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CLASS III FOMC

June 27, 1997

SUPPLEMENT  
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

TABLE OF CONTENTS

|  | Page |
|--|------|
| THE DOMESTIC NONFINANCIAL ECONOMY  |      |
| Real GDP: 1997:Q1. . . . .   | 1    |
| Michigan (SRC) Survey of Consumer Attitudes. . . . .                                     | 2    |
| <u>Tables</u>  |      |
| Real Gross Domestic Product and Related Items. . . . .                                   | 3    |
| University of Michigan Survey Research Center:<br>Survey of Consumer Attitudes . . . . . | 4    |
| THE FINANCIAL ECONOMY  |      |
| <u>Table</u>   |      |
| Selected financial market quotations . . . . .   | 5    |

SUPPLEMENTAL NOTES

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THE DOMESTIC NONFINANCIAL ECONOMY

Real GDP: 1997:Q1

As expected, the BEA's final estimate of real GDP for the first quarter changed little from the preliminary estimate. Relative to the staff expectations shown in Part 2, the final estimate indicated somewhat smaller downward revisions to business equipment spending and to nonfarm inventory accumulation. This report would not lead us to materially alter our current-quarter forecast of real output.

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

| Category                                  | BEA<br>Preliminary | Revision to<br>preliminary |              |
|---|--------------------|----------------------------|--------------|
|   |                    | June 25<br>GB              | BEA<br>Final |
| Real GDP                                  | 98.8               | .2                         | 2.3          |
| Inventory investment                      | 34.3               | -4.3                       | -2.8         |
| Final sales                               | 64.9               | 4.8                        | 5.0          |
| PCE                                       | 66.2               | -.5                        | -.7          |
| BFI                                       | 21.8               | -2.1                       | -1.3         |
| Residential structures                    | 4.0                | .1                         | .5           |
| Government                                | .2                 | .5                         | .2           |
| Net exports                               | -28.4              | 6.4                        | 6.1          |
| Exports                                   | 23.1               | -.9                        | -.7          |
| Imports                                   | 51.6               | -7.4                       | -6.9         |
| Memo:                                     |                    |                            |              |
| Real GDP growth (percent,<br>annual rate) | 5.8                | 5.8                        | 5.9          |

The final report also included revised estimates of corporate profits for the first quarter. Corporate profits (with inventory valuation and capital consumption adjustments) now are reported to have risen \$42.4 billion from the fourth-quarter level. This figure represents a downward revision of about \$4 billion from the preliminary release. The downward revision occurred in the foreign component of profits; domestic profits were revised up slightly. The profit share of GNP (excluding Federal Reserve banks) was 8.8 percent in the first quarter, up from 8.4 percent in the fourth quarter.<sup>1</sup>

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1. Profits in the fourth quarter were held down about \$18 billion because of a special assessment on thrift institutions to recapitalize the Savings Association Insurance Fund. Excluding this adjustment, the fourth-quarter profit share would have been 8.6 percent.

Real gross domestic income (GDI)--the output of the economy measured from the income side of the national accounts--increased 5.9 percent at an annual rate in the first quarter, the same as GDP. Over the past four quarters, however, real GDI has increased 4.7 percent, compared with real GDP growth of 4.1 percent.

Michigan (SRC) Survey of Consumer Attitudes

According to the final report, the Michigan SRC index of consumer sentiment climbed 1.3 percentage points in June to an historical high; the preliminary report had shown only a small increase (0.2 percentage point). Respondents had highly favorable assessments of future business conditions and of their current financial situation relative to last year. While households were less optimistic about their personal financial situation over the coming year, that index remains at a high level. Similarly, appraisals of buying conditions for large household appliances fell back in June, but remained at a highly favorable level.

Among the questions not included in the overall index, the index of expected unemployment change over the next 12 months, which has been on a downtrend for more than a year, edged down in June. The index of car buying conditions rose to its highest level since early 1994, reflecting favorable views concerning price discounts and interest rates. However, appraisals of home buying conditions were unchanged in June as more positive views on home prices were offset by more negative views of current mortgage rates. Households' willingness to use credit to finance a major purchase fell back somewhat in June after a jump in May, while their willingness to use savings rose.

The mean of expected inflation over the next 12 months edged down 0.2 percentage point to 3.5 percent in June and has changed little, on balance, of the past four months. The mean and median of expected inflation over the next five to ten years both edged up 0.1 percentage point to 3.9 and 3.1 percent, respectively in June.

