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January 30, 1991

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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DOMESTIC NONFINANCIAL DEVELOPMENTS

The Commerce Department's advance estimate indicates that real GNP fell 2.1 percent at an annual rate in the fourth quarter. The dearth of first-quarter data makes the rate of contraction after year-end difficult to gauge. However, a few considerations suggest that the steepest part of the decline in output may be behind us. In particular, motor vehicle assemblies, which reached a very low level in December, apparently moved up a bit in January. Production cuts elsewhere have kept inventories under good control in most sectors. Furthermore, although much uncertainty exists about the effects of the Persian Gulf conflict, the drop in oil prices following the Allied attack, if sustained, should provide some support for economic activity. Wage increases slowed last quarter, suggesting an easing of domestic cost pressures. Nonetheless, the trend in underlying inflation of retail prices has receded only slightly in recent months.

Employment and Unemployment

The labor market softened further in December, but apparently not as sharply as in the preceding two months. Although the civilian unemployment rate rose an additional 0.2 percentage point to 6.1 percent, the decline of 76,000 in total payroll employment was considerably smaller than the job losses posted in October and November. An increase in the average workweek pushed up aggregate hours of production or nonsupervisory workers for a second consecutive month in December, after the extraordinary plunge in October. For the fourth quarter as a whole, both the workweek and employment declined significantly, pushing down aggregate production-worker hours at a 4.2 percent annual rate (chart on payroll survey).

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

			1990			1990		
	1989	1990	Q2	Q3	Q4	Oct.	Nov.	Dec.
	------------Average monthly changes---------							
Nonfarm payroll employment[2]	193	60	236	-72	-172	-180	-259	-76
Private	162	25	106	8	-183	-194	-278	-78
Manufacturing	-16	-48	-23	-43	-102	-68	-204	-33
Durable	-16	-37	-20	-44	-73	-42	-159	-18
Nondurable	-0	-10	-3	1	-29	-26	-45	-15
Construction	5	-18	-14	-31	-60	-83	-70	-28
Trade	47	-3	27	3	-64	-67	-63	-62
Finance, insurance, real estate	9	4	8	2	-7	-8	-9	-3
Services	100	79	92	72	45	35	70	31
Total government	30	35	129	-80	12	14	19	2
Private nonfarm production workers	134	11	94	-25	-170	-147	-270	-92
Manufacturing production workers	-17	-39	-18	-36	-81	-50	-170	-23
Total employment[3]	148	-32	1	-118	-103	-150	-347	188
Nonagricultural	148	-38	-27	-90	-123	-131	-357	120

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments.
3. Survey of households.

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

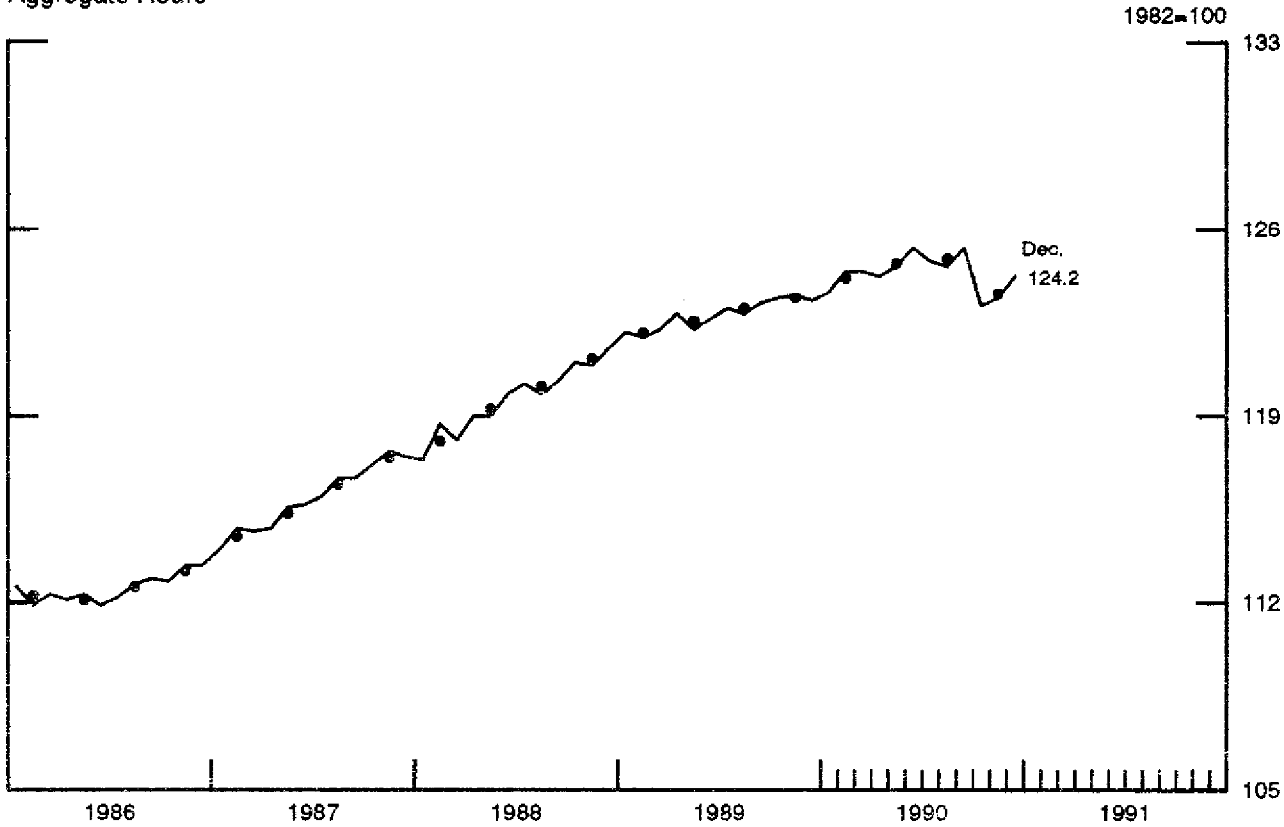
			1990			1990		
	1989	1990	Q2	Q3	Q4	Oct.	Nov.	Dec.
Civilian, 16 years and older	5.3	5.5	5.3	5.6	5.9	5.7	5.9	6.1
Teenagers	15.0	15.5	15.0	16.0	16.4	16.2	16.4	16.6
20-24 years old	8.6	8.8	8.7	8.9	9.2	9.4	9.1	9.2
Men, 25 years and older	3.9	4.4	4.1	4.5	4.8	4.6	4.8	5.1
Women, 25 years and older	4.2	4.3	4.2	4.3	4.6	4.3	4.6	4.8
White	4.5	4.8	4.6	4.8	5.1	4.9	5.0	5.3
Black	11.5	11.3	10.6	11.7	12.0	11.7	12.2	12.2
Fulltime workers	4.9	5.2	5.0	5.3	5.7	5.5	5.7	5.8
Memo:								
Total national[1]	5.2	5.4	5.2	5.5	5.8	5.6	5.8	6.0

1. Includes resident armed forces as employed.

Labor Market Indicators

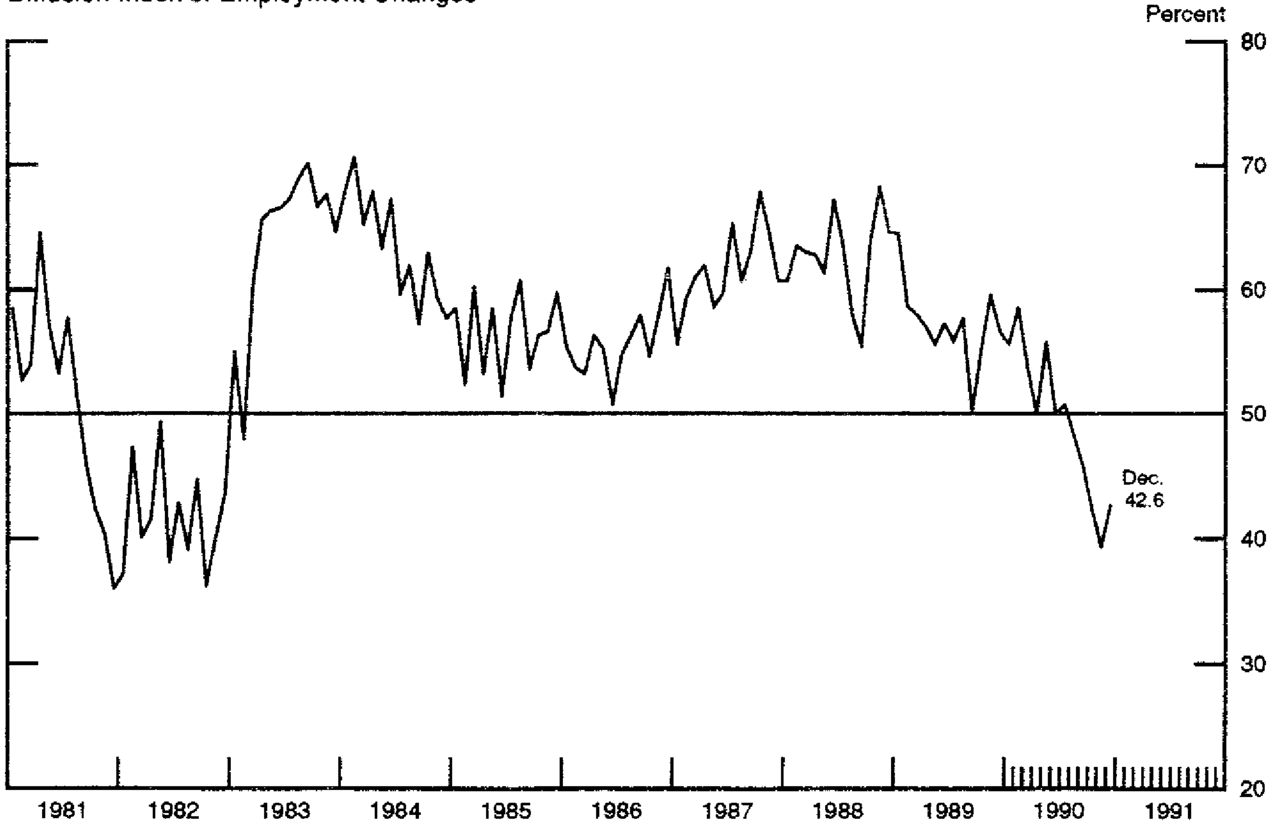
Payroll Survey

Aggregate Hours[1]



1. Dots denote quarterly averages.

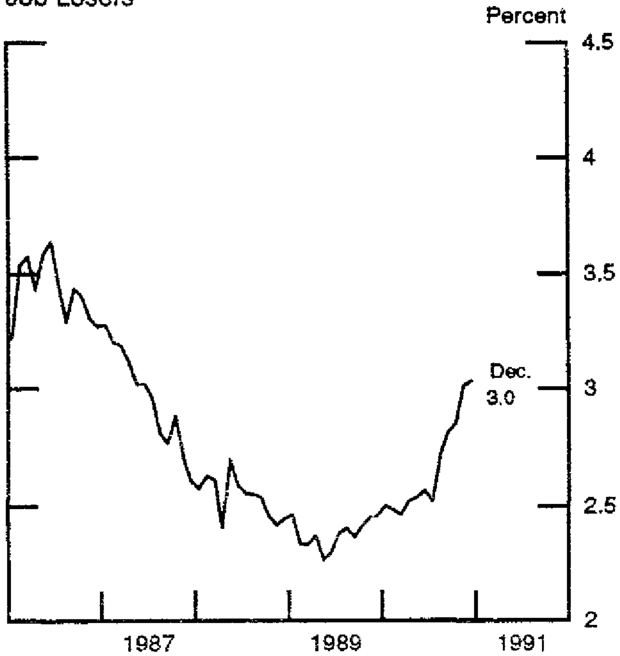
Diffusion Index of Employment Changes



Labor Market Indicators

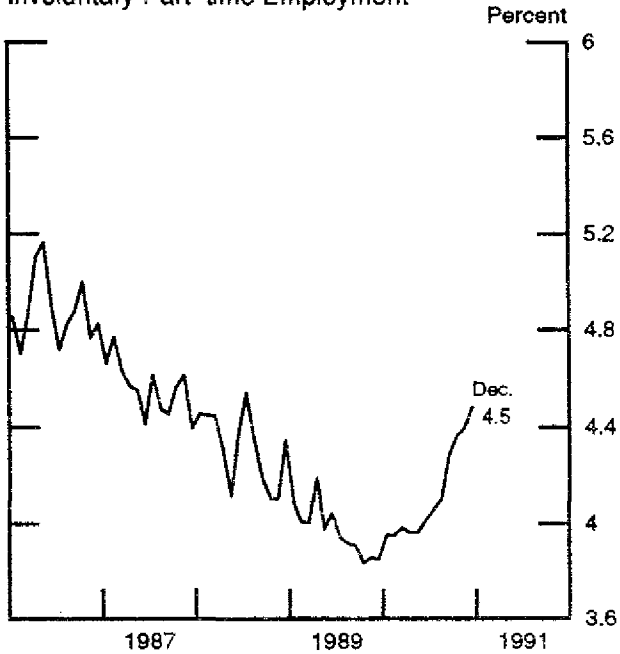
Household Survey

Job Losers [1]



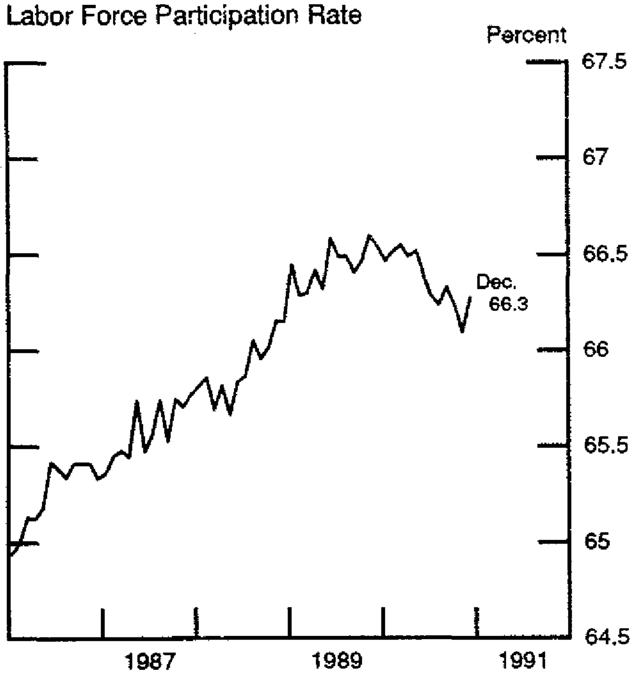
1. Job losers as a percentage of civilian labor force.

Involuntary Part–time Employment [1]



1. Persons employed part–time for economic reasons as a percentage of household employment.

Labor Force Participation Rate



Discouraged Workers [1]

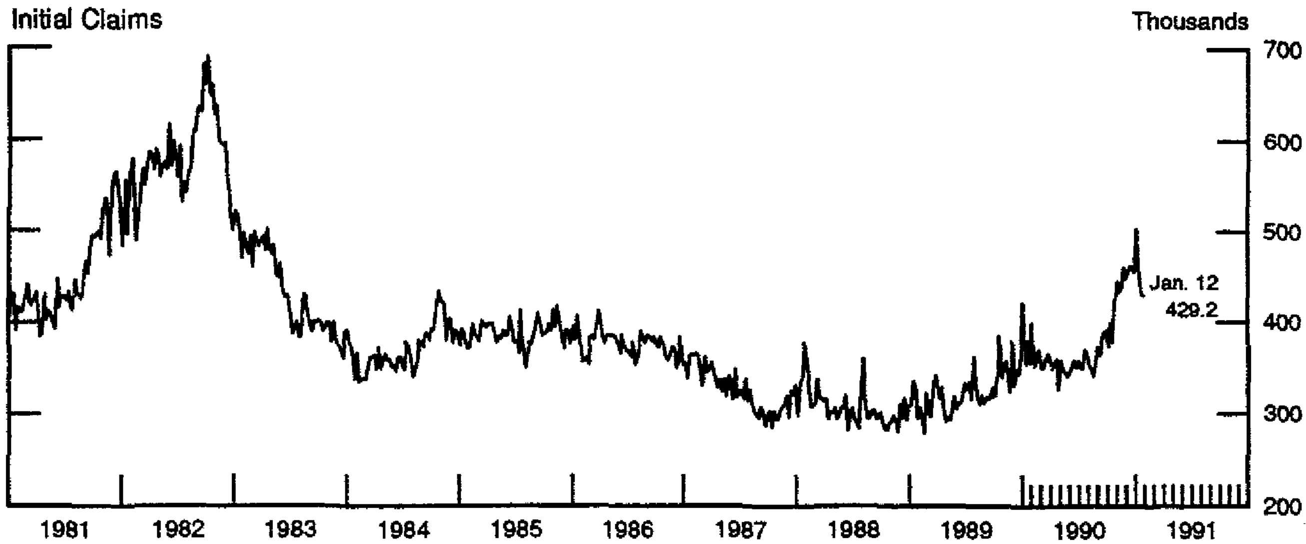
1. Discouraged workers as a percentage of civilian labor force, quarterly data.

Although the payroll employment losses in December were not so deep as those of the preceding two months, they were again widespread. The diffusion index of one-month employment changes, which has remained below 50 percent since last August, stood at 42.6 percent in December. Manufacturing lost an additional 33,000 jobs in December, and construction employment fell 28,000 after job losses averaging about 75,000 per month in October and November. In the private service-producing sector, employment fell 23,000 in December, largely because of another sizable drop in retail trade, where hiring for the holiday season was slower than usual. Employment also fell in finance, insurance, and real estate, the fourth consecutive monthly decline. Only the services industry posted an employment increase in December, boosted by the 56,000 jobs added in health services.

Unemployment rates increased in December for virtually all major demographic groups. The number of job losers and the number of individuals involuntarily employed part-time continued to rise (chart on household survey). In addition, although the labor force participation rate ticked up in December, it remained below its year-ago level. Part of the continued weakness in labor force growth reflects a rise in the number of discouraged workers--those who believe that no jobs are available to them.

In recent weeks, initial claims for unemployment insurance continued to fluctuate around the 450,000 mark. Week-to-week movements in this series must be regarded with some caution because they are inherently noisy and because seasonal adjustment is especially difficult around year-end. Moreover, historically, the cyclical position of the economy has proved hard to infer from initial claims alone. In the postwar period, claims have

Weekly Unemployment Insurance
(Weekly data; seasonally adjusted, FRB basis)[1]



1. Only the State Program Components are seasonally adjusted.

moved erratically around cyclical troughs and have not registered marked declines until a month or two after the trough (see the table below).[1]

INITIAL CLAIMS AROUND CYCLICAL TROUGHS
(Monthly percent change; state programs; BLS seasonally adjusted data)

	-2 months	-1 month	Trough	+1 month	+2 months
Largest decrease	-1.0	-16.9	-12.2	-13.8	-13.4
Mean change	**8.6**	**-1.2**	**1.9**	**-7.2**	**-3.7**
Largest increase	15.8	7.1	20.6	0.3	2.5

As a result of the Persian Gulf crisis, about 157,000 reservists are currently on active duty, and the military expects to call up as many as

1. Initial claims are included as a component of the index of leading economic indicators because they lead business cycle peaks; however, claims are considered by BEA as a coincident indicator around troughs.

170,000 more in coming weeks.[2] At least half of the reservists already called to duty are estimated to remain on private payrolls; thus, the call-up accounted for no more than about 75,000 of the 565,000 drop in private nonfarm payroll employment between August and December. The employers facing the largest call-ups appear to be airlines, police departments, private security services, and health services. There is little information on whether employers have kept these positions vacant or filled them with temporary help.[3]

Industrial Production

Industrial production fell nearly 8 percent at an annual rate in the fourth quarter of last year. A 1-3/4 million unit drop in motor vehicle output directly accounted for about one-fourth of the decline in IP last quarter; cutbacks at suppliers to the motor vehicle industry probably accounted for about another fourth. Most other industries also cut back production last quarter; declines were especially sharp for computers, construction supplies, and a wide range of consumer durables excluding motor vehicles. Although we cannot quantify the effect of the Persian Gulf operations on production last quarter, output likely was supported by an increase in military orders for such goods as food products, chemicals, clothing, and some types of ordnance.[4]

2. On January 18, President Bush signed an executive order raising the number of reservists who can be on active duty from approximately 200,000 to 1 million. In addition, the tour of duty for reservists was extended from ninety days to two years. However, the government has stated that tours will last a maximum of one year.

3. Employers are required by law to hold open reservists' jobs for four years, and for an additional year at the request of the government.

4. Production of defense and space equipment is estimated to have fallen in the fourth quarter. Although orders for defense capital goods spurted in December, the level of bookings for the fourth quarter as a whole fell 12 percent from the third-quarter average.

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

	Proportion in total IP 1989:Q4	1990 H1[1]	1990 Q3	1990 Q4	1990 Oct.	1990 Nov.	1990 Dec.
		----Annual rate----			---Monthly rate----		
Total index	100.0	2.4	3.9	-7.9	-0.7	-1.8	-0.6
Excluding motor vehicles and parts	95.7	2.2	3.9	-5.8	-0.6	-1.1	-0.3
Products, total	61.2	2.8	2.4	-5.8	-0.5	-1.7	-0.4
Final products	46.6	3.2	3.4	-5.4	-0.4	-2.0	-0.3
Consumer goods	25.9	-0.3	1.9	-4.1	-0.2	-2.2	-0.0
Automotive products	2.4	7.8	2.0	-36.8	-4.4	-12.4	-6.7
Other consumer goods	23.5	-1.1	1.9	-0.0	0.2	-1.1	0.6
Durables	3.1	4.6	-6.9	-14.7	-2.2	-2.3	-0.1
Nondurables	20.4	-2.0	3.3	2.4	0.6	-0.9	0.7
Energy	2.7	-9.3	13.7	-6.6	0.7	-4.5	1.6
Other	17.7	-0.9	1.9	3.8	0.6	-0.4	0.6
Business equipment	15.2	8.7	8.1	-7.9	-0.9	-2.2	-0.9
Motor vehicles	1.1	14.1	3.1	-49.9	-4.2	-21.1	-10.2
Other business equipment	14.1	8.2	8.5	-3.7	-0.6	-0.7	-0.3
Computers	2.5	16.1	8.9	-13.2	-0.2	-4.5	-2.6
Other	11.6	6.6	8.4	-1.4	-0.7	0.2	0.2
Defense and space equip.	4.8	1.8	0.4	-2.9	-0.0	-0.9	0.5
Construction supplies	6.0	-1.7	-2.6	-14.5	-1.2	-1.2	-1.5
Materials	38.8	1.8	6.3	-11.3	-1.1	-2.0	-1.0
Durable	19.8	3.2	7.1	-15.0	-1.5	-2.4	-2.2
Nondurable	8.8	1.4	5.1	-7.0	-0.6	-1.1	-0.6
Energy	10.2	-0.6	6.0	-7.2	-0.8	-2.0	1.1
Memorandum:							
Manufacturing	84.9	2.9	3.4	-8.0	-0.6	-1.8	-0.9
Excluding motor vehicles	80.6	2.6	3.3	-5.5	-0.5	-1.0	-0.5

1. From the final quarter of the previous period to the final quarter of the period indicated.

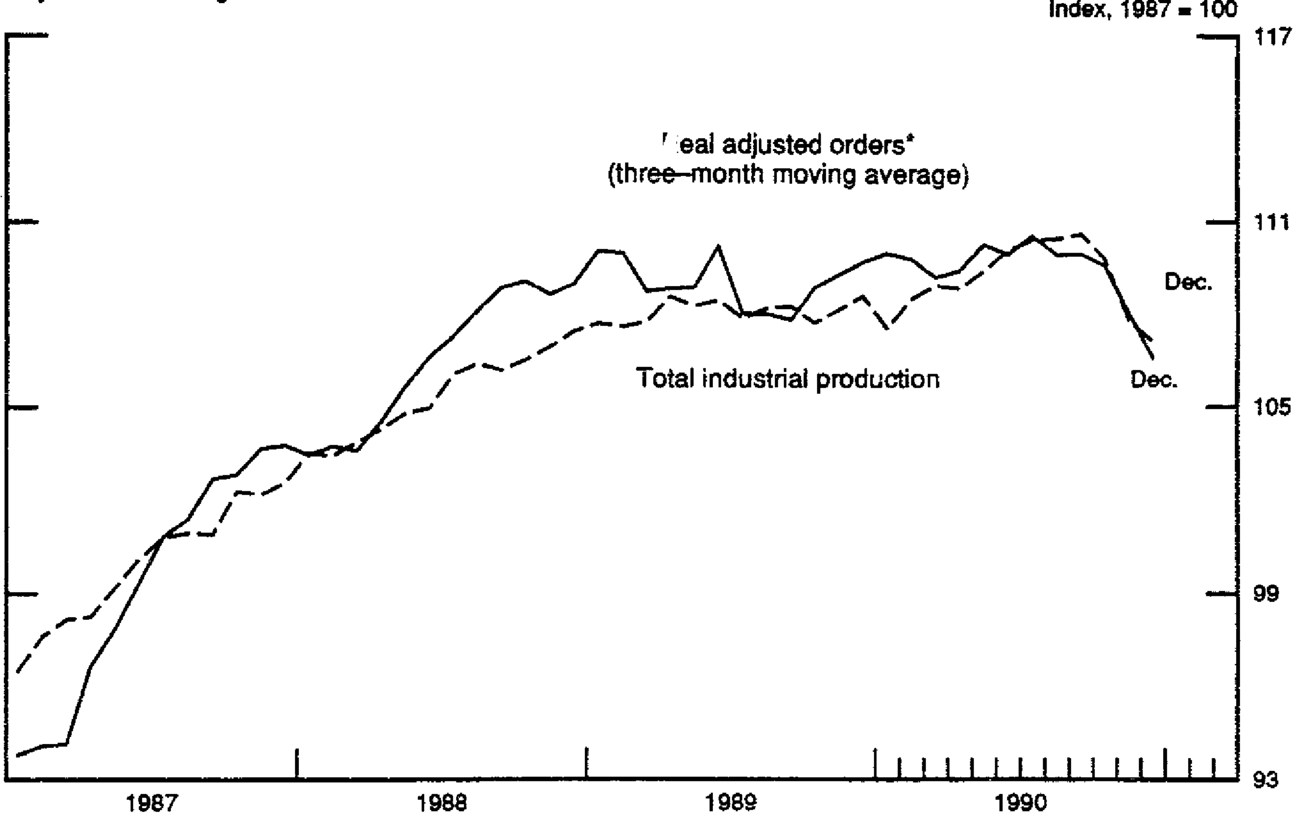
CAPACITY UTILIZATION IN MANUFACTURING
(Percent of capacity; seasonally adjusted)

	1967-89 Avg.	1988-89 High	1989 Dec.	1990 Oct.	1990 Nov.	1990 Dec.
Total industry	82.2	85.0	83.7	82.7	81.0	80.4
Manufacturing	81.5	85.1	82.8	81.9	80.2	79.3
Primary processing	82.3	89.0	85.2	83.9	82.3	80.9
Advanced processing	81.1	83.6	81.8	81.1	79.3	78.6

INDICATORS OF INDUSTRIAL ACTIVITY

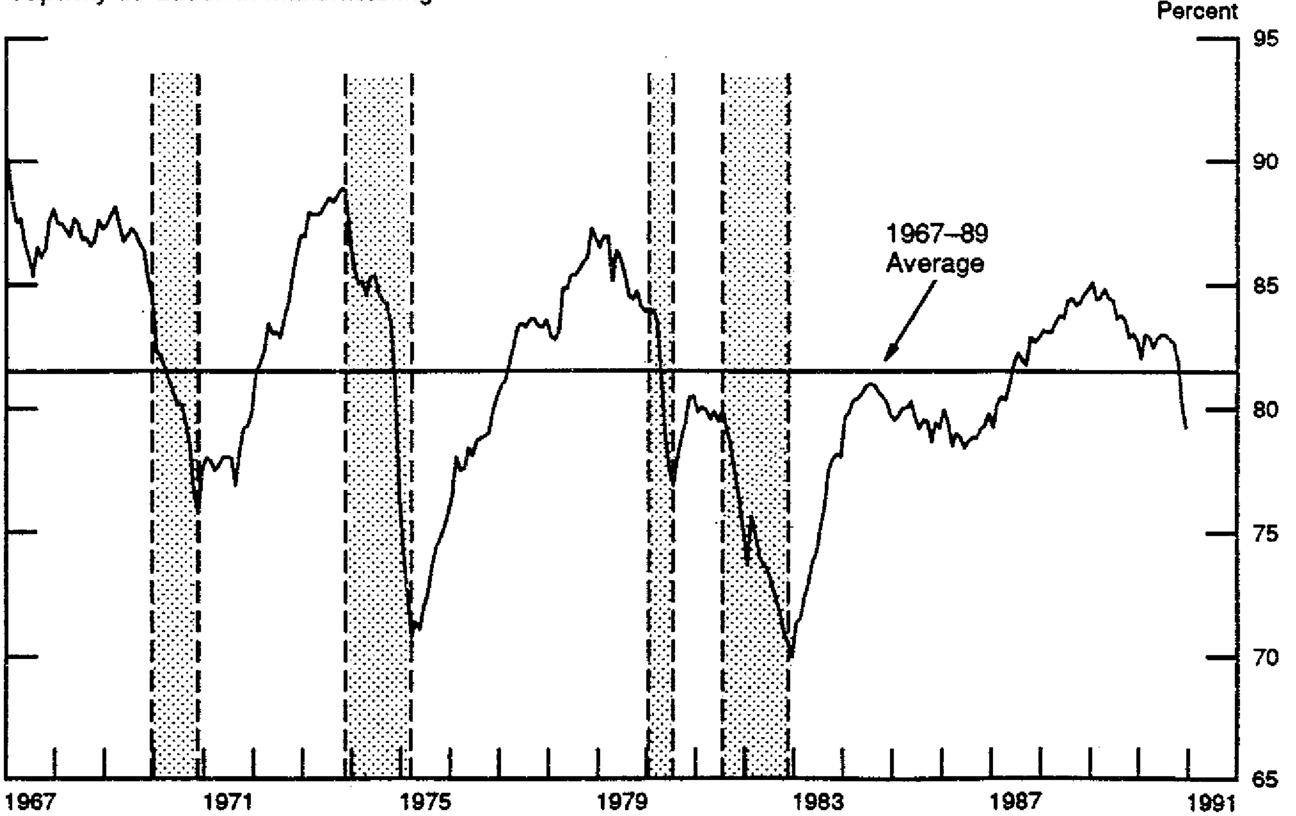
(Based on monthly,seasonally adjusted data)

Adjusted durable goods orders



*Adjusted goods orders equal bookings for durable goods industries that report unfilled orders, excluding orders for defense capital goods, nondefense aircraft, and motor vehicle parts. N(ninal orders are deflated using the PPI for durable goods.

