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# Part 2

# 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

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Available data point to appreciable further gains in output and employment into November, with noteworthy strength in the manufacturing sector. The more limited data on domestic demand suggest that final sales have softened, but so far there is little evidence of a significant spillover from the collapse in the stock market. Although the prices of intermediate materials and components have been registering sizable increases in response to dollar depreciation and rising industrial activity, neither wages nor prices of final goods and services have shown any clear acceleration.

Employment and Unemployment

The labor market surveys taken in mid-November indicated continued strength in labor demand last month: nonfarm payroll employment rose about 275,000. For the sixth consecutive month, substantial gains in employment were seen in the goods-producing sector of the economy. Manufacturing employment grew 70,000 last month and has risen nearly 300,000 since June. Job gains have been widespread in both the durable and nondurable goods industries with large increases in metals, machinery, printing, and rubber. The factory workweek edged down 0.1 hour in November, but, at 41.2 hours, still was at a very high level by historical standards. Elsewhere in the goods-producing sector, construction employment increased by 34,000 in November as seasonal layoffs were fewer than usual after weak summer hiring.

November employment gains in the service-producing sector were concentrated in the services industry where more than half the increase

CHANGES IN EMPLOYMENT[1]
(Thousands of employees; based on seasonally adjusted data)

| | | 1987 | | | 1987 | | |
|---|---|---|---|---|---|---|---|
| | 1986 | Q1 | Q2 | Q3 | Sept. | Oct. | Nov. |
| | --Average Monthly Changes-- | | | | | | |
| Nonfarm payroll employment[2] | 159 | 254 | 163 | 205 | 159 | 536 | 274 |
| Strike-adjusted | 159 | 241 | 164 | 227 | 219 | 479 | 268 |
| Manufacturing | -14 | 8 | 7 | 51 | 40 | 76 | 69 |
| Durable | -17 | 0 | 0 | 31 | 20 | 52 | 36 |
| Nondurable | 4 | 8 | 7 | 21 | 20 | 24 | 33 |
| Construction | 13 | 32 | -8 | -6 | -17 | 55 | 34 |
| Trade | 31 | 57 | 35 | 41 | 66 | 101 | 3 |
| Finance | 29 | 25 | 20 | 14 | 5 | 15 | 15 |
| Services | 81 | 99 | 80 | 71 | 16 | 116 | 88 |
| Total government | 30 | 18 | 18 | 6 | 2 | 156 | 42 |
| Private nonfarm production workers | 105 | 199 | 112 | 143 | 77 | 298 | 142 |
| Total employment[3] | 174[e] | 244 | 296 | 172 | -309 | 415 | 313 |
| Nonagricultural | 174[e] | 203 | 332 | 174 | -387 | 301 | 430 |

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.
e--Adjusted by Board staff to eliminate distortions caused by the introduction of revised population estimates.

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

| | | 1987 | | | 1987 | | |
|---|---|---|---|---|---|---|---|
| | 1986 | Q1 | Q2 | Q3 | Sept. | Oct. | Nov. |
| Civilian, 16 years and older | 7.0 | 6.7 | 6.2 | 6.0 | 5.9 | 6.0 | 5.9 |
| Teenagers | 18.3 | 17.9 | 17.0 | 15.9 | 16.3 | 17.4 | 16.8 |
| 20-24 years old | 10.7 | 10.4 | 10.0 | 9.4 | 9.3 | 8.7 | 8.9 |
| Men, 25 years and older | 5.4 | 5.2 | 4.8 | 4.6 | 4.4 | 4.5 | 4.4 |
| Women, 25 years and older | 5.5 | 5.1 | 4.6 | 4.7 | 4.7 | 4.7 | 4.7 |
| White | 6.0 | 5.7 | 5.3 | 5.1 | 5.1 | 5.2 | 5.1 |
| Black | 14.5 | 14.2 | 13.2 | 12.4 | 12.3 | 12.0 | 12.1 |
| Fulltime workers | 6.6 | 6.3 | 5.9 | 5.6 | 5.4 | 5.5 | 5.5 |
| Memo: | | | | | | | |
| Total national[1] | 6.6 | 6.6 | 6.1 | 5.9 | 5.8 | 5.9 | 5.8 |

1. Includes resident armed forces as employed.

was in health services. The layoffs in the securities industry had yet to show through, as finance, insurance, and real estate employment rose again.[1] Transportation and wholesale trade also showed gains. However, retail trade employment fell somewhat, primarily because holiday-related hiring in general merchandise stores was less than seasonally expected. Employment in state and local government grew 37,000 after an unusually large advance in October.

The civilian unemployment rate edged back down to 5.9 percent in November and has been essentially flat since June. Compared with the first half of the year when declines in joblessness were widespread, the improvement in unemployment since June has been concentrated among adult men.

Industrial Production and Capacity Utilization

The index of industrial production rose 0.6 percent in October, owing in large part to an uptick in auto assemblies. Industrial output apparently continued to expand at a moderate pace in November, as indicated by the labor market report and available physical product data. The purchasing managers' survey also indicated continued expansion in output through November, although the number of firms reporting increases in production exceeded that reporting declines by a smaller margin than in previous months. More respondents still are reporting increases in orders and employment than are reporting decreases.

1. Although employment in the finance industry has grown almost 50 percent faster than total payroll employment over the past five years, the industry still accounts for only about 3 percent of total employment.

INDUSTRIAL PRODUCTION
(Percentage change from preceding period;
based on seasonally adjusted data)

| | 1987 | | 1987 | | |
|---|---|---|---|---|---|
| | Q2 | Q3 | Aug. | Sept. | Oct. |
| | --Annual rate-- | | --Monthly rate-- | | |
| Total Index | 4.2 | 8.3 | .3 | .0 | .6 |
| Products | 3.6 | 8.5 | .2 | .0 | .9 |
| Final products | 3.0 | 8.5 | .3 | .1 | 1.1 |
| Consumer goods | 1.5 | 7.1 | .2 | -.6 | 1.2 |
| Durable consumer goods | -5.8 | 5.9 | .5 | -2.3 | 3.3 |
| Nondurable consumer goods | 4.1 | 7.4 | .2 | .0 | .4 |
| Equipment | 4.7 | 10.2 | .4 | .9 | 1.0 |
| Business equipment | 5.6 | 9.4 | -.1 | .7 | 1.3 |
| Defense and space eq. | 1.6 | 2.1 | .7 | .7 | .4 |
| Oil and gas well drilling | 15.1 | 159.6 | 9.2 | 8.2 | -.6 |
| Intermediate products | 5.6 | 8.4 | -.2 | -.4 | .3 |
| Construction supplies | -2.0 | 9.5 | -.7 | .2 | .0 |
| Materials | 5.3 | 8.1 | .4 | -.1 | .1 |
| Durable goods materials | 5.2 | 7.4 | .2 | -.3 | .7 |
| Nondurable goods materials | 9.5 | 14.0 | .3 | .5 | -.4 |
| Energy materials | 1.2 | 3.5 | 1.0 | -.3 | -.4 |

CAPACITY UTILIZATION IN INDUSTRY
(Percent of capacity, seasonally adjusted)

| | 1978-80 | 1982 | 1967-86 | 1984 | 1987 | | 1987 |
|---|---|---|---|---|---|---|---|
| | High | Low | Avg. | High | Q2 | Q3 | Oct. |
| Total industry | 86.9 | 69.5 | 81.5 | 81.8 | 79.9 | 81.1 | 81.3 |
| Manufacturing | 86.5 | 68.0 | 80.6 | 81.3 | 80.5 | 81.4 | 81.7 |
| Durable | 86.3 | 63.7 | 78.7 | 79.9 | 77.6 | 78.5 | 79.2 |
| Nondurable | 87.0 | 74.2 | 83.5 | 84.2 | 84.7 | 85.7 | 85.5 |
| Mining | 95.2 | 76.9 | 87.2 | 86.6 | 76.3 | 77.6 | 78.9 |
| Utilities | 88.5 | 78.0 | 87.3 | 84.8 | 78.3 | 80.3 | 79.6 |
| Industrial materials | 89.1 | 68.5 | 82.3 | 82.8 | 79.4 | 80.7 | 80.6 |
| Metals | 93.6 | 45.7 | 77.8 | 70.8 | 70.0 | 76.1 | 78.0 |
| Paper | 97.3 | 79.9 | 91.4 | 97.5 | 95.7 | 99.8 | n.a. |
| Chemicals | 87.9 | 63.5 | 80.8 | 78.3 | 83.6 | 85.9 | n.a. |

Capacity utilization has been rising over the past year, and the overall rate in manufacturing is now above the 1984 high. Among industrial materials producers, operating rates of nondurable goods materials industries, particularly paper and chemicals, remain high by historical standards; rates for certain metals continue to climb, but are still short of the highs reached earlier in the expansion. Although output of business equipment has risen appreciably this year, operating rates remain relatively low.

Personal Income and Consumption

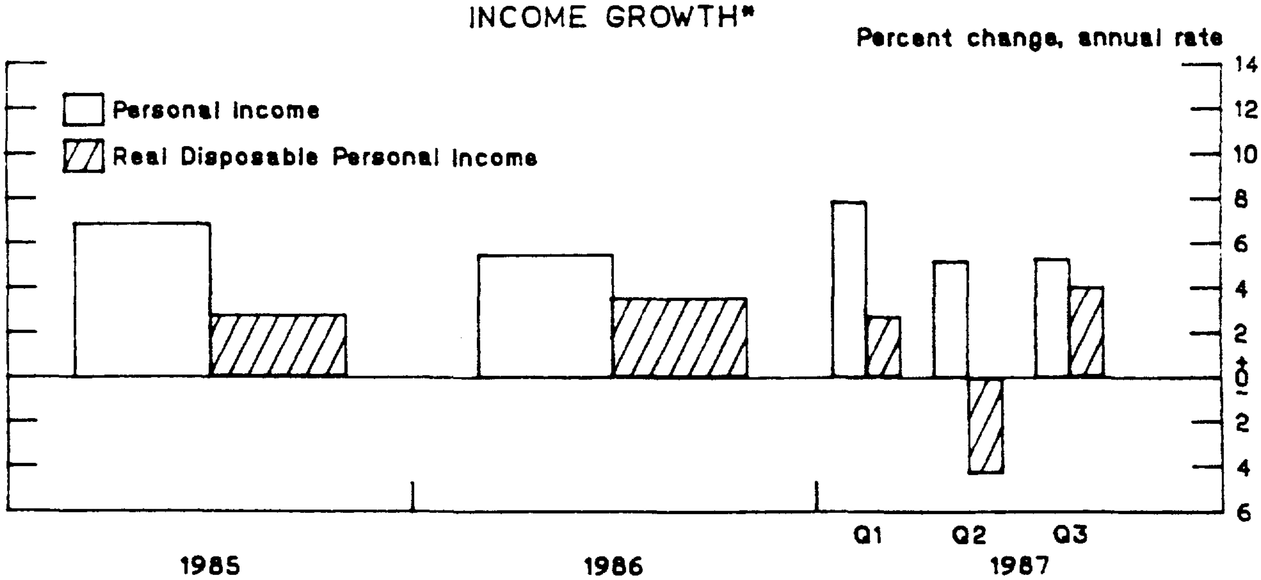
Nominal personal income increased sharply in October, boosted by a $36 billion rise (annual rate) in federal subsidy payments to farmers. Even excluding subsidy payments, total personal income increased somewhat faster than the average pace in the third quarter. Wages and salaries posted another strong gain,[2] and BEA figures show a further rise in personal interest income. Now that personal tax payments are not showing large month-to-month fluctuations as they had earlier this year, the pattern of growth in disposable income has been similar to that for personal income. Nevertheless, increases in nominal income continued to be substantially offset by increases in consumer prices, and real disposable income in September was less than 1 percent above the level of the fourth quarter of 1986.

2. Based on available data on average hourly earnings and hours of production workers, wages and salaries apparently posted another strong gain in November.

PERSONAL INCOME
(Average monthly change at an annual rate;
billions of dollars)

| | 1986 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Aug. | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|
| Total personal income | 14.2 | 23.5 | 10.6 | 20.6 | 19.3 | 21.1 | 63.3 |
| Wages and salaries | 7.5 | 12.9 | 8.6 | 14.2 | 19.1 | 12.6 | 15.3 |
| Private | 5.6 | 10.1 | 6.6 | 12.1 | 17.1 | 10.5 | 13.3 |
| Other labor income | .7 | .8 | .7 | .8 | .7 | .8 | .8 |
| Proprietors' income | 2.6 | 6.7 | -2.9 | .5 | -4.0 | 2.0 | 38.1 |
| Farm | .5 | 3.5 | -4.4 | -1.6 | -6.8 | .9 | 34.1 |
| Rent, dividends and interest | 1.7 | 2.7 | 2.3 | 4.5 | 4.7 | 5.0 | 5.8 |
| Transfer payments | 2.5 | 2.1 | 2.5 | 1.6 | .0 | 1.4 | 3.6 |
| Less: Personal contributions for social insurance | .8 | 1.7 | .5 | .9 | 1.2 | .7 | .4 |
| Less: Personal tax and nontax payments | 3.2 | -1.2 | 7.0 | 3.8 | 5.0 | 3.9 | 4.7 |
| Equals: Disposable personal income | 11.0 | 24.7 | 3.6 | 16.8 | 14.3 | 17.2 | 58.6 |
| Memo: Real disposable income | 6.3 | 6.1 | -7.4 | 4.7 | .9 | .6 | -- |

INCOME GROWTH*




*Based on quarterly averages; annual percent changes are from Q4 to Q4.

Consumer spending is estimated to have fallen in real terms in October,[3] owing chiefly to lower spending on motor vehicles with the expiration of manufacturers' incentives on September 30. Outside the motor vehicle sector, however, spending posted a moderate gain in real terms, rising to a level 1/2 percent above the third-quarter average. Purchases of durable goods other than motor vehicles picked up, more than reversing two months of decline, and spending on services posted a large gain, reflecting in part increases in electricity and natural gas (owing to cold weather) and in brokerage services (owing to large trading volumes). In contrast, outlays for nondurables remained sluggish.

Domestic auto sales were at a 6.8 million unit annual rate in November, up from 5-3/4 million units in October. The higher selling pace last month largely reflects a sharp jump in sales during the final 10 days of the month, presumably related, to a new round of incentive programs. Although the incentives now cover roughly half of the domestic manufacturers' output, the programs are neither as generous nor as widespread as the round of price and financing incentives of a few months ago.

Domestic auto sales have not kept up with production in recent months, and inventories edged up again last month from a level that already was regarded as high. In addition to the new incentive programs, automakers have reacted to this inventory problem by cutting their production schedules. Domestic auto production, which was 7.1

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3. Estimates of real consumption spending in October are based on actual nominal spending from the BEA, CPI data from the BLS, and staff estimates of the translation from the CPI to BEA deflators.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period;
based on seasonally adjusted data)

| | 1986[1] | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Sept. | 1987 Oct.[2] |
|---|---|---|---|---|---|---|
| | | --Annual rate-- | | | -Monthly rate- | |
| Personal consumption expenditures | 4.1 | -.7 | 1.9 | 4.9 | -.8 | -.3 |
| Durable goods | 12.4 | -21.2 | 10.5 | 22.4 | -2.7 | -5.0 |
| Excl. motor vehicles | 12.7 | -3.8 | 2.2 | 3.9 | -.5 | 1.5 |
| Nondurable goods | 2.9 | 1.3 | -1.9 | -1.2 | -.8 | .1 |
| Excluding gasoline | 2.4 | 2.9 | -3.2 | -.6 | -1.0 | .1 |
| Services | 2.4 | 5.4 | 2.1 | 4.1 | -.2 | .9 |
| Excluding energy | 2.8 | 6.6 | 2.1 | 3.5 | -.1 | .5 |
| Memo: | | | | | | |
| Personal saving rate (percent) | 4.3 | 4.4 | 3.0 | 2.8 | 3.0 | 4.7 |

1. Percent change from fourth quarter of 1985 to fourth quarter of 1986.
2. Staff estimates based on actual nominal consumer spending data and CPI data for October.

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

| | 1986 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Oct. | 1987 Nov. |
|---|---|---|---|---|---|---|
| Autos and light trucks | 16.1 | 13.8 | 15.0 | 16.4 | 13.7 | 14.9 |
| Autos | 11.5 | 9.7 | 10.3 | 11.4 | 9.1 | 10.1 |
| Light trucks | 4.7 | 4.2 | 4.8 | 5.0 | 4.6 | 4.8 |
| Domestically produced[1] | 12.0 | 10.2 | 11.0 | 11.9 | 9.6 | 10.8 |
| Autos | 8.2 | 6.9 | 7.2 | 7.8 | 5.8 | 6.8 |
| Light trucks | 3.7 | 3.4 | 3.8 | 4.1 | 3.8 | 4.0 |
| Imports | 4.2 | 3.6 | 4.0 | 4.5 | 4.1 | 4.1 |
| Autos | 3.2 | 2.8 | 3.1 | 3.6 | 3.3 | 3.3 |
| Japanese | 2.4 | 2.0 | 2.1 | 2.4 | 2.2 | 2.3 |
| Korean | .2 | .2 | .3 | .5 | .3 | -- |
| European | .7 | .6 | .7 | .7 | .7 | -- |
| Light trucks | .9 | .8 | .9 | .9 | .8 | .8 |
| Memo: | | | | | | |
| Auto production | 7.8 | 7.8 | 7.1 | 6.3 | 7.3 | 7.1 |

1. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler as well as foreign makes produced in the U.S.

million units in November, is scheduled at approximately 6-3/4 million units in December and in the first quarter of next year.

