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November 8, 1989

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

Recent Developments

The economy has continued to expand, but unevenly: While the service-producing sector appears to be growing moderately, manufacturing has been quite weak of late, owing in good measure to strikes and other disruptions to production. Price increases have been smaller since midyear, but there has been no abatement of wage inflation.

Private nonfarm payroll employment increased 146,000 in October on a strike-adjusted basis, well below the average monthly change earlier in the year. Manufacturing payrolls declined further, held down by continued weakness in motor vehicles and other durable goods industries. Much of the gain in October was in the private service-producing sector, where increases were evident in transportation, health and business services, and retail trade. In addition, hiring was strong for the second month in a row in government and reportedly reflected increases in local education. The civilian unemployment rate remained at 5-1/4 percent in October. Initial claims for unemployment insurance rose somewhat through late October, but they remained below the level that typically has been associated with an increase in the unemployment rate.

Industrial production increased at a 1-1/4 percent annual rate in the third quarter, 1-1/2 percentage points less than in the first half of the year. Cutbacks in the production of motor vehicles accounted for a large part of the deceleration, but there was a leveling in the output of business equipment. Production likely posted a sizable drop in October because of

natural disasters and the Boeing strike, which together may have cut as much as 3/4 percentage point from growth. Elsewhere, output appears to have been little changed. Production worker hours (excluding transportation equipment) were essentially flat. Auto assemblies edged down to an annual rate of 6.7 million units, truck production declined, while other physical product data were mixed.

Real consumer spending was quite strong in the third quarter, increasing at a 5-3/4 percent annual rate. Generous incentive programs and a desire to avoid the higher prices on 1990 model vehicles induced a surge in purchases of cars and light trucks. In addition, other consumer expenditures were up sharply, buoyed by healthy gains in real disposable income. Although spending on nonauto durable goods was flat in the third quarter, sales of nondurable goods bounced back from their second-quarter decline, and purchases of services advanced rapidly. Consumer sentiment remains quite positive, and with gains in labor income well maintained through October, consumer spending is likely to rise further in the fourth quarter despite an anticipated "payback" in motor vehicle sales.

Growth in business fixed investment moderated in the third quarter from its rapid first-half pace. The slowdown was concentrated in producers' durable equipment and reflected a leveling in business purchases of information-processing equipment. Spending picked up for other types of business equipment and nonresidential structures. Forward-looking indicators suggest a further deceleration of business fixed investment in the current quarter. Although orders for office and computing equipment have risen recently, bookings for other types of nondefense capital goods (excluding aircraft) fell sharply in the third quarter. The Boeing strike

is trimming deliveries to both domestic and foreign customers. In addition, nonresidential construction permits have been trending downward for much of this year.

Residential construction activity fell somewhat further in the third quarter, despite a decline in mortgage rates. Single-family starts averaged 1 million units, as weakness in the Northeast offset a pickup in other regions of the country. Indicators of demand in the market are mixed of late: New home sales revived in July and August but dropped sharply in September; in contrast, sales of existing homes rose steadily over the quarter and in September were at their highest level since late 1988. In the multifamily market segment, starts fell throughout the third quarter.

Inventory data are sparse beyond August. Available statistical and anecdotal evidence suggests that inventories generally are not excessive at the retail and wholesale levels. The inventory-to-sales ratio has stopped declining in manufacturing, but there appear to be only scattered and moderate imbalances at the factory level.

A variety of data on labor costs have been published since the last Greenbook, and they convey a somewhat ambiguous impression of prevailing trends. Average hourly earnings jumped 0.7 percent in October, but the twelve-month change, at 4 percent, remained well within the range of recent experience. In contrast, the broader-based employment cost index (ECI) gave evidence of a persistent updrift in wages and salaries in the third quarter, a trend that was apparent in most industry and occupational groupings. Although lower than a year ago, the growth in ECI benefits remained high in the third quarter, owing mainly to rising health insurance costs. The

deceleration in benefits relative to 1988 reflects the absence of an increase in the social security tax rate this year.

Despite the persistent pressure from labor costs, retail price inflation has slowed in recent months. The consumer price index increased 0.2 percent in September, as energy prices declined and other prices rose modestly on average. At the producer level, finished goods prices increased 0.9 percent in September. This only offset the declines of the preceding three months, however, and reflected a rebound in wholesale energy prices and problems in the seasonal adjustment of motor vehicle prices at the end of the 1989 model year. Taking a longer view, the PPI for consumer goods excluding food and energy has risen 4-1/2 percent over the past twelve months, well above the 2-3/4 percent increase in the comparable component of the CPI. These differential movements mainly reflect the direct restraining influence on the CPI of falling import prices.

Outlook

The staff forecast continues to be conditioned on the FOMC's stated objective of a reduction in the rate of inflation over time. The recent data on wages and prices have been consistent with our view that additional slack will be necessary to achieve that objective. It does appear that, at current interest rate levels, aggregate demand will be more moderate in the near term. But, if the dollar depreciates as projected, the resultant stimulus to net exports will tend to cause activity to strengthen in 1991. Although the projected decline in the dollar facilitates the process of external adjustment, it inhibits progress on the inflation front.

Consistent with this assessment, the forecast assumes that short-term interest rates will be essentially unchanged through the middle of 1990 and

then rise gradually thereafter. M2 growth is expected to be near the midpoint of its target range this year and in the upper half of its tentative range during 1990. Higher interest rates and a small associated increase in velocity are expected to induce some moderation in the rate of M2 growth in 1991. The contraction of thrift balance sheets is expected to continue to restrain M3 over the rest of this year, and its growth is expected to be just within its target range. M3 growth is projected to pick up a bit in 1990 to the middle of the tentative range and to remain at about that pace into 1991.

Fiscal policy is expected to remain somewhat restrictive in 1990 and 1991. The federal deficit is projected to fall from \$152 billion in FY1989 to \$133 billion in FY1990. Following the spirit of the spring bipartisan budget agreement, the forecast assumes that the Congress still will enact sufficient tax and spending measures to cut the deficit by \$27 billion in the current fiscal year. These measures would have about the same effect on the deficit as the present sequester, which would be repealed. Another \$25 billion in new deficit reduction actions is assumed in FY1991. However, given the staff's economic outlook, such policies still imply an FY1991 deficit of around \$122 billion--well above the \$74 billion Gramm-Rudman sequestration trigger. Thus, the forecast implicitly assumes that the Gramm-Rudman legislation will be amended.

The staff's near-term outlook for economic activity is influenced by the effects of Hurricane Hugo, the San Francisco earthquake, and the machinists' strike at Boeing. Enormous uncertainty surrounds any

THE IMPACT OF NATURAL DISASTERS AND STRIKES ON REAL GNP GROWTH
(Billions of 1982 dollars)

	1989		1990
	Q3	Q4	Q1
TOTAL	-1.0	-2.5	6.5
Natural disasters			
Direct output loss	-1.0	-1.5	2.5
Rebuilding effect		5.0	-2.0
Boeing strike		-6.0	6.0

Note: \$1 billion is equivalent to 0.1 percentage point (at an annual rate) on real GNP growth.

calculation of this type, but we have assumed that the combined effect of these special factors is to lower real GNP growth by about 0.3 percentage point in the fourth quarter and to boost it by almost 0.7 percentage point in the first quarter of 1990. As shown in the above table, the direct output loss associated with the natural disasters is expected to be small and quickly reversed. In addition, rebuilding activity began almost immediately and is expected to be a net plus to GNP growth in the current quarter; as the initial wave of activity subsides, this effect has a negative influence on growth in the first quarter of 1990. The strike at Boeing is assumed to last through November and to lower real GNP growth by more than 1/2 percentage point.¹ Although the level of output snaps back in the first quarter of 1990, the forecast assumes that, because of capacity constraints, Boeing will not be able to "make up" any of the lost output.

¹ The negative effect of the Boeing strike on the fourth-quarter projection of industrial production is 1-1/2 percentage points at an annual rate.

