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January 31, 1990

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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The Bureau of Economic Analysis estimates that real GNP rose only marginally in the fourth quarter, and the signs are that the picture has changed little thus far this year. Indeed, industrial activity appears to have dipped sharply in January, owing to dramatic cuts in auto production and to the effects of warmer weather on energy usage. On the inflation front, sharp increases in aggregate price measures are likely in the near term as a consequence of shocks to food and energy prices associated with December's cold snap; no change is evident, however, in the underlying trends of wages and prices.

The Labor Market

The household and establishment surveys for December did not appear to signal any major change in labor market trends. Growth in payrolls was relatively slow, as further job losses in manufacturing and a weather-related drop in construction jobs partly offset continued gains in the service-producing sector. In the household survey, the unemployment rate held steady at 5.3 percent--the same level that has prevailed since June of last year.[1]

In the weeks since the December labor market surveys, initial claims for unemployment insurance have fluctuated markedly, but on average have moved up somewhat further. Harsh weather in December and layoffs in the auto industry were among the factors that pushed initial claims higher. In the auto sector, the big three laid off more than 100,000 workers in early

1. In the December release, the Bureau of Labor Statistics incorporated its annual revision to the seasonal adjustment factors for data derived from the Current Population Survey. Before the revision, the data for November had showed a slight uptick to 5.4 percent.

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

	1988	1989	1989 Q2	Q3	Q4	1989 Oct.	Nov.	Dec.
	-----------Average monthly changes---------							
Nonfarm payroll employment[2]	276	203	240	163	146	75	222	142
Strike-adjusted	275	204	245	177	122	80	219	66
Private	248	175	198	115	148	98	239	108
Strike-adjusted	248	176	203	128	124	105	236	32
Manufacturing	29	-9	-10	-30	-25	-22	-27	-25
Durable	20	-13	-12	-29	-24	-23	-21	-27
Nondurable	9	4	2	-1	-1	1	-6	2
Construction	14	9	10	14	-1	10	25	-38
Trade	64	48	32	38	43	61	65	2
Finance, insurance, real estate	11	12	11	15	11	-1	21	13
Services	118	98	137	76	82	29	133	84
Total government	27	28	42	48	-2	-23	-17	34
Private nonfarm production workers	197	138	151	94	103	60	219	31
Manufacturing production workers	20	-9	-14	-27	-16	-12	-28	-7
Total employment[3]	192	146	165	-41	156	166	251	52
Nonagricultural	193	145	181	-68	164	188	288	15

1. Average change from final month of preceding period to final month of period indicated.
2. Survey of establishments. Strike-adjusted data noted.
3. Survey of households.

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

	1988	1989	1989 Q2	Q3	Q4	1989 Oct.	Nov.	Dec.
Civilian, 16 years and older	5.5	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Teenagers	15.3	15.0	15.0	15.0	15.2	14.9	15.3	15.2
20-24 years old	8.7	8.6	8.4	8.7	8.9	8.9	9.0	8.9
Men, 25 years and older	4.2	3.9	3.9	3.9	4.0	3.9	4.0	3.9
Women, 25 years and older	4.3	4.2	4.2	4.2	4.3	4.2	4.2	4.3
White	4.7	4.5	4.5	4.5	4.5	4.5	4.5	4.6
Black	11.7	11.5	11.3	11.3	11.8	11.7	11.9	11.8
Fulltime workers	5.1	4.9	4.9	5.0	5.0	4.9	5.0	5.0
Memo:								
Total national[1]	5.4	5.2	5.2	5.2	5.3	5.2	5.3	5.3

1. Includes resident armed forces as employed.

January, extending the traditional shutdown for the Christmas-New Year holidays. Since that time, General Motors has lengthened some shutdowns through early February.

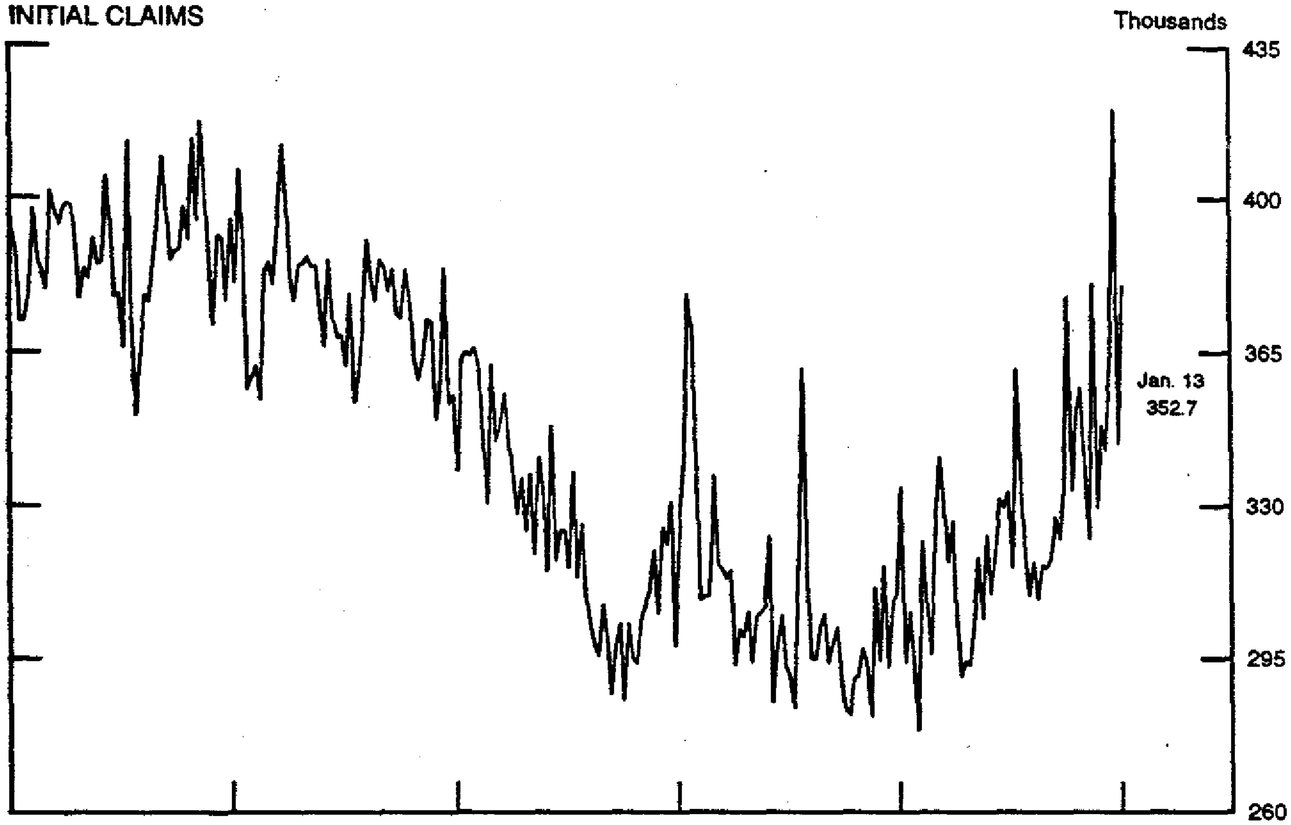
Over 1989 as a whole, total payroll employment grew almost 2-1/2 million. About 95 percent of the new jobs were generated in the service-producing sector, in which gains were sizable in health services, finance, insurance and real estate, and wholesale and retail trade. In the goods-producing sector, increases in construction and mining offset the loss of 104,000 jobs in manufacturing.

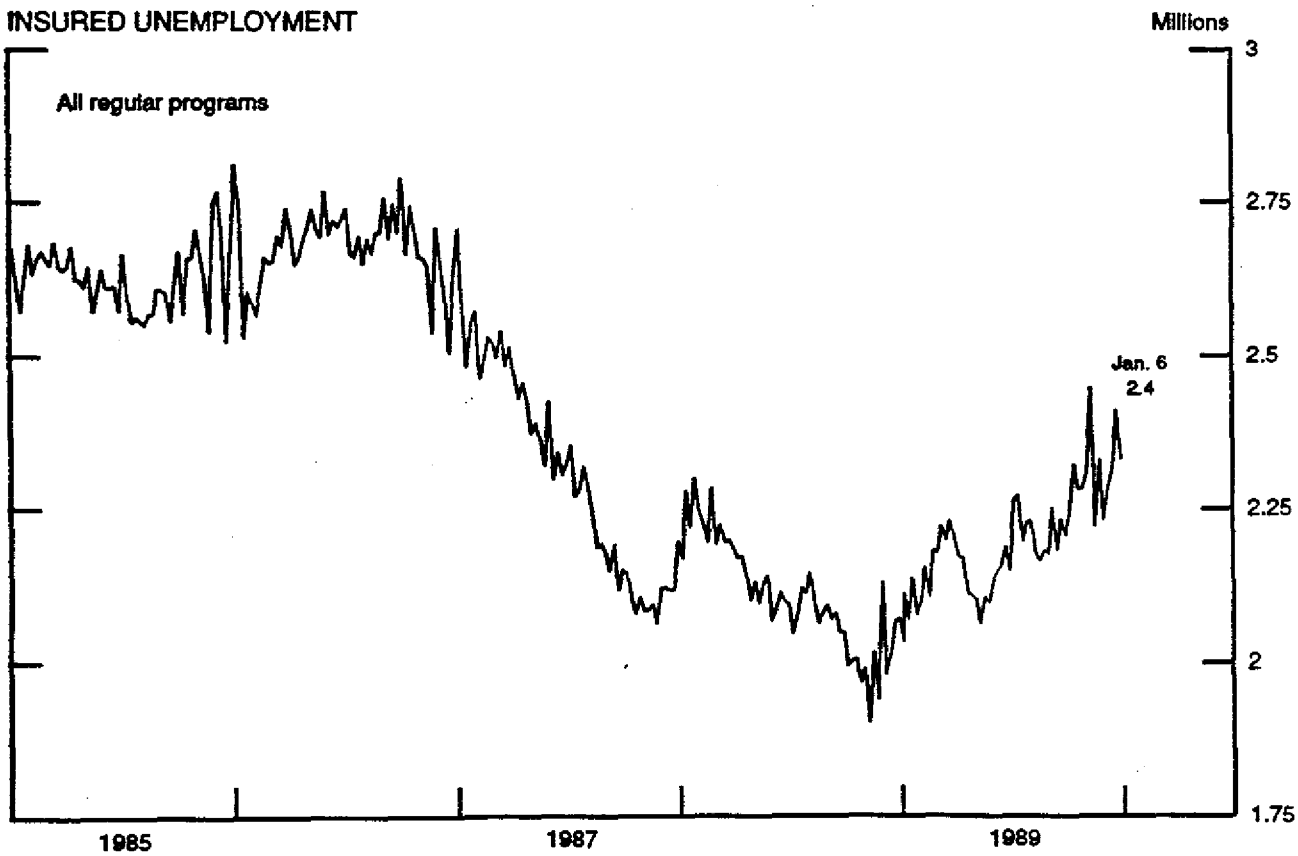
Although productivity data for the fourth quarter are not yet available, the gain over 1989 as a whole appears to have been small--probably on the order of 1/2 percent. Aggregate hours worked appear to have risen about 1-1/2 percent over the year, and nonfarm business output currently is estimated to have risen 2.1 percent.

The small productivity increase of 1989 probably reflects a pattern of cyclical adjustment that is fairly typical of a slowing economy; businesses tend to adjust output growth faster than they adjust labor input, in effect holding on to workers until it becomes clear that the slowing of demand is more than temporary. By this interpretation, the flatness of the unemployment rate in 1989--in the face of growth appreciably below presumed potential--is a consequence of businesses not yet having brought employment into equilibrium with a lower output path.

Given this view of the past year's events, the staff continues to estimate that potential GNP is rising at a rate of about 2-1/2 to 2-3/4 percent. Potential labor input is estimated to be rising at a rate of around 1-1/4 percent per year, and the upward trend in labor productivity is

Unemployment Insurance
Seasonally Adjusted, FRB Basis





thought to be adding another 1-1/4 to 1-1/2 percentage points to the growth of potential output. The staff's estimate of potential GNP growth is slightly below the 3 percent figure being used by the Administration, whose estimate is based on trend productivity growth of about 1-3/4 percent.

Industrial Production

Industrial production looks basically flat at present, but is being bounced around from month to month by swings in auto assemblies and by a number of special factors. A December rise in output of 0.4 percent reflected both the rebound in aircraft production after the settlement of the Boeing strike and a weather-related surge in the output of utilities. Apart from these temporary factors, production edged down last month.

For January, the available data point to a decline in industrial production of more than 1 percent, two-thirds of which reflects cutbacks in motor vehicles. Automakers cut assemblies aggressively this month to an annual rate of around 4-1/4 million units (FRB seasonals) from a 6-1/4 million unit rate in December; production of trucks also appears to have declined after two months of increases. In addition, the January thaw apparently has reduced electricity generation to a much lower level, more than reversing the December surge. By contrast, the firmness of the orders data in late 1989 (table) gives a sense that there still is underlying support for production more generally.

For 1989 as a whole, the increase in total IP was 1.7 percent. The output of final products rose 2.3 percent, but production of materials expanded only 0.3 percent, owing primarily to a decline in output of parts for motor vehicles and a substantial decrease in production of basic metals. Among the final products, assemblies of motor vehicles fell substantially

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

	1988 Proportion	1989[1]	1989 H1[1]	1989 Q3	1989 Q4	1989 Oct.	1989 Nov.	1989 Dec.
			---Annual rate---			---Monthly rate---		
Total index	100.0	1.7	2.7	1.3	.2	-.4	.3	.4
Previous			2.7	1.1		-.6	.1	
Final products	47.1	2.3	5.0	.3	-.9	-1.0	.5	1.0
Consumer goods	24.9	2.2	3.5	-1.6	3.3	.6	-.1	.6
Motor vehicles	2.7	-8.3	-3.6	-21.5	-3.2	-1.4	.3	2.2
Durables excluding motor vehicles	3.6	2.6	6.3	-.9	-.9	.6	-1.3	-.4
Nondurables	18.6	3.6	4.1	1.4	5.0	.9	.1	.6
Business equipment	16.5	3.8	9.5	1.1	-4.4	-2.6	1.2	1.6
Motor vehicles	1.0	-14.0	-13.2	-25.0	-3.3	-2.6	-1.1	2.0
Computers	4.2	9.7	24.0	-4.7	-1.1	-4.8	4.3	.9
Civilian aircraft	.8	.5	22.7	18.7	-43.0	-24.6	9.8	23.4
Other	10.5	3.5	5.4	5.1	-1.6	.4	-.4	.2
Construction supplies	6.0	1.7	-.3	2.9	4.5	1.1	1.0	-.7
Materials	38.6	.3	-.1	2.0	-.4	.0	.0	-.3
Durable	20.2	-.4	-.3	4.0	-4.9	-.9	-.1	-.9
Nondurable	9.7	2.4	2.5	2.4	2.2	1.3	.1	.1
Memo:								
Manufacturing	87.6	1.8	3.4	1.5	-.9	-.5	.4	.2
Durable	50.8	.3	2.8	.4	-4.4	-1.5	.4	.3
Nondurable	36.8	3.9	4.3	3.1	4.0	.7	.3	-.1
Utilities	5.0	3.2	2.4	-5.9	15.2	1.2	-.3	6.3

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

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

	1989 Q2	1989 Q3	1989 Q4	1989 Oct.	1989 Nov.	1989 Dec.
Durable goods excluding civilian aircraft, defense, and motor vehicles	2.0	-1.9	2.8	-1.4	1.3	2.1
Nondefense capital goods excluding aircraft	2.9	-4.2	1.7	-4.1	4.5	1.8
Nondurable goods	2.3	-.7	n.a.	-.9	1.7	n.a.

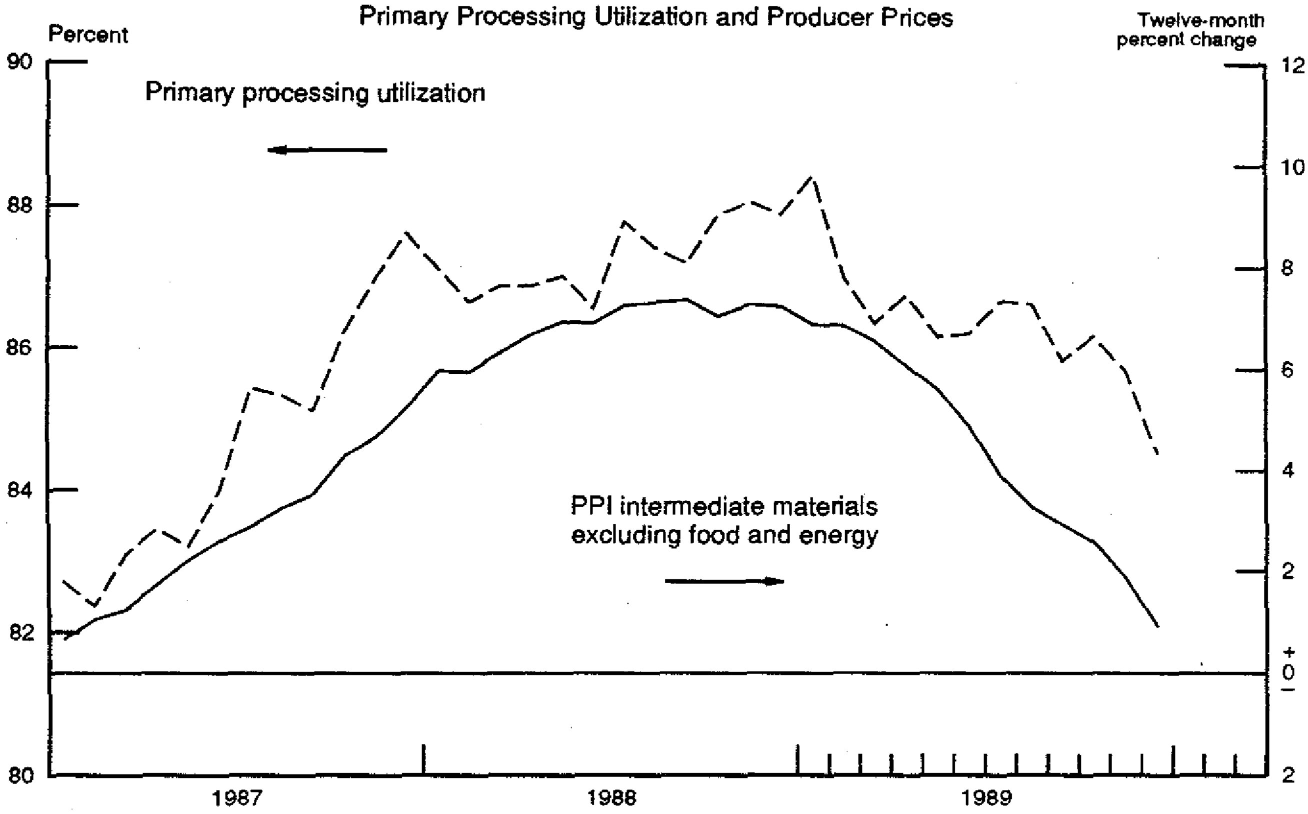
1. Percent change from prior comparable period.
n.a.--not available.

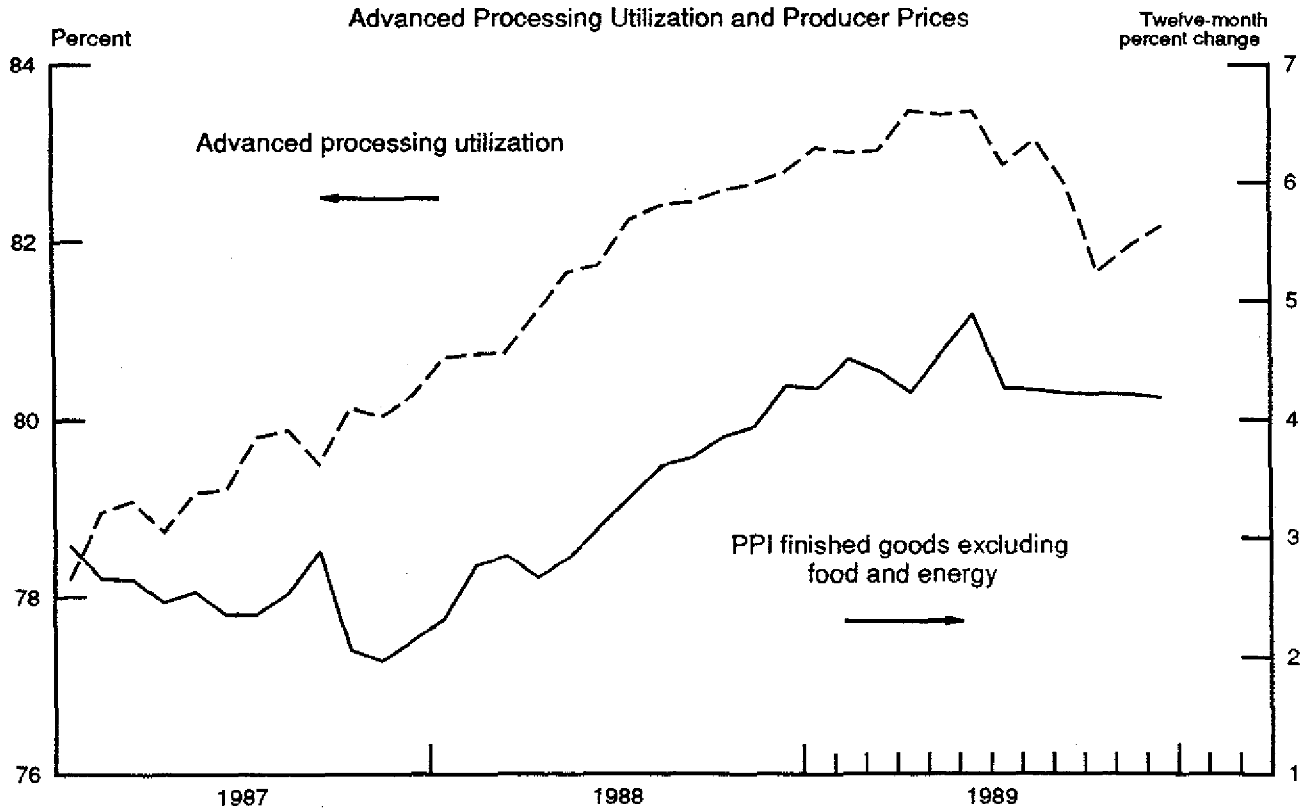
CAPACITY UTILIZATION IN INDUSTRY[1]
(Percent of capacity; seasonally adjusted)

	1967-88 Ave.	1973 Ave.	1978-79 Ave.	1988 Dec.	1989 Oct.	1989 Nov.	1989 Dec.
Total industry	81.6	87.9	85.0	84.3	83.1	83.1	83.3
Manufacturing	80.7	87.0	84.4	84.4	83.1	83.2	83.1
Primary processing	82.0	91.3	86.3	87.9	86.2	85.7	84.5
Advanced processing	80.2	85.1	83.3	82.8	81.7	81.9	82.2
Durable manufacturing	78.8	86.2	83.5	83.1	80.9	81.0	81.1
Primary metals	79.9	96.6	87.8	87.6	84.9	81.0	78.8
Iron and steel	79.0	97.9	88.2	86.5	83.3	78.5	75.1
Nonferrous metals	81.5	94.2	87.1	89.1	87.0	84.4	83.6
Motor vehicles and parts	78.2	94.5	83.6	87.2	75.4	75.5	75.4
Autos	76.1	89.3	81.7	79.8	69.8	64.3	64.3
Aerospace and miscellaneous transportation equipment	78.1	75.4	77.6	85.6	78.3	79.4	85.3
Nondurable manufacturing	83.6	88.1	85.7	86.3	86.2	86.2	85.8
Textile mill products	85.2	90.1	86.7	89.1	91.7	90.7	90.2
Paper and products	88.8	94.2	89.4	94.1	93.2	92.8	93.7
Chemicals and products	79.3	86.9	81.4	89.2	87.3	87.6	87.3
Petroleum products	86.9	97.1	87.8	87.5	87.1	87.0	85.2
Mining	86.5	91.4	90.5	83.6	84.0	84.3	83.4
Utilities	86.7	92.8	85.3	82.0	81.7	81.3	86.3
Electric utilities	87.9	94.9	84.9	84.7	86.1	85.6	90.7
Memo:							
Industrial materials	82.3	91.1	86.7	84.9	83.5	83.3	82.8
Raw steel	80.7	100.4	90.7	87.6	84.7	80.2	74.4
Aluminum	87.8	93.8	94.0	99.4	93.5	96.2	96.1
Paper materials	92.0	96.8	92.1	98.4	96.3	95.8	96.5
Chemical materials	81.3	91.1	85.9	90.7	87.4	87.2	86.6
Energy materials	88.9	93.7	89.4	86.5	86.1	86.1	86.6

1. Data for stone, clay, and glass products, iron and steel, nonferrous metals, foods, textile mill products, paper and products, chemicals and products, rubber and plastic products, raw steel, aluminum, paper materials, and chemical materials are unpublished estimates for December.

