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Confidential (FR) Class III FOMC

August 16, 1989

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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Economic activity appears to be expanding at a moderate pace. Private payrolls increased appreciably in July, and the unemployment rate remained around 5-1/4 percent. Consumer spending evidently was not so sluggish in the second quarter as previously had been thought and is estimated to have picked up somewhat in early summer. Residential building activity has revived a bit, buoyed by a decline in financing costs. Meanwhile, wage inflation appears to have leveled off, and consumer prices have begun to decelerate with a reversal of the earlier upswing in oil prices.

Labor Markets

Hiring remained strong around midyear. In July, private payroll employment rose 204,000 on a strike-adjusted basis, while job growth in June was revised upward to 256,000 (also strike adjusted).[1] These gains, like those in April and May, were smaller, on average, than those over the preceding six months, but they still were well above the pace consistent with economic growth at its potential rate. Almost all of the job increase in July occurred in the service-producing sector, where especially large gains were posted in health services and retail trade. Employment also was up sharply in the construction industry, where hiring had slowed during the first half of the year. In contrast, employment in manufacturing was essentially flat in July after three months of declines. Employment in the auto industry fell 10,000 in July, bringing the total number of layoffs since May to 30,000. In part, these declines reflect earlier-than-usual shutdowns for model changeover; seasonally adjusted employment may retrace

1. Strikes at eastern coal mines held down payroll growth by about 10,000 in both June and July.

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

	1987	1988	1988 Q4	1989 Q1	1989 Q2	1989 May	1989 June	1989 July
	---------------	------	Average	Monthly	Changes	------	------	---------------
Nonfarm payroll employment[2]	268	276	297	264	224	209	250	169
Strike-adjusted	265	275	291	274	229	210	261	179
Private	241	248	279	239	192	148	245	194
Strike-adjusted	238	248	274	250	198	151	256	204
Manufacturing	29	29	53	30	-8	-5	-12	3
Durable	16	20	34	13	-12	-6	-27	-18
Nondurable	13	9	19	17	4	1	15	21
Construction	15	14	17	13	10	4	-2	37
Trade	61	64	65	77	31	55	27	57
Finance and services	122	128	130	107	143	74	223	85
Total government	27	27	17	25	32	61	5	-25
Private nonfarm production workers	199	197	223	202	143	111	215	153
Manufacturing production workers	25	20	41	19	-12	-4	-21	22
Total employment[3]	257	189	213	376	135	102	326	-82
Nonagricultural	252	191	207	371	172	93	343	-205

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	1988 Q4	1989 Q1	1989 Q2	1989 May	1989 June	1989 July
Civilian, 16 years and older	6.2	5.5	5.3	5.2	5.3	5.2	5.3	5.2
Teenagers	16.9	15.3	14.6	15.0	15.1	15.2	15.6	14.7
20-24 years old	9.7	8.7	8.7	8.4	8.3	7.7	8.9	8.6
Men, 25 years and older	4.8	4.2	4.1	4.0	3.9	3.7	3.7	3.7
Women, 25 years and older	4.8	4.3	4.2	4.0	4.3	4.4	4.4	4.4
White	5.3	4.7	4.6	4.4	4.5	4.4	4.5	4.6
Black	13.0	11.7	11.3	11.6	11.2	11.0	11.9	10.9
Fulltime workers	5.8	5.2	5.0	4.9	4.9	4.8	4.8	4.9
Memo:								
Total National[1]	6.1	5.4	5.3	5.1	5.2	5.1	5.2	5.2

1. Includes resident armed forces as employed.

some of these losses in coming months as automakers begin production of the 1990 models.

Readings on labor demand in the July household survey were mixed. The unemployment rate remained at 5-1/4 percent in July and has changed little, on net, since the beginning of the year. A straightforward interpretation of this continued flatness would be that the economy is growing at roughly its potential rate. Other indicators of continued growth in labor demand in July include a third consecutive monthly decline in the number of individuals involuntarily employed part-time and a continuation of the labor force participation rate at a high level. However, signs of slowing were evident in higher numbers of job losers and individuals unemployed for 15 weeks or longer.

Average hourly earnings--the most current information on wages--jumped 3/4 percent in July after showing little change in May and June. Smoothing through the monthly fluctuations, however, growth in average hourly earnings remains in the neighborhood of 4 percent at an annual rate. Compensation per hour, as measured by the more-comprehensive employment cost index, rose 4-1/2 percent over the twelve months ending in June; this 12-month change has been relatively stable since mid-1988. Increases in benefit costs continued to outstrip gains in wages and salaries, led by further increases in health care costs; excluding health insurance, benefit costs rose only 3-3/4 percent over the twelve months ending in June. The growth in benefits appears to have leveled off in the goods-producing sector, while a further acceleration is evident in service-producing industries.

Relative to their pace in the second half of 1988, increases in ECI wages and salaries (on a 12-month basis) picked up a bit in the first six

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

	1987	1988	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 July
							Monthly
Employment cost index[1]							
Compensation, all persons	3.3	4.9	3.9	4.8	4.5	4.7	--
By occupation:							
White collar	3.7	5.0	4.3	5.7	5.5	4.8	--
Blue collar	3.1	4.4	2.8	3.8	3.5	4.6	--
Service workers	2.4	5.3	5.3	4.8	3.9	4.2	--
By sector:							
Goods-producing	3.1	4.4	2.9	3.5	3.6	4.3	--
Service-producing	3.7	5.1	4.3	5.9	5.5	5.1	--
By bargaining status:							
Union	2.8	3.9	3.1	2.4	2.6	4.1	--
Nonunion	3.6	5.1	4.2	5.8	5.2	4.7	--
Wages and salaries, all persons	3.3	4.1	3.7	5.0	3.9	3.9	--
Benefits, all persons	3.5	6.8	4.1	4.9	7.0	6.4	--
Labor costs and productivity, all persons[2]							
Nonfarm Business Sector							
Output per hour	2.5	1.7	3.4	1.9	-1.3	.2	--
Compensation per hour	4.0	4.9	5.5	5.9	4.8	5.5	--
Unit labor costs	1.5	3.1	2.0	3.9	6.2	5.2	--
Manufacturing							
Output per hour	3.8	3.7	5.2	2.3	2.1	2.4	--
Compensation per hour	2.4	5.3	4.9	5.9	3.1	2.5	--
Unit labor costs	-1.4	1.5	-.3	3.5	1.0	.1	--
Major collective bargaining agreements[3]							
First-year wage adjustments	2.2	2.5	2.5	2.6	3.2	3.7	--
Total effective wage change	3.1	2.6	2.9	2.6	2.7	2.8	--
Average hourly earnings, production workers[2]							
Total private nonfarm	3.0	3.7	3.5	4.4	3.6	4.0	.8
Manufacturing	2.3	3.0	2.7	3.4	2.6	2.2	.3
Services	4.7	4.9	4.9	5.2	5.4	6.1	1.3
Hourly earnings index, wages of production workers[4]							
Total private nonfarm	2.6	3.5	2.9	4.1	3.0	3.7	.7

1. Changes are from final month of preceding period to final month of period indicated at a compound annual rate. The data are seasonally adjusted by FRB staff.
2. Changes over periods longer than one quarter are measured final quarter of preceding period to final quarter of period indicated at a compound annual rate. Seasonally adjusted data.
3. Agreements covering 1,000 or more workers; not seasonally adjusted. The numbers reported are cumulative averages from the beginning of the year through the indicated quarter.
4. Values for the HEI after 1988 were produced by FRB staff.

EMPLOYMENT COST INDEX
(Private industry workers; 12-month percent changes)

	1987	1988				1989	
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June
Total compensation costs:							
Private industry workers	3.3	3.9	4.5	4.5	4.9	4.6	4.5
By industry:							
Goods-producing	3.1	4.4	4.8	4.5	4.4	3.5	3.6
Service-producing	3.7	3.6	4.3	4.4	5.1	5.3	5.2
Wages and salaries:							
Private industry workers	3.3	3.3	3.7	3.7	4.1	4.2	4.1
By industry:							
Goods-producing	3.2	3.5	3.8	3.3	3.1	3.1	3.2
Manufacturing	3.4	3.6	3.8	3.3	3.0	3.1	3.3
Construction	3.2	3.5	4.0	3.9	3.8	3.6	3.1
Service-producing	3.5	3.1	3.7	3.9	4.7	5.1	4.7
Finance, insurance, and real estate	1.2	-.4	2.6	2.4	6.3	7.4	7.6
Services	5.4	4.8	4.9	4.8	5.0	5.2	5.3
Benefits:							
Private industry workers	3.5	5.8	6.4	6.7	6.8	5.4	5.6
By industry:							
Goods-producing	2.9	6.4	7.0	7.2	7.1	4.6	4.5
Service-producing	4.0	5.3	5.8	6.1	6.6	6.1	6.7

GROWTH IN SELECTED COMPONENTS OF INDUSTRIAL PRODUCTION
(Percent change from preceding comparable period)

	1987[1]	1988[1]	1989 Q1	1989 Q2[r]	1989 May[r]	1989 June[r]	1989 July[e]
			-Annual rate-		----Monthly rate----		
Total Index	5.8	5.0	2.1	2.6	-.1	-.1	.2
Previous	5.8	5.0	2.1	2.1	-.1	-.2	
Ex. motor vehicles	5.9	4.9	2.3	3.3	.0	.0	.4
Products	4.9	5.4	4.3	4.1	.1	.1	.0
Consumer goods	3.2	6.0	4.1	2.6	-.2	.1	-.4
Motor vehicles	4.4	8.8	.0	-6.1	-2.2	-1.9	-4.5
Ex. motor vehicles	3.0	5.6	4.6	3.7	.1	.4	.1
Durables excluding motor vehicles	4.0	3.9	5.0	6.1	.4	.5	-1.1
Nondurable goods	2.8	6.0	4.5	3.2	.0	.3	.4
Business equipment	7.0	8.3	9.6	8.8	.7	.0	.2
Motor vehicles	3.9	10.7	-14.1	-12.3	-3.8	-2.6	-8.1
Computers	9.4	8.7	28.6	18.4	.3	-1.1	.2
Other	6.4	8.0	5.5	7.2	1.2	.7	.9
Defense and space	1.9	-3.7	-6.2	2.8	.5	.2	.3
Construction supplies	4.7	5.2	-1.0	-1.7	-.6	.4	-.4
Materials	7.2	4.6	-1.3	.3	-.4	-.4	.5
Durable	8.0	6.9	-1.7	-.3	-.4	-.1	.5
Consumer durable parts	1.8	9.0	-3.9	-2.0	1.0	-1.6	-.8
Equipment parts	6.3	6.8	1.3	4.4	.2	.0	.9
Basic metals	21.3	3.6	-9.2	-9.9	-4.1	1.6	1.9
Nondurable	8.1	4.1	3.0	2.6	.0	.3	.6
Energy	4.5	-.1	-5.2	-.9	-1.0	-1.8	.2

1. From the fourth quarter of the previous year to the fourth quarter of the year indicated.
r--revised
e--estimated

months of 1989, owing mostly to larger increases in the service-producing sector (table). Wages and salaries continued to grow rapidly in finance, insurance, and real estate, where gains in late 1987 and early 1988 were held down in the wake of the stock market crash. In addition, wages in the service industry, where employment growth has been strong, were up 5-1/4 percent. In the goods-producing sector, growth in wages and salaries was unchanged from its pace in the second half of last year.

Output per hour in the nonfarm business sector is estimated to have been virtually unchanged in the second quarter after declining in the first quarter. The weakness in productivity growth in the first half of this year is not surprising given the sharp slowing in output growth, and it seems consistent with the normal adjustment lags between changes in production and aggregate hours. A similar pattern is evident in manufacturing, where the rise in productivity over the first half--2 percent at an annual rate--was below the 3-1/2 percent trend observed during the 1980s.[2]

Industrial Production

Total industrial production increased 0.2 percent in July, after slipping 0.1 percent in May and June. Although IP has shown an erratic pattern in recent months, in part owing to swings in output of motor vehicles, on balance production appears to be rising at a moderate pace: about 2-1/2 percent at an annual rate.

2. Productivity data were revised by the BLS, as is the case each year, to reflect the new NIPA estimates of output. Productivity also was redefined to reflect a change in the hours concept from hours paid to hours actually worked. Although the redefinition raised the overall level of productivity since 1947 by 5 to 10 percent, revisions to the trend in productivity growth were small. Revised data indicate that productivity in 1988 was a bit stronger than previously estimated at 1.7 percent in the nonfarm business sector and 3.7 percent in manufacturing.

CAPACITY UTILIZATION IN INDUSTRY[1]
(Percent of capacity; seasonally adjusted)

	1967-88 Ave.	1973 Ave.	1978-79 Ave.	1988 July	1989 May	1989 June	1989 July
Total industry	81.6	87.9	85.0	83.7	83.9	83.6	83.6
Manufacturing	80.7	87.0	84.4	84.0	84.2	84.0	83.9
Primary processing	82.0	91.3	86.3	87.8	86.1	85.9	86.3
Advanced processing	80.2	85.1	83.3	82.2	83.4	83.1	82.8
Durable manufacturing	78.8	86.2	83.5	82.3	82.8	82.6	82.3
Primary metals	79.9	96.6	87.8	89.5	83.8	84.0	85.3
Iron and steel	79.0	97.9	88.2	89.7	80.8	80.8	82.4
Nonferrous metals	81.5	94.2	87.1	89.3	87.8	88.3	89.1
Fabricated metal products	78.0	84.0	84.6	83.8	83.6	83.3	83.3
Nonelectrical machinery	78.2	86.6	83.2	82.4	86.6	86.4	86.6
Motor vehicles & parts	78.2	94.5	83.6	81.5	82.5	80.2	76.2
Autos	76.1	89.3	81.7	71.4	73.1	69.6	61.8
Aerosp. & misc. trans. eq.	78.1	75.4	77.6	86.7	87.4	87.9	89.0
Nondurable manufacturing	83.6	88.1	85.7	86.4	86.2	86.1	86.2
Textile mill products	85.2	90.1	86.7	90.2	92.8	93.4	93.9
Paper and products	88.8	94.2	89.4	95.9	91.6	90.2	91.1
Chemicals and products	79.3	86.9	81.4	88.1	87.5	87.5	87.5
Petroleum products	86.9	97.1	87.8	85.2	86.1	87.6	88.[illegible]
Mining	86.5	91.4	90.5	82.5	81.4	80.6	80.9
Utilities	86.7	92.8	85.3	81.5	82.3	81.2	81.8
Memo:							
Industrial materials	82.3	91.1	86.7	84.4	83.7	83.2	83.4
Raw steel	80.7	100.4	90.7	95.1	83.7	85.4	89.3
Aluminum	87.8	93.8	94.0	100.8	98.4	99.6	100.1
Paper materials	92.0	96.8	92.1	100.0	93.2	92.3	92.9
Chemical materials	81.3	91.1	85.9	88.8	88.9	89.1	89.2
Energy materials	88.9	93.7	89.4	86.2	85.2	83.7	83.9

1. Data for iron and steel, nonferrous metals, textile mill products, paper and products, chemicals and products, raw steel, aluminum, paper materials, and chemical materials are unpublished estimates for July.

The output of motor vehicles and parts declined 5 percent last month, which reduced growth in total IP 0.2 percentage point. Auto assemblies fell 800,000 units in July to a 6.0 million unit annual rate (FRB seasonals), and assemblies of light trucks, which have trended down since January, declined nearly 4 percent. Current schedules call for an increase in auto assemblies to a 6.7 million unit rate in August, and a rebound in truck assemblies. If realized, these gains would provide a considerable boost--about 1/4 percentage point--to growth in total IP.

Excluding motor vehicles, production of capital goods has continued to advance at a strong pace in recent months while output of consumer goods has been rising moderately, on balance. After a 7-1/4 percent (annual rate) increase during the second quarter, production of capital goods excluding motor vehicles and computers advanced 0.9 percent in July. Output of computers has been about flat since April, but, in recent months, strong gains have been posted in production of aircraft, capital goods for manufacturing industries, and construction and mining machinery. Output of nondurable consumer goods increased 0.4 percent in July, after an upward-revised gain of 3-1/4 percent at an annual rate during the second quarter. Output of durable consumer goods excluding motor vehicles rose at a 5-1/2 percent annual rate during the first half of this year but declined 1 percent last month. Output gains earlier this year apparently stemmed from both strong domestic and foreign demand.

Output of materials, which declined, on net, over the first half of the year, rose 0.5 percent in July. Production of durable materials rebounded last month, as increased production of metals and parts for capital goods more than offset a further decline in parts for consumer durables. Output

RETAIL SALES
(Seasonally adjusted percentage change)

	1988	1989				
	Q4	Q1	Q2	May	June	July
Total sales	2.2	.6	1.8	.8	-.1	.9
Retail Control[1]	1.5	1.7	2.1	1.2	.1	.4
Durable	3.3	-.6	1.2	.4	-.9	1.7
Automotive dealers	4.2	-2.4	.9	-.7	-1.0	2.7
Furniture and appliances	2.6	4.3	1.7	.4	1.3	-.3
Other durable goods	-.9	3.3	2.2	4.6	-3.8	1.0
Nondurable	1.6	1.4	2.1	1.0	.4	.4
Apparel	2.7	-.2	3.8	.5	1.9	-1.5
Food	.9	2.5	1.9	1.2	-.2	.6
General merchandise[2]	3.4	.9	.5	-.9	2.1	.5
Gasoline stations	-.3	1.5	8.2	2.9	-.1	.0
Other nondurables	-.5	-1.2	4.6	2.8	-1.5	1.6
Memo: GAF[3]	3.0	1.5	1.5	-.2	1.8	-.2

1. Total excluding auto dealers, building material, and supply stores.
2. General merchandise excludes mail order nonstores; mail order sales are also excluded in the GAF grouping.
3. General merchandise, apparel, furniture, and appliance stores.

SALES OF AUTOMOBILES AND LIGHT TRUCKS[1]
(Millions of units at an annual rate, BEA seasonals)

		1989		1989		
	1988	Q1	Q2	May	June	July
Autos and light trucks	15.45	14.34	14.93	14.81	14.19	14.99
Autos	10.64	9.82	10.33	10.34	9.85	10.25
Light trucks	4.81	4.52	4.59	4.47	4.34	4.74
Domestically produced[2]	11.74	11.02	11.44	11.46	10.85	11.71
Autos	7.54	6.98	7.33	7.45	6.96	7.45
Light trucks	4.21	4.04	4.11	4.01	3.89	4.26
Imports	3.70	3.32	3.49	3.35	3.34	3.28
Autos	3.10	2.84	3.01	2.88	2.89	2.79
Light trucks[3]	.60	.49	.48	.47	.45	.48

Note: Data on sales of trucks and imported autos for the current month are preliminary and subject to revision.
1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
3. Based on seasonals for domestic light trucks.

of nondurable materials continued to advance in July, reflecting gains in textiles, chemicals, and paper. Production of energy materials edged up last month, as coal production was unchanged after sharp declines earlier this year, and electricity generation increased.

Capacity utilization in manufacturing edged down to 83.9 percent in July, and has declined nearly 1 percentage point since January. The operating rate in primary processing industries has dropped nearly 2 percentage points since January. Utilization in advanced processing industries has eased about 3/4 percentage point since its recent peak in April.

Personal Income and Consumption

Consumer spending evidently was not as weak during the second quarter as previously had been estimated. Other things equal, the revisions contained in the latest retail sales report would imply second-quarter growth in real PCE of about 2 percent at an annual rate--the same as in the first quarter. Much of the new-found strength in retail sales was at nondurable goods stores--including food, apparel, and general merchandise outlets--which had been puzzlingly weak in the earlier estimates. The May increase in sales at gasoline stations also was revised up substantially.

Outlays apparently continued to advance in July. Spending in the control category grew 0.4 percent in nominal terms according to the advance estimate and probably posted a small gain in real terms.[3] In addition, a new round of incentives boosted motor vehicle sales. Meanwhile, outlays

3. The control category consists of total retail sales less sales at automotive dealers and building material and supply stores. It is the component of retail sales used by the BEA to track spending on nonauto consumer goods.

for electricity and natural gas likely recovered from their weather-depressed June levels.

Consumer sentiment generally has drifted downward since the beginning of the year according to the University of Michigan survey and has been about flat as measured by the Conference Board; nonetheless, consumer confidence remains quite strong according to both measures. And in the most recent round of surveys, sentiment improved a bit. In the Michigan survey, an improvement in respondents' assessments of the general business outlook was responsible for the gain in the overall index, while survey participants viewed their current financial condition slightly less favorably. In the Conference Board survey, respondents were somewhat more upbeat about the current economic situation, but viewed the business outlook a bit less optimistically in the most recent reading.

Autos and Trucks

Sales of domestically produced cars and light trucks picked up to an annual rate of 11-3/4 million units in July from a 10-3/4 million unit pace in June. The gain in sales coincided with yet another enhancement of consumer and dealer incentives by manufacturers. In another step intended to control inventories, the automakers extended shutdowns associated with model-year changeover at a number of plants last month; reflecting these more lengthy shutdowns, production fell to a 4-3/4 million unit annual rate on a BEA-seasonal basis. The magnitude of this slowdown in measured production was amplified by BEA's seasonal adjustment factors, which expected model changeover to be concentrated in August and September; as full-scale production resumes somewhat earlier than usual, the seasonals will overstate the underlying improvement in output. These variations in measured production likely will be reflected as exaggerated swings in BEA's estimates of unit stocks. Given current assembly schedules, and assuming an average sales pace for the third quarter of 7-1/2 million units at an annual rate (the July figure), stocks of domestically produced automobiles at the end of the third quarter would stand at roughly 1.65 million units--a shade higher than the automakers would prefer.

Early reports from the Big Three point to substantial increases in sticker prices of 1990 model-year cars; some of the increase in sticker prices will reflect the cost of mandatory passive restraint systems.[4] However, consumers may balk at these higher prices, and the autumn production schedules could prove to be overly optimistic unless the new models are discounted immediately upon introduction.[5]

Sales of foreign-made cars and light trucks registered a 3-1/4 million unit annual rate in July--about in line with the sales pace in May and June. Most foreign automakers also are running incentive programs, as stocks remain relatively high by historical standards.

Business Fixed Investment

Real business fixed investment rose 7-1/2 percent at an annual rate during the second quarter, extending the strong resurgence begun in the

4. On a preliminary basis, Chrysler has indicated increases in sticker prices of between 4 and 8 percent; Ford has announced hikes in the range of 5 to 7 percent and has stated that these increases will correspond to 2-1/2 percent on a comparably equipped car. GM has not announced sticker prices, but has indicated that prices of comparably equipped cars will increase about 2-1/2 percent on average, and that new safety equipment will add nearly another percentage point.

5. Passive restraint systems will be considered a quality improvement by the BLS and hence will not affect the CPI for new cars. However, any enhancement of incentive programs caused by "sticker shock" associated with the price increases from this new equipment would be picked up in the CPI.

