplier deliveries minus those reporting faster deliveries, seasonally adjusted.

The output of motor vehicles and parts rose further in February, to a level more than 8 percent above the strike-related low in October. Assemblies of light vehicles, at 12.4 million units (annual rate), raised the days' supply at the end of the month (based on February sales) only to a still comfortable 64 days. Looking ahead, schedules call for production to be well maintained over the remainder of the first half at an annual rate of slightly more than 12 million units.

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

	1996		1997			
	Nov.	Dec.	Jan.	Feb.	Mar.	Q2
					--scheduled--	
U.S. production	12.0	12.1	12.3	12.4	12.2	12.1
Autos	6.1	5.8	6.0	6.1	5.8	5.9
Trucks	5.8	6.3	6.4	6.3	6.4	6.2
Days' supply						
Autos	67.3	61.2	56.0	59.6	---	---
Light trucks	67.2	67.5	70.8	69.4	---	---

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

The output of aircraft and parts, an area of ongoing strength, rose further in February, with a sharp 3 percent gain in the production of commercial aircraft. Underpinned by the strength in orders, mainly from foreign airlines, Boeing's current schedule calls for raising the output of completed planes from twenty-six per month this quarter to forty planes a month by the fourth quarter of this year--the company's highest ever monthly production rate. This planned increase would be consistent with growth of total commercial aircraft output of more than 50 percent this year.

By major market group (excluding energy items), the output of consumer goods advanced 1/2 percent in February, boosted by a snap-back in the production of goods for the home, mainly appliances and carpeting. The output of business equipment rose 1.1 percent further in February, with all major categories posting gains. The output of construction supplies, which was weak around the turn of the year, rebounded in February and has, on balance, remained at the high level reached last summer. The output of durable materials rose sharply, a result not only of a 2 percent advance in semiconductor output but also of a rebound in the production of

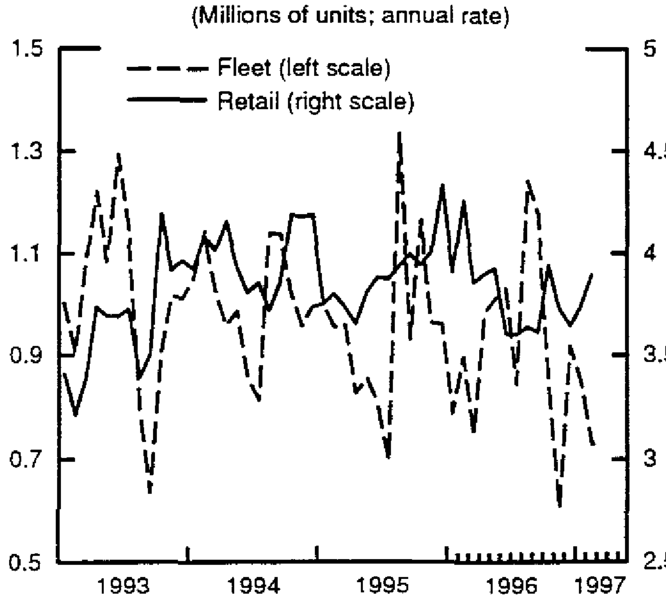
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

			1996			1996	1997	
	1995	1996	Q2	Q3	Q4	Dec.	Jan.	Feb.
Total	14.7	15.1	15.0	15.0	14.8	14.9	15.3	15.1
Adjusted[1]	14.7	15.0	15.0	15.1	14.7	14.5	15.4	15.2
Autos	8.6	8.5	8.7	8.6	8.0	8.2	8.7	8.4
Light trucks	6.1	6.6	6.3	6.4	6.8	6.7	6.6	6.7
North American[2]	12.8	13.4	13.3	13.3	13.1	13.1	13.4	13.2
Autos	7.1	7.2	7.4	7.3	6.7	6.9	7.4	7.0
Big Three	5.4	5.3	5.5	5.3	4.8	5.0	5.2	5.1
Transplants	1.7	1.9	1.9	2.1	1.9	1.9	2.2	1.9
Light trucks	5.7	6.1	5.9	6.0	6.3	6.2	6.0	6.2
Foreign produced	1.9	1.7	1.7	1.7	1.8	1.8	1.9	1.9
Autos	1.5	1.3	1.3	1.3	1.3	1.3	1.4	1.4
Light trucks	.4	.4	.4	.4	.5	.5	.5	.5

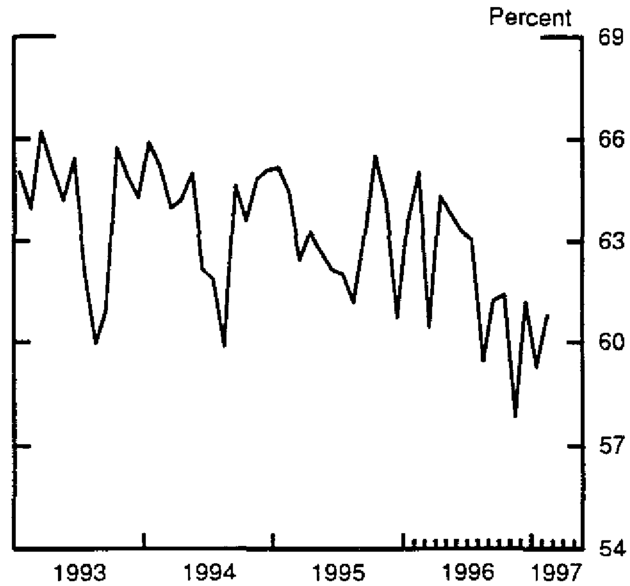
Note. Components may not add to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

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 Fleet and Retail Sales (Confidential)
(Millions of units; annual rate)



Big Three Auto Market Share



basic metals. Output of basic metals stepped up in the second half of last year, raising utilization in some industries--particularly raw steel and primary copper--to relatively high rates and likely contributing to the recent firming of the spot prices of some basic metals.

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

	Share 1996:H2	1996 Q3	1996 Q4	1996 Nov.	1996 Dec.	1997 Jan.
Total durable goods	100.0	1.7	.6	-1.7	-1.7	4.0
Adjusted durable goods[1]	68.0	1.7	.1	-2.5	-1.6	4.5
Computers	5.0	5.0	.2	-3.0	10.4	-3.3
Nondefense capital goods excluding aircraft and computers	17.0	1.9	-.7	-1.9	-6.0	6.4
All other categories	46.0	1.3	.3	-2.7	-1.3	4.8
Memo:						
Real adjusted orders[2]	---	2.2	.3	-2.4	-1.1	4.1

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.

Most of the indicators of economic activity suggest a moderate production pace in the next few months. The staff's series on adjusted orders for durable goods bounced back in January after two months of significant negative growth, and the National Association of Purchasing Managers' (NAPM) diffusion index for orders increased in February after having fallen in January. With manufacturing capacity estimated to be expanding at about a 4 percent annual rate, a continuation of the recent pace of production, which to date has not resulted in a deterioration of vendor performance, is unlikely to put much upward pressure on the overall factory operating rate.

Motor Vehicles

Sales of light motor vehicles picked up to a 15-1/4 million unit pace on average in January and February (annual rate). The increase reflects, in large part, a recovery in the supply of vehicles, which had been disrupted last quarter by labor disputes at GM and by model changeover difficulties. On balance, sales in the past five months averaged 15 million units, the same pace that prevailed in the second and third quarters of last year.

RETAIL SALES
(Percent change; seasonally adjusted)

	1996			1996	1997	
	Q2	Q3	Q4	Dec.	Jan.	Feb.
Total sales	1.3	.2	1.3	.5	1.5	.8
Previous estimate			1.2	.3	.6	
Building materials and supplies	6.5	1.4	-.7	-.1	1.6	2.2
Automotive dealers	-1.1	.7	1.5	1.0	1.9	1.7
Retail control[1]	1.8	.0	1.3	.3	1.3	.4
Previous estimate			1.2	.1	.3	
Durable goods	3.2	-.8	1.5	-.5	.3	1.3
Furniture and appliances	2.2	.7	-.4	-.3	.4	.3
Other durable goods	4.1	-1.9	3.1	-.7	.2	2.2
Nondurables	1.5	.1	1.2	.5	1.5	.2
Apparel	1.7	-.7	-1.1	.8	2.8	.4
Food	.5	1.0	.9	.5	.4	-.2
General Merchandise	2.3	.4	.8	1.3	3.0	1.8
Gasoline stations	5.2	-3.1	2.5	1.3	2.0	-.2
Drug stores	1.6	2.3	2.3	.2	1.9	.6
Other nondurables	.5	.4	2.1	-.3	1.2	-.3

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

REAL PCE SERVICES
(Percent change from the preceding period)

		1996				1996	1997
	1996	Q1	Q2	Q3	Q4	Dec.	Jan.
		- - - - - Annual rate		- - - - -		Monthly rate	
PCE services	2.7	2.4	2.7	1.3	4.3	.3	.5
Energy	2.2	7.3	8.8	-11.4	5.4	-5.7	3.6
Non-energy	2.7	2.2	2.4	1.9	4.3	.6	.4
Housing	1.6	1.6	1.5	1.3	2.1	.1	.2
Household operation	3.7	-.4	5.9	.1	9.4	.5	.1
Transportation	4.3	5.6	1.8	4.2	5.8	2.0	.3
Medical	2.5	-.1	2.9	2.1	5.2	.3	.3
Personal business	1.8	5.9	-1.1	-3.0	5.5	1.0	1.4
Other	4.4	3.4	5.2	6.4	2.7	.7	.3

Confidential data indicate that a step-up in sales to consumers accounted for the strong performance in February, with fleet sales having only partially recovered from November's strike-related plunge.

In the near term, several factors are working to sustain the strength in consumer demand. The preliminary Michigan SRC survey for March reported that consumers' attitudes toward car-buying jumped back to the upper end of the favorable range that has prevailed since early 1996. The Conference Board consumer survey for February also indicated that the proportion of households planning to buy new automobiles moved up. According to the Michigan survey, consumers are finding the prices of new cars quite attractive. Indeed, sales incentives remain sizable, and news reports suggest they will remain high or perhaps increase in the second quarter. The heavy incentives activity is being driven, at least in part, by the recent deterioration in GM, Ford, and Chrysler's market share of automobile sales. While the Big Three's market share has recovered from the strike-related fourth-quarter plunge, it remains at the low end of recent experience.

Personal Income and Consumption

After a lackluster December, consumer spending picked up considerably in early 1997, supported by continued solid growth of income and highly favorable consumer sentiment. According to the advance report, total nominal retail sales increased 0.8 percent in February and are now estimated to have increased 1-1/2 percent in January. Spending in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 1.3 percent in January and 0.4 percent in February. On the whole, average nominal spending in the retail control category during the first two months of this year was up 1.8 percent from its fourth-quarter level--9 percent, at an annual rate.

Spending on services rose strongly in January, the latest month for which estimates are available. Real expenditures on energy services jumped 3.6 percent (not at an annual rate) because of unseasonably cold weather in January. However, energy spending probably fell back last month, when, according to national weather data, temperatures were milder than normal. Non-energy services rose 0.4 percent in January, reflecting the gains in brokerage services that accompanied the large volume of equity trading.

PERSONAL INCOME
(Average monthly percent change)

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.
Total personal income	.5	.5	.6	.4	.5	.7	.3
Wages and salaries	.4	.6	.8	.4	.6	1.1	-.1
Private	.5	.6	.9	.4	.7	1.3	-.3
Other labor income	.5	.2	.4	.3	.3	.3	.2
Less: Personal tax and nontax payments	.6	.9	1.2	.7	.6	1.0	-1.9
Equals: Disposable personal income	.4	.4	.6	.4	.5	.7	.6
Memo:							
Real disposable income[1]	.3	.2	.4	.2	.2	.5	.5
Saving rate (percent)	4.7	4.9	4.3	5.3	5.1	5.4	5.4

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

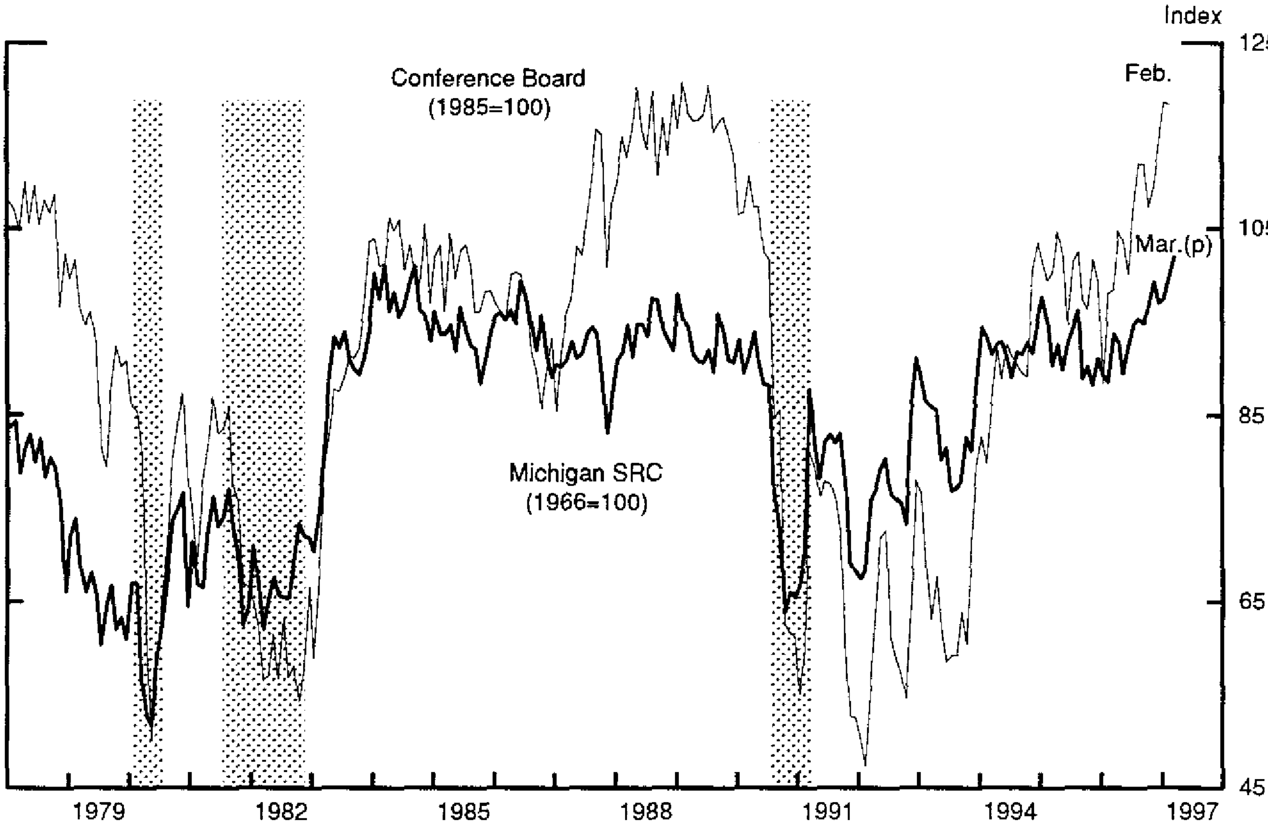
REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.
			- - - Annual rate	- - -		Monthly rate	
PCE	1.9	2.7	3.4	.5	3.4	.0	.6
Estimated revision[1]	1.9	2.7	3.4	.5	3.6	.2	1.0
Durables	1.3	5.2	11.4	-2.6	4.1	-.3	1.7
Motor vehicles	-3.8	-.9	3.0	-10.0	-2.4	-1.4	4.2
Computers	52.3	57.2	113.6	40.8	34.8	4.8	3.9
Other durable goods	.4	2.1	5.6	-4.1	3.1	-.7	-.4
Nondurables	1.1	1.7	1.3	.4	1.4	-.2	.1
Gas and oil	1.9	-.1	6.2	-3.2	.6	-.7	-.8
Clothing and shoes	.7	4.9	10.1	3.2	-1.6	.9	-.5
Other nondurables	1.1	1.1	-1.2	.1	2.3	-.5	.4
Services	2.4	2.7	2.7	1.3	4.3	.3	.5
Energy	5.4	2.2	8.8	-11.4	5.4	-5.7	3.6
Non-energy	2.3	2.7	2.4	1.9	4.3	.6	.4
Housing	1.8	1.6	1.5	1.3	2.1	.1	.2
Household operation	3.8	3.7	5.9	.1	9.4	.5	.1
Transportation	3.1	4.3	1.8	4.2	5.8	2.0	.3
Medical	2.5	2.5	2.9	2.1	5.2	.3	.3
Other	2.1	3.2	2.2	2.0	4.0	.8	.8

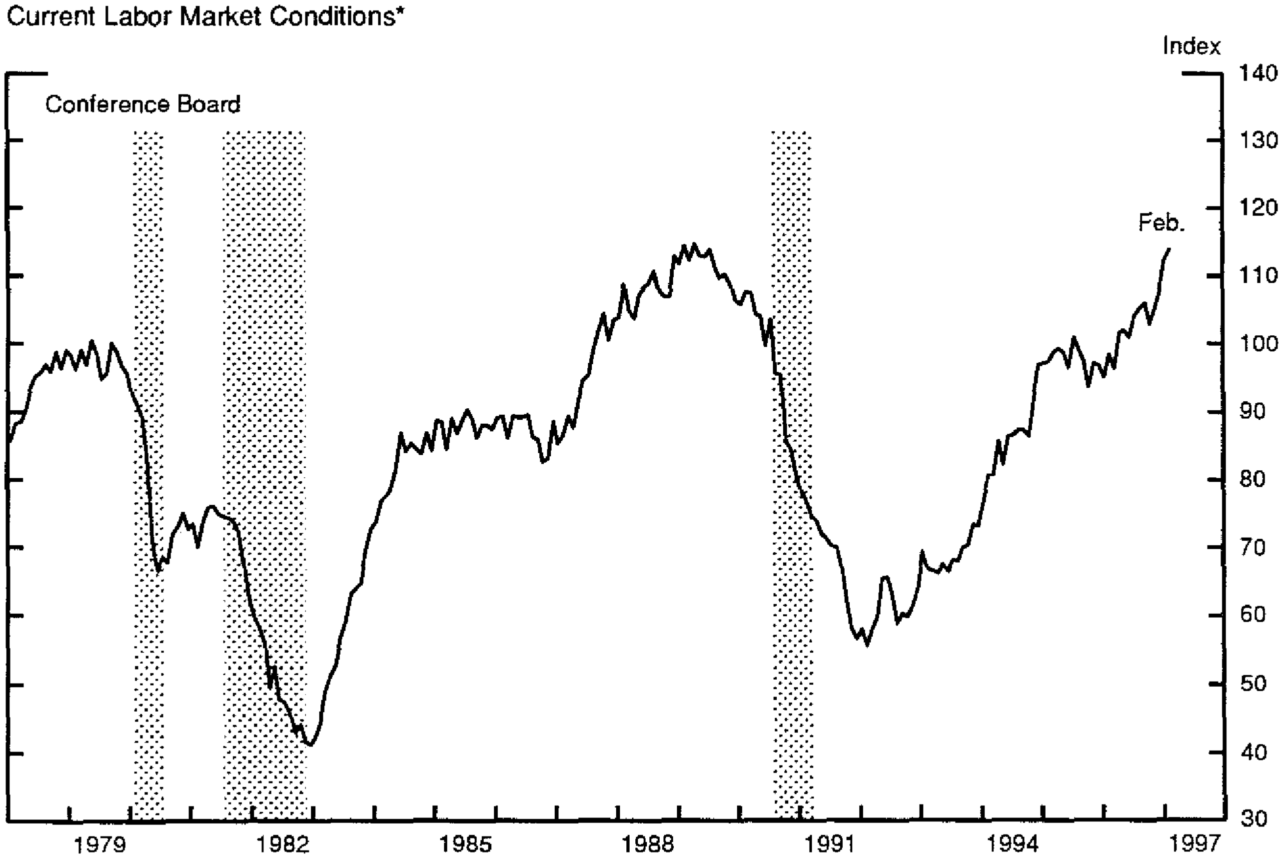
Note. Derived from billions of chained (1992) dollars.
1. Staff estimate of revised PCE growth based on February retail sales report.

Consumer Surveys

Consumer Sentiment



Current Labor Market Conditions*



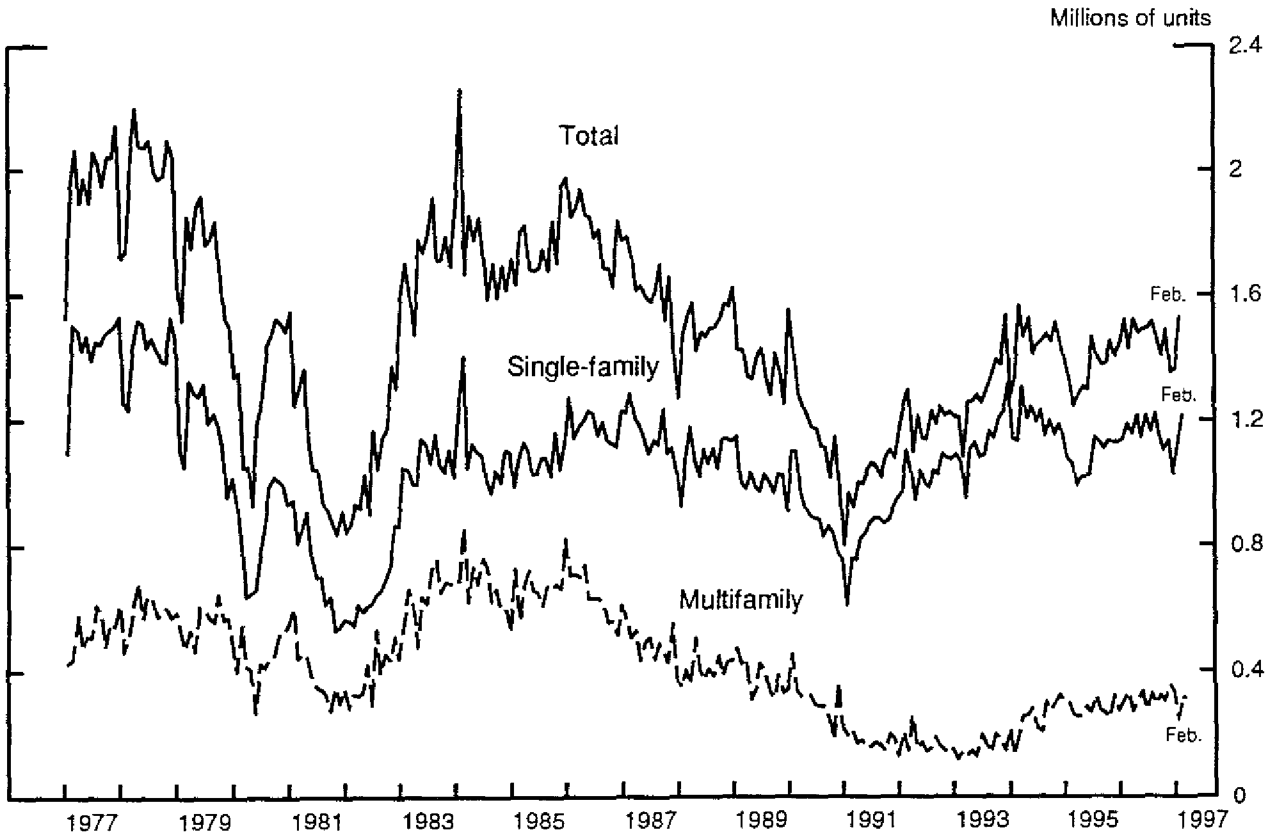
* The index is defined as the proportion of respondents reporting that jobs are plentiful minus the proportion reporting that jobs are hard to get, plus 100.

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

		1996				1997	
	1996	Q2	Q3	Q4r	Dec.r	Jan.r	Feb.p
All units							
Starts	1.48	1.50	1.49	1.42	1.35	1.36	1.53
Permits	1.43	1.44	1.43	1.40	1.42	1.40	1.44
Single-family units							
Starts	1.16	1.19	1.18	1.09	1.02	1.12	1.22
Permits	1.07	1.10	1.06	1.02	1.02	1.05	1.08
New home sales	0.76	0.74	0.79	0.77	0.80	0.87	n.a.
Existing home sales	4.09	4.21	4.11	3.95	3.86	3.94	n.a.
Multifamily units							
Starts	0.32	0.31	0.31	0.33	0.33	0.25	0.31
Permits	0.36	0.34	0.36	0.38	0.41	0.35	0.37
Mobile homes							
Shipments	0.36	0.37	0.37	0.35	0.34	0.34	n.a.

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

Private Housing Starts
(Seasonally adjusted annual rate)



Official estimates are available only through January, but personal income growth is apparently continuing at a fast pace this quarter. Real disposable personal income rose 0.5 percent in January after increasing the same amount in December. The January gain was largely attributable to a sizable increase in transfer payments, primarily the result of annual cost-of-living adjustments in federal transfer programs (which are not seasonally adjusted), but also boosted by changes to the earned income credit program. Private-sector wage and salary disbursements actually declined in January when average weekly hours dropped. Nonetheless, the substantial increase in aggregate hours in February suggests that the January decline was more than reversed last month.

Readings of consumer sentiment have remained very upbeat. In January, the sentiment index from the Conference Board survey reached its highest level since the late 1980s. In February and in March's preliminary report, the Michigan SRC survey followed suit--reaching the highest level since 1965. Households reported increasingly favorable views of their current personal financial situation.

Although both sentiment indexes have registered solid gains in the past year, the increase has been more dramatic for the Conference Board index. A key factor explaining its rise has been a marked improvement in households' views of current employment conditions: The percentage of respondents saying that jobs are plentiful rose from one-quarter in June 1996 to almost one-third in February 1997. In contrast, because the Michigan index does not include a question about current employment conditions, it is not directly affected by perceptions of the labor market. Nonetheless, the Michigan survey does ask a question, not included in the composite index, about expectations for unemployment during the next twelve months. Here, also, households' views have improved considerably since last summer, with the fraction expecting higher unemployment dropping from 35 percent in June 1996 to 24 percent in February and March. Thus, both surveys provide evidence of receding concerns about unemployment, enhancing the prospects for sustained strength in household spending in the near term. Further gains in stock market wealth of course point in the same direction.

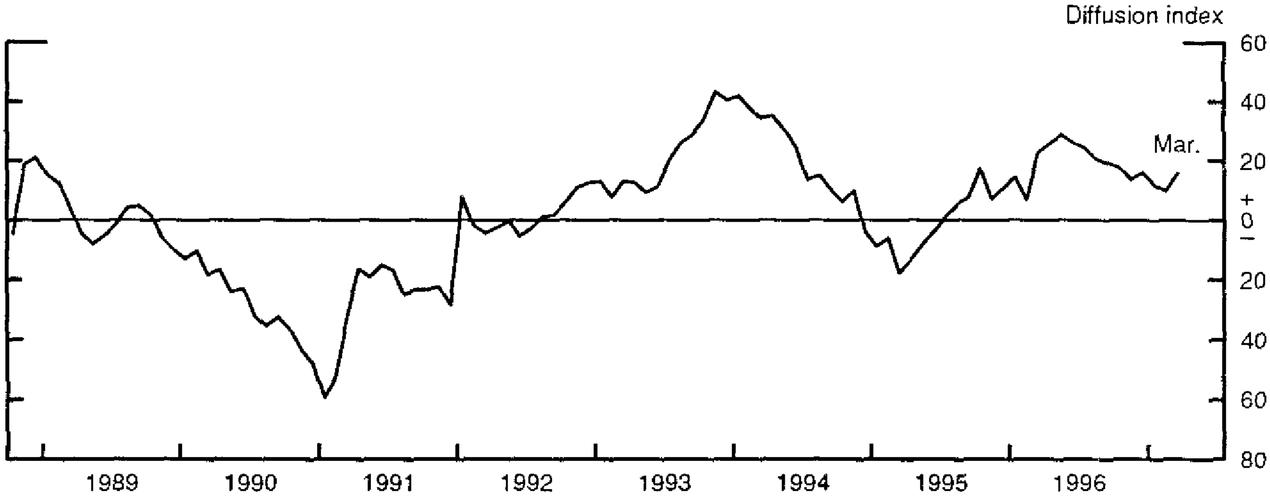
<u>Housing Markets</u>

As so often happens in the winter season, variations in weather conditions have distorted month-to-month movements in building

Indicators of Housing Demand

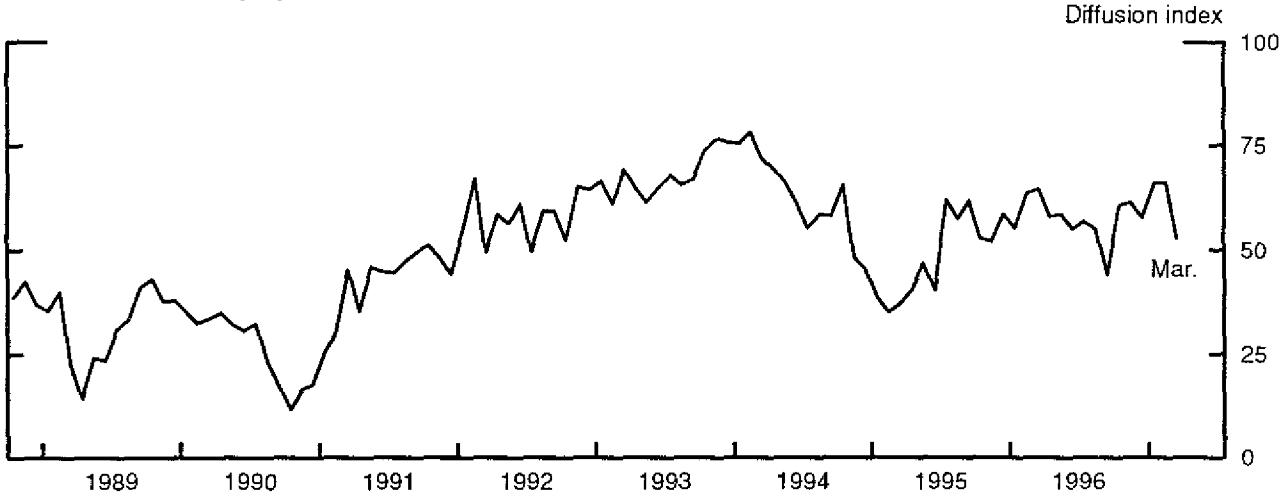
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



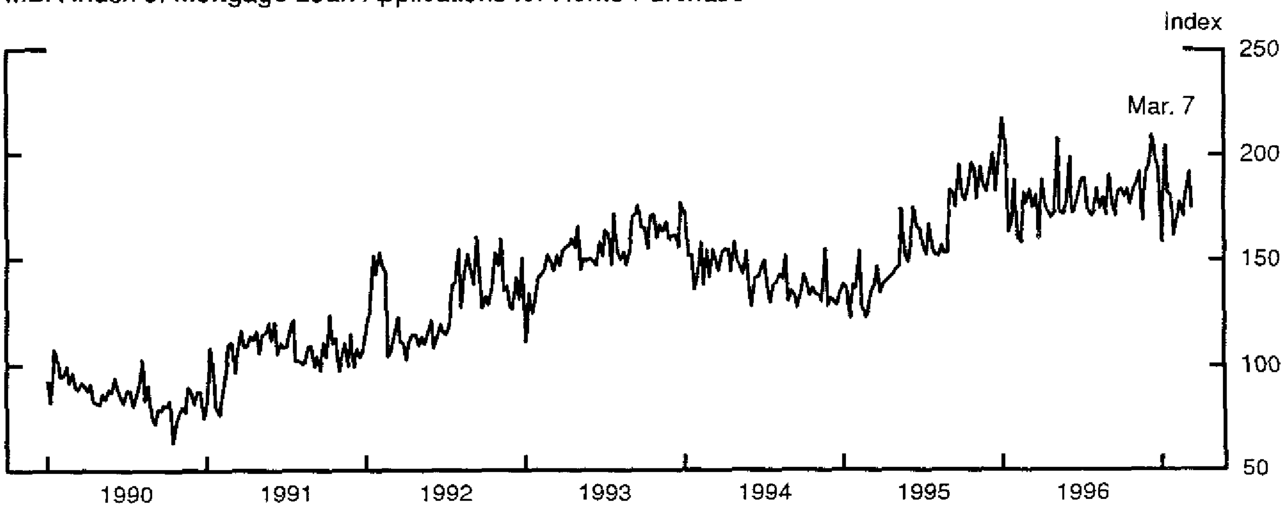
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

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.

