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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

June 25, 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

June 25, 1997

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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DOMESTIC NONFINANCIAL DEVELOPMENTS

After surging in the first quarter, real GDP appears to be headed toward only a moderate increase in the second quarter--primarily because of a slackening in consumer spending. In contrast, industrial production, which has been less volatile recently, will likely post a third consecutive 4 percent to 5 percent (annual rate) gain this quarter. Growth of payroll employment subsided a bit recently, but the unemployment rate moved down further. Meanwhile, inflation remained modest despite high rates of resource utilization, with the core CPI rising 2.5 percent over the year ending in May.

Real GDP

According to BEA's preliminary estimate, real GDP grew 5.8 percent at an annual rate in the first quarter of 1997. As shown in the table, we expect data revisions, on net, to leave this figure unchanged. Among the components of GDP, the largest expected change is to net exports, where annual revisions to the merchandise trade data point to a smaller first-quarter rise in imports. However, revised book-value data suggest that the pace of inventory accumulation was slightly slower than BEA estimated at the time of the preliminary release.

FIRST-QUARTER GROWTH OF REAL GDP
(Billions of 1992 chained dollars)

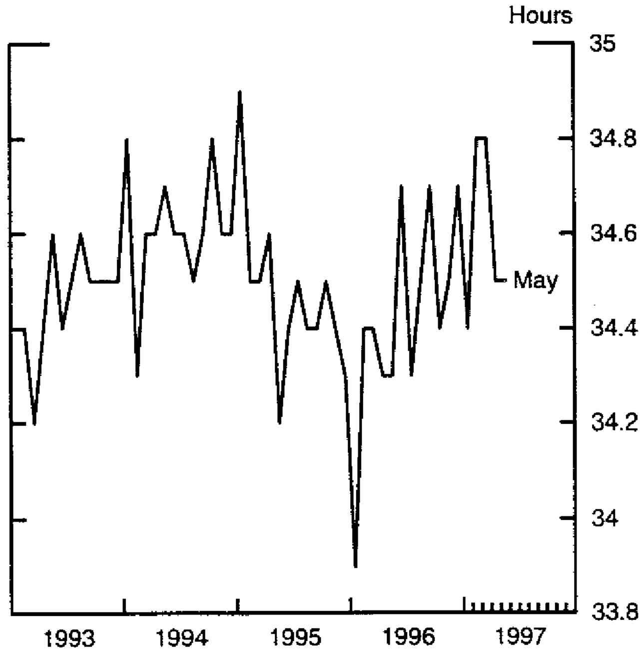
Category	BEA preliminary	Expected revision
Real GDP	98.8	.2
Inventory investment	34.3	-4.3
Final sales	64.9	4.8
PCE	66.2	-.5
BFI	21.8	-2.1
Residential structures	4.0	.1
Government	.2	.5
Net exports	-28.4	6.4
Exports	23.1	-.9
Imports	51.6	-7.4
Memo:		
Real GDP growth (percent, annual rate)	5.8	5.8

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

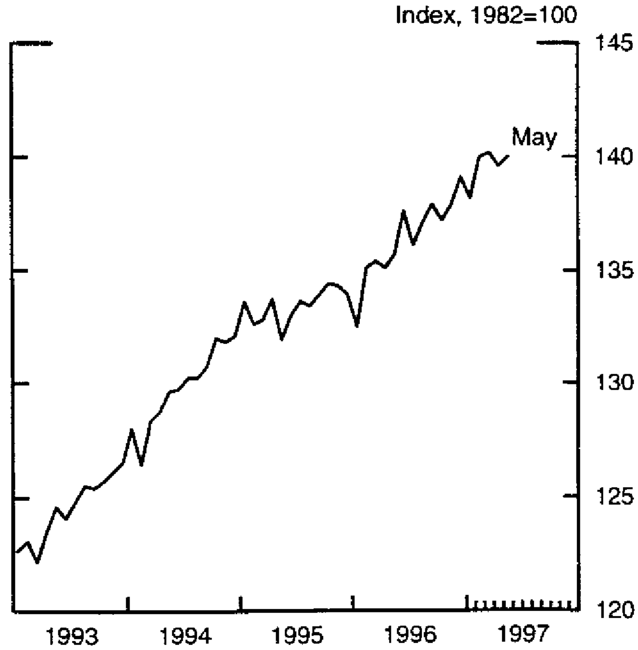
	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Mar.	1997 Apr.	1997 May
	-----------Average monthly changes---------							
Nonfarm payroll employment[1]	185	212	168	213	228	182	323	138
Private	176	198	142	213	218	184	290	166
Manufacturing	-1	-5	-14	7	14	14	2	-5
Durable	11	5	-2	11	15	12	8	0
Transportation equipment	-1	1	-1	3	6	6	-6	-1
Nondurable	-12	-10	-11	-4	-1	2	-6	-5
Construction	10	24	11	27	29	5	-10	23
Trade	48	60	54	80	28	41	103	3
Finance, insurance, real estate	-1	11	9	12	10	12	27	11
Services	113	98	77	88	97	85	146	125
Help supply services	10	13	13	3	17	25	-38	-17
Total government	9	14	25	0	10	-2	33	-28
Private nonfarm production workers[1]	151	168	116	180	195	158	190	161
Manufacturing production workers	-2	-5	-9	7	9	9	1	11
Total employment[2]	32	232	219	202	440	745	209	255
Nonagricultural	51	225	195	220	453	651	98	322
Memo:								
Aggregate hours of private production workers (percent change)[1]	.1	.3	.1	.3	.3	.1	-.4	.3
Average workweek (hours)[1]	34.5	34.4	34.5	34.5	34.7	34.8	34.5	34.5
Manufacturing (hours)	41.6	41.5	41.7	41.8	41.9	42.1	42.1	42.0

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



Aggregate Hours of Production or Nonsupervisory Workers



Labor Market Developments

Growth of payroll employment moderated just a bit from the fast pace in the first quarter, although after incorporating the annual revisions to the establishment survey, it now appears that the second quarter began with greater strength in hiring than initially reported.[1] In May, the unemployment rate fell to its lowest level since 1973, and the labor force participation rate, though down from its historical high in March, was just under the previous cyclical peak reached in January 1990.

Nonfarm payrolls increased 138,000 in May, and employment growth in April was revised up from 142,000 to 323,000. Part of the upward revision for April was a technical adjustment made as part of the annual revisions.[2] But even netting out the effects of special factors, employment growth averaged a little under 200,000 over the first two months of the second quarter--not far from the first-quarter pace.

The bulk of employment growth over the past two months has been in services, particularly health, hotel, and amusement services. One surprisingly weak industry has been help-supply, where employment has fallen 55,000 over the past two months. This weakness may reflect a lack of available workers, rather than a slowdown in demand: Help-supply firms report no drop-off in new orders but have had problems filling them. In the goods-producing sector, the pace of employment growth has slowed from the first quarter. As expected, construction employment bounced back in May from the weather-depressed levels in March and April. However, averaging through the fluctuations, employment growth in construction has dropped back from the pace at the end of last year.

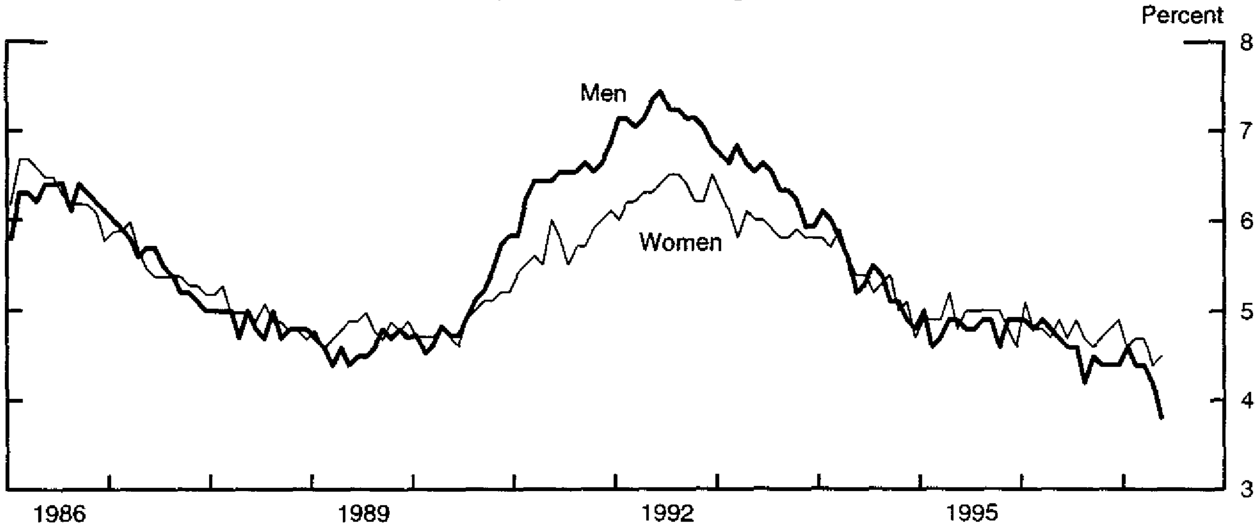
1. The annual revisions to the data from the establishment survey stemmed from four sources: the benchmarking of employment in March 1996 to levels derived from state unemployment insurance records; the recalculation of bias adjustment factors for the period after March 1996; the updating of seasonal adjustment factors; and the reassigning, or "resizing," of surveyed establishments into size classes based on their recent employment levels.

2. We estimate that this technical factor--the resizing adjustment mentioned above--accounted for about 100,000 of the upward revision for April. However, this discrete adjustment actually represents job growth that occurred over the course of the previous year, and ideally it should be smoothed into the employment data starting in April 1996 rather than entered all at once in April 1997. In addition, payroll growth in May probably was understated because of seasonal adjustment difficulties. Using concurrent seasonals, nonfarm payroll employment increased 155,000 in May.

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

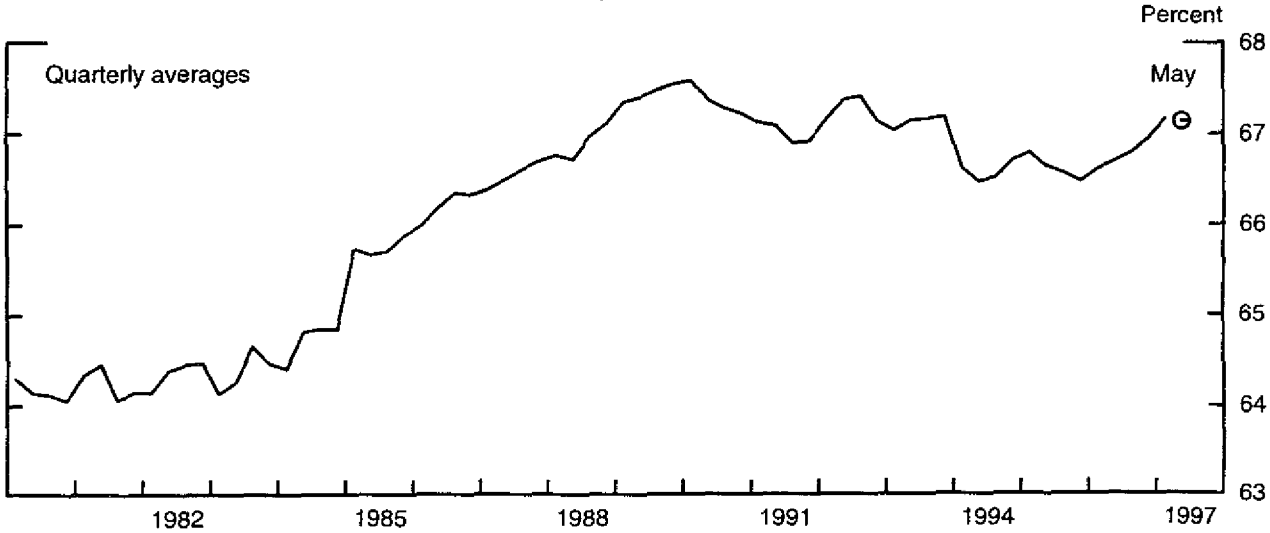
			1996		1997	1997		
	1995	1996	Q3	Q4	Q1	Mar.	Apr.	May
Civilian unemployment rate (16 years and older)	5.6	5.4	5.3	5.3	5.3	5.2	4.9	4.8
Teenagers	17.3	16.7	16.6	16.6	17.0	16.4	15.4	15.6
Men	4.8	4.6	4.5	4.4	4.5	4.4	4.2	3.8
Women	4.9	4.8	4.7	4.8	4.7	4.7	4.4	4.5
Full-time workers	5.5	5.3	5.2	5.2	5.2	5.1	4.8	4.7
Labor force participation rate	66.6	66.8	66.8	66.9	67.2	67.3	67.2	67.1

Unemployment Rates, Age 20+



Note. Series are adjusted for CPS redesign in 1994.

Labor Force Participation Rate, Age 16+



Note. Series adjusted for CPS redesign in 1994.

In addition, on a strike-adjusted basis, manufacturing employment has changed little since March, compared with average monthly growth of about 15,000 in the first quarter.

The average workweek of production or nonsupervisory workers held steady at 34.5 hours in May, after averaging 34.7 hours in the first quarter. As a result, the average level of aggregate hours of production or nonsupervisory workers in April and May was only 0.2 percent above the level in the first quarter.

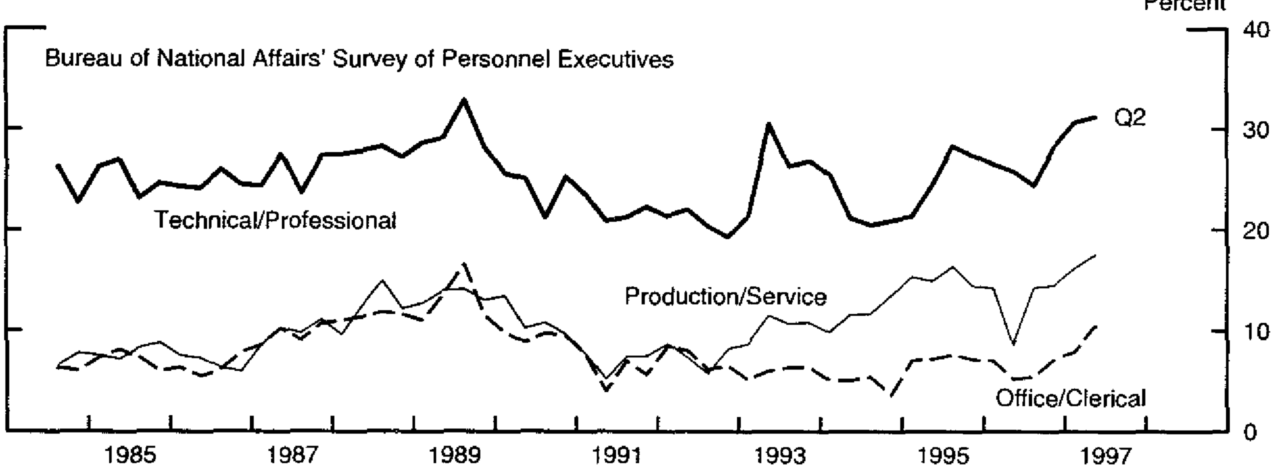
In the household survey, the unemployment rate edged down to 4.8 percent in May, from 4.9 percent in April.[3] Declines were particularly noticeable for adult men, while the rates for women and teenagers rose slightly. The tight labor market continued to keep labor force participation at relatively high levels. The participation rate in May inched down to 67.1 percent after reaching a record 67.3 percent in March. But cutting through the monthly wiggles, the participation rates of virtually all major demographic groups have trended up over the past year.

Most other labor market indicators provide evidence of a strong labor market. According to the BNA survey, the share of employers reporting some difficulty filling jobs rose further in the second quarter for all three occupational categories included in the survey. The Manpower, Inc. survey of hiring intentions for the next quarter showed a further strengthening of labor demand, with hiring intentions now at the highest level since 1988. (Although the Manpower survey reports hiring intentions for the next quarter, statistical evidence suggests that the reading is more closely correlated with hiring strength in the current quarter). Households' views of current job availability, as measured by the Conference Board survey, moved to very positive levels in June. The one sign pointing toward moderation is the level of initial claims for unemployment insurance. Since the last Greenbook, the four-week moving average of claims has risen slightly, to 335,000, after dipping in early June. Unlike the rise in mid-April, the recent increase in claims does not appear to have been caused by special weather- or strike-related factors.

3. On a concurrent seasonal basis, the unemployment rate fell from 5.0 percent in April to 4.8 percent in May.

Labor Market Indicators

Some Jobs Difficult to Fill

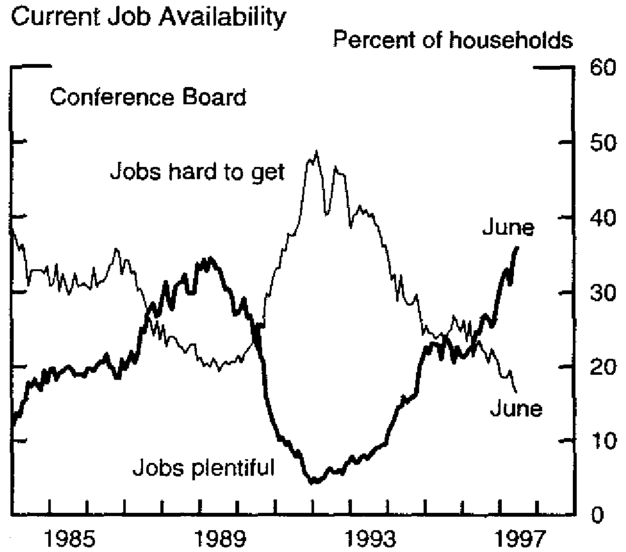


Note. Seasonally adjusted by FRB staff.

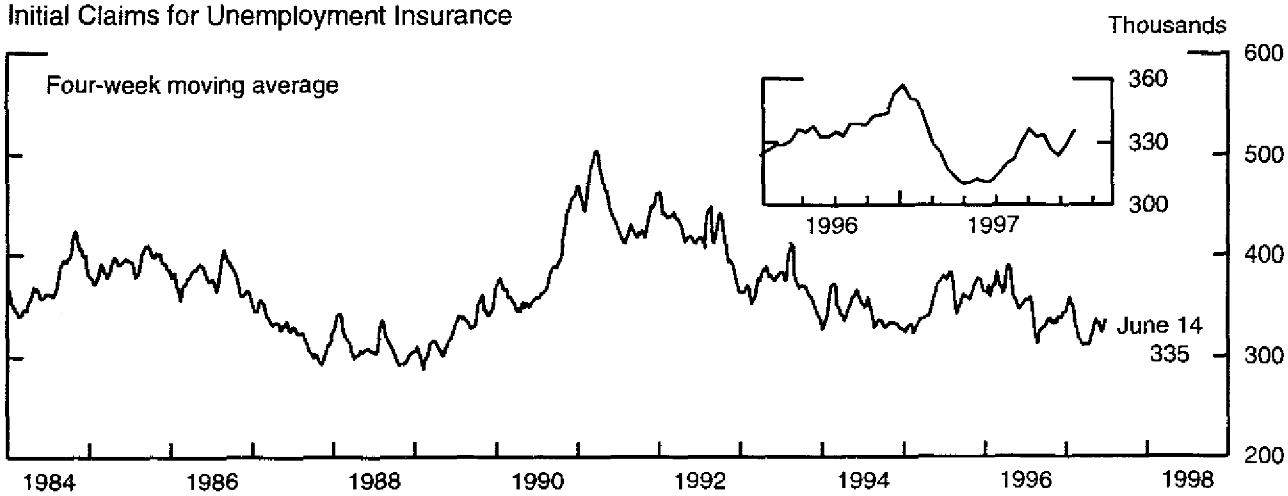
Net Hiring Strength

Note. Percent planning an increase in employment minus percent planning a reduction.

Current Job Availability



Initial Claims for Unemployment Insurance



Note. State programs, includes EUC adjustment.

Industrial Production

Industrial output continued to grow briskly in the spring, rising 0.4 percent in May after registering similar gains in the preceding two months. Manufacturing output posted a sizable 0.5 percent increase in May and mining was up 2.0 percent, while utility production fell because of cooler-than-average temperatures. On balance, the recent growth of factory output has been about in line with the growth in capacity. As a result, manufacturing capacity utilization has held steady at slightly above 82-1/2 percent over the past four months.

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

	1997			1997		
	Apr.	May	June^e	Q1	Q2^e	Q3
						Sched.
U.S. production	11.3	11.5	12.1	12.3	11.6	12.3
Autos	5.7	5.8	6.0	6.1	5.8	6.2
Trucks	5.6	5.7	6.1	6.3	5.8	6.0
Days' supply						
Autos	61.1	59.7	61.2	55.0	61.2	--
Light trucks	77.3	71.8	68.1	69.4	68.1	--

Note. Components may not sum to totals because of rounding.
e--Staff estimates based on weekly data for June.

The motor vehicle and parts industry has been quite volatile in recent months, owing mainly to strikes. Production of motor vehicles and parts bounced back 1.2 percent in May after falling 2.7 percent in April, when strikes curtailed assemblies at Chrysler and General Motors. However, with inventories still ample at the end of May, only a part of the strike-related losses in production, most of which were light trucks, is likely to be made up. At the end of May, the days' supply of light trucks was just above 70 days, a little on the high side, while the days' supply of autos was running about 60 days. Assemblies appear to be increasing a little more rapidly in June than in May, rising just above 12 million units (annual rate); only one strike at a truck assembly plant has affected June output. Total assemblies for the second quarter are expected to be 11.6 million units at an annual rate, compared with 12.3 million in the first quarter.

Outside of motor vehicles, the production of consumer goods edged down in May, as a decline in consumer nondurables offset a

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

	Proportion 1996	1996[1]	1996 Q4	1997 Q1	1997 Mar.	Apr.	May
			-Annual rate-		--Monthly rate---		
Total index	100.0	3.9	4.5	4.4	.4	.3	.4
Previous		3.9	4.5	4.7	.6	.0	
Manufacturing	86.5	4.1	4.3	5.3	.4	.2	.5
Durables	47.1	5.7	2.8	8.2	.7	.6	.8
Motor veh. and parts	4.9	-1.6	-15.2	14.1	-.5	-2.7	1.2
Aircraft and parts	2.3	34.5	33.0	18.1	1.9	1.6	.7
Nondurables	39.4	2.3	6.0	2.0	.1	-.2	.2
Manufacturing excluding motor vehicles and parts	81.6	4.5	5.6	4.8	.5	.4	.5
Mining	5.6	3.4	.5	8.0	1.3	-.5	2.0
Utilities	7.9	1.4	9.5	-7.1	-.3	2.3	-1.9
IP by market group, exluding motor vehicles and parts and energy							
Consumer goods	22.7	2.6	6.4	.5	.7	-.4	-.1
Durables	4.1	3.0	.0	4.3	2.3	-1.4	.5
Nondurables	18.7	2.5	7.9	-.3	.3	-.2	-.2
Business equipment	12.7	9.1	9.3	11.1	.5	1.6	.4
Information processing	5.8	10.8	7.5	12.4	1.0	1.0	.6
Industrial	4.5	-.2	1.1	2.6	-.5	2.1	-.1
Transit	1.2	53.1	48.4	33.3	2.5	1.1	.8
Other	1.3	3.6	12.3	14.4	.0	3.4	.8
Construction supplies	5.7	5.7	-.4	2.5	1.2	-.8	.3
Materials	30.4	5.2	5.4	7.2	.6	.6	.9
Durables	21.5	6.3	4.9	7.6	.9	.9	1.2
Semiconductors	4.0	16.0	17.8	33.4	2.9	2.1	2.8
Basic metals	3.4	2.6	7.2	.2	-.2	.6	1.1
Nondurables	9.0	2.8	6.3	6.3	.1	.0	.1

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

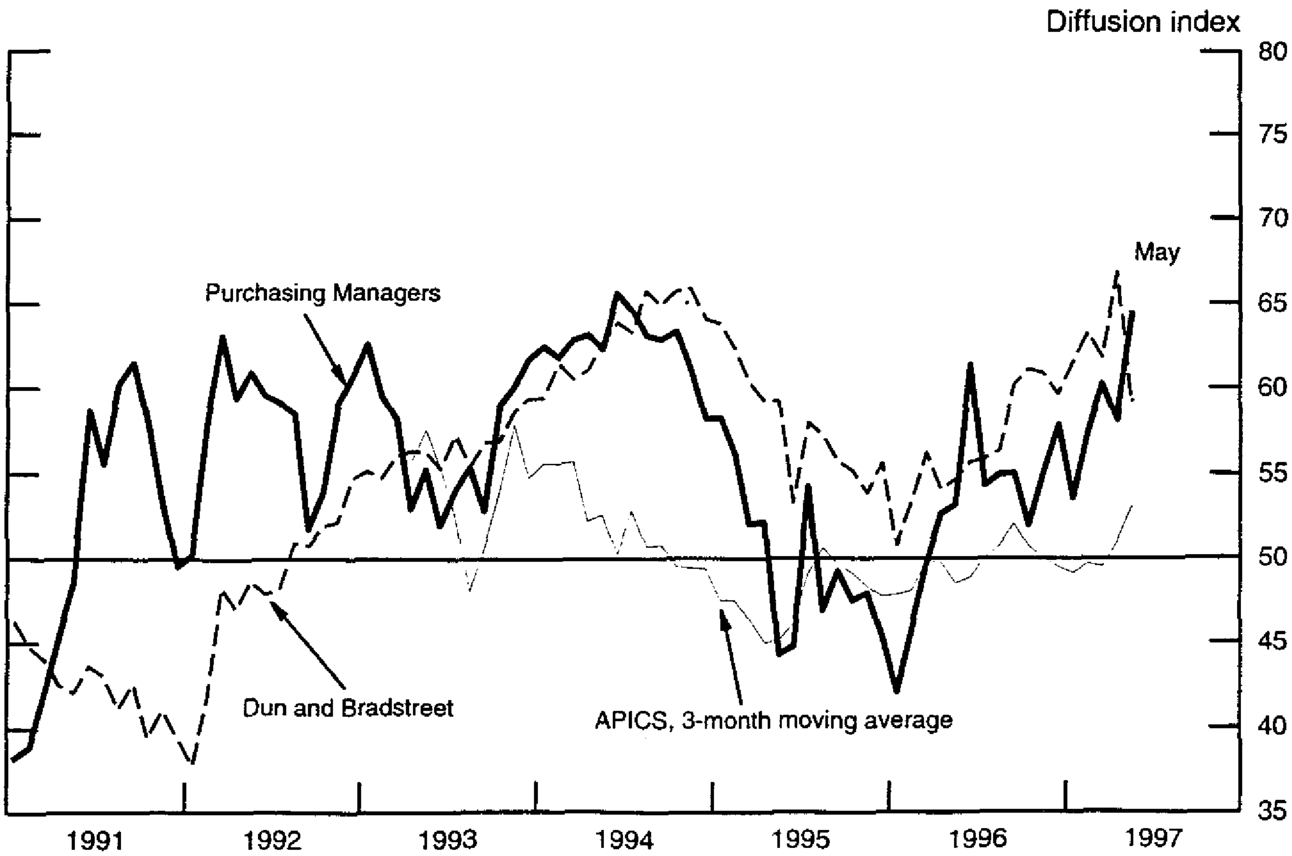
	1988-89 High	1959-96 Avg.	1996 Q4	1997 Q1	1997 Mar.	Apr.	May
Manufacturing	85.7	81.7	82.3	82.5	82.7	82.6	82.7
Primary processing	88.9	82.8	86.6	86.8	87.2	87.1	87.5
Advanced processing	84.2	81.2	80.4	80.7	80.7	80.6	80.7

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

	Share, 1996:H2	1996 Q4	1997 Q1	1997 Mar.	1997 Apr.	1997 May
Total durable goods	100.0	.6	1.9	-2.8	1.8	-.6
Adjusted durable goods[1]	68.0	.2	4.5	-2.2	.9	.9
Computers	5.0	-.6	.1	.4	-1.0	5.5
Nondefense capital goods excluding aircraft and computers	16.0	-.8	7.2	-2.2	-1.7	-.8
All other categories	46.0	.7	4.0	-2.4	2.0	1.0
Memo:						
Real adjusted orders[2]		.4	4.7	-2.2	1.3	1.7

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Nominal adjusted durable goods orders were split into two components, computers and all other. These components were deflated and then aggregated in a chain-weighted fashion.

Indicators of Future Production: New Orders Indexes



Note. Indexes above 50 indicate orders are increasing, and indexes below 50 indicate orders are decreasing.

rise in consumer durables. After dropping in April, the production of construction supplies rose again in May and is still a bit above the high level attained late last summer. Business equipment posted another healthy gain in May, consistent with the ongoing strength in the demand for producers' durable equipment. The production of information processing equipment registered another strong advance, and the output of civilian aircraft grew rapidly, boosted by Boeing's increased production of 737s and 777s. The company's announced production schedules suggest that the output of civilian aircraft will continue to grow at an extraordinary pace throughout the year before leveling off in 1998. Consistent with the strong pickup in orders registered earlier this year, the output of industrial equipment jumped 2.1 percent in April and held that higher level in May. Until the recent surge in production, output in this sector had changed little since mid-1995.

Materials production (excluding energy) also continued to grow rapidly in May. The output of semiconductors posted another hefty gain, and the production of basic metals, mainly steel, picked up further. The output of nondurable materials was about unchanged.

Indicators of future production continue to be upbeat. The indexes of new orders from the National Association of Purchasing Managers and the American Production and Inventory Control Society (APICS) rose to high levels in May. The comparable index from Dun and Bradstreet retreated in May but remained at a level suggesting that new orders are increasing. Real adjusted durable goods orders, the most volatile of the production indicators, continued to rise sharply in April and May, following a large increase in the first quarter.

Consumption and Personal Income

Consumer spending flattened out this spring after the large run-up in the preceding two quarters. However, the fundamental determinants of consumer demand point to an early resumption of spending growth: Job gains are generating income, consumers are extraordinarily optimistic, and household net worth has increased enormously over the past few years.

Total nominal retail sales fell 0.1 percent in May.[4] At stores in the "retail control" category, which excludes automotive dealers and building material and supply stores, nominal spending also edged down in May. However, the data for the preceding two months were revised down to show declines of 0.5 percent in April and 0.1 percent in March. We estimate that real personal consumption expenditures (PCE) for goods other than motor vehicles edged down 0.1 percent in May after declining 0.5 percent in April.

Unusually mild weather likely contributed to the first-quarter surge in retail sales, and some slowdown in the second quarter was to be expected as temperatures returned to "normal." But, in the event, April and May were cooler than average, reportedly depressing sales of such items as seasonal apparel, air conditioners, and recreational equipment. Data on chain store sales and anecdotal reports suggest some bounceback in overall sales in June.

Spending on services was up strongly in April--the last month for which we have data. Cool weather boosted real outlays for energy services in that month nearly 5 percent (not at an annual rate). In contrast, spending on energy services probably fell somewhat in May, as continued cool temperatures likely delayed the usual onset of air conditioning use. Real expenditures on non-energy services rose 0.2 percent in April, with spending up across most major categories.

Real disposable personal income was essentially unchanged in April after three months of strong growth. Both the aggregate hours and the average hourly earnings of production workers rose in May, suggesting another solid increase in income for the month. The saving rate moved back up to 5.1 percent in March and held at that level in April.

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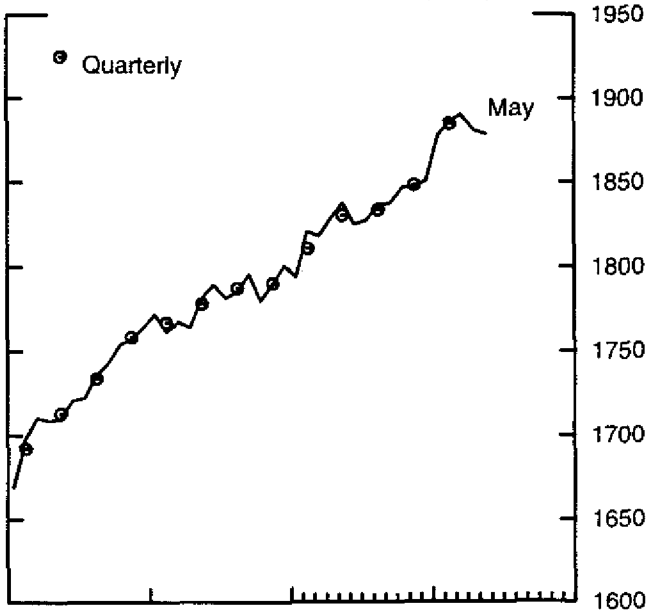
4. On June 25, the Census Bureau published revised estimates of growth in retail sales in March, April, and May. The revisions were small. The new estimates incorporate updated seasonal factors. The revisions for April reflect a redrawing of the sample of stores for the Monthly Survey of Retail Trade (which is done every five years) and a shift from a rotating to a fixed panel. The estimates published earlier this month were based on the old rotating sample; to provide a transition to the new fixed sample, the revised estimates average, by retail sector, sales growth from the old and new samples. Because the sample changes do not affect the smaller advance sample, the advance estimates of sales growth for May (before seasonal adjustment) were not revised; however, new seasonal factors did induce some small changes to the growth in sales in May on a seasonally adjusted basis.