Sales of imported cars were at a 3.3 million unit annual rate in November, about the same as in October. Domestic light truck sales rose to 4.0 million units, close to the brisk pace seen in the third quarter; sales of imported light trucks, meanwhile, held steady at 800,000 units.

Data through October on total consumption spending and through November on auto sales give no clear indication of immediate consumer reaction to the stock market collapse. Nonetheless, the risks of some retrenchment are pointed up in both the Conference Board and the University of Michigan surveys of consumer attitudes, which show a sharp deterioration in the overall indexes of sentiment. The change in the Michigan measure is attributable mainly to much less favorable assessments of both expected personal financial conditions and business conditions in general. Perhaps because stock holdings are so concentrated, assessments of current personal financial conditions are off only slightly since before the crash. Nonetheless, more consumers reported that it is a bad time to make purchases on credit or out of savings. In addition, sales of major chain stores--up 7.6 percent in nominal terms over the 12 months ended in November--posted their smallest gain in several months; this series, however, has not proven to be a good predictor of the broader retail sales figures published by the Commerce Department, which will be released on Friday.

BUSINESS CAPITAL SPENDING INDICATORS
(Percentage change from preceding comparable periods;
based on seasonally adjusted data)

| | 1987 | | | 1987 | |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Sept. | Oct. |
| Producers' durable equipment | | | | | |
| Nondefense capital goods | | | | | |
| Shipments | -3.2 | 2.7 | 5.1 | 4.3 | -3.0 |
| Aircraft | -13.7 | 4.1 | -1.0 | 27.1 | -16.5 |
| Excl. aircraft | -1.8 | 2.5 | 5.8 | 1.8 | -1.2 |
| Office & computing equip. | -3.3 | 2.4 | 6.2 | 1.9 | 1.6 |
| Orders | -3.8 | 9.0 | 3.3 | .7 | 1.3 |
| Aircraft | -26.2 | 30.5 | -5.3 | -21.8 | 24.8 |
| Excl. aircraft | .6 | 5.9 | 4.9 | 4.2 | -1.4 |
| Office & computing equip. | -10.3 | 13.4 | 4.3 | .9 | 5.5 |
| Sales of heavy-weight trucks (thousands of units, A.R.) | 277 | 312 | 327 | 377 | 191 |
| Nonresidential structures | | | | | |
| Nonresidential construction | -3.8 | .8 | 4.4 | -1.3 | -1.4 |
| Commercial building | -5.4 | -.2 | 2.5 | -2.7 | -.1 |
| Office | -5.2 | -4.0 | 5.0 | .0 | 1.8 |
| Other commercial | -5.5 | 3.5 | .1 | -5.3 | -2.0 |
| Industrial building | -13.8 | 6.6 | 7.7 | 5.9 | -7.5 |
| Public utilities, institutional, and other | .1 | .4 | 5.5 | -1.6 | -1.1 |
| Rotary drilling rigs in use | 3.4 | 6.8 | 16.3 | 6.9 | -1.5 |

CONSUMER CONFIDENCE BEFORE AND AFTER OCTOBER 19

| Survey | September | October Before crash | October After crash | November |
|---|---|---|---|---|
| University of Michigan[1] | 93.6 | 92.5 | 82.4 | 83.1 |
| Conference Board[2] | 115.7 | 116.9 | 110.4 | 96.3 |

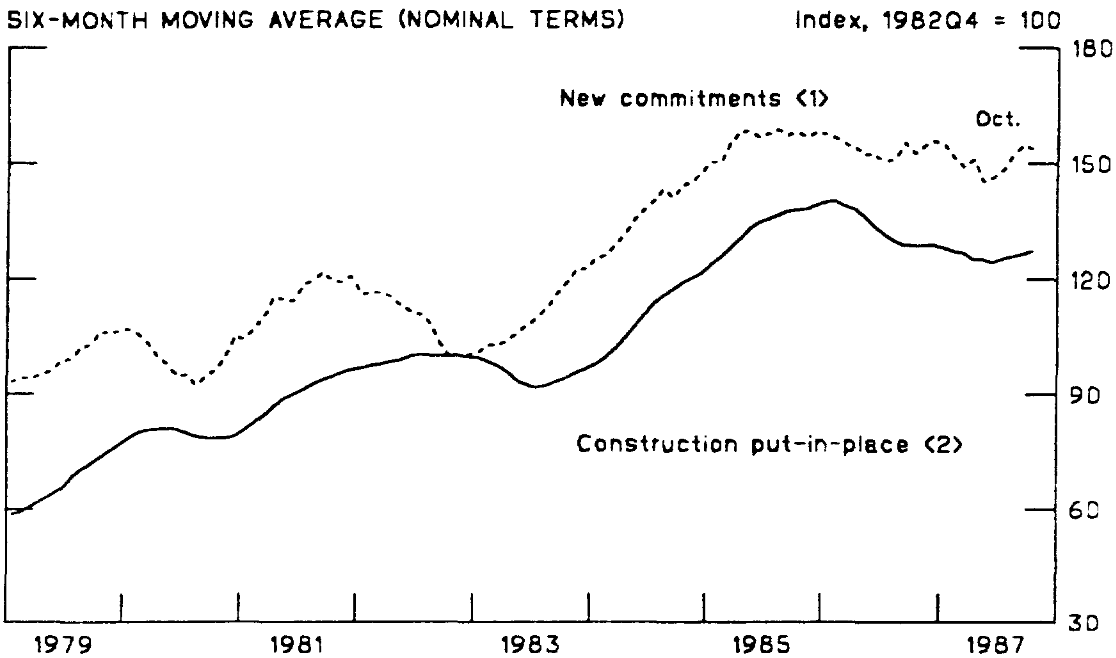
1. February 1966=100.
2. 1985=100.

Business Fixed Investment

Shipments of nondefense capital goods fell 3 percent in nominal terms in October, but because of earlier gains, the level of shipments still was slightly above the third-quarter average. Shipments for office and computing equipment, however, continued to rise briskly, up another 1-1/2 percent in nominal terms. Moreover, the sizable increases in nominal shipments of computers in recent months have understated the growth in real outlays because of the continued downtrend in the prices of these items. In contrast, outlays for motor vehicles fell sharply in the past two months, reflecting both a post-incentive slump in automobile purchases and a sharp drop in heavy truck sales in October.

Real spending for nonresidential structures jumped 23 percent at an annual rate in the third quarter, after trending down for the past couple of years. Much of the increase reflected a sharp expansion of petroleum drilling. Drilling activity declined slightly in October and November but remained about 2 percent above the third-quarter average. The value of nonresidential construction put-in-place (which excludes petroleum drilling) fell in October after posting a strong gain in the third quarter.

## Nonresidential Construction and New Commitments




<1> Sum of contracts (from F.W.Dodge) and permits (from Census) for industrial, commercial, and institutional construction.
<2> Includes only the building components of nonresidential construction, i.e., industrial, commercial, institutional, and hotels and motels.

MCGRAW-HILL SURVEY OF PLANT AND EQUIPMENT EXPENDITURES[1]
(Percent change from previous year, seasonally adjusted)

| | 1987 | 1988 |
|---|---|---|
| All business | 3.1 | 6.2 |
| Manufacturing | 5.1 | 8.8 |
| Durables | 1.6 | 10.8 |
| Nondurables | 8.5 | 7.6 |
| Nonmanufacturing | 1.9 | 4.6 |

1. Based on the September-October Survey; in nominal terms.

While we have little hard information about the effects of the stock market crash on the demand for capital goods, the anecdotal evidence does not suggest an immediate response. Earlier information shows that new orders for nondefense capital goods excluding aircraft dropped 1.4 percent in October but were still 0.6 percent above the strong third-quarter average. For construction, new commitments remained firm through October.

The McGraw-Hill survey, which collected responses in September and October, indicates that firms expected nominal outlays to increase 6-1/4 percent next year, with increases in nearly all industries. However, given the steep uptrend in investment since early this year and the likelihood of some increase in investment prices, achieving a 6 percent year-over-year gain in nominal BFI for 1988 as a whole would require only small increases in real outlays in coming quarters.

Business Inventories

Inventories in manufacturing and trade rose modestly in the third quarter, up at an annual rate of $3 billion in 1982 prices, compared with the average pace of $27 billion over the first half of this year. However, the slowing was largely due to the liquidation of auto dealers' stocks. Excluding autos, the pace of inventory expansion in the third quarter was not much different from that observed during the first half of this year and, on the whole, was in line with growth in shipments and sales.

Manufacturers have been building up their stocks since June. During the third quarter, factory inventories expanded at an annual rate

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

| | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Aug. | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|
| **Current Cost Basis:** | | | | | | |
| Total | 41.2 | 47.0 | 31.5 | 8.4 | 50.3 | -- |
| Manufacturing | 7.7 | 6.1 | 20.2 | 24.7 | 15.3 | 21.5 |
| Wholesale | 8.8 | 14.1 | .8 | -17.1 | 24.9 | -- |
| Retail | 24.8 | 26.7 | 10.5 | .8 | 10.1 | -- |
| Automotive | 19.9 | 9.3 | 1.8 | -3.2 | .0 | -- |
| Ex. auto | 4.8 | 17.4 | 8.7 | 4.0 | 10.1 | -- |
| **Constant Dollar Basis:** | | | | | | |
| Total | 34.1 | 20.7 | 2.9 | -19.5 | 6.9 | -- |
| Manufacturing | 5.3 | -4.4 | 11.9 | 6.3 | 8.7 | -- |
| Wholesale | 3.6 | 9.6 | -2.3 | -18.6 | 17.1 | -- |
| Retail | 25.2 | 15.5 | -6.6 | -7.2 | -18.9 | -- |
| Automotive | 21.3 | 3.0 | -12.6 | -4.6 | -28.1 | -- |
| Ex. auto | 3.9 | 12.5 | 5.9 | -2.6 | 9.2 | -- |

INVENTORIES RELATIVE TO SALES[1]
(Months supply; based on seasonally adjusted data)

| | Range in Preceding 12 months:[2] low | Range in Preceding 12 months:[2] high | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Aug. | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|---|
| **Current Cost Basis:** | | | | | | | | |
| Total | 1.47 | 1.57 | 1.51 | 1.51 | 1.49 | 1.48 | 1.47 | -- |
| Manufacturing | 1.61 | 1.73 | 1.65 | 1.63 | 1.62 | 1.62 | 1.59 | 1.59 |
| Wholesale | 1.21 | 1.29 | 1.24 | 1.23 | 1.20 | 1.18 | 1.18 | -- |
| Retail | 1.44 | 1.59 | 1.58 | 1.60 | 1.59 | 1.57 | 1.59 | -- |
| Automotive | 1.33 | 2.12 | 2.03 | 1.96 | 1.86 | 1.81 | 1.88 | -- |
| Ex. auto | 1.43 | 1.49 | 1.46 | 1.49 | 1.50 | 1.49 | 1.50 | -- |
| **Constant Dollar Basis:** | | | | | | | | |
| Total | 1.49 | 1.54 | 1.51 | 1.51 | 1.49 | 1.49 | 1.49 | -- |
| Manufacturing | 1.62 | 1.67 | 1.64 | 1.63 | 1.63 | 1.63 | 1.61 | -- |
| Wholesale | 1.24 | 1.30 | 1.26 | 1.27 | 1.23 | 1.21 | 1.22 | -- |
| Retail | 1.43 | 1.57 | 1.55 | 1.57 | 1.54 | 1.54 | 1.55 | -- |
| Automotive | 1.42 | 2.05 | 1.97 | 1.88 | 1.67 | 1.71 | 1.69 | -- |
| Ex. auto | 1.43 | 1.49 | 1.44 | 1.49 | 1.50 | 1.49 | 1.51 | -- |

1. Ratio of end-of period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessary coincident.

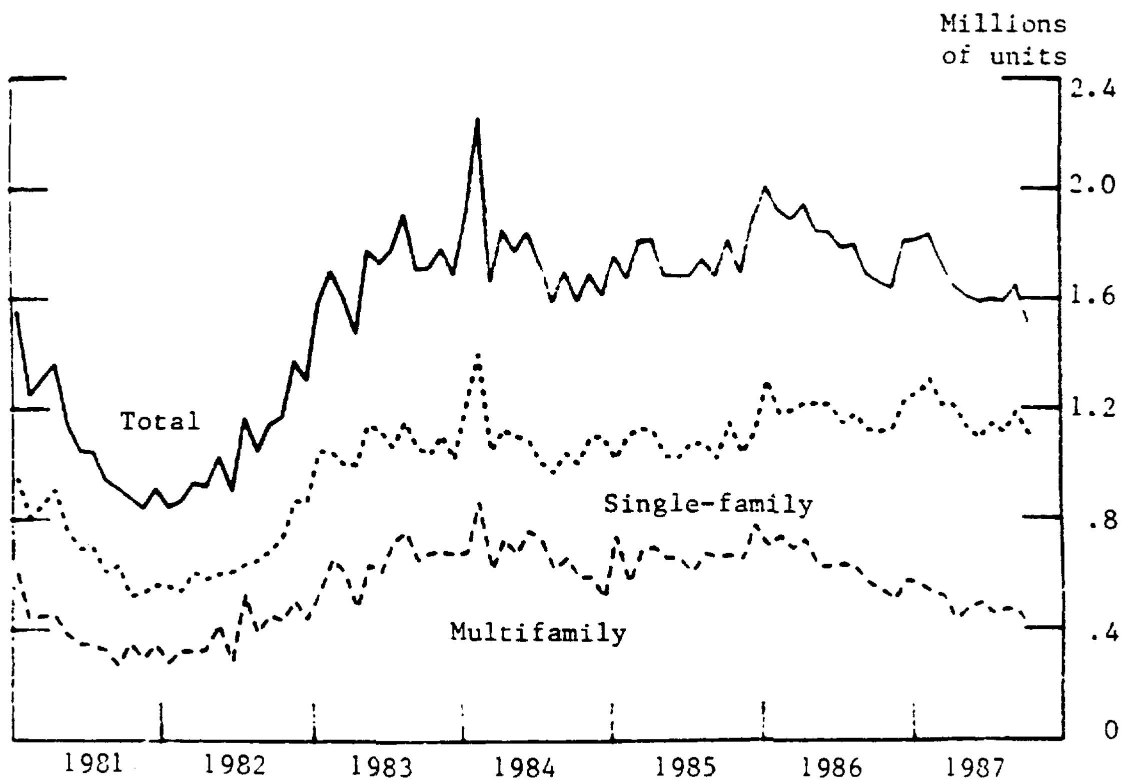
of $12 billion in real terms, and preliminary data for October show further accumulation. Recent stockbuilding, which was fairly widespread both by industry and by stage of processing, generally coincided with even larger gains in shipments, and inventory-sales ratios continued to trend down. Lead times for production supplies--the number of days that orders are placed in advance of expected delivery--remain short, having edged down slightly in November after only small increases in the previous two months. Most manufacturing purchasing managers evidently do not yet feel anxious about their ability to obtain inputs as they need them, even though some materials reportedly are in short supply.

In the trade sector, merchant wholesalers' inventories were drawn down in the third quarter as shipments from wholesale distributors advanced briskly, up 2.4 percent in real terms. In contrast, some nonauto retail establishments, especially those carrying discretionary consumption goods, have experienced significant inventory accumulation in recent months. In particular, inventories at retail apparel stores have been rising steadily since the beginning of this year, and the inventory-sales ratio for these stores reached an unusually high level in September. However, some adjustment appears to be under way. Retailers appear to have been cautious in placing orders with domestic producers of home goods (apparel and household durables), and preliminary data indicate that apparel sales picked up in October. In addition, there have been reports of widespread discounting in recent weeks.

PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates; millions of units)

| | 1986 | 1987 | | | 1987 | | |
|---|---|---|---|---|---|---|---|
| | Annual | Q1 | Q2 | Q3 | Aug. | Sept. | Oct. |
| All units | | | | | | | |
| Permits | 1.75 | 1.68 | 1.54 | 1.50 | 1.50 | 1.50 | 1.45 |
| Starts | 1.81 | 1.80 | 1.61 | 1.61 | 1.59 | 1.65 | 1.51 |
| Single-family units | | | | | | | |
| Permits | 1.07 | 1.15 | 1.04 | 1.00 | 1.02 | .99 | .98 |
| Starts | 1.18 | 1.26 | 1.14 | 1.15 | 1.11 | 1.19 | 1.10 |
| Sales | | | | | | | |
| New homes | .75 | .72 | .67 | .67 | .69 | .67 | .66 |
| Existing homes | 3.57 | 3.62 | 3.61 | 3.43 | 3.41 | 3.45 | 3.56 |
| Multifamily units | | | | | | | |
| Permits | .68 | .54 | .50 | .4[illegible] | .48 | .51 | .47 |
| Starts | .63 | .54 | .47 | .46 | .47 | .46 | .41 |

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



Housing Markets

Residential construction activity slowed further during October, reflecting, in part, the effects of rising mortgage interest rates, which peaked at 11-1/2 percent (for conventional fixed-rate loans) in mid-October. Total housing starts were off 8 percent, to 1.51 million units at a seasonally adjusted annual rate, and permits edged down.