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

	1988	1989		1989		
	Q4	Q1	Q2	Apr.	May	June
Producers' durable equipment						
Shipments of nondefense capital goods	.9	3.2	2.8	1.5	-.2	.2
Excluding aircraft and parts	.8	3.2	2.8	3.0	-.6	-.3
Office and computing equipment	-3.3	.0	5.8	-.3	-.7	5.1
All other categories	1.9	4.0	2.1	3.8	-.6	-1.6
Weighted PDE shipments[1]	.8	3.0	2.9	2.3	.3	-.4
Shipments of complete aircraft[2]	-14.8	13.8	--	11.2	16.5	--
Sales of heavy-weight trucks	5.9	-3.6	-3.7	5.2	2.7	-3.3
Orders of nondefense capital goods	.0	5.3	-.5	5.9	-7.7	.3
Excluding aircraft and parts	-2.3	4.9	1.0	2.5	-2.3	.7
Office and computing equipment	-4.1	-.1	1.2	-4.0	-1.4	-3.1
All other categories	-1.8	6.1	.9	4.2	-2.5	1.5
Weighted PDE orders[1]	-.3	2.4	.0	2.4	-2.5	-1.2
Nonresidential structures						
Construction put-in-place	.2	2.1	-.7	-3.4	1.4	2.1
Office	-1.6	4.5	-2.5	-3.5	-1.1	1.5
Other commercial	-4.2	2.7	-6.7	-12.9	5.7	2.5
Public utilities	2.0	-2.6	2.2	1.7	.8	.5
Industrial	2.9	1.6	5.3	3.6	-1.1	4.5
All other	3.6	5.1	1.3	-2.3	2.1	2.7
Rotary drilling rigs in use	-16.0	-5.4	18.2	8.2	1.1	3.9

1. Computed as a weighted sum of 25 individual equipment series (excluding aircraft) from the Census M-3 report with weights equal to the fraction of final business spending for each type of equipment.

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

first quarter.[6] The strength in BFI in the first half was in equipment purchases--particularly office and computing equipment. Real outlays for computers rose at almost a 30 percent annual rate during the first half of this year--accounting for more than half of all PDE growth--after having fallen in the second half of last year.

Real outlays for nonresidential structures fell at a 10 percent annual rate in the second quarter, after decreasing 1 percent in the first quarter. Declines were notable in the office and other commercial sectors. In contrast, construction spending in the industrial sector increased about 11 percent at an annual rate in the second quarter. In the recent GNP revision, outlays for industrial building were revised up, and now show fairly steady growth since the middle of 1986, in line with the export-led rebound in manufacturing.

The indicators of near-term equipment spending suggest a continuation of growth in the third quarter. New orders for nondefense capital goods, excluding the aircraft group and weighted to reflect the fraction in each category of shipments that is allocated to business investment spending, were unchanged in nominal terms in the second quarter, after a 2-1/2 percent gain in the first quarter.[7] Orders for office and computing equipment rose 1-1/4 percent in the second quarter (not at an annual rate); given the declining prices for these goods, even flat nominal spending would be

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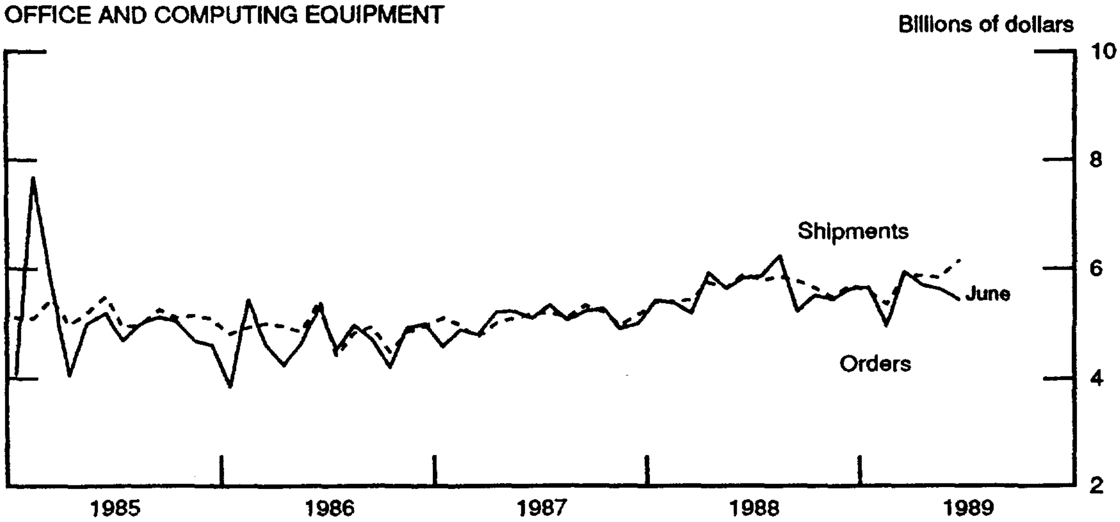
6. The recent revisions to shipments of nondefense capital goods during May and June were small and suggest little change in BEA's estimate of PDE spending in the second quarter. Construction put-in-place data also were consistent with BEA's assumptions, and little revision to NRS is anticipated.

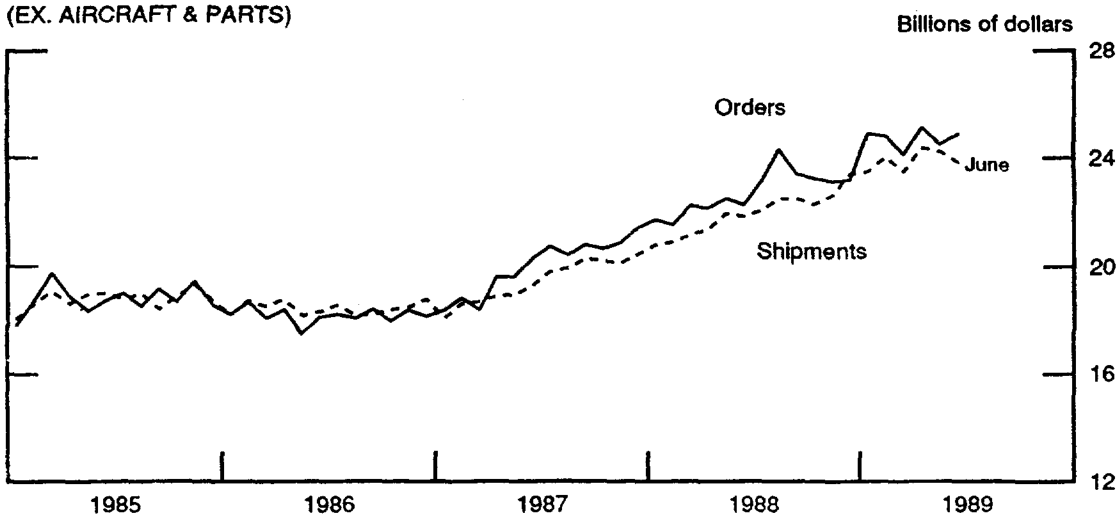
7. The relationship between shipments and PDE is somewhat loose, given that some shipments will be exported and a portion of PDE will be bought from foreign manufacturers; however, little is known about the third-quarter level or composition of net exports of capital goods.

Indicators of Business Fixed Investment

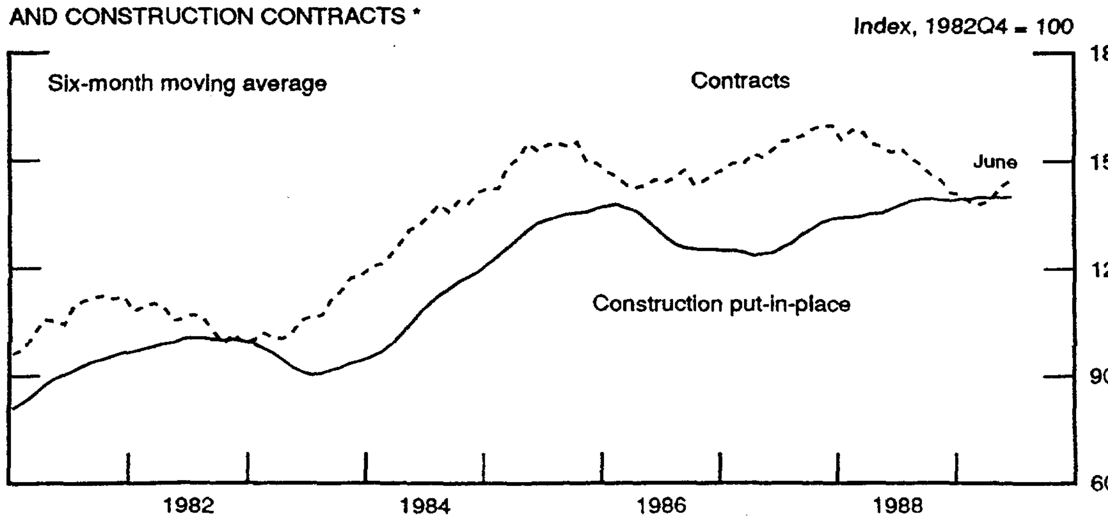
OFFICE AND COMPUTING EQUIPMENT



OTHER NONDEFENSE CAPITAL GOODS
(EX. AIRCRAFT & PARTS)



NONRESIDENTIAL CONSTRUCTION PUT-IN-PLACE
AND CONSTRUCTION CONTRACTS *



* Includes industrial, commercial, and institutional construction; derived from source data that are in current dollars.

translated into sizable gains in real terms. New orders and backlogs for nonelectrical machinery have continued to trend upward, suggesting that manufacturing investment will continue to grow appreciably.

As for indicators of structures spending, the value of new construction contracts has moved up recently for most categories except office building.[8] Nonetheless, to date the upturn has been unimpressive and does not, in itself, suggest that the generally sluggish pace of activity in this sector has turned around.

Business Inventories

Business inventory investment appears to have moderated toward the end of the second quarter. In current-cost terms, inventories in all manufacturing and trade rose at a $33 billion annual rate in June--well below the $58-1/2 billion average rate of increase during the first five months of this year. Together with BEA's re-benchmarking of the NIPA data--which showed sharp downward revisions to the level of nonfarm inventories since 1986--the incoming information suggests that, on the whole, businesses currently are not saddled with big overhangs of stocks.

In manufacturing, materials inventories declined further in June at several industries, including some types of machinery and fabricated metal products, processed food, and rubber and plastics. The reduction in recent months of materials inventories held by the manufacturing sector is in line with the restrained pace of the growth in output and suggests a continued tight control of stocks. Work-in-process inventories held by the aircraft industry continued to rise through June, as the industry tries to keep pace

8. Office vacancy rates remain around 20 percent on a national basis, only slightly below their high-point in 1986.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES[1]
(Billions of dollars at annual rates;
based on seasonally adjusted data)

	1988 Q4	1989 Q1	1989 Q2	1989 Apr.	1989 May	1989 June
Current-cost basis:						
Total	38.7	47.1	61.4	70.0	81.0	33.0
Total ex. auto	41.3	42.2	48.3	48.6	65.4	30.7
Manufacturing	25.5	27.9	20.4	27.9	19.2	14.0
Wholesale	5.4	5.5	12.2	18.5	16.7	1.5
Retail	7.8	13.8	28.8	23.6	45.2	17.6
Automotive	-2.6	4.9	13.1	21.4	15.6	2.3
Ex. auto	10.4	8.9	15.7	2.1	29.6	15.3

INVENTORIES RELATIVE TO SALES[2]
(Months supply; based on seasonally adjusted data)

	Range in preceding 12 months:[3] Low	High	1988 Q4	1989 Q1	1989 Q2	1989 Apr.	1989 May	1989 June
Current-cost basis:								
Total	1.48	1.51	1.50	1.50	1.51	1.49	1.50	1.51
Total ex. auto	1.46	1.48	1.48	1.47	1.47	1.46	1.47	1.48
Manufacturing	1.53	1.59	1.57	1.58	1.57	1.55	1.57	1.58
Wholesale	1.27	1.31	1.30	1.28	1.28	1.27	1.28	1.29
Retail	1.56	1.62	1.59	1.61	1.63	1.60	1.62	1.63
Automotive	1.76	2.04	1.88	1.96	2.05	1.99	2.04	2.07
Ex. auto	1.48	1.51	1.51	1.51	1.51	1.49	1.50	1.51

1. Constant-dollar data are under revision and not available at this time.
2. Ratio of end-of period inventories to average monthly sales for the period.
3. 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.

with its mounting orders. Inventories of most types of finished goods have risen only moderately, despite some signs of slowing orders and shipments. Although the inventory-to-shipments ratio for all manufacturing has moved up somewhat this year after reaching a low in December, its level in June was still quite low compared with those observed in recent years (chart, upper panel).

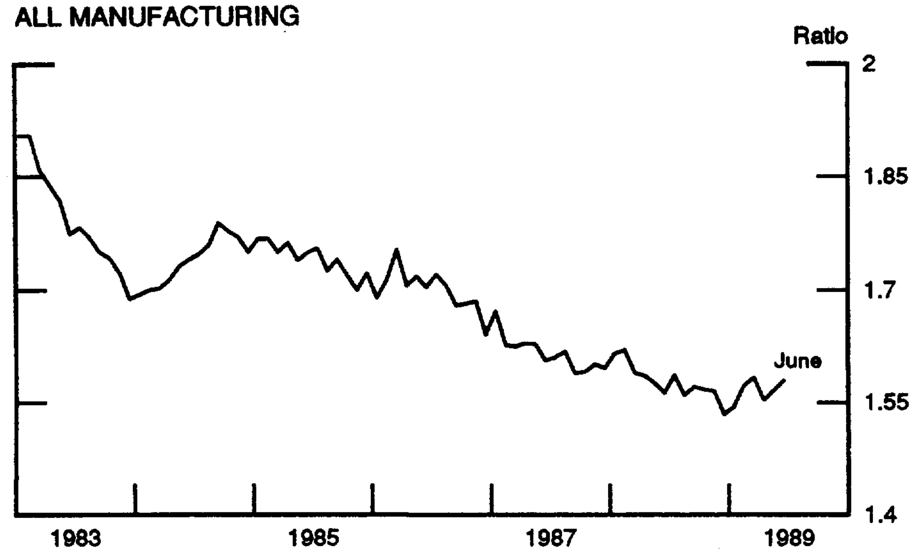
In the trade sector, auto dealers' stocks have remained on the high side, but apart from autos, troubling overhangs do not appear to be widespread. In June, stocks at retail establishments that carry mostly discretionary consumption goods (general merchandise, apparel, and furniture and appliances) expanded further after a sharp rise in May; however, sales at these stores also picked up strongly, and the inventory-sales ratio for stores in this grouping fell. BEA's latest benchmark revision sharply reduced the level of retail inventories since early 1986 (table).

The re-benchmarked data also showed a sharply lower inventory-sales ratio for nonfarm businesses than had been estimated previously (chart). Among the three major sectors in manufacturing and trade, the downward revision was the largest for retail inventories, corroborating the recent annual revision to the current-cost data in suggesting that the retailers' constant-dollar ratios also will be revised downward substantially.[9]

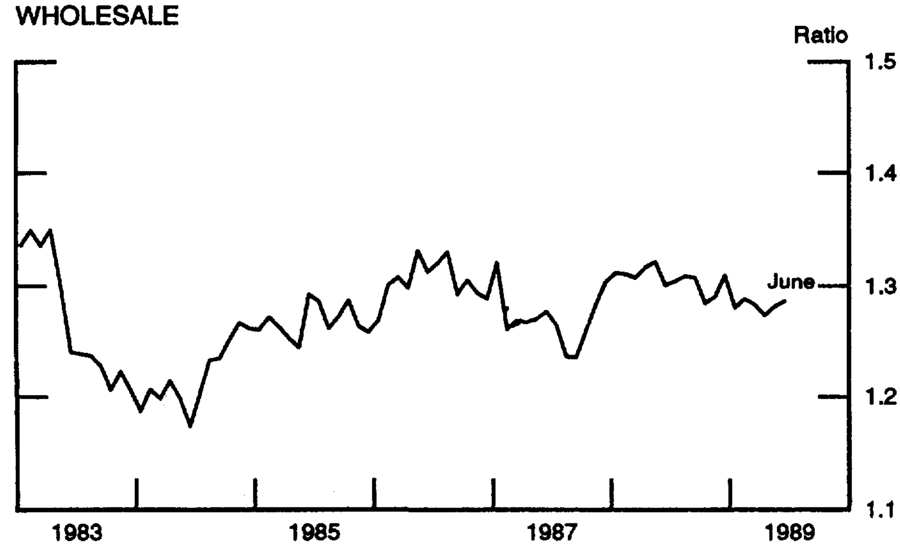
9. As shown in the table, a larger downward revision occurred for the "other nonfarm" sector, which includes utilities, contract construction, transportation, communication, pipelines, and service industries. Because these industries are not included in the Census Bureau's monthly surveys, no current monthly inventory data exist. As a result, it is not unusual to see sizable revisions at the time of the annual re-benchmarking of these series.

Ratio of Inventories to Sales
(Based on current-cost data)

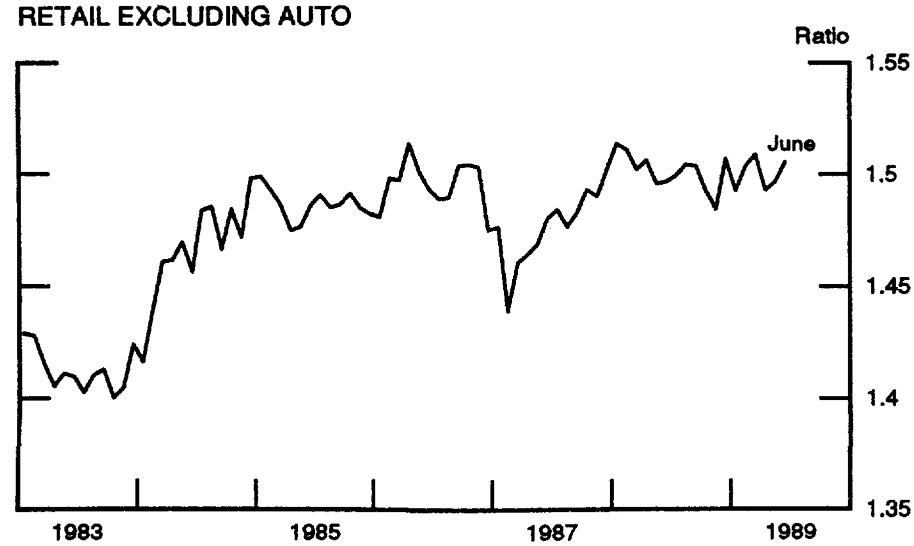
ALL MANUFACTURING



WHOLESALE



RETAIL EXCLUDING AUTO

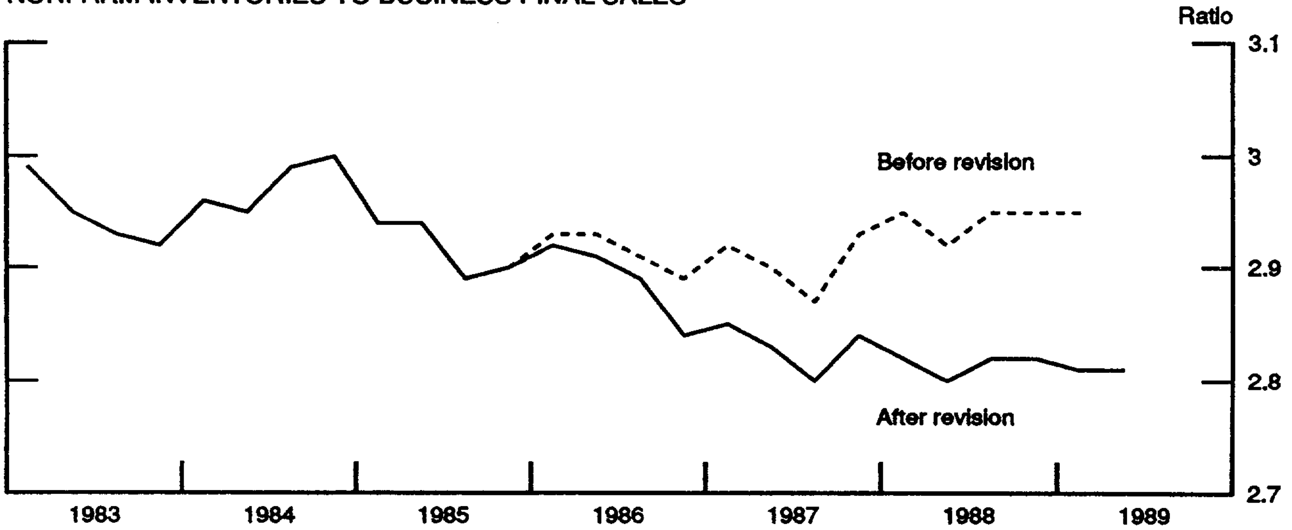


REVISION TO REAL NONFARM INVENTORIES

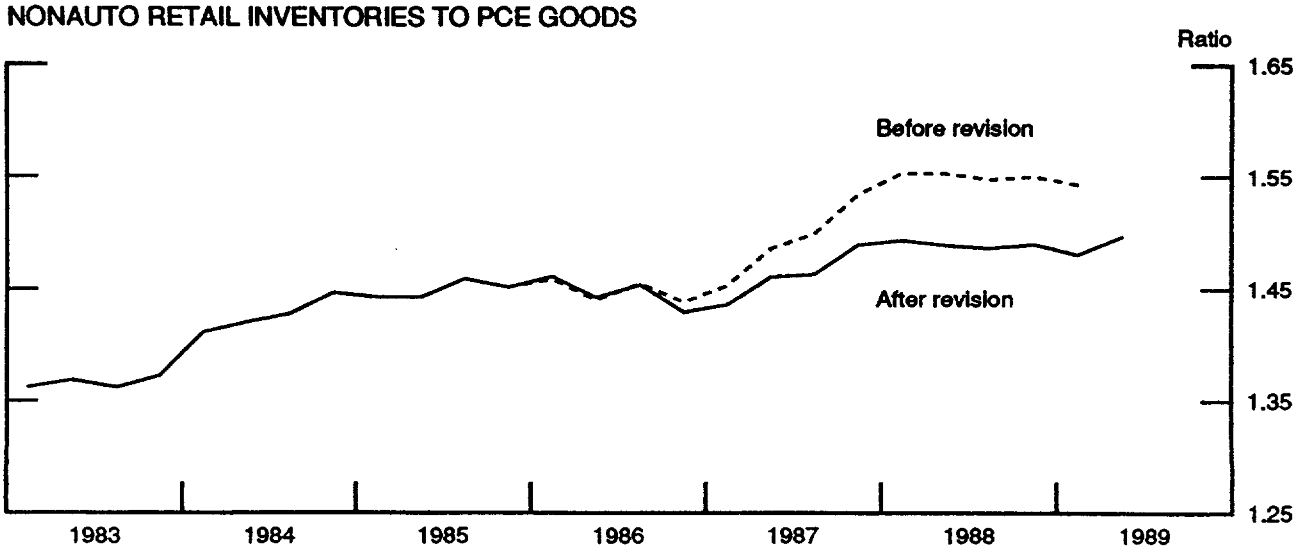
		Revised level 1988–Q4	Revision to 1988–Q4 level	
			Billions, 1982$	Percent
1.	Nonfarm	822.7	–30.3	–3.6
2.	Manufacturing	327.3	–4.7	–2.6
3.	Wholesale	193.5	–3.2	–1.6
4.	Retail	193.6	–7.7	–3.8
5.	Excluding autos	143.0	–4.8	–3.2
6.	Other nonfarm	108.2	–14.8	–12.0
Memo:				
7.	Business final sales	3502.8	36.0	1.0

