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Confidential (FR) Class III FOMC

December 13, 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 probably has expanded further in the fourth quarter, but only modestly. Manufacturing has weakened noticeably, with a good deal of the softness--apart from the setback at Boeing--concentrated among the big-three automakers and their suppliers. Construction activity has been relatively firm, and the service sector still appears to be growing fairly rapidly. Price increases remain damped by ample supplies and foreign competition; with no apparent relief from rising labor costs, profit margins are under pressure in many industries.

Labor Market

Private payrolls rose 199,000 in November, following a downward-revised gain of 106,000 in October. All of the November increase occurred in the service-producing sector, where employment grew 213,000. While much of this rise occurred in the services industry, especially in health care, gains were widespread. A noticeable exception was general merchandise where hiring in November only about matched seasonal norms; whether this reflected demand or supply conditions is not clear, but reports of labor scarcity were common among retailers.

Manufacturing employment fell 27,000 last month; since March, this industry has trimmed nearly 165,000 jobs. Much of the decline has occurred in the motor vehicle and related industries, but there have been notable cutbacks elsewhere, particularly in electrical machinery.

State and local government employment grew only 6,000 in November, after a loss of 2,000 jobs in October. An increase of 106,000 originally had been reported for October; that gain had looked suspicious, and the

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

	1987	1988	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.
	---------------Average monthly changes---------------							
Nonfarm payroll employment[2]	268	276	264	240	163	209	93	210
Strike-adjusted	265	275	274	245	177	133	98	205
Private	241	248	239	198	115	147	106	199
Strike-adjusted	238	248	250	203	128	69	113	194
Manufacturing	29	29	30	-10	-30	-85	-16	-27
Durable	16	20	13	-12	-29	-71	-26	-24
Nondurable	13	9	17	2	-1	-14	10	-3
Construction	15	14	13	10	14	4	8	17
Trade	61	64	77	32	38	19	56	51
Services	107	118	97	137	76	101	36	125
Finance, insurance, and real estate	15	11	10	11	15	16	-3	15
Total government	27	27	25	42	48	62	-13	11
Private nonfarm production workers	199	197	202	151	94	96	56	202
Manufacturing production workers	25	20	19	-14	-27	-82	-9	-19
Total employment[3]	257	189	376	135	-28	-141	89	241
Nonagricultural	252	191	371	172	-82	-91	128	317

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	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.
Civilian, 16 years and older	6.2	5.5	5.2	5.3	5.2	5.3	5.3	5.4
Teenagers	16.9	15.3	15.0	15.1	14.8	15.1	14.9	15.5
20-24 years old	9.7	8.7	8.4	8.3	8.8	8.9	8.9	9.1
Men, 25 years and older	4.8	4.2	4.0	3.9	3.9	4.1	3.9	4.0
Women, 25 years and older	4.8	4.3	4.0	4.3	4.2	4.1	4.2	4.2
White	5.3	4.7	4.4	4.5	4.5	4.5	4.4	4.6
Black	13.0	11.7	11.6	11.2	11.2	11.6	11.8	12.1
Fulltime workers	5.8	5.1	4.9	4.9	4.9	5.0	4.9	5.0
Memo:								
Total national[1]	6.1	5.4	5.1	5.2	5.2	5.2	5.2	5.3

1. Includes resident armed forces as employed.

downward revision to this series, which has a history of questionable "first closings," was not surprising.

In the household survey, the civilian unemployment rate edged up to 5.4 percent in November, the highest level since January. However, the increase in the unemployment rate was accompanied by a gain of 241,000 in household employment, and the employment-population ratio returned to its historical high of 63.0 percent. Nevertheless, other data from the household survey suggested some softening in the labor market last month: the percentage of job losers (particularly those on layoff) rose substantially, and the number of individuals involuntarily employed part-time increased.

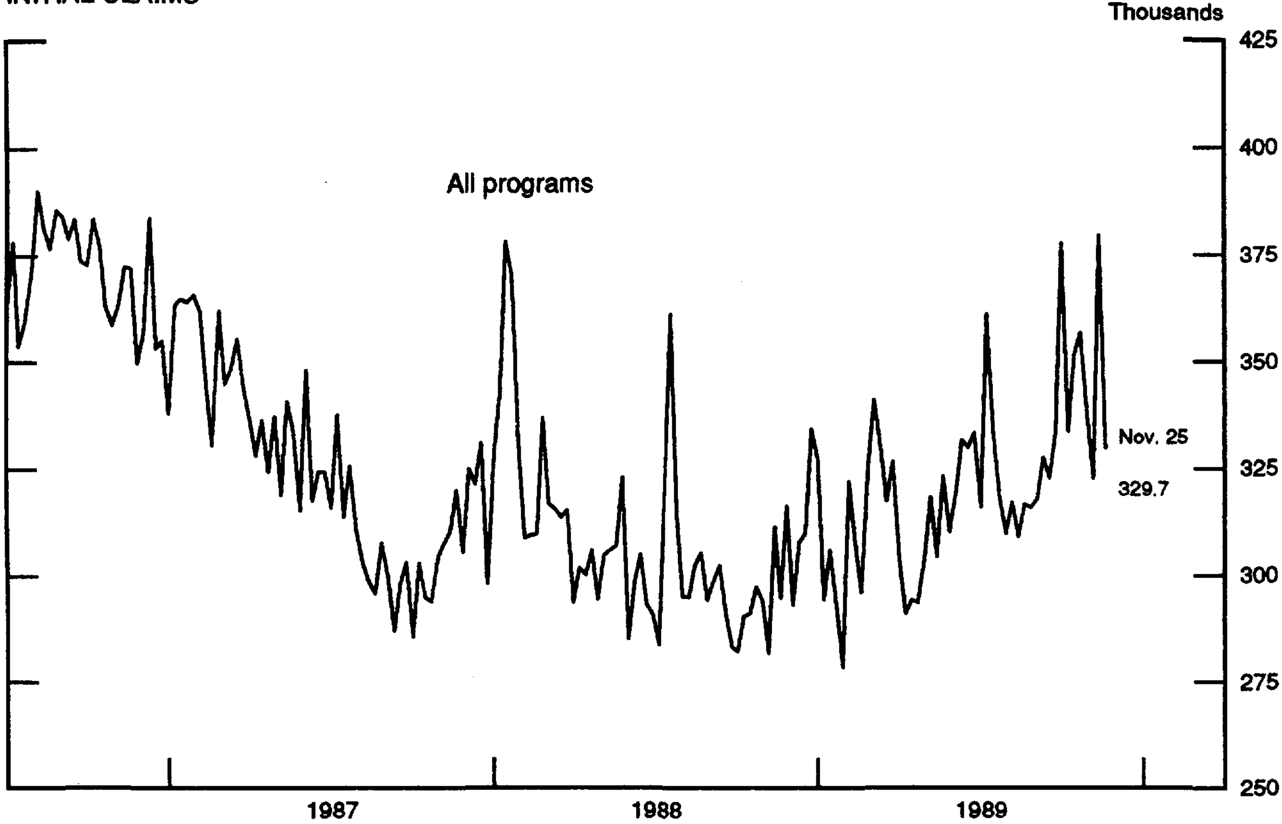
A slight uptick in joblessness also is apparent in data for insured unemployment. New claims for unemployment insurance have fluctuated around 350,000 per week since early October--up from around 320,000 in August and September. Claims were inflated to some extent in October by Hurricane Hugo, strikes in the telecommunications industry, and the California earthquake. But more recently, layoffs in the manufacturing sector appear to have boosted initial claims. The level of insured unemployment also moved higher in October and early November, but, to date, the insured unemployment rate is only a tenth higher than in late September.

Industrial Production

Industrial activity has been weak in the current quarter, even after allowance for the effects of the Boeing strike and the California earthquake. Industrial production was about unchanged in October, after adjustment for these special influences. Based on preliminary estimates, output--with the same adjustment--appears to have declined a bit in

Unemployment Insurance
(Weekly data; seasonally adjusted, FRB basis <1>)

INITIAL CLAIMS



INSURED UNEMPLOYMENT

<1> Only the state program components of these series are seasonally adjusted.

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

	Share of total IP[1]	1987[2]	1988[2]	1989 H1[2]	1989 Q3	1989 Aug.[r]	1989 Sept.[r]	1989 Oct[e]
				-Annual rate-		---Monthly rate---		
Total index	100.0	5.8	5.0	2.7	1.3	.4	.0	-.7
Excluding motor vehicles	95.5	5.9	4.9	3.2	2.4	.2	.1	-.6
Products	**61.4**	4.9	5.4	4.5	.6	.3	.0	-.9
Consumer goods	24.9	3.2	6.0	3.5	-1.8	.3	-.1	-.3
Motor vehicles	2.7	4.4	8.8	-3.6	-21.4	1.7	-1.1	-3.0
Other	22.2	3.0	5.6	4.4	.8	.2	.0	.0
Business equipment	16.5	7.0	8.3	9.5	.8	.7	-.2	-2.1
Motor vehicles	1.0	3.9	10.7	-13.5	-25.0	6.1	-.1	-3.8
Computers	4.2	9.8	8.2	24.0	-5.0	2.1	.9	-1.9
Other	11.2	5.8	6.2	6.7	5.8	-.3	-.6	-2.0
Materials	**38.6**	7.2	4.6	-.1	2.4	.5	.0	-.5
Durable	20.2	8.0	6.9	-.3	3.8	.6	-.3	-.8
Nondurable	9.7	8.1	4.1	2.5	2.5	-.1	-1.1	-.5
Energy	8.7	4.5	-.1	-2.7	-1.2	.8	2.2	.1
Memo:								
Manufacturing	**87.6**	4.3	6.0	3.5	1.3	.4	-.2	-.8
Durable	50.8	3.7	2.6	3.2	.4	.6	-.3	-1.5
Nondurable	36.8	5.2	5.2	4.4	2.7	.1	-.1	.1

1. As of 1988
2. From the final quarter of the previous period to the final quarter of the period indicated.

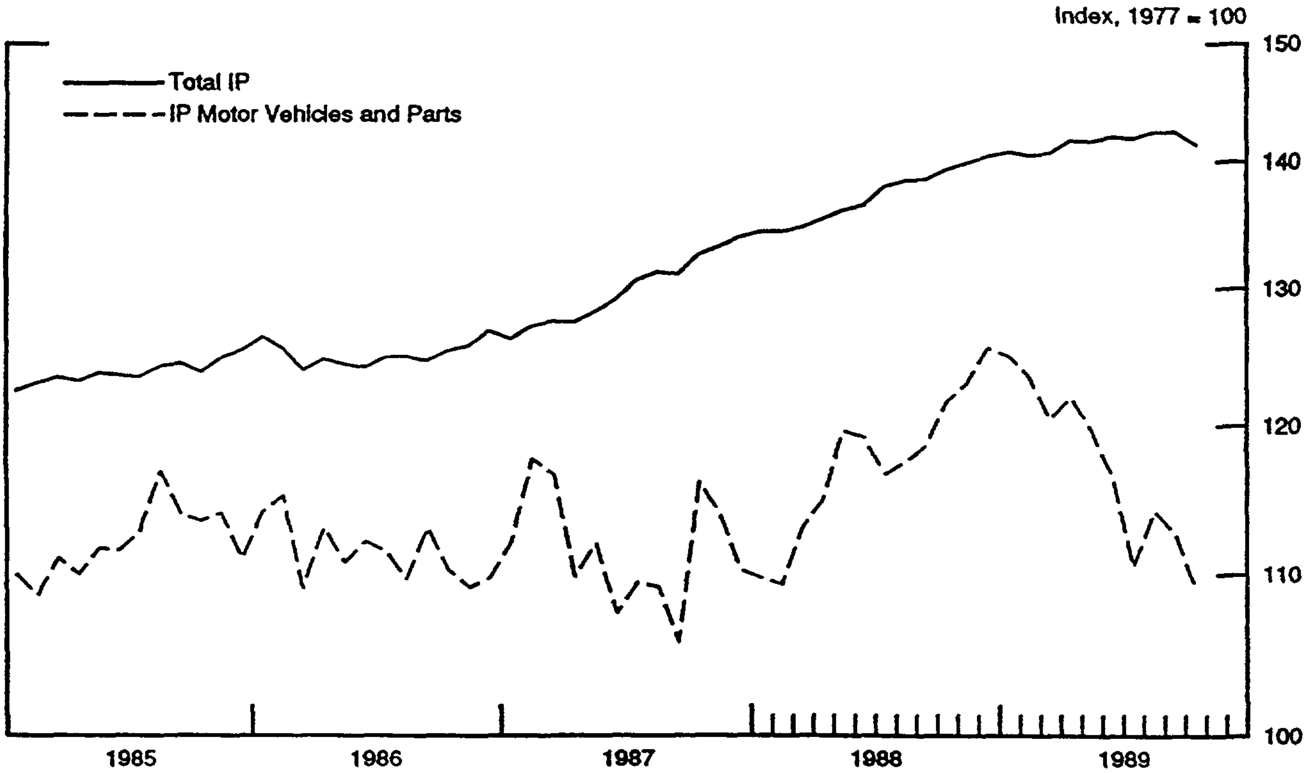
r--revised
e--estimated

PERCENT CHANGE IN ORDERS FOR MANUFACTURED GOODS[1]
(For industries that report unfilled orders; seasonally adjusted)

	1989 Q2	1989 Q3	1989 Oct./Q3[2]	1989 Aug.	1989 Sept.	1989 Oct.
Durable goods excluding civilian aircraft, defense, and motor vehicles	1.4	-2.1	.3	3.6	1.4	-1.8
Nondefense capital goods excluding aircraft	2.9	-4.2	-2.9	4.4	1.1	-5.0
Nondurable goods	2.6	-1.0	1.0	3.0	-1.0	.2

1. Percent change from prior comparable period.
2. Percent change from third-quarter average to October.

INDUSTRIAL PRODUCTION: TOTAL AND MOTOR VEHICLES



CONTRIBUTION OF MOTOR VEHICLES TO GROWTH IN INDUSTRIAL PRODUCTION
(Percent change)

	1987	1988	1989, year to date[1]	Memo: Share of total IP[2]
Direct effect[3]				
Motor vehicles and parts	.2	.4	-.6	4.2
Autos	-.1	.2	-.3	1.3
Trucks and buses	.2	.1	-.2	1.1
Parts	.0	.1	-.1	1.7
Estimated total effect[4]				
Motor vehicles and parts	.4	.8	-1.2	
Memo: Total IP	5.8	5.0	.7	

1. December 1988 to November 1989.
2. In 1989:Q3.
3. Based on 1977 value-added weights.
4. Based on input-output relationships.

November. Auto assemblies fell 500,000 units to a 6.2 million unit annual rate (FRB seasonals), but the output of trucks rebounded.

Much of the weakening in industrial production this year has been the result of a significant decline in the output of motor vehicles (chart). The falloff in production of motor vehicles and parts directly reduced total IP about 0.6 percent between December 1988 and November 1989 (table). Judging by input-output relations, the reduction to IP may have totaled 1.2 percent when account is taken of the secondary effects on industries that supply materials to automakers (for example, steel, machinery, and plastics). IP increased only 0.7 percent over this span.

Personal Income and Consumption

Personal income increased $41 billion in October--well above the average pace of recent months. In part, the pickup in October reflected the influence of special factors, including bonus payments to employees in the motor vehicle industry ($6.8 billion at an annual rate) and an increase in subsidy payments to farmers ($7.2 billion). Although the October change in personal income was boosted by the recovery of rental income from the effects of Hurricane Hugo, the rise was more than offset by the California earthquake; on net, the two disasters subtracted $6 billion from the increase in income in October. Stripping away all of these effects, the October increase--at $33 billion--was still a strong one. In November, however, labor income growth likely was weak, given the performance of aggregate hours and hourly earnings.

Consumer spending apparently was not quite so strong during the third quarter as previously had been estimated; taken alone, the downward revisions contained in the latest retail sales report would be consistent

PERSONAL INCOME
(Average monthly change; billions of dollars)

		1989		1989		
	1988	Q2	Q3p	Aug.r	Sept.r	Oct.p
Total personal income	21.8	18.9	17.4	14.2	11.2	40.6
Wages and salaries	13.4	14.1	15.6	6.3	17.4	32.9
Private	11.2	11.9	13.3	4.1	15.2	30.7
Other labor income	1.5	1.5	1.6	1.6	1.5	1.6
Proprietors' income	.1	-5.3	-2.3	-.3	-3.9	6.9
Farm	-1.2	-6.6	-3.4	-2.2	-3.7	6.9
Rent	.1	-.1	-3.8	-1.0	-10.1	-5.8
Dividends	.9	.5	.6	.5	.3	1.2
Interest	4.5	6.8	3.6	3.6	3.3	2.8
Transfer payments	3.2	2.2	3.1	3.8	3.8	3.3
Less: Personal contributions for social insurance	1.8	.8	.8	.4	1.1	2.4
Less: Personal tax and nontax payments	.1	2.8	4.5	3.1	5.5	7.5
Equals: Disposable personal income	21.6	16.1	12.9	11.1	5.8	33.0
Memo: Real disposable income	8.0	1.5	6.1	11.0	-2.1	4.9

r--Revised.
p--Preliminary.

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from preceding period)

		1989		1989		
	1988	Q2	Q3p	Aug.r	Sept.r	Oct.p
	----Annual rate---			----Monthly rate---		
Personal consumption expenditures	3.8	1.9	6.2	1.1	.1	-.9
Durable goods	8.0	5.5	13.2	4.0	-2.0	-5.6
Excluding motor vehicles	8.0	8.0	.3	1.6	-.1	-.3
Nondurable	2.1	-2.3	5.7	.7	.7	-.6
Excluding gasoline	2.0	-2.0	6.5	.4	.7	-.8
Services	3.6	3.8	4.4	.5	.3	.5
Excluding energy	3.4	4.0	5.1	.5	.3	.6
Memo:						
Personal saving rate (percent)	4.2	5.4	5.0	4.8	4.7	5.7

r--Revised.
p--Preliminary.

with growth in real PCE of about 6 percent during the third quarter (annual rate), down 1/4 percentage point from the first estimate.

Turning to the fourth quarter, BEA's initial estimate for real PCE in October showed a decline of 0.9 percent. However, the most recent retail sales report is consistent with a downward revision to this figure as well; other things equal, the October decline at this point appears to have been more on the order of 1.1 percent (not at an annual rate). Outlays for motor vehicles were very weak in both October and November, as sales of new cars and trucks fell markedly after the introduction of the 1990 models. The only major area of strength in the October spending figures was services, which increased 0.5 percent--somewhat above the pace of recent months; the increases in this category were widespread.

Non-auto spending rebounded considerably in November, according to the advance retail sales estimates; spending at apparel stores surged 2-1/2 percent in nominal terms, more than retracing the declines in the preceding two months; spending at general merchandise stores and furniture outlets also posted sizable gains in nominal terms last month. Anecdotal reports suggest that shopping since Thanksgiving has been about in line with most retailers' expectations. Promotional activity has been described as aggressive, especially at the upper end of the market.

Autos and Light Trucks

Sales of new cars and light trucks were 12.8 million units at an annual rate in November, down 300,000 units at an annual rate from the already sluggish pace in October. Slower auto sales by the domestic big three accounted for the decline from October to November, and their share of the domestic market in November sank to 60 percent--among the lowest readings on

RETAIL SALES
(Seasonally adjusted percentage change)

	1989					
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Total sales	.5	1.8	1.7	.3	-1.3	.8
Previous estimate[1]			*1.8*	*.7*	*-1.0*	
Retail Control[2]	1.7	2.0	1.1	.4	-.2	.9
Previous estimate[1]			*1.3*	*1.0*	*.1*	
GAF[3]	1.5	1.3	1.0	.6	-.1	1.3
Previous estimate			*1.0*	*.9*	*.3*	
Durable goods stores	-.9	1.4	2.7	.0	-3.0	.7
Automotive dealers	-2.6	1.2	4.0	.8	-4.9	.5
Furniture and appliances	4.0	1.5	-.7	-.6	.8	1.6
Other durable goods	2.1	2.9	2.3	-1.0	-.9	-1.3
Nondurable goods stores	1.4	2.0	1.1	.5	-.3	.9
Apparel	-.1	3.4	1.5	-.9	-.3	2.4
Food	2.5	1.9	1.3	.2	.8	.8
General merchandise[4]	1.0	.3	1.6	1.9	-.5	.7
Gasoline stations	1.5	7.9	-2.0	-.2	-.2	.9
Other nondurables	-1.2	4.4	1.1	-.4	-3.3	1.5
Memo:						
Motor vehicle sales[5]	14.3	14.9	15.9	15.8	13.1	12.8
Autos	9.8	10.3	10.8	10.6	8.8	8.5
Light trucks	4.5	4.6	5.1	5.2	4.3	4.2

1. Based on incomplete sample counts approximately one month ago.
2. Total less auto dealers and building material and supply stores.
3. General merchandise, apparel, furniture and appliance stores.
4. General merchandise excludes mail order nonstores; mail order sales also are excluded in the GAF grouping.
5. Millions of units at an annual rate; BEA seasonals.

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

		1989			1989		
	1988	Q1	Q2	Q3	Sept.	Oct.	Nov.
Autos and light trucks	15.5	14.3	14.9	15.9	15.8	13.1	12.8
Autos	10.6	9.8	10.3	10.7	10.6	8.8	8.5
Light trucks	4.8	4.5	4.6	5.1	5.2	4.3	4.2
Domestically produced[2]	11.7	11.0	11.4	12.4	12.5	9.9	9.8
Autos	7.5	7.0	7.3	7.9	7.8	6.1	6.0
Big three	6.8	6.3	6.6	7.0	7.0	5.4	5.1
Transplants[3]	.7	.7	.7	.9	.8	.7	.9
Light trucks	4.2	4.0	4.1	4.6	4.6	3.8	3.8
Imports	3.7	3.3	3.5	3.5	3.3	3.2	3.0
Autos	3.1	2.8	3.0	2.9	2.8	2.7	2.6
Light trucks[4]	.6	.5	.5	.6	.6	.5	.4

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.
3. Vehicles made in U.S. plants of foreign manufacturers.
4. Based on seasonals for domestic light trucks.

record. Lower sales in November of imported autos were offset by an increase in sales of domestically produced foreign nameplates, and thus total sales of "foreign" autos were unchanged.

In large part, the recent slowdown in sales is a payback from the elevated pace of the third quarter. But demand likely has been restrained by other factors as well, including large increases in sticker prices on many of the 1990 model-year cars. The relative strength of foreign auto sales during the first two months of the 1990 model year may reflect smaller sticker price increases than for domestic makes as a result of the strength of the dollar. At the end of November, inventories of domestically produced cars stood at an estimated level of 1.7 million units--up more than 100,000 units since the beginning of the new model year.

Faced with soft demand and rising inventories, the domestic automakers have cut production. The most recent schedules put assemblies in December and January close to the low 6.3 million unit annual pace (BEA seasonals) of November. A shortfall from these plans would not be surprising. Moreover, although the companies have not made significant revisions to their initial plans for February and March, industry analysts have suggested that additional cuts may well be announced.

Capital Goods

Indicators of business fixed investment in the current quarter are sparse, especially when one recognizes the importance of exports and imports of equipment and the susceptibility of construction data to large revisions. Our best judgment at this point, however, is that real business fixed investment will be about unchanged this quarter, abstracting from the hiatus in deliveries of Boeing jets.

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

	1989			1989		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Producers' durable equipment						
Shipments of nondefense capital goods	3.2	3.0	2.2	5.5	-1.2	-4.6
Excluding aircraft and parts	3.2	3.0	-.2	4.2	-2.2	-2.3
Office and computing equipment	.0	6.1	-1.0	2.0	3.2	-7.3
All other categories	4.0	2.3	.0	4.7	-3.5	-1.1
Weighted PDE shipments[1]	3.0	3.1	1.2	4.1	-1.8	-1.9
Shipments of complete aircraft[2]	1.2	14.7	46.2	53.2	19.1	n.a.
Sales of heavy-weight trucks	-3.6	-3.7	-2.2	2.4	-10.7	10.4
Orders of nondefense capital goods	5.3	1.0	-2.5	-10.4	-4.8	1.2
Excluding aircraft and parts	4.9	2.9	-4.2	4.4	1.1	-5.0
Office and computing equipment	-.1	1.8	6.5	6.7	6.3	-9.2
All other categories	6.1	3.1	-6.6	3.8	-.2	-3.8
Weighted PDE orders[1]	2.4	.8	-.4	5.0	1.7	-3.7
Nonresidential structures						
Construction put-in-place	2.1	-.8	2.3	3.1	-.2	.6
Office	4.5	-3.4	-3.4	2.8	-.3	-1.0
Other commercial	2.7	-6.5	5.4	1.6	-1.2	3.5
Public utilities	-2.6	3.8	-.4	-.7	.5	-1.4
Industrial	1.6	3.9	7.2	7.1	2.6	1.7
All other	5.1	.3	5.3	7.2	-1.7	.5
Rotary drilling rigs in use	-5.4	18.2	2.6	-1.5	2.7	-3.2

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.
n.a. Not available.

In October, shipments of nondefense capital goods--excluding aircraft, and weighted to include only final business purchases--fell 1.9 percent, to a level 1-3/4 percent below the third-quarter average. A notable drop in computing equipment was reinforced by small, but widespread, declines elsewhere. In addition, shipments of complete aircraft declined about 24 percent in October, mainly reflecting the strike at Boeing; the effects of this decline will be felt more strongly on exports than on domestic investment.[1]

The orders data for October suggest that the weakness in equipment shipments will continue in the near term. Outside of aircraft and computers, bookings fell 3.8 percent in October, to a level 2 percent below the third-quarter average (table and chart). Although computer orders fell in October, they have been in an uptrend for some months, suggesting a potential for growth in nominal shipments.[2] Given the ongoing price decline for computers, this sector still could make a positive contribution to real equipment shipments in the current quarter. Bookings for nonelectrical machinery outside of computers fell in October and have trended down since earlier this year. In addition, orders for communications equipment posted a notable decline in October, after a strong showing in the third quarter.