RETAIL SALES
(Percent change; seasonally adjusted)

	1996		1997	1997		
	Q3	Q4	Q1	Mar.	Apr.	May
Total sales	.3	1.3	2.7	-.3	-.9	-.1
Previous estimate[1]			2.8	.0	-.3	
Building materials and supplies	1.1	-.3	4.4	1.5	.0	-.4
Automotive dealers	.7	1.4	3.8	-1.3	-2.3	-.2
Retail control[2]	.0	1.4	2.1	-.1	-.5	-.1
Previous estimate			2.1	.0	-.2	
GAF	.1	.4	3.1	-.7	-.4	.5
Durable goods	-.7	1.5	2.2	-.9	-.2	-.2
Furniture and appliances	.5	-.4	2.5	-.8	.8	.6
Other durable goods	-1.6	3.0	2.0	-.9	-1.0	-.8
Nondurables	.2	1.4	2.1	.1	-.6	-.0
Apparel	-.7	-.9	2.4	-1.4	-1.0	.7
Food	.9	.9	.7	.9	-.7	.2
General Merchandise	.3	1.2	3.6	-.4	-.7	.4
Gasoline stations	-2.5	2.6	1.9	-.5	-1.1	-.6
Other Nondurables[3]	.6	2.1	2.2	.2	-.1	-.5
Eating and drinking	.1	1.9	2.1	-.5	-.6	-.9
Drug and Proprietary	2.2	2.2	3.2	.4	-.7	.2

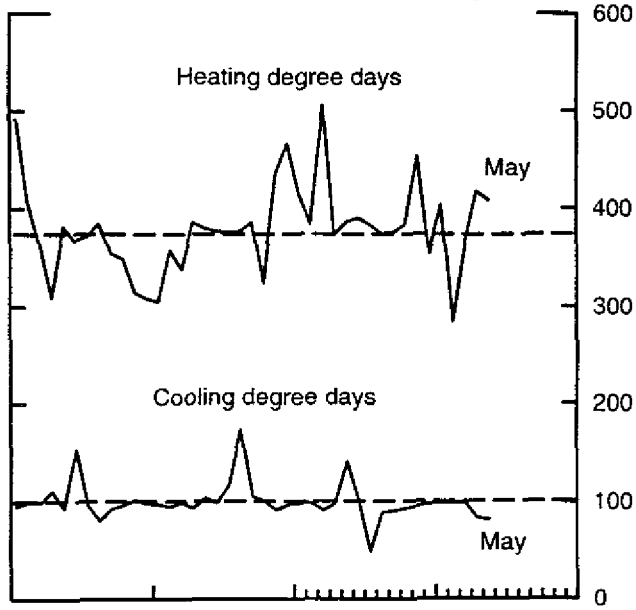
1. As of the May 13, 1997 release.
2. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.
3. Also includes liquor stores and mail order houses.

PCE Goods Excluding Motor Vehicles
Billions of chained (1992) dollars



Note. Data for first quarter, April, and May are staff estimates.

Cooling and Heating Degree Days
Degree days



Note. Seasonally adjusted by Board staff.

REAL PCE SERVICES
(Percent change from the preceding period;
derived from billions of chained 1992 dollars)

	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
	- -Q4/Q4- -		- - Annual rate - -			- -Monthly rate- -		
Services	2.4	2.6	1.3	3.8	3.3	.1	.1	.4
Energy	5.4	1.8	-11.4	3.7	-7.3	-4.7	-.2	4.9
Non-energy	2.3	2.6	1.9	3.8	3.8	.3	.1	.2
Housing	1.8	1.6	1.3	1.9	2.0	.2	.1	.1
Household operation	3.8	3.7	.1	9.5	1.2	-.1	.1	.4
Transportation	3.1	4.4	4.2	6.1	7.4	.2	.6	.0
Medical	2.5	2.2	2.1	3.9	3.3	.6	.5	.3
Personal business	2.5	1.8	-3.0	5.6	5.9	-.4	-.3	-.2
Other	1.7	4.3	6.4	2.3	5.2	.6	-.3	.4

Note. Derived from BEA's advance estimates.

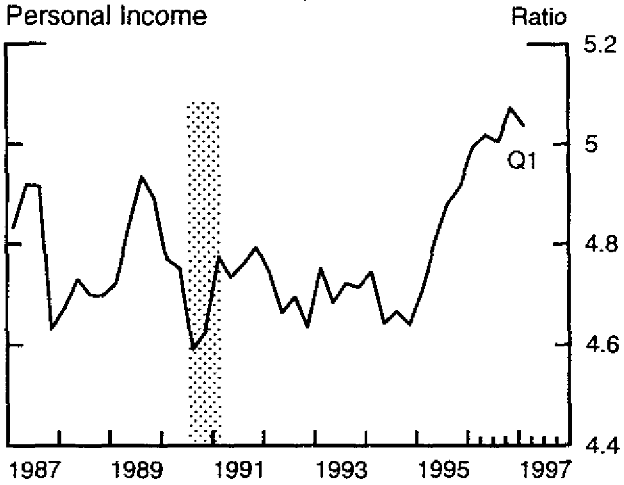
PERSONAL INCOME
(Average monthly percent change)

	1995	1996	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
	- Q4/Q4 -		Annual rate		- - Monthly rate - -		
Total personal income	5.6	5.7	5.4	7.3	.8	.6	.1
Wages and salaries	5.3	6.2	6.3	8.5	1.3	.7	-.1
Private	5.8	6.8	7.3	9.2	1.5	.8	-.1
Other labor income	5.5	3.0	4.0	2.9	.2	.2	.2
Less: Personal tax and nontax payments	7.9	9.9	6.9	15.2	1.8	1.0	.2
Equals: Disposable personal income	5.3	5.1	5.2	6.1	.7	.5	.1
Memo:							
Real disposable income[1]	3.1	2.7	2.6	4.3	.4	.5	-.0
Saving rate (percent)	4.6	4.9	5.1	4.8	4.8	5.1	5.1

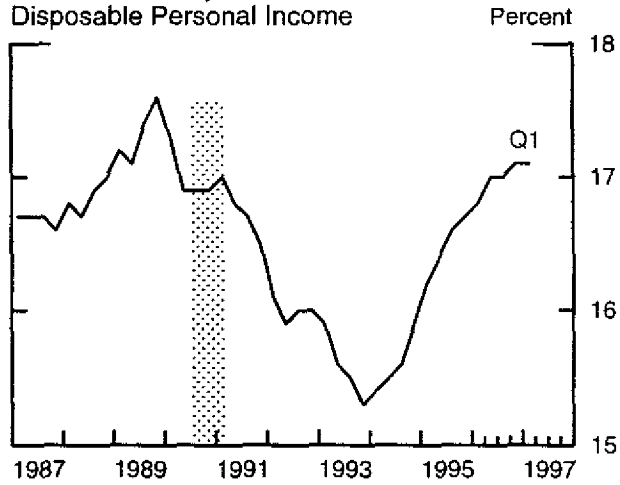
Note. Derived from BEA's advance estimates.
1. Derived from billions of chained (1992) dollars.

Household Indicators

Ratio of Net Worth to Disposable Personal Income

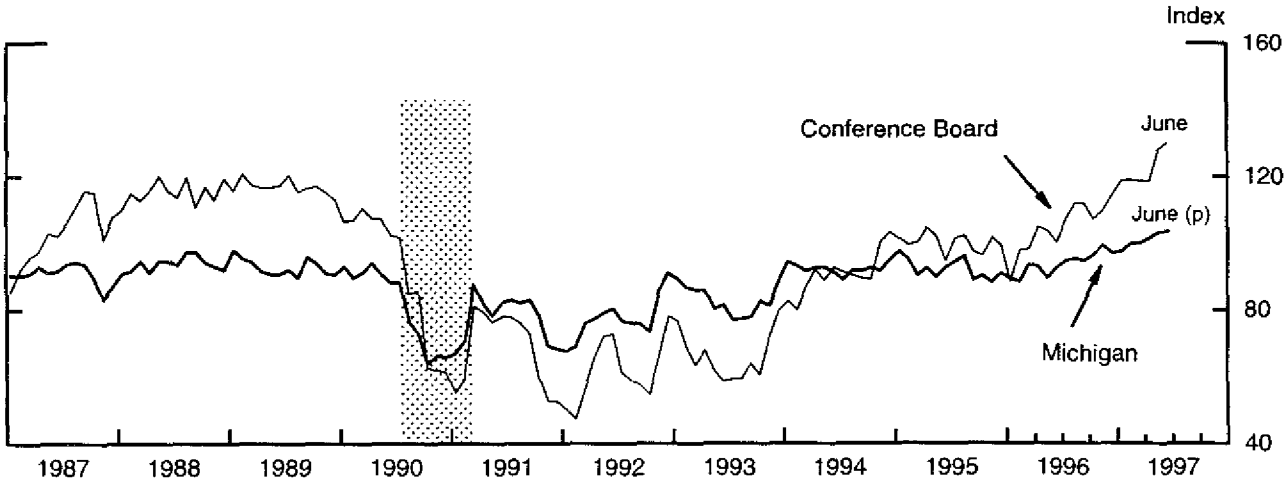


Debt Service Payments as a Share of Disposable Personal Income

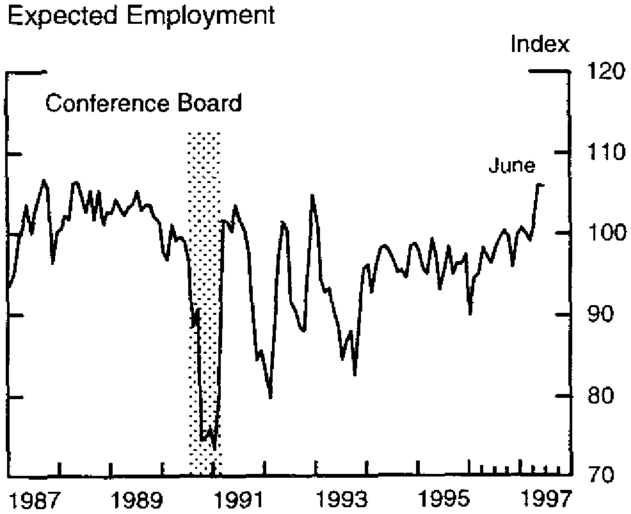


Note. Debt service payments estimated by Board staff.

Consumer Confidence

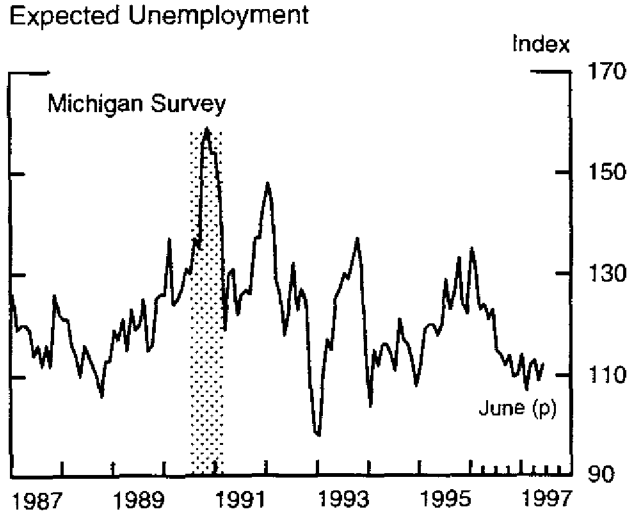


Expected Employment



Note. Percent expecting more jobs six months hence less those expecting fewer jobs plus 100.

Expected Unemployment



Note. Percent expecting unemployment to rise over next 12 months less those expecting unemployment to fall plus 100.

Recent indicators suggest that household balance sheets remain in good shape overall. Although the ratio of net worth to disposable income edged down in the first quarter, the renewed surge in the stock market has likely pushed the ratio to a new high. The ratio of total debt service payments to disposable personal income held at 17.1 percent in the first quarter and has changed little over the past year.

Consumer sentiment has been a real standout in recent months, suggesting that the recent lull in spending is likely to prove temporary. In June, both the Michigan SRC and Conference Board measures of consumer sentiment were at levels not seen since the 1960s.[5] Part of the recent strength in the Conference Board index reflected respondents' upbeat assessments of current and expected job availability--not too surprising, given the strong growth in employment over the past year and favorable press reports on the labor market. Although it is not included in the overall sentiment index, the Michigan series on expected unemployment also has trended down since early last year.

Motor Vehicles

Sales of motor vehicles fell off in April and May after surging in the first quarter. Nonetheless, smoothing through the effects of strikes and shifts in reporting periods, the underlying pace of sales has remained around 15 million units (annual rate)--the same pace that has prevailed since the second half of 1995. Adjusting for changes in reporting periods, vehicle sales increased about 200,000 units in May, to 14.7 million units. However, sales were held down last month--as much as 250,000 units--by the recent strikes at General Motors and Chrysler. GM's fleet sales bore the brunt of its supply problems, contributing to a decline in total fleet sales in May.[6]

To counteract the erosion of their market share by foreign firms, the Big Three automakers have continued to provide generous incentives. Indeed, incentives were sweetened during the second

5. Although current sentiment levels are somewhat higher than would be expected from the economic fundamentals, the divergence is not dramatic. For example, the Michigan SRC index currently is about 2-1/2 percent above the level that would be expected on the basis of recent trends in income growth, unemployment, and inflation.

6. The drop in fleet sales at General Motors was partially offset by a rebound in fleet sales at Ford. Fleet and retail sales data from General Motors and Ford are confidential.

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

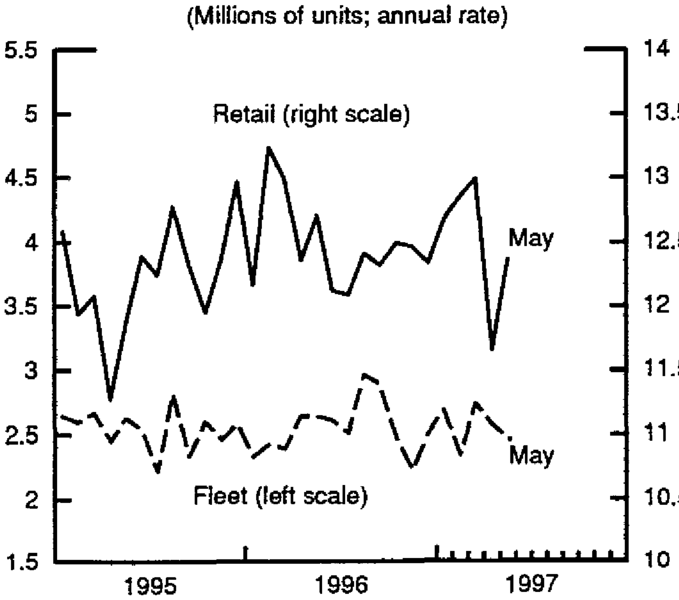
			1996		1997	1997		
	1995	1996	Q3	Q4	Q1	Mar.	Apr.	May
Total	14.72	15.09	15.06	14.83	15.44	15.73	14.23	14.76
Adjusted[1]	14.69	15.03	15.06	14.72	15.34	15.48	14.51	14.67
Autos	8.63	8.53	8.65	8.02	8.63	8.64	7.89	8.02
Light trucks	6.09	6.56	6.41	6.81	6.80	7.09	6.34	6.74
North American[2]	12.82	13.38	13.37	13.09	13.49	13.72	12.40	12.89
Autos	7.13	7.25	7.37	6.75	7.25	7.25	6.62	6.78
Big Three	5.43	5.28	5.27	4.82	5.15	5.15	4.80	4.87
Transplants	1.69	1.97	2.10	1.93	2.10	2.10	1.82	1.91
Light trucks	5.69	6.13	6.00	6.33	6.24	6.47	5.78	6.11
Foreign produced	1.90	1.71	1.69	1.74	1.95	2.01	1.84	1.86
Autos	1.51	1.27	1.27	1.27	1.39	1.39	1.27	1.24
Light trucks	.39	.43	.41	.47	.56	.62	.56	.63

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.

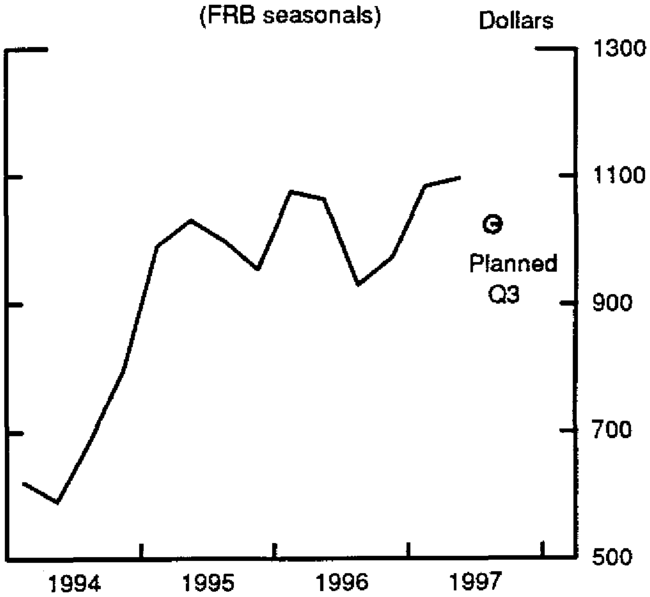
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

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



Note. Board staff estimate

Marketing Incentives for Light Vehicles
(FRB seasonals)



Note. Data from J.D. Powers.

quarter, and initial industry plans for the third quarter suggest that they will remain relatively generous.

Other indicators also suggest that, barring any other major strikes, sales should remain solid in the near term. According to preliminary data from the Michigan survey, consumers' attitudes toward car-buying conditions improved further in June, reflecting more favorable views of the economy, falling motor vehicle prices, and lower finance rates.

Housing Markets

Although single-family housing starts have fallen recently, the underlying pace of housing activity has been well maintained overall this year. In May, single-family starts declined 2.5 percent, to 1.09 million units. The decline was partly an aftereffect of the unusually mild weather in February, which shifted starts forward from the spring. Permits for single-family units, which are typically less volatile than housing starts, hardly changed in May--holding at a level well above the average of the past few quarters. Indeed, based on an average ratio of starts to permits, the number of permits issued in May would imply a level of starts closer to the average of the March and April readings.

Existing home sales rose 4.4 percent in May to the highest level since May 1996 and the fourth highest on record. New home sales dropped 7.7 percent in April but remained at a high level. The Census Bureau has been modifying its procedures for collecting data on new home sales, making it especially difficult to interpret monthly movements.

Readings for a number of indicators from early June show continued firm demand for single-family housing. The builders' rating of new home sales has strengthened in recent months to the highest level since last August. According to the Michigan Survey, consumers' attitudes toward homebuying improved further in June, reaching the most favorable level in three years. Also, applications for mortgages to purchase homes have remained high.

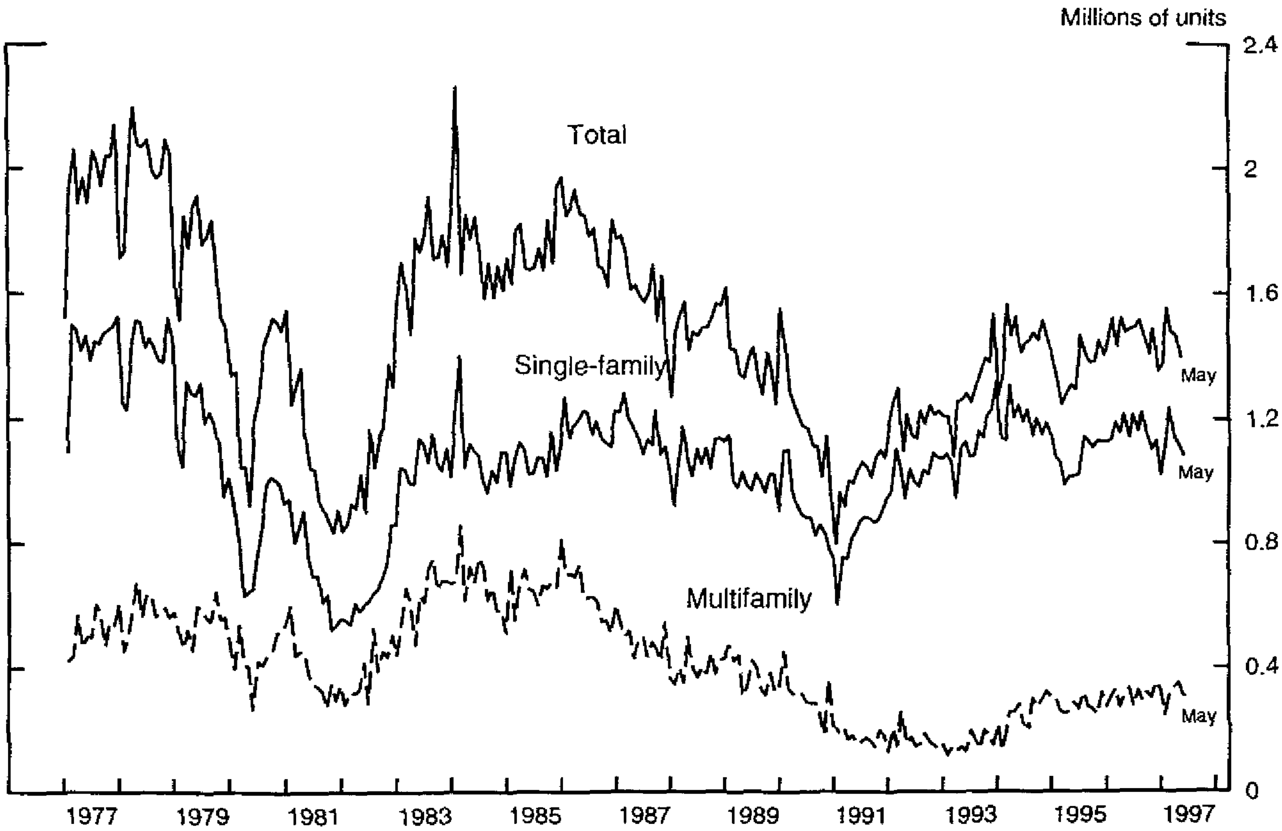
Multifamily housing starts dropped 12 percent in May from an extremely high level in March and April. Nonetheless, the underlying pace of multifamily starts remained healthy, with the April-May average noticeably above the 1996 level. Meanwhile, permit issuance in this sector continued to trend up.

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

	1996	1996 Q3	1996 Q4	1997 Q1[r]	1997 Mar.[r]	1997 Apr.[r]	1997 May [p]
All units							
Starts	1.48	1.49	1.42	1.47	1.48	1.47	1.40
Permits	1.43	1.42	1.38	1.43	1.46	1.44	1.44
Single-family units							
Starts	1.16	1.18	1.09	1.17	1.14	1.12	1.09
Permits	1.07	1.06	1.01	1.05	1.03	1.06	1.06
New home sales	.76	.79	.76	.83	.84	.77	n.a.
Existing home sales	4.09	4.09	4.00	4.10	4.16	4.06	4.24
Multifamily units							
Starts	.32	.31	.33	.30	.34	.35	.31
Permits	.36	.36	.38	.38	.42	.38	.39
Mobile homes							
Shipments	.36	.37	.35	.35	.35	.37	n.a.

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

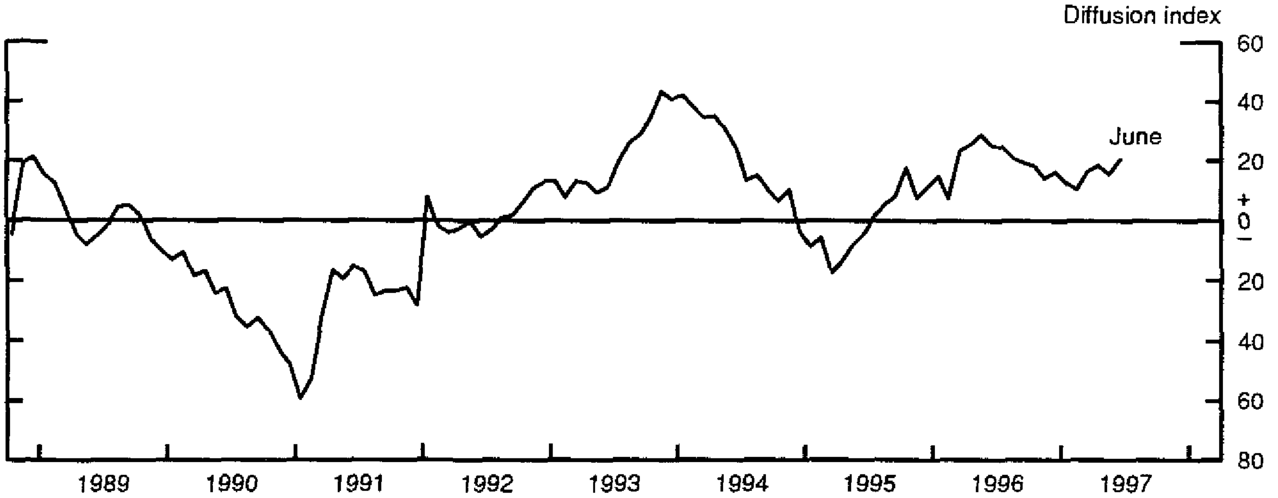
Private Housing Starts
(Seasonally adjusted annual rate)



Indicators of Housing Demand

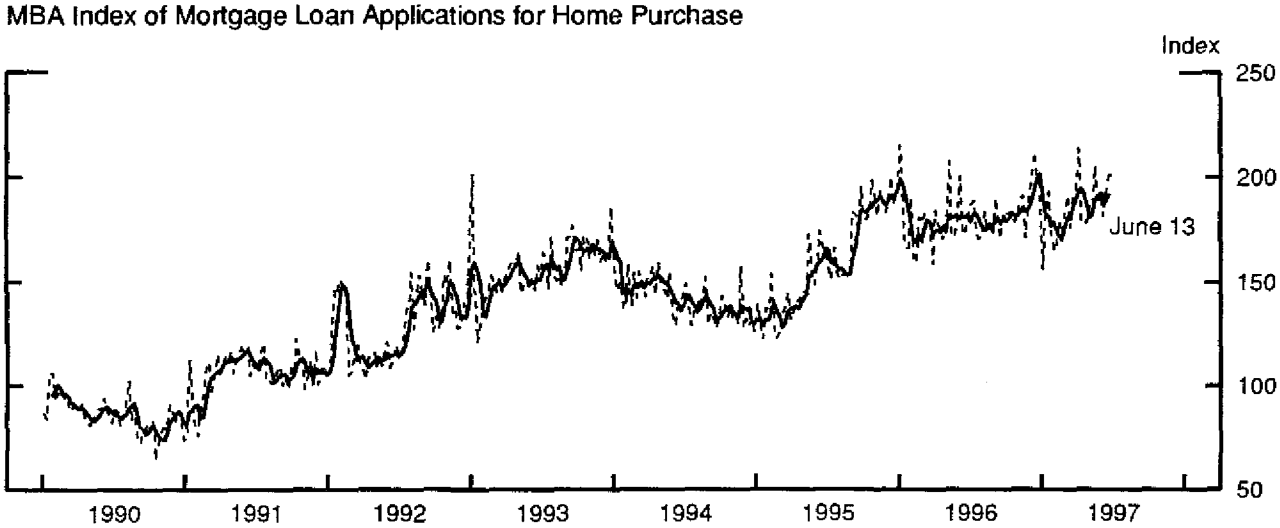
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



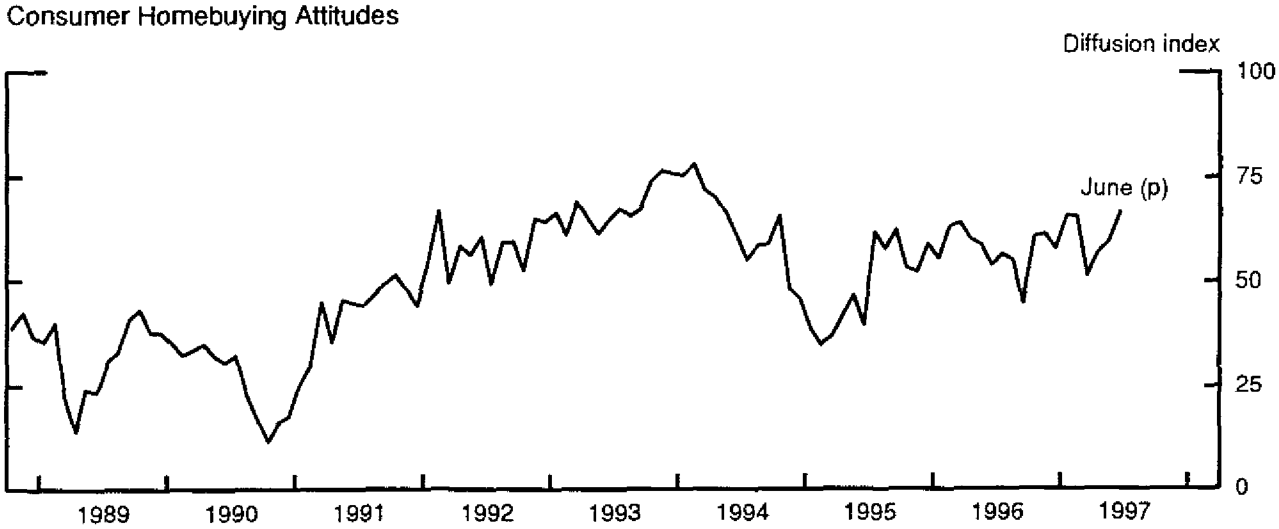
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

MBA Index of Mortgage Loan Applications for Home Purchase



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

Consumer Homebuying Attitudes



Note. The homebuying attitudes index is calculated from Survey Research Center data as the proportion of respondents rating current conditions as good minus the proportion rating such conditions as bad.

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

	1996			1997	1997		
	Q2	Q3	Q4	Q1	Mar.	Apr.	May
Producers' durable equipment							
Shipments of nondefense capital goods	3.3	1.7	1.5	1.4	3.4	1.6	.1
Excluding aircraft and parts	1.6	1.5	.8	.8	2.1	.4	.6
Office and computing	-.1	3.8	-.7	2.6	2.8	-2.0	2.6
Communications equipment	4.4	4.6	4.1	-1.0	4.5	-4.1	2.9
All other categories	1.6	-.1	.5	.6	1.2	2.4	-.6
Shipments of complete aircraft[1]	12.2	14.7	21.1	-7.8	40.7	5.5	n.a.
Sales of heavy trucks	1.3	-.8	-5.6	6.0	3.5	1.8	-1.7
Orders of nondefense capital goods	-6.4	4.9	.2	2.5	-3.8	-1.7	.7
Excluding aircraft and parts	-1.7	2.8	-.8	5.5	-1.7	-1.5	.6
Office and computing	1.9	4.8	-.6	.1	.4	-1.0	5.5
Communications equipment	-8.7	6.7	3.7	12.4	-5.0	-8.2	6.4
All other categories	-1.2	1.2	-1.9	5.9	-1.5	.0	-2.5
Nonresidential structures							
Construction put in place, buildings	-.6	3.7	8.4	2.6	-1.4	-2.6	n.a.
Office	8.3	9.2	8.4	3.8	-6.1	-3.7	n.a.
Other commercial	-1.0	1.4	7.7	3.3	.7	-6.4	n.a.
Institutional	1.2	8.2	9.4	5.0	1.4	5.3	n.a.
Industrial	-8.0	-1.0	10.0	-5.4	-5.8	1.9	n.a.
Lodging and miscellaneous	.0	4.5	6.6	9.3	2.9	-7.6	n.a.
Rotary drilling rigs in use[2]	9.9	-4.0	-1.6	16.2	8.8	.8	2.5
Memo:							
Business fixed investment	3.8	17.5	5.5	11.5	n.a.	n.a.	n.a.
Producers' durable equipment	6.7	20.9	-.9	13.4	n.a.	n.a.	n.a.
Office and computing	29.6	42.3	28.9	29.4	n.a.	n.a.	n.a.
Communications equipment	14.9	28.2	-.7	13.9	n.a.	n.a.	n.a.
Other equipment[3]	5.3	2.0	-3.7	9.4	n.a.	n.a.	n.a.
Nonresidential structures	-3.7	8.4	25.8	6.5	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. Producers' durable equipment excluding office and computing, communications, motor vehicles, and aircraft and parts.
n.a. Not available.

Business Fixed Investment

Real business fixed investment appears to have increased further during the second quarter, as evidenced by the high levels of orders and shipments. Moreover, the fundamental determinants of investment are consistent with vigorous growth: Cash flow continues to surge, and business output has accelerated. Although the user cost of capital for many types of equipment has changed little, the falling user cost for office and computing equipment continues to provide a substantial boost to high-tech investment.

Shipments of nondefense capital goods excluding aircraft and parts--one of the building blocks for BEA's estimates of real PDE--edged higher in May after substantial increases in earlier months.[7] Nominal shipments of office and computing equipment jumped 2.6 percent in May, more than reversing April's decline. Shipments of communications equipment rose 2.9 percent last month, while shipments of other equipment fell 0.6 percent, the first decline after three months of robust gains.

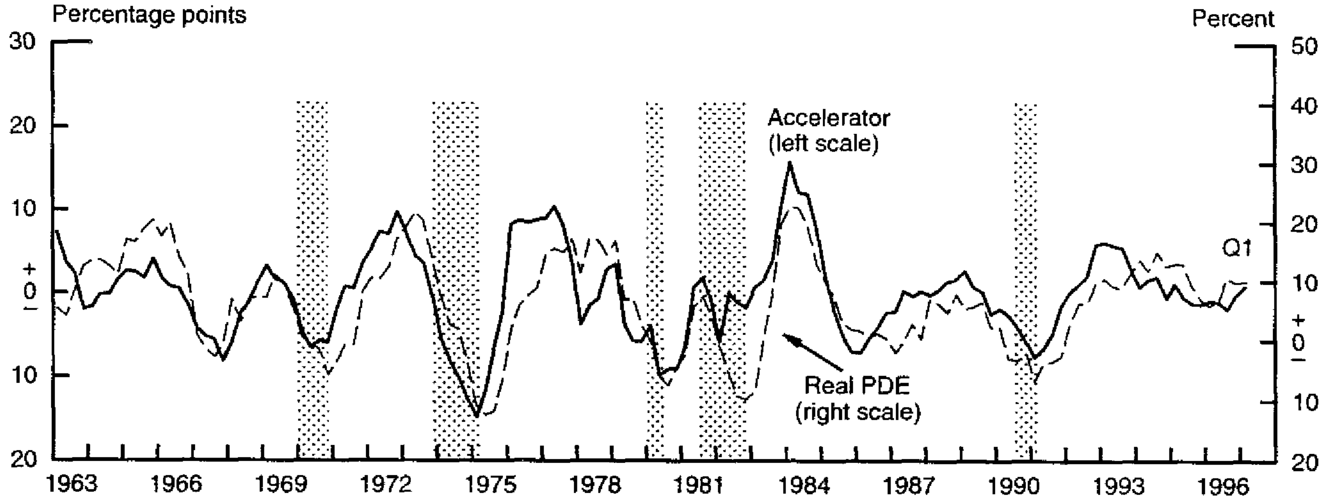
Plummeting prices for computers will help to sustain investment in the near term. The computer component of the PPI declined 4.6 percent in May, bringing the year-to-date drop to 28 percent at an annual rate. Furthermore, price cutting is likely to remain noteworthy in coming months. Intel recently announced that sharp reductions in the prices of Pentium processors will take effect at the end of July. In addition, several manufacturers of switches and routers--essential equipment for building computer networks--have cut prices 10 percent to 33 percent. Also, IBM's newest generation of mainframes, which provides substantially higher performance at lower cost than previous lines, was introduced in June.