Ratio of Inventories to Sales
(Based on 1982 dollar data)

NONFARM INVENTORIES TO BUSINESS FINAL SALES



NONAUTO RETAIL INVENTORIES TO PCE GOODS

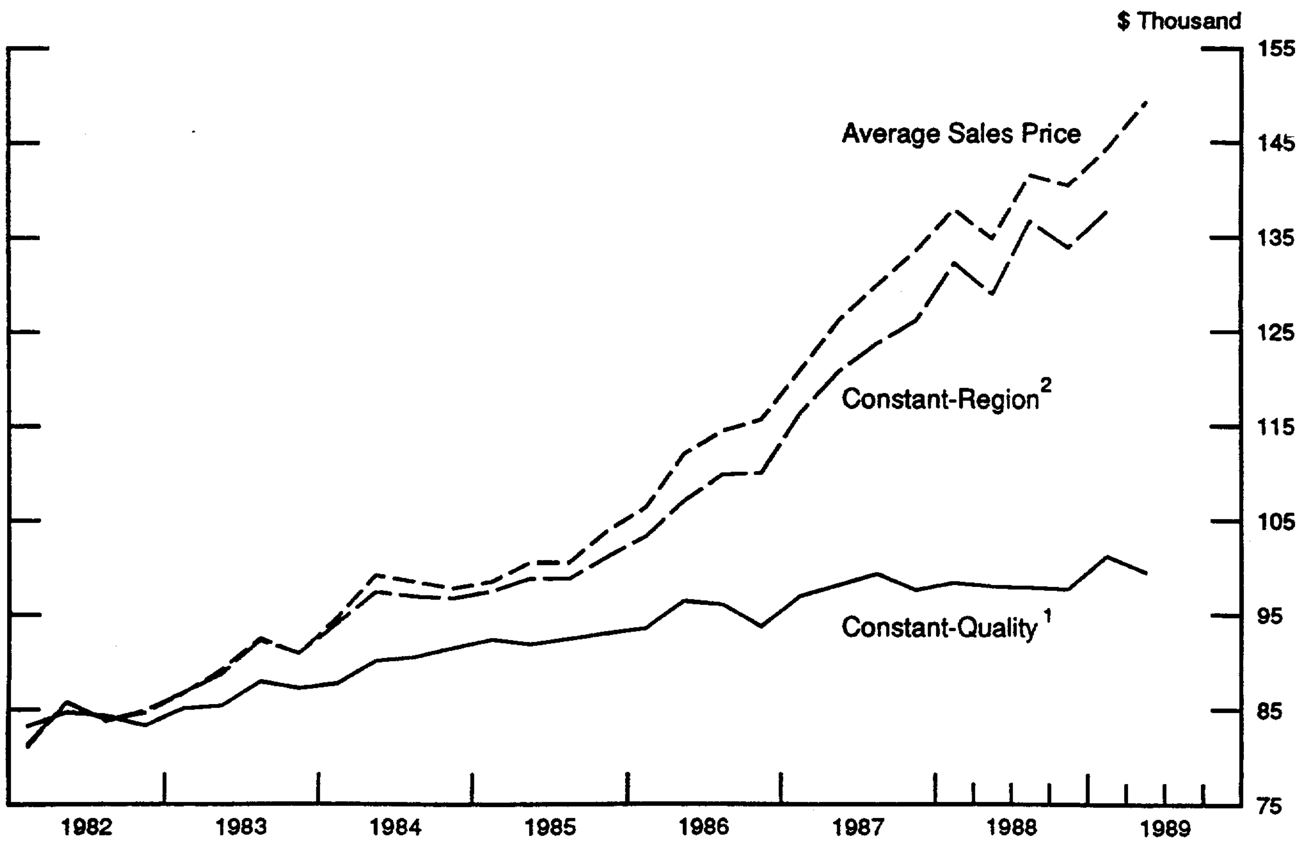


PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates; millions of units)

	1988 Annual	1988 Q4	1989 Q1	1989 Q2[r]	1989 May	1989 June[r]	1989 July[p]
All units							
Permits	1.46	1.52	1.37	1.33	1.35	1.31	1.27
Starts	1.49	1.56	1.52	1.36	1.31	1.42	1.43
Single-family units							
Permits	.99	1.04	.97	.91	.91	.87	.90
Starts	1.08	1.14	1.07	1.00	.98	.98	1.04
Sales							
New homes	.68	.68	.63	.64	.64	.67	n.a.
Existing homes	3.59	3.77	3.48	3.34	3.21	3.40	n.a.
Multifamily units							
Permits	.46	.48	.40	.42	.44	.43	.37
Starts	.41	.42	.45	.36	.33	.44	.39

p--preliminary estimates. r--revised.

NEW HOME PRICES



1. The constant-quality new home price series holds constant a variety of new home structural attributes as well as the regional mix of new home sales in accordance with their weights in the 1982 base year.
2. The constant-region new home price series holds constant only the regional mix of new home sales.

Housing Markets

Housing activity has picked up in recent months. Total private housing starts averaged 1.42 million units at an annual rate in June and July--up about 7 percent from the April-May average.

In the single-family market, starts strengthened to 1.04 million units at an annual rate in July. The upturn in starts occurred in the wake of the June bounceback in the sales of both new and existing homes from the reduced levels recorded earlier this spring. The rebound in single-family activity likely was spurred by reductions in housing finance costs. Conventional fixed-rate mortgage interest rates have fallen by more than a percentage point since April and averaged just under 10 percent in July. Initial rates on ARMs also have declined recently, though not by as much as rates on conventional fixed-rate loans.

In the multifamily sector, starts eased in July but remained somewhat above their weak second-quarter average. Rental vacancy rates in this sector were about unchanged in the second quarter and remain relatively high by historical standards. Activity has been further damped in recent quarters by a weakening of starts of multifamily condominium units, which have fallen to the lowest levels since the late 1970s.

The constant-quality new home price index rose about 2 percent during the four quarters ending in June. Over the same period, average new home prices increased about 11 percent. The divergence between unadjusted transaction prices and "constant-quality" prices mainly reflects the ongoing "upscaling" of new home structural characteristics and within-region shifts in construction to more expensive locations (chart).

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

	Relative importance Dec. 1988	1987	1988	1989 Q1	1989 Q2	1989 May	1989 June
				-Annual rate-		-Monthly rate-	
All items[2]	100.0	4.4	4.4	6.1	5.7	.6	.2
Food	16.2	3.5	5.2	8.2	5.6	.6	.2
Energy	7.3	8.2	.5	10.2	24.8	1.6	-1.0
All items less food and energy	76.5	4.2	4.7	5.2	3.8	.5	.2
Commodities	25.7	3.5	4.0	4.1	2.0	.4	-.1
Services	50.8	4.5	5.0	5.9	4.3	.5	.4
Memorandum:							
CPI-W[3]	100.0	4.5	4.4	6.2	5.7	.6	.2

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. 1988	1987	1988	1989 Q1	1989 Q2	1989 June	1989 July
				-Annual rate-		-Monthly rate-	
Finished goods	100.0	2.2	4.0	10.2	5.1	-.1	-.4
Consumer foods	25.8	-.2	5.7	13.1	-2.0	-.8	.1
Consumer energy	8.8	11.2	-3.6	41.0	31.0	-3.1	-3.0
Other consumer goods	39.6	2.7	4.8	5.4	5.3	.7	-.3
Capital equipment	25.8	1.3	3.6	4.6	4.1	.7	.0
Intermediate materials[2]	94.8	5.4	5.3	8.7	2.5	-.2	-.3
Excluding energy	83.4	5.2	7.2	5.5	.3	-.2	-.2
Crude food materials	43.8	1.8	14.2	16.9	-18.7	-2.6	-1.1
Crude energy	36.9	10.7	-9.5	48.3	22.3	-1.8	2.1
Other crude materials	19.3	22.6	7.5	10.3	-9.8	-1.3	-1.5

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

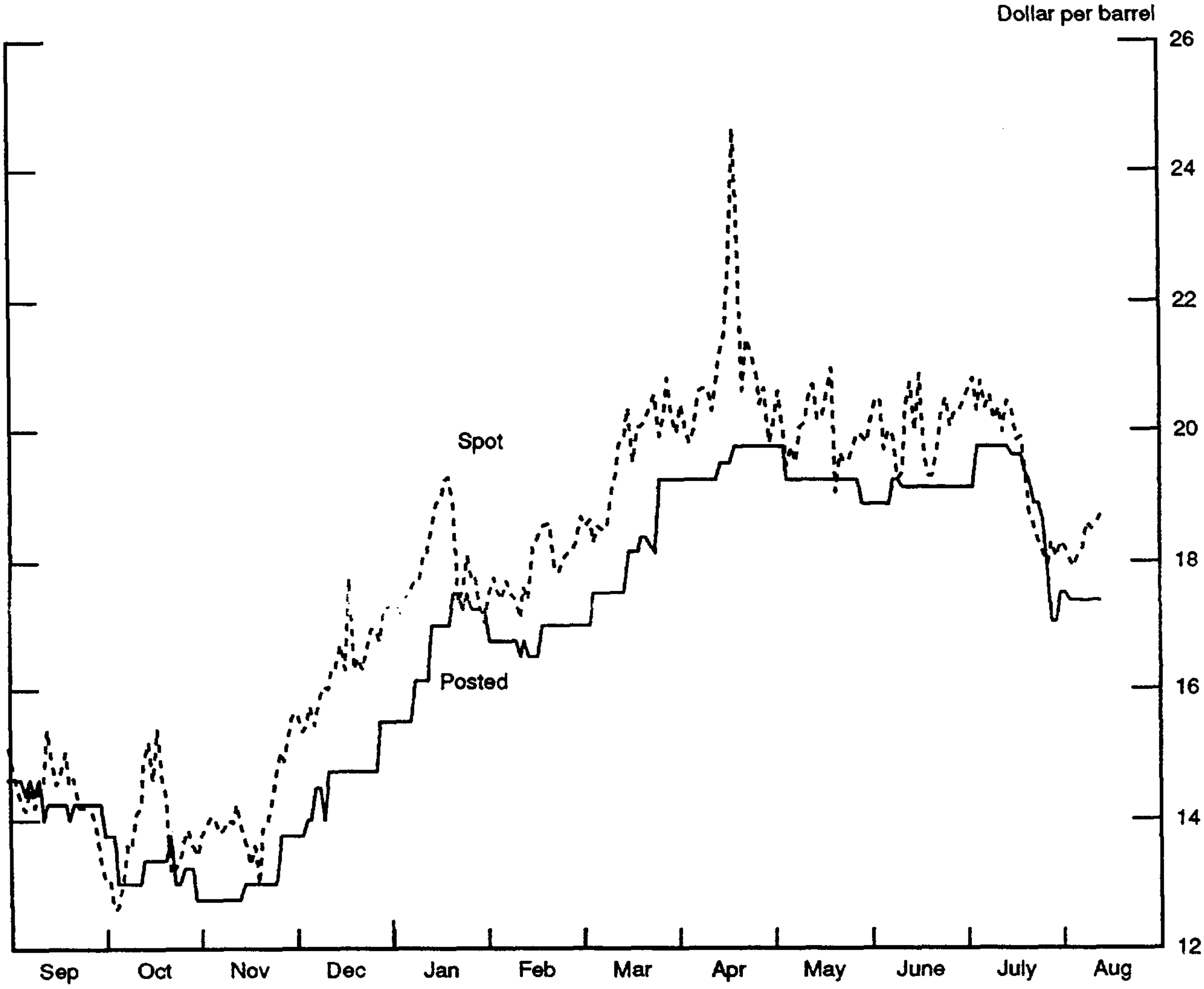
Prices

Price inflation has slowed in recent months, in large part reflecting a retracing of price increases in the food and energy sectors that boosted inflation rates earlier this year. The consumer price index increased only 0.2 percent in June, and producer prices of finished goods declined 0.1 percent in June and 0.4 percent in July. Apart from food and energy, the CPI rose at an annual rate of 4-1/2 percent over the first half of the year, a bit below the pace in 1988. In recent months, materials prices (less food and energy) have declined somewhat, on balance, at the intermediate level and have come down markedly at the crude stage.

The CPI for energy dropped 1 percent in June, with lower prices registered for gasoline, fuel oil, and electricity. Refinery prices of petroleum products were down sharply in the June and July PPIs, and both spot and posted prices of crude oil have retreated in more recent weeks (chart). These developments, which have been associated with high levels of gasoline inventories and refinery output as well as unexpectedly weak consumption, point to further declines in coming months in retail energy prices.

Food prices rose 0.2 percent in the June CPI--after several months of large increases--as prices of fresh fruits and vegetables dropped back, offsetting most of the advances in other categories. Producer prices of finished foods fell 0.8 percent in June and were little changed in July. Steep declines were posted for fresh vegetables and poultry, while price changes for other foods were mixed. At the farm level, prices of crude foods have come down sharply over the past two months, led by big declines for poultry.

Daily Spot and Posted Prices of West Texas Intermediate



* Posted prices are evaluated as the mean of the range listed in the Wall Street Journal.

MONTHLY AVERAGE PRICES–WEST TEXAS INTERMEDIATE

Month	Posted	Spot
September	14.33	14.47
October	13.29	13.80
November	12.98	13.98
December	14.55	16.27
January	16.68	17.98
February	16.79	17.83
March	17.93	19.45
April	19.46	21.04
May	19.35	20.03
June	19.07	20.01
July	19.25	19.64
August *	17.37	18.29

* Price through August 15, 1989.

Compiled in the Economic Activity Section, Division of Research and Statistics.

At the producer level, prices for finished goods less food and energy declined slightly in July, following a steep rise in June. Swings in tobacco prices accounted for part of this monthly pattern, as did a June surge in ship prices and a sharp reduction in manufacturers' prices for cars and light trucks in July.[10] At earlier stages of processing, the PPI for intermediate materials excluding food and energy fell in July for the second month in a row and has been little changed since the first quarter, after rising at about a 7 percent annual rate for more than a year. This leveling off appears consistent with the slowing in materials production, as well as the higher dollar in the first half of the year.

The deceleration in the prices of intermediate materials excluding food and energy is likely to be reflected in the prices of consumer goods fairly quickly. As shown in the table, movements in intermediate materials prices lead CPI inflation, on average, by three months at inflation peaks and by two months at inflation troughs, although there is a good deal of variation in the individual observations, including some periods where turning points in the PPI actually lag turning points in the CPI.[11] Econometric evidence is consistent with a relatively fast pass-through: an estimated 50 percent of the effect of an increase in intermediate prices tends to be reflected in consumer prices within two months. The evidence also suggests that

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10. In past years, automakers have offered inventory liquidation allowances to dealers in September, and this behavior is built into the current PPI seasonal factors. This year, GM introduced liquidation allowances in July, and inappropriate seasonal factors exaggerated the extent of the price decline. Unusually large price increases are expected in September when the decline that is expected by the seasonals fails to materialize.

11. These results pertain to the CPI for commodities excluding food, energy, and used cars; prices of services and used cars are excluded because they are unlikely to be directly affected by rising materials costs.

LEADING INDICATOR PROPERTIES
OF THE PPI FOR INTERMEDIATE MATERIALS
EXCLUDING FOOD AND ENERGY

Inflation Peaks		Inflation Troughs	
Year	Months Lead[1]	Year	Months Lead
----------- Overall CPI -----------			
1953	7	1954	6
1957	11	1958	9
1960	5	1960	-1
1966	2	1967	2
1969	-6	1972	-2
1974	2	1976	13
1980	1	1983	6
Average	3.1	Average	4.7
------ CPI commodities excluding food, energy and used cars -----			
1969	-1	1972	4
1975	4	1975	5
1980	7	1982	-2
Average	3.3	Average	2.3

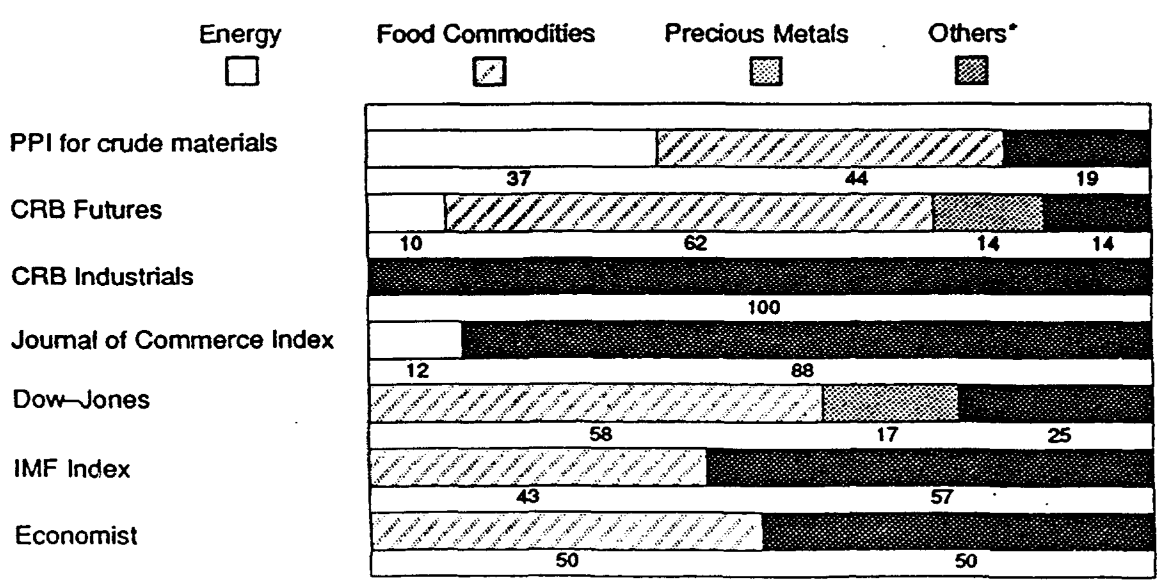
1. "Months Lead" measures the number of months between the turning point in the CPI inflation rate and the nearest preceding turning point in the inflation rate for intermediate materials prices excluding food and energy (prior to 1975, excluding food only).

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last Observation	1987	1988	1989 To June 27*	1989 June 27* To Date	Memo: Year Earlier To Date
		Percent change[2]				
1. PPI for crude materials[3]	July	8.9	3.1	6.8	-.2	6.6
1a. Foods and feeds	July	1.8	14.2	1.7	-1.5	-.4
1b. Energy	July	10.7	-9.5	16.1	2.1	17.2
1c. Ex. food and energy	July	22.6	7.5	.6	-2.0	1.5
1d. Ex. food and energy, seas. adj.	July	22.8	7.6	-.1	-1.5	1.6
2. Commodity Research Bureau						
2a. Futures prices	Aug. 15	11.7	8.5	-6.7	-5.1	-9.7
2b. Industrial spot prices	Aug. 14	19.2	7.3	3.1	-1.6	1.4
3. Journal of Commerce industrials	Aug. 15	10.7	3.8	3.0	-.7	3.8
4. Dow-Jones Spot	Aug. 15	17.0	6.9	-6.8	-2.5	-1.9
5. IMF commodity index[3]	June	30.8	12.6	-7.3	n.a.	-7.6
5a. Metals	June	51.9	33.7	-15.6	n.a.	-13.1
5b. Nonfood agric.	June	47.5	-9.4	-3.1	n.a.	-5.8
6. Economist (U.S. dollar index)	Aug. 8	42.5	17.7	-13.7	-4.2	-11.7
6a. Industrials	Aug. 8	62.6	18.9	-17.5	-.3	-10.1

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.
*Week of the June Greenbook.
n.a.--Not available.

Index Weights



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

VALUE OF THE OUTPUT OF SELECTED FARM CROPS
(Billions of 1982 dollars)

	1986	1987	1988	1989[1]
Wheat	7.4	7.4	6.4	7.2
Soybeans	11.2	11.1	8.9	11.0
Corn	19.6	16.8	11.7	17.4
Other feed grains[2]	4.3	3.6	2.4	3.1
Cotton	2.6	3.9	4.1	3.1
Total for these crops	45.1	42.8	33.5	41.8

1. Derived from the USDA's August 10 projection of crop production.
2. Barley, oats, and sorghum.

INDEXES OF CROP CONDITIONS[1]
(Range: 100=excellent; 0=very poor)

	Week ended				
	July 2	July 16	July 30	Aug. 6	Aug. 13
Corn	70.3	64.3	69.8	70.0	65.3
(Previous year)	(47.5)	(38.0)	(39.8)	(38.0)	(38.3)
Spring wheat	67.8	50.0	48.5	48.5	51.0
(Previous year)	(26.3)	(22.0)	(25.0)	(25.0)	(25.0)
Soybeans	65.3	61.5	65.8	65.8	61.0
(Previous year)	(45.3)	(46.5)	(49.0)	(46.8)	(46.5)
Cotton	56.8	57.3	56.3	58.3	58.8
(Previous year)	(59.3)	(66.5)	(68.8)	(68.5)	(68.8)

1. Indexes are constructed by the staff of the Federal Reserve, using data from the Weekly Weather and Crop Bulletin. The data in that report show the proportion of respondents who characterize crop conditions as excellent, good, fair, poor, or very poor. In constructing the indexes these proportions have been weighted as follows: excellent=1.0; good=.75; fair=.5; poor=.25; very poor=.0. A crop that is viewed as excellent by all respondents in all locations would thus have an index value of 100.0.

intermediate materials prices have their greatest influence on retail prices during periods of high capacity utilization.