Capacity utilization in manufacturing



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

	1990	1990		1990		
	H1	Q3	Q4	Oct.	Nov.	Dec.
Total personal income	24.0	19.0	16.5	-1.7	17.6	33.6
Wages and salaries	14.7	12.0	3.0	-15.6	-2.2	26.8
Private	11.4	10.4	.7	-17.9	-4.5	24.4
Other labor income	1.5	1.2	1.0	1.0	1.0	1.0
Proprietors' income	2.1	-.7	5.5	-.1	15.2	1.5
Farm	-.1	-2.5	5.2	.6	14.4	.7
Rent	.8	1.7	-1.2	.6	-2.3	-1.9
Dividend	.8	.6	.6	.8	.7	.4
Interest	2.2	1.8	1.5	1.8	1.6	1.2
Transfer payments	5.5	3.3	6.1	8.7	3.6	6.0
Less: Personal contributions for social insurance	1.8	.8	.2	-1.0	-.1	1.6
Less: Personal tax and nontax payments	4.2	5.7	2.9	-.6	2.0	7.2
Equals: Disposable personal income	19.8	13.4	13.6	-1.1	15.6	26.4
Memo: Real disposable income	2.2	-6.8	-1.4	-22.6	3.7	14.8

REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period)

	1990[1]	1990		1990		
	H1	Q3	Q4	Oct.	Nov.	Dec.
	-----Annual rate------			----Monthly rate----		
Personal consumption expenditures	.7	2.7	-3.1	-.9	-.1	.5
Durable goods	1.8	2.6	-8.6	-3.3	-.3	1.0
Excluding motor vehicles	.0	1.5	.0	-1.2	1.0	1.1
Nondurable goods	-2.5	2.3	-5.8	-.9	.0	-.2
Excluding gasoline	-2.0	2.3	-6.4	-1.3	-.1	-.1
Services	2.6	3.0	.7	-.2	-.1	.9
Excluding energy	3.6	3.1	1.5	.0	.2	.4
Memo: Personal saving rate (percent)	4.9	4.2	4.1	3.9	4.2	4.2

1. Percent change from 1989-Q4 to 1990-Q2.

By slashing fourth-quarter output, domestic automakers appear to have kept inventories under reasonably tight control; absent a further erosion in demand, auto production is likely to stabilize or possibly pick up somewhat in the coming months from the low December rate. Through late January, domestic producers are estimated to have assembled autos and trucks at a pace slightly above the 7-1/2 million unit rate recorded in December (FRB seasonals).

Other weekly IP data for the first couple of weeks in January were mixed: Production of steel continued to decline while output in energy-producing industries increased slightly. More generally, the staff's series on adjusted durable goods orders, which tends to lead IP by a month or two, edged lower in December, continuing the downtrend evident since the middle of last year. On balance, these indicators point to further declines in industrial production in the near term, though the rate of contraction may be slower than in the fourth quarter.

Capacity utilization in manufacturing fell further in December to 79.3 percent, down nearly 6 percentage points from its peak in early 1989. In most industries, operating rates at year-end were down substantially not only from their recent peaks but also from their averages during 1967-90. Utilization in primary processing industries, which was still fairly high by historical standards last summer, has dropped more than 5 percentage points since July.

Personal Income and Consumption

Nominal personal income rose nearly $34 billion at an annual rate in December. An increase of $27 billion in wages and salaries, which more than reversed the declines in the preceding two months, accounted for the bulk of this rise. In real terms, disposable personal income increased 0.5 percent in December, after edging up in November. However, even with these increases, real DPI declined at about a 1-1/2 percent annual rate over the last six months of 1990, depressed by the spurt in consumer energy prices between July and October.

Consumer demand during the holiday shopping season was lackluster. Real PCE for goods other than motor vehicles was about flat in December and remained considerably below the levels seen earlier in the year. Real outlays for apparel were notably weak in December, falling 2 percent, not at an annual rate. There is some evidence from the BEA data that consumers bought tobacco, alcohol, and jewelry in advance of the January 1 effective date of the new taxes on those items. Although spending increases in those categories were modest, we believe that spending for these items would have been substantially weaker absent the influence of the new taxes. This hypothesis can be reexamined a month from now when we receive revised data on spending in December and new data for January.

Moving beyond the so-called control category, consumer demand for motor vehicles remained tepid in December. Spending for consumer services rose nearly 1 percent in December, boosted by a jump in outlays for electricity and natural gas from the low November levels. However, for the fourth quarter as a whole, real spending on services increased only 0.7 percent at an annual rate, well below the gains registered earlier in 1990.

With nominal income and personal outlays up by roughly comparable amounts in December, the personal saving rate held steady at 4.2 percent. Since the Iraqi invasion of Kuwait, the personal saving rate has averaged about 4.0 percent--nearly 1 percentage point below the average of the first seven months of 1990. In an arithmetic sense, about half of this decline reflects the higher gasoline prices that have prevailed since August: Nominal PCE for gasoline increased from 2.2 percent of nominal disposable personal income in the first seven months of 1990 to 2.6 percent in the period since August.[5] An increase in gasoline prices could reduce the saving rate either if the non-gasoline components of consumer spending adjusted with a lag to changes in real income or if the runup in energy prices were expected to be short-lived.[6] Note that both explanations point to a rebound in the saving rate, provided that the jump in energy prices indeed proves to be temporary.

Consumer confidence, as measured by the Conference Board index, fell in January from the already low December level. The Conference Board provided separate tabulations of the responses received before the January 16 Allied attack and those received thereafter. Although the index rose about 4 index points after the attack, the post-attack level--at 56.7--was still below the December reading, with further deterioration evident in almost all components of the index. At this point, the results from the Michigan survey for January are still incomplete. Based on the 70 households polled over January 16-20, consumer sentiment improved markedly just after the Allied attack and expectations about inflation moderated somewhat. However,

5. The increase since July in prices for fuel oil and coal has been even sharper than for gasoline, but real consumption of these items has declined dramatically, leaving nominal spending about unchanged relative to nominal DPI. In comparison with the price increases for either gasoline or fuel oil and coal, the increases since August in prices for electricity and natural gas have been modest.

6. It is difficult to assign precise weights to these two hypotheses, though both probably have some merit. Surveys of consumer long-term inflation expectations, which showed a marked increase in August, provide some evidence against the explanation that households treated the energy price increase as temporary.

we would caution against reading much into this apparent improvement in the consumer's outlook because of the small sample and because the euphoria evident early in the war might not have been sustained.

Autos and Light Trucks

Unit sales of new cars and light trucks were about unchanged in December from their November level, at a 12.7 million unit annual rate. Domestically produced cars sold at a 6.6 million unit annual pace--up about 1/4 million units from the previous month. In the first twenty days of January, the average selling pace for these cars is estimated to have been around 6 million units at an annual rate.[7] Even accounting for the apparent downward bias in the first twenty-day figures--due to difficulties in seasonal adjustment of transplant sales--the sales pace thus far in January appears to have been slightly below the fourth-quarter average. Sales of domestically built light trucks weakened in December and stayed at that lower level through the first 20 days of January.

Sales of imported cars slowed in December to a 2.3 million unit rate even though purchases of high-priced cars soared as consumers bought aheadof the January 1 introduction of the excise tax on vehicles priced over $30,000.[8] On a not-seasonally-adjusted basis, unit sales of Mercedes were up 37 percent from the November level; BMWs, up 27 percent; and Jaguars, up 64 percent. All told, unit sales of imported models with base prices over

7. Chrysler no longer releases 10-day sales data. The sales figure for January incorporates an estimate for Chrysler that is based on the assumption that Chrysler sales in the first 20 days were the same fraction of GM and Ford sales that they were in the past year.

8. The existing "gas-guzzler" tax on low-mileage cars was doubled effective January 1, but this tax reportedly affects relatively few models.

$30,000 jumped about one-third in December; in contrast, sales of lower-priced imports declined 6 percent. Sales of high-priced domestic makes also increased in December, though apparently by a lesser amount, in part because fewer of these domestic cars are priced substantially above $30,000.

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

	1989	1990	1990 Q3	1990 Q4	1990 Oct.	1990 Nov.	1990 Dec.	1991 Jan. 1-20
Total	14.51	13.86	14.18	12.94	13.51	12.67	12.64	
Autos	9.90	9.50	9.72	8.98	9.35	8.66	8.91	
Light trucks	4.61	4.36	4.47	3.97	4.16	4.02	3.73	
Domestic total[2]	11.19	10.84	11.30	10.18	10.67	9.90	9.96	9.20e
Autos	7.08	6.90	7.21	6.59	6.91	6.24	6.61	5.92
Light trucks	4.11	3.95	4.09	3.59	3.76	3.65	3.35	3.28
Import total	3.33	3.01	2.88	2.76	2.84	2.78	2.68	
Autos	2.82	2.60	2.51	2.38	2.43	2.42	2.30	
Light trucks	0.50	0.41	0.38	0.38	0.40	0.36	0.38	

1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
e Includes estimates of Hyundai North American built cars and Chrysler cars and trucks.

In December, domestic automakers cut production from the anemic November pace of 5.4 million units (annual rate, BEA seasonals) to 4.8 million units. With sales outpacing production by a substantial margin, inventories of new cars fell at the end of the month to 1.29 million units, or about 60 days' supply at the average selling pace for December; however, by failing to count the large stock of nearly-new cars soon to be recycled by the rental companies to dealers, this figure tends to understate the effective inventory of cars. In contrast to the largely satisfactory inventory situation for new cars, inventories of light trucks continued to

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

	1990			1990		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
Producers' durable equipment						
Shipments of nondefense capital goods	-0.9	1.1	-0.1	-0.1	-1.7	-0.4
Complete aircraft	-3.1	16.7	-6.5	-1.2	-2.0	-0.8
Excluding aircraft and parts	-1.5	-0.8	0.9	1.3	-1.8	-1.5
Office and computing	-1.0	-1.4	4.1	3.5	-6.4	2.4
All other categories	-1.6	-0.7	0.1	0.7	-0.6	-2.4
Weighted PDE shipments[1]	-1.4	-0.1	2.3	2.8	-1.0	-1.7
Sales of heavy-weight trucks	-5.9	6.4	-10.8	-4.5	-5.8	4.0
Orders of nondefense capital goods	-5.8	4.9	4.7	8.7	-14.0	16.9
Excluding aircraft and parts	-1.4	0.6	-0.5	2.7	-6.1	1.2
Office and computing	-1.2	5.2	-6.2	-12.4	-2.4	-4.1
All other categories	-1.5	-0.6	1.0	7.0	-7.0	2.5
Weighted PDE orders[1]	-0.7	0.1	1.6	4.6	-4.8	0.4
Nonresidential structures						
Construction put-in-place	-0.5	1.1	n.a.	-2.2	-1.5	n.a.
Office	-3.8	1.6	n.a.	-4.2	-4.3	n.a.
Other commercial	-3.5	-2.5	n.a.	-3.0	-3.7	n.a.
Public utilities	-0.5	0.0	n.a.	1.0	0.5	n.a.
Industrial	0.7	2.3	n.a.	-1.2	2.7	n.a.
All other	4.9	4.5	n.a.	-3.7	-2.1	n.a.
Rotary drilling rigs in use	10.7	-2.8	-2.8	-0.9	0.3	-2.3
Footage drilled[2]	1.5	4.3	n.a.	7.2	-10.1	n.a.

Note: The Census M-3 report does not provide information on complete aircraft orders.
1. Computed as the 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 Department of Energy. Not seasonally adjusted.
n.a. Not available.

run quite heavy. At the December sales pace, the year-end stock of light trucks on dealers' lots represented nearly a 100-day supply.

Business Fixed Investment

Real spending for business fixed investment fell 4-1/2 percent at an annual rate in the fourth quarter, according to BEA's advance estimate.[9] Business outlays for motor vehicles dropped sharply, after the third-quarter spike in fleet sales, while aircraft purchases stayed at the robust third-quarter level.[10] Excluding the transportation sector, equipment investment rose at a 7-3/4 percent annual rate, mainly because of strong increases in spending for computers; in contrast, outlays on industrial equipment were flat. Investment in structures plummeted, reflecting large declines in the commercial, industrial, and institutional sectors.

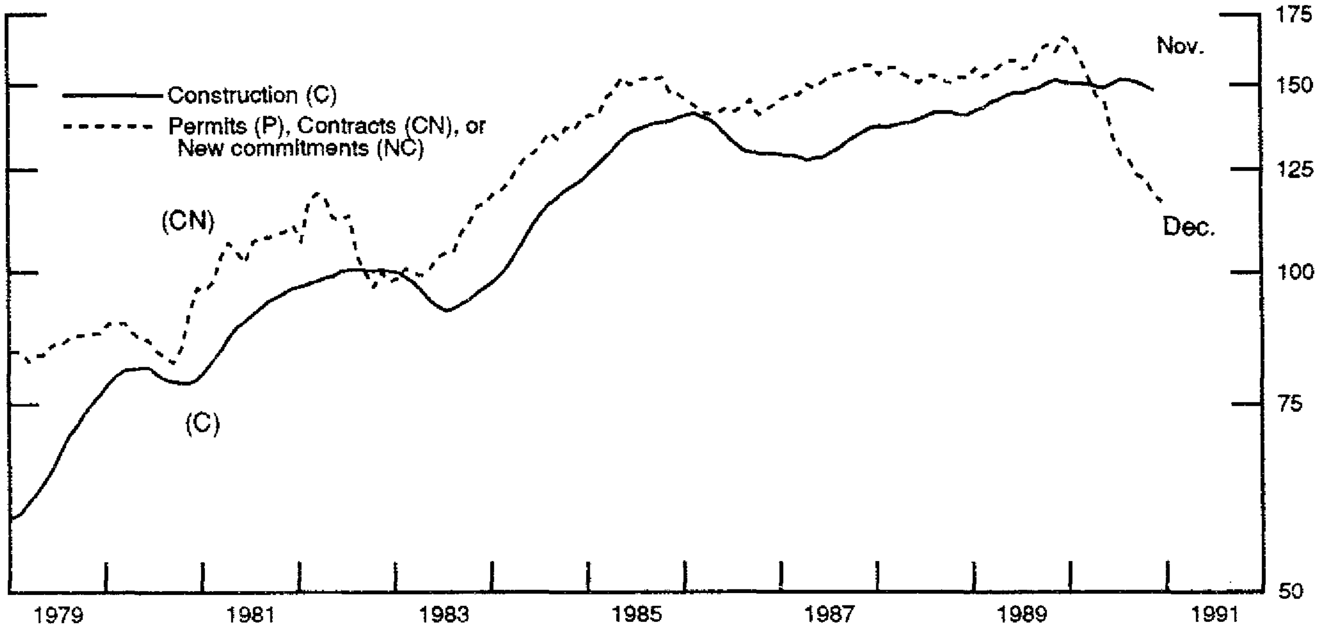
Recent data point to softness in equipment spending in the current quarter. In nominal terms, new bookings for nondefense capital goods excluding the aircraft group were down 1/2 percent (not an annual rate) in the fourth quarter. Bookings for office and computing equipment have been especially weak, with the recent declines pushing the fourth-quarter level of this series 6-1/4 percent below the third-quarter average. Moreover, based on the January sales figures for autos and light trucks,

9. December shipments of nondefense capital goods were close to what BEA had assumed and suggest little revision to the advance estimate of PDE.

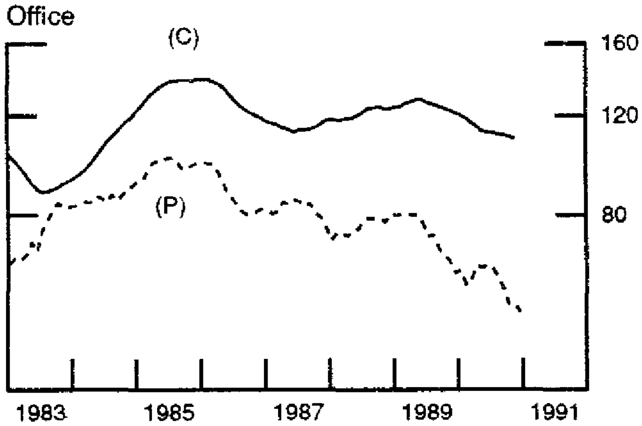
10. The Census Bureau was unable to release data on shipments of complete civil aircraft from the Current Industrial Report (CIR) for either October or November 1990 because the composition of shipments by manufacturer was such that public release would have violated confidentiality restrictions. Thus, for the advance estimate of fourth-quarter PDE, BEA used shipments of complete nondefense aircraft as reported in the M3 survey.

NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS*
(Index, Dec. 1982 = 100, ratio scale)

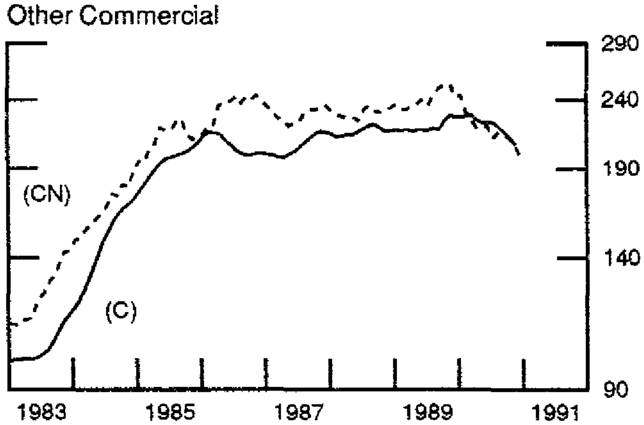
Total Building



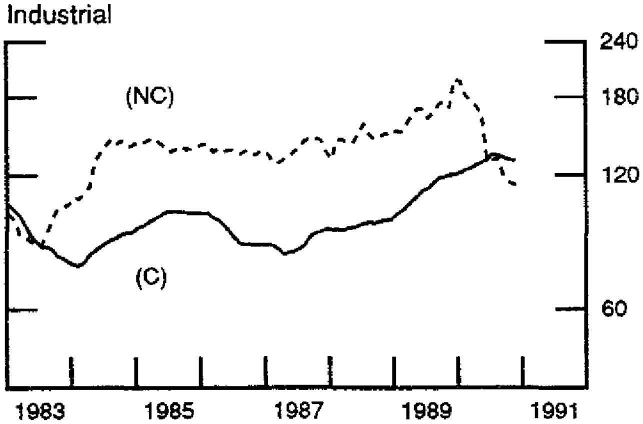
Office



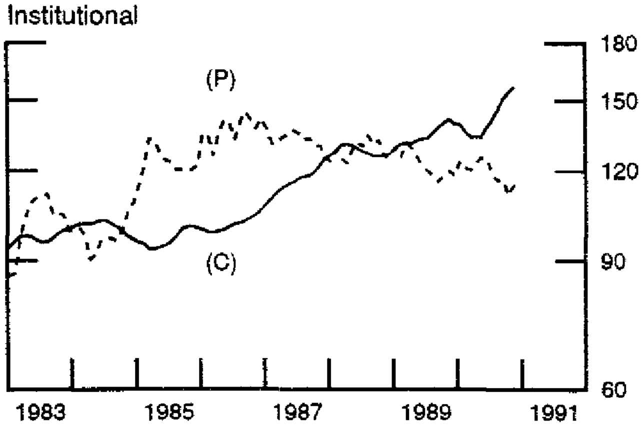
Other Commercial



Industrial



Institutional



*Six-month moving average for all series shown. For contracts, total only includes private, while individual sectors include private and public. New commitments are the sum of permits and contracts. The contracts and permits data extend through December.

business purchases of motor vehicles likely were sluggish early in the current quarter.

The near-term outlook is even weaker for structures, as indicated by information on building permits and contracts. As shown in the top panel of the chart, contracts for total private building have trended sharply lower for the past year and a half. This series has proved to be a fairly reliable leading indicator, signaling each of the three downturns in nonresidential construction during the 1980s. The falloff in contracts likely reflects several factors. Most important, office and other commercial space continues to exceed current demand, even though the pace of total commercial construction already has fallen more than 20 percent from its peak at the end of 1985. In addition, with the rate of capacity utilization in manufacturing down sharply since early 1989, the pace of industrial construction appears to be softening Aside from these demand-side factors limiting activity, anecdotal reports suggest that some worthwhile projects--particularly in the commercial sector--have been denied financing as part of the general shift to tighter lending standards. We have no way of estimating the extent of the financing constraint; however, we believe it to be of secondary importance when compared with the negative fundamentals on the demand side.

According to the recent Commerce Department survey of business capital spending plans--taken in October and November of last year--firms expect to increase nominal outlays 2.4 percent this year, after an estimated 5.2 percent rise in 1990. Much of the expected slowdown occurs in manufacturing, where the Commerce survey estimates a 4.6 percent gain for 1990 but only a 0.7 percent rise in 1991. Although the survey has been a

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

	1990			1990		
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Current-cost basis:						
Total	-7.0	11.2	57.5	40.3	41.7	24.0
Total excluding retail auto	9.1	9.8	36.7	40.5	35.3	37.6
Manufacturing	2.7	-4.2	25.2	32.2	5.6	9.0
Wholesale	2.2	7.6	8.2	3.7	14.3	19.0
Retail	-11.8	7.8	24.1	4.3	21.8	-4.0
Automotive	-16.1	1.4	20.8	-0.2	6.4	-13.6
Excluding auto	4.3	6.5	3.3	4.5	15.4	9.6
Constant-dollar basis:						
Total	-25.0	6.2	5.1	-12.4	-1.9	16.6
Total excluding retail auto	-2.4	3.3	1.9	-11.1	-6.7	22.0
Manufacturing	1.7	-2.6	3.7	1.0	-17.5	5.1
Wholesale	-1.1	1.2	0.6	-9.1	5.2	13.9
Retail	-25.6	7.6	0.8	-4.3	10.3	-2.4
Automotive	-22.6	2.8	3.2	-1.4	4.8	-5.4
Excluding auto	-3.0	4.8	-2.4	-3.0	5.6	3.0

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

	Range in preceding 12 months:[2]		1990			1990		
	Low	High	Q1	Q2	Q3	Sept.	Oct.	Nov.
Current-cost basis:								
Total	1.46	1.51	1.48	1.48	1.48	1.48	1.48	1.50
Total excluding retail auto	1.43	1.49	1.46	1.45	1.45	1.45	1.44	1.46
Manufacturing	1.52	1.65	1.60	1.56	1.56	1.55	1.53	1.57
Wholesale	1.24	1.27	1.25	1.25	1.26	1.27	1.27	1.29
Retail	1.55	1.61	1.55	1.58	1.60	1.59	1.60	1.60
Automotive	1.81	2.12	1.84	1.92	2.08	2.07	2.06	2.05
Excluding auto	1.46	1.50	1.48	1.49	1.47	1.46	1.47	1.48
Constant-dollar basis:								
Total	1.42	1.46	1.44	1.43	1.43	1.44	1.45	1.47
Total excluding retail auto	1.39	1.45	1.42	1.41	1.41	1.42	1.42	1.45
Manufacturing	1.44	1.54	1.50	1.47	1.46	1.47	1.45	1.49
Wholesale	1.26	1.32	1.28	1.27	1.28	1.30	1.32	1.33
Retail	1.51	1.58	1.51	1.55	1.55	1.55	1.57	1.57
Automotive	1.72	2.04	1.73	1.82	1.85	1.84	1.84	1.85
Excluding auto	1.44	1.49	1.46	1.48	1.47	1.47	1.49	1.49

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.

useful indicator of general trends in outlays, it is not a precise forecasting tool. In the past, this survey has had a mean absolute error of 2.6 percentage points in predicting the actual growth of spending on plant and equipment.