In the single-family market, starts fell back in October to a 1.10 million unit rate, 3-1/2 percent below the third-quarter average, and new home sales edged down further. A survey of home builders fielded at the end of that month did not indicate any general falloff in sales after the stock market crash, but some trade reports indicate a weakening of demand at the upper end of the price distribution. The 12-month rise in the median new home price moderated to 8 percent in October, perhaps in part because of this reduced top-end demand. In the resale market, transactions picked up a bit in October but remained below the sales volumes recorded during the first half of the year when mortgage interest rates were considerably lower.

Multifamily housing starts were down sharply in October to 410,000 units at a seasonally adjusted annual rate, the lowest monthly pace in more than five years. The continued slowing of multifamily construction stems from two negative factors specific to the multifamily sector--a 20-year high in rental vacancy rates seen during 1987-Q3 and changes in tax laws that eliminated an important stimulus for multifamily construction. Until the vacancy rate turns down in response to the recently lower construction levels and other stock adjustments, rents and profitability of new construction will remain depressed in many market areas.

Federal Government

Congress has begun the process of enacting the measures agreed upon by the President and the bipartisan leadership in the compromise of November 20th; but much remains to be done, with major steps likely to be worked out in House-Senate conferences not yet under way. The compromise calls for deficit reductions that total $30 billion in FY1988 and $46 billion in FY1989. Taxes are to be raised by $9 billion this year and $14 billion next year; spending cuts, user fees, and asset sales are to account for most of the remainder of required actions.

It is contemplated that Congress will incorporate the measures in two bills. One will be a budget reconciliation bill that will include the tax increases, changes to entitlements, and a number of miscellaneous alterations to existing laws. The second bill will be an omnibus continuing resolution that will set all FY1988 appropriations levels consistent with the compromise.

At present, appropriated programs are operating under a temporary continuing resolution. Both bills are expected to go to the President for his signature or veto before that temporary continuing resolution expires on December 16. Legislation implementing the compromise is intended to replace the Gramm-Rudman-Hollings sequester now in effect. The sequester specifies defense and domestic discretionary outlay cuts of $23 billion. The recent compromise also results in about $23 billion of deficit-reduction for FY1988 under the Gramm-Rudman-Hollings accounting rules, which do not allow inclusion of asset sales and some other items contemplated in the bipartisan agreement.

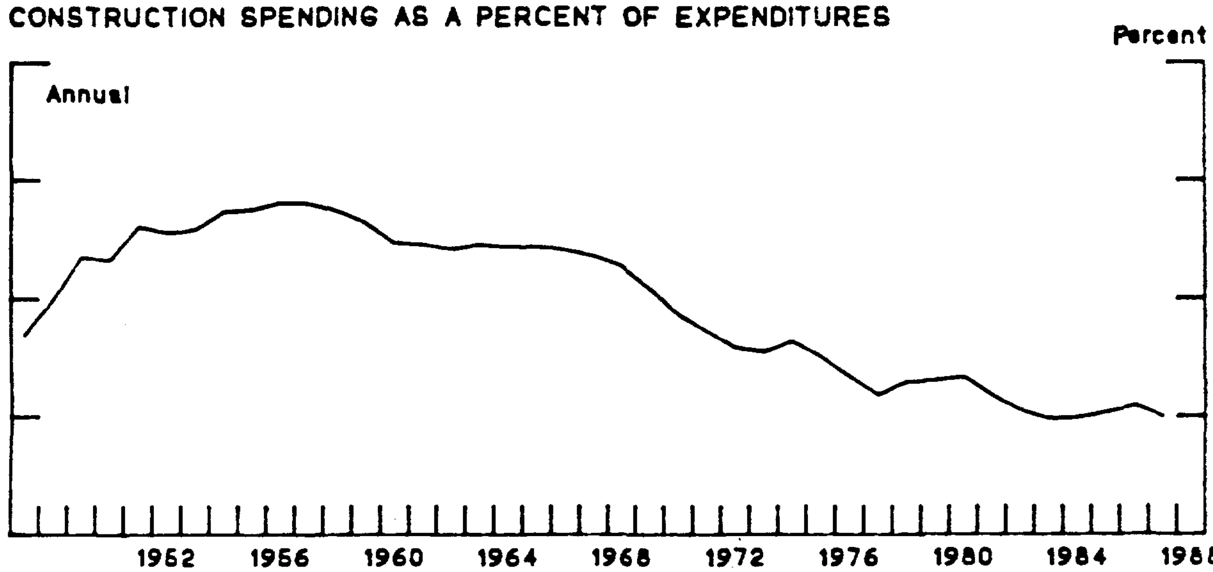
Meanwhile, the federal government recorded a deficit of nearly $31 billion in October, up sharply from the deficit of $25 billion a year earlier. A number of events boosted outlays in October. Foremost among these was a coincidence of two payments for a portion--about $2.8 billion--of military salaries. Legislation aimed at curbing the FY1987 deficit had changed some military pay from the last day of the month to the first day of the next month beginning with the payment made on October 1. Moreover, because November 1, 1987, fell on a Sunday, the salaries due on that date were paid on October 30. In November, military pay will, of course, be about $2.8 billion lower than otherwise. Spending in October also was boosted by large outlays by the FDIC and the Department of Agriculture (for price supports and related programs). Payments in these categories tend to be lumpy and do not necessarily foretell of higher or lower spending in subsequent months of the fiscal year. There were few surprises on the receipts side of the budget; neither this October nor last October was affected by tax-reform changes.

State and Local Governments

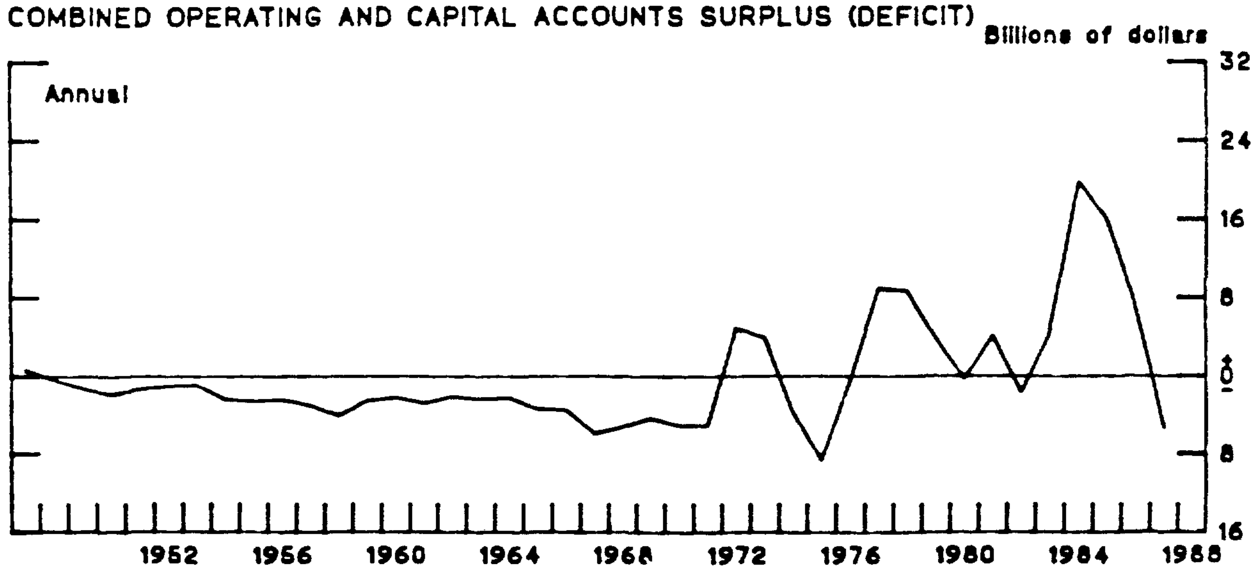
Growth in purchases of goods and services by state and local governments appears to be picking up in the fourth quarter, after two quarters of relatively small gains. Real construction outlays in October rose to a level somewhat above the third-quarter average. In

# STATE AND LOCAL GOVERNMENT SECTOR

CONSTRUCTION SPENDING AS A PERCENT OF EXPENDITURES




COMBINED OPERATING AND CAPITAL ACCOUNTS SURPLUS (DEFICIT)




Note: 1987 is the average of three quarters.

addition, employment of state and local workers increased 37,000 in November, after rising appreciably in the preceding month.

Despite the slowdown in purchases during the middle of the year, the fiscal condition of the state and local government sector remained weak. In the third quarter, state and local governments recorded a $6.4 billion (annual rate) deficit in their operating and capital account (excluding social insurance funds), the fourth consecutive quarterly deficit. And even though many states took action during their 1987 fiscal years to deal with eroding budgetary positions, further adjustments appear to be under way. In particular, budget cuts are expected in Louisiana and New York City, and tax hikes are being discussed in Idaho, Michigan, and Ohio.

The deterioration in the budgetary position of the state and local sector cannot be attributed to strength in public construction, which tends normally to be financed more by borrowing than by current taxation. In the 1950s and 1960s, large deficits were associated with a high level of spending for construction, amounting to around one-quarter of total expenditures. But, over the past year, operating and capital account deficits have persisted, even though nominal outlays for construction have edged down, and accounted for only about 10 percent of total expenditures.

Prices

Price measures continued to show a mixed picture in October. The consumer price index for all urban consumers was up 0.4 percent--similar to its average monthly pace over the first three quarters. Producer

RECENT CHANGES IN CONSUMER PRICES
(Percentage change; based on seasonally adjusted data)[1]

| | Relative Importance Dec. 1986 | 1986 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|
| | | | --Annual rate-- | | | Monthly rate | |
| All items[2] | 100.0 | 1.1 | 6.2 | 4.6 | 3.6 | .2 | .4 |
| Food | 16.2 | 3.8 | 2.5 | 6.5 | 1.4 | .5 | .4 |
| Energy | 7.4 | -19.7 | 26.1 | 7.9 | 5.0 | -.5 | -.9 |
| All items less food and energy | 76.4 | 3.8 | 5.2 | 4.0 | 3.7 | .2 | .5 |
| Commodities | 26.1 | 1.4 | 5.1 | 3.8 | 3.0 | .3 | .5 |
| Services | 50.3 | 5.2 | 5.3 | 3.8 | 4.2 | .1 | .5 |
| Memorandum: | | | | | | | |
| CPI-W[3] | 100.0 | .7 | 6.3 | 4.8 | 3.8 | .2 | .4 |

1. Changes are from final month of preceding period to final month of period indicated.
2. Official index for all urban consumers.
3. Index for urban wage earners and clerical workers.

RECENT CHANGES IN PRODUCER PRICES
(Percentage change; based on seasonally adjusted data)[1]

| | Relative Importance Dec. 1986 | 1986 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|
| | | | --Annual rate-- | | | Monthly rate | |
| Finished goods | 100.0 | -2.3 | 4.3 | 3.9 | 2.7 | .3 | -.2 |
| Consumer foods | 26.3 | 2.9 | -6.7 | 12.7 | -1.7 | 1.1 | -.1 |
| Consumer energy | 8.6 | -38.0 | 59.8 | 5.5 | 2.0 | -3.7 | -1.0 |
| Other consumer goods | 40.6 | 3.0 | 4.2 | -.2 | 4.9 | .6 | .0 |
| Capital equipment | 24.5 | 2.1 | .4 | 1.2 | 4.4 | .7 | -.4 |
| Intermediate materials[2] | 95.0 | -4.5 | 7.8 | 5.7 | 4.6 | .0 | .5 |
| Exc. energy | 82.9 | .1 | 3.3 | 4.6 | 5.0 | .5 | .9 |
| Crude food materials | 42.5 | -1.4 | -10.3 | 34.8 | -6.2 | .5 | 1.3 |
| Crude energy | 40.9 | -27.5 | 50.0 | 11.4 | 6.1 | -2.7 | -1.7 |
| Other crude materials | 16.6 | 1.7 | 15.9 | 31.9 | 37.1 | 3.8 | 4.1 |

1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

prices turned down 0.2 percent for finished goods but rose substantially for crude and intermediate materials less food and energy.

The CPI for food rose 0.4 percent in October, after advancing 0.5 percent in September. Some large increases, particularly for fresh fruits, beef, and dairy products, more than offset declines in prices of fresh vegetables, eggs, poultry, and other items. At the farm level, prices of crude foods advanced more than 1 percent in October. However, after the mid-October PPI pricing date, spot prices of hogs dropped sharply, suggesting a significant decline in the November PPI for crude foods.

Energy prices were down at all levels in the October price reports. The CPI decline for energy, of 0.9 percent, mainly reflected lower electricity prices associated with the switch to winter rates.[4] More recently, spot prices of crude oil have weakened somewhat, apparently in response to the buildup of stocks resulting from high levels of OPEC production.

Excluding food and energy items, the CPI subindexes for both commodities and services rose 0.5 percent in October. The commodities component was boosted for the second month by large, probably import-related, increases in apparel prices. In addition, new car prices were up 0.6 percent in October, reflecting increases on 1988 models--which are phased into the CPI over several months in accordance with sales patterns--and the ending of incentives on most of this year's models.

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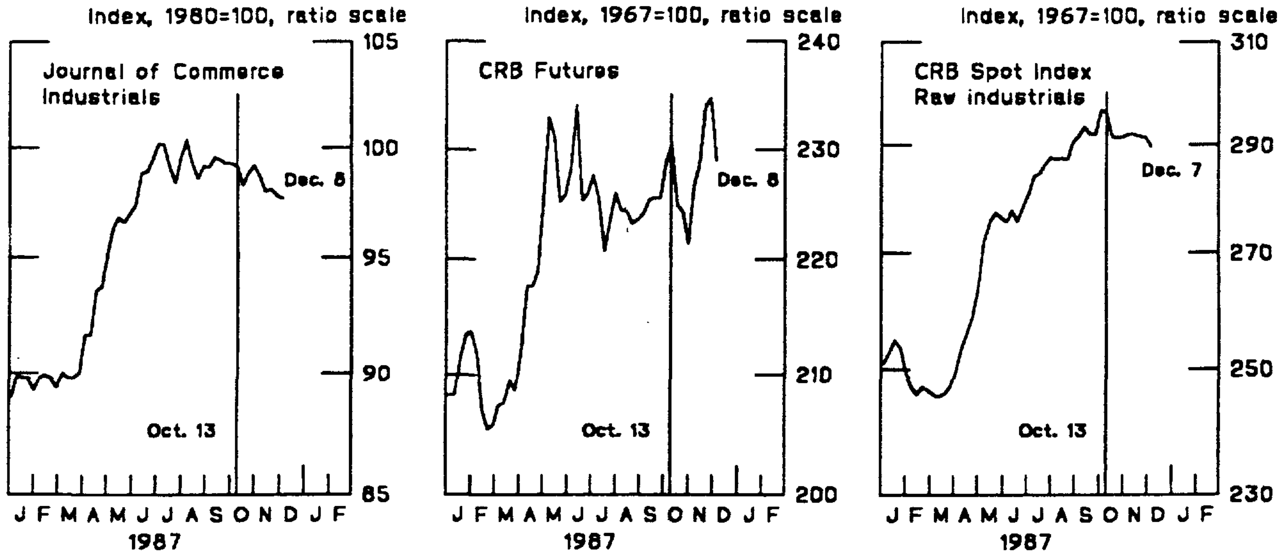
4. The changes are not fully captured by the seasonal factors owing to a change last year in the sample used by the BLS to measure electricity prices. The new sample is more sensitive to the seasonal rate changes.

## Commodity Prices
(Not Seasonally Adjusted)




### SPOT PRICES OF SELECTED COMMODITIES

| | Percent change | |
|---|---|---|
| | Dec. 30, 1986 to Oct. 13, 1987 | Oct. 13, 1987 to Dec. 8, 1987 |
| Aluminum (COMEX futures) | 68.2 | -6.5 |
| Copper | 41.1 | 35.4 |
| Steel scrap | 64.6 | -9.9 |
| Rubber | 20.0 | -.4 |
| Hides | 50.0 | -8.2 |
| Cotton | 12.3 | -5.5 |
| | | |
| Gold | 18.1 | 5.5 |
| Silver | 46.3 | -12.9 |
| Platinum | 23.3 | -14.1 |
| | | |
| Oil (Brent) | 6.0 | -5.1 |
| | | |
| Lumber | .0 | -4.3 |
| | | |
| Wheat | 10.1 | 6.8 |
| Corn | 13.4 | 11.5 |
| Soybeans | 7.8 | 11.0 |
| Hogs | 10.3 | -20.8 |

The termination of incentive programs also affected the services component of the CPI, as auto finance charges increased sharply. In addition, owners' equivalent rent and entertainment service costs registered large increases.

The PPI for finished goods less food and energy fell 0.2 percent in October, after a large September increase of 0.6 percent. On net, the average increase in this index over the two months was little different from its pace earlier in the year, and it appears that problems with seasonal adjustment were partly responsible for the September-October monthly pattern. In October, declines were posted for a number of consumer and capital equipment categories, notably for light and heavy trucks. However, prices of new cars increased 1.6 percent, reflecting manufacturers' increases on the 1988 models--net of cost-based adjustments for the estimated value of quality changes--as well as the removal of sales incentives.[5]

At the intermediate materials level, the PPI excluding food and energy items rose nearly 1 percent further in October, with large increases for metals, chemicals, plastics, and textiles. Prices of crude nonfood materials less energy were up another 4 percent in October, led by hikes for scrap metals.