MBA Index of Mortgage Loan Applications for Home Purchase



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

activity, obscuring underlying trends. In December, adverse weather depressed single-family housing starts quite noticeably; in contrast, exceptionally mild weather boosted starts in February. Putting greater weight on the permits figures, which ordinarily provide a more reliable reading of the direction of activity than do the starts numbers, we would judge that single-family construction has been on a steady to slightly upward sloped course of late.

In addition to the potentially distorting effects of unusual weather, a statistical break in the Census Bureau's series on sales of new homes has made discerning current market conditions more difficult than usual. While reporting that sales of new homes jumped in January to 870,000 units, the second-fastest pace on record, the Census Bureau noted that new computerized data collection methods that it began implementing last May seem to be imparting an upward bias to the estimates. The Census staff used ad hoc procedures to counteract the overstatement of the January estimate, but the accuracy of the resulting adjustments is difficult to assess. Until the Census Bureau accumulates more experience with the new data collection methods, we will likely face considerable uncertainty about the reliability of monthly estimates of new-home sales. Sales of existing homes also rose in January, offsetting part of the December decline.

Other indicators are somewhat ambiguous about the strength of demand for single-family homes. Builders' assessments of new-home sales increased in early March but remain at a moderate level, well below their recent high in the second quarter of 1996. In the first half of March, homebuying attitudes, as measured by preliminary readings from the Michigan SRC survey, dropped back to the lowest level since September. Applications for mortgages to purchase homes have continued the erratic pattern they have exhibited since late last year. Smoothing through the sharp ups and downs, in recent weeks the pace of applications is running at about the same average level as was observed during most of last year.

Multifamily housing starts rebounded in February after plunging abruptly in January. Although the demand for multifamily units has strengthened in some areas, the imbalance of supply and demand for the sector as a whole has not improved noticeably. The vacancy rate for multifamily rental units has edged up over the past two years, and residential rent remains at an eleven-year low in real terms (as measured in the CPI).

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

	1996				1996	1997	
	Q1	Q2	Q3	Q4	Dec.	Jan.	Feb.
Producers' durable equipment							
Shipments of nondefense capital goods	-.5	2.9	1.8	1.5	1.5	-2.5	n.a.
Excluding aircraft and parts	.8	1.5	1.5	1.0	1.1	-2.6	n.a.
Office and computing	3.7	-.8	4.4	-.4	5.8	.2	n.a.
Communications equipment	-.3	4.7	4.5	4.2	-3.2	-7.8	n.a.
All other categories	.0	1.7	-.3	.6	.6	-2.3	n.a.
Shipments of complete aircraft[1]	1.4	12.2	14.7	21.1	20.4	-50.8	n.a.
Sales of heavy trucks	-1.9	1.3	-.8	-5.6	.8	6.8	-.4
Orders of nondefense capital goods	3.1	-6.5	4.9	.5	.0	5.3	n.a.
Excluding aircraft and parts	3.1	-1.7	2.6	-.5	-2.2	3.9	n.a.
Office and computing	2.1	1.6	5.0	.2	10.4	-3.3	n.a.
Communications equipment	8.7	-8.5	6.6	3.8	-35.9	46.1	n.a.
All other categories	2.2	-1.2	.8	-1.8	2.3	-.5	n.a.
Nonresidential structures							
Construction put in place, buildings	.2	-.6	3.7	8.2	-3.0	2.8	n.a.
Office	-6.6	8.3	9.2	7.6	-3.8	1.2	n.a.
Other commercial	3.0	-1.0	1.4	7.9	-1.6	5.9	n.a.
Institutional	-2.9	1.2	8.2	9.0	.0	-.2	n.a.
Industrial	-1.6	-8.0	-1.0	9.8	-6.9	2.0	n.a.
Lodging and miscellaneous	10.6	.0	4.5	6.5	-3.0	2.9	n.a.
Rotary drilling rigs in use[2]	6.5	9.9	-4.0	-1.6	1.5	6.0	8.3
Memo:							
Business fixed investment[3]	11.6	3.8	17.5	5.5	n.a.	n.a.	n.a.
Producers' durable equipment[3]	13.1	6.7	20.9	-.8	n.a.	n.a.	n.a.
Nonresidential structures[3]	7.7	-3.7	8.4	25.2	n.a.	n.a.	n.a.

1. From the Current Industrial Report "Civil Aircraft and Aircraft Engines." Monthly data are seasonally adjusted using FRB seasonal factors constrained to BEA quarterly seasonal factors. Quarterly data are seasonally adjusted using BEA seasonal factors.
2. 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.

<u>Business Fixed Investment</u>

Available indicators suggest that real business fixed investment is continuing to grow at a healthy pace in the first quarter, led by another large gain in business purchases of computers and by a further expansion of nonresidential construction activity.

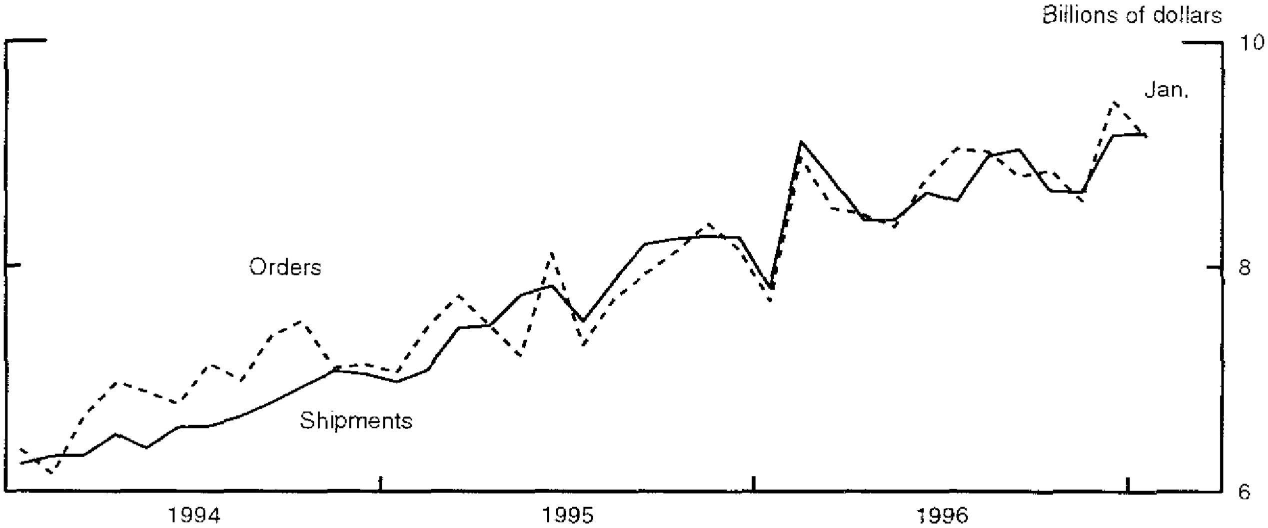
After large increases at the end of 1996, nominal shipments of nondefense capital goods fell 2.5 percent in January. Outside of transportation and information technology, shipments fell 2.3 percent in January, and bookings were little changed. Both shipments and orders for these goods have been fluctuating around a fairly stable level for the past year.

In the office and computing equipment component, nominal shipments held at their high December level; businesses have continued to seek efficiency gains through advances in automation, and the reduced operating costs of the latest generation of servers running Windows NT has sparked a new wave of system upgrades. Given the steep price declines in this sector, the January reading points to another large increase in real spending on office and computing equipment.

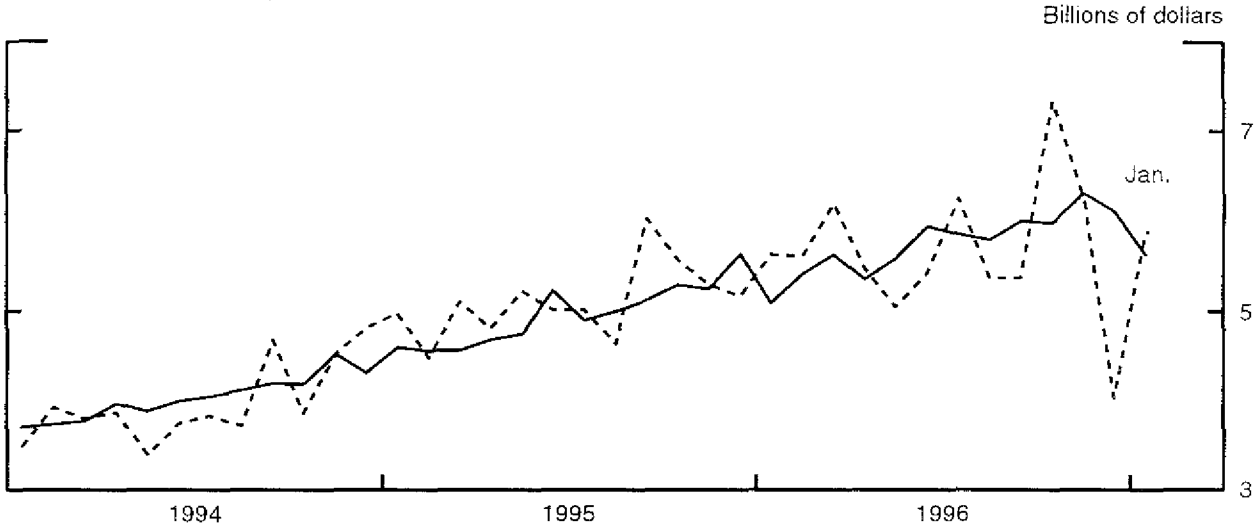
Shipments of communications equipment fell substantially over the December-January period after posting large gains in 1996. Bookings tend to be lumpy for the diverse products grouped in this category, but of late they have been even more volatile than usual. Nonetheless, underlying the month-to-month swings seems to be an ongoing expansion of investment in communications equipment driven by technological change. For example, increased usage of the Internet is boosting capital spending on telecommunications equipment, as local phone lines in some regions have become overloaded and on-line providers struggle to meet rising demand--American Online being the most highly publicized case. In addition, many states are proceeding with telecommunications deregulation in spite of the delays in implementation of the Telecommunications Reform Act at the federal level. Perhaps as a response to these developments, AT&T has announced plans to almost double capital spending on its network this year--to $9 billion--in anticipation of its entry into local phone markets. In addition, a series of multiyear, multiple-satellite orders in recent months suggests that the demand for satellites is strong.

Orders and Shipments of Nondefense Capital Goods

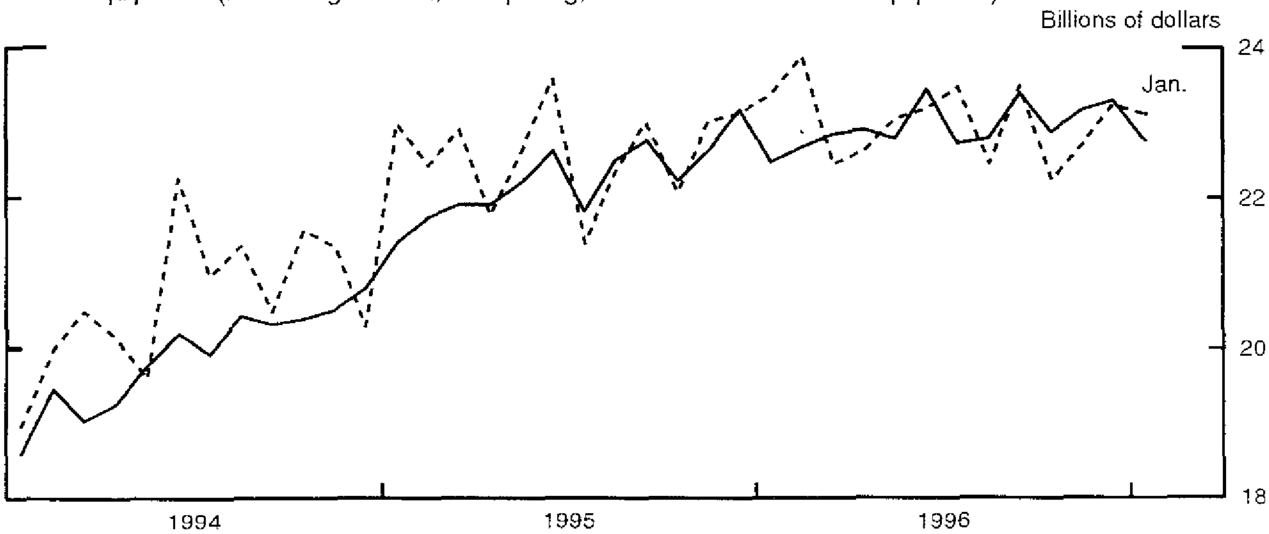
Office and Computing Equipment



Communications Equipment

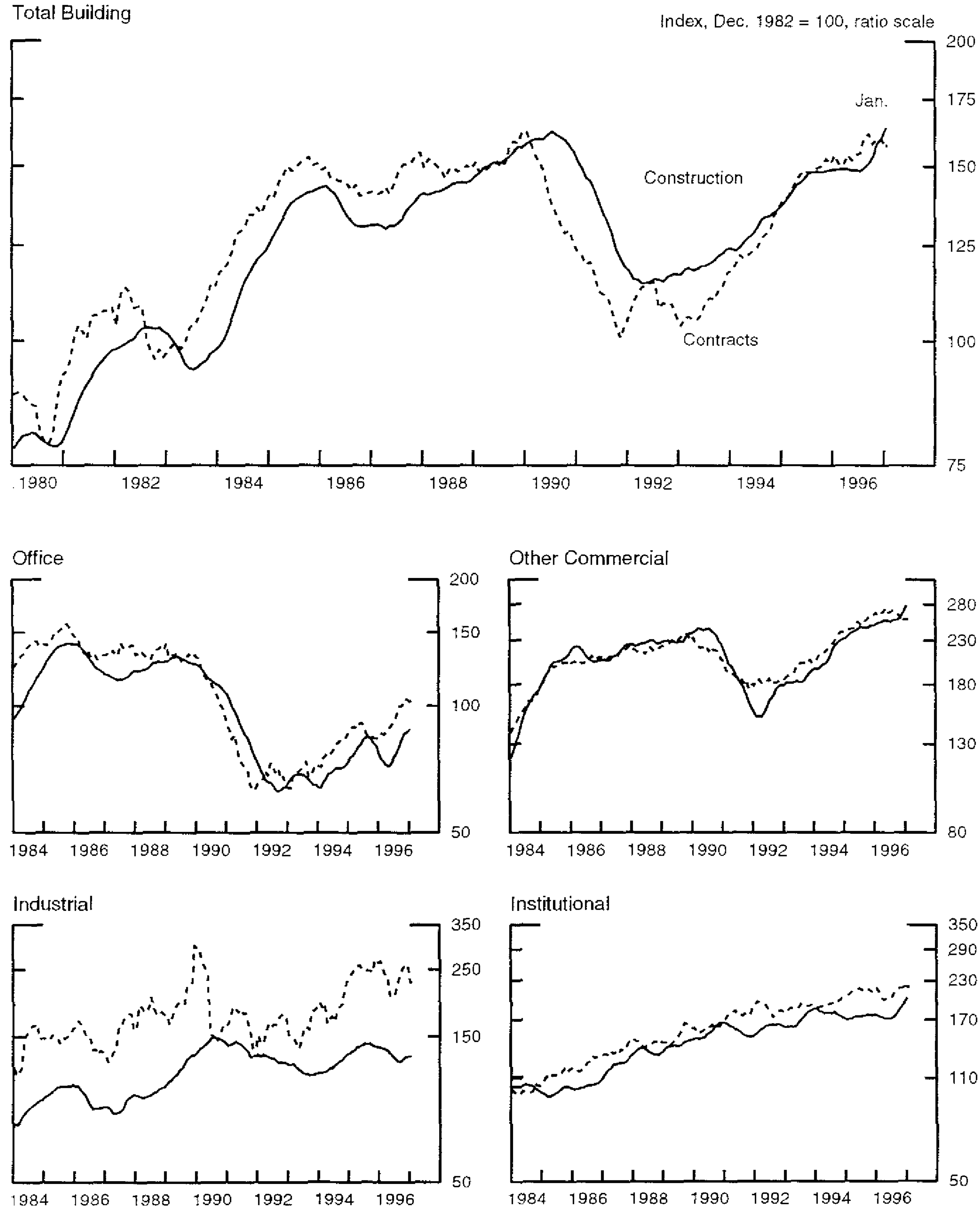


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

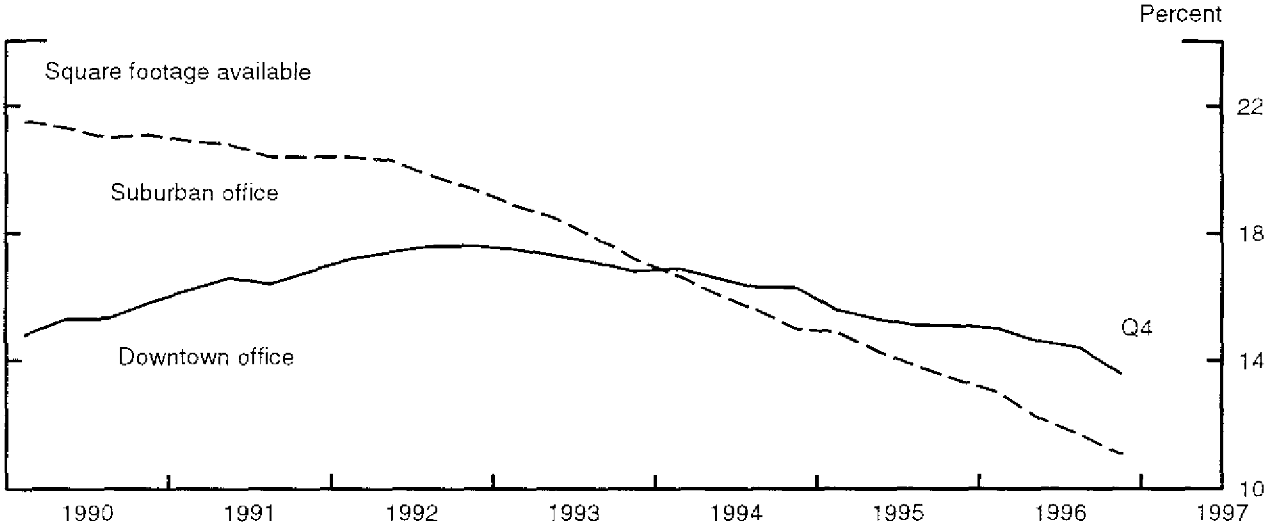
(Six-month moving average)



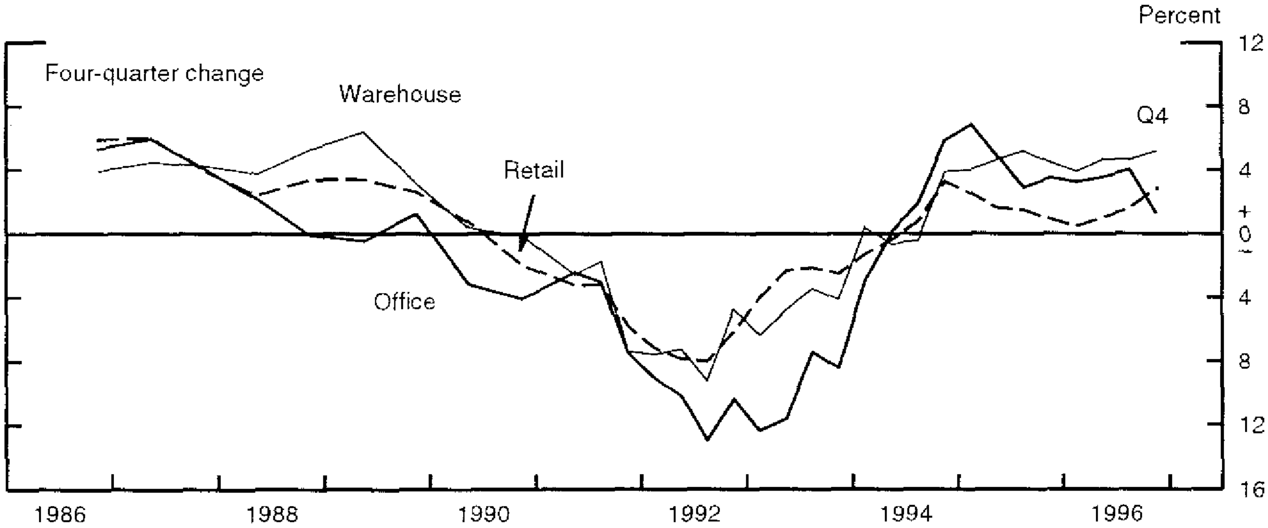
Note. For contracts, total includes private only; individual sectors include public and private.

Nonresidential Construction Indicators

CB Commercial Vacancy Rates

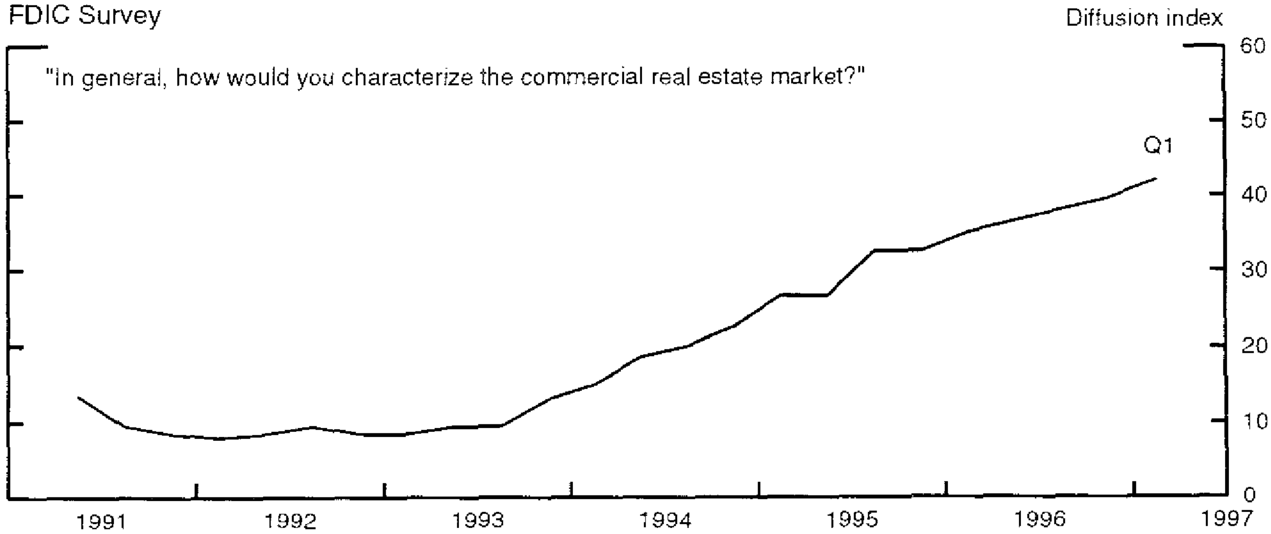


National Real Estate Price Index *



* Data are semiannual from 1986 to 1991 and quarterly from 1992 to present.

FDIC Survey



((percent reporting tight supply - percent reporting excess supply)/2) + 50

Business purchases of motor vehicles have changed little, on balance, in recent months. Fleet sales of autos increased sharply in December and January, partially recovering from strike-depressed levels in October and November. In contrast, sales of light trucks to businesses--which were less affected by the GM strike--fell back in December and January after outsized gains in the prior two months. After bottoming out in November and December, sales of medium and heavy trucks turned up in January and were essentially unchanged in February.

Even after rising very rapidly in the fourth quarter, outlays for nonresidential structures appear to be increasing further this quarter. Construction put-in-place rose 2.8 percent in January, to a level 1.7 percent above the fourth-quarter average. Following December declines, spending for office, other commercial, and lodging and miscellaneous buildings resumed upward trends. Other indicators of demand paint a picture of continuing growth over the coming quarters. Contracts for construction remain at a high level and point, in particular, to increased construction of office buildings. Vacancy rates for office buildings stand near their lowest levels since the mid-1980s, and the National Real Estate Index indicates that transactions prices for office buildings have been rising since early 1994. The FDIC real estate survey of senior examiners and asset managers also reports a very upbeat assessment of the strength of the commercial market.

Business Inventories

Modest inventory investment in January, following stock drawdowns in November and December, left business inventories lean early in the first quarter. For most manufacturing industries and trade groupings, inventory-sales ratios in January were near the low end of their recent ranges. On the whole, business establishments appear to have some room for restocking in coming months.

Manufacturers' stocks were virtually unchanged in January. Among industries producing capital goods, the sizable buildup in inventories of aircraft and parts that began more than a year ago continued; stocks of several types of industrial machinery also expanded. In contrast, inventories of computing and office equipment declined further in January (in book value terms), the ninth monthly decline during the past twelve months. Stocks of telecommunications equipment and construction machinery were little changed. In the consumer goods sector, producers of household

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

	1996			1996		1997
	Q2	Q3	Q4	Nov.	Dec.	Jan.
Book value basis						
Total	13.2	36.4	13.2	-4.1	-14.1	16.4
Excluding wholesale and retail motor vehicles	6.0	22.0	19.5	14.7	-7.3	13.4
Manufacturing	-6.2	11.3	4.9	14.8	-17.4	2.7
Excluding aircraft	-10.7	8.6	.5	8.3	-16.0	-8.4
Tobacco	-.2	.6	1.2	1.9	-.4	-9.7
Wholesale	11.3	-9.2	4.6	1.9	2.1	32.3
Excluding motor vehicles	7.6	-6.1	6.6	.8	12.3	20.6
Retail	8.2	34.3	3.8	-20.9	1.2	-18.6
Auto dealers	3.5	17.5	-4.2	-20.0	3.3	-8.8
Excluding auto dealers	4.6	16.8	7.9	-.9	-2.2	-9.9

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

	Cyclical reference points		Range over preceding 12 months		January
	1990-91 High	1994-95 Low	High	Low	1997
Manufacturing and trade	1.58	1.40	1.44	1.39	1.37
Less wholesale and retail motor vehicles	1.55	1.37	1.41	1.35	1.34
Manufacturing	1.75	1.39	1.46	1.38	1.37
Primary metals	2.08	1.45	1.62	1.56	1.54
Nonelectrical machinery	2.48	1.88	1.94	1.77	1.79
Electrical machinery	2.08	1.52	1.60	1.46	1.52
Transportation equipment	2.94	1.59	1.87	1.65	1.73
Motor vehicles	.97	.53	.67	.55	.55
Aircraft	5.85	4.42	5.95	4.89	5.27
Nondefense capital goods	3.09	2.33	2.58	2.38	2.45
Textile	1.71	1.44	1.66	1.49	1.51
Petroleum	.94	.88	.88	.76	.79
Tobacco	2.83	1.99	2.18	1.93	1.69
Home goods & apparel	1.96	1.70	1.89	1.67	1.69
Merchant wholesalers	1.36	1.28	1.33	1.26	1.27
Less motor vehicles	1.31	1.26	1.30	1.23	1.24
Durable goods	1.83	1.54	1.63	1.56	1.57
Nondurable goods	.96	.98	1.01	.95	.95
Retail trade	1.61	1.46	1.53	1.48	1.48
Less automotive dealers	1.48	1.42	1.45	1.41	1.41
Automotive dealers	2.21	1.60	1.77	1.64	1.68
General merchandise	2.43	2.21	2.31	2.20	2.13
Apparel	2.56	2.47	2.54	2.35	2.44
G.A.F.	2.44	2.24	2.33	2.23	2.18

durables, nondurable home goods, and apparel all reported small stock accumulations in January following little net change over the fourth quarter. However, inventories held by tobacco producers posted an unusually large runoff in January, with the bulk of the decline in stocks of materials and supplies. Given the brisk pace of shipments of finished tobacco in December and January and the sizable decline in the inventory-shipments ratio for the industry, the January runoff did not appear to have stemmed from a serious overhang.[6] On the whole, manufacturers' inventories were reasonably well balanced in January; the inventory-shipments ratio for all manufacturing was at its lowest point in recent years.

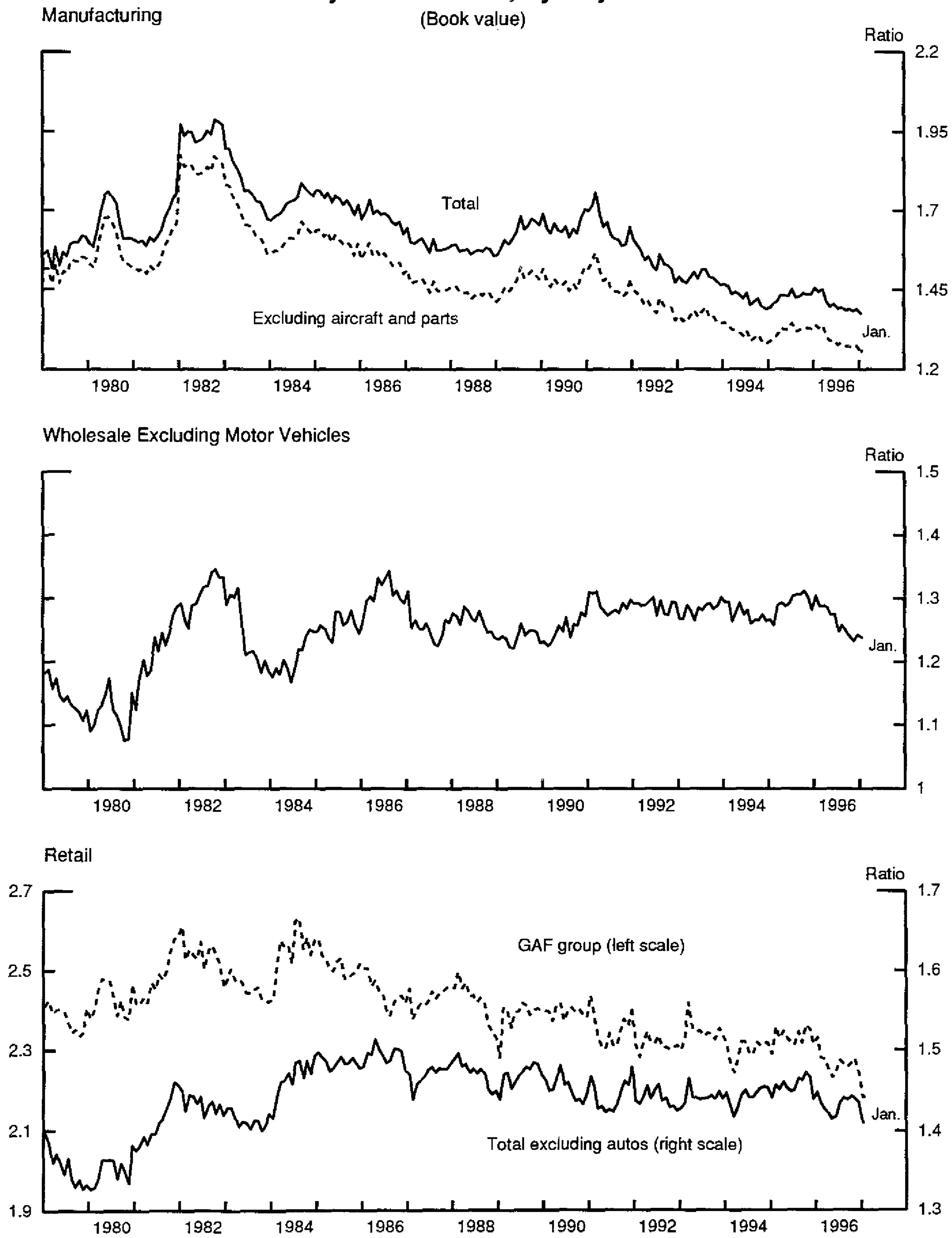
In contrast to manufacturing, wholesale inventories expanded substantially in January--up at an annual rate of $32 billion in book-value terms--after generally moderate inventory buildups during the fourth quarter. While stocks of motor vehicles and accessories accounted for about one-third of the January accumulation, non-vehicle stocks also showed widespread increases. In particular, inventories at wholesale apparel outlets expanded further in January after increasing substantially in December. In both months, however, the accumulations were accompanied by very strong shipments, and the inventory-sales ratio for apparel distributors dropped to its lowest level in the current expansion. Most types of wholesale establishments appear to have had no serious inventory imbalances.

