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Confidential (FR) Class III FOMC

September 14, 1988

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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Sorting through the volatile monthly data, there are some hints that the anticipated mild second-half deceleration in economic activity may be in train. Meanwhile, there has been little evidence of a change in underlying wage and price trends.

Employment and Unemployment

Nonfarm payroll employment rose about 220,000 in both July and August, on a strike-adjusted basis. While below the extraordinarily rapid pace of the first half, these are nonetheless strong gains, amounting to 2-1/2 percent growth at an annual rate, a figure well in excess of what can be sustained by underlying trends in labor force growth. On balance this year, increases in payroll employment have exceeded considerably the growth in employment recorded in the household survey; the gap constitutes something of a puzzle at this point, although it likely reflects, at least in part, an increase in multiple-job holders.

In July and August, the pace of hiring at trade and finance and services establishments and at contract construction sites slowed considerably. In addition, manufacturing employment edged down 5,000 last month, after posting four months of large increases.[1] While small declines were widespread, there were increases in the machinery, electrical equipment, and chemical industries, where domestic and export sales have been strong. The average workweek in the private nonfarm

1. The increase in July, initially reported at 68,000, was revised down to 45,000.

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

	1987	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug.
	-------Average Monthly Changes-------					
Nonfarm payroll employment[2]	286	340	346	568	200	219
Strike-adjusted	283	343	345	571	220	216
Private employment	258	302	326	539	249	153
Manufacturing	38	19	46	54	45	-5
Durable	21	7	35	38	48	2
Nondurable	16	12	12	16	-3	-7
Construction	21	25	39	71	17	3
Trade	68	114	81	108	85	42
Finance and services	114	128	141	279	86	107
Total government	28	38	20	29	-49	66
Total employment[3]	257	120	305	823	41	121
Nonagricultural	252	123	345	773	81	15
Total workweek (hours)	34.7	34.7	34.8	34.7	34.9	34.6
Aggregate hours of production workers (percent change)	.3	.3	.5	.8	.8	-.7

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.

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

	1987	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug.
Civilian, 16 years and older	6.2	5.7	5.5	5.3	5.4	5.6
Teenagers	16.9	16.0	15.0	13.6	15.2	15.8
20-24 years old	9.7	9.0	8.7	8.4	8.5	8.4
Men, 25 years and older	4.8	4.4	4.1	4.1	3.9	4.4
Women, 25 years and older	4.8	4.4	4.3	4.2	4.5	4.4
White	5.3	4.8	4.6	4.5	4.7	4.9
Black	13.0	12.5	12.0	11.5	11.4	11.3
Fulltime workers	5.8	5.3	5.1	4.9	5.0	5.3
Memo:						
Total National[1]	6.1	5.6	5.4	5.2	5.4	5.5

1. Includes resident armed forces as employed.

sector dropped back last month, and coupled with the employment gains, resulted in a decline in aggregate hours of production and nonsupervisory workers. Nonetheless, the July-August average of aggregate hours remains almost 3/4 percent above the second-quarter level.

In the household survey, the civilian unemployment rate rose 0.2 percentage point to 5.6 percent in August, returning to its May level. Increases in unemployment rates of around 1/2 percentage point were recorded for adult men and teenagers, while rates for adult women and young adults were essentially unchanged. Although the decline in manufacturing employment in the payroll survey was small, in the household survey the unemployment rate in manufacturing rose 0.4 percentage point, probably accounting for much of the increase in unemployment for adult males. Together, the decline in aggregate hours and the higher unemployment rate suggest somewhat more moderate GNP growth for the third quarter than the staff had anticipated in the last forecast.

Since March, the civilian jobless rate has hovered at a level about equal to its 1979 low, after falling almost 1-1/2 percentage points over the preceding year and a half, suggesting considerable tightening of labor markets. However, in assessing the extent of tightness, an evaluation of alternative measures of labor market conditions is useful. The Conference Board's index of national help-wanted advertising also suggests that current labor market conditions are similar to those that prevailed in 1979. This index was at its peak in 1979, and after falling sharply through the early 1980s has now risen to its 1979 level. Further corroborating evidence is provided by data from a Bureau of National Affairs survey of personnel managers, showing that strong labor demand has led to shortages in some occupations. The percentage of firms reporting that production or service jobs are difficult to fill has about doubled since the beginning of 1987, to 13 percent, while the percentage reporting difficulties in filling clerical jobs has moved up from 8 percent at the end of 1986 to 12 percent in the second quarter of this year.

Industrial Production and Capacity Utilization

Total industrial production is estimated to have risen 0.2 percent in August after a sharp increase in July; the level of output in August was about 6-1/2 percent above the second-quarter average, at an annual rate. Output of business equipment rose at a slower rate than earlier this year, as strong gains in manufacturing equipment (including machine tools) were offset by a second month of weak output of computers. Production of consumer goods increased moderately, driven by a substantial rise in residential electricity generation--owing to unseasonably warm temperatures--and a rebound in assemblies of light trucks. Auto assemblies were little changed last month, while output of clothing continued weak. Among materials, output of basic metals and chemicals rose further in August, while production of paper and textile materials, parts for consumer goods, and coal declined.

Total industrial capacity utilization was little changed in August. Although the operating rate at utilities moved up sharply owing to

INDUSTRIAL PRODUCTION
(Percent change from preceding period)

	1986	1987	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug.
	--------Annual rate--------				----Monthly rate----		
Total Index	1.0	5.8	3.9	4.6	.3	1.0	.2
Products	1.8	4.9	6.3	4.4	.2	.6	.2
Final products	.8	4.6	6.0	5.2	.4	.5	.2
Consumer goods	3.3	3.2	5.8	4.1	.2	.5	.2
Durable goods	4.2	4.2	-6.1	13.2	-.3	.1	.1
Automotive products	.5	4.4	-4.5	23.3	.0	-2.3	.9
Home goods	7.0	4.0	-7.3	6.2	-.4	2.0	-.4
Nondurable goods	3.1	2.8	10.1	1.2	.4	.6	.3
Equipment	-2.1	6.3	6.4	6.4	.6	.5	.1
Business equipment	-1.1	7.0	9.3	11.8	.9	.6	.2
Defense & space equip.	5.0	1.9	2.6	-9.2	-.5	.5	-.3
Intermediate products	5.4	5.9	7.1	2.0	-.4	.8	.4
Construction supplies	5.0	4.7	10.9	1.8	-1.1	.2	.3
Materials	-.2	7.2	.3	4.7	.4	1.7	.3
Durable goods	-.5	8.0	3.8	8.3	.1	1.4	.3
Nondurable goods	5.7	8.1	-2.1	3.7	.2	1.9	-.1
Energy materials	-5.2	4.5	-4.7	-2.0	1.2	2.1	.7

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

	1967-87 Average	1973 High	1978-80 High	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug.
Total index	81.5	88.6	86.9	82.4	82.8	83.0	83.6	83.7
Manufacturing	80.6	87.7	86.5	82.7	83.2	83.3	83.9	83.8
Primary processing	81.7	91.9	89.1	86.9	86.8	86.6	87.8	87.8
Advanced processing	80.1	86.0	85.1	80.7	81.5	81.7	82.1	82.1
Durable manufacturing	78.7	87.4	86.3	80.4	81.5	81.7	82.3	82.3
Primary metals	79.6	101.9	97.1	84.7	85.7	85.8	89.5	91.0
Fabricated metal products	77.8	85.0	87.4	81.9	82.8	83.2	84.3	84.4
Nonelectrical machinery	78.1	89.0	86.0	78.7	81.0	81.7	82.1	82.0
Electrical machinery	78.1	85.7	89.9	76.9	77.4	77.4	78.1	78.1
Nondurable manufacturing	83.5	88.8	87.0	85.9	85.6	85.5	86.1	85.9
Textile mill products	85.0	92.1	88.3	91.1	90.0	89.7	89.6	88.2
Paper and products	88.5	95.6	92.7	95.4	94.5	93.8	95.3	93.9
Chemicals and products	78.9	88.6	82.9	85.3	86.3	86.6	88.0	88.4
Mining	86.7	92.8	95.2	80.3	81.4	81.0	83.0	82.9
Utilities	86.9	95.6	88.5	82.0	79.7	80.2	80.7	82.4
Industrial materials	82.2	92.0	89.1	82.5	83.0	83.2	84.4	84.5

unusually hot weather, the utilization rate for manufacturing edged down after four consecutive months of increases. Since last December, capacity utilization in manufacturing has increased about 1-1/4 percentage points to approximately 83-3/4 percent--midway between the average operating rate during the 1967-87 period and the peak rates posted between 1978 and 1980.

The rate for advanced processing industries leveled off at 82.1 percent in August and now stands about 2 percentage points above the rate at the end of last year. A principal contributor to this increase has been nonelectrical machinery, where utilization dropped back in August, but still has climbed more than 4 percentage points this year. Primary processing industries have been operating close to capacity throughout this year, and the utilization rate in August was 87-3/4 percent. This high rate has been associated with reports by purchasing managers of price increases for a number of important industrial materials, such as various chemicals, paper, aluminum, steel products, and plastic resins, that continue to be in short supply.

Agriculture

Additional drought losses in August appear to have been relatively slight, as the Agriculture Department's September crop report showed only small revisions in the production estimates for most crops. Based on conditions as of the start of September, the agency is projecting that U.S. production of corn will total 113.4 million metric tons this year, compared with a projection of 113.8 million metric tons in August. The estimate for wheat, at 49.3 million metric tons, was revised down slightly from a month ago, while the projection for soybeans was virtually unchanged. For all three of these crops, the 1988 harvest will be substantially below that of a year ago, reflecting markdowns that were reported in the July and August crop data. Large year-to-year declines also are apparent for a number of other feed crops; in contrast, production of several other crops--including cotton, peanuts, tobacco, and sugar cane--is expected to be about the same, or somewhat higher, than a year ago.

With the current growing season beginning to wind down, market focus in agriculture is likely to shift more to the demand side in coming months. At present, the USDA generally is projecting that this year's price runup for farm crops will result in only small reductions in domestic and foreign use and that, consequently, most of the production shortfall will be reflected in a steep drawdown of inventories. By the end of the current marketing season, stocks of the major crops are expected to be much tighter, relative to consumption, than has been the case in recent years. Crop prices, therefore, are likely to remain sensitive to changing market conditions over the next few months.

Based on the August crop report, the Commerce Department had pegged agricultural losses from this year's drought at about $14-1/2 billion, consisting of $13 billion in crop losses and $1-1/2 billion in livestock losses (all figures in 1982 dollars). Given the September crop report it appears likely that the BEA figure will be revised only slightly.

Personal Income and Consumption

Personal income growth was strong in July, led by a jump in wages and salaries of nearly $25 billion--about 12 percent at an annual rate. This increase may be revised down, given the downward revision in payroll employment in July, but the trend in income growth clearly has remained robust. With farm income falling, total nominal disposable personal income moved up at about the same rate as in the first half of the year.

August retail sales will be released on September 15, along with the usual revisions for the prior two months. At this point, consumer spending in July is estimated to have been about flat, but given an especially large gain in June, was more than 2 percent (annual rate) above the second-quarter average. Consumption of durable goods other than motor vehicles, which had risen appreciably in the first half, is estimated to have dropped 1 percent in July, and outlays for nondurables remained sluggish. In contrast, spending on services has remained at a high level, boosted by the effect of hot weather on outlays for electricity. Meanwhile, recent survey data indicate that consumer confidence has improved; the Conference Board index moved up last month and the Survey Research Center's index rose appreciably in August, reaching the highest level in more than two years.

Autos and Trucks

Sales of new cars and trucks remained at relatively high levels in August. Domestically produced autos sold at a 7.3 million unit annual rate last month--a healthy pace, although down a bit from the average

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

	1987	1988 Q1	1988 Q2	1988 May	1988 June[r]	1988 July[p]
Total personal income	26.3	15.6	20.0	21.3	25.4	25.2
Wages and salaries	16.8	7.1	17.6	14.5	18.9	24.5
Private	14.5	4.8	15.6	12.5	16.9	22.5
Other labor income	1.0	.6	.7	.6	1.0	1.1
Proprietors' income	1.4	4.9	-2.7	2.9	-.6	-5.7
Farm	-.6	5.1	-5.4	.5	-3.6	-8.1
Rent, dividends and interest	6.1	-.2	4.9	4.8	5.3	4.5
Transfer payments	2.1	8.1	.6	-.6	1.9	2.2
Less: Personal contributions for social insurance	1.1	4.8	1.1	1.0	1.2	1.3
Less: Personal tax and nontax payments	4.5	-6.7	.0	-63.6	-.3	4.6
Equals: Disposable personal income	21.8	22.3	20.0	84.9	25.7	20.6
Memo: Real disposable income	7.5	11.4	4.4	56.7	13.6	--

r--Revised.
p--Preliminary.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

	1987[1]	1988 Q1	1988 Q2	1988 May	1988 June	1988 July[e]
	----Annual rate----			----Monthly rate---		
Personal consumption expenditures	1.8	4.5	2.7	.3	.9	-.1
Durable goods	-2.4	14.7	8.4	.5	2.3	-.4
Motor vehicles	-6.6	17.3	10.0	.1	4.6	.5
Other	1.0	12.7	7.2	.7	.6	-1.0
Nondurable goods	.6	1.0	.0	.6	.4	-.5
Gasoline	.3	1.6	2.0	-2.4	1.9	-2.2
Other nondurables	.6	.9	-.3	1.0	.2	-.3
Services	4.2	4.0	3.0	.1	.8	.2
Memo:						
Personal saving rate (percent)	3.2	4.4	3.9	4.5	4.2	4.3

1. Annual changes are Q4/Q4.
e--Staff estimate.

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

	1987	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug.
Autos and light trucks[1]	15.0	15.6	15.6	15.9	15.4	15.4
Autos	10.3	10.8	10.8	11.1	10.4	10.2
Light trucks	4.7	4.8	4.8	4.9	5.0	5.2
Domestically produced[2]	11.0	11.8	11.8	12.1	11.9	11.9
Autos	7.1	7.6	7.6	7.9	7.5	7.3
Light trucks	3.8	4.2	4.2	4.3	4.4	4.6
Imports	4.0	3.8	3.8	3.8	3.5	3.5
Autos	3.2	3.1	3.2	3.2	2.9	2.9
Japanese	2.2	2.1	2.2	2.2	2.1	2.1
Korean	.3	.5	.5	.5	.3	.3
European	.7	.6	.5	.6	.5	.5
Light trucks	.8	.6	.6	.6	.6	.6

1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico for General Motors, Ford, and Chrysler.

over the first seven months of the year. Meanwhile, sales of domestic and foreign light trucks surged to a 5.2 million unit pace--the fastest monthly selling rate on record for these vehicles. In contrast, sales of imported cars remained at the relatively low rate of 2.9 million units.

A major factor in the near-term outlook for autos is the relatively comfortable level of dealer inventories, which have made major end-of-model year incentive efforts unlikely. This contrasts with the pattern of the past three years in which auto production outstripped sales for much of the model year. This left dealers with excessive stocks near the ends of model years, leading to massive year-end incentive programs that created dramatic fluctuations in sales. This experience now weighs heavily in the FRB seasonal factors, which expect a speedup in sales in August and September, followed by a steep decline in October, reflecting the "payback period" that typically accompanied the end of the incentive programs. Thus, sales in August probably were understated and in September will be artificially weak on a seasonally adjusted basis, while October and November may appear strong.[2]

Business Fixed Investment

Real outlays for business equipment continued to expand in July, although at a pace well below the 20 percent annual rate posted in the first half of this year. Nominal shipments of nondefense capital goods rose to a level 1-1/2 percent above the second-quarter average.

2. Because BEA's seasonal factors have shifted less in response to this recent behavior, sales data adjusted on a BEA basis should more accurately reflect underlying activity.

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

	1987	1988		1988		
	Q4	Q1	Q2	May	June	July
Producers' durable equipment						
Shipments of nondefense capital goods	.8	4.8	3.8	2.2	.5	.5
Excluding aircraft and parts	.6	3.9	4.3	1.7	.5	.2
Office and computing equipment	-1.9	5.6	6.6	-1.5	4.3	-2.1
All other categories	1.3	3.4	3.7	2.6	-.4	.9
Shipments of complete aircraft[1]	-21.8	34.4	4.4	35.4	-30.2	n.a.
Orders of nondefense capital goods	2.6	6.1	1.1	-6.6	12.5	.9
Excluding aircraft and parts	.8	4.3	3.4	.2	-.1	1.7
Office and computing equipment	-2.8	5.3	8.6	-4.8	3.6	1.2
All other categories	1.7	4.1	2.1	1.5	-1.0	1.8
Nonresidential structures						
Construction put-in-place	2.2	-5.5	2.8	3.1	-1.2	.6
Office	2.6	-3.1	4.3	4.6	.0	2.8
Other commercial	-.1	-8.4	5.8	.5	-2.2	-.7
Public utilities	3.4	-8.8	1.6	5.2	1.2	3.9
Industrial	-2.2	-2.6	7.9	3.0	-11.6	-.8
All other	5.2	-2.0	-3.2	1.9	1.9	-3.6
Rotary drilling rigs in use	-3.7	-2.1	6.7	-2.0	-.7	-2.3

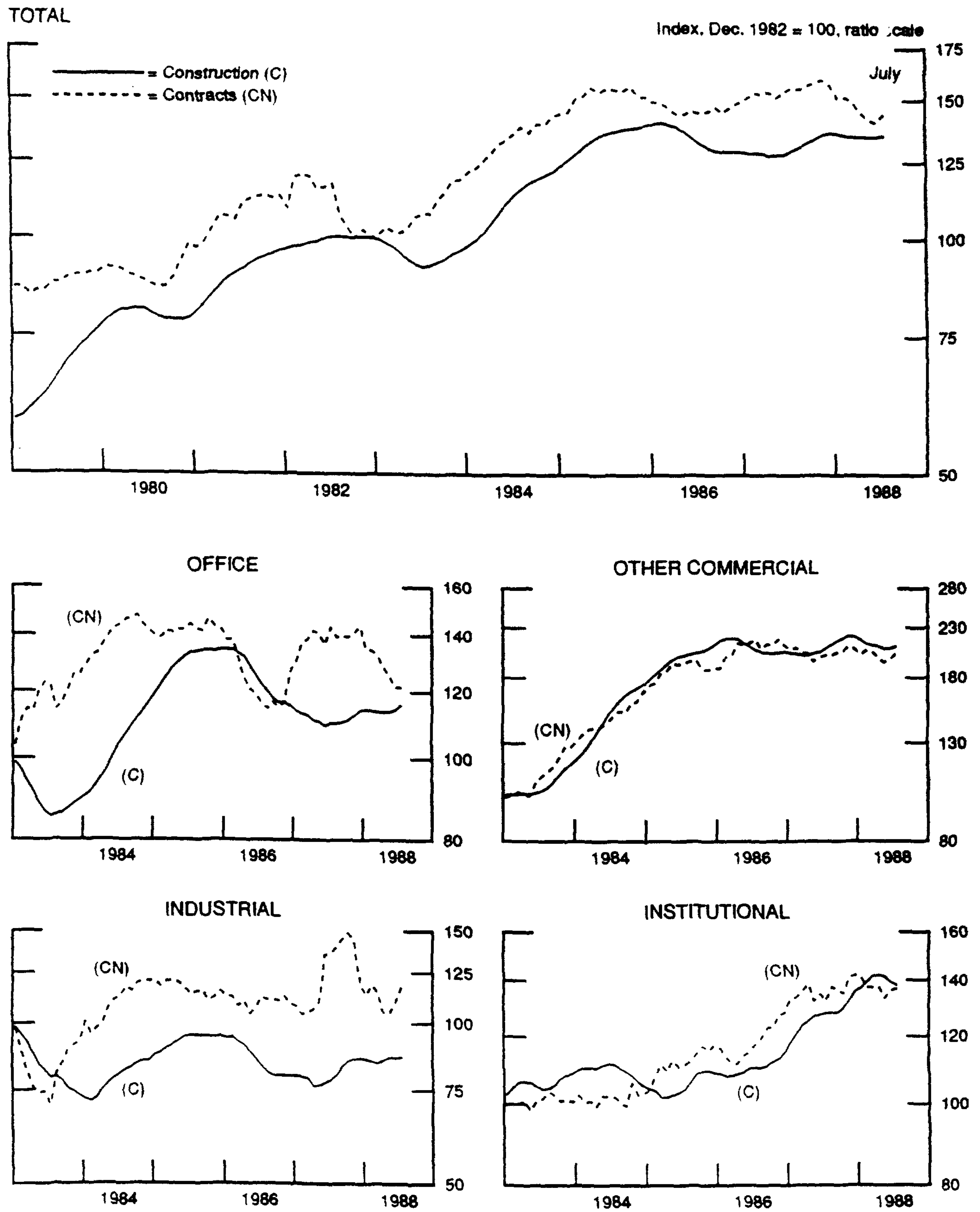
1. From the Current Industrial Report (CIR) titled "Civil Aircraft and Aircraft Engines." To estimate PDE spending for aircraft, BEA uses the aircraft shipments shown in that report, not the corresponding M-3 series. The CIR does not provide information on aircraft orders.