CAPACITY UTILIZATION AND PRODUCER PRICES
(Based on seasonally adjusted data)





over the year. Production of other consumer durables turned down in the second half, after a strong first-half performance. By contrast, output of nondurable consumer goods held up well through year-end, and the gain for 1989 as a whole was 3-1/2 percent. Like consumer durables, the output of business equipment excluding motor vehicles was strong early on, but changed little, on net, through the second half; production of computers declined in the second half, aircraft production was limited in the fourth quarter by the strike, and output of other business equipment leveled off, on balance, after growing more than 5 percent at an annual rate over the first three quarters.

Reflecting the sluggishness in materials output, the capacity utilization rate at primary processing industries, which by late 1988 had risen almost to the 1978-80 peak, dropped more than 3 percentage points over the course of 1989. By contrast, capacity utilization at advanced processing industries was essentially unchanged, on net, over the year, although it did turn down in the second half. These different trends in capacity use have been mirrored in the recent patterns of price change (chart): Increases in materials prices, as measured by the PPI for intermediate materials excluding food and energy, have slowed substantially as capacity rates have eased; however, the slowing of price inflation for finished goods excluding food and energy has been small.

Consumption and Personal Income

Real personal consumption expenditures were little changed in the fourth quarter, as auto and light truck sales fell substantially. Excluding motor vehicles, real consumption expenditures rose at an annual rate of about 2-3/4 percent last quarter. While this rate of increase was only

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

	1989	1989 Q3	1989 Q4	1989 Oct.	1989 Nov.	1989 Dec.
Total personal income	30.2	16.5	34.0	38.4	42.5	21.2
Wages and salaries	16.6	15.6	15.8	28.6	2.0	16.9
Private	14.1	13.3	13.6	25.9	.0	14.9
Other labor income	1.6	1.6	1.6	1.6	1.5	1.6
Proprietors' income	2.1	-2.5	4.1	6.2	7.4	-1.4
Farm	.6	-3.4	1.3	7.1	-.2	-3.1
Rent	-.3	-3.8	4.7	-6.3	18.2	2.2
Dividend	.8	.6	.9	1.2	1.0	.6
Interest	6.5	2.9	4.5	4.4	4.6	4.5
Transfer payments	4.5	3.1	3.3	4.4	7.6	-2.0
Less: Personal contributions for social insurance	1.6	.8	1.0	1.8	.0	1.1
Less: Personal tax and nontax payments	5.7	4.5	5.3	7.2	3.2	5.5
Equals: Disposable personal income	24.5	12.1	28.7	31.1	39.3	15.6
Memo: Real disposable income	8.8	5.2	9.0	4.8	18.1	4.0

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

	1989	1989 Q3	1989 Q4	1989 Oct.	1989 Nov.	1989 Dec.
	---Annual rate---			---Monthly rate---		
Personal consumption expenditures	2.3	5.6	-.1	-.3	-.1	.8
Durable goods	.3	11.3	-12.9	-2.2	-1.0	1.1
Excluding motor vehicles	4.5	.2	4.4	-.3	1.6	-.4
Nondurable goods	.6	5.0	-1.4	-.8	-.1	.5
Excluding gasoline	1.0	5.5	-1.2	-.9	.3	.7
Services	4.3	4.3	5.3	.5	.1	.9
Excluding energy	4.5	4.7	4.6	.6	.0	.3
Memo:						
Personal saving rate (percent)	5.5	5.1	5.8	5.5	6.2	5.6

slightly below the average for the first three quarters of the year, some of the gain was weather-related and therefore probably only transitory. In particular, the extremely cold weather of December pushed up expenditures on natural gas and electricity 9-1/2 percent that month, and the outlays for fuel oil rose 19 percent. With the much warmer temperatures of January, spending on these energy-related items probably fell sharply.[2] Spending on most non-energy services, notably medical and transportation services, is estimated to have been robust throughout the fourth quarter.

In contrast to services, real spending on goods other than motor vehicles and fuel oil has been weak in recent months and was down at an annual rate of 1.2 percent for the fourth quarter as a whole. Extensive discounting during the holiday season may have aided the sales of some products; for example, apparel purchases rose about 1-3/4 percent in real terms over the last two months of the year.

Real disposable personal income rose at an annual rate of 2.6 percent in the final quarter of 1989. The gain over the four quarters of the year was 3.6 percent. In December, the growth of real income was less than in previous months, but remained positive. The personal saving rate averaged 5.8 percent in the fourth quarter, up about 3/4 of a percentage point from the third quarter. For the year, the saving rate averaged 5.5 percent, the highest annual figure since 1984.

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2. The BEA computes spending on electricity and natural gas from utility billings and attempts to allocate expenditures to the month when the billing liability was incurred. However, these data are available only with a lag; in the interim, spending in these categories is estimated using data on average temperatures throughout the country. December was one of the coldest months on record, while the first three weeks of January were unseasonably warm.

Motor Vehicles

Responding to bulging inventories and extremely sluggish sales, automakers not only cut production but also enhanced incentive programs toward year-end. As a result, sales of autos and light trucks picked up sharply in late December. In the first three ten-day periods affected by the programs, sales of domestically produced cars averaged about 7-1/2 million units at an annual rate, compared with the 6 million unit pace in October and November. Incentives now cover about 85 percent of the 1990 model-year cars and almost 40 percent of light trucks; on many models the incentives amount to $1,000 or more.

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

			1989		1989		1990
	1988	1989	Q3	Q4	Nov.	Dec.	Jan.
Autos and light trucks	15.45	14.51	15.91	15.74	12.72	13.26	n
Autos	10.64	9.90	10.77	10.78	8.54	8.88	n
Light trucks	4.81	4.61	5.14	4.96	4.18	4.38	n.a.
Domestically produced[2]	11.74	11.19	12.43	11.95	9.74	10.37	n.a.
Autos	7.54	7.08	7.87	7.52	6.00	6.47	7.47[3]
Light trucks	4.21	4.11	4.57	4.43	3.74[4]	3.90	n.a.
Imports	3.70	3.33	3.48	3.79	2.98	2.98	n.a.
Autos	3.10	2.82	2.90	3.26	2.55	2.41	n.a.
Light trucks[5]	.60	.50	.58	.53	.44	.48	n.a.

Note: Data on sales of trucks and imported autos for the current month are preliminary and subject to revision.

1. Components may not add to totals due to rounding.
2. Includes vehicles produced in Canada and Mexico and vehicles made in U.S. plants of foreign manufacturers.
3. First 20 days.
4. Revised nsa data.
5. Based on seasonals for domestic light trucks.

n.a.--not available.

The efforts to cut bloated inventories extended to most auto firms in January. About two-thirds of the big three's production lines in the United

States and Canada were idled for one to three weeks, and some foreign transplants temporarily slowed operations as well. Most plants were scheduled to be back on line by the end of January, and current production schedules call for output at a rate of 6-1/2 million units in February and March. Even so, the 5.8 million units scheduled for the first quarter as a whole would be the lowest quarterly output since 1982.

Sales of imported cars were at a 2.4 million unit annual rate in December--their lowest sales pace since 1984. However, the market share of foreign nameplates, which includes transplants made in the United States, was 37.7 percent in December--near its recent record highs.

Business Fixed Investment

Real spending for business fixed investment fell 3 percent at an annual rate in the fourth quarter, according to BEA's advance estimate. Excluding investment in aircraft, which was held down by the strike at Boeing, spending declined at a 1-1/2 percent annual rate. Business outlays for motor vehicles dropped sharply, but there were increases in spending for computers and communications equipment as well as heavy machinery. Investment in structures rose slightly, as oil drilling perked up.

Over the four quarters of 1989, equipment spending increased about 6 percent; most of the growth came in the first half of the year when there was a surge in spending for computers. Outlays for nonresidential structures declined slightly in 1989, reflecting softness in all major sectors except industrial building; the rise in industry apparently reflects a lagged response to the earlier increase in utilization, given the very long gestation periods often involved.

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

	1989			1989		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
Producers' durable equipment						
Shipments of nondefense capital goods	3.0	2.2	-3.4	-4.4	-.6	1.3
Excluding aircraft and parts	3.0	-.2	-.9	-1.9	1.2	1.2
Office and computing	6.1	-1.0	-3.8	-7.9	2.2	.7
All other categories	2.3	.0	-.2	-.4	.9	1.3
Weighted PDE shipments[1]	3.1	1.2	.5	-.5	1.6	-.7
Shipments of complete aircraft[2]	14.7	46.2	n.a.	-43.7	-26.1	n.a.
Sales of heavy-weight trucks	-3.7	-2.2	-4.7	10.4	-11.2	-.3
Orders of nondefense capital goods	1.0	-2.5	6.1	1.8	7.9	18.6
Excluding aircraft and parts	2.9	-4.2	1.7	-4.1	4.8	1.8
Office and computing	1.8	6.5	-4.6	-9.2	1.2	-5.8
All other categories	3.1	-6.6	3.4	-2.7	5.7	3.6
Weighted PDE orders[1]	.8	-.4	2.2	-2.8	2.9	1.4
Nonresidential structures						
Construction put-in-place	-.8	1.9	n.a.	.2	-.8	n.a.
Office	-3.4	-3.5	n.a.	-2.1	-.7	n.a.
Other commercial	-6.5	5.4	n.a.	5.4	-3.9	n.a.
Public utilities	3.8	-1.8	n.a.	-.2	-.8	n.a.
Industrial	3.9	7.0	n.a.	-.6	1.3	n.a.
All other	.3	5.3	n.a.	-2.2	1.1	n.a.
Rotary drilling rigs in use	16.2	3.0	-3.1	-3.2	-.4	-3.1

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

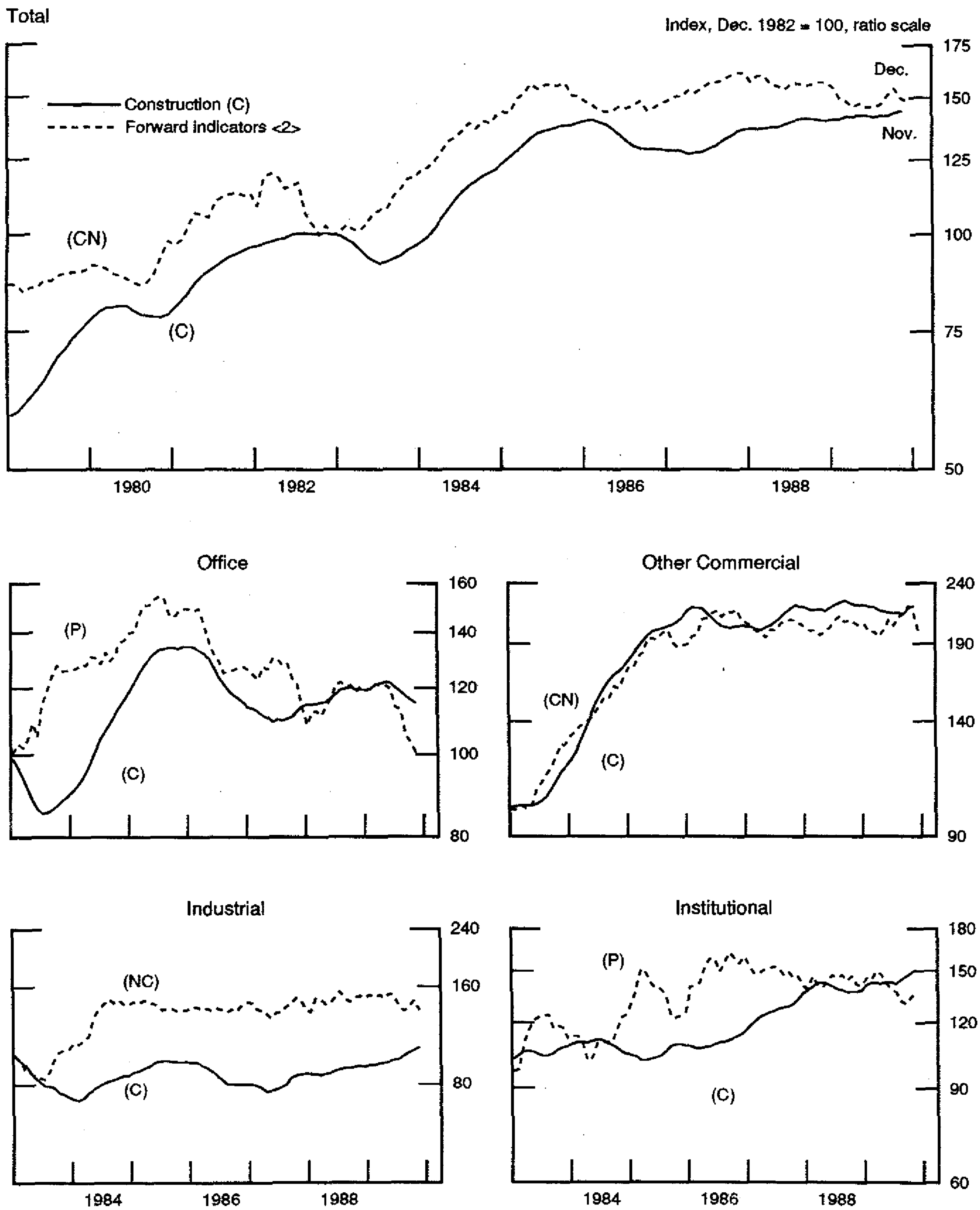
n.a. Not available.

Recent data point to some improvement in equipment spending in the current quarter. New bookings for nondefense capital goods, excluding the aircraft group, rose 1-3/4 percent (not at an annual rate) in the fourth quarter. Furthermore, with the ending of the Boeing strike, aircraft shipments should recover to normal levels this period. Similarly, given recent incentive programs, business purchases of automobiles should revive from the depressed fourth-quarter pace.

In contrast to equipment, the outlook is weaker for structures. Activity here still is being damped by the overhang in office and other commercial space that was created during the building boom of the mid-1980s, and the forward-looking indicators--contracts and permits--have remained lackluster. To provide a better gauge of the usefulness of the forward-looking indicators, the staff recently assessed the predictive power of building permits and construction contracts for each of the major construction sectors.[3] This analysis identified permits as the preferred indicator for office and institutional construction, while contracts were the better indicator in the other commercial and total building categories (chart). Both permits and contracts were found to have predictive power for industrial construction; we thus are using an unweighted average of permits and contracts as the preferred indicator for this sector. Recent movements in these indicators suggest softness for the first half of this year in office and institutional building accompanied by little change in the other commercial and the industrial sectors.

3. The statistical analysis evaluated the "Granger causality," or predictive power, of lags of each indicator in regressions of construction on lags of construction, permits, and contracts.

NONRESIDENTIAL CONSTRUCTION AND SELECTED INDICATORS <1>



<1> Six-month moving average for all series shown. Data end in November for all series except contracts, which go through Decmber.
<2> Varies by panel: either permits (P), contracts (CN), or new commitments(NC).

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

		Planned for 1989	Planned for 1990	
	1988[1]	Commerce (Oct.-Nov.)	McGraw-Hill (Sept.-Oct.)	ECAP (Sept.-Oct.)
All business	10.3	6.4	4.4	3.0
Manufacturing	10.1	3.8	6.4	3.4
Durable	6.1	.2	6.4	.4
Nondurable	13.7	6.8	6.4	5.7
Nonmanufacturing	10.4	8.0	3.1	2.8
Memo:[2]				
Mean error		-1.2	-1.2	-2.0
Mean absolute error		2.9	4.0	4.7

1. As estimated in the October-November Commerce Department Survey.
2. Estimated from 1970 for McGraw-Hill and ECAP and from 1985 for Commerce Department.

Taking equipment and structures together, the recent capital spending surveys point to a further gain in 1990, though not at the pa:e of 1989. The Commerce Department survey of business plans for plant and equipment outlays, taken in October and November, suggests that firms will boost nominal outlays for plant and equipment 6.4 percent in 1990, after an estimated 10.3 percent rise in 1989. The Commerce figure for 1990 is somewhat stronger than the spending plans reported earlier in the private surveys. Much of the slowdown from 1989 is expected to occur in manufacturing, where the Commerce Department survey shows a rise in spending this year of 3.8 percent, as compared with a 10.1 percent estimated gain for 1989. An 8 percent rise is planned in the nonmanufacturing sector.

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

	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.
Current-cost basis:						
Total	47.1	61.2	39.1	2.4	31.0	41.8
Total excluding auto	42.2	47.6	30.0	-8.0	67.1	42.2
Manufacturing	27.9	21.4	17.6	-7.2	9.9	13.7
Wholesale	5.5	11.5	1.4	-7.7	38.7	11.7
Retail	13.8	28.3	20.1	17.3	-17.6	16.4
Automotive	4.9	13.6	9.1	10.4	-36.0	-.4
Excluding auto	8.9	14.7	11.1	6.9	18.5	16.8
Constant-dollar basis:						
Total	10.1	16.2	9.9	-24.4	46.7	38.9
Total excluding auto	1.2	19.2	18.9	-21.0	43.0	34.3
Manufacturing	3.8	8.3	12.0	-12.1	1.1	11.6
Wholesale	-2.1	5.2	-.5	-11.4	30.6	11.7
Retail	8.4	2.6	-1.6	-.9	14.9	15.6
Automotive	9.0	-3.0	-9.0	-3.4	3.6	4.6
Excluding auto	-.6	5.7	7.4	2.5	11.3	11.0

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

	Range in preceding 12 months: 2 Low	Range in preceding 12 months: 2 High	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.
Current-cost basis:								
Total	1.48	1.54	1.50	1.51	1.52	1.51	1.53	1.52
Total excluding auto	1.46	1.51	1.47	1.47	1.49	1.48	1.49	1.49
Manufacturing	1.53	1.64	1.57	1.57	1.59	1.59	1.60	1.60
Wholesale	1.27	1.31	1.28	1.28	1.28	1.27	1.29	1.28
Retail	1.59	1.64	1.61	1.63	1.64	1.63	1.64	1.64
Automotive	1.87	2.06	1.96	2.05	2.04	2.01	2.03	2.04
Excluding auto	1.49	1.53	1.51	1.51	1.52	1.52	1.53	1.53
Constant-dollar basis:								
Total	1.48	1.52	1.50	1.50	1.49	1.49	1.51	1.51
Total excluding auto	1.46	1.51	1.47	1.47	1.48	1.47	1.49	1.49
Manufacturing	1.52	1.63	1.57	1.57	1.58	1.58	1.59	1.59
Wholesale	1.31	1.36	1.33	1.33	1.32	1.31	1.33	1.32
Retail	1.51	1.56	1.55	1.55	1.52	1.51	1.55	1.56
Automotive	1.70	1.93	1.93	1.88	1.72	1.70	1.81	1.84
Excluding auto	1.44	1.47	1.45	1.46	1.46	1.46	1.47	1.48

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

Business Inventories

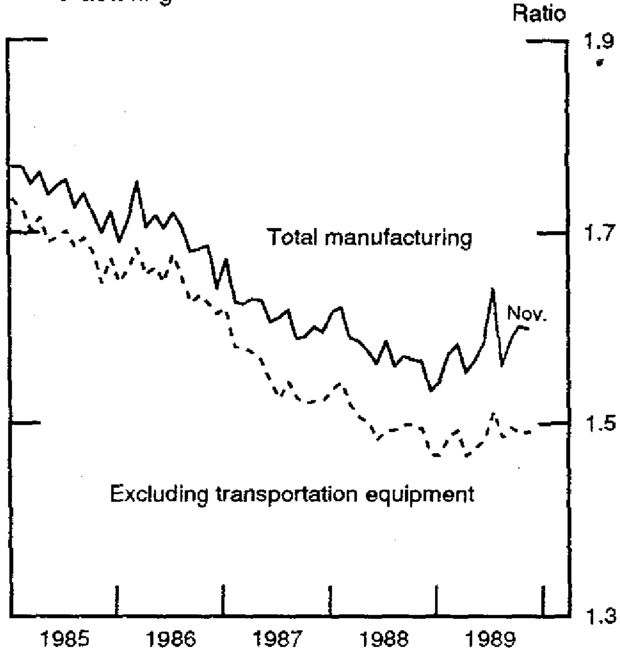
Inventory accumulation picked up in the fourth quarter. In October and November, the growth of nonauto inventories in manufacturing and trade averaged $38.7 billion at an annual rate in constant-dollar terms--a notably faster rate of increase than in the first nine months of last year. Although the currently available data suggest that serious overhangs are not widespread, the sluggishness of final demand probably is causing businesses everywhere to view their inventory positions in a more cautious light.

In manufacturing, part of the recent accumulation has occurred in the aircraft industry--largely in stocks of materials and work-in-process--where new orders have remained strong and production bottlenecks are still of greater concern than excessive stockpiling. Outside of aircraft, net stock increases in other industries have been quite small. The inventory-to-shipments ratio for all manufacturing excluding aircraft and motor vehicles has remained relatively flat since midyear (chart). This is a departure from the earlier downtrend, and it is likely that many manufacturers would prefer to see still lower ratios, especially in the current environment of ample supply availability.

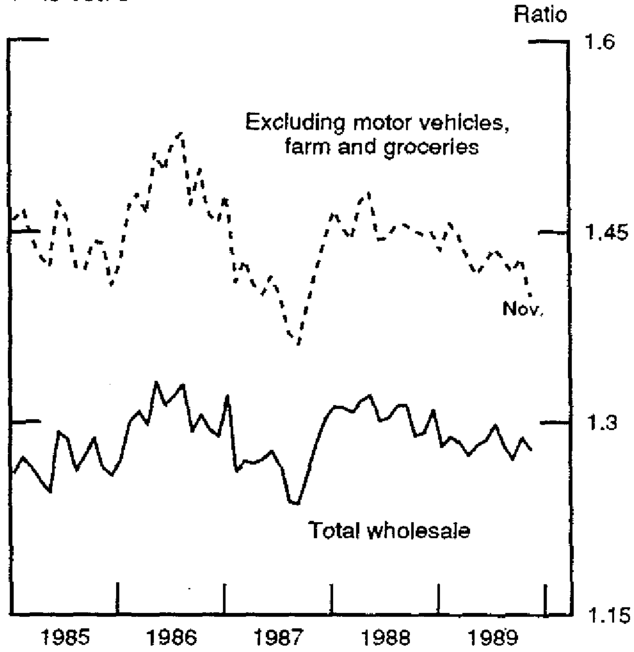
In contrast, retail stockbuilding accelerated late last year even excluding buildups in autos. In particular, retailers of general merchandise have reported persistent inventory runups since midyear and went into the holiday season with their inventory-sales ratio precariously high. The heavy discounting observed during the holiday season probably was in part reflective of this problem.