Further downstream, non-auto retail inventories fell at a $10 billion annual rate in January. Large drawdowns occurred at general merchandise stores, where sales surged in January, and at outlets selling other durable goods. In contrast, stores selling nondurables other than general merchandise, food, and apparel saw a second large monthly accumulation of inventories. Overall, the inventory-sales ratio for non-auto retailers dropped to the low end of the range of the preceding year. However, at general merchandisers, stocks fell to a twenty-year low relative to sales.

6. Output fell sharply in the tobacco industry in January, and the precipitous drop in inventories of materials and supplies was consistent with that decline. In addition, some U.S. tobacco manufacturers are reported to be taking steps to shift their production operations overseas--partly to take advantage of the lower labor costs and partly to escape the increasingly prevalent anti-smoking sentiment in this country. Thus, a portion of the January drawdown in materials inventories in the tobacco industry may also reflect the initial downshift in tobacco manufacturing in the United States as part of the industry's new global strategy.

Inventory-Sales Ratios, by Major Sector

(Book value)



Given the continued strength in sales at general merchandise stores in February, some rebuilding of stocks in coming months seems likely.

Federal Sector

Real federal expenditures on consumption and gross investment, as measured in the national income and product accounts, rose about 1-1/2 percent from the fourth quarter of 1995 to the fourth quarter of 1996. The rise was mostly an artifact of events in late 1995--government shutdowns and restrictive continuing resolutions for programs covered by unpassed appropriations bills--that held real purchases to especially low levels.[7] The underlying trend of federal consumption and investment expenditures probably is better represented by the 2-1/2 percent average annual rate of decline from the fourth quarter of 1994 to the final quarter of 1996. Reductions have occurred in both real defense purchases and real nondefense purchases.

For the first four months of fiscal year 1997, the federal unified budget deficit, adjusted for payment timing shifts and excluding deposit insurance and spectrum auction proceeds, was $2 billion higher than last year--a 4-1/4 percent increase. Relative to last year, both receipts and adjusted outlays were up about 6 percent. One factor contributing to the rise in outlays was increased spending on health programs, with Medicare spending 10 percent higher and Medicaid spending 11 percent higher than last year. While the growth in Medicare is in line with recent trends, Medicaid growth far exceeds the 3 percent rate observed last year. The rebound in Medicaid growth appears to indicate that last year's slowdown in outlays for that program was only a temporary phenomenon. Other increases in outlays included a 4 percent rise in adjusted defense spending and a 13 percent surge in outlays for nondefense items other than net interest and social insurance programs (social security, health, income security). In the first

7. The Bureau of Economic Analysis's $3.7 billion downward revision from its advance estimate to its preliminary estimate of real federal purchases in the fourth quarter of 1996 primarily reflected the incorporation of additional data on defense purchases. New detail from the Monthly Treasury Statement for December led the BEA to reallocate the composition of total defense purchases so that defense consumption was decreased and defense investment was increased, although total defense purchases were unchanged. Also, additional Department of Defense procurement and delivery data caused BEA to revise down defense investment, thus reducing total defense purchases. The new data included information indicating that one fewer C17 airplane than expected had been delivered.

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

	January		Fiscal year to date totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	123.5	137.4	503.4	542.7	39.3	7.8
Deposit insurance (DI)	-1.2	-.4	-3.9	-6.9	-3.0	75.5
Spectrum auction (SA)	.0	.0	.0	-3.6	-3.6	N.A.
Other	124.7	137.8	507.3	553.2	45.8	9.0
Receipts	143.0	150.7	467.1	496.7	29.6	6.3
Deficit (+)	-19.5	-13.4	36.3	46.0	9.7	26.6
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	131.8	137.8	514.4	546.0	31.6	6.1
National defense	22.1	22.1	86.8	90.3	3.5	4.0
Net interest	20.8	21.1	80.3	82.7	2.4	3.0
Social security	28.7	30.4	113.2	118.7	5.6	4.9
Medicare	15.5	16.3	57.0	62.5	5.6	9.8
Medicaid	6.7	8.3	28.8	32.0	3.2	11.1
Other health	1.9	2.5	8.4	9.8	1.4	16.7
Income security	19.3	19.6	71.5	72.5	1.0	1.4
Other	16.8	17.6	68.4	77.4	9.0	13.2
Receipts	143.0	150.7	467.1	496.7	29.6	6.3
Individual	86.2	87.2	230.7	246.5	15.8	6.8
Withheld	55.4	55.4	192.8	204.0	11.2	5.8
Nonwithheld	31.2	33.6	42.3	48.8	6.5	15.4
Refunds (-)	.3	1.8	4.4	6.2	1.9	43.3
Social insurance taxes	42.2	48.8	150.3	165.5	15.3	10.2
Corporate	5.2	4.8	47.1	47.0	-.1	-.2
Other	9.5	9.9	39.1	37.7	-1.4	-3.5
Deficit(+)	-11.2	-12.9	47.2	49.3	2.0	4.2

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.

four months of 1996, spending out of many defense and nondefense accounts was depressed by restrictive continuing resolutions.

The President's budget for fiscal 1998, which was released in early February, incorporates proposals broadly similar to those he offered last year. According to OMB scoring, the President's proposals would result in a narrowing of the deficit over the next several years and would yield a $17 billion surplus in 2002. The proposals would reduce net spending--particularly discretionary spending and Medicare--and step up the pace of spectrum auctions. The President's plan also includes a set of tax provisions that on net lead to a small revenue loss. Measured relative to the OMB's current-services baseline, the President's plan produces $254 billion in aggregate deficit reduction (including associated lower debt-service payments) over six years, with about three-quarters of the savings scheduled to occur in fiscal 2001 and 2002.

According to CBO scoring, however, the deficit under the President's "basic" budget plan would be $69 billion in 2002, $86 billion more than estimated by the OMB. Differences in economic assumptions underlying the baseline budget projections account for almost two-thirds of the discrepancy between the OMB and CBO projections. The remaining one-third is due to differences in the scoring of the President's policies; the largest differences are for spectrum sales in 2002 and the President's Medicare proposals.

In anticipation of the CBO's less favorable assessment, the President proposed a trigger mechanism that would be used if the budget seems unlikely to reach balance in fiscal 2002. The trigger would invoke a set of "alternative policies," including maintaining the scheduled suspension of the tax cuts after 2000 (raising an additional $24 billion in 2002) and imposing additional spending cuts in fiscal years 2001 and 2002 (reducing spending by $45 billion in 2002). In this scenario, essentially all of the aggregate 1998-2002 deficit reduction would occur in the last two fiscal years.

The aviation excise taxes that had expired on December 31, 1996, were reinstated on March 7. These taxes, which were included in the President's proposals, are expected to raise a total of $2.7 billion through the remainder of fiscal 1997.

State and Local Governments

State and local spending trends remained firm in early 1997. Employment has expanded at a solid clip, rising 29,000 in January and 49,000 in February; however, the BLS suspects that some of the

OMB ESTIMATES OF THE PRESIDENT'S BUDGET PROPOSALS
(Fiscal years, billions of dollars)

	1997	1998	1999	2000	2001	2002
1. Current services deficit[1]	128	120	140	128	109	101
2. Cuts resulting from FY98 cap[2] (including debt service)	--	-5	-13	-10	-10	-10
3. Capped baseline deficit[3]	128	114	127	118	99	91
4. Basic policies (including debt service)	-2	7	-10	-30	-63	-108
5. Resulting deficit	126	121	117	87	36	-17

1. Assumes that discretionary spending grows with inflation from the 1997 level on. Based on economic projections that include the fiscal dividend.
2. Reductions in 1998 necessary to meet OBRA cap; savings thereafter from lower discretionary spending base.
3. Assumes that discretionary spending is equal to the OBRA cap in fiscal 1998 and grows with inflation thereafter.

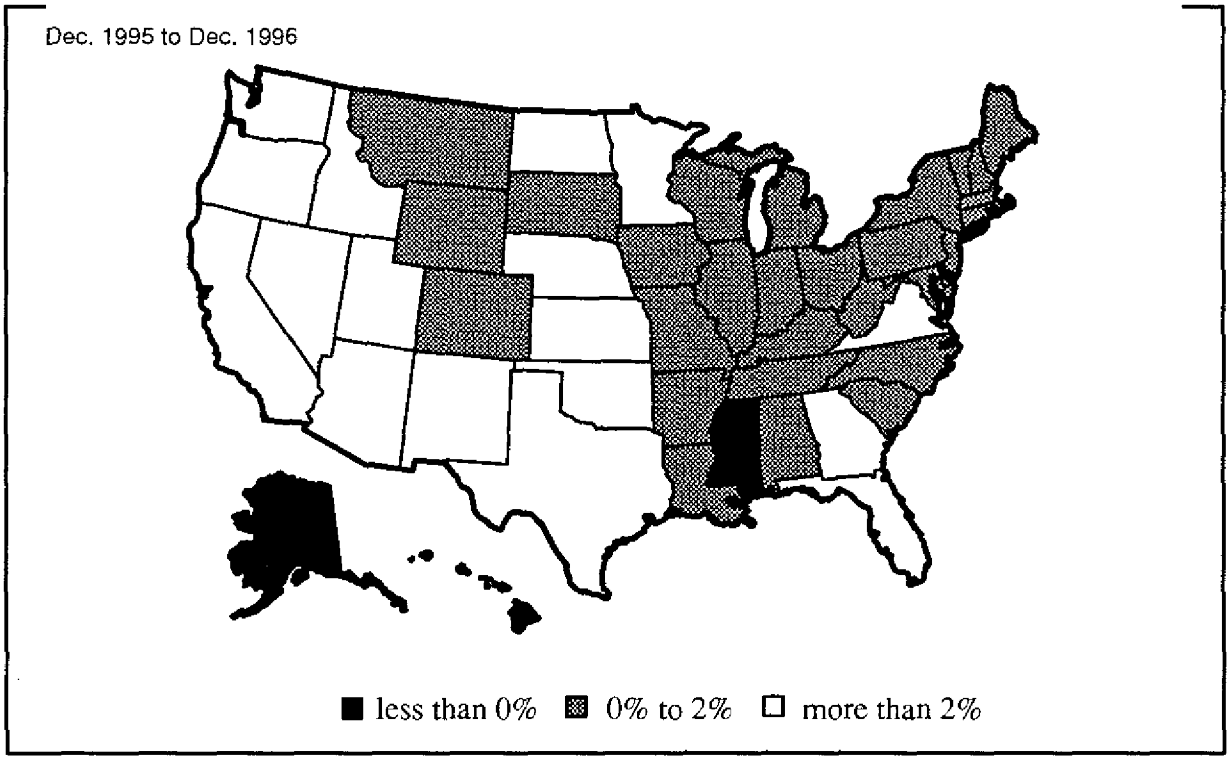
CBO ESTIMATES OF THE PRESIDENT'S BUDGET PROPOSALS
(Fiscal years, billions of dollars)

	1997	1998	1999	2000	2001	2002
1. Baseline deficit[1]	115	121	145	159	142	153
2. Basic policies	1	24	-2	-24	-47	-84
3. Deficit with basic policies	116	145	142	135	95	69
4. Alternative policies[2]	--	--	--	2	-17	-69
5. Resulting deficit[2]	116	145	142	137	78	0

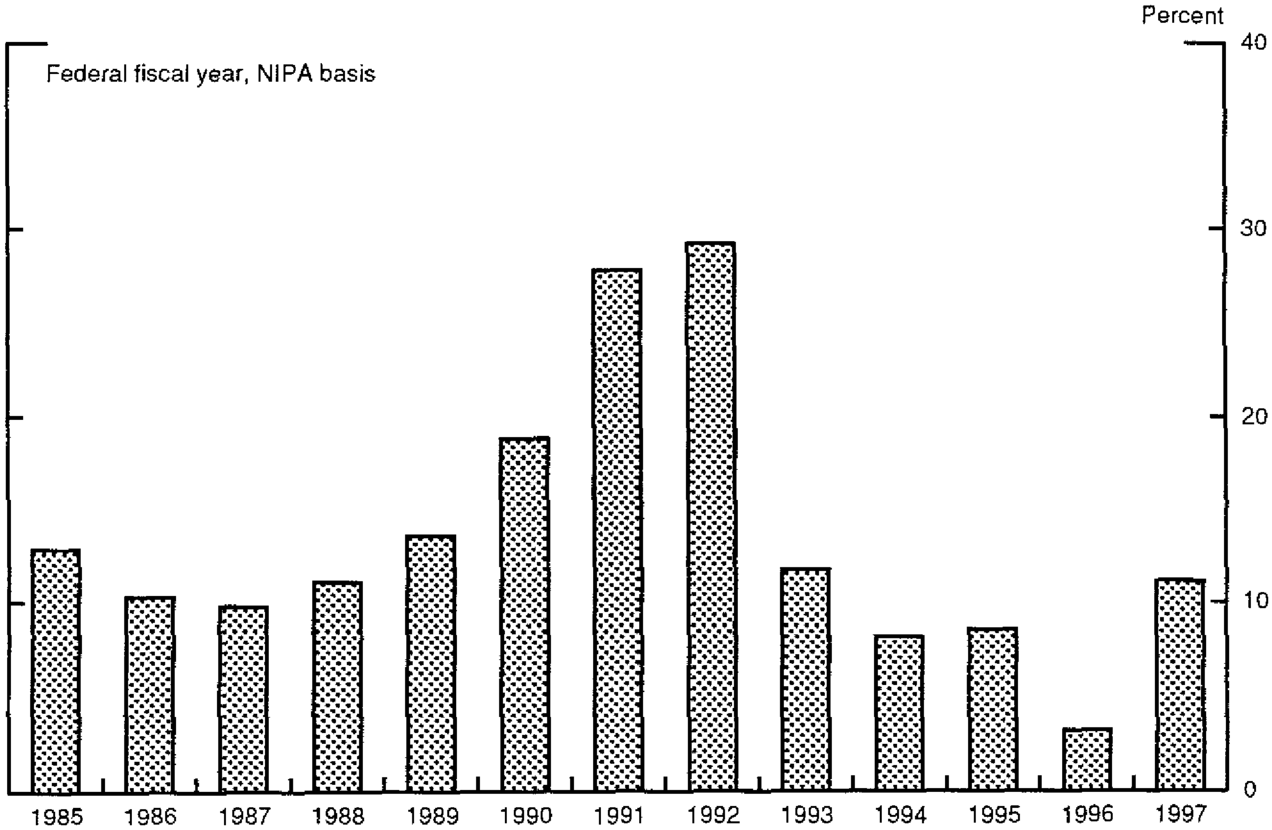
1. Assumes that discretionary spending is equal to the OBRA cap in fiscal 1998 and grows with inflation thereafter. Based on economic projections that include the fiscal dividend.
2. Deficit effects of the budget's trigger mechanism. The $2 billion increase in the deficit in 2000 reflects a revenue loss from timing effects in anticipation of the sunsetting of tax reductions.

State and Local Governments

Employment Growth by State



Growth in Medicaid Grants



Note. 1997 data are for the first four months of the fiscal year compared with the same period of the previous year.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996		1996	
	Feb. 1996	Feb. 1997	Q3	Q4	Jan.	Feb.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.7	3.0	2.3	3.1	0.1	0.3
Food (15.9)	2.3	3.8	5.6	4.7	-0.3	0.3
Energy (7.0)	1.2	7.8	-4.0	10.2	0.8	0.3
CPI less food and energy (77.0)	2.9	2.5	2.4	2.7	0.1	0.2
Commodities (23.4)	1.7	1.0	0.4	1.4	0.1	0.1
New vehicles (5.0)	2.0	1.3	2.9	0.9	-0.2	.0
Used cars (1.3)	2.7	-2.0	-2.5	-1.8	0.1	0.5
Apparel (4.8)	0.1	0.3	-3.8	2.1	0.5	0.2
House furnishings (3.3)	0.3	-0.2	-0.5	0.1	-0.4	0.2
Other Commodities (9.0)	2.7	1.9	1.8	2.2	0.1	0.1
Services (53.7)	3.4	3.1	3.6	3.1	0.1	0.3
Shelter (28.2)	3.4	3.1	3.3	2.7	0.3	0.3
Medical care (6.1)	4.1	3.0	3.1	2.9	0.2	0.2
Auto finance charges (0.6)	-6.9	1.4	9.4	-3.0	0.1	0.2
Other Services (18.8)	3.5	3.2	4.3	3.9	-0.2	0.2
PPI						
Finished goods (100.0)[2]	2.0	2.2	2.3	3.8	-0.3	-0.4
Finished consumer foods (23.6)	1.8	2.4	6.8	4.7	-1.0	-0.3
Finished energy (14.7)	1.6	9.8	1.0	18.1	-0.2	-1.2
Finished goods less food and energy (61.6)	2.1	0.5	1.0	0.2	.0	-0.1
Consumer goods (38.0)	2.3	0.6	1.0	0.5	.0	-0.1
Capital equipment (23.6)	1.7	0.3	1.0	.0	.0	-0.1
Intermediate materials (100.0)[3]	1.1	1.2	.0	1.3	0.2	-0.1
Intermediate materials less food and energy (81.2)	0.4	-0.1	-0.5	0.2	0.1	.0
Crude materials (100.0)[4]	8.3	6.3	1.8	1.8	5.2	-5.9
Crude food materials (38.9)	10.5	-3.7	10.2	-28.0	-1.0	-1.9
Crude energy (41.1)	18.8	24.2	-2.6	56.0	12.9	-12.4
Crude materials less food and energy (20.0)	-8.3	-2.5	-8.1	0.8	2.0	1.0

1. Relative importance weight for CPI, December 1996.
2. Relative importance weight for PPI, December 1996.
3. Relative importance weight for intermediate materials, December 1996.
4. Relative importance weight for crude materials, December 1996.

strength may be related to seasonal adjustment difficulties. Construction outlays were up a bit further in January; during the fourth quarter, real spending on structures, on a NIPA basis, rose at a rapid 11.6 percent annual rate. In January, a large drop in construction of sewer systems was more than offset by increases in school and highway building.

The fiscal position of most states continues to look quite strong. More than half the states are reporting that revenues have been coming in ahead of expectations; few are requesting supplemental appropriations to cover overruns, and about a third are considering tax cuts. Nonetheless, the budgetary picture in a small number of states remains tight. In particular, three states--Idaho, Hawaii, and Tennessee--report that revenues are below expectations so far this year. More generally, with Medicaid costs having picked up, many analysts caution that cost increases for health care may once again become a budget problem for the states.

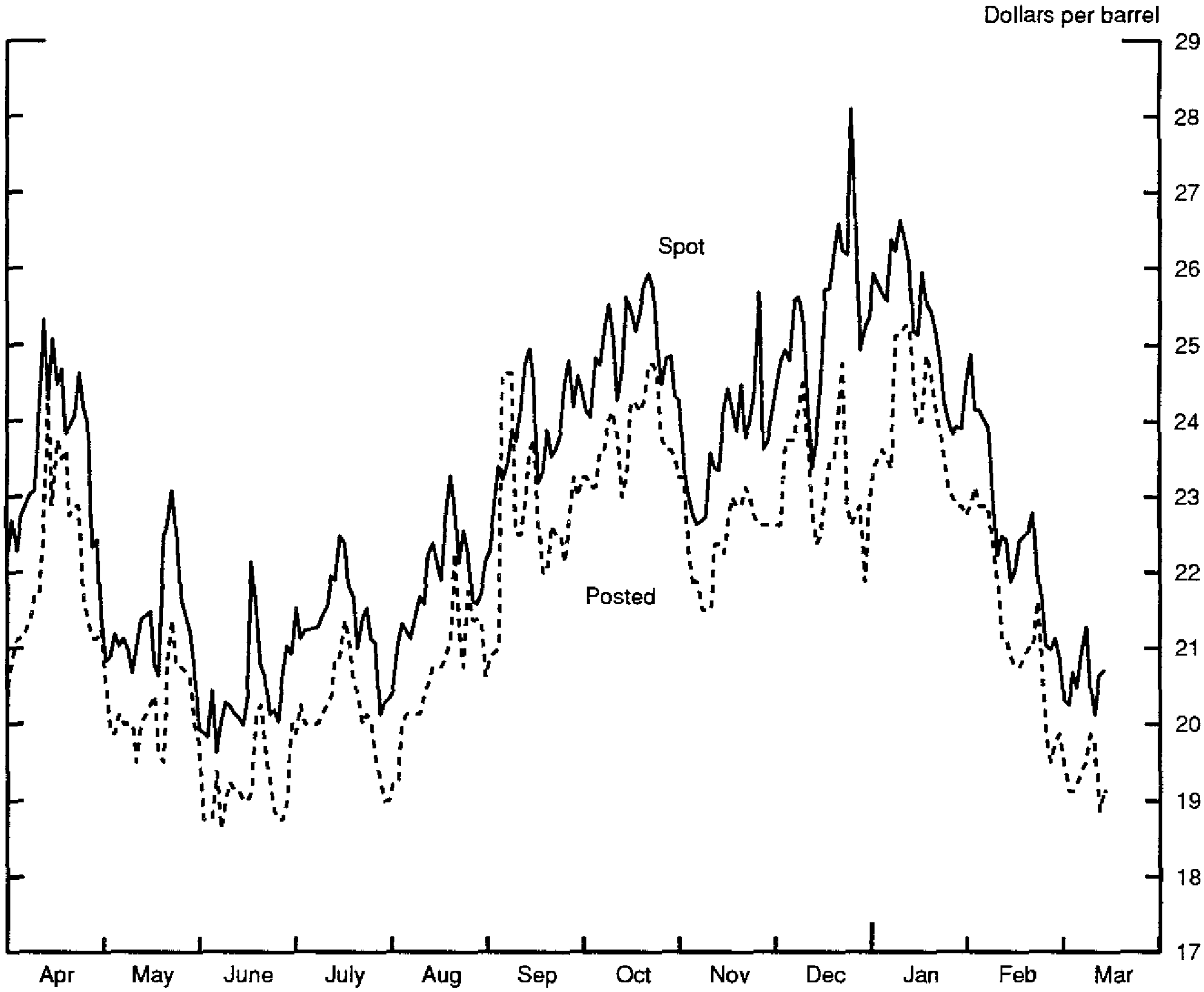
Prices and Labor Costs

Recent readings for core consumer prices extended the modest increases seen over the past year. For items other than food and energy, the CPI rose 0.2 percent in February after increasing just 0.1 percent in January. During the twelve months ended in February, the core CPI increased 2.5 percent, down from the 2.9 percent pace recorded in the year-earlier period. Within the core, the deceleration was most noticeable in the goods category, while prices of services rose only a bit less than over the previous twelve months. Among goods, prices decelerated for motor vehicles, house furnishings, and a range of other items such as personal care goods. Because many of these products are produced outside the United States, their prices can be heavily influenced by non-oil import prices, which have decelerated considerably over the past several quarters as the dollar has strengthened.[8] This constellation of developments suggests that the downswing in import prices helped restrain core consumer prices in the past year.

Consumer energy prices rose 0.3 percent further last month, a pace considerably more moderate than in the previous several months. Crude-oil prices have largely reversed last year's run-up, relieving much of the pressure on gasoline and heating oil prices. With mild weather in many parts of the country as the heating season draws to

8. During the four quarters of 1996, non-oil import prices dropped 2.8 percent--a notable turnaround from the 0.8 percent increase for 1995 and the 2.8 percent advance for 1994.

Daily Spot and Posted Prices of West Texas Intermediate



Note. Posted prices are evaluated as the mean of the range listed in the Wall Street Journal.

Monthly Average Prices of West Texas Intermediate

Month	Posted	Spot
April	22.10	23.57
May	20.12	21.26
June	19.19	20.45
July	20.11	21.32
August	20.75	21.96
September	22.94	23.99
October	23.78	24.90
November	22.40	23.71
December	23.30	25.39
January	23.89	25.17
February	21.08	22.21
March [1]	19.33	20.62

1. Through March 13, 1997.

a close, heating oil prices dropped 1.9 percent further in February. Although retail gasoline prices were unchanged in February, developments at earlier stages of processing suggest that the bad news on gasoline prices is now receding in the rear-view mirror. Similarly, although natural gas prices rose further in February, lower wellhead prices will likely ease pressure on prices paid by consumers. However, consumer electricity prices were up 0.5 percent in February after subsiding over the preceding four months.

After a couple of months of favorable news, consumer food prices turned up 0.3 percent in February as the January freeze in Florida began to push up prices of fresh fruits and vegetables. Increases in the prices of other food items appear largely to have returned to a modest trend, with a couple of exceptions. The price of raw coffee beans has surged about 50 percent since the end of December; inventories have been low for some time, and weather and other factors have caused delays in getting the harvest to market. Even with futures prices pointing down sharply over the summer, substantial increases in retail coffee prices appear to be in train for the next few months. In a more favorable development, McDonald's recently announced that it will cut the price of Big Macs to 55 cents beginning April 25 and will establish discounts on some breakfast items at the beginning of April. Because the company's domestic sales amounted to an estimated 6-1/2 percent of total food purchased in restaurants last year, these hefty price cuts could show through to the CPI for overall food.[9]

For items other than food and energy, prices were up 0.2 percent in February. Airfares dropped further, likely a result of the sale initiated by American Airlines after the pilots' strike was averted in mid-February.[10] This month, airfares may be boosted by the reinstatement of the ticket tax on March 7. However, while these excise taxes will likely be passed on to consumers in the long run, the short-run effect on airfares may be muted because prices for airline tickets are constantly changing in response to a host of other factors. Observers have noted that not all airline

9. A very rough estimate by the staff suggests that these price cuts could shave roughly 0.1 percentage point off the increase in the food price index this year.

10. Because airfares are sampled only every other month in some cities, the expiration of the airline ticket tax at the end of last year would be picked up in these cities only in February. Thus, the expiration of this tax may also have contributed to the February decline in airfares.

SPOT PRICES OF SELECTED COMMODITIES

	Current price ($)	Percent change[1]: 1995	1996	Dec. 31 to Jan. 28[2]	Jan. 28[2] to Mar. 18	Memo: Year earlier to date
Metals						
Copper (lb.)	1.170	-3.5	-18.3	8.4	.9	-4.9
Steel scrap (ton)	136.500	-6.6	-13.7	14.2	2.6	-1.8
Aluminum, London (lb.)	.730	-12.9	-9.8	6.2	.2	.3
Precious metals						
Gold (oz.)	346.300	1.7	-5.1	-4.2	-2.1	-12.4
Silver (oz.)	5.150	7.2	-8.8	4.2	3.5	-6.8
Forest products						
Lumber (m. bdft.)	376.000	-14.4	66.0	.7	-10.0	31.0
Plywood (m. sqft.)	335.000	-6.1	1.6	-3.2	9.8	14.3
Petroleum						
Crude oil (barrel)	19.070	16.8	25.9	-4.7	-15.4	-5.9
Gasoline (gal.)	.630	7.7	24.3	-2.0	-4.8	3.2
Fuel oil (gal.)	.564	22.6	16.1	-5.2	-15.5	-26.2
Livestock						
Steers (cwt.)	68.000	-5.7	.0	-1.5	4.6	13.3
Hogs (cwt.)	48.000	27.5	34.1	3.6	-15.8	-3.0
Broilers (lb.)	.543	10.7	12.4	-4.8	-8.8	6.3
U.S. farm crops						
Corn (bu.)	2.875	57.4	-29.5	4.7	7.7	-25.9
Wheat (bu.)	4.543	24.0	-16.6	.9	-1.0	-15.6
Soybeans (bu.)	8.125	29.0	-7.1	7.0	10.4	16.3
Cotton (lb.)	.707	-8.1	-10.9	.9	-1.0	-13.2
Other foodstuffs						
Coffee (lb.)	2.050	-39.1	43.2	15.1	31.0	63.0
Memo:						
JOC Industrials	108.500	-1.7	-3.7	.8	.3	-1.4
JOC Metals	100.300	-1.8	-7.7	4.5	2.7	-1.5
KR-CRB Futures	244.340	3.3	-2.6	1.7	.9	-2.2
KR-CRB Spot	340.750	-3.5	1.0	1.8	.0	3.2

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

ticket prices fell when the taxes expired at the end of last year; some airlines increased their fares when the tax cut expired. Similarly, many airlines are reported to have lowered their base (pre-tax) ticket prices following the tax reinstatement so as to reduce the impact on consumers. Outside of airfares, most items registered small price increases last month.[11]

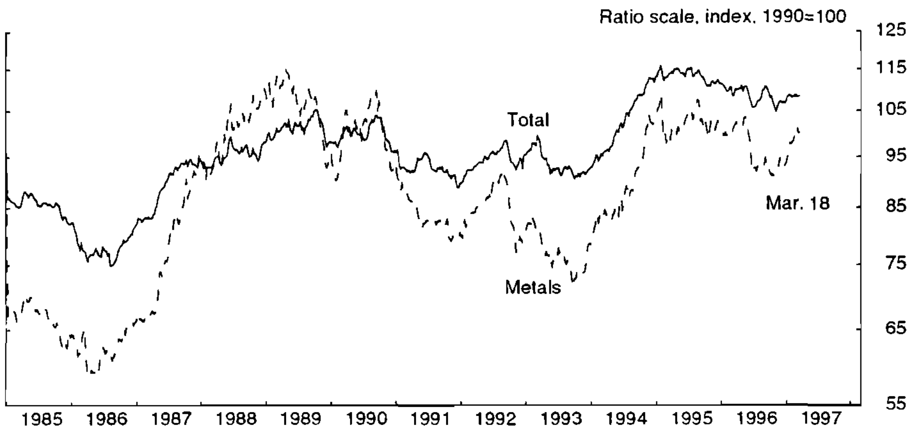
At the producer level, the recent news on finished goods prices has been quite favorable. The PPI for finished goods declined 0.4 percent in February; the index for food continued a string of monthly declines, and lower prices for crude oil fed through to a 1.2 percent decline in the index for finished energy items. Prices of finished goods excluding food and energy ticked down 0.1 percent last month, with prices decreasing for both consumer and capital goods. Among consumer goods, price declines were widespread across a range of durable and nondurable items. Within the capital goods component, computer prices posted an extraordinary plunge of 5.2 percent at a monthly rate, the largest drop since the series was added to the PPI in 1991. Over the twelve months ended in February, the core PPI rose only 0.5 percent, down from a 2.1 percent increase in the prior twelve-month period. Although the producer price index covers only domestically produced goods, prices of some of those items likely have been restrained in the past year by competitively priced imports.

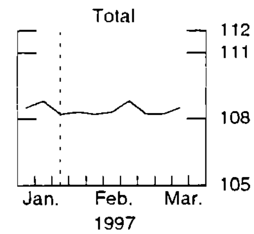
Although broad measures of prices remain relatively tame for the time being, some prices at earlier stages of processing have moved up, perhaps reflecting scattered capacity pressures. On balance, metals prices have trended up since the end of last year, with the Journal of Commerce metals index rising an additional 2.7 percent since the last Greenbook. Price increases have been sharpest for steel scrap, although copper and aluminum prices have risen as well. Moreover, the purchasing managers' index of prices paid moved up in February; more respondents reported paying higher prices for metals as well as some other items. Among other industrial materials, plywood prices have moved higher since the last Greenbook; lumber prices have eased recently but are still up significantly from their average last year. Considering basic

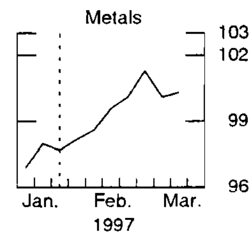
11. With the release of the January CPI, the BLS initiated new procedures for measuring hospital prices, moving in the direction of the treatment-path approach used in the PPI. On the assumption that the new CPI for hospital services moves similarly to its PPI counterpart, this shift in methodology should shave about 0.05 percentage point from the change in the CPI over 1997.

