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Confidential (FR) Class III FOMC

Part 2

September 24, 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

September 24, 1997

RECENT DEVELOPMENTS

Prepared for the Federal Open Market Committee
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DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity appears to have risen substantially further this quarter, paced by brisk growth in consumer spending and a large gain in business fixed investment. Overall manufacturing output accelerated over the July-August period, lifting capacity utilization, and brisk hiring has maintained a taut labor market. Nonetheless, inflation has remained subdued.

Labor Market Developments

Labor demand continued to grow strongly this summer. Net of the direct effects of the UPS strike estimated by the BLS, private nonfarm payrolls expanded slightly more than 200,000 per month on average during July and August, in line with the pace over the first half of the year. Aggregate weekly hours of production or nonsupervisory workers for the first two months of the third quarter averaged nearly 2 percent above their second-quarter level at an annual rate.[1]

Among the major sectors, factory payrolls rose considerably last month, 47,000, of which 10,000 reflected the return of striking workers in the auto and steel industries. After adjustment for the UPS strike, employment in the private service-producing sector grew 80,000 in August, after a surge of 295,000 in July. Payroll growth during August in the services industries and retail trade--the two main engines of job growth during the current expansion--was modest. However, the slowing followed sharp rises in July, and smoothing through the two months gives a picture of robust job growth so far in the third quarter.

The household survey continues to point to tight labor markets. Although the unemployment rate edged up 0.1 percentage point in August, to 4.9 percent, it was still very low by the standards of the recent decades. The labor force participation rate held steady for the fourth straight month at 67.1 percent, slightly below its historical high of 67.3 percent reached in March.

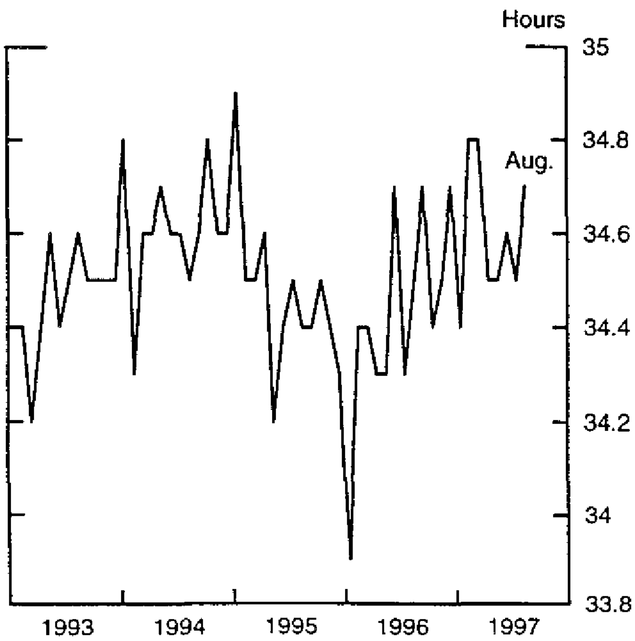
1. The BLS estimates that the net decline in private employment due to the UPS strike was 158,000. This includes the direct effect of 185,000 striking workers, less a 27,000 offset in the air transport and trucking industries. In addition, the U.S. Postal Service temporarily hired 5,000 workers who were not counted in private employment. We estimate that the strike had a negligible effect on the average workweek. All told, the strike probably held down measured aggregate hours in August approximately 0.2 percent.

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

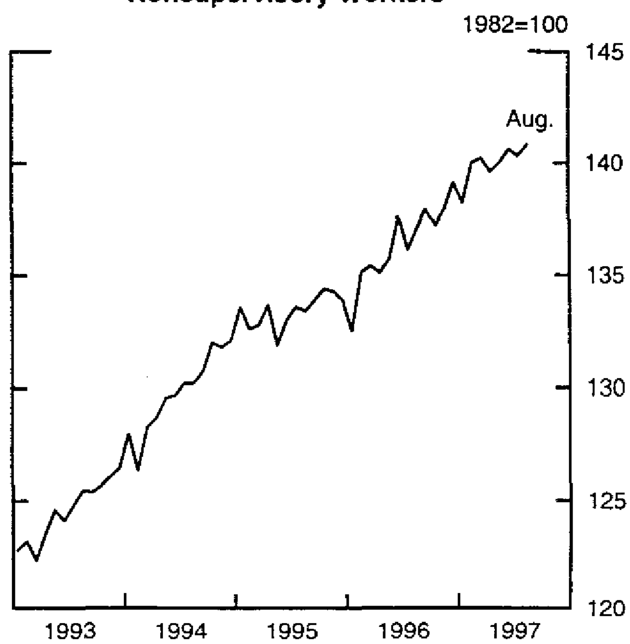
	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 June	1997 July	1997 Aug.
	---Average monthly changes---							
Nonfarm payroll employment[1]	185	212	213	228	237	222	365	49
Private	176	198	213	218	206	148	277	-23
Goods Producing	8	19	34	43	15	12	-18	55
Manufacturing	-1	-5	7	14	10	20	-17	47
Durable	11	5	11	15	14	27	10	50
Nondurable	-12	-10	-4	-1	-5	-7	-27	-3
Construction	10	24	27	29	4	-6	0	10
Service Producing	168	178	179	175	191	136	295	-78
Transportation and utilities	8	9	-1	39	10	3	19	-160
Trade	48	60	80	28	52	57	101	39
Finance, insurance, real estate	-1	11	12	10	14	5	20	11
Services	113	98	88	97	115	71	155	32
Help supply services	10	13	3	17	-17	-2	13	-16
Total government	9	14	0	10	31	74	88	72
Private nonfarm production workers[1]	151	168	180	195	163	100	249	-130
Manufacturing production workers	-2	-5	7	9	7	1	-10	30
Total employment[2]	32	232	202	440	63	-275	344	96
Nonagricultural	51	225	220	453	61	-236	253	195
Memo:								
Aggregate hours of private production workers (percent change)[1]	.1	.3	.3	.3	.1	.4	-.2	.4
Average workweek (hours)[1]	34.5	34.4	34.5	34.7	34.5	34.6	34.5	34.7
Manufacturing (hours)	41.6	41.5	41.8	41.9	42.0	41.8	41.8	41.9

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

Average Weekly Hours



Aggregate Hours of Production or Nonsupervisory Workers



Solid labor demand and tight labor supply are also evident in other indicators of labor market activity. Initial claims for unemployment insurance remain near their lowest level of the current expansion. The Conference Board's Index of Help Wanted Advertising held steady in July at just a shade below the historical high reached in February. Similarly, the Manpower, Inc., Survey of Net Hiring Strength for the fourth quarter points to strong labor demand. This index is better as an indicator of employment growth in the quarter in which the survey was taken (in this case, the third quarter) than as a leading indicator. The surveys of individuals also suggest a tight labor market; indeed, in the Conference Board's Survey of Consumer Confidence, a record number of respondents reported that jobs are plentiful.

Despite the consistent picture of apparent pressures in the job market, recent data on average hourly earnings have revealed no further wage acceleration. After having risen only 0.1 percent in July, average hourly earnings increased 0.4 percent in August.[2] On a twelve-month basis, average hourly earnings were up 3.7 percent--within the range prevailing for some months now.

The recent UPS settlement provides for wage gains that average 3 percent per year over the life of the contract for full-time workers, who make up about 40 percent of UPS's union employees. Wage gains for part-time workers will depend on tenure. Part-time workers with at least five years of tenure will receive wage gains averaging nearly 8 percent per year. Those with less tenure will receive smaller increases. Given the high turnover of UPS's part-time workforce, we expect that, on average, the wage increases for UPS's part-time workforce will be in the area of 2 to 3 percent. Unrelated to wages, the Teamsters won concessions on two of the key issues in the strike: the creation of 10,000 full-time jobs by combining part-time positions and the continuation of the system of Teamster-run pension plans. However, the company prevailed in its demand for a five-year contract. All told, on this analysis, the settlement does not appear to signal an important departure from prevailing labor cost trends.

2. The rate of rise in August was held down about 0.1 percentage point by a shift in the composition of hours worked towards lower paid industries. Most of the compositional shift is likely explained by the UPS strike, which held down total hours in the relatively highly paid transportation and public utilities industries, and an increase in hours due to a spurt in the workweek in the retail trade industry.

SELECTED UNEMPLOYMENT RATES
(Percent; based on seasonally adjusted data)

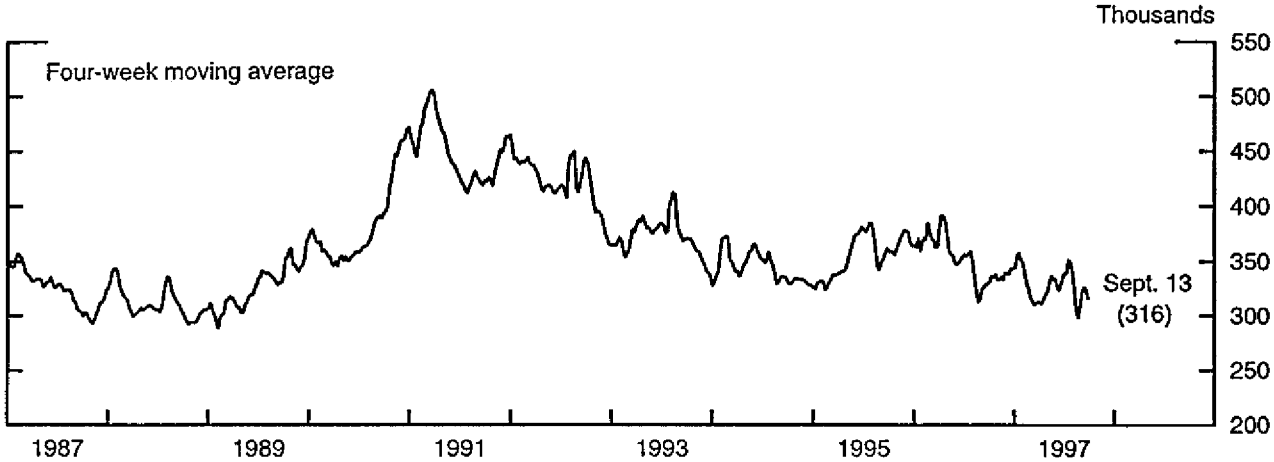
			1996	1997		1997		
	1995	1996	Q4	Q1	Q2	June	July	Aug.
Civilian unemployment rate (16 years and older)	5.6	5.4	5.3	5.3	4.9	5.0	4.8	4.9
Teenagers	17.3	16.7	16.6	17.0	15.9	16.8	16.4	16.4
Men: 20 years and older	4.8	4.6	4.4	4.5	4.1	4.2	4.0	4.1
20-24 years	9.2	9.5	9.1	9.1	8.1	8.2	8.1	8.7
25-54 years	4.4	4.2	4.0	4.0	3.7	3.8	3.6	3.6
55 years and older	3.7	3.3	3.2	3.3	3.0	3.1	2.9	3.0
Women: 20 years and older	4.9	4.8	4.8	4.7	4.4	4.4	4.2	4.4
20-24 years	9.0	9.0	8.9	8.9	8.9	8.6	7.2	7.8
25-54 years	4.5	4.4	4.5	4.4	4.0	4.0	4.1	4.1
55 years and older	3.6	3.5	3.2	2.9	3.0	3.2	3.0	3.0

Labor Force Participation

Note. Labor force participation rate adjusted for the redesign of the CPS in 1994 and the introduction of updated population controls in 1990.

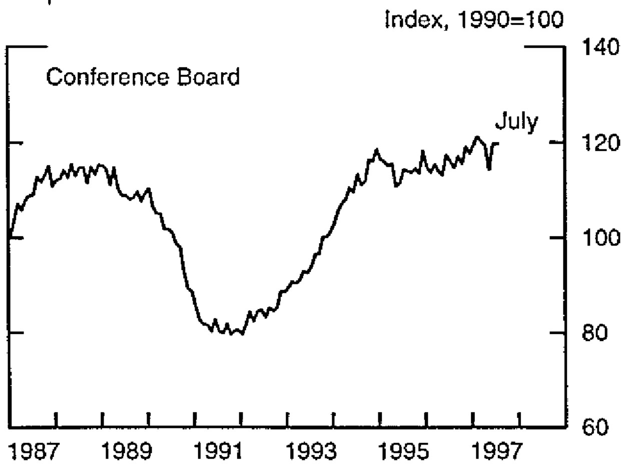
Labor Market Indicators

Initial Claims for Unemployment Insurance



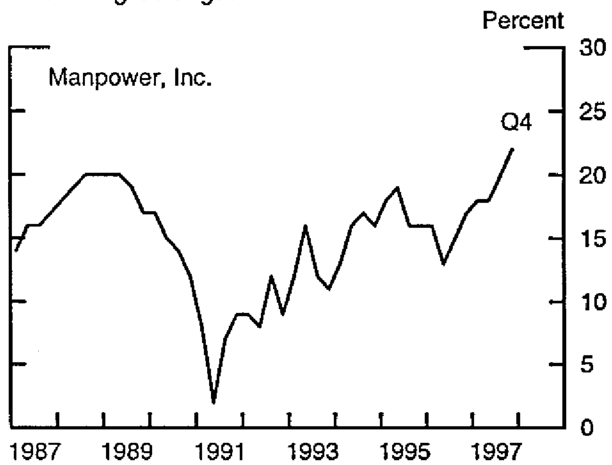
Note. State programs, includes EUC adjustment.

Help Wanted Index



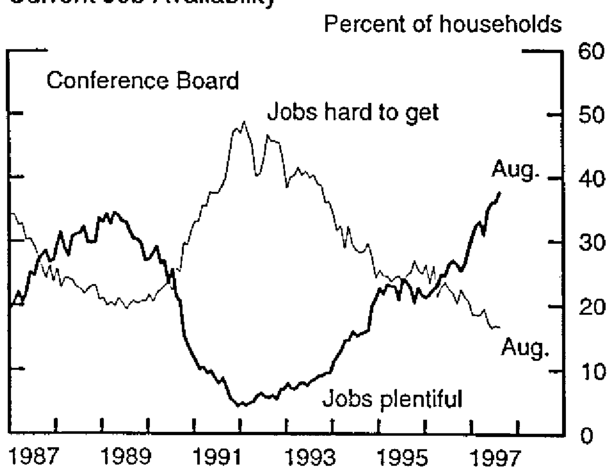
Note. Series has been adjusted to take account of structural and institutional changes, including consolidation of newspaper industry and tendency to increase hiring through personnel supply agencies.

Net Hiring Strength

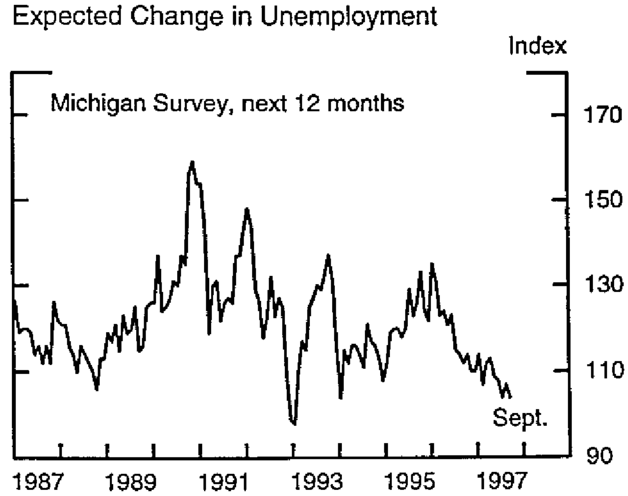


Note. Percent planning an increase in employment minus percent planning a reduction.

Current Job Availability



Expected Change in Unemployment



Note. Percentage expecting "more" minus percentage expecting "less" plus 100.

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

	Twelve-month percent change[1]			Percent change to Aug. 1997		1997	
	Aug. 1995	Aug. 1996	Aug. 1997	Feb. 1997	May 1997	July	Aug.
	-Annual rate-					-Monthly rate-	
Total private nonfarm	2.9	3.5	3.7	3.2	3.3	.1	.4
Manufacturing	2.8	3.6	3.0	2.9	3.4	.0	.8
Construction	2.6	2.4	3.3	3.1	3.1	.0	.5
Transportation and public utilities	2.7	2.4	3.2	4.3	4.1	.7	.0
Finance, insurance, and real estate	4.6	3.6	4.2	4.6	6.2	-.2	.9
Total trade	3.1	3.7	4.3	3.6	3.8	.0	.5
Services	3.0	3.7	4.1	3.3	4.0	.0	.5

1. Uses not seasonally adjusted data.

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

	1995[1]	1996[1]	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1996:Q2 to 1997:Q2
Output per hour							
Total business	.4	1.4	-1.1	1.9	1.8	2.7	1.3
Nonfarm business	.4	1.2	-1.0	1.8	1.4	2.7	1.2
Manufacturing	3.3	3.9	5.5	3.7	2.5	2.4	3.5
Nonfinancial corporations[2]	1.4	2.2	2.3	2.0	1.9	3.2	2.4
Compensation per hour							
Total business	2.9	3.5	3.3	3.3	4.4	3.2	3.5
Nonfarm business	2.8	3.3	2.9	3.3	4.5	3.2	3.5
Manufacturing	3.3	3.1	3.2	1.9	4.4	2.6	3.0
Nonfinancial corporations[2]	2.6	3.2	3.4	2.9	4.3	3.2	3.5
Unit labor costs							
Total business	2.5	2.1	4.4	1.4	2.5	.4	2.1
Nonfarm business	2.4	2.1	3.9	1.5	3.1	.5	2.2
Manufacturing	-.1	-.8	-2.2	-1.7	1.8	.1	-.5
Nonfinancial corporations[2]	1.2	1.0	1.1	.9	2.3	.0	1.1

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

Output per hour of all persons in the nonfarm business sector is now estimated to have advanced 2.7 percent at an annual rate in the second quarter, up from the 1.4 percent rate of increase in the first quarter. Output per hour of all employees in the nonfinancial corporate sector rose 3.2 percent annual rate in the second quarter, bringing the increase over the past year to 2.4 percent. Largely because of last quarter's surge in productivity, unit labor costs in the nonfarm business sector increased just 0.5 percent at an annual rate in the second quarter and were unchanged in the nonfinancial corporate sector. Over the past four quarters, unit labor costs rose 2.2 percent in the nonfarm business sector and 1.1 percent in the nonfinancial corporate sector.

Industrial Production

Industrial production grew 0.7 percent in August. In the manufacturing sector, output rose a robust 1 percent, boosted by the direct and indirect effects of a sharp bounceback in motor vehicle assemblies and large increases in computers, semiconductors, commercial aircraft, and primary metals. In addition, the output of nondurables, which had been weak in the first half of the year, rebounded in July and posted a further increase in August. The factory operating rate rose to 83.1 percent in August, the highest level since the spring of 1995. Outside of manufacturing, the output of utilities and mines (mainly coal) dropped noticeably as a result of this summer's unseasonably cool temperatures.

With regard to the data for prior months, growth in manufacturing output for June and July was revised up 0.1 and 0.4 percentage point respectively. For the second quarter, industrial production is now estimated to have risen 4.3 percent and appears to be on track for a bigger gain in the third quarter. Looking ahead, data on orders and other indicators of future production continue to be upbeat (chart).

Motor vehicle assemblies rose to 12.3 million units at an annual rate in August, following a month plagued by start-up problems for new models and a strike.[3] At the end of August, days' supply of light trucks remained a touch on the high side, while days' supply of autos was a bit lean. Motor vehicle assemblies are scheduled to increase 650,000 units in September, but weekly data suggest a smaller, 250,000 unit increase. The makers'

3. The possibility of further strikes in the auto industry in the near term has lessened considerably, as only five local UAW unions remain without a contract.

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

	Proportion 1996	1996[1]	1997 Q1	1997 Q2	1997 June	1997 July	1997 Aug.
			-Annual rate-		--Monthly rate---		
Total index	100.0	3.9	4.4	4.3	.3	.4	.7
Previous		3.9	4.4	3.7	.3	.2	
Manufacturing	86.5	4.1	5.3	4.1	.4	.5	1.0
Durables	47.1	5.7	8.2	7.5	1.0	.4	1.6
Motor vehicles and parts	4.9	-1.6	14.1	-13.5	3.1	-3.5	6.3
Aircraft and parts	2.3	34.5	18.1	19.7	1.6	2.5	2.2
Nondurables	39.4	2.3	2.0	.0	-.3	.6	.3
Manufacturing excluding motor vehicles and parts	81.6	4.5	4.8	5.2	.3	.7	.7
Mining	5.6	3.4	7.8	5.4	-.6	-.5	-.9
Utilities	7.9	1.4	-7.1	6.5	-.3	.5	-1.1
IP by market group excluding motor vehicles and parts							
Consumer goods	26.1	2.6	-1.6	3.6	-.2	.7	.1
Durables	4.1	3.0	4.1	6.3	1.6	.8	-.6
Nondurables	22.0	2.5	-2.6	3.1	-.5	.7	.3
Business equipment	12.7	9.1	11.0	11.9	1.1	1.3	1.6
Information processing	5.8	10.8	12.0	14.4	2.0	1.2	1.1
Industrial	4.5	-.2	2.6	5.3	-.2	1.6	1.8
Transit	1.2	53.1	33.3	23.3	2.0	2.1	3.3
Other	1.3	3.6	15.2	15.1	.7	.0	1.5
Construction supplies	5.7	5.7	3.0	2.4	-.2	-1.2	.4
Materials	38.5	4.3	5.6	5.7	.3	1.0	.5
Durables	21.5	6.3	7.7	10.1	.6	1.1	1.3
Semiconductors	4.0	16.0	33.4	31.0	2.7	3.3	2.3
Basic metals	3.7	3.2	-.2	6.4	-.1	-.7	1.9
Nondurables	9.0	2.8	6.2	.3	.0	1.1	-.3

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

CAPACITY UTILIZATION
(Percent of capacity; seasonally adjusted)

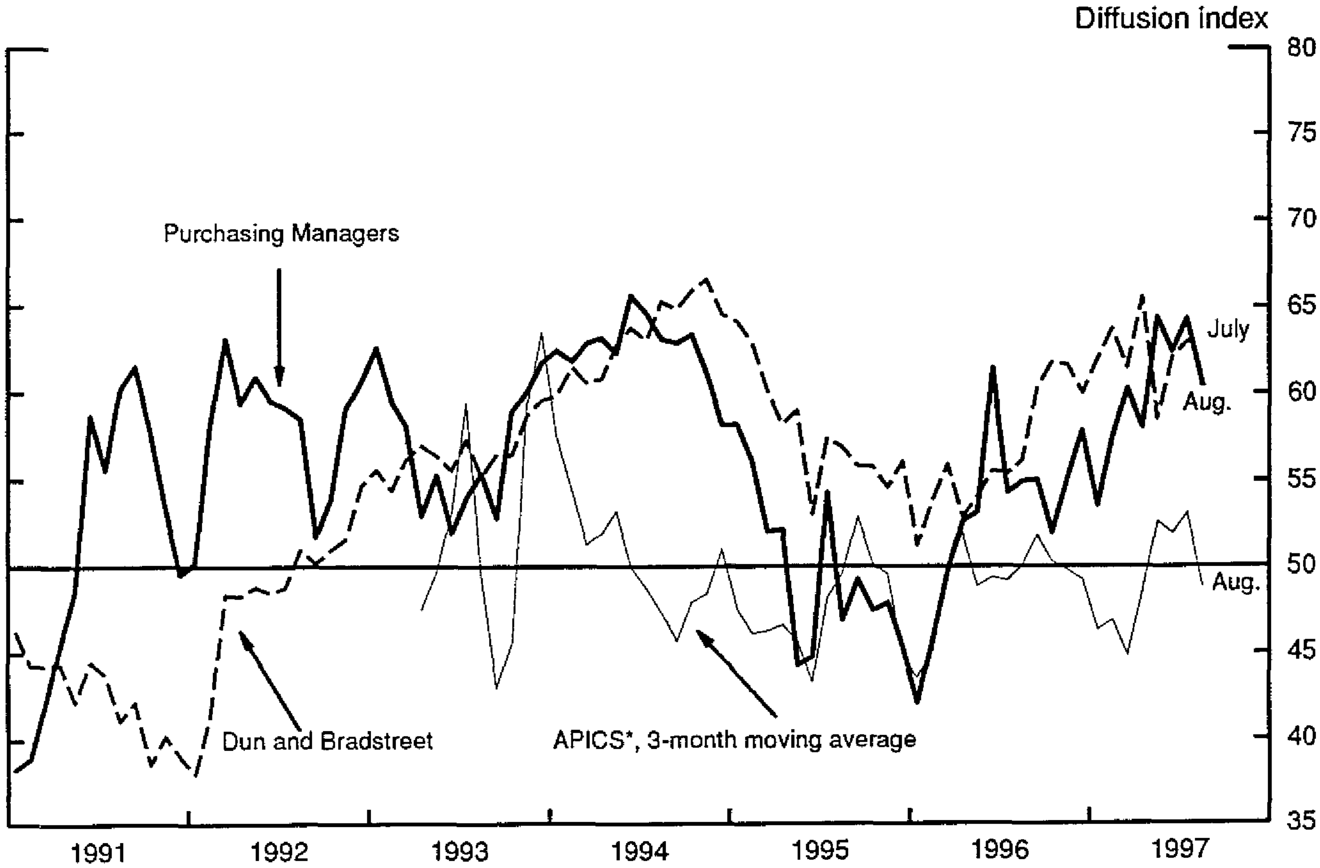
	1988-89 High	1959-96 Avg.	1996 Q2	1997 Q1	1997 Q2	1997 June	1997 July	1997 Aug.
Manufacturing	85.7	81.7	82.1	82.5	82.5	82.5	82.6	83.1
Primary processing	88.9	82.8	86.0	86.8	87.0	86.9	86.9	87.3
Advanced processing	84.2	81.2	80.4	80.7	80.5	80.6	80.7	81.3

PRODUCTION OF DOMESTIC AUTOS AND TRUCKS
(Millions of units at an annual rate, FRB seasonals)

	1997				
			Scheduled		
	July	Aug.	Sept.	Q3	Q4
U.S. Production	11.0	12.3	13.0	12.1	12.5
Autos	5.8	6.1	6.4	6.1	5.9
Trucks	5.2	6.2	6.6	6.0	6.5
Days' supply					
Autos	54.1	54.6	...	...	...
Light trucks	69.0	70.5	...	...	...

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

Indicators of Future Production: New Orders Indexes



Note. Indexes above 50 indicate orders are increasing, and indexes below 50 indicate orders are decreasing.
* APICS data from the American Production and Inventory Control Society.

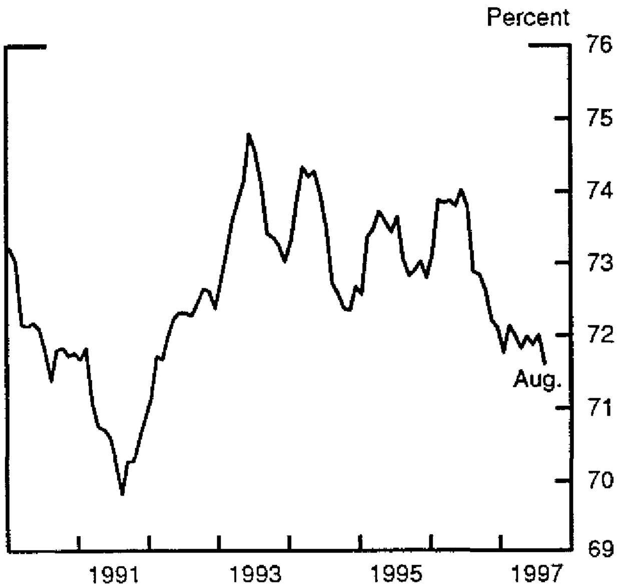
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate; FRB seasonals)

	1995	1996	1996	1997		1997		
			Q4	Q1	Q2	June	July	Aug.
Total	14.7	15.1	14.9	15.3	14.5	14.2	15.5	15.6
Adjusted[1]	14.7	15.0	14.7	15.2	14.7	14.5	15.5	14.9
Autos	8.6	8.5	8.1	8.5	8.0	7.9	8.5	8.7
Light trucks	6.1	6.6	6.7	6.7	6.5	6.3	6.9	6.9
North American[2]	12.8	13.4	13.1	13.3	12.7	12.3	13.4	13.5
Autos	7.1	7.3	6.8	7.2	6.7	6.6	7.1	7.2
Big Three	5.4	5.3	4.9	5.1	4.8	4.7	5.1	5.0
Transplants	1.7	2.0	2.0	2.1	1.9	1.9	2.0	2.2
Light trucks	5.7	6.1	6.3	6.2	5.9	5.7	6.3	6.3
Foreign produced	1.9	1.7	1.8	1.9	1.8	1.8	2.0	2.1
Autos	1.5	1.3	1.3	1.4	1.3	1.3	1.4	1.5
Light trucks	.4	.4	.5	.5	.6	.6	.6	.6

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

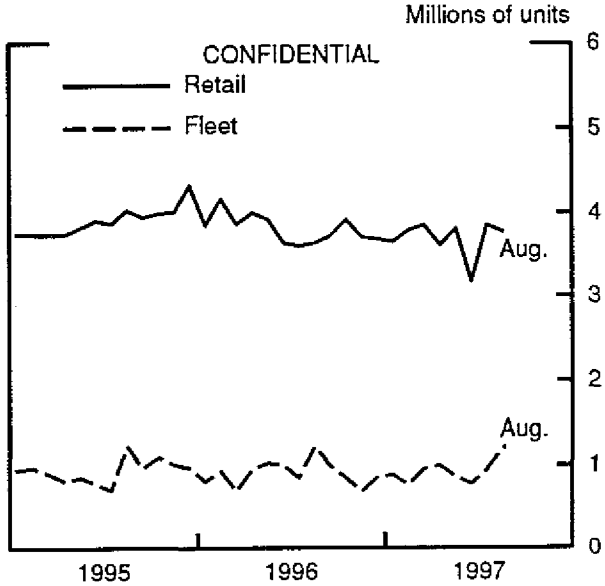
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that the industry classifies as imports

Big Three Market Share
(Six-month moving average)



Note. Data from Ward's Communications.

General Motors Sales
(Annual rate)



initial schedules for the fourth quarter, at a 12-1/2 million unit rate, are similar to the pace of the past couple of months and seem to anticipate a continuation of the recent pace of motor vehicle sales.

Outside of motor vehicles, the production of consumer durable goods fell back 0.6 percent in August, reversing a small part of the surge over the preceding few months. Business equipment continued to grow briskly, with strong gains registered in all major categories. In particular, production of transit equipment rose especially rapidly, in large part because of a continued ramp-up in production at Boeing.[4] Construction supplies increased 0.4 percent, thereby making up about a third of their drop in July, and the production of materials grew strongly again, with notable strength in semiconductors and metals.

Sales of Light Motor Vehicles

Cutting through the monthly noise, the underlying pace of sales of light motor vehicles has remained at about 15 million units over the past few years. After adjustment for the extended reporting periods by most firms, sales in August were near that rate.[5]

While overall sales have held steady at a high level in the 1997 model year, the mix of sales has changed (chart). Notably, domestic firms have lost market share, in part because foreign firms, particularly Japanese manufacturers, have pursued aggressive pricing strategies made possible by cost-cutting measures and favorable exchange rate movements. The Big Three have responded by maintaining incentives in the relatively high range that has prevailed since early 1995.

Another major development over the past year has been a series of strikes, primarily at General Motors. The strikes at General Motors have caused periodic supply shortages, leading the company to delay fleet sales in order to better serve the retail market. With its most recent strike settled in late July and start-up problems largely resolved, model availability at General Motors improved noticeably in August. Not surprisingly, the company's fleet sales

4. Although Boeing continues to increase its production, the firm recently announced that it is having problems finishing several planes due to "parts shortages, a stretched supplier base, and an influx of new employees." As a result, Boeing stated that it was postponing until the fourth quarter the delivery of 12 of the 36 planes originally scheduled for September.

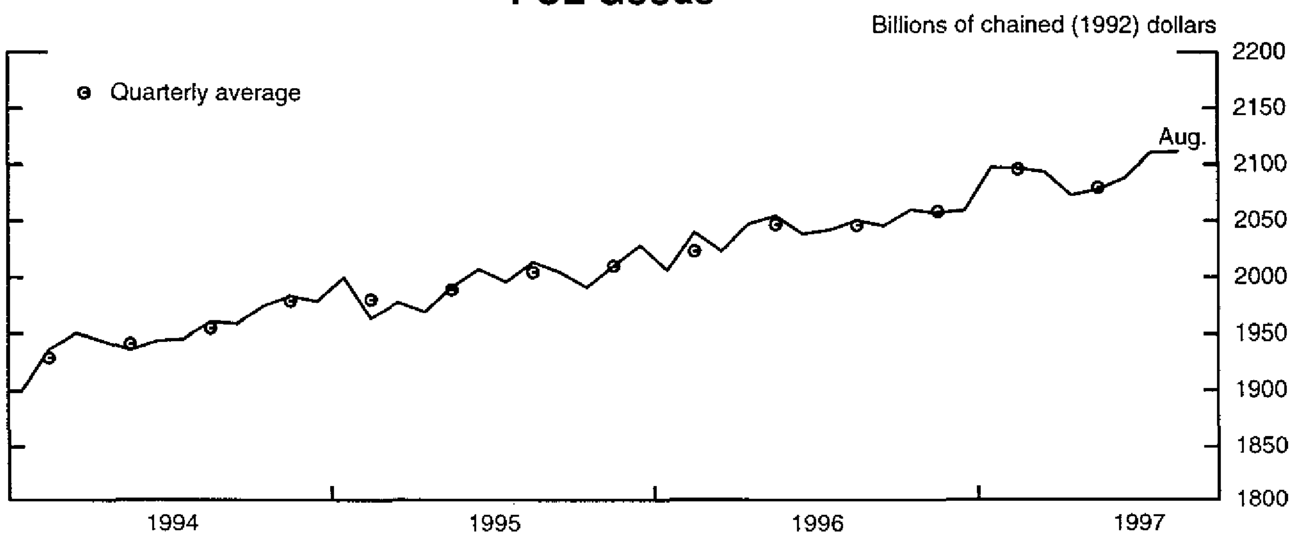
5. The reporting periods for these firms were extended through September 2. If, as expected, the reporting periods for this month end on September 30, sales for September will be understated.