Surveys of Plant and Equipment Expenditures
(Percent change from previous year, current dollars)

		Planned for 1988		
	1987*	Commerce (July-Aug.)	Commerce (Apr.-May)	McGraw-Hill (Apr.-May)
1. All Business	2.7	**10.6**	10.7	9.9
2. Manufacturing	2.2	**12.1**	12.1	13.2
3. Durable	2.7	**9.9**	9.5	9.5
4. Nondurable	1.8	**14.2**	14.5	16.7
5. Nonmanufacturing	3.0	**9.7**	9.9	7.9

* As estimated in the July-August Commerce Department survey.

Nonresidential Construction and Contracts <1>



<1> Six-month moving average for all series shown.

However, shipments of office and computing equipment, which are magnified in importance in the translation to real terms owing to their low deflator, fell in July and remain at about their second-quarter average.[3] As a consequence, the recent robust quarterly increases in computer purchases probably will not be repeated in the current quarter, although advances are still expected. Looking ahead, orders for nondefense capital goods continue to show gains, though once again not at the exceptional pace posted earlier in the year. Excluding aircraft and parts, the July level of orders was up 1-3/4 percent from the second-quarter average, and appears consistent with some deceleration in equipment outlays in the second half.

Recent indicators of real spending for nonresidential construction have been mixed. Petroleum drilling activity, as measured by the number of rigs in use, showed renewed declines in July and early August, after a temporary upswing in the second quarter. In contrast, construction put-in-place, which covers all nonresidential structures except oil and gas wells, rose in July to a level about 3/4 percent above the second-quarter average.[4]

The composition of building activity has been somewhat surprising in recent months. Industrial construction, after rising strongly in the

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3. As expected, the annual revision to the Census M3 data last month smoothed the pattern of shipments of office and computing equipment, but the average growth rate over the past year and a half was little changed.

4. The initially reported figures for nonresidential construction put-in-place are subject to large revisions. Indeed, the latest report substantially weakened nominal June spending, and we expect a downward revision to second-quarter nonresidential construction of about $2 billion in constant dollars.

spring, has fallen back in recent months, even as factory utilization rates have continued to rise. Meanwhile, the level of office building has been well maintained this year, in the face of high national-average vacancy rates. As shown in the chart, the six-month moving average of the value of new construction contracts--a broad indicator of future building--has generally trended down since the beginning of this year, suggesting that outlays will show little improvement into 1989. The chart also shows that the decline in contract awards has been widespread among the major components of nonresidential construction.

The latest Commerce Department survey of business plans for plant and equipment outlays indicates a 10.6 percent rise in nominal outlays this year, with particular strength expected in the manufacturing sector. These plans, which were collected in July and August, were similar to those reported in the spring survey.

Business Inventories

Nonfarm business inventory accumulation slowed quite a bit in the second quarter. Manufacturing and trade inventories rose (in constant dollars) at an annual rate of $19 billion in the second quarter, compared with a $40 billion rate in the first quarter. Current-cost data for July indicate that inventory investment remained moderate in the manufacturing and wholesale sectors.

The slowing in the second-quarter stock accumulation was most notable in the non-auto trade sector. For wholesale and retail establishments other than auto dealers, inventories in constant dollars were little changed during the second quarter, compared with a $34.3

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

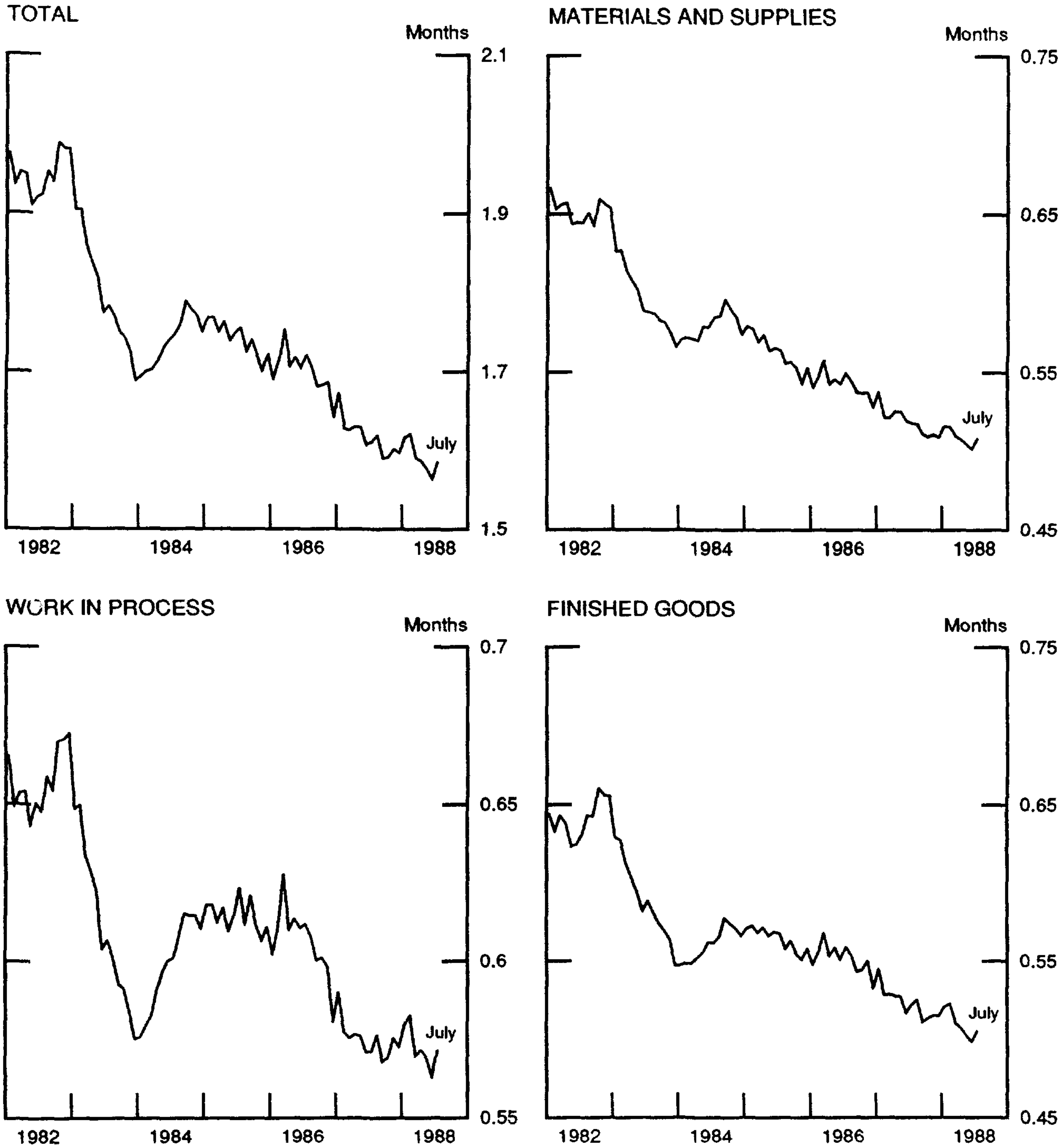
	1987	1988		1988		
	Q4	Q1	Q2	May	June	July
Current cost basis:						
Total	82.4	39.7	56.5	57.8	66.6	--
Total ex. auto	68.2	61.3	44.4	36.0	59.9	--
Manufacturing	29.0	22.3	21.1	25.7	22.7	18.7
Wholesale	23.8	26.5	13.1	-1.3	19.0	9.9
Retail	29.6	-9.1	22.4	33.5	25.0	--
Automotive	14.2	-21.6	12.2	21.9	6.7	--
Ex. auto	15.3	12.5	10.2	11.6	18.3	--
Constant dollar basis:						
Total	57.6	39.9	19.0	22.6	15.3	--
Total ex. auto	44.4	50.0	8.6	3.1	10.5	--
Manufacturing	14.4	15.8	5.7	10.1	1.5	--
Wholesale	18.1	22.7	-.1	-11.4	-.3	--
Retail	25.1	1.5	13.4	23.9	14.0	--
Automotive	13.2	-10.1	10.4	19.5	4.8	--
Ex. auto	11.9	11.6	3.0	4.4	9.2	--

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

	Range in preceding 12 months:[2]		1987	1988		1988		
	Low	High	Q4	Q1	Q2	May	June	July
Current cost basis:								
Total	1.48	1.53	1.53	1.53	1.51	1.51	1.50	--
Total ex. auto	1.46	1.51	1.49	1.51	1.49	1.48	1.47	--
Manufacturing	1.56	1.62	1.61	1.62	1.58	1.58	1.56	1.58
Wholesale	1.21	1.30	1.27	1.31	1.30	1.30	1.28	1.28
Retail	1.56	1.64	1.65	1.60	1.62	1.60	1.61	--
Automotive	1.74	2.06	2.06	1.76	1.86	1.84	1.86	--
Ex. auto	1.50	1.55	1.54	1.55	1.55	1.53	1.54	--
Constant dollar basis:								
Total	1.48	1.53	1.52	1.52	1.51	1.52	1.51	--
Total ex. auto	1.46	1.51	1.49	1.51	1.49	1.50	1.49	--
Manufacturing	1.59	1.62	1.61	1.62	1.59	1.59	1.58	--
Wholesale	1.22	1.32	1.29	1.32	1.32	1.32	1.31	--
Retail	1.51	1.59	1.61	1.57	1.59	1.58	1.59	--
Automotive	1.65	1.93	1.93	1.73	1.82	1.81	1.82	--
Ex. auto	1.47	1.53	1.52	1.53	1.53	1.52	1.52	--

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 necessarily coincidental. Range is for the 12-month period preceding the latest month for which data are available.

Manufacturers' Inventory to Sales Ratios
(Current cost data)



billion runup from January to March. Lower levels of imports in the second quarter, and relatively flat domestic production of home goods and consumer nondurables earlier this year, suggest that the reduced pace of inventory investment reflects efforts on the part of retail and wholesale establishments to control stockbuilding. The slower accumulation has helped to stem the rise in inventory-sales ratios at a few types of retail stores--in particular, apparel and general merchandise--where those ratios reached historically high levels earlier this year.

In the manufacturing sector, inventory investment also slowed in the second quarter; with production strong over that period, however, the slowing may have been unintended. The recently revised constant-dollar data show that inventories at all stages of processing in the manufacturing sector were low relative to shipments at mid-year. Inventory-related indicators for the industrial sector--the high level of new factory orders, the backlog of unfilled orders, and relatively low inventory-shipments ratios for most major industries--suggest that stockbuilding could pick up a bit, particularly in those industries in which production remained strong through August.

Housing Markets

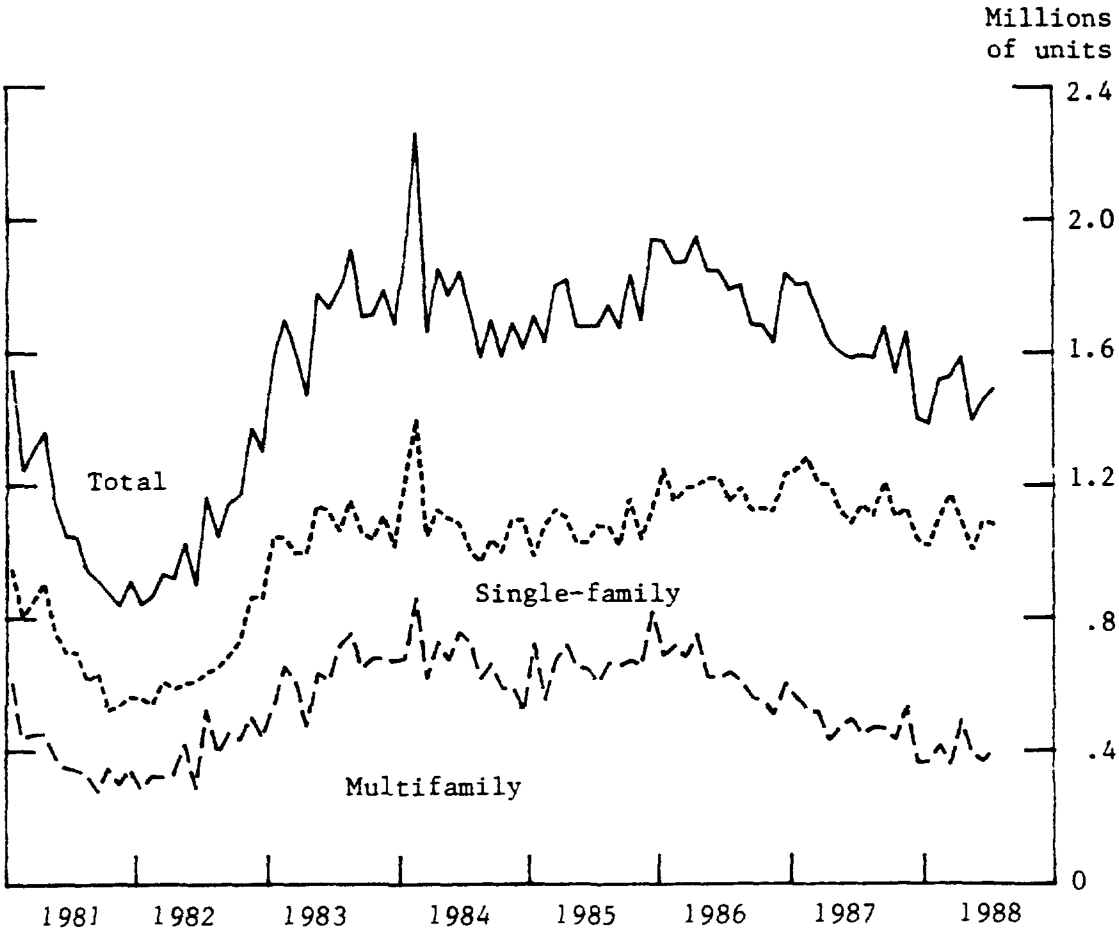
Housing starts rose 2-1/2 percent in July to a 1.49 million unit annual rate, owing entirely to a rebound in multifamily construction from the low June level. Single-family starts, at 1.08 million units, were little changed and matched the average pace of the first half of

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

	1987 Annual	1987 Q4	1988 Q1	1988 Q2[r]	1988 May[r]	1988 June[r]	1988 July[p]
All units							
Permits	1.53	1.4[illegible]	1.38	1.46	1.44	1.49	1.41
Starts	1.62	1.53	1.48	1.48	1.39	1.45	1.49
Single-family units							
Permits	1.02	.96	.98	.98	.98	1.00	.99
Starts	1.15	1.09	1.10	1.06	1.00	1.09	1.08
Sales							
New homes	.67	.62	.63	.69	.68	.72	.69
Existing homes	3.53	3.39	3.25	3.64	3.59	3.82	3.63
Multifamily units							
Permits	.51	.47	.40	.48	.45	.49	.42
Starts	.47	.44	.38	.42	.39	.37	.41

p--preliminary estimates.
r--revised.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



the year. However, mortgage interest rates moved up in August, and some weakening of demand for single-family homes can be expected.

New and existing home sales fell approximately 5 percent in July from the surprisingly high level recorded in June, to a level more in line with single-family starts. Sales in the single-family sector in July appeared generally consistent with mortgage market conditions during the early summer and recent assessments of market conditions by consumers and builders.

In the multifamily sector, starts strengthened in July to about 410,000 units at an annual rate, a pace close to the average for the year to date. At its current rate, multifamily construction remains 40 percent below the annual average of 650,000 units during the 1984-86 period. This falloff accounts for nearly all of the decline in total housing starts in the past two years, from an annual average of almost 1-3/4 million units in the 1983-86 period to an annual rate of 1-1/2 million units thus far in 1988. Apart from the less favorable tax climate for residential income properties, the multifamily rental vacancy rate has remained at an historically high level, holding down potential profitability.

In contrast, the pace of single-family starts has remained close to the levels of the mid-1980s. Household formations, which averaged 1.4 million units annually over the 1983-87 period, underpinned overall building activity. Moreover, single-family construction was stimulated by gradual improvements in housing finance costs and housing affordability, which released demand pent up from the previous housing downturn. That pent-up demand probably had dissipated by the first half of 1988, but housing finance costs and affordability levels were more favorable than in much of the 1983-87 period.

Looking ahead, the coming of age of the "baby bust" generation should result in a slowdown in the overall rate of household formation, to 1.2 million by 1990. Abstracting from macroeconomic developments, the projected decline in young adult households implies continued weak demand for multifamily units over the next several years. However, continued household growth among those aged 30-54 should help bolster the demand for single-family homes, all else equal.

Federal Sector

The total deficit for the current fiscal year through July was essentially unchanged from the same period of FY1987. The deficit for FY1988 remains uncertain, however, because of differences in special factors affecting the budget at the end of the fiscal year.

In FY1987, receipts in September were boosted by the expiration of a "safe harbor" that had allowed corporations to defer some estimated tax payments from earlier in the year. This year, a more limited safe harbor for corporate payments concentrated corporate receipts in June, and no special boost to September receipts is expected.

On the outlay side, spending in late FY1987 was reduced by the concentration of asset sales and loan prepayments in September, as well as shifts in the timing of some expenditures. In FY1988, asset sales are being distributed more evenly throughout the fiscal year, and there are no other special shifts in the timing of outlays.

MONTHLY BUDGET TOTALS FOR FISCAL YEARS 1987 AND 1988
(Billions of dollars; not seasonally adjusted)

	Revenues		Outlays		Deficit	
	1987	1988	1987	1988	1987	1988
October-December	190.0	204.9	254.8	287.1	64.7	82.2
January-March	193.7	207.9	252.2	245.3	58.5	37.4
April	122.9	109.3	84.0	95.6	38.9	-13.8
May	47.7	59.7	83.3	82.3	35.6	22.6
June	82.9	99.2	83.6	89.9	.6	-9.3
July	64.2	60.7	86.6	83.6	22.3	22.9
Total, fiscal year to date	701.5	741.7	844.4	883.7	142.9	142.0

However, the recent flurry of actions by the FDIC and FSLIC to restructure bank and saving institutions is adding substantially to outlays; the spending is in the form of either direct cash assistance or the issuance of agency notes--both of which are recorded as outlays in the budget. How many of these restructurings will be completed by the end of this month, and their exact cost, remains a major source of uncertainty for FY1988 deficit calculations. On the other hand, the effect of this summer's drought on CCC loan activity may reduce expenditures in late FY1988; high grain prices have made it advantageous for farmers to repay CCC loans, permitting them to reclaim their crop collateral and to sell the crops in the open market.