Commodity Price Measures

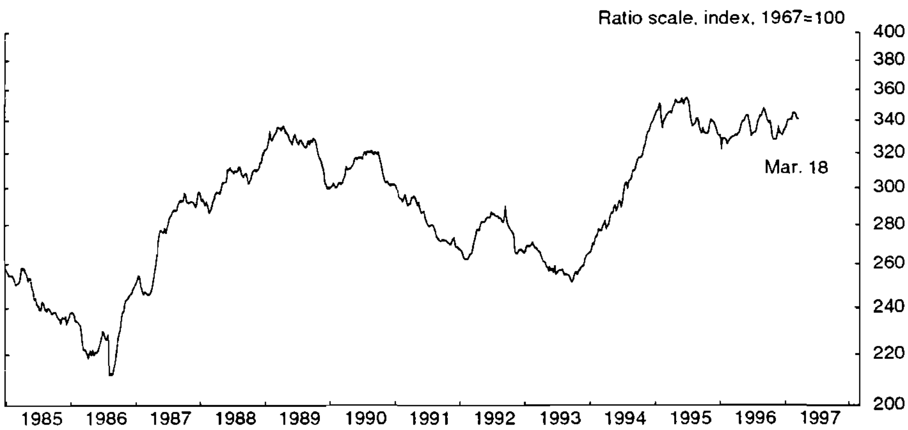
Journal of Commerce Index

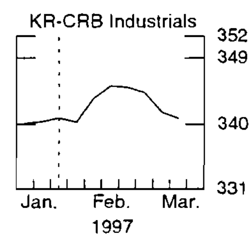




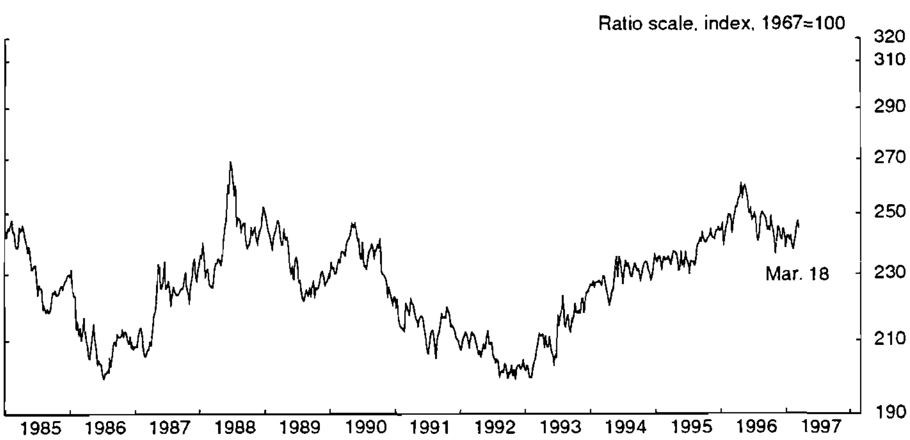


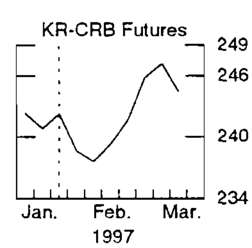
KR-CRB Spot Industrials





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.

materials prices over a longer horizon, the PPI for crude materials other than food and energy has continued to accelerate; this index has increased 3.2 percent over the past six months, compared with a decline of 5.6 percent over the preceding half-year period.

Despite assorted factors that have buffeted consumer prices, inflation expectations have continued to show no signs of picking up. Indeed, the mean expected price increase over the next year, as measured by the Michigan SRC survey, is now running lower than it was six months ago. On the other hand, median inflation expectations have been little changed.[12] Similarly, other survey measures of inflation expectations--over both short and long horizons--have remained flat or have edged off in recent months.

Turning to labor markets, employers' hourly wage costs have continued their moderate acceleration despite only small increases in January and February. Over the twelve months ended in February, average hourly earnings of production or nonsupervisory workers on nonagricultural payrolls increased 3.8 percent, up from 3.0 percent and 2.6 percent during the twelve-month periods ended in February 1996 and 1995, respectively. Compensation per hour in the nonfarm business sector--which includes estimates of nonwage benefit costs as well as wages and salaries--was up 3.6 percent at an annual rate in the fourth quarter. On a fourth-quarter over fourth-quarter basis, hourly compensation increased 3.6 percent in 1996, about the same rate of increase as in 1995.[13]

12. In recent months, the decline in mean inflation expectations relative to the median reflects drops in the inflation forecasts of survey respondents at both the upper and lower ends of the distribution.

13. In this environment of tightening labor markets, American Airlines and its pilots continue to negotiate an end to their dispute. In addition to differences in wage demands--the pilots were demanding an 11.5 percent increase over four years while the airline was offering 5 percent--the major point of contention is the company's proposal to have lower-paid pilots from a different union fly smaller jets on routes serviced by its American Eagle subsidiary. The two sides are in the middle of a sixty-day cooling-off period imposed by the President, which ends on April 16; a three-member "emergency board" is mediating the dispute. Were the pilots to strike at the end of the cooling-off period, 75,000 to 90,000 American Airlines workers would likely be put on leave without pay; a strike could also have many ripple effects on employment in regions served predominantly by American and at American's hubs.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan (1-year) Mean[2]	University of Michigan (1-year) Median[3]	Conference Board (1-year)	Professional forecasters (10-year)[4]
1995-Q1	2.8	4.1	3.1	4.2	3.3
Q2	3.1	4.1	3.1	4.2	3.4
Q3	2.6	3.9	2.9	4.0	3.2
Q4	2.7	3.6	2.8	3.9	3.0
1996-Q1	2.7	3.9	2.9	4.1	3.0
1996-Apr.	2.9	4.5	3.0	4.2	
May	2.9	4.9	3.0	4.5	
Jun	2.8	4.2	2.9	4.3	3.0
Jul	3.0	4.3	2.9	4.2	
Aug.	2.9	4.1	3.0	4.3	
Sept.	3.0	4.3	3.2	4.4	3.0
Oct.	3.0	4.2	3.0	4.3	
Nov.	3.3	4.0	3.0	4.3	
Dec.	3.3	3.9	3.0	4.1	3.0
1997-Jan.	3.0	4.1	3.0	4.3	
Feb.		3.8	3.0	4.3	
Mar.		3.3	2.9		3.0

1. CPI; percent change from the same period in the preceding year.
2. Average increase for responses to the question: By about what percent do you expect prices (CPI) to go up, on the average, during the next 12 months?
3. Median increase for responses to the question above.
4. Compiled by the Federal Reserve Bank of Philadelphia.

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

	Twelve-month percent change[1]			Percent change to Feb. 1997		1997	
	Feb. 1995	Feb. 1996	Feb. 1997	Aug. 1996	Nov. 1996	Jan.	Feb.
	-Annual rate-					-Monthly rate-	
Total private nonfarm	2.6	3.0	3.8	3.7	3.4	.2	.2
Manufacturing	2.2	2.5	3.6	2.0	2.5	.3	-.1
Contract construction	2.7	1.8	3.2	3.3	5.0	.4	.1
Transportation and public utilities	1.6	2.8	1.5	.3	1.1	1.2	-1.1
Finance, insurance, and real estate	3.7	4.2	3.7	3.9	2.5	-.4	1.1
Retail trade	2.4	3.1	4.6	4.8	3.5	.2	.2
Wholesale trade	2.8	2.8	4.6	5.2	5.0	-.6	1.0
Services	2.9	3.3	4.4	5.3	3.7	-.2	.7

1. Uses not seasonally adjusted data.

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

	1995[1]	1996[1]	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1995:Q4 to 1996:Q4
Output per hour							
Total business	-.1	1.2	2.1	1.2	.3	1.2	1.2
Nonfarm business	-.1	.9	1.9	.6	.0	1.1	.9
Manufacturing	3.7	4.2	4.3	2.1	5.9	4.4	4.2
Nonfinancial corporations[2]	1.5	ND	1.3	1.5	4.1	ND	ND
Compensation per hour							
Total business	3.7	3.7	3.2	4.3	3.8	3.7	3.7
Nonfarm business	3.7	3.6	3.4	3.9	3.3	3.6	3.6
Manufacturing	4.2	3.4	.4	5.8	4.6	2.8	3.4
Nonfinancial corporations[2]	3.5	ND	2.7	3.9	4.1	ND	ND
Unit labor costs							
Total business	3.8	2.5	1.1	3.1	3.4	2.5	2.5
Nonfarm business	3.7	2.7	1.5	3.3	3.3	2.5	2.7
Manufacturing	.5	-.8	-3.7	3.6	-1.2	-1.6	-.8
Nonfinancial corporations[2]	1.9	ND	1.5	2.4	.0	ND	ND

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

DOMESTIC FINANCIAL DEVELOPMENTS

Selected Financial Market Quotations

Instrument	1996 Feb. low	1996 July high	1996 FOMC,* Feb. 5	1997 Mar. 18	Change to Mar. 18, from: Feb. low	July high	FOMC,* Feb. 5
Short-term rates							
Federal funds[2]	5.15	5.39	5.33	5.27	.12	-.12	-.06
Treasury bills[3]							
3-month	4.76	5.21	4.97	5.11	.35	-.10	.14
6-month	4.67	5.40	5.08	5.26	.59	-.14	.18
1-year	4.55	5.64	5.25	5.45	.90	-.19	.20
Commercial paper							
1-month	5.27	5.50	5.43	5.47	.20	-.03	.04
3-month	5.12	5.59	5.44	5.52	.40	-.07	.08
Large negotiable CDs[3]							
1-month	5.21	5.44	5.32	5.40	.19	-.04	.08
3-month	5.12	5.59	5.40	5.52	.40	-.07	.12
6-month	4.99	5.83	5.50	5.65	.66	-.18	.15
Eurodollar deposits[4]							
1-month	5.13	5.38	5.31	5.38	.25	.00	.07
3-month	5.13	5.56	5.41	5.50	.37	-.06	.09
Bank prime rate	8.25	8.25	8.25	8.25	.00	.00	.00
Intermediate- and Long-term Rates							
U.S. Treasury (constant maturity)							
3-year	4.98	6.62	6.02	6.38	1.40	-.24	.36
10-year	5.58	7.06	6.45	6.72	1.14	-.34	.27
30-year	6.02	7.19	6.72	6.96	.94	-.23	.24
U.S. Treasury indexed bond	n.a.	n.a.	3.33	3.45	n.a.	n.a.	.12
Municipal revenue (Bond Buyer)[5]	5.67	6.24	6.02	6.02	.35	-.22	.00
Corporate-A utility, recently offered	7.18	8.23	7.92	8.11	.93	-.12	.19
High-yield corporate[6]	9.57	10.36	9.71	9.59	.02	-.77	-.12
Home mortgages[7]							
FHLMC 30-yr fixed rate	6.94	8.42	7.88	7.84	.90	-.58	-.04
FHLMC 1-yr adjustable rate	5.19	6.01	5.55	5.61	.42	-.40	.06

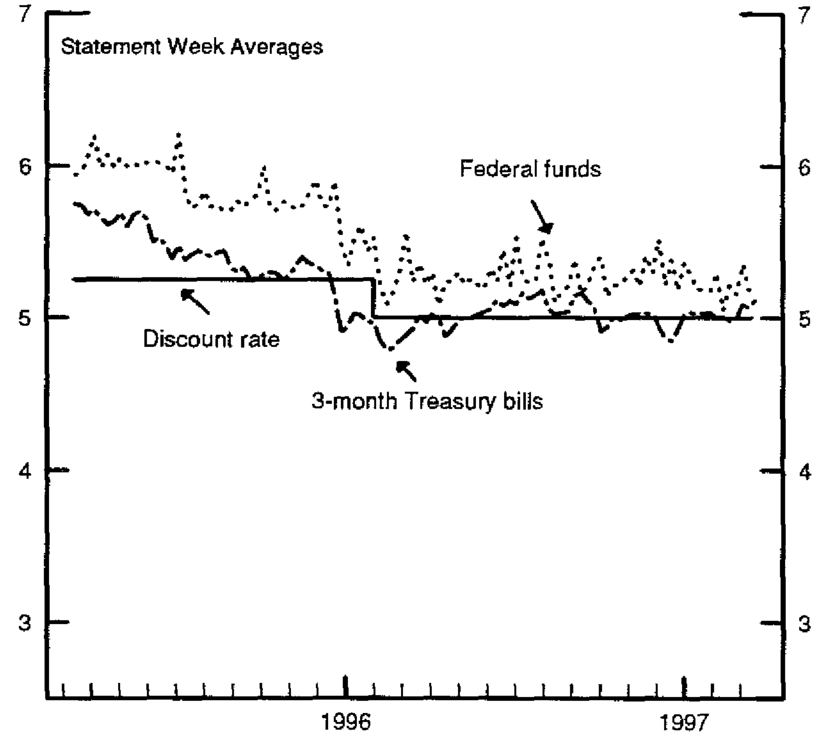
Stock exchange index	Record high Level	Record high Date	1996 July low	1996 FOMC,* Feb. 5	1997 Mar. 18	Percentage change to Mar. 18, from: Record high	July low	FOMC,* Feb. 5
Dow-Jones Industrial	7085.16	3/11/97	5346.55	6833.48	6896.56	-2.66	28.99	.92
S&P 500 Composite	816.29	2/18/97	626.65	789.26	789.66	-3.26	26.01	.05
NASDAQ (OTC)	1388.06	1/22/97	1042.37	1373.75	1269.34	-8.55	21.77	-7.60
Russell 2000	370.65	1/22/97	307.78	368.32	354.93	-.68	19.61	-3.64
Wilshire	7792.57	2/18/97	6099.34	7592.64	7517.90	-3.52	23.26	-.98

1. One-day quotes except as noted.
2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average to date for maintenance period ending March 26, 1997.
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.

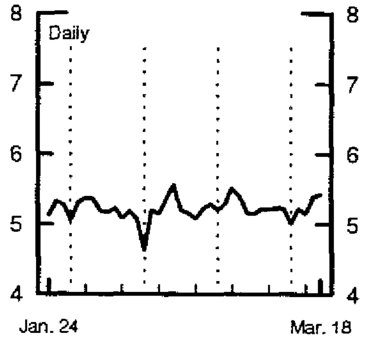
* Figures cited are as of the close on February 4.

Selected Financial Market Data

Selected Short-Term Interest Rates

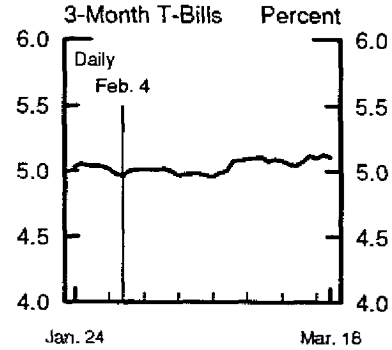


Federal Funds*

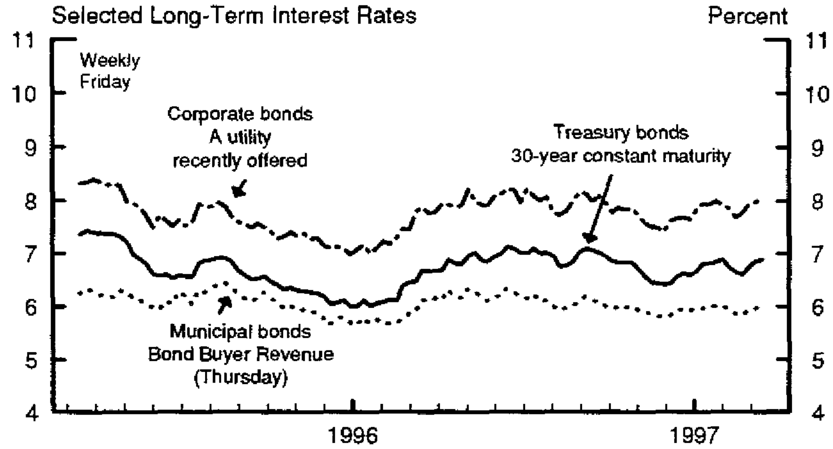


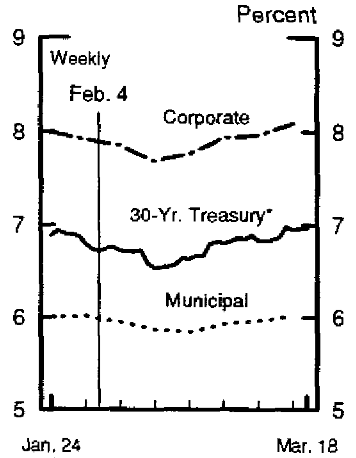
*Vertical lines indicate end of reserve period.

3-Month T-Bills



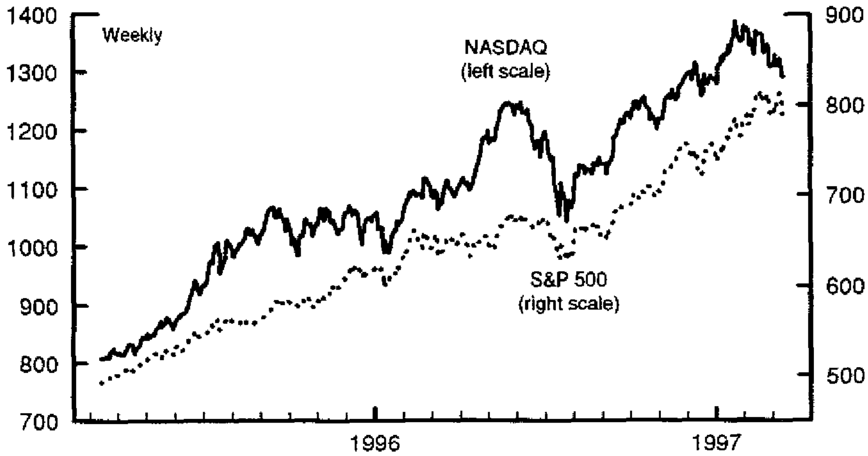
Selected Long-Term Interest Rates

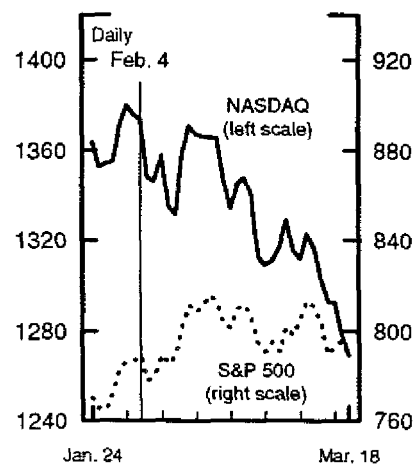




*Daily frequency.

Selected Stock Indexes





BAMMA:kmd

Interest rates have increased since the February FOMC meeting, responding to both economic news and the Chairman's Humphrey-Hawkins testimony. In the opening weeks of the intermeeting period, market participants generally interpreted incoming data as implying subdued inflation and reduced odds of Federal Reserve tightening (chart, top panel). However, rates rose markedly after the Humphrey-Hawkins testimony, in which the Federal Reserve was seen as more concerned about potential inflation and more willing to take preemptive action to restrain it than markets had thought. Against this background, rates also increased after the March 13 report on retail sales, which seemed to provide some rationale for a policy tightening, but then eased slightly on the release of favorable February data for producer prices. On balance, Treasury bill rates have moved up 15 to 20 basis points, and longer-term yields 25 to 35 basis points. Current quotes on short-term interest rate futures suggest that, allowing for liquidity premiums, the market places the odds of a 25 basis point System tightening at about 50 percent in March and roughly 70 percent by May (bottom panel).

With interest rates rising, stock prices flattened out or turned down over the intermeeting period. The S&P 500 index was essentially unchanged, and the NASDAQ and Russell 2000 indexes fell 7-1/2 percent and 3-1/2 percent respectively. Nevertheless, price-earnings ratios remain generally quite high.

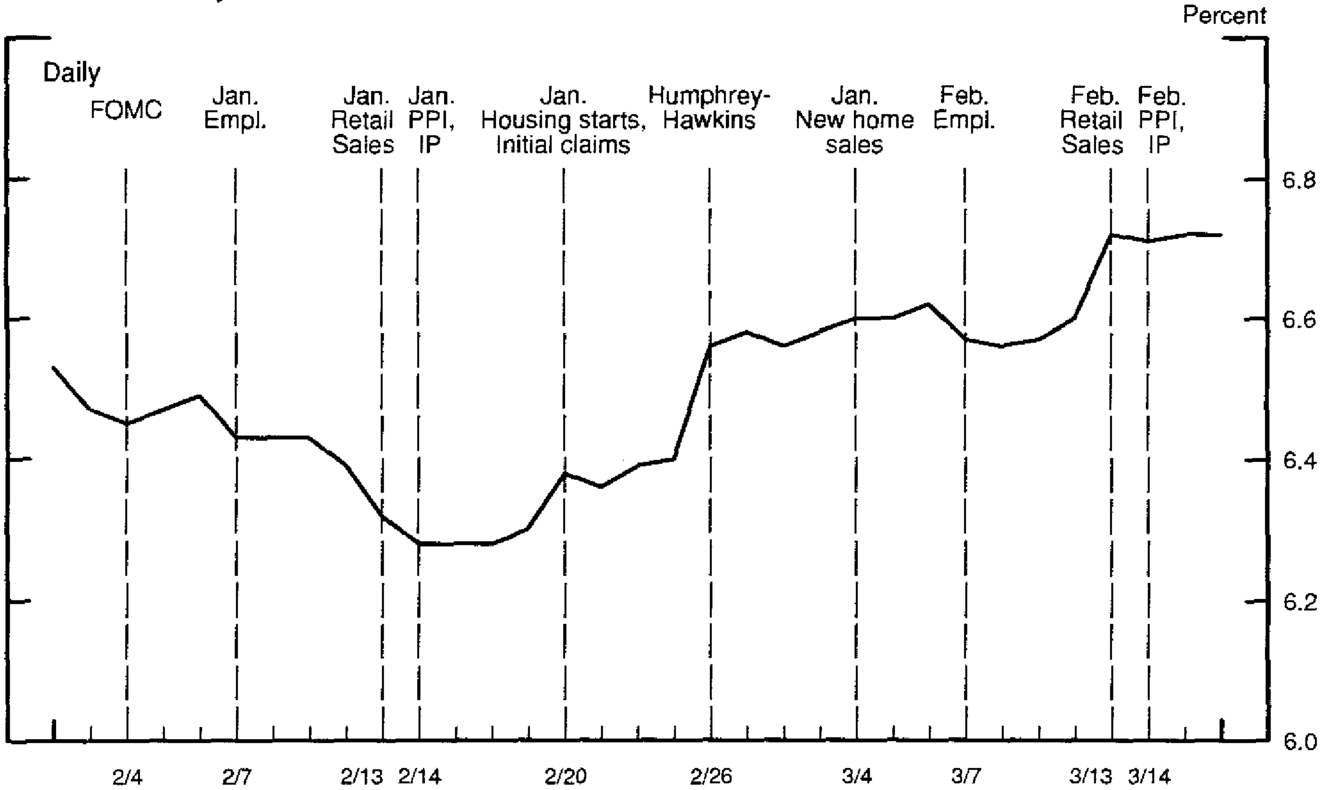
Private debt growth appears to have stepped up a bit in the first quarter from its fourth-quarter pace. Borrowing by nonfinancial corporations, in particular, seems to have strengthened. Commercial paper issuance has turned positive on net, C&I bank loans have grown briskly, and bond offerings have remained close to the fourth-quarter average. Meanwhile, preliminary data suggest that household borrowing may have ticked up in the first quarter. In contrast, government debt issuance weakened in the early part of the year, with federal debt growth slowing further and state and local government debt flattening out.

Business Finance

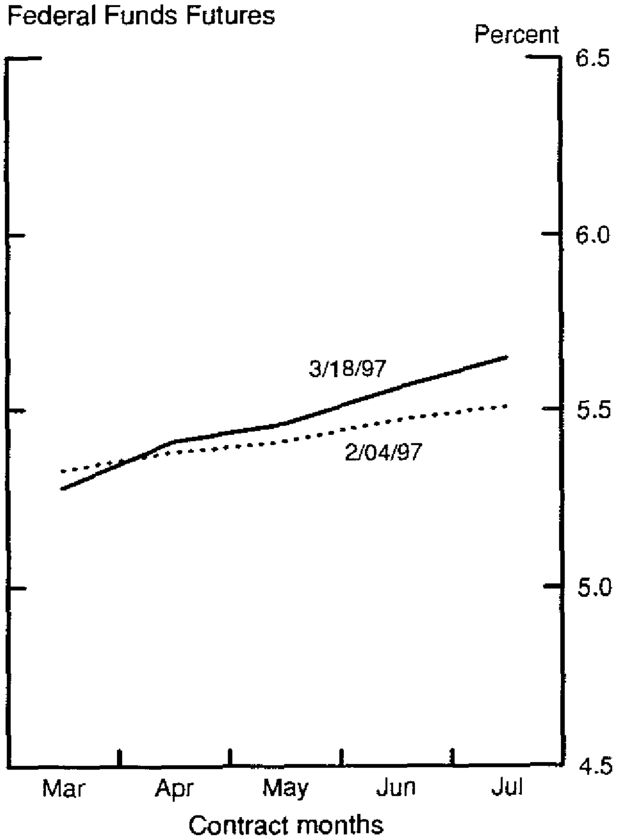
Business activity in credit markets has been strong in the first quarter. Gross bond issuance by nonfinancial corporations in January and February was close to the fourth-quarter pace (table). The run-up in interest rates since December apparently damped sales

Selected Short-Term Futures Rates and Treasury Yields

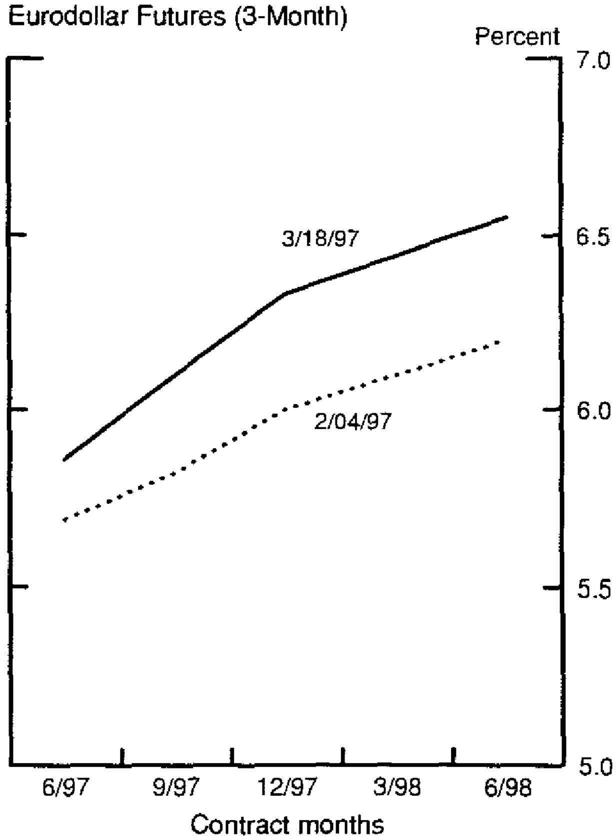
Ten-Year Treasury Yield



Federal Funds Futures



Eurodollar Futures (3-Month)



SMT:kmd

of investment-grade bonds, but offerings of speculative-grade bonds have been brisk. Fully a third of the nonfinancial bonds issued in the first two months of the year were rated B or lower (lower left panel). Despite the heavy issuance of junk bonds, spreads between their rates and Treasury yields have continued to narrow and are now at their lowest point since data collection began in the mid-1980s. The market has been supported by sizable flows into junk-bond mutual funds, as investors appear to have less concern about credit risk.

Among the new investment-grade issues by nonfinancial companies were a few 100-year bonds. Although the yields on "century" bonds are somewhat higher than other long-term yields, companies believe that these bonds can lower their overall borrowing costs by raising their profile among investors. However, sales of these bonds may soon come to a halt because of the President's proposal to eliminate the tax deductibility of interest paid on bonds of such long maturity.[1]

The flattening of the yield curve in late 1996 encouraged companies to pay down commercial paper by selling bonds, but the recent backup in long rates has stemmed this practice. As a consequence, nonfinancial commercial paper outstanding has risen moderately this quarter after contracting sharply in the fourth quarter of last year (lower right panel). Quality spreads on commercial paper have been largely unaffected by the default of Mercury Finance, a subprime auto lender.

Corporate credit quality remains quite good overall. Moody's downgraded slightly more nonfinancial debt in January and February than it upgraded, but the largest downgrade (of $6 billion of JC Penney bonds) was related to a merger that many analysts believe will prove to be successful. Moreover, possible upgrades exceed downgrades on Moody's Watchlist, both by number and volume, and the default rate on speculative-grade debt so far this year has trailed last year's already low pace. In contrast, business failures appear to have picked up appreciably in December and January, although the figures are preliminary and subject to possibly large revisions.

1. Another recent innovation in capital markets was the issuance of inflation-indexed securities by several financial corporations shortly after the first Treasury auction of indexed government debt. However, these companies quickly swapped the debt with dealers, who have been unable so far to find counterparties interested in bearing the inflation risk. Instead, the dealers have purchased inflation-indexed Treasury bonds to hedge their positions.

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

Type of security	1995	1996	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.	1997 Feb.
All U.S. corporations	47.7	58.5	50.8	60.2	53.7	56.5	48.6
Stocks[1]	6.1	10.3	7.0	13.0	12.0	12.3	8.0
Bonds	41.6	48.2	43.8	47.3	41.8	44.2	40.6
Nonfinancial corporations							
Stocks[1]	4.4	6.8	4.8	6.3	4.2	4.6	5.7
Initial public offerings	1.7	2.9	2.0	2.8	1.5	.6	1.8
Seasoned offerings	2.7	4.0	2.8	3.6	2.7	4.0	3.8
Bonds	10.8	12.5	0.4	13.6	10.8	12.0	4.2
By rating, bonds sold in U.S.[2]							
Investment grade	6.5	6.3	5.4	7.6	7.3	6.1	6.7
Speculative grade	3.0	4.8	3.6	4.9	3.0	4.3	6.5
Public	2.0	2.3	1.8	1.4	.8	3.2	1.4
Rule 144A	1.1	2.5	1.8	3.5	2.2	1.0	5.1
Financial corporations							
Stocks[1]	1.7	3.5	2.2	6.6	7.7	7.7	2.4
Bonds	30.8	35.7	33.4	33.7	31.0	32.2	26.4

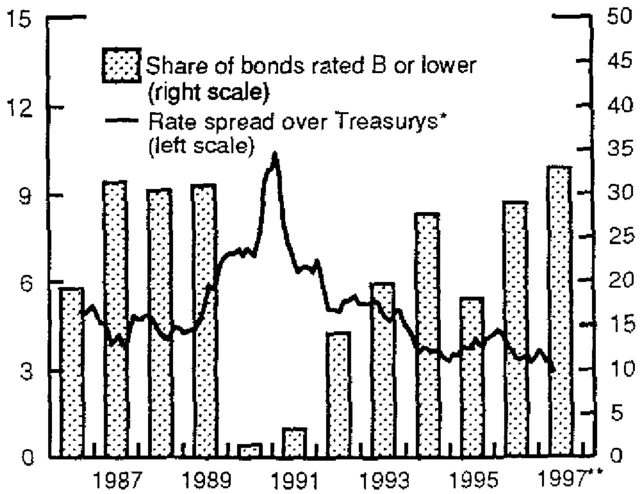
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.

2. 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.

Nonfinancial Corporations

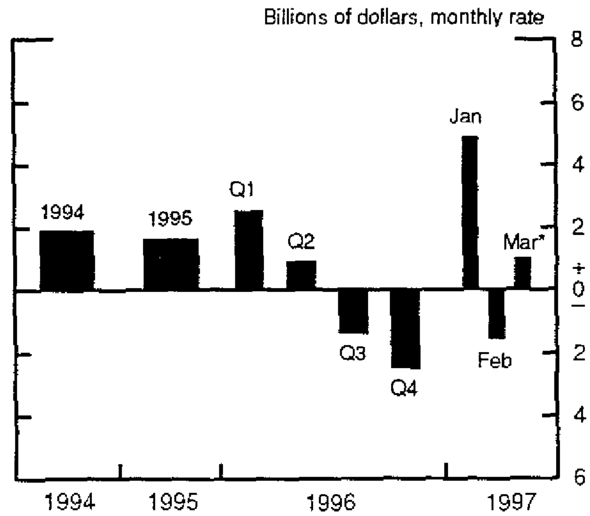
Junk Bonds



*Merrill Lynch Master II Index less 7-year Treasury yield.
**January and February

Net Commercial Paper Issuance

(Change in outstandings over period shown)



*Staff estimate

Moving beyond the securities markets, businesses have acquired substantial new funds through bank loans in the first quarter. Commercial and industrial loans at banks increased about 11 percent on average in January and February, slightly below the fourth-quarter increase but above the growth rate for 1996 as a whole.

