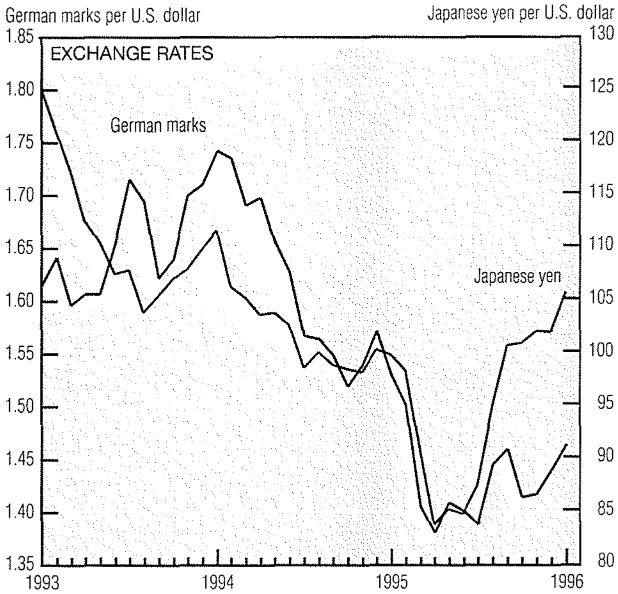
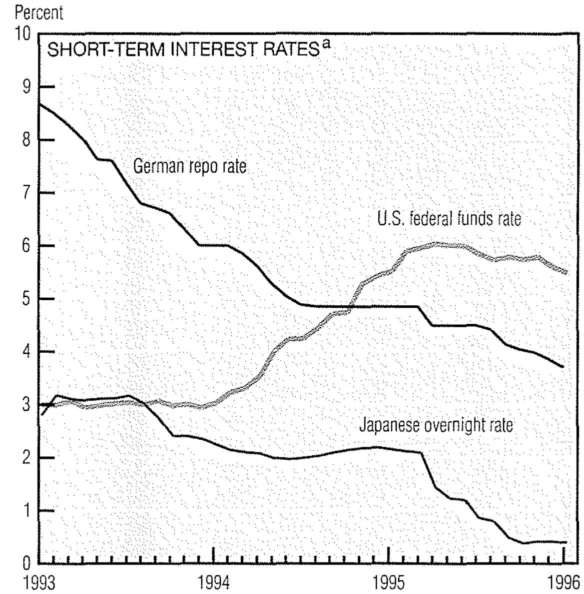
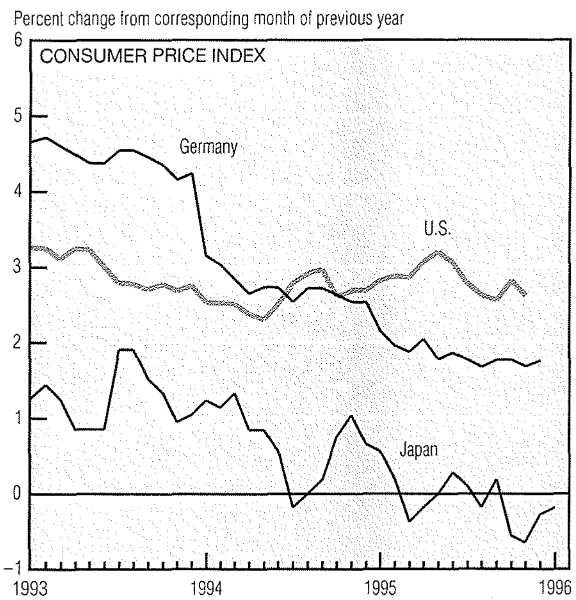
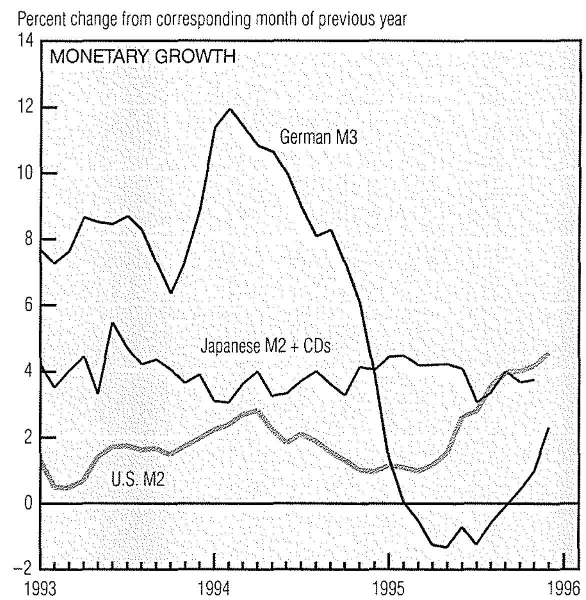
International Developments









a. Monthly averages of daily rates for the U.S. and Japan; monthly average of weekly rates for Germany.
SOURCES: Board of Governors of the Federal Reserve System; Bank of Japan; and DRI/McGraw-Hill.

The dollar has strengthened against both the German mark and the Japanese yen over the last month. Evidence of weak economic growth in Germany and elsewhere in Europe has led market observers to anticipate further European interest rate cuts, which would be expected to pull funds into U.S. dollar assets. Though Japanese economic growth has picked up, unexpected weakness in the Japanese trade surplus may be partly responsible for the increase in the yen–dollar rate, just as a worsening U.S. trade balance might move the dollar lower.

Short-term interest rates have recently edged down in the major industrial countries. The decline in German short-term rates has followed weakness in M3, the Bundesbank's targeted monetary aggregate. Economists generally focus on short-term interest rate differentials as determinants of short-term swings in exchange rates.