## Real Gross Domestic Product and Related Items

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

|   | 1995:Q4 to<br>1996:Q4 | 1996:Q4 | 1997:Q1     |        |
|---|-----------------------|---------|-------------|--------|
|   |                       | Final   | Preliminary | Final  |
| 1. Gross domestic product   | 3.1                   | 3.8     | 5.8         | 5.9    |
| 2. Final sales  | 3.1                   | 4.9     | 3.8         | 4.1    |
| 3. Consumer spending  | 2.7                   | 3.4     | 5.7         | 5.6    |
| 4. Durables   | 5.4                   | 5.0     | 19.3        | 18.8   |
| 5. Nondurables  | 1.8                   | 1.8     | 4.9         | 4.6    |
| 6. Services   | 2.6                   | 3.8     | 3.3         | 3.4    |
| 7. Business fixed investment  | 9.5                   | 5.5     | 11.5        | 11.0   |
| 8. Producers' durable equipment   | 9.7                   | -9      | 13.4        | 12.7   |
| 9. Nonresidential structures  | 9.1                   | 25.8    | 6.5         | 6.6    |
| 10. Residential investment  | 3.9                   | -1.8    | 6.0         | 6.7    |
| 11. Federal government consumption<br>expenditures and investment         | 1.5                   | -5.3    | -3.1        | -3.2   |
| 12. Defense   | .2                    | -6.9    | -10.0       | -10.1  |
| 13. Nondefense  | 4.1                   | -2.1    | 11.7        | 11.3   |
| 14. State and local government consumption<br>expenditures and investment | 2.1                   | 1.9     | 2.0         | 2.1    |
| 15. Exports of goods and services   | 7.4                   | 25.0    | 11.2        | 10.8   |
| 16. Imports of goods and services   | 8.3                   | 3.3     | 23.2        | 19.9   |
| <hr/>   |                       |         |             |        |
| <i>ADDENDA:</i>   |                       |         |             |        |
| 17. Nonfarm inventory investment <sup>1</sup>                             | 17.1 <sup>2</sup>     | 19.3    | 52.0        | 49.2   |
| 18. Motor vehicles <sup>1</sup>   | -3.6 <sup>2</sup>     | -4.6    | .3          | .2     |
| 19. Excl. motor vehicles <sup>1</sup>                                     | 20.7 <sup>2</sup>     | 23.9    | 51.7        | 49.0   |
| 20. Farm inventory investment <sup>1</sup>                                | -4.0 <sup>2</sup>     | -2.6    | -1.2        | -1.1   |
| 21. Net exports of goods and services <sup>1</sup>                        | -113.6 <sup>2</sup>   | -98.4   | -126.8      | -120.7 |
| 22. Nominal GDP   | 5.0                   | 5.4     | 8.1         | 8.3    |
| 23. GDP price index   | 2.1                   | 1.9     | 2.8         | 2.7    |
| 24. GDP implicit price deflator   | 1.8                   | 1.5     | 2.2         | 2.2    |
| 25. Corporate profits <sup>3</sup>  | 670.2 <sup>2</sup>    | 670.1   | 716.8       | 712.5  |
| 26. Profit share <sup>4</sup>   | 8.9                   | 8.7     | 9.1         | 9.1    |
| 27. (Excluding FR banks)  | 8.6                   | 8.4     | 8.8         | 8.8    |
| 28. Personal saving rate (percent)  | 4.9 <sup>2</sup>      | 5.1     | 4.8         | 4.7    |

1. Level, billions of chain (1992) dollars.

2. Annual average.

3. With inventory valuation adjustment (IVA) and capital consumption adjustment (CCAdj), level, billions of dollars.

4. Economic profits as a share of nominal GNP.

June 27, 1997

UNIVERSITY OF MICHIGAN SURVEY RESEARCH CENTER: SURVEY OF CONSUMER ATTITUDES  
(Not seasonally adjusted)