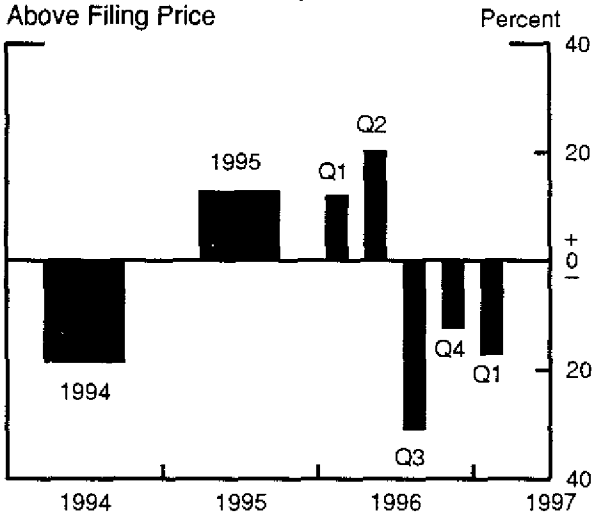
The pace of new equity offerings in January and February fell back from the fourth-quarter rate, with the decline attributable entirely to a drop in initial public offerings. Registrations of prospective IPOs have edged off as well. The IPO market has cooled substantially, with new issues being priced below the intended range more often than above it and first-day trading returns down sharply from last year (top panel). Nonfinancial corporations have continued to retire equity on net since year-end. Merger-related retirements alone in January and February, at $10.5 billion, equaled gross issuance. Data on completed share repurchases are available only through the third quarter of last year; however, announcements of new repurchase programs have moved up from last year's already high level.

Stock prices have slipped a little, on balance, since the last FOMC meeting, but valuations generally remain rich by historical standards. For the S&P 500, the ratio of expected twelve-month-ahead earnings to price is low relative to the thirty-year Treasury yield (middle panel). Stock prices have been buoyed by expectations of long-term nominal earnings growth that are above their peak in the early 1990s and have been revised higher in recent months (bottom left panel). The run-up in expected earnings growth is even more dramatic in real terms because long-term inflation expectations (for example, as measured in the Philadelphia Fed survey) seem to have declined about half a percentage point in the past few years. Part of the explanation for this favorable outlook may be the surge in profits from overseas operations since late 1994: Analysts' earnings projections for S&P 500 firms with significant foreign operations exceed expectations for other firms in the S&P 500, and the gap has widened noticeably over the past two years (bottom right panel).

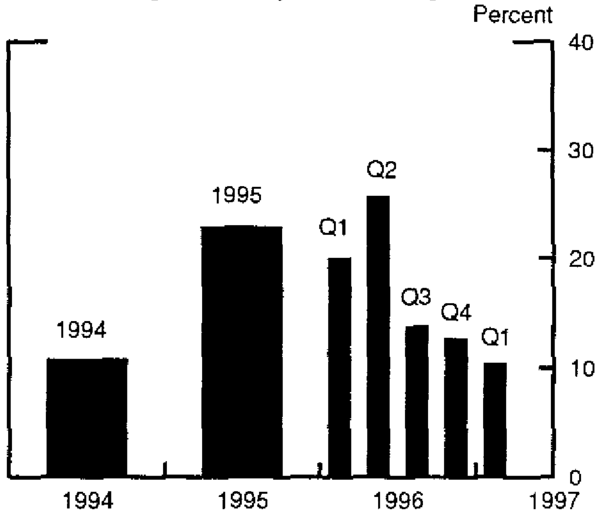
The markets for commercial real estate and commercial mortgages continue to be strong. In the January FDIC survey of federal examiners and asset managers, significantly more respondents reported increases in demand for new office space than reported decreases, compared with three months earlier (top left panel).

Stock Market and Earnings Expectations

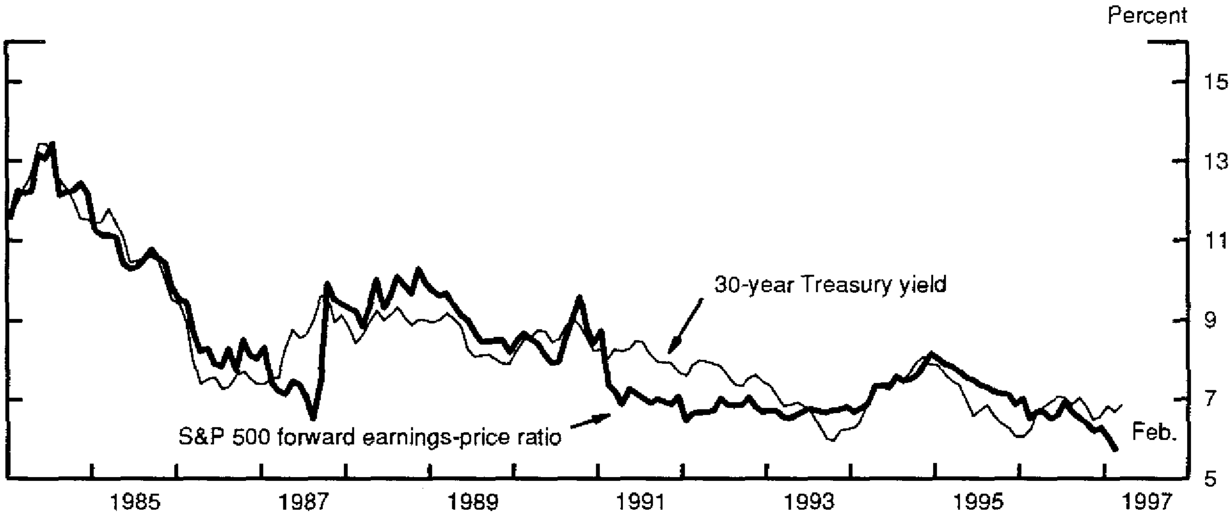
Net Percent of IPOs Completed Above Filing Price



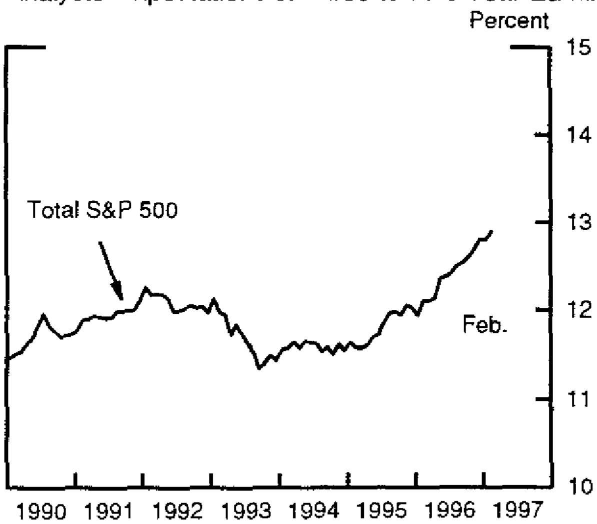
IPOs: Average First-Day Price Change

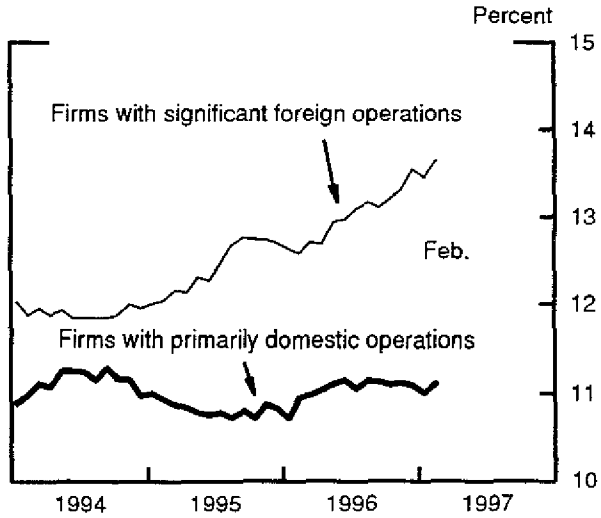


Stock Valuations



Analysts' Expectations of Three-to-Five Year Earnings Growth for S&P 500 Firms

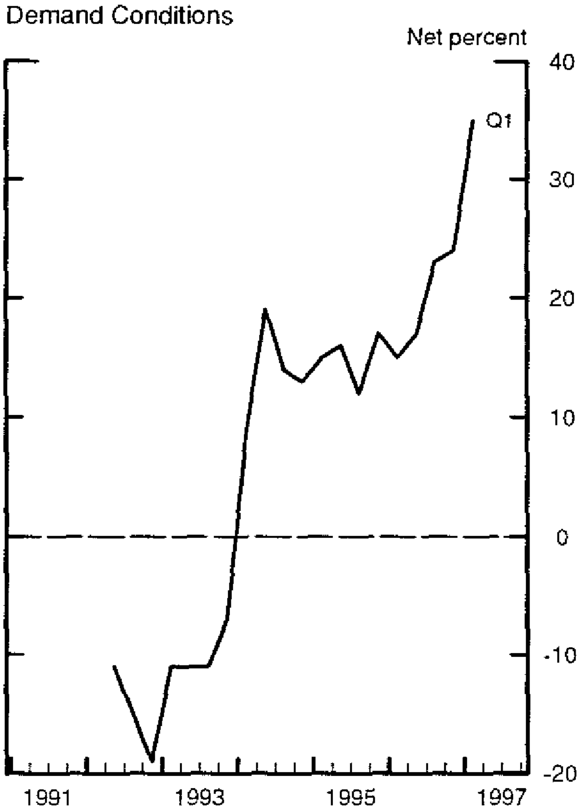




Source. I/B/E/S.

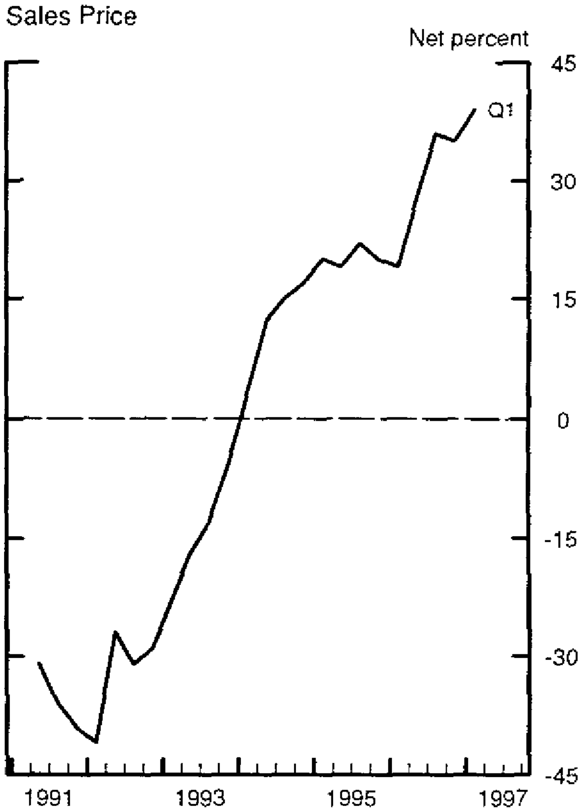
Commercial Real Estate Trends

Demand Conditions



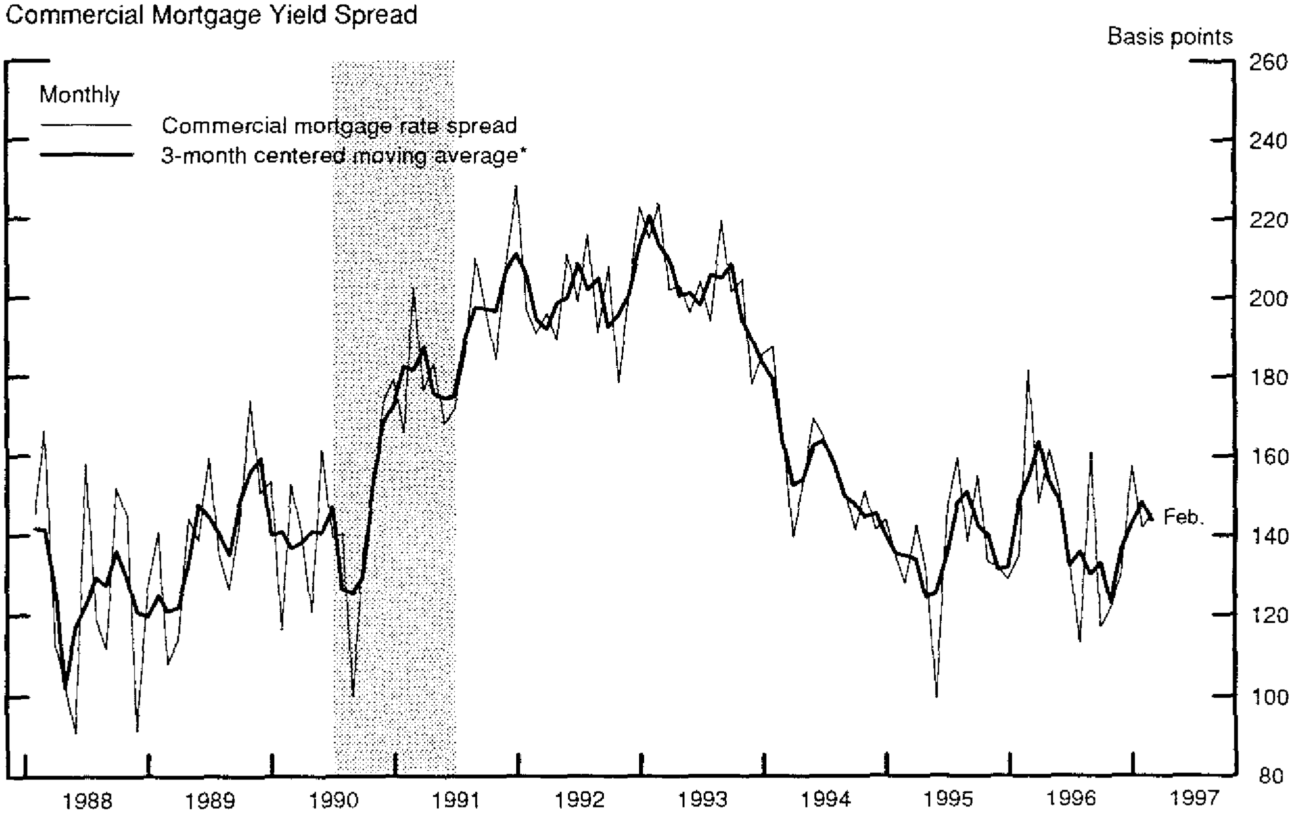
Note. Percent reporting greater demand less percent reporting less demand.
Source. Federal Deposit Insurance Corporation.

Sales Price



Note. Percent reporting higher prices less percent reporting lower prices.
Source. Federal Deposit Insurance Corporation.

Commercial Mortgage Yield Spread



Note. Barron's/Levy Commercial Mortgage Rate less 10-year Treasury yield.
*Last value equals average of current and previous months' observations.

Consumer Credit

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1996 Nov	1996 Dec	1997 Jan[p]
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.2	8.3	7.7	8.1	5.4	4.9	3.9	8.4
Auto	10.6	7.6	10.2	7.4	3.1	-0.4	2.2	3.8
Revolving	22.0	11.7	13.1	7.4	7.6	10.6	5.2	20.6
Other	9.2	4.8	-1.7	9.9	5.1	3.2	3.9	-2.6
Levels (billions of dollars, SA)								
Total	1103.3	1194.6	1155.1	1178.6	1194.6	1190.8	1194.6	1203.0
Auto	350.8	377.3	367.7	374.5	377.3	376.7	377.3	378.6
Revolving	413.9	462.4	445.4	453.7	462.4	460.4	462.4	470.3
Other	338.6	354.8	341.9	350.4	354.8	353.7	354.8	354.1
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	8.9	9.1	9.0	9.0	n.a.	8.9[5]
Personal (24 mo.)[2]	13.9	13.5	13.5	13.4	13.6	13.6	n.a.	13.5[5]
Credit cards[3]	16.0	15.6	15.4	15.7	15.6	15.6	n.a.	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	9.5	10.3	9.8	10.3	8.6	7.2
Used cars	14.5	13.5	13.5	13.9	13.6	13.6	13.4	12.9

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 period.
4. Average rate for all loans of each type, regardless of maturity, made during the period.
5. Data are for the first full week of February.
p Preliminary. n.a. Not available.

There was also a wider gap between the percentage of respondents reporting increases in prices and the percentage reporting decreases (top right panel). Meanwhile, the Barron's/Levy February survey of primary commercial mortgage lenders indicated that interest rate spreads on ten-year mortgages remained in the relatively favorable range that has prevailed over the past few years (bottom panel). In addition, spreads on commercial-mortgage-backed securities (CMBSs) have slipped to historically narrow levels.

Over the past two years, outstanding commercial mortgage credit has grown very rapidly, with net lending increasing from close to zero in 1994 to $35 billion in 1995 and $61 billion in 1996. The surge of lending activity reflects stronger nonresidential construction, a greater willingness to lend, and reduced loan chargeoffs. Gross issuance of CMBSs soared in 1996, raising the securitized share of commercial mortgage originations to about 55 percent. These securities are being purchased by insurance companies and mutual funds, among other investors.

Household Finance

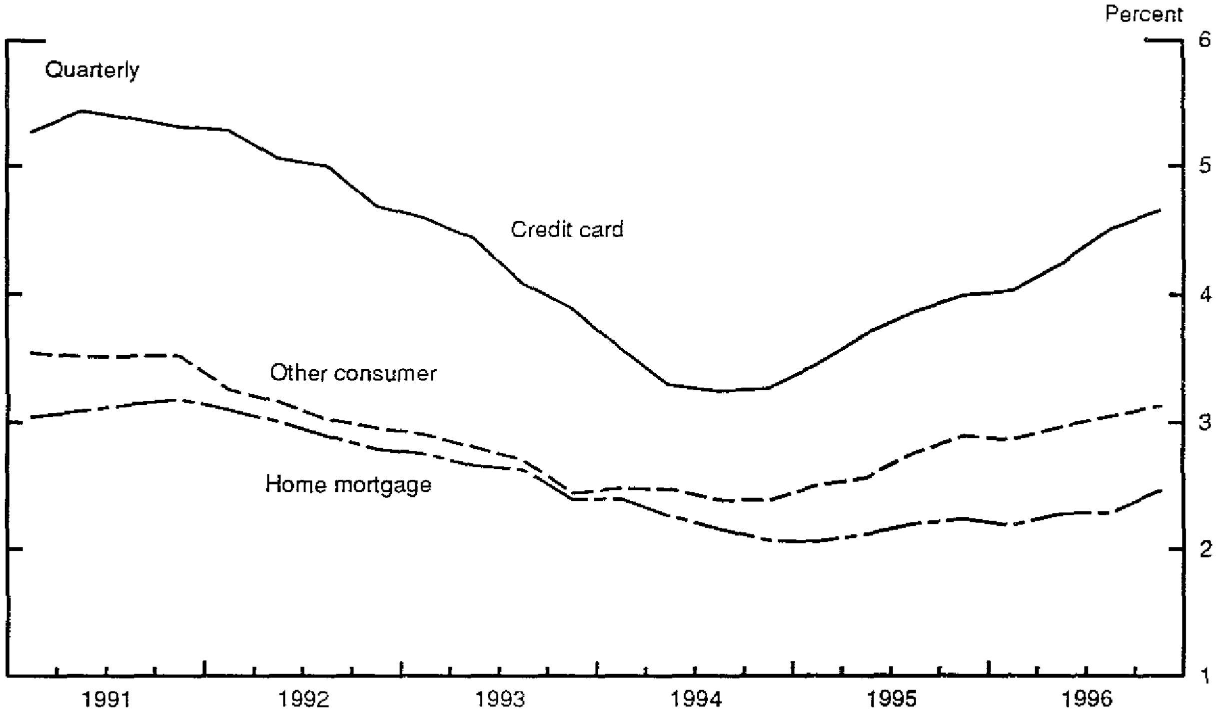
The growth of household debt appears to have edged above the fourth-quarter rate. Fragmentary data for home-mortgage borrowing--including the Mortgage Bankers Association index of mortgage applications to purchase homes--indicate a fairly steady expansion. Consumer credit growth picked up in January, although a slowing in lending at banks (adjusted for securitization) in February suggests some subsequent easing in overall consumer credit growth.

The January rebound in consumer credit was driven by a jump in revolving credit (table). However, swings in this category are especially large during the holiday season, so seasonally adjusted growth rates are very sensitive to small variations in the pattern of monthly charge volume or repayments. Averaging growth rates for November through January, revolving credit expanded about 12 percent at an annual rate, approximately the same as for 1996 as a whole.

Firms specializing in subprime auto loans have encountered troubles of late. Intense competition has led to some erosion of credit standards and smaller margins, which have reduced profits and resulted in acute liquidity problems for some subprime specialists. The difficulties of Mercury Finance and Jayhawk Acceptance have received the most publicity. After Mercury announced that "accounting irregularities" had inflated the firm's profits for the past few years, rating agencies downgraded the company's debt,

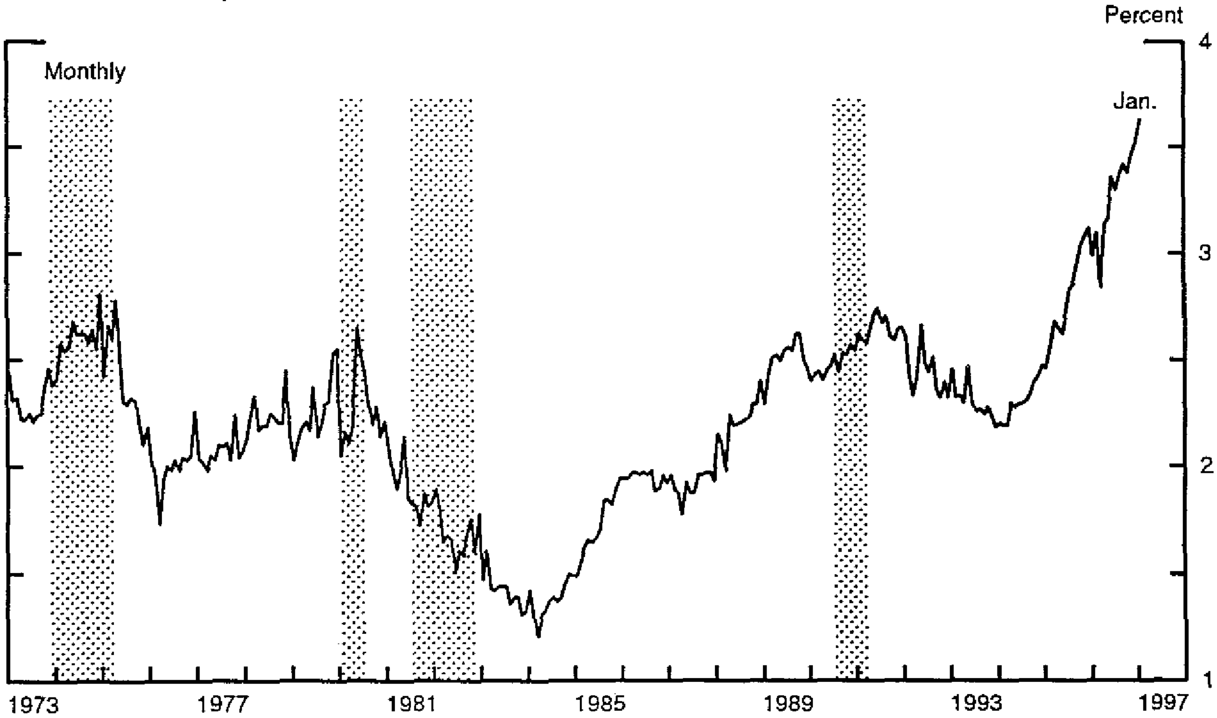
Household Sector Loan Delinquency Rates

Commercial Banks



Source. Call report.

Auto Finance Companies



leaving it unable to sell new commercial paper to repay maturing paper and forcing it to default. Mercury recently won a loan extension from Bank of America through early June, which will allow it to continue operations and look for long-term financing. Jayhawk reported a fourth-quarter loss related to substantially increased provisions for loan write-offs, which placed the company in violation of bank loan covenants and prompted it to file for bankruptcy.

The problems of subprime auto lenders have been concentrated in firms that focus on the highest-risk category of subprime debt, which accounts for less than 10 percent of all subprime auto debt and a minuscule share of total auto loans. In consequence, these problems have had little impact on the availability or terms of credit in the broader market for auto credit. New- and used-car loan rates at the three captive auto finance companies in January averaged well below their fourth-quarter values, while maturities and loan-to-value ratios were in line with recent experience.[2] The average new-car loan rate at banks in early February was marginally below its level last fall.

Household loan delinquency rates deteriorated somewhat further in the fourth quarter of last year and the beginning of 1997 (chart). According to the Call Report, delinquency rates at commercial banks increased in the fourth quarter for residential real estate loans, credit cards, and other consumer loans. The American Bankers Association series for delinquencies on credit cards and other consumer loans also moved up. Moreover, the average delinquency rate on loans at captive auto finance companies continued to trend upward in early 1997, reaching another new high at 3.6 percent in January (chart). Contacts at these companies have said that the recent uptrend in delinquencies had been anticipated and in part reflected earlier efforts to stimulate sales by making credit more broadly available.[3]

The uptrend in credit card delinquencies and chargeoffs has significantly affected some issuers' profitability and has also led

2. The steep drop in the interest rate for new cars partly reflects deeply discounted rates at GMAC subsidized by the parent company.

3. The delinquency rate also has been boosted somewhat--perhaps 0.10 to 0.20 percentage point in the past few years--by the shift toward leasing from loans. (Leases are not included in the auto loan delinquency rate.) Lease customers have tended to be better credit risks on average, so their withdrawal from the loan market has left a somewhat-higher-risk customer base for loans.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q3	1996 Q4	1997 Q1[p]	1997 Jan.	1997 Feb.[e]	1997 Mar.[p]
Total surplus/deficit (-)	-33.0	-59.3	-69.9	13.4	-50.7	-32.5
Means of financing deficit						
Net cash borrowing and repayments (-)	39.4	48.7	45.5	-16.8	36.2	26.0
Nonmarketable	-1.0	7.4	4.1	1.5	0.2	2.5
Marketable	40.3	41.3	41.4	-18.2	36.0	23.5
Bills	-12.4	16.2	5.0	-14.8	-0.4	20.2
Coupons	52.7	25.1	36.3	-3.4	36.4	3.3
Decrease in cash balance	-6.2	11.4	14.3	-3.8	21.4	-3.3
Other[1]	-0.2	-0.8	10.1	7.2	-6.8	9.7
Memo:						
Cash balance, end of period	44.2	32.8	18.5	36.6	15.2	18.5

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.
e Estimate.
p Projection.

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

Agency	1996 Q3	1996 Q4	1996 Nov.	1996 Dec.	1997 Jan.
FHLBs	5.7	8.5	-1.0	10.5	-6.3
FHLMC	3.6	10.0	9.7	-1.2	6.2
FNMA	10.8	12.1	3.3	6.9	2.0
Farm Credit Banks	-2.1	-0.1	0.1	0.3	7.6
SLMA	0.2	-0.2	-0.2	-2.2	n.a.

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

to tighter lending standards at many banks. Advanta Corporation, a large "monoline" credit card issuer, announced this week that it anticipated a substantial first-quarter loss. But industry contacts have suggested that Advanta was late in addressing its more serious problem areas and has just begun to take steps that many card issuers had initiated as early as last spring. Consequently, these contacts expect other issuers to report better earnings than Advanta's and to have less need for additional restrictive measures.[4] Indeed, the most recent Senior Loan Officer Opinion Survey showed a smaller share of banks tightening credit card standards in February than last November.

Treasury and Agency Finance

We anticipate that the first-quarter federal budget deficit will be somewhat larger than in the previous quarter. This increase will be financed by a larger drawdown of cash balances and some quirks in the government's cash flow, leaving borrowing from the public little changed at about $45 billion (table).[5] However, the composition of marketable borrowing will be substantially different from that in the fourth quarter, with a sharp decline in bills offsetting a pickup in coupon issuance.

Since the February FOMC meeting, interest rates on inflation-indexed Treasury securities have generally moved with nominal rates, but they have been decidedly less volatile. The spread between the two rates has widened about 15 basis points over the period. This pattern is consistent with an increase in expected inflation or greater uncertainty about future inflation, as well as some backup in real rates, but the thinness of the market--in terms of both amount outstanding and trading volume as a share of that amount--argues for caution in interpreting the relative rate movements.

Federally sponsored agencies have been active borrowers of late. Fannie Mae, the Federal Home Loan Banks, and the Federal Home

4. The magnitude of Advanta's expected loss surprised some investors: In the two days after the announcement, its stock price dropped nearly 25 percent. The share prices of other credit card specialists also declined, but by less than 5 percent. The rating agencies downgraded some of Advanta's debt obligations, but its asset-backed issues retained their triple-A ratings, reflecting the substantial investor protections provided by the spread accounts and other enhancements.

5. These quirks include a drop in student loan disbursements (which affect required borrowing dollar-for-dollar but change the deficit only by the expected present value of the loss on the loans) and various smaller factors.

Loan Mortgage Corporation (Freddie Mac) have recently issued so-called global bonds, which are sold simultaneously in the United States, Europe, and Asia. These transactions can involve more than one currency: for example, Freddie Mac sold bonds for yen but will redeem them in pounds sterling. Agencies have also launched their first issues of inflation-indexed debt, with three-year to ten-year notes recently sold by the Student Loan Marketing Association, the Tennessee Valley Authority, and others.

State and Local Government Finance

State and local governments' issuance of long-term tax-exempt debt remained light in January and February, as most municipalities had tapped the market heavily in the fourth quarter to take advantage of relatively low interest rates (table). Meanwhile, short-term debt issuance rebounded in February from a weak January, as governments borrowed in anticipation of tax receipts and other seasonal revenue streams.

A number of state and local governments have announced plans to sell taxable debt and to use the proceeds to reduce their unfunded pension obligations. These governments appear to believe that the pension funds can purchase assets whose return will over time exceed the yield on the bonds being sold. In general, tax laws prohibit the issuance of tax-exempt debt to purchase taxable assets. New Jersey recently announced that it will sell $2.9 billion in taxable pension bonds in March, the largest issuance of taxable municipal debt on record.

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

				1996		1997	
	1994	1995	1996	Q3	Q4	Jan.	Feb.
Total tax-exempt	16.1	14.9	17.9	17.3	18.7	11.3	13.2
Long-term	12.8	12.1	14.3	11.9	16.2	10.4	10.9
Refundings[1]	4.0	3.4	4.9	4.1	5.2	4.1	3.5
New capital	8.8	8.7	9.4	7.8	11.0	6.3	7.4
Short-term	3.3	2.8	3.6	5.4	2.5	.9	2.3
Total taxable	.7	.7	.8	.7	1.5	.6	.8

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

Commercial Banking Developments

With fourth-quarter data now available, the Call Report shows that domestically chartered commercial banks had another good year in 1996 (top panels). Return on assets reached a new high just above 1.2 percent, and return on equity stayed close to the elevated levels of the past several years. The share of loans in total assets continued to rise last year, helping to boost the net interest margin slightly, and net non-interest income also improved a bit. Despite the industry's well-publicized problems with consumer loans, overall asset quality remains excellent, and provisioning last year again was on the low side. Delinquencies and charge-offs on other types of loans are near their lowest levels in a decade, leaving the total loan portfolio in very good shape (bottom panels).

