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CLASS III - FOMC

December 12, 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

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## SUPPLEMENTAL NOTES

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### THE DOMESTIC NONFINANCIAL ECONOMY

#### Producer Prices

The PPI for finished goods moved down 0.2 percent last month, and the index excluding food and energy edged down 0.1 percent. Over the twelve months ended in November, the core PPI rose just 0.3 percent, about 1/4 percentage point less than its increase over the prior year.

The price index for finished foods edged down 0.1 percent in November and is down 1-1/4 percent over the past year. Among specific items, coffee prices continued to decline last month, after having risen considerably earlier this year. At the crude level, food prices have dropped 6-1/2 percent over the past year. Although we still think that the CPI for food might have blipped up in November, the risks of persistent pressures in the food area do not seem to be large in the near term.

Finished energy prices moved down 0.8 percent in November. Gasoline prices fell considerably for a second month, and refiners' margins dropped back from their elevated levels of early autumn. Prices of residential electricity--about half of the energy index--also fell last month; electricity prices have been unusually volatile of late but are about unchanged, on average, over the past four months. However, natural gas prices continued to rise in November, as concerns about supply adequacy continued into the early part of the month. Nevertheless, spot prices are down since mid-November and may point to some easing in wholesale gas prices in December. Overall, the index for finished energy is 3-1/2 percent below its year-earlier level.

Prices of finished consumer goods other than food and energy ticked down 0.1 percent in November. News on motor vehicle prices has been particularly favorable. Prices for new cars and light trucks both moved down last month, and both are down between 1 and 2 percentage points over the past year. Elsewhere, apparel prices turned up, offsetting their declines of September and October while other prices were little changed last month.

Prices of capital equipment edged down 0.1 percent in November. In addition to the decline in light vehicle prices, computer prices were down 2-1/2 percent after showing no change in October. This price swing reflected movements in prices of mid-range machines; the

index for personal computers was down at about the same rate in both months.

At earlier stages of processing, the PPI for intermediate materials other than food and energy inched up in November and stood 1/2 percent higher than a year earlier. Prices for crude materials other than food and energy declined last month and are up 1-1/2 percent over the past twelve months.

#### Consumer Sentiment

According to the preliminary report, the Michigan SRC index of consumer sentiment retreated 4.2 index points in early December from the historical high posted in November; nonetheless, the value of the index in early December remained at a very high level. Households reported less favorable views of their personal finances in the past year, expected business conditions in the next year and in the next five years, and of buying conditions for large appliances. In contrast, their views of personal finances in the next twelve months held steady in early December.

Among questions not included in the overall index, the index of car buying conditions declined in early December, as did the index of house buying conditions; nonetheless, both indexes remained well within the favorable ranges that have prevailed in the past two years. The expected change in unemployment over the next year rose in early December, reaching to its highest level since April.

The mean value of expected inflation over the coming year rose 0.1 percentage point to 3.5 percent, while the median held steady at 2.9 percent. The mean value of expected inflation over the next five to ten years rose 0.3 percentage point to 4.1 percent, while the median edged up 0.1 percent to 3.2 percent.

#### Business Inventories

Excluding the stocks held by auto dealers, retail inventories edged down \$2.5 billion (annual rate) in October on a book-value basis, and the inventory-sales ratio for non-auto retailers remained at 1.42 months.

For all manufacturing and trade excluding motor vehicles, inventories rose at a \$42.7 billion annual rate in October, a touch faster than the average increase in the third quarter. With total nonvehicle shipments and sales in manufacturing and trade up 0.4 percent in October, the inventory-sales ratio for this aggregate remained at 1.33 months.