RATIO OF INVENTORIES TO SALES
(Current–cost data)

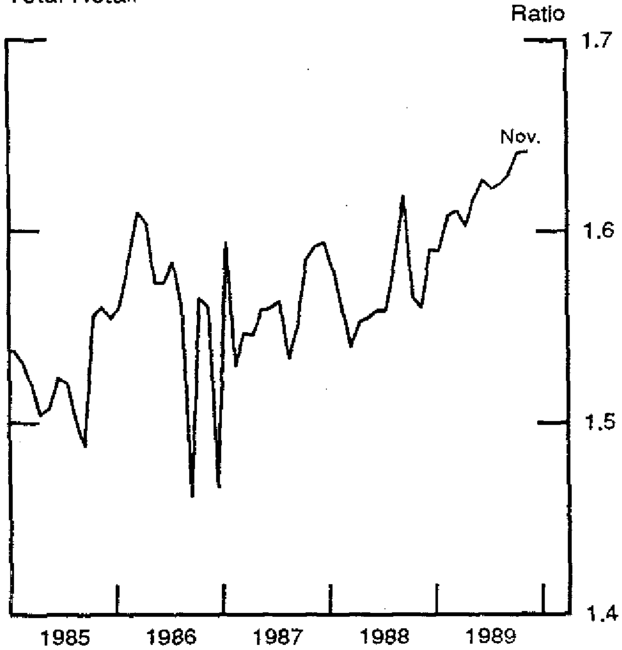
Manufacturing



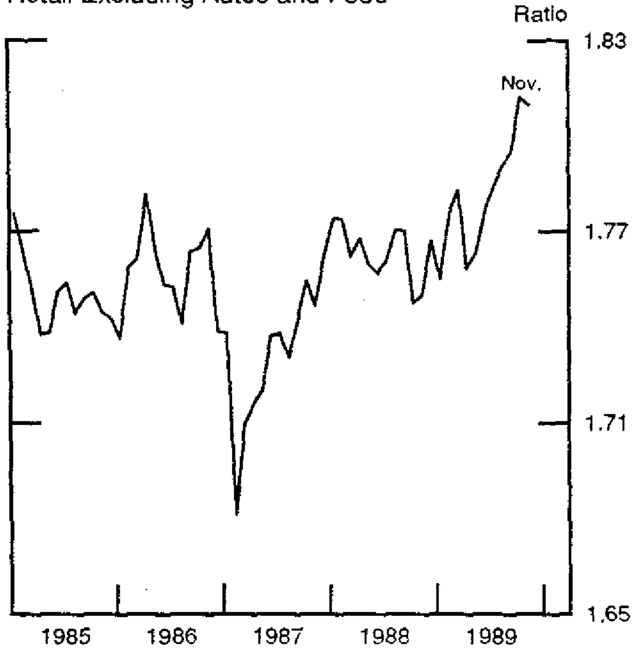
Wholesale



Total Retail



Retail Excluding Autos and Food



Housing Markets

The cold December weather took a toll on home construction, as starts of single-family units fell 10 percent to an annual rate of 900,000 units. However, issuance of single-family building permits, a largely coincident and less volatile indicator of construction, registered only a 4 percent decline last month. A divergence between starts and permits is not unusual during periods of abnormally cold winter weather; experience suggests that starts delayed are largely transferred to subsequent months. Sales of new homes fell in December from a robust November level; the average for the fourth quarter was about the same as for the year as a whole. Sales of existing homes were little changed in December.

Perhaps of more fundamental concern at the moment is the recent upturn in long-term interest rates. Mortgage interest rates were essentially unchanged during the last few months of 1989. However, with the rise in bond rates over the past few weeks, pressures for an upward move in mortgage rates increased, and late in the month the rate on conventional fixed-rate mortgages increased about one-quarter of a percentage point to just above 10 percent. Even before this upturn in rates, it had seemed that the expansion in housing activity was being damped to some degree by financing constraints. In particular, in the wake of FIRREA, thrifts have cut back their lending for acquisition, development, and construction. Nonetheless, homebuilder perceptions of new home sales conditions over the next six months rose in December and January from the relatively weak levels reported in earlier months.

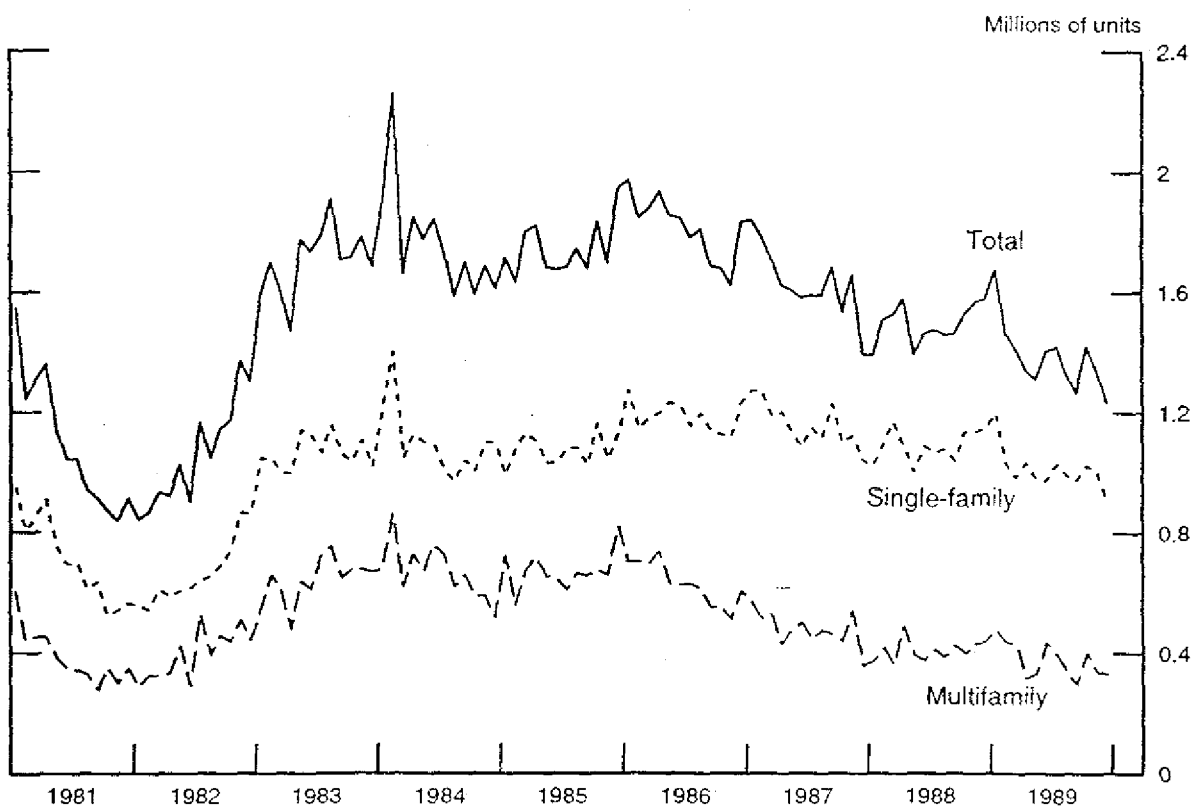
In the multifamily sector, starts edged down 2 percent in December to an annual rate of 331,000 units. For the fourth quarter as a whole,

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

	1989	1989			1989		
	Annual[p]	Q2	Q3	Q4[p]	Oct.[r]	Nov.[r]	Dec.[p]
All units							
Permits	1.33	1.33	1.31	1.35	1.36	1.34	1.34
Starts	1.37	1.35	1.34	1.33	1.42	1.34	1.24
Single-family units							
Permits	.93	.91	.93	.96	.96	.98	.94
Starts	1.00	.99	1.00	.98	1.02	1.00	.90
Sales							
New homes	.65	.64	.70	.65	.64	.70	.63
Existing homes	3.43	3.32	3.44	3.54	3.48	3.59	3.55
Multifamily units							
Permits	.40	.42	.38	.38	.40	.36	.39
Starts	.37	.36	.34	.36	.40	.34	.33
Vacancy rate[1]							
Rental	9.3	9.3	9.2	9.5	n.a.	n.a.	n.a.
Owner	7.5	6.8	7.6	9.6	n.a.	n.a.	n.a.

1. Percent.
p--preliminary r-revised estimates.

PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



multifamily starts averaged 356,000 units, close to the rates of construction in the second and third quarters of last year. Vacancy rates for multifamily owner and rental properties moved up to about 9-1/2 percent in the fourth quarter; in the condominium market, vacancy rates trended up perceptibly over the course of 1989.' Starts of multifamily owner units have declined by about one-third from a high in late 1987 to 80,000 units in the third quarter of last year (most recent data).

In some areas of the country, the demand for housing probably is being affected by reduced expectations of the investment return from homeownership. As of the third quarter of 1989, year-to-year declines in nominal sales prices of existing homes were evident in several metropolitan areas, both in the Northeast and in other scattered localities (table). For the nation as a whole, transaction prices of existing homes continued to move up in 1989, though a bit more slowly than in most recent years (chart). During the final months of 1989, the year-to-year rate of increase in existing home prices was relatively stable at about 5 percent.

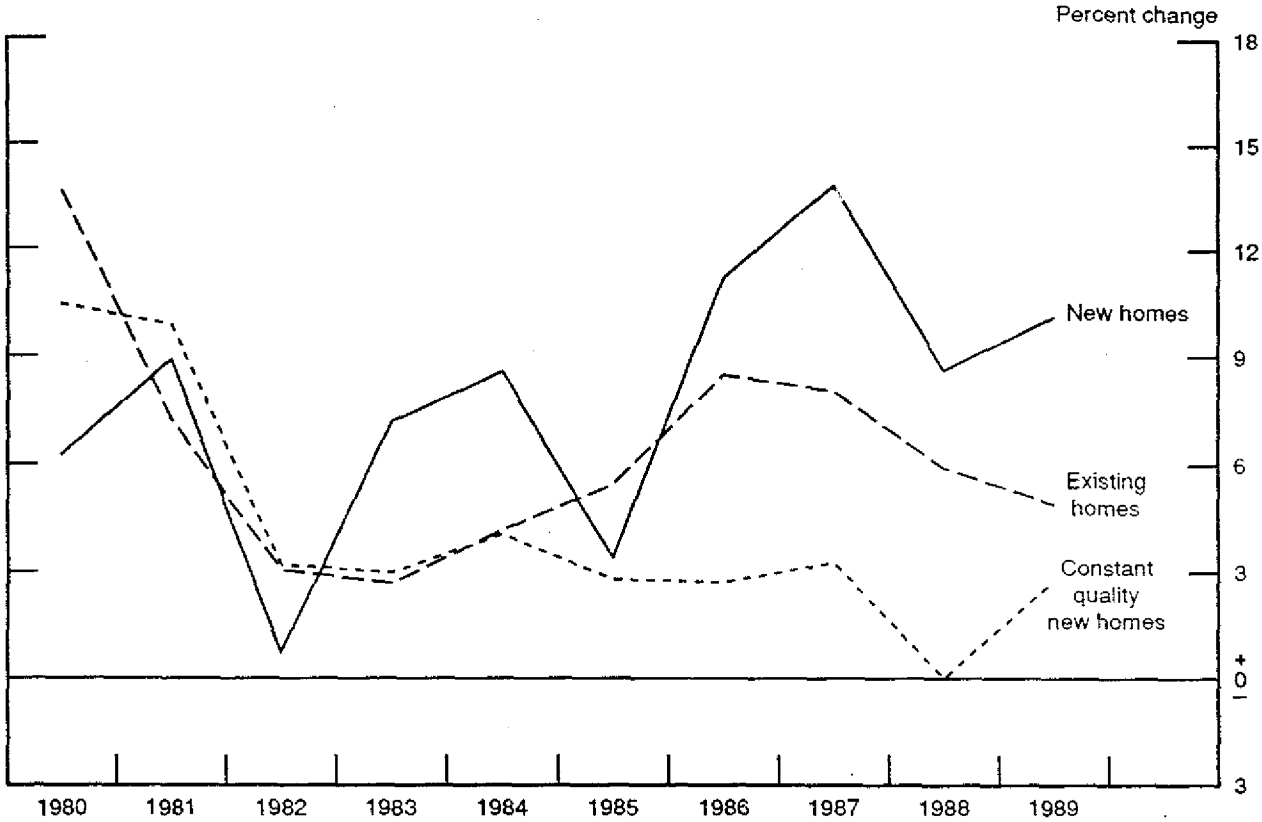
Of course, fluctuations in the average prices of existing homes may reflect changes in the geographic or quality mix of homes sold, in addition to house price inflation. Although quality-adjusted house price information is not available for the existing home market, the Census Bureau does publish such a series for new homes. During the first three quarters of 1989, year-over-year increases in these quality-adjusted new home prices averaged about 3 percent, close to rates of increase for earlier years of the decade (chart).

MEDIAN PRICE OF EXISTING HOMES SOLD IN SELECTED
METROPOLITAN STATISTICAL AREAS
(Percent change from a year earlier)

	1985	1986	1987	1988	1989 Q1	1989 Q2	1989 Q3
South							
Oklahoma City	1.3	-2.6	-1.1	-9.8	-7.4	-8.1	-4.1
Houston	1.3	-11.1	-5.7	-6.2	4.5	8.2	8.2
Dallas	6.7	6.3	-2.6	.0	9.6	2.1	6.9
Washington, DC	4.4	4.6	12.4	16.0	8.5	7.1	7.0
Tampa	.0	4.6	4.4	2.8	14.0	9.6	10.5
Northeast							
Boston	34.2	18.6	11.3	2.3	.1	1.8	-.3
New York City	27.3	19.9	14.3	.2	-3.9	-4.0	-4.9
Philadelphia	8.6	5.2	17.7	5.6	7.2	6.8	1.4
West							
Seattle	n.a.	n.a.	n.a.	7.4	13.0	16.6	22.5
San Francisco	n.a.	n.a.	6.3	24.1	31.9	31.0	23.1
Los Angeles	n.a.	n.a.	14.7	21.5	26.3	24.6	18.7
Phoenix	.0	5.0	3.2	-1.1	-.6	3.9	-6.1
Las Vegas	-1.6	3.2	-.6	2.3	6.3	10.5	8.2
Midwest							
Milwaukee	-1.0	3.6	.9	5.7	4.7	7.8	5.8
Chicago	2.0	6.2	5.5	8.9	7.3	5.7	10.5
Kansas City	3.9	6.5	6.7	1.0	4.1	1.0	-1.1
St. Louis	6.3	7.9	4.8	5.1	9.9	-5.3	-5.8

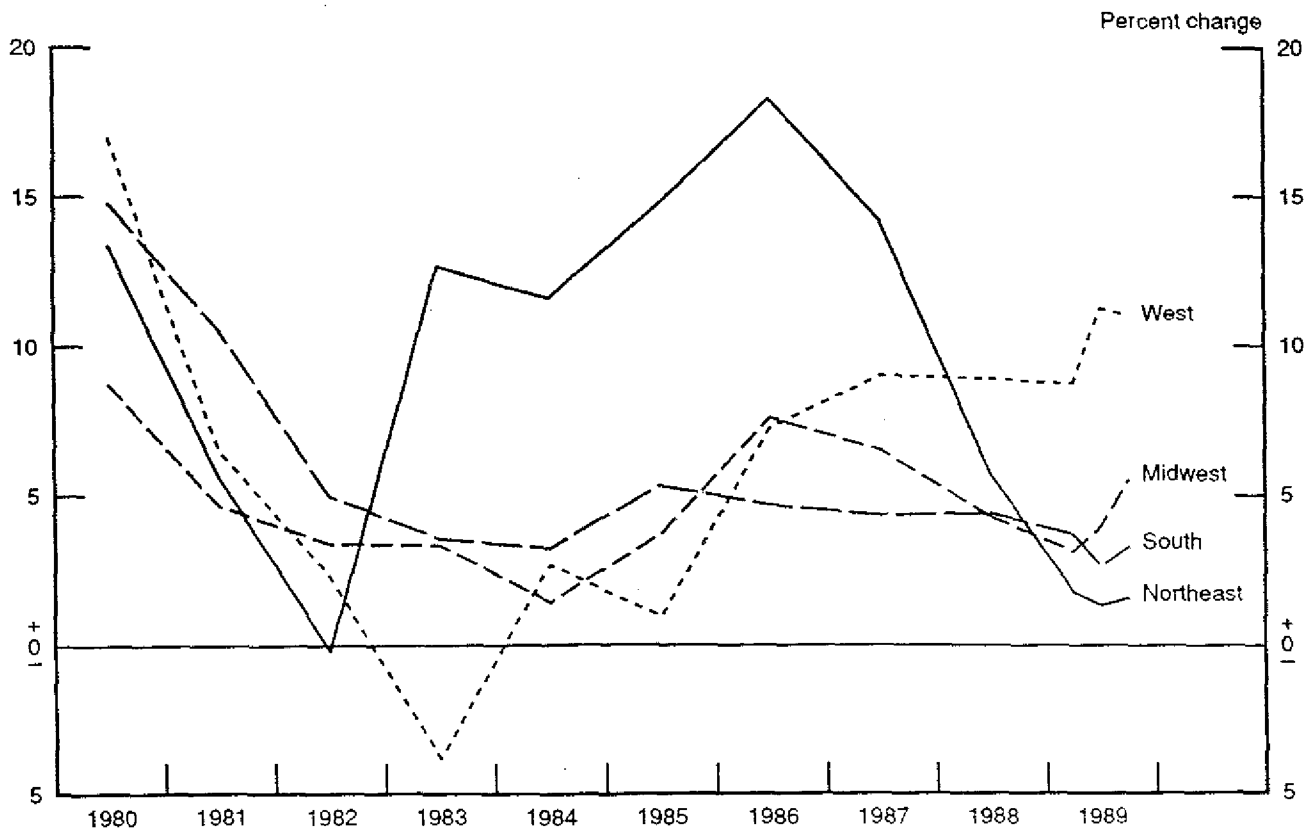
n.a.--not available.
Source: National Association of Realtors.

ANNUAL CHANGES IN HOUSE PRICES



For 1989, the constant quality new home price change is based on data for the first three quarters of the year. The unadjusted new home price change for 1989 reflects a staff estimate for December averaged with published data for the remainder of the year.

EXISTING HOME PRICES BY REGION



For 1989, the plots are quarterly and are measured relative to a year earlier.

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

	October-December 1988	October-December 1989	Net change	Percent change
Outlays	289.2	298.5	9.3	3.2
National defense	79.6	73.7	-5.9	-7.4
Net interest	39.6	44.2	4.6	11.6
OASDI	55.1	58.8	3.7	6.7
Medicare	19.5	22.8	3.3	16.9
International affairs	.9	3.9	3.0	433.3
Deposit insurance	8.3	7.0	-1.3	-15.7
Agriculture	7.2	4.0	-3.2	-44.4
Other	79.0	84.1	5.1	6.5
Receipts	221.6	228.8	7.2	3.2
Personal income taxes	100.8	107.3	6.5	6.4
Withheld	96.5	102.6	6.1	6.3
Nonwithheld less refunds	4.3	4.7	.4	9.3
Social insurance contributions	73.6	76.9	3.3	4.5
Corporate income taxes, net	25.5	22.0	-3.5	-13.7
Other	21.7	22.5	.8	3.7
Deficit	67.6	69.7	2.1	3.1

The Federal Sector

Federal purchases of goods and services, excluding the CCC, fell at an annual rate of 6-1/4 percent in real terms in the fourth quarter. Real defense purchases declined at an 8 percent rate and are expected to continue to shrink owing to the steady reduction of real spending authority for defense since FY1985. Nondefense purchases were the same as in the previous quarter.

The federal government recorded a budget deficit of $70 billion for the first quarter of fiscal year 1990, compared with a $68 billion deficit a year earlier. Typically, a major portion of the fiscal year deficit is recorded in the fall quarter because most nonwithheld personal and corporate income tax payments occur in other quarters.

Outlays for the most recent quarter were about $9 billion higher than in the year-earlier period, reflecting a $5 billion increase in net interest outlays and a $7 billion rise in OASDI and medicare payments. Defense expenditures were $6 billion lower, of which half was due to a shift in the timing of a military pay hike from fiscal year 1990 to fiscal year 1989. Fourth-quarter spending for deposit insurance was $7 billion--high by historical standards but about the same as a year earlier. Agriculture spending was off $3 billion because of declining farm subsidy payments related to higher prices for farm commodities. Net outlays for international affairs were $3 billion higher because the previous year's expenditures had been reduced by a large prepayment on foreign military sales credit.

Receipt growth has slowed markedly because of weakness in net income tax payments; receipts for the October-December period were only 3 percent

ADMINISTRATION BUDGET PROPOSAL
(Billions of dollars)

	Fiscal years					
	1990	1991	1992	1993	1994	1995
Outlays:						
Baseline outlays[1]	1197.2	1258.7	1307.9	1361.2	1412.3	1463.4
Policy changes:						
Excluding SSIDRF[2]	.0	-25.4	-36.5	-53.5	-67.9	-88.2
Payments to SSIDRF	.0	.0	.0	14.1	53.6	101.8
Proposed outlays	1197.2	1233.3	1271.4	1321.8	1398.0	1477.0
Receipts:						
Baseline receipts	1072.8	1156.3	1234.9	1323.5	1401.9	1480.8
Policy changes	.6	13.9	11.4	4.1	6.7	5.6
Proposed receipts	1073.5	1170.2	1246.4	1327.6	1408.6	1486.3
Deficit:						
Baseline deficit(-)	-124.4	-102.4	-73.0	-37.7	-10.4	17.4
Policy changes	-.6	-39.3	-47.9	-43.4	-21.1	8.0
Proposed deficit(-)	-123.8	-63.1	-25.1	5.7	10.7	9.4
Memo:						
Proposed deficit excluding SSIDRF(-)	-123.8	-63.1	-25.1	19.9	64.2	111.2

1. Baseline includes extension of food stamp program and Postal Service outlays.
2. Starting in FY1993 with a three-year phase-in, the government will make payments equal to the projected social security surplus into a new off-budget fund--the Social Security Integrity and Debt Reduction Fund (SSIDRF).

ADMINISTRATION ECONOMIC ASSUMPTIONS

	Calendar years					
	1990	1991	1992	1993	1994	1995
	--------Percent change, Q4 to Q4----------					
Real GNP	2.6	3.3	3.2	3.1	3.0	3.0
GNP deflator	4.2	4.1	3.8	3.5	3.2	2.9
CPI-U	4.1	4.0	3.8	3.5	3.2	2.9
	----------Percent, annual average---------					
Unemployment rate	5.4	5.3	5.2	5.1	5.0	5.0
Interest rates:						
Treasury bills	6.7	5.4	5.3	5.0	4.7	4.4
Treasury notes	7.7	6.8	6.3	6.0	5.7	5.4

above the year-earlier level. Taken together, withheld personal income taxes and social security payroll taxes were 5 percent above a year earlier, but corporate income tax payments were \$3-1/2 billion lower than in the fall quarter of 1988, reflecting weaker corporate profits. Turning to the first quarter of 1990, preliminary data from the Daily Treasury Statement indicate that in January receipts of nonwithheld individual income tax payments are running 7 percent above last year's levels (January 15 was the deadline for making the final estimated payment on 1989 liabilities); this rise is consistent with the view that some of last year's surprisingly large final payments reflected permanent factors such as tax base broadening rather than merely transitory factors such as timing of capital gains realizations.

On January 29, the Administration unveiled its latest budget proposals. The FY1990 deficit now is projected to be \$124 billion, up \$25 billion from the Mid-Session Review. Changed economic assumptions (primarily in regard to corporate profits) added \$11 billion to the deficit; an upward revision of projected spending for deposit insurance added \$8 billion.

As expected, the proposed budget for FY1991 is built around the Gramm-Rudman deficit target of \$64 billion and the President's pledge of no new taxes. On the revenue side, the President proposes a capital gains tax rate reduction, inclusion of state and local employees in the social insurance tax base, and some other smaller measures. While some of these measures may reduce revenues in the long run, the Administration expects the short-run effects to augment FY1991 revenues by \$14 billion dollars. Proposed cuts in outlays, relative to current-services estimates, would amount to \$25 billion, with reductions proposed for defense (\$4 billion) and medicare

($6 billion). Over the longer term, the Administration proposes a budget path that reaches balance in FY1993, in line with GRH targets.