RETAIL SALES
(Percent change; seasonally adjusted)

	1997		1997		
	Q1	Q2	June	July	Aug.
Total sales	2.7	-.8	.7	.9	.4
Previous estimate		-.9	.7	.6	
Building materials and supplies	4.4	1.7	.2	.3	.8
Automotive dealers	3.8	-2.7	1.6	1.8	.8
Retail control[1]	2.1	-.4	.5	.6	.3
Previous estimate		-.4	.4	.5	
GAF	3.1	.3	.8	.9	.7
Durable goods	2.2	-.7	.7	.7	.8
Furniture and appliances	2.5	2.1	.0	1.3	.8
Other durable goods	2.0	-2.8	1.3	.2	.8
Nondurables	2.1	-.3	.5	.6	.2
Apparel	2.4	-.2	1.6	.8	.6
Food	.7	-.6	-.3	.4	-.2
General merchandise	3.6	-.2	.8	.8	.6
Gasoline stations	1.9	-3.4	-.2	.7	.5
Other nondurables[2]	2.2	.9	.9	.6	-.1
Eating and drinking	2.1	-.7	.2	.1	.2
Drug and proprietary	3.2	1.1	1.2	1.1	.1

1. Total retail sales less building material and supply stores and automotive dealers, except auto and home supply stores.
2. Also includes liquor stores and mail order houses.

PCE Goods



Note. Data for June, July and August are staff estimates.

(<u>confidential</u>) surged last month, making up for most of the shortfalls earlier in the year (chart). Although weakness in retail sales in August may have allowed General Motors to close more of the gap in fleet sales than it had anticipated, we expect that the company will hold fleet sales a bit above trend through the end of the year in order to fully recoup earlier shortfalls.

The near-term outlook for sales remains quite positive. The preliminary September results from the Michigan survey indicated that consumers' attitudes toward buying conditions for cars are favorable, largely a reflection of the view that "times are good." Pricing, from the consumers view, also remains attractive. On comparably equipped vehicles, prices announced by the Big Three for the 1998 models have been little changed; price increases on foreign-nameplate models have been modest. In addition, initial industry plans for incentives in the fourth quarter, while down from the level of the current quarter, remain relatively high.

<u>Personal Income and Consumption</u>

Consumer spending grew at a healthy rate in August after having picked up smartly in June and July. Available indicators suggest that spending is continuing to grow in September. Moreover, nothing would seem to be in the way of further significant gains: Income and job growth are solid; consumer confidence is high; and households have experienced large gains in net worth.

According to the advance report, an upward-revised gain of 0.9 percent in total nominal retail sales in July was followed by an increase of 0.4 percent in August. Spending in the retail control category, which excludes sales at automotive dealers and building material and supply stores, rose 0.3 percent last month after having increased 1/2 percent per month in June and July. Gains were especially large at general merchandise and apparel stores, a reading consistent with anecdotal reports of strong back-to-school sales last month; durable goods stores also registered strong growth. The August retail sales report, together with available information on prices, suggests that real PCE for goods excluding motor vehicles in July and August was about 1 percent higher than the average level in the second quarter (not at an annual rate).

Real spending on services rose 0.4 percent in July, the latest month for which data are available. Expenditures on energy services rose 1.1 percent in July (on a seasonally adjusted basis), following an unusually cool June. According to national weather data,

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

	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 June	1997 July
	--- Q4/Q4 ---		----- Annual rate -----			Monthly rate	
PCE	2.2	2.7	3.3	5.3	1.0	.1	.6
Durables	3.0	3.9	3.5	14.1	-5.4	.6	2.1
Motor vehicles	-.4	-1.6	-3.1	9.9	-16.6	.4	4.7
Other durable goods	5.3	7.5	7.6	16.5	1.6	.8	.6
Nondurables	1.0	1.8	2.1	4.7	-2.3	.3	.4
Services	2.7	2.8	3.9	3.9	4.0	-.1	.4
Energy	7.4	.7	10.5	-12.4	22.6	-6.3	1.1
Non-energy	2.4	2.9	3.6	4.7	3.3	.2	.4
Housing	1.7	1.7	1.8	2.0	2.1	.1	.2
Household operation	4.3	2.0	7.1	.3	5.4	.6	.5
Transportation	4.9	4.2	3.3	4.8	1.3	.5	.3
Medical	2.2	2.5	4.3	4.2	3.9	.3	.4
Other	2.3	4.3	3.8	8.3	3.7	.1	.5

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

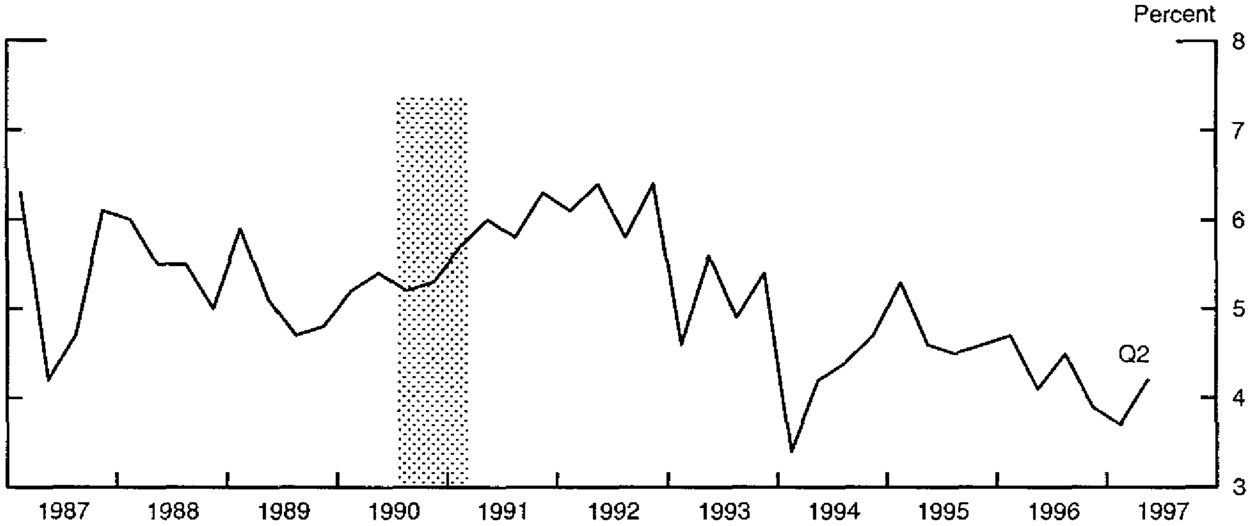
PERSONAL INCOME
(Average monthly percent change)

	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 June	1997 July
	-- Q4/Q4 --		--- Annual rate ---			--- Monthly rate ---		
Total personal income	5.2	5.8	4.8	8.0	5.0	.3	.6	.1
Wages and salaries	5.0	6.4	6.0	8.3	5.3	.3	.8	-.0
Private	5.4	7.1	6.9	8.9	5.9	.4	1.0	-.1
Other labor income	-.9	.7	.7	3.2	2.8	.2	.1	.2
Less: Personal tax and nontax payments	8.9	12.5	11.8	15.1	11.5	.9	1.1	.5
Equals: Disposable personal income	4.7	4.8	3.7	6.8	4.0	.2	.5	.1
Memo:								
Real disposable income[1]	2.4	2.0	.7	4.6	2.9	.3	.4	-.1
Saving rate (percent)	4.8	4.3	3.9	3.7	4.2	4.1	4.3	3.7

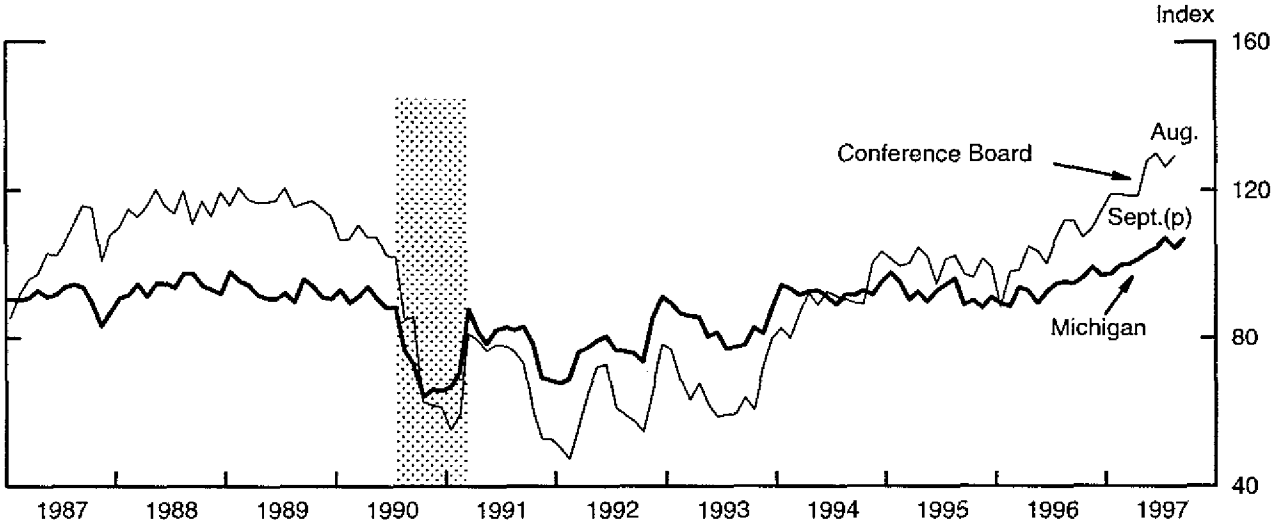
Note. Derived from BEA's advance estimates.
1. Derived from billions of chained (1992) dollars.

Household Indicators

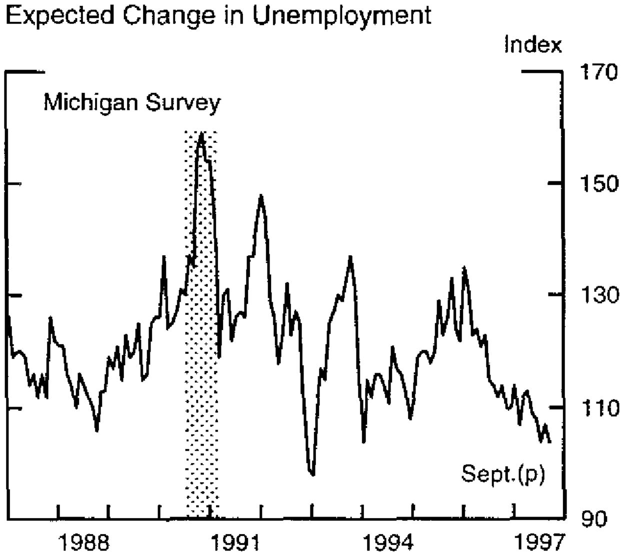
NIPA Personal Saving Rate



Consumer Confidence

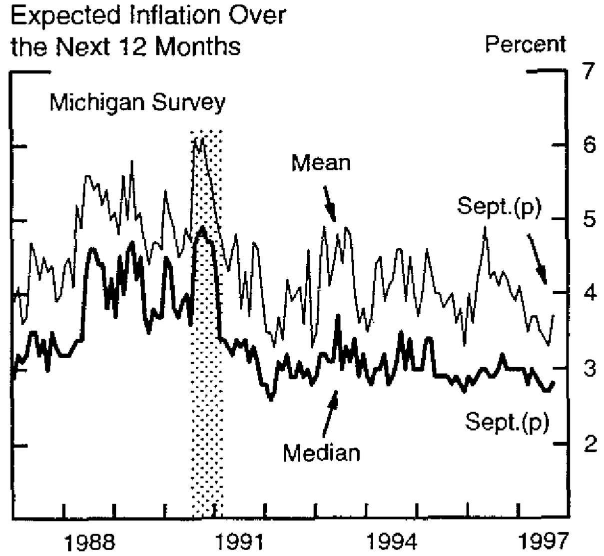


Expected Change in Unemployment



Note: Percentage expecting more unemployment over the next 12 months minus those expecting less plus 100

Expected Inflation Over the Next 12 Months



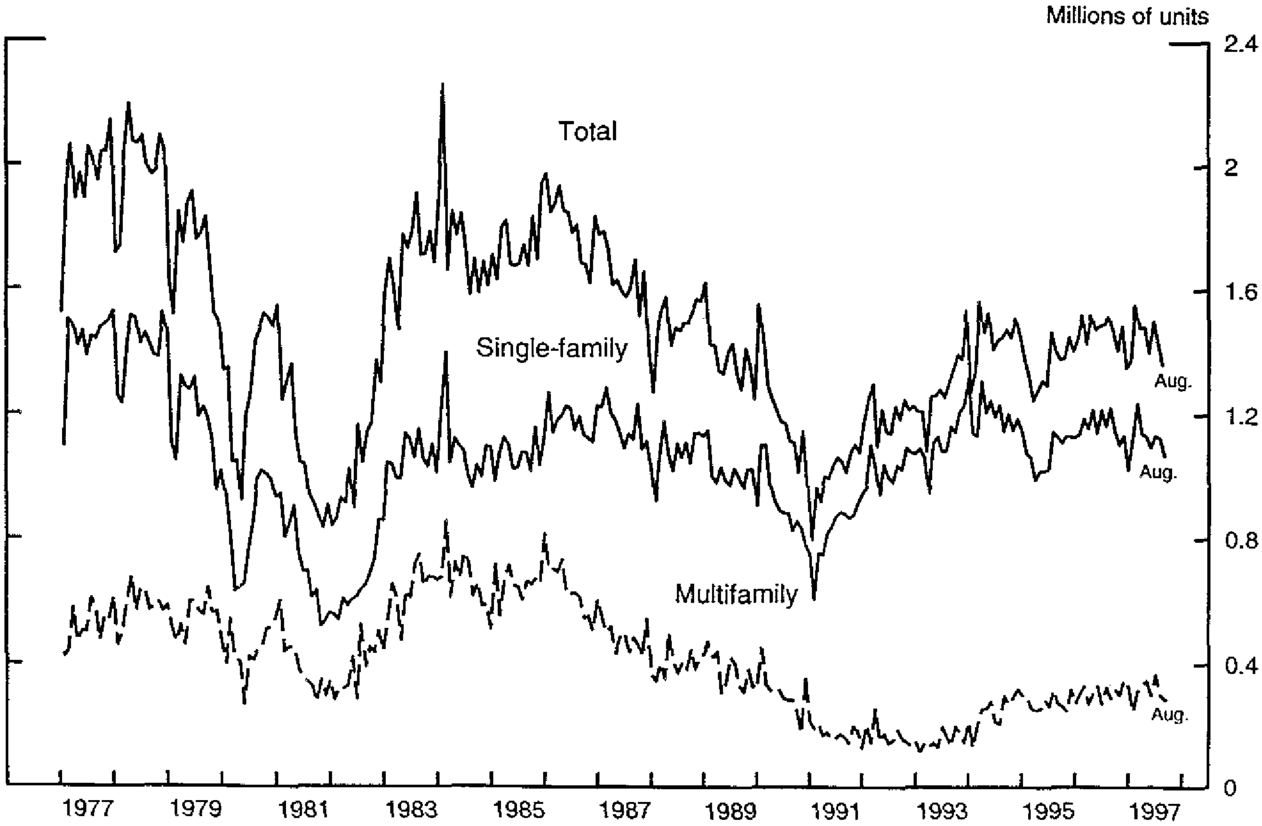
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		1996	1997				
	1996	Q4	Q1	Q2r	Juner	Julyr	Aug.p
All units							
Starts	1.48	1.42	1.47	1.46	1.50	1.43	1.36
Permits	1.43	1.38	1.43	1.43	1.40	1.41	1.39
Single-family units							
Starts	1.16	1.09	1.17	1.12	1.13	1.13	1.07
Permits	1.07	1.01	1.05	1.05	1.05	1.03	1.03
New home sales	.76	.76	.82	.78	.81	.82	n.a.
Existing home sales	4.09	4.00	4.10	4.15	4.15	4.24	n.a.
Multifamily units							
Starts	.32	.33	.30	.34	.37	.30	.29
Permits	.36	.38	.38	.37	.35	.38	.36
Mobile homes							
Shipments	.36	.35	.35	.36	.36	.36	n.a.

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

Private Housing Starts

(Seasonally adjusted annual rate)



temperatures in July and August were somewhat below normal, while September temperatures have been normal; these data suggest that energy spending will be little changed in August and rise in September. Spending on non-energy services increased 0.4 percent in July, with most categories of services registering solid growth.

Estimates of personal income are available only through July, when real disposable personal income edged down 0.1 percent. Income was held down by the decline in the average workweek and the nearly flat average hourly earnings reported in the July employment release. Aggregate hours and average hourly earnings both rose in August, suggesting that private wage and salary disbursements will show a sizable gain for the month.

Readings of sentiment for August and early September continued to show that consumers have highly favorable views of economic conditions. The Conference Board index moved back up in August to a level just below June's 28-year high. The Michigan SRC index, which slipped a bit last month, reversed much of its decline in early September and returned to its historical high recorded in July. Overall, both the Conference Board and Michigan surveys show consumers to be highly optimistic about business conditions and labor market prospects. In addition, measures of inflation expectations have tended to edge down over the past year.

Housing Markets

The drop in housing starts last month was somewhat surprising, given indicators of demand. Starts of single-family units declined in August to a 1.07 million unit annual rate, compared with the average pace of 1.14 million units over the first seven months of the year. Adjusted permits for these units, which we view as a better indicator of the underlying trend in construction, also declined in August but by less than starts.[6]

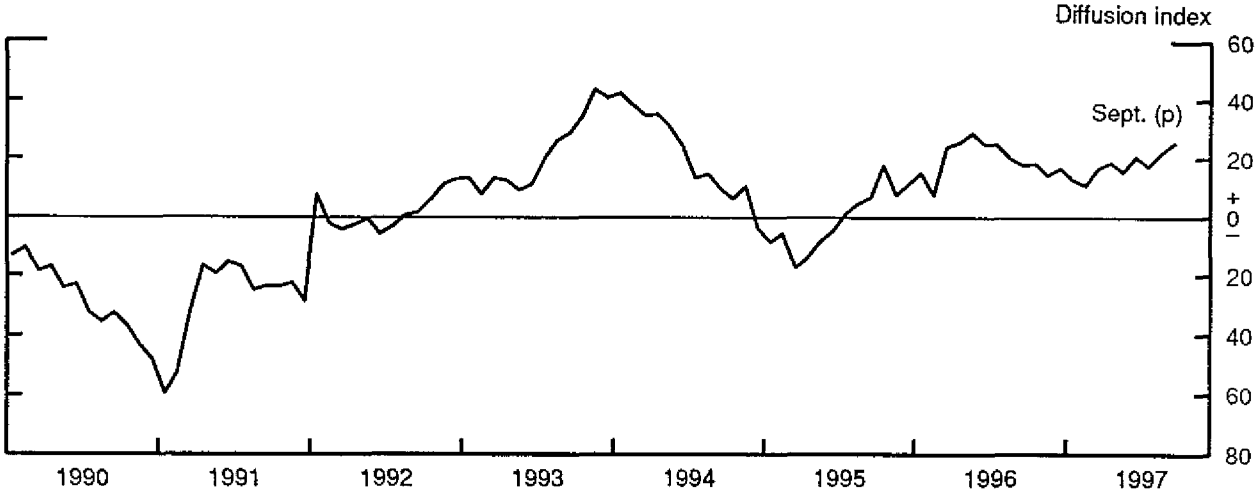
Indicators of housing demand have remained upbeat: Income and employment have continued to show healthy gains, mortgage rates are relatively low, and consumer assessments of homebuying conditions are quite positive. Indeed, the recent trends in sales are favorable. The average level of new home sales in June and July was 7-1/2 percent higher than that over 1996 as a whole, and sales of existing homes have been running ahead of the record-setting 1996 pace. Among the more timely indicators of activity, builders'

6. Adjusted permits are equal to the published permits series, plus starts outside of permit-issuing places, plus an adjustment for units started without a permit in permit-issuing places.

Indicators of Housing Demand

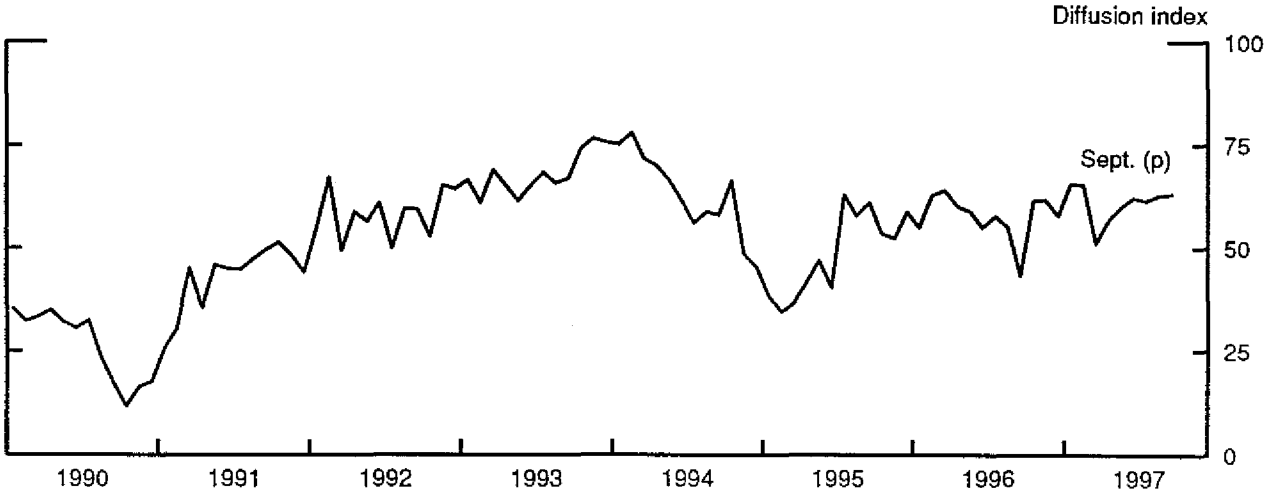
(Seasonally adjusted; FRB seasonals)

Builders' Rating of New Home Sales



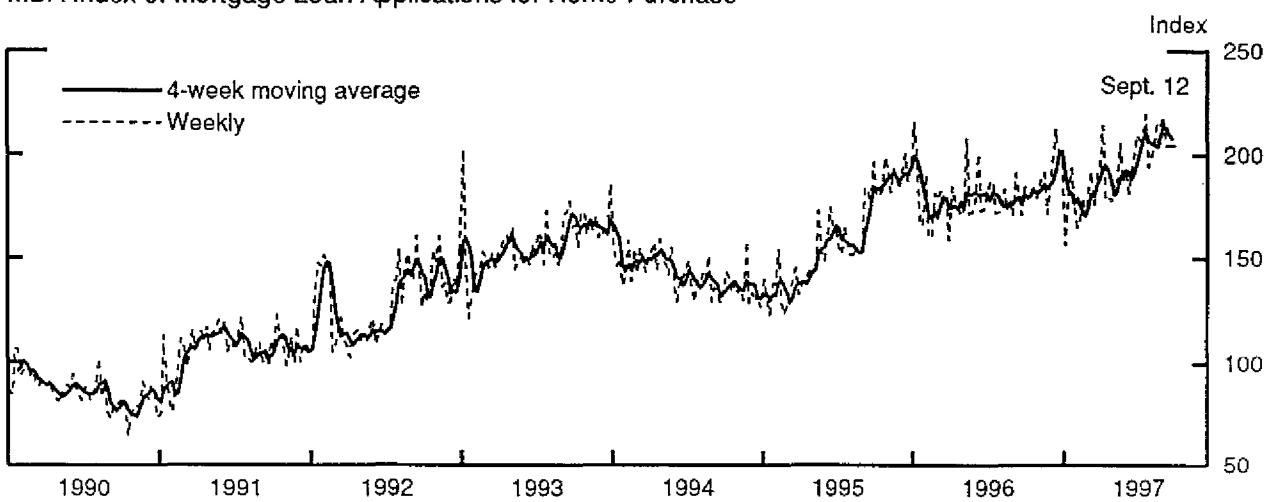
Note. The index is calculated from National Association of Homebuilders data as the proportion of respondents rating current sales as good minus the proportion rating them as poor.

Consumer Homebuying Attitudes



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

MBA Index of Mortgage Loan Applications for Home Purchase



ratings of new-home sales improved further in both August and September, and applications for mortgages to finance home purchases have continued to run at a relatively high level in recent weeks.

Multifamily starts were at a 291,000 unit annual rate in August, compared with an average pace of 319,000 units during the first seven months of this year. Permits for these units also declined last month but less than starts. The level of multifamily starts was low relative to permits in August, suggesting that multifamily starts likely will rebound some in September.

Business Fixed Investment

Outlays for producers' durable equipment are continuing to grow rapidly. Shipments and orders of nondefense capital goods excluding aircraft have posted exceptional gains in recent months. In addition, outlays for nonresidential structures show signs of recovering from the declines of the past two quarters.

The boom in expenditures on producers' durable equipment continues to be led by office and computing equipment. These outlays advanced at an annual rate of 46 percent in the second quarter and do not appear to have slowed since: Nominal shipments of office and computing equipment in July were 6 percent above their second-quarter average level. In addition, the price of computing equipment has been falling even faster than usual--the PPI for computers dropped 2.8 percent (monthly rate) in August, a decline likely reflecting price cuts for Intel microprocessors. Anecdotal reports from industry sources suggest the possibility of further large price cuts on personal computers in the coming quarters.

Shipments of communications equipment rose 2.9 percent in July to a level 6 percent above the second-quarter average. Smoothing over the recent zigs and zags, the orders picture for communications equipment also looks healthy.

The current-quarter outlook for producers' durable equipment outside the high-tech sector is also positive. For transportation equipment, sales of heavy trucks picked up in July, and fleet sales of light vehicles recoverd from their low levels of earlier this year. Although Boeing will not fully meet its announced delivery schedule for September, aircraft production has risen rapidly this quarter, and domestic deliveries are likely to post a large gain over the quarter as a whole. Shipments of capital goods excluding

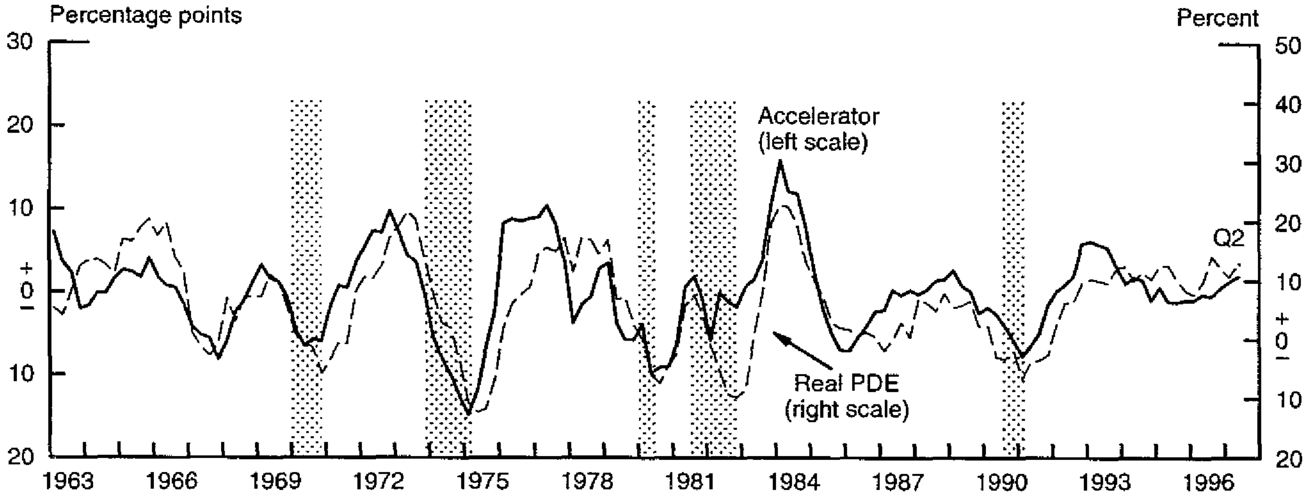
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	1996	1997		1997		
	Q4	Q1	Q2	May	June	July
<u>Producers' durable equipment</u>						
Shipments of nondefense capital goods	1.5	1.4	5.5	-.1	2.6	3.0
Excluding aircraft and parts	.8	.8	4.1	.3	3.8	1.3
Office and computing	-.7	2.6	2.3	1.6	5.9	1.7
Communications equipment	4.1	-1.0	6.2	5.1	2.1	2.9
All other categories	.5	.6	4.3	-1.3	3.5	.7
Shipments of complete aircraft[1]	21.1	-7.8	30.6	2.0	-15.8	n.a.
Sales of heavy trucks	-5.5	7.3	-1.8	.8	-11.9	18.8
Orders of nondefense capital goods	.2	2.5	-.5	1.1	6.8	.2
Excluding aircraft and parts	-.8	5.5	.3	-.6	3.1	6.1
Office and computing	-.6	.1	.2	1.1	1.7	7.1
Communications equipment	3.7	12.4	4.6	8.1	13.9	-16.1
All other categories	-1.9	5.9	-.7	-3.4	.7	12.5
<u>Nonresidential structures</u>						
Construction put in place, buildings	5.2	1.8	-1.4	2.4	1.1	1.2
Office	2.2	4.1	-3.0	4.0	7.1	-.3
Other commercial	5.6	2.7	-5.3	2.6	-2.4	-.8
Institutional	7.5	4.6	4.8	-5.7	-2.1	-.4
Industrial	4.6	-4.2	-2.8	3.7	4.5	6.8
Lodging and miscellaneous	6.8	2.7	4.8	9.1	.2	1.3
Rotary drilling rigs in use[2]	-1.6	16.2	11.9	2.5	2.2	-4.0
Memo:						
Business fixed investment	5.9	4.1	15.4	n.a.	n.a.	n.a.
Producers' durable equipment	2.6	6.7	23.8	n.a.	n.a.	n.a.
Office and computing	31.0	27.9	46.0	n.a.	n.a.	n.a.
Communications equipment	-5.6	10.3	7.5	n.a.	n.a.	n.a.
Other equipment[3]	-2.8	6.0	19.2	n.a.	n.a.	n.a.
Nonresidential structures	15.3	-2.1	-3.9	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.

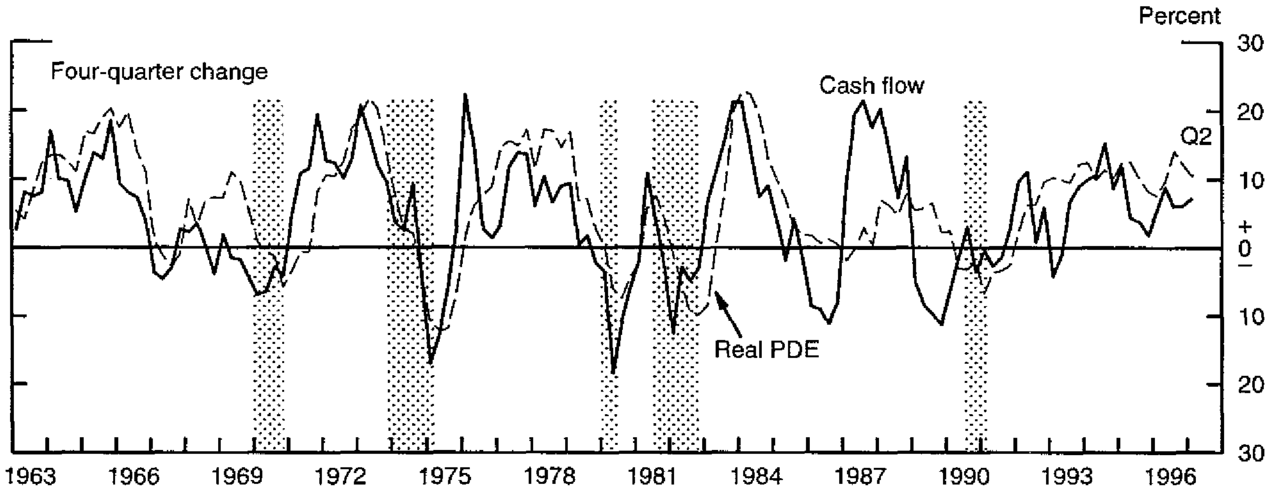
Fundamental Determinants of Equipment Spending

Acceleration of Business Output

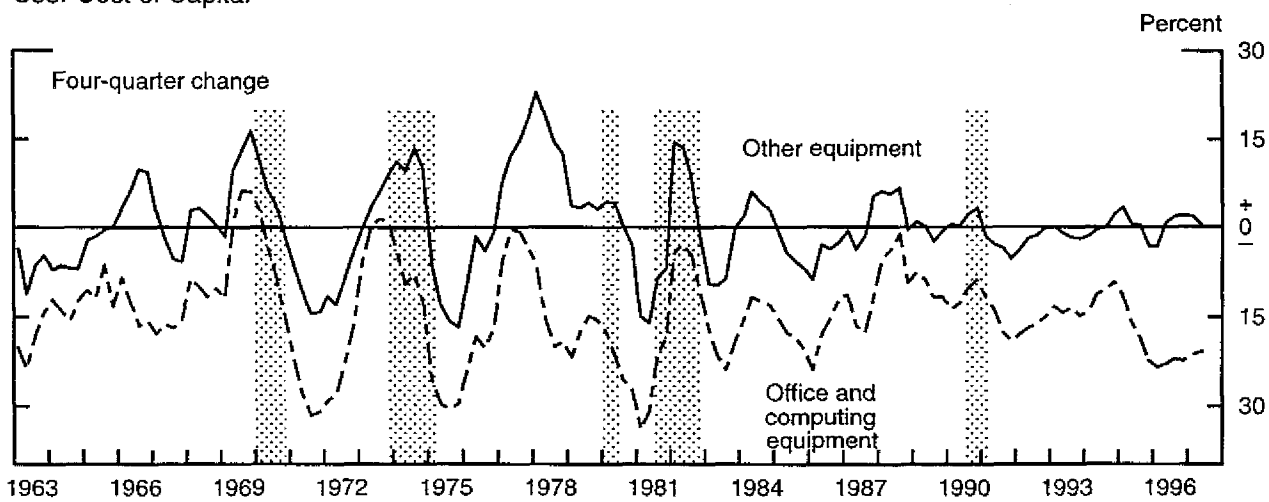


Note. The accelerator is the eight-quarter percent change in business output less the year-earlier eight-quarter percent change. Real PDE is the four-quarter percent change.