CPI AND PPI INFLATION RATES  
(Percent change)

	From twelve months earlier		1997		1997	
	Nov. 1996	Nov. 1997	Q2	Q3	Oct.	Nov.
			-Annual rate-		-Monthly rate	
<u>CPI</u>						
All items (100.0) <sup>1</sup>	3.3	n.a.	1.0	2.0	.2	n.a.
Food (15.9)	4.4	n.a.	.9	3.6	.2	n.a.
Energy (7.0)	8.1	n.a.	-15.6	2.5	.1	n.a.
CPI less food and energy (77.0)	2.6	n.a.	2.9	1.7	.2	n.a.
Commodities (23.4)	1.1	n.a.	1.4	-1.2	.1	n.a.
New vehicles (5.0)	1.8	n.a.	-.2	-.1	-.3	n.a.
Used cars (1.3)	-.8	n.a.	-7.4	-12.2	-.5	n.a.
Apparel (4.8)	-.5	n.a.	3.6	-2.5	.1	n.a.
House furnishings (3.3)	-.2	n.a.	.5	-3.3	.1	n.a.
Other Commodities (9.0)	2.1	n.a.	2.8	1.1	.3	n.a.
Services (53.7)	3.2	n.a.	3.5	2.8	.3	n.a.
Shelter (28.2)	3.0	n.a.	3.4	2.8	.3	n.a.
Medical care (6.1)	3.3	n.a.	3.3	2.2	.1	n.a.
Auto finance charges (0.6)	-1.3	n.a.	-1.0	-2.4	-.1	n.a.
Other Services (18.8)	3.6	n.a.	3.9	3.2	.5	n.a.
<u>PPI</u>						
Finished goods (100.0) <sup>2</sup>	3.0	-.6	-3.9	.4	.1	..
Finished consumer foods (23.6)	3.8	-1.2	.2	-2.0	.4	..
Finished energy (14.7)	12.9	-3.4	-22.9	5.9	.1	..
Finished goods less food and energy (61.6)	.6	.3	-.5	.0	.0	..
Consumer goods (38.1)	.8	.6	.1	.1	.1	..
Capital equipment (23.6)	.3	-.2	-.9	-.3	-.1	..
Intermediate materials (100.0) <sup>3</sup>	.5	-.1	-2.9	-.1	-.1	.
Intermediate materials less food and energy (81.3)	-1.3	.5	.3	.4	.1	.
Crude materials (100.0) <sup>4</sup>	10.6	-.9	-26.0	-3.4	4.0	1.
Crude food materials (38.0)	3.1	-6.4	7.7	-13.4	.0	..
Crude energy (42.4)	34.6	3.8	-58.5	8.4	10.7	5.
Crude materials less food and energy (19.6)	-6.5	1.6	-3.7	.1	.3	..

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.

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

	1997 Apr	1997 May	1997 Jun	1997 Jul	1997 Aug	1997 Sep	1997 Oct	1997 Nov	1997 Dec (p)
Indexes of consumer sentiment (Feb. 1966=100)									
Composite of current and expected conditions	101.4	103.2	104.5	107.1	104.4	106.0	105.6	107.2	103.0
Current conditions	115.2	113.5	113.2	114.0	110.7	114.1	109.8	114.9	111.0
Expected conditions	92.5	96.6	98.9	102.6	100.3	100.7	102.8	102.3	97.9
-----									
Personal financial situation									
Now compared with 12 months ago*	132	122	126	130	121	127	124	130	121
Expected in 12 months*	130	138	131	133	138	138	136	138	138
Expected business conditions									
Next 12 months*	130	142	147	151	150	149	154	151	145
Next 5 years*	113	109	121	130	116	119	125	123	111
Appraisal of buying conditions									
Cars	136	150	154	136	139	143	141	140	135
Large household appliances*	167	173	168	166	167	170	161	169	167
Houses	153	160	160	165	166	172	164	163	160
Willingness to use credit									
Willingness to use savings	41	49	43	49	48	50	37	46	41
Willingness to use savings									
Willingness to use savings	68	71	73	68	70	57	69	69	78
Expected unemployment change - next 12 months									
Expected unemployment change - next 12 months	113	109	108	104	107	103	100	108	112
Expected inflation - next 12 months									
Mean	3.7	3.7	3.5	3.4	3.3	3.5	3.2	3.4	3.5
Median	3.0	2.9	2.8	2.7	2.7	2.8	2.8	2.9	2.9
Expected inflation - next 5 to 10 years									
Mean	3.6	3.8	3.9	3.4	3.8	3.6	3.6	3.8	4.1
Median	2.9	3.0	3.1	2.9	3.0	3.1	3.0	3.1	3.2