The Administration's projections are based on growth in real GNP of 2.4 percent over the four quarters of 1990, and 3.2 percent in 1991. Nominal interest rates on three-month Treasury bills are expected to average 6.2 percent in 1990 and 5.4 percent in 1991 while inflation hovers around 4 percent. Over the longer term, real GNP growth is projected to remain at about 3 percent per year, while inflation is expected to fall gradually to 3 percent by 1995 and short-term interest rates to 4.4 percent.

A more detailed presentation of the proposals will be included in an appendix to the Greenbook supplement.

State and Local Government Sector

Real purchases of goods and services by state and local governments rose at an annual rate of 4.3 percent in the fourth quarter, after three quarters of slower growth. The pickup at the end of last year largely reflected a surge in construction activity, especially for highways and schools. Nevertheless, construction was down for the year as a whole--the first decline since 1983.

The fiscal condition of the state and local sector appears to have deteriorated further during the fourth quarter; the annual NIPA data imply that the quarterly deficit in the operating and capital accounts (excluding social insurance funds) was $41-1/2 billion at an annual rate,[4] compared with figures in the range of $26 to $35 billion in previous quarters of 1989. In the Northeast especially, revenues have been coming in well below

4. The fourth-quarter figure has not been published in the NIPA, but can be derived implicitly from the annual figure, which has been published.

prior projections, and many state and local government officials in that region are beginning to talk about the need to raise taxes in order to meet spending objectives. For example, New York is facing a potential $700 million shortfall in FY1990, which ends on March 31, and an even larger deficit the next year. In response, Governor Cuomo has proposed raising a variety of taxes, imposing new taxes, and suspending the final phase of an income tax cut.

Prices

Inflation rates were relatively high toward the end of 1989 and, because of the adverse effects of the severe winter on food and energy prices, seem almost certain to pick up further in early 1990. The consumer price index rose 0.4 percent in December, the same as in November. Producer prices of finished goods jumped 0.7 percent in December, boosted by a pickup in energy prices and a climb for tobacco products.

In the food sector, freezing weather around Christmas caused major damage to citrus and vegetable crops in Florida and Texas and began pushing up prices in the wholesale and retail markets almost immediately. By the second week of January, the wholesale prices of some fresh vegetables were more than double the levels of a month earlier. Futures prices for orange juice also increased substantially--by more than 50 percent from mid-December to late January; apparently, traders feel that Brazilian supplies will not be available in sufficient quantity to offset fully the domestic losses. Much of the current surge in vegetable prices may be reversed within a few months, given the short growing cycle for fresh vegetables. But the high prices for citrus products are likely to persist at least until the harvest of next year's crop--and perhaps longer, if the freeze caused

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

	Relative importance Dec. 1988	1988	1989	1989 Q2	1989 Q3	1989 Q4	1989 Nov.	1989 Dec.
				------Annual rate-----			-Monthly rate-	
All items[2]	100.0	4.4	4.6	5.7	1.6	5.2	.4	.4
Food	16.2	5.2	5.6	5.6	2.9	5.8	.6	.5
Energy	7.3	.5	5.1	24.8	-13.4	2.2	-.1	.0
All items less food and energy	76.5	4.7	4.4	3.8	3.1	5.3	.4	.4
Commodities	25.7	4.0	2.7	2.0	.7	4.1	.2	.2
Services	50.8	5.0	5.3	4.3	4.5	6.0	.5	.5
Memorandum:								
CPI-W[3]	100.0	4.4	4.5	5.7	1.6	4.6	.3	.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. 1988	1988	1989	1989 Q2	1989 Q3	1989 Q4	1989 Nov.	1989 Dec.
				------Annual rate-----			-Monthly rate-	
Finished goods	100.0	4.0	4.8	5.8	-.3	4.3	-.1	.7
Consumer foods	25.8	5.7	5.0	-1.3	-1.3	10.9	.8	.5
Consumer energy	8.8	-3.6	9.6	31.8	-16.8	-7.1	-3.3	1.4
Other finished goods	65.3	4.3	4.2	5.1	3.3	3.3	.2	.6
Consumer goods	39.6	4.8	4.5	5.7	2.6	4.5	.0	.9
Capital equipment	25.8	3.6	3.7	4.5	4.8	1.0	.3	.2
Intermediate materials[2]	94.8	5.3	2.6	2.9	-1.1	-.4	-.1	-.1
Excluding food and energy	83.4	7.2	.9	.3	-.7	-1.3	.0	-.4
Crude food materials	43.8	14.2	2.6	-17.8	-2.2	17.1	1.7	3.0
Crude energy	36.9	-9.5	17.9	23.6	-6.5	12.6	.3	2.2
Other crude materials	19.3	7.5	-3.8	-9.3	-.6	-14.3	-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.

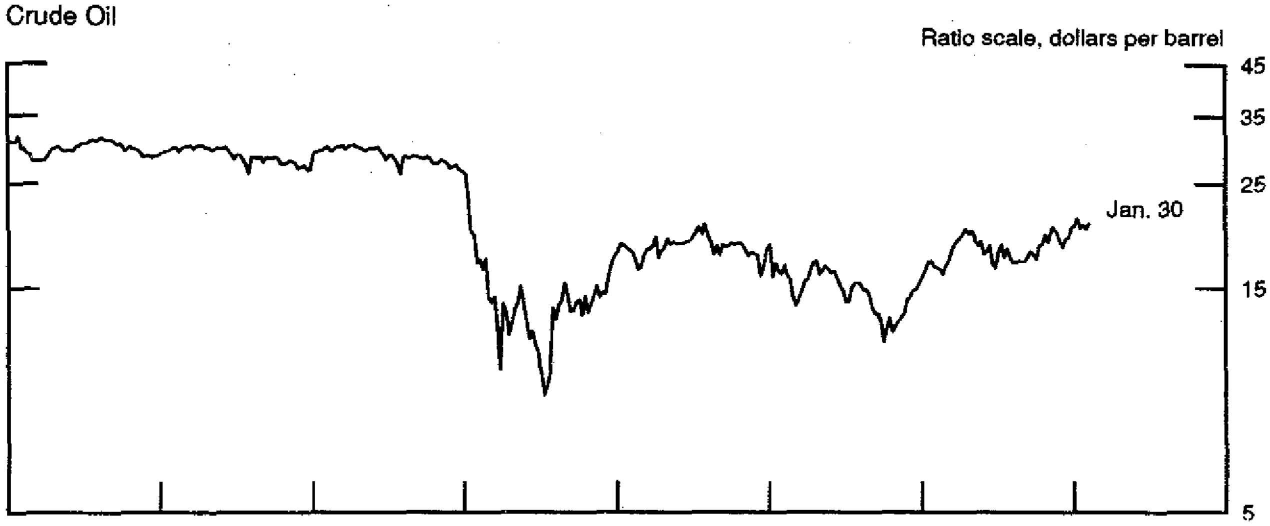
extensive damage to the trees. On a somewhat more positive note, there is a hint in dairy markets of some easing of the tight supply situation that pushed up prices in the second half of 1989. In particular, milk production in December was back up to its year-earlier level for the first time since May, and although there was still strong upward pressure on the price of unprocessed milk, product prices--notably for nonfat dry milk--have turned down sharply in some spot markets. Egg prices, which surged late last year, also have eased since early January. Overall, though, it appears that the rise in consumer food prices in the near term might be considerably higher than the average increase of about 1/2 percent per month in November and December.

In the energy sector, December's cold weather boosted heating oil demand about 14 percent above year-earlier levels. Equally important, supplies from several major U.S. refineries were disrupted in late December by explosions or by damage from the cold. By year-end, inventories of heating oil had fallen about 14 percent below year-earlier levels, and gasoline inventories were more than 5 percent below their year-earlier levels. Spot prices for heating oil doubled over the period from November 15 to December 29.

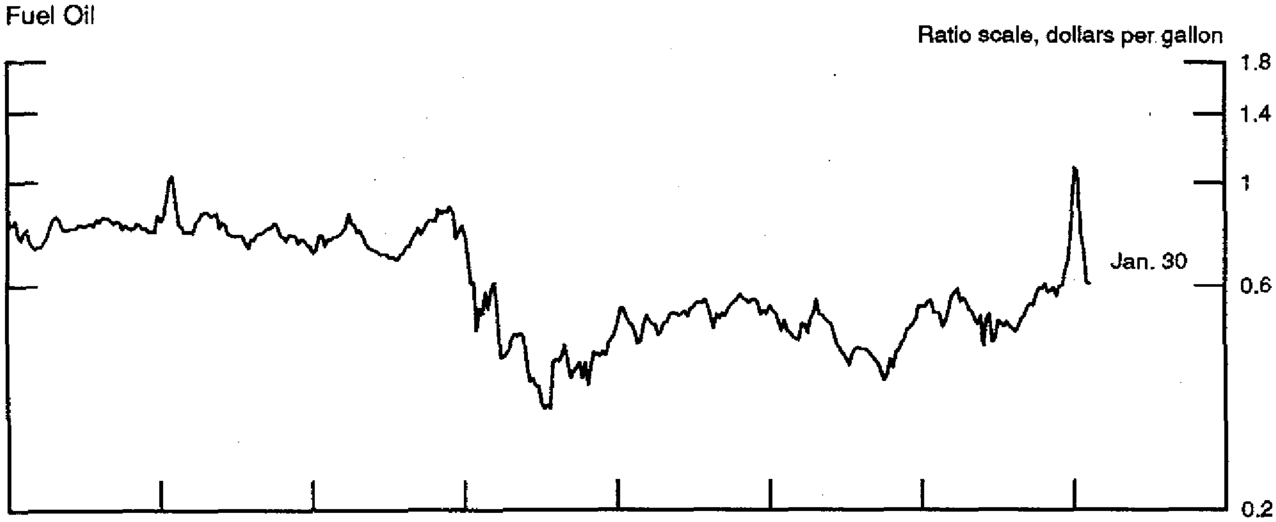
December's unusually cold weather has been followed by a balmy January, and the heating oil market reflects this reversal. By mid-January, inventories of heating oil were only 7 percent below year-earlier levels, and as of late January, spot prices were back near their mid-November range. For much of January, however, heating oil prices remained well above December levels. The producer price index survey was taken early in January, when wholesale heating oil prices were about 25 percent above

SPOT PRICES FOR PETROLEUM PRODUCTS

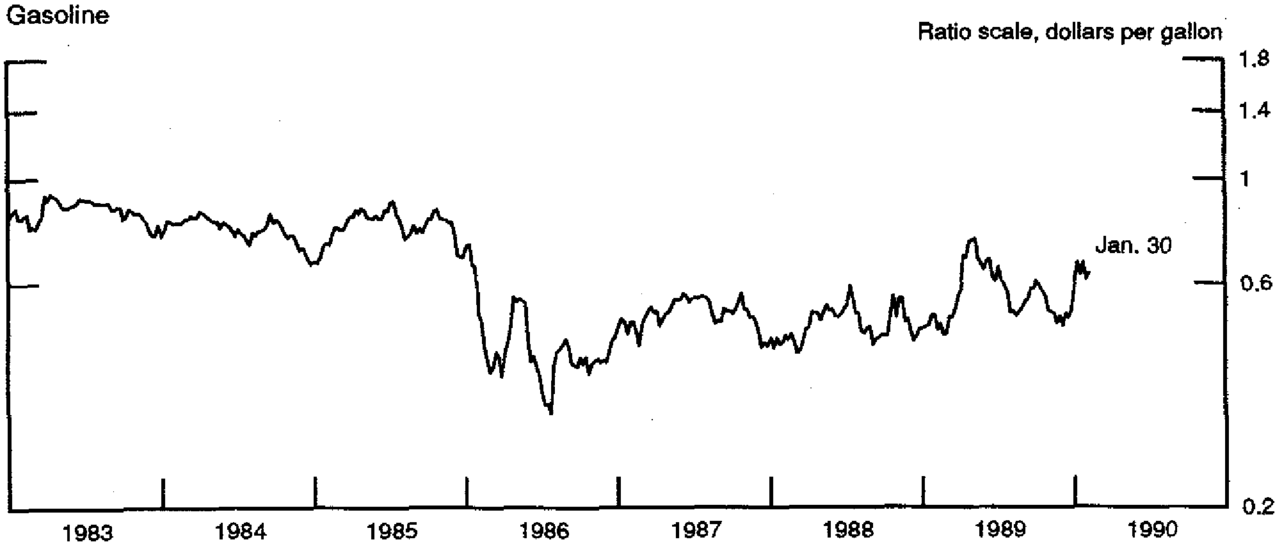
Crude Oil



Fuel Oil



Gasoline



early-December quotes. The consumer price survey covers the entire month, but also is likely to show a major increase in January. The collapse in the spot heating oil market is likely to be reflected in sharp declines in the February price indexes. With regard to gasoline, mid-January inventories remained about 7 percent below year-earlier levels, and private surveys suggested major increases in both wholesale and retail gasoline prices for the month.

Excluding food and energy items, the CPI rose 0.4 percent in December, the same as the index total. The commodities component was up a moderate 0.2 percent, held down by discounting in several categories, notably for apparel, toys, and house furnishings. However, new car prices rose 1 percent further, as higher-priced (and less discounted) 1990 models continued to be phased into the CPI sample. More widespread discounting of the 1990 models likely will affect the January index. In contrast to commodities, nonenergy service prices were up 0.5 percent in December, the same as in November but somewhat above the pace earlier last year.

At the producer level, the PPI for finished goods excluding food and energy rose 0.6 percent in December, of which 0.2 percentage point reflected a jump in prices of tobacco products.[5] Prices of intermediate materials (also excluding food and energy) were down 0.4 percent, as sharp declines for nonferrous metals more than offset increases for some of the more processed materials. The PPI for crude nonfood materials less energy fell 1.8 percent, mainly reflecting declines for metal scrap and ores. Since the mid-December pricing date for the PPI, the domestic indexes of commodity

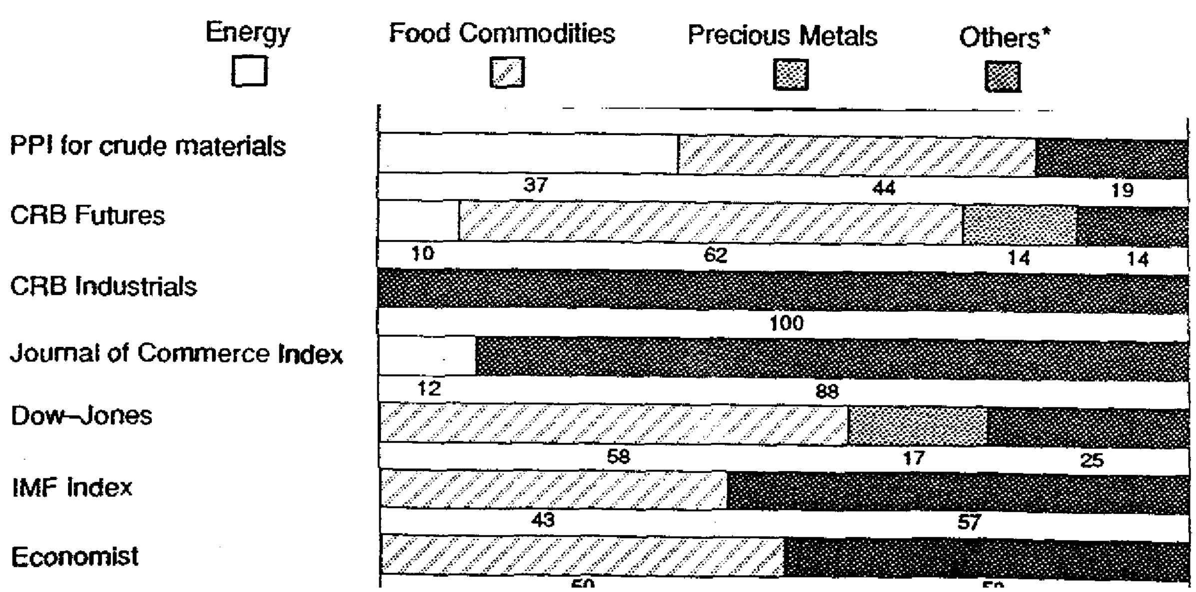
5. Owing to a shift in the timing of price increases for tobacco products, the BLS seasonal factors do not correspond to the current monthly pattern.

PRICE INDEXES FOR COMMODITIES AND MATERIALS[1]

	Last observation	Percent change[2] 1987	1988	1989	1989 Dec. 12[3] to date	Memo: Year earlier to date
1. PPI for crude materials[4]	Dec.	8.9	3.1	6.9	n.a.	6.9
1a. Foods and feeds	Dec.	1.8	14.2	2.6	n.a.	2.6
1b. Energy	Dec.	10.7	-9.5	17.9	n.a.	17.9
1c. Excluding food and energy	Dec.	22.6	7.5	-3.8	n.a.	-3.8
1d. Excluding food and energy, seasonally adjusted	Dec.	22.8	7.6	-3.9	n.a.	-3.9
2. Commodity Research Bureau						
2a. Futures prices	Jan. 30	11.7	8.5	-9.0	1.1	-5.1
2b. Industrial spot prices	Jan. 29	19.2	7.3	-5.9	-.1	-9.5
3. Journal of Commerce industrials	Jan. 30	10.7	3.8	1.3	.7	.5
4. Dow-Jones Spot	Jan. 30	17.0	6.9	-10.1	-.7	-7.4
5. IMF commodity index[4]	Dec.	30.8	12.6	-12.9	n.a.	-12.9
5a. Metals	Dec.	51.9	33.7	-23.2	n.a.	-23.2
5b. Nonfood agric.	Dec.	47.5	-9.4	-4.6	n.a.	-4.6
6. Economist (U.S. dollar index)	Jan. 23	42.5	17.7	-22.8	-2.5	-23.3
6a. Industrials	Jan. 23	62.6	18.9	-23.8	-5.8	-28.8

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.

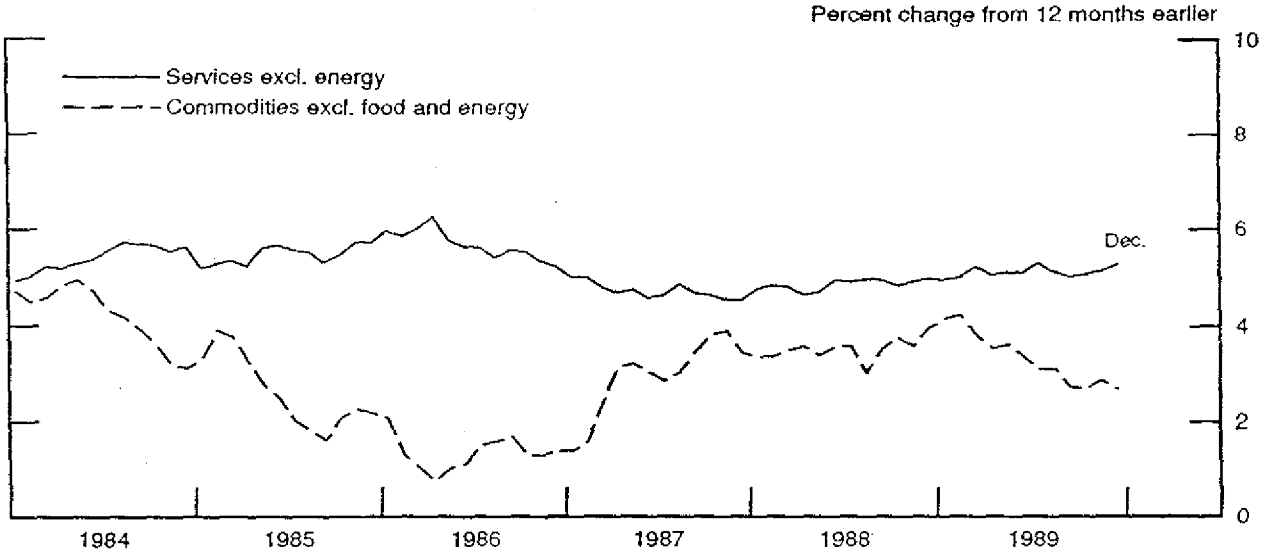
prices based mainly on industrial materials have registered relatively small net changes, although a hint of renewed softness in industrial metals prices seemed apparent late in January.

For 1989 as a whole, the major price indexes rose a bit more than they did in 1988. The increase in the CPI was 4.6 percent, compared with 4.4 percent the year before; producer prices of finished goods were up 4.8 percent in 1989--about 3/4 of a percentage point more than in the preceding year. In both the CPI and PPI, energy prices picked up sharply, and food prices rose 5 percent or more for the second year in a row. Developments in other sectors were mixed; on the whole, the restraining influence of import prices was largely offset by labor cost pressures.

At the consumer level, the effect of moderating import prices showed up in the prices of commodities other than food and energy, which, after rising 4 percent over the course of 1988, slowed to a pace of 2-3/4 percent in 1989. Deceleration was notable for apparel, house furnishings, and sporting goods. By contrast, the prices of nonenergy services, which are relatively insulated from foreign competition, rose 5-1/4 percent in 1989, somewhat above the 5 percent increase in 1988. Price increases picked up last year for a variety of services, including medical, entertainment, rents, and airfares. All told, the 1989 rise in the CPI excluding food and energy was 4.4 percent; increases in this measure of underlying price change have been in the range of 4-1/4 to 4-3/4 percent in all but one of the last eight years.

The PPI for capital equipment rose 3-3/4 percent in 1989, slightly more than in 1988 and well above the rates in preceding years. This contrasts

Recent Developments in Consumer Prices: Selected Detail



		Relative importance Dec. 1988[1]	Twelve-month percent change to December of:			
			1986	1987	1988	1989
1.	**Services ex. energy**	50.8	5.2	4.5	5.0	5.3
	Selected services:					
2.	Owners' equivalent rent	19.3	4.6	5.3	4.8	5.1
3.	Residential rent	6.0	5.0	4.0	3.6	4.2
4.	Medical services	4.7	7.9	5.6	6.9	8.6
5.	Entertainment services	2.3	5.4	4.3	4.6	6.8
6.	Automobile finance	.8	-7.3	5.9	8.3	4.3
7.	Automobile insurance	2.2	11.8	5.8	8.4	5.9
8.	**Commodities ex. food and energy**	25.7	1.4	3.5	4.0	2.7
	Selected commodities:					
9.	Apparel	5.8	.4	4.9	4.8	.7
10.	Sporting goods	.5	-2.7	3.6	4.4	2.1
11.	Medical care	1.1	6.8	7.1	6.9	8.2
12.	Housekeeping supplies	1.2	1.8	2.9	4.0	5.6

1. Official index for all urban consumers.

with import prices for capital goods--which decelerated markedly last year--as well as with recent price trends for intermediate materials. The PPI for (nonfood, nonenergy) intermediate materials was relatively flat during most of 1989--with a net increase of about 1 percent--after rising at about a 7 percent rate for more than a year. Reflecting in part the sluggish pace of industrial activity, prices have dropped back steeply for nonferrous metals and have declined or slowed for a variety of other materials. Prices of crude nonfood materials less energy retreated 3-3/4 percent during 1989--mainly reflecting sharp declines for scrap metal--after a climb of about two years.

Wages and Compensation

Labor cost pressures did not abate in 1989. The employment cost index (ECI) showed a rise in compensation for private industry workers of 4.8 percent last year--virtually the same as the previous year's increase. The rise in wages and salaries was a little above 4 percent in both 1988 and 1989, and the rise in benefits exceeded 6 percent in both years. With regard to benefits, the big 1988 increase in the social security tax rate was not repeated last year. However, the cost of health care continued to surge; a 13 percent increase last year was almost as big as the 15 percent hike of 1988.

Growth of hourly compensation in the service-producing sector continued to outpace that in the goods-producing industries in 1989. The largest gain was recorded in health services, no doubt reflecting the rapid growth of labor demand in that area.