Abstracting from these special factors, real GNP growth in the fourth quarter of 1989 and first quarter of 1990 is expected to slow to something under 2 percent. Consumer spending excluding motor vehicles is projected to remain buoyant, and homebuilding picks up some. However, net exports (adjusted for special factors) make little contribution to growth, and recent movements in contracts and new orders point to a deceleration in fixed investment.² Moreover, with sales growth turning more sluggish, businesses are expected to curtail their stockbuilding.

For 1990 as a whole, real GNP is forecast to increase around 1-1/2 percent. Real consumer spending is projected to rise only about 2 percent next year, owing to the slower growth in real disposable personal income as payroll gains diminish. Capital spending is expected to post only a small increase, as profit margins decline and easing capacity pressures reduce the urgency of plant expansion. In addition, net exports make virtually no contribution to growth. The lagged effects of the appreciation of the dollar, coupled with moderate growth abroad, slow increases in the demand for U.S. exports, while non-oil merchandise imports continue to grow more rapidly than domestic demand.

Economic activity is expected to pick up in 1991, with the projected depreciation of the dollar stimulating nonagricultural exports and restraining the rise in non-oil merchandise imports. However, domestic demand is expected to remain weak, reflecting ongoing fiscal

2. The growth rate of expenditures on producers' durable equipment is inflated in the first quarter of 1990 by a rebound in aircraft shipments following the end of the Boeing strike.

restraint and rising interest rates. Growth in consumer spending remains slow, as rising prices for imported products hold down real income gains, while higher mortgage interest rates induce some cutback in residential construction activity. Business fixed investment accelerates mildly over the course of the year in response to the export-led pickup in production.

In the short run, despite the tautness in labor markets, we are not projecting a significant further acceleration in wages. This projection hinges on our anticipation that the recent softening of consumer prices will damp nominal wage demands. However, growth in compensation per hour is boosted 1-1/4 percentage points in the first quarter of 1990 by higher social security taxes and 3/4 percentage point in the second quarter by an increase in the minimum wage.³ As slack begins to emerge in the latter part of 1990 and into 1991, wage inflation starts to diminish, apart from a second round of increases in the minimum wage.

The trajectory for price inflation over the forecast horizon is influenced by the offsetting movements in labor costs and import prices. In the near term, the lagged effects of the past appreciation of the dollar are projected to be a restraining influence on consumer price inflation, while increases in labor costs imply pressures on profits and prices. However, as the dollar depreciates, rising import prices are expected to more than offset the projected moderation in the growth of

3. Compromise legislation now making its way through the Congress would raise the minimum wage from \$3.35 per hour to \$3.80 in the second quarter of 1990 and to \$4.25 in the second quarter of 1991. This two-year phase-in is faster than that assumed in the September Greenbook, which was based on the Bush Administration proposal to raise the minimum wage to \$4.25 per hour by the first quarter of 1992.

compensation. We are expecting the CPI excluding food and energy to increase 4-1/4 percent in 1989 and to accelerate to a 4-1/2 percent annual pace by the middle of next year, where it remains for the remainder of the forecast horizon. Model simulations suggest that, were the dollar to remain constant at recent levels, consumer price inflation would be about 1/2 percentage point lower in both 1990 and 1991.⁴

4. As in the September Greenbook, these model simulations assume that monetary policy would be adjusted so as to keep the path for real GNP during 1990 and 1991 the same in the alternative as in the basic Greenbook forecast.

November 8, 1989

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STAFF GNP PROJECTIONS

Percent changes, annual rate

		Nominal GNP		Real GNP		GNP fixed-weight price index		Consumer Price Index <1>		Unemployment rate (percent)	
		9/27/89	11/8/89	9/27/89	11/8/89	9/27/89	11/8/89	9/27/89	11/8/89	9/27/89	11/8/89
Annual changes:											
1987	<2>	6.9	6.9	3.7	3.7	3.6	3.6	3.7	3.7	6.2	6.2
1988	<2>	7.9	7.9	4.4	4.4	4.2	4.2	4.1	4.1	5.5	5.5
1989		7.3	7.2	3.0	3.0	4.5	4.5	4.8	4.8	5.2	5.2
1990		5.8	5.7	1.9	1.8	4.0	4.0	3.9	3.8	5.6	5.6
1991		5.6	5.7	1.7	1.8	4.2	4.2	4.3	4.4	6.1	6.1
Quarterly changes:											
1988	Q1 <2>	6.5	6.3	4.0	4.0	3.8	3.8	3.9	3.9	5.7	5.7
	Q2 <2>	8.6	8.6	3.7	3.7	4.8	4.8	4.5	4.5	5.5	5.5
	Q3 <2>	7.5	7.5	3.2	3.2	5.2	5.2	4.5	4.5	5.5	5.5
	Q4 <2>	7.5	7.5	2.7	2.7	4.3	4.3	4.4	4.4	5.3	5.3
1989	Q1 <2>	7.9	7.9	3.7	3.7	4.8	4.8	5.4	5.4	5.2	5.2
	Q2 <2>	7.1	7.1	2.5	2.5	5.0	5.0	6.4	6.4	5.3	5.3
	Q3 <2>	6.1	5.6	2.5	2.5	3.3	2.9	2.6	2.6	5.2	5.2
	Q4	5.3	4.9	2.1	1.7	3.6	3.6	3.3	3.3	5.3	5.3
1990	Q1	6.4	6.4	1.8	2.2	4.4	4.4	3.9	3.7	5.4	5.4
	Q2	5.7	5.4	1.5	1.3	4.1	4.1	4.2	4.1	5.5	5.5
	Q3	5.2	5.4	1.3	1.5	4.1	4.1	4.2	4.2	5.7	5.7
	Q4	5.3	5.2	1.5	1.5	4.1	4.1	4.3	4.3	5.9	5.9
1991	Q1	5.8	6.2	1.6	1.7	4.6	4.7	4.5	4.6	6.0	6.0
	Q2	5.7	5.8	2.1	2.1	4.0	4.1	4.3	4.4	6.1	6.1
	Q3	6.0	5.9	2.2	2.2	4.0	4.0	4.3	4.4	6.2	6.2
	Q4	5.8	5.9	2.2	2.3	4.0	4.0	4.3	4.4	6.2	6.2
Two-quarter changes: <3>											
1988	Q2 <2>	7.5	7.5	3.9	3.9	4.2	4.2	4.1	4.1	-4	-4
	Q4 <2>	7.5	7.5	2.9	2.9	4.8	4.8	4.6	4.6	-2	-2
1989	Q2 <2>	7.5	7.5	3.1	3.1	5.0	5.0	5.9	5.9	.0	.0
	Q4	5.7	5.3	2.3	2.1	3.4	3.2	2.9	2.8	.0	.0
1990	Q2	6.0	5.9	1.7	1.7	4.3	4.3	4.0	3.9	.2	.2
	Q4	5.3	5.3	1.4	1.5	4.1	4.1	4.2	4.3	.4	.4
1991	Q2	5.8	6.0	1.8	1.9	4.3	4.4	4.4	4.5	.2	.2
	Q4	5.9	5.9	2.2	2.2	4.0	4.0	4.3	4.4	.1	.1
Four-quarter changes: <4>											
1987	Q4 <2>	8.6	8.6	5.4	5.4	4.0	4.0	4.4	4.4	-.9	-.9
1988	Q4 <2>	7.5	7.5	3.4	3.4	4.5	4.5	4.3	4.3	-.6	-.6
1989	Q4	6.6	6.4	2.7	2.6	4.2	4.1	4.4	4.4	.0	.0
1990	Q4	5.6	5.6	1.5	1.6	4.2	4.2	4.1	4.1	.6	.6
1991	Q4	5.8	6.0	2.0	2.0	4.2	4.2	4.4	4.4	.3	.3

For all urban consumers.

Actual.

<3> Percent change from two quarters earlier.

<4> Percent change from four quarters earlier.