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

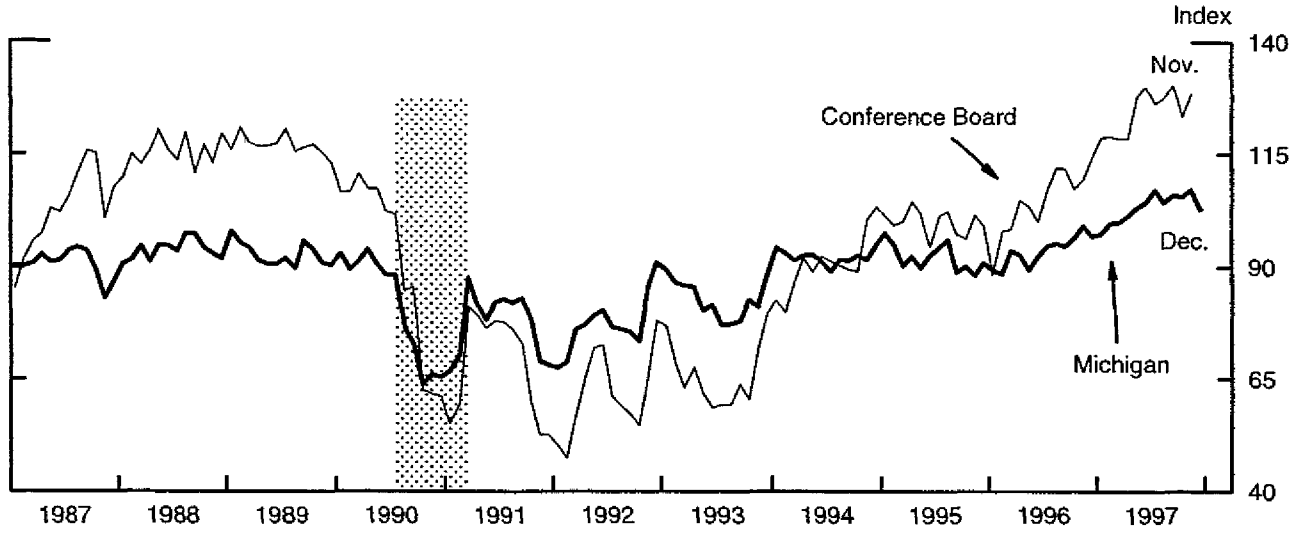
(p) -- Preliminary

(f) -- Final

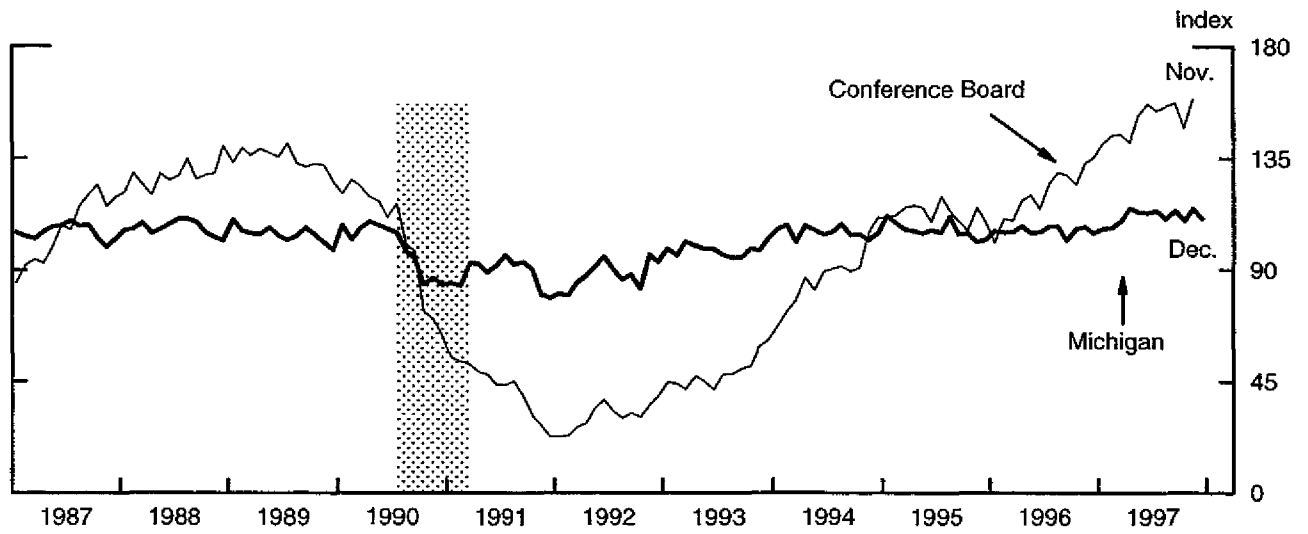
Note: Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to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