Inflation rates remain moderate in Germany and the U.S. Prices continue to fall in Japan, but economic activity there has recently shown signs of reviving. The last half of 1995 saw German economic growth fall to 1.9% and the nation's budget deficit widen.

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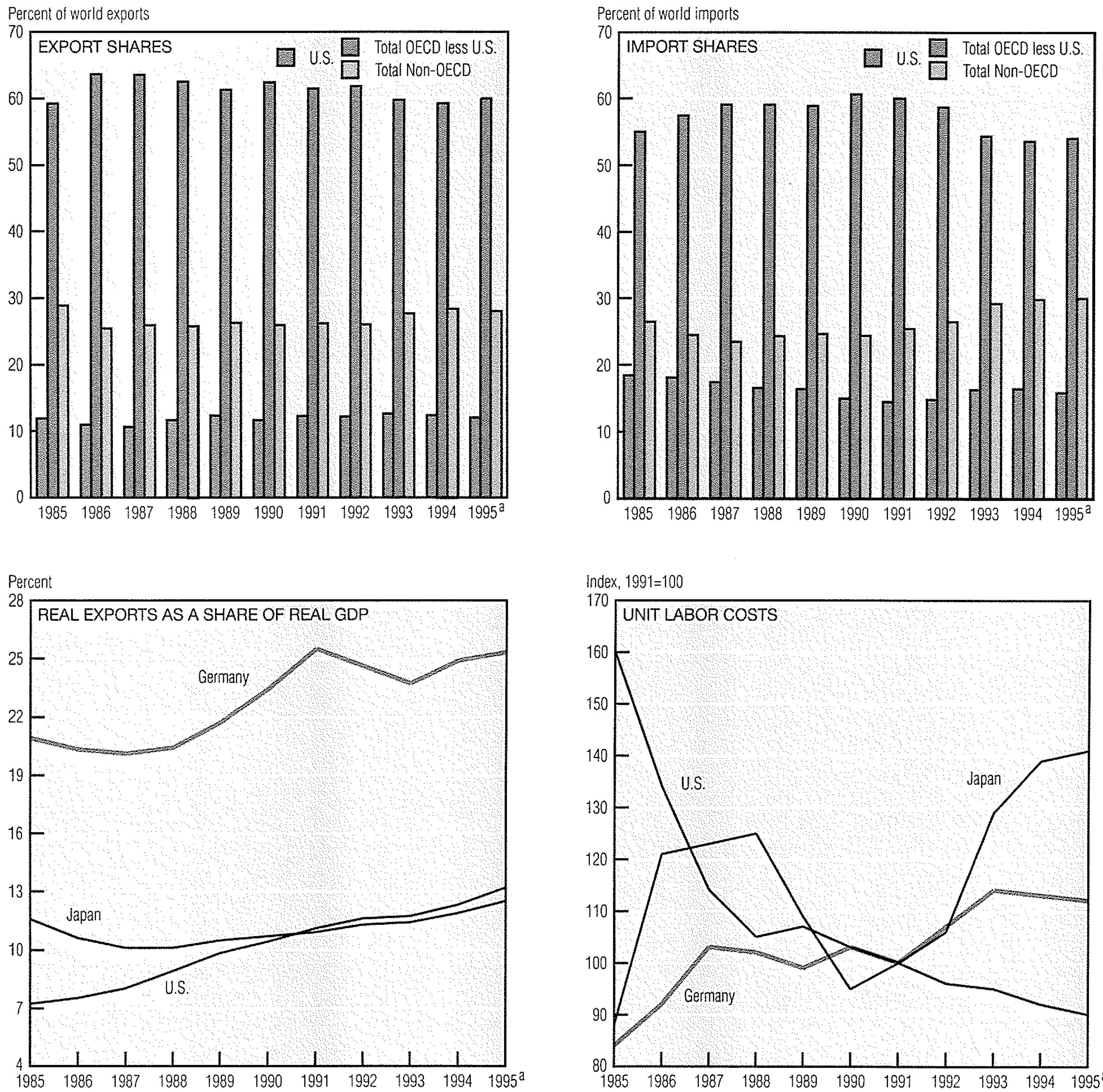
World Trade Patterns



a. OECD forecast.
SOURCES: Organisation for Economic Co-operation and Development (OECD); and DRI/McGraw-Hill.

According to the Organisation for Economic Co-operation and Development (OECD), the U.S. share of the world's export trade has inched up over the last decade. U.S. shipments amounted to approximately 11% of total export trade between 1985 and 1987, and to more than 12% between 1993 and 1995. Over this same period, the export share of other OECD countries (relatively developed nations) fell from 62% to under 60%, and the export share of non-OECD countries (developing nations) expanded from 27% to 28%.

Despite the growing U.S. trade deficit, our share of world imports actually declined over the past 10 years, falling from 18% to 16% between 1985 and 1995. Similarly, the share of other OECD countries dropped from 57% to 54%. Thus, developing countries' share rose from 25% to nearly 30% over this period.

As the U.S. has captured a larger share of the world markets, exports have become more important to our economic performance. In 1995, exports accounted for 13.2% of U.S. GDP, up from 7.2% in 1985. This puts us roughly on a par with Japan, where exports account for 12.5% of total output, but below Germany, where exports make up 25% of GDP.

In part, our export gains may reflect trends in U.S. labor costs—a major factor in international competitiveness. Over the last 10 years, U.S. labor costs have fallen 15.9%.