Real Domestic Corporate Cash Flow

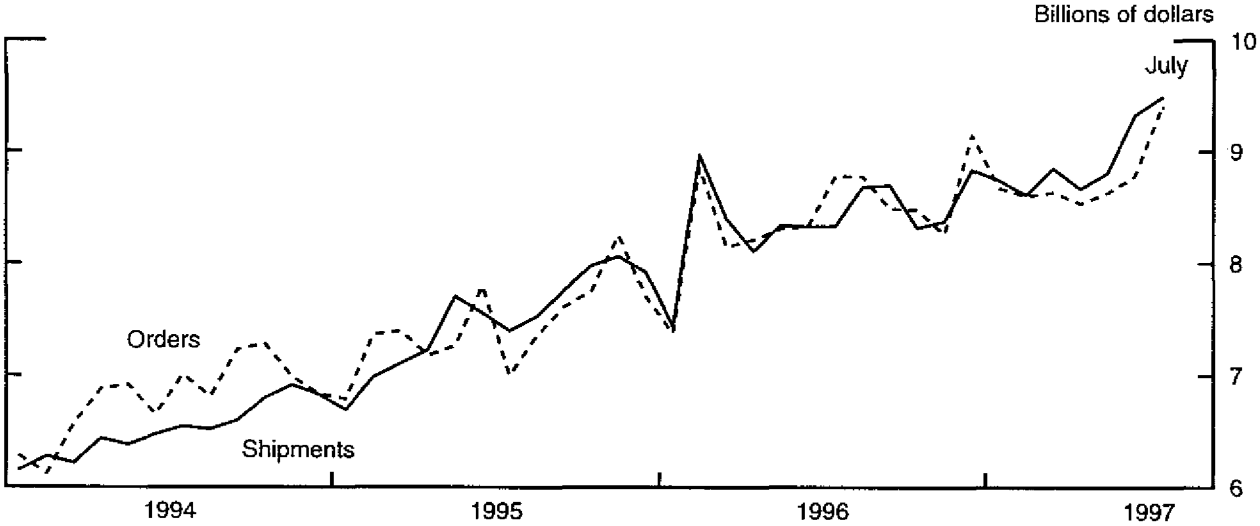


User Cost of Capital

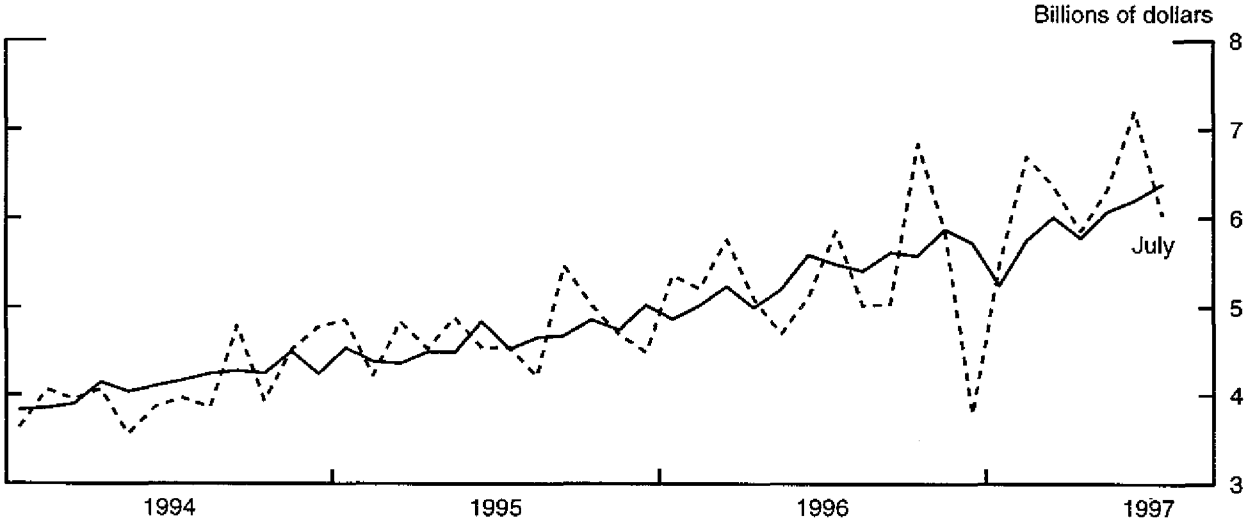


Orders and Shipments of Nondefense Capital Goods

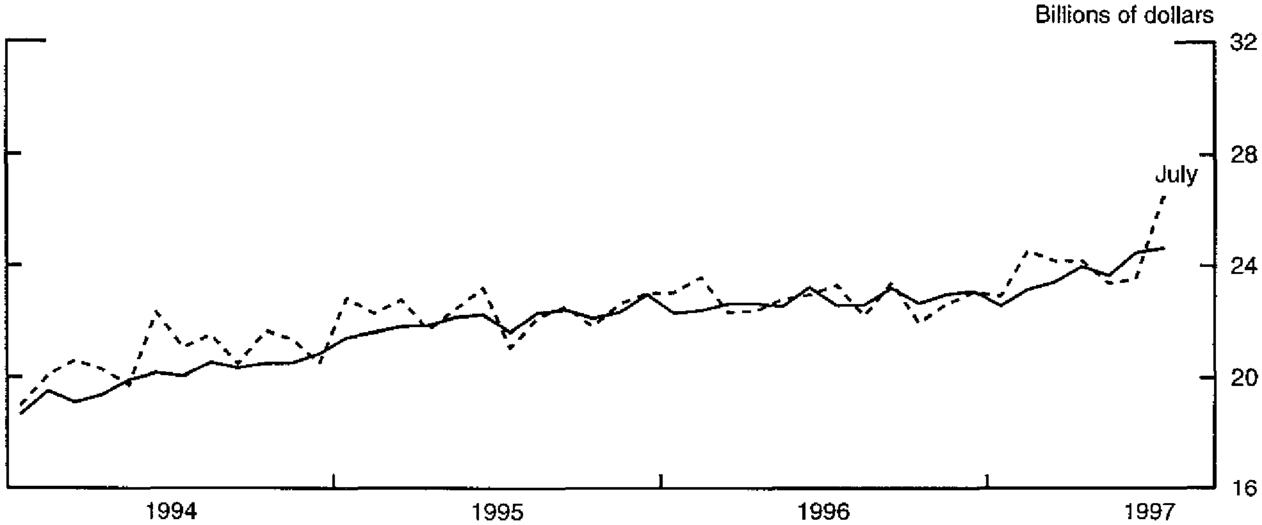
Office and Computing Equipment



Communications Equipment

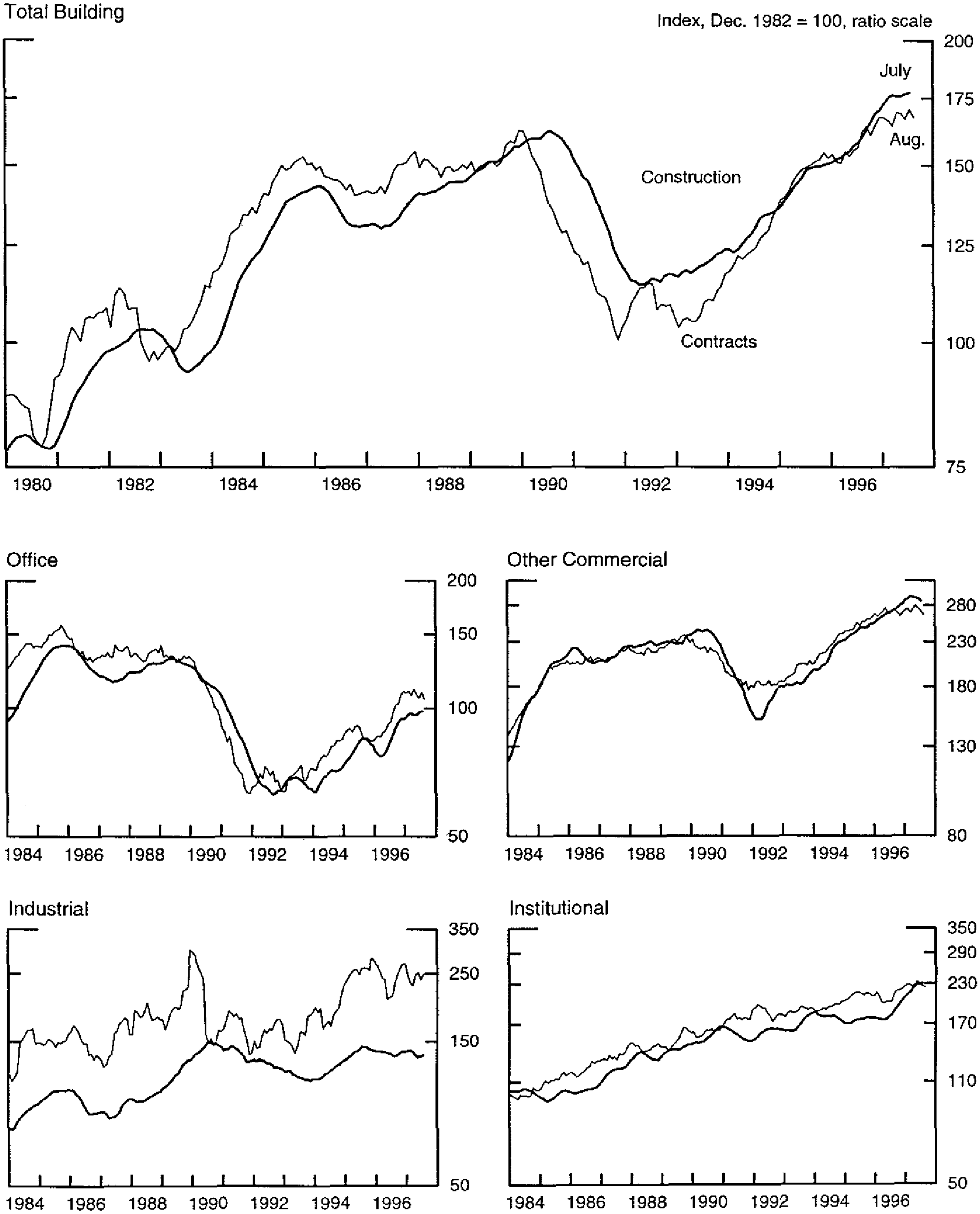


Other Equipment (Excluding Aircraft, Computing, and Communications Equipment)



Nonresidential Construction and Contracts

(Six-month moving average)



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

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

	1996	1997		1997		
	Q4	Q1	Q2	May	June	July
Book value basis						
Total	16.0	35.8	51.5	22.5	86.8	22.3
Excluding wholesale and retail motor vehicles	22.2	30.9	48.9	35.1	64.8	25.8
Manufacturing	7.0	16.5	25.1	23.4	16.4	25.7
Excluding aircraft	2.5	9.1	19.8	22.0	8.0	21.9
Wholesale	4.1	14.3	19.1	11.8	61.5	-20.4
Excluding motor vehicles	6.0	11.5	14.3	6.4	44.7	-13.0
Retail	4.9	5.0	7.4	-12.7	8.9	17.0
Auto dealers	-4.3	2.1	-2.1	-18.0	5.2	3.9
Excluding auto dealers	9.1	2.8	9.6	5.3	3.7	13.1

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

	Cyclical reference points 1990-91 High	Cyclical reference points 1995-96 Low	Range over preceding 12 months High	Range over preceding 12 months Low	July 1997
Manufacturing and trade	1.58	1.37	1.39	1.35	1.36
Less wholesale and retail motor vehicles	1.55	1.34	1.35	1.32	1.33
Manufacturing	1.75	1.36	1.38	1.35	1.34
Primary metals	2.08	1.49	1.70	1.60	1.59
Nonelectrical machinery	2.48	1.80	1.89	1.74	1.72
Electrical machinery	2.08	1.41	1.48	1.33	1.38
Transportation equipment	2.93	1.48	1.61	1.49	1.51
Motor vehicles	.97	.56	.62	.57	.56
Aircraft	5.84	4.15	4.88	4.09	4.06
Nondefense capital goods	3.09	2.31	2.39	2.27	2.23
Textile	1.71	1.44	1.54	1.47	1.48
Petroleum	.94	.75	.84	.75	.81
Home goods & apparel	1.96	1.67	1.72	1.65	1.71
Merchant wholesalers	1.36	1.24	1.27	1.22	1.24
Less motor vehicles	1.31	1.22	1.24	1.20	1.21
Durable goods	1.83	1.53	1.57	1.50	1.50
Nondurable goods	.96	.93	.96	.92	.94
Retail trade	1.61	1.50	1.53	1.48	1.50
Less automotive dealers	1.48	1.43	1.45	1.41	1.43
Automotive dealers	2.21	1.68	1.80	1.68	1.71
General merchandise	2.43	2.21	2.26	2.12	2.10
Apparel	2.56	2.42	2.56	2.43	2.49
GAF	2.44	2.23	2.28	2.16	2.14

high-tech and transportation equipment advanced 0.7 percent in July, and the high level of orders points to further growth.[7]

Real expenditures on nonresidential structures appear to be rebounding somewhat in the current quarter after moderate declines in the first two quarters of this year. The value of construction put in place rose in July for the third month in a row and now stands 2-3/4 percent above its second-quarter average. Looking forward, although construction contracts have been moving sideways in recent months, low vacancy rates, rising prices for commercial real estate, and widespread availability of financing through REITs suggest that conditions for further gains in nonresidential construction are good.

Business Inventories

After a sharp run-up in the second quarter, investment in business inventories slowed in July. For manufacturing and trade excluding motor vehicles, inventories rose at an annual rate of $26 billion (book value) in July, considerably below the second-quarter pace of $49 billion, as the June bulge in accumulation at wholesalers was partially reversed.

In manufacturing, inventories increased at a $26 billion annual rate in July, an advance similar to the second-quarter pace. As in recent quarters, a sizable portion of the accumulation was in stocks of nondefense capital goods--especially aircraft and parts, computer and office equipment, and communications equipment--where shipments and orders have increased notably and production has been brisk.

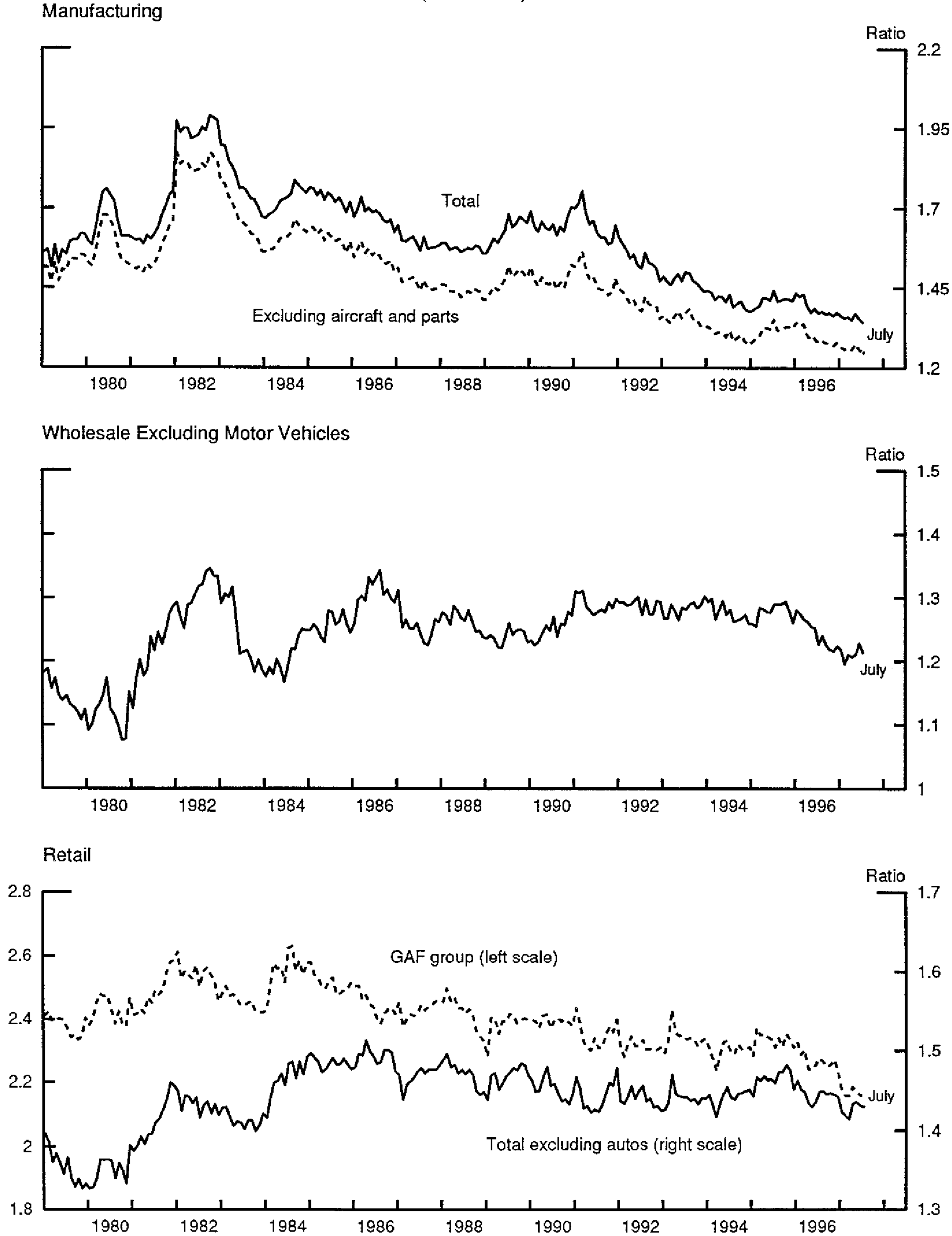
MANUFACTURERS' RECENT INVENTORY INVESTMENT
(Book value, billions of dollars at annual rate)

	1996	1997		1997			
	Q4	Q1	Q2	Apr.	May	June	July
All manufacturing	7.0	16.5	25.1	35.4	23.4	16.4	25.7
Nondefense cap. goods	3.2	9.4	11.6	15.0	7.2	12.7	12.9
Aircraft	6.8	8.0	6.4	5.6	3.0	10.5	3.1
Ex. aircraft	-3.6	1.4	5.3	9.4	4.2	2.2	9.8
Household durables	.3	-.4	1.5	1.5	1.1	1.8	4.5
Home goods and apparel	-.3	.1	3.2	2.7	2.7	4.3	5.9
Other	3.8	7.4	8.8	16.2	12.4	-2.4	2.4

7. Most of the 12.5 percent rise in orders for this category in July was due to an increase in orders for search and navigation equipment, which is unlikely to be sustained. Excluding this category, orders still grew a very strong 4-3/4 percent rate.

Inventory-Sales Ratios, by Major Sector

(Book value)



Aside from capital goods, stocks of non-auto consumer goods--household durables, and home goods and apparel--also expanded substantially in July after a moderate increase in the second quarter. However, given the pickup in non-auto retail sales in July and August and the expected strength in consumer spending in coming months, the recent accumulation of consumer goods inventories was probably intentional. For most industries and market groupings in manufacturing, inventory-shipments ratios in July remained around the lower end of their recent ranges.

Wholesale inventories declined in July after a massive buildup in June.[8] The July drawdown was largely in durable stocks and in many cases coincided with very strong wholesale shipments in that month. For instance, stocks held by distributors of machinery fell $10 billion in book-value terms, while shipments of wholesale machinery surged 3 percent. In the wholesale sector as a whole, stocks appear to be well in line relative to sales.

In retail trade, investment in non-auto inventories picked up somewhat in July from the preceding two months but remained generally moderate. Notably, sales at stores selling general merchandise, apparel, and furnishings (GAF) have been quite brisk since late spring, and the inventory-sales ratio fell in July to the lowest level in recent years.

Federal Sector

News on the deficit front continues to be good. With data for eleven months of the fiscal year (October 1996 to August 1997) now complete, the unified deficit is down $62 billion from the same period last year, adjusted for shifts in payment timing and excluding deposit insurance and proceeds from spectrum auctions. The drop in the deficit is a result of strong receipts (up 8-1/2 percent), most notably from personal income and social insurance taxes (up 9-1/4 percent). Adjusted outlays have grown 3-1/4 percent so far this fiscal year, 1 percentage point faster than they did over the first eleven months of fiscal 1996. The acceleration has been concentrated in two areas: defense spending, which has edged up after several years of declines, and the "other" spending category, principally nondefense discretionary spending,

8. Despite the huge increase shown in the preliminary report last month, wholesale inventory investment in June was revised up in the final estimate, albeit only modestly. Excluding motor vehicles, wholesale inventories are now shown to have increased $44.7 billion in June and $14 billion (annual rate) over the second quarter as a whole.

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

	July-Aug.		Fiscal year to date totals			
	1996	1997	1996	1997	Dollar change	Percent change
Outlays	272.6	272.9	1437.8	1475.5	37.7	2.6
Deposit insurance (DI)	-.5	-1.1	-7.6	-13.9	-6.3	
Spectrum auction (SA)	.0	-.7	-.2	-11.0	-10.8	
Other	273.1	274.7	1445.7	1500.5	54.8	3.8
Receipts	203.9	212.7	1295.1	1404.2	109.1	8.4
Deficit(+)	68.7	60.2	142.7	71.3	-71.4	-50.0
	Adjusted for payment timing shifts[1] and excluding DI and spectrum auction					
Outlays	266.0	267.4	1445.7	1493.2	47.6	3.3
National defense	46.2	45.1	245.6	246.9	1.3	.5
Net interest	41.8	42.1	221.9	226.4	4.5	2.0
Social security	58.5	61.1	320.5	334.8	14.3	4.5
Medicare and health	53.5	55.3	270.6	289.3	18.7	6.9
Income security	36.3	35.5	211.9	214.5	2.6	1.2
Other	31.1	29.8	175.1	182.7	7.6	4.3
Receipts	203.9	212.7	1295.1	1404.2	109.1	8.4
Personal income and social insurance taxes	176.1	186.3	1053.8	1151.0	97.2	9.2
Corporate	8.0	6.0	136.7	145.0	8.2	6.0
Other	19.7	20.4	104.6	108.2	3.6	3.5
Deficit(+)	62.2	54.8	150.6	89.0	-61.6	-40.9

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.

OMB 1997 MIDSESSION REVIEW

Measure	1997	1998	1999	2000	2001	2002	2007
	Budget projections (billions of dollars: fiscal years)						
Baseline deficit, February	128	120	140	128	109	101	92
Changes							
Economic	-11	-13	-10	-1	1	2	na
Technical	-80	-56	-46	-41	-39	-41	na
Policy	1	7	-26	-44	-64	-124	-193
Bills enacted	-1	2	2	1	1	0	0
Reconciliation bills	1	6	-27	-44	-62	-121	-187
Other	0	-1	-1	-2	-3	-4	-6
September deficit	37	58	57	41	7	-63	-167
	Economic assumptions (calendar years)						
	------Percentage change, year over year--------						
Nominal GDP	5.5	4.5	4.5	4.6	4.9	4.9	4.9
Real GDP	3.5	2.0	2.0	2.1	2.4	2.4	2.4
GDP price index	2.3	2.5	2.5	2.4	2.4	2.4	2.4
CPI-U	2.7	2.5	2.5	2.5	2.5	2.5	2.5
	-----------Percent, annual average------------						
Unemployment rate	5.0	5.2	5.4	5.5	5.5	5.5	5.5
Yield on selected Treasuries							
Three-month	5.2	5.1	4.9	4.6	4.4	4.4	4.4
Ten-year	6.6	6.1	5.8	5.6	5.4	5.4	5.4

Note. The February baseline assumes that discretionary spending equals then-enacted appropriations in FY1997, and grows at the projected rate of inflation thereafter. The current deficit projections incorporate the discretionary spending caps for FY1998-FY2002 called for by the Budget Enforcement Act of 1997, and assume discretionary spending growth equal to the rate of inflation in FY2003-FY2007.

Source. Office of Management and Budget, Mid-Session Review of the 1998 Budget, September 1997. Economic assumptions beyond 2002 were provided by the Administration and are confidential.

CBO SEPTEMBER 1997 UPDATE

Measure	1997	1998	1999	2000	2001	2002	2007
	Budget projections (Billions of dollars: fiscal years)						
Baseline deficit, March	115	122	149	172	167	188	278
Changes							
Economic	-23	-43	-52	-65	-75	-89	-198
Technical	-56	-44	-41	-38	-34	-36	-56
Policy	-2	21	-3	-20	-21	-95	-109
Bills enacted	-2	0	0	0	0	0	0
Reconciliation bills	0	21	-3	-20	-21	-95	-109
September deficit	34	57	52	48	36	-32	-86
	Economic assumptions (calendar years)						
	------Percentage change, year over year-------						
Nominal GDP	5.5	4.5	4.6	4.8	4.9	5.1	5.0
Real GDP	3.4	2.1	1.9	2.1	2.2	2.4	2.3
GDP price index	2.0	2.4	2.6	2.6	2.6	2.6	2.7
CPI-U	2.4	2.7	3.0	3.0	3.0	3.1	3.1
	-----------Percent, annual average-----------						
Unemployment rate	5.0	5.1	5.5	5.8	5.9	6.0	6.0
Yield on selected Treasuries							
Three-month	5.2	5.4	4.7	4.4	4.4	4.4	4.4
Ten-year	6.4	6.2	5.8	5.7	5.7	5.7	5.7

Note. The March baseline assumes that discretionary spending equals the OBRA93 cap in 1998, and grows at the projected rate of inflation thereafter. The current deficit projections incorporate the discretionary spending caps for FY1998-FY2002 called for by the Budget Enforcement Act of 1997, and assume discretionary spending growth equal to the rate of inflation in FY2003-FY2007.

Source. Congressional Budget Office, The Economic and Budget Outlook: An Update, September 1997.

which is up $8 billion this year after having declined $13.5 billion last year. The slowdown in spending for health care programs has continued into this year.

The Office of Management and Budget and the Congressional Budget Office released revised budget projections for fiscal 1997-2007 earlier this month. The estimates are in close agreement, projecting deficits of about $35 billion and $55 billion for fiscal years 1997 and 1998 and surpluses beginning in fiscal 2002. These budget projections are much more favorable than those made earlier this year. The improvement results in part from the recently passed reconciliation legislation and from a substantial upward revision to the CBO's estimates of taxable incomes that now closely aligns their forecast with that of OMB. In addition, both agencies have lowered their deficit estimates for technical reasons, mainly to reflect the windfall in tax receipts this year. Information on the sources of the windfall remains limited, but both OMB and CBO assume that only a portion of it is permanent.

The economic assumptions underlying the OMB and CBO budget projections are very similar. Both expect real GDP growth to slow to the area of 2 percent in 1998-2000, which allows unemployment to rise back toward their estimates of the NAIRU.[9] Over the longer run, both agencies expect real GDP to grow at about its potential rate, and the unemployment rate to hold steady. They expect inflation to be about 2-1/2 percent per year as measured by the GDP price index and 2-1/2 to 3 percent per year as measured by the CPI. Both agencies forecast the rate on ten-year Treasury notes to fall to the neighborhood of 5-1/2 percent by the year 2000 in part because of the reduction in the budget deficit.

Although none of the thirteen regular appropriations bills for fiscal 1998 have been signed into law, most analysts expect most of the bills to be in place before the end of the fiscal year on September 30. With the current Budget Resolution calling for roughly $20 billion more in new budget authority than was legislated last year, appropriations have not been seriously hindered for lack of money. However, progress has been slowed by disagreements over a few policy issues, including the methodology for the 2000 census,

9. CBO's estimate of the NAIRU remains at 5.8 percent, and OMB continues to cite 5.5 percent as the middle of its estimated range for the NAIRU. CBO expects potential GDP to increase 2.4 percent per year over 1997-2002 and 2.3 percent per year over 1997-2007 as a whole. OMB expects potential GDP to rise 2.4 percent per year throughout the ten-year period.

pay increases for members of the Congress, and a pilot program of school vouchers for the District of Columbia. A short stopgap spending bill is expected, if necessary, to fund programs without completed appropriations.

State and Local Governments

As reported by the BLS, state and local employment has soared in recent months, with job gains averaging 82,000 per month from May through August. Much of this rise, which compares with an average monthly increase of 17,000 over the two years ended May, was at local educational establishments. Although we anticipated some pickup in school-system hiring this year, the recent acceleration in local educational employment is probably an artifact of difficulties with the seasonal adjustment procedure. Notably, analysts at BLS are testing alternatives that they hope to put in place next March. Above-trend increases during the previous two summers were followed by large declines in September, and we would not be surprised to see a similar pattern this year.[10] Real state and local construction spending has trended down since last winter after having risen moderately, on net, over the preceding two quarters.

According to preliminary findings by the National Conference of State Legislatures, the aggregate general fund balance for fiscal 1997, which ended in June for most states, was 7.3 percent of general fund spending, the highest ratio since 1980, when it stood at 9.0 percent. With forty-seven states reporting, none showed a deficit.[11] Despite having underpredicted their revenues in each of the past four years, states remain conservative in their expectations for the coming year and are forecasting year-end balances to fall to 5.2 percent of spending in fiscal 1998, a ratio still quite high by historical standards. Uses of the unexpected revenues this year went to rainy day funds, one-time outlays, capital projects, and debt reduction, among other things. As in the two prior years, states enacted tax cuts during fiscal year 1997, but the reduction was smaller than in either 1995 or 1996.

Prices

The news on inflation continues to be very favorable. The consumer price index rose 0.2 percent in August, the same pace as in

10. Employment rose 64,000 per month, on average, over the three months ending in August 1996 and fell 34,000 in September. In 1995, employment grew 24,000, on average, over the three summer months and fell 22,000 in September.

11. Alabama, North Carolina, and Wisconsin are not included.

July. On a twelve-month change basis, the CPI has remained in the neighborhood of 2-1/4 percent since May, down from nearly 3 percent in August of last year.

The CPI for energy advanced 1.7 percent in August, pushed up by a 5.4 percent increase in gasoline prices. The price of gasoline jumped because a surprisingly strong late summer driving season pushed up demand for gasoline and some minor refinery disruptions held down supply. As these factors unwind, price pressures are likely to ease. Indeed, recent survey data point to a considerably smaller increase in retail gasoline prices in September. In contrast to gasoline, heating oil prices moved down 0.7 percent further in August. As refiners expanded gasoline production to meet strong demand over the summer, they also boosted output of heating oil, and--in contrast to recent years--stocks are now ample.

Retail food prices advanced 0.4 percent in August. The volatile index for fruit and vegetables jumped 2.8 percent, while other food prices were up only 0.1 percent. Relative to a year earlier, consumer food prices were up 2-1/2 percent, about 1 percentage point less than in the preceding twelve months.

For items other than food and energy, consumer prices increased just 0.1 percent in August and registered a modest twelve-month change of 2-1/4 percent--a deceleration of about 1/4 percentage point from the year-earlier pace. Prices of goods other than food and energy, which have been damped noticeably by the appreciation of the dollar over the past few years, decelerated slightly more than those of "core" services. Among goods, the flat price of new motor vehicles and the decline in the index for used cars have been particularly notably, accounting for about two-thirds of the 0.3 percentage point deceleration in the core CPI over the past twelve months.

Turning to the details of the August rise in the core CPI, the 1 percent drop in apparel prices reflected the slower-than-usual introduction of higher-priced fall and winter merchandise.[12] By contrast, tobacco prices moved up in August in response to increases

12. Fall and winter merchandise tend to enter the sample at a higher price than the outgoing summer merchandise, which tends to be discounted by the end of the summer. Because a greater share of fall and winter items are expected to enter the sample this September than is typical, seasonally adjusted prices should rise; last year, when apparel prices also fell 1.0 percent in August for the same reason, more than half of the decline was reversed in the following month.

CPI AND PPI INFLATION RATES
(Percent change)

	From twelve months earlier		1997		1997	
	Aug. 1996	Aug. 1997	Q1	Q2	July	Aug.
			-Annual rate-		-Monthly rate-	
CPI						
All items (100.0)[1]	2.9	2.2	2.3	1.0	.2	.2
Food (15.9)	3.6	2.5	.3	.9	.3	.4
Energy (7.0)	3.9	.8	7.3	-15.6	-.1	1.7
CPI less food and energy (77.0)	2.6	2.3	2.2	2.9	.2	.1
Commodities (23.4)	1.0	.6	1.0	1.4	-.1	-.3
New vehicles (5.0)	2.1	.1	-.5	-.2	.1	-.1
Used cars (1.3)	-.3	-5.2	1.6	-7.4	-1.1	-.8
Apparel (4.8)	-2.0	1.4	2.2	3.6	.1	-1.0
House furnishings (3.3)	-.2	-1.0	-.7	.5	-.6	-.5
Other Commodities (9.0)	2.4	1.9	1.7	2.8	.1	.1
Services (53.7)	3.3	3.0	2.7	3.5	.3	.2
Shelter (28.2)	3.3	3.0	3.1	3.4	.2	.2
Medical care (6.1)	3.5	2.7	2.6	3.3	.1	.3
Auto finance charges (0.6)	-1.7	-2.1	-1.8	-1.0	1.6	-1.0
Other Services (18.8)	3.4	3.2	2.1	3.9	.4	.1
PPI						
Finished goods (100.0)[2]	3.0	-.2	-.7	-4.0	-.1	.3
Finished consumer foods (23.6)	5.0	-.4	-4.2	.0	-.2	.3
Finished energy (14.7)	6.5	-.7	1.4	-23.2	.1	1.4
Finished goods less food and energy (61.6)	1.5	.0	.4	-.6	-.1	.1
Consumer goods (38.1)	1.6	.2	.5	.0	-.1	.1
Capital equipment (23.6)	1.2	-.4	.1	-1.1	-.1	.0
Intermediate materials (100.0)[3]	.1	-.4	.7	-2.9	-.2	.1
Intermediate materials less food and energy (81.3)	-1.8	.4	.8	.2	.0	.1
Crude materials (100.0)[4]	15.4	-7.1	1.3	-25.7	-.1	.7
Crude food materials (38.0)	23.6	-13.7	-15.5	8.0	.3	-.1
Crude energy (42.4)	27.7	-4.5	15.3	-58.2	-.4	1.7
Crude materials less food and energy (19.6)	-12.1	3.3	12.8	-3.6	-.5	.8

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.

in the prices of smoking products other than cigarettes. In early September, tobacco companies announced wholesale price hikes for cigarettes, which are expected to boost retail tobacco prices further.[13] Prices of services excluding food and energy rose only 0.2 percent in August--a shade less than in recent months--as airfares tumbled. More recently, however, airlines have posted fare increases, which are likely to be picked up in the September CPI.[14]

Other broad measures confirm the recent quiescence of inflation, but none shows the deceleration apparent in the CPI over the past year. Among other expenditure price measures, core PCE prices accelerated 1/4 percentage point over the past four quarters, in contrast to the small deceleration in the core CPI. However, this follows a sharp deceleration in core PCE prices over the preceding year; over the past several years, these measures have shown similar amounts of deceleration. Measures of product prices show low and stable inflation over the past four quarters. Meanwhile, inflation expectations as measured by the Michigan index have moved a bit lower over the past year.