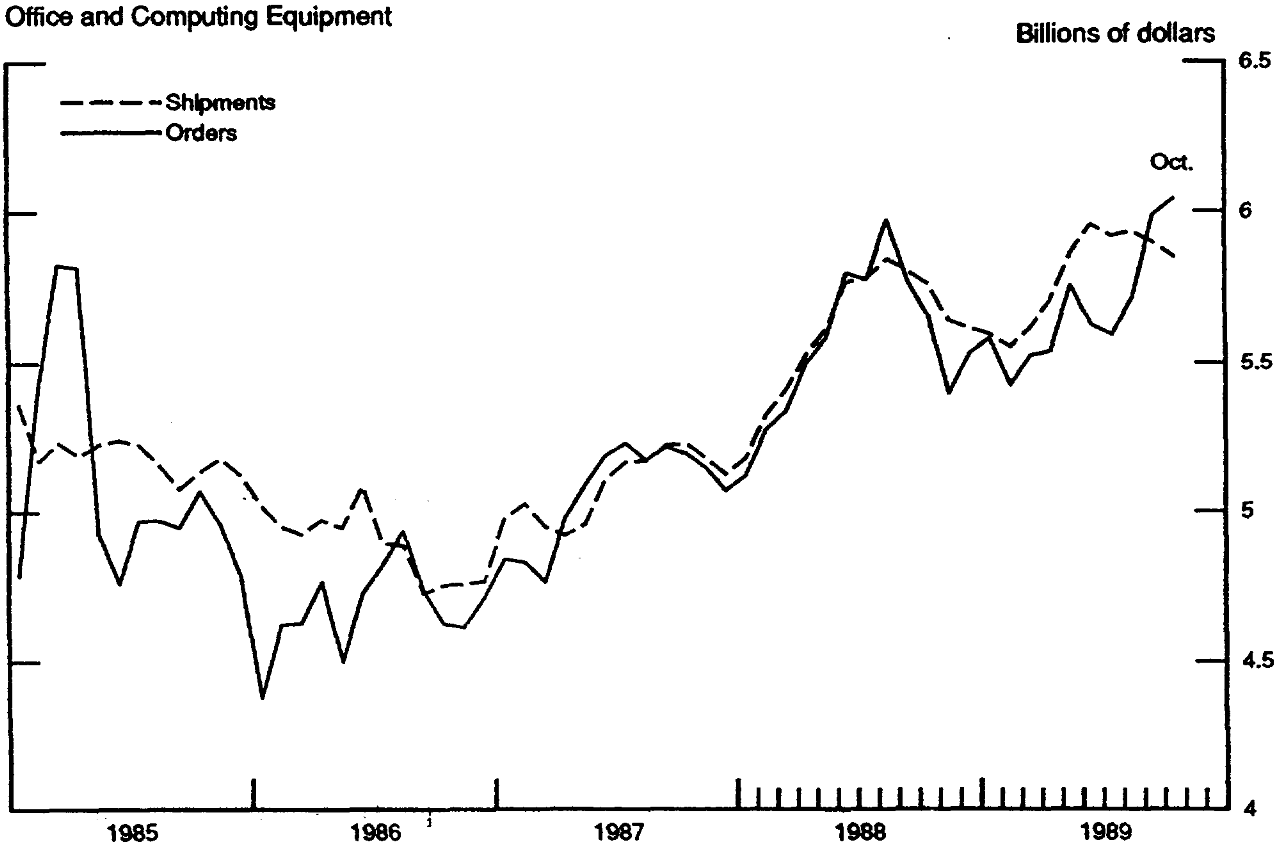
Recent data suggest continued moderate growth in nonresidential construction in the current quarter, but advance indicators point to renewed

1. BEA's NIPA calculation of aircraft purchases does not use the Census M-3 data on aircraft shipments; BEA uses data from the Current Industrial Report, which is available about a month later. Nevertheless, the M-3 data provide a preliminary measure of aircraft shipments.

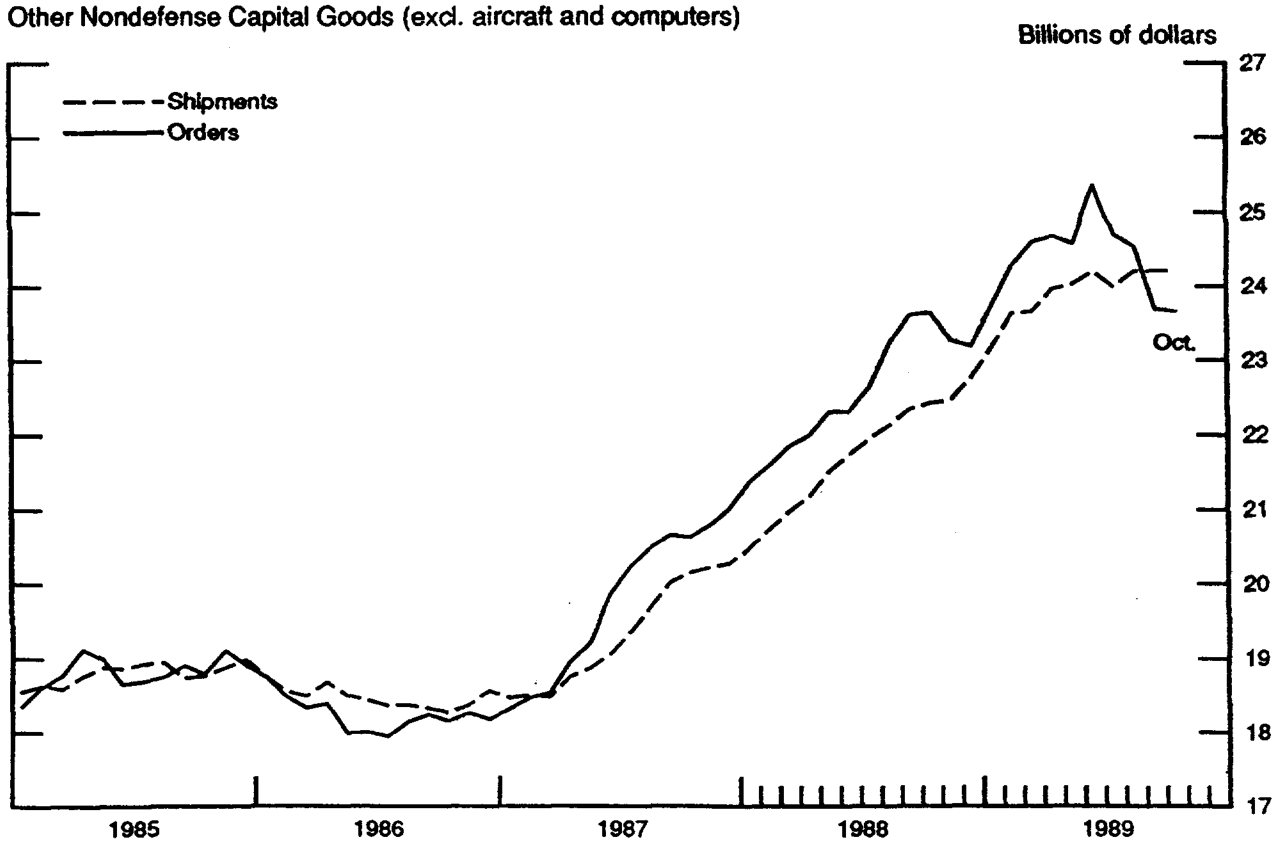
2. A caveat: data on computer orders and shipments have been subject to large revisions recently.

RECENT DATA ON ORDERS AND SHIPMENTS
(three-month moving average)

Office and Computing Equipment



Other Nondefense Capital Goods (excl. aircraft and computers)



weakness in coming quarters. Construction put in place rose 0.6 percent in October, led by a 3.5 percent increase in non-office commercial construction.[3] Industrial and institutional construction also were up in October, in a continuation of recent trends (chart). In contrast, the Baker-Hughes count of oil and gas rigs in use moved down in October and the first three weeks of November.

Looking beyond the current quarter, vacancy rates have remained high, and construction permits have turned down.[4] Furthermore, credit may not be so readily available for new projects as it has been in recent years, especially with lending institutions recognizing sizable losses on commercial real estate. As a result, the prospects for any sustained expansion in nonresidential construction do not appear favorable.

The McGraw-Hill survey taken in September and October also points to a substantial deceleration in capital spending next year. The survey indicates that firms expect nominal outlays to increase 4-1/2 percent in 1990, a pace slightly stronger than reported in the fall survey from Economic Consulting and Planning, Inc. (ECAP). Manufacturers expect a 6-1/2 percent increase--about two-thirds of this year's advance--with much of the slowdown concentrated at producers of nondurable goods. The survey also reports a substantial slowing outside of manufacturing.

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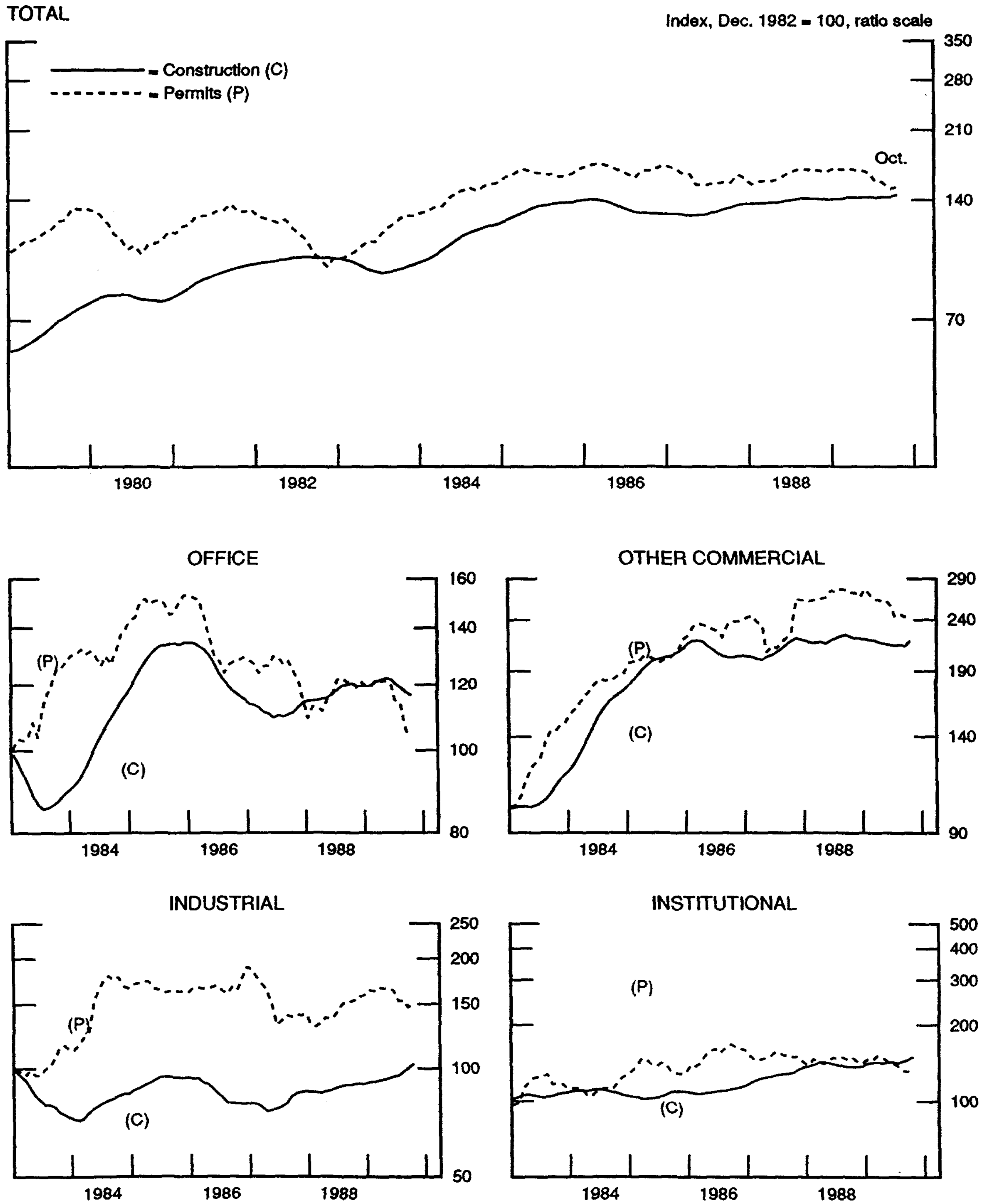
3. Over the next few quarters, business spending on nonresidential structures likely will be boosted by rebuilding activity in the wake of Hurricane Hugo and the California earthquake. The uptick in October--particularly in the non-office commercial sector--could reflect the effects of the hurricane, but probably only a small amount of rebuilding from the October 17 earthquake had occurred by the end of the month.

4. The Coldwell Banker metropolitan office vacancy rate was 19.8 percent in the third quarter and has been little changed since mid-1988. However, the vacancy rate has declined somewhat from its peak of 21.5 percent in early 1987.

Nonresidential Construction and Permits <1>



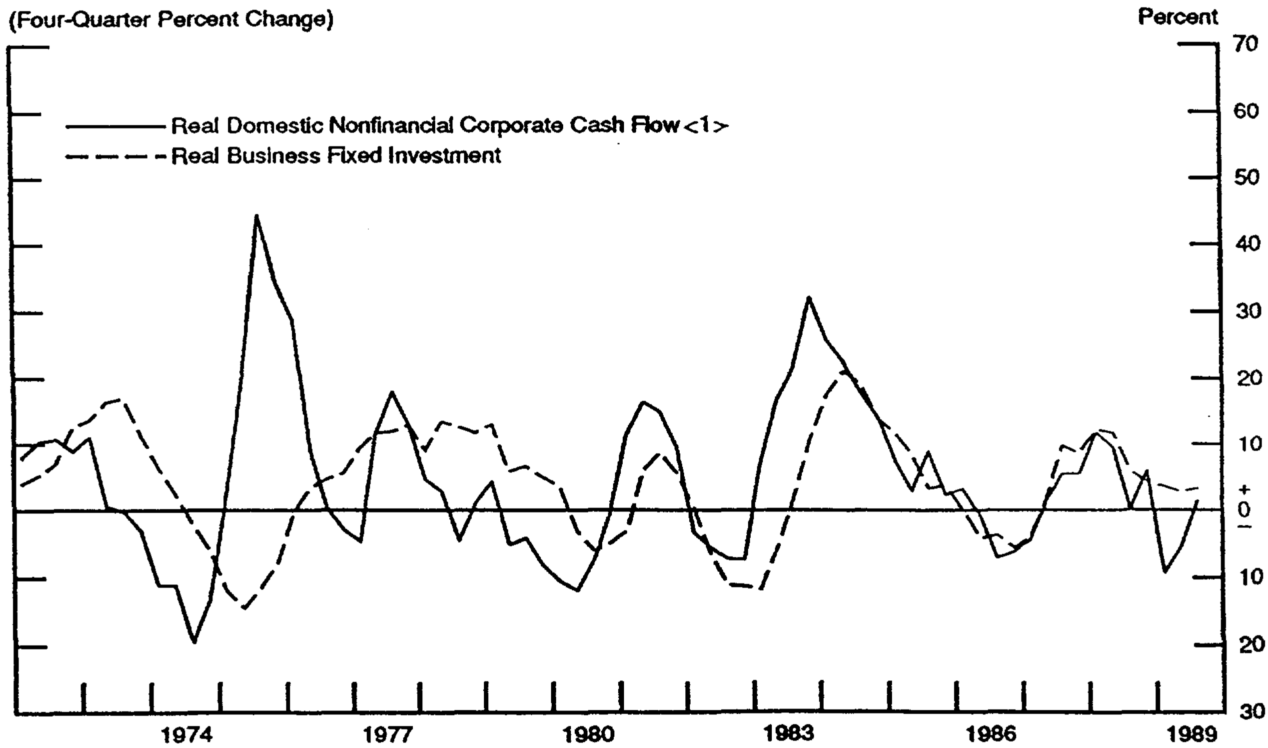
<1> Six-month moving average for all series shown.

SURVEYS OF PLANT AND EQUIPMENT EXPENDITURES
(Percent change from previous year, current dollars)

	1988	Planned for 1989 Commerce (July-Aug.)	Planned for 1990 ECAP[1] (Sept.-Oct.)	Planned for 1990 McGraw-Hill (Sept.-Oct.)
All business	10.5	10.0	3.0	4.4
Manufacturing	14.0	9.4	3.4	6.4
Durable	10.3	5.0	.4	6.4
Nondurable	17.5	13.2	5.7	6.4
Nonmanufacturing	8.5	10.3	2.8	3.1
Memo:[2]				
Prediction of P & E				
Mean error			-2.0	-1.2
Mean absolute error			4.7	4.0

1. Economic Consulting and Planning, Inc.
2. Estimated from 1970 to the present.

INVESTMENT AND CASH FLOW
(Four-Quarter Percent Change)



1. Excluding dividends. With inventory valuation adjustment and capital capital consumption adjustment.

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

	1989 Q1	1989 Q2	1989 Q3	1989 Aug.	1989 Sept.	1989 Oct.
Current-cost basis:						
Total	47.1	61.2	42.6	33.4	13.0	n.a.
Excluding autos and aircraft[1]	31.1	38.3	25.1	16.0	-.7	n.a.
Manufacturing	27.9	21.4	17.6	8.2	-7.2	11.7
Wholesale	5.5	11.5	1.7	-5.1	-7.7	37.3
Retail	13.8	28.3	23.6	30.2	27.9	n.a.
Automotive	4.9	13.6	11.7	16.4	18.3	n.a.
Excluding auto	8.9	14.7	12.0	13.8	9.6	n.a.
Constant-dollar basis:						
Total	10.1	16.2	8.4	23.5	-15.8	n.a.
Excluding autos and aircraft[1]	-6.7	13.4	17.2	18.0	-9.8	n.a.
Manufacturing	3.8	8.3	13.2	11.3	-9.3	n.a.
Wholesale	-2.1	5.2	-.3	-2.7	-10.7	n.a.
Retail	8.4	2.6	-4.5	15.0	4.2	n.a.
Automotive	9.0	-3.0	-12.7	4.3	-.7	n.a.
Excluding auto	-.6	5.7	8.2	10.7	4.9	n.a.

1. All manufacturing and trade excluding transportation equipment in manufacturing, and autos and auto parts at retail dealers.
n.a. Not available.

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

	Range in preceding 12 months:[2] Low	High	1989 Q1	1989 Q2	1989 Q3	1989 Aug.	1989 Sept.	1989 Oct.
Current-cost basis:								
Total	1.48	1.54	1.50	1.51	1.52	1.50	1.51	n.a.
Excluding autos and aircraft[3]	1.41	1.44	1.43	1.42	1.43	1.43	1.43	n.a.
Manufacturing	1.53	1.64	1.57	1.57	1.59	1.56	1.59	1.60
Wholesale	1.27	1.31	1.28	1.28	1.28	1.28	1.27	1.29
Retail	1.56	1.63	1.61	1.63	1.64	1.62	1.63	n.a.
Automotive	1.83	2.06	1.96	2.05	2.06	2.00	2.04	n.a.
Excluding auto	1.48	1.51	1.51	1.51	1.52	1.52	1.51	n.a.
Constant-dollar basis:								
Total	1.48	1.52	1.50	1.50	1.49	1.48	1.48	n.a.
Excluding autos and aircraft[3]	1.42	1.44	1.43	1.43	1.43	1.42	1.42	n.a.
Manufacturing	1.52	1.63	1.57	1.57	1.58	1.55	1.57	n.a.
Wholesale	1.32	1.36	1.33	1.33	1.32	1.32	1.31	n.a.
Retail	1.50	1.56	1.55	1.55	1.51	1.50	1.50	n.a.
Automotive	1.68	1.93	1.93	1.88	1.69	1.68	1.67	n.a.
Excluding auto	1.43	1.46	1.45	1.46	1.46	1.45	1.45	n.a.

1. Ratio of end-of period inventories to average monthly sales for the period.
2. Highs and lows are specific to each series and are not necessarily coincidental. Range is for the 12-month period preceding the latest month for which data are available.
3. All manufacturing and trade excluding transportation equipment in manufacturing, and autos and auto parts at retail dealers.
n.a. Not available.

In addition to the indicators discussed above, recent declines in corporate cash flow do not bode well for investment spending in the near term. Growth in real gross business fixed investment and real cash flow have moved together in recent years (chart), with peaks and troughs in the growth of cash flow in the 1980s generally leading those in investment by one or two quarters.[5] Although the growth of cash flow has been quite volatile during 1989 (even when measured as the change from a year ago), it nonetheless is signaling a deterioration in the availability of internal funds. Given the lags involved, this decline in corporate liquidity is likely to be a restraining influence on capital spending into 1990.

Inventories

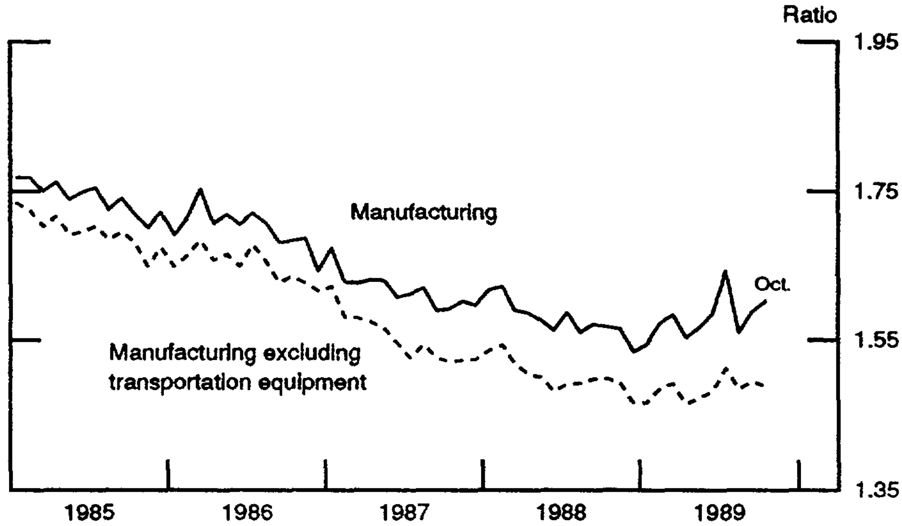
Inventories in manufacturing and trade excluding auto dealers rose at a $21 billion annual rate in real terms in the third quarter, close to the $19 billion pace in the second quarter. Preliminary current-cost data show that manufacturers' inventory investment was moderate in October, but that merchant wholesalers experienced a sharp increase in their stocks.

Preliminary current-cost data show that manufacturers' inventories rose at annual rate of $12 billion in October. The bulk of this accumulation in October was in defense aircraft and parts, a series that is rather volatile. Despite a small drop in shipments, the inventory-to-shipments ratio for all manufacturing excluding transportation equipment edged down (chart, upper panel).

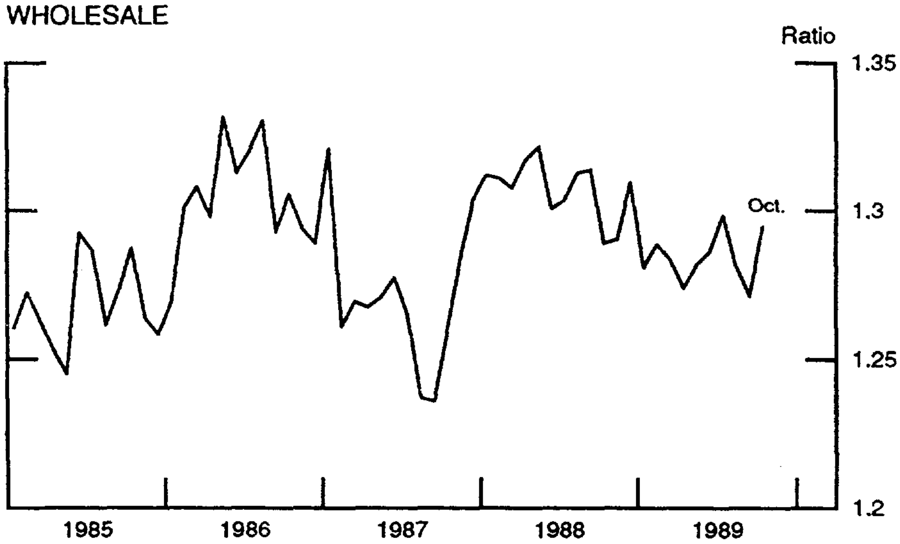
In the wholesale trade sector, inventories rose at an annual rate of $37 billion in October, after increasing just $1.4 billion (annual rate)

5. Cash flow is defined here as the sum of undistributed after-tax profits and capital consumption allowances, with capital consumption and inventory valuation adjustments.

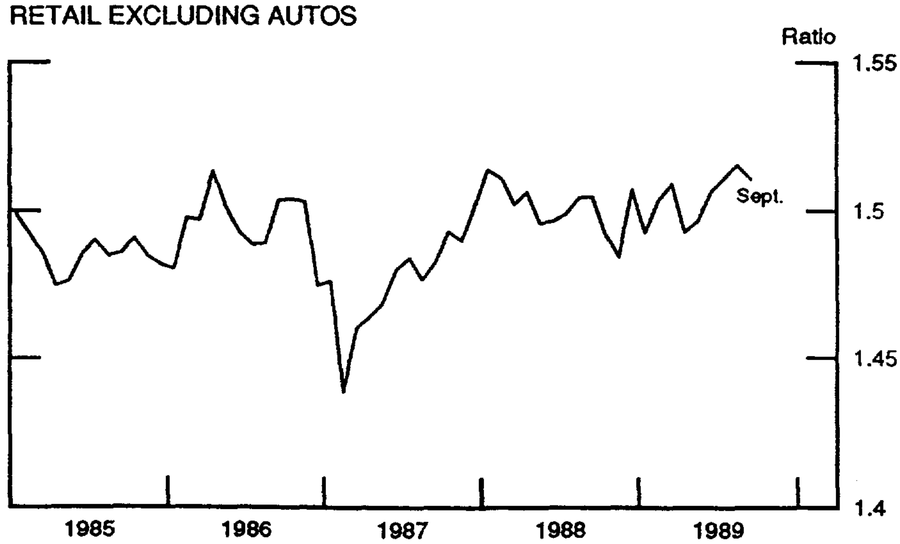
Ratio of Inventories to Sales
(Current-cost data)



WHOLESALE



RETAIL EXCLUDING AUTOS



over the third quarter. About two-thirds of the October increase was in motor vehicles, groceries, and farm products. The motor vehicle category tends to be dominated by imports; the increase probably was largely transitory, although import car sales have been rather soft. The food stock increases almost certainly were transitory. There also was a $3 billion increase (annual rate) in stocks held by wholesale distributors of apparel. Wholesale sales edged down 0.1 percent in October, after posting gains in the preceding two months. The wholesalers' inventory-sales ratio rose from 1.27 months to 1.29 months in October--in the middle of the range of 1.27 to 1.32 months observed over the past couple of years (chart, middle panel).

The inventory-sales ratio for non-auto retailers edged down in September but remained on the high side of recent experience (chart, lower panel). Anecdotal reports suggest that some financially troubled department stores may have had difficulty obtaining desired stocks from producers, but that other merchandisers--including discounters--took on the supplies.

Overall, the available inventory data do not indicate a significant misalignment with recent sales levels, but they suggest the possibility of some heaviness of stocks here and there--an impression consistent with the anecdotal information.

Housing Market

Housing starts rose appreciably in October from an exceptionally low September level, but remained well below the average pace of recent years. The subdued level of activity reflects in part longer-run demographic trends but also some short-term changes in supply and financing conditions.