|   | 1996<br>Oct | 1996<br>Nov | 1996<br>Dec | 1997<br>Jan | 1997<br>Feb | 1997<br>Mar | 1997<br>Apr | 1997<br>May | 1997<br>Jun<br>(f) |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------------|
| Indexes of consumer sentiment (Feb. 1966=100) |             |             |             |             |             |             |             |             |                    |
| Composite of current and expected conditions  | 96.5        | 99.2        | 96.9        | 97.4        | 99.7        | 100.0       | 101.4       | 103.2       | 104.5              |
| Current conditions                            | 106.6       | 107.5       | 104.9       | 106.8       | 107.2       | 109.8       | 115.2       | 113.5       | 113.2              |
| Expected conditions                           | 89.9        | 93.9        | 91.8        | 91.3        | 94.9        | 93.6        | 92.5        | 96.6        | 98.9               |
| -----   |             |             |             |             |             |             |             |             |                    |
| Personal financial situation                  |             |             |             |             |             |             |             |             |                    |
| Now compared with 12 months ago*              | 115         | 121         | 117         | 116         | 114         | 119         | 132         | 122         | 126                |
| Expected in 12 months*                        | 127         | 133         | 132         | 128         | 134         | 134         | 130         | 138         | 131                |
| Expected business conditions                  |             |             |             |             |             |             |             |             |                    |
| Next 12 months*                               | 131         | 137         | 130         | 136         | 135         | 138         | 130         | 142         | 147                |
| Next 5 years*                                 | 103         | 108         | 107         | 103         | 113         | 105         | 113         | 109         | 121                |
| Appraisal of buying conditions                |             |             |             |             |             |             |             |             |                    |
| Cars  | 132         | 135         | 134         | 141         | 130         | 135         | 136         | 150         | 154                |
| Large household appliances*                   | 161         | 158         | 155         | 160         | 164         | 166         | 167         | 173         | 168                |
| Houses  | 159         | 157         | 156         | 162         | 166         | 155         | 153         | 160         | 160                |
| Willingness to use credit                     | 37          | 43          | 41          | 45          | 39          | 37          | 41          | 49          | 43                 |
| Willingness to use savings                    | 62          | 70          | 63          | 71          | 67          | 66          | 68          | 71          | 73                 |
| Expected unemployment change - next 12 months | 114         | 110         | 110         | 114         | 107         | 112         | 113         | 109         | 108                |
| Expected inflation - next 12 months           |             |             |             |             |             |             |             |             |                    |
| Mean  | 4.2         | 4.0         | 3.9         | 4.1         | 3.8         | 3.5         | 3.7         | 3.7         | 3.5                |
| Median  | 3.0         | 3.0         | 3.0         | 3.0         | 3.0         | 2.8         | 3.0         | 2.9         | 2.8                |
| Expected inflation - next 5 to 10 years       |             |             |             |             |             |             |             |             |                    |
| Mean  | 4.2         | 3.7         | 3.9         | 4.0         | 3.7         | 3.6         | 3.6         | 3.8         | 3.9                |
| Median  | 3.0         | 3.0         | 3.0         | 3.1         | 3.1         | 3.0         | 2.9         | 3.0         | 3.1                |

\* -- Indicates the question is one of the five equally-weighted components of the index of sentiment.

(p) -- Preliminary

(f) -- Final

Note: Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

Selected Financial Market Quotations<sup>1</sup>

(Percent except as noted)