COMMERCE SURVEY OF PLANT AND EQUIPMENT EXPENDITURES[1]
(Percent change from previous year, current dollars)

	Actual	Planned	
	1989	1990	1991
All business	11.4	5.2	2.4
Manufacturing	12.5	4.6	.7
Durable	7.2	1.4	-.8
Nondurable	17.2	7.3	1.8
Nonmanufacturing	10.8	5.6	3.4

1. Taken in October and November of 1990.

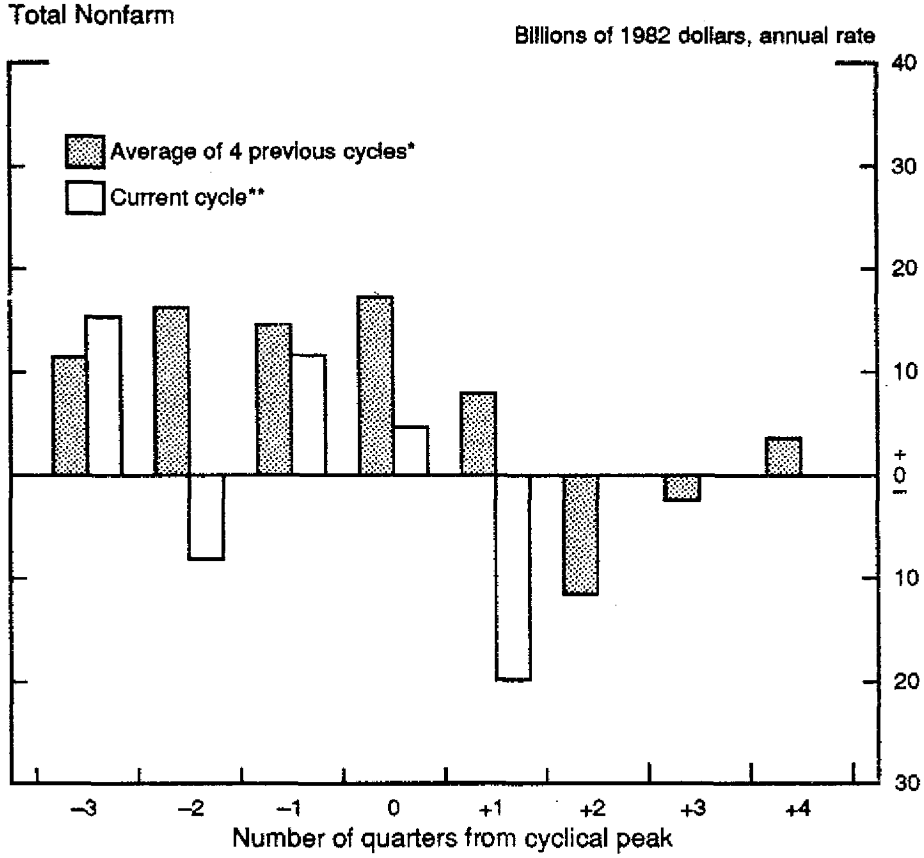
Business Inventories

Since late last summer, businesses have trimmed their stocks in reaction to sluggish sales and to expectations of additional economic weakness. From August to October, constant-dollar inventories in manufacturing and trade were reduced at an annual rate of $9.6 billion. Inventory adjustments apparently continued in November as industrial producers slashed their output further. Nonetheless, with the sharp decline in factory shipments and in sales at many types of wholesale distributors in that month, total manufacturing and trade inventories increased somewhat on net.

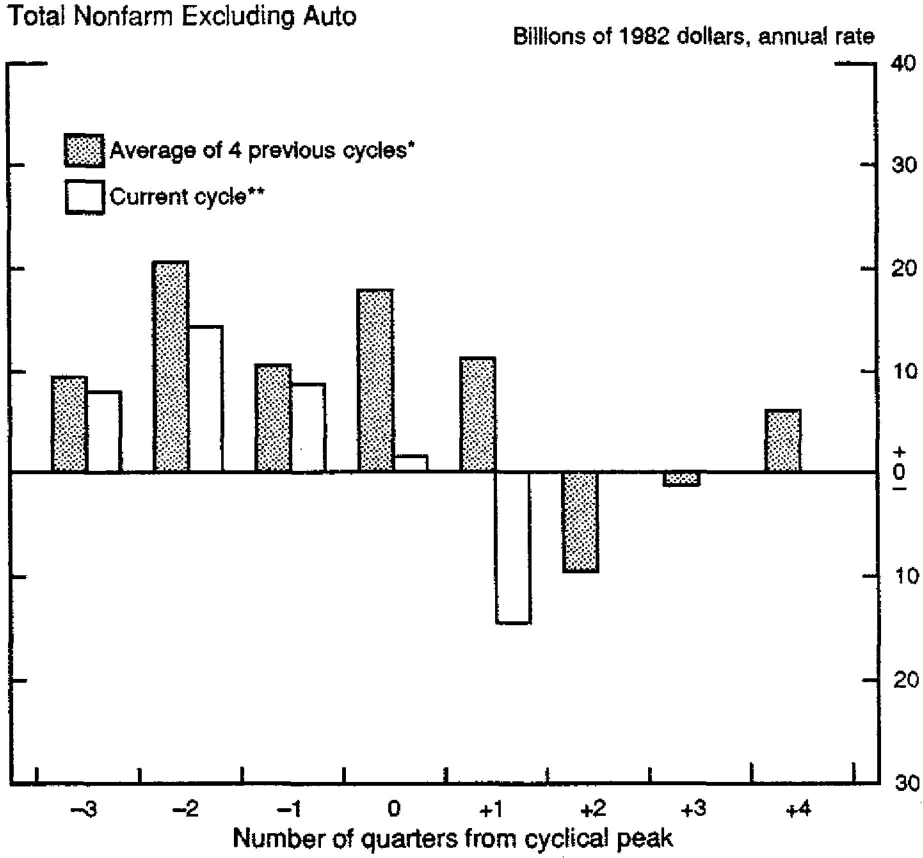
In manufacturing, real stocks declined at an average annual rate of $5.9 billion between August and November. Virtually all of the recent decumulation was in stocks held by petroleum refineries--likely the result

INVENTORY CHANGES AROUND CYCLICAL PEAKS

Total Nonfarm



Total Nonfarm Excluding Auto



* Includes all cycles since 1959 except 1973–1975 recession.
** Assumes a cyclical peak in 1990–Q3.

of the Persian Gulf developments and not directly related to domestic demand. Outside of petroleum, factory stocks were little changed, on net, from August to November. Stocks of finished goods also were flat, even with the large decline in shipments. The absence of a sharp runup in inventory-sales ratios for most industries suggests that factory stocks continued to be tightly managed through late last year.

In the trade sector, real inventories outside of auto dealers rose at a $13.8 billion annual rate, on average, in October and November after moderate liquidations in the preceding two months. The Census current-cost data suggest that this increase largely reflected the notable accumulations of machinery inventories at the wholesale level and of general merchandise stocks at the retail level. In each case, the accumulation was accompanied by flat sales and likely was unintended. Elsewhere in the trade sector, stocks seemed to be generally under control late last year.

By historical comparison, businesses adjusted their inventory positions relatively promptly over 1990 (chart).[11] Assuming that the BEA's estimated inventory changes for the fourth quarter hold up, it appears that stock imbalances at present probably are less serious than in the early phase of previous cycles and will not require as much correction. Inventories also should be less of a restraint on production when the recovery in final demand begins.

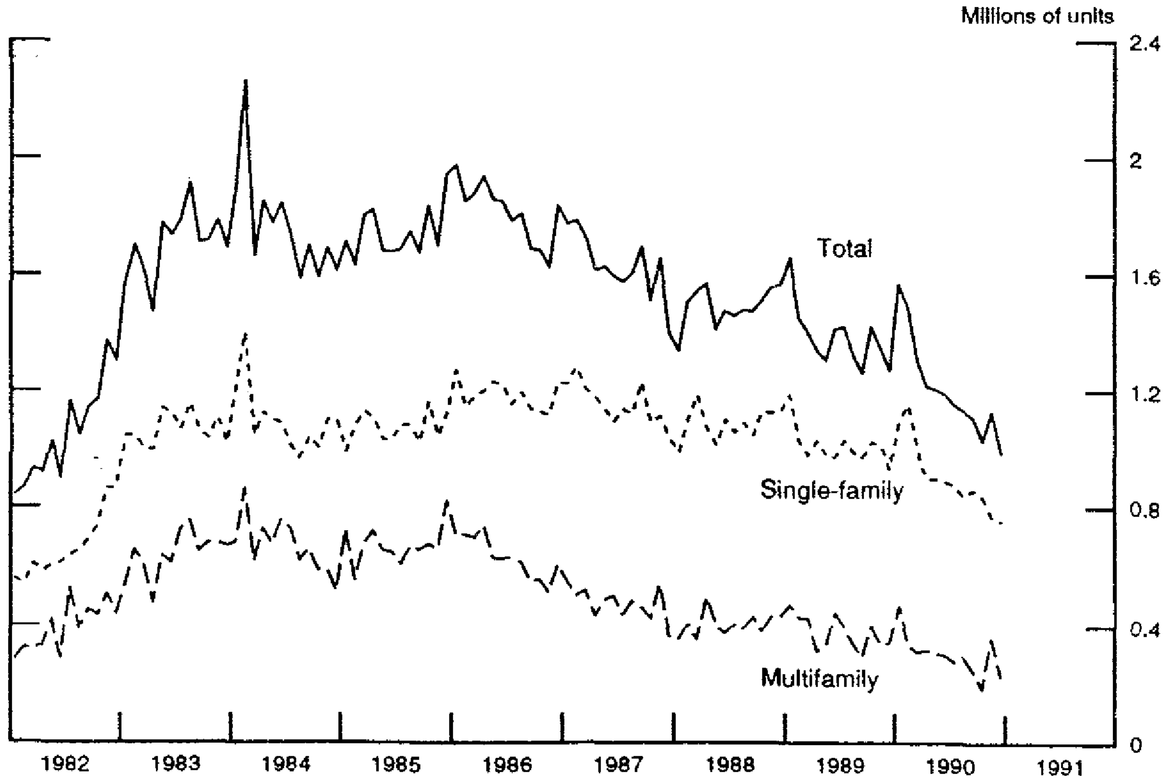
11. The chart includes the cycles only since 1959 because no constant-dollar inventory data exist for earlier cycles. The 1973:Q4-1975:Q1 recession was excluded, as inventory decumulation was delayed until the sixth quarter after the cyclical peak.

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

	1990p	1990			1990		
	Annual	Q2	Q3	Q4p	Oct.	Novp	Dec.p
All units							
Permits	1.10	1.09	1.04	.89	.92	.91	.85
Starts	1.19	1.20	1.13	1.05	1.03	1.13	.99
Single-family units							
Permits	.79	.80	.76	.68	.71	.67	.65
Starts	.89	.90	.86	.79	.84	.77	.76
Sales							
New homes	n.a.	.54	.53	n.a.	.49	.51	n.a.
Existing homes	3.30	3.32	3.33	3.14	3.05	3.15	3.22
Multifamily units							
Permits	.30	.29	.28	.22	.21	.24	.20
Starts	.30	.31	.27	.26	.19	.36	.23
Vacancy rate[1]							
Rental units	9.1	8.5	9.5	9.0	n.a.	n.a.	n.a.
Owned units	7.2	7.9	6.6	6.6	n.a.	n.a.	n.a.

1. Percent. Owned units consist mainly of condominiums. All vacancy rate data are revised.
p Preliminary. r Revised estimates. n.a. Not available.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



Housing Markets

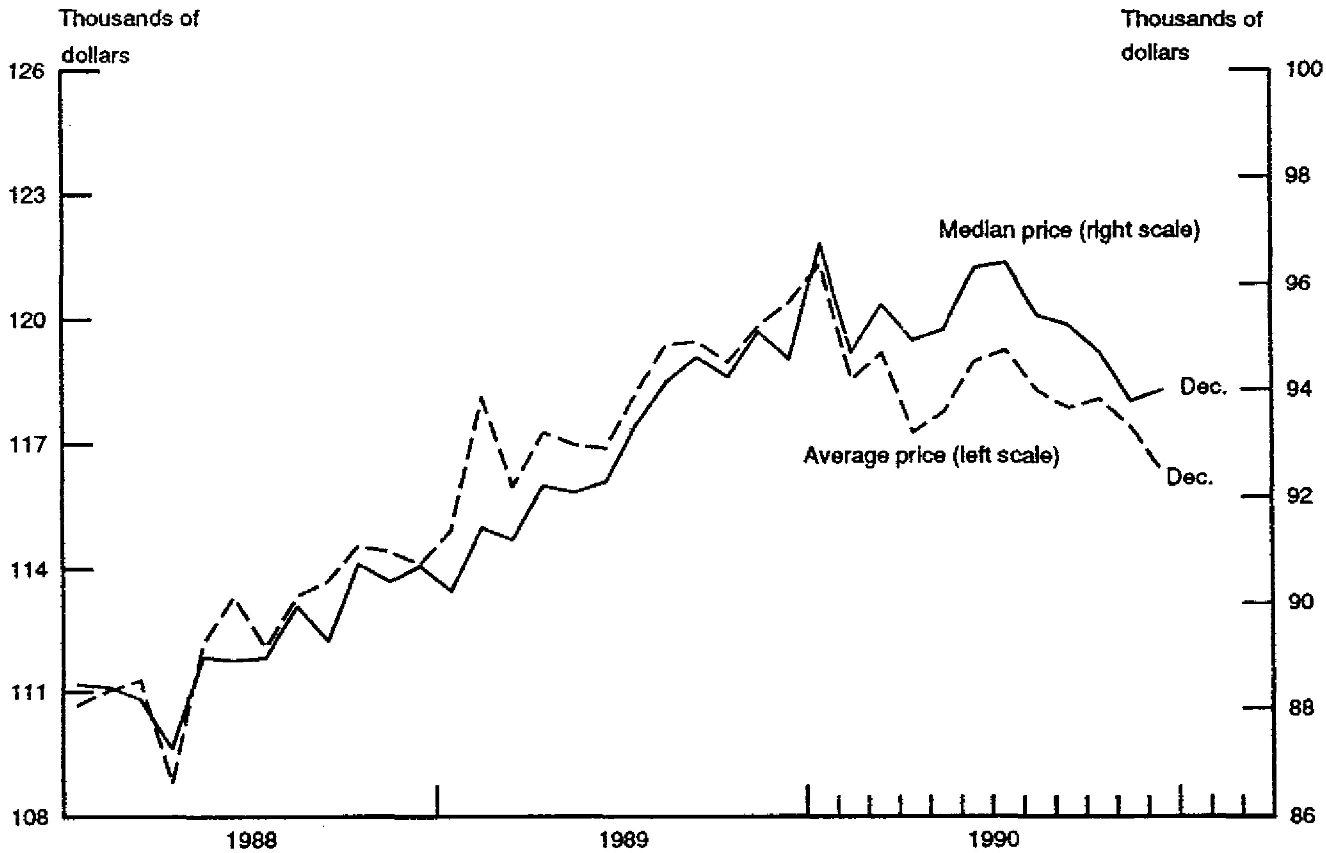
Housing construction declined further in the fourth quarter. Total housing starts fell to an annual rate of 987,000 units in December, more than reversing the gain of a month earlier; the average pace of starts in the fourth quarter stood about 7 percent below that recorded in the preceding quarter. In addition, the issuance of building permits declined during each month of the fourth quarter.

In the multifamily sector, starts moved erratically through the fourth quarter, but, on average, were down 5 percent from the third-quarter pace. This drop was considerably smaller than those posted earlier in the year. The cumulative decline in starts since 1985 has reduced the pace of activity by two-thirds, and the current level of activity may be near the floor in the market, given the diversity of demands across regional markets and the need to replace the existing stock. Although the vacancy rate for multifamily rental housing units declined from 9.5 percent in the third quarter to 9.0 percent in the fourth quarter, the most recent observation remains high by historical standards.

Starts in the single-family sector edged down to 755,000 units at an annual rate in December, the lowest figure since October 1982, and permit issuance decreased slightly. In the fourth quarter, single-family starts were down 8 percent and remained generally well in line with permit issuance.

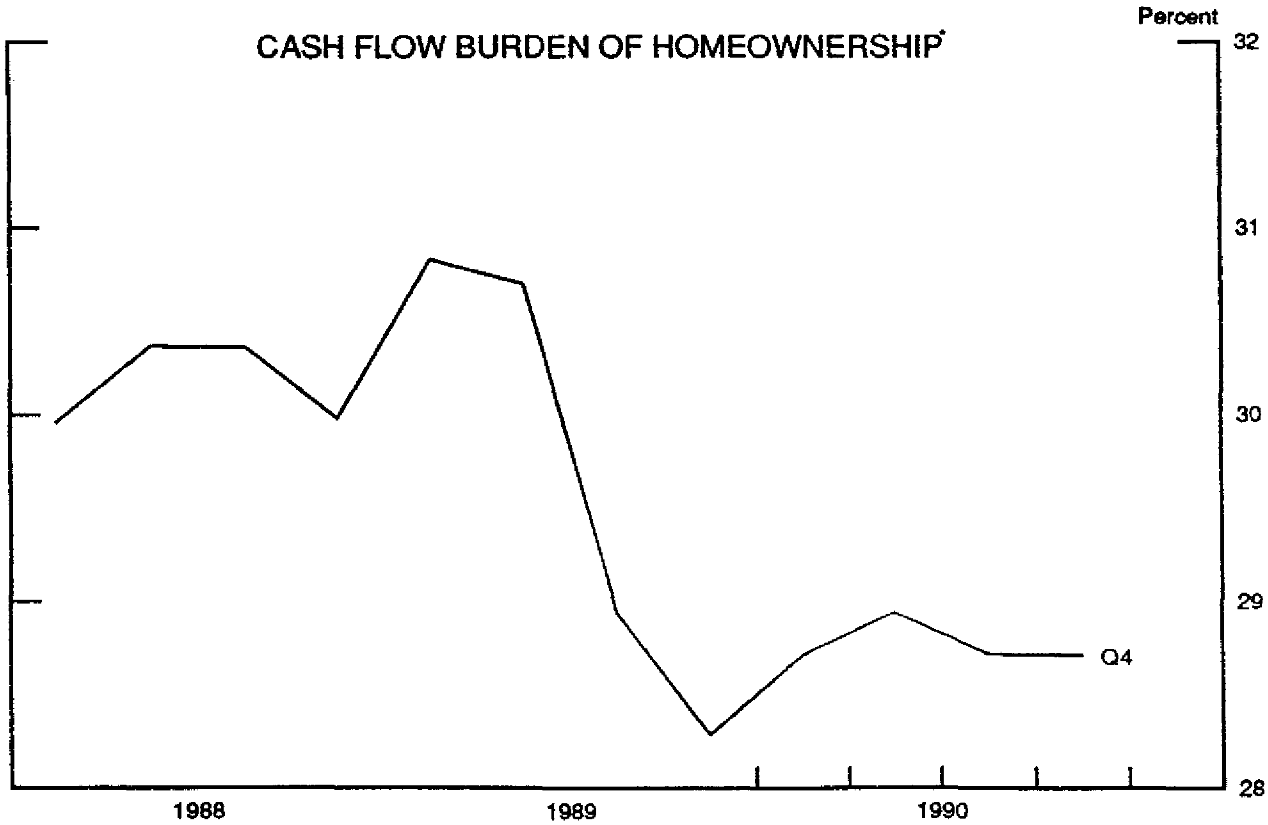
Despite the continued decline in single-family construction, recent sales developments raise the possibility that demand has begun to firm. Sales of existing homes edged up 2 percent in December, following a 3 percent rise in November. New home sales also increased 3 percent in

EXISTING HOME PRICES
(seasonally adjusted)



Source: National Assoc. of Realtors; seasonally adjusted at Federal Reserve Board.

CASH FLOW BURDEN OF HOMEOWNERSHIP*



*Scheduled payments on a fixed-rate mortgage for 80 percent of the purchase price of a constant-quality new home, as a percentage of average household income.

November. In part, the pickup in sales may reflect improved housing affordability. Home prices have trended lower in recent months, as indicated by median and average prices of existing homes after seasonal adjustment by the Board's staff (chart).[12] Affordability also has been enhanced by a decline of about 50 basis points in interest rates on fixed-rate mortgages during November and December.

The slowing pace of construction, combined with small increases in sales, is gradually helping to align the inventory of unsold homes with sales; the inventory-to-sales ratio for new homes edged down from 8.3 months in September and October to 7.8 months in November. However, even with this decline, the supply of homes relative to sales remains high by historical standards and likely will continue to limit new construction of single-family units in the near term.

Tighter requirements for construction loans have been mentioned as another factor likely constraining residential construction. A survey of homebuilders in January suggests that lending restrictions have tightened since last spring. The proportion of respondents reporting that changes in lending practices affected building or development plans rose from 60 to 70 percent. The perceived effect was particularly strong in the Northeast and for firms engaged in multifamily or commercial construction or in land development. Small builders seem to have been affected less than medium-sized and large firms. According to builders, tough actions by regulators

12. The recent price declines could reflect, in part, a shift in sales composition toward smaller, less expensive units, because the price series do not account for changes in the structural characteristics or geographic mix of homes sold. Constant-quality new home prices for the fourth quarter, which adjust for changes in the mix of structural attributes, will not be available until early February.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Billions of dollars, except where otherwise noted)

	Dec. 1989	Dec. 1990	Fiscal year to date FY1990	FY1991	Dollar change	Percent change
Outlays	103.9	109.7	299.4	340.7	41.3	13.8
Deposit insurance (DI)	1.6	4.3	7.0	14.8	7.8	112.2
Outlays excluding DI	102.3	105.3	292.4	325.9	33.5	11.5
National defense	28.6	26.0	73.7	80.9	7.1	9.7
Net interest	14.6	16.4	44.2	46.2	2.0	4.6
Social security	19.6	21.3	58.8	63.4	4.5	7.7
Medicare and health	12.0	13.2	35.9	40.2	4.3	11.9
Income security	13.2	13.9	34.4	40.5	6.1	17.7
Other	14.3	14.5	45.3	54.7	9.4	20.8
Receipts	89.1	102.3	228.8	253.8	25.0	10.9
Personal income taxes	37.4	46.5	107.4	114.3	6.9	6.5
Social insurance taxes	25.8	25.5	76.9	85.8	8.9	11.6
Corporate income taxes	18.9	22.5	22.0	25.4	3.4	15.6
Other	7.0	7.8	22.5	28.2	5.7	25.5
Deficit(+)	14.8	7.4	70.6	86.9	16.3	23.1

Details may not add to totals due to rounding.

and examiners were the reason most frequently cited by thrifts and commercial banks in explaining the stiffer lending policies. Although the loans-to-one-borrower limit was cited by two-fifths of the builders noting a tightening of credit by thrifts, this factor had been even more widely cited in the earlier survey.

Federal Government Sector

The Administration announced that Operation Desert Shield cost $10 billion in calendar year 1990.[13] For the year ahead, the total cost of the Gulf military operations obviously will rise far above that figure now that war is under way. However, the ultimate cost still cannot be estimated with any precision, largely because of uncertainty about the duration and intensity of the air and ground action. Before the Allied attack, the Congressional Budget Office released cost estimates for the Persian Gulf military operations based on different war scenarios. These are estimates of the costs incurred since last August, not just the costs of the war itself. The CBO estimates range from $28 billion to $86 billion; the lower figure assumes a war lasting several weeks with limited ground action, and the higher figure assumes a war lasting several months with repeated ground assaults.

For any given war scenario, the CBO estimate assumes the full replacement of lost equipment and munitions drawn down from defense stocks. However, full replacement of most items is unlikely, because of the planned reductions in the size and readiness of the military. Even if the desired stocks of certain "smart" weapons increase because of their apparently

13. All Persian Gulf cost estimates cited in this section are net costs over a baseline that includes military payrolls and other costs that would have been incurred in normal circumstances.

impressive performance, the build-ups in these areas probably will not offset the more general trend toward downsizing.

Whatever the ultimate cost of the Persian Gulf operation, only a portion of it will be reflected in this year's defense outlays. So far, the Department of Defense has increased orders for some items--such as the Patriot missile--to support the ongoing war effort. Over the coming months, additional orders are likely to be placed to replenish stocks drawn down in the war. The long lead times for acquisition of missiles and aircraft suggest that the increased production would be spread over several years. The CBO assumes, for example, that only $13 billion to $26 billion in additional outlays would show up in FY1991.[14]

The financial assistance recently offered by Saudi Arabia, Kuwait, Germany, and Japan--on the order of $40 billion since the war began--will offset a substantial portion of the cost of the war. These pledges augment the $8 billion in cash and in-kind contributions pledged last year, of which $6 billion already has been received.

Turning to other fiscal developments, the CBO and the Administration announced their economic assumptions for the FY1992 budget. Both sets of assumptions include two consecutive quarters of negative real GNP growth, which activates the recession provisions of the Budget Enforcement Act. The Senate <u>must</u> vote, and the House <u>may</u> vote, on suspending the budget targets. The Senate Budget Committee voted unanimously against suspending the enforcement provisions. However, the measure still must be considered by the full Senate. If it and the House vote to suspend the targets, the

14. The extra defense spending necessitated by Operation Desert Storm will not be limited by defense spending caps under the new budget law; the caps will be adjusted upward for expenditures related to this operation.

resolution will go to the President, who has said that he would veto such legislation.

The Treasury's data on outlays and receipts for the first three months of FY91 show a deficit of $87 billion, compared with a $71 billion deficit a year earlier. Outlays were $41 billion, or 14 percent, higher than a year earlier. The major entitlement programs for health, low-income support, and retirement accounted for $15 billion of the increase, with outlays for deposit insurance--at $15 billion--representing another $8 billion of the rise. National defense expenditures were $7 billion higher, but nearly half of the increase was due to a shift in military pay dates. Among smaller programs, international affairs, agriculture, and education showed substantial increases over a year earlier.

Receipts in the first quarter of FY1991 were 11 percent above a year earlier, largely reflecting stronger corporate profits tax receipts and social insurance contributions; receipts also were boosted by the $4 billion in cash contributions from our allies to support Operation Desert Shield. Gross corporate income tax collections totaled $23 billion in December, about $4 billion above the year-earlier total. Nonetheless, for the calendar year as a whole, these collections were a bit below the 1989 level.

Real federal government purchases of goods and services, excluding CCC, grew at almost a 10 percent annual rate in the fourth quarter (NIPA basis). Real defense purchases rose at a 15 percent annual rate, reflecting Operation Desert Shield and accelerated deliveries of aircraft. Real purchases of nondefense goods and services, excluding CCC, declined at a

6 percent annual rate because the employment of temporary Census workers ended.

State and Local Government Sector

The deficit of state and local operating and capital accounts rose sharply, to about $45 billion, in the fourth quarter, largely because of slower growth in personal and indirect business receipts.[15] In addition, real purchases of goods and services climbed 4 percent at an annual rate largely because of a surge in construction spending in October and November.

The increase in the NIPA deficit measure reflects widespread deterioration in the finances of state and local units. According to a December survey by the National Conference of State Legislators, 29 states are facing potential deficits in their general fund accounts. Much of the recent fiscal erosion is directly related to weakness in economic activity and the consequent shortfall in tax collections relative to the continued uptrend in outlays. To balance their budgets, many states are expected to institute broad spending cuts. For example, in Michigan, the governor has proposed that most functions be reduced about 9 percent from previously planned levels.

At the local level, New York City is planning layoffs, a property tax hike, and other measures to deal with a projected budget gap of more than $2 billion in fiscal year 1992. Among governmental authorities, the Massachusetts Water Resources Authority, charged with cleaning up Boston Harbor, is cutting spending by 10 percent; however, court-ordered construction projects are expected to proceed on schedule.

15. An official fourth-quarter deficit has not been published; however, the given estimate is implicit in BEA's 1990 annual figure.

Labor Costs

Recent data on labor costs have been relatively favorable. Compensation per hour, as measured by the Employment Cost Index (ECI), rose 3.8 percent at a seasonally adjusted annual rate in the fourth quarter after a rise of 4.3 percent in the third quarter. These moderate gains offset larger increases earlier in the year such that, over the year as a whole, hourly compensation in private industry rose 4.6 percent, a bit more slowly than in 1989. Slightly smaller wage increases in 1990 accounted for the deceleration compared with a year earlier; benefit costs rose more rapidly.

The deceleration in compensation costs over the second half of 1990 was evident both in wages and salaries and in benefits. Wage and salary inflation has come down markedly since June, and stood at 3.1 percent (at an annual rate) in the September-to-December period. Benefits costs continued to outpace wages in the fourth quarter, owing in large part to health insurance costs; however, benefits costs also increased more slowly than earlier in the year (which saw a boost in contributions for social insurance).