Turning to FY1989, the Office of Management and Budget's preliminary sequester report, issued on August 25, projects a deficit of $144 billion for the coming fiscal year, on a Gramm-Rudman accounting basis. This is slightly less than the $146 billion trigger that would force automatic spending cuts to reduce the deficit to the $136 billion Gramm-Rudman target. The recent OMB figure differs from the projection published at the time of the Mid-Session Review of the Budget primarily because of the addition of the estimated $3.9 billion cost of the Drought Relief Bill enacted in early August. OMB will issue its final sequester report on October 15. It will take into account the additional legislative and regulatory actions taken by that date,[5] but

5. Much of the legislation implementing the 1989 budget must still be enacted; to date, only two of the thirteen regular appropriation bills that fund discretionary programs have been signed by the President. However, action in Congress on the remaining bills is well advanced and (Footnote continues on next page)

is required by law to use the same economic and technical estimating assumptions as the preliminary report.

In contrast to OMB's estimate, the CBO's update of the Economic and Budget Outlook and an advisory sequestration report, issued on August 19, projects a Gramm-Rudman baseline deficit of $153 billion for FY1989. The CBO deficit estimate is higher than OMB's estimate because of less favorable economic assumptions and different technical estimating assumptions for some programs.

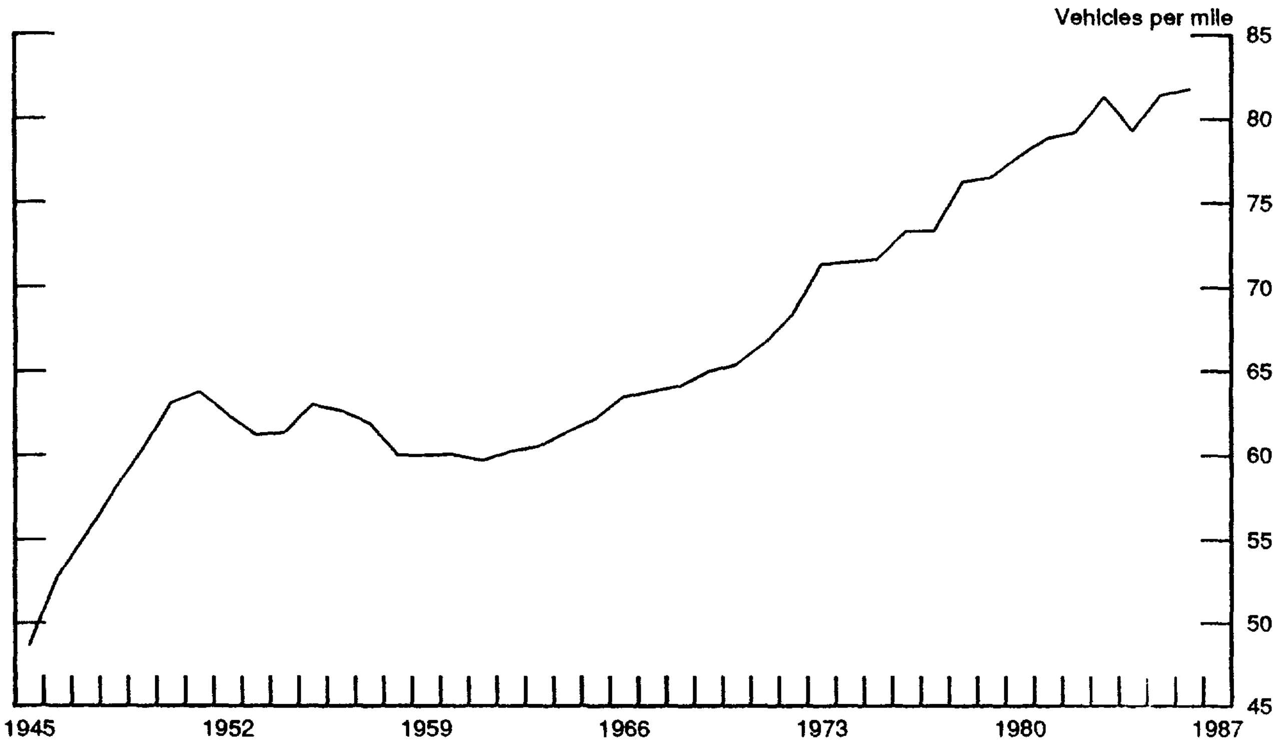
State and Local Government Sector

State and local government spending appears to have expanded on balance so far in the third quarter. Employment rose 50,000 in August, nearly offsetting the large decline in July. Real outlays for construction increased 5 percent in July, the largest monthly advance since January 1986, and now stands 2-1/2 percent above the second-quarter average.

Spending on the two largest components of state and local construction--highways and educational facilities--is 10-1/2 percent higher for the first seven months of the year than for the comparable period last year. In the case of highways, total motor vehicle registrations relative to miles of paved roads continue to increase, suggesting growing pressures to expand and repair roads and bridges. Demands for expanded educational facilities have apparently followed the changes in the number of school-age children, shown in the chart.

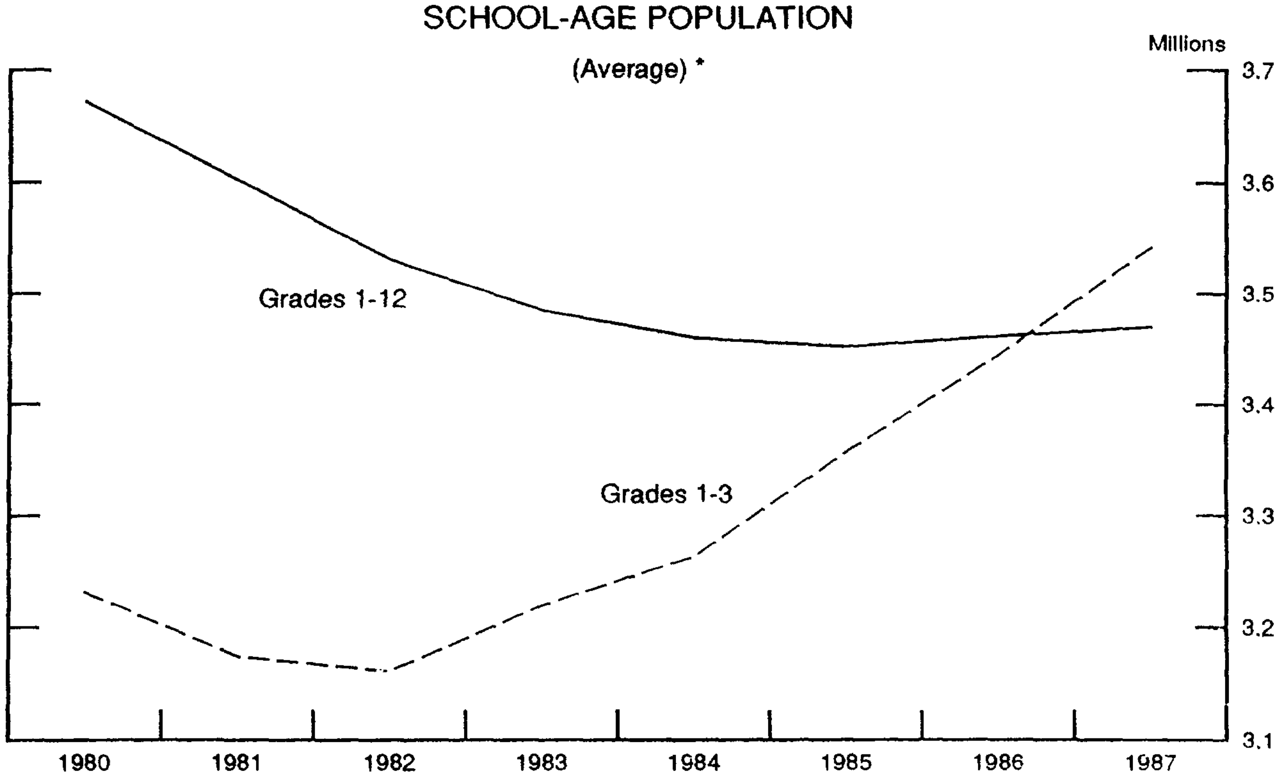
(Footnote continued from previous page)
thus far appears consistent with the outlay estimates used for the sequester report.

TOTAL MOTOR VEHICLE REGISTRATIONS PER PAVED MILE



SCHOOL-AGE POPULATION

(Average) *



* -- Population per grade based on data by age.

Births fell from the late 1960s into the mid-1970s, but they began to rise sharply in 1977, leading to crowded classrooms in the early grades. These cohorts will be followed by even larger ones, as in 1987 births reached their highest level in 24 years.

Prices

The consumer price index for all urban consumers rose 0.4 percent in July. The CPI for food jumped 1 percent, after a 0.6 percent increase in June. Much of the July runup in food prices appears to be weather-related, led by hikes for poultry, eggs, and fruits and vegetables. Large increases also were recorded for cereal and bakery products, fats and oils, and other processed foods, but meat prices were down. The PPI for crude foods was up another 2.2 percent in August, the fourth month of large increases. More recently, spot commodity prices have moved up further for cattle and crops. These developments suggest continued upward pressures on retail food prices in the near term.

Energy prices were up 0.3 percent in the July CPI, mainly reflecting higher gasoline prices. Moreover, refinery prices of gasoline rose sharply in both the July and August PPI. However, domestic crude oil prices fell 12 percent from May to August, and gasoline prices are likely to turn down in coming months, as lower crude oil costs are passed through to the pump.

Excluding food and energy items, consumer prices rose 0.3 percent for goods and 0.4 percent for services in July, about the average pace over the preceding twelve months. In the goods component, large increases for cigarettes, pharmaceuticals, and household cleaning and

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

	Relative importance Dec. 1987	1987	1987 Q4	1988 Q1	1988 Q2	1988 June	1988 July
			----Annual rate----			-Monthly rate-	
All items[2]	100.0	4.4	3.2	4.2	4.5	.3	.4
Food	16.1	3.5	2.8	1.4	7.1	.6	1.0
Energy	7.6	8.2	-3.9	-4.9	4.2	-.2	.3
All items less food and energy	76.3	4.2	4.4	5.4	4.3	.4	.3
Commodities	25.8	3.5	2.5	4.7	3.9	.2	.3
Services	50.6	4.5	5.0	5.9	4.5	.5	.4
Memorandum:							
CPI-W[3]	100.0	4.5	2.8	3.5	4.9	.3	.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. 1987	1987	1987 Q4	1988 Q1	1988 Q2	1988 July	1988 Aug.
			----Annual rate----			-Monthly rate-	
Finished goods	100.0	2.2	-1.9	2.7	4.6	.5	.6
Consumer foods	25.9	-.2	-5.7	6.0	9.4	.4	.4
Consumer energy	9.6	11.2	-9.6	-18.5	4.8	.0	2.2
Other consumer goods	40.1	2.7	1.7	5.7	2.4	.9	.3
Capital equipment	24.4	1.3	-.7	3.2	3.6	.1	.4
Intermediate materials[2]	95.0	5.4	4.3	4.3	7.4	.6	.4
Excluding energy	82.5	5.2	7.2	8.2	6.9	.7	.4
Crude food materials	39.5	1.8	-4.8	17.7	30.5	1.5	2.2
Crude energy	41.9	10.7	-15.2	-24.1	12.2	-5.4	.1
Other crude materials	18.6	22.6	18.0	15.9	-7.0	1.9	.9

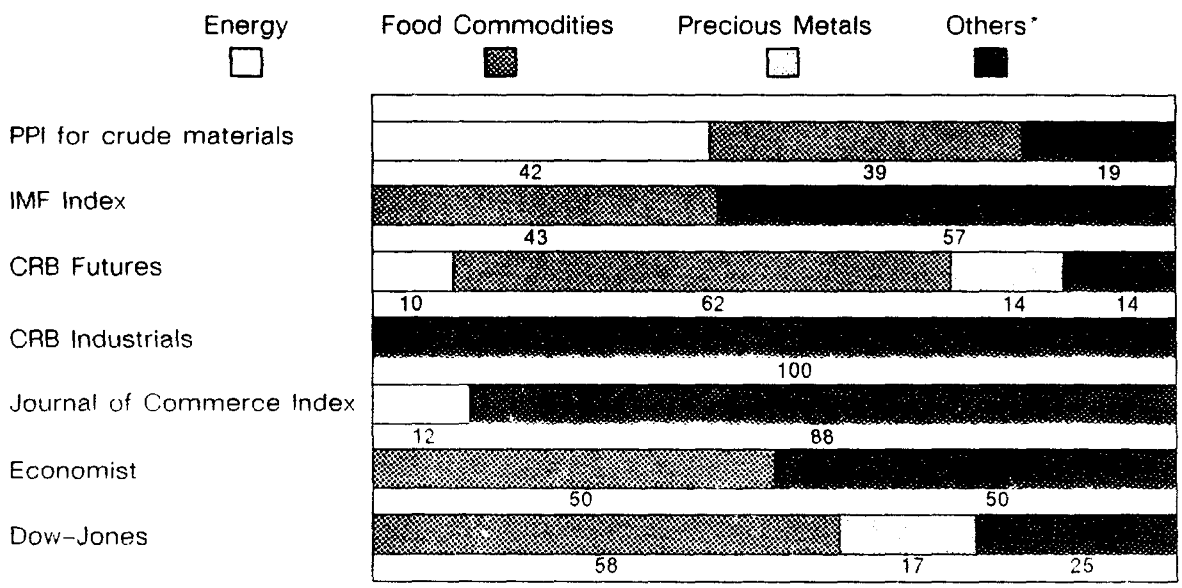
1. Changes are from final month of preceding period to final month of period indicated.
2. Excludes materials for food manufacturing and animal feeds.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1986	1987	1988 To August 9*	1988 August 9* to date
1. PPI for crude materials[3]	August	-8.9	8.9	3.1	n.a.
1a. Ex. food and energy	August	1.8	22.6	5.1	n.a.
1b. Ex. food and energy, seas. adj.	August	1.7	22.8	4.8	n.a.
2. IMF commodity index[3]	August	-7.9	30.8	5.2	n.a.
2a. Metals	August	-.5	51.9	13.4	n.a.
2b. Nonfood agric.	August	8.5	47.5	-12.9	n.a.
3. Commodity Research Bureau					
3a. Futures prices	Sept. 12	-9.1	11.7	6.7	-1.5
3b. Industrial spot prices	Sept. 9	5.1	19.2	4.8	-2.2
4. Journal of Commerce industrials	Sept. 12	-1.4	10.7	1.7	.6
5. Economist (U.S. dollar index)	Sept. 6	-4.7	42.5	10.3	-.5
5a. Industrials	Sept. 6	5.8	62.6	8.9	-1.3
6. Dow-Jones Spot	Sept. 12	-8.9	17.0	-1.8	1.4

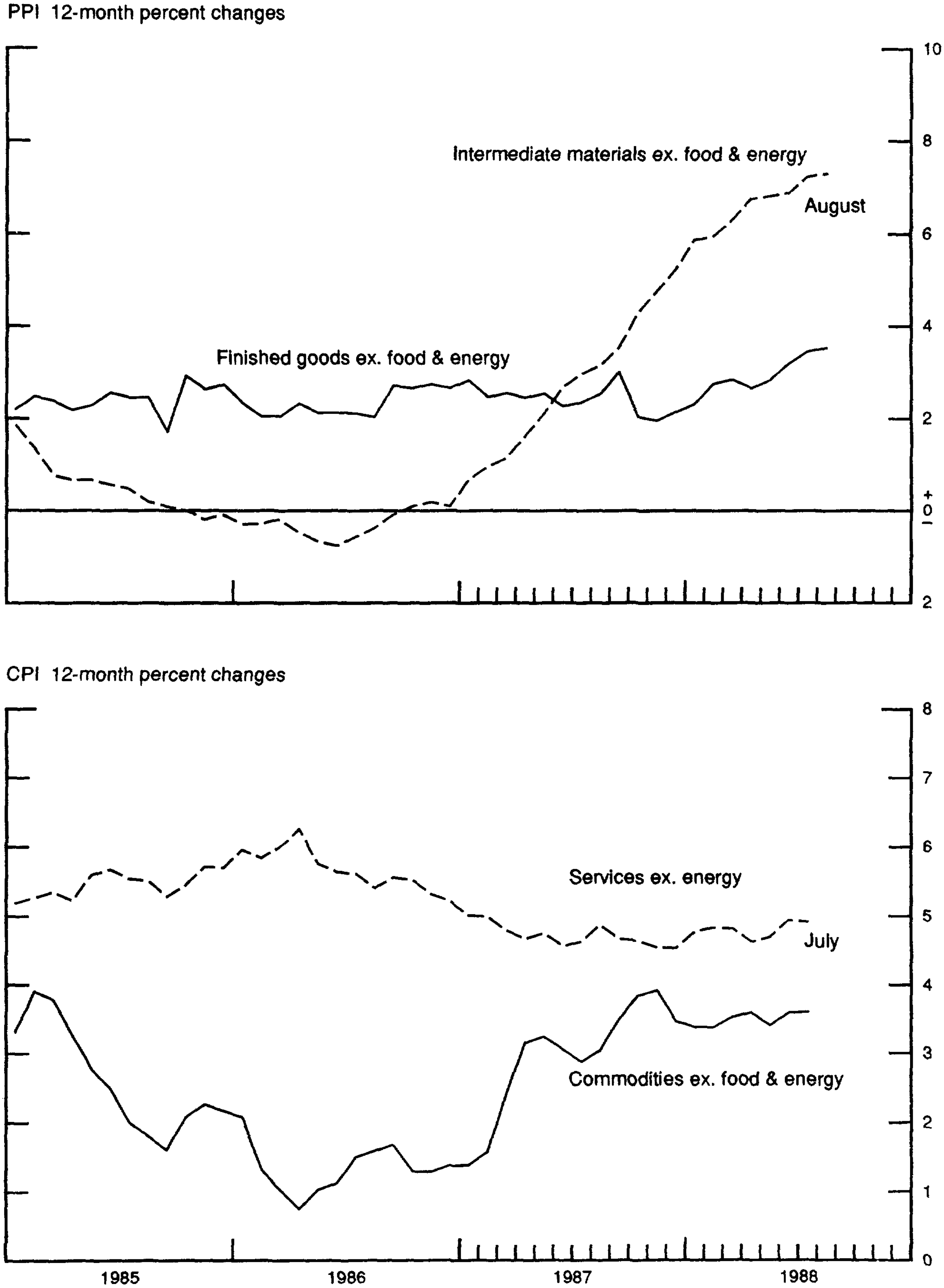
1. Not seasonally adjusted.
2. Change is measured to end of period, from last observation of previous period.
3. Monthly observations. IMF index includes items not shown separately.
n.a.--Not available.
*Week of the August Greenbook.

Index Weights



*Forest products, industrial metals, and other industrial materials.

Recent Inflation Trends



paper products were partly offset by a decline for clothing. Apparel prices, which had risen sharply in the spring, dropped back in both June and July, as merchants made larger end-of-season markdowns than usual in response to generally sluggish demand. Nevertheless, apparel prices have risen more than 5 percent above their level a year ago, and further increases are likely this fall.

At the producer level, prices of consumer goods other than food or energy rose 0.3 percent in August, after increasing nearly 1 percent in July. Capital equipment prices edged up in July and rose 0.4 percent in August. The PPI for intermediate materials less food and energy rose 0.7 percent in July and 0.4 percent in August, as these prices remained on the sharp uptrend that has been evident over the past year. Prices of crude nonfood materials less energy, which receded in the second quarter, posted sizable increases in July and August.

However, since the pricing date for the August PPI, movements in spot commodity prices have been mixed. Among industrial materials, prices have firmed for copper, tin, and zinc, but have come down for steel scrap, aluminum, and cotton. Prices of precious metals have been little changed. As seen in the table, the available domestic commodity price indexes also have registered mixed and relatively small net changes.