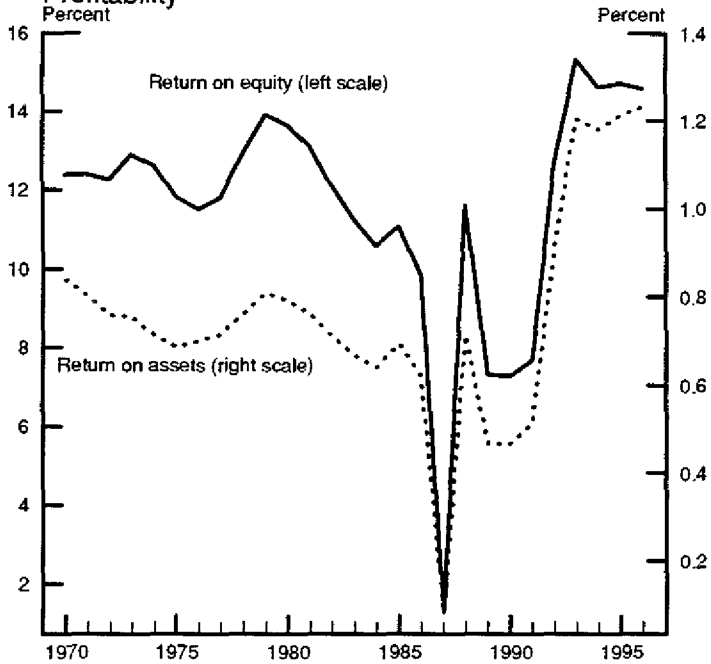
With good asset quality and solid capital cushions, banks continued to bid aggressively for large-dollar loan business, as shown in the latest data from the Survey of Terms of Bank Lending, taken in the first week of February (chart). Even though the spread between the rates on loans over $1 million (those most likely to involve investment-grade borrowers) and the intended federal funds rate ticked up, it remained at the lower end of the range of the last decade. Spreads for smaller loans held steady at the lowest levels in several years.

Favorable supply conditions combined with strong demand to produce another rapid expansion of business loans in February (table), with large increases at both domestic and foreign banks. The robust pace of mergers and acquisitions likely contributed to the faster February loan growth. Real estate lending expanded at a 6 percent annual rate in February, with the home equity component remaining below the elevated fourth-quarter pace. Reported consumer loans ran off in February because of heavy securitizations, but even with the securitized amounts added back in, consumer loans showed only a weak expansion.

In the securities category, growth in adjusted securities holdings picked up in February despite a drop in U.S. government securities. The acceleration is partly attributable to the acquisition by some banks of other banks' CDs for trading purposes.

Commercial Banks

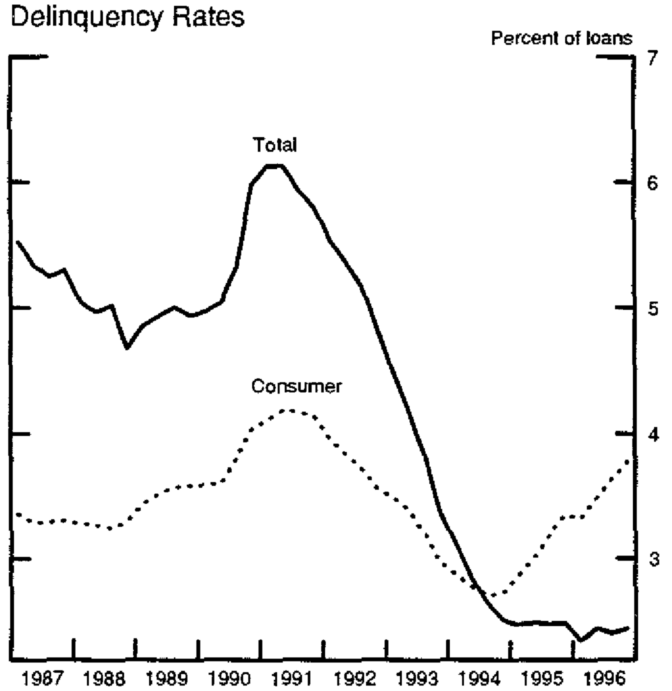
Profitability



Income and Expenses (percent of assets)

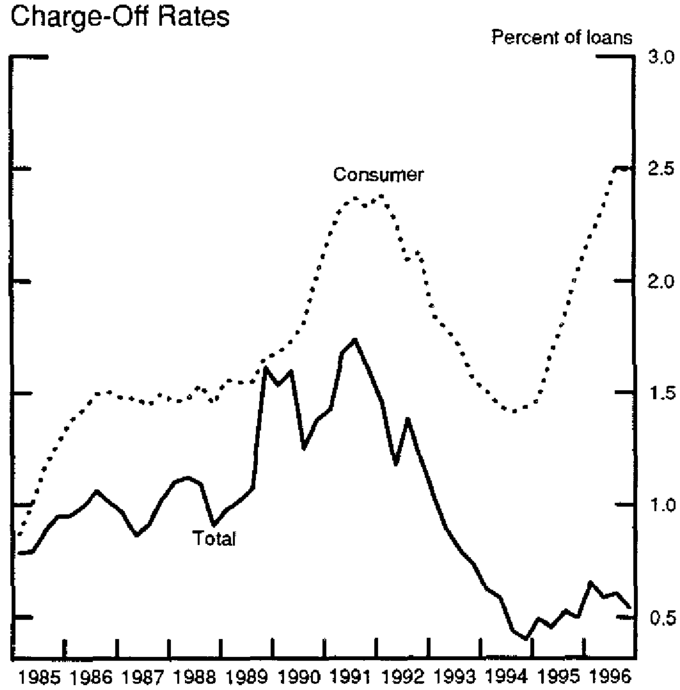
Items	1993	1994	1995	1996
Net interest income	3.90	3.79	3.73	3.76
Net noninterest income	-1.82	-1.75	-1.62	-1.55
Loss provisioning	-.47	-.28	-.30	-.38
Other items incl. taxes	-.41	-.59	-.62	-.62
Net income (ROA)	1.20	1.15	1.18	1.21
Memo:Return on equity	15.34	14.64	14.71	14.60

Delinquency Rates



Source. Call Report.

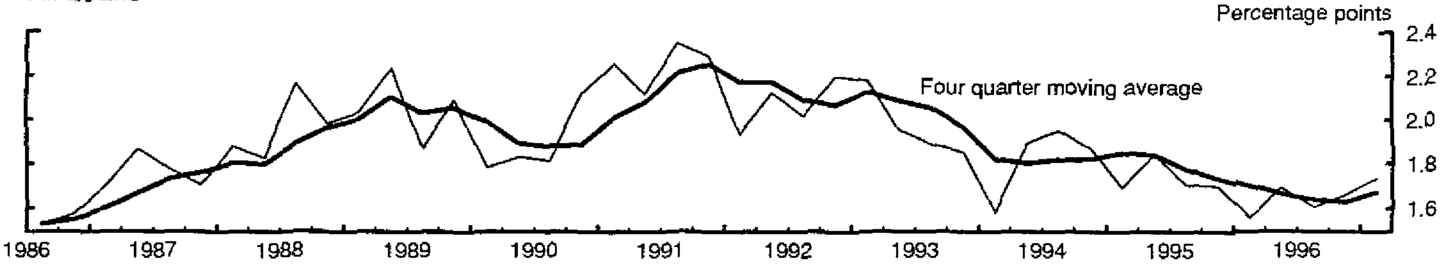
Charge-Off Rates



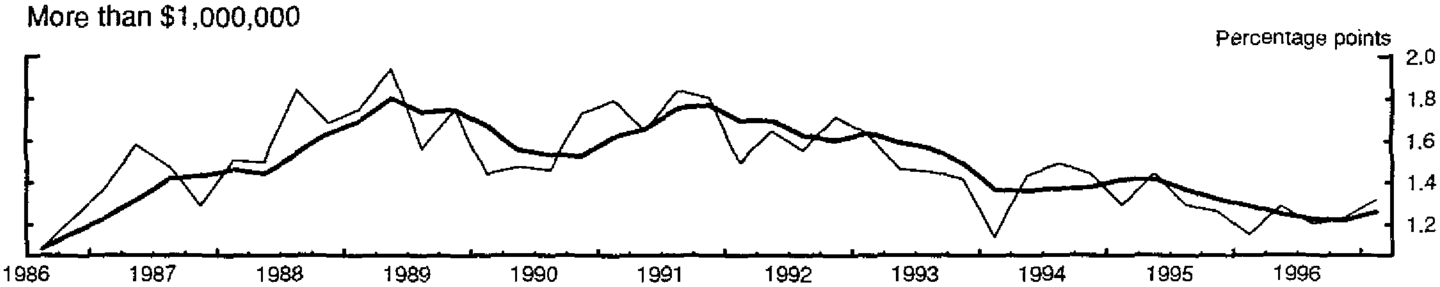
Commercial and Industrial Loan Rates

(Spreads over intended federal funds rate, by loan size)

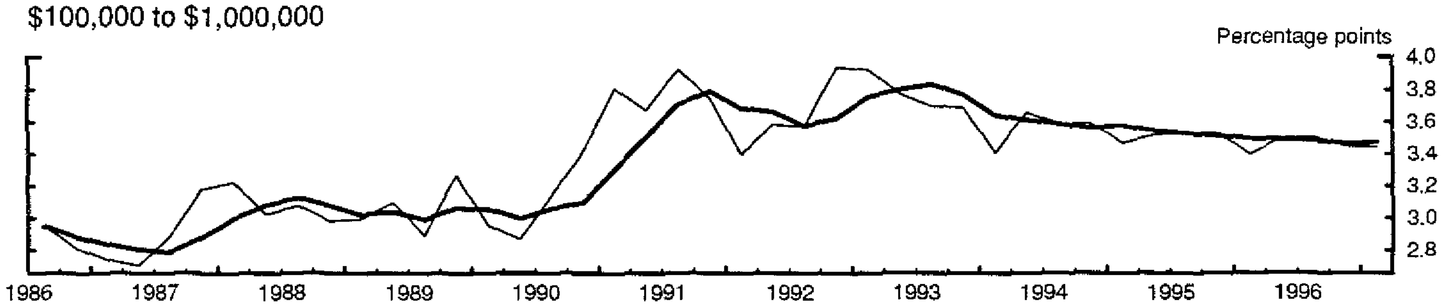
All Loans



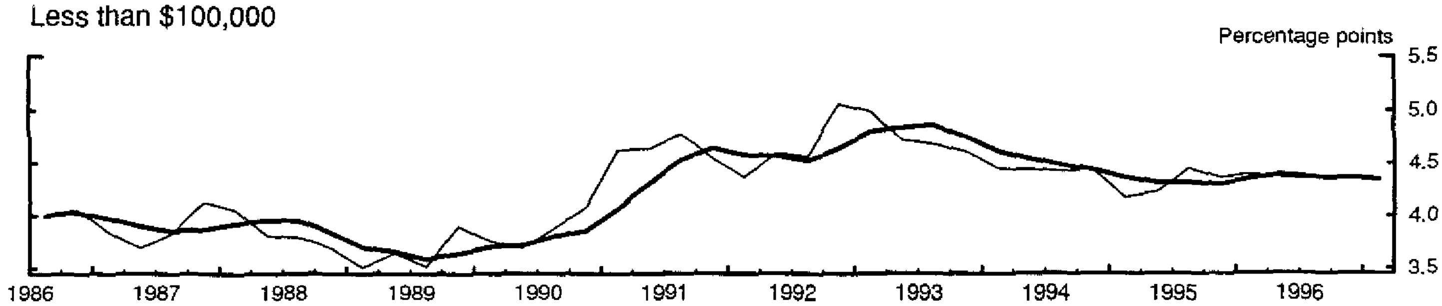
More than $1,000,000



$100,000 to $1,000,000



Less than $100,000



Source. Survey of Terms of Bank Lending.

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

Type of credit	1996	1996 Q3	1996 Q4	1996 Dec	1997 Jan	1997 Feb	Level, Feb 1997 (billions of $)
1. Bank credit: Reported	4.1	1.7	6.6	8.8	11.2	12.6	3,845.8
2. Adjusted[1]	4.7	2.6	6.7	6.1	6.1	9.4	3,753.4
3. Securities: Reported	-1.5	-5.4	3.0	12.5	15.8	20.3	1,022.6
4. Adjusted[1]	0.4	-2.6	3.1	2.2	-4.3	8.2	930.2
5. U.S. government	-0.6	-2.6	1.1	-0.8	-2.2	-4.9	703.2
6. Other[2]	-3.6	-12.6	7.9	46.8	60.6	79.7	319.4
7. Loans[3]	6.2	4.3	7.9	7.4	9.5	9.9	2,823.2
8. Business	9.1	8.4	14.4	16.7	6.3	14.9	800.9
9. Real estate	3.9	2.1	4.3	5.5	6.2	6.0	1,137.4
10. Home equity	6.7	4.0	18.4	15.7	7.0	8.4	86.4
11. Other	3.7	2.0	3.3	4.6	6.0	5.9	1,051.0
12. Consumer: Reported	5.8	6.6	4.3	0.5	5.1	-1.4	520.6
13. Adjusted[4]	11.1	10.8	8.7	10.3	5.4	2.4	694.8
14. Other[5]	8.2	-1.2	10.7	3.1	35.4	26.9	364.3

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.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1996 Q3	1996 Q4	1996 Dec.	1997 Jan.	1997 Feb.	1996:Q4 to Feb. 97	Level (bil. $) Feb. 97
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-6.5	-7.3	1.2	-1.6	0.9	0.0	1080.6
2. M2[2]	4.6	3.4	5.0	7.5	5.3	5.1	5.9	3866.3
3. M3	6.9	5.4	8.4	11.1	7.4	10.7	9.4	5010.0
Selected components								
4. Currency	5.7	7.6	7.7	8.3	5.5	10.6	8.0	400.5
5. Demand deposits	2.7	-0.9	-5.4	1.2	-2.1	7.2	3.3	404.3
6. Other checkable deposits	-23.1	-29.8	29.4	-8.7	10.5	-23.3	-16.1	267.1
7. M2 minus M1[3]	8.8	7.7	10.2	10.0	7.9	6.8	8.2	2785.8
8. Savings deposits	11.7	8.4	12.1	11.4	10.9	7.3	10.0	1290.3
9. Small time deposits	1.3	2.2	3.8	1.4	1.0	1.9	1.6	946.7
10. Retail money market funds	17.1	16.3	17.2	21.6	13.0	13.9	15.6	548.7
11. M3 minus M2[4]	15.5	12.7	20.4	23.8	14.9	29.9	21.6	1143.6
12. Large time deposits, net[5]	17.6	16.4	25.5	29.3	26.2	32.4	28.3	524.4
13. Institution-only money market mutual funds	19.8	20.6	19.8	30.0	12.0	36.9	16.8	305.4
14. RPs	4.1	-4.7	2.1	13.6	16.8	21.5	9.1	198.7
15. Eurodollars	17.4	8.7	34.7	48.5	34.7	13.7	27.1	115.1
Memo								
16. Sweep-adjusted M1[6]	5.4	3.6	5.0	9.5	4.0	7.7	7.0	1264.4
17. Monetary base	3.8	5.4	5.1	9.1	2.9	5.8	5.7	456.2
18. Household M2[7]	4.8	4.1	6.0	7.2	6.1	6.2	6.4	3462.6
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	8.5	15.3	15.7	10.8	14.7	...	579.1
19. Net due to related foreign institutions	-2.1	-2.0	-5.1	-7.6	-9.8	0.1	...	219.7
20. U.S. government deposits at commercial banks	0.0	1.0	0.0	-4.8	3.0	-4.5	...	15.2

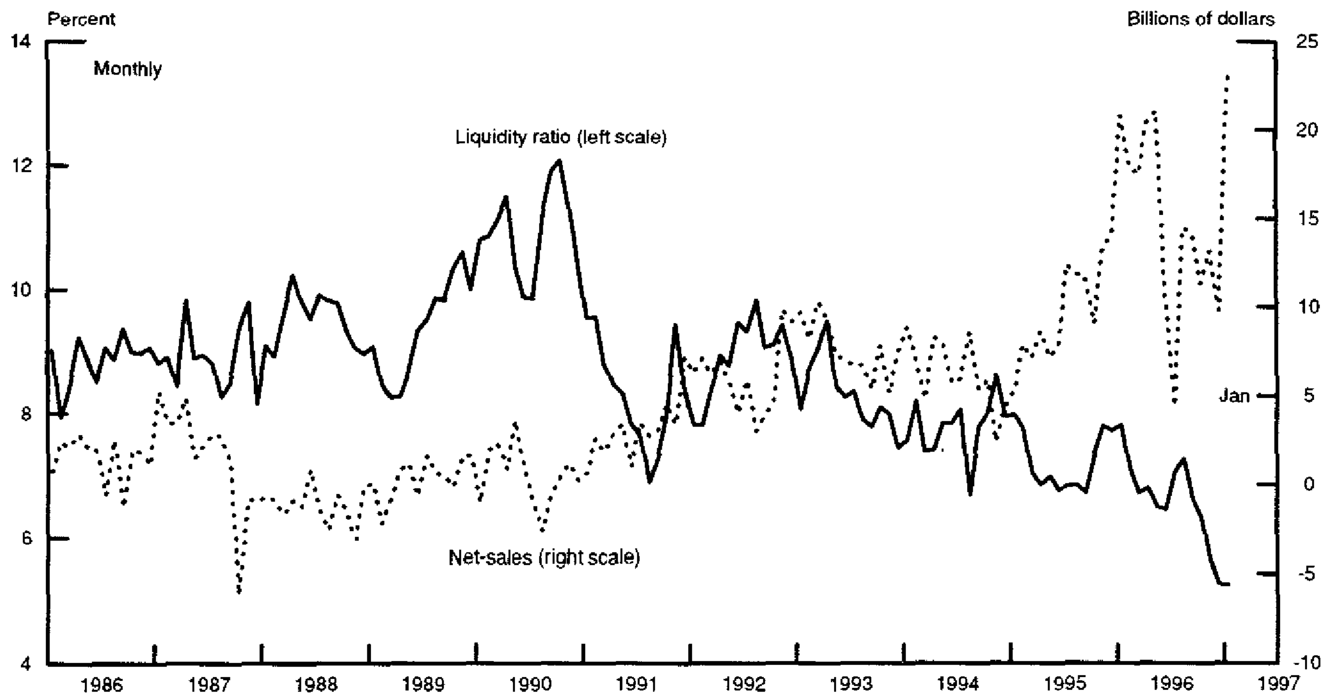
1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
2. Sum of seasonally adjusted M1, retail money market funds, savings deposits, and small time deposits.
3. Sum of retail money funds, savings deposits, and small time deposits, 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.

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

			1996			1997		Memo:
	1995	1996	Q3	Q4	Dec	Jan	Feb[e]	Jan assets
Stock funds	10.7	18.6	13.8	14.2	11.8	29.4	19.5	1854.8
Domestic[1]	9.7	14.7	11.0	11.4	9.8	23.4	15.0	1559.3
Aggressive growth	3.1	4.7	3.5	3.2	3.1	5.7	2.4	292.2
Growth	3.1	3.9	2.7	2.7	1.5	6.1	2.9	512.9
Growth and income[2]	3.7	6.2	4.9	5.6	5.3	11.6	9.7	749.6
International[3]	1.0	3.9	2.8	2.7	2.0	6.0	4.5	295.5
Bond funds	-0.4	1.1	0.3	1.1	2.4	2.9	2.0	897.7
High-yield	0.7	1.0	1.3	1.3	1.8	1.8	1.6	80.7
Income	0.9	1.6	0.8	1.5	2.3	3.2	0.4	362.5
Other	-2.0	-1.5	-1.8	-1.7	-1.7	-2.1	0.1	454.5

1. Includes precious metals funds, not shown elsewhere.
2. The sum of "Growth and income" and "Income equity" funds.
3. The sum of "International " and "Global equity" funds.
e Aggregate stock and bond figures are ICI estimates. Components are staff estimates.
Source. Investment Company Institute.

Net Sales (Excluding Reinvested Distributions) and Liquidity Ratio of Domestic Stock Funds



Note. Liquidity ratio is cash and short-term securities as a percent of total assets.
Source. Investment Company Institute.

Monetary Aggregates

Growth in the broad monetary aggregates has been relatively brisk in recent months--especially M3. Banks have continued to issue substantial amounts of large time deposits, partly to finance credit expansion and partly to substitute for offshore borrowing. This shift in funding patterns has been particularly strong at foreign banks, where it may be related to an expansion of funding operations in the United States. M3 has also been boosted by rapid expansion of institution-only money funds (table). The month-to-month growth of institutional money funds is influenced heavily by fluctuations in short-term market interest rates, but over the longer term, the growing share of these funds in M3 partly reflects their more widespread use by nonfinancial corporations. Nonfinancial businesses now hold about a third of institutional money fund shares, up from a sixth in 1989, and institutional money fund shares now make up 14 percent of the liquid assets of such businesses, compared with 4 percent in 1989. These trends suggest that firms may view money funds as a cost-effective substitute for in-house cash management.

M2 expanded at about a 5 percent annual rate in February, quite close to the pace recorded in the fourth quarter. Retail money funds again grew more rapidly than deposits, as has regularly been the case for several years. M2 growth apparently has tracked the growth of nominal GDP fairly closely, a "normal" velocity pattern in a period of minimal change in opportunity costs.

Mutual Funds

Net sales of stock and bond mutual funds declined somewhat in February from January's torrid pace (table). The record January inflow to stock funds was attributable partly to the seasonal peak in investments in individual retirement accounts and 401(k) plans. Stock fund inflows have continued to shift away from the more aggressive growth funds and toward the more conservative growth and income funds, whose share of total domestic net equity sales climbed to about 60 percent in February from 42 percent last year. Preliminary data suggest that net sales of stock funds weakened somewhat in the first two weeks of March, with inflows again concentrated in relatively conservative funds. The liquidity ratio of domestic stock funds was about unchanged in January at 5.3 percent, holding at the lowest level since 1977 (chart).

The recent default of Mercury Finance on its commercial paper obligations had a very limited impact on money market mutual funds, as most funds apparently had little credit exposure to Mercury. One fund management company bought Mercury's paper from the funds it advises at par, thus maintaining the funds' share prices at $1 and not "breaking the buck."

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In December, the U.S. deficit in trade in goods and services widened from levels recorded in the previous two months. Exports declined, particularly categories such as machinery and agricultural products that had risen sharply in October and November. Imports increased in December, largely oil, consumer goods, and machinery. Trade data for January will be released on March 20, and will be described in the Greenbook supplement.

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

	1996	Annual rates 1996 Q2	Q3	Q4	Monthly rates 1996 Oct	Nov	Dec
Real NIPA 1/							
Net exports of G&S	-114.0	-114.7	-137.4	-100.0	...	...	...
Nominal BOP							
Net exports of G&S	-114.2	-115.8	-137.1	-105.4	-8.0	-7.9	-10.3
Goods, net	-187.7	-189.5	-207.5	-181.2	-14.1	-14.3	-16.6
Services, net	73.5	73.6	70.4	75.9	6.1	6.3	6.3

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

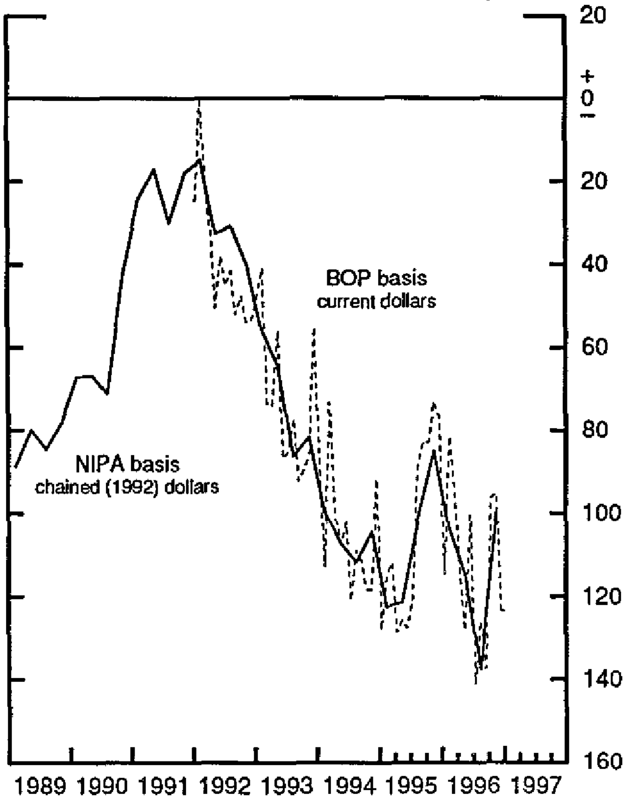
For 1996-Q4, the trade deficit was significantly smaller than in the third quarter, and was about the same as the average for the first half of the year. Exports of goods and services were 5 percent higher in the fourth quarter than in the third quarter. The increase was spread among all major trade categories except automotive products (which were held down by the effects of strikes against GM). Exports of aircraft and services rebounded from low third-quarter levels. Exports of machinery and industrial supplies moved to new record levels. Over the past year, the value of merchandise exports rose 6 percent (Q4/Q4). Most of the rise went to Mexico. Smaller increases went to Canada, South America, and Asia. Exports to Western Europe were about the same in 1996-Q4 as a year earlier.

Imports of goods and services in the fourth quarter were only slightly higher than in the third quarter. Declines in automotive imports from Canada (which were affected to a larger extent than automotive exports by strikes against GM) nearly offset increases in a wide range of other trade categories, especially imported consumer

U.S. International Trade in Goods and Services
(Seasonally adjusted annual rate)

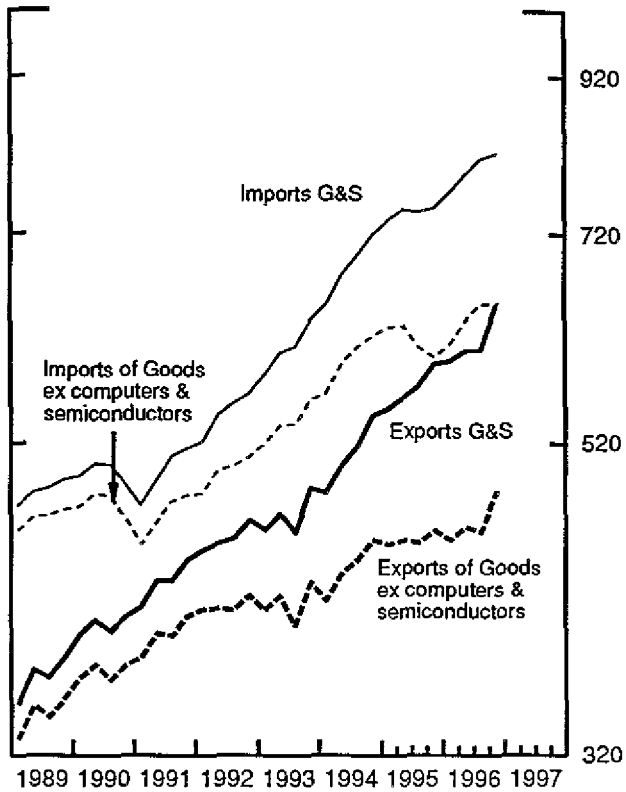
Net Exports

Billions of dollars, SAAR



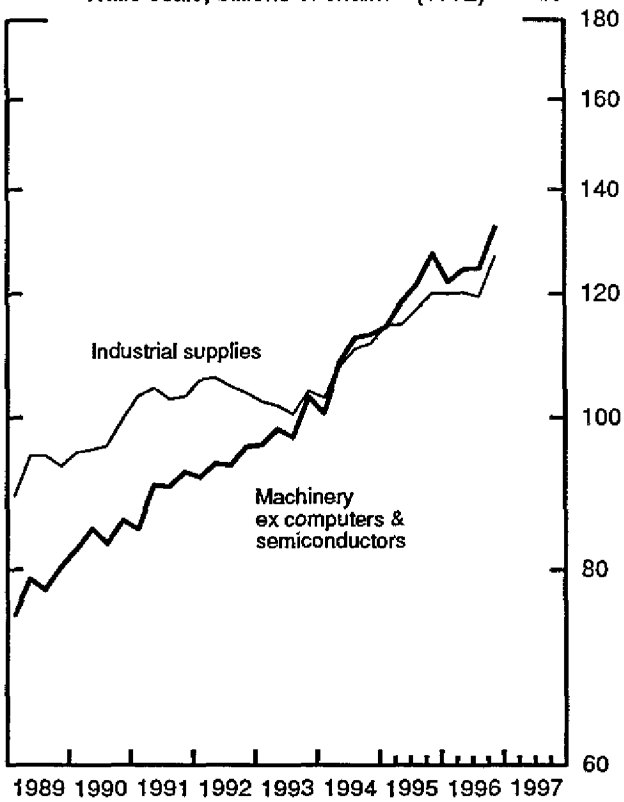
NIPA Exports and Imports

Ratio scale, billions of chained (1992) dollars



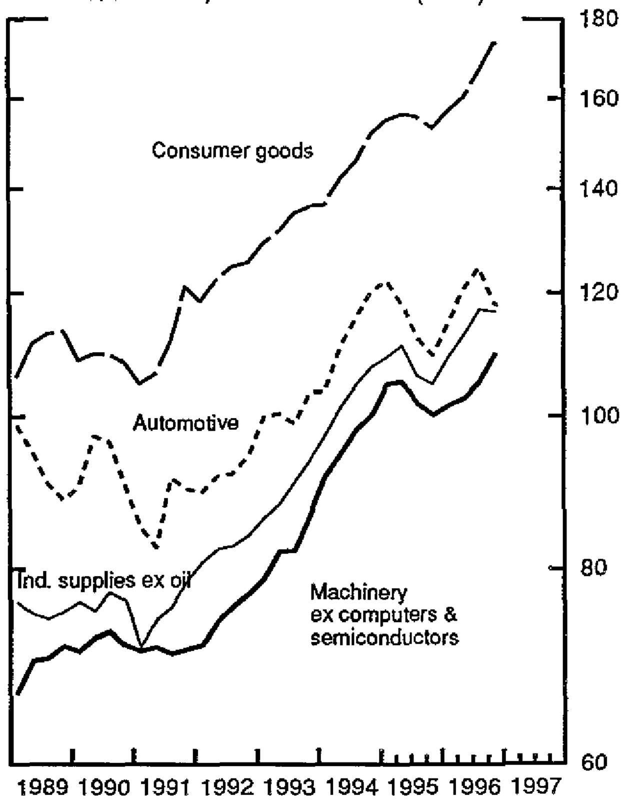
Selected NIPA Exports

Ratio scale, billions of chained (1992) dollars



Selected NIPA Imports

Ratio scale, billions of chained (1992) dollars



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

	Levels				Amount Change 1/			
	1996		1996		1996		1996	
	Q3	Q4	Nov	Dec	Q3	Q4	Nov	Dec
Exports of G&S	822.8	863.1	870.3	856.7	-13.5	40.3	9.6	-13.5
Goods exports	600.6	633.5	639.5	625.9	-11.9	32.9	5.0	-13.6
Agricultural	60.1	61.7	66.3	59.3	-0.3	1.6	6.7	-7.0
Gold	5.2	3.7	3.2	3.6	-7.3	-1.5	-1.3	0.4
Other goods	535.3	568.1	570.1	563.1	-4.3	32.8	-0.5	-7.0
Aircraft & pts	26.7	36.8	33.7	39.7	-6.7	10.1	-3.3	6.1
Computers	42.9	43.3	44.5	41.6	-0.3	0.4	0.4	-2.9
Semiconductors	33.7	36.7	37.2	36.0	-1.2	3.0	0.4	-1.2
Other cap gds	141.0	150.4	152.4	147.8	0.5	9.4	1.4	-4.6
Automotive	66.8	66.2	69.4	66.5	3.9	-0.6	6.6	-2.9
to Canada	36.3	33.4	37.1	33.0	1.7	-2.9	7.0	-4.1
to Mexico	7.9	10.6	9.5	11.8	-0.0	2.7	-1.0	2.3
to ROW	22.6	22.2	22.9	21.8	2.2	-0.4	0.6	-1.1
Ind supplies	128.9	135.4	132.4	134.9	-0.6	6.5	-6.2	2.5
Consumer goods	69.1	73.4	73.2	72.3	-1.3	4.3	-1.5	-0.9
All other	26.2	25.9	27.3	24.3	1.4	-0.3	-3.6	-3.0
Services exports	222.3	229.7	230.7	230.8	-1.1	7.4	4.6	0.1
Imports of G&S	960.0	968.5	965.5	980.2	8.3	8.5	8.8	14.7
Goods imports	808.1	814.7	810.8	824.8	6.1	6.6	7.2	14.1
Petroleum	71.8	75.0	69.5	79.1	1.5	3.2	-7.0	9.6
Gold	6.2	3.4	3.5	2.9	-8.4	-2.8	-0.4	-0.6
Other goods	730.1	736.3	737.8	742.8	13.0	6.2	14.5	5.0
Aircraft & pts	13.1	13.7	13.5	14.8	0.4	0.6	0.7	1.3
Computers	61.5	61.6	61.1	62.8	0.9	0.1	0.8	1.7
Semiconductors	33.4	32.6	32.5	33.6	-3.6	-0.8	0.7	1.1
Other cap gds	117.6	121.9	122.0	123.4	1.6	4.3	2.6	1.5
Automotive	135.7	128.6	135.4	127.5	4.6	-7.1	12.3	-7.9
from Canada	51.3	42.3	46.8	43.4	2.2	-9.0	9.6	-3.4
from Mexico	23.2	23.2	23.5	20.5	-0.9	-0.0	-2.2	-3.0
from ROW	61.2	63.1	65.1	63.7	3.3	1.9	4.9	-1.4
Ind supplies	131.0	130.7	129.8	130.3	3.8	-0.3	-1.4	0.5
Consumer goods	173.1	180.3	177.1	183.4	6.1	7.2	-1.7	6.3
Foods	35.9	36.7	35.5	38.1	-0.1	0.8	-0.8	2.6
All other	28.8	30.2	31.1	29.0	-0.7	1.4	1.3	-2.1
Services imports	151.9	153.8	154.7	155.3	2.1	1.9	1.6	0.6
Memo:								
Oil qty (mb/d)	10.03	9.21	8.58	9.55	0.18	-0.82	-0.89	0.97
Oil price ($/bbl)	19.58	22.31	22.15	22.68	0.04	2.73	0.07	0.53

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

goods, machinery (other than computers and semiconductors), and services. Over the past year imports rose 8-1/2 percent (Q4/Q4) with the increases spread over most major trade categories. Exceptions were imports of semiconductors, which declined sharply through most of the year and have only recently begun to move back up, and automotive products from Canada.