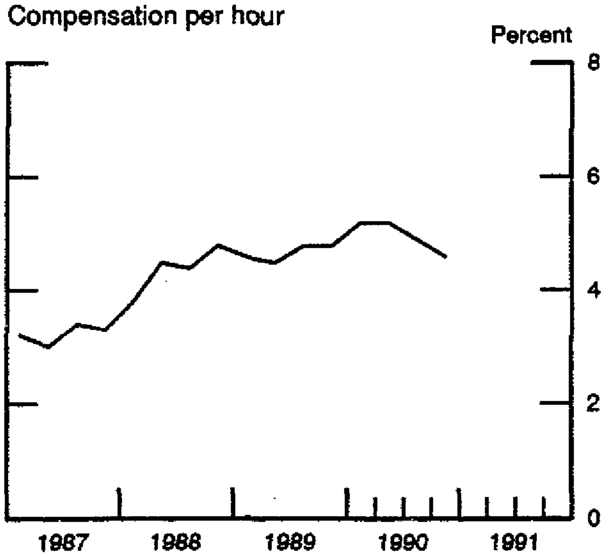
By industry, the goods-producing and service-producing sectors registered similar increases in compensation costs in the fourth quarter, but this masks large differences at the more disaggregated industry level. In particular, compensation costs in construction decelerated to 1.5 percent in the fourth quarter, apparently reflecting the weakness in activity in that industry. Compensation costs in manufacturing also decelerated. In the service-producing sector, compensation gains in services and in transportation and public utilities picked up a bit, while gains in wholesale trade remained low, and gains in finance, insurance, and real

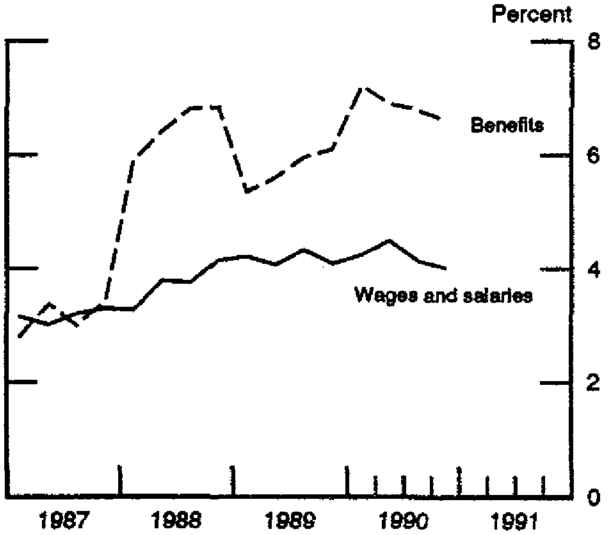
EMPLOYMENT COST INDEX
(Percent change from preceding period at compound annual rates; based on seasonally adjusted data)[1]

	1988	1989	1990	1990 March	1990 June	1990 Sep.	1990 Dec.
Total compensation costs:							
Private industry workers	4.8	4.8	4.6	5.6	5.1	4.3	3.8
Excluding sales workers	4.6	4.5	4.9	n.a	n.a.	n.a.	n.a.
By industry:							
Goods-producing	4.4	4.3	4.8	6.0	5.1	4.3	3.8
Service-producing	5.1	5.1	4.6	5.2	5.1	4.3	3.8
By occupation:							
White-collar	5.0	5.2	4.9	6.8	5.5	4.6	2.7
Blue-collar	4.5	4.1	4.4	5.2	4.7	3.9	3.8
Service workers	5.3	4.4	4.7	4.8	5.1	3.5	5.0
By bargaining status:							
Union	3.9	3.7	4.3	6.0	3.1	3.9	4.3
Nonunion	5.1	5.1	4.8	6.8	5.5	4.2	2.7
Memo:							
Wages and salaries	4.1	4.1	4.0	4.4	4.3	3.9	3.1
Benefits	6.9	6.1	6.6	8.0	6.2	6.5	5.7

1. Changes are from final month of preceding period to final month of period indicated. Percent changes are seasonally adjusted by the BLS.

Employment Cost Index
(Private industry workers; twelve-month percent change)





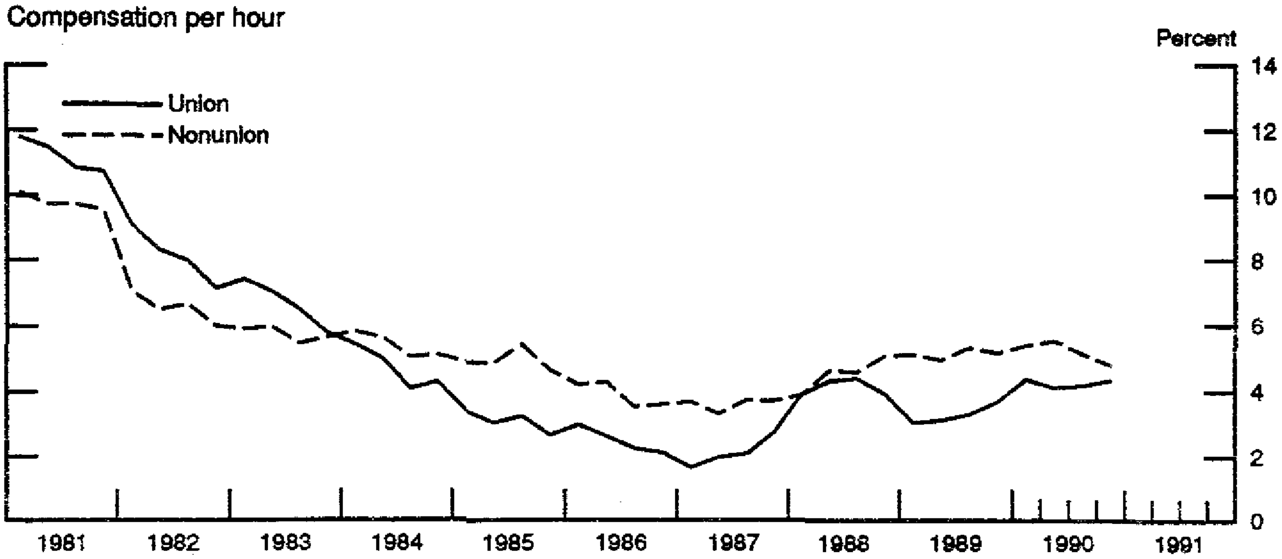
estate plummeted. The slow compensation gains in these last two industries owe largely to a sharp deceleration in the earnings of sales workers. In fact, weakness in earnings of sales workers in a variety of industries contributed importantly to the slowdown in the ECI in this past year. While compensation costs as a whole decelerated slightly between 1989 and 1990, compensation costs for workers other than sales workers increased slightly.

By occupation, the recent deceleration in compensation costs was particularly large for white-collar workers; in the fourth quarter, compensation gains for white-collar occupations were smaller than gains for blue-collar occupations. For the year as a whole, however, compensation increased 1/2 percentage point faster in white-collar occupations than in blue-collar occupations. Similarly, by bargaining status, the recent deceleration comes from non-union workers only; the ECI for workers in the unionized sector has not slowed in recent months.

Separate data on major collective bargaining agreements indicate that wage adjustments in new union contracts last year were about the same as in 1989. First-year wage adjustments averaged 4 percent in both years (excluding lump-sum payments and COLAs). When the parties that bargained in 1990 last negotiated--two or three years ago--first-year wage adjustments averaged 2.3 percent. The distribution of first-year wage adjustments in 1990 was more tightly concentrated around the mean of 4 percent than in 1989. Last year, 85 percent of the settlements had first-year increases between 0 and 6 percent, up from 73 percent in 1989. Continuing the trend of recent years, only 4 percent of the agreements in 1990 called for wage cuts or no wage change in the first year, down sharply from the figure of about 30 percent when these parties last negotiated.

Employment Cost Index

(Private industry workers; twelve-month percent change)



NEGOTIATED WAGE RATE CHANGES
UNDER MAJOR COLLECTIVE BARGAINING SETTLEMENTS[1]
(Percent change)

	1987	1988	1989	Same parties under prior settlements	1990
All industries					
First-year adjustments	2.2	2.5	4.0	2.3	4.0
Average over life of contract	2.1	2.4	3.3	2.0	3.2
Workers affected (in thousands)	2037	1799	1847	--	2004

1. Contracts covering 1,000 or more workers; estimates exclude lump-sum payments and potential gains under cost-of-living clauses.

SIZE DISTRIBUTION OF FIRST-YEAR WAGE RATE ADJUSTMENTS IN
MAJOR COLLECTIVE BARGAINING SETTLEMENTS
(Percent)

	1986	1987	1988	1989	1990
Decreases	9	4	2	1	0
No wage change	21	23	20	8	4
0 to 4 percent	51	50	51	45	58
4 to 6 percent	14	17	24	28	27
6 percent and over	4	5	4	18	8
Mean adjustment	1.2	2.2	2.5	4.0	4.0

Although private employers are under no legal obligation to continue pay or benefits to reservists called up for active duty, one private survey indicates that more than half of employers will continue some salary payments, generally making up the difference between workers' military and private salaries. This practice will tend to raise unit labor costs. However, to date, the effect has been small--probably raising the level of labor costs at most 0.1 percentage point over the period of the call-up.

Prices

Inflation slowed toward the end of last year as prices eased for energy and food. The CPI rose 0.3 percent in both November and December, and the PPI for finished goods declined 0.6 percent in December, more than retracing its November increase. Over the twelve months of 1990, these measures rose about 6 percent and 5-1/2 percent, respectively, the largest increases registered since 1981, mainly because of the surge in energy prices.

The CPI for energy fell 0.4 percent in December, the first monthly decline since the beginning of the Persian Gulf crisis. With the retreat in crude oil prices, the retail price of fuel oil fell about 3-1/2 percent. However, the decline in gasoline prices was only 0.3 percent in December because of an offsetting 5 cents per gallon increase in the federal excise tax. Even with the downturn in December, prices of both fuels remained 30 percent or more above their levels at the end of 1989. In contrast, the prices of electricity and natural gas were up less than 2 percent over the year.

Survey data suggest that retail prices of petroleum products declined further through late January. Spot and posted prices of crude oil have moved wildly since December, both before and after the outbreak of war.

DAILY SPOT AND POSTED PRICES OF WEST TEXAS INTERMEDIATE

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

MONTHLY AVERAGE PRICES--WEST TEXAS INTERMEDIATE

Month	Posted	Spot
February	21.27	22.12
March	20.08	20.42
April	17.77	18.58
May	17.55	18.24
June	16.15	16.87
July	17.23	18.64
August	24.99	27.17
September	31.10	33.69
October	34.82	35.92
November	31.32	32.30
December	26.32	27.34
January *	24.09	25.33

* Price through January 29, 1991.

This month, through January 29, posted prices of West Texas Intermediate crude oil have averaged about $24 per barrel, and spot prices have averaged a bit above $25, approximately $2 below their December levels (chart). With the decline in crude oil prices, margins for petroleum products have widened in recent weeks to a relatively high level. Further discussion of recent events in oil markets is provided in the International Developments section.

Food prices edged up only 0.1 percent in the December CPI, as large declines for fresh vegetables and dairy products about offset increases for meats, fresh fruits, and other foods. However, over 1990 as a whole, the CPI for food rose 5.3 percent, similar to the increases posted in 1988 and 1989. The January index is likely to be boosted by higher prices for citrus fruit and some vegetable crops because of the crop losses sustained during the December freeze in California. By contrast, increases in dairy production have been pushing milk prices down sharply at the farm level, and the passthrough of these declines seems likely to carry over into 1991. In addition, this past year's plunge in wheat prices has led to a slowing of the price trend for cereals and bakery products. Meat prices continued to rise rapidly in the fourth quarter, as supplies remained below the levels of a year earlier; however, steer prices have dropped back in January, and futures prices for steers currently point to further declines in the months ahead.

Apart from food and energy, the CPI rose 0.3 percent in November, 0.4 percent in December, and 5.2 percent for 1990, as compared with annual increases of 4-1/4 to 4-3/4 percent for the preceding three years. Prices of nonfood, nonenergy commodities, which were unchanged in November, advanced 0.4 percent in December, boosted by a sharp increase for tobacco

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

	Relative importance Dec. 1989	1989	1990	1990 Q2	1990 Q3	1990 Q4	1990 Nov.	1990 Dec.
				------Annual rate-----			-Monthly rate-	
All items[2]	100.0	4.6	6.1	3.5	7.9	4.9	.3	.3
Food	16.3	5.6	5.3	2.1	3.7	4.3	.5	.1
Energy	7.4	5.1	18.1	-2.0	42.7	20.3	.5	-.4
All items less food and energy	76.3	4.4	5.2	3.9	5.7	3.8	.3	.4
Commodities	25.2	2.7	3.4	.7	2.9	2.3	.0	.4
Services	51.1	5.3	6.0	5.5	7.2	4.5	.4	.3
Memorandum:								
CPI-W[3]	100.0	4.5	6.1	3.2	8.0	5.0	.2	.3

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. 1989	1989	1990	1990 Q2	1990 Q3	1990 Q4	1990 Nov.	1990 Dec.
				------Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.9	5.6	.3	11.7	4.0	.5	-.6
Consumer foods	25.9	5.2	2.5	-3.8	.6	3.3	.8	-.9
Consumer energy	9.2	9.5	29.8	-14.3	137.4	12.2	.1	-4.8
Other finished goods	64.9	4.2	3.5	4.2	3.2	3.2	.5	.3
Consumer goods	39.5	4.4	3.6	5.4	2.2	3.4	.6	.2
Capital equipment	25.4	3.8	3.4	2.3	5.3	1.9	.2	.4
Intermediate materials[2]	94.9	2.5	4.6	-.4	13.4	3.1	.2	-1.0
Excluding food and energy	82.5	.9	1.9	.7	4.0	2.0	.2	-.2
Crude food materials	41.9	2.8	-3.6	-10.2	-7.9	-2.9	-1.7	-.1
Crude energy	40.5	17.9	18.6	-39.2	296.0	-18.2	-10.3	-10.7
Other crude materials	17.5	-3.6	.4	13.2	8.7	-20.9	-2.3	-1.8

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

products. Despite numerous reports of holiday season discounting by retailers, the discounts appear, on average, to have been about in line with seasonal norms and thus had little effect on the December CPI. In January, higher federal excise taxes on alcoholic beverages, tobacco products, and luxury items are expected to add an extra 0.1 percentage point to the total CPI.

The CPI for nonenergy services advanced 0.3 percent in December. The December rise included further large increases for airfares, reflecting the continued passthrough of earlier rises in fuel costs. During 1990, the prices of nonenergy services rose 6 percent, 3/4 percentage point more than in the preceding year; airfares were responsible for about half of this acceleration, rising 23 percent. The acceleration also reflected a pick-up in inflation for medical services, lodging away from home, and a variety of other services. Despite the sharp increase in owners' equivalent rent over the first half of 1990, this component of the CPI did not accelerate over the year as a whole; the 4.8 percent rise over 1990 compares with a 5.1 percent increase over 1989.

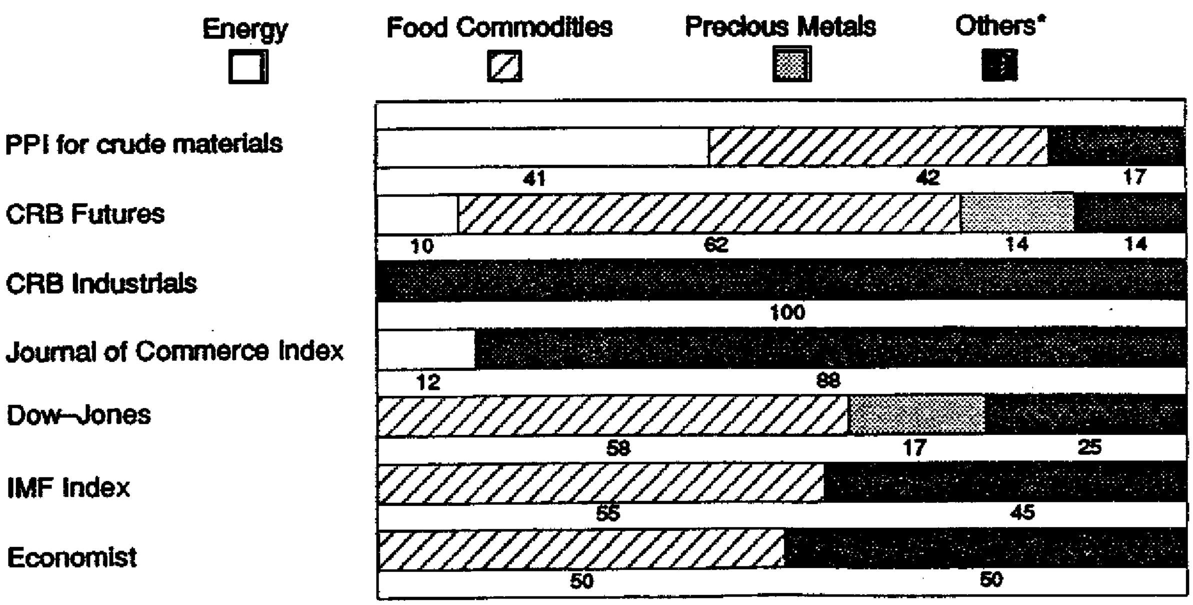
At earlier stages of processing, the PPI for intermediate materials less food and energy edged down 0.2 percent in December, as declines for nonferrous metals and industrial chemicals more than offset increases for other materials. However, prices rose sharply further for some petroleum-related materials, such as plastic resins and materials. Prices of crude nonfood materials less energy fell 1-3/4 percent, mainly reflecting declines--for the third consecutive month--in prices of metal scrap and ores. This index was little changed, on net, over the past year.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1988	1989	1990	Dec. 11[3] to date	Memo: Year earlier to date
1. PPI for crude materials[4]	Dec.	3.1	7.1	6.0	n.a.	6.0
1a. Foods and feeds	Dec.	14.2	2.8	-3.6	n.a.	-3.6
1b. Energy	Dec.	-9.5	17.9	18.6	n.a.	18.6
1c. Excluding food and energy	Dec.	7.5	-3.6	.4	n.a.	.4
1d. Excluding food and energy, seasonally adjusted	Dec.	7.6	-3.6	.3	n.a.	.3
2. Commodity Research Bureau						
2a. Futures prices	Jan. 29	8.5	-9.0	-2.7	-3.1	-6.4
2b. Industrial spot prices	Jan. 28	7.3	-5.9	.6	-2.4	-2.3
3. Journal of Commerce industrials	Jan. 29	3.8	1.3	-2.4	-2.5	-5.5
3a. Metals	Jan. 29	11.0	-7.2	-3.9	-1.7	-1.9
4. Dow-Jones Spot	Jan. 29	6.9	-10.1	-1.7	-1.1	-3.8
5. IMF commodity index[4]	Dec.	12.6	-12.9	-5.6	n.a.	-5.6
5a. Metals	Dec.	33.7	-23.4	-3.0	n.a.	-3.0
5b. Nonfood agric.	Dec.	-9.4	-4.6	-3.5	n.a.	-3.5
6. Economist (U.S. dollar index)	Jan. 22	17.7	-22.8	-4.4	-2.5	-4.2
6a. Industrials	Jan. 22	18.9	-23.8	-3.2	-1.1	-.3

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

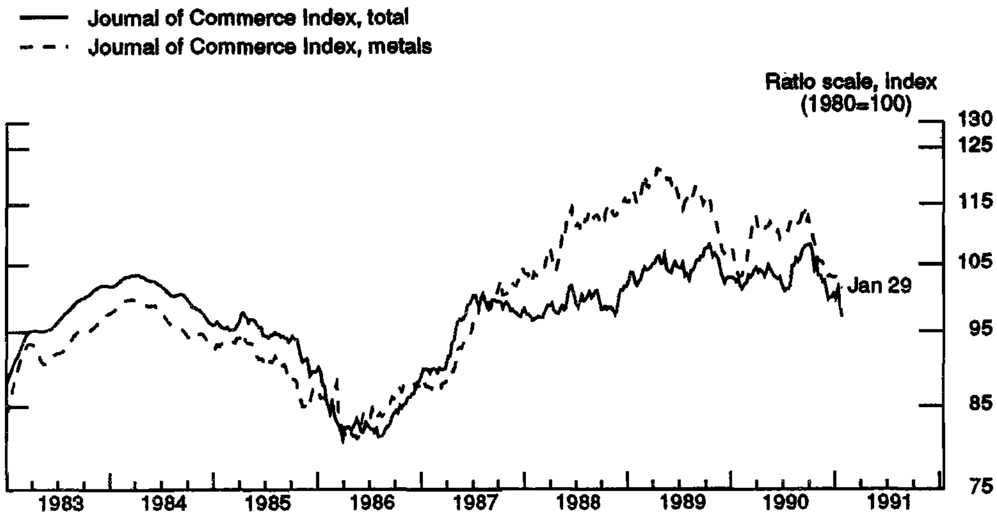
Index Weights

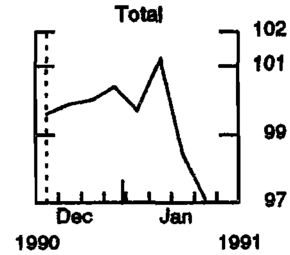


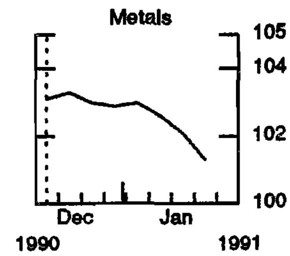
*Forest products, industrial metals, and other industrial materials.

In spot markets for industrial materials, prices recently have weakened further for copper, lead, and zinc. Since the week of the December Greenbook, the Journal of Commerce sub-index for metals and the CRB spot index for industrials have posted net declines of about 1-1/2 to 2-1/2 percent.

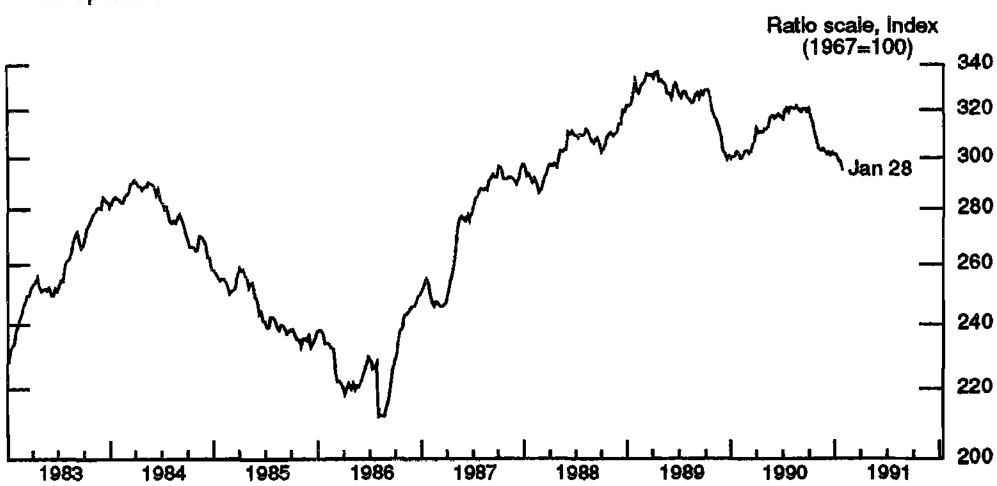
COMMODITY PRICE MEASURES *

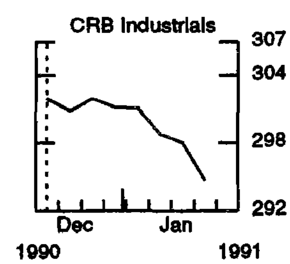




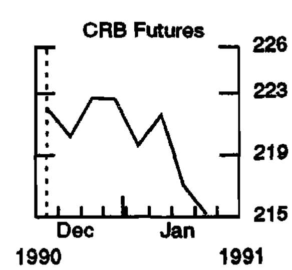


CRB Spot Industrials





CRB Futures



* Weekly data, Tuesdays; Journal of Commerce data monthly before 1985

Dotted lines indicate week of last Greenbook.

APPENDIX

NBER DATING OF THE BUSINESS CYCLE PEAK FOR 1990

The NBER Committee on Business Cycle Dating has indicated that a recession began sometime during the summer or early fall of 1990. This appendix examines recent data on economic activity in order to narrow the range of dates that the NBER might select as the latest business cycle peak.

To determine the dates of business cycle turning points, the NBER committee examines the co-movements of a large number of macroeconomic series. The turning points of these individual series tend to be clustered together, and the month in which the central tendency of this cluster falls is designated by the NBER as the general business cycle turning point. Previous applications of the NBER methodology indicate the macroeconomic series that are especially important in determining cyclical timing.[1] These series are listed in table 1, along with a chronology of their recent individual cyclical peaks. In the past, a few of these series have experienced small but fairly regular deviations from coincident timing that should be taken into account. In particular, the inverted unemployment rate and number of unemployed (both of which peaked in March 1989) tend to lead at business cycle peaks because employment typically rises more slowly than the labor force in the late stages of expansion. Similarly, employee hours often lead at peaks by a short interval, a tendency that reflects the much longer and more systematic lead in the average workweek. Apart from these series, turning points for most series are grouped in a fairly tight "clustering zone" running from June through September, with employment peaking first, in the early summer, followed by income, sales, and production.[2]

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1. For example, see Victor Zarnowitz and Geoffrey H. Moore, "The Recession and Recovery of 1973-1976," Explorations in Economic Research, vol. 4 (Fall 1977), pp. 471-557; and Victor Zarnowitz and Geoffrey H. Moore, "The Timing and Severity of the 1980 Recession," in Geoffrey H. Moore, ed., Business Cycles, Inflation, and Forecasting, 2d ed. (Cambridge, Mass.: Ballinger, 1983), pp. 11-17. In contrast to popular belief, the NBER's criterion for declaring a recession has never been the occurrence of two consecutive quarterly declines in real GNP.

2. The NBER committee focuses on the broadest measures of economic activity; it has taken into account the effects of the temporary federal Census hiring but has not necessarily excluded these effects from its analysis. In any case, excluding the income generated by the temporary Census employment (which peaked in June 1990 according to BEA estimates), fails to change the dates of the peaks of any of the personal income measures. Excluding Census employment (which peaked in May 1990) does change the cyclical peaks in the employment series but not in a consistent way: The peak in nonfarm payroll employment shifts from June to September, the peak in nonfarm employment from the household survey moves from March to February, and the peak in total civilian employment shifts from May to March.

Table 1

MOST RECENT CYCLICAL PEAKS FOR SIXTEEN SERIES ON AGGREGATE ACTIVITY

Year and month of peak	Series reaching peak	Number of series reaching peak
1989		
March	Number of unemployed (inverted) Civilian unemployment rate (inverted)	2
September	Retail Sales (1982 dollars)	1
1990		
March	Nonfarm civilian employment, household survey	1
May	Total civilian employment, household survey	1
June	Nonfarm employment, establishment survey[1] Nonfarm employee hours, total Index of coincident indicators	3
July	Personal income (1982 dollars) Personal income less transfer payments (1982 dollars)[1] Disposable personal income (1982 dollars)	3
August	Manufacturing and trade sales (1982 dollars)[1] GNP (1982 dollars) (quarterly)[2] Final sales (1982 dollars) (quarterly)[2]	3
September	Industrial production, total[1] Personal consumption expenditures (1982 dollars)	2

1. A component of the BEA's composite index of coincident indicators.
2. Following NBER convention, the monthly date for a peak in a quarterly series is generally identified with the middle of the peak quarter.

According to the NBER methodology, the cluster of individual series peaks in table 1 narrows the choice of the date of the 1990 business cycle peak to either July or August. June appears to be too early, as three of the components of the BEA's composite index of coincident indi‹ators turned down in later months. Furthermore, a June peak would be difficult, although not impossible, to reconcile with the increase in real GNP in the third quarter.[3] September 1990 appears to be too late, as almost all of the monthly series peaked earlier.

The choice between July and August requires an examination of the magnitudes of movements in the data. In table 1, relatively flat peaks, which may be consistent with closely neighboring dates, are not distinguished from relatively sharp peaks. In addition, a look at the size of the movements in the monthly data avoids reliance on peaks that may be misdated because of spurious volatility in the series.

Table 2 examines the monthly movements in the composite coincident index and its four components between April and November 1990. The level of each series is shown along with its three-month centered moving average, which smooths through some of the volatility but has little effect on timing. Individual series peaks are shown in boldface type. The cluster of individual turning points for the smoothed series is in July (table 2, last row). Indeed, most of the percentage changes in table 2 are positive or zero through July and are almost uniformly negative from August onward. Thus, although August cannot be ruled out, July is the more likely date of the business cycle peak in 1990, assuming that the NBER ‹ ommittee follows its past procedures. However, the flatness that characterizes the peaks of most of the series makes the choice of the overall cyclical peak more sensitive to data revisions than would be the case if the individual peaks were sharper.