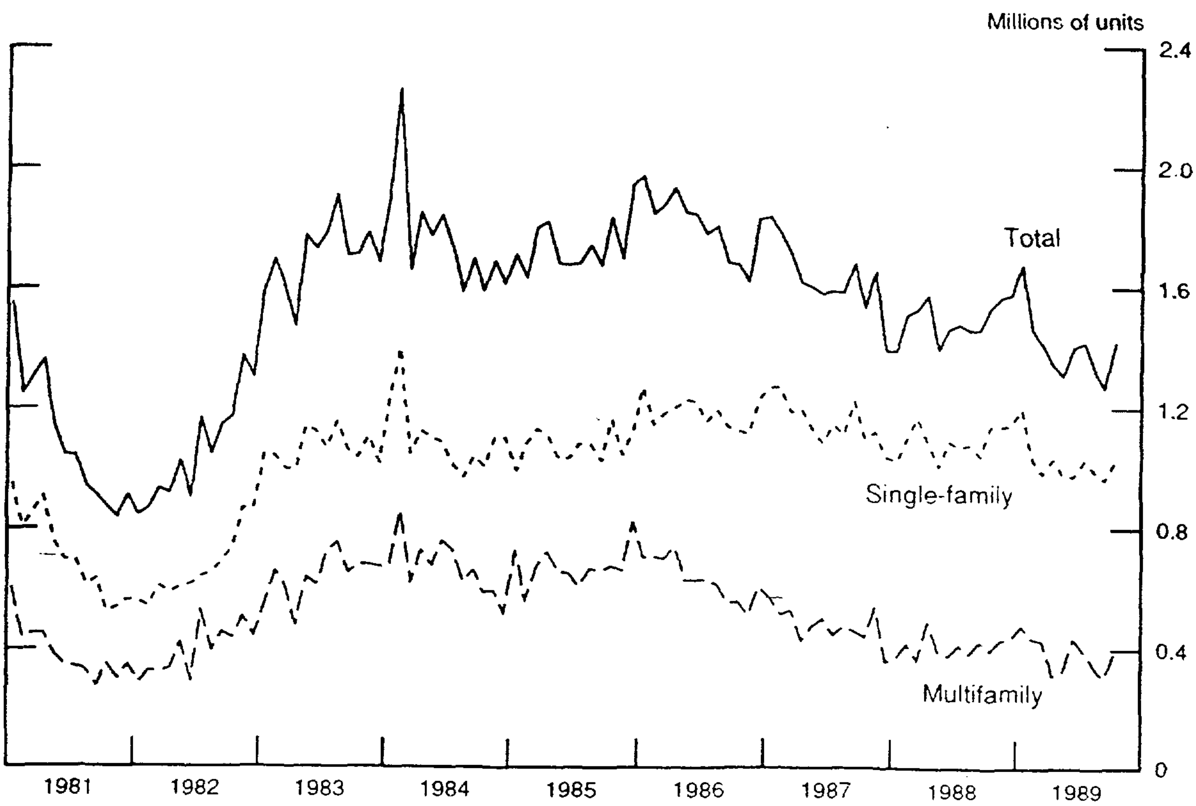
In the market for single-family homes, starts increased 7 percent in October to 1.03 million units, 3 percent above the level that prevailed

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

	1988	1989			1989		
	Annual	Q1	Q2[r]	Q3[r]	Aug.[r]	Sept.[r]	Oct.[p]
All units							
Permits	1.46	1.37	1.33	1.31	1.33	1.32	1.33
Starts	1.49	1.52	1.35	1.34	1.33	1.27	1.42
Single-family units							
Permits	.99	.97	.91	.93	.93	.95	.95
Starts	1.08	1.07	.99	.99	.99	.96	1.03
Sales							
New homes	.68	.63	.64	.71	.73	.65	.65
Existing homes	3.59	3.48	3.32	3.44	3.48	3.52	3.52
Multifamily units							
Permits	.46	.40	.42	.38	.40	.37	.38
Starts	.41	.45	.36	.35	.34	.31	.39

p--Preliminary. r--Revised.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



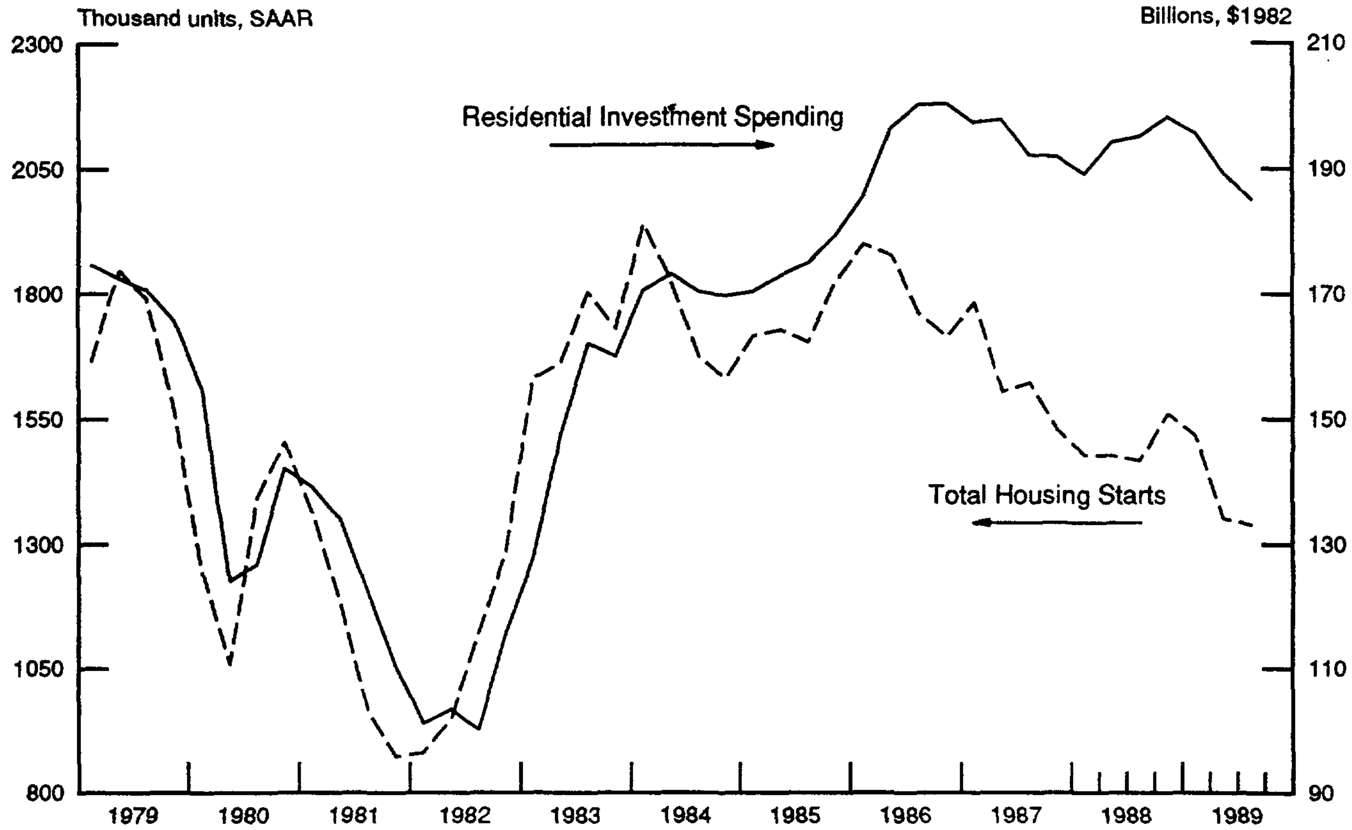
during the second and third quarters. Sales of new homes slowed in September-October, after surging in July and August. In the existing-home market, sales held in October at a level near the high for the year.

Despite the October rise, the reaction of starts to moderating mortgage rates has been rather weak. Although interest rates on conventional fixed-rate mortgages declined by more than a full percentage point during the summer months, and initial rates on adjustable-rate mortgages fell about 2/3 percentage point, single-family starts have been essentially flat since early 1989, likely owing to the effects of other factors that impinge on home construction. For example, several areas of the country have an overhang of single-family homes and condominiums for sale, especially the Northeast, where the rise in home prices in recent years has impaired housing affordability. In addition, trade reports suggest that some savings and loan associations have restricted the credit available to builders in both the single-family and multifamily markets because of new capital requirements as well as new limitations on the amount of credit that a thrift can extend to a single borrower.

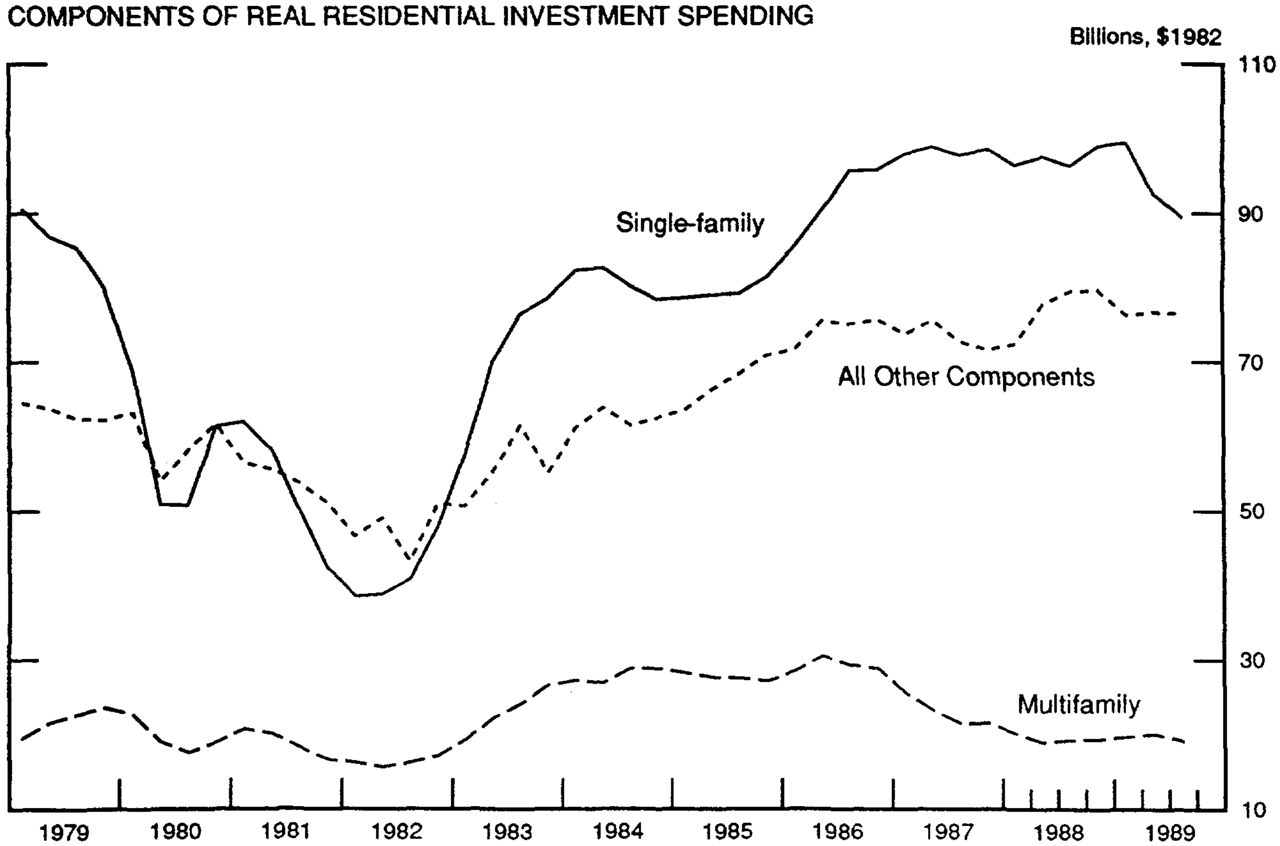
In the multifamily sector, starts rebounded in October from a dismal September, rising to 393,000 units. Multifamily starts averaged 350,000 units for the two months, about the same as the average in the second and third quarters. Continued high rental vacancy rates are likely to inhibit any significant expansion in multifamily construction activity in the near term; and recent surveys of homebuilders indicate continued pessimism about the outlook for this segment of the market.

Although housing starts have declined in recent years, real residential investment expenditures have remained relatively stable (chart). This

Housing Starts and Residential Investment Spending



COMPONENTS OF REAL RESIDENTIAL INVESTMENT SPENDING



divergence between starts and real expenditures stands in contrast to the pattern that prevailed through the mid-1980s, when these series usually moved in tandem. Shifts in the composition of housing starts in recent years have contributed to the greater stability of residential investment spending. The decline in total starts has been concentrated in the multifamily market, which has less than half the average value per unit of single-family homes. As a result, the reduction in starts has exerted a less-than-proportional effect on residential investment spending.

Gradual increases, on average, in the size of dwellings and the addition of other structural characteristics that boost costs have bolstered construction spending in both the single-family and multifamily categories relative to the pace of starts.[6] Upscaling of structural characteristics helped maintain expenditures on new single-family homes through 1988; more recently, real spending in that category has declined because of the slowing of single-family starts (lower panel). Spending in the multifamily category similarly has been bolstered by a rise in the unit value of multifamily starts, which partly counteracted the sizable falloff since 1986 in units constructed. Finally, the overall uptrend of other components of residential expenditures, including home improvements, has lent continued support to residential investment spending in recent years.

Federal Government

In October, the first month of fiscal year 1990, the federal government recorded a budget deficit of $26.1 billion, compared with $27.0 billion a

6. For example, the living area of a typical new single-family home increased 9 percent during the 1986-88 period to about 2,000 square feet. A similar relative increase occurred for multifamily units. Other structural features, such as central air conditioning and fireplaces, have become increasingly common in newly constructed homes in recent years.

year earlier. Receipts in October rose 7-1/2 percent from the year-earlier level to $68.4 billion, an increase that was about in line with the change in nominal GNP over this period. Outlays, at $94.5 billion, were reduced $3 billion by a shift in a military pay date from October 1 to September 29. Spending on agriculture continued at a reduced level; CCC outlays were $0.3 billion compared with $2.5 billion a year earlier. Gross spending of $7.9 billion in October by the Resolution Trust Corporation (RTC) was partially offset by $4.5 billion in receipts from the Resolution Funding Corporation (REFCORP).[7]

Congress now has passed all of the FY90 appropriations bills and has approved a reconciliation bill that reduces the FY90 deficit by $17.8 billion (according to preliminary calculations by the Congressional Budget Office), a bit more than contemplated in the April bipartisan budget agreement.[8] This reconciliation bill, including the temporary extension of the Gramm-Rudman-Hollings sequester through the first week of February, is estimated to reduce FY90 noninterest outlays $11.1 billion, increase receipts $6.1 billion, and cut debt service $0.6 billion.

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7. The RTC is responsible for resolving thrift cases that were still open after December 31, 1988, and all new insolvencies over the ensuing three years. The RTC was authorized to spend $20 billion in FY89, with $19 billion provided by the Treasury and $1 billion from the Federal Home Loan Banks. The RTC has spent only $10 billion; the remaining $10 billion can be spent this fiscal year. RTC's receipts comprise the proceeds from asset liquidation and REFCORP bond issues. RTC is expected to have little budgetary impact beyond its initial $19 billion authority, except for mismatches of receipts and outlays in particular accounting periods.

8. The total effect of these bills on the deficit is still being estimated by OMB and CBO; it is expected to be close to the April total but with larger cuts in defense.

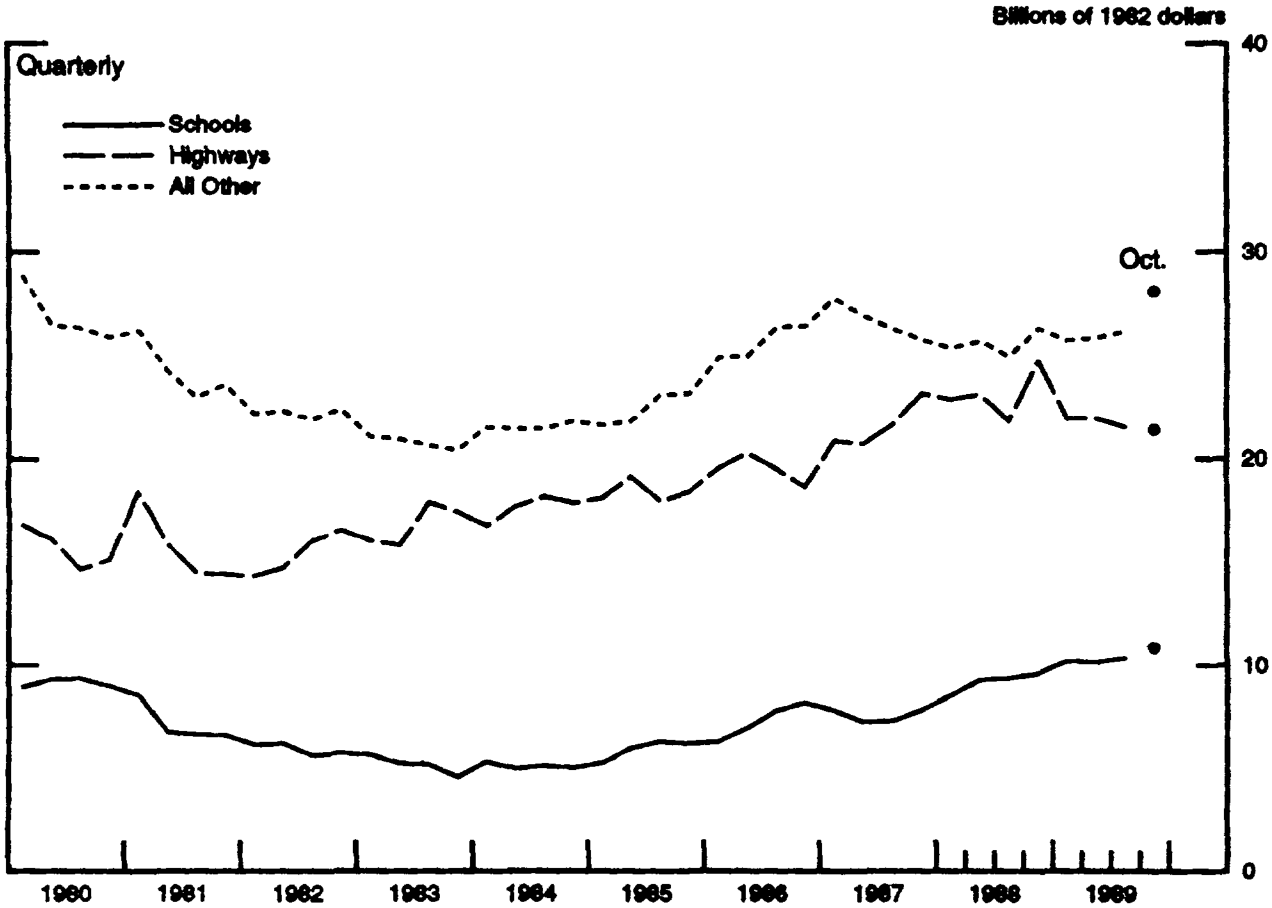
CHANGES IN THE DEFICIT RESULTING FROM THE FY90 RECONCILIATION BILL, 1990-94
(Billions of dollars)

	Fiscal year				
	1990	1991	1992	1993	1994
	--------- change in deficit --------				
Outlays	-11.1	-5.7	-7.2	-6.6	-6.4
130-day sequester	-4.6	-4.7	-4.8	-5.0	-5.3
Other outlays	-6.5	-1.0	-2.4	-1.6	-1.1
Permanent reductions	-1.9	-2.3	-2.4	-2.3	-2.2
One-time reductions	-2.0	0.5	0.1	0.0	0.0
User fees	-0.2	-0.0	-0.0	0.0	0.0
Off-budget items and Postal Service reform	-2.6	-0.0	-1.3	-0.0	-0.4
New spending	0.2	0.6	0.8	0.3	0.3
Revenues	-6.1	-4.8	-4.7	-6.3	-7.9
Debt service	-0.6	-1.8	-2.8	-3.9	-5.2
Total	-17.8	-12.2	-14.6	-16.7	-19.5

The extension of the sequester lowers outlays $4.6 billion, which will reduce new budget authority in defense programs 1.4 percent and in unprotected nondefense programs 1.5 percent. Few other provisions generate permanent reductions in outlays; the major exception is the $2.2 billion cut in Medicare payments. Among the essentially one-time savings in the bill are the extension of certain lump-sum civil service retirement benefit rules ($0.7 billion), reductions in farm payments ($0.6 billion), and increases in user fees ($0.2 billion).

On the receipts side, the major revenue producers in the reconciliation bill are the temporary extension of certain excise taxes ($1.4 billion) and a speedup of the collection of payroll taxes ($2.7 billion). Accounting gimmicks include the shift of the Postal Service to off-budget status to reduce recorded outlays by $1.8 billion, an increase in payments from the

STATE AND LOCAL CONSTRUCTION



Postal Service to the government by $0.4 billion, and the reclassification of the Financial Assistance Corporation (part of the Farm Credit System) as a government-sponsored agency to reduce on-budget outlays by $0.4 billion.[9]

State and Local Governments

Real purchases of goods and services by state and local governments rose an estimated 2.3 percent at an annual rate in the third quarter. Thus far this year, growth in real purchases has averaged just 2.0 percent, less than half the pace recorded during the preceding five years. Nonetheless, nominal growth in expenditures continued to outpace revenue gains in the third quarter, and the deficit on operating and capital accounts, which excludes social insurance funds, deteriorated to a record $34.8 billion.

Construction spending in the state and local sector now has fallen for three consecutive quarters, the first such string of declines since 1980; the weakness so far this year has been widespread. In contrast, preliminary estimates show large advances for some categories of building in October (chart). In particular, real spending for school facilities jumped nearly 5 percent above the previous month; education, driven by an uptrend in the school-age population, has been one of the few areas of public construction to experience sustained growth since 1985. Construction spending for sewer systems also advanced sharply in October. Highway construction declined in October despite the start of earthquake-related repairs and rebuilding of highways and bridges. Highway construction, which makes up nearly 40

9. Press reports have cited $14.7 billion as the size of deficit reduction in the reconciliation bill. However, this figure excludes the $2.7 billion increase in FY1990 receipts arising from an acceleration in the collection of payroll taxes, and $0.4 billion in outlay timing shifts; it does include other "savings" such as moving the Post Office off-budget.

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

	1987	1988	1989 Q1	1989 Q2	1989 Q3	1989 Oct.	1989 Nov.
						---Monthly---	
Employment cost index[1]							
Compensation, all persons	3.3	4.9	4.5	4.8	4.7	n.a.	n.a.
By occupation:							
White collar	3.7	5.0	5.6	4.8	5.2	n.a.	n.a.
Blue collar	3.1	4.4	3.5	4.6	4.8	n.a.	n.a.
Service workers	2.4	5.3	3.9	4.2	3.5	n.a.	n.a.
By sector:							
Goods-producing	3.1	4.4	3.5	4.4	4.8	n.a.	n.a.
Service-producing	3.7	5.1	5.5	5.1	4.8	n.a.	n.a.
By bargaining status:							
Union	2.8	3.9	2.7	4.1	3.6	n.a.	n.a.
Nonunion	3.6	5.1	5.3	4.7	5.5	n.a.	n.a.
Wages and salaries, all persons	3.3	4.1	3.9	3.9	4.5	n.a.	n.a.
Benefits, all persons	3.5	6.8	7.1	6.3	5.8	n.a.	n.a.
Labor costs and productivity, all persons[2]							
Nonfarm business sector							
Output per hour	2.5	1.6	-1.3	1.1	2.5	n.a.	n.a.
Compensation per hour	4.0	4.8	4.9	5.6	5.3	n.a.	n.a.
Unit labor costs	1.5	3.1	6.2	4.5	2.8	n.a.	n.a.
Manufacturing							
Output per hour	3.8	2.9	2.4	3.7	1.0	n.a.	n.a.
Compensation per hour	2.4	4.4	3.5	2.7	5.9	n.a.	n.a.
Unit labor costs	-1.4	1.5	1.0	-1.0	4.9	n.a.	n.a.
Major collective bargaining agreements[3]							
First-year wage adjustments	2.2	2.5	3.2	3.7	3.7	n.a.	n.a.
Total effective wage change	3.1	2.6	2.7	2.8	3.0	n.a.	n.a.
Average hourly earnings, production workers[2]							
Total private nonfarm	3.0	3.7	3.6	4.0	4.1	.4	-.1
Manufacturing	2.3	3.0	2.6	2.2	3.6	.0	.2
Services	4.7	4.9	5.4	6.1	5.7	.9	-.6
Hourly earnings index, wages of production workers[4]							
Total private nonfarm	2.6	3.5	3.0	3.8	3.9	.4	-.2

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 1989 were produced by FRB staff.
n.a. Not available.

percent of real state and local government outlays for structures, peaked in 1988 and has dropped back this year. Construction of most other types of infrastructure also flattened out in the last year or so, except construction of prison facilities. Expenditures on corrections and law enforcement have become the fastest growing spending category in state general funds budgets.

Labor Costs

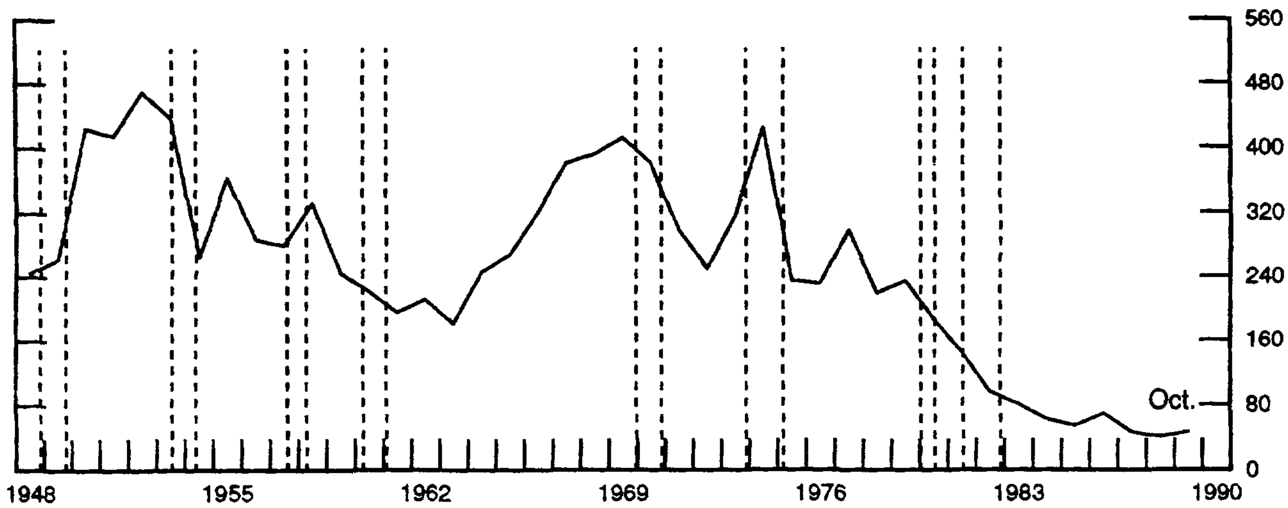
Few new data on wages have been received since the last Greenbook. In November, average hourly earnings are estimated to have edged down 0.1 percent. The largest declines occurred in finance, insurance, and real estate and in services, reversing much of the large increase reported in those industries in October. In addition, the increase in average hourly earnings in October was revised down to 0.4 percent--0.3 percentage point less than initially reported. The revisions were widespread. Over the past twelve months, average hourly earnings have risen 3.6 percent.

In 1989, with the unemployment rate averaging about 5-1/4 percent, labor unions have been more successful in collective bargaining than they were earlier in the decade. However, gains in compensation this year have not been associated with a substantial pickup in strike activity. Major work stoppages (through October) totaled 46, up only slightly from their historical low of 40 in 1988 (chart); and days lost because of strikes and the proportion of workers on strike, while higher this year, remain low in historical perspective.