Developments in spot commodity markets since the stock market began its plunge in mid-October have been mixed. Among industrial materials, copper prices have continued to surge, reportedly in response to tight

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5. In contrast with the CPI, prices of new cars in the PPI are based on current-year models through September, and on new models thereafter. The adjustments for quality changes are similar for the two measures.

HOURLY EARNINGS INDEX[1]
(Percentage change; based on seasonally adjusted data)[2]

| | 1986 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Sept. | 1987 Oct. | 1987 Nov. |
|---|---|---|---|---|---|---|---|
| | | --Annual rate-- | | | --Monthly rate-- | | |
| Total private nonfarm | 2.3 | 2.1 | 2.6 | 2.7 | .3 | .1 | .5 |
| Manufacturing | 1.7 | 1.5 | 2.1 | 2.1 | .7 | -.2 | .2 |
| Durable | 1.3 | .3 | 2.1 | 2.6 | .6 | -.2 | .2 |
| Nondurable | 2.3 | 3.5 | 2.2 | 1.2 | 1.0 | -.3 | .2 |
| Contract construction | 2.2 | -2.7 | 3.4 | .2 | -.4 | .4 | 1.1 |
| Transportation and public utilities | 2.8 | 3.2 | 3.5 | .8 | -.2 | .2 | .3 |
| Finance, insurance and real estate | 4.4 | 9.7 | .5 | 3.4 | -.3 | .2 | 1.4 |
| Total trade | 1.8 | .7 | 2.5 | 3.5 | .7 | -.2 | .3 |
| Services | 3.1 | 4.2 | 3.2 | 4.6 | -.1 | .9 | .7 |

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime hours in manufacturing.
2. Annual changes are measured from fourth quarter to fourth quarter. Quarterly changes are at compound annual rates.

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

| | 1985[1] | 1986[1] | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1986 Q3 to 1987 Q3 |
|---|---|---|---|---|---|---|---|
| Output per hour | 1.0 | 1.5 | .0 | .4 | 1.4 | 3.6 | 1.3 |
| Compensation per hour | 4.8 | 3.4 | 4.0 | 1.1 | 3.0 | 3.8 | 3.0 |
| Unit labor costs | 3.7 | 1.9 | 4.0 | .8 | 1.5 | .2 | 1.6 |

1. Percent changes are from fourth quarter to fourth quarter.

near-term supplies, while prices have receded for aluminum, steel scrap, and some other industrial materials. Prices of precious metals also have been mixed; a net increase over the period for gold contrasts with net declines for silver and platinum, which have more industrial uses. Spot prices of crude oil and of lumber also have weakened since mid-October. Among food commodities, crop prices have continued to firm, particularly for corn and soybeans, but hog prices are down sharply, as indicated above. Both the Journal of Commerce index of industrial materials prices and the CRB spot price index for raw industrials have declined somewhat, on balance, over the past eight weeks.

Wages and Labor Costs

Wage inflation continued at a moderate pace in recent months with most measures showing little sign of change in underlying pay patterns. Wage rates, as measured by the hourly earnings index, rose 0.5 percent in November after a small gain in October. The gains were concentrated in services (0.7 percent) and construction (1.1 percent), with small gains in other industries. Over the past 12 months, this measure of wages has risen 2-1/2 percent for the nonfarm sector and 2 percent in manufacturing.

Published numbers show a substantial pickup in hourly compensation in the nonfarm business sector--to 3-3/4 percent at an annual rate last quarter. However, the apparent acceleration is associated with an artificially low reading for September hours because of the unusual occurrence of the Labor Day holiday during the labor market survey week in September. The staff estimates that the Labor Day influence, which will be reversed in the fourth quarter, added as much as a percentage point to the increases in compensation last quarter. Making a similar adjustment to productivity, the staff estimates that productivity in the nonfarm business sector rose about 2-1/2 percent at an annual rate. Unit labor costs, which are not affected by the timing of Labor Day, were essentially unchanged in the third quarter.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

| | 1987 | | | | | Change from: | |
|---|---|---|---|---|---|---|---|
| | Jan.-Feb. lows | Sept. 3[2] | Oct. 16[3] | FOMC Nov. 3 | Dec. 8 | Oct. 16[3] | FOMC Nov. 3 |
| **Short-term rates** | | | | | | | |
| Federal funds[4] | 5.95 | 6.85 | 7.59 | 6.81 | 6.86 | -.73 | .05 |
| Treasury bills[5] | | | | | | | |
| 3-month | 5.30 | 6.19 | 6.93 | 5.63 | 5.86 | -1.07 | .23 |
| 6-month | 5.31 | 6.30 | 7.58 | 6.08 | 6.43 | -1.15 | .35 |
| 1-year | 5.35 | 6.98 | 7.74 | 6.42 | 6.72 | -1.02 | .30 |
| Commercial paper | | | | | | | |
| 1-month | 5.81 | 6.88 | 7.94 | 6.93 | 7.66 | -.28 | .73 |
| 3-month | 5.73 | 6.97 | 8.65 | 7.36 | 7.57 | -1.08 | .21 |
| Large negotiable CDs[5] | | | | | | | |
| 1-month | 5.85 | 6.90 | 7.92 | 6.93 | 7.80 | -.12 | .87 |
| 3-month | 5.80 | 7.01 | 8.90 | 7.46 | 7.72 | -1.18 | .26 |
| 6-month | 5.78 | 7.35 | 9.12 | 7.51 | 7.73 | -1.39 | .22 |
| Eurodollar deposits[6] | | | | | | | |
| 1-month | 6.00 | 7.01 | 7.79 | 7.08 | 7.54 | -.25 | .46 |
| 3-month | 6.00 | 7.11 | 8.69 | 7.73 | 7.71 | -.98 | -.02 |
| Bank prime rate | 7.50 | 8.25 | 9.25 | 9.00 | 8.75 | -.50 | -.25 |
| **Intermediate- and long-term rates** | | | | | | | |
| U.S. Treasury (constant maturity) | | | | | | | |
| 3-year | 6.34 | 8.48 | 9.52 | 8.02 | 8.15 | -1.37 | .13 |
| 10-year | 7.01 | 9.29 | 10.23 | 8.91 | 9.09 | -1.14 | .18 |
| 30-year | 7.29 | 9.47 | 10.24 | 9.03 | 9.26 | -.98 | .23 |
| Municipal revenue[7] (Bond Buyer) | 6.92 | 8.47 | 9.59 | 8.78 | 8.40 | -1.19 | -.38 |
| Corporate A utility (recently offered) | 8.78 | 10.60e | 11.50 | 10.60e | 10.51e | -.99 | -.09 |
| Home mortgage rates[8] | | | | | | | |
| S&L fixed-rate | 9.10 | 10.63 | 11.58 | 10.97 | 10.60 | -.98 | -.37 |
| S&L ARM, 1-yr. | 7.52 | 7.84 | 8.45 | 8.20 | 7.95 | -.50 | -.25 |

| | 1986 | 1987 | | | Change from: | |
|---|---|---|---|---|---|---|
| | Year end | Record highs | FOMC Nov. 3 | Dec. 8 | Record highs | FOMC Nov. 3 |
| **Stock prices** | | | | | | |
| Dow-Jones Industrial | 1895.95 | 2722.42 | 1963.53 | 1868.37 | -31.37 | -4.85 |
| NYSE Composite | 138.58 | 187.99 | 140.11 | 131.42 | -30.09 | -6.20 |
| AMEX Composite | 263.27 | 365.01 | 255.49 | 236.57 | -35.19 | -7.41 |
| NASDAQ (OTC) | 348.83 | 455.26 | 320.66 | 297.96 | -34.55 | -7.08 |

1. One-day quotes except as noted.
2. Day prior to increase in discount rate on September 4, 1987.
3. Last business day prior to stock market decline on Monday, October 19, 1987.
4. Average for two-week reserve maintenance period closest to date shown, except Jan.-Feb. low, which is one-week average ending Feb. 25, and Sept. 3 which is one-week average ending Sept. 2. Last observation is average to date for week ending Dec. 9, 1987.
5. Secondary market.
6. Averages for statement week closest to date shown.
7. One-day quotes for closest Thursday.
8. Quotes for week ending Friday closest to date shown.
e--estimate.

Market rates of interest have shown mixed and, in most cases, fairly small changes from their levels at the time of the November FOMC meeting. On a technical level, the fixed-income securities markets are operating in a more normal fashion: bid-asked spreads have narrowed and dealer financing is again available from the usual sources. Nontheless, sentiment has remained somewhat volatile, in part because of unresolved questions about the potential extent of dollar depreciation and the policy actions of fiscal and monetary authorities here and abroad, as well as because of great uncertainty about the effects of the stock market collapse.

Spreads between rates on U.S. government and private securities at the short end of the maturity spectrum, which narrowed in the first part of the intermeeting period, widened again sporadically in late November and early December, as the dollar dropped to new lows, some commodity prices rose, and the stock market encountered renewed selling that drove major indexes temporarily below their October 19 lows. Additional pressure on very short private interest rates have come from positioning for the year-end. In longer-term markets, however, private rates have declined while Treasury yields are up about 20 basis points.

What indications there might have been earlier of a heightened demand for liquidity in the form of money balances seem to have disappeared. After a late-October increase in the aftermath of the stock market turbulence, M1 weakened in November, returning by the end of the month almost to September levels. The growth of the nontransactions component of M2 also slowed in November and, consequently, M2 was about flat; over the past two months, it fell further below its 1987 target cone and has risen at only a 4 percent annual rate since the final quarter of last year. In contrast, growth in the non-M2 component of M3 picked up sharply in November; the somewhat stronger average expansion of M3 in recent months has put its growth rate for the year at about 5-3/4 percent, just within its annual range.

Treasury borrowing has picked up in the current quarter, but borrowing by other sectors has remained relatively moderate. Gross public offerings of corporate bonds last month fell to the lowest level since last spring's market downturn; junk bond volume has been minimal recently. After a small spurt in October, net borrowing by businesses at banks and in the commercial paper market also appears to have slackened in November. Although buyout activity has diminished, share repurchases and negligible gross equity issuance probably are driving aggregate corporate sector leverage upward. Tax-exempt bond issuance continued relatively light in November, although up from the pace of the previous two months. In the household sector, consumer installment borrowing diminished in October, as auto sales incentive programs expired; non-auto installment credit growth also slowed somewhat. Mortgage lending, especially by thrift institutions, continued in October and early November to shift toward adjustable-rate loans.

Monetary Aggregates and Bank Credit

M1 contracted at a 6 percent annual rate in November, after growing at a 15 percent pace in October. This pattern largely reflected the behavior of demand deposits, which jumped $11 billion in the last two weeks of October, owing to a heavy volume of financial transactions. By mid-November, this buildup had reversed, and demand deposits had returned almost to their average September level. To a lesser degree, OCDs also surged in late October and then ran off in November. Currency rose rapidly in late October and continued to advance into mid-November, boosting monthly average expansion in November to nearly a 14 percent rate. However, smaller increases in recent weeks suggest that currency growth is returning to more normal rates.

In addition to the runoffs of transactions balances, other liquid deposit instruments also showed weakness in November. Evidently, the October plunge in stock prices has not resulted in a sustained flight to liquid deposits. MMDAs declined at a 14-1/2 percent average annual rate over October and November, while savings deposits contracted at a 10-1/2 percent rate. Runoffs were particularly strong at thrifts. By contrast, small time deposits at both thrifts and banks grew at their fastest pace of the year in October and November. In part, this reflected the relatively wide yield spreads between rates paid on time deposits and those paid on more liquid retail deposits; these spreads increased in September and October when particularly sizable rate increases were registered in long-term markets, and have been only partly reversed more recently. M2-type money funds slowed only a little

MONETARY AGGREGATES

(Based on seasonally adjusted data unless otherwise noted)[1]

| | 1985:Q4 to 1986:Q4 | 1987 Q2 | 1987 Q3 | 1987 Sept. | 1987 Oct. | 1987 Nov.pe | Growth from Q4 1986 to Nov. 1987p |
|---|---|---|---|---|---|---|---|
| | ------ Percentage change at annual rates ------ | | | | | | |
| 1. M1 | 15.3 | 6.4 | 0.0 | 0.3 | 15.0 | -6 | 6 |
| 2. M2 | 9.0 | 2.3 | 3.1 | 5.7 | 7.1 | 0 | 4 |
| 3. M3 | 8.9 | 4.3 | 5.2 | 6.0 | 8.0 | 5 | 5-3/4 |
| | | | | | | | Levels in billions of dollars Oct. 1987 |
| Selected components | | | | | | | |
| 4. M1-A | 10.0 | 2.7 | -2.2 | -1.9 | 19.1 | -6 | 503.6 |
| 5. Currency | 7.5 | 6.6 | 6.7 | 8.1 | 10.5 | 14 | 196.2 |
| 6. Demand deposits | 11.6 | 0.0 | -8.1 | -9.3 | 25.7 | -18 | 300.4 |
| 7. Other checkable deposits | 28.5 | 14.0 | 4.6 | 4.7 | 7.5 | -8 | 257.2 |
| 8. M2 minus M1[2] | 6.9 | 0.9 | 4.2 | 7.5 | 4.2 | 2 | 2133.1 |
| 9. Overnight RPs and Eurodollars, NSA | 16.1 | -24.3 | 18.0 | 56.1 | 39.1 | -80 | 85.6 |
| 10. General purpose and broker/dealer money market mutual fund shares, NSA | 17.3 | -1.1 | 6.1 | 20.9 | 15.5 | 13 | 219.3 |
| 11. Commercial banks | 6.8 | -1.4 | 1.7 | 0.3 | 2.4 | 7 | 909.5 |
| 12. Savings deposits, SA, plus MMDAs, NSA[3] | 16.0 | 0.8 | -2.4 | -3.8 | -8.4 | -6 | 536.6 |
| 13. Small time deposits | -4.2 | -4.6 | 8.0 | 6.2 | 18.6 | 25 | 373.0 |
| 14. Thrift institutions | 4.3 | 5.0 | 3.6 | 1.2 | 0.0 | 2 | 922.4 |
| 15. Savings deposits, SA, plus MMDAs, NSA[3] | 12.0 | 9.7 | -3.9 | -9.7 | 15.2 | -25 | 412.8 |
| 16. Small time deposits | -1.2 | 1.0 | 10.1 | 9.8 | 12.9 | 25 | 509.6 |
| 17. M3 minus M2[4] | 8.7 | 12.4 | 13.4 | 7.4 | 11.7 | 25 | 757.0 |
| 18. Large time deposits | 3.0 | 9.3 | 6.2 | 5.4 | 18.7 | 25 | 476.2 |
| 19. At commercial banks, net[5] | 2.7 | 18.3 | 4.1 | -0.4 | 13.0 | 24 | 317.0 |
| 20. At thrift institutions | 3.4 | -8.4 | 10.7 | 17.2 | 29.4 | 28 | 159.1 |
| 21. Institution-only money market mutual fund shares, NSA | 30.3 | -11.4 | 1.9 | -38.8 | 13.4 | 102 | 81.6 |
| 22. Term RPs, NSA | 31.1 | 73.0 | 26.4 | 20.0 | -30.6 | 39 | 106.9 |
| 23. Term Eurodollars, NSA | 3.1 | -0.0 | 29.0 | 69.2 | -12.1 | -17 | 98.0 |
| | -- Average monthly change in billions of dollars -- | | | | | | |
| MEMORANDA: | | | | | | | |
| 24. Managed liabilities at commercial banks (25+26) | 2.1 | 6.9 | 2.9 | 12.4 | 6.2 | 3 | 553.5 |
| 25. Large time deposits, gross | 0.6 | 6.3 | -0.8 | -0.4 | 7.3 | 7 | 377.8 |
| 26. Nondeposit funds | 1.5 | 0.6 | 3.7 | 12.8 | -1.1 | -4 | 175.7 |
| 27. Net due to related foreign institutions, NSA | 0.6 | 1.5 | 4.3 | 12.2 | -0.5 | -4 | 10.3 |
| 28. Other[6] | 1.0 | -0.9 | -0.6 | 0.6 | -0.6 | 0 | 165.4 |
| 29. U.S. government deposits at commercial banks[7] | 0.4 | 3.4 | -1.5 | -5.8 | 12.3 | 3 | 35.6 |

1. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Growth rates are for savings deposits, seasonally adjusted, plus money market deposit accounts (MMDAs) not seasonally adjusted. Commercial bank savings deposits excluding MMDAs decreased in October and November at rates of 3.4 percent and 3 percent, respectively. At thrift institutions, savings deposits excluding MMDAs decreased in October and November at rates of 9.9 percent and 22 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.
6. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
7. Consists of Treasury demand deposits and note balances at commercial banks.

pe--preliminary estimate.

in November as their yields continued to be attractive relative to liquid deposit rates. Overnight RPs and Eurodollars contracted sharply in November, in part due to seasonal influences (these items are not seasonally adjusted).