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3. Geoffrey H. Moore, a member of the NBER dating committee, has expressed some preference for June as a cyclical peak, a selection that appears to apply a large weight to the labor market data.

Table 2

RECENT DATA FOR THE COINCIDENT INDEX AND ITS COMPONENTS, 1990[1]

Item	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.
Coincident index (1982=100)								
Unsmoothed series	133.7	134.4	**134.9**	134.6	134.4	133.3	131.9	130.3
Percentage change	-.4	.5	.4	-.2	-.1	-.8	-1.1	-1.2
Smoothed series	134.1	134.3	134.6	**134.6**	134.1	133.2	131.8	130.8
Percentage change	.1	.2	.2	.0	-.4	-.7	-1.0	-.8
Employees on nonfarm payrolls (millions)								
Unsmoothed series	100.18	110.62	**110.83**	110.74	110.61	110.61	110.43	110.17
Percentage change	.0	.4	.2	-.1	-.1	.0	-.2	-.2
Smoothed series	110.31	110.54	110.73	**110.73**	110.66	110.55	110.41	110.23
Percentage change	.2	.2	.2	.0	-.1	-.1	-.1	-.2
Personal income less transfer payments (annual rate, billions of 1982 dollars)								
Unsmoothed series	2908.8	2909.2	2912.5	**2919.6**	2906.6	2896.1	2867.8	2869.6
Percentage change	.1	.0	.1	.2	-.4	-.4	-1.0	.1
Smoothed series	2908.0	2910.2	**2913.8**	2912.9	2907.4	2890.5	2877.8	2874.2
Percentage change	.1	.1	.1	.0	-.2	-.6	-.4	-.1
Industrial production (1987=100)								
Unsmoothed series	108.83	109.40	110.07	110.40	110.46	**110.60**	109.78	107.76
Percentage change	-.1	.5	.6	.3	.1	.1	-.7	-1.8
Smoothed series	109.05	109.43	109.96	110.31	**110.48**	110.28	109.38	108.22
Percentage change	.3	.3	.5	.3	.2	-.2	-.8	-1.1
Manufacturing and trade sales (billions 1982 dollars)								
Unsmoothed series	477.90	482.40	485.39	482.36	**488.05**	479.11	478.22	471.76
Percentage change	-.9	.9	.6	-.6	1.2	-1.8	-.2	-1.3
Smoothed series	480.92	481.90	483.38	**485.27**	483.17	481.87	476.36	n.a.
Percentage change	.2	.2	.3	.4	-.4	-.3	-1.1	n.a.
Memo								
Number of smoothed series reaching peaks	0	0	1	3	1	0	0	0

1. Peaks are shown in boldface type. The smoothed series are three-month centered moving averages. Percentage change from the preceding month.

DOMESTIC FINANCIAL DEVELOPMENTS

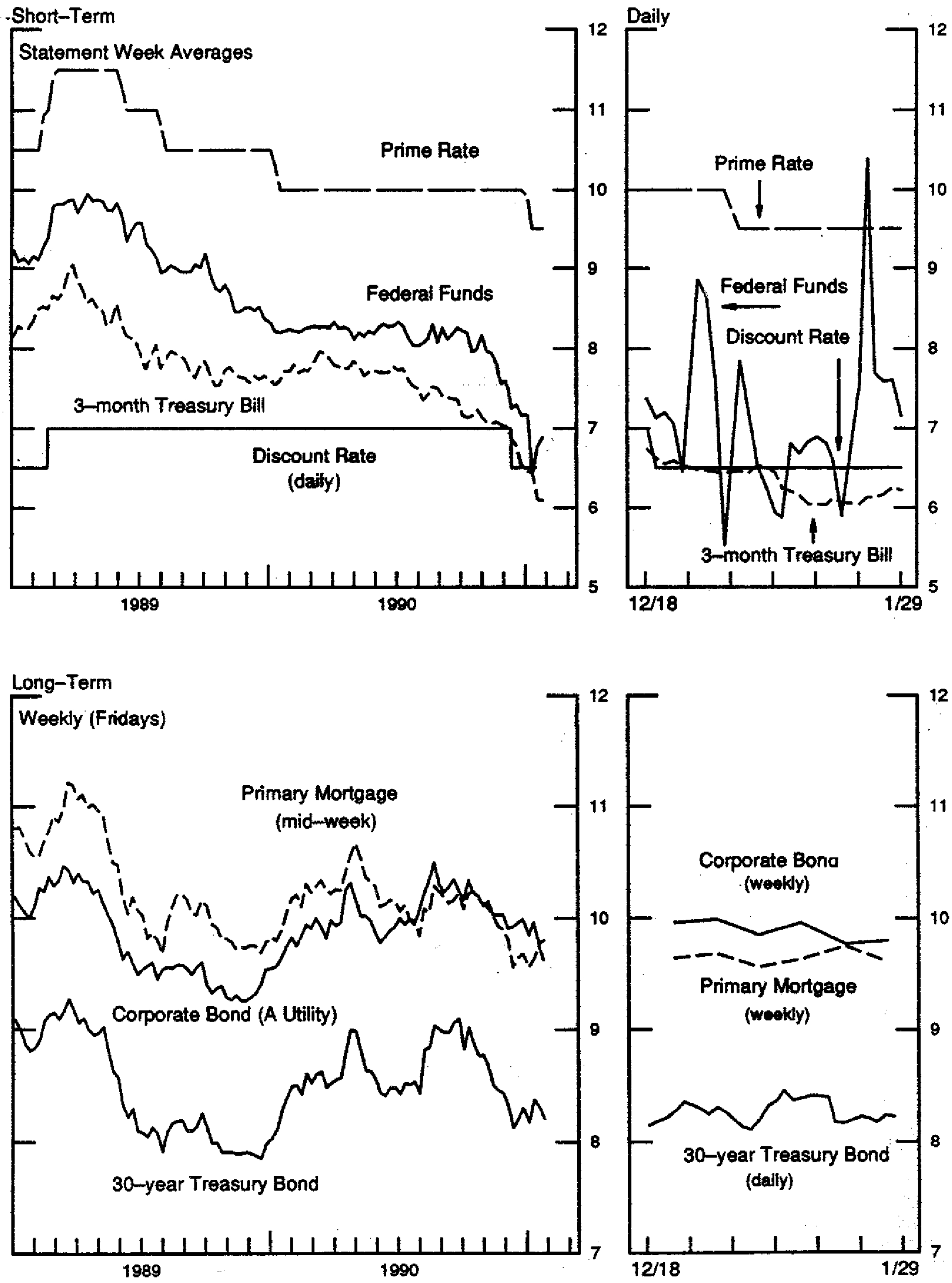
SELECTED FINANCIAL MARKET QUOTATIONS
(percent)

	1989		1990		1991	Change from:		
	March highs	Dec lows	Aug highs	FOMC Dec 18	Jan 29	Dec 89 lows	Aug 90 highs	FOMC Dec 18
Short-term rates								
Federal funds[2]	9.85	8.45	8.21	7.43	7.54	-.91	-.67	.11
Treasury bills[3]								
3-month	9.09	7.53	7.59	6.73	6.22	-1.31	-1.37	-.51
6-month	9.11	7.29	7.51	6.72	6.26	-1.03	-1.25	-.46
1-year	9.05	7.11	7.45	6.58	6.20	-.91	-1.25	-.38
Commercial paper								
1-month	10.05	8.51	8.10	8.28	6.96	-1.55	-1.14	-1.32
3-month	10.15	8.22	8.05	7.79	6.96	-1.26	-1.09	-.83
Large negotiable CDs[3]								
1-month	10.07	8.52	8.14	8.26	6.85	-1.67	-1.29	-1.41
3-month	10.32	8.22	8.18	7.86	6.95	-1.27	-1.23	-.91
6-month	10.08	8.01	8.25	7.60	6.98	-1.03	-1.27	-.62
Eurodollar deposits[4]								
1-month	10.19	8.38	8.13	8.38	6.88	-1.50	-1.25	-1.50
3-month	10.50	8.25	8.19	7.94	7.06	-1.19	-1.13	-.88
Bank prime rate	11.50	10.50	10.00	10.00	9.50	-1.00	-.50	-.50
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	9.88	7.69	8.50	7.28	7.35	-.34	-1.15	.07
10-year	9.53	7.77	9.05	7.99	8.05	.28	-1.00	.06
30-year	9.31	7.83	9.17	8.15	8.20	.37	-.97	.05
Municipal revenue[5] (Bond Buyer)	7.95	7.28	7.80	7.28	7.31	.03	-.49	.03
Corporate--A utility recently offered	10.47	9.29	10.50	9.89	9.78	.49	-.72	-.11
Home mortgage rates[6]								
S&L fixed-rate	11.22	9.69	10.29	9.56	9.61	-.08	-.68	.05
S&L ARM, 1-yr.	9.31	8.34	8.39	7.91	7.69	-.65	-.70	-.22

			1989	1990	1991	Percent change from:		
	Record highs	Date	Lows Jan 3	FOMC Dec 18	Jan 29	Record highs	1989 lows	FOMC Dec 18
Stock prices								
Dow-Jones Industrial	2999.75	7/16/90	2144.64	2626.73	2662.62	-11.24	24.15	1.37
NYSE Composite	201.13	7/16/90	154.98	180.19	183.37	-8.83	18.32	1.76
AMEX Composite	397.03	10/10/89	305.24	305.03	310.57	-21.78	1.75	1.82
NASDAQ (OTC)	485.73	10/9/89	378.56	370.17	400.61	-17.52	5.82	8.22
Wilshire	3523.47	10/9/89	2718.59	3089.85	3167.31	-10.11	16.51	2.51

1/ One-day quotes except as noted.
2/ Average for two-week reserve maintenance period closest to date shown. Last observation is average to date for the maintenance period ending February 6, 1991.
3/ Secondary market.
4/ Bid rates for Eurodollar deposits at 11 a.m. London time.
5/ Based on one-day Thursday quotes and futures market index changes.
6/ Quotes for week ending Friday closest to date shown.

Selected Interest Rates*
(percent)



*—Friday weeks through January 25, Wednesday weeks through January 23.

Financial markets were buffeted during the intermeeting period by year-end pressures and by the prospect and reality of war in the Persian Gulf. On balance, however, long-term interest rates are little changed and stock prices are up slightly. Yields on Treasury bills have fallen about 1/2 percentage point, in line with easing steps by the System. Other private market rates, especially very short-term, fell more than Treasuries as year-end effects unwound. These year-end pressures, shortfalls in reserve availability at the ends of maintenance periods, and the effects of reductions in required-reserve balances have contributed to unusually erratic movements in the federal funds rate.

Evidence of financial stress continues to mount. Defaults on low-rated bonds, debt downgrades, and adverse dividend actions in 1990 were at their highest levels in twenty years; deterioration was most acute at financial institutions and below-investment-grade nonfinancial corporations. Downgradings of municipal credits also rose markedly. Concerns about the health of depositories probably were heightened recently by the closing of privately insured depositories in Rhode Island, the takeover of the Bank of New England, reports by several banks of sharply lower earnings in the fourth quarter, and continuing discussion of the FDIC's solvency.

Borrowing by nonfinancial businesses in both long- and short-term categories has remained light in recent months. In municipal markets, issuance of long-term debt has fallen sharply after a December pickup. Available data on the household sector suggest that mortgage borrowing and consumer credit have stayed subdued.

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

	1990[1]	1990 Q3	1990 Q4	1990 Nov	1990 Dec	1991 Jan pe	Growth Q4 90- Jan 91pe
	------------Percent change at annual rates						
1. M1	4.2	3.7	3.4	3.1	2.9	1	2
2. M2	3.9	2.9	2.3	0.3	1.7	2	1½
3. M3	1.7	1.5	1.1	0.2	0.3	4	2
	------------Percent change at annual rates						Levels bil. $ Dec 90
Selected components							
4. M1-A	4.6	6.0	4.8	2.3	2.5	2	531.5
5. Currency	10.9	11.2	10.9	4.9	6.9	24	246.3
6. Demand deposits	-0.7	1.3	-0.9	0.0	-1.3	-17	276.8
7. Other checkable deposits	3.5	-0.3	0.7	4.5	3.7	0	293.8
8. M2 minus M1[2]	3.8	2.6	1.9	-0.6	1.3	2	2505.2
9. Overnight RPs and Eurodollars, NSA	2.8	5.9	-22.2	-86.2	-60.4	-16	73.6
10. General purpose and broker/dealer money market mutual fund shares	11.4	9.9	11.2	4.6	16.4	28	347.7
11. Commercial banks	10.0	11.4	7.9	2.7	11.2	6	1176.0
12. Savings deposits plus MMDAs[3]	7.5	7.4	4.0	2.5	4.4	4	577.6
13. Small time deposits	12.4	15.5	11.7	2.9	17.9	9	598.4
14. Thrift institutions	-5.4	-9.0	-7.5	-2.5	-12.8	-7	906.0
15. Savings deposits plus MMDAs[3]	-2.2	-4.9	-7.4	-5.6	-11.9	-5	338.9
16. Small time deposits	-7.2	-11.4	-7.6	-0.4	-13.6	-8	567.1
17. M3 minus M2[4]	-6.4	-4.0	-3.6	-0.3	-6.1	11	781.4
18. Large time deposits	-9.7	-8.9	-14.0	-10.0	-14.6	10	504.6
19. At commercial banks, net[5]	-3.9	-2.3	-9.7	-3.4	-6.5	23	383.7
20. At thrift institutions	-23.9	-27.3	-26.6	-30.0	-39.4	-29	120.9
21. Institution-only money market mutual fund shares	20.2	21.6	30.4	9.0	51.8	41	125.7
22. Term RPs, NSA	-12.7	0.8	-28.8	-5.0	-75.9	-23	88.8
23. Term Eurodollars, NSA	-10.0	12.2	27.2	27.0	3.3	-41	72.9
	-----Average monthly change in billions of dollars----						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	-0.1	0.8	-2.1	-0.4	-9.8	-4	718.8
25. Large time deposits, gross	-2.5	-2.6	-3.7	-2.5	-3.2	7	432.5
26. Nondeposit funds	2.4	3.4	1.6	2.1	-6.6	-11	286.3
27. Net due to related foreign institutions	2.2	1.5	4.6	0.2	4.7	0	33.3
28. Other[7]	0.3	2.0	-3.0	1.9	-11.3	-11	253.0
29. U.S. government deposits at commercial banks[8]	0.3	1.8	-0.5	2.9	-0.8	1	24.4

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 December and January at rates of 7.3 percent and 13 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during December and January at rates of -8.5 percent and -6 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.
pe - preliminary estimate

Growth in the monetary aggregates has remained sluggish. M2 has advanced at only an estimated 2 percent annual rate this month, with the increase accounted for by strong growth in money funds and currency. Weakness in retail deposits has been particularly notable in the Boston District, perhaps reflecting public concerns about asset-quality troubles in those banks as well as the soft economy in the Northeast. Paced by rapid growth in large time deposits, M3 increased at a 4 percent rate; however, this growth did not seem to be associated with a pickup in depository credit.

Monetary Aggregates and Bank Credit[1]

The weakness in M2 this month reflects in part a decline in transactions accounts; OCDs have been flat, and demand deposits dropped at a 17 percent rate. A falloff in demand deposits has occurred in January for several years; a new seasonal pattern appears to be evolving related to the increasing dominance of transactions motives relative to compensating balances in corporate demand deposits and may be behind the pronounced January decline.[2] Meanwhile, retail nontransaction deposits are little changed for the month, despite further declines in their opportunity costs. Led by runoffs at the Bank of New England, the weakness in core deposits is especially marked in the Boston District (chart). Weakness in retail deposits continues to be accompanied by large purchases of Treasury securities, as indicated by substantial noncompetitive tenders, and

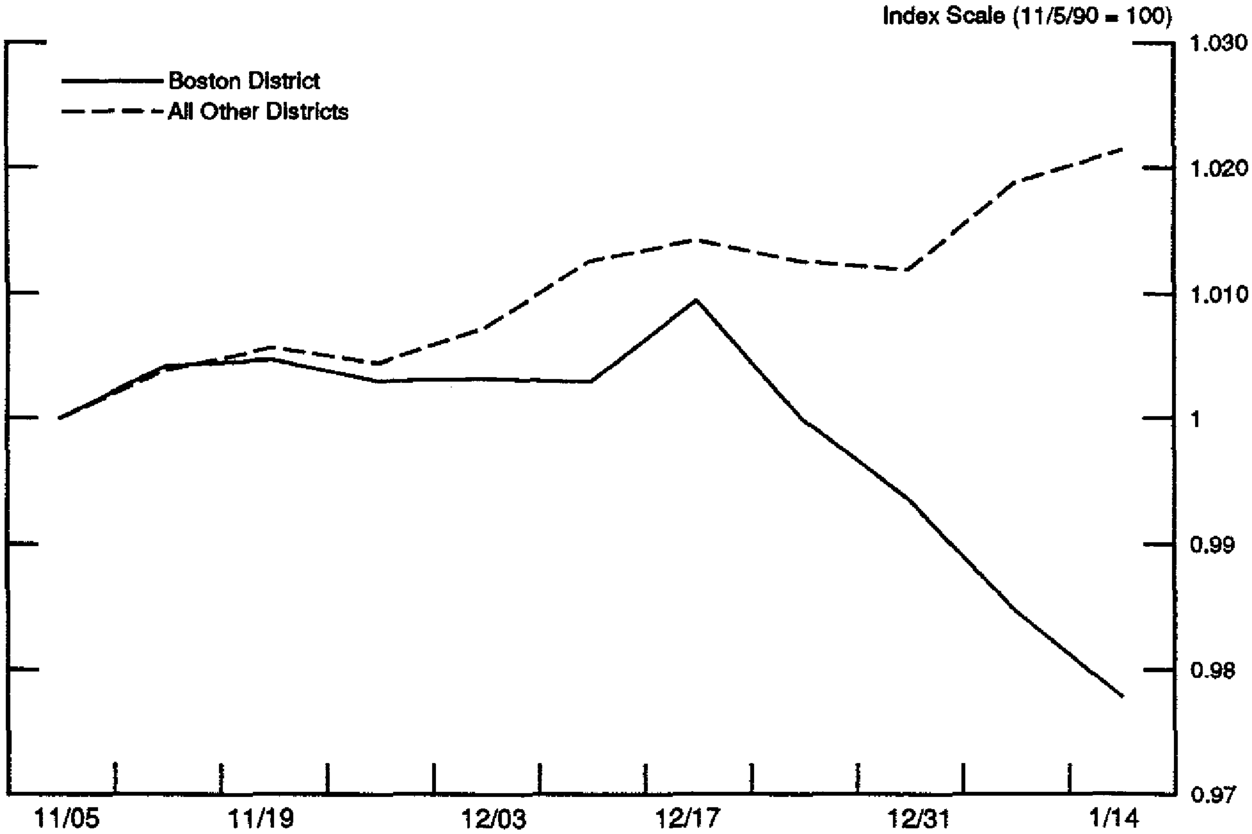
1. The monetary data in this document incorporate benchmarks and updates to seasonal adjustment factors that will not be made public until February 7, 1991.

2. Evolving seasonal factors have tended to damp the declines, but apparently are lagging behind the actual change in seasonal patterns, leaving negative January growth rates for demand deposits in five of the last six years.

according to industry sources, efforts by households to pay down revolving-credit balances.

Partially countering the weakness in other components of M2 has been a surge in money market mutual funds and currency. Inflows to money market funds probably are attributable to a widening in the spread between money fund yields and market interest rates, but concerns about the health of the banking system also may be playing a role. The war in the Middle East apparently contributed to an increased demand for U.S. currency abroad and helped boost its growth to a 24 percent rate in January.

Levels of Bank Core Deposits* at Large Commercial Banks
(weekly averages, n.s.a)



* Core Deposits = Savings + MMDAs + Small Time

The modest show of strength in M3 in January owes primarily to a rebound in large time deposits, which grew at an estimated 10 percent rate after declining steadily over the last half of 1990. Rather than reflecting any strengthening of demands for bank credit, however, the pickup in M3 growth owed to a shift in funding patterns away from nondeposit sources, particularly borrowing from foreign offices.

Bank credit rose at a 2-1/2 percent annual rate in December, but partial data for January show it declining this month. Holdings of government securities fell at an 11-1/2 percent rate last month with banks apparently running off investments to trim their balance sheets and to realize capital gains before year-end. Total loan growth strengthened slightly in December, with the increases recorded in real estate and consumer loans. However, all of the gain in real estate loans was associated with acquisitions by commercial banks of thrift assets rather than new lending. The pickup in growth of consumer loans resulted, in part, from a slowdown in securitization, as the higher rate spreads required by the market on asset-backed securities around year-end led several banks to postpone issuance. In January, consumer and real estate lending appears to have weakened. Preliminary evidence from the January Senior Loan Officer Opinion Survey of Bank Lending Practices indicates that banks tightened somewhat their lending standards both for residential mortgages and consumer loans in the October to January period.[3] The survey also found that demand for residential mortgages slackened a bit further in the last three months of 1990.

3. A summary of the January Senior Loan Officer Opinion Survey will be presented in the supplement to the Greenbook.

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM

(Percentage changes at annual rates, based on seasonally adjusted data)

	1989:Q4 to 1990:Q4	1990 Q3	1990 Q4	1990 Oct.	1990 Nov.	1990 Dec.	Levels bil.$ Dec.
	Commercial Bank Credit						
1. Total loans and securities at banks	5.2	5.8	1.6	.9	1.5	2.5	2719.8
2. Securities	8.9	6.5	-2.4	3.3	-2.5	-7.8	623.1
3. U.S. government securities	14.3	7.8	.2	11.8	.3	-11.4	447.7
4. Other securities	-2.9	3.1	-8.7	-18.1	-9.5	1.4	175.4
5. Total loans	4.1	5.6	2.8	.3	2.7	5.6	2096.7
6. Business loans	2.1	.9	2.3	-2.6	5.5	3.9	654.5
7. Real estate loans	9.0	6.4	6.9	8.1	5.1	7.4	829.2
8. Consumer loans	2.1	3.1	.6	-.3	-2.8	5.0	381.9
9. Security loans	-1.0	88.4	-16.7	-47.3	-43.5	42.1	41.3
10. Other loans	-3.0	7.7	-3.8	-11.3	3.2	-3.2	189.8
	Short- and Intermediate-Term Business Credit						
11. Business loans net of bankers acceptances	2.0	1.1	2.0	-2.6	5.4	3.4	646.5
12. Loans at foreign branches[2]	20.3	28.8	30.3	25.2	19.8	43.7	25.6
13. Sum of lines 11 & 12	2.6	2.0	3.0	-1.6	5.8	4.8	672.1
14. Commercial paper issued by nonfinancial firms	16.4	16.8	-3.2	19.0	-24.1	-4.0	150.5
15. Sum of lines 13 & 14	4.9	4.6	1.9	2.2	.1	3.2	822.6
16. Bankers acceptances: U.S. trade related[3,4]	-11.3	-27.6	18.9	12.1	44.0	.0	31.1
17. Line 15 plus bankers acceptances: U.S. trade related	4.2	3.5	2.5	2.5	1.7	3.1	853.7
18. Finance company loans to business[3]	n.a.	20.7	n.a.	10.6	4.6	n.a.	287.9[5]
19. Total short- and intermediate-term business credit (sum of lines 17 & 18)	n.a.	7.6	n.a.	4.6	2.3	n.a.	1139.3[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. November data.
p--preliminary.
n.a.--not available

C&I loan growth strengthened moderately late in November and December when some lower-rated commercial-paper issuers borrowed from banks ahead of year-end to avoid sharply higher costs in the paper market. Most of this loan growth took place at branches and agencies of foreign banks, which have been most active in the market for backup lines of credit in recent years. Business loans at commercial banks dropped back early in January, perhaps reflecting an unwinding of year-end borrowing; scattered reports suggest, however, that some banks have had success retaining these A2/P2 credits by bettering loan rates.

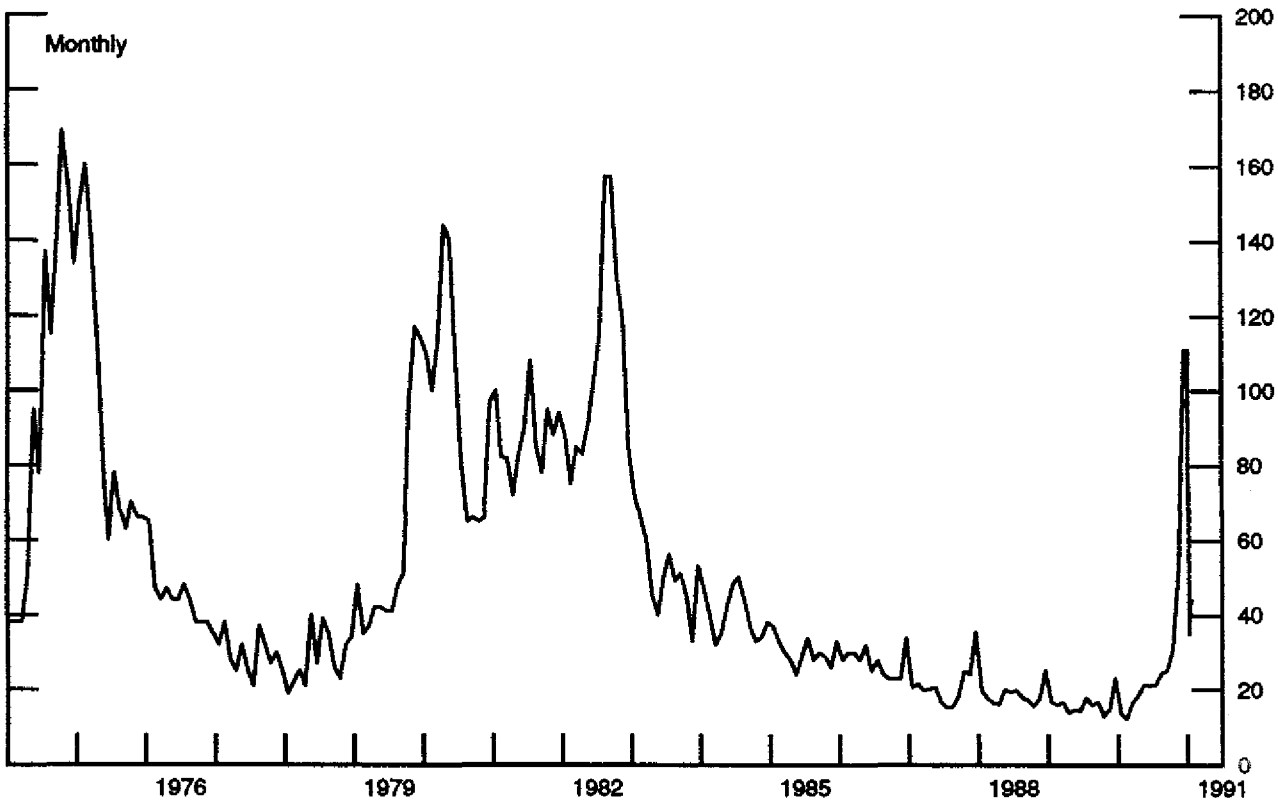
Nonfinancial Business Finance

Total borrowing by nonfinancial corporations appears to have weakened somewhat in January. Gross public bond issuance was robust in December but has fallen off in January as uncertainty increased about how interest rates would respond to events in the Gulf. Business loans likely contracted this month, and commercial paper outstanding has been flat.

Business credit at finance companies fell in November to a 4-1/2 percent annual rate from the double-digit rates recorded since summer. Virtually all of the slowdown reflected a large decline in financing of auto-dealer inventories. Contacts at finance companies suggest that aggregate demand for business credit softened recently; however, finance companies are gaining some market share relative to banks, particularly in equipment financing and working-capital lending. Most recent data on bank willingness to lend, from the January Senior Loan Officer Survey, indicated further tightening in bank lending standards for all sizes of business firms in the October to January period.