Orders data suggest that the growth of expenditures on equipment will remain brisk in coming months. Orders for nondefense capital goods excluding aircraft and parts increased 0.6 percent in May after a 1.5 percent decline in April and a 5-1/2 percent gain in the first quarter. Orders for communications equipment rose 6.4 percent, while bookings for computers jumped 5.5 percent in nominal terms; given the large computer price declines last month,

7. These figures reflect the Census Bureau's annual revisions to data on manufacturers' orders and shipments. The revision benchmarked the data to the Annual Survey of Manufacturers and corrected for late receipts, reclassifications, and data revisions. Changes to orders and shipments of nondefense capital goods were minor.

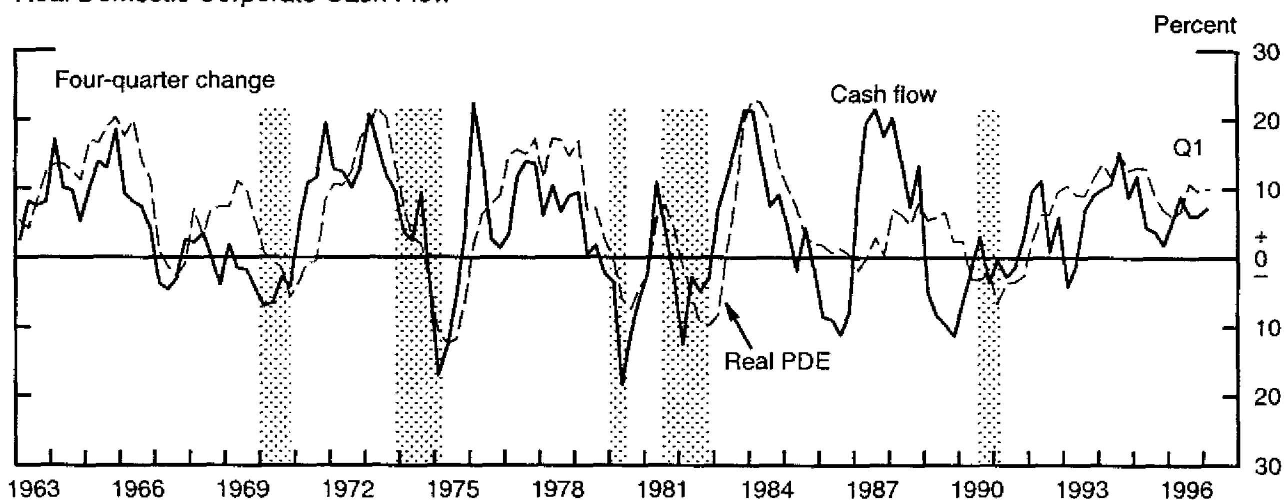
Fundamental Determinants of Equipment Spending

Acceleration of Business Output

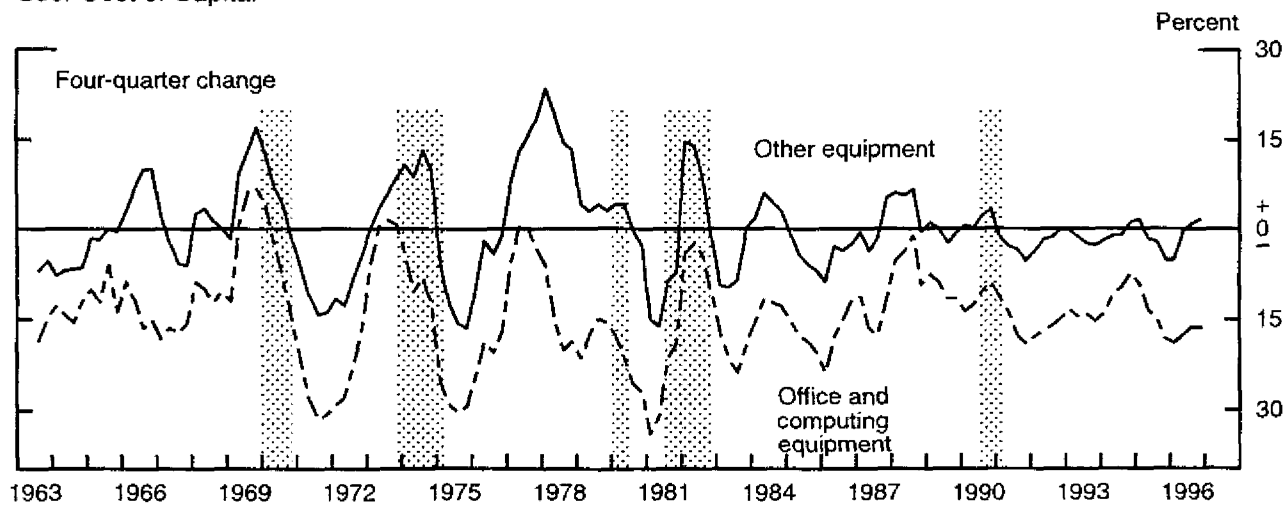


Note. The accelerator is the eight-quarter percent change in business output less the year-earlier eight-quarter percent change. Real PDE is the four-quarter percent change.

Real Domestic Corporate Cash Flow

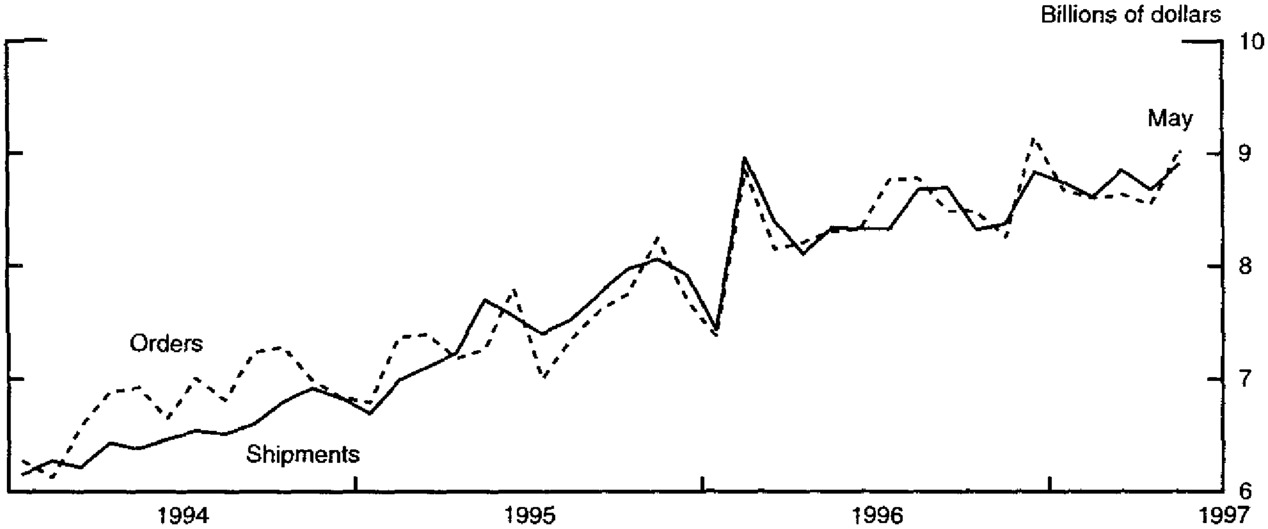


User Cost of Capital

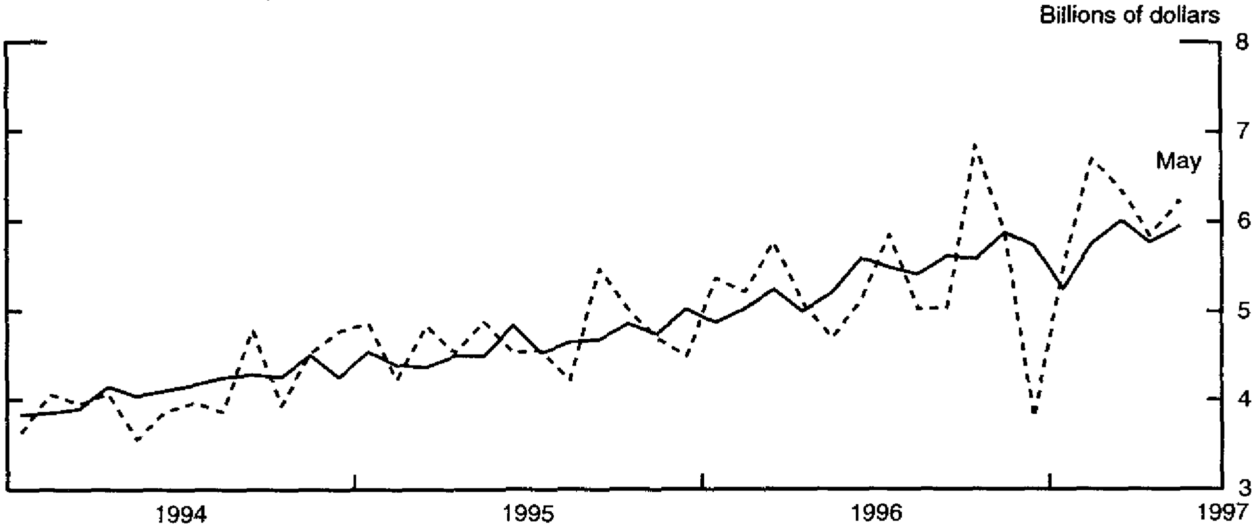


Orders and Shipments of Nondefense Capital Goods

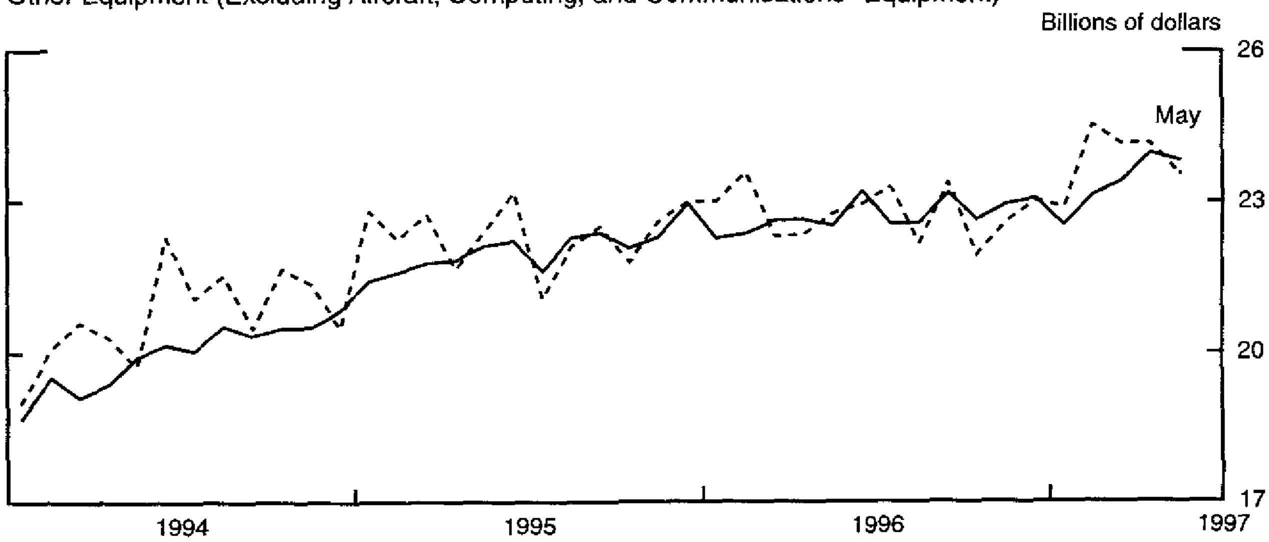
Office and Computing Equipment



Communications Equipment

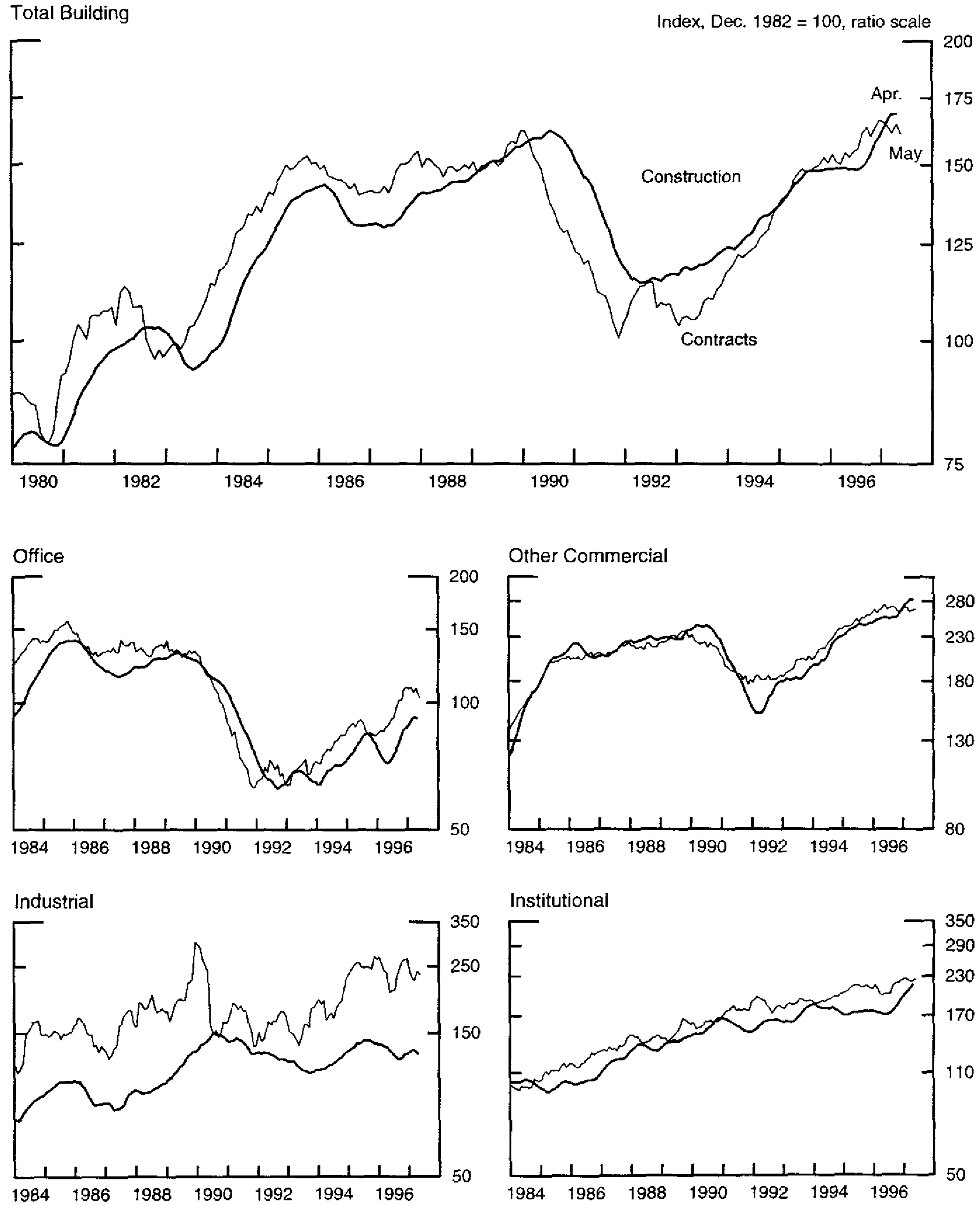


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



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

the latter increase likely was substantial in real terms. Orders for equipment excluding aircraft, communications equipment, and computers dropped 2.5 percent in May but still remained at an elevated level.

Business spending on motor vehicles edged up last month. Sales of light trucks rose in May from the low level in April but remained below the first-quarter level. Sales of medium and heavy trucks were little changed in May, remaining at a relatively high level. Sales of cars dipped, as General Motors directed vehicles in short supply toward retail customers and away from fleet sales.

Domestic spending on aircraft is climbing. Shipments of commercial aircraft to domestic airlines jumped 40.7 percent in March and rose 5.5 percent further in April. Boeing is stepping up production to meet heavy demand, which continues to mount. In the latest addition to its bulging order book, Boeing recently received a commitment from Continental Airlines to purchase thirty-five new wide-body aircraft, with an estimated value of more than $3 billion. Delivery is set to begin in September 1998.

Expenditures on nonresidential structures have inched down in recent months, with construction put-in-place slipping in March and April from the lofty levels of earlier this year. A drop in spending on office and other commercial properties accounted for most of the decline. Still, the outlook for nonresidential building is bright: Contracts for private nonresidential buildings rose sharply in April, with all major categories posting gains. In addition, vacancy rates for office space have declined steadily, and prices for commercial real estate have been edging up.

Business Inventories

Business inventory investment resumed a vigorous pace in April. On a book-value basis, inventories in manufacturing and trade excluding motor vehicles rose at a $36.7 billion annual rate, after a brief slowing in March. The April inventory buildup occurred against a backdrop of rather uneven sales across major sectors: While factory shipments were quite firm (up 1.4 percent in April), nonvehicle sales in the trade sector were generally lackluster.[8] Nonetheless, inventory-sales ratios for most types of business establishments remained low by historical standards.

8. Nonvehicle sales in wholesale trade were little changed in April, while sales in retail trade excluding auto dealers fell 0.4 percent in that month.

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

	1996		1997	1997		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
Book value basis						
Total	32.9	16.0	35.8	51.4	17.7	41.1
Excluding wholesale and retail motor vehicles	18.8	22.2	30.9	46.1	10.0	36.7
Manufacturing	11.5	7.0	16.5	25.6	8.2	34.1
Excluding aircraft	8.8	2.5	9.1	17.1	6.1	25.0
Wholesale	-7.8	4.1	14.3	2.3	15.6	-21.0
Excluding motor vehicles	-4.9	6.0	11.5	7.8	10.4	-12.2
Retail	29.2	4.9	5.0	23.5	-6.1	28.0
Auto dealers	17.0	-4.3	2.1	10.7	2.5	13.1
Excluding auto dealers	12.2	9.1	2.8	12.8	-8.7	14.9

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

	Cyclical reference points		Range over preceding 12 months		April
	1990-91 high	1994-95 low	High	Low	1997
Manufacturing and trade	1.58	1.39	1.40	1.35	1.36
Less wholesale and retail motor vehicles	1.55	1.36	1.37	1.32	1.33
Manufacturing	1.75	1.38	1.39	1.36	1.35
Primary metals	2.08	1.46	1.71	1.61	1.60
Nonelectrical machinery	2.48	1.91	1.94	1.79	1.78
Electrical machinery	2.08	1.49	1.49	1.33	1.39
Transportation equipment	2.93	1.50	1.60	1.48	1.56
Motor vehicles	.97	.54	.61	.57	.59
Aircraft	5.84	4.28	4.88	4.15	4.11
Nondefense capital goods	3.09	2.32	2.42	2.30	2.29
Textile	1.71	1.44	1.57	1.47	1.47
Petroleum	.94	.87	.83	.75	.83
Tobacco	2.83	1.92	2.16	1.94	2.06
Home goods & apparel	1.96	1.69	1.73	1.66	1.65
Merchant wholesalers	1.36	1.28	1.29	1.22	1.23
Less motor vehicles	1.31	1.25	1.26	1.20	1.20
Durable goods	1.83	1.54	1.57	1.50	1.51
Nondurable goods	.96	.98	.99	.92	.92
Retail trade	1.61	1.46	1.53	1.48	1.51
Less automotive dealers	1.48	1.42	1.45	1.41	1.43
Automotive dealers	2.21	1.61	1.79	1.68	1.77
General merchandise	2.43	2.20	2.26	2.12	2.16
Apparel	2.56	2.50	2.56	2.42	2.56
G.A.F.	2.44	2.23	2.27	2.16	2.19

Much of the April upswing in inventory investment occurred in the manufacturing sector, especially in durable goods industries where production has been strong. As in the preceding several months, a significant part of the accumulation was in stocks of capital goods. Inventories of aircraft and parts expanded further, continuing a trend that has been apparent for more than a year; stocks of industrial machinery and office equipment also rose briskly. Indeed, as shown in the table below, the April buildup of stocks of "other" nondefense capital goods far exceeded the pace observed in recent months and, given the uptrend in orders and shipments in recent months, likely was intended. Elsewhere in manufacturing, inventories in a few other durable goods industries also expanded in April, while stocks held by nondurable goods producers were little changed on net.

INVENTORY INVESTMENT IN MANUFACTURING
(Book value, billions of dollars at annual rate)

	1996		1997	1997		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
All manufacturing	11.5	7.0	16.5	25.6	8.2	34.1
Nondefense cap. goods	6.5	3.2	9.4	15.3	3.9	17.2
Aircraft and parts	4.9	6.8	8.0	12.4	4.9	8.6
Other	1.6	-3.6	1.4	2.9	-1.0	8.6
Other manufacturing	5.0	3.8	7.1	10.3	4.3	16.9

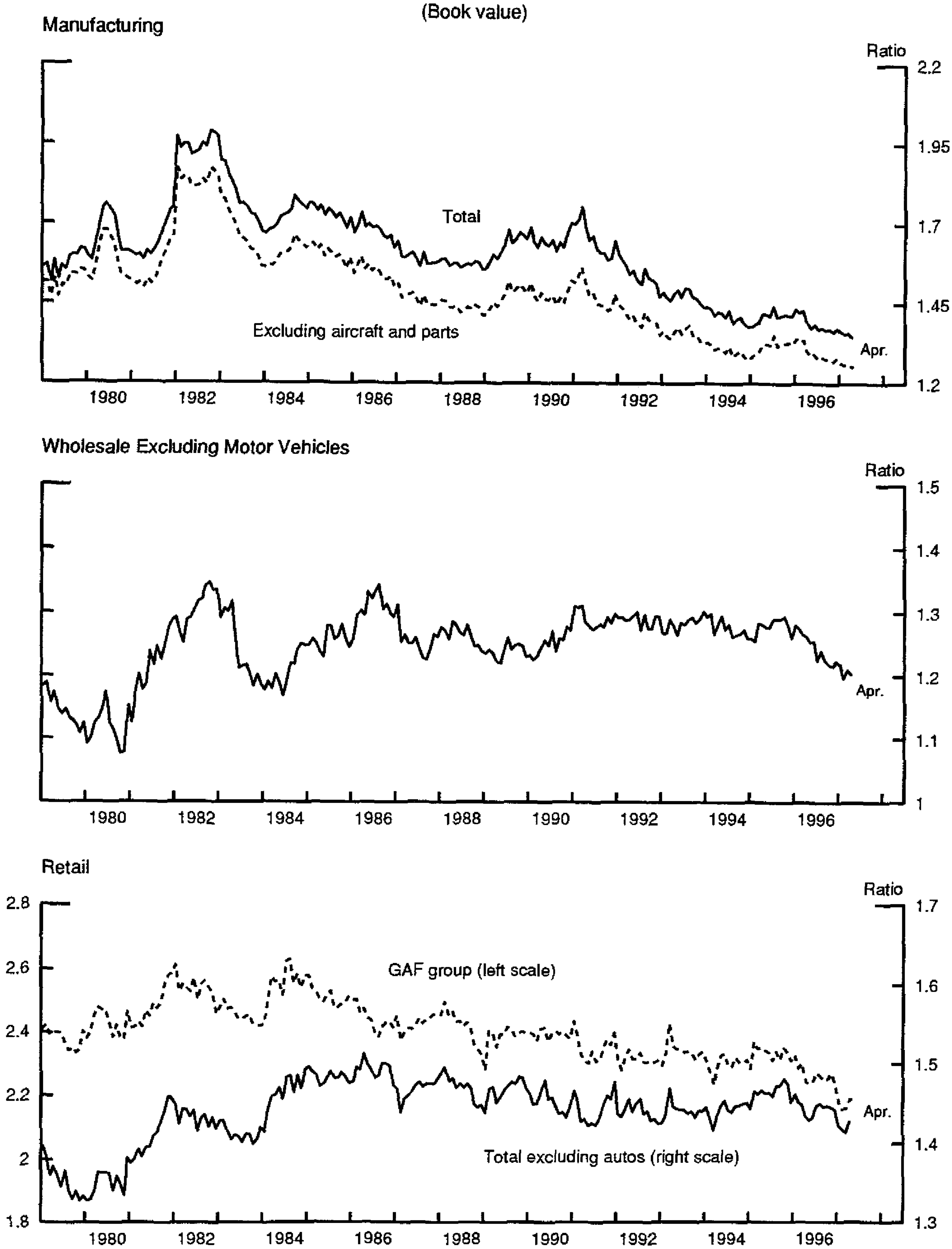
In the trade sector, inventory developments in April appear to have been influenced by the slowing of consumer demand. In wholesale trade, distributors carrying many types of consumer-oriented merchandise--apparel, furniture, lumber and home-improvement supplies, and hardware and plumbing--reported some inventory backups in April. Similar backups in stocks were reported in the retail trade sector--notably apparel and general merchandise. For most types of retail establishments, inventory-sales ratios rose considerably in April, in contrast to the general downtrend in recent months. However, retail sales in the GAF category were up again in May, and inventory-sales ratios for this grouping have likely fallen back. In a longer-term perspective, nonvehicle trade inventories remained low relative to sales.

Federal Sector

According to the preliminary GDP release, real federal purchases declined 3.1 percent (annual rate) in the first quarter of

Inventory-Sales Ratios, by Major Sector

(Book value)



1997--in line with the 3 percent annual trend rate of decline over the past four years.

For the first eight months of fiscal year 1997, the unified federal deficit, adjusted for shifts in the timing of payments and excluding deposit insurance and spectrum auction proceeds, was $39.4 billion (34 percent) below the level for the same period in fiscal 1996. Receipts were almost 8-1/2 percent higher than the year-earlier level, while adjusted outlays were up 3-3/4 percent. Spending growth was subdued across most categories. Outlays for income security programs were up only 2-1/4 percent, partly as a result of the continued strong economy. Spending on Medicare was 8-1/2 percent higher than in the first eight months of the last fiscal year, and spending on Medicaid was only 4 percent above the same period last year--both somewhat below their recent average rates of growth. Defense spending was almost 1 percent above its year-earlier level, a reversal from its average downtrend of almost 3 percent per year over the past four years.[9]

Congress recently passed the fiscal 1998 budget resolution, which records its interpretation of the tax and spending changes agreed upon with the Administration. Although Congress plans to balance the budget by 2002, spending over the near term is expected to be somewhat higher than previously anticipated. In particular, Congress and the Administration agreed to raise the 1998 discretionary spending caps that had been enacted in OBRA93, allowing discretionary spending in fiscal 1998 to run roughly $8 billion above the OBRA93 caps (as estimated by CBO).

The policy details underlying the budget resolution will be implemented in separate reconciliation bills for taxes and mandatory spending programs. These bills have now been passed by the relevant committees, and there are plans for them to be considered by the full House and Senate before the July 4 recess. In general, the tax and spending bills follow the budget resolution closely, although differences in policies between the House and Senate bills will need to be reconciled.

State and Local Governments

Current data on spending by state and local governments are sparse, but the indicators in hand point to modest growth in the second quarter. Employment by state and local governments rose

9. The strong defense spending reported in the Monthly Treasury Statements for April and May likely will boost second-quarter real federal purchases as reported in the NIPAs.

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

	Apr.-May		Fiscal year to date totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	274.2	277.6	1047.6	1083.6	36.0	3.4
Deposit insurance (DI)	-1.2	-2.4	-6.6	-12.5	-5.9	N.A.
Spectrum auction (SA)	.0	-1.4	-.2	-5.0	-4.8	N.A.
Other	275.4	281.5	1054.4	1101.1	46.7	4.4
Receipts	293.6	323.1	939.2	1018.2	79.0	8.4
Deficit (+)	-19.4	-45.4	108.4	65.4	-43.0	-39.6
	Adjusted for payment timing shifts[1] and excluding DI and SA[2]					
Outlays	268.4	274.3	1054.4	1093.9	39.6	3.8
National defense	47.0	45.9	177.8	179.1	1.3	.7
Net interest	40.8	42.3	161.2	164.8	3.6	2.2
Social security	58.2	60.7	229.4	239.6	10.3	4.5
Medicare	31.3	33.5	116.5	126.3	9.7	8.4
Medicaid	17.0	16.1	60.9	63.5	2.6	4.1
Other health	4.7	4.7	17.8	18.8	1.0	5.6
Income security	40.8	40.9	162.2	165.6	3.4	2.2
Other	28.6	30.1	128.7	136.3	7.7	6.0
Receipts	293.6	323.1	939.2	1018.2	79.0	8.4
Individual	137.4	165.0	431.0	485.3	54.3	12.6
Withheld	84.3	93.7	365.7	396.0	30.3	8.3
Nonwithheld	95.8	116.8	147.0	174.9	27.9	19.0
Refunds (-)	42.7	45.5	81.7	85.6	3.9	4.7
Social insurance taxes	109.3	104.9	340.2	356.4	16.1	4.7
Corporate	27.5	31.7	91.7	99.6	7.9	8.6
Other	19.4	21.6	76.2	76.9	.6	.8
Deficit(+)	-25.2	-48.8	115.2	75.8	-39.4	-34.2

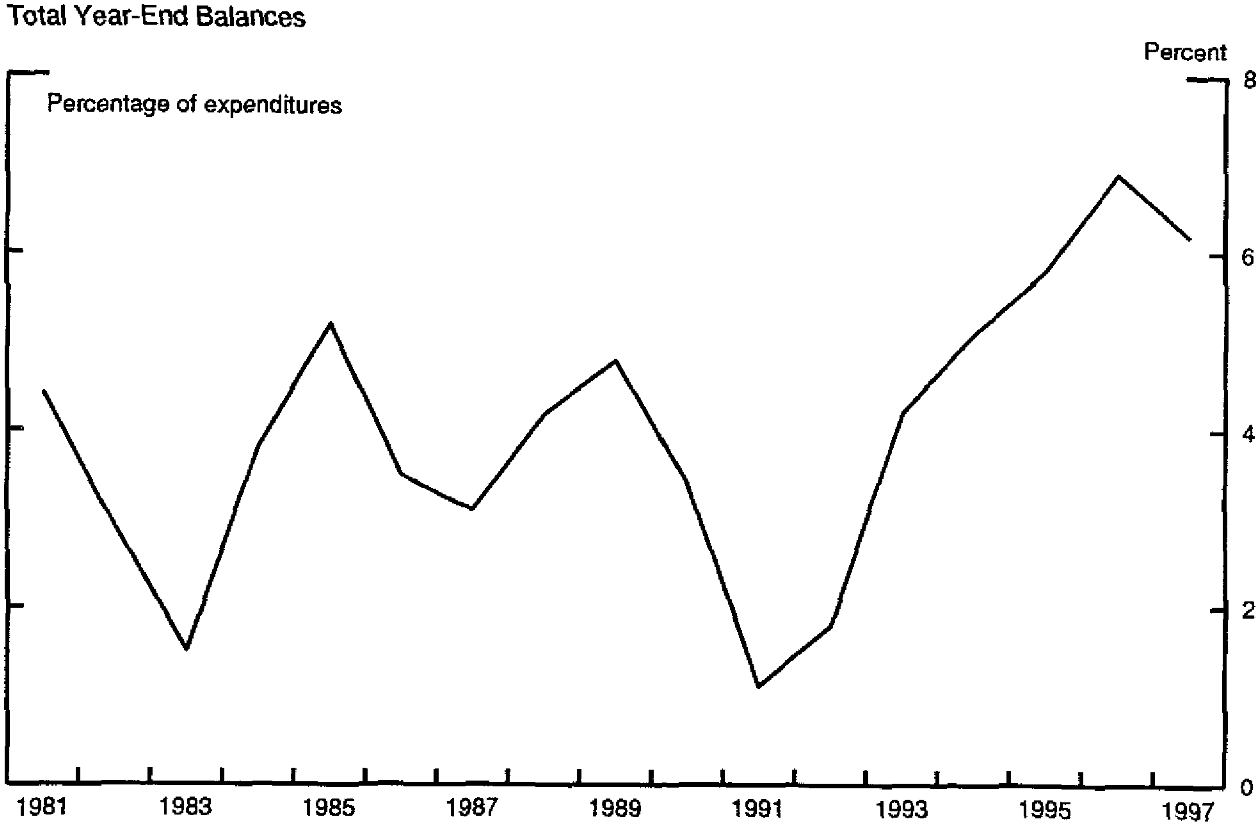
Note. Components may not sum to totals because of rounding.