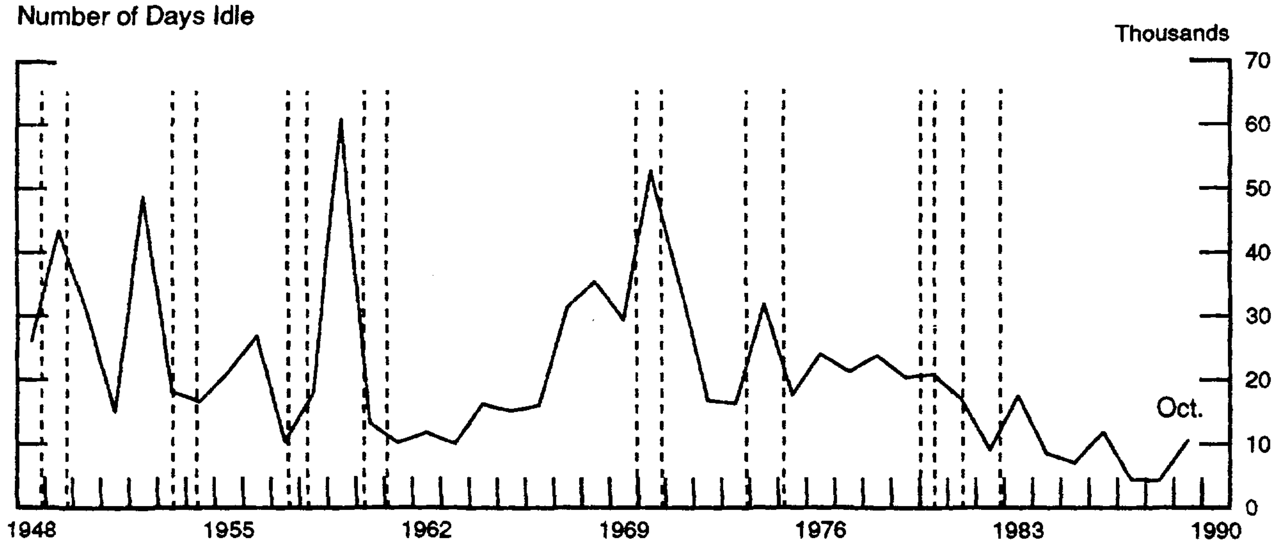
In this environment, first-year union wage adjustments have picked up noticeably; in the first nine months of 1989, 45 percent of new agreements called for first-year wage increases in excess of 4 percent, up from 25

Strike Activity
(Involving 1,000 or more workers)

Number of Work Stoppages



Number of Days Idle



Workers on Strike/Household Employment

percent of all contracts in 1988 (table). Although wage gains have generally been higher this year, lump-sum payments have continued as an important feature of new settlements.

Recent major settlements have underscored the tougher bargaining attitude of unionized labor. In the agreement with Boeing, 58,000 machinists ended their 48-day strike on November 20. After accepting lump-sum payments in lieu of wage increases in their previous contract, the profitability of Boeing led the union to demand both base wage increases and lump-sum payments. Under the terms of the agreement, workers will receive base wage increases totaling 10 percent over the life of the contract (table). Furthermore, a generous COLA formula will almost fully protect real wages against inflation; this feature contrasts with the general pattern of declining COLA protection in contracts through the third quarter of this year. In addition, workers will continue to receive substantial yearly bonus payments. Given the backlog of unfilled orders and the extraordinary profitability of the firm, the settlement at Boeing is unlikely to set a pattern for labor agreements in the aerospace industry. Although the machinists' union will attempt to replicate portions of the Boeing pact, it is likely to represent a ceiling rather than a floor in negotiations with other, less prosperous, companies.

In recent strikes at the regional telephone companies, the major issue in the negotiations was the preservation of health insurance benefits.[10] Management had attempted to require workers to pay a portion of their health

10. On August 6, strikes began at the seven regional phone companies: Ameritech, NYNEX, Bell Atlantic, Bell South, Pacific Telesis, Southwestern Bell, and US West. Most of the strikes ended by early September; however, the walk-out at NYNEX did not end until December 1, when workers ratified a new three-year agreement.

DISTRIBUTION OF WORKERS BY FIRST-YEAR
WAGE RATE ADJUSTMENTS

	1985	1986	1987	1988	1989[1]
Decreases	3	9	4	2	1
No wage change	33	21	23	11	9
0 to 4	31	51	51	63	45
4 to 6	25	14	18	23	31
6 and over	8	4	5	2	14

1. Data are through the first nine months of 1989 with contracts covering 52 percent of workers negotiating contracts this year.

PERCENT OF WORKERS RECEIVING COLAs AND LUMP-SUM PAYMENTS
IN MAJOR COLLECTIVE BARGINING SETTLEMENTS
(Involving 1,000 or more workers)

	1985	1986	1987	1988	1989[1]
COLAs					
All industries	30.7	31.4	44.9	38.1	15.0
Manufacturing	54.7	37.8	70.6	60.3	20.3
Nonmanufacturing	15.6	29.2	24.3	23.7	14.0
Lump-sum payments	31.1	40.0	51.9	28.0	34.9

1. Data are through the first nine months of 1989 with contracts covering 52 percent of workers negotiating contracts this year.

MAJOR ASPECTS OF BOEING'S PREVIOUS
AND NEWLY RATIFIED CONTRACTS

	Previous Contract (10/86 - 10/89)	Ratified Agreement 11/20/89
Wage increase	None	4 percent (11/20/89) 3 percent (10/4/90) 3 percent (10/4/91)
Lump-sum payments	12 percent of gross pay (1986) 5 percent of gross pay (1987) 5 percent of gross pay (1988)	10 percent of gross pay (12/89) 5 percent of gross pay (12/90) 4 percent of gross pay (12/91)
Overtime	Mandatory 200 hours per quarter.	Mandatory 144 hours per quarter. Pay is doubled after 160 hours per quarter.
COLA	$.01 for every .03 percent change in the CPI. $.45 automatic prepayment (10/86).	$.60 per hour in the first year of the contract.[1] Plus $.01 for every .075 percent rise in the CPI.

1. Workers also get a $.45 prepayment from the expired contract--payable before any other adjustments are made.

insurance premiums--a demand that was unacceptable to the unions. In the NYNEX settlement, the company agreed to continue to pay the full cost of insurance, but in return, the workers accepted lower increases in base wages and gave up their bonus payments.[11] Ultimately, the overall cost of the NYNEX settlement will depend on whether the company can bring its health insurance costs under control. Should the price of medical care continue to rise at its recent pace, the NYNEX agreement is likely to represent a sizable increase in the firm's overall compensation costs.

Family-care benefits were an important issue in negotiations between the Communications Workers and AT&T that were concluded in May. As growth in the working-age population slows during the next decade, the provision of such benefits likely will become more widespread as employers try to attract and retain experienced workers. However, such benefits programs also are likely to raise employers' costs. The AT&T agreement provided for modest wage increases and bonus payments. However, the contract established a fund to develop community child-care centers and grants to cover adoption fees. In addition, workers are allowed to take up to a year of unpaid leave to care for a newborn child, newly adopted child, or an ill dependent; in all cases, the company will pay for the employee's benefits for the first six months. Funding of career development programs was expanded significantly, and a computer system was established to assist workers in finding new positions at AT&T if their present jobs are eliminated.

11. In the NYNEX contract, workers will receive a first-year base wage increase of 3 percent and 1.5 percent in the second and third years. Contracts at the other regional phone companies also did not require workers to pay for their health insurance coverage. Instead "preferred provider plans" were established in some contracts and deductibles were increased.

Prices

The consumer price index rose 0.5 percent in October, a bit faster than in recent months, mainly reflecting a pickup in energy prices. Excluding food and energy, the CPI was still up 0.5 percent; over the past twelve months, the CPI excluding food and energy has risen 4-1/4 percent--down slightly from the 4-1/2 percent annual pace over the preceding year. Producer prices of finished goods rose 0.4 percent in October, following a 0.9 percent increase in September; this price measure has registered wide swings since the summer, reflecting movements in the prices of food, energy, and motor vehicles.

The CPI for energy rose 0.6 percent in October--after four months of declines--as higher crude oil costs were passed on to the retail level. Prices of gasoline and fuel oil were up about 1 percent and 3-1/2 percent, respectively. However, posted prices of domestic crude oil have eased a bit since October, and private survey data point to a decline in retail gasoline prices in November.

Food prices advanced 0.4 percent in the October CPI, a moderate pickup from the pace of recent months. Sharp increases were posted for dairy products, pork, and some fresh fruits and vegetables. Further increases in the prices of dairy products appear likely over the remainder of 1989 as the price of milk continued to rise sharply at the farm level in November. In addition, livestock prices have moved up recently in spot commodity markets, and egg prices have climbed, suggesting further upward pressures on the retail prices of related products. However, vegetable prices appear to have eased in some spot markets in recent weeks after a temporary surge around mid-autumn.

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

	Relative importance Dec. 1988	1987	1988	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.
				----Annual rate----			-Monthly rate-	
All items[2]	100.0	4.4	4.4	6.1	5.7	1.6	.2	.5
Food	16.2	3.5	5.2	8.2	5.6	2.9	.2	.4
Energy	7.3	8.2	.5	10.2	24.8	-13.4	-.9	.6
All items less food and energy	76.5	4.2	4.7	5.2	3.8	3.1	.2	.5
Commodities	25.7	3.5	4.0	4.1	2.0	.7	.4	.6
Services	50.8	4.5	5.0	5.9	4.3	4.5	.2	.4
Memorandum:								
CPI-W[3]	100.0	4.5	4.4	6.2	5.7	1.6	.2	.5

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 Q3	1989 Sept.	1989 Oct.
				----Annual rate----			-Monthly rate-	
Finished goods	100.0	2.2	4.0	10.2	5.8	-.3	.9	.4
Consumer foods	25.8	-.2	5.7	13.1	-1.3	-1.3	-.6	1.4
Consumer energy	8.8	11.2	-3.6	41.0	31.8	-16.8	6.5	.2
Finished goods less food and energy	65.3	2.1	4.3	5.1	5.1	3.3	.7	.1
Consumer goods	39.6	2.7	4.8	5.4	5.7	2.6	.6	.2
Capital equipment	25.8	1.3	3.6	4.6	4.5	4.8	1.0	-.3
Intermediate materials less food and energy	83.4	5.2	7.2	5.5	.3	-.7	.1	.1
Crude food materials	43.8	1.8	14.2	16.9	-17.8	-2.2	-.8	-.6
Crude energy	36.9	10.7	-9.5	48.3	23.6	-6.5	3.5	.5
Other crude materials	19.3	22.6	7.5	10.3	-9.3	-.6	.3	.3

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

All told, the rise in food prices over 1989 as a whole likely will match or slightly exceed the 5-1/4 percent hike recorded in 1988, when supplies of a number of crops were severely damaged by drought. The lack of deceleration this year partly reflects continued supply problems in some agricultural markets--notably a poor wheat crop this year and a drop in dairy production. At the same time, increases in demand also appear to have played a role. For example, the USDA projects that exports of meat and poultry in 1989 will be up about 30 percent from 1988; although exports constitute only a small portion of the total use of these products, the additional demand this year probably has helped to forestall a softening of prices that otherwise might have developed in the face of this year's production gains.

Apart from these supply-demand shifts, an impetus for inflation in the food area seemingly is still coming from wages and other nonfarm costs. An area in which these underlying pressures are most apparent is in the CPI for food away from home, which as of October was up more than 4-1/2 percent from a year earlier--a slight acceleration from the pace of 1988. Prices of more heavily processed grocery products also have risen sharply--some of them as much as 6 percent over the past year.

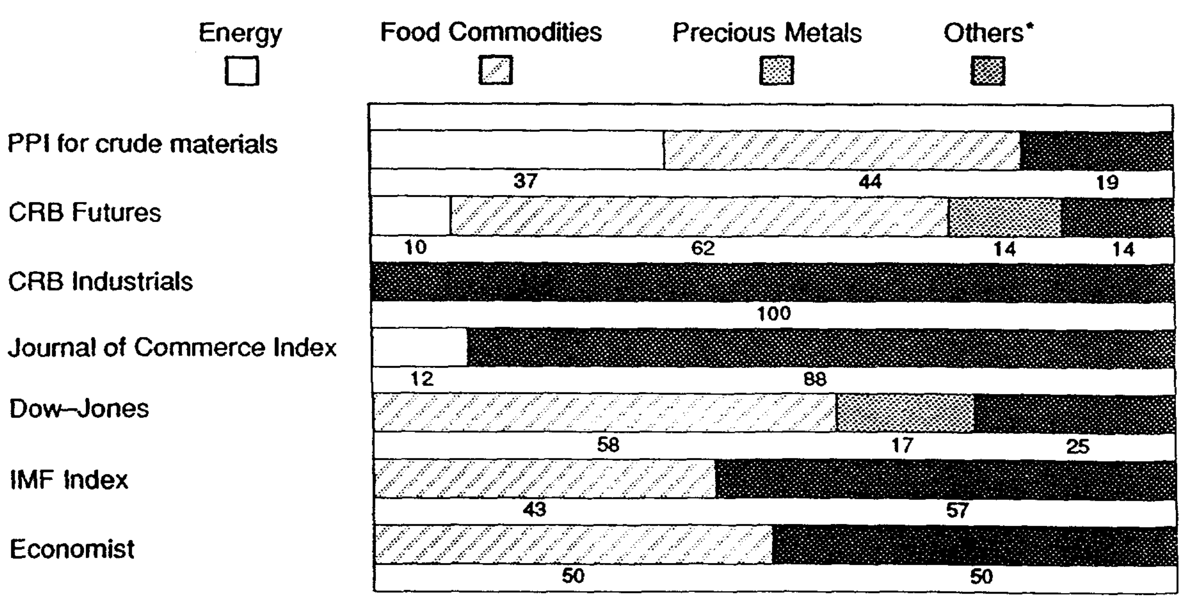
The commodities component of the CPI less food and energy was up 0.6 percent in October, boosted for the second month by a hike in apparel prices associated with the introduction of fall and winter clothing. Nevertheless, apparel prices, which had been heavily discounted during the summer, were only 1-1/2 percent above their levels in October 1988. Prices of new cars advanced 0.6 percent--after five months of declines--as higher-priced 1990

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1987	1988	1989 to Nov. 7[3]	1989 Nov. 7[3] to date	Memo: Year earlier to date
1. PPI for crude materials[4]	Oct.	8.9	3.1	4.6[4]	n.a.	6.2[4]
1a. Foods and feeds	Oct.	1.8	14.2	-2.1[4]	n.a.	-4.2[4]
1b. Energy	Oct.	10.7	-9.5	15.0[4]	n.a.	21.0[4]
1c. Excluding food and energy	Oct.	22.6	7.5	.4[4]	n.a.	3.0[4]
1d. Excluding food and energy, seasonally adjusted	Oct.	22.8	7.6	.1	n.a.	2.9[4]
2. Commodity Research Bureau						
2a. Futures prices	Dec. 12	11.7	8.5	-9.5	-.4	-7.4
2b. Industrial spot prices	Dec. 11	19.2	7.3	-.8	-4.6	-3.8
3. Journal of Commerce industrials	Dec. 12	10.7	3.8	5.0	-4.4	1.0
4. Dow-Jones Spot	Dec. 12	17.0	6.9	-9.2	-1.4	-7.0
5. IMF commodity index[4]	Nov.	30.8	12.6	-11.7	n.a.	-9.0
5a. Metals	Nov.	51.9	33.7	-20.6	n.a.	-15.2
5b. Nonfood agric.	Nov.	47.5	-9.4	-2.6	n.a.	-2.1
6. Economist (U.S. dollar index)	Dec. 5	42.5	17.7	-19.2	-4.3	-19[illegible]
6a. Industrials	Dec. 5	62.6	18.9	-19.6	-5.1	-18.[illegible]

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

Index Weights



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

models were entered in the sample for the first time.[12] Despite the latest increases, the CPI for commodities less food and energy has risen at an average annual rate of 2-3/4 percent so far this year, well below the 4 percent pace during 1988; this slowdown reflects, in part, the moderation in import prices. In contrast, the 0.4 percent increase in the CPI for nonenergy services in October was similar to the 5 percent annual pace that has prevailed since mid-1988.

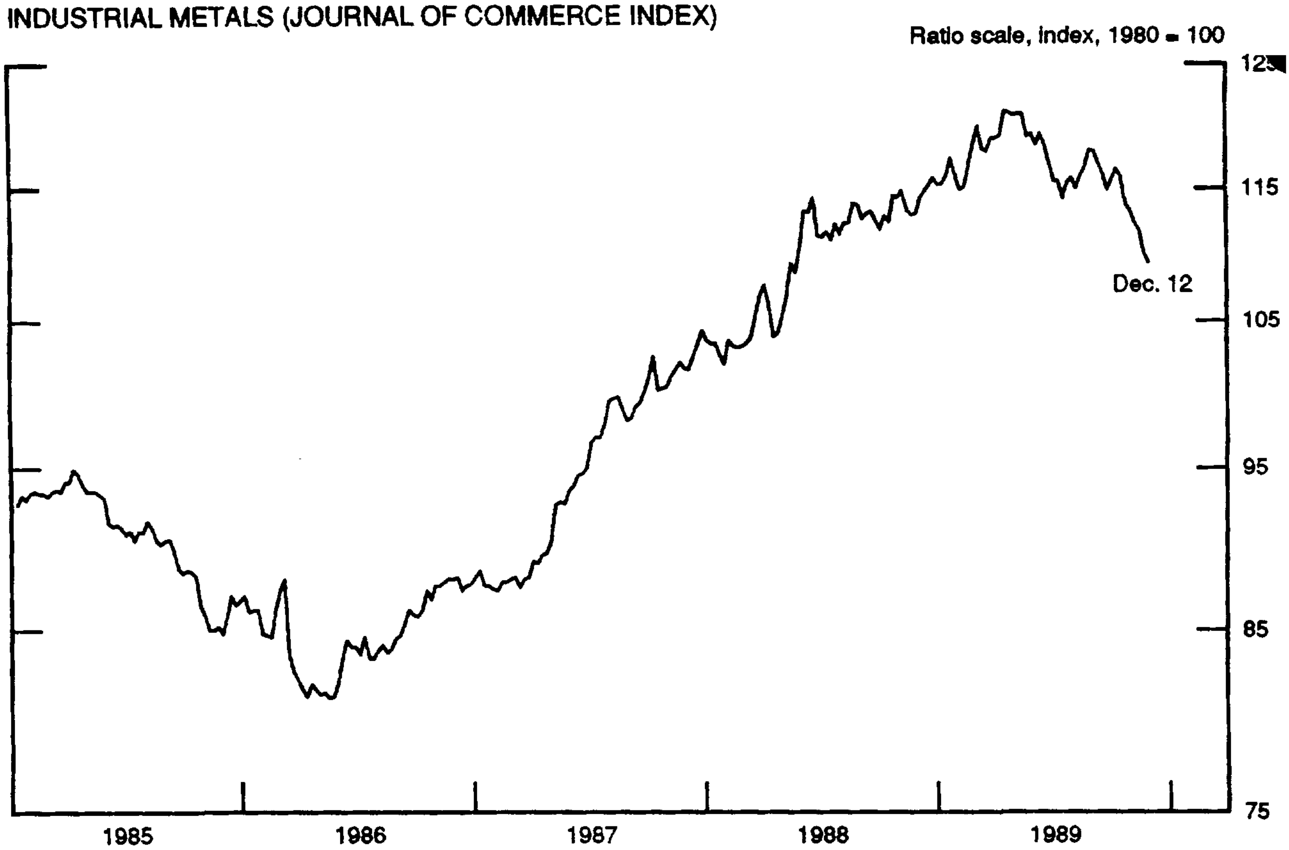
Since mid-October, spot prices of industrial commodities have moved lower. Notable among these declines is an 8 percent drop in the prices of industrial metals (chart), which reflects in part the slowdown in the pace of industrial activity. Special factors in individual markets also have played a role; in particular, copper prices have fallen more than 20 percent over the past two months as earlier disruptions to supply have eased.[13] In contrast, the prices of precious metals have risen sharply, on net, since mid-October, led by a rise in gold prices of nearly 15 percent. While the explanation for this movement is not entirely clear, many market analysts have attributed it to concerns about the stability of financial markets, in the aftermath of the October stock market drop, and to uncertainty generated by events in Eastern Europe and the USSR. Heightened concerns about inflation also have been mentioned as a contributing factor, although a rise in inflation expectations is not confirmed by other data.[14] Indeed, in the

12. In the CPI, the new-model cars are phased into the sample over several months, roughly in proportion to sales. In October, 1990 models represented approximately 25 percent of new cars in the CPI sample.

13. The most notable example was a labor agreement reached at a large Canadian mine after a long strike.

14. The Survey Research Center survey shows expectations for inflation (CPI) a year ahead holding at 4-3/4 percent in November. According to the Hoey survey, inflation expectations a year ahead were 4-1/4 percent in November, about 1/2 percentage point below the August reading.

INDUSTRIAL METALS (JOURNAL OF COMMERCE INDEX)



GOLD (SPOT PRICES)

Weekly data (Tuesday quotations).

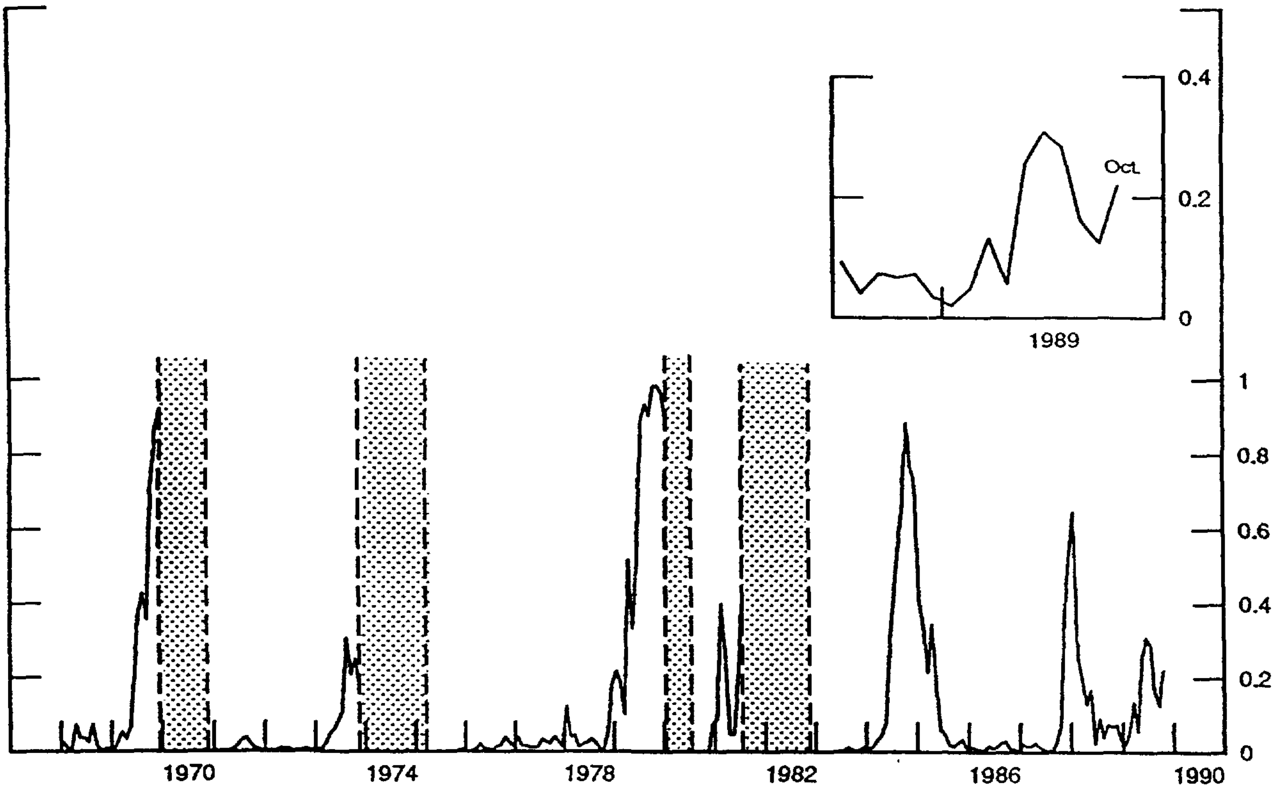
Hoey survey, 10-year inflation expectations dropped from 4-1/2 percent in August to 4-1/4 percent in November, the lowest figure in the 11-year history of the survey. Over longer periods, the dollar price of gold has tended to move inversely with the exchange value of the dollar, and indeed the recent increases in gold prices have coincided roughly with a weakening of the dollar.

Leading Indicators of Recession

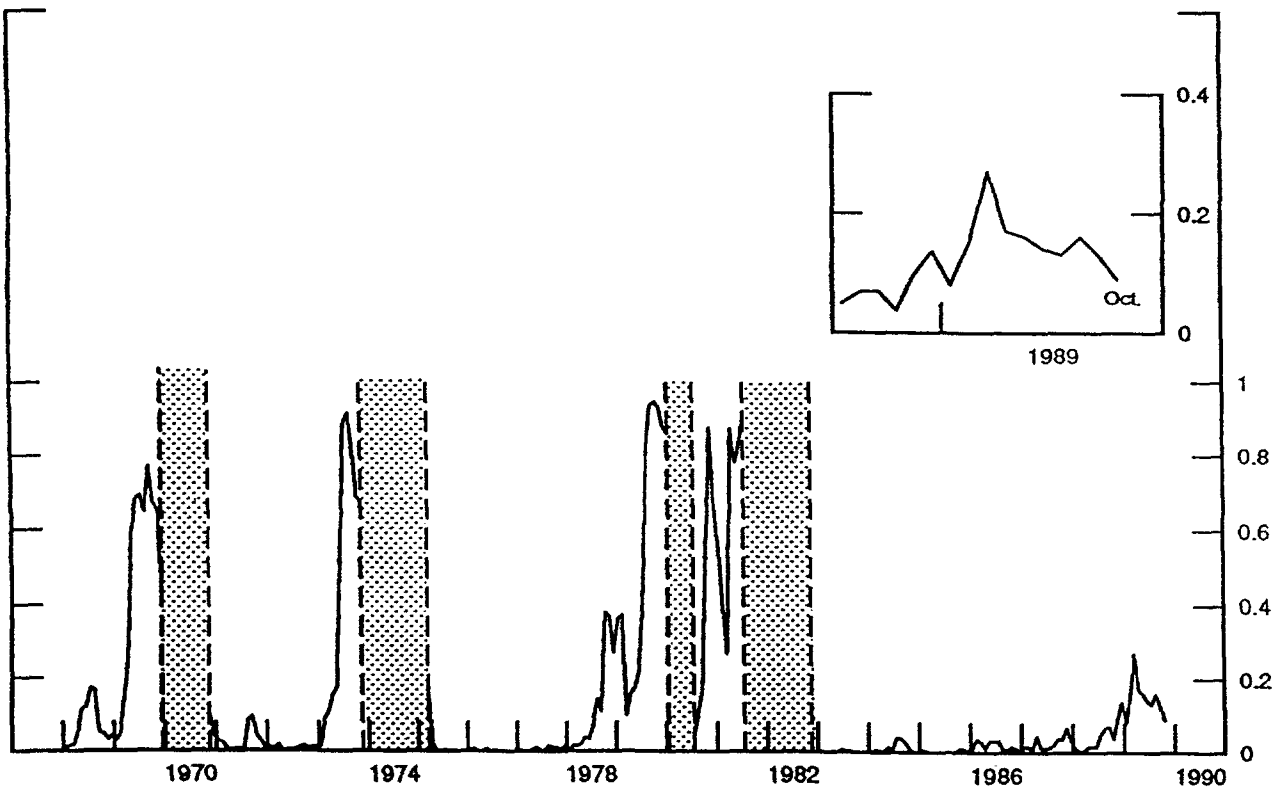
The latest readings on recession-probability measures based on indexes of leading economic indicators are generally in the ranges that have prevailed since last spring. Based on the October report for the Commerce Department's index of leading economic indicators, the probability that a recession would start in the next six months was 22 percent. This was up from the September reading of 12 percent. In contrast, a measure based on a leading index compiled by the NBER showed a 9 percent probability, slightly below the September reading.