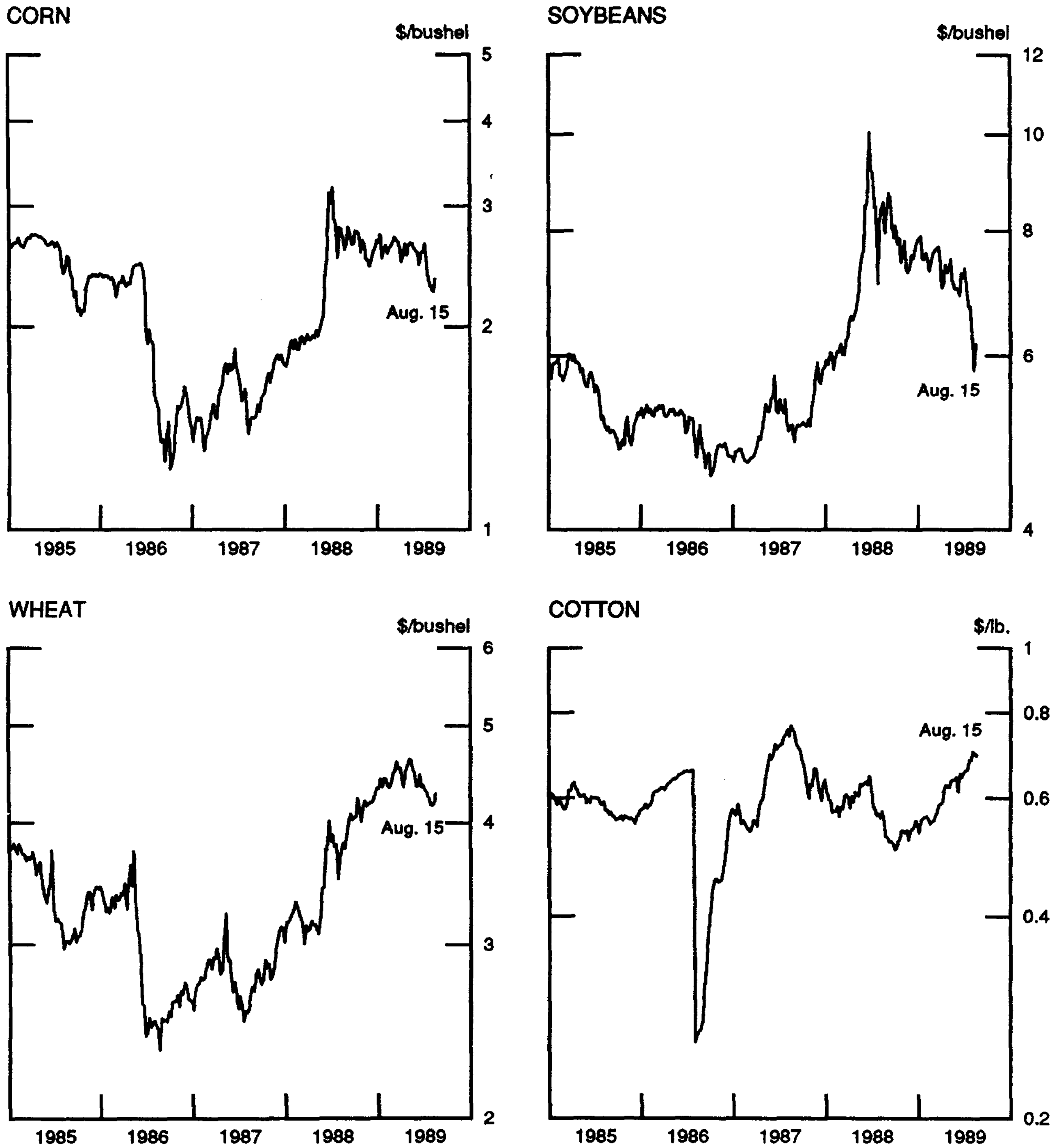
For the CPI excluding food and energy, prices were up only 0.2 percent in June. The commodity component edged down 0.1 percent, mainly reflecting lower prices for apparel. Over the first six months of the year, goods prices rose at about a 3 percent annual rate, compared with 4 percent during 1988. Slowing has been most evident in the apparel and housefurnishings categories, where the effects of the higher dollar on import prices likely have been a contributing factor. In contrast, prices of nonenergy services rose at an average rate of about 5 percent, similar to 1988.

The PPI for crude nonfood materials less energy has dropped back notably since March, more than retracing its increase during the first quarter. The declines have been led by metal scrap and nonferrous ores. As of July, this index was only about 1-1/2 percent above its level of a year earlier. More recently, price changes have been mixed in spot commodity markets for industrial materials, and the domestic commodity price indexes based mainly on these materials have posted relatively small net declines.

Agriculture

Weather conditions since midyear have been reasonably favorable in the agricultural regions, and, although the current situation differs a bit by crop, the risk of a second year of low production has diminished greatly since the last FOMC meeting in early July. Based on conditions as of August 1, the Agriculture Department is forecasting that total crop production will be up 16 percent from a year ago, reversing most of the drought-related drop of 1988. The corn harvest this year is projected to rise 49 percent from a year ago, and soybean production is expected to be up

Spot Prices for Farm Crops*



* A ratio scale is used in all panels.

24 percent. Output of spring wheat also is expected to be up substantially from a year ago, despite some deterioration in the Upper Midwest over the past few weeks. Cotton production, however, is likely to be lower than a year ago, owing both to cutbacks in acreage and to adverse weather in Texas (too dry) and in the Delta (too wet). According to the USDA's weekly qualitative updates, the conditions of the corn and soybean crops deteriorated slightly in the first two weeks of August, while the spring wheat and cotton crops improved somewhat since the beginning of the month.

With the increased likelihood that corn and soybean stocks will be ample over the coming year, the prices of those commodities have come under sharp downward pressure in recent weeks, and a sizable portion of the 1988 runup of prices has now been reversed (chart). By contrast, wheat prices, despite recent declines, still are at a relatively high level, reflecting expectations that stocks will remain tight in coming months. Cotton prices have been rising over the summer, as the prospective supply-demand balance in that market has continued to tighten.

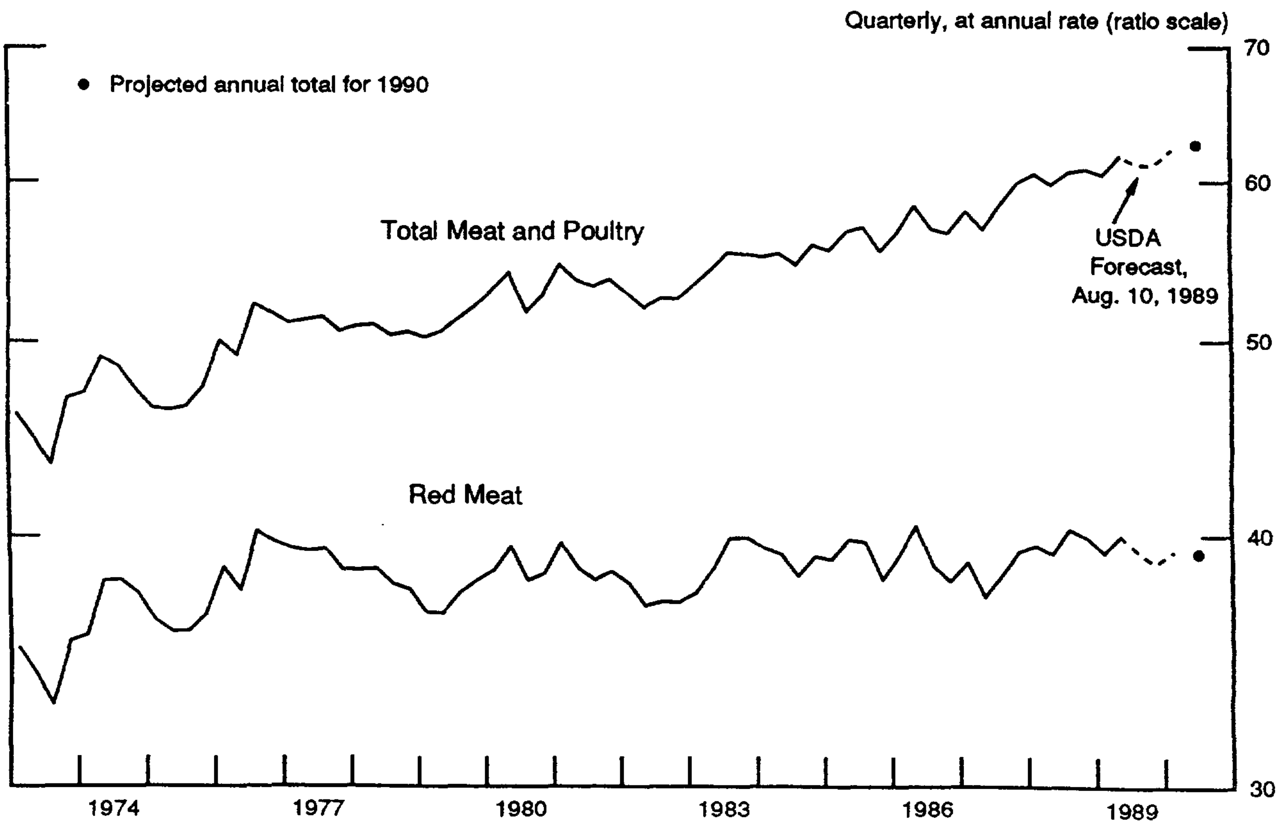
In the livestock area, the picture for the balance of 1989 still appears to be one of fairly stable supplies overall, but with some divergent trends within the sector. The USDA marked up its production forecasts for pork and poultry in July and raised the poultry estimate further in mid-August. However, the USDA projection for beef output over the second half has been lowered. For 1989 as a whole, the USDA now is projecting a total gain in meat and poultry production of about 1-1/2 percent. The agency's initial projection for 1990 shows an annual rise of about 2-1/2 percent; all of the expected gain is accounted for by another big increase in the

MEAT AND POULTRY PRODUCTION
(Millions of pounds)

		USDA Projection for 1989		USDA Projection for 1990
	1988	as of July 12	as of Aug. 10	as of Aug. 10
1. Total red meat and poultry	60350	61138	61125	62640
2. Red meat[1]	39763	39383	39313	39215
3. Beef	23424	22779	22706	22825
4 Pork	15623	15912	15915	15700
5. Poultry	20587	21755	21812	23425

1. Includes veal and lamb, in addition to beef and pork.

Meat and Poultry Production
(Billions of pounds, seasonally adjusted)*



* USDA data, seasonally adjusted by the staff of the Federal Reserve Board.

production of poultry, which, in terms of poundage, will have supplanted beef as the industry leader.

Federal Government

According to BEA's advance estimates, federal purchases excluding CCC increased 1-1/2 percent in real terms in the second quarter, but they remained within the narrow range of values seen over the last two years. Defense purchases, which had trended lower in recent quarters, ticked up 2-3/4 percent at an annual rate in the second quarter, while nondefense purchases excluding CCC fell 2-1/4 percent. Taking into account the positive swing in CCC inventories, total purchases rose in both real and nominal terms.

On a unified budget basis, total federal outlays are up nearly 7 percent in the current fiscal year through June, compared with the same period a year earlier. However, owing to the revenue surge this spring, receipts have increased even more (10 percent), and the deficit for the fiscal year to date has totaled $106 billion--about $14 billion below the comparable year-earlier figure.[12] Nevertheless, excluding the effects of the thrift bailout, the deficit over the remainder of the fiscal year is expected to be a bit larger than last year; revenue growth is expected to slow, while outlays continue to increase at their recent rapid pace. Indeed, the Administration, in its July Mid-Session Review, projected a deficit of $148 billion for FY1989 on a total budget basis--only $7 billion

12. The July NIPA revisions suggested some explanation for the spring receipts surprise. Although nonwage personal income was revised downward in both 1987 and 1988, the revision was larger in 1987, implying stronger income growth (and hence greater tax liabilities) between the two years. This appears to account for only a part of the greater-than-anticipated April-May payments, however.

ADMINISTRATION FEDERAL BUDGET FOR FY1990, MIDSESSION REVIEW
(Billions of dollars)

	Fiscal years					
	1989	1990	1991	1992	1993	1994
Outlays	1144	1179	1237	1288	1329	1381
Receipts	996	1080	1152	1221	1298	1356
Deficit(-)	-148	-99	-85	-67	-30	-25

Source: OMB, Mid-Session Review of the Budget, July 18, 1989.

ADMINISTRATION ECONOMIC ASSUMPTIONS

	Calendar years					
	1989	1990	1991	1992	1993	1994
	---------Percent change, Q4 to Q4----------					
Nominal GNP	7.1	6.8	7.2	6.8	6.4	6.0
Real GNP	2.7	2.6	3.3	3.2	3.1	3.0
GNP deflator	4.2	4.1	3.8	3.5	3.2	2.9
	----------Percent, annual average----------					
Civilian unemployment rate	5.3	5.5	5.4	5.3	5.2	5.1
Interest rate						
(3-month Treasury Bills)	8.0	6.7	5.3	5.0	4.7	4.4
(10-year Treasury Notes)	8.5	7.7	6.8	6.0	5.7	5.4

Source: OMB, Mid-Session Review of the Budget, July 18, 1989.

Note: The President's budget for FY1990 incorporates the Bipartisan Budget Agreement of this spring and the Administration's Financial Institutions Reform Legislation. The budget totals for years beyond 1990 reflect the following:

(a) a rise, beginning in FY1991, to the President's February proposed levels for defense (military) budget authority and outlays;

(b) higher spending for defense atomic-waste cleanup, beginning in FY1991, than proposed in February;

(c) February proposals for savings in entitlements; those savings that were not incorporated in FY1990 are assumed to begin in FY1991;

(d) a gradual return of budget authority and resulting outlays for discretionary programs to the lower path proposed in February;

(e) the year-to-year pattern of receipts gains determined by the President's specific February receipts proposals, including the lowering of tax rates for capital gains.

less than last year. The Mid-Session estimate did not include the approximately $20 billion of on-budget spending recently authorized under the new thrift legislation, which will bring the deficit to almost $170 billion. After fiscal 1989, spending under the new legislation will be recorded off-budget.

For fiscal year 1990, the Mid-Session Review projected a deficit of $99 billion on the assumption that the Bipartisan Budget Agreement would be fully implemented in budget legislation (table). Congress has yet to complete the fiscal 1990 appropriations bills; although all thirteen of the appropriation bills have been passed by the House, only four have been passed by the Senate, and none has been reported from House-Senate conferences. Moreover, the House reconciliation bill, which implements those spending and revenue measures in the Bipartisan Agreement that are not covered by appropriations, has not been reported out of committee. Nonetheless, it appears that all the legislation in train likely would achieve the Gramm-Rudman deficit trigger of $110 billion by the final deadline of October 15.

State and Local Governments

Purchases of goods and services by state and local governments increased 1-3/4 percent in real terms at an annual rate in the second quarter--about the same as in the first quarter, but only half as fast as in 1988. The increase over the first half of the year was the slowest for any two-quarter period since the first half of 1983, reflecting reductions in construction spending.

Many state governments ended the 1989 fiscal year with stronger positions in their general funds accounts than had been projected earlier, owing to a revenue surprise this spring. Despite the better-than-expected fiscal condition of the sector as a whole, many states still face budgetary pressure. The dimensions of the problem were small enough for most state governments, however, that relatively modest corrective measures were sufficient--including drawing down past surpluses, implementing minor tax increases (especially on gasoline, cigarettes, and liquor), and some reductions in expenditures from planned levels.

APPENDIX

ANNUAL REVISIONS TO THE NATIONAL INCOME AND PRODUCT ACCOUNTS

The Commerce Department released its annual revision to the National Income and Product Accounts on July 27. This revision incorporated new source data and revised estimates of seasonal factors back to the first quarter of 1986. On the expenditure side of the accounts, the changes largely reflected revised data on U.S. international transactions, as well as revisions to Census Bureau data on retail and wholesale trade, services, construction, and state and local government. Revisions to the income side of the accounts were based primarily on information from the state unemployment insurance system, business and personal income data from the Internal Revenue Service, and farm statistics from the Department of Agriculture.

The revision indicated that real activity was somewhat stronger in both 1987 and 1988 than previously estimated. Real GNP growth was revised up about 1/2 percentage point over the four quarters of each year, and it now stands at 5.4 percent in 1987 and 4 percent in 1988 (excluding the effects of last summer's drought). In contrast, little adjustment was made to the estimate of growth for 1986, which remains at about 2 percent. Moreover, inflation rates were not substantially affected by this revision. The GNP fixed-weighted price index continues to show a pickup in inflation from about 2-3/4 percent in 1986 to 4 percent in 1987 and 4-1/2 percent in 1988.

The upward revisions to output growth in 1987 and 1988 were concentrated in net exports, reflecting a combination of stronger U.S. exports and less robust growth of imports. Net exports also were revised up for 1986, offsetting the small downward adjustment made to gross domestic purchases. As a result of these revisions to the import and export data, the deficit in real net exports at the end of last year is now placed at about $74 billion, compared with the earlier estimate of $105 billion, with two-thirds of this improvement occurring on the services side of the accounts. Within services, the adjustment was the result of revisions in the balance of payments (BOP) data extending back to 1980, as well as changes in the deflator for service imports. The BOP revisions reflect new survey information on travel and passenger fares, the introduction of estimates of foreign students' expenditures in the United States and those of U.S. students abroad, and the introduction of survey data for a wider range of business and professional services.

Because BEA did not work the revisions to the BOP data into the national income accounts for years prior to 1986, the revised estimates of exports and imports are not fully comparable with the data for the earlier period. Based on information provided by BEA, the Board staff estimates that the trade deficit at year-end 1985 would be about $5 billion lower had the revision been carried back. Accordingly, the improvement in the trade over the course of 1986 is overstated by the same amount in the current data, and this distortion will persist until November 1990, when BEA publishes a benchmark revision of the national income accounts.

To avoid double counting, some of the upward adjustments to the service components of net exports were offset by a downward revision to personal consumption expenditures (PCE). For example, the spending by foreign students in the United States previously had been picked up in surveys of retail sales and services expenditures and thus had been included in PCE.

The revision reallocated these outlays to net service exports from the net travel component of PCE services. Overall, about $12 billion of the $31 billion improvement in the level of real net exports as of year-end 1988 is offset by lower consumer spending on services.

Apart from net exports, the adjustments to GNP growth were rather minor on balance. Growth in gross domestic purchases was revised down slightly in 1986 and up a bit in 1987 and 1988, with little net change over the three-year period as a whole. Among the major components of domestic final purchases, the revisions also tended to be small. In addition, the adjustments made to nonfarm inventory accumulation had a modest effect on output growth, except for 1986, when the downward-revised pace of stock-building shaved about 1/4 percentage point from the advance in GNP.

However, the cumulation of these small changes in inventory investment was enough to cause a substantial downward revision to the **level** of nonfarm inventories. Indeed, the 1988-Q4 level of total nonfarm stocks was adjusted down roughly $30 billion--about 3-1/2 percent in real terms. Although stock levels were revised down in all major sectors, the bulk of the revision occurred in the residual category of "other nonfarm" inventories, which consists mainly of stocks held by construction companies and utilities, as well as oil in transit to refineries. When combined with the small upward adjustment made to final sales, the revision to inventory levels implies a marked reduction in the ratio of nonfarm inventories to final sales. Because BEA will not publish revised sectoral data on real final sales until late August, it is not yet possible to compute the revised inventory-sales ratios for manufacturing, wholesale trade, or retail trade on a constant-dollar basis. Nonetheless, for the retail sector excluding autos--where intermittent concerns about stock overhangs have arisen since the beginning of last year--the level of stocks was revised down noticeably and the inventory-sales ratio seems likely to be lowered as well.

On the income side of the accounts, the adjustments were small by comparison with previous annual revisions. The most significant change occurred in corporate profits, which were adjusted down considerably during 1986 and early 1987, as the collapse of oil prices caused profits in the petroleum industry to fall more sharply than was previously thought. As a result, the share of economic profits (both before and after tax) in GNP was revised down about 1/2 percentage point during this period. However, in more recent quarters, the revision to the profit share turned out to be slight.

The level of disposable personal income was little changed by the revision, owing to offsetting adjustments to various income components. Because even these minor revisions tended to be accompanied by similar movements in nominal personal outlays, there was essentially no adjustment to the saving rate, which continues to display a marked rebound from the extremely low level recorded in mid-1987.