Oil Imports

The value of imported oil was slightly higher in the fourth quarter than in the third quarter, as a drop in quantity was more than offset by a sharp increase in price.

The quantity of oil imported fell 8-1/2 percent (0.833 mb/d) on average during the fourth quarter after rising 2 percent during the third quarter. A larger than normal stock drawdown -- particularly in the U.S. territories -- and an increase in crude oil production offset higher consumption and led to the lower rate of oil imports. Preliminary Department of Energy statistics for January and February indicate that oil imports into the fifty states remain at the fourth-quarter rate.

The average price of imported oil in the fourth quarter was 14 percent above its third-quarter level. The price of imported oil rose another 1-1/4 percent in January placing it 38 percent above its December 1995 level. Skirmishes in the Kurdish region of Northern Iraq, strikes in France that interrupted refinery operations, and concern over the level of heating oil stocks in the United States and Europe because of extremely cold weather in Europe pushed prices up at the end of last year. Spot WTI declined $0.22 per barrel in January and plummeted $2.96 per barrel in February. Deliveries of oil from Iraq put downward pressure on prices during January, offsetting the effect of the cold winter. Mild weather in February -- oil consumption was 0.7 mb/d below February 1996's rate -- accompanied by the appearance of Iraqi oil on the spot market led to the sharp fall in spot WTI. Spot WTI is currently trading in the $20-22 per barrel range. The severe backwardation has disappeared from the WTI futures market; the December 1997 futures quote is currently just $0.80 below the current spot price.

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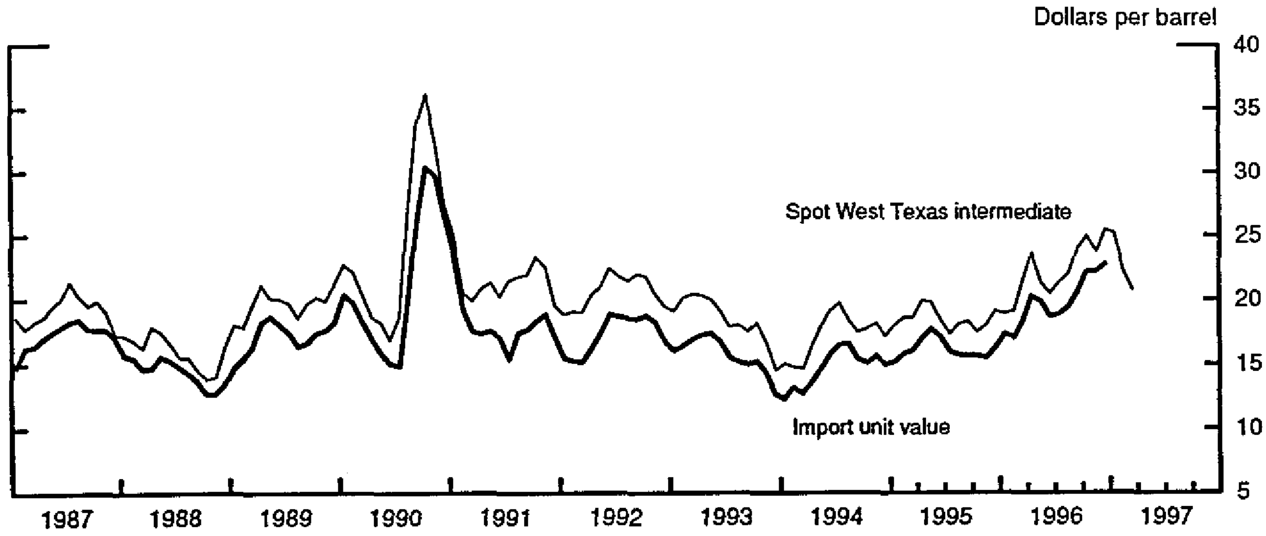
Oil Prices



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

	Annual rates			Monthly rates		
	1996			1996		1997
	Q2	Q3	Q4	Nov	Dec	Jan
	-----------BLS prices (1990=100)----------					
Merchandise imports	1.6	-2.4	5.0	-0.2	0.1	-0.3
Oil	41.5	1.9	60.4	-0.8	0.2	1.3
Non-oil	-2.4	-2.8	-0.4	-0.1	0.1	-0.4
Foods, feeds, bev.	11.4	-10.5	3.6	0.2	-1.2	-0.3
Ind supp ex oil	-5.1	-5.3	0.8	0.4	0.7	1.0
Computers	-16.9	-10.9	-8.5	-0.9	-0.7	-2.0
Semiconductors	-16.7	-15.4	-14.9	-2.6	-2.1	-6.4
Cap. goods ex comp & semi	-2.7	-0.1	-0.0	-0.1	0.2	-1.2
Automotive products	-0.5	0.7	0.1	-0.1	0.2	-0.1
Consumer goods	-0.8	-0.8	-0.5	-0.1	0.0	-0.1
Merchandise exports	2.4	-3.5	-4.2	-0.4	0.0	0.2
Agricultural	31.5	-18.0	-31.9	-2.3	-0.9	0.1
Nonagricultural	-1.2	-0.9	0.4	0.0	0.1	0.1
Ind supp ex ag	-4.9	-3.2	0.8	-0.4	0.2	0.1
Computers	-7.6	-11.9	-10.2	-0.9	-1.1	0.0
Semiconductors	-5.5	-15.5	-3.1	-0.2	0.2	-0.2
Cap. goods ex comp & semi	2.4	2.4	1.2	0.1	0.2	0.2
Automotive products	0.3	0.3	1.3	0.2	0.0	0.2
Consumer goods	1.3	0.7	0.9	0.0	0.2	0.1
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	0.7	-2.0	3.7	...	...	...
Non-oil merchandise	-3.8	-3.0	-1.4	...	...	...
Exports of gds & serv.	1.4	-1.8	-2.2	...	...	...
Nonag merchandise	-2.6	-2.3	-0.8	...	...	...

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports decreased slightly in January after edging up in December. The largest declines were for imported capital goods, particularly computers and semiconductors. Partly offsetting these declines was an increase, for the third consecutive month, in prices of imported industrial supplies. For the fourth quarter, non-oil import prices declined only slightly, as increases in prices of industrial supplies and automotive products nearly offset declines in other categories.

Prices of exports rose slightly in January. Prices of agricultural exports, which had declined in the previous seven months, edged up in January (primarily agricultural industrial supplies). Small price increases were recorded in most other major trade categories. In the fourth quarter, prices of agricultural exports dropped about 30 percent at an annual rate. Prices of nonagricultural exports changed only slightly in the fourth quarter, with increases spread among all major trade categories except computers and semiconductors.

Price data for February will be released on March 21.

U.S. Current Account through 1996-Q4

In the fourth quarter of 1996, the U.S. current account deficit narrowed $26 billion SAAR. Smaller deficits for net goods and services and net investment income were partly offset by larger net unilateral transfers.

The deficit in goods and services narrowed $32 billion SAAR largely because of the jump in exports. For net investment income, the increase in income receipts (primarily from U.S. direct investment abroad) was larger than the increase in income payments to foreigners (on foreign investment in the United States). The rise in unilateral transfers reflected U.S. Government grants to Israel that are usually made during the fourth quarter of each year.

For the year 1996, the current account deficit was $165 billion, $17 billion larger than in 1995. About half of the change was from goods and services and the other half from unilateral transfers. Transfers were larger than usual for the year because the Government shutdown at the end of 1995 pushed payment of some grants to Israel from the fourth quarter of 1995 into the first quarter of 1996.

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
1996	-114.2	-8.4	-42.5	-165.1
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	-98.5	1.2	-43.8	-141.1
2	-115.8	-8.9	-37.7	-162.4
3	-137.1	-16.4	-37.9	-191.4
4	-105.4	-9.7	-50.5	-165.5
Memo:				
$ Change				
Q1-Q4	-21.0	8.8	-7.2	-19.4
Q2-Q1	-17.3	-10.1	6.1	-21.3
Q3-Q2	-21.3	-7.5	-0.2	-29.0
Q4-Q3	31.7	6.7	-12.6	25.9

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

U.S. International Financial Transactions

Private foreign net purchases of U.S. securities finished 1996 on a high note, with over $43 billion net in December, and continued at a fast pace in January (line 4 of the Summary of U.S. International Transactions table). For the year, records were set for private net purchases of Treasury securities ($156 billion) and corporate and other bonds ($121 billion) (lines 4a and 4b). Of the record net purchases of corporate and other bonds in line 4b, about $45 billion were for U.S. agency bonds. Most of the net private purchases of U.S. bonds reported in line 4 went to international financial centers in the United Kingdom, the Caribbean, or Hong Kong. Japanese residents purchased net $14 billion in corporate and other bonds and $24 billion in U.S. Treasury securities. After the first half of the year, foreigners showed virtually no interest on net in U.S. stocks (although there seemed to be some resurgence in January; see line 4c).

U.S. residents continued very strong purchases of foreign stocks and bonds through December (line 5). In January, however, stock purchases were low and there was a net selloff of $3.4 billion in foreign bonds. For the year 1996, U.S. net purchases of foreign securities rose to $104 billion, a strong pace, but still below the peak reached in 1993. As usual, most purchases were made in the developed countries. Net stock purchases in Japan were over $10 billion in the first half of the year, but nothing thereafter; U.S. investors also sold foreign bonds net in Japan in the second half of the year.

Foreign official reserve assets held in the United States continued their robust growth in December and January (line 1); partial information from the FRBNY for February indicates continued large increases. For the year 1996, as was the case in 1995, only a moderate part of this growth was associated with exchange market intervention by G-10 countries; in both years, G-10 countries accounted for only about 30 percent of the increase in foreign official holdings in the United States.

Banks and securities dealers reported a continuation of capital outflows in December and January (line 3). For the year, net outflows through banks mounted to $60 billion; given the slower growth in U.S. bank credit in 1996, banks relied more heavily on domestic rather than foreign sources of financing. Moreover, about $18 billion of the outflow represented RP transactions of securities dealers with foreign purchasers of U.S. Treasury securities.

Recently released data on direct investment capital flows show that both outflows (line 6) and inflows (line 7) were strong in 1996. Direct investment abroad was very strong in the fourth quarter and finished the year close to the record total in 1995. Much of the large increase in fourth-quarter outflow was the result of a buildup of intercompany debt by finance affiliates in the United Kingdom. The direct investment inflow to the United States was almost as strong as the outflow, with much of it financing mergers and acquisitions.

The statistical discrepancy for the year mounted to a negative $53 billion, indicating significant unrecorded capital outflows during 1996.

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

	1995	1996	1996					1997
			Q1	Q2	Q3	Q4	Dec	Jan
Official capital								
1. **Change in foreign official reserve assets in U.S. (increase, +)**	109.9	121.6	52.2	13.4	23.2	32.9	14.9	10.9
a. G-10 countries	33.1	35.5	28.5	3.5	1.4	2.2	3.4	.6
b. OPEC countries	4.3	13.4	-.8	5.3	5.3	3.6	1.8	2.2
c. All other countries	72.6	72.7	24.5	4.5	16.5	27.2	9.7	8.1
2. **Change in U.S. official reserve assets (decrease, +)**	-9.7	6.7	*	-.5	7.5	-.3	-.1	4.3
Private capital								
Banks								
3. **Change in net foreign positions of banking offices in the U.S.**[1]	-33.1	-59.8	-25.6	-11.9	-8.4	-13.9	-5.4	-14.7
Securities[2]								
4. **Foreign net purchases of U.S. securities (+)**	190.8	290.6	49.8	61.7	78.9	100.2	43.8	28.2
a. Treasury securities[3]	99.9	155.7	13.1	31.8	43.6	67.3	33.8	13.4
b. Corporate and other bonds[4]	82.6	121.3	32.8	23.6	33.4	31.4	9.6	11.8
c. Corporate stocks	8.2	13.6	3.8	6.3	2.0	1.5	.4	3.0
5. **U.S. net purchases (-) of foreign securities**	-98.7	-104.4	-34.4	-20.2	-21.1	-28.6	-16.6	2.4
a. Bonds	-48.4	-46.3	-11.9	-2.8	-13.0	-18.5	-10.7	3.4
b. Stocks	-50.3	-58.1	-22.5	-17.4	-8.1	-10.2	-5.9	-1.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-95.5	-88.3	-23.2	-26.2	-9.1	-29.8	n.a	n.a
7. Foreign direct investment in U.S.	60.2	84.0	28.7	17.4	21.1	16.8	n.a	n.a
8. Other (inflow, +)[5]	-7.2	-32.2	-16.7	16.2	-22.4	-9.3	n.a	n.a
U.S. current account balance (s.a.)	-148.2	-165.1	-35.3	-40.6	-47.9	-41.4	n.a	n.a
Statistical discrepancy (s.a.)	31.5	-53.1	4.5	-9.3	-21.8	-26.6	n.a	n.a

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

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes Treasury bills.

4. Includes U.S. goverment agency bonds.

5. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

Foreign Exchange and Foreign Financial Markets

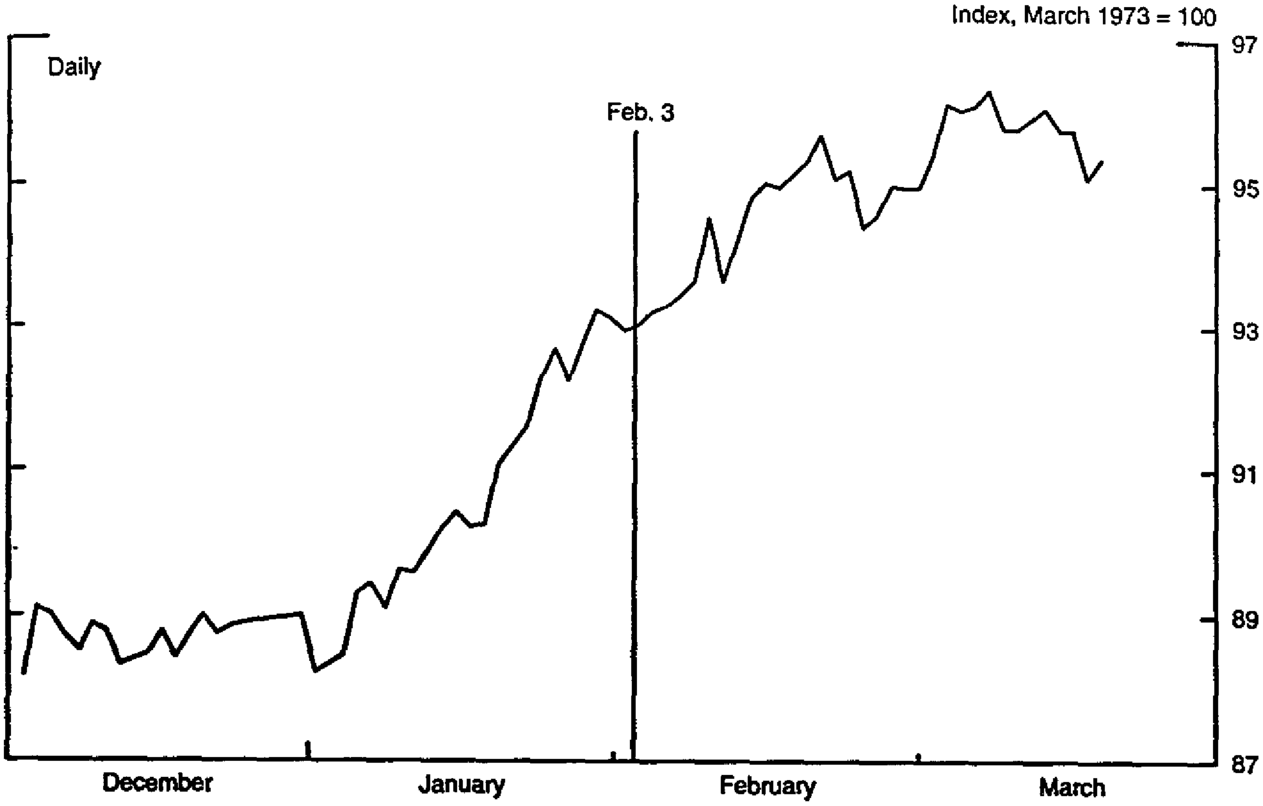
The weighted average value of the dollar in terms of the other G-10 currencies has risen 2-1/4 percent since the day before the February FOMC meeting. The bulk of the dollar's gains came in February, boosted in part by the Chairman's Humphrey-Hawkins testimony. Most recently, strong U.S. data releases for retail sales and employment have solidified the dollar's gains, with the dollar now trading at levels last seen in February 1994.

The dollar's gains came mainly at the expense of the mark and other continental European currencies. Movements in the dollar against the mark appear to be related to changing views regarding economic performance in Germany. Reports that sluggish economic activity was increasing the chance that Germany would fail to meet the EMU criterion of a three percent government deficit to GDP ratio dropped the value of the mark more than one percent. Most of this decline was reversed on the release of data showing strong growth in M3 and a positive IFO survey. Expectations of a large increase in German unemployment for February weighed on the mark in early March. Since the middle of March, prospects of a delay in the start of EMU appear to have boosted the mark. On balance, the dollar has appreciated 2-1/2 percent against the mark since early February. Other European currencies have lost value relative to the mark on talk of an EMU delay. Most notable are the declines in the Swedish krona and Italian lira against the mark, amounting to 2-3/4 and 1-1/2 percent respectively.

Sterling depreciated vis-a-vis the dollar, largely in March. The drop in sterling's value was prompted by remarks from Chancellor Clarke who made it clear that there was little chance of a rate increase prior to the general election. Subsequently, Bank of England Deputy Governor Davies stated that the pound was overvalued against the mark. Prime Minister Major's announcement that the general election would be held on May 1 also prompted sales of sterling. Over the period as a whole, sterling declined 1 percent against the dollar.

With regard to the yen, the dollar appreciated only slightly over the past six weeks. Almost all of these gains came early in the period on reports of Japanese financial firm difficulties. Since the middle of February, the yen has appreciated 1 percent.

Weighted Average Exchange Value of the Dollar



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Feb. 3	Mar. 19	Change	Feb. 3	Mar. 19	Change
Germany	3.05	3.18	0.13	5.72	5.88	0.16
Japan	0.53	0.55	0.02	2.42	2.31	-0.11
United Kingdom	6.19	6.19	0.00	7.34	7.55	0.21
Canada	3.17	3.29	0.12	6.48	6.63	0.15
France	3.23	3.28	0.05	5.58	5.78	0.20
Italy	7.38	7.50	0.12	7.17	7.68	0.51
Belgium	3.01	3.48	0.47	5.80	6.04	0.24
Netherlands	2.90	3.15	0.25	5.56	5.76	0.20
Switzerland	1.63	1.81	0.18	3.67	3.49	-0.18
Sweden	4.03	4.28	0.25	6.65	7.25	0.60
Weighted-average foreign	3.46	3.59	0.13	5.59	5.77	0.18
United States	5.42	5.52[p]	0.10	6.47	6.73[p]	0.26

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

The yen's largest gains came on announcements in mid-February and mid-March by Japan's Finance Ministry that the government may purchase jusen-related land and that such land would be eligible for securitization. Stock prices in Japan rose more than two percent on both announcements. The yen also strengthened on data releases that showed strong retail sales and healthy increases in industrial output. A larger than expected increase in the Japanese current account surplus for January, coupled with a statement from Treasury Secretary Rubin that a sustained increase in the Japanese current account surplus "was in nobody's interest," provided some further support for the yen.

Short-term interest rates in the major industrial countries are little changed on average, with a relatively large increase (47 basis points) in Belgium, where rates have risen with the unfolding of a political crisis involving bribery of government officials. In the Netherlands, official rates were increased twice, the latest move coming on March 10, in an effort to maintain stability in the guilder/mark exchange rate. The repurchase rate in Spain was cut 25 basis points after the release of favorable consumer price data. At the other end of the maturity spectrum, long-term rate changes were largest in Sweden, Italy, and Spain (averaging 48 basis points) on prospects for a delay in EMU. Italian long-term rates, up 51 basis points, have also been pressured by concerns over the passage of a mini-budget. Ten-year interest rates in Switzerland fell roughly 20 basis points on continued lackluster economic performance.

The Mexican peso depreciated sharply in late February, following the rise in U.S. interest rates and amid concerns over the U.S. re-certification of Mexico as a drug-fighting ally. Earlier in the month, Bank of Mexico officials announced procedures to accelerate the accumulation of foreign exchange reserves in the event of a peso appreciation and to reduce the volatility of the floating exchange rate in the event of a peso depreciation. The accumulation of reserves will be accelerated by a second, mid-month sale of dollar put options in the event that put options sold at the beginning of the month are fully exercised. Volatility of a depreciating peso will be reduced by an auction of $200 million on any day when the peso depreciates by more than two percent. Only one part of the new program came into play in February, when a second tranche of $300 million put options was sold after the first tranche was exercised. The February 27 decline in the peso came too late in the day to trigger an auction by the Bank of Mexico, and a partial recovery of the peso prevented an auction the following day.

. The Desk did not intervene in the foreign exchange market over the period.

Developments in Foreign Industrial Countries

Recent information suggests that the pace of expansion continues to diverge across the major industrial countries. Japan, Canada, and the United Kingdom posted strong GDP growth in the fourth quarter, and first-quarter indicators generally have been positive. In contrast, GDP growth was sluggish in the fourth quarter in continental Europe, although confidence indicators have improved in the past few months.

Inflationary pressures have generally remained subdued. In Japan, wholesale prices have risen due to the depreciation of the yen in recent months, but consumer price inflation remains near zero. In Germany and France, CPI inflation is running under 2 percent, while in Canada it is slightly higher, and in Italy, it is less than 2-1/2 percent, about half the rate recorded a year ago. In the United Kingdom, in contrast, the underlying inflation rate remained above 3 percent in January.

Individual country notes. In **Japan**, real GDP rose 3.9 percent (SAAR) in the fourth quarter after registering an upward-revised 1.3 percent increase in the third quarter. Fourth-quarter growth was led by private consumption spending and a strong expansion of net exports. Total investment declined as a significant increase in business capital formation was more than offset by a plunge in public investment.

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

	1995	1996	1996 Q1	1996 Q2	1996 Q3	1996 Q4
GDP	2.6	3.1	8.4	-1.1	1.3	3.9
Total Domestic Demand	4.0	3.0	9.8	-0.3	0.4	2.3
Consumption	3.0	2.0	8.3	-3.9	-0.7	4.9
Investment	5.6	5.7	14.2	9.9	1.4	-1.9
Government Consumption	3.2	2.9	3.2	0.4	5.5	2.6
Inventories (contribution)	0.2	-0.3	0.3	-0.9	-0.2	-0.2
Exports	3.8	5.4	-2.6	0.5	6.5	18.4
Imports	17.3	4.7	8.2	7.6	1.1	4.5
Net Exports (contribution)	-1.3	0.1	-1.3	-0.8	0.9	1.6

1. Annual changes are Q4/Q4.

Available indicators of economic activity for the first quarter suggest continued economic expansion; industrial production and machinery orders rose in January, and new car registrations picked up on average in January and February, reflecting brisk spending on big-ticket items in advance of the April 1 increase of the consumption tax. The latest surge of spending on consumer durables is also related to last year's strong housing cycle that recently seems to have come to an end. Housing starts in January fell further to a level almost 9 percent below the fourth-quarter average.

The unemployment rate of 3.3 percent in January is only slightly below its postwar high of 3.5 percent in May and June 1996. The job offers/applicants ratio remained at 0.76 in January. However, these figures mask a distinct improvement in the labor market; in January employment rose strongly, the number of unemployed dropped for the third consecutive month, and job offers remained firm.

Japan's current account surplus rose sharply in January, to \$81 billion (SAAR) compared with a surplus of \$67 million for all of 1996 and \$112 billion in 1995. The surge in the current account

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

	1996					1997	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	-0.3	1.6	3.1	-1.4	0.1	5.6	n.a.
Housing Starts	1.4	2.6	4.3	-5.5	-6.3	-2.8	n.a.
Machinery Orders	0.8	2.8	7.4	-3.6	-17.7	16.3	n.a.
New Car Registrations	-6.0	5.8	10.6	4.2	0.4	2.6	-1.6
Unemployment Rate (%)	3.5	3.3	3.3	3.3	3.3	3.3	n.a.
Job Offers Ratio[1]	0.69	0.71	0.74	0.74	0.76	0.76	n.a.
Business Sentiment[2]	-3	-7	-3	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	0.1	0.1	0.2	0.0	0.1
Wholesale Prices[3]	1.3	0.7	0.6	0.5	0.9	1.0	1.6

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.

surplus in January mainly reflected greater investment income and a rise in the volume of exports.

On March 5, the lower house of the Diet passed the budget for fiscal year 1997 (beginning April 1). The budget is in the upper house for consideration, and should pass before the beginning of the fiscal year.

Real GDP in **Germany** advanced at a pace of 0.3 percent (SAAR) in the fourth quarter of 1996. Taking the year as a whole, real GDP expanded 1.4 percent (or 2.2 percent on a Q4/Q4 basis). In the fourth quarter, domestic demand was up modestly owing to a revival of investment on machinery and equipment and inventory accumulation (a residual in German GDP statistics). Private consumption, government spending, and construction contracted in the fourth quarter. While exports continued to grow rapidly (more than 20 percent at an annual rate in the fourth quarter), a surge in imports more than offset the increase in exports.

Only limited information is available for the first quarter. Although industrial production dropped in January, output excluding construction activity was up, and orders rebounded due to a surge in

GERMAN REAL GDP
(Percent change from previous period, annual rate; adjusted for seasonal and calendar variation)

	1995	1996	1996			
	Q4/Q4	Q4/Q4	Q1	Q2	Q3	Q4
GDP	0.8	2.2	-0.4	6.1	3.0	0.3
Total Domestic Demand	0.7	1.3	-0.5	4.6	-0.3	1.3
Consumption	1.5	0.9	2.0	2.2	0.5	-1.1
Investment	-2.0	2.8	-17.6	30.0	3.6	0.7
Government Consumption	2.6	1.5	2.1	3.2	3.2	-2.6
Inventories (contribution)	-0.3	-0.2	2.1	-3.1	-2.0	2.3
Exports	5.4	9.4	3.0	1.4	13.3	21.1
Imports	4.9	5.7	2.6	-3.9	0.4	26.1
Net Exports (contribution)	0.1	1.0	0.1	1.5	3.3	-1.0

export demand. Unemployment rose by a total of 150,000 (s.a.) in January and February, bringing total unemployment to just over 4.3 million persons and the unemployment rate to 11.3 percent. However, these figures likely are overstated because of effects from unseasonably cold winter and a change in welfare registration procedures. Inflation on a 12-month basis ticked up in January, primarily reflecting increases in energy prices.

According to official figures, the general government deficit as a share of GDP widened to 3.9 percent last year from 3.5 percent in 1995. The Finance Ministry has revised its deficit forecast for 1997 to 2.9 percent of GDP (from 2.5 percent previously), owing to an upward revision to the government's forecast for unemployment. Given the importance of meeting the 3 percent deficit target proscribed in the Maastricht Treaty, it is quite likely that the Finance Ministry will impose a freeze on large federal expenditures, a measure that has been implemented in each of the past two years in order to give the Kohl government more flexibility over spending.

In mid-January, the government announced its proposal for reform of the tax system that seeks to reduce marginal tax rates for individuals and businesses and broaden the tax base by eliminating deductions and loopholes. Altogether, the reform would provide tax

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

	1996					1997	
	Q3	Q4	Oct	Nov	Dec	Jan	Feb
Industrial Production	1.2	-0.2	-0.6	0.9	0.8	-1.7	n.a.
Orders	1.0	-0.4	2.7	-0.6	-1.9	2.4	n.a.
Unemployment Rate (%)	10.4	10.8	10.6	10.8	10.9	11.3	11.3
Western Germany	9.2	9.5	9.4	9.5	9.6	9.8	9.8
Eastern Germany	15.4	15.9	15.6	15.9	16.2	17.3	17.4
Capacity Utilization[1]	82.6	83.0	...	...	...	...	...
Business Climate[1,2]	-11.3	-3.3	-2.0	-4.0	-4.0	-1.0	n.a.
Consumer Prices[3]	1.5	1.4	1.5	1.4	1.4	1.8	n.a.

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.

relief of roughly DM30 billion (including effects from a proposed one percentage point increase in the value-added tax).

In **France**, real GDP rose 0.6 percent (s.a.a.r.) in the fourth quarter following an increase of 3.1 percent in the third quarter. For 1996 as a whole, GDP increased 1.3 percent on average. While strength in consumption underpinned overall activity last year, growth last quarter was restrained by a decline in private consumption; this decline followed the third-quarter surge associated with the expiration of a government car-buying incentive program. Negative calendar effects also restrained measured growth. While growth of fixed investment slowed, owing to a slight decline in business investment, inventories made a strong positive contribution. Export growth slowed sharply and net exports subtracted marginally from GDP growth.

Economic activity is expected to accelerate during the first half of this year. Producers' expectations of future manufacturing output improved further in January and February as foreign orders strengthened; inventories appear to have returned to a more normal level following a sizable decumulation last year. Consumption of manufactured products rose in January despite a continued decline in

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

	1995	1996	1996 Q1	Q2	Q3	Q4
GDP	0.4	2.1	5.1	-0.5	3.1	0.6
Total Domestic Demand	0.4	1.5	2.5	1.0	1.8	0.8
Consumption	1.1	1.9	10.3	-3.8	3.7	-2.0
Investment	-0.1	-0.1	-2.9	-1.3	2.8	1.0
Government Consumption	1.0	1.6	1.2	2.4	1.2	1.6
Inventories (contribution)	-0.4	0.1	-3.2	3.1	-1.2	1.5
Exports	0.5	7.8	19.6	-6.3	15.0	4.5
Imports	0.7	5.9	9.9	-1.5	10.2	5.3
Net Exports (contribution)	-0.1	0.5	2.5	-1.5	1.3	-0.2

1. Annual changes are Q4/Q4.

car purchases; and consumer confidence has continued to improve, albeit at a subdued pace. Twelve-month consumer-price inflation has remained low, averaging about 1-3/4 percent through February, and the unemployment rate was unchanged in January.

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

	1996 Q3	Q4	Oct	Nov	Dec	1997 Jan	Feb
Consumption of Manufactured Products	2.7	-3.5	-3.1	-0.7	-1.3	1.9	n.a.
Industrial Production[1]	1.9	-1.1	-0.6	0.0	0.6	n.a.	n.a.
Capacity Utilization	82.3	83.0	...	...	...	...	...
Unemployment Rate (%)	12.5	12.7	12.6	12.7	12.7	12.7	n.a.
Business Confidence[2]	-26.7	-19.7	-23.0	-21.0	-14.0	1.0	6.0
Consumer Prices[3]	1.8	1.7	1.8	1.6	1.7	1.8	1.6

1. For the months of July and August, INSEE publishes a composite number for industrial production.
2. Percent balance of respondents citing an improvement in the outlook versus those citing a worsening.
3. Percent change from previous year.