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

	1987	1988	1989	1989 Mar.	June	Sept.	Dec.
Total compensation costs:							
Private industry workers	3.3	4.9	4.8	4.6	4.5	4.7	4.8
By industry:							
Goods-producing	3.1	4.4	4.3	3.5	3.6	4.1	4.3
Service-producing	3.7	5.1	5.1	5.3	5.2	5.4	5.1
By occupation:							
White-collar	3.7	5.0	5.2	5.2	5.1	5.4	5.2
Blue-collar	3.1	4.4	4.1	3.6	3.7	4.2	4.1
Service workers	2.4	5.3	4.3	4.9	4.6	4.1	4.3
By bargaining status:							
Union	2.8	3.9	3.7	3.0	3.1	3.2	3.7
Nonunion	3.6	5.1	5.1	5.1	5.0	5.3	5.1
Memo:							
Wages and salaries	3.3	4.1	4.2	4.2	4.1	4.4	4.2
Benefits	3.5	6.8	6.1	5.4	5.6	6.0	6.1

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

	1986	1987	1988	Same parties under prior settlements	1989
All industries					
First-year adjustments	1.2	2.2	2.5	2.1	4.0
Average over life of contract	1.8	2.1	2.4	2.4	3.3
Workers affected (in thousands)	2486	2037	1799	n.a.	1847

1. Contracts covering 1,000 or more workers; estimates exclude lump sum payments and potential gains under cost-of-living clauses.
n.a.--not available.

Compensation of union employees rose 3.7 percent in 1989, while that of nonunion workers increased 5.1 percent. The faster rate of increase in non-union compensation extended a trend that began in 1983 and resulted in a further narrowing of the gap between union and nonunion wages. For non-union workers, the 1989 rise in the wage portion of compensation--4.5 percent--was the same as in 1988; union wages accelerated by nearly a percentage point, from 2.2 percent in 1988 to 3.1 percent in 1989.

An acceleration in union wages also was apparent in the 1989 data on major collective bargaining agreements--those covering 1,000 workers or more. The first-year wage adjustments in these contracts picked up from a pace of 2.5 percent in 1988 to 4.0 percent in 1989. When the same parties last negotiated two or three years ago, first-year wage adjustments were only 2.1 percent. Nearly half of the union workers involved in major settlements received wage gains of 4 percent or more last year, compared with 28 percent of those bargaining in the previous year.

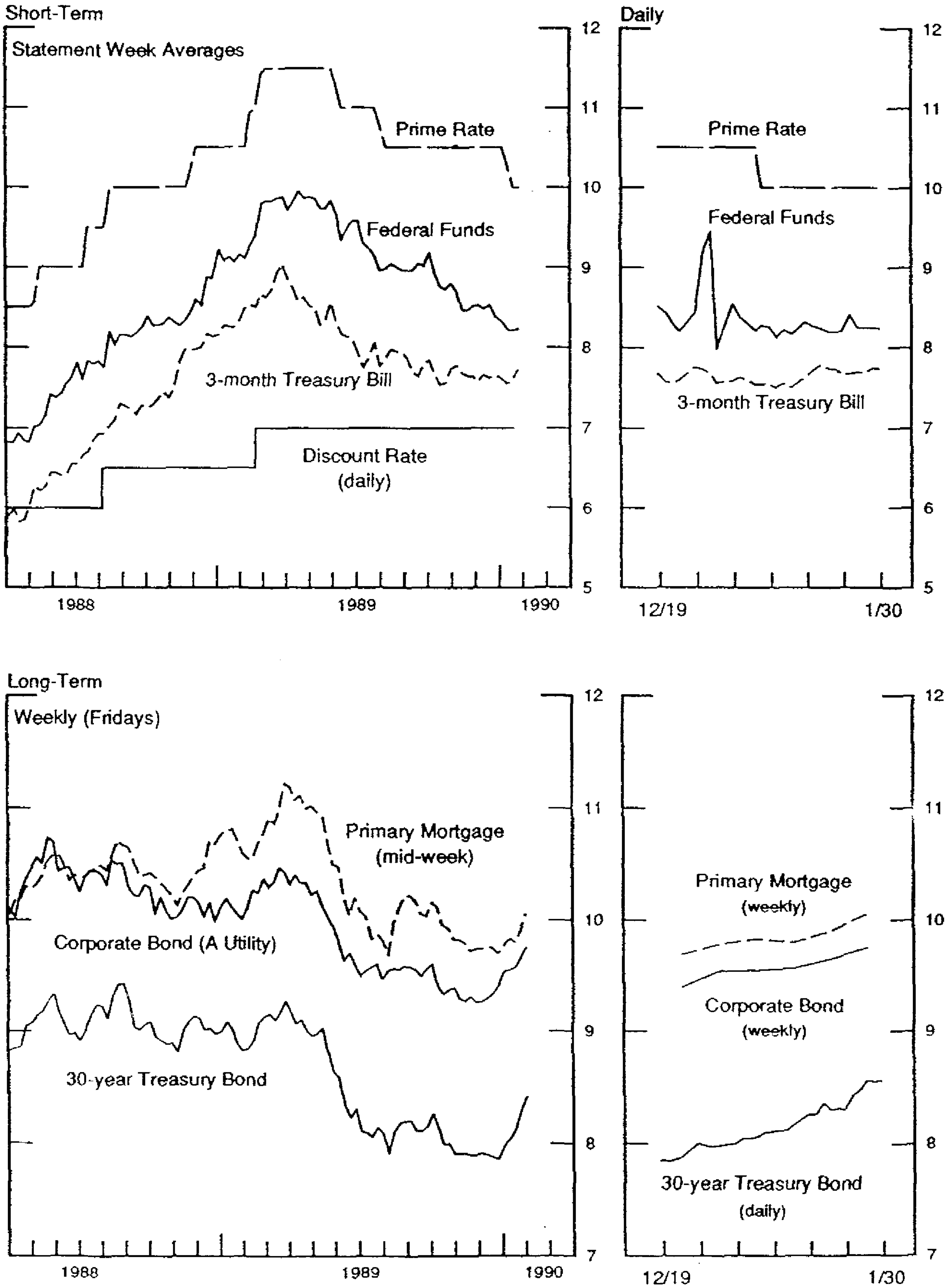
SELECTED FINANCIAL MARKET QUOTATIONS[1]
(Percent)

	1987	1989		1990	Change from:	
	Oct. 16[2]	Mar. highs	FOMC Dec. 19	Jan.30	Mar 89 highs	FOMC Dec. 19
Short-term rates						
Federal funds[3]	7.59	9.85	8.50	8.24	-1.61	-.26
Treasury bills[4]						
3-month	6.93	9.09	7.67	7.74	-1.35	.07
6-month	7.58	9.11	7.48	7.72	-1.39	.24
1-year	7.74	9.05	7.20	7.53	-1.52	.33
Commercial paper						
1-month	7.94	10.05	8.75	8.21	-1.84	-.54
3-month	8.65	10.15	8.39	8.13	-2.02	-.26
Large negotiable CDs[4]						
1-month	7.92	10.07	8.76	8.17	-1.90	-.59
3-month	8.90	10.32	8.43	8.19	-2.13	-.24
6-month	9.12	10.08	8.20	8.23	-1.85	-.03
Eurodollar deposits[5]						
1-month	8.00	10.19	8.81	8.19	-2.00	-.62
3-month	9.06	10.50	8.50	8.25	-2.25	-.25
Bank prime rate	9.25	11.50	10.50	10.00	-1.50	-.50
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	9.52	9.88	7.73	8.39	-1 49	.66
10-year	10.23	9.53	7.78	8.51	-1.02	.73
30-year	10.24	9.31	7.85	8.55	-.76	.70
Municipal revenue[6] (Bond Buyer)	9.59	7.95	7.29	7.52	-.43	.23
Corporate A-utility (recently offered)	11.50	10.47	9.36	9.79	-.68	.43
Home mortgage rates[7]						
S&L fixed-rate	11.58	11.22	9.75	10.05	-1.17	.30
S&L ARM, 1-yr.	8.45	9.31	8.39	8.41	-.90	.02

			1989		1990	Percent change from:		
	Record highs	Date	Lows Jan.3	FOMC Dec.19	Jan.30	Record highs	1989 lows	FOMC Dec.19
Stock prices								
Dow-Jones Industrial	2810.15	1/2/90	2144.64	2695.61	2543.24	-9.50	18.59	-5.65
NYSE Composite	199.34	10/9/89	154.98	189.40	178.43	-10.49	22.21	-5.79
AMEX Composite	397.03	10/10/89	305.24	367.95	345.50	-12.98	20.54	-6.10
NASDAQ (OTC)	485.73	10/9/89	378.56	434.35	410.72	-15.44	14.74	-5.44
Wilshire	3523.47	10/9/89	2718.59	3314.70	3112.99	-11.65	21.93	-6.09

1. One-day quotes except as noted.
2. Last business day prior to stock market decline on Monday, October 19, 1987.
3. Average for two-week reserve maintenance period closest to date shown. Last observation is average-to-date for maintenance period ending February 7, 1990.
4. Secondary market.
5. Bid rates for Eurodollar deposits at 11 a.m. London time.
6. Based on one-day Thursday quotes and futures-market index changes.
7. Quotes for week ending Friday closest to date shown.

Selected Interest Rates*
(percent)



*--Friday weeks through January 26, Wednesday weeks through January 24.

Yields on intermediate- and long-term securities have risen sharply since the December FOMC meeting. Some stronger than anticipated economic data and soaring food and energy prices have been interpreted by market participants as intensifying inflation risks and prompting a more cautious attitude toward easing on the part of the Federal Reserve; statements by System officials have reinforced this view. In addition, traders have expressed concern that rising bond rates in Japan and Europe might divert private capital from dollar-denominated assets. Stock prices approached new highs at the start of the year, but since have fallen to levels 6 percent or more below those prevailing in mid-December, buffeted by disappointing earnings reports and higher bond rates.

In the money markets, the federal funds rate was reduced 1/4 percentage point just after the December FOMC meeting and has been trading at 8-1/4 percent since then. Other private market yields have declined too, and on January 8 commercial banks reduced the prime rate 1/2 percentage point to 10 percent. Treasury bill rates have risen somewhat over the intermeeting period as the market's reassessment of the outlook for monetary policy has begun to outweigh the effects of the easing in December. In addition, concerns that RTC working capital needs would add to the supply of short-term government obligations may have been a factor boosting bill rates relative to private money market rates.

Monetary expansion has slowed considerably in January. M1 has contracted, M2 has decelerated to a 4 percent rate of growth, and M3 eked out a gain of only 2 percent at an annual rate. Household liquidity seems

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

	1989[1]	1989 Q3	1989 Q4	1989 Nov	1989 Dec	1990 Jan pe	Growth Q4 89- Jan 90pe
	Percent change at annual rates						
1. M1	0.5	1.5	6.7	2.9	12.2	-4	2¾
2. M2	4.5	7.1	7.7	8.5	7.8	4	5¾
3. M3	3.3	4.0	2.8	5.0	3.7	2	3
	Percent change at annual rates						Levels bil. $ Dec 89
Selected components							
4. M1-A	0.4	1.2	3.7	-1.9	9.9	-7	510.8
5. Currency	4.7	3.7	3.8	2.7	10.4	12	222.1
6. Demand deposits	-2.8	-0.4	3.3	-6.4	9.9	-23	281.2
7. Other checkable deposits	0.9	2.2	12.2	11.6	16.1	3	286.8
8. M2 minus M1[2]	5.9	9.0	8.0	10.4	6.4	6	2419.4
9. Overnight RPs and Eurodollars, NSA	-5.5	1.1	-12.8	-16.5	16.7	26	72.8
10. General purpose and broker/dealer money market mutual fund shares, NSA	29.1	34.3	29.6	32.6	10.2	23	309.1
11. Commercial banks	7.4	6.9	11.0	14.3	11.4	10	1064.8
12. Savings deposits, SA, plus MMDAs, NSA[3]	-1.7	3.6	13.7	22.3	14.3	10	543.4
13. Small time deposits	18.6	10.3	8.3	6.1	8.3	10	521.4
14. Thrift institutions	-0.3	4.0	-1.1	0.5	-0.4	2	969.1
15. Savings deposits, SA, plus MMDAs, NSA[3]	-9.7	-6.0	4.8	8.2	2.4	11	354.8
16. Small time deposits	6.0	9.8	-4.5	-3.9	-2.0	-4	614.3
17. M3 minus M2[4]	-1.2	-7.0	-15.0	-8.5	-12.3	-4	822.6
18. Large time deposits	4.4	-1.5	-7.5	-3.2	-10.7	-7	554.2
19. At commercial banks, net[5]	10.1	2.1	1.5	6.6	-6.0	1	397.8
20. At thrift institutions	-7.7	-9.8	-28.2	-26.5	-23.3	-28	156.4
21. Institution-only money market mutual fund shares, NSA	17.0	34.1	7.7	40.1	9.4	35	102.8
22. Term RPs, NSA	-15.1	-32.2	-39.8	6.5	-115.0	-64	100.0
23. Term Eurodollars, NSA	-20.2	-33.6	-29.0	8.9	38.4	-9	83.9
	Average monthly change in billions of dollars						
MEMORANDA:[6]							
24. Managed liabilities at commercial banks (25+26)	5.1	3.4	3.0	5.4	-8.4	-8	705.3
25. Large time deposits, gross	2.6	-0.3	0.7	2.0	-1.3	0	460.1
26. Nondeposit funds	2.5	3.7	2.3	3.4	-7.1	-8	245.2
27. Net due to related foreign institutions	-0.3	0.7	-2.2	-1.2	-5.8	1	3.0
28. Other[7]	2.8	3.0	4.5	4.6	-1.3	-9	242.2
29. U.S. government deposits at commercial banks[8]	-0.3	-1.2	-0.8	0.5	0.9	-3	21.3

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 11.5 percent and 8 percent, respectively. At thrift institutions, savings deposits excluding MMDAs grew during December and January at rates of 3.8 percent and 8 percent, respectively.
4. The non-M2 component of M3 is seasonally adjusted as a whole.
5. Net of large denomination time deposits held by money market mutual funds and thrift institutions.
6. Dollar amounts shown under memoranda are calculated on an end-month-of-quarter basis.
7. Consists of borrowing from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowing from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.
8. Consists of Treasury demand deposits and note balances at commercial banks.

pe - preliminary estimate

not to have suffered, however; money market funds, and savings and MMDAs have continued to expand briskly.

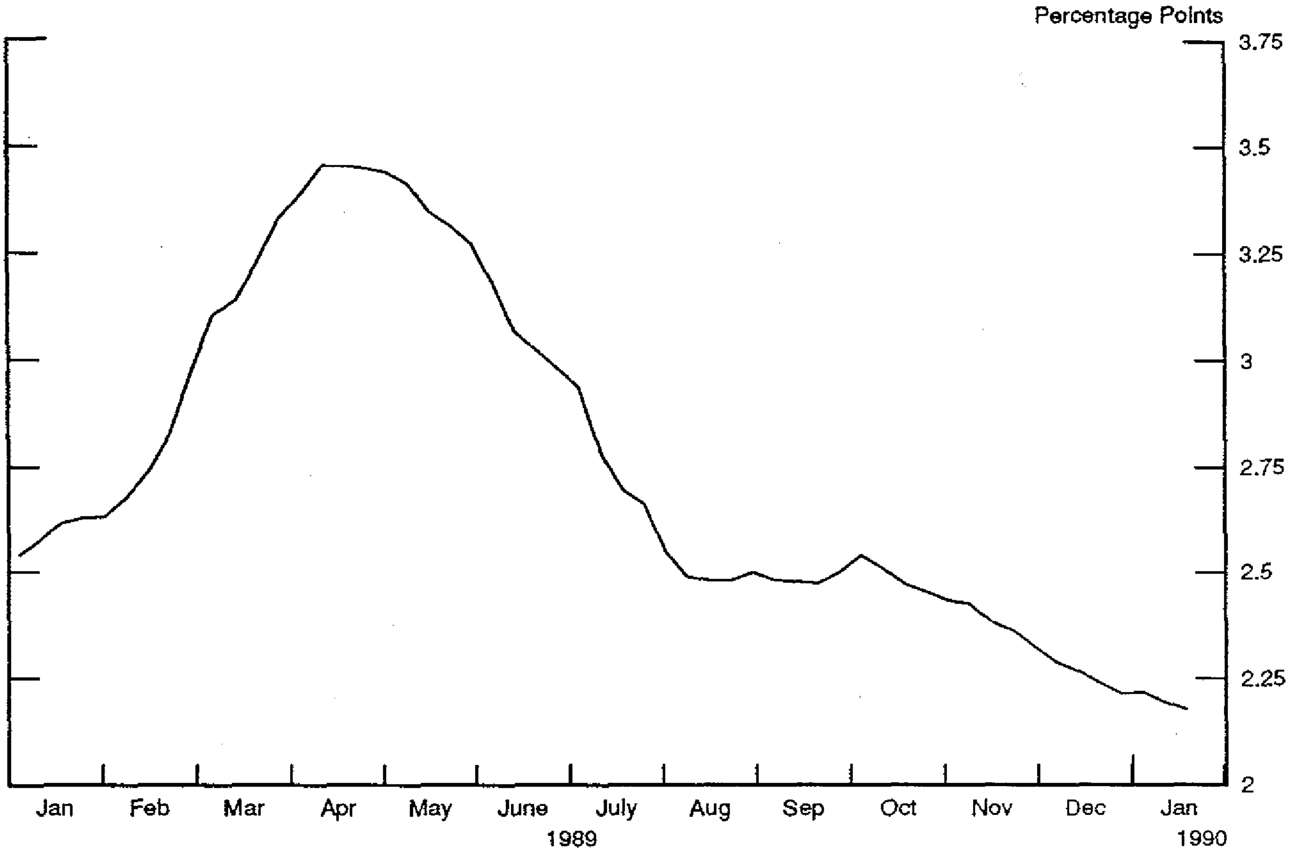
Borrowing by nonfinancial businesses was quite soft in December and January, with strength in commercial paper only partially offsetting weakness in bank lending and public bond offerings. Limited information suggests that household debt finished the past year with a slight pickup in growth, stemming from a bulge in consumer debt and a flatness in mortgage borrowing. Borrowing by state and local governments surged in December, but it has dropped off sharply early this year, partly because the backup in interest rates has discouraged advance refunding. Federal borrowing, not seasonally adjusted, has moved lower this year as well, coinciding with a reduced first-quarter deficit. Emerging concerns over credit quality have begun to affect the availability of some types of credit, particularly for highly leveraged businesses and for construction projects.

Monetary Aggregates

M1 contracted at a 4 percent annual rate in January, in sharp contrast to the 12 percent gain in December.[1] The weakness reflects largely a turnaround in demand deposits, which fell at nearly a 24 percent pace in January after rising at a 10 percent rate in December. A similar pattern--of strength relative to trend in December and weakness in January--can be seen in demand deposits last year and in other checkable deposits this year, suggesting the possibility of an emerging seasonal pattern in

1. Data on the monetary aggregates do not reflect new benchmarks or revised seasonal adjustment factors. Benchmarked data and updated seasonal factors will be incorporated in the Bluebook. Also, the revised aggregates will be calculated to remove deposits denominated in foreign currencies, which were authorized by the Board, effective January 1, 1990. By preliminary indications, such deposits totaled $61 million in M1, $111 million in M2, and $1.3 billion in M3 in the week ended January 8.

Spread of 6-month CD Rate over Average of Savings and MMDA Rates [1]



1) Note: Rates are calculated as a simple average of bank and thrift rates.

transactions deposits around the turn of the year that has not yet been captured in seasonal factors. The innovations in cash management or banking practices that might account for such a change have not been pinned down, but a shift from the use of compensating balances to the payment of fees for transactions services may be partly responsible.

The deceleration of M2 in January is attributable arithmetically to the fall in M1, as the non-M1 component of M2 roughly maintained its December pace. Inflows to both small time deposits and MMDA and savings components were strong at commercial banks in January; indeed, the combined growth rate of these deposits stayed close to the 11 percent pace of the fourth quarter. At thrifts, such deposits picked up in January after a small decline in the fourth quarter, as flows into adequately capitalized thrifts outstripped further runoffs at insolvent institutions. Despite the steepening of the market yield curve recently, yields on small time deposits continued to slip relative to rates on savings deposits and MMDAs (see chart), extending a trend that began last spring and that is largely responsible for rising shares of liquid deposits in household portfolios.

The non-M2 component of M3 contracted more slowly in January than it did in December, primarily because of large inflows to institution-only MMMFs. Most of these inflows occurred in the early part of the month when, owing to the drop in short-term rates with the System's easing in late December, MMMFs enjoyed a wider yield advantage over comparable market instruments. The ongoing shrinkage in managed liabilities at thrifts continued in January, as adequately capitalized institutions ran off high-cost borrowed funds in response to larger inflows of core deposits, and thinly capitalized and insolvent thrifts pared their balance sheets further.

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

		1988:Q4 to 1989:Q4	1989 Q3	1989 Q4	1989 Nov.	1989 Dec.	Jan.p	Levels bil.$ December
		Commercial Bank Credit						
1.	Total loans and securities at banks	7.2	8.0	5.4	3.9	-2.8	5	2577.4
2.	Securities	4.1	1.6	11.8	7.1	.8	0	578.2
3.	U.S. government securities	10.3	5.4	19.1	17.8	-1.8	13	396.9
4.	Other securities	-7.3	-6.2	-3.5	-15.8	6.7	-26	181.3
5.	Total loans	8.1	9.9	3.6	3.0	-3.9	6	1999.2
6.	Business loans	6.4	8.3	-1.6	.9	-13.7	2	634.2
7.	Real estate loans	12.7	13.7	11.6	10.7	11.7	8	754.8
8.	Consumer loans	6.5	6.1	6.5	8.0	3.8	7	378.1
9.	Security loans	4.2	-6.8	-21.1	-26.2	-80.2	-41	37.8
10.	Other loans	1.5	10.6	-9.6	-22.5	-30.1	22	194.3
		Short- and Intermediate-Term Business Credit						
11.	Business loans net of bankers acceptances	6.3	7.9	-2.0	1.1	-13.6	3	630.1
12.	Loans at foreign branches [2]	-4.7	-83.3	9.6	6.0	77.6	50	21.4
13.	Sum of lines 11 & 12	5.9	4.1	-1.6	1.3	-10.8	4	651.5
14.	Commercial paper issued by nonfinancial firms	31.3	10.3	17.3	15.2	41.2	40	132.7
15.	Sum of lines 13 & 14	9.4	5.1	1.5	3.5	-2.3	10	784.2
16.	Bankers acceptances: U.S. trade related [3,4]	5.8	-1.1	-12.4	-10.3	-6.9	n.a.	34.4
17.	Line 15 plus bankers acceptances: U.S. trade related	9.2	4.9	.9	2.9	-2.3	n.a.	818.7
18.	Finance company loans to business [3]	n.a.	14.1	n.a.	-2.3	n.a.	n.a.	258.5 [5]
19.	Total short- and intermediate-term business credit (sum of lines 17 & 18)	n.a.	7.0	n.a.	1.7	n.a.	n.a.	1078.9 [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

At commercial banks, large time deposits were quite weak in December and January, a consequence of healthy increases in core deposits and pronounced weakness in bank credit.

Bank Credit

Bank credit contracted at a 2-3/4 percent annual rate in December, the first decline in this series since the second quarter of 1980 when credit controls were in effect. A sharp drop in merger-related lending, together with net paydowns of existing merger loans, contributed to a plunge in business loans in December. Although early indications point to some bounce-back in merger-related lending in January, overall business lending at banks apparently remained sluggish. Nevertheless, preliminary evidence suggests that bank credit expanded at a moderate 5 percent annual rate in January, boosted by a rebound in holdings of government securities and expansion in real estate and consumer loans.

Thrift Institutions

SAIF-insured thrift institutions became subject to FIRREA-mandated minimum capital standards in early December. The standards, set by the Office of Thrift Supervision (OTS), have three components: a 1.5 percent tangible capital requirement, a 3 percent leverage requirement, and a 6.4 percent risk-based requirement.[2] Based upon third-quarter balance sheets, it is estimated that 507 solvent thrifts failed to meet at least one of the requirements, and as a result will not be permitted to grow and will have to file a compliance plan with the OTS. The leverage requirement represented the greatest shortfall; absent an infusion of capital, thrifts

2. The risk-based requirement rises to 7.2 percent in 1991 and to its final level of 8 percent in 1992. An interest-rate risk component will eventually be incorporated in the calculation of risk-based capital.