## Consumer Surveys

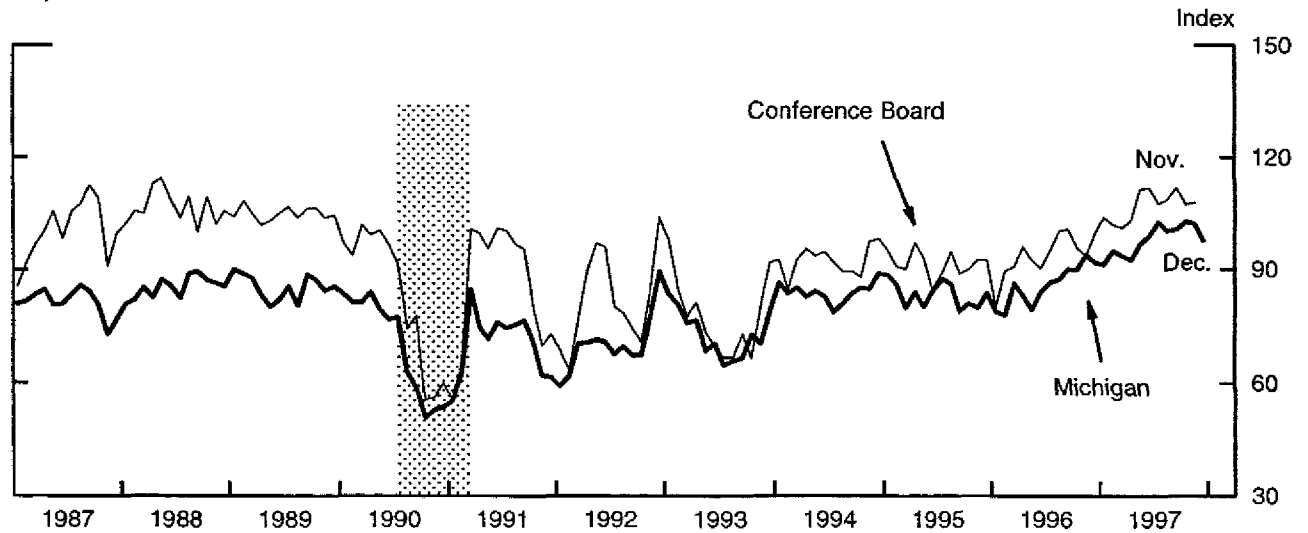
Consumer Sentiment



Current Conditions



Expected Conditions





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

	1997			1997		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
<u>Book value basis</u>						
Total	35.8	51.5	43.7	29.5	83.1	43.8
Excluding wholesale and retail motor vehicles	30.9	48.9	36.7	21.1	71.4	42.7
Manufacturing	16.5	25.1	17.3	22.1	8.5	23.9
Excluding aircraft	9.1	19.8	13.3	12.0	11.9	18.1
Wholesale	14.3	19.1	15.8	31.0	38.6	18.5
Excluding motor vehicles	11.5	14.3	14.2	25.5	34.1	21.3
Retail	5.0	7.4	10.5	-23.7	36.1	1.4
Auto dealers	2.1	-2.1	5.4	2.9	7.3	3.9
Excluding auto dealers	2.8	9.6	5.1	-26.6	28.8	-2.5