To provide a longer-term perspective on recent inflation rates, the accompanying chart shows 12-month changes in major CPI and PPI series (excluding food and energy items) from 1985 through the most recent reporting period. For nearly all of the indexes, an acceleration of prices is evident. The clearest pattern of price acceleration has occurred at the intermediate level. Prices of intermediate materials, which had been flat or declining in 1985-86, have accelerated sharply since then, affected by high levels of capacity utilization and tight world markets. This index has risen more than 7 percent over the past year. At the finished goods level, domestic producer prices had shown little sign of acceleration until early this year, when price increases picked up for a wide range of goods. The latest 12-month increase in this PPI series is 1 percentage point above the increase for the preceding year. The CPI for commodities, which slowed markedly in 1985-86, picked up to the 3-1/2 percent pace during 1987 and, on average, has remained at that pace over the course of this year. This pattern was associated in part with the lagged effects of movements in the exchange value of the dollar on retail prices of imported goods.[6] In contrast, service price inflation has been roughly flat over the past year.

Wages and Labor Costs

Few additional labor cost data have become available since the last Greenbook. As shown in the chart, available measures for the first half of 1988 show some pickup in the four-quarter rates of increase in wages and compensation. The hourly earnings index for production and nonsupervisory workers was up 0.1 percent in August, bringing the rise in the index to 3.1 percent over the past year--about 1/2 percentage point more than in the preceding 12-month period. In addition, revised

6. The 1985-86 rates also were held down by steep declines in prices of used cars, which had a large weight in the CPI before the 1987 revision.

SELECTED MEASURES OF LABOR COSTS IN THE NONFARM BUSINESS SECTOR
(Percentage change at annual rates)

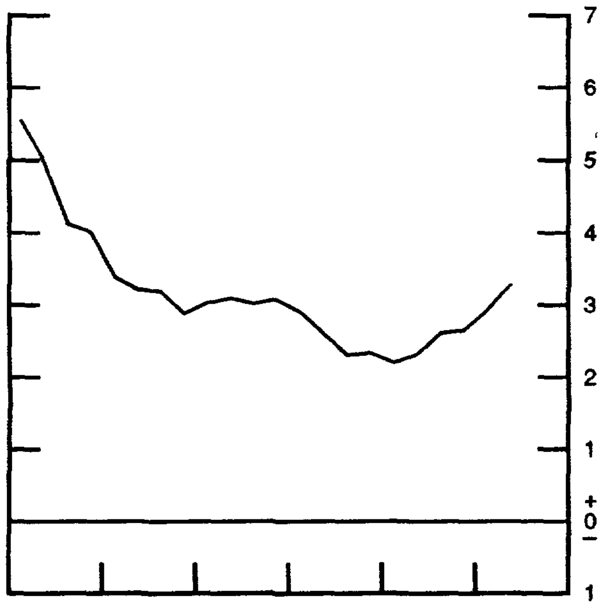
				1988		
September 1988	1985	1986	1987	Q1	Q2	August
						Monthly rate
Hourly earnings index, wages of production workers[1]						
Total private nonfarm	3.1	2.3	2.6	3.1	3.8	.1
Manufacturing	3.3	1.7	1.9	1.6	2.9	.2
Contract construction	1.6	2.2	.7	4.1	1.1	-.3
Transportation and public utilities	3.0	2.8	2.9	2.7	4.8	.3
Trade	2.1	1.8	2.3	2.8	4.2	-.2
Services	4.2	3.1	4.6	4.2	5.7	.1
Employment cost index[2]						
Compensation, all persons	3.9	3.2	3.3	3.9	4.5	--
By occupation:						
White collar	4.8	3.5	3.7	3.7	4.4	--
Blue collar	3.2	2.7	3.1	4.4	4.7	--
Service workers	3.0	3.1	2.4	2.9	3.6	--
By bargaining status:						
Union	2.6	2.1	2.8	3.9	4.3	--
Nonunion	4.6	3.6	3.6	4.0	4.5	--
Wages and salaries, all persons	4.1	3.1	3.3	3.3	3.7	--
Benefits, all persons	3.5	3.4	3.5	5.8	6.4	--
Major collective bargaining agreements[3]						
First-year wage adjustments	2.3	1.2	2.2	--	2.6	--
Total effective wage change	3.3	2.3	3.1	--	3.0	--
Labor costs and productivity, all persons[1]						
Compensation per hour	4.5	4.2	4.1	3.5	4.2	--
Output per hour	1.5	1.2	1.9	3.4	-1.4	--
Unit labor costs	2.9	3.0	2.1	0.1	5.7	--
Manufacturing						
Compensation per hour	4.9	3.3	1.6	5.4	3.0	--
Output per hour	4.5	2.8	3.4	3.2	3.6	--
Unit labor costs	.4	.5	-1.8	2.2	-.6	--

1. Changes are from final quarter of preceding period to final quarter of period indicated at a compound annual rate. Seasonally adjusted data.
2. Four-quarter changes.
3. Agreements covering 1,000 or more workers; not seasonally adjusted.

Wages and Labor Costs

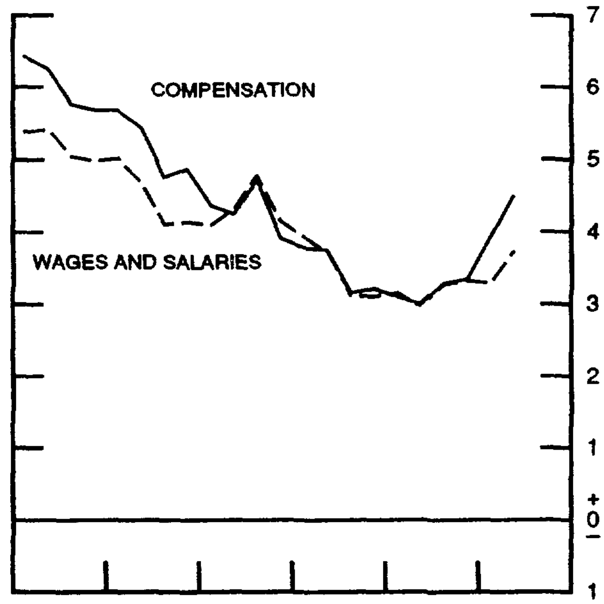
Four-quarter Percent Changes

HOURLY EARNINGS INDEX



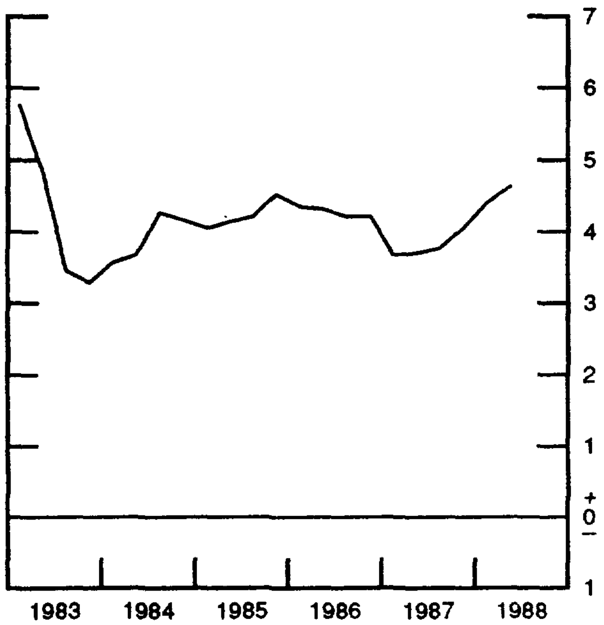
Production and nonsupervisory workers

EMPLOYMENT COST INDEX



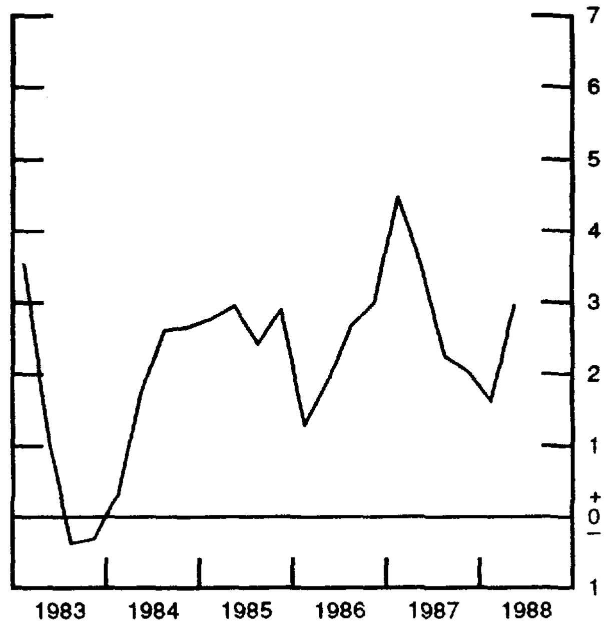
Private industry workers

COMPENSATION PER HOUR



Nonfarm business sector

UNIT LABOR COSTS



Nonfarm business sector

data show that nonfarm compensation per hour--as reported in the productivity and cost data--rose about 4-1/4 percent at an annual rate in the second quarter. For the four-quarter period ended in the second quarter of this year, nonfarm business compensation per hour rose 4-1/2 percent, while unit labor costs advanced nearly 3 percent; both of these measures are rising more rapidly thus far this year than in 1987. A similar pickup is evident in the manufacturing sector, where hourly compensation rose at a 3 percent rate in the second quarter, and 3-1/4 percent over the past year. With productivity growth of 2-3/4 percent, unit labor costs turned up slightly for the four quarters ending in 1988-Q2 after declining 1-1/4 percent over the preceding four quarters.

APPENDIX[1]

A NEW MEASURE OF DISCRETIONARY FISCAL POLICY

The Board staff is presenting for the first time a new budget measure of discretionary fiscal policy, dubbed FI (for fiscal impetus). This new measure has been developed to help interpret the role of federal budget developments in the short-run path of aggregate demand.[2] It is premised on the view that such a fiscal indicator should be derivable from a macroeconomic model. The model provides guidance in the selection and weighting of various aspects of federal sector behavior, as they influence aggregate demand.

The macroeconomics literature offers several competing models with widely differing implications about the short-run effects of fiscal policy. For example, models exist in which it is theoretically possible for tax cuts to increase, decrease, or not affect GNP. However, FI has been derived from a simplified model of aggregate demand determination in a growing economy that attempts to capture essential elements of the staff's judgmental GNP projection framework and of the Board's MPS quarterly econometric model.[3] In this model, a tax cut does, indeed, increase GNP, especially when the cut is judged to be permanent.

By combining information about discretionary tax and spending changes (with appropriate weighting), FI essentially quantifies the magnitude of the shift in the IS curve attributable directly to fiscal actions. Indeed, a positive value for FI indicates that fiscal policy is, ceteris paribus, increasing GNP growth.

The new discretionary measure, FI, is similar to the change in the high-employment budget deficit, the traditional summary measure of the stance of discretionary fiscal policy, because it excludes cyclical influences on taxes and spending. However, FI differs from the change in the high-employment budget in some important respects. For example, FI <u>excludes</u> interest payments on the debt, fiscal drag, and built-in

1. Prepared by Darrel S. Cohen, Economist, Fiscal Analysis Section, Division of Research and Statistics.

2. For a detailed discussion of the derivation and implementation issues relating to the new fiscal measure, see Darrel Cohen, "Models and Measures of Fiscal Policy," Economic Activity Section Working Paper Series, No. 70. Board of Governors of the Federal Reserve System, March 1987.

3. FI (in constant dollars) is given by, $\Delta G-\sum_i b_i \Delta T_i$, where ΔG is the discretionary change in real government spending, ΔT_i is the discretionary change in real taxes of type i, and b_i is the coefficient weight associated with tax i (e.g., for personal taxes b is the marginal propensity to consume). To express FI in its derived percentage form, the above expression is divided by the level of discretionary real government purchases.

trends in spending (e.g., demographic trends in social security). Furthermore, FI measures discretionary spending and tax changes in real terms, weights various tax and spending changes differently,[4] and evaluates them at actual -- rather than at high-employment -- levels of economic activity. Moreover, in line with the life-cycle model of consumption, FI gives substantially less weight to temporary tax changes (such as the one-time tax rebate in 1975, the temporary tax surcharge in the late 1960s, or the early-1987 surge in capital gains tax receipts that resulted from tax reform) than to permanent ones (such as the tax rate reductions enacted in the 1981 Economic Recovery Tax Act).

A comparison of the key properties of FI and the change in the high-employment budget is presented in table 1. FI (expressed as a percent of discretionary government purchases) and the change in the high-employment budget (expressed as a percent of nominal potential GNP) are shown graphically for the period, CY1971 to CY1987, in the chart. Underlying data (both on a quarterly and calendar year basis) for the 1980s are presented in table 2.

4. For example, the personal income tax rate changes resulting from tax reform receive a coefficient weight of 0.7, while the repeal of the investment tax credit receives a coefficient weight of 0.5. Furthermore, discretionary changes in government purchases (such as defense) and transfer payments (such as those resulting from Gramm-Rudman-Hollings cutbacks) each receive a coefficient weight of unity; transfers receive the same weight as purchases because the marginal propensity to consume out of transfer income is 1.0 in the MPS model.

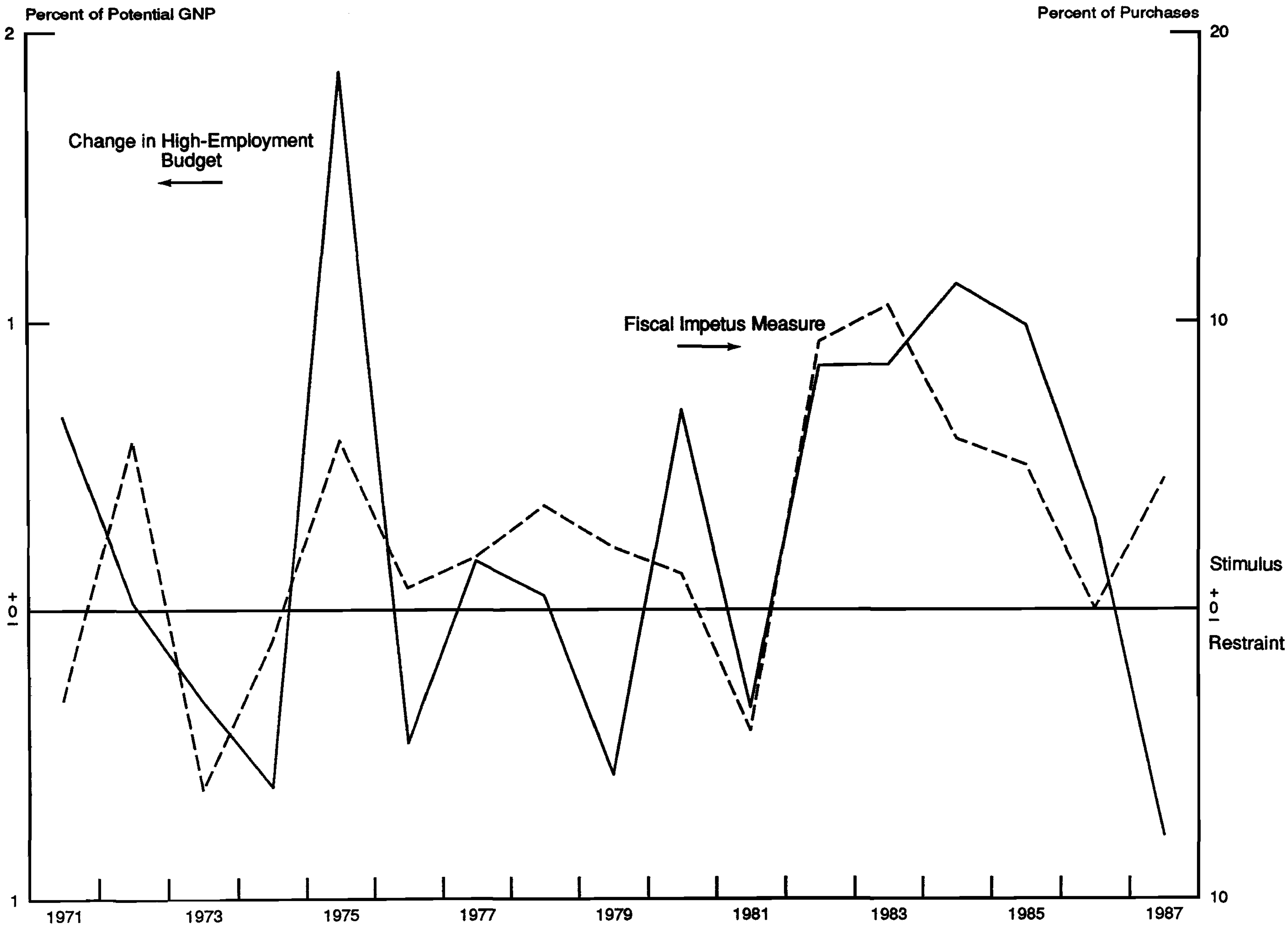
1. A COMPARISON OF PROPERTIES OF TWO MEASURES OF FISCAL POLICY

Properties	Fiscal impetus (FI)	Change in high-employment budget
1. Units	Constant dollar (or percent of constant dollar government purchases, which makes measure comparable to a real GNP or potential GNP growth rate).	Current dollar (or percent of nominal potential GNP, which roughly converts to real terms and scales for GNP growth).
2. Effects of economy on measure	Minimal.	Affected especially by prices (nominal potential GNP and indexed spending programs) and interest rates (net interest on debt).
3. Taxes	Includes changes in tax law with each category receiving a different coefficient weight; tax changes are evaluated at actual levels of economic activity; temporary tax changes receive a much smaller weight than permanent changes; indexed tax changes are included only in first year; extension of expiring tax law is not included.	Includes all noncyclical changes in taxes evaluated at high-employment levels of economic activity (i.e., it includes legislative changes, fiscal drag, changes due to an altered distribution of taxable income, overwithholding, etc.); each tax category receives the same coefficient weight of unity.
4. Nondefense purchases	Includes change in these purchases (including compensation of employees) in real terms; however, CCC is excluded.	Includes total change in current dollars (including CCC).

1. A COMPARISON OF PROPERTIES OF TWO MEASURES OF FISCAL POLICY--CONTINUED

Properties	Fiscal impetus (FI)	Change in high-employment budget
5. Defense	Includes change in real defense purchases.	Includes change in nominal defense purchases.
6. Grants	Roughly half of grants are classified as "purchases;" the change in real terms in this set of grants is included in FI. The remaining portion is allocated to "transfers and subsidies," and only clearly identifiable <u>discretionary</u> program changes are included.	Includes total change.
7. Transfers and subsidies	Includes discretionary program changes only.	Includes noncyclical changes (due to inflation, beneficiary growth, program changes, etc.).
8. Interest	Not included.	Total change is included.