With core deposit inflows slowing, the non-M2 component of M3 accelerated to about a 25 percent annual growth rate in November, more than twice the October pace. Large time deposits grew at their most rapid rate in three years in November; their robust expansion at thrifts may reflect the greater weakness of core deposits at these institutions as well as heavy demand for ARMs, which are more likely than fixed-rate mortgages to be held in portfolio instead of sold into the market. Owing to favorable rate relationships, institution-only money funds grew at their fastest pace in about seven years. With rapid expansion of domestic managed liabilities and slowing of credit growth, banks paid down net advances from their foreign branches in November; this paydown likely contributed to the decline in the Eurodollar components of the aggregates.

Bank credit declined slightly in November after three months of relatively rapid growth. Despite a runoff of U.S. government securities, growth of investments picked up a bit as banks apparently added in volume to their holdings of CMOs. In part due to a reversal of October credit demands associated with the stock market crash, bank lending declined at a 1-3/4 percent rate last month. Security loans, which had increased by a huge $8-1/2 billion just after the stock market collapse, ran off in the next two weeks and continued to contract

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT[1]
(Percentage changes at annual rates, based on seasonally adjusted data)

| | 1985:Q4 to 1986:Q4 | 1987 Q2 | Q3 | Sept. | Oct. | Nov.p | Levels in bil. of dollars Nov.p |
|---|---|---|---|---|---|---|---|
| | ---------------- Commercial Bank Credit --------------------- | | | | | | |
| 1. Total loans and securities at banks | 9.8 | 7.7 | 7.3 | 9.7 | 10.4 | -0.8 | 2224.4 |
| 2. Securities | 14.2 | 4.4 | 8.5 | 6.4 | 0.5 | 2.3 | 527.5 |
| 3. U.S. government securities | 11.9 | 3.3 | 18.7 | 11.3 | 2.2 | -5.1 | 330.9 |
| 4. Other securities | 18.0 | 6.1 | -7.9 | -1.8 | -2.5 | 14.2 | 196.6 |
| 5. Total loans | 8.4 | 8.9 | 7.0 | 10.7 | 13.5 | -1.7 | 1696.9 |
| 6. Business loans | 6.6 | 4.6 | 1.9 | 10.6 | 11.4 | 3.4 | 567.3 |
| 7. Security loans | -3.7 | 40.7 | 26.5 | 27.3 | 10.7 | -182.4 | 38.5 |
| 8. Real estate loans | 14.1 | 19.3 | 13.6 | 10.4 | 17.5 | 13.4 | 570.6 |
| 9. Consumer loans | 7.3 | 1.2 | 6.5 | 7.6 | 5.6 | 4.9 | 321.7 |
| 10. Other loans | 5.4 | 0.2 | 0.0 | 13.3 | 22.2 | -25.9 | 199.1 |
| | ----- Short- and Intermediate-Term Business Credit ----- | | | | | | |
| 11. Business loans net of bankers acceptances | 6.3 | 4.0 | 1.4 | 10.9 | 11.0 | 4.3 | 561.3 |
| 12. Loans at foreign branches[2] | -8.6 | -14.7 | 25.5 | -41.6 | -21.6 | 14.1 | 17.2 |
| 13. Sum of lines 11 & 12 | 5.8 | 3.4 | 2.1 | 9.1 | 11.4 | 4.6 | 578.5 |
| 14. Commercial paper issued by nonfinancial firms | -0.8 | 17.6 | -11.4 | -3.1 | 1.5 | -9.2 | 77.7 |
| 15. Sums of lines 13 & 14 | 4.9 | 5.1 | 0.4 | 7.8 | 10.2 | 3.1 | 656.3 |
| 16. Bankers acceptances: U.S. trade related[3,4] | -3.9 | 23.8 | 22.5 | -6.7 | n.a | n.a | 35.7 (Sept) |
| 17. Line 15 plus bankers acceptances: U.S. trade related | 4.4 | 6.1 | 1.5 | 7.1 | n.a | n.a | 684.8 (Sept) |
| 18. Finance company loans to business[3] | 11.7 | 17.9 | 14.2 | 10.0 | n.a | n.a. | 192.9 (Sept) |
| 19. Total short- and intermediate-term business credit (sum of lines 17 & 18) | 5.8 | 8.6 | 4.2 | 7.7 | n.a | n.a. | 877.7 (Sept) |

1. Average of Wednesdays.
2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.
3. Based on average of data for current and preceding ends of month.
4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.
n.a.--not available.
p--preliminary.

rapidly into November, probably reflecting both the restoration of normal financing channels for dealers and reduced securities issuance. Real estate lending slowed to a 13-1/2 percent rate of growth, the same pace as in the third quarter, and consumer loan growth remained moderate. Business loans decelerated markedly in November from the rate of the preceding two months, with weakness centered at large banks and foreign-related institutions. The recent runoff of commercial paper issued by nonfinancial firms resumed in November after a minor interruption in October, and the sum of C&I loans and commercial paper expanded at only a 3 percent rate. Merger-related lending is estimated to have accounted for all of the growth in this form of short- and intermediate-term business credit last month.

Corporate Finance

After a brief flurry of sales of new high-grade debt in late October when yields dropped, gross public issuance of all categories of corporate securities was weak in November. Junk-bond offerings were extremely light because of continued investor caution. The dispersion of yields on low-rated bonds reportedly has widened substantially; issues of firms that have largely completed their restructurings have outperformed those of more recent issuers whose programs to sell assets are only beginning. New Eurobond borrowing by nonfinancial firms was nil in November as foreign investors continued to be reluctant to acquire long-term dollar-denominated debt.

Bond issuance by financial corporations, too, was well below the pace of earlier months. The major element in the drop-off was slower

GROSS OFFERINGS OF SECURITIES BY U.S. CORPORATIONS
(Monthly rates, not seasonally adjusted, billions of dollars)

| | 1986 | 1987 | | | | | |
|---|---|---|---|---|---|---|---|
| | Year | Q1 | Q2 | Q3[p] | Sept[p] | Oct.[p] | Nov.[p] |
| Corporate securities - total[1] | 28.18 | 29.79 | 24.33 | 26.50 | 30.26 | 19.73 | 12.08 |
| Public offerings in U.S. | 24.48 | 26.81 | 22.23 | 23.73 | 28.00 | 18.50 | 11.60 |
| Stocks--total[2] | 5.15 | 5.50 | 5.70 | 5.11 | 6.00 | 2.70 | .60 |
| Nonfinancial | 2.51 | 2.74 | 3.45 | 2.48 | 2.70 | 1.70 | .50 |
| Utility | .64 | .74 | .71 | .64 | .40 | .10 | .03 |
| Industrial | 1.87 | 2.00 | 2.74 | 1.84 | 2.30 | 1.60 | .47 |
| Financial | 2.64 | 2.76 | 2.25 | 2.63 | 3.30 | 1.00 | .10 |
| Bonds--total[1] | 19.33 | 21.31 | 16.53 | 18.62 | 22.00 | 15.80 | 11.00 |
| Nonfinancial | 9.62 | 8.98 | 6.07 | 6.60 | 6.85 | 5.60 | 2.50 |
| Utility | 3.61 | 2.05 | 1.54 | 2.43 | 2.60 | 2.55 | 1.10 |
| Industrial | 6.01 | 6.93 | 4.53 | 4.17 | 4.25 | 3.05 | 1.40 |
| Financial | 9.71 | 12.33 | 10.46 | 12.02 | 15.15 | 10.20 | 8.50 |
| By quality[3] | | | | | | | |
| Aaa and Aa | 4.70 | 3.30 | 2.25 | 2.78 | 2.40 | 7.54 | 3.40 |
| A and Baa | 6.05 | 7.31 | 5.05 | 4.36 | 4.55 | 4.01 | 2.90 |
| Less than Baa | 3.42 | 3.06 | 2.91 | 3.67 | 4.06 | 1.25 | .40 |
| No rating (or unknown) | .20 | .08 | .22 | .07 | .08 | .13 | .10 |
| Memo items: | | | | | | | |
| Equity-based bonds[4] | .86 | 1.37 | 1.29 | .47 | .67 | .39 | .00 |
| Mortgage-backed bonds | 4.14 | 7.26 | 5.18 | 6.40 | 8.65 | 2.20 | 2.15 |
| Variable-rate notes | 1.02 | 2.43 | 1.65 | 2.75 | 3.40 | .68 | .80 |
| Bonds sold abroad - total | 3.55 | 2.92 | 1.82 | 2.50 | 1.65 | 1.09 | .48 |
| Nonfinancial | 1.50 | 1.14 | .97 | 1.27 | .75 | .74 | .00 |
| Financial | 2.05 | 1.78 | .85 | 1.23 | .90 | .35 | .48 |
| Stocks sold abroad - total | .15 | .06 | .28 | .27 | .61 | .14 | .00 |
| Nonfinancial | .09 | .06 | .24 | .16 | .28 | .14 | .00 |
| Financial | .06 | .00 | .04 | .11 | .33 | .00 | .00 |

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Includes equity issues associated with debt/equity swaps.
3. Bonds categorized according to Moody's bond ratings or Standard and Poors if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.
p--preliminary.

sales of CMOs and multi-class REMICs, which have become more difficult to price because of increased prepayment uncertainty in the more volatile rate environment.

Gross offerings of new corporate equity shares have nearly dried up since October 19. Corporate restructuring activity has continued to result in a net retirement of equity, but the volume of mergers and acquisitions has been damped by higher costs of junk bonds and concerns about the future climate for asset sales. Two major LBO transactions could not be completed as scheduled in November and the pace of new proposals also fell off. However, one of the LBO-related bond issues which had been postponed--Southland Corp--was repriced in early December and a successful sale of this issue could lead to some recovery in new activity. Corporate share repurchases are contributing heavily to equity retirements, but the pace of activity is difficult to track. More than 600 firms have announced buyback programs since the stock market crash, but only a small share of the plans apparently have been initiated; however, buybacks from previously announced programs reportedly have accelerated somewhat.

Some return to normalcy has been seen in the operation of the equity markets in recent weeks. On November 9, the NYSE lifted restrictions on member firms' use of the Exchange's automated order delivery systems for computer-assisted program trading; and trading hours, which were shortened during the initial hectic days after October 19, returned to normal on November 12. The volume of trading in stocks and derivative stock instruments has moved back down to ranges observed in September and early October--still heavy by historical standards. Nonetheless, equity markets remain uneasy and highly sensitive to incoming economic indicators. After fluctuating narrowly over much of last month, share prices dropped sharply in late November and early December, largely in response to weakness in the dollar. A part of this decline was reversed in more recent days, but most major indexes still are roughly 6 percent below their November meeting levels and 30 percent below August highs.

It still does not appear likely that any major securities firms will fail as a result of the stock market turmoil. However, losses at some firms evidently were sizable. Four U.S. underwriters are estimated to have lost between $70 and $80 million each, before tax, on the British Petroleum offering and a number of firms reportedly lost large amounts on their own trading positions or when customers could not cover losses on leveraged accounts. With earnings already trending down in 1987, these losses, along with more uncertainty about future profits, contributed to sharply lower share prices for securities firms. While average stock prices for all U.S. companies have declined only 5 to 7 percent since the beginning of the year, equity prices of securities and brokerage firms have declined over 30 percent. These lower share prices and an increased need for capital have spurred further consolidation in the industry. Shearson Lehman acquired E.F. Hutton in early December, and a Japanese company, the Yasuda Mutual Life Insurance Company, recently purchased a 25 percent share in Paine Webber.

Treasury and Sponsored Agency Financing

The federal deficit for the fourth quarter is estimated to be nearly $81 billion, of which $62 billion is expected to be financed by borrowing from the public. Most of the borrowing will be in the form of marketable coupon securities. Apart from one set of weekly bill auctions that was moved from September to October owing to debt ceiling problems, bill offerings will contribute negligible net funds this quarter. Bill issues sold to foreign central banks on an "add-on" basis, which increase issuance above the announced auction sizes, have been considerably greater than usual; these sales have about offset announced net paydowns.

The Treasury will finance the remainder of the deficit by running down its enlarged beginning-of-quarter cash balance and through a pickup in nonmarketable securities issuance, which almost entirely reflects a surge in state and local government securities (SLGS). The sharp drop in interest rates after the stock market collapse enabled some state and local governments, which earlier had been able to purchase marketable Treasury securities with the proceeds of tax-exempt refunding bonds (while still meeting the arbitrage restrictions), to profit by selling the marketable securities and purchasing SLGS. The Treasury subsequently prohibited trading profits from being earned on similar conversions.

Borrowing by federally sponsored credit agencies is expected to pick up a little in the fourth quarter. On net, much of the increase is attributable to the $1.2 billion raised by the Financing Corporation

TREASURY AND AGENCY FINANCING[1]
(Total for period; billions of dollars)

| | 1987 | | | | |
|---|---|---|---|---|---|
| | Q3 | Q4[e] | Oct.[e] | Nov.[e] | Dec.[e] |
| Treasury financing | | | | | |
| Total surplus/deficit(-) | -28.7 | -83.7 | -30.7 | -24.7 | -28.2 |
| Means of financing deficit: | | | | | |
| Net cash borrowing from the public | 21.9 | 61.1 | 27.3 | 22.7 | 11.0 |
| Marketable borowings/ repayments(-) | 16.9 | 48.4 | 26.7 | 12.3 | 9.4 |
| Bills | -12.9 | 10.1 | 11.9 | .2 | -1.9 |
| Coupons | 29.8 | 38.3 | 14.9 | 12.2 | 11.3 |
| Nonmarketable | 5.0 | 12.7 | .6 | 10.4 | 1.6 |
| Decrease in the cash balance | 3.6 | 19.4 | -1.8 | 14.8 | 6.5 |
| Memo: Cash balance at end of period | 36.4 | 17.0 | 38.3 | 23.5 | 17.0 |
| Other[2] | 3.2 | 3.2 | 5.2 | -12.8 | 10.8 |
| Federally sponsored credit agencies, net cash borrowing[3] | 7.8e | 9.1 | 6.3 | 2.3 | .6 |
| FHLBs | 4.7 | 5.3 | 3.7 | 1.0 | .6 |
| FNMA | 1.6 | 1.4 | 1.7 | -.2 | -.1 |
| Farm Credit Banks | -1.0 | .0 | .3 | -.1 | -.2 |
| FHLMC | .6e | .5 | .2 | .2 | .1 |
| FICO | .0 | 1.2 | .6 | .6 | .0 |
| SLMA | 2.0 | .7 | -.2 | .8 | .1 |

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes checks issued less checks paid, accrued items and other transactions.
3. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
e--staff estimate.
Note: Details may not add to totals due to rounding.

(FICO). FICO's first issue came to market in September and settled in October; its second issue was priced in mid-November. Both issues had yields around 90 basis points over Treasuries.

Excluding FICO, borrowing by the sponsored agencies is about unchanged from the third quarter. The steady paydown of debt by the Farm Credit Banks (FCBs) that began in 1984 is expected to halt temporarily in the fourth quarter, before resuming next year as continued slack farm loan demand causes the FCBs to experience further declines in their holdings of farm loans. The Farm Credit System reported a small profit in the third quarter, but this appeared to have little effect on market sentiment; market participants also appear to have been unimpressed by Senate passage of an FCB assistance bill that must be reconciled with a differing House-passed version.[1]

Given large October and November increases in advances to savings and loan associations, the Federal Home Loan Banks are expected to increase their borrowing during the fourth quarter. Seasonal factors primarily account for the decline in borrowing by Sallie Mae.

Municipal Securities Markets

Tax-exempt bond issuance rose somewhat in November, largely reflecting a step-up in borrowing to raise new capital; however, bond issuance, overall, has remained well below the pace of recent years.

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1. The House bill provides $5.4 billion in assistance for the Farm Credit System to be funded through the sale of Farmers Home Administration loans, while the Senate bill provides $4.0 billion to be funded through the issuance of federally guaranteed securities by a new agency of the System. Major differences also exist concerning the reorganization of the System; both would establish a new secondary market for farm loans but they differ in many details.

Refunding volume fell to the lowest level since January 1986. The continued light volume has been accompanied by a series of announcements of cutbacks in staffing of municipal finance departments at investment and commercial banks, but these cutbacks seem to have had little if any effect on the market's operation.

GROSS OFFERINGS OF MUNICIPAL SECURITIES
(Monthly rates, not seasonally adjusted, billions of dollars)

| | 1985 | 1986 | 1987 | | | 1987 | | |
|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q1 | Q2 | Q3 | Sept. | Oct. | Nov.p |
| Total tax-exempt | 19.81 | 14.04 | 10.86 | 9.65 | 8.16 | 6.15 | 7.46 | 8.94 |
| Short-term[1] | 1.96 | 1.79 | .56 | 1.83 | 1.83 | .64 | 1.20 | 1.83 |
| Long-term | 17.85 | 12.25 | 10.30 | 7.82 | 6.33 | 5.51 | 6.26 | 7.11 |
| Refundings[2] | 4.85 | 5.29 | 7.24 | 2.98 | 1.69 | 1.17 | 2.16 | .99 |
| New capital | 13.00 | 6.96 | 3.06 | 4.84 | 4.63 | 4.34 | 4.09 | 6.12 |
| Total taxable | .03 | .38 | .27 | .29 | .15 | .22 | .25 | .09 |

1. Does not include tax-exempt commercial paper.
2. Includes all refunding bonds, not just advance refundings.
p--preliminary.