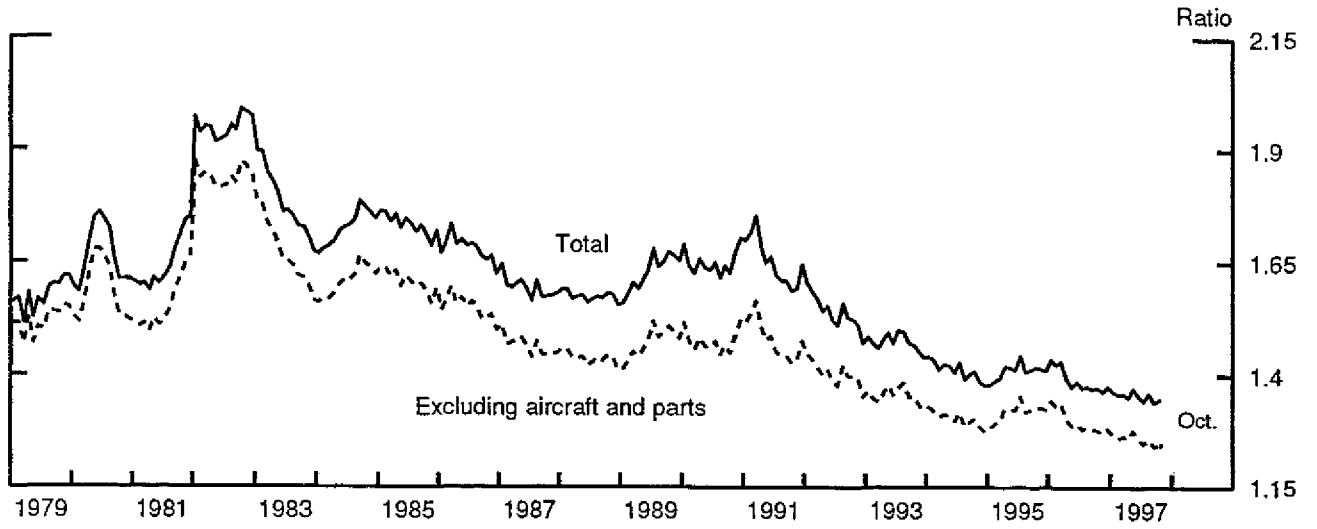
SELECTED INVENTORY-SALES RATIOS  
(Months' supply, based on Census book-value data, seasonally adjusted)

	Cyclical reference points		Range over preceding 12 months		October 1997
	1990-91 high	1995-96 low	High	Low	
Manufacturing and trade	1.58	1.37	1.38	1.35	1.37
Less wholesale and retail motor vehicles	1.55	1.34	1.35	1.32	1.33
Manufacturing	1.75	1.36	1.37	1.34	1.35
Primary metals	2.08	1.49	1.68	1.59	1.60
Nonelectrical machinery	2.48	1.80	1.87	1.71	1.72
Electrical machinery	2.08	1.41	1.46	1.29	1.32
Transportation equipment	2.93	1.48	1.61	1.52	1.56
Motor vehicles	.97	.56	.62	.56	.54
Aircraft	5.84	4.15	4.73	4.09	4.70
Nondefense capital goods	3.09	2.31	2.39	2.21	2.28
Textile	1.71	1.44	1.53	1.47	1.49
Chemicals	1.44	1.25	1.31	1.27	1.33
Petroleum	.94	.75	.84	.75	.80
Home goods & apparel	1.96	1.67	1.74	1.65	1.71
Merchant wholesalers	1.36	1.24	1.27	1.22	1.26
Less motor vehicles	1.31	1.21	1.24	1.20	1.24
Durable goods	1.83	1.53	1.56	1.50	1.53
Nondurable goods	.96	.93	.96	.92	.97
Retail trade	1.61	1.50	1.52	1.48	1.50
Less automotive dealers	1.48	1.43	1.45	1.41	1.42
Automotive dealers	2.21	1.68	1.77	1.68	1.75
General merchandise	2.43	2.21	2.26	2.08	2.07
Apparel	2.56	2.42	2.56	2.44	2.56
GAF	2.44	2.23	2.27	2.10	2.12