| Instrument                                  | 1996        |         | 1997    |         | Change to June 26, from: |                                     |        |        |
|---|-------------|---------|---------|---------|--------------------------|-------------------------------------|--------|--------|
|   | Feb.        | July    | FOMC *  |         | Feb.                     | July                                | FOMC * |        |
|   | low         | high    | May 20  | June 26 | low                      | high                                | May 20 |        |
| <b>Short-term rates</b>                     |             |         |         |         |                          |                                     |        |        |
| Federal funds <sup>2</sup>                  | 5.15        | 5.39    | 5.50    | 5.43    | 0.28                     | 0.04                                | -0.07  |        |
| Treasury bills <sup>3</sup>                 |             |         |         |         |                          |                                     |        |        |
| 3-month                                     | 4.76        | 5.21    | 5.16    | 5.03    | 0.27                     | -0.18                               | -0.13  |        |
| 6-month                                     | 4.67        | 5.40    | 5.37    | 5.06    | 0.39                     | -0.34                               | -0.31  |        |
| 1-year                                      | 4.55        | 5.64    | 5.55    | 5.33    | 0.78                     | -0.31                               | -0.22  |        |
| Commercial paper                            |             |         |         |         |                          |                                     |        |        |
| 1-month                                     | 5.27        | 5.50    | 5.65    | 5.61    | 0.34                     | 0.11                                | -0.04  |        |
| 3-month                                     | 5.12        | 5.59    | 5.72    | 5.63    | 0.51                     | 0.04                                | -0.09  |        |
| Large negotiable CDs <sup>3</sup>           |             |         |         |         |                          |                                     |        |        |
| 1-month                                     | 5.21        | 5.44    | 5.63    | 5.60    | 0.39                     | 0.16                                | -0.03  |        |
| 3-month                                     | 5.12        | 5.59    | 5.73    | 5.66    | 0.54                     | 0.07                                | -0.07  |        |
| 6-month                                     | 4.99        | 5.83    | 5.89    | 5.76    | 0.77                     | -0.07                               | -0.13  |        |
| Eurodollar deposits <sup>4</sup>            |             |         |         |         |                          |                                     |        |        |
| 1-month                                     | 5.13        | 5.38    | 5.56    | 5.56    | 0.43                     | 0.18                                | 0.00   |        |
| 3-month                                     | 5.13        | 5.56    | 5.69    | 5.63    | 0.50                     | 0.07                                | -0.06  |        |
| Bank prime rate                             | 8.25        | 8.25    | 8.50    | 8.50    | 0.25                     | 0.25                                | 0.00   |        |
| <b>Intermediate- and long-term rates</b>    |             |         |         |         |                          |                                     |        |        |
| U.S. Treasury (constant maturity)           |             |         |         |         |                          |                                     |        |        |
| 3-year                                      | 4.98        | 6.62    | 6.42    | 6.24    | 1.26                     | -0.38                               | -0.18  |        |
| 10-year                                     | 5.58        | 7.06    | 6.71    | 6.50    | 0.92                     | -0.56                               | -0.21  |        |
| 30-year                                     | 6.02        | 7.19    | 6.92    | 6.78    | 0.76                     | -0.41                               | -0.14  |        |
| U.S. Treasury indexed bond                  | n.a.        | n.a.    | 3.58    | 3.66    | n.a.                     | n.a.                                | 0.08   |        |
| Municipal revenue (Bond Buyer) <sup>5</sup> | 5.67        | 6.24    | 5.91    | 5.82    | 0.15                     | -0.42                               | -0.09  |        |
| Corporate-A utility, recently offered       | 7.18        | 8.23    | 8.00    | 7.79    | 0.61                     | -0.44                               | -0.21  |        |
| High-yield corporate <sup>6</sup>           | 9.57        | 10.36   | 9.59    | 9.38    | -0.19                    | -0.98                               | -0.21  |        |
| Home mortgages <sup>7</sup>                 |             |         |         |         |                          |                                     |        |        |
| FHLMC 30-yr fixed rate                      | 6.94        | 8.42    | 7.91    | 7.58    | 0.64                     | -0.84                               | -0.33  |        |
| FHLMC 1-yr adjustable rate                  | 5.19        | 6.01    | 5.78    | 5.66    | 0.47                     | -0.35                               | -0.12  |        |
| <b>Stock exchange index</b>                 |             |         |         |         |                          |                                     |        |        |
|   | Record high |         | 1996    | 1997    |                          | Percentage change to June 26, from: |        |        |
|   | Level       | Date    | July    | FOMC *  |                          | Record                              | July   | FOMC * |
|   |             |         | low     | May 20  | June 26                  | high                                | low    | May 20 |
| Dow-Jones Industrial                        | 7796.51     | 6/20/97 | 5346.55 | 7228.88 | 7654.25                  | -1.82                               | 43.16  | 5.88   |
| S&P 500 Composite                           | 898.70      | 6/20/97 | 626.65  | 833.27  | 883.68                   | -1.67                               | 41.02  | 6.05   |
| NASDAQ (OTC)                                | 1452.43     | 6/24/97 | 1042.37 | 1341.24 | 1436.38                  | -1.11                               | 37.80  | 7.09   |
| Russell 2000                                | 396.49      | 6/19/97 | 307.78  | 366.57  | 390.27                   | -1.57                               | 26.80  | 6.47   |
| Wilshire                                    | 8484.51     | 6/20/97 | 6099.34 | 7861.08 | 8364.37                  | -1.42                               | 37.14  | 6.40   |

1. One-day quotes except as noted.

2. Average for two-week reserve maintenance period closest to date shown. Last observation is the average for maintenance period ending June 25, 1997.

3. Secondary market.

4. Bid rates for Eurodollar deposits at 11 a.m. London time.

5. Most recent observation based on one-day Thursday quote and futures market index changes.

6. Merrill Lynch Master II high-yield bond index composite.

7. Quotes for week ending Friday previous to date shown.

\* Figures cited are as of the close on May 19, 1997.