REAL GROSS NATIONAL PRODUCT AND RELATED ITEMS

(Percent change from previous period)

	1985–Q4 to 1986–Q4	1986–Q4 to 1987–Q4	1987–Q4 to 1988–Q4
1. Gross national product	1.9	5.4	3.4
Previous	*(2.0)*	*(5.0)*	*(2.8)*
1a. Excl. drought effects			4.0
Previous			*(3.5)*
2. Gross domestic purchases	2.1	4.6	2.4
Previous	*(2.4)*	*(4.4)*	*(2.2)*
3. Personal consumption expenditures	3.8	2.2	3.8
Previous	*(4.2)*	*(1.8)*	*(3.7)*
4. Business fixed investment	–5.5	8.5	4.2
Previous	*(–7.3)*	*(8.8)*	*(5.7)*
5. Residential structures	11.6	–4.6	3.2
Previous	*(11.3)*	*(–3.5)*	*(2.0)*
6. Government purchases	3.1	2.1	1.8
Previous	*(2.9)*	*(2.3)*	*(.4)*
ADDENDA:			
7. Change in net exports [1]	–10.1	25.6	36.0
Previous	*(–17.1)*	*(16.4)*	*(20.6)*
8. Net exports [2]	–135.4	–109.8	–73.8
Previous	*(–142.4)*	*(–126.0)*	*(–105.4)*
9. Change in nonfarm inventories [2]	–10.9	55.6	31.9
Previous	*(1.2)*	*(68.2)*	*(37.6)*
10. Nominal GNP	4.6	8.6	7.5
Previous	*(4.8)*	*(8.3)*	*(7.2)*
11. GNP fixed–weight price index	2.7	4.0	4.6
Previous	*(2.7)*	*(4.0)*	*(4.5)*
12. GNP implicit price deflator	2.6	3.0	4.0
Previous	*(2.8)*	*(3.1)*	*(4.3)*
13. Real disposable personal income	3.3	3.0	4.0
Previous	*(3.4)*	*(3.0)*	*(3.6)*

1. Over four quarters of the year, billions of 1982 dollars.
2. End of period, billions of 1982 dollars

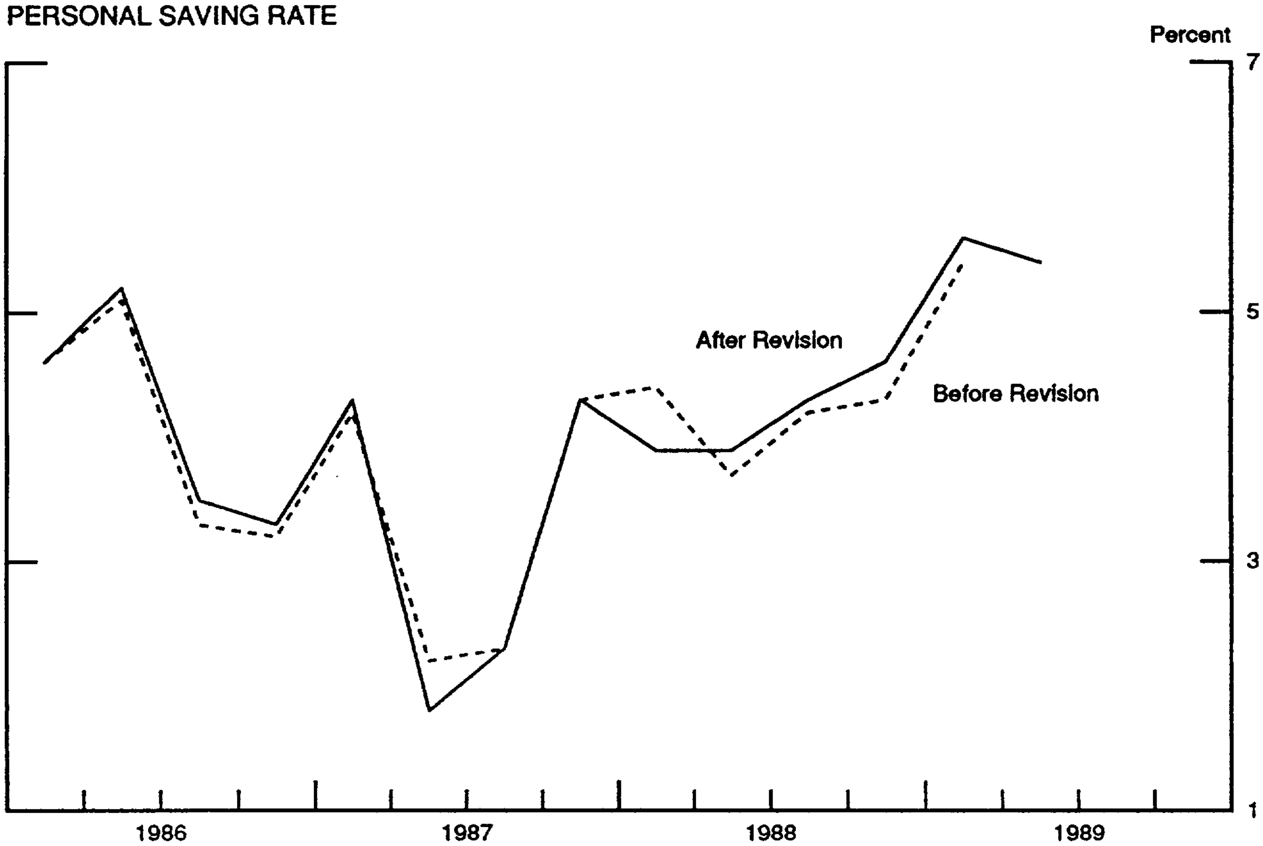
REVISIONS TO THE NATIONAL INCOME ACCOUNTS

(Change in billions of dollars, fourth quarter to fourth quarter)

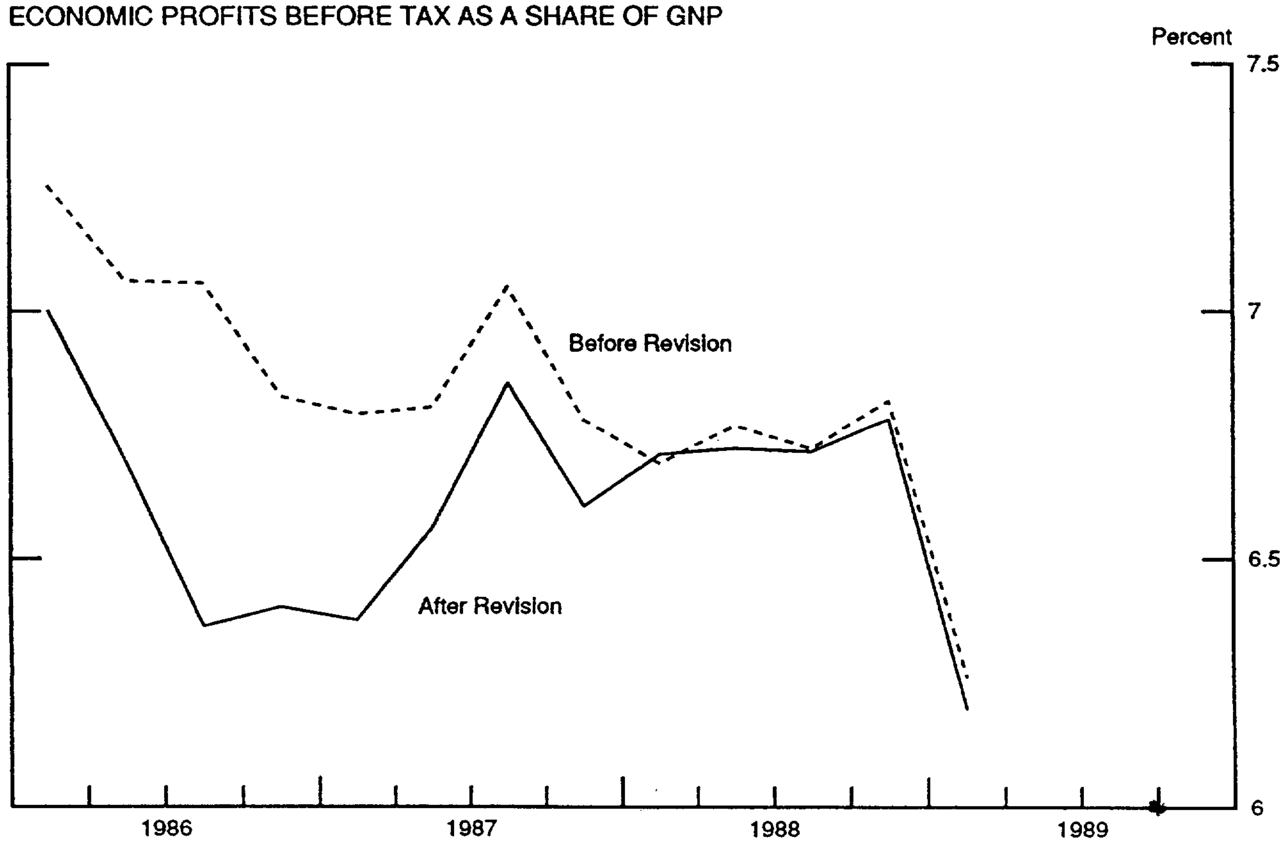
	Revision to the change		
	1986	1987	1988
	--------1982 dollars--------		
GNP	-1.1	13.7	23.4
Net exports	7.0	9.2	15.3
Gross domestic purchases	-8.1	4.5	7.9
Consumption	-8.4	9.0	.9
Business fixed investment	8.4	-.5	-6.6
Residential structures	.6	-1.4	2.3
Nonfarm inventory investment	-12.1	-.5	6.9
Farm inventory investment	1.8	.3	-7.2
Federal purchases	1.9	-4.7	11.2
State and local purchases	-.4	2.7	.2
	------Current dollars-------		
National income	-23.5	21.4	6.1
Compensation	5.4	3.4	-6.9
Proprietors income	-5.0	7.7	1.8
Rental income	.1	6.3	4.2
Net interest	-5.3	5.8	-.2
Corporate profits with IVA and CCA	-18.7	10.8	7.2
Saving rate (annual average)	.1	.0	.0

Revision to National Income

PERSONAL SAVING RATE



ECONOMIC PROFITS BEFORE TAX AS A SHARE OF GNP



III-T-1
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

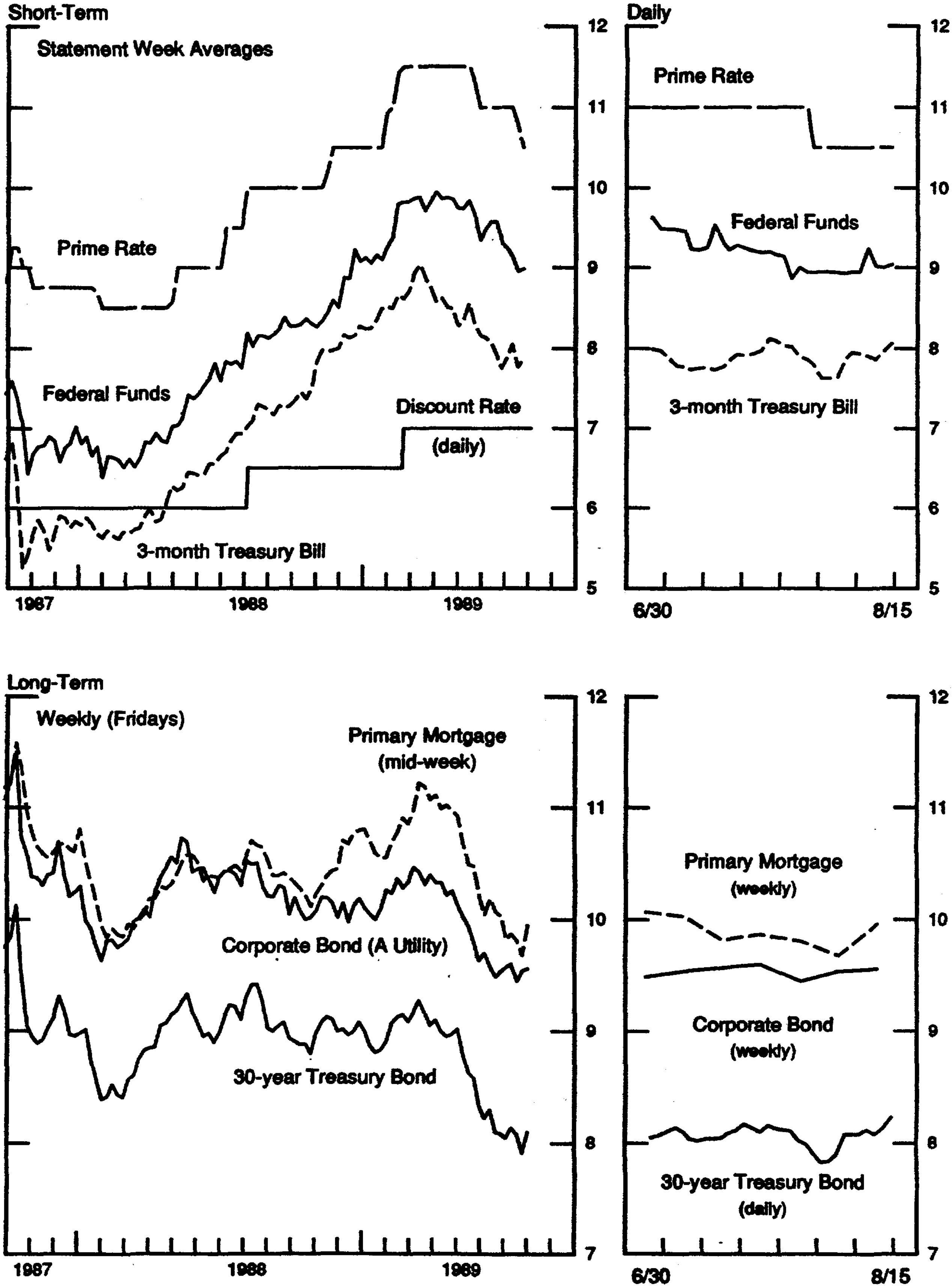
	1987	1989				Change from:		
	Oct.16[2]	March highs	Jul-Aug lows	FOMC July 6	Aug 15	Mar 89 highs	Jul-Aug lows	FOMC July 6
Short-term rates								
Federal funds[3]	7.59	9.85	8.97	9.56	9.04	-.81	.07	-.52
Treasury bills[4]								
3-month	6.93	9.09	7.63	7.77	8.03	-1.06	.40	.26
6-month	7.58	9.11	7.34	7.55	7.87	-1.24	.53	.32
1-year	7.74	9.05	7.10	7.41	7.75	-1.30	.65	.34
Commercial paper								
1-month	7.94	10.05	8.52	9.18	8.91	-1.14	.39	-.27
3-month	8.65	10.15	8.24	8.92	8.71	-1.44	.47	-.21
Large negotiable CDs[4]								
1-month	7.92	10.07	8.45	9.17	8.90	-1.17	.45	-.27
3-month	8.90	10.32	8.26	8.99	8.80	-1.52	.54	-.19
6-month	9.12	10.08	8.12	8.78	8.72	-1.36	.60	-.06
Eurodollar deposits[5]								
1-month	8.00	10.19	8.44	9.25	8.94	-1.25	.50	-.31
3-month	9.06	10.50	8.31	9.06	8.88	-1.62	.57	-.18
Bank prime rate	9.25	11.50	10.50	11.00	10.50	-1.00	.00	-.50
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	9.52	9.88	7.51	7.92	8.26	-1.62	.75	.34
10-year	10.23	9.53	7.74	8.08	8.21	-1.32	.47	.13
30-year	10.24	9.31	7.83	8.10	8.19	-1.12	.36	.09
Municipal revenue[6] (Bond Buyer)	9.59	7.95	7.17	7.32	7.37	-.58	.20	.05
Corporate--A utility (recently offered)	11.50	10.47	9.45	9.56	9.59	-.88	.14	.03
Home mortgage rates[7]								
S&L fixed-rate	11.58	11.22	9.68	10.07	9.96	-1.26	.28	-.11
S&L ARM, 1-yr.	8.45	9.31	8.60	8.92	8.62	-.69	.02	-.30

	1987		1989		Percent change from:		
	highs	lows	FOMC July 6	Aug 15	1987 highs	1987 lows	FOMC July 6
Stock prices							
Dow-Jones Industrial	2722.42	1738.74	2462.44	2687.78	-1.27	54.58	9.15
NYSE Composite	187.99	125.91	179.82	192.08	2.18	52.55	6.82
AMEX Composite	365.01	231.90	361.11	379.82	4.06	63.79	5.18
NASDAQ (OTC)	455.26	291.88	439.57	460.91	1.24	57.91	8.00

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday Oct. 19, 1987.
3. Average for two-week reserve maintenance period closest to date shown except Feb.low which is the average for the statement week ended Feb. 10, 1988. Last observation is average-to-date for maintenance period ending August 23, 1989.
4. Secondary market.
5. Bill rates for Eurodollar deposits at 11 a.m. London time.
6. Based on one-day Thursday quotes and futures market index changes.
7. Quotes for week ending Friday closest to date shown.

Selected Interest Rates*

(percent)



*--Friday weeks through August 11, Wednesday weeks through August 9.

Interest rates in the intermeeting period have swung with the market's shifting perceptions of the economy's strength and the likely course of Federal Reserve policy. Short-term rates generally fell during July, as the federal funds rate moved down to around 9 percent and incoming economic data led to expectations of further easing by the System. More recently, stronger-than-anticipated reports on employment and retail sales put a damper on those expectations and prompted a back-up in rates. For the period as a whole, key Treasury bill yields--perhaps boosted by added supply to finance thrift resolutions--are up by about 25 basis points, while private short-term rates remain down on balance, but by less than the federal funds rate. Most long-term yields are unchanged to up slightly. Major stock price indexes rose to all-time highs before retreating somewhat in recent days.

The monetary aggregates accelerated to 10 to 12 percent annual rates of growth in July. Compensating-balance arrangements were partly responsible for a surge in demand deposits, a lagged response to the spring decline in short-term rates. The growth in M2 during the month reflected households' restocking of liquid balances that had been drawn down earlier to make tax payments--a process encouraged by substantial declines in the opportunity costs of these balances. The non-M2 components of M3 grew relatively slowly in July, as the large buildup in core deposits in the past two months lessened the need of depository institutions to tap managed liabilities.

The evidence on debt growth thus far in the third quarter is clearest in the federal sector, where the thrift legislation has contributed to a

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

	1988[1]	1989 Q1	1989 Q2	1989 May	1989 Jun	1989 Jul p	Growth Q4 88- Jul 89p
	------------Percent change at annual rates--------------------						
1. M1	4.3	-0.4	-5.6	-15.0	-4.3	10.4	-1.9
2. M2	5.2	1.9	1.2	-3.6	6.1	12.4	3.0
3. M3	6.2	3.7	2.9	-1.5	5.7	9.7	4.1
	------------Percent change at annual rates------------						Levels bil. $ Jul 89p
Selected components							
4. M1-A	2.5	-0.2	-3.3	-6.4	-5.5	10.8	504.1
5. Currency	8.1	7.0	4.1	2.8	5.5	2.8	217.9
6. Demand deposits	-1.2	-5.5	-8.7	-13.6	-13.8	17.5	279.0
7. Other checkable deposits	7.7	-0.7	-9.7	-31.0	-1.8	10.2	273.2
8. M2 minus M1[2]	5.5	2.6	3.5	0.3	9.6	12.9	2341.8
9. Overnight RPs and Eurodollars, NSA	-5.8	13.6	-29.8	-27.6	30.0	65.0	77.9
10. General purpose and broker/dealer money market mutual fund shares, NSA	7.4	20.8	22.2	-1.4	29.1	42.4	275.6
11. Commercial banks	6.9	5.4	5.4	-1.1	6.2	7.8	1018.2
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.4	-8.4	-14.9	-28.5	0.7	6.6	512.5
13. Small time deposits	14.7	22.4	29.0	28.2	12.1	9.1	505.7
14. Thrift institutions	4.6	-3.0	-1.1	1.4	6.2	4.5	969.6
15. Savings deposits, SA, plus MMDAs, NSA[3]	-4.3	-14.0	-24.6	-33.5	-9.9	-3.1	348.4
16. Small time deposits	11.7	4.3	14.0	22.5	15.6	8.6	621.1
17. M3 minus M2[4]	10.2	10.4	9.2	5.9	4.2	0.5	884.7
18. Large time deposits	11.0	12.7	14.1	9.5	2.7	2.5	574.8
19. At commercial banks, net[5]	12.2	18.1	18.0	10.1	3.3	7.0	399.3
20. At thrift institutions	8.8	1.2	6.0	8.2	1.4	-7.5	175.5
21. Institution-only money market mutual fund shares, NSA	-0.8	10.6	12.2	53.4	45.9	39.1	98.2
22. Term RPs, NSA	13.7	5.8	0.6	1.9	0.0	-53.8	121.5
23. Term Eurodollars, NSA	11.2	-1.2	-5.5	-9.4	-15.4	4.8	100.1
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	4.9	4.7	7.9	6.9	17.8	7.0	688.7
25. Large time deposits, gross	3.3	5.8	4.0	4.1	1.9	2.9	461.6
26. Nondeposit funds	1.6	-1.1	3.9	2.8	15.9	4.1	227.1
27. Net due to related foreign institutions, SA	-0.4	0.5	-0.1	-3.0	8.0	3.3	11.2
28. Other[7]	2.0	-1.6	4.0	5.7	7.9	0.8	215.9
29. U.S. government deposits at commercial banks[8]	0.0	-1.5	2.3	6.2	0.2	2.6	29.9

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 June and July at rates of -5.9 percent and 2.6 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during June and July at rates of -9.2 percent and -6 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 the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.
p - preliminary

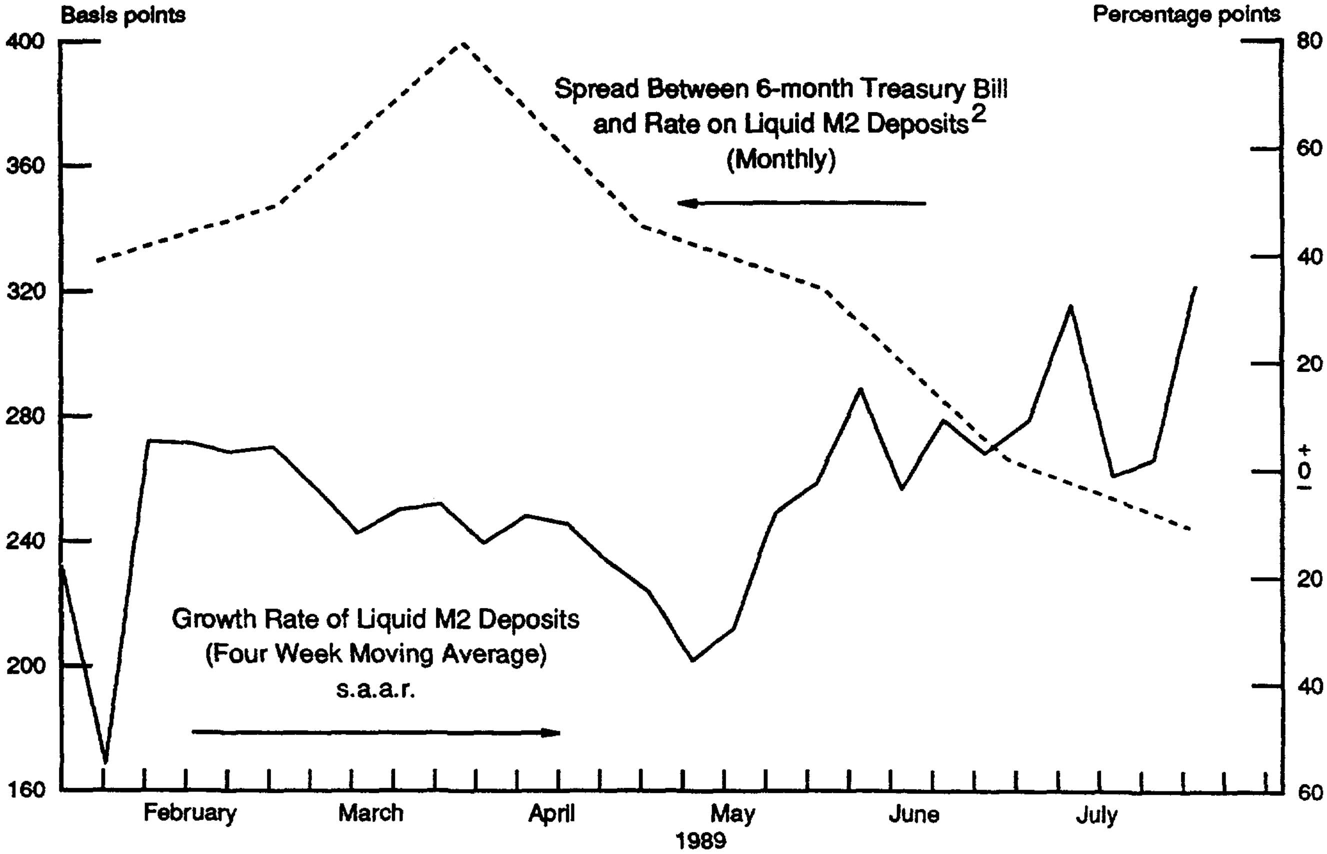
sharp pickup in Treasury borrowing. Businesses borrowed heavily from banks in July, while turning away from the commercial paper market; gross public bond issuance by nonfinancial firms has been running somewhat below the strong pace recorded early in the summer. Gross borrowing by state and local governments continued in July near its first-half pace. Sketchy data for the household sector suggest no sharp deviations from the recent growth paths of either mortgage or consumer credit.

Monetary Aggregates and Bank Credit

The monetary aggregates posted robust gains in July. A surge in demand deposits, after three consecutive months of double-digit rates of decline, largely accounts for the 10-1/2 percent annual rate of growth in M1 in July. Since compensating-balance arrangements typically relate business demand deposits to lagged short-term interest rates, the bulge in demand deposits in July would seem to reflect, in large part, the decline in market interest rates that began in March.