In the **United Kingdom**, real GDP growth picked up in the fourth quärter with a strong increase in consumption and a sizable contribution from net exports. However, fixed investment growth was weak for a second consecutive quarter following rapid growth earlier in the year.

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

	1995	1996	1996 Q1	Q2	Q3	Q4
GDP	1.9	2.7	2.4	2.2	2.7	3.4
Total Domestic Demand	0.6	2.1	3.6	0.5	2.0	2.5
Consumption	1.4	3.7	4.8	2.6	4.0	3.5
Investment	-1.9	1.9	6.8	8.3	-7.6	0.9
Government Consumption	1.4	1.0	-0.6	0.8	2.7	1.0
Inventories (contribution)	-0.2	-0.7	-0.4	-2.7	0.3	-0.0
Net Exports (contribution)	1.0	0.0	-2.2	1.7	-0.4	0.7
Non-oil GDP	1.8	2.6	2.3	1.9	2.6	3.4

1. Annual changes are Q4/Q4.

More recent information suggests that domestic demand has continued to expand rapidly. Retail sales rebounded in January following a drop in December and continued to rise in February; for the two months on average, sales were 0.8 percent above the fourth-quarter level. In addition, consumer confidence returned in January and February to the high level recorded in November. Industrial production was unchanged in January at a level about 1/2 percent above the fourth-quarter average, as a rise in manufacturing output was offset by a drop in the utility sector due to slightly warmer weather. Business sentiment improved in January and February following a sharp fall in December, but the index remains below the high levels recorded in the fall, reflecting reduced expectations for exports in response to the recent sharp appreciation of sterling. The unemployment rate has continued to drop, reaching 6.2 percent in February, its lowest level in over six years. About half of the one-percentage point decline since October has been attributed to a tightening in the rules for unemployment compensation and the rest to new job creation.

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

	1996					1997	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	0.3	0.3	0.9	0.6	0.6	0.0	n.a.
Retail Sales	1.3	0.9	1.1	1.0	-0.9	0.6	0.5
Unemployment Rate (%)	7.7	7.5	6.9	6.9	6.7	6.5	6.2
Business Sentiment	14.0	21.3	18.0	21.0	13.0	14.0	16.0
Consumer Prices[1]	2.8	2.9	3.2	3.3	3.1	3.1	n.a.
Producer Input Prices[2]	0.0	-2.7	-4.6	-5.3	-6.2	-6.5	-6.6
Average Earnings[2]	3.8	4.0	4.2	4.3	4.8	5.0	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 3.1 percent in January from a year earlier, well above the government's target rate of 2-1/2 percent or less. Goods-price inflation has declined over the past year despite a surge in petrol prices, while services prices have accelerated. This trend continued in January. Growth in average earnings has also picked up. The underlying rate of increase of average earnings was revised up to 4.8 percent in December and increased further to 5 percent in January, although financial sector bonus payments may have biased the recent figures upwards. However, producer input prices have dropped considerably below year-earlier levels, in part a result of sterling's appreciation over the past year.

Prime Minister Major announced March 17 that the next election wil be held on May 1. The Labour Party is widely expected to win, as recent polls show it having a lead of over 20 points.

In **Italy**, real GDP declined a provisional 0.4 percent (SAAR) in the fourth quarter, and growth for 1996 as a whole (year/year), amounted to only 0.8 percent. Complete details will not be available until mid-April. However, we do know that the quarter-on-quarter drop was due, in part, to two fewer working days than in the third quarter and to weaker exports.

Indicators for the first-quarter are very limited. Business sentiment that remained weak in the last three quarters of 1996, strengthened in January. Consumer confidence, which remains below its 1996 average, rose in January but declined slightly in February.

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

	1996					1997	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	-0.8	-0.5	-0.7	0.4	-2.2	n.a.	n.a.
Cap. Utilization (%)	76.6	75.6	75.1	...	...	...	...
Unemployment Rate (%)	12.2	12.1	12.0	...	...	...	...
Consumer Confidence[1]	113.8	114.1	104.7	102.7	105.3	109.9	109.0
Bus. Sentiment[2] (%)	-1.0	-1.0	1.3	-5.0	12.0	21.0	n.a.
Consumer Prices[3]	4.2	3.4	2.8	2.6	2.6	2.6	2.4
Wholesale Prices[3]	3.4	2.0	1.8	1.8	1.5	1.0	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.

After remaining stable at 2.6 percent for three consecutive months, the consumer price index rose, on a year-over-year basis, 2.4 percent in February, less than half the rate recorded twelve months ago. Inflation is very likely to remain stable in light of continued moderation in wholesale and producer price increases, reflecting both the appreciation of the lira over the past year and a half and productivity gains due to containment of labor costs since 1993.

In February, the government formally committed to presenting a supplemental 1997 deficit reduction package by the end of March in order to reach the Maastricht criteria on time. On February 21, the official statistical agency of the EU, Eurostat, ruled permissible the Italian accounting of taxes on wage funds and guaranteed enterprise debt. As a result, Italy's 1996 budget deficit to GDP ratio declined to 6.8 percent from 7.2 percent.

Economic activity in **Canada** expanded 2.9 percent (SAAR) in the fourth quarter of 1996. Total domestic demand was very strong, reflecting a rebound in consumption expenditures and residential construction as well as continued strength in machinery and equipment investment. Inventory accumulation also contributed to the quarter's growth, while net exports subtracted from growth. Exports fell sharply, and in large part reflected the GM strike early in the quarter. The increase in imports was accounted for largely by computers and other machinery and equipment.

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

	1995	1996	1996			
			Q1	Q2	Q3	Q4
GDP	0.7	2.3	1.4	1.4	3.3	2.9
Total Domestic Demand	-0.1	4.5	2.9	-2.1	7.3	10.3
Consumption	0.9	3.3	5.1	0.6	2.0	5.6
Investment	-1.8	12.0	10.0	-0.8	19.4	20.8
Government Consumption	-1.4	-1.6	-1.8	0.6	-3.9	-1.5
Inventories (contribution)	0.1	0.3	-1.8	-2.5	2.8	2.6
Exports	5.0	1.3	-0.7	8.4	8.6	-10.1
Imports	4.0	6.6	3.4	-2.2	18.8	7.4
Net Exports (contribution)	0.4	-2.2	-1.7	4.4	-3.8	-7.8

1. Annual changes are Q4/Q4.

Indicators for the first quarter are limited but point to continued strong growth. Employment changed little in January and February, and the unemployment rate remained 9.7 percent in both months. Housing starts picked up in January and February; for the two months on average, starts were up 17.5 percent from the fourth-quarter average. Manufacturing shipments recovered in January and new orders increased sharply to a level 5.7 percent over the fourth-quarter average. Headline consumer price inflation has picked up a little in recent months but remains close to the midpoint of the Bank of Canada's target range of 1-3 percent.

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

	1996					1997	
	Q2	Q3	Q4	Nov	Dec	Jan	Feb
Industrial Production	0.5	2.1	0.7	1.1	-1.1	n.a.	n.a.
Manufacturing Survey:							
Shipments	2.4	3.2	-0.3	3.2	-0.6	2.2	n.a.
New Orders	2.5	2.7	0.2	2.2	1.0	4.3	n.a.
Retail Sales	0.3	0.8	2.4	1.0	-0.3	n.a.	n.a.
Housing Starts	10.0	3.9	0.4	17.0	-1.5	7.8	9.6
Employment	0.2	0.1	0.4	0.1	0.2	0.0	-0.1
Unemployment Rate (%)	9.6	9.7	9.9	10.0	9.7	9.7	9.7
Consumer Prices[1]	1.4	1.4	2.0	2.0	2.2	2.2	n.a.

1. Percent change from year earlier.

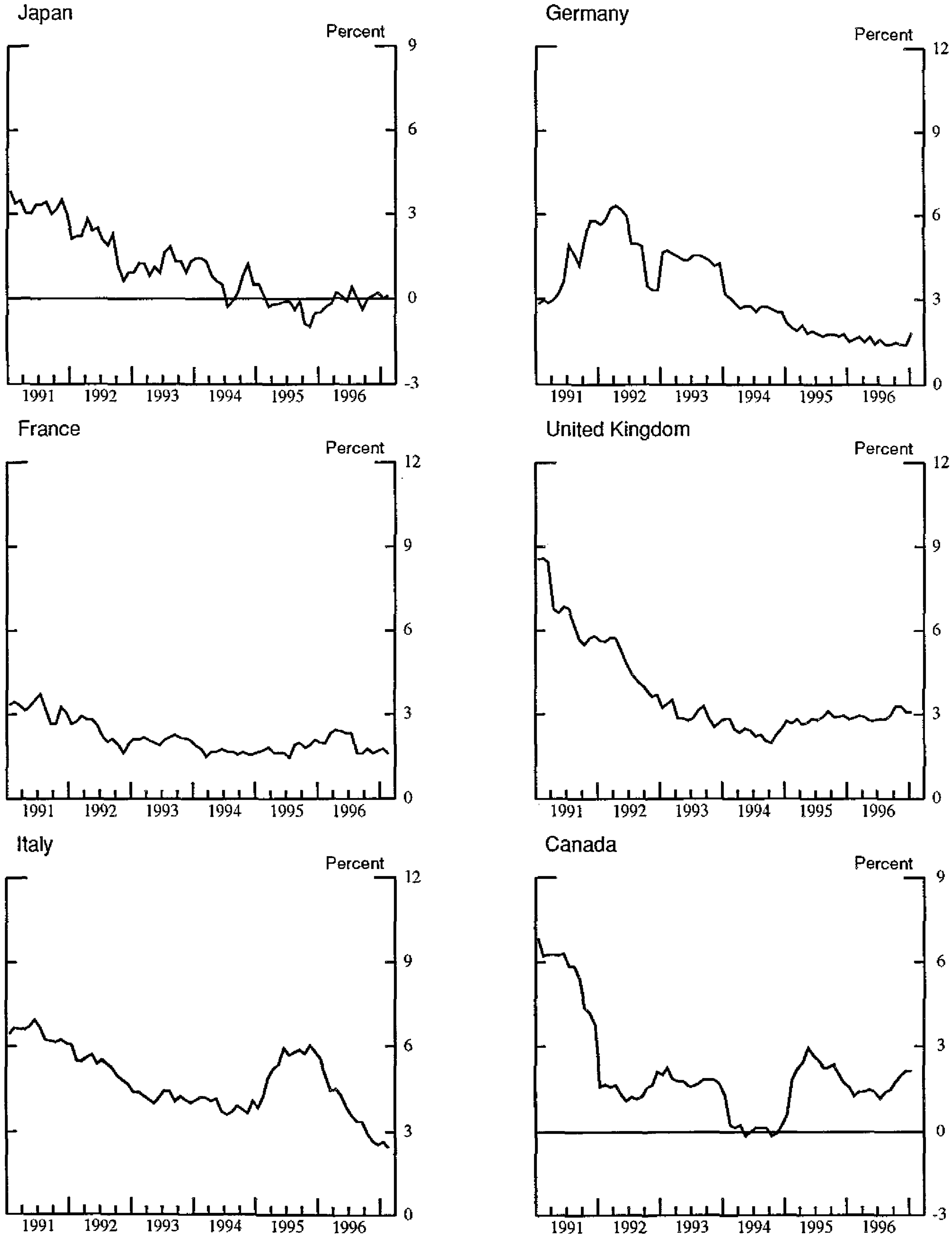
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1996	1996						
		Q2	Q3	Q4	Nov	Dec	Jan	Feb
Japan: trade	61.4	13.4	15.0	15.9	6.9	4.4	5.5	3.8
current account	66.9	15.3	18.9	17.4	7.4	5.1	6.8	n.a.
Germany: trade[1]	64.8	15.3	18.1	18.3	6.5	4.6	n.a.	n.a.
current account[1]	-15.9	-3.7	-7.1	-2.6	0.3	-1.9	n.a.	n.a.
France: trade	23.8	4.6	6.4	7.1	1.7	2.2	n.a.	n.a.
current account	20.6	3.8	5.4	4.1	1.4	0.5	n.a.	n.a.
U.K.: trade	-19.4	-4.7	-4.6	-4.3	-1.7	-1.4	n.a.	n.a.
current account	n.a.	0.7	-0.2	n.a.	...	...	...	...
Italy: trade	n.a.	12.4	9.6	n.a.	3.9	n.a.	n.a.	n.a.
current account[1]	n.a.	11.1	14.3	n.a.	4.1	n.a.	n.a.	n.a.
Canada: trade	25.0	7.3	7.1	4.7	1.5	1.7	n.a.	n.a.
current account	-1.2	0.8	0.2	-1.3	...	...	...	...

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

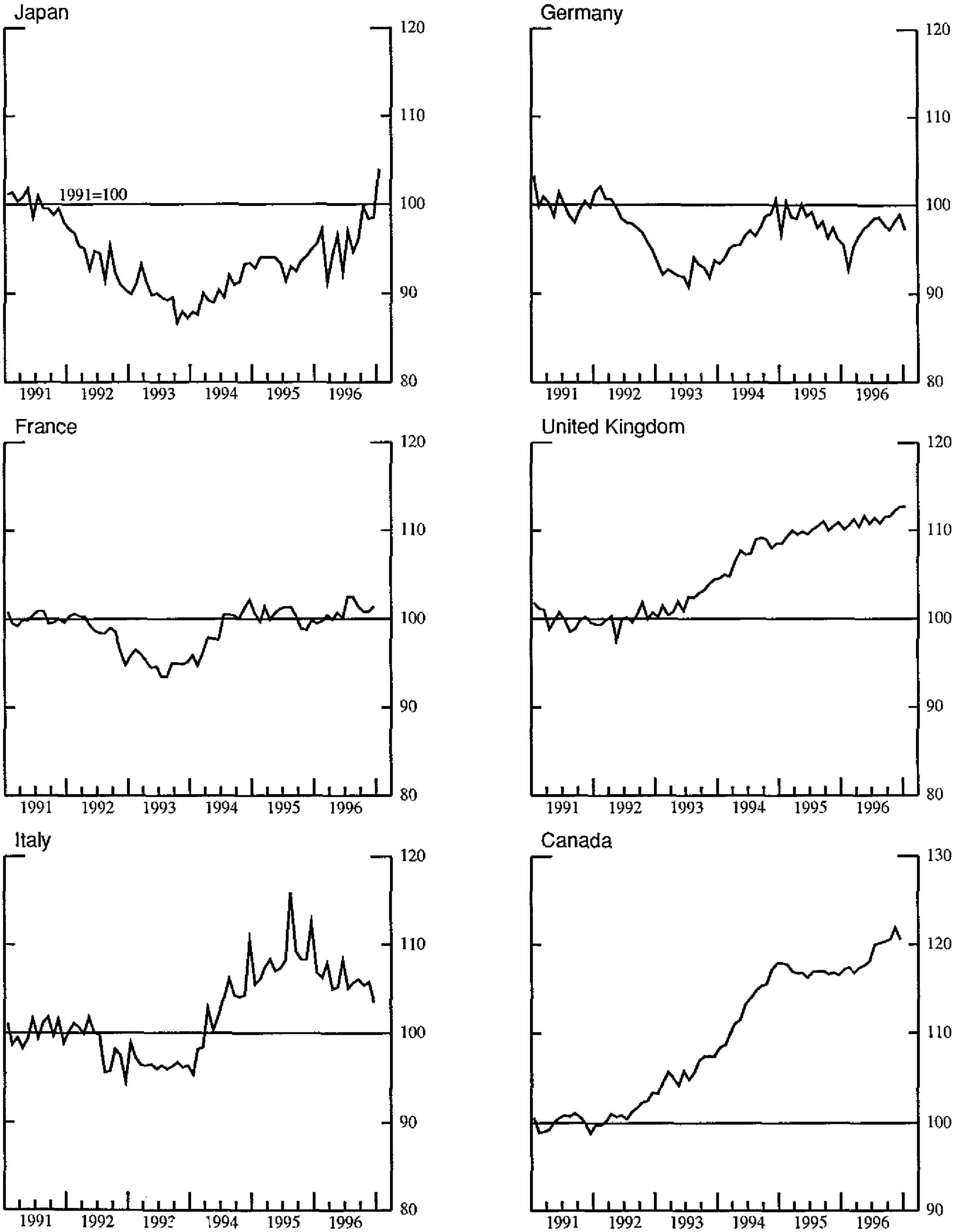
MARCH 19, 1997

Consumer Price Inflation in Selected Industrial Countries
(12-month change)



MARCH 19, 1997

Industrial Production in Selected Industrial Countries
(12-month change)



Economic Situation in Other Countries

In Latin America, the strong expansion in economic activity in Mexico, Argentina, and Brazil continues. In Venezuela, prospects for a near-term recovery remain uncertain. In Asia, output growth, although high, has slowed somewhat in China, but prospects look better for Taiwan, which seems to have recovered from a mild slowdown in 1996. The situation in Korea remains uncertain due in part to recent industrial unrest and also due to the political scandal after the second largest steel producer defaulted on a loan payment. In Russia, the economy seems to be on the verge of a turnaround.

Inflation for 1996 in the developing economies varied across countries. but generally the trend was lower. The decline in inflation rates for 1996 to single digits in Brazil and China is notable. In Russia, inflation is higher than target inflation, but considerably lower than last year's inflation. Prospects for a further reduction in inflation in Venezuela disappeared after the government agreed to public sector wage increases averaging 75 percent. External balances have worsened in Mexico, Brazil, and Korea. For Mexico and Brazil, a pick up in aggregate demand is the leading cause of this decline. For Korea, the deterioration of the current account in 1996 was further exacerbated in January by the impact of industrial unrest on exports. External balances have improved in Argentina and Venezuela due to strong export growth in Argentina (led by strong Brazilian export demand), and high oil prices in Venezuela. In China, the trade surplus for 1996 was down relative to 1995, but recently there has been strong export growth.

Individual country notes. In **Mexico**, the economy has recovered more rapidly than previously expected from the sharp downturn that followed the December 1994 devaluation. In the fourth quarter of 1996, real GDP was 7.6 percent higher than the year-earlier quarter. The increase was much higher than market expectations of 5 to 5-1/2 percent. The sharp increase over the previous four quarters more than offset the 7 percent decline (Q4/Q4) in 1995, putting the level of GDP in the fourth quarter of 1996 for the first time above its pre-crisis level. For 1996 as a whole, real GDP grew 5.1 percent from the previous year, following a 6.2 percent decline in 1995. The industrial sector led the way during 1996, with a 10.4 percent increase in production from 1995, while the service sector showed a more moderate increase of 3.1 percent. On a seasonally adjusted basis, we estimate GDP to have increased a robust 3 percent (not at an annual rate) in the third and fourth quarters.

Recent data revealed a moderate worsening in the Mexican current account picture. The current account deficit widened in the fourth quarter of 1996 to bring the deficit for 1996 as a whole to $1.8 billion, compared with a revised deficit of $1.6 billion for 1995 (previously reported to be only $0.7 billion). Monthly data on the trade balance showed some improvement in December and January, largely due to a moderation in imports, which had been growing rapidly in previous months.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	-6.2	5.1	7.0	7.6	...	...
Industrial Production (SA)	-7.5	10.4	16.2	12.8	n.a.	n.a.
Unemployment Rate (%)	6.3	5.5	5.5	4.7	4.5	n.a.
Consumer Prices[1]	52.1	27.7	4.4	6.1	2.6	1.7
Trade Balance[2]	7.0	6.3	1.4	0.7	0.5	n.a.
Imports[2]	72.5	89.6	22.9	25.5	7.7	n.a.
Exports[2]	79.5	95.9	24.3	26.2	8.1	n.a.
Current Account[2]	-1.6	-1.8	-0.8	-1.4	...	...

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

Consumer price inflation slowed in February to a monthly rate of 1.7 percent, returning to the pace it exhibited last fall. That is in contrast to monthly inflation of 3.2 percent in December and 2.6 percent in January, when the seasonal effects of greater spending and bonuses paid during the Christmas season were exacerbated by increases in the minimum wage and public sector prices.

On February 19, Mexico announced a pre-payment of $590 million to the International Monetary Fund, continuing the Mexican strategy of pre-paying external debt in order to diminish the concentration of payments due in 1998 and 1999. The funds for the pre-payment represent half of the approximately $1.18 billion that Mexico will receive from two recent bond issues. The other half of the bond proceeds will be used to build international reserves.

In **Argentina**, the upturn in economic activity has gained further strength, but there are signs that inflation may be increasing a little. Real GDP grew by a strong 9.2 percent in the fourth quarter of 1996 compared with the same period a year ago, bringing the year-over-year rate of growth for 1996 to 4.4 percent. Industrial production was up 11.4 percent in January over a year ago. Monthly consumer price inflation was 0.5 and 0.4 percent in January and February, respectively. The January rise can be attributed to a seasonal increase in tourism-related prices with the onset of the Southern summer. The February figure is partly due to a telephone tax rate increase, but also reflects to some extent the recent pick up in domestic demand (monthly inflation in February 1996 was -0.3 percent).

The recovery in activity led to growth in imports of about 11 percent in 1996, but exports, led by strong demand from Brazil, more than kept pace and grew by 14 percent last year, resulting in an increase in the trade balance surplus from $3 billion in 1995 to $3.8 billion in 1996. However, exports have fallen in January and, according to preliminary data, the January 1997 trade balance shows a deficit of $200 million, compared with a deficit of $70 million in January 1996.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	-4.6	4.4	6.6	9.2	...	...
Industrial Production (SA)	-6.2	3.4	8.6	11.7	11.4	n.a.
Unemployment Rate (%)[2]	17.4	17.2	17.3	...	...	...
Consumer Prices[1]	1.5	0.2	0.5	0.3	0.5	0.4
Trade Balance[3]	3.0	3.8	0.7	0.3	-0.2	n.a.
Current Account[3]	-1.6	n.a.	n.a.	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.

International reserves (excluding gold) were $16.5 billion at the end of February 1997, higher than the year-earlier level of $14 billion. Peso and dollar deposits have grown strongly recently and reached $55 billion by year-end 1996. This represents a nearly 50 percent increase since June 1995, when deposits were at their lowest point following the Mexican peso crisis. The public sector deficit in 1996 was $5.8 billion (under 2 percent of GDP) and in line with the revised IMF-agreed target of $6 billion. The January deficit was $400 million, also roughly in line with the IMF-agreed target of $1.04 billion for the first quarter of 1997.

In **Brazil**, real GDP grew at a revised 2.9 percent in 1996, but this masks very strong growth over the last three quarters that averaged 8 percent on an annualized basis. Growth was led by strong performance in the service sectors (especially communications), while industrial output grew by only 2.3 percent. Inflation has continued to be remarkably low by Brazilian standards, despite the lack of progress towards fiscal reform. The fiscal deficit on an operational basis (which removes interest payments eroded in real terms by inflation) was 4.5 percent of GDP in 1996, slightly lower than in 1995, but the improvement owed to lower real interest payments on public debt.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	4.2	2.9	6.5	5.4	...	...
Industrial Production (SA)[1]	3.6	2.3	5.3	n.a.	n.a.	n.a.
Open Unemployment Rate (%)	4.6	5.4	5.5	4.5	5.1	n.a.
Consumer Prices[2]	22.0	9.4	1.9	1.0	0.8	0.45
Trade Balance[3]	-3.2	-5.5	-1.2	-3.9	-0.4	-1.6
Current Account[3]	-17.8	-24.3	-3.7	-10.7	-1.9	-2.7

1. Annual data are from national income accounts.
2. INPC, Percentage change from previous period. Annual data are Dec/Dec.
3. Billions of U.S. dollars, NSA

Strong aggregate demand has contributed to continued trade deficits. The deterioration in the external balance in recent months has put some downward pressure on the *real*/dollar exchange rate. So far, however, the *real*/dollar exchange rate has continued to depreciate slowly, and the government has maintained that there will be no large devaluation. (As of mid-March, the *real*/dollar exchange rate was 1.06 *reais* to the U.S. dollar.) International reserves stood at $59.4 billion at the end of February 1997, slightly down from a peak of $60.5 billion in November 1996.

In **Venezuela**, developments in the labor market have fueled further concerns about high inflation. In January, the government awarded a 164 percent pay rise to striking public sector doctors, which fanned other wage demands from the over 1 million public employees. The government relented in late February and has agreed to wage increases averaging 75 percent. The effects of this wage settlement are expected to spill over to the private sector as well. Thus, despite mildly encouraging consumer price inflation of 2.6 and 2.3 percent monthly for January and February, respectively, analysts believe the government will miss by a wide margin its current target of 25 percent annual inflation in 1997. The IMF is expected to negotiate a new target inflation rate with Venezuela when it concludes its second review under a $1.4 billion stand-by agreement expiring in mid-July. The second review was underway in January 1997, but was suspended pending the outcome of the wage negotiations and has not yet been renewed.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	2.2	-1.6	n.a.	n.a.	...	...
Unemployment Rate (%)	10.8	11.2	...	11.2	...	...
Consumer Prices[1]	56.7	103.3	13.2	10.6	2.6	2.3
Trade Balance[2]	-6.0	n.a.	-1.6	n.a.	n.a.	n.a.
Current Account[2]	2.6	n.a.	...	...	...	...

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

According to preliminary data, real GDP declined year-over-year by 1.6 percent in 1996, with the oil sector expanding by 4.9 percent, but the non-oil sector contracting by 3.6 percent. The recession has led to a narrowing of the non-oil trade deficit, which over the period Jan-Sep 1996 was $3.8 billion compared with $4.5 billion over the same period in 1995. However, oil exports increased markedly during 1996 and are estimated at $18 billion, compared with less than $14 billion in 1995. The oil revenues have also kept international reserves high, which at the end of January

1997 stood at $12 billion (excluding gold), compared with $6.7 billion a year ago.

In **China**, the 12-month consumer price inflation rate fell to 6.8 percent in January, a marked decline from the 25.5 percent recorded in 1994. Strong export growth led to a trade surplus of $3.8 billion in the first two months of 1997, compared with a deficit of $0.4 billion in the year-earlier period. The dollar value of exports rose 21 percent, while imports fell 3 percent. The official budget deficit for 1996/97 equalled 1 percent of GDP (note that this does not count the sizable subsidies to state-owned enterprises through the banking system); the government had forecast a larger deficit, but tax revenue grew faster than expected. China's foreign exchange reserves rose to $110 billion at the end of February, up from $75 billion at the end of 1995.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP[1]	10.5	9.7	9.6	9.7	...	...
Industrial Production	17.8	15.6	15.2	15.6	...	...
Consumer Prices	10.1	7.0	7.9	7.0	6.8	...
Trade Balance[2]	16.7	12.2	7.3	4.0	1.7	2.1

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

The death in mid-February of China's supreme leader, Deng Xiaoping, will likely have little effect on China's economy or the pace of reform in the near term. Officially, the new leadership has been in place for years, and leaders have pledged to continue reforms. Over time, however, renewed leadership struggles may develop, and the outcome may help, or may hinder, economic developments. Financial markets reacted relatively little to the news, which was widely expected. For example, Hong Kong's Hang Seng index--which had fallen slightly the previous week amid rumors of Deng's ill health--rose 2 percent on the first day of trading after the news, and has remained relatively flat since.

In **Taiwan**, economic activity recovered strongly in the fourth quarter of 1996 from a mild slowdown earlier in the year, with GDP rising 6.6 percent from the year-earlier period. The unemployment rate was 2.7 percent in January 1997 and has fallen fairly steadily since reaching its ten-year high of 3.2 percent in August 1996. Inflation remained low, with consumer prices rising 2.0 percent in February. Taiwan's trade surplus in the first two months of 1997 was $1.2 billion, compared with a surplus of $1.7 billion in the year-earlier period. The dollar value of exports fell 1 percent from a year earlier, while the dollar value of imports rose 2 percent. Foreign exchange reserves were $88.3 billion at the end of February, up from its recent low of $83 billion in March 1996, following Chinese missile tests near Taiwan.

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

	1995	1996	1996		1996	
			Q3	Q4	Jan	Feb
Real GDP	6.1	5.7	5.6	6.6	...	...
Industrial Production	4.2	1.6	1.9	4.8	6.0	...
Consumer Prices	4.6	2.5	3.8	2.5	2.0	2.0
Trade Balance[1]	8.3	14.3	4.6	4.0	1.0	0.2
Current Account[1]	5.0	10.5	4.0	2.8	...	...

1. Billions of U.S. dollars, NSA

In **Korea**, the Hanbo Steel Company, the country's second-largest steel producer, defaulted on loan payments on January 23. So far, the investigation into the financial collapse has led to the arrests of several prominent bankers and politicians on charges of bribery in connection with loans extended to Hanbo Steel. On March 5, President Kim appointed a new Prime Minister and a new Finance Minister as part of a sweeping cabinet reshuffle intended to deflect criticism of his handling of the Hanbo scandal.

Ruling and opposition parties struck a deal on March 10 on amendments to controversial labor laws that had sparked widespread industrial unrest for a month starting December 26. The compromise allows for the formation of multiple umbrella labor groups, which is a move aimed at legalizing the outlawed Korea Federation of Trade Unions (KFTU); however, the formation of more than two unions at one work site would not be permitted until 2002. Employers' groups have accepted the amended bills, but the KFTU is threatening to wage a general strike on May 1.

The impact of the labor unrest was reflected in the figures for January's industrial production and external balances.

Industrial production grew by 5.9 percent (year-on-year) compared with a 12.4 percent rise a year earlier. Korea's trade and current account deficits showed a sharp jump in January, in part due to the adverse impact of the strikes on automobile exports.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	9.0	6.8	6.4	6.6	n.a.	n.a.
Industrial Production	11.7	8.4	7.9	9.8	5.9	n.a.
Consumer Prices	4.5	5.0	5.2	4.8	4.7	4.9
Trade Balance[1]	-4.7	-15.3	-4.4	-3.9	-2.2	n.a.
Current Account[1]	-8.9	-22.6	-7.3	-6.2	-3.1	n.a.

1. Billions of U.S. dollars, NSA

In **Russia**, both the economy and the health of President Yeltsin seem to be on the verge of a turnaround. January year-on-year GDP growth was 0.1 percent, which was low but nonetheless the first positive reading since the beginning of the reforms. Similarly, Yeltsin made a strong showing at his first substantive public appearance since his election nine months ago when he gave a half-hour speech on the state of the country on March 6.

Yeltsin's return to full-time work may give a needed jolt to economic reform, which had been stalled. Yeltsin signed a 1997 budget in late February, but also said that he considered the budget flawed and not achievable. Moreover, on March 7 he initiated a cabinet shakeup by naming the effective, but unpopular Anatoly Chubais First Deputy Prime Minister. During the past week, Yeltsin made additional changes, shifting the cabinet composition toward reformers. Most notably, Chubais was also named Minister of Finance, and the Economy Ministry absorbed the Defense Industry Ministry and the Industry Ministry. There now seems to be hope that a sorely needed tax code may be passed sometime during 1997, although it may not be implemented until 1999.

Inflation for the first two months of 1997 came in at 3.8 percent, higher than would be consistent with the targeted annual rate of 12 percent but still lower than last year's inflation for the same period (1996 inflation came in at 22 percent for the year). The ruble-dollar exchange rate has continued to remain well within the corridor set by the Central Bank. However, U.S. dollar shipments to Russia remain higher than ever, and official Russian statistics indicate that individuals spent one quarter of their incomes on foreign currency purchases during the month of January, 1997.

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

	1995	1996	1996		1997	
			Q3	Q4	Jan	Feb
Real GDP	-4	-6	-7	-6	0.1	n.a.
Industrial Production	-3	-5	-8	-5	0.3	n.a.
Consumer Prices[1]	7	1.7	0	2	2.3	1.5
Ruble Depreciation[1]	2	1.5	2	1	1.3	0.8
Trade Balance[2]	18.3	n.a.	4.9	n.a.	n.a.	n.a.
Current Account[2]	5.7	n.a.	n.a.	n.a.	n.a.	n.a.

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

Russia's three-year, $10 billion IMF Extended Fund Facility was held up in October and November, but has been moving back on track, with a double tranche released in January and another double tranche expected soon. The IMF and Russia are working now on a plan for 1997; the chief concerns are structural changes, including restructuring of the energy monopolies, and revenue collection.