November 8, 1989

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CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	1983	1984	1985	1986	1987	1988	Projection		
								1989	1990	1991
EXPENDITURES										

Nominal GNP	Billions of \$	3405.7	3772.2	4014.9	4231.6	4524.3	4880.6	5231.1	5528.2	5845.5
Real GNP	Billions of 82\$	3279.1	3501.4	3618.7	3717.9	3853.7	4024.4	4143.3	4219.6	4293.6
Real GNP	Percent change*	6.5	5.1	3.6	1.9	5.4	3.4	2.6	1.6	2.0
Gross domestic purchases		8.4	6.4	4.3	2.1	4.6	2.4	2.5	1.5	1.3
Final sales		3.7	4.7	4.6	2.7	3.3	4.4	2.5	1.8	2.1
Private dom. final purchases		7.7	5.6	4.6	2.9	2.7	3.8	2.8	2.0	1.4
Personal consumption expend.		5.4	4.1	4.6	3.8	2.2	3.8	2.9	1.9	1.3
Durables		14.7	10.8	7.0	11.5	-2.0	8.0	2.7	1.5	1.3
Nondurables		4.4	2.3	3.3	2.9	1.1	2.1	1.5	1.1	.7
Services		3.9	3.5	5.0	2.1	4.4	3.6	3.9	2.6	1.7
Business fixed investment		10.8	13.8	3.7	-5.5	8.5	4.2	5.4	2.9	2.8
Producers' durable equipment		20.9	14.9	4.6	.4	11.1	7.0	7.5	4.0	3.6
Nonresidential structures		-4.8	11.8	1.9	-17.7	1.9	-3.4	-1.0	-1.1	-.2
Residential structures		38.1	6.1	5.8	11.6	-4.2	3.2	-4.1	1.3	-1.7
Exports		5.8	5.9	-2.4	10.6	19.1	13.9	7.6	7.0	10.2
Imports		23.8	17.4	4.5	10.0	9.6	5.3	6.2	6.0	4.6
Government purchases		-2.7	7.9	8.6	3.1	2.1	1.8	.5	.7	.9
Federal		-8.1	13.0	13.3	.5	.7	-.3	-2.0	-.9	-.4
Defense		5.1	6.5	7.1	6.0	4.3	-1.9	-3.5	-3.3	-1.5
State and local		1.5	4.4	4.9	5.2	3.1	3.4	2.4	1.8	1.8
Change in business inventories	Billions of 82\$	-6.4	62.3	9.1	5.6	23.7	27.9	24.1	11.4	12.4
Nonfarm	Billions of 82\$	-.1	57.8	13.4	8.0	25.8	30.7	21.4	13.8	18.2
Net exports	Billions of 82\$	-19.9	-84.0	-104.3	-129.7	-115.7	-74.9	-62.7	-69.6	-50.8
Nominal GNP	Percent change*	10.4	8.6	6.6	4.6	8.6	7.5	6.4	5.6	6.0
EMPLOYMENT AND PRODUCTION										

Nonfarm payroll employment	Millions	90.1	94.5	97.5	99.5	102.2	105.6	108.6	110.4	111.4
Unemployment rate	Percent	9.6	7.5	7.2	7.0	6.2	5.5	5.2	5.6	6.1
Industrial production index	Percent change*	14.3	6.6	1.7	1.0	5.8	5.0	1.2	1.7	2.8
Capacity utilization rate-mfg.	Percent	73.9	80.5	80.1	79.7	81.1	83.5	83.9	82.1	81.4
Housing starts	Millions	1.70	1.75	1.74	1.81	1.62	1.49	1.40	1.38	1.35
Auto sales	Millions	9.23	10.38	11.06	11.47	10.26	10.69	10.04	9.64	9.50
Domestic	Millions	6.82	7.92	8.22	8.22	7.06	7.55	7.16	6.91	6.90
Foreign	Millions	2.41	2.46	2.84	3.25	3.21	3.14	2.88	2.73	2.60
INCOME AND SAVING										

Nominal personal income	Percent change*	7.8	8.4	6.6	5.8	8.6	7.1	7.9	6.1	5.8
Real disposable income	Percent change*	5.1	4.3	2.7	3.3	3.0	4.0	3.4	1.7	1.1
Personal saving rate	Percent	5.4	6.1	4.4	4.1	3.2	4.2	5.3	5.2	5.0
Corp. profits with IVA & CCAadj	Percent change*	70.1	7.4	9.2	-5.6	12.0	10.4	-18.2	.7	1.6
Profit share of GNP	Percent	6.3	7.1	7.0	6.7	6.6	6.7	5.7	5.1	4.8
Federal govt. surplus/deficit	Billions of \$	-176.0	-169.6	-196.9	-206.9	-161.4	-145.8	-152.0	-134.6	-115.6
State and local govt. surplus		47.5	64.6	65.1	62.8	51.3	49.7	46.2	51.2	62.0
Exc. social insurance funds		4.4	19.8	13.8	5.6	-12.4	-21.4	-31.8	-33.2	-28.4
PRICES AND COSTS										

GNP implicit deflator	Percent change*	3.6	3.4	2.9	2.6	3.0	4.0	3.6	4.0	3.8
GNP fixed-weight price index		3.9	3.7	3.3	2.6	4.0	4.5	4.1	4.2	4.2
Cons. & fixed invest. prices		3.3	3.3	3.4	2.5	4.7	4.2	4.2	4.0	4.3
CPI		3.2	4.2	3.5	1.3	4.4	4.3	4.4	4.1	4.4
Exc. food and energy		4.2	5.0	4.3	3.9	4.2	4.6	4.2	4.4	4.6
ECI hourly compensation		5.7	4.9	3.9	3.2	3.3	4.9	4.7	5.1	4.5
Nonfarm business sector										
Output per hour		3.4	1.5	1.6	1.3	2.5	1.6	.5	.9	1.3
Compensation per hour		3.1	4.2	4.6	5.0	4.0	4.8	5.3	5.8	5.2
Unit labor costs		-.4	2.6	3.0	3.6	1.5	3.1	4.8	4.8	3.8

* Percent changes are from fourth quarter to fourth quarter.