Both M1 and M2 were propelled in July by large inflows to liquid household-type accounts. These inflows, which began slowly in June, helped push M2 to a 12-1/2 percent annual growth rate in July, lifting this aggregate just above the lower edge of its annual target cone. Beginning in June, and especially in July, households restocked liquid balances that had been depleted by unusually large nonwithheld tax payments in April and May. This rebuilding was encouraged by continued substantial declines in the opportunity cost of holding liquid deposits. As illustrated in the chart, the opportunity cost of holding these balances has fallen approximately 150 basis points, to about two-thirds of its recent peak in March. Average M2 growth from March through July responded to the drop in interest rates

Growth Rate and Opportunity Cost of Liquid M2 Deposits[1]



1. Consists of OCDs, savings deposits and MMDAs.
2. Yield on 6-month Treasury bills less weighted average return on OCDs, savings deposits and MMDAs.

about as predicted by the staff's monthly money demand model, although the month-to-month pattern was erratic, presumably reflecting the outsized tax payments out of M2 in April and May and the more recent restocking.

Changing opportunity costs have affected other components of M2 as well. Assets of M2-type money market mutual funds soared in June and July as money fund yields lagged the decline in market rates. With rates on small CDs declining relative to comparable Treasury yields, growth in small time deposits eased somewhat from the explosive pace of earlier months. Core deposit growth at commercial banks slightly exceeded growth at thrifts during July, reversing two months of more rapid gains at thrifts. This monthly pattern is consistent with previous periods of declining market interest rates, when shifts toward liquid deposits tended to benefit banks at the expense of thrifts.

M3 grew in July at a 9-3/4 percent annual rate. Despite the large buildup of core deposits in the past two months, a strengthening of bank credit in July implied the need for these institutions to continue to tap managed liabilities, albeit at a much slower pace than in June. At thrift institutions, large time deposits ran off, possibly reflecting a further trimming of asset portfolios in an environment of rising security prices, as these institutions look ahead to their new capital requirements.

At banks, in contrast, credit growth is estimated to have rebounded to a 10-1/2 percent annual rate in July, up from a 5 percent pace in June. This pickup mainly reflects a surge in loans, especially business loans, which expanded at a 14 percent rate after declining in June. Consumer loan growth was fairly sluggish, restrained by sizable securitizations of

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

	1987:Q4 to 1988:Q4	1989 Q1	1989 Q2	1989 May	1989 June	1989 July p	Levels bil.$ July p
	----- Commercial Bank Credit -----						
1. Total loans and securities at banks	7.6	7.9	5.2	7.5	5.1	10.5	2518.7
2. Securities	4.8	2.2	.7	4.3	-.9	-.2	559.4
3. U.S. government securities	7.3	8.2	5.4	9.1	1.0	2.2	374.5
4. Other securities	.5	-8.9	-8.2	-5.1	-3.9	-5.8	184.9
5. Total loans	8.5	9.6	6.5	8.4	6.7	13.6	1959.3
6. Business loans	6.8	10.6	4.6	11.0	-2.7	14.2	632.3
Security loans	-5.4	53.0	-22.9	-60.0	97.9	-23.4	40.3
8. Real estate loans	14.3	11.8	11.7	10.3	11.1	12.8	719.6
9. Consumer loans	8.4	5.5	6.0	8.3	2.0	3.6	367.1
10. Other loans	-.4	-2.7	1.2	7.6	12.5	41.6	200.0
	----- Short- and Intermediate-Term Business Credit -----						
11. Business loans net of bankers acceptances	6.9	11.0	4.6	10.7	-2.7	14.1	629.5
12. Loans at foreign branches[2]	30.3	51.9	32.8	69.1	32.7	.0	26.4
13. Sum of lines 11 & 12	7.5	12.3	5.7	12.7	-1.3	13.5	655.9
14. Commercial paper issued by nonfinancial firms	15.5	37.5	38.2	37.8	27.7	.0	124.0
15. Sum of lines 13 & 14	8.6	16.0	10.5	16.6	3.3	11.3	779.9
16. Bankers acceptances: U.S. trade related[3,4]	-6.8	17.9	8.0	10.3	17.0	n.a.	35.7[5]
17. Line 15 plus bankers acceptances: U.S. trade related	7.8	16.0	10.5	16.3	4.0	n.a.	808.4[5]
18. Finance company loans to business[3]	12.3	8.0	14.7	14.4	10.8	n.a.	247.6[5]
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.8	14.1	11.5	15.8	5.6	n.a.	1056.0[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. June data.
p--preliminary.
n.a.--not available
Note: Data have been revised to reflect new benchmark adjustments.

consumer receivables, while real estate loans expanded briskly despite the first-ever packaging and sale of home equity loans.

Thrift Institution Legislation

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was signed into law by the President on August 9. The last of the key provisions to be agreed upon by the House and Senate conferees pertained to budgetary treatment of the borrowing required to deal with current and future insolvent thrift institutions. As enacted, FIRREA contains both on-budget and off-budget financing. The legislation puts $20 billion of spending (gross) on budget in fiscal 1989. Outlays of $18.8 billion will be financed directly by the Treasury; the remaining $1.2 billion is to be financed by a transfer from the Federal Home Loan Banks, a transaction that will show up as a negative outlay on the budget. And, $30 billion of spending is to be financed off budget during the next two fiscal years through bonds issued by the Resolution Funding Corporation (REFCORP), a new government-sponsored agency. Most of the interest on the REFCORP borrowings will be paid by the Treasury and from the proceeds of asset sales from failed thrifts, but a portion of the earnings of the Federal Home Loan Banks also will be tapped. The principal will be repaid with maturing zero-coupon Treasury bonds to be purchased with an additional draw on the FHL Banks, as well as by future deposit insurance premiums paid by thrift institutions. Funds for resolutions will be disbursed through the Resolution Trust Corporation, managed by the FDIC.

Other key provisions of FIRREA include the following:

Deposit Insurance and Enforcement Powers

FSLIC is dissolved and replaced by the Saving Association Insurance Fund (SAIF). This new deposit insurance fund and the enforcement powers of the FSLIC are placed under administrative control of the FDIC, and the Federal Home Loan Bank Board is dissolved. The regulatory functions of the FHLBB are moved within the Treasury Department to the Office of Thrift Supervision (OTS), which will parallel the structure of the Office of the Comptroller of the Currency. In contrast to the existing FHLBB, which has three members, the OTS has a single director, who will be the primary supervisor for all state- and federal-chartered thrifts.

Capital Requirements

FIRREA mandates that OTS establish capital standards for all SAIF-insured thrifts that are no less stringent than those applied to commercial banks. In the event of failure to meet the new capital standards by January 1, 1991, the legislation requires the OTS to prohibit asset growth and impose restrictions on dividends and compensation. As of the end of the first quarter, 23 percent of all solvent SAIF-insured institutions, representing 42 percent of the assets of these institutions, did not meet the new standards.

Investment Provisions

FIRREA defines a new qualified thrift lender (QTL) test that requires a thrift to hold 70 percent of its portfolio in housing-related assets by July 1, 1991. Failure to meet the QTL test will, in general, require a thrift to convert to a bank and will effectively increase the cost of borrowings from the FHL Banks. All junk bond investments must be either liquidated or placed in separately capitalized subsidiaries by July 1, 1994, and all future junk bond investments must be made only through such subsidiaries.

Membership in the FHLB System

The act expands the types of institutions eligible for membership in the FHLB System. Banks and credit unions can qualify for membership and are entitled to borrow from the FHL Banks if these institutions have at least 10 percent of their assets in residential mortgages. It is not anticipated that many additional institutions will be attracted to membership.

Treasury and Sponsored Agency Financing

The staff expects a third-quarter federal deficit of almost $63 billion, compared with a $23 billion surplus registered last quarter. In addition to the normal seasonal upswing, nearly $20 billion of this projected increase in the deficit is attributable to the financing provisions of FIRREA. The Treasury likely will finance the unexpected increase in cash requirements initially in the bill market, as well as by drawing down its cash balance. The Treasury increased the size of the 247-day cash management bill sold last week by $5 billion, to $15 billion, and plans to tap regular weekly issues for additional cash, reversing a general pattern of paying down bills in these auctions since the April tax period. On balance, $14 billion of the expected marketable borrowing of $38 billion in the third quarter may be done in the bill sector.

Passage of the thrift legislation had no immediately discernible impact on rates in related agency markets, including the FHL Banks and FICO. More generally, spreads on sponsored agency debt have been stable or narrowed a bit since the July FOMC meeting. The growth in total debt of these agencies slowed sharply to $5-3/4 billion in the second quarter, after a $15 billion increase a quarter earlier. More than half of the slowing is attributable to the Federal Home Loan Banks and reflects the ongoing paydown of advances by FSLIC-insured thrifts owing to faster deposit growth and declines in assets.

Business Finance

Total borrowing by nonfinancial firms probably has strengthened since the last FOMC meeting, largely reflected in a pickup in bank lending to

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

	1989				
	Q2	Q3[p]	Jul.[e]	Aug.[p]	Sept.[p]
Treasury financing					
Total surplus/deficit (-)	22.9	-62.8	-22.5	-27.2	-13.0
Means of financing deficit:					
Net cash borrowing from the public	10.1	41.0	-4.1	34.3	10.9
Marketable borrowings/ repayments (-)	5.4	38.4	-4.4	32.8	10.0
Bills	-20.0	14.5	-5.8	18.8	1.5
Coupons	25.3	23.9	1.4	13.9	8.5
Nonmarketable	3.3	2.7	.2	1.5	.9
Other borrowing[2]	1.4	.0	.0	.0	.0
Decrease in the cash balance	-29.1	12.3	21.6	-3.7	-5.7
Memo: Cash balance at end of period	43.7	31.5	22.1	25.8	31.5
Other[3]	-3.9	9.5	5.0	-3.3	7.8
Federally sponsored credit agencies, net cash borrowing[4]	5.9[e]	-	-	-	-
FHLBs	3.9	-	-	-	-
FNMA	1.6	-	-	-	-
Farm Credit Banks	.3	-	-	-	-
FAC	.2	-	-	-	-
FHLMC	-1.7[e]	-	-	-	-
FICO	1.1	-	-	-	-
SLMA	.5	-	-	-	-

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

business in July. Corporate financings in the commercial paper and bond markets, however, slackened in July and early August from the strong second-quarter pace. After growing rapidly since last December, commercial paper outstanding has been unchanged since early June. Following heavy issuance in June, new public offerings of investment-grade corporate bonds by nonfinancial firms eased in July, as issuers evidently anticipated another drop in market rates. The junk bond market has continued to absorb a steady supply of new issues in recent months, despite difficulties that have increased spreads between junk bonds and less risky securities to their highest levels in this decade. Part of the deterioration in the junk market may reflect provisions in the savings and loan legislation which require federally insured thrift institutions to divest their junk bond holdings, amounting to $14 billion, over the next five years. In addition, recent publicity about actual and projected losses on junk-bond portfolios and unease about a slowdown in the economy raised concerns about the soundness of investment in high-yield securities.

An increase in stock prices of about 7 percent since the last meeting sent most market indexes to all-time highs before they retreated in recent days (update on Wednesday). Spurred by the runup in stock prices, new issuance of equity by nonfinancial firms has staged a modest revival in recent months, with the increase encompassing both seasoned and initial public offerings. Despite this increased issuance, net retirements of corporate equities are expected to rise to about a $170 billion annual rate in the third quarter, bolstered by retirements associated with the Time-Warner deal.

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

	1987	1988	1989				
	Year	Year	Q1[p]	Q2[p]	May[p]	June[p]	July[p]
Corporate securities - total[1]	24.08	22.23	18.82	19.74	20.99	23.86	15.27
Public offerings in U.S.	21.89	20.21	16.25	17.42	19.00	20.81	13.66
Stocks--total[2]	4.45	3.53	1.47	1.80	1.60	2.81	3.36
Nonfinancial	2.32	1.14	.60	.95	.90	1.27	1.09
Utility	.57	.24	.16	.29	.46	.15	.17
Industrial	1.75	.90	.44	.66	.44	1.12	.92
Financial	2.12	2.39	.87	.85	.70	1.54	2.27
Bonds--total[1]	17.44	16.68	14.78	15.62	17.40	18.00	10.30
Nonfinancial	6.61	6.08	4.57	7.33	10.30	7.60	5.20
Utility	2.02	1.77	.62	2.01	.56	3.45	1.50
Industrial	4.59	4.31	3.95	5.32	9.74	4.15	3.70
Financial	10.83	10.60	10.21	8.29	7.10	10.40	5.10
By quality[3]							
Aaa and Aa	3.25	2.68	3.46	3.12	2.05	3.58	2.20
A and Baa	5.20	5.57	4.96	6.29	6.50	7.70	3.90
Less than Baa	2.77	2.51	1.91	3.82	7.25	2.85	2.45
No rating (or unknown)	.07	.07	.02	.02	.00	.06	.10
Memo items:							
Equity-based bonds[4]	.87	.28	.12	.59	1.02	.63	.11
Mortgage-backed bonds	5.19	4.69	2.85	.88	.50	1.30	1.00
Other asset-backed	.96	1.26	1.58	1.49	1.10	2.51	.65
Variable-rate notes	1.88	1.19	.87	1.80	3.52	.89	.30
Bonds sold abroad - total	2.03	1.93	2.55	2.28	1.91	3.00	1.50
Nonfinancial	.94	.69	.89	.51	.22	.85	.15
Financial	1.09	1.24	1.66	1.77	1.69	2.15	1.35
Stocks sold abroad - total	.16	.09	.02	.04	.08	.05	.11
Nonfinancial	.12	.08	.02	.04	.08	.05	.11
Financial	.04	.01	.00	.00	.00	.00	.00

1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.

2. Excludes equity issues associated with equity for equity swaps that have occured in restructurings. Such swaps totaled $2.2 billion in 1989 Q1 and $4.2 billion in 1989 Q2.

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.

Municipal Securities

Issuance of long-term municipal securities slowed to $8 billion in July, near the average pace of the first half of the year, after surging a month earlier. July's easing reflec'ed a falloff in both bonds issued for new capital and refunding issues, as yields on long-term municipal bonds have lagged declines in other bond rates. Market participants indicate that issuers had been anticipating further declines in municipal yields, in which event volume, especially refunding issues, would have picked up.

GROSS OFFERINGS OF MUNICIPAL SECURITIES

(Monthly rates, not seasonally adjusted, billions of dollars)

	1988	1988		1989		1989		
	Year	Q3	Q4	Q1	Q2	May	June	July[p]
Total offerings[1]	10.88	11.50	11.58	9.20	13.09	7.48	18.28	9.17
Total tax-exempt	10.60	11.30	11.21	8.92	12.95	8.31	18.15	9.00
Long-term	9.01	8.00	10.09	7.77	9.56	7.44	13.78	7.95
Refundings[2]	2.75	1.87	2.91	2.49	2.20	1.50	3.70	1.53
New capital	6.26	6.93	7.18	5.28	7.36	5.94	10.08	6.42
Short-term[3]	1.59	2.52	1.12	1.15	3.39	.87	4.37	1.05
Total taxable	.28	.23	.37	.28	.14	.11	.13	.17

p--preliminary.
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.

The Securities and Exchange Commission (SEC) recently adopted a disclosure rule, effective next January, that requires underwriters of municipal bond issues to review for accuracy and completeness the official statements released by issuers prior to primary offerings of $1 million or more. In addition, underwriters must maintain copies of final official

ARM DISCOUNTS
(June 1989)

Size of discount (basis points)	Average initial rate (percent)	Average base rate (percent)[1]	Percent of total
0	9.95	9.94	44
100 or fewer	9.96	10.56	6
101 - 200	9.79	11.39	25
201 - 300	9.16	11.68	20
301 or more	9.19	12.56	5
All discounted loans	9.53	11.49	56

1. The base rate represents the rate to which the loan will adjust following the discount period. If an index-plus-margin formula determines the adjusted rate, the base rate uses the current value of the index.
Source: FHLBB survey of conventional home mortgages closed during the first five working days of the month.

AVERAGE ARM INDEX VALUES AND INITIAL RATE SPREADS
(Percent)

Period (1)	Initial ARM rate[1] (2)	One-year Treasury (3)	FHLB 11th District cost of funds (4)	ARM spreads: Treasury (2)-(3)	ARM spreads: 11th District (2)-(4)
1985	10.04	8.43	9.52	1.61	.52
1986	8.42	6.46	8.24	1.96	.18
1987	7.82	6.76	7.38	1.06	.44
1988	7.90	7.65	7.69	.25	.21
1988-Q1	7.66	6.78	7.59	.88	.07
Q2	7.71	7.30	7.55	.41	.17
Q3	8.00	8.00	7.70	0	.30
Q4	8.22	8.53	7.92	-.31	.30
1989-Q1	8.76	9.29	8.30	-.53	.46
Q2	9.24	8.93	n.a.	.31	n.a.
1989-Jan.	8.55	9.05	8.13	-.50	.42
Feb.	8.65	9.25	8.35	-.60	.30
Mar.	9.09	9.57	8.42	-.48	.67
Apr.	9.40	9.36	8.65	.04	.75
May	9.30	8.98	8.80	.32	.50
June	9.03	8.44	8.92	.59	.11
July p	8.73	7.89	n.a.	.84	n.a.

1. Initial rate on ARMs indexed to the one-year constant-maturity Treasury yield.

statements for distribution to initial purchasers and secondary market customers of newly issued municipal securities. The SEC's action is not expected to have a noticeable effect on the new issue market: a variety of market participants believe that the new rule simply codifies market practice.

Mortgage Markets

Mortgage lending data for the third quarter are sketchy; but the pickup in single-family housing starts in July, together with the 11-1/2 percent annual rate of growth in real estate lending at banks last month, suggests that home mortgage debt expansion early in the quarter at least matched the second-quarter pace of roughly 8 percent.

Interest rates on fixed-rate mortgages declined during July before turning back up in early August. In the primary market, the average contract rate on new commitments for 30-year fixed-rate conventional home mortgages dipped about 40 basis points to 9.7 percent, the lowest level since the spring of 1987, but has since returned to near 10 percent. Initial rates on adjustable-rate mortgages (ARMs) indexed to the one-year constant-maturity Treasury yield are down about 30 basis points over the intermeeting period. Data on ARM pricing indicate a continued falloff in the availability of deep discount ARMs. About one-quarter of all new ARM loans originated in early June carried rate discounts of 2 percentage points or more (table), down from half of all originations as recently as January. Comparisons between initial ARM rates and common indexes provide additional evidence that ARM lenders have become less aggressive in pricing loans.

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
1986 r	21.9	19.8	14.1	4.6	1.2	3.4
1987 r	21.1	20.0	10.5	6.1	2.4	3.7
1988	19.9	19.4	8.8	4.8	3.8	1.0
1988-Q2 r	19.6	18.8	9.4	6.1	4.1	2.0
Q3 r	21.4	20.9	8.5	6.3	5.7	.7
Q4 r	19.8	19.9	9.5	3.8	2.7	1.1
1989-Q1 r	20.5	19.3	8.3	4.3	2.5	1.7
Q2 p	14.5	12.8	7.0	-1.2	1.4	-2.6
1989-Jan. r	21.5	19.6	7.7	.8	2.6	-1.8
Feb. r	19.6	19.7	8.6	5.7	2.0	3.7
Mar. r	20.4	18.6	8.6	6.3	3.0	3.3
Apr. r	16.1	13.9	7.0	3.0	4.3	-1.3
May r	15.1	12.7	7.1	-.3	.5	-.8
June p	12.3	11.8	7.0	-6.3	-.5	-5.8

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

MORTGAGE-BACKED SECURITY ISSUANCE
(Monthly averages, billions of dollars, NSA unless noted)

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Total	ARM-backed	Total	Private issues[1]	FNMA REMICs[2]	FHLMC REMICs	Agency strips
1986	21.3	21.6	.7	4.0	4.0	0	0	0
1987	20.1	19.6	1.2	5.9	5.0	.1	0	.8
1988	12.4	12.6	2.4	7.1	4.2	.9	1.2	.6
1988-Q2	12.1	12.5	3.0	7.7	4.1	1.3	1.2	.5
Q3	13.2	14.9	3.0	6.1	3.7	.7	1.1	.6
Q4	14.7	14.5	2.6	8.0	4.3	1.2	1.8	.7
1989-Q1	16.0	13.7	3.1	6.9	2.5	1.3	2.8	.4
Q2 p	13.6	13.8	2.8	5.2	.4	2.0	2.1	.1
1989-Jan.	14.6	12.1	.9	6.6	2.2	.9	3.5	0
Feb.	16.2	13.7	3.5	4.7	1.7	1.4	1.5	.2
Mar.	17.1	15.4	4.8	9.4	3.6	1.5	3.4	.9
Apr.	14.8	13.9	3.0	3.9	.4	1.8	1.5	.2
May r	13.0	12.4	2.2	4.0	.2	1.4	2.4	.0
June p	12.9	15.2	3.2	5.9	.7	2.7	2.5	.0

1. Excludes pass-through securities with senior/subordinated structures.
2. FNMA's first REMIC, a $500 million strip security issued in January 1987, is included in the FNMA REMIC category rather than in the strip category.

Thrift restructurings and expectations of sizable liquidations of thrift mortgage-backed security (MBS) portfolios have continued to attract considerable attention in secondary mortgage markets and have contributed to the generally wider spreads of mortgage instruments to comparable Treasuries since early this year. Thrifts currently insolvent on a tangible GAAP basis held approximately $46 billion of MBSs at the end of the first quarter, and additional supply could come from other, thinly capitalized, thrifts. The combined holdings of these two groups account for around $120 billion of the roughly $815 billion of mortgage pass-throughs outstanding. Thrift holdings of MBSs fell sharply in June; this selloff appears to have been mainly a short-run response to the declines in interest rates during the month, which boosted securities prices and allowed capital-hungry thrifts to book a profit on the sales.

Mortgage originations and commitments at thrifts were down in June by a bit more than recent home sales and construction levels would suggest. The explanation may be that borrowers are responding to recent pricing changes by shying away from adjustable-rate mortgages in favor of fixed-rate contracts. Only 31 percent of conventional loans originated in early July for home purchase were ARMs, the lowest proportion in two years. This mix shift would tend to reduce the thrift industry's share of total home mortgage originations, because thrifts more than other mortgage lenders tend to specialize in originating and holding adjustable-rate products.