The PPI for capital goods also has been restrained recently, remaining flat last month after having edged lower in July. In August, computer prices fell considerably as the latest round of price cutting by chipmaker Intel began feeding through to computer prices. At earlier stages of processing, prices have remained relatively subdued. The PPI for intermediate materials other than food and energy picked up a little over the past month but still barely registered an increase over the past year. For crude materials less food and energy, prices rose in August; however, since the mid-August pricing date for the PPI, the Journal of Commerce and KR-CRB industrial price indexes have moved lower.

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13. The recent budget deal increased cigarette taxes 10 cents in 2000 and another 5 cents in 2002. As for the broader tobacco settlement, many political hurdles still remain. If approved, such a settlement likely will lead to additional cigarette taxes and price increases over the next decade or so.

14. Full-price (or business) fares, which account for only about one-tenth of the fares sampled in the CPI, increased roughly 5 percent. Discounted leisure fares, which receive most of the weight in the CPI, also increased, although apparently not on all routes. In addition, some analysts have suggested that airlines will soon come back with sales on some leisure fares.

BROAD MEASURES OF INFLATION
(Four-quarter percent change)

	1994 Q2	1995 Q2	1996 Q2	1997 Q2
Product prices				
GDP chain price index	2.3	2.6	2.2	2.1
GDP deflator	2.3	2.6	2.2	2.1
Nonfarm business chain-type price index[1]	2.2	2.6	1.6	1.7
Expenditure prices				
Gross domestic purchases chain-type price index	2.1	2.7	2.0	1.9
Less food and energy	2.4	2.7	1.8	1.9
PCE chain-type price index	2.2	2.9	2.3	2.2
Less food and energy	2.5	2.8	2.0	2.2
CPI	2.4	3.0	2.8	2.4
Less food and energy	2.8	3.0	2.7	2.5
Median CPI	2.8	3.0	3.1	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-Q1	2.9	3.8	2.9	4.2	3.0
Q2	2.3	3.6	2.9	4.0	2.9
Q3	2.1	3.5	2.7	4.0	3.0
Apr.	2.5	3.7	3.0	4.1	
May	2.2	3.7	2.9	4.0	
Jun	2.3	3.5	2.8	4.0	2.9
Jul	2.2	3.4	2.7	4.0	
Aug.	2.2	3.3	2.7	3.9	
Sept.		3.7	2.8		3.0

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

Agricultural Production, Inventories, and Prices

According to the Agriculture Department's latest assessment, farm supply prospects changed little during the month of August. Based on survey evidence that was collected around the start of September, the agency nudged down its 1997 production forecast for wheat but held its forecasts for corn and soybeans essentially unchanged. Changes for other crops were mixed; for example, cotton prospects improved noticeably as a result of favorable weather in Texas and some other states, but tobacco and peanuts were hurt to some extent by dry weather in the Southeast. Production prospects for livestock were raised slightly, as downward revisions to the USDA's current-year forecasts for pork and poultry were more than offset by upward revisions for beef and milk. Summation of these various pieces of physical product data suggests that real aggregate farm output is headed for a moderate increase this year.[15] By our calculations, increases of the past two years have essentially reversed a 1995 decline, returning total farm output to about its 1994 record high.[16]

Inventories of farm crops have increased a bit from the lows of late 1995 and early 1996, and the levels of production and consumption being predicted by the USDA appear likely to result in further moderate accumulation of these inventories over the coming year. In dollar terms, buildups that are predicted for soybeans and wheat should more than offset an anticipated reduction for corn, stocks of which are expected to remain fairly low both in absolute terms and relative to expected levels of usage. In the livestock sector, inventories of cattle appear to be headed for a second year of decline in 1997, but growth in the number of hogs and pigs appears to be picking up.[17]

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15. Valued at 1996 prices, as in the accompanying chart, the rise in farm output this year appears likely to be close to $5 billion.

16. With the crops having made it past mid-September without extensive weather damage, the risk of such major losses in the current growing season would appear to have greatly diminished. Still, in some years at least, significant revisions have been made to the crop estimates in October or November (or even in January of the following year). Over the past ten years, the final estimates for corn and soybeans have differed from the September estimates by roughly 5 percent, on average. Changes for wheat from this point forward have been considerably smaller--less than 1-1/2 percent on average.

17. The national income and product accounts show real farm inventories accumulating at a rapid pace in the first half of 1997. However, these estimates of farm inventory accumulation look high

(Footnote continues on next page)

With production having expanded during the past two years and inventories of farm crops not quite so tight as they were in late 1995 and the first half of 1996, farm prices have fallen back from the peaks of a year ago. According to the USDA, the index of prices received by farmers in August 1997 was about 8-1/2 percent below the level of a year earlier; the index had gone up about 15 percent over the preceding twelve months. Prices of crude foods in the PPI have displayed an even bigger swing, falling 14 percent during the most recent twelve months after a rise of about more than 20 percent from August 1995 to August 1996. Futures prices as of mid-September suggest that declines in crude food prices should persist on a year-to-year basis at least into the early part of 1998 but at a slower rate than over the past year. El Nino--the weather disturbance in the Pacific that is attracting so much attention in the popular press--does not yet appear to have had much impact on prices in the futures markets. The price of the December 1997 contract for corn has changed little, on net, since last spring, when evidence of a new El Nino first began to appear; and the prices of late 1997 contracts for wheat and soybeans have declined.

(Footnote continued from previous page)

compared to estimates that we are deriving from physical product data. In the past, current-year estimates of farm inventory accumulation in the national accounts often have been revised by sizable amounts in the following year in conjunction with annual benchmark revisions.

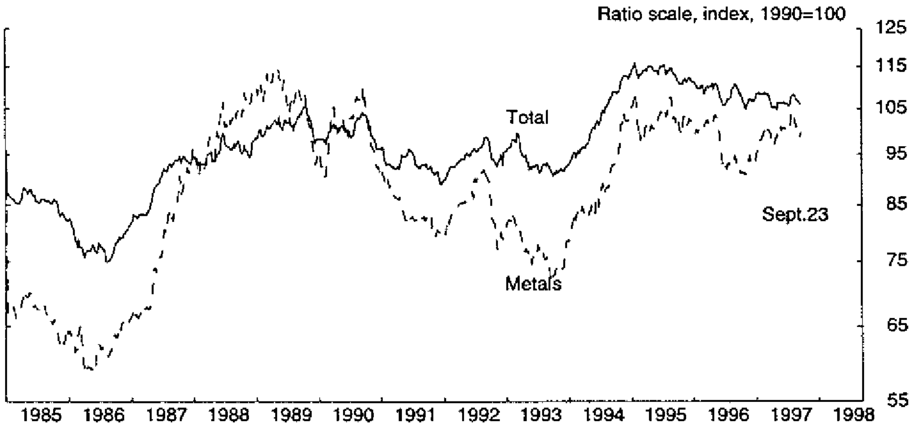
SPOT PRICES OF SELECTED COMMODITIES

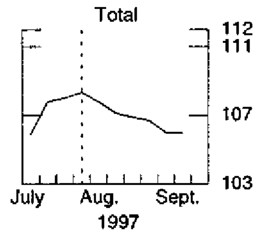
	Current price ($)	Percent change[1]: 1995	1996	Dec. 31 to Aug. 12[2]	Aug. 12[2] to Sept. 23	Memo: Year earlier to date
Metals						
Copper (lb.)	.980	-3.5	-18.3	2.8	-10.9	5.4
Steel scrap (ton)	137.500	-6.6	-13.7	25.8	-6.1	1.1
Aluminum, London (lb.)	.749	-12.9	-9.8	13.8	-4.0	22.0
Precious metals						
Gold (oz.)	320.900	1.7	-5.1	-11.7	-1.6	-16.1
Silver (oz.)	4.655	7.2	-8.8	-7.6	5.6	-4.4
Forest products						
Lumber (m. bdft.)	325.000	-14.4	66.0	-14.5	-8.5	-21.7
Plywood (m. sqft.)	335.000	-6.1	1.6	9.5	-2.9	-8.7
Petroleum						
Crude oil (barrel)	18.680	16.8	25.9	-21.5	.5	-16.8
Gasoline (gal.)	.593	7.7	24.3	.7	-12.8	-.8
Fuel oil (gal.)	.543	22.6	16.1	-22.7	-.2	-22.0
Livestock						
Steers (cwt.)	67.000	-5.7	.0	-3.0	4.7	-6.9
Hogs (cwt.)	49.000	27.5	34.1	.0	-10.9	-12.5
Broilers (lb.)	.540	10.7	12.4	3.2	-16.4	-9.6
U.S. farm crops						
Corn (bu.)	2.555	57.4	-29.5	1.6	-1.4	-19.8
Wheat (bu.)	3.783	24.0	-16.6	-16.7	-.1	-19.9
Soybeans (bu.)	6.380	29.0	-7.1	4.1	-10.9	-19.4
Cotton (lb.)	.716	-8.1	-10.9	2.2	-1.1	-5.6
Other foodstuffs						
Coffee (lb.)	2.100	-39.1	43.2	57.4	-1.9	78.0
Memo:						
JOC Industrials	106.000	-1.7	-3.7	.9	-2.1	-2.8
JOC Metals	99.700	-1.8	-7.7	10.8	-3.8	8.1
KR-CRB Futures	241.460	3.3	-2.6	2.1	-.7	-1.6
KR-CRB Spot	ND	-3.5	1.0	2.1	-1.7	-2.0

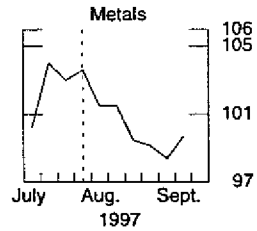
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the August Greenbook.

Commodity Price Measures

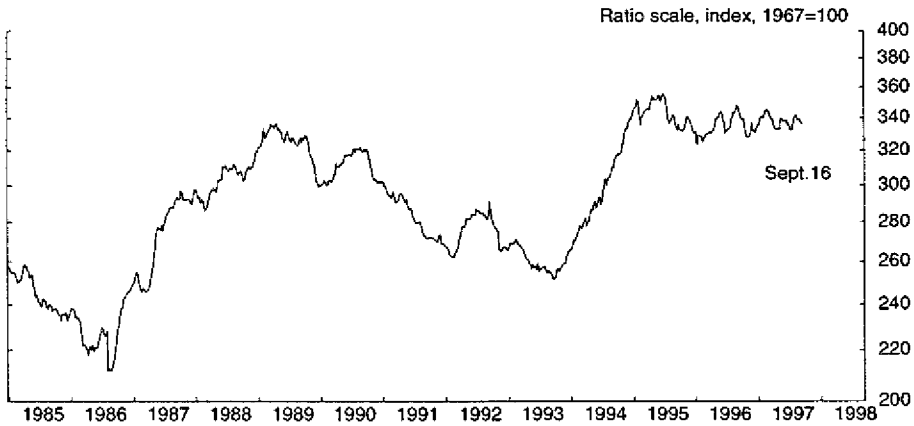
Journal of Commerce Index

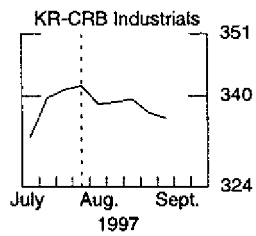




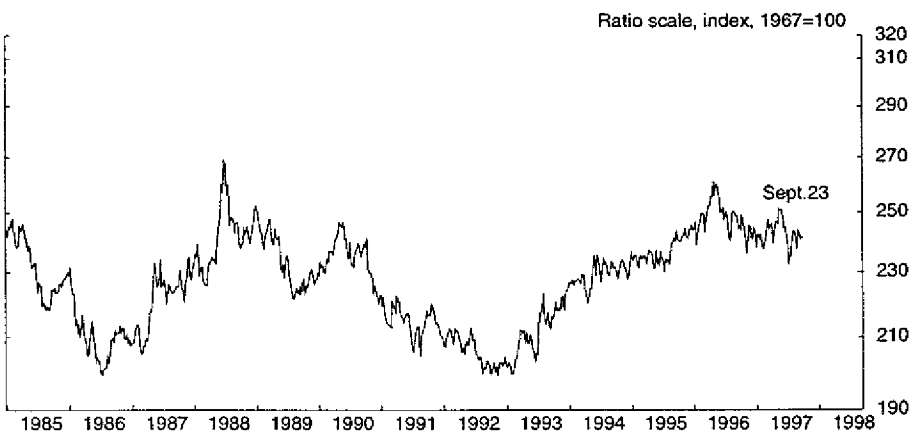


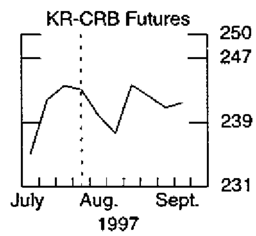
KR-CRB Spot Industrials





KR-CRB Futures

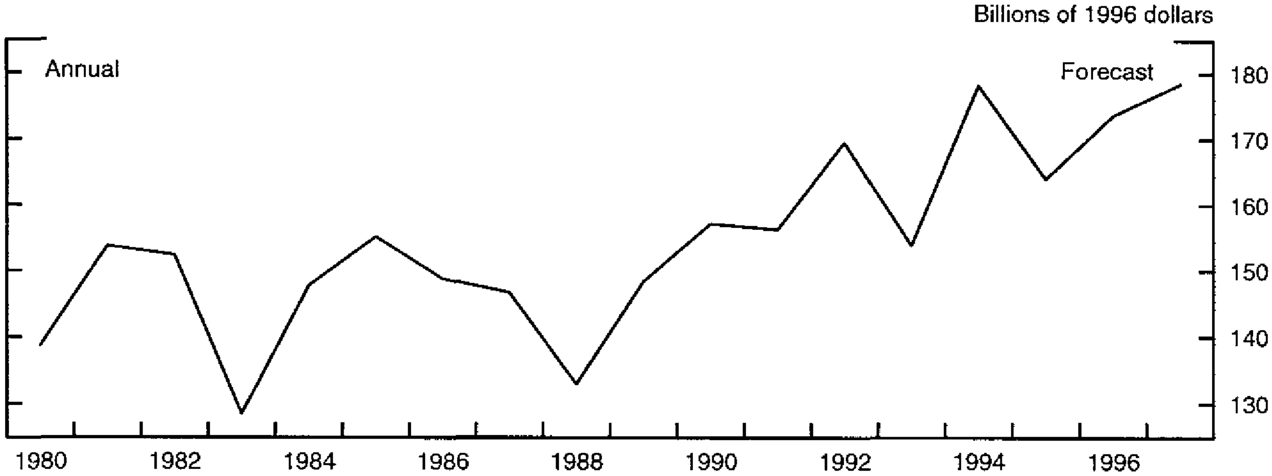




Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the KR-CRB spot price index consists entirely of industrial commodities, 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.

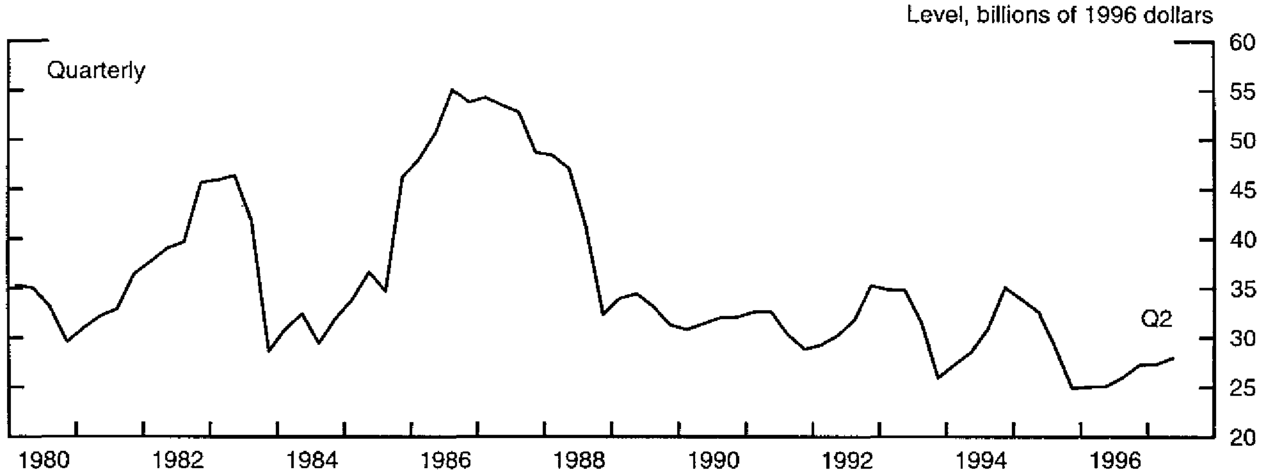
Agriculture

Farm Output



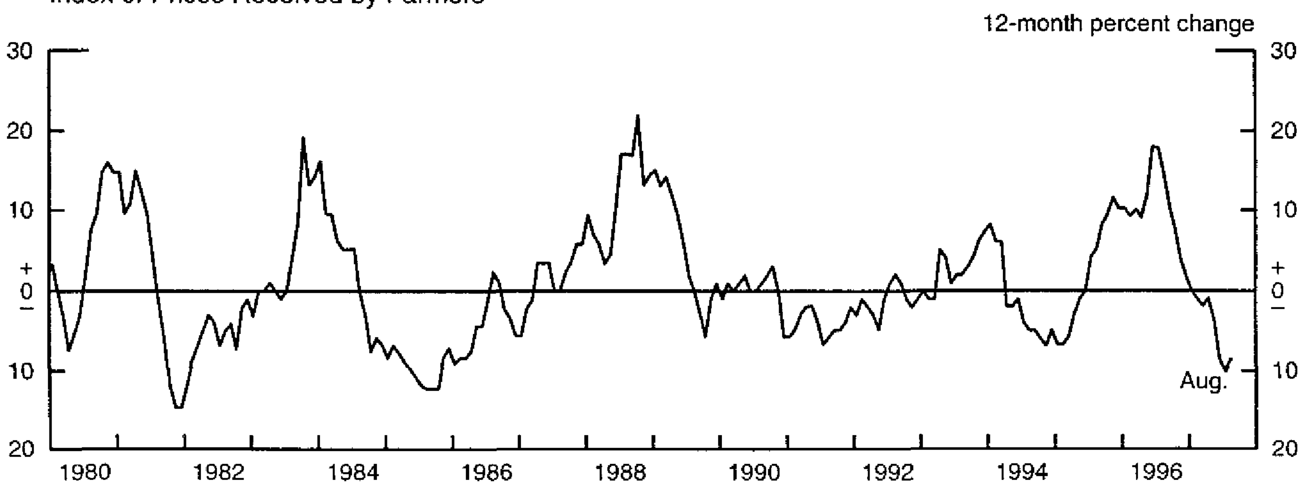
Note. FRB aggregation for 27 farm commodities; 1997 observation is based on USDA forecasts.

Real Crop Inventories



Note. FRB aggregation for wheat, feed grains, soybeans and cotton.

Index of Prices Received by Farmers



DOMESTIC FINANCIAL DEVELOPMENTS

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

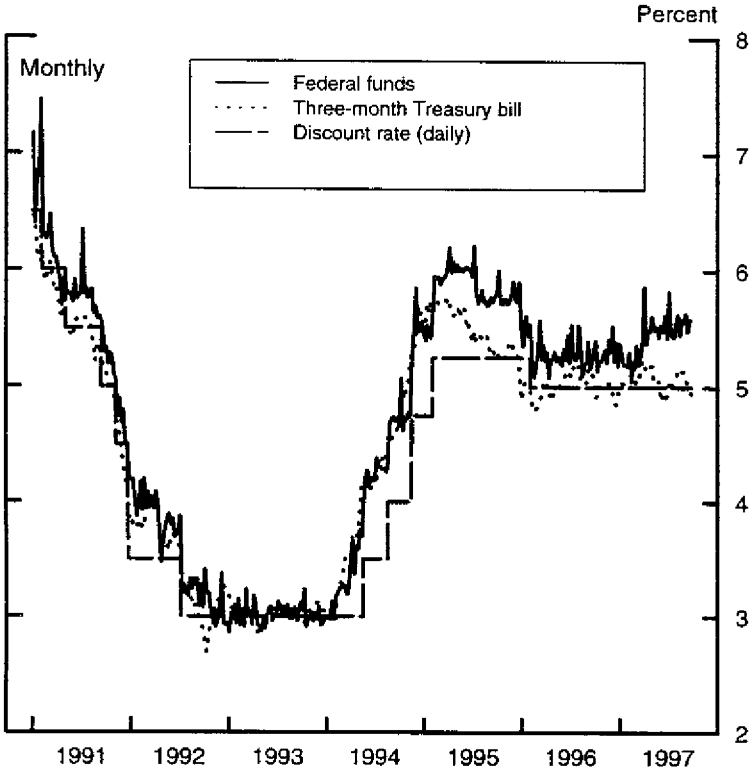
Instrument	1997 Jan. 2	1997 Mar. low	1997 FOMC * Aug. 19	1997 Sep. 23	Change to Sep. 23, from: Jan. 2	Change to Sep. 23, from: Mar. low	Change to Sep. 23, from: FOMC * Aug. 19
Short-term rates							
Federal funds [2]	5.79	5.27	5.58	5.57	-.22	.30	-.01
Treasury bills [3]							
3-month	5.05	5.04	5.13	4.89	-.16	-.15	-.24
6-month	5.14	5.17	5.15	5.01	-.13	-.16	-.14
1-year	5.28	5.37	5.21	5.19	-.09	-.18	-.02
Commercial paper [4]							
1-month	5.48	5.40	5.54	5.49	.01	.09	-.05
3-month	5.47	5.45	5.56	5.49	.02	.04	-.07
Large negotiable CDs [3]							
1-month	5.39	5.32	5.53	5.56	.17	.24	.03
3-month	5.42	5.42	5.58	5.59	.17	.17	.01
6-month	5.50	5.58	5.68	5.67	.17	.09	-.01
Eurodollar deposits [5]							
1-month	5.38	5.31	5.50	5.56	.18	.25	.06
3-month	5.44	5.44	5.56	5.56	.12	.12	.00
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	6.13	6.25	5.94	5.89	-.24	-.36	-.05
10-year	6.54	6.56	6.21	6.10	-.44	-.46	-.11
30-year	6.75	6.83	6.53	6.38	-.37	-.45	-.15
U.S. Treasury 10-year indexed note	n.a.	3.36	3.53	3.57	n.a.	n.a.	.04
Municipal revenue (Bond Buyer) [6]	5.96	5.97	5.71	5.58	-.38	-.39	-.13
Corporate-A utility, recently offered	7.64	7.97	7.64	7.45	-.19	-.52	-.19
High-yield corporate [7]	9.72	9.49	9.15	9.03	-.69	-.46	-.12
Home mortgages [8]							
FHLMC 30-yr fixed rate	7.64	7.84	7.54	7.38	-.26	-.46	-.16
FHLMC 1-yr adjustable rate	5.57	5.54	5.56	5.53	-.04	-.01	-.03

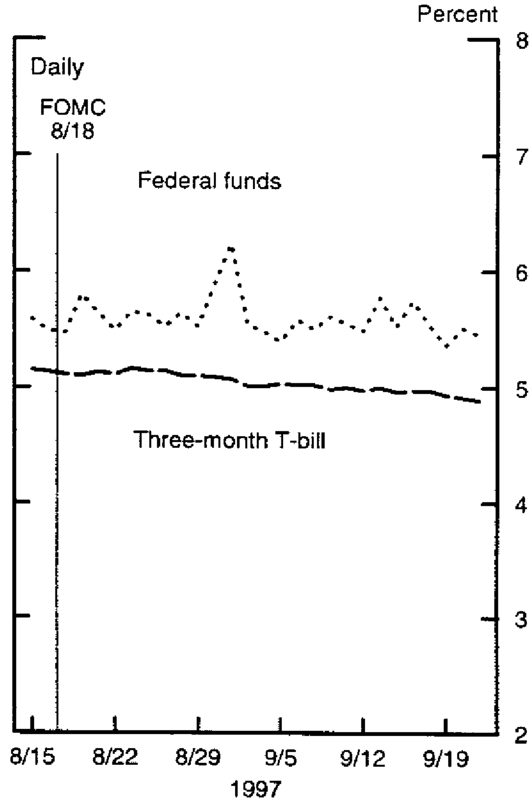
Stock exchange index	Record high Level	Record high Date	1997 Jan. 2	1997 FOMC * Aug. 19	1997 Sep. 23	Percentage change to Sep. 23, from: Record high	Percentage change to Sep. 23, from: Jan. 2	Percentage change to Sep. 23, from: FOMC * Aug. 19
Dow-Jones Industrial	8259.31	8/6/97	6441.49	7803.36	7970.06	-3.50	23.73	2.14
S&P 500 Composite	960.32	8/6/97	735.01	912.49	951.93	-.87	29.34	4.32
NASDAQ (OTC)	1697.36	9/23/97	1279.70	1569.52	1697.36	.00	32.64	8.15
Russell 2000	449.42	9/23/97	357.96	408.73	449.42	.00	25.55	9.96
Wilshire	9222.33	9/22/97	7146.80	8708.58	9195.63	-.29	28.67	5.59

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 September 24, 1997.
3. Secondary market.
4. As of September 2, 1997, commercial paper rates are those collected by the Depository Trust Company; prior rates are averages of offering rates at several large dealers.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. Most recent observation based on one-day Thursday quote and futures market index changes.
7. Merrill Lynch Master II high-yield bond index composite.
8. Quotes for week ending Friday previous to date shown.
* Figures cited are as of the close on August 18, 1997.

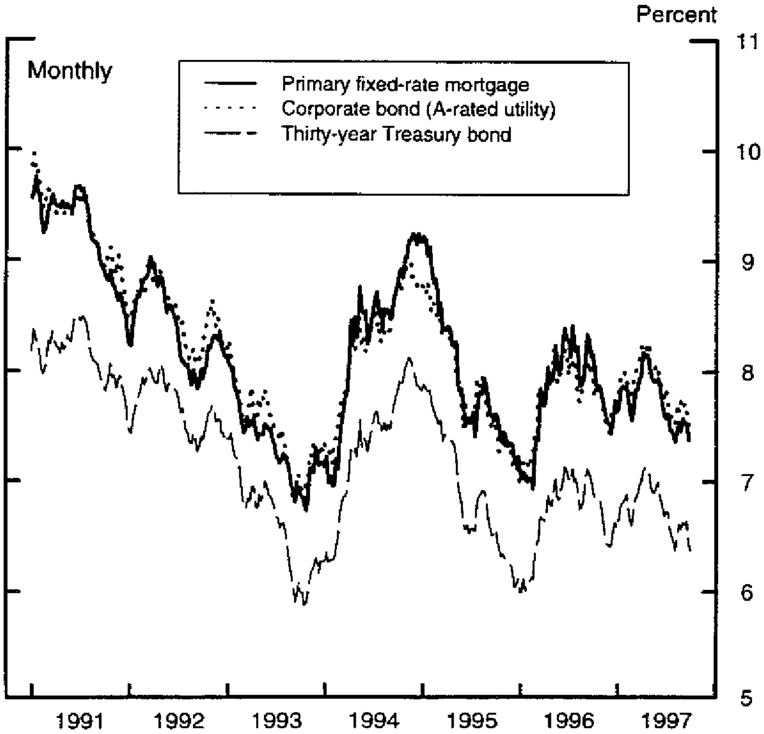
Selected Interest Rates

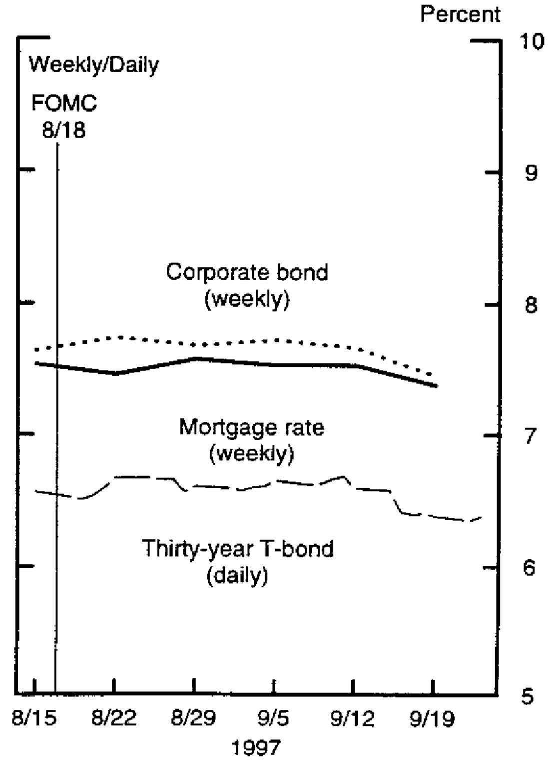
Short-Term





Long-Term





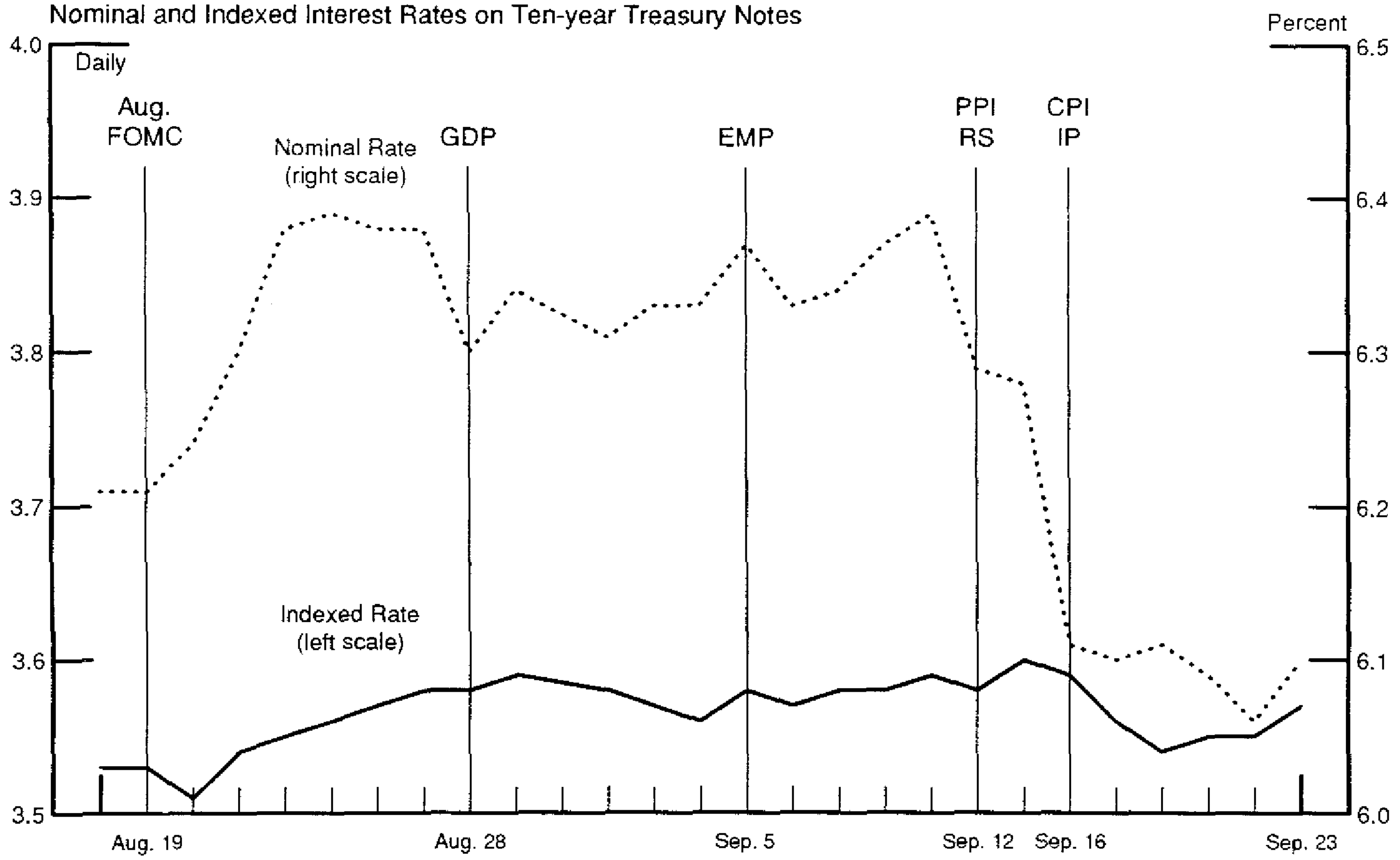
Yields on intermediate- and long-term securities moved higher after the August FOMC meeting. News pointing to relatively robust economic growth, along with the minutes of the July meeting that suggested a fairly strong bias toward tightening by the FOMC, led market participants to see somewhat higher odds on tighter monetary policy over the intermediate term. The rate increases were subsequently reversed, however, as data for August implied some moderation in growth and surprisingly tame inflation. On balance, yields on Treasury notes and bonds are down between 5 and 15 basis points since the last FOMC meeting.