Probability of a Recession*

GENERATED FROM COMMERCE LEADING INDEX



GENERATED FROM NBER LEADING INDEX



*Each probability represents the likelihood that a recession will begin during the next six months.

SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

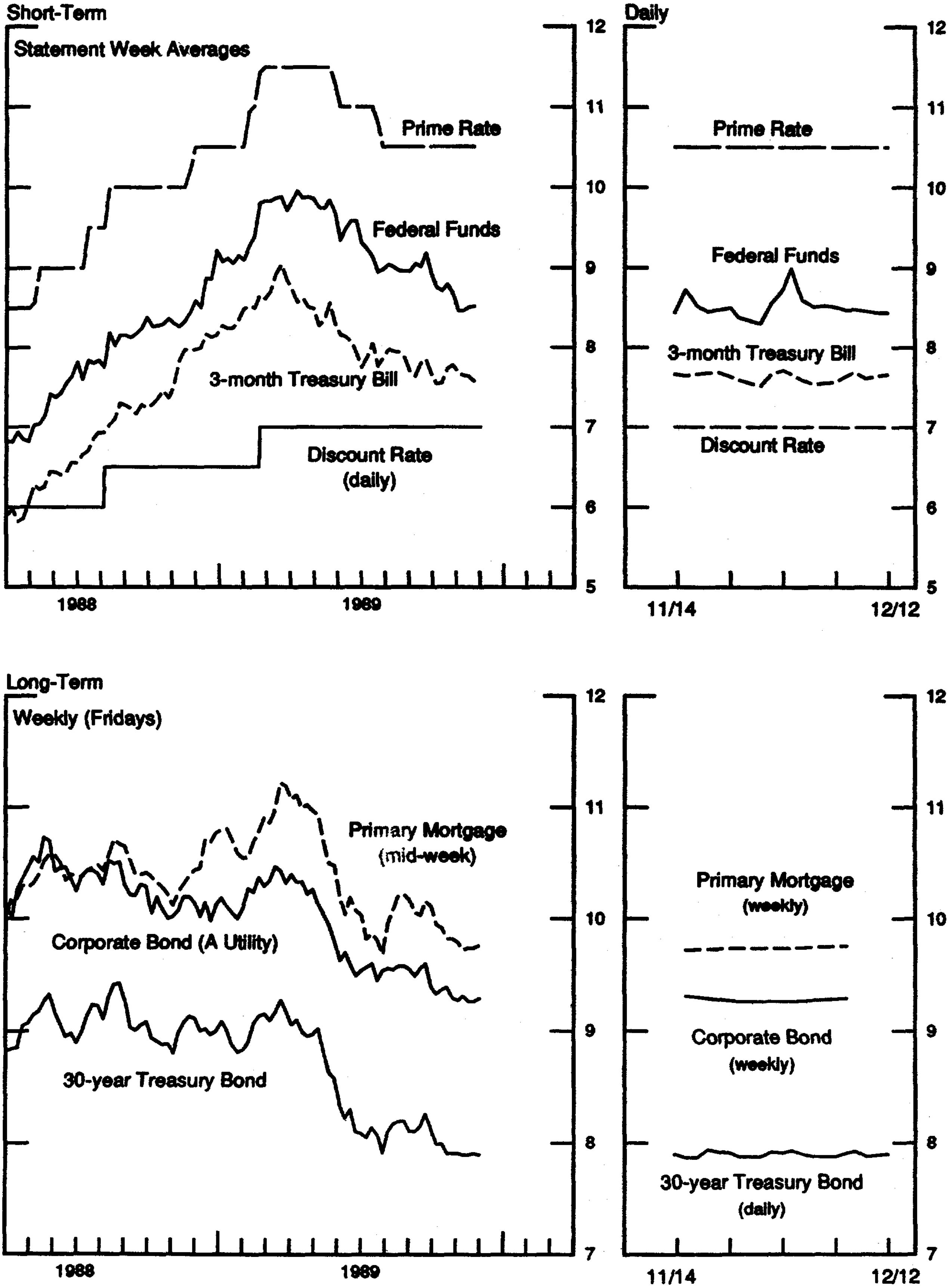
	1987	1989			Change from:	
	Oct. 16[2]	Mar. highs	FOMC Nov. 14	Dec.12	Mar.89 highs	FOMC Nov. 14
Short-term rates						
Federal funds[3]	7.59	9.85	8.57	8.49	-1.36	-.08
Treasury bills[4]						
3-month	6.93	9.09	7.66	7.66	-1.43	.00
6-month	7.58	9.11	7.43	7.44	-1.67	.01
1-year	7.74	9.05	7.20	7.25	-1.80	.05
Commercial paper						
1-month	7.94	10.05	8.43	8.58	-1.47	.15
3-month	8.65	10.15	8.35	8.27	-1.88	-.08
Large negotiable CDs[4]						
1-month	7.92	10.07	8.39	8.63	-1.44	.24
3-month	8.90	10.32	8.36	8.31	-2.01	-.05
6-month	9.12	10.08	8.18	8.12	-1.96	-.06
Eurodollar deposits[5]						
1-month	8.00	10.19	8.44	8.69	-1.50	.25
3-month	9.06	10.50	8.25	8.38	-2.12	.13
Bank prime rate	9.25	11.50	10.50	10.50	-1.00	.00
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	9.52	9.88	7.75	7.76	-2.12	.01
10-year	10.23	9.53	7.87	7.84	-1.69	-.03
30-year	10.24	9.31	7.90	7.90	-1.41	.00
Municipal revenue[6] (Bond Buyer)	9.59	7.95	7.45	7.35	-.60	-.10
Corporate A-utility (recently offered)	11.50	10.47	9.27	9.33	-1.14	.06
Home mortgage rates[7]						
S&L fixed-rate	11.58	11.22	9.79	9.76	-1.46	-.03
S&L ARM, 1-yr.	8.45	9.31	8.52	8.39	-.92	-.13

	1987		1989			Percent change from:			
	highs	lows	Oct.12	FOMC Nov.14	Dec.12	1987 highs	1987 lows	1989 Oct.12	FOMC Nov.14
Stock prices									
Dow-Jones Industrial	2722.42	1738.74	2759.84	2610.25	2752.13	1.09	58.28	-.28	5.44
NYSE Composite	187.99	125.91	196.98	187.51	194.44	3.43	54.43	-4.81	3.70
AMEX Composite	365.01	231.90	395.01	371.52	377.41	3.40	62.75	-5.95	1.59
NASDAQ (OTC)	455.26	291.88	482.19	454.03	450.43	-1.06	54.32	-5.84	-.79
Wilshire	3299.44	2188.11	3485.24	3308.81	3408.19	3.30	55.76	-5.06	3.00

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week reserve maintenance period closest to date shown. Last observation is average-to-date for maintenance period ending 12/13/89.
4. Secondary market.
5. Bid 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 December 8, Wednesday weeks through December 6.

Interest rates have changed little on balance since the November FOMC meeting, despite indications of a sluggish economy and more favorable prospects for reduced defense spending. Some notable gyrations occurred in the money markets in the days surrounding the Thanksgiving holiday as a result of the market's mistaken view--and its subsequent correction--that the Federal Reserve had eased policy. Federal funds have traded recently at around 8-1/2 percent, where they were at the last FOMC meeting. Since peaking in March, interest rates have declined between 1-1/2 and 2 percentage points.

Continuing to respond to previous declines in market rates, M2 growth remained relatively rapid in November. M3 growth picked up last month as runoffs in managed liabilities at thrift institutions abated. In November, M2 was near the midpoint of its 1989 target range, while M3 was just above the lower bound of its range.

Credit demands from nonfinancial sectors appear to have weakened in November. Business borrowing moderated, as nonfinancial firms cut bond issuance well below October's brisk pace, while growth in the total of commercial bank business loans and commercial paper advanced only a little. Federal debt issuance slackened last month, as the Treasury drew down its cash balance, and borrowing by state and local governments moderated further. Current information on recent credit use by households is scarce, but commercial bank data suggest some slowdown in mortgage lending in

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

	1988[1]	1989 Q2	1989 Q3	1989 Sep	1989 Oct	1989 Nov pe	Growth Q4 88- Nov 89pe
	------------Percent change at annual rates------------						
1. M1	4.3	-5.6	1.5	5.7	10.1	3	½
2. M2	5.2	1.2	7.3	7.5	7.8	8	4½
3. M3	6.3	2.9	4.6	1.0	4.5	6	4
	------------Percent change at annual rates------------						Levels bil. $ Oct 89
Selected components							
4. M1-A	2.5	-3.3	1.2	1.9	8.6	-2	507.4
5. Currency	8.1	4.1	3.7	5.5	1.6	3	219.7
6. Demand deposits	-1.2	-8.7	-0.4	-0.9	13.4	-6	280.4
7. Other checkable deposits	7.7	-9.8	2.2	12.7	13.0	13	280.3
8. M2 minus M1[2]	5.5	3.5	9.3	8.1	7.1	10	2389.1
9. Overnight RPs and Eurodollars, NSA	-5.7	-24.2	1.1	-41.7	19.9	-20	73.5
10. General purpose and broker/dealer money market mutual fund shares, NSA	7.4	21.0	36.5	39.1	27.3	33	301.5
11. Commercial banks	6.9	5.4	6.9	7.4	11.1	14	1042.8
12. Savings deposits, SA, plus MMDAs, NSA[3]	1.4	-14.9	3.6	10.2	9.4	23	527.2
13. Small time deposits	14.7	29.0	10.4	4.7	12.9	5	515.6
14. Thrift institutions	4.6	-1.1	4.0	-0.4	-5.8	0	968.0
15. Savings deposits, SA, plus MMDAs, NSA[3]	-4.3	-24.6	-6.0	4.1	4.8	11	351.6
16. Small time deposits	11.7	14.0	9.8	-2.9	-11.8	-6	616.4
17. M3 minus M2[4]	10.2	9.2	-4.9	-22.3	-7.8	-3	850.6
18. Large time deposits	11.0	14.0	-1.6	-11.4	-6.0	-2	560.9
19. At commercial banks, net[5]	12.2	17.8	1.9	-3.6	6.4	8	397.9
20. At thrift institutions	8.8	5.8	-9.5	-29.3	-34.3	-27	163.1
21. Institution-only money market mutual fund shares, NSA	-0.8	12.2	34.1	-17.9	-4.8	40	98.7
22. Term RPs, NSA	14.5	2.8	-32.2	-43.7	-34.8	10	110.4
23. Term Eurodollars, NSA	11.2	-6.7	-13.5	-46.7	-43.5	12	90.4
	-----Average monthly change in billions of dollars-----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	5.0	9.0	3.4	5.8	11.8	4	707.7
25. Large time deposits, gross	3.3	4.0	-0.3	-2.4	1.3	2	459.3
26. Nondeposit funds	1.7	4.9	3.7	8.2	10.5	2	248.4
27. Net due to related foreign institutions	-0.4	-0.2	0.6	0.4	0.4	-2	10.0
28. Other[7]	2.1	5.1	3.0	7.8	10.1	4	238.4
29. U.S. government deposits at commercial banks[8]	0.0	2.4	-1.2	0.9	-3.9	0	19.9

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 October and November at rates of 5.9 percent and 14 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during October and November at rates of 3.8 percent and 8 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.
pe - preliminary estimate

October and November; growth in consumer installment credit likely was weak in November, with rapid growth at banks probably offset by declines at other holders.

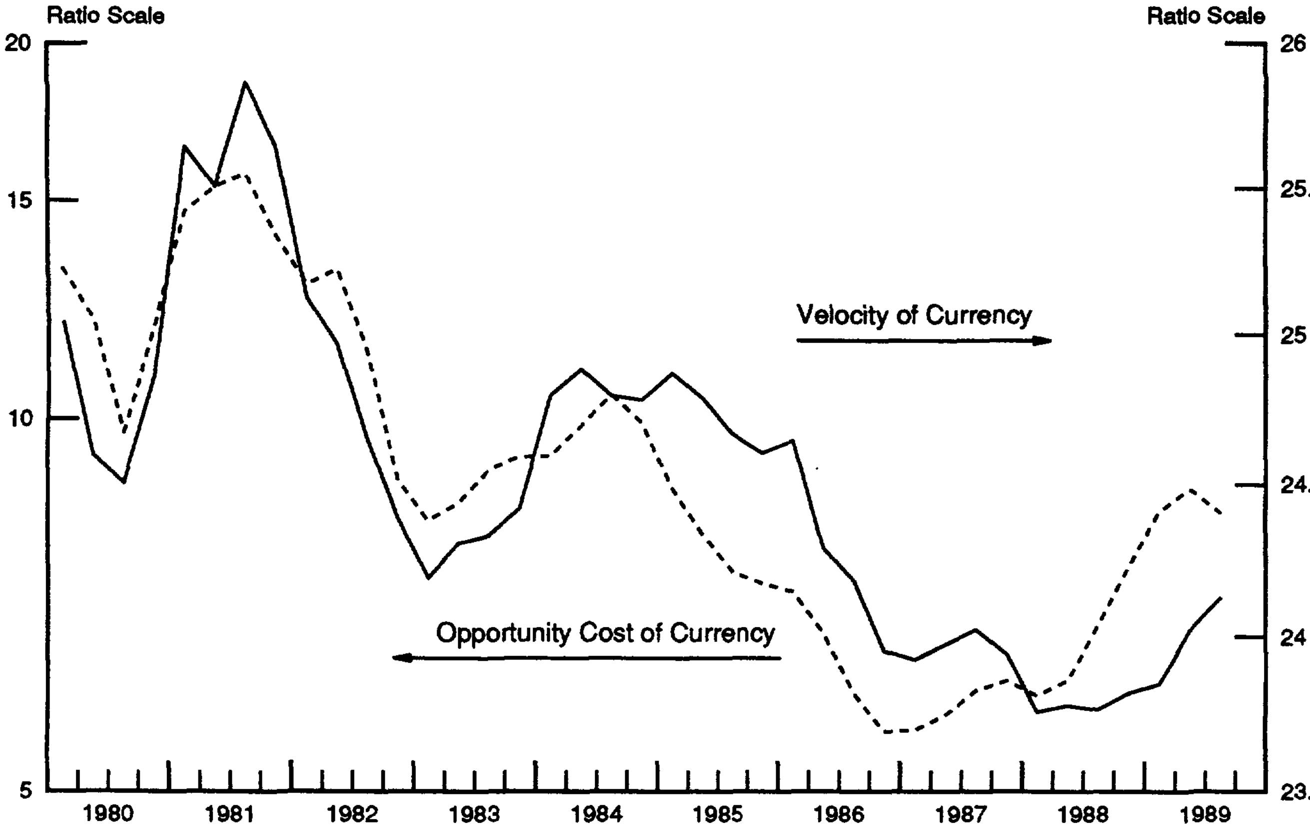
Monetary Aggregates and Bank Credit

Despite continued rapid expansion of OCDs, M1 growth slowed to a 3 percent annual rate in November, as demand deposits declined after their October bulge. Currency continued to advance sluggishly, and its velocity likely has risen further in the fourth quarter. As shown in the chart, the velocity of currency does respond to changes in its opportunity cost, but (since the mid-1980s) with a lag. Thus, the recent weakness in the quantity of currency demanded may be an ongoing response to earlier increases in its opportunity cost.

M2 growth, at an 8 percent annual rate in November, owed mainly to strength in its liquid components. The opportunity cost of OCDs, MMDAs, and savings deposits, whose own-rates adjust sluggishly, has fallen almost 2 percentage points since market rates began to decline in the spring, and growth in these liquid deposit components reached a 16 percent rate in November (chart). Retail money market mutual funds (MMMFs), which have grown rapidly most of the year, were again robust in November, despite reports that banks and thrifts have mounted aggressive promotional efforts to market MMDAs as insured alternatives to MMMFs. The expansion in the liquid components of M2 came mainly at the expense of small time deposits, which edged down in October and November. However, a weakening in recent months in net noncompetitive tenders for Treasury issues suggests that the expansion in liquid accounts also represented some shifts out of instruments not in M2.

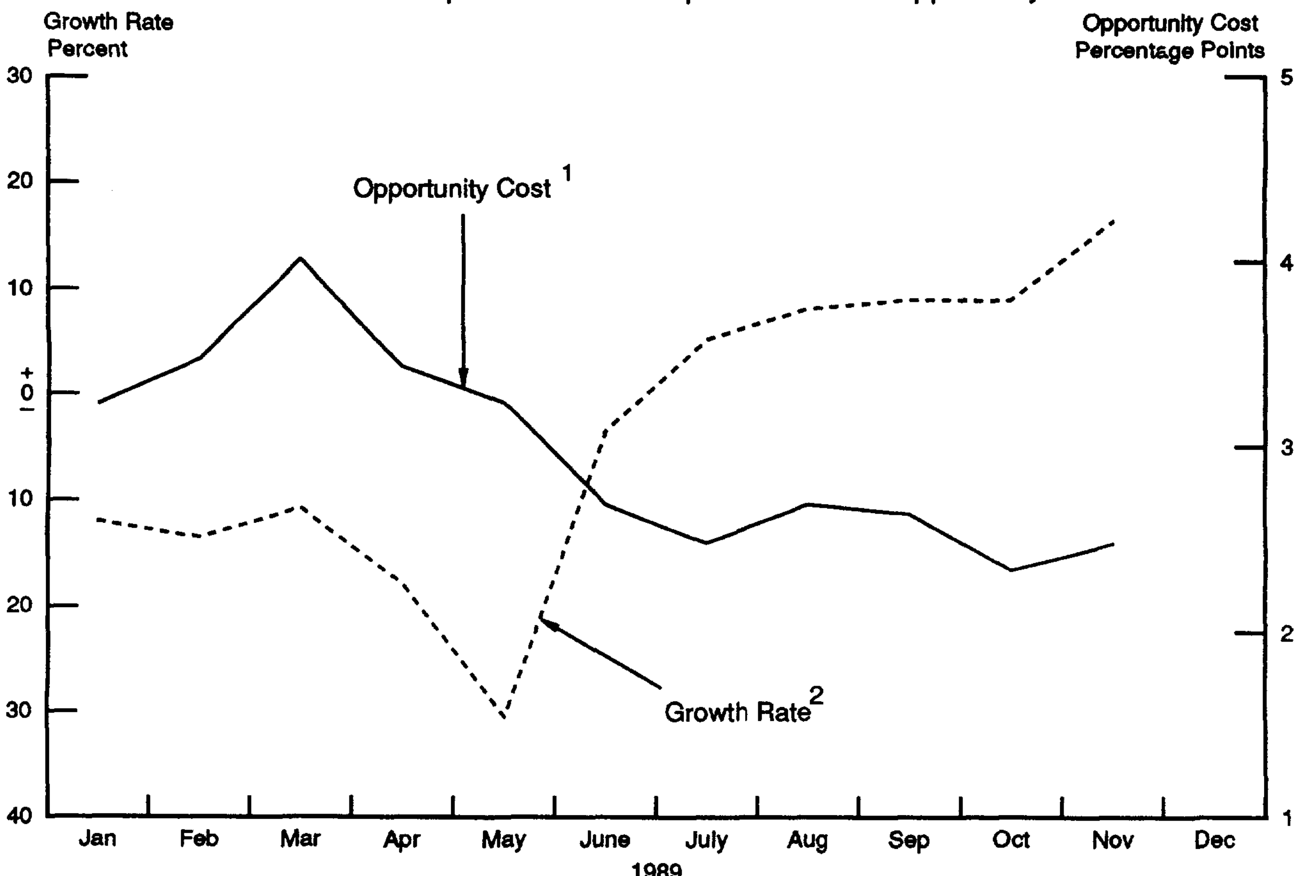
Velocity of Currency Relative to its Opportunity Cost [1]

(Quarterly Data)



1) A 2-quarter moving average of the 3-month Treasury bill yield.

Growth Rate of Liquid Household Deposits and their Opportunity Cost



1) 6-month Treasury bill less the simple average of the NOW and MMDA rates.
2) Liquid household deposits include OCDs, MMDAs and savings deposits.

The acceleration of M3 to a 6 percent pace in November largely reflected a slowing in the contraction of managed liabilities at thrifts. As discussed more fully below, the pace of asset shrinkage at capital-deficient thrifts evidently moderated in November. In addition, Resolution Trust Corporation (RTC) infusions into, and resolutions of, institutions in conservatorship ceased temporarily. Thrift institutions reduced large time deposits by less last month than in October, and runoffs of term RPs abated sharply from the rapid pace of recent months. Large time deposits at commercial banks expanded last month at about their October pace, and term RPs grew briskly, though some of the strength in term RPs reflected normal switching out of overnight RPs that occurs around the Thanksgiving holiday. Institution-only money funds expanded in November after declining in September and October, as their yields lagged declines in market rates.

Bank credit decelerated sharply in November to a 4 percent rate of growth. Net purchases of government securities, though at a still rapid 16-1/4 percent pace, were well down from October's extraordinary increase, which had been boosted by the investment of cash received when banks acquired failed thrifts from the RTC. Federally related mortgage-backed securities (MBSs), which are part of government securities, were responsible for a significant share of the October growth. Banks' purchases of MBSs were somewhat smaller in November, but still made up the lion's share of inflows to investment accounts. Other securities declined at a 15-3/4 percent annual rate in November as several large banks sold holdings of municipals. These banks had recently made substantial additions to their loan-loss reserves and apparently chose to sell their municipals in the expectation that the tax benefits the securities confer would be less

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 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.p	Level: bil.$ Nov.p
		------ Commercial Bank Credit ------						
1.	Total loans and securities at banks	7.6	5.2	8.0	6.2	15.2	4.0	2584.1
2.	Securities	4.8	.7	1.6	4.7	27.1	6.1	577.3
3.	U.S. government securities	7.3	5.4	5.4	7.0	40.9	16.2	397.0
4.	Other securities	.5	-8.2	-6.2	.7	-1.3	-15.8	180.3
5.	Total loans	8.5	6.5	9.9	6.6	11.8	3.4	2006.8
6.	Business loans	6.8	4.6	8.3	.4	8.1	1.1	641.7
7.	Real estate loans	14.0	11.7	13.7	12.9	11.9	10.4	747.5
8.	Consumer loans	8.5	6.1	6.1	9.1	7.4	8.3	377.0
9.	Security loans	-5.7	-21.1	-6.8	21.1	50.2	-19.9	41.6
10.	Other loans	-.4	1.2	10.6	-6.0	23.0	-19.0	199.0
		------ Short- and Intermediate-Term Business Credit ------						
11.	Business loans net of bankers acceptances	6.9	4.6	7.9	-.2	6.6	1.3	637.5
12.	Loans at foreign branches[2]	30.3	32.8	-83.3	-192.8	-51.7	.0	20.0
13.	Sum of lines 11 & 12	7.6	5.6	4.1	-7.5	4.8	1.3	657.5
14.	Commercial paper issued by nonfinancial firms	15.5	38.2	10.3	41.0	-4.7	17.0	128.5
15.	Sum of lines 13 & 14	8.6	10.5	5.1	.0	3.1	4.1	786.1
16.	Bankers acceptances: U.S. trade related[3,4]	-6.8	6.9	-1.1	-6.7	-23.7	n.a.	34.8[5]
17.	Line 15 plus bankers acceptances: U.S. trade related	7.8	10.4	4.9	-.1	2.1	n.a.	818.3[5]
18.	Finance company loans to business[3]	12.3	14.7	14.1	18.1	12.6	n.a.	259.0[5]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	8.9	11.4	7.0	4.2	4.6	n.a.	1077.3[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. October data.
p--preliminary.
n.a.--not available

valuable in coming years[1]. Growth in business loans slowed to a 1 percent rate last month despite some pickup in merger-related lending. Real estate loans edged down to a 10-1/2 percent rate of increase. At 8-1/4 percent, consumer loans at banks registered their fourth consecutive rapid advance in November, even as securitization of consumer receivables depressed the measured growth rate by about 2 percentage points.

Thrift Institutions

Total assets at SAIF-insured institutions shrank at a 12 percent annual rate in the third quarter, compared with a 3 percent decline in the second quarter. The sell-off in thrift assets was concentrated in mortgage assets and reflected both the need of capital-deficient thrifts to reduce assets in order to meet the new regulatory requirements and an RTC-mandated contraction of thrifts in conservatorship. In line with the decline in assets, funding needs at these institutions also dwindled in the third quarter. The chart shows the relatively close correlation between changes in the "funding proxy" (total deposits, Federal Home Loan Bank Advances, and repurchase agreements) and changes in total assets. Thrift funding continued to shrink rapidly in October, but the decline moderated in November, signaling at least a pause in the shrinkage of the thrift industry.

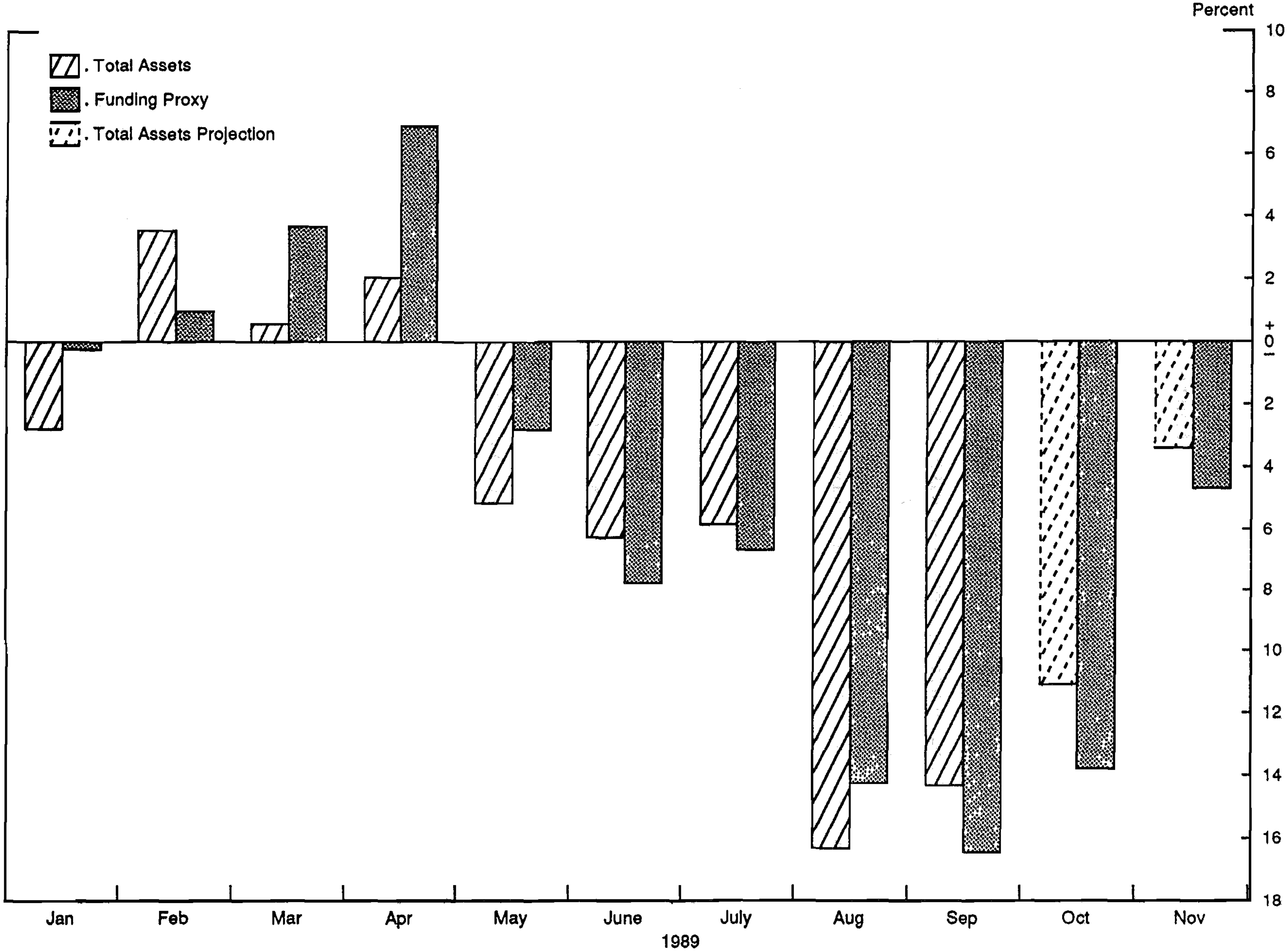
Third-quarter earnings for SAIF-insured institutions are not yet available, but announced losses at 53 thrifts, which hold more than a fourth of the industry's assets, widened to $600 million in the third quarter from

1. The securities sold were grandfathered under the Tax Reform Act of 1986, allowing banks to continue to deduct from taxable income 80 percent of the cost of carrying them. The deduction would no longer be available if banks wished to repurchase these (or similar) municipals.