Consumer Credit

Consumer credit growth remained moderate through early summer. Installment credit expanded in June at a 5 percent annual rate, somewhat

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
			1989		1989		1989		1989
	1987	1988	Q1[1]	Q2	May.[r]	June[p]	May[r]	June[p]	June[p]
Total installment[2]	6.2	8.5	8.7	5.8	7.3	5.1	4.22	2.99	701.1
Installment, excluding auto	5.2	10.7	9.8	8.3	9.3	9.6	3.13	3.25	410.6
Selected types									
Auto	7.5	5.7	7.1	2.2	4.5	-1.1	1.09	-.27	290.5
Revolving	12.3	13.6	16.1	14.8	13.0	20.0	2.00	3.11	189.6
All other	.1	8.3	4.7	2.8	6.2	.8	1.13	.15	221.0
Selected holders									
Commercial banks	7.6	12.7	3.9	7.6	10.9	3.4	2.90	.91	324.3
Finance companies	4.7	3.5	10.0	8.3	9.5	4.4	1.15	.21	146.1
Credit unions	5.1	7.5	11.1	9.0	7.5	8.3	.56	.62	90.5
Savings institutions[3]	6.6	3.8	4.1	-17.8	-11.8	-26.9	-.61	-1.37	59.9
Asset pools (NSA)	n.a.	n.a.	65.4	12.6	3.3	67.7	.09	1.85	34.7
Memorandum:									
Total[4]	4.9	7.3	10.0	3.5	3.4	1.7	2.18	1.08	765.1

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
2. Includes items not shown separately.
3. Savings and loans, mutual savings banks, and federal savings banks.
4. Installment plus noninstallment.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

			1988		1989			
	1987	1988	Aug.	Nov.	Feb.	Apr.	May	June
At commercial banks[1]								
New cars (48 mo.)	10.46	10.86	10.93	11.22	11.76	...	12.44	...
Personal (24 mo.)	14.23	14.68	14.81	15.06	15.22	...	15.65	...
Credit cards	17.92	17.79	17.79	17.77	17.83	...	18.11	...
At auto finance cos.[2]								
New cars	10.73	12.60	12.64	13.20	13.07	12.10	11.80	11.96
Used cars	14.61	15.11	15.16	15.75	15.90	16.39	16.45	16.45

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.

below the reduced pace of the previous three months. The annual growth rate for the second quarter was just under 6 percent, compared with about 8-1/2 percent during the first quarter and for 1988 as a whole. Bank data for July suggest continuation of the recent growth rate in consumer credit.

Sluggish growth of automobile credit has held down the overall expansion of consumer debt. Auto debt outstanding declined slightly in June, and grew at only a 2 percent rate during the second quarter. Although the auto manufacturers progressively sweetened their low-rate financing and rebate programs during the quarter, new-car unit sales rose only moderately. The fact that some form of incentive program has been in place almost continuously over the past two years may account in large part for the tepid reaction to the incentives. With incentives apparently entrenched, the need to respond quickly no doubt has seemed less urgent to consumers than when the programs were first introduced.

Revolving credit, which reflects use of both credit cards and unsecured personal lines of credit, continued to grow rapidly through June. Outstandings increased at a 20 percent annual rate in June, raising the second quarter's pace to almost 15 percent. The rise at banks was quite small, but this reflects a large volume of credit card securitizations, which shift outstandings from originating lenders into the "asset pools" category--rather than any slowdown in new borrowings through revolving accounts. Households also have been increasing their debt against lines of credit secured by home equity (an element of mortgage debt rather than consumer credit). During the second quarter, this type of debt increased at a 27 percent annual rate at commercial banks, the dominant lender in the field with more than one-half of the total amount outstanding.

The delinquency rate on auto loans at the auto finance companies rose somewhat further during the second quarter, continuing a gradual uptrend of four to five years' duration, a period during which the promotional financing schemes of these companies were typically accompanied by some relaxing of credit standards. At 2.6 percent, the delinquency rate is not far below past highs, recorded mostly during business recessions. The experience of the auto finance companies appears out of step with that of other lenders, however, and thus may not accurately reflect the financial situation of households. Other series on loan delinquencies are not yet available for the second quarter, but through the first quarter there was little evidence of any general upward trend.

U.S. Merchandise Trade

In May, the U.S. merchandise trade deficit was $10.2 billion (seasonally adjusted, Census basis, customs valuation), compared with $8.3 billion (revised) in April. The widening of the deficit in May was primarily the result of increases in oil and non-oil imports. Data for June will be available on August 17 and will be discussed in the Greenbook supplement.

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	Balance
1988-May	27.4	3.1	24.3	36.1	3.6	32.5	-8.7
Jun	26.7	2.8	23.9	37.3	3.3	34.0	-10.6
Jul	26.6	3.1	23.5	35.1	3.2	31.9	-8.5
Aug	27.5	3.3	24.2	37.6	3.4	34.2	-10.1
Sep	27.6	3.4	24.2	36.8	3.1	33.7	-9.2
Oct	27.9	3.1	24.8	37.1	2.9	34.2	-9.2
Nov	27.6	3.3	24.3	38.1	2.9	35.2	-10.5
Dec	28.9	3.3	25.6	39.7	3.3	36.4	-10.8
1989-Jan	29.0	3.3	25.7	37.9	3.5	34.4	-8.9
Feb	28.8	3.4	25.4	38.2	3.2	35.0	-9.4
Mar	30.0	3.8	26.2	39.5	3.6	35.9	-9.5
Apr[r]	30.7	3.6	27.1	39.0	4.0	35.0	-8.3
May[p]	30.5	3.5	27.0	40.7	4.7	36.0	-10.2

r--revised p--preliminary

Exports in May were only fractionally less than in April, with small declines in most major trade categories except industrial supplies. Imports in May increased 4 percent, the result of large increases in imports of capital goods, foods, and petroleum and products. The volume of oil imports rose 10 percent in May and the price of imported oil increased by 57 cents per barrel.

For April/May, the deficit was $111 billion at an annual rate (balance-of-payments basis), little changed from the first quarter (see table on the following page). Exports rose 3 percent in both value and volume in April/May, following strong growth in both the fourth quarter of 1988 and the first quarter of this year. By geographic region, most of the increase in the value of exports was to Canada, Japan, and the Asian newly industrialized economies (NIEs).

Both the value and volume of imports rose 2 percent in April/May. The increase in value was accounted for entirely by the rise in the value of oil imports. The average price per barrel rose at an annual rate of 60 percent in April and 10 percent in May; the increase occurred largely in response to accidents in Alaska and the North Sea. Spot and posted prices peaked in April and have since fallen about $2.50 per barrel, partly in response to increases in OPEC production. The quantity of imported oil increased in May from the pace recorded in both the first quarter and April as inventories were replenished.

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

	1988				1989		
	Year	Q2	Q3	Q4	Q1	April	May
Value (Bil. $)	39.31	40.99	39.10	36.87	43.34	50.90	58.90
Price ($/BBL)	14.39	15.20	14.24	12.85	15.53	18.35	18.78
Volume (mbd.)	7.48	7.37	7.50	7.84	7.65	7.60	8.59

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - BOP basis (current dollars) - - - - - - -						
1987	250	30	220	410	43	367	-160
1988	319	38	281	446	39	407	-127
1988-1	306	36	270	440	40	399	-133
-2	314	38	276	440	41	399	-126
-3	322	40	283	444	39	405	-121
-4	335	39	296	463	37	426	-128
1989-1	354	44	310	465	43	421	-110
A/M	365	44	321	476	55	421	-111
	- - - - - BOP basis (constant 1982 dollars)[1] - - - -						
1988-1	337	40	297	461	84	377	-124
-2	339	40	299	457	85	372	-118
-3	338	35	303	463	86	377	-125
-4	352	36	316	477	89	388	-125
1989-1	368	41	327	473	89	384	-105
A/M	378	42	336	482	94	388	-104
Percent Change:							
A/M/Q2	11.5	5.0	9.0	5.5	10.6	4.3	
A/M/Q1 (not AR)	2.7	2.4	2.8	1.9	5.6	1.0	
	- - - - - - GNP basis (constant 1982 dollars) - - - - -						
1988-1	336	40	296	460	83	377	-124
-2	339	39	300	457	85	372	-118
-3	344	36	308	468	86	382	-124
-4	359	36	323	483	90	393	-124
1989-1	373	40	333	477	88	389	-104
-2	384	41	343	486	94	392	-102
Percent Change:							
Q2/Q2	13.3	5.1	14.3	6.3	10.6	5.4	
Q2/Q1 (not AR)	2.9	2.5	3.0	1.9	6.8	0.8	

1. Constant dollar estimates are derived using deflators from the GNP accounts.

The value of non-oil imports was unchanged in April/May, while the volume increased by 1 percent. By region, declines in imports from Japan and Western Europe were matched by increased imports from Canada. Imports from developing countries were also unchanged, as increases in imports from Mexico and the NIEs were offset by declines from other developing countries.

Import and Export Prices

During the second quarter of 1989, the price of non-oil imports, as measured by the Bureau of Labor Statistics, fell 3.1 percent at an annual rate following a 2.2 percent increase in the first quarter. The net decline in non-oil import prices during the first half of 1989 follows a nearly 4 percent annual rate of increase in the second half of last year, and results in a net increase of 1.4 percent since the second quarter of last year. The pattern of rising prices in the second half of 1988 (when the dollar was depreciating) and flat or falling prices more recently (when the dollar was appreciating) was evident across most major categories of imports with the notable exception of consumer goods, which continued to show price increases this year. A large proportion of imports of consumer goods come from developing countries, especially in Asia, against whom the dollar has depreciated this year.

Prices of nonagricultural exports rose 0.7 percent at an annual rate during the second quarter, and 3.1 percent over the year ending in the second quarter. Since the beginning of the year, prices of exports of capital goods and industrial supplies have moved in tandem with their counterparts in the Producer Price Index (PPI): in both indexes prices of capital goods increased at a fairly constant rate in the first two quarters and prices of industrial supplies rose sharply in the first

IMPORT AND EXPORT PRICE MEASURES
(percentage change from previous period, annual rate)

	Year 1989-Q2 / 1988-Q2	Half-Yr 1988-Q4 / 1988-Q2	Quarters 1989 Q1	Quarters 1989 Q2	Months 1989 May	Months 1989 June
					(monthly rates)	
	BLS Prices					
Imports, Total	3.3	1.4	7.3	3.4	0.7	-0.6
Foods, Feeds, Bev.	-1.8	-1.8	-1.4	-7.2	2.0	-3.1
Industrial Supplies	2.4	5.1	5.0	-5.4	2.2	-0.2
Capital Goods	0.0	2.0	0.3	-4.2	-0.2	-1.1
Automotive Products	2.0	5.5	-0.3	-2.5	-0.2	-0.1
Consumer Goods	2.4	1.7	4.1	1.9	0.2	-0.1
Memo:						
Oil	25.5	-21.7	104.4	97.9	4.8	1.4
Non-oil	1.4	3.4	2.2	-3.1	0.3	-0.8
Exports, Total	3.4	3.9	6.2	-0.4	0.3	-0.3
Foods, Feeds, Bev.	6.4	13.2	12.1	-11.4	3.5	-3.1
Industrial Supplies	2.0	0.5	7.3	0.0	-0.4	-0.4
Capital Goods	3.0	2.7	3.8	2.7	0.1	0.4
Automotive Products	3.6	5.6	1.5	1.9	0.0	0.6
Consumer Goods	4.5	4.2	8.8	1.0	0.2	0.1
Memo:						
Agricultural	4.6	5.7	13.6	-5.7	3.1	-2.1
Nonagricultural	3.1	3.5	4.7	0.7	-0.2	0.0
	Prices in the GNP Accounts					
Fixed-Weighted						
Imports, Total	4.7	0.2	11.3	7.6	--	--
Oil	20.5	-28.6	114.9	92.7	--	--
Non-oil	2.6	4.5	2.6	-1.2	--	--
Exports, Total	3.5	6.9	-0.8	1.1	--	--
Ag.	9.9	24.9	-2.9	-3.6	--	--
Nonag.	2.3	3.7	-0.3	2.2	--	--
Deflators						
Imports, Total	2.6	1.5	6.0	1.6	--	--
Oil	20.7	-28.3	113.1	93.8	--	--
Non-oil	1.2	5.1	-1.5	-3.4	--	--
Exports, Total	4.1	5.2	5.2	1.0	--	--
Ag.	9.9	24.9	-2.9	-3.6	--	--
Nonag.	3.5	3.3	5.6	1.8	--	--

quarter and were essentially flat in the second quarter. On the other hand, prices of consumer goods in the PPI have risen smoothly in the first two quarters of the year, but prices of exports of consumer goods have shown an uneven pattern of sharp increase in the first quarter and little change in the second quarter.

U.S. International Financial Transactions

Capital inflows into the United States in the form of net private purchases of U.S. bonds continued in the second quarter, but at a slower pace than in the first quarter. Private foreign net purchases of U.S. Treasury securities were $1.8 billion, down from $8.7 billion in the first quarter. (See line 3 of the Summary of U.S. International Transactions Table.) Large net purchases in May were reversed partially in June; the bond market rallied substantially in both months. Foreign net purchases of U.S. corporate and government agency bonds were $6.2 billion in the second quarter, down from $8.8 billion in the first quarter (see line 2a), and with larger purchases in June than in May. More recent data for July and early August indicate that new issues of Eurobonds by U.S. corporations are down somewhat from the second quarter pace. Investor concern about takeovers has resulted in wide spreads between rates on corporate and sovereign Eurobonds.

Foreign net purchases of U.S. corporate stocks were very large in the second quarter, particularly in June (see line 2b). Residents of Japan were the largest purchasers. U.S. net purchases of foreign securities, particularly stocks, were also very large in the second quarter (see line 2c). Purchases were mainly from Europe; there were net sales to Japan.

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

	1987 Year	1988 Year	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Apr.	1989 May	1989 June
.vate Capital										
Banks										
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	47.5	21.0	15.3	-0.5	9.1	-0.9	0.6	-3.3	4.2	-0.3
Securities										
2. Private securities transactions, net[1]	36.4	15.5	10.9	5.8	0.9	5.8	3.6	2.5	-0.1	1.2
a) foreign net purchases (+) of U.S. corporate bonds	26.4	26.9	8.9	6.4	9.0	8.8	6.2	3.6	0.4	2.2
b) foreign net purchases (+) of U.S. corporate stocks	16.8	0.4	1.1	1.3	-2.0	0.1	3.7	*	1.0	2.6
c) U.S. net purchases (-) of foreign securities	-6.9	-11.8	1.0	-1.9	-6.1	-3.1	-6.2	-1.1	-1.4	-3.7
3. Foreign net purchases (+) of U.S. Treasury obligations	-7.3	20.6	5.6	3.5	5.5	8.7	1.8	-1.0	8.2	-5.4
Official Capital										
4. Changes in foreign official reserves assets in U.S. (+ = increase)	47.7	40.2	6.5	-2.0	10.7	7.8	-5.4	6.2	-7.4	-4.2
a) By area										
G-10 countries (incl. Switz.)	38.8	15.5	-0.8	-6.8	5.3	0.1	-8.7	2.6	-3.7	-7.6
OPEC	-8.9	-3.4	-1.7	-0.8	0.7	6.8	0.2	-0.7	-0.4	1.2
All other countries	17.8	28.0	9.0	5.7	4.6	0.9	3.2	4.3	-3.3	2.3
b) By type										
U.S. Treasury securities	43.2	41.7	5.9	-3.8	11.9	4.6	-9.8	-0.2	-5.4	-4.2
Other[2]	4.5	-1.6	0.6	1.8	-1.3	3.1	4.4	6.4	-2.0	*
5. Changes in U.S. official reserve assets (+ = decrease)	9.1	-3.6	*	-7.4	2.3	-4.0	-12.1	-0.3	-6.5	-5.3
Other transactions (Quarterly data)										
6. U.S. direct investment (-) abroad[4]	-44.2	-17.5	2.4	-4.9	-8.9	-3.7	n.a.	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.[4]	46.9	58.4	13.9	11.9	23.0	14.4	n.a.	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[3,4]	5.7	2.5	-5.4	1.9	5.5	-10.8	n.a.	n.a.	n.a.	n.a.
9. U.S. current account balance[4]	-143.7	-126.5	-33.5	-32.3	-28.7	-30.7	n.a.	n.a.	n.a.	n.a.
10. Statistical discrepancy[4]	1.9	-10.6	-15.7	24.0	-19.4	13.4	n.a.	n.a.	n.a.	n.a.
MEMO:										
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-159.5	-127.2	-31.4	30.3	-32.0	-27.6	n.a.	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. Line 2a includes all U.S. bonds other than Treasury obligations.
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 to the data in lines 1 through 5 since publication of the quarterly data in the ey of Current Business.
ncludes seasonal adjustment for quarterly data.
ess than $50 million.

NOTE: Details may not add to total because of rounding.

A small net inflow was reported by banks in the second quarter (see line 1). In addition, credit extended to U.S. residents by the foreign branches of U.S. banks continued to expand through July, as the prime-LIBOR spread continued to widen. (See line 2 of the International Banking Data Table.)

Official reserve assets in the United States declined substantially in the second quarter, reflecting large intervention sales of dollars by the G-10 countries. (See line 4 of the Summary of U.S. International Transactions Table.) Partial information from FRBNY indicates little further change in G-10 holdings in July. U.S. foreign exchange reserves (line 5) increased by $6.5 billion in May and $5.3 billion in June, largely reflecting foreign exchange market intervention to limit the appreciation of the dollar.

Foreign Exchange Markets

The weighted-average foreign-exchange value of the dollar in terms of the other G-10 currencies, shown in Chart 1, has risen 2-1/4 percent since the July FOMC meeting. The dollar strengthened gradually to mid-July, then declined as dollar interest rates moved lower. In August, as the likelihood of a continued decline in domestic interest rates seemed to recede, the dollar began climbing again, especially after U.S. retail sales figures were released on August 11. Overall, the dollar has risen more against the mark, about 3 percent, than against the yen, about 2 percent.

Foreign exchange market intervention was light during most of the period since the July FOMC meeting. The Desk remained largely out of the market until mid-August. Desk sales totaled $850 million: $500 million against yen and the remainder against marks.

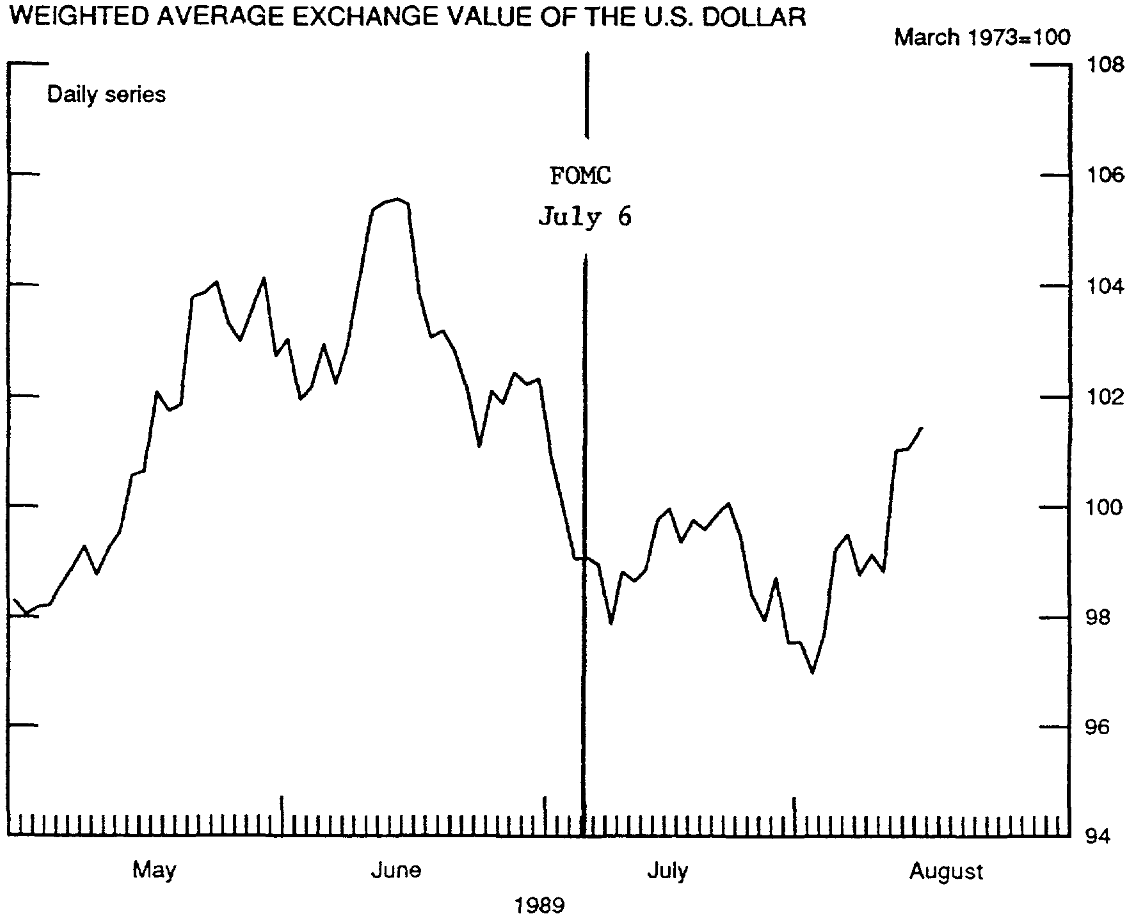
INTERNATIONAL BANKING DATA
(Billions of dollars)

	1986	1987	1988				1989				
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	Apr.	May	June	July
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	22.3	-10.9	8.7	-4.8	-4.9	-4.9	-2.9	3.4	1.6	-3.9	-4.1
(a) U.S.-chartered banks	31.7	15.2	27.8	17.0	16.6	21.6	20.4	23.7	22.7	19.2	17.2
(b) Foreign-chartered banks	-9.4	-26.1	19.0	-21.8	21.5	-26.5	23.3	-20.3	-21.1	-23.1	-21.3
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	16.8	15.8	19.1	19.7	21.4	21.2	24.0	24.2	25.4	26.0	26.2
3. Eurodollar Holdings of U.S. Nonbank Residents	124.5	132.6	128.9	138.1	141.1	145.3	144.2	144.3	141.8	138.3	142.0

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

Movements in interest rate differentials between dollar-denominated and foreign-currency-denominated assets have shown a mixed picture in the period since the July FOMC meeting. Short-term interest rate differentials have generally narrowed: some short-term rates in the United States have declined, while Japanese short-term interest rates have increased slightly and German short-term rates have changed little. Long-term differentials have widened: long-term bond yields in the United states have risen, while in both Japan and Germany, they have declined by 10 to 15 basis points.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



Developments in Foreign Industrial Countries

Economic growth slowed significantly in the major foreign industrial countries in the second quarter, following a robust first quarter. Much of the slowing was attributable to special factors that affected growth in both quarters. Industrial production in the second quarter was flat in Japan and fell in Germany, largely because the anticipated introduction in April of a sales tax in Japan and a mild winter in Europe had boosted first-quarter growth in both those countries to unsustainable rates. Second-quarter growth in industrial production was sluggish in the United Kingdom and moderately strong in France, Canada, and Italy.