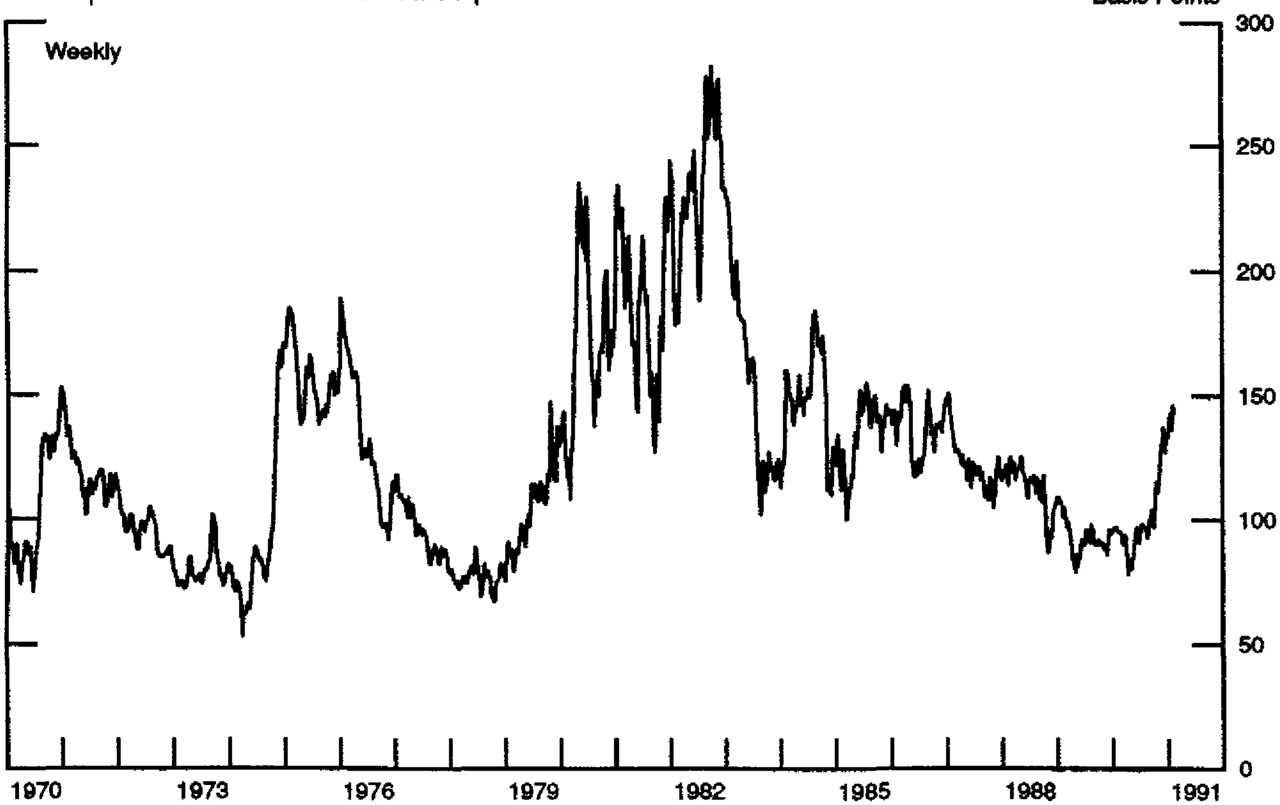
Quality Spreads

Yield Spread Between Medium and High–Grade Commercial Paper



* Medium–grade CP is rated A2/P2; High–grade CP is that issued by AAA–rated firms

Yield Spread Between Baa and Aaa Corporate Bonds



Access to nonbank intermediaries such as finance companies likely has shielded many businesses from the cutbacks in bank lending. The overall availability of credit to small businesses, as indicated by the National Federation of Independent Business' monthly survey, was little changed in December from its level in earlier months; although availability reportedly tightened last year--especially in some parts of the country--the survey has not suggested the existence of a substantial credit squeeze. Indeed, credit access ranks low on the NFIB survey respondents' list of concerns.

Concern about the ability of firms to obtain financing at year-end was significant, but pressures on interest rates waned quickly with the turn of the calendar. Quality spreads in the commercial paper market, which widened in late December to levels not seen since 1983, narrowed dramatically in January (upper panel of chart). The reported willingness of the SEC to consider less stringent limits on money funds' holdings of A2/P2-rated paper also may have contributed to the reduction in spreads. Quality spreads on longer-term investment-grade debt increased about 25 basis points over the intermeeting period to about 140 basis points, steadily widening since the invasion of Kuwait but much narrower than in the early 1980s (lower panel of chart).

In equity markets, major stock indexes fell 4 percent or so from mid-December to mid-January, reflecting concerns about the prospects for war and generally disappointing earnings reports. With the start of the Gulf war and the first optimistic assessments of its progress, major indexes recovered around 4 percent on January 17, tripping circuit breakers in both the cash and stock-index futures markets. Since then, stock prices are up

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

	1988	1989	1990p	1990 Q3	1990 Q4p	1990 NOVp	1990 DECp	1991 JANe
Corporate securities - total[1]	22.40	19.82	19.25	16.27	20.17	22.64	18.41	13.70
Public offerings in U.S.	20.37	17.76	17.14	13.98	18.76	21.14	17.59	13.20
Stocks--total[2]	3.54	2.69	1.95	1.16	1.33	1.24	1.79	1.20
Nonfinancial	1.15	1.08	1.03	0.73	0.56	0.66	0.46	0.10
Utility	0.24	0.29	0.35	0.26	0.36	0.46	0.30	0.00
Industrial	0.91	0.79	0.68	0.47	0.20	0.20	0.16	0.10
Financial	2.39	1.60	0.92	0.43	0.77	0.57	1.33	1.10
Bonds	16.84	15.08	15.19	12.82	17.43	19.90	15.80	12.00
Nonfinancial	6.17	6.26	5.04	3.32	6.20	8.50	5.70	5.00
Utility	1.80	1.78	1.84	1.40	2.39	3.00	2.90	1.20
Industrial	4.37	4.48	3.20	1.92	3.81	5.50	2.80	3.80
Financial	10.67	8.81	10.14	9.50	11.23	11.40	10.10	7.00
By quality[3]								
Aaa and Aa	2.72	3.29	3.35	2.50	4.46	5.99	3.86	4.10
A and Baa	5.54	5.67	5.90	4.96	5.96	7.89	4.28	3.80
Less than Baa	2.56	2.39	0.15	0.08	0.11	0.00	0.17	0.10
No rating (or unknown)	0.05	0.06	0.03	0.00	0.00	0.01	0.00	[illegible]
Memo items:								
Equity-based bonds[4]	0.28	0.52	0.36	0.34	0.17	0.01	0.36	0.[illegible]
Mortgage-backed bonds	4.72	1.67	2.41	2.74	2.29	2.23	2.41	2.00
Other asset-backed	1.26	2.02	3.35	2.53	4.62	3.79	5.08	2.00
Variable-rate notes	1.19	1.03	0.81	0.37	1.11	0.79	1.52	0.10
Bonds sold abroad - total	1.93	1.90	1.89	2.14	1.39	1.50	0.80	0.80
Nonfinancial	0.73	0.48	0.43	0.48	0.26	0.35	0.28	0.30
Financial	1.20	1.42	1.47	1.66	1.13	1.15	0.52	0.50
Stocks sold abroad - total	0.09	0.16	0.22	0.15	0.02	0.00	0.02	0.00
Nonfinancial	0.08	0.12	0.10	0.10	0.02	0.00	0.02	0.00
Financial	0.02	0.04	0.12	0.05	0.01	0.00	0.00	0.00

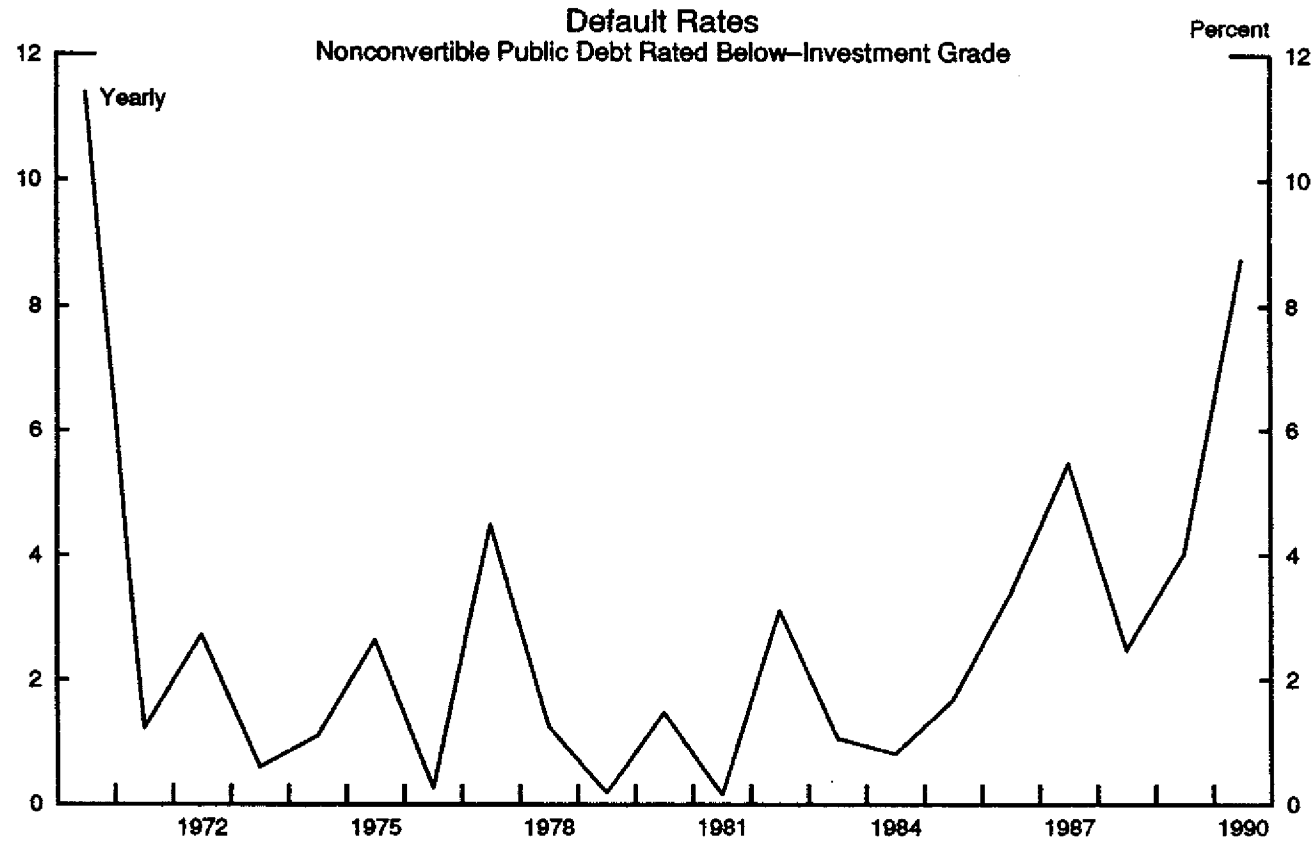
1. Securities issued in the private placement market are not included. Total reflects gross proceeds rather than par value of original discount bonds.
2. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings. Such swaps totaled $20.4 billion in 1989.
3. Bonds categorized according to Moody's bond ratings, or to Standard and Poor's 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. e--staff estimate.

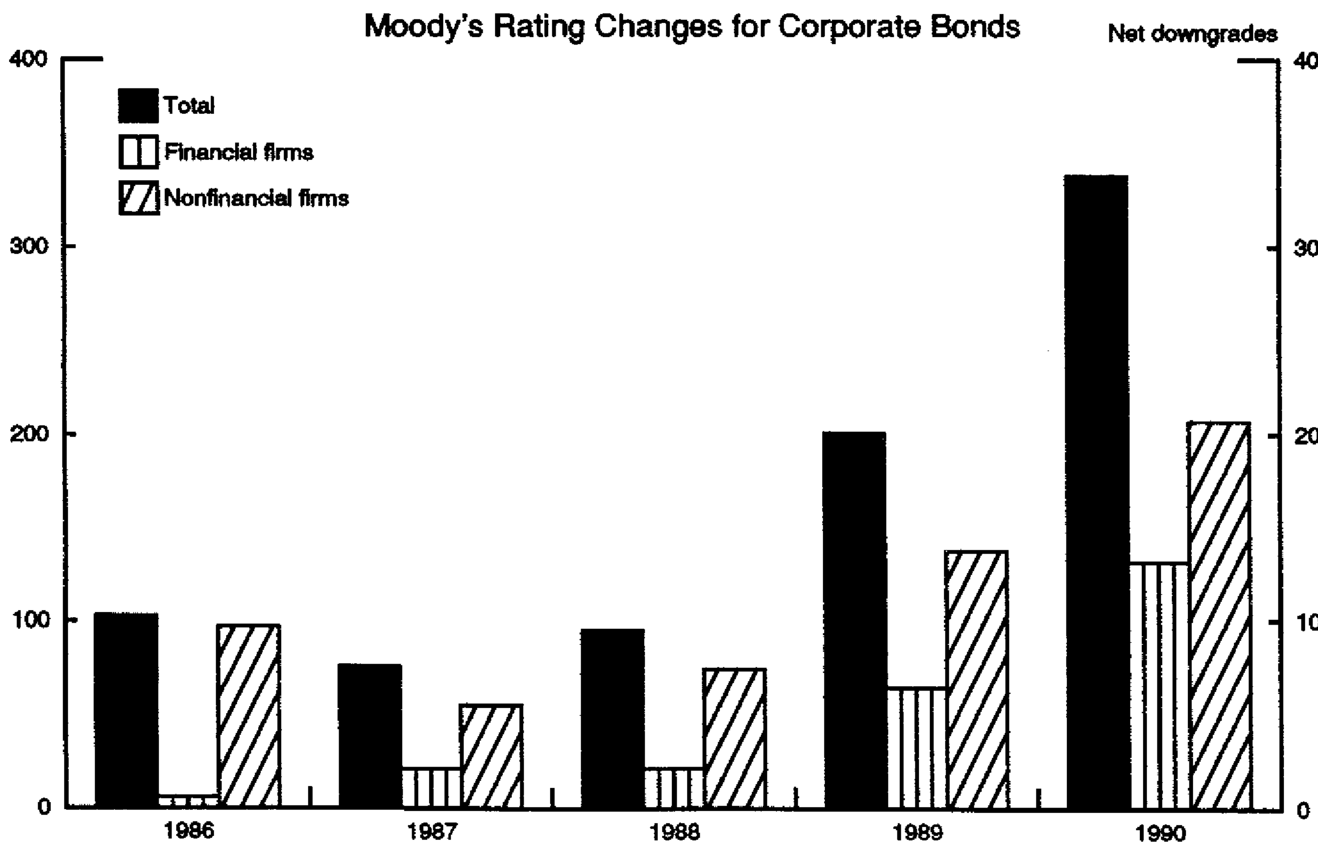
slightly, but the market continues to react skittishly to news about the war.

Offerings of new shares by nonfinancial firms remained low in December and January, and initial public offerings were extremely scarce. The MCA acquisition was completed late in the fourth quarter of 1990, leaving a light calendar of proposed mergers and acquisitions for the first few months of 1991. Nonetheless, net equity retirements in the first quarter of 1991 could run at about the same moderate pace as in the previous quarter if the acquisition of NCR by AT&T occurs.

Bond markets also were affected by uncertainty created by events in the Persian Gulf. Some underwriters broadened "war-out" clauses, standard fixtures in corporate-bond sales agreements between underwriters and issuers. These clauses allow underwriters to cancel sales if hostilities escalate and markets are disrupted. Underwriters also reportedly shortened settlement periods to enhance further their protection against increases in interest rates. The uncertainty generated by events in the Gulf likely would have depressed issuance independent of these actions: Many issuers and investors apparently were unwilling to enter the market at the start of the conflict, but some issuers returned as the situation clarified.

Issuance of all types of asset-backed securities was a strong $5.1 billion in December, despite record spreads that caused several prospective issuers to postpone their offerings. Banks and thrifts accounted for about a third of this total as they sought to remove assets and enhance balance-sheet ratios by year-end. Issuance fell sharply in January, again primarily because of increased uncertainty about the effects of the Gulf war on interest rates.


Default Rates
Nonconvertible Public Debt Rated Below–Investment Grade
Percent
Yearly
12
10
8
6
4
2
0
1972
1975
1978
1981
1984
1987
1990


Moody's Rating Changes for Corporate Bonds
Net downgrades
Total
Financial firms
Nonfinancial firms
400
300
200
100
0
1986
1987
1988
1989
1990

Financial Stress

Events in the Middle East are occurring against a background of mounting financial stress in both the nonfinancial and financial sectors. A record estimated $18.35 billion of corporate bonds defaulted in 1990, representing 8.7 percent of the par amount of outstanding noninvestment-grade bonds, the highest default rate since the Penn Central default in 1970 and more than double the rate in 1989 (chart). The number of debt downgrades continued to far exceed the number of upgrades in the fourth quarter, and for the year as a whole, downgradings reached a record high. Most of these downgrades were attributable to deteriorating conditions affecting financial institutions and below-investment grade nonfinancial corporations. Signs of stress also were reflected in the number of corporations reducing, omitting, or deferring dividends. While the number of positive dividend actions was the smallest fourth quarter in more than three decades, adverse dividend actions were only surpassed in 1958. These dividend reductions and omissions also appear to be concentrated in financial firms.

Stress in depository institutions in particular mounted over the intermeeting period. Confronted with runs prompted by the failure of Rhode Island's largest privately insured credit union, the governor of that state ordered the closure of all privately insured depository institutions until they obtained federal deposit insurance. Thirty-five credit unions and ten banks having book assets of $1.7 billion were closed on January 1. Twenty-three credit unions subsequently reopened with insurance provided by the National Credit Union Administration. The failure of the insurance fund has created political pressure at the national level for the termination of private state insurance and for a closer monitoring of the federal credit union insurance fund.

A week after the closure of the Rhode Island credit unions, the FDIC took over the Bank of New England Corporation following announcement of an estimated $450 million loss in the fourth quarter. Bond and stock prices of other banks perceived to have serious asset-quality problems fell sharply after the FDIC move. Among these troubled institutions was MNC Financial, which was able to avoid defaulting on maturing bonds in mid-January by borrowing from its bank subsidiaries. The loans to MNC were to be paid off through the sale of credit-card operations in an initial public-stock offering. This offering was brought to market in mid-January and raised $950 million. Recently, Moody's downgraded the commercial paper, long-term debt, and preferred stock of Citicorp. Immediate market reaction to the downgrading was limited and did not extend to the debt of other bank holding companies. Citicorp's preferred stock fell below investment grade, however, likely constraining further this avenue for raising capital. Spreads on the debt of money center banks relative to Treasuries have narrowed a little over the past month, and despite the initial reaction to the Bank of New England failure, bank stock prices are up slightly over the intermeeting period.

Moody's recently completed a review of insurers' mortgage portfolios that resulted in the downgrading of financial-strength ratings of four firms: Equitable Life, Mutual of New York, Mutual Benefit Life, and Home Life. These and other insurers reportedly have become more cautious in extending new loans. A board member of one major firm recently noted that his company has stopped making commercial real estate loans altogether. The company's pullback partly reflects a sharp deterioration in the quality of its own real estate portfolio, but it also reflects an expected deterioration in the commercial real estate market more generally.

First Executive, the largest holder of junk bonds among life insurance companies, is taking several steps to restructure its liabilities to both senior debtholders and policyholders. Meanwhile, Executive Life is discussing an assumption-reinsurance transaction with Hartford Life whereby the latter would assume Executive Life's entire book of annual-premium life insurance policies. These liabilities are valued at \$2.3 billion, roughly 19 percent of Executive Life's total policy reserves. Company officials fear that, in the absence of such an arrangement, continued unfavorable publicity surrounding the company's investment portfolio will lead to further surrenders of policies.

Treasury and Sponsored-Agency Financing

The federal deficit is expected to total \$91 billion in the first quarter of 1991, up \$4 billion from last quarter. The staff expects that the Treasury will hold constant the gross sizes of the weekly bill auctions and forgo issuing cash-management bills. By contrast, borrowing in the coupon sector is expected to increase somewhat. The Treasury recently announced the decision to hold monthly auctions of five-year notes in lieu of quarterly auctions of notes with five-year-and-two-month and four-year maturities; the change will not have a large effect on borrowing in the coupon sector for this quarter, however.

Spreads of government-sponsored-enterprise debt remain relatively narrow by historical standards. In January, REFCORP exhausted its \$30 billion borrowing authority by issuing \$7 billion of bonds. The offering

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

	1990		1991			
	Q3	Q4	Q1^p	Jan.^p	Feb.^p	Mar.^p
Treasury financing						
Total surplus/deficit (-)	-57.8	-86.9	-90.6	-6.6	-38.7	-45.3
Means of financing deficit:						
Net cash borrowing from the public	69.0	98.8	66.3	23.3	36.4	6.6
Marketable borrowings/ repayments (-)	64.5	83.9	66.8	25.3	36.6	5.0
Bills	29.0	45.0	20.4	9.5	5.9	5.0
Coupons	35.6	38.9	46.4	15.7	30.7	.0
Nonmarketable[2]	4.5	15.0	-.5	-2.0	-0.2	1.6
Decrease in the cash balance	-5.5	7.9	5.2	-28.1	9.8	23.5
Memo: Cash balance at end of period	40.2	32.2	27.0	60.3	50.6	27.0
Other	-5.6	-19.9	19.1	11.4	-7.5	15.2
Federally sponsored credit agencies, net cash borrowing[4]	-1.9	--	--	--	--	--
FHLBs	-6.7	--	--	--	--	--
FHLMC	-3.1	--	--	--	--	--
FNMA	.9	4.6	--	--	--	--
Farm Credit Banks	.9	--	--	--	--	--
FAC	.1	.0	.0	.0	.0	.0
SLMA	1.0	.8	--	--	--	--
REFCORP	5.0	5.0	6.9	6.9	.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 and the face value of zero-coupon bonds issued to REFCORP (the discount from face value 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.
Note: Details may not add to totals due to rounding.

consisted of $5 billion of new 30-year bonds and a $2 billion reopening of a previously-issued 40-year bond. At the time of the pricing, the spread relative to Treasuries on the 30-year debt was 29 basis points, in line with previous offerings. However, that on the reopened 40-year issue, at 19 basis points, was considerably lower than any of the earlier 40-year issues. Stock prices of FNMA and FHLMC have risen more than 10 percent since mid-December. FNMA announced record earnings for the fourth quarter and, unlike many depositories, does not appear to be plagued by asset-quality problems.

The RTC is requesting an additional $77 billion from Congress to continue its cleanup of the thrift industry through the end of this fiscal year. Thirty billion dollars would cover thrift losses, and the remaining appropriation would cover working-capital needs. Without additional funding, the RTC will exhaust its resources in February. Funding problems have contributed to a slowing in RTC activities thus far in the first quarter, but the agency continues to have difficulties disposing of assets because of legislative restrictions, weak real estate markets, and administrative problems within the agency. Nonetheless, RTC's portfolio grows: Columbia Savings and Loan, with assets of some $7 billion at its June quarterly report, was placed in conservatorship recently.

Municipal Securities

Issuance of long-term tax-exempt securities picked up in December, buoyed by a rash of general obligation bonds and revenue bonds for transportation services and for public buildings, correctional facilities, and redevelopment agencies. The drop in yields during the month also boosted refunding issuance, which had been little more than a trickle in the preceding three months. Since December, long-term issuance has fallen off sharply, owing to the uncertainty surrounding developments in the Middle East. A backup in yields prior to the outbreak of war also damped refunding volume. After falling in December, quality spreads on municipal securities jumped in anticipation of the outbreak of war and, on net, are slightly above mid-December levels.

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

	1989	1990	1990						1991
	Year	Year	Q1	Q2	Q3	Q4	Nov.	Dec.[p]	Jan.[f]
Total offerings[1]	11.90	13.10	8.86	15.63	15.49	12.36	12.57	14.63	--
Total tax-exempt	11.65	12.84	8.74	15.35	15.24	11.94	12.24	14.03	5.75
Long-term	9.47	7.64	11.22	10.90	10.25	9.96	12.25	5.00	
Refundings[2]	2.47	1.34	1.45	1.86	1.07	0.98	0.90	1.54	--
New capital	7.01	8.66	6.19	9.36	9.83	9.27	9.06	10.71	--
Short-term	2.17	2.81	1.10	4.13	4.34	1.69	2.28	1.78	.75
Total taxable	.25	.27	.12	.28	.25	.42	.33	.60	--

p--preliminary. f--forecast.
1. Includes issues for public and private purposes; also includes taxable issues.
2. Includes all refunding bonds, not just advance refundings.

Philadelphia averted bankruptcy in mid-January by selling $105 million in three-month notes to city and state pension funds and local banks. The notes yield 9.5 percent on an annual basis, but the annualized all-in cost to the city is approximately 24 percent as a result of fees required by the purchasers. The $105 million obtained by the initial sale will be enough to bridge a gap in receipts and avoid default through the remainder of the fiscal year ending in June.

After showing mild deterioration over the previous three years, pressures on municipal credit ratings intensified in 1990 as the economy slipped into recession. Standard & Poor's downgraded 474 ratings on $48.2

billion in debt, while only 131 ratings on $13.4 billion of debt were upgraded. The bulk of the reductions was accounted for by 290 housing ratings suffering from the downgrading of several banks and insurance companies that provided credit enhancements. States and their agencies fared best; 42 issues were upgraded, while only 26 were downgraded.

The credit quality of states is not likely to fare as well this year. Budget woes continue to escalate and threaten to make fiscal year 1991 the worst in nearly a decade. Twenty-eight states have stated that they must cut spending or increase taxes to balance their budgets. Rhode Island, which already had a large budget deficit, now is under pressure to reimburse depositors suffering from the closure of its privately-insured credit unions and banks. Fiscal troubles facing states are spreading from the East into the West, and California and Arizona now project budget shortfalls of approximately 5 percent of outlays.

Mortgage Markets

Given the continued weakness in housing activity, mortgage lending volume likely remained subdued, and may have slowed, in the fourth quarter. Growth of real estate loans at commercial banks was little changed from the moderate third-quarter pace, while the disinvestment in mortgage assets at SAIF-insured institutions proceeded. Reports continue to surface periodically about the reluctance of lenders to extend credit in view of concerns about credit quality of borrowers and stricter regulatory oversight. According to recent trade reports, small- to medium-sized mortgage bankers that are not affiliated with parent financial institutions are the latest victims of credit stringency. Several such firms apparently are experiencing difficulties obtaining warehouse lines of credit from depositories to finance loan originations, although this credit restraint is not thought to be a major problem in the industry. Indeed, there is no indication, most notably in the spreads of mortgage rates over Treasury rates, that potential homebuyers have faced any constriction of credit availability.

The steepening in the Treasury yield curve over the intermeeting period has been reflected in a widening in the initial rate differential between fixed- and adjustable-rate loans. Yields on fixed-rate mortgages have risen about 5 basis points, on net, while initial rates on ARMs indexed to the one-year Treasury yield have declined about 20 basis points. The initial rate spread has widened to about 190 basis points, but remains well below the levels reached in 1987 and 1988 when the ARM share of loans closed peaked at nearly 70 percent. Evidence of refinancings of ARMs into FRMs has not appeared, despite reports that borrowers might find it attractive with rates on FRMs now relatively low.