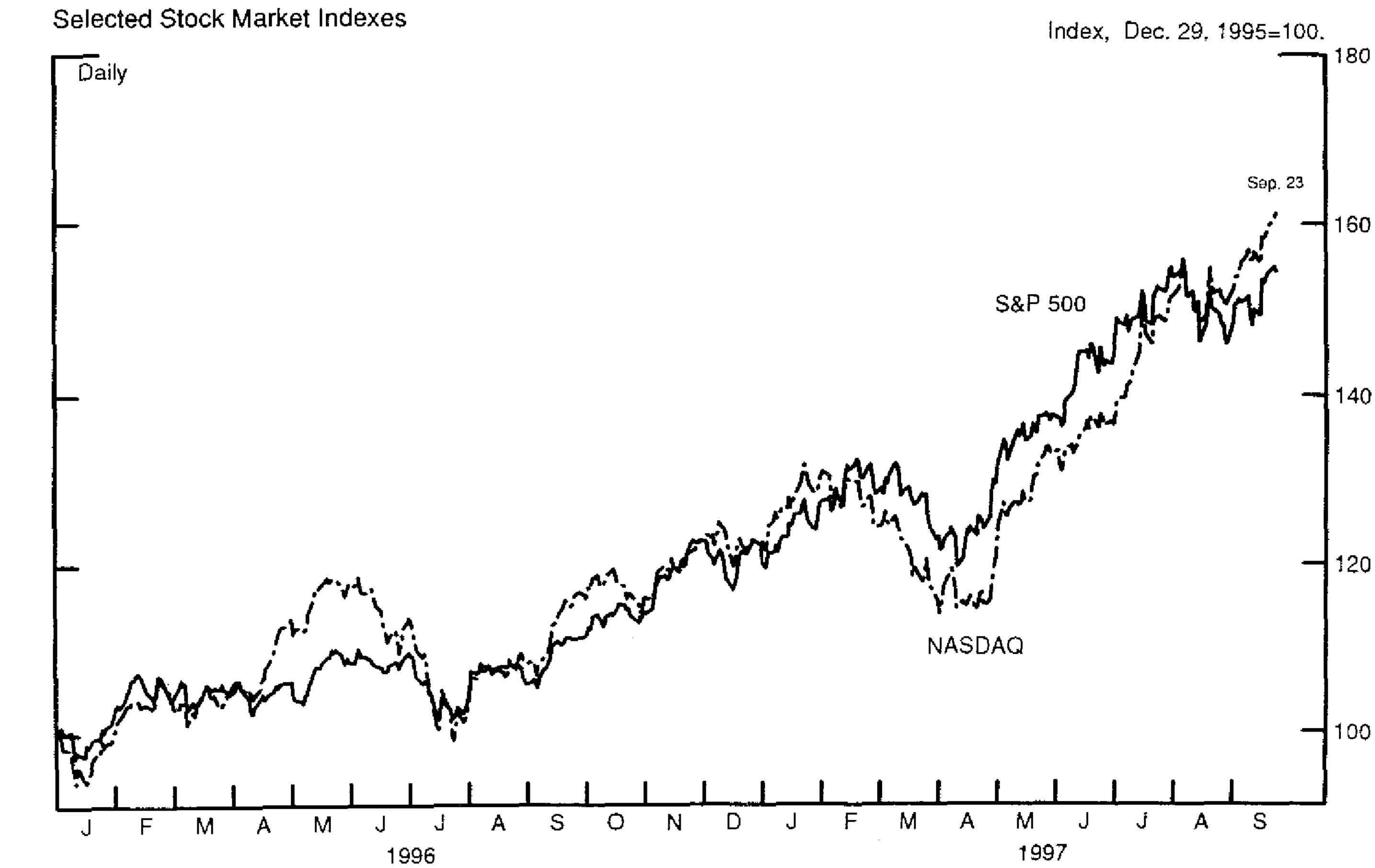
Money market rates show mixed changes, with private rates holding steady while the three-month Treasury bill yield dropped 24 basis points. The Treasury has not gone as far as market participants had expected in boosting the issuance of three-month bills, and the relatively tight supply has helped push down yields on these issues.

Stock markets remained volatile over the intermeeting period. Prices of the larger-capitalization stocks had fluctuated below July peaks until quite recently, when the Dow Industrials and S&P 500 stocks rallied strongly as bond yields fell. Meanwhile, the NASDAQ and Amex composite indexes posted new highs in September; and prices of small-capitalization stocks soared, pushing the Russell 2000 index up nearly 10 percent to a record high.

Borrowing by nonfinancial businesses has remained strong in the third quarter. Issuance of corporate bonds has been brisk, though down some from the surge in July, and growth of bank loans to businesses has jumped to double digits. In the household sector, growth of consumer credit perked up in July from June, but year-over-year increases have been trending down, and consumer lending by banks remained damped in August and early September. Mortgage debt indicators point to continued moderate growth in the third quarter. Federal borrowing has been light as the Treasury has chosen to finance the federal deficit for the third quarter largely by drawing down its sizable midyear cash balance. Relative to the past few years, state and local governments have increased their net issuance of long-term debt to fund new capital outlays. M2 posted a rapid advance in August, about double the pace in June and July; the acceleration owed largely to heavy inflows to retail money market

Selected Financial Market Quotes





funds that likely were diverted from equity mutual funds when stock prices slumped in mid-August.

Business Finance

Gross issuance of bonds by nonfinancial corporations slowed to a $16 billion rate in August, below the record pace in the June-July period but still above the average rate earlier in the year (table). Data for the first three weeks of September suggest that issuance has remained near the pace of August. Offerings of investment-grade securities continued to be bolstered by funding for several large mergers and acquisitions. Also, some proceeds from recent bond offerings were used to pay down short-term debt, which sharply slowed the growth in outstanding commercial paper in August after two months of rapid expansion. But nonfinancial commercial paper resumed its growth in September as companies financed merger activities and corporate tax payments.

Speculative-grade bond issuers--mainly in the high-technology, telecommunications, and oil sectors--continued to take advantage of relatively favorable interest rates to finance capital expenditures. As a result, junk bond issuance has accounted for nearly half of total nonfinancial bond volume, somewhat above the high share recorded in the late 1980s (chart, bottom left). Meanwhile, strong investor demand has held spreads in the junk bond market near historic lows. Inflows to junk bond mutual funds have remained strong. Also, junk bonds' appeal to more conservative types of institutional lenders has grown through repackaging into collateralized bond obligations.

Recent data continue to paint a rosy picture for overall business credit quality. The dollar value of Moody's downgrades in July and August was small and about matched upgrades. Moreover, Moody's listing of companies currently under review is very short, implying little further net change in ratings over the next few months. No defaults of junk bonds were reported in August (chart, bottom right), keeping the default rate over the past few months near the lowest level in almost a decade. Business failures have risen this year, but they remain well below the pre-1994 rate. Over the past several months, failures were lifted by bankruptcies of some firms in the retail sector. These bankruptcies were not a surprise, however, as the companies, which included Montgomery Ward and Levitz Furniture, had been having difficulties for several years.

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

Type of security	1995	1996	1997				
			Q1	Q2	June	July	Aug.
All U.S. corporations	47.7	58.4	61.4	68.3	95.3	75.4	49.5
Stocks[1]	6.1	10.2	9.9	9.0	11.8	9.6	4.9
Bonds	41.6	48.2	51.4	59.4	83.5	65.7	44.6
Nonfinancial corporations							
Stocks[1]	4.4	6.7	4.9	4.3	6.0	5.7	2.8
Initial public offerings	1.7	2.9	1.1	1.8	3.4	1.9	1.2
Seasoned offerings	2.7	3.8	3.8	2.5	2.6	3.7	1.6
Bonds	10.8	12.5	13.3	17.4	20.8	28.2	16.1
By rating, sold in U.S.[2]							
Investment grade	6.5	6.3	5.7	7.0	6.8	13.6	8.0
Speculative grade	3.0	4.8	6.2	8.9	13.4	11.6	6.9
Public	2.0	2.3	2.7	1.5	1.5	1.3	.7
Rule 144A	1.1	2.5	3.6	7.4	11.9	10.3	6.2
Financial corporations							
Stocks[1]	1.7	3.5	5.0	4.7	5.9	4.0	2.1
Bonds	30.8	35.8	38.1	41.9	62.7	37.5	28.5

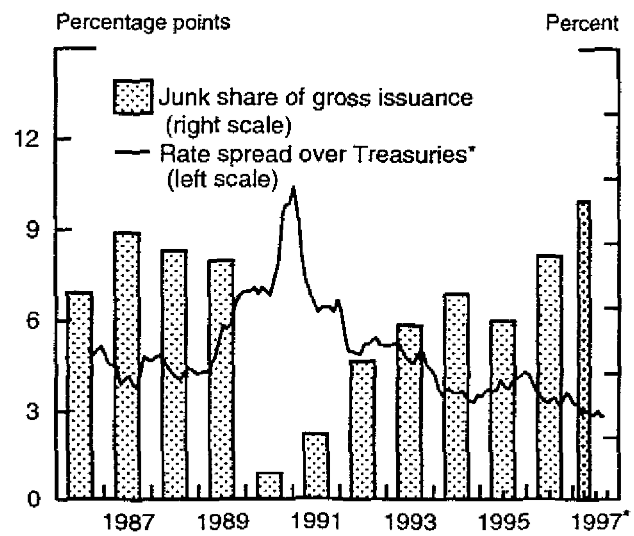
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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.

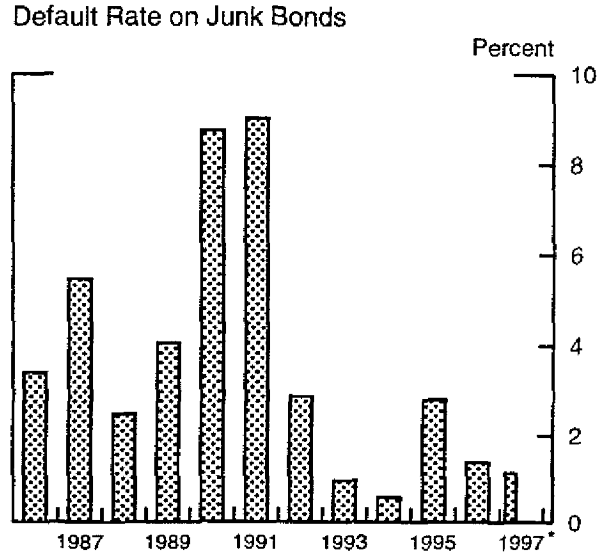
Nonfinancial Corporations

Junk Bonds



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

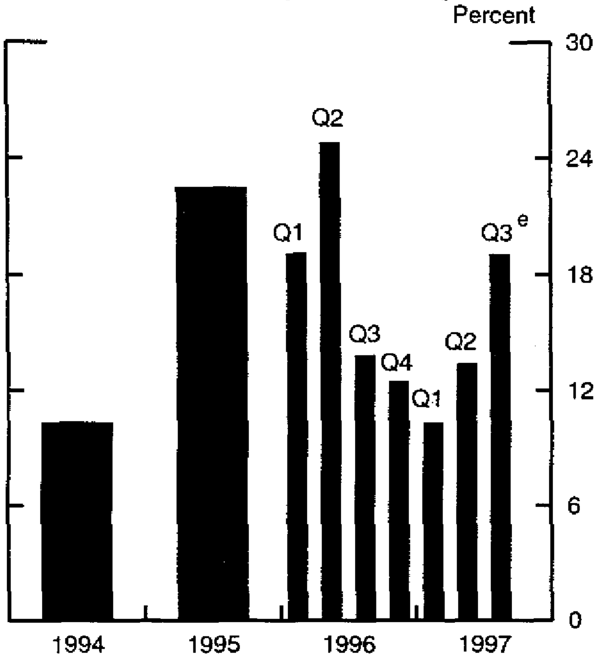
Default Rate on Junk Bonds



*January through August at an annual rate.
Source. Edward Altman, CS First Boston.

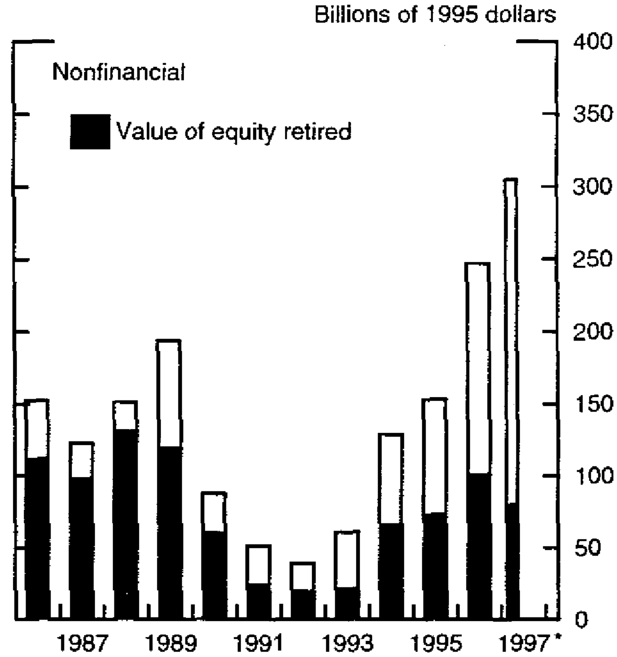
Corporate Finance

IPOs: Average First-Day Price Change



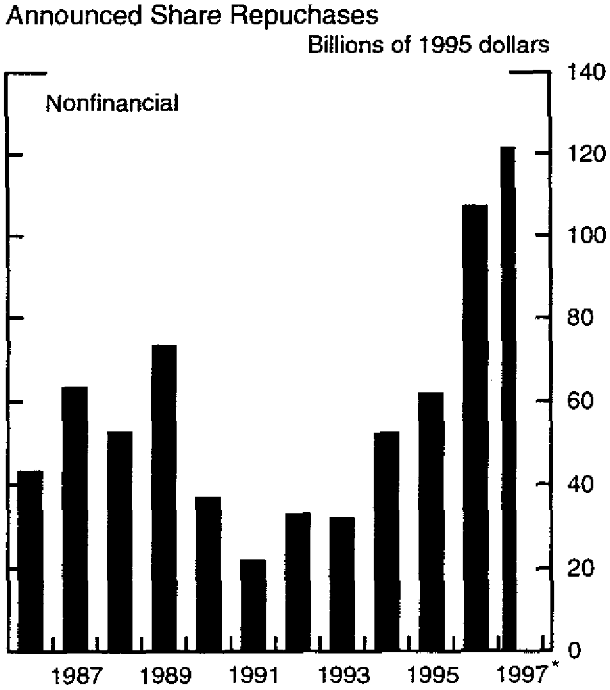
e=estimate.

Volume of Merger Activity



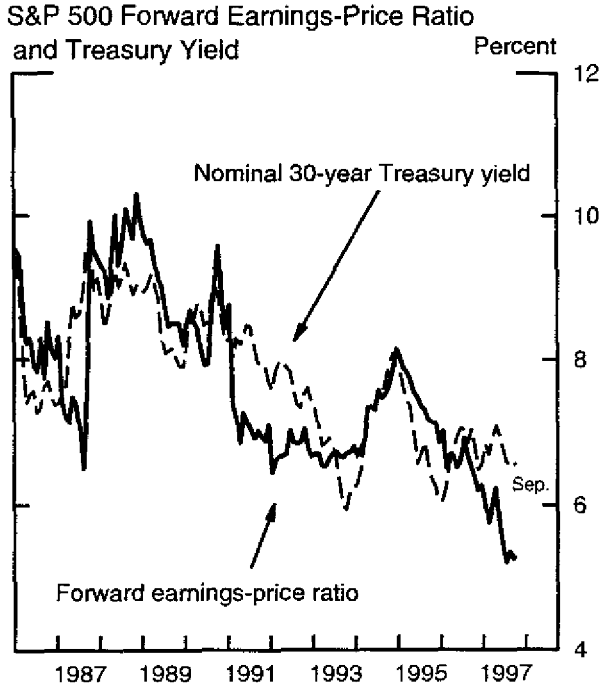
*January through August at an annual rate.
Source. Securities Data Company.

Announced Share Repuchases



*January through August at an annual rate.
Source. Securities Data Company.

S&P 500 Forward Earnings-Price Ratio and Treasury Yield



Gross equity issuance in August was less than $3 billion, but the summer lull in issuance appears to have ended in recent weeks. In August and the first half of September, first-day returns to IPOs were the highest in over a year, and fewer new issues, on net, sold at a discount to their filing prices (chart, upper left). Strong demand for new issues encouraged additional firms to file registration statements with the Securities and Exchange Commission in August, thereby boosting the inventory of prospective equity issues for the fall.

Overall, nonfinancial corporations continue to retire a greater volume of equity than they issue, as mergers and share repurchases remain brisk. The total dollar amount of equity retired through mergers likely will fall short of last year's near-record volume but only because some of this year's largest deals have been structured as stock swaps that result in no retirement of equity (chart, top right). Recent announcements by corporations point to a heavy volume of share repurchases through the rest of this year (chart, lower left).

After soaring to record highs in early August, the S&P 500 index fell sharply and finished the month down 6 percent--its largest monthly drop in seven years. Investors were perhaps a bit skittish after the large July gains in stock prices pushed the expected earnings yield on S&P stocks further below the thirty-year bond yield (chart, lower right). Shares of large multinational corporations were especially vulnerable amid growing concerns that their third-quarter earnings would be limited by weaker sales abroad, owing to the strengthened dollar and currency devaluations in Southeast Asia. Subsequently, in September, prices recovered the lost ground as bond yields fell, and the S&P is now up nearly 5 percent for the intermeeting period.

Meanwhile, shares of smaller companies have fared consistently well since mid-August. The Russell 2000 index of smaller capitalization firms has risen almost 10 percent over the intermeeting period, and the Amex, NASDAQ, and Russell 2000 indexes posted successive new record highs. Still, small-capitalization stocks have risen less, on balance, this year than large-capitalization stocks.

Household Sector

Growth of household debt appears to have slowed in recent months. Although total consumer credit rebounded to a 6-1/2 percent

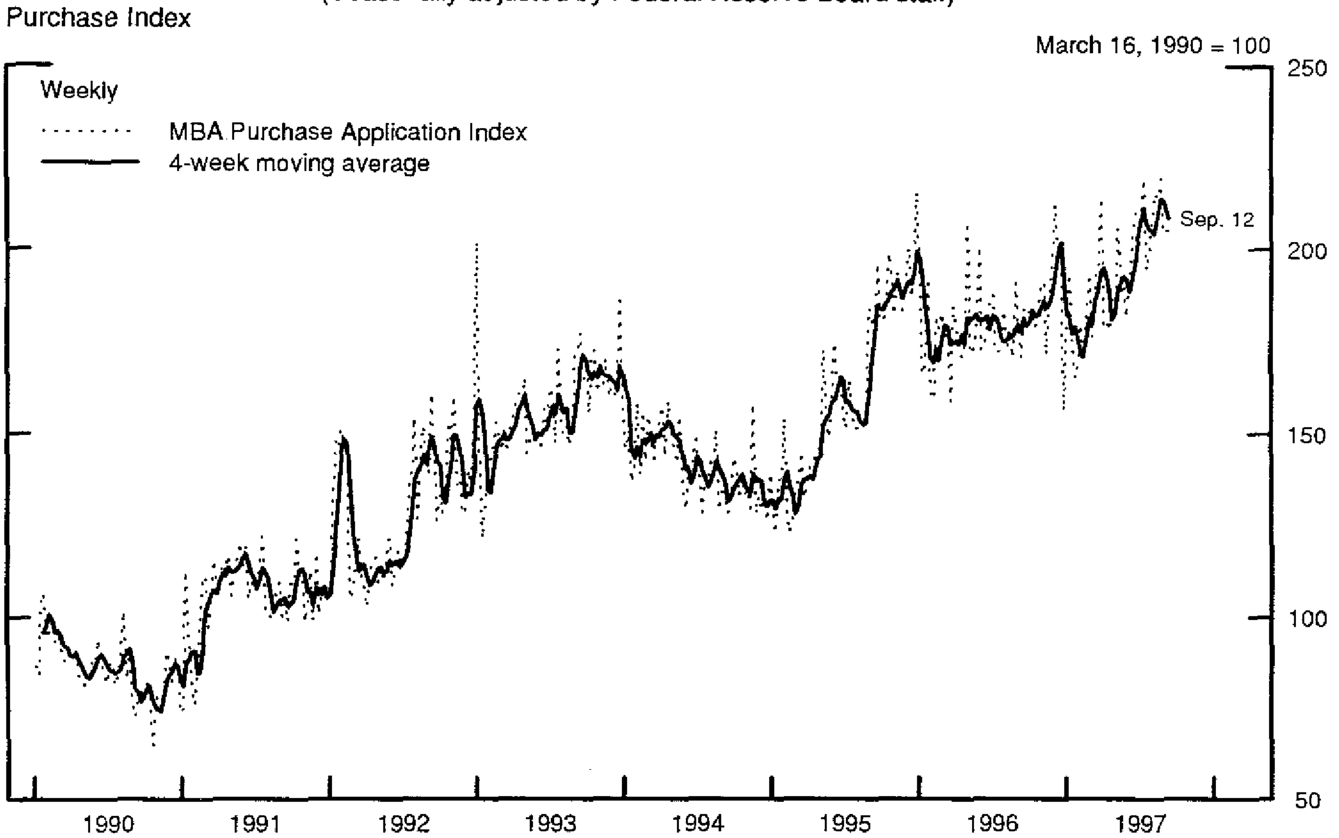
Consumer Credit

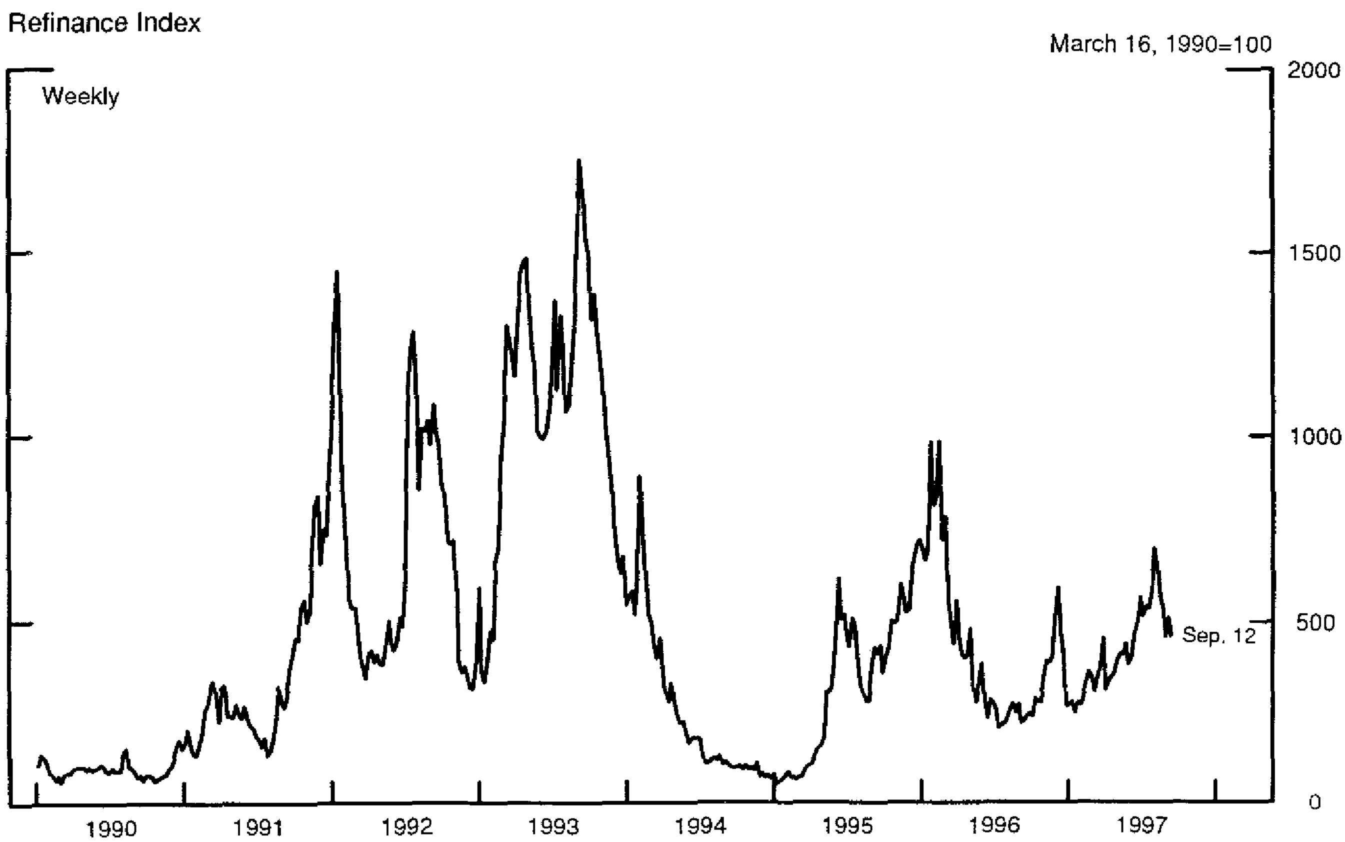
	1995	1996	1996 Q4	1997 Q1	1997 Q2	1997 May	1997 Jun	1997 Jul[p]
Credit outstanding, end of period								
Growth rates (percent, SAAR)								
Total	14.1	7.6	3.4	7.3	4.3	2.7	0.8	6.4
(Previous)	*(14.1)*	*(7.6)*	*(3.4)*	*(7.3)*	*(3.8)*	*(2.5)*	*(0.0)*	
Auto	11.0	7.8	3.5	0.1	5.0	0.4	2.8	10.9
Revolving	21.2	12.7	10.9	9.2	5.5	4.1	5.6	12.5
Other	8.5	-0.3	-8.5	13.3	1.6	3.2	-9.8	-9.7
Levels (billions of dollars, SA)								
Total	1100.7	1184.0	1184.0	1205.5	1218.6	1217.8	1218.6	1225.1
Auto	362.1	390.3	390.3	390.4	395.3	394.4	395.3	398.9
Revolving	441.9	498.0	498.0	509.5	516.5	514.1	516.5	521.9
Other	296.8	295.7	295.7	305.6	306.8	309.3	306.8	304.3
Interest rates[1] (annual percentage rate)								
Commercial banks								
New cars (48 mo.)[2]	9.6	9.0	9.0	8.9	9.2	9.2	n.a.	n.a.
Personal (24 mo.)[2]	13.9	13.5	13.6	13.5	13.8	13.8	n.a.	n.a.
Credit cards[3]	16.0	15.6	15.6	15.9	15.8	15.8	n.a.	n.a.
Auto finance companies[4]								
New cars	11.2	9.8	9.8	7.6	8.0	7.8	7.6	6.7
Used cars	14.5	13.5	13.6	13.1	13.4	13.5	13.6	13.5

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.

MBA Indexes of Mortgage Loan Applications

(Seasonally adjusted by Federal Reserve Board staff)





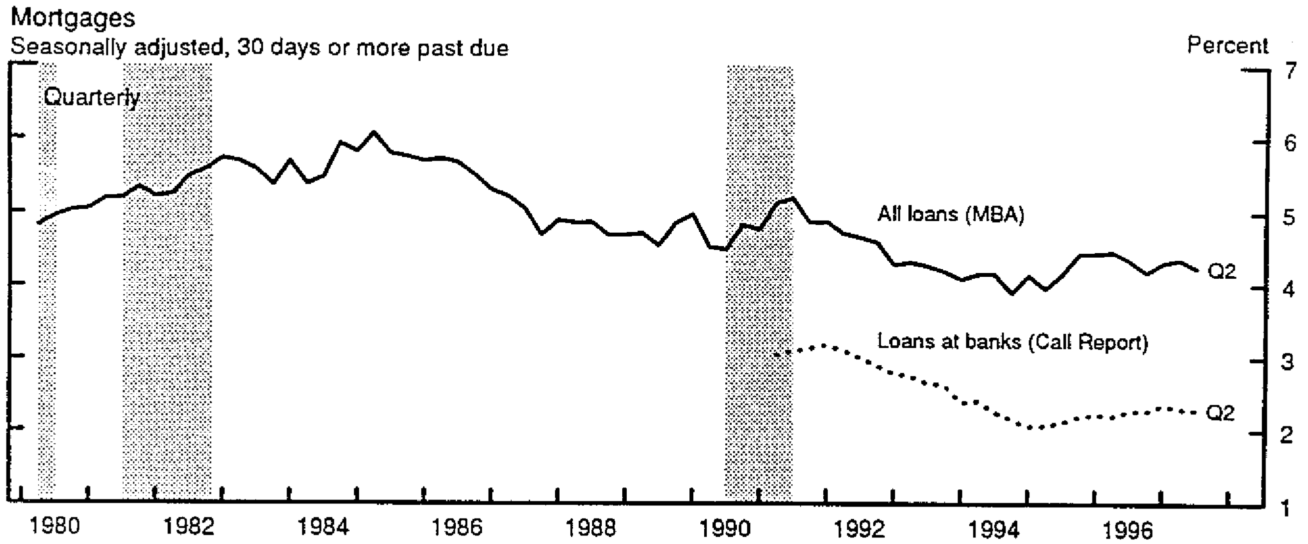
annual rate in July, the rise followed much slower growth in previous months (table), and bank data suggest growth remained sluggish in August and early September. Expansion of mortgage debt also slowed in the second quarter, but more recent indications point to a return to the moderate pace of earlier in the year.

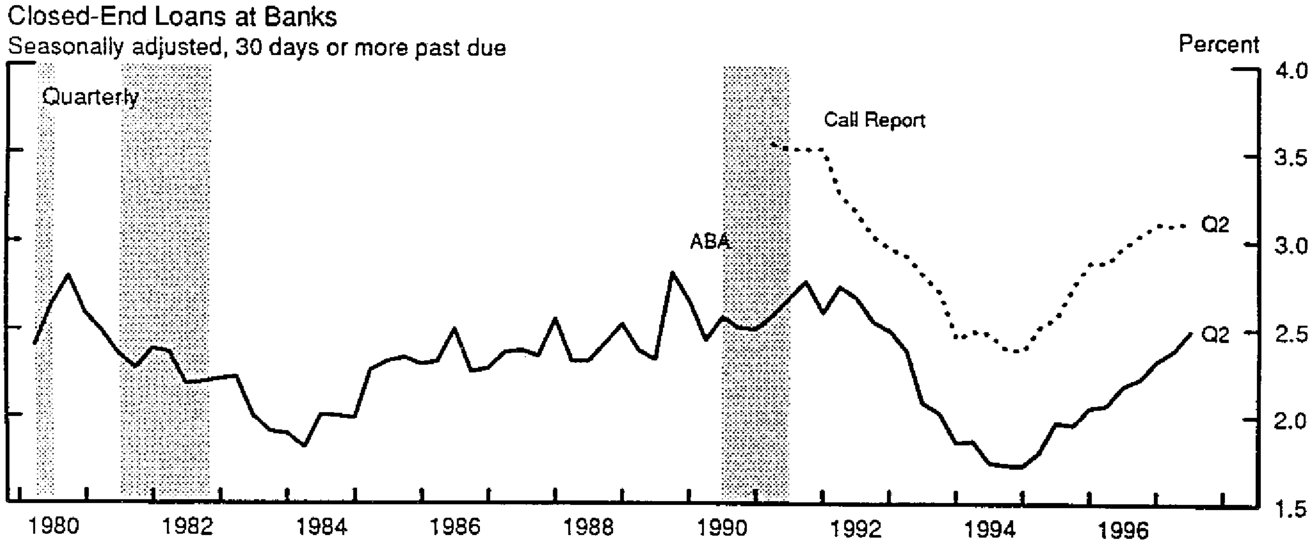
Interest rates on new mortgage loans have declined about 15 basis points, on net, since the August FOMC meeting. With mortgage rates around 7-1/2 percent on average in recent months, many households apparently have found it desirable to finance a home purchase. For instance, the Mortgage Bankers Association (MBA) index of applications for home purchase loans remains near its highest level (chart, upper panel), while the refinancing index has remained noticeably below its recent peak (lower panel). The MBA purchase index may overstate somewhat the current level of home sales, because lower long-term mortgage rates in recent months have led to an increase in the fixed-rate share of total loan originations. Compared with other lenders, mortgage banking firms originate a higher proportion of fixed-rate loans and are somewhat overweighted in the MBA survey. However, MBA staff believe that any overstatement is not large enough to be materially misleading.

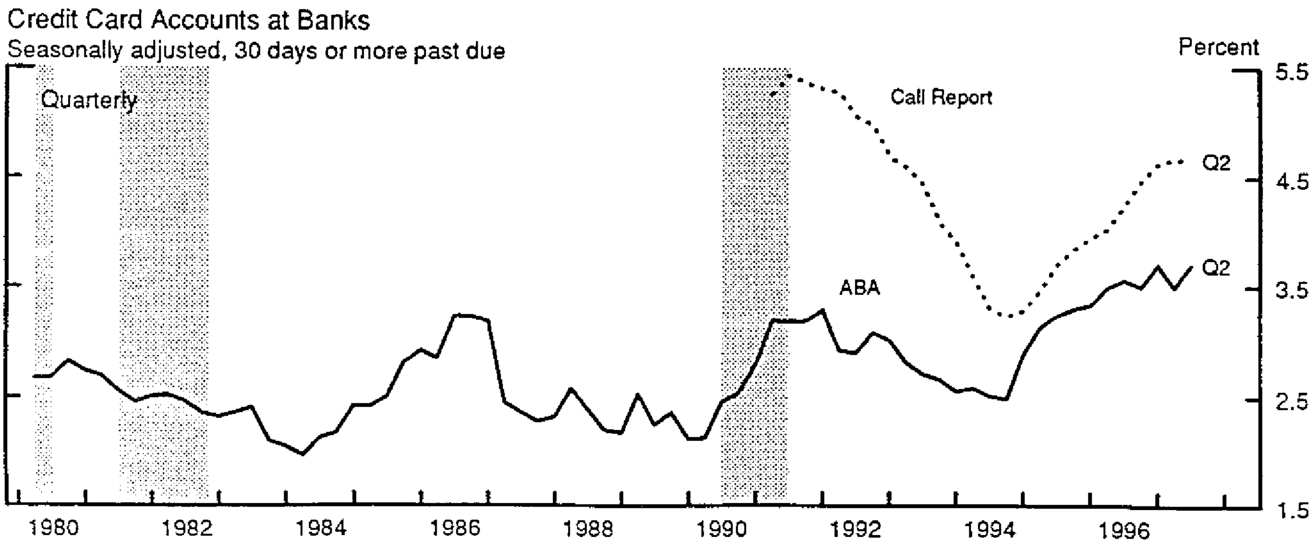
The latest information on household credit quality suggests that the deterioration of the past couple of years may be abating. According to the MBA loan delinquency survey, mortgage delinquencies fell in the second quarter by about the same amount that they had risen in the previous two quarters, putting the mortgage delinquency rate near its average of the past five years (chart, upper panel). Also, Call Report data indicate that the already low percentage of problem real estate loans at banks declined in the second quarter. The net charge-off rate for all real estate loans at banks also remained extremely low.