Inflation rates rose slightly in the major foreign economies in the second quarter on average, but inflation appears to have been leveling off by the end of the quarter. Some of the acceleration in inflation reflected currency depreciations against the dollar and increases in indirect taxes in Japan and Canada. The slowing at the end of the quarter partly reflected an easing in energy prices.

Trade-balance developments abroad have been mixed recently. Japan, Germany, and Canada recorded smaller trade surpluses in the second quarter, while the French deficit widened. The trade deficits of the United Kingdom and Italy narrowed, but remained relatively high.

Individual Country Notes. The pace of economic activity in Japan slowed substantially in the second quarter from a very rapid first-quarter rate. This pattern was mainly the consequence of a bunching of purchases in advance of the introduction of the 3 percent consumption tax in April. The underlying rate of economic growth seems to have remained fairly robust.

The substantial impact of the introduction of the consumption tax can be seen in the table on Japanese economic indicators. Industrial production, retail sales, and the capacity utilization rate all jumped sharply in March in advance of the tax, and then declined in April. Later, all of these series resumed their upward movement and, as of June, industrial production and retail sales were both well above year-earlier levels (7.8 percent and 6.6 percent, respectively). The unemployment rate fell in June to its lowest level in seven years.

JAPANESE ECONOMIC INDICATORS
(percent change from previous period except were noted, s.a.)

	1988	1989					
	Q4	Q1	Q2	Mar.	Apr.	May	Jun.
Real GNP	0.8	2.2	--	--	--	--	--
Industrial Production	1.8	3.1	0.0	5.4	-3.8	0.5	2.0
Retail Sales	2.7	6.4	-5.4	17.0	-18.0	4.9	2.1
Capacity Utilization	1.6	0.0	--	5.3	-3.6	1.0	--
Unemployment Rate (percent)	2.4	2.3	2.3	2.3	2.3	2.4	2.2

Prices increased sharply in the second quarter in Japan, due both to the introduction of the consumption tax in April and the weakness of the yen in May and June. The 12-month increase in wholesale prices rose from 2.5 percent in April to 3.7 percent in June, while the 12-month increase in consumer prices in Tokyo moved up from 2.7 percent in April to 3.3 percent in June. With the strengthening of the yen in July, the rise in consumer and wholesale prices moderated.

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

	Q4/Q4 1987	Q4/Q4 1988	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Feb.	1989 Mar.	1989 Apr.	1989 May	1989 June	Latest 3 months from year ago 2
Canada												
GDP	6.5	4.0	.8	.7	.9	n.a.	*	*	*	*	*	3.9
IP	8.5	2.5	.9	-.6	.1	n.a.	.7	-.5	1.3	.2	n.a.	1.7
France												
GDP	2.6	3.0	1.0	.5	1.0	n.a.	*	*	*	*	*	2.9
IP	3.2	4.3	3.2	-.1	1.0	n.a.	-.7	-.6	3.4	-2.2	n.a.	5.6
Germany												
GNP	2.4	2.6	1.1	.3	2.9	n.a.	*	*	*	*	*	4.2
IP	1.5	4.0	1.8	.6	2.4	-1.4	.0	-.1	1.0	-4.6	2.3	3.4
Italy												
GDP	2.7	3.0	1.1	1.0	.7	n.a.	*	*	*	*	*	3.1
IP	5.7	6.7	.2	4.4	.1	n.a.	1.9	-2.6	.1	n.a.	n.a.	4.5
Japan												
GNP	5.7	4.8	2.3	.8	2.2	n.a.	*	*	*	*	*	4.5
IP	8.1	7.6	2.0	1.8	3.1	.0	-1.8	5.4	-3.8	.5	2.0	7.1
United Kingdom												
GDP	4.2	3.0	.3	.5	.4	n.a.	*	*	*	*	*	1.4
IP	4.1	2.6	1.6	.2	-1.9	-.8	-.7	.3	.0	-1.2	.1	-.9
United States												
GNP	5.4	3.4	.8	.7	.9	.4	*	*	*	*	*	2.8
IP	5.8	5.0	1.7	1.1	.5	.5	-.2	.1	.6	-.1	-.2	4.0

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 1987	Q4/Q4 1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Apr.	1989 May	1989 June	1989 July	Latest 3 months from year ago
Canada													
CPI	4.2	4.1	.8	1.3	1.1	.8	1.2	1.7	.3	1.0	.5	n.a.	5.0
WPI	4.3	3.5	1.1	.9	1.0	.5	1.1	n.a.	.1	.0	n.a.	n.a.	3.3
France													
CPI	3.2	3.0	.5	1.0	.9	.6	.8	1.2	.6	.4	.1	n.a.	3.6
WPI	2.6	7.5	1.1	.8	2.7	2.6	2.1	n.a.	*	*	*	*	8.6
Germany													
CPI	1.0	1.5	.5	.5	.1	.4	1.6	1.0	.6	.2	.2	-.2	3.1
WPI	-.7	2.7	.1	1.1	.4	1.2	2.7	1.7	1.1	.3	-.1	-.9	5.6
Italy													
CPI	5.2	5.2	1.1	1.0	1.0	1.9	2.0	1.7	.7	.4	.5	n.a.	6.8
WPI	4.6	5.4	1.1	1.3	1.2	1.7	2.3	n.a.	.5	.4	n.a.	n.a.	6.9
Japan													
CPI	1.1	1.5	-.2	.6	.1	1.0	-.1	2.1	1.4	.6	-.1	-.2	3.4
WPI	-.6	-1.4	-1.2	-.3	.9	-.8	.5	2.7	1.7	.7	.7	.0	3.4
United Kingdom													
CPI	4.1	6.5	.5	2.4	1.4	2.1	1.6	2.9	1.8	.6	.3	n.a.	8.2
WPI	4.1	4.9	1.1	1.4	1.2	1.1	1.4	1.2	.5	.3	.3	.3	4.9
United States													
CPI (SA)	4.4	4.3	.9	1.1	1.2	1.1	1.3	1.6	.7	.6	.2	n.a.	5.2
WPI (SA)	2.5	3.4	.6	.8	1.1	.9	2.2	1.6	.4	.9	-.1	-.4	5.7

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)

	1987	1988	1988				1989		1989			
			Q1	Q2	Q3	Q4	Q1	Q2	Apr.	May	June	July
Canada												
Trade	8.3	7.8	1.6	2.1	2.6	1.5	2.0	n.a.	.1	.3	n.a.	n.a.
Current account	-8.0	-8.4	-1.4	-1.7	-2.1	-3.2	-3.1	.0	*	*	*	*
France												
Trade	-5.2	-5.4	-.9	-.6	-1.9	-2.0	-.6	-2.0	-.6	-1.0	-.4	n.a.
Current account	-4.1	-4.0	1.4	-.7	-1.1	-3.6	1.0	n.a.	*	*	*	*
Germany												
Trade (NSA)	65.9	72.8	15.0	19.9	17.0	21.0	19.4	17.7	5.3	5.4	7.0	n.a.
Current account (NSA)	45.6	48.7	9.7	14.4	8.7	15.9	15.8	13.6	4.1	4.4	5.1	n.a.
Italy												
Trade	-9.0	-10.1	-2.9	-1.7	-2.4	-2.9	-4.4	-3.4	-1.2	-1.5	-.8	n.a.
Current account (NSA)	-1.6	-5.4	-5.2	1.0	.2	-1.5	n.a.	n.a.	*	*	*	*
Japan												
Trade	79.5	78.1	20.9	16.9	18.4	21.9	21.9	15.4	6.7	3.6	5.1	5.0
Current account 2	87.0	79.6	22.3	17.1	18.1	21.2	21.2	12.5	6.2	3.4	2.9	n.a.
United Kingdom												
Trade	-15.9	-36.1	-7.1	-8.1	-9.4	-11.5	-10.4	-9.4	-3.7	-2.8	-2.9	n.a.
Current account	-4.7	-26.3	-5.1	-4.9	-6.3	-10.0	-8.4	-7.5	-3.0	-2.2	-2.3	n.a.
United States												
Trade 2	-159.5	-127.2	-33.4	-31.4	-30.3	-32.0	-27.6	n.a.	*	*	*	*
Current account	-143.7	-126.5	-32.0	-33.5	-32.3	-28.7	-30.7	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.

The Japanese trade surplus in July was \$60 billion (s.a.a.r.), virtually unchanged from June and below the average surplus rate so far this year. On a cumulative basis through July, the trade surplus rate was \$72 billion (s.a.a.r.), down slightly from the \$75 billion surplus rate in the first seven months of last year.

On July 23, the ruling Liberal Democratic Party (LDP) suffered a severe defeat in elections for half of the seats in the upper house of the parliament. Following the elections, LDP Prime Minister Sosuke Uno resigned, and the LDP chose former Education Minister Tashiki Kaifu as the new Prime Minister. Elections for the more powerful lower house of the parliament are not required until next July, but the magnitude of the LDP's defeat in the recent upper-house elections makes a lower-house election within the next several months likely.

Economic growth slowed sharply in Germany in the second quarter, following unsustainably rapid growth in the first quarter. The see-saw pattern of growth in the first half largely reflected a temporary boom in construction activity, the result of a very mild winter. Industrial production (s.a.) fell in the second quarter to a level 3.4 percent above its year-earlier level, down from a 5.5 percent year-over-year rise in the first quarter. In contrast, the volume of manufacturers' new orders (s.a.) rose in the second quarter to a level 8.8 percent above its year-earlier level. In the labor market, the unemployment rate (s.a.) has stabilized at just under 8 percent in recent months. A shortage of skilled workers has been reported in numerous industries, and virtually all short-time employment has been pulled into full-time employment. Moreover, capacity utilization in manufacturing rebounded in the second quarter to its highest level since the early-1970s.

GERMAN ECONOMIC INDICATORS
(percent change from previous period except where noted, s.a.)

	1988	1989					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial Production	0.6	2.4	-1.4	1.0	-4.6	2.3	--
Volume of Manufacturing Orders	-0.7	2.3	3.0	1.7	-3.4	1.8	--
Capacity Utilization	1.5	-0.9	1.1	--	--	--	--
Unemployment Rate (percent)	8.5	7.9	7.9	7.9	8.0	7.9	7.9

Inflation remains a key concern, but it has lessened somewhat in recent months, as shown in the table below. Most of the easing reflects an appreciation of the mark (on a trade-weighted basis) since late-May and a decline in energy prices. A weak mark, rising energy prices, and higher consumer excise taxes boosted inflation earlier in the year.

GERMAN INFLATION INDICATORS
(percent change from year earlier)

	1988	1989					
	Q4	Q1	Q2	Apr.	May	June	July
Consumer Prices	1.5	2.6	3.1	3.0	3.1	3.1	3.0
Industrial Producer Prices	1.7	3.1	3.3	3.5	3.4	3.0	3.0
Wholesale Prices	2.7	5.4	6.1	6.5	6.5	5.5	5.0
Import Prices	2.2	6.1	6.6	7.3	7.1	5.3	--
GNP Deflator	1.9	2.6	--	--	--	--	--

Germany's trade and current account surpluses (s.a.)--after establishing new records in the first quarter--narrowed in the second quarter. However, on a cumulative basis through June, both the trade surplus and the current account surplus remained somewhat larger than their year-earlier levels. Almost all of the rise in Germany's trade surplus this year reflects an increase in its surplus within the EEC; its surplus with the United States has been more than halved.

The Bundesbank, still concerned about inflation, raised its official lending rates in late-June for the fourth time since December. Growth in M3 since the fourth quarter of 1988 eased from 6.1 percent (s.a.a.r.) through April to 4.3 percent through June, putting M3 growth below the Bundesbank's 1989 target of "about 5" percent.

Economic growth in France appears to have moderated in recent months from the strong pace in the first quarter. Industrial production fell sharply in May, but was still 5.2 percent above its year-earlier level. The unemployment rate has remained at 10 percent for the past three quarters. In the second quarter, real consumption expenditures on manufactures were nearly 2 percent (s.a.) below their first-quarter level. Inflation slowed in June, and consumer prices were only 3.6 percent above their year-earlier level.

After two consecutive months of larger trade deficits, the deficit narrowed considerably in June, largely reflecting the sale of 14 Airbus airliners. The cumulative trade deficit for the first half of 1989 was slightly larger than in the first half of 1988, but considerably narrower than that registered in the second half of last year.

Evidence that economic growth has slackened in the United Kingdom is mounting. Total industrial production fell 0.8 percent (s.a.) in the second quarter to a level 0.9 percent below its year-earlier level. Manufacturing output has trended downward in each month of this year. The volume of retail sales declined 2.3 percent (s.a.) in June and 0.6 percent in July, reducing the 12-month increase to only 0.2 percent, the lowest annual increase in more than six years. Housing starts continued to fall in June and were 25 percent below their level of June 1988. According to the latest survey conducted by the Confederation of British Industry, U.K. business optimism has fallen sharply, and investment intentions were markedly lower than at the time of the previous survey in April.

Producer-price inflation edged down from 5.2 percent in the year to the first quarter to 4.8 percent in the year to July. The 12-month inflation rate in retail prices remained at 8.3 percent in June, prompting government officials to contend that U.K. inflation may have peaked. However, wage pressures continued, as average earnings rose to a level 9.5 above a year earlier in May.

The U.K. trade deficit (s.a.) rose slightly in June. Through the first half of 1989, the trade deficit average $39.6 billion (s.a.a.r.), up from a rate of $30.6 billion in the first half of 1988, but down slightly from its rate in the second half of last year.

There is mixed evidence of a slowdown in Canada. Strong investment has boosted some measures of activity. Industrial production rose 0.3 percent (s.a.) in May, following a 1.3 percent rise in April, and manufacturers' new orders rose 2 percent (s.a.) in May. Recent investment surveys suggest that the business sector will increase capital outlays by nearly 14 percent this year, stronger than earlier surveys suggested. In contrast, high interest rates have reduced activity in other sectors. Canada's unemployment rate rose from 7.3 percent in May to 7.5 percent in June. Housing starts were unchanged in June following three monthly declines, putting the second-quarter level down 13 percent (s.a.a.r.) from the first quarter, and auto sales declined in July for the third consecutive month to a rate 13 percent below that of a year earlier.

Higher federal and provincial sales tax rates contributed to a sharp rise in inflation in May and June. As a result, the 12-month increase in consumer prices rose from 4.6 percent in April to 5.4 percent in June. In view of the recent pickup in inflation and strong growth, the Bank of Canada has allowed the differential between Canadian and U.S. short-term interest rates to widen, thereby contributing to upward pressure on the Canadian dollar.

Economic growth in Italy appears to have slowed during the early months of 1989. Real GDP grew 3 percent (s.a.a.r.) in the first quarter, down from 4.2 percent in the previous quarter. Industrial production was essentially flat (s.a.) through April, but picked up late in the second quarter, according to unofficial data. The 12-month rate for consumer-price inflation was 6.8 percent in the second quarter, up from 5.2 percent in 1988 and 6.1 percent in the first quarter. Much of the rise in inflation during the first half was due to increases in indirect taxes. The Italian trade deficit narrowed, but remained large, in the second quarter.

The new Italian coalition government--Italy's 49th since World War II--is headed by Giulio Andreotti, who is Prime Minister for the sixth time. He has the support of the center and right wing factions in the Christian Democratic party, which puts his government in a better position to implement unpopular fiscal reforms. The new Treasury Minister is Guido Carli, a well respected Christian Democrat, who from

1960 through 1975 was Governor of the Bank of Italy. The shift in control of the Treasury from the Socialist party to the Christian Democrat party is significant because it strengthens the Treasury's control over spending by other Christian Democrat ministers.

Economic Situation in Major Developing Countries

Mexico and its bank advisory committee reached agreement on July 23 on a comprehensive financial package that provides creditor banks options of principal reduction, interest reduction, and new money. Since the inauguration of President Carlos Menem on July 8, Argentina has begun to implement a stabilization program, including a large devaluation of the austral, hikes in public-sector prices, and a 90-day price freeze. Short-term interest rates have fallen in Mexico, Argentina, and Brazil, and official reserves have risen in Mexico and Argentina. Colombia signed a $1.65 billion new-money loan on August 10 with its commercial bank creditors; the commercial banks began their signing on July 23. The Philippines has reached a substantive agreement on a financing package, and Venezuela is actively negotiating a financing package with its commercial bank creditors.

Individual country notes. Mexico and its bank advisory committee reached agreement in principle on July 23, 1989 on a comprehensive financial package that provides creditor banks with three basic options: principal reduction, interest reduction, and new money. Depending on the preferences of banks for these options, the package should provide $7-$8 billion in financing over the next three years at current interest rates. Under the debt-reduction and interest-reduction options, creditor banks would exchange their medium- and long-term loans for new

30-year bonds to be issued by Mexico. Principal-reduction (discount) bonds would be issued in exchange for existing loans at a discount of 35 percent, with a floating interest rate of LIBOR plus 13/16 percent. Interest-reduction (par) bonds would be exchanged for existing loans at par, and would bear interest at a fixed rate of 6-1/4 percent. Principal payments on the new bonds will be collateralized by 30-year, U.S. Treasury zero-coupon obligations or comparable collateral purchased by Mexico. Interest payments will be supported on a rolling basis for at least 18 months and up to 24 months by a collateral account established by Mexico. Support for both types of bonds will come from $7 billion of enhancements from the IMF, the World Bank, Mexico, and development loans from Japan. Banks electing these options may be eligible, beginning in July 1996, to "recapture" some of the lost value of their former claims, depending on the level of Mexico's real earnings from oil exports at that time. Creditor banks electing to provide new money will be asked to commit, over a four-year period, to new loans amounting to a total of 25 percent of their existing medium- and long-term loans that are not exchanged for principal-reduction or interest-reduction bonds. The new loans will be repayable in 15 years, with 7 years of grace, and will bear interest at LIBOR plus 13/16 percent. In support of this agreement, the U.S. Treasury and the Federal Reserve have agreed to work with other monetary authorities to develop a short-term bridge loan of up to $2 billion. A number of issues related to the bank financing package still need to be resolved before a complete term sheet can be circulated. Discussions on these issues are continuing.

In the aftermath of the financial agreement, the decline in domestic interest rates underway since late June accelerated in Mexico. At the August 8 auction, the rate for 28-day Treasury bills was 35.6 percent, compared with 57.5 percent on June 27. There was a 12-percentage point decline at the July 24 auction alone. The return of confidence that this represents was reflected in a reflow of capital that enabled the Director General of the Bank of Mexico, Miguel Mancera, to announce on August 3 that international reserves, including gold, totalled $6 billion at the end of July, only about $600 million less than at the end of 1988. Mancera estimated the net repatriation of private capital in the first seven months of the year at $2.3 billion, much of it presumably having occurred in recent weeks. He also estimated the current account deficit in January-July at $2.5 billion, reflecting the continued buoyancy of imports.

Since the inauguration of President Carlos Menem on July 8, Argentina has begun to implement a wide-ranging stabilization program. In the first two weeks of the new administration, the official austral price of the dollar was doubled, public-sector prices and utility rates were raised by as much as 500 percent, and a 90-day price freeze was negotiated with Argentina's 300 leading firms. Legislation currently before Congress will enable the privatization of most state economic enterprises, suspension of the costly industrial subsidies program, revision of the central bank's charter to provide greater independence, and consolidation and refinancing of the government's internal debt. A new system of dollar deposits has also been introduced in an attempt to recapture flight capital and private residents' holdings of dollars.

As a result of the substantial devaluation and hikes in public-sector prices at the beginning of the month, consumer prices soared a record 197 percent in July, following monthly rates of 115 percent in June and 79 percent in May. However, inflation slackened considerably in the latter part of July, and is expected to fall to the 40 to 60 percent range in August. In response to the government's commitment to keep the official exchange rate fixed for the next three months, financial markets have stabilized dramatically. Short-term interest rates fell from over 100 percent per month at the end of June to about 15 percent in mid-July, and have remained relatively stable at that rate. The parallel-market exchange rate has also remained relatively stable since mid-July, and its premium over the official rate has been negligible. As a result, sales of dollars to the central bank have totaled roughly $1 billion since July 8, providing a much-needed replenishment of international reserves, which are believed to have fallen to as low as $100 million at the beginning of July.

Both the World Bank and the IMF have voiced support for the new stabilization package, and talks on a new IMF program are currently underway. Toward this end, Argentina has made various payments to the IMF in the last few months to eliminate arrears more than 60 days overdue. A letter of intent may be signed by late September.

<u>Brazil</u>'s financial situation has also stabilized somewhat over the last several weeks. Consumer prices rose at monthly rates of 25 percent in June and 29 percent in July, but earlier fears that the inflation rate was going to continue to accelerate seem to have abated: the overnight interest rate dropped from around 45 percent per month at the

end of June to around 38 percent now, and the spread between the official and parallel exchange rates narrowed from over 100 percent to 66 percent during the same period. Industrial production was 4.4 percent higher in June than a year earlier. However, because of sharp declines in industrial production earlier in the year, industrial production in the first half of 1989 was 2.1 percent lower than in the first half of 1988.

Brazil continues to generate large trade surpluses. The surplus was $2.2 billion in June and $9.2 billion in the first half of 1989, which was larger than last year's record pace over the same periods. Despite the large trade surpluses, Brazilian officials claim that reserve levels are under strain. (At the beginning of August, the president of the central bank said liquid reserves were about $6 billion. Brazilian officials have stated several times that they will not let liquid reserves fall below the $4-$6 billion range.) As a result, Brazil centralized most foreign exchange transactions at the central bank on June 30 and devalued the cruzado 12 percent against the dollar. The government also failed to make payments of $812 million due the Paris Club in late June and early July, citing its unwillingness to draw on reserves. Subsequently, Brazil resumed some payments to Paris Club creditors, but is still in arrears.

Brazil is currently trying to negotiate a short-term IMF stand-by arrangement. Such an agreement would facilitate release in September of the next $600 million tranche under Brazil's financing package from commercial banks and Brazil's scheduled payment to banks of over $2 billion in the same month.

On August 10, Colombia signed a $1.65 billion commercial bank new-money loan, which will finance Colombia's amortization payments to commercial banks during 1989 and 1990; the commercial banks began their signing on July 23.

On August 8, the Philippines resumed debt negotiations with its commercial bank creditors. Substantive agreement has been reached on a package that includes issuing new-money bonds that would be excluded from future restructurings and a cash buyback of commercial-bank debt at a deep discount--50-55 percent. This package is to be premarketed. On September 12, the Philippines and its bank creditors are expected to meet again to complete agreement on the financing package.

In July, Venezuela presented its first formal proposal for reduction of its external public-sector debt to commercial banks. The proposal was for cash buybacks at a 60 percent discount and debt-for-bond swaps with either the principal or the interest rate reduced by 50 percent. The banks rejected the proposal because of the size of the discounts and the exclusion of an option for lending new money rather than participating in debt reduction. However, negotiations are continuing. Venezuela's economic reform program remains on track; inflation fell to a monthly rate of 2.5 percent in July from a peak of 21.3 percent in March.