After rising sharply in mid-October, the ratio of tax-exempt to taxable bond rates has returned to around the level prevailing just prior to the collapse of the stock market. That level is still on the high side, however, in part because various tax-related legislative proposals have added significantly to investor concerns. One of these is a proposal in the House to require owners of non-original discount bonds to pay taxes annually on the amortized discount, which would have the greatest effect on the tax-exempt sector.

## Mortgage Markets

Despite a small backup most recently, the average contract rate on new commitments for fixed-rate conventional home mortgages has fallen about 40 basis points since the last FOMC meeting to 10.60 percent. Initial rates on adjustable-rate mortgages indexed to the one-year constant maturity Treasury yield also have declined during the intermeeting period, though the decline has been smaller for ARMs than for fixed-rate loans since mid-October. In fact, the commitment rate advantage of ARMs over fixed-rate loans has shrunk more than 1/2 percentage point. Nevertheless, at more than 2-1/2 percentage points, this spread remains historically high.

In early November, roughly 63 percent of conventional home purchase loans closed had adjustable rates, the highest proportion since late 1984. Mortgage origination activity at thrifts has been buoyed by the renewed ARM popularity. Though interest rates on fixed-rate mortgages have increased a good deal since early this year and refinancing volume has fallen further, the October origination volume at FSLIC-insured thrifts was only 10 percent below the average monthly level during the first half of the year. The heavier ARM volume also has permitted S&Ls to add a sizable amount of these loans to their portfolios. Thrift holdings of unsecuritized mortgages jumped by an unprecedented $8.2 billion in October; investment in ARMs accounted for all of this growth. In contrast, lenders that traditionally have specialized in fixed-rate mortgages, such as mortgage bankers, have experienced a more pronounced falloff in origination business than have thrifts.

The drop in fixed-rate mortgage originations has resulted in a continued slowing in the pace of mortgage pass-through security issuance. Issuance of mortgage-backed pass-throughs fell for the

MORTGAGE ACTIVITY AT ALL FSLIC-INSURED INSTITUTIONS
(Billions of dollars, seasonally adjusted)

| | Mortgage transactions | | Net change in mortgage assets[1] | | |
|---|---|---|---|---|---|
| | Originations | Sales | Total | Mortgage loans | Mortgage-backed securities |
| 1987-Jan. | 20.1 | 13.7 | 1.1 | -3.4 | 4.5 |
| Feb. | 21.3 | 12.1 | .3 | -.5 | .9 |
| Mar. | 22.7 | 11.6 | 2.2 | 1.8 | .4 |
| Apr. | 24.2 | 14.8 | 7.9 | 1.6 | 6.3 |
| May | 22.4 | 11.9 | 11.9 | 3.2 | 8.7 |
| June r | 23.2 | 11.4 | 1.5 | 2.2 | -.7 |
| July r | 21.8 | 12.3 | 3.3 | .5 | 2.8 |
| Aug. r | 18.5 | 9.5 | 4.9 | 2.5 | 2.3 |
| Sept.r | 19.5 | 8.4 | 9.7 | 4.2 | 5.5 |
| Oct. p | 19.9 | 7.1 | 10.0 | 8.2 | 1.8 |

1. Net changes are adjusted to account for structural changes caused by mergers, acquisitions, liquidations, terminations, or de novo institutions.

NEW ISSUES OF MORTGAGE-BACKED PASS-THROUGH SECURITIES
BY FEDERALLY RELATED AGENCIES
(Monthly averages, billions of dollars,
not seasonally adjusted)

| Period | Total | GNMAs | FHLMCs | FNMAs |
|---|---|---|---|---|
| 1984 | 5.0 | 2.3 | 1.6 | 1.1 |
| 1985 | 9.0 | 3.8 | 3.2 | 2.0 |
| 1986 | 21.6 | 8.2 | 8.3 | 5.0 |
| 1987-Q1 | 24.0 | 10.4 | 8.4 | 5.2 |
| Q2 | 24.8 | 9.6 | 8.4 | 6.9 |
| Q3 r | 17.7 | 7.9 | 5.2 | 4.6 |
| 1987-Jan. | 25.2 | 10.6 | 8.2 | 6.4 |
| Feb. | 22.2 | 9.7 | 7.8 | 4.7 |
| Mar. | 24.5 | 10.7 | 9.1 | 4.6 |
| Apr. | 28.8 | 11.9 | 9.9 | 7.0 |
| May | 23.2 | 8.4 | 7.8 | 7.1 |
| June | 22.5 | 8.4 | 7.4 | 6.6 |
| July | 21.5 | 8.8 | 6.8 | 5.8 |
| Aug. r | 17.0 | 8.2 | 4.7 | 4.0 |
| Sept.r | 14.7 | 6.5 | 4.2 | 4.1 |
| Oct. p | 12.1 | 5.4 | 2.9 | 3.8 |
| Nov. p | 11.1 | 5.7 | 2.7 | 2.6 |

r--revised. p--preliminary.

seventh consecutive month in November to $11.1 billion (NSA), about half of the average monthly pace during the first six months of the year. ARM-backed issues continued to account for only a small fraction of pass-through volume; new ARM-backed programs offered by the federally sponsored agencies have yet to have much effect on volume.

Consumer Installment Credit

Consumer installment credit increased at a 7-1/2 percent annual rate in October, off from September's rapid 13 percent pace. The primary reason for the deceleration was the end of auto sales incentive programs. Non-auto installment credit growth, although slowing, remained above its 1987 average rate. Revolving credit continued to show strong growth for the fourth consecutive month and may be reflecting less substitution into home equity lines of credit.

Growth in home equity lines of credit at large banks has been slowing in recent months, dropping to an annual rate of perhaps around 40 percent in October and November from roughly 70 percent during most of this summer. The most often cited reason for this slowdown, among respondents to the November Senior Loan Officer Opinion Survey, was that banks have been marketing less aggressively; however, some banks also attributed the slower growth to higher interest rates and asserted that many qualified borrowers already had obtained home equity lines.

The October stock market plunge appears to have had little immediate effect on the demand for home equity lines, with more than

CONSUMER INSTALLMENT CREDIT
(Seasonally adjusted)

| | Percent change (at annual rate) | | | | | | Net change (billions of dollars) | | Memo: Outstandings (billions of dollars) |
|---|---|---|---|---|---|---|---|---|---|
| | | | 1987 | | 1987 | | 1987 | | 1987 |
| | 1985 | 1986 | H1 | Q3 r | Sept. r | Oct. p | Sept. r | Oct. p | Oct. p |
| Total[1] | 17.1 | 10.5 | 3.5 | 10.1 | 12.9 | 7.4 | 6.43 | 3.74 | 606.3 |
| Total, excluding auto | 14.9 | 5.7 | 3.0 | 8.8 | 10.4 | 7.7 | 2.97 | 2.20 | 347.3 |
| Selected types | | | | | | | | | |
| Auto | 20.7 | 17.8 | 4.1 | 11.7 | 16.3 | 7.6 | 3.46 | 1.63 | 259.1 |
| Revolving | 22.5 | 10.6 | 3.6 | 12.5 | 16.0 | 13.3 | 1.87 | 1.57 | 143.3 |
| All other | 10.6 | 2.6 | 2.5 | 6.3 | 6.5 | 3.7 | 1.10 | .64 | 204.0 |
| Selected holders | | | | | | | | | |
| Commercial banks | 15.7 | 8.1 | 2.1 | 7.2 | 14.7 | 7.9 | 3.26 | 1.78 | 270.9 |
| Finance companies | 26.3 | 20.7 | 2.3 | 13.4 | 16.7 | 4.0 | 1.96 | .47 | 143.1 |
| Credit unions | 9.9 | 8.0 | 7.0 | 13.7 | 12.4 | 12.5 | .85 | .87 | 84.2 |
| Savings institutions[2] | 30.0 | 10.7 | 10.1 | 15.1 | 3.8 | 5.1 | .20 | .27 | 63.5 |

1. Includes items not shown separately.
2. Savings and loans, mutual savings banks, and federal savings banks.
r--revised. p--preliminary.

CONSUMER INTEREST RATES
(Annual percentage rate)

| | | | 1987 | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1985 | 1986 | Feb. | May | Aug. | Sept. | Oct. | Nov. |
| At commercial banks[1] | | | | | | | | |
| New cars (48 mo.) | 12.91 | 11.33 | 10.36 | 10.24 | 10.37 | ... | ... | 10.86 |
| Personal (24 mo.) | 15.94 | 14.83 | 14.11 | 14.00 | 14.22 | ... | ... | 14.58 |
| Credit cards | 18.69 | 18.26 | 18.11 | 17.92 | 17.83 | ... | ... | 17.82 |
| At auto finance cos.[2] | | | | | | | | |
| New cars | 11.98 | 9.44 | 10.78 | 10.69 | 9.63 | 8.71 | 10.31 | n.a. |
| Used cars | 17.59 | 15.95 | 14.56 | 14.45 | 14.53 | 14.58 | 14.76 | n.a. |

1. Average of "most common" rate charged for specified type and maturity during the first week of the mid-month of each quarter.
2. Average rate for all loans of each type made during the month regardless of maturity.

half of the surveyed banks reporting that the volume of applications has stayed about the same as before the crash, and like numbers reporting increases and decreases.

Over the period from early August to early November, most consumer loan rates at banks rose roughly in line with other interest rates with the exception of credit card rates, which fell slightly over this period. Rates for new cars and personal loans were at their highest levels in over a year and showed their first back-to-back increases since 1984.

Foreign Exchange Markets

The trade-weighted, foreign-exchange value of the dollar in terms of the other G-10 currencies has declined more than 2-3/4 percent since the last FOMC meeting and is now about 4-3/4 percent below the low of early May. Since November 3, the value of the dollar has declined about 2-3/4 percent against the mark and about 3-1/2 percent against the yen. Selling pressure on the dollar was fueled intermittently by reactions to efforts in the United States to reduce the fiscal deficit. The dollar was given some further downward impetus by indications from U.S. and German officials that they were not willing to sacrifice domestic objectives to stabilize exchange rates, but has recently rebounded somewhat following concerted interest-rate reductions in Europe.

As the dollar weakened, European central banks altered official interest rates in their countries in three rounds of coordinated actions. (See the table on Official Interest Rates in Selected Countries.) Early in the period, in an effort to ease strains within the EMS generated by the strengthening of the mark, the Bundesbank lowered the Lombard rate and announced a reduction in the rate for its next repurchase tender, and the Bank of France raised its money-market intervention and 7-day repurchase rates. In the United Kingdom, Switzerland, and the Netherlands, officials followed Germany by lowering lending rates, presumably with the intention of contributing to the stability of their currencies against the mark. In the second round,

OFFICIAL INTEREST RATES IN SELECTED COUNTRIES

| | Level on Nov. 3 | Change in week ending: Nov. 6 | Nov. 27 | Dec. 4 | Level Dec. 4 |
|---|---|---|---|---|---|
| Germany | | | | | |
| Lombard | 5.00 | -0.50 | | | 4.50 |
| Fixed-rate RP | 3.80 | -0.30* | -0.25 | | 3.25 |
| T-bill selling | 3.20 | | -0.20 | | 3.00 |
| Discount | 3.00 | | | -0.50 | 2.50 |
| United Kingdom | | | | | |
| Money-market dealing | 9.38 | -0.50 | | -0.50 | 8.38 |
| France | | | | | |
| Money-market intervention | 7.50 | 0.75 | -0.25 | -0.25 | 7.75 |
| 7-day RP | 8.00 | 0.75 | -0.25 | -0.25 | 8.25 |
| Switzerland | | | | | |
| Lombard | 5.00 | -0.50 | | -0.50 | 4.00 |
| Discount | 3.50 | -0.50 | | -0.50 | 2.50 |
| Netherlands | | | | | |
| Promissory notes | 5.50 | -0.25 | -0.25 | -0.25 | 4.75 |
| Advances | 5.00 | -0.25 | -0.25 | -0.25 | 4.25 |
| Discount | 4.50 | -0.25 | -0.25 | -0.25 | 3.75 |
| Belgium | | | | | |
| Advances | 7.50 | | | -0.25 | 7.25 |
| Discount | 7.25 | | | -0.25 | 7.00 |
| Austria | | | | | |
| Lombard | 5.00 | | | -0.50 | 4.50 |
| Discount | 3.50 | | | -0.50 | 3.00 |

*--Announced during week of Nov. 6, effective in week of Nov. 13.

official lending rates in Germany, France, the Netherlands, and Belgium were cut. A third round of concerted actions came last week when the Bundesbank lowered the discount rate 1/2 point to a record 2.5 percent; the Bank of England cut official dealing rates 1/2 point, prompting an equivalent decline in the major clearing banks' base lending rates; and five other European central banks also lowered official rates, as shown in the table.

Short-term market interest rates in Europe have responded to these changes in official interest rates. Since the beginning of November, the multilateral weighted average of short-term interest rates in the other G-10 countries has declined about 50 basis points, with three-month interest rates in the United Kingdom down almost 70 basis points and in Germany down about 50 basis points. Only in France have short-term interest rates risen. In Japan, the three-month gensaki rate is about unchanged.

Stock prices in Germany and Japan continued to decline during the intermeeting period, while stock prices in the United Kingdom have edged up slightly. Since the previous FOMC meeting on November 3, the index of London stock prices has risen about 1/2 percent, while those in Tokyo have dropped about 3 percent and in Frankfurt about 13 percent. Consistent with expectations that the Bundesbank would lower interest rates and perhaps consistent also with a shift in investors' preferences from stocks to long-term bonds, the average bond yield in Germany has declined about 25 basis points since early November to 5.93 percent.

The average bond yield in Japan has also declined about 25 basis points to 4.44 percent. It appears that the bellwether government bond in Japan is in the process of being changed. The yield on the #89 bond has risen about 50 basis points during the period, while the yield on the #105 bond, issued in November, has fallen below that on the #89. The yield on the #105 is currently 4.68, while the yield on the #89 is 5.07.

The Desk purchased a total of $433 million against yen and $864 million against marks during the intermeeting period.

U.S. International Financial Transactions

Foreign official reserve assets in the United States increased sharply in October. (See line 4 of the Summary of U.S. International Transactions table.) Holdings of the G-10 countries increased by more than $8 billion,

. Partial information from the FRBNY indicates that G-10 reserves increased approximately another $4 billion in November. In contrast, OPEC reserves in the United States continued to decline in October, bringing the total reduction during the first ten months of 1987 to $7.5 billion. Holdings of

INTERNATIONAL BANKING DATA
(Billions of dollars)

| | 1982 Dec. | 1983 Dec. | 1984 Dec. | 1985 Dec. | 1986 Dec. | 1987 Mar. | June | Aug. | Sep. | Oct. |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS | 49.1 | 44.5 | 33.0 | 28.2 | 22.3 | 9.1 | 5.0 | 4.5 | -7.8 | -7.2 |
| (a) U.S.-chartered banks | 40.0 | 40.5 | 32.1 | 32.4 | 31.7 | 21.6 | 16.3 | 18.5 | 12.6 | 15.6 |
| (b) Foreign-chartered banks | 9.1 | 4.0 | .9 | -4.2 | -9.4 | -12.4 | -11.3 | -14.0 | -20.3 | -22.8 |
| 2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks | 15.8 | 18.6 | 20.7 | 18.7 | 16.8 | 16.0 | 15.6 | 17.2 | 17.1 | 17.0 |
| 3. Eurodollar Holdings of U.S. Nonbank Residents 1/ | 112.6 | 124.3 | 117.6 | 111.1 | 124.5 | 134.0 | 135.7 | 136.8 | 145.0 | 142.2 |

1. Includes term and overnight Eurodollars held by money market mutual funds.

Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices. Line 2 is an average of daily data. Line 3 is an average of daily data for the overnight component and an average of Wednesday data for the term component.

the rest of the world continued to increase rapidly, largely as the result of reserve accumulation by Taiwan. Partial information for November indicates that Taiwan's holdings increased again by almost $2 billion.

Private foreigners sold U.S. Treasury securities net in October, but continued to add to their holdings of U.S. corporate equities and bonds. Net sales of Treasury securities (line 3) were more than accounted for by residents of Japan. Despite the turmoil in the U.S. stock market in October, private foreigners added net almost $2 billion to their holdings of U.S. stocks (line 2b). This total was down from September, but still above the monthly average in the third quarter. Japanese residents added $1.7 billion to their holdings of U.S. equities. Net purchases of U.S. corporate bonds were $1.4 billion in October (line 2a), reflecting the weakness of new issues of Eurobonds by U.S. corporations in September and October. There was a further decline in new issues of Eurobonds by U.S. corporations in November, reflecting both a general reduction in new bond issues by U.S. corporations, and a weakness in demand of Eurobond investors reportedly associated with concerns about dollar depreciation, debt quality, and secondary-market liquidity.