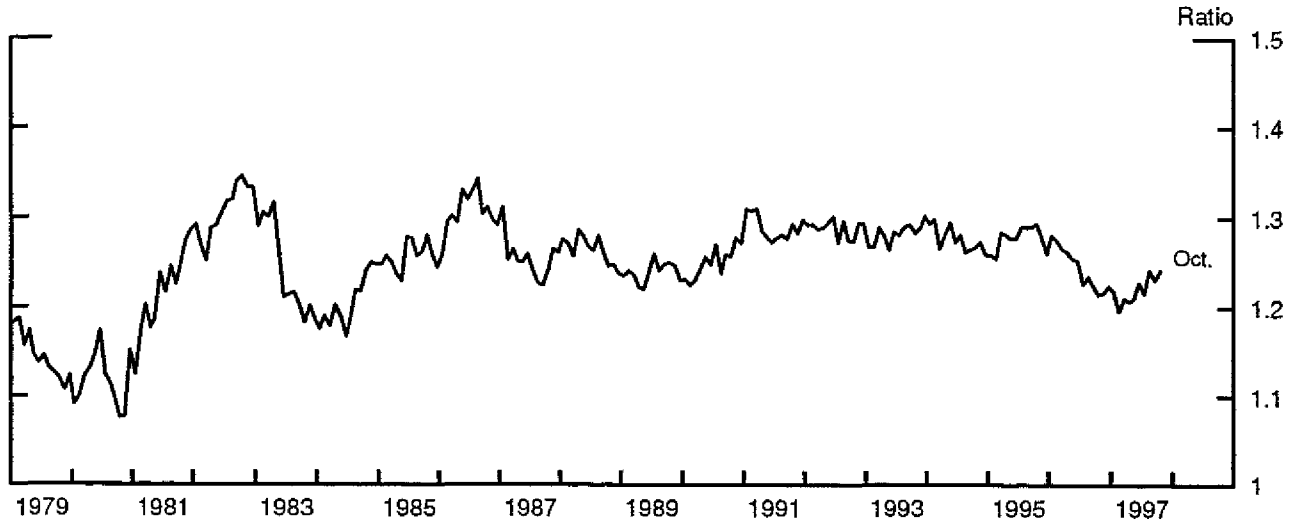
### Inventory-Sales Ratios, by Major Sector

(Book value)