November 8, 1989

CONFIDENTIAL - FR
CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	1987				1988				1989	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
EXPENDITURES											
Nominal GNP	Billions of \$	4388.8	4475.9	4566.6	4665.8	4739.8	4838.5	4926.9	5017.3	5113.1	5201.7
Real GNP	Billions of \$25	3783.0	3823.5	3872.8	3935.6	3974.8	4010.7	4042.7	4069.4	4106.8	4132.5
Real GNP		5.4	4.4	5.3	6.6	4.0	3.7	3.2	2.7	3.7	2.5
Gross domestic purchases		3.4	4.0	5.4	5.5	.7	3.0	3.4	2.5	1.8	2.1
Final sales		1.1	4.9	6.0	1.4	6.5	5.0	1.6	4.7	3.1	3.1
Private dom. final purchases		-.9	5.9	6.5	-.6	6.0	4.4	3.1	1.7	2.3	2.0
Personal consumption expend.		.1	4.8	4.7	-.7	6.2	2.5	3.3	3.0	2.0	1.9
Durables		-19.9	14.8	15.8	-13.5	21.0	6.4	-3.9	9.9	-1.1	5.5
Nondurables		1.9	.6	1.3	.5	1.7	1.2	5.0	.7	1.3	-2.3
Services		6.0	5.0	3.8	3.0	5.2	2.2	4.5	2.6	3.6	3.8
Business fixed investment		-4.3	14.4	26.7	-.1	9.5	12.3	2.6	-6.5	6.9	8.6
Producers' durable equipment		-2.0	24.1	25.9	-.3	18.2	15.8	2.9	-6.9	9.6	14.8
Nonresidential structures		-10.3	-7.8	29.3	.6	-11.8	2.3	1.6	-5.1	-1.0	-9.5
Residential structures		-5.9	1.0	-11.0	-.4	-5.7	11.2	1.9	6.3	-5.0	-12.3
Exports		12.6	21.4	21.4	21.3	30.5	1.8	9.7	15.5	14.0	13.1
Imports		-3.6	14.5	19.1	9.8	1.2	-2.2	10.2	12.6	-.4	9.3
Government purchases		.3	-.9	4.5	4.5	-8.3	4.1	-3.6	16.7	-3.3	5.4
Federal		-4.9	-4.0	7.4	5.0	-22.3	5.2	-9.5	33.7	-9.4	10.0
Defense		5.1	8.9	9.4	-5.6	-5.4	-.8	-5.5	4.4	-10.6	2.2
State and local		4.6	1.5	2.5	4.0	3.7	3.4	.9	5.7	1.5	2.2
Change in business inventories	Billions of \$25	18.1	13.3	6.8	56.6	34.3	21.5	37.5	18.3	24.5	19.1
Nonfarm	Billions of \$25	20.3	14.5	12.9	55.6	28.3	25.4	37.2	31.9	16.9	19.5
Net exports	Billions of \$25	-118.2	-115.9	-118.9	-109.8	-78.2	-72.6	-74.9	-73.8	-55.0	-51.2
Real GNP	Percent change	8.8	8.2	8.4	9.0	6.5	8.6	7.5	7.5	7.9	7.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	101.0	101.8	102.5	103.5	104.4	105.2	106.0	106.8	107.7	108.3
Unemployment rate	Percent*	6.6	6.3	6.0	5.9	5.7	5.5	5.5	5.3	5.2	5.3
Industrial production index	Percent change	3.2	4.2	8.8	7.0	3.9	4.6	7.1	4.6	2.1	3.3
Capacity utilization rate-mfg.	Percent*	80.0	80.5	81.4	82.3	82.7	83.2	84.0	84.4	84.4	84.4
Housing starts	Millions	1.78	1.60	1.62	1.53	1.48	1.48	1.47	1.56	1.52	1.35
Auto sales	Millions	9.57	10.19	10.98	10.32	10.76	10.69	10.32	11.00	9.72	10.31
Domestic	Millions	6.77	7.12	7.40	6.93	7.60	7.50	7.20	7.89	6.89	7.30
Foreign	Millions	2.80	3.06	3.58	3.38	3.15	3.19	3.12	3.11	2.82	3.01
INCOME AND SAVING											
Nominal personal income	Percent change	8.7	6.6	6.9	12.5	4.1	8.1	7.2	8.8	13.3	7.9
Real disposable income	Percent change	4.0	-5.8	6.7	7.8	4.6	2.4	4.9	4.3	6.6	.8
Personal saving rate	Percent*	4.3	1.8	2.3	4.3	3.9	3.9	4.3	4.6	5.6	5.4
Corp. profits with IVA & CCAdj	Percent change	7.0	21.2	29.0	-6.0	13.5	9.4	7.1	11.7	-25.3	-10.3
Profit share of GNP	Percent*	6.4	6.6	6.9	6.6	6.7	6.7	6.7	6.8	6.2	5.9
Federal govt. surplus/deficit	Billions of \$	-199.4	-137.7	-143.9	-164.4	-151.8	-141.5	-122.5	-167.6	-147.5	-145.4
State and local govt. surplus		46.3	60.4	50.5	48.0	50.8	52.4	49.8	45.7	48.8	47.5
Exc. social insurance funds		-14.6	-2.5	-14.0	-18.4	-17.5	-17.9	-22.3	-28.1	-26.6	-29.6
PRICES AND COSTS											
GNP implicit deflator	Percent change	3.2	3.8	2.8	2.4	2.0	4.8	4.4	4.7	4.0	4.6
GNP fixed-weight price index		4.3	4.1	3.8	3.8	3.8	4.8	5.2	4.3	4.8	5.0
Cons. & fixed invest. prices		5.5	5.1	3.9	4.3	3.1	4.7	4.4	4.7	4.8	5.9
CPI		5.2	5.1	3.6	3.5	3.9	4.5	4.5	4.4	5.4	6.4
Exc. food and energy		4.2	4.2	3.8	4.4	4.7	4.7	4.0	4.9	5.2	4.1
ECI hourly compensation**		3.3	3.0	3.6	3.5	5.7	5.1	3.7	4.9	4.5	4.8
Nonfarm business sector											
Output per hour		.4	3.3	3.6	2.7	2.8	-1.6	3.3	1.9	-1.3	1.1
Compensation per hour		1.4	2.7	4.8	7.3	2.5	5.4	5.4	5.9	4.9	5.6
Unit labor costs		1.0	-.6	1.2	4.5	-.3	7.1	2.0	3.8	6.2	4.5

* Not at an annual rate.

** Private industry workers; seasonally adjusted by Board staff.

November 8, 1989

CONFIDENTIAL - FR
CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	Projection									
		1989		1990				1991			
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
EXPENDITURES											
Nominal GNP	Billions of \$	5273.2	5336.6	5420.1	5491.8	5564.9	5636.2	5721.1	5802.9	5886.3	5971.8
Real GNP	Billions of \$2\$	4158.1	4175.7	4198.1	4211.2	4226.8	4242.1	4259.5	4281.4	4304.6	4329.0
Real GNP		2.5	1.7	2.2	1.3	1.5	1.5	1.7	2.1	2.2	2.3
Gross domestic purchases		4.7	1.3	1.4	2.2	1.5	1.0	1.1	1.3	1.3	1.3
Final sales		1.4	2.5	3.8	.7	1.0	1.8	1.8	2.0	2.2	2.3
Private dom. final purchases		5.1	2.0	3.4	1.9	1.5	1.4	1.3	1.3	1.4	1.5
Personal consumption expend.		5.8	1.8	2.9	1.8	1.5	1.5	1.4	1.3	1.2	1.3
Durables		15.0	-7.2	5.3	.7	-5	.6	1.3	1.0	1.3	1.7
Nondurables		4.0	3.3	1.2	1.3	.9	.9	.7	.7	.7	.8
Services		4.2	4.0	3.2	2.6	2.6	2.2	2.0	1.7	1.5	1.5
Business fixed investment		5.3	1.0	6.6	2.0	1.5	1.4	1.6	2.9	3.3	3.4
Producers' durable equipment		5.2	.9	8.3	3.0	2.5	2.5	2.5	4.0	4.0	4.0
Nonresidential structures		5.9	1.4	1.2	-1.4	-2.0	-2.1	-1.7	-.9	.8	1.2
Residential structures		-4.8	6.6	2.6	1.7	1.7	-.8	-2.2	-2.2	-1.5	-.9
Exports		.0	4.0	12.6	.0	6.1	9.7	9.1	10.2	11.0	10.4
Imports		15.1	1.2	6.4	6.1	5.9	5.8	5.1	4.9	4.5	4.1
Government purchases		-2.3	2.5	1.4	.9	-.7	1.1	1.1	.9	.7	.9
Federal		-8.7	1.5	.8	-.5	-4.0	.0	.1	-.3	-.9	-.3
Defense		3.8	-8.7	-4.7	-2.7	-3.8	-2.1	-1.8	-1.1	-1.8	-1.3
State and local		2.8	3.2	1.9	1.9	1.7	1.8	1.8	1.8	1.7	1.6
Change in business inventories	Billions of \$2\$	30.2	22.5	5.8	11.3	15.9	12.5	11.5	12.6	12.9	12.7
Nonfarm	Billions of \$2\$	24.6	24.4	8.6	13.5	17.5	15.5	15.7	18.4	19.2	19.5
Net exports	Billions of \$2\$	-74.1	-70.4	-62.8	-72.9	-73.7	-69.0	-63.7	-56.2	-46.7	-36.9
Real GNP	Percent change	5.6	4.9	6.4	5.4	5.4	5.2	6.2	5.8	5.9	5.9
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	108.9	109.5	110.0	110.5	110.4	110.6	110.9	111.2	111.5	111.8
Unemployment rate	Percent*	5.2	5.3	5.4	5.5	5.7	5.9	6.0	6.1	6.2	6.2
Industrial production index	Percent change	1.3	-1.8	2.8	1.0	1.5	1.5	2.0	3.0	3.1	3.1
Capacity utilization rate-mfg.	Percent*	84.0	82.8	82.7	82.2	81.9	81.6	81.4	81.4	81.4	81.5
Housing starts	Millions	1.34	1.38	1.38	1.38	1.38	1.37	1.36	1.35	1.35	1.34
Auto sales	Millions	10.51	9.64	9.90	9.70	9.50	9.45	9.50	9.50	9.50	9.50
Domestic	Millions	7.62	6.83	7.05	6.90	6.85	6.85	6.90	6.90	6.90	6.90
Foreign	Millions	2.88	2.81	2.85	2.80	2.65	2.60	2.60	2.60	2.60	2.60
INCOME AND SAVING											
Nominal personal income	Percent change	5.2	5.6	8.1	5.7	5.0	5.8	6.8	5.4	5.2	5.7
Real disposable income	Percent change	4.8	1.6	4.6	1.3	.0	1.1	2.4	.2	.6	1.1
Personal saving rate	Percent*	5.1	5.1	5.5	5.4	5.0	5.0	5.2	5.0	4.9	4.8
Corp. profits with IVA & CCAdj	Percent change	-27.3	-8.2	12.2	-4.3	1.8	-5.9	-11.3	5.5	6.6	6.8
Profit share of GNP	Percent*	5.4	5.2	5.3	5.2	5.1	5.0	4.8	4.7	4.8	4.8
Federal govt. surplus/deficit	Billions of \$	-152.2	-162.9	-146.3	-140.4	-125.7	-126.0	-128.6	-121.5	-109.1	-103.4
State and local govt. surplus		45.3	43.4	48.4	48.3	53.6	54.3	57.0	63.9	63.7	63.2
Exc. social insurance funds		-33.8	-37.2	-33.7	-35.3	-31.5	-32.3	-31.1	-25.7	-27.4	-29.4
PRICES AND COSTS											
GNP implicit deflator	Percent change	2.9	3.2	4.2	4.1	3.9	3.7	4.4	3.7	3.6	3.6
GNP fixed-weight price index		2.9	3.6	4.4	4.1	4.1	4.1	4.7	4.1	4.0	4.0
Cons. & fixed invest. prices		2.3	3.6	3.7	4.0	4.1	4.2	4.3	4.3	4.3	4.3
CPI		2.6	3.3	3.7	4.1	4.2	4.3	4.6	4.4	4.4	4.4
Exc. food and energy		3.5	4.0	4.2	4.3	4.4	4.5	4.8	4.5	4.5	4.5
ECI hourly compensation**		4.7	4.8	6.0	5.4	4.6	4.5	4.8	4.9	4.3	4.2
Nonfarm business sector											
Output per hour		2.1	.3	.8	.6	1.0	1.2	1.2	1.3	1.4	1.5
Compensation per hour		5.3	5.4	6.6	6.0	5.3	5.2	5.5	5.6	5.0	4.9
Unit labor costs		3.2	5.1	5.8	5.4	4.3	4.0	4.2	4.2	3.6	3.3