SAIF-Insured Institutions

Total Assets and Funding Proxy

(percentage changes, annual rate; seasonally adjusted, end-of-month data)



Note: Funding Proxy is defined as total deposits, advances, and repurchase agreements (RPs). The value for the growth of the funding proxy in October and November is a projection, based in part, on weekly data from a selection of SAIF-insured institutions. Values for prior months are based on data for all SAIF-insured institutions

$154 million in the second quarter. The fourfold increase mainly reflected increased loan-loss provisions on real estate loans at thrifts in Florida, the Southwest, and New England, and large losses on junk bond portfolios at a few thrifts. It is unlikely that the thrift industry as a whole experienced such a dramatic decline in earnings, as few institutions hold junk bonds, but the numerous reports of increased asset quality problems bode ill for the rest of the industry.

Since its inception in early August, the RTC has spent $9.9 billion to resolve 33 insolvent institutions having $9.1 billion in assets. More than half of these assets were accounted for by two institutions. In the vast majority of cases the RTC transferred insured deposits to healthy institutions, mostly banks, which have paid premiums for the deposits ranging from zero to 2.5 percent. To date RTC also has spent about $9 billion to replace high-cost borrowed funds at thrifts in conservatorship. Recently, however, such replacements have ceased, causing these thrifts to bid more aggressively for deposits.

Although insolvent thrifts have continued to enter conservatorship, the RTC has not resolved any cases since October 20. The pace of resolutions has been slowed by the lack of a well-defined plan of action, the lack of working capital, and difficulties involved in completing a catalogue of assets for sale.[2] Nonetheless, the RTC recently announced that it will soon take bids on fourteen small thrifts.

2. Currently, the RTC has a strategic plan out for public comment, and it is expected to be ready for implementation by January.

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

	1987	1988	1989					
	Year	Year	Q1	Q2	Q3[p]	Sept.[p]	Oct.[p]	Nov.[p]
Corporate securities - total[1]	24.08	22.23	19.18	20.15	16.15	15.74	24.06	20.49
Public offerings in U.S.	21.89	20.21	16.62	17.86	14.44	13.07	22.30	18.20
Stocks--total[2]	4.45	3.53	1.78	1.88	3.12	2.27	3.80	4.20
Nonfinancial	2.32	1.14	.92	.97	1.06	1.08	1.47	1.10
Utility	.57	.24	.16	.31	.35	.73	.55	.20
Industrial	1.75	.90	.76	.66	.71	.35	.92	.90
Financial	2.12	2.39	.86	.91	2.06	1.19	2.33	3.10
Bonds--total[1]	17.44	16.68	14.84	15.98	11.32	10.80	18.50	14.00
Nonfinancial	6.61	6.08	4.57	7.32	4.93	4.40	8.40	6.30
Utility	2.02	1.77	.62	2.01	1.44	1.40	3.15	2.10
Industrial	4.59	4.31	3.95	5.31	3.49	3.00	5.25	4.20
Financial	10.83	10.60	10.27	8.66	6.39	6.40	10.10	7.70
By quality[3]								
Aaa and Aa	3.25	2.68	3.45	3.19	2.93	2.80	3.45	3.65
A and Baa	5.20	5.57	4.94	6.45	4.10	3.80	6.50	4.70
Less than Baa	2.77	2.51	1.91	3.81	1.90	1.48	3.02	1.45
No rating (or unknown)	.07	.07	.02	.02	.03	.00	.00	.20
Memo items:								
Equity-based bonds[4]	.87	.28	.12	.59	.60	.93	1.19	.45
Mortgage-backed bonds	5.19	4.69	2.94	1.01	1.25	1.10	.85	.60
Other asset-backed	.96	1.26	1.58	1.49	1.11	1.70	4.68	3.40
Variable-rate notes	1.88	1.19	.96	1.82	.25	.20	.82	1.00
Bonds sold abroad - total	2.03	1.93	2.55	2.25	1.41	2.00	1.50	2.00
Nonfinancial	.94	.69	.89	.48	.38	.85	.30	.50
Financial	1.09	1.24	1.66	1.77	1.03	1.15	1.20	1.50
Stocks sold abroad - total	.16	.09	.01	.04	.30	.67	.26	.29
Nonfinancial	.12	.08	.01	.04	.30	.60	.17	.13
Financial	.04	.01	.00	.00	.00	.07	.09	.16

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.

Business Finance

In November short- and intermediate-term business borrowing grew only a bit faster than its lackluster October pace, as the slowdown in business lending at banks was offset by a turnaround in commercial paper growth. Gross public offerings of bonds by nonfinancial corporations declined from October's hectic pace, largely owing to reduced issuance of junk bonds. Yields on these bonds widened about 20 basis points further over Treasuries in November, and there were more than usual delays and reconstitutions of scheduled issues, reflecting increased investor resistance. Recently passed legislation, removing tax advantages of high-yield bonds that delay cash interest payments, could discourage issuance and put a damper on some mergers and takeovers. Lately conditions have settled down a bit. While yield spreads remain large, rates on higher-quality junk issues have declined. Junk bond mutual funds, which experienced sizable outflows in September and October, have reported renewed investor interest in recent weeks.

Corporate restructurings have slowed this quarter, perhaps reflecting uncertainties in the junk bond market and bank reluctance to finance takeovers. The staff currently projects net equity retirements in the fourth quarter at an annual rate of roughly $85 billion, down from $145 billion in the third quarter. Despite this slowdown in mergers and acquisitions and disappointing third-quarter corporate earnings, broad stock indexes have increased 3 to 4 percent since the last FOMC, and the price-earnings ratio for the S&P500, at 14-1/2, now stands at a high for 1989. These gains appear to be based on market expectations of further near-term declines in interest rates, since the outlook for corporate profits has not

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

	1989					
	Q2	Q3	Q4[p]	Oct.	Nov.[e]	Dec.[p]
Treasury financing						
Total surplus/deficit (-)	22.9	-46.5	-74.9	-26.1	-26.2	-22.6
Means of financing deficit:						
Net cash borrowing from the public	10.1	38.6	64.0	36.7	20.6	6.7
Marketable borrowings/ repayments (-)	5.4	33.4	53.3	28.8	18.7	5.8
Bills	-20.0	9.5	24.5	21.4	5.7	-2.6
Coupons	25.3	23.9	28.8	7.4	13.0	8.3
Nonmarketable[2]	4.7	5.2	10.6	7.8	1.9	.9
Decrease in the cash balance	-29.1	2.8	21.6	-2.5	21.7	2.4
Memo: Cash balance at end of period	43.7	41.0	19.3	43.5	21.7	19.3
Other[3]	-3.9	5.1	-10.7	-8.1	-16.2	13.5
Federally sponsored credit agencies, net cash borrowing[4]	9.4	1.6	--	--	--	--
FHLBs	3.9	-10.3	--	-2.7	-2.6	--
FHLMC	1.9	1.5	--	-1.6	--	--
FNMA	1.6	5.2	--	.3	--	--
Farm Credit Banks	0.3	1.7	--	.0	--	--
FAC	0.2	.0	.0	.0	.0	.0
SLMA	0.5	2.9	--	--	--	--
FICO	1.1	0.7	.0	.0	.0	.0
REFCORP	--	--	4.5	4.5	.0	.0

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes proceeds from securities issued by federal agencies under special financing authorities (primarily FSLIC) and the face value of the $4.5 billion zero coupon bond issued by the Treasury to REFCORP in October. The discount is offset in other means of finance.
3. Includes checks issued less checks paid, accrued items and other transactions.
4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
p--projected.
e--staff estimate.
Note: Details may not add to totals due to rounding.

improved. Indeed, large advances in share prices were reported for the interest-sensitive utility sector.

Equity issuance by nonfinancial corporations, at $1.2 billion in November, remained close to its third-quarter pace. Issuance by financial firms was boosted by a $1.7 billion closed-end mutual fund offered by Merrill Lynch. This fund will invest in the senior debt of highly-leveraged transactions, either through purchases from commercial banks in the secondary market or as a participant in primary syndicates. The fund expects to pay investors at a rate approximating the bank prime rate. Since their emergence in April 1988, these prime-rate mutual funds have attracted about $5.5 billion. In most cases fund shares are not expected to be traded in secondary markets. The funds themselves will continue the practice of redeeming shares quarterly at their net asset value.[3]

Treasury and Sponsored Agency Financing

The staff estimates that the projected $75 billion fourth-quarter federal deficit is being financed by $64 billion of borrowing from the public and by a substantial drawdown of the Treasury's cash balance. The increase in borrowing relative to last quarter is taking place primarily through increases in the regularly auctioned 3-, 6-, and 12-month bills. Since the beginning of the third quarter, the gross sizes of the weekly bill auctions have been raised in steps from $13.2 billion to $16.0 billion. These increases were prompted by the need for funds associated with the thrift bailout, and by the usual seasonal swing in financing needs, which typically is accommodated through bill issuance.

3. Because of the illiquidity of the secondary market for the loans that make up the bulk of the funds' assets, the determination of net asset values can involve a good deal of judgment by the funds' managements.

The Treasury raised $15 billion in the third quarter through cash management bills, which are issued irregularly in response to special, usually short-term, needs. Because they are costly, with rates running 25 basis points or more above those on regularly scheduled bills of similar maturity, the Treasury probably will not use cash management bills as a net source of funds this quarter. Such bills have been used by the Treasury twice so far this quarter, however: once in late October in connection with the reversion of the debt ceiling to $2.8 trillion on November 1, and again in late November to bridge a low point in the cash balance in early December.

Although the bill sector is shouldering most of the load from higher fourth-quarter borrowing, the contribution from the coupon sector also is rising, as the gross sizes of coupon auctions have been boosted by between $250 million and $500 million. Nonmarketable borrowing was boosted in October by the zero-coupon bond issued by the Treasury to back the principal of the REFCORP bond. The full $4.5 billion face value was included in nonmarketable borrowing, although the market value of the issue was substantially less. The discount from face value showed up as a negative entry in the "Other" category of means of finance.

In the market for sponsored agency debt, spreads on new issues were slightly narrower in November than in October. Secondary-market spreads on REFCORP bonds have stayed in a range of 25 to 28 basis points since these bonds were issued in October.

In October both Freddie Mac and the Federal Home Loan Banks paid down sizable amounts of debt. In November the paydown continued at the FHLBs. FHLB financing needs were damped by the continued decline in advances to member thrifts, whose balance sheets were shrinking to meet regulatory capital requirements. Partly offsetting this influence, however, has been the FHLBs' move toward investing in mortgage-backed securities, as their spreads over Treasury securities have been viewed as attractive. Press reports estimated total FHLB holdings of MBSs at less than $2 billion, or only about 1 percent of assets, at the end of October. Current system-wide FHLB policy limits holdings of mortgage securities to 50 percent of capital, or roughly 4 percent of assets. Fannie Mae has been acquiring mortgage assets on a larger scale than have the FHLBs, and continued to do so in October, concomitantly increasing its debt by $300 million.

Municipal Securities

Gross issuance of long-term municipal securities eased to $8.7 billion in November, down slightly from October's moderate $9.1 billion pace. Offerings for new capital were up slightly. Refunding volume fell, however, despite a small decline in municipal bond yields, perhaps indicating that issuers foresee further declines in yields.

The ratio of tax-exempt to taxable yields now stands at the high level of .93 (up from .84 in May), partly because of heavy sales of municipals by banks since mid-summer. This increase in their relative yield evidently has attracted the interest of individual investors. In October $1.8 billion flowed to municipal bond mutual funds, up from $1.0 billion in September, and a $.7 billion monthly average in 1988.

Reflecting weaker economic conditions in the northeast, Moody's recently downgraded Massachusetts general obligation bonds to Baa-1 from A, and Standard and Poor's has been reviewing the credit rating of the Commonwealth's general obligation debt. Massachusetts lawmakers recently passed a bill designed to cut in half the projected 1990 budget deficit of $730 million. New York City and Connecticut also are projecting significant budget deficits. These budget problems already have raised the cost of borrowing for Massachusetts and New Yofk City, as recent issues have traded at yields substantially higher than those on bonds from other regions.

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

	1988	1988	1989			1989		
	Year	Q4	Q1	Q2	Q3	Sept.	Oct.[p]	Nov.[p]
Total offerings[1]	11.73	12.35	9.20	13.14	12.78	12.27	10.46	9.23
Total tax-exempt	11.41	11.94	8.92	12.95	12.58	12.18	10.27	9.07
Long-term	9.54	10.68	7.77	9.56	9.80	10.82	9.08	8.65
Refundings[2]	2.90	3.14	2.49	2.20	2.83	3.35	1.81	.96
New capital	6.64	7.54	5.28	7.36	6.97	7.47	7.27	7.69
Short-term[3]	1.87	1.26	1.15	3.39	2.78	1.36	1.19	.42
Total taxable	.32	.41	.28	.19	.20	.09	.19	.16

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.

Mortgage Markets

Rates on conventional fixed-rate mortgage loans have declined a few basis points since the last FOMC meeting, about in step with declines in secondary mortgage market yields. Initial rates on adjustable-rate mortgages indexed to the one-year constant maturity Treasury yield have declined by slightly more over the period, widening the initial rate advantage of ARMs to 137 basis points. The FRM-ARM rate spread is still narrow by past standards and, coupled with relatively low fixed-rate credit costs, has kept the FRM share of new conventional mortgage originations at

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

	Mortgage transactions			Net change in mortgage assets		
	Origina-tions	Commit-ments	Sales	Total	Mortgage loans	Mortgage-backed securities
1987	21.1	20.0	10.5	5.3	2.0	3.6
1988	19.9	19.4	8.8	5.1	3.6	1.3
1988-Q3	21.4	20.9	8.5	5.9	5.1	.8
Q4	19.8	19.9	9.6	4.2	3.0	1.2
1989-Q1	20.5	19.3	8.1	5.9	4.2	1.5
Q2	14.7	13.0	7.2	-1.0	-.4	-1.7
Q3 p	14.1	14.8	9.1	-10.8	-3.3	-8.0
1989-Apr.	16.2	13.9	7.0	1.0	3.2	2.0
May	15.1	12.7	7.1	-1.2	-.8	-1.3
June	12.9	12.3	7.4	-8.3	-3.8	-6.5
July r	12.4	12.6	8.0	-7.3	-1.1	-6.2
Aug. r	15.2	16.1	10.9	-13.3	-3.3	-10.2
Sep. p	14.6	15.6	8.4	-11.8	-5.6	-7.7

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
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-Q3 r	13.3	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 r	15.8	13.7	3.1	6.9	2.5	1.2	2.8	.4
Q2 r	13.4	13.8	2.8	5.2	.6	2.4	2.1	.1
Q3 r	16.1	17.8	2.5	9.8	1.2	3.6	4.4	.5
1989-Apr. r	14.5	13.9	3.0	4.5	.4	2.4	1.5	.2
May	12.9	12.4	2.2	4.1	.2	1.4	2.4	.0
June r	13.0	15.0	3.2	7.1	1.1	3.5	2.5	.0
July r	13.4	15.5	2.9	10.5	1.2	4.9	3.3	1.1
Aug. r	16.2	17.2	2.3	9.7	1.5	3.3	4.6	.3
Sept. p	18.6	20.7	2.2	9.1	1.0	2.7	5.2	.2
Oct. p	19.4	19.3	1.7	9.6	.6	5.1	3.9	.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.
r--revised p--preliminary

about 75 percent, according to results from the Federal Housing Finance Board's monthly survey of major institutional lenders.

Increased fixed-rate lending in recent months has been associated with an expansion in the operations of mortgage bankers, while commercial bank lending activity also has been strong. Mortgage originations at SAIF-insured thrift institutions, meanwhile, slowed to a seasonally adjusted $14.6 billion in September, and new commitments to originate mortgages declined slightly. Sales of mortgages by SAIF-insured institutions totaled $8.4 billion in September, down from the August level but above the average monthly level of the first two quarters. The pickup in mortgage sales by thrifts in the third quarter is consistent with the shift toward FRMs: to lessen the maturity gap on their balance sheets, thrifts are more likely to sell FRMs (as opposed to ARMs) into the secondary market than to hold them in portfolio.

The recent surge in new FRMs has allowed issuance of federally related pass-through securities to rise sharply since mid-summer, to a seasonally adjusted $19.4 billion in October. Despite the strong pace of issuance and heavy sales of securities associated with thrift restructurings, spreads of MBSs over Treasuries have changed little, on balance, in recent months. This may be attributable in part to the strong demand for pass-throughs as collateral for CMOs and other derivative securities. FNMA and FHLMC have remained the dominant issuers of CMOs and REMICs primarily because the flatness of the yield curve has made it difficult for private, higher-cost issuers to generate arbitrage profits from CMOs.

Reacting to recent softness in housing prices, FNMA and FHLMC recently announced that, effective January 1, 1990, the maximum limit on single-family loans they will buy or guarantee has been lowered from $187,600 to $187,450. Multi-family loan limits also will decrease.

Consumer Credit

Growth in consumer installment credit picked up to a 5-3/4 percent rate in October, at the high end of the range evident since the spring. Automobile credit rebounded to a 4-1/2 percent rate of growth in October after declining the month before, tracing a pattern that seemed out of kilter with that of new-car sales, which dropped in October. However, part of the discrepancy likely reflects difficulties in the seasonal adjustment process owing to the timing of major sales incentive programs in the past few years.

Revolving credit and the large "all other" component (primarily personal cash loans and sales finance contracts) both grew somewhat faster than auto credit in October. Nevertheless, revolving credit growth, at 6-1/2 percent, was relatively slow for the second consecutive month and was well below the 16 percent annual rate recorded during the first half of 1989. With revolving credit at banks following a more subdued path and new-car sales even weaker in November than October, consumer installment credit probably experienced little growth in November, despite the fairly brisk advance in total consumer loans at banks. The growth at banks probably reflected a gain in their market share rather than faster growth in aggregate consumer lending. Savings and loans have been selling off

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	H1[1]	Q3[r]	Sept.[r]	Oct.[p]	Sept.[r]	Oct.[p]	Oct.[p]
Total installment[2]	6.2	8.5	7.2	2.0	2.3	5.7	1.37	3.34	707.7
Installment, excluding auto	5.2	10.7	9.2	5.8	6.2	6.5	2.15	2.24	418.9
Selected types									
Auto	7.5	5.7	4.5	-3.4	-3.2	4.5	-.78	1.09	288.8
Revolving	12.3	13.6	15.8	12.0	5.6	6.4	.90	1.04	196.3
All other	.1	8.3	3.8	.5	6.8	6.5	1.25	1.21	222.5
Selected holders									
Commercial banks	7.6	12.7	5.9	3.6	4.4	12.4	1.19	3.39	330.7
Finance companies	4.7	3.5	9.3	-5.1	-1.6	-24.3	-.20	-2.92	141.3
Credit unions	5.1	7.5	9.2	-.8	-1.6	1.6	-.12	.12	90.0
Savings institutions[3]	6.6	3.8	-7.0	-.2	13.2	-19.4	.65	-.97	58.9
Asset pools (NSA)	n.a.	n.a.	40.2	26.3	-9.5	120.1	-.30	3.70	40.7
Memorandum:									
Total[4]	4.9	7.3	6.7	2.4	4.3	2.6	2.75	1.65	771.0

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	Nov.	May	Aug.	Sept.	Oct.	Nov.
At commercial banks[1]								
New cars (48 mo.)	10.46	10.86	11.22	12.44	12.13	...	...	11.94
Personal (24 mo.)	14.23	14.68	15.06	15.65	15.45	...	...	15.42
Credit cards	17.92	17.79	17.77	18.11	18.07	...	...	18.07
At auto finance cos.[2]								
New cars	10.73	12.60	13.20	11.80	12.22	12.42	13.04	...
Used cars	14.61	15.11	15.75	16.45	16.31	16.22	16.17	...

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.

receivables most of the year and growth at credit unions has been minimal recently.

Recent data suggest some deterioration in consumer credit quality at banks. The American Bankers Association reported that the average delinquency rate for all types of closed-end loans climbed from 2.3 percent in the second quarter to 2.8 percent in the third, thus recording one of the series's largest increases and putting the rate at a high level by historical standards. The ABA's series for credit card delinquencies rose as well, though by a much smaller amount. At the auto finance companies delinquency rates remained at relatively high levels, rising from 2.5 percent in the second quarter to 2.6 percent in the third.

DELINQUENCY RATES ON CONSUMER INSTALLMENT LOANS[1]
(Percent of loans outstanding)

	Commercial banks		Automobile
	Closed-end	Credit card	finance companies
1979	2.43	2.39	2.25
1980	2.61	2.73	2.27
1981	2.38	2.56	1.89
1982	2.25	2.42	1.68
1983	2.01	2.24	1.41
1984	1.96	2.18	1.38
1985	2.31	2.67	1.72
1986	2.34	3.13	1.95
1987	2.42	2.36	1.92
1988	2.40	2.34	2.21
1988 - Q1	2.32	2.58	2.09
Q2	2.32	2.39	2.21
Q3	2.42	2.21	2.22
Q4	2.53	2.18	2.32
1989 - Q1	2.38	2.53	2.40
Q2	2.33	2.25	2.52
Q3	2.82	2.36	2.58

1. Number of loans past due 30 days or more as percent of number of loans outstanding. Quarterly data are seasonally adjusted.

APPENDIX

GROWTH OF MONEY AND CREDIT IN 1989

Growth in M2 has been uneven over the course of 1989, with marked weakness in the first part of the year giving way to robust growth thereafter. On balance over the year, M2 expanded 4-1/2 percent, down from 5-1/4 percent growth in 1988, placing it just below the midpoint of its 1989 annual target range of 3 to 7 percent. The slower rate of increase in M2 this year reflected some moderation in income growth, but it primarily arose from the pattern of interest rate changes, with the effects of sharp increases late in 1988 and early 1989 outweighing the later drop in rates. As a result, annual velocity rose. In addition to the swings in interest rates and opportunity costs, M2 was buffeted by the special effects of outsized tax payments in April. M1 evinced a similar, though more pronounced, intrayear pattern, ending up in November 1/4 percent above its level of the fourth quarter of 1988; this is down appreciably from last year's growth of 4-1/4 percent.

After expanding 6-1/4 percent in 1988, M3 hugged the lower bound of its 3-1/2 to 7-1/2 percent target cone in 1989, closing the year about 4 percent above its 1988:4 base. The relative weakness in M3 during 1989 mostly reflected the shrinkage of the thrift industry; growth in bank credit was maintained at the 7-1/2 percent pace of last year.

Domestic nonfinancial debt grew at a fairly steady pace over 1989, averaging 8 percent from the last quarter of 1988 through October of this year, which placed it near the midpoint of its monitoring range of 6-1/2 to 10-1/2 percent. This year's rate of debt expansion was down more than one percentage point from the rate recorded in 1988, about in line with the projected deceleration of nominal income.

<u>M1</u>

By May, M1 had declined at about a 3-1/2 percent annual rate from its 1988:4 base, reflecting a lagged response to earlier increases in short-term rates and an extraordinary bulge in net individual tax remittances to the Treasury. From May to November, M1 rebounded at a 4-1/2 percent rate as the cumulating effects of falling interest rates boosted demands for money. Velocity continued the upward trend begun in 1987, increasing at about an 8-1/2 percent rate in the first three quarters of 1989 before turning down in the fourth quarter in lagged response to interest rate developments. Still, for 1989 as a whole, growth in velocity likely will equal its most rapid pace in the last 30 years.

Demand deposits declined in 1989 at a rate exceeding last year's runoff, although outflows from those accounts slowed in the second half of the year. Indeed, sharp increases in demand deposits were recorded in the opening weeks of the third and fourth quarters of 1989, most likely because of the need to post higher required compensating balances in response to previous declines in short-term interest rates.

THE GROWTH AND FLOW OF MONETARY AND CREDIT AGGREGATES
(Q4 to Q4 averages, seasonally adjusted unless noted otherwise)

Growth rates or flows	1985	1986	1987	1988	1989[1]	Memo: 1989 levels (billions of dollars)[1]
Growth rates (percent)						
M1	12.0	15.6	6.4	4.3	0.3	789.9
M2	8.9	9.3	4.2	5.2	4.6	3199.2
M3	7.7	9.1	5.7	6.3	3.9	4047.6
Domestic nonfinancial debt	13.1	13.1	9.9	9.2	8.1	9681.9
Bank credit	10.2	9.7	7.9	7.6	7.4	2583.6
Thrift credit	9.8	9.8	8.1	6.2	-0.5	1783.3
Flows ($ billions)						
M1						
Currency	11.6	12.4	15.5	15.8	9.6	220.3
Demand deposits	21.3	30.9	-2.5	-3.6	-9.5	278.9
Other checkable deposits	32.3	52.0	31.7	20.1	2.4	283.3
M2						
Nontransaction M2	142.4	141.5	72.1	118.7	139.6	2409.3
MMDAs (NSA)	105.0	59.3	-39.2	-24.3	-23.2	482.4
Savings deposits	12.9	62.1	54.9	14.1	-21.4	409.4
Small time deposits	-0.9	-20.8	41.3	116.8	113.7	1131.3
General purpose and broker/dealer money market mutual fund assets (NSA)	15.1	30.8	12.1	16.3	73.8	309.8
Overnight RPs, net (NSA)	7.5	6.8	4.4	0.0	-3.6	59.7
Overnight Eurodollars, net (NSA)	3.6	4.0	-1.2	-4.5	-0.8	12.6
M3						
Non-M2 component	20.4	51.4	80.2	78.0	8.4	848.4
Institution-only money market mutual fund assets (NSA)	6.4	20.6	2.5	-0.7	15.5	102.0
Large time deposits	20.4	7.4	40.8	53.1	25.4	560.1
Term RPs, net (NSA)	-2.6	19.9	27.4	15.9	-14.6	111.3
Term Eurodollars, net (NSA)	-4.1	3.4	11.2	10.3	-11.2	91.3

1. For monetary aggregates and bank credit, through November; for domestic nonfinancial debt, through October; for thrift credit, through September.