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

	1987	1988	1989p	1989				1990
	Year	Year	Year	Q3	Q4p	Nov.p	Dec.p	Jan.e
Corporate securities - total[1]	24.08	22.23	19.23	15.98	22.01	20.56	20.82	13.60
Public offerings in U.S.	21.89	20.21	17.30	14.53	20.18	18.24	19.14	11.60
Stocks--total[2]	4.45	3.53	2.69	3.12	3.95	4.24	3.94	1.60
Nonfinancial	2.32	1.14	1.09	1.06	1.42	1.09	1.72	.60
Utility	.57	.24	.29	.36	.33	.21	.24	.10
Industrial	1.75	.90	.80	.70	1.09	.88	1.48	.50
Financial	2.12	2.39	1.60	2.06	2.53	3.15	2.22	1.00
Bonds--total[1]	17.44	16.68	14.61	11.41	16.23	14.00	15.20	10.00
Nonfinancial	6.61	6.08	5.99	4.96	7.09	6.10	6.80	3.30
Utility	2.02	1.77	1.68	1.43	2.65	2.05	2.80	.90
Industrial	4.59	4.31	4.31	3.53	4.44	4.05	4.00	2.40
Financial	10.83	10.60	8.62	6.45	9.14	7.90	8.40	6.70
By quality[3]								
Aaa and Aa	3.26	2.68	3.20	2.93	3.21	3.16	2.80	1.80
A and Baa	5.20	5.47	5.32	4.21	5.71	4.95	5.35	3.69
Less than Baa	2.77	2.54	2.39	1.90	1.94	1.43	1.37	.
No rating (or unknown)	.07	.04	.03	.03	.05	.15	.00	.
Memo items:								
Equity-based bonds[4]	.87	.28	.50	.60	.69	.41	.49	.15
Mortgage-backed bonds	5.19	4.69	1.59	1.23	1.17	.90	1.33	1.00
Other asset-backed	.95	1.26	2.08	1.11	4.15	3.41	4.35	3.00
Variable-rate notes	1.88	1.19	1.01	.25	1.01	1.11	1.12	2.30
Bonds sold abroad - total	2.03	1.93	1.87	1.15	1.54	2.00	1.50	2.00
Nonfinancial	.94	.74	.49	.29	.30	.40	.40	.50
Financial	1.09	1.19	1.38	.86	1.24	1.60	1.10	1.50
Stocks sold abroad - total	.16	.09	.16	.30	.29	.32	.18	.00
Nonfinancial	.12	.08	.12	.29	.16	.16	.14	.00
Financial	.04	.01	.04	.01	.13	.16	.04	.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 exchanges that have occurred in restructurings. Such exchanges totaled $21.4 billion in 1989. Time-Warner issued $7 billion of stock in an exchange in 1990-Q1.
3. Bonds categorized according to Moody's bond ratings or Standard and Poors if unrated by Moody's. Excludes mortgage-backed and asset-backed bonds.
4. Includes bonds convertible into equity and bonds with warrants that entitle the holder to purchase equity in the future.
p--preliminary. e--staff estimate.

failing this requirement needed to reduce assets roughly $88 billion to be in compliance.

Thrifts have been taking dramatic steps to meet the new requirements. The 507 undercapitalized thrifts pared their assets by $19 billion during the third quarter in anticipation of the new capital standards, with the bulk of the reduction coming in mortgage-backed securities. On the liability side of the balance sheet, these thrifts made sizable reductions in nondeposit sources of funds, especially in repurchase agreements, but experienced only modest declines in deposits.

The thrift industry suffered a loss of $3.8 billion in the third quarter, largely driven by $4 billion in provisions for loan losses. Although such provisions declined by nearly $3/4 billion among thrifts in conservatorship, they were offset by higher provisions at some healthier thrifts. Net operating earnings at SAIF-insured thrifts worsened slightly in the third quarter, after moving into the red in the second quarter. Reflecting falling interest rates, interest expenses generally declined over the quarter, but this improvement was offset by continued high funding costs at thrifts in conservatorship and lower gross operating income at other thrifts (resulting from asset sell-offs).

Business Finance

Total borrowing by nonfinancial firms has weakened noticeably since the last FOMC meeting. Higher long-term interest rates and greater investor caution towards low-rated debt slowed the issuance of corporate bonds, and business borrowing at banks recovered only a bit in January. In contrast to these areas of weakness, commercial paper outstanding from nonfinancial firms has continued to grow rapidly. The strong growth in commercial paper--

amounting to 30 percent last year--has been associated with heavy inflows to money market funds, the largest purchasers of commercial paper. A $58 billion increase in commercial paper holdings by MMMFs over the first eleven months of 1989 (latest data available) accounted for 90 percent of net commercial paper issuance in the period.

The junk bond market has remained edgy, as prices generally have fallen in reaction to weakness in the equity market, to uncertainty surrounding the Campeau bankruptcy that spilled over to other highly leveraged retailers, and to Moody's unexpected downgrading of RJR's debt. In late January, yields on RJR bonds jumped 2 to 5 percentage points; yields on other junk bonds rose about 60 basis points. Junk bond issuance has been light since the beginning of November, and the volume of prospective issues has continued to shrink, largely because of the slowdown in debt-financed mergers that began last summer. With announcements of new merger proposals remaining sparse, equity retirements in the first quarter are expected to drop below the fourth quarter's reduced volume. The $14 billion Time-Warner merger was completed in January with an exchange of preferred stock for the remaining Warner common shares.

Defaults on low-rated bonds were about $8 billion in 1989, with more than $2.5 billion occurring in November and December; defaults in 1990 may be substantial as well, for the total already includes about $2.5 billion from the Campeau bankruptcy. More generally, credit quality, as measured by rating downgrades relative to upgrades, continued to erode in the fourth quarter of 1989. While industrial firms displayed the most serious signs of financial distress, new concern also arose about credit quality at financial institutions. Two investment banks were downgraded because of their exposure to the junk bond market, and debt ratings of several New England banks were lowered when the deterioration in their holdings of real estate loans became evident.

After rallying in early January, major stock price indexes have retreated and now stand about 5 to 6 percent below their levels in mid-December. Stock price volatility measured by intra-day fluctuations has increased noticeably since the last FOMC meeting. Day-to-day volatility also has increased, as exemplified by declines of about 2-1/2 percent in major indexes on January 12, after an unfavorable PPI report and retrenchment in the Japanese stock market, and on January 22, apparently in response to disappointing fourth-quarter earnings reports and rising long-term interest rates. Gross equity offerings by nonfinancial firms, which were strong in early December, have all but dried up since then.

Treasury and Sponsored Agency Financing

The staff projects that the federal government will run a $59 billion deficit in the first quarter, down from $70 billion last quarter. Net cash borrowing from the public is expected to slow to about $51 billion, and the Treasury is expected to draw its cash balance down to a low level, as it usually does in the first quarter, in anticipation of April tax inflows.

Partial data for the fourth quarter of 1989 show a pickup in borrowing by government-sponsored enterprises to about $5-1/2 billion. The Federal Home Loan Banks continued to pay down debt, but borrowings by Fannie Mae and other agencies, and the initial issue from REFCORP, more than offset the reduction of $7.5 billion in FHLB debt.

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

	1989 Q3	1989 Q4	1990 Q1^p	Jan.^p	Feb.^p	Mar.^p
Treasury financing						
Total surplus/deficit (-)	-46.5	-69.7	-58.8	10.4	-28.6	-40.6
Means of financing deficit:						
Net cash borrowing from the public	38.6	63.3	51.0	15.6	16.0	19.5
Marketable borrowings/ repayments (-)	33.4	52.8	43.9	10.8	15.2	17.9
Bills	9.5	24.0	17.2	4.5	2.1	10.6
Coupons	23.9	28.8	26.7	6.3	13.1	7.3
Nonmarketable[2]	5.2	10.5	7.1	4.8	.7	1.6
Decrease in the cash balance	2.8	14.1	11.4	-16.8	21.7	6.5
Memo: Cash balance at end of period	41.0	26.9	15.5	43.7	22.0	15.5
Other[3]	5.1	-7.6	-3.6	-9.1	-9.1	14.6
Federally sponsored credit agencies, net cash borrowing[4]	1.6	5.4	--	--	--	--
FHLBs	-10.3	-7.5	--	--	--	--
FHLMC[5]	1.5	.3	--	--	--	--
FNMA	5.2	4.6	--	--	--	--
Farm Credit Banks	1.7	1.9	--	--	--	--
FAC	0.0	0.0	0.0	0.0	0.0	0.0
SLMA	2.9	1.6	--	--	--	--
FICO	0.7	0.0	0.0	0.0	0.0	0.0
REFCORP	--	4.5	5.0	5.0	5.0	0.0

1. Data reported on a not seasonally adjusted, payment basis.
2. Includes proceeds from securities issued by federal agencies under special financing authorities (primarily FSLIC) and the face value of the 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.
5. Borrowing reflects October and November only.
p--projected.
Note: Details may not add to totals due to rounding.

Over the second half of 1989, FHLB debt declined about 13 percent. Further declines for the first quarter of 1990 appear likely, in view of another $1.3 billion net paydown in January. Spreads on FHLB securities issued in January were generally in line with recent offerings.

REFCORP issued the first $4.5 billion of its $30 billion authorization in October. That 30-year issue traded in a fairly narrow range of 23 to 28 basis points over comparable Treasury securities until widening some on the January 17 announcement that REFCORP would auction $5 billion of 40-year bonds. The new 40-year bond met with a relatively poor reception when auctioned January 23; it was an unfamiliar issue sold at a time when market participants were reassessing their previously bullish expectations for bond prices. The 40-year bond sold at a higher-than-expected 8.60 percent average yield, and initially traded at a spread of about 28 basis points over the 30-year Treasury bond, a spread much wider than had characterized when-issued trading on the morning of the auction. However, the spread has since narrowed to around 23 basis points. REFCORP currently plans to issue $5 billion of securities each quarter until it exhausts its borrowing authority.

Fannie Mae's debt increased $4.6 billion during the fourth quarter of 1989, as it financed a portfolio of mortgages that grew to about $110 billion by year-end. Freddie Mac, which holds a far smaller mortgage portfolio, has engaged in little net borrowing since the end of the third quarter. Concerns about real estate credit quality have taken their toll on the prices of Fannie Mae and Freddie Mac stock. Although prices of both equities are above year-earlier levels, Fannie Mae's stock is down 35 percent from its early-October peak, and Freddie Mac stock is 43 percent below its October high. The credit quality concerns reflected in these significant declines in stock prices have not shown up in the agencies' borrowing costs, however. The spreads on Fannie Mae and Freddie Mac debt have not changed appreciably in recent months.

Municipal Securities

In December, gross issuance of long-term municipal securities surged to nearly $13 billion, the highest monthly rate of the year. Refunding, stimulated by interest rate declines early in the month, and new capital offerings both picked up sharply. The new capital offerings consisted primarily of revenue bonds intended to finance education and housing. Total long-term issuance in January is expected to taper off to $6 billion or less, with refunding in particular damped by the backup of interest rates.

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

	1988	1989	1989			1989		1990
	Year	Year[p]	Q2	Q3	Q4[p]	Nov.	Dec.[p]	Jan.[f]
Total offerings[1]	11.73	11.67	13.14	12.78	11.57	10.51	13.83	--
Total tax-exempt	11.41	11.43	12.95	12.58	11.26	10.20	13.41	6.40
Long-term	9.55	9.37	9.56	9.80	10.33	9.56	12.45	6.00
Refundings[2]	2.90	2.43	2.20	2.83	2.20	1.78	3.04	--
New capital	6.65	6.94	7.36	6.97	8.13	7.78	9.41	--
Short-term[3]	1.89	2.06	3.39	2.78	.93	.64	.96	.40
Total taxable	.33	.24	.19	.20	.31	.31	.42	--

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.
3. Does not include tax-exempt commercial paper.

Despite the revenue shortfalls that plague a number of northeastern and mid-Atlantic states, the credit quality of the general obligation debt of municipalities overall improved in 1989. The states of Oregon, Michigan, and California received higher ratings, as did the debts of Cleveland and Boston. The heavily publicized downgrade of Massachusetts debt--to Baa-1 in Moody's ratings--by itself accounted for $8.3 billion of the $13.7 billion of tax-exempt debt downgraded during 1989.

Changes in revenue bond ratings were mixed in 1989. Downgrades for housing and health-care bonds outnumbered upgrades, as they had in 1988, but upgrades were somewhat more numerous than downgrades for education, airport, and tax-backed issues. Downgrades were especially prevalent in the Northeast and in Colorado, reflecting weak real estate markets. Upgrades of revenue issues were prominent in southern states and in California.

Mortgage Markets

Mortgage interest rates have increased since the December FOMC meeting, though by less than yields on comparable Treasury securities. In the primary market, the average contract rate on new commitments for conventional fixed-rate home loans has risen 30 basis points. Secondary market yields have risen somewhat over the intermeeting period, suggesting further increases in commitment rates in the near term. Mortgage rates have moved up less than Treasury yields in recent weeks, partly reflecting reduced prepayment risks in an environment of higher interest rates.

Overall growth in mortgage debt in the fourth quarter appears to have been maintained at about the 9 percent annual rate experienced in the third quarter, judging from partial data. Thrift institutions continue to shed mortgage assets, especially pass-through securities. Between April and

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

	Mortgage transactions			Net change in mortgage assets		
	Origina-tions	Commit-ments	Sales	Total	Mortgage loans	Mortgage-backed securities
1987 r	21.1	20.0	10.5	5.5	2.0	3.6
1988 r	19.9	19.4	8.8	5.0	3.6	1.0
1988-Q3	21.4	20.9	8.5	6.5	5.1	.7
Q4	19.8	19.9	9.5	4.2	3.1	1.7
1989-Q1	20.5	19.3	8.1	6.1	4.2	.7
Q2	14.7	13.0	7.2	-2.8	-.5	-1.9
Q3	14.2	14.8	9.2	-10.8	-3.3	-8.0
1989-Jan.	21.5	19.6	7.0	7.5	6.9	-1.6
Feb. r	19.7	19.7	8.7	6.2	3.1	4.8
Mar.	20.4	18.6	8.7	4.7	2.7	-1.1
Apr. r	16.2	13.9	7.0	.9	3.2	2.0
May	15.1	12.7	7.1	-1.2	-.8	-1.3
June r	12.9	12.3	7.4	-8.1	-3.8	-6.4
July	12.4	12.6	8.0	-7.3	-1.1	-6.3
Aug. r	15.2	16.1	10.9	-13.4	-3.5	-10.3
Sep. r	14.9	15.6	8.6	-11.8	-5.4	-7.4
Oct. r	15.4	16.1	10.0	-16.0	-9.4	-7.7
Nov. p	16.7	17.2	10.4	-5.9	-3.2	-4.3

p--preliminary r--revised.

SOURCES OF RESIDENTIAL MORTGAGE CREDIT
(Shares as a percent of change in outstanding debt)

Period	Net change ($ billions, NSA, AR)	All sources[1]	Thrifts	Commer-cial banks	Federal and related agencies	Mortgage pools	Indi-viduals and others
1986	253	100	21	22	10	58	15
1987	267	100	25	24	-1	57	7
1988	247	100	24	22	5	38	8
1988-Q1	148	100	3	23	13	37	4
Q2	322	100	27	24	4	27	15
Q3	271	100	33	21	0	42	1
Q4	244	100	23	20	5	46	11
1989-Q1	185	100	12	31	1	62	6
Q2	212	100	0	51	6	42	24
Q3	217	100	-55	45	9	68	8

1. Rows do not sum to 100 percent because thrifts' and commercial banks' holdings of mortgage pass-through securities are included in both their respective columns and the mortgage pool column.

November, total mortgage assets of SAIF-insured institutions declined at about a 12 percent annual rate. In contrast, funds provided by other mortgage lenders grew at well above a 10 percent annual rate during this period.

Problems with defaulted loans have precipitated changes recently in some federal housing programs. HUD has announced plans to end its co-insurance programs for multifamily housing, which accumulated an estimated $1 billion in defaulted mortgages during its six-year existence.[3] Freddie Mac has tightened requirements for its multifamily mortgage programs, citing losses disproportionate to the size of the programs. It has lowered the maximum loan-to-value ratio on loans it will purchase from 85 to 70 percent of appraised value, and it has imposed a more conservative minimum servicing spread.

On the whole, the default problems of the housing agencies do not appear to be characteristic of the broader home mortgage market. Although the home mortgage delinquency rates reported by the Mortgage Bankers Association rose during the third quarter, the rise was the first in several quarters and was concentrated in the 30-day category that is considered more

3. Under the multifamily coinsurance programs, eligible lenders performed underwriting, servicing, management, and property disposition functions and assumed responsibility for a portion of any insurance loss (up to a maximum of approximately 20 percent of the loan). Because of basic weaknesses in the programs, involving inadequate levels of capital and deficient coinsurer monitoring, a substantial portion of the losses incurred have been borne by the FHA.

CONSUMER CREDIT
(Seasonally adjusted)

	Percent change (at annual rate)						Net change (billions of dollars)		Memo: Outstandings (billions of dollars)
				1989	1989		1989		1989
	1987	1988	1989[1]p	Q4p	Nov.r	Dec.p	Nov.r	Dec.p	Dec.p
Total installment[2]	6.2	8.5	6	8	7	10	4.2	6.3	718
Installment, excluding auto	5.2	10.7	9	11	11	14	3.8	5.1	428
Selected types									
Auto	7.5	5.7	2	3	1	5	.3	1.2	290
Revolving	12.3	13.6	16	16	17	24	2.7	4.0	203
All other	.1	8.3	4	6	6	6	1.1	1.1	225
Selected holders									
Commercial banks	7.6	12.7	6	9	7	8	1.9	2.3	335
Finance companies	4.7	3.5	2	-6	1	6	.1	.7	142
Credit unions	5.1	7.5	4	0	-2	3	-.2	.2	90
Savings institutions[3]	6.6	3.8	-8	-18	-20	16	-.0	-.0	57
Asset pools (NSA)	n.a.	n.a.	64	114	91	102	3.1	3.7	47
Memorandum:									
Total[4]	4.9	7.3	6	8	8	13	5.0	8.1	785

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

CONSUMER INTEREST RATES
(Annual percentage rate)

			1988	1989				
	1987	1988	Dec.	May	Aug.	Oct.	Nov.	Dec.
At commercial banks[1]								
New cars (48 mo.)	10.46	10.86	...	12.44	12.13	...	11.94	...
Personal (24 mo.)	14.23	14.68	...	15.65	15.45	...	15.42	...
Credit cards	17.92	17.79	...	18.11	18.07	...	18.07	...
At auto finance cos.[2]								
New cars	10.73	12.60	13.25	11.80	12.22	13.04	13.27	n.a.
Used cars	14.61	15.11	15.80	16.45	16.31	16.17	16.09	n.a.

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

subject to statistical aberrations.[4] The delinquency rate on home mortgages past due 60 days or more, a measure of more serious payment problems, increased just 0.08 percentage points to 1.60 percent, which is still relatively low compared with levels near 2.0 percent a few years ago (chart). The bulk of the real estate problems experienced recently by institutions in the Northeast and certain other areas appears to have been concentrated in loans for construction or development.

Consumer Credit

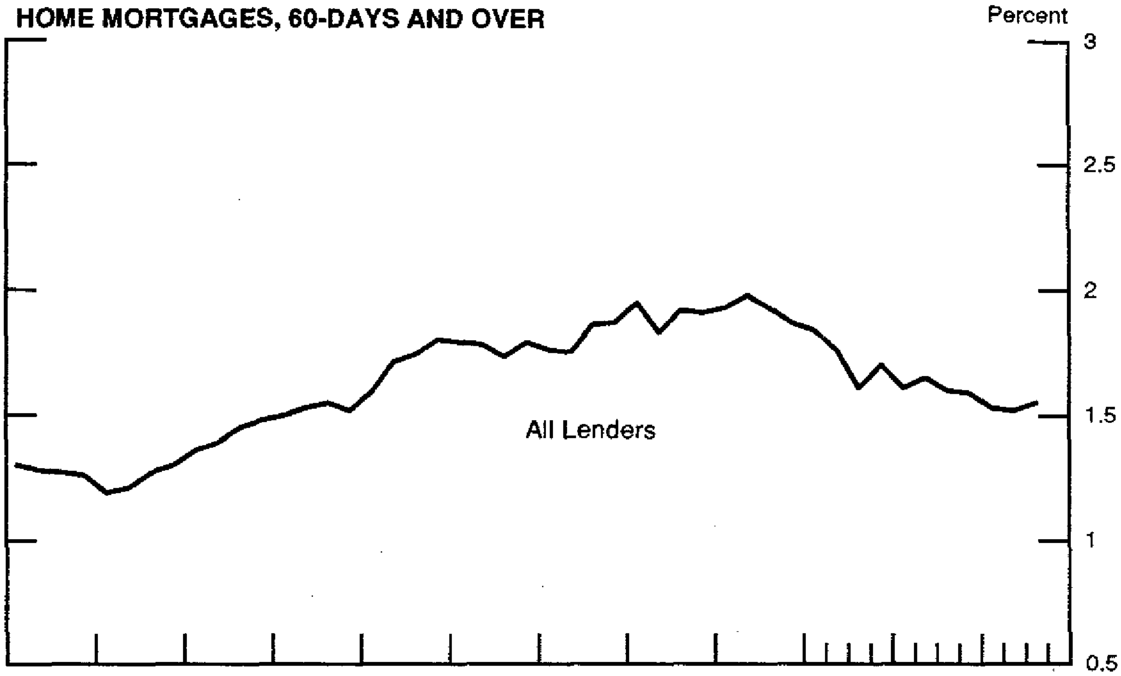
Consumer installment credit outstanding is estimated to have increased at about a 10 percent annual rate in December, lifting the fourth-quarter rate to 8 percent, up fairly sharply from the third quarter. Growth in December owed mainly to a large jump in revolving credit. This component is particularly volatile in December and January because the proportions of Christmas season transactions entering lenders' books in each of these months can vary substantially from year to year, complicating seasonal adjustment.

Some evidence, most of it pertaining to the third quarter, suggests that repayment performance on consumer loans may have deteriorated some last year. At commercial banks, according to the American Bankers Association, the average 30-day delinquency rate for all closed-end types of consumer loans climbed nearly 1/2 percentage point in the third quarter to the

4. Home mortgages delinquent 30 days or more rose 1/2 percentage point in the third quarter to just over 5 percent of loans outstanding. Some industry participants attributed this increase to stepped-up selling by lenders of the servicing function on the mortgages they hold. When the servicing of a mortgage is sold, the mortgagees often fail at first to send their payments to the new servicer, and the original lender may be slow in forwarding payments. If the new servicer does not receive the payment within 30 days of the due date the loan becomes classified as delinquent.