* Not at an annual rate.

** Private industry workers; seasonally adjusted by Board staff.

November 8, 1989

CONFIDENTIAL - FR
CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Net changes, billions of 1982 dollars)

											Projection			
	1987				1988				1989		1986	1987	1988	1989
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	(fourth quarter to fourth quarter, net change)			
Real GNP	49.4	40.5	49.3	62.8	39.2	35.9	32.0	26.7	37.4	25.7	71.2	202.0	133.8	106.3
Gross domestic purchases	32.2	38.2	52.3	53.7	7.6	30.3	34.3	25.6	18.6	21.9	81.3	176.4	97.8	102.9
Final sales	10.5	45.2	55.9	13.0	61.5	48.7	16.0	45.8	31.3	31.2	99.7	124.6	172.0	102.2
Private dom. final purchases	-7.3	44.6	50.3	-4.7	46.9	35.2	25.4	14.2	19.2	16.8	86.5	82.9	121.7	94.5
Personal consumption expend.	.5	29.4	28.8	-4.2	38.5	16.0	21.3	19.6	13.3	12.7	90.9	54.5	95.4	75.9
Durables	-21.4	13.2	14.5	-14.4	19.0	6.4	-4.1	9.8	-1.2	5.6	41.1	-8.1	31.1	11.3
Nondurables	4.2	1.3	2.8	1.1	3.7	2.6	11.1	1.7	3.0	-5.3	25.2	9.4	19.1	14.1
Services	17.7	15.0	11.4	9.1	15.9	6.9	14.2	8.2	11.5	12.3	24.6	53.2	45.2	50.4
Business fixed investment	-4.8	14.7	27.2	-.1	10.9	14.2	3.2	-8.3	8.3	10.4	-25.2	37.0	20.0	26.6
Producers' durable equipment	-1.6	17.2	19.4	-.3	14.8	13.5	2.7	-6.7	8.6	13.3	1.2	34.7	24.3	27.8
Nonresidential structures	-3.3	-2.4	7.8	.2	-3.9	.7	.5	-1.6	-.3	-3.0	-26.5	2.3	-4.3	-1.2
Residential structures	-3.0	.5	-5.7	-.2	-2.8	5.1	.9	3.0	-2.5	-6.3	20.9	-8.4	6.2	-8.1
Change in business inventories	38.9	-4.8	-6.5	49.8	-22.3	-12.8	16.0	-19.2	6.2	-5.4	-28.5	77.4	-38.3	4.2
Nonfarm	31.2	-5.8	-1.6	42.7	-27.3	-2.9	11.8	-5.3	-15.0	2.6	-34.1	66.5	-23.7	-7.5
Farm	7.7	1.0	-4.9	7.1	4.9	-9.9	4.3	-13.9	21.2	-8.1	5.6	10.9	-14.6	11.7
Net exports	17.2	2.3	-3.0	9.1	31.6	5.6	-2.3	1.1	18.8	3.8	-10.1	25.6	36.0	3.4
Exports	12.2	20.8	21.8	22.8	33.3	2.3	12.2	19.5	18.3	17.8	39.1	77.6	67.3	41.9
Imports	-5.0	18.5	24.8	13.7	1.7	-3.3	14.6	18.3	-.6	14.1	49.3	52.0	31.3	38.5
Government purchases	.6	-1.7	8.6	8.6	-17.0	7.9	-7.1	30.5	-6.7	10.6	23.3	16.1	14.3	4.3
Federal	-4.3	-3.4	6.0	4.2	-21.1	4.1	-8.1	24.1	-8.4	8.1	1.8	2.5	-1.0	-6.8
Defense	3.2	5.6	6.0	-3.9	-3.7	-.5	-3.7	2.8	-7.2	1.4	14.4	10.9	-5.1	-9.2
Nondefense	-7.5	-9.0	.0	8.1	-17.4	4.6	-4.4	21.3	-1.2	6.7	-12.6	-8.4	4.1	2.4
State and local	4.9	1.6	2.7	4.4	4.1	3.8	1.0	6.4	1.7	2.5	21.5	13.6	15.3	11.1

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Net changes, billions of 1982 dollars)