Problems with consumer loans seem to be stabilizing, though the picture is still mixed. According to Call Report data, the steady uptrend in bank delinquencies on closed-end consumer loans, such as auto loans, appears to have leveled off in the first half of 1997, although the comparable ABA series continued to rise (chart, middle panel). At the captive auto finance companies, the delinquency rate edged lower in the second quarter from a historical high, then dropped sharply further in July. Call Report data indicate that the delinquency rate on bank credit cards was about unchanged in the

Delinquency Rates on Household Loans







Note. The MBA and ABA series are by number of loans; the Call Report series are by dollar volume.

first half of the year, a reading broadly consistent with data from the American Bankers Association (ABA) (chart, lower panel).

Government Finance

Treasury borrowing from the public in the third quarter should total only about $7 billion (table, top panel), and the Treasury's $51 billion midyear cash balance likely will be drawn down to less than half that size at this quarter's end. Recent marketable borrowing needs have been more than met with coupon issues--including five-year indexed notes auctioned in July. Weekly bill auctions have been trimmed by $1 billion, and with essentially no new net issuance, the relative "shortage" of bills continues--keeping bill rates low relative to other yields.

The rally in bond markets earlier in the quarter spurred a pickup in advance refundings of municipal bonds in July and August. Some of the proceeds from these issues were placed in nonmarketable Treasury issues (SLGS). Municipalities wishing to defease outstanding and noncallable bonds could also meet their need for Treasuries in the strips market, where gross purchases increased to more than $4 billion in August, double the pace of earlier months this year.

Government-sponsored enterprises have continued to tap global markets for funds. For example, the Federal National Mortgage Association (Fannie Mae) has recently issued $750 million in global bonds denominated in Australian dollars, and the Federal Home Loan Mortgage Corporation (Freddie Mac) announced that it plans to create an overseas investment fund aimed at making its mortgage-backed securities more attractive to European institutional investors.

The Student Loan Marketing Association (Sallie Mae) was converted to a private holding company (SLM Holding Corporation) in August. SLM is a private corporation, not a government-sponsored enterprise, and Sallie Mae has now become a wholly owned subsidiary of the holding company. Sallie Mae, as a separate entity, will be dissolved by September 30, 2008.

Gross issuance of long-term municipal debt totaled $15 billion in August, a bit below its July and second-quarter pace (table). As in July, total offerings were bolstered in August by a hefty volume of refunding issues. Yields on tax-exempt bonds fell in August to about 30 basis points below levels of last spring, and lately they have edged even lower, creating conditions that might stimulate additional refunding volume.

TREASURY FINANCING
(Billions of dollars; total for period)

Item	1997 Q1	Q2	Q3[e]	July	Aug.	Sep.[e]
Total surplus/deficit (-)	-52.0	100.1	--	-25.6	-34.6	--
Means of financing deficit						
Net cash borrowing and repayments (-)	48.0	-69.2	--	-1.4	30.3	--
Nonmarketable	4.0	1.9	--	-1.8	2.4	--
Marketable	44.0	-71.1	6.7	.4	27.9	-21.5
Bills	7.9	-81.4	-1.1	1.8	15.7	-18.7
Coupons	36.1	10.3	7.8	-1.5	12.2	-2.9
Decrease in cash balance	-.7	-17.8	--	23.7	15.4	--
Other[1]	4.6	-13.1	--	3.3	-11.2	--
Memo:						
Cash balance, end of period	33.5	51.3	--	27.5	12.1	--

Note. Data reported on a payment basis. Details may not sum to totals because of rounding.
1. Accrued items, checks issued less checks paid, and other transactions.
e Estimated.

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

Agency	1997 Q1	Q2	May	June	July
FHLBs	3.1	23.6	7.0	5.2	1.9
FHLMC	-3.4	8.3	4.5	-5.5	-.4
FNMA	4.9	9.3	2.6	1.1	3.1
Farm Credit Banks	.8	1.2	.4	.7	-.2
SLMA	-1.7	1.7	-.9	-2.8	n.a.

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

For the year, issuance of long-term municipal securities is up nearly 10 percent relative to the same period in 1996. Although refundings have been strong recently, much of the year-to-date rise reflects financing of new capital outlays. Retirement of outstanding debt has declined substantially in 1997 because the bulge in advance-refunded obligations was largely worked down in 1996. In dollar terms, net issuance of long-term municipal debt has totaled $24 billion for the first eight months of this year, compared with only $1 billion for the same period of last year.

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

				1997			
	1994	1995	1996	Q1	Q2	July	Aug.
Total tax-exempt	16.1	15.4	17.9	13.7	20.8	22.8	19.2
Long-term	12.8	12.1	14.3	12.1	16.9	16.1	15.3
Refundings[1]	4.0	3.6	4.9	4.3	4.4	7.0	6.6
New capital	8.8	8.5	9.4	7.8	12.5	9.1	8.7
Short-term	3.3	3.3	3.6	1.6	3.9	6.7	3.9
Total taxable	.7	.7	.8	.7	1.6	1.0	.3

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

Bank Credit

Bank credit decelerated in August because of a drop in security holdings (table). The weakness was mainly in U.S. government securities. Total loan growth was up in August, to a 7 percent annual pace. Lending to businesses was brisk and probably reflected borrowing to finance mergers and acquisitions and possibly some inventories. Loan growth in early September appears to have slowed, especially for business loans.

Results for the August Survey of Terms of Business Lending (STBL) showed spreads on loans larger than $1 million rising 10 basis points and those on loans of $1 million or less falling a bit (chart). Although average spreads have trended down since the end of the recession, there has been a noticeable uptick of spreads on large loans since the middle of 1996. This movement is at odds with reports in the financial press of continued erosion in spreads

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

Type of credit	1996	1997 Q1	1997 Q2	1997 Jun	1997 Jul	1997 Aug	Level, Aug 1997 (billions of $)
1. Bank credit: Reported	3.9	9.9	8.3	7.1	9.3	3.5	3,974.8
2. Adjusted[1]	4.5	7.3	10.1	7.5	6.0	1.3	3,879.1
3. Securities: Reported	-1.6	13.8	3.1	-3.9	23.8	-7.2	1,026.5
4. Adjusted[1]	-0.0	3.9	9.8	-2.9	11.5	-17.3	930.8
5. U.S. government	-0.7	0.7	10.5	5.1	1.3	-20.5	715.0
6. Other[2]	-3.7	47.4	-13.7	-25.9	80.5	24.4	311.5
7. Loans[3]	6.0	8.5	10.2	10.9	4.3	7.3	2,948.3
8. Business	8.7	8.2	9.5	9.8	6.2	12.9	830.1
9. Real estate	4.0	7.6	12.0	9.7	4.5	5.7	1,197.6
10. Home equity	6.9	11.9	19.8	19.8	11.7	10.3	94.1
11. Other	3.8	7.3	11.4	8.7	3.9	5.4	1,103.5
12. Consumer: Reported	5.5	-0.1	-0.8	6.0	-0.7	1.4	522.0
13. Adjusted[4]	10.8	4.7	1.9	5.2	2.7	2.2	703.9
14. Other[5]	7.9	24.7	21.4	23.9	6.4	8.5	398.7

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.

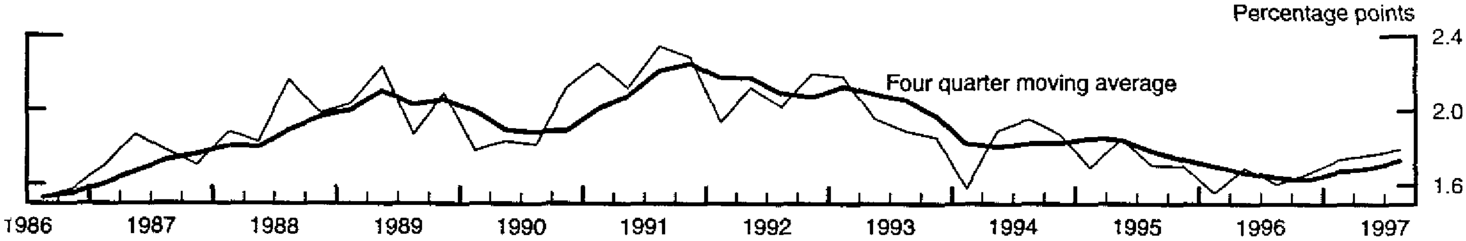
4. Includes an estimate of outstanding loans securitized by commercial banks.

5. Includes security loans, loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

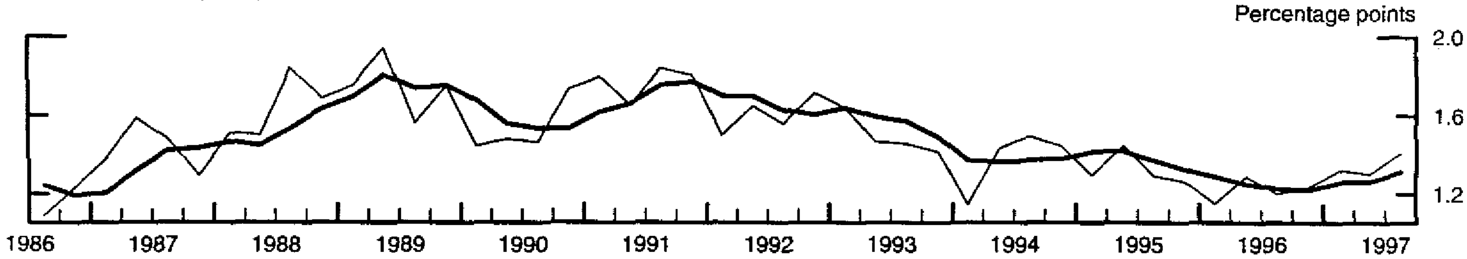
Commercial and Industrial Loan Rates

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

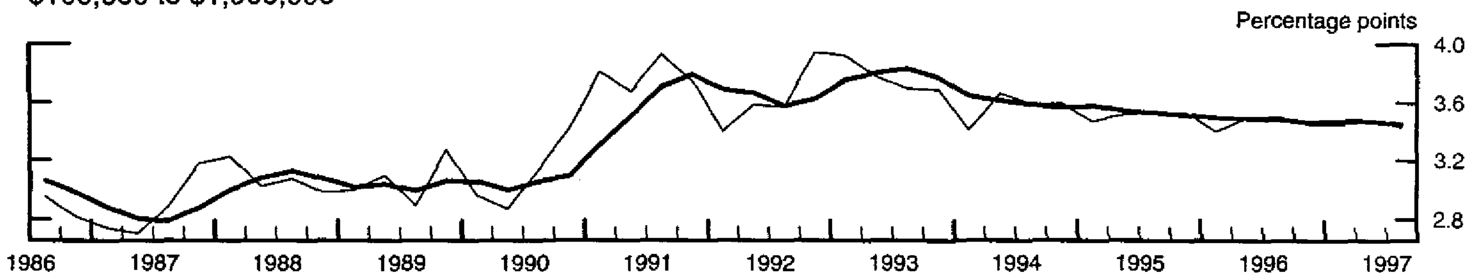
All Loans



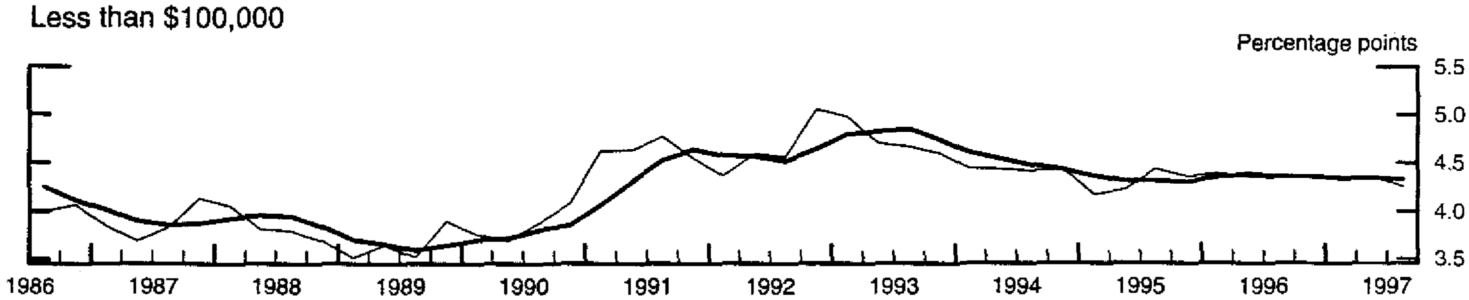
More than $1,000,000



$100,000 to $1,000,000



Less than $100,000

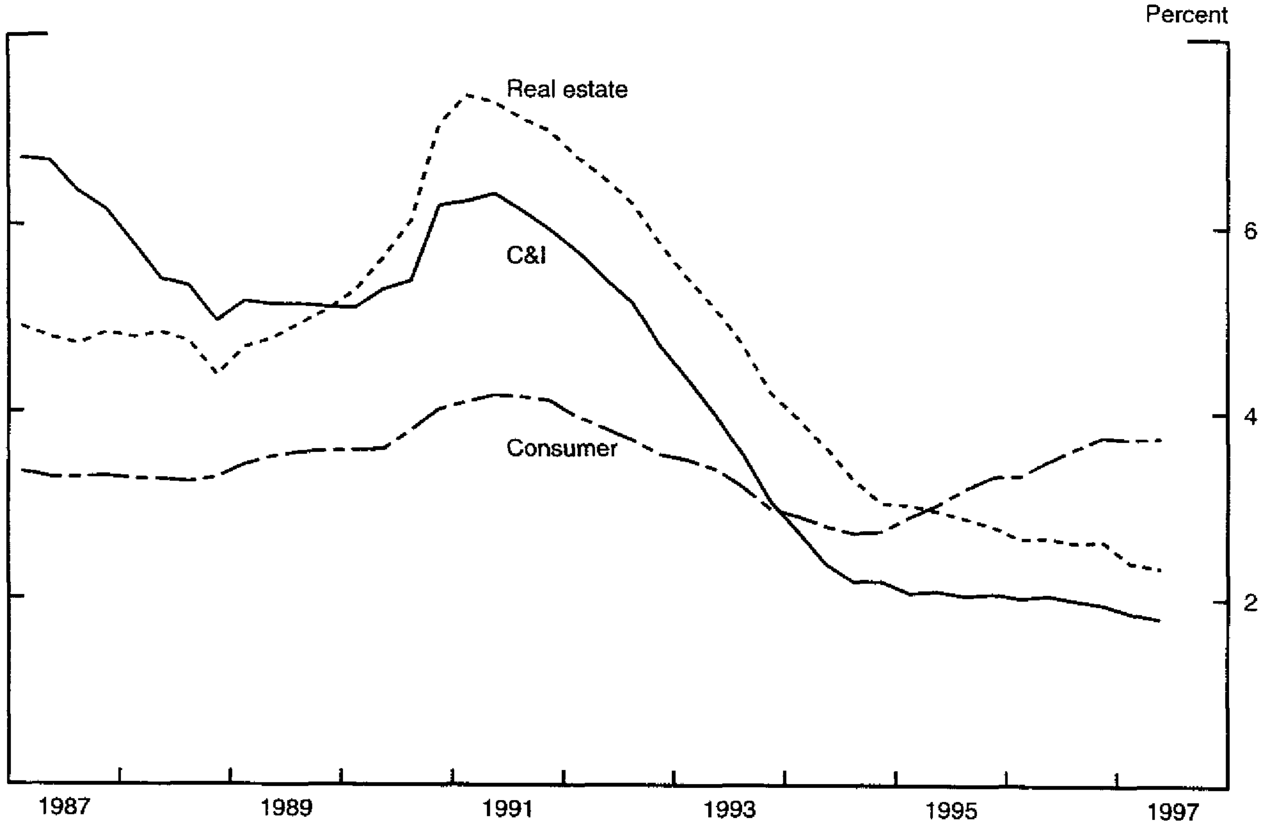


Source. Survey of Terms of Business Lending, domestic banks.

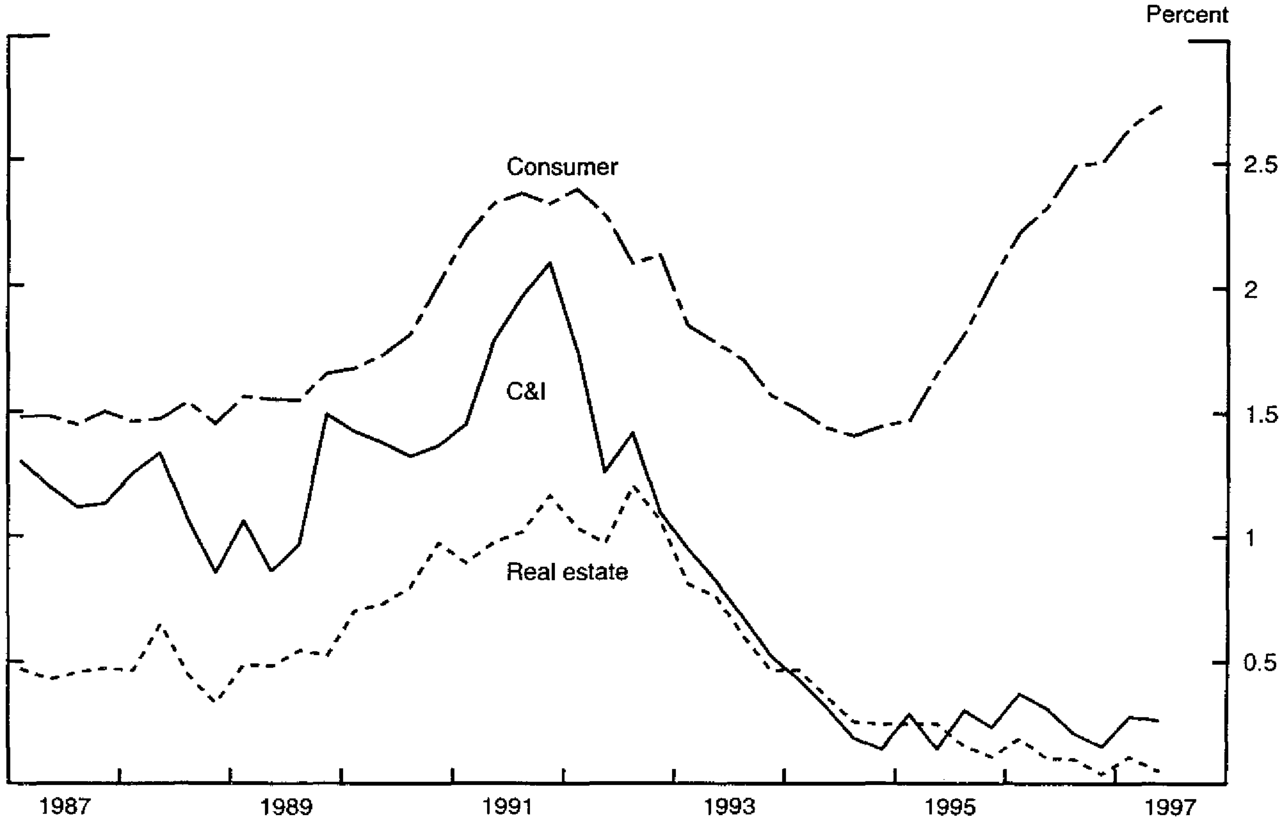
Loan Performance at Commercial Banks

(Quarterly; seasonally adjusted)

Delinquency Rates



Charge-Off Rates



Note. Delinquent loans are those past due 30 days or more and accruing interest and those in nonaccrual status. Charge-off rates are annualized, net of recoveries.

Source. Call Reports.

and with results from the Senior Loan Officer Opinion Survey indicating spreads on loans to large borrowers have narrowed over this period. Merger and acquisition activity, particularly involving less than mega-sized firms, has heated up lately, and because these mergers more often tend to be bank-financed, such a shift toward these generally riskier loans might explain the increases in large-loan spreads reported in recent STBLs.

Meanwhile, real estate loans grew moderately in August as home equity loans decelerated slightly. The growth of consumer loans at banks, even after adjusting for securitizations, was subdued at a meager 2 percent annual rate. The latest sluggishness in consumer loans seems to reflect the overall reduction in demand for credit by households rather than tightening of terms or further shifts toward home equity loans.

Data from the June 1997 Call Report (chart) indicate that charge-offs of consumer loans continued to climb, although other loan quality measures seem to be improving. Business loan quality continues to be good, with charge-offs low and delinquencies edging off further. Indeed, with little change in the provisioning for loan losses in recent quarters and a continuation of solid net interest margins, the net income of banks remained robust in the second quarter at about 1-1/4 percent of average total assets.

Mutual Funds and Monetary Aggregates

Net sales of stock mutual funds are estimated to have slowed to $13-1/2 billion in August, about half the exceptionally large volume recorded in July and considerably below the second-quarter pace (table). Data for September suggest that net sales of stock funds have picked up, with growth funds leading the way, although the overall rate may not reach that recorded early in the summer. Net sales of bond funds remained strong in August but appear to have slowed in September.

Sizable declines in the stock market in mid-August raised questions among some analysts about the ability of stock mutual funds to withstand a high volume of redemptions. Mutual funds can satisfy redemptions by selling off liquid assets or by tapping an established line of credit. Industry contacts report that lines of credit with banks--especially committed lines--have become more common in recent years and are often arranged with a lead bank and shared with several other banks through participation agreements. The typical size of a committed line of credit is reported to be on

MONETARY AGGREGATES
(Based on seasonally adjusted data)

Aggregate or component	1996	1997 Q1	1997 Q2	1997 June	1997 July	1997 Aug.	1996:Q4 to Aug. 97	Level (bil. $) Aug. 97
Aggregate	Percentage change (annual rate)[1]							
1. M1	-4.6	-0.7	-5.6	0.5	-1.2	8.2	-1.4	1069.4
2. M2[2]	4.7	6.1	4.3	4.6	3.6	10.3	5.4	3965.5
3. M3	6.9	8.2	7.0	5.3	10.2	11.9	8.2	5192.5
Selected components								
4. Currency	5.7	7.5	5.8	4.7	7.7	5.3	6.6	412.1
5. Demand deposits	2.8	2.0	-6.8	4.9	-2.7	16.0	0.2	401.7
6. Other checkable deposits	-23.1	-16.1	-20.4	-12.8	-13.4	-0.5	-14.9	247.2
7. M2 minus M1[3]	8.8	8.7	8.1	6.2	5.5	11.1	8.1	2896.1
8. Savings deposits	11.7	10.7	9.3	4.1	4.0	8.4	8.5	1339.1
9. Small time deposits	1.4	1.9	2.6	5.7	3.1	1.5	2.6	962.1
10. Retail money market funds	17.1	16.3	14.7	12.1	12.6	33.2	16.9	594.9
11. M3 minus M2[4]	15.5	15.6	16.5	7.6	32.2	16.9	17.8	1227.0
12. Large time deposits, net[5]	16.6	12.8	20.4	21.5	40.3	15.9	20.1	558.3
13. Institution-only money market mutual funds	19.8	15.6	12.5	28.1	19.6	18.9	16.4	329.2
14. RPs	4.5	8.4	4.0	-23.7	44.1	11.7	8.8	208.0
15. Eurodollars	21.5	40.5	31.4	-46.9	9.4	26.1	28.1	131.6
Memo								
16. Sweep-adjusted M1[6]	5.1	6.7	4.1	4.9	3.1	12.4	6.0	1295.2
17. Monetary base	3.8	5.6	3.2	4.7	7.3	5.9	5.0	466.5
18. Household M2[7]	4.9	6.7	5.6	4.4	5.0	10.0	6.2	3567.3
	Average monthly change (billions of dollars)[8]							
Memo								
Selected managed liabilities at commercial banks:								
18. Large time deposits, gross	8.5	12.7	11.3	12.3	18.9	8.7	. . .	647.8
19. Net due to related foreign institutions	-2.0	-7.2	2.8	-4.3	-14.1	-8.5	. . .	206.8
20. U.S. government deposits at commercial banks	0.0	0.5	2.5	-9.1	-5.9	0.0	. . .	17.4

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

the order of 5 to 10 percent of the fund's assets. As of August, liquid assets of stock funds totaled $128 billion, or 5-1/2 percent of total assets--a liquidity ratio that, while low by historical standards, still exceeds all previous net redemption experiences. In the October 1987 stock market crash, for example, net redemptions for the month amounted to 4 percent of total assets. Thus, in the aggregate, the industry appears to have satisfactory access to liquidity, although individual funds could still experience some difficulties in meeting their redemption requests.

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

			1997					Memo:
Type of Fund	1995	1996	Q1	Q2	June	July	Aug.[e]	July assets
Stock funds	10.7	18.6	19.3	17.6	16.6	27.6	13.5	2302.8
Domestic[1]	9.7	14.7	14.9	12.6	12.0	21.9	11.6	1925.6
Aggressive growth	3.1	4.7	1.9	2.4	2.0	4.0	2.1	344.9
Growth	3.1	3.9	3.7	3.1	3.0	7.5	2.8	628.9
Growth and income[2]	3.7	6.2	9.3	7.4	7.2	10.3	6.7	947.7
International[3]	1.0	3.9	4.4	4.7	4.8	5.7	1.9	377.2
Bond funds	-.4	1.1	1.2	1.9	2.1	6.8	6.5	976.6

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.
e Aggregate stock and bond are ICI estimates; components are staff estimates.
Source. Investment Company Institute.

The acceleration of the monetary aggregates in August reflects both a surge in demand deposits, which tend to be volatile, and shifts in portfolio preferences of retail investors. The main story for M2 was the acceleration in growth in retail money market mutual fund assets, which soared up at an annual rate of 33 percent in August; the mid-August decline in stock prices and heightened volatility likely induced some investors to redirect money away from equity stock mutual funds. The non-M2 components of M3 decelerated last month to about half of July's torrid pace but growth remained robust at a 17 percent annual rate. As a result, M3 grew faster than M2 and moved further above its annual range.

INTERNATIONAL DEVELOPMENTS

U.S. International Trade in Goods and Services

In July, the deficit in U.S. trade in goods and services widened to $10.3 billion as exports declined and imports rose.

The 1-1/2 percent decline in total exports in July reversed the increase recorded in June. Most categories of exports decreased with the exception of capital goods where there were moderate increases in machinery and aircraft deliveries. The level of exports of goods and services in July was about 3/4 percent less than the average of the second quarter.

The 1 percent increase in imports in July followed a decline in June and was spread among almost all trade categories. The largest increase was in automotive products, three-fourths of which were vehicles from Canada which rebounded from a decline in June. Imports of consumer goods turned up after two months of decreases. The level of imports of goods and services in July was 1 percent higher than the average of the second quarter.

Trade data for August will be released on October 21.

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

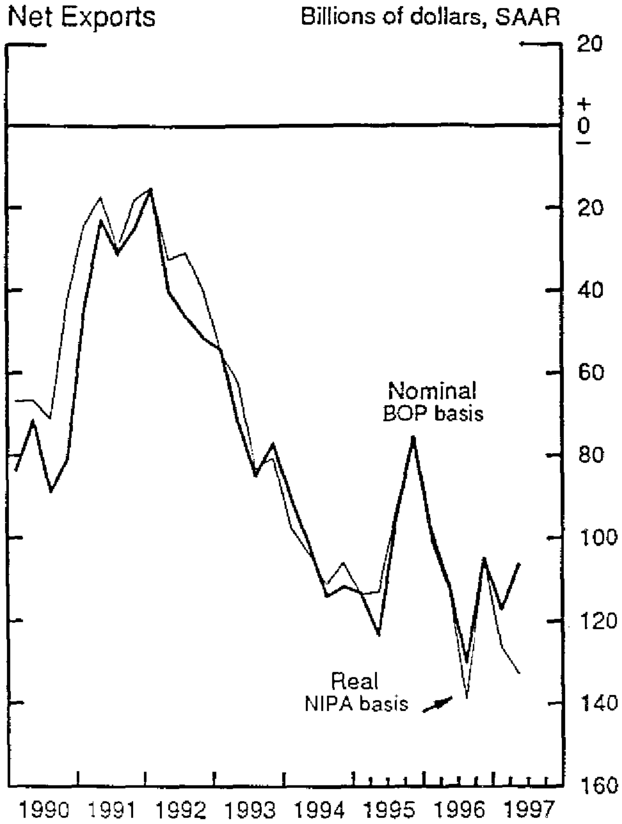
		Annual rates			Monthly rates		
	1996	1996	1997		1997		
		Q4	Q1	Q2	May	Jun	Jul
Real NIPA 1/							
Net exports of G&S	-114.4	-105.6	-126.3	-132.7	...	...	...
Nominal BOP							
Net exports of G&S	-111.0	-104.8	-117.2	-106.6	-9.6	-8.3	-10.3
Goods, net	-191.2	-192.8	-199.1	-188.5	-16.4	-15.2	-17.1
Services, net	80.1	88.0	82.0	82.0	6.8	7.0	6.8

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

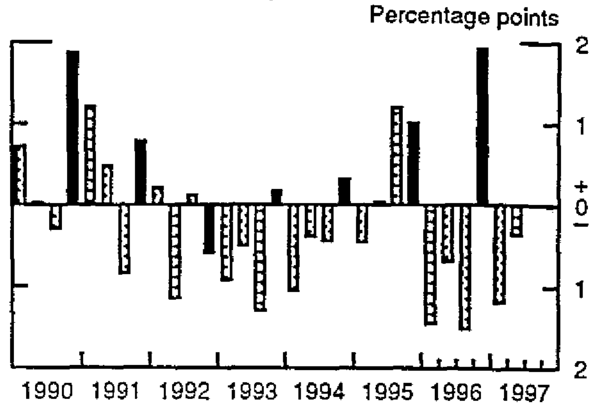
In nominal terms, the trade balance was about the same in the second quarter of 1997 as in the fourth quarter of 1996. However, real net exports weakened $26 billion SAAR over the same period, resulting in a negative contribution to real GDP growth of three-fourths of a percentage point over the first half of the year. U.S. real exports of goods and services grew at a 15 percent annual rate in the first half of 1997. The increase was spread among most major trade categories (especially aircraft and other capital goods) and was directed particularly towards countries in Latin America and

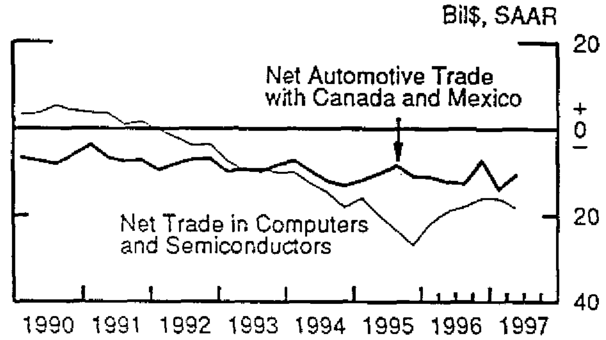
U.S. International Trade in Goods and Services

Net Exports

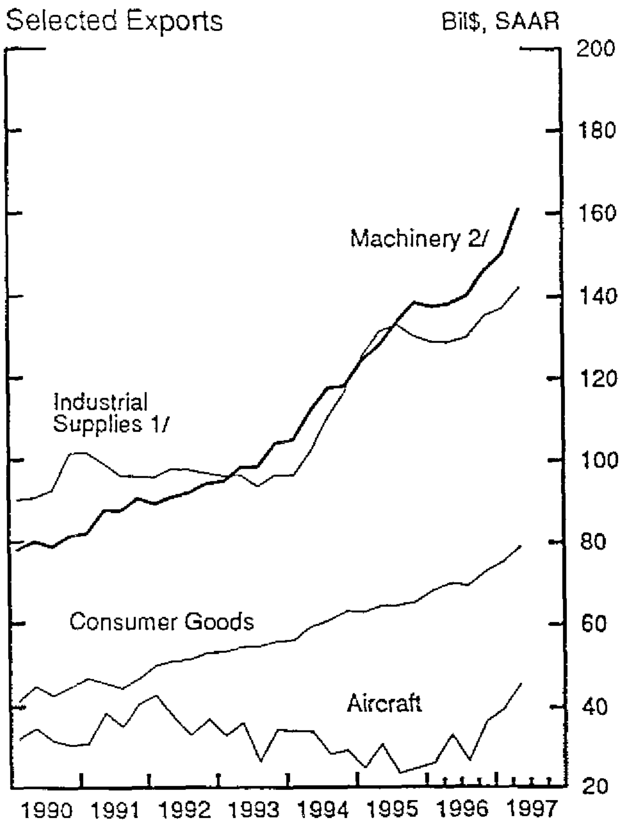


Contribution of Net Exports to Real GDP Growth



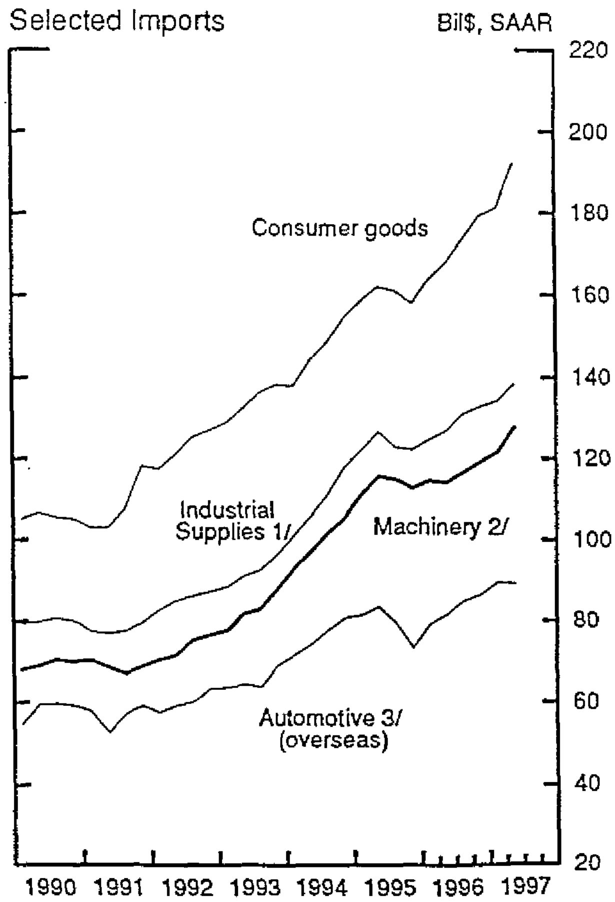


Selected Exports



1/ Excludes agriculture and gold.
2/ Excludes computers and semiconductors.