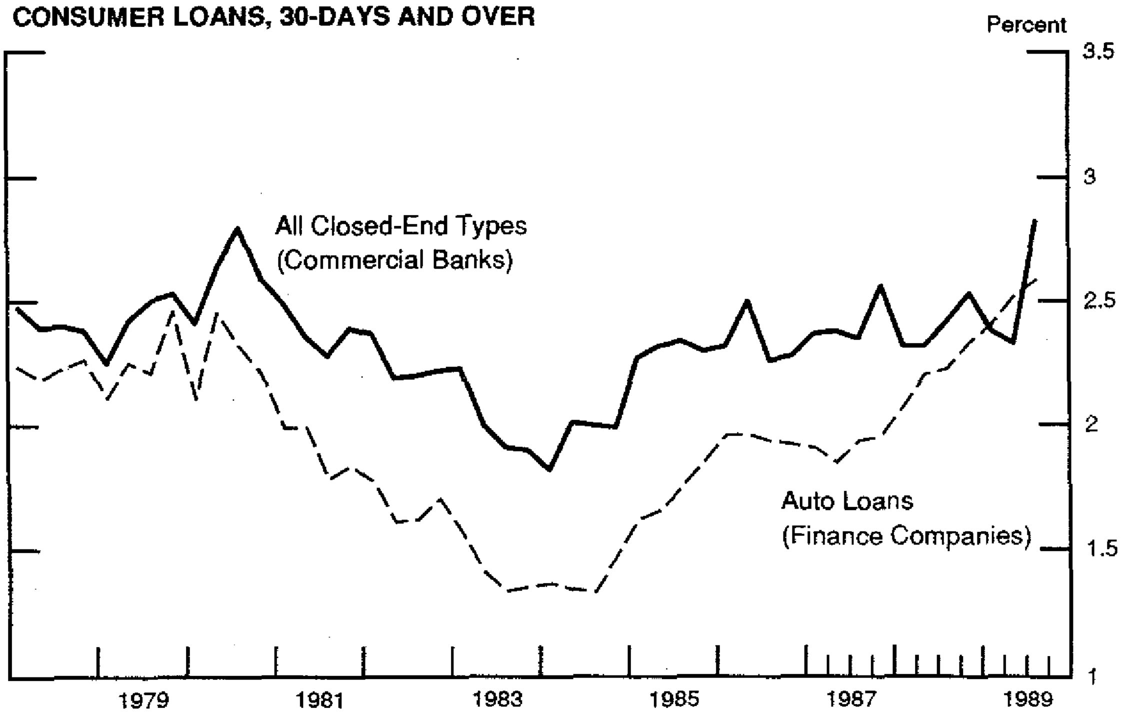
DELINQUENCY RATES FOR HOUSEHOLD DEBTS

HOME MORTGAGES, 60-DAYS AND OVER



Source: Mortgage Bankers Association.

CONSUMER LOANS, 30-DAYS AND OVER



Source: American Bankers Association, Federal Reserve.

highest level since 1980. The magnitude of the jump seems questionable because only one minor component (mobile homes) rose as much as the total. However, all components showed significant increases, so that the direction of movement seems clearly upward. Delinquencies reported on the Call Report by banks with more than $300 million in assets showed a much smaller rise than the ABA series in the third quarter, but also were high by historical standards.

The captive auto finance companies reported another sizable rise in loan delinquencies in the third quarter, and then little further change in October and November. The average for those two months--2.58 percent--has been exceeded in only four quarters since the series was begun in 1967, all coming during the 1970 and 1974-75 recessionary periods. The steady lengthening of maturities on auto loan contracts in recent years may account for some secular updrift in delinquencies. The longer the maturity, other things equal, the longer a car owner's equity remains negative, a condition that reduces the incentive to keep loans current. But delinquency rates at the captives also have been greatly affected by shifts in the mix of customers at these companies under the various sales incentive programs in recent years, and may not accurately reflect movements in auto loan quality as a whole. When the programs featured low-rate financing in the mid-1980s, the companies attracted many low-risk borrowers, and delinquency rates subsequently dropped. Under the more recent emphasis on car-price rebates, lower-risk borrowers have usually chosen the rebate alternative and obtained financing elsewhere, restoring the captives to their more traditional role of lending to higher-risk borrowers. Accordingly, delinquency rates at the captives have climbed again.

Personal bankruptcies have been increasing rapidly through most of the current expansion, partly because of changes in federal and state law that make bankruptcy a more attractive alternative to debtors for dealing with financial distress. In the third quarter, however, personal bankruptcy filings declined somewhat from the second quarter.

U.S. Merchandise Trade

Preliminary data for November of last year indicate that the deficit on U.S. merchandise trade widened slightly further to $10.5 billion (on a seasonally adjusted, Census basis, customs valuation), from the $10.2 billion revised deficit registered in October. On a seasonally adjusted balance of payments basis, the combined October-November deficit exceeded the deficit recorded in the third quarter of 1989 by nearly $20 billion (at an annual rate), as imports rose strongly and exports were essentially unchanged.

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil (nsa)	Non-oil	Balance
1988-Oct	27.9	3.1	24.8	37.1	2.9	34.2	-9.2
Nov	27.6	3.2	24.3	38.1	2.9	35.2	-10.5
Dec	28.9	3.3	25.6	39.7	3.3	36.4	-10.8
1989-Jan	29.0	3.2	25.7	37.9	3.5	34.4	-8.9
Feb	28.8	3.4	25.4	38.2	3.2	35.0	-9.4
Mar	30.1	3.9	26.2	39.5	3.7	35.9	-9.5
Apr	30.8	3.7	27.1	39.0	4.0	35.0	-8.3
May	30.5	3.5	27.0	40.5	4.7	35.8	-10.1
Jun	31.3	3.3	28.0	39.3	4.2	35.1	-8.0
Jul	30.5	3.3	27.2	38.7	4.3	34.4	-8.2
Aug	30.6	3.0	27.5	40.7	4.3	36.4	-10.1
Sept	30.7	3.2	27.4	39.2	4.0	35.2	-8.5
Oct[r]	31.0	3.2	27.8	41.3	4.4	36.8	-10.2
Nov[p]	30.2	3.4	26.8	40.7	4.4	36.3	-10.5

r--revised p--preliminary

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

	Exports			Imports			
	Total	Ag.	Nonag.	Total	Oil	Non-oil	Balance
	- - - - - - - BOP basis (current dollars) - - - - - - -						
1988-1	306	36	270	440	40	399	-134
-2	314	38	276	440	41	399	-126
-3	322	40	283	444	39	405	-121
-4	335	39	296	463	37	426	-128
1989-1	352	43	309	465	43	422	-114
-2	366	43	322	476	54	422	-110
-3	366	39	327	477	53	424	-111
Oct-Nov	366	40	327	497	53	443	-130
	- - - - - BOP basis (constant 1982 dollars) [1] - - - -						
1988-1	337	39	297	461	83	377	-124
-2	338	39	300	457	85	372	-119
-3	339	36	303	463	86	377	-124
-4	352	36	316	477	90	388	-125
1989-1	365	40	325	473	88	385	-108
-2	378	40	338	482	92	390	-104
-3	386	38	349	500	99	401	-114
Oct-Nov	386	39	348	516	95	420	-130
Percent Change:							
O-N/88-Q4	9.7	8.3	10.1	8.2	5.6	8.2	
O-N/89-Q3 (not AR)	0.0	2.6	0.0	3.2	-4.1	4.7	
	- - - - - - GNP basis (constant 1982 dollars) - - - - -						
1988-1	336	40	296	460	83	377	-124
-2	339	39	300	457	85	372	-118
-3	344	36	308	468	86	382	-124
-4	359	36	322	483	90	393	-125
1989-1	373	40	332	477	88	390	-105
-2	387	41	346	488	92	396	-101
-3	391	37	354	504	97	407	-114
-4	398	40	358	516	96	420	-118
Percent Change:							
89-Q4/88-Q4	10.9	11.1	11.2	6.8	6.7	6.9	
89-Q4/89-Q3 (not AR)	1.8	8.1	1.1	2.4	-1.0	3.2	

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

While total exports were about unchanged in October-November compared with the third quarter in both value and quantity, the composition of exports changed significantly. The strike at Boeing from early October to late November disrupted shipments of aircraft, reducing exports by an estimated $6 billion at an annual rate during the fourth quarter. This decline was offset by increases in exports of a broad array of other products, notably energy, certain metals, semiconductors, telecommunications equipment, automobiles, and consumer goods. A small increase in agricultural exports was led by an increase in the quantity of corn shipped to the Soviet Union.

Total imports increased rapidly in October-November, rising over 4 percent in value compared with the third quarter of 1989, with almost all of the increase in non-oil categories. Imports of capital goods were especially strong, including computers, semiconductors, aircraft and parts, and other machinery; imports of consumer goods and industrial supplies showed smaller increases. Most of the increase was in terms of quantity, as prices of non-oil imports rose only moderately. Declines in the relative price of non-oil imports associated with the rise in the dollar earlier in 1989 probably contributed significantly to the strong growth in the quantity of imports.

The value of oil imports was about unchanged in October-November, as higher prices were mostly offset by a moderate decline in the quantity of imports. Oil import prices reached $17.55 in November, when West Texas spot prices of crude petroleum were running $19.82 per barrel. The cold snap and associated refinery mishaps in the United States pushed the spot price up further to $23.35 per barrel by the third week of December. Since that time, prices have been volatile and strengthened somewhat on news of supply disruptions in the centrally planned economies.

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

	1988		1989			
	Year	Q4	Q1	Q2	Q3	Oct/Nov
Value (Bil. $)	39.31	36.87	43.40	53.72	53.18	53.58
Price ($/BBL)	14.39	12.85	15.54	18.46	16.85	17.43
Quantity (mb/d.)	7.49	7.84	7.65	7.97	8.64	8.42

Import and Export Prices

As reported by the BLS, the average price of imports rose almost 5 percent at an annual rate in the fourth quarter of 1989, as price increases were recorded across most major categories of trade. Oil prices increased over 30 percent, reversing the decline registered in the third quarter, and continuing the upward trend from the first half of the year. Increasing prices of non-oil products in the fourth quarter -- particularly foods -- reversed part of the decline during the second and third quarters of 1989. Prices of imported commodities tend to be more volatile than the prices of imported capital goods, consumer goods, and automotive products.

Export prices declined slightly in the fourth quarter, as a small increase in the average price of nonagricultural exports was offset by a large decline in the prices of agricultural exports. Prices of exported capital goods, consumer goods, and automotive products rose slightly in nearly every month of 1989, and at about the same rate as comparable domestic prices. This suggests that the exporters of these products

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

	Year 1989-Q4 / 1988-Q4	Quarters 1989 Q2	Q3	Q4	Months 1989 Nov	Dec
		(annual rates)			(monthly rates)	
	- - - - - - - - - BLS Prices - - - - - - - - - -					
Imports, Total	1.9	0.3	-4.6	4.8	0.3	0.3
Foods, Feeds, Bev.	-4.7	-7.2	-15.5	6.5	-0.9	3.2
Industrial Supplies	6.2	8.5	-14.1	7.4	-0.2	0.8
Ind Supp Ex Oil	-2.5	-5.5	-7.4	-1.9	-0.6*	0.6*
Capital Goods	-0.8	-4.2	-0.6	2.2	0.3	0.7
Automotive Products	0.6	-2.8	0.0	0.0	0.4	-0.8
Consumer Goods	2.8	1.2	1.2	4.7	0.9	-0.2
Memo:						
Oil	31.5	47.8	-24.4	30.8	0.7	1.4
Non-oil	-0.2	-3.1	-2.8	2.9	0.2	0.3
Exports, Total	0.6	-0.4	-2.8	-0.4	-0.5	0.2
Foods, Feeds, Bev.	-7.8	-11.4	-21.6	-7.4	-0.1	-0.8
Industrial Supplies	0.1	0.7	-4.6	-2.7	-1.3	0.8
Capital Goods	2.9	2.7	3.0	2.2	-0.2	0.0
Automotive Products	2.9	1.9	3.0	5.2	0.1	0.1
Consumer Goods	3.7	1.0	2.8	2.4	0.3	0.5
Memo:						
Agricultural	-3.7	-5.3	-15.8	-4.9	-0.3	-0.6
Nonagricultural	1.3	0.7	-0.4	0.4	-0.5	0.4
	- - - - - - - Prices in the GNP Accounts - - - -					
Fixed-Weight						
Imports, Total	3.5	8.0	-8.9	4.8	--	--
Oil	38.4	100.2	-30.7	24.1	--	--
Non-oil	-0.6	-1.3	-5.8	2.3	--	--
Exports, Total	-0.5	2.7	-4.1	0.4	--	--
Ag.	-6.5	-3.1	-9.4	-10.3	--	--
Nonag.	1.1	3.9	-1.6	2.2	--	--
Deflators						
Imports, Total	-0.5	0.4	-11.8	4.1	--	--
Oil	38.4	100.5	-30.8	23.9	--	--
Non-oil	-4.1	-6.2	-7.0	-1.2	--	--
Exports, Total	-0.4	-0.4	-5.5	0.0	--	--
Ag.	-6.5	-3.2	-9.3	-10.4	--	--
Nonag.	0.4	0.0	-4.3	0.8	--	--

*Not for publication.

allow foreign-currency prices to vary along with the exchange value of the dollar. In contrast, prices of most exported industrial supplies have fallen steadily since mid-year, but at rates less than those of domestic prices. It appears that pricing decisions of U.S. exporters of industrial supplies have been influenced by the decline in the dollar's value.

U.S. International Financial Transactions

Recorded capital flow data for October and November 1989 show net capital inflows in the first two months of the fourth quarter coming primarily in the form of foreign net purchases of private and government securities. However, the data available to date account for less than one-half of the estimated current account deficit for this period.

Foreigners reduced their holdings of corporate stocks in November for the first time since February (line 2b of the Summary of U.S. International Transactions table). This followed the downturn in the U.S. stock market in mid-October.

Concomitant with the drop in foreign holdings of stocks in November was an $11 billion increase in foreign holdings of corporate and agency bonds and U.S. Treasury obligations (lines 2a and 3). Of particular interest is the degree to which this change was concentrated in U.S. government obligations; in addition to the $6.6 billion increase in the holdings of Treasury obligations (line 3), private foreigners purchased $1.5 billion of the bonds and notes of U.S. government agencies and corporations (included in line 2a). In recent years foreign purchases of Treasury securities have been correlated with the size of the Treasury's mid-quarter refunding; in November, foreigners increased

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

	1987 Year	1988 Year	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 Sept.	1989 Oct.	1989 Nov.
Private Capital										
Banks										
1. Change in net foreign positions of banking offices in the U.S. (+ = inflow)	47.5	22.2	-0.6	9.7	-1.6	-0.1	13.4	6.0	-10.3	4.3
Securities										
2. Private securities transactions, net[1]	36.4	17.8	5.8	3.2	5.7	3.7	-0.1	1.7	3.1	2.6
a) foreign net purchases (+) of U.S. corporate bonds[2]	26.4	26.8	6.4	8.9	8.8	6.0	5.6	1.7	3.8	4.4
b) foreign net purchases (+) of U.S. corporate stocks	16.8	0.4	1.3	-2.0	0.2	3.8	5.1	2.5	1.3	-1.4
c) U.S. net purchases (-) of foreign securities	-6.9	-9.4	-1.9	-3.7	-3.3	-6.1	-10.8	-2.5	-2.0	-0.4
3. Foreign net purchases (+) of U.S. Treasury obligations	-7.3	20.6	3.5	5.5	8.7	2.4	12.9	5.4	-0.2	6.6
Official Capital										
4. Changes in foreign official reserves assets in U.S. (+ = increase)	47.7	40.2	-1.8	10.6	8.0	-5.5	12.5	-2.8	0.3	*
a) By area										
G-10 countries (incl. Switz.)	38.8	15.5	-6.8	5.3	0.3	-9.4	5.8	-0.4	-3.7	2.6
OPEC	-8.9	-3.4	-0.8	0.7	6.8	0.3	4.6	0.5	-0.6	.5
All other countries	17.8	28.1	5.8	4.6	0.9	3.6	2.1	-2.9	4.7	-3.1
b) By type										
U.S. Treasury securities	43.2	41.7	-3.8	11.9	4.6	-9.7	12.8	-1.2	-5.9	2.7
Other[3]	4.5	-1.5	2.0	-1.3	3.4	4.3	-0.3	-1.6	6.2	-2.7
5. Changes in U.S. official reserve assets (+ = decrease)	9.1	-3.6	-7.4	2.3	-4.0	-12.1	-6.0	-4.0	-2.3	-0.7
Other transactions (Quarterly data)[4]										
6. U.S. direct investment (-) abroad	-44.2	-17.5	-4.9	-8.9	-5.5	-5.8	-11.0	n.a.	n.a.	n.a.
7. Foreign direct investment (+) in U.S.	46.9	58.4	11.9	23.0	19.2	13.3	11.4	n.a.	n.a.	n.a.
8. Other capital flows (+ = inflow)[5]	5.7	-1.0	1.8	2.7	-1.8	2.7	-7.8	n.a.	n.a.	n.a.
9. U.S. current account balance	-143.7	-126.5	-32.3	-28.7	-30.4	-32.1	-22.7	n.a.	n.a.	n.a.
10. Statistical discrepancy	1.9	-10.6	24.0	-19.4	1.7	33.5	-2.6	n.a.	n.a.	n.a.
MEMO:										
U.S. merchandise trade balance -- part of line 9 (Balance of payments basis, seasonally adjusted)	-159.5	-127.2	-30.3	-32.0	-28.4	-27.6	-27.8	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.

their holdings of Treasury coupon bonds by $6.5 billion, a typical 50 percent of the sizeable $13 billion refunding. (These net purchases are frequently followed by net sales in subsequent periods.)

Foreign official holdings in the United States were virtually unchanged in November, although G-10 holdings increased by $2.6 billion (line 4). Partial data from the FRBNY for December show no change in G-10 holdings.

A moderate net inflow of $4.3 billion for banking offices in November partially reversed the large net outflow in the previous month (line 1 of the Summary table). Line 1 of the table on International Banking Data suggests little change in December in the net positions of banking offices in the United States vis-a-vis their IBFs and offices abroad. Lending by foreign branches of U.S. banks to U.S. nonbanks (line 2) shows virtually no change in November and December. Credit extended by U.S.-based banks was at about the same level in December 1989 as it had been in December 1988. In contrast, borrowing by U.S. residents from other foreign sources appears to have increased. Reports from foreign agencies and branches on the custody liabilities of U.S. customers to banks outside the United States show that loans to U.S. residents booked at offshore offices of foreign banks increased by $1 billion in November. The increase for the eleven-month period from the end of December 1988 to the end of November was $7.6 billion. These totals are incomplete, however, because they only include those loans where the U.S. office of the foreign agency or branch arranges the loan, acts as the U.S. address, or services the loan for the foreign lender.

INTERNATIONAL BANKING DATA
(Billions of dollars)

	1987	1988	1989					
	Dec.	Dec.	Mar.	June	Sept.	Oct.	Nov.	Dec.
1. Net Claims of U.S. Banking Offices (excluding IBFS) on Own Foreign Offices and IBFS	-10.9	-4.9	-2.9	-3.9	-6.4	-5.4	-5.7	-5.5
(a) U.S.-chartered banks	15.2	21.6	20.4	19.2	14.9	15.1	15.4	19.2
(b) Foreign-chartered banks	-26.1	-26.5	23.3	-23.1	-21.3	-20.5	-21.1	-24.7
2. Credit Extended to U.S. Nonbank Residents by Foreign Branches of U.S. Banks	15.8	21.2	24.0	26.0	21.6	20.6	21.0	20.7
3. Eurodollar Holdings of U.S. Nonbank Residents 1/	132.6	145.3	144.8	131.5	129.8	124.4	124.1	125.6

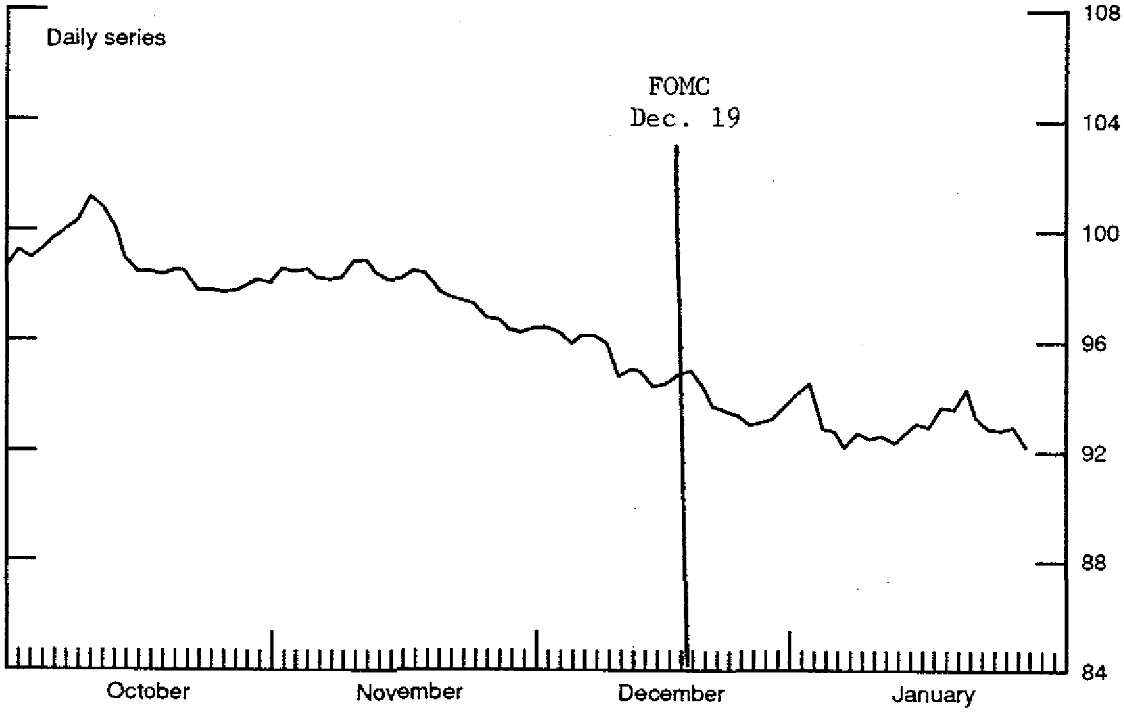
1. Includes term and overnight Eurodollars held by money market mutual funds. Note: These data differ in coverage and timing from the overall banking data incorporated in the international transactions accounts. Line 1 is an average of daily data reported to the Federal Reserve by U.S. banking offices.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

Since the December FOMC meeting, the weighted-average foreign exchange value of the dollar has declined 2-1/2 percent, on balance, as shown in the accompanying chart. The dollar declined in late December amid perceptions that the Federal Reserve had eased monetary conditions, but then moved up, on balance, through mid-January as anticipations of further easing faded. Since mid-January, the dollar has depreciated.

The dollar's movements against individual currencies were mixed. Overall, the German mark continued to be buoyed by developments in Eastern Europe -- which included the overthrow of the Romanian government and the acceleration of elections in East Germany -- rising 3-1/2 percent against the dollar. The Swiss franc appreciated 4-1/2 percent against the dollar as the Swiss National Bank aggressively tightened monetary conditions further to defend its currency, which had depreciated substantially against the mark during 1989. Three-month interbank rates in Switzerland have risen more than 110 basis points since the December FOMC meeting and 250 basis points since mid-1989. After continuing to weaken over much of the intermeeting period, the yen recovered in late January as the outlook for the governing LDP party in the February 18 election of the Lower House of Parliament improved; on net, the yen was little changed against the dollar. Meanwhile, the Canadian dollar fell 2-1/2 percent against the U.S. dollar as the Bank of Canada allowed short-term interest rates to ease slightly from peak levels amid signs of weakening in the Canadian economy.

Apart from Switzerland, changes in short-term rates generally were modest. Although the Bank of Japan raised its discount rate 1/2



	Bond yields			Stock prices[1] (percent change)	
	Dec. 19	Jan. 3	Jan. 30	Jan. 3-Jan. 24	Jan. 3-Jan. 30
Japan	5.64	5.84	6.68 (1/31)	-6.1[2]	-5.0[2] (1/31)
Germany	7.13	7.46	7.64	-5.5	-2.1
United Kingdom	10.61	10.60	11.24	-7.1	-5.8
Canada	9.51	9.69	10.05	-6.2	-7.5
United States	7.78	7.99	8.51	-7.7	-9.8

1/ Japan, New Tokyo Stock Exchange; Germany, FAZ; United Kingdom, FT Ordinary; Canada, Toronto Stock Exchange Composite Index; United States, NYSE Compsite Index.
2/ Tokyo markets were closed on January 3; changes are from December 29.

percentage point to 4-1/4 percent on December 25, this move was generally anticipated; 3-month CD rates in Japan increased only 1/4 percentage point for the intermeeting period as a whole, with most of the rise occurring since the beginning of the year. On balance, 3-month interbank rates in Germany were little changed, and comparable rates in the United States eased.