MEASURES OF FISCAL POLICY



2. MEASURES OF FISCAL POLICY[1]
(Historical Data: 1980s)

		Fiscal impetus (FI)		Change in high-employment budget	
		Billions of 1982 dollars	Percent of government purchases	Billions of dollars	Percent of potential GNP
1980	Q1	2.6	.9	8.9	.3
	Q2	-.3	-.1	2.5	.1
	Q3	1.0	.3	.2	.0
	Q4	-3.4	-1.2	-3.7	-.1
1981	Q1	-17.9	-6.1	-13.7	-.5
	Q2	4.2	1.4	-4.1	-.1
	Q3	-2.7	-.9	11.0	.4
	Q4	16.1	5.4	15.6	.5
1982	Q1	-.3	-.1	-9.1	-.3
	Q2	3.4	1.1	-5.2	-.2
	Q3	24.2	8.2	30.5	.9
	Q4	7.3	2.4	32.7	.9
1983	Q1	2.3	.8	-15.8	-.5
	Q2	-.2	-.1	-4.9	-.1
	Q3	21.3	6.8	17.8	.5
	Q4	2.7	.9	5.3	.1
1984	Q1	-.4	-.1	5.9	.2
	Q2	7.0	2.2	19.3	.5
	Q3	-4.5	-1.4	11.3	.3
	Q4	14.5	4.4	14.4	.4
1985	Q1	-2.0	-.6	-21.6	-.5
	Q2	2.8	.8	51.3	1.3
	Q3	16.2	4.7	-5.3	-.1
	Q4	-8.1	-2.2	11.4	.3
1986	Q1	-6.7	-1.9	-3.0	-.1
	Q2	4.7	1.3	25.8	.6
	Q3	2.7	.7	-31.5	-.7
	Q4	-8.0	-2.1	-26.0	-.6
1987	Q1	8.9	2.4	11.7	.3
	Q2	11.4	3.1	-35.7	-.8
	Q3	4.4	1.2	2.6	.1
	Q4	-1.7	-.5	35.3	.8
1988	Q1	.4	.1	-.9	.0
	Q2	-.9	-.2	-19.0	-.4
1980		3.5	1.2	17.2	.7
1981		-12.2	-4.2	-9.4	-.3
1982		27.7	9.3	26.7	.8
1983		31.6	10.6	29.2	.9
1984		18.7	5.9	41.2	1.1
1985		16.6	5.0	38.4	1.0
1986		.1	.0	12.8	.3
1987		16.5	4.5	-33.7	-.8

1. Annual data are for calendar years. A positive (negative) sign indicates fiscal stimulus (restraint).

DOMESTIC FINANCIAL DEVELOPMENTS

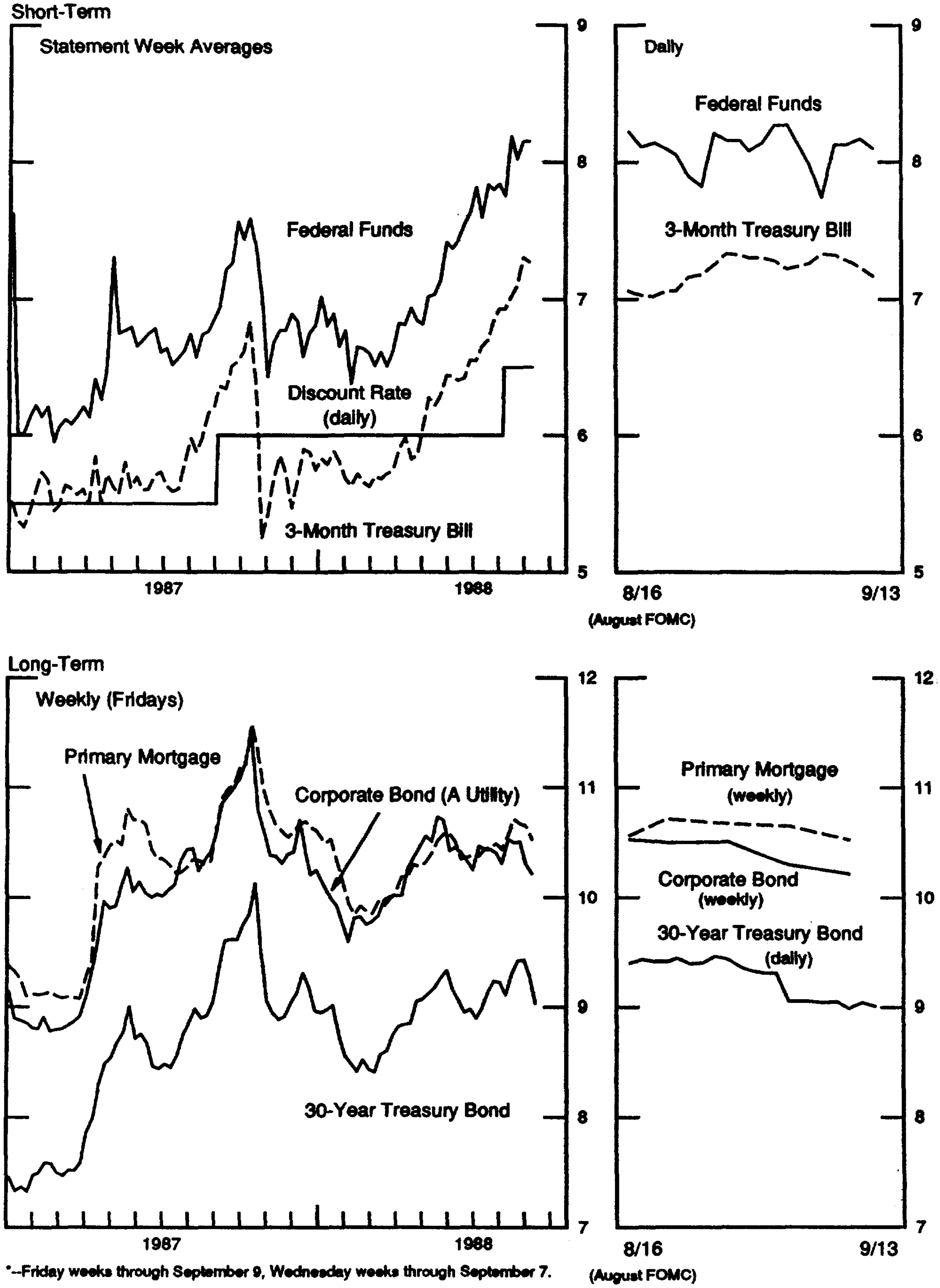
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1987 Jan.-Feb. lows	1987 Oct. 16[2]	1988 Feb lows	1988 FOMC Aug 16	1988 Sept. 13	Change from: FOMC Aug 16
Short-term rates						
Federal funds[3]	5.95	7.59	6.38	7.80	8.13	.33
Treasury bills[4]						
3-month	5.30	6.93	5.59	7.06	7.17	.11
6-month	5.31	7.58	5.77	7.54	7.40	-.14
1-year	5.35	7.74	6.10	7.69	7.46	-.23
Commercial paper						
1-month	5.81	7.94	6.41	8.26	8.07	-.19
3-month	5.73	8.65	6.45	8.42	8.17	-.25
Large negotiable CDs[4]						
1-month	5.85	7.92	6.44	8.24	8.11	-.13
3-month	5.80	8.90	6.49	8.55	8.22	-.33
6-month	5.78	9.12	6.55	8.85	8.49	-.36
Eurodollar deposits[5]						
1-month	6.00	7.79	6.60	8.31	8.26	-.05
3-month	6.00	8.69	6.69	8.59	8.39	-.20
Bank prime rate	7.50	9.25	8.50	10.00	10.00	.00
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	6.34	9.52	7.28	8.84	8.52	-.32
10-year	7.01	10.23	8.11	9.35	8.94	-.41
30-year	7.29	10.24	8.32	9.40	9.01	-.39
Municipal revenue[6] (Bond Buyer)	6.92	9.59	7.76	8.18	7.98	-.20
Corporate A utility (recently offered)	8.78	11.50	9.63	10.53e	10.17e	-.36
Home mortgage rates[7]						
S&L fixed-rate	9.10	11.58	9.84	10.57	10.53	-.04
S&L ARM, 1-yr.	7.52	8.45	7.59	8.00	8.14	.14

	1986 Year-end	1987 Record highs	1987 Lows	1988 FOMC Aug 16	1988 Sept 13	Percent change from: FOMC Aug. 16
Stock prices						
Dow-Jones Industrial	1895.95	2722.42	1738.74	2021.51	2083.04	3.04
NYSE Composite	138.58	187.99	125.91	147.49	151.15	2.48
AMEX Composite	263.27	365.01	231.90	294.57	296.79	.75
NASDAQ (OTC)	348.83	455.26	291.88	375.66	382.38	1.79

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week maintenance period closest to date shown except lows shown which are one-week average ending Feb.25 and Feb.10, respectively. Last observation is average to date for maintenance period ending 9/21/88.
4. Secondary market.
5. Average for statement week closest to date shown.
6. One-day quotes for Thursday.
7. Quotes for week ending Friday closest to date shown.
e--estimate.

Selected Interest Rates*
(percent)



*--Friday weeks through September 9, Wednesday weeks through September 7.

Federal funds have continued to trade around the 8-1/8 percent level established shortly after the August 9 discount rate hike. Most other market interest rates have fallen noticeably on balance since the last FOMC meeting, the declines amounting to as much as 3/8 percentage point. Much of the drop occurred in response to the less robust August employment report, which, combined with weakness in oil and other commodity prices, was perceived by many as lessening the prospects for a near-term firming in monetary policy.

In response to the upward trend in interest rates over recent months, growth of the broader monetary aggregates slowed a bit further in August, with M2 and M3 growing at annual rates of 2 and 4 percent, respectively, while M1 was flat. From the fourth quarter of 1987 through August, M2 expanded 6-1/4 percent and M3 grew 7 percent, placing the two measures well within the FOMC's annual ranges.

Overall credit demands have continued to ease from the second-quarter pace, leaving debt growth, too, comfortably inside the 1988 monitoring range. Net borrowing by nonfinancial businesses apparently remained subdued in August as a small pickup in bond offerings was accompanied by a slowdown in business loan growth at banks. In the federal sector, Treasury net borrowing from the public has picked up seasonally in the current quarter. Borrowing by state and local governments remains moderate, reflecting a dropoff in offerings of bonds for new capital as well as very light issuance of refunding bonds.

MONETARY AGGREGATES
(based on seasonally adjusted data unless otherwise noted)

	1987[1]	1988 Q1	1988 Q2	1988 Jun	1988 Jul	1988 Aug pe	Growth Q4 87-Aug 88p
	------------Percent change at annual rates------------						
1. M1	6.2	3.8	6.3	9.8	9.1	0	5 1/4
2. M2	4.0	6.8	7.7	5.8	3.7	2	6 1/4
3. M3	5.4	7.1	7.5	7.7	6.2	4	7
	------------Percent change at annual rates------------						Levels bil. $ Jul 88
Selected components							
4. M1-A	2.8	1.4	3.9	9.2	4.8	1	504.1
5. Currency	8.7	9.4	8.4	7.7	8.2	5	206.3
6. Demand deposits	-1.0	-4.4	1.0	10.4	2.9	-2	290.6
7. Other checkable deposits	13.6	8.3	10.6	11.0	17.1	0	278.3
8. M2 minus M1[2]	3.3	7.8	8.3	4.4	1.8	3	2243.4
9. Overnight RPs and Eurodollars, NSA	4.1	-11.8	3.0	3.0	-38.5	46	78.4
10. General purpose and broker/dealer money market mutual fund shares, NSA	5.8	19.3	3.1	-14.5	3.1	7	229.5
11. Commercial banks	2.5	7.2	6.8	9.0	5.0	4	958.7
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.8	2.8	3.2	11.1	2.2	-3	548.9
13. Small time deposits	3.5	13.7	11.8	6.2	8.8	13	409.8
14. Thrift institutions	3.5	8.7	9.1	3.0	1.1	2	972.4
15. Savings deposits, SA, plus MMDAs, NSA[3]	0.8	-7.3	2.3	4.8	2.1	-2	404.1
16. Small time deposits	5.6	21.3	14.0	1.7	0.4	4	568.3
17. M3 minus M2[4]	11.2	8.4	6.8	15.1	16.0	10	806.
18. Large time deposits	8.5	7.3	7.5	15.2	18.4	13	510.0
19. At commercial banks, net[5]	11.2	3.4	6.7	23.4	26.9	22	341.7
20. At thrift institutions	3.4	15.7	8.8	0.0	1.4	-4	168.3
21. Institution-only money market mutual fund shares, NSA	3.0	44.0	-30.6	-49.3	-20.9	-11	84.8
22. Term RPs, NSA	32.8	6.6	25.1	27.1	7.9	-17	123.0
23. Term Eurodollars, NSA	13.8	-23.4	19.4	18.4	12.9	72	93.9
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	6.1	1.5	7.9	4.8	4.0	11	599.5
25. Large time deposits, gross	3.5	2.3	1.5	4.1	6.2	7	406.7
26. Nondeposit funds	2.7	-0.8	6.4	0.7	-2.2	4	192.8
27. Net due to related foreign institutions, NSA	2.9	-6.1	4.0	-0.8	2.2	8	11.2
28. Other[7]	-0.2	5.3	2.4	1.5	-4.4	-4	181.6
29. U.S. government deposits at commercial banks[8]	0.3	-0.4	-1.0	-2.7	-1.8	-4	20.2

1. Amounts shown are from fourth quarter to fourth quarter.
2. Nontransactions M2 is seasonally adjusted as a whole.
3. Commercial bank savings deposits excluding MMDAs grew during July and August at rates of 9.6 percent and 8 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during July and August at rates of 6.5 percent and 4 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. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing 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 borrowing from Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially esti
8. Consists of Treasury demand deposits and note balances at commercial banks.

pe - preliminary estimate

Available data on the household sector suggest some slackening in the pace of mortgage and consumer debt expansion.

Monetary Aggregates and Bank Credit

The slower growth in M2 last month reflected a sharp deceleration in M1 that more than offset a small pickup in its nontransaction component. Within M2, overnight RPs and Eurodollars rebounded while retail accounts weakened, likely reflecting higher market interest rates and opportunity costs. The slower M2 expansion and some weakening in its non-M2 component accounted for the deceleration in M3.

In August, the composition of growth in the retail-type components of M2 appears to have become more consistent with recent movements in interest rates. Small time deposits, which in June and July had posted unusually weak growth in view of the widening gap between their own rates and those paid on liquid accounts, picked up to an 8 percent annual rate last month, while growth in savings deposits and MMDAs weakened further. There appears, however, to have been a significant change recently in both the growth and pricing of small time deposit accounts at thrift institutions relative to those at commercial banks. Over most of the five-year period since the deregulation of small time deposit rates, thrifts had priced more aggressively than banks and consistently had experienced stronger growth in these deposits. In each of the past three months, however, small time deposit growth at thrifts has been unusually weak and markedly below that of commercial banks.

Recent data suggest that the spread between thrift and bank rates paid on 6-month retail CDs had fallen by August to less than half its first-quarter level and was the narrowest on record. While the falloff in growth of thrift small time deposits could simply reflect in part a shifting into bank deposits, it may also represent a source of weakness in overall growth of small time deposits and M2, to the extent that the previous high rates had attracted funds from market instruments.

The non-M2 component of M3 slowed in August as growth in large time deposits eased somewhat. A moderate runoff in large CDs at thrift

THRIFT AND COMMERCIAL BANK PRICING OF RETAIL DEPOSITS AND SMALL TIME DEPOSIT GROWTH

		Thrift 6-month CD rate less bank rate[1]	Slope of thrift deposit yield curve[2]	Slope of bank deposit yield curve[2]	Small time deposit growth: Thrifts	Small time deposit growth: Banks
		----------------Basis points----------------			Percent, s.a.a.r.	
1987	Q3	41	134	123	9.3	7.5
	Q4	43	180	167	16.1	14.8
1988	Q1	53	186	161	21.3	13.7
	Q2	35	165	160	14.0	11.8
	May	34	160	156	10.7	6.6
	June	29	171	171	1.7	6.2
	July	27	179	181	.4	8.8
	August[pe]	23	192	198	4	13

1. Rate paid by FSLIC-insured institutions less that paid by commercial banks.
2. Rate paid on 6-month retail CDs less rate paid on NOW accounts.
pe--preliminary estimate.
Note: Interest rate data are as of the end of the preceding month. All deposit interest rate data reflect effective annual yields.

institutions, apparently largely concentrated in the Dallas Federal Reserve District, contributed to the slower growth in aggregate large time deposits. Institution-only money market mutual funds and term RPs continued to decline last month, while term Eurodollars surged.

Commercial banks increased their borrowings from foreign branches last month to fund a mild pickup in bank credit to a 6-1/2 percent annual rate of growth. The strengthening of bank asset growth reflected an increase in holdings of U.S. government securities, after a decline in July. Total loans increased at a 7-1/4 percent rate, down somewhat from July; a drop in business lending was partially offset by a strong turnaround in the volatile security loan category, some strengthening in real estate lending, and faster growth of consumer loans. Consumer loans on bank balance sheets continue to be affected by the issuance of consumer credit-backed securities. Adjusting for this activity, consumer loan growth last month was roughly 8 percent, about 3 percentage points above the comparable July figure, but still noticeably below its second-quarter pace.

Growth of business loans at U.S. offices of commercial banks fell to a 1-1/2 percent annual rate last month, with the slowdown evident at both large and small U.S.-chartered banks and at U.S. offices of foreign banks. Booking of loans at foreign branches of large U.S. banks picked up, likely reflecting shifts from prime-based domestic bookings to LIBOR-based loans at foreign offices as the prime-LIBOR spread widened last month after the increase in the prime rate.

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

	1986:Q4 to 1987:Q4	1988 Q1	1988 Q2	1988 June	1988 July	1988 Aug. p	Levels bil.$ Aug. p
				Commercial Bank Credit			
1. Total loans and securities at banks	7.9	7.8	11.9	11.1	4.9	6.6	2366.6
2. Securities	5.0	5.4	8.9	10.6	-9.6	5.1	546.2
3. U.S. government securities	9.1	6.8	12.9	13.5	-17.2	8.7	347.3
4. Other securities	-1.3	2.9	2.0	5.5	3.6	-1.2	198.9
5. Total loans	8.8	8.6	12.9	11.2	9.4	7.2	1820.3
6. Business loans	7.5	2.7	16.7	14.3	12.7	1.6	601.5
7. Security loans	1.0	76.6	-12.1	-6.2	-18.7	47.4	39.5
8. Real estate loans	18.1	10.8	13.8	12.3	11.6	13.4	631.9
9. Consumer loans	4.9	10.4	7.2	5.3	3.5	5.6	343.2
10. Other loans	-2.3	5.4	13.2	11.9	7.6	-.6	204.2
				Short- and Intermediate-Term Business Credit			
11. Business loans net of bankers acceptances	7.6	2.3	17.0	14.4	12.8	1.4	597.9
12. Loans at foreign branches[2]	-4.1	115.8	4.1	-35.3	-48.5	56.8	19.9
13. Sum of lines 11 & 12	7.2	5.2	16.6	12.5	10.8	3.1	617.8
14. Commercial paper issued by nonfinancial firms	-1.6	8.8	12.2	-7.8	-23.3	9.4	90.4
15. Sum of lines 13 & 14	6.0	5.7	16.0	10.0	6.5	3.9	708.2
16. Bankers acceptances: U.S. trade related[3,4]	13.3	-11.6	-9.5	-10.9	-7.3	n.a.	32.6[5]
17. Line 15 plus bankers acceptances: U.S. trade related	6.3	4.9	14.8	9.0	5.9	n.a	738.5[5]
18. Finance company loans to business[3]	16.6	8.4	12.1	8.7	9.2	n.a.	222.9[5]
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.4	5.6	14.2	17.2	6.7	n.a.	961.4[5]

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.
5. July data.
n.a.--not available
p--preliminary

Business Finance

Total borrowing by nonfinancial businesses in August evidently continued around the reduced pace registered in the preceding month. Commercial paper of nonfinancial corporations increased in August, after a steep decline in July, but the sum of commercial paper outstanding and overall business loan growth at banks expanded at only a 4 percent annual rate, down somewhat from July and substantially below the pace of the second quarter. Gross public bond offerings picked up somewhat, though they remained low relative to the average pace earlier in the year.[1] To some extent, the recent slowdown in the growth of business debt likely reflects the dropoff in the volume of share retirements so far this quarter from the record totals in the spring. Few acquisitions or leveraged buyouts have resulted in equity retirements of a billion dollars or more since June. Nonetheless, there have been numerous smaller deals, which, along with a continued excess of share repurchases over new issues, have kept net retirements somewhat above their average pace of recent years, at roughly a $100 billion annual rate.

This continued restructuring activity has helped support a large flow of junk bond financing. New bonds rated below investment grade have been flowing into bond portfolios at an average rate of $3 billion a month since early 1986, except for last fall and winter after the stock market crash. Some investors withdrew from the junk market during

1. One uncertainty in the assessment of business borrowing developments is the lack of data on private placements. Market reports suggest that private placement activity has been heavy, but there is no basis for judging whether recent levels have differed from those in earlier months of the year.