U.S. net purchases of foreign securities (line 2c) increased in October, reflecting net purchases of bonds and net sales of equities. U.S. residents sold net $2 billion in foreign equities in October; $1.7 billion was reported as sold to Japanese residents. (Presumably, most U.S. sales of foreign equities to Japanese residents involve Japanese

SUMMARY OF U.S. INTERNATIONAL TRANSACTIONS
(Billions of dollars)

| | 1985 Year | 1986 Year | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Aug. | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|---|---|---|
| Private Capital | | | | | | | | | | |
| Banks | | | | | | | | | | |
| 1. Change in net foreign positions of banking offices in the U.S. (+ = inflow) | 33.6 | 21.1 | 12.4 | 8.2 | 12.7 | -6.0 | 32.3 | 6.0 | 9.9 | 0.1 |
| Securities | | | | | | | | | | |
| 2. Private securities transactions, net | 43.0 | 66.1 | 17.3 | 14.8 | 16.7 | 16.0 | 11.6 | 1.0 | 5.9 | 2.6 |
| a) foreign net purchases (+) of U.S. corporate bonds | 46.0 | 53.5 | 12.7 | 12.2 | 8.5 | 7.5 | 7.6 | 1.3 | 3.3 | 1.4 |
| b) foreign net purchases (+) of U.S. corporate stocks | 4.8 | 18.0 | 4.5 | 0.3 | 10.2 | 8.7 | 5.4 | 0.2 | 2.8 | 1.9 |
| c) U.S. net purchases (-) of foreign securities | -7.9 | -5.3 | 0.1 | 2.3 | -1.9 | -0.2 | -1.4 | -0.6 | -0.2 | -.8 |
| 3. Foreign net purchases (+) of U.S. Treasury obligations | 20.5 | 4.8 | -1.3 | -3.7 | -2.7 | -2.1 | -2.5 | -1.8 | -1.1 | -4.6 |
| Official Capital | | | | | | | | | | |
| 4. Changes in foreign official reserves assets in U.S. (+ = increase) | -2.0 | 35.0 | 14.6 | 1.7 | 15.1 | 11.6 | 0.5 | 5.4 | 1.3 | 12.0 |
| a) By area | | | | | | | | | | |
| G-10 countries (incl. Switz.) | -0.4 | 32.6 | 14.7 | 0.9 | 15.7 | 13.0 | -6.8 | 1.3 | -1.0 | 8.4 |
| OPEC | -6.9 | -8.3 | -2.9 | -4.8 | -2.8 | -2.0 | -1.4 | 0.1 | -0.2 | -1.4 |
| All other countries | 5.3 | 10.8 | 2.8 | 5.5 | 2.2 | 0.5 | 7.7 | 4.0 | 2.5 | 4.9 |
| b) By type | | | | | | | | | | |
| U.S. Treasury securities | -0.8 | 36.1 | 12.2 | 4.4 | 12.1 | 11.1 | .8 | 7.2 | -1.1 | 5.6 |
| Other <1> | -1.1 | -3.0 | 2.4 | -2.8 | 2.9 | 0.5 | -.4 | -1.8 | 2.4 | 6.4 |
| 5. Changes in U .S. official reserve assets (+ = decrease) | -3.9 | 0.3 | 0.3 | 0.1 | 2.0 | 3.4 | * | -0.8 | 0.4 | 0.4 |
| Other transactions (Quarterly data) | | | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -17.3 | -28.0 | -5.7 | -3.8 | -9.8 | -4.6 | n.a. | n.a. | n.a. | n.a. |
| 7. Foreign direct investment (+) in U.S. | 19.0 | 25.1 | 6.1 | 12.6 | 7.7 | 7.2 | n.a. | n.a. | n.a. | n.a. |
| 8. Other capital flows (+ = inflow) 2/ 3/ | 5.6 | -4.9 | 1.4 | -3.7 | 0.6 | -2.0 | n.a. | n.a. | n.a. | n.a. |
| 9. U.S. current account balance 3/ | -116.4 | -141.4 | -36.6 | -38.0 | -36.8 | -41.1 | n.a. | n.a. | n.a. | n.a. |
| 10. Statistical discrepancy 3/ | 17.9 | 23.9 | -8.5 | 11.8 | -5.5 | 17.6 | n.a. | n.a. | n.a. | n.a. |
| MEMO: | | | | | | | | | | |
| U.S. merchandise trade balance — part of line 9 (Balance of payments basis, seasonally adjusted) | -124.4 | -147.7 | -37.1 | -38.6 | -38.8 | -39.5 | n.a. | n.a. | n.a. | n.a. |

1. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
2. Includes U.S. government assets other than official reserves, transactions by nonbanking concerns, and other banking and official transactions not shown elsewhere. In addition, it includes amounts resulting from revisions of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
3. Includes seasonal adjustment for quarterly data.
* Less than $50 million.
NOTE: Details may not add to total because of rounding.

stocks.) Foreign issues of dollar bonds in the U.S. market were very large in September and October. Among the issuers were the World Bank, the Export-Import Bank of Japan, and the Metropolis of Tokyo.

Banks reported virtually no net capital inflow in October, after massive inflows in the third quarter (line 1). Most of the third-quarter inflow was accounted for by transactions with affiliated and unaffiliated banks outside the United States. These third-quarter inflows coincided with strong credit demands relative to core deposit growth in the United States and followed a period when official monetary authorities invested large dollar holdings acquired through intervention in the Euromarkets. While credit demands in the United States continued to be strong in October, core deposit growth was up sharply, particularly after October 19, and banks apparently had little need to add to their net Eurodollar borrowings.

U.S. Merchandise Trade Through 1987-Q3

The U.S. merchandise trade deficit for the third quarter of 1987 was $159 billion at a seasonally adjusted annual rate (balance-of-payments basis), about the same as in the second quarter. The value of exports increased 9 percent from the second-quarter level and the value of imports rose 6 percent. These increases were largely in terms of volume as the implicit deflators of both exports and imports were little changed on average. Over the past four quarters, the volume of exports has increased 15 percent, while the volume of imports has risen only 3 percent. (See the table.) Data for the month of October will be re-

U.S. MERCHANDISE TRADE
(Billions of dollars, annual rates, BOP basis, seasonally adjusted)

| | Exports | | | Imports | | | |
|---|---|---|---|---|---|---|---|
| | Total | Ag. | Nonag. | Total | Oil | Non-oil | Balance |
| 1984 | 220 | 38 | 182 | 332 | 57 | 275 | -112 |
| 1985 | 216 | 30 | 186 | 338 | 50 | 288 | -122 |
| 1986 | 224 | 27 | 197 | 369 | 34 | 335 | -144 |
| 1986-1 | 216 | 28 | 187 | 355 | 41 | 314 | -140 |
| -2 | 228 | 25 | 202 | 362 | 31 | 332 | -135 |
| -3 | 226 | 27 | 200 | 375 | 32 | 343 | -149 |
| -4 | 228 | 28 | 200 | 383 | 32 | 350 | -154 |
| 1987-1 | 228 | 26 | 202 | 383 | 35 | 348 | -155 |
| -2 | 240 | 29 | 211 | 399 | 40 | 359 | -158 |
| -3 | 261 | 34 | 227 | 420 | 51 | 370 | -159 |
| Constant 1982 dollars; Percent change from: | | | | | | | |
| Previous quarter: | | | | | | | |
| 1987-2 | 5.0 | 9.7 | 4.3 | 1.8 | 3.5 | 1.4 | |
| -3 | 8.3 | 18.0 | 6.9 | 5.6 | 21.5 | 2.4 | |
| Year earlier: | | | | | | | |
| 1987-3 | 14.8 | 30.8 | 12.6 | 3.0 | 1.0 | 3.5 | |

leased by the Commerce Department on Thursday, December 10; a summary will be included in the Greenbook Supplement.

Nearly half of the increase in the value of exports in the third quarter was in capital goods. The strong rise in exports of capital goods was virtually all in volume (up 13 percent) and was concentrated in a surge in exports of civilian aircraft (largely deliveries to Japan and Brazil) and business machines. While nearly 50 percent of exports of business machines are shipped to Western European countries, the increase in the third quarter went largely to developing countries in the Far East and Latin America as well as to Japan. Agricultural exports also increased substantially in the third quarter; all of the increase was in volume. Most of the rise was in soybeans that were shipped to Western Europe, Latin America, and South Korea. Soybean exports more than doubled in volume in the third quarter because of sharply reduced supplies from Latin America, especially Brazil. The volume of wheat exports also rose noticeably (by 16 percent) due to increased shipments to the Soviet Union. The average prices of soybeans and wheat were little changed. Shipments of cotton to South Korea and Taiwan increased and prices rose because of increased demand and lower worldwide production in the current crop year.

About half of the rise in the value of imports in the third quarter was accounted for by oil. The volume of oil imports was up by 22 percent (to 7.67 million barrels per day) as both primary and tertiary inventories were built up. The average price of oil in the third quarter rose by 4 percent to $18.05 per barrel. After having risen steadily over the preceding 12 months, the price of imported oil then dropped by about 85 cents per barrel in September, reflecting declines in world spot market prices that began during the summer.

OIL IMPORTS
(BOP basis, seasonally adjusted, value at annual rate)

| | 1986 | | | 1987 | | | |
|---|---|---|---|---|---|---|---|
| | Year | Q3 | Q4 | Q1 | Q2 | Q3 | Sept. |
| Value (Bil. $) | 33.76 | 31.61 | 32.04 | 34.80 | 39.91 | 50.53 | 44.72 |
| Price ($/BBL) | 14.18 | 11.38 | 12.73 | 15.64 | 17.32 | 18.05 | 17.53 |
| Volume (mbd.) | 6.52 | 7.61 | 6.89 | 6.09 | 6.31 | 7.67 | 6.99 |

The volume of non-oil imports rose about 2-1/2 percent in the third quarter (see the summary table above). Most of the increase in the third quarter (as in the second quarter) was in capital goods, particularly business machines and other electronic and telecommunications equipment; these increases were consistent with unusually strong rises in U.S. producers' durable equipment expenditures in the second and third quarters. The volume of passenger cars imported from areas other than Canada rose nearly 10 percent, with much of the increase from Japan. Despite these increases in the third quarter, the number of cars Japan has shipped to the United States since the beginning of the current quota-year (April 1987 through October 1987) is about 80 thousand cars (5 percent) less than was shipped during the same period a year ago. This year the data show a more even pattern of monthly imports from Japan than in previous years. In 1987, 54 percent of the quota was shipped in the first half of the quota-year; this compares with 58 percent during the same period last year. Changes in the volume of imports among other non-oil import trade categories were generally small in the third quarter: small declines in the volume of consumer goods and food imports were offset by small increases in imports of industrial supplies (largely gold).

The implicit deflator for non-oil imports recorded only a 3 percent increase at an annual rate for the third quarter compared with a 6 percent increase in the second quarter. The low rate of increase, and the deceleration from second to third quarters, reflects importantly the increasing share of capital goods in the total index; the implicit deflator for capital goods is influenced increasingly by continued declines in the price of business machines as measured by BEA. On a fixed-weighted basis, the price of non-oil imports increased at an annual rate of 8 percent in the third quarter, about the same as in the second quarter. By individual trade category, in addition to the decline recorded by capital goods, there were rapid increases in prices of imported foods (16 percent annual rate) and industrial supplies (21 percent), and moderate increases in prices of imported consumer goods (7 percent) and automotive products (3 percent).

Developments in the Foreign Industrial Countries

Economic growth in the major foreign industrial countries increased markedly in the third quarter. Real GNP surged in Japan in the third quarter, and rose sharply in Germany. Meanwhile, GDP growth in the third quarter was strong in France and output growth increased from an already strong pace in the United Kingdom. Real growth in Canada in 1987 since the fourth quarter last year was the highest among the G-7 countries. These data reflect economic developments that occurred prior to the stock market declines and related events since October.

Inflation remained low, on average, in the major foreign industrial countries although it has increased in some countries. Consumer price inflation in Japan has not increased in recent months. In Germany, inflation has remained low, but the decline in import prices may have temporarily lessened. Price pressures in the United Kingdom, Canada, and Italy continued to rise.

Except in Japan, where export volumes continued to decline and import volumes continued to increase, the achievement of better external balance in the major foreign industrial countries remains an elusive objective. Germany's trade and current account surpluses through October were above last year's, and through September growth in the volume of exports surpassed growth in import volume. Trade balances in France, the United Kingdom, and Canada continued to deteriorate.

Coordinated reductions in central bank official lending rates occurred in Germany, France, the United Kingdom, Switzerland, Belgium and the Netherlands.

Individual country notes. In Japan, real GNP increased 8.4 percent (s.a.a.r.) in the third quarter, as domestic demand grew 7.6 percent and net exports (on a national income basis) made a small positive contribution to growth. Growth was strong in all components of domestic demand, but particularly in residential investment. Strong growth appears to be continuing in the fourth quarter. Industrial production (s.a.) rose 3.6 percent in the third quarter, and preliminary data for October show an increase of 1.2 percent. The unemployment rate (s.a.) declined from its May peak of 3.2 percent to 2.7 percent in October. Capacity utilization (s.a.) rose 1.9 percent in September but still remains well below the recent peak reached in mid-1985. Total new machinery orders (s.a.) declined 4.9 percent in the third quarter, but the Economic Planning Agency predicts that orders will rise 3.9 percent in the fourth quarter, reflecting rising public sector orders in connection with public works projects. Indicators of consumer spending in the third quarter were mixed. Growth in retail sales (s.a.) slowed to 0.2 percent, but real consumption expenditures of working households (s.a.) increased 1.1 percent.

Consumer price inflation, while higher than earlier in the year, has not increased in recent months. The Tokyo index of consumer prices rose 1 percent relative to a year earlier in each of the three months through November. The all-commodities index of wholesale prices rose 0.6 percent in the 12 months ending in October, the first year-on-year increase since May 1985. Wage gains remain limited.

Japan's trade balance (s.a.) widened in both September and October. Still, for the first ten months of 1987, the cumulative trade surplus annualized was $81.1 billion, little changed from the $82.5 billion surplus registered in 1986. In the first ten months of this year, export volume declined 2.2 percent and import volume increased 5.5 percent relative to the comparable period in 1986. The current account surplus narrowed in October bringing the cumulative surplus (s.a.a.r.) to $86 billion for the first ten months of the year compared with a surplus of $85.5 billion over the comparable period in 1986.

Monetary conditions remain relaxed. M2+CDs grew 11.7 percent in the 12 months through October, primarily due to portfolio demands for more liquid assets in response to recent financial market instability. In the fourth quarter, the Bank of Japan projects M2+CDs will increase 11 to 12 percent from a year earlier.

In Germany, real GNP increased 5.7 percent (s.a.a.r.) in the third quarter (as measured in Bundesbank seasonally adjusted data), mainly the result of strong domestic demand, though the external sector also contributed to growth. The level of real GNP in the third quarter was roughly 1.4 percent above the previous peak reached in the third quarter last year. Industrial production increased 0.9 percent in October following an upward revised September decline of 2.2 percent. The September-October average of industrial production was slightly above the July-August average and the comparable period last year. Manufacturing orders declined in September after strong growth in August. In the third quarter, orders were about 3-1/2 percent above the second-quarter average level. The unemployment rate remained at 9 percent in November, slightly above rates observed during the first half of the year.

Inflation remains low, but there are some signs that downward pressure on domestic prices is waning. In November, consumer prices (n.s.a.) were unchanged after increasing slightly in October. The index stood 1 percent above its level a year earlier. Import prices rebounded in October, reaching a level 0.4 percent higher than a year ago, the first twelve-month rise since July 1985.

The trade surplus (n.s.a.) declined in October. However, through the first ten months of 1987, the cumulative trade surplus was $51.3 billion, exceeding the $42 billion surplus for the same period in 1986. The current account surplus (n.s.a.) rose in October bringing the cumulative surplus through October to $33 billion, compared with the $28 billion recorded during the first ten months of 1986. Export volume rose 2.7 percent and import volume declined 0.2 percent in September, but through September export volumes were 1.1 percent and import volumes were 4.2 percent ahead of comparable figures last year.

On November 27, the Bundestag adopted a budget for 1988 raising total federal expenditures 2.4 percent. The projected 1988 budget deficit is DM 29.5 billion, about 1.4 percent of GNP. The budget will be discussed and voted on in the Bundesrat on December 18, where it is expected to be adopted (as it always has been in the 38-year history of the FRG). Government officials announced on December 2 a package of stimulative economic measures. A three-year program of DM 21 billion in low-interest loans, beginning in 1988, will be provided through a state-supported lending unit (the Kreditanstalt fuer Wiederaufbau). Low-interest loans of DM 15 billion will be provided to municipalities for investment in environmental projects and DM 6 billion will be provided to small- to medium-sized firms for business investment. The subsidy may be as high as a 2 percentage point reduction from market rates and is projected to cost the government DM 2.6 billion. In addition, the Bundespost, the federal postal and communications monopoly, plans to increase investment DM 1.5 billion above previous plans bringing its total investment to DM 20 billion in 1988. Other parts to the program were a pledge to deregulate the country's rigidly structured economy, a promise to allow revenue shortfalls to occur, and a formal commitment to privatize further.

Growth of Central Bank Money (CBM) from the 1986-Q4 target base was 7.7 percent (s.a.a.r.) in October, up slightly from 7.6 percent in September. Continued growth of CBM above the current target range of 3-6 percent was a factor in the Bundesbank's decision to raise the interest rate on repurchase operations in September and October. However, following the recent stock market developments, official rates have been reduced. Early in November, the Bundesbank lowered the Lombard rate to 4.5 percent and the rate on its repurchase arrangements to 3.5 percent. On November 23 the Bundesbank announced a further reduction to 3.25 percent in its next fixed-rate repurchase tender, in conjunction with interest rate cuts in France, Belgium, and the Netherlands. On December 3, the Bundesbank announced a 50 basis point reduction in the discount rate to 2.5 percent, effective on December 4, again in conjunction with cuts by other European central banks.