Payments for nonwithheld taxes were unexpectedly large in April of this year, depressing holdings of liquid balances at the end of that month and into May as those payments were cleared. Other checkable deposits, the main personal payment medium, fell 30 percent at an annual rate in May after having declined at a 2-1/2 percent rate in April. From May to November, OCDs rebounded to average about an 8-1/2 percent annual rate of increase as tax-depleted balances were rebuilt, and as depositors responded to relative movements in opportunity costs. In general, rates on liquid deposits tend to adjust more slowly to changes in market rates than those of less-liquid small time deposits. Accordingly, as interest rates declined, rates on time deposits were marked down more quickly, producing a relatively greater decline in opportunity costs of liquid deposits.

Currency growth has decelerated in each of the three quarters of 1989 and likely will end the year up about 4-1/2 percent. This rate of growth is quite slow in a historical context, particularly relative to the rapid expansion of currency in the 1985 to 1988 period. However, it is consistent with econometric evidence that suggests a response of currency to interest rate changes, but with long lags.

M2

The pattern of M2 growth in 1989 mostly reflected rising and then falling short-term market interest rates, although special factors added variability to the overall aggregate and its composition. Through the first five months of 1989, M2 grew at only a 1 percent annual rate from its 1988:4 base but then accelerated to an 8-1/4 percent pace in the period from May through November. After a succession of quarterly increases since 1986, M2 velocity turned down in the third quarter of 1989, responding to diminished opportunity costs; still, evidence suggests that M2 velocity will rise about 1-1/2 percent, on average, over 1989, about in line with model forecasts.

The composition of the nontransaction portion of M2 shifted substantially. Early in the year, rising market interest rates buoyed the growth of small time deposits at the expense of more liquid deposits, as rates on the latter accounts adjusted only sluggishly to the upward market movements. Unexpectedly large tax payments apparently contributed to the weakness in liquid instruments in April and May, as those balances were drawn down to meet tax obligations directly or through transfer to M1 accounts. By May, MMDAs plus savings deposits had declined at a 16 percent rate from their levels of the fourth quarter of 1988, while small time deposits had risen at a 17-1/4 percent rate. As market interest rates fell, the relative rate advantage reversed in favor of liquid instruments and, from May to November, MMDAs plus savings deposits and small time deposits averaged growth rates of 6-3/4 and 4-1/2 percent, respectively. The rebound in liquid deposits also was fueled by the replenishment of accounts drained by tax payments. It appears the the tax-payment episode was only an exaggeration of the normal seasonal pattern and that it had no effect on the growth of M2 on a fourth-quarter-to-fourth-quarter basis.

Another major compositional shift within M2 reflected a movement of deposits from thrift institutions to commercial banks and money fund shares. Funds were withdrawn from thrifts as depositors abandoned reputation-scarred institutions and regulatory pressures brought down rates paid by some high-flying thrifts. This latter factor gained importance following the passage of FIRREA and the creation of the RTC in August, which targeted some of its funds to pay down high-cost deposits at intervened thrifts. The RTC also began a program of closing insolvent thrifts and selling their deposits to other institutions--for the most part, banks. In October, the closure of four large thrifts by the RTC transferred roughly $5 billion in deposits from thrift to commercial bank ledgers. Overall, household savings instruments (the sum of MMDAs, savings, and small time deposits) grew 7-1/2 percent at commercial banks from the fourth quarter of 1988 to November and declined 1/2 percent at thrifts. On balance, however, weak deposit growth at thrifts appears to have been about offset by shifting into commercial banks and money market mutual funds, leaving overall M2 little affected by the thrift crisis.

Indeed, by November, the money funds--which posted a record inflow in 1989--were about 30 percent above their level of the fourth quarter of 1988. In addition to attracting investors avoiding thrifts, money funds drew customers because they offered a rate advantage relative to Treasury bills for much of the year, in part, because of the tendency for returns reported on money funds to lag declines in market rates.

Overnight RPs and Eurodollars, although changing erratically from month to month, trended downward through the year. Apparently, stronger inflows into core deposits allowed banks to bid less aggressively for funds. Also, the $3-1/2 billion drop in overnight RPs reported at banks is comparable in magnitude to declines identified with reporting changes during 1989, as several large banks reclassified their primary dealer operations in U.S. government securities from operating units of the bank to nonbank subsidiaries of the bank holding company.[1]

<u>M3</u>

While the movements of M2 in 1989 are well explained by the underlying demands for its components, M3 continued to reflect bank and thrift funding needs. While bank credit in 1989 will likely about match last year's 7-1/2 percent pace, credit at thrift institutions at the end of third quarter of this year stood a bit below the level of the fourth quarter of 1988. In addition, funds paid out by the RTC directly substituted for both M3 and non-M3 liabilities, or permitted institutions acquiring deposits to pay down other liabilities.

As a result, M3 was hit far harder by the thrift crisis, with less of the rebound in the narrower aggregates in the second half of the year showing through to this broader aggregate. In May, M3 stood 3 percent above its 1988:4 base, moderately accelerating in the six months ending in

1. The operations were transferred to subsidiaries set up to engage in underwriting certain securities--such as commercial paper, municipal revenue bonds, and corporate bonds--that have been authorized by the Board. Government securities business provides volume to dilute these activities down to the mandated maximum of 10 percent of the subsidiary's business volume.

FLOWS OF ASSETS AND LIABILITIES AT COMMERCIAL BANKS AND THRIFTS
(Billions of dollars, seasonally adjusted unless noted otherwise)

	1987	1988	1989	Memo: 1989	
	Q4 to Q4		Q4 to November	Q4 to May	May to November
Commercial banks					
Bank credit	163.9	170.5	178.3	77.1	101.2
Liabilities					
Core deposits (Demand deposits in M1 plus retail deposits)	43.0	72.9	67.3	9.8	57.5
M2 managed liabilities					
Overnight RPs, net (NSA)	4.4	0.0	-3.6	-4.4	0.8
M3 managed liabilities					
Large time deposits, gross	40.4	40.2	35.9	31.2	4.7
Term RPs, net (NSA)	3.0	4.2	7.4	0.8	6.6
Non-M3 managed liabilities					
U.S. Government deposits	10.8	-5.7	-4.7	2.1	-6.8
Borrowing from foreign branches	34.5	-3.0	0.4	-7.3	7.7
Other	-3.6	20.4	31.3	6.1	25.2
Thrifts					
Thrift credit	126.9	105.2	-28.2	22.8	-51.0
Liabilities					
Core deposits (Demand deposits in M1 plus retail deposits)	42.8	50.1	-5.6	-18.6	13.0
M3 managed liabilities					
Large time deposits, gross	6.5	14.0	-13.6	3.3	-16.9
Term RPs, net (NSA)	24.5	11.6	-22.0	2.5	-24.5
Non-M3 managed liabilities					
FHLB advances	18.0	16.4	0.4	22.6	-22.2
Other	28.5	11.8	12.6	13.0	-0.4

Note: Thrift deposit data for November are preliminary. Thrift asset data for October and November are projected.

November to post a 4-3/4 percent growth rate. In particular, managed liabilities at thrifts ran off at a stunning pace as insolvent institutions were sold off by the RTC and thinly capitalized ones pared their balance sheets (table). From May to November, thrift large time deposits declined at about a 19 percent annual rate, while thrift term RPs fell at a 57 percent rate, despite the $22 billion paydown of FHLB advances.

Through November, the 5 percent increase in large time deposits over the level in the fourth quarter of 1988 obscures an 8-1/2 percent rate of increase at banks and a 7-3/4 percent drop at thrifts. Similarly, the 16-1/2 percent decline in term RPs overall is made up of a 26-1/2 percent rate of contraction at thrifts compared with a 17 percent rate of growth at banks. Growth in institution-only money market mutual funds, which in November were 15-1/2 percent above their fourth quarter 1988 levels, helped stanch the flow of the non-M2 components out of M3. As is the case with M2 money funds, rates on institution-only funds lag market declines, an effect that boosted these funds as interest rates fell over much of the year.

Domestic Nonfinancial Sector Debt

Although growth of domestic nonfinancial sector debt slowed in 1989 as it had the preceding two years, it still exceeded the growth of nominal GNP. The federal sector's debt grew at a 7-1/4 percent annual rate through October, more than 3/4 percentage point below 1988's rate of increase and the slowest rate of expansion in a decade. Debt growth outside the federal sector eased more, to average 8-1/4 percent through October, mostly because of a decline in the growth of household debt. Mortgage credit slowed in line with the reduced pace of housing activity. Consumer credit growth, although volatile from month to month, trended down through much of the year. In the first half, consumer credit growth generally tracked movements in personal consumption expenditure. In the third quarter, however, consumer credit expansion fell short of the growth in spending--particularly for automobiles.

The growth of nonfinancial business debt so far this year slipped further below the extremely rapid rates of the mid-1980s; heavy corporate restructuring activity continued to be a major factor buoying corporate borrowing, although such restructuring activity showed distinct signs of slowing late in the year as lenders adopted more caution.

U.S. Merchandise Trade

The U.S. merchandise trade deficit was $7.9 billion in September (on a seasonally adjusted Census basis, customs valuation), compared with a revised $10.1 billion deficit in August. About half of the narrowing of the deficit in September resulted from a reduction in non-oil imports from peak August levels. The decline in oil imports in September (nsa) was all in quantity as prices rose by about 25 cents per barrel. An increase in exports in September was about evenly divided between agricultural shipments and other exports. The degree of volatility in recent monthly trade figures is not unusual. Data for October will be released December 15 and will be summarized 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-Oct	27.9	3.1	24.8	37.1	2.9	34.2	-9.2
Nov	27.6	3.2	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	3.2	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	30.1	3.9	26.2	39.5	3.7	35.9	-9.5
Apr	30.8	3.7	27.1	39.0	4.0	35.0	-8.3
May	30.5	3.5	27.0	40.5	4.7	35.8	-10.1
Jun	31.3	3.3	28.0	39.3	4.2	35.1	-8.0
Jul	30.5	3.3	27.2	38.7	4.3	34.4	-8.2
Aug[r]	30.6	3.1	27.5	40.7	4.3	36.4	-10.1
Sep[p]	31.1	3.3	27.8	39.1	4.0	35.1	-7.9

r--revised p--preliminary

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) - - - - - - -				
1988 Year	319	38	281	447	39	407	-127
1988-1	306	36	270	440	40	399	-134
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	352	43	309	465	43	422	-114
2r	366	43	322	476	54	422	-110
3	366	39	327	477	53	424	-111
			- - - - - BOP basis (constant 1982 dollars) [1] - - - -				
1988-1	337	39	297	461	83	377	-124
2	338	39	300	457	85	372	-119
3	339	36	303	463	86	377	-124
4	352	36	316	477	90	388	-125
1989-1	365	40	325	473	88	385	-108
2r	380	41	339	483	92	392	-103
3	386	38	349	500	99	401	-114
Percent Change:							
89Q3/88-Q3	14.0	3.8	15.2	8.0	15.0	6.4	
89Q3/89-Q2 (not AR)	1.6	-7.8	2.7	3.5	8.6	2.3	
			- - - - - - 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	322	483	90	393	-125
1989-1	373	40	332	477	88	390	-105
2	387	41	346	488	92	396	-101
3	394	38	356	505	99	406	-111
Percent Change:							
89-Q3/88-Q3	14.3	3.6	15.6	7.8	15.0	6.2	
89-Q3/89-Q2 (not AR)	1.7	-7.9	2.8	3.6	8.5	2.4	

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

For the third quarter, the U.S. merchandise trade deficit, on a seasonally adjusted balance-of-payments basis, was $111 billion at an annual rate, $1 billion larger than in the second quarter (revised).

The growth of total exports slowed substantially in the third quarter in terms of quantity; and excluding sharp increases in aircraft and computers, the quantity of exports fell. The greatest declines were in agricultural products (most importantly corn and soybeans), automotive parts to Canada, consumer durables, chemicals, and coal. Exports of other capital goods were about the same in the third quarter as in the second quarter after having risen strongly each quarter since mid-1988. The increase in aircraft exports resulted in part as Boeing stepped up deliveries of 747-400s in an effort to reduce inventories. The strike at Boeing, which began October 3 and lasted 7 weeks, will reduce substantially the value of aircraft exports in the fourth quarter. The value of exports rose less than 1 percent in the third quarter as prices declined slightly.

The quantity of imports rose 4 percent in the third quarter reflecting increases in both oil and non-oil categories. A 2 percent increase in the quantity of non-oil imports (the strongest rate of increase since the fourth quarter of last year) was largely in computers and parts, consumer goods, and food. The demand for consumer goods reflected a pickup in U.S. domestic consumer expenditures (excluding autos) in the third quarter. The value of non-oil imports rose less than 1 percent as prices fell.

The quantity of oil imports jumped 8 percent in the third quarter, reaching the highest level in 10 years. The bulk of the increase went into domestic stocks as production fell only slightly more than consumption. Weekly data suggest that the quantity of oil imports was slightly higher in October than in September.

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

	1988		1989				
	Q3	Q4	Q1	Q2	Q3	Aug	Sep
Value (Bil. $)	39.10	36.87	43.40	53.72	53.18	56.25	49.80
Price ($/BBL)	14.24	12.85	15.54	18.46	16.85	16.46	16.71
Quantity (mbd.)	7.51	7.84	7.65	7.97	8.65	9.36	8.17

The price of imported oil declined in the third quarter by about $1.60 per barrel from the high second quarter level. However, in October spot and posted prices rose in response to a series of events that led to concerns about availability of supplies, including unexpected short-falls in North Sea and Nigerian crude supplies, and the announcement of a possible 50 percent cut in Soviet exports.

Import and Export Prices

The price of total imports (reported by BLS) increased 0.7 percent in October, led by a 5.0 percent jump in oil prices. Prices of non-oil imports edged up by 0.2 percent for the second month in a row. Most of the increase in non-oil import prices reflected a strong rise in passenger car prices with the introduction of 1990-models. The increase in car prices (in September and October) followed seven consecutive months of price declines. Nearly offsetting the increase in prices of imported cars were declines in the prices of capital goods (importantly attributable to the appreciation of the dollar during the calculation period), foods, and industrial supplies other than oil. These last three categories have recorded price declines in nearly every month

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

	Year 1989-Q3 / 1988-Q3	Quarters 1989 Q1	Q2	Q3	Months 1989 Sep	Oct
		(annual rates)			(monthly rates)	
	- - - - - - - - - BLS Prices - - - - - - - - -					
Imports, Total	2.5	7.3	0.3	-5.2	0.2	0.7
Foods, Feeds, Bev.	-5.0	-1.4	-7.2	-15.5	-1.2	-0.6
Industrial Supplies	5.3	25.8	8.5	-14.5	0.1	1.3
Ind Supp Ex Oil	0.4	5.0	-5.4	-7.5	0.2*	-0.4*
Capital Goods	1.4	0.3	-4.2	-0.6	-0.6	-0.5
Automotive Products	1.7	-0.3	-2.8	0.0	1.2	1.9
Consumer Goods	3.5	4.1	1.2	0.9	0.1	0.2
Memo:						
Oil	18.6	104.4	47.8	-28.2	0.0	5.0
Non-oil	1.4	2.2	-3.1	-2.8	0.2	0.2
Exports, Total	0.4	6.2	-0.4	-2.8	0.4	0.2
Foods, Feeds, Bev.	-11.4	12.1	-11.4	-21.6	-0.4	-0.7
Industrial Supplies	0.7	7.3	0.7	-4.6	1.1	-0.3
Capital Goods	3.1	3.8	2.7	3.0	0.2	0.7
Automotive Products	2.7	1.5	1.9	3.0	0.6	1.1
Consumer Goods	4.6	8.8	1.0	2.8	0.0	-0.2
Memo:						
Agricultural	-7.8	13.6	-5.3	-15.8	-0.7	-0.1
Nonagricultural	2.0	4.7	0.7	-0.4	0.6	0.3
	- - - - - - Prices in the GNP Accounts - - - -					
Fixed-Weighted						
Imports, Total	3.0	11.3	8.0	-8.9	--	--
Oil	18.4	114.9	99.4	-31.0	--	--
Non-oil	1.1	2.6	-1.3	-4.9	--	--
Exports, Total	-0.5	-0.8	2.7	-4.1	--	--
Ag.	-5.2	-2.9	-3.1	-9.5	--	--
Nonag.	0.6	-0.3	3.9	-2.9	--	--
Deflators						
Imports, Total	-0.4	6.0	0.2	-11.9	--	--
Oil	18.3	113.1	100.2	-31.0	--	--
Non-oil	-1.5	-1.5	-6.4	-7.2	--	--
Exports, Total	-0.4	5.2	-0.5	-5.4	--	--
Ag.	-5.2	-2.9	-3.1	-9.5	--	--
Nonag.	0.4	5.6	-0.0	-4.4	--	--

*Not for publication.

since March. The price of imported consumer goods showed small increases in most months of 1989 (including October), with increases in some categories (such as apparel and nondurable household goods) being offset by declines in other categories (such as photographic and home entertainment equipment).

Changes in the exchange value of the dollar significantly affect import prices published by BLS for capital goods (e.g. machinery, professional and scientific apparatus) and consumer goods (e.g. photographic apparatus and optical goods). Prices of imported automotive products are largely in dollars. Producers in European countries are more likely to price in their own currencies than producers in Japan. Developing countries, including the NIEs, tend to price in dollars. Prices (about 15 percent of which are quoted in foreign currencies) are sampled at the beginning of the month and converted into dollars at the average rate of the preceding month.

Export prices in October rose for the second consecutive month. Prices of capital goods and automotive products provided most of the increase. Since the beginning of the year export prices of these two categories have risen slightly in nearly every month, with a cumulative increase to date for each of 3 percent; this was about the same rate as domestic prices suggesting that producers allow the foreign-currency price of their products to vary along with the exchange value of the dollar. Prices of exported consumer goods also rose by a cumulative 3 percent since the beginning of the year (recording an increase in every month except October); this was only a marginally slower rate than domestic prices. In contrast, prices of most exported industrial supplies appear to be affected somewhat by changes in exchange rates and have fallen steadily since mid-year at rates in excess of declines in comparable domestic prices. Prices of agricultural exports declined in October for the third month in a row. During the first 10 months of the year agricultural export prices declined 3 percent (led by soybeans and corn).

U.S. Current Account in 1989-Q3

In figures released this morning by the Commerce Department, the U.S. current account deficit narrowed to $91 billion (saar) in the third quarter, from $128 billion (revised) in the second quarter. Nearly all of the improvement was attributable to a swing from reported capital losses to reported capital gains on net direct investment assets, reflecting changes in the exchange value of the dollar. Excluding capital gains and losses, the current account narrowed by $6 billion in the third quarter, entirely the result of increased net service receipts (primarily recovery of insured losses from foreign reinsurers, and increased military sales). A table and an assessment of the data will be included in the Greenbook supplement.

U.S. International Financial Transactions

Large net inflows into banks were reported again in September, bringing the total for the third quarter of 1989 to $13 billion on a balance-of-payments basis. (See line 1 of the Summary of U.S. International Transactions table.) Most of these inflows resulted from transactions of banks in the United States (excluding IBFs) with their own offices abroad. However, these data, which are based on changes between the last days of each month, give a misleading impression of developments in the quarter because of large day-to-day changes. Examination of the daily Federal Reserve data indicates a very large

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

	1987 Year	1988 Year	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 July	1989 Aug.	1989 Se
Private Capital										
Banks										
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	47.5	21.3	-0.4	9.6	-1 4	0.3	13.3	-0 9	8 3	5.8
Securities										
2 Private securities transactions, net[1]	36 4	15.5	5.8	3 4	5.8	3.7	0.7	-3.2	2.0	2.0
a) foreign net purchases (+) of U.S. corporate bonds[2]	26.4	26.9	6 4	9 0	8.8	6.2	6.3	2 7	1.6	2 0
b) foreign net purchases (+) of U.S. corporate stocks	16.8	0.4	1.3	-2.0	0.1	3.7	5.0	1 7	0 9	2.4
c) U.S. net purchases (-) of foreign securities	-6.9	-11.8	-1.9	-3.5	-3.0	-6.2	-10.7	-7.6	-0.5	-2.5
3. Foreign net purchases (+) of U.S. Treasury obligations	-7.3	20.6	3.5	5.5	8 7	2 4	13.2	-4 2	11 7	5 6
Official Capital										
4 Changes in foreign official reserves assets in U.S. (+ = increase)	47.7	40 2	-2 0	10.7	8 0	-5.6	11 8	5.3	10 0	-3 6
a) By area										
G-10 countries (incl. Switz.)	38.8	15.5	-6 8	5.3	0 3	-9.5	5.7	0.8	5.5	-0 6
OPEC	-8.9	-3.4	-0 8	0.7	6.8	0.3	4 5	0 7	3.3	0
All other countries	17.8	28.0	5 7	4 6	0.9	3.6	1.6	3.8	1 2	-3
b) By type										
U.S. Treasury securities	43.2	41.7	-3 8	11.9	4.6	-9 7	12.1	3.4	10 6	-1 9
Other[3]	4.5	-1.6	1.8	-1 3	3.4	4 1	-0.3	2 0	-0 6	-1 7
5. Changes in U.S. official reserve assets (+ = decrease)	9.1	-3 6	-7 4	2.3	-4.0	-12 1	-6 0	-0 8	-1.2	-4 0
Other transactions (Quarterly data)[4]										
6. U.S. direct investment (-) abroad	-44.2	-17 5	-4.9	-8.9	-5.5	-2.7	n.a.	n a	n.a	n.a.
7 Foreign direct investment (+) in U.S.	46.9	58.4	11.9	23.0	19.2	12.3	n.a.	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	5.7	2 2	1 8	2.5	2 1	6 1	n a	n a.	n a.	n a
9. U.S. current account balance	-143.7	-126.5	-32 3	-28.7	-30.4	-31.0	n a.	n.a.	n.a	n a.
10 Statistical discrepancy	1 9	-10.6	24 0	-19.4	1.7	26.6	n.a	n.a	n.a	n.a.
MEMO.										
U.S merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-159 5	-127.2	-30.3	-32.0	-28.4	-27.7	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.
2 Includes all U.S bonds other than Treasury obligations.
3. Includes deposits in banks, commercial paper, acceptances, borrowing under repurchase agreements, and other securities.
4 Seasonally adjusted.
5. 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 Survey of Current Business.
*--Less than $50 million.
NOTE: Details may not add to total because of rounding.

inflow in the last days of September and a $20 billion outflow on the first business day in October. The large inflow at the end of September appears to be, in part, the result of semi-annual window dressing by Japanese-based banks, inflating the size of their end-of-period balance sheets. On a monthly average basis, Federal Reserve data show only a small reduction in the net claims of U.S. banking offices on their offices abroad and IBFs. (Line 1 of the International Banking Data table shows an inflow of about $2.5 billion n.s.a. between the June and September averages; this inflow was partially reversed in October and November.)

Renewed investor concern about event risk on corporate bonds, as evidenced by the widened spread between corporate and Treasury bond interest rates, also appeared to shape foreign activity in U.S. bond markets in the third quarter. Net purchases of U.S. Treasury securities by private foreigners (line 3 of the Summary of U.S. Transactions table) were very large. In addition, securities issued by U.S. government agencies and corporations were an increasing fraction of foreign purchases of other U.S. bonds (line 2a); that fraction rose to one-half in the third quarter of 1989, from one-third in the first half of 1989, and one-fifth or less in previous years. New Eurobonds issued by U.S. corporations dropped sharply in the third quarter, more sharply than issuance by U.S. corporations in the domestic market; some rebound appears to have occured so far in the fourth quarter. Foreign net purchases of U.S. corporate stocks (line 2b) were strong in the third quarter.

U.S. net purchases of foreign securities (line 2c) were very large in the third quarter. More than half the total reflected a single

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1987	1988				1989				
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Oct.	Nov. [2]
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-10.9	8.7	-4.8	-4.9	-4.9	-2.9	-3.9	-6.4	-5.5	-4.5
(a) U.S.-chartered banks	15.2	27.8	17.0	16.6	21.6	20.4	19.2	14.9	15.1	15.7
(b) Foreign-chartered banks	-26.1	19.0	-21.8	21.5	-26.5	23.3	-23.1	-21.3	-20.6	-20.2
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	15.8	19.1	19.7	21.4	21.2	24.0	26.0	21.6	20.6	21.0
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	132.6	128.9	138.1	141.1	145.3	144.2	137.8	138.7	133.3	132.9

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.
2. Through November 27, 1989.

transaction. SmithKline (U.S.) and Beecham (U.K.) merged to form SmithKline Beecham (U.K.); part of the payment to the stockholders of SmithKline (U.S.) was $5.5 billion in shares of SmithKline Beecham (U.K.). Since the U.S. company is now an affiliate of a foreign company, the merger will also swell the total for foreign direct investment in the United States (line 7) for the third quarter.

Foreign official holdings in the United States increased substantially in the third quarter, even for the G-10 countries, despite some reported intervention sales of dollars. Accumulation of interest earnings and troop dollars by the G-10 countries, as well as some shifting of dollar investments from the Euro-markets by the G-10 and OPEC, probably account for much of the reported increases. Partial information from the FRBNY indicates that G-10 reserves in the United States declined by about $3 billion in October.

The large inflows reported so far in the balance of payments accounts for the third quarter suggest that the statistical discrepancy in the accounts will swing from a large inflow in the second quarter to an outflow in the third. Errors and omissions in the reporting of capital flows probably are responsible for much of these wide swings. However, part may also be the result of timing problems in the direct investment reports. Firms are not required to report on the basis of calendar quarters; in cases where the firm's fiscal year does not correspond to the calendar year, BEA places the report in the quarter that matches most closely. In the case of highly publicized large transactions, BEA does shift transactions to the calendar quarter when they actually occurred; for example, U.S. direct investment abroad in the second quarter of 1989 will be revised down by a couple of billion dollars as the result of the June sale of foreign affiliates by a U.S. company that was reported by the company as part of its fiscal third-quarter operations. However, apart from the few large transactions that come to BEA's attention, timing discrepancies in the direct investment accounts probably contribute to swings in the statistical discrepancy.

Foreign Exchange Markets

The weighted-average exchange value of the dollar in terms of the other G-10 currencies has declined about 3-1/2 percent since the November 14 FOMC meeting, as shown in the accompanying chart. News about the U.S. economy seemed to have little influence on dollar exchange rates during this period, even as market perceptions that the Federal Reserve had eased further were disappointed and U.S trade data for September showed a smaller-than-expected deficit. Rather, the dollar's decline was largely the counterpart of the mark's rise, with the dollar falling 5-1/2 percent against the mark, to a 12-month low, and somewhat less against other EMS currencies. The dollar eased 1 percent against sterling but firmed 1/2 percent against the yen. The mark's strength arose primarily from the market's favorable assessment of the potential impact on the German economy of political developments in Eastern Europe.