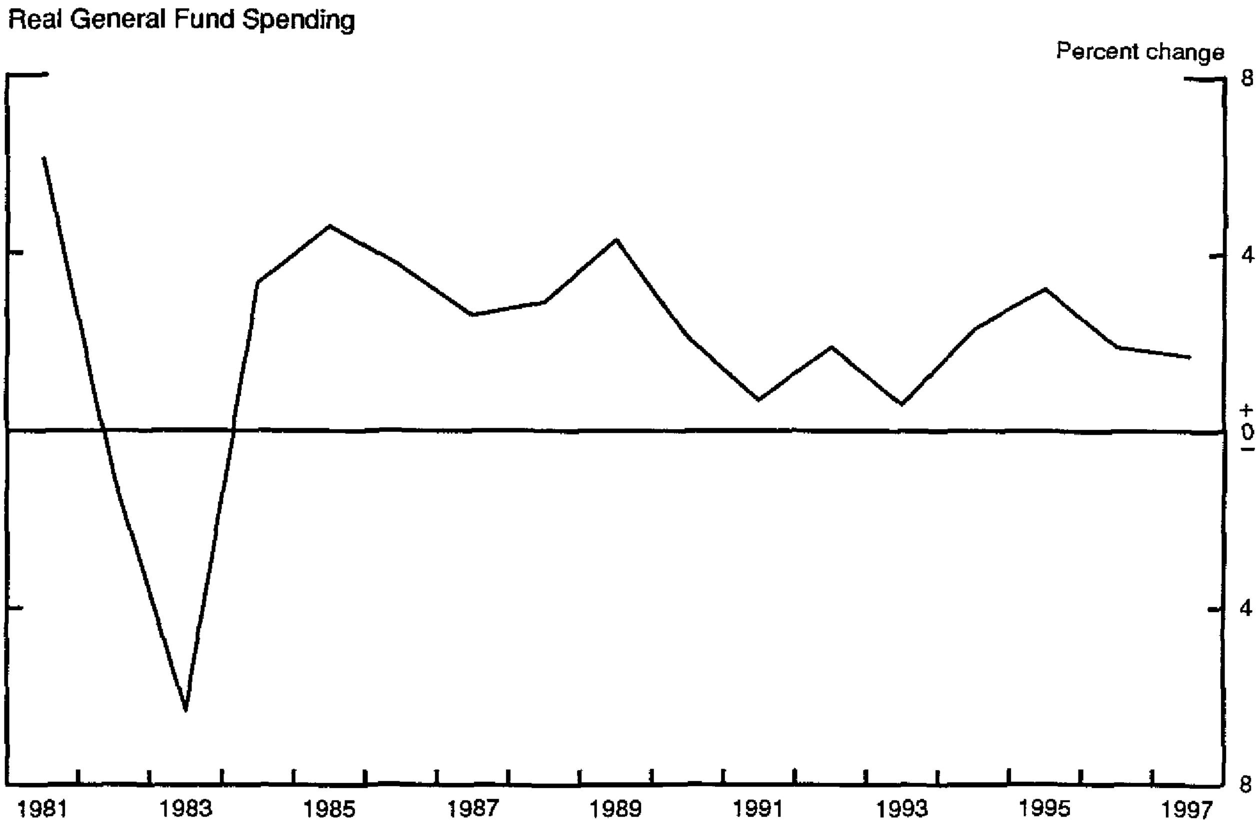
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday. The monthly and fiscal year to date outlays for defense, Medicare, income security, and "other" have been adjusted to account for this shift.

2. Excluding deposit insurance and spectrum auction proceeds.

Fiscal Situation of the States

(General-fund budgets)





Note. 1997 data estimated by National Association of State Budget Officers (NASBO).
Source. The Fiscal Survey of States, NASBO, April 1997.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1996	1997	1996	
	May 1996	May 1997	Q4	Q1	Apr.	May
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.9	2.2	3.3	2.3	0.1	0.1
Food (15.9)	2.5	3.0	4.7	0.3	-0.2	0.4
Energy (7.0)	6.2	-2.7	10.2	7.3	-1.5	-2.4
CPI less food and energy (77.0)	2.7	2.5	2.7	2.2	0.3	0.2
Commodities (23.4)	1.5	1.1	1.4	1.0	0.3	0.1
New vehicles (5.0)	1.6	0.8	0.9	-0.5	.0	-0.2
Used cars (1.3)	-0.1	-2.3	-1.8	1.6	-1.6	-0.9
Apparel (4.8)	0.2	1.1	2.1	2.2	1.1	0.2
House furnishings (3.3)	0.2	0.3	0.1	-0.7	-0.2	0.7
Other Commodities (9.0)	2.7	2.1	2.2	1.7	0.5	0.1
Services (53.7)	3.2	3.2	3.1	2.7	0.3	0.3
Shelter (28.2)	3.2	3.1	2.7	3.1	0.3	0.3
Medical care (6.1)	3.9	3.0	2.9	2.6	0.3	0.3
Auto finance charges (0.6)	-8.6	0.3	-3.0	-1.8	0.7	-2.5
Other Services (18.8)	3.2	3.5	3.9	2.1	0.3	0.3
PPI						
Finished goods (100.0)[2]	2.3	0.3	3.9	-0.7	-0.6	-0.3
Finished consumer foods (23.6)	2.7	2.7	4.9	-4.1	-0.4	0.4
Finished energy (14.7)	5.2	-3.1	17.6	1.6	-2.6	-2.1
Finished goods less food and energy (61.6)	1.6	0.1	0.4	0.3	-0.1	-0.3
Consumer goods (38.1)	1.8	0.3	0.6	0.3	.0	-0.3
Capital equipment (23.6)	1.2	-0.1	.0	0.5	-0.4	-0.2
Intermediate materials (100.0)[3]	0.7	-0.7	0.9	1.0	-0.3	-0.2
Intermediate materials less food and energy (81.3)	-1.1	0.1	0.1	0.8	.0	.0
Crude materials (100.0)[4]	12.7	-4.6	6.4	6.8	-0.9	1.3
Crude food materials (38.0)	28.2	-8.1	-28.1	-15.8	3.3	-0.3
Crude energy (42.4)	15.1	-2.3	76.4	32.8	-5.2	3.4
Crude materials less food and energy (19.6)	-12.4	-0.4	1.0	12.1	-2.3	1.2

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.

33,000 in April but retraced half that gain in May. Real construction spending by these governments slipped more than 2 percent in April, after advancing strongly in each of the two preceding months.

According to a recent survey by the National Association of State Budget Officers, states' year-end balances (current surplus plus accumulated surpluses from past years) have been remarkably strong in recent years. Indeed, since 1994, balances for state governments as a group have topped 5 percent of expenditures--a benchmark favorably regarded by bond market analysts. For fiscal 1997, which ends June 30 for most states, the balance is projected at 6.2 percent of expenditures, down a little from 6.8 percent in 1996, which was the highest reading since 1980. With strong underlying economic activity in recent years, revenue growth has been robust despite widespread, though mostly small, tax cuts. In this environment, many governments have worked to rebuild reserves partly by holding the line on spending programs. Indeed, expenditure plans have been conservative, with the public's desire for a smaller public sector and concern about further cuts in federal aid among the reasons cited.

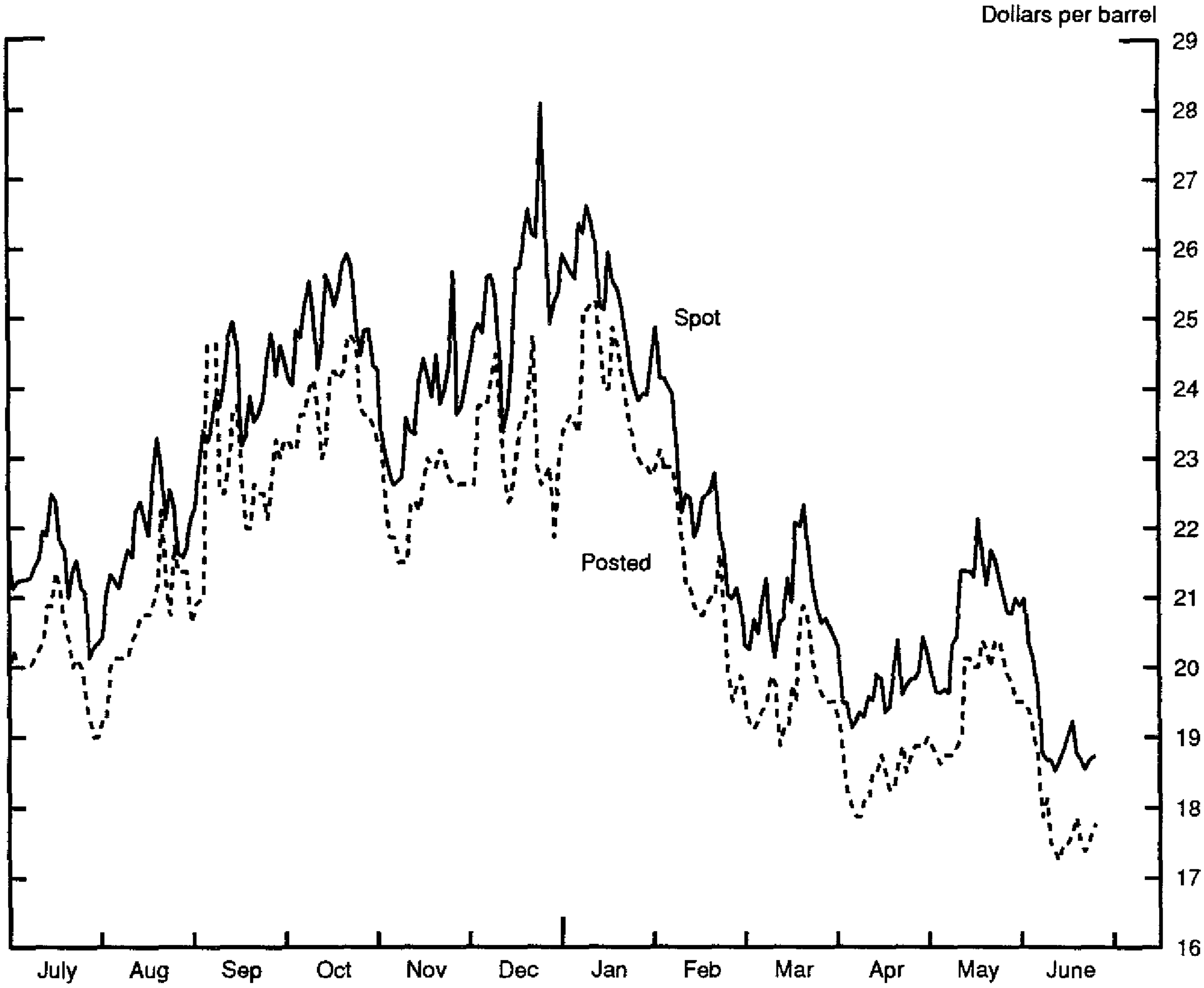
Prices and Labor Costs

The incoming data on prices have continued to be very favorable. In May, the CPI edged up 0.1 percent for the third consecutive month; over the past twelve months, the CPI has risen only 2-1/4 percent--down from a 3-1/4 percent pace at the end of 1996. The deceleration reflects favorable developments in food and energy prices, while the twelve-month change in the core CPI has held at a 2-1/2 percent rate.

The CPI for energy in May continued to reflect declines earlier this year in crude oil prices; retail energy prices fell 2.4 percent, led by a 4 percent drop in gasoline prices. In spot markets for crude oil, prices climbed in May because of tensions in the Middle East but have fallen back in June. The spot price of West Texas intermediate, for example, has averaged about $19 per barrel in June after peaking at more than $22 per barrel in mid-May. In addition, private survey data suggest that, on a seasonally adjusted basis, the retail price of gasoline is continuing to decline in June, albeit at a slower pace than in April and May.

Consumer food prices advanced 0.4 percent in May. Coffee prices surged for the third consecutive month, and prices of fruits

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
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	19.66	20.99
April	18.52	19.72
May	19.55	20.83
June [1]	17.96	19.12

1. Through June 24, 1997.

and vegetables turned back up after a considerable drop in April. Nonetheless, retail food prices have increased only slightly since the start of the year, and pressures are not very evident at earlier stages of processing. The PPI for crude foodstuffs and feedstuffs edged down in May after increasing substantially in the preceding two months, and spot commodity prices for foodstuffs have declined further in June.

Consumer prices excluding food and energy rose 0.2 percent in May and were up 2.5 percent over the past twelve months. The index for commodities other than food and energy edged up 0.1 percent in May and rose 1.1 percent from a year earlier. Goods prices have been held down this year by falling prices for new motor vehicles and used cars. Facing intense competition from foreign producers, U.S. automakers are attempting to maintain market share through generous incentive programs. The declines in used car prices may reflect these same pressures as well as a growing supply of vehicles coming off leases.

The index for services excluding energy, which advanced 0.3 percent in May, was up 3.2 percent over the past twelve months--the same pace as in the year earlier. The prices of shelter and "other" services have accelerated a bit so far this year. In contrast, the index for medical services has continued to decelerate. In January 1997, the BLS introduced a new measure of prices of hospital services, which account for roughly one-third of the CPI for medical services. As with PCE prices, which are based on the PPI, this new measure attempts to price treatment paths rather than inputs and has moved toward collecting transactions prices rather than list prices for hospital services. Since the end of last year, CPI hospital services prices have increased 1.3 percent, compared with 0.4 percent for PPI hospital services prices. While differences are to be expected between these series, the divergence in these measures this year reportedly reflects data collection problems in the first few months of this year that have now been resolved.[10]

The deceleration in the growth of consumer prices since the end of last year has been associated with a somewhat smaller decline in

10. Most of the increase in the CPI for hospital services so far this year occurred in January and February. The BLS reported, on a confidential basis, that they had encountered sampling problems for hospital prices early this year, which resulted in part from the deregulation of New York hospitals at the end of 1996.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994 Q1	1995 Q1	1996 Q1	1997 Q1
<u>Product prices</u>				
GDP chain price index	2.3	2.4	2.2	2.2
GDP deflator	2.2	2.5	2.1	1.8
Nonfarm business chain price index[1]	2.1	2.4	1.6	2.2
<u>Expenditure prices</u>				
Gross domestic purchases chain price index	2.1	2.5	2.2	2.2
Less food and energy	2.3	2.5	2.2	1.9
PCE chain price index	2.2	2.5	2.0	2.5
Less food and energy	2.5	2.6	2.0	2.1
PCE deflator	2.2	2.6	2.0	2.2
Less food and energy	2.5	2.6	1.9	1.7
CPI	2.5	2.9	2.8	2.9
Less food and energy	2.9	3.0	2.9	2.5
Median CPI	3.0	2.7	3.3	2.7

1. Excluding housing

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
Q2	2.8	4.5	3.0	4.3	3.0
Q3	2.9	4.2	3.0	4.3	3.0
Q4	3.2	4.0	3.0	4.2	3.0
1997:Jan.	3.0	4.1	3.0	4.3	
Feb.	3.0	3.8	3.0	4.3	
Mar.	2.8	3.5	2.8	4.1	3.0
Apr.	2.5	3.7	3.0	4.1	
May	2.2	3.7	2.9	4.0	
June		3.3	2.8	4.0	2.9

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.

short-term and longer-term measures of inflation expectations. The median expected price increase over the next twelve months, as measured in the Michigan SRC survey, is about 1/4 percentage point lower than the average rate expected at the end of 1996. The Conference Board's measure of inflation expectations over the next twelve months and the Philadelphia Fed survey's reading on inflation expectations over the next ten years also have ticked down since last year.

Prices at earlier stages of processing remain subdued, with no sign of a buildup in "pipeline" pressures that is likely to show through in substantial finished-goods inflation in the near term. The PPI for intermediate materials less food and energy has remained nearly flat over the past twelve months, and while the PPI for core crude materials advanced 1.2 percent in May, the index remains below its year-earlier level. Since mid-May, the Journal of Commerce and KR-CRB spot industrial price indexes have been little changed, on balance, as have metal prices.

We have received little new information on labor costs since the last Greenbook. Responding to tight labor market conditions, average hourly earnings rose 3.8 percent in the twelve months ending in May, up from 3.3 percent in the previous year. Over the year, gains have been particularly strong in the trade and services industries and have been more moderate in manufacturing and construction.

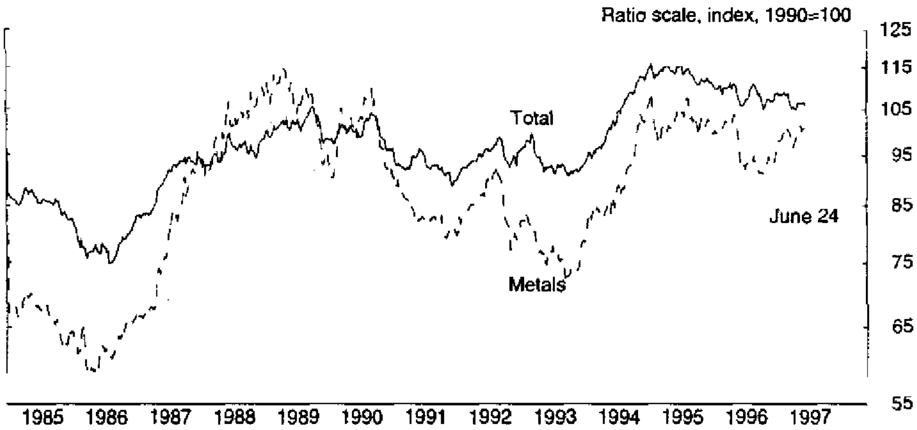
SPOT PRICES OF SELECTED COMMODITIES

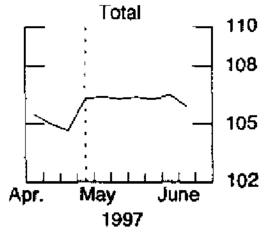
	Current price ($)	Percent change[1]: 1995	1996	Dec. 31 to May 13[2]	May 13[2] to June 24	Memo: Year earlier to date
Metals						
Copper (lb.)	1.230	-3.5	-18.3	10.3	4.2	18.3
Steel scrap (ton)	138.500	-6.6	-13.7	18.9	.0	.0
Aluminum, London (lb.)	.707	-12.9	-9.8	8.1	-4.6	5.8
Precious metals						
Gold (oz.)	338.350	1.7	-5.1	-5.5	-3.0	-12.1
Silver (oz.)	4.770	7.2	-8.8	1.8	-1.9	-7.6
Forest products						
Lumber (m. bdft.)	372.000	-14.4	66.0	-7.0	-3.6	9.4
Plywood (m. sqft.)	355.000	-6.1	1.6	-1.6	14.5	19.9
Petroleum						
Crude oil (barrel)	17.810	16.8	25.9	-17.8	-8.4	-2.7
Gasoline (gal.)	.528	7.7	24.3	-6.1	-16.7	-7.8
Fuel oil (gal.)	.513	22.6	16.1	-19.7	-9.2	.4
Livestock						
Steers (cwt.)	63.000	-5.7	.0	4.5	-8.7	5.0
Hogs (cwt.)	61.500	27.5	34.1	10.9	.8	8.8
Broilers (lb.)	.612	10.7	12.4	-9.4	7.9	2.6
U.S. farm crops						
Corn (bu.)	2.500	57.4	-29.5	8.6	-9.7	-47.4
Wheat (bu.)	3.490	24.0	-16.6	-.3	-23.0	-41.2
Soybeans (bu.)	8.195	29.0	-7.1	25.8	-5.3	7.0
Cotton (lb.)	.722	-8.1	-10.9	-2.1	4.2	-8.6
Other foodstuffs						
Coffee (lb.)	2.260	-39.1	43.2	107.7	-20.0	57.5
Memo:						
JOC Industrials	105.900	-1.7	-3.7	-.9	-.4	.3
JOC Metals	100.200	-1.8	-7.7	7.5	-.3	9.2
KR-CRB Futures	241.440	3.3	-2.6	5.5	-3.9	-2.5
KR-CRB Spot	335.360	-3.5	1.0	1.0	-.9	1.4

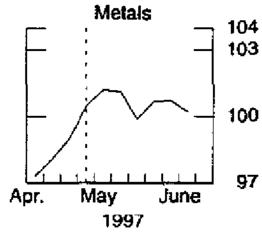
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the May Greenbook.

Commodity Price Measures

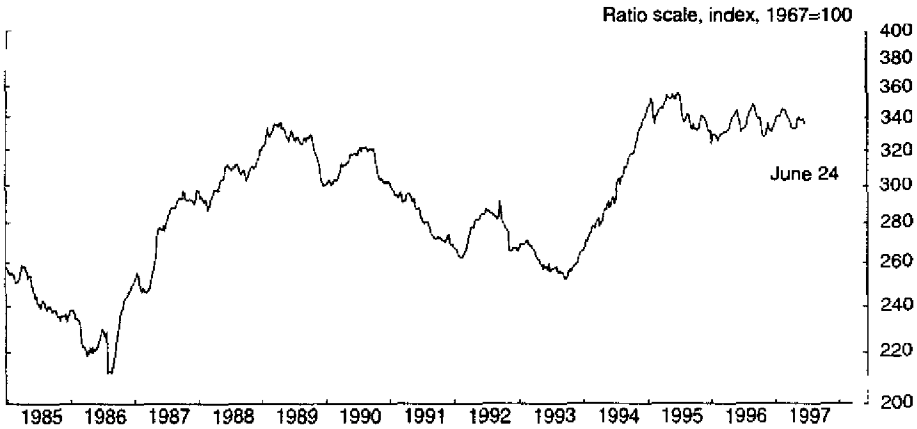
Journal of Commerce Index

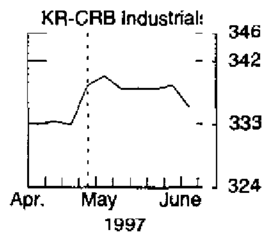




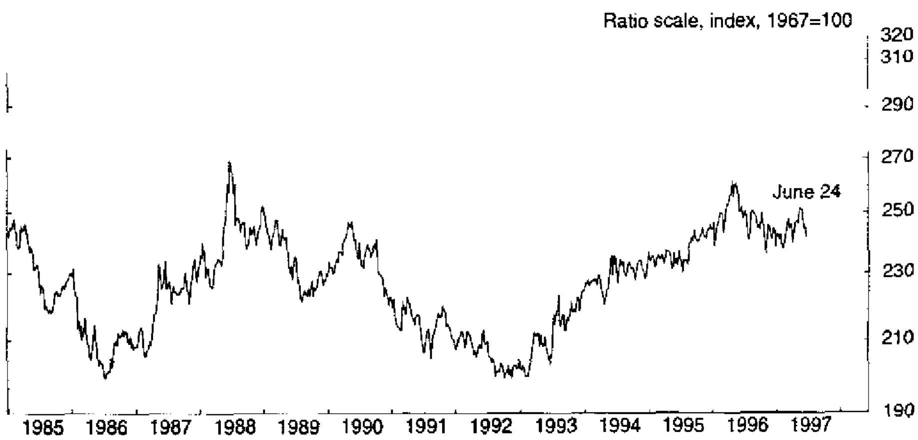


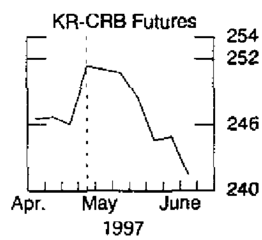
KR-CRB Spot Industrials





KR-CRB Futures





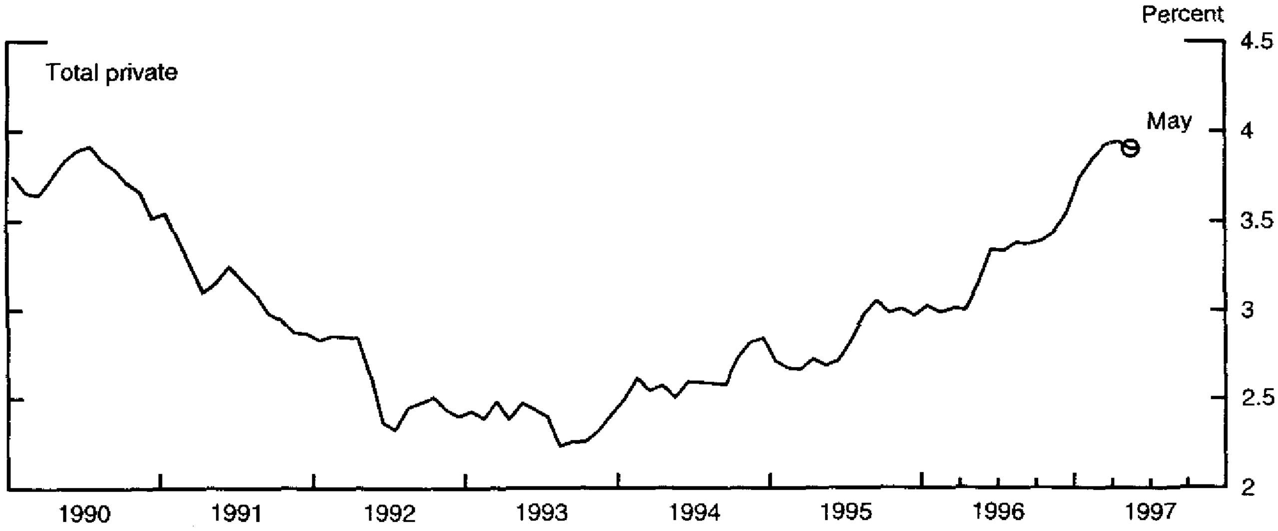
Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the KR-CRB spot price index consists entirely of industrial commodities, excluding energy. The KR-CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

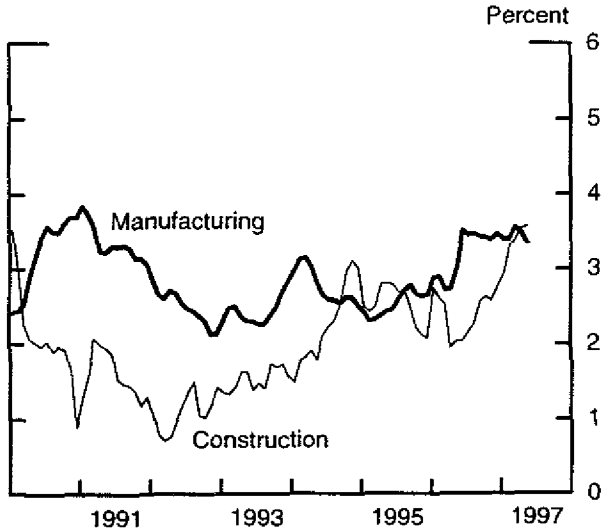
AVERAGE HOURLY EARNINGS
(Percentage change; based on seasonally adjusted data)

	Twelve-month percent change[1]			Percent change to May. 1997		1997	
	May 1995	May 1996	May 1997	Nov. 1996	Feb. 1997	Apr.	May
	-Annual rate-					-Monthly rate-	
Total private nonfarm	2.3	3.3	3.8	3.5	3.0	.1	.3
Manufacturing	2.3	3.3	3.0	2.8	2.5	.0	.3
Construction	2.6	1.9	3.7	4.5	3.6	.4	.4
Transportation and public utilities	2.2	2.7	2.6	3.8	4.4	.3	.2
Finance, insurance, and real estate	3.4	4.1	3.2	2.6	2.2	-.8	1.1
Total trade	2.5	3.4	4.6	3.8	3.4	.1	.2
Services	2.7	3.2	4.3	3.5	2.7	.0	.3

1. Uses not seasonally adjusted data.

Average Hourly Earnings
(Smoothed twelve-month changes)





DOMESTIC FINANCIAL DEVELOPMENTS

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

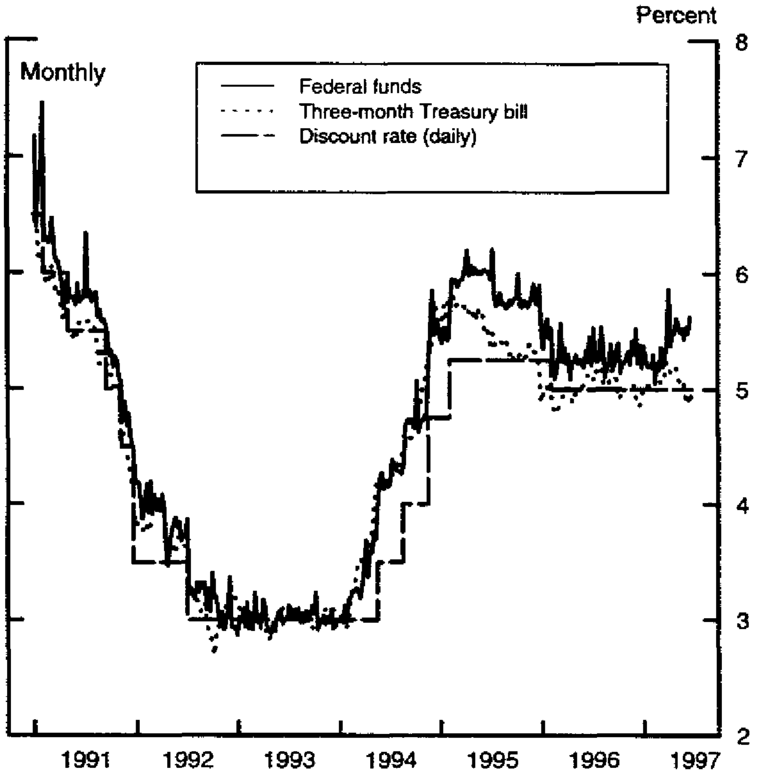
Instrument	1996 Feb. low	1996 July high	1997 FOMC * May 20	1997 June 24	Change to June 24, from: Feb. low	July high	FOMC * May 20
Short-term rates							
Federal funds[2]	5.15	5.39	5.50	5.50	.35	.11	.00
Treasury bills[3]							
3-month	4.76	5.21	5.16	4.94	.18	-.27	-.22
6-month	4.67	5.40	5.37	5.08	.41	-.32	-.29
1-year	4.55	5.64	5.55	5.36	.81	-.28	-.19
Commercial paper							
1-month	5.27	5.50	5.65	5.60	.33	.10	-.05
3-month	5.12	5.59	5.72	5.63	.51	.04	-.09
Large negotiable CDs[3]							
1-month	5.21	5.44	5.63	5.57	.36	.13	-.06
3-month	5.12	5.59	5.73	5.65	.53	.06	-.08
6-month	4.99	5.83	5.89	5.75	.76	-.08	-.14
Eurodollar deposits[4]							
1-month	5.13	5.38	5.56	5.56	.43	.18	.00
3-month	5.13	5.56	5.69	5.63	.50	.07	-.06
Bank prime rate	8.25	8.25	8.50	8.50	.25	.25	.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	4.98	6.62	6.42	6.18	1.20	-.44	-.24
10-year	5.58	7.06	6.71	6.42	.84	-.64	-.29
30-year	6.02	7.19	6.92	6.70	.68	-.49	-.22
U.S. Treasury indexed bond	n.a.	n.a.	3.58	3.64	n.a.	n.a.	.06
Municipal revenue (Bond Buyer)[5]	5.67	6.24	5.91	5.72	.05	-.52	-.19
Corporate-A utility, recently offered	7.18	8.23	8.00	7.79	.61	-.44	-.21
High-yield corporate[6]	9.57	10.36	9.59	9.33	-.24	-1.03	-.26
Home mortgages[7]							
FHLMC 30-yr fixed rate	6.94	8.42	7.91	7.61	.67	-.81	-.30
FHLMC 1-yr adjustable rate	5.19	6.01	5.78	5.66	.47	-.35	-.12

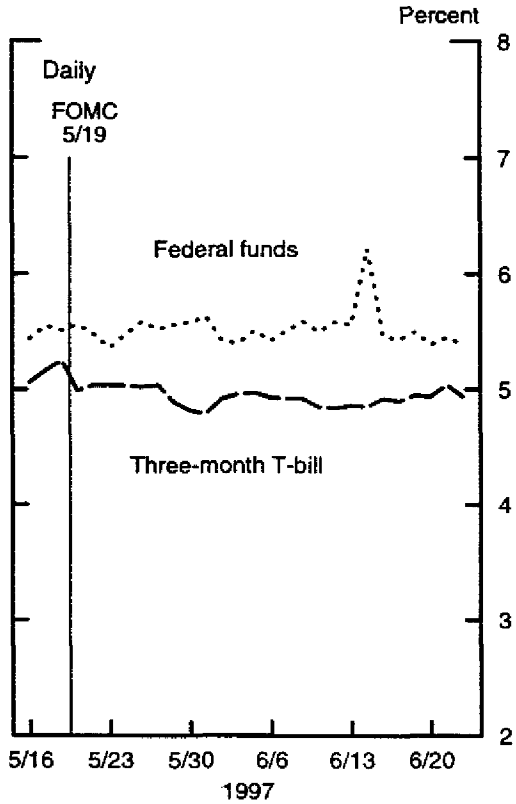
Stock exchange index	Record high Level	Record high Date	1996 July low	1997 FOMC * May 20	1997 June 24	Percentage change to June 24, from: Record high	July low	FOMC * May 20
Dow-Jones Industrial	7796.51	6/20/97	5346.55	7228.88	7758.06	-.49	45.10	7.32
S&P 500 Composite	898.70	6/20/97	626.65	833.27	896.34	-.26	43.04	7.57
NASDAQ (OTC)	1452.43	6/24/97	1042.37	1341.24	1452.43	.00	39.34	8.29
Russell 2000	396.49	6/19/97	307.78	366.57	393.30	-.80	27.79	7.29
Wilshire	8484.51	6/20/97	6099.34	7861.08	8460.86	-.28	38.72	7.63

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 June 25, 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 May 19, 1997.