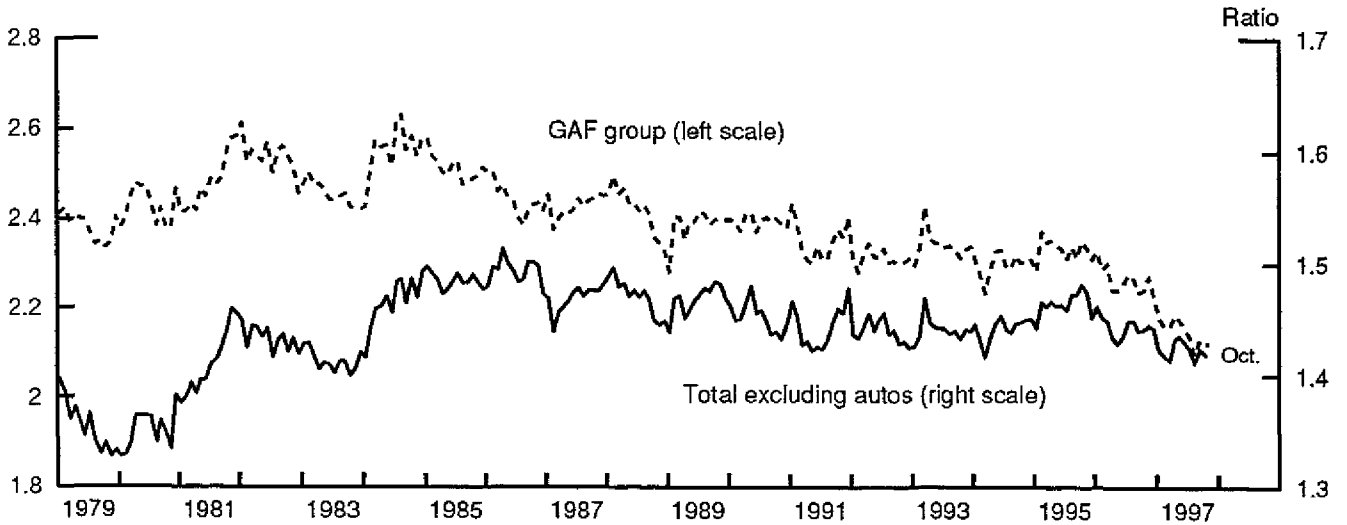
Manufacturing



Wholesale Excluding Motor Vehicles



Retail



**Selected Financial Market Quotations<sup>1</sup>**  
(Percent except as noted)

Instrument	1997				Change to Dec. 11, from:		
	Jan. 2	Mar. low	FOMC * Nov. 12	Dec. 11	Jan. 2	Mar. low	FOMC * Nov. 12
<b>Short-term rates</b>							
Federal funds <sup>2</sup>	5.79	5.27	5.50	5.42	-0.39	0.13	-0.08
Treasury bills <sup>3</sup>							
3-month	5.05	5.04	5.21	5.06	0.02	0.02	-0.15
6-month	5.14	5.17	5.17	5.18	0.08	0.01	0.01
1-year	5.28	5.37	5.17	5.19	-0.06	-0.18	0.02
Commercial paper <sup>4</sup>							
1-month	5.48	5.40	5.53	5.76	0.28	0.36	0.23
3-month	5.47	5.45	5.54	5.68	0.21	0.23	0.14
Large negotiable CDs <sup>3</sup>							
1-month	5.39	5.32	5.57	5.87	0.48	0.55	0.30
3-month	5.42	5.42	5.70	5.80	0.38	0.38	0.10
6-month	5.50	5.58	5.75	5.84	0.34	0.26	0.09
Eurodollar deposits <sup>5</sup>							
1-month	5.38	5.31	5.50	5.88	0.50	0.57	0.38
3-month	5.44	5.44	5.63	5.81	0.37	0.37	0.18
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	6.13	6.25	5.78	5.72	-0.41	-0.53	-0.06
10-year	6.54	6.56	5.91	5.82	-0.72	-0.74	-0.09
30-year	6.75	6.83	6.15	6.02	-0.73	-0.81	-0.13
U.S. Treasury 10-year indexed note	n.a.	3.36	3.55	3.54	n.a.	0.18	-0.01
Municipal revenue (Bond Buyer) <sup>6</sup>	5.96	5.97	5.65	5.45	-0.51	-0.52	-0.20
Corporate-A utility, recently offered	7.64	7.97	7.30	7.22	-0.42	-0.75	-0.08
High-yield corporate <sup>7</sup>	9.72	9.49	9.06	9.05	-0.67	-0.44	-0.01
Home mortgages <sup>8</sup>							
FHLMC 30-yr fixed rate	7.64	7.84	7.24	7.17	-0.47	-0.67	-0.07
FHLMC 1-yr adjustable rate	5.57	5.54	5.53	5.50	-0.07	-0.04	-0.03

Stock exchange index	Record high		1997			Percentage change to Dec. 11, from:		
	Level	Date	Jan. 2	FOMC * Nov. 12	Dec. 11	Record high	Jan. 2	FOMC * Nov. 12
Dow-Jones Industrial	8259.31	8/6/97	6441.49	7552.59	7848.99	-4.97	21.85	3.92
S&P 500 Composite	983.79	12/5/97	736.01	921.13	954.94	-2.93	29.75	3.67
NASDAQ (OTC)	1745.85	10/9/97	1279.70	1590.72	1558.54	-10.73	21.79	-2.02
Russell 2000	465.21	10/13/97	357.96	435.40	424.70	-8.71	18.64	-2.46
Wilshire	9486.69	10/7/97	7146.80	8917.32	9125.19	-3.81	27.68	2.33

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 December 17, 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 November 10, 1997.