Selected Imports



1/ Excludes oil and gold.
2/ Excludes computers and semiconductors.
3/ Excludes Canada and Mexico.

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

	Levels				Amount Change 1/			
	1997		1997		1997		1997	
	Q1	Q2	Jun	Jul	Q1	Q2	Jun	Jul
Exports of G&S	897.0	936.2	942.2	928.6	19.0	39.2	9.3	-13.6
Goods exports	650.1	685.6	688.5	677.4	18.7	35.5	6.1	-11.1
Agricultural	57.3	56.4	55.1	54.2	-4.5	-0.9	-2.1	-0.8
Gold	6.7	9.3	9.3	3.4	3.0	2.6	1.6	-5.9
Other goods	586.1	619.9	624.2	619.8	20.2	33.8	6.6	-4.4
Aircraft & pts	39.6	45.5	39.7	41.2	2.9	5.8	-9.4	1.6
Computers	46.3	50.1	51.6	52.1	3.0	3.8	2.3	0.4
Semiconductors	37.8	38.3	38.7	39.5	0.8	0.5	0.4	0.7
Other cap gds	152.2	163.0	163.8	166.2	4.0	10.8	3.4	2.5
Automotive	70.9	73.4	75.0	75.2	3.9	2.5	3.8	0.2
to Canada	38.7	38.5	39.2	39.5	3.6	-0.2	1.3	0.3
to Mexico	10.4	11.3	12.6	10.5	0.7	0.9	2.9	-2.1
to ROW	21.8	23.6	23.2	25.3	-0.4	1.8	-0.4	2.1
Ind supplies	137.2	142.1	145.6	142.0	1.7	5.0	5.0	-3.6
Consumer goods	75.3	78.9	80.6	76.2	2.3	3.6	0.7	-4.4
All other	26.8	28.6	29.2	27.4	1.6	1.8	5.0	-1.8
Services exports	246.9	250.5	253.6	251.2	0.3	3.6	3.2	-2.5
Imports of G&S	1014.2	1042.8	1041.7	1052.7	31.4	28.6	-5.9	11.0
Goods imports	849.3	874.2	871.5	882.7	25.1	24.9	-7.3	11.2
Petroleum	76.7	71.0	71.6	68.6	-5.6	-5.7	-1.8	-2.9
Gold	8.7	11.0	10.1	3.0	5.2	2.3	-0.7	-7.1
Other goods	763.9	792.2	789.8	811.1	25.4	28.3	-4.9	21.3
Aircraft & pts	13.6	15.5	15.9	19.0	-0.3	1.9	-0.2	3.1
Computers	65.5	70.5	70.9	72.1	2.7	5.1	0.3	1.2
Semiconductors	34.7	36.1	38.3	38.1	1.1	1.4	3.5	-0.2
Other cap gds	123.5	129.6	129.9	127.8	2.4	6.1	-0.5	-2.1
Automotive	142.2	138.3	139.1	148.1	13.3	-3.9	-0.4	9.0
from Canada	52.6	49.2	47.9	54.5	10.2	-3.5	-2.6	6.6
from Mexico	24.2	26.0	25.8	24.2	1.0	1.8	-0.9	-1.6
from ROW	65.4	63.2	65.5	69.4	2.2	-2.2	3.2	3.9
Ind supplies	134.3	138.1	136.6	139.2	1.4	3.9	-1.5	2.6
Consumer goods	181.2	192.0	188.6	192.7	1.8	10.8	-4.4	4.1
Foods	38.0	39.9	39.0	40.7	1.3	1.9	-1.5	1.7
All other	30.9	32.1	31.5	33.4	1.7	1.2	-0.2	1.9
Services imports	164.9	168.6	170.2	170.0	6.3	3.6	1.5	-0.2
Memo:								
Oil qty (mb/d)	9.85	10.80	10.96	10.89	-0.29	0.95	-0.16	-0.07
Oil price ($/bbl)	21.35	18.01	17.88	17.25	-0.87	-3.34	-0.19	-0.63

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

Canada. Healthy increases were also recorded for exports to Western Europe and developing countries in Asia. Real imports grew at a 19 percent annual rate in the first half of 1997, with increases spread among all major trade categories.

Oil Imports and Prices

The quantity of oil imported during 1997-Q2 was sharply higher than rates recorded during 1997-Q1 and also well above rates recorded last year. Imports in July were 2 percent above 1997-Q2 rates. Imports were driven by extremely strong consumption in the second quarter--up three percent from rates observed a year ago--and a building of oil stocks. Inventory accumulation induced the rise in imports in July as oil consumption slowed from its strong second-quarter pace. Preliminary Department of Energy statistics indicate that oil imports remained strong in August due to high consumption demand.

The price of imported oil which peaked at $22 per barrel in the fourth quarter of 1996 fell to $18 per barrel by the second quarter of 1997. Deliveries of oil from Iraq and mild weather that lowered the demand for heating oil allowed firms to rebuild inventories from near historic lows and removed the upward pressure on prices that had characterized the market for the past year. Import prices declined slightly in June and July and rose 2.2 percent in August.

The price of spot WTI rose $0.30 per barrel in August and averaged $19.93 per barrel, reflecting the delays in Iraq's shipments under U.N. supervision and the interruption of exports from Colombia due to repeated bombing of the oil pipeline by terrorists. Prices have been moving in the $19-20 per barrel range in September.

Prices of Non-oil Imports and Exports

Prices of U.S. non-oil imports declined slightly in July and August after recording little change in the previous two months. This decline was primarily the result of lower computer prices, and to a lesser degree, lower prices for all other major end-use categories with the exception of automotive products and industrial supplies. For July-August combined, the decline was 1.3 percent at an annual rate, less than decreases recorded in the previous two quarters.

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

	Annual rates			Monthly rates		
	1997			1997		
	Q1	Q2	Q3e/	Jun	Jul	Aug
	----------BLS prices (1995=100)----------					
Merchandise imports	-4.6	-8.8	-1.7	-0.1	-0.3	-0.1
Oil	-23.8	-48.5	-6.1	-2.0	-1.7	2.2
Non-oil	-2.3	-3.4	-1.3	0.1	-0.2	-0.3
Foods, feeds, bev.	4.9	7 9	-7.2	1.1	-2.6	-0.8
Ind supp ex oil	4.8	-6.0	1.6	0.0	0.3	-0.1
Computers	-13.8	-17.7	-12.8	-0.9	-1.0	-2.3
Semiconductors	-24.7	-2.2	-4.3	0.9	-1.3	-0.5
Cap. goods ex comp & semi	-5.8	-3.8	-0.7	0.2	0.0	-0.4
Automotive products	0.1	-0.7	1.5	0.5	0.1	0.1
Consumer goods	-0.8	-1.3	-0.4	-0.2	0.1	-0.2
Merchandise exports	0.5	-0.4	-0.9	-0.1	-0.1	0.1
Agricultural	2.5	-0.8	-10.9	-2.0	-1.3	0.4
Nonagricultural	0.1	-0.1	0.3	0.1	0.0	0.0
Ind supp ex ag	0.6	1.4	1.4	0.3	0.2	-0.2
Computers	-9.4	-10.4	-7.8	-0.7	-1.0	0.0
Semiconductors	-5.2	-2.7	-4.4	-1.3	-0.1	-0.2
Cap. goods ex comp & semi	2.0	1.0	0.6	0.4	-0.1	0.0
Automotive products	1.3	1.4	0.7	0.0	0.2	0.0
Consumer goods	0.8	0.1	1.4	0.1	0.1	0.3
	---Prices in the NIPA accounts (1992=100)--					
Chain-weight						
Imports of gds & serv.	-5.3	-7.5	n.a	...	...	...
Non-oil merchandise	-4.2	-3.8	n.a	...	...	...
Exports of gds & serv.	-1.8	-2.4	n.a	...	...	...
Nonag merchandise	-2.5	-2.6	n.a	...	...	...

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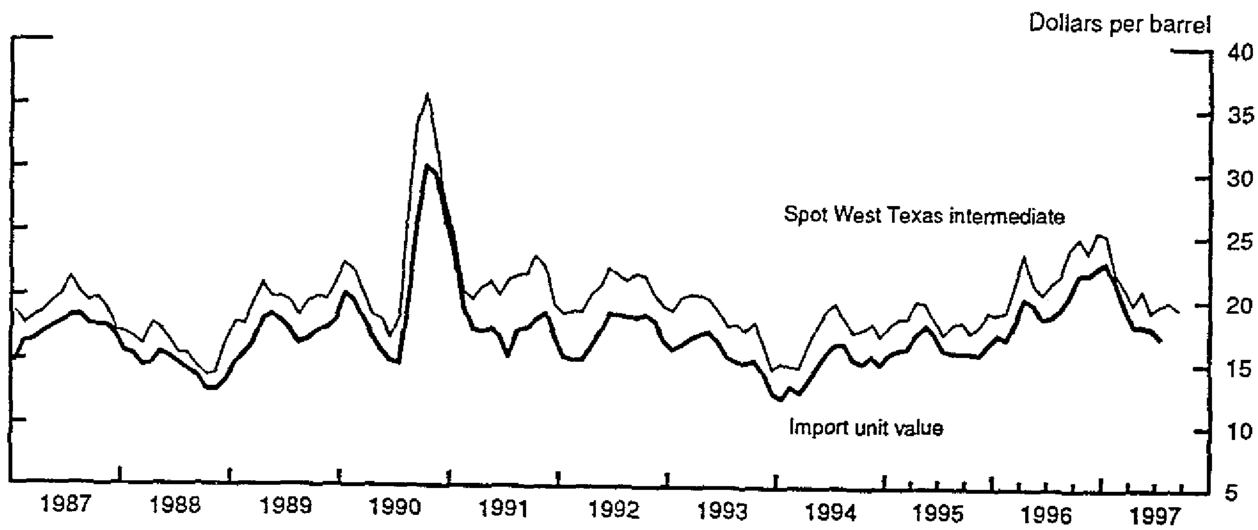
Oil Prices



Prices of exports increased slightly in August, following three months of decline. This increase was primarily the result of higher agricultural export prices, and to a lesser degree, higher prices for exported consumer goods. For July-August combined, the decline in prices of exports was attributable to agricultural products. Prices of nonagricultural goods rose marginally.

U.S. Current Account through 1997-Q2

The U.S. current account deficit narrowed $4 billion SAAR in the second quarter. A smaller deficit for net goods and services (a jump in exports exceeded the growth of imports) was partly offset by larger net unilateral transfers and net investment income payments.

U.S. CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	Goods & services balance	Investment income, net	Transfers, net	Current acct balance
Years				
1995	-101.9	6.8	-34.0	-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	7.8	-34.5	-102.2
1996-1	-98.2	8.2	-41.6	-131.5
2	-111.1	3.5	-34.8	-142.3
3	-130.1	-5.5	-35.8	-171.3
4	-104.8	5.0	-47.7	-147.5
1997-1	-117.2	-8.0	-34.7	-159.9
2	-105.7	-14.2	-36.3	-156.1
Memo:				
$ Change				
Q4-Q3	25.3	10.5	-11.9	23.8
Q1-Q4	-12.4	-13.0	13.0	-12.4
Q2-Q1	11.5	-6.3	-1.5	3.8

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

The increase in net investment income payments was entirely in portfolio transactions as payments rose about twice as much as receipts. Net receipts from direct investment leveled off in the second quarter after declining in the first quarter from the very strong fourth-quarter rate. Receipts from U.S. direct investment abroad and payments on foreign direct investment in the United

States both increased. Receipts from abroad increased strongly in manufacturing and other industries as a result of robust foreign demand. Payments continued their strong rebound from the downturn in 1996-Q4; they now stand 29 percent higher than the level in the second quarter of 1996.

U.S. International Financial Transactions

Private foreigners continued to acquire U.S. securities at a rapid pace in July. (See line 4 of the Summary of U.S. International Transactions table.) Foreign purchases of U.S. bonds (other than Treasuries) picked up a bit from June and remain on a path to match last year's record total (line 4b). Foreign purchases of U.S. equities also picked up in July (line 4c). Net equity purchases have been running at a very high rate throughout the year, with the total through July reaching $44 billion. This compares with net purchases of $12 billion for all of 1996. As with the other securities, foreign purchases of U.S. Treasuries remained robust in July and here again the trend for this year points to a total near last year's record.

Foreign official reserves in the United States were little changed in July (line 1), as a modest reduction in G-10 reserves was offset by an increase in reserve holdings of Brazil and Mexico. Partial data for August from FRBNY indicate a $13 billion increase in official reserves in the United States, with developing countries in Asia accounting for most of the increase. Even with this latest increase, foreign official inflows have been small since the first quarter of this year, and the total through August is likely to be on the order of $30 billion. This is in sharp contrast to last year when official reserve accumulation averaged more than $30 billion per quarter. The slowing from last year is primarily attributable to developing countries in Asia. This group increased official reserves in the United States significantly last year and reduced them this year. Several of these countries drew down their dollar reserves in efforts to support their currencies this year. In addition, China shifted a substantial portion of its dollar reserves to custodians outside of the United States. Reserve accumulation by developed countries has been only slightly slower than last year, while developing countries in Latin America have increased reserves in the United States at a rate roughly equal to that of last year.

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

	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Jun	1997 Jul
Official capital								
1. Change in foreign official reserve assets in U.S. (increase, +)	110.0	128.1	23.4	39.2	27.4	-5.4	-4.8	.4
a. G-10 countries	33.1	36.7	1.4	3.4	7.5	4.7	.8	-2.9
b. OPEC countries	4.3	15.3	5.3	5.5	7.1	2.4	-1.7	-.7
c. All other countries	72.6	76.1	16.7	30.3	12.8	-12.6	-4.0	3.8
2. Change in U.S. official reserve assets (decrease, +)	-9.7	6.7	7.5	-.3	4.5	-.2	-.1	-.2
Private capital								
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-30.9	-51.0	-4.6	-7.7	-25.3	15.7	-23.7	-22.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	190.8	300.8	77.3	112.1	83.5	97.3	47.3	35.3
a. Treasury securities[3]	99.9	167.0	43.6	78.5	44.3	45.3	27.1	10.0
b. Corporate and other bonds[4]	82.6	121.7	33.3	32.1	28.5	29.9	11.1	14.3
c. Corporate stocks	8.2	12.1	.5	1.5	10.7	22.1	9.2	11.0
5. U.S. net purchases (-) of foreign securities	-98.7	-105.9	-20.9	-30.4	-17.1	-22.7	-19.3	-17.1
a. Bonds	-48.4	-48.8	-14.2	-19.9	-5.3	-8.6	-13.0	-9.8
b. Stocks	-50.3	-57.1	-6.7	-10.5	-11.8	-14.1	-6.3	-7.3
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-86.7	-87.8	-11.1	-30.9	-26.4	-29.1	n.a	n.a
7. Foreign direct investment in U.S.	67.5	77.0	26.0	17.7	30.6	28.9	n.a	n.a
8. Foreign holdings of U.S. currency	12.3	17.3	7.4	7.8	3.5	4.8	n.a	n.a
9. Other (inflow, +)[5]	-10.6	-90.1	-23.9	-67.3	-26.4	-33.2	n.a	n.a
U.S. current account balance (s.a.)	-129.1	-148.2	-42.8	-36.9	-40.0	-39.0	n.a	n.a
Statistical discrepancy (s.a.)	-14.9	-46.9	-38.3	-3.3	-14.3	-17.1	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.

INTERNATIONAL BANKING DATA[1]
(Billions of dollars)

	1994 Dec.	1995 Dec.	1996 Sep.	1996 Dec.	1997 Mar.	1997 Jun.	1997 Jul.	1997 Aug.
1. Net claims of U.S. banking offices (excluding IBFs) on own foreign offices and IBFs	-224.0	-260.0	-247.4	-231.2	-220.4	-225.7	-214.4	-205.5
a. U.S.-chartered banks	-70.1	-86.1	-73.6	-66.4	-72.5	-79.8	-79.4	-73.7
b. Foreign-chartered banks	-153.9	-173.9	-173.8	-164.8	-147.9	-145.9	-135.0	-131.8
2. Credit extended to U.S. nonbank residents								
a. By foreign branches of U.S. banks	23.1	26.5	29.2	31.9	32.9	33.4	33.8	33.9
b. By Caribbean offices of foreign-chartered banks	78.4	86.3	83.4	79.4	82.7	74.8	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	86.3	94.6	103.4	119.5	128.3	131.2	132.6	134.5
b. At the Caribbean offices of foreign-chartered banks	86.0	92.3	109.4	122.2	135.5	130.6	n.a	n.a
MEMO: Data as recorded in the U.S. international transactions accounts								
4. Credit extended to U.S. nonbank residents	177.8	212.5	243.8	238.7	252.6	249.6	n.a.	n.a.
5. Eurodeposits of U.S. nonbank residents	242.6	276.5	314.9	337.3	368.2	383.2	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

U.S. net purchases of foreign securities remained strong in July, bringing the total for the first seven months of this year to $57 billion (line 5). This is similar to last year's record-setting pace.

U.S. banks recorded large net outflows in July (line 3), reflecting in large part increased lending to unaffiliated foreigners in offshore financial centers. On a monthly-average basis, U.S. banks increased their net claims on foreign affiliates in both July and August, with most of the increase attributable to foreign-based banks in the United States. (See lines 1 and 1b of the International Banking Data table.)

In addition, recently released balance of payments data for the second quarter show significant outflows associated with transactions between banks outside the United States and U.S. nonbank residents. Credit extended to U.S. nonbanks declined by several billion dollars in the second quarter and Eurodollar deposits of U.S. nonbanks increased by $15 billion (lines 4 and 5 of the Banking table). These transactions account for roughly half of the "other" outflow shown on line 9 of the Summary table.

The balance of payments data also show a continuation of robust direct investment capital flows both into and out of the United States (lines 6 and 7 of the Summary table). Of the direct investment outflows, roughly half was directed toward Western Europe. Foreign direct investment inflows into the United States were swelled by substantial lending by foreign companies (largely banks) to their U.S. finance affiliates.

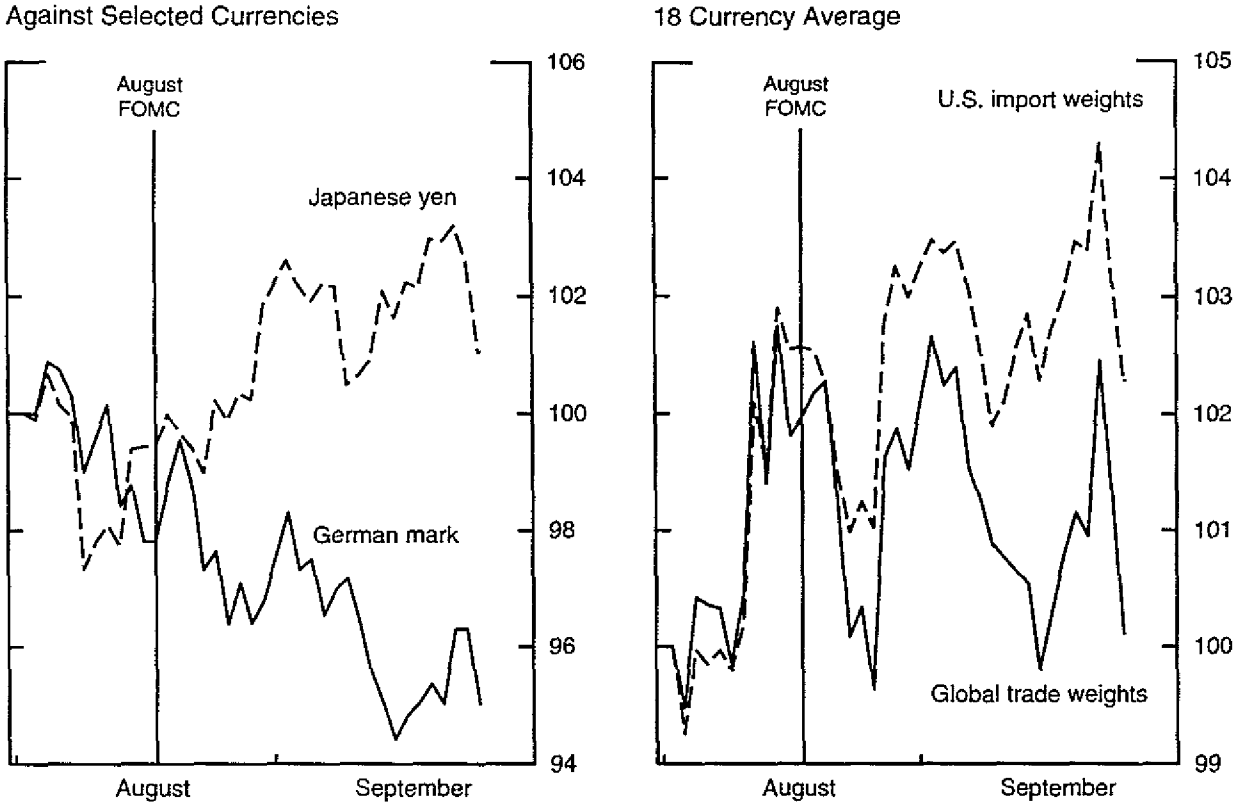
The statistical discrepancy in the second quarter was $-17 billion--the same sign and slightly larger than that recorded in the first quarter.

Foreign Exchange Markets

In the period since the August FOMC meeting, the foreign exchange value of the dollar has exhibited divergent trends against the major currencies. Against the mark, the dollar has declined 2-3/4 percent, amid market commentary that the Bundesbank will tighten at least once more before the middle of next year. In contrast, the dollar has risen 1-1/2 percent against the yen, on a continuing flow of data showing weak economic conditions in Japan. The substantial depreciations of several southeast Asian currencies

Exchange Value of the Dollar

(Daily indices, Aug. 1, 1997 = 100)



Interest Rates in Major Industrial Countries

	Three-month rates			Ten-year bond yields		
	Aug. 18	Sept. 24	Change	Aug. 18	Sept. 24	Change
Germany	3.22	3.23	0.01	5.65	5.53	-0.12
Japan	0.57	0.55	-0.02	2.14	1.98	-0.16
United Kingdom	7.13	7.19	0.06	7.02	6.63	-0.39
Canada	3.60	3.66	0.06	5.97	5.79	-0.18
France	3.32	3.30	-0.02	5.59	5.47	-0.12
Italy	6.88	6.38	-0.50	6.60	6.06	-0.54
Belgium	3.50	3.53	0.03	5.75	5.61	-0.14
Netherlands	3.38	3.36	-0.02	5.60	5.49	-0.11
Switzerland	1.38	1.39	0.01	3.32	3.36	0.04
Sweden	4.31	4.19	-0.12	6.39	6.03	-0.36
Weighted-average foreign	3.69	3.65	-0.04	5.38	5.18	-0.20
United States	5.58	5.60p	0.02	6.21	6.09p	-0.12

Note. Change is in percentage points. p Preliminary.

may also have weighed on the yen, eroding the price competitiveness of Japanese exports. Furthermore, the financial turmoil in the region may also have raised concerns about Japanese investments in those countries.

These differing patterns against the mark and yen correspond to similarly divergent movements in the weighted average indices of the dollar's foreign exchange value against the 18 currencies of industrial and developing countries used in our model forecasts. The index with multilateral (global) trade weights, used in our forecasts of U.S. exports, has declined 1-3/4 percent on balance since the August FOMC meeting. Over the same period, however, the index with U.S. import weights, used in our forecasts of U.S. import prices, has declined only 1/4 percent.[1]

The shift in view on Bundesbank tightening was supported by data released during the period that showed an acceleration in the pace of economic activity in Germany and a creeping higher of consumer price inflation. Bundesbank President Tietmeyer noted publicly the possibility of tightening before the decision on EMU membership is made in the spring of 1998. In addition, the Bundesbank altered its standing practice of announcing a week or two in advance the rate at which its fixed-rate RP operations would be conducted. Instead, it has chosen to wait until immediately before its weekly RP operations to announce the terms on which they would be done, setting the stage for a quick rate hike.

Movements in the prices of three-month euromark futures contracts are consistent with an increase in expectations for a tightening by the Bundesbank in the first part of next year, with rates up about 10 basis points on the March and June contracts for 1998. Expectations for a hike in rates before the end of this year, however, do not appear to have changed significantly during the intermeeting period; the three-month interest rate is little changed at nearly 25 basis points above the Bundesbank's current RP rate.

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[1]The Federal Reserve Board Staff index of the dollar's foreign exchange value against the currencies of the other G-10 countries, which uses weights based on multilateral trade flows from 1972-1976, has declined 1-7/8 percent during the intermeeting period.

The yield on the bellwether bond declined modestly--in line with the decline in the comparable U.S. Treasury security yield.

EMU optimism continued to rise during the period, as favorable budget news in Italy helped to diminish further any expectations that the start of monetary union would be delayed for some or all countries. In addition, an announcement following the September meeting of EU finance ministers and central bank governors seemed to inspire further confidence that monetary union would begin on time. The ministers and governors agreed that the bilateral conversion rates of the currencies taking part in the monetary union would be revealed at the time the initial membership is announced next spring. European asset markets seemed to reflect that confidence. Long-term interest rates in Italy and Spain declined 54 and 41 basis points, respectively, during the period, narrowing their spreads with the comparable German rate by roughly one-half. The French franc firmed about 1/4 percent against the mark, bringing it closer to its bilateral central rate against the mark--the exchange rate at which many believe the franc and mark will be locked upon entry into monetary union. The Irish pound, which has been trading well above its central parities with the other prospective EMU currencies, declined 2 percent against the mark during the period.

The souring of the outlook for economic activity in Japan over the past 5 weeks has prompted a decline of 16 basis points in the Japanese government bond yield to a record low. Equity prices also slid further, with the Topix index declining 4-1/2 percent on balance over the period. The three-month interest rate in Japan was little changed, however, reflecting the unchanged prospects for an easing of monetary policy.

The term structure of interest rates in the United Kingdom has turned from flat to inverted during the intermeeting period, with the three-month rate up 6 basis points and the ten-year yield down 39. Signs that economic activity in the United Kingdom is slowing and expectations the Bank of England's Monetary Policy Committee may nonetheless tighten once more have contributed to the yield curve movement.

In other currency developments, the dollar has depreciated more than 5-1/2 percent against the Norwegian krone and the Swedish krona and declined 3-1/2 percent against the Swiss franc. In large part, these currencies have firmed against the dollar along with the mark and other European currencies. The Scandinavian currencies rose further on the back of above-trend growth in Norway and Sweden and large external surpluses. In addition, concerns have arisen in market commentary that political changes will prompt a shift toward more expansionary fiscal policies and possibly tighter monetary policies, although interest rates in these countries do not seem to be registering such concerns. The Swiss franc moved higher in reaction to signs that economic activity in Switzerland is picking up and to remarks from Swiss National Bank President Meyer indicating that inflationary pressures may be building.

Several southeast Asian currencies have continued to depreciate during the period. The Thai baht and Malaysian ringgit have depreciated another 9-1/2 percent and 8-1/4 percent, respectively, against the dollar, while the Philippine peso slid another 7-3/4 percent. In contrast, the Indonesian rupiah moved down only 1-7/8 percent, reflecting a judgement by the market that the response of Indonesian authorities to the fundamental economic imbalances that prompted these market pressures has been more appropriate than that in other countries. Developments in these countries are discussed more thoroughly elsewhere in Section IV.

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

Developments in Foreign Industrial Countries

Although the pattern of quarter-to-quarter growth has been disrupted by special factors in some countries, second-quarter GDP data confirm that growth in the first half of the year solidified in most major industrial countries. Expansions in Canada and the United Kingdom continued at healthy paces. Growth in Germany, France, and Italy picked up, indicating that modest recoveries are underway amid signs that domestic demand may be firming. Available third-quarter data suggest that the stronger performance has extended into the current quarter in all five countries. In contrast, an unexpectedly sharp contraction of Japanese domestic demand in the second quarter, along with further weak data from the current quarter, has renewed worries about prospects in Japan for sustained recovery.

Inflation rates remain low, although concerns have heightened in some countries as the pace of recovery has quickened. In Germany, consumer-price inflation has continued to edge up and in August exceeded 2 percent for the first time in almost 2-1/2 years. However, rates of inflation are near 1-1/2 percent in other major industrial countries.

Individual country notes. In **Japan**, second-quarter GDP was surprisingly weak, falling 11.2 percent (SAAR) from its level in the first quarter. Consumption plunged 21 percent, reversing the surge of expenditures before the April hike in the consumption tax. Private investment also declined sharply, with plant and equipment investment falling after posting increases in the previous nine quarters. Public investment, however, rebounded somewhat from sharp

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

	1995	1996	1996		1997	
			Q3	Q4	Q1	Q2
GDP	2.6	3.0	1.3	3.8	5.7	-11.2
Total Domestic Demand	4.0	2.9	0.4	2.2	5.6	-15.0
Consumption	3.0	2.0	-0.7	4.8	18.6	-21.0
Investment	5.6	5.8	1.4	-1.5	-14.3	-7.2
Government Consumption	3.2	2.9	5.5	2.6	0.2	-5.0
Inventories (contribution)	0.2	-0.3	-0.2	-0.4	-0.2	0.7
Exports	3.8	6.1	6.5	21.5	2.9	28.0
Imports	17.3	5.5	-1.1	7.5	1.8	-7.6
Net Exports (contribution)	-1.3	0.1	0.9	1.6	0.1	3.9

1. Annual changes are Q4/Q4.

drops registered in the previous two quarters, offsetting a decline in government consumption. External demand made a strong positive contribution to growth. Exports grew robustly, reflecting the competitive level of the yen; imports contracted.

Economic indicators for the third quarter suggest some improvement, although domestic demand appears to have remained weak. In July, industrial production was up a revised 1.7 percent, with the government projecting a 0.6 percent increase for the third quarter as a whole. However, July retail sales and household expenditures were essentially unchanged from second-quarter levels, and housing starts declined sharply. Labor-market conditions were little changed in July, with the unemployment rate and the offers-to-applicants ratio remaining at second-quarter levels. In contrast, machinery orders continue to be strong, with overall orders rising by 0.6 percent and private orders rising by 5.9 percent. Consumer-price inflation remains subdued.

Third-quarter external trade data suggest a continuation of second-quarter trends. Exports remain strong, and there is little evidence of a rebound in imports.

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

	1996	1997					
	Q4	Q1	Q2	May	Jun	Jul	Aug
Industrial Production	2.1	2.5	-0.1	4.5	-3.2	1.7	n.a.
Housing Starts	4.3	-11.5	-5.2	2.7	-11.6	-7.6	n.a.
Machinery Orders	5.0	-3.1	6.0	11.5	-1.9	0.6	n.a.
New Car Registrations	10.6	2.3	-23.9	14.7	-2.2	1.6	-4.9
Unemployment Rate (%)	3.3	3.3	3.4	3.5	3.5	3.4	n.a.
Job Offers Ratio[1]	0.75	0.74	0.73	0.73	0.74	0.74	n.a.
Business Sentiment[2]	-3	2	7	...	...	...	...
CPI (Tokyo area)[3]	0.1	0.0	1.5	1.4	1.8	1.4	1.6
Wholesale Prices[3]	0.6	1.4	2.6	2.7	1.9	1.8	2.1

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

Real GDP in **Germany** advanced 4.1 percent (SAAR) in the second quarter, up from 1.2 percent growth in the first quarter, owing to a surge in exports. Domestic demand contributed little to growth, as a rebound in private consumption expenditure from its laggard first-quarter pace and modest growth in government and investment spending were largely offset by a drawdown in inventories. (Inventories are a residual in the national income accounts and can be subject to substantial revision.) Investment on machinery and equipment, which had registered respectable growth rates in the fourth quarter of 1996 and the first quarter of this year, advanced at a sluggish pace. Exports, aided by the decline in the mark, rose more than 15 percent at an annual rate in the second quarter.

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

	1995	1996	1996		1997	
			Q3	Q4	Q1	Q2
GDP	0.7	2.1	2.2	0.7	1.2	4.1
Total Domestic Demand	0.5	1.3	-0.3	1.4	0.9	0.4
Consumption	1.6	1.2	2.2	-1.9	0.4	5.2
Investment	-2.8	2.4	1.4	0.7	-8.3	2.7
Government Consumption	2.8	-0.1	5.0	-8.2	4.5	1.0
Inventories (contribution)	-0.4	0.1	-2.8	4.1	1.7	-3.3
Exports	5.3	8.1	12.0	12.0	7.7	15.5
Imports	4.1	4.8	2.4	15.3	6.6	1.9
Net Exports (contribution)	0.3	0.8	2.4	-0.7	0.3	3.7

1. Annual changes are Q4/Q4.

Data for the current quarter suggest that the expansion has continued. Industrial production and manufacturing orders continued to increase strongly, and the IFO business climate survey, an indicator of current and expected conditions in industry, rose significantly further. Conditions in the labor market remain stagnant, however, with the all-German unemployment rate at 11.6 percent in August. The rise in unemployment reflects to some extent the termination of government subsidized work programs and weakness in the construction sector in the eastern states, where the unemployment rate rose to 18.8 percent in August. Inflation at the consumer level has risen in recent months, registering 2.1 percent in all-Germany over the year to August and a preliminary 1.8 percent in the western states over the year to September. This acceleration in prices owes in part to rising import prices. An additional factor pushing up prices at the consumer level has been a change in the share of medical prescription costs paid by consumers, which increased in July and will affect the year/year measure of inflation until July 1998.

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

	1996	1997					
	Q4	Q1	Q2	May	Jun	Jul	Aug
Industrial Production	-0.5	0.3	1.1	-1.3	2.9	3.5	n.a.
Orders	0.2	1.0	4.0	-1.4	2.1	1.0	n.a.
Unemployment Rate (%)	10.8	11.2	11.3	11.4	11.4	11.5	11.6
Western Germany	9.5	9.8	9.9	9.9	9.9	9.8	9.9
Eastern Germany	16.0	17.0	17.5	17.6	17.9	18.3	18.8
Capacity Utilization[1]	83.2	84.1	85.1	...	...	...	...
Business Climate[1,2]	-3.3	1.3	6.0	7.0	6.0	13.0	n.a.
Consumer Prices[3]	1.4	1.7	1.6	1.6	1.7	1.9	2.1

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.