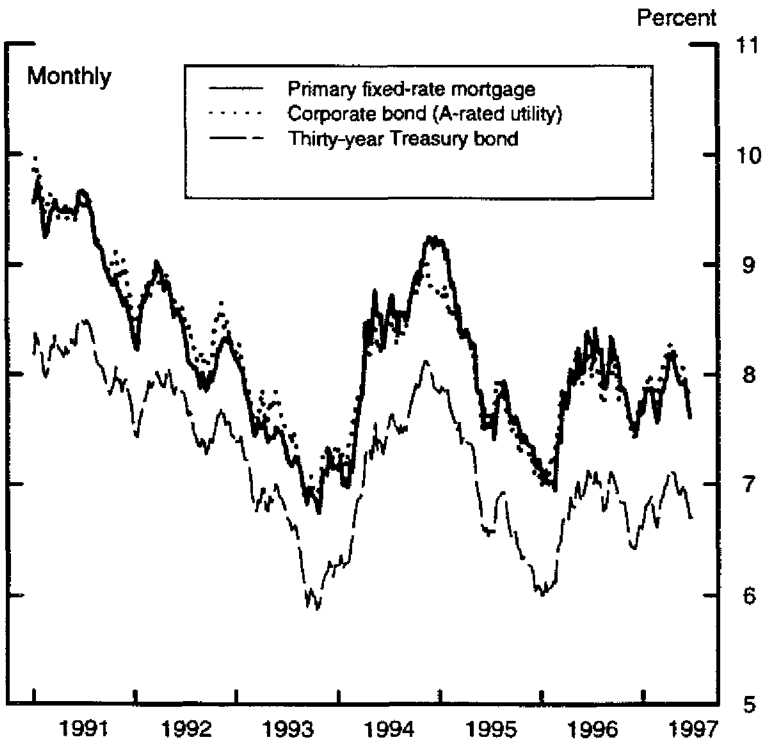
Selected Interest Rates

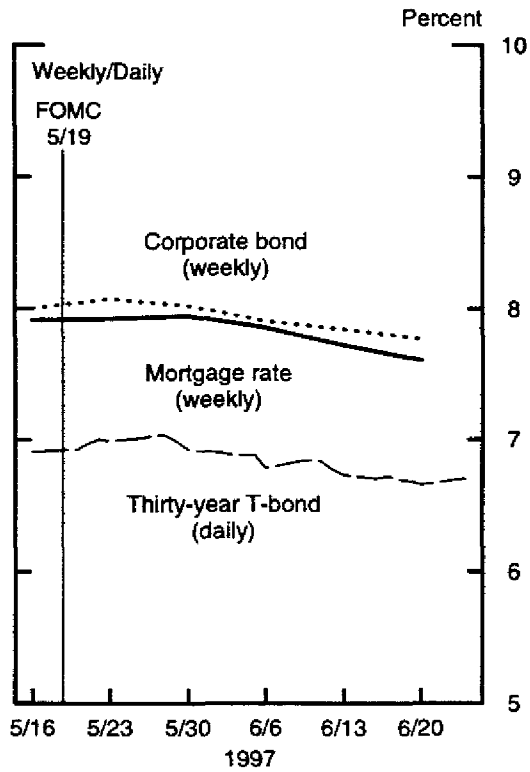
Short-Term





Long-Term





With recent data indicating a marked slowing of GDP growth this quarter and a continuation of low inflation, most interest rates have declined considerably since May 20; on net, nominal yields on Treasury coupon issues are down 20 to 30 basis points. In contrast, the yield on the Treasury's indexed bond was about flat, implying a decline in inflation premia. Some concerns remained after the FOMC's May inaction that the System might take another tightening step or two this year in a preemptive strike against inflation. But the events of the intermeeting period have erased such fears (chart).

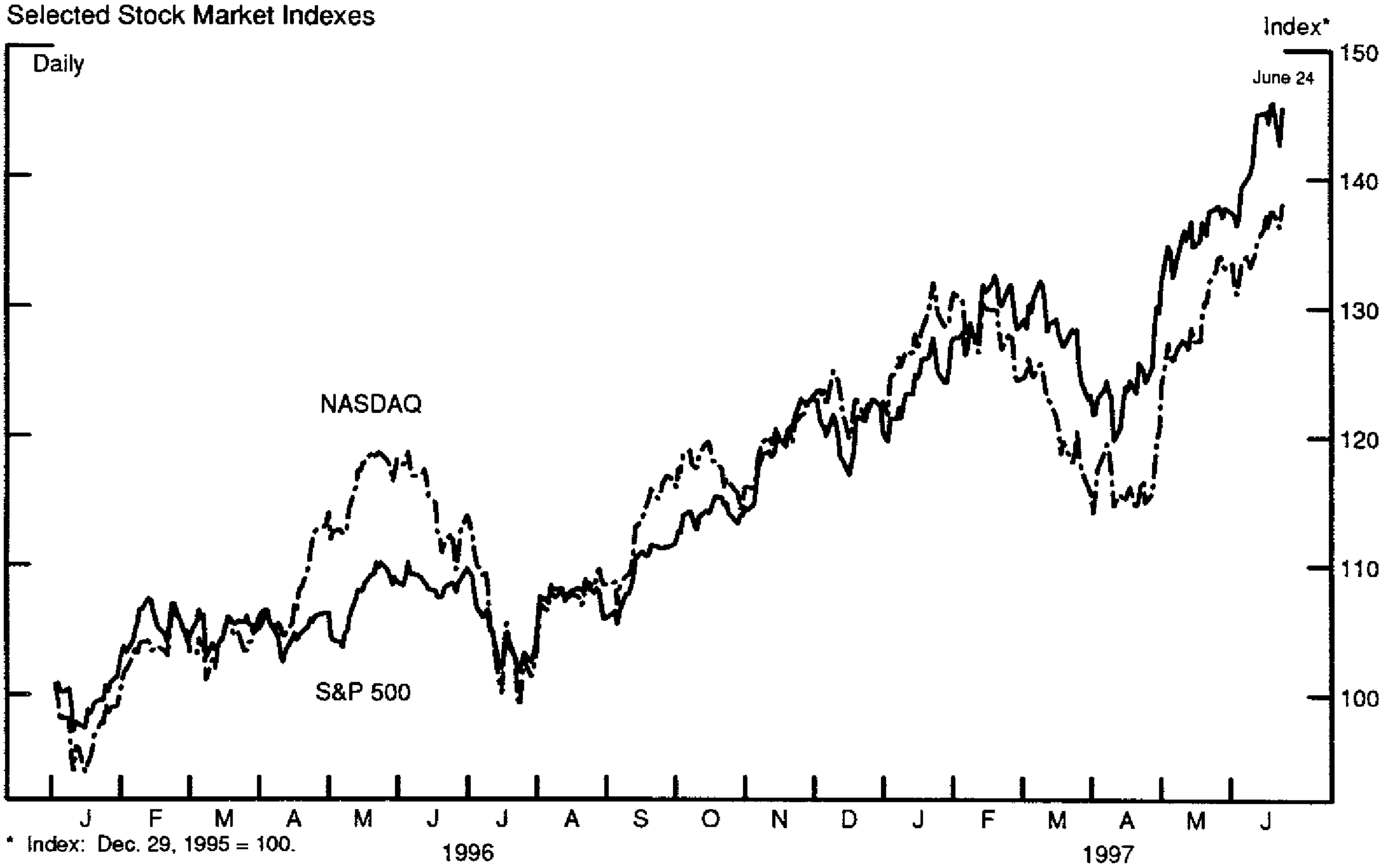
Yields on private money-market instruments are down about 5 to 15 basis points since the May FOMC meeting. However, Treasury bill rates are off 20 to 30 basis points as this sector continues to benefit from reduced auction supplies. The yield on the three-month Treasury bill is now more than 1/2 percentage point below the intended federal funds rate, compared with a historical average of 1/4 percentage point.

Equity markets have continued to rally in recent weeks, albeit experiencing wide swings day to day. The shares of some companies that announced their near-term earnings would be disappointing were hammered, at least temporarily, but the decline in interest rates has buoyed valuations more broadly. Following a sizable one-day drop in late June, in the wake of remarks by Japan's prime minister, stocks staged a rapid comeback, and, on net, the major indexes have gained about 7 percent to 8 percent since the May meeting.

Borrowing by nonfinancial businesses has remained strong in the second quarter. Growth of business loans at banks has eased slightly from the first-quarter pace, but issuance of corporate bonds has picked up appreciably. Offerings of speculative-grade bonds have been at record levels, and offerings of investment-grade bonds have strengthened. In the household sector, fragmentary data suggest that the growth of mortgage debt has continued around the relatively brisk first-quarter pace, while the growth of consumer credit has slowed on balance. In the wake of April's surprisingly large tax receipts, the Treasury built up its cash position and paid down debt. Meanwhile, gross debt issuance by state and local governments has been nearly matched by retirements. The monetary

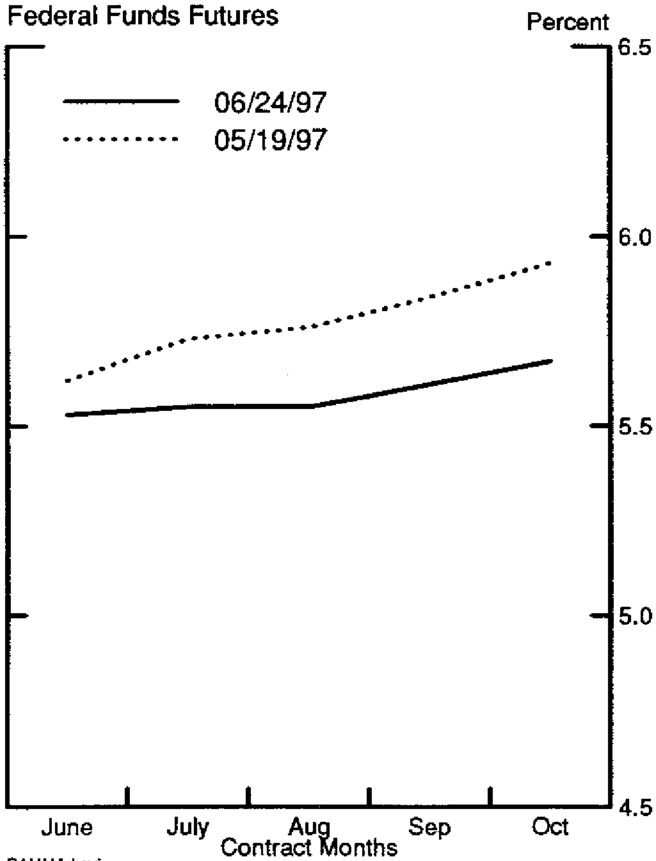
Selected Stock Market Indexes and Short Term Futures Rates

Selected Stock Market Indexes

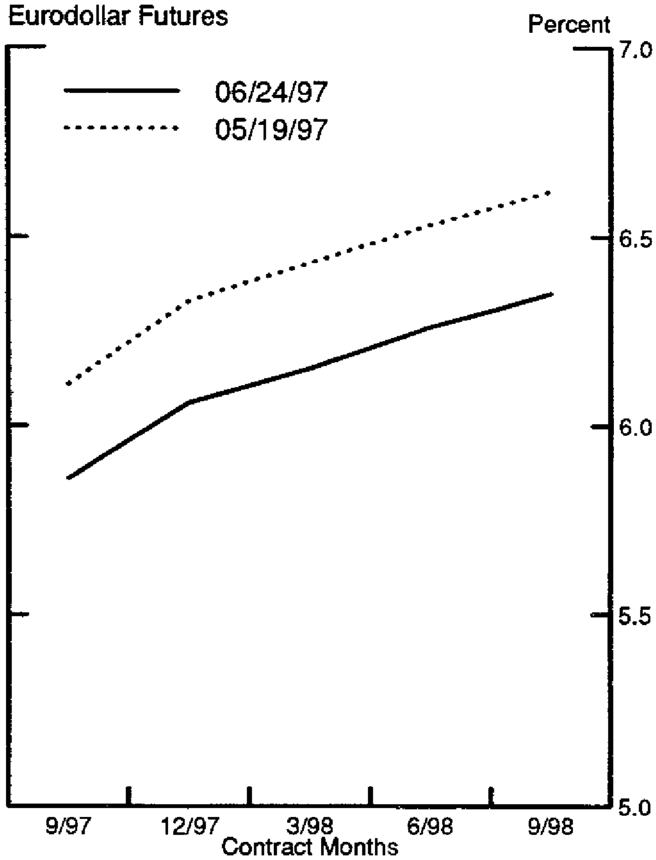


* Index: Dec. 29, 1995 = 100.

Federal Funds Futures



Eurodollar Futures



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aggregates were depressed in May by the drawdown of private deposits that occurred as federal tax payments cleared, but growth has turned up in June.

Business Finance

Gross issuance of nonfinancial corporate bonds increased in May for both investment-grade and speculative-grade securities (table). Investment-grade offerings were almost entirely merger related, including Norfolk Southern's $4-1/4 billion issue to buy part of Conrail. The Norfolk offering was the largest single investment-grade issue ever. Speculative-grade offerings returned to the record level of March, driven by efforts of telecommunications firms to finance the creation of infrastructure for new wireless and cable networks. Over the first five months of this year, junk bonds accounted for about 45 percent of total nonfinancial bond issuance, the highest share on record (chart, lower left). The recent strength in junk bond financings reflects both firms' needs to support ongoing capital spending and an apparent increased willingness of investors to assume the associated credit risk. Indeed, spreads of interest rates on these securities over those on comparable Treasuries have narrowed a bit further in recent months.

Merger-related issuance also boosted the volume of nonfinancial commercial paper in May and the early weeks of June, reversing some of the April decline in outstandings (chart, lower right). Several announced mergers and acquisitions are expected to lead to additional commercial paper issuance over the near term.

Equity issuance by nonfinancial firms picked up somewhat in May, but average issuance for April and May was about 30 percent less than the first-quarter rate and more than 50 percent below last year's rapid pace. Initial public offerings (IPOs) remained sluggish in May but have strengthened in June. Moreover, initial offer prices and first-day returns have firmed somewhat this month, suggesting stronger investor demand than had been evident earlier this year. Although some pickup in equity offerings may be under way, net issuance of nonfinancial equity has remained negative. Announcements of planned equity repurchases continued apace in April and May, reflecting the cash-rich positions of large firms, and ongoing merger activity.

Recent information on corporate credit quality has been mixed. In April and May, Moody's downgraded $24 billion more nonfinancial debt than it upgraded. Most of the net downgrade is attributable to

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

Type of security	1995	1996	1996 Q4	1997 Q1	1997 Mar.	1997 Apr	1997 May
All U.S. corporations	47.7	58.4	59.5	61.3	67.0	46.9	58.0
Stocks[1]	6.1	10.2	12.1	9.9	7.8	5.9	7.9
Bonds	41.6	48.2	47.4	51.4	59.1	41.0	50.1
<u>Nonfinancial corporations</u>							
Stocks[1]	4.4	6.7	6.4	4.9	4.0	2.6	3.6
Initial public offerings	1.7	2.9	2.8	1.1	.7	1.0	.8
Seasoned offerings	2.7	3.8	3.6	3.8	3.3	1.6	2.8
Bonds	10.8	12.5	13.6	13.3	13.5	13.3	18.3
By rating, bonds sold in U.S.[2]							
Investment grade	6.5	6.3	7.6	5.7	4.4	6.8	7.2
Speculative grade	3.0	4.8	4.9	6.2	8.1	5.1	8.1
Public	2.0	2.3	1.4	2.7	3.6	1.0	2.0
Rule 144A	1.1	2.5	3.5	3.6	4.5	4.1	6.1
<u>Financial corporations</u>							
Stocks[1]	1.7	3.5	5.8	4.9	3.9	3.3	4.3
Bonds	30.8	35.8	33.8	38.1	45.6	27.7	31.8

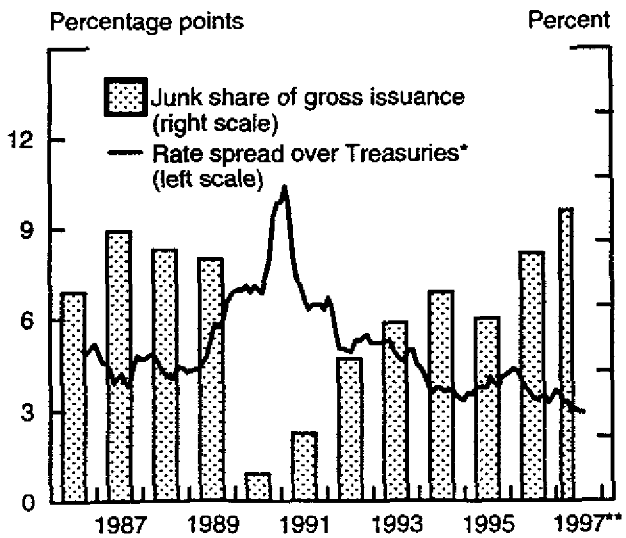
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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

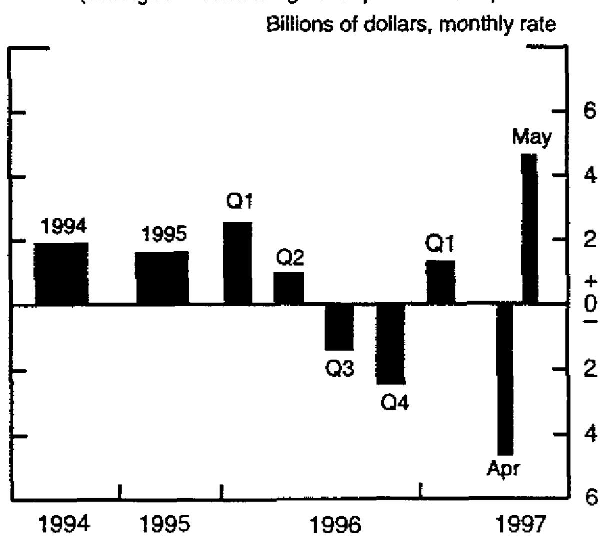
Junk Bonds



*Merrill Lynch Master II Index less 7-year Treasury yield.
**Data through May.
Source. Securities Data Company.

Commercial Paper

(Change in outstandings over period shown)

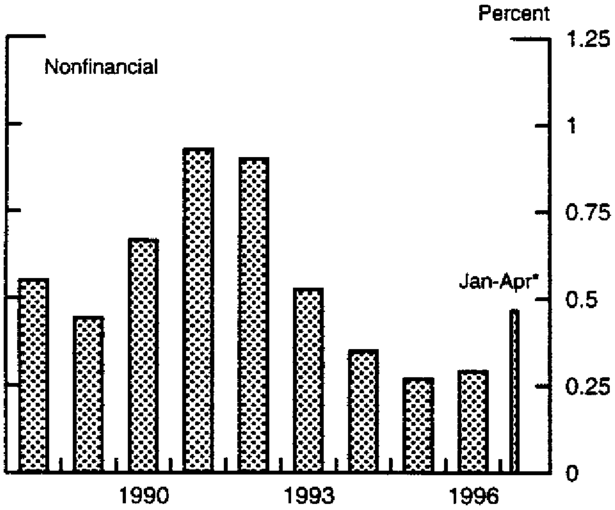


*Staff estimate.

Stock Market and Earnings

Failed-Business Liabilities

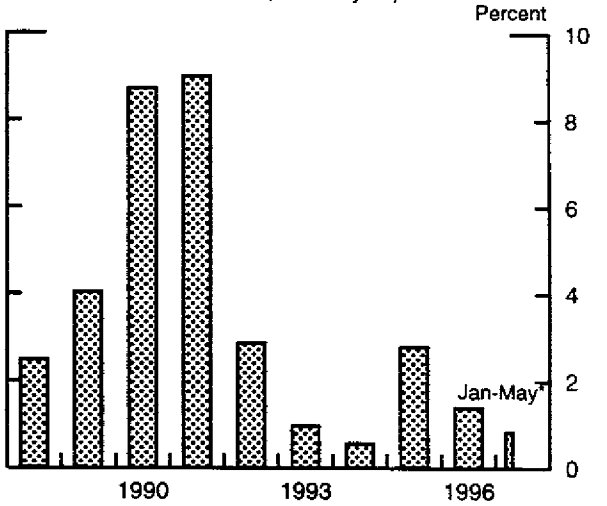
(As a percentage of total liabilities)



*At an annual rate.
Source. Dun & Bradstreet.

Default Rate on Junk Bonds

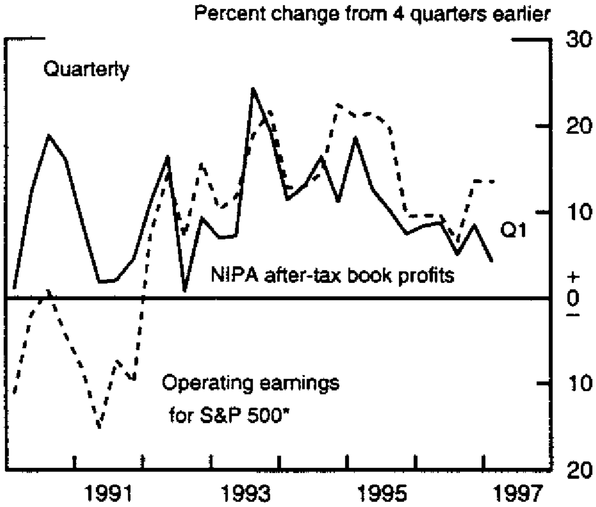
(Ratio of junk bond defaults to junk bonds outstanding at end of previous year)



*At an annual rate.
Source. Edward Altman, CS First Boston.

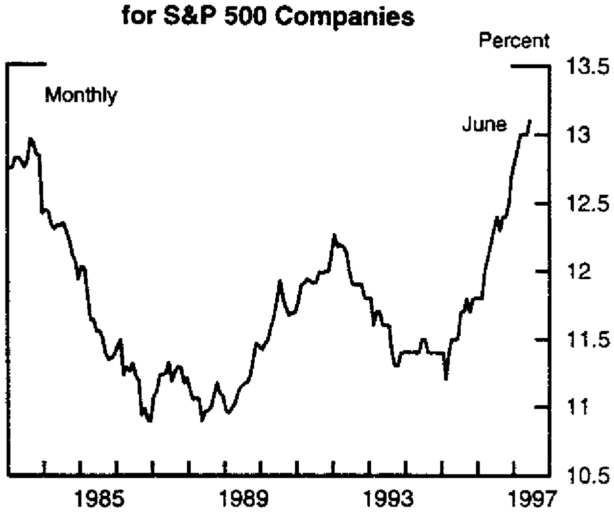
Corporate Profits

Percent change from 4 quarters earlier



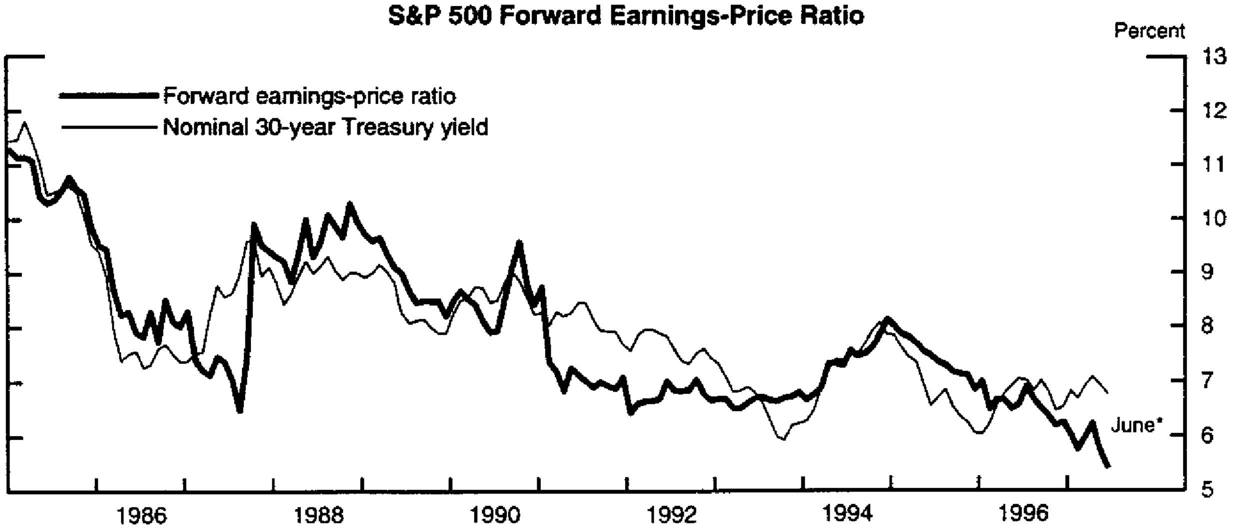
*Source. Goldman Sachs.

Expected Long-Term Earnings Growth for S&P 500 Companies



Source. I/B/E/S.

S&P 500 Forward Earnings-Price Ratio



*Based on data through June 18.

merger-related transactions, with $22 billion reflecting downgrades of CSX and Norfolk Southern in response to their accumulation of debt for the buyout of Conrail. Business failures in the nonfinancial sector also picked up in the first four months of 1997 (chart, top left). However, more positive signals continue to come from Moody's Watchlist, which shows possible upgrades slightly exceeding downgrades in both number and dollar value, and from the continued low default rate on speculative-grade bonds (chart, top right).

According to initial NIPA estimates, the growth of book profits after-tax, the closest analogue to the earnings measure in financial reports, slowed in the first quarter (chart, middle left panel). This estimate of profits growth, however, looks low compared with the gains implied by first-quarter financial reports (chart, middle left panel), which are a more important source of earnings information to stock market analysts. Only a handful of companies--those whose fiscal quarters end in May--have reported second-quarter earnings thus far, and market attention has been drawn to pre-announcements by firms expecting to report poorer-than-anticipated earnings. Thus, equity price indexes dipped when a few technology companies warned recently about slower earnings growth.

Indeed, the recent dramatic rise in stock prices has been accompanied by considerable volatility, as evidenced when concerns about Japanese investors precipitated a 190-point drop in the Dow on June 22 that was largely reversed the next day. On balance, however, the market has continued its uptrend. Since the beginning of the year, the Dow and S&P 500 have jumped roughly 20 percent, on net, while the NASDAQ Composite and the Russell 2000 are up about 10 percent. One important factor behind the current high level of stock prices appears to be the market's expectation of robust earnings growth over the next three to five years. These expectations currently are at a level not seen since the early 1980s, at the trough of a steep recession when earnings levels were extremely low (chart, middle right).

With the recent rise in share prices, market valuations have become even richer relative to bonds. The yield on the thirty-year Treasury bond currently exceeds the S&P 500 ratio of expected twelve-month-ahead earnings to price by an amount last reached in mid-1991 (chart, bottom panel). At the time, the earnings-price (E/P) ratio was depressed by the low level of earnings as the economy emerged from recession; no such explanation can be offered for the low E/P ratio today.

Household Sector

Growth of consumer credit increased in April from the sluggish March pace. However, smoothing through the monthly gyrations, the general pattern of gradual moderation evident since early last year appears intact as growing repayments of seasoned loans constrain the growth of debt outstanding (chart). Revolving credit--primarily credit card debt--advanced at less than a 5 percent rate in both March and April. The volatility of this component makes any two-month period a tenuous indicator of trend; however, the slowing of revolving credit growth over the past year may reflect, in part, some firming of credit standards, as has been reported by banks in surveys of lending.

Information on the growth of home mortgage debt for the current quarter is still sparse. The rate of mortgage purchases and securitizations at Fannie Mae and Freddie Mac in April and May slowed appreciably from the first-quarter pace. However, the growth of total real estate loans at commercial banks picked up a bit in these months, partly reflecting continued strength in home equity lending. Market reports also indicate that securitization of home equity loans is at record levels and now exceeds that of auto loans and credit card receivables.

Credit quality measures in the household sector continue to send mixed signals. Delinquency rates for bank credit card accounts and for car loans at captive auto finance companies hovered near or at record levels in the first quarter--reflecting past liberalization of credit standards.[1] However, delinquency rates for other categories of consumer lending have shown only moderate increases, and home mortgage delinquencies are still fluctuating near twenty-year lows (chart).

According to the Call Report, credit card delinquencies at banks flattened out in the first quarter, providing some hint that the steps taken by card issuers in recent months to tighten credit availability may be slowing the erosion of credit quality. The credit card delinquency rate estimated by the American Bankers Association, which had set new records in three of four quarters last year, fell in the first quarter. Meanwhile, the charge-off

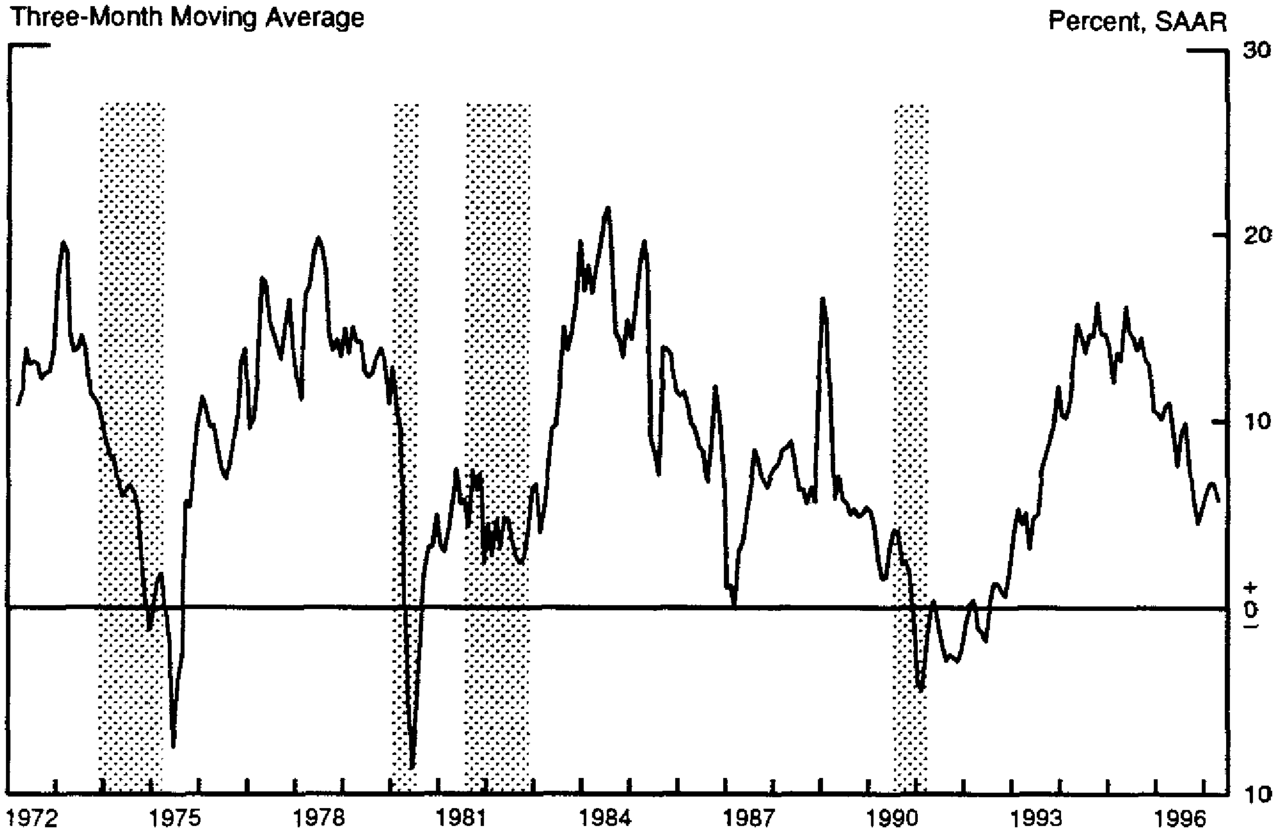
1. More recent data for April indicate that delinquency rates at auto finance companies edged down only slightly from first-quarter levels.

Consumer Credit

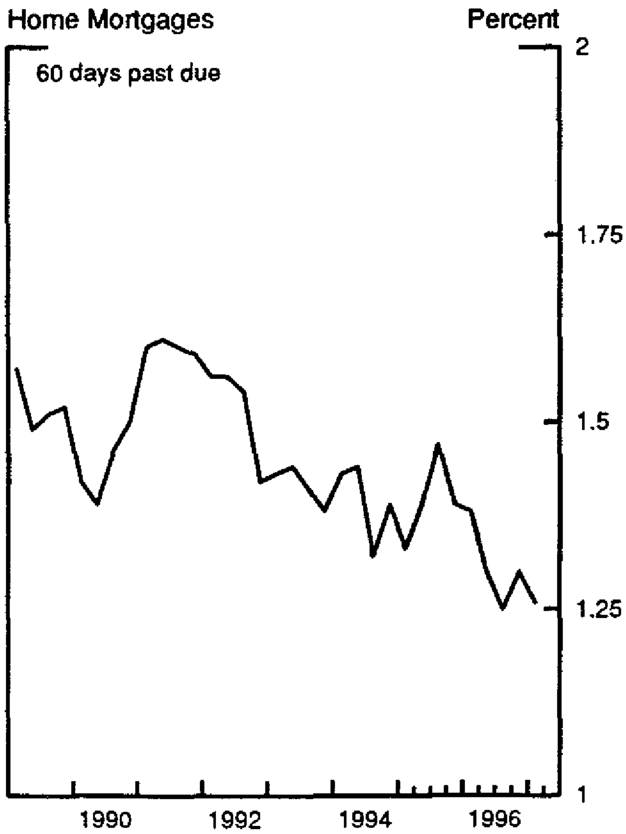
	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Feb	1997 Mar	1997 Apr[p]
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.2	8.1	7.8	5.3	6.7	6.7	3.0	7.6
(Previous)	*(14.2)*	*(8.1)*	*(7.8)*	*(5.3)*	*(6.4)*	*(6.7)*	*(2.0)*	
Auto	10.6	6.9	6.2	1.9	0.4	0.7	-2.7	12.7
Revolving	22.0	13.0	7.7	12.2	12.8	12.7	3.9	4.3
Other	9.2	3.4	9.7	-0.1	5.4	5.1	8.0	6.6
Levels (billions of dollars, SA)								
Total	1103.3	1193.2	1177.6	1193.2	1213.3	1210.2	1213.3	1220.9
Auto	350.8	375.2	373.4	375.2	375.5	376.4	375.5	379.5
Revolving	413.9	467.9	454.0	467.9	482.8	481.3	482.8	484.6
Other	338.6	350.2	350.2	350.2	354.9	352.5	354.9	356.9
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	9.1	9.0	8.9	8.9	n.a.	n.a.
Personal (24 mo.)[2]	13.9	13.5	13.4	13.6	13.5	13.5	n.a.	n.a.
Credit cards[3]	16.0	15.6	15.7	15.6	15.9	15.9	n.a.	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	10.3	9.8	7.6	7.4	8.1	8.6
Used cars	14.5	13.5	13.9	13.6	13.1	13.1	13.2	13.3

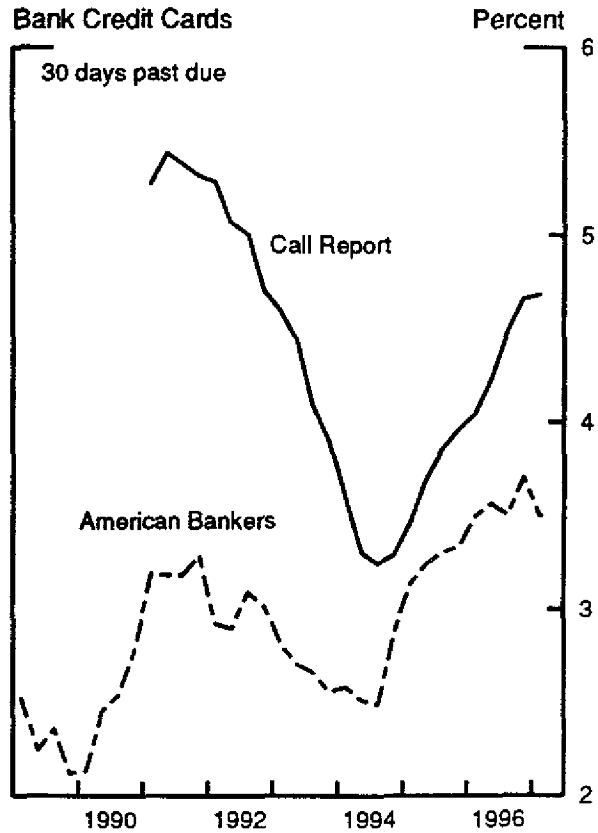
1. Annual data are averages of quarterly data for commercial banks and of monthly data for finance companies.
2. Average of most common rate charged for specified type and maturity during the first week of the middle month of each quarter.
3. Stated APR averaged across all credit card accounts at all reporting banks during the period.
4. Average rate for all loans of each type, regardless of maturity, made during the period.
p Preliminary. n.a. Not available.