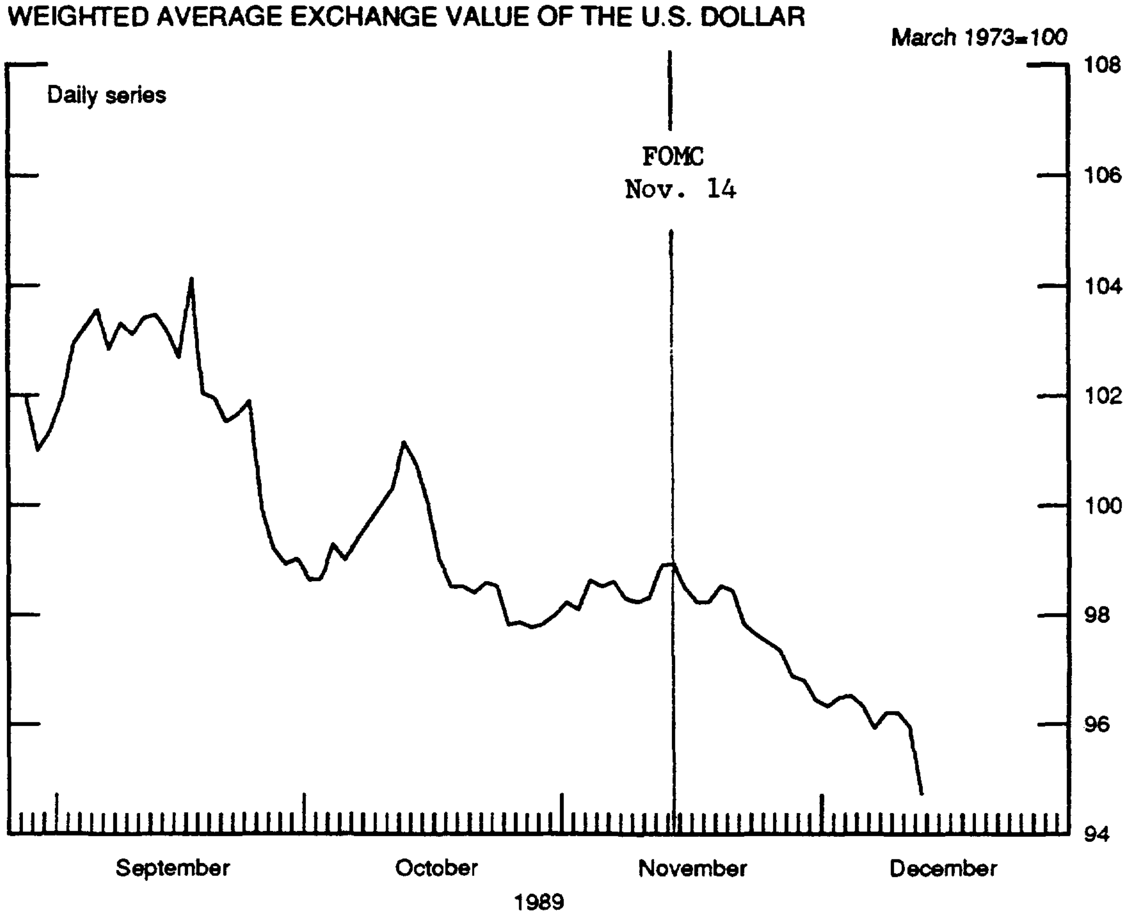
The German stock market recovered from the loss it suffered in October, rising about 9 percent over the intermeeting period, with its rise especially sharp during the last two weeks. Stock markets were strong in Japan, the United Kingdom, and France as well, as each of those markets rose to higher levels than before the stock sell-off in October.

One factor which depressed the yen was an unraveling of previous expectations of a near-term discount rate hike in Japan. Market participants now expect the Bank of Japan to postpone an increase in its discount rate until after the general election of the Lower House of Parliament in February. Japanese 3-month CD rates eased about 15 basis points over the period, to 6.6 percent. In Germany, the 3-month interbank rate eased 25 basis points to just above 8 percent. Bond yields were little changed in both Germany and Japan. The price of goldrose more than 6 percent over the intermeeting period.

The mark's strength generated pressures within the EMS during the intermeeting period and prompted speculation about an EMS realignment. Spreads between bilateral mark rates and central rates increased by about 70 basis points for the franc, which fell to near the bottom of its 2-1/4 percent band, and 160 basis points for the lira, which fell out of the narrow band at the period's close. The lira's allowed deviation within the EMS is 6 percent, though Italian authorities have expressed an interest in reducing that to 2-1/4 percent. The peseta-mark spread has declined about 230 basis points.

the Desk followed with intervention on two occasions, selling a total of $150 million against yen.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



Developments in Foreign Industrial Countries

Recently released national accounts data suggest divergence in economic activity among industrial countries in the third quarter. Growth in Japan rebounded very strongly in the third quarter. Although special factors reduced the measured rate of third-quarter growth in Germany, growth adjusted for calendar effects continued to be firm. In the United Kingdom the pace of non-oil economic activity remained depressed in the third quarter, while in Canada domestic demand slowed and real growth rebounded only slightly in the third quarter after a sharp slowdown in the first half of the year. Monthly data for France and Italy also suggest a slowdown in economic activity in the third quarter.

Inflation appears to have moderated somewhat in recent months, although special factors contributed to better price performance in the United Kingdom and Japan. Recent developmerts in external accounts have been mixed. Germany's trade surplus increased significantly in the third quarter, while deficits in France, and Italy continued to grow. On the other hand, Japan's external surpluses continued to decline, due, in part, to valuation effects associated with earlier weakness of the yen earlier this year.

Individual Country Notes. In Japan, the pace of real activity has been strong in recent months. Real GNP increased by 12.2 percent (s.a.a.r.) in the third quarter, mainly reflecting rapid domestic demand growth. Consumption spending in the third quarter rose at an 8.2 percent annual rate. Plant and equipment spending increased at a 32.5 percent rate, and residential investment was up at a 9.6 percent rate. Net exports made a small positive contribution to growth. Imports

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

	Q4/Q4 1987	Q4/Q4 1988	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 June	1989 July	1989 Aug.	1989 Sept.	1989 Oct.	Latest 3 months from year ago 2
Canada												
GDP	6.5	4.0	.7	.7	.3	.6	*	*	*	*	*	2.3
IP	9.6	2.7	-.7	.2	.7	-.1	-.4	-.2	.2	.4	n.a.	.2
France												
GDP	2.6	3.0	.6	1.1	.6	n.a.	*	*	*	*	*	3.4
IP	3.2	4.3	-.2	1.0	1.8	.5	1.7	.7	.0	-2.1	n.a.	3.2
Germany												
GNP	2.3	3.0	.5	2.9	.3	-.5	*	*	*	*	*	3.2
IP	1.5	4.0	.6	2.4	-.8	2.1	4.2	1.0	.2	-.6	n.a.	4.4
Italy												
GDP	3.8	3.3	.9	.8	.4	n.a.	*	*	*	*	*	3.1
IP	5.7	6.7	4.4	.1	-1.0	1.9	2.9	1.4	-1.2	-.3	n.a.	5.4
Japan												
GNP	6.1	5.1	1.2	1.8	-.8	2.9	*	*	*	*	*	5.2
IP	8.1	7.6	1.8	3.1	.0	.2	2.0	-2.6	3.0	-2.0	.3	5.1
United Kingdom												
GDP	5.1	3.5	.7	.5	-.3	n.a.	*	*	*	*	*	2.2
IP	4.4	2.6	.1	-1.0	-.7	1.7	.2	1.4	1.5	-.8	n.a.	.1
United States												
GNP	5.4	3.4	.7	.9	.6	.7	*	*	*	*	*	2.9
IP	5.8	5.0	1.1	.5	.8	.3	.3	-.1	.4	.0	-.7	2.3

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 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 Aug.	1989 Sept.	1989 Oct.	1989 Nov.	Latest 3 months from year ago
Canada													
CPI	4.2	4.1	1.3	1.1	.8	1.2	1.7	1.4	.1	.1	.4	n.a.	5.2
WPI	4.3	3.7	.8	1.1	.6	1.0	.3	-.2	.1	-.2	-.1	n.a.	1.6
France													
CPI	3.2	3.0	1.0	.9	.6	.8	1.2	.7	.2	.2	.4	n.a.	3.4
WPI	3.4	7.2	1.2	2.4	2.5	2.4	.6	n.a.	*	*	*	*	8.1
Germany													
CPI	1.0	1.5	.5	.1	.4	1.6	1.0	.1	-.1	.2	.2	.2	3.2
WPI	-.7	2.7	1.1	.4	1.2	2.7	1.7	-.7	-.3	1.1	-.2	-.4	4.8
Italy													
CPI	5.2	5.2	1.0	1.0	1.9	2.0	1.7	1.0	.2	.5	1.0	.4	6.6
WPI	4.6	5.4	1.3	1.2	1.7	2.3	1.4	.6	.4	.5	.8	n.a.	6.2
Japan													
CPI	1.1	1.5	.6	.1	1.0	-.1	2.1	.1	-.3	1.0	.8	-.9	2.9
WPI	-.6	-1.4	-.3	.9	-.8	.5	2.7	.8	.0	.4	-.6	n.a.	3.2
United Kingdom													
CPI	4.1	6.5	2.4	1.4	2.1	1.6	2.9	.9	.3	.7	.8	n.a.	7.4
WPI	4.1	4.9	1.4	1.2	1.1	1.4	1.2	1.1	.4	.4	.5	.2	5.0
United States													
CPI (SA)	4.4	4.3	1.1	1.2	1.1	1.3	1.6	.6	.0	.2	.5	n.a.	4.5
WPI (SA)	2.5	3.4	.8	1.1	.9	2.2	1.7	-.2	-.4	.9	.4	n.a.	4.6

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 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 Aug.	1989 Sept.	1989 Oct.	1989 Nov.
Canada												
Trade	8.6	8.0	2.5	2.3	1.6	2.0	1.0	.8	.2	.2	n.a.	n.a.
Current account	-8.0	-8.4	-1.7	-2.0	-3.2	-3.1	-4.5	-4.0	*	*	*	*
France												
Trade	-5.2	-5.4	-.6	-1.9	-2.0	-.6	-2.1	-2.3	-1.4	.3	n.a.	n.a.
Current account	-4.1	-3.9	-.6	-1.1	-3.6	1.6	-1.2	n.a.	*	*	*	*
Germany												
Trade (NSA)	65.9	72.9	19.9	17.0	21.0	19.4	17.7	17.8	5.8	6.4	5.1	n.a.
Current account (NSA)	45.6	48.7	14.4	8.7	15.9	15.8	13.7	10.4	3.6	4.2	3.8	n.a.
Italy												
Trade	-8.7	-9.9	-1.4	-2.6	-2.6	-5.2	-3.1	-2.2	-1.0	-.6	n.a.	n.a.
Current account (NSA)	-1.6	-5.4	1.0	.2	-1.5	-6.6	n.a.	n.a.	*	*	*	*
Japan												
Trade	79.4	77.4	17.0	18.4	21.9	21.9	15.4	15.0	4.4	5.5	3.8	4.7
Current account 2	87.0	79.6	17.1	18.4	20.8	21.5	12.7	13.2	5.1	4.1	3.8	n.a.
United Kingdom												
Trade	-16.9	-35.7	-8.1	-9.4	-11.2	-10.2	-9.3	-10.7	-3.7	-3.0	-2.9	n.a.
Current account	-6.1	-26.0	-5.1	-5.8	-9.6	-8.4	-8.0	-9.3	-3.2	-2.5	-2.5	n.a.
United States												
Trade 2	-159.5	-127.2	-31.4	-30.3	-32.0	-28.4	-27.6	-27.8	*	*	*	*
Current account	-143.7	-126.5	-33.5	-32.3	-28.7	-30.4	-31.0	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.

roseat a rapid 16.9 percent rate, but exports grew at an even faster 25.3 percent rate.

Industrial production (s.a.) increased 0.3 percent in October and was 5.4 percent above its year-earlier level. Retail sales (s.a.) rose 2.6 percent in September and, for the third quarter as a whole, were up 5.5 percent from the second quarter. Capacity utilization (s.a.) declined 2.9 percent in September, only partially reversing a 4.2 percent jump in August that raised the index to its highest level in over 9 years. The unemployment rate (s.a.) edged up slightly in October, but remained in the narrow 2.2 percent to 2.3 percent range it has maintained since the beginning of the year.

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

	1989						
	Q1	Q2	Q3	Jul.	Aug.	Sept.	Oct.
Real GNP	1.8	-0.8	2.9	--	--	--	--
Industrial Production	3.1	0.0	0.2	-2.6	3.0	-2.0	0.3
Retail Sales	6.4	-5.4	5.5	2.7	-1.8	2.6	--
Capacity Utilization	0.0	0.2	0.0	-3.8	4.2	-2.9	--
Unemployment Rate (%)	2.3	2.3	2.2	2.2	2.3	2.2	2.3

The consumer price index for the Tokyo area (n.s.a.) declined 0.9 percent in November, due in part to a weather-related drop in food prices. This lowered the 12-month rate of increase of the consumer price index to 2.5 percent, the first time since April that this rate has been below 3 percent. Wholesale prices (n.s.a.) declined 0.6 percent in October, but the 12-month rate of increase remained unchanged at 3.3 percent.

The current account surplus (s.a.) declined further in October. For the first 10 months of the year, the cumulative current account surplus was $61.5 billion (s.a.a.r.), well below the annualized $80 billion surplus in the same period last year. A lower trade surplus accounted for about half of this decline, reflecting in part the J-curve effect from the lower value of the yen earlier in the year. Over half of the decline in the services account is accounted for by a more negative tourism balance.

In Germany, real GNP (s.a.a.r) fell by 2.1 percent in the third quarter, after increasing 12.2 and 1.4 percent (s.a.a.r.) in the preceding two quarters respectively. The decline in third-quarter output reflects, in part, significant calendar effects from fewer working days in the quarter. The Bundesbank reported that when both seasonal and calendar factors are taken into account real GNP actually increased at a moderate pace. The external sector continues to support German demand as an increase in net exports partially offset a 0.6 percent decline in domestic demand. Other data suggest that economic activity has been firm. Industrial production in the third quarter was 2.1 percent greater than in the second quarter and capacity utilization rose further to its highest level since the early 1970s. Total orders increased 0.7 percent in the third quarter while foreign orders increased 1.1 percent.

Despite large influx of immigrants from Eastern Europe, principally East Germany, the unemployment rate has been stable. It remained at 7.8 percent in October, and increased only 0.1 percentage point (s.a.) in November. Between August and November the number of East European immigrants reported as unemployed increased by 102,000, or 0.4 percent of the civilian dependent labor force.

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

	1989							
	Q1	Q2	Q3	July	Aug.	Sep.	Oct.	Nov.
GNP	2.9	0.3	-0.5	---	---	---	---	---
Industrial Prod. (excl. cons.)	2.4	-0.8	2.1	1.2	0.2	-0.6	---	---
Capacity Utilization	-0.9	1.1	0.7	---	---	---	---	---
Unemployment Rate (percent)	7.9	7.9	7.8	7.9	7.8	7.8	7.8	7.9

Inflation appears to have eased slightly in recent months. wholesale prices declined in October and November after sharp increases in September. Producer prices (n.s.a.) also declined 0.1 percent in November. Consumer prices (n.s.a.) were 3.0 percent higher in November than they were a year earlier, compared with 3.2 percent in September.

GERMAN INFLATION INDICATORS
(percent change from year earlier)

	1989								
	Q1	Q2	Q3	June	July	Aug.	Sep.	Oct.	Nov.
Consumer Prices (nsa)	2.5	2.9	2.8	2.9	2.8	2.8	2.8	3.2	3.0
Producer Prices (nsa)	3.1	3.3	3.0	3.0	3.0	3.0	3.0	3.4	---
Wholesale Prices (nsa)	5.4	6.1	5.0	5.5	5.0	4.5	5.5	4.9	3.1
Import Prices	6.1	6.5	3.2	5.3	3.1	2.7	3.7	3.2	3.9

Germany's trade surplus (s.a.a.r) increased by $6.8 billion to $77.4 billion in the third quarter, only slightly below the record level recorded in the first quarter. Because this increase was partially offset by a sharp increase in transfers, the current account surplus (s.a.a.r.) increased by only half that amount to $57.8 billion. In October both the trade and current account surpluses fell sharply to $61 billion and $45 billion (n.s.a.a.r.), respectively.

Domestic activity in France has shown signs of slowing recently. The September industrial production index (s.a.) was 2.1 percent below the July-August average and now stands only 1.2 percent above the level of September last year. This slowing was seen in virtually all industrial sectors. Consumption of manufactured products fell 7.9 percent (s.a.a.r) from August to September, but since consumption (s.a.) grew vigorously during the summer, consumption of manufactured products in September was still 5.2 percent above September 1988. Gross fixed investment for the second quarter of 1989 grew only 0.3 percent (s.a.a.r.) from the first quarter, although corporate investment growth continued to be strong.

In September, France posted a trade surplus (s.a.) for the first time since September 1988, but the surplus appears anomalous since it reflects unusually large shipment of Airbus jets and other special factors. In the year through September, the cumulative trade deficit (s.a.) is 28 percent greater than cumulative trade deficit for the same period in 1988. The increase in the trade deficit has been counterbalanced by a widening surplus in services, due primarily to record earnings from tourism, so the current account has remained relatively stable.

The October CPI showed a 3.6 percent increase from a year earlier; the differential above German inflation has remained roughly stable at 0.3 percent.

The U.K. economy has remained weak. Although the output measure of GDP grew 3.9 percent (s.a.a.r.) in the third quarter, most of the increase was a result of a rebound in oil production; excluding oil, real output grew only 1.4 percent (s.a.a.r.), compared with 0.7 percent in the second quarter. In November, the Confederation of British Industry, the leading employers' association, reported that companies' outlook for orders is the worst in two years, and that exports have declined while stocks have accumulated. Industrial production fell 0.8 percent (s.a.) in September, with manufacturing production down 1.1 percent. The volume of retail sales (s.a.) fell 0.8 percent in November to a level about the same as a year ago. However, the unemployment rate (s.a.) fell to 5.9 percent in October, its lowest level since 1980.

The 12-month change in consumer prices fell to 7.3 percent in October; but the index which excludes mortgage interest payments increased to a record 6.1 percent. Output prices for manufactured goods (n.s.a.) rose 0.2 percent in November to a level 4.9 percent above year-earlier levels. Import prices for materials and fuel stood 5.8 percent above year-ago levels in November. Average earnings rose 9.7 percent in the year to September while the underlying annual rate of increase in average earnings was 9 percent.

On November 22, Chancellor John Major delivered the Autumn Statement, in which he reaffirmed the government's priority of fighting inflation. He also presented a gloomy official forecast: in 1990, real GDP is projected to grow only 1-1/4 percent, while only a small improvement in the current account and slow moderation of inflation are expected.

Growth in real GDP (s.a.a.r.) in Canada increased slightly to 2.2 percent in the third quarter from a revised rate of 1.4 percent in the second quarter. However, growth of final domestic demand (s.a.a.r.) was down sharply to 1.1 percent from 5.8 percent. Investment was weak, and consumption was unchanged from the previous quarter. Canada's current account deficit improved slightly to $3.9 billion in the third quarter from $4.5 billion in the second.

Inflationary pressures appear to have eased slightly. Consumer price inflation (n.s.a.) remained high at 5.1 percent in October due to price level increases from excise taxes earlier this year, but monthly changes in prices have been much lower recently. The unemployment rate (s.a.), which has been largely unchanged in recent months, increased 0.2 percentage points in November to 7.6 percent.

The slower pace of economic activity in Italy reflected in second-quarter GDP appears to have continued in the third quarter. Industrial production (s.a.) fell 0.3 percent in September, after falling 1.2 percent in August. Unemployment (n.s.a.) rose slightly in the third quarter to 12 percent (n.s.a.) from 11.9 percent in the previous quarter.

Inflation slowed in November, with consumer prices (n.s.a.) 6.4 percent (n.s.a.) above their year-earlier level, following an increase in October of 6.8 percent. These increases are below peak rates of 7 percent registered earlier in the summer that were associated with the introduction of indirect taxes. Wholesale and consumer price inflation increased in October, due primarily to increases in regulated prices. The wholesale price index in October was 6.5 percent (n.s.a.) above its level a year ago compared with 6 percent in September. In the third-quarter wholesale prices were 6.2 percent above their year-earlier level, down from the 6.8 percent in the second-quarter.

The current account (n.s.a.) worsened sharply in the first half of 1989, registering a deficit of $10.1 billion (n.s.a.), considerably larger than the $5.4 billion deficit for all of 1988. The trade balance through September registered a cumulative deficit of $14 billion (s.a.a.r.), considerably larger than the deficit of $10 billion for all of 1988.

In a recent speech Governor Carlo Ciampi called for greater formal autonomy for the Bank of Italy, including the authority to set the discount rate. He argued that this is needed to preserve the independence of monetary policy from fiscal policy and is a necessary step if Italy is to participate in the monetary unification of Europe.

Economic Situation in Major Developing Countries

The Mexican anti-inflation pact has been extended to July 31, 1990. In the Mexican debt restructuring operation, with about 95 percent of the base debt accounted for, creditors holding about 10 percent of the base debt had pledged $1.4 billion in new money by December 13. Brazilian economic conditions are dominated by political uncertainty as the December 17 presidential election approaches. Argentina announced additional measures to shore up its IMF-supported adjustment program. Venezuela's central bank raised interest rates on short-term deposits to stabilize the bolivar and reduce inflation. The Peruvian government made its first substantial debt service payment to the IMF since 1986. New money commitments to the Philippines have fallen short of the government's goal, but an offer to buy back $1.3 billion of the country's $7.2 billion in medium- and long-term bank debt at a 50 percent discount was oversubscribed. Opposition parties received more support than had been anticipated in recent elections in Taiwan. In Korea, the government introduced a package of measures to boost sagging growth and investment.

Individual country notes. Mexico's anti-inflation pact has been extended for four months beyond its March 31, 1990 expiration date. The extension includes a 10 percent increase in minimum wages, increases in energy and other public sector prices averaging about 5 percent, a business commitment to keep prices stable despite higher wages, and a government pledge to continue devaluing the peso-dollar exchange rate by 1 peso per day.

The recently announced 1990 budget calls for a public sector deficit of 1.6 percent of GDP, counting as revenue the discount to be earned under the external debt reduction agreement soon to be signed with commercial banks. Excluding this item, the public sector deficit would be 5.3 percent of GDP, compared with a 1989 deficit officially estimated to be 6.3 percent of GDP. The new budget calls for interest payments to decline by 3 percentage points of GDP, and for public investment to rise by 14 percent in real terms. Public sector revenues are projected to decline by about a percentage point of GDP, mainly because the export price of Mexican oil is forecast to average $13 per barrel ($2 less than in 1989).

As of December 13, 378 non-Mexican banks holding $45.3 billion in Mexican public sector debt have indicated their choice among the three options under the debt restructuring agreement. Of a total base debt of about $48 billion, $5.7 billion has been earmarked by 17 non-Mexican banks ($3.6 billion) and five Mexican banks ($2.1 billion) to the new money option, for a total new money commitment of just under $1.4 billion.

In Brazil, economic conditions are dominated by political uncertainty as the December 17 presidential election approaches. A public opinion poll released on December 10 showed left-wing candidate Luis Inacio Lula da Silva advancing to within several percentage points of conservative candidate Fernando Collor de Mello. This news helped to push the spread between the parallel and official cruzado-dollar exchange rates from 85 percent on December 6 to 150 percent on December 11. The monthly interest rate in the overnight market for government debt rose to a record 58.7 percent on December 11, while monthly consumer price inflation accelerated to over 41 percent in November.

For the three months ending in October, Brazil registered a trade surplus of $3.6 billion, compared with $5.6 billion over the same period last year. The cumulative surplus for the year through October was $14.2 billion, compared with $16.1 billion for the same period in 1988.

Argentina announced additional measures to shore up its IMF-supported economic adjustment program on December 10. The measures include a 54 percent increase in the austral value of the dollar in the official exchange market, the legalization of the parallel market for foreign exchange for transactions not related to trade, substantial increases in public sector prices, a rescheduling of most of the domestic debt of the government, and the elimination of many government subsidies that previously had been suspended for 180 days. These actions were prompted by a widening of the spread between the parallel and official market exchange rates, which was encouraging the withholding of export receipts from the official market and leading to large reductions in the international reserve holdings of the central bank. Efforts to restrain depreciation in the parallel market by tightening liquidity had not been successful; during the first week of December, the spread between the parallel and official exchange rates averaged about 50 percent.

The new adjustment measures were also made necessary by the fact that inflation has not continued to decline as initially anticipated: monthly inflation rose from 5.6 percent in October to 6.5 percent in November. Because of the new measures, monthly inflation may reach 20 percent in December, compared with the government's original goal of 2 percent monthly inflation by year-end.

Disagreements over policy between central bank president Javier Gonzalez Fraga and Economy Minister Nestor Rapanelli led to the resignation of Gonzalez Fraga on November 24. He was replaced by Egidio Iannella, who has previously headed the central bank.

On November 10, the IMF Executive Board approved a 17-month, SDR 1.1 billion stand-by arrangement for Argentina. Notwithstanding this support, progress in implementing the structural reform program initiated following President Menem's inauguration in July has been slow. The Argentine Congress is still considering tax measures which are a key part of the program, and plans for privatization of state enterprises are also experiencing delays.

The Venezuelan bolivar's floating exchange rate, which had remained in the 36-38 Bs/$ range from April through September, depreciated to 45 Bs/$ by early December. To prevent a further depreciation and to combat inflation, the Central Bank of Venezuela raised the interest rate it pays on 21 to 30 day deposits to 45 percent per annum. The monthly rate of consumer price inflation fell from 3 percent in October to a ten-month low of 1.3 percent in November. On November 29, the operating foreign exchange reserves of the Venezuelan Central Bank stood at $3 billion, up about $900 million from their end-1988 level.

The center-left Democratic Action party of Venezuela's President Perez won about two-thirds of the country's gubernatorial posts and a plurality of local offices in elections held on December 4. Opposition parties did well in some states, but failed to capitalize nationwide on discontent with the economic adjustment policies of President Perez. Popular dissatisfaction with all of the political parties was reflected in a 70 percent rate of abstention.

The Venezuelan state oil company, PDVSA, is purchasing the Southland Corporation's half-interest in the U.S. oil company CITGO. This purchase raises PDVSA's equity stake in CITGO to 100 percent. Commercial banks have criticized this purchase as an inappropriate use of scarce foreign exchange reserves, but Venezuela has indicated that the purchase will be essentially self-financing.

In December, Peru resumed partial debt service to the IMF. The government made a payment of $42.3 million covering obligations that have accrued since September. This represents the first significant payment by Peru since 1986. Peru's arrears to the IMF total about $800 million.

The government of the Philippines announced late in November that only about $700 million of new money (rather than an anticipated $950 million) had been pledged by commercial banks towards a forthcoming bond issue. Philippine authorities also announced that 156 foreign financial institutions had tendered $1.8 billion in loans for a proposed debt buyback operation and that the country had accepted $1.3 billion of these tenders from 140 financial institutions at a 50 percent discount. These operations are scheduled to take place on January 3, 1990, but may be delayed due to the recent coup attempt.

On December 2, Taiwan held its first parliamentary and local elections since the end of martial law in 1987 and the legalization of opposition parties. The opposition captured 40 percent of the vote, considerably more than had been anticipated. This outcome may be related to recent large declines in Taiwan's stock market that occurred despite a ruling-party campaign advertisement that had implied that the government would sustain the bull market. Over the last month, Taiwan's central bank has sold a large quantity of dollars in a successful attempt to counter an incipient depreciation of the New Taiwan dollar.

On November 15, Korean Deputy Prime Minister Cho Soon introduced a package of measures to boost sagging growth and investment. The measures included interest rate cuts for manufacturers and concessional loans and tax credits for additional investment, but did not include won devaluation. The Korean won has remained largely unchanged since last Greenbook after depreciating about 1 percent from its peak in April.

Concluding prolonged negotiations, the Cote d'Ivoire obtained a 17-month SDR 176 million stand-by arrangement from the IMF in November.