November 8, 1989

	Projection										Projection			
	1989		1990				1991				1988	1989	1990	1991
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	(fourth quarter to fourth quarter, net change)			
Real GNP	25.6	17.6	22.4	13.2	15.5	15.4	17.4	21.8	23.2	24.4	133.8	106.3	66.4	86.9
Gross domestic purchases	48.5	13.9	14.8	23.3	16.3	10.6	12.1	14.4	13.7	14.6	97.8	102.9	65.0	54.8
Final sales	14.4	25.3	39.1	7.7	10.9	18.8	18.4	20.8	22.9	24.6	172.0	102.2	76.4	86.7
Private dom. final purchases	41.9	16.6	28.6	15.9	13.1	11.8	10.8	11.4	11.9	13.1	121.7	94.5	69.4	47.3
Personal consumption expend.	37.5	12.4	19.1	12.5	10.4	10.3	9.9	8.6	8.3	8.9	95.4	75.9	52.2	35.7
Durables	15.1	-8.2	5.7	.7	-.5	.7	1.4	1.1	1.4	1.9	31.1	11.3	6.6	5.8
Nondurables	8.9	7.5	2.8	3.0	2.1	2.1	1.6	1.6	1.6	1.9	19.1	14.1	10.0	6.8
Services	13.5	13.1	10.6	8.7	8.8	7.5	6.9	5.9	5.2	5.2	45.2	50.4	35.7	23.1
Business fixed investment	6.6	1.3	8.4	2.6	1.9	1.9	2.1	3.9	4.4	4.5	20.0	26.6	14.8	14.9
Producers' durable equipment	5.0	.9	8.0	3.0	2.5	2.6	2.6	4.1	4.2	4.2	24.3	27.8	16.1	15.0
Nonresidential structures	1.7	.4	.4	-.4	-.6	-.6	-.5	-.3	.2	.3	-4.3	-1.2	-1.3	-.2
Residential structures	-2.3	3.0	1.2	.8	.8	-.4	-1.1	-1.1	-.7	-.4	6.2	-8.1	2.4	-3.3
Change in business inventories	11.1	-7.7	-16.7	5.5	4.6	-3.4	-1.0	1.0	.4	-.3	-38.3	4.2	-10.0	.1
Nonfarm	5.1	-.2	-15.8	4.9	4.0	-2.0	.2	2.6	.9	.3	-23.7	-7.5	-8.9	4.0
Farm	6.0	-7.4	-.9	.6	.6	-1.4	-1.2	-1.6	-.5	-.5	-14.6	11.7	-1.1	-3.8
Net exports	-22.9	3.7	7.6	-10.1	-.8	4.8	5.3	7.4	9.5	9.8	36.0	3.4	1.4	32.1
Exports	.0	5.8	17.9	-.1	9.1	14.6	14.0	16.0	17.5	17.1	67.3	41.9	41.4	64.7
Imports	22.9	2.1	10.3	10.1	9.9	9.8	8.7	8.6	8.0	7.3	31.3	38.5	40.0	32.6
Government purchases	-4.6	5.0	2.9	1.9	-1.4	2.2	2.3	1.9	1.4	1.8	14.3	4.3	5.6	7.3
Federal	-7.7	1.2	.7	-.4	-3.4	.0	.1	-.3	-.7	-.2	-1.0	-6.8	-3.1	-1.2
Defense	2.4	-5.8	-3.0	-1.7	-2.4	-1.3	-1.1	-.7	-1.1	-.8	-5.1	-9.2	-8.4	-3.7
Nondefense	-10.1	7.0	3.7	1.3	-1.0	1.3	1.2	.4	.4	.6	4.1	2.4	5.3	2.5
State and local	3.2	3.7	2.2	2.3	2.0	2.2	2.2	2.2	2.1	2.0	15.3	11.1	8.7	8.5

FEDERAL SEC
(Billions

ACCOUNTS¹
(Billions

	Fiscal years				1989				1990				1991			
	1988a	1989a	1990	1991	Ia	IIa	IIIa	IV	I	II	III	IV	I	II	III	IV
BUDGET	Not seasonally adjusted															
Budget receipts ²	909	991	1060	1129	219	308	242	227	244	327	263	248	261	340	280	264
Budget outlays ²	1063	1143	1193	1251	280	285	288	306	298	299	291	318	308	314	310	321
Surplus/deficit (-) to be financed ²	-155	-152	-133	-122	-61	23	-47	-79	-54	28	-28	-70	-48	26	-30	-57
(On-budget)	-194	-205	-200	-194	-77	0	-54	-88	-73	5	-43	-80	-68	1	-46	-67
(Off-budget)	39	52	66	72	16	23	7	9	19	23	15	10	21	24	16	10
Means of financing:																
Borrowing	162	140	122	119	38	10	39	59	38	9	16	67	24	7	21	51
Cash decrease	-8	3	6	0	19	-29	3	25	5	-29	5	10	10	-25	5	10
Other ³	1	8	6	3	4	-4	5	-4	11	-8	7	-7	14	-8	4	-4
Cash operating balance, end of period	44	41	35	35	15	44	41	16	11	40	35	25	15	40	35	25
NIPA FEDERAL SECTOR	Seasonally adjusted annual rates															
Receipts	958	1031	1101	1183	1036	1053	1039	1055	1099	1116	1134	1151	1175	1194	1214	1235
Expenditures	1103	1184	1245	1305	1184	1199	1191	1218	1245	1257	1260	1277	1303	1316	1323	1338
Purchases	377	404	414	428	399	406	403	408	416	418	416	418	429	431	433	434
Defense	297	302	302	307	299	301	306	301	303	303	302	302	308	309	309	310
Nondefense	80	102	112	121	100	105	97	107	112	115	114	116	122	123	124	125
Other expend.	726	780	830	877	785	793	788	810	829	838	844	859	874	884	890	904
surplus/deficit	-145	-153	-144	-121	-148	-145	-152	-163	-146	-140	-126	-126	-129	-122	-109	-103
FISCAL INDICATORS⁴																
High-employment (HEB) surplus/deficit (-)	-150	-169	-149	-103	-165	-162	-169	-175	-156	-144	-122	-115	-112	-100	-84	-75
Change in HEB, percent of potential GNP	.3	.4	-.4	-.9	-.3	-.1	.1	.1	-.4	-.2	-.4	-.1	-.1	-.2	-.3	-.1
Fiscal impetus measure (FI), percent	.2 *	-3.5 *	-7.0 *	-2.8 *	-2.7	-.2	.5	-3.0	-4.0	-.2	-1.2	-1.6	-1.0	.0	-.2	-.1

a--actual

*--calendar year

Note: Details may not add to totals due to rounding.

- Staff projections. The FY89 and FY90 deficits in OMB's Mid-Session Review of the Budget (July) are \$148 billion and \$99 billion, respectively. The FY89 figure omits \$19 billion of on-budget RTC spending authorized in FIRREA. The FY90 estimate incorporates the Bipartisan Budget Agreement. The FY89 and FY90 deficits in CBO's Economic and Budget Outlook: An Update (August) are \$161 billion and \$118 billion, respectively, given congressional budget resolution policies and CBO's estimate of spending under FIRREA.
- Budget receipts, outlays, and surplus/deficit include social security (OASDI) receipts, outlays and surplus, respectively. The OASDI surplus is excluded from the "on-budget" deficit and shown separately as "off-budget", as classified under current law.
- Other means of financing are checks issued less checks paid, accrued items; and changes in other financial assets and liabilities, including Post Office surplus/deficit in FY90 and FY91.
- HEB is the NIPA measure in current dollars with cyclically-sensitive receipts and outlays adjusted to a 6 percent unemployment rate and 2.7% potential output growth. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GNP, is reversed in sign. FI is the weighted difference of discretionary federal spending and tax changes (in 1982 dollars), scaled by real federal purchases. For change in HEB and FI, (-) indicates restraint.

Recent Developments

Interest rates generally have declined since the last FOMC meeting, a movement encouraged by the more generous provision of reserves by the System. The federal funds rate has eased to around 8-1/2 percent from the 9 percent level that prevailed through September, while other interest rates have declined 1/4 to 1/2 percentage point.

The intermeeting period has been one of considerable turmoil for the corporate securities markets. Investors' concerns about junk bonds continued to mount, and the spread between yields on lower-quality junk issues and Treasuries widened markedly. With bankers, too, evincing greater caution in funding highly leveraged transactions, equity investors lowered their valuations of potential takeover candidates, and the stock market adjusted downward sharply on October 13. Only a small fraction of that drop has been reversed, and broad share price indexes are off 5 to 6 percent since early October.

In October, M2 moved closer to the middle of its annual target range, expanding at about an 8 percent rate, driven mainly by brisk growth in M1 and other liquid components. This shift toward liquid elements likely was spurred by the narrowing of the yield advantage on small time deposits that took place during the summer. Declines in small time deposits at thrifts, which have been less aggressive in bidding for funds, were roughly offset by gains at commercial banks.

M3, almost flat in September, grew at about a 5 percent pace in October, moving a bit above the lower bound of its annual range. Large time

deposits at commercial banks accelerated, but managed liabilities at thrifts fell rapidly, as in September, because of both RTC liquidations of some institutions and, more important, of balance-sheet reductions at others.

Bank credit accelerated to around a 13 percent pace last month, about twice the earlier rate. Particularly large advances were registered in government securities, including mortgage pools, and in business loans, although merger-related lending apparently subsided. Consumer and real estate lending weakened slightly from the September pace.