Growth in Consumer Credit



Loan Delinquency Rates





Source. Mortgage Bankers Association

rate for credit cards at banks rose further in the first quarter, indicating that weak accounts were still being purged from portfolios.

Personal bankruptcy filings recorded another sharp increase in the first quarter, rising at a 27 percent annual rate from the level of filings in the fourth quarter. Bankruptcies exceeded 1 million last year for the first time and are on pace to reach 1.3 million this year. Still, the annual total represents only about 1 percent of all households, and the accompanying financial disruption has left no clear imprint on household spending. Carried to an extreme, widespread use of bankruptcy could prompt severe curtailment of credit supply, but there is little evidence that such a point is at hand. For instance, while the profitability of credit card programs at banks has declined recently, net returns on this line of business as of the latest Call Report still exceeded the average net return for all business activities of banks.

The marked deterioration in some measures of consumer credit quality, together with warnings from credit rating firms about emerging credit problems, has tempered investor enthusiasm in some sectors of the asset-backed securities market. In addition, concerns about the impact of poor credit performance on future earnings have depressed equity prices of a number of participants in the subprime sector of this market. The rate of issuance of securities backed by auto loans and credit card receivables has slowed sharply from last year's pace. Analysts report that one factor contributing to the overall higher delinquency rate for securities backed by auto loans is the increasing proportion of used-car loans in securitized pools. While the issuance of securities backed by credit card receivables and auto loans has slowed, the home equity loan sector of the asset-backed securities market continues to experience near-record growth. In the first quarter, four out of every five loans backing home equity loan securitizations were classified as subprime.

Federal Government Finance

The Treasury has used the stronger-than-expected inflow of federal tax receipts and higher surplus during the current quarter both to make larger paydowns of bills and to build up its cash balance even more than it had anticipated. Even though the Treasury has slashed its weekly auctions of bills to under $15 billion, its cash balance at the end of June is still expected to be about

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1996 Q3	1996 Q4	1997 Q1	1997 Mar.	1997 Apr.	1997 May
Total surplus/deficit (-)	-33.4	-58.9	-52.0	-21.3	93.9	-48.5
Means of financing deficit						
Net cash borrowing and repayments (-)	39.4	48.7	48.0	28.8	-39.0	-19.1
Nonmarketable	-1.3	7.4	4.0	2.2	0.9	-0.4
Marketable	40.6	41.3	44.0	26.6	-39.9	-18.6
Bills	-12.4	16.2	7.9	23.1	-44.2	-21.7
Coupons	53.0	25.1	36.1	3.4	4.2	3.1
Decrease in cash balance	-6.2	11.4	-0.7	-18.3	-55.9	72.5
Other[1]	0.3	-1.3	4.6	10.8	1.0	-5.0
Memo:						
Cash balance, end of period	44.2	32.8	33.5	33.5	89.4	16.9

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.

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

Agency	1996 Q4	1997 Q1	1997 Feb.	1997 Mar.	1997 Apr.
FHLBs	8.5	3.1	-1.6	11.0	11.40
FHLMC	10.0	-3.4	-1.6	-7.9	9.3
FNMA	12.1	4.9	-1.3	4.1	5.6
Farm Credit Banks	-0.1	0.8	-7.5	0.8	0.1
SLMA	-0.2	-1.7	-0.1	-5.6	n.a.

Note. Excludes mortgage pass-through securities issued by FNMA and FHLMC.

n.a. Not available.

$47 billion, roughly $12 billion above the intended level announced in late April. Bills outstanding have fallen substantially and have been associated with some downward pressures on the short end of the yield curve, presumably reflecting a scarcity premium. To lessen those pressures and to align its financing strategy with a smaller expected deficit for the year, the Treasury recently announced that it would remove the ten-year note from its auction calendar for July and October, in effect reversing the debt-management changes instituted last year. The Treasury's decision makes room for a higher volume of bill issuance in coming quarters and also gives it more scope to sell inflation-protected securities (TIPS). The next offering of indexed debt, in mid-July, will be at the five-year maturity, but the Treasury also announced plans to add a thirty-year maturity to its menu in 1998. The Chicago Board of Trade will inaugurate futures and options on the five-year TIPS, coincident with the start of when-issued trading in the five-year indexed note early next month.

After slowing in the first quarter when interest rates were rising, gross bond issuance by federal agencies appears to have rebounded in April (table). Borrowing by the Federal Home Loan Banks increased, in part to fund the strong demand for advances by member institutions. Fannie Mae and Freddie Mac also reported increased borrowing to fund growth in their mortgage holdings. Both agencies have continued to tap global bond markets, with recent offerings totaling a combined $820 million.

State and Local Government Finance

Gross issuance of long-term municipal debt eased some in May, in part as borrowing to finance new capital dropped back from its strong pace in April (table). Long-term bond issuance thus far this year is running about 2 percent behind the average pace set in the first half of 1996. Meanwhile, retirements through May were off 12 percent on a year-over-year basis, owing largely to smaller paydowns of advance-refunded debt. With fewer retirements, net long-term issuance has totaled about $13 billion so far this year, up from about $4 billion over the same period in 1996.

Tax-exempt bond yields declined, on balance, relative to comparable Treasury yields in the first five months of 1997 as a result of strong demand for municipal bonds. The decline in recent weeks partly reflects the market's anticipation of the seasonal reduction of net supply resulting from the heavy bond redemptions ($40 billion) scheduled for June and July.

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

	1994	1995	1996	1996 Q4	1997 Q1	1997 April	1997 May
Total tax-exempt	16.1	15.4	17.9	18.7	13.7	16.3	15.3
Long-term	12.8	12.1	14.3	16.2	12.1	15.4	14.2
Refundings[1]	4.0	3.6	4.9	5.2	4.3	3.9	4.6
New capital	8.8	8.5	9.4	11.0	7.8	11.5	9.6
Short-term	3.3	3.3	3.6	2.5	1.6	.9	1.1
Total taxable	.7	.7	.8	1.5	.7	.3	.8

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

Financial Intermediaries and Monetary Aggregates

Net sales of long-term mutual funds increased in May, posting the largest net inflow since January (table). Net sales of equity funds accounted for most of the rise, boosted last month by stronger inflows to aggressive growth funds and growth funds. Sales of growth and income funds--which invest in large, well-known companies--remained robust and continued to account for a relatively large share of inflows to domestic stock funds. Inflows to bond funds also increased in May, with high-yield and balanced bond funds (which have some equity exposure) accounting for nearly the entire net inflow. Preliminary data suggest that sales of long-term mutual funds continued strong in early June and remained tilted toward relatively conservative stock funds and high-yield bond funds.

Growth of the monetary aggregates was weak in May but appears to have rebounded in June (table). M2 edged lower last month, a result of the clearing of checks associated with the April 15 tax date, which prompted a runoff of household liquid deposits. Smoothing through the fluctuations caused by tax payments, M2 growth appears to be running at about a 4-1/4 percent annual rate this quarter. The slowdown of M2 growth in May showed through to M3, which grew at only a 1-1/4 percent rate. M3 growth in May also was held down by weakness in large time deposits, but the falloff in

Net Sales of Selected Mutual Funds Excluding Reinvested Distributions

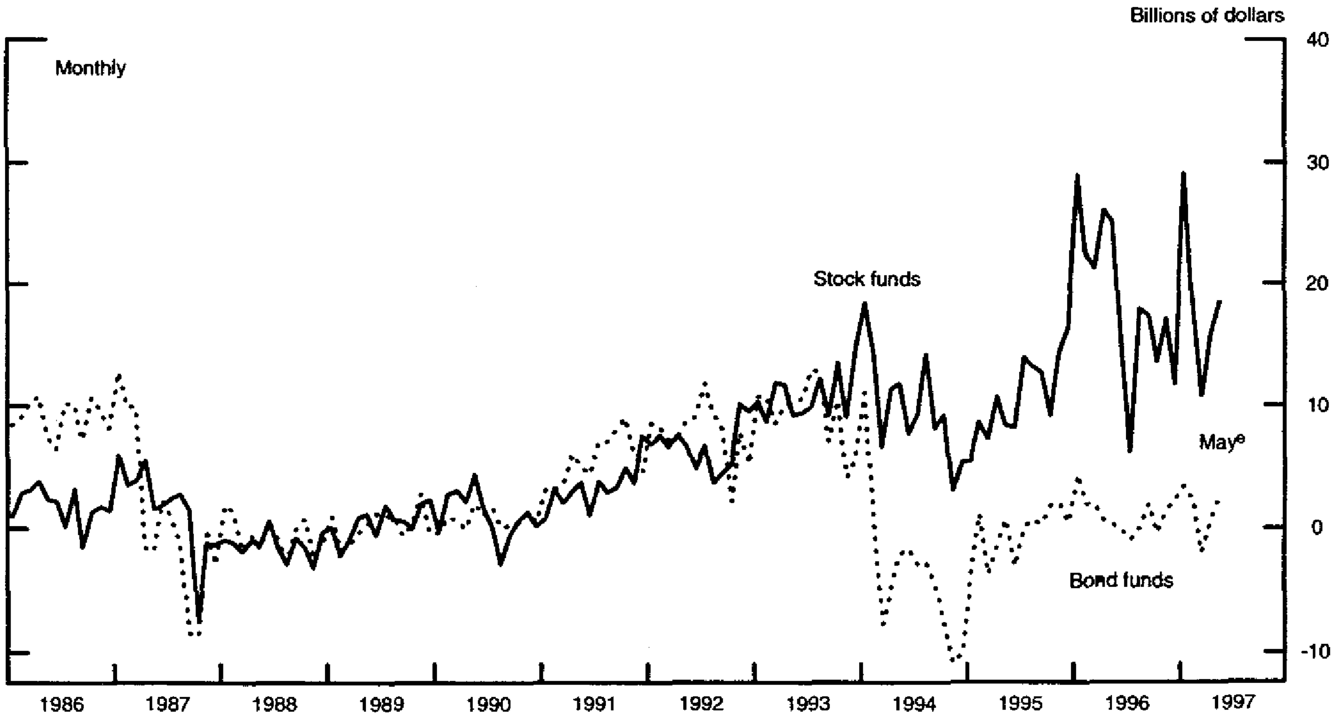
(Billions of dollars; quarterly and annual data at monthly rate)

			1996	1997				Memo:
	1995	1996	Q4	Q1	Mar.	Apr.	May[e]	April assets
Stock funds	10.7	18.6	14.2	19.2	10.7	15.7	18.5	1879.0
Domestic[1]	9.7	14.7	11.4	14.8	8.1	10.6	14.1	1566.8
Aggressive growth	3.1	4.7	3.2	1.8	0.1	1.4	3.5	271.5
Growth	3.1	3.9	2.7	3.7	1.4	2.0	3.3	509.5
Growth and income[2]	3.7	6.2	5.6	9.2	7.0	7.2	7.1	781.4
International[3]	1.0	3.9	2.7	4.5	2.7	5.1	4.5	312.2
Bond funds	-0.4	1.1	1.1	1.2	-2.0	0.5	2.5	903.1
High–yield	0.7	1.0	1.3	0.8	-1.2	1.3	1.5	82.9
Balanced[4]	1.4	2.6	0.6	1.7	1.4	0.8	0.9	263.9
Other	-4.7	-2.5	-0.8	-1.3	-2.1	-1.5	0.2	556.3

1. Includes precious metals funds, not shown elsewhere.
2. Calculated as the sum of "Growth and income" and "Income equity" in the ICI data.
3. Calculated as the sum of "International" and "Global equity" in the ICI data.
4. Calculated as the sum of "Income–Mixed", "Balanced", and "Flexible Portfolio" in the ICI data; these funds invest in both stocks and bonds.

e Aggregate Stock and Bond are ICI estimates, components are staff estimates.
Source. Investment Company Institute.

Net Sales of Long-Term Mutual Funds Excluding Reinvested Distributions



Source. Investment Company Institute.
e ICI estimates.

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1996 Q4	1997 Q1	1997 Mar.	1997 Apr.	1997 May (p)	1996:Q4 to May 97 (p)	Level (bil. $) May 97 (p)
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-7.3	-0.7	-6.0	-11.3	-2.7	-3.3	1062.7
2. M2[2]	4.6	5.0	5.9	5.1	6.0	-0.5	4.7	3900.2
3. M3	6.7	7.9	7.7	6.8	8.6	1.3	6.8	5056.6
Selected components								
4. Currency	5.7	7.7	7.5	5.7	3.9	7.1	6.9	406.1
5. Demand deposits	2.7	-5.5	2.0	-4.2	-22.3	0.0	-2.8	395.3
6. Other checkable deposits	-23.1	-29.4	-16.1	-25.6	-17.4	-21.9	-18.1	253.1
7. M2 minus M1[3]	8.8	10.1	8.5	9.4	12.6	0.3	7.9	2837.5
8. Savings deposits	11.7	12.1	10.7	12.8	15.5	-1.3	9.7	1319.7
9. Small time deposits	1.3	3.8	1.1	-1.4	1.7	5.5	1.7	950.7
10. Retail money market funds	17.1	17.2	16.3	19.9	24.5	-4.2	14.8	567.2
11. M3 minus M2[4]	15.0	18.5	14.0	12.6	17.4	7.4	14.1	1156.4
12. Large time deposits, net[5]	16.1	20.1	12.6	21.2	30.6	4.6	15.8	521.6
13. Institution-only money market mutual funds	19.8	19.8	15.6	25.1	-0.8	0.0	12.6	311.6
14. RPs	4.1	1.9	7.8	-10.8	11.5	-9.0	4.4	198.7
15. Eurodollars	18.8	39.9	28.2	-17.3	18.6	66.2	28.0	124.4
Memo								
16. Sweep-adjusted M1[6]	5.3	5.0	6.8	5.3	0.5	4.6	5.3	1275.3
17. Monetary base	3.8	5.1	5.6	3.4	1.6	3.4	4.4	459.5
18. Household M2[7]	4.8	6.0	6.4	6.3	7.9	0.8	5.8	3505.9
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	15.3	12.7	10.3	16.3	2.1	...	607.7
19. Net due to related foreign institutions	-2.0	-4.7	-7.0	-8.1	2.7	22.3	...	235.2
20. U.S. government deposits at commercial banks	0.0	0.0	0.5	10.2	1.6	5.5	...	32.5

1. For the years shown, fourth quarter-to-fourth quarter percent change. For the quarters shown, based on quarterly averages.
2. Sum of seasonally adjusted M1, retail money market funds, savings deposits, and small time deposits.
3. Sum of retail money funds, savings deposits, and small time deposits, each seasonally adjusted separately.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees, each seasonally adjusted separately.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government, and foreign banks and official institutions.
6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs, on the basis of monthly averages of daily data.
7. M2 less demand deposits
8. For the years shown, "average monthly change" is the fourth quarter-to-fourth quarter dollar change, divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.

p--Preliminary.

Commercial Bank Credit

(Percent change; seasonally adjusted annual rate)

Type of credit	1996	1996 Q4	1997 Q1	1997 Mar	1997 Apr	1997 May	Level, May 1997 (billions of $)
1. Bank credit: Reported	4.1	6.7	10.4	6.8	10.9	2.2	3,912.1
2. Adjusted[1]	4.6	6.9	7.7	10.7	13.0	4.9	3,835.2
3. Securities: Reported	-1.7	2.2	14.0	-7.3	22.0	-21.2	1,015.5
4. Adjusted[1]	-0.1	2.5	3.5	6.9	32.0	-12.1	938.6
5. U.S. government	-0.7	0.7	0.5	7.2	23.7	0.2	722.6
6. Other[2]	-4.0	5.9	48.9	-39.0	17.6	-71.3	292.8
7. Loans[3]	6.3	8.3	9.1	11.9	6.9	10.6	2,896.6
8. Business	8.9	13.6	9.3	8.3	11.2	7.9	814.1
9. Real estate	4.0	4.6	7.6	14.2	8.9	10.1	1,172.5
10. Home equity	6.8	18.9	11.9	18.0	16.4	16.1	90.4
11. Other	3.7	3.5	7.3	13.8	8.3	9.6	1,082.1
12. Consumer: Reported	6.3	6.3	0.9	-2.8	-4.6	6.5	522.5
13. Adjusted[4]	11.5	10.3	5.4	3.4	-1.2	7.6	703.2
14. Other[5]	8.5	12.1	25.4	33.3	7.6	23.4	387.6

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.

this component appears to have been reversed in June. On balance, M3 appears to be running at about a 6-1/4 percent growth rate this quarter, keeping the level of M3 above its annual growth cone of 2 percent to 6 percent.

Growth of credit provided by commercial banks slowed to a 5 percent annual rate in May, less than half the pace in April (table). Much of the slowing last month is attributable to a runoff in securities holdings. In response to large deposit inflows in April--most likely tax-related--banks increased their investment in U.S. government obligations. These purchases were mostly reversed in May as deposits fell when payments cleared. Even so, averaging across the two months, the annual growth rate of adjusted securities holdings, about 10 percent, was still well above the first-quarter rate, and data for early June suggest that growth of securities holdings remains fairly strong.

Loan growth picked up in May as business and real estate lending remained strong and consumer loan growth rebounded. The recent bounceback in measured growth of consumer loans likely better reflects the actual underlying rate of expansion, as growth of consumer loans in March and April was damped by asset sales and one-time accounting rule changes for which no adjustments have been made in the series. Partial data for June point to a continuation of fairly brisk loan growth, about in line with the pace of the past several months.

Anecdotal reports suggest that banks continue to offer favorable terms on commercial real estate and business loans. According to the Survey of Terms of Business Lending conducted in the first week of May, the four-quarter moving average of the spread of commercial and industrial loan rates over the intended federal funds rate remained near its low for the decade (chart).

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In the first quarter, the deficit in U.S. international trade in goods and services was substantially larger than that recorded in the fourth quarter of last year. The April deficit (at an annual rate), however, was well below the first-quarter level and somewhat below the fourth-quarter level.

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

		Annual rates			Monthly rates		
	1996	1996		1997	1997		
		Q3	Q4	Q1	Feb	Mar	Apr
Real NIPA 1/							
Net exports of G&S	-113.6	-137.4	-98.4	-126.8	...	...	...
Nominal BOP							
Net exports of G&S	-114.3	-130.1	-104.8	-116.5	-9.9	-7.8	-8.4
Goods, net	-187.8	-210.0	-192.8	-199.1	-16.8	-14.9	-15.1
Services, net	73.5	79.9	88.0	82.7	6.9	7.1	6.8

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

Exports of goods and services expanded 9 percent (SAAR) in 1997-Q1, led by a sharp rise in exports of capital goods and automotive products to Canada (from strike-reduced levels in the fourth quarter). Exports rose further in April, with most of the increase in exports of machinery and aircraft.

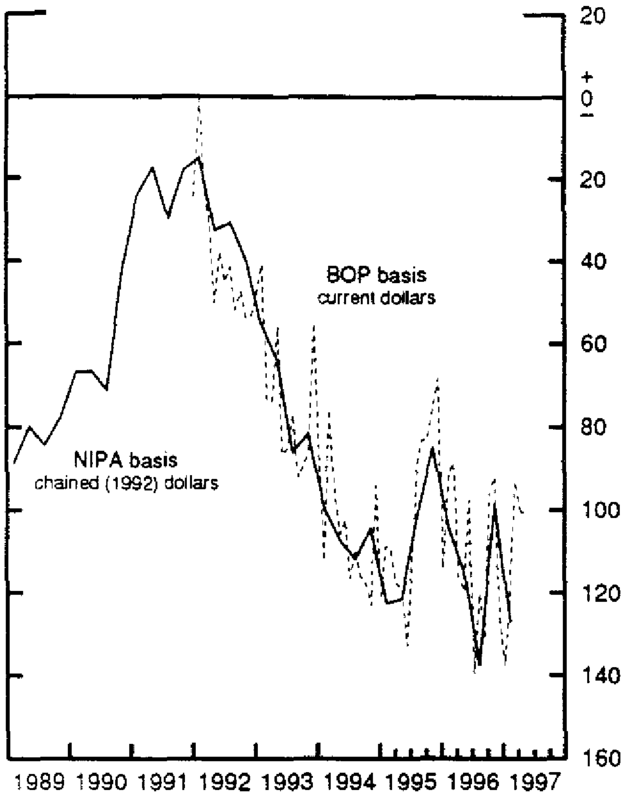
Imports of goods and services grew 14 percent (SAAR) in the first quarter. Almost half of the increase was in automotive imports (largely a rebound from strike-reduced levels in the fourth quarter). The remaining increase was spread though other major categories except oil, which declined in the first quarter from a significantly upward-revised fourth-quarter level. Imports in April also rose strongly; increases were recorded in most major trade categories (consumer goods, industrial supplies, capital goods, and services). As in the first quarter, the value of imported petroleum products declined.

U.S. International Trade in Goods and Services

(Seasonally adjusted annual rate)

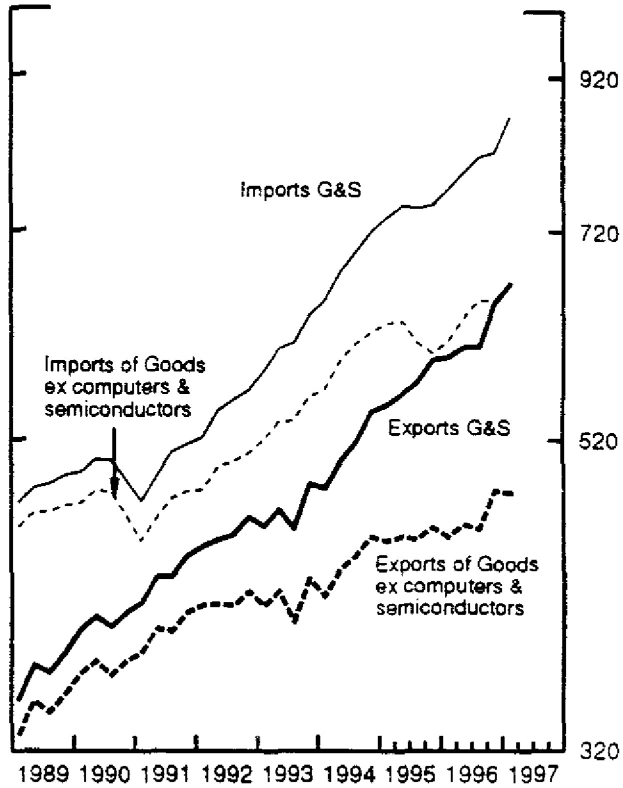
Net Exports

Billions of dollars, SAAR



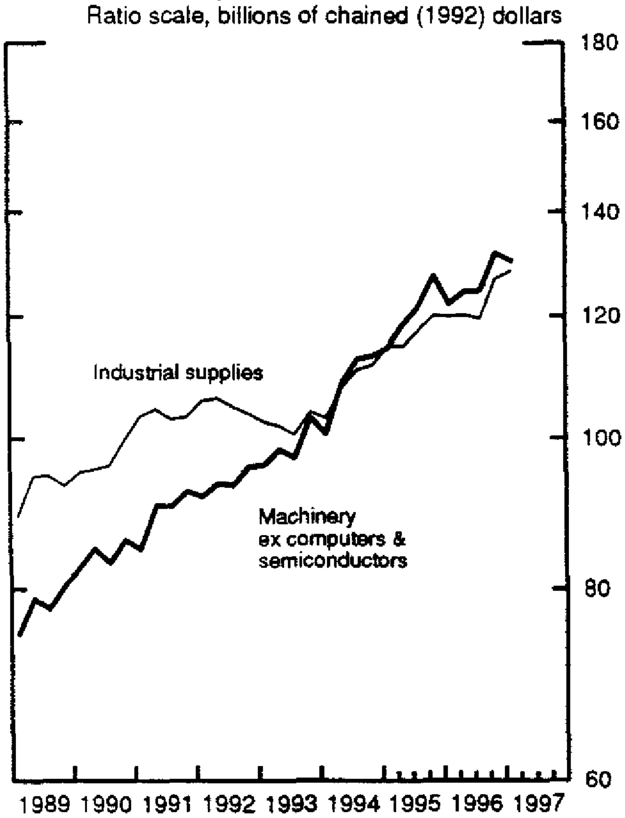
NIPA Exports and Imports

Ratio scale, billions of chained (1992) dollars



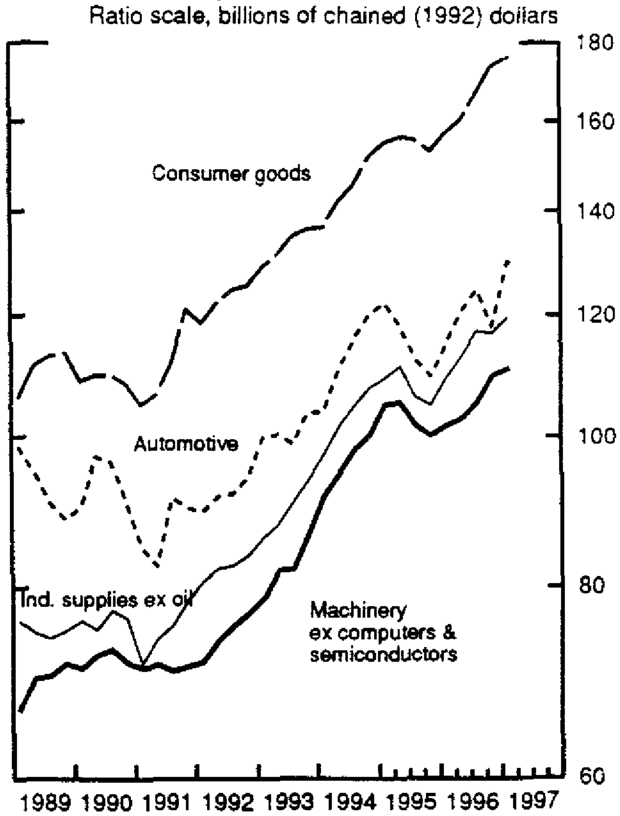
Selected NIPA Exports

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	1997	1997		1996	1997	1997	
	Q4	Q1	Mar	Apr	Q4	Q1	Mar	Apr
Exports of G&S	878.0	898.1	938.3	940.3	37.7	20.1	45.9	2.0
Goods exports	631.4	650.1	685.9	691.5	28.3	18.7	41.6	5.6
Agricultural	61.8	57.3	57.0	57.2	1.4	-4.5	-0.4	0.2
Gold	3.7	6.7	13.1	10.9	-1.5	3.0	8.6	-2.2
Other goods	565.9	586.1	615.8	623.4	28.4	20.2	33.4	7.6
Aircraft & pts	36.7	39.6	51.7	52.8	9.9	2.9	14.0	1.1
Computers	43.3	46.3	48.2	49.4	-0.2	3.0	2.3	1.2
Semiconductors	37.0	37.8	37.1	37.9	2.6	0.8	-0.5	0.7
Other cap gds	148.2	152.2	159.5	165.9	6.2	4.0	8.1	6.4
Automotive	67.0	70.9	74.7	74.2	0.8	3.9	3.9	-0.6
to Canada	35.1	38.7	40.0	38.5	-1.2	3.6	1.5	-1.6
to Mexico	9.7	10.4	11.2	11.6	1.8	0.7	0.3	0.5
to ROW	22.2	21.7	23.5	24.1	0.2	-0.4	2.0	0.5
Ind supplies	135.5	137.2	140.5	140.3	5.2	1.7	2.4	-0.2
Consumer goods	72.9	75.3	77.8	76.4	3.5	2.3	2.6	-1.3
All other	25.2	26.8	26.2	26.5	0.4	1.6	4.2	0.3
Services exports	246.6	248.0	252.5	248.8	9.3	1.3	4.3	-3.7
Imports of G&S	982.8	1014.5	1031.4	1040.6	12.4	31.7	20.3	9.2
Goods imports	824.1	849.3	864.4	872.8	11.1	25.1	19.0	8.4
Petroleum	82.2	76.7	73.2	69.7	6.0	-5.6	-3.9	-3.5
Gold	3.4	8.7	18.7	12.1	-2.7	5.2	14.0	-6.6
Other goods	738.5	763.9	772.5	791.0	7.8	25.4	8.8	18.5
Aircraft & pts	14.0	13.6	13.4	14.5	1.0	-0.3	-0.3	1.1
Computers	62.8	65.5	66.2	70.0	1.1	2.7	1.7	3.8
Semiconductors	33.6	34.7	36.7	35.2	-0.7	1.1	3.1	-1.6
Other cap gds	121.1	123.5	128.7	128.1	2.7	2.4	7.4	-0.6
Automotive	128.9	142.2	140.2	136.6	-4.7	13.3	-5.1	-3.6
from Canada	42.5	52.6	49.9	49.0	-6.4	10.2	-3.9	-0.9
from Mexico	23.3	24.2	24.9	25.5	0.0	1.0	0.2	0.6
from ROW	63.2	65.4	65.4	62.1	1.6	2.2	-1.4	-3.3
Ind supplies	132.9	134.3	137.8	139.6	1.8	1.4	5.6	1.8
Consumer goods	179.4	181.2	179.1	194.1	6.2	1.8	-3.9	14.9
Foods	36.7	38.0	39.9	40.0	0.9	1.3	2.7	0.0
All other	29.1	30.9	30.4	33.0	-0.3	1.7	-2.2	2.6
Services imports	158.7	165.3	167.0	167.8	1.3	6.6	1.3	0.8
Memo:								
Oil qty (mb/d)	10.14	9.85	10.19	10.52	-0.56	-0.29	0.35	0.33
Oil price ($/bbl)	22.22	21.35	19.66	18.14	2.74	-0.87	-1.78	-1.52

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

Oil Imports and Prices

The quantity of oil imported declined 2-1/2 percent in 1997-Q1 from substantially upward-revised 1996-Q4 rates, but rose sharply in April. April imports were driven by a higher-than-normal seasonal inventory buildup that offset the slight decline in oil consumption. Preliminary Department of Energy statistics indicate that oil imports remained strong in May due to a continuation of a strong build-up in oil inventories.

Deliveries of oil from Iraq and mild weather put downward pressure on prices during the first quarter; prices of imported oil declined substantially, partly reversing the very large increase recorded in the fourth quarter of 1996. In May, however, concerns about the renewal of the Iraq oil-for-food arrangement put a floor under those prices: Spot WTI rose $1.11 per barrel in May, averaging $20.83 per barrel. Spot prices have been trading near the $19 per barrel level since the U.N. announced the extension of Iraq's limited oil shipments.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports dropped slightly in May, continuing a downward trend that began in late 1995. The declines were in automotive products, computers, semiconductors, and other capital goods. Increases were recorded in other categories. For April-May combined, non-oil import prices declined at a moderate rate, about the same as in the first quarter, with decreases in all categories except foods.

Prices of exports decreased slightly in May following a slightly larger decline in April. The decline in May was attributable to lower prices for agricultural products, and, to a lesser degree, decreases in prices of computers, semiconductors, and automotive products. For April-May combined, export prices decreased moderately, whereas prices of agricultural products declined sharply. Prices of nonagricultural exports were little changed in April-May (as in the previous two quarters) with moderate increases spread among major trade categories with the exception of computers and semiconductors.

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

	Annual rates			Monthly rates		
	1996	1997		1997		
	Q4	Q1	Q2e/	Mar	Apr	May
	-----------BLS prices (1995=100)-----------					
Merchandise imports	5.3	-4.6	-9.1	-1.3	-1.2	0.0
Oil	64.3	-23.7	-46.7	-8.6	-7.0	1.2
Non-oil	-0.4	-2.3	-3.8	-0.4	-0.6	-0.1
Foods, feeds, bev.	1.8	4.9	6.6	2.9	-1.8	1.7
Ind supp ex oil	1.0	4.8	-6.9	-1.3	-0.9	0.1
Computers	-8.5	-14.2	-19.6	-1.5	-2.9	-2.1
Semiconductors	-15.0	-24.7	-2.9	2.5	-2.0	-0.5
Cap. goods ex comp & semi	0.1	-5.6	-4.0	-0.7	-0.2	-0.3
Automotive products	0.1	0.1	-0.9	0.1	-0.2	-0.2
Consumer goods	-0.5	-0.8	-0.9	-0.6	0.0	0.2
Merchandise exports	-4.2	0.5	-2.7	0.1	-0.7	-0.2
Agricultural	-31.9	2.4	-21.4	1.4	-6.9	-1.1
Nonagricultural	0.4	0.1	-0.1	-0.1	0.1	-0.1
Ind supp ex ag	0.8	0.6	0.7	0.0	0.1	0.0
Computers	-10.6	-9.5	-6.7	-0.7	-0.5	-0.9
Semiconductors	-3.6	-5.2	-0.9	-0.2	0.0	-0.1
Cap. goods ex comp & semi	1.2	2.1	0.4	0.0	0.1	0.0
Automotive products	1.3	1.3	1.5	0.2	0.3	-0.1
Consumer goods	0.9	1.1	0.5	-0.1	0.1	0.1
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	3.6	-4.2	n.a	...	...	...
Non-oil merchandise	-1.5	-2.7	n.a	...	...	...
Exports of gds & serv.	-2.2	-0.0	n.a	...	...	...
Nonag merchandise	-0.9	-1.0	n.a	...	...	...

e. Average of two months.