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

	1987	1988				
	Year	Q1	Q2[p]	June[p]	July[p]	Aug.[p]
Corporate securities - total[1]	24.08	23.56	24.94	29.98	17.09	18.38
Public offerings in U.S.	21.89	22.17	22.35	26.57	14.90	17.50
Stocks--total[2]	4.45	3.89	3.64	4.17	4.40	3.50
Nonfinancial	2.32	.76	1.63	2.41	1.70	1.20
Utility	.57	.32	.30	.25	.10	.20
Industrial	1.75	.44	1.33	2.16	1.60	1.00
Financial	2.12	3.13	2.01	1.76	2.70	2.30
Bonds--total[1]	17.44	18.28	18.70	22.40	10.50	14.00
Nonfinancial	6.61	6.59	7.92	9.90	4.10	5.20
Utility	2.02	2.25	2.55	3.10	1.20	.30
Industrial	4.59	4.34	5.37	6.80	2.90	4.90
Financial	10.83	11.69	10.78	12.50	6.40	8.80
By quality[3]						
Aaa and Aa	3.27	3.83	3.10	3.04	1.20	3.00
A and Baa	5.20	7.06	7.16	8.84	2.20	3.30
Less than Baa	2.77	1.33	2.85	4.74	3.10	2.70
No rating (or unknown)	.07	.16	.14	.01	.10	.10
Memo items:						
Equity-based bonds[4]	.87	.13	.37	.77	.50	.10
Mortgage-backed bonds	5.19	5.47	4.12	3.50	3.00	4.40
Variable-rate notes	1.88	1.44	1.35	.62	.95	1.00
Bonds sold abroad - total	2.03	1.34	2.40	3.00	1.99	.85
Nonfinancial	.94	.39	.87	.87	.80	.45
Financial	1.09	.95	1.53	2.13	1.19	.40
Stocks sold abroad - total	.16	.05	.19	.41	.20	.03
Nonfinancial	.12	.04	.14	.33	.20	.01
Financial	.04	.01	.05	.08	.00	.02

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.

that period, but as the stock market stabilized and the economy's prospects brightened, demand for new issues rebounded and is evidenced by the narrowing to pre-crash widths of yield spreads vis-à-vis Treasuries. Demand for high-yield debt increasingly has been augmented by indenture clauses limiting further leveraging in any subsequent restructuring, and by assurances that future interest costs on some of the floating-rate bank financing are hedged by interest rate caps or swaps. The recent legal difficulties of Drexel Burnham Lambert, the dominant underwriter of junk bonds, reportedly have had little net effect on the market as a whole.

In contrast to the moderate rebound in bond issuance, new equity offerings fell off sharply in August. The decline in stock prices early in the month likely discouraged some issuers. Currently, share price indexes are a little above their levels at the time of the August FOMC.

Treasury and Sponsored Agency Financing

The outlook for the federal sector has changed little since the August FOMC meeting. The federal budget deficit is projected to widen to $39 billion in the third quarter, after ending the second quarter roughly in balance. For the fiscal year as a whole, the deficit is projected at roughly $158 billion. The staff expects the Treasury to finance its current-quarter deficit mainly by borrowing $42 billion, net, from the public. Net marketable borrowing of $33 billion is expected to be split about evenly between bills, which had been running off in previous quarters, and coupon issues; other special borrowing

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

	1988		1988		
	Q2	Q3[e]	Jul.	Aug.[p]	Sep.[e]
Treasury financing					
Total surplus/deficit (-)	.5	-38.9	-22.9	-22.7	6.7
Means of financing deficit:					
Net cash borrowing from the public	18.7	42.1	3.7	22.8	15.6
Marketable borrowings/ repayments (-)	11.3	32.8	3.6	17.1	12.1
Bills	-10.4	16.5	.4	10.7	5.4
Coupons	21.6	16.3	3.2	6.4	6.7
Nonmarketable	6.4	3.5	.7	2.3	.5
Other borrowing[2]	1.1	5.9	-.6	3.5	3.0
Decrease in the cash balance	-16.6	-.2	15.6	11.0	-26.8
Memo: Cash balance at end of period	39.6	39.8	23.9	13.0	39.8
Other[3]	-2.7	-3.1	3.7	-11.2	4.5
Federally sponsored credit agencies, net cash borrowing[4]	3.6	--	3.2	--	--
FHLBs	-.5	--	1.6	2.3	--
FNMA	4.9	--	.0	--	--
Farm Credit Banks	-.4	--	-1.2	-.5	--
FAC[5]	--	--	.5		
FHLMC	-2.5	--	.4p	--	--
FICO	1.1	--	.0	.9	
SLMA	1.0	--	2.0p	--	--

1. Data reported on a not seasonally adjusted, payment basis.
2. Securities issued by federal agencies under special financing authorities (primarily FSLIC).
3. Includes checks issued less checks paid, accrued items and other transactions.
4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
5. Financial Assistance Corporation, an institution within Farm Credit System, was created in January 1988 by Congress to provide financial assistance to Farm Credit Banks. It first issued bonds in July 1988.

e--staff estimate.
p--preliminary.
Note: Details may not add to totals due to rounding.

(mostly FSLIC notes described below) is expected to contribute $6 billion toward financing the current-quarter deficit. Considerable uncertainty remains as to whether the Treasury will have the authority to issue 30-year bonds in the November refunding. A technical corrections bill for the 1986 tax legislation, which contains a provision to repeal the limit on the authority, has yet to be taken up by the full Senate.

In spite of the publicity surrounding liquidations and mergers of financially troubled savings and loan associations, the rate spread of Financing Corporation (FICO) obligations over Treasury bonds has narrowed about 15 basis points since the last issue was brought to market in late July. In the last two months, the FSLIC has greatly accelerated the pace at which it is resolving thrift insolvencies, and Chairman Wall of the Federal Home Loan Bank Board has testified that he expects this rapid pace to extend through September. Despite the issuance of more than $2-1/2 billion of FICO bonds this year, the FSLIC's cash resources have not been adequate to provide the financial assistance necessary to complete these transactions. The FSLIC instead has relied on the issuance of adjustable-rate obligations (FSLIC notes) to augment its resources. By the end of August, FSLIC notes outstanding had reached $9.3 billion, compared with $5 billion at the beginning of this year.[2] The issuance of large amounts of FSLIC notes has attracted considerable attention from the public and Congress and has

2. Outstanding FSLIC notes include those issued to purchase Income Capital Certificates and Net Worth Certificates as part of earlier assistance programs. The figures cited in the text do not include a $900 million FSLIC note payable to Federal Home Loan Banks.

raised further concerns about the ability of the insurance fund to handle the remaining insolvencies without additional financial assistance.

The improvement in the FICO spread has been attributed to enhanced demand associated with stripping of the FICO securities by several dealers to form zero coupon issues; there has been no stripping as yet of the most recent 30-year Treasury bond. Spreads of Federal Home Loan Bank securities over Treasuries have remained relatively stable over the summer, while spreads on Farm Credit System securities, which had widened somewhat earlier in the summer, were unchanged to down slightly at the System's last offering in late August. The yield on the 15-year bond issued by the Financial Assistance Corporation, which was established earlier this year to provide aid to the Farm Credit Banks, has risen slightly relative to the 10-year Treasury rate, reportedly owing to a lack of liquidity in the issue.

Municipal Securities

Gross issuance of long-term tax-exempt securities slowed to $6-1/2 billion in August and is expected to remain light in September. The August long-term volume reflects a dropoff in offerings of bonds for new capital, combined with a continued weakness in issuance of refunding bonds. By contrast, short-term issuance surged to $5-1/2 billion last month, with about $3-1/4 billion accounted for by the state of California. As has been the case since last winter, long-term tax-exempt yields have continued to be remarkably steady compared with other bond rates. The tax-exempt to taxable ratio has remained low by the standards of recent years.

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

	1986	1987	1987	1988		1988		
	Year	Year	Q4	Q1	Q2	June	July	Aug.[p]
Total offerings[1]	14.39	10.44	9.99	8.68	11.73	17.16	11.08	12.34
Total tax-exempt	14.04	10.05	9.38	8.46	11.41	16.98	10.98	12.13
Long-term	12.25	8.53	7.84	7.94	9.20	13.91	9.75	6.61
Refundings[2]	5.29	3.80	2.16	3.05	3.18	4.98	1.36	1.43
New capital	6.96	4.73	5.68	4.89	6.02	8.93	8.39	5.18
Short-term[3]	1.79	1.52	1.54	.52	2.21	3.07	1.23	5.52
Total taxable	.35	.39	.61	.22	.32	.18	.10	.21

1. Includes issues for public and private purposes; also includes taxable issues.
2. Includes all refunding bonds, not just advance refundings.
3. Does not include tax-exempt commercial paper.
p--preliminary.

Inflows to tax-exempt bond funds in the first seven months of 1988 have been running somewhat behind the pace of a year ago. Unit investment trusts, however, have been active purchasers of municipal bonds, with inflows of about $4.7 billion thus far, up roughly 20 percent on a year-over-year basis. The rebound in UITs is consistent with reports of demands by individual investors for municipal securities as shelter from taxes and stock market volatility.

Mortgage Markets

Residential mortgage lending activity appears to have diminished in July, as rising mortgage interest rates have contributed to a slowdown in sales of new and existing homes. The volume of mortgage loans closed at FSLIC-insured thrift institutions fell to a seasonally adjusted $19.3

MORTGAGE ACTIVITY AT ALL FSLIC-INSURED INSTITUTIONS
(Monthly averages, billions of dollars, seasonally adjusted)

	Mortgage transactions			Net change in mortgage assets[1]		
	Origina- tions	Commit- ments	Sales	Total	Mortgage loans	Mortgage- backed securities
1985	16.4	15.0	8.2	4.1	4.2	-.1
1986	22.2	19.8	14.1	4.7	1.3	3.4
1987	21.1	20.0	12.5	6.1	2.6	3.4
1988-Q1 r	18.6	17.8	7.7	2.6	3.6	-1.0
Q2 r	19.7	19.1	10.1	5.9	3.4	2.5
1988-Jan.	17.4	18.6	6.1	5.7	5.1	.6
Feb. r	18.9	16.7	7.8	.7	3.9	-3.1
Mar. r	19.5	18.0	9.2	1.3	1.8	-.5
Apr.	18.7	17.7	10.4	5.8	2.8	3.1
May r	19.5	19.0	9.4	5.3	3.6	1.7
June r	20.8	20.5	10.4	6.5	3.7	2.8
July p	19.3	18.5	8.3	7.1	5.2	1.9

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)

	Seasonally adjusted				Not seasonally adjusted	
Period	Total	GNMAs	FHLMCs	FNMAs	Total	ARM-backed
1985	9.0	3.8	3.2	2.0	9.0	.3
1986	21.6	8.2	8.4	5.0	21.6	.7
1987	19.7	8.2	6.2	5.3	19.7	1.2
1988-Q1	9.4	3.7	2.6	3.1	8.5	.9
Q2 p	13.1	4.4	3.0	5.8	12.5	3.0
1988-Jan.	8.7	4.4	2.4	1.9	7.9	.5
Feb.	9.3	3.3	3.0	3.0	8.7	1.2
Mar. r	10.3	3.3	2.5	4.5	8.8	1.0
Apr. r	12.9	3.4	3.1	6.4	11.0	3.0
May r	11.9	4.2	2.4	5.2	11.1	2.3
June p	14.7	5.6	3.4	5.7	15.4	3.8
July p	12.6	4.9	3.3	4.3	13.5	1.6

r--revised. p--preliminary.

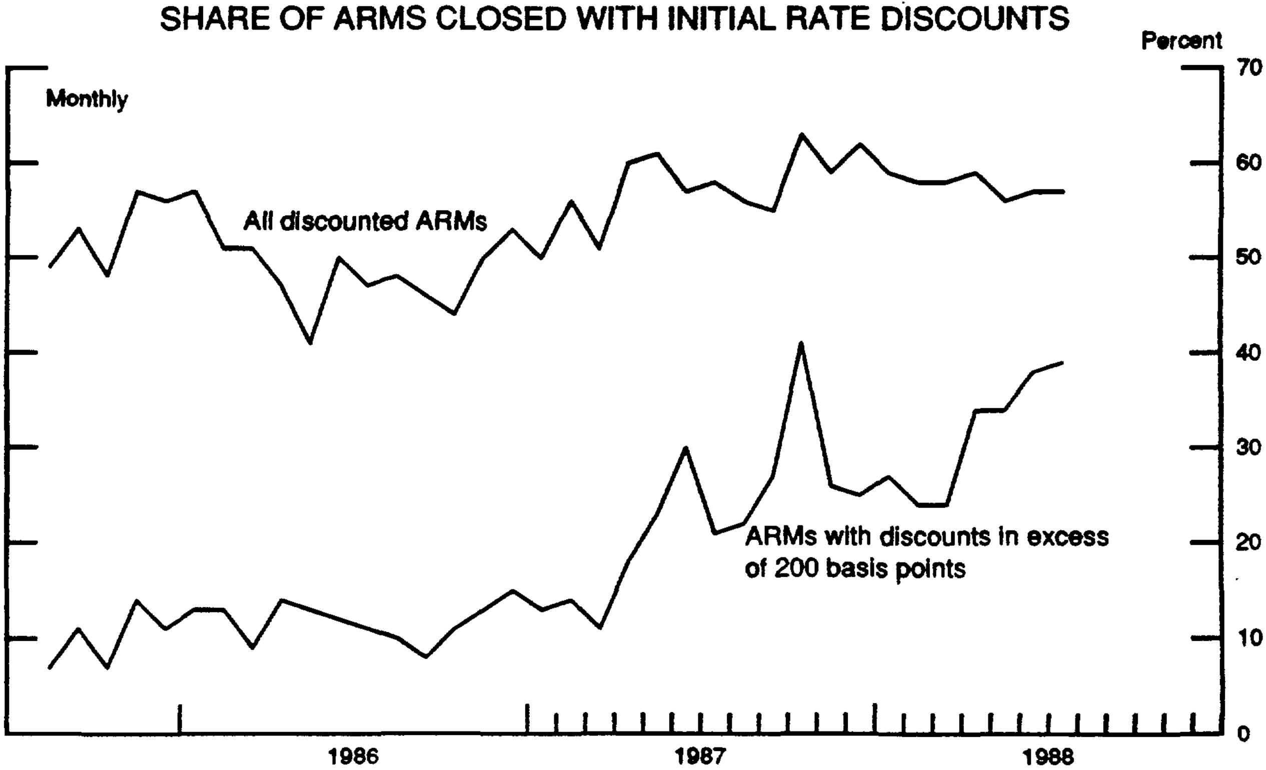
billion in July. Refinancings as a proportion of loans closed at thrifts declined to 16 percent, the lowest share since 1985, while new commitments to originate mortgages dropped to a seasonally adjusted $18.5 billion. A decrease in originations of fixed-rate mortgages, which are more likely to be passed through to the secondary market, led to a decline in thrift sales of mortgages into the secondary market and thus to a net increase in mortgage assets.

In primary markets, mortgage interest rates are little changed, on balance, from their levels at the time of the previous FOMC meeting. Reflecting the sizable initial rate advantage of ARMs in recent months, the proportion of conventional mortgages closed with adjustable rates has continued its upward trend, increasing for the fifth consecutive month to 61 percent in early August. Lenders evidently have priced ARMs more aggressively during recent months, in attempts to attract borrowers to ARMs and to raise market share. Although the overall prevalence of ARMs closed with initial rate discounts has been fairly stable of late, the proportion of ARMs at FSLIC-insured lenders carrying discounts in excess of 2 percentage points has risen steadily this year, to a historically high level of almost 40 percent in July (see chart on page III-16). The trend toward deep discounting of ARMs also is reflected in spreads between initial ARM rates and common benchmarks. The difference between the average initial ARM quote and the one-year, constant maturity Treasury yield, the most prevalent ARM index, has shrunk dramatically since the beginning of 1988, though ARM rates actually have

AVERAGE ARM INDEX VALUES AND INITIAL RATE SPREADS
(Percent)

Period (1)	Initial ARM rate (2)	One-year Treasury (3)	FHLB 11th District cost of funds (4)	ARM spreads: Treasury (2)-(3)	ARM spreads: 11th District (2)-(4)
1984	11.49	10.89	10.50	.61	.99
1985	10.04	8.43	9.52	1.61	.52
1986	8.42	6.46	8.24	1.96	.18
1987-Q1	7.57	5.92	7.39	1.65	.19
Q2	7.80	6.77	7.25	1.03	.55
Q3	7.84	7.13	7.32	.72	.52
Q4	8.07	7.24	7.55	.83	.52
1988-Q1	7.66	6.78	n.a.	.88	n.a.
1988-Jan.	7.85	6.99	7.62	.86	.23
Feb.	7.61	6.64	7.65	.97	-.04
Mar.	7.52	6.71	7.51	.81	.01
Apr.	7.58	7.01	7.52	.57	.06
May	7.71	7.40	7.50	.31	.21
June	7.85	7.49	7.62	.36	.23
July	7.84	7.75	7.59	.09	.25

SHARE OF ARMS CLOSED WITH INITIAL RATE DISCOUNTS



increased since winter relative to the commonly used Eleventh Federal Home Loan Bank District cost-of-funds index.

Lenders often attempt to recoup interest income lost from ARM teasers by raising the "margin," the markup over the index rate that determines the borrower's interest rate after expiration of the discount period. Thus, the lower the initial rate on an ARM relative to the index, the higher will be the interest rate in subsequent periods. ARM borrowers, however, are shielded somewhat from large jumps in interest rates by rate caps, which typically limit rate increases to 2 percentage points per adjustment period and 6 percentage points over the life of the loan.

Consumer Credit

Consumer installment credit outstanding grew at a 4-3/4 percent seasonally adjusted annual rate in July, down from the revised 15-1/4 percent June pace. The abrupt slowing in July reflected sharply lower growth in automobile loans, particularly at finance companies, and in revolving credit at commercial banks; in addition, all other installment loans outstanding were about flat after expanding sharply in June. The slowing in the use of installment credit in July is consistent with the dropoff in unit sales of new autos and with the lackluster sales of other (non-auto) types of consumer goods during the month.

Measures of the quality of household debt in the second quarter were mixed, though patterns differed from those in the first quarter. Delinquency rates on commercial bank credit cards edged down from a five-quarter high to 2.39 percent in the second quarter, while the rate

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
			1988		1988		1988		1988
	1986	1987	Q1	Q2[r]	June[r]	July[p]	June[r]	July[p]	July[p]
Total installment[1]	10.4	7.2	10.7	9.5	15.2	4.8	8.05	2.57	646.8
Installment, excluding auto	5.7	6.2	8.0	10.7	17.5	6.7	5.22	2.02	364.1
Selected types									
Auto	17.4	8.6	14.4	7.9	12.2	2.4	2.84	.56	282.8
Revolving	11.8	16.8	15.9	17.3	25.9	14.2	3.65	2.04	174.9
All other	1.7	-1.5	1.2	4.8	10.0	-.2	1.56	-.02	189.3
Selected holders									
Commercial banks	8.5	7.4	13.2	13.0	19.2	7.1	4.72	1.77	302.0
Finance companies	20.4	4.8	11.4	1.9	2.4	-7.8	.29	-.94	143.8
Credit unions	5.9	6.4	7.6	11.2	14.7	9.0	1.03	.64	85.6
Savings institutions[2]	14.5	12.4	7.1	13.5	32.3	16.4	1.77	.91	68.2
Memorandum:									
Total[3]	9.0	6.1	8.2	7.6	10.3	4.6	6.09	2.76	715.6

1. Includes items not shown separately.
2. Savings and loans, mutual savings banks, and federal savings banks.
3. Installment plus noninstallment.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

	1985	1986	1987	1988 Apr.	May	June	July	Aug.
At commercial banks[1]								
New cars (48 mo.)	12.91	11.33	10.46	...	10.55	...	...	10.93
Personal (24 mo.)	15.94	14.83	14.23	...	14.40	...	...	14.81
Credit cards	18.69	18.26	17.92	...	17.78	...	...	17.79
At auto finance cos.[2]								
New cars	11.98	9.44	10.73	12.29	12.29	12.32	12.44	...
Used cars	17.59	15.95	14.61	14.82	14.81	14.83	14.99	...