Data on banks' business loans and on commercial paper suggest only a slow expansion of shorter-term nonfinancial business borrowing in October. With the drop in interest rates, firms were more inclined toward long-term financing, and gross bond offerings by both utilities and industrials rebounded during the month. The issuance of junk bonds was fairly robust in October, as the market remained receptive to "top tier" issues. Equity issuance also was stronger than might have been expected, given the stock market volatility during the period. Issuance by nonfinancial companies in October, in fact, was the highest in more than a year.

The federal deficit is expected to rise to about \$77 billion in the current quarter, to be financed mainly by marketable debt, but also by a large drawdown of the cash balance. Late in October, settlement of bill auctions was accelerated, and a cash management bill was added, in anticipation of the debt ceiling reversion to \$2.8 trillion at the turn of the month. The debt ceiling was increased to \$3.12 trillion on November 8, allowing the Treasury to resume its scheduled auctions. In the agency market, FHLB debt fell substantially as advances to thrifts were replaced by funds from the RTC and other sources, but higher borrowing by other agencies

roughly offset this decline. Late in the month, REFCORP's initial issue of \$4.5 billion in 30-year debt to finance thrift liquidations was sold at 28 basis points above comparable Treasuries.

Issuance of long-term municipal securities slowed during October, as tax-exempt rates backed up a bit from their late-summer lows and, in consequence, the discount from Treasury rates has narrowed considerably. This narrowing may be associated, in part, with reduced demands for tax-exempt securities by money center banks, several of whom reported large losses in the third quarter.

The decline in rates on fixed-rate mortgages evidently has reinforced borrower preference for such loans, which recently have accounted for about three-quarters of new conventional loan commitments for home purchases. Lenders continue to offer initial discounts on adjustable-rate mortgages, but not so aggressively as in earlier periods. Overall, thrift mortgage originations have been relatively weak, although recovering a bit, and latest data show commercial banks taking the lead in this area. As they struggle to meet new capital requirements, thrifts also have cut back on their balance-sheet holdings of mortgage assets. Funding data through October, in fact, suggest continued shrinkage in total thrift assets at around the brisk pace of previous months. Issuance of mortgage pass-throughs has picked up to a rapid pace, as has repackaging of these securities into derivative securities such as CMOs.

Consumer installment credit is estimated to have grown at only around 1 percent in September and, for the third quarter as a whole, was somewhat lower than the growth of durables expenditures. Securitization of consumer

credit, especially credit card receivables, continues to expand vigorously, with more than \$5 billion of total placements during the past quarter.

Outlook

The staff projection anticipates no significant further declines in interest rates in the period ahead; indeed, rates may tend to firm by late 1990 if, as assumed, the dollar depreciates and there ensues a rise in import prices and a strengthening in net exports.

Debt growth of nonfinancial businesses is projected to continue on a slow downward course over the next two years. A weakening of profits and larger projected corporate financing gap might contribute to more borrowing, but borrowing associated with mergers and LBOs likely will diminish in the aftermath of recent developments. Reflecting lenders' tougher assessments of proposed new deals, projected net equity retirements through 1991 are expected to run at only about half the record pace reached earlier this year. Noncorporate business borrowing, often associated with the commercial real-estate sector, likely will remain subdued, owing to weakness in that market.

Household debt is forecast to decelerate a bit further over the projection period. Both the moderation in residential construction--after a near-term pickup--and slow expansion of consumer durables purchases should contribute to this outcome. While the staff anticipates a substantial further contraction of the thrift industry, it is doubtful that this change in market structure will be associated with a significant deterioration in the cost or availability of mortgage credit to households or to other sectors. The large number of potential lenders and ready securitization of residential mortgages seem to ensure an elastic supply of funds to this

market, and it has been assumed that spreads between mortgage rates and yields on Treasury securities will remain near recent levels.

Apart from short-term disruptions, federal borrowing also is projected to move lower over the projection period, especially in terms of growth rates. Principal funding for thrift resolutions now is lodged with REFCORP, which is a sponsored agency outside the federal sector and the nonfinancial debt aggregate. Net debt growth of state and local governments is forecast to remain subdued, partly in consequence of heavier retirements of existing debt, possibly through asset drawdowns.

Overall, debt of domestic nonfinancial sectors is projected to grow at about 8 percent this year, more than a percentage point lower than in 1988, and drop further to around 7-1/2 percent in 1990 and to about 6-3/4 percent in 1991. With projected growth in federal debt shrinking to 4-1/4 percent in 1991, nonfinancial businesses and households continue to provide the main impetus to total debt growth in the projection.

Recent developments

The weighted average foreign exchange value of the dollar in terms of the other G-10 currencies has declined on balance about 1-1/4 percent since the October FOMC meeting. Early in the period the dollar rose despite increases in official interest rates abroad,

, and the release of U.S. employment data that were weaker than expected. Market participants interpreted reports about Chairman Greenspan's seminar presentation in the Soviet Union as expressing criticism of U.S. intervention policy; this interpretation contributed temporarily to the upward pressure on the dollar. The dollar peaked for the intermeeting period on October 11 and began to retrace its previous gains amid expectations that interest rates in Germany and Japan would continue rising and that Federal Reserve policy might ease. The drop in U.S. stock prices two days later was accompanied by a further decline in the dollar. Later in the intermeeting period the dollar continued to fall as interest rate differentials moved against dollar assets and as the release of data revealed that the U. S. merchandise trade deficit in August had been larger than expected.

Foreign interest rates rose on balance over the intermeeting period as market rates responded to increases in official lending rates. Many European central banks raised rates on October 6 as the Bundesbank increased its discount and lombard rates a full percentage point. On October 11, the Bank of Japan surprised the market with an increase in

its discount rate of 1/2 percentage point. Over the period, short-term interest rates rose about 1/3 percentage point in Germany and about 1 percentage point in Japan while U.S. short-term rates declined. Stock prices worldwide fell after the sharp decline in the United States on October 13. Since then, stock prices have recovered only slightly in the United Kingdom and have fallen further in Germany and France. Only in Japan have stock prices returned to their levels at the beginning of the period.

. The Desk sold \$770 million against yen and \$390 million against marks. The Desk's activity occurred exclusively before October 13.

In the major foreign industrial countries except Germany, indicators of economic activity during the third quarter suggest that the slower pace observed in the second quarter has continued. Industrial production rose only slightly in Japan for the third quarter as a whole and remained relatively flat in several European countries in July and August. In contrast, German industrial production rebounded strongly from its second-quarter decline. Consumer price inflation edged up slightly in Japan, Germany, and the United Kingdom, in part in response to earlier depreciation of their respective currencies. In

Japan and, to a lesser extent in Germany, trade and current account surpluses have narrowed from rates registered earlier in the year. However, on a cumulative basis through September, the German surpluses remain above last year's rates while those for Japan declined significantly.

Among the major developing countries, Mexico has experienced a weakening of its external accounts and fiscal balances, while real growth has been stronger than expected. In Brazil, the government has had limited success in preventing inflation from rising further before the November 15 presidential election, and the gap between official and parallel market exchange rates has widened. Argentina reached agreement with the IMF in late September on a stand-by arrangement of SDR 1.1 billion for seventeen months; the program calls for further implementation of fiscal restraint and structural reforms by the new government. In early October, Venezuela cleared its interest arrears on public-sector debt to commercial banks. The clearing of arrears has led to a resumption of talks on restructuring Venezuela's public-sector debt to the banks and on a financing package of new money and debt and debt-service reduction, although significant disagreements remain among the banks and between the banks and Venezuelan authorities as to Venezuela's financing needs.