In secondary mortgage markets, yield spreads between agency pass-through securities and comparable-duration Treasuries remain tight, despite fairly heavy issuance of mortgage-backed securities. Monthly issuance of federally related pass-throughs has averaged about $18 billion since mid-1990, pushing total issuance for the year as a whole to near-record levels. The new-issue volume has been augmented by large sales of securities associated with thrift restructurings. The RTC, for example, has sold roughly $17 billion of securities since March 1990, including a record block of $883 million in December. This large volume was handled without adverse effect on price spreads for mortgage-backed securities. Demand by traditional investors other than thrifts has been strong, and new investors reportedly continue to enter the market. Multiclass securities, primarily REMICs and CMOs, have continued to absorb a sizable volume of pass-throughs, with agency issuance in 1990 on a pace that should surpass the record 1989 volume. Issuance by securities dealers of multiclass pass-throughs also was stronger last year than in 1989, despite tailing off toward the end of the year.

A factor expected to help some lenders securitize their mortgage originations is the recent increase in the ceiling on the size of conventional loans eligible for purchase by federal agencies. FNMA and FHLMC announced in late December that the maximum original-loan amount on

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

	Federally related pass-through securities			Multiclass securities				
	Total (SA)	Fixed-Rate	ARM-backed	Total	Private issues[1]	FNMA REMICs	FHLMC REMICS	Agency strips
1989	16.8	14.1	2.6	8.1	1.4	3.1	3.2	.3
1990 p	19.4	16.8	2.3	11.2	2.2	5.0	3.4	.5
1989-Q4	21.6	19.4	2.2	10.7	1.2	5.2	4.0	.4
1990-Q1	23.3	18.5	1.4	11.3	1.6	5.0	3.8	.9
Q2 r	17.9	16.3	2.2	11.1	2.9	4.7	3.0	.4
Q3 r	17.3	17.5	1.6	12.0	2.6	6.6	2.3	.6
Q4 p	19.0	14.9	4.1	10.4	1.7	3.9	4.5	.3
1990-June	17.0	17.3	2.2	11.5	1.8	4.7	3.8	1.3
July	14.7	16.2	0.5	11.0	1.5	6.7	2.8	.0
Aug.	19.3	19.1	1.6	11.6	3.4	4.4	2.4	1.4
Sep.	18.0	17.3	2.8	13.4	2.9	8.6	1.6	.3
Oct. p	19.1	16.7	2.5	14.5	2.5	5.6	5.7	.6
Nov. p	20.3	16.8	2.6	7.7	1.6	3.8	2.1	.2
Dec. p	17.7	11.1	7.1	9.0	1.1	2.4	5.5	.0

1. Excludes pass-through securities with senior/subordinated structures.
r--revised p--preliminary n.a.--not available.

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)								Memo: Outstandings (billions of dollars)
				1990					1990
	1988	1989[1]	1990[2]	H1	Q3	Q4[3]	Oct.[r]	Nov.[p]	Nov.[p]
Total installment	8.9	5.5	3.3	2.2	5.9	2.2	2.2	2.8	738.3
Installment, excluding auto	10.3	8.6	7.3	5.4	11.5	5.8	5.9	5.7	454.3
Selected types									
Auto	7.0	1.3	-2.5	-2.5	-2.7	-2.7	-3.6	-1.8	284.0
Revolving	13.7	14.2	12.3	11.7	16.2	7.2	8.7	5.7	219.4
All other	7.6	4.2	2.9	.3	7.1	4.5	3.4	5.7	234.9
Memorandum:									
Total[4]	7.3	5.0	2.3	1.9	3.1	2.2	.9	3.6	794.5

1. Growth rates are adjusted for discontinuity in data between December 1988 and January 1989.
2. Through November.
3. November/September.
4. Installment plus noninstallment.
r--revised. p--preliminary.
Note: Details may not add to totals due to rounding.

CONSUMER INTEREST RATES
(Annual percentage rate)

				1990			
	1988	1989	1990[1]	Aug.	Sept.	Oct.	Nov.
At commercial banks[2]							
New cars (48 mo.)	10.86	12.07	11.81	11.89	...	...	11.72
Personal (24 mo.)	14.68	15.44	15.46	15.46	...	...	15.69
Credit cards	17.79	18.02	18.17	18.18	...	...	18.23
At auto finance cos.[3]							
New cars	12.60	12.62	12.51	12.62	12.34	12.57	12.74
Used cars	15.11	16.18	15.99	15.98	16.03	16.12	16.07

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

single-family mortgages eligible for purchase by the agencies would increase from $187,450 to $191,250 effective January 1, 1991.[4]

Consumer Installment Credit

Consumer installment credit grew at 2-3/4 percent seasonally adjusted annual rate in November, near its October pace. Installment credit was supported by a pickup in the non-auto, non-revolving category. Auto loans outstanding contracted in November, the tenth decline in the past thirteen months, although at a slower pace than October. Revolving credit growth slowed further in November, in part reflecting larger-than-normal repayments according to some lenders. Industry sources suggest this trend in paydowns may be continuing into the new year.

For the first eleven months of 1990, growth in outstanding consumer installment credit, at 3-1/4 percent, was the slowest since 1980 when credit controls and a recession held the increase to a mere one-half of one percent. The deceleration in 1990 was most noticeable in automobile credit, which actually declined for the first time since 1980. In part, the decline in auto loans reflected a general slackening in sales; however, the weakness also may have been indicative of the availability or tax advantage of other forms of financing, such as leasing or home-equity loans.

Gross public issuance of consumer asset-backed securities was about $35 billion in 1990, some $10 billion stronger than the pace in 1989 (table). The preponderance of new public issues was securities backed by credit cards and originated by commercial banks. GMAC also issued

4. Changes in the loan limit reflect year-over-year percentage changes in the national-average home-purchase price as calculated by the FHFB's Monthly Interest Rate Survey. According to the FHFB, the average price for a single-family nonfarm home financed with a conventional mortgage was $139,600 in early October, about 2 percent higher than in October 1989.

securities after several years' absence from the market. Some market participants have suggested that fears of rising consumer delinquencies and bankruptcies are lowering demand for credit-card-backed securities because these problems lead to chargeoffs that trigger early amortization with the associated prepayment risk for holders. However, only a few issues appear to be close to the level of chargeoffs that would trigger early amortization.

INTERNATIONAL DEVELOPMENTS

U.S. Merchandise Trade

In November, the U.S. merchandise trade deficit narrowed to $9.7 billion (seasonally adjusted, Census basis) from a revised deficit in October of $11.0 billion. For October-November combined, the deficit was larger than in any quarter since 1988-Q1. Exports increased faster than non-oil imports, but these changes were exceeded by a sharp run-up in the value of oil imports (a result of rising oil prices).

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	Balance
1990-Jan	31.4	3.6	27.8	41.6	5.9	35.6	-10.2
Feb	31.6	3.4	28.2	38.7	4.8	33.8	-7.1
Mar	33.3	3.7	29.6	41.6	4.8	36.8	-8.4
Apr	32.1	3.3	28.8	39.4	3.9	35.5	-7.3
May	32.8	3.3	29.5	40.5	4.4	36.2	-7.8
Jun	34.2	3.6	30.6	39.6	3.9	35.7	-5.3
Jul	32.1	3.1	29.0	41.2	4.1	37.2	-9.1
Aug	32.5	3.4	29.2	42.3	5.3	37.0	-9.7
Sep	32.0	3.1	29.0	41.3	6.2	35.1	-9.3
Oct[r]	35.0	3.0	32.0	46.0	7.0	39.0	-11.0
Nov[p]	33.6	3.3	30.4	43.3	6.4	36.9	-9.7

r--revised p--preliminary
Source: U.S. Department of Commerce, Bureau of the Census.

Nonagricultural exports in October-November were 6 percent above the third-quarter average, with strong increases recorded in all major trade categories except aircraft and computers. About half of the rise was in industrial supplies, of which one-third was fuels. (See the table on the next page.) By area, the largest increases were to Canada, Western Europe, and developing countries in Asia. Much of the increase in nonagricultural exports in October-November was in quantity.

MAJOR TRADE CATEGORIES
(Billions of dollars, BOP basis, SAAR)

	Year 1989	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 O/N-e
Agricultural Exports	41.5	40.9	43.8	41.3	38.9	38
Nonagricultural Exports	319.0	326.1	341.2	345.7	345.7	367
Industrial Supplies	90.6	89.0	94.2	92.9	95.2	110
Gold	2.5	2.1	2.6	3.6	3.7	5
Fuels	12.1	12.2	12.8	11.2	13.9	19
Other Ind. Supp.	76.0	74.7	78.8	78.1	77.6	86
Capital Goods	138.0	140.8	152.9	154.6	152.2	152
Aircraft & Parts	26.5	25.6	32.3	34.5	31.4	29
Computers & Parts	24.2	24.7	26.4	24.9	26.2	25
Other Machinery	87.3	90.5	94.2	95.2	94.6	98
Automotive Products	34.7	35.6	34.7	38.5	36.1	38
Canada	22.5	22.8	20.8	23.5	21.7	22
Other	12.2	12.9	13.9	15.0	14.4	16
Consumer Goods	35.4	38.0	40.7	42.0	43.7	46
Other Nonagric.	20.3	22.7	18.7	17.7	18.5	21
Oil Imports	50.9	53.3	62.4	48.7	62.8	81
Non-Oil Imports	424.4	428.6	427.8	430.8	440.9	457
Industrial Supplies	84.1	83.2	80.4	82.2	83.3	87
Gold	3.6	4.3	1.7	2.1	2.7	3
Other Fuels	3.2	3.7	3.1	3.1	3.4	5
Other Ind. Supp.	77.3	75.2	75.6	77.0	77.2	79
Capital Goods	113.1	116.5	115.7	115.6	116.7	124
Aircraft & Parts	9.5	9.0	9.2	10.5	9.8	13
Computers & Parts	21.5	23.4	23.1	22.8	23.1	23
Other Machinery	82.1	84.1	83.4	82.3	83.8	88
Automotive Products	86.0	83.0	83.9	84.9	90.4	90
Canada	29.5	29.6	27.6	30.7	33.0	30
Other	56.5	53.4	56.3	54.2	57.5	60
Consumer Goods	102.8	106.4	103.4	104.3	107.1	113
Foods	25.1	25.0	27.8	26.8	25.5	26
Other Non-oil	13.3	14.5	16.6	17.0	17.9	17

r--revised. p--preliminary. e--estimated.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Agricultural exports in October-November were 2 percent less than in the third quarter, with much of the decrease attributable to prices (especially for wheat). In addition, exports of corn and soybeans got off to a slow start after the harvest, in part reflecting weak sales to the Soviet Union.

Non-oil imports for October-November were 4 percent higher than in the third quarter, with about half of the increase in quantity. The increase in value was strongest in capital and consumer goods. The increase in industrial supplies was primarily in chemicals and precious metals other than gold. There was also a jump in imports of foreign-type passenger cars. Most of the increase in non-oil imports came from Japan, Western Europe, and Canada. Some of the higher value of non-oil imports resulted from an increase in prices that was associated, in part, with the decline in the foreign exchange value of the dollar. (See the discussion of prices below.)

U.S. MERCHANDISE TRADE: QUARTERLY DATA
Billions of dollars, SAAR, BOP-basis

	Years		1990				Percent Change 1990:Q/N from	
	1989	1990-e (11 months)	Q1	Q2	Q3	O/N-e	Prev. Qtr.	Year Ago
Exports	360	390	385	387	385	405	5.0	10.4
Imports	475	503	490	479	504	538	6.7	11.6
Non-oil	424	439	428	431	441	457	3.6	6.5
Balance	-115	-113	-105	-92	-119	-133		

e--estimate.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

In November, the value of imported oil dropped 8 percent following sharp increases in the previous three months. The November decline was more than accounted for by quantity. (See the table on the next page.) The average quantity (mbd) for October-November was nearly 15 percent less than in the third quarter. This decrease reflects the decline in U.S. economic activity, the effects of mild weather, and slowdown in refinery runs in order to perform maintenance. The price of oil in November was about the

OIL IMPORTS
(BOP basis, value at annual rates)

	1990			Months				
	Q1	Q2	Q3-p	Jul	Aug	Sep	Oct-r	Nov-e
Value (Bil. $)	62.37	48.66	62.78	49.08	63.70	75.57	83.92	77.14
Price ($/BBL)	19.47	15.81	19.58	14.77	19.95	24.37	29.27	29.61
Quantity (mb/d)	8.90	8.45	8.71	8.93	8.58	8.61	7.71	7.24

r--revised. p--preliminary. e--estimated.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

same as published in October, and about $10 per barrel higher than the average for the third quarter. The rise in prices of imported oil lagged the sharp increases in posted and spot prices, following the same pattern as in previous oil market disruptions.

Prices of Imports and Exports

BLS prices of imported oil dropped 6.7 percent in December, the second month of decline. (See the table on the next page.) Nonetheless, the price of imported oil in December was still nearly 90 percent higher than in July. For the fourth quarter on average, oil prices rose 47 percent (not an annual rate) above the third-quarter level.

Prices of non-oil imports rose at an annual rate more than 6 percent in the fourth quarter, after having shown only small increases earlier in the year. The strongest rises were in automotive products, capital goods, and consumer durables (particularly professional and scientific apparatus); part of these increases were associated with the depreciation of the dollar. There were also increases in the prices of petroleum-related goods. Smaller

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

	Year 1990-Q4 / 1989-Q4	Quarters 1990 Q2	Q3	Q4	Months 1990 Nov	Dec
	(Quarterly Average, AR)				(monthly rates)	
	BLS Prices					
Imports, Total	8.3	-5.7	10.2	24.9	-0.5	-0.5
Foods, Feeds, Bev.	7.2	-4.9	7.4	4.8	-1.6	2.6
Industrial Supplies	20.0	-18.7	31.7	76.7	-3.2	-3.1
Ind Supp Ex Oil	-0.5	0.6	-1.5	1.6	-1.5*	-0.5*
Capital Goods	5.6	2.4	3.8	8.3	0.8	1.2
Automotive Products	1.3	-5.0	3.3	10.0	1.7	0.1
Consumer Goods	3.4	4.3	-0.3	4.8	0.5	0.4
Memo:						
Oil	62.5	-47.4	134.1	310.0	-5.4	-6.7
Non-oil	2.8	0.2	1.8	6.1	0.2	0.5
Exports, Total	2.3	1.3	1.7	4.4	0.2	-0.3
Foods, Feeds, Bev.	-6.7	8.1	-13.1	-16.3	-0.2	0.0
Industrial Supplies	4.9	-2.4	5.2	15.9	-0.4	-0.8
Capital Goods	2.7	1.6	3.3	2.2	0.5	-0.1
Automotive Products	2.1	1.8	1.9	3.5	0.8	0.2
Consumer Goods	3.7	3.3	1.6	3.7	0.2	0.5
Memo:						
Agricultural	-5.3	8.3	-11.9	-14.0	-0.4	0.1
Nonagricultural	3.6	-0.1	3.9	8.0	0.3	-0.3
	Prices in the GNP Accounts					
Fixed-Weight						
Imports, Total	11.3	-12.3	15.8	37.3	--	--
Oil	63.6	-56.7	135.7	374.5	--	--
Non-oil	3.1	-2.3	3.9	6.5	--	--
Exports, Total	1.7	1.5	0.7	0.8	--	--
Ag.	-3.1	10.7	-10.1	-13.6	--	--
Nonag.	2.7	-0.2	3.1	3.8	--	--
Deflators						
Imports, Total	8.9	-8.7	11.3	31.6	--	--
Oil	63.7	-56.6	135.2	373.9	--	--
Non-oil	1.9	-1.0	2.1	3.9	--	--
Exports, Total	0.4	4.7	-3.9	1.4	--	--
Ag.	-3.1	10.7	-10.1	-13.6	--	--
Nonag.	0.8	4.4	-3.1	3.4	--	--

*Not for publication.

increases were recorded for prices of imported consumer nondurables, foods, and industrial supplies (increases for fuels more than offset price declines for other supplies and materials).

Prices of nonagricultural exports rose at an annual rate of 8 percent in the fourth quarter on a quarterly average basis according to BLS (4 percent on a fixed-weight GNP basis). Most of that increase was associated with rising prices of exported fuels and other industrial supplies (especially petrochemicals). Price increases for exported capital goods, automotive products, and consumer goods were in the 2 to 4 percent annual rate range in the fourth quarter. Prices of agricultural exports dropped for the sixth time in the last seven quarters, led by declining prices of grain, especially wheat.

U.S. International Financial Transactions

Large net foreign official inflows into the United States were recorded in October and November. (See the Summary of U.S. International Transactions, line 4.) The G-10 countries increased their net holdings in the United States as the result of intervention purchases of dollars and the accumulation of interest earnings. Certain oil producing countries, particularly in Latin America, also increased their holdings, as higher oil prices produced larger export earnings. In addition, Spain and Isreal increased their reserve holdings in the United States. Reports that Taiwan shifted $35 billion out of U.S.-based banks and into U.S. Treasury securities and foreign-based banks in late 1990 were false and subsequently were denied in a press release by Taiwan's central bank.

Apart from official transactions, the net capital inflows that were the counterpart of continuing U.S. current account deficits were not apparent in the data available for October and November. Monthly data on private securities transactions (lines 2 and 3) show only small net inflows

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

	1988 Year	1989 Year	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 Sept.	1990 Oct.	1990 Nov.
Private Capital									
Banks									
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	22.2	27.4	10.6	17.1	-1.3	26.6	8.1	-1.1	-18.7
Securities									
2. Private securities transactions, net[1]	17.8	16.1	6.2	-7.4	-8.7	-3.2	-4.1	-5.8	5.4
a) foreign net purchases (+) of U.S. corporate bonds[2]	26.8	32.8	12.5	5.1	6.6	0.8	-1.7	0.8	3.6
b) foreign net purchases (+) of U.S. corporate stocks	0.4	7.9	-1.3	-3.1	-3.5	-2.3	-2.3	-3.5	0.5
c) U.S. net purchases (-) of foreign securities	-9.4	-24.6	-5.0	-9.4	-11.8	-1.8	-0.2	-3.1	1.3
3. Foreign net purchases (+) of U.S. Treasury obligations	20.6	30.1	5.2	-0.9	3.7	0.4	-4.1	1.3	-0.4
Official Capital									
4. Changes in foreign official reserves assets in U.S. (+ = increase)	40.2	8.3	-7.6	-7.4	4.9	13.8	2.4	5.4	11.0
a) By area									
G-10 countries	15.8	-5.2	-2.2	-6.2	-0.9	8.9	4.2	1.7	3.6
OPEC	-3.4	10.1	-1.5	3.1	*	-1.3	0.4	0.1	0.7
All other countries	27.9	3.4	-3.9	-4.3	5.8	6.3	-2.2	3.6	6.7
b) By type									
U.S. Treasury securities	41.7	0.1	-7.5	-5.8	2.4	12.1	3.5	1.2	12.8
Other[3]	-1.5	8.2	-0.1	-1.6	2.4	1.7	-1.1	4.1	-1.8
5. Changes in U.S. official reserve assets (+ = decrease)	-3.9	-25.3	-3.2	-3.2	0.4	1.7	-0.2	-0.1	-0.4
Other transactions (Quarterly data)[4]									
6. U.S. direct investment (-) abroad	-16.2	-31.7	-8.8	-9.3	-4.8	-19.3	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	58.4	72.2	21.5	5.5	7.2	7.6	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	-1.8	-9.5	-3.3	5.8	-7.6	-1.6	n.a.	n.a.	n.a.
9. U.S. current account balance	-128.9	-110.0	-26.7	-21.7	-22.5	-25.6	n.a.	n.a.	n.a.
10. Statistical discrepancy	-8.4	22.4	6.1	21.8	28.7	0.4	n.a.	n.a.	n.a.
MEMO:									
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-127.2	-114.9	-28.7	-26.3	-23.1	-29.8	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.

for these two months together. Net private purchases of U.S. Treasury securities (line 3) were less than $1 billion. Foreign net sales of U.S. corporate stocks (line 2b) were substantial in October, but ended in November, as the U.S. stock market began to recover. U.S. residents bought foreign securities net over the two months (line 2c). In contrast, there were substantial net private foreign purchases of U.S. corporate and other bonds (line 2a). However, new issues of Eurobonds by U.S. corporations, which in October and November were only slightly below monthly averages for the last several years, dropped sharply in December and do not appear to have picked up in January.

Banks reported substantial net capital outflows on a month-end basis, particularly in November (line 1). However, on a monthly average basis, there were net inflows from own foreign offices and IBFs in October and November, and again in December. (See line 1 of the International Banking Data table on the next page.) Foreign-chartered banks more than accounted for the December inflow.

Matsushita's $6 billion purchase of MCA was completed on December 29. However, little direct investment capital inflow is likely to result initially because about two-thirds of the necessary funds were raised in the U.S. commercial paper market by Matsushita's U.S. subsidiary, Panasonic Finance. Multinational companies in general apparently found it advantageous to borrow in the United States in 1990; compared to earlier years, foreign interest rates were high relative to dollar rates. As a result of the shift in the location of funding, direct investment capital inflows dropped sharply in the first three quarters of 1990 compared with 1989, despite the fact that the value of acquisitions of U.S. companies by foreigners remained strong.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1988	1989				1990					
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Oct.	Nov.	Dec.
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-4.9	-2.9	-3.9	-6.4	-5.5	-11.7	-11.0	-15.6	-23.6	-25.1	-31.3
(a) U.S.-chartered banks	21.6	20.4	19.2	14.9	19.2	12.2	7.2	5.7	2.1	.6	5.6
(b) Foreign-chartered banks	-26.5	-23.3	-23.1	-21.3	-24.7	-23.9	-18.2	-21.3	-25.8	-25.7	-36.9
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	21.2	24.0	26.0	21.6	20.7	21.8	22.2	24.0	25.0	25.2	24.7
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	145.3	144.8	131.5	130.3	123.5	110.6	106.5	109.1	113.3	113.4	116.1

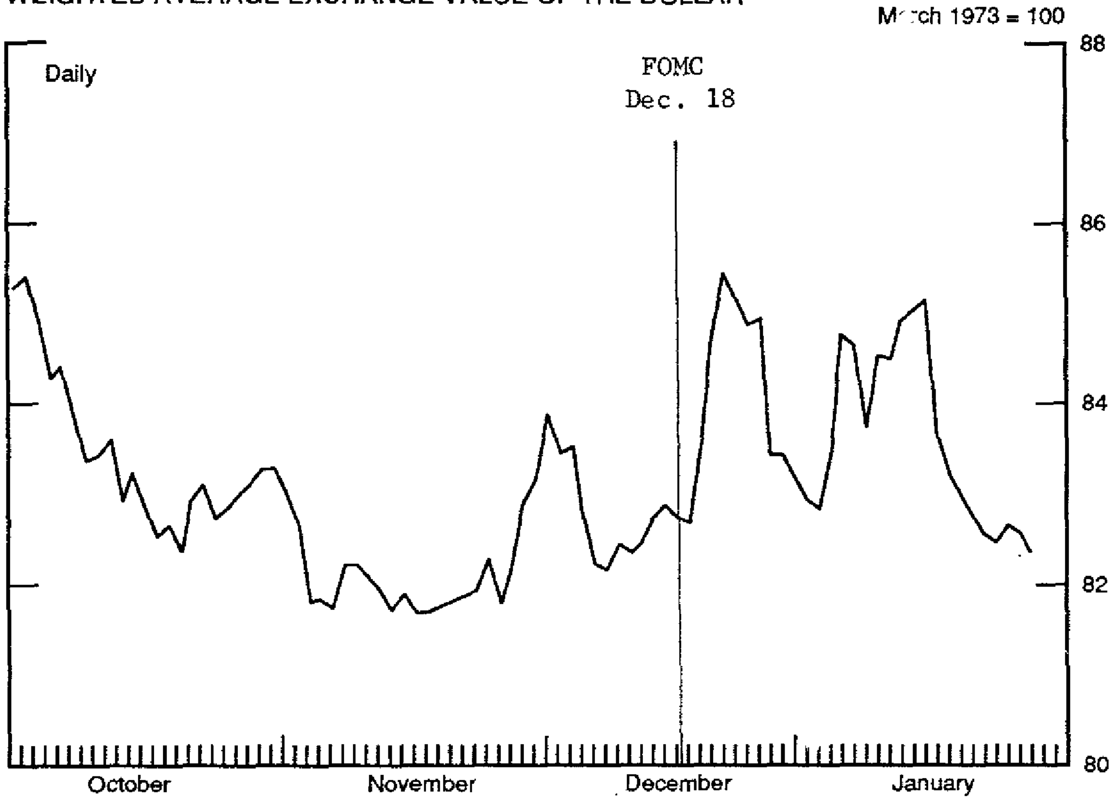
1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices.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

Foreign Exchange Markets

The weighted-average foreign-exchange value of the dollar, in terms of the other G-10 currencies, is virtually unchanged on balance since the December 18 FOMC meeting, as shown in the accompanying chart. The dollar declined 1 percent against the yen and sterling but rose 3/4 percent against the mark. The dollar showed wide swings over the period. The dollar rose more than 3 percent in thin pre-Christmas markets amid concerns about dollar funding for the year-end and remained firm until trading began for the new year. Concerns about the deteriorating political situation in the Soviet Union also contributed to the dollar's temporary strength, especially against the German mark. Soon after year-end, the dollar rose sharply once again as a Persian Gulf war began to look increasingly likely. Once the war actually began, the dollar initially rose to highs of about ¥138 and DM1.55, but within two hours the dollar had fallen 2 percent from its highs as news of the strong first strike by Allied forces was seen as reducing uncertainty about the outcome of the war and the extent of damage to oil supplies.

Short-term interest rates abroad were not greatly changed over the period, except Canadian short-term rates, which declined by a full percentage point. Japanese interest rates declined 5 to 10 basis points at short maturities and about 30 basis points on the long end. German short-term interest rates rose by as much as 25 basis points as the mark weakened before January 16, but the subsequent strengthening of the mark and disappointed expectations of an imminent Lombard rate hike reversed the interest rate gains. In both Germany and Japan, stock prices declined considerably in the run-up to war, rose sharply after fighting began, then eased somewhat over the next two weeks. On balance, Japanese stock prices are 4 percent lower than at the time of the last FOMC meeting while German

WEIGHTED AVERAGE EXCHANGE VALUE OF THE DOLLAR



stock prices have declined about 6 percent, the latter weighed down in part by Soviet political turmoil.

U.S. authorities did not intervene, but the Desk did convert yen funds received from Japan to help the financing of the Persian Gulf war.

Developments in Foreign Industrial Countries

Growth in most major foreign industrial countries appears to have slowed in the fourth quarter. Industrial production (s.a.) declined in November in Japan and Western Germany and again in December in Japan. Other recent indicators in these two economies have been mixed. After strong growth in the third quarter, France and Italy showed signs of slowing in the fourth quarter. In Canada and the United Kingdom, which both saw decreases in GDP (s.a.) in the third quarter, preliminary data indicate continuing weakness in the fourth quarter.

In most countries, data for November and December pointed to a moderation of consumer price inflation, mostly because of lower oil prices, although in January inflation picked up in Japan and Western Germany. Trade and current account surpluses have decreased in recent months in Japan and Germany. Trade deficits in France and the United Kingdom have moderated, while Italy's has increased sharply.