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.

on all closed-end loans at banks was unchanged at about the midpoint of its range in recent years. Auto loan delinquencies at finance companies rose to 2.21 percent, the highest quarterly average since mid-1980. Delinquencies on home mortgages increased, but remained well below the 1985-86 highs. Personal bankruptcy filings, meanwhile, edged down 2-1/4 percent, seasonally adjusted, from their record first-quarter level; nonetheless, bankruptcy filings for the first half of 1988 were running at a pace almost 13 percent above that in the year-earlier period.

Consumer loan rates generally increased between early May and early August, and if banks follow their usual practices, the mid-August increase in the prime rate should result in even higher consumer loan rates over the next few months. In the late 1970s and early 1980s, state usury ceilings effectively constrained banks from raising consumer loan rates in response to increases in the prime. Since the removal of these constraints, spreads of consumer loan rates over prime generally have averaged close to levels prevailing in the mid to late 1970s. Through the first three quarters of 1988, however, movements in consumer loan rates at banks have lagged those of the prime, and spreads have narrowed 50 to 85 basis points for selected categories. Auto loan spreads have narrowed the most, perhaps reflecting competition from other lenders. Credit card rates, which are typically slow to react to changes in market rates, have shown virtually no movement, while personal loan rates also have changed little, owing perhaps to the increased popularity of variable-rate home equity lines of credit.

U.S. Merchandise Trade

In July, the seasonally adjusted U.S. merchandise trade deficit was $9.5 billion (Census basis, CIF valuation), compared with a $13.2 billion (revised) deficit in June. The deficit declined as imports fell sharply and exports rose slightly. This is the first release since 1979 in which both the CIF and Customs value for imports were reported simultaneously; on a Customs basis the July deficit was $8.1 billion.

U.S. MERCHANDISE TRADE: MONTHLY DATA
(Billions of dollars, seasonally adjusted, Census basis)

	Exports	Imports		Balance	
		CIF	Customs	CIF	Customs
1988-Jan	24.5	35.8	34.3	-11.3	-9.8
Feb	24.5	38.9	37.7	-14.4	-13.2
Mar	26.9	38.6	36.6	-11.7	-9.7
Apr	26.0	36.3	34.8	-10.3	-8.0
May	27.5	37.2	35.7	-9.8	-8.2
Jun[r]	26.3	39.5	37.9	-13.2	-11.7
Jul[p]	26.5	36.0	34.5	-9.5	-8.1

r--revised
p--preliminary

Among imports the largest seasonally adjusted declines from June to July were in consumer goods and capital goods, particularly power generating machinery, ADP equipment, and office machines. Exports showed small increases across all major categories with the exception of automotive vehicles and parts. (Further discussion of trade through July will be contained in the Greenbook supplement.)

For the second quarter, the merchandise trade deficit was $120 billion at a seasonally adjusted annual rate (balance-of-payments basis), substantially below the $141 billion first-quarter rate. The value of exports again reached an all-time high, while the value of imports declined slightly from its record level of the first quarter (see table below).

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - - - - current dollars - - - - - - - - - - - -						
1985	216	30	186	338	50	288	-122
1986	224	27	197	369	34	335	-144
1987	250	30	220	410	43	367	-160
1986-1	216	29	188	358	42	317	-142
-2	228	26	202	363	31	332	-135
-3	225	27	199	372	32	340	-147
-4	227	28	199	381	32	348	-154
1987-1	227	26	201	387	35	352	-159
-2	239	28	211	398	40	357	-158
-3	260	33	226	418	51	367	-159
-4	272	31	242	437	45	392	-165
1988-1	301	36	265	442	40	402	-141
-2	319	39	280	438	41	398	-120
	- - - - - - - - constant 1982 dollars - - - - - - - - - -						
1987-1	249	31	218	416	70	347	-168
-2	263	34	229	420	72	349	-157
-3	286	40	246	446	88	358	-160
-4	299	35	264	459	81	378	-160
1988-1	327	39	288	463	82	381	-135
-2	341	40	301	459	85	374	-118

Nonagricultural exports increased to all areas of the world in the second quarter, with the exception of the OPEC countries. Agricultural exports to developed countries fell slightly, while those to developing countries grew at an annual rate of 138 percent (partly explained by shipments of corn to Mexico and wheat to Egypt). Non-oil imports from Japan and Latin America fell slightly, while those from Canada, Western Europe, and Asian developing countries rose.

In constant 1982 dollars, exports expanded at a 17 percent annual rate from the first to the second quarter, a slower rate of increase than recorded during the past year. The strongest increases were in exports of civilian aircraft, industrial supplies excluding gold, and consumer goods. Agricultural exports rose at a 6 percent annual rate. The volume of non-oil imports declined by 7 percent at an annual rate in the second quarter, reversing the steady upward trend of the past year. Decreases were recorded in imports of industrial supplies excluding gold, automotive products, and consumer goods. Reflecting strength in U.S. domestic demand, imports of capital goods rose strongly (largely due to deliveries of several Airbuses and an increase in imports of semiconductors).

The volume of oil imports recorded a 14 percent annual increase in the second quarter due to a greater than normal building of inventories.

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

	1987			1988			
	1987	Q3	Q4	Q1	Q2	May	June
Value (Bil. $)	42.88	51.04	45.15	39.83	40.88	43.55	40.43
Price ($/BBL)	17.33	18.26	17.46	15.23	15.14	15.51	15.25
Volume (mbd.)	6.78	7.66	7.08	7.14	7.38	7.67	7.25

The increase in inventories reflected an expectation that oil prices would rise in the second half of the year. Prices of oil imports were higher in May and June than in the previous two months, but prices in world markets dropped sharply beginning in July. The lower world prices reflected increased OPEC production (especially by Arab Persian Gulf states) that began at the end of May. With increased prospects of peace in the Persian Gulf, and further production increases by OPEC, prices have fallen further in recent weeks.

U.S. Current Account

The U.S. current account deficit decreased to an annual rate of $133 billion in the second quarter, compared with $148 billion (revised) in the first quarter. The improvement was more than accounted for by the $21 billion decrease in the merchandise trade deficit. Receipts on

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

	1987		1988	
	Year	Q4	Q1[r]	Q2[p]
Trade balance	-160.3	-164.8	-140.7	-119.8
Exports	249.6	272.1	301.2	318.7
Imports	409.9	436.8	441.9	438.4
Investment income, net	20.4	50.2	4.6	-7.0
Direct investment, net	41.8	75.1	28.7	22.7
Capital gains or losses[1]	15.8	44.7	2.0	-8.2
Other direct investment	26.0	30.7	26.7	30.9
Portfolio income, net	-21.4	-25.2	-24.0	-29.7
Military, net	-2.4	-5.0	-4.1	-3.5
Other services, net	1.8	3.1	5.0	8.5
Unilateral transfers	-13.4	-17.5	-12.5	-11.6
Current account balance	-154.0	-134.1	-147.8	-133.3

1. Gains or losses on foreign currency assets owing to their revaluation at current exchange rates, and other valuation adjustments. Plus = gains; minus = losses.
r--revised

both travel and passenger fares increased for the eighth consecutive quarter, helping to boost net services by $3.5 billion, while direct investment income, excluding capital gains and losses, rose by $4.3 billion. Capital losses on direct investment, due to the dollar's recent appreciation, combined with higher net payments on portfolio investment to swing total net investment income into deficit in the second quarter.

U.S. International Financial Transactions

In July, private foreign residents continued to add to their holdings of U.S. securities. Net private purchases of U.S. Treasury securities (line 3 on the Summary of U.S. International Transactions Table) amounted to $2.9 billion, adding to the $12.6 billion in net purchases in the first half of 1988. Japanese residents accounted for most of the net purchases in July; however, earlier in the year, net purchases by residents of the United Kingdom and Germany were also large.

Net purchases of U.S. corporate bonds by private foreign residents (line 2a) amounted to $3.4 billion in July, adding to the $11.6 billion in net purchases recorded in the first half of 1988. Again, residents of the United Kingdom (including Eurobond underwriters), Japan, and Germany were the largest net purchasers. However, issuance of new bonds, both domestic and Eurobonds, by U.S. corporations has been depressed in the third quarter to date.

Private foreign residents also added $1 billion to their holdings of U.S. corporate stocks in July, equal to about the amount they had

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

	1986 Year	1987 Year	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 May	1988 June	1988 July
Private Capital										
Banks										
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	22.3	47.1	-6.1	31.2	10.3	0.4	14.4	-3.9	1.8	-4.9
Securities										
2. Private securities transactions, net <1>	65.9	36.6	15.5	11.5	-6.9	-2.1	11.2	5.0	3.4	3.7
a) foreign net purchases (+) of U.S. corporate bonds	53.5	26.4	7.5	7.5	2.8	2.6	9.0	4.3	3.5	3.4
b) foreign net purchases (+) of U.S. corporate stocks	18.0	16.8	8.7	5.4	-7.4	*	1.0	-1.1	0.8	1.0
c) U.S. net purchases (-) of foreign securities	-5.5	-6.5	-0.7	-1.5	-2.3	-4.8	1.2	1.8	-0.9	-0.7
3. Foreign net purchases (+) of U.S. Treasury obligations	4.0	-7.3	-2.3	-2.8	0.6	7.0	5.6	5.3	0.6	2.9
Official Capital										
4. Changes in foreign official reserves assets in U.S. (+ = increase)	33.5	47.7	11.6	0.9	19.9	24.8	6.4	8.2	-4.0	0.2
a) By area										
G-10 countries (incl. Switz.)	30.8	38.8	13.2	-5.7	15.6	17.7	-0.9	1.5	-5.6	-1.7
OPEC	-8.3	-8.9	-2.0	-1.3	-2.9	-1.6	-1.6	-0.4	-0.8	-0.1
All other countries	10.8	17.8	0.5	7.9	7.1	8.6	8.9	7.2	2.4	1.9
b) By type										
U.S. Treasury securities	34.4	43.2	11.1	0.8	19.2	27.7	5.8	6.4	-3.0	-0.6
Other <2>	-1.0	4.4	0.6	0.1	0.7	-2.9	0.6	1.8	-1.1	0.8
5. Changes in U.S. official reserve assets (+ = decrease)	0.3	9.1	3.4	*	3.7	1.5	*	0.2	-0.4	n.a.
Other transactions (Quarterly data)										
6. U.S. direct investment (-) abroad <4>	-27.8	-44.5	-6.2	-7.9	-19.7	-6.4	-0.1	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S. <4>	34.1	42.0	7.2	15.0	11.7	7.3	13.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow) <3> <4>	-9.1	4.8	4.7	-1.5	-2.4	0.1	-1.9	n.a.	n.a.	n.a.
9. U.S. current account balance <4>	-138.8	-154.0	-40.9	-42.0	-33.5	-36.9	-33.3	n.a.	n.a.	n.a.
10. Statistical discrepancy <4>	15.6	18.5	13.1	-4.4	16.3	4.3	-15.7	n.a.	n.a.	n.a.
MEMO:										
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-144.5	-160.3	-39.6	-39.7	-41.2	-35.2	-29.9	n.a.	n.a.	n.a.

<1> These data have not been adjusted to exclude commissions on securities transactions and therefore, do not match exactly the data on U.S. international transactions as published by the Department of Commerce.
<2> Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
<3> 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 adjustments to the data made by the Department of Commerce and revisions of the data in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.
<4> Includes seasonal adjustment for quarterly data.
<*> Less than $50 million.
NOTE: Details may not add to total because of rounding.

added in the whole first half of 1988 (line 2b). Residents of Japan accounted for the bulk of the net purchases.

Banks reported a substantial net capital outflow in their transactions with all foreign residents in July, partially reversing the very large capital inflow reported in the second quarter. (See line 1.) However, it appears that domestic banking offices continued to bring in funds, net, from their own foreign offices and IBFs on average in July and August. (See line 1 of the International Banking Data Table.) These reductions in net claims of U.S. banking offices on their own foreign offices and IBFs in both the second quarter and the first two months of the third quarter coincided with more rapid growth of bank credit than core deposits.

Foreign official reserve assets in the United States were virtually unchanged in July. (See line 4 of the Summary of U.S. International Transactions Table.) G-10 reserves did decline,

. Partial information for August indicates additional reductions in G-10 official reserve holdings at the FRBNY (about $4 billion).

OPEC official reserves in the United States were virtually unchanged in July, after declining $3 billion in the first six months of 1988. The reserves held by other countries in the United States continued to increase.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1985	1986	1987			1988				
	Dec.	Dec.	June	Sept.	Dec.	Mar.	May	June	July	Aug. 2/
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	28.2	22.3	5.0	-7.8	-10.9	8.7	-5.6	-4.8	-7.0	-14.5
(a) U.S.-chartered banks	32.4	31.7	16.3	12.6	15.2	27.8	17.4	17.0	14.6	8.0
(b) Foreign-chartered banks	-4.2	-9.4	-11.3	-20.3	-26.1	-19.0	-23.0	-21.8	-21.6	-22.5
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	18.7	16.8	15.6	17.1	15.8	19.1	20.0	19.7	18.8	20.1
3. Eurodollar Holdings of U.S. Nonbank Residents <1>	111.1	124.5	135.7	141.1	132.6	128.9	135.5	138.1	137.8	142.2

<1> Includes term and overnight Eurodollars held by money market mutual funds.
<2> Through August 29, 1988.
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.

Data released September 13 by the Department of Commerce indicate a sharp increase in foreign direct investment in the United States (line 7) from $7 billion in the first quarter of 1988 to $13 billion in the second quarter. Much of the total was accounted for by acquisitions of U.S. companies. U.S. direct investment abroad (line 6) declined to virtually zero in the second quarter from an outflow of $6 billion in the first quarter. There were continued sales of assets abroad by Texaco and repayments of several large loans by foreign affiliates of other companies. In addition, reinvested earnings were depressed by a $3 billion swing from capital gains to losses associated with the appreciation of the dollar. The statistical discrepancy in the U.S. international transactions accounts (line 10) shifted from $4 billion of unrecorded credits in the first quarter to -$16 billion in the second. Alternative data sources indicate that unreported increases in U.S. nonbanks' holdings of Eurodollar deposits accounted for part of the omitted outflows.

Foreign Exchange Markets

Since the most recent FOMC meeting on August 16, the weighted-average foreign-exchange value of the dollar in terms of other G-10 currencies has moved down on balance about 1/4 percent, as shown in Chart 1. The dollar has declined most against the mark and other related European currencies, about 1 percent; against the yen, the dollar rose about 1/2 percent on balance. In the early part of the intermeeting period the dollar moved up

, as market participants continued to focus on signs

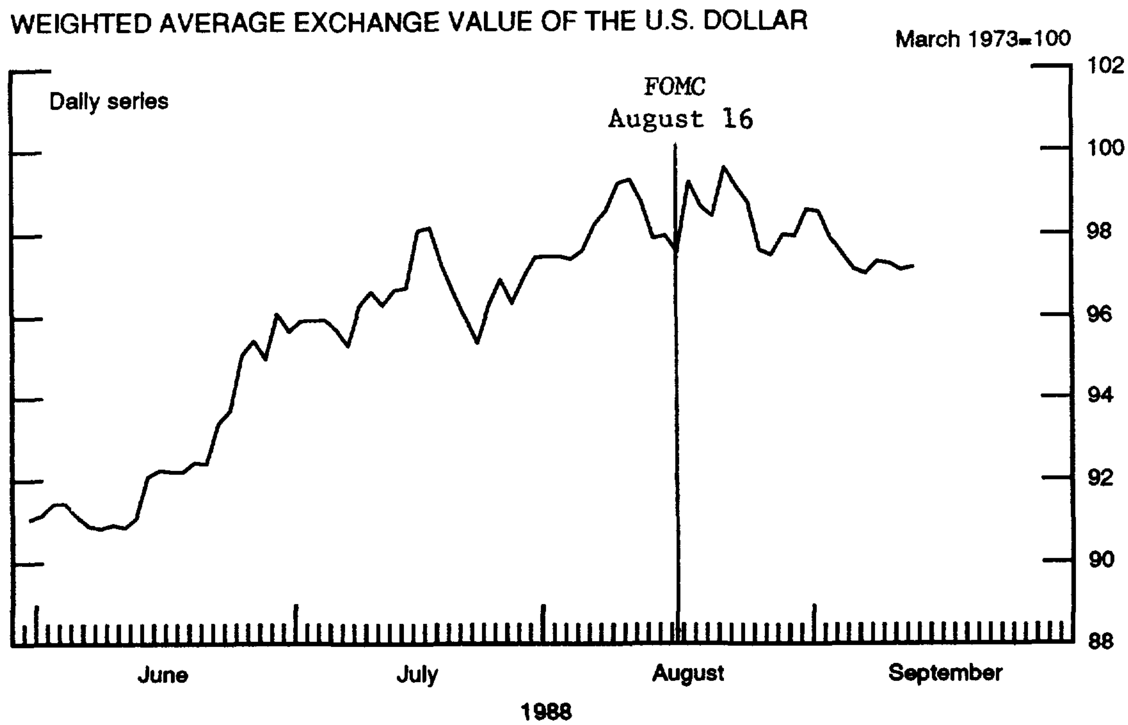


Table 1

Selected Official and Market Interest Rates

	August 16	September 13
Germany		
Discount	3.00	3.50
Lombard	5.00	5.00
28-day RP	4.25	4.25
3-month interbank	5.35	4.95
France		
Money-market intervention	6.75	7.00
Seven-day RP	7.50	7.75
3-month interbank	7.44	7.63
Italy		
Discount	12.00	12.50
3-month interbank	11.00	11.38
United Kingdom		
Money-market dealing	10.88	11.88
3-month interbank	11.38	12.00
Japan		
Discount	3.00	3.00
2-month bill discount	4.06	4.19
3-month gensaki	3.98	4.16
Canada		
Discount	9.80	10.35
3-month interbank	10.00	10.42

of strength in U.S. demand and the likelihood of further U.S. tightening. Dollar strength was particularly evident against the mark, as the dollar-mark rate briefly reached 1.92 DM/$, and the mark-yen cross rate fell below 70 Y/DM. The dollar more than reversed these early gains in the latter part of the period following increases in foreign official interest rates and release of U.S. employment data for August that indicated somewhat weaker U.S. activity. The dollar moved up sharply following the release on September 14 of U.S. trade figures for July which showed a smaller than expected deficit of $9-1/2 billion.

During the period, short-term interest rates on average moved slightly against the dollar as many foreign interest rates moved up more than did interest rates on dollar assets. An exception was Germany where market short-term interest rates declined on balance by 40 basis points. On August 25, the Bundesbank announced a 1/2 percentage point increase in the German discount rate to 3-1/2 percent, and German officials indicated that further decline in the mark would be resisted. Even though the Lombard rate was not increased as some market participants had anticipated and the Bundesbank continued to provide liquidity at an unchanged RP-rate of 4-1/4 percent, the mark began to strengthen, and German short-term market interest rates eased back from high levels reached in a run-up earlier in the quarter.

The German discount rate change, as shown in Table 1, was accompanied by similar increases in official rates in other European countries including a 1/2 point increase in the Italian and Swiss discount rates and a 1/4 percentage point increase in the Dutch discount rate, the French money market intervention rate, and the French 7-day RP rate. U.K. money market dealing rates and base lending rates also were raised by a full percentage point at about this time to combat inflation and downward pressure on sterling. Japanese short-term interest rates increased about 20 basis points during the intermeeting period, as Japanese authorities allowed the key 2-month bill discount rate to edge upward. Long-term interest differentials against the major currencies remained about unchanged.