In France, real GNP increased 4.3 percent (s.a.a.r.) in the third quarter, the result of strong domestic demand and exports. The stock market plunge has caused a slowdown in the government's privatization program. Public companies that were scheduled to be sold by the government by the end of 1987 have had their sales postponed due to weak market conditions.

In the United Kingdom, Chancellor of the Exchequer Lawson delivered the government's autumn statement on the economy on November 3. The Chancellor raised previously announced spending plans for the coming fiscal year, but predicted that, despite this increase, the government's overall fiscal position would remain in near balance. Real growth was forecast to slow to 2-1/2 next year from this year's rapid 4 percent rate.

In Canada, third-quarter real GDP expanded 4.4 percent (s.a.a.r.) after annualized growth of 6 percent for the first half of 1987. All domestic sectors contributed to real growth while net exports continued to deteriorate.

In Italy, the inability of the government, weakened by divisions within the coalition, to address serious medium-term budgetary problems was highlighted by the political crisis that occurred on November 13. It was provoked by the small Liberal party that temporarily resigned to protest the cancellation by the government of planned reductions in income taxes and direct charges for health care. This step was necessitated by the Senate's rejection of the offsetting rise in the value added tax as too inflationary. On November 25 the Italian labor movement, which over the past year has become increasingly assertive, held its first general strike since 1985 to protest the revised budget.

Economic Situation in Major Developing Countries

The Presidents of eight Latin American nations met in Acapulco at the end of November to discuss various issues including the servicing of their external debts. The summit communique included a call for increased new lending and reduced interest rates, a proposal to decouple commercial bank lending from compliance with IMF programs, and plans to initiate negotiations with banks to take account of the debt's market value. While it called for "solidarity" with countries acting individually to reduce their debt burdens, no unilateral actions and no concrete plans for coordinating negotiations across countries were proposed.

Considerable progress has been made in completing a $4.5 billion package, agreed to in early November between Brazil and its foreign

## REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period, seasonally adjusted) 1/

| | Q4/Q4 1985 | Q4/Q4 1986 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 June | 1987 July | 1987 Aug. | 1987 Sept. | 1987 Oct. | Latest 3 months from year ago 2/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Canada** | | | | | | | | | | | | |
| GDP | 4.0 | 1.8 | .0 | 1.5 | 1.5 | 1.1 | * | * | * | * | * | 4.1 |
| IP | 4.4 | -.5 | .6 | 1.7 | 1.6 | 2.2 | 1.3 | -.1 | 1.3 | 1.2 | n.a. | 6.1 |
| **France** | | | | | | | | | | | | |
| GDP | 1.7 | 2.1 | .2 | -.0 | 1.0 | 1.1 | * | * | * | * | * | 2.3 |
| IP | 2.0 | -.3 | -1.3 | -.3 | 2.3 | .6 | 1.0 | -1.0 | .0 | 1.0 | n.a. | 1.3 |
| **Germany** | | | | | | | | | | | | |
| GNP | 1.7 | 2.4 | -.3 | -.8 | 1.0 | 1.4 | * | * | * | * | * | 1.4 |
| IP | 3.4 | .5 | -1.0 | -2.1 | 2.2 | .5 | -1.7 | -.8 | 4.1 | -2.2 | .9 | 1.0 |
| **Italy** | | | | | | | | | | | | |
| GDP | 3.2 | 2.4 | .2 | .1 | 1.4 | n.a. | * | * | * | * | * | 2.2 |
| IP | 1.0 | 2.8 | 1.6 | 3.0 | 2.0 | -2.9 | -2.9 | -.5 | -4.0 | 3.2 | n.a. | 3.7 |
| **Japan** | | | | | | | | | | | | |
| GNP | 4.4 | 2.0 | .7 | 1.5 | .0 | 2.0 | * | * | * | * | * | 4.3 |
| IP | .9 | -.5 | -.0 | 1.4 | -.2 | 3.6 | 4.3 | 1.0 | -1.1 | 3.1 | 1.2 | 6.1 |
| **United Kingdom** | | | | | | | | | | | | |
| GDP | 2.7 | 4.3 | 1.2 | 1.1 | .5 | n.a. | * | * | * | * | * | 3.7 |
| IP | 4.3 | 2.6 | .1 | .9 | .4 | 1.8 | -1.1 | 2.2 | .8 | -1.3 | n.a. | 3.2 |
| **United States** | | | | | | | | | | | | |
| GNP | 3.3 | 2.2 | .4 | 1.1 | .6 | 1.0 | * | * | * | * | * | 3.1 |
| IP | 1.7 | 1.0 | 1.0 | .8 | 1.1 | 2.0 | .7 | 1.2 | .3 | -.1 | .6 | 5.0 |

1. Asterisk indicates that monthly data are not available.
2. For quarterly data, latest quarter from year ago.

TRADE AND CURRENT ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES 1/
(Billions of U.S. dollars, seasonally adjusted except where otherwise noted)

| | 1985 | 1986 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 July | 1987 Aug. | 1987 Sept. | 1987 Oct. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| <u>Canada</u> | | | | | | | | | | | | |
| Trade | 12.4 | 7.5 | 2.3 | 1.7 | 1.8 | 2.4 | 2.2 | n.a. | .5 | .7 | n.a. | n.a. |
| Current account | -.4 | -6.7 | -1.1 | -1.5 | -2.1 | -1.3 | -1.5 | n.a. | * | * | * | * |
| <u>France</u> | | | | | | | | | | | | |
| Trade | -2.6 | .1 | -.8 | .0 | .4 | -1.0 | -2.2 | -1.1 | -.5 | -.2 | -.4 | -.8 |
| Current account | .1 | 3.7 | .5 | 1.2 | .9 | -.1 | -.7 | n.a. | * | * | * | * |
| <u>Germany</u> | | | | | | | | | | | | |
| Trade (NSA) | 25.5 | 52.5 | 12.5 | 14.1 | 16.2 | 15.1 | 15.4 | 15.2 | 5.4 | 3.5 | 6.3 | 5.6 |
| Current account (NSA) | 15.8 | 37.7 | 8.3 | 8.6 | 13.8 | 10.9 | 10.7 | 7.4 | 2.5 | 1.3 | 3.6 | 3.8 |
| <u>Italy</u> | | | | | | | | | | | | |
| Trade | -11.2 | -1.6 | -.7 | .7 | .1 | -1.4 | -4.5 | -1.2 | -1.2 | .5 | -.5 | -.5 |
| Current account (NSA) | -3.5 | 3.7 | .8 | 5.4 | 1.2 | -2.8 | -.9 | n.a. | * | * | * | * |
| <u>Japan</u> | | | | | | | | | | | | |
| Trade | 46.1 | 82.5 | 20.4 | 23.6 | 22.5 | 23.6 | 19.0 | 18.3 | 6.2 | 5.9 | 6.2 | 6.6 |
| Current account 2/ | 49.2 | 85.5 | 21.6 | 23.8 | 24.3 | 24.9 | 21.1 | 19.9 | 6.3 | 5.9 | 7.7 | 5.7 |
| <u>United Kingdom</u> | | | | | | | | | | | | |
| Trade | -2.6 | -12.4 | -2.4 | -4.3 | -3.7 | -1.7 | -3.9 | -5.0 | -1.5 | -2.4 | -1.1 | -1.5 |
| Current account | 3.9 | -1.5 | .2 | -1.3 | -1.4 | 1.0 | -.3 | -2.0 | -.5 | -1.5 | -.0 | -.5 |
| <u>United States</u> | | | | | | | | | | | | |
| Trade 2/ | -122.1 | -144.3 | -33.6 | -37.1 | -38.6 | -38.8 | -39.6 | -39.8 | * | * | * | * |
| Current account | -116.4 | -141.4 | -33.8 | -36.6 | -38.0 | -36.8 | -41.1 | n.a. | * | * | * | * |

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period) 1/

| | Q4/Q4 1985 | Q4/Q4 1986 | 1986 Q2 | 1986 Q3 | 1986 Q4 | 1987 Q1 | 1987 Q2 | 1987 Q3 | 1987 Aug. | 1987 Sept. | 1987 Oct. | 1987 Nov. | Latest 3 months from year ago |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | | | | | | | | | | | | | |
| CPI | 4.2 | 4.3 | .8 | 1.2 | 1.0 | .9 | 1.4 | 1.2 | .1 | .0 | .4 | n.a. | 4.4 |
| WPI | 2.5 | 1.1 | -1.5 | 1.1 | .6 | -.6 | 1.4 | n.a. | .6 | n.a. | n.a. | n.a. | 3.6 |
| France | | | | | | | | | | | | | |
| CPI | 4.8 | 2.1 | .7 | .6 | .7 | 1.2 | .9 | .6 | .2 | .1 | .2 | n.a. | 3.3 |
| WPI | 1.9 | -3.4 | -1.4 | -.7 | -.7 | .4 | .7 | n.a. | * | * | * | * | -.3 |
| Germany | | | | | | | | | | | | | |
| CPI | 1.8 | -1.0 | -.3 | -.5 | -.3 | .6 | .4 | .0 | -.1 | -.2 | .2 | .0 | .8 |
| WPI | -1.1 | -9.0 | -2.6 | -2.9 | -1.6 | -.2 | .0 | -.4 | .3 | -.8 | .4 | n.a. | -1.9 |
| Italy | | | | | | | | | | | | | |
| CPI | 8.6 | 4.7 | 1.1 | .6 | 1.2 | 1.3 | 1.0 | 1.1 | .3 | .7 | .9 | .3 | 5.2 |
| WPI | 5.9 | -2.4 | -1.8 | -.8 | .7 | 1.5 | 1.0 | .8 | .4 | .5 | n.a. | n.a. | 4.1 |
| Japan | | | | | | | | | | | | | |
| CPI | 2.0 | .1 | .3 | -.5 | .0 | -.3 | 1.2 | -.2 | .2 | .7 | .1 | -.4 | 1.0 |
| WPI | -3.7 | -10.5 | -4.2 | -2.8 | -1.5 | -.5 | -.5 | 1.3 | .2 | -.1 | .0 | n.a. | -.3 |
| United Kingdom | | | | | | | | | | | | | |
| CPI | 5.5 | 3.4 | 1.3 | .1 | 1.3 | 1.2 | 1.5 | .2 | .3 | .3 | .5 | n.a. | 4.4 |
| WPI | 5.2 | 4.2 | 1.6 | .4 | .8 | 1.2 | 1.1 | .5 | .2 | .2 | .5 | n.a. | 3.7 |
| United States | | | | | | | | | | | | | |
| CPI (SA) | 3.5 | 1.3 | -.3 | .6 | .7 | 1.3 | 1.2 | 1.0 | .5 | .2 | .4 | n.a. | 4.3 |
| WPI (SA) | 1.4 | -1.8 | -1.2 | -.1 | .7 | .7 | 1.1 | .7 | .0 | .3 | -.2 | n.a. | 3.0 |

1. Asterisk indicates that monthly data are not available.

creditor banks, to cover 1987 interest payments. (The package includes a $1.5 billion drawdown of Brazil's own reserves.) Mexico's financial markets have been disrupted by collapses in the stock market and in the free-market value of the peso against the dollar; the government announced an anti-inflation program on December 4 in response to an acceleration of price increases. Amendment of Argentina's IMF stand-by arrangement received Executive Board approval on December 2. Ecuador signed a letter of intent for an IMF stand-by program in early December, and has resumed interest payments to banks; it also received a $31 million bridge loan to World Bank disbursements from the U.S. Treasury.

Individual Country Notes. In early November, Brazil reached a preliminary agreement with foreign creditor banks on a $4.5 billion package to cover 1987 interest payments, which are currently in arrears. Brazil has agreed to draw down $1.5 billion of its reserves while bank creditors raise the remaining $3 billion. The formal signing of the interim financing arrangement is scheduled for December 15. As part of the agreement, Brazil agreed to seek an IMF program in support of its economic program. The Brazilian government maintains that it intends to put together an economic program on its own and then seek IMF approval, emphasizing that there should be no link between commercial bank disbursements and an IMF program. An IMF team has recently returned from Brazil.

A slowing in Brazil's real GDP growth to around 2 percent is expected in 1987, down sharply from the 8.2 percent growth registered in 1986. Industrial production has fallen in recent months, plagued by weak consumer demand, rapidly rising input costs, and minimal investment. Since prices were decontrolled in September, the CPI has registered a 9.2 percent increase in October, a 12.8 percent rise in November, and is expected to jump 14 to 15 percent in December. The trade surplus for October was $1.2 billion, bringing the January-October trade balance to $9.06 billion.

Brazil's operational public sector deficit (which excludes the inflationary component of nominal interest payments) is expected to approach 6 percent of GDP in 1987, a sharp contrast to the 3.7 percent rate registered in 1986 and the 3.5 percent figure targeted for 1987 by the Macroeconomic Plan announced in July. Recently, the government instituted measures aimed at achieving greater fiscal and monetary control and a new fiscal package is expected to be unveiled soon.

Since mid-October, the <u>Mexican</u> financial markets have been in considerable turmoil. The stock market index, which had risen by about 700 percent in the first nine months of the year, fell precipitously in October and November, closing on December 7 about 72 percent below the October 6 peak. To stem a capital outflow related to the initial collapse of the stock market, the authorities reversed their policy of nudging interest rates down. At the November 24 Treasury bill auction, the nominal rate on 28-day bills was 24 percentage points higher than five weeks earlier. (At the December 1 Treasury bill auction, when the authorities held the nominal rate unchanged from a week earlier, the value of new bills sold accounted for less than 6 percent of the amount of maturing bills.) The authorities also raised the monthly rate of crawl of the controlled exchange rate from 4.5 percent in October, the lowest in 27 months, to 7.3 percent in November.

The collapse of talks aimed at stabilizing the stock market, news of a rising fiscal deficit, and rising domestic interest rates led to a further plunge in stock prices on November 16. As capital outflows intensified, the Bank of Mexico, on November 18, withdrew its support of the free market peso to conserve official reserves. Between November 18 and December 7, the free market peso has depreciated by about 24 percent against the dollar.

Widespread price increases have followed the peso's depreciation, and organized labor has threatened a nationwide strike unless emergency wage increases are granted. In response, the government announced on December 4 a tightening of price controls, increased subsidies on basic foodstuffs, and a further easing of import controls.

Amendment of Argentina's stand-by arrangement with the IMF received Executive Board approval on December 2. The second drawing of $225 million from the stand-by took place on December 7. Argentina will also draw $250 million on its trade policy loan with the World Bank and a $500 million disbursement of new money from commercial banks in upcoming weeks, probably by year-end 1987. A $500 million bridge loan involving the U.S. Treasury, the BIS (acting for 11 central banks), Mexico, Colombia, and Uruguay was disbursed November 12, and is being repaid with the proceeds of IMF and World Bank disbursements.

New tax legislation aimed at improving fiscal balance was introduced in the Argentine Congress in October but has yet to pass.

President Alfonsin's Radical Civic Union party will lose its majority (but retain a plurality) in the Chamber of Deputies on December 10 when deputies elected in September take their seats.

Monthly CPI inflation in Argentina was 10.3 percent in November, down from 19.5 percent in October and 11.7 percent in September. For October, industrial production (s.a.) is estimated to have declined by 6 percent and preliminary sales data (s.a.) show an 11 percent decline.

Ecuador has reached agreement on an IMF stand-by arrangement providing SDR 75.4 million and an SDR 42.7 million drawing under the CFF. The program is expected to be approved by the IMF's Executive Board by the end of December. The terms sheet for the commercial bank debt financing package agreed to in principle in mid-October has been completed and distributed; it will provide $350 million in new money and restructure $4.9 billion in old debt. A pre-condition for the agreement was Ecuador's resumption of interest payments, and these began on November 16. These payments will be facilitated by a $31 million loan bridged to World Bank disbursements that has been provided by the U.S. Treasury.

In November, the Venezuelan government significantly increased sales of foreign exchange at preferential rates. The free market exchange rate has appreciated from September levels of 35 Bs/$, moving at times below 30 Bs/$. On December 8, the free market exchange rate was 30.1 Bs/$. Venezuela's $21 billion debt rescheduling agreement with commercial banks became effective on November 13. In mid-November, it issued regulations improving incentives for new direct and portfolio investment by allowing some export earnings on these investments to be retained abroad.

The Philippines has obtained an extension--from November 15 to December 22--of the deadline for all creditor banks to sign the July 1987 agreement to reschedule $13.2 billion in external debt. A handful of the 483 creditor banks have not signed the agreement. If any of these banks do not sign, part of the retroactive reduction in spreads specified in the package will be rescinded, and the Philippines will be required to pay an additional $93 million in 1987 interest. A severe deterioration in its trade deficit and increased buydowns by residents of Philippine foreign debt have caused international reserves to decline about $600 million to $1.9 billion in the three months through the end of November.

Commitments to the "voluntary" $1.06 billion commercial bank loan to Colombia (about the same magnitude as scheduled amortization payments over the period from fourth quarter 1987 through year-end 1988) have been almost completed.

Yugoslavia imposed wage and price controls in mid-November after first raising sharply the prices of many necessities; monthly inflation rose from 12.2 percent in October to 15.9 percent in November. Some wages were raised subsequently in response to widespread worker unrest.