Prices of bonds and equities (the bottom panel of the chart) declined sharply worldwide after the first of the year. Since the December FOMC meeting, bond yields in Japan have risen 100 basis points, on balance, after having been up nearly 130 basis points through mid-January. Long-term interest rates increased about 75 basis points in the United States and were up 50-60 basis points in the United Kingdom, Germany, and Canada. Stock prices fell 5 to 10 percent in major markets during most of January, but prices in Japan and Europe, particularly Germany, recovered somewhat toward the end of the month.

. The Desk sold $600 million against yen.

The Bank of Italy

devaluing the lira's central parity rate against the other currencies in the the EMS by 3.7 percent on January 5. At the same time, the allowable deviation for the lira from its central parity rate was decreased from ±6 percent to the ±2-1/4 percent that applies to all other EMS currencies except the Spanish peseta. Since then, the lira has strengthened somewhat,

Developments in Foreign Industrial Countries

Recently the pace of economic activity in the major foreign industrial nations has varied, suggesting that tighter monetary policy has taken hold in some, but not all, of these countries. In the fourth quarter of 1989, available data on activity for Japan showed a mixed performance while most indicators for Germany, France, and Italy pointed to renewed strength. German officials have stated that real GDP growth (on an annual average basis) probably exceeded 4 percent in 1989, the strongest rate of expansion in the decade. In contrast, recent growth has been sluggish in both the United Kingdom and Canada.

Inflation abroad appears to have steadied in recent months, but in 1989 as a whole, prices rose considerably more than they did in the previous year. In December, the 12-month rate of consumer price inflation was roughly one percentage point higher than a year earlier in most of the major foreign industrial economies. On this basis, Japanese consumer price inflation was 3.3 percent in January, more than double the year-ago rate. During 1989, the external surplus diminished in Japan and remained about the same in Germany, while larger deficits emerged in the United Kingdom, Italy, Canada, and France.

Individual Country Notes. In Japan, strong growth appears to have continued in the fourth quarter, but the latest indicators of economic activity have been mixed. Some slowing was suggested by industrial production (s.a.), which fell 0.1 percent in December, and retail sales (s.a.), which declined 4.5 percent in November, almost completely

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

	Q4/Q4 1988	Q4/Q4 1989	1989 Q1	1989 Q2	1989 Q3	1989 Q4	1989 Aug.	1989 Sept.	1989 Oct.	1989 Nov.	1989 Dec.	Latest 3 months from year ago 2
Canada												
GDP	4.0	n.a.	.7	.3	.6	n.a.	*	*	*	*	*	2.3
IP	2.7	n.a.	.2	.7	-.2	n.a.	.0	.3	-1.2	.7	n.a.	.1
France												
GDP	3.4	n.a.	1.3	.7	.5	n.a.	*	*	*	*	*	3.2
IP	4.6	n.a.	.9	1.9	.4	n.a.	.0	-2.1	1.6	1.1	n.a.	3.2
Germany												
GNP	3.0	n.a.	2.9	.3	-.5	n.a.	*	*	*	*	*	3.2
IP	4.0	n.a.	2.4	-.8	2.2	n.a.	.2	-.2	.0	.4	n.a.	4.4
Italy												
GDP	3.3	n.a.	1.0	.3	.8	n.a.	*	*	*	*	*	2.8
IP	6.7	n.a.	.1	-1.0	1.9	n.a.	-1.2	-.3	1.6	.5	n.a.	3.2
Japan												
GNP	5.1	n.a.	1.8	-.8	2.9	n.a.	*	*	*	*	*	5.2
IP	7.6	4.0	3.1	.0	.2	.6	3.0	-2.0	.4	.9	-.1	4.0
United Kingdom												
GDP	3.5	n.a.	.8	.2	.5	n.a.	*	*	*	*	*	1.9
IP	2.1	n.a.	-.5	-.5	1.3	n.a.	1.5	-.5	1.4	-.5	n.a.	.7
United States												
GNP	3.4	2.4	.9	.6	.7	.1	*	*	*	*	*	2.4
IP	5.0	1.7	.5	.8	.3	.1	.4	-.1	-.4	.3	.4	1.7

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 1988	Q4/Q4 1989	1988 Q3	1988 Q4	1989 Q1	1989 Q2	1989 Q3	1989 Q4	1989 Oct.	1989 Nov.	1989 Dec.	1990 Jan.	Latest 3 months from year ago
Canada													
CPI	4.1	5.2	1.1	.8	1.2	1.7	1.4	.7	.4	.3	-.1	n.a.	5.2
WPI	3.7	n.a.	1.1	.6	1.0	.3	-.2	n.a.	-.2	-.2	n.a.	n.a.	1.0
France													
CPI	3.0	3.6	.9	.6	.8	1.2	.7	.8	.4	.2	.1	n.a.	3.6
WPI	7.2	n.a.	2.4	2.5	2.4	.5	-.5	n.a.	*	*	*	*	5.0
Germany													
CPI	1.6	3.1	.1	.3	1.5	.9	.0	.6	.4	.2	.3	.5	2.9
WPI	2.7	4.1	.4	1.2	2.7	1.7	-.7	.3	-.2	-.4	.4	n.a.	4.1
Italy													
CPI	5.2	6.6	1.0	1.9	2.0	1.7	1.0	1.8	1.0	.4	.5	.5	6.4
WPI	5.4	n.a.	1.2	1.7	2.3	1.4	.6	n.a.	.8	.2	n.a.	n.a.	6.1
Japan													
CPI	1.5	2.9	.1	1.0	-.2	2.1	.1	.9	.8	-.8	.1	.3	3.0
WPI	-1.4	3.7	.9	-.8	.5	2.7	.8	-.3	-.6	-.1	.1	n.a.	3.7
United Kingdom													
CPI	6.5	7.6	1.4	2.1	1.6	2.9	.9	2.0	.8	.9	.3	n.a.	7.6
WPI	4.9	5.0	1.2	1.1	1.4	1.2	1.1	1.2	.5	.2	.2	n.a.	5.0
United States													
CPI (SA)	4.3	4.5	1.2	1.1	1.3	1.6	.6	1.0	.5	.4	.4	n.a.	4.5
WPI (SA)	3.4	4.8	1.1	.9	2.2	1.7	-.1	1.0	.4	-.1	.7	n.a.	4.8

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)

	1988	1989	1988		1989				1989			
			Q3	Q4	Q1	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Canada												
Trade	8.0	n.a.	2.3	1.6	2.0	1.0	.8	n.a.	.2	-.3	.6	n.a.
Current account	-8.4	n.a.	-2.0	-3.2	-3.1	-4.5	-4.0	n.a.	*	*	*	*
France												
Trade	-5.4	n.a.	-1.9	-1.9	-.6	-2.1	-2.3	n.a.	.3	-1.4	-.4	n.a.
Current account	-3.9	n.a.	-1.1	-3.6	1.6	-1.3	-1.3	n.a.	*	*	*	*
Germany												
Trade (NSA)	72.9	n.a.	17.0	21.0	19.4	17.7	17.8	n.a.	6.4	5.1	5.8	n.a.
Current account (NSA)	48.7	n.a.	8.7	15.9	15.8	13.7	10.4	n.a.	4.2	4.1	5.2	n.a.
Italy												
Trade	-9.9	-12.3	-2.8	-2.5	-5.2	-3.0	-2.4	-1.6	-.7	-.5	-1.0	-.1
Current account (NSA)	-5.4	n.a.	.2	-1.5	-6.6	n.a.	n.a.	n.a.	*	*	*	*
Japan												
Trade	77.4	64.8	18.4	21.9	21.9	15.4	15.0	12.6	5.5	3.8	4.7	4.1
Current account [2]	79.6	n.a.	18.4	20.8	21.5	12.7	13.2	n.a.	4.1	3.8	4.8	n.a.
United Kingdom												
Trade	-36.2	-37.4	-9.5	-11.5	-10.2	-9.3	-10.7	-7.2	-3.0	-2.9	-2.4	-1.9
Current account	-26.0	-33.8	-5.8	-9.6	-8.4	-8.0	-10.4	-7.0	-2.9	-2.7	-2.4	-1.9
United States												
Trade [2]	-127.2	n.a.	-30.3	-32.0	-28.4	-27.6	-27.8	n.a.	*	*	*	*
Current account	-126.5	n.a.	-32.3	-28.7	-30.4	-32.1	-22.7	n.a.	*	*	*	*

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

reversing the increase of the previous two months. However, in November the unemployment rate (s.a.) declined to 2.2 percent and the ratio of job offers to applicants increased slightly, indicating some further tightening of labor market conditions.

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

	1989							
	Q2	Q3	Q4	Aug.	Sep.	Oct.	Nov.	Dec.
Real GNP	-0.8	2.9	--	--	--	--	--	--
Industrial Production	0.0	0.2	0.6	3.0	-2.0	0.4	0.9	-0.1
Retail Sales	-5.4	5.5	--	-1.8	2.6	2.3	-4.5	--
Capacity Utilization	0.2	0.0	--	4.2	-2.9	0.0	--	--
Unemployment Rate (%)	2.3	2.2	--	2.3	2.2	2.3	2.2	--

Inflation showed little trend in the fourth quarter. In 1989 as a whole, however, inflation was up sharply. In the 12 months to December, consumer prices in the Tokyo area rose 3 percent, substantially above the 1.2 percent increase in the comparable period of 1988. About 1-1/4 percentage points of the increase in inflation stemmed from the introduction of a consumption tax in 1989. Wholesale prices increased 3.9 percent in the 12 months to December, compared with a 1.1 percent decline during 1988. Oil price increases and weakness of the yen also contributed to the rise in inflation last year. Wholesale prices of domestically produced goods rose 2.5 percent between December 1988 and December 1989, while those of imported goods jumped 13 percent. In January, consumer prices were up a further 0.3 percent. There is concern that cost pressures may heighten after the upcoming spring wage round; Japan's largest labor confederation has indicated that it will seek wage increases of 8 to 9 percent. Last spring, initial wage demands were 6 to 8 percent, and actual wage increases averaged 5.1 percent.

The trade surplus (s.a.) declined further in December. For 1989 as a whole, the trade surplus was about $64.8 billion, down from $77.4 billion in 1988. In volume terms, exports grew 4.4 percent in 1989 (the same rate of increase as the previous year), while imports rose 7.7 percent (down from a 16.7 percent increase the previous year).

In December, the cabinet approved and forwarded to the Diet its proposed budget for FY 1990 (beginning in April). The proposal contains no significant fiscal initiatives, and its likely macroeconomic effect should be neutral to mildly contractionary. Diet debate over the budget is expected to begin in March, after Lower House elections scheduled for February 18.

In Germany, industrial production (s.a.) increased 0.4 percent in November, after stagnating in the previous two months. New orders also recovered in November; the volume of foreign orders (s.a.) increased 4.3 percent, largely offsetting October's 5.5 percent decline. Despite considerable immigration from Eastern Europe, principally East Germany, the unemployment rate (s.a.) declined from 7.9 percent in November to 7.8 percent in December. The flood of immigrants from East Germany is continuing with 45,000 East Germans emigrating to West Germany in January.

The recent pattern of inflation has been mixed. Import prices declined 0.5 percent in December to a level 0.9 percent above the level a year ago. Producer prices were unchanged in December, while wholesale prices increased 0.4 percent. In January, consumer prices rose 0.5

percent, but the 12-month rate of consumer price inflation fell to 2.6 percent from 3 percent in December as the effect of increased indirect taxes in January 1989 dropped out of the measured inflation rate. M3 increased 4.7 percent in 1989 (s.a., Q4/Q4), and therefore the Bundesbank met its monetary growth target for the first time since 1985.

GERMAN INFLATION INDICATORS
(percent change from year earlier)

	1989							
	Q2	Q3	Q4	Sep.	Oct.	Nov.	Dec.	Dec.
Consumer Prices (nsa)	2.9	2.8	3.1	2.8	3.2	3.0	3.0	2.6
Producer Prices (nsa)	3.3	3.0	3.1	3.0	3.4	3.1	2.9	--
Wholesale Prices (nsa)	6.1	5.0	4.1	5.5	4.9	3.9	3.4	--
Import Prices	6.5	3.2	--	3.7	3.2	2.5	0.9	--

Germany's trade surplus (n.s.a.) widened in November but was accompanied by a sharp rise in transfer payments so that the current account surplus rose by less. The cumulative totals for the trade balance and current account through November (a.r.) are $71.9 billion and $53.8 billion, respectively. This compares with $72.9 billion and $48.7 billion for all of 1988.

After slower growth in the third quarter of 1989, economic activity showed signs of renewed strength in France. In October and November, industrial production (s.a.) recovered strongly from its unusually low level in September (when automobile workers were on strike); on a year-to-year basis, industrial production was up 3.3 percent in November. Surveys point to a continuation of the current investment boom, with corporate investment expected to grow 14 to 15 percent in 1990 after rising 13 percent in 1989.

The trade deficit has continued to widen. For the eleven months through November of 1989, the cumulative deficit (s.a.a.r.) was $7.4 billion compared with a deficit of $5.1 billion in the same period of 1988. This deficit has been counterbalanced by a widening surplus in services, due primarily to record earnings from tourism, so that deterioration in the current account in 1989 was probably smaller.

M2 growth through November 1989 was in the middle of the 4-6 percent target range for 1989. The Bank of France reduced the target range for 1990 to 3.5-5.5 percent to further tighten monetary policy and discourage inflation. Recently, inflation has been slowing; in December the CPI rose 0.1 percent and was up 3.6 percent from a year earlier compared with a rate of 3.1 percent in December 1988.

The pace of Italian economic activity picked up in the third quarter of 1989, as GDP rose 3.2 percent (s.a.a.r), roughly twice the rate registered in the second quarter. This strength appears to have continued into the fourth quarter. Industrial production (s.a.) rose 0.5 percent in November, following a 1.6 percent rise in October. The inflation rate decreased in January, with the consumer price index rising at a 12-month rate of 6.3 percent, down from peak rates of 7 percent last summer. The wholesale price index also reflected this general slowing trend in inflation; in November, it was 5.7 percent (n.s.a.) above its year-ago level, down from a rate of 6.5 percent in October.

The Italian government passed the 1990 budget on December 21, the first time in several years that this has been accomplished before the beginning of the fiscal year. In January, the government announced a series of measures to centralize control over public expenditures. These include a requirement that all new spending laws introduced by ministers be approved by the Prime Minister, and a sharp reduction in appropriations set aside to fund additional spending approved during the year. Upcoming local elections in June may make these efforts to restrain spending more difficult.

In the United Kingdom, industrial production (s.a.) fell 0.5 percent in November to a level only 0.6 percent above the year-ago level. However, in December the volume of retail sales (s.a.) was unexpectedly strong, rising 2.2 percent after falling 0.4 percent in November while the unemployment rate (s.a.) remained at 5.8 percent, well below its year-earlier level of 7.1 percent. The 12-month rate of retail price inflation was 7.7 percent in December, compared with a rate of 6.8 percent in December 1988. Producer prices increased by 5 percent in the 12 months to December. Persistent wage pressures along with slowing productivity growth have caused an escalation of unit labor costs. The underlying 12-month rate of increase of average earnings was 9.25 percent in November. In January, Ford autoworkers agreed to a 10.2 percent pay raise, sending a potentially inflationary signal to other unions that traditionally emulate the Ford agreement.

The U.K. current account registered a record deficit of $33.8 billion in 1989, compared with a $26 billion deficit in 1988. However, in recent months the trade and current account gaps have narrowed as exports have grown much faster than imports.

Expansion in Canada appears to be slowing considerably. Industrial production (s.a.) fell 1.2 percent in October, but rebounded

0.7 percent in November to a level only 0.8 percent above a year ago. Total Canadian bankruptcies in November were 19.2 percent above a year ago. The unemployment rate (s.a.) increased to 7.7 percent in December from a low of 7.3 percent in September as employment declined. The consumer price index (n.s.a.) declined 0.1 percent in December, but the 12-month rate remained above 5 percent. In recent months, imports have fallen sharply and in November the merchandise trade balance (s.a.) rebounded into a surplus of $600 million. The cumulative trade balance (s.a.a.r.) through November was $4.5 billion compared with a surplus of $8 billion for all of 1988.

Developments in East European Economies

Poland and Yugoslavia have implemented radical economic reform programs, both in cooperation with the IMF. The programs are intended to move the countries toward market economies and to reduce inflation. Between December 1988 and December 1989, Polish inflation soared to 740 percent, while industrial output appears to have contracted. In December, Poland signed a letter of intent for a 13-month, $725 million, IMF stand-by arrangement intended to stabilize the economy and support far-reaching systemic changes. Additional support for Poland has been provided by the major industrial countries in the form of a $500 million bridge loan and a $1 billion exchange stabilization fund. Yugoslavia has implemented a currency reform and devaluation, and has frozen wages and the exchange rate of the dinar against the mark for up to six months, in anticipation of an IMF stand-by arrangement. The banking system and bankruptcy laws are being reformed as well. Economic reform in Yugoslavia has been made more difficult by political divisions that exist among ethnic regions.

Economic Situation in Major Developing Countries

The bank debt package for Mexico is scheduled to be signed beginning February 4. The Philippines completed the debt buyback part of its debt restructuring program, repurchasing $1.3 billion in commercial bank debt at a 50 percent discount on January 3. Venezuela continues to negotiate debt restructuring and possible debt and debt-service reduction with its commercial bank creditors. Inflation in Argentina has risen and financial conditions have deteriorated. In Brazil, the present outgoing government is unable to implement measures to reduce its high inflation rate and has instead concentrated on maintaining stability in that rate (currently 56 percent per month), through mid-March, when the next government takes office.

Individual country notes. Banks with about $48.4 billion in claims on Mexico have made commitments to sign the bank financing package beginning February 4. The package provides principal reduction, interest reduction, and new money options. The package will lower net interest payments by about $1.25 billion in 1990, reduce existing debt to banks by nearly $7 billion, and provide new bank loans totalling about $1.4 billion over the next three years. The new money commitments represent 25 percent of the approximately $5.9 billion in old debt that will not be exchanged for new bonds.

Mexico will use about $5.7 billion borrowed from the IMF, the World Bank, and Japan, and about $1.3 billion from its reserves to enhance the principal and 18 months of interest on $34.5 billion in new bonds that it will issue to non-Mexican banks in exchange for about $41 billion in old debt.[1] Another $670 million in new bonds to be issued to Mexican banks holding about $1 billion in old debt will not be enhanced. About $22.5 billion of the new bonds will bear interest at 6.25 percent and will be issued at par. Another $12.7 billion in new bonds will bear market interest rates and will be issued at a 35 percent discount on the old debt.

The bank debt package should enable Mexico to hold its current account deficit in 1990 to an estimated $4.5 billion, about $1 billion less than in 1989. However, gross international reserves are likely to decline, unless unexpectedly high foreign direct investment and other private capital inflows materialize. For now, optimism appears to be strong, and stock prices have risen by more than 20 percent since a mid-November 1989 low, encouraged, perhaps, by new government moves to reduce consumer subsidies. Recent cuts in subsidies led to a tripling of Mexico City's urban transport fares and a 63 percent increase in tortilla prices. Reflecting these adjustments, the CPI rose 3.4 percent in December. This was the highest monthly increase in nearly two years, but it closed the year at 20 percent over December 1988 compared with 52 percent over the previous 12 months.

On January 3, the Philippines completed the debt buyback part of its debt restructuring program when $1.3 billion in commercial bank debt was repurchased at a 50 percent discount. The buyback was financed by

1. For banks whose claims are not in dollars, the interest enhancement may vary from 18-months depending on the "price" of zero-coupon obligations in the domestic currency.

funds from the IMF, World Bank, Export-Import Bank of Japan, U.S. AID and indirectly from Brunei. The Philippine government also hopes to obtain $750 million from its creditor banks from the issue of new money bonds. As of January 9, $615 million had been pledged by the banks. Last December, the IMF Board reviewed the Philippine program, granted a waiver in connection with the growth of the monetary base exceeding its ceiling, and modified the program slightly.

Venezuela continues to negotiate a debt restructuring and financing package, including possible debt and debt service reduction, with its commercial bank creditors. In January 1990, the IMF approved release of the third disbursement of SDR 170 million (net of the debt-reduction set-aside) under Venezuela's Extended Fund Facility. Venezuela achieved the 1989-Q3 targets under its IMF program, except for a shortfall of more than $300 million in international reserves on account of the absence of bank financing, for which it received a waiver from the IMF.

The Venezuelan current account moved from a $4-1/2 billion deficit in 1988 to surplus of about $1 billion in 1989. An 8 percent decline in real GDP combined with a sharp devaluation of the Venezuelan bolivar led to a cut in imports from $11 billion in 1988 to an estimated $7-1/2 billion last year. At the same time, higher oil and non-oil exports boosted export revenue by 16 percent, to $12 billion, in 1989.

Consumer prices rose 81 percent in calendar 1989, more than double the 1988 rate. Much of this increase resulted from the devaluation of the bolivar and decontrol of prices early in 1989. By the last quarter of the year, inflation had decelerated sharply, to an annual rate of 27 percent.

Inflation in Argentina has accelerated, and financial conditions have deteriorated. The devaluation and public sector price hikes announced on December 10, 1989, did not succeed in stabilizing interest rates or the parallel market exchange rate. As a result, economy minister Nestor Rapanelli stepped down on December 18 and was replaced by Antonio Ernan Gonzalez; central bank president Egidio Ianella, who had been in office less than a month, was replaced by Rudolfo Rossi. Rossi, who is widely viewed to have been ineffectual as central bank head, was replaced by Enrique Fulcini on January 22, 1990. Upon taking office, Gonzalez announced a disinflation strategy that included the unification and floating of the exchange rate, the elimination of exchange controls, and the dismantling of price controls. These measures failed to stem the continuing run on the austral, and the exchange rate reached almost 2,000 australs per dollar on December 28 compared with 1,000 australs per dollar on December 10 and 650 australs per dollar in the previous five months.

On January 1, 1990, the government announced a new program to support the austral that included an involuntary swap of BONEX (long-term dollar-denominated government debt) for most outstanding austral-denominated government debt, as well as a swap of BONEX for all holdings of bank time deposits in excess of one million australs, or about $500. These measures have strengthened the austral by reducing liquidity, but have lowered the level of confidence in the banking system and have cut off all sources of domestic financing of the fiscal deficit. If this deficit is not reduced substantially in the coming months, money creation to finance the deficit will probably lead to a resurgence of the hyperinflation experienced during mid-1989. The administration's tax reform bill was approved by the Argentine Congress in December; it is uncertain how much additional revenue will result from the new law, however.

As a result of the devaluations and public sector price increases implemented during December, inflation in that month registered 40.1 percent compared with 6.5 percent in November and 5.6 percent in October. January inflation is expected to reach at least 60 percent, largely reflecting continued adjustment to the cost increases of the previous month.

In Brazil, the present government is unable to implement the necessary fiscal measures to reduce its high inflation rate and has instead concentrated on maintaining stability of that rate through mid-March. Fernando Collor de Mello, elected president in mid-December, is expected to introduce an anti-inflation package when he takes office March 15. Collor has not yet revealed the details of the program and has not announced his choices for the economic policy officials. His package is expected to include measures aimed at reducing the fiscal deficit, the main cause of the high and rising inflation rates. Consumer prices rose 56 percent in January. The overnight rate in the government debt market has risen from 60 percent per month in early January to 74 percent per month January 30. According to preliminary data, real GDP grew 3-4 percent in 1989, compared with prior estimates of 1 percent. The unexpectedly high growth rate may be the result of an underestimation of GDP price deflators due to price controls.

The 15 percent real appreciation in the exchange rate and import liberalization led to a fall in the trade surplus from $19 billion in 1988 to $16 billion in 1989. Reflecting an expectation that the new government will devalue the official exchange rate, the spread between the parallel and official exchange rates was about 135 percent between late December and mid-January, but fell to 110 percent at the end of the month when the domestic interest rate rose sharply.

In early January, the government increased its restrictions on capital outflows, and delayed payment of $1 billion to Paris Club creditors to protect liquid foreign exchange reserves, which are estimated at about $7 billion at the end of 1989. The waiting period for repatriation of capital was increased from 4 to 6 months, and that for repatriation of profits and dividends was increased from 3 to 6 months. By March 15, Brazil's interest arrears to international commercial banks will be over $5 billion.