Individual Country Notes. The pace of economic activity in Japan may be slowing, although evidence remains preliminary and inconclusive. Housing starts (s.a.) fell 5.4 percent in November, after four declines in the preceding five months, and were 3.7 percent below their year-earlier level. The number of new passenger car registrations (s.a.) declined by 2.8 percent in December, the fourth consecutive monthly decline. Industrial production

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

	Q4/Q4 1989	Q4/Q4 1990	1990 Q1	1990 Q2	1990 Q3	1990 Q4	1990 Aug.	1990 Sept.	1990 Oct.	1990 Nov.	1990 Dec.	Latest 3 months from year ago 2
Canada												
GDP	2.9	n.a.	.5	-.3	-.3	n.a.	*	*	*	*	*	.5
IP	-.4	n.a.	-1.8	.1	-.4	n.a.	-1.0	-1.3	.1	n.a.	n.a.	-3.2
France												
GDP	3.5	n.a.	.8	.0	1.2	n.a.	*	*	*	*	*	2.8
IP	2.8	n.a.	-.5	1.5	1.4	n.a.	.0	-1.5	.1	-1.9	n.a.	.9
West Germany												
GNP	3.2	n.a.	3.6	-.9	1.7	n.a.	*	*	*	*	*	5.5
IP	4.8	n.a.	2.4	-.7	3.2	n.a.	.7	.8	.2	-.5	n.a.	6.2
Italy												
GDP	3.0	n.a.	.7	-.4	.7	n.a.	*	*	*	*	*	1.7
IP	3.3	n.a.	-2.3	-1.2	1.5	n.a.	.0	.9	-2.9	-.8	n.a.	-2.4
Japan												
GNP	5.3	n.a.	1.6	1.4	1.0	n.a.	*	*	*	*	*	5.4
IP	4.2	7.1	.9	1.9	2.4	1.8	.3	-.9	3.0	-.8	-.5	7.1
United Kingdom												
GDP	1.5	n.a.	1.0	.4	-1.2	n.a.	*	*	*	*	*	.6
IP	.2	n.a.	-.2	1.9	-3.0	n.a.	-.7	-.2	-.4	-1.4	n.a.	-2.4
United States												
GNP	1.8	.3	.4	.1	.4	-.5	*	*	*	*	*	.3
IP	1.1	.1	.2	1.0	1.0	-2.0	.1	.1	-.7	-1.8	-.6	.1

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	Q4/Q4	1989		1990				1990			1991	Latest 3 months
	1989	1990	Q3	Q4	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.	from year ago
Canada													
CPI	5.2	4.9	1.4	.7	1.4	.9	1.1	1.4	.8	.6	-.1	n.a.	4.9
WPI	.2	1.6	-.3	-.6	.4	.3	-.1	1.0	.3	.5	-.2	n.a.	1.6
France													
CPI	3.6	3.6	.7	.8	.7	.9	1.0	1.0	.5	-.2	-.1	n.a.	3.6
WPI	.9	n.a.	-.7	-1.0	-.4	-.2	.2	n.a.	*	*	*	*	-1.4
West Germany													
CPI	3.1	3.0	.0	.6	1.1	.5	.4	.9	.7	-.2	.1	.7	2.9
WPI	4.3	.9	-.6	.3	-.3	.6	.2	.4	.6	-.9	-.3	n.a.	.9
Italy													
CPI	6.6	6.3	1.0	1.8	1.6	1.2	1.4	2.0	.8	.6	.4	n.a.	6.3
WPI	n.a.	n.a.	.0	3.2	1.4	-.1	3.9	n.a.	3.1	-1.7	n.a.	n.a.	10.8
Japan													
CPI	2.9	3.5	.1	.9	.4	1.2	.2	1.6	1.1	-.2	.0	.9	3.9
WPI	3.7	1.9	.8	-.3	.4	.8	.0	.7	.0	.4	.3	n.a.	1.9
United Kingdom													
CPI	7.6	10.0	.9	2.0	1.8	4.7	1.6	1.6	.8	-.2	-.1	n.a.	10.0
WPI	5.2	5.9	1.2	1.2	1.6	2.1	.9	1.1	.5	.3	.2	n.a.	5.9
United States													
CPI (SA)	4.6	6.3	.7	1.0	2.0	.9	1.6	1.7	.6	.3	.3	n.a.	6.3
WPI (SA)	4.9	6.4	.0	1.2	2.3	-.2	1.5	2.7	1.1	.5	-.6	n.a.	6.4

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)

	1989	1990	1989 Q3	1989 Q4	1990 Q1	1990 Q2	1990 Q3	1990 Q4	1990 Sept.	1990 Oct.	1990 Nov.	1990 Dec.
Canada												
Trade	6.4	n.a.	1.6	1.1	1.4	2.4	2.9	n.a.	1.1	.9	1.1	n.a.
Current account	-14.1	n.a.	-3.5	-4.0	-4.4	-3.6	-3.0	n.a.	*	*	*	*
France												
Trade	-6.6	-11.0	-1.6	-2.1	-.4	-3.5	-3.9	-3.2	-2.0	-1.1	-.1	-2.0
Current account	-4.0	n.a.	-1.2	-3.0	.3	-2.4	-3.0	n.a.	*	*	*	*
West Germany												
Trade (NSA)	71.6	n.a.	17.8	16.6	22.4	16.7	12.0	n.a.	3.4	4.2	.5	n.a.
Current account (NSA)	55.5	n.a.	11.1	13.5	17.0	10.8	8.7	n.a.	3.4	4.3	.9	n.a.
Italy												
Trade	-12.4	n.a.	-2.7	-1.8	-4.1	-2.1	-2.4	n.a.	-.7	-1.6	-2.8	n.a.
Current account (NSA)	-10.6	n.a.	.1	-1.5	-6.0	-6.1	n.a.	n.a.	*	*	*	*
Japan												
Trade	64.5	53.8	15.5	12.2	15.6	13.5	16.3	8.5	5.2	2.5	3.3	2.6
Current account 2	57.2	n.a.	14.2	9.2	15.3	8.3	7.1	n.a.	2.3	2.5	2.1	n.a.
United Kingdom												
Trade	-38.2	-29.7	-10.5	-6.9	-9.0	-8.2	-6.8	-5.6	-1.5	-2.1	-1.9	-1.6
Current account	-30.7	-26.9	-9.6	-6.1	-7.8	-7.2	-6.3	-5.6	-1.5	-2.1	-1.9	-1.6
United States												
Trade 2	-114.9	n.a.	-29.8	-28.7	-26.3	-23.1	-29.8	n.a.	*	*	*	*
Current account	-110.0	n.a.	-27.6	-26.7	-21.7	-22.5	-25.6	n.a.	*	*	*	*

1. The current account includes goods, services, and private and official transfers. Asterisk indicates that monthly data are not available.
2. Before July 1990, West Germany only.
3. Annual data are subject to revisions and therefore may not be consistent with quarterly and/or monthly data.

(s.a.) was down 0.5 percent in December, after declining 0.8 percent the previous month. On a twelve-month basis, however, industrial production was up 6.3 percent in December. In contrast, new machinery orders (s.a.) rose 3.8 percent in October, but remained 2.8 percent below year-earlier levels. The capacity utilization rate (s.a.) increased 3.1 percent in October, reaching its highest level since 1973. Labor market indicators also show near-record degrees of tightness. The unemployment rate (s.a.) moved down to 2.1 percent in November.

The consumer price inflation rate has moved higher in recent months. Much of this increase has been attributed to transitory factors, especially a jump in perishable food prices, but officials have also expressed concern over underlying inflationary pressure arising from tight labor and capital markets. Consumer prices in the Tokyo area (n.s.a.) increased by 0.9 percent in January, after remaining unchanged in December. The twelve-month increase moved up to 4.2 percent in January, but was only 3.3 percent excluding perishables. Wholesale prices (n.s.a.) rose by 0.3 percent in December, due partly to the weakness of the yen over this period, and the increase from year-earlier levels rose to 2.2 percent.

The Japanese current account surplus has continued to decline. The surplus in November was lower than in the same month a year earlier, as it has been in all but two months since the beginning of 1989. In the first eleven months of 1990, the current account surplus (s.a.) was $38.6 billion (a.r.), $23 billion less than in the corresponding period in the previous year.

On December 24, the Ministry of Finance presented to the cabinet its draft budget for fiscal year 1991 (beginning in April). The proposed general accounts budget (covering most spending programs) calls for a 2.7 percent expenditure increase from estimates for the current fiscal year (including supplemental spending measures). The proposed budget contains no major tax initiatives. However, the additional $9 billion Persian Gulf contribution announced last week appears likely to be financed by higher taxes. (Japan also made a $4 billion Gulf contribution last year.)

Real GNP in Western Germany increased 4.6 percent in 1990. All elements of final domestic demand were up sharply, while net exports declined slightly. Although official figures for the fourth quarter will not be released until April, the annual figures suggest that there was a sharp deterioration in net exports in the fourth quarter.

Industrial production in Western Germany (s.a.) fell 0.5 percent in November, but this is a provisional figure that is likely to be revised upward. In November industrial production was 5.6 percent above the same period in 1989. The volume of new orders for West German manufactured goods (s.a.) fell 3.4 percent in November, although they remained 6.1 percent above year-earlier levels. The West German unemployment rate (s.a.) fell another 0.1 percentage point in December to 6.6 percent.

Industrial production in Eastern Germany (n.s.a.) increased 3 percent in November, after small increases in September and October. For the third quarter as a whole, however, industrial production was 48 percent below year-earlier levels. East German third-quarter retail sales (n.s.a.) were 45 percent below their level in the same period of 1989. Official East German unemployment (n.s.a.) was 7.3 percent in December, up from 6.7 percent in November. The number of workers engaged in government subsidized "short-time" work (n.s.a.) increased 1 percentage point in October, to 20.3 percent of the labor force.

West German consumer prices (n.s.a.) increased 0.7 percent in January, after being almost unchanged the previous two months. On a year-over-year basis, consumer price inflation fell from 3.3 percent in October to 2.8

percent in December, and then rose slightly to 2.9 percent in January. The year-over-year change in consumer prices excluding energy remained between 2.4 and 2.6 for all of 1990. West German wholesale prices (n.s.a.) and producer prices (n.s.a.) both fell 0.3 percent in December and were 0.3 and 1.5 percent above year-earlier levels, respectively.

The combined German trade balance (s.a.) dropped sharply in November to $4 billion (a.r.). Exports (s.a.) were up 6 percent in November from the average for the previous four months, but imports (s.a.) increased 21 percent over the same period. The combined German current account surplus (n.s.a.) was $11 billion (a.r.) in November, compared with $39 billion (a.r.) in July-October.

In December the Bundesbank announced that it will shift in 1991 from targeting West German M3 to targeting M3 in all of Germany. The current target range of 4-6 percent annual growth will be maintained. West German M3 (s.a.) grew at an annual rate of 5.5 percent from the fourth quarter of 1989 through December 1990.

The Federal budget deficit is estimated to have widened from DM 20 billion in 1989 to about DM 50 billion in 1990, somewhat lower than previously expected. Virtually the entire increase can be attributed to additional expenditures related to unification. If no changes in current policies are made, the Federal deficit is expected to increase further to DM 105 billion (3-3/4 percent of GNP) in 1991. In recent negotiations over the formation of a new government, however, policy changes were accepted that will reduce the 1991 Federal deficit by DM 35 billion. In contrast with statements prior to the December election, anticipated increases in revenues (DM 20 billion) are larger than cuts in spending (DM 15 billion). The agreed changes also include special tax breaks for Eastern Germany. (Recently Germany announced that it will contribute $5.5 billion to the

United States for expenditures related to the Gulf War, increasing Germany's total contribution since the Gulf crisis began to $9.2 billion.)

In France, after a strong third quarter, preliminary data indicate that activity slowed sharply in the fourth quarter. GDP (s.a.) grew 5 percent (a.r.) in the third quarter, although inventory accumulation contributed 3.5 percentage points to this figure. After a 0.1 percent rise in October, industrial production (s.a.) fell sharply in November and was down 2.8 percent from its average level in the third quarter.

French inflation has remained moderate. The CPI (n.s.a.) fell 0.2 percent in November and another 0.1 percent in December. Inflation on a twelve-month basis was 3.4 percent in December, down from 3.9 percent in October and 3.6 percent in November. Excluding energy prices, twelve-month inflation was 3.1 percent in December, the same as in October and slightly above the November figure of 3 percent.

The French merchandise trade deficit (s.a.) narrowed from $15.6 billion (a.r.) in the third quarter to $12.8 billion (a.r.) in the fourth quarter. For the year as a whole, the deficit expanded from $6.6 billion in 1989 to $11 billion in 1990.

Preliminary data from Italy indicate that GDP (s.a.) rose 2.8 percent (a.r.) in the third quarter of 1990, following a small drop in the previous quarter. Consumption spending and inventory accumulation were the prime contributors to this growth. Industrial production (s.a.) declined 2.9 percent in October and another 0.8 percent in November.

Consumer prices rose 6.3 percent in December from their level a year earlier, down from a 6.5 percent increase in November. Wholesale prices in November rose 9.4 percent from their level a year earlier, down from 12.1 percent in the previous month.

The trade deficit (s.a.) increased sharply in November to \$33.6 billion (a.r.). The cumulative trade deficit for the first eleven months of 1990 increased roughly 25 percent from the same period a year earlier, in part reflecting a deterioration in the energy balance.

According to preliminary data, the 1990 budget deficit was 10.7 percent of GDP, exceeding its target by 0.4 percentage points. In December, Parliament passed the 1991 budget, which includes deficit-reduction package of 3-3/4 percent of GDP.

Recent data provide evidence that the recession in the United Kingdom is deeper than had been expected. Real GDP (s.a.) contracted 4.7 percent (a.r.) in the third quarter, after rising 1.6 percent in the second quarter of 1990. The decline in GDP was dominated by the largest drop in investment since 1985. Exports, private consumption, and government consumption also fell. In November, industrial output (s.a.) declined 1.4 percent to stand 2.8 percent below its year-earlier level. Unemployment rose for the ninth consecutive month in December, reaching a rate (s.a.) of 6.5 percent.

Retail prices fell slightly in December to a level 9.3 percent above a year earlier. This followed a marked decline in the year-over-year rate of inflation in November, as the mortgage rate increase of 1989 dropped out of the calculation and the 1990 mortgage rate cut took effect. Excluding mortgage interest payments and the poll tax, the "underlying" rate of inflation edged down to 7.7 percent in December from 8 percent the previous month.

In December, U.K. external deficits narrowed, bringing the cumulative trade and current account deficits for 1990 to \$30 billion and \$27 billion, respectively, down from \$38 billion and \$31 billion in 1989.

Real GDP (s.a.) in Canada declined 1 percent (a.r.) in the third quarter, following a slightly larger decline in the second quarter. All components of domestic demand except consumption fell, with real gross fixed investment (s.a.a.r.) dropping 16.6 percent.

Continued weakness in economic activity is evident from fourth-quarter indicators. Manufacturing shipments (s.a.) fell 3 percent in November. October retail sales (s.a.) decreased 0.3 percent in both October and November. Unemployment (s.a.) rose for the sixth consecutive month in December to 9.3 percent. Housing starts (s.a.) were down nearly 40 percent in December from a year earlier.

Seasonal factors and lower fuel prices pushed the consumer price index (n.s.a.) down 0.1 percent in December, while the index remained 5 percent above its year-earlier level. Excluding food and energy, consumer price inflation on a twelve-month basis fell to 4 percent in December from 5.5 percent rate a year earlier. Major wage settlements (n.s.a.) accelerated to 6.5 percent (a.r.) in the third quarter, after moderating in the second quarter to a 5.4 percent rate.

The controversial Goods and Services Tax went into effect on January 1. The 7 percent, broadly based value-added tax replaces the 13-1/2 percent manufacturers' sales tax. Official government estimates maintain that the tax will add 1-1/4 percent to the level of consumer prices, although preliminary reports indicate that many retailers are absorbing the tax in an effort to promote sales.

Developments in East European Economies

In Poland, data for November indicate that the recession is bottoming out, although inflation continues to exceed the objectives of the reform program, largely because of increases in real wages. Hungarian industrial production continued to contract, but increasing production at medium-sized firms suggests that industry restructuring is beginning to take effect. The Czech and Slovak Federal Republic embarked on a program of sweeping economic reform on January 1. Industrial production in the CSFR for the first nine months of 1990 was down compared with a year earlier.

Individual Country Notes. Poland's new government is taking shape. President Walesa's choice for Prime Minister, Jan Krysztof Bielecki, has indicated that he will conform to the Balcerowicz program in substance, although with some greater priority to financial sector reforms. The extended period of political uncertainty set key elements of the macroeconomic program off-track. The IMF stand-by arrangement was allowed to lapse when it was clear that renegotiated targets for wage and domestic credit growth for the fourth quarter would not be met.

November data confirm the bottoming-out of the recession with industrial sales by state-owned firms only 15.7 percent below November 1989 levels; on a month-over-month basis, sales have been rising the past two months. The unemployment rate (in the non-agricultural sector) was 8.3 percent at the end of the first year of the reform program. Monthly inflation continued to run higher than programmed, in part because of oil prices, but more importantly because of a continued increase in real wage costs.

Poland was required to dip into reserves after posting a hard-currency trade deficit in November of $162 million, the first monthly deficit of 1990. International reserves remain comfortable, totaling $5.2 billion at the end of December, up from about $2.5 billion at the end of 1989. Poland has not used the $1 billion multilaterally sponsored Stabilization Fund, which has been extended for another year.

The Hungarian government is negotiating two agreements with the IMF: a three-year Extended Fund Facility (EFF) worth about $1.5 billion and a Compensatory and Contingency Financing Facility (CCFF) worth about $450 million. Key provisions of the EFF agreement are that the government budget deficit should not exceed 78 billion forints ($1.2 billion, about 3 percent of GDP) and that growth in net domestic assets for 1991 should be limited to 14.6 percent. Parliament has passed the budget underpinning this program.

Industry restructuring is evident in production data. While industrial production contracted about 10 percent in the first eight months of 1990, production at enterprises employing between 50 and 300 people increased 21 percent over the same period. The unemployment rate stood at 1.7 percent at year end. Inflation for the year was estimated to be 29 percent.

Hungary achieved a hard currency trade surplus of $0.9 billion in 1990, compared with a surplus of $0.6 billion in 1989. Trade is increasingly oriented toward the European Community (EC), which now accounts for about half of Hungary's trade. As part of its program to reach current account convertibility by 1992, Hungary devalued the forint by 15 percent on January 7.

The EC has approved the disbursement of the second tranche of the $1 billion loan to Hungary that it arranged last year. In addition, the G-24 is considering funding another $700 million loan.

January 1 marked the starting date for sweeping changes in the structure and functioning of the economy of the Czech and Slovak Federal Republic. The most obvious changes involved liberalization of wages, prices, foreign exchange, and trade. While price increases are apparent, they are much less widespread and much smaller than when Poland freed prices on January 1, 1990. The koruna exchange rate was unified at 28K/$, implying a devaluation of about 14 percent of the business rate and a revaluation of about 7 percent of the tourist rate. Import licensing and quota restrictions were reduced (and are scheduled to be eliminated in May 1991), but a GATT-legal import tax of 20 percent was imposed on some consumer goods to support the move to a convertible currency.

To back the reforms, the CSFR made drawings from its recently negotiated IMF stand-by arrangement and CCFF agreement totalling about \$755 million. In the first two weeks of January, the CSFR State Bank spent \$170 million defending the new koruna rate. The EC is coordinating efforts within the G-24 to design a \$1 billion loan for the CSFR that would be similar to the one for Hungary.

In the first nine months of 1990, gross industrial output fell 3.7 percent from a year earlier. In the same period, hard-currency exports and imports were flat, yielding a trade deficit of about \$88 million; the hard-currency trade surplus was \$419 million in 1989. As of mid-year 1990, more than one-half of trade was with hard-currency countries, up from 35 percent in 1989.

<u>Economic Situation in Major Developing countries</u>

In Brazil, rising inflation underscored the need for renewed adjustment effort, but no steps have been taken to implement additional stabilization policies. Lack of progress in negotiations between Brazil and the commercial banks led the IMF to continue to hold up consideration of a stand-by program. The Mexican economy registered stronger-than-expected growth in 1990, and the government has not moved to restrain this activity; inflation rose toward the end of the year, in part due to boosts in energy prices. In Argentina, a run on the currency at the end of January prompted a replacement of the economic team and may portend a rise in inflation, which had continued to decline in December. In December 1990, Venezuela completed its financing package covering almost all the country's \$19.7 billion medium- and long-term commercial bank debt. A debt restructuring package for Uruguay is expected to be signed at the end of

January 1991. The Philippines plans to sign a Letter of Intent for an IMF package of stand-by and CCFF loans by early February, while the IMF approved a 15-month stand-by loan for Nigeria. In Taiwan, a large drop in interest rates led to a rebound in industrial production and exports during the second half of 1990, while 1990 inflation reached 4.5 percent, the highest rate since 1981. Inflationary pressures also increased in Korea in 1990, and the Korean current account deficit widened substantially as well. The governments of both these East Asian economies announced measures to increase foreign access to domestic securities markets.

Individual Country Notes. In Brazil, inflation has been rising amid fiscal pressures and skepticism about the prospects for the survival of the Collor government's stabilization program launched last March. Monthly inflation was 18.3 percent in December, compared with 15.6 percent in November and 14.2 percent in October. Economic activity has continued to decline. GDP registered an estimated 4.3 percent decline in 1990, and industrial production in November was 9.4 percent lower than a year earlier. Real interest rates remain high despite easing of monetary policy since October, about 5 percent per month for 30-day corporate borrowing. Brazil's trade surplus fell to $11.3 billion in 1990 from $16.1 billion in 1989.

President Collor's popular support appears to remain solid, despite the worsening economic situation. The government has continued to resist the reintroduction of mandatory wage indexation; Collor vetoed the latest proposal from Congress in early January. However, observers believe that in the coming months, after the newly elected Congress takes office in early February, the government will need to announce new disinflation measures. These are expected to include a wage and price freeze, but it is not known what fiscal measures will be included.

Brazil and its bank creditors remain far apart on the terms of an agreement on the estimated $9 billion in interest arrears that have accumulated through December 1990, and whether implementation of an agreement on the arrears should be linked to an agreement on the remaining stock of debt. Banks warned that short-term credit lines would continue to decline if no agreement were reached. The IMF management continues to hold up Executive Board consideration of a negotiated stand-by arrangement, the Letter of Intent for which was signed last August, until Brazil makes satisfactory progress with bank creditors. Disbursements on over 30 World Bank loans totalling $3 billion are suspended, pending a report on overall World Bank relations with Brazil that is scheduled to be ready in February.

Indications are that Mexico's 1990 real GDP growth may have been around 3.5 percent, more than the 2.8 percent forecast. Recently released data show a third-quarter annual growth rate of 5.5 percent and an upward revision of the second-quarter rate to 2.8 percent. Fourth-quarter growth is also thought to have been high. Imports through November were 26 percent above the year-earlier level, up from 19 percent through June. Apart from catch-up energy price increases in November, there has been no move to curb growth. On the contrary, part of the windfall from the higher-than-expected oil revenues is being spent on an anti-poverty program. With congressional elections this summer, restraining actions are unlikely in the near term.

Domestic interest rates have fallen since mid-December. At the January 22 auction, the 28-day Treasury bill rate was 23.5 percent, down from 26.1 percent on December 18. Since mid-November, the 28-day rate has been negative in real terms. Following the energy price increases, the CPI rose 2.7 percent in November and 3.2 percent in December after rising by only 1.4 percent each in September and October.

The assurances provided by the anti-inflation pact that the peso price of the dollar will increase by only 5 percent during 1991 appear to have boosted demand for Mexican interest-bearing assets. However, the fall of oil prices to pre-Gulf crisis levels and the ongoing real appreciation of the peso portend a widening of the current account deficit that could trigger an outflow of capital unless macroeconomic policies are tightened.

In December, a controlling interest in the state-owned telephone system was sold for $1.76 billion to a conglomerate in which Southwestern Bell and a French telecommunications company are investing $485 million and $412 million, respectively. Half of the purchase price was paid in December and the other half is due by the end of January.

In Argentina, a run on the exchange rate has clouded the future of the disinflation program. The austral price of the dollar rose from roughly 6,200 on January 23 to 7,800 on January 28, after which a two-day bank and exchange holiday was declared. The sharp run-up in the dollar reflected strong monetary growth and poor fiscal performance in previous months, a seasonal downturn in money demand, and the perception that the exchange rate was overvalued and would have to depreciate to restore Argentina's competitiveness. Economy Minister Antonio Erman Gonzalez and Central Bank President Javier Gonzalez Fraga resigned in response to the exchange rate's move; current Foreign Minister and former Central Bank President Domingo Cavallo has been named as the new Economy Minister, but the new Central Bank head has yet to be selected. These developments follow an earlier cabinet reshuffling in mid-January, when a corruption scandal led the Ministry of Public Works, long thought to be tainted by corruption, to be dismantled and taken over by the Economy Ministry.

Consumer price inflation registered 4.7 percent (monthly basis) in December, down from 6.2 percent in November and the lowest rate since

December 1987. The decline reflected a seasonal strengthening of money demand associated with the holidays, and took place in spite of rapid monetary emission linked to extensive purchases of foreign exchange and central bank financing of troubled provincial banks and the Social Security System. In the coming months, inflation is likely to rise in response to the sharp depreciation of the exchange rate and continuing fiscal problems that will make monetary restraint difficult. In January, the government also increased partial interest payments to commercial banks from $40 million to $60 million per month, compared with monthly interest obligations in excess of $250 million; total interest arrears to commercial banks were roughly $8 billion at end-1990.

In December 1990, Venezuela completed a financing package covering almost all of the country's $19.7 billion in medium- and long-term external debt to commercial banks. The package included a buyback (at 45 cents per dollar of face value), a par bond swap (with a 6-3/4 percent fixed interest rate), a discount bond swap (at a 30 percent discount), and a new money option (20 percent increase in exposure over three years). Also in December, the IMF approved a Venezuelan purchase of over SDR 1 billion (about $1.4 billion). This total includes disbursements under Venezuela's Extended Fund Facility and funds to support the reduction of commercial bank debt and debt service.

Preliminary data indicate that Venezuela's real GDP grew about 4 percent last year after falling 8.3 percent in 1989. Annual consumer price inflation declined from 81 percent in 1989 to 36.5 percent in 1990, but monthly inflation jumped to 3.5 percent in December. A larger-than-expected increase in oil export revenues last year contributed to a current account surplus of $7.4 billion (about 13 percent of GDP) and international reserve growth of $4.1 billion.

The Philippines plans to sign a Letter of Intent for an 18-month IMF stabilization program to replace the discontinued Extended Fund Facility by early February, after it meets IMF policy pre-conditions. The financing package will total SDR 543 million (about $765 million) and consists of a SDR 264 million stand-by arrangement and SDR 279 million from the Compensatory and Contingency Financing Facility. The IMF Board is scheduled to consider the program on February 20, and approval of the program is expected to lead to the provision of additional funds to the Philippines from non-IMF sources amounting to about $700 million. The Philippines will also be seeking funds from its major official donors at a pledging conference in Hong Kong on February 25-26.

Following prolonged negotiations, Nigeria received IMF approval of a 15-month SDR 319 million ($450 million) stand-by arrangement from the IMF on January 9. As in its two previous stand-bys, Nigeria is not expected to draw on this arrangement due to domestic political considerations.

By the end of January 1991, Uruguay is expected to have signed the debt restructuring package with its commercial bank creditors originally agreed to in October 1990. By mid-December 1990, all creditor banks had agreed to participate, with $535 million (33 percent of debt) committed to swaps, $628 million (39 percent) to buybacks, and $447 million (28 percent) to a base for new money loans.

In Taiwan, a large drop in interest rates in the second half of 1990 contributed to a recovery in industrial production and exports. Industrial production was 2.5 percent higher in November than a year earlier, and exports were over 11 percent higher, the largest increase in over a year. Consumer prices rose 4.5 percent over 1990, the largest increase since 1981. The global trade surplus (on a customs basis) fell to $12.5 billion in 1990 from $14 billion in 1989, largely due to a decline in the fourth-quarter surplus. At end-December, Taiwan's authorities approved limited direct investment in Taiwan securities by foreign institutions starting in the first quarter of 1991. In addition, the authorities will allow two foreign securities firms, both U.S., to establish branches in Taiwan and to sell foreign securities directly to local investors beginning this quarter.

In Korea, consumer price inflation rose to 9.4 percent in 1990 from 5.1 percent in 1989. The increase reflected strong domestic demand stimulated by rapid money growth over most of 1990, as well as the pass-through of oil prices to consumers at end-November. Korea's current account deficit soared to $1.2 billion in November, bringing the cumulative January-November current account deficit to $2.5 billion compared with a surplus of $4.3 billion in the same period of 1989. The Korean Ministry of Finance announced it will begin taking applications from foreign securities firms for the establishment of domestic branches or joint ventures on February 1, 1991.