. Of this amount about $1.3 billion was sales by the Desk against marks, divided equally between sales for System and Treasury accounts.

. Pressures within the EMS intensified during the period, particularly in recent weeks as the mark strengthened;

.

Developments in the Foreign Industrial Countries

After widespread strength in the first quarter, economic activity slackened in the second quarter, as performances of the major foreign industrial nations diverged. In Germany, real GNP declined slightly in the second quarter. Industrial production, housing starts, and export volume fell in Japan, and comments by government officials indicate that real GNP is likely to have fallen there as well. French growth slowed to a moderate pace. In contrast, real GDP accelerated in Canada and the United Kingdom in the second quarter. On balance during the first half of the year, real growth was fairly strong in the major foreign industrial countries, and available data for the third quarter generally indicate continued expansion.

Germany recorded another peak trade surplus in June, while Japan's trade surplus narrowed in August. In Germany, the cumulative trade surplus for the first half of the year was considerably above the surplus for the first half of 1987. In contrast, the United Kingdom registered record trade and current account deficits in July and has recorded cumulative deficits that are already much larger than last year's totals.

Although inflation remains low in most of the major foreign industrial nations, it has risen somewhat in recent months, especially in the United Kingdom. Recent concerns about overheating, renewed inflationary pressures, and/or unwelcome declines in the exchange value of their currencies led several monetary officials to raise interest rates. On August 25, the Bundesbank raised its discount rate by 1/2 percentage point and other European central banks, including the French and Italian monetary authorities, followed suit. On the same day, the Bank of England raised its money market dealing rate by a full

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

	Q4/Q4 1986	Q4/Q4 1987	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 Mar.	1988 Apr.	1988 May	1988 June	1988 July	Latest 3 months from year ago 2/
Canada												
GDP	1.2	6.1	1.5	1.6	.8	1.0	*	*	*	*	*	4.9
IP	-.3	8.5	2.5	2.5	1.3	.8	-.1	.0	1.2	.2	n.a.	7.4
France												
GDP	2.0	2.7	.8	.7	1.0	n.a.	*	*	*	*	*	3.5
IP	-.3	3.6	.6	1.0	.6	.3	.0	-.9	1.0	1.9	n.a.	2.6
Germany												
GNP	2.4	2.3	1.4	.7	1.3	-.2	*	*	*	*	*	3.3
IP	.6	1.7	.1	.7	1.1	.3	-.7	-.7	.3	2.9	-2.2	2.9
Italy												
GDP	3.0	2.8	.9	.3	.9	n.a.	*	*	*	*	*	3.1
IP	2.8	5.7	-2.8	3.3	2.7	2.0	.3	9.8	-9.6	1.6	n.a.	5.1
Japan												
GNP	2.0	5.5	2.0	1.8	2.7	n.a.	*	*	*	*	*	6.7
IP	-.6	8.1	3.6	3.4	3.2	-.2	.5	-.9	-2.3	3.3	-.7	9.3
United Kingdom												
GDP	4.4	4.3	1.9	.7	.7	n.a.	*	*	*	*	*	4.0
IP	2.3	4.1	1.5	1.0	-.7	2.4	2.0	1.5	.9	-.9	.4	3.9
United States												
GNP	2.0	5.0	1.1	1.5	.8	.8	*	*	*	*	*	4.3
IP	1.0	5.8	2.1	1.7	1.0	1.1	.2	.5	.5	.4	.8	5.8

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

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

	Q4/Q4 1986	Q4/Q4 1987	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 May	1988 June	1988 July	1988 Aug.	Latest 3 months from year ago
Canada													
CPI	4.3	4.2	.9	1.4	1.2	.7	.8	1.3	.6	.1	.6	n.a.	3.9
WPI	.3	4.3	.5	1.3	1.4	1.1	1.1	.8	.4	.2	.2	n.a.	4.1
France													
CPI	2.1	3.2	1.2	.9	.6	.5	.5	1.0	.2	.3	.3	n.a.	2.6
WPI	-3.4	2.6	.7	.3	.5	1.0	1.1	n.a.	*	*	*	*	2.9
Germany													
CPI	-1.0	1.0	.6	.4	.0	.0	.5	.5	.2	.2	-.1	.0	1.0
WPI	-9.0	-.7	-.2	.0	-.4	-.2	.1	1.1	.3	.9	-.5	.2	1.1
Italy													
CPI	4.7	5.2	1.3	1.0	1.1	1.7	1.1	1.0	.3	.3	.3	.4	4.9
WPI	-2.4	4.6	1.5	1.0	.8	1.2	1.1	1.3	.5	.3	.2	n.a.	4.5
Japan													
CPI	.1	1.1	-.3	1.2	-.2	.4	-.2	.6	-.1	-.2	-.1	-.1	.7
WPI	-9.1	-.6	-.7	-.7	1.3	-.4	-1.2	-.3	-.1	.3	.6	.1	-.8
United Kingdom													
CPI	3.4	4.1	1.2	1.5	.2	1.1	.5	2.4	.4	.4	.1	n.a.	4.5
WPI	4.2	3.9	1.2	1.1	.5	1.1	1.3	1.5	.3	.3	.1	.4	4.6
United States													
CPI (SA)	1.3	4.4	1.3	1.2	.9	.9	.8	1.2	.3	.3	.4	n.a.	4.0
WPI (SA)	-1.9	2.5	.7	1.1	.7	.0	.2	1.1	.4	.4	.5	.6	2.5

1. Asterisk indicates that monthly data are not available.

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

	1986	1987	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 May	1988 June	1988 July	1988 Aug.
Canada												
Trade	7.1	8.3	2.4	2.1	2.3	1.6	2.1	2.5	.6	1.4	n.a.	n.a.
Current account	-6.7	-8.0	-1.4	-1.9	-2.1	-2.6	-1.3	-1.8	*	*	*	*
France												
Trade	.1	-5.2	-1.1	-2.0	-1.0	-1.0	-.7	-1.0	-.3	-.3	-.6	n.a.
Current account	3.0	-4.1	-.1	-.8	-.9	-2.3	1.3	n.a.	*	*	*	*
Germany												
Trade (NSA)	52.5	65.9	15.1	15.5	15.2	20.1	15.0	19.8	6.1	8.1	n.a.	n.a.
Current account (NSA)	39.7	45.4	11.4	10.9	7.8	15.3	8.6	15.1	4.5	5.5	n.a.	n.a.
Italy												
Trade	-1.9	-8.9	-1.0	-2.8	-2.7	-2.5	-2.8	n.a.	-.2	n.a.	n.a.	n.a.
Current account (NSA)	2.6	-1.1	-2.3	1.1	1.6	-1.6	-5.1	n.a.	*	*	*	*
Japan												
Trade	82.4	79.5	23.8	19.5	17.8	18.3	20.8	16.7	5.1	5.2	6.2	5.5
Current account 2/	85.8	87.0	25.3	21.3	19.9	20.5	23.1	17.6	6.0	5.2	4.9	n.a.
United Kingdom												
Trade	-12.4	-15.9	-1.7	-3.9	-5.0	-5.3	-7.1	-8.2	-3.1	-2.7	-4.5	n.a.
Current account	.1	-3.0	1.2	-.5	-1.4	-2.3	-5.1	-5.4	-2.2	-1.8	-3.7	n.a.
United States												
Trade 2/	-144.5	-160.3	-39.9	-39.6	-39.7	-41.2	-35.2	-29.9	*	*	*	*
Current account	-138.8	-154.0	-37.6	-40.9	-42.0	-33.5	-39.8	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.

percentage point. The Bank of Canada has increased its key rates about 80 basis points in the last month.

Individual country notes. In Japan, economic activity slowed dramatically in the second quarter. The average level of industrial production (s.a.) was down slightly from its first-quarter average, while housing starts continued to fall sharply. In addition, export volume (s.a.) fell 3.1 percent from the first quarter. Although second-quarter GNP data have not yet been released, EPA officials have commented that real GNP may have declined, reversing some of the vigorous growth in the previous quarter.

Economic activity may be rebounding in the third quarter, although data for July provide a mixed picture: industrial production (s.a.) declined 0.7 percent after a 3.3 percent increase in June, but remained above the second-quarter average level. Housing starts (s.a.) fell 0.4 percent, but retail sales (s.a.) rose 1.5 percent. Export volume increased, and import volume declined. Unemployment (s.a.) increased from 2.4 percent in June to 2.5 percent in July, but the ratio of job-offers-to applicants continued to rise. For the first time in 14 years, job offers exceeded job seekers in June and July. Recent data on new machinery orders also suggest continued strength in investment, as private orders rose 25 percent (s.a.) in the second quarter. Consumer price inflation remains low, with the Tokyo index of consumer prices (n.s.a.) in August 0.6 percent above a year ago. Wholesale prices (n.s.a.) were 1.0 percent below year-earlier levels in August.

The trade surplus widened in July, but then narrowed in August to a level about equal to the second-quarter average. The cumulative trade surplus for the first eight months of 1988 was $73.9 billion (s.a.a.r.) compared with $79.5 billion for 1987 as a whole. The current account surplus through July was $78.2 billion (s.a.a.r.) compared with $87 billion in 1987.

Real GNP in Germany declined in the second quarter after unusually strong growth in the first. Following a surge in the first quarter due to unseasonably mild weather, construction activity (s.a.) declined 3.7 percent in the second quarter, and on balance grew 6.3 percent (s.a.a.r.) since the fourth quarter of 1987. Private consumption expenditures declined 2.2 percent (s.a.a.r.), while government spending increased 3.4 percent (s.a.a.r.) in the second quarter. Net exports increased sharply. More recent indicators suggest weakness in the third quarter. Industrial production (s.a.) declined 2.2 percent in July, offsetting most of June's surge. The volume of total new manufacturing orders (s.a.) was flat in July after increasing 1 percent in June as domestic orders rose 3 percent, but foreign orders declined 2 percent. In addition, the business sentiment index declined in July after increasing six months consecutively. In August, the unemployment rate was 8.9 percent (s.a.), unchanged from the rate for the previous four months.

Consumer prices were flat in August after declining 0.1 percent in July, resulting in year-over-year inflation of 1.1 percent. Wholesale prices increased 0.2 percent in August, to a level 1.0 percent above last August's level.

The trade surplus (n.s.a.) increased sharply in June to $8.1 billion, bringing the cumulative surplus to $34.9 billion, up from the surplus of $30.6 billion over the same period in 1987. The current account surplus (n.s.a.) also rose in June to a record high of $5.5 billion boosting the cumulative surplus to $23.7 billion, compared with a $22.3 billion surplus in the first half of last year.

Growth in the average level of M3 in July was 2.6 percent (s.a.a.r.), a dramatic slowdown from an average growth rate of 7.7 percent during the last six months. The average level of M3 in July stood 6.8 percent above the target base period of 1987-Q4, exceeding the target range of 3 to 6 percent set for this year. On August 25th the Bundesbank increased its discount rate 50 basis points to 3-1/2 percent, while leaving the repurchase rate unchanged at 4-1/4 percent.

In <u>France</u>, real marketable GDP grew by 2.4 percent (s.a.a.r.) in the second quarter after expanding at a 4.9 percent rate in the previous quarter. Consumption expenditures fell slightly, while gross fixed capital formation surged, in part due to increased housing starts. Consumer prices rose 0.3 percent in July, bringing the 12-month inflation rate to 2.7 percent which forced the government to concede that it would not meet its 2.5 percent target.

The foreign trade deficit widened in July as a 1 percent fall in imports was accompanied by a 3 percent decline in exports. Despite this recent deterioration, the cumulative trade deficit through July of $2.3

billion represents an improvement from the $3.6 billion deficit registered for the first seven months of last year.

In the United Kingdom, recent data have provided further evidence of overheating. The output measure of real GDP increased by 5.3 percent (s.a.a.r.) in the second quarter after rising by 2.7 percent in the first. The volume of retail sales (s.a.) showed a 12-month increase of 6.3 percent in August, while the unemployment rate declined to 8.2 percent (s.a.) in July, the 24th consecutive monthly decline. Industrial production rose 0.4 percent (s.a.) in July to a level 3.5 percent above that of a year ago. Consumer price inflation in the 12 months through July rose to 4.8 percent, the fifth consecutive monthly increase in this rate. In August, producer prices rose to a level 4.8 percent above their year-ago level.

The trade and current accounts both showed record deficits in July. The cumulative trade deficit through July was $33.9 billion (s.a.a.r.), nearly triple the $12.4 billion deficit rate in the same period last year. On August 25, U.K. monetary authorities raised their money market dealing rates by one percentage point to 11-7/8 percent just after the release of the July trade figures.

Real GDP in Canada expanded at an annual rate of 3.9 percent in the second quarter, up from the 3.2 percent rate posted in the first quarter of 1988. Consumer spending rebounded and rose 0.9 percent after falling 0.1 percent in the first quarter of the year. Non-residential investment and exports continued to be buoyant. Both industrial production and monthly GDP reports showed lower growth rates in June than they had in May, suggesting that, at least in the near term, growth may have peaked. In addition, the unemployment rate rose to 8.0 percent in August from a second-quarter average rate of 7.7 percent. Consumer prices increased 0.6 percent in July; the year-over-year inflation rate was 3.8 percent. Producer prices held steady, increasing 0.2 percent in July to a level 3.7 percent above last July.

Canada's trade surplus increased slightly in June from May and April, resulting in a cumulative first-half surplus a bit higher than in the first half of 1987. On August 31, Canada's House of Commons passed legislation to implement the proposed free trade agreement with the United States and sent the bill to the Canadian Senate for approval.

In Italy, recently released data indicate that the strong growth recorded in 1987 continued in the first quarter of 1988; real GDP rose to a level 3.1 percent above the first quarter of last year. The major source of this strength was investment spending, which grew 6.6 percent from its level a year ago. Italy's current account deteriorated considerably in the first quarter; the deficit of $5.1 billion was more than twice the size of that in the first quarter of 1987. However, recently released trade data for April and May indicate that the deficit may be smaller in the second quarter. The cumulative trade deficit through May was $3.4 billion compared with a deficit of $2.5 billion in the same period of 1987.

Economic Situation in Major Developing Countries

In Brazil a new constitution has been completed and the successful syndication to creditor banks of a financing package brought about final

IMF Executive Board approval of a stand-by loan agreement. The Mexican government announced on August 14 that the freeze on the exchange rate, public sector prices, controlled private-sector prices, and minimum wages would be extended through November. An incomes policy implemented in August appears to have temporarily reduced inflation in Argentina. Venezuela's foreign exchange reserves fell by $440 million in July. Nigeria has reached a preliminary agreement on a rescheduling with its commercial bank creditors. Ecuador and Peru announced anti-inflation programs which include devaluations and domestic price increases.

Individual country notes. Brazil's new constitution has been completed and goes into effect on October 5. Under this constitution all major budgetary and financial decisions, including future agreements with the IMF and foreign banks, must be approved by the legislature--greatly increasing the difficulty of future negotiations.

By August 18, foreign banks had committed 95 percent of $5.2 billion in new money proposed for Brazil. The achievement of this critical mass of financing permitted formal IMF Executive Board approval of an SDR 1.1 billion stand-by agreement on August 23. Brazil and the banks are expected to sign their agreement by the end of September.

Consumer prices rose 21 percent in August, following a 24 percent increase in July. Turmoil in the financial markets, due to the inclusion of a 12 percent real interest rate cap in the new constitution and to increased taxes on short-term investments, sharply intensified the demand for dollars. As a result, the spread between the parallel and official dollar rates jumped from about 50 percent in August to 75 percent at the beginning of September.

Increased exports of manufactured goods resulted in a trade surplus for the first seven months of this year of $10.5 billion, more than double the $4.9 billion registered for the same period in 1987. The expansion of exports contributed to positive growth of industrial production, which was 1.5 percent higher in June than a year before.

The Mexican government announced on August 14 that the freeze on the exchange rate, public sector prices, controlled private-sector prices, and minimum wages would be extended through November. To gain organized labor's support, the government agreed to eliminate the value added tax on processed foods and medicines and to reduce income taxes by 30 percent for individuals earning up to 4 times the minimum wage. Business leaders pledged to reduce prices by an average of 3 percent.

This announcement helped to quiet the foreign exchange market, where nervousness had prevailed for several weeks, and the outflow of capital underway since late May appears to have abated somewhat.

The trade surplus is continuing to shrink. In June it was about $300 million, less than one-third as large as in June 1987. Imports exceeded $1.6 billion, the highest level since March 1982, and were 64 percent higher than in June 1987, while exports were nearly 3 percent lower than a year earlier. Non-petroleum exports in June 1988 were 11 percent higher than in the same month in 1987, but oil exports were 25 percent lower, owing to weaker oil prices.

The CPI, which had increased by 1.7 percent in July, rose by only 0.9 percent in August, the smallest monthly increase since April 1978. Interest rates have changed little since early June, after their dramatic decline of the previous four months. The nominal annual rate on 28-day Treasury bills at the September 6 auction was 41.8 percent. This is slightly higher than at the June 7 auction (40.3 percent), but much lower than on February 23 (151.7 percent).

The incomes policy implemented in early August in Argentina appears to have at least temporarily reduced the rate of inflation. Inflation is projected to fall to about 10 percent for September--down sharply from the average monthly rate of 27 percent for July and August. However, it remains uncertain whether the government will achieve the fiscal reform necessary to translate these gains into a permanent reduction in the inflation rate. Recent private sector wage agreements have been relatively generous; for example, the metal workers' union was able to negotiate a 47 percent wage increase for August/September. But so far industrialists seem to be adhering to price agreements with the government despite increasing costs.

The Central Bank has been selling dollars through daily auctions since early August. So far, demand has been weak as sales of dollars in the free market have kept the austral price of dollars near the Central Bank's minimum asking price of 14.4 australs. Interest rates on interfirm and interbank loans have stayed around 10 percent on a monthly basis since early August.

Due to the postponement of projected dates of effectiveness for World Bank loans, disbursement of the $500 million U.S. Treasury and Bank for International Settlements bridge loan that was agreed to in principle in August has also been delayed.

In Venezuela, the government has failed to adjust to falling oil prices and rising world interest rates, leading to a widening of the current account deficit and a more rapid draw-down of foreign exchange reserves. In July total reserves minus gold dropped $440 million to $4.5 billion; reserves were $6 billion at the beginning of 1988. The Venezuelan government met with some of its commercial bank creditors last month to discuss the possibility of new long-term loans to help stem this loss of reserves.

Consumer prices rose 2.4 percent in August and stood 28 percent higher than a year ago. Unusually favorable food supply conditions helped to keep average monthly inflation for the first five months of 1988 down to 0.4 percent, but recent food price increases have pushed the CPI up an average of 4 percent per month over the last three months.

Nigeria has reached preliminary agreement with its creditor banks to reschedule $2.9 billion in principal payments due 1986-91 over 20 years with three years grace at a spread of 7/8 over LIBOR. The agreement also reschedules $2.45 billion in letter-of-credit principal arrears over 15 years with three years grace at a spread of 13/16 over LIBOR and $381 million in interest arrears and commissions over 1989-91. The rescheduling provides no new money and is not subject to IMF conditionality.

Newly elected President Rodrigo Borja of Ecuador announced a series of measures to contain inflation and improve the current account balance. The measures include: a 56 percent devaluation of the official exchange rate, a 5 percent surtax on all import and export transactions, a doubling of gasoline prices, a cap on domestic lending rates of interest, and a compensatory increase in the minimum wage.

Peru announced a new program to control inflation, which reached 22 percent in August. The multiple exchange rate system will be unified with the primary export rate devalued by 47.5 percent. As subsidies are reduced to help close the fiscal deficit, the cost of gasoline will increase almost 400 percent and the price of basic food items will double. A compensating increase in the minimum wage is planned, and wages and prices are to remain fixed for 120 days.

The Philippines met its end-June 1988 economic performance targets, the central bank announced on August 31. This allowed the country to draw the seventh and last tranche under an SDR 198 million IMF stand-by.