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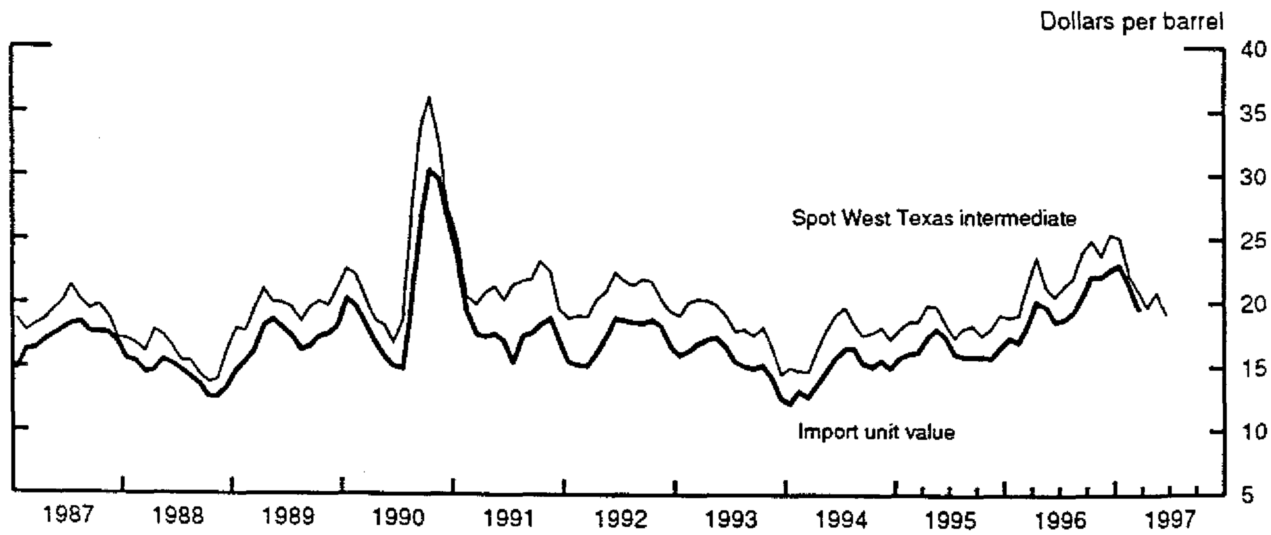
Oil Prices



U.S. Current Account

The U.S. current account deficit increased $16.4 billion (SAAR) in the first quarter of 1997. An increase in the deficit on trade in goods and services and a shift to a deficit in net investment income more than offset a decrease in unilateral transfers. The shift in net investment income was primarily due to larger payments on foreign assets in the United States, while income on U.S. assets abroad was virtually unchanged. The reduction in net unilateral transfers in the first quarter reflected lower U.S. government grant disbursements, which were boosted in the fourth quarter by the annual payment of grants to Israel.

As is customary each June, estimates of U.S. international transactions were revised to incorporate updated source data and improved methodologies. These revisions lowered the deficit $15 to $19 billion in 1994 through 1996 and had much smaller effects on the deficit in 1986 through 1993. For 1996, more than half of the $17 billion downward revision to the current account deficit was accounted for by substantial increases in net investment income, mostly owing to higher estimated U.S. holdings of foreign securities (discussed further in the next section) and, hence, larger receipts on those holdings. There were also significant increases in exports of services and decreases in unilateral transfers.

U.S. International Financial Transactions

Massive foreign private net purchases of U.S. securities continued in April. (See line 4 of the Summary of U.S. International Transactions table.) Demand for U.S. Treasury securities (line 4a) was strong, particularly from the Far East. Demand for U.S. government agency bonds also was strong in April; agency bonds accounted for more than half of private foreign net purchases of U.S. corporate and other bonds (line 4b). Private foreigners also continued to add to their holdings of U.S. corporate stocks in April (line 4c), with purchases in the first four months of 1997 exceeding the total for all of 1996.

In contrast, U.S. residents were net sellers of foreign securities (line 5) in April. Net purchases of foreign bonds (line 5a), which were modest in the first quarter of 1997, turned to substantial net sales in April, largely to the United Kingdom. U.S.

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

	1995	1996	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Mar	1997 Apr
Official capital								
1. **Change in foreign official reserve assets in U.S. (increase, +)**	110.0	121.7	13.4	23.2	33.0	28.3	8.9	-3.4
a. G-10 countries	33.1	35.5	3.5	1.4	2.2	7.9	1.8	1.1
b. OPEC countries	4.3	13.4	5.3	5.3	3.6	8.2	2.6	3.4
c. All other countries	72.6	72.8	4.5	16.5	27.3	12.2	4.5	-7.9
2. **Change in U.S. official reserve assets (decrease, +)**	-9.7	6.7	-.5	7.5	-.3	4.5	.2	-.1
Private capital								
Banks								
3. **Change in net foreign positions of banking offices in the U.S.**[1]	-30.9	-58.1	-12.6	-5.4	-14.1	-25.9	-11.1	12.3
Securities[2]								
4. **Foreign net purchases of U.S. securities (+)**	190.8	290.9	61.7	78.9	100.5	81.8	21.6	34.5
a. Treasury securities[3]	99.9	156.2	31.8	43.6	67.7	43.4	14.1	18.1
b. Corporate and other bonds[4]	82.6	120.9	23.6	33.4	31.1	27.8	5.3	10.5
c. Corporate stocks	8.2	13.8	6.3	2.0	1.7	10.7	2.3	6.0
5. **U.S. net purchases (-) of foreign securities**	-98.7	-107.4	-20.2	-22.4	-30.4	-17.1	-6.8	2.1
a. Bonds	-48.4	-48.8	-2.8	-14.2	-19.9	-5.3	-3.0	6.2
b. Stocks	-50.3	-58.6	-17.4	-8.2	-10.5	-11.8	-3.8	-4.1
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-86.7	-87.8	-23.6	-11.1	-30.9	-24.6	n.a	n.a
7. Foreign direct investment in U.S.	67.5	77.0	17.4	26.0	17.7	21.7	n.a	n.a
8. Foreign holdings of U.S. currency	12.3	17.3	4.5	7.4	7.8	3.5	n.a	n.a
9. Other (inflow, +)[5]	-10.6	-65.2	16.3	-23.0	-43.1	-13.1	n.a	n.a
U.S. current account balance (s.a.)	-129.1	-148.2	-35.6	-42.8	-36.9	-41.0	n.a	n.a
Statistical discrepancy (s.a.)	-14.9	-46.9	-20.8	-38.3	-3.3	-18.1	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.

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	9.7	-38.8	-133.5
1995	-101.9	6.8	-34.1	-129.1
1996	-111.0	2.8	-40.0	-148.2
Quarters				
1995-1	-113.2	8.2	-33.8	-138.8
2	-123.2	12.9	-32.5	-142.8
3	-95.5	-1.6	-35.4	-132.5
4	-75.5	8.3	-34.5	-102.2
1996-1	-98.2	8.2	-42.6	-131.5
2	-111.1	3.5	-34.8	-142.3
3	-130.2	-5.5	-35.8	-171.3
4	-104.8	5.0	-47.7	-147.5
1997-1	-116.5	-12.6	-34.8	-163.9
Memo:				
$ Change				
Q3-Q4	25.4	10.5	-11.9	23.8
Q4-Q1	-11.7	-17.6	12.9	-16.4

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

net purchases of foreign stocks (line 5b) continued at a substantial pace in April; Japan and the United Kingdom accounted for more than half the total.

Foreign official holdings in the United States (line 1) declined modestly in April, in contrast to generally large increases during the previous two years. The decline was more than accounted for by countries outside the G-10 or OPEC (line 1c), particularly Singapore and Argentina. Preliminary data from FRBNY suggest only modest changes in official holdings in May as well.

Banks in the United States reported net capital inflows in April (line 3) on a month-end basis. On a monthly-average basis, banks reported an increase in net liabilities to their own foreign offices and IBFs in May. (See line 1 of the International Banking Data table.) Both domestic and foreign-chartered banks shared in the May net inflows.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1994	1995	1996		1997			
	Dec.	Dec.	Sep.	Dec.	Feb.	Mar.	Apr.	May.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-247.4	-231.2	-230.3	-220.4	-210.5	-231.0
a. U.S.-chartered banks	-70.1	-86.1	-73.6	-66.4	-79.5	-72.5	-74.4	-84.3
b. Foreign-chartered banks	-153.9	-173.9	-173.8	-164.8	-150.8	-147.9	-136.1	-146.7
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	29.2	31.9	32.1	32.9	33.1	33.6
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	83.4	79.4	n.a.	82.7	n.a.	n.a
3. Eurodollar holdings of U.S. nonbank residents								
a. At all U.S.-chartered banks and foreign- chartered banks in Canada and the United Kingdom	85.6	91.2	101.4	113.0	121.2	120.0	118.8	125.3
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	109.4	122.2	n.a.	135.6	n.a.	n.a
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	178.2	212.9	244.1	239.1	n.a.	243.9	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	241.7	275.5	313.9	336.4	n.a.	345.0	n.a.	n.a.

1. Data on lines 1 through 3 are from Federal Reserve sources and sometimes differ in timing from the banking data incorporated in the U.S. international transactions accounts.

Lines 1a, 1b, and 2a are averages of daily data reported on the FR 2950 and FR2951.

Lines 2b and 3b are end-of-period data reported quarterly on the FFIEC 002s.

Line 3a is an average of daily data (FR 2050) supplemented by the FR 2502 and end-of-quarter data supplied by the Bank of Canada and the Bank of England. There is a break in the series in April 1994.

Lines 4 and 5 are end-of-period data estimated by BEA on the basis of data provided by the BIS, the Bank of England, and the FR 2502 and FFIEC 002s. They include some foreign-currency denominated deposits and loans. Source: SCB

Data recently released by BEA indicate that both foreign direct investment in the United States and U.S. direct investment abroad were very strong in the first quarter. (See lines 6 and 7 of the Summary of U.S. International Transactions table.) Mergers and acquisitions across international borders continue to contribute to the strength of these flows.

BEA revised up substantially its estimate of the increase in U.S. nonbanks' deposits at banks outside the United States in 1996. The outflow for 1996 now amounts to more than $60 billion. (See line 5 of the International Banking Data table.) Partial information suggests that outflows have continued in 1997. (See lines 3a and b for more up to date Federal Reserve data.)

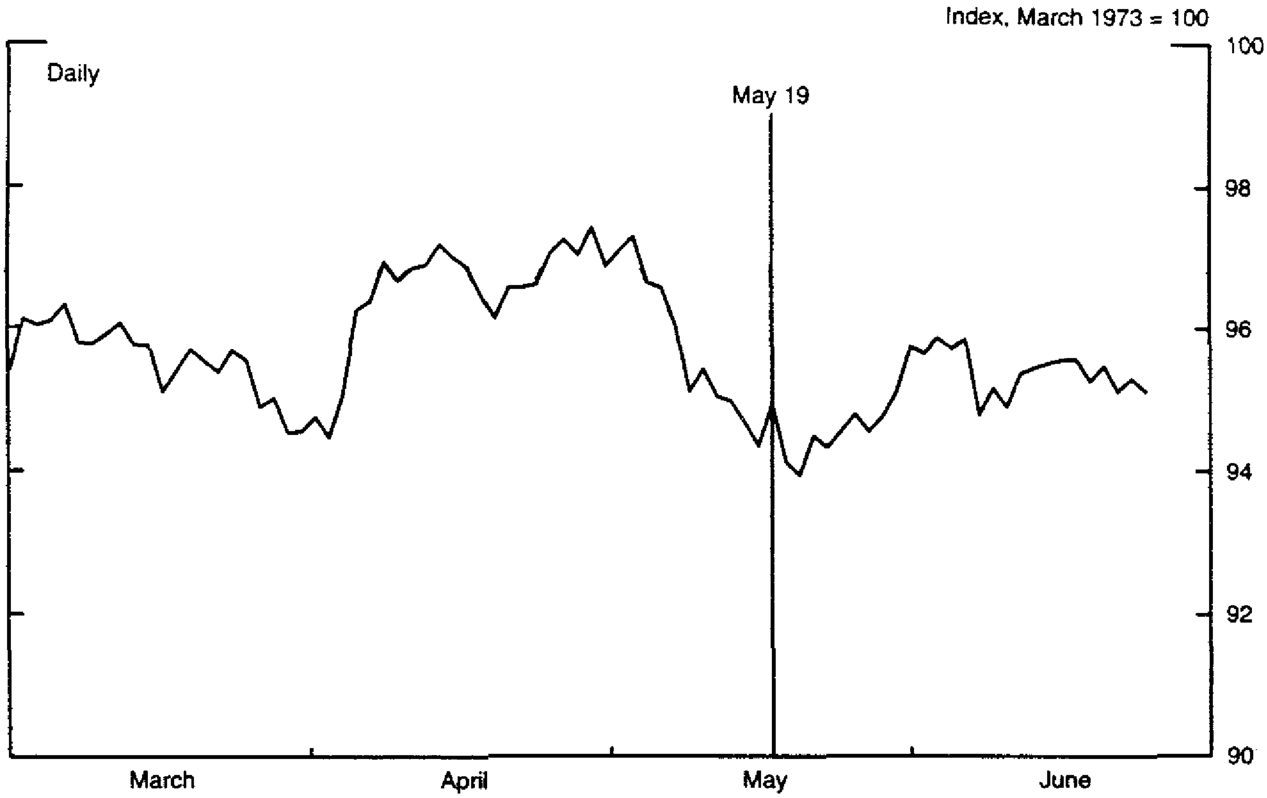
BEA also has introduced a number of improvements and revisions in the data on U.S. international transactions. They incorporated the results of the Treasury Department's Benchmark Survey of U.S. Ownership of Foreign Long-Term Securities as of March 31, 1994 in their estimates of the international investment position of the United States (scheduled to be released June 30) and, as discussed above, in their estimates of income on portfolio investments and the current account. However, they have not revised the historical data on U.S. net purchases of foreign securities because they have no firm basis to establish the extent to which their underestimates of U.S. holdings were the result of unreported capital outflows or underestimated capital gains.

BEA also has included an estimate of changes in foreign holdings of U.S. currency in the U.S. international accounts (line 8 of the Summary of U.S. International Transactions table). As a result of the recording of these previously unrecorded capital inflows, the statistical discrepancy in the accounts has been revised down substantially in recent years. It was negative $46.9 billion in 1996.

Foreign Exchange Markets

The weighted-average value of the dollar in terms of the other G-10 currencies has risen 1/4 percent since the day before the May 20 FOMC meeting. The dollar strengthened 3/4 percent against the mark and most other European currencies, and 1-1/2 percent against the Canadian dollar. However, the dollar depreciated 1-3/4 percent against sterling and 2 percent against the yen.

Weighted Average Exchange Value of the Dollar



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	May 19	June 25	Change	May 19	June 25	Change
Germany	3.09	3.05	-0.04	5.76	5.69	-0.07
Japan	0.57	0.63	0.06	2.52	2.54	0.02
United Kingdom	6.38	6.75	0.37	7.06	7.12	0.06
Canada	3.39	3.27	-0.12	6.52	6.13	-0.39
France	3.27	3.26	-0.01	5.63	5.60	-0.03
Italy	6.75	6.75	0.00	7.06	6.75	-0.31
Belgium	3.18	3.30	0.12	5.77	5.78	0.01
Netherlands	3.16	3.13	-0.03	5.60	5.58	-0.02
Switzerland	1.63	1.31	-0.32	3.35	3.22	-0.13
Sweden	4.17	4.09	-0.08	6.65	6.45	-0.20
Weighted-average foreign	3.51	3.53	0.02	5.54	5.49	-0.05
United States	5.73	5.66[p]	-0.07	6.71	6.43[p]	-0.28

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

The dollar was supported against the mark and other European currencies by growing perceptions that Italy, Spain, and Portugal will be included in the charter group of EMU members in 1999. These three countries are seen as having more tolerance for inflation than Germany, and thus their inclusion in monetary union raises market concerns that the euro initially will be a weak currency. Perceptions that EMU will be launched with a softer currency were reinforced by the confluence of the leftist victory in the French parliamentary elections and the aborted attempt by the German government to transfer the capital gains from revaluation of the Bundesbank's gold reserves this year. The platform of the French Socialist party called for the inclusion of Italy, Spain, and Portugal in first-round EMU membership. The ill-fated gold revaluation plan followed news of a shortfall in German tax revenues and was seen as signalling German willingness to employ fiscal gimmicks as a means of meeting the EMU convergence criteria, a development that would make it more difficult to deny others admission to EMU. Further German budget proposals are expected in July.

The dollar weakened against the yen as economic indicators in the United States generally suggested a slowdown in U.S. economic activity in the second quarter. The yen was supported on June 25 by the stronger-than-expected Tankan report. In addition, market concerns over prospects of a ballooning Japanese current account surplus reportedly contributed to the yen's stronger tone. Since the last FOMC meeting, the yen has appreciated 3 percent against the mark and 2-1/2 percent on a multilateral trade-weighted basis.

During the intermeeting period short-term interest rates were little changed in foreign G-10 countries except in the United Kingdom and Switzerland. The nearly 40 basis point rise in U.K. short-term rates reflects the 25 basis point increase in official rates by the Bank of England on June 6, and expectations of further near-term tightening by the Bank. Monetary authorities in Switzerland guided Swiss short-term rates about 30 basis points lower following the appreciation of the Swiss franc, brought on by EMU jitters, in late May.

Favorable inflation data in Italy and Spain, as well as the increased likelihood that those countries will be included in EMU in 1999, contributed to the 1/4 percentage point decline in Italian and Spanish long-term interest rates over the intermeeting period. Despite more favorable odds of broad-based EMU, long-term rates were little changed in Germany and other "core" European countries. Japanese long-term rates declined early in the period as softer-than-expected data on industrial production, machinery orders, and employment led market participants to conclude that the pace of Japanese economic activity in the second quarter slumped more than initially expected, albeit following stronger-than-expected growth in the first quarter. However, Japanese long-term rates backed up following the release of the stronger-than-expected Tankan report, and ended the period little changed on balance. Canadian long-term interest rates declined 1/2 percentage point due largely to the victory by the Liberal Party in the federal election on June 2 and the subsequent reappointment of Finance Minister Martin, which reinforced market perceptions that fiscal consolidation will continue in that country.

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

<u>Developments in Foreign Industrial Countries</u>

Indicators for the second quarter suggest that, on average, economic activity has continued at a healthy pace in the major foreign industrial countries. Expansions remain robust in the United Kingdom and Canada following strong first-quarter performances. Improving growth in Germany, France, and Italy appears to have offset a temporary slowing in Japan that was associated with the increase in the consumption tax in April.

Inflationary pressures generally remain subdued in the foreign industrial countries. CPI inflation is under 2 percent in Germany, France, Italy, and Canada. In Japan, the increase in the consumption tax was responsible for a rise in the twelve-month change in the CPI to about 1-1/2 percent. In the United Kingdom, CPI inflation has eased, largely reflecting a decline in food and energy prices and recent sterling appreciation.

On June 1, a coalition of Socialist, Communist, and other leftist-parties won control of the French National Assembly, ushering in a period of "cohabitation" with Conservative President

Chirac. The leftist-government remains committed to EMU, but with broad membership and a more flexible interpretation of the Maastricht criteria. In Canada's June 2 federal election, the Liberal-Party government was returned to power by a slim majority; the new government continues to emphasize fiscal deficit reduction.

Individual country notes. In **Japan**, GDP surged during the first quarter, led by strong consumption growth. The rise in consumption was the largest in over 30 years as households front-loaded expenditures in anticipation of the April 1 increase in the consumption tax from 3 percent to 5 percent. Aggregate investment, by contrast, fell sharply. Increased machinery and equipment investment was more than offset by the sharp decline in residential investment and a 40 percent drop in public investment. Net exports continued to make a positive contribution to GDP; the growth rates of imports and exports, however, were below those registered in the fourth quarter.

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

	1995	1996	1996			1997
			Q2	Q3	Q4	Q1
GDP	2.6	3.0	-1.1	1.3	3.8	6.6
Total Domestic Demand	4.0	2.9	-0.3	0.4	2.2	6.3
Consumption	3.0	2.0	-3.9	-0.7	4.8	19.6
Investment	5.6	5.8	9.9	1.4	-1.5	-14.4
Government Consumption	3.2	2.9	0.4	5.5	2.6	0.3
+Inventories (contribution)	0.2	-0.3	-0.9	-0.2	-0.4	0.1
Exports	3.8	6.1	0.5	6.5	21.5	2.8
Imports	17.3	5.5	7.6	-1.1	7.5	0.7
Net Exports (contribution)	-1.3	0.1	-0.8	0.9	1.6	0.3

1. Annual changes are Q4/Q4.

Economic activity during the second quarter has slowed as consumers have curbed expenditures following the first-quarter surge. In April, industrial production continued to decline, unemployment rose slightly, and new car registrations plummeted. The current account surplus increased to $8.1 billion, from $3.9 billion in March, and the trade surplus widened in April and May. Import volumes declined from year-earlier levels, reflecting sluggish domestic demand in the aftermath of the consumption tax increase, and export volumes rose sharply. As expected, however, indications suggest that the current weakness in economic activity is temporary. Private machinery orders, a key leading indicator, increased strongly in April, led by export orders. New car registrations in May regained about half of April's decline. The Bank of Japan's June survey (Tankan) showed an improving outlook for large manufacturing firms, with the diffusion index rising to 7. The diffusion indices for other classes of firms remained negative, but were generally stronger than anticipated in the previous survey. Underlying inflationary pressures appear to remain subdued, despite a jump in the price level after the consumption tax increase.

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

	1996	1997					
	Q4	Q1	Q2	Feb	Mar	Apr	May
Industrial Production	2.1	2.5	n.a.	-3.5	-0.3	-0.5	n.a.
Housing Starts	4.3	-11.5	n.a.	-3.2	-2.6	-0.3	n.a.
Machinery Orders	5.0	-3.1	n.a.	-5.0	-1.7	2.0	n.a.
New Car Registrations	10.6	2.3	n.a.	-1.6	-2.3	-28.7	14.7
Unemployment Rate (%)	3.3	3.3	n.a.	3.4	3.2	3.3	n.a.
Job Offers Ratio[1]	0.75	0.74	n.a.	0.73	0.73	0.71	n.a.
Business Sentiment[2]	-3	2	7	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	n.a.	0.0	0.0	1.2	1.4
Wholesale Prices[3]	0.6	1.4	n.a.	1.6	1.6	3.2	2.7

1. Level of indicator.
2. Percent of large manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook (Tankan survey).
3. Percent change from previous year.

In recent weeks, progress has been made in implementing Prime Minister Hashimoto's "Big Bang" financial reform program and related legal reforms. In mid-June, the Diet gave final approval to the Bank of Japan Reform Law enhancing the independence of the Central Bank and increasing the transparency of its policymaking process. Legislation transferring much of the Ministry of Finance's responsibility for supervising financial institutions to a new, independent regulatory authority was also approved in mid-June. Finally, on June 13, three government advisory panels proposed a timetable for further financial sector reforms, including liberalizing the activities of banks, brokerages and insurers by 2001, and lifting the prohibition on financial holding companies.

Economic activity in **Germany** expanded at an annual rate of 1.8 percent in the first quarter, a bounce-back from the tepid 0.3 percent growth registered in the fourth quarter of last year. The sources of growth in domestic demand were government spending, investment in machinery and equipment, and inventories (a pure residual in the German national accounts and highly subject to revision); strength in these components offset the significant decline in construction that resulted from the harsh winter weather. Although exports continued to rise at a healthy pace, the rise in imports was nearly as rapid, and the external sector contributed little on balance to growth.

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

	1995	1996	1996			1997
	Q4/Q4	Q4/Q4	Q2	Q3	Q4	Q1
GDP	0.8	2.2	6.1	3.0	0.3	1.8
Total Domestic Demand	0.7	1.3	4.6	-0.3	1.3	1.4
Consumption	1.5	0.9	2.2	0.5	-1.1	0.5
Investment	-2.0	2.8	30.0	3.6	0.7	-9.8
Government Consumption	2.6	1.5	3.2	3.2	-2.6	12.0
Inventories (contribution)	-0.5	0.6	-3.1	-2.0	2.3	1.1
Exports	5.4	9.4	1.4	13.3	21.1	9.3
Imports	4.9	5.7	-3.9	0.4	26.1	7.8
Net Exports (contribution)	0.1	1.0	1.5	3.3	-1.0	0.4

Economic indicators available for the second quarter suggest that the expansion is continuing at a healthy pace. Industrial production rose again in April and real manufacturing orders surged, boosted by orders from both domestic and foreign firms. The IFO business climate survey, an indicator of current and expected conditions in industry, continued to improve in April, with the index firmly in the positive range for the first time in two years. However, the labor market worsened again in May, as total unemployment edged above the 4.3 million (SA) level and the all-German unemployment rate rose to 11.4 percent. Consumer price inflation in Germany remains subdued, with inflation registering 1.6 percent over the year to May.

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

	1996		1997				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Industrial Production	1.2	-0.5	0.3	1.8	0.3	0.3	n.a.
Orders	0.6	0.1	1.1	0.2	0.9	3.7	n.a.
Unemployment Rate (%)	10.4	10.8	11.3	11.3	11.2	11.2	11.4
Western Germany	9.2	9.5	9.8	9.8	9.8	9.8	9.9
Eastern Germany	15.4	15.9	17.3	17.5	17.2	17.1	17.5
Capacity Utilization[1]	82.6	83.0	84.1	...	...	...	...
Business Climate[1,2]	-11.3	-3.3	1.3	3.0	2.0	5.0	n.a.
Consumer Prices[3]	1.4	1.4	1.7	1.7	1.5	1.4	1.6

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.

Recent fiscal developments suggest that the government must close a budgetary gap on the order of 1/4 to 1/2 percentage point of GDP in order to reduce the general government deficit to the Maastricht reference level of 3 percent of GDP this year. Now that the revaluation of the Bundesbank's gold and foreign exchange reserves has been ruled out as a possible means of reducing the deficit in 1997, it is not clear what initiatives will be pursued. The government continues to reiterate its commitment to satisfying strictly the Maastricht deficit criterion. The Finance Ministry could close a small budgetary gap with minor measures, such as a freeze on federal expenditures and the shifting of payments to the EU from the fourth quarter to the first quarter of next year. If the budgetary gap is on the high side, other more substantial measures will be more difficult to implement without causing a further rift in the government's ruling coalition.

In **France**, first-quarter real GDP increased 0.8 percent (SAAR) after having expanded at the same pace in the fourth quarter. Strength from net exports more than offset a decline in total domestic demand. Consumption retraced some of the fourth-quarter decline associated with the expiration of a government car-buying incentive program. Fixed investment by firms and households declined, and inventories contributed negatively.

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

	1995	1996	1996			1997
			Q2	Q3	Q4	Q1
GDP	0.3	2.1	-0.7	3.1	0.8	0.8
Total Domestic Demand	0.1	1.2	-0.9	2.5	0.1	-1.4
Consumption	0.9	1.7	-4.0	3.4	-1.9	1.4
Investment	0.0	-0.6	-5.6	6.5	0.2	-5.1
Government Consumption	0.1	1.3	0.9	1.2	1.3	0.8
Inventories (contribution)	-0.4	0.1	2.5	-1.1	1.0	-1.4
Exports	1.5	8.5	-2.6	13.4	6.1	4.7
Imports	0.9	5.6	-3.4	11.1	3.9	-2.3
Net Exports (contribution)	0.2	0.8	0.2	0.7	0.7	2.1

1. Annual changes are Q4/Q4.

Recent indicators point to a pick-up in economic activity this quarter, coupled with favorable calendar effects that are expected to boost measured second-quarter GDP growth. Business surveys suggest that manufacturing output strengthened further in April and May, mostly on robust foreign orders, and inventory levels have dipped below their long-run average. Industrial production increased sharply in April on continued strength in manufacturing output and a strong bounce in energy production, which had damped the overall index during the previous two months. Consumer spending in April also expanded at a robust pace. In recent months, the unemployment rate has held steady at a high level, and consumer-price inflation through May remained subdued.

In an apparent expression of discontent with fiscal austerity and high unemployment, the French electorate ousted the previous center-right majority in the National Assembly on June 1. Conservative President Chirac must now "cohabitate" with a leftist-coalition government. Socialist Prime Minister Jospin has formed a cabinet that includes ministers from the Socialist, Communist, and Green parties. In his first address to the National Assembly on

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

	1996		1997				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Consumption of Manufactured Products	2.7	-3.5	0.7	-1.2	0.2	1.5	n.a.
Industrial Production	1.0	-0.6	0.0	1.7	-0.6	3.0	n.a.
Capacity Utilization	82.3	81.4	81.1	...	...	...	...
Unemployment Rate (%)	12.5	12.7	12.8	12.8	12.8	12.8	n.a.
Business Confidence[1]	4.0	3.3	10.3	13.0	7.0	8.0	9.0
Consumer Prices[2]	1.8	1.7	1.5	1.6	1.1	0.9	0.9

1. Percent balance of manufacturing firms citing an improvement in the outlook versus those citing a worsening.
2. Percent change from previous year.

June 19, Jospin broadly outlined the new government's policy; the government will respect the Maastricht Treaty timetable, present a corrective mini-budget for 1997 this autumn, and organize a jobs conference among unions and employers to address labor market conditions. The mini-budget will be based on the findings of an audit of the public sector finances to be completed in July; this budget will likely overshoot the Maastricht 3-percent reference value.

Real GDP In the **United Kingdom** grew 3.8 percent (SAAR) in the first quarter. As was widely expected, the composition of expenditure confirmed that domestic demand expanded at a robust pace, while net exports subtracted from growth.

More recent indicators suggest that growth continues at a robust pace. Industrial production rebounded in April, with manufacturing output rising 0.6 percent, as strong domestic demand appeared to be offsetting sterling-related weakness in exports. However, business confidence has fallen in recent months, largely on expectations of weak export demand. Consumer demand remains strong. For April and May on average, retail sales were up 1.3 percent from their average level in the first quarter. Consumer confidence rose sharply in May and somewhat further in June. The unemployment rate in May fell to its lowest level since September 1990.

The twelve-month rate of increase in retail prices excluding mortgage interest payments remained 2.5 percent in May, meeting the

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

	1995	1996	1996			1997
			Q2	Q3	Q4	Q1
GDP	1.9	2.6	2.1	2.6	3.4	3.8
Total Domestic Demand	0.7	2.2	-0.9	2.4	3.6	5.1
Consumption	1.2	4.0	2.9	3.5	3.5	3.9
Investment	-1.9	2.3	0.6	-5.7	9.5	13.9
Government Consumption	1.4	1.7	1.5	1.5	4.5	-0.6
Inventories (contribution)	0.0	-0.9	-3.2	0.8	-1.1	0.5
Net Exports (contribution)	1.0	-0.2	2.3	-0.9	0.9	-0.9
Non-oil GDP	1.7	2.6	1.9	2.6	3.0	4.1

1. Annual changes are Q4/Q4.

government's inflation target for the second month in a row. Goods-price inflation remained more moderate than service-price inflation in part reflecting the strength of sterling. The underlying rate of increase in average earnings held steady at 4.5 percent in April. Nonetheless, the most recent rate is up from 3.75 percent a year ago, reflecting the tighter labor market.

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

	1996	1997					
	Q4	Q1	Q2	Mar	Apr	May	Jun
Industrial Production	0.6	-0.2	n.a.	-0.3	1.2	n.a.	n.a.
Retail Sales	1.1	1.1	n.a.	0.6	0.3	1.0	n.a.
Unemployment Rate (%)	6.9	6.3	n.a.	6.1	5.9	5.8	n.a.
Business Confidence[1]	18.0	18.3	17.7	25.0	23.0	17.0	13.0
Consumer Confidence[2]	-0.7	2.0	13.0	2.0	1.0	18.0	20.0
Consumer Prices[3]	3.2	2.9	n.a.	2.7	2.5	2.5	n.a.
Producer Input Prices[4]	-4.6	-7.1	n.a.	-8.0	-10.8	-9.1	n.a.
Average Earnings[4]	4.2	4.6	n.a.	4.5	4.5	n.a.	n.a.

1. Percent of firms expecting output to increase in the next four months minus those expecting output to decrease.
2. Balance of opinion on general economic situation over next 12 months.
3. Retail prices excluding mortgage interest payments. Percent change from previous year.
4. Percent change from previous year.

As part of the reform of the Bank of England, Chancellor of the Exchequer Gordon Brown appointed Professor Charles Goodhart, Dr. DeAnne Julius, Sir Alan Budd, and Professor Willem Buiter as the outside members of the Bank's new independent Monetary Policy Committee. At the first meeting of the new Committee on June 6, official interest rates were raised another 25 basis points. Chancellor Brown also announced that supervision of Britain's banking sector would be transferred from the Bank of England to a newly strengthened Securities and Investments Board, which will be chaired by current Bank Deputy Governor Howard Davies. On June 12, Brown announced that the government's inflation target would be 2-1/2 for underlying inflation, altering slightly the previous target of under 2-1/2 percent. However, if inflation diverges from the target by more than one percentage point in either direction, a public letter should be written by the Governor of the Bank of England explaining the reasons why inflation has deviated from the target, the policy actions being undertaken, and the period within which inflation is expected to return to the target.