In **France**, real GDP rose 4 percent (SAAR) in the second quarter, after posting a subdued 1 percent increase in the first quarter. Net exports and inventories underpinned the robust second-quarter expansion. Consumption declined, owing to continued effects

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

	1995	1996	1996		1997	
			Q3	Q4	Q1	Q2
GDP	0.3	2.1	3.3	0.9	1.0	4.0
Total Domestic Demand	0.2	1.4	2.5	0.2	-1.6	1.8
Consumption	0.8	1.8	3.5	-1.9	0.9	-0.2
Investment	0.1	-0.6	7.1	-0.1	-4.8	0.6
Government Consumption	0.1	1.7	1.6	2.0	1.6	1.2
Inventories (contribution)	-0.4	0.1	-1.3	1.0	-1.5	1.6
Exports	1.6	8.5	15.2	7.6	8.2	21.4
Imports	1.1	5.8	12.6	5.3	-0.4	14.1
Net Exports (contribution)	0.1	0.8	0.7	0.7	2.6	2.2

1. Annual changes are Q4/Q4.

from last-year's government-sponsored car-purchase incentive scheme and a late start to the summer sales season. The slight increase in investment reflected uncertainty about the outcome of the recent parliamentary elections and the outlook for a sustained expansion in final domestic demand. Favorable calendar effects accounted for about 1 percentage point of the measured GDP growth.

Net exports and consumption are expected to support continued expansion in the current quarter. Consumption of manufactured products rose about 3 percent in July-August relative to the second quarter. The rebound in consumer spending, which was anticipated, reflects in part the 4-percent hike in the minimum wage and the rise in back-to-school allowances. Business confidence in July remained firm; foreign demand continued to boost production expectations, and inventories were judged be about normal. At just under its post-war high, unemployment edged down slightly in July. Consumer-price inflation accelerated in August owing to increased energy, food, and government-controlled prices. However, inflation in manufactured goods and services remained subdued.

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

	1996	1997					
	Q4	Q1	Q2	May	Jun	Jul	Aug
Consumption of Manufactured Products	-3.5	0.8	-0.7	-0.5	-2.9	n.a.	n.a.
Industrial Production	-0.6	0.0	2.6	-1.0	-0.1	n.a.	n.a.
Capacity Utilization	81.4	83.6	83.5	...	...	...	...
Unemployment Rate (%)	12.5	12.5	12.5	12.5	12.6	12.5	n.a.
Business Confidence[1]	3.3	10.3	8.3	7.0	10.0	11.0	n.a.
Consumer Prices[2]	1.7	1.5	0.9	0.9	1.0	1.0	1.5

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

On September 24, the French government presented its 1998 budget package to the National Assembly. The package is designed to reduce the general government deficit to 3 percent of GDP in 1998 from a targeted 3-1/4 percent in 1997. The central government deficit is projected to decline 1/4 percentage point of GDP to

3.1 percent of GDP. The social security budget, to be presented on October 8, is projected to register a small deficit in 1998, while local authorities/other administrations accounts should continue to record a surplus. The budget is based on an official forecast of 3 percent growth in real GDP growth. The 1998 budget does not include "exceptional" transfers such as transfer of France Telecom pension assets that was included in this year's budget.

Real GDP in the **United Kingdom** expanded 4 percent (SAAR) in the second quarter. Consumption expenditures and fixed investment were especially strong. Net exports subtracted from growth, as imports grew more rapidly than exports.

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

	1995	**1996**	**1996**		**1997**	
			Q3	Q4	Q1	Q2
GDP	2.0	2.9	2.2	4.4	3.3	4.0
Total Domestic Demand	1.1	3.0	2.9	4.5	2.9	6.0
Consumption	1.6	4.3	2.9	5.2	3.6	6.0
Investment	-1.6	3.7	-9.3	10.5	3.6	6.5
Government Consumption	1.3	2.4	1.0	1.5	-0.4	0.6
Inventories (contribution)	0.1	-0.7	2.6	-0.8	0.1	1.0
Net Exports (contribution)	0.9	-0.4	-0.8	-0.3	1.0	-2.0
Non-oil GDP	1.9	2.8	2.2	4.5	3.7	3.7

1. Annual changes are Q4/Q4.

Recent indicators suggest that economic activity continued to expand at a robust pace in the third quarter, although more forward-looking indicators point to a slowing in the pace of activity ahead. Industrial production increased further in July, reflecting strong domestic demand. According to the Purchasing Managers Survey, manufacturing industries expanded further in August, but the rate of growth slowed sharply, and new export orders declined for the second consecutive month. Retail sales for July and August were up 1.7 percent from the average volume in the second quarter. Household spending has been boosted in recent months by "windfall gains" of shares that consumers have received as several building societies have converted into or merged with commercial banks. Current estimates suggest that about 16.5 percent of the expected windfall gains in 1997 will be spent this year, amounting to about 1 percent of total consumer spending.

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

	1996	1997					
	Q4	Q2	Q3	Jun	Jul	Aug	Sep
Industrial Production	0.4	0.6	n.a.	1.8	0.6	n.a.	n.a.
Retail Sales	1.1	1.9	n.a.	0.8	0.5	0.4	n.a.
Unemployment Rate (%)	6.9	5.8	n.a.	5.7	5.5	5.3	n.a.
Business Confidence[1]	18.0	17.7	18.0	13.0	21.0	16.0	17.0
Consumer Prices[2]	3.2	2.6	n.a.	2.7	3.0	2.8	n.a.
Producer Input Prices[3]	-4.6	-9.6	n.a.	-8.6	-8.8	-7.8	n.a.
Average Earnings[3]	4.2	4.3	n.a.	4.3	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. Retail prices excluding mortgage interest payments. Percent change from previous year.
3. Percent change from previous year.

Retail prices excluding mortgage interest payments rose 2.8 percent over the year to August, somewhat above the government's inflation target of 2-1/2 percent for underlying inflation. However, much of the recent change in inflation reflects special factors, such as the petrol tax imposed in the July budget. Annual nominal earnings growth remains moderate. When earnings are adjusted for the impact of bonuses, the rate of growth in underlying earnings has been largely unchanged at slightly under 4-1/2 percent since early this year. The official claimant unemployment rate dropped further in August to 5.3 percent, the lowest rate since August 1980. The unemployment rate derived from the Labor Force Survey for the March-May period was 7.2 percent, its lowest reading since the Spring 1990 survey.

In **Italy**, real GDP rose a provisional 6 percent (SAAR) in the second quarter. Final figures and details on the composition of second-quarter growth will be available at the end of September. The accelerated pace of growth in the second quarter is attributable in part to a greater number of working days than in the first quarter, to higher net exports, and to strong industrial production.

The government's highly successful tax incentive scheme continued to provide stimulus to Italian auto manufacturing.

Third-quarter indicators are limited, but available data suggest further expansion. In July, new car registrations leapt for the sixth consecutive month, with growth in auto sales averaging close to 40 percent higher than in July 1996. Consumer confidence, which rose significantly in the first quarter and remained relatively flat in the second quarter, rose in July and August.

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

	1996	1997					
	Q4	Q1	Q2	Jun	Jul	Aug	Sep
Industrial Production	-1.0	1.4	2.2	0.1	0.1	n.a.	n.a.
Cap. Utilization (%)	75.1	76.2	77.7	...	...	...	...
Unemployment Rate (%)	12.0	12.2	12.4	...	...	...	...
Consumer Confidence[1]	104.7	109.2	108.8	108.9	114.1	117.8	n.a.
Bus. Sentiment[2] (%)	1.3	20.0	13.7	11.0	n.a.	n.a.	n.a.
Consumer Prices[3]	2.7	2.5	1.6	1.4	1.6	1.5	1.4
Wholesale Prices[3]	1.8	0.6	-0.4	-0.3	0.1	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.

Italian inflation remains at record low levels. In September, the consumer price index was up a preliminary 1.4 percent on a 12-month basis. Although short-term price movements suggest that the deceleration in inflation has come to an end, a significant pick-up in CPI inflation is not likely in the near term.

The rift on welfare reform between the center-left coalition and the Communists remains wide. As part of his 1998 budget, Prime Minister Prodi hopes to include cuts in health care spending and pensions, which the Communists adamantly oppose. The 1998 budget proposal, which will outline the extent of intended reforms, will be presented to the parliament by the end of September. Under Italian law, the parliament is required to approve the budget by the end of December.

The **Canadian** economy expanded strongly in the second quarter, as real GDP rose 4.9 percent (SAAR). Growth was boosted by a rise in domestic demand of nearly 7-1/2 percent, while strong growth in imports exerted some drag on the economy. Consumption continued to grow at a rapid pace, despite the very low level of the savings rate; the ratio of personal savings to disposable income is now below 1 percent.

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

	1995	1996	1996		1997	
			Q3	Q4	Q1	Q2
GDP	0.7	2.3	3.3	2.9	3.7	4.9
Total Domestic Demand	-0.1	4.5	7.3	10.3	3.1	7.4
Consumption	0.9	3.3	2.0	5.6	5.0	4.6
Investment	-1.8	12.0	19.4	20.8	15.2	9.3
Government Consumption	-1.4	-1.6	-3.9	-1.5	-1.6	-0.2
Inventories (contribution)	0.1	0.3	2.8	2.6	-2.9	2.6
Exports	5.0	1.3	8.6	-10.1	23.6	2.8
Imports	4.0	6.6	18.8	7.4	22.3	8.8
Net Exports (contribution)	0.4	-2.2	-3.8	-7.8	0.1	-2.7

1. Annual changes are Q4/Q4.

Preliminary indicators for the third quarter point to continued expansion. Employment, which rose substantially in the second quarter, edged up in July and expanded more rapidly in August. Despite the increase, the unemployment rate remained at 9 percent in August, as rapid labor force growth offset greater demand for labor. Consumer prices rose 1.8 percent over the year to August, up a bit from the second-quarter average.

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

	1996	1997					
	Q4	Q1	Q2	May	Jun	Jul	Aug
GDP at Factor Cost	1.0	0.9	1.1	0.3	-0.0	n.a.	n.a.
Industrial Production	0.5	0.9	1.4	-0.2	-0.2	n.a.	n.a.
Manufacturing Survey: Shipments	-0.2	2.9	0.6	-0.3	-0.1	n.a.	n.a.
New Orders	0.2	4.4	0.8	-2.3	-4.6	n.a.	n.a.
Retail Sales	2.5	2.0	1.6	1.0	-0.2	n.a.	n.a.
Housing Starts	0.4	19.9	-6.3	4.5	-6.5	2.8	n.a.
Employment	0.4	0.3	0.9	0.4	0.4	0.1	0.4
Unemployment Rate (%)	9.9	9.6	9.4	9.5	9.1	9.0	9.0
Consumer Prices[1]	2.0	2.1	1.6	1.5	1.8	1.8	1.8
Consumer Attitudes[2]	104.8	108.0	116.2	...	...	...	...
Business Confidence[3]	153.1	160.1	165.0	...	...	...	...

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

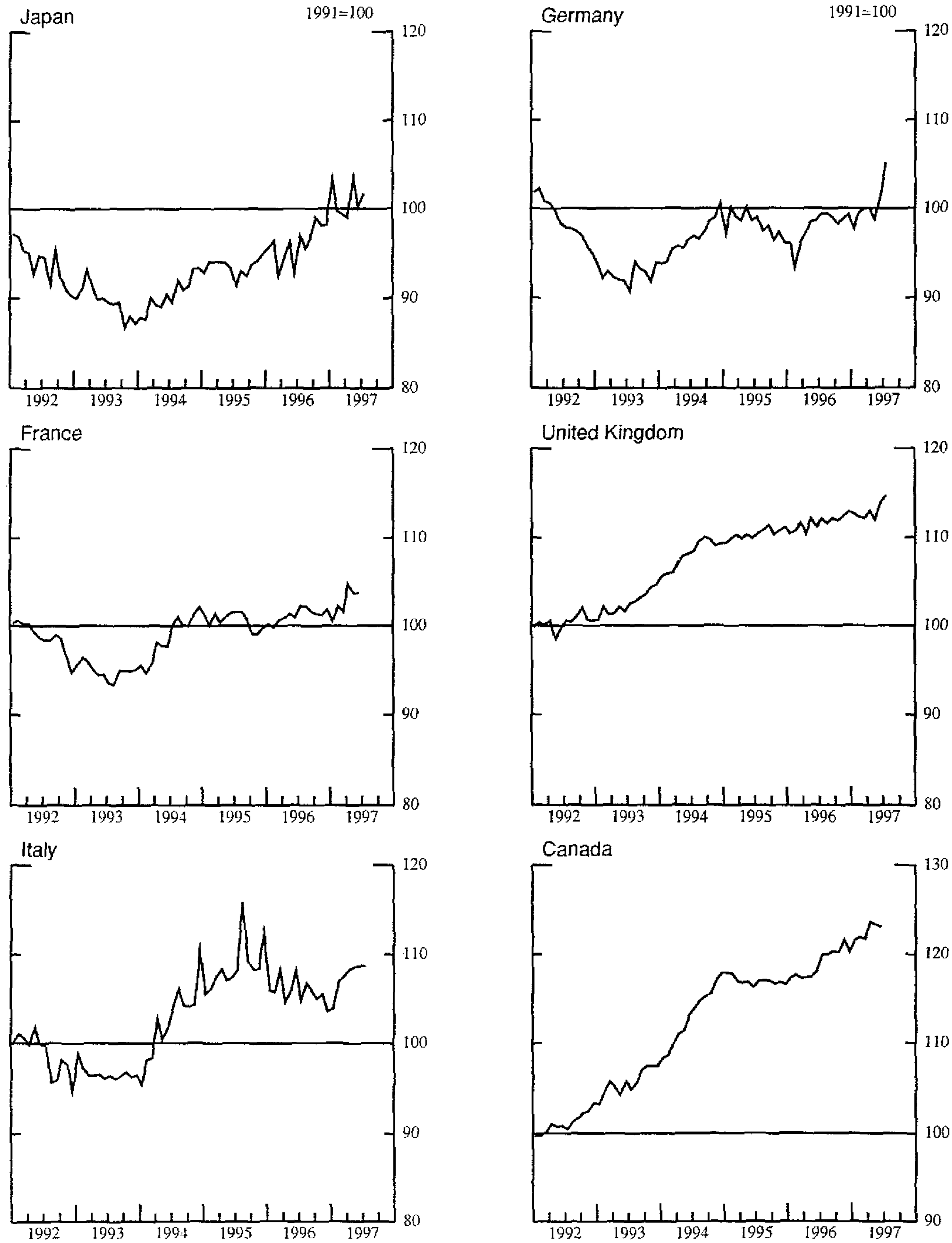
EXTERNAL BALANCES
(Billions of U.S. dollars, seasonally adjusted)

	1996	1997						
		Q1	Q2	Apr	May	Jun	Jul	Aug
Japan: trade	61.4	12.9	23.3	6.5	9.3	7.6	6.3	9.3
current account	65.9	15.4	27.3	8.1	10.7	8.5	8.1	n.a.
Germany: trade[1]	65.4	14.7	19.4	6.1	5.7	7.6	6.2	n.a.
current account[1]	-13.1	-5.8	3.0	1.8	-1.5	2.7	-1.9	n.a.
France: trade	17.4	5.5	8.8	2.8	2.8	3.2	n.a.	n.a.
current account	21.9	8.9	11.2	4.1	3.9	3.2	n.a.	n.a.
U.K.: trade	-19.0	-3.0	-4.1	-1.6	-0.9	-1.6	n.a.	n.a.
current account	0.0	2.7	1.5	...	...	...	...	...
Italy: trade	44.4	8.7	n.a.	3.5	n.a.	n.a.	n.a.	n.a.
current account[1]	41.1	8.8	n.a.	2.5	2.4	n.a.	n.a.	n.a.
Canada: trade	30.0	5.9	4.1	1.2	1.4	1.6	1.2	n.a.
current account	2.8	-0.6	-2.3	...	...	...	...	...

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

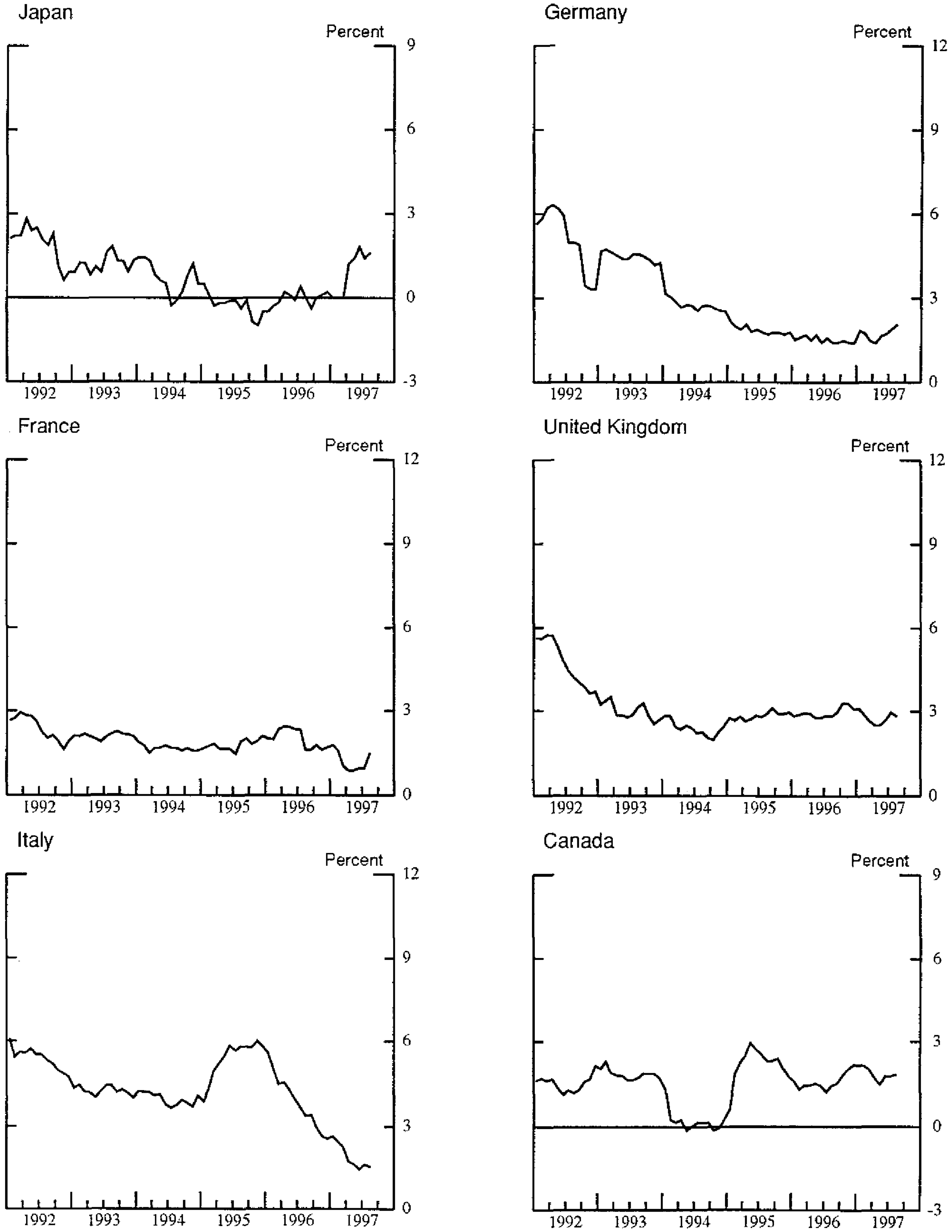
SEPTEMBER 24, 1997

Industrial Production in Selected Industrial Countries



SEPTEMBER 24, 1997

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



Economic Situation in Other Countries

In the major Latin American and Asian countries growth has remained steady in recent months, although there is some evidence of a slight slowdown in Taiwan. Inflation rates in these countries have been low to moderate with no general signs of an increase. External balances in most Latin American countries and Taiwan have deteriorated. By contrast, in Korea the trade deficit has decreased and in China the trade surplus has increased.

Financial markets have remained volatile in many of the ASEAN countries and their currencies have been depreciating against the dollar. Policy responses to the currency turmoil in these countries have been varied.

Individual country notes. On August 20, the IMF approved a stand-by credit for **Thailand**, authorizing drawings of up to about $4 billion over the next three years to support the government's economic program. The stand-by credit is equivalent to 505 percent of Thailand's quota. Thailand has also received pledges of financial support totaling $13.2 billion from other Asian countries, Australia, and other multilateral agencies. [Pledges were received from Japan ($4 billion), Australia, China, Hong Kong, Malaysia, and Singapore ($1 billion each), Indonesia, Korea, and Brunei ($0.5 billion each), the World Bank ($1.5 billion), and Asian Development Bank ($1.2 billion).]

As part of the improved public disclosure of key economic information envisaged under the IMF program, Bank of Thailand (BOT) Governor Chaiyawat announced that the bank's foreign exchange obligations arising from forward contracts over the next 12 months amounted to $23.4 billion. On September 15, the BOT stated that reserves stood at $25.9 billion as of August 29.

The Thai government has not developed a clear strategy for restructuring the 58 suspended finance companies. Restrictions have been placed on foreign ownership. Suspended finance companies are continuing to operate and the period for determining the disposition of these companies has been lengthened. Debate in Parliament over a new constitution is also standing in the way of progress on financial sector reform.

Progress toward adjustment in other ASEAN countries has been mixed. In the **Philippines**, the central bank appears to be adhering more closely to its stated intent of letting the peso seek its value freely by refraining from direct intervention. In **Malaysia**, the Prime Minister has made several pronouncements that have whipsawed the financial markets. The government also announced measures to keep current account deficits in check by tightening its fiscal policy through the postponement of infrastructure projects and by imposing some restrictions on capital goods imports. In **Indonesia**, the government has announced steps to restructure the banking sector by promoting mergers or acquisitions of ailing banks with healthy ones, and promising to liquidate banks where needed. Other announced measures included limits on forward contracts with foreign counterparties, taxes on some imported goods, and elimination of the limit on foreign acquisition of shares for future initial public offerings.

The financial markets of many **ASEAN** members have remained volatile. From July 1 to September 23, the exchange rates of ASEAN members have depreciated against the dollar by a little over 5 percent in Singapore, over 50 percent in Thailand, about 20 percent in Indonesia and Malaysia, and over 25 percent in the Philippines. These depreciations have occurred despite substantial increases in overnight interest rates and the imposition of capital controls, although in Malaysia and the Philippines, interest rates appear to be back to their July 1 levels.

The health of the financial sector in **Korea** continues to be a source of concern. On September 5, the Bank of Korea (BOK) decided to provide $1.1 billion in special loans to Korea First Bank--the second-largest of six major city banks--and a similar amount to financially troubled merchant banks to ease their liquidity problems. The BOK also announced on September 5 that foreign exchange reserves fell to $31.1 billion at the end of August from $33.7 billion in July. The slide in reserves is reportedly due to BOK's provision of foreign currency-denominated loans to domestic financial institutions to ease the difficulties they have been facing in borrowing overseas.

There has been some pressure on the Korean won in the wake of the currency crises in ASEAN countries and the bankruptcy of the conglomerates. The won depreciated by nearly 2-1/2 percent between July 1 and September 23 and has moved down over 8 percent since the start of the year. The stock market has declined by about 8 percent since July 1. Overnight interest rates stood at nearly 13-1/2 percent on September 23, about 200 basis points above their July 1 level, whereas the yield on three-year corporate bonds, a benchmark long-term interest rate, has edged up by about 75 basis points.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP	6.8	6.6	5.3	6.3	...	...	...
Industrial Production	8.4	9.8	7.0	9.7	12.4	7.9	n.a.
Consumer Prices	5.0	4.8	4.7	4.0	4.0	3.7	4.0
Trade Balance[1]	-15.3	-3.9	-5.4	-0.8	0.3	-0.3	n.a.
Current Account[1]	-23.7	-6.2	-7.9	-3.0	-0.4	-1.0	n.a.

1. Billions of U.S. dollars, NSA

Korea's trade deficit in July was $0.3 billion, compared with $1.8 billion in the same month last year; the current account deficit was $1 billion, compared with $2.3 billion a year ago. Industrial production grew by about 8 percent from year-earlier levels. Inflation remained moderate in August.

In **Taiwan**, second-quarter real GDP registered a sizeable increase over its year-earlier level, but the staff estimates that growth at a seasonally adjusted annual rate was only 4.2 percent in the second quarter, the slowest rate since 1991. This weakness appears to reflect in part the temporary effects of bad weather and an outbreak of foot-and-mouth disease in hogs. Strong import growth contributed to a narrowing of Taiwan's trade surplus in the first eight months of 1997, compared with the comparable period last year. Exports rose 5 percent over this period, while imports rose 10 percent. Foreign-exchange reserves fell about $1 billion in July from June, though they are still up about $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	Q2	Jun	Jul	Aug
Real GDP	5.7	6.6	6.8	6.3	...	..	...
Industrial Production	1.6	4.8	5.4	6.2	5.3	4.0	n.a.
Consumer Prices	2.5	2.5	1.1	1.8	1.8	3.3	-0.6
Trade Balance[1]	14.3	4.0	1.8	1.7	0.3	0.5	0.3
Current Account[1]	10.5	2.8	1.9	1.0	...	...	...

1. Billions of U.S. dollars, NSA

In **China**, growth remained steady, inflation continued to moderate, and the trade surplus continued to grow in the first eight months of 1997. During this period, surging exports led to a trade surplus of $25 billion, compared with a surplus of $5 billion in the year-earlier period. The value of exports rose 24 percent while the value of imports rose 2 percent from the year-earlier period. International reserves have risen steadily. In July 1997, reserves reached $128 billion, up $21 billion for the year.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP[1]	9.7	9.7	9.4	9.5	...	...	...
Industrial Production	15.6	15.6	13.0	14.2	14.2	n.a.	n.a.
Consumer Prices	7.0	7.0	4.0	2.8	2.8	2.7	1.9
Trade Balance[2]	12.2	4.0	6.8	11.0	3.9	2.8	5.0

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

Mexico's economy continued to show strength in the second quarter, with both real GDP and industrial production rising to well above their year-earlier levels. The increase in second-quarter GDP was led by exports and fixed investment, as in prior quarters, but the rate of recovery of private consumption picked up as well. To a certain extent, the second-quarter data overstate the improvement in economic activity, as there were more working days than usual in the second quarter of this year because Easter Week fell early. However, the underlying movement in the economy remains positive, as evidenced by the continued high growth of industrial production in July, the fall in the unemployment rate over the past few months, and the sustained rapid expansion of imports. The trade deficit was

$18 million in July. This marks the first time since January 1995 that the trade balance moved into deficit and reflects the real appreciation of the peso as well as rising domestic spending. The current account deficit expanded strongly in the second quarter as well. Monthly consumer price inflation remained just below 1 percent for the fourth consecutive month in August, reflecting both seasonal factors and the continued stability of the peso.

On September 22 the Bank of Mexico announced that, in a departure from recent policy, when conditions were appropriate, it would provide sufficient liquidity to the money market to move the reserve accounts of commercial banks with the Bank of Mexico into surplus. The move was prompted by concerns that a uniformly tight monetary policy might keep interest rates excessively high at times, thereby encouraging capital inflows, a real appreciation of the peso, and a widening of external imbalances. The Bank indicated that it would not necessarily loosen monetary conditions immediately, but that it would do so in the event that interest rates became inconsistent with the exchange rate, that inflation fell more quickly than anticipated, that the exchange rate appreciated unsustainably, or that interest rates increased due to disorderly money market conditions.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP	5.1	7.6	5.1	8.8	...	...	...
Industrial Production	10.4	12.8	6.3	11.3	9.9	9.9	n.a.
Unemployment Rate (%)	5.5	4.7	4.3	3.9	3.4	4.1	3.5
Consumer Prices[1]	27.7	6.1	5.6	2.9	0.9	0.9	0.9
Trade Balance[2]	6.3	0.7	1.4	0.6	0.3	0.0	n.a.
Imports[2]	89.6	25.5	23.5	26.8	9.1	9.4	n.a.
Exports[2]	95.9	26.2	24.9	27.4	9.4	9.4	n.a.
Current Account[2]	-1.9	-1.5	-0.3	-1.4	...	...	...

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

In **Argentina**, growth in economic activity continues to be strong. Led by investment, real GDP in the second quarter registered another substantial year-over-year gain, dispelling some earlier anticipation that the pace of growth might slow somewhat.

Despite high growth, inflation was very low, and the 12-month inflation rate remained under 1 percent. The expansion has led to strong growth in imports, especially those of capital goods. With exports cooling off, the trade deficit through July this year has widened by roughly $1.6 billion, compared with the same period last year.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP	4.3	8.8	8.1	7.8	...	...	...
Industrial Production (SA)	3.4	11.7	8.0	8.0	10.7	6.8	n.a.
Unemployment Rate (%)[2]	17.2	17.3	...	16.1	...	...	...
Consumer Prices[1]	0.2	0.3	0.3	-0.2	0.2	0.2	0.2
Trade Balance[3]	1.6	0.0	-0.4	0.4	0.1	-0.3	n.a.
Current Account[3]	-4.0	-1.7	-2.4	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 two leading opposition parties have formed an alliance and are likely to provide a strong challenge to the Peronists in upcoming congressional elections in October. The opposition is focusing on voter concerns about unemployment and corruption, creating pressures for the government to ease fiscal austerity just before the elections.

The long-awaited Brady debt buyback by Argentina occurred in September. The Argentine government issued $2.25 billion worth of a 30-year global bond at a spread of 305 basis points over comparable U.S. Treasuries and retired $3 billion of Brady debt. The net present value savings were $242 million.

In **Brazil**, real GDP grew at an annual rate of 13.9 percent in the second quarter, after declining in the first quarter. Growth was led by strong performance in the agricultural and industrial sectors. Weak consumer demand in recent weeks and apparently unsold inventories put downward pressures on prices. The CPI was nearly unchanged in August and the 12-month inflation rate was 4.3 percent, the lowest in 40 years.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP, s.a.a.r.[1]	2.9	5.9	-2.2	13.9	...	...	...
Industrial Production (SA)[2]	2.3	0.0	-1.6	1.3	2.1	-1.3	n.a.
Open Unemployment Rate (%)	5.4	4.5	5.6	5.8	5.6	6.0	n.a.
Consumer Prices[3]	9.4	1.0	2.0	1.0	0.3	0.2	0.0
Trade Balance[4]	-5.5	-3.9	-3.1	-1.7	-0.5	-0.8	-0.3
Current Account[4]	-24.3	-10.7	-6.9	-8.8	-2.7	-2.8	-1.9

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

The currency turmoil in Southeast Asia has renewed concerns about Brazil's external balance. The cumulative trade deficit through August stood at nearly $6 billion, compared with a deficit of $5.5 billion for 1996 as a whole, and the real exchange rate is roughly 25 percent higher than it was three years ago. Concern about the Brazilian outlook has contributed to the 20 percent fall in the Bovespa stock price index since early July. Over a three-day period in late August, the central bank intervened to counter downward pressures on the *real*. High domestic interest rates have also helped defend the *real*, but short-term rates have fallen slightly in recent weeks; the rate on one-month CDs was recently 20.5 percent, down from 22 percent in early August. Despite pressures against the *real*, on balance, international reserves have risen from $60 billion at the end of July to $62 billion at the end of August. Net capital flows have been boosted by foreign purchases of recently privatized firms.

The government has also responded to concerns about the possibility of a devaluation by issuing more dollar-indexed bonds. Issuing dollar-indexed bonds serves as a signal of the government's determination not to devalue by making it more costly should it do so. Dollar-indexed bonds have been issued regularly by the Treasury, and since early 1997, the central bank has issued these also. The stock of dollar-indexed debt has risen from about $6 billion at the end of 1995 to an estimated $19 billion in mid-September 1997. Recently, the maturity of these bonds has predominantly been two to three years. The latest issue on

September 17 is a two-year bond, which was priced at about 430 basis points above comparable U.S. Treasuries.

In **Venezuela**, there is evidence of a pick-up in economic activity. While estimates of GDP growth differ, according to the central bank, whose data are considered the most accurate, the economy grew by 4 percent in the first half of this year, with the non-oil sector growing by 2 percent and the oil sector growing by roughly 9 percent. As expected, inflation has picked up, with the August increase reflecting the highest monthly rise in consumer prices since October 1996. The increase in economic activity has widened the non-oil trade deficit considerably, but strong oil exports have kept the cumulative trade surplus high.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP	-1.6	...	...	...	...	...	...
Unemployment Rate (NSA, %)	11.8	12.4	12.6	12.1	...	...	...
Consumer Prices[1]	103.3	10.6	6.6	7.5	1.8	2.8	3.3
Non-oil Trade Balance[2]	-6.0	-1.0	-1.3	-1.6	-0.5	n.a.	n.a.
Trade Balance[2]	12.5	4.7	3.2	n.a.	n.a.	n.a.	n.a.
Current Account[2]	7.6	...	...	...	...	...	...

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

In September, Venezuela issued some $4 billion of 30-year global bonds at a spread of 325 basis points over comparable U.S. Treasuries. The issue was in connection with a debt swap and Venezuela retired $4.4 billion in Brady bonds, with net present value savings estimated at $385 million.

In **Russia**, recent data continue to present a relatively favorable picture. After years of decline, output appears to be increasing slightly this year. Official figures show real GDP in August up slightly from its year-earlier level, and industrial production showed an even stronger gain. In August, the 12-month CPI inflation rate remained unchanged at slightly below 15 percent. The ruble-dollar exchange rate has remained well within the corridor set by the central bank.

The pace of privatization has accelerated recently, and the competitiveness of these transactions has increased. The sale of a minority share in Svyazinvest, the Russian telecommunications conglomerate, to the highest bidder represented an important break with earlier, less transparent share transfers. Plans have been announced to accelerate privatization further next year with the goal of privatizing 37 firms, including oil companies Rosneft and Lukoil, as well as the oil pipeline company, Transneft.

On September 17, Russia signed an agreement to join the Paris Club of creditor countries, and also indicated that it plans to close a debt-rescheduling deal with its commercial creditors soon.

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

	1996	1996	1997		1997		
		Q4	Q1	Q2	Jun	Jul	Aug
Real GDP	-6	-5	0	-1	0	0	1
Industrial Production	-5	-5.4	0.9	0.9	2.0	3.4	3.0
Consumer Prices[1]	1.7	1.5	1.7	1.0	1.1	0.9	-0.1
Ruble Depreciation[1]	1.5	0.9	1.0	0.7	0.0	0.7	0.6
Trade Balance[2]	23.1	9.2	n.a.	n.a.	n.a.	n.a.	n.a.
Current Account[2]	9.6	5.3	n.a.	n.a.	n.a.	n.a.	n.a.

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