The deficit on U.S. merchandise trade worsened in August to \$10.8 billion (seasonally adjusted, Census basis) from the revised \$8.2 billion deficit in July. A surge in the value of non-oil imports was largely responsible for the deterioration in August. On a seasonally adjusted, balance-of-payments basis, the average trade balance for July

and August deteriorated from its second-quarter rate nearly to the pace experienced in the second half of 1988. Between the second quarter and July-August, exports declined about 1 percent. This decline was accounted for by a reduction in the rate of agricultural shipments from the record levels observed during the first half of this year; the value of nonagricultural exports was changed little on balance. The value of imports increased more than 2 percent between the second quarter and July-August. Non-oil imports surged in the two months, with important increases in imports of consumer goods and machinery. The value of oil imports was about unchanged, with significantly higher volumes of oil imports offset by lower prices. According to the BLS figures, which the Commerce Department now relies on for most major trade categories for its GNP estimates, prices of imports fell more than 5 percent at an annual rate in the third quarter, reflecting declines in the prices of oil and non-oil products. The price of non-oil imports fell for the second consecutive quarter, in part because of the effects of the appreciation of the dollar this year. Export prices also declined in the third quarter, almost 3 percent at an annual rate. This decline was attributable largely to falling agricultural prices.

Recorded foreign net purchases of U.S. Treasury securities totaled \$11.7 billion in August. These large net purchases coincided with the Treasury's mid-quarter refunding and reflect the increasing link between the Treasury's funding schedule and foreign net purchases of Treasury securities. Foreign net purchases of U.S. corporate stocks and bonds declined slightly in August but remained close to the second-quarter pace. Foreign official reserve assets in the United States rose almost

\$10 billion in August, with large net inflows attributed to the G-10 countries and OPEC. Most of the inflow probably reflects a shifting out of Eurodollar deposits into Treasury securities as the spread between the two narrowed. Partial data from FRBNY indicate that official reserves in the United States declined \$4 billion in September, reflecting very large intervention sales of dollars in the month.

Outlook

The staff forecast continues to incorporate a moderate decline in the foreign exchange value of the dollar. In light of recent exchange market developments, the path for the dollar in the near term is lower than in the last forecast. By the end of the forecast horizon, the level of the dollar is unchanged from that in the last Greenbook.

Real growth in the major foreign industrial countries is expected to ease from its pace during the first half of this year but to remain moderate through the end of 1991, averaging about 2-3/4 percent at an annual rate. The rate of consumer price inflation in these countries is expected to slow, as monetary tightening has its effect, and to remain below the U.S. rate. In the developing countries, real growth is expected to strengthen somewhat from its reduced 1989 pace, largely because of the improved outlook for countries in the Western Hemisphere, and to remain near 4 percent over the forecast horizon.

Prices of oil imports are assumed to rise in the very near term to an average of about \$17.65 per barrel in the fourth quarter compared with an estimated \$16.90 in the third quarter. Such a price rise is in line with recent increases observed in spot market prices in response to tightening of supplies. The average oil import price is assumed to fall

to \$17.00 per barrel for most of 1990 in response to continued strong OPEC production and to rise with the rate of inflation in 1991.

The U.S. merchandise trade balance is projected to be essentially unchanged through the fourth quarter of 1990, as the continuation of relatively strong growth abroad offsets the effects of the appreciation of the dollar earlier this year and as various special factors, such as the Boeing strike and bulges in oil imports, have their effects. During 1991, the trade deficit is projected to narrow slightly, reaching about \$106 billion (annual rate) in the fourth quarter of the year. The projected decline in the dollar contributes to the improvement in the trade balance. The increase in the projected trade deficit from that reported in the last Greenbook, which equals about \$10 at an annual rate by the fourth quarter of 1991, is accounted for largely by the higher projected rate for non-oil imports.

The current account deficit (excluding capital gains and losses) is expected to widen slightly through the end of next year: payments on foreign portfolio investments in the United States continue to expand and the rise in net receipts on other non-trade current account transactions (for example, tourism) moderates because of the dollar's appreciation. In 1991, improvement in the trade balance and in these other service payments result in a narrowing of the projected current account deficit. Under the alternative assumption of an unchanged dollar, the current account deficit would be significantly greater over most of the forecast horizon, amounting to about \$25 billion by 1991Q4.

Outlook for U.S. Exports and Related Items
(Billions of Dollars, Seasonally Adjusted Annual Rates)

	ANNUAL			1989		1990				1991			
	1989-P	1990-P	1991-P	Q3	Q4-P	Q1	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP Exports and Imports 1/													
Current \$, Net	-59.9	-61.6	-52.0	-68.0	-67.2	-54.1	-64.1	-65.6	-62.5	-60.0	-56.1	-49.5	-42.4
Exports of G+S	618.7	659.2	736.5	618.8	624.2	645.1	648.2	661.9	681.7	701.9	724.1	748.2	771.9
Imports of G+S	678.6	720.8	788.6	686.8	691.4	699.3	712.3	727.5	744.2	762.0	780.2	797.7	814.3
Constant \$2, Net	-62.7	-69.6	-50.9	-74.4	-70.4	-62.8	-73.0	-73.7	-69.0	-63.7	-56.2	-46.7	-36.9
Exports of G+S	584.5	619.3	673.8	587.7	593.3	611.2	611.1	620.2	634.7	648.8	664.8	682.3	699.4
Imports of G+S	647.3	688.9	724.7	662.1	663.7	674.0	684.1	693.9	703.7	712.4	721.0	729.0	736.3
2. Merchandise Trade Balance 2/													
	-114.7	-115.0	-113.6	-118.0 ^f	-116.5	-105.1	-116.4	-119.5	-119.0	-119.2	-116.7	-112.0	-106.4
Exports	363.0	391.3	436.0	364.6 ^f	372.2	386.2	384.1	391.5	403.2	414.2	427.6	443.1	458.9
Agricultural	41.4	42.2	44.9	37.7 ^f	42.0	41.6	42.2	41.6	43.2	43.6	44.5	45.2	46.2
Non-Agricultural	321.5	349.1	391.1	326.9 ^f	330.1	344.6	341.9	349.9	360.0	370.6	383.2	397.9	412.7
Imports	477.7	506.3	549.6	482.6 ^f	488.6	491.3	500.6	511.0	522.2	533.4	544.4	555.2	565.3
Petroleum and Products	50.5	52.0	55.6	52.7 ^f	52.2	51.3	51.6	52.2	52.8	53.9	55.1	56.2	57.4
Non-Petroleum	427.2	454.3	493.9	429.9 ^f	436.5	440.0	448.9	458.8	469.4	479.5	489.3	498.9	507.9
3. Other Current Account Transactions													
Capital Gains and Losses 3/	-8.0	1.4	1.3	-0.2 ^f	0.8	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.3
Other D.I. Income, Net	36.0	37.0	41.0	35.9 ^f	36.0	36.0	36.1	37.0	38.7	40.3	40.6	41.5	41.8
Portfolio Income, Net	-37.2	-45.9	-52.7	-38.2 ^f	-41.5	-43.5	-45.0	-46.7	-48.3	-49.9	-51.6	-53.7	-55.6
Other Current Account, Net	4.9	9.6	13.9	6.4 ^f	4.6	8.7	10.0	10.9	8.7	12.7	14.0	15.3	13.7
4. U.S. Current Account Balance													
Including Capital G/L	-119.0	-112.9	-110.0	-114.0 ^f	-116.6	-102.4	-113.8	-116.9	-118.5	-114.8	-112.5	-107.7	-105.2
Excluding Capital G/L	-111.0	-114.3	-111.4	-113.8 ^f	-117.4	-103.8	-115.3	-118.3	-119.9	-116.1	-113.8	-109.0	-106.6
5. Foreign Outlook 4/													
Real GNP--Ten Industrial 5/	3.4	2.8	2.8	2.8	3.4	3.1	2.9	2.7	2.8	2.6	2.7	3.4	2.8
Real GNP--LDC 6/	2.9	3.9	4.0	3.2	3.9	4.3	4.2	4.0	3.8	3.7	4.0	4.4	4.8
Consumer Prices--Ten Ind. 5/	4.0	3.6	3.4	2.3	3.6	3.2	4.5	2.9	3.3	3.6	3.9	2.7	3.2

1/ National Income and Product Account data.

2/ International accounts basis.

3/ The net of gains (+) or losses (-) on foreign-currency denominated assets due to their revaluation at current exchange rates and other valuation adjustments.

4/ Percent change, annual rates.

5/ Weighted by multilateral trade-weights of G-10 countries plus Switzerland; prices are not seasonally adjusted.

6/ Weighted by share in LDC GNP.

f/ Projected