In **Italy**, real GDP declined a provisional 1.2 percent (SAAR) in the first quarter. (Details will not be available until July 4 when ISTAT will release final data.) This was the second quarter in a row in which a decline was registered. Economic activity in the first quarter was more sluggish than monthly indicators had indicated. Industrial production and business sentiment rose during the quarter, and consumer confidence recovered somewhat in January-February. Given the pick-up in industrial production, consumer spending and the improvements in the trade surplus, it is likely that part of the first-quarter decline resulted from inventory decumulation. Unfavorable calendar effects also contributed.

In the second quarter, monthly indicators, which are scarce at this stage, point to a pick-up in activity. Industrial production rose in April to its highest level since 1995. Business sentiment, which had risen significantly in the first quarter, remained relatively high in April. Consumer confidence, after having improved significantly in the first quarter, remained little changed in the second quarter. Moreover, positive calendar effects in the second quarter will provide a modest impetus to measured GDP, which is not adjusted for this factor.

ITALIAN REAL GDP
(percent change from previous period, SAAR)

	1995	1996	1996			1997
	Q4/Q4	Q4/Q4	Q2	Q3	Q4	Q1
GDP	2.5	0.1	-1.5	2.2	-0.9	-1.2
Private Consumption	1.6	0.9	1.0	0.9	1.0	n.a.
Investment	8.4	-1.9	-1.0	-1.4	-1.2	n.a.
Government Consumption	-0.5	0.4	1.1	1.3	-1.1	n.a.
Exports	5.5	3.4	7.6	14.1	-4.0	n.a.
Imports	5.6	-1.4	-16.0	11.8	9.2	n.a.
Total Domestic Demand	2.4	-1.0	-6.9	1.2	2.1	n.a.
Net Exports (contribution)	0.1	1.1	5.3	1.0	-2.8	n.a.

Inflation continues to decline. In June, the twelve-month rise in consumer prices -- of 1.5 percent -- was the lowest since the late 1960s. Inflationary pressures are likely to remain subdued given continued moderation in producer prices, a sizeable output gap, and lagged effects of lira appreciation.

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

	1996	1997					
	Q4	Q1	Q2	Mar	Apr	May	June
Industrial Production	-1.0	1.4	n.a.	0.6	0.7	n.a.	n.a.
Cap. Utilization (%)	75.1	76.2	n.a.	...	...	...	...
Unemployment Rate (%)	12.0	12.2	n.a.	...	...	...	...
Consumer Confidence[1]	104.7	109.2	108.8	108.6	108.1	109.4	108.9
Bus. Sentiment[2] (%)	1.3	20.0	n.a.	17.0	16.0	n.a.	n.a.
Consumer Prices[3]	2.7	2.5	1.6	2.2	1.7	1.6	1.5
Wholesale Prices[3]	1.8	0.6	n.a.	0.3	-0.7	n.a.	n.a.

1. Level of index, NSA.
2. Percent of manufacturing firms having a favorable view of business conditions minus those with an unfavorable outlook.
3. Percent change from previous year.

On May 30, the Italian cabinet approved its three-year financial and economic planning document. If the stated objectives are realized, the budget deficit as a share of GDP will fall from 6.8 percent in 1996 to 2.8 percent in 1998 and to 1.8 percent in 2000. The document also contains details of deficit-cutting measures worth $15 billion equivalent (approximately 1-1/2 percent of GDP) that will be implemented next year in order to reach the 2.8 percent deficit/GDP target. Two-thirds of the $15 billion package will come from spending cuts, and the remaining one-third from revenue-raising measures.

Real GDP in **Canada** rose 3.4 percent (SAAR) in the first quarter, following growth of 2.9 percent in the fourth quarter of 1996. Final domestic demand rose 6.6 percent, driven by strong gains in business investment in machinery and equipment, consumption expenditures, and housing investment. A decline in the pace of inventory accumulation subtracted from growth, as did net exports. Exports, which dropped in the fourth quarter owing mainly to the GM strike, rebounded sharply as activity in the automobile industry returned to normal. However, imports also increased sharply, in part due to a sharp pick-up in imports of automobile parts, but also due to a surge in imports of computers and other machinery and equipment.

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

	1995	1996	1996			1997
			Q2	Q3	Q4	Q1
GDP	0.7	2.3	1.4	3.3	2.9	3.4
Total Domestic Demand	-0.1	4.5	-2.1	7.3	10.3	4.3
Consumption	0.9	3.3	0.6	2.0	5.6	5.2
Investment	-1.8	12.0	-0.8	19.4	20.8	15.7
Government Consumption	-1.4	-1.6	0.6	-3.9	-1.5	0.1
Inventories (contribution)	0.1	0.3	-2.5	2.8	2.6	-2.3
Exports	5.0	1.3	8.4	8.6	-10.1	23.2
Imports	4.0	6.6	-2.2	18.8	7.4	23.8
Net Exports (contribution)	0.4	-2.2	4.4	-3.8	-7.8	-0.6

1. Annual changes are Q4/Q4.

Preliminary indicators for the second quarter point to continued expansion. Retail sales in April advanced strongly. Employment edged up again in April and May, but the unemployment rate remained elevated owing to an increase in labor force participation. Housing starts, however, fell on average in April and May to a level about 4 percent below their first-quarter average. The rate of consumer price inflation continued to moderate in May.

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

	1996		1997				
	Q3	Q4	Q1	Feb	Mar	Apr	May
Industrial Production	2.0	0.5	0.6	0.1	-0.4	n.a.	n.a.
Manufacturing Survey:							
Shipments	3.2	-0.2	3.0	0.5	0.2	0.7	n.a.
New Orders	2.7	0.2	4.5	-2.2	-0.3	4.9	n.a.
Retail Sales	1.2	2.5	2.0	1.0	-0.8	1.1	n.a.
Housing Starts	3.9	0.4	19.9	11.0	-2.2	-7.8	4.6
Employment	0.1	0.4	0.3	-0.1	0.4	0.2	0.4
Unemployment Rate (%)	9.8	9.9	9.6	9.7	9.3	9.6	9.5
Consumer Prices[1]	1.4	2.0	2.1	2.2	2.0	1.7	1.5
Consumer Attitudes[2]	101.7	104.8	106.9	...	...	...	...
Business Confidence[3]	148.3	153.1	160.1	...	...	...	...

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

In the federal election on June 2, Liberal Prime Minister Jean Chrétien's government was re-elected with a slim majority. The Liberals won 155 of the 301 seats in Parliament, just four more seats than needed for a majority, and far short of the 177 seats won in the 1993 federal election. On June 11, Chrétien announced his new cabinet. Most notably, Paul Martin was reappointed as Finance Minister, indicating that fiscal policy would continue to focus on deficit reduction.

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

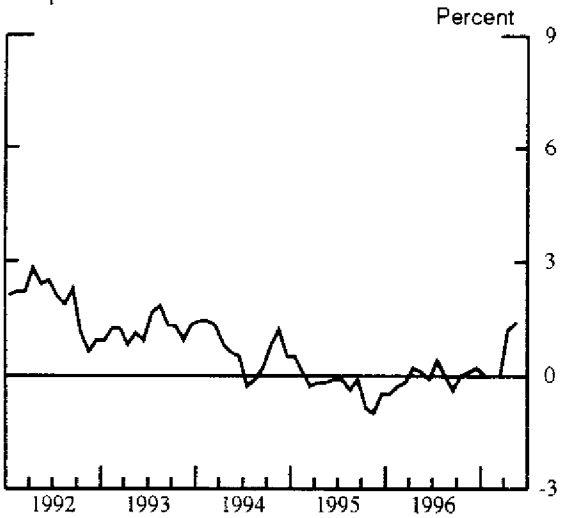
	1996	1996	1997					
		Q4	Q1	Jan	Feb	Mar	Apr	May
Japan: trade	61.4	16.5	12.9	5.5	3.8	3.6	6.1	9.3
current account	66.9	17.4	15.5	6.8	4.8	3.9	8.1	n.a.
Germany: trade[1]	65.4	19.0	14.5	3.4	5.5	5.8	n.a.	n.a.
current account[1]	-14.3	-1.6	-5.4	-6.1	-0.9	1.7	n.a.	n.a.
France: trade	18.0	5.1	5.9	2.2	2.0	1.7	n.a.	n.a.
current account	21.9	5.4	8.9	3.9	3.4	1.6	n.a.	n.a.
U.K.: trade	-19.4	-4.3	-3.2	-0.9	-1.3	-1.1	-1.6	n.a.
current account	-0.3	1.3	n.a.	...	...	...	...	...
Italy: trade	44.4	10.5	n.a.	3.2	3.1	n.a.	n.a.	n.a.
current account[1]	41.1	9.4	n.a.	3.2	2.3	n.a.	n.a.	n.a.
Canada: trade	30.0	5.9	6.1	2.2	2.0	1.9	1.2	n.a.
current account	2.8	-0.4	-0.9	...	...	...	...	...

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

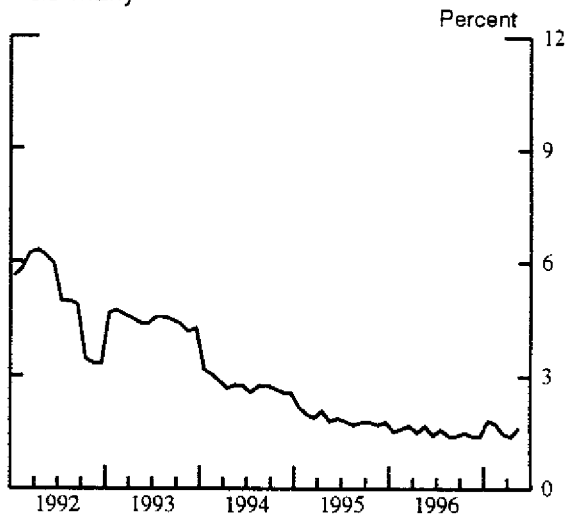
JUNE 25, 1997

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

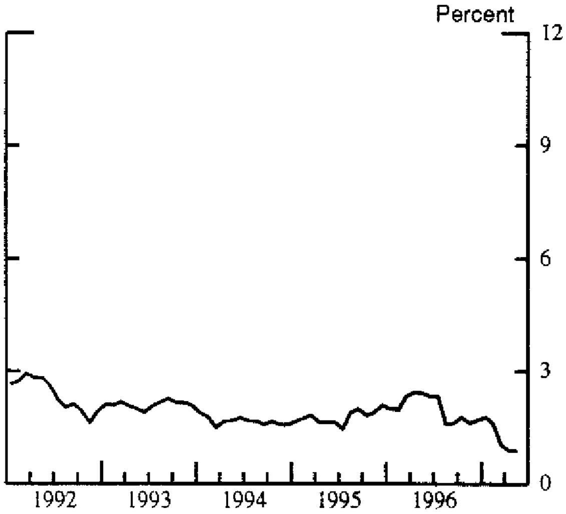
Japan



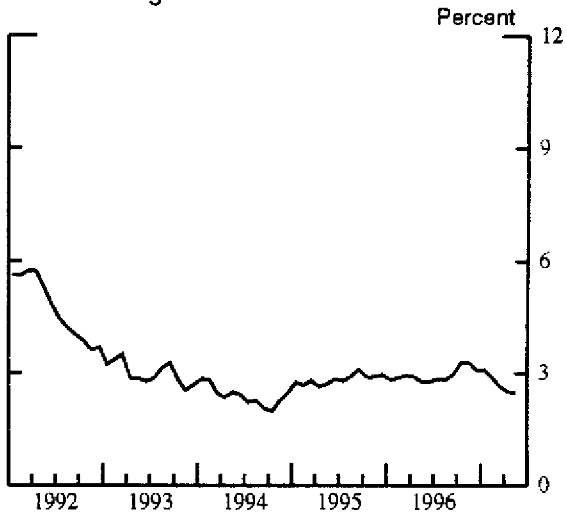
Germany



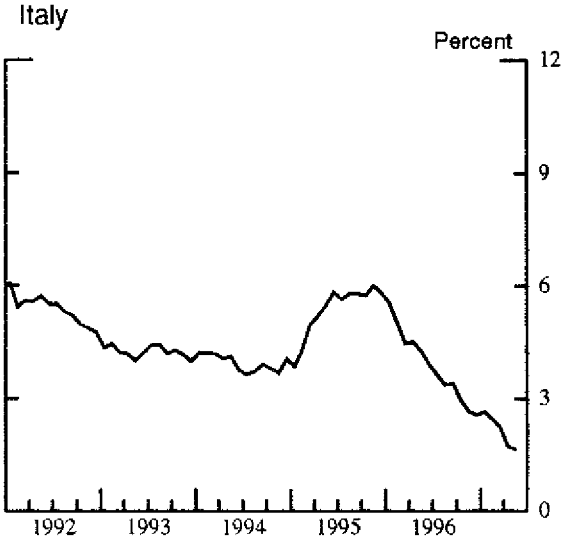
France



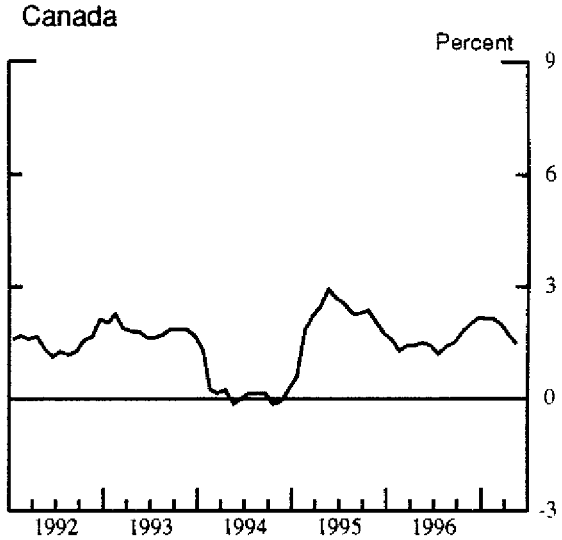
United Kingdom



Italy

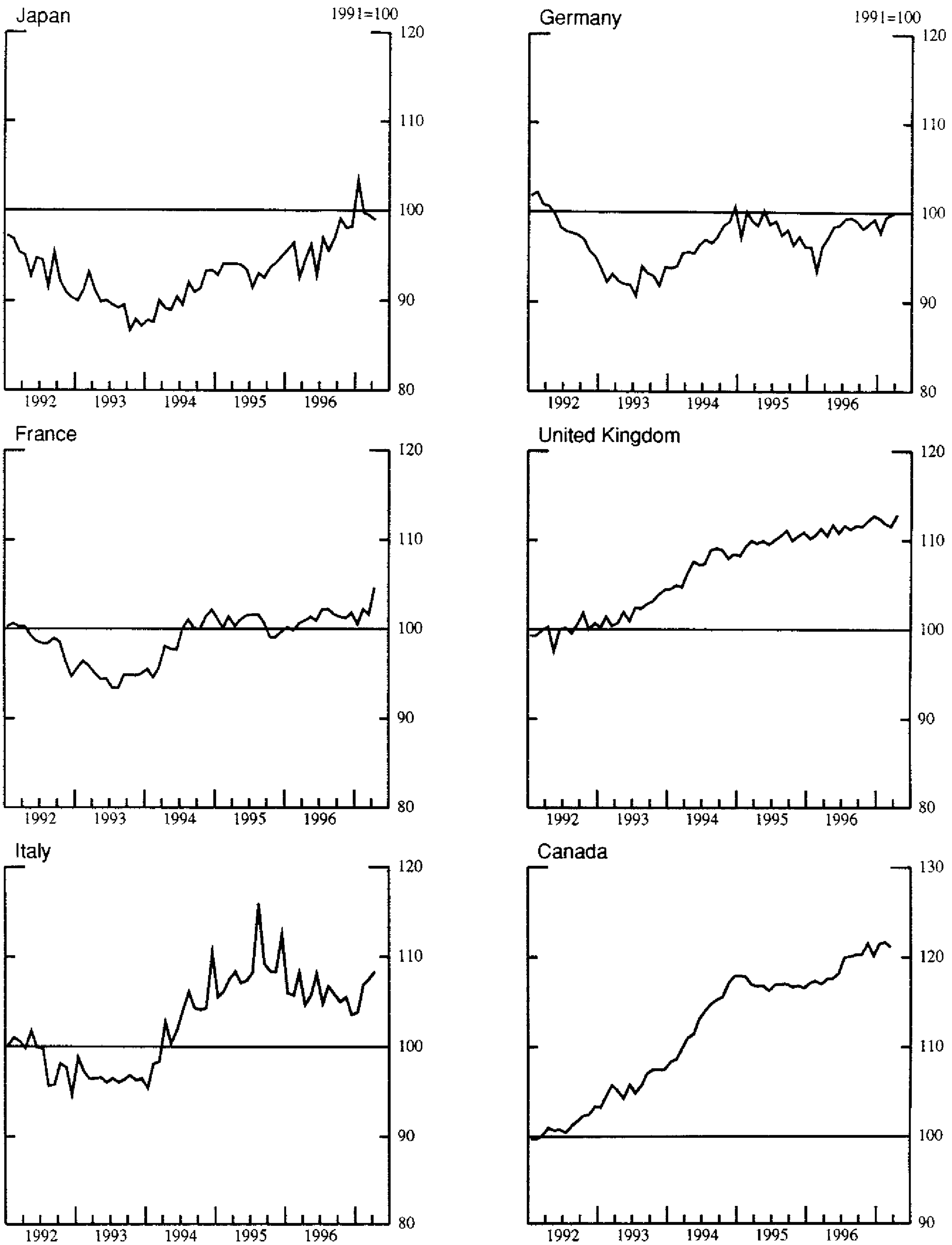


Canada



JUNE 25, 1997

Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Growth in recent months has been generally healthy in most major Latin American and Asian countries. In Argentina and Mexico, growth remains strong, though it has slowed somewhat in Mexico, and Venezuela shows signs of a recovery; growth has been uneven in Brazil. Industrial production has picked up recently in China, Taiwan, and Korea. In Russia, indications continue that the economy is on the verge of a turnaround, as GDP and industrial production appear to have leveled off in recent months. Inflation performance has been good in most cases other than in Venezuela and has been at historic lows in Brazil.

Strong growth in imports led to a decline in the trade balances of Mexico, Argentina, Brazil, Venezuela, and Taiwan. By contrast, strong exports led to an improvement in the trade balances of China and Korea. In Thailand, the government imposed capital controls to counter the downward pressure on the currency.

Individual country notes. In **Mexico**, we estimate that real GDP grew at a 6 percent annual rate in the first quarter on a seasonally adjusted basis (and adjusted for fewer working days due to Easter week falling in March), about half the torrid pace in the second half of last year but still a bit stronger than had been expected. The industrial sector continued to lead the recovery while the services sector lagged. Industrial production rose 9.7 percent in the March-April period from the same period a year earlier. That is slower than the 12.8 percent growth rate in the fourth quarter.

Further evidence for strength in domestic demand was provided by a recent pickup in imports and consequent narrowing of the trade surplus to $50 million in April and $88 million in May, compared with $565 million in March. Consumer price inflation moved below a 1 percent monthly rate in May for the first time since the December 1994 devaluation. The stability of the peso has contributed to the moderation in inflation, but also to the narrowing of the trade surplus and to tensions in Mexico over exchange rate policy.

On June 3, the Mexican government announced a medium-term program that outlined government objectives for key economic variables through the year 2000. The government's target for real GDP growth rises steadily from 4.5 percent in 1997 to 5.6 percent in

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr.	May
Real GDP	5.1	7.6	5.1	...	...	...
Industrial Production	10.4	12.8	6.2	4.2	15.0	n.a.
Unemployment Rate (%)	5.5	4.7	4.3	4.2	4.3	n.a.
Consumer Prices[1]	27.7	6.1	5.6	1.2	1.1	0.9
Trade Balance[2]	6.3	0.7	1.4	0.6	0.1	0.1
Imports[2]	89.6	25.5	23.5	8.2	9.1	8.7
Exports[2]	95.9	26.2	24.9	8.7	9.1	8.8
Current Account[2]	-1.8	-1.4	-0.4	...	...	...

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

2000. The GDP expansion is to be fueled primarily by investment and exports, with consumption recovering gradually. Investment as a percent of GDP is targeted to increase from 20.9 percent in 1996 to 25.4 percent in 2000. Part of that will be financed by domestic savings, which are targeted to grow from 20.4 percent of GDP in 1996 to 22.2 percent in 2000, while the current account deficit is expected to increase from 0.9 percent of GDP in 1996 to 3.2 percent in 2000. The government expects foreign direct investment to be sufficient to finance the current account deficit. Fiscal policy is to remain tight, with the overall government budget deficit below 1 percent of GDP through 2000, and monetary policy is to be consistent with a steady decline in the inflation rate target from 15 percent in 1997 to 7.5 percent in 2000. This medium-term plan is expected to be the basis for a new Extended Fund Facility agreement with the IMF.

The Mexican government announced on June 17 that it will prepay in August all $6 billion of the five-year floating rate notes that it issued in August 1996. Those notes, like the U.S. Treasury loans that they refinanced, are backed by the proceeds of Mexican oil exports. The funds for the prepayment will come from proceeds of previous bond sales, new debt sales, and a commercial bank loan. It is a significant indication of improved investor sentiment toward Mexico over the past year that it can replace collateralized debt with uncollateralized debt at lower cost and longer maturity.

In **Argentina**, economic activity continues to grow at a healthy pace. Real GDP grew 8.1 percent in the first quarter of 1997 from the same period a year ago, and has just now recovered to its level reached in late 1994, before the recession induced in part by the Mexican crisis. Industrial production in May was up 5.3 percent over a year earlier. The recent growth in activity was led by investment, which grew almost 30 percent in the first quarter over a year ago. Despite strong growth, inflation remains subdued. Consumer prices fell for the third consecutive month in May, bringing the twelve-month inflation rate down to 0.6 percent. Unemployment remains a problem, as evidenced by several recent protests in different parts of the country against poverty and joblessness, and it could hurt the government in the autumn congressional elections.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP	4.3	8.8	8.1	...	...	...
Industrial Production (SA)	3.4	11.7	8.0	4.1	8.1	5.3
Unemployment Rate (%)[2]	17.2	17.3	...	...	...	...
Consumer Prices[1]	0.2	0.2	0.2	-0.5	-0.3	-0.1
Trade Balance[3]	1.6	0.0	-0.2	-0.1	0.1	n.a.
Current Account[3]	-4.0	-1.7	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.

The pace of growth of exports has slowed somewhat but imports continue to expand at a rapid rate. As a result, the trade balance moved from near zero in the fourth quarter of 1996 to a deficit of $0.2 billion in the first quarter of 1997. In April, there was a surplus of $0.1 billion. International reserves also continue to recover and were about $18 billion (excluding gold) at the end of May, roughly 30 percent higher than a year ago.

In other developments, the process of foreign buy-outs continues in the banking industry, with two purchases of Argentine banks by Spanish financial institutions in May.

In **Brazil**, inflation has remained at an historical low and growth has been uneven, as declines in GDP and industrial production in the first quarter were followed by a surge in industrial production in April. Real GDP fell by 2.2 percent in the first quarter (s.a.a.r.), after three quarters of very strong growth. Strong growth in the service sector offset to some extent declines in output in other sectors. The seasonal adjustment for first-quarter growth may not have completely accounted for the smaller number of working days in March this year because of the Easter holiday period. This may explain in part the strong growth in industrial output in April, when production grew 3.5 percent (s.a. not at an annual rate). Strong growth in both sales and output in April were also boosted by purchases made in anticipation of new taxes on credit and imports, which the government imposed in late April and early May. The taxes were aimed at reducing the demand for autos and other durable goods, the two major sources of upward pressures on imports.

The taxes contributed to an improvement in the trade balance in May. However, the current account deficit for the year through May was nearly $13 billion, more than double the level reached over the same period in 1996. International reserves stood at $59.3 billion at the end of May, up by nearly $3 billion from April. Reserves were boosted by capital inflows, which prompted the central bank to purchase foreign exchange to mitigate upward pressures on the *real*.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP, s.a.a.r.[1]	2.9	5.9	-2.2	...	...	...
Industrial Production (SA)[2]	2.3	0.0	-1.5	-1.0	-3.5	n.a.
Open Unemployment Rate (%)	5.4	4.5	6.0	6.0	n.a.	n.a.
Consumer Prices[3]	9.4	1.0	2.0	0.7	0.6	0.1
Trade Balance[4]	-5.5	-3.9	-3.1	-1.0	-0.9	0.3
Current Account[4]	-24.3	-10.7	-6.9	-2.4	-3.9	-2.2

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

On June 4, Brazil issued about $2.8 billion (market value) of a 30-year dollar-denominated bond at 395 basis points over U.S. Treasury securities. The government sold about one-quarter of the bonds for cash, and the rest were swapped for three types of Brady bonds, with about $2.7 billion (face value) of Bradys consequently retired. These transactions were aimed at reducing Brazil's debt-servicing costs. Before this issue, the Brazilian government's longest uncollateralized bond outstanding had been a five-year bond.

In early June, Congress approved an amendment to the Constitution that allows an incumbent president to run for re-election, which paves the way for President Cardoso to run for a second term. Cardoso has been highly popular because of the fall in inflation under the anti-inflation plan, the Plano Real. Thus, the prospect that Cardoso will be reelected has boosted the perception that the economic reform process will continue in Brazil.

In **Venezuela**, one year after the announcement of an IMF-backed package of free-market oriented reforms, there are signs that economic activity is picking up. While there is a lack of timely data on output, indicators of aggregate demand point to a pickup: automobile sales and imports are rising at a rapid pace and bank lending grew by 9.7 percent in May over April. Inflation is rising, as expected, in the wake of recently authorized increases in public and private sector wages, including a 44 percent rise in the minimum wage. Consumer prices rose 3.1 percent in May and have risen by about 13 percent since the start of the year. Several increases in government-controlled prices are pending, which will put further pressure on inflation for the rest of the year.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP	-1.6	...	...	...	...	...
Unemployment Rate (NSA, %)	11.8	12.4	12.6	...	...	...
Consumer Prices[1]	103.3	10.6	6.6	1.6	2.4	3.1
Trade Balance[2]	-4.7	-1.2	-1.4	-0.5	-0.5	n.a.
Current Account[2]	n.a.	...	...	...	...	...

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

The government continues to follow a strong bolivar policy to try to curb inflation, despite its negative impact on non-oil exports. This factor, together with strong import growth of nearly 40 percent in the first quarter, led to a non-oil trade deficit of $1.4 billion in the first quarter of 1997, compared with a deficit of $0.8 billion in the same period last year. International reserves (excluding gold) at the end of May were $12.6 billion, compared with $6.4 billion a year previously.

In mid-June, the Venezuelan Congress gave its final approval to a Labor Law reform bill that will increase labor market flexibility in the long run, but increase government spending in the short run because of the cost of liquidating the old severance pay system. Also in June, Venezuela launched a $315 million 10-year Eurobond, which was priced at about 270 basis points over comparable U.S. Treasury securities. At about the same time, Standard and Poor's raised its rating of Venezuela's long-term foreign currency debt to B+ from B.

In **China**, inflation continued to moderate, and the trade surplus continued to grow. Twelve-month consumer price inflation of 2.8 percent in April was the lowest level since 1991. In the first five months of 1997, the trade surplus was $13.9 billion, compared with a deficit of $0.5 billion in the year-earlier period. The dollar value of exports rose 26 percent, while the value of imports fell by 1 percent. Chinese reports continue to stress the importance of base-year effects in explaining the export surge and import fall; the first half of 1996 had the reverse pattern of falling exports and surging imports, when China cut the VAT rebate rate on exports. International reserves were $117 billion in April, up $10 billion from the beginning of the year.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP[1]	9.7	9.7	9.4	...	...	...
Industrial Production	15.6	15.6	13.0	16.1	14.2	n.a.
Consumer Prices	7.0	7.0	4.0	4.0	3.2	2.8
Trade Balance[2]	12.2	4.0	6.8	3.0	3.5	3.6

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

In May and June, in response to rapid equity price increases in 1996 and early 1997, China put in place various policies to try to restrain the stock market. First, it announced an increase in the quota of new share issues for 1997. Second, it banned state enterprises and listed firms from short-term "speculative" stock trading. Third, it began to tighten restrictions on bank involvement in stock trading. In the second half of May, all of the share indices fell more than 10 percent from their mid-May peak before leveling off. As of June 24, however, domestic shares were still up by 40 percent from the beginning of the year.

In **Taiwan**, strong growth continued in the first five months of 1997, while prices remained flat. In the first quarter, real GDP rose 6.8 percent from the year-earlier period, continuing the economic recovery that was evident in the second half of 1996. Industrial production growth continued robustly in April and May. Consumer prices in April and May were less than 1 percent higher than their year-earlier level. Strong import growth contributed to a narrowing of Taiwan's trade surplus to $3.2 billion in the first five months of 1997, compared with a surplus of $5.3 billion in the year-earlier period. Exports rose 4 percent, while imports rose 10 percent. Foreign-exchange reserves stood at $89 billion in April, up less than $1 billion from the beginning of 1997.

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

	1996	1996	1997	1996		
		Q4	Q1	Mar	Apr	May
Real GDP	5.7	6.6	6.8	...	...	...
Industrial Production	1.6	4.8	5.4	10.0	7.3	7.3
Consumer Prices	2.5	2.5	1.1	1.1	0.5	0.8
Trade Balance[1]	14.3	4.0	1.8	0.6	-0.2	1.6
Current Account[1]	10.5	2.8	1.9	...	...	...

1. Billions of U.S. dollars, NSA

On June 16, **Korea's** Finance Minister released the final draft of the government's proposals for financial sector reforms. Under the proposals, three existing supervisory agencies for the banking, securities, and insurance sectors will be integrated into a unified agency under the Prime Minister. Other proposals increase the central bank's independence by stipulating that the Bank of Korea's governor replace the finance minister as head of the Monetary Board, the top monetary policymaking body, and by banning government officials from sitting on the Board. The central bank governor would be asked to set annual targets for inflation and would be held responsible for meeting those targets. The proposals have to be approved by Parliament, and their prospects remain uncertain.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP	6.8	6.6	5.3	n.a.	n.a.	n.a.
Industrial Production	8.4	9.8	7.0	9.1	10.7	n.a.
Consumer Prices	5.0	4.8	4.7	4.5	4.3	3.8
Trade Balance[1]	-15.3	-3.9	-5.4	-1.4	-0.8	n.a.
Current Account[1]	-23.7	-6.2	-7.9	-2.3	-1.7	n.a.

1. Billions of U.S. dollars, NSA

The current account deficit on a non-seasonally adjusted basis has been on a downward trend since the beginning of the year ($1.7 billion in April versus $3.1 billion in January); customs-cleared trade numbers for May indicate a continuation of the trend. Industrial production in April grew at a robust rate of nearly 11 percent (year-over-year), with strong growth registered in key industries such as computer chips and automobiles. Inflation remained moderate at about 4 percent (year-over-year) in May.

Thailand's deputy prime minister and finance minister, Mr. Amnuay Viravan, resigned on June 19 after the cabinet reversed his decision to raise excise taxes to reduce the country's budget deficit. Following news of the resignation, the stock market declined by about 4 percent, and the baht depreciated by about 10 percent. The minister was part of a five-member "dream team" of skilled technocrats appointed after the elections last November to remedy Thailand's economic problems. The economy has been in disarray since mid-1996, with exports showing no growth, finance companies and banks in trouble over imprudent lending to the property sector, and the baht under attack. The new Finance minister, Thanong Bidaya, has pledged to pursue the fiscal and monetary policies of his predecessor, saying they were mostly on the right track in tackling Thai economic problems. Bidaya is Thailand's sixth finance minister since 1995.

In mid-May, the government resorted to capital controls to counter an attack on the baht. By forcing Thai banks to stop lending baht to foreigners without "genuine underlying business," the Bank of Thailand segmented the onshore and offshore markets for the baht. However, these steps have undermined the government's plan to lower interest rates; overnight interest rates have remained in the range of 13 to 14 percent, compared with an average of about 8 percent in the month preceding the recent crisis. Spillover effects of the baht crisis on other countries appear to be receding. In Malaysia and the Philippines, overnight interest rates had shot up to about 20 percent around the time of the crisis, but they have since started to fall. In Malaysia, overnight interest rates are back to their pre-crisis levels, but are substantially above pre-crisis levels in the Philippines.

In **Russia**, recent data present a relatively favorable picture of the economy. After years of declines, output and industrial production have been flat this year, while inflation has fallen steadily and the ruble has remained stable. During the first five months of this year, year-on-year GDP growth rates hovered around zero, while industrial production growth was positive, though less than 1 percent. Consumer prices rose only 0.9 percent in May from April, and were 15 percent higher than a year earlier. Also, the ruble-dollar exchange rate continues to remain well within the corridor set by the Central Bank.

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

	1996	1996	1997	1997		
		Q4	Q1	Mar	Apr	May
Real GDP	-6	-6	0.2	-0.3	-1.0	-0.4
Industrial Production	-5	-5	0.9	0.4	0.5	0.2
Consumer Prices[1]	1.7	2	2	1.4	1.0	0.9
Ruble Depreciation[1]	1.5	1	1	0.9	0.3	0.4
Trade Balance[2]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Current Account[2]	7	n.a.	n.a.	n.a.	n.a.	n.a.

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

Russia continues to have fiscal problems, especially on the revenue side. Tax revenues are significantly below target (less than 70 percent of the target for the first quarter) and arrears continue to accumulate. There has been some progress in recent weeks, however, as a result of increased government pressure on enterprises. Gazprom, one of Russia's biggest debtors, reportedly paid off all of its federal tax arrears, some $2.6 billion, in mid-June (they still owe money to other federal bodies such as the pension fund) and arrangements are being negotiated with other firms. Two measures aimed at restoring fiscal balance are now under consideration by the Communist-dominated Duma. The first is a plan to cut one-fifth (equivalent to $18.8 billion) of budgeted expenditures, and the second is a new tax code that already forms the basis for the government's 1998 budget.

The IMF resumed lending to Russia in mid-May with the disbursement of almost $700 million equivalent. In early June, the World Bank approved nearly $820 million in loans for Russia, the largest of which is a $600 million Structural Adjustment Loan that will support wide-ranging reforms.